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U.S. Department of Justice

Executive Office for United States Trustees

Office of the General Counsel

20 Massachusetts Avenue, NW, Suite 8100
Washington, D.C. 20530

Voice - (202) 307-1399
Fax - (202) 307-2397

May 27, 2011

Re: FOIA No. 2011-2041

This further responds to your request for records dated April 10, 2011, received in this Office on April 11, 2011, and assigned the above-referenced tracking number for processing under the Freedom of Information Act (FOIA), Privacy Act (PA) and related rules. 5 U.S.C. §§ 552-552a; 28 C.F.R. § 16.1, et seq.

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[1] See 5 U.S.C. § 552(a)(4)(A)(ii)(III).

[2] See 28 C.F.R. § 16.11(c).

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Sincerely,

Larry Wahlquist
FOIA/PA Counsel

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[5] <u>See</u> 28 U.S.C. § 16.11(d)(3)(i).

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In re Nick O. Adams (Bolen, UST v. Adams)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*
N.D. Miss.

3. ("CCN") ***CURRENT*** CASE NO.
No.: 2:08-cv-170-SA

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*
No.: 06-11354
Court: Bankr. N.D. Miss.
(Identify judge & cite, if any)

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U.S. TRUSTEES

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8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***
- Whether the bankruptcy court erred by denying the United States Trustee's motion to dismiss on the ground that section 707(b)(2)(A)(iii) permits debtors to deduct retirement account loan repayments as secured debts in determining ability to repay because such loan repayments are not "debts" or "secured" obligations within the meaning of the Bankruptcy Code.

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BEFORE THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF MISSISSIPPI

CASE NO. 2:08-CV170-SA

IN RE NICK O. ADAMS
Debtor

R. MICHAEL BOLEN, UNITED STATES TRUSTEE
Appellant

v.

NICK O. ADAMS
Appellee

ON APPEAL FROM THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF MISSISSIPPI

THE HONORABLE SHARION AYCOCK, PRESIDING
Bankruptcy Case No. 06-11354

BRIEF OF THE APPELLANT
R. MICHAEL BOLEN, UNITED STATES TRUSTEE

Of Counsel:

RAMONA D. ELLIOTT
GENERAL COUNSEL

P. MATTHEW SUTKO
DAVID A. LEVINE
Department of Justice
Executive Office for United States Trustees
20 Massachusetts Avenue, NW
Washington, D.C. 20530

R. MICHAEL BOLEN
Department of Justice
United States Trustee

SAMMYE S. THARP
Department of Justice
Trial Attorney
Office of the U. S. Trustee
100 W. Capitol Street, Suite 706
Jackson, MS 39269

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STATEMENT OF JURISDICTION

The bankruptcy court had jurisdiction over the debtor's chapter 7 bankruptcy case under 28 U.S.C. §§ 157(a) and (b), and 1334(a). Those provisions also gave the bankruptcy court jurisdiction to decide the United States Trustee's[1] motion to dismiss the debtor's bankruptcy case for abuse under 11 U.S.C. § 707(b). The bankruptcy court denied the United States Trustee's motion by order entered May 4, 2007. The United States Trustee timely appealed that order under 28 U.S.C. § 158(c)(2) and Fed. R. Bankr. P. 8002(a) on May 11, 2007. This Court has jurisdiction over this appeal under 28 U.S.C. § 158(a)(1).

STATEMENT OF THE ISSUE

In 2005, Congress and the President amended section 707(b) of the Bankruptcy Code to prohibit debtors with above median income from obtaining chapter 7 relief, absent special circumstances, whenever their income, less allowable expenses, as calculated under a statutory means test, exceeds a specified amount. In this case, the United States Trustee sought dismissal

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[1] Congress authorized the United States Attorney General to appoint 21 United States trustees, each to serve in a specific geographic region of the United States. See generally 28 U.S.C. § 581 et. seq. (establishing the United States Trustee Program). The United States trustees are senior officials of the Department of Justice. Id. The United States trustees "supervise the administration of cases and trustees" in all bankruptcy cases within his or her region through the exercise of a range of oversight responsibilities. 28 U.S.C. §586(a)(3). See generally, Morgenstern v. Revco, D.C., Inc. (In re Revco D.S. Inc.), 898 F. 2d 498, 500 (6th Cir. 1990)(explaining that United States trustees oversee the bankruptcy process, protect the public interest, and ensure that bankruptcy cases are conducted according to law.). United States trustees may raise, appear, and be heard on any issue in any case or proceeding under Title 11. 11 U.S.C. § 307; See also In re Revco, D.S, Inc., 898 F. 2d at 499-500 (upholding broad appellate standing of United States trustees). Section 707(b) explicitly authorizes United States Trustees to move to dismiss debtors' chapter 7 bankruptcy cases. In addition, when the United States Trustee determines that the presumption of abuse arises under the means test, section 704(b)(2) requires Unites States Trustees to either file a motion to dismiss under section 707(b) or file a statement setting forth the reasons the United States Trustee does not consider such a motion to be appropriate.

of Mr. Adams' bankruptcy case based upon the United States Trustee's conclusion that Mr. Adams failed that means test. The court below denied the United States Trustee's motion. The court below ruled that Mr. Adams' disposable income was less than the United States Trustee suggested because Mr. Adams could deduct monthly payments on a loan from a 401(k) retirement plan under section 707(b)(2)(A)(iii). This additional expense allowed Mr. Adams to pass the means test and obtain chapter 7 relief. Given that ruling, the issue presented to this Court for determination on appeal from the May 4, 2007, order denying the section 707(b) motion to dismiss is: Whether the bankruptcy court erred in ruling that Mr. Adams' voluntary loan repayments to a retirement plan constituted an expense under 11 U.S.C. § 707(b)(2)(A)(iii) that reduced his net disposable income to enable him to pass section 707(b)'s means test?

STANDARD OF REVIEW

On appeal, "conclusions of law are reviewed de novo, findings of fact are reviewed for clear error, and mixed questions of fact and law are reviewed de novo." In re National Gypsum Co., 208 F. 3d 498, 503 (5th Cir. 2000). Whether 11 U.S.C. § 707(b)(2)(A)(iii) permits debtors to claim an expense for loan repayments to a retirement plan and whether the presumption of abuse arose under 11 U.S.C. § 707(b)(2) are issues of law subject to de novo review.

STATEMENT OF THE CASE

On June 26, 2006 Nick O. Adams filed for bankruptcy protection under chapter 7 of the Bankruptcy Code. (Bankruptcy Docket Entry Number 1, hereafter "Dkt. 1"). On November 20, 2006, the United States Trustee filed a motion to dismiss Mr. Adams' case on two independent grounds: (1) Mr. Adams' monthly disposable income, when properly calculated, was sufficient to give rise to a presumption of abuse that mandated dismissal of his case under 11 U.S.C. §

707(b)(2); and (2) the totality of Mr. Adams' financial circumstances demonstrated abuse under 11 U.S.C. § 707(b)(3) because he had sufficient means to repay a meaningful portion of his debts. Dkt. 32.

On May 4, 2007, the bankruptcy court entered an order denying the United States Trustee's motion to dismiss Mr. Adams' case as a presumed abuse of chapter 7, concluding that 11 U.S.C. § 707(b)(2)(A)(iii) authorized him to claim as an expense his average monthly payments on account of a retirement plan loan. Dkt. 47. The court also denied the United States Trustee's request for relief under 11 U.S.C. § 707(b)(3). Id. The United States Trustee then timely filed this appeal, which appeals only on section 707(b)(2) grounds.[2] Dkt. 49.

STATEMENT OF FACTS

I. Statutory Framework

This appeal involves the interpretation of provisions added to the Bankruptcy Code, 11 U.S.C. § 101, et seq., by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005.[3] The 2005 Act significantly amended the Bankruptcy Code, including a new means test for determining whether granting a discharge to a chapter 7 individual debtor with primarily consumer debts would be an abuse. The means test is the "heart" of the 2005 Act's consumer bankruptcy reforms and acts as a "screening mechanism . . .to ensure that debtors repay creditors

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[2] On April 30, 2007, before the bankruptcy court denied the motion to dismiss, the court clerk's office erroneously entered an order granting Mr. Adams a discharge. Dkt. No. 45. In an order dated May 21, 2007, the bankruptcy court vacated the April 30 discharge order "as having been entered prematurely through administrative error" because Federal Rule of Bankruptcy Procedure 4004(c)(D) provides that a discharge order should not be entered when a motion to dismiss the case under section 707(b) is pending. Dkt. No. 52.

[3] Pub. L. No. 109-8, 119 Stat. 23 (2005). The 2005 Act applies to Mr. Adams' case, because the act's general effective date is for cases filed on or after October 17, 2005.

the maximum they can afford." H.R. Rep. 109-31 at 1 (I)(2005), as reprinted in 2005 U.S.C.C.A.N. 88, 89. Legislative history to the 2005Act reveals that Congress meant to prevent debtors from obtaining chapter 7 relief if they had an ability to repay their creditors. Although "some bankruptcy debtors are able to repay a significant portion of their debts," Congress acted because existing law had "no clear mandate requiring these debtors to repay their debts." Id. at 5 and n. 18, as reprinted in 2005 U.S.C.C.A.N. 88, 92.

Prior to the 2005 Act, section 707(b) authorized dismissal based on a finding that granting a discharge of debts would be a "substantial abuse" of chapter 7. Section 707(b) now authorizes dismissal where the court finds that granting of relief merely would be an "abuse" of chapter 7 under the circumstances described in newly added subsections (b)(2) and (b)(3). Before the 2005 amendment, section 707(b) also required courts to presume that a debtor was entitled to relief under chapter 7 of the Bankruptcy Code. Section 707(b) repealed this former presumption and replaced it with a new presumption: a case will be presumed to be an "abuse" of chapter 7 if a detailed mathematical formula set out in the statute, commonly referred to as the "means test," yields a minimum amount of monthly disposable income. See 11 U.S.C. § 707(b)(2). When a presumption of abuse does not arise or is rebutted under subsection (b)(2), section 707(b)(3) allows the court to find abuse where the debtor filed the petition in bad faith, or the totality of the circumstances of the debtor's financial situation demonstrates abuse.

Section 707(b)(2)'s Means Test

Section 707(b)(2)'s means test requires the bankruptcy court to use a series of calculations when determining whether the presumption of abuse arises. See 11 U.S.C. § 707(b)(2)(A). The means test applies to debtors whose income exceeds the state median. Under it, the court calculates a debtor's "current monthly income" ("CMI") based on the debtor's average income for the six calendar months preceding the month of the bankruptcy filing. See 11 U.S.C. § 101(10A). If a debtor's annualized CMI is below the applicable state median family income, the debtor's case will not be presumed abusive. 11 U.S.C. § 707(b)(7).

When annualized CMI exceeds the applicable median family income, however, as is the case here, section 707(b)(2)(A) requires a calculation of the debtor's monthly disposable income available to repay creditors by reducing CMI by certain enumerated categories of expenses, such as the cost of food, clothing, utilities and health care. See 11 U.S.C. § 707(b)(2)(A)(ii). In addition, the debtor may deduct, *inter alia*, "monthly payments on account of secured debts," averaged over the 60 months following the date of the petition. Id. § 707(b)(2)(A)(iii).

If a debtor's monthly disposable income, determined by deducting allowed expenses from CMI, is less than $100 per month (or $6,000 over 60 months), the presumption of abuse does not arise. If the debtor's monthly disposable income is equal to or exceeds $166.67 per month (or $10,000 over 60 months), the presumption of abuse arises. If the above median income debtor's monthly disposable income is between $100 and $166.67 per month, the presumption of abuse arises if that amount, over 60 months, is sufficient to pay at least 25% of the debtor's nonpriority unsecured debt. 11 U.S.C. § 707(b)(2)(A)(i).

Every debtor in a chapter 7 case who owes primarily consumer debt is required to file, in conjunction with their bankruptcy schedules and statement of financial affairs, a Statement of Current Monthly Income and Means Test Calculation, Official Form 22A (the "Means Test Form"). 11 U.S.C. §§ 521, 707(b)(2)(C); Interim Fed. R. Bankr. P. 1007(b)(4). In chapter 7 cases, the main purpose of the Means Test Form is to calculate monthly disposable income (ability to pay) following the formula set forth in 11 U.S.C. § 707(b)(2), and determine whether the presumption of abuse arises.

The presumption of abuse under section 707(b)(2) can be rebutted if the debtor establishes "special circumstances, such as a serious medical condition or a call or order to active duty in the Armed Forces" and demonstrates that necessary expenses associated with those special circumstances reduce the debtor's current monthly income below the specified benchmarks. Id. § 707(b)(2)(B).

Even if the presumption of abuse does not arise or is rebutted under section 707(b)(2), a chapter 7 petition may be dismissed for abuse under section 707(b)(3), which requires the bankruptcy court to consider whether "the totality of the circumstances. . .of the debtor's financial situation demonstrates abuse."[4]

Congress enacted enforcement provisions to ensure that these reforms would be implemented. Under the 2005 Act, the United States Trustee reviews a chapter 7 debtor's petition and files with the court a statement explaining whether the presumption of abuse arises under section 707(b). Id. § 704(b)(1). If the United States Trustee determines that the presumption of abuse arises, he or she then files either a motion to dismiss or convert the chapter 7 petition, or a statement explaining why he or she believes such a motion is not appropriate. Id. § 704(b)(2).

II. Factual Background

The debtor, Mr. Adams, is the Vice President of CPI Concrete, and voluntarily

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[4] Section 707(b)(3) also requires the court to consider "whether the debtor filed the petition in bad faith." 11 U.S.C. § 707(b)(3)(A).

participates in an ERISA-qualified 401(k) plan administered through CPI Concrete's parent corporation, Railworks Corporation. Dkt. 1., Schedules D and I. On February 17, 2005, Mr. Adams borrowed from his 401(k) retirement account and accepted the terms and conditions of the loan. See Debtor's Ex. 1.[5] Mr. Adams agreed to repay the loan, plus interest, in five years. Id. He also authorized his employer to deduct loan payments in the amount of $76.23 per week. Id. Under the terms of the agreement, Mr. Adams' last 401(k) loan repayment will be due in February 2010. Id.

To ensure repayment of the loan, Mr. Adams granted the plan a lien against 50% of his vested account balance, which he valued at $34,600 as of the date of his bankruptcy filing. Id.. See also, Dkt. 1, Schedule D. If Mr. Adams defaults on the loan, the agreement permits the plan administrator to foreclose upon the plan's security interest in Mr. Adams' vested account balance. See Debtor's Ex. 1. Nothing in the loan documents, however, permits Railworks Corporation to pursue Mr. Adams personally for any unpaid amounts. Id.

On June 26, 2006, Mr. Adams filed a voluntary chapter 7 bankruptcy petition with the United States Bankruptcy Court for the Northern District of Mississippi. Dkt. 1. In conjunction with the petition, he filed a Means Test Form with the court, which he amended on August 8, 2006, to correct an error. Dkt. 3, 11. The amended Means Test Form listed his monthly disposable income under section 707(b)(2) as $64.30. Dkt. 11.

The United States Trustee subsequently filed a motion to dismiss Mr. Adams' petition as an abuse of chapter 7 on two independent grounds. Dkt. 32. First, the United States Trustee argued that Mr. Adams' monthly disposable income, when properly calculated, was sufficient to

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[5] Entered into evidence at the January 17, 2007, hearing on the motion to dismiss.

create a presumption of abuse under 11 U.S.C. § 707(b)(2). Id. The United States Trustee explained that although Mr. Adams listed his monthly disposable income as $64.30, his calculations improperly included a deduction of $381.80 for payments Mr. Adams was making to repay his 401(k) savings account loan. Id. This deduction was improper, the United States Trustee explained, because section 707(b)(2) only allows a deduction for loan payments on account of "secured debts," calculated with reference due to amounts due to "secured creditors." 11 U.S.C. § 707(b)(2)(A)(iii). Id. The overwhelming majority of courts to consider the issue have held that retirement loans are not "debts" under the Bankruptcy Code because the retirement plans have no right of recourse against the debtor.

On January 10, 2007, after the United States Trustee filed his motion to dismiss, Mr. Adams filed a second amended Means Test Form that reduced his 401(k) loan repayments from $381.90 to $330.33. Dkt. 36. This reduction increased his monthly disposable income to $115.77. Id. At the hearing on the motion to dismiss, the United States Trustee demonstrated that once the 401(k) loan payments were removed from Mr. Adams' list of deductible expenses, his monthly disposable income was $446.10 and a presumption of abuse arose under section 707(b)(2). The United States Trustee also explained that even if the presumption of abuse did not arise in this case under section 707(b)(2), the totality of Mr. Adams' financial circumstances demonstrated abuse under 11 U.S.C. § 707(b)(3) because Mr. Adams has sufficient means to repay a meaningful portion of his debts. At the conclusion of the hearing, the bankruptcy court asked the parties to submit post-hearing briefs on the 401(k) loan issue. The court also granted Mr. Adams' request to file an amended schedule of current expenses (Schedule J), which Mr. Adams filed on January 25, 2007. Dkt. 37.

The bankruptcy court denied the United States Trustee's motion to dismiss Mr. Adams' petition as an abuse of chapter 7. The court concluded that Mr. Adams could properly list his 401(k) loan as secured debt on his Means Test Form, and thus had insufficient disposable income for purposes of section 707(b)(2). Dkt. 47. In light of additional documentation provided by Mr. Adams to the Unites States Trustee after the hearing, the United States Trustee was no longer seeking dismissal under section 707(b)(3), and was seeking relief solely under section 707(b)(2). Accordingly, the order denying the motion noted that the "remaining issues" had also been resolved based on documentation that Mr. Adams provided to the United States Trustee's office. Id. This appeal followed.

SUMMARY OF ARGUMENT

The bankruptcy court's denial of the United States Trustee's motion to dismiss should be reversed because Mr. Adams' disposable income, when properly calculated, gives rise to a presumption of abuse under section 707(b)(2). Although Mr. Adams listed his monthly disposable income as $115.77, which is below the threshold dollar amount necessary to trigger the presumption of abuse, his calculations improperly included a large deduction for payments he was making to his employer in order to repay a loan he took from his 401(k) savings account.

Allowing this expense as payments on a "secured debt" under 11 U.S.C. § 707(b)(2)(A)(iii) was improper for at least two reasons. First, as an overwhelming majority of courts have held, a debtor's obligation to repay a loan from his retirement account is not a "debt" within the meaning of the Bankruptcy Code. Second, retirement loans are not secured obligations under section 506 of the Bankruptcy Code because a debtor's interest in his retirement account is not property of the debtor's bankruptcy estate.

ARGUMENT

The court below erred by denying the United States Trustee's motion to dismiss on the ground that section 707(b)(2)(A)(iii) permits debtors to deduct retirement account loan repayments as secured debts in determining ability to repay because such loan repayments are not "debts" or "secured" obligations within the meaning of the Bankruptcy Code.

In this case, Mr. Adams would have failed the means test under section 707(b)(2) but for the fact that the court below allowed him to deduct an improper expense. Specifically, the bankruptcy court allowed as a payment on account of secured debts under section 707(b)(2)(A)(iii) Mr. Adams' monthly repayments for amounts borrowed from his 401(k) retirement plan account prior to his bankruptcy filing. An "overwhelming majority" of courts have held that such deductions are improper under section 707(b)(2), McVay v. Otero, 371 B.R. 190, 195 (W.D. Tex. 2007), for the reasons explained below. By disallowing this improper expense, Mr. Adams fails the means test and his case must be dismissed unless he chooses to convert it to chapter 13.

I. An obligation to repay a 401(k) loan is not a "debt" within the plain meaning of the Bankruptcy Code.

Section 707(b)(2) only allows a deduction for loan payments made on account of "secured debts." 11 U.S.C. § 707(b)(20(A)(iii). As defined by the Bankruptcy Code, the term "debt" means "liability on a claim." Id. § 101(12). In turn, the Bankruptcy Code defines the term "claim" broadly, to mean

> (A) right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matures, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured; or
>
> (B) right to an equitable remedy for breach of performance if such breach gives rise to a right to payment, whether or not such right to an equitable remedy is reduced to

> judgment, fixed, contingent, matured, unmatured, disputed, undisputed, secured, or unsecured.

Id., § 101(5). The definitions of "claim" and "debt" are "coextensive." Pennsylvania Dept. of Public Welfare v. Davenport, 495 U.S. 552, 558 (1990); Johnson v. Home State Bank, 501 U.S. 78, 84-85 n.5 (1991); S. Rep. No. 989, 95th Cong. 2d Sess 23 (1978) reprinted in 1978 U.S. Code Cong. & Admin. News, pp. 5787, 5809 ("The terms 'debt' and 'claim' are coextensive: a creditor has a 'claim' against the debtor; the debtor owes a 'debt' to the creditor").

Courts have consistently ruled that a debtor's obligation to repay a loan from his or her retirement account is not a "debt" under the Bankruptcy Code. See In re Esquivel, 239 B.R. 146, 152 (Bankr. E.D. Mich. 1999) ("There is a clear consensus that an individual's pre-petition borrowing from his retirement account does not give rise to a secured or unsecured 'claim,' or a 'debt' under the Bankruptcy Code.") see also Eisen v. Thompson, 370 B.R. 762, 769 (N.D. Ohio 2007) (explaining that the "majority view. . .developed over the past 25 years" is that retirement plan loans are not secured debts under the Bankruptcy Code); McVay v. Otero, 371 B.R.190, 195 (W.D. Tex. 2007) (observing that the "overwhelming majority of courts that have addressed this issue" have held that retirement plan loans are not secured debts under the Bankruptcy Code).

This clear consensus is based, in part, on the fact that employer retirement plans generally lack the power to commence collection actions against the debtor, and hence have no enforceable "right to payment" against the debtor, as required by 11 U.S.C. § 101(5). The earliest and most frequently cited case on this point in In re Villarie, 648 F.2d 810 (2d Cir. 1981), a Second Circuit case in which the debtor borrowed money from his account with the state retirement system and listed the retirement system as a "secured creditor." After the debtor filed for bankruptcy, the retirement system sought declaratory relief that the loan was not a "debt" within the meaning of the Bankruptcy Code. The Second Circuit analogized the transaction to "an annuitant's withdrawal from the savings account of his annuity fund" or "an insured's advance from the reserve fund of his insurance policy," and held that it did not create a debtor-creditor relationship that gave rise to a claim under the Bankruptcy Code because the retirement system had no right to sue the debtor if he failed to repay the loan. Id. at 812.

The Sixth Circuit adopted this same reasoning in Mullen v. United States, 696 F.2d 470 (6th Cir. 1983). In Mullen, the debtor had received a "readjustment allowance" from his employer, the U.S. Air Force, pursuant to 10 U.S.C. § 687, when he was released following a force reduction. The statute provided, *inter alia*, that if the debtor returned to the military, he would not receive any retirement pay until he repaid 75% of the readjustment allowance. The debtor later returned to the military and retired after completing the necessary term of service, but without repaying the readjustment balance. Shortly after he left military service, the debtor filed a chapter 7 bankruptcy petition, and then filed a motion to hold the U.S. Air Force in contempt for violating the automatic stay[6] against collection efforts by continuing to withhold his retirement benefits. The Sixth Circuit rejected the debtor's argument, relying on both Villarie and the legislative history of 11 U.S.C. § 101, which notes that

> [the] definition of "debt" and the definition of "claim on which it is based, proposed 11 U.S.C. § 101(4), will not include a transaction such as a policy loan on an insurance policy. Under that kind of transaction, the debtor is not liable to the insurance company for repayment; the amount owed is merely available to the company for setoff against any benefits that become payable under the policy. As such, the loan will not be a claim (it is not a right to payment) that the company can

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[6] The "automatic stay," codified in 11 U.S.C. § 362, automatically and broadly enjoins any creditor collection actions upon a debtor's bankruptcy filing.

> assert against the estate; nor will the debtor's obligation be a debt (a liability on a claim) that will be discharged under proposed 11 U.S.C. § 523 or 524.

Mullen, 696 F.2d at 472 (quoting H.R. No. 595, 95th Cong., 2d Sess., 310, reprinted in 1978 U.S. Code Cong. & Ad. News 5787, 6267).

Like the Air Force in Mullen, a debtor's retirement plan administrator has no right to recover any unpaid portion of the 401(k) loan from any source other than the debtor's vested retirement account balance, which is akin to the "prepaid retirement benefit" at issue in that case. As one district court explained,

> Retirement plan loans are qualitatively different than secured debts such as home mortgages and car loans. The retirement plan administrator does not loan the plan participant the administrator's money. It simply deducts the requested loan amount from the participant's own account, and credits the loan payments and interest back to the participant's account. If the participant defaults on the loan, the plan administrator deducts the amount owed from the vested account balance, and repays the loan with this deduction. The participant must treat this deduction as a distribution which is taxable as income to the participant in the default year. The participant may also be subject to an early withdrawal penalty. But, the plan administrator has no right to payment under the Bankruptcy Code.

Thompson, 370 B.R. at 768 n. 10.

Numerous district courts and bankruptcy courts have adopted this reasoning and concluded that retirement loan repayments are not debts within the meaning of the Bankruptcy Code. See, e.g., In re Cohen, 246 B.R. 658, 667 (Bankr. D. Colo. 2000) (explaining that a retirement loan is in essence a debt to oneself); In re Fulton, 211 B.R. 247, 264 (Bankr. S.D. Ohio 1997); Esquivel, 239 B.R. at 149-52; In re Scott, 142 B.R. 126, 127-31 (Bankr. E.D. Va. 1992); In re Jones, 138 B.R. 536, 537-38 (Bankr. S.D. Ohio 1991).

Because a debtor's obligation to repay his retirement loan does not constitute a "claim" or a "debt" under the Bankruptcy Code, the vast majority of courts to consider the issue after the enactment of the 2005 Act have held that debtors may not include payments on such loans as a deduction on their means test under section 707(b)(2). See, e.g., In re Smith, 388 B.R. 885, 887 (Bankr. C.D. Ill. 2008); In re Watkins, 2008 WL 2475749, at *6 (Bankr. D. Ariz. June 18, 2008); In re Mowris, 384 B.R. 235, 237-38 (Bankr. W.D. Mo. 2008); Otero, 371 B.R. at 195-97; Thompson, 370 B.R. at 768-72; In re Masur, 2007 WL 3231725, at *4-5 (Bankr. D. S.D. Oct. 30, 2007); In re Mordis, 2007 WL 2962903, at *4 (Bankr. E.D. Mo. Oct. 9, 2007); In re Turner, 376 B.R. 370, 376 (Bankr. D. N.H. 2007).

These decisions rely both on the plain language of the Bankruptcy Code and on two basic canons of statutory construction. Id.

The first canon requires courts to “presume that Congress is aware and understands past judicial interpretation and practice when it amends the Code.” Mordis, 2007 WL 2962903, at *3 (citing Dewsnup v. Timm, 502 U.S. 773, 779 (1992)). Because the overwhelming majority of pre-2005 Act opinions held that retirement plan loans were not “debts” under the Code, courts “must assume that Congress was aware of this judicial interpretation when it enacted [the 2005 Act] and intended to preserve it.” Id. at *4; see also Thompson, 370 B.R. at 771 (“Because overwhelming case law preceding the 2005 Act held that 401(k) loans were not ‘debts’ under the Code, and because Congress has not expressly said otherwise, the Court must presumed that ‘debt’ retains its pre-2005 Act meaning.”); Mowris, 384 B.R. at 238; Otero, 371 B.R. at 202-03.[7]

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[7] Indeed, Congress explicitly preserved that interpretation when it added section 362(b)(19), which provides that the automatic stay does not apply to automatic deductions from a debtor’s wages to repay a retirement plan loan, but expressly states that “nothing in this paragraph may be construed to provide that any loan made under . . . a contract or account under section 403(b), of the Internal Revenue Code of 1986 constitutes a claim or a debt under this title.” 11 U.S.C. § 362(b)(19); see also Mowris, 384 B.R. at 238.

The second relevant canon requires courts to presume that "when Congress includes particular language in one section of a statute but omits it in another section of the same Act, courts should presume that Congress acted intentionally in that exclusion." Mordis, 2007 WL 2962903, at *4 (citing KP Permanent Make-Up, Inc. v. Lasting Impression I, Inc., 543 U.S. 111, 118 (2004)). In enacting the 2005 Act, Congress expressly gave chapter 13 debtors the ability to deduct 401(k) loan payments from their disposable income calculation, see 11 U.S.C. § 1322(f), but did not include any similar exemption for chapter 7 debtors. As one court observed, "[i]n light of the amendments sprinkled throughout the Code [addressing 401(k) loans] – especially section 1322(f) – the lack of a 401k provision in section 707 is a glaring indication that Congress did not intend 401k loan repayments to be deducted in Chapter 7." Turner, 376 B.R. at 376; see also Masur, 2007 WL 3231725, at *5 ("Obviously, Congress knew well how to craft direct language requiring courts to treat 401(k) loans as secured debts for purposes of the means test, [but declined to do so.]").

Congress's decision to treat 401(k) loan payments differently under chapter 13 than chapter 7 is consistent with two of the 2005 Act's primary goals: protecting an individual's retirement savings while also "redirect[ing] chapter 7 petitioners into chapter 13 proceedings in order to 'ensure that those who can afford to repay some portion of their unsecured debts [be] required to do so.'" Otero, 371 B.R. at 201 (quoting 151 Cong. Rec. S2470 (daily ed. Mar. 10, 2005); see also Thompson, 370 B.R. at 771 ("Such an approach serves both the Congressional intent to protect retirement contributions and to ensure that debtors repay creditors an amount they can afford, a primary goal of the 2005 Act.").

II. Alternatively, because Mr. Adams' retirement loan obligations are not "secured" within the meaning of the Bankruptcy Code, the court below erred in ruling that the obligations were "secured debts" due to a "secured creditor" within the meaning of 11 U.S. C. § 707(b)(2)(A)(iii).

Although most courts have not found it necessary to reach this issue, the bankruptcy court's ruling should also be reversed because a 401(k) loan is also not "secured" within the meaning of the Bankruptcy Code. See Thompson, 370 B.R. at 770. Section 506(a) applies to all chapter 7 bankruptcy cases,[8] and provides a general framework for assessing whether and to what extent a creditor's claim is secured for bankruptcy purposes. See, e.g., In re Miller, 907 F.2d 80, 82 (8th Cir. 1990). Section 506(a)(1) provides, in relevant part, that "[a]n allowed claim of a creditor secured by a lien on property in which the estate has an interest, or that is subject to setoff under section 553 or this title, is a secured claim to the extent that the value of such creditor's interest in such title, is a secured claim to the extent that the value of such creditor's interest in such property." 11 U.S.C. § 506(a)(1). In other words, a secured claim under the Bankruptcy Code refers to a claim secured by a lien on property in which the debtor's *bankruptcy estate* owns an interest. See In re Foremost Mfg. Co., 137 F.3d 919, 924 (6th Cir. 1998).

A debtor's interest in his 401(k) retirement plan is not property of the debtor's bankruptcy estate because section 541 defines what property is included and excluded from a debtor's bankruptcy estate under section 541(c)(2), and "any interest in a plan or trust that contains a transfer restriction enforceable under any relevant nonbankruptcy law" is excluded from property of the estate. Patterson v. Shumate, 504 U.S. 753, 758-60 (1992). Moreover,

---

[8] See 11 U.S.C. § 103(a).

section 541(b)(7) broadly excludes from "property of the estate" "any amount (A) withheld by an employer from the wages of employees for payment as contributions (i) to – (I) an employee benefit plan that is subject to . . .[ERISA] . . ." or (B) received by an employer from employees for payment as contributions (i) to . . . an employee benefit plan that is subject to [ERISA]. . . ." 11 U.S.C. § 541(b)(7). Under this section, any of Mr. Adams' contributions to his 401(k) account are not property of the debtor's bankruptcy estate. See Fulton, 211 B.R. at 263-64 (noting that no case law existed in support of debtors' proposition that their retirement loans were "secured debts" and that the Bankruptcy Code did not transform "this type of transaction – a loan from the debtor's pension fund – into a secured debt giving rise to a right to payment under § 101(5)."). Accordingly, Mr. Adams' repayment obligation on his 401(k) loan is neither a debt nor a secured debt under the Bankruptcy Code, and the bankruptcy court erred by holding to the contrary.

CONCLUSION

For these reasons, the United States Trustee respectfully asks this Court to reverse the order entered below denying the United States Trustee's motion to dismiss, and remand with instructions that the bankruptcy court correctly apply the statutory provisions of 11 U.S.C. § 707(b)(2).

Respectfully submitted,

R. MICHAEL BOLEN
United States Trustee

/s/ Sammye S. Tharp
Sammye S. Tharp
Department of Justice

Office of the United States Trustee
100 W. Capitol Street, Suite 706
Jackson, MS 39269
Telephone: (601) 965-5241
Fax: (601) 965-5226

RAMONA D. ELLIOTT
General Counsel

P. MATTHEW SUTKO
Associate General Counsel

DAVID A. LEVINE
Executive Office for United States Trustees
Department of Justice
20 Massachusetts Avenue, N.W.
Washington, D.C. 20530

CERTIFICATE OF SERVICE

I, **SAMMYE S. THARP**, Trial Attorney for the Office of the U. S. Trustee, do hereby certify that a copy of the Brief of Appellant R. Michael Bolen, United States Trustee, has been served this day on the below-named individual(s) via first class U.S. Mail at the address(es) listed below or by Notice of Electronic Filing via the email address(es) on file with the court's CM/ECF system:

Paige McDowell
Goeldner, Porter & McDowell, P.C.
P.O. Box 1468
Southaven, MS 38671
Email: paige@gpmlawfirm.net

Alex B. Gates
CHAPTER 7 TRUSTEE
P. O. Box 216
Sumner, MS 38957
E-mail: alexgates@bellsouth.net

DATED, this the 29th day of August, 2008.

/s/Sammye S. Tharp
SAMMYE S. THARP

BRIEF BANK — "SUMMARY SHEET" *Printed Mon-5/23/11 11:24*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*
In re Nick O. Adams (R. Michael Bolen, UST v. Nick O. Adams)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*
N. D. Miss.

3. ("CCN") ***CURRENT*** CASE NO.
No.: 2:08-CV170-SA

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*
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(Identify judge & cite, if any)

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U.S. TRUSTEES

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Michael E. Ridgway, Sammye S. Tharp, R. Michael Bolen, P. Matthew Sutko.
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s)
• Whether the bankruptcy court erred when it ruled that 11 U.S.C. § 707(b)(2)(A)(iii) permits a debtor to deduct retirement loan repayments.

&

√ Any Miscellaneous ***BACKGROUND***

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BEFORE THE UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF MISSISSIPPI

CASE NO. 2:08-CV170-SA

NICK O. ADAMS
Debtor.

R. MICHAEL BOLEN, UNITED STATES TRUSTEE
Appellant,

v.

NICK O. ADAMS
Appellee.

ON APPEAL FROM THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF MISSISSIPPI

THE HONORABLE SHARION AYCOCK, PRESIDING
Bankruptcy Case No. 06-11354

REPLY BRIEF OF THE APPELLANT R. MICHAEL BOLEN, UNITED STATES TRUSTEE

Of Counsel

RAMONA D. ELLIOTT
GENERAL COUNSEL

P. MATTHEW SUTKO
MICHAEL E. RIDGWAY
Department of Justice
Executive Office for United States Trustees
20 Massachusetts Avenue, NW
Washington, D.C. 20530
(202) 307-1399

R. MICHAEL BOLEN
Department of Justice
United States Trustee

SAMMYE S. THARP
Department of Justice
Trial Attorney
Office of the U.S. Trustee
100 W. Capitol Street, Suite 706
Jackson, MS 39269
(601) 965-5241

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I. INTRODUCTION

The United States Trustee's opening brief established that the bankruptcy court erred when it ruled that 11 U.S.C. § 707(b)(2)(A)(iii) permits a debtor to deduct retirement loan repayments. That error led the bankruptcy court to rule Mr. Adams "passed" the means test of section 707(b)(2). Mr. Adams has proffered several arguments to support the bankruptcy court's ruling, but fails to explain how money a debtor borrows from his own retirement account can ever be a "debt" — much less a secured debt owed to a secured creditor — within the meaning of the Bankruptcy Code. The expense deduction for means test purposes under section 707(b)(2)(A)(iii) is available only for payments on account of "debts" that are "secured," calculated with reference to amounts due to "secured" creditors.

Mr. Adams' retirement plan loan repayments do not qualify as a debt under section 707(b)(2)(A)(iii) for at least three reasons: **First**, a retirement loan is not a "debt" under 11 U.S.C. § 101(12) of the Bankruptcy Code because no debtor-creditor relationship exists between Mr. Adams and his retirement plan administrator. **Second**, a retirement loan is not a "secured" obligation under 11 U.S.C. § 506 of the Bankruptcy Code because Mr. Adams' interest in his retirement account was never property of the estate. **Third**, allowing a debtor to claim retirement loan repayments under the means test would contravene public policy objectives of bankruptcy reform legislation — to require a debtor to repay his debts when he can.

Without the deduction for retirement plan loan repayments, Mr. Adams' monthly disposable income increases to a level in which the statutory presumption of abuse arises. The record reflects that Mr. Adams' monthly 401(k) loan repayment was $330.33. Dkt. 36. If he is not allowed to take this as a deduction on his means test form, his monthly disposable income increases from $115.77 (*Id.*) (below the presumption of abuse) to $299.62 (Tr. of hearing at 21), which exceeds the $166.67 per month threshold necessary to trigger the presumption of abuse under 11 U.S.C. § 707(b)(2).

II. Section 707(b)(2)(A)(iii) does not permit Mr. Adams to deduct retirement account loan repayments.

A. The money Mr. Adams withdrew from his own retirement account does not constitute a "debt" under the Bankruptcy Code.

In his opening brief, the United States Trustee established that a debtor's retirement loan is not a "debt" under the Bankruptcy Code — a conclusion the Second Circuit has reached, and which the Sixth Circuit has followed. App. Brief at 17-18 [citing *In re Villarie*, 648 F.2d 810 (2d Cir. 1981) and *Mullen v. United States*, 696 F.2d 470 (6th Cir. 1983)]. In response, Mr. Adams asks this Court to split with the Second and Sixth Circuits by ruling his retirement account loan is a debt under the Code. He does so under a misplaced theory that the plan has recourse against his property.

Appellee's Brief at 4-5.

Mr. Adams suggests the specific language contained in the underlying "Loan Note and Security Agreement" (attached as Exhibit "A" to Appellee's Brief)[1] ("Agreement") makes his withdrawal a debt. Appellee's Brief at 4. He notes the Agreement gives the creditor the right to sue the debtor which necessarily transforms this retirement loan into a "debt" under the Bankruptcy Code. Appellee's Brief at 5. The Agreement itself contains much the same language as any "garden variety" loan, including the granting of a security interest "in that portion of my vested amount in the Plan (the 'Collateral') equal to the loan amount, which

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[1] This document is also referred to in the record as Debtor's Exhibit 1.

amount does not exceed 50% of my vested account balance under the Plan." Exhibit "A" to Appellee's Brief. It also includes the usual Truth-In-Lending (TILA) Disclosure Statement showing a finance charge of $2,895.67 being added to the amount financed ($17,000.00). *Id.*

The relevant question here is whether Mr. Adams' withdrawal from his retirement account is a "debt" as that term is used in the Bankruptcy Code. Section 101(12) defines the term "debt" to mean "liability on a claim." In turn, the Bankruptcy Code defines the term "claim" broadly, to mean

> (A) right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured or unsecured; or
>
> (B) right to an equitable remedy for breach of performance if such breach gives rise to a right to payment, whether or not such right to an equitable remedy is reduced to judgment, fixed, contingent, matured, unmatured, disputed, undisputed, secured, or unsecured.

Id. § 101(5). The definitions of "claim" and "debt" are "coextensive." *Pennsylvania Dept. of Public Welfare v. Davenport*, 495 U.S. 552, 558 (1990); *Johnson v. Home State Bank*, 501 U.S. 78, 84-85 n.5 (1991); S. Rep. No. 989, 95th Cong. 2d Sess. 23 (1978) *reprinted in* 1978 U.S. Code Cong. & Admin. News, pp. 5787, 5809 ("The terms 'debt' and 'claim' are coextensive: a creditor has a 'claim' against the debtor; the debtor owes a 'debt' to the creditor"). The Second Circuit, in *Villarie*, and the Sixth Circuit, in *Mullen*, relied upon this analysis in concluding that the respective loans in those cases were not "debts" within the meaning of the Bankruptcy Code. *In re Villarie,* 648 F. 2d at 812; *Mullen v. United States*, 696 F.2d at 472.

The retirement loan documentation in one of the cases cited by the United States Trustee in his opening brief, *In re Smith*, 388 B.R. 885 (Bankr. C.D. Ill. 2008), bears a striking similarity to the facts of this case. In *Smith*, one of the joint debtors, Earl Smith, advanced much the same argument as Mr. Adams does here, pointing to the language contained in the underlying loan documents to support his contention there was a "debt" for bankruptcy purposes. The bankruptcy court ruled against Mr. Smith, finding that his plan trustee had no "claim" against him, and hence no "debt" which could be deducted as a "secured debt" for means test purposes. The bankruptcy court in *Smith* disallowed the retirement loan repayment as a deduction notwithstanding the underlying loan documentation (almost identical to the loan here) containing many of the same provisions as a typical secured transaction (e.g., a TILA disclosure statement and a collateral pledge of 50% of the vested retirement account). "The form of the documentation cannot get around the substance of the transaction, that [Mr. Smith] borrowed his own money." *In re Smith*, 388 B.R. at 887.

B. No valid right of setoff exists to transform Mr. Adams' transaction into a "secured debt" under 11 U.S.C. § 506(a).

In his opening brief, the United States Trustee also demonstrated that the Mr. Adams' interest in his retirement account is not property of his bankruptcy estate under section 541. App. Brief at 21-22. Accordingly, the United States Trustee argued that the Mr. Adams' interest cannot be a secured claim under section 506(a) of the Bankruptcy Code. Section 506(a) limits a secured claim to the extent of a creditor's interest in the bankruptcy estate's interest in the property.

Mr. Adams' responsive argument focuses on that part of section 506(a) that provides that an allowed claim "that is subject to setoff under section 553 of [the Bankruptcy Code]" is also a secured claim "to the extent of the amount subject to setoff." But section 553 of the Bankruptcy

Code[2] does not create an independent right to setoff, rather it

> recognizes and preserves rights of setoff in bankruptcy cases if four conditions exist: (I) the creditor holds a "claim against the debtor that arose before the commencement of the case, (ii) the creditor owes a "debt" to the debtor that also arose before the commencement of the case, (iii) the claim and debt are "mutual," and (iv) the claim and debt are each valid and enforceable.

4 Collier on Bankruptcy ¶ 506.03[1][b] at 506-16 (15th ed. Rev. 2005).

Nor does Mr. Adams have a valid right of setoff under section 553(a). As the United States Trustee has already established, no creditor holds a claim against Mr. Adams. App. Brief at 17.

In addition, even assuming for the sake of argument that Mr. Adams' obligation to repay his retirement loan is a "debt" and the retirement plan's obligation to repay the funds in Mr. Adams' retirement is a "claim," the claim and the debt are not "mutual." In order to satisfy the mutuality requirement, the debt and claim must be owed by each entity in the same right or capacity. "Thus, for example, where the debt of an entity arises from a fiduciary duty, or is in the nature of a trust, there is no mutuality." *In re County of Orange*, 183 B.R. 609, 619 (Bankr. C.D. Cal. 1995); *see Dakin v. Bayly*, 290 U.S. 143, 146 (1933) (funds held in trust for a particular purpose may not be setoff against creditor's claims); *Fore Improvement Corp. v. Selig*, 278 F. 2d 143, 145 (2d Cir. 1960); *Cohen v. Savings Building & Loan Co.*, 896 F. 2d 54, 57-58 (3d Cir. 1990); *In re Bob Richards Chrysler - Plymouth Corp.*, 473 F. 2d 262, 265 (9th Cir. 1973).

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[2] Section 553(a) provides, in relevant part: "Except as otherwise provided in this section and in sections 362 and 363 of this title, this title does not affect any right of a creditor to offset a mutual debt owing by such creditor to the debtor that arose before the commencement of the case under this title against a claim of such creditor against the debtor that arose before the commencement of the case . . ."

> This rule has been described in the following terms:
> If A in his individual capacity owes $100 to B in B's individual capacity, and B likewise owes $50 to A, the obligations are 'mutual.' On the other hand, if A in his individual capacity owes $100 to B, but B owes $50 to A in A's capacity as trustee of a trust, or as a fiduciary or agent for some other party, the obligations are not mutual because they are not acting in the same 'capacity.'

5 Collier on Bankruptcy ¶ 553.03[3][c] at 553-34 (15th ed. Rev. 2005).

In this case, Mr. Adams "owes" the plan administrator on account of the money the Debtor borrowed from his retirement account. However, the retirement plan's obligation to receive the loan repayments and to remit funds in his retirement account creates no mutual claim because, as Collier on Bankruptcy explains, it arises from a fiduciary obligation. *See also In re Jones*, 107 B.R. 888, 899 (Bankr. N.D. Miss. 1989) (Commodity Credit Corporation could not offset pecan disaster payments owed by it to sole proprietorship owned by individual debtor against deficiency obligation owed by corporate debtor owned 100% by individual debtor because there was no mutuality of debts).

Because no setoff rights exist and because the Mr. Adams' bankruptcy estate does not have any interest in his retirement account, no secured debt exists under section 506(a) of the Bankruptcy Code.

III. CONCLUSION

For these reasons, the United States Trustee respectfully asks this Court to reverse the order denying the motion to dismiss the case entered in the bankruptcy court and remand this case for further proceedings.

Dated: October 15, 2008 Respectfully submitted,

R. MICHAEL BOLEN
United States Trustee

/s/ Sammye S. Tharp
Department of Justice
Office of the United States Trustee
100 W. Capitol Street, Suite 706
Jackson, MS 39269
Telephone: (601) 965-5241
Fax: (601) 965-5226

RAMONA D. ELLIOTT
General Counsel

P. MATTHEW SUTKO
Associate General Counsel

MICHAEL E. RIDGWAY
Executive Office for United States Trustees
Department of Justice
20 Massachusetts Avenue, N.W.
Washington, D.C. 20530
(202) 307-1399

CERTIFICATE OF SERVICE

I, **SAMMYE S. THARP**, Trial Attorney for the Office of the U.S. Trustee, do hereby certify that a copy of the Reply Brief of Appellant R. Michael Bolen, United States Trustee, has been served this day on the below-named individual(s) via first class U.S. Mail at the address(es) listed below or by Notice of Electronic Filing via the email address(es) on file with the Court's CM/ECF system:

LeAnne L. Abbott
Goeldner, Porter & McDowell, P.C.
P.O. Box 1468
Southaven, MS 38671
Email: leanne@gpmlawfirm.net

Alex B. Gates
CHAPTER 7 TRUSTEE
P.O. Box 216
Sumner, MS 38957
Email: alexgates@bellsouth.net

DATED this the 15th day of October, 2008.

/s/ Sammye S. Tharp
SAMMYE S. THARP

BRIEF BANK — "SUMMARY SHEET" *Printed Wed-6/30/10 10:49*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	Adirondack Mines Inc., v. United States Trustee
2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	N.D.N.Y.
3. ("CCN") ***CURRENT*** CASE NO.	No.: 1:10-cv-0411 GLS
4. ("PCN") ***PRIOR*** CASE NO. - & COURT *[IF ANY]*	No.: 09-12248 Court: Bankr. N.D.N.Y *(Identify judge & cite, if any)*
5. ("SO") ***SOURCE***	**U.S. TRUSTEES**
6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	Filed: June 29, 2010 Type: Appellee's Brief
7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*	Kevin Purcell, Sean Day, Anne Stukes, P. Matthew *(UST/OGC: 202-307-1399/FAX-2397)*
8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	• Whether the bankruptcy court abused its discretion by dismissing the bankruptcy case under 11 U.S.C. § 1112(b).
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UNITED STATES DISTRICT COURT
FOR THE
NORTHERN DISTRICT OF NEW YORK

ADIRONDACK MINES INC.,
Appellant

v. CIVIL NO. 1:10-CV-0411 GLS

UNITED STATES TRUSTEE
Appellee

ON APPEAL FROM THE UNITED STATES BANKRUPTCY COURT FOR THE NORTHERN DISTRICT OF NEW YORK

APPELLEE'S BRIEF

DATED: June 28, 2010
Albany, New York.

Respectfully submitted,

Diana G. Adams
United States Trustee
For Region 2

/s/ Kevin Purcell
Kevin Purcell, Esq.
Bar I.D. 512555
74 Chapel Street, Suite 200
Albany, NY 12207
(518) 434-4553
(518) 434-4459 (fax)
Kevin.J.Purcell@usdoj.gov

Attorney for the United States Trustee/Appellee

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STATEMENT OF JURISDICTION

On February 12, 2010, the United States Bankruptcy Court for the Northern District Court of New York issued an order pursuant to 11 U.S.C. § 1112 dismissing the bankruptcy case of the Appellant, Adirondack Mines Inc. ("Adirondack"). (Bankr. Dkt. 77). On February 19, Adirondack timely filed a notice of appeal under 28 U.S.C. § 158(c)(2) and Fed. R. Bankr. P. 8002(a). (Bankr. Dkt. 82). An order of dismissal is a final order of the bankruptcy court. *Pellegrino v. Boyajian (In re Pellegrino)*, 423 B.R. 586, 589 (B.A.P. 1st Cir. 2010). This Court has jurisdiction to hear the appeal pursuant to 28 U.S.C. § 158(a)(1).

ISSUE PRESENTED

1. Did the bankruptcy court abuse its discretion under 11 U.S.C. § 1112(b) when it dismissed Adirondack's bankruptcy case?

STANDARD OF REVIEW

Adirondack presents the standard of review for this court as *de novo*. (App. Br. at 1). This is incorrect. The bankruptcy court dismissed Adirondack's case on the basis of bad faith in filing. (Bankr. Dkt. 89 at 5). The bankruptcy court's determination of bad faith is a factual finding that is reviewed for clear error. *Squires Motel, LLC v. Gance*, 426 B.R. 29, 34 (N.D.N.Y. 2010) (Sharpe, J.). A bankruptcy court's decision to dismiss on the basis of bad faith is reviewed for an abuse of discretion. *Id.; see also C-TC 9th Ave. P'Ship v. Norton Co. (In re C-TC 9th Ave. P'ship)*, 113 F.3d 1304, 1312 (2d Cir. 1997) ("Based on these factors, the bankruptcy court did not abuse its discretion in dismissing C-TC's petition for bad faith.").

STATUTORY BACKGROUND

"[A]bsent unusual circumstances specifically identified by the court," section 1112(b)(1) of Bankruptcy Code requires a bankruptcy court, upon a the request of a party in interest, to convert a bankruptcy case under another chapter to a chapter 7 case or dismiss the case "if the movant establishes cause." 11 U.S.C. § 1112(b)(1). The United States Trustee is authorized by statute to file motions to convert or dismiss bankruptcy cases. *See* 28 U.S.C. § 586(a)(8).

Subsection 1112(b)(4) of the Bankruptcy Code provides a list of what constitutes "cause" to convert or dismiss a case. 11 U.S.C. § 1112(b)(4). "[T]his list is illustrative, not exhaustive." *In re C-TC 9th Ave. P'ship*, 113 F.3d at 1311; *see also* 11 U.S.C. § 102(3) (defining the term "includes" as used, *inter alia*, in section 1112(b)(4)'s list of bases for dismissal as "not limiting"). Bad faith, or the absence of good faith, is a well established basis for dismissal for cause. *In re C-TC 9th Ave. P'ship*, 113 F.3d at 1310; *In re Copy Crafters Quickprint, Inc.*, 92 B.R. 973, 985 (Bankr. N.D.N.Y. 1988).

STATEMENT OF THE CASE

Adirondack is a New York corporation formed March 19, 2009. (Bankr. Dkt. 56 at Ex. A). On June 18, 2009, 91 days after it was formed, Adirondack filed a voluntary bankruptcy petition under chapter 11 of the United States Bankruptcy Code. (Bankr. Dkt. 1). The president and sole shareholder of Adirondack is Ms. Christine Thomas. (*Id.* at 3, 4).

I. **The Las Vegas Properties**.

In its Schedules and Statement of Financial Affairs filed with its petition, Adirondack lists six assets: five rental properties in Las Vegas, Nevada; and a "[c]laim against State of New York for failure to renew mining permit in Groton, NY." (*Id.* at 9, 11). Four of the properties were transferred by quitclaim deed from Ms. Thomas to Adirondack on April 1, 2009. (Bankr. Dkt. 40 at Ex. 1). The fifth property was transferred that same day by grantors listing the same address as Ms. Thomas. (*Id.*). Each of the quitclaim deeds recite consideration of between $150,000 and $765,000. (*Id.*). There is no evidence, however, that Adirondack actually made any payments to the grantors.

Each of the five properties is subject to a note and deed of trust executed by Ms. Thomas or her husband, Anthony Thomas, or both. (Bankr. Dkt. 68 at Exs. B-D, F, H).[1] The secured creditor listed on Adirondack's schedules for these properties is Countrywide Home Loans ("Countrywide"). Countrywide's loans were transferred in November 2008 to Bank of America, N.A. ("Bank of America").[2] (Bankr. Dkt. 68 at 1-2 and Ex. A). BAC Home Loan Servicing, L.P. ("BAC") is the loan servicer on behalf of Bank of America for loans previously held by Countrywide. (*Id.*). Consequently, the secured creditor for present purposes is BAC.

Section 13 of each of the deeds of trust requires approval by the lender of any successor in interest to the borrower. (*E.g., id.* at Ex. B). Section 18 of each of the deeds of trust permits the lender to require "immediate payment in full of all sums" in the event that "all or any part of the Property is sold or transferred without Lender's prior written consent." (*Id.*). This provision of the deeds is known as a "due on sale" clause. In an affidavit filed with the bankruptcy court, Ms. Thomas informed the court that she did not notify or seek the consent of Countrywide or

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[1] Two of the properties are also the security interests for home equity lines of credit. (Bankr. Dkt. 68 at Exs. E, G).

[2] Bank of America acquired Countrywide's parent, Countrywide Financial Corporation on July 1, 2008. *Bank Of America Completes Countrywide Acquisition*, Bus. Rev. (Albany), July 1, 2008, *available at* 2008 WLNR 12350796. Bank of America is the ultimate parent of Countrywide.

BAC prior to transferring the properties to Adirondack. (Bankr. Dkt. 65 at Ex. A).

II. **The Mining Permit Claim**.

The final asset held by Adirondack is a "[c]laim against State of New York for failure to renew a mining permit in Groton, NY," valued by Adirondack at $950,000. (Bankr. Dkt. 1 at 11). The claim was acquired from International Mining, Inc. in exchange for a promissory note in the amount of $950,000. (Bankr. Dkt. 1 at 6). The mining permit at issue involved gravel mining rights.[3] In 2003, an earlier holder of the permit, Internetworkone.com, Inc. initiated an adversary proceeding against the New York State Department of Environmental Conservation in its own bankruptcy case in the United States Bankruptcy Court for the District of Nevada claiming the Department had improperly revoked the permit prior to its 2004 expiration date. *Internetworkone.com, Inc. v. Crotty*, 03-01006 (Bankr. D. Nev.). In August 2004, the bankruptcy court issued an order abstaining from hearing the adversary proceeding. (03-01006 Bankr. Dkt. 53).

There is no evidence that Adirondack has ever commenced litigation against the State of New York regarding this claim. The United States Trustee submitted to the bankruptcy court a declaration of Phillip Lodico, deputy counsel for the New York State Department of Environmental Conservation. (Bankr. Dkt. 55). In his declaration, Mr. Lodico stated that he found, after review of the Department's files from 1988 until August 2009, no evidence that Adirondack had filed any legal proceeding against the Department or the State of New York.

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[3] In its Schedules and Statement of Financial Affairs, Adirondack lists its business as "[m]ining, sand and gravel exploration; real estate investment and management." (Bankr. Dkt. 1, at 4). There is no evidence, however, that other than holding the rights to pursue a legal claim involving a mining permit, that Adirondack, a company with no employees, is actually involved in the business of mining, or sand and gravel exploration.

(*Id.*).

III. **Adirondack's Monthly Operating Reports and Plan of Reorganization**.

Adirondack filed monthly operating reports with the bankruptcy court for July through December 2009. (Bankr. Dkts. 16, 17, 20, 38, 53, 63). These reports show that Adirondack has made no mortgage payments on the Las Vegas properties. (*Id.*). In its December 2009 monthly operating report, Adirondack listed cumulative post-petition receipts of $30,355 and $88,578 in unpaid cumulative post-petition mortgage payments. (Bankr. Dkt. 63 at 8, 12). Under that section of the operating report where the debtor is instructed to "[e]xplain how and when the Debtor intends to pay any past due post-petition debts," Adirondack wrote only that "[s]ecured [d]ebts have not been paid." (*Id.* at 12).

On November 10, 2009, Adirondack filed an amended motion to abandon two of the properties. (Bankr. Dkt. 30). Six days later, Adirondack filed a plan of reorganization. (Bankr. Dkt. 33). This plan proposed recasting the mortgages on the remaining properties as 30 year fixed interest mortgages at a rate of prime on the date the plan is effective plus one percent. As of the date Adirondack filed its plan of reorganization, the prime rate was 3.25%.[4] At the time the plan was filed, the interest rate for the loans securing two of the properties Adirondack did not seek to abandon was fixed at 6.25%. (Bankr. Dkt. 68 at Ex. B, D). The third property was subject to an adjustable interest rate calculated by reference to the LIBOR plus 2.25%. (*Id.* at Ex. H). On December 2, 2009, the United States Trustee filed an objection to Adirondack's disclosure statement and plan of reorganization. (Bankr. Dkt. 39). On January 13, 2010, BAC

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[4] The prime rate has remained at 3.25% throughout this case. *See* http://online.wsj.com/mdc/public/page/mdc_bonds.html.

filed an objection to Adirondack's motion to abandon. (Bankr. Dkt. 57).

IV. **The United States Trustee's Motion to Dismiss**.

On November 9, 2009, the United States Trustee moved to dismiss Adirondack's case for cause pursuant to pursuant to 11 U.S.C. § 1112(b). (Bankr Dkt. 27). The United States Trustee asserted three principal bases for the motion. First, that Adirondack had acted in bad faith in filing the case. (*Id.* at 1). Second, that there existed "'substantial or continuing loss to or diminution of the estate and the absence of a reasonable likelihood of rehabilitation.'" (*Id.*) (citing 11 U.S.C. § 1112(b)(4)(A)). Third, that Adirondack had failed "to timely file a disclosure statement and plan." (*Id.*) (citing 11 U.S.C. § 1112(b)(4)(J)).

Adirondack filed a response to this motion on December 4, 2009. (Bankr. Dkt. 40). In response to the United States Trustee's argument that it had failed to timely file a disclosure statement and plan, Adirondack noted that after the motion to dismiss it had filed a disclosure statement and plan and that there was no court ordered date for filing the statement or plan. (*Id.* at 1, 2). Adirondack also disputed the United States Trustee's claim that it had filed for bankruptcy in bad faith and challenged the United States Trustee's assertion that is was afflicted with "new debtor syndrome." (*Id.* at 3-5). In the course of doing so, Adirondack acknowledged the reason for its formation: "The fact that the debtor was formed months prior to its bankruptcy filing and that the bankruptcy filing was timed to prevent a sale at foreclosure is not itself an indication of bad faith." (*Id.* at 5).

A hearing was held on the United States Trustee's motion on December 9, 2009 and supplemental briefing ordered by the bankruptcy court on jurisdictional issues in anticipation of a further hearing on January 20, 2010. (Bankr. Dkt. 95). The United States Trustee submitted its supplemental briefing on January 7. (Bankr. Dkt. 55). Adirondack filed a reply on January 13. (Bankr. Dkt. 56).

V. **The Bankruptcy Court's Order of Dismissal.**

At the January 20 hearing, the bankruptcy court raised the issue of Ms. Thomas's non-compliance with the due on sale clauses in the deeds of trust. (Bankr. Dkt. 97 at 1). The bankruptcy court expressed concern that the transfer of the properties to Adirondack was accomplished without the consent of BAC in a bad faith effort to invoke the protection of chapter 11:

> [I]f it's clear to me, as I said, that this was artificially created to generate a Title 11 case, then with all due respect to everyone, I'm going to dismiss that as not being filed in good faith.

(*Id*. at 8). The bankruptcy court directed the parties to file additional briefing addressing the transfer of the properties to Adirondack and reiterated its position that if the transfers occurred in violation of the due on sale clause it would dismiss the case. (*Id.* at 12-13).

In its filing, Adirondack conceded that no notice had been provided to BAC of the quitclaim transfers of the five properties to Adirondack. (Bankr. Dkt. 65 at Ex. A). As noted above, Ms. Thomas admitted in an affidavit attached to this filing that she did not notify or seek consent for the transfers to Adirondack. (*Id.*). Nonetheless, Adirondack argued that the due on sale clause could "be cured or modified" in a chapter 11 bankruptcy, and the violation was not sufficient to dictate dismissal of the case. (Bankr. Dkt. 65 at ¶ 8).

BAC also filed papers supporting the motion to dismiss and addressing the bankruptcy court's concern regarding the due on sale clauses. (Bankr. Dkt. 68). In its filing, BAC argued that Adirondack had breached the due on sale clauses and its case should be dismissed for bad faith. (*Id.*).

On February 10, the bankruptcy court held a third hearing on the motion to dismiss. (Bankr. Dkt. 89). At that hearing, the court dismissed Adirondack's case. Noting Adirondack's admission that it "'was formed months prior to its bankruptcy filing and that the bankruptcy filing was timed to prevent a sale at foreclosure,'" (*id.* at 4) (citing Bankr. Dkt. 40 at 5), the bankruptcy court held that it could not "countenance the deliberate, strategic breach of an otherwise valid agreement which would be actionable at law and then use that breach as a sword in Title 11, while at the same time, hide behind the protective skirts of the automatic stay found in Section 362." (Bankr. Dkt. 89 at 4). The bankruptcy found "bad faith both in the debtors' acquisition of the property and in the Chapter 11 filing." (*Id.* at 5). The court also noted that:

> The U.S. Trustee makes many valid points in its own motion to dismiss. However, to even discuss those points dilutes the seriousness of the Court's very narrow *sua sponte* concerns and even serves to give some legitimacy to a debtor whose short, shadowy existence should never have given rise to a Chapter 11 filing.

(*Id.*). An order of dismissal granting the United States Trustee's motion was entered on February 12, 2010. (Bankr. Dkt. 77). This appeal followed.

SUMMARY OF ARGUMENT

This Court should affirm the bankruptcy court's order. The bankruptcy court did not abuse its discretion in dismissing Adirondack's case on the basis of bad faith. The underlying factual finding that the case was filed in bad faith was not clearly erroneous. Adirondack is a short-lived corporation with assets consisting solely of properties transferred to it by its sole shareholder in violation of valid due on sale clauses and a latent claim against the state of New York. The conclusion of the bankruptcy court that: a) Adirondack was formed and entered into bankruptcy for the purpose of avoiding foreclosure of properties previously owned by Ms. Thomas, its sole shareholder and; b) Ms. Thomas transferred these properties to Adirondack in violation of the lending documents and then attempted through reorganization to obtain a subsequent favorable modification of the mortgages, is fully supported by the record.

The issues raised in the United States Trustee's motion to dismiss were briefed by both parties to the bankruptcy court and provide additional bases for dismissal. Adirondack is an example of "new debtor syndrome" whereby a newly formed and closely held entity is created to shelter assets and avoid foreclosure. Moreover, Adirondack's monthly operating reports demonstrate that there exists a "substantial or continuing loss to or diminution of the estate and the absence of a reasonable likelihood of rehabilitation." 11 U.S.C. § 1112(b)(4). For these reasons, this Court should affirm.

ARGUMENT

A. The Bankruptcy Court Did Not Abuse Its Discretion in Dismissing This Case For Bad Faith.

After three hearings and a series of briefings by the United States Trustee, Adirondack, and BAC, the district court ordered dismissal on the basis that Adirondack had acted in bad faith in filing this case. This conclusion is fully supported by the record and is not clearly erroneous. Adirondack holds the Las Vegas properties, its principal assets, only as the result of a violation by Ms. Thomas of due on sale clauses in mortgages securing the property that require notice of transfer to the lender and consent to the transfer by the lender. (Bankr. Dkt. 65 at Ex. A). Ms. Thomas has admitted that prior to transferring the properties to Adirondack she neither sought nor received the consent of the lender. (*Id.*). The bankruptcy court was correct to recognize the situation for what it was: an attempt by Ms. Thomas to divert, in violation of contracts and to the detriment of her creditors, properties at risk for foreclosure to an entity under her sole control which would file for bankruptcy and then use the protection of bankruptcy as a bulwark against the enforcement of the terms of the contract. (Bankr. Dkt. 89 at 4).

The bankruptcy court's decison to dismiss is consistent with this Court's two-pronged test for the establishment of bad faith in filing. *Squires Motel, LLC v. Gance*, 426 B.R. 29, 34 (N.D.N.Y. 2010). "First, the movant must demonstrate the objective futility of the reorganization process such that at the time of filing there was no reasonable probability that the debtor would eventually emerge from bankruptcy proceedings. Second, in demonstrating subjective bad faith, the movant must show that there was no reasonable likelihood that the debtor intended to reorganize." *Id.* (citing *In re Cohoes Indus. Terminal, Inc.*, 931 F.2d 222, 227 (2d Cir.1991)).

In the present case, the bankruptcy court was correct in finding bad faith by Adirondack. The objective futility of reorganization is supported by the record. Despite Adirondack's claims to the contrary, nothing in its filings before the bankruptcy court suggest a "reasonable probability that [it] would eventually emerge from bankruptcy proceedings." *Id.*

Throughout the post-petition period, Adirondack has accumulated substantial arrearages. All of Adirondack's operating reports show that it has not made its current mortgage payments as they became due. Over the course of the operating reports, Adirondack incurred post-petition $88,578 in unpaid secured mortgage debt compared to cash receipts of only $30,355. (Bankr. Dkt. 63 at 8, 12). No portion of these receipts was dedicated to paying down secured debt. Adirondack's monthly secured debt payments are $12,654. (*See e.g., id.* at 12). Its operating reports show that it had positive cash flow in four of the months covered by the operating reports and negative cash flows in two of the months (including the last operating report). However, even in positive months, cash flow never exceeded approximately 73% of the due, but not paid, secured debt payments for that month.[5]

Adirondack filed its last operating report in January and its financial condition from that time to present is unknown. There is no reason to believe, however, that since January Adirondack has begun the process of paying down post-petition secured debt. In all of its filings since the motion to dismiss was filed (including its brief to this Court) Adirondack has certainly not suggested its financial picture has markedly improved or that it has made any payments on secured debt, surely something Adirondack would be eager to emphasize.

Subjective bad faith also exists. The Second Circuit has listed the following factors as evidence of subjective bad faith:

> (1) the debtor has only one asset;
> (2) the debtor has few unsecured creditors whose claims are small in relation to those of the secured creditors;
> (3) the debtor's one asset is the subject of a foreclosure action as a result of arrearages or default on the debt;
> (4) the debtor's financial condition is, in essence, a two party dispute between the debtor and secured creditors which can be resolved in the pending state foreclosure action;
> (5) the timing of the debtor's filing evidences an intent to delay or frustrate the legitimate efforts of the debtor's secured creditors to enforce their rights;
> (6) the debtor has little or no cash flow;
> (7) the debtor can't meet current expenses including the payment of personal property and real estate taxes; and
> (8) the debtor has no employees.

C-TC 9th Ave. P'Ship v. Norton Co. (In re C-TC 9th Ave. P'ship), 113 F.3d 1304, 1311 (2d Cir.

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[5] Adirondack's July operating report shows net cash flow of $9,310. (Bankr. Dkt. 16 at 2). In no month did Adirondack's *operating* cash flow exceed $6,935 or 55% of due, but not paid, secured debt payments for that month. (*Id.*).

1997) (quoting *Pleasant Pointe Apts., Ltd. v. Kentucky Hous. Corp.*, 139 B.R. 828, 832 (W.D. Ky.1992)).

Adirondack has no employees. Although Adirondack holds more than one asset, the situation is similar to that in *Squires Motel*, where the debtor held a small number of properties all subject to one secured creditor. *See Squires Motel, LLC*, 426 B.R. at 31. The principal assets held by Adirondack are properties transferred to it by its sole shareholder and president shortly before it filed for bankruptcy, a mere 91 days into the corporation's existence. All of the properties are secured by loans from the same lender.

Adirondack's only other asset is a $950,000 claim against the State of New York evidenced only by a lawsuit filed <u>seven</u> years ago for a mining permit that expired by its own terms <u>six</u> years ago. *Supra* at 4. Neither Adirondack nor any previous holders of that claim have demonstrated any interest in pursuing the claim since a bankruptcy court abstained from hearing the claim when raised by another party in 2004. *Id.* Adirondack has not filed a lawsuit to support the claim and has not provided the bankruptcy court with any evidence it intends to do so. Adirondack's conclusion in its disclosure statement that the asset's value is "speculative" (Bankr. Dkt. 34, Disclosure Statement at 3) is all too accurate.

Tied to this claim is the "nearly a million dollars in unsecured debt" Adirondack points to distinguish it from typical bad faith cases where the debtor has "few if any unsecured debts." (App. Br. At 3) (citing *In re Adbrite Corp.*, 290 B.R. 209, 218 (Bankr. S.D.N.Y. 2003)). Adirondack's "nearly a million dollars in unsecured debt" is the $950,000 promissory note on this dormant claim against the state of New York.

Although Adirondack's principal assets were not *yet* "the subject of a foreclosure action as a result of arrearages or default on the debt," *In re C-TC 9th Ave. P'ship*, 113 F.3d at 1311, Adirondack has admitted the purpose for its formation: to avoid the sale at foreclosure of properties held by its sole shareholder. (Bankr. Dkt. 40 at 5; App. Br. at 3). Thus, "the timing of the debtor's filing evidences an intent to delay or frustrate the legitimate efforts of the debtor's secured creditors to enforce their rights." *In re C-TC 9th Ave. P'ship*, 113 F.3d at 1311. In this case it is not just the timing of the *filing* that was intended "to delay or frustrate the legitimate efforts of the debtor's secured creditors to enforce their rights," *id.*, the bankruptcy court was correct to conclude that the *formation* of Adirondack was part of an effort to frustrate secured creditors of its president and sole shareholder.

Adirondack attempts to minimize the breach by Ms. Thomas of the due on sale contracts by suggesting that "[e]very bankruptcy case involves breach of contractual obligations, whether monetary or non-monetary." (App. Br. at 4). While debtors may breach contractual obligations to make payments to their creditors and the reorganization of debtors often involves the reworking of the contractual obligations of debtors and creditors, the contractual breach here is of a different type. While a breach may not categorically deprive a debtor of the right to bring a bankruptcy case, it also does not *entitle* a debtor to that relief. Here the debtor was formed for the express and admitted purpose of holding assets subsequent to a breach of contract. As the bankruptcy court noted:

> This Court deals with contractual breaches, default and cures every day from individuals who failed to tender their contractually mandated mortgage payments and then propose a cure through a Chapter 13, to a corporation that overexpanded and needs to reject the lease pursuant to Section 365. The difference is that in the above examples, the breach didn't give rise solely to an entree to the bankruptcy process.

(Bankr. Dkt. 89 at 4-5).

B. The United States Trustee's Motion to Dismiss Provides Support for the Bankruptcy Court's Decision to Dismiss the Case.

Although the bankruptcy court's decision to dismiss was based on the breach of the due on sale clauses, it acknowledged the arguments raised by the United States Trustee in its motion to dismiss. (Bankr. Dkt. 89 at 4). These arguments were briefed by both parties and provide strong support for the bankruptcy court's dismissal of the case.

1. Adirondack Filed in Bad Faith and Exhibits New Debtor's Syndrome.

Although the bankruptcy court did not describe Adirondack as such, it is clear the court considered it an example of the subset of bad faith filers who exhibit "new debtor syndrome." The court described the debtor as having a "short, shadowy existence [that] should never have given rise to a Chapter 11 filing." (*Id.* at 5). Such is precisely the case with new debtor syndrome. "[N]ew debtor syndrome involves a transfer of distressed property into a newly created corporation on the eve of foreclosure for no consideration; the debtor has no assets other than the transferred property; the debtor has no or minimal unsecured debt and no employees or ongoing business and no means to service the debt." *In re Diamond Oaks Vineyards, Inc.*, No. 09-12995, 2010 WL 580099, at *1 (Bankr. N.D. Cal. Feb., 2010).[6]

Citing *In re Levinsky*, 23 B.R. 210 (Bankr. E.D.N.Y. 1982), Adirondack argues that

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[6] Most cases involving new debtor syndrome involve newly formed entities holding only a single asset. This Court, however, has found new debtor syndrome where the debtor possessed more than one distressed asset. In *Squires Motel, LLC*, 426 B.R. at 35, this Court recently found new debtor syndrome where the debtor held more than one asset. Other courts have done the same. *See also In re Diamond Oaks Vineyards, Inc.*, 2010 WL 580099, at *1; *In re McCarthy*, 312 B.R. 413, 418 (Bankr. D. Nev. 2004) (in new debtor syndrome case holding that "[w]hile one of the factors generally listed as evidence of a bad faith filing is that the debtor has only one asset, the Court does not view the fact that there are multiple properties involved in this case as helpful to the debtor.").

transfer of property to a newly formed entity to avoid foreclosure is not by itself an indication of bad faith. (App. Br. at 3). Adirondack is correct in that courts should not "*blindly* impute bad faith under such circumstances." *Id.* at 218 (emphasis added). Nonetheless, the same court noted that "last minute changes in form by the debtor are subject to close scrutiny as possibly indicative of bad faith where such transformation serves to shield certain assets." *Id.*

In the present case, the bankruptcy court's close scrutiny revealed a clear factual basis for finding bad faith. Here it is not just the transfer of assets to a newly formed entity that suggests bad faith. It is the transfer of assets in admitted violation of an anti-transfer provision to a newly formed entity controlled by the transferor that establishes bad faith. *Squires Motel, LLC*, 426 B.R. at 35.

Levinsky is also inapposite on its facts. *Levinsky* concerned the transfer of property from individuals to a newly-formed New York general partnership with the individuals as the general partners. *Id.* at 216. The court held that the transfer did not impair the substantive or procedural rights of creditors of the individuals because under New York partnership law, the individuals remained as "as liable as partners for their debts as they were as individuals." *Id.* at 218. Here of course, the transfer was to a New York corporation where a shareholder is not liable for the debt of the corporation. *See generally Townley v. Emerson Elec. Co.*, 178 Misc.2d 740, 742-43, 681 N.Y.S.2d 741 (N.Y. Sup. Ct. 1998).

Moreover, the absence of notice of the transfer also distinguishes this case from *Levinsky*. In that case, the creditor claimed a fraudulent conveyance of property from a corporation to individuals in violation of an anti-transfer provision. *Levinsky*, 23 B.R. at 221.[7] The court held that the creditor "had clear notice" of the transfer, the transfer had been accomplished for the benefit of the creditor, and the creditor had raised no issue for ten years during which mortgage payments were made until the individuals transferred their interest to a general partnership and filed for bankruptcy. *Id.* In the present case, there was not "clear notice" to the lender. There was no notice at all.

2. There Exists Substantial or Continuing Loss to or Diminution of the Estate and the Absence of a Reasonable Likelihood of Rehabilitation Which Forms a Sufficient Alternative Basis for Affirming the Bankruptcy Court Under 11 U.S.C. § 1112(b)(4)(A).

The monthly operating reports submitted by Adirondack justify dismissal on the basis that there exists a "substantial or continuing loss to or diminution of the estate and the absence of a reasonable likelihood of rehabilitation." 11 U.S.C. § 1112(b)(4)(A). The United States Trustee argued this basis for dismissal to the bankruptcy court and believes that it provides support for the bankruptcy court's decision to dismiss Adirondack's case.

Adirondack, however, claims in its brief that "[n]o one made any allegation of gross mismanagement or even a continuing loss to the Estate, § 1112(4)(b)(A) and (B) [*sic*]." (App. Br. at 2). This is incorrect. The United States Trustee has repeatedly advanced continuing loss to the estate as a basis for dismissal. The first argument advanced in the United States Trustee's motion to dismiss was that "sufficient facts under 11 U.S.C. § 1112(b)(4)(A) . . . exist to convert or dismiss this case." (Bankr. Dkt. 27 at 5, ¶¶ 20-22). The United States Trustee again referred

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[7] The property at issue was held by individuals, transferred to a corporation under their control, transferred back to the individuals and held by individuals for ten years until shortly before the bankruptcy case at which time the individuals formed a general partnership and filed for bankruptcy as a general partnership. *Levinsky*, 23 B.R. 213-15.

to this basis for dismissal in its Second Supplement and in two hearings on the motion. (Bankr. Dkt. 67 at 4; Bankr. Dkt. 95 at 8; Bankr. Dkt. 97 at 10).

For the same reasons that objective bad faith exists in the filing of this case, there is also continuing and substantial loss to the estate. Throughout the period covered by the operating reports, Adirondack continued to accrue outstanding secured debt, well outstripping any cash flow or proceeds from the rental of its properties. *Taub v. Taub (In re Taub),*427 B.R. 208, 231 (Bankr. E.D.N.Y. 2010) ("One indication of continuing loss to the bankruptcy estate is negative cash flow after the bankruptcy case is commenced."). Adirondack has made no payments to its secured creditor throughout this case and offered nothing where it was asked in the monthly reports to explain its plan for repaying secured debt. *In re Strawbridge*, No. 09-17208, 2010 WL 779267, at 4 (Bankr. S.D.N.Y. March 5, 2010) ("[The debtor] Strawbridge continues to [flout] her payment obligations to her secured creditors, causing continuing losses to the estate."); *see also In re 3868-70 White Plains Road, Inc.*, 28 B.R. 515, 518 (Bankr. S.D.N.Y. 1983) (finding continuing and substantial loss to the estate where "[t]he debtor has been unable to make any payments to its first mortgagee during the pendency of this case, which is now over six months old.").

The continual and substantial loss to the estate cannot be rebutted by asserting, as Adirondack does, the mining permit claim as an integral part of Adirondack's plan of rehabilitation. (App. Br. at 4). Whatever merits the mining permit claim may have, courts have tended to disregard the potential effect that recovery from a lawsuit would have on the rehabilitation prospects of a debtor. *See In re FRGR Managing Member LLC*, 419 B.R. 576, 584 (Bankr. S.D.N.Y. 2009) (collecting cases); *In re Rey*, No. 04 B 35040, 2006 WL 2457435, at *7

(Bankr. N.D. Ill. Aug. 21, 2006) ("To confirm a plan, a debtor's income projections must be based on concrete evidence and must not be speculative or conjectural. A lawsuit's outcome, though, is always speculative. Without a solid basis for believing litigation is highly likely to generate large sums of money quickly, it cannot provide a sufficiently reliable source of income to support confirmation.") (internal citations omitted); *cf. In re Jensen*, 425 B.R. 105, 110 (Bankr. S.D.N.Y. 2010) (finding debtor's chapter 13 plan infeasible because it was premised in part on a "speculative lawsuit").

There is no reason to believe that losses to the estate have not continued to present and, aside from its aspirations to solvency, there is no reason to believe that these losses will not continue into the future. *Id.* at *19 ("The debtor's 'boundless confidence' that reorganization will be successful is not a sufficient basis on which to conclude that rehabilitation is possible.") (citing *Hansen, Inc. v. Tiana Queen Motel, Inc. (In re Tiana Queen Motel, Inc.)*, 749 F.2d 146, 151 (2d Cir.1984)). The record provides ample support for this Court to conclude that "continual and substantial loss to the estate" persists and that the case should be dismissed on that basis.

*** * ***

CONCLUSION

For these reasons, the United States Trustee respectfully asks this Court to affirm the order of the bankruptcy court to dismiss Adirondack's case.

DATED: June 28, 2010
Albany, New York.

Respectfully submitted,

Diana G. Adams
United States Trustee
For Region 2

/s/ Kevin Purcell
Kevin Purcell, Esq.
Bar I.D. 512555
74 Chapel Street, Suite 200
Albany, NY 12207
(518) 434-4553
(518) 434-4459 (fax)
Kevin.J.Purcell@usdoj.gov

Attorney for the United States Trustee/Appellee

BRIEF BANK — "SUMMARY SHEET" *Printed Fri.-8/8/3 (10:27)*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	In re: Airspect Air, Inc.
2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	The United States Court of Appeals for the Sixth Circuit
3. ("CCN") ***CURRENT*** CASE NO.	No.: 03-3484, 03-3303
4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*	No.: 96-50540 Court: The United States Bankruptcy Appellate Panel of the Sixth Circuit Northern District of Ohio at Akron Trial Judge Marilyn Shea-Stonum
5. ("SO") ***SOURCE***	**U.S. TRUSTEES**
6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	Filed: July 2003 Type: Brief for Federal Appellant
7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g., "UST/OGC"]*	Appellate Staff Civil Division, U.S. Dept. Of Justice
8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") ! ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	Whether a bankruptcy court that authorizes employment of a professional as a special counsel under 11 U.S.C. § 327(e) also presumptively approves that professional's contingent fee agreement as a "term or condition [] of employment" for purposes of 11 U.S.C. § 328(a). √ Background:
10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)	C:\WINNT\Profiles\rschnell\Desktop\tony\airspec1.wpd
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No. 03-3484, 03-3303

IN THE UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

In re: AIRSPECT AIR, INC., DEBTOR

JEFFREY L. NISCHWITZ ET AL.,

Appellees,

v.

SAUL EISEN, U.S. TRUSTEE FOR REGION 9,

Appellant.

ON APPEAL FROM THE UNITED STATES
BANKRUPTCY APPELLATE PANEL OF THE SIXTH CIRCUIT

FINAL BRIEF FOR FEDERAL APPELLANT

PETER D. KEISLER
Assistant Attorney General

GREGORY A. WHITE
United States Attorney

WILLIAM KANTER
(202) 514-4575
R. CRAIG GREEN
(202) 514-2498
Attorneys, Appellate Staff
Civil Division, Room 9104
Department of Justice
601 D Street, N.W.
Washington, D.C. 20530-0001

OF COUNSEL:

JOSEPH A. GUZINSKI
General Counsel
P. MATTHEW SUTKO
Office of the General Counsel, Executive Office for U.S. Trustees
20 Massachusetts Ave., N.W.
Washington, D.C. 20530

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STATEMENT IN SUPPORT OF ORAL ARGUMENT

Counsel for Appellant respectfully requests oral argument to illuminate the party’s positions and to aid the Court in reaching its decision.

STATEMENT OF RELATED CASES

We know of no case currently pending before this Court related to these two cases, which have been consolidated on appeal.

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STATEMENT OF JURISDICTION

This is a bankruptcy case where the United States Trustee appealed from a decision of the Bankruptcy Appellate Panel ("BAP"). The bankruptcy court's jurisdiction in the underlying chapter 11 proceeding was proper under 11 U.S.C. § 157(b)(1). The bankruptcy court authorized Airspect Air, Inc. ("Airspect") to retain Jeffrey Nischwitz and related attorneys ("Nischwitz") as special counsel. The bankruptcy court awarded fees to Nischwitz, who appealed the amount of that award to the BAP. The BAP had jurisdiction over that appeal under 28 U.S.C. §§ 158(b) and (c). On February 6, 2003, the BAP reversed. Airspect's sole interest-holder filed a notice of appeal to this Court on February 27, 2003; that case was docketed as Nischwitz v. Miskovic, No. 03-3303. The United States Trustee filed a timely notice of appeal on April 2, 2003, based on his authority to "be heard on any issue in any case or proceeding under [Title 11]." 11 U.S.C. § 307; In re Pillowtex, Inc., 304 F.3d 246, 250 (3d Cir. 2002); In re Donovan Corp., 215 F.3d 929, 930 (9th Cir. 2000); see also Fed. R. App. P. 4(a)(1).[1] This Court has jurisdiction over this appeal pursuant to 28 U.S.C. § 158(d).

ISSUE PRESENTED

Whether a bankruptcy court that authorizes employment of a professional as special counsel under 11 U.S.C. § 327(e) also presumptively approves that professional's contingent fee agreement as a "term[] or condition[] of employment" for purposes of 11 U.S.C. § 328(a).

STATEMENT OF THE CASE

This case arises from Airspect's voluntary petition for reorganization under chapter 11. 11 U.S.C. § 1101, et seq. The bankruptcy court authorized Airspect, as a debtor-in-possession, to retain Nischwitz as special counsel. Nischwitz applied for fees, but the bankruptcy court awarded only part of the requested amount. Nischwitz appealed to the BAP, which reversed and

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[1] In the alternative, we ask that this brief be considered as an amicus curiae brief in Nischwitz v. Miskovic, 03-3303.

remanded. On remand, the bankruptcy court again awarded only part of Nischwitz's requested fees. Nischwitz appealed, and the BAP again reversed.

STATEMENT OF FACTS

1. Statutory Background

This case concerns three Bankruptcy Code provisions that regulate the employment of special counsel by trustees or debtors-in-possession.[2] Under 11 U.S.C. § 327(e) ("Section 327(e)"), bankruptcy courts may authorize employment of special counsel if such employment is in the estate's best interest, and if the attorney does not represent or hold any interest adverse to the debtor or the estate with respect to the matter on which the professional is employed.[3]

Payment of special counsel is governed by 11 U.S.C. § 328 ("Section 328") and 11 U.S.C. § 330 ("Section 330"). Section 328 allows, but does not require, bankruptcy courts to approve terms and conditions of employment proposed by the trustee or

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[2] 11 U.S.C. § 1107 provides that, in respects pertinent here, "a debtor in possession shall have all of the rights * * * and powers, and shall perform all the functions and duties * * * of a trustee serving in a case under this chapter."

[3] 11 U.S.C. § 327(e) ("The trustee, with the court's approval, may employ, for a specific special purpose * * * an attorney that has represented the debtor, if in the best interest of the estate, and if such attorney does not represent or hold any interest adverse to the debtor or to the estate with respect to the matter on which such attorney is to be employed.").

debtor-in-possession if they are "reasonable."[4] If the bankruptcy court chooses to approve specific employment terms, those terms must be followed, and cannot be changed by the bankruptcy court unless they "prove to have been improvident in light of developments not capable of being anticipated at the time." 11 U.S.C. § 328(a).

If a bankruptcy court does not approve specific employment terms, or if such terms prove improvident, compensation is determined by the bankruptcy court under Section 330, after notice and a hearing.[5] Section 330 allows bankruptcy courts to award reasonable compensation to approved professionals for "actual, necessary services rendered" and "actual, necessary expenses." 11 U.S.C. § 330.

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[4] 11 U.S.C. § 328 ("The trustee, * * * with the court's approval, may employ [special counsel] * * * on any reasonable terms and conditions of employment, including on a retainer, on an hourly basis, or on a contingent fee basis. * * * [T]he court may allow compensation different from the compensation provided under such terms and conditions after the conclusion of such employment, if such terms and conditions prove to have been improvident in light of developments not capable of being anticipated at the time of the fixing of such terms and conditions.").

[5] 11 U.S.C. § 330 ("After notice * * * and a hearing, and subject to [Section 328], * * * the court may award to [special counsel] * * * (1) reasonable compensation for actual, necessary services rendered * * * based on the nature, the extent, and the value of such services, the time spent on such services, and the cost of comparable services other than in a case under this title; and (2) reimbursement for actual, necessary expenses.").

2. Factual Background

Airspect Air, Inc. provided aircraft services at the Akron-Fulton International Airport, and held a lease with the City of Akron prescribing rent and fees for use of the airport. When legal disputes arose concerning the lease, Airspect sued the City of Akron in state court. (R. 161 at 2, J.A. 397) In December 1995, Airspect's counsel withdrew from that litigation, and Airspect retained Nischwitz. In turn, Nischwitz referred Airspect to a bankruptcy attorney, and on March 13, 1996, Airspect filed for chapter 11 reorganization. The state lawsuit concerning the lease was stayed and transferred to federal bankruptcy court as an adversary proceeding in the chapter 11 reorganization. (R. 191 at 3-4, J.A. 418-419)

During the bankruptcy proceedings, Airspect administered its affairs as a "debtor in possession." See 11 U.S.C. § 1107. (R. 19 at 1, J.A. 26) On May 3, 1996, Airspect applied to the bankruptcy court for authorization to employ Nischwitz as special counsel to handle issues concerning the prior state lawsuit. See 11 U.S.C. § 327(e) (governing the appointment of special counsel). Airspect's application requested a $7000 retainer and indicated that "[f]ees, other than expenses, are to be paid on a contingency basis and are subject to approval by this court. The fee agreement states 33% [sic] if settled at least two weeks before trial; 40% if within two weeks of trial or, after commencement of trial; 50% if post-trial or re-trial.” On May 20, 1996, the bankruptcy court issued an order authorizing Nischwitz’s employment, and allowing payment of the $7000 retainer. The order also directed “Nischwitz * * * [to] submit application for fees to this Court for approval.” (R. 24 at 1, J.A. 30) In July 1999, the chapter 11 proceedings concluded when the bankruptcy court granted Airspect’s motion to settle the case and sell the estate’s assets. Airspect surrendered the leased property and received $575,000 from the City. (R. 208 at 3, J.A. 457)

On February 2, 2000, Nischwitz applied to the bankruptcy court for $189,750 in fees (33% of Airspect’s total payment). Objections were filed by Airspect’s sole interest-holder, Spasoje Miskovic. (R. 191 at 7, J.A. 422) On February 28, 2000, the U.S. Trustee filed comments suggesting that the amount of Nischwitz’s fees was “a two party dispute” that should be “resolved by the Court” using standards of “reasonableness.” (R. 144 at 1-2, J.A. 211-212) On March 6, 2000, the U.S. Trustee commented that he had no objection to the amount of Nischwitz’s fee request.[6] (R. 146 at 1, J.A. 392) At that time, there was no dispute that Nischwitz’s fees would be determined pursuant to

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[6] The U.S. Trustee interprets his second comment, which was filed four days after a hearing on Nischwitz’s fees, as reasserting the views expressed in the first comment, namely, that the precise amount of Nischwitz’s fees constitutes a two party dispute to be resolved by the court according to standards of reasonableness.

Section 330’s standard of “reasonableness.” On September 23, 2000, the bankruptcy court held that Nischwitz’s fees were not compensable under the contingent fee agreement, and the court awarded Nischwitz $37,050 for “actual and necessary” services under Section 330. (R. 191 at 8, J.A. 423)

Nischwitz appealed, and on August 10, 2001, the BAP reversed. The BAP held that the bankruptcy court had, in its initial order authorizing Nischwitz’s employment, implicitly “approved the retention agreement * * * between Nischwitz and the Debtor” as a term or condition of employment under Section 328. (R. 191 at 5, J.A. 420) Because the BAP concluded that the contingent fee had been approved as a term of employment under Section 328, the BAP held that the bankruptcy court had erred in awarding fees using Section 330’s reasonableness standard. Accordingly, the BAP determined that Nischwitz must be paid according to his fee agreement unless the agreement was “improvident” as that term is used in Section 328. Because the bankruptcy court had not made any findings of improvidence, the BAP reversed and remanded with instructions for the bankruptcy court to apply Section 328. (Id. at 10-11, J.A. 436-37)

On March 29, 2002, the bankruptcy court again awarded Nischwitz $37,050. The bankruptcy court first expressed its view that it had never approved Nischwitz’s fee agreement under Section 328. The bankruptcy court explained that fee agreements may be “approved” under Section 328 only if (i) the application to employ counsel under Section 327(e) unambiguously requests approval of fees under Section 328, and (ii) the court unconditionally approves that application. The bankruptcy court found such approval lacking in this case for three reasons. First, Airspect’s application to employ Nischwitz under Section 327(e) did not invoke Section 328. Second, the order authorizing Nischwitz’s employment did not mention the fee arrangement. Third, all briefs concerning Nischwitz’s fee request had, prior to the BAP appeal, relied only on Section 330, not Section 328. (R. 197 at 11-12, J.A. 437-38)

The bankruptcy court nonetheless followed the BAP’s instructions and applied Section 328. The bankruptcy court determined that Nischwitz’s fee agreement was “improvident” under Section 328, and therefore granted reimbursement only of $37,050 in “actual, necessary expenses” under Section 330. (<u>Id.</u> at 13-18, J.A. 438-44)

Nischwitz appealed, and on February 6, 2003, the BAP again reversed. First, the BAP held that Nischwitz’s fee agreement was not “improvident” under Section 328. (R.208 at 8-12, J.A. 462-66)   Second, the BAP found that the bankruptcy court had “clearly” approved Nischwitz’s contingent fee agreement under Section 328 by granting Airspect’s motion to employ special counsel under Section 327(e). (<u>Id.</u> at 13, J.A. 467) The BAP held that because Airspect's motion to employ Nischwitz under Section 327(e) indicated that fees, other than expenses, "are to be paid on a contingency basis," (ibid.) "[i]f the bankruptcy court had wished to approve his employment on some other basis, it had the duty, in all fairness, to propose a different employment," (id. at 18, J.A. 472). The BAP's conclusion regarding Section 328 was not altered by the bankruptcy court's statement that Nischwitz must "submit application for fees to [the] Court for approval." Rather, the BAP held that the bankruptcy court's reserved right to review Nischwitz's fees was not enough to allow determination of fees by the court under Section 330. (Id. at 16-18, J.A. 470-72) The BAP concluded that "[m]erely reciting * * * that obvious statutory requirements are in effect does not warn counsel that he is being employed on a basis other than the one he agreed to. Thus, where counsel clearly proposes a specific employment and the court wishes to change it, the court should clearly restate the different terms of employment." (Id. at 18, J.A. 472)

On February 27, 2003, Miskovic filed a notice of appeal to this Court from the BAP's decision. On April 2, 2003, the United States Trustee filed a notice of appeal based on his authority to "be heard on any issue in any case or proceeding under [Title 11]." 11 U.S.C. § 307.[7]

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[7] United States Trustees are officials of the Department of Justice appointed by the Attorney General to supervise the administration of bankruptcy cases and trustees. See 28 U.S.C. §§ 581-589 (specifying the powers of United States Trustees); In

SUMMARY OF ARGUMENT

Departing from principles adopted by the Third, Fifth, and Ninth Circuits, the BAP held that Nischwitz's contingent fee agreement was legally binding under Section 328 even though the bankruptcy court neither mentioned Section 328 nor explicitly "approved" the terms of Nischwitz's fee agreement. Instead, contrary to settled law, the BAP presumed that Nischwitz's fee agreement had been approved under Section 328 because the bankruptcy court authorized Nischwitz's employment under Section 327(e). That reasoning conflates distinct legal inquiries under

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re Revco D.S., Inc., 898 F.2d 498, 499 (6th Cir. 1990) ("The United States trustee, an officer of the Executive Branch, represents * * * [the] public interest."); In re Columbia Gas Sys., Inc., 33 F.3d 294, 296 (3d Cir. 1994) (noting that United States Trustees oversee the bankruptcy process, protect the public interest, and ensure that bankruptcy cases are conducted according to law). United States Trustees have express statutory standing to appear and be heard on any issue at any stage of a bankruptcy case. See 11 U.S.C. § 307; In re Revco D.S., Inc., 898 F.2d at 499 (applying 11 U.S.C. § 307); In re Pillowtex, Inc., 304 F.3d 246, 255 n.7 (3d Cir. 2002) ("It is difficult to conceive of a statute that more clearly signifies Congress's intent to confer standing" to pursue claims against bankruptcy professionals.); In re Donovan Corp., 215 F.3d 929, 930 (9th Cir. 2000) (finding that the U.S. Trustee has standing under § 307 to appeal bankruptcy court's denial of her motion for disgorgement of payments received by debtor's counsel); In re Columbia Gas Sys. Inc., 33 F.3d at 295-299 (noting that the U.S. Trustee has broad standing, including the ability to challenge investment guidelines for a chapter 11 debtor); In re Clark, 927 F.2d 793, 795-96 (4th Cir. 1991) (finding standing to appeal the denial of a motion to dismiss); In re Plaza de Diego Shopping Ctr., Inc., 911 F.2d 820, 824 (1st Cir. 1990) (allowing the U.S. Trustee standing to appeal the appointment of a private trustee).

Section 327(e) and Section 328, and misconstrues bankruptcy courts’ gatekeeping function with respect to professional fees.

Under Section 327(e), bankruptcy courts determine whether professional employment is in the estate’s best interest and whether the professional is free of disqualifying conflicts of interest. If so, the bankruptcy court considers the separate question of how such professionals should be paid. Under Section 328, bankruptcy courts <u>may</u> approve proposed terms of compensation if they are “reasonable.” But if specific terms of employment are <u>not</u> approved by the court, Section 330 allows payment only for “actual, necessary services rendered” and “actual, necessary expenses.”

In this case, the bankruptcy court’s May 1996 order authorized Nischwitz’s employment under Section 327(e). But that order never determined that Nischwitz’s fee agreement was “reasonable” for purposes of Section 328, much less did the order “approve” Nischwitz’s fee agreement as legally binding. On the contrary, the order expressly reserved the bankruptcy court’s right to review Nischwitz’s fees. The Bankruptcy Code does not presume that fee agreements are “reasonable” until found unreasonable, nor that they are “approved” unless disapproved. Thus, the bankruptcy court’s silence with respect to Nischwitz’s contingent fee agreement in no way “approved” such compensation under Section 328. Under the Bankruptcy Code, private employment agreements have no necessary effect on determining fees until and unless the bankruptcy court “approves” terms of employment under Section 328. Primary evidence of bankruptcy court approval must be sought in the express terms of the bankruptcy court’s order, and there is no such evidence in this case.

Bankruptcy courts have independent discretion to authorize professional employment and to prescribe the amount of professionals’ payment, and those judgments may be made simultaneously or separately. The BAP was wrong in compelling the bankruptcy court to “use or lose” its discretion to determine fees under Section 330. As Section 330 indicates, bankruptcy courts have inherent authority by default to award fees for “actual, necessary services rendered” and “actual, necessary expenses.” Contrary to the BAP’s ruling, bankruptcy courts do not need to “disapprove” a contingent fee agreement, much less must they propose “different terms of employment” to preserve their authority under Section 330. Accordingly, in this case, where the bankruptcy court’s retention order did not mention a fee agreement, that agreement was not “approved” and does not bind the bankruptcy court under Section 328.

STANDARD OF REVIEW

Bankruptcy courts' decisions regarding attorney's fees are reviewed for abuse of discretion. In re Kisseberth, 273 F.3d 714, 719 (6th Cir. 2001). Whether authorization of employment under Section 327(e) presumptively constitutes approval of fees under Section 328 is a legal question that is reviewed de novo. See In re Federated Dep't Stores, Inc., 44 F.3d 1310, 1315 (6th Cir. 1995).

ARGUMENT

The bankruptcy court authorized Nischwitz's employment and approved payment of a $7000 retainer, as Airspect had requested. But Airspect did not request, and the bankruptcy court did not grant, approval of Nischwitz's contingent fee agreement. Because the court did not "approve" Nischwitz's contingent fee agreement for purposes of Section 328, the bankruptcy court was authorized under Section 330 to reimburse only Nischwitz's "actual, necessary services rendered" and "actual, necessary expenses."

I. The Bankruptcy Code Requires Determination of Nischwitz's Fees Under Section 330.

The BAP reasoned that the bankruptcy court necessarily approved Nischwitz's contingent fee agreement under Section 328 when it approved his employment for purposes of Section 327(e). (R. 208 at 13, J.A. 467) But that analysis, which has not been adopted by any court of appeals, misconstrues the relevant provisions of the Bankruptcy Code. The Code provides two methods for bankruptcy courts to award professional fees. If the bankruptcy court pre-approves specific, “reasonable” terms and conditions under Section 328, those terms are binding unless they are found to have been “improvident.” In the vast majority of cases, however, bankruptcy courts wait until the professionals’ services are rendered, and then approve reimbursement under Section 330 of “actual, necessary services rendered” and “actual, necessary expenses.” The Bankruptcy Code prescribes compensation under Section 330 as a default rule, and assigns bankruptcy courts the discretion to pre-approve specific terms under Section 328. The BAP’s contrary conclusion that “[t]he provisions of § 328 are not exceptions to those in § 330” conflicts with clear statutory text. Compare R. 208 at 17, J.A. 471 with 11 U.S.C. § 330 (authorizing courts to reimburse actual expenses “subject to section[] * * * 328”).

The BAP also failed to acknowledge the difference between general authorization of employment under Section 327(e) and approval of specific employment terms under Section 328. Section 327(e) provides that a professional’s employment must be in the estate’s best interest, and that the professional must not suffer from a disqualifying conflict of interest. Section 328 imposes additional requirements that the specific terms of employment be “reasonable” and that the bankruptcy court exercise its discretion to “approve” those terms.

Airspect’s motion to employ Nischwitz illustrates those different standards. Consistent with Section 327(e), Airspect’s motion to employ Nischwitz contained specific allegations that “[i]t would be in this best interest of the estate to employ Nischwitz” and that Nischwitz had “no connection as relates to the debtor, any of the creditors or any party in interest.” (R. 19 at 1-2, J.A. 26-27) The motion did <u>not</u>, however, contain any allegation under Section 328 that the terms of Nischwitz’s fee agreement were “reasonable.” That omission explains why the bankruptcy court declined to consider whether Nischwitz’s fee agreement was “reasonable” for purposes of Section 328, and declined to “approve” that agreement as legally binding. The issue of reasonableness, which is critical under Section 328, did not arise before the bankruptcy court because both Airspect and the court were focused solely on standards for general authorization of employment under Section 327(e).

The BAP’s statement is unsupported that, in approving Nischwitz’s general employment under Section 327(e), the bankruptcy court “clearly” approved his contingent fee agreement. (R. 208 at 13, J.A. 467) The BAP overlooked the fact that the bankruptcy court’s May 1996 order authorizing Nischwitz’s employment did not mention the fee agreement. The BAP also discarded the bankruptcy court’s explanation on remand that it had <u>not</u> intended to approve the fee agreement under Section 328 when it authorized Nischwitz’s employment. (R. 208 at 11-12, J.A. 465-66)

Instead, the BAP focused on two sentences in the bankruptcy court’s March 2000 decision to award fees under Section 330. First, the BAP relied on the bankruptcy court’s factual observation that “Applicant was retained as special counsel on a <u>contingency basis</u>.” (R. 208 at 13, J.A. 467) Nothing in that statement supports the BAP’s conclusion that the bankruptcy court approved Nischwitz’s fee agreement. On the contrary, the bankruptcy court’s opinion makes clear that its May 1996 order did not intend to approve that agreement. (R. 208 at 11-12, J.A. 465-66) The bankruptcy court’s view of the May 1996 order also finds support in the order’s text, which did not even mention Nischwitz’s fee agreement.

Second, the BAP noted that, in awarding fees <u>under Section 330</u>, the bankruptcy court’s first step was to “assess[] the award of professional fees * * * by reference to [the contingent fee] agreement.” (R. 208 at 13, J.A. 467) Regardless of whether a fee agreement that lacks bankruptcy court approval is a proper basis for determining fees under Section 330, the bankruptcy court’s statement in no way suggests that the fee agreement was judicially approved under Section 328. Indeed, the very decision to apply Section 330 implicitly contradicts such approval.

In any event, the BAP was wrong to focus on two isolated statements from the bankruptcy court’s March 2000 opinion. The critical evidence of what the bankruptcy court allegedly “approved” in its May 1996 order must be the order’s explicit language. The bankruptcy court’s May 1996 order does not support the BAP’s ruling because it does not mention, must less approve, Nischwitz’s fee agreement.

Without legal support, the BAP assumed that a bankruptcy court’s decision to authorize professional employment under Section 327(e) presumptively and implicitly approves any fee agreement that is in place for purposes of Section 328. Thus, the BAP felt justified in asking “[w]hat arrangement did the court approve,” and in replying that Nischwitz’s employment was offered “only on a contingent fee basis.” (R. 208 at 17-18, J.A. 471-72) The BAP similarly declared that the bankruptcy court had a duty to warn Nischwitz if it wished to “change” the terms of employment or “to propose a different employment.” (Id. at 18, J.A. 472)

That analysis is incorrect. The bankruptcy court had no duty to “warn” Nischwitz of any “change[d]” terms of employment because the bankruptcy court had never “approved” such terms in the first place. Indeed, Airspect’s application to employ Nischwitz never requested approval for the contingency fee arrangement, and that application expressly noted that the court would retain authority to review fee requests. Under Section 328, professionals may rely on specific terms and conditions of employment only if a bankruptcy court approves them. Professionals are not entitled to rely on fee agreements simply because such agreements are mentioned by the applicant in a motion before the bankruptcy court — and that is all Nischwitz did here.

Applicants have long borne the burden of showing that their requested fee award is warranted. See, e.g., Zolfo, Cooper & Co. v. Sunbeam-Oster Co., 50 F.3d 253, 261 (3d Cir. 1995). In contrast, bankruptcy courts have never been required to demonstrate that a proposed fee agreement was not approved, in order to preserve their statutory authority to set fees under Section 330. The BAP's contrary ruling in this case finds no support in the Bankruptcy Code, and its upside-down burden of proof would constrain bankruptcy courts' gatekeeping role with respect to professional fees.

II. Decisions From Other Circuits Require Determination Of Nischwitz's Fees Under Section 330.

The BAP characterized its judgment as stemming from the Fifth Circuit's decision In re National Gypsum Co., 123 F.3d 861 (5th Cir. 1997). But in fact the BAP's decision conflicts with rulings from the Third, Fifth, and Ninth Circuits, each of which has applied Section 328 only where a bankruptcy court has specifically approved a term or condition of employment. See

Zolfo, Cooper & Co. v. Sunbeam-Oster Co., 50 F.3d 253, 261-62 (3d Cir. 1995); In re National Gypsum Co., 123 F.3d at 862; In re Circle K Corp., 279 F.3d 669, 671 (9th Cir.), cert. denied, 536 U.S. 959 (2002).

Contrary to the BAP's characterization, In re National Gypsum does not support the result in this case. The language of the bankruptcy court's order in In re National Gypsum explicitly authorized professional employment "'upon the terms and conditions of [a] certain engagement letter dated April 16, 1991.'" Id. at 862 (quoting bankruptcy court order) (emphasis added). The bankruptcy court in this case, by contrast, never approved any term of employment except the $7000 retainer. The controversy in In re National Gypsum — which is not at issue here — was whether the bankruptcy court's express approval of terms was contradicted by the bankruptcy court's statement that it "retain[ed] the right to consider and approve the reasonableness and amount of * * * fees on both an interim and final basis." Ibid.

The Fifth Circuit in In re National Gypsum resolved the internal conflict in the bankruptcy court's decision, which approved a term of employment yet asserted discretion to alter that term, by narrowly construing the court's "retain[ed] * * * right to consider and approve" fees. The Fifth Circuit interpreted the bankruptcy court as merely "recit[ing] its control of the compensation in the event of subsequent and unanticipated circumstances affecting the reasonableness of that agreed fee," id. at 863, i.e., as reserving only questions of "improvidence" under Section 328. Even if that were a fair construction of the order in In re National Gypsum, the Fifth Circuit's analysis does not support the BAP's result in this case, because the bankruptcy court here did not expressly approve Nischwitz's contingency arrangement in its order authorizing his employment under Section 327(e).

Moreover, the Ninth Circuit has cogently criticized that aspect of In re National Gypsum. The Ninth Circuit noted that bankruptcy courts do not need expressly to "retain" their authority to review professional fees for "improvidence" under Section 328. See In re B.U.M. Int'l, Inc., 229 F.3d 824, 829 (9th Cir. 2000). Thus, the Fifth Circuit's approach makes superfluous the bankruptcy court's effort to "retain" supervisory review over professional fees. Moreover, the bankruptcy court's language in In re National Gypsum invoked authority to review fees' "reasonableness," which appears significantly broader than mere "improvidence" analysis under Section 328.

Regardless of how this Court would decide a case like In re National Gypsum, the Fifth Circuit's analysis does not support the BAP's decision in this case. Here, the bankruptcy court's order contains no internal conflict because that order does not include any language approving Nischwitz’s fee agreement. On the contrary, the bankruptcy court expressly directed that Nischwitz “submit application to [the] Court for approval” of fees, and the court never indicated approval of the parties’ private agreement regarding fees. Consistent with the face of the May 1996 order, the bankruptcy court’s requirement that Nischwitz submit fee requests for further judicial approval only illustrates that the bankruptcy court did not “approve” Nischwitz’s contingent fee agreement under Section 328 when it authorized his employment under Section 327(e). Even the Fifth Circuit in In re National Gypsum readily acknowledged that terms of employment must be judicially approved in order to be legally binding. 123 F.3d at 862. No such approval occurred in this case; thus, the bankruptcy court’s order cannot reasonably be read as granting Nischwitz a legal right to his contingent fee.

The BAP’s analysis also conflicts with cases from the Ninth and Third Circuits analyzing judicial “approval” under Section 328. The Ninth Circuit in In re B.U.M. International, Inc. refused to restrict a bankruptcy court’s authority to award fees under Section 330, even though the bankruptcy court had explicitly approved employment “under the terms and conditions set forth in the application.” 229 F.3d at 826. The court of appeals reached that result because the bankruptcy court’s order also stated that “‘all fees and costs * * * are subject to Court approval,'" and the bankruptcy court clarified its intent to review the reasonableness of professional fees after the services were rendered. Ibid. Given such conflicting evidence of "approval" and a reserved right to disapprove, the Ninth Circuit concluded that the bankruptcy court had "conditionally" approved the professional's terms of employment, and that the court was not legally bound because it had "not convey[ed] its complete approval under § 328." Id. at 829.

Although the Ninth Circuit's analysis demonstrates an appropriately narrow interpretation of the term "approve," that approach also can be taken too far. For example, the Ninth Circuit's analysis of Section 328 in In re Circle K Corp., 279 F.3d at 673-74, unduly focused on the applicant's retention application, apparently requiring applicants to cite Section 328 specifically. That pleading requirement seems unnecessary under the Code. Because Section 328 turns explicitly on whether the bankruptcy court has "approved" terms and conditions, the primary factor is the court's opinion, not the litigant's application.[8]

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[8] Indeed, the result in Circle K is supportable without reference to the litigant's application. The bankruptcy court's order stated that the professional should be paid "the amount of $100,000 per month and reimburse[d] expenses as set forth in the Application and Retainer Agreement subject to review by the court in a final fee application to be submitted * * * on notice pursuant to relevant provisions of the Bankruptcy Code." Id. at 672 (emphasis added). Under In re B.U.M., 229 F.3d at 829, that reservation of judicial review is enough to render the bankruptcy court's order a "conditional approval," which does not bind the bankruptcy court's authority to calculate fees under Section 330.

Thus, although the better practice would be for applicants to cite Section 328 explicitly or to otherwise make their intentions clear, the United States Trustee does not view the Bankruptcy Code as requiring any specific form of pleading for that purpose.

The Third Circuit's opinion in Zolfo, Cooper & Co v. Sunbeam-Oster Co., 50 F.3d at 253, rests on similarly solid principles, but its analysis also may go too far in contexts unrelated to this case. The Zolfo court stated that if a bankruptcy court's order does not "expressly and unambiguously state specific terms and conditions * * * that are being approved pursuant to the first sentence of sentence 328(a), then the terms and conditions are merely those that apply in the absence of specific agreement." Id. at 261 (internal quotation marks omitted). Articulating important bankruptcy principles, the Third Circuit explained its rule as:

> a useful and appropriate presumption that prevents courts from being bound to specific terms unintentionally. There is no reason why the burden should be on the court to specify in its order authorizing retention of the professional that it rejects specific terms and conditions. Instead, the burden should rest on the applicant to ensure that the court notes explicitly the terms and conditions if the applicant expects them to be established at that early point. Further, the bankruptcy court's duty to conduct an independent examination of fee applications for services rendered would be unduly restricted if employment authorization orders were routinely construed as binding the court to particular terms of employment.

Id. at 262 (citation omitted); accord In re Engel, 124 F.3d 567, 576-77 (3d Cir. 1997).

The analysis underlying Zolfo is unquestionably correct. But the Third Circuit was perhaps too strict in refusing to allow bankruptcy courts to "approve" employment terms by reference and incorporation within a judicial order. Specifically, although the bankruptcy court in Zolfo had authorized professional employment "as set forth in the foregoing Motion and Affidavit," the Third Circuit interpreted Section 328 as requiring the court explicitly to reiterate the pertinent employment terms in its order, rather than incorporate them by reference. Zolfo, 50 F.3d at 262. Where the bankruptcy court's order explicitly refers to employment terms and endorses them unambiguously, it might seem overly formalistic to hold that such terms are not "approved" unless directly set forth in full.

Accordingly, and consistent with principles adopted in three other circuits, the United States Trustee views the Bankruptcy Code as prescribing a "middle ground" that flatly contradicts the BAP's judgment in this case. The BAP erred in finding that the bankruptcy court had "approved" Nischwitz's fee agreement for purposes of Section 328, even though the court's order never mentioned that agreement — much less approved it. The BAP also erred in placing an unwarranted burden on the bankruptcy court to "disapprove" of any terms of employment it deemed unsuitable, or forfeit its authority to regulate fees under Section 330. On the other hand, proper recognition of bankruptcy courts' gatekeeping function does not require any particular form of "approval" or "magic words" by the bankruptcy court or by applicants seeking approval of employment terms. Rather, Section 328 seems satisfied if and only if the bankruptcy court's order is reasonably read, using standard methods of interpretation, as having "approved" specific terms and conditions of professional employment. Approval of specific compensation under Section 328 may occur within an order that also authorizes employment under Section 327(e), but the BAP legally erred in holding that those different types of judicial approval are interchangeable.

Rejecting the BAP's interpretation of "approve" would also yield practical benefits for the general administration of bankruptcy proceedings. Judges who preside over large bankruptcy cases typically receive many professional employment applications during the litigation's early stages. In the exceptional case, where specific terms of employment are necessary to obtain adequate professional services, an applicant may of course seek approval of those terms at the time employment begins. In many other contexts, however, bankruptcy courts approve professional applications under Section 327(e), but the professionals' fees are restricted to what the court deems reasonable after a hearing under Section 330.

By binding bankruptcy courts to fee agreements that they never intended to approve, the BAP’s rule would force courts and litigants to scour the record before approving any professional’s employment, for fear that a cursory description of some professional’s fee arrangement might inadvertently constrain the court under Section 328. That approach would needlessly increase the administrative costs of authorizing professional employment under Section 327(e), and would incite novel litigation over how much of a fee arrangement must be disclosed for preclusive effect to attach under Section 328.

The BAP’s approach would also risk substantial costs for the estate by forcing bankruptcy courts to “implicitly approve” payment of potentially excessive professional fees. Because debtors are often insolvent, funds that go to their professionals typically reduce creditors’ ability to recover. Indeed, some debtors’ liabilities so exceed their assets that their chapter 11 cases are administratively insolvent, which means that only professional and similar claims receive payment. <u>See</u> 11 U.S.C. § 507 (establishing priority of payments). Even though Airspect in this case ultimately had a surplus so that all creditors were paid regardless of Nischwitz’s fees, more general concerns to preserve estate assets explain why debtors may not hire or compensate counsel without judicial approval, and why bankruptcy courts play such a critical role in supervising professional fees. Bankruptcy courts are responsible for approving counsel under Section 327(e) and for either approving specific compensation under Section 328 at the time employment begins, or determining fees at the end of the case under Section 330. By limiting the bankruptcy court’s discretion and improperly reducing judicial authority to calculate fees under Section 330, the BAP’s rule distorts current bankruptcy practice and risks the diversion of estate funds to pay fees that no bankruptcy court ever explicitly approved.

The United States Trustee submits that the most sensible rule is that prescribed by the Bankruptcy Code itself. Where the bankruptcy court’s order affirmatively “approves” specific terms and conditions of professional employment as “reasonable,” Section 328 applies. Under those circumstances, the bankruptcy court has discharged its proper gatekeeping responsibility, and the professional must be compensated according to those terms unless they prove to be “improvident.” Where the bankruptcy court’s order authorizes employment for purposes of Section 327(e), but does not expressly approve terms for compensating that employment, fee determinations are governed by Section 330’s default rule. Under those more typical circumstances, payment issues are deferred until an evidentiary hearing after professional services are complete, and the professional is compensated only for “actual, necessary services” and expenses.

There is no reason that bankruptcy professionals should receive a special presumption in favor of their fee agreements, and the Bankruptcy Code does not create one. The BAP’s contrary holding is mistaken.

CONCLUSION

For the foregoing reasons, this Court should reverse the BAP’s judgment and should remand for determination of whether the amount of the bankruptcy court’s award under Section 330 was proper.

Respectfully submitted,

PETER D. KEISLER
Assistant Attorney General

GREGORY A. WHITE
United States Attorney

WILLIAM KANTER
(202) 514-4575
R. CRAIG GREEN
(202) 514-2498
Attorneys, Appellate Staff
Civil Division, Room 9104
Department of Justice
601 D Street, N.W.
Washington, D.C. 20530-0001

OF COUNSEL:

JOSEPH A. GUZINSKI
General Counsel
P. MATTHEW SUTKO
Office of the General Counsel, Executive Office for U.S. Trustees
20 Massachusetts Ave., N.W.
Washington, D.C. 20530

JULY 2003

CERTIFICATE OF COMPLIANCE

I certify that this brief is printed in monospaced typeface that does not contain more than 10.5 characters per inch and that, based on WordPerfect 9.0, the brief contains 6170 words.

____

Craig Green, Attorney

CERTIFICATE OF SERVICE

I certify that on July 25, 2003, I served the foregoing Proof Brief For Federal Appellant by causing two copies of this brief to be mailed to this Court and two copies to each of the following counsel by Federal Express:

Timothy L. McGarry
Chriszt, McGarry Company
1265 W. Sixth Street
Fourth Floor Cort Shoe Building
Cleveland, OH
44113-1326

Daniel J. McGown, Sr.
300 Sharon Woods Road
Wadsworth, OH
44281-9736

____
Craig Green, Attorney

APPELLANT’S DESIGNATION OF APPENDIX CONTENTS

Appellant hereby designates the following items to be included in the joint appendix.

Description	Date Filed
Voluntary Petition (Bankr Dkt 1)	3/13/1996
Application/Motion To Employ Jeffrey L. Nischwitz et al. As Special Counsel (Bankr Dkt 19)	5/3/1996
Affidavit and Verified Statement (Bankr Dkt 20)	5/3/1996
Affidavit and Verified Statement (Bankr Dkt 21)	5/3/1996
Order Granting Application To Employ Jeffrey L. Nischwitz et al. (Bankr Dkt 24)	5/20/1996
Final Stipulated Order (Bankr Dkt 132)	7/22/1999
Application By Jeffrey L. Nischwitz et al. For Compensation (Bankr Dkt 140)	2/3/2000
Comments by U.S. Trustee (Bankr Dkt 144)	2/28/2000
Objection of Miskovic (Bankr Dkt 145)	2/29/2000
Hearing Re: Application for Compensation	3/1/2000
Hearing Re: Application for Compensation	3/2/2000
Further Comments by U.S. Trustee (Bankr Dkt 146)	3/6/2000
Order And Entry Of Judgment Granting Application For Compensation (Bankr Dkt 160-161)	9/28/2000
Final Order by the BAP (Bankr Dkt 191)	8/10/2001
Order After Remand Re: “Application of Special Counsel for * * * Payment of Attorney’s Fees” (Bankr Dkt 198)	3/29/2001
Final Judgment Order & Opinion by the BAP (Bankr Dkt 207-208)	2/6/2003

BRIEF BANK — "SUMMARY SHEET" *Printed Wed-9/8/10 13:40*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*: Dora L. Aja v. John P. Fitzgerald, Acting United States Trustee, Region One

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*: B. A. P. 1st. Cir.

3. ("CCN") ***CURRENT*** CASE NO.: No.: 10-010

4. ("PCN") ***PRIOR*** CASE NO. - & COURT *[IF ANY]*: No.: 09-21872-JNF

Court: Bankr. Mass.

(Identify judge & cite, if any)

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6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*: Filed: September 7, 2010

Type: Brief of the United States Trustee

7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*: Eric Bradford, P. Matthew, Anne Stukes

(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***: **BANKRUPTCY**

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***:

- Did the bankruptcy court abuse its discretion when it denied the debtor's third motion for reconsideration of the order converting her case from chapter 11 to chapter 7 under 11 U.S.C. § 1112(b)?

10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)

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UNITED STATES BANKRUPTCY APPELLATE PANEL
For The
FIRST CIRCUIT

DORA L. AJA, Debtor	BAP NO. MB 10-010
DORA L. AJA, Appellant v. JOHN P. FITZGERALD, ACTING UNITED STATES TRUSTEE, REGION ONE, Appellee	Case No. 09-21872-JNF

BRIEF OF THE UNITED STATES TRUSTEE

JOHN P. FITZGERALD, III
ACTING UNITED STATES TRUSTEE, REGION ONE

Eric K. Bradford
United States Department of Justice
John W. McCormack Post Office & Courthouse
5 Post Office Square, 10th Floor, Suite 1000
Boston, MA 02109-3934
PHONE: (617) 788-0415
FAX: (617) 565-6368
Eric.K.Bradford@USDOJ.gov

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STATEMENT REGARDING ORAL ARGUMENT

The appellee, John P. Fitzgerald, III, the Acting United States Trustee for Region 1, believes that the Court can decide this appeal on the briefs. Fed. R. Bankr. P. 8012; 1st Cir. BAP L.R. 8012-1.

STATEMENT OF JURISDICTION

The United States Bankruptcy Court for the District of Massachusetts had jurisdiction over Ms. Dora L. Aja's bankruptcy case under 28 U.S.C. 157(b). *Appendix* ("*App*.") at 1 - 30.[1] This Court has jurisdiction over Ms. Aja's appeal from the bankruptcy court's March 19, 2010 order denying her third request to reconsider its order converting her chapter 11 case to chapter 7 under 28 U.S.C. 158(a) and (c). *Id.* at 541.

STANDARD OF REVIEW

Denial of a request for reconsideration is reviewed for abuse of discretion. *Aybar v. Crispin-Reyes*, 118 F.3d 10, 15 (1st Cir. 1997).

STATEMENT OF THE ISSUE PRESENTED FOR REVIEW

The bankruptcy court granted the United States Trustee's motion to convert Ms. Aja's chapter 11 case to chapter 7, because she failed to insure her assets, to open a debtor-in-possession bank account and to appear at her initial debtor interview. 11 U.S.C. 1112(b). She failed to file a timely appeal from the conversion order. She sought reconsideration three times. The third attempt is at issue here. In order to prevail on reconsideration, a movant must demonstrate newly discovered, material evidence or manifest error of law or fact.

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[1] Ms. Aja's appendix omits relevant parts of the record below. The United States Trustee has included these documents in his Appendix and has separately moved to supplement the record on appeal. 1st Cir. BAP L.R. 8009-2.

The bankruptcy court re-opened the record and conducted a plenary hearing on the third request for reconsideration. Ms. Aja admitted on the record that she had converted estate property (rents) that she was required to surrender to the chapter 7 trustee. She also admitted that she had skipped her chapter 7 section 341 meeting. She presented no newly discovered, material evidence and identified no manifest error of law or fact.

Did the bankruptcy court abuse its discretion in denying Ms. Aja's third request for reconsideration?

STATEMENT OF THE CASE AND STATEMENT OF THE FACTS

A. Nature of the Case.

This Court has twice ruled that Ms. Aja did not timely appeal the conversion order and that the sole issue presented here is whether the bankruptcy court erred when it denied her third request to reconsider. *App*. at 31 - 36.

On March 18, 2010, the bankruptcy court re-opened the record and conducted a plenary hearing on Ms. Aja's third request for reconsideration. *Id.* at 37 - 66; 532 - 540. As with her first two requests, she presented no newly discovered, material evidence, and she identified no manifest error of law or fact. *Compare Id.* at 490 - 493, *and* 500 - 503, *with* 532 - 540. She admitted that she had converted estate property (rents) that she was required to surrender to the chapter 7 trustee. *Id.* at 62 - 64. She admitted that she skipped her chapter 7 section 341 meeting. *Id.* The bankruptcy court denied reconsideration. *Id.* at 18 - 19; 63 - 64; 541. This appeal followed. *Id.* at 13; 31 - 36.

B. Statutory Framework.

Individuals file bankruptcy to stop collection actions and to relieve themselves of personal liability for their debts. Like Ms. Aja, the vast majority of people who file for bankruptcy do so voluntarily. 11 U.S.C. 301 *et seq.*

Individuals may choose to file bankruptcy under chapters 7, 11 or 13 of title 11. Regardless of the chapter, the Bankruptcy Code and Rules impose duties upon them.

Prior to filing, individual debtors must obtain credit counseling from a credit counseling agency approved by the United States Trustee, unless they certify "exigent circumstances." 11 U.S.C. 109(h).[2] They must also file schedules of assets and liabilities and statements of financial affairs under penalty of perjury, appear and testify under oath at an initial meeting of creditors and cooperate with any appointed trustee. 11 U.S.C. §§ 341 and 521; Fed. R. Bankr. P. 4002; MLBR 4002-1.

Under chapter 11, debtors may obtain a discharge only by confirming a plan to repay creditors' claims. 11 U.S.C. 1129 and 1141. They have a 120 day "exclusive" period within which to propose plans. 11 U.S.C. 1121. Creditors have the right to vote for or against plans. 11 U.S.C. 1126. Bankruptcy courts may confirm plans notwithstanding creditors' objections.

Chapter 11 debtors, including individuals, remain in possession of all of their property, and they may continue to operate their businesses in the ordinary course. Chapter 11 imposes numerous, additional responsibilities upon debtors that are not required by chapters 7 and 13.[3]

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[2] The United States Trustee has attached relevant statutes and rules to this brief as an addendum.

[3] For example, chapter 11 debtors must account for all property received, examine proofs of claim, furnish information to parties in interest, file reports with the United States Trustee and

Chapter 11 debtors may use cash collateral, which is defined as rents or proceeds of secured creditors' pre-petition collateral, only if they file a written request and receive, after notice and a hearing, court permission to do so. 11 U.S.C. 363 and 364; Fed. R. Bankr. P. 4001. Otherwise, they must escrow cash collateral for the benefit of creditors asserting interests in it.

United States Trustees are officials of the Department of Justice appointed by the Attorney General to supervise the administration of bankruptcy cases and trustees. *See* 28 U.S.C. 581-589 (specifying the powers and duties of United States Trustees).[4] Congress has expressly authorized United States Trustees to supervise chapter 11 cases and to ensure that the chapter 11 process works efficiently and transparently. 28 U.S.C. 586(a)(3).

United States Trustees have issued comprehensive, written operating guidelines that all chapter 11 debtors, including individuals, follow. *Id.* The guidelines require chapter 11 debtors to file monthly reports of their income and expenses, to provide evidence that they have insured all of their assets and operations and to use only debtor-in-possession bank accounts for all post-petition

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taxing authorities, prepare and file a final account and file a plan of reorganization or report on why a plan cannot be filed. They act as fiduciaries for the bankruptcy estate. 11 U.S.C. 704, 1106, 1107 and 1108.

[4] *See also In re Columbia Gas Sys., Inc.*, 33 F.3d 294, 296 (3d Cir. 1994) (United States Trustees oversee the bankruptcy process, protect the public interest, and ensure that bankruptcy cases are conducted according to law) (*citing* H.R. Rep. No. 95-595, 109 (1977)); *United States Trustee v. Revco D.S., Inc. (In re Revco D.S., Inc.)*, 898 F.2d 498, 499 (6th Cir. 1990) ("[t]he United States trustee, an officer of the Executive Branch, represents . . . [the] public interest . . . ."); *In re Castillo*, 297 F.3d 940, 950 (9th Cir. 2002) ("The United States Trustee is the 'watchdog' of the bankruptcy system . . . charged with preventing fraud and abuse and with 'fill[ing] the vacuum' caused by possible creditor inactivity . . . .").

banking transactions.[5] 11 U.S.C. 345. Chapter 11 debtors sign monthly operating reports under penalty of perjury.

Chapter 11 debtors receive the guidelines soon after they file for bankruptcy. *See* 3 *United States Trustee Manual*, ch. 11, Case Administration, § 3-3.1 - 3-3.3.6. United States Trustees review the guidelines with chapter 11 debtors at initial debtor interviews, which are conducted before section 341 meetings. 28 U.S.C. 586(a)(3). United States Trustees conduct chapter 11 section 341 meetings no earlier than 21 days and no later than 40 days after the order for relief. 11 U.S.C. 341; Fed. R. Bankr. P. 2003.

United States Trustees request conversion or dismissal of chapter 11 cases under 11 U.S.C. 1112(b) for cause, including when debtors do not comply with the guidelines and/or violate the Bankruptcy Code, such as by failing to provide evidence of insurance, to open a debtor-in-possession account or to attend the initial debtor interview. 28 U.S.C. 586(a)(8). Bankruptcy courts consider motions under these sections "after notice and a hearing . . . ." 11 U.S.C. 102, 307, 1104 and 1112. Fed. R. Bankr. P. 2002(a)(4).

The Bankruptcy Code defines "after notice and a hearing" as "after such notice as is appropriate in the particular circumstances, and such opportunity for a hearing as is appropriate in the particular circumstances . . . ." 11 U.S.C. 102(1). Bankruptcy courts may exercise discretion to reduce notice periods "for cause shown . . . with or without motion or notice . . . ." Fed. R. Bankr.

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[5] Unless the bankruptcy court orders otherwise for "cause," chapter 11 debtors must open DIP accounts only at banks approved by the United States Trustee. 11 U.S.C. 345(b). *See In re Service Merchandise Co., Inc.*, 240 B.R. 894 (Bankr. M.D. Tenn. 1999) (establishing a totality of the circumstances test to determine "cause"). These banks insure the full value of all DIP account deposits and independently report account balance information to the United States Trustee. Under the guidelines, debtors attach the original copies of their monthly DIP account bank statements to their monthly operating reports.

P. 2002 and 9006(c). Courts may also take *sua sponte* action under 11 U.S.C. 1112(b) in order to prevent an abuse of process. 11 U.S.C. 105(a).

Debtors whose cases have been converted to chapter 7 do not have an absolute right to reconvert to chapter 11. 11 U.S.C. 706. Upon conversion, all persons having estate property, including debtors, must immediately surrender and account for it to the chapter 7 trustee. 11 U.S.C. 542(a); Fed. R. Bankr. P. 1019(4).

In order to prevail on reconsideration, a movant must demonstrate newly discovered, material evidence or manifest error of law or fact. Fed. R. Bankr. P. 9023 (incorporating Fed. R. Civ. P. 59(e)).

C. Factual Background and Proceedings Below.

1. In 2003 and 2004, Ms. Aja acquired two rental properties through an LLC. She then left the country for two years.

Dora L. Aja acquired two rental properties in Worcester, Massachusetts in 2003 and 2004.[6] *App*. at 68; 85. She paid $375,000 for 92 Hamilton Street. *Id.* at 85. It had six units. *Id.* at 99.

Ms. Aja paid $830,000 for 9-11 William Street. *Id.* at 68. It had 12 units. *Id.* at 99; 149 - 177.

Ms. Aja owned the properties through an entity called 86-92 Hamilton Street Realty, LLC. *Id.* at 67 - 106; 149 - 177. At all times, she owned 100% of the equity interest in the LLC and was its sole managing member. *Id.* at 98 - 99; 132; 343; 380; 406. The LLC had its own taxpayer

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[6] "A party's assertion of fact in a pleading is a judicial admission by which it is normally bound throughout the course of a proceeding . . . ." *Gourdin v. Agin (In re Gourdin)*, 431 B.R. 885, 892 (1st Cir. BAP 2010) (citations omitted).

identification number but no employees. *Id.* at 133; 139. Ms. Aja "disregarded" the LLC as a separate entity and reported its income on her personal tax return. *Id.* at 139.

Soon after acquiring the properties, Ms. Aja left the United States "to better herself" and to study medicine. *Id.* at 149 - 150. She claimed that she did not return for two years. *Id.*

2. Beginning in 2004, Ms. Aja incurred mortgage and car loan debt, and she refinanced the LLC's debts with Emigrant.

Ms. Aja took out a personal loan totaling $362,500 from Shamrock Financial Corporation on December 20, 2004. *Id.* at 178 - 192. She secured the loan by granting Shamrock a lien on a condominium located at 22.5 Sigourney Street, Unit F, Jamaica Plain, Massachusetts. *Id.* At 184 - 189.

On July 13, 2005, Ms. Aja purchased a silver Cadillac STS for $35,103.40 *Id.* at 193 - 199. She financed the $20,941.85 purchase through Brookline Bank. *Id.* Ms. Aja listed a Portland, Maine address in the retail installment sale agreement. *Id.* at 195.

On April 13, 2006, Ms. Aja refinanced the LLC's mortgage debt through Emigrant Funding Corporation. *Id.* at 98 - 99; 200 - 245. She obtained $625,000 in new loans, which she secured by granting Emigrant mortgages on the LLC's Worcester properties. *Id.* As additional collateral, she provided Emigrant an assignment of rents. *Id.*

Ms. Aja took out a personal loan totaling $600,000 from Fremont Investment & Loan on December 13, 2006. *Id.* at 250 - 279. She secured the loan by granting Fremont a mortgage on rental property located at 103 Townsend Street, Roxbury, Massachusetts. *Id.*

The record is unclear whether Ms. Aja used the Shamrock, Emigrant and Fremont loans to cash out equity from the properties.

Ms. Aja had difficulty finding a full-time job. *Id.* at 68 - 70; 85 - 87. She earned only "sporadic" income. *Id.* She experienced problems in repaying the Emigrant loans. *Id.* She negotiated with Emigrant. *Id.* She could not refinance the Emigrant loans. *Id.* Emigrant published a notice that it intended to foreclose on the Worcester properties. *Id.*

3. Ms. Aja filed three voluntary chapter 11 petitions for the LLC to prevent Emigrant from foreclosing on the Worcester properties. All of these cases, which lasted a total of 523 days, were dismissed for failure to comply with court orders.

Over a 27 month period, Ms. Aja filed three successive voluntary chapter 11 petitions for the LLC in order to stop Emigrant's foreclosure. *Id.* at 68 - 70; 85 - 87; 280 - 317. The first case was assigned to Judge Hillman. *Id.* at 280. The next two cases were assigned to Judge Feeney. *Id.* at 283 - 317.

The first case lasted 62 days. *Id.* at 280 - 282. The second lasted 217 days. *Id.* at 283 - 297. The third case lasted 244 days. *Id.* at 298 - 317.

Ms Aja affirmed under penalty of perjury in each case that she was authorized, as the LLC's manager and 100% shareholder, to file each petition. *Id.* at 319; 343; 348; 375; 378 ,380; 385 - 386; 406. Her home address and the LLC's were the same. *Compare Id.* at 318, *and* 348, *and* 383, *with* 435.

Ms. Aja filed schedules and a statement of financial affairs in each case, executing them as the LLC's manager under penalty of perjury. *Id.* at 334; 345; 366; 377; 400; 409 - 410. She acknowledged that the net value of the Worcester properties (current fair value less liens) declined from $469,030.12 in the first case, to $268,078.47 in the second case and to $13,000 in the third case. *Id.* at 321; 349; 398.

Ms. Aja stated that the LLC had made no payments requiring disclosure to creditors, including mortgagees, during the 90 days prior to each filing. *Id.* at 336; 368; 402. The LLC retained, or applied to retain, counsel in each case. *Id.* at 280 - 317.

Ms. Aja admitted that she continually collected rents from the Worcester properties in each case. *Id.* at 332; 381;411 - 424. But she never sought bankruptcy court permission to use the rents as cash collateral in the first case. *Id.* at 280 - 282. She did not do so in the second for more than four months after filing in the second case. *Id.* at 411 - 420. She did so in the third case after five weeks. *Id.* at 421 -424.

Ms. Aja never proffered a disclosure statement and plan of reorganization in any of the LLC's cases.[7] *Id.* at 280 - 317. The bankruptcy court dismissed all three cases for failure to comply with the Bankruptcy Code and/or court orders, including to file monthly operating reports, to pay quarterly fees and to file disclosure statements and plans.[8] *Id.* at 425 - 427.

Ms. Aja agreed to the dismissal of the LLC's third case on July 22, 2009. *Id.* at 427. Emigrant then scheduled a foreclosure sale on the Worcester properties for December 8, 2009. *Id.* at 68 - 70; 85 - 87; 202 - 203.

On December 2, 2009, the LLC filed an emergency motion to vacate the dismissal of the third case. *Id.* at 428 - 432. Ms. Aja argued that the LLC could cure its deficiencies and file a plan and disclosure statement within "30-60 days of an Order Re-Opening the Debtor's case . . . ." *Id.*

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[7] She had requested and received an extension to do so in the third case. *Id.* at 314.

[8] The court dismissed the second case twice. *Id.* at 284.

The bankruptcy court scheduled a hearing on the motion to vacate for 11:45 a.m. on December 7, 2009, one day before Emigrant's scheduled foreclosure sale. *Id.* at 316. Ms. Aja took a personal credit counseling course that morning at 10:35 a.m. *Id.* at 433.

The bankruptcy court denied the motion to vacate. *Id.* at 317; 434.

4. Ms. Aja transferred the Worcester rental properties to herself and filed her own voluntary chapter 11 petition.

On December 8, 2009, Ms. Aja transferred the Worcester properties from the LLC to herself by quitclaim deed in exchange for $1. *Id.* at 248 - 249. She filed the deed with the Worcester Registry of Deeds at 9:06 a.m. *Id.*

Ms. Aja filed her personal, voluntary chapter 11 petition 65 minutes later. *Id.* at 435. She did not include a telephone number in the blank provided on the petition. *Id.* at 436.

The case was assigned to Judge Feeney. *Id.* at 1. Emigrant completed its foreclosure sale at 10:17 a.m., unaware of Ms. Aja's filing. *Id.* at 203.

In her schedules, Ms. Aja stated under penalty of perjury that her principal assets were her home, a rental property located at 103 Townsend Street, Dorchester, MA, the two Worcester rental properties previously owned by the LLC and her Cadillac. *Id.* at 453 - 456. She admitted that her total liabilities exceeded the value of all of her real estate and other assets by $243,320. *Id.* at 452.

In her schedule "I," Ms. Aja said that rents represented most of her monthly income. *Id.* at 466. In her SOFA, she stated that she had made installment payments totaling $1,800 during the 90 days prior to filing, but not to Emigrant. *Id.* at 443.

She did not attend her initial debtor interview with the United States Trustee. *Id.* at 472.

5. Ms. Aja did not appear at the January 21, 2010 hearings on the United States Trustee's motion to convert and her own cash collateral motion.

The United States Trustee filed a motion to convert Ms. Aja's chapter 11 case to chapter 7, arguing that her failure to insure her real properties and the Cadillac, to attend her initial debtor interview and to open a debtor-in-possession account constituted "cause" under 11 U.S.C. 1112(b)(4)(B) ("gross mismanagement"), (C) ("failure to maintain appropriate insurance that poses a risk to the estate or to the public"), (F) ("unexcused failure to satisfy timely any filing or reporting requirement established by [title 11] or any rule applicable to a case under this chapter") and (H) ("failure timely to provide information or attend meetings reasonably requested by the United States trustee . . . ."). *Id.* at 472 - 475.

The Clerk scheduled a hearing on the motion to convert for February 17, 2010 at 10:15 a.m. *Id.* at 3. The United States Trustee mailed a written notice of the hearing to the Debtor and all other parties in interest. *Id.* at 474 - 475.

On January 15, 2010, Ms. Aja filed an expedited motion to use cash collateral. *Id.* at 149 - 177. She included her telephone number on it. *Id.* at 153. The Clerk scheduled a hearing on the Cash Collateral Motion for January 21, 2010 at 10:00 a.m. *Id.* at 4.

On January 19, 2010, citing Ms. Aja's failure to provide evidence of insurance, the bankruptcy court *sua sponte* rescheduled the hearing on the motion to convert for January 21, 2010 at 10:00 a.m., the same date and time as the hearing on her cash collateral motion. *Id.* 11 U.S.C. 102(1); Fed. R. Bankr. P. 2002(a)(4) and 9006(c). The United States Trustee mailed written notice of the re-scheduled hearing to Ms. Aja that day. *App.* at 4; 477 - 478.

The United States Trustee's attorney, Paula R. C. Bachtell, confirmed at the January 21, 2010 hearing that she had called Ms. Aja on January 19, 2010, informed her of the date and time of the consolidated hearings and explained to her how to cure the deficiencies cited in the motion to convert.[9] *Id.* at 482 - 483. Ms. Aja did not appear at the hearing. *Id.* at 481 - 489.

Attorney Bachtell stated that she had met in person with Ms. Aja at the January 12, 2010 section 341 first meeting of creditors.[10] *Id.* at 485 - 486. She related that Ms. Aja had emailed on the evening of January 20, 2010, inquiring whether the United States Trustee had received confirmation of insurance coverage.[11] *Id.* at 484 - 485.

Attorney Bachtell informed the bankruptcy court that, as of that morning, Ms. Aja had provided evidence of insurance on all of her assets, except 103 Townsend Street and her Cadillac. *Id.* at 485. She added that she had "other communication" with Ms. Aja "regarding the opening of a debtor-in-possession account, because the operating report we have shows her still using the account that was being used in the last [LLC] case . . . ." *Id.* at 484.

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[9] "I told her that the motion to convert was being scheduled at the same time as her motion to use cash collateral, which was scheduled for today . . . And that in order to respond to the motion to convert she needed to produce insurance, evidence of a DIP account, and her first operating report . . . ." *Id.* at 483 - 484. The court noted that "our Clerk's office has attempted to contact Ms. Aja by phone as well . . ." and that Ms. Aja "should have received the mailed notices by now . . . ." *Id.* at 483.

[10] Ms. Aja had admitted under oath at the section 341 meeting "that after the Court's hearing and the Court's order denying the motion to reopen Case 3, she did transfer Hamilton Street and Williams Street to herself . . . ." *Id.* at 486.

[11] Attorney Bachtell had promptly replied, informing Ms. Aja that she still needed to provide evidence of insurance for the 103 Townsend Street property and her Cadillac. *Id.* at 484.

After reviewing the record, including a monthly operating report signed by Ms. Aja,[12] the court denied Ms. Aja's cash collateral motion and granted the motion to convert. It stated:

> Well, the debtor is not here to pursue her motion filed on an expedited basis for use of cash collateral, and as of right now she's using cash collateral without authority. The U.S. Trustee has not received evidence of insurance on all of the properties; albeit the debtor has produced evidence of some insurance, she is required to submit proof of insurance for all properties; and based upon the operating report, which is mathematically deficient, it appears that there is no likelihood of rehabilitation, and I find that there is cause to convert the case under Section 1112. The case is converted . . . .

Id. at 488; 479 - 480

6. In her first written request for reconsideration, Ms. Aja presented no new, material evidence and identified no manifest error of law or fact. The bankruptcy court denied it.

Ms. Aja filed her first request for reconsideration on January 22, 2010. *Id.* at 490 - 493. But she offered no new, material evidence, and she identified no manifest error of law or fact. *Id.*

Ms. Aja did not dispute that she had received telephonic notice of the hearing from Attorney Bachtell. *Id.* Nor did she complain that the bankruptcy court had acted unreasonably under the circumstances in re-scheduling the hearing on shortened notice for January 21, 2010. *Id.*

Ms. Aja did not allege that the court had misinterpreted or misapplied Bankruptcy Rules 2002(a)(4) and 9006(c) or 11 U.S.C. 102(1). *Id.* She stated only that she had not received mail notice of the January 21, 2010 hearing "until January 22nd, 2010 . . . ." *Id.* at 490.

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[12] The court expressed concern that the rent collections reported in the report did not "add up," because "those aren't all of the rent rolls . . . as I recall from the prior case . . . ." *Id.* at 486 - 487.

Ms. Aja acknowledged that she still had not provided evidence of insurance for 103 Townsend Street and her Cadillac to the United States Trustee. *Id.* at 490. But she did not identify any "unusual circumstances" demonstrating that conversion was not in the best interests of creditors and the estate under 11 U.S.C. 1112(b)(1). *Id.* at 490 - 493.

Ms. Aja did not suggest that the deficiencies cited by the United States Trustee were justified or that she could presently cure them. *Id.* She could have stated that there was a reasonable likelihood that she could confirm a plan within the time established by the Bankruptcy Code. *Id.* She might have outlined the parameters of her reorganization scheme. *Id.* She did neither of those things. *Id.*

The bankruptcy court denied Ms. Aja's reconsideration motion without a hearing on January 26, 2010, finding that "[b]ased upon the representations of the attorney for the U.S. Trustee, [Ms. Aja] was provided with both notice by mail and telephonic notice on January 19, 2010 of the date and the time of the hearing on the U.S. Trustee's Motion to Convert . . . ." *Id.* at 6 - 7; 494. The court found that she "did not proffer a credible excuse for her failure to appear at the hearing . . . ." " *Id.* at 494. The court concluded that Ms. Aja "has presented no new evidence or demonstrated an error of law warranting reconsideration . . . ." *Id.* at 494.

7. At a February 3, 2010 hearing, Ms. Aja orally requested reconversion. She again presented no new, material evidence and identified no manifest error of law or fact.

At a February 3, 2010 hearing on Emigrant's stay relief motions, Ms. Aja orally moved for reconversion, not reconsideration.[13] *Id.* at 502 - 503. She again presented no new, material

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[13] Ms. Aja re-characterized this request as one for reconsideration for the first time in her February 18, 2010 motion for leave to appeal. *Id.* at 505 - 506. The bankruptcy court and Ms.

evidence, and she directed the court's attention to no manifest error of fact or law. *Id.* She did not discuss whether she was eligible to re-convert to chapter 11 under 11 U.S.C. 706(a). *Id.*.

The bankruptcy court denied reconversion, stating "[Y]ou just couldn't put it together in three bankruptcy cases in a reorganization, and I don't think that you can now. So I'm denying your request to reconvert to chapter 11. And I wish you luck in the future . . . ." *Id.* at 503.

8. Ms. Aja did not attend her chapter 7 section 341 meeting. She did not produce documents requested by the chapter 7 trustee. She did not turn over rents that she said she was holding.

The chapter 7 trustee met with Ms. Aja for an hour and a half after the February 3, 2010 hearing. *Id.* at 524 - 526. She asked Ms. Aja to provide her with documents, including tax returns, so that she might determine the value of the Worcester properties and decide whether selling them would benefit the estate. *Id.* Ms. Aja said that she had the documents and would cooperate. *Id.* at 529.

The chapter 7 trustee also directed Ms. Aja to turn over rents that she had collected on the 9-11 Williams Street property for the months of January and February, 2010. *Id.* at 528 - 529. The trustee understood that the property "generate[d] $14,000/month gross income . . . ." *Id.* Ms. Aja represented to the trustee that she was holding the rents. *Id.* at 528.

The chapter 7 trustee followed up with Ms. Aja by telephone. *Id.* at 525. She also emailed Ms. Aja on February 10, 2010 (at the email address that Ms. Aja had provided) to remind her of her section 341 meeting the next day. *Id.*

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subsequently treated it as such. *Id.* at 31 - 36; 37 - 66.

Ms. Aja did not attend the meeting.[14] *Id.* She did not produce the documents. *Id.* at 525 and 60. She did not turn over the rents. *Id.* at 529; 60 - 64. She did not return the chapter 7 trustee's subsequent telephone calls and emails. *Id.* at 525.

The trustee filed a motion to compel Ms. Aja to attend the rescheduled 341 meeting and to produce documents. *Id.* at 524 - 527. The bankruptcy court granted the motion. *Id.* at 12.

9. In her third request for reconsideration, Ms. Aja admitted that Attorney Bachtell had called her. She advanced new arguments that she could have previously made.

Ms. Aja filed her second written request for reconsideration on February 18, 2010. *Id.* at 13; 532 - 540. She admitted that Attorney Bachtell had called her prior to January 21, 2010 and had told her that the hearings on the motions to use cash collateral and to convert had been consolidated. *Id.* at 533. But she claimed that she did "not have recollection **<u>of any date</u>** being mentioned in that conversation . . . ." *Id.* (emphasis in original).

Ms. Aja admitted receiving separate email notice from Attorney Bachtell the morning of the hearing. *Id.* But she said that she "did not read that email until after the hearing had taken place . . . ." *Id.*

Ms. Aja advanced four new arguments in her motion. First, she insisted that only 21 days' mail notice of the hearing on the conversion motion would be sufficient under Fed. R. Bankr. P. 2002(a)(4). *Id.* Second, she said that the bankruptcy court's re-scheduling the hearing for January

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[14] The Clerk issued a notice of the conversion, scheduling the chapter 7 section 341 meeting of creditors for February 11, 2010 at 2:30 p.m. *Id.* at 519 - 520. The Bankruptcy Noticing Center certified on January 23, 2010 that it had mailed the notice to all parties in interest, including Ms. Aja, by United States mail, First Class postage pre-paid. *Id.* at 521 - 523. Ms. Aja never disputed that she had received this notice.

21, 2010 deprived her of "due process." *Id.* at 534. Third, she claimed that the court erred in finding that she had no likelihood of rehabilitating her affairs. *Id.* at 535. Fourth, she argued that the decision to convert was premature. *Id.* She could have asserted these arguments in her first reconsideration motion but had not done so.

10. At the March 18, 2010 hearing, the bankruptcy court opened the record and permitted Ms. Aja to proffer evidence in support of reconsideration.

The bankruptcy court heard the third reconsideration motion on March 18, 2010.[15] *Id.* at 17 - 18; 37. It opened the record and solicited input from Ms. Aja, the United States Trustee, Emigrant and the chapter 7 trustee. *Id.* at 37 - 65.

Ms. Aja proffered evidence of her personal and business income and expenses. *Id.* at 39 - 44. She handed up to the court written forecasts, showing that she expected to have cash totaling $23,732.79 by the end of June, 2010. *Id.* at 39 - 42. Ms. Aja explained that she anticipated increasing her income from personal services, such as language translations, and rents. *Id.* at 42. She said that she could begin making plan payments in July, 2010. *Id.* at 42 - 43.

The bankruptcy court directed questions to Ms. Aja and Emigrant's counsel about the amount of Emigrant's claim. *Id.* at 43 - 45; 48 - 49; 56. It asked whether Emigrant had credited adequate protection payments in the LLC's cases. *Id.* at 56.

Ms. Aja argued that she did not have notice of the January 21, 2010 hearing on her cash collateral motion and the United States Trustee's conversion motion. *Id.* at 45. The court stated that Ms. Aja "knew about the hearing because we notified you of the hearing on your [cash collateral]

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[15] The Court simultaneously heard Ms. Aja's motions to stay the conversion order and the order granting Emigrant stay relief on 92 Hamilton Street. *App.* at 14 - 19.

motion . . . ." *Id.* at 46. When Ms. Aja stated that she "was not called for the expedited motion to use cash collateral . . . ," the court responded that "Our records show differently . . . ." *Id.*

The court also asked Ms. Aja to explain what interest rate she intended to apply to Emigrant's claim under her proposed plan, to quantify proposed debt service payments to Emigrant and to discuss her tax liabilities to the Internal Revenue Service. *Id.* at 48 - 49. She did so. *Id.*

Attorney Bachtell stated that Ms. Aja had cured the deficiencies cited in the conversion motion. *Id.* at 53. She added that while the United States Trustee did not oppose reconsideration, it was unclear whether Ms. Aja could propose a viable plan. *Id.* at 54 - 55.

After listening to Ms. Aja, Emigrant and the United States Trustee, the bankruptcy court stated that the threshold question before it was "whether there is a likelihood of a viable reorganization here, based upon a restructuring of the obligation to the bank . . . . ." *Id.* at 59. The court then asked the chapter 7 trustee to weigh in. *Id.* at 60.

11. Ms. Aja admitted at the March 18, 2010 hearing that she had not only skipped her chapter 7 section 341 meeting but also converted rents that she should have surrendered to the chapter 7 trustee. The bankruptcy court denied reconsideration.

The chapter 7 trustee stated that Ms. Aja had not complied with court's order compelling her to turn over financial records. *Id.* at 60. This had required her to gather information about the rental properties independently. *Id.*

The trustee said that Ms. Aja had skipped the chapter 7 section 341 meeting and had intercepted the February rents on the 9-11 Williams Street property. *Id.* at 60 - 62. She added that Ms. Aja had failed to provide an accounting. *Id.*

The court asked Ms. Aja to confirm this. *Id.* at 62. Ms. Aja admitted that she had collected rents totaling $6,592 and that she had not turned them over to the trustee, because "I had many issues regarding the Chapter 7 bankruptcy . . . ." *Id.*

The court then asked whether this was the reason that she had skipped the section 341 meeting. Ms. Aja confirmed that it was. *Id.* at 62 - 63.

The court responded:

> [T]hat's not your decision. The Trustee is entitled to examine you under oath, and if you had cooperated with the Trustee and appeared at the 341 meeting and had complied with the order to provide the Trustee with documents, I would have converted you back to Chapter 11, but I will not now, because you have failed in your duties as a debtor . . . You have not cooperated with the Trustee, which is your duty . . . .
>
> [Y]ou've had three chances to propose a viable plan of reorganization, and you have failed at each step . . . You could not do it in your prior two cases when you were represented, and I don't believe that you can do it now, even based upon the documents that you've given me today. You simply do not have the ability to propose or fund a viable plan of reorganization. And I am distressed to hear that you have not given the Trustee documentation in support of the income and expenses; and moreover, I find that you have converted property of the estate in retaining the rents that were sent directly to you. You should have turned those over immediately to the Chapter [7] Trustee, and you have not.
>
> And therefore, I deny the motion for reconsideration and for stay pending appeal . . . . .

Id. at 63 - 64.

The bankruptcy court memorialized its order denying Ms. Aja's third reconsideration request the next day. *Id.* at 541. For the second time, it "reject[ed] [Ms. Aja's] contention . . . that she did not have notice of the hearing on the U.S. Trustee's Motion to Convert as [Attorney Bachtell] represented in open court at the hearing on January 21, 2010 that she spoke personally to the Debtor on the telephone on January 19, 2010 about the date and time of the hearing on the [cash collateral motion and the motion to convert] . . . ." *Id.*

The court found that re-conversion to chapter 11 would be "futile . . . ." *Id.* "[E]ven were this Court to reconsider conversion in the exercise of its discretion, the Court further finds that the Debtor does not have a plan of reorganization in prospect . . . Upon review of the cash flow projections, which the Debtor submitted in open court, and upon consideration of the Debtor's arguments in support of her request for an opportunity to submit a reorganization plan in a Chapter 11 case, the Court finds that the Debtor's proposal for a plan of reorganization is not feasible . . . ." *Id.*

The court also found that Ms. Aja's failure to cooperate with Trustee Dwyer by attending the section 341 meeting, providing requested documents and turning over the rents undercut her claim for relief. *Id.*

Ms. Aja appealed. *Id.* at 13; 31 - 36.

SUMMARY OF ARGUMENT

The bankruptcy court did not abuse its discretion in denying Ms. Aja's third request for reconsideration. She presented no newly discovered material evidence or manifest error of law. She rehashed arguments she had previously made or should have made.

The bankruptcy court did not abuse its discretion in shortening the notice of the January 21, 2010 hearing, because Ms. Aja had not provided evidence of insurance. Ms. Aja credibly received telephonic notice of the January 21, 2010 hearing on the cash collateral and conversion motions from Attorney Bachtell. Any conceivable prejudice was cured when the court conducted a plenary hearing on the third reconsideration motion and allowed Ms. Aja to proffer evidence supporting reconversion.

For purposes of 11 U.S.C. 102(1), notice and opportunity for hearing were appropriate under the circumstances. Accordingly, she received due process.

Ms. Aja has waived her argument that the bankruptcy court and the United States Trustee were biased, because she did not raise them below. Her claim that the bankruptcy court erred in not considering her objection to Emigrant's stay relief motion fails for the same reason.

Ms. Aja misunderstands the role and capacity of the chapter 7 trustee. Contrary to her argument, the trustee owed no fiduciary duty to protect Ms. Aja. A trustee's foremost duties are to the creditors and the bankruptcy estate. The trustee breached no fiduciary duty in assenting to Emigrant's stay relief motion.

Ms. Aja converted estate assets (rents) and failed to appear at her chapter 7 section 341 meeting. In doing so, she exhibited bad faith and was ineligible under 11 U.S.C. 706(a) to reconvert to chapter 11. This Court can sustain the bankruptcy court's order on that basis.

Alternatively, because the bankruptcy court granted stay relief as to all of the assets upon which Ms. Aja could predicate a reorganization, including the Worcester rental properties, this appeal is moot, as the Court can grant no effective relief. The Court should dismiss this appeal.

ARGUMENT

I. The Bankruptcy Court Did Not Abuse Its Discretion In Denying Ms. Aja's Third Request For Reconsideration

A. A party seeking reconsideration must demonstrate newly discovered, material evidence or a manifest error of law or fact.

In order to prevail on a request for reconsideration, a movant must demonstrate "newly discovered material evidence or a manifest error of law or fact that enables the court to correct its own errors . . . ." *Aybar v. Crispin-Reyes* at 16 (citations omitted) (interpreting Fed. R. Civ. P. 59(e) and affirming denial of appellants' second reconsideration motion, because they had presented no new evidence). The rule does not permit "a party to undo its own procedural failures . . . ." *Id.*

Nor may a party use reconsideration to introduce new evidence or to propound new arguments "that could and should have been presented to the [lower] court prior to the judgment . . . ." *Id.* It "is not a means by which parties can rehash previously made arguments . . . ." *In re Wedgestone Financial*, 142 B.R. 7, 8 (Bankr. D. Mass. 1992).

Courts have considerable discretion in deciding whether to grant reconsideration. *Venegas-Hernandez v. Sonolux Records*, 370 F.3d 183, 190 (1st Cir. 2004). "That discretion requires a balancing of the need for finality of judgments with the need to render a just decision . . . ." *Id.* Granting reconsideration "is an extraordinary remedy which should be used sparingly . . . ." *Palmer v. Champion Mort.*, 465 F.3d 24, 29 (1st Cir. 2006) (internal quotation marks and citations omitted).

B. Ms. Aja cannot obtain review of the underlying conversion of her case under section 1112(b) because only the denial of her third attempt to obtain reconsideration is before this Court. If Ms. Aja had a case to make, she should have made it earlier.

The First Circuit has long held that an appellant with a procedural record such as the one in this case - with a notice of appeal timely only to obtain review from the denial of reconsideration - cannot seek review of the merits of the underlying judgment. *See, e.g.*, *Rodriguez-Antuna v. Chase Manhattan Bank Corp.*, 871 F.2d 1, 2 (1st Cir. 1989) ("a punctual appeal from an order denying such a [post-judgment] motion does not automatically produce a Lazarus-like effect; it cannot resurrect appellants' expired right to contest the merits of the underlying judgment, nor bring the judgment itself before us for review . . . ."). In other words, as the First Circuit has previously stated, Ms. Aja, "if [she] had a case to make, should have made it in a timeous fashion in the [trial] court . . . ." *Id*. at 3.

Moreover, when only the denial of reconsideration is before this Court, the appellant has an extremely difficult burden on appeal, because this Court's review is highly deferential to the trial court. The First Circuit has observed that "[a]n appellate court ought not to overturn a trial court's denial of a motion for reconsideration unless a *miscarriage of justice* is in prospect or the record otherwise reveals a manifest abuse of discretion." *Ruiz Rivera v. Riley*, 209 F.3d 24, 27 (1st Cir. 2000) (emphasis added); *see also Ramos-Pena v. New Puerto Rico Marine Mgmt., Inc.* 2 Fed. Appx. 19, 22, No. 00-1228, 2001 WL 113678, *2 (1st Cir. Feb. 8, 2001) (noting that a lower court's denial of a successive motion for reconsideration is "reviewed deferentially").

As discussed in further detail below, the record in this case does not establish that a miscarriage of justice would occur if the bankruptcy court's denial of reconsideration is affirmed. Indeed, quite the opposite is true.

C. Ms. Aja's due process argument fails, because notice and opportunity for hearing on the conversion motion were appropriate under the circumstances.

Ms. Aja reiterates the argument advanced in her third reconsideration motion that anything less than 21 days' mail notice of the hearing on the conversion motion deprived her of substantive and procedural due process. *Appellant's Brief* at 10 - 13, *citing* Rule 2002(a)(4) and U.S. Const. amend. XIV, § 1. This argument fails, because she received appropriate notice and opportunity to be heard under the circumstances, as required by 11 U.S.C. 102(1)(A). There are three reasons why this is so.

First, notice was appropriate under the circumstances. The Bankruptcy Rules govern bankruptcy procedure generally and cannot themselves trump substantive bankruptcy law.[16] 28 U.S.C. 2075 (providing that "[s]uch rules shall not abridge, enlarge, or modify any substantive right . . . ."). *Id.* "[T]o the extent that the Bankruptcy Rules and the Bankruptcy Code are inconsistent, the statute controls . . . ." *In re Perrotta*, 406 B.R. 1, 8 (Bankr. D.N.H. 2009) (holding that two rules affecting the timing of discharge must yield to the substantive right to object to discharge under 11 U.S.C. 727(a)).

Section 1112(b) provides that conversion may occur "after notice and a hearing . . . ." Section 102(1)(A), in turn, defines this term as "after such notice as is appropriate in the particular circumstances, and such opportunity for a hearing as is appropriate in the particular circumstances . . . ." 11 U.S.C. 102(1)(A).[17] *See* 2 *Collier on Bankruptcy* ¶ 102.02[1] (Alan N. Resnick & Henry J. Sommer, eds., 16th ed. rev. 2010).

Ms. Aja assigns error to the bankruptcy court's consolidating the hearings on her cash collateral motion and the conversion motion on two days' notice. *Appellant's Brief* at 10 - 13. Consistent with her first motion for reconsideration, however, she does not dispute that she had failed to provide evidence of insurance for all her assets as of January 6, 2010, when the United States Trustee filed the conversion motion. *Id.*; *App*. at 490 - 493. She also does not dispute that she had skipped her initial debtor interview and that she had not yet opened a debtor-in-possession account.

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[16] Rule 1001 provides that "[t]hese rules shall be construed to secure the just, speedy, and inexpensive determination of every case and proceeding . . . ."

[17] Section 102(1)((B) also authorizes bankruptcy courts to act "without an actual hearing if such notice is given properly and if . . such hearing is not requested timely by a party in interest . . . or . . . there is insufficient time for a hearing to be commenced before such act must be done, and the court authorizes such act . . . ."

Id.[18] *Appellant's Brief* at 10 - 13.

As of January 19, 2010, after reading the United States Trustee's conversion motion, the bankruptcy court reasonably understood that Ms. Aja, with whom she was familiar after two previous cases, was operating in chapter 11 without adequate insurance. *App.* at 32. This exposed the estate to unnecessary risk – an uninsured casualty involving any of Ms. Aja's real properties or Cadillac would have created an administrative priority claim.[19]

The estate, which Ms. Aja admits was balance sheet insolvent, would have had no means of paying it. *Id.* at 452. Under the undisputed circumstances as they existed on January 19, 2010, the bankruptcy court acted prudently in *sua sponte* rescheduling the hearing on two days notice. *Id.* at 4. *In re AbiJoe Realty Corp.*, 943 F.2d 121, 125 - 126 (1st Cir. 1991) (affirming dismissal of chapter 11 case under 11 U.S.C. 1112(b) and rejecting appellant's due process argument, because notice was adequate under the circumstances, as required by 11 U.S.C. 102).

Second, Rule 9006(c) permitted the bankruptcy court to shorten the 21 day notice period of Rule 2002(a)(4) "for cause shown . . . in its discretion or without motion or notice order. . . ." *See* 10 *Collier on Bankruptcy* at ¶ 9006.09. Shortening notice was a reasonable exercise of discretion for the reasons stated above. *App.* at 4; 490 - 493. Ms. Aja is incorrect in suggesting that the court could only reduce the notice period on motion filed by the United States Trustee. *See Appellant's Brief* at

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[18] As late as January 22, 2010, she had still not yet provided evidence of insurance for 103 Townsend Street and her Cadillac. *App.* at 490 - 493. Again, she does not dispute this on appeal. *Appellant's Brief* at 10 - 13.

[19] *Compare* 11 U.S.C. 502 and 503; 11 U.S.C. 1112(b)(4)(C) ("the term 'cause' includes . . . failure to maintain appropriate insurance that poses a risk to the estate or to the public . . . ."). *See In re Gilroy*, 2008 WL 4531982,*5 (BAP 1st Cir. 2008) (affirming order dismissing individual chapter 11 debtor's case for "cause" under 11 U.S.C. 1112(b)(4)(C), because she had not insured her assets). *See also* 3 *United States Trustee Manual* at § 3-3.2.3; 7 *Collier on Bankruptcy* at ¶1112.04[6][c].

11 - 12.

Telephonic notice of the hearing was also appropriate under the circumstances. 11 U.S.C. 102(1)(A). It is implausible for Ms. Aja to insist here, as she did in the third reconsideration motion, that Attorney Bachtell, who called her on January 19, 2010, informed her that the court had consolidated the hearings on the cash collateral and conversion motions and explained to her how to cure the deficiencies cited by the United States Trustee, would have not informed her of the date and time of the hearing. *Appellant's Brief* at 11 - 12; *App.* at 532 - 540. The bankruptcy court correctly found that Ms. Aja had "no credible excuse" for not attending the January 21, 2010 hearing. *Id.* at 494.

Third, Ms. Aja received an adequate opportunity to be heard. The bankruptcy court reopened the record on March 18, 2010 and permitted her to proffer evidence supporting reconversion to chapter 11. *Id.* at 37 - 60. Ms. Aja delimited how she would treat creditors under a plan. *Id.* at 39 - 52. She provided the court with her projected financial performance. *Id.* She argued that she could confirm a plan. *Id.*

The bankruptcy court seemed willing to reconvert Ms. Aja's request, based upon her presentation. *Id.* at 63. But she undercut herself when she admitted that she had converted the rents and failed to appear at her chapter 7 section 341 meeting. *Id.* at 62 - 63.

A neutral review of the record confirms that notice and opportunity for a hearing were reasonable under 11 U.S.C. 102(1)(A). Ms. Aja received procedural and substantive due process. *In re Bartle*, 560 F.3d 724, 729 - 730 (7th Cir. 2009) (affirming conversion order and holding that appellant was not denied due process, because he timely sought reconsideration, which provided him with the opportunity to present his defense).[20]

The bankruptcy court committed no abuse of discretion. *AbiJoe Realty Corp*. at 125 - 126 (affirming dismissal). The Court should affirm the order below.

D. The bankruptcy court did not abuse its discretion in rejecting Ms. Aja's arguments that she could confirm a plan and that conversion was premature.

Ms. Aja, reiterating two arguments advanced in her third reconsideration request, claims that the bankruptcy court erred in finding that she could not submit a confirmable chapter 11 plan and that conversion was appropriate six weeks into the case.[21] *Appellant's Brief* at 10 - 14 and 16 (arguments 2 and 5). The Court should affirm, because Ms. Aja has not demonstrated how the bankruptcy court abused its discretion in rejecting these arguments for a second time. *Palmer v. Champion Mort.* at 29 (affirming denial of reconsideration, because motion rehashed arguments propounded at trial).

Moreover, Ms. Aja points to no evidence in the record that the bankruptcy court erroneously failed to consider. *Aybar v. Crispin-Reyes* at 17 (affirming denial of reconsideration, because "the evidence that appellants submitted to support the argument they advanced for the first time in their second motion for reconsideration was neither new or unavailable at the time the [lower court] entered judgment . . . ."). The Court should credit the bankruptcy court's evaluation of Ms. Aja's

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[20] *See In re I Don't Trust*, 143 F.3d 1, 3 - 4 (1st Cir. 1998) (holding that where bankruptcy court approved fee application without a hearing, the "notice and hearing" requirement of section 102 was nevertheless satisfied, because the appellant timely requested reconsideration).

[21] *See United Sav. Ass'n of Texas v. Timbers of Inwood Forest Associates, Ltd.*, 808 F.2d 363, 371 (5th Cir. 1987) (*en banc*), *aff'd* 484 U.S. 365 (1988) (noting that "[i]n the case of most Chapter 11 debtors . . . a plan of reorganization can be effectuated, if at all, within a matter of months, not years . . . The charge to the bankruptcy judge under §1112, then, is to evaluate each debtor's viability in light of the best interest of creditors and the estate . . . .").

credibility. *App.* at 46; 494; 541. Fed. R. Bankr. P. 8013 (stating that "due regard shall be given to the opportunity of the bankruptcy court to judge the credibility of the witnesses . . . ."). *See Palmacci v. Umpierrez*, 121 F.3d 781, 785 (1st Cir. 2005) (evaluating deference accorded to witness credibility).

Inasmuch as Ms. Aja fails to demonstrate how the bankruptcy court abused its discretion, this Court should affirm. *Palmer v. Champion Mort.* at 29.

E. Ms. Aja's final two arguments are barred, because she did not present them below.

Ms. Aja's remaining arguments – bias by the bankruptcy court[22] and the United States Trustee (*Appellant's Brief* at 14 - 15), failure to consider her objection to Emigrant's stay relief motion (*Appellant's Brief* at 15 - 16) – are barred, because she raises them for the first time here. *Taylor v. U.S. Dept. of Labor*, 440 F.3d 1, 8 (1st Cir. 2005) (holding that arguments presented for the first time on appeal are waived).

Separately, her suggestion (*Appellant's Brief* at 15 - 16) that the chapter 7 trustee breached her fiduciary duty by withdrawing her objection to Emigrant's stay relief motion misapprehends that the trustee, not the debtor, is the sole estate representative and may exercise her discretion in administering estate assets without a debtor's input. 11 U.S.C. 323 and 704. "The trustee does not represent the debtor and does not owe the debtor any fiduciary duty . . . ." 3 *Collier on Bankruptcy* at ¶ 323.02[1]. Regardless, Ms. Aja lacks standing to raise objections to creditors' claims, because, as she admitted below, the estate is insolvent. *App.* at [31]; *In re Choquette*, 290 B.R. 183, 188 - 189 (Bankr. D. Mass, 2003).

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[22] "In general, [o]ne must raise the disqualification of the . . . [judge] at the earliest moment after [acquiring knowledge of the relevant facts . . . ." *Abijoe Realty Corp.* at 126 (citations and internal quotation marks omitted) (affirming dismissal).

Accordingly, the Court should affirm.

II. The Court Can Also Affirm On The Alternative Ground That Ms. Aja Was Ineligible To Reconvert Under 11 U.S.C. 706(a)

Additionally, the Court can affirm, because Ms. Aja was ineligible to reconvert to chapter 11 under 11 U.S.C. 706(a).

Section 706(a)(1) gives chapter 7 debtors a one-time right to convert to a different chapter at any time, "if the case has not been converted to under section 1112 . . . ."[23] Debtors who exhibit "bad faith," however, may not do so. *Marrama v. Citizens Bank of Mass.*, 549 U.S. 635 (2007) (holding that a debtor who concealed assets would be subject to dismissal under 11 U.S.C. 1307(c) and did not have the right to convert to chapter 13).

Ms. Aja converted estate assets. *App*. at 60 - 64; 524 - 531. She failed to produce documents requested by the chapter 7 trustee, even after she was ordered to do so. *Id.* She failed to attend her chapter 7 section 341 meeting. *Id.*

Ms. Aja exhibited bad faith. She was therefore ineligible for chapter 11. *Marrama v. Citizens Bank of Mass.* The Court can affirm on that basis.

III. Alternatively, The Court Should Dismiss This Appeal As Moot, Because It Can Grant No Effective Relief

Emigrant obtained stay relief on both of the Worcester properties. *App.* at 9 - 10; 18; 554 - 555. Ms. Aja unsuccessfully sought to stay Emigrant's foreclosure sales pending appeal from both the bankruptcy court and this Court. *Id.* at 19; 542 - 546. Emigrant has foreclosed on the 92 Hamilton Street, extinguishing Ms. Aja's state law right of redemption. *Id.* at 547 - 549.

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[23] Courts are divided on whether they have discretion to reconvert to chapter 11 a case that has already been converted under 11 U.S.C. 1112(b). *See In re Nelson*, 2009 WL 3062319 (Bankr. D. Md. 2009) (collecting cases).

The holders of liens against her remaining significant assets, including the rental properties located at 103 Townsend Street, her home and her Cadillac, also obtained stay relief. *Id.* at 11 (as to her home); 14 - 15; 552 (Cadillac); 553 (103 Townsend Street). Ms. Aja did not oppose them. *Id.* at 1 - 30. The chapter 7 trustee abandoned all of Ms. Aja's real properties, because they were burdensome to the estate. *Id.* at 567 - 578. 11 U.S.C. 554.

The chapter 7 trustee filed her final report on July 19, 2010. *Id.* at 556 - 566. She proposes to distribute $7,602.13 in satisfaction of chapter 7 administrative priority claims. *Id.* at 556. Holders of pre-petition claims will receive nothing. *Id.* There are no impediments to Ms. Aja receiving her chapter 7 discharge.[24] 11 U.S.C. 727(a).

Consequently, this Court cannot provide an effective remedy, because stay relief has been granted as to all of the assets upon which Ms. Aja predicated her proposed reorganization at the March 18, 2010 hearing.[25] *Id.* at 1 - 30; 37 - 66; 542 - 578. This appeal is, therefore, moot, and the Court should dismiss it. *Rochman v. Northeast Utilities Group (In re Public Service Co. of New Hampshire)*, 963 F.2d 469, 476 (1st Cir. 1992) (dismissing appeal of order confirming plan, because plan had been consummated, appellant had failed to obtain a stay pending appeal, which "[left] the court powerless to grant effective relief . . . .").

CONCLUSION

For all of the foregoing reasons, this Court should affirm the denial of Ms. Aja's third reconsideration request or, alternatively, dismiss this appeal as moot.

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[24] The extended deadline for objecting to Ms. Aja's discharge expired on June 21, 2010. *App.* at 20 - 21.

[25] Alternatively, all effective relief to which Ms. Aja is entitled – possession of the assets upon which her creditors have not foreclosed – has been effectuated through the chapter 7 trustee's abandonment. *Id.* at 1 - 30; 37 - 66; 542 - 578.

Respectfully submitted,

JOHN P. FITZGERALD, III
ACTING UNITED STATES TRUSTEE,
REGION ONE

By: *_/s/ Eric K. Bradford_*
Eric K. Bradford
United States Department of Justice
John W. McCormack Post Office & Courthouse
5 Post Office Square, 10th Floor, Suite 1000
Boston, MA 02109-3934
PHONE: (617) 788-0415
FAX: (617) 565-6368
Eric.K.Bradford@USDOJ.gov

P. Matthew Sutko
Associate General Counsel for Appellate Matters
Anne W. Stukes
Executive Office for United States Trustees
United States Department of Justice
20 Massachusetts Ave., N.W.
Washington, D.C. 20530
PHONE: (202) 307-1399
FAX: (202) 307-2397

Dated: September 7, 2010.

CERTIFICATE OF SERVICE

I certify that on September 7, 2010, I caused copies of the foregoing brief and the concomitantly-filed appendix to be served via United States mail, First Class postage pre-paid, or email upon the parties listed below, where indicated.

JOHN P. FITZGERALD, III
ACTING UNITED STATES TRUSTEE,
REGION ONE

By: *<u>/s/ Eric K. Bradford</u>*
Eric K. Bradford BBO#560231
United States Department of Justice
John W. McCormack Post Office & Courthouse
5 Post Office Square, 10th Floor, Suite 1000
Boston, MA 02109-3934
PHONE: (617) 788-0415
FAX: (617) 565-6368
<u>Eric.K.Bradford@USDOJ.gov</u>

Dated: September 7, 2010.

BY REGULAR MAIL:

Dora L. Aja
20 Sigourney St.
Jamaica Plain, MA 02130
(<u>Pro</u> <u>Se</u> Appellant)
(By Federal Express)

Kathleen P. Dwyer, Esq.
MacLean Holloway Doherty
Ardiff & Morse, P.C.
8 Essex Center Drive
Peabody, MA 01960

(Chapter 7 Trustee)

BY EMAIL:

Thomas E. Carlotto on behalf of Creditor Emigrant Funding Corporation

carlotto@shslawfirm.com

Shawn Masterson on behalf of Creditor Emigrant Funding Corporation

smasterson@shslawfirm.com

BRIEF BANK — "SUMMARY SHEET" *Printed Mon-5/23/11 14:35*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*
In re Fred Leroy Allman (Fred Leroy Allman v. United States Trustee, et al.)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*
BAP 9th Cir.

3. ("CCN") ***CURRENT*** CASE NO.
No.: OR-09-1143

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*
No.: 08-31282-elp
Court: Bankr. Or.
(Identify judge & cite, if any)

5. ("SO") ***SOURCE***
U.S. TRUSTEES

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*
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7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*
Pamela J. Griffith
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***
• Opposition to request for interlocutory appeal.

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YES NO **DATE:**

Pamela J. Griffith, OSB #812495
Office of the United States Trustee
620 SW Main Street, Suite 213
Portland, OR 97205
Telephone: (503) 326-4004

Attorney for Robert D. Miller Jr., Acting United States Trustee, Appellee

UNITED STATES BANKRUPTCY APPELLATE PANEL OF THE NINTH CIRCUIT

In re

Fred Leroy Allman,

Debtor.

Fred Leroy Allman,

Appellant,

v.

United States Trustee,

Appellee.

BAP No. OR-09-1143
Bk. No. 08-31282-elp
Adv. No. 08-03115-elp

UNITED STATES TRUSTEE'S ANSWER IN OBJECTION TO APPELLANT'S MOTION FOR LEAVE TO APPEAL

The United States Trustee ("UST"), Appellee, by and through Assistant United States Trustee Pamela J. Griffith, objects to the Motion for Leave to Appeal, Docket #154[1], filed by Fred Leroy Allman ("Allman")[2], Appellant, on the grounds that an appeal of the interlocutory order at issue would result in increased delay and expense and would waste judicial resources.

Factual Background

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[1] All docket references are to the docket in the adversary proceeding entitled United States Trustee v. Fred Leroy Allman, United States Bankruptcy Court for the District of Oregon Adv. No. 08-03115-elp. A copy of the adversary proceeding docket is contained in Exhibit 1, pages 1-15.

[2] Allman is pro se in this appeal and in the bankruptcy case below.

The UST filed his complaint objecting to Allman's discharge pursuant to 11 U.S.C. § 727 on June 30, 2008. In early September 2008, the court set a trial in the adversary proceeding for December 17, 2008. Docket #10 (Exhibit 1, page 16). The court denied Allman's December 11, 2008 motion to postpone the trial, *see* Docket #62, 63 (Exhibit 1, pages 17-21), but determined that Allman could present his defense on April 29, 2009, after the UST presented his case. *See* Docket # 68, 82, 84 (Exhibit 1, pages 22-25). Allman declined to appear when the UST presented his case on December 17, 2008 and January 21, 2009. *See* Docket #92, 93, 94, 95, 98 (Exhibit 1, pages 26-56).

Allman filed his Motion for Order to Change Venue and Judicial Oversight on April 7, 2009. Docket #136 (Exhibit 1, pages 57-58). He filed a memorandum in support of the motion on April 15, 2009. Docket #141 (Exhibit 1, pages 59-84). In the memorandum, Allman complained about a number of the court's pre-trial rulings and asserted that the bankruptcy judge was biased. (*See* Exhibit 1, pages 60-61).

The court conducted a hearing on Allman's Motion for Order to Change Venue and Judicial Oversight on April 22, 2009. Allman did not appear at the hearing. *See* Docket #143 (Exhibit 1, page 85). The court entered an order denying the motion on April 24, 2009. Docket #144 (Exhibit 1, pages 87-89). This appeal followed.

Allman filed his notice of appeal on April 28, 2009. Docket # 147 (Exhibit 1, pages 90-96). He failed to appear the next day, April 29, 2009, the date that the court had set for him to present his case in the adversary proceeding. The court therefore heard the UST's closing argument and took the matter under advisement. *See* Docket #152 (Exhibit 1, page 97). The court has not yet issued its opinion or judgment.

Legal Argument

The Bankruptcy Appellate Panel ("BAP") has jurisdiction to hear bankruptcy appeals from final judgments, orders, and decrees as well as from interlocutory orders as to which the BAP grants leave to appeal. *See* 28 U.S.C. §§ 158(a) and (b).

A final judgment or order is one that finally determines the rights of the parties in securing the relief they sought in the suit. In re Moberg Trucking, Inc., 112 B.R. 362, 363

(9th Cir. BAP 1990). In the instant adversary proceeding, the final judgment will occur when the bankruptcy court enters the judgment granting or denying Allman's discharge.

The April 24, 2009 Order Denying Motion for Order to Change Venue and Judicial Oversight that Allman seeks to appeal is an interlocutory order. *See*, e.g., In re Goodwin, 194 B.R. 214, 221 (9th Cir. BAP 1996)(order denying motion to recuse is interlocutory); In re Donald, 328 B.R. 192, 196 (9th Cir. BAP 2005)(order transferring case to another district is interlocutory). Therefore, for the appeal to proceed, the BAP must grant leave to appeal the order pursuant to 28 U.S.C. §§ 158(a)(3) and (b).

The BAP's decision to grant or deny leave to appeal is an exercise of discretion. In re City of Desert Hot Springs, 339 F.3d 782, 787-88 (9th Cir. 2003).[3] Factors to be considered in the analysis include whether or not 1) the order on appeal involves a controlling question of law as to which there is a substantial ground for difference of opinion; 2) an immediate appeal may materially advance the ultimate termination of the litigation; and 3) a denial of leave to appeal will result in wasted litigation and expense. In re Roderick Timber Company, 185 B.R. 601, 604 (9th Cir. BAP 1995).

Application of the In re Roderick Timber Company factors in this case compels the conclusion that leave to appeal should be denied. No controlling question of law is presented as to which there is a substantial ground for difference of opinion. The appeal will not materially advance the ultimate termination of the litigation. Indeed, all evidence in the adversary proceeding has been presented and final argument has been made. The outcome of the litigation awaits only the bankruptcy court's opinion and judgment. Denying leave to appeal would not result in increased litigation and expense. To the contrary, granting leave to appeal would have this result. The final judgment in this adversary proceeding is imminent. Either the UST will not prevail, in which event the appeal will become moot, or the UST will prevail, at which time Allman can, if he so

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[3] Moreover, the court held that the BAP's exercise of discretion not to hear an interlocutory appeal was not subject to review by the Ninth Circuit. Id. at 792.

chooses, appeal the court's judgment and raise the issues about which he complains in the Motion for Order to Change Venue and Judicial Oversight as well as any other appealable issues. Granting leave to appeal at this time very likely could result in two appeals and the unnecessary costs and burdens associated therewith. *See* In re Lewis, 113 F.3d 1040, 1043 (9th Cir. 1997) noting that "traditional finality concerns nonetheless dictate that "'we avoid having a case make two complete trips through the appellate process'"(*quoting* In re Vylene Enterprises, Inc., 968 F.2d 887, 895 (9th Cir. 1992).

Conclusion

The BAP should deny Allman's motion for leave to appeal the Order Denying Motion for Order to Change Venue and Judicial Oversight and dismiss this appeal. Continuation of the appeal would result in increased delay and expense and would waste judicial resources.

DATED this _27th_ day of May, 2009.

Respectfully submitted,

ROBERT D. MILLER JR.
Acting United States Trustee

/s/ Pamela J. Griffith
PAMELA J. GRIFFITH, OSB #812495
Assistant United States Trustee

CERTIFICATE OF SERVICE

I hereby certify that on May 27, 2009, I served a copy of the foregoing UNITED STATES TRUSTEE'S by mailing a copy of this document, by United States first class mail, postage prepaid, addressed to the following:

Fred Leroy Allman
9991 NE Worden Hill Rd
Dundee, OR 97115

Fred Leroy Allman
POB 5366
Portland, OR 97228

Fred Leroy Allman
POB 575
Dundee, OR 97115

I further certify that based on the Bankruptcy Court's electronic case filing records, the following person(s) will be served electronically when the foregoing document is filed with the court:

BRADLEY O BAKER bradleyo10@msn.com
ERIC M BOSSE emb@cobbandbosse.com, info@cobbandbosse.com

ROBERT D. MILLER JR.
Acting United States Trustee

/s/ Pamela J. Griffith
PAMELA J. GRIFFITH, OSB #812495
Assistant United States Trustee

BRIEF BANK — "SUMMARY SHEET"

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WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	Rodney Andrews and Valerie Andrews v. August B. Landis, Acting United States Trustee Region 17 (In re Rodney Andrews and Valerie Andrews)
2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	E. D. Cal.
3. ("CCN") ***CURRENT*** CASE NO.	No.: 2:10-CV0-1205
4. ("PCN") ***PRIOR*** CASE NO. - & COURT *[IF ANY]*	No.: 08-28963-C-7 Court: Bankr. E.D. Cal. *(Identify judge & cite, if any)*
5. ("SO") ***SOURCE***	**U.S. TRUSTEES**
6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	Filed: September 10, 2010 Type: Brief of Appellee, August B. Landis, Acting United States Trustee
7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*	Antonia G. Darling, Judith C. Hotze, Anne W. Stukes, P. Matthew Sutko, Ramona D. Elliott *(UST/OGC: 202-307-1399/FAX-2397)*
8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	• (A) Whether the bankruptcy court clearly erred in denying the appellants discharge under 11 U.S.C. § 727(a)(4)(A). (B) Whether the appellants may seek relief under Rule 60(b) from an appellate court.
10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)	
11. DO YOU RECOMMEND POSTING IN UST BRIEFBANK?	| x | YES | | NO ***NAME:*** Linda Figueroa ***DATE:***

IN THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF CALIFORNIA

)
In re:)
)Civ. App.
Rodney Andrews)No. 2:10-CV0-1205-JAM
and Valerie Andrews,)
Debtors)
)
) Bk. Case No. 08-28963-C-7
Rodney Andrews)Adversary Pro. No. 09-02153
and Valerie Andrews,)
Appellants,)
v.)
)
August B. Landis,)
Acting United States Trustee)
Region 17,)
Appellee.)
)

Brief of Appellee, August B. Landis, Acting United States Trustee

Ramona D. Elliott
General Counsel

P. Matthew Sutko
Associate General Counsel

Anne W. Stukes
Trial Attorney

Executive Office for United States Trustees
20 Massachusetts Ave., N.W., Ste. 8000
Washington, D.C. 20530
Tel: (202) 307-1405

Judith C. Hotze
Trial Attorney

Antonia G . Darling
Assistant United States Trustee

Office of the U.S. Trustee
501 "I" Street, Suite 7-500
Sacramento, CA 95814
Tel: (916) 930-2087
Fax: (916) 930-2099

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TABLE OF AUTHORITIES

FEDERAL STATUTES

FEDERAL RULES

MISCELLANEOUS

I. PRELIMINARY STATEMENT

This is an appeal from the judgment of the United States Bankruptcy Court for the Eastern District of California, denying the discharge of husband-and-wife debtors, Rodney and Valerie Andrews (hereinafter, "Appellants" or "the Andrews"), based on 11 U.S.C. §727(a)(4)(A) (False Oath or Account). The Andrews have appealed this judgment, asking for reversal of the bankruptcy court's judgment under Federal Rule of Bankruptcy Procedure 60(b)(6) (hereinafter "Rule 60(b)(6)" or "Rule 60(b)").

II. JURISDICTIONAL STATEMENT

Sections 157(b)(1) and (b)(2) of Title 28 of the United States Code confer jurisdiction upon bankruptcy courts to hear and determine all core proceedings under title 11 of the United States Code. An adversary proceeding seeking denial of a debtor's discharge under 11 U.S.C. § 727 is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(J). On April 7, 2010, the bankruptcy court entered its judgment denying the Appellants' discharge. The Appellants filed a timely notice of appeal on April 20, 2010. The Appellee elected to have the appeal heard by this Court. This Court has jurisdiction over this appeal. 28 U.S.C. § 158(a)(1), (c)(1)(B).

III. STANDARD OF REVIEW

"The bankruptcy court's conclusions of law are reviewed <u>de novo</u>, and its findings of fact are reviewed for clear error." <u>In re Doser</u>, 412 F.3d 1056, 1061 (9th Cir. 2005). The Ninth Circuit standard of review of a judgment on an objection to discharge is that: (1) the court's determinations of the historical facts are reviewed for clear error; (2) the selection of the applicable legal rules under § 727 is reviewed <u>de novo</u>; and (3) the application of the facts to those rules requiring the exercise of judgments about values animating the rules is reviewed <u>de novo</u>. <u>Searles v. Riley (In re Searles)</u>, 317 B.R. 368, 373 (9th Cir. BAP 2004) (citations omitted), aff'd, 212 Fed. Appx. 589 (9th Cir. 2006); Khalil v. Developers Sur. & Indem. Co. (In re Khalil), 379 B.R. 163, 171 (9th Cir. BAP 2007), aff'd, 578 F.3d 1167 (9th Cir. 2009).

IV. STATEMENT OF ISSUES PRESENTED

A. Whether the bankruptcy court clearly erred in denying the Appellants discharge under 11 U.S.C. § 727(a)(4)(A).

B. Whether the Appellants may seek relief under Rule 60(b) from an appellate court.

V. STATEMENT OF THE CASE

A. Nature of the proceedings.

This case is about whether denial of the Appellants' bankruptcy discharge was warranted based on material misstatements and omissions that they made under oath during the course of their bankruptcy.

B. Course of proceedings and disposition in the court below.

On March 4, 2009, the then-Acting United States Trustee[1] ("United States Trustee") filed a complaint to deny the Appellants discharge under § 727 of the Bankruptcy Code. Trial was conducted on March 9, 2010. At the conclusion of trial, the bankruptcy court entered judgment in favor of the United States Trustee and denied the Appellants a discharge pursuant to 11 U.S.C. § 727(a)(4)(A), entitled False oath or Account.

C. Statutory Framework.

1. 11 U.S.C. § 727(a)(4)(A) denies discharge to a debtor who knowingly and fraudulently makes a false oath or account in the course of a bankruptcy case.

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[1] Sara L. Kistler was the Acting United States Trustee until July 20, 2010, on which date August B. Landis assumed that position. Pursuant to F. R. Civ. P. Rule 25(d), as incorporated in F.R. Bankruptcy P. 7025, Mr. Landis was automatically substituted as a party.

Section 727(a)(4)(A) of the Bankruptcy Code denies a discharge to a debtor who "knowingly and fraudulently" makes a false oath or account in the course of the bankruptcy case. 11 U.S.C. § 727(a)(4)(A). It provides:

> (a) The court shall grant the debtor a discharge unless –
> . . .
> (4) the debtor knowingly and fraudulently, in connection with the case –
>
> (A) made a false oath or account . . .

2. Fed. R. Civ. P. 60(b).

The Appellants request that the district court reverse the bankruptcy court's judgment denying their discharge based on Federal Rule of Civil Procedure 60(b)(6).

Rule 60(b)(6) provides:

> **(b) Grounds for Relief from a Final Judgment, Order, or Proceeding**. On motion and just terms, the court may relieve a party or its legal representative from a final judgment, order, or proceeding for the following reasons:
> . . . . . .
> (6) any other reason that justifies relief.

Rule 60 applies in bankruptcy courts, with exceptions not relevant here, by virtue of Fed. R. Bankr. P. 9024.

VI. STATEMENT OF THE FACTS

A. The Appellants' Circumstances as of, and Prior to, the Filing of Their Chapter 7 Case.

Prior to filing this bankruptcy, the Appellants had been in a chapter 13 case in which they received a discharge.[2] A 13; A 17, P 17, Ln 10-25 - P 18, Ln 1-7; A 17, P 77, Ln 9-12.[3] In 2007, during the course of that case, the Appellants incurred a $315,000 debt to a creditor named Vicki Martin. A 1, P 25. The Appellants filed the instant chapter 7 case primarily to seek relief from this debt, and they claimed that Ms. Martin was threatening to "take our home." A 17, P 20, Ln 12, through P 21, Ln 18.

On June 29, 2007, while still in chapter 13, the Appellants held an elaborate Sweet 16 birthday party for their daughter at the Sacramento Grand Ballroom. A 15, Pg 84-93; A 17, P 53, Ln 21-25; A 15, P 84, Ln 3-22. It was filmed and televised as part of MTV's reality show "My Super Sweet 16," and cost approximately $26,000.00. A 15, P 84, Ln 23, through Pg 85, Ln 7; A 17, P 54, Ln 1-6; A 15, P 84, Ln 23, through P 85, Ln 9. The Appellants paid for the party with: (1) a $10,000 advance on a loan received from a person named Peter Slater, which loan had been acquired in order to pay off the Appellants' chapter 13 plan, and was secured by a second deed of trust on the Appellants' home. A 15, Pg 93, Ln 3-22; (2) a few thousand dollars from the Appellants' business; (3) some commissions Mr. Andrews had received; and (4) $4,000-5,000 received from his brother. A 15, Pg 94, Ln 21, through Pg 95, Ln 20.

When they filed their chapter 7 bankruptcy case on July 2, 2008 [A 1, P 1], Valerie Andrews had been employed for over 23 years as an auditor for the State of California,

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[2] Although the issue on appeal in this case is a denial of discharge under 11 U.S.C. § 727(a)(4)(A), the fact that the Appellants had received a chapter 13 discharge within six years of the filing of their chapter 7 bankruptcy case was another reason that they were not entitled to chapter 7 relief. See 11 U.S.C. § 727(a)(9) (denying discharge under certain conditions to serial bankruptcy filers who have received chapter 13 relief within six years of filing under chapter 7).

[3] Per the naming convention utilized herein: "A" refers to the United States Trustee's Appendix, consisting of Exhibits 1-15 which were admitted into evidence at trial [See the Trial Transcript, P 10, L 10-11], plus Exhibit 16 [the United States Trustee's Trial Brief], and Exhibit 17 [the Trial Transcript]; the number "1" means Exhibit 1; "P 1" means Page 1.

Department of Water Resources. A 17, P 76, Ln 9-12. She had a bachelor's degree in business administration. A 17, P 76, Ln 6-8. Rodney Andrews had worked over the years in various real estate-related and construction-related businesses. A 17, P 13-16.

At the time of filing, the Appellants owned and operated a sole proprietorship called "Andrews Investment Group." A 17, P 35, Ln 14-19; A 17, P 38, Ln 22, through P 39, Ln 1; A 17, P 83, Ln 10-20; A 15, P 28, Ln 10-12; A 15, P 30, Ln 14-19. It had been started in 2007 under the name "Rod Andrews & Associates" and it had been engaged in the business of generating construction and refinance leads. A 17, P 14, Ln 18 - P 15, Ln 14. In 2007, Rod Andrews & Associates had generated gross income of $82,667. A 11, Pg 4, Part 1, Ln 1; A 17, Pg 88, Ln 15-24. At some point the name Rod Andrews & Associates was changed to "Andrews Investment Group," or more fully, "Andrews Investment Group Mortgage Specialists." A 17, P 15, Ln 7-11. As of the bankruptcy, the company was engaged in generating loan modifications and loans. A 15, P 28, Ln 10-18. Although Valerie worked for the State, she also spent some time on weekends helping her husband in the Andrews Investment Group business. A 17, P 76, Ln 24, through Pg 77, Ln 1.

Just five months before bankruptcy, Valerie Andrews executed a 36-month lease on a business premises for "Andrews Investment Group." A 9; A 17, P 84, Ln 23, through P 85, Ln 8. The lease was still in existence when the bankruptcy was filed. A 17, P 85, Ln 1-4.

The Appellants had also owned and operated a construction company named "Skyline Construction" from about 1989 to 2005 or 2006, prior to the bankruptcy. A 17, P 13, Ln 10-12; A 1, Pg 76, Ln 18-22.

As of the bankruptcy filing, the Appellants had three bank accounts:

(1) an account in Valerie Andrews' name, ending in 2994, into which her pay checks

from the State of California were deposited (*"Valerie's pay check account"*). A 5; A 17, P 78, Ln 19, through P 79, Ln 3.

(2) an account in the name of Andrews Investment Group Mortgage Specialists, ending in 8368 (*"Andrews Investment Group account"*), which had been opened on May 15, 2008. A 6; A 17 , P 79, Ln 4-10; A 6, Pg 2.

(3) another account in Valerie Andrews' name, ending in 9504 (*"Valerie's second account"*), which had been opened on June 10, 2005. A 7; A 17, P 79, Ln 4-13.

All three accounts were in Valerie Andrews' name and she had the sole signature authority over them, because her husband Rodney had trouble opening bank accounts in his own name due to bounced checks. A 17, P 79, Ln 17-21; A 17, P 31 Ln 1-20.

During the six months prior to the filing of the bankruptcy, $24,146 was deposited into the Andrews Investment Group account and $15,000 was deposited into Valerie's second account. A 3, P 1; A 17, P 106, Ln 5-9. This money was not attributable to Valerie's salary or inter-account transfers among the three accounts; it was additional income from outside sources. A 17, P 99, Ln 2, through P 100, Ln 4; A 17, P 105, Ln 21-24.

During the month in which the bankruptcy was filed (July, 2008), $8,596 was deposited into the Andrews Investment Group account and $4,389.07 was deposited into Valerie's second account. A 3, P 2; A 17, P 107, Ln 14-24. In comparison, $4,789 was deposited into Valerie's pay check account. A 3, P 2; A 17, P 108, Ln 1-3.

The total gross income received by the Appellants from all sources in the six months preceding the month in which the bankruptcy was filed (i.e., January through June of 2008) was at least $76,897.73. A 4, P 1; A 17, P 108, Ln 4 - P 109, Ln 25.

B. The Appellants' Schedules, Statement of Financial Affairs, and Means Test.

The picture painted by the Appellants in their Petition, Schedules, Statement of Financial Affairs, and Means Test, all of which were signed under penalty of perjury, was not that of a couple who spent $26,000 on a televised birthday party for their teenage daughter and operated an income-producing loan-modification business in addition to receiving a salary from the State. Rather, the picture was that of a State-worker wife and her unemployed husband.[4]

On their chapter 7 Petition, the Appellants failed to list their prior chapter 13 case, in which they had just recently received a discharge. A 1, Pg 2.[5]

The Appellants listed only one of their three bank accounts on Schedule B – Valerie's pay check account. A 1, Pg 13, Item 2. They failed to list the Andrews Investment Group account or Valerie's second account, despite the fact that $39,146 had gone into those two accounts during the two months before bankruptcy. A 3, Pg 1. Almost $13,000.00 more was deposited into those accounts during the month the Appellants filed for chapter 7 relief. A 3, Pg 2.

The Appellants nowhere revealed that they owned an active, income-producing business, "Andrews Investment Group." On Schedule B at Item 13, where they should have listed this sole proprietorship, they answered "None." A 1, Pg 14, Item 13. On the Statement of Financial Affairs at Item 18a, which asks for businesses in which they had an interest within the last six years, they also answered "None." A 1, Pg 38, Item 18a. On Schedule G, which asks for unexpired leases, instead of listing the 36-month commercial lease Valerie Andrews had recently entered into for the purpose of providing a business premises for Andrews Investment Group, they checked the box indicating that they had no leases. A 1, Pg 27.

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[4] The initially filed documents are at A1, and a subsequent amendment is at A2.

[5] This failure to disclose was not only a material omission, the Andrews' serial bankruptcy filing was also, as noted above, another reason to deny discharge, pursuant to 11 U.S.C. § 727(a)(9). This appeal concerns only section 727(a)(4)(A), however.

The Appellants did not reveal in the Statement of Financial Affairs at Item 18a that during the previous six years they had owned and operated a construction company named "Skyline Construction."

On the Means Test,[6] the Appellants listed only Valerie Andrews' salary from the State. A1, Pg 49, Ln 3. In fact, more than $39,000.00 had been deposited into the Andrews Investment Group account and Valerie Andrews' second account during that period. A 3, Pg 1. Moreover, additional amounts, other than the payments from the State, had been deposited into Valerie's pay check account. A 4.

Consistent with this false picture of their income, the Appellants showed Rodney Andrews' current income on Schedule I as "0.00." A 1, Pg 29, Ln 1. The Appellants stated at the bottom of Schedule I at Line 17, "Debtor [Mr. Andrews] is self employed, but he claims he has not made any income for this year of 2008." A 1, Pg 29, Ln 17. In truth, as shown by the bank statements for the two unscheduled accounts, money was flowing in immediately before and after the bankruptcy was filed. A 6 and A 7; A 3. Likewise, the Statement of Financial Affairs, Item 1, asserted that Rodney Andrews' year-to-date gross income in 2008 was "0.00." A 1, Pg 33, Item 1. In fact, as already noted, thousands of dollars had been deposited into the undisclosed Andrews Investment Group account. A 3; A 6. Item 1 also asserted that, in 2007, Rodney Andrews' gross income had been only $30,000. A 1, Pg 33, Item 1. In fact, Rodney Andrews had received gross income of $82,667 from the operation of Rod Andrews & Associates, per Schedule C of his 2007 Federal Income Tax return. A 11, Pg 4, Part 1, Ln 1; A 17, Pg 88, Ln

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[6] The "Means Test" refers to Bankruptcy Form 22A. With exceptions not relevant here, individual chapter 7 debtors are required to file a statement of monthly income that helps the bankruptcy court determine whether the case should be dismissed as an abuse of the provisions of chapter 7. See 11 U.S.C. § 707(b); Fed. R. Bankr. P. 1007(b)(4).

15-24.

Overall, the bankruptcy papers concealed the Appellants' involvement, both past and present, in their various businesses, most notably Andrews Investment Group, and the cash flow generated therefrom. Yet as far as the casual observer could tell, the case involved merely a long-time state worker and her unemployed husband.

C. The 341 Meeting.

Even a month after filing their chapter 7 petition, the Andrews were perpetuating an inaccurate picture of their financial circumstances via testimony under oath at the First Meeting of Creditors ("the 341 meeting"). A 14.

The questioning started with the chapter 7 trustee establishing the Appellants' familiarity with, and agreement with, the content of their bankruptcy papers:

TRUSTEE ACEITUNO: . . . Now, did you both sign the bankruptcy petition and the schedules that were filed in the case?

MS. ANDREWS: Yes.

MR. ANDREWS: Yes.

TRUSTEE ACEITUNO: And did you read the petition and the schedules before you signed them?

MR. ANDREWS: Yes.

MS. ANDREWS: Yes.

TRUSTEE ACEITUNO: And are you personally familiar with everything that's in your petition and schedules?

MS. ANDREWS: Yes.

MR. ANDREWS: Yes.

TRUSTEE ACEITUNO: To the best of your knowledge is everything in your petition an schedules true and correct?

MS. ANDREWS: Yes.

MR. ANDREWS: Yes.

TRUSTEE ACEITUNO: All right. Do you have any changes or corrections to bring up at this time?

MS. ANDREWS: No.

MR. ANDREWS: No.

A 14, Pg 3, Ln 14, through Pg 4, Ln 10.

When the trustee asked Rodney Andrews "What kind of work do you do?," Mr. Andrews answered "I was in the mortgage business" (past tense). The trustee then asked "Are you no longer working at all?" Rodney Andrews answered "Not now I'm not working at all." The trustee followed up by asking "Have you had any gross income during 2008?," to which Mr. Andrews untruthfully answered " – the first month, January.". . . "Probably about 9,000." A 14, Pg 6, Ln 8-18.

No mention of the thousands of dollars which had been deposited into the unscheduled Andrews Investment Group account and Valerie Andrews' second account. No mention of the recently leased business premises in which Andrews Investment Group was currently operating. And a needless lie about having received income in January of 2008. Mr. Andrews had undergone a serious eye surgery on December 21, 2007, and did not work for approximately the first four months of 2008, as evidenced by the lack of deposits into the unscheduled accounts during that time and by his later testimony. A 3, Pg 1; A 15, Pg 38, Ln 14, through Pg 39, Ln13.

Creditor Vicki Martin's attorney, Helen Liu, was at the 341 meeting and asked questions of the Appellants. In answering both her questions and those of the chapter 7 trustee, the Appellants continued to cover up their true financial situation and their business operations. Ms. Liu asked Rodney Andrews whether he currently held any checking accounts other than the Downey savings account listed in the petition (Valerie's pay check account). Mr. Andrews answered, "No, I don't." Valerie Andrews did not contradict him or say anything about the two unscheduled accounts. A 14, Pg 7, Ln 13-19.

Then Ms. Liu asked if he had had any checking accounts in the last five years other than the one listed on the petition (Valerie's pay check account). Mr. Andrews answered "Yes," but he limited his answer to an account they had previously held at Wells Fargo Bank. Again, no mention of the two unscheduled Downey Savings and Loan accounts. Again, no contradiction by Valerie Andrews. A 14, Pg 7, Ln 19, through Pg 8, Ln 10.

Ms. Liu asked Rodney Andrews whether he owned a computer. He answered "Two at my office." A 14, Pg 9, Ln 12. Alerted thereby to the existence of an office, the trustee asked "Where is your office located?" Mr. Andrews answered "It's – well we're moving out. We got kicked out. We're at 1004 J Street. That's where we were." A 14, Pg 9, Ln 13-17. He failed to mention that they had a new office space, recently leased from Zoe Treaster, at 7321 Stockton Blvd. A 9.

The trustee asked "What's the business name?" Mr. Andrews answered "Andrews Investment." A 14, Pg 9, Ln 18-19. The trustee asked when he had stopped operating Andrews Investment. Mr. Andrews responded, "Well, we still have the company. We're just not doing any business. Nobody's doing mortgages." A 14, Pg 9, Ln 20-24.

The trustee pointed out that the business was not listed on Schedule B or the Statement of

Financial Affairs. A 14, Pg 9, Ln 25 - Pg 10, Ln 3. An "Unidentified Speaker," believed to be the Andrews' then-attorney, Steele Lanphier,[7] asked "How long has it been closed?" Mr. Andrews testified ". . . - - about since January." A 14, Pg 10, Ln 6-7.

When the trustee asked whether Mr. Andrews had operated any other businesses during the past six years, he said he had worked as an employee of "SM1 [sic] Mortgage" but didn't own it. A 14, Pg 10, Ln 17-24. He did not mention having owned and operated "Skyline Construction."

Ms. Liu embarked upon a series of questions regarding the televised Sweet 16 party, including asking how much the Andrews had spent on the party. Mr. Andrews testified, "We didn't spend anything. It was gifts from family members." A 14, Pg 19, Ln 10-13. He later retreated from this position. A 15, Page 94, through Pg 95, Ln 20.

D. The Rule 2004 Examination.

Having received a letter of complaint from Vicki Martin's attorney, the United States Trustee began independently to investigate the matter. The United States Trustee then subpoenaed the Appellants for a Rule 2004 Examination (a deposition-like interview), requiring that they produce various documents. A 15, Exh. A and B. The Examination was held on December 8, 2008. The Andrews testified, accompanied by their attorney Steele Lanphier. A 15.

The United States Trustee had asked for documents on all financial accounts the Andrews had held during the 2 1/2 years before filing for chapter 7 bankruptcy. A 15, Exh. A and B, document requests # 3-4. Among the documents produced were some which alerted the United States Trustee, for the first time, to the existence of the previously concealed Andrews

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[7] The Appellants were represented by Steele Lanphier in the bankruptcy case in chief, by Julius Engel in the Adversary Proceeding and trial, and are now represented by Steven Royston in the appeal.

Investment Group account. However, these documents related only to the period of time from the filing of bankruptcy forward. When asked why the United States Trustee had not been given documents from before the bankruptcy, both Appellants testified that it was because the account had been opened on July 1, 2008, just one day before the bankruptcy was filed. A 15, Pg 44, Ln 8-21. The complete bank records later revealed that the account had been opened on May 15, 2008 (pre-bankruptcy). A 6, Pg 2.

The Appellants failed to produce any documents relating to Valerie's second account which had not been listed in the bankruptcy. The United States Trustee independently discovered the existence of this account by noticing inter-account transfers on computer printouts relating to Valerie's pay check account. During the 2004 Examination, the United States Trustee asked the Appellants whether there had been any money in Valerie's second account on the day they filed bankruptcy. Valerie Andrews testified "No" . . . "Maybe $12. Not very much." A 15, Pg 46, Ln 23, through Pg 47, Ln 3. In fact, on July 2, 2008, the date of filing, that account had a balance of $2,149.17. A 7 Pg 28. Upon obtaining the records on Valerie's second account, the United States Trustee determined that the account had been opened on June 10, 2005. A 7, Pg 6.

Under questioning by the United States Trustee, the Andrews "came clean" about Andrews Investment Group, admitting that it still exists and is operating from premises located at 7321 Stockton Blvd. A15, Pg 28, Ln 10-18, and Pg 30, Ln 14-19. The United States Trustee had previously become aware of Valerie Andrews' lease of the business premises on Stockton Blvd. from a motion and declaration filed in the case by the landlord, Zoe Treaster. A 8. In response to the Rule 2004 subpoena, the Andrews furnished a copy of the lease to the UST. A 9. Valerie Andrews testified that she had leased the premises so they could operate their business, Andrews Investment Group. A 15, P 71, Ln 2-5.

Both Rodney and Valerie Andrews admitted that their gross income in 2007 from the business "Rod Andrews & Associates" (the former name of Andrews Investment Group) had been $82,667, as shown on their 2007 tax return, and not $30,000, as shown on their Statement of Financial Affairs. A 15, Pg 82, Ln 2-19; A 11, Pg 4.

The document requests in the United States Trustee's subpoena sought very specific Sweet 16 party-related documents. A 15, Exh A and B. The Andrews supplied birthday party-related documents and finally admitted that, with the exception of $4,000 to $5,000, they had picked up the tab for the $26,000 party. A 15, Pg 93, Ln 3-22; A 15, Pg 94, Ln 21, through Pg 95, Ln 20.

E. The Trial.

The United States Trustee filed a complaint for denial of the Appellants' discharge under 11 U.S.C. § 727 on March 4, 2009, based on the errors and omissions in the Appellants' bankruptcy papers and in their sworn testimony during the 341 meeting and Rule 2004 examination. Trial on the matter was held on March 9, 2010. A 17.

Rodney Andrews testified at trial that he had never seen his bankruptcy papers before. He claimed that the paperwork had been prepared over the phone with someone in their attorney's office, and that he and Valerie had later gone into the office to sign the documents. He claimed that his attorney (Steele Lanphier) had never given them copies of the bankruptcy papers. A 17, Pg 18, Ln 19, through Pg 19, Ln 25; Pg 65, Ln25, through Pg 66, Ln 13; Pg 72, Ln 20-21; Pg 73, Ln 14-16; Pg. 74, Ln 5-7. This directly contradicted the couple's recognition of, and acknowledged familiarity with, the bankruptcy papers during their 341 meeting. A 14, Pg 3, Ln 14, through Pg 4, Ln 10.

Mr. Andrews also claimed a lack of knowledge regarding the Andrews Investment account and Valerie's second account, saying "You'll have to ask her [Valerie] about that, because she took – because I don't know. I don't know." A 17, Pg 25, Ln 2-13. Those two accounts had been discussed at length during the Rule 2004 examination. A 15, Pg 43-46. Eventually, Mr. Andrews admitted that he knew about the accounts. A 15, Pg 31, Ln 2-20; A 15, Pg 33, Ln 11-14.

Mr. Andrews also admitted that at the time the bankruptcy was filed he owned and operated Andrews Investment Group, and he blamed his attorney, Steele Lanphier, for not having included the business in the bankruptcy papers. A 17, Pg 35, Ln 14-19. He testified that he had told the attorney they had a business. A 17, Pg 38, Ln 25, through Pg 39, Ln 1. He also blamed the attorney for not listing the 36-month lease with Zoe Treaster on Schedule G. A 17, Pg 42, Ln 12-24.

When asked if he recognized their 2007 Federal Income Tax return (A 11), Mr. Andrews testified: "No, I don't. My wife prepares them." A 17, Pg 48, Ln 3-6. He had admitted to recognizing the tax return and to its accuracy during the 2004 Examination. A 15, Pg 82, Ln 12-16. After this initial denial at trial, he finally agreed that his gross income had been $82,657 as shown on the tax return. A 17, Pg 48, Ln 16-25.

When asked about the Sweet 16 party, Mr. Andrews would only admit to having spent about $5,000 of their money on it. A 17, Pg 54, Ln 15, through Pg 55, Ln 23. Eventually, however, he admitted that he and his wife had paid for most of the party, except for about $5,000. A 17, Pg 56, Ln 24, through Pg 57, Ln 10. And yet, on cross-examination by his attorney, he reverted to asserting that they had spent only $5,000. A 17, Pg 58, Ln 8-13.

When Valerie Andrews took the stand, she, too, denied ever having seen the bankruptcy papers. A 17, Pg 77, Ln 13-18. But after having her recollection refreshed by her testimony at the Rule 2004 Examination, she ultimately admitted that she had seen the paperwork before. A 17, Pg 77, Ln 19, through Pg 78, Ln 1. When asked whether she read the documents before she signed them, she admitted, “Very briefly. But yes.” A 17, Pg 78, Ln 12-14.

She also admitted that when the couple filed bankruptcy, the unlisted Andrews Investment Group account and Valerie’s second account were still open. A 17, Pg 79, Ln 4-20. She agreed that the 36-month lease was still in existence on the day the case was filed, and that it had been entered into for the purpose of providing a business premises for Andrews Investment Group. A 17, Pg 85, Ln 1-8.

In connection with discussing the Means Test (A 1, Pg 49-50), a form on which the Appellants claimed that Rodney Andrews had had zero income during the six months prior to filing, the United States Trustee’s questions regarding whether Valerie Andrews knew the difference between gross income and net income were met with objections by her counsel. A 17, Pg 85, Ln 9, through Pg 86, Ln12. The Court responded: “If she’s a bookkeeper, she would know the difference between gross and net income. Being an auditor, she should be in a higher status than a bookkeeper.” A 17, Pg 86, Ln 13-16.

Valerie Andrews admitted that she had prepared the couple’s 2007 tax return, and that Rodney’s gross income of $82,667, as shown on the return, was correct. A 17, Pg 88, Ln 15-24.

The United States Trustee’s Bankruptcy Analyst, Teresa Field, testified regarding the funds which had been deposited into the two undisclosed bank accounts, as summarized by the charts at A 3 and A 4. Not only were the accounts not revealed on the bankruptcy papers, but the money received and deposited into them was also not revealed as income. A 17, Pg 105, Ln 21-25. Instead of receiving income of $33,701.34 during the six months prior to filing, as shown on the bankruptcy papers, the Andrews actually received gross income of $76,897.73. A 17, Pg 109, Ln 19-25.

In rebuttal, Rodney Andrews asserted that many of the funds in the unlisted Andrews Investment Group account had been held in trust for another company and were not his. A 17, Pg 114, Ln 3, through Pg 116, Ln 8. However, no evidence was provided to substantiate that assertion, and the deposited checks bore no indication that they were trust funds. A 17, Pg 119, Ln 13-15; A 6.

F. **The Bankruptcy Court's Ruling.**

The bankruptcy court ruled in favor of the United States Trustee, and denied the Appellants' discharge under 11 U.S.C. § 727(a)(4)(A).

The bankruptcy court opined that, although he had found the Appellants to be honest and forthcoming, (A 17, P 126, Ln 23; P 127, Ln 3), the United States Trustee had presented an overwhelming number of mistakes and omissions, many of which were material. A 17, P 127, Ln 7-8. The court rejected the Appellants' defense of not having read the schedules, saying "The law is, that you just can't bury your head in the sand." A 17, P 127, Ln 14-18. The court stated that certainly people with the background of the Appellants would recognize that it is important to actually read the documents when signing under penalty of perjury. A 17, P 127, Ln 25, through P 128, Ln 1-4. The court was troubled by the fact that the Appellants had failed to amend their schedules to correct the errors in them, despite having had the right to do so and sufficient time. A17, P 128, Ln 8-12.

The court stated that he did not know whether the Appellants' first bankruptcy attorney (Mr. Lanphier) had given them improper advice as they had alleged. A 17, P 128, Ln 15-16. The court noted, however, that the Appellants could have called that attorney or his staff as witnesses to find out what had transpired, but the Appellants had not done so. A 17, P 128, Ln 17-20.

The court referenced an Eighth Circuit case[8] in which failure to read the schedules had been found to be a reckless indifference to the truth, and in turn, fraudulent intent. The court opined that he guessed that the difference there was that actual fraudulent intent may not have necessarily been present.[9] A 17, P 129, Ln 1-7.

Although favorably impressed by the Appellants' demeanor at trial, the court concluded "But darn it. The debtor knowingly and fraudulently, or in connection with the case, made false oaths or accounts. And then you have the cases that say not reading the Schedules is not a defense to that provision to cover." A 17, P 129, Ln 17-23.

The court denied the Appellants' discharge under section 727(a)(4)(A). A 17, P 129, Ln 24-25, through A 17, P130, Ln 1.

VII. ARGUMENT

A. The purpose and application of 11 U.S.C. § 727(a)(4)(A).

"The fundamental purpose of § 727(a)(4)(A) is to insure that the trustee and creditors have accurate information without having to conduct costly investigations." Fogal Legware of Switzerland, Inc. v. Wills (In re Wills) 243 B.R. 58, 63 (9th Cir. BAP 1999) (citation omitted).

There are three elements to a section 727(a)(4)(A) determination: (1) debtor made such a

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[8] The UST believes the reference was to a case cited in the UST's trial brief , Jordan v. Bren (In re Bren), 303 (B.R. 610, 614(8th Cir. BAP 2004).

[9] Under the controlling 9th Circuit case of Khalil v. Developers Sur. & Indem. Co. (In re Khalil), 578 F.3d 1167(9th Cir. 2009), which affirmed the 9th Circuit BAP's decision in Khalil v. Developers Sur. & Indem. Co. (In re Khalil), 379 B.R. 163 (9th Cir. BAP 2007), recklessness can be probative of fraudulent intent, and reckless indifference to the truth can be combined with other circumstantial evidence to prove fraudulent intent, but recklessness alone is insufficient to prove fraudulent intent. See also Retz v. Samson (In re Retz), 606 F.3d 1189, 1199 (9th Cir., 2010).

false statement or omission, (2) regarding a material fact, and (3) did so knowingly and fraudulently. In re Khalil, 379 B.R. at 172.

1. False statement or omission.

A false oath need not be an oral oath. A false statement or an omission in the debtor's bankruptcy schedules or statement of financial affairs can constitute a false oath. In re Khalil, 379 B.R. at 172. See also In re Wills, 243 B.R. at 62.

2. Involving a material fact.

The debtor's false statement or omission must involve a material fact. A fact is material if it bears a relationship to the debtor's business transactions or estate, or concerns the discovery of assets, business dealings, or the existence and disposition of the debtor's property. In re Khalil, 379 B.R. at 173, citing In re Wills, 243 B.R. at 62 (citations omitted).

A false statement or omission may be material even if it does not cause direct financial prejudice to creditors. In re Wills, 243 B.R. at 63; In re Hoblitzell, 223 B.R. 211, 215-16 (Bankr. E.D. Cal. 1998). An omitted asset may ultimately be found to have no value, but its disclosure is necessary "if it aids in understanding the debtor's financial affairs and transactions." Garcia v. Coombs (In re Coombs) 193 B.R. 557, 564 (Bankr. S.D.Cal. 1996).

3. Made knowingly and fraudulently.

The debtor must have "knowingly and fraudulently" made a false oath or account. A debtor acts "knowingly" if he or she acts deliberately and consciously. In re Khalil, 379 B.R. at 173, citing Roberts v. Erhard (In re Roberts), 331 B.R. 976, 883 (9th Cir. BAP), aff'd 241 Fed.Appx. 420 (9th Cir. 2005). A debtor acts "fraudulently" if he or she: (1) made the representations; (2) at the time, knew they were false; and (3) made them with the intention and purpose of deceiving the creditors. In re Khalil, 379 B.R. at 173; In re Roberts, 331 B.R. at 884 (citations omitted).

Although mere recklessness alone is not equivalent to "knowing" under the statute, In re Roberts, 331 B.R. at 884, recklessness can be probative of fraudulent intent, In re Khalil, 379 B.R. at 173. Intent usually must be proven by circumstantial evidence or inferences drawn from the debtor's course of conduct. In re Khalil, 379 B.R. at 174; Retz v. Samson (In re Retz), 606 F.3d 1189, 1199 (9th Cir., 2010) (requisite intent found from significant number of omissions and errors, large monetary value of omitted transfers, debtor's failure to read schedules and Statement of Financial Affairs before signing them, and debtor's failure to amend the documents to correct the errors). See, e.g., In re Searles, 317 B.R. at 377 (evidence supported "factual inference" that debtor "intended to list a sum below the trustee's radar screen"); In re Roberts, 331 B.R. at 884 (fraudulent intent "may be established by inferences drawn from [debtor's] course of conduct"); In re Wills, 243 B.R. at 64 (same).

A court may find the requisite intent where there has been a pattern of falsity or from a debtor's reckless indifference to or disregard of the truth. Coombs, 193 B.R. at 564; Wills, 243 B.R. at 64. As stated in Coombs:

> The essential point is that there must be something about the adduced facts and circumstances which suggest that the debtor intended to defraud creditors or the estate. For instance, multiple omissions of material assets or information may well support an *inference of fraud* if the nature of the assets or transactions suggests that the debtor was aware of them at the time of preparing schedules and that there was something about the assets or transactions which, because of their size or nature, a debtor might want to conceal.

Coombs, 193 at 565 (emphasis added) (cited in In re Khalil, 379 B.R. at 174).

The advice of counsel is not a defense when the erroneous information should have been evident to the debtor. In re Retz, 606 F.3d at 1199 (quoting Boroff v. Tull (In re Tully), 818

F.2d 106, 111 (1st Cir. 1987)). "A debtor cannot, merely by playing ostrich and burying his head deeply enough in the sand, disclaim all responsibility for statements which he has made under oath." Id.

As discussed below, under these legal standards, the bankruptcy court did not clearly err in finding that the Appellants were not entitled to a discharge.

B. The bankruptcy court did not clearly err in denying the Appellants' discharge under 11 U.S.C. § 727(a)(4)(A).

Each element of section 727(a)(4)(A) was present in this case.

1. The bankruptcy court did not clearly err in finding that the Appellants made false oaths and omissions in the course of their bankruptcy case.

It is not disputed that there were numerous errors and omissions in the Appellants' bankruptcy papers and in their sworn testimony at the 341 meeting, 2004 examination, and even at trial, as described above. Most notably, there were no references whatsoever to the business, Andrews Investment Group, no mention of the income received from its operations, and no mention of the two bank accounts into which the business income and other income unrelated to Valerie Andrews' job with the State were deposited. Mr. Andrews falsely testified at the 341 meeting that the business had ceased operations and that the Appellants had no bank accounts when they filed, other than the one listed on Schedule B.

2. The bankruptcy court did not clearly err in finding that the Appellants' false oaths and omissions involved material facts.

The Appellants' falsehoods and omissions bore a relationship to the Appellants' business, Andrews Investment Group, to the income from that business and other sources, to the bank accounts into which that income was deposited, to the existence of a prior business, and to the expenditure of approximately $21,000 for a $26,000 Sweet 16 party at a time when the

Appellants owed Vicki Martin $315,000. As such, the falsehoods and omissions bore a relationship to the debtor's business transactions or estate or the existence and disposition of the debtor's property, and the omission harmed creditors. Accordingly, the falsehoods and omissions were material. In re Khalil, 379 B.R. at 173, citing In re Wills, 243 B.R. at 62-63 (citations omitted)

3. The bankruptcy court did not clearly err in finding that the Appellants made the false oaths knowingly and fraudulently.

"[O]missions of several significant assets and disclosures of significant transfers, which reveal a pattern, are willful and knowing admissions and therefore warrant a denial of discharge." In re Slater, 318 B.R. 881, 888 (Bankr. M.D. Fla. 2004). In this case, the sheer number of inaccuracies in the bankruptcy papers makes it impossible to conclude that those inaccuracies derived from innocent mistake, misunderstanding, or inadvertence. That the omissions primarily related to Mr. Andrews' business, Andrews Investment Group, also supports the inference that the Andrews intended the chapter 7 trustee and creditors not to find out about the business and the income generated from it. A bankruptcy court does not clearly err — and the court below did not clearly err — by finding that an omission can be a false oath under 11 U.S.C. § 727(a)(4)(A). In re Roberts, 331 B.R. 876 at 882-83.

Valerie Andrews had signed a three-year lease of the business premises just five months prior to filing the bankruptcy. During the six months prior to the filing of the bankruptcy, $24,146 was deposited into the Andrews Investment Group account and $15,000 was deposited into Valerie's second account. A 3, P 1; A 17, P 106, Ln 5-9. These were not remote events. They had to have been fresh in the minds of the Appellants at the time their bankruptcy was prepared and filed.

Also of significance, as noted by the bankruptcy court in its ruling, at no time did the Appellants amend their bankruptcy paperwork to correct their numerous errors and omissions, despite having had the right and the opportunity to do so. This, too, is evidence of fraudulent intent. See In re Retz, 606 F.3d at 1199 (requisite intent found from, among other things, the debtor's failure to amend the documents to correct the errors).

Moreover, rather than "coming clean" to their chapter 7 trustee immediately after the case was filed, the Appellants continued to tell a variety of falsehoods under oath at their 341 meeting, the Rule 2004 Examination, and even at trial, as described above. The truth, when it finally came out, came out begrudgingly and piecemeal.

The Appellants' defense of not having read the bankruptcy papers before signing them and of having relied on their prior attorney (A 17, Pg 78, Ln 12-14) is not well taken. Valerie Andrews ultimately admitted that she had read the papers before signing. A 17, Pg 78, Ln 12-14. Rodney Andrews' continued insistence that he had never seen the paperwork before is, at a minimum, evidence of a reckless indifference to the truth or falsity of his statements made under penalty of perjury, which in turn, is evidence of fraudulent intent when viewed in the context of all of the other circumstances. In re Retz, 606 F.3d at 1199 (requisite intent found from, among other things, debtor's failure to read schedules and Statement of Financial Affairs before signing them).

Thus, based upon the record of this case, the bankruptcy court did not clearly err when it denied the Appellants a discharge under 11 U.S.C. § 727(a)(4)(A).

C. The Appellants' request for Rule 60(b) relief is misplaced because requests for relief under Rule 60(b) must be presented to the rendering court, not the appellate court.

In their opening brief, the Appellants argue that this Court should grant them relief under

Federal Rule of Civil Procedure 60(b)(6). But Rule 60(b) motions[10] must be directed in the first instance to the trial court. First Beverages, Inc. of Las Vegas v. Royal Crown Cola Co., 612 F.2d 1164, 1172 (9th Cir. 1980). See Board of Trustees, Sheet Metal Workers' Nat'l Pension Fund v. Elite Erectors, Inc., 212 F.3d 1031, 1034 (7th Cir. 2000) (requests for modification of a judgment under Rule 60(b) must be presented to the rendering court); 11 C. Wright & A. Miller, Federal Practice and Procedure § 2865 (1973) (discussing that relief under Rule 60(b) ordinarily is obtained by motion in the court that rendered the judgment).

Rule 60(b) complements the discretionary power that bankruptcy courts have as courts of equity "to reconsider, modify or vacate their previous orders so long as no intervening rights have become vested in reliance on the orders." In re International Fibercom, Inc., 503 F.3d 933, 940 (9th Cir. 2007) (citing In re Lenox, 902 F.2d 737, 740 (9th Cir. 1990)). The Appellants could have presented a Rule 60(b) motion to the bankruptcy court following entry of the adverse judgment, but did not. Rule 60(b) is not a rule under which one obtains appellate relief. The appellate court's role as to Rule 60(b) motions is limited to reviewing the propriety of the trial court's decision on the motion. First Beverages, Inc. of Las Vegas, 612 F.2d at 1172.

The two cases cited by the Appellants in their brief bear this out. Community Dental Services v. Tani, 282 F.3d 1164 (9th Cir. 2002) was the circuit court's review of the propriety of the trial court's (district court's) denial of a Rule 60(b) motion. AB, Pg 10, Ln 20-26. The same is true of Latshaw v. Trainer Wortham & Co., 452 F.3d 1097 (9th Cir. 2006). AB, Pg 11, Ln 3-6. The Rule 60(b) motions had been brought in the first instance in the trial court.

Accordingly, the Appellants' request for Rule 60(b)(6) relief in this Court, which is

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[10] The Appellants have not filed a formal motion, but the gravamen of their appellate brief is that of a Rule 60(b) motion.

sitting in its appellate capacity, should be denied.

D. **The Appellants' assertions that they are entitled to reversal because the bankruptcy court found that their lawyer was negligent are incorrect and unsupported by the record.**

Appellants' sole argument on appeal is that they are entitled to reversal because — according to their characterization of the record — the bankruptcy judge sua sponte found that their bankruptcy attorney was grossly negligent. The record does not bear out this assertion.[11]

The Appellants' "Statement of Issue on Appeal" says that Judge Russell clearly and candidly accused and acknowledged "on the transcript of record" that: Attorney Steele Lanphier, who had represented the Appellants in the bankruptcy case in chief but not in the adversary proceeding, had committed acts of gross negligence in their representation; the Appellants had recourse against Mr. Lanphier; his acts had directly resulted in injury to the Appellants; and the Appellants had no reason to know about or protect themselves against that gross negligence. Appellants' Brief (hereinafter "AB"), Pg 2-3.

There were no such finding by Judge Russell. What Judge Russell said about Mr. Lanphier in the course of rendering his findings of fact and conclusions of law was: "***Now, it could be that the debtors were not getting proper advice. I don't know.*** But as Ms. Hotze points out, again, you could have called Mr. Lanphier, you could have called the clerk or tried to find out who the person was that interviewed you over the phone, and what was said and not said. But it wasn't done. It wasn't done." A 17, Pg 128, Ln 15-21 [Emphasis added]. Judge Russell further said, "And if you got bad advice, I'm sure Mr. Engel can explain to you that there are

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[11] In addition, Appellant's brief includes some clerical errors that might be confusing to a reviewing court. Judge David Russell is referred to as "Judge Thomas Russell." Attorney Steele Lanphier is sometimes referred to as "Steele Lamphier,""Steele Lamphire," and "Mr Steele." Attorney Julius Engel is referred to as "Jewel Eagle."

other potential rights." The bankruptcy court made no findings of wrongdoing by Mr. Lanphier.

The Appellants' "Statement of the Case and Statement of Facts" states that ". . . Judge Russell noted with extraordinary candor from the bench that the Appellants had been 'plowed down the road' by their 'representation' by Mr. Steele. Among numerous shortcomings he noted that day, schedules had not been filed and those which were in need of amending which Mr. Lamphier did not have the Appellants do with his input." AB, Pg 7, Ln 3-8. This statement is a distortion of what was actually said by the bankruptcy court. While Judge Russell did, in fact, admonish the Appellants for not having amended their erroneous schedules, he did not blame this shortcoming on Mr. Lanphier. He stated: "And what I don't – and what troubles me here, and that there were several times when corrective action could have been taken. Debtors always have the right to amend schedules. And there was time for them to amend schedules, to correct the errors that were in there. But it wasn't done. There were no amendments filed that I could see in the proceedings. We just went plowing ahead." A 17, Pg 128, Ln 6-14.

The Appellants' "Statement of the Case and Statement of Facts" also erroneously asserts that "The court found no fault in the Appellants conduct in trusting and relying on Mr. Lamphier, and said in essence the Appellants had been 'thrown under the bus' by their counsel." AB, Pg 7, Ln 13-15. In reality, the court said, "But to file documents, sure, you're going to rely on your attorney. But to file documents that are essentially very misleading, full of misstatements and omissions is improper. It's wrong." A 17, Pg 129, Ln 8-11. The United States Trustee's closing argument included the assertion that the Appellants were attempting to defend themselves by throwing Mr. Lanphier under the bus, to which the court opined generally that "Sometimes attorneys deserve to be thrown under the bus." A 17, Pg 121, Ln 10-15. Again, the bankruptcy court made no findings of wrongdoing by Mr. Lanphier.

The above-referenced inaccuracies are essentially repeated in the Appellants' "Argument and Conclusion." AB, Pg 8-10. This Court should not be swayed by these inaccurate characterizations of the record.

VIII. CONCLUSION

The bankruptcy court did not clearly err in denying the Appellants' discharge under 11 U.S.C. § 727(a)(4)(A). The Appellants are not entitled to seek Rule 60(b) relief from the appellate court. And the bankruptcy court did not find that the Appellants' false oaths and omissions were due to the negligence of their attorney. For these reasons, the United States Trustee respectfully asks this Court to affirm the judgment of the bankruptcy court denying the Appellants' discharge pursuant to 11 U.S.C. § 727(a)(4)(A).

Respectfully submitted,

Dated: September 10, 2010

Judith C. Hotze
Counsel for August B. Landis,
Acting United States Trustee, Region 17
Direct Phone: (916) 930-2087
E-mail: judy.c.hotze@usdoj.gov

Of Counsel:

Ramona D. Elliott
General Counsel

P. Matthew Sutko
Associate General Counsel

Anne W. Stukes
Trial Attorney

Executive Office for United States Trustees
20 Massachusetts Ave., NW
Room 8100
Washington, DC 20530
(202) 307-1399

CERTIFICATE OF SERVICE

I certify that on September 10, 2010, a true and correct copy of the **Brief of Appellee, August B. Landis, Acting United States Trustee** was served by Federal Express, pre-paid and by ECF upon all persons having filed notices of appearance in the Court's ECF database:

Steven A. Royston
Law Offices of Steven A. Royston
7321 Stockton Blvd.
Sacramento, CA 95823

Dated: September 10, 2010

By: ______________________
Susan Wolny
Office of the U.S. Trustee
501 "I" Street, Suite 7-500
Sacramento, CA 95814

ADDENDUM

1. 11 U.S.C. § 727(a)(4)(A).
2. 28 U.S.C. § 157
3. 28 U.S.C. § 158

BRIEF BANK — 'SUMMARY SHEET" *Printed Wed-6/29/05 9:40*

WESTLAW CODES

1. **("TI")** *TITLE* OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	Schwartz (UTS) v. Aquatic Dev. Group
2. **("CO")** *CURRENT* COURT *[E.g., "CTA9"]*	CTA2
3. **("CCN")** *CURRENT* CASE NO.	No.: 02-5059
4. **("PCN")** *PRIOR* CASE NO. & COURT *[IF ANY]*	No.: Court: DC ND NY *(Identify judge & cite, if any)*
5. **("SO")** *SOURCE*	U.S. TRUSTEES
6. **("DA")** *DATE* OF FILING *& TYPE* OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	Filed: April 7, 2003 Type: Appellant's Brief (UST)
7. **("AU")** *PRINCIPAL AUTHORS & OFFICE [E.g.,"UST/OGC"]*	Paul Bridenhagen, Esq.- UST/OGC Eric Miller, Esq.-Civil Div. Appellate Staff *(UST/OGC: 202-307-1399/FAX-2397)*
8. **("TO")** *TOPIC*	BANKRUPTCY
9. **("SU")** ● *SUMMARY* OF KEY ISSUE(s) & √ Any Miscellaneous *BACKGROUND*	● Whether the bankruptcy court erred in entering a retroactive decree closing a case in order to allow the debtor to avoid paying fees to the United States Trustee expressly required by statue, 28 U.S.C. § 1930(a)(6). √ Background:
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Title (TI): In re AQUATIC DEVELOPMENT GROUP, INC., CAROLYN S. SCHWARTZ v. AQUATIC DEVELOPMENT GROUP, INC. (Gov't/Appellant)

Court (CO): CTA2

Current-Case (CCN): 02-5059

Source (SO): Northern District of New York

Date-of-Filing (DA): April 7, 2003

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02-5059

IN THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT
In re AQUATIC DEVELOPMENT GROUP, INC., Debtor.
CAROLYN S. SCHWARTZ, Appellant,
v.
AQUATIC DEVELOPMENT GROUP, INC. Appellee.
ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF NEW YORK
BRIEF FOR APPELLANT

ROBERT D. McCALLUM, JR.

Assistant Attorney General

GLENN T. SUDDABY

United States Attorney

ROBERT M. LOEB

(202) 514-4332

ERIC D. MILLER

(202) 514-2754

Attorneys, Appellate Staff

Civil Division, Room 9131

U.S. Department of Justice

601 "D" Street, N.W.

Washington, D.C.20530-0001

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***2** In re Jamko, Inc., 240 F.3d 1312 (11th Cir. 2001)

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No. 02-5059

IN THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT
In re AQUATIC DEVELOPMENT GROUP, INC., Debtor.
CAROLYN S. SCHWARTZ, Appellant,
v.
AQUATIC DEVELOPMENT GROUP, INC. Appellee.
ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF

NEW YORK
BRIEF FOR APPELLANT

PRELIMINARY STATEMENT

Neither the opinion of the district court (Scullin, J.) nor that of the bankruptcy court (Littlefield, J.) is reported.

STATEMENT OF JURISDICTION

The bankruptcy court had jurisdiction under 28 U.S.C. §§ 157(b) and 1334. After that court entered a final order on December 21, 2000, appellant filed a timely notice of appeal to the district court. See Appendix ("App.") 38. The district court had jurisdiction over the appeal under 28 U.S.C. § 158(a), and it entered a final judgment on July 30, 2002. See App. 42. A notice of appeal was filed on September 20, 2002, see App. 150, so the appeal is timely under Fed. R. App. P. 4(a)(1)(B). This Court has jurisdiction under 28 U.S.C. §§ 158(d) and 1291.

STATEMENT OF THE ISSUE PRESENTED FOR REVIEW

Whether the bankruptcy court erred in entering a retroactive decree closing a case in order to allow the debtor to avoid paying fees to the United States Trustee expressly required by statute, 28 U.S.C. § 1930(a)(6).

STATEMENT OF THE CASE

***3** Appellee Aquatic Development Group, Inc., and several affiliated debtors (collectively, "Aquatic") filed petitions under Chapter 11 of the Bankruptcy Code. The bankruptcy court consolidated the cases, and in February 1996, it confirmed a reorganization plan. During the pendency of the case, appellant United States Trustee sent quarterly bills to Aquatic under 28 U.S.C. § 1930(a)(6), which provides that debtors must pay a fee to the United States Trustee "for each quarter... until the case is converted or dismissed." Aquatic paid only some of the bills. In September 1999, the United States Trustee asked the bankruptcy court for an order compelling Aquatic to pay its overdue fees. Instead, the bankruptcy court granted Aquatic's motion to declare the case closed as of December 1996, and it relieved Aquatic of the obligation to pay fees incurred after that date. On appeal, the district court affirmed the bankruptcy court's ruling. The United States Trustee now appeals that ruling to this Court.

STATEMENT OF FACTS

A. Statutory Background

This case involves the statutory obligation of debtors in Chapter 11 bankruptcy proceedings to pay quarterly fees to the United States Trustee. See 28 U.S.C. § 1930(a)(6). The United States Trustee is an official of the Executive Branch of the federal government and is responsible for "protecting the public interest and ensuring that bankruptcy cases are conducted according to the law." H.R. Rep. No. 95-595, at 109 (1978), reprinted in 1978 U.S.C.C.A.N. 5963, 6070. United States Trustees are authorized by statute to perform specific duties that include, among other things, "supervis[ing] the administration of cases" in chapter 11 proceedings. 28 U.S.C. § 586(a)(3). [FN1]

Fees paid by debtors are a significant source of revenue to the United States Trustee system. Congress has provided:

> In addition to the filing fee paid to the clerk, a quarterly fee shall be paid to the United States trustee, for deposit in the Treasury, in each case under chapter 11 of title 11 for each quarter (including any fraction thereof) until the case is converted or dismissed, whichever occurs first.

28 U.S.C. § 1930(a)(6).

This statute was amended by Congress in January 1996. See Pub. L. No. 104- 99, § 211, 110 Stat. 26, 37-38 (1996), amending Pub. L. No. 104-91, § 101(a), 110 Stat. 7, 11 (1996), enacting into law H.R. Conf. Rep. No. 104- 378, at 17 (1995). Under the old version of the statute, debtors were obliged to pay fees "until a plan is confirmed or the case is converted or dismissed." 28 U.S.C. § 1930(a)(6) (1994) (emphasis added). In January 1996, Congress deleted the first part of this clause, so the current statute continues the obligation to pay "until the case is converted or dismissed." 28 U.S.C. § 1930(a)(6) (2000). In other words, a debtor must continue to pay fees even after a reorganization plan is confirmed.

In September 1996, Congress enacted an additional provision to clarify the meaning and effect of the January 1996 amendment. The clarifying legislation provided that, "notwithstanding any other provision of law, the fees under 28 U.S.C. 1930(a)(6) shall accrue and be payable from and after January 27, 1996, in all cases (including, without limitation, any cases pending as of that date), regardless of confirmation status of their plans." Pub. L. No. 104- 208, § 109(d), 110 Stat. 3009, 3009-19 (1996).

B. Facts and Prior Proceedings

***4** 1. In 1995, Aquatic Development Group, Inc., and several related entities filed voluntary bankruptcy petitions under Chapter 11 of the Bankruptcy Code. See App. 119. Shortly thereafter, Aquatic filed a reorganization plan, and in February 1996, the bankruptcy court confirmed the reorganization plan. See App. 44-70. Under the terms of the plan, Aquatic was required, among other things, to issue stock in the name of the unsecured creditors and to then redeem that stock either by a stream of payments tied to its after-tax profits, or by a lump-sum payment. See App. 48-49. The plan provided that the bankruptcy court would retain jurisdiction "until there is substantial consummation of the plan," App. 53, and the order confirming the plan stated that "substantial consummation" would be achieved "only when all payments to the holders of general unsecured claims under the plan have been made," App. 59-60. Aquatic did not begin making cash payments until 1999. See App. 77.

The confirmation order also directed, in conformity with 28 U.S.C. § 1930(a)(6), that Aquatic pay all fees owed to the United States Trustee within ten days. See App. 70. And it required that, on an ongoing basis, "all fees due to the Office of the United States Trustee shall be timely paid." App. 59. In February 1996, the United States Trustee mailed notices to all debtors in pending bankruptcy cases -- including Aquatic -- to inform them of the statutory change of the previous month. See App. 74. The notices stated: "Effective January 27, 1996, all cases with confirmed reorganization plans which are pending before the Bankruptcy Court will be required to make quarterly fee payments based on disbursements until the case is converted to another chapter of the Code, dismissed by the Court, or closed by Court order." App. 86.

In June 1996, the United States Trustee sent Aquatic a bill for $11,000 for fees due since the inception of the case. See App. 75. Aquatic paid the bill, and its attorney stated, "I understand there will be some additional fees." Ibid. Thereafter, the United States Trustee sent Aquatic a bill every quarter, but Aquatic made only two more fee payments, the last of which was in November 1996. See App. 76, 79.

In September 1999, the United States Trustee sought an order directing Aquatic to pay its overdue fees, which totaled about $110,000. See App. 30. In response, Aquatic asked the bankruptcy court to rule that the reorganization plan was substantially consummated on December 5, 1996, and to enter an order retroactively closing the case as of that date, thus relieving it of the obligation to pay the fees that were subsequently incurred. See App. 31.

2. In December 2000, the bankruptcy court entered a closure order that was retroactive to December 1996. See App. 118-133. It began with the premise that "a bankruptcy court, as a court of equity, has an inescapable duty to ensure fundamental fairness." App. 124. In the court's view, Aquatic's motion was appropriately evaluated under the framework of In re Keren Ltd. Partnership, 189 F.3d 86 (2d Cir. 1999). Ibid. The bankruptcy court observed that in that case, this Court stated: "Nunc pro tunc approval should only be granted in narrow situations and requires that (i) if the application had been timely, the court would have authorized the [relief], and (ii) the delay in seeking court approval resulted from extraordinary circumstances." Keren, 189 F.2d at 87. The bankruptcy court concluded that both of these requirements were satisfied.

***5** The bankruptcy court determined that it would have entered a final decree had it been asked to do so in December 1996. Even though an adversary proceeding was pending at the time, the court concluded that it could have terminated the case while retaining jurisdiction over that proceeding. See App. 125. The court rejected the argument that the plan and the confirmation order defined "substantial consummation" to require payments to the holders of general unsecured claims, and that cash payments were not completed until January 2000. It noted that in August 1996, Aquatic had transferred stock intended for the unsecured creditors to its attorney. See App. 126-127. In the court's view, the debtor's attorney was acting as the agent for the unsecured creditors, so the transfer of stock satisfied the payment requirement. Because "[a]ll but one of the factors necessary for the final decree" had been met by December 1996, the bankruptcy court concluded that it would have entered a final decree at that time if it had been asked to do so. See App. 128.

Next, the court concluded that Aquatic's failure to seek a final decree in 1996 was due to extraordinary circumstances, which included "the prolonged nature of this plan; and the timing of the amendment of 28 U.S.C. § 1930; the consequences of that change; and the failure of the parties to adequately monitor the progress of this case." App. 129. Specifically, the court determined that payment of fees to the

United States Trustee would not be equitable and would not "serve the Code's underlying purpose of providing deserving debtors a fresh start" -- especially since the continued accumulation of fees had not been possible under the version of the statute in effect at the time the plan was filed. App. 130. In addition, it found that Aquatic's failure to respond to the bills it received from the United States Trustee was excusable because the United States Trustee "did not contact the Debtor for payment of the fees." App. 131. Accordingly, the bankruptcy court held that a retroactive decree was appropriate, with the effect that Aquatic was not required to pay the accrued fees.

3. The United States Trustee appealed to the district court. See 28 U.S.C. § 158(a)(1); App. 38. The district court affirmed, giving essentially the same reasons as the bankruptcy court. See App. 134-149. The United States Trustee filed a timely notice of appeal to this Court. See App. 150.

SUMMARY OF ARGUMENT

The bankruptcy court entered a retroactive closure order to relieve Aquatic from its obligation to pay statutorily mandated fees to the United States Trustee. This action was improper for several independent reasons.

Most fundamentally, the equitable powers of a bankruptcy court, like those of any court, are limited by the requirements of statutes. Title 28 U.S.C. § 1930(a)(6) specifies that Chapter 11 debtors must pay quarterly fees to the United States Trustee even after a reorganization plan has been confirmed. And a subsequent statute made clear that this provision applies even to cases that were pending when it was enacted. Because of this clear statutory command, the bankruptcy court lacked the authority to enter a order enabling Aquatic to avoid paying these fees.

***6** Even if the bankruptcy court did have discretion to enter a retroactive closure order, that discretion was abused. Retroactive relief is appropriate only when extraordinary circumstances prevented a timely application, and when a timely application would have been granted by the court. Here, neither condition is satisfied. There is nothing extraordinary about the fees in this case, which are simply those prescribed by statute. They continued to accrue only because of Aquatic's lack of diligence in seeking to have the case closed. Simple inadvertence or oversight is not an extraordinary circumstance. In addition, a timely application for closure could not have been granted by the bankruptcy court. The order approving Aquatic's reorganization plan specified that the case could only be closed once payments had been made to the unsecured creditors in accordance with the plan, and those payments had not yet been made. Moreover, closure would have left the bankruptcy court without jurisdiction to issue the many orders it entered during the pendency of the case.

STANDARD OF REVIEW

"When it is acting as an appellate court in a bankruptcy case, a district court's rulings are subject to plenary review." In re Bean, 252 F.3d 113, 116 (2d Cir. 2001). This Court therefore reviews the bankruptcy court's legal conclusions de novo. See ibid.

ARGUMENT

I. The Bankruptcy Court Lacked Discretion to Enter a Retroactive Closure Order to Allow Aquatic to Avoid its Obligation to Pay Fees to the United States Trustee.

A. The bankruptcy court erred when it determined that it had discretion to enter an order relieving Aquatic from its statutory obligation to pay fees to the United States Trustee. As a general matter, a bankruptcy court is a court of equity with broad powers to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of" the bankruptcy code. 11 U.S.C. § 105(a); see In re Ionosphere Clubs, Inc., 85 F.3d 992, 999 (2d Cir. 1996). But a bankruptcy court may not use its equitable powers to contravene the requirements of a statute: this Court has held that "[t]he equitable powers emanating from § 105(a)... are not a license for a court to disregard the clear language and meaning of the bankruptcy statutes and rules." In re Barbieri, 199 F.3d 616, 620-621 (2d Cir. 1999), quoting Official Comm. of Equity Sec. Holders v. Mabey, 832 F.2d 299, 302 (4th Cir. 1987); see also Raleigh v. Illinois Dep't of Revenue, 530 U.S. 15, 24-25 (2000) ("Bankruptcy courts are not authorized in the name of equity to make wholesale substitution of underlying law controlling the validity of creditors' entitlements, but are limited to what the Bankruptcy Code itself provides").

As the Supreme Court has explained, "a court sitting in equity cannot 'ignore the judgment of Congress, deliberately expressed in legislation."' United States v. Oakland Cannabis Buyers' Cooperative, 532 U.S. 483, 497 (2001), quoting Virginian Ry. Co. v. Railway Employees, 300 U.S. 515, 551 (1937); see also Miller v. French, 530 U.S. 327, 338 (2000) (Courts may not "exercise their equitable discretion" to "contradict [a statute's] plain terms"). If Congress has "decided the order of priorities in a given area, it is... for the courts to enforce them when enforcement is sought." TVA v. Hill, 437 U.S. 153, 194 (1978).

***7** In this case, Congress has directly addressed the question of when the United States Trustee may collect fees from debtors. Under the statute, "a quarterly fee shall be paid... until the case is converted or dismissed." 28 U.S.C. § 1930(a)(6) (emphasis added). This statute is written in mandatory terms ("shall be paid"), and it leaves the bankruptcy court with no discretion to decide that fees should stop at any point before the case is "converted or dismissed." [FN2] Indeed, the entire purpose of the January 1996 amendment was to eliminate the possibility of an earlier cutoff to fees, by removing the phrase "a plan is confirmed or" before the phrase "the case is converted or dismissed." See Pub. L. No. 104-99, § 211, 110 Stat. 26, 37-38 (1996), amending Pub. L. No. 104-91, § 101(a), 110 Stat. 7, 11 (1996), enacting into law H.R. Conf. Rep. No. 104-378, at 17 (1995).

Nor is there any ambiguity about how the statute should apply to cases, like this one, that were pending when it was amended. Congress addressed that issue in September 1996 when it provided that, "notwithstanding any other provision of law, the fees under § 1930(a)(6) shall accrue and be payable from and after January 27, 1996, in all cases (including, without limitation, any cases pending as of that date), regardless of confirmation status of their plans." Pub. L. No. 104-208, § 109(d), 110 Stat. 3009, 3009-19 (1996) (emphasis added). Under this statute, fees continue to accrue in all cases pending as of January 1996.

Although the bankruptcy court relied on its power "as a court of equity... to ensure fundamental fairness," App. 124, it exceeded the scope of its discretion. Under 28 U.S.C. § 1930(a)(6), Aquatic incurred fees every quarter between December 1996 and December 2000, because the case had not yet been closed. The bankruptcy court used the legal fiction of retroactive closure to relieve Aquatic from this explicit statutory obligation. Because its order nullified the effect of the statute, it was improper.

B. The bankruptcy court based its decision on In re Keren Limited Partnership, 189 F.3d 86 (2d Cir. 1999), aff'g 225 B.R. 303 (S.D.N.Y. 1998). Its reliance on that case was misplaced. In Keren, the debtor had retained a brokerage firm without seeking the court's permission as required by 11 U.S.C. § 327(a). See 189 F.3d at 87-88; 225 B.R. at 305-306. The brokerage firm subsequently sought nunc pro tunc approval of its retention, in order to allow it to be paid for its services under 11 U.S.C. § 503(b). See ibid. The bankruptcy court denied the motion, and the district court affirmed. See 225 B.R. at 306-307. This Court affirmed, noting that nunc pro tunc approval "should only be granted in narrow situations." 189 F.3d at 87.

Keren does not support the decision below, for two reasons. First, the case considered the limited issue of the appointment of a professional. See 189 F.3d at 87. Although the Court stated that a bankruptcy court has discretion to make a retroactive appointment, it did not establish the broad proposition that bankruptcy courts may enter retroactive orders whenever they deem retroactivity to be equitable. Second, Keren arose in a very different statutory context. The Court in Keren relied on the First Circuit's decision in In re Jarvis, 53 F.3d 416 (1st Cir. 1995). In Jarvis, as in Keren, the court considered whether retroactive approval of the retention of a professional was permissible under § 327(a). See Jarvis, 53 F.3d at 419. The First Circuit concluded that the issue was essentially one of statutory construction, and that § 327(a) was ambiguous. It noted that "[s]ection 327(a) neither expressly sanctions nor expressly forbids the post facto authorization of outside professional services." Ibid. It therefore concluded that retroactive approval of the retention of professionals was permissible under limited, extraordinary circumstances.

***8** Unlike § 327(a), section 1930(a)(6) contains no ambiguity. It clearly expresses the congressional mandate that quarterly fees be paid in all cases, irrespective of plan consummation or confirmation status. Indeed, as noted above, Congress enacted clarifying legislation providing that fees would accrue in all pending cases "notwithstanding any other provision of law." Pub. L. No. 104-208, § 109(d), 110 Stat. 3009, 3009-19 (1996). The use of the phrase "notwithstanding any other provision of law" demonstrates the desire of Congress that this provision prevail in any conflict with another statutory provision.

This case was open in every quarter between December 1996 and December 2000, and no exercise of equitable discretion can alter that historical fact. Section 1930(a) therefore requires that the debtor pay a fee for each of those quarters, and the bankruptcy court's equitable authority under § 105(a) may not be used to circumvent the clearly expressed will of Congress.

II. Even If the Bankruptcy Court Did Have Discretion to Enter a Retroactive Closure Order, That Discretion Was Abused.

The retroactive closure of a case is almost unprecedented, and as we have explained, it is wholly inappropriate when done for the sole purpose of excusing a debtor from paying a valid, statutorily mandated fee. Nevertheless, even assuming that the bankruptcy court had discretion to enter a retroactive order closing the case and relieving Aquatic of its obligation to pay fees, it abused its discretion in doing so. The bankruptcy court applied the framework of In re Keren and concluded that it could enter a retroactive order so long as (1) the order would have been granted had a timely motion been made and (2) the failure to make a timely motion resulted from extraordinary circumstances. As noted, Keren dealt with an entirely different issue, and it does not justify retroactive relief here. But in any event, neither of the two conditions identified in Keren is satisfied in this case.

A. Aquatic's Failure to Seek Closure in December 1996 Was Not the Result of "Extraordinary Circumstances."

The bankruptcy court identified several features of this case that, in its view, constituted extraordinary circumstances justifying Aquatic's failure to make a timely motion for closure of the case in 1996. None withstands scrutiny. Instead, even assuming that retroactive relief was within the power of the bankruptcy court, no aspect of this case made that unusual remedy appropriate.

The bankruptcy court believed that "unique provisions" of Aquatic's reorganization plan "led to the case being open post-confirmation for several years." App. 129. But the case remained open for several years only because Aquatic failed to take the actions necessary to close the case in a timely manner. [FN3] Those, of course, are the very omissions that the bankruptcy court sought to excuse. That fact that the case remained open for a long time therefore cannot be an "extraordinary circumstance," or else retroactive relief would always be appropriate when a case remains open for an extended period of time due to the fault of the debtor. Moreover, the fact that the case was in a "post-confirmation" status cannot be a basis for relief. To the contrary, Congress expressly provided that fees would accrue in all pending cases, "regardless of confirmation status of their plans." Pub. L. No. 104-208, § 109(d), 110 Stat. 3009, 3009-19 (1996).

***9** The bankruptcy court also emphasized its view that the fees incurred by Aquatic were very large, indeed "staggering," and it observed that no fees would have been required under the statute in effect at the time the reorganization plan was confirmed. App. 130. But both of these factors were expressly considered by Congress. The amount of the United States Trustee's fees are fixed by a schedule set out in 28 U.S.C. § 1930(a)(6); over the course of this case, the quarterly fees owed by Aquatic ranged from $5,000 to $10,000, see App. 117. Likewise, Congress specifically chose to make the new statute apply to pending cases, so that fees would accrue after plan confirmation, even though such a result might not have been anticipated at the time the plan was adopted. See Pub. L. No. 104-208, § 109(d), 110 Stat. 3009, 3009-19 (1996). Since these factors were the direct result of the statute, there was nothing "extraordinary" about them.

Finally, the bankruptcy court noted that, although the United States Trustee sent quarterly bills to Aquatic, it did not "contact the Debtor for payment" or "monitor the case in any other manner." App. 131. The bankruptcy court's reasoning in this regard was wrong for two reasons. First, the amendment to § 1930(a)(6) did not impose on the United States Trustee an obligation to monitor plan consummation, nor does anything in the statute link the debtor's obligation to pay fees to the amount of effort expended by the United States Trustee in a given case. See In re Jamko, Inc., 240 F.3d 1312, 1316 n.6 (11th Cir. 2001) (recognizing that fees are not tied to the post-confirmation activity of the United States Trustee).

Second, if Aquatic wanted to avoid paying fees, it had the burden of taking timely action. Aquatic was on notice that it was continuing to accrue liability to the United States Trustee. Aquatic was fully informed of its obligation to pay: it was sent a notice of the statutory change, and it also was sent a bill every quarter. See App. 74, 79. Even the bankruptcy court acknowledged that Aquatic "should have reacted to these billings in some manner." App. 131. If Aquatic believed that the bills were in error, it should have taken some action to correct the error. One who ignores three years of quarterly bills from the federal government should not later be able to complain that it was ignorant of its accruing obligation. Aquatic's failure to act for three years does not support "extraordinary" equitable relief from its obligation to pay the United States Trustee. See Jarvis, 53 F.3d at 421 ("[I]f the category of extraordinary circumstances were expanded to include mere oversight, the modifying adjective 'extraordinary' would be completely stripped of its meaning"); see also In re Land, 943 F.2d 1265, 1268 (10th Cir. 1991) ("[s]imple neglect" is not an extraordinary circumstance); In re Arkansas Co., Inc., 798 F.2d 645, 650 (3d Cir. 1986) (Extraordinary circumstances "do not include the mere neglect of the professional who was in a position to file a timely application").

***10** As a general matter, a party must have acted with reasonable diligence in order to merit equitable relief. See Chapman v. Choicecare Long Island Term Disability Plan, 288 F.3d 506, 512 (2d Cir. 2002). In this case, Aquatic exercised no diligence during the period in which it accrued fees. It failed even to adhere to the terms of payments to unsecured creditors set out in its own plan and the court order confirming the plan. It therefore was not entitled to the extraordinary relief granted by the bankruptcy court.

B. An Order Closing the Case Would Not Have Been Appropriate in December 1996.

As we have shown, even if the case could have been closed in December 1996, it was not proper for the bankruptcy court to enter an order in December 2000 retroactively closing the case as of that date. Retroactive relief is an extraordinary remedy that is not to be granted simply because a case could have been closed earlier. But in any event, the bankruptcy court's order closing the case as of December 1996 was improper for the independent reason that, had the court been asked to close the case at that time, it could not have done so.

What the bankruptcy court did in this case was not a simple correction of an omission in the court's records -- the traditional use of the nunc pro tunc device. See, e.g., In re Singson, 41 F.3d 316, 318 (7th Cir. 1994); cf. Wight v. Nicholson, 134 U.S. 136, 143-146 (1890). Nor was it the belated entry of an order that could have been entered at an earlier date but was not entered because of an oversight, as contemplated in Keren. Instead, it was an order whose purported retroactivity was entirely inconsistent with proceedings that occurred in the case during the four years after the order's supposed entry. The retroactive closure order was therefore improper, both because the conditions for closure specified in the reorganization plan and the confirmation order had not been satisfied by the time of the purported closure, and because unresolved issues remained in the case as of that time.

1. Under Bankruptcy Rule 3022, the bankruptcy court "shall enter a final decree closing" a Chapter 11 reorganization case "[a]fter an estate is fully administered." Conversely, "[i]f the plan or confirmation order provides that the case shall remain open until a certain date or event because of the likelihood that the court's jurisdiction may be required for specific purposes prior thereto, the case should remain open until that date or event." Fed. R. Bankr. P. 3022, Advisory Committee Note (1991). In this case, the plan provided that the court "shall retain jurisdiction... until there is substantial consummation of the Plan." App. 53. And the confirmation order defined "substantial consummation" as occurring "only when all payments to be made to the holders of general unsecured claims under the Plan have been made." App. 60. As of December 1996, Aquatic had not made these payments.

***11** The reorganization plan prescribed, in considerable detail, the method by which payment would take place. On the effective date of the plan, unsecured creditors were to "receive a new issue of preferred stock in the reorganized debtor with a face value of $1,500,000.00." App. 48. Thereafter, the stock was to be redeemed by annual payments equal to twenty percent of Aquatic's after-tax income. See ibid. Accordingly, the payments were to "continue until such time as [Aquatic] has redeemed all of the [preferred] stock issued in satisfaction" of the unsecured creditors' claims. See App. 48-49. At "any time prior to the final payment for redemption," the debtor could choose to redeem the remaining stock by a lump-sum cash payment. App. 49. With some modifications, these provisions were restated in the confirmation order. See App. 62-63.

Aquatic had not taken these steps by December 1996. Instead, Aquatic had simply issued stock to its attorney, whom the bankruptcy court believed was "acting as the agent for the unsecured creditors." App. 126; see also App. 104 (stock certificate in the name of Aquatic's attorneys "as escrow agent for the Aquatic Development Group, Inc. official committee of unsecured creditors"). Relying on the definition of "payment" in Black's Law Dictionary, the bankruptcy court concluded that this issuance of stock constituted payment to the creditors. See App. 127. But while it may have been "payment" in some abstract sense, it did not constitute "all payments... under the Plan," as required by the confirmation order. App. 60. Nor is there any indication in the record that Aquatic's attorney had the power to consent, on behalf of the creditors, to a payment scheme other than that specified in the reorganization plan. To be sure, a bankruptcy court normally is entitled to some deference in the interpretation of its own order. See In re Casse, 198 F.3d 327, 333 (2d Cir. 1999). But here the court simply disregarded the detailed payment requirements set out in its order, so its interpretation does not deserve deference.

2. Closure as of December 1996 was also inappropriate because of its effect on the bankruptcy court's ongoing exercise of its jurisdiction. A retroactive closure of a bankruptcy case is virtually unprecedented -- so far as we are aware, there is no case, other than In re Jr. Food Mart of Arkansas, Inc., 201 B.R. 522 (Bankr. E.D. Ark. 1996), in which a bankruptcy court has closed an entire case retroactively. But during much of the time it was open, the Jr. Food Mart case was stayed in order to allow a state court case to proceed. See id. at 525-26. Therefore there were no

legal or factual matters resolved by the bankruptcy court while the case was pending that might have been affected by a retroactive closure.

In contrast, this case was pending for four years after December 1996, and legal proceedings continued during that period. In particular, two adversary proceedings were pending, and they were not dismissed until March 1997 and January 2000. See App. 30, 34-35. Also pending as of December 1996 were motions to determine unsecured claims and for turnover of property, as well as a motion for administrative expenses. These motions were not resolved by the court until March 1997. See App. 30. In addition, the bankruptcy court adjudicated attorney's fee applications in early 2000. See App. 37-38. All of the orders issued after the closure of the case were issued when the bankruptcy court no longer had jurisdiction. The ongoing proceedings demonstrate that the case was not actually closed in December 1996, and indeed that it could not have been closed until much later. The bankruptcy court's order purporting to close the case as of that date was therefore improper.

CONCLUSION

***12** The judgment of the district court should be reversed.

Respectfully submitted,

ROBERT D. McCALLUM, JR.

Assistant Attorney General

GLENN T. SUDDABY

United States Attorney

ROBERT M. LOEB

(202) 514-4332

ERIC D. MILLER

(202) 514-2754

Attorneys, Appellate Staff

Civil Division, Room 9131

U.S. Department of Justice

601 "D" Street, N.W.

Washington, D.C. 20530-0001

APRIL 2003

CERTIFICATE OF COMPLIANCE WITH RULE 32(a)(7)(C) OF THE FEDERAL RULES OF

APPELLATE PROCEDURE

I certify, pursuant to Fed. R. App. P. 32(a)(7)(C), that the foregoing brief contains no more than 5,749 words, according to the count of Corel WordPerfect 9.

Eric D. Miller

CERTIFICATE OF SERVICE

I certify that on April 7, 2003, I filed and served the foregoing brief by causing ten copies to be sent by Federal Express to the Clerk of the Court, and by causing two copies to be sent by Federal Express to the following counsel:

Mr. Ralph Bandel
13 Green Mountain Drive
Cohoes, N.Y. 12057
(518) 783-0038

Eric D. Miller

FN1. Each of the 21 United States Trustees is responsible for bankruptcy proceedings within a particular region. Carolyn S. Schwartz, the appellant in this case, is the United States Trustee for Region 2, which includes New York, Connecticut, and Vermont.

FN2. Although the statute does not explicitly refer to the closure of cases, every court of appeals to consider the question has held that fees stop accruing once a case is closed. As the Tenth Circuit explained, "because a 'case' no longer exists once it is closed... the obligation to pay [United States Trustee] fees terminates upon closure, dismissal, or conversion of a Chapter 11 case." In re CF&I Fabricators of Utah, Inc., 150 F.3d 1233, 1236 (10th Cir. 1998), quoting In re A.H. Robins Co., 219 B.R. 145, 149 (Bankr. E.D. Va. 1998); see also Vergos v. Gregg's Enterps., Inc., 159 F.3d 989 (6th Cir. 1998).

FN3. In order to achieve "substantial consummation" and enable it to seek closure, Aquatic would have had to make payments under its reorganization plan to all unsecured creditors in accordance with the court's order confirming the plan. As we explain below, see infra pp. 21-23, it had not done so by 1996, and in fact it did not even begin those payments until 1999. That is an independent reason why retroactive closure was improper.

2003 WL 21297231 (2NDBRIEFS)

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Frank Xu, Esq. v. United States Trustee (In re Lihua and Manuel Arebalo)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*
E.D. N.Y.

3. ("CCN") ***CURRENT*** CASE NO.
No.: 10-02025(SJF)

4. ("PCN") ***PRIOR*** CASE NO. - & COURT *[IF ANY]*
No.: 8-09-74046-reg
Court: Bankr. E.D.N.Y.
(Identify judge & cite, if any)

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Catherine B. Sevcenko, Alfred Dimino, Christine Black, P. Matthew Sutko, Ramona D. Elliott, Tracy Hope Davis
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***
• 1) Did the bankruptcy court abuse its discretion under section 329 and 330 of the Bankruptcy Code when it awarded Mr. Xu $4,000 in fees, given that (a) chapter 13 attorneys typically receive no more than $4,500 in such cases, and (b) Mr. Xu’s legion of errors in the case led the bankruptcy court to conclude that he had “performed at an incompetent level?” 2) Did the bankruptcy court abuse its discretion when it refused to consider a motion to avoid a second mortgage lien at the hearing scheduled to decide Mr. Xu’s attorney fee award, given that the motion was facially defective and given that Mr. Xu could have separately scheduled it but never did so?

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No. 10-02025 (SJF)
THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF NEW YORK

In re

Lihua and Manuel Arebalo, Debtors. — Bankr. Case No. 8-09-74046-reg

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Frank Xu, Esq.
Appellant,
v.
United States Trustee,
Appellee.

Hon. Sandra J. Feuerstein

APPELLEE BRIEF OF UNITED STATES TRUSTEE TRACY HOPE DAVIS

Ramona D. Elliott
General Counsel

P. Matthew Sutko
Associate General Counsel

Catherine B. Sevcenko
Trial Attorney

Executive Office for United States Trustees
Department of Justice
20 Massachusetts Ave, N.W.
Washington, DC 20530
Phone: 202-307-1399
Fax: 202-307-2397

Tracy Hope Davis
United States Trustee, Region 2

Christine Black
Assistant United States Trustee

Alfred Dimino
Trial Attorney

Department of Justice
560 Federal Plaza, Suite 560
Long Island Federal Courthouse
Central Islip, NY 11722
Phone: 631-715-7800
Fax: 631-715-7777

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Statement of Appellate Jurisdiction

Bankruptcy courts have jurisdiction over all core proceedings under the Bankruptcy Code. 28 U.S.C. § 157(b)(1)-(2). The bankruptcy court's award of "reasonable" fees under sections 329 and 330 of the Bankruptcy Code is a core proceeding. 28 U.S.C. §157(b)(2)(A).

A determination of attorney fees under sections 329 and 330 is a final order. 28 U.S.C. §158(a)(1); 28 U.S.C. § 158(c)(1)(B); *see Bernheim v. Damon and Morey, LLP*, slip op., No. 06-3386-BK, 2007 WL 1858292, at *1 (2d Cir. June 28, 2007) (order); *cf. In re Stable Mews Assoc.*, 778 F.2d 121 (2d Cir. 1985) (contrasting award of interim attorney fees to final fee award and holding the former is not final).

The bankruptcy court awarded Mr. Xu fees on March 19, 2010. [Dkt. #40]. On March 29, 2010 Mr. Xu filed a timely indication of his intent to appeal. Fed. R. Bankr. P. 8002(a). On that day he filed a district court civil docket sheet in the bankruptcy court to notice his appeal. [Dkt. #43-44] The space to name the appellees was left blank. *Id.* The sheet contained only the following information (1) the debtors' names; (2) identification of Mr. Xu as their attorney; the bankruptcy case number; and the date. *Id.*

This filing did not "conform substantially" with the official bankruptcy form for noticing an appeal, as required by the bankruptcy rules. Fed. R. Bankr. P. 8001(a). However, an "appellant's failure to take any step other than timely filing a notice of appeal does not affect the validity of the appeal," although an appellate court has discretion to take appropriate action, including dismissal. *Id.*

In this case, the clerk of the bankruptcy court notified the chapter 13 trustee of Mr. Xu's appeal by mail. [Dkt. #45]. The chapter 13 trustee in turn informed the United States Trustee. Therefore, Mr. Xu's deficient notice of appeal did not prejudice the appellees, and this Court may assert jurisdiction over his appeal. *Longmire v. Guste*, 921 F.2d 620, 623 (5th Cir. 1991) (holding that failure to name appellees did not defeat jurisdiction as long as they had notice of the appeal).

Issues Presented[1]

1. Did the bankruptcy court abuse its discretion under sections 329 and 330 of the Bankruptcy Code when it awarded Mr. Xu $4,000 in fees, given that (a) chapter 13 attorneys typically receive no more than $4,500 in such cases, and (b) Mr. Xu's legion of errors in the case led the bankruptcy court to conclude that he had "performed at an incompetent level?"
2. Did the bankruptcy court abuse its discretion when it refused to consider a motion to avoid a second mortgage lien at the hearing scheduled to decide Mr. Xu's attorney fee award, given that the motion was facially defective and given that Mr. Xu could have separately scheduled it but never did so?

---

[1] Mr. Xu has also appealed the bankruptcy court's order that he return his excess fees to the trustee rather than to the debtors. This is a two-party dispute between the chapter 13 trustee and the debtors. The United States Trustee did not take a position on the issue in the bankruptcy court and does not do so here.

Statement of the Case

This is a section 329 and 330 fee award case. Appellant, Frank Xu, Esq., sought an award of more than $34,000 for representing Lihua and Manuel Arebalo in their chapter 13 case. The bankruptcy court held two hearings to determine an appropriate fee. After the second hearing on March 11, 2010, the bankruptcy court awarded Mr. Xu $4,000, even though the Court found Mr. Xu's representation had been incompetently performed.

Mr. Xu appeals to this Court on three grounds. First, he argues that the bankruptcy court abused its discretion in awarding him $4,000 rather than the $34,000 he sought. Second, he maintains the bankruptcy court misapplied 11 U.S.C. 1306 by ordering fees to be turned over to the chapter 13 trustee instead of the Arebalos.[2] Third, he claims the bankruptcy court abused its discretion when it refused to consider a motion to avoid a second mortgage lien during the fee hearing.

1. Statutory Framework

This appeal arises from a chapter 13 bankruptcy case. Under chapter 13, "a debtor commits to repay some portion of his or her financial obligations" over a

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[2] The United States Trustee questions, however, whether Mr. Xu has standing to challenge the bankruptcy court's determination that the trustee should receive the funds. In order to have standing, a litigant in bankruptcy must be a "person aggrieved." *Int'l Trade Admin. v. Rensselaer Polytechnic Institute*, 936 F.2d 744, 747 (2d Cir. 1991). A "person aggrieved" is someone who is "'directly and adversely affected pecuniarily by'" the challenged order of the bankruptcy court." *Id.* (citation omitted). Mr. Xu's interests will not be affected in any way by who receives the funds he has been ordered to return. In this case, the aggrieved party would be the debtors.

period of no more than five years. Under this scenario, the debtor retains non-exempt assets and, after completing the repayment plan, receives a discharge. *See* 11 U.S.C. §§ 1321-1330.

Under sections 329 and 330 of the Bankruptcy Code, attorneys are allowed to charge only a reasonable fee for such costs, and those federal statutes require the court determine a reasonable fee amount. 11 U.S.C. § 329 (stating a court can reduce or eliminate fees if the "compensation exceeds the reasonable value" of the services provided; 11 U.S.C. § 330(a)(4)(B) (allowing "reasonable compensation" to a debtor's attorney in a chapter 13 case).

In this chapter 13 case attorney Frank Xu provided legal counsel to Mr. and Mrs. Arebalo to obtain confirmation of a repayment plan under chapter 13. The chapter 13 trustee objected to Mr. Xu's subsequent fee request and the United States Trustee appeared at the hearing.

The United States trustees are senior officials of the Department of Justice. *See generally*, 28 U.S.C. § 581 *et. seq.* They "supervise the administration of cases and trustees" in all bankruptcy cases within his or her region through the exercise of a range of oversight responsibilities. 28 U.S.C. §586(a)(3). *See generally, Morgenstern v. Revco, D.C., Inc. (In re Revco D.S. Inc.)*, 898 F. 2d 498, 500 (6th Cir. 1990) (explaining that United States trustees oversee the bankruptcy process, protect the public interest, and ensure that bankruptcy cases are conducted according to law.). United States trustees may raise, appear, and be heard on any issue in any case or proceeding under Title 11. 11 U.S.C. § 307. Section

586(a)(3)(A)(i)-(ii) explicitly authorizes United States Trustees to object to attorney fee applications.

In assessing an attorney fee request, a bankruptcy court must conduct a two-step analysis. First it evaluates the value of the attorney's work and, in a chapter 13 case, the "benefit and necessity" of those services to the debtor. 11 U.S.C. § 329(b); 11 U.S.C. § 330(a)(4)(B). Second, it determines whether the fees the attorney seeks are reasonable in light of other factors, such as the time, reasonableness of the work, and skill of the practitioner. *Id.*

If a bankruptcy court determines that a fee request is excessive, it may reduce a requested award or cancel the agreement between a debtor and his attorney and "order the return of any such payment, to the extent [it is] excessive." 11 U.S.C. § 329(b). And under section 330(a)(4)(B) the court will issue an award of reasonable fees.

Mr. Xu is also appealing the refusal of the bankruptcy court to consider his motion to avoid a second lien on the Arebalos' home mortgage. The Rules of Federal Bankruptcy Procedure require that this action be brought by complaint. Adjudications to determine the "validity, priority, or extent of a lien or other interest in property" must be decided in the context of an adversary proceeding. Fed. R. Bankr. P. 7001(2). An adversary proceeding is commenced by serving a complaint. Fed. R. Bankr. P. 7004. It is then adjudicated under a process that incorporates extensive portions of the Federal Rules of Civil Procedure. *See, generally*, Fed. R. Bankr. P., Part VII.

2. Statement of Facts

On April 1, 2009, Lihua and Manuel Arebalo, the debtors, hired attorney Frank Xu, Esq. to handle their chapter 13 bankruptcy case. They gave him approximately $28,000 to keep in his trust account. Appx. at 78. Mr. Xu filed the chapter 13 petition on behalf of the Arebalos on June 3, 2009. Appx. at 4, Dkt. #1.

The same day the Clerk's office issued a deficiency notice because the petition Mr. Xu filed was missing a pre-petition statement. Appx. at 5 (docket statement). It lacked a summary of schedules. *Id.* It had no statistical summary of liabilities. *Id.* The schedule H was missing. *Id.* It did not include a proposed chapter 13 plan. *Id.* It did not append the Arebalos' pay stubs from the previous sixty days, as required. *Id.*

During the case, Mr. Xu made a number of other incomplete or improper filings. Specifically:

- On six separate occasions, Mr. Xu amended one or more of the Arebalos' bankruptcy schedules, statement of current monthly income, statement of financial affairs, or schedule summaries – June 23, July 30, July 31, August 2, August 11, and August 13 of 2009. Appx. at 6-10, Dkt. #s12, 13, 14, 16, 17, 18, 20, 22. He amended the Arebalos' chapter 13 repayment plan three times – August 11, August 31, September 9. Appx. at 8-12, Dkt #s19, 25, 28.
- Mr. Xu failed to notify the trustee virtually every time he filed an amended document, although the bankruptcy court court clerk informed Mr. Xu of the

notice requirement five separate times. Bankr. Local R. 1009-1(a). Appx. at 6-10, Dkt. #12, 14, 20, 21, 22.

- On or about November 13, Mr. Xu filed a motion to avoid a second lien on the Arebalos' mortgage as a "presentment," which was not allowed under the courtroom practice of the presiding judge. None of his attempts to correct the error complied with proper bankruptcy court procedure because he never filed an adversary proceeding to resolve the matter, as required by Federal Rule of Bankruptcy Procedure 7001.
- Mr Xu's first applications for attorney compensation was rejected as deficient. Appx. at 12 (docket statement).
- Mr. Xu's first amended application for attorney compensation was similarly rejected because it was deficient. Appx. at 13-14.

Mr. Xu's corrected filings cost extra filing fees, which Mr. Xu billed to the Arebalos. See Appx. at 65 (claiming 3 ECF charges).

Mr. Xu had to amend the chapter 13 plan that he prepared three times before the bankruptcy court approved it on September 18, 2009. Appx. at 29. The order provided that "no property received by the Trustee for the purpose of distribution under the Plan shall revest in the Debtor(s) except to the extent that such property may be in excess of the amount needed to pay in full all allowed claims as provided in the Plan." *Id.* It also provided that "such property as may revest in the Debtor(s) shall so revest upon the approval by the Court of the Trustee's Final Report and Account." *Id.* The confirmation order also specified that any reference in the plan to avoiding liens "is null and void" unless such an avoidance is "explicitly . . . approved by the Court." *Id.*

a. Attorney Fee Request

On October 7, 2009, Mr. Xu applied for court approval of $18,405.93 in attorney's fees, based on a half-page "Statement of Attorney Bill. Appx. at 30.

The chapter 13 trustee, Michael Macco, opposed Mr. Xu's fee request. Trustee Aff. in Opp'n at 1 (Jan. 27, 2010) (Dkt. #38) (stating that he was "thoroughly confused" by the application).

On November 13, Mr. Xu filed an amended fee request in which he asserted he charged the Arebalos a $2,000 retainer and billed them at a rate of $350 per hour. Appx. at 42. The bankruptcy court rejected it as improperly entered as a "presentment." Appx. at 13-14. Mr. Xu filed a third application on January 19, 2010. Appx. at 54, Dkt. #37.

The bankruptcy court held two hearings on Mr. Xu's attorney fee request, the first on February 8, 2010, which was continued when Mr. Xu could not produce time records and expense reports. Appx. at 14-15. The hearing resumed on March 11, at which time Mr. Xu argued that his bill was "quite modest" and "reasonable for the value of the service rendered." Appx. at 88 (fee hearing transcript).

The bankruptcy court found that the Arebalos' case was a routine chapter 13 consumer debt case. Appx. at 86 (including statement by the court that this was "not a complicated case"). The court also found that the standard fee for an "experienced practitioner"in the Eastern District of New York is $4,500. Appx. at

86-87. Mr. Xu, in contrast, sought authorization to bill the Arebalos a total of $34,650 in attorney's fees, plus $409.93 in expenses. Appx. at 64-65. At the fee hearing, Mr. Xu petitioned the court for $15,353.45 – the balance of his fees, because the Arebalos had already paid him a $2,000 retainer and $17,296.55 in legal fees. Appx. at 82-84 (fee hearing testimony), 64-65 (attorney bill). The latter payment was made without bankruptcy court approval. Appx. at 83, 89-90.

After Mr. Xu's testimony, the bankruptcy court found that Mr. Xu did not "understand the fundamentals of the bankruptcy process." Appx. at 88. It further concluded that Mr. Xu "performed at an incompetent level" and that Mr. Xu was "lucky" that the court "decided not to sanction him." Appx. at 90. In fact, Mr. Xu himself admitted to "possible procedural inexperience" in his fee application. Appx. at 33, 55.

In spite of its assessment of Mr. Xu's performance, the court authorized a $4,000 fee. Appx. at 88 (stating "you're lucky I'm giving you $4,000"). It summarily rejected Mr. Xu's argument that the $4,000 would "overrule the debtor's wishes to pay for the service rendered." *Id.* Accordingly, the court ordered Mr. Xu to return over $15,000, the amount above $4,000 that he had already been paid. *Id.* at 14-15, 17. In its order, the bankruptcy court clarified that Mr. Xu was required to return the excess to the chapter 13 trustee. Appx. at 29; *compare* Fee Hr'g tr. at 14 (Appx. at 87) (stating money should be given to the estate) *with* 15 (Appx. at 88) (stating money should go to the debtors).

b. Motion to Avoid Second Lien

Mr. Xu commingled his November, 2009 and January, 2010 fee requests with a request that the bankruptcy court avoid the lien securing the Arebalos' second mortgage. Appx. at 31, 54. The bankruptcy court refused to consider the avoidance issue at the March 11 fee hearing. Mr. Xu never sought to reassert that part of the blended motion in a separate hearing and never filed a complaint to avoid the lien under Federal Rule of Bankruptcy Procedure 7001.

The record is unclear concerning when Mr. Xu first raised the second mortgage avoidance issue. Mr. Xu states that he filed the motion dated November 11, 2009 as a "presentment," namely as an order to be signed by the judge without hearing. Xu Br. at 3 and Ex. A. But the docket sheet does not contain an entry for November 11 but does have an entry for November 13 indicating "ENTERED INCORRECTLY ADVISED ATTORNEY TO REFILE; Application for Compensation." (Emphasis in original). Appx. at 13-14. The entry also indicates that the clerk "terminated presentment on November 16, 2009." *Id.*

The case docket has no indication that Mr. Xu attempted to re-file the avoidance request either as a separate motion or as an adversary proceeding.

The lien avoidance issue was raised in Mr. Xu's second amended fee application, filed on January 19, 2010, however. Appx. at 54. *The Amended Notice of Motion for Attorney Compensation and Mortgage Lien Avoidance* requests consideration of the issue at the compensation hearing, then scheduled for February 8, 2010. *Id.* The accompanying affidavit raises the issue in paragraphs 4-7. Appx.

at 56-58. The certificate of service indicates that the Notice was served on Dennis Jose, attorney for JP Morgan Chase in Buffalo, New York. Appx. at 59. Mr. Jose represented the servicer of the Arabelos' first mortgage, which was held by Bank of America. Appx. at 10, Dkt. #24 (notice of appearance). The second lien is held by JP Morgan Chase in its own right operating out of Ohio. Appx. at 112, 115. The record does not indicate that Mr. Xu served notice on JP Morgan Chase in its capacity as second lien holder.

The bankruptcy court did not consider the lien avoidance request because the fee application was the only issue that had been calendared. Appx. at 13-15. After confirming its understanding of the purpose of the hearing with the United States Trustee, the court responded to Mr Xu: "Look, this is a fee app that's on today. I don't know what you're talking about mortgages or anything else. That's the only thing on today." Appx. at 75-76.

On March 29, 2010, Mr. Xu appealed the bankruptcy court's fee award order to this Court. Although the order did not mention the lien issue, he also appealed the bankruptcy court's refusal at the hearing to consider the Arebalos' request that their second mortgage lien be avoided.[3]

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[3] At the March 11 hearing, Mr. Xu testified about the funds that the Arebalos had placed in his client trust fund and how Mr. Xu had used the funds to pay himself and some of the debtors' other obligations. The bankruptcy court raised concerns about the propriety of Mr. Xu's actions, but that issue is not before this Court on appeal. See Appx. at 81-82.

Standard of Review

A bankruptcy court's factual findings are reviewed for clear error, and its conclusions of law are reviewed *de novo*. *Lubow Mach. Co. v. Bayshore Wire Prods. (In re Bayshore Wire Prods.)*, 209 F.3d 100, 103 (2d Cir. 2000) (citation omitted). In the Second Circuit, "[a]n abuse of discretion may consist of an error of law or a clearly erroneous finding of fact." *Jasco Tools, Inc. v. Dana Corp. (In re Dana Corp.)*, 574 F.3d 129, 145 (2d Cir. 2009) (quotation omitted). It is "basic" that a reviewing court will not overturn a fee award "absent a clear abuse of discretion." *In re Arlan's Dept. Stores, Inc.*, 615 F.2d 925, 943 (2d. Cir. 1979).

Summary of Argument

Mr. Xu sought to charge his client $34,000 for his chapter 13 work on their behalf, which is $29,500 more than the maximum amount chapter 13 attorneys in the Eastern District of New York typically receive. The bankruptcy court awarded Mr. Xu $4,000 for what it termed to be an "uncomplicated case."[4] This corresponds to the $4,000-$4,500 that bankruptcy attorneys generally receive for a chapter 13 case. The $4,000 award was not an abuse of the broad discretion this bankruptcy court had under two provisions of the Bankruptcy Code, 11 U.S.C. § 329 and 11 U.S.C. § 330(a)(4)(B), to limit Mr. Xu's fees to a "reasonable" amount.

Although the bankruptcy court awarded Mr. Xu the same fees that most chapter 13 attorneys receive under sections 329 and 330, the court could have

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[4] Appx. at 86.

reasonably awarded Mr. Xu far less. Mr. Xu made a host of mistakes in this case, as the bankruptcy court docket demonstrates. That led the bankruptcy court to find that Mr. Xu had "performed at an incompetent level."[5] That finding was supported by substantial evidence, so the court below did not abuse its discretion in awarding Mr. Xu $4,000 for his work here, pursuant to sections 329 and 330.

In addition, the bankruptcy court did not abuse its discretion when it refused to consider Mr. Xu's mortgage lien avoidance motion during the fee hearing. A bankruptcy court generally must consider the validity of a lien in response to a complaint filed to initiate an adversary proceeding. Fed. R. Bankr. P. 7001(2). Furthermore, Mr. Xu served the first, not the second, lien-holder with the notice of his motion to avoid the second lien. This error underscores Mr. Xu's "incompeten[ce]" in this case.

Even if the issue could have been properly raised by motion, the bankruptcy court scheduled the March 11 hearing only on the issue of the fee application. Like any other court, a bankruptcy court is entitled to exercise discretion over how it handles its docket. The bankruptcy court did not abuse its discretion when it refused to consider the avoidance issue during the fee hearing. If Mr. Xu seriously wanted to pursue that motion, he could have calendared it separately or asked the court to schedule another hearing. He did neither.

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[5] Appx. at 90.

Argument

I. The Bankruptcy Court Did Not Abuse its Discretion Under 11 U.S.C. § 329 and 11 U.S.C. § 330(a)(4)(B) When it Awarded Mr. Xu $4,000 in Fees.

The bankruptcy court did not abuse its discretion under 11 U.S.C. § 329 and 11 U.S.C. § 330 when it awarded Mr. Xu a typical chapter 13 fee of $4,000. Counsel bears the burden of proof to demonstrate entitlement to the requested fees, including providing documentation of time worked. *See Hensley v. Eckerhart*, 461 U.S. 424, 437 (1983). Therefore, a bankruptcy court is required to examine the nature, extent, and value of the services provided by an attorney. *Riker Danzig, Scherer, Hyland & Perretti v. Official Comm. Unsecured Creditors (In re Smart World Technologies, LLC)* , 552 F.3d 228, 232 (2d Cir. 2009). The bankruptcy court did not clearly err in finding that Mr. Xu failed to demonstrate that he deserved $34,000 in fees for a routine chapter 13 case.

In this case, the bankruptcy court did not commit clear error in finding that Mr. Xu's work in the Arebalos' case did not provide services that were of "necessity and benefit" to them. 11 U.S.C. § 329(b); 11 U.S.C. § 330(a)(3); 11 U.S.C. § 330(a)(4)(B). *See Grant v. George Schumann Tire & Battery Co.*, 908 F.2d 874, 877-78 (11th Cir. 1990) (describing criteria for fees as nature, value and extent of services rendered; difficulty of legal question; customary fees; efficiency of the representation and whether any of the services rendered were duplicative).

Here, the bankruptcy court did not clearly err in finding that Mr. Xu "performed at an incompetent level," and that therefore his $34,000 fee request was excessive. Appx. at 90. This is so for three reasons.

A. The bankruptcy court did not err under sections 329 and 330 in awarding Mr. Xu the typical fee for attorneys handling chapter 13 cases.

Attorneys in the Eastern District typically receive fees ranging from $4,000-$4,500 for chapter 13 cases.[6] Appx. at 84-85; *see e.g.*, *In re Herbert*, No. 04-86487, 2009 WL 1941978, at *1 (Bankr. E.D.N.Y. July 2, 2009) (increasing initial attorney fee of $3,000 to $4,500 for a chapter 13 case that lasted over two years and involved four proposed repayment plans).

In further comparison, the Utica Division of the Bankruptcy Court for the Northern District of New York has capped chapter 13 fees at $3,700 by administrative order. *Debtor Counsel Fees in Chapter 13 Cases Filed in the Utica Division*, Admin. Order 09-07 (Bankr. N.D.N.Y. Aug. 8, 2009), Appx. at 94. In fact, Mr. Xu's award of $4,000 is at the high end of the scale. *In re Wesseldine*, 434 B.R. 31, 40, n.9 (N.D.N.Y 2010) (citing instances of chapter 13 flat fees throughout the country, ranging from $2,000 to $4,500). In contrast, Mr. Xu seeks over $34,000 in compensation.

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[6] The Eastern District of New York Bankruptcy Court has not promulgated any local rule or administrative order regarding fees, but the $4,500 figure reflects local practice. Appx. at 84-85.

The bankruptcy court did not clearly err when it did not permit Mr. Xu to pass on the costs of educating himself about chapter 13 bankruptcy law. Mr. Xu used the Arebalos' case to educate himself about chapter 13 procedure, not an activity that the Bankruptcy Code subsidizes through a higher fee award. *See* 11 U.S.C. § 330(a)(3)(E) (citing "skill and experience in the bankruptcy field" as a factor for determining attorney compensation). Mr. Xu's high fee request stems in part from the fact that he spent far more time on the Arebalos' case than is the norm. *In re Thorn*, 192 B.R. 52, 56 (Bankr. N.D.N.Y. 1995) (assuming a simple chapter 13 case would require six hours of work); *In re Wesseldine*, 434 B.R. at 35 (26 hours). The United States Trustee attributed this to inexperience. Appx. at 84. The bankruptcy court agreed because it found that Mr. Xu did not "understand the fundamentals of the bankruptcy process." Appx. at 88; *see also* Appx. at 87 (stating that the $4,500 fee was for an "experienced practitioner").

Furthermore, in chapter 13, attorneys are compensated for services that are of "benefit and necessity" to the debtor. 11 U.S.C. § 330(a)(4)(B). Mr. Xu acknowledges that his efforts did not always benefit the Arebalos directly. He stated in his November 11 affirmation in support of fees that he "self-studied chapter 13 procedures and substantive law." Appx. at 33. He also acknowledged "possible procedural inexperience." *Id.* He repeated these admissions in his January 19 filing. *Id.* at 55.

Furthermore, Mr. Xu was required to re-file the Arebalos' schedules several times due to inaccuracies and missing documentation. In total, Mr. Xu filed 28 different documents, including multiple amendments to the petition, schedules, and repayment plans. The Arebalos did not benefit, and were more likely harmed, by the filing delays and inaccuracies in their schedules. And they were certainly harmed when Mr. Xu billed them for the additional filing fees.

The extra hours Mr. Xu spent on the case did not benefit the Arebalos, as required by the Code. Therefore the bankruptcy court did not abuse its discretion in refusing to compensate Mr. Xu for the full amount of time he spent on the case.

B. The evidence supports the bankruptcy court's finding that the Arebalos' chapter 13 case was routine and thus did not warrant exceptional compensation.

Third, the bankruptcy court did not clearly err in finding that the Arebalos' case was straight-forward and thus not eligible for exceptional compensation above the $4,500 norm. *In re Wesseldine*, 434 B.R. at 40 (stating that "debtors should not be overcharged in cases that lack the complexity or difficulty"). A typical chapter 13 case requires an attorney to handle issues such as secured debt, such as a house and automobile, a judgment liens or claims based on financing of other personal property. *Id.* at 38 (citing *In re Dabney*, 417 B.R. 826, 834 (Bankr. N.D. Ga. 2009)). Other issues commonly include pending foreclosure of the debtor's home and priority tax debt. *Id.* A chapter 13 debtor's attorney must therefore anticipate having to handle requests for stay relief, mortgage arrears work-outs, adequate protection payments for secured creditors, whether liens may be avoided, or whether cramdown is available. *Id.*

In this case, Mr. Xu faced few of these issues. One creditor, Bank of America, objected to the Arebalos' plan on August 19, 2009. Dkt #23. It withdrew that objection on September 1, 2009, after the debtors amended their plan. Dkt #27. The court entered an order confirming the plan on September 18, 2009. Dkt #29. Mr. Xu attempted to avoid a second lien on the Arebalos' mortgage by having the issue adjudicated in conjunction with his fee application. Even if this were the proper procedure, an avoidance motion does not bring the case outside of the normal chapter 13 standard. *Wesseldine*, 434 B.R. at 38. The bankruptcy court did not clearly err in concluding that the Arebalos' chapter 13 bankruptcy case was routine.

In addition, the bankruptcy court did not commit clear error in concluding that the Arebalos' case was straight-forward because Mr. Xu's billing descriptions do not indicate otherwise.[7] Mr. Xu initially filed with the court a one-page accounting of his time with block entries such as "Preparation of petition, schedules, statement of affairs; review and analysis of documents gathered on monthly budget, creditors, earnings and assets; etc. from April 1, 2009 to September 21, 2009........20 hours." Appx. at 29.

In his first amended request for fees, Mr. Xu submitted a hand-written document supporting his fee request, in which block entries were reduced from several months to "9 a.m. - 5:30 p.m. x 5 days." Appx. at 45 (assigning five days to

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[7] Mr. Xu was required to provide copies of contemporaneous billing statements that "describe with specificity, by attorney, the nature of the work done, the hours expended, and the dates on which the work was performed." *In re Bailey*, No. 08-73915, 2009 Bankr. LEXIS 4166, at *14 (Bankr. E.D.N.Y. July 14, 2009).

the description “study substantive and procedural law regarding chapter 13 bankruptcy lien avoidance and motion practice, draft affirmation in support of attorney compensation and second mortgage lien avoidance, etc.”).

In his second amended request for fees, Mr. Xu produced a table with dates, billing descriptions, and hours worked. Appx. at 60-63. His activities included “client consultation,” “preparation of petitions,” “legal research,” “section 341(a) meeting appearance,”“amended form schedules,” “plan confirmation hearing” and “telephonic and fax negotiation” with the trustee and JP Morgan Chase Bank. *Id.* None of these tasks go beyond those expected in a routine chapter 13 case. *In re Wesseldine*, 434 B.R. at 38.

The bankruptcy court did not clearly err in concluding that $4,000 – the standard rate in the Eastern District of New York – was appropriate compensation. It therefore did not abuse its discretion when it ordered Mr. Xu to disgorge the remaining $15,432.48 in fees he had already collected to the chapter 13 trustee.

II. The Bankruptcy Court Did Not Improperly Limit Mr. Xu’s Fees, Regardless of Mr. Xu’s Payment Agreement with the Arebalos.

The bankruptcy court did not commit clear error by rejecting Mr. Xu’s argument that it should honor the desire of the Arebalos to pay him $34,000 for their chapter 13 case. Mr. Xu’s argument fails for two reasons.

Mr. Xu. fundamentally misunderstands bankruptcy law. In a chapter 13 case, section 330(a)(4)(B) authorizes the court to determine the statutorily reasonable amount. Mr. Xu does not make that decision. Nor do his clients. *See*

Appx. 88-90. The court does that by evaluating the factors set forth in section 330(a)(3). Section 329 also allows the court to review and reduce fees that exceed a reasonable amount.[8]

This bankruptcy court was required to analyze Mr. Xu's fee request to determine whether his requested payment was reasonable, rather than simply comply with Mr. Xu's desires or even with the Arebalos' alleged wishes. 11 U.S.C. §§ 329-30; *see In re Busy Beaver Bldg. Centers, Inc.,* 19 F.3d 833, 841 (3d Cir. 1994) (stating in the chapter 11 context that a bankruptcy court has "a duty" to review fee applications); *Thorn*,192 B.R. at 55 (same in chapter 13 context).

In addition, it is particularly important in a chapter 13 case that courts determine fees. Debtors have no incentive to curtail attorney fees, as the funds that go to fees otherwise will be paid to creditors. In turn, creditors may be deterred from challenging a fee request because of the litigation costs. *Busy Beaver Bldg.,* 19 F.3d at 842-43; *Thorn*,192 B.R. at 55. Thus, although Mr. Xu claimed at the fee hearing that the bankruptcy court "overrule[d] the debtor's wishes to pay for the service rendered," the bankruptcy court followed the law here.

Secondly, the bankruptcy court has an "inherent obligation to monitor the debtor's estate and to serve the public interest." *Busy Beaver Bldg*, 19 F.3d at 841. Ensuring that section 329 and 330 fee awards are reasonable serves the "overarching policy of avoid the waste of the debtor's estate" and reinforces public

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[8] Sections 329 and 330 are appended to this brief.

trust in the bankruptcy system. *Id.* (citing *In re Wonder Corp. of America*, 82 B.R. 186, 191 (D. Conn.1988)).

In addition, bankruptcy courts preserve the integrity of the bankruptcy system by scrutinizing fees applications "to prevent overbearing attorneys from taking advantage of desperate debtors." *In re Jackson*, 401 B.R. 333 (Bankr. N.D. Ill. 2009); *See In re Datta*, No. 8-08-72740-ast, 2009 WL 1941974 at *6 (Bankr. E.D.N.Y. July 2, 2009) (stating that section 329 is designed to protect debtors). Furthermore, oversight prevents "overreaching attorneys" from "drain[ing] [the estate] of wealth" which should be distributed to unsecured creditors. *Busy Beaver Bldg.*, 19 F.3d at 843-44 (citing numerous cases). Accordingly, Mr. Xu is incorrect that an attorney is always entitled to whatever fee that the debtor has agreed to pay him. *Datta*, 2009 WL 1941974 at *5 (citing *In re Geraci*, 138 F.3d 314, 319-20 (7th Cir. 1998)).

Here, the bankruptcy court addressed the reasonableness of Mr. Xu's attorney's fees and adjusted them accordingly. *See* Fed. R. Bankr. P. 2017; 11 U.S.C. § 329; 11 U.S.C. § 330; *In re Monahan Ford Corp. of Flushing*, 390 B.R. 493, 503 (Bankr. E.D.N.Y. 2008). The Arebalos' consent to statutory award was not necessary.

III. The Bankruptcy Court Did Not Abuse Its Discretion in Refusing to Consider Mr. Xu's Motion to Strip a Second-Mortgage Lien During the Fee Hearing.

The bankruptcy court did not abuse its discretion in refusing to consider Mr. Xu's second-mortgage lien avoidance motion during the attorney compensation hearing on March 11, 2010 on two grounds.

Mr. Xu failed to follow bankruptcy court procedures to ensure that the issue would be adjudicated. The bankruptcy court did not commit clear error in declining to waive these safeguards for three reasons.

First, issues related to a property liens should be considered pursuant to Federal Rule of Bankruptcy 7001(2), which requires that an attorney file an adversary complaint. Fed. R. Bankr. P. 7001(2) (stating that a proceeding to determine "the validity, priority, or extent of a lien" is an adversary proceeding).

Second, Mr. Xu's attempt to raise the issue by motion was procedurally incorrect. The original presentment motion to avoid the lien was not docketed because this form of motion is not allowed under local practice.

Third, Mr. Xu never corrected this deficiency by initiating an adversary proceeding or a separate motion to resolve the issue. Indeed, he did not even request a separate hearing on the motion, something he could have done.

As a separate and independent ground, the March 11 hearing was noticed to approve Mr. Xu's application for attorney's fees. Dkt. #36, 37. Like any court, a bankruptcy court has the power to regulate its docket. *In re MPM Enters., Inc.*, 231 B.R. 500, 504 (E.D.N.Y. 1999) (citing *In re Robinson*, 198 B.R. 1017, 1025 (Bankr.

N.D. Ga. 1996)). The bankruptcy court did not abuse its discretion in refusing to hear the mortgage avoidance issue that had not been properly noticed or calendared.

Conclusion

For the foregoing reasons, the United States Trustee respectfully asks this Court to affirm the bankruptcy court's order of March 19, 2010.

Dated: October 20, 2010

Respectfully Submitted,

TRACY HOPE DAVIS

United States Trustee, Region 2

/s/ Christine H. Black

CHRISTINE H. BLACK
United States Department of Justice
560 Federal Plaza, Suite 560
Long Island Federal Courthouse
Central Islip, NY 11722
Phone: 631-715-7800
Fax: 631-715-7777

Ramona D. Elliott
General Counsel

P. Matthew Sutko
Associate General Counsel

Catherine B. Sevcenko
Trial Attorney

United States Department of Justice
Executive Office for United States Trustees
20 Massachusetts Ave, N.W.
Washington, DC 20530

Prudhomme

(Cite as: 1994 WL 1004480 (USTBRIEFS))

[*1] Title (TI): JOHN F. ARENS v. AL BOUGHTON, TRUSTEE (IN RE PRUDHOMME & BATTEN) — BRIEF OF U.S. TRUSTEE, APPELLEE
Court (CO): CTA5, U.S. Court of Appeals (5th Cir.)
Current-Case (CCN): No. 93-5467
Previous-Case (PCN): No. N/A
Source (SO): U.S. TRUSTEES
Date-of-Filing (DA): February 2, 1994
Author (AU): Martha L. Davis, General Counsel & Anastasia M. Petrou, Attorney (202-307-1399)
Topic (TO): BANKRUPTCY — Whether Bankruptcy Court properly ordered disgorgement of all fees paid to Debtors' counsel under 11 U.S.C. § 329.

Summary (SU): Disgorgement was warranted here by counsel's breach of fiduciary obligations, multiple violations of mandatory disclosure requirements, and fact that value of services rendered was zero. Accord: In re Prudhomme & Batten, 43 F.3d 1000 (5th Cir. 1995) (attorney's failure to disclose pre-petition fees paid over a year prior to filing constitutes misconduct warranting disgorgement).

Accord: In re Prudhomme & Batten, 43 F.3d 1000 (5th Cir. 1995)

No. 93-5467

IN THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

JOHN F. ARENS,
Appellant,
v.
AL BOUGHTON, TRUSTEE, ET AL.,
Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF LOUISIANA

BRIEF OF THE UNITED STATES TRUSTEE, APPELLEE

VICTORIA E. YOUNG
United States Trustee
WILLIAM E. O'CONNOR
Assistant U.S. Trustee
FRANCES HEWITT STRANGE
Attorney Advisor
500 Fannin St., Room 3B12
Shreveport, LA 71101
(318) 676-3456

MARTHA L. DAVIS
General Counsel
ANASTASIA M. PETROU
Attorney Advisor
Executive Office For United States Trustees
901 E. Street, N.W., Ste. 780
Washington, D.C. 20530
(202) 307-1399

STATEMENT REGARDING ORAL ARGUMENT

The United States Trustee agrees with co-appellee, Farm Credit Bank, that oral argument is not necessary in this case.

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Local Bankruptcy Rule 4.0
Local Bankruptcy Rule 7.1
Rules of Professional Conduct 1.5(a), 1.15(a), 1.16(d)

No. 93-5467

IN THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

JOHN F. ARENS,
Appellant,
v.
AL BOUGHTON, TRUSTEE, ET AL.,
Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF LOUISIANA

BRIEF OF THE UNITED STATES TRUSTEE, APPELLEE

STATEMENT OF JURISDICTION

The subject matter jurisdiction of the United States Bankruptcy Court for the Western District of Louisiana is based on 28 U.S.C. § 157(b)(1) and the jurisdiction of the United States District Court for the Western District of Louisiana is based on 28 U.S.C. §§ 158(a) and 1334. This Court has jurisdiction over this appeal under 28 U.S.C. § 158(d) and 1291. The appeal is taken from the final order of the district court entered on October 12, 1993, affirming the bankruptcy court's final order requiring debtors' counsel to disgorge his entire retainer fee of $75,000. The notice of appeal to the district court was timely filed on February 16, 1993, and the notice of appeal from the district court's order was timely filed on November 4, 1993 in accordance with 4(a) and 6(b) of the Federal Rules of Appellate Procedure.

STANDARD OF REVIEW

The applicable standard of review on appeal is clearly erroneous as to findings of fact and de novo as to conclusions of law. In re Consolidated Bancshares, Inc., 785 F.2d 1249, 1252 (5th Cir. 1986). A bankruptcy court's award or denial of compensation is reviewed under an abuse of discretion standard. Id.; In re Anderson, 936 F.2d 199 (5th Cir. 1991).

STATEMENT OF THE ISSUE

Whether the bankruptcy court correctly ordered the disgorgement of all fees paid to debtors' counsel.

STATEMENT OF THE CASE

A. Course of Proceedings and Disposition Below

[*4] This matter arose in August 1992, in the Alexandria Division of the United States Bankruptcy Court for the Western District of Louisiana upon the motion of the United States Trustee to examine the transactions of Mr. and Mrs. Batten and Ms. Prudhomme (collectively, the "debtors") with their attorneys, the Arens Law Firm. (R. Vol. 3 at 439, 448-467.) On August 18, 1992, Farm Credit Bank ("FCB"), the debtors' major creditor, filed a motion to intervene in support of the United States Trustee's motion, and also filed a motion for disgorgement of the retainer paid by debtors to the Arens Law Firm. (Id. at 468-488.) On September 1, 1992, the plan trustee [**FN**1], Mr. Al Boughton, moved for intervention in support of FCB's motion for disgorgement. (Id. at 489-495.)

A consolidated evidentiary hearing on the U.S. Trustee's and FCB's motions was held October 28, 1992. (Id. at 424, 440.) The court entered its Reasons for Decision on January 29, 1993 (Aplt. Excerpts at 13-65), and entered an order on February 1, 1993, requiring Arens to pay the plan trustee the full sum of $75,000. (Id. at 11-12.) On February 16, 1993, Arens filed a notice of appeal from the final order to the United States District Court for the Western District of Louisiana (R. Vol. 1 at 2-3), and on October 12, 1993, the district court entered an order affirming the bankruptcy court's decision. (R. Vol. 6 at 980-985.) Arens now appeals the district court's ruling to this Court pursuant to 28 U.S.C. § 158(d). (Id. at 986-987.)

B. Statement of the Facts

In February 1990, Mr. and Mrs. John Batten and Ms. Daisy Prudhomme hired John Arens' law firm to represent them in "all dealings and negotiations and representations with Farm Credit system for how ever long it took." (10/28/92 Transcript at 25:20-25:23.) [**FN**2] After their initial meeting with Arens in Arkansas, the debtors returned to their home in Louisiana where they signed the retainer agreement and returned it to Arens with a payment of $50,000. [**FN**3] (Aplee. Excerpts at 1 and 10/28/92 Transcript at 25:24-26:3, 26:23-26:25.) An additional $25,000 payment was made on February 27, 1991. (10/28/92 Transcript at 26:25, and U.S. Trustee Ex. Nos. 2 and 11.) [**FN**4] The retainer agreement also provided that Arens would acquire a 40% interest in the debtors' lender liability claim against FCB. (Aplee. Excerpts at 1.)

On July 30, 1991, the Arens Law Firm filed a Chapter 11 bankruptcy petition for Ms. Prudhomme. (R. Vol. 3 at 430.) On

September 4, 1991, pursuant to Local Bankruptcy Rule 7.1 and Uniform District Court Rule 20.06, Mr. Eldred N. Bell of the Arens Law Firm filed an application to be admitted to practice in the Bankruptcy Court for the Western District of Louisiana. (R. Vol. 1 at 14-15.) Attached to this application was a document entitled "Affidavit for Approval of Employment of Attorney under a General Retainer" which stated in pertinent part:

> Neither I, the Firm of Arens and Alexander, nor any member or associate thereof, insofar as I have been able to ascertain, has any connection with the trustee herein, the estate's creditors, or any other party in interest, or their respective attorneys and accountants.... Neither I, the firm of Arens and Alexander, nor any member or associate, insofar as I have been able to ascertain, represents any interest adverse to that of the estate, the trustee or the debtor in the matters upon which said law firm is to be engaged.

[*5] (Aplee. Excerpts at 2.) Notwithstanding the disclosure requirements of Bankruptcy Rule 2014, the firm did not disclose the retainer agreement, the payments they received pursuant to the agreement, or the contingency interest in the debtors' lender liability claim which they had acquired. (Id.) On September 9, 1991, the court entered an order approving counsel's employment application, based on his representation that the Arens Law Firm represented no interest adverse to the debtor in possession or her estate, and that they are disinterested persons under sections 101(13) and 327 of title 11, United States Code. (R. Vol. 1 at 18-19.) Terry Zelinski and Richard Alexander, also members of the Arens Law Firm, were subsequently admitted. (Id. 20-23.)

The firm also failed to file a supplemental schedule as required by Local Bankruptcy Rule 4.0, Western District of Louisiana, which, if filed, would have required the disclosure of the $50,000 payment received in February 1990, the $25,000 payment received in February 1991, and the 40% contingency interest. (R. Vol. 3 at 430-445.) [**FN**5] Additionally, while the cause of action against the FCB is listed in the debtor's Schedule B as an asset under item "q", there is no listing of the interest of the Arens Law Firm in that cause of action. (U.S. Trustee Ex. Nos. 3 and 4.) The Statement of Financial Affairs also failed to disclose counsel's interest in the lender liability claim. (Id. No. 2.)

The Arens Law Firm filed a Chapter 11 bankruptcy petition on behalf of the Battens on October 15, 1991. (R. Vol. 3 at 409.) The court entered an order authorizing the debtors in possession to employ Robert Royer and the Arens Law Firm on November 14, 1991. (Aplee. Excerpts at 4-7.) The order was signed by Mr. Royer and Ms. Terry Zelinski (on behalf of the Arens Law Firm), who agreed that they "represent[ed] no interest adverse to the debtors in possession." (Id. at 7.) Other Arens' firm lawyers admitted in the Batten case include Eldred Bell, Gregory House and Richard Alexander. (R. Vol. 3 at 411-412, 414.)

Although a supplemental schedule pursuant to Local Bankruptcy Rule 4.0 was filed in this case, which listed the $25,000 payment received in February 1991, it did not mention the existence of counsel's contingency interest in debtors' lender liability claim. (U.S. Trustee Ex. No. 13.) Likewise, the Statement of Financial Affairs failed to disclose counsel's interest in the lender liability claim. (Id. No. 11.)

Further, while the disclosure statement and the first amended disclosure statement submitted in connection with the Battens' plan of reorganization list the lender liability claim as an asset, neither document mentions counsels' interest in this asset. (Id. Nos. 17 and 18.) The Arens Law Firm finally revealed its interest in the debtors' lender liability claim against the FCB in the second amended disclosure statement filed in the Batten case on April 30, 1992. (Id. No. 19.) The contingency fee interest was never disclosed in any of the pleadings filed in the Prudhomme case. (R. Vol. 3 at 430-445.)

[*6] On August 5, 1992, the United States Trustee filed a motion in the Batten case to examine debtors' transactions with the debtors' attorneys. (R. Vol. 3 at 448-467.) A similar motion was filed in the Prudhomme case on September 1, 1992. (R. Vol. 3 at 439.) On August 18, 1992, FCB filed a motion to intervene in support of the United States Trustee's motion, and also filed a motion for disgorgement of the retainer paid by debtors to the Arens Law Firm. (Id. at 468-488.) The plan trustee, Mr. Al Boughton, moved for intervention in support of FCB's motion for disgorgement on September 1, 1992. (Id. at 489- 495.)

A consolidated evidentiary hearing on the U.S. Trustee's and FCB's motions was held October 28, 1992. (Id. at 424, 440.) No representative appeared on behalf of the Arens Law Firm. (10/28/92 Transcript at 2:1-2:18.) The court established a posthearing briefing schedule (id. 118:9-118:25), and the U.S. Trustee and FCB filed timely briefs. (R. Vol. 4 at 511-567 and 568-587.) Arens obtained two extensions of time, and eventually filed an untimely brief on December 29, 1992. (Id. at 595-615.) Attached to this brief were untimely proffers of evidence in affidavit form and attorney time sheets. (Id. at 616- 663 and 664-680.) The court entered its Reasons for Decision on January 29, 1993 (Aplt. Excerpts at 13-65), and entered an order on February 1, 1993, requiring Arens to pay the plan trustee the full sum of $75,000. (Id. at 11- 12.)

In his Reasons for Decision, the bankruptcy judge determined that he had jurisdiction to examine the reasonableness of fees paid for services rendered in connection with bankruptcy proceedings, regardless of their source, (id. at 40), and that in this instance, not only were the fees paid in contemplation of bankruptcy, but they were excessive in light of the lack of benefit to the debtors and their estates. (Id. at 58.) The court also found that the Arens Law Firm "consciously avoids disclosure" (id. at 61-62), and that in this case, they breached their affirmative duty to disclose the retainer fee received from the debtors as well as their contingency interest in an asset of the debtors. (See id. at 39-40, 52-55.) The court concluded that disgorgement of the entire retainer fee was an appropriate sanction for the firm's intentional misrepresentations to the court and for their failure to perform competent services for the debtors and their estates. (Id. at 62, 65.)

Arens filed a timely notice of appeal to the district court on February 16, 1993 (R. Vol. 1 at 2-3), and on October 12, 1993, the district entered an order affirming the bankruptcy court's order. (R. Vol. 6 at 980-985.) The court concluded that debtors' counsel failed to disclose all their connections with the debtors as required by Rules 2014 and 2016(b) of the Federal Rules of Bankruptcy Procedure, section 329(a) of the Bankruptcy Code, and Local Bankruptcy Rule 4.0. (Aplt. Excerpts at 7-9.) In recognition of the bankruptcy court's broad equitable discretion in awarding and denying attorneys' fees, the court held that the bankruptcy court did not abuse its discretion in ordering the disgorgement of the entire retainer fee. (Id. at 9-10.)

SUMMARY OF THE ARGUMENT

[*7] In recognition of the need to protect the integrity of the bankruptcy process as well as protect failing debtors (and their creditors) from overreaching by their attorneys, Congress furnished the bankruptcy courts with extensive supervisory power to regulate the attorney-client relationship in bankruptcy cases. To that end, sections 327 of the Bankruptcy Code requires court approval before a debtor in possession can hire counsel to assist him in fulfilling his statutory duties. In addition, 11 U.S.C. § 329, Bankruptcy Rules 2014 and 2016, and Local Bankruptcy Rule 4.0(9) require debtors' counsel to disclose all connections with the debtors, including any proposed arrangement for compensation and any amounts paid within 18 months before filing. The purpose of these stringent disclosure requirements is to facilitate the bankruptcy court's determination of disinterestedness and its review of debtors' transactions with their attorneys. In light of the unique nature of bankruptcy proceedings, debtors' counsel are held to a high fiduciary standard, thus failure to make complete disclosure can result in disqualification, denial of compensation, and disgorgement of previously received fees.

In the instant case, the bankruptcy court determined that counsel violated their statutory and fiduciary obligations to the court, and accordingly ordered counsel to disgorge the entire retainer fee received from the debtors. Disgorgement was particularly appropriate in this case where the court determined that the value of the services rendered to the debtors and their estates amounted to zero. In light of the court's broad discretion in awarding and denying fees paid in connection with bankruptcy proceedings, the court was entitled to sanction debtors' counsel for their lack of candor with the court, their breach of fiduciary obligations to the court and the estates, and their multiple violations of mandatory disclosure requirements.

ARGUMENT

THE BANKRUPTCY COURT CORRECTLY ORDERED THE DISGORGEMENT OF FEES PAID TO DEBTORS' COUNSEL

A. Counsel's flagrant nondisclosure and lack of candor with the court, without more, warranted total disgorgement of fees

Section 327 of the Bankruptcy Code, 11 U.S.C. § 101 et seq., requires a chapter 11 debtor in possession [**FN**6] to obtain court approval prior to employing counsel to assist him in fulfilling his statutory duties. Section 327(a) provides as follows:

> Except as otherwise provided in this section, the trustee, with the court's approval, may employ one or more attorneys, accountants, appraisers, auctioneers, or other professional persons, that do not hold or represent an interest adverse to the estate, and that are disinterested persons, to represent or assist the trustee in carrying out the trustee's duties under this title.

In order to assist the court in its determination of whether counsel is disinterested and free from the influence of adverse interests, [**FN**7] Federal Rule of Bankruptcy Procedure 2014 requires proposed counsel to file an affidavit with the court setting forth "all of [counsel's] connections with the debtor, creditors, or any other party in interest." Fed. R. Bankr. P. 2014(a). See In re Arlan's Dept. Stores, Inc., 615 F.2d 925, 936 (2d Cir. 1979) (General Order in Bankruptcy 44, a predecessor of Rule 2014, required disclosure of all connections between proposed counsel and debtors, which included, inter alia, a substantial pre-petition retainer); In re Futuronics Corp., 655 F.2d 463, 469 (2d Cir. 1981) (Bankruptcy Rule 215, a predecessor of Rule 2014, required counsel to disclose all "connections" which included counsels' retainer agreement).

[*8] In addition to the disclosure requirements of Federal Rule of Bankruptcy Procedure 2014(a), Local Bankruptcy Rule 4.0 of the Western District of Louisiana requires all employment applicants to file a supplemental schedule disclosing "any amount owed by the debtor or its affiliates to proposed counsel or proposed counsel's law firm at the time of filing, and also amounts paid within 18 months before filing." Local Bankruptcy Rule 4.0(9); See also Order Regarding Amendment of Local Bankruptcy Rules at (Aplee. Excerpts at 8-9.) (This rule was established upon a determination by the local bankruptcy judges that the disclosure requirements of Rule 2014 were insufficient in providing the court with enough information to make a proper determination of disinterestedness.) [**FN**8]

The purpose of these stringent disclosure requirements is to ensure that the bankruptcy court is informed of all facts that may be relevant to its determination of disinterestedness. In re Granite Sheet Metal Works, Inc., 159 B.R. 840, 845 (Bankr. S.D. Ill.

1993); In re Lee, 94 B.R. 172, 176 (Bankr. C.D. Cal. 1988). Thus, the disclosure of any connection must be made at the time of application, and it is not sufficient for information concerning counsel's disinterested status to surface at a later point. In re Martin, 817 F.2d 175, 182 (1st Cir. 1987); In re B.E.S. Concrete Products, Inc., 93 B.R. 228, 236-37 (Bankr. E.D. Cal. 1988). Disclosure of all connections is mandatory. "[R]ule ... [2014] does not give the attorney the right to withhold certain information on the grounds that, in the attorney's opinion, the connection is of no consequence or is not adverse." In re Coastal Equities, Inc., 39 B.R. 304, 308 (Bankr. S.D. Cal. 1984). See also In re Arlan's Dept. Stores, Inc., 615 F.2d 925, 943 (2d Cir. 1979); In re Haldeman Pipe & Supply Co., 417 F.2d 1302, 1304 (9th Cir. 1969).

Failure to make complete disclosure can result in disqualification and denial of all compensation. In Woods v. City National Bank & Trust Co., 312 U.S. 262, 269 (1941), the Supreme Court concluded that the only way to assure that professionals maintain the requisite standards of fiduciary conduct is to strictly enforce compliance with the conflict of interest rules by denial of compensation. See generally In re Haldeman & Supply Co., 417 F.2d at 1305; In re Kendavis Industries International, Inc., 91 B.R. 742, 748 (Bankr. N.D. Tex. 1988); In re B.E.S Concrete Products, Inc., 93 B.R. at 237; In re Coastal Equities, Inc., 39 B.R. at 308.

Even beyond the statutory duties imposed by the Bankruptcy Code and Rules, counsel for a debtor in possession serves as an officer of the court, and consequently owes a fiduciary duty to both the court and the estate. See In re Evangeline Refining Co., 890 F.2d 1312, 1323 (5th Cir. 1989); In re Consolidated Bancshares, 785 F.2d 1249, 1255 (5th Cir. 1986); In re Burke, 147 B.R. 787, 800 (Bankr N.D. Okla. 1992); In re Coastal Equities, Inc., 39 B.R. at 308 (citations omitted) ("[I]t is a well established principle that those performing duties in the administration of an estate are doing so as officers of the court.") Breaches of this fiduciary obligation are sanctionable by the denial of all compensation and the disgorgement of previously received fees. See In re Evangeline Refining Co., 890 F.2d at 1323; In re Arlan's Dept. Stores, Inc., 615 F.2d 925, 943 (2d Cir. 1979); In re Futuronics Corp., 655 F.2d 463, 471 (2d Cir. 1981); In re Coastal Equities, Inc., 39 B.R. at 309.

[*9] The Second Circuit's opinion in In re Futuronics is particularly instructive. In that case, the debtor's general counsel and special counsel failed to disclose their receipt of compensation from the debtor as well as a fee-splitting agreement between them. 655 F.2d at 469-471. The Second Circuit held that given counsels' "callous disregard for the disclosure requirements of Rule 215" and their "flagrant[] breach[] [of] their fiduciary obligations to the bankruptcy court," the bankruptcy court abused its discretion by permitting debtor's counsel to "retain any of the fees they had received, let alone to allow any further compensation." Id.

In the instant case, debtors' counsel violated their statutory and fiduciary obligations to the court by failing to disclose all their connections with the debtors. Notably, counsel failed to disclose that they had been employed by debtors since February 1990 in connection with debtors' bankruptcy cases. Consistent with this lack of candor is counsel's failure to reveal any information relating to their employment fee, which consisted in part of a $75,000 retainer, $50,000 of which was paid in February 1990, with the remaining $25,000 paid in February 1991. Counsel also failed to disclose that they had acquired a 40% interest in a state court lender liability claim against the primary creditor, FCB, thereby giving counsel a substantial potential interest in the estate.

Even though counsel had an affirmative duty pursuant to Federal Rule of Bankruptcy Procedure 2014 to disclose "all connections" it had with the debtors, none of these aforementioned connections were revealed by counsel in their Rule 2014 affidavits. Instead, counsel averred in both cases that the Arens Law Firm had no connection with the trustee, the estate's creditors, or any other party in interest, and that they represented no interest adverse to that of the estate, the trustee or the debtor. (Aplee. Excerpts at 2-3, 4, 7.) While the $25,000 payment was mentioned in debtors' statements of financial affairs, this did not vitiate counsel's duty to disclose this transaction in the employment applications. It is not the court's obligation to search through the files for information regarding counsel's disinterested status. See In re Maui 14k, Ltd., 133 B.R. 657, 661 (Bankr. D. Hawaii 1991); In re Rusty Jones, Inc., 134 B.R. 321, 345 (Bankr. N.D. Ill. 1991).

Debtors' counsel also failed to file a supplemental schedule as required by Local Bankruptcy Rule 4.0 in the Prudhomme case. (R. Vol. 3 at 430-445.) Had counsel complied with this rule, they would have been required to disclose their interest in the lender liability claim as well as the $50,000 they received in February 1990 and the $25,000 payment they received in February 1991. While they did file the supplemental schedules in the Batten case, which disclosed the $25,000 payment they received in February 1991, they did not list their contingency interest in the lender liability claim. (U.S. Trustee Ex. No. 13.) In fact, the contingency interest was not disclosed until April 30, 1992, six months after the Batten petition was filed and nine months after the Prudhomme petition was filed.

[*1]0 Ultimately, the bankruptcy court concluded that not only was there "inadequate disclosure but that the modus operandi of the Arens Firm was to avoid disclosure at all costs." (Aplt. Excerpts at 62.) Based on the facts presented in this case, which clearly establish a pattern of nondisclosure, coupled with the Arens firm's behavior in other bankruptcy cases, (see id. at 41-51), this finding was not clearly erroneous. In light of the court's broad discretion in awarding and denying fees paid in connection with the bankruptcy proceedings, the court was entitled to sanction debtors' counsel for their lack of candor with the court, their breach of fiduciary obligations to the court and the estates, and their multiple violations of mandatory disclosure requirements. See Woods v. City National Bank & Trust Co., 312 U.S. 262, 268 (1941); In re Anderson, 936 F.2d 199, 204 (5th Cir. 1991); In re Futuronics Corp., 655 F.2d 463, 471 (2d Cir. 1981); In re Arlan's Dept. Stores, Inc., 615 F.2d 925, 943 (2d Cir. 1979). The court determined that the appropriate sanction was to order John Arens to disgorge the entire retainer fee. In light of the circumstances of this case, this decision was an appropriate exercise of discretion.

B. Section 329(a) does not restrict the court's authority to order the disgorgement of fees

paid to a debtor's attorney more than a year pre-petition

Arens argues that because the $75,000 retainer fee was paid pursuant to an agreement that was made more than one year before the date of the filing of either bankruptcy petition, the bankruptcy court had no authority to examine the reasonableness of the retainer fee or order its disgorgement. As support for this proposition, Arens cites to 11 U.S.C. § 329(a). [**FN**9] Arens' reliance on section 329(a) to limit the court's authority is misplaced. The one year look-back period of section 329(a) simply provides debtor's counsel with a perimeter regarding which prior transactions with the debtors must be reported. The disclosure requirements of section 329(a) were designed to facilitate the court in its examination of counsel's prior transactions with the debtors, not limit the court's authority in this regard.

Instead, the court's authority to examine the reasonableness of fees paid to debtors' counsel pre-petition and order the disgorgement of any fees determined to be excessive is based on 11 U.S.C. § 329(b) of the Bankruptcy Code and on Federal Rule of Bankruptcy Procedure 2017. In re Hargis, 895 F.2d 1025 (5th Cir. 1990), clarifying, 887 F.2d 77 (5th Cir. 1989) ("Section 329 authorizes the bankruptcy court to order an attorney to return fees paid for services rendered in connection with a bankruptcy proceeding, if those fees are determined by the court to be excessive, regardless of their source."); In re Walters, 868 F.2d 665, 668 (4th Cir. 1989) ("The regulatory effect of neither section 329 nor Bankruptcy Rule 2017 is conditioned on the source of payment; rather it depends upon the services rendered.")

[*1]1 Section 329(b) states in pertinent part:

> (b) If [debtor's attorney's] compensation exceeds the reasonable value of any such services, the court may cancel such agreement, or order the return of any such payment, to the extent excessive, to--
>
> (1) The estate, if the property transferred--
>
> > (A) would have been property of the estate....
> > (B) was paid by or on behalf of the debtor under a plan under chapter 11, 12, or 13 of this title; or
>
> (2) the entity that made such payment.

Rule 2017(a) states that:

> (a) Payment of Transfer to Attorney Before Order for Relief. On motion by any party in interest or the court's own initiative, the court, after notice and a hearing may determine whether any payment of money or any transfer of property by the debtor, made directly or indirectly and in contemplation of the filing of a petition under the Code by or against the debtor or before entry of the order for relief in an involuntary case, to an attorney for services rendered or to be rendered is excessive. (emphasis added.)

Neither of these provisions, which speak directly to the court's authority to examine pre-petition transactions between debtors and their counsel places a limitation on the court's authority as suggested by Arens. In fact, "Bankruptcy Rule 2017's only requirement for review is that the services be in any way related to the bankruptcy case." In re Walters, 868 F.2d at 667. Cf. In re Olivier, 819 F.2d 550, 554-55 (5th Cir. 1987) (the court upheld the bankruptcy court's denial of discharge under 11 U.S.C. § 727(a)(2)(A) even though the concealment at issue occurred prior to the statute's one-year examination period); In re Sanders, 128 B.R. 963, 966 (Bankr. W.D. La. 1991) (Not all transfers which occur more than one year before the filing of the petition are immune from the court's review.)

To interpret section 329 in the manner suggested by debtors' counsel would defeat the statute's very purpose, which is to protect persons with financial troubles from unscrupulous attorneys. See H.R. Rep. 595, 95th Cong., 1st Sess. 329, reprinted in 1978 U.S. Code Cong. & Admin. News 5963, 6285; S. Rep. No. 989, 95th Cong., 2d Sess. 39, reprinted in 1978 U.S. Code Cong. & Admin. News 5787, 5825. See also In re Woods & Henderson, 210 U.S. 246, 253 (1908) (Section 60d, a predecessor to section 329, was enacted in recognition of "the temptation of a failing debtor to deal too liberally with his property in employing counsel to protect him in view of financial reverses and probable failure.")

C. The bankruptcy court correctly found that the $75,000 retainer agreement was made in contemplation of bankruptcy

Arens argues that even if the court had the authority to look beyond the one year limitation of section 329(a), the court improperly examined the reasonableness of these fees because they were clearly not made in contemplation of the filing of a petition in bankruptcy. This argument is without merit. It is the court, and not debtors' counsel, who determines whether a fee arrangement was made in contemplation of bankruptcy. 11 U.S.C. § 329(b); Fed. R. Bankr. P. 2017(b).

[*1]2 Following the guidance of the court's decision in In re Rheuban, 121 B.R. 368, 378 (Bankr. C.D. Cal. 1990), the bankruptcy court below applied a subjective rather than objective test in making this determination. (Aplt. Excerpts at 36.) Noting that the subjective nature of the "in contemplation of" test is made clear by the Supreme Court's decision in Conrad, the Rheuban court stated:

> ... the controlling question is with respect to the state of mind of the debtor and whether the thought of bankruptcy was the impelling cause of the transaction. [Citation] If the payment or transaction was thus motivated, it may be reexamined and its reasonableness be determined.

Rheuban, 121 B.R. 368, citing, Conrad, Rubin & Lesser v. Pender, 289 U.S. 472, 476-77 (1932). See also In re GIC Government Secur., Inc., 92 B.R. 525, 530-31 (Bankr. M.D. Fla. 1988) (applying subjective test). Arens contends that the "test of 'in contemplation of' bankruptcy goes far beyond any subjective test envisioned by the United States Supreme Court." (Aplt. Opening Brief at 30.) However, he cites no authority for this position, and then concludes that the bankruptcy court's findings in this regard were clearly erroneous. Id.

In light of existing law on this issue, the bankruptcy court did not abuse its discretion in relying on Conrad and concluding that an ensuing bankruptcy was reasonably predictable at the time the payment or transfer to the attorney was made. See In re Placid Oil Co., 158 B.R. 404, 418 (N.D. Tex. 1993); 8 Collier on Bankruptcy, Section 2017.05 (3) (15th ed. 1992).

In this case, the court reviewed all relevant facts and determined that the retainer was made in contemplation of bankruptcy. In reaching this conclusion, the court appeared to consider the following circumstances: 1) the debtors were in desperate financial straits at the time of consulting the Arens Law Firm; 2) they had been unsuccessful in their restructuring efforts; 3) they were pessimistic about their chances on appeal; 4) their business could not survive without new capital; 5) a merger or takeover were not realistic possibilities; and 6) extrication from financial difficulties was urgently needed. Additionally, while Arens claims not to have contemplated bankruptcy for his clients when he received the $50,000 payment in February 1990, it is clear from the evidence that bankruptcy was not completely ruled out. (Arens Dep. 87:3- 96:2 and FCB Ex. Nos. 8-11.) [**FN**10] In December 1990 counsel was preparing a chapter 12 petition and in February 1991 members from the Arens Law Firm were threatening FCB that debtors would probably have to file bankruptcy. Id.

The court's ruling that the fees were paid in contemplation of bankruptcy is a factual finding. Cf. In re Hargis, 895 F.2d 1025, 1026 (5th Cir. 1990), clarifying, 887 F.2d 77 (5th Cir. 1989) (remanding the case to the bankruptcy court for a determination of the amount of fees owed for services rendered on matters unrelated to the bankruptcy proceeding and the amount and reasonableness of fees charged for bankruptcy-related services). To overcome this decision Arens must show that the court was clearly erroneous. Arens has not met this burden, and consequently the lower court's decision should be affirmed.

D. The bankruptcy court correctly found that the retainer payment was unreasonable and excessive

[*1]3 Upon determining that the retainer fee was paid "in contemplation of bankruptcy," the court examined the "reasonableness" of the fee in light of the legal services rendered. To the extent that the compensation exceeded the value the attorney's services, disgorgement was the proper remedy. In re Kroh Bros. Development Co., 120 B.R. 997, 1000 (W.D. Mo. 1989); In re Chapel Gate Apartments., Ltd., 64 B.R. 569, 572-74 (Bankr. N.D. Tex. 1986). See also Louisiana State Bar Asso. v. Kilgarlin, 550 So.2d 600, 605 (La. 1989) (Attorneys practicing in the courts of Louisiana are required to return unearned portions of advanced fees.) [**FN**11]

In this case, the record is replete with evidence showing that the Arens Law Firm did not render any services that benefitted either the debtors or their estates. In fact, the evidence shows that the Arens Law Firm actually injured the debtors. For example, in the Prudhomme case, had counsel filed the chapter 12 petition that was prepared in December 1990, Ms. Prudhomme probably would not have lost her property. (See 10/28/92 Transcript at 69:6-73:2.) Additionally, Robert Berry gave expert testimony that the Arens Law Firm was unsatisfactory, and Mrs. Batten testified that their counsel probably hurt them more than helped them. (Id. at 47:24-48:2.) In fact, Arens wrote a letter to the Battens apologizing for the quality of service provided by the Arens firm. (Id. at 39:30-41:19 and Aplt. Excerpts at 66-69.)

While Arens insists that the retainer fee was paid to the Arens Law Firm for its services in restructuring the debt, Arens failed to introduce admissible evidence to show how the fees were earned for pre-petition services. In fact, neither Arens nor anyone from his firm appeared at the hearing. [**FN**12] All the evidence that was admitted at the hearing shows that the Arens Law Firm did little, if anything at all, to restructure the debt pre-petition. Further, to the extent that proof of services rendered was offered in the form of affidavits and time sheets, it was untimely submitted after the evidence was closed, and therefore properly found to be inadmissible. United States v. Glass, 744 F.2d 460 (5th Cir. 1984); United States v. Stone, 604 F.2d 922 (5th Cir. 1979); (Aplt. Excerpts at 11, 56 and R. Vol. 3 at 426, 442.)

Even if the affidavits and time sheets had been admissible, the court made the factual determination that they were inadequate in addressing the factors relative to the quality of representation required by In re First Colonial Corporation of America, 544 F.2d 1291, 1298-1300 (5th Cir.), reh'g denied, 547 F.2d 573 (5th Cir.), cert. denied, 431 U.S. 904 (1977); (Aplt. Excerpts at 57-59.) Based on the evidence presented in the affidavits, this determination was not clearly erroneous. (R. Vol. 4 at 616-680.) See the

Reasons for Decision which discuss in great detail the deficiencies of the inadmissible affidavits. (Aplt. Excerpts at 57-61.)

[*1]4 The bankruptcy court has broad discretion in determining the reasonableness of an attorney's compensation, and debtors' counsel bears the burden of proof to show that his fees are reasonable. See In re Evangeline Refining Co., 890 F.2d 1312, 1325-26 (5th Cir. 1989); In re U.S. Golf Corp., 639 F.2d 1197 (5th Cir. 1981); In re Land, 138 B.R. 66, 70 (D. Neb. 1992); In re Kroh Bros. Development Co., 120 B.R. 997, 1001 (W.D. Mo. 1989). In the instant case, the record clearly supports the bankruptcy court's determination that counsel's fees were excessive and unreasonable. As such, the bankruptcy court's disgorgement of the entire fee was not an abuse of discretion.

E. To the extent that the debtors retained an equitable interest in the unearned portion of the $75,000 retainer fee, the court did not abuse its discretion in ordering the entire fee disgorged upon finding that counsel did not render any valuable services to the debtors or their estates

Independent of the court's authority to order the disgorgement of unreasonable and excessive fees pursuant to 11 U.S.C. § 329(b) and Federal Rule of Bankruptcy Procedure 2017(b) is the court's authority to order estate assets returned to the estate for the benefit of its creditors. See 11 U.S.C. §§ 541(a)(1) & 542. In general, a bankruptcy estate is comprised of all legal and equitable interests of the debtor in property, wherever located, as of the commencement of the case. 11 U.S.C. § 541(a)(1) (emphasis added). Both the statutory language and its legislative history reflect the Congressional intent that this section be construed broadly. See H.R. Rep. No. 595, 95th Cong., 1st Sess. 367-68, reprinted in 1978 U.S. Code Cong. & Admin. News 5963, 6323-24; S. Rep. No. 989, 95th Cong., 2nd Sess. 82-83, reprinted in 1978 U.S. Code Cong. & Admin. News 5787, 5868-69; United States v. Whiting Pools, Inc., 462 U.S. 198, 204-05 (1983) ("The House and Senate Reports on the Bankruptcy Code indicate that section 541(a)(1)'s scope is broad"); In re Missionary Baptist Foundation of America, Inc., 792 F.2d 502, 504 (5th Cir. 1986), citing In re U.S. Golf Corp., 706 F.2d 574, 578 (5th Cir. 1983).

While federal bankruptcy law defines what is property of the estate, state law determines a debtor's interest in any particular property. Butner v. United States, 440 U.S. 48, 55 (1979); In re Missionary Baptist Foundation, Inc., 792 F.2d at 504, citing In re U.S. Golf Corp., 706 F.2d at 578. In the instant case, the bankruptcy court correctly applied Louisiana law in guiding its decision to disgorge the entire retainer fee. (Aplt. Excerpts at 41.) See, e.g., In re Printing Dimensions, Inc., 153 B.R. 715, 720 (Bankr. D. Md. 1993) (attorneys who practice before the bankruptcy courts in Maryland are subject to Maryland's Rules of Professional Conduct); In re NBI, Inc., 129 B.R. 212, 220 n.5 (Bankr. D. Colo. 1991) (same); In re Doors and More, Inc., 127 B.R. 1001, 1003 (Bankr. E.D. Mich. 1991) (bankruptcy court sitting in Michigan applied Michigan law).

[*1]5 Under Louisiana law, an advanced fee or retainer paid to an attorney for particular services not yet performed constitutes "funds of the client" which must be deposited in a trust account and not withdrawn or withheld without the client's consent." See Louisiana State Bar Asso. v. Kilgarlin, 550 So.2d 600, 605 (La. 1989); Louisiana State Bar Asso. v. Williams, 512 So.2d 404, 408 (La. 1987) ("[counsel] was bound to refund ... some amount which reasonably represented the unearned portion of the advanced fee.") Thus, based on applicable law, the debtors in the instant case retained an equitable interest in any portion of the retainer fee that was not earned by their counsel. Id. [**FN**13] Accordingly, the court was entitled to examine the services allegedly performed by debtors' counsel to determine what, if any, portion of the retainer fee had been earned. As discussed previously (see supra at pp. 22- 25), the court concluded that the Arens Law Firm did not perform any services which justified compensation by the debtors or their estates, and appropriately ordered Arens to disgorge the entire retainer fee. In light of the standards of conduct required of attorneys who appear before the state and federal courts in Louisiana, the court did not abuse its discretion in reaching this decision.

CONCLUSION

For the foregoing reasons, the district court's order should be affirmed.

Respectfully submitted,
VICTORIA E. YOUNG
United States Trustee

WILLIAM E. O'CONNOR
Assistant U.S. Trustee
FRANCES HEWITT STRANGE
Attorney Advisor
500 Fannin St., Room 3B12
Shreveport, LA 71101
(318) 676-3456

MARTHA L. DAVIS
General Counsel
ANASTASIA M. PETROU

Attorney Advisor
Executive Office For United States Trustees
901 E. Street, N.W., Ste. 780
Washington, D.C. 20530
(202) 307-1399

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing document was served by first class mail, postage pre-paid this 2 day of February, 1994 upon:

Donald E. Wilson
E. Lamar Pettus
Pettus Law Firm
151 West Dickson
P. O. Box 1665
Fayetteville, Arkansas 72702

Brett Brunson
Luster, Conine & Brunson
P. O. Box 1209
Natchitoches, Louisiana 71458-1209
Robert L. Royer
P. O. Box 1306
Alexandria, Louisiana 71309

Kenneth D. McCoy, Jr.
Mark A. Begnaud
McCoy, Hawthorne & Roberts, Ltd.
300 St. Denis Street
P.O. Box 1369
Natchitoches, Louisiana 71458-1369

Jeff Bohm
David B. Young
McGinnis, Lochridge & Kilgore, L.L.P.
1300 Capitol Center
919 Congress Avenue
Austin, Texas 78701

Anastasia M. Petrou

FOOTNOTES

FN1. In both cases, FCB obtained approval of a disclosure statement and, ultimately, confimed a plan of reorganization in which a trustee was appointed to administer the plans post-confirmation. (R. Vol. 3 at 436-437.)

FN2. This transcript is contained in Record Supp. No. 3.

FN3. Although the firm has been referred to as Arens and Alexander, the evidence in the record clearly indicates that Arens was the sole proprietor of the firm. All attorneys employed there were his agents, and Arens retained ultimate decision-making authority and responsibility over debtors' cases. See Arens Dep. at 14:21-16:3, 65:9-65:23, 116:9-116:15 contained in R. Supp. No. 6; Bell Dep. at 57:18-57:19, 57:24-58:8, 60:13-62:24 contained in R. Supp. No. 7; Zelinski Dep. at 8:7-8:8, 49:13-50:2 contained in R. Supp. No. 8; House Dep. at 12:11-13:6 contained in R. Supp. No. 10; Alexander Dep. at 8:13-8:25, 12:17- 13:6 contained in R. Supp. No. 11.

FN4. All U.S. Trustee Hearing Exhibits are contained in Record Supp. Nos. 1 and 2.

FN5. This rule requires the disclosure of payments made to attorneys within 18 months of a petition or any amount owed by the debtors to counsel.

FN6. Although § 327(a) refers to the "trustee", 11 U.S.C. § 1107(a) makes § 327(a) applicable to chapter 11 debtors in possession.

FN7. A "disinterested person" is defined at section 101(14), inter alia, as one "... who does not have an interest materially adverse to the interest of the estate...". 11 U.S.C. § 101(14)(E). While the Code does not define what it means to "hold or represent an adverse interest to the estate," courts have interpreted the phrase as "possessing, or serving as an attorney for a person possessing, either an 'economic interest that would tend to lessen the value of the bankruptcy estate or that would create either an actual or potential dispute in which the estate is a rival claimant ... or ... a predisposition under circumstances that render such a bias against the estate.'" Roger J. Au & Son, Inc. v. Aetna Ins. Co., 64 B.R. 600, 604 (N.D. Ohio 1986), citing, In re Roberts, 46 B.R. 815, 826-27 (Bankr. D. Utah 1985), aff'd in part and rev'd in part en banc, 75 B.R. 402 (D. Utah 1987).

FN8. Regardless of whether bankruptcy counsel seeks appointment under section 327(a), the Bankruptcy Code requires all counsel to file a statement of compensation paid or agreed to be paid for any services rendered or to be rendered in contemplation of or in connection with a bankruptcy case. See 11 U.S.C. § 329(a). As Federal Rule of Bankruptcy Procedure 2016(b) makes clear, the disclosure provisions of section 329(a) are mandatory. See In re Investment Bankers, Inc., 4 F.3d 1556, 1566 (10th Cir. 1993), petition for cert. filed, 62 U.S.L.W. 3429 (U.S. Dec. 16, 1993) (No. 93-956) (an attorney who fails to comply with the requirements of section 329(a) forfeits any right to receive compensation for services rendered on behalf of the debtor). See also In re Bennett, 133 B.R. 374, 378 (Bankr. N.D. Tex. 1991); In re Chapel Gate Apartments, Ltd., 64 B.R. 569, 575 (Bankr. N.D. Tex. 1986).

FN9. Section 329(a) states as follows:
Any attorney representing a debtor in a case under this title, or in connection with such a case, whether or not such attorney applies for compensation under this title, shall file with the court a statement of the compensation paid or agreed to be paid, if such payment or agreement was made after one year before the date of the filing of the petition, for services rendered or to be rendered in contemplation of or in connection with the case by such attorney, and the source of such compensation.

FN10. Arens Dep. is located in Record Supp. No. 6, and FCB Exhibits are in Record Supp. No. 3.

FN11. The Louisiana Rules of Professional Conduct have been adopted by the United States District Courts for Louisiana pursuant to Uniform District Court Rule 20:04, and the District Court Rules apply to proceedings in the Bankruptcy Courts of the Western District of Louisiana pursuant to Local Bankruptcy Rule 7.1.

FN12. Arens' failure to offer evidence to support the reasonableness of his fees may be considered in affirming the amount of fees ordered disgorged. See In re Placid Oil Co., 158 B.R. 404, 419 n.17 (N.D. Tex. 1993).

FN13. The same result would likely occur under Arkansas law. Arkansas has adopted the Model Rules of Professional Conduct. See Arkansas Court Rules 1.5, 1.15, and 1.16. Courts which have construed these rules have generally concluded that advanced fees for services not yet performed are client funds which must be deposited in a client trust account, and counsel is bound to return the unearned fees. See generally, Louisiana State Bar Asso. v. Kilgarlin, 550 So.2d 600, 605 (La. 1989); In re NBI, Inc., 129 B.R. 212, 220-221 (Bankr. D. Colo. 1991) (same); In re Doors and More, Inc., 127 B.R. 1001, 1003 (Bankr. E.D. Mich. 1991) (same).

1994 WL 1004480 (USTBRIEFS)

END OF DOCUMENT

BRIEF BANK — "SUMMARY SHEET" *Printed Tue-1/5/10 14:31*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*
In re Barry Lee Armistead (Barry Lee Armistead v. United States Trustee)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*
W. D. Tenn.

3. ("CCN") ***CURRENT*** CASE NO.
No.: 1:09-cv-01246

4. ("PCN") ***PRIOR*** CASE NO. - & COURT *[IF ANY]*
No.: 09-11656-GHB
Court: Bankr. W. D. Tenn.
(Identify judge & cite, if any)

5. ("SO") ***SOURCE***
U.S. TRUSTEES

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*
Filed: January 5, 2010
Type: Motion of the United States Trustee to Dismiss Appeal

7. **("AU") *PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*
Carrie A. Rohrscheib, Noah M. Schottenstein, P. Matthew Sutko, Richard F. Clippard
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") ● ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***
● Whether the district court should dismiss the debtor's appeal for lack of jurisdiction, because the notice of appeal was untimely filed.

10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)

11. DO YOU RECOMMEND POSTING IN UST BRIEFBANK?
| x | YES | | NO
NAME: Linda Figueroa
DATE:

Case No. 1:09-cv-01246

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF TENNESSEE

In Re BARRY LEE ARMISTEAD

BARRY LEE ARMISTEAD,
Appellant,

v.

UNITED STATES TRUSTEE,
Appellee.

ON APPEAL FROM THE UNITED STATES BANKRUPTCY COURT
FOR THE WESTERN DISTRICT OF TENNESSEE

MOTION OF THE UNITED STATES TRUSTEE TO DISMISS APPEAL

Appellee, Richard F. Clippard, the United States Trustee for Region 8, moves for a summary action under Federal Rule of Bankruptcy Procedure 8011, dismissing this appeal for lack of jurisdiction.[1] In support of his motion, the United States Trustee states:

1. Barry Lee Armistead ("Debtor") filed an untimely notice of appeal from an order of the United States Bankruptcy Court for the Western District of Tennessee dismissing his Chapter

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[1] United States Trustees are Justice Department officials, appointed by the Attorney General, to supervise the administration of bankruptcy cases within specified geographic regions. 28 U.S.C. § 581–89. United States Trustees "serve as bankruptcy watch-dogs to prevent fraud, dishonesty, and overreaching in the bankruptcy arena." S. Rep. No. 989, 95th Cong., 2d Sess. 88 (1978). The United States Trustee Program thus acts in the public interest to promote the efficiency and to protect and preserve the integrity of the bankruptcy system. To this end, Congress has provided that "[t]he United States trustee may raise and may appear and be heard on any issue in any case or proceeding." 11 U.S.C. § 307.

7 bankruptcy petition for the failure of the Debtor to appear and submit to the examination under oath at the Meeting of Creditors and the Court's Standing Order No. 05-0004.

2. Because the Debtor's appeal from the bankruptcy court was not filed within the time mandated by 28 U.S.C. § 158(c)(2) and Fed. R. Bankr. P. 8002, the District Court lacks jurisdiction over this appeal.

3. For this reason, the Debtor's appeal should be dismissed for lack of subject matter jurisdiction.[2]

4. In support of his Motion, the United States Trustee relies upon his Memorandum of Law in Support of the Motion of the United States Trustee to Dismiss Appeal and related Exhibits filed contemporaneously herewith.

WHEREFORE, PREMISES CONSIDERED, Appellee, Richard F. Clippard, the United States Trustee for Region 8, moves for a summary action under Federal Rule of Bankruptcy Procedure 8011 and entry of an Order dismissing this appeal for lack of jurisdiction.

Respectfully submitted,

RICHARD F. CLIPPARD
United States Trustee, Region 8

By: /s/ Carrie Ann Rohrscheib
Carrie Ann Rohrscheib, Trial Attorney (TN 022991)
United States Department of Justice
Office of the United States Trustee
200 Jefferson Avenue, Suite 400
Memphis, Tennessee 38103
(901)544-3211/fax (901) 544-4138

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[2] For purposes of this motion, the United States Trustee seeks summary relief solely on the ground this Court lacks jurisdiction. Consequently, this motion does not address the merits of the Debtor's appeal of the bankruptcy court's Order dismissing the chapter 7 bankruptcy case.

Case No. 1:09-cv-01246

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF TENNESSEE

In Re BARRY LEE ARMISTEAD

BARRY LEE ARMISTEAD,
Appellant,

v.

UNITED STATES TRUSTEE,
Appellee.

ON APPEAL FROM THE UNITED STATES BANKRUPTCY COURT
FOR THE WESTERN DISTRICT OF TENNESSEE

MEMORANDUM IN SUPPORT OF THE MOTION OF THE UNITED STATES TRUSTEE TO DISMISS APPEAL

Appellee, Richard F. Clippard, the United States Trustee for Region 8, moves for a summary action under Federal Rule of Bankruptcy Procedure 8011 to dismiss this appeal for lack of jurisdiction and respectfully submits this Memorandum of Law in Support of the Motion of the United States Trustee to Dismiss Appeal.

FACTUAL AND PROCEDURAL BACKGROUND

1. On April 22, 2009, Barry Lee Armistead ("Debtor"), proceeding pro se,[1] filed a voluntary petition for relief under Chapter 7 of Title 11 of the U.S. Code (*In re Armistead*, Case No. 09-11656 Docket No. 1). A copy of the docket of *In re Armistead*, Case No. 09-11656 is attached as Exhibit A.[2]

2. On May 8, 2009, the bankruptcy court issued a Notice of Commencement of Bankruptcy Case and Meeting of Creditors. A copy of the Notice is attached as Exhibit B. Pursuant to the Notice, the bankruptcy clerk notified the Debtor and his creditors that the Debtor's 11 U.S.C. § 341 meeting of creditors was scheduled to be held on June 9, 2009. (Docket No. 19). The Notice was served on the Debtor and all creditors on the creditor matrix on May 10, 2009. (Docket No. 21).

3. The Debtor did not appear at the June 9, 2009 meeting of creditors or otherwise arrange for a waiver of appearance. The meeting was continued until June 23, 2009. (Docket No. 25).

4. The Debtor did not appear on June 23, 2009 at the first continued meeting of creditors or otherwise arrange for a waiver of appearance. The meeting was continued a second time until July 21, 2009. (Docket No. 30).

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[1] Debtors proceeding pro se do so at their own peril. The Sixth Circuit Court of Appeals declared in *Sharwell v. Baumgart* (*In re Sharwell*), No. 97-3320, 1997 U.S. App. LEXIS 30278 at *1 (6th Cir. October 30, 1997) that "[w]hile [the debtor] was proceeding pro se and may not have fully understood the rules of procedure, he was still required to comply with the rules; his pro se status does not exempt him from compliance." (citing *Jourdan v. Jabe,* 951 F.2d 108, 110 (6th Cir. 1991)).

[2] All references to docket numbers shall refer to Exhibit A.

5. The Debtor did not appear on July 21, 2009 at the second continued meeting of creditors or otherwise arrange for a waiver of appearance. On September 2, 2009, the Chapter 7 Trustee filed his report and recommendation that the Debtor's case be dismissed. (Docket No. 39).

6. The Debtor's attendance at his § 341 meeting is required by statute. 11 U.S.C. § 343. Pursuant to Standing Order No. 05-0004, the bankruptcy court has the authority to dismiss a bankruptcy case for the Debtor's failure to appear at his § 341 meeting upon the United States Trustee's report and recommendation for dismissal. A copy of Standing Order No. 05-0004 is attached as Exhibit C. The United States Trustee filed his report and recommendation for dismissal on September 17, 2009. (Docket No. 40).

7. On September 17, 2009, the bankruptcy court entered an order dismissing the case, incorporating the United States Trustee's report and recommendation for dismissal. (Docket No. 40). A copy of the order of dismissal is attached as Exhibit D.

8. On September 19, 2009, the Debtor was served with the order dismissing his case. (Docket No. 41).

9. On September 29, 2009, the Debtor filed a Notice of Appeal for the order of dismissal. (Docket No. 43). A copy of the Notice of Appeal is attached as Exhibit E.

10. On October 29, 2009, the United States Trustee elected to have this appeal heard by the district court. (Docket No. 21).

11. The appeal was docketed with this Court on November 13, 2009. (Docket No. 54).

ARGUMENT

THE DISTRICT COURT SHOULD DISMISS THE DEBTOR'S APPEAL FOR LACK OF JURISDICTION, BECAUSE THE NOTICE OF APPEAL WAS UNTIMELY FILED.

A. The Timely Filing of a Notice of Appeal in a Bankruptcy Cases is Jurisdictional.

The failure to file a timely notice of appeal is a jurisdictional defect that prohibits appellate review. The appellate jurisdiction of this Court is granted pursuant to 28 U.S.C. § 158(a)(1), which states that "[t]he district courts of the United States shall have jurisdiction to hear appeals from final judgments, orders, and decrees." Subsection 158(c)(2) sets forth a time frame for appealing bankruptcy decisions to the district courts, requiring that such appeals "shall be taken in the same manner as appeals in civil proceedings generally are taken to the courts of appeals from the district courts and in the time provided by Rule 8002 of the Bankruptcy Rules." 28 U.S.C. § 158(c)(2). Federal Rule of Bankruptcy Procedure 8002(a) specifically provides that "[t]he notice of appeal shall be filed with the clerk within 10 days of the date of entry of the judgment, order, or decree appealed from."[3]

In *Bowles v. Russell*, 551 U.S. 205 (2007), the U.S. Supreme Court confirmed that when the time limit for filing a notice of appeal is statutorily prescribed, the time limit is jurisdictional. The Supreme Court held that "the taking of an appeal within the prescribed time is 'mandatory and jurisdictional.'" *Id.* at 209 (quoting *Griggs v. Provident Consumer Discount Co.*, 459 U.S. 56

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[3] Amendments to the Federal Rules of Bankruptcy Procedure took effect on December 1, 2009, altering the ten (10) day deadline in Rule 8002 to fourteen (14) days. However, such amendments were not in effect at the time of the filing of the Notice of Appeal in this case.

(1982)). The Supreme Court stated that it has always "regarded statutory limitations on the timing of appeals as limitations on [the court's] own jurisdiction."[4] *Id*.

Within the Sixth Circuit, it is well established that the ten-day deadline for filing a notice of appeal from a bankruptcy court order is jurisdictional. *LML Corp. v. Bank of Cadiz* (*In re LBL Sports Center, Inc.*), 684 F.2d 410, 412 (6th Cir. 1982) (applying former Bankruptcy Rules 801, 802, and 893, which also established a ten0day deadline for filing notices of appeal). All of the United States Courts of Appeals appear to agree. *See, e.g.*, *In re Siemon*, 421 F.3d 167, 169 (2d Cir. 2005); *In re Bond*, 254 F.3d 669, 673 (7th Cir. 2001); *Hamilton v. Lake Elmo Bank* (*In re Delta Eng'g Int'l*, Inc.), 270 F.3d 584, 586 (8th Cir. 2001); *Williams v. EMC Mortgage Corp.* (*In re Williams*), 216 F.3d 1295, 1298 (11th Cir. 2000); *Stangel v. United States* (*In re Stangel*), 219 F.3d 498, 500 (5th Cir. 2000); *Don Vicente Macias, Inc. v. Texas Gulf Trawling Co., Inc.* (*In re Don Vicente Macias, Inc.*), 168 F.3d 209, 211 (5th Cir. 1999); *Shareholders v. Sound Radio, Inc.*, 109 F.3d 873, 879 (3d Cir. 1997); *Veltman v. Whetzal*, 93 F.3d 517, 520-21 (8th Cir. 1996); *In re Maurice*, 69 F.3d 830, 832 (7th Cir. 1995); *Solomon v. Smith* (*In re Moody*), 41 F.3d 1024, 1026 (5th Cir. 1995); *Anderson v. Mouradick* (*In re Mouradick*), 13 F.3d 326, 327 (9th Cir. 1994); *Fellows v. Colonial Sav. and Loan Ass'n* (*In re Fellows*), 19 F.3d 245, 247 (5th Cir. 1994); *Deyhimy v. Rupp* (*In re Herwitt*), 970 F.2d 709, 710 (10th Cir. 1992); *In re Schultz Mfg. Fabricating Co.*, 956 F.2d 686 (7th Cir. 1992); *Colon v. Hart* (*In re Colon*), 941 F.2d 242, 245 (3d Cir. 1991); *River Prod. Co., Inc. v. Webb* (*In re*

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[4] In *Bowles*, the Supreme Court differentiated its earlier decision in *Kontrick v. Ryan*, 540 U.S. 443 (2004), which held that the period of time for a creditor to object to a debtor's discharge established by Federal Rule of Bankruptcy Procedure 4004 was not jurisdictional because it was not established by statute. In contrast, the period of time for filing a notice of appeal is not merely established by Rule; it is derived from 28 U.S.C. § 158(c)(2) and is therefore jurisdictional.

Topco, Inc.), 894 F.2d 727, 733 & n.7 (5th Cir. 1991); *Slimick v. Silva* (*In re Slimick*), 928 F.2d 304, 306 (9th Cir. 1990); *Greene v. United States* (*In re Souza*), 795 F.2d 855, 856-57 (9th Cir. 1986); *Stelpflug v. Fed. Land Bank of St. Paul*, 790 F.2d 47, 49 (7th Cir. 1986); *Whitemere Dev. Corp., Inc. v. Township of Cherry Hill*, 786 F.2d 185, 187 (3d Cir. 1986); *In re Abdallah*, 778 F.2d 75, 77 (1st Cir. 1985); *In re Universal Minerals, Inc.*, 755 F.2d 309, 310 (3d Cir. 1985).

The requirement of a timely appeal is included in the statutory language of 28 U.S.C. § 158(c)(2), which expressly references Federal Rule of Bankruptcy Procedure 8002. Thus, 28 U.S.C. § 158(c)(2) creates a jurisdictional requirement for a timely appeal. "[F]ailure to file a timely notice of appeal of the . . . Order 'creates a jurisdictional defect barring appellate review.'" *Rieser v. Dinsmore & Shohl, LLP* (*In re Troutman Enterprises, Inc.*), 343 B.R. 590, 605 (Bankr. S.D. Ohio 2005) (quoting *Shareholders v. Sound Radio, Inc.*, 109 F.3d 873, 879 (3d Cir. 1997)); *see also Anderson v. Duvoisin* (*In re Southern Indus. Banking Corp.*), 70 B.R. 196 (E.D. Tenn 1986).

B. The Notice of Appeal in the Present Case was Untimely.

The Debtor's Notice of appeal was filed outside of the ten day time period established by the Rules. On September 17, 2009, based on the U.S. Trustee's Report and Recommendation, the bankruptcy court entered an order dismissing the Debtor's case for failure to attend the meeting of creditors. The Debtor had ten days — or until September 28, 2009 — to appeal from the order dismissing the case.[5] *See* 28 U.S.C. § 158(c)(2) and Fed. R. Bankr. P. 8002(a). The Debtor filed a notice of appeal on September 29, 2009, twelve days after entry of the bankruptcy court's

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[5] Pursuant to Federal Rule of Bankruptcy Procedure 9006, the period was actually eleven (11) calendar days, because the last day of the period fell on a Sunday, thus extending the final day to appeal until the following Monday — September 28, 2009.

September 17, 2009 order. (Docket No. 43). Therefore, the notice of appeal was untimely, and this Court does not have jurisdiction to entertain the Debtor's appeal.

CONCLUSION

The Debtor filed his Notice of Appeal after the ten day limitation period of 28 U.S.C. §158(c)(2) and Federal Rule of Bankruptcy Procedure 8002(a). Accordingly, this Court should dismiss the Debtor's appeal for lack of subject matter jurisdiction.

Respectfully submitted,

RICHARD F. CLIPPARD
United States Trustee, Region 8

By: /s/ Carrie Ann Rohrscheib
Carrie Ann Rohrscheib, Trial Attorney (TN 022991)
United States Department of Justice
Office of the United States Trustee
200 Jefferson Avenue, Suite 400
Memphis, Tennessee 38103
(901)544-3211/fax (901) 544-4138

CERTIFICATE OF SERVICE

I HERBY CERTIFY that on the ___ day of ________, 2009, a copy of the foregoing electronically filed Motion of the United States Trustee to Dismiss Appeal and Memorandum of Law in Support of the Motion of the United States Trustee to Dismiss Appeal was served on the parties listed below by first-class mail, postage prepaid.

Barry Lee Armistead
118532 CBCX-21/14
7466 Centinnial Blvd.
Nashville, TN 37209

Marianna Williams
Chapter 7 Trustee
P.O. Box H
Dyersburg, TN 38024-2008

By: /s/ Carrie Ann Rohrscheib
Carrie Ann Rohrscheib, Trial Attorney (TN 022991)

BRIEF BANK — 'SUMMARY SHEET" *Printed Mon-5/23/11 11:17*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	In re Armstrong (Brunner v. Armstrong)
2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	E.D. Wash.
3. ("CCN") ***CURRENT*** CASE NO.	No.: 07-2822
4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*	No.: 06-02476 Court: Bankr. E.D. Wash. *(Identify judge & cite, if any)*
5. ("SO") ***SOURCE***	**U.S. TRUSTEES**
6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	Filed: Nov. 2007 Type: AMICUS BRIEF OF UNITED STATES TRUSTEE
7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*	Gary Dwyer, P. Matthew Sutko, Melissa R. Burgess, Ilene Lashinsky, Robert D. Miller *(UST/OGC: 202-307-1399/FAX-2397)*
8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	•Whether the Bankruptcy Court erred by holding that the Debtors could claim the IRS Standard expense allowance for vehicle financing in the calculation of their disposable income, even though they had no vehicle financing expense because they owned their car debt free? √ **Background:**
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UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF WASHINGTON

In re:

ARMSTRONG, NATHAN,
ARMSTRONG, GEORGENA

Debtor.

In re:

Daniel Brunner, Chapter 13 Trustee,

Appellant,

vs.

NATHAN ARMSTRONG, and
GEORGENA ARMSTRONG

Appellees.

Case No. 07-cv-282-EFS

[Bankruptcy Appeal]
[Bk.Case No. 06-02476]

AMICUS BRIEF OF UNITED STATES TRUSTEE IN SUPPORT OF APPELLANT, DANIEL BRUNNER, CHAPTER 13 TRUSTEE

Of Counsel

ROBERTA A. DeANGELIS
General Counsel

P. Matthew Sutko
Melissa R. Burgess
United States Department of Justice
Executive Office for U.S. Trustee

ILENE J. LASHINSKY
United States Trustee

ROBERT D. MILLER
Assistant U.S. Trustee
U. S. Department of Justice
Office of the U.S. Trustee
920 W. Riverside Ave.,
Rm 593
Spokane, WA 99201

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INTEREST OF THE UNITED STATES

The Attorney General appoints United States Trustees to supervise the administration of bankruptcy cases and trustees in regions comprising the vast majority of federal judicial districts. 28 U.S.C. §§ 581-589a. United States Trustees "serve as bankruptcy watchdogs to prevent fraud, dishonesty, and overreaching in the bankruptcy arena." H.R. Rep. No. 595, 95th Cong., 1st Sess. 88 (1977). The United States Trustee Program thus acts in the public interest to promote the efficiency and to protect and preserve the integrity of the bankruptcy system. By statute, "[t]he United States Trustee may raise and may appear and be heard on any issue in any case or proceeding under this Title." 11 U.S.C. § 307. See also In re Donovan Corp., 215 F.3d 929, 930 (9th Cir. 2000) (upholding broad appellate standing of United States Trustees).

This case involves a dispute over confirmation of a plan under chapter 13 of the Bankruptcy Code. In this matter, the United States Trustee has two separate and distinct interests. First, the United States Trustee has the statutory duty to oversee the administration of chapter 13 cases, which includes monitoring and, if necessary, objecting to chapter 13 plans under 11 U.S.C. § 1324. 28 U.S.C. § 586(a)(3)(C). Second, the United States Trustee has an interest in this appeal because the issue on appeal directly implicates 11 U.S.C. § 707(b), which the United States Trustee oversees pursuant to her duties set forth in 11 U.S.C. § 704(b), and under which United States Trustees regularly seek relief involving the same legal issue.

The question of law involved in this appeal is not limited to the Armstrongs. Rather, it will apply globally to thousands of debtors in a myriad of different financial circumstances who will file bankruptcy cases in this district and nationally. For this reason, the United States Trustee respectfully offers this Court its views on whether debtors in a chapter 13 case may deduct the IRS Local Standard expense for vehicle financing costs, even though they do not make monthly note or lease payments.

STATEMENT OF APPELLATE JURISDICTION

The Bankruptcy Court had jurisdiction over this matter pursuant to 28 U.S.C. § 1334(b) and § 157(b)(2)(L). The District Court has jurisdiction over this appeal pursuant to 28 U.S.C. § 158(a)(1) and (b) and Federal Rule of Bankruptcy Procedure 8001. Daniel Brunner, Chapter 13 Trustee, appeals from orders of the United States Bankruptcy Court, Eastern District of Washington, overruling his Objection to Confirmation of Chapter 13 Plan filed in the case of the Debtors, Nathan and Georgena Armstrong, (“Debtors”), and confirming the Armstrongs’ chapter 13 plan.

STATEMENT OF ISSUES PRESENTED FOR REVIEW

The Chapter 13 Trustee objected to confirmation of the Debtors’ modified plan on the grounds that it did not commit all of the Debtors’ disposable income to the plan as required under 11 U.S.C. § 1325(b)(1)(B). The Bankruptcy Court overruled the Chapter 13 Trustee’s objection and confirmed the plan, holding that the Debtors could properly claim the IRS Local Standard expense allowance for vehicle ownership, notwithstanding that the Debtors had no vehicle loan or lease payment, thereby substantially reducing the funds available to pay creditors under the plan.

In this case, the Debtors’ income exceeds the family median income for the State of Washington. In chapter 13 bankruptcy cases, when the debtors’ income exceeds their state’s family median income, 11 U.S.C. § 1325(b)(3) requires the debtors to use the “means test” provisions of 11 U.S.C. § 707(B)(2)(A) and (B) to determine their expenses. Given that 11 U.S.C. 707(B)(2)(A)(ii)(I) allows only “applicable” vehicle ownership expenses to be deducted under the means test, the issue presented is whether the Bankruptcy Court erred by holding that the Debtors could claim the IRS Standard expense allowance for vehicle financing in the calculation of their disposable income, even though they had no vehicle financing expense because they owned their car debt free.

STANDARD OF REVIEW

On appeal "conclusions of law are reviewed de novo, findings of fact are reviewed for clear error, and mixed questions of fact and law are reviewed de novo." Since the underlying facts are not disputed, the question is one in which legal issues predominate and is thus subject to de novo review. United States v. McConney, 728 F.2d 1195, 1199-1204 (9th Cir. 1984) (en banc), cert. denied, 469 U.S. 824, 105 S.Ct. 101, 83 L.Ed.2d 46 (1984); In re Kelly, 841 F.2d 908, 911 (9th Cir., 1988). In an appeal taken from a bankruptcy court order, a district court reviews the bankruptcy court’s findings on questions of law *de novo*. In re Emery, 317 F.3d 1064, 1069 (9th Cir. 2003) (citing In re Allen, 300 F.3d 1055, 1058 (9th Cir. 2002)).

STATUTORY FRAMEWORK AND BACKGROUND

I. Statutory Framework

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (the “2005 Reform Act”) altered the analysis bankruptcy courts must employ when determining whether to confirm proposed chapter 13 repayment plans. When, as here, a trustee or holder of an allowed unsecured claim objects to plan confirmation, 11 U.S.C. § 1325(b)(1) conditions plan confirmation upon the debtors committing all of their "projected disposable income" to payments to unsecured creditors through the plan. "Disposable income" is the current monthly income received by the debtors (other than child support payments, foster care payments, or disability payments for a dependent child) less amounts reasonably necessary to be expended. 11 U.S.C. § 1325(b)(2). The term "current monthly income" is the average monthly income from all sources that the debtors receive during the six-month period ending on the last day of the calendar month immediately preceding the date of the commencement of the case, including any amount paid by a third party on a regular basis for the household expenses of the debtor or the debtor's dependents, but excluding benefits received under the Social Security Act. 11 U.S.C. § 101(10A). For above-median-income debtors, the "amounts reasonably necessary to be expended" are determined "in accordance with" § 707(b)(2)(A)[1]and (B), which provides various specific expense categories from which debtors may reduce their "current monthly income."[2] 11 U.S.C. § 1325(b)(3).

The "means test" provisions of §§ 707(b)(2)(A) and (B) are used in

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[1] As amended by the 2005 Reform Act, § 707(b)(2) repealed the former presumption in favor of the debtor, and replaced it with a new presumption. A case is an "abuse" of Chapter 7 if a detailed mathematical formula set out in the statute, commonly referred to as the "means test," yields a minimum amount of monthly disposable income. The means test uses a series of calculations to determine whether the § 707(b)(2) presumption of abuse arises in Chapter 7 cases. *See* 11 U.S.C. § 707(b)(2)(A).

[2] Form 22C, which debtors must file pursuant to Interim Federal Rule of Bankruptcy Procedure 1007(b)(6), serves, in part, to calculate debtor's "current monthly income."

determining the expenses of chapter 13 debtors, like these debtors, whose income exceeds their state's median family income. 11 U.S.C. § 1325(b)(3). In determining expenses, § 707(b)(2)(A)(ii)(I) provides that a debtor's "monthly expenses shall be the debtor's *applicable* monthly expense amounts specified under the National Standards and Local Standards and the debtor's actual monthly expenses for the categories specified as Other Necessary Expenses issued by the Internal Revenue Service for the area in which the debtor resides…." 11 U.S.C. § 707(b)(2)(A)(ii)(I) (emphasis added).

II. Factual Background

On their Schedule B, the Armstrongs listed ownership of one vehicle, a 1998 GMC Truck. CR No. 1.[3] They stipulated before the lower court they had no payment associated with the vehicle. CR No 59. They did not list any secured debt for their GMC truck on their Schedule D. CR No 1. On their Official Form 22C, Line 28, the Armstrongs claimed the IRS Standard "transportation ownership/lease expense" in the amount of $471 for the GMC truck.[4] CR No. 34.

On November 8, 2007, the Chapter 13 Trustee filed an objection to

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[3] Following the appellant's citations, the cites to the record are to the Court's Record followed by the docket number of the document in the Bankruptcy Court's docket as identified in the Designation of record on appeal. The relevant facts were not in dispute before the Bankruptcy Court.

[4] This amount is in addition to the "vehicle operation expenses" taken on Line 27. Because the vehicle is over six years old, the United States Trustee would also allow the Debtors an additional $200 operating expense per vehicle, based on the Internal Revenue Manual which allows such an additional vehicle operating expenses. See Internal Revenue Manual, Part 5 (entitled Collecting Process), Chapter 8, § 5.8.5.5.2, Treatment of Non-Business Transportation Expenses, which may be found on the IRS website at http://www/irs/gov/irm/part5/ch08s05.html.

confirmation of the Debtors' Chapter 13 plan, claiming the plan failed to provide all of the Debtors' disposable income for the payment of creditors, contrary to 11 U.S.C. §§ 1325(a)(3) and (b)(1)(B). CR No. 27. The objection was amended December 22, 2006. CR No. 40 and 41. In his objection, the Chapter 13 Trustee argued that the Debtors had more income to devote to paying creditors because they were improperly claiming the IRS Standard expense for vehicle financing expenses, even though that expense deduction was not applicable because these Debtors have no vehicle or lease payments. Id.

The parties briefed their respective positions, CR No. 59 and 61. Argument was held On May 15, 2007.

On June 12, 2007, the bankruptcy court overruled the Chapter 13 Trustee's objection to the Debtors' plan. CR No. 65. The bankruptcy court ruled that Mr. and Mrs. Armstrong were entitled to reduce their disposable income by the amount of the IRS Standard allowance for vehicle financing costs even though they had no vehicle financing costs. Id.

On August 22, 2007, the court confirmed the plan of the debtors. CR No. 73.

This appeal followed on August 31, 2007. CR No.77.

SUMMARY OF ARGUMENT

The bankruptcy court erred as a matter of law in overruling the Chapter 13 Trustee's objection to confirmation and confirming the Armstrongs' chapter 13 plan. It did so by misinterpreting when debtors can claim a vehicle ownership expense under section 707(b)(2), which is made applicable to chapter 13 debtors under § 1325(b). The court held that the

Armstrongs were entitled to deduct $471 in vehicle ownership expenses for their vehicle, even though the vehicle was owned free and clear of encumbrances. This was incorrect because 11 U.S.C. § 707(b)(2)(A)(ii)(I) allows the Armstrongs to claim only "applicable" expenses, and they had no applicable vehicle ownership expenses because the vehicle was not subject to a loan or lease payment. By using the word "applicable," Congress limited eligibility for expenses under the Local Standards to debtors for whom the expenses apply. Because the vehicle acquisition/financing expense does not apply with respect to the Armstrongs' vehicle, the bankruptcy court erred in holding they were eligible to deduct the expense under the means test.

Reading "applicable" in section 707(b)(2) as requiring debtors to have a loan or lease payment on a vehicle as a prerequisite to eligibility for the vehicle ownership expense has the salutary effect of applying the means test in a manner that is consistent with the Internal Revenue Service's longstanding application of this standard. Under section 707(b)(2), the means test looks to the IRS to establish certain standard expenses. 11 U.S.C. § 707(b)(2)(A)(ii)(I). In applying its standards to taxpayers, the IRS does not allow taxpayers to claim vehicle ownership expenses absent a monthly car expense. See IRS Collection Financial Standards attached hereto as Exhibit 1 of the Addendum.[5]

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[5] The IRS revised its Collection Financial Standards, effective October 1, 2007, and such revisions will be made applicable to bankruptcy cases filed as of January 1, 2008. Because the Armstrongs' case was filed on October 3, 2006, only the Collection Financial Standards in effect prior to October 1, 2007, are applicable to the Armstrongs' case. For the Court's convenience, a true and correct PDF copy of the Collection Financial Standards applicable to this case are attached as Exhibit "1" on the Addenda and incorporated herein by reference. It is important to note, however, that

Finally, the bankruptcy court's order overruling the Chapter 13 Trustee's objection to confirmation of the Armstrongs' plan conflicts with sound notions of public policy and the primary purpose of Congress in passing bankruptcy reform legislation in 2005 - including the amendments at issue in this appeal. The 2005 Reform Act was intended to ensure that debtors repay their debts when they can. By allowing the Armstrongs to claim a fictional expense for their vehicle, the bankruptcy court frustrated that purpose.

ARGUMENT

I.

THE BANKRUPTCY COURT ERRED IN HOLDING THAT THE ARMSTRONGS WERE ELIGIBLE TO CLAIM THE IRS LOCAL STANDARDS FOR VEHICLE OWNERSHIP FOR THEIR VEHICLE BECAUSE THE EXPENSE WAS NOT APPLICABLE TO THEM.

The bankruptcy court's order overruling the Chapter 13 Trustee's objection to confirmation of the Armstrongs' plan should be reversed because it fails to recognize that the Bankruptcy Code only allows debtors to claim vehicle expenses that are applicable to them. 11 U.S.C. § 707(B)(2)(A)(ii)(I). The Armstrongs do not have any "applicable" vehicle ownership expense because they own their vehicle outright.

A. Vehicle ownership expenses are allowable only if "applicable" to the debtors.

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the revisions made by the IRS effective October 1, 2007, do not change any result in this case. As set forth in the current Collection Financial Standards, the Local Standard for Vehicle Operation is still made expressly contingent on the existence of a loan or lease payment on a vehicle. *See Id.* As explained by the IRS, the recent revisions to the Local Standards were made to create equal allowances for first and second vehicles, add a separate public transportation allowance and reorganize the manner in which taxpayers in certain counties calculate their transportation operating expenses. See id., under heading "Recent Revisions."

Section 707(b)(2)(A)(ii)(I) of the Bankruptcy Code provides that a "debtor's monthly expenses shall be the debtor's *applicable* monthly expense amounts specified under the...Local Standards...issued by the Internal Revenue Service..." 11 U.S.C. § 707(b)(2)(A)(ii)(I) (emphasis added). The statute expressly provides that before the specific IRS expense amounts may be included in the debtor's allowed monthly expenses, the expense must itself first be *applicable* to the debtor. Id.

The Bankruptcy Code does not define the word "applicable," nor has the United States Trustee identified any Supreme Court or Ninth Circuit decision that provides a definition in the bankruptcy context.[6] Where, as here, a statutory term is undefined, a basic principle of statutory construction provides that courts should give such terms their ordinary meanings. E.g., Smith v. U.S., 508 U.S. 223, 228 (1993) ("When a word is not defined by statute, we normally construe it in accord with its ordinary or natural meaning."). See also Watson v. Ray, 192 F.3d 1153, 1155 (8th Cir. 1999) ("When interpreting a statute the court starts with the statute's plain meaning"). The dictionary defines "applicable" to mean applying or capable of being applied; relevant; suitable; appropriate. Random House Unabridged Dictionary (2006). Accordingly, such a meaning should be imparted to the term "applicable" as it appears in section 707(b)(2)(A)(ii)(I) absent clear indication to the contrary. See Johnson v. Aljian, 490 F3d 778,780 (9th Cir. 2007) (quoting U.S. v. TRW Rifle 7.62x51 Meter Caliber, 447 F.3d 686,689 (9th Cir. 2006) ("[W]e follow the common practice of

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[6] But see, Fong v. Glover, 197 F.2d 710, 711 (9th Cir. 1952) (defining "applicable" as it appears in the Federal Rules of Civil Procedure as "capable of being applied.")

consulting dictionary definitions to clarify their ordinary meaning[] and look to how the terms were defined at the time [the statute] was adopted.”).

By inserting the word “applicable” in section 707(b)(2)(A)(ii)(I), Congress limited eligibility for expenses under the Local Standards to debtors for whom such expenses are “relevant; suitable; appropriate”-- thereby excluding phantom ones. The bankruptcy court’s order is inconsistent with the ordinary, common sense definition of “applicable” because it allows debtors like the Armstrongs to deduct expenses that do not apply to them. If such inapplicable expenses are disallowed, the Armstrongs have the ability to repay their unsecured creditors an additional $16,260 in their 60-month chapter 13 repayment plan.

The court below concluded that the Armstrongs could deduct vehicle expenses they do not have because "applicable" in section 707(b)(2)(A)(ii)(I) refers solely to choosing the correct number from the IRS expense tables based on the "geographical location of the debtors and the number of vehicles... .” CR No. 65, p.8 and 11 . In other words, the court read "applicable" merely as referring to the number of standardized expenses amounts the Armstrongs can claim.

The court’s reading does not interpret section 707(b)(2)(A)(ii)(I), it *rewrites* it. For its proffered construction to be the correct one, the statute would need to read "[t]he debtor's monthly expenses shall be the ~~debtor's~~ applicable [number of] monthly expense amounts . . ." 11 U.S.C. § 707(b)(2)(A)(ii)(I) (as modified). The statute does not say that. Nowhere does it state "applicable" means the "number" of expenses. To the contrary, "applicable" follows the word "debtor's," making it clear that the section asks debtors to claim those IRS standard expenses that apply to them.

Given this, the Armstrongs should not be allowed to claim inapplicable expenses, ones they do not have.

Not surprisingly, both appellate courts that have interpreted the word applicable in section 707(b)(2)(A)(ii)(I) have rejected the bankruptcy court's proffered reading. In re Ross-Tousey, 368 B.R. 762, 766 (E.D. Wis. 2007); In re Hartwick, 373 B.R. 645, 649-50 (D. Minn. 2007). They did so, in part, because the bankruptcy court's reading is not faithful to the purpose underlying section 707(b)(2)'s means test. As the Ross-Tousey court noted, "if it really is that simple, the statute would not seem to achieve its purpose" of ensuring that debtors are allowed expenses for the necessities of life but pay creditors from what remains. Ross-Tousey, 368 B.R at 766 (E.D. Wis. 2007). See also In re Howell, 366 B.R. 153, 157 (Bankr. D. Kan. 2007) ("denying debtors the ownership allowance when they have no ownership expense (i.e. loan or lease payments) is entirely consistent with one of the apparent objectives of BAPCPA: to ensure that debtors actually pay what they are capable of paying to unsecured creditors.").

The bankruptcy court's proffered numerical definition also fails to appreciate that a debtor's ability to pay creditors is not affected by mere vehicle *ownership* but by *payments* on a car. Accordingly, section 707(b)(2)(A)(ii)(I) does not focus on how many cars a debtor owns, but how many cars she makes *payments* on every month. Ross-Tousey, 368 B.R. at 766 ("The statute is only concerned about protecting the debtor's ability to continue owning a car, and if the debtor already owns the car, the debtor is adequately protected."); see also Hartwick, 373 B.R. at 652 (same).

In addition, the Hartwick and Ross-Tousey courts reversed the bankruptcy court rulings in those cases because they, like the court here, created an arbitrary distinction between the word "actual" and "applicable" expenses in section 707(b)(2)(A)(ii)(I). See, e.g., In re Fowler, 349 B.R. 414, 418 (Bankr. D. Del. 2006) (stating "The use of 'actual' with respect to the Other Necessary Expenses and 'applicable' with respect to the National and Local Standards must mean that Congress intended two different applications.) The bankruptcy court below agreed with courts like Fowler that "applicable" and "actual" must have different meanings, reasoning that because Congress used both terms in the statute, debtors like the Armstrongs need not have any "actual" expense for the Ownership Expense Standard to be "applicable." CR No. 65, p. 5 and 11. This logic is misguided, however, because, as the Ross-Tousey court explained, there is no indication in section 707(b)(2)(A)(ii)(I) that Congress intended the words "applicable" and "actual" to have essentially *opposite* meanings. Ross-Tousey, 368 B.R. at 765. Rather, the better reading of "applicable" in the context of section 707(b)(2)(A)(ii)(I) is that it may have two meanings: first, the ownership expense is "applicable" if the debtor makes a loan or lease payment on a vehicle, and second, the *amount* allowed to the debtor is the "applicable" amount provided under the IRS Standards, and not the "actual" amount." Id. See also Hartwick, 373 B.R. at 653. "This reading gives meaning to the distinction between 'applicable' and 'actual' without taking a further step to conclude that 'applicable' means "nonexistent' or 'fictional.'" Ross-Tousey, 368 B.R. at 765.

By giving the term "applicable" its proper meaning, a determination of allowable expenses under the means test is a two-step process. The first step is eligibility—i.e., does the debtor qualify for an expense allowance in the category at issue? If so, then the second step is to quantify the expense amount the eligible debtor is allowed by looking at the IRS Standard amounts that are specified for the number of vehicles owned by the debtor and where the debtor lives. See, e.g., In re Carlin, 348 B.R. 795, 798 (Bankr. D. Or. 2006)("There is nothing absurd in Congress drawing the line for vehicle ownership expense eligibility at those debtors who are making payments on the vehicle.") The bankruptcy court's ruling impermissibly skips the first step of determining whether the Armstrongs are *eligible* for the ownership expense by virtue of having a loan or lease payment for a vehicle, and proceeds directly to the second—only considering the *amount* the IRS would allow eligible taxpayers to claim for ownership of two vehicles.

B. The UST's construction of "applicable" in § 707(b)(2) has the salutary effect of treating transportation costs the same way in bankruptcy cases that the IRS treats them.

Reversal of the bankruptcy court's order allowing the Armstrongs to deduct vehicle financing expenses that they do not have has the additional benefit of treating inapplicable phantom expenses in bankruptcy cases the way the IRS has long treated them. In providing which deductions debtors may take under the means test, Congress specifically stated that debtors are permitted to deduct "the debtor's *applicable* monthly expense amounts specified under the…Local Standards…issued by the *Internal Revenue Service*." 11 U.S.C. § 707(b)(2)(A)(ii)(I) (emphasis added). Accordingly, how the Internal Revenue Service applies the Standards that it developed for its own internal debt collection purposes is instructive on the question of how the same Standards might be applied in bankruptcy cases under section 707(b)(2). See, e.g., Hartwick, 373 B.R. at 650-51 ("in order to determine whether the expense Standards issued by the IRS are 'applicable,' the most logical resource to consult is the IRS"). See also In re Slusher, 359 B.R. 290, 309 (Bankr. D. Nev. 2007) ("if guidance is sought on the meaning of the IRS standards that Congress incorporated into the Bankruptcy Code, practical reason would suggest that court should consider the full manner by which the IRS uses these standards.").

The IRS Collection Financial Standards in effect as of the date of the Armstrongs' bankruptcy filing[7] fully support the United States Trustee's construction of the term "applicable" and provide as follows:

> The transportation standards consist of nationwide figures for monthly loan or lease payments referred to as ownership costs, and additional amounts for monthly operating costs….The ownership costs provided maximum allowances for the lease or purchase of up to two automobiles if allowed as a necessary expense….If a taxpayer has a car payment, the allowable ownership cost added to the allowable operating cost equals the allowable transportation expense. **If a taxpayer has no car payment, or no car, the operating costs portion of the transportation standard is used to come up with the allowable transportation expense.**

See IRS Collection Standards attached hereto as Exhibit 1of the Addendum; (emphasis added); *see also* Internal Revenue Manual, Financial Analysis Handbook, Pt. 5, ch. 15, § 5.15.1.7(4.B), available at http://www.irs.gov/irm/part5/ch15s01.html#d0e187819.

As of the date the Armstrongs filed their bankruptcy petition,[8] the "ownership cost" was specifically calculated by the IRS based on the cost to finance the acquisition of a vehicle, and not simply a cost associated with

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[7] See Footnote 5, supra.

[8] See Footnote 5, supra.

owning a car, such as repair or maintenance. The IRS noted that the "ownership cost" Standards are based on the **"five-year average of new and used car financing data compiled by the Federal Reserve Board of Governors."** See id. (emphasis added). As such, the IRS does not treat the "ownership cost" expense as applicable when a taxpayer does not have a monthly expense related to financing a car. In exercising its discretion to collect taxes, the IRS recognizes that taxpayers may claim the vehicle "ownership cost" portion of the Local Transportation Standards only in situations where the taxpayer has a monthly vehicle acquisition financing expense, i.e., has a monthly vehicle loan or lease payment. See id.

II.

THE BANKRUPTCY COURT'S ORDER CONFLICTS WITH THE MAJOR GOALS OF THE 2005 AMENDMENTS TO THE BANKRUPTCY CODE.

The bankruptcy court's order is also inconsistent with Congress' goals and purpose in implementing bankruptcy reform. Congress amended the Bankruptcy Code in 2005 to rectify perceived abuses in the bankruptcy process. "Among the abuses identified by Congress was the easy access to chapter 7 liquidation proceedings by consumer debtors who, if required to file under chapter 13, could afford to pay some dividend to their unsecured creditors." In re Hardacre, 338 B.R. 718, 720 (Bankr. N.D. Tex. 2006) (citing 151 Cong. Rec. S2459, 2469-70 (March 10, 2005)). A "primary goal" of the 2005 Reform Act was to "ensure that debtors repay creditors the maximum they can afford." In re Lenton, 358 B.R. 651 (Bankr. E.D. Pa. 2006) (citing H.R. Rep. No. 109-31, pt. 1, at 1 (2005), reprinted in 2005 U.S.C.C.A.N. 88, 89). In cases such as this one, where the Armstrongs have no loan or lease payment, Congress has established a system which does not provide them an expense deduction for vehicle financing. “Allowing debtors to deduct from their disposable income a fictional ownership allowance would give debtors with unencumbered vehicles a windfall at the expense of their unsecured creditors.” In re Howell, 366 B.R. 153, 157 (Bankr. D. Kan. 2007).

CONCLUSION

For all of these reasons, the United States Trustee respectfully asks this Court to reverse the July 30, 2007, Orders entered by the bankruptcy court overruling the Chapter 13 Trustee’s objection to confirmation of the Debtors’ plan and confirming the Debtors’ plan, and remand this case to the bankruptcy court for further proceedings.

Respectfully submitted,

ILENE J. LASHINSKY
UNITED STATES TRUSTEE

ROBERT D. MILLER
ASSISTANT U.S. TRUSTEE

/s/ Gary W. Dyer
Gary W. Dyer CSBA #106701
Trial Attorney
920 W. Riverside Ave., Rm 593
Spokane, WA 99201
Telephone: (509) 353-2999 ext 110
Fax: (509) 353-3124
E-mail: Gary.W.Dyer@usdoj.gov

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Court: Bankr. E.D. Wash.
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(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC*** **BANKRUPTCY**

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***

•Whether the Bankruptcy Court erred by holding that the Debtors could claim the IRS Standard expense allowance for vehicle financing in the calculation of their disposable income, even though they had no vehicle financing expense because they owned their car debt free?

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UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF WASHINGTON

In re: ARMSTRONG, NATHAN, ARMSTRONG, GEORGENA Debtor.	Case No. 07-cv-282-EFS [Bankruptcy Appeal] [Bk.Case No. 06-02476]
In re: Daniel Brunner, Chapter 13 Trustee, Appellant, vs. NATHAN ARMSTRONG, and GEORGENA ARMSTRONG Appellees.	

AMICUS BRIEF OF UNITED STATES TRUSTEE IN SUPPORT OF APPELLANT, DANIEL BRUNNER, CHAPTER 13 TRUSTEE

Of Counsel

ROBERTA A. DeANGELIS
General Counsel

P. Matthew Sutko
Melissa R. Burgess
United States Department of Justice
Executive Office for U.S. Trustee

ILENE J. LASHINSKY
United States Trustee

ROBERT D. MILLER
Assistant U.S. Trustee
U. S. Department of Justice
Office of the U.S. Trustee
920 W. Riverside Ave.,
Rm 593
Spokane, WA 99201

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INTEREST OF THE UNITED STATES

The Attorney General appoints United States Trustees to supervise the administration of bankruptcy cases and trustees in regions comprising the vast majority of federal judicial districts. 28 U.S.C. §§ 581-589a. United States Trustees "serve as bankruptcy watchdogs to prevent fraud, dishonesty, and overreaching in the bankruptcy arena." H.R. Rep. No. 595, 95th Cong., 1st Sess. 88 (1977). The United States Trustee Program thus acts in the public interest to promote the efficiency and to protect and preserve the integrity of the bankruptcy system. By statute, "[t]he United States Trustee may raise and may appear and be heard on any issue in any case or proceeding under this Title." 11 U.S.C. § 307. See also In re Donovan Corp., 215 F.3d 929, 930 (9th Cir. 2000) (upholding broad appellate standing of United States Trustees).

This case involves a dispute over confirmation of a plan under chapter 13 of the Bankruptcy Code. In this matter, the United States Trustee has two separate and distinct interests. First, the United States Trustee has the statutory duty to oversee the administration of chapter 13 cases, which includes monitoring and, if necessary, objecting to chapter 13 plans under 11 U.S.C. § 1324. 28 U.S.C. § 586(a)(3)(C). Second, the United States Trustee has an interest in this appeal because the issue on appeal directly implicates 11 U.S.C. § 707(b), which the United States Trustee oversees pursuant to her duties set forth in 11 U.S.C. § 704(b), and under which United States Trustees regularly seek relief involving the same legal issue.

The question of law involved in this appeal is not limited to the Armstrongs. Rather, it will apply globally to thousands of debtors in a myriad of different financial circumstances who will file bankruptcy cases in this district and nationally. For this reason, the United States Trustee respectfully offers this Court its views on whether debtors in a chapter 13 case may deduct the IRS Local Standard expense for vehicle financing costs, even though they do not make monthly note or lease payments.

STATEMENT OF APPELLATE JURISDICTION

The Bankruptcy Court had jurisdiction over this matter pursuant to 28 U.S.C. § 1334(b) and § 157(b)(2)(L). The District Court has jurisdiction over this appeal pursuant to 28 U.S.C. § 158(a)(1) and (b) and Federal Rule of Bankruptcy Procedure 8001. Daniel Brunner, Chapter 13 Trustee, appeals from orders of the United States Bankruptcy Court, Eastern District of Washington, overruling his Objection to Confirmation of Chapter 13 Plan filed in the case of the Debtors, Nathan and Georgena Armstrong, ("Debtors"), and confirming the Armstrongs' chapter 13 plan.

STATEMENT OF ISSUES PRESENTED FOR REVIEW

The Chapter 13 Trustee objected to confirmation of the Debtors' modified plan on the grounds that it did not commit all of the Debtors' disposable income to the plan as required under 11 U.S.C. § 1325(b)(1)(B). The Bankruptcy Court overruled the Chapter 13 Trustee's objection and confirmed the plan, holding that the Debtors could properly claim the IRS Local Standard expense allowance for vehicle ownership, notwithstanding that the Debtors had no vehicle loan or lease payment, thereby substantially reducing the funds available to pay creditors under the plan.

In this case, the Debtors' income exceeds the family median income for the State of Washington. In chapter 13 bankruptcy cases, when the debtors' income exceeds their state's family median income, 11 U.S.C. § 1325(b)(3) requires the debtors to use the "means test" provisions of 11 U.S.C. § 707(B)(2)(A) and (B) to determine their expenses. Given that 11 U.S.C. 707(B)(2)(A)(ii)(I) allows only "applicable" vehicle ownership expenses to be deducted under the means test, the issue presented is whether the Bankruptcy Court erred by holding that the Debtors could claim the IRS Standard expense allowance for vehicle financing in the calculation of their disposable income, even though they had no vehicle financing expense because they owned their car debt free.

STANDARD OF REVIEW

On appeal "conclusions of law are reviewed de novo, findings of fact are reviewed for clear error, and mixed questions of fact and law are reviewed de novo." Since the underlying facts are not disputed, the question is one in which legal issues predominate and is thus subject to de novo review. United States v. McConney, 728 F.2d 1195, 1199-1204 (9th Cir. 1984) (en banc), cert. denied, 469 U.S. 824, 105 S.Ct. 101, 83 L.Ed.2d 46 (1984); In re Kelly, 841 F.2d 908, 911 (9th Cir., 1988). In an appeal taken from a bankruptcy court order, a district court reviews the bankruptcy court's findings on questions of law *de novo*. In re Emery, 317 F.3d 1064, 1069 (9th Cir. 2003) (citing In re Allen, 300 F.3d 1055, 1058 (9th Cir. 2002)).

STATUTORY FRAMEWORK AND BACKGROUND

I. Statutory Framework

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (the "2005 Reform Act") altered the analysis bankruptcy courts must employ when determining whether to confirm proposed chapter 13 repayment plans. When, as here, a trustee or holder of an allowed unsecured claim objects to plan confirmation, 11 U.S.C. § 1325(b)(1) conditions plan confirmation upon the debtors committing all of their "projected disposable income" to payments to unsecured creditors through the plan. "Disposable income" is the current monthly income received by the debtors (other than child support payments, foster care payments, or disability payments for a dependent child) less amounts reasonably necessary to be expended. 11 U.S.C. § 1325(b)(2). The term "current monthly income" is the average monthly income from all sources that the debtors receive during the six-month period ending on the last day of the calendar month immediately preceding the date of the commencement of the case, including any amount paid by a third party on a regular basis for the household expenses of the debtor or the debtor's dependents, but excluding benefits received under the Social Security Act. 11 U.S.C. § 101(10A). For above-median-income debtors, the "amounts reasonably necessary to be expended" are determined "in accordance with" § 707(b)(2)(A)[1]and (B), which provides various specific expense categories from which debtors may reduce their "current monthly income."[2] 11 U.S.C. § 1325(b)(3).

The "means test" provisions of §§ 707(b)(2)(A) and (B) are used in

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[1] As amended by the 2005 Reform Act, § 707(b)(2) repealed the former presumption in favor of the debtor, and replaced it with a new presumption. A case is an "abuse" of Chapter 7 if a detailed mathematical formula set out in the statute, commonly referred to as the "means test," yields a minimum amount of monthly disposable income. The means test uses a series of calculations to determine whether the § 707(b)(2) presumption of abuse arises in Chapter 7 cases. *See* 11 U.S.C. § 707(b)(2)(A).

[2] Form 22C, which debtors must file pursuant to Interim Federal Rule of Bankruptcy Procedure 1007(b)(6), serves, in part, to calculate debtor's "current monthly income."

determining the expenses of chapter 13 debtors, like these debtors, whose income exceeds their state's median family income. 11 U.S.C. § 1325(b)(3). In determining expenses, § 707(b)(2)(A)(ii)(I) provides that a debtor's "monthly expenses shall be the debtor's *applicable* monthly expense amounts specified under the National Standards and Local Standards and the debtor's actual monthly expenses for the categories specified as Other Necessary Expenses issued by the Internal Revenue Service for the area in which the debtor resides…." 11 U.S.C. § 707(b)(2)(A)(ii)(I) (emphasis added).

II. Factual Background

On their Schedule B, the Armstrongs listed ownership of one vehicle, a 1998 GMC Truck. CR No. 1.[3] They stipulated before the lower court they had no payment associated with the vehicle. CR No 59. They did not list any secured debt for their GMC truck on their Schedule D. CR No 1. On their Official Form 22C, Line 28, the Armstrongs claimed the IRS Standard "transportation ownership/lease expense" in the amount of $471 for the GMC truck.[4] CR No. 34.

On November 8, 2007, the Chapter 13 Trustee filed an objection to

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[3] Following the appellant's citations, the cites to the record are to the Court's Record followed by the docket number of the document in the Bankruptcy Court's docket as identified in the Designation of record on appeal. The relevant facts were not in dispute before the Bankruptcy Court.

[4] This amount is in addition to the "vehicle operation expenses" taken on Line 27. Because the vehicle is over six years old, the United States Trustee would also allow the Debtors an additional $200 operating expense per vehicle, based on the Internal Revenue Manual which allows such an additional vehicle operating expenses. See Internal Revenue Manual, Part 5 (entitled Collecting Process), Chapter 8, § 5.8.5.5.2, Treatment of Non-Business Transportation Expenses, which may be found on the IRS website at http://www/irs/gov/irm/part5/ch08s05.html.

confirmation of the Debtors' Chapter 13 plan, claiming the plan failed to provide all of the Debtors' disposable income for the payment of creditors, contrary to 11 U.S.C. §§ 1325(a)(3) and (b)(1)(B). CR No. 27. The objection was amended December 22, 2006. CR No. 40 and 41. In his objection, the Chapter 13 Trustee argued that the Debtors had more income to devote to paying creditors because they were improperly claiming the IRS Standard expense for vehicle financing expenses, even though that expense deduction was not applicable because these Debtors have no vehicle or lease payments. Id.

The parties briefed their respective positions, CR No. 59 and 61. Argument was held On May 15, 2007.

On June 12, 2007, the bankruptcy court overruled the Chapter 13 Trustee's objection to the Debtors' plan. CR No. 65. The bankruptcy court ruled that Mr. and Mrs. Armstrong were entitled to reduce their disposable income by the amount of the IRS Standard allowance for vehicle financing costs even though they had no vehicle financing costs. Id.

On August 22, 2007, the court confirmed the plan of the debtors. CR No. 73.

This appeal followed on August 31, 2007. CR No.77.

SUMMARY OF ARGUMENT

The bankruptcy court erred as a matter of law in overruling the Chapter 13 Trustee's objection to confirmation and confirming the Armstrongs' chapter 13 plan. It did so by misinterpreting when debtors can claim a vehicle ownership expense under section 707(b)(2), which is made applicable to chapter 13 debtors under § 1325(b). The court held that the

Armstrongs were entitled to deduct $471 in vehicle ownership expenses for their vehicle, even though the vehicle was owned free and clear of encumbrances. This was incorrect because 11 U.S.C. § 707(b)(2)(A)(ii)(I) allows the Armstrongs to claim only "applicable" expenses, and they had no applicable vehicle ownership expenses because the vehicle was not subject to a loan or lease payment. By using the word "applicable," Congress limited eligibility for expenses under the Local Standards to debtors for whom the expenses apply. Because the vehicle acquisition/financing expense does not apply with respect to the Armstrongs' vehicle, the bankruptcy court erred in holding they were eligible to deduct the expense under the means test.

Reading "applicable" in section 707(b)(2) as requiring debtors to have a loan or lease payment on a vehicle as a prerequisite to eligibility for the vehicle ownership expense has the salutary effect of applying the means test in a manner that is consistent with the Internal Revenue Service's longstanding application of this standard. Under section 707(b)(2), the means test looks to the IRS to establish certain standard expenses. 11 U.S.C. § 707(b)(2)(A)(ii)(I). In applying its standards to taxpayers, the IRS does not allow taxpayers to claim vehicle ownership expenses absent a monthly car expense. See IRS Collection Financial Standards attached hereto as Exhibit 1 of the Addendum.[5]

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[5] The IRS revised its Collection Financial Standards, effective October 1, 2007, and such revisions will be made applicable to bankruptcy cases filed as of January 1, 2008. Because the Armstrongs' case was filed on October 3, 2006, only the Collection Financial Standards in effect prior to October 1, 2007, are applicable to the Armstrongs' case. For the Court's convenience, a true and correct PDF copy of the Collection Financial Standards applicable to this case are attached as Exhibit "1" on the Addenda and incorporated herein by reference. It is important to note, however, that

Finally, the bankruptcy court's order overruling the Chapter 13 Trustee's objection to confirmation of the Armstrongs' plan conflicts with sound notions of public policy and the primary purpose of Congress in passing bankruptcy reform legislation in 2005 - including the amendments at issue in this appeal. The 2005 Reform Act was intended to ensure that debtors repay their debts when they can. By allowing the Armstrongs to claim a fictional expense for their vehicle, the bankruptcy court frustrated that purpose.

ARGUMENT

I.

THE BANKRUPTCY COURT ERRED IN HOLDING THAT THE ARMSTRONGS WERE ELIGIBLE TO CLAIM THE IRS LOCAL STANDARDS FOR VEHICLE OWNERSHIP FOR THEIR VEHICLE BECAUSE THE EXPENSE WAS NOT APPLICABLE TO THEM.

The bankruptcy court's order overruling the Chapter 13 Trustee's objection to confirmation of the Armstrongs' plan should be reversed because it fails to recognize that the Bankruptcy Code only allows debtors to claim vehicle expenses that are applicable to them. 11 U.S.C. § 707(B)(2)(A)(ii)(I). The Armstrongs do not have any "applicable" vehicle ownership expense because they own their vehicle outright.

A. Vehicle ownership expenses are allowable only if "applicable" to the debtors.

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the revisions made by the IRS effective October 1, 2007, do not change any result in this case. As set forth in the current Collection Financial Standards, the Local Standard for Vehicle Operation is still made expressly contingent on the existence of a loan or lease payment on a vehicle. *See Id.* As explained by the IRS, the recent revisions to the Local Standards were made to create equal allowances for first and second vehicles, add a separate public transportation allowance and reorganize the manner in which taxpayers in certain counties calculate their transportation operating expenses. See id., under heading "Recent Revisions."

Section 707(b)(2)(A)(ii)(I) of the Bankruptcy Code provides that a "debtor's monthly expenses shall be the debtor's *applicable* monthly expense amounts specified under the...Local Standards...issued by the Internal Revenue Service..." 11 U.S.C. § 707(b)(2)(A)(ii)(I) (emphasis added). The statute expressly provides that before the specific IRS expense amounts may be included in the debtor's allowed monthly expenses, the expense must itself first be *applicable* to the debtor. Id.

The Bankruptcy Code does not define the word "applicable," nor has the United States Trustee identified any Supreme Court or Ninth Circuit decision that provides a definition in the bankruptcy context.[6] Where, as here, a statutory term is undefined, a basic principle of statutory construction provides that courts should give such terms their ordinary meanings. E.g., Smith v. U.S., 508 U.S. 223, 228 (1993) ("When a word is not defined by statute, we normally construe it in accord with its ordinary or natural meaning."). See also Watson v. Ray, 192 F.3d 1153, 1155 (8th Cir. 1999) ("When interpreting a statute the court starts with the statute's plain meaning"). The dictionary defines "applicable" to mean applying or capable of being applied; relevant; suitable; appropriate. Random House Unabridged Dictionary (2006). Accordingly, such a meaning should be imparted to the term "applicable" as it appears in section 707(b)(2)(A)(ii)(I) absent clear indication to the contrary. See Johnson v. Aljian, 490 F3d 778,780 (9th Cir. 2007) (quoting U.S. v. TRW Rifle 7.62x51 Meter Caliber, 447 F.3d 686,689 (9th Cir. 2006) ("[W]e follow the common practice of

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[6] But see, Fong v. Glover, 197 F.2d 710, 711 (9th Cir. 1952) (defining "applicable" as it appears in the Federal Rules of Civil Procedure as "capable of being applied.")

consulting dictionary definitions to clarify their ordinary meaning[] and look to how the terms were defined at the time [the statute] was adopted.”).

By inserting the word “applicable” in section 707(b)(2)(A)(ii)(I), Congress limited eligibility for expenses under the Local Standards to debtors for whom such expenses are “relevant; suitable; appropriate”--thereby excluding phantom ones. The bankruptcy court’s order is inconsistent with the ordinary, common sense definition of “applicable” because it allows debtors like the Armstrongs to deduct expenses that do not apply to them. If such inapplicable expenses are disallowed, the Armstrongs have the ability to repay their unsecured creditors an additional $16,260 in their 60-month chapter 13 repayment plan.

The court below concluded that the Armstrongs could deduct vehicle expenses they do not have because "applicable" in section 707(b)(2)(A)(ii)(I) refers solely to choosing the correct number from the IRS expense tables based on the "geographical location of the debtors and the number of vehicles... .” CR No. 65, p.8 and 11 . In other words, the court read "applicable" merely as referring to the number of standardized expenses amounts the Armstrongs can claim.

The court’s reading does not interpret section 707(b)(2)(A)(ii)(I), it *rewrites* it. For its proffered construction to be the correct one, the statute would need to read "[t]he debtor's monthly expenses shall be the ~~debtor's~~ applicable [number of] monthly expense amounts . . ." 11 U.S.C. § 707(b)(2)(A)(ii)(I) (as modified). The statute does not say that. Nowhere does it state "applicable" means the "number" of expenses. To the contrary, "applicable" follows the word "debtor's," making it clear that the section asks debtors to claim those IRS standard expenses that apply to them.

Given this, the Armstrongs should not be allowed to claim inapplicable expenses, ones they do not have.

Not surprisingly, both appellate courts that have interpreted the word applicable in section 707(b)(2)(A)(ii)(I) have rejected the bankruptcy court's proffered reading. In re Ross-Tousey, 368 B.R. 762, 766 (E.D. Wis. 2007); In re Hartwick, 373 B.R. 645, 649-50 (D. Minn. 2007). They did so, in part, because the bankruptcy court's reading is not faithful to the purpose underlying section 707(b)(2)'s means test. As the Ross-Tousey court noted, "if it really is that simple, the statute would not seem to achieve its purpose" of ensuring that debtors are allowed expenses for the necessities of life but pay creditors from what remains. Ross-Tousey, 368 B.R at 766 (E.D. Wis. 2007). See also In re Howell, 366 B.R. 153, 157 (Bankr. D. Kan. 2007) ("denying debtors the ownership allowance when they have no ownership expense (i.e. loan or lease payments) is entirely consistent with one of the apparent objectives of BAPCPA: to ensure that debtors actually pay what they are capable of paying to unsecured creditors.").

The bankruptcy court's proffered numerical definition also fails to appreciate that a debtor's ability to pay creditors is not affected by mere vehicle *ownership* but by *payments* on a car. Accordingly, section 707(b)(2)(A)(ii)(I) does not focus on how many cars a debtor owns, but how many cars she makes *payments* on every month. Ross-Tousey, 368 B.R. at 766 ("The statute is only concerned about protecting the debtor's ability to continue owning a car, and if the debtor already owns the car, the debtor is adequately protected."); see also Hartwick, 373 B.R. at 652 (same).

In addition, the Hartwick and Ross-Tousey courts reversed the bankruptcy court rulings in those cases because they, like the court here, created an arbitrary distinction between the word "actual" and "applicable" expenses in section 707(b)(2)(A)(ii)(I). See, e.g., In re Fowler, 349 B.R. 414, 418 (Bankr. D. Del. 2006) (stating "The use of 'actual' with respect to the Other Necessary Expenses and 'applicable' with respect to the National and Local Standards must mean that Congress intended two different applications.) The bankruptcy court below agreed with courts like Fowler that "applicable" and "actual" must have different meanings, reasoning that because Congress used both terms in the statute, debtors like the Armstrongs need not have any "actual" expense for the Ownership Expense Standard to be "applicable." CR No. 65, p. 5 and 11. This logic is misguided, however, because, as the Ross-Tousey court explained, there is no indication in section 707(b)(2)(A)(ii)(I) that Congress intended the words "applicable" and "actual" to have essentially *opposite* meanings. Ross-Tousey, 368 B.R. at 765. Rather, the better reading of "applicable" in the context of section 707(b)(2)(A)(ii)(I) is that it may have two meanings: first, the ownership expense is "applicable" if the debtor makes a loan or lease payment on a vehicle, and second, the *amount* allowed to the debtor is the "applicable" amount provided under the IRS Standards, and not the "actual" amount." Id. See also Hartwick, 373 B.R. at 653. "This reading gives meaning to the distinction between 'applicable' and 'actual' without taking a further step to conclude that 'applicable' means "nonexistent' or 'fictional.'" Ross-Tousey, 368 B.R. at 765.

By giving the term "applicable" its proper meaning, a determination of allowable expenses under the means test is a two-step process. The first step is eligibility—i.e., does the debtor qualify for an expense allowance in the category at issue? If so, then the second step is to quantify the expense amount the eligible debtor is allowed by looking at the IRS Standard amounts that are specified for the number of vehicles owned by the debtor and where the debtor lives. See, e.g., In re Carlin, 348 B.R. 795, 798 (Bankr. D. Or. 2006)("There is nothing absurd in Congress drawing the line for vehicle ownership expense eligibility at those debtors who are making payments on the vehicle.") The bankruptcy court's ruling impermissibly skips the first step of determining whether the Armstrongs are *eligible* for the ownership expense by virtue of having a loan or lease payment for a vehicle, and proceeds directly to the second—only considering the *amount* the IRS would allow eligible taxpayers to claim for ownership of two vehicles.

B. The UST's construction of "applicable" in § 707(b)(2) has the salutary effect of treating transportation costs the same way in bankruptcy cases that the IRS treats them.

Reversal of the bankruptcy court's order allowing the Armstrongs to deduct vehicle financing expenses that they do not have has the additional benefit of treating inapplicable phantom expenses in bankruptcy cases the way the IRS has long treated them. In providing which deductions debtors may take under the means test, Congress specifically stated that debtors are permitted to deduct "the debtor's *applicable* monthly expense amounts specified under the…Local Standards…issued by the *Internal Revenue Service*." 11 U.S.C. § 707(b)(2)(A)(ii)(I) (emphasis added). Accordingly, how the Internal Revenue Service applies the Standards that it developed for its own internal debt collection purposes is instructive on the question of how the same Standards might be applied in bankruptcy cases under section 707(b)(2). See, e.g., Hartwick, 373 B.R. at 650-51 ("in order to determine whether the expense Standards issued by the IRS are 'applicable,' the most logical resource to consult is the IRS"). See also In re Slusher, 359 B.R. 290, 309 (Bankr. D. Nev. 2007) ("if guidance is sought on the meaning of the IRS standards that Congress incorporated into the Bankruptcy Code, practical reason would suggest that court should consider the full manner by which the IRS uses these standards.").

The IRS Collection Financial Standards in effect as of the date of the Armstrongs' bankruptcy filing[7] fully support the United States Trustee's construction of the term "applicable" and provide as follows:

> The transportation standards consist of nationwide figures for monthly loan or lease payments referred to as ownership costs, and additional amounts for monthly operating costs….The ownership costs provided maximum allowances for the lease or purchase of up to two automobiles if allowed as a necessary expense….If a taxpayer has a car payment, the allowable ownership cost added to the allowable operating cost equals the allowable transportation expense. **If a taxpayer has no car payment, or no car, the operating costs portion of the transportation standard is used to come up with the allowable transportation expense.**

See IRS Collection Standards attached hereto as Exhibit 1of the Addendum; (emphasis added); *see also* Internal Revenue Manual, Financial Analysis Handbook, Pt. 5, ch. 15, § 5.15.1.7(4.B), available at http://www.irs.gov/irm/part5/ch15s01.html#d0e187819.

As of the date the Armstrongs filed their bankruptcy petition,[8] the "ownership cost" was specifically calculated by the IRS based on the cost to finance the acquisition of a vehicle, and not simply a cost associated with

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[7] See Footnote 5, supra.

[8] See Footnote 5, supra.

owning a car, such as repair or maintenance. The IRS noted that the "ownership cost" Standards are based on the **"five-year average of new and used car financing data compiled by the Federal Reserve Board of Governors."** See id. (emphasis added). As such, the IRS does not treat the "ownership cost" expense as applicable when a taxpayer does not have a monthly expense related to financing a car. In exercising its discretion to collect taxes, the IRS recognizes that taxpayers may claim the vehicle "ownership cost" portion of the Local Transportation Standards only in situations where the taxpayer has a monthly vehicle acquisition financing expense, i.e., has a monthly vehicle loan or lease payment. See id.

II.

THE BANKRUPTCY COURT'S ORDER CONFLICTS WITH THE MAJOR GOALS OF THE 2005 AMENDMENTS TO THE BANKRUPTCY CODE.

The bankruptcy court's order is also inconsistent with Congress' goals and purpose in implementing bankruptcy reform. Congress amended the Bankruptcy Code in 2005 to rectify perceived abuses in the bankruptcy process. "Among the abuses identified by Congress was the easy access to chapter 7 liquidation proceedings by consumer debtors who, if required to file under chapter 13, could afford to pay some dividend to their unsecured creditors." In re Hardacre, 338 B.R. 718, 720 (Bankr. N.D. Tex. 2006) (citing 151 Cong. Rec. S2459, 2469-70 (March 10, 2005)). A "primary goal" of the 2005 Reform Act was to "ensure that debtors repay creditors the maximum they can afford." In re Lenton, 358 B.R. 651 (Bankr. E.D. Pa. 2006) (citing H.R. Rep. No. 109-31, pt. 1, at 1 (2005), reprinted in 2005 U.S.C.C.A.N. 88, 89). In cases such as this one, where the Armstrongs have no loan or lease payment, Congress has established a system which does not provide them an expense deduction for vehicle financing. "Allowing debtors to deduct from their disposable income a fictional ownership allowance would give debtors with unencumbered vehicles a windfall at the expense of their unsecured creditors." In re Howell, 366 B.R. 153, 157 (Bankr. D. Kan. 2007).

CONCLUSION

For all of these reasons, the United States Trustee respectfully asks this Court to reverse the July 30, 2007, Orders entered by the bankruptcy court overruling the Chapter 13 Trustee's objection to confirmation of the Debtors' plan and confirming the Debtors' plan, and remand this case to the bankruptcy court for further proceedings.

Respectfully submitted,

ILENE J. LASHINSKY
UNITED STATES TRUSTEE

ROBERT D. MILLER
ASSISTANT U.S. TRUSTEE

/s/ Gary W. Dyer
Gary W. Dyer CSBA #106701
Trial Attorney
920 W. Riverside Ave., Rm 593
Spokane, WA 99201
Telephone: (509) 353-2999 ext 110
Fax: (509) 353-3124
E-mail: Gary.W.Dyer@usdoj.gov

BRIEF BANK — 'SUMMARY SHEET" Printed Wed-11/30/05 13:30

WESTLAW CODES

1. ("TI") TITLE OF CASE
[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]
In re Attorneys at Law and Debt Relief Agencies

2. ("CO") CURRENT COURT
[E.g., "CTA9"]
S.D. Georgia

3. ("CCN") CURRENT CASE NO.
No.: 4:05-cv-00206

4. ("PCN") PRIOR CASE NO. & COURT
[IF ANY]
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B. Amon James, AUST
P. Matthew Sutko, OGC
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") TOPIC
BANKRUPTCY

9. ("SU") • SUMMARY OF KEY ISSUE(s)
&
√ Any Miscellaneous BACKGROUND

• 1. Did the Bankruptcy Court lack jurisdiction to enter the Order based on the absence of a "case or controversy" under Article III of the United States Constitution? 2. Did the Bankruptcy Court lack authority under section 151 of title 28 to enter the Order because there was no properly commenced "action, suit or proceeding" pending before the Bankruptcy Court? 3. Assuming arguendo that the Bankruptcy Court properly exercised its jurisdiction, was it correct in ruling that the provisions of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 regulating debt relief agencies do not apply to licensed attorneys?

√ **Background:**

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UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF GEORGIA
SAVANNAH DIVISION

In re:

ATTORNEYS AT LAW AND DEBT RELIEF AGENCIES	District Court Case No. 4:05-cv-00206-WTM
	Docketed in Bankruptcy Court as Miscellaneous Proceeding No. 05-00400

______________________________/

FELICIA S. TURNER,
UNITED STATES TRUSTEE,

Appellant.

______________________________/

BRIEF OF UNITED STATES TRUSTEE AS APPELLANT

B. AMON JAMES, ESQUIRE
Assistant United States Trustee
United States Department of Justice
Office of the United States Trustee
225 West Oglethorpe Avenue, Suite 302
Savannah, GA 31401
(912) 652-4112

Of Counsel

Roberta A. DeAngelis
Acting General Counsel

P. Matthew Sutko
Office of the General Counsel

Executive Office for United States Trustees
United States Department of Justice
20 Massachusetts, Ave. N.W., Suite 8100
Washington, D.C. 20530
(202) 307-1399

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INTRODUCTION AND STATEMENT OF BASIS FOR APPELLATE JURISDICTION

The United States Trustee appeals an order of the United States Bankruptcy Court for the Southern District of Georgia (the "Bankruptcy Court") issued on October 17, 2005 (the "Order"). The United States Trustee is an official of the United States Department of Justice that must administer and enforce the Bankruptcy Code. *See* 11 U.S.C. § 307 (United States Trustee has standing to "raise . . . any issue in any case or proceeding" under Bankruptcy Code); 28 U.S.C. § 586 (setting forth many duties of United States Trustee); *United States Trustee v. Columbia Gas Systems, Inc. (In re Columbia Gas Systems, Inc.)*, 33 F.3d 294, 295-299 (3d Cir. 1994).

The Order interprets certain provisions of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 that define and regulate "debt relief agencies." *See* 11 U.S.C. §§ 526-528.[1] The Bankruptcy Court ruled that these provisions, which became effective on the date the Bankruptcy Court issued the Order, do not apply to attorneys and that attorneys admitted to practice before the Bankruptcy Court are "excused from compliance" with them. Order at 9. The Bankruptcy Court so ruled even though the statutory definition of "debt relief agencies" includes persons that provide "legal representation" in bankruptcy proceedings. *See* 11 U.S.C. §§ 101(12A),[2] 101(4A). The Order plainly undermines the enforcement of the Bankruptcy Code (and undermines the United States Trustee's ability to assist with such enforcement) because it purports to render these new statutory provisions inoperative in the Southern District of Georgia as applicable to attorneys.

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[1] The full text of these sections is set forth in the attached Addendum.

[2] The full text of § 101(12A) is likewise set forth in the Addendum.

The Order is final in the sense that it disposes of all issues raised by the Bankruptcy Court. *See* Order at 4, n.1. This Court therefore has appellate jurisdiction to review the Order under section 158(a) of title 28.[3] As explained more extensively in the body of the brief, however, the Bankruptcy Court lacked both Article III and statutory jurisdiction to issue the order *sua sponte* due to the absence of a live case or controversy between actual parties. The United States Trustee therefore believes that this Court should vacate the Order for lack of jurisdiction and need not address the merits of the Order in this appeal. *See United States v. Corrick*, 298 U.S. 435, 440 (1936) (court had "jurisdiction on appeal, not of the merits, but merely for the purpose of correcting the error of the lower court in entertaining the suit" (footnotes omitted) (*quoted in Arizonans for Official English and Robert D. Park v. Arizona*, 520 U.S. 43, 73 (1997) (vacating with remand for dismissal for lack of case or controversy)). *See also Steel Co. v. Citizens For A Better Environment*, 523 U.S. 83, 110 (1998) (vacating with remand for dismissal for lack of case or controversy).

In the event, however, that this Court deems it appropriate to reach the merits, the United States Trustee requests that this Court reverse the Bankruptcy Court and hold that the Bankruptcy Court premised the Order on an erroneous construction of the statutory provisions regarding debt relief agencies.

STATEMENT OF THE ISSUES

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[3] If it did not have jurisdiction under section 158, this Court would have jurisdiction to review the Order under the authority of mandamus set forth in section 1651 of title 28, because the Bankruptcy Court plainly exceeded its jurisdiction in issuing the Order. See *In re BellSouth Corp.*, 334 F.3d 941 (11th Cir. 2003) (mandamus is extraordinary remedy that may be used to correct a "judicial usurpation of power" and "'confine a lower court to its jurisdiction'"), quoting *In re Evans*, 524 F.2d 1004, 1007 (5th Cir.1975).

The United States Trustee raises three issues on appeal:

1. Did the Bankruptcy Court lack jurisdiction to enter the Order based on the absence of a "case or controversy" under Article III of the United States Constitution?

2. Did the Bankruptcy Court lack authority under section 151 of title 28 to enter the Order because there was no properly commenced "action, suit or proceeding" pending before the Bankruptcy Court?

3. Assuming *arguendo* that the Bankruptcy Court properly exercised its jurisdiction, was it correct in ruling that the provisions of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 regulating debt relief agencies do not apply to licensed attorneys?

STANDARDS OF REVIEW

The standards of review on appeal are clearly erroneous as to findings of fact and *de novo* as to conclusions of law. *In re Sublett*, 895 F.2d 1381 (11th Cir. 1990); Fed. R. Bankr. P. 8013. This appeal raises only issues of law.

STATEMENT OF THE CASE

I. PROCEDURAL HISTORY

As indicated above, the Bankruptcy Court issued the Order *sua sponte* on October 17, 2005, the date that the relevant provisions of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (the "BAPCPA") took effect. There was no case or proceeding pending in the Bankruptcy Court to which the Order related, and it consequently contained no case or docket number at the time the Bankruptcy Court issued it. The Bankruptcy Court posted the

Order on its Internet web site and later docketed it as Miscellaneous Proceeding No. 05-00400. The United States Trustee filed a timely notice of appeal from the Order on October 27, 2005.

II. THE STATUTORY AND LEGISLATIVE BACKGROUND

The President signed the BAPCPA into law on April 20, 2005, and the bulk of its provisions became effective on October 17, 2005. This legislation constitutes the most extensive overhaul of the Bankruptcy Code since its enactment in 1978. As indicated by its title, the BAPCPA has two primary goals: the prevention of bankruptcy abuse and the protection of consumers involved in the bankruptcy process. The consumer protection provisions consist, *inter alia*, of enhanced disclosure requirements and other safeguards pertaining to reaffirmations of dischargeable debt by bankruptcy debtors, penalties for abusive practices by creditors, requirements for credit counseling and debtor education, and the provisions at issue in this appeal pertaining to debt relief agencies.

The requirements imposed on debt relief agencies are for the benefit of persons "whose debts consist primarily of consumer debts and the value of whose nonexempt property is less than $150,000," 11 U.S.C. § 101(3), *i.e.*, persons of moderate and less than moderate means. These requirements are set forth in three new sections of the Bankruptcy Code: 526, 527 and 528. Section 526 prohibits debt relief agencies from: (i) misrepresenting to assisted persons the services to be provided to them or the risks attendant upon becoming a debtor; (ii) advising an assisted person to make untrue or misleading statements in bankruptcy filings; and (iii) advising an assisted person to incur more debt in contemplation of filing bankruptcy or for the purpose of paying an attorney or bankruptcy petition preparer for bankruptcy services. It also provides that any waiver of rights under sections 526, 527 and 528 is unenforceable.

Section 527 requires debt relief agencies to provide assisted persons with certain information, notices and disclosures, including: (i) notice of the right to proceed *pro se*, hire an attorney or hire a bankruptcy petition preparer; (ii) information on how to complete the bankruptcy schedules, value assets and determine what property is exempt; and (iii) notice of the obligation of debtors to provide truthful and accurate information and the potential consequences of failing to do so.

Section 528 requires debt relief agencies to provide assisted persons a written contract explaining clearly and conspicuously the nature of services they will render, the amount of the fees or charges for such services, and the terms of payment. In addition, section 528 requires debt relief agencies to disclose in their advertising that they are debt relief agencies, that the assistance they provide may involve bankruptcy relief, and that they are in the business of helping people file for relief under the Bankruptcy Code.

SUMMARY OF THE ARGUMENT

This Court should vacate the Order because the Bankruptcy Court entered it in the absence of a case or controversy under Article III of the United States Constitution. Alternatively, the Bankruptcy Court lacked the power and jurisdiction to enter the Order under under sections 151 and 157 of title 28. Assuming *arguendo* that the Bankruptcy Court had authority to enter the Order, the United States Trustee submits that this Court should reverse the Order as an erroneous interpretation of the statutes regarding debt relief agencies.

ARGUMENT

I. THE BANKRUPTCY COURT LACKED JURISDICTION UNDER ARTICLE III OF THE UNITED STATES CONSTITUTION BECAUSE THERE WAS NO "CASE OR CONTROVERSY." THE BANKRUPTCY COURT HAD NO CASE OR PROCEEDING BEFORE IT, AND NO PARTIES WITH STANDING SOUGHT JUDICIAL RELIEF FROM THE BANKRUPTCY COURT.

"[I]t is well settled that the jurisdiction of the bankruptcy courts to hear cases related to bankruptcy is limited initially by statute and eventually by Article III." *In re Lemco Gypsum, Inc.*, 910 F.2d 784, 787 (11th Cir. 1990). Although a bankruptcy court is not itself an Article III court, *see Northern Pipeline Construction Co. v. Marathon Pipe Line Co.*, 458 U.S. 50, 60-61 (1982), a bankruptcy court may exercise a judicial function as a "unit of the district court." *See* 11 U.S.C. § 151 ("In each judicial district, the bankruptcy judges . . . shall constitute a unit of the district court to be known as the bankruptcy court for that district."); *In re Goerg*, 930 F.2d 1563, 1565 (11th Cir. 1991) ("original jurisdiction over bankruptcy cases is vested in Article III courts and [] bankruptcy courts obtain jurisdiction only at the discretion of the district court"). Accordingly, bankruptcy courts are bound by the jurisdictional limitations of Article III.

The Bankruptcy Court's entry of the Order violates an essential premise of judicial power under the Constitution – judicial action is limited to cases and controversies. United States Constitution, Article III, section 2, cl. 1. As the United States Supreme Court stated in *Aetna Life Ins. Co. v. Haworth*, 300 U.S. 227, 239-40 (1937) (citations omitted):

> The controversy must be definite and concrete, touching the legal relations of parties having adverse legal interests. It must be a real and substantial controversy admitting of specific relief through a decree of a conclusive character, as distinguished from an opinion advising what the law would be upon a hypothetical state of facts.

See also Dixie Electric Co-op. v. Citizens of the State of Alabama, 789 F.2d 852, 857-58 (11th Cir. 1986) (federal court may not adjudicate potential issues that may arise). In summary, the dispute must call "for an adjudication of present right upon established facts." *Aetna*, *supra*, 300 U.S. at 242. By limiting the judicial role to such cases or controversies, brought by parties with standing, Article III thereby limits the judicial power "to those disputes which confine federal courts to a role consistent with a system of separated powers and which are traditionally thought to be capable of resolution through the judicial process." *Valley Forge Christian College v. Americans United for Separation of Church and State*, 454 U.S. 464, 472 (1982).

It is clear beyond peradventure that the Bankruptcy Court had no concrete case or controversy before it when it issued the Order. The Bankruptcy Court issued the Order on the very morning that the new federal statutes became effective, before a concrete dispute could even be brought to the Bankruptcy Court by parties having a stake in the interpretation of the statutes.

The Order also presents a pristine illustration of why standing is a crucial element of the “case or controversy” requirement of Article III. In the absence of any party possessing standing to request or contest the relief granted by the Bankruptcy Court, the Bankruptcy Court could neither address any alleged violations of the relevant statutes, nor consider the arguments for or against any particular interpretation of the relevant statutes as made by parties affected by the outcome. The absence of any briefing meant the Bankruptcy Court below acted in a vacuum without the benefit of the views of the United States Trustee, who helps administer these statutes, affected debtors, whom Congress enacted the statutes to protect, or attorneys, whom Congress regulated by passing the statutes. Practically speaking, it was precipitous for the Bankruptcy

Court to interpret these federal statutes this way. Constitutionally speaking, it lacked jurisdiction to enter an opinion with no case and no parties.

Due to the lack of a cognizable case or controversy below, the United States Trustee respectfully submits that this Court should exercise "jurisdiction on appeal, not of the merits, but merely for the purpose of correcting the error of the lower court in entertaining the suit." *United States v. Corrick*, 298 U.S. 435, 440 (1936) (footnotes omitted) (*quoted in Arizonans for Official English and Robert D. Park v. Arizona*, 520 U.S. 43, 73 (1997) (vacating with remand for dismissal for lack of case or controversy). *See also Steel Co. v. Citizens For A Better Environment*, 523 U.S. 83, 110 (1998) (vacating with remand for dismissal for lack of case or controversy). The United States Trustee, therefore, asks the Court to vacate the Order for lack of a case or controversy.

II. ALTERNATIVELY, THE BANKRUPTCY COURT LACKED BOTH JURISDICTION AND POWER TO ENTER THE ORDER UNDER SECTIONS 151 AND 157 OF TITLE 28.

Due to the absence of a case or controversy, this Court should vacate the Order and need not evaluate any other arguments raised in this brief. Nonetheless, the Order was also improper because the Bankruptcy Court lacked jurisdiction to enter the Order under section 157 of title 28 and lacked power to enter the Order under section 151 of title 28.

1. The Bankruptcy Court Lacked Jurisdiction Under Section 157 of Title 28.

The Bankruptcy Court derives its jurisdiction from the bankruptcy jurisdiction of the District Court. Section 1334(a) of title 28 provides that the district courts, except as set forth in subsection (b), "shall have original and exclusive jurisdiction *of all cases* under title 11."

(Emphasis added). Subsection (b), in turn, provides that the district courts have "original but not exclusive jurisdiction *of all civil proceedings* arising under title 11, or arising in or related to cases under title 11." (Emphasis added). A bankruptcy court's jurisdiction is then based on the referral of such cases and proceedings from the district court to the bankruptcy court pursuant to section 157 of title 28: "Each district court may provide that any or all *cases* under title 11 and any and all *proceedings* arising under title 11 or arising in or related to a case under title 11 shall be referred to the bankruptcy judges for the district." (Emphasis added.) [4]

The Order did not adjudicate an issue in a pending bankruptcy "case" or "proceeding." Consequently, the Bankruptcy Court lacked jurisdiction to enter the Order.

2. The Bankruptcy Court Lacked Power to Enter the Order Under Section 151 of Title 28.

Alternatively, the Bankruptcy Court lacked statutory power under section 151 of title 28 to enter an order without a pending bankruptcy case. A bankruptcy court is a "unit of the district court" and derives its authority from the district court. 28 U.S.C. § 151.[5] A bankruptcy court has authority "with respect to any action, suit, or proceeding . . . except as otherwise provided by law or by rule or order of the district court." *Id.*

The Bankruptcy Court exceeded its statutory authority under section 151 of title 28 by interpreting five new statutory provisions outside of any "action, suit or proceeding." The United States Trustee is aware of no authority for the proposition that a bankruptcy court may interpret

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[4] The full text of this section is set forth in the attached Addendum.

[5] The full text of this section is set forth in the attached Addendum.

federal statutes, and thereby excuse compliance with those statutes, outside of an action, suit or proceeding being brought by a party with standing to seek relief from the court. The Bankruptcy Court based its authority on sections 105 and 526(c) of title 11, but those provisions presume the existence of a bankruptcy case within which a bankruptcy court may consider a matter. "Except as provided in section 1161 of this title, chapters 1, 3, and 5 of this title apply *in a case under chapter 7, 11, 12, or 13 of this title*." 11 U.S.C. § 103(a) (emphasis added). The Bankruptcy Court's issuance of the Order outside of its grant of judicial authority also rendered ineffective the procedural protections normally afforded to litigants under the Federal Rules of Bankruptcy Procedure and, to the extent that they are incorporated therein, the Federal Rules of Civil Procedure. *See* Fed. R. Bankr. P. 1001 ("The Bankruptcy Rules and Forms govern procedure *in cases under title 11 of the United States Code*.") (emphasis added). S*ee also* Fed. R. Bankr. P. 7001 and 9014 (addressing applicability of various rules to adversary proceedings and contested matters within bankruptcy cases). *Cf. Reserve Mining Co. v. Lord*, 529 F.2d 181, 185 (8th Cir. 1976) (lower court exceeded its authority by unilaterally ordering deposit of $100,000 as bond without affording due process to affected party).

III. THE BANKRUPTCY COURT'S RULING THAT THE PROVISIONS OF THE BAPCPA REGULATING DEBT RELIEF AGENCIES DO NOT APPLY TO LICENSED ATTORNEYS WAS INCORRECT AS A MATTER OF LAW.

If this Court determines that the Order satisfies the Article III "case or controversy" requirement and that the Bankruptcy Court had the jurisdiction and power to issue the Order, then the United States Trustee submits that this Court should reverse the Order as an erroneous construction of the statutory provisions regarding debt relief agencies.

1. Statutory Framework – The Debt Relief Agency Provisions.

The BAPCPA creates a new term, “debt relief agency.” Section 101(12A) of title 11[6] defines it to mean, with certain listed exceptions not applicable here, “any person who provides any bankruptcy assistance to an assisted person in return for the payment of money or other valuable consideration” or who is a bankruptcy petition preparer.[7] Section 101(4A) defines the term “bankruptcy assistance” to mean:

> [A]ny goods or services sold or otherwise provided to an assisted person with the express or implied purpose of providing information, advice, counsel, document preparation, or filing, or attendance at a creditors' meeting or appearing in a case or proceeding on behalf of another or *providing legal representation with respect to a case or proceeding under this title.*

(Emphasis supplied). Section 101(3) of title 11 defines the term “assisted person” to mean “any person whose debts consist primarily of consumer debts and the value of whose nonexempt property is less than $150,000.”

Sections 526, 527 and 528 of title 11 impose obligations and prohibitions on debt relief agencies designed to, *inter alia*: i) protect consumer debtors of modest means from becoming debtors under the Bankruptcy Code without full awareness that they are doing so or without knowledge of the obligations and consequences attendant on doing so; and ii) prevent those in

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[6] The full text of this section is set forth in the attached Addendum.

[7] Section 110(a)(1&2) defines the term “bankruptcy petition preparer” to mean “a person, other than an attorney for the debtor or an employee of such attorney under the direct supervision of such attorney, who prepares for compensation ... a petition or any other document prepared for filing by a debtor in a United States bankruptcy court or a United States district court in connection with a [bankruptcy] case ...” Regulation of bankruptcy petition preparers under section 110 of title 11 existed prior to the BAPCPA.

the business of providing document preparation, planning, or other bankruptcy-related services from engaging in misleading or exploitative conduct in their dealings with debtors or prospective debtors.

Section 526 prohibits a debt relief agency from:

- failing to perform any service that it promised an assisted person or prospective assisted person it would perform in connection with a bankruptcy case;
- making any statement or counseling or advising any assisted person or prospective assisted person to make a statement in a document filed in a bankruptcy case that is untrue or misleading or that, upon the exercise of reasonable care, it should have known was untrue or misleading;
- misrepresenting to an assisted person or prospective assisted person the services that it will provide or the benefits and risks that may result if the person becomes a debtor in a bankruptcy case; or
- advising an assisted person or prospective assisted person to incur more debt in contemplation of filing a bankruptcy case or for the purpose of paying an attorney or bankruptcy petition preparer for services performed in preparing for or representing the assisted person.

Section 526 further specifies that any waiver by a assisted person of any protection or right provided thereunder is unenforceable and provides civil remedies and penalties for violations of that section, section 527 or section 528.

Section 527 requires debt relief agencies to provide assisted persons with certain information, notices and disclosures pertaining to the rights and obligations of bankruptcy debtors, including: (i) notice of the right to proceed *pro se* or to hire an attorney or bankruptcy petition preparer; (ii) information on how to complete the bankruptcy schedules, value assets and determine what property is exempt; and (iii) notice of the obligation of debtors under the Bankruptcy Code to provide truthful and accurate information and of the potential consequences of failing to do so.

Section 528 requires debt relief agencies to provide assisted persons to whom they provide bankruptcy assistance a copy of a written contract explaining clearly and conspicuously the services the agency will provide, the fees or charges for such services, and the terms of payment. In addition, section 528 requires debt relief agencies to disclose in their advertising that they are debt relief agencies, that the assistance they provide may involve bankruptcy relief, and that they are in the business of helping people file for relief under the Bankruptcy Code.

2. The Bankruptcy Court's Interpretation of the Provisions Regarding Debt Relief Agencies Was Erroneous.

The Bankruptcy Court acknowledged both that "the language defining debt relief agencies is broad enough on its face to include attorneys" and that "the reference to 'providing legal representation' in § 101(4A) suggests that attorneys are covered." Order at 2. The Bankruptcy Court further acknowledged that published legal commentary on the BAPCPA has assumed that the term "debt relief agency" includes attorneys. Order at 3. The Bankruptcy Court concluded, however, that "[b]ecause the definition of 'debt relief agency' omits express reference to attorneys and includes a term [i.e., ‘bankruptcy petition preparer’] which excludes attorneys,” Congress did not intend to include attorneys within the its purview. Order at 5. Instead, reasoned the Court:

> the inclusion of the term “legal representation” in the definition of “bankruptcy assistance” was Congress's effort to empower the Bankruptcy Courts presiding over a case with authority to protect consumers who are before the Court, who may have been harmed by a debt relief agency that may have engaged in the unauthorized practice of law, and whose existing remedies for any damage is more theoretical than real.

Order at 5-6. Stated differently,

> Congress intended to establish regulation of entities who interface with debtors in shadowy, gray areas not already covered by bankruptcy petition preparer regulations and to bolster the existing regulation of bankruptcy petition preparers, but it did not intend to regulate attorneys.

Order at 6.

The Bankruptcy Court expressed concern that if the definition of “debt relief agency” encompasses attorneys, “a new layer of regulation will be superimposed on the bar of this Court, and evaluation of new risks and liabilities will preoccupy them as they strive to represent their clients, comply with existing state regulation of their practice, learn the new substantive and procedural mandates of this new law, and adhere to the separate professional standards applicable to members of the Bar of this Court,” a result that the Bankruptcy Court stated “should not be borne by the Bar needlessly or merely out of an abundance of caution” but only “if that is the result Congress mandated.” Order at 4. In the Bankruptcy Court’s view, the effect of such an interpretation would be to “usurp state regulation of the practice of law” and thereby “possibly violate the Tenth Amendment to the Constitution ...” Order at 8.

"In ascertaining the plain meaning of the statute, the court must look to the particular statutory language at issue, as well as the language and design of the statute as a whole." *K Mart Corp. v. Cartier, Inc.*, 486 U.S. 281, 291 (1988). As the Bankruptcy Court noted, the language of sections 101(12A) and (4A) is broad enough on its face to include attorneys. Section 101(12A) defines a "debt relief agency" as "any person who provides any bankruptcy assistance to an assisted person ... *or* who is a bankruptcy petition preparer under section 110 ..." (Emphasis added). Section 101(4A) defines "bankruptcy assistance" to include "providing legal representation with respect to a case or proceeding under the [Bankruptcy Code]." There is no doubt that bankruptcy attorneys provide legal representation with respect to bankruptcy cases. While section 101(12A) lists several exclusions from the definition of debt relief agency (*e.g.*, nonprofit organizations, depository institutions, and distributors of copyrighted works), attorneys are not among them. Thus, the plain and ordinary meaning of the statutory language used to define "debt relief agency" encompasses attorneys, and the reference to "legal representation" should not be narrowly read as "unauthorized legal representation."

Aside from the statutory language used to define "debt relief agency" and "bankruptcy assistance," other provisions of the legislation also indicate that Congress intended to include attorneys and lawful legal representation within its purview. Section 526(d)(2), for example, provides that no language in sections 526, 527, or 528 shall be deemed to

> limit or curtail the authority or ability –
>
> (A) of a State or subdivision or instrumentality thereof to determine and enforce qualifications for the practice of law under the laws of that State; or
>
> (B) of a Federal Court to determine and enforce the qualifications for the practice of law before that court.

This provision would be meaningless if the provisions regarding debt relief agencies did not apply to attorneys. Also, section 527(b) requires debt relief agencies to provide assisted persons with a written notice containing the following disclosures:

> If you decide to seek bankruptcy relief, you can represent yourself, you can hire an attorney to represent you, or you can get help in some localities from a bankruptcy petition preparer who is not an attorney. THE LAW REQUIRES AN ATTORNEY OR BANKRUPTCY PETITION PREPARER TO GIVE YOU A WRITTEN CONTRACT SPECIFYING WHAT THE ATTORNEY OR BANKRUPTCY PETITION PREPARER WILL DO FOR YOU AND HOW MUCH IT WILL COST. Ask to see the contract before you hire anyone.

It makes little sense to require someone other than an assisted person's attorney to disclose to the assisted person that the law requires the attorney to provide the assisted person with a written contract specifying what the attorney is going to do and how much it will cost. While the Bankruptcy Court found it "hard to imagine" that this provision "really requires an attorney to tell an assisted person that he/she has the right to hire an attorney or how to prepare documents *pro se* that the attorney is poised to prepare on that person's behalf," Order at 6, this is no more odd than requiring a non-attorney petition preparer who is poised to prepare documents for an assisted person to disclose to the assisted person that "you can get help in some localities from a bankruptcy petition preparer who is not an attorney."

The legislative history of the BAPCPA reinforces the conclusion that Congress intended the term "debt relief agency" to encompass attorneys and lawful legal representation. In March 2005, while the BAPCPA was under consideration by the Senate, Senator Feingold offered an amendment to exclude attorneys from the definition of debt relief agency. The amendment would have changed section 101(12A) of title 11 to read, in relevant part, as follows:

> The term “debt relief agency” means any person, other than an attorney or an employee of an attorney, who provides any bankruptcy assistance to an assisted person in return for the payment of money or other valuable consideration, or who is a bankruptcy petition preparer under section 110 ...

Id. It would also have removed the words “an attorney or” from the title of the notice required by section 527(b) so as to make it read, “IMPORTANT INFORMATION ABOUT BANKRUPTCY ASSISTANCE SERVICES FROM A BANKRUPTCY PETITION PREPARER,” rather than “IMPORTANT INFORMATION ABOUT BANKRUPTCY ASSISTANCE SERVICES FROM AN ATTORNEY OR BANKRUPTCY PETITION PREPARER.”

Senator Feingold discussed his amendment on the floor of the Senate as follows:

> Another of my amendments deals with a provision that bankruptcy lawyers are very concerned about. This is amendment No. 93 on debt relief agencies. The amendment is strongly supported by the American Bar Association. This amendment would exclude lawyers from the provisions dealing with “debt relief agencies” in sections 226 to 228 of the bill. As currently written, the bill would impose a number of unnecessary burdens on the attorney/client relationship in bankruptcy proceedings. Subjecting attorneys to the "debt relief agency" provisions will add little substantive protection for consumers, but require substantial amounts of extra paperwork and cost.
>
> Requiring lawyers to call themselves “debt relief agencies” will do more to confuse the public than to protect it. I think members of the public generally understand what the word “lawyer” means, but the phrase “debt relief agency” is vague and unhelpful. It is also misleading, because there are significant differences between lawyers and nonlawyers, but both would be identifying themselves as debt relief agencies under this bill.
>
> Only lawyers are permitted to give legal advice, to file pleadings, or to represent debtors in bankruptcy hearings. Perhaps most importantly, only lawyers are bound to confidentiality by the attorney-client privilege. These distinctions are important to consumers, but they would be obscured by the bill as written.

> Furthermore, these provisions would apparently apply to any law firm that provides bankruptcy services, even if that law firm were primarily providing landlord-tenant advice even to landlords criminal defense services, or other unrelated services. Large firms with only one bankruptcy practitioner may be required to advertise themselves as "debt relief agencies."
>
> I think this will be immensely confusing to consumers without any apparent benefit.
>
> The substantive provisions on "debt relief agencies" would add little to the already existing laws and regulations governing attorney conduct. Attorneys currently have extensive duties relating to disclosures, fees, and ethical obligations. These provisions would micromanage that relationship without adding any meaningful substantive protection. I think the intention of the bill's drafters was to prevent attorneys from tricking consumers into bankruptcy by not telling consumers from the beginning that they work on bankruptcy issues, and then sort of springing the idea of bankruptcy on the consumer. But rather than simply prohibiting this sort of unethical behavior, the bill tries to micromanage the attorney-client relationship by requiring large amounts of additional paperwork and disclosure. Extra paperwork substantially burdens the consumer and adds to the cost of bankruptcy. Given that attorney conduct is already regulated, I believe these provisions are unnecessary as applied to attorneys and provide no clear benefit.

151 Cong Rec. S2306 (daily ed. Mar. 09, 2005) (statement of Sen. Feingold).

Because Congress did not adopt Senator Feingold's amendment, it is clear from the legislative history of the BAPCPA, as well as its plain language and the design of the statute as a whole, that Congress intended for the provisions governing debt relief agencies to be applicable to attorneys.

The Bankruptcy Court was, of course, correct in its observation that this will impose a new layer of regulation on bankruptcy attorneys already subject both to state regulation of their practice and to the separate professional standards applicable under the rules of this Court and the Bankruptcy Court. However, this is not the first time Congress has extended the reach of consumer protection legislation to attorneys. There is no question, for example, that debt collection attorneys are subject to the requirements of The Fair Debt Collection Practices Act, 15 U.S.C. §§ 1601 *et seq.* *See Crossley v. Lieberman*, 868 F2d 566, 569 (3rd Cir. 1989). If a debt collection attorney qualifies as a "person ... who regularly collects or attempts to collect ... debts owed or due or asserted to be owed or due another" within the contemplation of section 1692a(6) of title 15, there is no reason why a bankruptcy attorney would not qualify as a "person who provides any bankruptcy assistance" within the contemplation of section 101(12A) of title 11.

Congress has likewise subjected attorneys to federal regulation for the purpose of protecting investors. Section 307 of the Sarbanes-Oxley Act of 2002 (codified as 15 U.S.C. § 7245) requires the U.S. Securities and Exchange Commission to "issue rules, in the public interest and for the protection of investors, setting forth minimum standards of professional conduct for attorneys appearing and practicing before the Commission ... in the representation of issuers," including certain specified requirements regarding the reporting of evidence of violations of the securities laws. Accordingly, the provisions of the BAPCPA governing debt relief agencies are by no means unique in their application to conduct by attorneys. They are simply another effort by Congress to protect a segment of the public, in this case a vulnerable class of consumer debtors, from the detrimental acts of third parties, including attorneys.[8]

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[8] Contrary to the Bankruptcy Court's suggestion (Order at 8 & n.4), this construction of these statutes presents no Tenth Amendment problems. Congress has express constitutional authority to establish federal bankruptcy laws (U.S. Const., Art. I, sec. 8), and nothing in the relevant provisions involves any federal commandeering of state resources. *See Printz v. United States*, 521 U.S. 898 (1997); *New York v. United States*, 505 U.S. 144 (1992).

CONCLUSION

Based on the foregoing legal authorities and analysis, the United States Trustee respectfully requests that this Court vacate the Order due to the absence of a "case or controversy" in the Bankruptcy Court as required under Article III of the United States Constitution. Alternatively, the Bankruptcy Court lacked statutory jurisdiction and power to enter the Order. If, however, this Court concludes that the Bankruptcy Court properly exercised its jurisdiction and authority, the United States Trustee submits that the Bankruptcy Court nonetheless erred in its interpretation of the statutes regarding debt relief agencies, and respectfully requests that this Court reverse the Order.

Respectfully submitted,

____
B. AMON JAMES
Assistant United States Trustee

United States Department of Justice
Office of the United States Trustee
225 West Oglethorpe Avenue, Suite 302
Savannah, GA 31401
(912) 652-4112

<u>Of Counsel</u>
Roberta A. DeAngelis
Acting General Counsel
P. Matthew Sutko
Office of the General Counsel
Executive Office for United States Trustees
Department of Justice
20 Massachusetts, Ave. N.W., Suite 8100
Washington, D.C. 20530
(202) 307-1399

ADDENDUM

The full text of **11 U.S.C. § 101(12A)** is as follows:

> The term "debt relief agency" means any person who provides any bankruptcy assistance to an assisted person in return for the payment of money or other valuable consideration, or who is a bankruptcy petition preparer under section 110, but does not include –
>
> (A) any person that is an officer, director, employee or agent of a person who provides such assistance or of such preparer;
>
> (B) a nonprofit organization which is exempt from taxation under section 501(c)(3) of the Internal Revenue Code of 1986;
>
> (C) a creditor of such assisted person, to the extent that the creditor is assisting such assisted person to restructure any debt owed by such assisted person to the creditor;
>
> (D) a depository institution (as defined in section 3 of the Federal Deposit Insurance Act) or any Federal credit union or State credit union (as those terms are defined in section 101 of the Federal Credit Union Act), or any affiliate or subsidiary of such a depository institution or credit union; or
>
> (E) an author, publisher, distributor, or seller of works subject to copyright protection under title 17, when acting in such capacity.

11 U.S.C. § 526 provides as follows:

Restrictions on debt relief agencies.

> (a) A debt relief agency shall not--
>
> (1) fail to perform any service that such agency informed an assisted person or prospective assisted person it would provide in connection with a case or proceeding under this title;
>
> (2) make any statement, or counsel or advise any assisted person or prospective assisted person to make a statement in a document filed in a case or proceeding under this title, that is untrue and misleading, or that upon the exercise of reasonable care, should have been known by such agency to be untrue or misleading;
>
> (3) misrepresent to any assisted person or prospective assisted person, directly or indirectly, affirmatively or by material omission, with respect to--
>
> (A) the services that such agency will provide to such person; or

(B) the benefits and risks that may result if such person becomes a debtor in a case under this title; or

(4) advise an assisted person or prospective assisted person to incur more debt in contemplation of such person filing a case under this title or to pay an attorney or bankruptcy petition preparer fee or charge for services performed as part of preparing for or representing a debtor in a case under this title.

(b) Any waiver by any assisted person of any protection or right provided under this section shall not be enforceable against the debtor by any Federal or State court or any other person, but may be enforced against a debt relief agency.

(c) (1) Any contract for bankruptcy assistance between a debt relief agency and an assisted person that does not comply with the material requirements of this section, section 527, or section 528 shall be void and may not be enforced by any Federal or State court or by any other person, other than such assisted person.

(2) Any debt relief agency shall be liable to an assisted person in the amount of any fees or charges in connection with providing bankruptcy assistance to such person that such debt relief agency has received, for actual damages, and for reasonable attorneys' fees and costs if such agency is found, after notice and a hearing, to have–

(A) intentionally or negligently failed to comply with any provision of this section, section 527, or section 528 with respect to a case or proceeding under this title for such assisted person;

(B) provided bankruptcy assistance to an assisted person in a case or proceeding under this title that is dismissed or converted to a case under another chapter of this title because of such agency's intentional or negligent failure to file any required document including those specified in section 521; or

(C) intentionally or negligently disregarded the material requirements of this title or the Federal Rules of Bankruptcy Procedure applicable to such agency.

(3) In addition to such other remedies as are provided under State law, whenever the chief law enforcement officer of a State, or an official or agency designated by a State, has reason to believe that any person has violated or is violating this section, the State--

(A) may bring an action to enjoin such violation;

(B) may bring an action on behalf of its residents to recover the actual damages of assisted persons arising from such violation, including any liability under paragraph (2); and

(C) in the case of any successful action under subparagraph (A) or (B), shall be awarded the costs of the action and reasonable attorneys' fees as determined by the court.

(4) The district courts of the United States for districts located in the State shall have concurrent jurisdiction of any action under subparagraph (A) or (B) of paragraph (3).

(5) Notwithstanding any other provision of Federal law and in addition to any other remedy provided under Federal or State law, if the court, on its own motion or on the motion of the United States trustee or the debtor, finds that a person intentionally violated this section, or engaged in a clear and consistent pattern or practice of violating this section, the court may –

(A) enjoin the violation of such section; or

(B) impose an appropriate civil penalty against such person.

(d) No provision of this section, section 527, or section 528 shall –

(1) annul, alter, affect, or exempt any person subject to such sections from complying with any law of any State except to the extent that such law is inconsistent with those sections, and then only to the extent of the inconsistency; or

(2) be deemed to limit or curtail the authority or ability –

(A) of a State or subdivision or instrumentality thereof, to determine and enforce qualifications for the practice of law under the laws of that State; or

(B) of a Federal court to determine and enforce the qualifications for the practice of law before that court.

The full text of **11 U.S.C. § 527** is as follows:

Disclosures.

(a) A debt relief agency providing bankruptcy assistance to an assisted person shall provide–

(1) the written notice required under section 342(b)(1); and

(2) to the extent not covered in the written notice described in paragraph (1), and not later than 3 business days after the first date on which a debt relief agency first offers to provide any bankruptcy assistance services to an assisted person, a clear and conspicuous written notice advising assisted persons that--

(A) all information that the assisted person is required to provide with a petition and thereafter during a case under this title is required to be complete, accurate, and truthful;

(B) all assets and all liabilities are required to be completely and accurately disclosed in the documents filed to commence the case, and the replacement value of each asset as defined in section 506 must be stated in those documents where requested after reasonable inquiry to establish such value;

(C) current monthly income, the amounts specified in section 707(b)(2), and, in a case under chapter 13 of this title, disposable income (determined in accordance with section 707(b)(2)), are required to be stated after reasonable inquiry; and

(D) information that an assisted person provides during their case may be audited pursuant to this title, and that failure to provide such information may result in dismissal of the case under this title or other sanction, including a criminal sanction.

(b) A debt relief agency providing bankruptcy assistance to an assisted person shall provide each assisted person at the same time as the notices required under subsection (a)(1) the following statement, to the extent applicable, or one substantially similar. The statement shall be clear and conspicuous and shall be in a single document separate from other documents or notices provided to the assisted person:

IMPORTANT INFORMATION ABOUT BANKRUPTCY ASSISTANCE SERVICES FROM AN ATTORNEY OR BANKRUPTCY PETITION PREPARER.

If you decide to seek bankruptcy relief, you can represent yourself, you can hire an attorney to represent you, or you can get help in some localities from a bankruptcy petition preparer who is not an attorney. THE LAW REQUIRES AN ATTORNEY OR BANKRUPTCY PETITION PREPARER TO GIVE YOU A WRITTEN CONTRACT SPECIFYING WHAT THE ATTORNEY OR BANKRUPTCY PETITION PREPARER WILL DO FOR YOU AND HOW MUCH IT WILL COST. Ask to see the contract before you hire anyone.

The following information helps you understand what must be done in a routine bankruptcy case to help you evaluate how much service you need. Although bankruptcy can be complex, many cases are routine.

Before filing a bankruptcy case, either you or your attorney should analyze your eligibility for different forms of debt relief available under the Bankruptcy Code and which form of relief is most likely to be beneficial for you. Be sure you understand the relief you can obtain and its limitations. To file a bankruptcy case, documents called a Petition, Schedules and Statement of Financial Affairs, as well as in some cases a Statement of Intention need to be prepared correctly and filed with the bankruptcy court. You will have to pay a filing fee to the bankruptcy court. Once your case starts, you will have to attend the required first meeting of creditors where you may be questioned by a court official called a 'trustee' and by creditors.

If you choose to file a chapter 7 case, you may be asked by a creditor to reaffirm a debt. You may want help deciding whether to do so. A creditor is not permitted to coerce you into reaffirming your debts.

If you choose to file a chapter 13 case in which you repay your creditors what you can afford over 3 to 5 years, you may also want help with preparing your chapter 13 plan and with the confirmation hearing on your plan which will be before a bankruptcy judge.

If you select another type of relief under the Bankruptcy Code other than chapter 7 or chapter 13, you will want to find out what should be done from someone familiar with that type of relief.

Your bankruptcy case may also involve litigation. You are generally permitted to represent yourself in litigation in bankruptcy court, but only attorneys, not bankruptcy petition preparers, can give you legal advice.

(c) Except to the extent the debt relief agency provides the required information itself after reasonably diligent inquiry of the assisted person or others so as to obtain such information reasonably accurately for inclusion on the petition, schedules or statement of financial affairs, a debt relief agency providing bankruptcy assistance to an assisted person, to the extent permitted by nonbankruptcy law, shall provide each assisted person at the time required for the notice required under subsection (a)(1) reasonably sufficient information (which shall be provided in a clear and conspicuous writing) to the assisted person on how to provide all the information the assisted person is required to provide under this title pursuant to section 521, including –

(1) how to value assets at replacement value, determine current monthly income, the amounts specified in section 707(b)(2) and, in a chapter 13 case, how to determine disposable income in accordance with section 707(b)(2) and related calculations;

(2) how to complete the list of creditors, including how to determine what amount is owed and what address for the creditor should be shown; and

(3) how to determine what property is exempt and how to value exempt property at replacement value as defined in section 506.

(d) A debt relief agency shall maintain a copy of the notices required under subsection (a) of this section for 2 years after the date on which the notice is given the assisted person.

4. The full text of **11 U.S.C. § 528** is as follows:

Requirements for debt relief agencies.

(a) A debt relief agency shall –

(1) not later than 5 business days after the first date on which such agency provides any bankruptcy assistance services to an assisted person, but prior to such assisted person's petition under this title being filed, execute a written contract with such assisted person that explains clearly and conspicuously--

(A) the services such agency will provide to such assisted person; and

(B) the fees or charges for such services, and the terms of payment;

(2) provide the assisted person with a copy of the fully executed and completed contract;

(3) clearly and conspicuously disclose in any advertisement of bankruptcy assistance services or of the benefits of bankruptcy directed to the general public (whether in general media, seminars or specific mailings, telephonic or electronic

messages, or otherwise) that the services or benefits are with respect to bankruptcy relief under this title; and

(4) clearly and conspicuously use the following statement in such advertisement: "We are a debt relief agency. We help people file for bankruptcy relief under the Bankruptcy Code." or a substantially similar statement.

(b) (1) An advertisement of bankruptcy assistance services or of the benefits of bankruptcy directed to the general public includes--

(A) descriptions of bankruptcy assistance in connection with a chapter 13 plan whether or not chapter 13 is specifically mentioned in such advertisement; and

(B) statements such as "federally supervised repayment plan" or "Federal debt restructuring help" or other similar statements that could lead a reasonable consumer to believe that debt counseling was being offered when in fact the services were directed to providing bankruptcy assistance with a chapter 13 plan or other form of bankruptcy relief under this title.

(2) An advertisement, directed to the general public, indicating that the debt relief agency provides assistance with respect to credit defaults, mortgage foreclosures, eviction proceedings, excessive debt, debt collection pressure, or inability to pay any consumer debt shall –

(A) disclose clearly and conspicuously in such advertisement that the assistance may involve bankruptcy relief under this title; and

(B) include the following statement: "We are a debt relief agency. We help people file for bankruptcy relief under the Bankruptcy Code." or a substantially similar statement.

CERTIFICATE OF SERVICE

The undersigned hereby certifies that the within and foregoing Brief of United States Trustee as Appellant has this day been served upon the following by mailing a copy of the same through the United States Mail bearing sufficient postage thereon:

Mr. Terry P. Leiden
Leiden & Leiden
Attorneys at Law
330 Telfair Street
Augusta, Georgia 30901

This 18th day of November, 2005.

By:______________________________________
Lynn M. Bostwick
Office of the United States Trustee

222 West Oglethorpe Avenue, Ste. 302
Savannah, Georgia 31401
(912) 652-4112

BRIEF BANK — 'SUMMARY SHEET"

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WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*

In re Attorneys at Law and Debt Relief Agencies

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*

S.D. Georgia

3. ("CCN") ***CURRENT*** CASE NO.

No.: 4:05-cv-00206

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*

No.: 05-00400

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(Identify judge & cite, if any)

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U.S. TRUSTEES

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B. Amon James, AUST

P. Matthew Sutko, OGC

(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***

BANKRUPTCY

9. ("SU") ● ***SUMMARY*** OF KEY ISSUE(s)

&

√ Any Miscellaneous ***BACKGROUND***

● 1. Did the Bankruptcy Court lack jurisdiction to enter the Order based on the absence of a "case or controversy" under Article III of the United States Constitution? 2. Did the Bankruptcy Court lack authority under section 151 of title 28 to enter the Order because there was no properly commenced "action, suit or proceeding" pending before the Bankruptcy Court? 3. Assuming *arguendo* that the Bankruptcy Court properly exercised its jurisdiction, was it correct in ruling that the provisions of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 regulating debt relief agencies do not apply to licensed attorneys?

√ **Background:**

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UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF GEORGIA
SAVANNAH DIVISION

In re:

ATTORNEYS AT LAW AND DEBT RELIEF AGENCIES	District Court Case No. 4:05-cv-00206-WTM Docketed in Bankruptcy Court as Miscellaneous Proceeding No. 05-00400

______________________________/

FELICIA S. TURNER,
UNITED STATES TRUSTEE,

Appellant.

______________________________/

REPLY BRIEF OF UNITED STATES TRUSTEE

B. AMON JAMES, ESQUIRE
Assistant United States Trustee
United States Department of Justice
Office of the United States Trustee
222 West Oglethorpe Avenue, Suite 302
Savannah, GA 31401
(912) 652-4112

Of Counsel

Roberta A. DeAngelis
Acting General Counsel

P. Matthew Sutko
Office of the General Counsel

Executive Office for United States Trustees
Department of Justice
20 Massachusetts, Ave. N.W., Suite 8100
Washington, D.C. 20530
(202) 307-1399

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MISCELLANEOUS

I. NOTWITHSTANDING THE INTERVENORS' CHARACTERIZATION OF THE ORDER ON APPEAL AS A "GENERAL ORDER," THIS COURT SHOULD VACATE THE ORDER BECAUSE IT VIOLATES THE UNITED STATES CONSTITUTION'S CASE OR CONTROVERSY REQUIREMENT.

In her opening brief, the United States Trustee demonstrated that this Court should vacate the Order on appeal because the Bankruptcy Court entered it in the absence of a case or controversy under Article III of the United States Constitution. Leiden & Leiden, P.C., filed a brief opposing the United States Trustee's position on December 2, 2005. Another group of attorneys (the "Intervenors") did the same on January 5, 2006. Both Leiden & Leiden and the Intervenors (collectively, the "Appellees") assert in their briefs that their interests are affected by the Order. The Appellees fail to rebut the government's argument that the court below could not enter a substantive order interpreting federal cases in the absence of a "case or controversy." Consequently, this Court should vacate the Order.[1]

A. THE ORDER IS NOT A GENERAL ORDER THAT IS IMMUNE FROM CONSTITUTIONAL ATTACK DUE TO THE ABSENCE OF A CASE OR CONTROVERSY.

The Intervenors argue that Judge Lamar Davis could issue the Order without a "case or controversy" because it is a "general order" issued pursuant to the Bankruptcy Court's statutory and inherent authority to regulate attorneys. Because the Order does not have any of the incidents of a general order and would violate various provisions of law if it were such an order,

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[1] Attorneys in at least three other federal districts have moved bankruptcy courts to follow Judge Davis' lead and issue a similar order. Each court has denied such relief. *See In re McCartney*, 2006 WL 75306, 2006 Bankr. LEXIS 36 (Bankr. M.D. Ga. Jan. 12, 2005) (denying motion based on absence of a case or controversy). The United States Trustee attaches two unpublished decisions in an appendix to this brief for this Court's convenience should the Court desire to consider them.

the United States Trustee does not believe that Judge Davis intended the Order to be a general order, and this Court should not consider it as such. Even if the Order is a general order, however, it nonetheless violates Article III's requirement of a case or controversy because it is not procedural in nature.

Rules and general orders that govern practice and procedure before the federal courts are issued pursuant to federal statutes and, ultimately, Article III of the United States Constitution:

> Article III of the Constitution . . . empowers Congress to establish a system of federal district and appellate courts and, impliedly, to establish procedural Rules governing litigation in these courts. In the Rules Enabling Act, Congress authorized [the Supreme Court] to prescribe uniform rules to govern the 'practice and procedure' of the federal district courts and courts of appeals.

Burlington Northern Railroad Co. v. Woods, 480 U.S. 1, 5 n.3 (1987). Because each bankruptcy court is a unit of the district court, 28 U.S.C. § 151, the bankruptcy courts' authority to issue generally applicable rules is therefore also derived from Article III of the United States Constitution, federal statutes, and federal rules that govern the establishment of rules of practice and procedure. *See* 28 U.S.C. §§ 2071-2075 (providing authority and procedures to be followed in prescribing rules); Fed. R. Civ. P. 83 (outlining authority and procedures to be followed by district court in prescribing local rules); Fed. R. Bankr. P. 9029 (bankruptcy court's equivalent of Rule 83); Local Bankr. R. 9029-1(providing authority to local bankruptcy court).

The Intervenors characterize the Order as a "general order" issued under Fed. R. Bankr. P. 9029 and Local Bankr. R. 9029-1. Brief of Intervenors, at 11. Those rules state:

> Rule 9029. Local Bankruptcy Rules; Procedure When There is No Controlling Law
>
> (a) Local Bankruptcy Rules
>
> (1) . . . A district court may authorize the bankruptcy judges of the district, subject to any limitation or condition it may prescribe and the requirements of 83 F.R.Civ.P., to make and amend rules of practice and procedure which are consistent with – but not duplicative of – Acts of Congress and these rules . . . Local rules shall conform to any uniform numbering system prescribed by the Judicial Conference of the United States.
>
> . . . .
>
> (b) Procedure When There is No Controlling Law. A judge may regulate practice in any manner consistent with federal law, these rules, Official Forms, and local rules of the district. No sanction or other disadvantage may be imposed for noncompliance with any requirement not in federal law, federal rules, Official Forms, or the local rules of the district unless the alleged violator has been furnished in the particular case with actual notice of the requirement.

Fed. R. Bankr. P. 9029. Local Bankr. R. 9029-1 states as follows:

> Pursuant to Bankruptcy Rule 9029, the Bankruptcy Court may by *General Order* regulate its practice in any manner not inconsistent with these Rules or the District Court Local Rules."

(Emphasis added).

The Order on appeal is not a general order under Local Bankr. R. 9029-1 for several reasons. First, Judge Davis did not caption the Order as a "general order." Unlike other general orders issued by the United States Bankruptcy Court for the Southern District of Georgia, this Order is not denominated and numbered as such (for example, "General Order 2005-1").

Second, the Order on appeal has not been placed with the general orders on the Bankruptcy Court's website, but instead, it has been placed on the website under the heading of *BAPCPA Decisions of the Southern District of Georgia* (included in the attached Appendix is a copy of the website page listing the various general orders and a copy of the website page listing the various BAPCPA decisions).[2] Third, the Order has been published as a decision of the Bankruptcy Court, at 322 B.R. 66 (Bankr. S.D. Ga. 2005). Fourth, the Bankruptcy Court expressly based its authority, *inter alia*, on 11 U.S.C. § 526, which authorizes a court to enjoin a violation of the debt relief agency provisions of the BAPCPA[3] *sua sponte*. *See* Order at 2, n.1. In other words, the Bankruptcy Court based its authority to issue the Order on the statute being construed and not upon its authority to issue general orders. Fifth, and most importantly, the Order is clearly a ruling on an issue of substantive law, and thereby purports to decide an issue that is an improper subject for a general order.

The non-procedural nature of the Order is clear from its first paragraph, where the Court states the issue upon which it is ruling:

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[2] The Bankruptcy Court's website at http://www.gas.uscourts.gov/usbc/lbr/GenOrders.htm currently lists eight general orders issued in 2005, addressing procedures in that court. They are numbered General Order 2005-1 through General Order 2005-8. The Order on appeal is not among them. The Order on appeal likewise does not appear among the general orders listed at www.gasb.uscourts.gov . Instead, the Order appears on the Bankruptcy Court's website at http://www.gas.uscourts.gov/usbc/bapcpa.html under the heading of *BAPCPA Decisions of the Southern District of Georgia*.

[3] Bankruptcy Abuse Prevention and Consumer Protection Act of 2005.

> The issue before the Court is whether amendments to the Bankruptcy Code, which become effective today, regulating Debt Relief Agencies apply to attorneys licensed to practice law who are members of the Bar of this Court.

Order at 1. The remainder of the Order consists of statutory construction, focusing on the language of the statutes, their legislative history, and the published commentary on the statutes. The Order concludes with the Bankruptcy Court's holding. The Order thus is not procedural in nature.

Federal rules and standing orders are not proper vehicles for a federal court's determination of substantive law. *See Burlington Northern Railroad Co. v. Woods*, 480 U.S. 1, 5 (1987) (stating that rules that are "procedural" satisfy constitutional standard)*; Adams v. Bonner*, 734 F.2d 1094, 1102 (5th Cir. 1984) ("[T]he test is whether the rule will operate to abridge, enlarge, or modify the rules of decision by which the court will adjudicate the parties' rights.").

It is axiomatic that a federal court may resolve legal questions only in the context of an Article III "case" or "controversy." *See McConnell v. Fed. Election Comm'n,* 540 U.S. 93, 225 (2003). Absent a live controversy between adverse parties, the court's legal interpretation amounts to an advisory opinion, which is impermissible under Article III. *See United States National Bank of Oregon v. Independent Insurance Agents of America, Inc.*, 508 U.S. 439, 446 (1993); *Dixie Electric Co-op. v. Citizens of State of Alabama*, 789 F.2d 852, 857 (11th Cir. 1986)

("Federal courts may not render advisory opinions on abstract or hypothetical propositions of law.").[4]

The Appellees' reliance upon the "inherent authority" of the Bankruptcy Court ignores limitations on the Bankruptcy Court's authority. The bankruptcy courts are a creation of Congress, and there is "no general grant of legislative authority to regulate the practice of law." *Rodgers v. United States Steel Corp.*, 508 F.2d 152, 163 (3d. Cir. 1975)), *certiorari denied*, 423 U.S. 832 (1975) (citation omitted). Courts may, once created, have certain inherent authorities, including the inherent authority to sanction inappropriate conduct in the context of a particular case. *See, e.g.*, *Chambers v. NASCO, Inc.*, 501 U.S. 32, 43 (1991) (sanctioning party for bad faith litigation); *Matter of Egwim*, 291 B.R. 559, 581 (Bankr. N.D. Ga. 2003) (addressing sanctions of counsel for conduct in case). However, all the cases cited by the Appellees for the "inherent authority" of the Court arise, not surprisingly, within the context of a particular case or controversy.

The fact that members of the bar now seek to present arguments to this Court in this appeal, as affected parties, demonstrates the wisdom of the historic requirement that a "case or

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[4] "[I]t is well settled that the jurisdiction of the bankruptcy courts to hear cases related to bankruptcy is limited initially by statute and eventually by Article III." *In re Lemco Gypsum, Inc.*, 910 F.2d 784, 787 (11th Cir. 1990). Although a bankruptcy court is not itself an Article III court, *see Northern Pipeline Construction Co. v. Marathon Pipe Line Co.*, 458 U.S. 50, 60-61 (1982), a bankruptcy court may exercise a judicial function only as a "unit of the district court." *See* 11 U.S.C. § 151 ("In each judicial district, the bankruptcy judges . . . shall constitute a unit of the district court to be known as the bankruptcy court for that district."); *In re Goerg*, 930 F.2d 1563, 1565 (11th Cir. 1991) ("original jurisdiction over bankruptcy cases is vested in Article III courts and [] bankruptcy courts obtain jurisdiction only at the discretion of the district court"). Accordingly, bankruptcy courts are bound by the jurisdictional limitations of Article III.

controversy" exist *before* a court determines an issue of substantive law. Local rules and general orders cannot impair substantive rights of any persons, whether attorneys or debtors. Sections 2072 and 2075 of title 28 specifically provide that federal rules cannot "abridge, enlarge or modify any substantive right . . . ." Indeed, such rules may not even be duplicative of such substantive law. Fed. R. Bankr. P. 9029(a)(1).

Local rules and general orders which infringe on substantive rights, or which affect procedural rights under duly-prescribed federal rules of procedure, are simply invalid. *See Miner v. Atlass*, 363 U.S. 641 (1960) (invalidating local rule as contrary to federal admiralty rules); *Brown v. Crawford County, GA*, 960 F.2d 1002, 1008-09 (11th Cir. 1992) (invalidating local summary judgment rule of Middle District of Georgia because it violates the parties' procedural and substantive rights under Fed. R. Civ. P. 56); *In re Standing Order With Reasons Regarding Objections to Discharge Under 11 U.S.C. § 727 and Purported Settlement of Actions,* 272 B.R. 917, 923 (W.D. La. 2001) (invalidating rule that impairs creditors' substantive rights under 11 U.S.C. §§ 727 and 523, where bankruptcy court also lacked delegated authority to prescribe local rule); *In re Steinacher,* 283 B.R. 768, 773-74 (Bankr. 9th Cir. 2002) (invalidating a local rule that impairs debtors' substantive rights under 11 U.S.C. § 1322(b)); *cf. Northland Ins. Co. v. Shell Oil Co.,* 930 F.Supp. 1069, 1074, 1076 (D.N.J. 1996) (describing procedure for prescribing local rules, and upholding local rule as consistent with the Federal Rules of Civil Procedure).

The Order on appeal is especially problematic because it is not even a local rule promulgated by a majority of the bankruptcy judges acting under authority delegated by the

District Court. General orders issued under Fed. R. Bankr. P. 9029 do not satisfy the procedural requirements of Rule 9029(a) that local rules be issued by the entire court , acting by a majority of the judges, "after giving appropriate public notice and an opportunity for comment . . . ." *See* Fed. R. Bankr. P. 9029(a) (applying notice and comment requirements of Fed. R. Civ. P. 83 to all local bankruptcy rules). In sharp contrast to local rules, a single judge may issue general orders under Rule 9029(b), but such general orders cannot be the basis for "disadvantage" to a person violating the order "unless the alleged violator has been furnished in the particular case with actual notice of the requirement." By its terms, the Order on appeal addresses, and determines, the rights and obligations of attorneys under the debt relief agency statutes and, importantly, the rights of their debtor clients as well. The court below issued this Order with no official notice or opportunity for comment whatsoever.

In sum, (i) Judge Davis did not denominate the Order a general order; (ii) the Order does not serve the purpose of a general order; and (iii) the Order addresses matters that do not fall within the permissible scope of a general order. Finally, even if the Bankruptcy Court intended it to be a general order, the Order on appeal determines issues under substantive law, and therefore could not have been entered absent a case or controversy. Consequently, this Court should vacate the Order.

B. THERE IS NO MOOTNESS ISSUE PRESENTED BY THIS APPEAL, AND THUS THE ALLEGED "EXCEPTION" TO THE REQUIREMENT OF A CASE OR CONTROVERSY DOES NOT APPLY.

The Intervenors attempt to argue a limited "exception" to the case or controversy requirement at page 14, footnote 3, of their brief filed January 5, 2006. They assert that the

Court should affirm the Order because attorney actions that may fall subject to the debt relief agency statutes are "capable of repetition but would otherwise evade review."

This argument fails for several reasons. First and foremost, each decision to which the Intervenors cite pertains to an actual case commenced by actual plaintiffs. *See Bourgeois v. Peters*, 387 F.3d 1303, 1307 (11th Cir. 2004) (plaintiffs sought injunctive relief); *Irish Lesbian & Gay Org. v. Giuliani*, 143 F.3d 638, 645 (2d. Cir. 1998) (plaintiffs sought injunctive relief).

Second, the court below did not invoke that exception and did not enter its order under it. Third, the "capable of repetition" standard is an exception to the *mootness doctrine*. A federal court cannot entertain a matter "unless an actual dispute continues to exist between the parties." *Bourgeois*, 387 F.3d at 1307-08. "Past injury . . . does not in itself show a present case or controversy regarding injunctive relief, if unaccompanied by current adverse effects." *Id.* at 1308 (quoting *Lynch v. Baxley*, 744 F.2d 1452, 1456 (11th Cir. 1984)). If there are no longer adverse effects from a past injury, then the court may nonetheless entertain an otherwise moot case if it arises from a situation that is "capable of repetition, yet evading review." *Id.*; *Alabama Disabilities Advocacy Program v. J.S. Tarwater Devel.*, 97 F.3d 492, 496 n.1 (11th Cir. 1996).

In order to satisfy the mootness exception, there are three requirements:

> (1) the challenged action was in its duration too short to be fully litigated prior to its cessation or expiration, and (2) there was a reasonable expectation that the same complaining party would be subjected to the same action again..

Bourgeois, 387 F.3d at 1308 (quoting *Weinstein v. Bradford*, 423 U.S. 147, 149 (1975) (per curiam)). "As a final requirement, if there exists some alternative vehicle through which a particular policy may effectively be subject to a complete round of judicial review, then the courts will not generally employ this exception to the mootness doctrine." *Id.*

These requirements are not met in the present circumstances. The Order did not address any particular, concrete instance of an attorney's conduct. There was no challenged action of an attorney, whether by a debtor or the United States Trustee. No attorney sought judicial relief. There was never a case or controversy to become moot. There is no record that can support the mootness argument, because the Bankruptcy Court issued the Order on the very morning that the applicable statutes came into effect, before a case or controversy could even arise. Indeed, it is the Order itself which eliminates the opportunity for judicial review of attorney actions under the debt relief agency provisions.

C. THE ABSENCE OF A CASE OR CONTROVERSY IN THE BANKRUPTCY COURT DOES NOT PRECLUDE THE UNITED STATES TRUSTEE'S STANDING TO APPEAL THE ORDER.

Leiden & Leiden argue that the United States Trustee lacks standing to appeal the Order because of the lack of a case or controversy. Brief of Leiden & Leiden at pp. 3- 4. This Court, however, has jurisdiction to vacate the Order based on the absence of a case or controversy. *Bender v. Williamsport Area School District*, 475 U.S. 534, 541 (1986) (vacating lower court's decision where there was a lack of jurisdiction in that court). The United States Trustee, in turn, has standing to raise that issue based on her role as an officer of the Executive Branch.

The Supreme Court has held that a public interest may "give a sufficient stake in the outcome of a bankruptcy case to confer appellate standing." *Morganstern v. Revco D.S., Inc. (In re Revco D.S., Inc.)*, 898 F.2d 498 (6th Cir. 1990) (citing *SEC v. U.S. Realty & Imp. Co.*, 310 U.S.

434, 460 (1940) and *Data Processing Serv. v. Camp*, 397 U.S. 150, 153 (1970)). The United States Trustee’s role in behalf of such a public interest is specifically delineated in the statute at issue. *See* 11 U.S.C. §§ 526(c)(5) (United States Trustee may seek judicial relief for violations of the statute). The Order on appeal impairs the United States Trustee’s performance of that role, and consequently the United States Trustee’s interest in pursuing the appeal lies "within the zone of interests to be protected or regulated by the statute . . . in question." *Revco D.S., Inc.,* 898 F.2d at 499 (quoting *Data Processing Serv. v. Camp*, 397 U.S. 150, 153 (1970)). The contention that the United States Trustee lacks standing is also contrary to the broad grants of authority set forth in 11 U.S.C. § 307 and 28 U.S.C. § 586. *See* Brief of United States Trustee as Appellant, at 1. All courts of appeals that have addressed the issue agree that a United States Trustee has standing to appeal bankruptcy court decisions. *United States Trustee v. Columbia Gas Sys. Inc. (In re Columbia Gas Sys. Inc.)*, 33 F.3d 294, 295-299 (3d Cir. 1994) (holding U.S. Trustee has broad standing, including ability to challenge investment guidelines for chapter 11 debtor); *United States Trustee v. Price Waterhouse*, 19 F.3d 138, 141 (3d Cir. 1994) (finding United States Trustee has standing to appeal appointment of professionals in chapter 11 case); *In re Clark*, 927 F.2d 793, 795-96 (4th Cir. 1991) (finding standing to appeal denial of motion to dismiss); *In re Plaza de Diego Shopping Ctr., Inc.*, 911 F.2d 820, 824 (1st Cir. 1990) (standing to appeal appointment of trustee); *Morganstern v. Revco D.S., Inc. (In re Revco D.S., Inc.)*, 898 F.2d at 498 (standing to appeal decision refusing to appoint examiner). *See also United States Trustee v. Fishback (In re Glados, Inc.)*, 83 F.3d 1360, 1361 n.1 (11th Cir. 1996) (noting United States Trustee has standing under § 307 to raise issues concerning calculation of compensation and statutory construction under § 726); *St. Angelo v. Victoria Farms, Inc.*, 38 F.3d 1525, 1535 (9th Cir. 1994), *modified*, 46 F.3d 969 (1995) (holding United States Trustee had standing to bring appeal involving constitutional and statutory issues).

II. BOTH THE PLAIN LANGUAGE OF THE STATUTE AND ITS LEGISLATIVE HISTORY LEAD INESCAPABLY TO THE CONCLUSION THAT CONGRESS INTENDED TO SUBJECT BANKRUPTCY ATTORNEYS REPRESENTING CONSUMER DEBTORS TO THE "DEBT RELIEF AGENCY" REQUIREMENTS OF THE BAPCPA.

A. THE DICTIONARY DEFINITION OF "AGENCY" HAS NO BEARING ON THE MEANING OF THE TERM "DEBT RELIEF AGENCY" AS USED IN THE BAPCPA.

The Intervenors argue that the plain and ordinary meaning of "debt relief agency" excludes attorneys because "[n]one of the [dictionary] definitions of 'agency' reasonably would be understood by a consumer to suggest a lawyer or law firm." Brief of Intervenors, at 17. However, the dictionary definition of a statutory term does not govern its interpretation where the statute itself defines the term. *See FDIC v. Meyer*, 510 U.S. 471, 476, 114 S.Ct. 996 (1994); *Smith v. United States*, 508 U.S. 223, 228, 113 S.Ct. 2050, 2054 (1993). Subject to certain exclusions not applicable here, 11 U.S.C. § 101(12A) defines the term "debt relief agency" to mean, *inter alia*, "any person who provides any bankruptcy assistance to an assisted person in return for the payment of money or other valuable consideration … " Section 101(4A), in turn, defines "bankruptcy assistance" to include "providing legal representation with respect to a case under this title." Under these circumstances, it is the plain and ordinary meaning of "legal representation" that determines whether the term "debt relief agency" encompasses lawyers, rather than the plain and ordinary meaning of "agency." The United States Trustee submits that it is not reasonably open to dispute that bankruptcy attorneys are "person[s]" in the business of "providing legal representation with respect to" bankruptcy cases.

B. NOTWITHSTANDING A SENATOR'S PERSONAL BELIEFS ON THE ISSUE, THE LEGISLATIVE HISTORY OF THE BAPCPA ESTABLISHES BEYOND QUESTION THAT CONGRESS INTENDED THE TERM "DEBT RELIEF AGENCY" TO ENCOMPASS BANKRUPTCY ATTORNEYS.

On March 10, 2005, shortly before the Senate passed the BAPCPA in the form of S. 256, Sen. Feingold withdrew several amendments that he had proposed, including Amendment No. 93,[5] which sought to exclude lawyers from the definition of "debt relief agency." In so doing, he stated:

> Mr. President, I appreciate the fact that we have had some opportunity to make a few modest modifications at the end of this process. Obviously, I hoped for more, but I do thank [several named Senators], who are working on a number of changes and accepting a couple of amendments so we can move this process through. The result will be that the next five votes on my amendments will not be necessary, if this agreement is made. So I hope that causes the unanimous consent agreement to go through.

151 Cong.Rec. S2462-3 (March 10, 2005).

The Intervenors argue that this record does not indicate that Sen. Feingold withdrew the amendment due to lack of support but is "at least equally as consistent with an interpretation that the amendment was withdrawn because Senator Feingold decided on further reflection that it was redundant and unnecessary." Brief of Intervenors, at 21. Clearly, however, Senator Feingold introduced the amendment because he concluded, like the American Bar Association, the Federal Bar Association, and the United States Trustee in this case, that the debt relief

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[5] Amendment 93 is sometimes referred to as the "ABA Amendment" because it was, in Sen. Feingold's words, "strongly supported by the American Bar Association." 151 Cong.Rec. S2316 (March 9, 2005). Sen. Feingold also stated for the record that the amendment had the strong support of the Federal Bar Association. *Id.*

agency provisions of the bill did apply to attorneys,[6] and he did not want them to so apply. Given his accompanying comments, the United States Trustee submits that it is highly unlikely that the Senator withdrew the amendment because he decided on further reflection that it was redundant and unnecessary.

Whatever Senator Feingold's thoughts may have been, however, the official House Judiciary Committee report on the bill makes it clear that Congress did intend for the debt relief agency provisions to apply to attorneys. "'[I]t is the official committee reports that provide the authoritative expression of legislative intent …'" *In re Walton*, 866 F.2d 981, 983 (8th Cir.1989), quoting *Zolg v. Kelly (In re Kelly*), 841 F.2d 908, 912 n. 3 (9th Cir.1988). Under the heading, "Highlights of Bankruptcy Reforms," the House Judiciary Committee report on the BAPCPA provides, as follows:

> *Consumer Debtor Bankruptcy Protections*. The bill's consumer protections include provisions strengthening professionalism standards for attorneys and others who assist consumer debtors with their bankruptcy cases. S. 256 mandates that certain services and specified notices be given to consumers by professionals and others who provide bankruptcy assistance. To ensure compliance with these provisions, the bill institutes various enforcement mechanisms.[7]

H.R. Rep. No. 109-31(I), at 17 (April 8, 2005), reprinted in 2005 U.S.C.C.A.N. 88, 103.

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[6] See note 1, supra.

[7] This language from the House Judiciary Committee report also conflicts with the Intervenors' contention, on page 3 of their brief, that Congress did not intend the debt relief agency provisions to be consumer protection provisions but instead designed them to reduce the number of bankruptcy filings "by making it especially difficult for poorer debtors to get competent assistance to file a bankruptcy petition." The Court will note that this contention by the Intervenors also conflicts with their position that Congress did not intend for the debt relief agency provisions to apply to attorneys.

Congress' use of the term "professionals" in this paragraph is as revealing as its use of the term "attorneys." "Professional" is used as a term of art in the Bankruptcy Code to include attorneys, not to exclude them, and Congress is presumed to draft legislation with an understanding of existing law. *See., e.g.*, 11 U.S.C. § 327(a) (trustee may employ "attorneys . . . or other professional persons."); 11 U.S.C. § 327(b) ("attorneys . . . or other professional persons"); 11 U.S.C. § 328 (use of professional person in this section includes attorneys employed under § 327(a)); 11 U.S.C. § 330(a) (same). Consequently, the legislative history of the BAPCPA does establish that Congress intended the statutory definition of debt relief agency to encompass attorneys.

III. THE DEBT RELIEF AGENCY PROVISIONS OF THE BAPCPA DO NOT CONFLICT WITH THE GEORGIA RULES OF PROFESSIONAL CONDUCT. EVEN IF THERE WERE SUCH A CONFLICT, THE FEDERAL STATUTE WOULD GOVERN.

The United States Trustee disagrees with the Intervenors' contention that an attorney cannot refer to him or herself as a debt relief agency without violating Rule 7.5(e) of the Georgia Rules of Professional Conduct. Rule 7.5(e) permits an attorney in private practice to use a trade name provided:

> (1) the trade name includes the name of at least one of the lawyers practicing under said name ...; and
>
> (2) the trade name does not imply a connection with a government entity, with a public or charitable legal services organization or [with] any other organization, association or institution or entity, unless there is, in fact, a connection.

The term "debt relief agency" as used in the BAPCPA neither refers to nor implies a connection with any existing organization, association or institution or entity. Rather, it is a generic term defined, subject to certain enumerated exclusions not applicable here, to mean "any person who provides any bankruptcy assistance to an assisted person in return for the payment of money or other valuable consideration, or who is a bankruptcy petition preparer under section 110 . . . . " 11 U.S.C. § 101(12A). Consequently, a Georgia attorney providing bankruptcy assistance to an "assisted person" would not violate Rule 7.5(e) by identifying him or herself as a debt relief agency.

The United States Trustee likewise disagrees with Leiden & Leiden's contention that the requirement of 11 U.S.C. § 527(d) that debt relief agencies retain for two years copies of the notices required by § 527(a) conflicts with the requirement of Rule 1.6 of the Georgia Rules of Professional Conduct that lawyers "maintain in confidence all information gained in the professional relationship with a client ... " A statutorily required notice to a client does not equate to "information gained in the professional relationship with a client."

If a conflict does exist between the state rule and the federal statute, however, then under the Supremacy Clause of the United States Constitution the federal statute must control.[8] The Supremacy Clause requires courts to follow federal, not state, law when Congress enacts a federal statute within the realm of its constitutional authority. *Barnett Bank of Marion County, N.A. v. Nelson*, 517 U.S. 25, 30 (1996). As the Supreme Court recently reiterated in *Crosby v.*

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[8] The Supremacy Clause of the United States Constitution mandates that "the Laws of the United States . . . shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding." U. S. Const. art. VI, § 2. Thus, under the Supremacy Clause, federal legislation can preempt state or local laws. *See M'Culloch v. Maryland*, 17 U. S. (4 Wheat.) 316, 327 (1819).

Nat'l Foreign Trade Counsel, 530 U.S. 363, 372-73 (2000), inconsistent state laws must yield to congressional enactments when one of two tests is met, regardless of whether Congress has inserted a clause in legislation explicitly preempting state law. First, where Congress intends federal law to occupy a given field, it preempts state law in that area. *Crosby*, 530 U.S. at 372-73 (citations omitted). Second, even if Congress has not entirely displaced state regulation over the matter in question, federal law still preempts state law to the extent that state law actually conflicts with federal law. *Id*. This occurs when it is impossible to comply with both state and federal law, or when the state law stands as an obstacle to the accomplishment of the full purposes and objectives of Congress. *Id*. *Accord Edgar v. MITE Corp.*, 457 U.S. 624, 631, 102 S.Ct. 2629, 2635 (1982); *Cipollone v. Liggett Group, Inc.*, 505 U.S. 504, 516, 112 S.Ct. 2608, 2717 (1992).

The debt relief agency provisions clearly satisfy the second test because the Bankruptcy Code supersedes state law when there is a conflict and because state law cannot stand as an obstacle to the administration of bankruptcy cases as mandated by the Bankruptcy Code. Sections 526 through 528 are part of a comprehensive and pervasive statutory scheme to address the rights and obligations of debtors, creditors, and other persons involved in bankruptcy matters. *See, e.g.*, *Sherwood Partners, Inc. v. Lycos, Inc.*, 394 F.3d 1198, 1201 (9th Cir. 2005) ("Bankruptcy law [preempts inconsistent state law] because it occupies a full title of the United States Code. It provides a comprehensive system of rights, obligations and procedures, as well as a complex administrative machinery that includes a special system of federal courts and United States Trustees."). Bankruptcy is particularly federal because the Bankruptcy Clause of the Constitution, U. S. Const. art. I, § 8, cl. 4, grants Congress the power [t]o establish . . . uniform Laws on the subject of Bankruptcies throughout the United States." Congress has exercised that power by enacting the Bankruptcy Code, 11 U.S.C. § 101, *et seq*. Attorneys are not excluded from the reach of federal bankruptcy laws. *See, e.g.,* 11 U.S.C. § 327 (giving courts rather than debtors and trustees control over selection of counsel to represent estate); 11 U.S.C. § 328 (allowing courts to approve or disapprove conditions of employment of counsel on behalf of estate); 11 U.S.C. § 329 (allowing courts to evaluate the quality of services of debtors' attorneys even where services were provided pre-bankruptcy); 11 U.S.C. § 330 (allowing courts rather than clients to determine whether, and how much, attorneys may receive for work performed in representation of bankruptcy estate); 11 U.S.C. § 503(b)(2) (deeming certain attorneys fees eligible for payment as administrative expenses); and 11 U.S.C. § 507 (dictating the payment priority attorneys have vis-à-vis assets of the estate). Thus, sections 526 through 528 preempt Georgia law to the extent, if any, that Georgia law conflicts with them. Indeed, section 526(d)(1) expressly provides that these sections will supersede state law to the extent that they are inconsistent.[9]

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[9] Section 526(d) provides as follows:

> (d) No provision of this section, section 527, or section 528 shall –
>
> (1) annul, alter, affect, or exempt any person subject to such sections from complying with any law of any State except to the extent that such law is inconsistent with those sections, and then only to the extent of the inconsistency; or
>
> (2) be deemed to limit or curtail the authority or ability –
>
> (A) of a State or subdivision or instrumentality thereof, to determine and enforce qualifications for the practice of law under the laws of that State; or
>
> (B) of a Federal court to determine and enforce the qualifications for the practice

The United States Trustee submits, however, that the debt relief agency provisions of the BAPCPA do not conflict with regulations of the Georgia Bar governing the admission of attorneys to the practice of law, either in state court or federal court, and do not govern attorneys' relationships with their clients in general. Rather, the new statutes at issue in this appeal require specified disclosures by attorneys, and others, who give bankruptcy advice to debtors. But even if there were a conflict in regard to such matters as the disclosures required under these statutes, then Congress clearly crafted the legislation in such a way as to serve a bankruptcy purpose. Consequently, this Court must give the legislation supremacy.

Finally, no "conflict" issue was properly raised before the Bankruptcy Court. The Bankruptcy Court did not enter the Order in response to a challenge to Congress' authority to enact the debt relief agency provisions. Judge Davis did not determine that Congress lacked the authority to apply the debt relief agency provisions of the BAPCPA to attorneys, but instead determined *sua sponte* that Congress did not intend to do so. If the Intervenors determine that they wish to challenge Congress' authority to enact the provisions at issue in this appeal, they must do so in a proceeding that satisfies the "case or controversy" requirement of Article III of the United States Constitution.

CONCLUSION

For the foregoing reasons, the United States Trustee respectfully renews her request that this Court either vacate or, in the alternative, reverse the Order from which this appeal is taken.

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of law before that court.

Respectfully submitted,

____
B. AMON JAMES, ESQUIRE
Assistant United States Trustee
United States Department of Justice
Office of the United States Trustee
222 West Oglethorpe Avenue, Suite 302
Savannah, GA 31401
(912) 652-4112
Of Counsel:

Roberta A. DeAngelis
Acting General Counsel
P. Matthew Sutko
Office of the General Counsel

Executive Office for United States Trustees
Department of Justice
20 Massachusetts, Ave. N.W., Suite 8100
Washington, D.C. 20530
(202) 307-1399

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing REPLY BRIEF OF UNITED STATES TRUSTEE was this day deposited in the U.S. Mail, properly addressed and with correct first-class postage prepaid to the following:

Christian J. Steinmetz, III, Esq.
Clark, Clark & Steinmetz
P.O. Box 8151
Savannah, GA 31412-8151

Kate Dodson Strain, Esq.
Hunter, Maclean, Exley & Dunn, PC
P.O. Box 9848
Savannah, GA 31412-0048

Frank J. Perch, III, Esq.
Hunter, Maclean, Exley & Dunn, PC
P.O. Box 9848
Savannah, GA 31412-0048

Mark Bulovic, Esq.
McCallar & Associates
P.O. Box 9026
Savannah, GA 31412-9026

Terry P. Leiden, Esq.
Leiden & Leiden
330 Telfair Street
Augusta, GA 30901

This 3rd day of February, 2006.

____
B. AMON JAMES
Assistant United States Trustee

BRIEF BANK — 'SUMMARY SHEET" *Printed Fri-7/27/07 14:55*

WESTLAW CODES

1. ("TI") *TITLE* OF CASE
[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]
Babcock v. Official Committee of Administrative Claimants (In re: LTV Steel Co.)

2. ("CO") *CURRENT* COURT
[E.g., "CTA9"]
Unites States Circuit Court for the Sixth circuit

3. ("CCN") *CURRENT* CASE NO.
No.: 07-3534; 07-3537

4. ("PCN") *PRIOR* CASE NO. & COURT
[IF ANY]
No.: 05-02158
Court: U.S District Court for Northern District of Ohio, Eastern Division
(Identify judge & cite, if any)

5. ("SO") *SOURCE*
U.S. TRUSTEES

6. ("DA") *DATE* OF FILING *& TYPE* OF BRIEF
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7. ("AU") *PRINCIPAL AUTHORS & OFFICE* *[E.g.,"UST/OGC"]*
Amy Good, P. Matthew Sutko, Sean Martin
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") *TOPIC*
BANKRUPTCY

9. ("SU") ● *SUMMARY* OF KEY ISSUE(s)

&

√ Any Miscellaneous *BACKGROUND*

●Did the district court clearly err in finding Mr. Babcock lacked prudential standing to appeal the bankruptcy court's order denying his motion to dissolve the committee of unsecured creditors?

√ Background:

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No. 07-3537

In the
United States Court of Appeals
for the Sixth Circuit

In re: LTV Steel Company, Inc.
Debtor

Dennis Babcock, et al.

Appellants

v.

The Official Committee of Administrative Claimants,

Appellees

On Appeal from the United States District Court
for the Northern District of Ohio
Eastern Division

Proof Brief of Appellee

Counsel for Appellee Saul Eisen, United States Trustee

Amy L. Good
Trial Attorney
Office of the U.S. Trustee
United States Department of Justice
H.M. Metzenbaum U.S. Courthouse
201 Superior Avenue, Suite 441
Cleveland, Ohio 44114
(216) 522-7800 ext. 236

Roberta A. DeAngelis
P. Matthew Sutko
Sean E. Martin
Office of the General Counsel
Executive Office for U.S. Trustees
United States Department of Justice
20 Massachusetts Avenue NW
Washington, D.C. 20530
(202) 307-1399

CORPORATE DISCLOSURE

Pursuant to 6th Cir. R. 26.1 Appellee, the United States Trustee, is not required to complete a disclosure of corporate affiliations and financial interests because he is a representative of an agency of the United States government.

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STATEMENT REGARDING ORAL ARGUMENT

The United States Trustee does not believe oral argument will materially aid the Court in determining this appeal but stands ready to participate at argument should this Court deem that appropriate.

No. 07-3534

No. 07-3537

In the

United States Court of Appeals
for the Sixth Circuit

Dennis Babcock, James Baske, Eric Evans, and George Henning,

Appellants,

v.

The Official Committee of Administrative Claimants,

Appellee.

On Appeal from the United States District Court
for the Northern District of Ohio
Eastern Division

JURISDICTIONAL STATEMENT

The United States Bankruptcy Court for the Northern District of Ohio had subject matter jurisdiction under 28 U.S.C.§ 1334 and 157(b) over Mr. Dennis Babcock's motion asking it to dissolve a bankruptcy committee the United States Trustee appointed under 11 U.S.C. § 1102(a)(1).[1] The bankruptcy court denied the motion in an oral ruling on March 28, 2006. (B.R. 9217 Transcript, pg. 10, Apx. pg. ___).[2] Mr. Babcock filed an appeal from the oral ruling on May 2, 2006. (D.R. 1 Appeal, Apx. pg. ___). The bankruptcy court reaffirmed its denial in a written order entered May 12, 2006. (B.R. 9289 Order Denying Motion, Apx. pg. __). Mr. Babcock appealed this order. (See D.R. 9 Merit Brief, Apx. pg. __). The United States District Court for the Northern District of Ohio had jurisdiction under 28 U.S.C. § 158(a) over Mr. Babcock's appeals. In an opinion and order entered March 27, 2007,

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[1] Mr. Babcock was joined in the motion by James Baske, Eric Evans, and George Henning. (B.R. 9116 Motion to Dissolve, Apx. pg. __). Each is a former LTV employee sued by the bankruptcy committee under a court-authorized lawsuit for losses sustained in operating LTV. (*see* D.R. 9 Merits Brief, pg. 1, Apx. pg. __; B.R. 8942 Memorandum of Opinion and Order, Apx. pg. __). All four individuals jointly appealed to the district court and are appellants in the current appeal. (*see* D.R. 9 Merit Brief, Apx. pg. __). Each individual filed an administrative claim. (B.R. 9100-9103 Administrative Expense Claims, Apx. pg. __). This brief, for simplicity, refers to the joint appellants as "Mr. Babcock."

[2] This brief references the bankruptcy court record as "B.R." It references the district court record as "D.R."

the district court dismissed Mr. Babcock's appeals for lack of standing. (D.R. 31 Opinion and Order, pg. 8, Apx. pg. ___). Mr. Babcock filed a timely notice of appeal to this Court on April 20, 2007. (D.R. 33 Notice of Appeal, Apx. pg. __). This Court has appellate jurisdiction under 28 U.S.C. § 158 (d)(1) over this appeal.

The bankruptcy court's orders are final because they "finally dispose[] of discrete disputes within the larger case." In re Dow Corning Corp., 86 F.2d 482, 488 (6th Cir. 1996) (holding that partial denial of motions to transfer claims was final order) (internal quotation omitted). The two orders were final because they finally adjudicated the contested matter and determined the question of the committee's right to proceed. *See* 1-5 Collier on Bankruptcy 5.07 [1][b] (15th ed. rev.) (each contested matter is a "discrete unit" for purposes of analyzing finality). *See also* In re Saco Dev. Corp., 711 F.2d 441, 445 (1st Cir. 1983)) (noting the "uninterrupted tradition of judicial interpretation in which courts have viewed a 'proceeding' within a bankruptcy case as the relevant 'judicial unit' for purposes of finality"). *Cf.* Tiboni v. Cleveland Trinidad Paving Co., 36 F.3d 533, 534 (6th Cir. 1994) (assuming jurisdiction without discussing finality where district court's order dismissed an action without prejudice to reopening upon motion by either party).

STATEMENT OF THE ISSUE

Did the district court clearly err in finding Mr. Babcock lacked prudential standing to appeal the bankruptcy court's order denying his motion to dissolve the committee of unsecured creditors?

STATEMENT OF THE CASE

This appeal challenges the district court's dismissal of an appeal for lack of prudential standing. The district court determined Mr. Babcock lacked prudential standing to appeal the bankruptcy court's order refusing to dissolve a bankruptcy committee in the LTV Steel bankruptcy case, because he was not a person aggrieved by the order. Because the district court dismissed on standing grounds, it did not pass upon the substantive question whether the bankruptcy court erred in denying Mr. Babcock's motion to dissolve the committee.

LTV Steel Corporation filed a voluntary chapter 11 bankruptcy petition in December 2000. In February 2003, the United States Trustee appointed the bankruptcy committee that Mr. Babcock challenged. Neither Mr. Babcock nor anyone else questioned the committee's propriety at that time. More than two years later, in April 2005, the committee filed a motion asking the bankruptcy court to allow it to sue former directors and officers of LTV Steel, including Mr. Babcock, on behalf of the LTV Steel estate. The court authorized the lawsuit in September 2005. Although he was provided notice, Mr. Babcock did not object to the committee's motion to sue him, did not appear at the hearings on the motion, and did not appeal the order authorizing the suit.

In September 2005, the committee filed a lawsuit that named Mr. Babcock and others as defendants. In February 2006, Mr. Babcock filed a motion to dissolve the committee. This was the first time that any party sought to dissolve or alter the committee. The bankruptcy court denied Mr. Babcock's motion in an oral bench ruling in March 2006. In May 2006, the bankruptcy court issued a written order reaffirming the denial. After Mr. Babcock appealed both, the district court dismissed his appeals on the ground that Mr. Babcock lacked standing to appeal. This appeal followed.

STATEMENT OF THE FACTS

I. Statutory Framework

In a chapter 11 case, "the United States trustee shall appoint a committee of creditors holding unsecured claims and may appoint additional committees of creditors or of equity security holders as the United States trustee deems appropriate." 11 U.S.C. § 1102(a)(1). A committee appointed by the United States Trustee under section 1102 may "investigate the acts, conduct, assets, liabilities, and financial condition of the debtor, the operation of the debtor's business . . . and any other matter relevant to the case." 11 U.S.C. § 1103(c)(2). In addition, a committee may perform such other services as are in the interest of those represented." Id. at (c)(5). Section 1109(b) of the Bankruptcy Code provides that "a creditors' committee . . . may raise and may appear and be heard on any issue in a case under this chapter." 11 U.S.C. § 1109(b).

Congress has authorized the Attorney General to appoint twenty-one United States Trustees, each to serve in a specific geographic region of the United States. *See generally* 28 U.S.C. § 581 et seq. (establishing United States Trustee Program). United States Trustees are senior Justice Department officials. Id. They "supervise the administration of cases and trustees" in all bankruptcy cases within his or her region through a range of oversight responsibilities. 28 U.S.C. § 586(a)(3). *See generally* Morganstern v. Revco D.S. Inc. (In re Revco D.S., Inc.), 898 F.2d 498, 500 (6th Cir 1990) (explaining United States Trustees oversee the bankruptcy process, protect the public interest, and ensure that bankruptcy cases are conducted according to law). The United States Trustee may raise and may appear and be heard on any issue in any case or proceeding under the Bankruptcy Code. 11 U.S.C. § 307; *see also* Revco, 898 F.2d at 499-500 (affirming the appellate standing of United States Trustees).

II. Factual Background and Proceedings Below

LTV Steel Corporation filed a voluntary chapter 11 bankruptcy petition on December 29, 2000. (*See* B.R. 9289 Order Denying Motion, pg. 2, Apx. pg. __). In January 2001, the United States Trustee appointed a committee of unsecured creditors. (B.R. 79 Notice of Appointment, Apx. pg. ___). That first-appointed committee participated in the bankruptcy case for more than two years. (*See* B.R. 5485 Notice of Disbandment, Apx. pg. __)

After more than two years of attempted reorganization, LTV concluded it could not devise a plan to reorganize as an ongoing business. For that reason, it filed a motion to liquidate its chapter 11 estate on January 15, 2003. (B.R. 5114 Motion of Debtor, Apx. pg. __). LTV informed the court that it did not have enough assets even to pay the costs associated with administering its bankruptcy case, and informed the court that no unsecured creditor would receive any compensation on any unsecured claim. Id. The court accepted LTV's proposal to liquidate its assets in chapter 11. (B.R. 5286 Order Sustaining in Part Motion of Debtor, Apx. pg. __).

In light of these developments, on February 25, 2003, the United States Trustee appointed a subsequent committee of unsecured creditors (the "committee")[3] under

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[3] The committee referred to itself as the Official Committee of Administrative Claimants, using the same label as in the notice of appointment filed by the United States Trustee. (*See* D.R. 21 Brief of United States Trustee, pg. 7, Apx. pg. __). It is undisputed that each member of the committee was an

the power granted by 11 U.S.C. § 1102(a)(1).[4] (B.R. 5365 Notice of Appointment, Apx. pg. __). There was no opposition to the committee's formation. The committee had eleven members, each of whom held a prepetition unsecured claim. (B.R. 5374 Notice ofAmended Appointment, Apx. pg. __; B.R. 985 LTV Steel Schedule F, Apx. pg. __). In March 2003, the United States Trustee disbanded the first-formed committee. (B.R. 5485 Notice of Disbandment, Apx. pg. __).

The new committee performed a number of tasks in the LTV Steel case relating to liquidation, settlement of claims, and resolution of appeals. Specifically, the bankruptcy court authorized the committee to negotiate and agree on: 1) budgets for liquidation expenses; 2) the timing and amount of interim distributions; 3) amounts to be deposited in LTV's post-dismissal accounts; 4) the timing and amount of final distributions; and 5) modifications or amendments to any of the distribution procedures. (B.R. 9217 Transcript, pgs. 4-5, Apx. pg. __). The committee also brokered large settlements of administrative claims, including the United Steelworkers' claim. (B.R. 7493 Committee Statement, Apx. pg. __). In addition, the

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unsecured creditor who, in addition to this prepetition claim, held an administrative expense claim. (B.R. 9217 Transcript, pg. 6, Apx. pg. __).

[4] In a chapter 11 case, "the United States trustee shall appoint a committee of creditors holding unsecured claims and may appoint additional committees of creditors or of equity security holders as the United States trustee deems appropriate." 11 U.S.C. § 1102(a)(1).

committee obtained court authorization to settle numerous avoidance actions. (B.R. 7201 Committee Report, Apx. pg. __). It also brokered an inter-company settlement, (*See* B.R. 6967 Findings of Fact and Conclusions of Law, pg. 11, Apx. pg. ___) and actively participated in settling appeals related to allocation and the liquidation order. (B.R. 7071 Joint Motion, Apx. pg. __).

On April 14, 2005, the committee filed a motion for leave to commence and prosecute a lawsuit against certain LTV directors and officers, including Mr. Babcock, on behalf of the LTV bankruptcy estate. (B.R. 8704 Motion, Apx. pg. __). LTV provided Mr. Babcock with a copy of this motion. (*see* B.R. 9218 Transcript, pg. 13, Apx. pg. __) .

Mr. Babcock did not appear at the hearings on the motion to allow the committee to sue him. Nor did he object to the motion. Although the bankruptcy court never ruled on the issue, Mr. Babcock's counsel has subsequently suggested Mr. Babcock did not exercise these rights because he assumed LTV would adequately represent his interests. Id. at 14. No one else objected to the committee's proposed lawsuit. Some creditors filed motions supporting it. (B.R. 8942 Memorandum of Opinion and Order, pg. 47, Apx. pg. __).

On September 2, 2005, the bankruptcy court granted the committee's motion to sue Mr. Babcock. Id. The court concluded a successful lawsuit by the committee could yield a recovery of more than $100 million for the benefit of the estate. Id. at pg. 4. Because LTV projected approximately $66 million of administrative claims, such a recovery would mean $44 million of the $100 million recovery could be available for unsecured creditors who otherwise will receive nothing. (D.R. 21 Brief of Appellee United States Trustee, pg. 8, Apx. pg. __) . Mr. Babcock did not appeal the order authorizing the committee's lawsuit.

On September 13, 2005, the committee filed a complaint in United States District Court against Mr. Babcock and other defendants, alleging breach of fiduciary duties, negligence, and corporate waste. Complaint, United States District Court, Northern District of Ohio, Case No. 05-CV-2158; *See* Mr. Babcock's Opening Brief ("BOB") at pg. 9.

Mr. Babcock has incurred no defense costs related to the committee's lawsuit against him. (D.R. 18 Opposition to Motion to Dismiss, Ex. A., pg. 4, Apx. pg. __). Instead, his costs have been fully covered by a trust established for former LTV officers, directors, and managers.[5] Id.

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[5] Mr. Baske's costs are also covered by the trust and Mr. Baske is covered by LTV Steel's Directors and Officers ("D&O") liability insurance. *See* Mr. Babcock's Opening Brief ("BOB"), pg. 18. Mr. Evans and Mr. Henning are covered by D&O insurance. Id. at pg. 10.

Mr. Baske, Mr. Evans, and Mr. Henning are former LTV officers. *See* BOB at pg. 6. Although Mr. Babcock claims that he is not a former LTV director or officer, *see* BOB at pg. 6, that is a question of fact not before this Court. Mr.

In early 2006, Mr. Babcock asked the bankruptcy court to grant him the status of an administrative claimant. (B.R. 9100-9103 Administrative Expense Claims, Apx. pg. __). He commenced that process by filing administrative expense claims seeking reimbursement and indemnification for his defense against the committee's complaint. Id.; *See also* 11 U.S.C. § 503(a). Administrative expense claims may only be allowed after notice and a hearing. *See* 11 U.S.C. § 503(b). The bankruptcy court has not yet ruled on Mr. Babcock's request to be deemed an administrative claimant. Nor has a hearing on his request been held. *See* id.

On February 9, 2006 – almost three years after the committee was appointed without any objection – Mr. Babcock filed a motion to dissolve the committee on the ground that the committee had not been properly appointed. (B.R. 9116 Motion to Dissolve, Apx. pg. __). The United States Trustee objected, as did the committee and various administrative claimants. (*see* B.R. 9218 Transcript, pgs. 18-19, Apx. pg. __; B.R. 9149 Objection by Committee, Apx., pg. __; B.R. 9150 Objection by Liquidity Solutions, Inc., Apx., pg. __; B.R. 9175 Objection by Hunter Corp., Apx. pg. __).

III. The Bankruptcy Court's Decision

On March 28, 2006, the bankruptcy court entered an oral ruling denying Mr.

Babcock requested coverage under LTV's D&O policy. (D.R. 18 Opposition to Motion to Dismiss, Ex. A, pg. 4, Apx. pg. __). He was initially denied coverage by the insurer. Id.

Babcock's motion to dissolve the committee. (B.R. 9217 Transcript, Apx. pg. __). The bankruptcy court found it "undisputed" that due process was met regarding the appointment of the committee because a notice of appointment had been issued to all entitled parties. Id. at pg. 5. The bankruptcy court also concluded the appointment was lawful. Id. at pgs. 5-6. The court, alternatively, ruled that law of the case doctrine and laches each barred Mr. Babcock from seeking dissolution of the committee. Id. at pg. 9.

On May 12, 2006, the bankruptcy court entered a written order reaffirming the oral ruling. (B.R. 9289 Apx. pg. __). The written order found that the committee had been "quite effective" in representing the interests of the administrative claimants and the estate generally, and that dissolution "would clearly be prejudicial to the committee, the Debtor's estate, creditors and claimants." Id. at Finding of Fact S.

Mr. Babcock appealed both the oral ruling and the written order. On June 6, 2006, the committee filed a motion to dismiss the appeals, arguing that Mr. Babcock lacked prudential standing. (D.R. 10 Motion to Dismiss, Apx. pg. __). On July 14, 2006, the United States Trustee filed an appellee brief agreeing that the appeals should be dismissed for lack of prudential standing. (D.R. 21 Brief of United States Trustee, Apx. pg. __). On September 1, 2006, the district court consolidated the appeals. (D.R. 28 Stipulation and Order to Consolidate, Apx. pg. __).

IV. The District Court's Decision

On March 27, 2007, the district court granted the committee's motion to dismiss Mr. Babcock's two appeals for lack of prudential standing. (D.R. 31 Opinion and Order, pg. 8, Apx. pg. __). The court found Mr. Babcock lacked prudential standing because was not a person aggrieved by the underlying orders, a prerequisite one must satisfy to have appellate standing in a bankruptcy case. Id. at pgs. 5-6. The court also found that bestowing appellate standing upon Mr. Babcock "would serve to encourage the filing of frivolous motions in order to confer appellate standing." Id. at pg. 6.

In dismissing Mr. Babcock's appeal, the district court specifically held that Mr. Babcock's status as a civil defendant in a lawsuit does not give him standing to appeal the denial of the motion to dissolve. Id.[6]

In dismissing the appeal, the district court found Mr. Babcock was not injured by his inability to appeal because he had "the unimpaired right and ability to raise all available defenses" against the committee's complaint in the actual case being brought against him. Id. Although Mr. Babcock claimed to suffer a financial burden in defending against the committee's complaint, the district court found that defense costs were covered by a court-approved trust established by LTV that is segregated

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[6] On this point, the court followed its prior decision in Moran v. Official Comm. of Admin.Claimants, No 1: 05CV2285 (N.D. Ohio Nov. 8, 2006), *available at* 2006 WL 3253128 (dismissing appeal by former LTV officer of bankruptcy court's September 2005 order authorizing the committee's lawsuit).

from estate assets. Id. Finally, the court rejected Mr. Babcock's argument that the committee's complaint negatively impacted his credit, concluding that a potential inability to obtain credit in the future is “too speculative” to constitute the adverse financial effect necessary to satisfy the prudential standing parties must meet in bankruptcy appeals. Id. at pgs. 6-7.

The district court also rejected Mr. Babcock's argument that he possessed “public interest” standing that overcame any lack of person aggrieved prudential standing. Id. at pg. 7. The court found that Mr. Babcock was not an individual the law recognized as “[one authorized to] safeguard[] the public interest.” Id. The court found Mr. Babcock instead “championed” only “a very private interest in derailing the litigation instituted on behalf of the LTV bankruptcy estate.” Id.

The district court next rejected Mr. Babcock’s arguments that his alleged status as a “party in interest” under 11 U.S.C. § 1109(b) conferred standing to appeal. Id. The district court held that even if Mr. Babcock was a party in interest, that was not equivalent to a person aggrieved who possessed prudential standing to appeal a bankruptcy court order. Id.

Finally, the district court found any potential harm suffered by Mr. Babcock arose not from the orders he was appealing but from the bankruptcy court’s September 2005 order authorizing the committee to commence the lawsuit. Id. The district court noted that Mr. Babcock neither opposed or appealed that order, nor did he object to the committee's motion to commence the litigation, and he did not even appear at hearings on the motion. Id. This led the district court to conclude Mr. Babcock's appeal was an "untimely, inappropriate attempt to challenge the authorization" of the committee to pursue its lawsuit against Mr. Babcock. Id. at pg. 8.

On April 20, 2007, Mr. Babcock timely appealed the district court's order dismissing his appeal. (D.R. 33 Notice of Appeal, Apx. pg. __).

SUMMARY OF ARGUMENT

1. The district court properly dismissed Mr. Babcock's appeal for lack of prudential standing. This Court and ten other circuits require parties to possess more than Article III standing to appeal a bankruptcy court order.[7] They must also possess person aggrieved prudential standing. In re Troutman Enters., Inc., 286 F.3d 359, 364 (6th Cir. 2002). This Court has ruled this sets a very high appellate bar, one that requires an appellant to establish that it has been "directly and adversely affected

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[7] *See* Fidelity Bank, Nat'l Ass'n, 77 F.3d 880, 882 (6th Cir. 1996); *accord* Spenlinhauer v. O'Donnell, 261 F.3d 113, 117-18 (1st Cir. 2001); Kane v. Johns-Manville Corp., 843 F.2d 636, 641-42 (2d Cir. 1988); In re Combustion Eng'g, Inc., 391 F.3d 190, 214-15 (3d Cir. 2004); In re Urban Broad. Corp., 401 F.3d 236, 243-44 (4th Cir. 2005); In re Coho Energy, Inc., 395 F.3d 198, 202-03 (5th Cir. 2004); Depoister v. Mary M. Holloway Found., 36 F.3d 582, 585 (7th Cir. 1994); Hartman Corp. of Am. v. United States, 304 F.2d 429, 431 (8th Cir. 1962); In re P.R.T.C., Inc., 177 F.3d 774, 777 (9th Cir. 1999); In re Am. Ready Mix, Inc., 14 F.3d 1497, 1500 (10th Cir. 1994); In re Westwood Cmty. Two Ass'n, Inc., 293 F.3d 1332, 1334-36 (11th Cir. 2002).

pecuniarily by the order." Id. (quoting Fidelity Bank, 77 F.3d at 882).

The court below ruled Mr. Babcock did not possess prudential standing, a determination this Court reviews under a clear error standard. The court below did not commit clear error by dismissing Mr. Babcock's appeal. Mr. Babcock is only a civil defendant in another case. This Court's jurisprudence supports the conclusion, and three other circuits have held, that bankruptcy court orders merely exposing parties to potential liability in other proceedings are not appealable by these parties. *See* Fidelity Bank, 77 F.3d at 883 (holding that an order that may subject appellants to future litigation "is remote and consequential rather than direct and immediate, and thus insufficient to confer standing").[8] The order challenged by Mr. Babcock in no way impaired his ability to defend against the actual lawsuit brought against him. Mr. Babcock is free to mount any and all challenges in that suit.

2. If this Court were to conclude the district court clearly erred in deciding Mr. Babcock lacks standing to appeal, this Court should remand to the district court for consideration of the merits of his appeal. *See, e.g.,* In re Westwood Cmty. Two Ass'n, Inc., 293 F.3d 1332, 1338 (holding that appellant was person aggrieved, reversing district court order dismissing appeal, and remanding to district court for further

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[8] *See also* Travelers Ins. Co. v. H.K. Porter Co., 45 F.3d 737, 743 (3d Cir. 1995); In re El San Juan Hotel, 809 F.2d 151, 155-56 (1st Cir. 1987); In re Fondiller, 707 F.2d 441, 443 (9th Cir. 1983).

proceedings); In re Clark, 927 F.2d 793, 797 (4th Cir. 1991) (holding that United States Trustee had standing to appeal dismissal of its motion, reversing decisions of district court and bankruptcy court, and remanding to district court for remand to bankruptcy court for consideration of the merits of the motion. Nichols v. Muskingum College, 318 F.3d 674, 676 (6th Cir. 2003) (reversing district court decision dismissing claim for lack of subject matter jurisdiction, and remanding for consideration of the merits of the claim).

3. Although Mr. Babcock specifically asks this Court to remand so the district court can consider the merits of his appeal, he also inconsistently devotes a large part of his brief to arguing multiple merits issues. This Court should not address these issues at this juncture. Should this Court reach them, they should be rejected.

STANDARD OF REVIEW

Whether an appellant has standing to appeal under the person aggrieved standard is a question of fact that the district court decides. Fidelity Bank, 77 F.3d at 882. This Court reviews that finding for clear error. Troutman Enters., 286 F.3d at 363. Clear error review is a “deferential” standard of review. United States v. Watford, 468 F.3d 891, 906 (6th Cir. 2006). Reversal is proper only if this Court has “the definite and firm conviction that a mistake has been committed.” Tran v. Gonzales, 447 F.3d 937, 943(6th Cir. 2006) (internal quotation omitted).

In reviewing a bankruptcy court's decision, this Court reviews its legal conclusions *de novo*. Troutman Enters., 286 F.3d at 363.

ARGUMENT

I. The district court did not commit clear error in holding that Mr. Babcock's status as a civil defendant did not give him prudential standing to appeal the bankruptcy court's order refusing to dissolve the LTV bankruptcy committee.

A. The district court did not commit clear error in deciding that Mr. Babcock is not sufficiently affected by the bankruptcy court's order to possess person aggrieved standing to appeal it.

1. The district court did not clearly err in dismissing Mr. Babcock's appeal for lack of standing because Mr. Babcock did not meet the stringent person aggrieved standard that governs bankruptcy appellate standing. As the district court explained, prudential standing in bankruptcy cases is more stringent than Article III standing. (D.R. 31 Opinion and Order, pg. 4, Apx. pg. __). *See* Troutman Enters., 286 F.3d at 364 ("Appellate standing in bankruptcy cases is more limited than Article III standing."). Under Article III, a party may establish standing by demonstrating that he has suffered a concrete injury-in-fact that is fairly traceable to the defendant's allegedly improper conduct and that is likely to be redressed by a favorable decision. *See* Fieger v. Ferry, 471 F.3d 637, 643 (6th Cir. 2006).

By contrast, a bankruptcy appellant must show more – that he is a person aggrieved. Fidelity Bank, 77 F.3d at 882. To qualify as a person aggrieved, a litigant must have "a financial stake in the bankruptcy court's order" and "must have been directly and adversely affected pecuniarily" by the challenged order. Id.

Mr. Babcock's only status in the LTV bankruptcy case is as a civil defendant being sued by the committee on behalf of the estate.[9] But this Court has indicated, as have the United States courts of appeals for the First, Third, and Ninth Circuits, that such civil defendants lack person aggrieved prudential standing to appeal orders outside the lawsuit they are defending.

2. In Fidelity Bank, for example, this Court ruled a party's status as a potential civil defendant did not give it person aggrieved standing. Id. at 882 (rejecting appellant's argument that it had standing because the order would subject it to defending future litigation). Such an order "does not impair" the ability of civil defendants "to defend themselves" in future suits, because they will retain all available defenses. Id.

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[9] Mr. Babcock has sought the status of an administrative claimant, but his claim has not been approved. (B.R. 9100-9103 Administrative Expense Claims, Apx. pg. __). Even if Mr. Babcock held a bona fide administrative claim, Mr. Babcock's brief makes no argument that this helps render him a person aggrieved. Instead, Mr. Babcock argues only that his alleged status as an administrative claimant makes him a "party in interest" under 11 U.S.C. § 1109(b). BOB at pgs. 20-23.

Like the appellant who lacked prudential standing in Fidelity Bank, Mr. Babcock's status as a civil defendant is too remote to give him person aggrieved prudential standing, especially when he retains the full ability to defend himself in the lawsuit. At a minimum, the district court did not commit clear error in making that determination.

Also like the Fidelity Bank appellant, Mr. Babcock as a civil defendant must restrict himself to litigating his issues with the lawsuit within that lawsuit. There is nothing unfair in that. He is free to mount any and all challenges to the litigation against him. He can raise affirmative defenses. He can seek dismissal of the suit. He can move for summary judgment. He can appeal an adverse judgment. But he cannot shortcut that process and manufacture appellate review by moving to dissolve the plaintiff and appeal the bankruptcy court's refusal to grant that relief. *See* In re Monus, 63 Fed. Appx. 215 (6th Cir. 2003) (unpublished decision) (so holding).

The district court's decision here draws support from a decision of the Bankruptcy Appellate Panel of the Sixth Circuit. In re First Cincinnati, Inc., 286 B.R. 49 (6th Cir. BAP 2002) . There, the appellate panel also held that a potential civil defendant lacks person aggrieved prudential standing. Id. at 54 (holding even a bankruptcy court order authorizing litigation against a party does not give that civil defendant standing to appeal the order).

3. The district court's ruling in this case is also fully consistent with the rulings of the Third, Ninth, and Tenth Circuits, each of which ruled litigants like Mr. Babcock lack standing to challenge a bankruptcy court order, whenever such an order exposes them to liability in another proceeding. *See* Travelers Ins. Co. v. H.K. Porter Co., 45 F.3d 737, 743 (3d Cir. 1995) (holding that "a potential defendant in [a separate] adversary proceeding" lacks standing to appeal an order reinstating claims against debtor); In re El San Juan Hotel, 809 F.2d 151, 155-56 (1st Cir. 1987) (holding a potential civil defendant lacks prudential standing to appeal from an order granting the United States leave to sue him); In re Fondiller, 707 F.2d 441, 443 (9th Cir. 1983) (holding that appellant was not a person aggrieved as a potential civil defendant from an order appointing special counsel); *see also* In re Alpex Computer Corp., 71 F.3d 353, 354, 358 (10th Cir. 1995) (holding that appellant's "status as a defendant in a [separate] civil suit" did not render it a "party in interest" with standing to move to reopen a chapter 11 bankruptcy case).

The First Circuit's decision in San Juan Hotel, 809 F.2d at 151, is particularly instructive. The bankruptcy court in San Juan Hotel issued an order authorizing the United States to bring suit against a former bankruptcy trustee for breach of fiduciary duty. *See* id. at 153. The former trustee sought to appeal the order authorizing suit against him. *See* id. The First Circuit held that he lacked standing, because the bankruptcy court's order had "'no direct and immediate impact on [his] pecuniary interests,'" but only exposed him to future litigation. *See* id. at 155-56 (appellant's "'only demonstrable interest in the order [was] as a potential party defendant in an adversary proceeding'") (quoting Fondiller, 707 F.2d at 443). The court recognized that the "former trustee [did] have an interest in defending himself against liability, but the order in question [did] not prevent [him]" from doing that, because he could assert any claims or defenses in the separate suit. *See* San Juan Hotel, 809 F.2d at 155.

4. This Court's ruling in Fidelity Bank that a party's exposure to liability in another proceeding is insufficient to confer prudential standing is fully consistent with this Court's other prudential standing holdings. In re L.T. Ruth Coal Co. supports the conclusion that a civil defendant like Mr. Babcock cannot appeal an order that merely exposes him to potential liability in another proceeding. 803 F.2d 720, *3 (6th Cir. 1986) (unpublished disposition) (holding a party lacked prudential standing to appeal an order sanctioning deficiency judgment for which the party could be liable). In re Monus supports the conclusion that an order preserving a party's full rights in outside civil proceedings, as in Mr. Babcock's case, will not render the party a person aggrieved. 63 Fed. Appx. 215 (6th Cir. 2003) (unpublished decision) (holding a party lacked prudential standing to appeal a tax settlement order that allowed the party to challenge the tax assessment in separate civil proceedings).

Where this Court has recognized that an appellant had prudential standing to appeal a bankruptcy court order, it has done so where there is a far stronger interest than Mr. Babcock's stake as a civil defendant in another proceeding. This Court held that investors have standing to appeal orders approving and finalizing a plan for distributing proceeds, because they "have a clear financial stake" in the challenged orders. SEC v. Basic Energy & Affiliated Res., Inc., 273 F.3d 657, 665 (6th Cir. 2001) (applying bankruptcy person aggrieved standard in receivership case). SEC is in harmony with other circuit case law that found standing to appeal from bankruptcy court orders transferring significant estate assets. *See, e.g.,* In re P.R.T.C. Inc., 177 F.3d 774, 779 (9th Cir. 1999) (holding that creditor is person aggrieved from order transferring the bankruptcy estates' only significant assets). Although Mr. Babcock cites P.R.T.C. to support his claim of standing, *see* AOB 23, the P.R.T.C. order is far different from the order that he appealed, which simply permitted a committee appointed more than three years earlier to continue operations, including prosecuting a lawsuit that the committee commenced with court approval and without appearance, objection, or appeal by Mr. Babcock.

5. The facts of this case reveal how remote and speculative Mr. Babcock's interest is in the order he appealed. Any future financial impact that Mr. Babcock may experience will not be the direct result of the order he challenges, but instead would

depend on a separate judgment that might issue in his civil case. He could appeal that order. But he lacks standing to appeal this one. *See* Travelers, 45 F.3d at 741 (appellant lacked standing because its interest was "too remote and contingent to satisfy the standing requirement[s] of bankruptcy appeals"). Indeed, Mr. Babcock is not even incurring defense costs. These are being paid by a trust using non-estate funds, and insurance may cover any liability he ultimately incurs. (D.R. 18 Opposition to Motion to Dismiss, Ex. A., pg. 4, Apx. pg. __); *supra* n.5.

6. Mr. Babcock's appeal is exactly the type of appeal the person aggrieved rule is designed to prohibit. The person aggrieved standard exists to avoid unreasonable delays and promote efficiency in bankruptcy proceedings, which often involve a "myriad of parties indirectly affected by every bankruptcy court order." In re Combustion Eng'g, Inc., 391 F.3d 190, 215 (3d Cir. 2004) (internal quotation omitted); *see also* First Cincinnati, 286 B.R. at 51 (the person aggrieved rule "is [designed] to prevent marginally interested parties from litigating satellite issues up and down the appellant [sic] chain while the bankruptcy case stalls out and neither creditors nor debtors receive the relief intended by the Code").

Mr. Babcock's appeal is inappropriate under this standard, because he has no interest in the bankruptcy proceedings. Instead, he would delay administration of this case and drain estate resources in litigating his outside interest as a civil defendant.

Mr. Babcock's only alleged financial stake in the LTV bankruptcy estate is his self-professed administrative claim for his defense costs against the committee's suit. (B.R. 9100-9103 Administrative Expense Claims, Apx. pg. __). Moreover, the order Mr. Babcock appeals does not even affect this alleged stake: the order does not increase his burden of establishing his administrative claim or impair his rights to assert this interest. The order Mr. Babcock appealed simply permitted the committee to continue operating, as it had for more than three years without any challenge. Mr. Babcock seeks to undermine the legitimate efforts of a committee to bring value to the LTV bankruptcy estate.

7. Even assuming Mr. Babcock's potential liability in the separate civil lawsuit were somehow sufficient to confer prudential standing to appeal the order that exposed him to liability,[10] Mr. Babcock failed to appeal that order – the order authorizing the suit against him. Therefore, he cannot relitigate through this appeal after declining the earlier opportunity. The district court correctly recognized that Mr. Babcock's appeal was untimely and inappropriate given his failure to participate earlier. (D.R. 31 Opinion and Order, pg. 8, Apx. pg. __).

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[10] But even that order did not require that Mr. Babcock pay any money to the LTV Steel estate, and did not adjudicate any of Mr. Babcock's rights or obligations relating to the LTV Steel bankruptcy or the separate lawsuit. (B.R. 8942 Memorandum of Opinion and Order, Apx. pg. __). Nor did it directly dispose of any bankruptcy assets in which Mr. Babcock may claim any interest. Id.

Mr. Babcock has no right here to litigate an already-decided issue for three separate and distinct reasons. First, Mr. Babcock is barred by the reasoning this Court employed in In re Pioneer Investment Servs. Co. There, a party received actual notice of a pending motion, but did not file any objection, participate in the hearing, or appeal the resulting order directly. 21 F.3d 428 at *3 (6th Cir. 1994) (unpublished decision). Instead, the party filed a Rule 60(b) motion several months after the order was issued. Id. This Court rejected this challenge to the order, holding that the party "attempts nothing other than to relitigate issues already properly decided, and to have the courts examine the substance and validity of [an] order it never bothered properly to challenge or appeal." Id. at *4.

Similar to Pioneer Investment, Mr. Babcock had notice of the proceedings leading to the order authorizing the lawsuit, but chose not to object to the committee's motion, participate in the hearing, or appeal the order directly. Instead, more than five months after the order, Mr. Babcock attempted to relitigate an issue that was already properly decided – the propriety of the committee's lawsuit against him – and to make the bankruptcy court re-examine an order he never properly challenged.

Second, collateral estoppel bars Mr. Babcock's attempt to relitigate the issue of the committee's authority to sue him, even if he would otherwise have standing to appeal the order authorizing the suit. Collateral estoppel dictates that once a court has decided an issue of fact or law necessary to its judgment, that decision may preclude relitigation of the issue in an action on a different cause of action involving a party to the first case. *See* In re Commonwealth Inst. Secs., Inc., 394 F.3d 401, 405 (6th Cir. 2005). Here, the bankruptcy court's order authorizing the suit necessarily decided that the committee was properly appointed. Mr. Babcock was fully apprised of the proceedings leading to the order and had a full and fair opportunity to litigate.

Finally, Mr. Babcock's failure to promptly appeal the order authorizing the lawsuit constitutes laches barring him from belatedly litigating the same issue in this appeal, even if he had prudential standing to appeal the earlier order. *See* Cont'l Can Co. v. Graham, 220 F.2d 420, 423 (6th Cir. 1955) ("The bankruptcy court is conducted upon principles of equity and equity will not aid those who have slept upon their rights.").

B. Mr. Babcock's general status as a "party in interest" that can participate at the bankruptcy court level is insufficient to satisfy the requirement that he also possess person aggrieved prudential standing in order to appeal bankruptcy court orders.

1. Even assuming Mr. Babcock is a "party in interest" under 11 U.S.C. § 1109(b), that status does not absolve Mr. Babcock – or the myriad of others who want to appeal bankruptcy court orders – from meeting the additional requirement that they

possess person aggrieved prudential standing.[11] *See, e.g.*, Combustion Eng'g, 391 F.3d at 217 (holding that person aggrieved standard, not party in interest standard, determines bankruptcy appellate standing); Westwood Cmty. Two, 293 F.3d at 1336-37 (holding that committee had appellate standing because it was person aggrieved, not because it appeared as party in interest in bankruptcy case); P.R.T.C., 177 F.3d at 778 ("[A] creditor has no independent standing to appeal an adverse decision regarding a violation of the automatic stay.") (internal quotation omitted) In re Am. Ready Mix, Inc., 14 F.3d 1497, 1502 (10th Cir. 1994) (rejecting argument that section 1109(b) provides standing to appeal); Kane v. Johns-Manville Corp., 843 F.2d 636, 642 (2d Cir. 1988) ("[A] party to the bankruptcy proceedings is permitted to appeal a particular order only if the order directly affects his pecuniary interests.").[12]

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[11] Section 1109(b) provides that "[a] party in interest, including the debtor, the trustee, a creditors' committee, an equity security holders' committee, a creditor, an equity security holder, or any indenture trustee, may raise and may appear and be heard on any issue in a case under this chapter."

[12] A leading bankruptcy treatise discusses why this is so:

> It might be said that all creditors and the debtor are parties to every order entered in a bankruptcy proceeding. However, that does not help in determining which parties have standing to take an appeal. If such reasoning were employed, the result would be a rule that any party who is involved either directly, indirectly or tangentially in the bankruptcy proceeding has the power to appeal from almost any order entered by the bankruptcy judge.

10 Collier on Bankruptcy § 8001.05, p. 8001-11 (Lawrence P. King ed., 15th ed.

2. Nor do the cases Mr. Babcock cites support his novel argument that the circuits' rigorous prudential standing requirement evaporates whenever someone is a party in interest who can participate at the bankruptcy court level. *See* BOB pgs. 21-23. In In re Caldor Corp., 303 F.3d 161, 176 (2d Cir. 2002), for example, the Second Circuit held that a party had the right to intervene in adversary proceedings before the bankruptcy court. This is not akin to the right to appeal to the district court, something the Second Circuit has recognized in Johns-Manville Corp., 843 F.2d at 642 (holding "a party to the bankruptcy proceedings is permitted to appeal a particular order only if the order directly affects his pecuniary interests"). Mr. Babcock also cites Southern Pacific Transp. Co. v. Voluntary Purchasing Groups, Inc., 227 B.R. 788, 792-93 (E.D. Tex. 1998). BOB at 22. But Southern Pacific merely held that a party aggrieved had the right under section 1109(b) to be heard as an appellee in an appeal brought by another party. Id. at 793. The court conducted both analyses because it stated that it was unclear that the person aggrieved inquiry governed whether a party may be an appellee. Id. at 790. Applying Southern Pacific's reasoning, Mr. Babcock's appeal would be analyzed under the person aggrieved framework. Under this framework, he has no standing.

1998).

II. Should this Court rule that Mr. Babcock possesses prudential standing, this Court should remand so the district court can address the merits of Mr. Babcock's appeal.

If this Court were to conclude that the district clearly erred by holding that Mr. Babcock lacks standing, this Court should remand to the district court for consideration of the merits of Mr. Babcock's appeal. Because the district court dismissed on standing grounds, it did not reach any merits issues. (D.R. 31 Opinion and Order, Apx. pg. __). If the standing order were reversed, the case should be remanded to reach the merits. *See* Westwood Cmty Two, 293 F.3d at 1338 (holding that appellant was person aggrieved, reversing district court order dismissing appeal, and remanding to district court for further proceedings); In re Clark, 927 F.2d at 797 (holding that United States Trustee had standing to appeal dismissal of its motion, reversing decisions of district court and bankruptcy court, and remanding to district court for remand to bankruptcy court for consideration of the merits of the motion); *see also* Muskingum College, 318 F.3d at 676 (reversing district court decision dismissing claim for lack of subject matter jurisdiction, and remanding for consideration of the merits of the claim); Smith v. City of Cleveland Heights, 760 F.2d 720, 724-25 (6th Cir. 1985) (holding that appellant had standing, reversing judgment of the district court dismissing action, and remanding for further proceedings on the merits).

III. Mr. Babcock's merits arguments are inappropriate and unpersuasive.

Although Mr. Babcock himself asks that this Court remand so the district court can consider the merits of his appeal, *See* BOB at pg. 40, he inconsistently presses arguments before this Court spanning ten pages of his brief. Because Mr. Babcock briefs two merits issues in his opening brief, the United States Trustee briefly responds in the event the Court should choose to address them.

A. Mr. Babcock's Due Process Argument Lacks Merit.

Mr. Babcock contends the committee's appointment violated due process, because it was formed to sue on behalf of administrative claimants without a finding as to its adequacy of representation. *See* BOB at pg. 4. This argument is both legally incorrect and factually inaccurate.

As the Supreme Court has noted, representative litigation commenced for the benefit of the bankruptcy estate is separate from that governed by Rule 23. "[R]epresentative damages litigation is common – from class actions under Fed.R.Civ.P. 23(b)(3) to suits by trustees representing hundreds of creditors in bankruptcy to *parens patriae* actions by state governments to litigation by and against executors of decedents' estates." United Food and Commercial Workers Union Local 751 v. Brown Group, Inc., 517 U.S. 544, 557 (1996) (quoting with approval In re Oil

Spill by the Amoco Cadiz Off the Coast of France on Mar. 16, 1978, 954 F.2d 1279, 1319 (7th Cir. 1992) (per curiam)). *See also* Glanton ex rel. ALCOA Prescription Drug Plan v. AdvancePCS Inc., 465 F.3d 1123, 1126 (9th Cir. 2006) ("Trustees and executors . . . have a stake in the litigation because they are acting on behalf of the estate, which owns the claims being litigated.").

The law permits representative lawsuits in a wide variety of contexts that render Federal Rule of Civil Procedure 23 inapplicable, and this lawsuit is no exception. It is an action on behalf of the LTV Steel bankruptcy estate, rather than a class action. Here, the committee had a proper stake in the litigation because it was acting with court-approved standing on behalf of the LTV Steel estate, which owns the claims being litigated. A successful lawsuit could bring millions of dollars to unsecured creditors and to administrative claimants.

Mr. Babcock's argument would absurdly require that corporations and trustees suing on behalf of the bankruptcy estate go through class-action certification procedures. As debtor-in-possession, LTV Steel had broad powers including the statutory authority to sue as the representative of the estate. *See* 11 U.S.C. § 1107(a), 11 U.S.C. § 323(a),(b); Commodity Futures Trading Com'n v. Weintraub, 471 U.S. 343, 352 (1986). *See also* In re Senior Cottages of America, LLC, 482 F.3d 997 (8th Cir. 2007) (holding that bankruptcy trustee may sue on behalf of debtor corporation against corporate principals for breach of fiduciary duty, because these claims could have been asserted by the debtor corporation).[13]

In this circuit, a creditor may file suit with court approval on behalf of the bankruptcy estate in a chapter 11 case. In re Gibson, 66 F.3d 1436 (6th Cir. 1995). Relying on this Court's precedential ruling in Gibson, the bankruptcy court unsurprisingly held the LTV committee similarly had standing to proceed on behalf of the estate, given LTV Steel's refusal to assert its claim. (B.R. 8942 Memorandum of Opinion and Order, pgs. 46-47, Apx. pg. __). *See also* Official Comm. of Unsecured Creditors of Cybergenics Corp. ex rel. Cybergenic Corp. v. Chinery, 330 F.3d 548, 580 (3d Cir. 2003) (en banc) (holding that in chapter 11 case bankruptcy court may grant standing to a creditors' committee to pursue claims on behalf of the bankruptcy estate, when the debtor neglects this duty).

The sole authority Mr. Babcock cites for his constitutional argument, Hansberry v. Lee, does not support it. *See* BOB at pgs. 32-33. In Hansberry, the Supreme Court held that a state court had impermissibly judged a party bound by another's court

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[13] Under Mr. Babcock's reasoning, state agencies would inexplicably have to be class-certified for participating in bankruptcy proceedings under consumer protection acts. But case law already holds that Rule 23 is not applicable to state agencies suing in bankruptcy proceedings, because the state has its own sufficient interest in ensuring consumer protection. *See* In re Edmond, 934 F.2d 1304, 1313 (4th Cir. 1991).

judgment in an earlier litigation to which it was not a party. 311 U.S. 32 (1940). In contrast to Hansberry, here there has been no adjudication of the rights of Mr. Babcock, and all of the bankruptcy court's actions were preceded by notice and opportunity to be heard. *See* Hansberry, 311 U.S. at 40.

Nor has Mr. Babcock identified how the existence of the committee – or the authorization of the lawsuit – is actually unfair to the interests of absent parties. In the lawsuit against him, Mr. Babcock is in no way bound by the bankruptcy court's actions. He can raise all claims and defenses, including that the committee is an improper plaintiff. Mr. Babcock's desire to dissolve the committee simply stems from his desire to avoid having a lawsuit to defend. If judgment is entered against him, he can appeal that judgment. This is not an issue of constitutional import.

Factually, Mr. Babcock miscasts the committee's appointment as being for the purpose of bringing the lawsuit. Mr. Babcock questions "whether the appointment of an official committee of administrative claimants to pursue a derivative action" violated due process. BOB at pg. 4. The committee, in fact, existed for more than two years before it requested any authorization to sue. (*see* B.R. 5365 Notice of Appointment, Apx pg. __; B.R. 8704 Motion, Apx. pg. __). In that time, the committee undertook an array of actions that brought assets to the LTV Steel estate and enabled proper administration of the case, as credited by the bankruptcy court below. (B.R. 9289 Order Denying Motion, Conclusion of Law S, Apx. pg. __). The committee performed wide-ranging duties relating to liquidation, claim settlement, and appeals resolution. (B.R. 9217 Transcript, pgs. 4-5, Apx. pg. __; B.R. 7493 Committee Statement, Apx. pg. __; B.R. 7201 Committee Report, Apx. pg. __; B.R. 6967 Findings of Fact and Conclusions of Law, pg. 11, Apx. pg. __; B.R. 7071 Joint Motion, Apx. pg. __). The committee only sued on behalf of the bankruptcy estate after LTV Steel refused to bring the action itself, a refusal the bankruptcy court concluded was unjustifiable. (B.R. 8942 Memorandum of Opinion and Order, pgs. 47-48, Apx. pg. __).

Mr. Babcock also erroneously suggests that the lawsuit is a shareholder derivative lawsuit. BOB at pg. 31. The lawsuit is not a shareholder derivative action; quite simply, the committee does not include LTV shareholders or members of an association. *See* Fed. R. Civ. P. 23.1; Fed. R. Bankr. P. 7023.1. Instead, the suit was brought by creditors of the LTV bankruptcy estate, acting for the benefit of the LTV bankruptcy estate. (*see* B.R. 8942 Memorandum of Opinion and Order, pg. 1, Apx. pg. __). The standing that the committee has under this Court's holding in Gibson may be "derivative" in that the committee is standing in the shoes of LTV Steel, but it is fundamentally different from a shareholder derivative suit.

Finally, the United States Trustee is aware of no case law, and Mr. Babcock cites none, where person aggrieved standing is waived for reasons of public policy or any other purpose. But Mr. Babcock asks this Court to waive person aggrieved standing rules and order the district court to review the merits of his appeal, because he is "entitled" to a "day in court." BOB at pg. 40. Granting this request would be unwise. Person aggrieved prudential standing is a doctrine that must be applied neutrally if it is to have integrity. Case-by-case exceptions will only engender confusion and destroy the predictability the doctrine exists to provide.

B. Mr. Babcock's statutory argument lacks merit.

Mr. Babcock devotes seven pages of his brief to his argument that the committee's formation constituted a violation of 11 U.S.C. § 1102 because the United States Trustee exceeded its authority in appointing a committee to represent the interests of administrative claimants. *See* BOB at pgs. 33-39.

First, this is a remand issue. Second, this argument lacks merit. A committee whose members are all creditors holding unsecured claims is, by definition, a lawful committee under section 1102(a)(1). *See* 11 U.S.C. § 1102(a)(1) ("[T]he United States trustee shall appoint a committee of creditors holding unsecured claims . . ."). Here, each member of the committee was a creditor holding an unsecured claim. (B.R. 5374 Notice ofAmended Appointment, Apx. pg. __; B.R. 985 LTV Steel Schedule F, Apx. pg. __). The Bankruptcy Code does not prohibit a committee of creditors holding unsecured claims who also hold administrative claims. (D.R. 21 Brief of United States Trustee, pgs. 14-15, Apx. pg. __). For these reasons, the bankruptcy court expressly rejected Mr. Babcock's statutory argument and held the appointment valid in all respects. (B.R. 9289 Order Denying Motion, Conclusion of Law 10, Apx. pg. __).

CONCLUSION

For these reasons, the United States Trustee respectfully asks this Court to affirm the district court's order dismissing Mr. Babcock's appeal for lack of prudential standing. Should this Court decide Mr. Babcock possesses prudential standing, it should remand to the district court for consideration of the merits of Mr. Babcock's appeal.

Respectfully submitted,
SAUL EISEN
United States Trustee
Michigan/Ohio Region 9

Date:__________ By: ______________________________
Amy L. Good (Ohio Bar #0055572)
Trial Attorney

Office of the United States Trustee
United States Department of Justice
H.M. Metzenbaum U.S. Courthouse
201 Superior Avenue E, Suite 441
Cleveland, Ohio 44114
(216) 522-7800 ext. 236
amy.l.good@usdoj.gov

CERTIFICATE OF COMPLIANCE

I hereby certify that the foregoing brief complies with the type-volume limitation provided in Fed. R. App. P. 32(a)(7)(B). The foregoing brief contains 8,724 words of Times New Roman (14 point) proportional type. The word processing software used to prepare this brief was WordPerfect 12.

____
Amy L. Good

CERTIFICATE OF SERVICE

A copy of the foregoing Brief of the United States Trustee, Dennis Babcock, James Baske, was served by regular U.S. Mail, postage prepaid, this 16th day of July 2007, upon the following:

Michael A. VanNiel, Esq.
Matthew R. Goldman, Esq.
Baker & Hostetler
3200 National City Center
1900 East Ninth Street
Cleveland, Ohio 44114

Attorneys for the Administrative Claimants Committee

James B. Niehaus
John Kostelnik
Gregory F. Frakas,
Frantz Ward, LLP
127 Public Square
2500 Key Center
Cleveland, Ohio 44114

Attorneys for Appellants

David G. Heiman, Esq.
Kathleen B. Burke, Esq.
Jones Day
901 Lakeside 44114

Attorneys for LTV Steel Company, Inc.

____
Amy L. Good

No. 07-3534 and No. 07-3537

United States Court of Appeals
for the Sixth Circuit

Dennis Babcock, James Baske,)
Eric Evans, and George Henning)
)
Appellants)
)
vs.)
)
The Official Committee of)
Administrative Claimants)
)
Appellee)

On Appeal from the United States District Court
for the Northern District of Ohio
Eastern Division

ADDENDUM

Exhibit A	*Moran v. Official Committee of Administrative Claimants,* Slip Copy, 2006 WL 3253128 (N.D. Ohio)
Exhibit B	*In re Monus*, 63 Fed. Appx. 215 (6th Cir. 2003) (unpublished decision).
Exhibit C	*In re L.T. Ruth Coal Co.*, 803 F. 2d 720 (6th Cir. 1986) (unpublished decision).
Exhibit D	*In re Pioneer Inv. Services Co*., 21 F. 3d 428 (6th Cir. 1994) (unpublished decision).

DESIGNATION OF APPENDIX CONTENTS

Appellee, in accordance with Sixth Circuit Rule 28(d) and 30(b), hereby cites to portions of the record contained in Appellants' and Co-Appellee's designations. The United States Trustee does not designate any additional items to be included in the Joint Appendix.

BRIEF BANK — "SUMMARY SHEET" *Printed Tue-11/4/08 16:11*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*
In re: Balco Equities, LTD, Inc., Haddon Holdings, LTD, and Sarah Enterprises International, LTD (Cohen, Estis & Associates, LLP v. Diana Adams, et al., Acting United States Trustee)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*
S.D.N.Y.

3. ("CCN") ***CURRENT*** CASE NO.
No.: 7:06-cv-05878-SCR

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*
No.: 05-09045
Court: Bankr. S.D.N.Y.
(Identify judge & cite, if any)

5. ("SO") ***SOURCE***
U.S. TRUSTEES

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*
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Eric J. Small, Diann G. Adams
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s)
• Whether the appellant's failure to make a full and timely disclosure under Federal Rule of Bankruptcy Procedure 2014(a) justified the bankruptcy court's denial of all compensation.

&

√ Any Miscellaneous ***BACKGROUND***

10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)

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UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

COHEN, ESTIS & ASSOCIATES, LLP, Appellant. v. PAUL L. BANNER, CHAPTER 7 TRUSTEE AND DIANA G. ADAMS, ACTING UNITED STATES TRUSTEE FOR REGION 2 Appellees.	:	Civil No. 06-CV-5878 (SCR)
In re: BALCO EQUITIES, LTD., INC, HADDON HOLDINGS, LTD. and SARAH ENTERPRISES INTERNATIONAL, LTD. Debtors.	:	Case No. 04-35777 (CGM) (Chapter 7) (Jointly Administered)

BRIEF OF APPELLEE UNITED STATES TRUSTEE

Office of the United States Trustee
for Region 2
74 Chapel Street - Suite 200
Albany, New York 12207
(518) 434-4553

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By order dated April 26, 2006, the bankruptcy court denied all compensation and substantially all expenses sought by Cohen, Estis & Associates, LLP as counsel to the Chapter 11 debtors prior to the conversion of the cases to Chapter 7. By Memorandum Decision dated July 7, 2006, the bankruptcy court denied the April 28, 2006 motion for reconsideration, and entered an order on July 10, 2006 sustaining the April 26, 2006 order. In addition to denying all compensation and substantially all expenses, the bankruptcy court ordered the retainer disgorged and delivered to the Chapter 7 trustee to hold subject to further determination by the bankruptcy court in connection with the Chapter 7 trustee's adversary proceeding. Cohen, Estis & Associates, LLP timely filed a notice of appeal on July 14, 2006. This Court has jurisdiction over the final order denying fees and expenses pursuant to 28 U.S.C. § 158(a)(1).[1] See, e.g. In re Ames Department Stores, Inc., 76 F.3d 66 (2d Cir. 1996)(noting that the appeal was from a final order denying fees); See also In re Palm Coast Matanza Shores Limited Partnership, 101 F.3rd 253, 256 (2d Cir. 1996)(in

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[1] The United States Trustee only appeared in connection with the fee application of Cohen, Estis & Associates, LLP. The order directing the turnover of the retainer to the Chapter 7 trustee to hold pending a final determination of the Chapter 7 trustee's adversary proceeding appears to be interlocutory, requiring leave of this Court to appeal under 28 U.S.C. § 158(a)(3). See In re Bethlehem Steel Corporation, 2003 WL 21738964 (S.D.N.Y. 2003)(part of order addressing success fee which required additional future review was interlocutory because it did not finally determine matter.

context of retention of counsel, setting forth a broad, flexible finality standard in bankruptcy cases, and noting that " '[O]rders in bankruptcy cases may be immediately appealed if they finally dispose of discrete disputes within the larger case.' (Citations omitted); In re Bethlehem Steel Corporation, 2003 WL 21738964 (S.D.N.Y. 2003)(part of order disposing of fee application was final, part addressing success fee which was subject to further review was interlocutory).

III. STATEMENT OF ISSUE PRESENTED

Did the bankruptcy court err by denying all compensation and substantially all expenses to Cohen, Estis & Associates, LLP?

IV. STANDARD OF REVIEW ON APPEAL

A bankruptcy court has broad discretion in determining applications for compensation. See In re Nine Associates, Inc., 76 B.R. 943, 944 (S.D.N.Y. 1987). Federal Rule of Bankruptcy Procedure 8013 provides that findings of fact, whether based upon oral or documentary evidence, shall not be set aside unless clearly erroneous. The bankruptcy court's findings of fact are subject to a clearly erroneous standard of review; its legal conclusions are reviewed *de novo*; and its decisions to award or deny fees are subject to an abuse of discretion standard. See In re United Merchants and Mfrs., Inc., 1999 WL 4929 (S.D.N.Y. 1999); In re JLM, Inc., 210 B.R. 19, 23 (2d Cir. BAP 1997).

As set forth in further detail below, the factual bases for the bankruptcy court's denial of fees were virtually undisputed, and are not clearly erroneous. The standard of review on appeal, therefore, is whether the bankruptcy court abused its broad discretion in denying compensation based upon those facts.

V. STATEMENT OF THE CASE

The law firm representing the Chapter 11 debtors prior to the conversion of the cases to Chapter 7, Cohen, Estis & Associates, LLP ("CEA"), filed this appeal from the bankruptcy court's July 10, 2006 order sustaining on reconsideration its April 26, 2006 order denying all compensation and denying reimbursement of substantially all expenses.

The United States Trustee, the Chapter 7 Trustee and a creditor had argued below that CEA's multiple untimely and incomplete disclosures required by Federal Rules of Bankruptcy Procedure 2014(a) and 2016(b) and the firm's lack of disinterest under 11 U.S.C. §§ 328(c), 327(a) and 101(14) should result in a denial of compensation. CEA asserts that the bankruptcy court should have held an evidentiary hearing on its fee application, and that it abused its discretion in denying all compensation.[2]

In its July 7, 2006 Memorandum Decision, the bankruptcy court extensively reviewed CEA's disclosures required by 11 U.S.C. § 329(a) and Federal Rules of Bankruptcy Procedure 2014

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[2] It also asserts that the bankruptcy court did not have jurisdiction to order the turnover of the retainer to the trustee pending a resolution of the Chapter 7 trustee's adversary proceeding.

and 2016. The bankruptcy court denied all compensation and substantially all expenses based upon its conclusion that CEA had made untimely and inaccurate disclosures of its connections to parties-in-interest, and that it was not disinterested as required by 11 U.S.C. §§ 327(a) and 101(14). The bankruptcy court also directed the turnover of the retainer received by CEA to the Chapter 7 trustee pending an evidentiary hearing on the ownership of the funds. On July 10, 2006, the bankruptcy court entered an order implementing the terms of its Memorandum Decision, and CEA timely appealed to this Court.

VI. FACTS

A. Procedural Background

Balco Equities, Ltd., Haddon Holdings, Ltd. and Sarah Enterprises International, Ltd. filed separate voluntary petitions under Chapter 11 of the United States Bankruptcy Code on March 31, 2004. (BR at 1 - Voluntary Petition; HR at 1 - Voluntary Petition; SR at 1 - Voluntary Petition)[3]. The cases were jointly administered pursuant to an order entered on April 8, 2004. (BR at 14, HR at 5; SR at 5 - Order Granting Motion for Joint Administration). By order dated April 8, 2004, the Court

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[3] BR at ___ refers to the official docket number in the bankruptcy court's case docket in Balco Equities, Ltd.; HR at ___ refers to the official docket number in the bankruptcy court's case docket in Haddon Holdings, Ltd.; SR at ___ refers to the official docket number in the bankruptcy court's case docket in Sarah Enterprises International, Ltd.

approved the retention of Cohen, Estis & Associates, LLP ("CEA") as counsel to the debtors-in-possession. (BR at 16 - Order Authorizing Retention). By order dated December 14, 2004, the cases were converted to cases under Chapter 7, and Paul L. Banner was appointed trustee. (BR at 248; HR at 22; SR at 22 - Order Granting Motion to Convert Cases to Chapter 7; BR at 247 - Notice of Appointment of Chapter 7 Trustee). CEA filed a fee application dated November 11, 2005 seeking compensation and reimbursement of expenses as counsel to the superceded debtors-in-possession. (BR at 314 - Application for Compensation). The United States Trustee, the Chapter 7 trustee and creditor Epic Orange LLC filed objections to the application, alleging, inter alia, CEA's failure to make appropriate and timely disclosures pursuant to FRBP 2014(a) and 2016(b) and lack of disinterest under 11 U.S.C. §§ 328(c), 327(a) and 101(14). (BR at 319, 320 and 322 - Objections to Fee Application). The Chapter 7 trustee had also commenced an adversary proceeding seeking the return to the estate of the retainer paid to CEA. (BR at 311 - Notice of Complaint, Adversary 05-9045).

At an initial hearing on the fee application held on February 21, 2006[4], the bankruptcy court declined to schedule an evidentiary hearing, but provided CEA with the opportunity to

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[4] The hearing was originally scheduled by CEA for February 14, 2006, and rescheduled at its request to February 21, 2006.

file an affidavit setting forth any matters it wished the Court to consider in making a determination on the fee application. (February 21, 2006 Transcript at pp.7-10). CEA availed itself of that opportunity, filing a March 17, 2006 affidavit of Ronald Cohen in a supplemental statement in further support of its fee application on March 20, 2006 (BR. at 325 - Supplemental Statement and Affidavit), and filed a response to the trustee's reply memorandum on March 31, 2006. (BR. at 328 - Response).

After another hearing held on April 11, 2006, the Court orally rendered a decision denying all fees, and all expenses except the three filing fees. (April 11, 2006 Transcript at pp. 27-37). The Court also directed the disgorgement to the Chapter 7 trustee of all fees paid, subject to all parties rights in the adversary proceeding commenced by the trustee. The Court has not yet determined the ultimate disposition of those funds, which is the subject of the adversary proceeding. A written order reflecting the Court's oral decision was entered on April 26, 2006. (BR at 329 - Order).

On April 28, 2006, CEA filed a motion for reconsideration of the bankruptcy court's April 26, 2006 order, attaching the affidavit of a CEA partner, Deborah Weisman-Estis, Esq. and that of Mr. Cohen's physician. (BR at 330 and 331 - Motion to Reconsider and Affidavit). The United States Trustee and the

Chapter 7 trustee filed objections to the motion (BR at 333 and 335 - Objections to Motion for Reconsideration), and CEA filed a written response (BR. at 334 - Response). By Memorandum Decision dated July 7, 2006, the bankruptcy court denied the April 28, 2006 motion for reconsideration (BR. at 338 - Memorandum Decision), and entered an order on July 10, 2006 sustaining the April 26, 2006 order. (BR. at 339 - Order Sustaining April 26, 2006 Order). In addition to denying all compensation and substantially all expenses, the bankruptcy court ordered the retainer disgorged and delivered to the Chapter 7 trustee to hold subject to further determination by the bankruptcy court in connection with the Chapter 7 trustee's adversary proceeding. Cohen, Estis & Associates, LLP timely filed a notice of appeal on July 14, 2006. (BR. at 329 - April 26, 2006 Order; BR. at 339 - Order Sustaining April 26, 2006 Order).

B. CEA's Disclosures of Connections to Parties-in-Interest

By application filed on April 8, 2004, the debtors-in-possession sought Court approval pursuant to 11 U.S.C. § 327(a) of the retention of Cohen, Estis & Associates, LLP ("CEA") as their counsel. (BR. at 10 - Application for Retention of Cohen, Estis & Associates, LLP). The application was supported by the April 7, 2004 affidavit pursuant to Federal Rule of Bankruptcy Procedure ("FRBP") 2014(a) of Ronald J. Cohen, Esq. (BR. at 10 - Affidavit), which, *inter alia*, contained the following statements:

> 3. CEA utilizes a number of procedures (the "Firm Procedures") to determine its relationships, if any, to parties that may have connections to a client debtor. In implementing such Firm Procedures, the following actions were taken to identify parties that may have connections to the Debtors and CEA's relationship with such parties:
>
> a) CEA requested and obtained from the Debtors a list of interested parties and significant creditors (the "Potential Parties-In-Interest"), which has been revised and supplemented from time-to-time. The Potential Parties-In-Interest include equityholders, officers, directors and major trade creditors.
>
> b) CEA compared each of the Potential Parties-In-Interest to the names in its master database of current and former clients (the "Client Database"). The Client Database generally includes the name of each client, the name of the parties that are or were adverse to such client with regard to the subject of CEA's retention, and the names of the CEA personnel who are or were primarily responsible for matters for such clients.
>
> c) A conflicts check was issued and an investigation performed to determine whether there were any connections between CEA and any of the Potential Parties-in-Interest as such connection may relate to the Debtors.
>
> d) Known connections between CEA and Potential Parties-In-Interest were compiled for purposes of preparing this Affidavit.
>
> 4. As a result of the foregoing procedures, I have ascertained that, upon information and belief, CEA has no connections with the Debtors and the Potential Parties-In-Interest except as follows:
>
> (a) Because of its broad-based general practice, CEA has appeared in the past and may appear in the future in cases unrelated to this chapter 11 case where one or more of the Potential Parties-In-Interest may be involved

> (b) Prior to the Petition Date, CEA represented certain of the Debtors with respect to providing counsel for certain transactions, and has also provided general restructuring advice and provided legal counsel with respect to organizing and preparing for the filing of these cases.
>
> **(c) CEA has not represented any Potential Parties-In-Interest.**
>
> (d) Certain members of CEA and certain associates of and "of counsel" attorneys to CEA, and certain of such persons' relatives may have familial or personal relationships with officers, directors and/or shareholders of creditors of the Debtors, competitors of the Debtors and/or other parties in interest in these cases. As of the date hereof, CEA is not aware of any such relationships.
>
> (e) Certain members of CEA and certain of the associates of and "of counsel" attorneys to CEA, and certain of such persons' relatives, may directly or indirectly be shareholders of creditors of the Debtors, competitors of the Debtors and/or other parties in interest. As of the date hereof, CEA is not aware of any such relationships.
>
> (f) Certain members of CEA and certain of the associates and "of counsel" attorneys to CEA, and certain of their relatives, may have business, contractual, economic, familial or personal relationships with creditors of the Debtors and/or other parties in interest or such entities' respective officers, directors or shareholders. As of the date hereof, CEA is not aware of any such relationships.
>
> (Emphasis added)

By order dated April 8, 2004, the Court approved the retention of CEA as counsel to the debtors-in-possession. (BR. at 16 - Retention Order).

CEA filed three subsequent amended FRBP 2014(a) affidavits. The first one, dated May 12, 2004 and signed by Andrew Wulfman, Esq., who at the time was an associate of CEA, clarified prior general statements by disclosing the pre-petition representation of Balco Equities, Ltd. ("Balco") with respect to the Epic Orange real estate transaction. (BR. at 85 - Supplemental Affidavit).

The next amended FRBP 2014(a) affidavit was dated July 29, 2004 and signed by Ronald J. Cohen, Esq., and disclosed, in response to an issue raised by Epic Orange, Mr. Cohen’s prior representation of a proposed purchaser of real property owned by Balco. (BR. at 171 - Affidavit Pursuant to FRBP 2014).

The last amended FRBP 2014(a) statement was dated December 8, 2004, just days prior to the return date of the United States Trustee’s motion to convert or dismiss the Chapter 11 cases. (BR. at 241 - Second Supplemental Affidavit). It disclosed for the first time that CEA had represented a major creditor of Haddon Holdings, Ltd. ("Haddon"), the Estate of Frederick J. Warmers. The Warmers Family Trust is listed in amended schedules filed in Haddon on May 18, 2004 as having a claim of $1,266,080.00. (HR at 11 - Amended Schedules). The affidavit described the connection to the Frederick J. Warmers Estate as follows:

> 7. The Estate of Frederick J. Warmers (the “Warmers Estate”), is a creditor of Haddon Holdings, Ltd., (Case No. 04-35778), as set forth on amended schedules filed on behalf of the debtor on May 3, 2004. Frederic J. Warmers died December 30, 1998.
>
> 8. Donald P. Boehm, served as Executor

of the Warmers Estate from May 20, 1999 to October, 2003 pursuant to testamentary letters issued by the Surrogates Court, Orange County.

9. On information and belief, between 1999 and early 2003, the Warmers Estate was represented by a law firm located in Newburgh, New York that continued to serve as counsel to the Warmers Estate until in or about early 2003. At about that time, the principal of that law firm retired and relocated to the State of Florida, retaining all the legal files pertaining to the administration of the Warmers Estate.

10. On information and belief, approximately concurrent with the retirement of the principal of that firm, a beneficiary of the Warmers Estate brought an application to compel an interim accounting by the Executor.

11. CEA was retained on behalf of the Warmers Estate on March 23, 2003 for the specific purpose of securing the pertinent information relating to the prior administration of the Warmers Estate and facilitating the submission of an accounting with respect to such periods.

12. As a result of subsequent proceedings in the Surrogate's Court, in or about October, 2003, Mr. Boehm was removed as Executor and a successor executrix was appointed. At that time, the successor executrix retained separate counsel to represent the Warmers Estate.

13. Notwithstanding the retention of separate counsel by the Warmers Estate, CEA continued to provide services in connection with the submission of a "final" accounting with respect to the prior administration of the Warmers Estate.

14. On March 8th, 2004, this firm filed an amended final accounting (the

> "Accounting"), with the Surrogate's Court.
>
> 15. After the commencement of these bankruptcy cases, CEA was called on to provide additional legal services supplemental to the submission of the Accounting, in proceedings before the Surrogate's Court. Those proceedings remain outstanding at this time.
>
> 16. The Firm has applied to the Surrogate's Court for an reimbursement of counsel fees incurred on behalf of the Warmers Estate. As of August 11, 2004, the fees and expenses sought to be awarded to the Firm total approximately $28,000.00.

This disclosure indicates that CEA was rendering services to a major creditor of Haddon until a month prior to the bankruptcy petitions being filed, continued to render services after the filing of the case, and was seeking payment from the Surrogates Court for its services, yet never disclosed the representation to the bankruptcy court in three prior FRBP 2014(a) affidavits.

The affidavit also indicated that CEA had represented Donald Boehm, the debtors' principal, and various other entities in which Mr. Boehm had an interest or served in a fiduciary capacity. These connections were described as follows:

> 24. Based on that review, I determined that CEA has represented and/or does presently represent certain third parties who are "parties-in-interest" or "related" to parties in interest in connection with certain transactions and/or legal proceedings which are completely unrelated to these bankruptcy proceedings. In particular, in addition to the matter of the Warmers Estate, CEA has represented Mr. Boehm and/or entities

> in which Mr. Boehm was, or is a principal with respect to transactions and/or legal proceedings that, to the best of my knowledge, do not implicate any aspect of these bankruptcy cases. These include the following matters:
>
> (a) Representation of the Tessie Warmers Trust in connection with the sale of certain real estate holdings;
>
> (b) Representation of, LMAD, Inc., (General Partner of Senlar Associates, NY General Partnership), Connelly Industries, Inc., and Donald Boehm, individually, in the case *DeBrizzi, et al., vs. Senlar Associates, et als*., Index No. 5854/99, State Of New York Supreme Court, Orange County;
>
> (c) Representation of Mr. Boehm in proceedings to foreclose his interest in his personal residence in New Windsor, New York in the case *Greenpoint Savings Bank v. Boehm*, Index No. 1623/03, State Of New York Supreme Court, Orange County.

C. CEA's FRBP 2016(b) Statements and Other Fee Disclosures.

CEA filed a total of four FRBP 2016(b) statements in the three cases:

(a) A statement in Balco dated May 3, 2004, signed by Ronald J. Cohen reflecting an agreement to accept $45,000.00, actual receipt of $3,000.00, and a balance due of $42,000.00, received from "Nancy Cook, Cook Family Trust, Donald Boehm." (BR. at 59 - Schedules containing 2016(b) Statement)

(b) An amended statement in Balco dated May 11, 2004, signed by Ronald J. Cohen reflecting an agreement to accept $45,000.00, actual receipt of $45,000.00, and a balance due of

$0.00, received from "Donald Boehm; payment was received April 29, 2004." (BR. at 84 - Updated Rule 2016 Statement).

(c) A statement in Haddon dated May 3, 2004, signed by Andrew S. Wulfman reflecting an agreement to accept $0.00, actual receipt of $0.00 and a balance due of $0.00. (HR at 11 - Schedules containing 2016(b) Statement).

(d) A statement in Sarah dated May 3, 2004, signed by Andrew S. Wulfman reflecting an agreement to accept $0.00, actual receipt of $0.00 and a balance due of $0.00. (SR at 11 - Schedules containing 2016(b) Statement)

The application for retention prepared by CEA, and signed by Nancy Cook, Balco and Haddon’s president, indicates that "CEA received prepetition retainers in the collective amount of $3,000, for preparation for the bankruptcy filing and postpetition fees, and it intends to apply to the Court for postpetition fees and expenses." (BR at 10 - Application for Retention).

The fee application, at paragraph 37 indicates that the

> "...sum of $3,000.00 was paid in two checks issued by Balco Equities, Ltd., Inc., dated on or about March 31, 2004. Of the sum of $3,000.00 which was paid on March 31, 2004, the sum of $2,517.00 was applied to filing fees for the three cases and the remaining balance of $483 was applied to the legal fee. We believe that this fee was earned by us prepetition for the work we did prior to the filing late in the day on March 31st. (Our computer records show that an additional sum of $3,000.00 was paid/credited to this file

> #00008269 in our computer system but upon good faith and diligent investigation we believe that this sum has been misapplied by bookkeeper mistake). The balance of the retainer payments we received in the sum of $42,000.00 was applied to legal fees."

(BR. at 314 - Fee Application).

CEA has never disputed that it filed these statements, which constituted a central part of the record considered by the bankruptcy court.[5] (BR at 338 - Memorandum Decision, pp. 17-26)

VII. ARGUMENT

A. CEA's Failure to Make Full and Timely Disclosure Under Federal Rule of Bankruptcy Procedure 2014(a) Justified the Bankruptcy Court's Denial of all Compensation.

Federal Rule of Bankruptcy Procedure ("FRBP") 2014(a) provides:

> *(a) Application for and Order of Employment*. An order approving the employment of attorneys, accountants, appraisers, auctioneers, agents, **or other professionals pursuant to § 327, § 1103, or § 1114 of the Code** shall be made only on application of the trustee or committee. The application shall be filed and, unless the case is a chapter 9 municipality case, a copy of the application shall be transmitted by the applicant to the United States trustee. The application shall

---

[5] The bankruptcy court observed that CEA "most recently" claims in the context of the trustee's adversary proceeding that it received the retainer as part of a $68,500.00 fee from either Connelly Industries or the Tessie Warmers Trust on April 27, 2004 in connection with the Tessie Warmers Trust real estate transaction. (BR at 338 - Memorandum Decision, p. 4; BR at 325 - Exhibit A to Cohen Supplemental Affidavit)

> state the specific facts showing the necessity for the employment, the name of the person to be employed, the reasons for the selection, the professional services to be rendered, any proposed arrangement for compensation, **and, to the best of the applicant's knowledge, all of the person's connections with the debtor, creditors, any other party in interest, their respective attorneys and accountants, the United States trustee, or any person employed in the office of the United States trustee**. The application shall be accompanied by a verified statement of the person to be employed setting forth the person's connections with [the specified parties]. (emphasis added.)

It is patently clear that CEA had an obligation to disclose all connections to parties-in-interest in existence at the time of the filing of the retention application. It failed to meet this responsibility.

All professionals appointed pursuant to 11 U.S.C. § 327 or § 1103 have a continuing obligation to disclose their connections to parties-in-interest. The obligation to disclose facts relevant to disinterest continues throughout the case. See, In re Bennett Funding Group, Inc., 226 B.R. 331, 334 (Bankr. N.D.N.Y. 1998); In re Granite Partners, L.P., 219 B.R. 22 (Bankr. S.D.N.Y. 1998); In re Tinley Plaza Associates, L.P., 142 B.R. 272, 278 (Bankr. N.D. Ill., Eastern Division, 1992). Disclosure after more than seven months denies all concerned a reasonable opportunity to properly assess applicant's eligibility to be retained prior to the entry of an order authorizing the retention.

> "Absent the spontaneous, timely and complete disclosure required by section 327(a) and Fed.R.Bankr.P. 2014(a), court appointed counsel proceed *at their own risk*." Rome v. Braunstein, 19 F.3d 54, 59 (1st Cir. 1994), citing In re Roger J. Au & Son, Inc., 71 B.R. 238, 242 (Bankr. N.D. Ohio 1986)("failure to disclose facts material to potential conflict may provide *totally independent* ground for denial of fees, quite apart from the actual representation of competing interests.")(Remaining citations omitted)(Italics in original).

See also In re the Leslie Fay Companies, Inc., 175 B.R. 525, 533 (Bankr. S.D.N.Y. 1994) citing Futuronics Corp. v. Arutt, Nachamie & Benjamin (In re Futuronics Corp.), 655 F.2d 463, 469 (2d Cir.1981); Matter of Arlan's Department Stores, Inc., 615 F.2d 925, 933 (2d Cir. 1979)(decided under substantially similar predecessor to FRBP 2014); Rome v. Braunstein, 19 F.3d 54, 59 (1st Cir. 1994); In re Granite Sheet Metal Works, Inc., 159 B.R. 840, 847 (Bankr.S.D.Ill.1993); In re Envirodyne Industries, Inc., 150 B.R. 1008, 1021 (Bankr.N.D.Ill.1993).

FRBP 2014 is extremely broad, and requires disclosure of all connections with parties in interest in the case, rather than just those which appear to implicate disinterestedness or adverse interest. See In re etoys, 331 B.R. 176, 190 (Bankr. D. Del. 2005), citing In re Filene's Basement, Inc., 239 B.R. 850, 856 (Bankr. D. Mass. 1999). See also In re C&C Demo, Inc., 273 B.R. 502, 507 (Bankr. E.D. Tex. 2001). As stated by one court:

> The professional cannot pick and choose which connections to disclose. No matter how old the connection, no matter how trivial it appears, the professional seeking employment must disclose it. The court and interested parties are then informed and the professional does not run the risk of serving the estate *pro bono.*

In re EWC, Inc., 138 B.R. 276, 281 (Bankr. W.D. Okla. 1992).

The failure to make proper disclosure under FRBP 2014(a) is not excused by general disclaimers in retention affidavits designed to explain the possibility of a remote and difficult to ascertain connection not identified in a thorough review. See In re C&C Demo, Inc., 273 B.R. 502, 507 (Bankr. E.D. Tex. 2001).

CEA cannot contend in this case that it merely omitted a remote connection through inadvertence after making an otherwise meaningful disclosure. It made no disclosure of the significant connections described for almost eight months.

A professional's duty to make full disclosure under FRBP 2014(a) is self-policing, with the Court and parties-in-interest relying on forthright disclosure, without the necessity for conducting independent investigations. See In re Granite Partners, L.P., 219 B.R. 22, 35 (Bankr. S.D.N.Y. 1998); In re C&C Demo, Inc., 273 B.R. 502, 507 (Bankr. E.D. Tex. 2001).

The courts of appeals have recognized the importance of these disclosure requirements and the power of the bankruptcy courts to sanction attorneys for noncompliance. See, e.g., Kravit, Gass & Weber, S.C. v. Michel (In re Crivello), 134 F.3d 831, 836 (7th Cir. 1998); Neben & Starrett, Inc. v. Chartwell Financial Corp. (In re Park-Helena Corp.), 63 F.3d 877, 881-882 (9th Cir. 1995), cert. denied, 516 U.S. 1049, 116 S.Ct. 712, 133 L.Ed. 2d 667 (1996); Rome v. Braunstein, 19 F.3d 54, 59-60 (1st Cir. 1994). In Park-Helena, in which the debtor's attorney failed to disclose the source of a prepetition retainer, the Ninth Circuit acknowledged that the disclosure requirements of Rule 2014 are applied "strictly." Id. at 881. "All facts that may be pertinent to a court's determination of whether an attorney is disinterested or holds an adverse interest to the estate must be disclosed." Id. at 882. "The duty of professionals is to disclose all connections with the debtor, debtor-in-possession, insiders, creditors, and parties in interest ... They cannot pick and choose which connections are irrelevant or trivial ... No matter how old the connection, no matter how trivial it appears, the professional seeking employment must disclose it." Id. The Ninth Circuit further stated that "[t]he disclosure rules are applied literally, even if the results are sometimes harsh." Id. at 881. Negligent or inadvertent omissions "do not vitiate the failure to disclose." Id. The failure to comply with the disclosure rules is a sanctionable violation, even if proper disclosure would have shown that the attorney had not actually violated any Bankruptcy

Code provision or Bankruptcy Rule. Id. at 880. Applying these strict standards, the Park-Helena court held that the attorney's failure to describe the circumstances of the payment of the retainer violated the disclosure requirements of Rule 2014, and that the bankruptcy court did not abuse its discretion in denying all the attorney's requested fees as a sanction for the attorney's failure to disclose. Id. at 882; See also Kravit, Gass & Weber, S.C. v. Michel (In re Crivello), 134 F.3d 831, 836 (7th Cir. 1998) ("failure to disclose is sufficient grounds to revoke an employment order and deny compensation"); Rome v. Braunstein, 19 F.3d at 59-60 (counsel's failure to make full and spontaneous disclosure of financial transactions between debtor and insiders provided sufficient ground for denial of compensation). CEA's failure to identify its connections to parties-in-interest properly resulted in a denial of all compensation.

B. CEA's Lack of Disinterestedness Supports the Denial of Fees.

Section 328(c) of the Bankruptcy Code provides:

> § 328. Limitation on compensation of professional persons.
>
> ***
>
> (c) Except as provided in section 327(c), 327(e) or 1107(b) of this title, the court may deny allowance of compensation for services and reimbursement of expenses of a professional person employed under section 327 or 1103 of this title if, at any time during such professional person's employment under section 327 or 1103 of this title, such

> professional person is not a disinterested person, or represents or holds an interest adverse to the interests of the estate with respect to the matter on which such professional person is employed.

In this case, CEA represented the debtors-in-possession as general counsel in the bankruptcy cases. This was not a discrete litigation for which an assertion could be made that the representation did not conflict with its obligations to the estate, nor could the assertion be made that the creditors and other parties represented by CEA were not significant. CEA represented the debtors’ principal, and another creditor who was a major creditor of Haddon.

In this case, the Court, the United States Trustee and other parties were denied the right to evaluate CEA’s other representations prior to the entry of an order authorizing CEA’s retention under 11 U.S.C. § 327(a), which the United States Trustee believes would have been denied by the Court if CEA had made proper disclosure of its connections. Retention of a professional under 11 U.S.C. § 327(a) requires that the professional to be retained "...not hold or represent an interest adverse to the estate, and that are disinterested persons...." The twin requirements combine into a single hallmark, which requires that the professional not have a meaningful incentive to act contrary to the best interests of the estate and its creditors - an incentive sufficient to place those parties at more than acceptable risk - or the reasonable perception of one. See In re Martin, 817 F.2d 175, 180 (1st Cir. 1987).

> "A fiduciary ... may not perfect his claim to compensation by insisting that, although he had conflicting interests, he served his several masters equally well or that his primary loyalty was not weakened by the pull of his secondary one."

Rome v. Braunstein, 19 F.3d 54, 62 (1st Cir. 1994)(noting that the bankruptcy court is authorized to impose sanctions under 11 U.S.C. § 328(c)), citing Woods v. City Nat'l Bank & Trust Co., 312 U.S. 262, 269, 61 S.Ct. 493, 497, 85 L.Ed. 820 (1941)(in the context of a bondholders committee); In re Roger J. Au, 71 B.R. 238, 241 (Bankr. N.D. Ohio 1986).

"Once counsel is employed, 'a lawyer owes his allegiance to the entity and not to the stockholder, director, officer, employee, representative or other person connected with the entity.'" In re The Leslie Fay Companies, Inc., 175 B.R. 525, 532 (Bankr. S.D.N.Y. 1994), citing In re Grabill Corp., 113 B.R. 966, 970 (Bankr.N.D.Ill.1990), quoting In re King Resources Co., 20 B.R. 191, 200 (D. Col. 1982). See also Interwest Business Equipment, Inc. v. United States Trustee (Interwest Business Equipment, Inc.), 23 F.3d 311, 318 (10th Cir. 1994)(affirming the bankruptcy court's finding: that a law firm's simultaneous representation of multiple debtors-in-possession and one of the other estates as a creditor constituted representation of an interest adverse to the estate, and that the firm was thus not disinterested; and that the existence of a pre-petition debt from one estate to the other created a disqualifying conflict of interest. Id. at 314, 318. In so holding, the court recognized the importance of the fiduciary duty of the debtor in possession, as trustee of the estate, and of counsel's obligation to serve the trustee independently. Id. at 317; See also In re BH & P, Inc., 949 F.2d 1300, 1317-1318 (3d Cir. 1991) (affirming disqualification of counsel for multiple related bankruptcy estates of corporation and its two principals, where estates had claims against one another and counsel failed to disclose potential conflicts).

C. CEA's Failure to Fully Comply with the Requirements of FRBP 2016(b) Supports the Denial of All Compensation.

Section 329(a) of the Bankruptcy Code provides:

§ 329. Debtor's transactions with attorneys.

> (a) Any attorney representing a debtor in a case under this title, or in connection with such a case, whether or not such attorney applies for compensation under this title, shall file with the court a statement of the compensation paid or agreed to be paid, if such payment or agreement was made after one year before the date of filing of the petition, for services rendered or to be rendered in contemplation of or in connection with the case by such attorney, and the source of such compensation.

FRBP 2016(b) requires the § 329 statement to be filed and sent to the United States trustee within 15 days after the order for relief, or at another time as the court may direct, and requires a supplemental statement to be filed and transmitted to the United States trustee within 15 days after any payment or agreement not previously disclosed, and 11 U.S.C. § 329(b) authorizes the Court to order the return of any payment deemed excessive.[6] A failure to fully comply with the disclosure requirements of FRBP 2016(b) is a basis for denial of all compensation and the disgorgement of all fees paid. See In re LaFerriere, 286 B.R. 520, 526-27 (Bankr. D. Vt. 2002)(FRBP 2016(b) disclosure requires "total candor"). See also Neben & Starrett, Inc. v. Chartwell Financial Corp. (In re Park-Helena Corp.), 63 F.3d 877, 881-882 (9th Cir. 1995), cert. denied, 516 U.S. 1049, 116 S.Ct. 712, 133 L.Ed. 2d 667 (1996)(holding that the debtor’s attorney failed to comply with the disclosure requirements of FRBP 2014(a) and 2016(b), and noting that the fiduciary duties of disclosure under Rule 2014(a) and Rule 2016(b) are similar and overlapping); In re Kisseberth, 273 F.3d 714, 721 (6th Cir. 2001); In re Independent Engineering Co., 197 F.3d 13, 17 (1st Cir. 1999); In re Downs, 103 F.3d 472, 479-480 (6th Cir. 1996); In re Prudhomme, 43 F.3d 1000, 1003-1004 (5th Cir. 1995).

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[6] Pursuant to 11 U.S.C. § 329(b), the bankruptcy court may order the return of a pre-petition retainer to the estate, if the property transferred would have been property of the estate or was to be paid under a plan, or to the entity that made such payment. This question is the subject of the trustee’s adversary proceeding and state court litigation. The trustee, CEA and the Tessie Warmers Trust have all claimed that the retainer should be returned to them.

The bankruptcy court followed this established line of cases in holding that CEA's inconsistent disclosures did not meet the requirements of FRBP 2016(b), and warranted the sanction imposed.

D. The Salient Facts Were Undisputed, and CEA Received a Full and Fair Hearing.

CEA's own sworn statements admit its representation of multiple entities who were parties in the bankruptcy cases. It does not dispute that it failed to disclose these prior and concurrent representations to the bankruptcy court in the sworn statements required to obtain an order authorizing its retention. The United States Trustee certainly would have filed an objection at the outset of the case, and does not believe that the Court would have authorized the firm's retention under 11 U.S.C. §§ 101(14) and 327 had CEA's first sworn FRBP 2014(a) statement accurately set forth its connections to all parties-in-interest. (See BR at 335 - United States Trustee Objection to Reconsideration, Par. 11) The bankruptcy court came to the same conclusion, noting that

> "Cohen Estis does not dispute that it failed to adequately disclose its connections with parties in interest. The failure to disclose resulted in the employment of Cohen Estis as Debtors' counsel when it was not eligible for retention."

(BR at 338 - Memorandum Decision at p. 36).

As set forth above, the bankruptcy court properly exercised its broad discretion to deny CEA's fees based upon CEA's own sworn statements which demonstrated (1) CEA’s failure to disclose its connections to parties in interest under FRBP 2014(a); (2) its failure to properly disclose the sources and amounts of its receipt of pre-petition retainer funds under 11 U.S.C. § 329(a) and FRBP 2016(b); and its patent lack of disinterestedness under 11 U.S.C. §§ 101(14), 327(a) and 328(c). Any one of these failures by CEA could properly form the basis for a denial of compensation, but all three are present here.

CEA’s suggestion that it was denied due process because it was “...not allowed to be present at an evidentiary hearing...” creates the unfortunate impression that the bankruptcy court’s decision was made in a vacuum. Nothing could be further from the truth. CEA initiated the fee application hearing by filing an application and scheduling a hearing. (BR at 316 - November 14, 2005 Notice of Hearing on Fee Application; BR at 316 - December 8, 2006 Amended Notice of Hearing)[7]. Objections to the fee application were filed by the United States Trustee, the Chapter 7 trustee and a creditor well in advance of the hearing date (BR at 319 - January 20, 2006 Epic Orange Objection; BR at 320 - February 6, 2006 Chapter 7 trustee Objection; BR at 322 and 323 - February 8, 2006 United States Trustee Objection and Memorandum

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[7] The notice and application mis-characterized the application as one for interim, rather than final compensation. It covered the entire Chapter 11 period of the cases, which had concluded by conversion to Chapter 7, and CEA’s services in the Chapter 11 cases had terminated. The application was treated by the bankruptcy court as a final fee application. (BR at 338 - Memorandum Decision at P. 2).

of Law), which was in any event adjourned for a week at CEA's request. (BR at un-numbered February 14, 2006 entry - Notice of Adjournment.) The bankruptcy court held a hearing on February 21, 2006, which was attended by CEA's counsel.

At that hearing, the bankruptcy court afforded CEA the opportunity to file an affidavit setting forth any information it wished the court to consider in making a ruling. (February 21, 2006 Transcript, at pp. 7-10). CEA took advantage of the opportunity, filing a Supplemental Statement supported by the affidavit of Ronald Cohen, Esq. (BR at 325 - Affidavit and Supplemental Statement filed on March 20, 2006). It also filed a response to the Chapter 7 trustee's reply memorandum. (BR at 328 - March 31, 2006 Response). The bankruptcy court then held another hearing and oral argument on April 11, 2006, which was attended by CEA's counsel. Subsequent to that hearing, CEA filed a motion for reconsideration, supported by affidavits by Deborah Weisman-Estis, Esq., a CEA partner, and Mr. Cohen's physician, Andrew Hirsch, D.O., as well as a memorandum of law. (BR at 330, 331 and 332 - Motion to Reconsider filed April 28, 2006 and attached affidavit; Affidavit of Andrew Hirsch, D.O. filed on April 28, 2006; Memorandum of Law) CEA also filed a response to the objections to the motion for reconsideration. (BR at 334 - Response filed on May 10, 2006).

CEA was afforded a full and fair opportunity to support its fee application. It had multiple opportunities to be heard and to provide the bankruptcy court with both sworn statements and legal argument: (1) it filed a fee application containing narrative in support of its fee request; (2) it scheduled a hearing, which it attended through counsel; (3) it filed a supplemental statement and an affidavit of a partner of the firm; (4) it filed a response; (5) it attended another hearing through its counsel; (6) it filed a motion for reconsideration, supported by the affidavit of another partner of the firm; (7) it filed an affidavit of one of the partner's physicians; (8) it filed a memorandum of law; and (9) it filed another response.

Section 330 of the Bankruptcy Code authorizes the bankruptcy court to award compensation after the specified notice and a hearing. The phrase "after notice and a hearing" is defined in 11 U.S.C. § 102(1) as meaning "...after such notice as is appropriate in the particular circumstances, and such opportunity for a hearing as is appropriate in the particular circumstances...." 11 U.S.C. § 102(1)(A). An evidentiary hearing is not a requirement. See In re Busy Beaver Building Centers, Inc., 19 F.3d 833, 846 (3d Cir. 1994); In re I Don't Trust, 143 F.3d 1, 3 (1st Cir. 1998); In re Ingersoll, 238 B.R. 202, 211 (D. Col. 1999); In re Pfleghaar, 215 B.R. 394, 397 (8th Cir. BAP 1997). See also In re BDC 56 LLC, 330 F.3d 111, 119 (2d Cir. 2003)(in context of hearing on determination of involuntary case, noting that bankruptcy court may rely on documentary evidence, that an evidentiary hearing is not obligatory, that the nature of a bankruptcy court’s findings is not altered by whether it holds an evidentiary hearing, and that factual findings based upon documentary evidence and affidavits are reviewed for “clear error,” not de novo).

In this case, the bankruptcy court’s findings were based primarily on the undisputed facts embodied by CEA’s own affidavits in the case. The bankruptcy court clearly had the discretion to deny fees based upon those facts.

VIII. CONCLUSION

For these reasons, the United States Trustee respectfully asks this Court to affirm the order entered below denying all compensation and substantially all reimbursement of expenses.

Dated: Poughkeepsie, New York
August 31, 2006

DIANA G. ADAMS
ACTING UNITED STATES TRUSTEE

By: /s/ Eric J. Small
Eric J. Small, Esq. (ES5231)
Office of the U.S. Trustee
U.S. Department of Justice
74 Chapel Street
Suite 200
Albany, NY 12207
(518) 434-4553

BRIEF BANK — "SUMMARY SHEET"

Printed Mon.-1/11/99 (16:02)

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*

BALLARD v. U.S. TRUSTEE (In re Forshee)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*

N.D. Tex., Dallas Div.

3. ("CCN") ***CURRENT*** CASE NO.

No.: District Court No. 3:97-CV-2777-R

4. ("PCN") ***PRIOR*** CASE NO. -&- COURT *(IF APPLICABLE)*

No.: Bankr. Case No. 397-37947-HCA-7

Court: Bankr. N.D. Tex.

(Identify judge & cite, if any)

5. ("SO") ***SOURCE***

U.S. TRUSTEES

6. ("DA") ***DATE*** OF FILING ***-&- TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*

Filed: Jan. 16, 1998

Type: U.S. TRUSTEE's OPENING BRIEF REGARDING APPLICATION TO APPEAL WITHOUT PREPAYMENT OF FEES

7. ("AU") ***PRINCIPAL AUTHORS -&- OFFICE*** *[E.g., "UST/OGC"]*

Anthony J. Ciccone (UST/OGC)
Mary Frances Durham (UST/Region 6, Dallas)

(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***

BANKRUPTCY

9. ("SU") ***SUMMARY*** OF KEY ISSUE(s)

! Whether appellant-Bankruptcy Petition Preparer could waive appellate filing fees & proceed *in forma pauperis* ("IFP") in appeal from Bankr. Court to District Court.

√ **Background:** Preparer appealed from fine & injunction imposed by Bky.Ct., but sought to proceed IFP. We briefed whether appellate filing fees may be waived under 28 U.S.C. §§ 1915 & 1930, and discussed the split of authority following Perroton v. Gray, 958 F.2d 889 (9th Cir. 1992).

√ **Argument:** As Art. III court, Dist. Court is authorized by § 1915 to waive filing fees, but should not as appellant showed no indigence or likelihood of success.

10. PATH TO FILE LOCATION: (e.g., S:\GENERAL COUNSEL\BRFBANK\etc...)

S:\General Counsel\BrfBank\ToWest\BALLARD1.wpd

11. DO YOU RECOMMEND POSTING IN UST BRIEFBANK?

| x | YES | | NO

NAME: Anthony J. Ciccone
DATE: Thu.-9/17/98 (10:21)

United States Department of Justice
Office of the United States Trustee
1100 Commerce Street, Room 9E23
Dallas, TX 75242 (214) 767-8967

Mary Francesca Durham, Attorney
for the United States Trustee

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

IN RE:	§	
	§	
Doyle Keith Forshee and wife,	§	
Cheryl Joan Forshee	§	
	§	**District Ct. No. 3:97-CV-2777-R**
	§	
Phillip Monroe Ballard	§	
vs.	§	**Bankr. Case No. 397-37947-HCA-7**
United States Trustee	§	
	§	**(No Hearing Set)**

BRIEF REGARDING APPLICATION TO APPEAL WITHOUT PREPAYMENT OF FEES

The United States Trustee respectfully files this Brief Regarding Phillip Monroe Ballard's Application to Proceed Without Prepayment of Fees and Affidavit (the "application"). Pursuant to the Court's December 23, 1997 letter,[1] we offer the following regarding Mr. Ballard's application to waive appellate fees here and proceed *in forma pauperis* ("IFP").

PROCEDURAL HISTORY

Phillip Monroe Ballard, a non-debtor, signed his name to a bankruptcy petition and other documents, as a "bankruptcy petition preparer," and caused to be filed a voluntary chapter 7 case upon behalf of Mr. and Mrs. Forshee (the "debtors"). Section 110 of the Bankruptcy Code, 11

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[1] That letter essentially requested citations to legal authority governing the imposition, and waiver, of court fees in appeals such as this, as well as inviting legal argument upon the issue.

U.S.C. § 110, governs the conduct of bankruptcy petition preparers, and the Code prescribes fines and other remedies that a bankruptcy court may take to ensure compliance with Section 110.

After an evidentiary hearing in which Mr. Ballard participated fully, the bankruptcy court found that Mr. Ballard violated several provisions of Section 110. It thus entered an order on September 26, 1997, fining Mr. Ballard $500, directing him to return to the debtors all money they paid him (at least $1,000 known), and enjoining him from acting as a bankruptcy petition preparer. Mr. Ballard did not appeal from this order. Instead, on October 6, 1997, he filed a motion to amend or for a new trial. The bankruptcy court denied that motion for lack of new facts, evidence, or law on October 21, 1997 ("Order On Motion To Amend").

On October 30, 1997, Mr. Ballard filed a Notice of Appeal regarding the bankruptcy court's Order On Motion To Amend. Although the United States Trustee was not served with the Notice of Appeal, Mr. Ballard designated the United States Trustee as appellee. Also on October 30, 1997, Mr. Ballard filed a "Declaration in Support of Request to Proceed *In Forma Pauperis*," stating that he had no assets and no funds with which to pay the $105 appellate filing fee,[2/] although he admittedly received income between $8,000 and $10,000 in the preceding 12 months. On November 5, 1997, Mr. Ballard filed a form entitled "Application to Proceed without Prepayment of Fees and Affidavit," again stating that he had no assets, although he had received $8,000 to $10,000 from self employment in the prior year.

By order dated November 24, 1997, the District Court (Chief Judge Buchmeyer) referred Mr. Ballard's IFP application to Bankruptcy Judge Abramson for review, and in a November 14th letter, the District Court Clerk established a briefing schedule, pursuant to Bankruptcy Rule 8009,

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[2/] The United States Trustee is not aware whether or not Mr. Ballard has also sought to waive the transcript preparation fee. <u>*See*</u> <u>*generally*</u> Bankruptcy Rules 5007(a) ("Transcript Fees"); 8007(a) ("Duty of Reporter to Prepare and File Transcript"); and 8014 ("Costs").

under which Mr. Ballard's opening brief was due by December 2, 1997. Because appellant failed to file a timely brief, we filed a Motion to Dismiss Appeal on December 9, 1997, one week after passage of appellant's briefing deadline.

The District Court initially granted our motion, in an Order Dismissing Appeal entered on December 15, 1997. However, on December 19, the Court vacated the dismissal and reinstated Mr. Ballard's appeal, "pending consideration of Appellant's Application to Proceed Without Prepayment of Fees and Affidavit." Also on December 19, the Court entered two additional orders (1) withdrawing its prior reference to Bankruptcy Judge Abramson, and (2) referring Mr. Ballard's IFP application to Magistrate Judge Sanderson. We now brief the IFP issue pursuant to the Magistrate's instructions of December 23, 1997, which asked the parties to address the following matters:

> 1. Rules and/or statutes which set out the applicable fees which are normally imposed upon a person who appeals a bankruptcy judge's ruling to a judge of a district court.
>
> 2. Rules and statutes which permit an appealing party to seek review <u>in forma pauperis</u>.
>
> In addition . . . each of you may include any arguments or authority in favor of or in opposition to Mr. Ballard's [IFP] request. . . .

THE UNITED STATES TRUSTEE'S RESPONSES TO THE COURT'S QUESTIONS

1. "Rules and/or statutes which set out the applicable fees which are normally imposed upon a person who appeals a bankruptcy judge's ruling to a judge of a district court"

Bankruptcy fees are prescribed by 28 U.S.C. § 1930, and in particular, subsections (b)-(c) set forth fees the bankruptcy court collects in appeals. The total filing fee in an appeal from a bankruptcy court decision is $105, consisting of two parts. First, section 1930(c) authorizes the bankruptcy clerk to collect $5 from the appellant for filing "any . . . notice of appeal or . . . writ of certiorari."[3] Further, section 1930(b) authorizes the Judicial Conference of the United States to establish additional fees.[4] Pursuant to this authority, the Judicial Conference has prescribed a $100 fee for filing an appeal (such as this) under 28 U.S.C. § 158(a).[5] *See* Judicial Conference Fee Schedule, ¶ 16.[6] Consequently, upon filing his appeal here, Mr. Ballard owed the clerk of the bankruptcy court a $105 filing fee.

2. "Rules and statutes which permit an appealing party to seek review *in forma pauperis*"

The above-referenced filing fees may be waived to the extent permitted by 28 U.S.C. § 1915, pursuant to which courts of the United States may allow indigents to proceed *in forma pauperis*. The statute provides in pertinent part:

> Subject to subsection (b) [regarding suits by "prisoners," as defined in subsection (h)], any court of the United States may authorize the commencement, prosecution or defense of any suit, action or proceeding, civil or criminal, or appeal therein, without prepayment of fees or security therefor, by a person who submits an affidavit that includes a statement of all assets such [person] possesses [and] that the person is unable to pay such fees or give security therefor. Such affidavit shall state the nature of the action, defense or appeal and affiant's belief that the person is entitled to redress.

28 U.S.C. § 1915(a)(1) (emphasis added). Further, Local Rule 83.6 of the Northern District of

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[3] *See* 28 U.S.C. § 1930(c) ("Upon the filing of any separate or joint notice of appeal or application for appeal or upon the receipt of any order allowing, or notice of the allowance of, an appeal or a writ of certiorari $5 shall be paid to the clerk of the court, by the appellant or petitioner").

[4] *See* 28 U.S.C. § 1930(b) ("The Judicial Conference of the United States may prescribe additional fees in cases under title 11 of the same kind as [it] prescribes under section 1914(b) of this title").

[5] Mr. Ballard's October 30, 1997 appeal notice states it was filed under 28 U.S.C. § 158(a)(1), which provides that "[t]he district courts of the United States shall have jurisdiction to hear appeals . . . from final judgments, orders, and decrees . . . of bankruptcy judges."

[6] Paragraph 16 of the Judicial Conference's fee schedule provides in pertinent part as follows: "For docketing a proceeding on appeal or review from a final judgment of a bankruptcy judge pursuant to 28 U.S.C. § 158(a) and (b), $100." *See* notes following 28 U.S.C. § 1930.

Texas provides that "[a] party desiring to proceed without prepayment of fees or costs must complete the appropriate form and file it with the clerk."

Despite the seemingly broad language in section 1915 authorizing IFP status, Congress specifically barred waiver of the bankruptcy *case-filing* fees prescribed by 28 U.S.C. § 1930(a). Section 1930(a) states that "[n]otwithstanding section 1915 . . . , the parties commencing a case under title 11 shall pay . . . [specified] filing fees" — whose amounts vary, according to which Bankruptcy Code chapter is invoked — although such fees may, in certain circumstances, be paid in "installments." *Id.* (emphasis added); *see also* United States v. Kras, 409 U.S. 434, 439-40 (1973) (holding that under former Bankruptcy Act of 1898 parties must pay commencement fees for filing a bankruptcy petition, and prior IFP statute similar to section 1915 was inapplicable to cases under former Bankruptcy Act). Thus, debtors clearly may not obtain IFP status to avoid paying the initial bankruptcy case-filing fees prescribed by section 1930***(a)***.[7]

There is, however, a split of authority as to whether a bankruptcy court may grant IFP status to waive the appellate filing fees prescribed by sections 1930***(b)-(c)***. The leading case holding against the existence of IFP status in bankruptcy appeals is Perroton v. Gray (In re Perroton), 958 F.2d 889 (9th Cir. 1992). Noting that only "courts of the United States" are authorized by section 1915(a) to grant IFP status, the Ninth Circuit focused upon whether a bankruptcy court is a "court of the United States" within the meaning of section 1915. The term

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[7] It should, however, be noted that Congress authorized a 3-year "pilot" program between October 1994-1997, during which six districts (not including this District) were allowed to waive fees under section 1930. The Judicial Conference is to file a report with Congress in March 1998 addressing fee policy and the results of the pilot program. *See* Pub. L. No. 103-121, § 111(d)(3), 107 Stat. 1153, 1165 (Oct. 27, 1993) ("Waiver of Fees in Selected Districts. . . . [T]he Judicial Conference . . . shall carry out in not more than six judicial districts, throughout the 3-year period beginning October 1, 1994, a program under which fees payable under section 1930 of title 28 . . . may be waived in cases under chapter 7 of title 11 . . . for debtors who are individuals unable to pay such fees in installments"); *accord* § 111(d)(1) ("Not later than March 31, 1998, the Judicial Conference . . . shall submit a report to [Congress] . . . relating to the bankruptcy fee system and the impact of such system on various participants in bankruptcy cases").

"court of the United States" is defined in 28 U.S.C. § 451 as

> the Supreme Court . . . , courts of appeals, district courts constituted under chapter 5 of this title, including the Court of International Trade and any court created by Act of Congress *the judges of which are entitled to hold office during good behavior*.

28 U.S.C. § 451 (emphasis added). The *Perroton* court concluded that it was unclear what Congress meant by "entitled to hold office during good behavior." 958 F.2d at 893. Although a bankruptcy court, in *In re Shumate*, 91 B.R. 23 (Bankr. W.D. Va. 1988), had previously allowed IFP filings on the theory that bankruptcy judges hold their office during good behavior, *Perroton* disagreed. Rather, the Ninth Circuit held that "good behavior" is a term-of-art mirrored in Article III of the Constitution,[8] which guarantees life-time tenure subject only to impeachment. *Perroton*, 958 F.2d at 893. Thus, a "court of the United States" is only an Article III court. *Id.* Because bankruptcy judges are not Article III judges, they lack authority to allow IFP filings. *Id.*

The *Perroton* court also found support for its conclusion in section 451's legislative history. It noted that Congress initially amended section 451 to include bankruptcy judges. Pub. L. No. 95-598, § 213, 92 Stat. 2668 (Nov. 6, 1978). Yet, Congress eliminated the amendment before it took effect. Pub. L. No. 98-353, § 113, 98 Stat. 333, 343 (July 10, 1984). Based on this action, *Perroton* held that Congress did not intend bankruptcy courts to be "courts of the United States" or to possess power to waive fees under section 1915. *Id.*, 958 F.2d at 894.

In reaching this conclusion, the Ninth Circuit expressly rejected *amicus* arguments advanced by the United States Trustee, to the effect that appellate fees under sections 1930*(b)-(c)* could be waived because the restrictive language "[n]otwithstanding section 1915" appeared only in connection with initial case-filing fees under section 1930*(a)*. Rather, while noting that the

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[8] *See* U.S. Const. art. III, § 2 ("Judges, both of the supreme and inferior courts, shall hold their Offices during good Behavior").

notwithstanding language in section 1930(a) "admittedly reinforces congressional intent" to bar the waiver of initial case-filing fees, Perroton held that the absence of such language in subsections (b)-(c) cannot be construed as legislative intent to permit the granting of IFP status under section 1915, "given the clearer implication to the contrary evidenced by Congress's decision not to include the bankruptcy court in § 451." Perroton, 958 F.2d at 895 (emphasis in original).

At least three other appellate courts have reached the conclusion that bankruptcy courts are not "courts of the United States."[9] *See also* In re Jeyes, 202 B.R. 153 (10th Cir. BAP 1996) ("The Tenth Circuit . . . has held that [the term] 'court of the United States,' as used in 28 U.S.C. § 451, is limited to Article III courts. . . . The Bankruptcy Appellate Panel is not an Article III court, and therefore lacks power to grant leave to proceed [on appeal] in forma pauperis.").

On the other hand, a number of bankruptcy courts have disagreed with Perroton and held that section 1915 allows them to waive fees other than the initial case-filing fees specified in section 1930(a), which, as noted, requires payment "notwithstanding" section 1915. For instance, the bankruptcy court in Huff v. Brooks (In re Brooks), 175 B.R. 409 (S.D. Ala. 1994) criticized Perroton's analysis and held that it could still grant IFP status under section 1915, reasoning as follows:

> As "units of the district court" pursuant to 28 U.S.C. § 151, authority flows to the bankruptcy courts from the district courts through the order of reference. Bankruptcy judges' authority to deal with [*in forma pauperis*] motions is derived from this "flow

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[9] *See* Huff v. Brooks (In re Brooks), 175 B.R. 409, 411 (S.D. Ala. 1994) (collecting cases) ("Four circuit courts of appeal, the Third, Ninth, Tenth and Eleventh, have ruled that bankruptcy courts are not 'courts of the United States.' Matter of Becker's Motor Transp., 632 F.2d 242 (3d Cir. 1980), [*cert. den.*, 450 U.S. 916 (1981)] (bankruptcy court is not a 'court of the United States' for purposes of 28 U.S.C. § 2201); . . . Jones v. Bank of Santa Fe (In re Courtesy Inns), 40 F.3d 1084 (10th Cir. 1994) (bankruptcy court is not a 'court of the United States' for purposes of 28 U.S.C. § 1927); IRS v. Brickell Inv. Corp. (In re Brickell Inv. Corp.), 922 F.2d 696 (11th Cir. 1991) (bankruptcy court is not a 'court of the United States' for purposes of 26 U.S.C. § 7430); Gower v. Farmers Home Admin. (In re Davis), 899 F.2d 1136 (11th Cir. 1990) (bankruptcy court is not a 'court of the United States' for purposes of 28 U.S.C. § 2412); *see also* Brown v. Mitchell (In re Arkansas Communities, Inc.), 827 F.2d 1219, 1221 (8th Cir. 1987) ('questionable whether bankruptcy court falls within the definition of "court of the United States."')").

> down" jurisdictional scheme. . . . [L]anguage specifically including bankruptcy judges in section 451 would be superfluous at best, and contradictory at worst, with this structure.

Id. at 412. Moreover, Brooks concluded that Perroton read too much into Congress's election to delete bankruptcy courts from the definition of "courts of the United States" in 28 U.S.C. § 451, because after Northern Pipeline Constr. Co. v. Marathon Pipeline Co., 458 U.S. 50 (1982), Congress reconstituted bankruptcy courts as "units of the district court," and language including them in section 451 was no longer necessary. Brooks, 175 B.R. at 412. Or, as reasoned in McGinnis v. McGinnis (In re McGinnis), 155 B.R. 294 (Bankr. D.N.H. 1993):

> Congress' subsequent amendment of 28 U.S.C. § 451 should not be interpreted to mean, as the Perroton court suggests, that Congress intended to strip the bankruptcy court of the power to enter appropriate orders in matters . . . incidental to proceedings which are properly before the court. . . . In its response to Northern Pipeline, Congress also enacted 28 U.S.C. § 157, the current statute under which the district court delegates authority to bankruptcy courts. . . . [In so] delegating . . . the district court also delegates its authority to entertain petitions and motions necessary to fully and fairly adjudicate these cases, including petitions to proceed in forma pauperis under 28 U.S.C. § 1930(b) or (c).

Id. at 296 (emphasis added).[10]

THE POSITION OF THE UNITED STATES TRUSTEE

As the foregoing reflects, the law is unsettled as to whether bankruptcy courts may grant IFP status under section 1915 and waive the filing fees required by section 1930(b)-(c) for appeals from bankruptcy judges to district courts. The central question has been viewed in terms of whether bankruptcy courts are "courts of the United States" and, thus, authorized to grant IFP

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[10] *See also* In re Fontaine, 10 B.R. 175 (Bankr. D. R.I. 1981), In re Palestino, 4 B.R. 721 (Bankr. M.D. Fla. 1980), and In re Gurda Farms, Inc., 10 B.R. 479 (S.D.N.Y. 1980) (holding that bankruptcy courts may waive fees other than section 1930(a) case-filing fees, on the theory that bankruptcy courts are "courts of the United States" for section 1915 purposes since their authority derives from a district court's general order of reference, and/or that Congress intended the absolute requirement that fees be paid to apply only to initial case-filing fees under section 1930(a) and its "notwithstanding" language).

status under section 1915. However, we believe there is an equally important issue to consider, namely, whether non-payment of an appellate filing fee in the court below deprives this Court of jurisdiction over the appeal. A review of the applicable law suggests that — irrespective of whether bankruptcy courts are "court of the United States" under section 1915 — this Court possesses jurisdiction to hear or dismiss the appeal.

More specifically, Rule 8001(a) of the Federal Rules of Bankruptcy Procedure (Fed. R. Bankr. P.) provides as follows in this regard:

> An appeal from a judgment, order or decree of a bankruptcy judge to a district court or bankruptcy appellate panel as permitted by 28 U.S.C. § 158(a)(1) or (a)(2) shall be taken by filing a notice of appeal with the clerk within the time allowed by Rule 8002. An appellant's failure to take any step other than timely filing a notice of appeal does not affect the validity of the appeal. . . .

Fed. R. Bankr. P. 8001(a) (emphasis added). Likewise, the Supreme Court has long held that failure to timely tender appellate filing fees, though sanctionable, does not deprive the reviewing court of jurisdiction. *See* Parissi v. Telechron, 349 U.S. 46 (1955) (*per curiam*) (holding that an appeal was not jurisdictionally defective despite appellant's failure to include a $5 filing fee along with a timely-filed notice of appeal, even though 28 U.S.C. § 1917 required that the $5 fee be paid "upon the filing" of the notice). Following Parissi, other courts have similarly held that a failure to pay appellate filing fees is not jurisdictionally fatal. As the Eighth Circuit, for example, held in H.L. Thorndal v. Smith, Wild, Beebe & Cades, 339 F.2d 676 (8th Cir. 1965):

> Here as in Parissi, the statute fixing the time for appeal contains no provision or condition with respect to payment of fees. In Parissi, the filing fee requirement is found in a separate federal statute. Here the [appellate] filing fee provision is found in local court rules . . . [which] cannot enlarge statutory jurisdictional requirements. Hence, in our view a firmer basis here exists for supporting jurisdiction than was present in Parissi.

Id. at 678-79 (further noting, however, that "Courts are not without power to provide sanctions for failure to pay fees"); *accord* Wrenn v. American Cast Iron Pipe Co., 575 F.2d 544, 547 (5th Cir. 1978) ("untimely payment of a filing fee does not vitiate the validity of a notice of appeal"); *cf*. Ecker v. Replogle (In re Replogle), 70 B.R. 444, 446 (Bankr. D. Mont. 1987) ("Since all the other prerequisite for filing [an adversary proceeding], namely, prompt receipt of the filing fee and cover sheet, were immediately cured, the Plaintiff's complaint should be deemed [timely] filed").

While non-payment of fees may not vitiate appellate jurisdiction, it remains for the reviewing court to determine whether those fees should be waived or, possibly, whether sanctions are warranted. *See* Fed. R. Bankr. P. 8001(a). Here, the reviewing court is an Article III district court, which is clearly a "court of the United States" and thus authorized to waive fees under section 1915.[11/] As a neighboring district court recently held, "to deny an indigent person the right to defend in bankruptcy . . . merely because he cannot afford to pay the fees would amount to an unconstitutional deprivation of due process and denial of equal protection." Tripati v. U.S. Bankruptcy Court for the Eastern District of Texas, 180 B.R. 160, 163 (E.D. Tex. 1995).

Finally, one should consider the appropriate standard to be applied in reviewing an IFP application. We believe the proper standard was enunciated in United States v. Merritt (In re Merritt), 186 B.R. 924 (Bankr. S.D. Ill. 1995).[12/] As that court explained:

> Qualification for in forma pauperis relief under § 1915 requires not only financial eligibility but also legal eligibility. . . . Congress, while opening the federal courts to individuals with rights to be adjudicated but inadequate means to pay the filing fees, at the same

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[11/] Indeed, it appears the Court here recognized as much when it withdrew its prior referral to the bankruptcy court on December 19, 1997, and instead referred to this Magistrate the issue of whether appellant should be allowed to proceed with this appeal *in forma pauperis*.

[12/] The bankruptcy court in Merritt was in one of the districts authorized to grant IFP status during the "pilot" program discussed above. Although the three-year pilot program has now concluded, that has no bearing on this Court's authority, as an Article III court of the United States, to grant IFP status at any time. (Note: The six pilot districts included the bankruptcy courts in Brooklyn (E.D.N.Y.), Philadelphia (E.D. Pa.), Memphis (W.D. Tn.), Peoria (S.D. Ill.), Great Falls (D. Mont.), and Salt Lake City (D. Utah).)

> time attempted to safeguard these courts from vexatious litigation that would require a disproportionate expenditure of time and judicial resources. . . . With regard to appeals, the statute provides that "[a]n appeal may not be taken in forma pauperis if the trial court certifies in writing that it is not taken in good faith." 28 U.S.C. § 1915(a)[3]. This "good faith" requirement is an objective one based on the legal merit of the issues sought to be appealed.
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> * * *
>
> Unlike the right to appeal a criminal conviction or seek redress for a violation of civil rights, obtaining a discharge of one's debts in bankruptcy is a matter of legislative grace, not a constitutional right. . . . Requiring such a litigant to show a reasonable likelihood of success before granting in forma pauperis relief incorporates into the court's evaluation the factors a paying litigant would consider in his decision to sue — the chance of success balanced against the anticipated cost of bringing suit.

Merritt, 186 B.R. at 930, 932 (emphasis added).

Here, we submit, Mr. Ballard has not and cannot make the requisite showing to allow his appeal to proceed *in forma pauperis*, either legally or financially. As a matter of law, Mr. Ballard does not appear to have a realistic expectation of success on the merits. He merely appeals a denial of rehearing in which he wholly failed to assert any new facts or law sufficient to warrant reconsideration of the bankruptcy court's sanctions under 11 U.S.C. § 110. Likewise, from a financial perspective, Mr. Ballard has utterly failed to demonstrate such indigence as to excuse his payment of the $105 appeal filing fee. To the contrary, he received at least $1,000 for his services as bankruptcy petition preparer here, and admits to having earned at least $8,000 to $10,000 in income from self-employment during the preceding 12 months.[13] At a minimum, before granting IFP status here, an evidentiary hearing, in which Mr. Ballard bears the burden of proof, would clearly seem to be required.

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[13] Moreover, inasmuch as Mr. Ballard admitted to the bankruptcy court that he renounced his social security number approximately 20 years ago, establishing his true financial worth may be quite difficult.

Finally, it is worth repeating that the Judicial Conference is required by law to submit a report to Congress by March 31, 1998, addressing the future of bankruptcy fees and IFP status. Presumably, Congress may revisit this entire area and perhaps enact amendments to sections 1915 and/or 1930 that will simplify their application in the future. Until the law is changed, however, we believe the Court should handle Mr. Ballard's IFP application as discussed above.

January 16, 1998

WILLIAM T. NEARY
United States Trustee

By: ____
MARY FRANCES DURHAM (TXB #00790144)
United States Department of Justice
Office of the United States Trustee
1100 Commerce Street, Room 9E23
Dallas, TX 75242 (214-767-8967)

MARTHA L. DAVIS
General Counsel
ANTHONY J. CICCONE
Attorney (D.C. Bar #249920)
Executive Office for U.S. Trustees
901 E Street, N.W., Suite 780
Washington, DC 20530 (202-307-1399)

Certificate of Service

I hereby certify that I caused a copy of the foregoing Brief by United States mail (first-class, postage prepaid) to be mailed, this 16th day of January, 1998, to the following:

Phillip Monroe Ballard
805 East Abram, Suite 10
Arlington, TX 76010

MARY FRANCES DURHAM

BRIEF BANK — 'SUMMARY SHEET" *Printed Tue-2/7/06 14:46*

WESTLAW CODES

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Baum v UST (In re Baum)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*
DC ND Texas

3. ("CCN") ***CURRENT*** CASE NO.
No.: 6 :05-CV-076

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*
No.:
Court:
(Identify judge & cite, if any)

5. ("SO") ***SOURCE***
U.S. TRUSTEES

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*
Filed: February 2006
Type: Brief of the UST

7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*
William S. Parkinson
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***

• 1) Whether the Bankruptcy Court erred in finding sufficient evidence from which to conclude by a preponderance that the Appellant/Defendant, with the intent to hinder, delay, and/or defraud creditors, transferred numerous articles of person property and horses in violation of 11 U.S.C. §727(a)(2)(A) and (B). 2) Whether the Bankruptcy Court erred in finding sufficient evidence from which to conclude by a preponderance that the Appellant/Defendant knowingly and fraudulently made a false oath when completing and filing his Schedules and Statement of Financial Affairs ("SOFA") in violation of 11 U.S.C. §727(a)(4)(A).

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IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF TEXAS
SAN ANGELO DIVISION

IN RE	**§**	
	§	
JOHN C. BAUM and	**§**	**Civil Action No. 6:05-CV-076-C**
LINDA D. BAUM	**§**	
	§	
DEBTORS	**§**	
	§	
-		
	§	
JOHN C. BAUM	**§**	
APPELLANT	**§**	
	§	
V.	**§**	
	§	
UNITED STATES TRUSTEE	**§**	
APPELLEE	**§**	

BRIEF OF THE UNITED STATES TRUSTEE

WILLIAM T. NEARY
UNITED STATES TRUSTEE
WILLIAM S. PARKINSON
TRIAL ATTORNEY
UNITED STATES TRUSTEE
United States Department of Justice
Office of the United States Trustee
1100 Commerce St.
Room 976
Dallas, Texas 75242
(214) 767-8967

CERTIFICATE OF INTERESTED PERSONS

The parties interested in the outcome of this appeal are:

John C. Baum
P.O. Box 762
Coleman, Texas 76834

Harvey Morton, Trustee
P.O. Box 10305
Lubbock, Texas 79408

United States Trustee
1100 Commerce St.
Room 976
Dallas, Texas 75242

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2) Whether the Bankruptcy Court erred in finding sufficient evidence from which to conclude by a preponderance that the Appellant/Defendant knowingly and fraudulently made a false oath when completing and filing his Schedules and Statement of Financial Affairs ("SOFA") in violation of 11 U.S.C. §727(a)(4)(A).

STANDARD OF REVIEW

The issues raised in this appeal are principally questions of fact. Findings of fact can be set aside only if found clearly erroneous. *See* Fed. R. Bankr. Pro. 8013. This Court reviews question of law de novo. *Matter of Pengo Industries, Inc.*, 962 F.2d 543 (5th Cir. 1992), *Matter of Luce*, 960 F.2d 1277 (5th Cir. 1992).

STATEMENT OF THE CASE

The Appellant filed a voluntary *pro se* Chapter 11 petition on November 4, 2003. On December 12, 2003, the Court converted this case to Chapter 7, and Harvey Morton was appointed Trustee. The United States Trustee timely filed this adversary seeking under 11 U.S.C. §727 to deny the Appellant's discharge. The Complaint, as amended, alleged 21 counts of conduct under 11 U.S.C. §727 justifying denial of the discharge. Trial was held over several days in October and November 2004. On March 30, 2005, The Bankruptcy Court entered its Memorandum Opinion in which it found for the United States Trustee on seven of those twenty-one counts. On April 4, 2005, the Bankruptcy Court entered an Order denying the Appellant's discharge. On April 15, 2005, the Appellant filed a motion for a new trial. On July 21, 2005, after a hearing on that Motion, the Bankruptcy Court denied the Appellant a new trial. It is from the April 4, 2005 and July 21, 2005, Orders that the Appellant appeals.

STATEMENT OF FACTS

General Background[1]

Prior to filing this case, the Appellant was engaged in the repairing of roads and highways under contract with the Texas Department of Transportation. This business involved an extensive amount of equipment and vehicles, many million of dollars of loans and contract payments, and a number of projects at locations widely spread across this State. Beyond his business, the Appellant was involved in a variety of avocational activities. One of these was his owning, breeding, raising, and training of horses. The Appellant periodically bought and sold horses to third parties and family members. However, he also used some horses to participate in roping and other rodeo activities. He practiced for these activities in a Preifert portable arena he owned and kept on his ranch. *See infra*. Most of the horses he owned were registered quarter and paint horses.

Starting on or about December 16, 1998, the Appellant and First Coleman National Bank ("Bank") entered into what became a series of loans and security agreements. *See* Record pages 161-179, *see also* Record Volume 4, PX 6(a)-6(q), PX 7(a)-(p). These transaction stretched over the next several years and culminated in the Appellant owing the Bank a total of $2,216,064.04. By virtue of these collective transactions, the Appellant had given the Bank encumbrances on *inter alia* a ranch of approximately 392 acres, virtually all his other personal property, equipment, vehicles, fixtures, and livestock, including, 29 specifically identified horses. One of the specifically identified horses was named "Justalena Peppy

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[1] This case is extremely fact intensive. It involves numerous transactions concerning various items of personal property and horses. The Statement of Facts will only identity facts relevant to the Counts of the Complaint on which the Court found for the United States Trustee. For ease of understanding, the facts will be presented topically rather than chronologically.

Dawn", *see infra*.

Beginning approximately June 2000 the Appellant began having financial difficulties, and the Bank noted defaults under the various notes. *See* Record page 192. The Bank began to pressure the Appellant for payments. Despite the Bank's patience and willingness to loan the Appellant additional funds, the Appellant's financial troubles continued. Ultimately, these defaults and the Bank's pressure led the Appellant to file this voluntary Chapter 11 proceeding on November 4, 2003.

PRE-PETITION TRANSACTIONS

Diamond Tennis Bracelet

Several years before this case was filed, the Appellant purchased as a present for his wife a diamond tennis bracelet from Keith Neal, a pawn store owner in Brownwood, Texas. *See* Record pages 144-146. Sometime thereafter, Mrs. Baum developed medical problems which required the Appellant's mother to care for their children. To repay those services, the Appellant and Mrs. Baum gave Mrs. Baum's mother the bracelet. *See* Record pages 575, 883. As the Appellant's financial problems deepened, she gifted the bracelet back to the Appellants, *see* Record page 883, without any expectation that she get it or the proceeds from its sale. *See* Record page 884. Approximately two weeks before this case was filed, the Appellant resold the bracelet back to Mr. Neal for approximately $2,500.00. *See* Record pages 146-148. The Appellants Statement of Financial Affairs ("SOFA") required the Appellant to disclose all transfers of assets within the year prior to the filing of his case. The Appellant did not disclose the sale of the tennis bracelet. *See* Record Volume 4, PX 4 (Statement of Financial Affairs, questions 6-7, 10), PX 5 (Statement of Financial Affairs, questions 6-7, 10).

Weapons

Approximately a year before this case was filed, the Appellant sold the house he lived in to Dr. Michael Bailey, a friend of the Appellant's. *See* Record page 369. In a separate transaction done approximately the same day, the Appellant also sold Dr. Bailey a large steel gun safe which he left at Dr. Bailey's house. *See* Record pages 369-370. When Dr. Bailey bought the safe he observed it to be full of guns, mostly rifles. *See* Record page 372. He originally estimated the number of weapons at between 60 and 65, but later learned it had spaces for 24 rifles and a shelf for pistols. *See* Record pages 373, 377. At the time of this sale the Appellant neither did nor said anything at the time to suggest that these weapons belonged to anyone other than himself. *See* Record page 373. Only Dr. Bailey's wife and the Appellant knew how to open the safe. *See* Record page 371. Between September 2003 and January 2004, just before and two months after he filed bankruptcy, the Appellant came to Dr. Bailey's house at least two times and removed guns from this safe. Once he was observed by Dr. Bailey, *see* Record pages 374-375, and once by Maria Hurtado, Dr. Bailey's housekeeper. *See* Record pages 391-395. Approximately January 2004, about the time Ms. Hurtado saw the Appellant removing weapons, Dr. Bailey observed the open safe and found it to contain only the few weapons he (Dr. Bailey) owned. *See* Record page 376.

As the Appellant's financial troubles continued, he let it be known in the community he had weapons in a safe for sale. *See* Record pages 148-149, 835. Several weeks before this case was filed, Mr. Barker, then a friend of the Appellant, went with the Appellant to Dr. Bailey's house to examine a .45 caliber pistol he was considering purchasing. *See* Record pages 839-840. Although Mr. Barker and the Appellant could not agree on a price, Mr. Barker observed the safe to be full of weapons. *See* Record pages 837-840. Mr. Barker also indicated he did not purchase the weapon because the Appellant told him he intended to file bankruptcy, and Mr. Barker believed it was too close to his doing so to buy any weapons. *See* Record pages 842-843. The Appellant eventually sold the .45 caliber pistol to Mr. Neal for $500.00 in the same transaction in which he resold the tennis bracelet. *See* Record page 152-153.

The Appellant's Schedule of assets required him to disclose all weapons he owned. Similarly, the Appellants SOFA required the Appellant to disclose all transfers of assets within the year prior to the filing of his case. *See* Record Volume PX 4 (Statement of Financial Affairs, questions 5-8, 10). Other than three guns: a .308 caliber rifle, a .22 caliber mag rifle, and a .22 rifle, *see* Record Volume 4, PX 4 (Schedule B), the Appellant did not disclose his ownership of any other weapons. Though he disclosed the sale of 2 shotguns and rifle to Keith Neal for $600.00, *see* Record Volume PX 4, (Statement of Financial Affairs, question 14), the Appellant did not disclose the sale of the .45 caliber pistol.

POST-PETITION TRANSACTIONS

Preifert Portable Arena

The Appellant owned a Preifert portable arena which he kept and used on his ranch. *See* Record page 398, *see also* Record Volume 11, Exhibit 4. This arena was pledged to the Bank as general equipment collateral. *See* Record page 179, *See also* Record Volume 4, PX 4, *e.g.* Exhibit 7(p). On January 5, 2004, after the case was converted to Chapter 7, and after the Bankruptcy Court gave the Bank relief from the automatic stay to foreclose its collateral, the Bank's agents appeared at the Appellant's ranch to take possession of its collateral.[2] *See* Record page 199. Though the Bank's agents noted that the arena was on the property at that time, they did not seize it, as they anticipated foreclosing the ranch the next day and did not want to incur the expense of moving it. *See* Record page 199. The ranch was foreclosed January 6, 2004, but the Bank did not actually physically take possession until February 11, 2004. *See* Record pages 199, 207. However, on or about February 3, 2004, before it took possession of the ranch, the Bank's agent noted that the arena was no longer on the ranch. *See* Record page 199, 229. The Bank later found the arena in the possession of one John Curtis, another friend of the Appellant. *See infra*.

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[2] The Bank initially tried to peacefully foreclose on December 18, 2004. However, the Appellant refused the Bank's representatives peaceful entry to the property, stating that he was going to require the Bank to obtain yet another Court order. The Bank then filed for and obtained a writ of sequestration from the State Court in Coleman.

The Appellant's original Schedules and SOFA[3] filed on January 10, 2004, two months after the case was filed, indicated that the Appellant owned a Preifert portable arena with a fair market value of $12,000.00. *See* Record Volume PX 4 (Schedule B, question 31, exhibit B-31). However, the Appellant testified at the first Chapter 7 creditors' meeting on January 22, 2004[4] that the Preifert portable arena belonged to one Russell Johnson, a friend of the Appellant's. *See* Record page 228. Consistent with that testimony, the Appellant amended his SOFA on January 29, 2004, to show the arena was only being held for Mr. Johnson. *See* Record Volume 4, PX 5 (Statement of Financial Affairs, question 14).

Despite the Appellant's creditors' meeting testimony and his amended schedules, Mr. Johnson testified he never owned or claimed any interest in that arena. *See* Record pages 399-401, 410. Rather, the Appellant tried to offer the arena to Mr. Johnson in payment of a personal favor the Appellant thought he owed Mr. Johnson.[5] *See* Record pages 399-401. Mr. Johnson is not listed as a creditor on either set of Schedules, and is not shown as the recipient of any transfers in the year prior to the case being filed. *See* Record Volume 4, PX 4 (Statement of Financial Affairs, questions 6-7). Indeed, after the case's conversion to Chapter 7, the Appellant approached John Curtis, another friend, about holding the arena for Mr. Johnson. *See* Record pages 434-438. Mr. Curtis agreed and picked-up the arena from the Appellant's ranch. *See* Record page 436. Mr. Curtis held the arena on his own property until the Bank learned of its whereabouts. Mr. Curtis ultimately surrendered the arena to the Bank. *See* Record pages 229, 437.

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[3] It was only after the Appellant retained counsel on or about December 30, 2003, that the Appellant filed any schedules or a statement of financial affairs. Such documents should have been filed 15 days after the case was filed. However, even after the Bankruptcy Court extended the due-date to December 4, 2003, the Appellant still did not file schedules and a SOFA until January 10, 2004.

[4] Technical problems caused there to be no audible or useable recording of either meeting.

[5] Mr. Johnson could not identify whether the Appellant's offer of the arena was pre- or post-petition. However, the only difference the date would make is whether §727(a)(2)(A) or (a)(2)(B) was applicable. The resulting effect of the transfer would have been the same regardless of the date it occurred.

Damaged Guardrail

As a result of his work on roads and highways, the Appellant was in possession of a quantity of damaged guardrail when he filed this case. *See* Record page 261. This was kept on his ranch and was there the day he filed his petition. On or about February 20, 2004, the Appellant, by or through another friend, Terry Gardner, arranged with Pine Street Salvage in Abilene for the sale of this damaged guardrail as scrap. *See* Record page 262. This guardrail to be removed from his ranch by Mason Cullins, an agent of the Pine Street Salvage. Mr. Cullins drove a truck to the Appellant's ranch and, and with the Appellant's personal assistance and direction, loaded this guardrail onto the truck. *See* Record pages 445-447. Mr. Cullins then took this guardrail from the Appellant's ranch to the Pine Street Salvage, which purchased it for $532.40. *See* Record page 262, *see also* Record Volume 7, PX 23. Mr. Morton, the Chapter 7, Trustee learned of this unauthorized sale of estate property and was able to intercept the check. *See* Record page 262. This guardrail was property of the bankruptcy estate. It was, however, neither scheduled nor exempted. The Trustee had not authorized the Appellant to dispose of the property, nor did the Appellant ask his permission. *See* Record page 262. It was not property over which the Appellant could unilaterally exercise dominion or control.

The Horse Justalena Peppy Dawn

As previously mentioned, the Appellant had granted the Bank a security interest in all his livestock. *See* Record pages 175 *et seq*. The October 25, 2002, security agreement specifically granted the Bank a lien on a horse named "Justalena Peppy Dawn". *See* Record page 185, *see also* Record Volume 4, PX 7(m). Shortly after granting the Bank this lien, the Appellant delivered the horse's registration papers to the Bank to hold. *See* Record page 184. Justalena Peppy Dawn was not found on the Appellant's ranch when the Bank's agents seized the collateral on January 5th. The horse was later found in the possession of one Tim Broadfoot, another friend of the Appellant. *See* Record page 200.

The Appellant testified at his creditors' meeting about Justalena Peppy Dawn. He explained that the horse had been sold to one Billy Dean Wilson, the Appellant's friend, on October 20, 2002. *See* Record pages 218, 233, 289. However, the evidence shows that on October 23, 2002, *three days after the Appellant said he sold Justalena Peppy Dawn to Mr. Wilson*, the Appellant had presented the American Quarter Horse Association ("AQHA") a transfer report asking that he be shown as the horse's owner. *See* Record pages 415-416, *see also* Record Volume5, PX 16 (deposition page 8-10, deposition exhibit A, pages 27-28).

Moreover, in February 2003, the Appellant was apparently trying to sell this horse and asked the Bank for the registration certificates. *See* Record page 185. The Bank delivered the papers to the Appellant, who apparently took them with him to a horse event in Big Spring. *See* Record page 186. Faxes exchange between the Bank and the Appellant indicate the Appellant was still trying to sell that horse through at least April 2003. *See* Record pages 186-189. Russell Johnson also testified that approximately September 2003, he observed the Appellant riding this horse in an event in San Angelo, *see* Record pages 403-404, as did Mr. Barker. *See* Record page 851. The AQHA records show that when this case was filed the Appellant owned Justalena Peppy Dawn. *See* Record Volume 5, PX 16 (deposition pages 8-10, deposition exhibit pages 27-28).

The Horses Hickorys Up In Smoke and Colonel Stone

Among the other horses the Appellant owned were "Hickorys Up In Smoke" and "Colonel Stone". He scheduled these horses, but indicated they were being held for his children. *See* Record Volume 4, PX4 (Statement of Financial Affairs question 14 and exhibit SFA-14). These horses were seized by the Bank from the Appellant's ranch on January 5, 2004. Because he claimed these horses belonged to his children, on or about January 24, 2004, the Appellant requested that the Bank release these horses. *See* Record pages 208, 210. As part of his effort to get the Bank to release these two horses, on January

25, 2004, the Appellant presented the Bank with registration certificates from the American Paint Horse Association ("APHA"). *See* Record page 211. These certificates indicated that the Appellant had transferred the two horses to his children on May 10, 2002. *See* Record page 212, *see also* Record Volume 6, PX 17 (deposition page 2). However, the Bank learned that the request to change the recorded ownership of these animals was presented to the APHA on January 23, 2004, and that the Appellant provided the APHA with the dates of these alleged transfers. *See* Record page 213. The Appellant did not volunteer information about his recent transfer of registration to Mr. Sloan. *See* Record page 213. This request to change the registration was after the case had been filed and converted to Chapter 7.

Testimony at the Creditors' Meeting

The Debtor testified at his creditors' meetings. This testimony was under oath. *See* 11 U.S.C. §343. The Appellant was asked about his transfer of the tennis bracelet and about weapons other than the ones he had scheduled. *See* Record pages 292-293, 264. In that testimony he denied owning any other weapons, including any at Dr. Bailey's house, and testified that the tennis bracelet belonged to his mother.

Requirements of the Schedules and Statement of Financial

The Schedules and Statement of Financial Affairs Appellants are required to file under penalty of perjury requires the disclosure of all assets owned or being held by those Appellants. *See e.g.* Record Volume 4, PX 4 (Schedules A and B, Statement of Financial Affairs, question 14. The documents also require Appellants to disclose the disposition of any assets within one year from the time a case is filed. *See e.g.* Record Volume 4, PX 4 (Statement of Financial Affairs questions 5-8, 10). Furthermore, Appellants are required to answer truthfully under oath questions put to them at creditors' meetings held under 11 U.S.C. §341. *See* 11 U.S.C. §343.

Inter alia, as a result of the Appellant's:

a) failure to fully disclose all the weapons he owned;

b) failure to list the transfer of the tennis bracelet and .45 caliber pistol;

c) his unauthorized disposition of the damaged guardrail;

d) attempt to conceal his ownership of certain horses

the United States Trustee filed a complaint to deny the Appellant's discharge. Because Mr. Baum was the only person the United States Trustee believed was responsible for the acts alleged in the Complaint, only Mr. Baum was named as a defendant. After a trial on this Complaint, the Bankruptcy Court found for the United States Trustee on counts related to this failures and denied the Appellant a discharge of his debts. This meant his lawful creditors were free to attempt to collect what was owed to them outside the bankruptcy process.

The Defendant filed a motion for a new trial. After a hearing on that motion, the Bankruptcy Court found that the Appellant failed to identify any manifest error of law or any newly discovered evidence warranting a new trial. It also found that the Appellant failed to raise any of the grounds identified in Federal Rule of Civil Procedure 60, as incorporated by Federal Rule of Bankruptcy Procedure 9024, warranting relief from the judgment. It is from these two orders that the Appellant appealed.

ARGUMENT

I. Initial Observations Concerning the Appellant's Brief

Taken as a whole, it appears the Appellant contends the Bankruptcy Court erred by making findings against the manifest weight of the Evidence. It appears, however, the Appellant does not understand that a Bankruptcy Court's factual findings cannot be reversed or supplanted on appeal unless clearly erroneous. Federal Rule of Bankruptcy Procedure 8013. *See also First National Bank LaGrange v. Martin* (*In re Martin*), 963 F.2d 809 (5th Cir. 1992), *In re Anderson, 936 F.2d 199, 204 (*5th Cir.1991*)*

("The bankruptcy court is in the best position to judge the credibility of any witness who testifies under oath before it . . ."), *Matter of Texas Mortgage Services Corp., 761 F.2d 1068, 1078* (5th Cir.1985) ("We will not attempt to reassess the credibility of witnesses whom we have not had an opportunity to see on the stand"). What the Appellant appears to misapprehend most is the wide discretion the Bankruptcy Judge has when considering the evidence. Judge Jones was free to believe or disbelieve any or all of the testimony of any witness, and to give total, little, or no effect to any or all of the tangible evidence presented. It was required to weigh that testimony and evidence according to the beliefs it developed during trial, and to rule accordingly.

It is difficult to glean the Appellant's legal theories in support of reversing the decision below. For example, his Brief discusses how the Bankruptcy Court erred in making findings concerning facts and issues which are wholly unrelated to the Counts on which it found for the United States Trustee. *See e.g.* Appellant's Brief, page 1 (discussing how the United States Trustee waived the right to complain about schedules not being timely filed because the Appellant's spouse was not named as a defendant), *see also* Brief page 30 (discussing whether the Appellant had or had not validly guaranteed corporate debts to the Bank).[6] The Brief also intermixes facts and findings on the various Counts without ever identifying with specificity how the evidence the United States Trustee presented was insufficient to constitute a preponderance.

In general, the Brief is a series of confusing and self-serving statements, most of which chronicle the findings the Defendant wishes the Bankruptcy Court would have made, but did not. Taken in its entirety, the Brief appears to claim the Bankruptcy Court erred simply because it rejected the "I testified about it, and therefore it must be true" approach the Appellant takes in arguing his case. Furthermore, what the Appellant characterizes as factual "inconsistencies" does not invalidate the inferences or

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[6] To the extent the Appellant does not support issues and arguments in the general context of his notice of appeal, his identification of issues, and/or his Brief, the United States Trustee believes these have been waived.

conclusions the Court was entitled to make from the totality of evidence, particularly given that the United States Trustee's burden of proof was to a preponderance. Clearly, there was sufficient evidence and testimony to support a finding for the United States Trustee on the seven Counts identified in the Court's Opinion.

II. Applicable Law

A. Concealment, Transfer, and Removal of Assets

Debtors who file Chapter 7 bankruptcy seek a summary discharge of all dischargable debts. Provided that debtors *inter alia* fully list all their pre-petition assets, liabilities, and transactions, truthfully testify about their financial affairs, do not conceal any assets, and file their petition in "good faith", they will get that discharge. However, if debtors materially fail to *inter alia* list all assets, liabilities, and transactions, attempt to conceal property from the bankruptcy trustee, or fail to testify truthfully about their affairs, they can be denied their discharge. *See generally*, 11 U.S.C. §727(a). This means creditors are free to pursue those debtors even after their bankruptcy case has been fully administered and closed.

In the Appellant's case, and for the reasons set forth *supra*, the United States Trustee brought a complaint to deny the Appellant's discharge. The Bankruptcy Court found for the United States Trustee principally on two subsections of 11 U.S.C. §727(a); the subsection dealing with the transfer and concealment of assets, and the subsection dealing with making a false oath or account. As to the former, §727(a)(2) states in pertinent part:

> (a) The court shall grant the Appellant a discharge, unless–
>
> > (2) the Appellant, with intent to hinder, delay, or defraud a creditor or an officer of the estate charged with custody of property under this title, has transferred, removed, destroyed, mutilated, or concealed, or has permitted to be transferred, removed, destroyed, mutilated, or concealed--
> >
> > > (A) property of the Appellant, within one year before the date

> > of the filing of the petition; or
> >
> > (B) property of the estate, after the date of the filing of the petition;

The United States Trustee had the burden of proving the elements of §727(a) by a preponderance. *In re Womble*, 289 B.R. 836 (Bankr. N.D. Tex. 2003).

To succeed under §727(a)(2)(A) (pre-petition concealment) or §727(a)(2)(B) (post-petition concealment), a plaintiff must establish that: (1) the Appellant transferred, removed, or concealed, or permitted to be transferred, removed, or concealed; (2) property of (i) the Appellant within one year before the petition was filed [in the case of a pre-petition concealment - §727(a)(2)(A)] or (ii) property of the bankruptcy estate [in the case of a post-petition concealment - §727(a)(2)(B)]; (3) with the intent to hinder, delay or defraud the creditor. *In re Bastrom*, 106 B.R. 223 (Bankr. D. Mont.1989), *In re Martin*, 88 B.R. 319 (D. Colo.1988). Any transfer of interest in property, including a transfer of possession, custody, or control in the absence of any transfer of title, qualifies as a "transfer" within the meaning of §727(a)(2) . *In re Golob*, 252 B.R. 69 (Bankr. E.D. Va. 2000). This includes property of which Appellant has possession, either actual or constructive, and is not limited to property titled in the Appellant's name.

To prove an act of "concealment" within the meaning of §727(a)(2), it must shown that Appellant placed assets beyond the reach of creditors or withheld knowledge of assets by failing or refusing to divulge information to which creditors were entitled. *In re Hayes*, 229 B.R. 253 (1st Cir. BAP 1999).

B. False Oath or Account

As for dealing with a false oath or account, §727(a)(4) further states in pertinent part:

> (a) The court shall grant the Appellant a discharge, unless--
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> > (4) the Appellant knowingly and fraudulently, in or in connection with the case--
> >
> > > (A) made a false oath or account....

To prevail under §727(a)(4)(A), a plaintiff must prove by a preponderance that a) the Defendant made a statement under oath, b) the statement was false, c) the Appellant knew the statement was false, d) the Appellant made the statement with fraudulent intent, and e) the statement materially related to the bankruptcy case. *Beaubouef v. Beaubouef*, (*In re Beaubouef*), 966 F.2d 174 (5th Cir. 1992), *Morton v. Dreyer* (*In re Dreyer*), 127 B.R. 587 (Bankr. N.D. Tex.1991). A false oath can include testimony given at a creditors' meeting or information listed in or omitted from the Appellant's schedules or statement of financial affairs. *In re Korte*, 262 B.R. 464 (8th Cir. BAP Iowa 2001). False testimony at a hearing can constitute a false oath for purposes of 11 U.S.C. §727(a)(4)(A). *See e.g. In re Wallace*,289 B.R. 428 (Bankr. N.D. Okla. 2003), *In re Bujak*, 86 B.R. 30 (Bankr. W.D. N.Y. 1986), *Matter of Hussan*, 56 B.R. 288 (Bankr. E.D. Mich. 1985).

C. The Intent Elements of §727(a)

A plaintiff can demonstrate the intent elements of §727(a) by circumstantial evidence. *Pavy v. Chastant* (*In re Chastant*), 873 F.2d 89 (5th Cir. 1989). Fraudulent intent, or the intent to hinder, delay, or defraud may be inferred from certain "badges of fraud" which include, but are not limited to:

a) the lack or inadequacy of consideration;

b) the family, friendship, or close association between the parties to a transaction;

c) the retention of possession, benefit, or use of the property in question;

d) the financial condition of the party both before and after the transactions in question;

e) the existence or cumulative effect of the pattern or series of transactions or course of conduct after the onset of financial difficulties; and/or

f) the general chronology of the events and transactions.

In re Womble, *supra*. Any one or more of these factors may be sufficient to find actual fraudulent intent, and an accumulation of several such factors strongly indicates that the Appellant possessed the requisite intent. *FDIC v. Sullivan* (*In re Sullivan*), 204 B.R. 919 (Bankr. N.D. Tex. 1997), *Cullen Center Bank &*

Trust v. Lightfoot (*In re Lightfoot*), 152 B.R. 141 (Bankr. S.D. Tex. 1993), *Sholdra v. Chilmark Fin., L.L.P.* (*In re Sholdra*), 249 F.3d 380 (5th Cir. 2001). *See The Cadle Company v. Mitchell* (*In re Mitchell*), 2003 WL 22016948 (N.D. Texas 2003). Fraudulent intent may also be shown by a Appellant's reckless indifference to the truth. *In re Krich,* 97 B.R. 919 (Bkrtcy.N.D.Ill.1988).

III. There is more than sufficient evidence from which the Court could find by a preponderance that the Appellant, with the intent to hinder, delay, and/or defraud creditors, transferred numerous articles of person property and horses in violation of 11 U.S.C. §727(a)(2)(A) and (B)

It is axiomatic that when this case was filed all the Appellant's property, regardless of where located or the character of the Appellant's interest in that property, became property of the Appellant's bankruptcy estate. *See* 11 U.S.C. §541. After the case's conversion to Chapter 7, the Appellant lost all legal right to unilaterally convert, transfer, or otherwise effectuate any disposition of any of his property.

Counts 5 and 6 of the United States Trustee's Complaint allege under §727(a)(2)(A) and (a)(2)(B) that the Appellant's removal and concealment of *inter alia* the Preifert portable arena, other weapons, and the damaged guardrail property violated §727(a)(2)'s prohibition against the removal and concealment of estate property.[7] The evidence clearly shows that in addition to the horses (which are the subject of additional counts, *see infra*), the Appellant removed, transferred, or concealed the portable arena, weapons, and guardrail.

A. Portable Arena

With respect to the portable arena, there was ample evidence from which the Bankruptcy Court could find that the Appellant owned the arena when he filed the case, that he attempted to conceal his

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[7] These Counts also allege that the Appellant removed and/or concealed the .45 caliber pistol and the tennis bracelet. The Bankruptcy Court found that the Appellant had neither illegally removed nor concealed these items, as their sale was for valuable consideration. However, the Bankruptcy Court also found culpable the Appellant's failure to disclose the transfers. *See infra*.

ownership, and that he attempted to conceal the arena from both the Bank and the Trustee:

a) the receipt showing he purchased the arena, *see* Record Volume 11, Exhibit 4;

b) the original Schedules wherein Appellant identified himself as owner of the arena, *see* Record Volume 4, PX 4, Schedule B, Exhibit B-31;

c) the arena appeared on a person financial statement the Appellant published, *see* Record Volume 11, Exhibit 4, page 3;

d) that he was in possession of the arena when the case was converted to Chapter 7, *see* Record Page 199;

e) the testimony of Mr. Sloan that arena was on the ranch at the time of foreclosure, *see* Record page 199;

f) that he caused it to be removed from his property, *see* Record Page 436;

g) testimony of John Curtis that Appellant asked him to hold the arena, *see* Record pages 434-438; and

h) testimony of Russell Johnson denying having accepted or having possession and/or control over the arena), *see* Record pages 399-401, 410.

By removing the arena or permitting its removal after a) the case was filed, b) after the case was converted to Chapter 7, and c) after the Bank was given authority to seize its collateral, the Appellant knowingly removed and concealed the arena from both the Bank and/or the Trustee, either of which were entitled to possess it. There was more than sufficient evidence from which the Court could derive this conclusion.

That this was done with the intent to hinder, delay, or defraud is evident from those same facts:

a) Mr. Johnson, a friend of the Appellant's, disavowed ever owning or possessing it the arena;

b) it was removed post-petition and post-conversion from the Appellant's property at the Appellant's direction by Mr. Curtis, another of the Appellant's friends;

c) there was no consideration paid for this arena;

d) it was still within the Appellant's possession and control up until the time it was moved;

e) the Appellant remained constructively under his control while it was in Mr. Curtis's possession;

f) it was never delivered to Mr. Johnson;

g) it was allegedly disposed of during financially troubled times; and

h) it was originally scheduled as owned by the Appellant.

These collective circumstances are clear indicia that the Appellant's claim to have transferred the arena was fiction. Moreover, under the prevailing standards for surmising fraudulent intent, they are sufficient "badges" of fraud from which the Bankruptcy Court could infer a fraudulent intent to hinder, delay and defraud.

Even if the Bankruptcy Court were to have accepted the Appellant's explanation that he had given the arena to Mr. Johnson by the time this case was either filed or converted, he had not consummated the gift with delivery. This is a necessarily act in order to effectively transfer legal title. *See e.g. Estate of Kuenstler v. Trevino*, 836 S.W.2d 715 (Tex.App.-San Antonio1992). Therefore, the Appellant's explanation fails.

Furthermore, the facts belie his claim. The Appellant's original Schedules claimed he owned the arena, and that Mr. Johnson was neither a creditor nor a person to whom payment was made within 90 days preceding the petition's filing. *See* Record Volume 4, PX 4 (Statement of Financial Affairs). Additionally, neither the original or amended SOFA identify the arena's transfer as one occurring in the year prior to the case's filing. This alleged gift also occurred after the Appellant had retained counsel, thus giving the Appellant an opportunity to consult with counsel prior to effectuating the alleged gift. Had his attorney's advice been sought, the attorney would likely have recognized that the gift had not and/or could not have been legally consummated, and would have advised against the Appellant acting as he claims. These factors are additional badges of fraud from which the Bankruptcy Court could find that the Appellant removed and concealed the arena with fraudulent intent. The collective effect of these facts and circumstances can easily lead to the conclusion that the Appellant fraudulently attempted to conceal the arena. The Appellant's present claim that this finding is clearly erroneous is without merit.

B. Damaged Guardrail

Similarly, there is ample evidence the Appellant permitted the post-petition, post-conversion removal of a quantity of damaged guardrail from his ranch. There was testimony that while on his ranch the Appellant met the truck picking-up the guardrail, directed it to the guardrail's location, identified what guardrail was to be removed, and permitted its removal. *See* Record pages 445-447 (testimony of Mason Cullins). The Trustee also testified that he neither knew about nor authorized the guardrail's removal or sale. *See* Record Page 262 (testimony of Mr. Morton). Again, there was no credible or substantiated evidence that this guardrail did not become property of the estate when the case was filed. Even if the Appellant had formed the intent pre-petition to gift this property, the gift was not consummated with delivery, thus causing the guardrail to remain property of the estate. *See Estate of Kuenstler v. Trevino*, *supra*. Post-petition, and especially post-conversion, the Appellant was without any authority to transfer or dispose of the guardrail. The Appellant's intent to hinder, delay, or defraud in trying to dispose of the property can be inferred from the fact that:

> a) Terry Gardner, the putative donee, has made no claim to the proceeds of sale, *see* Record page 261-263 (testimony of Mr. Morton);
>
> b) that the Appellant failed to consult the Trustee or any other party-in-interest before attempting to dispose of the guardrail, *see* Record page 262;
>
> c) that the guardrail was in the Appellant's possession and control when the case was filed;
>
> d) that the disposition was done during financial troubles; and
> e) Mr. Gardner is not listed as a creditor, the recipient of a payment within 90 days, or the recipient of a transfer within the year before the case commenced. *See* Record Volume 4, PX 4 (Statement of Financial Affairs).

And as with the portable arena, the Appellant caused or allowed the property to be removed after counsel had been retained, and after the Appellant filed his schedules (both original and amended) wherein he does not show the guardrail as property being held for another.

Causing or permitting this guardrail to be removed and sold, either directly or though Mr. Gardner, was a post-petition transfer which removed and concealed property of the estate from the Trustee. The collective effect of this evidence can easily lead to the conclusion that the Appellant fraudulently attempted to conceal and dispose of the guardrail. The Appellant's claim that this finding is clearly erroneous is without merit.

C. Undisclosed Disposition of Weapons

There was also ample evidence that the Appellant owned more weapons than were disclosed on his schedules or discussed in his SOFA. There was also ample evidence that he removed, concealed, and/or transferred those weapons with the intent to hinder, delay, and/or defraud. Specifically, the Court found credible the testimony of Dr. Bailey, a friend of the Appellant, who stated that the Appellant had a large collection of weapons at his house after he purchased the house from the Appellant in June 2001. *See* Record page 372 (testimony of Dr. Bailey).[8] At the time, the Appellant neither did nor said anything to indicate these were not his weapons. *See* Record page 373 (testimony of Dr. Bailey). He thereby created at least the belief, if not a tacit representation of the actual fact, that these were really his weapons.

Moreover, there were at least two occasions between September 2003 and January 2004 when the Appellant is known to have appeared at Dr. Bailey's house and removed weapons. *See* Record pages 374-375 (testimony of Dr. Bailey), Record pages 391-395 (testimony of Maria Hurtado). Dr. Bailey testified that as of January 2004, the weapons had been removed. *See* Record page376. Since the Appellant did not credibly explain the loss or whereabouts of all the weapons in the safe, the Bankruptcy Court determined that those weapons were there when this case was filed, or were at least subject to the Appellant's possession and disposition at times which should have been discussed on the SOFA. The Court noted that the Appellant listed only three weapons on his schedules, far less than the amount Dr.

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[8] In his deposition Dr. Bailey initially testified there may have been as many as 65 guns in the safe when it bought the safe. However, at trial he indicated he had since counted and found the safe to have 24 spaces for storing rifles and a shelf for pistols. *See* Record pages 373,377.

Bailey said the Appellant had in the safe.

However, Dr. Bailey’s testimony does not stand alone. It is supported by Mr. Neal’s testimony that about the time he purchased the Appellant’s .45 caliber Colt (shortly before this case was filed) the Appellant had let it be known he had other weapons for sale over and above those scheduled. Mr. Neal testified that by the time he told the Appellant he was interested in purchasing other weapons, there were apparently no more available. *See* Record pages 148-150 (testimony of Mr. Neal). No sales of weapons other than those already sold to Mr. Neal appeared on the Schedules and SOFA. Even if the Court accepted the explanation that these were not his weapons, the Appellant’s schedules do not identify any weapons as being held for others. *See* Record Volume 4, PX 4, (Statement of Financial Affairs, question 14).

Moreover, both Dr. Bailey’s and Mr. Neal’s testimony is supported by the testimony of Mr. Barker. He testified that shortly before this case was filed, both he and the Appellant went to Dr. Bailey’s house to view and negotiate for the purchase of the .45 caliber Colt. *See* Record page 839 (testimony of Mr. Barker). After the Appellant opened the safe, Mr. Barker observed the safe to be full of weapons, mostly rifles. *See* Record pages 837-840 (testimony of Mr. Barker). The Appellant neither did nor said anything to cause Mr. Barker to believe these weapons were not his. *See* Record page 840 (testimony of Mr. Barker). Based on the testimony of these four witnesses, it can hardly be said there was insufficient evidence from which the Court could find that the Appellant owned more weapons than were shown on his schedules.

As for the Appellant’s intent in not disclosing the weapons, the Court again looked to the surrounding circumstances for indicia of fraudulent intent;

> a) the Appellant sold the .45 caliber Colt to a friend at a time when he was under severe financial distress;
>
> b) he had left other weapons with another friend under circumstances where it was

> unlikely anyone would know about their existence;
>
> c) there is no record of this or any other transactions of weapons, and the private ownership and sale of weapons is generally unregistered and untraceable;
>
> d) the Appellant also continued to exercise control over those weapons, as he was able to effectuate their disappearance and/or disposition at times relevant to this case; and
>
> e) other than later claiming that his 8 year-old son owned some of these large and powerful weapons, he did not volunteer anything in his testimony to suggest that the weapons in the safe as of June 2001 belonged to anyone other than himself.

Without credible evidence to contradict facts which strongly suggested that these weapons actually belonged to the Appellant, and having been directly asked about weapons and given ample opportunity to amend his schedules, the Court found sufficient indicia that the Appellant's failure to disclose his ownership and disposition of these weapons was done knowingly and fraudulently. Without doubt, the collective effect of this evidence can easily lead to the conclusion that the Appellant fraudulently attempted to conceal and dispose of undisclosed weapons. The Appellant's claim that there is insufficient evidence to support this finding is clearly without merit.

D. The Horses Justalena Peppy Dawn, Colonel Stone, Hickorys Up In Smoke, and Tari Gay Diamond

As relevant to this appeal, the Court found for the United States Trustee on Count 7 of the Complaint. That count alleged, and the Court found the Appellant's attempted concealment of his ownership of "Hickorys Up In Smoke" and "Colonel Stone" culpable under §727(a)(2)(A). The Bankruptcy Court also found for the United States Trustee on Counts 12 and 16 of the Complaint. Those Counts alleged, and the Court found that the Appellant's attempt to conceal his ownership of the horses, "Tari Gay Diamond",[9] and "Justalena Peppy Dawn" was culpable under §727(a)(2)(A) and §727(a)(2)(B).

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[9] Other than indicating Tari Gay Diamond was purportedly sold pre-petition, the Bankruptcy Court's Opinion did not detail the sale the Appellant claimed to have made. The Appellant claimed in both his Schedules and creditors' meeting testimony to have sold the horse Tari Gay Diamond pre-petition to another friend, L.P. Carter. However, this horse was found on the Appellant's ranch during the January 5th seizure. There were no records produced at trial to memorialize the sale. Mr. Carter tried to claim this horse from the Bank after the seizure. Ultimately, the Bank filed suit in State court to "quiet title" to the horse. The Bank was awarded "title" to this horse.

Again, it is axiomatic that these horses become property of the estate when the case was filed. 11 U.S.C. §541. Documents from the AQHA and APHA clearly show that the Appellant had owned these horses.[10] *See* Record page 415-416, *see also* Record Volume 5, PX 16 (deposition pages 8-10, deposition Exhibit A, pages 27-28, Record Volume 5, PX 17 (deposition pages 2-3, deposition Exhibit A, pages 37-39, 46-48. Thereafter, the Appellant claims to have transferred these horses. However, the Court did not find these claims credible. Rather, the Court had before it evidence that the Appellant failed to schedule Hickorys Up In Smoke and Colonel Stone as being held for another, and that he attempted to "back-date" the purported transfers, *see* Record Volume 5, PX 17 (deposition pages 2-3). It also had before it evidence that:

> a) he registered Justalena Peppy Dawn into his name after the date he testified he sold the horse to someone else, *see* Record pages 415-416;
>
> b) that he pledged the horse to the Bank after the purported sale, *see* Record page 185 (security agreement), *see also* Record Volume 4, PX 7(m);
>
> c) that after he purportedly sold the horse he represented to the Bank that he was again trying to sell the horse, *see* Record pages 185-189 (testimony of Mr. Sloan), Record Volume 7, PX 25;
>
> d) that he continued to use the horse after he purportedly sold it. *See* Record pages 403-405 (testimony of Mr. Johnson) and Record page 851 (testimony of Mr. Barker);
>
> e) Tari Gay Diamond, Colonel Stone, and Hickorys Up In Smoke were all in his possession, *see* Record page 205 (testimony of Mr. Sloan), and Justalena Peppy Dawn was in the possession of a friend.

With only the Appellant's testimony to contradict that of these witnesses, there is ample evidence before the Court to conclude that the Appellant owned these horses when the case was filed. His attempts to cover that ownership constituted the concealment for purposes of §727(a)(2).

That the Appellant's attempt to conceal the horse's true ownership was done with the intent to

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[10] The United States Trustee agrees with the Appellant that registration and registration certificates alone do not establish ownership. They are, however, <u>indicia</u> of ownership which the Court can consider in assessing whether or not the Appellant owned the horses during the time in question.

hinder, delay, or defraud is again evident from the circumstances;

> a) Tari Gay Diamond, Colonel Stone, and Hickorys Up In Smoke were in the Appellant's possession at the time of seizure;
>
> b) Justalena Peppy Dawn was being held by a friend;
>
> c) these horses had been purportedly transferred to friends or family members for no apparent consideration or were allegedly transferred for cash;
>
> d) there are no records evidencing these transfers which were made contemporaneously with the transfers, and virtually no means to confirm the Appellant's story;[11]
>
> e) With respect to "Hickorys Up In Smoke" and "Colonel Stone", the Appellant did not schedule these horses as being held for his children, despite contending that he had gifted them more than a year and one-half prior;
>
> f) he did not volunteer to Mr. Sloan his recent change in the registration when he requested the Bank to release these horses;
>
> g) In the case of "Tari Gay Diamond", he did not volunteer his attempt to change the registration, even though the Bank knew the AQHA had refused to "back-date" the change of registrations; and
>
> h) he had continued use of Justalena Peppy Dawn after the purported transfer and shortly before this case was filed.

Based on the foregoing, there is more than sufficient evidence from this the Court can conclude by a preponderance that the concealment was done with a fraudulent intent to hinder delay, or defraud. Though the Appellant attempts to "nit-pick" the witnesses testimony, he points to no manifest error or omission in the Bankruptcy Court's analysis. On the joint and several Counts, there was sufficient evidence from which the Court could conclude that the Appellant concealed and/or removed weapons, the .45 Colt, the guardrail, and the horses with fraudulent intent, and that this warranted denying his discharge under §727(a)(2)(A) and or §727(a)(2)(B).

IV. There was more than sufficient evidence from which the Court could find that

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[11] It is somewhat hypocritical that the Appellant now argues how a horse's registration is not proof of ownership, when, at the time he tried to secure the horses' release from the Bank, he attempted to use those certificates for exactly that proposition.

by a preponderance that the Appellant made a false oath and account under 11 U.S.C. §727(a)(4) when he failed to disclose certain transfers, and when he failed to testify about those transfers at his creditors' meeting.

The Bankruptcy Court found for the United States Trustee on Count 20 and 21 of the Complaint. As relevant to this appeal, these Counts alleged under §727(a)(4)(A) that the Appellant knowingly and fraudulently made a false oath when he testified at the creditors' meetings about not owning any weapons other than those scheduled, and about having not sold or transferred any property (other than what is disclosed on the SOFA) outside the ordinary course of business in the year preceding the case.

Again, the Bankruptcy Court was free to accept or reject any or all of any witness's testimony, and to give whatever weight it felt appropriate to any or all evidence. As has been explained, there was more than sufficient evidence to show the Appellant owned and disposed of more property than he disclosed. *See supra*. It is highly unlikely a person would admit to disposing of certain items of his personal property while also maintaining that he never owned it. The Court's giving credibility to other witnesses' testimony instead of the Appellant's is not clearly erroneous. This other testimony provides a substantial basis for a finding of culpability in the Appellant's failure to disclose ownership and/or disposition of those assets, particularly when there is an affirmative duty to disclose such ownership and/or dispositions.

A. Undisclosed Ownership and Disposition of Weapons and .45 Caliber Pistol

Having found that the Appellant a) owned more weapons when this case was filed than were disclosed on his schedules, b) that he effectuated an undisclosed transaction of those weapons, and c) that he sold a .45 caliber Colt during a time when such transactions must be disclosed on the SOFA, the Court went on to find that the Appellant made a false oath when he filed the schedules and the SOFA which omitted information concerning the ownership and transaction of these weapons. *See* Record Volume 4, PX 4 (Schedule B question 8, and Statement of Financial Affairs question 10). There the Appellant scheduled only 3 weapons and the pre-petition transfer of only certain weapons, not including the kind witnesses indicated were in the safe, and not a sale of a .45 caliber Colt. Additionally, the Court had evidence that the Appellant testified, albeit falsely, at the creditors' meeting that he did not own other weapons, was not holding weapons for others, and/or had not transferred any weapons. *See* Record pages 292-293 (testimony of Mr. Harris), Record page 264 (testimony of Mr. Morton). For the same reasons and from the same circumstances surrounding the underlying transactions, the Court also inferred the Appellant's intent to defraud in making these statements. Any one of these false oaths warrants denying his discharge under §727(a)(4)(A).

The Appellant disputes that he owned or disposed of any weapons other than those shown on his schedules. But as discussed *supra*, the Appellant fails to show how the Bankruptcy Court's findings about his having owned and disposed of other weapons was clearly erroneous. Until that is shown, there is little "room" for the Appellant to argue that there was a concomitant and clearly erroneous finding that he fraudulently made a false oath and account about his ownership and disposition of the weapons.

Interestingly, the Appellant does not dispute the fact that the sale of the .45 caliber Colt occurred, or that the sale was not disclosed on his schedules. Even if this Court were to find the Bankruptcy Court's findings about the Appellant's ownership of additional weapons clearly erroneous, the failure to disclose the sale of the .45 caliber Colt on the SOFA and his false testimony about not having made such a sale was sufficient false oath or account to deny his discharge. *See Mitchell, supra, see also United States Trustee v. Moschella* (*In re Moschella*), Case No. 04-4055 (Bankr. N.D. Tex. Aug. 9, 2004).

B. Undisclosed Disposition of the Tennis Bracelet

The Appellant failed to schedule his disposition of the diamond tennis bracelet. Although it is unclear whether this sale occurred pre- or post-petition, it occurred. There is no dispute over this fact. There is also no dispute that it was not scheduled. *See* Record Volume 4, PX 4 (Statement of Financial

Affairs, question 10). Standing alone, the failure to schedule the sale was a false oath and account for §727(a)(4) purposes. That the failure to disclose this transaction was done fraudulently was inferred from the circumstances;

a) the sale occurred at a time the Appellant was under sever financial distress;

b) it was facilitated by a friend of the Appellant;

c) it was done in cash;

d) it is not the kind of property typically bought with cash; and

e) it was not memorialized by any check, receipts, or any other documentation.

It appears the Appellant's chief complaint about the Bankruptcy Court's finding that he should have disclosed the bracelet's sale is that the bracelet was not his. However, the mother testified that she gave the Appellants the bracelet with donative intent, she delivered it to them, and had no expectation that it be returned. *See* Record pages 883-884. As the Bankruptcy Court pointed out in the Appellant's closing argument, *see* Record pages 924-925, at the time of delivery, all the elements of a gift had been met and the watch became his. That he did not comprehend the import of his receipt and subsequent sale does not mitigate against its legal effect. More importantly, he should have disclosed the transaction regardless of what he believed rather than making a legal decision on his own about the effect. *See e.g. FDIC v. Sullivan* (*In re Sullivan*), *supra* (if a Appellant is uncertain as to whether certain assets are legally required to be included in his petition, it is his duty to disclose the assets so that any questions may be resolved). That he chose not to disclose the transaction when there was any question of its legal effect is yet another circumstance from which the Court could construe fraudulent intent. Since the Appellant does not and cannot dispute that the sale of the bracelet occurred, and that the sale was not disclosed on the SOFA, he cannot assert the Bankruptcy Court's findings on this issue was clearly erroneous. Without being clearly erroneous, there is no error in the Bankruptcy Court's factual finding.

Conclusion

For these reasons, the United States Trustee respectfully asks this Court to affirm the order entered below denying John C. Baum a chapter 7 discharge..

DATED: February 7, 2006

Respectfully submitted,
WILLIAM T. NEARY
UNITED STATES TRUSTEE

William S. Parkinson
Ohio Bar Registration 0021679
Office of the United States Trustee
1100 Commerce Street Room 976
Dallas, Texas 75242
(214) 767-8967

CERTIFICATE OF SERVICE

I do hereby certify that on February 7, 2006, a true copy of the foregoing document was forwarded by first class United States mail to the following persons:

John C. Baum
P.O. Box 762
Coleman, Texas 76834

William S. Parkinson

BRIEF BANK — 'SUMMARY SHEET" *Printed Fri-10/13/06 11:19*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE
[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]
Baum v UST (In re Baum)

2. ("CO") ***CURRENT*** COURT
[E.g., "CTA9"]
CTA5

3. ("CCN") ***CURRENT*** CASE NO.
No.: 06-10620

4. ("PCN") ***PRIOR*** CASE NO. & COURT
[IF ANY]
No.: 6 :05-CV-076
Court: DC ND Texas
(Identify judge & cite, if any)

5. ("SO") ***SOURCE***
U.S. TRUSTEES

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF
[E.g., "Opening Brief," "Reply," "Amicus," etc.]
Filed: October 2006
Type: Brief of the UST

7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*
William S. Parkinson
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s)
&
√ Any Miscellaneous ***BACKGROUND***

• 1) Whether the District Court erred in finding that the Bankruptcy Court had sufficient evidence to conclude that the Appellant, with fraudulent intent transferred numerous items in violation of 11 U.S.C. §727(a)(2)(A) and (B).
2) Whether the District Court erred in finding that the Bankruptcy Court had sufficient evidence to conclude that the Appellant fraudulently made a false oath in violation of 11 U.S.C. §727(a)(4)(A).

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Case No. 06-10620

IN THE UNITED STATES COURT OF APPEALS
FOR THE 5TH CIRCUIT

JOHN C. BAUM
APPELLANT

V.

US TRUSTEE
APPELLEE

Appeal from the United States District Court
for the Northern District of Texas
San Angelo Division
Case No. 6:05-CV-076C

BRIEF OF THE UNITED STATES TRUSTEE

WILLIAM T. NEARY
UNITED STATES TRUSTEE
WILLIAM S. PARKINSON
TRIAL ATTORNEY
UNITED STATES TRUSTEE
United States Department of Justice
Office of the United States Trustee
1100 Commerce St.
Room 976
Dallas, Texas 75242
(214) 767-8967

CERTIFICATE OF INTERESTED PERSONS

The parties interested in the outcome of this appeal are:

John C. Baum
P.O. Box 762
Coleman, Texas 76834

Harvey Morton, Trustee
P.O. Box 10305
Lubbock, Texas 79408

United States Trustee
1100 Commerce St.
Room 976
Dallas, Texas 75242

William S. Parkinson

STATEMENT REGARDING ORAL ARGUMENT

This appeal is essentially premised on the Appellant's contention that both the Bankruptcy Court's and District Court's decisions were against the manifest weight of the evidence. The Appellant advances neither errors of law nor novel legal theories. The evidence on which those decisions were based clearly appear in the trial court record. This Court can fully assess from that record whether there was sufficient evidence to support those Courts' findings. The United States Trustee believes oral argument is unnecessary.

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STATEMENT OF JURISDICTION

The Debtor filed a voluntary petition under §301 and §1101 *et seq*. of Title 11 of the United States Code.[1] The bankruptcy court had jurisdiction under 28 U.S.C. §§ 157(a) and (b), and 1334(a) to hear the underlying case and the adversary complaint brought under 11 U.S.C. §727(a). The bankruptcy court's adjudication of that complaint constituted a final and immediately appealable order. See In re Koch, 109 F.3d 1285, 1287 (8th Cir. 1997), In re Christian, 804 F.2d 46, 47-48 (3d Cir. 1986). The Defendant timely filed a notice of appeal from that order to the District Court. The District Court had jurisdiction to hear the appeal under 28 U.S.C. § 158(a). The district court affirmed, and the Defendant timely filed a notice of appeal to this Court. This Court has jurisdiction to hear the appeal under 28 U.S.C. § 158(d) and §1291.

STANDARD OF REVIEW

The issues raised in this particular appeal are solely questions of fact. Questions of fact will not be reversed unless found to be clearly erroneous. *See* Fed. R. Bankr. Pro. 8013.

STATEMENT OF ISSUES TO BE PRESENTED

1) Whether the District Court erred in finding that the Bankruptcy Court had

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[1] The case was subsequently converted to a case under Chapter 7, 11 U.S.C. §701 *et seq.*

sufficient evidence to conclude that the Appellant, with fraudulent intent transferred numerous items in violation of 11 U.S.C. §727(a)(2)(A) and (B).

2) Whether the District Court erred in finding that the Bankruptcy Court had sufficient evidence to conclude that the Appellant fraudulently made a false oath in violation of 11 U.S.C. §727(a)(4)(A).

STATEMENT OF THE CASE

The Appellant filed a voluntary *pro se* Chapter 11 petition on November 4, 2003. On December 12, 2003, the Bankruptcy Court converted this case to Chapter 7. The U.S. Trustee timely filed a complaint seeking under 11 U.S.C. §727 to deny the Appellant's discharge. The Complaint, as amended, alleged 21 counts under §727. Trial was held over several days in October and November 2004. On March 30, 2005, the Bankruptcy Court entered its Memorandum Opinion finding for the U.S. Trustee on seven of those counts. On April 4, 2005, the Bankruptcy Court entered an Order denying the Appellant's discharge. On April 15, 2005, the Appellant filed a motion for a new trial. On July 21, 2005, after a hearing on that Motion, the Bankruptcy Court denied the Appellant a new trial. The Appellant appealed that decision to the U.S. District Court. On March 21, 2006, the District Court issued its Opinion and Order affirming the Bankruptcy Court's decision in all respects. The Appellant now appeals the District Court's March 21, 2006, decision.

STATEMENT OF FACTS

General Background[2]

Prior to filing bankruptcy, the Appellant was engaged in the repaire of roads and highways. The Appellant was also involved in a variety of avocational activities, including the owning, breeding, and training of horses. The Appellant periodically bought and sold horses, but also used some horses to participate in roping and other rodeo activities. He practiced for these activities in a Preifert portable arena he owned and kept on his ranch. *See infra*. Most of the horses he owned were registered quarter and paint horses.

Starting on or about December 16, 1998, the Appellant and First Coleman National Bank ("Bank") entered into what became a series of loans and security agreements. *See* App. Record Vol. 2, pages 161-179, *see also* Plaintiff's Exhibit Vol. 4, Exhibit 6(a)-6(q), PX 7(a)-(p). These transactions stretched over the next several years and culminated in the Appellant owing the Bank $2,216,064.04. Through these contracts, the Appellant had given the Bank encumbrances on *inter alia* a ranch of approximately 392 acres, virtually all his other personal property, equipment, vehicles, fixtures, and livestock, including, 29 specifically identified horses. One of these was

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[2] This case is extremely fact intensive. It involves numerous transactions concerning various items of personal property and horses. The Statement of Facts will only identity facts relevant to the Counts of the Complaint on which the Court found for the U.S. Trustee and will be presented topically rather than chronologically.

a horse was named “Justalena Peppy Dawn”, *see infra*.

Beginning approximately June 2000 the Appellant began having financial difficulties. *See* App. Rec. Vol. 2, page 192. The Bank began to pressure the Appellant for payments. Despite receiving additional loans and concessions from the Bank, his troubles continued. Ultimately, these defaults and the Bank’s pressure led the Appellant to file a voluntary Chapter 11 proceeding on November 4, 2003.

PRE-PETITION TRANSACTIONS

Diamond Tennis Bracelet

Several years before filing this case, the Appellant purchased for his wife a diamond tennis bracelet from Keith Neal, a pawn store owner in Brownwood, Texas. *See* App. Rec. Vol. 2, pages 144-146. Sometime thereafter, Mrs. Baum developed medical problems which required the Appellant’s mother to care for their children. To repay those services, the Appellant and Mrs. Baum gave Mrs. Baum’s mother the bracelet. *See* App. Rec. Vol. 3, pages 575, Vol. 4, page 883. As the Appellant’s financial problems deepened, Mr.s Baum’s mother gifted the bracelet back to the Appellants, *see* App. Rec. Vol. 4, page 883, without any expectation that she get it or the proceeds from its sale. *See* App. Rec. Vol. 4, page 884. Approximately two weeks before this case was filed, the Appellant resold the bracelet to Mr. Neal for $2,500.00. *See* App. Rec. Vol. 2, pages 146-148. The Appellants Statement of Financial Affairs (“SOFA”) required him to disclose all transfers of assets within the year prior to filing of his case. The Appellant did not disclose the sale of the tennis bracelet. *See* Plaintiff's Exh. Vol. 4, Exhibit 4 (SOFA, questions 6-7, 10), Exhibit 5 (SOFA, questions 6-7, 10).

Weapons

Approximately a year before filing this case, the Appellant sold the house he lived in to Dr. Bailey, one of his friends. *See* App. Rec. Vol. 3, page 369. In a separate transaction done about the same day, the Appellant also sold Dr. Bailey a large steel gun safe which he left at Dr. Bailey's house. *See* App. Rec. Vol. 3, pages 369-370. When Dr. Bailey bought the safe he observed it to be full of guns, mostly rifles. *See* App. Rec. Vol. 3, page 372. Dr. Bailey originally estimated the number of weapons at between 60 and 65, but later learned the safe had spaces for 24 rifles and a shelf for pistols. *See* App. Rec. Vol. 3, pages 373, 377. At the time of this sale the Appellant said or did nothing to suggest that these weapons belonged to anyone other than himself. *See* App. Rec. Vol. 3, page 373. Only Dr. Bailey's wife and the Appellant knew how to open the safe. *See* App. Rec. Vol. 3, page 371. Between September 2003 and January 2004, just before and two months after he filed bankruptcy, the Appellant came to Dr. Bailey's house at least two times and removed guns from the safe. Once he was observed by Dr. Bailey, *see* App. Rec. Vol. 3, pages

374-375, and once by Maria Hurtado, Dr. Bailey's housekeeper. *See* App. Rec. Vol. 3, pages 391-395. Approximately January 2004, Dr. Bailey observed the open safe and found it to contain only the few weapons he (Dr. Bailey) owned. *See* App. Rec. Vol. 3, page 376.

As the Appellant's financial troubles continued, he let it be known in the community he had weapons in a safe for sale. *See* App. Rec. Vol. 2, pages 148-149, Vol 4, page 835. Several weeks before this case was filed, Mr. Barker, then a friend of the Appellant, went with the Appellant to Dr. Bailey's house to examine a .45 caliber pistol he was considering purchasing. *See* App. Rec. Vol. 4, pages 839-840. Although Mr. Barker and the Appellant could not agree on a price, Mr. Barker observed the safe to be full of weapons. *See* App. Rec. Vol. 4, pages 837-840. Mr. Barker also indicated he did not purchase the gun because the Appellant told him he intended to file bankruptcy, and Mr. Barker believed it was too close to his doing so to buy weapons. *See* App. Rec. Vol. 4, pages 842-843. The Appellant eventually sold the pistol to Mr. Neal for $500.00. *See* App. Rec. Vol. 2, page 152-153.

The Appellant's Schedule required him to disclose all weapons he owned. His SOFA required him to disclose all transfers made within the year prior to filing. *See* Plaintiff's Exh. Vol. 4, Exh. 4 (SOFA, questions 5-8, 10). Other than a .308 rifle, a .22 mag rifle, and a .22 rifle, *see* Plaintiff's Exh. Vol. 4, Exh. 4 (Schedule B), the

Appellant did not schedule any other weapons. Though he disclosed the sale of 2 shotguns and a rifle to Keith Neal for $600.00, *see* Plaintiff's Exh. Vol. 4, Exh. 4 (SOFA, question 14), the Appellant did not disclose the sale of the .45 caliber pistol.

POST-PETITION TRANSACTIONS

Preifert Portable Arena

The Appellant owned a Preifert portable arena which he kept and used on his ranch. *See* App. Rec. Vol. 3, page 398, *see also* Plaintiff's Exh. Vol. 11, Exh. 4. This arena was pledged to the Bank as general equipment collateral. *See* App. Rec. Vol. 2, page 179, *See also* Plaintiff's Exh. Vol. 4, Exh. 7(p). On January 5, 2004, after the case was converted to Chapter 7, and the Bankruptcy Court had given the Bank permission to foreclose its collateral, the Bank's agents appeared at the Appellant's ranch.[3] *See* App. Rec. Vol. 2, page 199. Though these agents noted that the arena was on the property at that time, they did not seize it, as they anticipated foreclosing the ranch the next day and did not want to incur the expense of moving it. *See* App. Rec. Vol. 2, page 199. The ranch was foreclosed January 6, 2004, but the Bank did not actually physically take possession until February 11, 2004. *See* App. Rec. Vol. 2, pages 199, 207. However, on or about February 3, 2004, before taking possession of the ranch, the agent noted that the arena was no longer there. *See* App. Rec. Vol. 2,

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[3] The Bank initially tried to peacefully foreclose on December 18, 2004. However, the Appellant refused the Bank's representatives peaceful entry to the property, stating that he was going to require the Bank to obtain yet another Court order. The Bank then filed for and obtained a writ of sequestration from the State Court.

pages 199, 229. The Bank later found the arena in the possession of one John Curtis, another friend of the Appellant. *See infra*.

The Appellant's original Schedules and SOFA, which were filed on January 10, 2004, two months after the case commenced, indicated the Appellant owned a Preifert portable arena with a fair market value of $12,000.00.[4] *See* Plaintiff's Exh. Vol. 4, Exh. 4 (Schedule B, question 31, exhibit B-31). However, the Appellant testified at the first creditors' meeting on January 22, 2004[5] that the arena belonged to one Russell Johnson, a friend of the Appellant's. *See* App. Rec. Vol. 2, page 228. The Appellant then amended his SOFA, to show that he was only holding the arena for Mr. Johnson. *See* Plaintiff's Exh. Vol 4, Exh. 5 (SOFA, question 14).

Contrary to the Appellant's testimony and amended schedules, Mr. Johnson testified at trial that he never owned or claimed any interest in that arena. *See* App. Rec. Vol. 3, pages 399-401, 410. Rather, he said the Appellant offered the arena to him in payment of a personal favor he thought he owed him.[6] *See* App. Rec. Vol. 3, pages 399-401. Mr. Johnson was never scheduled as a creditor, nor was he shown as

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[4] It was only after the Appellant retained counsel on or about December 30, 2003, that the Appellant filed any schedules or a statement of financial affairs. Such documents should have been filed 15 days after the case was filed. However, even after the Bankruptcy Court extended the due-date to December 4, 2003, the Appellant still did not file schedules and a SOFA until January 10, 2004.

[5] Technical problems caused there to be no audible or useable recording of either meeting.

[6] Mr. Johnson could not identify whether the Appellant's offer of the arena was pre- or post-petition. However, the only difference the date would make is whether §727(a)(2)(A) or (a)(2)(B) was applicable. The resulting effect of the transfer would have been the same regardless of the date it occurred.

the recipient of any transfers in the prior year. *See* Plaintiff's Exh. Vol. 4, Exh. 4 (SOFA, questions 6-7). Rather, after the case converted to Chapter 7, the Appellant asked John Curtis, another friend, to hold the arena for Mr. Johnson. *See* App. Rec. Vol. 3, pages 434-438. Mr. Curtis agreed, took the arena from the Appellant's ranch. *see* App. Rec. Vol. 3, page 436, and held it on his own property until the Bank learned of its whereabouts. Mr. Curtis ultimately surrendered the arena to the Bank. *See* App. Rec. Vol. 2, page 229, Vol. 3, page 437.

Damaged Guardrail

The Appellant was in possession of a quantity of damaged guardrail at his ranch when he filed this case. *See See* App. Rec. Vol. 2, page 261. On or about February 20, 2004, the Appellant, by or through another friend, Terry Gardner, arranged with Pine Street Salvage in Abilene to sell this damaged guardrail as scrap. *See See* App. Rec. Vol. 2, page 262. Mason Cullins, an agent of the Pine Street Salvage, drove a truck to the Appellant's ranch and, and with the Appellant's personal assistance and direction, loaded this guardrail onto the truck. *See See* App. Rec. Vol. 3, pages 445-447. Mr. Cullins then took this guardrail to Pine Street Salvage, which weighed and purchased it for $532.40. *See See* App. Rec. Vol. 2, page 262, *see also* Plaintiff's Exh. Vol. 7, Exh. 23. The Chapter 7 Trustee, learned of this unauthorized sale of estate property and intercepted the check. *See See* App. Rec. Vol. 2, page 262. This guardrail was property of the bankruptcy estate. It was, however, neither scheduled nor exempted. The Trustee had not authorized the Appellant to dispose of the property, nor did the Appellant ask his permission. *See See* App. Rec. Vol. 2, page 262.

The Horse Justalena Peppy Dawn

The October 25, 2002, security agreement specifically granted a lien on a horse named "Justalena Peppy Dawn". *See* App. Rec. Vol. 2, page 185, *see also* Plaintiff's Exh. Vol. 4, Exh. 7(m). Shortly after granting the Bank this lien, the Appellant delivered the horse's registration papers to the Bank. *See* App. Rec. Vol. 2, page 184. However, the Bank did not find Justalena Peppy Dawn on the Appellant's ranch when it seized its collateral. It was later found in the possession of Tim Broadfoot, another friend. *See* App. Rec. Vol. 2, page 200.

The Appellant testified at his creditors' meeting that Justalena Peppy Dawn was sold to Billy Dean Wilson, another of the Appellant's friends, on October 20, 2002. *See* App. Rec. Vol. 2, pages 218, 233, 289. However, on October 23, 2002, *three days after the Appellant said he sold Justalena Peppy Dawn to Mr. Wilson*, the Appellant had presented the American Quarter Horse Association ("AQHA") a transfer report asking that he be shown as the horse's owner. *See* App. Rec. Vol. 3, pages 415-416, *see also* Plaintiff's Exh. Vol. 5, Exh. 16 (deposition page 8-10, deposition exhibit A, pages 27-28).

Moreover, in February 2003, the Appellant was trying to sell this horse and asked the Bank for the registration certificates. *See* App. Rec. Vol. 2, page 185. The Bank delivered the papers to the Appellant, who apparently took them with him to a horse event in Big Spring. *See* App. Rec. Vol. 2, page 186. Faxes exchange between the Bank and the Appellant indicate the Appellant was still trying to sell that horse through at least April 2003. *See* App. Rec. Vol. 2, pages 186-189. The AQHA records show that when this case was filed the Appellant owned Justalena Peppy Dawn. *See* Plaintiff's Exh. Vol. 5, Exh. 16 (deposition pages 8-10, deposition exhibit pages 27-28). Furthermore, Russell Johnson testified that in September 2003, he observed the Appellant riding this horse in an event in San Angelo, *see* App. Rec. Vol. 3, pages 403-404, as did Mr. Barker. *See* App. Rec. Vol. 4, page 851.

The Horses Hickorys Up In Smoke and Colonel Stone

The Appellant also owned horses named "Hickorys Up In Smoke" and "Colonel Stone". He scheduled these horses, but indicated they were being held for his children. *See* Plaintiff's Exh. Vol. 4, Exh. 4 (SOFA, question 14 and exhibit SFA-14). These horses were seized from the ranch on January 5, 2004. Because he claimed these horses belonged to his children, on or about January 24, 2004, the Appellant requested that these horses be released. *See* App. Rec. Vol 2, pages 208, 210. On January 25, 2004, he presented Mr. Sloan with registration certificates from the American Paint Horse Association ("APHA"), *see* App. Rec. Vol 2, page 211, which indicated that the Appellant had transferred the two horses to his children on

May 10, 2002. *See* App. Rec. Vol 2, page 212, *see also* Plaintiff's Exh. Vol. 6, Exh. 17 (deposition page 2). However, the Bank learned the request to change the horses' records was presented to the APHA on January 23, 2004, and that the Appellant provided the APHA with the dates of these alleged transfers. *See* App. Rec. Vol 2, page 213. The Appellant did not volunteer this recent record change to Mr. Sloan. *See* App. Rec. Vol 2, page 213.

Testimony at the Creditors' Meeting

The Debtor testified at his creditors' meetings under oath. *See* 11 U.S.C. §343. He was asked about his transfer of the tennis bracelet and about weapons other than the ones he had scheduled. *See* App. Rec. Vol 2, pages 292-293, 264. He denied owning any other weapons, including any at Dr. Bailey's house, and testified that the tennis bracelet belonged to his mother.

Requirements of the Schedules and Statement of Financial

The Schedules and SOFA required him to disclose under penalty of perjury all assets he owned or was holding for anyone else. *See e.g.* Plaintiff's Exh. Vol. 4, Exh. (Schedules A and B, SOFA, question 14. They also required him to disclose the disposition of any assets within one year before he filed bankruptcy. *See e.g.* Plaintiff's Exh. Vol. 4, Exh. 4 (SOFA, questions 5-8, 10).

Inter alia, as a result of the foregoing conduct, U.S. Trustee filed a complaint to deny the Appellant's discharge. Only Mr. Baum was named as a defendant. After a three and one-half day trial, the Bankruptcy Court found for the United States Trustee on counts related to these failures and denied the Appellant's discharge. The Defendant moved for a new trial. The Bankruptcy Court found after a hearing that the Appellant failed to identify any grounds warranting a new trial. The Appellant then prosecuted an appeal to the United States District Court. In an Opinion that demonstrated a thorough reviewed the evidence, the District Court found there to be more than sufficient evidence from which the Bankruptcy Court could conclude that the Appellant materially violated a variety of the provisions in 11 U.S.C. §727(a). It is from this March 21, 2006, Opinion that the Appellant appeals to this Court.

SUMMARY OF THE ARGUMENT

The United States Trustee's Complaint to deny the Debtor's discharge under 11 U.S.C. §727(a) was based *inter alia* upon the Debtor's concealment, transfer, and removal of assets, and upon the Debtor's having given a false oath and/or account with respect to his assets and transfers. At trial, the United States Trustee presented a multitude of witnesses and exhibits substantiating the Complaint's allegations. In a detailed Opinion, the Bankruptcy Court denied the Debtor's discharge based upon specific facts and circumstances which demonstrated not only the transfers, concealments, removals, and false oaths and accounts, but also circumstances from which the Court inferred that the Debtor took these actions with fraudulent intent. The Debtor appealed the Bankruptcy Court's decision to the District Court. The District

Court found that the Bankruptcy Court's findings were not clearly erroneous, and that there was more than enough evidence from which it could find the Debtor culpable for the acts alleged in the Complaint. In this appeal, the Debtor continues to plead that the Bankruptcy Court's findings were clearly erroneous, whereas the United States Trustee maintains that there was more than sufficient evidence to demonstrate how the Debtor knowingly and fraudulently transferred, removed, and concealed assets and gave a false oath and account with respect to those assets.

ARGUMENT

I. Initial Observations Concerning the Appellant's Brief

Taken as a whole, it appears the Appellant continues to contend that the lower Courts' findings are against the manifest weight of the evidence. It also appears, however, the Appellant continues not to understand that factual findings cannot be reversed or supplanted on appeal unless clearly erroneous. Federal Rule of Bankruptcy Procedure 8013. *See also First National Bank LaGrange v. Martin* (*In re Martin*), 963 F.2d 809 (5th Cir. 1992), *In re Anderson, 936 F.2d 199, 204 (*5th Cir.1991*)* ("The bankruptcy court is in the best position to judge the credibility of any witness who testifies under oath before it . . ."), *Matter of Texas Mortgage Services Corp., 761 F.2d 1068, 1078 (*5th Cir.1985*)* ("We will not attempt to reassess the credibility of witnesses whom we have not had an opportunity to see on the stand"). As the District Court explained, Judge Jones was afforded wide discretion when considering the evidence, and was free to believe or disbelieve any or all of the testimony of any witness, and give total, little, or no effect to any or all of the exhibits. He was required to weigh that testimony and evidence according to the beliefs developed during trial, and to rule accordingly. While the Appellant's Brief identifies fragments, and paraphrases of various witnesses' testimony, *see e.g.* Appellant's Brief pg. 10-12, these do nothing to discredit, refute, or render suspect the quality or quantity of evidence on which Judge Jones relied.

It is difficult to glean the Appellant's legal theories in support of reversing either of the lower Courts' decisions. For example, his Brief discusses how the Bankruptcy Court erred in making findings concerning facts and issues which are wholly unrelated to the Counts on which the U.S. Trustee prevailed. *See e.g.* Appellant's Brief, page 5, ¶2 (discussing how the U.S. Trustee waived the right to complain about schedules not being timely filed because the Appellant's spouse was not named as a defendant). He also complains about various adjectives and characterizations in the U.S. Trustee's District Court Brief, *see e.g.* Appellant's Brief page 26 (complaining about use of the term "avocational"), and about transactions never made an issue in Bankruptcy Court. *See e.g.* Appellant's Brief pg. 22 (discussing the purchase of - presumably a horse - named Genuine Command). The Appellant also intermixes facts and findings, and never identifies with specificity how the evidence was insufficient to reach a preponderance.

In general, the Brief is a series of confusing and self-serving statements which at times border on gibberish. Most of these statements chronicle the findings the Defendant wishes the Bankruptcy Court would have made, but did not. In its entirety, the Appellant appears to claim the lower Courts erred simply because they rejected the "I testified about it, and therefore it must be true" approach he advances. Furthermore, what the Appellant characterizes as factual "inconsistencies" does not invalidate the inferences or conclusions Judge Jones was entitled to make from the totality of evidence, particularly given that the burden of proof was to a preponderance. Clearly, as the District Court discussed, there was sufficient evidence to support a finding for the U.S. Trustee on the seven relevant Counts. In the present appeal, the Debtor raises no novel arguments identifying clearly erroneous findings.

II. Applicable Law

A. Concealment, Transfer, and Removal of Assets

Debtors who file Chapter 7 bankruptcy will typically receive a discharge of all dischargable debts provided they *inter alia* fully list all their pre-petition assets, liabilities, and transactions, truthfully testify about their financial affairs, do not conceal any assets, and file their petition in "good faith". However, if debtors materially fail with those duties or in any of those respects, they can be denied their discharge. *See generally*, 11 U.S.C. §727(a).

In the Appellant's case, the Bankruptcy Court found for the U.S. Trustee principally on two subsections of 11 U.S.C. §727(a); the subsection dealing with the transfer and concealment of assets, and the subsection dealing with making a false oath or account. As to the former, §727(a)(2) states in pertinent part:

> (a) The court shall grant the Appellant a discharge, unless–
>
> (2) the Appellant, with intent to hinder, delay, or defraud a creditor or an officer of the estate charged with custody of property under this title, has transferred, removed, destroyed, mutilated, or concealed, or has permitted to be transferred, removed, destroyed, mutilated, or concealed--
>
>> (A) property of the Appellant, within one year before the date of the filing of the petition; or
>>
>> (B) property of the estate, after the date of the filing of the petition;

The U.S. Trustee had the burden of proving the elements of §727(a) by a preponderance. *In re Womble,* 289 B.R. 836 (Bankr. N.D. Tex. 2003).

To succeed under §727(a)(2)(A) (pre-petition concealment) or §727(a)(2)(B) (post-petition concealment), a plaintiff must establish that: (1) the Appellant transferred, removed, or concealed, or permitted to be transferred, removed, or concealed; (2) property of (i) the Appellant within one year before the petition was filed [in the case of a pre-petition concealment - §727(a)(2)(A)] or (ii) property of the bankruptcy estate [in the case of a post-petition concealment - §727(a)(2)(B)]; (3) with the intent to hinder, delay or defraud the creditor. *In re Bastrom,* 106 B.R. 223 (Bankr. D. Mont.1989), *In re Martin,* 88 B.R. 319 (D. Colo.1988). Any transfer of interest in property, including a transfer of possession, custody, or control in the absence of any transfer of title, qualifies as a "transfer" within the meaning of §727(a)(2) . *In re Golob*, 252 B.R. 69 (Bankr. E.D. Va. 2000). This includes property of which Appellant has possession, either actual or constructive.

To prove an act of "concealment" within the meaning of §727(a)(2), it must shown that Appellant placed assets beyond the reach of creditors or withheld knowledge of assets by failing or refusing to divulge information to which creditors were entitled. *In re Hayes*, 229 B.R. 253 (1st Cir. BAP 1999).

B. False Oath or Account

As for dealing with a false oath or account, §727(a)(4) states in pertinent part:

> (a) The court shall grant the Appellant a discharge, unless--
>
> (4) the Appellant knowingly and fraudulently, in or in connection with the case--
>
> (A) made a false oath or account....

To prevail under §727(a)(4)(A), it must be proven that a) the Defendant made a statement under oath, b) the statement was false, c) the Appellant knew the statement was false, d) the Appellant made the statement with fraudulent intent, and e) the statement materially related to the bankruptcy case. *Beaubouef v. Beaubouef*, (*In re Beaubouef*), 966 F.2d 174 (5th Cir. 1992), *Morton v. Dreyer* (*In re Dreyer*), 127 B.R. 587 (Bankr. N.D. Tex.1991). A false oath can include testimony given at a creditors' meeting or information listed in or omitted from the schedules or SOFA. *In re Korte*, 262 B.R. 464 (8th Cir. BAP Iowa 2001).

C. The Intent Elements of §727(a)

A plaintiff can demonstrate the intent elements of §727(a) by circumstantial evidence, *Pavy v. Chastant* (*In re Chastant*), 873 F.2d 89 (5th Cir. 1989), and may be inferred from "badges of fraud" which include, but are not limited to:

> a) the lack or inadequacy of consideration;
>
> b) the family, friendship, or close association between the parties to a transaction;
>
> c) the retention of possession, benefit, or use of the property in question;
>
> d) the financial condition of the party both before and after the transactions in question;
>
> e) the existence or cumulative effect of the pattern or series of transactions or course of conduct after the onset of financial difficulties; and/or
>
> f) the general chronology of the events and transactions.

In re Womble, *supra*. Any one or more of these factors may be sufficient to find fraudulent intent, and an accumulation of several factors is strongly indicative of the requisite intent. *FDIC v. Sullivan* (*In re Sullivan*), 204 B.R. 919 (Bankr. N.D. Tex. 1997), *Cullen Center Bank & Trust v. Lightfoot* (*In re Lightfoot*), 152 B.R. 141 (Bankr. S.D. Tex. 1993), *Sholdra v. Chilmark Fin., L.L.P.* (*In re Sholdra*), 249 F.3d 380 (5th Cir. 2001). *See The Cadle Company v. Mitchell* (*In re Mitchell*), 102 Fed. Appx. 860 (5th Cir. 2004). Fraudulent intent may also be shown by reckless indifference to the truth. *In re Krich*, 97 B.R. 919 (Bkrtcy.N.D.Ill.1988).

III. There was sufficient evidence to find that the Appellant fraudulently transferred items in violation of 11 U.S.C. §727(a)(2)(A) and (B)

It is axiomatic that when this case was filed all the Appellant's property, regardless of where located or the character of the Appellant's interest in that property, became property of his bankruptcy estate. *See* 11 U.S.C. §541. After the case's conversion to Chapter 7, the Appellant lost all legal right to unilaterally convert, transfer, or effectuate any disposition of any of his property.

Counts 5 and 6 of the United States Trustee's Complaint allege under §727(a)(2)(A) and (a)(2)(B) that the Appellant's removal and concealment of *inter alia* the Preifert portable arena, other weapons, and the damaged guardrail property violated §727(a)(2).[7] The evidence clearly shows that in addition to the horses (which are the subject of additional counts, *see infra*), the Appellant removed, transferred, or concealed the portable arena, weapons, and guardrail.

A. Portable Arena

There was ample evidence from which the lower Courts could find that the Appellant owned the arena when he filed the case, that he attempted to conceal his ownership, and that he attempted to conceal the arena from both the Bank and the Trustee. This included:

a) the receipt for the arena's purchase, *see* Plaintiff's Exh. Vol. 11, Exh. 4;

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[7] These Counts also allege that the Appellant removed and/or concealed the .45 pistol and tennis bracelet. The Court found that the Appellant had neither illegally removed nor concealed these items. However, the Court also found culpable the Appellant's failure to disclose the transfers. *See infra*.

> b) the original Schedules wherein Appellant identified himself as owner of the arena, *see* Plaintiff's Exh. Vol. 4, Exh. 4 (Schedule B, Exhibit B-31);
>
> c) the arena appeared on a person financial statement the Appellant published, *see* Plaintiff's Exh. Vol. 11, Exh. 4, page 3;
>
> d) that he was in possession of the arena when the case was converted to Chapter 7, *see* App. Rec. Vol. 2, page 199;
>
> e) the testimony of Mr. Sloan that arena was on the ranch at the time of foreclosure, *see* App. Rec. Vol. 2, page 199;
>
> f) that he caused it to be removed, *see* App. Rec. Vol. 4, page 436;
>
> g) testimony of John Curtis that Appellant asked him to hold the arena, *see* App. Rec. Vol. 3, page 434-438; and
>
> h) testimony of Mr. Johnson denying having accepted or having possession and/or control over the arena), *see* App. Rec. Vol. 3, pages 399-401, 410.

By removing the arena or permitting its removal after a) the case was filed, b) after the case was converted to Chapter 7, and c) after the Bank was given authority to seize its collateral, the Appellant knowingly removed and concealed the arena from both the Bank and/or the Trustee, either of which were entitled to possess it. There was more than sufficient evidence from which the Court could that the Appellant's claim to have transferred the arena was fiction.

That this was done with the fraudulent intent is evident from those same facts:

> a) Mr. Johnson, a friend of the Appellant's, disavowed ever owning or possessing it the arena;
>
> b) it was removed post-petition and post-conversion from the Appellant's property at the Appellant's direction by another of the Appellant's friends;
>
> c) there was no consideration paid for this arena;
>
> d) it was still within the Appellant's possession and control up until the time it

was moved;

e) the Appellant remained constructively under his control while it was in Mr. Curtis's possession;

f) it was never delivered to Mr. Johnson;

g) it was allegedly disposed of during financially troubled times; and

h) it was originally scheduled as owned by the Appellant.

Under the prevailing standards, there are sufficient "badges" of fraud from which the lower Courts could infer a fraudulent intent to hinder, delay and defraud.

Even if the lower Courts had accepted the Appellant's explanation that he had given the arena to Mr. Johnson, he had not consummated the gift with delivery. This is a necessarily act in order to effectively transfer legal title. *See e.g. Estate of Kuenstler v. Trevino*, 836 S.W.2d 715 (Tex.App.-San Antonio1992). Therefore, the Appellant's explanation fails.

Furthermore, the facts belie his claim. The Appellant's original Schedules claimed he owned the arena, and that Mr. Johnson was neither a creditor nor the recipient of a transfer within 90 days preceding the petition's filing. *See* Plaintiff's Exh. Vol. 4, Exh. 4 (SOFA). Additionally, neither the original or amended SOFA identify the arena's transfer as occurring in the year prior to bankruptcy. This alleged gift also occurred after the Appellant had retained counsel, thus giving the Appellant an opportunity to consult with counsel, who would likely have advised that the gift had not and/or could not have been legally consummated. These factors are additional badges of fraud from which the Bankruptcy Court could find that the Appellant removed and concealed the arena with fraudulent intent. The collective effect of these facts and circumstances could easily lead the District Court to the conclusion that the Bankruptcy Court's findings were not clearly erroneous.

B. Damaged Guardrail

There is ample evidence the Appellant permitted the post-petition, post-conversion removal of a quantity of damaged guardrail from his ranch. There was testimony that while on his ranch the Appellant met the truck picking-up the guardrail, directed it to the guardrail's location, identified what guardrail was to be removed, and permitted its removal. *See* App. Rec. Vol, 3, pages 445-447. The Trustee also testified that he neither knew about nor authorized the guardrail's removal or sale. *See* App. Rec. Vol, 2, page 262. Again, there was no credible or substantiated evidence that this guardrail did not become property of the estate when the case was filed. Even if the Appellant had formed the intent pre-petition to gift this property, the gift was not consummated with delivery and, therefore, remained property of the estate. *See Estate of Kuenstler v. Trevino, supra*.

The Appellant's intent to hinder, delay, or defraud in trying to dispose of the property can be inferred from the fact that:

> a) Terry Gardner, the putative donee, has made no claim to the proceeds of sale, *see* App. Rec. Vol, 2, pages 261-263;

> b) the Appellant failed to consult the Trustee or any other party before attempting to dispose of the guardrail, *see* App. Rec. Vol, 3, page 262;
>
> c) the guardrail was in the Appellant's possession and control when the case was filed;
>
> d) the disposition was done during financial troubles; and
>
> e) Mr. Gardner is not listed as a creditor, the recipient of a payment within 90 days, or the recipient of a transfer within the year before the case commenced. *See* Plaintiff's Exh. Vol. 4, Exh. 4 (SOFA).

And as with the portable arena, the Appellant caused or allowed the property to be removed after counsel had been retained, and after the Appellant filed his schedules (both original and amended) wherein he made no mention of the guardrail.

Causing or permitting this guardrail to be removed and sold, either directly or though Mr. Gardner, was a post-petition transfer which removed and concealed property of the estate from the Trustee. The effect of this evidence easily leads to a conclusion that it was not clearly erroneous to find the Appellant fraudulently attempted to conceal and dispose of the guardrail.

C. Undisclosed Disposition of Weapons

There was ample evidence that the Appellant owned more weapons than were disclosed on his schedules or SOFA. There was also ample evidence that he removed, concealed, and/or transferred those weapons with the intent to hinder, delay, and/or defraud. Specifically, the Court found credible the testimony of Dr. Bailey, who stated that the Appellant had a large collection of weapons at his house when he purchased it from the Appellant in June 2001. *See* App. Rec. Vol. 3, page 372[8] At the time, the Appellant neither did nor said anything indicating these were not his weapons. *See* App. Rec. Vol. 3, page 373.

Moreover, there were at least two occasions between September 2003 and January 2004 when the Appellant appeared at Dr. Bailey's house and removed weapons. *See* App. Rec. Vol. 3, pages 374-375, and pages 391-395. Dr. Bailey testified that as of January 2004, the weapons had been removed. *See* App. Rec. Vol. 3, page 376. Since the Appellant did not credibly explain the loss or whereabouts of all the weapons in the safe, the Bankruptcy Court determined that those weapons were there when this case was filed, or were at least subject to the Appellant's possession and disposition at times which should have been discussed on the SOFA. The Court noted that the Appellant listed only three weapons on his schedules, far less than the amount Dr. Bailey said the Appellant had in the safe.

Dr. Bailey's testimony is supported by Mr. Neal's testimony that about the time he purchased the Appellant's .45 Colt (shortly before this case was filed) the Appellant had let it be known he had other weapons in a safe for sale. Mr. Neal testified that by the time he told the Appellant he was interested in purchasing other weapons, there were apparently no more available. *See* App. Rec. Vol. 2, pages 148-

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[8] In his deposition Dr. Bailey initially testified there may have been as many as 65 guns in the safe when it bought the safe. However, at trial he indicated he had since counted and found the safe to have 24 spaces for storing rifles and a shelf for pistols. *See* Appellant Rec. Vol. 3, pages 373,377.

150. Yet no sales of weapons other than those already sold to Mr. Neal appeared on the Schedules or SOFA. Even if the Court accepted the explanation that these were not his weapons, the Appellant's schedules do not identify any weapons as being held for others. *See* Plaintiff's Exh. Vol. 4, Exh. 4, (SOFA, question 14).

Moreover, both Dr. Bailey's and Mr. Neal's testimony is supported by Mr. Barker, who testified that shortly before this case was filed, he and the Appellant went to Dr. Bailey's house to view and negotiate the purchase of the .45 Colt. *See* App. Rec. Vol. 4, page 839. After the Appellant opened the safe, Mr. Barker observed it to be full of weapons, mostly rifles. *See* App. Rec. Vol. 4, pages 837-840. As before, the Appellant neither did nor said anything to suggest these weapons were not his. *See* App. Rec. Vol. 4, page 840. Based on the testimony of these four witnesses, it can hardly be said there was insufficient evidence from which the Court could find that the Appellant owned more weapons than appeared on his schedules.

As for the Appellant's intent in not disclosing the weapons, the Court again looked to the surrounding circumstances for indicia of fraudulent intent;

> a) the Appellant sold the .45 caliber Colt to a friend at a time when he was under severe financial distress;
>
> b) he had left other weapons with another friend under circumstances where it was unlikely anyone would know about their existence;
>
> c) there is no record of any transactions of weapons, and the private ownership and sale of weapons is generally unregistered and untraceable;
>
> d) the Appellant also continued to exercise control over those weapons, as he

> was able to effectuate their disappearance and/or disposition at times relevant to this case; and
>
> e) other than later claiming that his 8 year-old son owned some of these large and powerful weapons, he did not volunteer anything in his testimony to suggest that the weapons in the safe as of June 2001 belonged to anyone other than himself.

Without credible evidence to contradict facts which strongly suggested that these weapons belonged to the Appellant, and having been directly asked about weapons and given ample opportunity to amend his schedules, the Court found sufficient indicia of fraudulent intent in failing to disclose his ownership and disposition of these weapons. Without doubt, the District Court could conclude that Judge Jones's findings about this were not clearly erroneous.

D. The Horses Justalena Peppy Dawn, Colonel Stone, Hickorys Up In Smoke, and Tari Gay Diamond

The Bankruptcy Court found for the U.S. Trustee on Count 7 of the Complaint (that the Appellant's attempt to conceal his ownership of "Hickorys Up In Smoke" and "Colonel Stone" was culpable under §727(a)(2)(A) and Counts 12 and 16 of the Complaint (that the Appellant's attempt to conceal his ownership of the horses, "Tari Gay Diamond",[9] and "Justalena Peppy Dawn" was culpable under §727(a)(2)(A) and

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[9] Other than indicating Tari Gay Diamond was purportedly sold pre-petition, the Bankruptcy Court's Opinion did not detail the sale the Appellant claimed to have made. The Appellant claimed in both his Schedules and creditors' meeting testimony to have sold the horse Tari Gay Diamond pre-petition to another friend, L.P. Carter. However, this horse was found on the Appellant's ranch during the January 5th seizure. There were no records produced at trial to memorialize the sale. Mr. Carter tried to claim this horse from the Bank after the seizure. The Bank filed suit in State court to "quiet title" to the horse, and was ultimately given its "title".

§727(a)(2)(B). Again, it is axiomatic that these horses become property of the estate when the case was filed. 11 U.S.C. §541. Documents from the AQHA and APHA clearly show that the Appellant had owned these horses.[10] *See* App. Rec. Vol. 3, pages 415-416, *see also* Plaintiff's Exh. Vol. 5, Exh. 16 (deposition pages 8-10, deposition Exhibit A, pages 27-28), Plainfiff's Exh. Vol. 5, Exh. 17 (deposition pages 2-3, deposition Exhibit A, pages 37-39, 46-48). Thereafter, the Appellant claims to have transferred these horses. However, the Court did not find these claims credible. Rather, the Court found credible the fact that the Appellant failed to schedule Hickorys Up In Smoke and Colonel Stone as being held for another, and attempted to "back-date" the purported transfers. *See* Plaintiff's Exh. Vol. 5, Exh. 17 (deposition pages 2-3). It also had before it evidence that:

> a) he registered Justalena Peppy Dawn into his name after the date he testified he sold the horse to someone else, *see* App. Rec. Vol. 3, pages 415-416;
>
> b) that he pledged the horse to the Bank after the purported sale, *see* App. Rec. Vol. 2, page 185, *see also* Plaintiff's Exh. Volume 4, Exh. 7(m);
>
> c) that after he purportedly sold the horse he represented to the Bank that he was again trying to sell the horse, *see* App. Rec. Vol. 2, pages 185-189, Plaintiff's Exh. Vol. 7, Exh. 25;
>
> d) that he continued to use the horse after he purportedly sold it. *See* App. Rec. Vol. 3, pages 403-405 and App. Rec. Vol. 4, page 851; and
>
> e) Tari Gay Diamond, Colonel Stone, and Hickorys Up In Smoke were all in his possession, *see* App. Rec. Vol. 2, page 205, and Justalena Peppy Dawn was

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[10] The United States Trustee agrees with the Appellant that registration and registration certificates alone do not establish ownership. They are, however, <u>indicia</u> of ownership which the Court can consider in assessing whether or not the Appellant owned the horses during the time in question.

in the possession of a friend.

With only the Appellant's testimony to contradict that of these witnesses, there is ample evidence before the Court to conclude that the Appellant owned these horses when the case was filed. His attempts to cover that ownership constituted the concealment for purposes of §727(a)(2).

That his intent was fraudulent is again evident from the circumstances;

> a) Tari Gay Diamond, Colonel Stone, and Hickorys Up In Smoke were in the Appellant's possession at the time of seizure;
>
> b) Justalena Peppy Dawn was being held by a friend;
>
> c) these horses were purportedly transferred to friends or family members for no apparent consideration or were allegedly transferred for cash;
>
> d) there are no records evidencing these transfers which were made contemporaneously with the record change, and virtually no means to confirm the Appellant's story;[11]
>
> e) With respect to "Hickorys Up In Smoke" and "Colonel Stone", the Appellant did not schedule these horses as being held for his children, despite asserting that he had gifted them more than a year and one-half prior;
>
> f) he did not volunteer to Mr. Sloan his recent change in the registration when he requested the Bank to release these horses;
>
> g) In the case of "Tari Gay Diamond", he did not volunteer his attempt to change the registration, even though the Bank knew the AQHA had refused to "back-date" the change of registrations; and
>
> h) he had continued use of Justalena Peppy Dawn after the purported transfer and shortly before this case was filed.

---

[11] It is somewhat hypocritical that the Appellant now argues how a horse's registration is not proof of ownership, when, at the time he tried to secure the horses' release from the Bank, he attempted to use those certificates for exactly that proposition.

Based on the foregoing, there is more than sufficient evidence from this the Court can infer fraudulent intent. Though the Appellant attempts to "nit-pick" the witnesses testimony, he points to no manifest error or omission in the lower Courts' analysis.

IV. There was sufficient evidence to conclude that the Appellant made a false oath and account under 11 U.S.C. §727(a)(4)

The Bankruptcy Court found for the U.S. Trustee on allegations under §727(a)(4)(A) that the Appellant knowingly and fraudulently made a false oath when he testified at the creditors' meetings that he owned no weapons other than those scheduled, and about having not transferred any property (other than what is on the SOFA) outside the ordinary course of business in the year preceding the case. Again, the Bankruptcy Court was free to accept or reject any or all of any witness's testimony, and to give whatever weight it felt appropriate to any or all evidence.

As has been explained, there was more than sufficient evidence to show the Appellant owned and disposed of more property than he disclosed. *Supra*. It is highly unlikely a person would admit to disposing of certain items of his personal property while also maintaining that he never owned it. The Court's giving credibility to other witnesses' testimony instead of the Appellant's is a substantial basis for finding culpable his failure to disclose ownership and/or disposition of those assets.

A. Undisclosed Ownership and Disposition of Weapons and .45 Pistol

Having found that the Appellant a) owned more weapons when this case was filed than were disclosed on his schedules, b) that he effectuated an undisclosed transaction of those weapons, and c) that he sold a .45 Colt during a time when such transactions must be disclosed on the SOFA, the Court went on to find that the Appellant made a false oath when he filed the schedules and the SOFA which omitted this information. *See* Plaintiff's Exh. Vol. 4, Exh. 4 (Schedule B question 8, and SOFA, question 10). There the Appellant scheduled only 3 weapons and the pre-petition transfer of only certain weapons(not including the kind witnesses indicated were in the safe). Additionally, the Court had evidence that the Appellant testified, albeit falsely, at the creditors' meeting that he did not own other weapons, was not holding weapons for others, and/or had not transferred any weapons. *See* App Rec. Vol. 2, pages 264, 292-293. For the same reasons and from the same circumstances surrounding the underlying transactions, the Court inferred the Appellant's intent to defraud. Any one of these false oaths warranted denying his discharge under §727(a)(9)(4).

The Appellant disputes that he owned or disposed of any weapons other than those on his schedules. But as discussed *supra*, the Appellant fails to show how the Bankruptcy Court's findings about his having owned and disposed of other weapons was clearly erroneous. Until that is shown, there is little basis for the Appellant to contend that there was a clearly erroneous finding that he fraudulently made a false oath and account about his ownership and disposition of the weapons.

Interestingly, the Appellant does not dispute that the sale of the .45 Colt occurred, or that this was not disclosed on his SOFA. Even if this Court views the lower Courts' findings about the ownership of additional weapons as clearly erroneous, the failure to disclose the sale of the .45 Colt on the SOFA and his false testimony about not making such a sale was sufficient to deny his discharge. *See Mitchell, supra, see also United States Trustee v. Moschella* (*In re Moschella*), Case No. 04-4055 (Bankr. N.D. Tex. Aug. 9, 2004).

B. Undisclosed Disposition of the Tennis Bracelet

Although it is unclear whether the sale of the tennis bracelet occurred pre- or post-petition, there is no dispute over the fact that it occurred or that it was not scheduled. *See* Plaintiff's Exh. Vol. 4, Exh. (SOFA, question 10). Standing alone, the failure to schedule this sale was a false oath and account under §727(a)(4). That the failure to disclose this transaction was done fraudulently was again inferred from the circumstances;

a) the sale occurred at a time the Appellant was under sever financial distress;
b) it was facilitated by a friend of the Appellant;
c) it was done in cash;
d) it is not the kind of property typically bought with cash; and
e) it was not memorialized by any check, receipts, or any other documentation.

It appears the Appellant's chief complaint about the lower Courts' finding that he should have disclosed the sale is that the bracelet was not his. However, the mother testified that she gave him the bracelet with donative intent, she delivered it to them, and had no expectation that it be returned. *See* App. Rec. Vol 4, pages 883-884. As the Bankruptcy Court pointed out, *see* App. Rec. Vol. 4, pages 924-925, at the time of delivery, all the elements of a gift had been met and the bracelet became his. That he did not comprehend the import of his receipt and subsequent sale does not mitigate its legal effect. More importantly, he should have disclosed the transaction rather than making a unilateral legal decision. *See e.g. FDIC v. Sullivan* (*In re Sullivan*), *supra*. That he chose not to disclose the transaction is yet another circumstance from which the Court could construe fraudulent intent. Since the Appellant does not and cannot dispute that the bracelet was sold, and that the sale was not disclosed, he cannot assert the findings on this issue was clearly erroneous. Without being clearly erroneous, there is no error in the lower Courts' decisions.

Conclusion

WHEREFORE, the U.S. Trustee respectfully prays that this Court affirm the District Court's decision in all respects.

DATED: October 13, 2006

Respectfully submitted,
WILLIAM T. NEARY
UNITED STATES TRUSTEE

William S. Parkinson
Ohio Bar Registration 0021679
Office of the United States Trustee
1100 Commerce Street Room 976

Dallas, Texas 75242
(214) 767-8967

CERTIFICATE OF COMPLIANCE

In accordance with Fed. R. App. P. 32(a)(7)(C), I hereby certify that this Brief is monospaced in 14-point Times New Roman font and was produced on Corel Wordperfect 12.0. Exclusive of the portions exempted by Fed. R. App. P. 32(a)(7)(B)(iii), this brief contains 8,637words according to Corel Wordperfect 12.0.

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William S. Parkinson

CERTIFICATE OF SERVICE

I do hereby certify that on October 13, 2006, a true copy of the foregoing document was forwarded by first class United States mail to the following persons:

John C. Baum
P.O. Box 762
Coleman, Texas 76834

____
William S. Parkinson

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Adams, UST v Marwil, Receiver

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SD NY

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Lisa L. Lambert, Trial Attorney

(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") *TOPIC*

BANKRUPTCY

9. ("SU") • *SUMMARY* OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***

● Given that the Bankruptcy Code required the pre-bankruptcy receiver to turn over all estate property to these debtors' dishonest managers, should the bankruptcy court have granted the United States Trustee's motion for the appointment of an impartial trustee to administer the bankruptcy estate for the benefit of all creditors.

√ Background:

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IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

In re BAYOU GROUP, et al, Debtors

DIANA G. ADAMS,
ACTING UNITED STATES TRUSTEE,
Appellant,
v.

JEFF MARWIL, RECEIVER, and
OFFICIAL COMMITTEE OF UNSECURED CREDITORS,
Appellees.

On Appeal from the United States Bankruptcy Court

for the Southern District of New York, White Plains Division

BRIEF FOR APPELLANT UNITED STATES TRUSTEE

Of Counsel:

Roberta A. DeAngelis
Acting General Counsel

Matthew Sutko
Walter W. Theus, Jr.
United States Department of Justice
Executive Office for United States Trustees
20 Massachusetts Avenue, NW
Washington, D.C. 20530
(202) 307-1399

Lisa L. Lambert
Office of United States Trustee
33 Whitehall St., 21st Floor
New York, NY 10004
(212) 510-0500
Lisa.L.Lambert@usdoj.gov

ATTORNEYS FOR APPELLANT
DIANA G. ADAMS,
ACTING U.S. TRUSTEE
FOR REGION 2

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Statement Regarding Oral Argument

Diana G. Adams, the Acting United States Trustee for Region 2, requests oral argument. The issue on appeal impacts the integrity of the bankruptcy system, and oral argument would be of material assistance to the Court.

Statement of Jurisdiction Statement of Jurisdiction

A. The bankruptcy court had subject matter jurisdiction and the power to resolve the motion to appoint a chapter 11 trustee. The bankruptcy court had subject matter jurisdiction and the power to resolve the motion to appoint a chapter 11 trustee.

The Article III federal district courts have “original and exclusive” subject matter jurisdiction over bankruptcy cases. 28 U.S.C. § 1334*; see* U.S. Const. Art. I, § 8; *Celotex Corp. v. Edwards*, 514 U.S. 300, 307 (1995); 115 S. Ct. 1493, 1498 (1995) (explaining that “[t]he jurisdiction of the bankruptcy courts . . . is grounded in and limited by statute”). The Article I bankruptcy courts acquire the power to resolve bankruptcy issues such as those in the Bayou cases through the standing order of reference from the district court. 28 U.S.C. § 157(a); Standing Order of Referral of Cases to Bankruptcy Judges of the United States District Court for the Southern District of New York, dated July 10, 1984 (Ward, Acting C.J.).

Bankruptcy jurisdiction is broader than bankruptcy power. Bankruptcy courts lack the power to resolve some bankruptcy issues that fall within the jurisdictional grant, so an Article III federal district court must resolve those issues. *Walker v. Cadle Co. (In re Walker)*, 51 F.3d 562, 570 (5th Cir. 1995) (distinguishing between bankruptcy jurisdiction and power). “A bankruptcy court may exercise plenary power only over ‘core proceedings.’” *Marshall v. Marshall*, 126 S. Ct. 1735, 1743 (2006) (construing 28 U.S.C. § 157 (b)-(c)). Here, the bankruptcy court held that it lacked the power to enter an order appointing a trustee. Tr. 23:23-24:3, Brief Appendix B; Order Denying United States Trustee’s Motion to Appoint a Trustee, Brief Appendix C. As detailed below, however, bankruptcy trustee issues are within the bankruptcy court’s plenary, core powers.

B. The United States Trustee had standing to bring the motion to appoint the trustee.The United States Trustee had standing to bring the motion to appoint the trustee.

Congress assigned the United States Trustee broad oversight responsibilities over bankruptcy cases. 28 U.S.C. § 586 (defining United States Trustee's responsibilities). The United States Trustee for Region 2 is a senior official of the Department of Justice appointed by the Attorney General. 28 U.S.C. § 581(a)(2). She acts as the "watchdog" of the bankruptcy system and may be "compared . . . to a prosecutor" for cases that arise under Title 11 of the Bankruptcy Code. H.R. Rep. No. 95-595, at 109 (1977), *as reprinted in* 1978 U.S.C.C.A.N. 5963, 6049 (using "watchdog" analogy); 6071 (using "prosecutor" analogy). Within this district, the United States Trustee "supervise[s] the administration of cases and trustees in cases under chapter 7, 11, 12, 13, or 15 of title 11." 28 U.S.C. §§ 581(a)(2) and 586(a)(3)(A). Section 1104, the statute governing chapter 11 trustee appointments, specifies that the United States Trustee has standing to seek a trustee. 11 U.S.C. § 1104(a); *see also* 11 U.S.C. § 307 (broadly defining United States Trustee's ability to raise issues).

C. This Court has appellate jurisdiction because the order denying appointment of a chapter 11 trustee is a final order.This Court has appellate jurisdiction because the order denying appointment of a chapter 11 trustee is a final order.

This Court has appellate jurisdiction over "final judgments, orders, and decrees" of bankruptcy judges. 28 U.S.C. §158(a)(1). The appellate courts have adopted a "flexible standard of finality" for bankruptcy cases. *Dicola v. American Steamship Owners Mut. Prot. and Indem. Ass'n, Inc. (In re Prudential Lines)*, 59 F.3d 327, 331 (2d Cir. 1995). A bankruptcy case serves as an umbrella for distinct sub-issues, and rulings on the sub-issues often immediately impact creditors and the outcome of a bankruptcy case. *State Gov't Creditors' Comm. v. McCay (In re Johns-Manville Corp.)*, 920 F.2d 121, 126 (2d Cir.1990)(citations omitted). Orders granting or denying appointment of a trustee have such impact, so these orders are final. *Committee of Dalkon Shield Claimants v. A.H. Robins Co.*, 828 F.2d 239, 241 (4th Cir. 1987); *In re Adelphia Communications Corp.*, 342 B.R. 122, 125 & n. 1, 128-29 (S.D.N.Y. 2006) (citations omitted); *see also Silverman v. Tracar (In re American Preferred Prescription, Inc.)*, 255 F.3d 87, 92 (2d Cir. 2001) (dicta) (citing *Cajun Elec. Power Coop., Inc. v. Central La. Elec. Co. (In re Cajun Elec. Power Coop., Inc.)*, 69 F.3d 746, 747-48 (5th Cir. 1995); *In re Plaza de Diego Shopping Ctr., Inc.*, 911 F.2d 820, 826-27 (1st Cir. 1990)).

Issue Presented Issue Presented

Upon a bankruptcy filing, the debtor's property vests in a bankruptcy estate that serves as a trust for the benefit of creditors. In a chapter 11 reorganization case, either the debtor's management or a trustee serves as the fiduciary for this trust. Section 543 of the Bankruptcy Code requires pre-bankruptcy receivers to turn over estate property to the appropriate bankruptcy fiduciary. Given that the Bankruptcy Code required the pre-bankruptcy receiver to turn over all estate property to these debtors' dishonest managers, should the bankruptcy court have granted the United States Trustee's motion for the appointment of an impartial trustee to administer the bankruptcy estate for the benefit of all creditors?

Standard of ReviewStandard of Review

This Court reviews the bankruptcy court's findings of fact for clear error. Fed. R. Bankr. P. 8013. In many contexts the appointment of a trustee involves factual interpretation and therefore appellate review is subject to the abuse of discretion standard. *In re Sharon Steel Corp.*, 871 F.2d 1217, 1222, 1225 (3d Cir. 1998)

Here no party disputes the material facts. Marwil's Memorandum of Law in Response to the Motion of the United States Trustee for the Appointment of a Chapter 11 Trustee, D.E. 35; p.

1, Preliminary Statement. By ruling from the bench without opening the evidence, the bankruptcy court acknowledged that the Bayou Motion to Appoint a Trustee did not involve factual interpretation. *Cf. In re Sharon Steel Corp.*, 871 F.2d 1217, 1225 (3d Cir. 1998) (discussing standards of review in context of motion to appoint a trustee). Here, appellate review is analogous to reviewing a summary judgment decision. The parties dispute the ultimate fact, which is the legal result of the undisputed facts. *Sharon Steel*, 871 F.2d at 1222, 1225. This Court reviews this question of law under a de novo standard of review. *Sharon Steel*, 871 F.2d at 1222.

Statement of the CaseStatement of the Case

Promoters marketed the Bayou Group and related legal entities (collectively "Bayou") as hedge funds – private pooled investment funds. But Bayou was ultimately exposed as a totally fraudulent enterprise. Bayou's managers falsely reported financial data and misappropriated assets. Federal agencies have filed forfeiture actions against Bayou's physical assets. The two key managers pled guilty to federal criminal charges, and they await sentencing. Israel and Marino Pleas; D.E. 41, Ex. B, Parts 1 and 2.[1] The parties uniformly agree that the prior management must not control Bayou.

After prior management's fraud was discovered, Bayou ceased all operations. Bayou's tangible assets were forfeited, so Bayou's only remaining assets were litigation claims. No one was pursuing these litigation claims. Some of Bayou's creditors styling themselves the "Unofficial On-Shore Creditors' Committee"[2] filed a securities lawsuit in the United States

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[1] The appellate record is organized by reference to the bankruptcy court's docket entries. The bankruptcy court ruled without opening an evidentiary record, indicating the Court considered judicial admissions and took judicial notice of transcripts and orders attached to pleadings.

[2] The Unofficial Committee consisted of voting and non-voting members. In accordance with 11 U.S.C. § 1102(a), the United States Trustee appointed an Official Creditors' Committee after the bankruptcy filing.

District Court for the Southern District of New York and asked the District Court to appoint a federal equity receiver to pursue the claims. Order Consolidating 06CIV2379 with MDL 1775 and Scheduling Conference; D.E. 41, Exhibit F, p. 3. When the District Court received the request, the District Court required additional notice to creditors and noted, "what the Unofficial Committee seeks is very much akin to what occurs in bankruptcy . . . . [A] trustee is appointed . . . ." Scheduling Order, D.E. 41, Exhibit F, p. 3. "I asked why the Unofficial Committee had not chosen to proceed in bankruptcy . . . . I confess that I did not understand the answer." Scheduling Order, D.E. 41, Exhibit F, p. 4.

The District Court ultimately appointed Jeff Marwil, the Unofficial Committee's candidate, as a non-bankruptcy federal equity receiver. The District Court's Order defined Marwil as the "Receiver" and created a Receivership Estate, which also was defined as the Bayou Entities. Order Granting the Unofficial On-Shore Creditors' Committee's Motion to Appoint a Receiver (the "Receivership Order"), Brief Appendix A, para. 1, p. 2; Appendix A to D.E. 35. The Bayou Receiver was expressly appointed pursuant to 28 U.S.C. § 754, 28 U.S.C. § 959, Federal Rule of Civil Procedure 66, and the District Court's inherent powers. Receivership Order, Brief Appendix A, para. 1.

The Receivership Order itemized the Receiver's duties. "[T]he Receiver is specifically authorized, empowered and directed to perform the following duties and responsibilities . . . . *Corporate Governance*: [The Receiver] . . . [shall] succeed to be the sole and exclusive managing member and representative of each of the Bayou Entities." Receivership Order, ¶ 7(e), Brief Appendix A. He "manage[s] and direct[s] the business and financial affairs of the Bayou Entities." Receivership Order, ¶ 7(e), Brief Appendix A. In addition to giving the Bayou Receiver the power to file bankruptcy, the Receivership Order specified that the Bayou Receiver would "be deemed a debtor-in-possession for . . . the Bayou Entities . . . and prosecute such adversary proceedings and other matters *as may be permitted under the [Bankruptcy] Code and/or applicable law."* Receivership Order, ¶ 7(e) (emphasis added), Brief Appendix A.

On May 30, 2006, the Bayou Receiver filed voluntary bankruptcy petitions for each of the Bayou entities. The United States Trustee agreed that the Bayou Receiver had the power to file the bankruptcy cases because the filing was a pre-bankruptcy act authorized by the Receivership Order and not prohibited by the Bankruptcy Code. The United States Trustee contended – and contends – that the federal law terminated the Receiver's authority to manage the estates of the Bayou entities when the bankruptcy cases were filed.

The United States Trustee filed a Motion to Appoint a Chapter 11 Trustee. D.E. 29. The United States Trustee sought the appointment of a neutral bankruptcy trustee based on the following legal position:

- The bankruptcy filing created a bankruptcy estate of property held in trust for the creditors. 11 U.S.C. § 541.
- This bankruptcy estate unwound the Receivership Estate that the Bayou Receiver controlled. *See* Receivership Order, ¶ 1, p. 2, Brief Appendix A (defining Receivership Estate).
- In bankruptcy, the Bayou Receiver became a custodian by operation of law, 11 U.S.C. § 101(11)(A), and the Bayou Receiver was required to turn over the property to the corporate management or the bankruptcy trustee. 11 U.S.C. § 543(a).
- Because Bayou's former corporate management had pled guilty to federal crimes, everyone concurred that the property should not be turned over to the former management.

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The United States Trustee argued below that the appointment of a bankruptcy trustee was necessary to fill the vacuum of lawful management under the Bankruptcy Code. The Bayou Receiver would turn over the property to the chapter 11 trustee, to be administered in accordance with the requirements of the Bankruptcy Code. 11 U.S.C. § 543. The United States Trustee acknowledged, "[t]here's actually no per se rule against a receiver becoming a trustee . . . . [W]e certainly would listen to the parties and assuming Mr. Marwil meets the disinterested standardness [sic] that will all be taken into consideration so it's not as if we're trying to necessarily displace Mr. Marwil. We're trying to get it into the proper procedural format." Tr. 13:4-17, Brief Appendix B, D.E. 84; see 11 U.S.C. § 1104(d) (requiring United States Trustee to confer with "parties in interest" when appointing a trustee); 11 U.S.C. § 101(14) (defining "disinterested person").

The Garfinkels, investors being sued by the Receiver, joined in the United States Trustee's Motion to Appoint a Chapter 11 Trustee. The Garfinkels focused on the Receiver's standing issue as it impacted them. They contended the Bayou Receiver lacked standing to pursue avoidance actions under the Bankruptcy Code. Garfinkels' Objection, ¶ 2; D.E. 41.

The Bayou Receiver and the Official Committee of Creditors opposed the appointment of a bankruptcy trustee, generally contending that the Bayou Receiver was Bayou's management under the Receivership Order and that the Receivership Order controlled the bankruptcy case. Receiver's Memorandum in Opposition, D.E. 35; Committee's Objection, D.E. 39; Receiver's Supplemental Response, D.E. 44.

Agreeing with the Bayou Receiver and the Official Committee, the bankruptcy court denied the United States Trustee's Motion to Appoint a Chapter 11 Trustee. The bankruptcy court held that it had subject matter jurisdiction but not the power to resolve the dispute because a District Court had appointed the pre-bankruptcy Bayou Receiver. Tr.16:4-10; 23:23-24:14, Brief Appendix B. The United States Trustee asked the bankruptcy court to defer ruling so she could seek withdrawal of the reference. Tr. 17:6-9. Instead of deferring the issue or dismissing the Motion to Appoint the Trustee, the bankruptcy court ruled. Rather than viewing the issue as one of the Bankruptcy Code supplanting the Receivership Order, the bankruptcy court perceived the Motion to Appoint a Chapter 11 Trustee as a collateral attack. "[T]his is not the Court to reverse Judge McMahon's order. . . . I haven't the power to do it, and I won't do it." Tr. 10:20-22, Brief Appendix B.

Alternatively, the bankruptcy court held the Bayou Receiver was "not a custodian any more than had the District Court approved the appointment of a new board of directors, a new president, somebody with a title other than receiver. I haven't studied her order that carefully . . . . I don't know how many times the word "receiver" appears. . . . But the substance of the order is that Mr. Marwil is not simply a custodian. He is given the management of these entities." Tr. 9:1-9, *see also* Tr. 24:3-10, Brief Appendix B. The bankruptcy court initially stated that the bankruptcy court would have the power to replace the Bayou Receiver if the Bayou Receiver was involved in wrongdoing, but the bankruptcy court later indicated that the District Court might be the proper court for that issue. Tr. 16:24-17:3, Brief Appendix B.

Based on these findings and conclusions, the bankruptcy court entered the Order Denying Motion of the United States Trustee for the Appointment of a Chapter 11 Trustee. D.E. 49. The United States Trustee thereafter filed a timely notice of appeal.

Summary of the ArgumentSummary of the Argument

When a debtor's property is under the control of a pre-bankruptcy receiver who has replaced unscrupulous management, the Bankruptcy Code requires the appointment of a bankruptcy trustee to succeed the pre-bankruptcy receiver and to administer the bankruptcy estate for the benefit of all creditors. When Congress adopted the Bankruptcy Code, it enacted § 543, which explicitly curtails the authority of custodians, including receivers such as the one in the Bayou case, and barred courts from appointing receivers under § 105(b). The Code also requires custodians to turn over property in their possession or control to the debtor in possession or a chapter 11 trustee to be administered pursuant to the Bankruptcy Code. Permitting receivers appointed before the filing of a chapter 11 petition to remain as bankruptcy management would not only violate federal law; it would also encourage races to non-bankruptcy courthouses and thereby vitiate statutory procedures designed to ensure the transparency of the process by which bankruptcy trustees are selected. Furthermore, real confusion would arise over whether the receivers were acting pursuant to the ad hoc terms of the orders appointing them or the fixed statutory requirements of the Bankruptcy Code. Congress' carefully thought-out statutory scheme for selecting independent estate fiduciaries cannot be circumvented by permitting a receiver to manage the debtor because of terms contained in the now-superseded pre-bankruptcy order originally appointing the receiver.

Argument Argument

A.A The bankruptcy court erred when it held that the Bayou Receiver could act as management for the debtor-in-possession.The bankruptcy court erred when it held that the Bayou Receiver could act as management for the debtor-in-possession.

Even since he filed the chapter 11 petitions for the Bayou debtors, the Bayou Receiver has been a "custodian" of the property of those entities. As defined by federal law, a "custodian" includes every "receiver or trustee of any of the property of the debtor, appointed in a case or proceeding not under this title." 11 U.S.C. § 101(11)(A). The application of this definition to the facts of this case is straightforward. Here, the District Court: (a) in a case not under title 11 of the U.S. Code; (b) appointed the Bayou Receiver "to be the federal equity receiver" of the Bayou entities, Receivership Order ¶ 1, p. 2, Brief Appendix A; (c) to have "complete jurisdiction and control over" all property of those entities , Receivership Order ¶ 2, p. 2, Brief Appendix A. Because the Bayou Receiver is a custodian, he is subject to the requirements of 11 U.S.C. § 543.

Under § 543, the Bayou Receiver is expressly prohibited from "tak[ing] any action in the administration of [] property of the debtor . . . or property of the estate . . . except such action as is necessary to preserve such property." 11 U.S.C. § 543(a). Instead, federal law requires the Bayou Receiver to turn over to the bankruptcy trustee all property of the debtor held by him and to file an accounting of property of the debtor that at any time was in his possession, custody, or control. 11 U.S.C. § 543(b). The Bayou Receiver, as a custodian, must turn all estate property over to the debtor in possession, or if a chapter 11 trustee has been appointed, to the trustee. 11 U.S.C. §§ 1106 and 1107.

These provisions expressly prohibit the Bayou Receiver from administering the debtors' property after the filing of Bayou's chapter 11 petitions. *In re 400 Madison Ave. Ltd. Partnership*, 213 B.R. 888, 894 (Bankr. S.D.N.Y. 1997). Under § 543 of the Bankruptcy Code, the Bayou Receiver is neither a debtor-in-possession nor a trustee and therefore cannot act in either of those capacities. *Id.* at 894; s*ee also In re Plantation Inn Partners*, 142 B.R. 561, 563-4 (Bankr. S.D. Ga. 1992) (improper to vest receiver with obligations of debtor in possession).

The limitations on the authority of receivers under the Bankruptcy Code represent a change from prior law. Under the Bankruptcy Act of 1898, receivers were frequently appointed in bankruptcy cases. The bankruptcy courts selected receivers and trustees. When Congress enacted the Bankruptcy Reform Act of 1978, it "sought to separate the administrative duties in bankruptcy from the judicial tasks, leaving the bankruptcy judges free to resolve disputes untainted by knowledge of administrative matters unnecessary and perhaps prejudicial to an impartial judicial determination." H.R.Rep. No. 764, 99th Cong., 2d Sess. 18 (1986), *as reprinted in* 1986 U.S.C.C.A.N. 5227, 5230. Accordingly, the Bankruptcy Code expressly prohibits a court from appointing a receiver in a bankruptcy case. 11 U.S.C. § 105(b). "The Bankruptcy Code has ample provision for the appointment of trustees when needed. Any appointment of a receiver would simply circumvent the established procedures." H.R. Rep. No 595, 95th Cong., 1st Sess. 317 (1977), *as reprinted in* 1978 U.S.C.C.A.N. 5787, 5815.

Under the Bankruptcy Code, the United States Trustee initially appoints trustees, and unsecured creditors are given the right to elect trustees. 11 U.S.C. §§ 701, § 702 (appointments and elections of chapter 7 trustees); 11 U.S.C. §1104(b)(1),(d) (elections and appointments of chapter 11 trustees). When a trustee election is held, the Bankruptcy Code sets forth strict requirements for voting eligibility and for calculating the percentage of claims held. 11 U.S.C. § 702*; see* 6 *Collier on Bankruptcy* ¶ 702 (Lawrence P. King, et al. eds., 15th ed. rev. 2006). (discussing standards for electing trustees). To assure that an elected trustee is not selected by creditors holding a small amount of claims against the debtor, holders of at least twenty percent of the dollar amount of eligible claims must request the election and vote. 11 U.S.C. § 702(b), (c)(1). Creditors cannot vote if they have an adverse interest. 11 U.S.C. § 702(a)(2). A creditor who received a possibly preferential transfer will not be permitted to vote in a trustee election. *In re Centennial Textiles, Inc.*, 209 B.R. 31, 33 (Bankr. S.D.N.Y. 1997). A report of election is filed. Fed. R. Bankr. P. 2003(d). If an election is disputed, the bankruptcy court will resolve the dispute by, among other things, determining what creditors were eligible to vote for a trustee. *See Centennial Textiles,* 209 B.R. at 33 (resolving such a dispute). Furthermore, the improper solicitation of votes by a candidate for trustee may result in the disapproval of the election. *In re Dalsimer & Co.,* 56 F.2d 644, 645-46 (S.D.N.Y. 1932). While no one suggests that the procedures followed by the District Court in appointing the Bayou Receiver were anything other than exemplary, those procedures clearly did not mirror the requirements of the Bankruptcy Code for the selection of an independent fiduciary to administer a chapter 11 estate.

If the Bayou Receiver is permitted to remain in possession of the estate notwithstanding the requirements of § 543, it is easy to envision a future situation where multiple state or federal courts, at the instance of creditors with differing interests, appoint multiple receivers for the same entity. Presumably the first such receiver to file a chapter 11 petition for the debtor entity would then argue that she, and none of the other receivers, is permitted by the terms of her order of appointment to serve as debtor in possession. In other words, affirming the Bayou Receiver's effort to remain in possession would set the stage for the classic "race to the courthouse." Each plaintiff group will want their selected receiver to manage the bankruptcy case, and that receiver might be beholden to that constituency. For example, in this case, Bayou investors who received redemptions may have participated in the selection of the Bayou Receiver. Bankruptcy policy eschews races to the courthouse that allow one creditor to impede others solely by acting quickly. *Cf. Celotex Corp. v. Edwards*, 514 U.S. 300,310, 115 S. Ct. 1493, 1500 (1995); *Union Bank v. Wolas*, 502 U.S. 151, 162, 112 S. Ct. 527, 533 (1991) (discussing "race to the courthouse" in context of bankruptcy preferences). The United States Trustee need not show that these harms occurred in this case. The possibility of harm in this or other cases is sufficient. *Cf. Weil v. Neary*, 278 U.S. 160, 173 49 S. Ct. 144, 149 (1929) (first using oft-quoted bankruptcy language about tendency to harm as opposed to actual harm). Accordingly, when an equity receiver is the only one serving as management, the appointment of a chapter 11 trustee pursuant to the explicit guidelines of the Bankruptcy Code will prevent the manipulation of the system and assure that the estate fiduciary represents the interests of all creditors.

Notwithstanding the clear dictates of the Bankruptcy Code and guidance provided by its legislative history, the bankruptcy court ruled that the Bayou Receiver did not have to comply with the turnover requirement of § 543. It based this decision on its view that the Bayou Receiver is not a custodian; the court held, "[t]he substance of the order is that [the Receiver] . . . is not simply a custodian. He is given the management of these entities." Tr. 9:7-9; Brief Appendix B. In reaching this conclusion, however, the bankruptcy court ignored a fundamental underpinning of the District Court action. The sole basis for the appointment of the Bayou Receiver was the request by some of Bayou's creditors for the appointment of a federal equity receiver in a non-bankruptcy case. *See* Receivership Order, ¶ 1, p. 2 (invoking federal equity receivership authority and duties in accordance with 28 U.S.C. § 754, 28 U.S.C.§ 959, Fed. R. Civ. P. 66, and inherent powers), Brief Appendix A. The corporate governance paragraph that the bankruptcy court quoted is preceded and qualified by the District Court's reference to the "duties and responsibilities" of the Receiver. Receivership Order, ¶ 7.[3] But for the Receivership Order the Bayou Receiver would have had no authority whatsoever. Therefore, because the Receiver's authority to "manage" these entities is completely dependent upon his status as a custodian, this authority cannot serve as a basis to allow the Bayou Receiver to violate § 543 of the Bankruptcy Code by allegedly serving as a debtor in possession and refusing to turn over estate property. Nor, given the clear prohibition of § 105(b), may the bankruptcy court appoint the pre-bankruptcy Bayou Receiver to act as a receiver in the Bayou bankruptcy cases.

Based upon the foregoing, it is clear that the bankruptcy court erred by not ordering the appointment of a chapter 11 trustee to whom the Bayou Receiver could turn over estate property pursuant to 11 U.S.C. § 543.

B. The Bankruptcy Code formalizes trustee obligations to protect creditors, but these requirements are not imposed on Bayou Receiver under the Receivership Order The Bankruptcy Code formalizes trustee obligations to protect creditors, but these requirements are not imposed on Bayou Receiver under the Receivership Order .

The Bankruptcy Code contains numerous mandatory provisions regulating a chapter 11 trustee's administration of a chapter 11 estate. These mandatory provisions establish how a chapter 11 case must be administered when the estate is in the hands of an independent fiduciary. Under the Receivership Order, the Bayou Receiver, while acting as a de facto quasi-trustee in these cases, is subject to requirements that differ substantially from those of the Bankruptcy Code. The following chart illustrates distinctions between the Bayou Receiver's duties and obligations under the Receivership Order and a chapter 11 trustee's duties and obligations under the Bankruptcy Code:

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[3] This situation differs from one where a business entity voluntarily changes management pursuant to its organizational documents and applicable non-bankruptcy law and then seeks bankruptcy relief. The Bankruptcy Code generally does not alter that result. 11 U.S.C. § 1107 (debtor-in-possession has powers of a trustee); 11 U.S.C. § 1104(a)(defining bases to remove management).

Duties of a Trustee under the Bankruptcy Code	**Duties of the Bayou Receiver under the Receivership Order**
Must be disinterested. 11 U.S.C. § 1104(b)(1),(d); 11 U.S.C. §101(14)	Does not require disinterest.
Trustee must post a surety bond. 11 U.S.C. § 322(a)	Does not require a bond absent a hearing. Receivership Order, ¶ 21. Bayou Receiver is indemnified. Receivership Order, ¶ 19.
Defers compensation until trustee makes disbursements to creditors and court approves compensation. 11 U.S.C. §§ 326(a), 331.	Compensation is monthly. Receivership Order, ¶ 9.
Compensation subject to a statutory cap and must be reasonable. 11 U.S.C. §§ 326(a), 330(a)(1)(A).	Compensation is the "greater of" $20,000 per month or two percent of the net amount of funds distributed. Receivership Order, ¶ 9.
Trustee must undergo a background check. U.S. Trustee requirement.	Not required.
Investments must be "insured or guaranteed by the United States" or subject to a bankruptcy court order authorizing an exception. 11 U.S.C. § 345	Bayou Receiver confers with unofficial committee about investments. Receivership Order, ¶ 7(k).
Settles cases subject to Court approval on notice to creditors. Fed. R. Bankr. P. 9019.	Settles cases after conferring with the unofficial committee. Receivership Order, ¶ 7(d).
Requires broad investigation of debtor and filing of public report of investigation with the Court. 11 U.S.C. § 1106(a)(3) - (4).	Requires limited investigation of claims of the Bayou Entities. Confidential report to be provided to only the unofficial committee. Receivership Order, ¶ 7(b).
Reporting contemplates recommendation whether or not to file a plan or to convert the bankruptcy case to chapter 7. 11 U.S.C. § 1106(a)(5)	Bayou Receiver files a liquidation plan "[u]nless a case is filed under the Bankruptcy Code." Receivership Order, ¶ 7(h)
Upon the appointment of a trustee, any party in interest may file a chapter 11 plan of reorganization. 11 U.S.C. § 1121(c)(1)	Bayou Receiver has exclusive right to file a plan unless bankruptcy case is filed. Receivership Order, ¶ (h). Because Bayou Receiver purports to be the debtor in possession, Bayou Receiver now claims exclusive right to file a chapter 11 plan. 11 U.S.C. § 1121(b).

As the chart establishes, the Bankruptcy Code imposes substantial requirements on a trustee to protect creditors' interests. The Bayou Receiver and Creditors' Committee contend that the Receivership Order makes the Bayou Receiver management and therefore a debtor in possession governed by § 1107 of the Bankruptcy Code. But the requirements of the Receivership Order differ substantially from those of §§ 1107 and 1106, and that deviation is improper under federal law. *See, e.g., In re 400 Madison Ave. Ltd Partnership,* 213 B.R. 888 (Bankr. S.D.N.Y. 1997). ("[N]o section of the Code includes a receiver who remains in possession within the definition of trustee, [so] the receiver does not take on the obligations of a trustee nor the somewhat different ones of a debtor-in-possession.").

Based upon the foregoing, this Court must direct the bankruptcy court to order the appointment of a disinterested trustee for the Debtors. Only such an appointment will clarify that the Bankruptcy Code alone governs the responsibilities of the person acting as a fiduciary for these estates.

C. The bankruptcy court had the power to order the appointment of a bankruptcy trustee, and the bankruptcy court erred when it held that it was bound to violate the Bankruptcy Code due to the Receivership Order.The bankruptcy court had the power to order the appointment of a bankruptcy trustee, and the bankruptcy court erred when it held that it was bound to violate the Bankruptcy Code due to the Receivership Order.

The bankruptcy court denied of the United States Trustee's motion seeking the appointment of a chapter 11 trustee based upon that court's doubts over whether it had jurisdiction to displace a pre-bankruptcy receiver appointed by a district court in a non-bankruptcy case. As federal courts, bankruptcy courts have jurisdiction to determine their own jurisdiction, *e.g. United States v. United Mine Workers*, 330 U.S. 258, 291, 67 S. Ct. 677, 695 (1947). In addition, bankruptcy courts must determine whether they have the power to resolve particular bankruptcy issues. 28 U.S.C. § 157(b)(3). In this case, the bankruptcy court incorrectly held that it lacked the power to resolve a motion seeking the appointment of a trustee.

Under 28 U.S.C. §§ 1334(a) and (e), district courts have exclusive jurisdiction over bankruptcy cases before them and all property of the debtor and of the estate. 28 U.S.C. § 1334(a),(e). As is discussed above, this Court, pursuant to 28 U.S.C. § 157(a), has delegated all cases under title 11 to the bankruptcy judges of this district. Given this, the bankruptcy court has jurisdiction over this case, and all property of the debtor and the estate, and it was bound to follow the requirements of §§ 543, 105(b), and 1104(a) of the Bankruptcy Code by precluding the pre-bankruptcy Bayou Receiver from continuing to control debtor and estate assets, something that violated federal law.

While an issue may properly fall within bankruptcy jurisdiction, the issue of the bankruptcy court's power involves a determination of where a particular issue falls within the three possibilities: core, "related to," or excluded from bankruptcy court authority. Bankruptcy courts most clearly have the power to resolve core issues, 28 U.S.C. § 157(b)(1); and precedent in this district holds that appointment of a trustee is a core matter. *Ngan Gung Rest., Inc. v. Official Committee of Unsecured Creditors (In re Ngan Gung Rest., Inc.)*, 195 B.R. 593, 597 n. 3 (S.D.N.Y. 1996). That precedent was correctly decided.

"Proceedings can be core by virtue of their nature if either (1) the type of proceeding is unique to or uniquely affected by the bankruptcy proceedings, or (2) the proceedings directly affect a core bankruptcy function." *United States Lines, Inc. v. American Steamship Owners Mut. Protection Ass'n (In re United States Lines, Inc.)*, 197 F.3d 631, 637 (2d Cir. 2005)(internal citation omitted); *see also Jamaica Shipping Co., Ltd. v. Orient Shipping Rotterdam (In re Millenium Seacarriers, Inc.)*, 458 F.3d 92 (2d Cir. 2006) (per curiam) (applying same standard). The Second Circuit construes the bankruptcy court's core powers broadly. *Id.* The appointment of a bankruptcy trustee profoundly impacts the administration of the bankruptcy estate. 28

U.S.C. § 157(b)(2)(A) (defining administration of estate as core matter). The request and standards for appointment are governed by § 1104, a statute that applies only because a bankruptcy case is pending. 11 U.S.C. § 1104. Thus, appointment of a bankruptcy trustee is unique to bankruptcy proceedings and impacts a core bankruptcy function, the control of the bankruptcy estate. The appointment of a trustee is a core issue.

The Receivership Order did not divest the bankruptcy court of its core jurisdiction to consider and rule on a motion seeking the appointment of a chapter 11 trustee. In a variety of contexts – including fact patterns similar to that of this case – federal courts have recognized that bankruptcy law supercedes other law and court orders. Examples include:

- District court's collateral order ignoring the bankruptcy court's injunction reversed. A bankruptcy court's order enjoining draw on supersedeas bond must be honored by other federal district courts absent appellate reversal. *Celotex Corp. v. Edwards*, 514 U.S. 300, 308-311, 115 S. Ct. 1493, 1499-1501 (1995);

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- District court's injunction barring parties from asking for interpretation of stay and relief in bankruptcy court reversed. The need for uniformity in bankruptcy is paramount when multiple parties have the same issue. *Erti v. Paine, Webber, Jackson & Curtis, LLP (In re Baldwin-United Corp.)*, 765 F. 2d 343, 347-48 (2d Cir. 1985);

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- An assignee for the benefit of creditors became a "custodian" under the Bankruptcy Code and therefore could not pursue state law avoidance actions. Bankruptcy ends creditors' race to courthouse by creating a ratable distribution system and affords a trustee the power to avoid preferential transfers. The "trustee exercising powers to liquidate a corporation is not hand-picked by the debtor, as was the [assignee] Sherwood, but appointed and supervised by the United States Trustee, an official of the Department of Justice . . . or elected by the creditors . . . to ensure impartiality." *Sherwood Partners, Inc. v. Lycos, Inc. (In re Sherwood Partners, Inc.)*, 394 F.3d 1198, 1203-04 (9th Cir.), *cert. denied*, 126 S. Ct. 1198 (2005);

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- Federal district court erred by failing to honor bankruptcy automatic stay even though federal district court's federal equity receivership arose in first filed case. Bankruptcy was preferred to federal equity receivership. *Gilchrist v. General Elec. Capital Corp.*, 262 F.3d 295, 297-98 (4th Cir. 2001) (relying on *Erti v. Paine, Webber, Jackson & Curtis, LLP (In re Baldwin-United Corp.)*, 765 F. 2d 343, 347-48 (2d Cir. 1985));

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- "Of the fact that the suit was begun in the circuit court with the express leave of the court of bankruptcy it suffices to say that the latter was not at liberty to

> surrender its exclusive control over matters of administration, or to confide them to another tribunal." *United States Fid. & Guar. Co. v. Bray*, 225 U.S. 205, 218, 32 S.Ct. 620, 625 (1912).

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The appellate record suggests that the District Court intended to honor the Bankruptcy Code's subsequent impact, Receivership Order, ¶ 7(e) (limiting the Receiver's powers to those permitted under the Bankruptcy Code), Brief Appendix A, and that the bankruptcy court intended to honor the District Court's authority. The result of this mutual deference is a quagmire. The effective operation of the bankruptcy system depends on the bankruptcy court's ability and willingness to exercise its core jurisdiction and to compel compliance with the mandatory requirements of the Bankruptcy Code in all bankruptcy cases, including the Bayou cases. Nothing inherently distinguishes a Southern District of New York court order from an order of a federal district court or a state court in another jurisdiction. Just as orders enjoining parties from acting in the bankruptcy court or disagreeing with a bankruptcy court's ruling cannot eviscerate bankruptcy law, so also the pre-bankruptcy Receivership Order cannot license a bankruptcy court to violate the Bankruptcy Code by allowing a receiver to administer a debtor's estate in contravention of 11 U.S.C. §§ 543 and 105(b).

In the federal system, the laws of Congress reign supreme, subject only to the constraints of the Constitution. U.S. Const. art.VI, cl. 2. Certainly, the bankruptcy court's reluctance to diverge from the District Court's Receivership Order is understandable. And, without question, the District Court order was entirely proper up to the moment Bayou went into bankruptcy. But thereafter federal law prohibited the Bayou Receiver from controlling or operating the debtor in possession. Because the debtor in possession's managers are convicted felons who cannot be trusted to fulfill the responsibilities of a debtor in possession, the bankruptcy court erred in not ordering the appointment of a federal bankruptcy trustee under 11 U.S.C. § 1104(a). *See C.F.T.C. v. Weintraub*, 471 U.S. 343, 355; 105 S.Ct. 1986, 1994 (1985) (a bankruptcy trustee's fiduciary duties run to all creditors and equity security holders).

ConclusionConclusion

For these reasons, the United States Trustee respectfully asks this Court to reverse the order entered below and remand this case for additional proceedings consistent with such reversal.

Respectfully submitted,
DIANA ADAMS,
ACTING U.S.TRUSTEE

/s/ Lisa L. Lambert
Lisa L. Lambert
Office of United States Trustee
33 Whitehall St., 21st Floor
New York, NY 10004
(212) 510-0500
Lisa.L.Lambert@usdoj.gov

ATTORNEYS FOR APPELLANT
DIANA G. ADAMS,
ACTING U.S. TRUSTEE
FOR REGION 2

Of Counsel:

Roberta A. DeAngelis
Acting General Counsel

Matthew Sutko
Walter W. Theus, Jr.
United States Department of Justice
Executive Office for United States Trustees
20 Massachusetts Avenue, NW
Washington, D.C. 20530
(202) 307-1399

Certificate of Compliance and Service

I certify that the preceding brief comports with page limitations of Federal Rule of Bankruptcy Procedure 8010(c). I further certify that on October 13, 2006, copies of this brief were provided to the following parties by first class mail and by additional methods reflected below:

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The Honorable Colleen McMahon
United States District Court
300 Quarropas Street, Room 533
White Plains, New York 10601-4150
Overnight bound copy and appellate record binder

Jeff J. Marwil
c/o Jenner & Block LLP
One IBM Plaza
Chicago, IL 60611
Email Jmarwil@jennerblock.com
Overnight bound copy

Elise Scherr Frejka
Dechert, LLP
30 Rockefeller Plaza
New York, NY 10112
Email: elise.frejka@dechert.com
Overnight bound copy of brief and appellate record binder

Robert M. Novick
Kasowitz, Benson, Torres & Friedman, LLP
1633 Broadway, 21st Floor
New York, NY 10019
Email: rnovick@kasowitz.com
Overnight bound copy

Richard A. Kirby
Preston, Gates, Ellis & Rouvelas
1735 New York Ave., Suite 500
Washington, DC 20006-5209
Email: richardk@prestongates.com
Overnight bound copy and appellate record binder

Philip Bentley
Kramer Levin Naftalis & Frankel, LLP
1177 Ave. of the Americas
New York, NY 10036
Email: pbentley@kramerlevin.com
Mail copy

Lori Lapin Jones
27 Shadow Lane
Great Neck, NY 11021
Email: lorelij007@aol.com
Mail copy

Joseph Thomas Moldovan
Morrison Cohen LLP
909 Third Avenue
New York, NY 10022-4731
Email: bankruptcy@morrisoncohen.com
Mail copy

George G. Wilder
Commodity Futures Trading Commission
1155 21st Street, N.W.
Washington, DC 20581
Email: gwilder2@cftc.gov
Mail copy

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3. ("CCN") ***CURRENT*** CASE NO.
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(Identify judge & cite, if any)

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Roberta DeAngelis, Walt Theus, Lisa Lambert, William Kanter, Michael Robinson
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***
●Whether the district court's judgement affirming the bankruptcy court's refusal to order the appointment of a Chapter 11 bankruptcy trustee should be reversed, where both the district and bankruptcy courts, incorrectly concluded that under section 1104 & 543 of the bankruptcy code the person the district court had appointed as "federal equity reciever" prior to bankruptcy became a "debtor in posession" upon bankruptcy who could administer the bankruptcy estate rather than a custodian who could not?

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07-1508-bk

IN THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

In re: Bayou Group, LLC, *et al.*

Debtors.

Diana G. Adams, United States Trustee

Appellant,
v.

Receiver Jeff J. Marwil, for the Bayou Group Official Committee of Unsecured Creditors, Official Committee of Unsecured Creditors, Bayou Group, LLC,

Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

BRIEF FOR THE APPELLANT

MICHAEL J. GARCIA
United States Attorney
ROSS E. MORRISON
Assistant United States Attorney
86 Chambers Street, 3rd Floor
New York, NY 10007

OF COUNSEL:
ROBERTA A. DEANGELIS
Acting General Counsel
WALTER W. THEUS, JR.
Department of Justice
Executive Office for United States Trustees
LISA L. LAMBERT
Assistant United States Trustee

PETER D. KEISLER
Assistant Attorney General

WILLIAM KANTER
(202) 514-4575
MICHAEL E. ROBINSON
(202) 514-1371
Attorneys, Appellate Staff
Civil Division, Room 7539
Department of Justice
950 Pennsylvania Ave., N.W.
Washington, D.C. 20530-0001

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of Unsecured Creditors, Bayou Group, LLC,

Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

BRIEF FOR THE APPELLANT

PRELIMINARY STATEMENT

Diane G. Adams, United States Trustee, appeals from a decision rendered by the United States District Court for the Southern District of New York (Hon. Colleen McMahon, J.) dated February 2, 2007, and entered on February 6, 2007. The decision is not yet reported but is currently available on Westlaw at 2007 WL 437675 (S.D.N.Y. Feb. 2, 2007). The district court's decision affirmed a decision of the United States Bankruptcy Court for the Southern District of New York (Hon. Adlai S. Hardin, Jr., J.). That decision is unreported.

JURISDICTIONAL STATEMENT

The bankruptcy court had jurisdiction pursuant to 28 U.S.C. § 157(b)(1). On June 30, 2006, the bankruptcy court denied the U.S. Trustee's motion to appoint a Chapter 11 trustee pursuant to 11 U.S.C. § 1104(a), and the U.S. Trustee appealed the order to the district court on July 10, 2006. The district court had subject matter jurisdiction pursuant to 28 U.S.C. § 158(a). The district court affirmed the denial of the motion to appoint a trustee in a decision and order signed on February 2, 2007, and entered on the docket on February 6, 2007. The U.S. Trustee filed a timely notice of appeal to this Court on April 6, 2007 (Appendix ("App.") A-216). See Fed. R. App. P. 4(a)(1). This Court has jurisdiction pursuant to 28 U.S.C. § 158(d).

STATEMENT OF THE ISSUE

Whether the district court's judgment affirming the bankruptcy court's refusal to order the appointment of a Chapter 11 bankruptcy trustee should be reversed, where both the district and bankruptcy courts incorrectly concluded that, under sections 1104 and 543 of the Bankruptcy Code, 11 U.S.C. §§ 1104 and 543, the person the district court had appointed as "federal equity receiver" prior to bankruptcy became a "debtor in possession" upon bankruptcy who could administer the bankruptcy estate, rather than a "custodian" who could not.

STATEMENT OF THE CASE

A. Nature of the Case

The Bayou Group, L.L.C., and related entities (collectively, Bayou), was a group of hedge funds that are now in bankruptcy. Bayou's managers committed fraud, and the company collapsed. Federal investigations ensued, Bayou's managers pleaded guilty to a variety of federal crimes, and Bayou ceased all operations. The government obtained forfeiture orders covering all of Bayou's tangible assets; the company's only remaining assets were litigation claims.

A group of Bayou's creditors organized themselves into an unofficial creditors' committee and filed a lawsuit in the United States District Court for the Southern District of New York. They sought to have Jeff J. Marwil appointed as receiver to pursue the company's litigation claims and mitigate the creditors' massive losses. After a hearing, the district court entered an order appointing Marwil "the federal equity receiver" for Bayou, and authorizing him as receiver to act as exclusive managing member and representative of the Bayou Entities.

One month after being appointed receiver, Marwil caused each of the Bayou companies to file voluntary petitions for Chapter 11 bankruptcy in the Southern District of New York. The U.S. Trustee then appointed an official creditors' committee, comprised mostly of members of the unofficial creditors' committee, and asked the bankruptcy court to order the appointment of a Chapter 11 trustee. The bankruptcy court denied the U.S. Trustee's motion for appointment of a trustee and the district court affirmed. The district court held that its previous order clearly appointed Marwil to be both receiver and Bayou's corporate management. In doing so, the court rejected the argument that Marwil was a "custodian" under 11 U.S.C. § 101(11)(A) & (C) of the Bankruptcy Code, finding that, as debtor in possession, he was under no obligation to turn over Bayou's property to a bankruptcy trustee pursuant to 11 U.S.C. § 543(b).

This appeal followed.

B. Statutory Framework

In a Chapter 11 bankruptcy, the debtor usually administers the bankruptcy estate, exercising most of the rights and fiduciary duties of a trustee. The debtor is then known as a "debtor in possession." 11 U.S.C. § 1107. A trustee may be appointed to administer the estate "for cause, including fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor by current management" or "if such appointment is in the interests of creditors, any equity security holders, and other interests of the estate." 11 U.S.C. § 1104(a)(1)-(2). When a court orders appointment of a trustee, the U.S. Trustee consults with parties in interest and appoints a disinterested person to serve as trustee, subject to the court's approval. 11 U.S.C. § 1104(d). Alternatively, a party in interest may request that the U.S. Trustee gather the creditors and hold a trustee election. 11 U.S.C. § 1104(b). Importantly, "a court may not appoint a receiver" in a Chapter 11 bankruptcy case, 11 U.S.C. § 105(b);[1] the bankruptcy estate must be administered by either a debtor in possession or a trustee.

Any "custodian" holding the debtor's property must "deliver to the [bankruptcy] trustee any property of the debtor held by or transferred to such custodian . . . on the date that such custodian acquires knowledge of the commencement of the [bankruptcy case]." 11 U.S.C. § 543(b). The term "custodian" includes any "receiver or trustee of any of the property of the debtor, appointed in a case or proceeding not under" Chapter 11 and any "trustee, receiver, or agent . . . that is appointed or authorized to take charge of property of the debtor for the purpose of

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[1] The Senate Report states that "[t]he bankruptcy judge is prohibited from appointing a receiver in a case under title 11 under any circumstances. The bankruptcy code has ample provision for the appointment of a trustee when needed. Appointment of a receiver would simply circumvent the established procedures." S. Rep. No. 95-989, at 29 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5815.

enforcing a lien against such property, or for the purpose of general administration of such property for the benefit of the debtor's creditors." 11 U.S.C. § 101(11)(A), (C).

C. Procedural History and Facts

1. Bayou Group is an affiliated group of legal entities that created and managed private pooled investment funds, or so-called "hedge funds." Bayou's managers operated the funds fraudulently and Bayou collapsed under the weight of the fraud. The United States Attorney for the Southern District of New York, the Securities and Exchange Commission and the Commodity Futures Trading Commission each conducted investigations into the fraud. On September 29, 2005, Bayou's managers pleaded guilty to conspiracy to commit mail and wire fraud and investment advisor fraud. Slip. Op. at 3-4 (App. A-191 to A-192).

After the fraud was discovered, Bayou ceased all operations. The United States seized all of Bayou's tangible assets pursuant to forfeiture orders covering those assets. Bayou's only remaining assets were litigation claims. *Id*. at 4 (App. A-192). A group of more than 60 Bayou creditors, holding more than $130 million in claims, organized themselves as the "Unofficial On-Shore Creditors' Committee of the Bayou Family of Companies" (Unofficial Creditors' Committee). On March 27, 2006, the Unofficial Creditors' Committee filed a securities lawsuit in federal district court seeking the appointment of Jeff J. Marwil as "federal equity receiver" to pursue these litigation claims and thereby mitigate the massive losses suffered by the creditors and others. See *ibid*. As authority for the appointment of a receiver, the Unofficial Creditors' Committee's motion cited Fed. R. Civ. P. 66, which is entitled, "Receivers Appointed by Federal Courts," and deals with "action[s] wherein a receiver has been appointed" and the rules and practice applicable to such actions. See Notice of Mot. of Pl. for Appointment of a Receiver (Mar. 28, 2006) at 1 (Addendum).

2. The district court conducted hearings to consider Marwil's appointment as receiver for the Bayou entities. On April 28, 2006, the district court, without objection, entered an order appointing Marwil as "the federal equity receiver." Order Granting the Unofficial On-Shore Creditors' Committee's Mot. to Appoint a Receiver ("Receivership Order") (April 28, 2006) ¶ 1 (App. A-38). The district court's order defined Marwil as the "Receiver" and created a "Receivership Estate," which was defined as the Bayou entities. *Ibid*.

According to the district court, its appointment of the receiver was "warranted under Section 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5 thereunder, state law claims of fraud and breach of fiduciary duty, Federal Rule of Civil Procedure 66, and the facts and circumstances of this case." Receivership Order ¶ 3 (App. A-39). The receiver was expressly appointed "[p]ursuant to 28 U.S.C.

§§ 754 and 959, Federal Rule of Civil Procedure 66 and [the] court's inherent authority." *Id.* ¶ 1 (App. A-38).

In a section entitled "RECEIVER'S AUTHORITY AND DUTIES," the Receivership Order "authorized, empowered, and directed [the Receiver] to perform . . . [a number of] duties and responsibilities," Receivership Order ¶ 7 (App. A-40), including the responsibility for "Corporate Governance," *id.* ¶ 7e (App. A-41). The portion of the order dealing with "Corporate Governance" directed Marwil, "[p]ursuant 28 U.S.C. § 959(b),"[2] to "succeed to be the exclusive managing member and representative of each of the Bayou [On-Shore] Entities . . . ." *Ibid.*

3. On May 30, 2006, one month after his appointment as "federal equity receiver," Marwil caused each of the Bayou entities to file separate voluntary petitions for relief under Chapter 11 of the Bankruptcy Code. Slip op. at 8 (App. A-196). On June 15, 2006, the U.S. Trustee appointed an Official Committee of Unsecured Creditors (Official Creditors' Committee), consisting of five members – four of whom were voting members of the Unofficial Creditors' Committee. *Id.* at 9 (App. A-197).

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[2] Section 959(b) provides: "a trustee, receiver or manager appointed in any cause pending in any court of the United States, including a debtor in possession, shall manage and operate the property in his possession . . . according to the requirements of the valid laws of the State in which such property is situated."

On June 20, 2006, the U.S. Trustee moved the bankruptcy court to order the appointment of a Chapter 11 trustee pursuant to 11 U.S.C. § 1104(a). U.S. Trustee's Mot. to Appoint a Chapter 11 Trustee (June 20, 2006) (App. A-80). The U.S. Trustee asserted that, because Bayou's former corporate management had pleaded guilty to federal crimes, turning over the property to former management was inconceivable. Appointment of a Chapter 11 trustee was thus necessary to fill the vacuum of lawful management. *Ibid.* Bayou and the Official Creditors' Committee opposed the motion, asserting that Marwil was Bayou's management under the district court's order and therefore could serve as debtor in possession. See Tr. of Hrg. On Mot. To Appoint a Trustee (June 29, 2006) at 19-20 (App. A-67 to A-68).

The bankruptcy court denied the U.S. Trustee's motion. The bankruptcy court found that the motion for appointment of a Chapter 11 trustee as a collateral attack on the district court's Receivership Order and held that it did "not have power to enter an order that would completely change and undermine the order entered by [the district court]." *Id.* at 24 (App. A-72). Alternatively, the bankruptcy court ruled that, even if it did have the power to appoint a Chapter 11 trustee, it would not do so because it viewed the district court's order "as not simply appointing a custodian or a receiver, but as appointing new management of these debtors . . . ." *Ibid.*

4. On July 10, 2006, the U.S. Trustee appealed the bankruptcy court's order to the district court. By Decision and Order dated February 2, 2007, the district court affirmed the bankruptcy court's decision. The district court held that its previous order "clearly contemplated appointing Marwil both as receiver and as Bayou's corporate management," and that Marwil's "corporate management appointment was not merely derivative of his receivership appointment" because the "corporate governance appointment was not made pursuant to federal receivership statutes only, but pursuant to federal securities law and this court's inherent authority as well." Slip Op. 13 (App. A-201). Thus, "[w]hen Marwil caused the Bayou entities to file for Chapter 11 bankruptcy . . . Marwil's status as corporate governor automatically blossomed into that of debtor-in-possession since, as managing member of Bayou, Marwil was the debtor's management." *Id.* at 20 (App. A-208). The court rejected the argument that Marwil was as a "custodian" under the Bankruptcy Code, finding that, as debtor in possession, he was "under no obligation to turn over Bayou's property to a bankruptcy trustee." *Id.* at 21 (App. A-209).

The district court admitted that this result "expose[d] a loophole in the Bankruptcy Code," inasmuch as the 1978 Bankruptcy Reform Act "expressly sought to supplant federal equity receivers in bankruptcy proceedings with the U.S. Trustee." *Id*. at 22 (App. A-210). The district court acknowledged that "[its] decision contradicts the spirit – albeit not the letter – of the 1978 Bankruptcy Reform Act" insofar as it permits creditors "to appoint their own bankruptcy 'trustee,' by having a district judge do it prior to any filing in bankruptcy." *Id*. at 25 (App. A-213). The court nevertheless expressed the view that "the remedy lies with Congress," since "nothing in the Code precludes a federal district judge from appointing corporate management, prior to the filing of any petition in bankruptcy." *Ibid.* For these reasons, the district court affirmed the bankruptcy court's denial of the U.S. Trustee's motion to appoint a Chapter 11 trustee. *Id*. at 26 (App. A-214).

This appeal followed.

STANDARD OF REVIEW

An order of the district court functioning in its capacity as an appellate court in a bankruptcy case is subject to plenary review, meaning that this Court undertakes an independent examination of the factual findings and legal conclusions of the bankruptcy court. *In re Taylor*, 243 F.3d 124, 128 (2d Cir. 2001). The bankruptcy court's findings of fact are reviewed for clear error and its conclusions of law – including its interpretation of the Bankruptcy Code – are reviewed de novo. See *In re Lehal Realty Assocs.*, 101 F.3d 272, 276 (2d Cir. 1996). Finally, this Court reviews the bankruptcy court's exercise of discretion for abuse. *Ibid.*

SUMMARY OF ARGUMENT

1. The district court's initial order appointed Marwil as "federal equity receiver" so that he could manage Bayou's property. The district court vested Marwil with management powers, but those powers were to be exercised as part of his receivership. The district court did not appoint Marwil to be Bayou's management.

2. Because Marwil served as a receiver pre-petition, he became a custodian post-petition. The definition of "custodian" in 11 U.S.C. § 101(11)(A) & (C) is broad, and it includes any receiver or agent of a debtor's property appointed in a non-Chapter 11 case, and any receiver appointed or authorized to administer the debtor's property for the benefit of the debtor's creditors. The plain terms of the district court's order makes clear that Marwil fell within *both* of these descriptions. Moreover, as custodian, Marwil was required to deliver to the bankruptcy trustee any property of the debtor held by or transferred to him and to file an accounting of the property within his custody or control.

The district attempted to justify the retention of Marwil as receiver post-bankruptcy by asserting that he was appointed pursuant to federal securities law and the court's inherent authority, and not solely pursuant to federal receivership statutes. However, the source of the court's authority to appoint receivers in securities cases is the same inherent equitable power that applies outside the securities context; and, in any event, there is no authority for the proposition that a person appointed by a district court to take control of property and manage the affairs of a defendant in a securities action would not be deemed a "custodian" if that defendant later became a debtor in a case under the Bankruptcy Code.

3. The district court's order also violates the policy of the Bankruptcy Code. The Bankruptcy Code gives the U.S. Trustees the authority to appoint disinterested trustees to administer bankruptcy estates. The district court's order calls that authority into question by allowing a select group of creditors to appoint their own trustee before a debtor files for bankruptcy, without any guarantee that the trustee is disinterested. As the district court itself recognized, this result is "contrary to the spirit" of the Bankruptcy Code.

4. The decisions of the bankruptcy court and the district court in this case also are inconsistent with the relevant case law. The cases, though few, uniformly suggest that courts may not permanently vest a receiver with the duties and powers of a debtor-in-possession and that the Bankruptcy Code clearly contemplates that the long-term administration of a Chapter 11 case will be managed by a trustee or debtor-in-possession, not a hybrid created by judicial fiat. The district court here, however, has done just that: it has created a receiver that, post-petition, effectively serves as trustee or debtor-in-possession.

ARGUMENT

THE BANKRUPTCY COURT ABUSED ITS DISCRETION IN DENYING THE U.S. TRUSTEE'S MOTION TO APPOINT A CHAPTER 11 TRUSTEE

A. The District Court's Initial Order Made Marwil A "Receiver" Within the Meaning Of The Bankruptcy Code And Nothing Else.

It is clear from the district court's order that the court appointed Marwil as a receiver and any management duties were to be exercised as a part of that receivership. The Receivership Order authorized the receiver to perform a number of duties and responsibilities, including the responsibility for "Corporate Governance." There is nothing unusual in giving a receiver authority to manage the affairs of a business estate.

The portion of the order dealing with "Corporate Governance," however, directed Marwil to "succeed to be the exclusive managing member and representative of each of the Bayou [On-Shore] Entities . . . ." Receivership Order at ¶ 7e (App. A-41). The district court subsequently reasoned that, by virtue of this provision, it had "appointed Marwil as receiver *and* as the exclusive managing member of Bayou." Slip op. at 21 (App. A-209). Moreover, the court determined, these roles were separate: "[Marwil's] corporate governance powers [were] not derived from his receivership." *Ibid.* Thus, the court concluded, "upon causing Bayou to file its bankruptcy petition, Marwil's receivership ended and he immediately became the managing member of a debtor-in-possession." *Ibid.*

Despite these assertions, it is clear from the motion filed by the Unofficial Creditors' Committee, which specifically asked the district court to appoint a receiver, and from the key portion of the district court's order, which deemed Marwil "the federal equity receiver" and gave him authority over Bayou's property, that the sole purpose of the appointment was to make Marwil a receiver. See Unofficial On-Shore Creditors' Comm.'s Mem. in Support of its Mot. To Appoint a Receiver (Mar. 28, 2006) at 2 (App. A-121);[3] see also Receivership Order ¶¶ 1, 2 (App. A-38). To be sure, the Unofficial Committee asked the court to "grant [the] receiver powers that include the day-to-day management of the business entity," Unofficial On-Shore Creditors' Comm.'s Mem. in Support of its Mot. to Appoint a Receiver (Mar. 28, 2006) at 20 (App. A-139); and the Committee included such powers in its proposed order, see Receivership Order at ¶ 7e (App. A-41). But nothing in the Unofficial Creditors' Committee motion or supporting memorandum suggests that these management duties could not be performed by a receiver; and the order granting the

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[3] The Unofficial Creditors' Committee notice of motion for appointment of a receiver cited Fed. R. Civ. P. 66 as authority for the appointment of a receiver. Rule 66 is entitled, "Receivers Appointed by Federal Courts," and deals with "action[s] wherein a receiver has been appointed" and the rules and practice applicable to such actions.

motion to appoint a receiver simply gave the receiver these customary powers to manage the companies.

Indeed, as the district court acknowledged, "[f]ederal courts may grant a receiver powers that include the day-to-day management of the business entity, including the authority to liquidate assets, the authority to pursue claims, and the authority to file for bankruptcy." Slip op. at 14 (App. A-202) (citing *SEC v. Credit Bancorp, Ltd.*, 297 F.3d 127, 130 (2d Cir. 2002) (recognizing lower court's appointment of receiver "who was granted broad powers to, *inter alia*, issue subpoenas, marshal [corporate] assets, liquidate those assets, and reinvest the proceeds in Treasury instruments")). In giving Marwil management responsibilities as part of his appointment as receiver, moreover, the district court stated that those responsibilities were to be exercised "with a view towards" preserving and distributing the Bayou assets. Receivership Order ¶ 7 (App. A-40). Thus, the management responsibilities were designed solely to ensure that Marwil could fulfill his role as receiver. The district court did not appoint him to a separate role as Bayou's manager that was independent of his receivership.

For these reasons, both the bankruptcy court and the district court were wrong to conclude that Marwil's corporate governance powers were not derived solely from his receivership.

B. Once Bankruptcy Petitions Were Filed, Marwil Became A "Custodian" Within The Meaning Of The Bankruptcy Code.

1. The Bankruptcy Code expressly prohibits courts from appointing receivers in Chapter 11 bankruptcy cases. 11 U.S.C. § 105(b). When Marwil caused the Bayou entities to file voluntary petitions for bankruptcy, Marwil's authority as receiver was circumscribed by operation of the Bankruptcy Code. Upon filing, he became a "custodian" within the meaning of the Code and subject to the turnover obligations set forth in § 543.

The statutory definition of "custodian" is broad, and it includes any "receiver . . . of the property of the debtor" appointed in a non-Chapter 11 case, and any "receiver, or agent . . . appointed or authorized to take charge of property of the debtor . . . for the purpose of general administration of such property for the benefit of the debtor's creditors." 11 U.S.C. § 101(11)(A), (C). Marwil qualifies under both of these provisions. That is, the court appointed Marwil to be "receiver . . . of the property of the debtor . . . in a case or proceeding not under [title 11]" of the U.S. Code. Moreover, Marwil plainly was a "receiver or agent" who was "authorized to take charge of property of the debtor . . . for the purpose of general administration of such property for the benefit of the debtor's creditors." Nothing in section

101(11)(A) or (C) excludes Marwil from the definition of "custodian" because, as receiver, he was authorized to manage the affairs of the debtor.

For these reasons, both the bankruptcy court and the district court were wrong to conclude that Marwil was not a "custodian" merely because he had been granted the "corporate governance powers" of a "managing member and representative" of the Bayou Entities. See Tr. of Hrg. On Mot. To Appoint a Trustee (June 29, 2006) at 9 (App. A-57); slip op. at 21 (App. A-209). As the legislative history of 11 U.S.C. § 101(11)(A) & (C) explains, courts are required to look beyond particular labels to determine if an officer of the court functions substantially like a receiver or trustee: "custodian" means "a prepetition liquidator of the debtor's property, . . . or administrator of the debtor's property. *The definition of custodian to include a receiver or trustee is descriptive, and not meant to be limited to court officers with those titles*." S. Rep. No. 95-989, at 23 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5809 (emphasis added). There is no doubt that, under the terms of the Receivership Order, Marwil became "administrator of the debtor's property," responsible for liquidating Bayou's litigation claims. See Receivership Order ¶¶ 6-7 (App. A-39 to A-42).

As a custodian, Marwil was subject to the requirements of 11 U.S.C. § 543. Under § 543, "[a] custodian with knowledge of the commencement of a case under this title concerning the debtor may not make any disbursement from, or take any action in the administration of, property of the debtor, proceeds, product, offspring, rents, or profits of such property, or property of the estate, in the possession, custody, or control of such custodian, except such action as is necessary to preserve such property." *Id.* § 543(a). Instead, the custodian must "deliver to the trustee any property of the debtor held by or transferred to such custodian" and "file an accounting of any property of the debtor . . . that, at any time, came into the possession, custody, or control of such custodian." *Id.* § 543(b).

2. The district court wrongly attempted to make a distinction between receivers allegedly appointed "pursuant to federal receivership statutes alone," slip op. at 13 (App. A-201), and persons appointed to act as corporate management "pursuant to federal securities laws and the court's inherent authority," *id.* at 14 (App. A-202) (footnote omitted). See also Receivership Order at 1 (App. A-37); slip op. at 4-5 (App. A-192 to a-193) (citing Section 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5, Fed. R. Civ. P. 66, 28 U.S.C. §§ 754 and 959). The district court acknowledged that the former would be "custodians," but asserted that the latter are not. See *ibid.*

However, neither Section 10(b) of the Securities Exchange Act of 1934 nor SEC Rule 10b-5, cited by the district court, specifically vests courts with the power to appoint receivers. See *SEC v. American Bd. of Trade, Inc.*, 830 F.2d 431, 436 (2d Cir. 1987) ("[N]either the Securities Act of 1933 nor the Securities Exchange Act of 1934 explicitly vests district courts with the power to appoint trustees or receivers . . . ."), *cert. denied*, 485 U.S. 938 (1988); see also *SEC v. Manor Nursing Ctrs., Inc.*, 458 F.2d 1082, 1105 (2d Cir. 1972) (noting "the absence of explicit statutory authority" to appoint a trustee "to receive the proceeds, to distribute them to defrauded public investors and to report to the court on the true state of affairs"). Rather, such authority derives wholly from the general equity powers of the district courts. See *American Bd. of Trade*, 830 F.2d at 436; *Manor Nursing Ctrs.*, 458 F.2d at 1105. The same is true with regard to a district court's authority to appoint a receiver in a non-securities case, so no distinction can be drawn between receivers appointed in securities cases and those appointed in other cases.

Nor did the district court cite *any* authority for the proposition that a person appointed by a district court to take control of the property and manage the affairs of a defendant in a securities action would not be deemed a "custodian" if that defendant later became a debtor in a case under the Bankruptcy Code. The definition of "custodian" in 11 U.S.C. § 101(11) contains no exception for custodians appointed in securities cases; and there appears to be no case law supporting such a distinction.

Furthermore, this straightforward reading of the definition of "custodian" is consistent with the framework of the Bankruptcy Code. Prior to bankruptcy, any number of persons may be engaged in helping to manage the property of a struggling company, but once the company declares bankruptcy, the Code authorizes only the debtor itself or a trustee to administer the estate. Thus, anyone previously serving as receiver or agent to manage the company's property becomes a custodian who must account for and turn over the property. 11 U.S.C. § 543.

This analysis is buttressed by the Code's prohibition on the appointment of receivers in bankruptcy. See 11 U.S.C. § 105(b); see also S. Rep. No. 95-989, at 23 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5809 ("custodian" means "a prepetition liquidator of the debtor's property, . . . or administrator of the debtor's property. *The definition of custodian to include a receiver or trustee is descriptive, and not meant to be limited to court officers with those titles*.") (emphasis added). If the debtor cannot administer the estate as debtor in possession, then a disinterested trustee (not a receiver) is to perform that function.

C. The Rulings Below Override The Scheme Contemplated By The Bankruptcy Code By Supplanting The Authority Of The U.S. Trustee In Chapter 11 Cases.

An appointment that seeks to circumvent the bankruptcy scheme established by Congress is invalid. The district court had the authority to appoint a receiver with management powers to run the affairs of the Bayou entities prior to bankruptcy. But, under the Bankruptcy Code, that authority did not supplant the right of the U.S. Trustee to appoint a trustee in Chapter 11 cases and to does not affect the status of receivers as custodians. See 11 U.S.C. §§ 101(11)(A)&(C); 105(b); 543.

An important policy underlying the Bankruptcy Code is the need to ensure that there are disinterested trustees, overseen by the U.S. Trustee, to manage bankrupt companies. See 11 U.S.C. § 1104 (requiring that a trustee appointed by the court at the request of the U.S. Trustee must be a "disinterested person").[4] In defining the obligation of "disinterestedness," the Code says that examiners and trustees may "not have an interest materially adverse to the interest of the estate or of any class of

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[4] The Code defines "disinterested person" as a person that:

> (A) is not a creditor, an equity security holder, or an insider;
>
> (B) is not and was not, within 2 years before the date of the filing of the petition, a director, officer, or employee of the debtor; and
>
> (C) does not have an interest materially adverse to the interest of the estate or of any class of creditors or equity security holders, by reason of any direct or indirect relationship to, connection with, or interest in, the debtor, or for any other reason.

11 U.S.C. § 101(14).

creditors or equity security holders, by reason of any direct or indirect relationship to, connection with, or interest in, the debtor, or for any other reason." 11 U.S.C. § 101(14)(C) (emphasis added). "By prohibiting any 'materially adverse' 'interest' to any party to the bankruptcy 'for any ... reason,' Congress plainly invited – indeed compelled – federal courts to construe 'disinterestedness' against the backdrop of the equitable duties that apply to positions of trust." *In re Big Rivers Elec. Corp.*, 355 F.3d 415, 431 (6th Cir. 2004).

The decisions of the district and bankruptcy courts, however, effectively allow creditors to handpick a person prior to bankruptcy to administer the bankruptcy estate, without any guarantee that the person will be disinterested. As a result, the district court's decision improperly intrudes on the role of the U.S. Trustees and undermines the policy of the federal bankruptcy system.

As explained, the district court admitted that this result seemed to "expose[] a loophole in the Bankruptcy Code," inasmuch as the 1978 Bankruptcy Reform Act "expressly sought to supplant federal equity receivers in bankruptcy proceedings with the U.S. Trustee." Slip Op. at 22 (App. A-210). But the supposed "loophole" in the statutory scheme results from the district court's mischaracterization of its Receivership Order and its faulty construction of the Bankruptcy Code provisions that make up the statutory scheme. See *Matter of Plantation Inn Partners*, 142 B.R. 561, 564 (Bankr. S.D. Ga. 1992) ("[T]o permit the Receiver to indefinitely remain in possession and to vest him permanently with all the duties and powers of a debtor-in-possession goes far beyond the limited relief envisioned by Section 543. . . . Clearly the Code contemplates that the long-term administration of a Chapter 11 case will be managed by a trustee or debtor-in-possession, not a hybrid created by judicial fiat.").

D. The Bankruptcy Court's Decision Is Inconsistent With Other Case Law.

The relevant case law supports the government's view. For example, in *Matter of Plantation Inn Partners*, 142 B.R. 561 (Bankr. S.D. Ga. 1992), the debtor sought turnover of property from a custodian (who had previously been a receiver), and the custodian sought to excuse turnover under the exception contained in 11 U.S.C. 543(d). But, as explained, the bankruptcy court held that the custodian could not continue to administer the estate, despite the statutory exception. To do so would "vest [the custodian] permanently with all the duties and powers of a debtor-in-possession" and thus far exceed the limited relief envisioned in Section 543. *Id.* at 564. As the court noted, the Bankruptcy Code clearly "contemplates that the long-term administration of a Chapter 11 case will be managed by a trustee or debtor-in-possession, not a hybrid created by judicial fiat." *Ibid.*

Similarly, in *In re Stratesec, Inc.*, 324 B.R. 156 (Bankr. D.D.C. 2004), the court held that allowing a receiver "to continue to manage the affairs of the debtor while that debtor utilizes chapter 11 of the Bankruptcy Code" would be "inconsistent with the Bankruptcy Code"; "[i]f a fiduciary is necessary, it should be a trustee appointed by the United States Trustee." *Id.* at 157-158. See also *In re 400 Madison Ave. Ltd. P'ship*, 213 B.R. 888, 894 (Bankr. S.D.N.Y. 1997) ("Since no section of the Code includes a receiver who remains in possession within the definition of trustee, the receiver does not take on the obligations and duties of a Chapter 11 trustee nor the somewhat different ones of a debtor-in-possession set forth in Code § 1107."). Here, the district court did not cite any contrary authority for the proposition that it had the authority to appoint a person to fulfill the duties of a receiver who could also administer the estate after the filing of a bankruptcy petition.

It also is important to note that Marwil's service as a custodian, standing alone, did not automatically disqualify him from being appointed or elected as a Chapter 11 trustee. See Tr. of Hrg. On Mot. To Appoint a Trustee (June 29, 2006) at 13:12-16 (App. A-61). But Marwil has never filed an affidavit of disinterestedness. See *ibid*. If Marwil cannot satisfy the requirements of "disinterestedness," then he should not continue in charge of the debtor during the bankruptcy.

The district court stated in its order that "[t]he U.S. Trustee can take some solace in the fact that this chain of events will rarely occur" because "[t]he necessary ingredients – corrupt management, inevitable bankruptcy, and a highly motivated group of creditors desirous of a particular individual to manage a troubled estate – will not often appear ensemble." Slip op. at 25 (App. A-213). But, the U.S. Trustee Program is confronted regularly with variations on this fact pattern. Although the district court decision is as yet unpublished, it has received substantial attention in the bankruptcy press. Therefore, unless the order is reversed, the U.S. Trustee's Office is likely to encounter creditor groups in non-bankruptcy courts carefully following the district court's roadmap to take advantage of the "loophole" so that they may dictate who will serve as estate fiduciary.

CONCLUSION

For the foregoing reasons, the decision of the district court should be reversed with instructions to remand the case to the bankruptcy court for entry of an order appointing a Chapter 11 trustee.

Respectfully submitted,

MICHAEL J. GARCIA
United States Attorney
ROSS E. MORRISON
Assistant United States Attorney
86 Chambers Street, 3rd Floor
New York, NY 10007

OF COUNSEL:
ROBERTA A. DEANGELIS
Acting General Counsel
WALTER W. THEUS, JR.
Department of Justice
Executive Office for United States Trustees
LISA L. LAMBERT
Assistant United States Trustee

PETER D. KEISLER
Assistant Attorney General

WILLIAM KANTER
(202) 514- 4575
/s/ Michael E. Robinson
MICHAEL E. ROBINSON
(202) 514-1371
Attorneys, Appellate Staff
Civil Division, Room 7539
Department of Justice
950 Pennsylvania Ave., N.W.
Washington, D.C. 20530-0001
michael.robinson@usdoj.gov

JUNE 2007

CERTIFICATE OF COMPLIANCE

Pursuant to Rule 32(a)(7)(C), Fed. R. App. P., I hereby certify that the foregoing brief complies with the type-volume limitation in Rule 32(a)(7)(B). The brief, excluding exempted portions, contains 6,028 words (using WordPerfect 12), and has been prepared in a proportional Times New Roman font of 14 points.

/s/ Michael E. Robinson
MICHAEL E. ROBINSON
Attorney

CERTIFICATE CONCERNING VIRUS PROTECTION

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/s/ Michael E. Robinson
MICHAEL E. ROBINSON
Attorney

ADDENDUM

Notice of Motion of Plaintiff for the Appointment of a Receiver (Mar. 28, 2006)

CERTIFICATE OF SERVICE

I hereby certify that on this 28th day of June, 2007, I caused a copy of the foregoing Brief For The Appellant to be transmitted by electronic mail, and two copies of that Brief to be served via FedEx next business day delivery on:

Elise Scherr Frejka
Dechert LLP
30 Rockerfeller Plaza
New York, NY 10112
elise.frejka@dechert.com

Robert M. Novick
Kasowitz, Benson, Torres & Friedman, LLP
1633 Broadway, 21st Floor
New York, NY 10019
rnovick@kasowitz.com

Richard A. Kirby
Preston, Gates, Ellis & Rouvelas
1735 New York Ave., Suite 500
Washington, D.C. 2006-5209
richardk@prestongates.com

Philip Bentley
Kramer Levin Naftalis & Frankel, LLP
1177 Ave. of the Americas
New York, NY 10036
pbentley@kramerlevin.com

MICHAEL E. ROBINSON
Attorney

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(UST/OGC: 202-307-1399/FAX-2397)

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BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***
• The bankruptcy court abused its discretion in denying the U.S. Trustee's motion to appoint a Chapter 11 Trustee.

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07-1508-bk

IN THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

In re: Bayou Group, LLC, *et al.*

Debtors.

Diana G. Adams, United States Trustee

Appellant,

v.

Receiver Jeff J. Marwil, for the Bayou Group Official Committee of Unsecured Creditors, Official Committee of Unsecured Creditors, Bayou Group, LLC,

Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

REPLY BRIEF FOR THE APPELLANT

MICHAEL J. GARCIA
United States Attorney
ROSS E. MORRISON
Assistant United States Attorney
86 Chambers Street, 3rd Floor
New York, NY 1007

OF COUNSEL:
ROBERTA A. DEANGELIS
Acting General Counsel
WALTER W. THEUS, JR.
Department of Justice
Executive Office for United States Trustees

PETER D. KEISLER
Assistant Attorney General

WILLIAM KANTER
(202) 514-4575
MICHAEL E. ROBINSON
(202) 514-1371
Attorneys, Appellate Staff
Civil Division, Room 7539
Department of Justice
950 Pennsylvania Ave., N.W.
Washington, D.C. 20530-0001

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ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

REPLY BRIEF FOR THE APPELLANT

INTRODUCTION

1. In our opening brief, we demonstrated that the bankruptcy court abused its discretion in denying the U.S. Trustee's motion to appoint a Chapter 11 trustee to take control of Bayou's property. The district court entered an order in April 2006

appointing Jeff Marwil as "the federal equity receiver," vesting him with corporate governance powers necessary to manage Bayou's property. App. A-38, A-41. The district court later construed this order as, in effect, having appointed Marwil both as receiver and as corporate management. App. A-201. The court further held that Marwil's purported appointment as management meant that Marwil did not have to be treated as a "custodian" under the Bankruptcy Code when Bayou filed for bankruptcy and that Marwil therefore was under no obligation to turn over Bayou's property to a bankruptcy trustee. App. A-209.

Because the 1978 Bankruptcy Reform Act expressly sought to supplant federal equity receivers in bankruptcy proceedings with Chapter 11 trustees, the district court acknowledged that its decision contradicted the spirit, if not the letter, of the 1978 Reform Act. App. A-213. The district court simply chalked up the result to a "loophole" in the Bankruptcy Code. App. A-210.

We showed, however, that the district court's initial order simply appointed Marwil Bayou's "receiver" and vested him with the powers necessary to manage the company, Br. for Appellant at 14-16; and that, as a receiver prior to the filing of a bankruptcy petition, Marwil became a "custodian" post-petition who, as such, was required to deliver to the bankruptcy trustee any property of the debtor held by him and to file an accounting, *id*. at 17-19. The district court was wrong to believe that a person appointed to take control of the property and manage the affairs of a defendant in a securities action could avoid becoming a "custodian" if that defendant later became a debtor in a case under the Bankruptcy Code. See *id*. at 19-21. The refusal by the district court and the bankruptcy court to grant the U.S. Trustee's motion to appoint a Chapter 11 trustee improperly intrudes on the authority of the U.S. Trustee and undermines the policy of the federal bankruptcy system by effectively allowing creditors to handpick a person prior to bankruptcy to administer the bankruptcy estate without any guarantee that the person will be disinterested. See Br. for Appellant at 21-24. Finally, relevant case law holds that it is inconsistent with the Bankruptcy Code for a court to allow a receiver to continue to manage the affairs of the debtor while that debtor utilizes Chapter 11 of the Code. Those cases make clear that, if a fiduciary is necessary, it should be a trustee appointed by the U.S. Trustee. See Br. for Appellant at 24-26.

2. Without addressing our argument that he became a "custodian" subject to the Code's turnover provisions once bankruptcy proceedings began, the Bayou Entities respond that the district court had authority to appoint Marwil to be Bayou's management and that, as management, he was automatically authorized to act as the debtor-in-possession upon the filing of bankruptcy petitions. See Br. for Appellees at 9-10, 20-21. Bayou does not identify the source of any such authority; and it is

clear from the court's order that the appointment of Marwil as managing members was entirely derivative of his appointment as receiver.

Bayou argues that the U.S. Trustee "did not raise a valid basis for the appointment of a trustee" in Marwil's stead. *Id*. at 12. Specifically, Bayou argues that the U.S. Trustee has not shown that Marwil has engaged in any of the misconduct enumerated in § 1104(a)(1) of the Bankruptcy Code and, as a consequence, has "failed to offer 'clear and convincing evidence' of 'cause' for the appointment of a trustee in the underlying bankruptcy cases." *Id*. at 13-14. Bayou also argues that Marwil is doing a good job as Bayou's management, *id*. at 14-18, and that a Chapter 11 trustee was not, and is not, in the best interests of Bayou's creditors. *Id*. at 18-19. These arguments miss the point, because the district court did not have authority to appoint a receiver with management authority that superseded the requirements of the Bankruptcy Code.

Likewise, the Official Committee of Unsecured Creditors' argument that the U.S. Trustee's motion to appoint a trustee is "an impermissible collateral attack" on the district court order appointing Marwil receiver and managing member should be rejected. See Br. of Appellee Official Comm. Of Unsecured Creditors ("Creditors' Br.") at 9. The U.S. Trustee's motion, of course, is not a collateral attack on the district court's appointment order at all, but only requires construction of that order.

Nor is there merit to the Unsecured Creditors' Committee's argument that the bankruptcy court correctly found that Marwil was a managing member with powers distinct from his receivership powers under the plain terms of the appointment order, *id*. at 14, and that the U.S. Trustee ignores the plain language and intent of that order. *Id*. at 18-20.

The U.S. Trustee's motion does not ignore the plain language and intent of the appointment order. Rather, the motion was premised on the fact that the district court did not – and could not – consistent with the Bankruptcy Code, appoint a receiver with management authority that survived the filing of the bankruptcy petitions. The judgment of the district court should be reversed.

SUMMARY OF ARGUMENT

1. The Official Creditors' Committee filed a Motion to Appoint a Receiver. In granting the motion, the district court stated that it was appointing Jeff Marwil as "federal equity receiver" to manage Bayou's property. The court confirmed that this is what it was asked to do and this is what it intended to do. As receiver, when Marwil caused the Bayou Entities to file petitions for bankruptcy, he became a "custodian" within the meaning of the Bankruptcy Code (11 U.S.C. § 101(11)(A)) and was subject to the turnover requirements of 11 U.S.C. § 543.

2. Bayou and the Official Creditors' Committee argue that the plain language of the appointment order states that Marwil was to be the "managing member" of the Bayou Entities and deemed a debtor-in-possession for any or all of the Bayou Entities in proceedings under Chapter 11 of the Code. But the order also states that the receiver is empowered to prosecute adversary proceedings and other matters "as may be permitted under the [Bankruptcy] Code and/or applicable law." Although the district court had the authority to appoint a receiver with management powers to run the affairs of the Bayou entities prior to bankruptcy, under the Bankruptcy Code, that authority did not supplant the jurisdiction of the bankruptcy court to direct the appointment of a trustee in Chapter 11 cases. Thus, the plain language of the order does not appoint Marwil as a managing member of Bayou following its bankruptcy filings.

3. In this regard, the scope of Marwil's authority is not a question of fact reviewable under the clearly erroneous standard, as the appellees suggest. Rather, it involves a legal question – the interpretation of the district court's appointment order in light of applicable Bankruptcy Code provisions – which is reviewable de novo.

4. The U.S. Trustee's motion to appoint a trustee cannot be characterized as a "collateral attack" on the district court's order appointing Marwil a receiver. The motion merely required the bankruptcy court to construe that order, a task courts

routinely perform. In any event, the principle that precludes collateral attacks on a prior ruling or judgment has no application where the person challenging the prior ruling or judgment was not a party or a privy to the first proceeding. The U.S. Trustee was not a party or a privy to the proceedings to appoint a receiver. On the other hand, once the receiver filed bankruptcy petitions on behalf of the Bayou Entities, the U.S. Trustee had every right to seek the appointment of a trustee and to have the receiver, as "custodian" of the debtors' property, turn over that property pursuant to § 543 of the Bankruptcy Code.

5. Bayou and the Creditors' Committee argue that the U.S. Trustee has failed to offer "clear and convincing evidence" of "cause" for the appointment of a trustee in the underlying bankruptcy cases because Marwil has not engaged in fraud, dishonesty, incompetence, gross mismanagement, or similar misconduct and because Marwil has done a good job managing the affairs of the Bayou Entities. This argument misses the point. Consideration of what is in the "best interests of creditors" cannot override the requirements of the Bankruptcy Code. If Marwil's corporate governance powers were derived from his receivership, then he became simply a "custodian" within the meaning of the Bankruptcy Code when petitions for bankruptcy were filed. Under these circumstances, "cause" exists for the appointment

of a trustee, since prior management's fraud precludes turning the property back over to them.

ARGUMENT

THE BANKRUPTCY COURT ABUSED ITS DISCRETION IN DENYING THE U.S. TRUSTEE'S MOTION TO APPOINT A CHAPTER 11 TRUSTEE

A. Marwil's Appointment As Bayou's "Receiver" Made Him A "Custodian" Within The Meaning Of The Bankruptcy Code.

As explained in our opening brief (at pp. 14-17), it is clear from the district court's order that the court appointed Marwil as a receiver and that any management duties he was given were to be exercised as a part of that receivership. The Receivership Order is entitled "ORDER GRANTING THE UNOFFICIAL ON-SHORE CREDITORS' COMMITTEE'S MOTION TO APPOINT A RECEIVER," and under the heading "APPOINTMENT OF RECEIVER AND PROPERTY OF THE RECEIVERSHIP ESTATE," the court stated, "the Court hereby APPOINTS Jeff J Marwil . . . to be the federal equity receiver [of the Bayou Entities]." At the hearing on appeal from the bankruptcy court's ruling, the district court made clear that its intention was to appoint a receiver, just as it was asked:

> The federal remedy I issued was the appointment of a receiver pursuant to Rule 66 of the Federal Rules of Civil Procedure. That's what I was asked to do, that's what I

> did. I was not asked to appoint an interim director. . . . I know what I was asked to do. I was asked to appoint a receiver, somebody who could marshall assets.

Nov. 17, 2006 Hearing Tr. 19-20 (at p. 10) (Dkt No. 15).

As we also explained (at pp. 17-21), when Marwil caused the Bayou entities to file voluntary petitions for bankruptcy, Marwil's authority as receiver was circumscribed by operation of the Bankruptcy Code. Upon filing, he became a "custodian" within the meaning of the Code and subject to the turnover obligations set forth in 11 U.S.C. § 543.

The statutory definition of "custodian" is broad, and it includes any "receiver . . . of the property of the debtor" appointed in a non-Chapter 11 case, and any "receiver, or agent . . . appointed or authorized to take charge of property of the debtor . . . for the purpose of general administration of such property for the benefit of the debtor's creditors." 11 U.S.C. § 101(11)(A), (C). Marwil qualifies under both of these provisions. He was a receiver of property of the debtor appointed in a non-Chapter 11 case, and he was a receiver appointed to take charge of the property of the debtor and administer it for the benefit of the debtor's creditors. As a custodian, Marwil's role in the bankruptcy case is limited. Custodians cannot "take any action in the administration of [] property of the debtor . . . or property of the estate . . . except such action as is necessary to preserve such property." 11 U.S.C. § 543(a).

To this end, Marwil was obliged to "deliver to the trustee any property of the debtor held by or transferred to [him]" and to "file an accounting of any property of the debtor . . . that, at any time, came into [his] possession, custody, or control . . . ." *Id.* § 543(b).

B. The "Plain Language" Of The Appointment Order Does Not Require A Conclusion That Marwil's Management Powers Were Distinct From His Receivership Powers.

In their appellee briefs, Bayou and the Official Creditors' Committee never come to grips with our argument that, as a receiver, Marwil falls squarely within the Bankruptcy Code's definition of "custodian." Rather, the appellees argue that the district court's appointment order effectively preempts application of the Code's provisions applicable to "custodians." That is, the appellees argue that the plain language of the district court's appointment order states that Marwil was to be the "managing member" of the Bayou Entities and that his powers as managing member were to be distinct from his receivership powers. Specifically, the appellees cite that portion of the district court's Receivership Order stating that "[Marwil shall] succeed to be the sole and exclusive managing member . . . and in connection therewith be and be deemed a debtor-in-possession for any or all of the Bayou Entities in proceedings under Chapter 11 of the Code . . . ." See Br. of Appellees at 5-6 (quoting

Receivership Order at ¶ 7(e)); Creditors' Br. at 15 (same). That same provision, however, makes clear that, in such circumstances, the receiver is empowered to "prosecute such adversary proceedings and other matters *as may be permitted under the [Bankruptcy] Code and/or applicable law*." App. A-41 (emphasis added).

As our previous brief explained (at pp. 21-24), an appointment that seeks to circumvent the bankruptcy scheme established by Congress is invalid. The district court had the authority to appoint a receiver with management powers to run the affairs of the Bayou entities prior to bankruptcy. But, under the Bankruptcy Code, that authority did not supplant the jurisdiction of the bankruptcy court to direct the appointment of a trustee in Chapter 11 cases and does not affect the status of receivers as custodians. See 11 U.S.C. §§ 101(11)(A)&(C); 543. Nor does that authority permit the district court to supersede the Bankruptcy Code's prohibition on the appointment of receivers in bankruptcy. See 11 U.S.C. § 105(b); S. Rep. No. 95-989, at 29 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5815 ("The bankruptcy judge is prohibited from appointing a receiver in a case under title 11 under any circumstances. The bankruptcy code has ample provision for the appointment of a trustee when needed. Appointment of a receiver would simply circumvent the established procedures.").

In any event, the Official Creditors' Committee is wrong in asserting that "[t]here is no suggestion anywhere in the text of the appointment order that the district court intended [Marwil's] appointment as managing member to be derivative of Mr. Marwil's powers under the equity receivership." *Id.* at 15-16. First, if Marwil had all the powers of management that the appellees now claim he did separate and apart from his receivership appointment, it is a wonder the district court bothered to appoint him receiver at all. His receivership powers would be entirely superfluous to the powers he would have had as actual management.

But it is evident, in any event, that the district court's appointment of Marwil as managing member necessarily was derivative of his appointment as receiver. If Marwil were, in fact, a true "managing member" of the Bayou limited liability companies ("LLCs"), he would need to be admitted as a managing member in compliance with applicable state law governing LLC members, such as Conn. Gen. Stat. § 34-179 (2005). Furthermore, to be a true manager of a Connecticut LLC, Marwil would need to be designated as such in compliance with Conn. Gen. Stat. § 34-140 (2005).[1] There is no evidence that Marwil was admitted to membership in

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[1] Conn. Gen. Stat. § 34-101(13) defines "manager" or "managers" to mean "the person or persons designated in accordance with section 34-140" to manage the LLC. Conn. Gen. Stat. § 34-101(14) defines "member" or "members" of an LLC to mean "a person or persons who have been admitted to membership in a limited liability (continued...)

the Bayou entities in compliance with this statute or with similar statutes in other pertinent states. Rather, Marwil's status as managing member derives from the Receiver Order itself, and not from applicable state law.

It is also evident that Marwil, as "managing member," did not have the full panoply of discretion that an ordinary manager has to operate the business of the debtor. The Receivership Order directed that Marwil was to perform his duties "at all times with a view towards (a) locating, preserving, and protecting the Bayou Assets; and (b) distributing the Bayou Assets that the Receiver collects as expeditiously as possible to creditors (including investors) of the Bayou Entities, pursuant to further order of [the] Court." Receivership Order ¶ 7 (App. A-40). Thus, even as "sole managing member," Marwil was not free to exercise normal managerial discretion. App. A-40. That is, Marwil's powers and rights, including the right to compensation (see App. A-43 to A-44), were entirely constrained by the district court order appointing him. Accordingly, the plain language of the district court's order

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[1](...continued)
company as provided in section 34-179 and who have not disassociated from the limited liability company as provided in section 34-180." The principal Bayou entity is a Connecticut LLC, but other debtors are Delaware and New York LLCs. The LLC statutes of those jurisdictions do not differ in any material respects from those of Connecticut. See Del. Code § 18-301 (admission of members); *id.* § 18-401 (admission of managers); N.Y. Limited Liability Company Law § 102(p) (definition of manager); *id.* § 408 (management by managers); *id.* § 410 (qualification of managers); § 602 (admission of members).

does not require that Marwil's management powers were distinct from his receivership powers.[2]

C. The Scope Of Marwil's Authority Is A Legal Question Subject To De Novo Review.

In this regard, the scope of Marwil's authority is not a question of fact reviewable under the clearly erroneous standard, as the appellees suggest. See Br. for Appellees at 20; Creditors' Br. at 14-15. Rather, it involves the interpretation of the district court's appointment order in light of applicable Bankruptcy Code provisions. As such, it involves a legal question reviewable de novo. See *United States v. Spallone*, 399 F.3d 415, 423 (2d Cir. 2005) ("The interpretation of the text of a court order or judgment is considered a conclusion of law subject to de novo review."); *In re Duplan Corp.*, 212 F.3d 144, 151 (2d Cir.2000) (reviewing bankruptcy court's interpretation of district court order de novo). While, as appellees note (Br. for Appellees at 19-20), an issuing judge's interpretation of her own order is entitled to deference, *Spallone*, 399 F.3d at 423, "where, as in this case, an ambiguity in

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[2] For these reasons, appellees' assertion that various federal agencies, including the Department of Justice and SEC, reviewed and consented to the proposed order before it was entered by the district court (Br. for Appellees at 2), is irrelevant. The order does not grant Marwil separate management powers apart from his role as receiver, and the Government therefore did not consent to Marwil serving as Bayou's management after its bankruptcy filing.

terminology results in a lack of clarity as to the scope of the ruling, a reviewing court may properly examine the entire record for the purpose of determining what was decided," *id*. at 424 (citation and internal quotation marks omitted). Furthermore, "an order will not be construed as going beyond the motion in pursuance of which the order was made, for a court is presumed not to intend to grant relief which was not demanded." *Ibid*. (citation and internal quotation marks omitted).

Here, as explained, the Official Creditors' Committee filed a "Motion to Appoint A Receiver" and, in granting that motion, the district court appointed Jeff Marwil to be the "federal equity receiver" of the Bayou Entities. The bankruptcy court and then the district court subsequently interpreted that order as having appointed Marwil as management of those entities with powers that would have made his appointment as receiver entirely unnecessary and which, as the district court admitted, "contradicts the spirit . . . of the 1978 Reform Act." *In re Bayou Group, L.L.C.*, 363 B.R. 674, 689 (S.D.N.Y. 2007). That interpretation of the appointment order should not be sustained.

D. The U.S. Trustee's Motion To Appoint A Trustee Is Not An Impermissible Collateral Attack On The District Court's Order Appointing Marwil A Receiver.

The Official Creditors' Committee assert that the U.S. Trustee's motion to appoint a trustee is "an impermissible collateral attack on the district court order appointing Mr. Marwil as receiver and managing member." Creditors' Br. at 9. According to the Creditors' Committee, the proper course for the U.S. Trustee would have been "to seek appropriate relief directly with the district court." *Id*. at 13. The Creditors' Committee is mistaken.

First, the U.S. Trustee's motion simply is not a collateral attack on the district court's appointment order. Rather, the motion merely seeks the appointment of a Chapter 11 trustee in light of the fact that Marwil became a "custodian" once the bankruptcy petitions were filed. To the extent that the bankruptcy court was called upon to construe the district court's Receivership Order before granting the motion, that fact does not transform the U.S. Trustee's motion into a collateral attack on the district court order. See *United States v. Spallone*, 399 F.3d 415, 424 (2d Cir. 2005) ("Court orders are construed like other written instruments, except that the determining factor is not the intent of the parties, but that of the issuing court.").

But even if the U.S. Trustee's motion could be considered a collateral attack on the district court's Receivership Order, the principle that precludes collateral attacks on a prior ruling or judgment – a principle derived from the related doctrines of res judicata and collateral estoppel[3] – has no application where the person challenging the prior ruling or judgment was not a party or a privy to the first proceeding. See *Parklane Hosiery Co. v. Shore*, 439 U.S. 322, 327 n. 7 (1979) ("It is a violation of due process for a judgment to be binding on a litigant who was not a party or a privy and therefore has never had an opportunity to be heard."); *Doctor's Associates, Inc. v. Reinert & Duree, P.C.*, 191 F.3d 297, 302 (2d 1999) ("a court cannot 'make a decree which will bind any one but a party'") (quoting *Alemite Mfg. Corp. v. Staff*, 42 F.2d 832, 832 (2d Cir.1930) (L. Hand, J.)). The U.S. Trustee was not a party to, nor indeed had any notice of, the appointment proceedings.

Although the district court invited the U.S. Attorney's Office to send representatives to the appointment hearing to ensure that the appointment of a receiver did not interfere with ongoing federal forfeiture proceedings, the United States Trustee was not a party to the receivership proceedings. In this regard, the U.S. Trustee has no standing outside of cases under title 11. See 11 U.S.C. § 307 and 28

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[3] "Collateral estoppel, like the related doctrine of res judicata, has the dual purpose of protecting litigants from the burden of relitigating an identical issue with the same party or his privy and of promoting judicial economy by preventing needless litigation." *Parklane Hosiery Co. v. Shore*, 439 U.S. 322, 326 (1979).

U.S.C. § 586.[4] See also *United States v. Mendoza*, 464 U.S. 154, 162-63 (1984) ("The conduct of government litigation in the courts of the United States is sufficiently different from the conduct of private civil litigation in those courts so that what might otherwise be economy interests underlying a broad application of collateral estoppel are outweighed by the constraints which peculiarly affect the government.").

Because the U.S. Trustee was not a party or a privy to the appointment proceedings, there is no basis for the bankruptcy court's suggestion that the U.S. Trustee "could make a motion directly before Judge McMahon seeking leave from her to displace the person she appointed as the manager of these entities . . . ." June 29, 2006 Hearing Tr. at 17 (App. A-65).[5]

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[4] As counsel for the U.S. Trustee explained at the bankruptcy court hearing:

> [T]he U.S. Trustee's Office was obviously not involved at the District Court level. We were not given notice that this order was being entered in. Obviously, we were only aware of this once the bankruptcy was filed. We obviously would have had no standing at the time the order was entered, because until a bankruptcy is filed . . . there is no standing for the U.S. Trustee's Office to appear and be heard . . . even if we had been made aware of the order.

App. A-60 to A-61.

[5] The authorities cited in the Official Creditors' Committee's brief (at pp. 10-

(continued...)

On the other hand, once the receiver filed bankruptcy petitions on behalf of the Bayou Entities, the U.S. Trustee had every right to seek the appointment of a trustee and to have the receiver, as "custodian" of the debtors' property, turn over that property pursuant to § 543 of the Bankruptcy Code. In this regard, it was perfectly appropriate for the U.S. Trustee to argue, in support of her motion, that the district

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[5] (...continued)
12) are not to the contrary. Each of those authorities involved a collateral attack by a person who was a party or a privy to the appointment proceedings or who had some prior opportunity to challenge the appointment. See, *e.g.*, *Miller v. Hockley*, 80 F.2d 980, 983 (4th Cir.) (the appointment of receivers for realty company could not be collaterally attacked by "[t]he defendant [who] knew of the appointment of the receivers . . . and made no objection to it until suit was brought against him by the receivers upon the notes here involved"), *cert. denied*, 298 U.S. 657 (1936); *Badger v. Hoidale*, 88 F.2d 208, 212 (8th Cir. 1937) (stockholders could not collaterally attack appointment of a receiver because they were in privity with corporation that was a party to original suit in which appointment was ordered); *Grant v. A.B. Leach & Co.*, 280 U.S. 351, 359 (1930) (defendant in suit by receiver (Grant) to recover the value of bonds alleged to have been illegally obtained from furnace company in exchange for preferred stock could not collaterally attack appointment of the receiver where the "validity [of the appointment] was not challenged in any respect by the answer of [defendant] in the District Court, which admitted the allegation that Grant had been 'duly appointed' receiver of all the Company's property"); *Stevens v. Carolina Scenic Stages*, 208 F.2d 332, 336 (4th Cir. 1953) ("If there was error in the appointment here, . . . it would not be a matter which would subject the appointment to collateral attack in the court of bankruptcy, since the appointing court had jurisdiction of the subject matter and the parties."), *cert. denied*, 347 U.S. 917 (1954); 65 Am. Jur.2d § 67 n.8 (2007) (when the court appointing a receiver has subject matter jurisdiction as well as "jurisdiction over the parties," its order appointing the receiver cannot be collaterally attacked); 75 C.J.S. § 84 (2007) ("Where the court has jurisdiction of the subject matter and of the necessary parties, its action with respect to the appointment of a receiver, whether or not erroneous, may not be questioned in a collateral proceeding.").

court did not, and could not, grant Marwil management powers that were independent of, and outlasted, his receivership powers.

E. The Standard For Appointing A Trustee Under Section 1104 Of The Bankruptcy Code Has Been Met.

1. A trustee shall be appointed to administer a Chapter 11 bankruptcy estate "for cause, including fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor by current management" or "if such appointment is in the interests of creditors, any equity security holders, and other interests of the estate." 11 U.S.C. § 1104(a)(1)-(2). Bayou and the Creditors' Committee argue that the U.S. Trustee has failed to offer "clear and convincing evidence" of "cause" for the appointment of a trustee in the underlying bankruptcy cases because Marwil has not engaged in fraud, dishonesty, incompetence, gross mismanagement, or similar misconduct and because Marwil has done a good job managing the affairs of the Bayou Entities. See Br. for Appellees at 12-18; Creditors' Br. at 21-23.

Of course, whether Bayou and the Creditors' Committee are correct that there is no cause for appointing a trustee depends on whether they are correct that Marwil's powers as manager of the debtor companies survived the termination of the receivership. If, as we have argued, Marwil's corporate governance powers were derived from his receivership and he became a "custodian" within the meaning of 11

U.S.C. § 101(11)(A) & (C), then it is evident that "cause" exists for the appointment of a trustee since prior management's fraud precludes turning the property back over to them.

2. The appellees engage in semantics by arguing that the U.S. Trustee "mischaracterizes the Bankruptcy Court and District Court holdings as stating that upon filing of the bankruptcy petitions, Marwil **became** the debtor-in-possession. . . . [N]o one ever argued, and neither lower court held, that Marwil became a debtor-in-possession." Br. for Appellees at 16. Of course, the district court itself characterized Marwil in this manner. See *In re Bayou Group*, 363 B.R. at 687 ("When Marwil caused the Bayou entities to file for Chapter 11 bankruptcy one month after his appointment, *Marwil's status as corporate governor automatically blossomed into that of debtor-in-possession* since, as managing member of Bayou, Marwil was the debtor's management.") (emphasis added). The U.S. Trustee merely characterized Marwil's status in the same way. While it might have been technically more correct for the court to characterize Marwil's status as sole managing member of the debtors-in-possession, as appellees suggest, Br. for Appellees at 16, the point remains that, as sole managing member of the debtors-in-possession, Marwil would be making the decisions for the debtors-in-possession. *Cf. In re Bayou Group*, 363 B.R. at 687

("[U]pon causing Bayou to file its bankruptcy petition, Marwil's receivership ended and he immediately became the managing member of a debtor-in-possession.").

3. In our previous brief (at pp. 22-23), we argued that an important policy underlying the Bankruptcy Code is the need to ensure that there are disinterested trustees to manage bankrupt companies. See 11 U.S.C. § 1104 (requiring that a trustee appointed by the court at the request of the U.S. Trustee must be a "disinterested person"). We also argued that the decisions of the district and bankruptcy courts, however, effectively allow creditors to handpick a person prior to bankruptcy to administer the bankruptcy estate, without any guarantee that the person will be disinterested. The appellees understood this argument to apply to "creditors in as-yet unfiled cases." Br. for Appellees at 17. But the concern was with this very case: The Official Creditors' Committee handpicked Marwil prior to bankruptcy to administer Bayou's bankruptcy estates without any guarantee that Marwil was "disinterested" within the meaning of the Bankruptcy Code. Indeed, Marwil still has not filed a sufficient affidavit demonstrating that he meets the standard of disinterestedness set forth at 11 U.S.C. § 101(14).

The appellees' position, moreover, would encourage creditors in anticipation of a bankruptcy to race to the courthouse to seek the appointment of a receiver/manager before another group of creditors got there first. In this way, one group of creditors can select who would get to wind up the affairs of the company post-bankruptcy whether or not that person satisfied the prerequisites of the Bankruptcy Code.

4. The appellees also argue that replacement of Marwil with a Chapter 11 trustee is not in the best interests of creditors. See Br. for Appellees at 18-19; Creditors' Br. at 23-24. But if we are correct that the district court had no authority to appoint a receiver with management authority that survived the filing of bankruptcy petitions, then it plainly is in the interests of all creditors to have a trustee appointed to administer the bankruptcy estate. See *In re Stratesec, Inc.*, 324 B.R. 156, 157-58 (Bankr. D.D.C. 2004) (allowing a receiver "to continue to manage the affairs of the debtor while that debtor utilizes Chapter 11 of the Bankruptcy Code" would be "inconsistent with the Bankruptcy Code"; "[i]f a fiduciary is necessary, it should be a trustee appointed by the United States Trustee"); *Matter of Plantation Inn Partners*, 142 B.R. 561, 564 (Bankr. S.D. Ga. 1992) ("[T]o permit the Receiver to indefinitely remain in possession and to vest him permanently with all the duties and powers of a debtor-in-possession goes far beyond the limited relief envisioned by Section 543. . . . Clearly the Code contemplates that the long-term administration of a Chapter 11 case will be managed by a trustee or debtor-in-possession, not a hybrid created by judicial fiat.").

In this regard, as explained in our previous brief (at p. 25), Marwil's service as a custodian, standing alone, did not automatically disqualify him from being appointed or elected as a Chapter 11 trustee. See Tr. of Hrg. On Mot. To Appoint a Trustee (June 29, 2006) at 13:12-16 (App. A-61). But, the Bankruptcy Code gives the authority to *appoint* to the U.S. Trustee, not to the district court. As a result, consideration of what is in the best interest of creditors cannot override the requirements of the Code.

CONCLUSION

For the foregoing reasons, the decision of the district court should be reversed with instructions to remand the case to the bankruptcy court for entry of an order directing the appointment of a Chapter 11 trustee.

Respectfully submitted,

MICHAEL J. GARCIA
United States Attorney
ROSS E. MORRISON
Assistant United States Attorney
86 Chambers Street, 3rd Floor
New York, NY 1007

OF COUNSEL:
ROBERTA A. DEANGELIS
Acting General Counsel
WALTER W. THEUS, JR.
Department of Justice
Executive Office for United States Trustees

PETER D. KEISLER
Assistant Attorney General

WILLIAM KANTER
(202) 514- 4575

MICHAEL E. ROBINSON
(202) 514-1371
Attorneys, Appellate Staff
Civil Division, Room 7539
Department of Justice
950 Pennsylvania Ave., N.W.
Washington, D.C. 20530-0001
michael.robinson@usdoj.gov

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CERTIFICATE OF COMPLIANCE

Pursuant to Rule 32(a)(7)(C), Fed. R. App. P., I hereby certify that the foregoing brief complies with the type-volume limitation in Rule 32(a)(7)(B). The brief, excluding exempted portions, contains 5,680words (using WordPerfect 12), and has been prepared in a proportional Times New Roman font of 14 points.

MICHAEL E. ROBINSON
Attorney

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MICHAEL E. ROBINSON
Attorney

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I hereby certify that on this 11th day of October, 2007, I caused a copy of the foregoing Reply Brief For The Appellant to be transmitted by electronic mail, and two copies of that Brief to be served via FedEx next business day delivery on:

Elise Scherr Frejka
Dechert LLP
30 Rockerfeller Plaza
New York, NY 10112
elise.frejka@dechert.com

Robert M. Novick
Kasowitz, Benson, Torres & Friedman, LLP
1633 Broadway, 21st Floor
New York, NY 10019
rnovick@kasowitz.com

Richard A. Kirby
Preston, Gates, Ellis & Rouvelas
1735 New York Ave., Suite 500
Washington, D.C. 2006-5209
richardk@prestongates.com

Philip Bentley
Kramer Levin Naftalis & Frankel, LLP
1177 Ave. of the Americas
New York, NY 10036
pbentley@kramerlevin.com

MICHAEL E. ROBINSON
Attorney

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: Case No. 06-11682 (BRL)
In re
:
DONNA BERG,
: (Chapter 7)
Debtor.
:
--- x
:
DONNA BERG,
: District Court
Appellant,
: Case No. 08-CV-05548 (DAB)
-against-
:
DIANA G. ADAMS as the
UNITED STATES TRUSTEE, :

:
Appellee.
:
--- x

BRIEF OF APPELLEE UNITED STATES TRUSTEE

Of Counsel:

RAMONA ELLIOTT
General Counsel
P. MATTHEW SUTKO
CARRIE WEINFELD
Office of the General Counsel

Executive Office for United States Trustees
United States Department of Justice
20 Massachusetts Avenue, N.W.
Suite 8100
Washington, DC 20530
(202) 305-0550

LINDA RIFFKIN
Assistant United States Trustee
SUSAN D. GOLDEN
MARYLOU MARTIN
Trial Attorneys

Office of the United States Trustee
33 Whitehall Street, 21st Floor
New York, NY 10004
(212) 510-0500

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I. INTRODUCTION AND STATEMENT OF JURISDICTION

Diana G. Adams, the United States Trustee for Region 2 (the "United States Trustee"),[1] respectfully submits this memorandum of law in opposition to the appeal of Donna Berg (the "Debtor") from the order of the Honorable Burton R. Lifland, dated May 6, 2008 (the "Order"), granting the motion of the United States Trustee to dismiss her Chapter 11 Case with prejudice to re-filing for a period of one year [D-11; ECF 67].[2]

On July 24, 2006, the Debtor filed a voluntary petition under Chapter 7 of the Bankruptcy Code. The case was converted to a case under Chapter 11 of the Bankruptcy Code on October 2, 2007. Under 28 U.S.C. § 157, the United States Bankruptcy Court for the Southern District of New York had jurisdiction over the bankruptcy case. On May 6, 2008, the Bankruptcy Court entered the Order and the Debtor filed a timely notice of appeal. This Court has jurisdiction to hear and determine this appeal pursuant to 28 U.S.C. § 158(a), which provides, in part, that the district courts of the United States shall have jurisdiction to hear appeals from final judgments, orders, and decrees of bankruptcy judges entered in cases under 28 U.S.C. § 157.

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[1] The United States Trustee is an official of the Executive Branch responsible for "protecting the public interest and ensuring that bankruptcy cases are conducted according to the law." H.R. Rep. No. 95-595, 95th Cong., 2d Sess. 109 (1978), reprinted in 1978 U.S.C.C.A.N. 5963, 6070. See 28 U.S.C. §586(a).

[2] "D-" is used herein to identify a document by its number in the Debtor's Designation of Contents for Inclusion in Record on Appeal and Statement of Issues On Appeal. For convenience, this brief will cross-reference the document to the corresponding docket entry on the electronic case filing system ("ECF") in the bankruptcy case, In re Donna Berg, Case No. 06-11682 (Bankr. S.D.N.Y.).

II. STATEMENT OF ISSUE PRESENTED

The Debtor consented to the dismissal of her bankruptcy case. The Debtor conceded that dismissal with prejudice for three to six months was reasonable. The only issue presented on appeal is whether the Bankruptcy Court abused its discretion when it imposed upon the Debtor a one-year bar to filing another petition.

III. STANDARD OF APPELLATE REVIEW

A district court reviews appeals of a bankruptcy court's conclusions of law *de novo*. Findings of fact made by a bankruptcy court may not be set aside unless clearly erroneous. See Fed. R. Bankr. P. 8013; Casse v. Key Bank Nat'l. Ass'n (In re Casse), 198 F.3d 327, 332 (2d Cir. 1999) (bankruptcy court's factual findings will be accepted unless clearly erroneous); Gulf States Exploration Co. v. Manville Prods. Corp. (In re Manville Prods. Corp.), 896 F.2d 1384, 1388 (2d Cir. 1990). This deferential standard applies not only to credibility assessments but also to interpretations deriving from "physical or documentary evidence or inferences from other facts." Anderson v. City of Bessemer, 470 U.S. 564, 574 (1985). A reviewing court may not "reverse the findings of the trier of fact simply because it is convinced that it would have decided the case differently." Anderson, 470 U.S. at 573 (1985). In a frequently cited passage, the Seventh Circuit explained, "[t]o be clearly erroneous, a decision must strike us as more than just maybe or probably wrong; it must . . . strike us as wrong with the force of a five-week-old, unrefrigerated dead fish." Parts & Elec. Motors, Inc. v. Sterling Elec., Inc., 866 F.2d 228, 233 (7th Cir. 1988). A bankruptcy court's order dismissing or converting a case is reviewed under an abuse of discretion standard. See Sullivan Cent. Plaza I, Ltd. v. Bancboston Real Estate Capital Corp., 935 F.2d 723, 728 (5th Cir. 1991); Hall v. Vance, 887 F.2d 1041, 1044-45 (10th Cir.

1989); In re Camden Ordnance Mfg. Co. of Ark, 245 B.R. 794, 797 (E.D. Pa. 2000); In re Sphere Holding Corp., 162 B.R. 639, 642-43 (E.D.N.Y. 1994). Discretion will be found to have been abused only when "the judicial action is arbitrary, fanciful or unreasonable which is another way of saying that discretion is abused only where no reasonable [person] would take the view adopted by the trial court." Camden Ordnance, 245 B.R. at 797 (quoting In re Blackwell, 162 B.R. 117, 119 (E.D. Pa. 1993)).

IV. STATEMENT OF FACTS

The facts of this case are largely undisputed. On July 24, 2006, the Debtor commenced this bankruptcy case by filing a voluntary petition under Chapter 7 of the Bankruptcy Code. [D-1; ECF 1]. The Debtor is an individual who is the sole principal and sole employee of an events planning business known as Donna Berg Productions Inc. ("DB Productions"). See Debtor's Brief in Support of Appeal ("Debtor's Brief"), p. 3, ¶2]. DB Productions was incorporated as a New York Subchapter S corporation [D-8; ECF 61 - Declaration of Brian S. Masumoto in support of Motion to Convert or Dismiss, ¶4].

While the Debtor concedes that DB Productions was only a "modest success" prior to filing bankruptcy, the Debtor lived an extraordinary lifestyle, wearing designer clothes, living in an apartment with a monthly rent of $7,100.00 and providing nanny care for her son at a cost of $2,800.00 per month. [CD- 1, pp.3- 4, ¶¶ 9, 12, 15; D-1; ECF 1 - Schedule J]. The Debtor's bankruptcy schedules list assets totaling $30,982.00. [D-1; ECF 1 - Schedule B]. These assets consist primarily of the security deposit of $14,000.00 on her apartment and an IRA valued at $15,000.00. [Id.]. The Debtor's liabilities, as set forth in the Bankruptcy Schedules, total $530,869.00, which includes $41,040.00 of priority tax claims and $489,829.00 of general unsecured claims.[D-1; D-2; ECF 1 - Schedule E; 6 - Amended Schedule F]. The general unsecured claims are comprised of amounts advanced by the Debtor's family members of approximately $144,000.00, amounts charged by the Debtor to credit cards totaling approximately $168,000.00, amounts owed by the Debtor for personal income taxes and related interest and penalties for the years 1993 though 2000 totaling $87,000.00, and amounts owed to vendors and service providers to DB Productions that were personally guaranteed by the Debtor, totaling approximately $81,000.00. [D-2; ECF 6].

The Chapter 7 Case and the United States Trustee's Motion to Dismiss the Chapter 7 Case for Bad Faith and Abuse, Pursuant to 11 U.S.C. § 707

Upon the filing of the Debtor's Chapter 7 case, Robert L. Geltzer, Esq., was appointed as Interim Chapter 7 Trustee and, thereafter, became permanent Chapter 7 Trustee of the Debtor's estate by operation of law (the "Chapter 7 Trustee").[3] On August 29, 2006, the Debtor appeared at the initial §341(a) Meeting of Creditors (the "341 Meeting"). [Debtor's Brief at Page 4 ¶2]. By Orders dated January 11, 2007, the Chapter 7 Trustee was authorized to retain the law firm Bryan Cave LLP as his counsel, and the accounting firm Davis Graber Plotzker & Ward, LLP as his accountants, to assist in his administration of the Debtor's chapter 7 estate. [Id.; ECF 14].

On March 30, 2007, the United States Trustee filed a motion seeking to dismiss the Debtor's Chapter 7 case for abuse under 11 U.S.C. §707(b) and for bad faith under 11 U.S.C.

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[3] A Chapter 7 trustee is appointed by the United States Trustee in all Chapter 7 cases. 11 U.S.C. § 701(a)(1) provides: "Promptly after the order for relief under this chapter, the United States Trustee shall appoint one disinterested person that is a member of a panel of private trustees established under section 586(a)(1) of title 28 . . . to serve as interim trustee in the case." Pursuant to 11 U.S.C. § 702(d), the interim trustee shall serve as the permanent trustee in the case if the creditors do not elect a trustee. The duties of a Chapter 7 trustee include, among other things, investigating the financial affairs of the debtor. 11 U.S.C. §704.

§707(a) (the "Section 707 Dismissal Motion"). [CD-1; ECF 20].[4] The Section 707 Dismissal Motion was based upon the Debtor's testimony at the 341 Meeting, as well as an evaluation of her credit card statements, which confirmed that the majority of the charges were for recurring luxury purchases such as Chanel suits and other couture clothing, recreational travel and fine dining. [Id. at pp. 2-3; ¶¶7-9]. The Debtor's bank statements also revealed that, prior to the bankruptcy filing, she spent significant sums on non-essential items such as yoga classes, designer chocolates, manicures, and wine. [CD-1; ECF 20, at pp. 5-6 ¶17(a)]. In addition, although the Debtor reported in her Bankruptcy Schedules that loans received from family members totaling approximately $144,000.00 were for the operation of DB Productions, she testified at the 341 Meeting that these funds were provided to help her with expenses that arose in connection with her divorce and otherwise. [CD-1; ECF 20 at p. 3, ¶8]. By characterizing the majority of her debts as "business debts," the Debtor circumvented the requirement of filing a means-test form in her bankruptcy case.[5] [CD-1; ECF 20, at p. 9, ¶20]. Based upon the totality of the circumstances, the United States Trustee sought to dismiss the Debtor's Chapter 7 case for abuse and bad faith. [Id. at p. 5, ¶ 17; p. 8, ¶¶19-20].

The Debtor's Conversion of Chapter 7 Case to Chapter 11

In response to the Section 707 Dismissal Motion, on July 6, 2007 the Debtor filed a motion seeking to convert the Chapter 7 case to a case under Chapter 11 of the Bankruptcy Code. [CD-2; ECF 29]. On October 2, 2007, the Bankruptcy Court entered an order converting

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[4] "CD-" is used herein to identify a document by its numbers in the United States Trustee Counter-Designation of the Record on Appeal.

[5] Under Interim Rule 1007(b)(4) of the Federal Rules of Bankruptcy Procedure, only an individual debtor with primarily consumer debts is required to file a statement of current monthly income (also known as the "means test") in a Chapter 7 case.

the Chapter 7 case to one under Chapter 11. [D-3; ECF 34]. Upon the conversion, the Chapter 7 Trustee was released of his rights, powers and duties over the Debtor's estate.[6]

The Relationship Between the Debtor and DB Productions

A lingering issue that existed in this case was the interrelationship between the Debtor and DB Productions. The Bankruptcy Court noted at a number of hearings that DB Productions had not filed for bankruptcy relief despite the fact that the Debtor and the corporation operated as a unit. [CD- 4; ECF 74, p. 3:23-25 and p. 4:1-2; 11-15; CD-5, p. 8:18-24; D-10; ECF 73, p. 12:13-15]. On January 24, 2008, the Bankruptcy Court held a status conference in the Debtor's chapter 11 case, and directed the Debtor to file a response to various questions posed by the Court regarding DB Productions. [D-8; ECF 61 - Declaration of Brian S. Masumoto, ¶ 13]. The Debtor filed a response to the Bankruptcy Court's directive on January 29, 2008, stating that DB Productions was operated out of her apartment and that she took money from the company whenever necessary to pay her bills. [Id.].

The Debtor, however, failed to address the Bankruptcy Court's concerns regarding the lack of transparency and disclosure of the financial relationship between the Debtor and DB Productions. [CD-4; ECF 74, p. 4:1-2, 13-15]. At the status conference held on February 28, 2008, the Court stated that the Debtor's response to the Court's directive did not answer the Court's questions and "raised more questions along the lines of those that were asked previously." CD- 4; ECF 74, p. 10:8-10]. The Court reiterated its concerns about the interrelated finances of the Debtor and DB Productions, stating that the Debtor was using DB

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[6] The appointment of a chapter 7 trustee pursuant to 11 U.S.C. §§ 701 and 702 terminates, by operation of law, upon conversion of a Chapter 7 case to Chapter 11. Under 11 U.S.C. § 1101(1), a Chapter 11 debtor operates as a "debtor in possession" and maintains possession and control of the property of her estate during the Chapter 11 case.

Productions as "... a piggy bank, whenever she needs money she takes it out of the corporation; she operates it as if they were a unit, the individual and the corporation." [CD- 4; ECF 74, p. 3: 25; p. 4:1-2]. The Court also questioned the Debtor's viability in Chapter 11 given the request for administrative expenses by the chapter 7 professionals, which the Court concluded "... is another potential devastating hole in the possibility of any successful reorganization here." [Id. at p. 4:7-15]. The Debtor was further cautioned that "... the aroma of substantial abuse still seems to be here." [CD-4; ECF 74, p. 9:10-11].

The Bankruptcy Court's Concern Over the Debtor's Delay in Administering the Estate

Throughout the course of this case, the Bankruptcy Court expressed concern as to the existence of abuse by the Debtor and the Debtor's failure to move the case through the bankruptcy process in a timely manner. At the March 11, 2008, hearing on the fee applications of the Chapter 7 professionals, the Court noted that "... there's been an inordinate delay in this case, and it has not been shown that this delay has been occasioned by the administration of the [Chapter 7] trustee and the accountants to the trustee. Clearly their efforts have been sufficient to bring on a motion by the U.S. Trustee for abuse, and a lot of the factors with respect to that abuse still have not been dissipated, at least in my eyes." [CD-5, p. 9 :21-25; p. 10:1-3].

The United States Trustee's Motion to Dismiss the Chapter 11 Case, Pursuant to 11 U.S.C. § 1112(b)

On March 28, 2008, the United States Trustee filed a Motion to Convert the Chapter 11 Case to a Chapter 7 Case, or in the Alternative, to Dismiss the Chapter 11 Case (the "Motion to Convert or Dismiss"). [D-8; ECF 61]. The Motion to Convert or Dismiss was premised on a number of factors, including the failure of the Debtor to satisfactorily comply with the Court's

January 24, 2008, request for detailed information regarding DB Productions. [D-8; ECF 61 at ¶11]. The Motion to Convert or Dismiss also cited the operating losses reported in the Debtor's Monthly Operating Reports filed for the periods October 2, 2007 through February 29, 2008. [D-8; ECF 61 at ¶¶ 17-20]. These reports, prepared by the Debtor's accountants, established that the Debtor operated at a significant loss every month with the exception of the month of December 2007, where there was a profit of only $1,320.00. [Id.]. In connection with her financial reporting requirements, the Debtor failed to provide bank statements and copies of cancelled checks as required by the United States Trustee Guidelines,[7] which prevented the United States Trustee from verifying any of the information provided. [D-8; ECF 61, pp. 8-9]. Given these losses, the United States Trustee concluded that the Debtor lacked the financial wherewithal to propose a feasible plan of reorganization such that she would be able to pay the administrative claims of the Chapter 7 professionals, the Chapter 11 professionals, her tax liabilities and her unsecured debt. [D-8; ECF 61, p.10]. The Debtor also failed to pay all of the statutory fees due to the United States Trustee as required by 28 U.S.C. § 1930(a)(6). [D-8; ECF 61, p. 11].

On May 1, 2008, the Debtor filed her response to the Motion to Convert or Dismiss, and advised the Bankruptcy Court and the United States Trustee that the Debtor no longer believed that she could successfully confirm a Chapter 11 plan, and that she would consent to either the conversion of her case to chapter 7 or the dismissal of her chapter 11 case. [D-9, ECF 66 ¶ 12;

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[7] Title 28 U.S.C. § 586(a)(3) directs the United States Trustee to supervise the administration of all Chapter 11 cases. In accordance with 28 U.S.C. § 586(a)(3), and in accordance with 11 U.S.C. § 704(8) and Federal Rule of Bankruptcy Procedure 2015, the United States Trustee for Region 2 has established Operating Guidelines and Reporting Requirements for Chapter 11 debtors. The Guidelines may be found at the United States Trustee's Region 2 website for its Manhattan Office at http://www.usdoj.gov/ust/r02/manhattan/chapter11.htm

D-10, ECF 73, p. 4:5-6].

The Bankruptcy Court's Decision and Order Dismissing the Debtor's Bankruptcy Case with Prejudice to Refiling for a Period of One Year

The hearing on the Motion to Convert or Dismiss was held on May 6, 2008, and the Bankruptcy Court ruled in favor of the dismissal of the Debtor's case. Debtor's counsel conceded a number of times at the hearing that the Debtor agreed to a dismissal with prejudice, and stated that a bar to refiling for a three to six month period would be reasonable. [D-10; ECF 73, p. 4:5-10, p. 13:19-23, p. 14:15-16]. The Bankruptcy Court concluded, however, that there was substantial justification for the dismissal of the Debtor's case with prejudice for a one year period, which was supported by the record. [Id.; ECF 73, p. 10:13-15, p. 13:22-25, p. 14:1-2 and 9-10]. The Court also expressed concern as to the Debtor's motivation with respect to her position on the one year prohibition, and the perception that the Debtor had the intention to refile for bankruptcy relief after dismissal:

> "[I]f this debtor has an intention possibly or is harboring some intention of coming back to this court, we've had enough exposure to the debtor that I see that the U.S. Trustee's request for with prejudice has substantial justification for a one year period."

[Id. at p. 5:19-24].

. . .

> "I'm beginning to suspect that you are contemplating a refiling here. . . . I'm having a problem with you, Mr. Pick [Debtor's counsel], if that's what you're contemplating and that's the basis for your arguing for an additional six months with prejudice, you concede that a with prejudice would be appropriate in this case or you wouldn't resist it"

[Id. at p. 11:18-19; 23-25; p. 12:1-2].

The Bankruptcy Court recited a number of factors in reaching its conclusion, including possible refiling, the escalating administrative expenses, chapter 7 professional fees, the substantial claims filed by the taxing authorities and credit card companies, and the Debtor's failure to explain the abuse as alleged by the United States Trustee. [D-10; ECF 73, p. 4:18-20;11-13; 14-22; p. 5: 5-11; p. 11: 23-25; p. 12:1-2]. The Court stated that ". . . [t]he abuse has never been fully explained except in colloquy in front of the court and that she needs to be very well dressed in order to function in her business, which is to show herself off at great expense, and that there is another entity out there that may or may not be bearing the freight." [Id. at p. 5:5-11]. The Court also expressed concern as to why the Debtor had not caused DB Productions to file for bankruptcy relief, despite the intermingling of its financial affairs with those of the Debtor, and noted that "[t]his case is just peppered with the lack of any information or potential for a successful Chapter 11." [D-10; ECF 73, p. 6:2-3; p. 12:13-15; p. 10:22-24].

In light of the Debtor's history in the bankruptcy court, which included conversion of her Chapter 7 case to Chapter 11 when faced with a motion to dismiss for abuse and bad faith, the inability to successfully reorganize in Chapter 11, and the lack of adequate disclosure with regard to the relationship between the Debtor and DB Productions, the Court found substantial justification for dismissal of the bankruptcy case with prejudice to the Debtor refiling for bankruptcy for a one year period. [D-10; ECF 73, p. 4:18-20;11-13; 14-22; p. 5: 5-11; p. 11: 23-25; p. 12:1-2].

V. SUMMARY OF ARGUMENT

The Debtor's conduct over the last two years gave the Bankruptcy Court ample cause to dismiss her bankruptcy case with prejudice. The Court had the discretion to impose what it deemed an appropriate prejudicial period to prevent the Debtor from immediately filing another petition. The record clearly reflects that the Court did not abuse its discretion, and the Order dismissing this case with prejudice to refiling for one year should be affirmed.

VI. ARGUMENT

A. Cause Existed to Dismiss the Case

The United States Trustee asks this Court to affirm the Bankruptcy Court's Order dismissing the case and precluding the Debtor from filing again for one year. There is no dispute that dismissal was proper. 11 U.S.C. § 1112(b) provides that on the request of a party in interest, and after notice and a hearing, the "Court shall convert a case to a case under chapter 7 or dismiss a case under this chapter, whichever is in the best interests of creditors and the estate, if the movant establishes cause." 11 U.S.C. § 1112(b)(1). Section 1112(b)(4) of the Bankruptcy Code describes a variety of enumerated factors which may constitute "cause" for conversion or dismissal, including substantial or continued diminution of the estate and absence of a reasonable likelihood of rehabilitation, gross mismanagement of the estate, unexcused failure to satisfy timely any filing or reporting requirement, failure to timely provide information requested by the United States Trustee, [failure to timely pay postpetition taxes], or failure to pay fees required under title 28. 11 U.S.C. § 1112(b)(4). The list is not exhaustive. In re State Street Assoc., 348 B.R. 627, 639, n. 24 (Bankr. N.D.N.Y. 2006) (citing In re RAM, Inc., 343 B.R. 113, 117 (Bankr. E.D. Pa. 2006)).[8] See also In re The 1031 Tax Group, LLC, 374 B.R.78, 93 (Bankr. S.D.N.Y. 2007) (a case may be dismissed for reasons other than those specified in §1112(b), as long as the reasons establish "cause").

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[8] Although decided before the enactment of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (the "BAPCPA"), Second Circuit authority providing that the list of factors in pre-BAPCPA section 1112(b) was illustrative rather than all-inclusive is still applicable. In re C-TC 9th Ave. P'ship., 113 F.3d 1304, 1311 (2d Cir. 1997) (bankruptcy court may dismiss chapter 11 filing upon a finding that case was filed in "bad faith" even without consideration of the factors set out in section 1112(b)).

In this case, the Debtor did not timely pay United States Trustee fees. She did not file a disclosure statement. She did not, and indeed could not, file a plan capable of confirmation. Despite the requests from the United States Trustee and a direction from the Bankruptcy Court, she continued to use the assets of DB Productions in order to fund her extravagant spending, apparently with monies from DB Productions without a full accounting. She did not timely provide the United States Trustee with information and documents as requested. She filed monthly operating reports that consistently reflected losses. In addition, the Debtor herself consented to dismissal.

B. Cause Existed to Dismiss the Case with Prejudice to Refiling for a One Year Period

The Second Circuit has long held that when dismissing a chapter 11 case under §1112(b) of the Bankruptcy Code, the bankruptcy court may preclude the debtor from refiling for bankruptcy relief for a specified period. See, e.g., In re Casse, 198 F.3d at 339-41 (it is within the sound discretion of the bankruptcy court to find "cause" to preclude a debtor from filing another petition for bankruptcy relief is made by the bankruptcy court within its discretion). The exercise of discretion to dismiss a bankruptcy case with prejudice should be based upon a review of a debtor's overall conduct throughout the entire bankruptcy process. In re Ladd, 82 B.R. 476, 477 (Bankr. N.D. Ind. 1988); In re McClure, 69 B.R. 282 (Bankr. N.D. Ind. 1987); see also In re Jones, 289 B.R. 436, 439 (Bankr. M.D. Ala. 2003) (finding that the Debtor's history in her bankruptcy case demonstrated an "abuse of the protection[s] of the Bankruptcy Code" sufficient to support dismissal with prejudice to refiling for one year); Phoenix Land Corp, 164 B.R. 174, 176 (Bankr. S.D. Fla. 1993) (filing a chapter 11 case in order to delay and thwart the efforts of secured creditors to enforce their rights was sufficient to dismiss with prejudice for a period of one year).

Significantly, the Debtor did not object to dismissal of the case with prejudice at the May 6, 2008 hearing on the Motion to Convert or Dismiss, and she does not object now. [D-10 ; ECF 73 - Page 4:5-10, Page 13:19-23, Page14:15-16]. Nor has the Debtor denied that the Bankruptcy Court has the power to bar her from refiling another case for longer than 180 days. Rather, she now argues that the Bankruptcy Court abused its discretion in entering a bar of one year, because her conduct was not sufficiently egregious to warrant such a lengthy prejudicial period. [Debtor's Brief at p. 15].[9] Her examples of such behavior included debtors who filed repeatedly on the eve of foreclosure (i.e., the "serial filers") (see e.g., Casse, 198 F. 3d at 341-42; Tomlin Colonial Auto Ctr. v. Tomlin (In re Tomlin), 105 F. 3d 933, 937 (4th Cir. 1997); In re Herrera, 194 B.R. 178 (Bankr. N.D. Ill. 1996), failure to file required schedules and refusal to comply with court directives (see e.g., In re Hughes, 360 B.R. 202, 205-06 (Bankr. N.D.Tex. 2007), and other delays and contumacious conduct (see e.g., In re Martin-Trigona, 35 B.R. 596, 601 (Bankr. S.D.N.Y. 1983) (quoting Durham v. Florida East Coast Railway Co., 385 F.2d 366, 368 (5th Cir. 1967)). The Debtor also argues that she was not a party to any litigation, she owns no real estate, she is current on her lease, does not have any property held under restraint or subject to tax lien, and that this case is her first bankruptcy case. She states that she is merely a bad businesswoman

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[9] The Debtor was aware that the United States Trustee was seeking dismissal with prejudice to refiling for a one year period well in advance of the hearing on the Dismissal Motion. Any contention that the Debtor was hindered because the Dismissal Motion did not expressly request that the case be dismissed with prejudice should not be entertained on this appeal. At the hearing held on March 11, 2008 – nearly seven weeks prior to the hearing on the Dismissal Motion – Debtor's counsel indicated that he had been in contact with the United States Trustee's Office concerning a motion to convert or dismiss, and stated that "[T]he alternative relief they've asked me is about dismissing the case. I said that we are prepared to discuss that with them and we'll agree to a certain period of time, but at the moment they are asking for a year that she can't [ever] refile." [CD-5 - Page 21:18-21].

with a tumultuous personal life. [Debtor's Brief at Page 2].

None of the cases and/or examples of willful conduct relied upon by the Debtor present facts that are present here. What they do share, however, is one major and significant theme: a debtor may be found to act in bad faith, and therefore, subject herself to dismissal with prejudice, when she causes delay that harms the estate, creditors and other parties in interest, or when she does not fulfill her duties as a debtor-in-possession. See also In re Phoenix Land Corp, 164 B.R. at 176 (in determining whether to dismiss a case with prejudice, courts have considered any factor which evidences a debtor's intent to abuse the judicial process). That is precisely what happened in this case and why the Bankruptcy Court found cause to impose the one-year bar.

From the time the Debtor filed her Chapter 7 case, the Bankruptcy Court was concerned not only with her extravagant lifestyle, which included a couture wardrobe, a $7,100 per month apartment and a $2,800 per month nanny for her son, but also the Debtor's continued use of DB Productions as a "piggy bank" to fund her personal needs. [CD-1; ECF 20, pp. 2-3; ¶7-9;CD- 4; ECF 74, p. 3: 25; p. 4:1-2]. The Court raised the issue of the "unity" between the Debtor and DB Productions on more than one occasion, viewing the indebtedness of the Debtor and the indebtedness of the corporation to be interchangeable "... as if they were a unit." [CD- 4; ECF 74, p. 3:23-25, p. 4:1-2; 11-15; 13-15; CD-5, p. 8:18-24; D-10; ECF 73, p. 12:13-15]. The Court was not satisfied with the Debtor's explanation that she needed an expensive wardrobe to appear to be a successful corporate events planner and that if DB Productions filed a bankruptcy petition, the business would be unable to operate. [D-10; ECF 73, p. 5:5-11].

At nearly every hearing and status conference in this case, the Bankruptcy Court chastised the Debtor for her lack of candor and her abuse of the bankruptcy process. For example, at the February 28, 2008, hearing, the Bankruptcy Court stated that “the aroma of substantial abuse still seems to be here” and found that the Debtor’s response to the Court’s directive to provide information regarding DB Productions insufficient to allow the Court to determine whether the Debtor was capable of filing a feasible plan of reorganization. [[CD-4, p. 9:10-11; ECF 74]. The Court further stated that the case “is just peppered with the lack of any information or potential for a successful Chapter 11.” [D-10; ECF 73, p. 10:22-24]. This lack of information cannot be underestimated, as “accurate financial disclosure is the lifeblood of the Chapter 11 process.” In re Berryhill, 127 B.R. 427, 433 (Bankr. N.D. Ind. 1991); see also In re Phouminh, 339 B.R. 231, 247 (Bankr. D. Colo. 2005)(in denying discharge in a Chapter 7 case, the court stated that “a lack of transparency creates a cloud of doubt as to the true nature of the debtor’s pre-petition activities.”); In re V Companies and V-S Architects, Inc., 274 B.R. 721, 725 (Bankr. N.D. Ohio 2002)(undue delay includes a debtor’s failure to provide meaningful information at any stage of the proceeding).

Further, at the March 11, 2008, hearing, the Bankruptcy Court expressed concern for the “inordinate delay” in the case and stated unequivocally that the factors in the United States Trustee’s Section 707 Dismissal Motion with respect to abuse “still have not been dissipated, at least in my eyes.” [CD-5, p. 9:21-25; Page 10:1-3]. At the May 6, 2008, hearing on the Motion to Convert or Dismiss was granted, the Bankruptcy Court further stated that “[t]he abuse has never been fully explained except in colloquy in front of the court that [the Debtor] needs to be very well dressed in order to function in her business, which is to show herself at great expense, and that there is another entity out there that may or may not be bearing the freight.” [D-10; ECF 73, p. 5:5-11]. The Bankruptcy Court opined that the Debtor would become a serial filer, and harbored the desire for “a potential refiling” of this case either in Chapter 7 or Chapter 11. [Id. at p. 11:18-19; 23-25; p. 12:1-2].

Moreover, as already stated, the Debtor failed or refused to carry out the duties required of a debtor in chapter 11. She did not timely pay United States Trustee fees. She did not file a disclosure statement or a plan. She could not propose a plan capable of confirmation. She took money from DB Productions to fund her extravagant spending and did not fully account for it. due. She did not timely provide the United States Trustee with information and documents as requested. She filed monthly operating reports that consistently reflected losses. She could not explain to the Bankruptcy Court the reasons for delay or why or how this case was going to succeed. The Bankruptcy Court properly determined that these circumstances supported its exercise of discretion to limit the Debtor’s access to future bankruptcy relief for a period of one year.

VII. CONCLUSION

Based on the foregoing, the United States Trustee requests that the Court affirm the Bankruptcy Court's order dismissing the Debtor's bankruptcy court with prejudice and grant other relief as is just and proper.

Dated: New York, NY

August 22, 2008

Respectfully submitted,

Of Counsel:

RAMONA ELLIOTT General Counsel P. MATTHEW SUTKO CARRIE WEINFELD Office of the General Counsel	LINDA RIFFKIN Assistant United States Trustee SUSAN D. GOLDEN MARYLOU MARTIN Trial Attorneys
Executive Office for United States Trustees United States Department of Justice 20 Massachusetts Avenue, N.W. Suite 8100 Washington, DC 20530 (202) 305-0550	Office of the United States Trustee 33 Whitehall Street, 21st Floor New York, NY 10004 (212) 510-0500

(Cite as: 1991 WL 807310 (USTBRIEFS))

[*1] Title (TI): IN RE BH&P, INC. — BRIEF OF U.S. TRUSTEE, AS AMICUS CURIAE
Court (CO): CTA3, U.S. Court of Appeals (3d Cir.)
Current-Case (CCN): No. 90-5877
Previous-Case (PCN): No. N/A
Source (SO): U.S. TRUSTEES
Date-of-Filing (DA): April 22, 1991
Author (AU): Martha L. Davis, General Counsel & T. Patrick Tinker, Attorney (202-307-1399)
Topic (TO): BANKRUPTCY— Whether, in related debtor cases with inter-company claims, trustee and his law firm were "disinterested" or should be disqualified from serving as trustee and as counsel to chapter 7 trustee under 11 U.S.C. § 324 & § 327(a).

Summary (SU): Although mere representation of a creditor is not a per se disqualification from employment as trustee's counsel, here the Bankruptcy Court found that the law firm had an "actual conflict of interest." Accord: In re BH&P, 949 F.2d 1300 (3d Cir. 1991) (applicants for appointment have a duty to disclose potential conflicts of interest, and § 327(a) allows for disqualification of attorneys only if they have actual or potential conflict of interest). See also: In re Marvel Entertainment, 140 F.3d 463 (3d Cir. 3/25/98).

COURT OF APPEALS NO. 90-5877
IN THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

In re BH&P, INC. a New Jersey Corporation, PHILIP ALAN HERMAN, and BRUCE BERKOW,
DEBTORS

CARMEN J. MAGGIO, Individually and Trustee for BH&P, INC., Debtor, and RAVIN, GREENBERG & MARKS, P.A. (Formerly RAVIN, GREENBERG & ZACKIN, P.A.),
APPELLANTS

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF NEW JERSEY

BRIEF OF THE UNITED STATES TRUSTEE AS AMICUS CURIAE

THOMAS E. ROSS
United States Trustee
Region 3

MARTHA L. DAVIS
General Counsel
T. PATRICK TINKER
Attorney
Executive Office for
United States Trustees
Department of Justice
320 First Street, N.W.
Room 812
Washington, D.C. 20530
(202) 307-1391

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  [*3] Ch. 1, 11 U.S.C. § 101 et seq.:

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NO. 90-5877

IN THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

In Re:
BH&P, INC. a New Jersey Corporation, PHILIP ALAN HERMAN, BRUCE BERKOW,
DEBTORS

CARMEN J. MAGGIO, Individually and Trustee for BH&P, INC., Debtor, and RAVIN,
GREENBERG & MARKS, P.A. (Formerly RAVIN, GREENBERG & ZACKIN, P.A.),
APPELLANTS

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF NEW JERSEY

BRIEF OF THE UNITED STATES TRUSTEE
AS AMICUS CURIAE

JURISDICTION

This appeal was taken from an order of the United States District Court for the District of New Jersey (the "District Court"), filed September 13, 1990, affirming in part and reversing and remanding in part an order of the United States Bankruptcy Court for the District of New Jersey (the "Bankruptcy Court"), filed June 13, 1989. The Bankruptcy Court and District Court opinions are published at 103 Bankruptcy Reporter 556 and 119 Bankruptcy Reporter 35.

The Bankruptcy Court's order disqualified and removed Carmen J. Maggio ("Maggio"), Ravin, Greenberg & Zackin, P.A. ("RGZ") and Bederson & Co. [**FN**1] (collectively, the "Applicants") from their respective positions as the chapter 7 trustee, trustee's bankruptcy counsel and accountants in the bankruptcy cases of Phlip Alan Herman ("Herman") and Bruce Berkow ("Berkow"). The Bank of New York initiated the proceeding as an objection to interim fee applications filed by the Applicants, and the proceeding was consequently a "core proceeding" arising under title 11 of the United States Code. 28 U.S.C. § 157(b)(2)(B). The bankruptcy court's subject matter jurisdiction was therefore based on 28 U.S.C. § 157(b)(1).

The appellate jurisdiction of the District Court was based on 28 U.S.C. § 158(a), because the Bankruptcy Court's order disqualifying and removing Maggio and RGZ and denying compensation was a "final order". To the extent that the District Court affirmed the disqualification and removal of Maggio and RGZ, its decision was a "final order". See United States v. Miller, 624 F.2d 1198, 1199 (3d Cir. 1980). This Court has appellate jurisdiction over the issues of disqualification and removal pursuant to 28 U.S.C. § 158(d). The District Court's remand for a determination of whether all compensation to the Applicants should be denied due to conflicts of interest raises questions collateral to the Applicants' disqualification and removal, and the remand should not impede this Court's appellate jurisdiction. [**FN**2]

STATEMENT OF ISSUES

[*4] I. Whether this Court has appellate jurisdiction over the matters raised in this appeal.

II. Whether RGZ should be disqualified and removed from serving as bankruptcy counsel to the chapter 7 trustee in the bankruptcy cases of Herman and Berkow pursuant to 11 U.S.C. §§ 101(13) and 327(a), because it also represented the trustee in the related bankruptcy case of BH&P, a corporation possessing disputed claims against Herman and Berkow.

III. Whether Maggio should be disqualified and removed as bankruptcy trustee for the estates of Herman and Berkow pursuant to 11 U.S.C. §§ 101(13) and 324, based on a conflict of interest, where Maggio served as trustee for the estate of BH&P, a corporation possessing disputed claims against Herman and Berkow.

STATEMENT OF THE CASE

The issues on appeal concern the presence and effect of conflicts of interest allegedly posed for Maggio and RGZ as a result of their multiple representation of BH&P and BH&P's two shareholders, Herman and Berkow, in their three bankruptcy cases.

A. Procedural History of the Three Cases

BH&P commenced its case under chapter 11 of the Bankruptcy Code ("Reorganization") on April 14, 1986. Following the sale of a substantial portion of BH&P's assets and the cessation of its business operations, the United States Trustee filed a motion to convert BH&P's case to a case under chapter 7 of the Bankruptcy Code ("Liquidation"). On November 10, 1986, the Bankruptcy Court filed its order converting BH&P's case to chapter 7.

On or about January 28, 1987, the United States Trustee appointed Maggio as the interim trustee in BH&P's chapter 7 case pursuant to 11 U.S.C. § 701(a)(1). Maggio continued to serve as the permanent chapter 7 trustee when BH&P's creditors failed to elect a trustee. 11 U.S.C. § 702(d).

On February 3, 1987, Maggio applied to retain RGZ as his counsel in the BH&P case under 11 U.S.C. § 327 and Bankruptcy Rule 2014. (A-188) The application to employ RGZ was approved by the Bankruptcy Court in an order filed February 20, 1987.

On February 9, 1987, one of BH&P's stockholders, Herman, filed his bankruptcy case under Chapter 7. On February 11, 1987, the United States Trustee appointed the Maggio as the interim trustee for Herman's bankruptcy estate, and Maggio continued to serve as permanent chapter 7 trustee. Maggio again applied to retain RGZ as his counsel in Herman's case. On April 20, 1987, the Bankruptcy Court filed an order approving employment of RGZ to represent the estate of Herman.

On September 18, 1987, the other shareholder in BH&P, Berkow, filed his case under Chapter 7. On September 23, 1987, the United States Trustee appointed the Maggio as the interim chapter 7 trustee in Berkow's case. Once again, Maggio applied to hire RGZ as his attorneys. On October 27, 1987, the Bankruptcy Court filed its order approving employment of RGZ in the Berkow case.

The three bankruptcy cases were administratively consolidated in two stages. Maggio first requested joint administration of the BH&P and Herman cases, which the Bankruptcy Court authorized in an order filed July 7, 1987. Following his appointment in the Berkow case, Maggio then requested joint administration of all three cases, which the Bankruptcy Court authorized in an order filed December 14, 1987.

B. History of the Appeal

[*5] The proceeding which gives rise to this appeal was initiated by the Bank of New York's objection to the Applicants' interim fee applications in the BH&P case. The Bank of New York asserted, inter alia, that the Applicants had conflicts of interest resulting from their multiple representation of BH&P, Herman, and Berkow which justified a denial of compensation.

On March 23, 1989, the Bankruptcy Court conducted a hearing on the interim fee applications, at which time it denied the fee applications without prejudice and ordered the Applicants and the Bank of New York to file certifications of facts relevant to the confict of interest allegations and briefs on the legal issues. The Bankruptcy Court filed a written order to that effect on April 10, 1989. The Applicants did not file a notice of appeal from that order.

The Bankruptcy Court conducted additional hearings on the conflict of interest issues on June 12, 1989 and June 22, 1989. In a bench opinion rendered at the conclusion of the June 22, 1989 hearing and in a written order entered July 19, 1989, the Bankruptcy Court disqualified and removed the Applicants from any further involvement in the Herman and Berkow cases, but allowed them to continue rendering services in the BH&P case. In addition, the Bankruptcy Court: (i) vacated the orders which administratively consolidated the three cases, (ii) directed the United States Trustee to appoint new trustees in the Herman and Berkow cases, (iii) denied compensation and reimbursement to Applicants for their services and expenses in the Herman and Berkow cases, and (iv) stayed the Applicants from filing fee applications in the BH&P case until ninety days following appointment or employment of replacement trustees and professionals in the Herman and Berkow cases. (A-423 to 425)

On July 28, 1989, Maggio timely filed a notice of appeal from the Bankruptcy Court's written order entered July 19, 1989. (docket no. 423, A-127) An amended notice of appeal from that order was filed by Maggio and RGZ on August 2, 1989. (A-472)

On August 11, 1989, the Bankruptcy Court filed its memorandum opinion in which it held that: (i) the Applicants knowingly and intentionally withheld required disclosures in the Herman and Berkow cases; (ii) the trustee was removable for "cause" under 11 U.S.C. § 324 because, as a "creditor", he failed the disinterest requirement of 11 U.S.C. § 701(a)(1); (iii) RGZ and Bederson & Co. possessed an actual conflict of interest which disqualified them from employment and justified a denial of compensation to them in the Herman and Berkow cases pursuant to 11 U.S.C. §§ 105(a) and 327; (iv) denial of compensation to the Applicants was based on their breach of a duty of disclosure, Maggio's intentional or negligent employment of an interested professional, and RGZ's and Bederson's employment by an interested trustee; and (v) the orders for joint administration of the three cases were vacated for failure to disclose potential conflicts of interest. The Bankruptcy Court also enunciated a standard for multiple representation of related entities in bankruptcy cases, holding that it is presumptively improper in related cases to appoint a single trustee, a single creditors' committee, or the same counsel, where certain enumerated interrelations between the debtors are present, and that the presumption is irrebuttable if there is an actual conflict of interest. Lastly, the Bankruptcy Court modified in one regard its earlier order, holding that the Applicants could not refile fee applications for services in the BH&P case until further order of the court or until the case was being closed. [**FN**3]

[*6] On September 13, 1990, the District Court filed its order and opinion affirming in part, and reversing and remanding in part, the Bankruptcy Court's order and memorandum opinion. Although the District Court questioned the Bankruptcy Court's conclusion that Maggio was a "creditor" under 11 U.S.C. § 101(13)(A), it nevertheless found that Maggio failed the disinterest requirement because he had a "materially adverse" interest under 11 U.S.C. § 101(13)(E). The District Court affirmed the Bankruptcy Court's conclusion that RGZ and Bederson & Co. failed the disinterest requirements of 11 U.S.C. §§ 101(13) and 327 due to actual conflicts of interest. The District Court reversed the Bankruptcy Court's finding that the Applicants had "knowingly and intentionally" breached their duty of disclosure (A-29), but upheld the Bankruptcy Court's determination that the duty of disclosure had, in fact, been breached (A-31). The District Court then remanded the matter for a reconsideration of the compensation issue, on the ground that the Bankruptcy Court might not have denied all compensation in the Herman and Berkow cases if it had found that the Applicants' failures to disclose were unintentional. (A- 32)

On October 12, 1990, Maggio and RGZ timely filed a notice of appeal from the District Court's order and opinion of September 13, 1989. No cross-appeal has been filed in the case, and the Bank of New York has not participated in the case as Appellee.

STATEMENT OF RELATED CASES

The United States Trustee is aware of no proceedings or cases on appeal which are related to these cases.

STANDARD OR SCOPE OF REVIEW

The Bankruptcy Court's findings of fact are subject to the "clearly erroneous" standard of review. Sharon Steel Corp. v. National Fuel Gas Distribution Corp., 872 F.2d 36, 38 (3d Cir. 1989). This Court's review of the legal conclusions of the Bankruptcy Court and District Court is plenary. Id. at 39; United States v. Miller, 624 F.2d 1198, 1201 (3d. Cir. 1980).

ARGUMENT

I. THIS COURT HAS APPELLATE JURISDICTION PURSUANT TO 28 U.S.C. § 158(d) BECAUSE THE DISTRICT COURT'S ORDER WAS A "FINAL" ORDER NOTWITHSTANDING THE LIMITED REMAND.

Pursuant to 28 U.S.C. § 158(d), this Court has jurisdiction over appeals from all "final decisions, judgments, orders, and decrees" entered by the district courts pursuant to their appellate jurisdiction under 28 U.S.C. § 158(a). This appeal does not raise any issue of the District Court's jurisdiction under 28 U.S.C. § 158(a).

The Third Circuit has expressed reluctance to expansively interpret the finality requirement. Matter of Marin Motor Oil, Inc., 689 F.2d 445, 448 (3d Cir. 1982) (citing Bachowski v. Usery, 545 F.2d 363, 373-74 (3d Cir. 1976)). However, the "unique characteristics of bankruptcy cases have led [the Third Circuit] to 'consistently consider [] finality in a more pragmatic and less technical way in bankruptcy cases than in other situations.' " F/S Airlease II, Inc. v. Simon, 844 F.2d 99, 103 (3d Cir. 1988), cert. denied 488 U.S. 852 (1988) (quoting In re Amatex Corp., 755 F.2d 1034, 1039 (3d Cir. 1985)). The Third Circuit has consistently followed a "pragmatic" or "functional" approach to finality in bankruptcy cases. See, e.g. U.S. v. Nicolet, Inc., 857 F.2d 202, 205 (3d Cir. 1988), Matter of West Electronics Inc., 852 F.2d 79, 81 (3d Cir. 1988), In re White Beauty View, Inc., 841 F.2d 524, 526 (3d Cir. 1988), Wheeling-Pittsburgh Steel Corp. v. McCune, 836 F.2d 153, 157 (3d Cir. 1987), In re Jeannette Corp., 832 F.2d 43, 45 (3d Cir. 1987), In re Meyertech Corp., 831 F.2d 410, 414 (3d Cir. 1987), Matter of Christian, 804 F.2d 46, 48 (3d Cir. 1986).

[*7] The District Court's remand on the issue of compensation poses a threshold jurisdictional question as to whether the remand renders the District Court's decision non-final for purposes of this Court's appellate jurisdiction under 28 U.S.C. § 158(d). The proceeding was remanded for a determination of whether the Applicants should be denied all compensation where their failure to disclose was non-wilful.

The Third Circuit has addressed the effect of a remand on finality in five bankruptcy cases. In three of those cases, the Third Circuit held that the remand did not render the district court's judgment non-final. F/S Airlease II, Inc. v. Simon, 844 F.2d 99 (3d Cir. 1988); In re Meyertech Corp., 831 F.2d 410 (3d Cir. 1987); Universal Minerals, Inc. v. C. A. Hughes & Co., 669 F.2d (3d Cir. 1981). In the other two cases involving remand, the Third Circuit held that it did not have jurisdiction because the judgment was not final. In re Jeannette Corp., 832 F.2d 43 (3d Cir. 1987); In re Brown, 803 F.2d 120 (3d Cir. 1986). Of these five cases, the case most strongly on point is F/S Airlease, a case which held that remand did not render the district court's order non-final.

In the bankruptcy proceeding in F/S Airlease, the debtor and creditors objected to a broker's application for compensation on the grounds that, inter alia, the broker was not a qualified professional whose employment was timely approved by the court and the amount of compensation requested was unreasonable. In re F/S Airlease II, Inc., 59 Bankr. 769, 772-73 (Bankr. W.D. Pa. 1986). The bankruptcy court approved the employment of the broker nunc pro tunc, holding that the broker satisfied the disinterest requirement of 11 U.S.C. § 327, that circumstances justified approval of the broker's employment nunc pro tunc, and that the requested compensation was reasonable and necessary.

The district court in F/S Airlease affirmed the bankruptcy court's determinations that the broker was disinterested and that the circumstances justified a nunc pro tunc approval of the broker's employment, but remanded for a more extensive investigation of the reasonableness of the requested compensation. In re F/S Airlease II, Inc., 84 Bankr. 389, 394 (W.D. Pa. 1986).

The Court of Appeals in F/S Airlease considered three factors relevant to the issue of finality: "the impact of the matter on the assets of the bankruptcy estate, the preclusive effect of a decision on the merits, and whether the interests of judicial economy will be furthered." 844 F.2d at 104 (citing Meyertech, 831 F.2d at 414). Applying those factors, the Court determined that the orders granting nunc pro tunc approval of the broker's employment were final. The Court stated that the resolution of that "discrete dispute ... would further the goal of judicial economy because it would obviate the need for further action by the bankruptcy court." Id. The Court added that, because the size of the compensation sought was so substantial, it would "severely affect the rights of the other creditors" as well as, perhaps, the debtor's chance for a reorganization. Id.

[*8] The Court of Appeals then specifically addressed the effect of the district court's remand for a determination of the amount of compensation to be paid to the broker, and found that the remand did not affect the finality of the approval of employment, because the remand did not deal with the issue on appeal. The Court stated that the district court's order "conclusively determined the question presented by this appeal". Id. at 105 (quoting Universal Minerals, 669 F.2d at 101). The Court of Appeals contrasted the remand in F/S Airlease with those which "involved the development of 'further factual findings related to a central issue raised on appeal.' " Id. at 104- 05, n. 4 (quoting In re Stanton, 766 F.2d 1283, 1287 (9th Cir. 1985).

The two Third Circuit cases which found that remands caused the district court orders to be non-final were distinguished. In Jeannette Corp., a remand for determination of whether Rule 11 sanctions should be imposed rendered non- final a district court's decision to affirm the bankruptcy court's finding that the attorney violated duties under Rule 11. The "liberal construction" of the bankruptcy finality requirement was held not to "apply in situations unrelated to the special needs of bankruptcy litigation." Id. at 105, n. 5. In Brown, the district court's order reversing the finding of a violation of the automatic stay and remanding for a calculation of damages "did not 'affect the distribution of the debtor's assets or the relationship among the creditors.' " Id. (quoting Brown, 803 F.2d at 123).

The instant appeal bears a number of similarities to F/S Airlease. In both cases, objections were filed to applications for compensation on the ground that, inter alia, the applicant was not disinterested, and the remand in each case was for a determination of the amount of compensation to be paid to the applicant(s).

Although this appeal involves an order affirming disqualification and removal, as opposed to the order approving employment that was at issue in F/S Airlease, the basis upon which the Third Circuit assumed jurisdiction in F/S Airlease supports the view that a remand for purposes of determining allowable compensation does not destroy the finality of an order regarding the qualifications of an applicant for employment. In addition, independent application of the F/S Airlease factors indicates that the District Court's order was final, and this appeal presents those general types of circumstances which call for a more "liberal" construction of finality in bankruptcy cases.

The first factor considered in F/S Airlease was the effect on assets in the estates. The Bankruptcy Court disqualified and removed the Applicants, in part, to ensure that conflicts of interest would not impede the resolution of BH&P's large, disputed claims against Herman and Berkow. The resolution of that litigation could affect the assets available to creditors in all three cases. In addition, while the disqualification and removal of professionals would seemingly confer an immediate benefit on the estates of Herman and Berkow, insofar as it ensures their representation by disinterested professionals, the apparent benefits may only be transitory. In the long run, the impact of the lower courts' ruling will necessitate, for these cases as well as others, separate trustees and professionals -- a factor which will inevitably increase administrative costs in such related-debtor cases.

[*9] The other two factors listed in F/S Airlease and considered by the Third Circuit in its cases were "the preclusive effect of a decision on the merits, and whether the interests of judicial economy will be furthered." This Court's determination of the issues on appeal would effectively resolve the issues of disqualification and removal, precluding additional consideration of those issues in the lower courts. In addition, if this Court were to determine that the Applicants were qualified and should not have been removed, then its decision would effectively reverse the grounds for a denial of compensation. The Applicants could then proceed with applications for compensation in the Herman and Berkow cases under 11 U.S.C. § 330 and Bankruptcy Rule 2014. [**FN**4] Cf. Meyertech, 831 F.2d 410, 414 (decision by court of appeals would "preclude the necessity of further activity by the fact-finding tribunal, will obliterate the need for more litigation and serves the ever-prevailing interest of judicial economy").

II. THE BANKRUPTCY COURT'S FINDING THAT RGZ POSSESSED AN ACTUAL CONFLICT OF INTEREST IN VIOLATION OF 11 U.S.C. § 327 WAS NOT IN ERROR.

This case concerns RGZ's eligibility for employment in light of the statutory requirements which govern the employment of professionals in bankruptcy cases. The analysis begins, as it must, with the language of the statute. U.S. v. Ron Pair Enterprises, Inc., 489 U.S. 35, 109 S. Ct. 1026, 1030 (1989). It then turns to the judicial construction of the relevant statutes and, specifically, a consideration of whether the Bankruptcy Court's conclusion that RGZ was disqualified for employment was in error.

The qualifications for employment of professionals are set forth in 11 U.S.C. §§ 327. Section 327(a) provides that the trustee may employ professionals "that do not hold or represent an interest adverse to the estate" and that are "disinterested persons". An examination of the definition of "disinterested person" in Section 101(13) indicates some overlap between the "no adverse interest" requirement and the "disinterested person" requirements. Viewed practically, persons failing one of the two requirements will often fail the other requirement as well, although the two requirements are not completely coterminous. See In re Martin, 817 F.2d 175, 179 n.4 (1st Cir. 1987) (there is "something of a redundancy" between Section 101(13) and Section 327(a)); Cf. Roger J. Au & Son, Inc., 64 Bankr. 600, 604 (N.D. Ohio 1986) (both requirements of Section 327(a) are met when a person is found to be disinterested under Section 101(13)).

Section 101(13) defines "disinterested person" negatively. A person is "disinterested" if the person is not excluded from that status under one of the five subparagraphs of Section 101(13). The first four subparagraphs exclude persons who have any of the enumerated relationships to the debtor. 11 U.S.C. § 101(13)(A)-(D). The fifth subparagraph, 11 U.S.C. § 101(13)(E), is the provision under which the Bankruptcy Court held that RGZ was disqualified.

[*1]0 Subparagraph (E) of Section 101(13), the so-called "catch-all" provision, provides that a person is disinterested if the person

> (E) does not have an interest materially adverse to the interest of the estate or of any class of creditors or equity security holders, by reason of any direct or indirect relationship to, connection with, or interest in, the debtor or an investment banker specified in subparagraph (B) or (C) of this paragraph, or for any other reason.

In order to fail the disinterest requirement under Subparagraph (E), a person would have to hold an interest materially adverse to the interest of the estate or to the interest of any class of creditors or equity security holders. Such a "materially adverse interest" may arise by reason of any relationship or connection with the debtor or "for any other reason".

The second qualification set forth in Section 327(a), that the professional not "hold or represent an interest adverse to the estate," is not further defined in the comparatively precise way that "disinterested person" is defined by Section 101(13). However, the phrase does bear some resemblance to the language of Section 101(13)(E), which provides that a disinterested person may not have "an interest materially adverse" to certain enumerated interests.

The differences between the language of Section 327(a) and Section 101(13)(E) are somewhat instructive. First, Section 327(a) refers merely to an interest that is "adverse", whereas subparagraph (E) refers to a "materially adverse" interest. Second, Section 327(a) disqualifies persons that hold or represent such an interest. In contrast, subparagraph (E) merely provides that a person may not have such an interest. All else being equal, these statutory differences demonstrate a somewhat broader standard of adversity in Section 327(a). However, subparagraph (E) appears to be more stringent than Section 327(a) in one regard. The adverse interest clause of Section 327(a) merely precludes employment of persons holding or representing an interest adverse to the estate, whereas subparagraph (E) addresses interests that are materially adverse to the interest of the estate or of any class of creditors or equity security holders. The additional language of subparagraph (E) appears to contemplate the possibility that a person might have an interest that is materially adverse to a class of creditors or equity security holders, but not to the more general interest of the estate.

These statutory distinctions are further complicated by the provision in subsection (c) of Section 327 that a professional is not disqualified for employment "solely because of such person's employment by or representation of a creditor, unless there is an objection by another creditor or the United States trustee, in which case the court shall disapprove such employment if there is an actual conflict of interest." (emphasis added) Thus, notwithstanding the requirements of Sections 327(a) and 101(13), a professional is not ineligible for employment simply because he represents a creditor, absent actual conflict being shown.

[*1]1 This appeal raises the issue of whether RGZ's representation of BH&P created an "actual conflict of interest" which requires their disqualification in the Herman and Berkow cases under Section 327(c). The Bankruptcy Court noted in its opinion that BH&P possessed "substantial claims against Herman and Berkow, including claims for transfers from BH&P within a year of its bankruptcy petition of approximately $1.7 million into seven real estate tax shelters of which Herman and Berkow were the sole limited partners." 103 Bankr. 559. Such transfers were found to raise the possibility of fraudulent transfers, conversions, and breaches of fiduciary duties. 103 Bankr. at 561. Indeed, the trustee filed proofs of claims on behalf of BH&P against Herman and Berkow making such allegations. [**FN**5] Id.

Although mere representation of a creditor is not, per se, a disqualification from employment, 11 U.S.C. § 327(c), in this case the Bankruptcy Court found that RGZ possessed an "actual conflict of interest". In reaching that conclusion, the Bankruptcy Court appeared to consider the following circumstances: (i) RGZ had to assert claims on behalf of the BH&P estate against its other clients, the estates of Herman and Berkow; (ii) RGZ would have to form an opinion on behalf of the Herman and Berkow estates as to the merits of those claims; (iii) there was a possibility, at least, that there were other inter-debtor claims to be investigated; (iv) the dispute over the claims were not such as would be conducive to RGZ putting forth their best efforts on behalf of the Herman and Berkow estates (at least in part, because such efforts would render any conflict even more "actual"); and (v) there were assets in the Herman and Berkow estates which might be sufficient to pay a dividend to unsecured creditors. 103 Bankr. at 565-66. [**FN**6]

Where the language is of a statute is unambiguous, the sole function of the court is to enforce the statute according to its terms. U.S. v. Ron Pair Enterprises, Inc., 489 U.S. 235, 109 S. Ct. 1026, 1030 (1989). However, where the meaning of a statutory provision is ambigous, the statute may be construed so as to effectuate just and reasonable results; it is a maxim of statutory construction that "[s]tatutes should be interpreted to avoid untenable distinctions and unreasonable results whenever possible." American Tobacco Co. v. Patterson, 456 U.S. 63, 71 (1981). Insofar as the term "actual conflict of interest" is not unambiguous, the statute affords considerable room for the courts to exercise their judgement and discretion, in determining whether an actual conflict exists "in light of the particular facts of each case." In re Star Broadcasting, Inc., 81 Bankr. 835, 844 (Bankr. D. N.J. 1988); In re Hoffman, 53 Bankr. 564, 566 (Bankr. W.D. Ark. 1985).

As RGZ noted in their appellate brief filed with this Court, some courts have indeed permitted multiple representation of related debtors having claims against one another. See, e.g., In re International Oil Co., 427 F.2d 186 (2d Cir. 1970); In re Global Marine, Inc., 108 Bankr. 998, 1004 (Bankr. S.D. Tex. 1987) (parent corporation and numerous subsidiaries); In re O.P.M. Leasing Services, Inc., 16 Bankr. 932 (Bankr. S.D. N.Y. 1982).

[*1]2 O.P.M. presents a typical multiple representation case involving numerous related corporate entities having intercorporate debts. The bankruptcy court held that counsel representing parent and subsidiary debtors having inter-debtor claims did not represent adverse interests, where the debtors shared a "unity of interest". O.P.M., 16 Bankr. at 941. Such a conclusion may be justifiable where several affiliated corporate entities are engaged in a single, large business enterprise whose operation would be severely disrupted by the appointment of a large number of separate trustees and counsel. See generally 2 Collier on Bankruptcy ¶ 327.03 (15th ed. 1990)

Other courts have found disqualifying conflicts of interest as a result of multiple representation. See, e.g., In re Star Broadcasting, Inc., 81 Bankr. 835, 841 (1987) (prohibiting dual representation of debtor and creditor/sole shareholder); In re Paolino, 80 Bankr. 341 (Bankr. E.D. Pa. 1987) (prohibiting representation of debtor and unrelated creditor). Cf. W.F. Development Corp., 905 F.2d 883 (5th Cir. 1990), cert. den., 59 USLW 3636 (March, 1991) (prohibiting dual representation of partnership debtors because of inter-debtor claims).

The present chapter 7 liquidations, which involve debtors who do not appear to be engaged in a single, overall business enterprise, are quite distinguishable from many of the multidebtor cases in which multiple-debtor representation has been allowed. Contrast H & S Transp. Co., Inc., 53 Bankr. 128 (Bankr. M.D. Tenn.) (describing four corporate debtors engaged in a single enterprise, represented by a single trustee and set of counsel).

The claims asserted in this case should also be distinguished, for some courts have focused on the nature of the claims as being somewhat dispositive. Thus, for example, the district court in In re Roberts, 75 Bankr. 402, 405- 06, 409 (D. Utah 1987), found, inter alia, that since inter-debtor claims were neither disputed nor priority claims, simultaneous representation of the debtors was not per se conflictual. Cf. Hathaway Ranch Partnership, 116 Bankr. 208, 220-21 (Bankr. C.D. Calif. 1990) (counsel disqualified for actual conflicts because the inter-debtor claims arose out of fraudulent transfers).

Insofar as the caselaw permits considerable judicial discretion in this area and because the presence of an actual conflict of interest should be considered in the light of the circumstances of each case, it is difficult to conclude that the Bankruptcy Court's decision in the instant cases was in error. [**FN**7]

III. MAGGIO'S REMOVAL FOR "CAUSE" WAS NOT IN ERROR.

The Bankruptcy Code imposes the "disinterested" requirement upon all interim chapter 7 trustees appointed by the United States Trustee. 11 U.S.C. § 701(a). Cf. 11 U.S.C. § 702 (no disinterest requirement imposed on trustees elected by creditors). [**FN**8] If creditors do not elect a chapter 7 trustee pursuant to Section 702, then the interim trustee continues to serve as trustee in the case. 11 U.S.C. § 702(d). There is no procedural requirement of court approval of trustee appointments in chapter 7.

[*1]3 The removal of all trustees is governed by 11 U.S.C. § 324, which provides that "[t]he court, after notice and a hearing, may remove a trustee... for cause." Section 324 does not enumerate the types of circumstances which constitute "cause".

Contrast 11 U.S.C. § 1104(a) (setting forth a nonexclusive list of circumstances which may constitute "cause" for appointment of a trustee in a chapter 11 case). Common grounds for removal include: incompetence or unwillingness to perform duties; fee-splitting arrangements; violations of fiduciary obligations through acting for one's own benefit and enrichment; the commission of bankruptcy crimes; and having an interest adverse to the general interest of the estate. 2 Collier on Bankruptcy ¶ 324.02, 324-6 (15th ed. 1990).

Several courts have stated that a lack of disinterest may be grounds for removal. See In re Micro-Time Management Systems, Inc., 102 Bankr. 602, 609 (Bankr. E.D. Mich. 1989) (vacating appointment of chapter 11 trustee); In re Southern Diversified Properties, Inc., 110 Bankr. 992, (Bankr. N.D. Ga. 1990) (dicta) (trustee resignation for conflict of interest and lack of disinterest "proper"); In re Paolino, 80 Bankr. 341 (Bankr. E.D. Pa. 1987) (dicta) (trustee resigned); O.P.M., 16 Bankr. at 937 (dicta) (court found no disinterest or impermissible conflict of interest). However, this is the first time that a court of appeals has considered the issue of whether a trustee may be removed for a lack of disinterest arising out of his capacity as trustee in another bankruptcy case. But cf. Katz v. Kilsheimer, 327 F.2d 633, 635-36 (2d Cir. 1964).

In considering whether to remove a trustee, courts have noted the effect of removal on the continuity of administration in a bankruptcy case, and the serious repercussions which removal of a trustee can have. Consequently, some courts have required the presence of circumstances in addition to a failure to satisfy the disinterest requirement. Courts in the Second Circuit, in particular, have adopted an additional "harm" or "prejudice" requirement for removal, in recognition of the disturbing effects which the removal of a trustee can have on a case. See, e.g., In re Freeport Italian Bakery, Inc., 340 F.2d 50, 54 (2d. Cir. 1965); Matter of REA Holding Corp., 2 Bankr. 733, 735 (S.D. N.Y. 1980). The requirement of "harm" or "prejudice" may be especially relevant in cases, such as Freeport and REA, where the trustees were elected by creditors (and thus do not need to be "disinterested"), but the concern for disruption to the estate has also been expressed in appointed trustee cases. See, e.g., O.P.M., 16 Bankr. at 939 (noting the importance of continuous representation in cases, and denigrating attempts to remove estate representatives for the purpose of delay).

Notwithstanding its agreement with the result reached by the lower courts, the United States Trustee is reluctant to endorse the use of Section 101(13)(E) as a standard for removing trustees under Section 324, particularly where the trustee's adverse interest is not personal but arises solely out of his role as trustee in another bankruptcy case. That is not to say that any clash between estates can be tolerated; merely that the trustee's ability to serve in multiple cases may be best determined by whether sufficient "cause" exists to remove him for purposes of Section 324. Thus, in this instance, the lower courts' rulings can be more easily explained in terms of traditional conflict principles, rather than by a difficult, and not completely convincing, application of Section 101(13).

[*1]4 This perspective comports with Bankruptcy Rule 2009(d), which requires that separate trustees be appointed in jointly administered cases on a showing that a conflict of interest will prejudice creditors or equity security holders. Significantly, the predicate for application of Bankruptcy Rule 2009(d) is not that a common trustee is "disinterested", but that prejudice will occur as a result of the trustee's dual representation.

This view would also lessen the potential for abusive, tactical maneuvers being directed against trustees. These fiduciaries play an invaluable and important role in the administration of bankruptcy cases. Multiple debtor cases inevitably require a high degree of responsibility on the part of the trustee, not only to balance competing interests but to guard against competing conflicts. Despite these tensions, one trustee can often maximize the return to jointly administrated estates. Trustees serving in multiple debtor cases should not have to bear an unreasonable risk of forfeiture simply because, in hindsight, it might be said that the mere fact of the trustee's appointment in a related case caused him not to be "disinterested".

Where trustees are found to have irreconcilable conflicts of interest, they should by all means be removed. Furthermore, despite suggestions that a conflict is only a potential conflict until an actual possibility of harm manifests itself, the United States Trustee believes that the line between potential and actual need not be drawn with a broad stroke. The difficult task of deciding where to draw the line is one that should be left largely to the discretion of the court. In considering the important issues presented by this appeal, the United States Trustee would urge this Court to limit its determination to the facts of the particular case.

The Bankruptcy Court found that Maggio's failure to satisfy the disinterest requirements of 11 U.S.C. § 101(13) constituted "cause" for his removal as trustee in the Herman and Berkow cases under 11 U.S.C. § 324. The conclusion that Maggio is a "creditor" is, as a matter of law, erroneous, but the conclusion that Maggio is disinterested under 11 U.S.C. § 101(13)(E) finds some support in the facts of the case.

The District Court appropriately called into question the Bankruptcy Court's conclusion that Maggio was disinterested as a creditor under Section 101(13)(A). A person who asserts a claim in a representative capacity is not thereby made a "creditor" for purposes of applying Section 101(13)(A). Cf. In re Hartley, 50 Bankr. 852, 861 (Bankr. N.D. Ohio 1985) (noting that the trustee succeeds to the debtor's property interests by operation of law). Indeed, if that were not the case, then every time the trustee filed a proof of claim on behalf of a creditor, which 11 U.S.C. § 501(c) specifically allows, the trustee would be automatically disqualified from serving. The Bankruptcy Court's reliance upon In re Enercons Virginia, Inc., 812 F.2d 1469, 1472 (4th Cir. 1987), was misplaced. In Enercons, the Fourth Circuit addressed the issue of whether the trustee of a foreign bankrupt creditor could pursue a claim of that creditor against the debtor in the case. The Fourth Circuit concluded that the trustee had authority to file a proof of claim as a "creditor" under 11 U.S.C. § 101(9). Enercons did not address the issue of whether a trustee, by asserting a claim in his representational capacity, actually becomes a creditor in his personal capacity for purposes of Sections 101(13)(E) and 701(a)(1).

[*1]5 The language of 11 U.S.C. §§ 101(13) and 327 dictate a reading of Section 101(13)(A) contrary to that reached by the Bankruptcy Court. The Bankruptcy Court's construction of Section 101(13)(A) would cause every counsel who represents a creditor and who files a claim on behalf of that creditor to automatically fail the disinterest requirement set forth in subparagraph (A). [**FN**9] Such a construction would also lead to anomolous results in light of Congress' express rejection of a per se bar to dual representation of creditors and the debtor in the 1984 amendment of Section 327(c). In addition, Section 327(a) clearly distinguishes between persons who hold adverse interests and persons who represent adverse interests, disqualifying both types of persons. These distinctions are absent in Section 101(13), which speaks only in terms of persons who have disqualifying interests. Section 101(13) does not disqualify persons because of whom they represent, but rather because of the nature of their own personal status, e.g. because they personally are creditors of the debtor or because they personally "have an interest" which is "materially adverse" under subparagraph (E).

Alternatively, the Bankruptcy Court concluded that Maggio failed the disinterest requirement of Section 101(13)(E). In discussing Maggio's disinterest under subparagraph (E), the Bankruptcy Court stated as follows:

> As trustee of BH&P, Maggio has the right and duty to pursue the claims of BH&P against Herman and Berkow. Unless all creditors are paid in full, such claims are materially adverse to those of the other unsecured creditors of Herman and Berkow, because all allowed unsecured claims will share pro rata in any dividend from the estates of Herman and Berkow....

103 Bankr. at 561. The Bankruptcy Court appears to have concluded that Maggio's obligation to BH&P to pursue claims against Herman and Berkow created an interest that was materially adverse to the interests of the other unsecured creditors of Herman and Berkow. Although that is not a foregone conclusion in all cases, such a conclusion in this case cannot be said to be in error. The Bankruptcy Court's conclusion is based on the facts cited in support of its holding that RGZ has a an actual conflict of interest, particularly the disputed nature of the claims against Herman and Berkow, and the resultant need for advocacy of competing interests.

The present case is easily distinguishable from the related-corporate debtor cases which condone multiple representation by trustees, of which In re O.P.M. Leasing Services, Inc., 16 Bankr. 932 (Bankr. S.D. N.Y. 1982), is illustrative. In O.P.M., a single trustee was appointed for two related debtors, a parent company and its subsidiary, in reorganization cases under Chapter 11 of the Bankruptcy Code. Notably, different trustees were appointed for the individual owners of the parent company in their liquidation cases. Objections were made to the multiple representation at a rather late point in the cases, during hotly contested adversary proceedings between the corporate debtors and the individual stockholders. The Bankruptcy Court found that the corporate debtors possessed a decisive "unity of interest and singleness of purpose" in prevailing in the adversary proceedings against the individual shareholders, even though there was a potential conflict between the parent and the subsidiary as to their respective rights to share in any proceeds of the litigation, and even though there were other intercorporate claims.

[*1]6 In cases involving multiple representation of related debtors, measures can sometimes be taken to cure conflict of interest problems. Thus, the O.P.M. court noted that the potential conflict regarding the debtors' respective rights to the litigation proceeds did not require the appointment of different trustees, because apparent conflicts of interest "might be resolved in a number of ways," including the appointment of special counsel. 16 Bankr. at 939 (quoting In re General Economics Corp., 360 F.2d 762 766 (2d Cir. 1966)). Although rejected as a general rule by the Bankruptcy Court, the appointment of separate or special counsel has been endorsed by several courts as a curative measure for conflicts. See, e.g., Katz v. Kilsheimer, 327 F.2d 633, 636 (2d Cir. 1964); In re O'Connor, 52 Bankr. 892 (Bankr. W.D. Okla. 1985); see also In re Iorizzo, 35 Bankr. 465, 468-69 (Bankr. E.D. N.Y. 1983); In re Fondiller, 15 Bankr. 890, 892 (Bankr. 9th Cir. 1981) (Section 327(a) precludes representation of adverse interests relating to the services to be performed).

O.P.M. illustrates the pragmatic treatment of conflict of interest problems in reorganization cases involving related corporate debtors having inter- affiliate claims, particularly where the objection to representation arises late in the case. While cases such as O.P.M., International Oil, and Global Marine do not stand for the proposition that the strictures of Section 101(13) and 327(a) may be violated for merely "equitable" grounds, they do demonstrate the care which is required in determining whether a trustee, as a factual matter, has a conflict of interest which constitutes cause for removal.

As suggested, this Court need not reach the issue of whether a failure of disinterest is an automatic ground for removal in every case, because the facts may be read to support affirmance on the alternative ground that the conflicts presented warrant separate trustees. When the Bankruptcy Court initially converted the BH&P case to Chapter 7, it stated as one ground for conversion the need for an independent fiduciary (a chapter 7 trustee) to pursue the claims against Herman and Berkow. (A-174) The Bankruptcy Court viewed the pursuit of those claims as a matter vital to the continuation of BH&P's case. The subsequent determination that the same claims justify the appointment of separate trustees indicates that Maggio's removal is not based on "non-harmful" conflicts, but rather on conflicts which had been, or would become, detrimental to the estates of BH&P, Herman and/or Berkow.

CONCLUSION

For the reasons stated, the orders of the Bankruptcy Court, as modified by the District Court, should be affirmed.

Respectfully submitted,
THOMAS E. ROSS
United States Trustee
200 Chestnut Street
Room 607
Philadelphia, PA 19106

MARTHA L. DAVIS
General Counsel
T. PATRICK TINKER
Attorney
[*1]7 Executive Office for
United States Trustees
320 First Street, N.W.
Room 812
Washington, D.C. 20534

CERTIFICATION

This is certify that I am a not, at the present time, a member of the bar of this Court, but that I am a practicing attorney for the United States Department of Justice, licensed to practice law in the State of Missouri, who is therefore waived from the admission requirement.

T. Patrick Tinker

CERTIFICATE OF SERVICE

I hereby certify that I have served a copy of the foregoing brief by first class mail this 22nd day of April, 1991, upon Gary N. Marks, Esq., Ravin, Greenberg & Marks, P.A., 101 Eisenhower Parkway, Roseland, NJ 07068.

T. Patrick Tinker

FOOTNOTES

FN1. Bederson & Co. is not a party to the appeal.

FN2. In response to the Court's request, the United States Trustee files this amicus brief to address, in part, the issue of appellate jurisdiction. That issue will therefore be more fully addressed in the arguments set forth subsequently in this brief.

FN3. The Bankruptcy Court directed counsel for the Bank of New York to submit a draft order to effectuate the modification. (A-471)

FN4. The instant appeal does not arise out of fee applications in the Herman and Berkow cases. Rather, it arises out of contested applications for compensation in the BH&P case.

FN5. Claims are broadly defined in the Bankruptcy Code so as to include claims that are disputed or contingent. See 11 U.S.C. § 101(4), (9) (defining "claim" and "creditor").

FN6. Some of the concerns of the Bankruptcy Court (Stripp, J.) were not new. Before the Herman and Berkow cases were even filed, the Bankruptcy Court (Wizmur, J.) conducted a hearing on the conversion of the BH&P case to Chapter 7, and found that "cause" existed for converting the case pursuant to 11 U.S.C. § 1112(b). During that hearing, the Bankruptcy Court indicated that it would grant the motion to convert, in part, on the ground that it would be in the interest of the estate for an independent fiduciary (a chapter 7 trustee) to investigate possible actions involving transfers to, or on behalf of, Herman and Berkow. The Bankruptcy Court noted that its decision to convert the case was not "a reflection on negative or deficient conduct on the part of" BH&P during the Chapter 11 case. (A-174)

FN7. Even if this Court were to determine that the finding of an actual conflict of interest was erroneous, the disqualification of RGZ might still be justified on other grounds, namely the presence of a potential conflict of interest. As noted by the Bankruptcy Court, Section 327(c) does not preclude disqualification on potential conflict grounds. 103 Bankr. at 564. A potential conflict of interest may result in RGZ failing the "disinterest" or "adverse interest" requirements of Section 327(a), because Section 327(c) merely provides that a professional is not precluded from employment "solely" because of the professional's representation of a creditor. See 2 Collier on Bankruptcy ¶ 327.03, 327-44, n. 40.

FN8. It is somewhat analogous that in chapter 11 cases the debtor in possession need not be disinterested, but if a trustee is ordered to be appointed, the appointee must meet the disinterest requirement. 11 U.S.C. § 1104(c).

FN9. Carried to its logical conclusion, the Bankruptcy Court's refusal to distinguish the personal and representative capacities of a trustee would also result in an absolute and automatic prohibition of dual representation of many affiliated corporate entities, even in the absence of inter-affiliate claims, because the trustee would be an "insider". See 11 U.S.C. § 101(30)(E) ("insider" includes an insider of an affiliate) and 11 U.S.C. § 101(2) (defining "affiliate").

1991 WL 807310 (USTBRIEFS)

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CA8

3. ("CCN") ***CURRENT*** CASE NO.
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Sandra Wein Simon, Esq., Civil/DOJ
P. Matthew Sutko, Esq., OGC/DOJ
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") ! ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***

! Whether the court had jurisdiction to review the district court's decision holding that the bankruptcy court's order denying a ch 11 debtor-in-possession's application under 11 U.S.C. §327(a) to retain counsel is not a final order.

√ **Background:** Big Mac Marine, a ch 11 debtor-in-possession, filed an application to retain Needler as counsel under 11 U.S.C. §327(a). The bankruptcy court denied the application. Case appealed to the district court, which dismissed the appeal on the grounds that the bankruptcy court's decision was not a final appealable order. Needler appealed to the 8th Circuit, which ordered parties to brief its jurisdiction to hear the appeal. The UST also filed an appeal for jurisdictional purposes only.

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No. 04-1746

IN THE UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

BIG MAC MARINE, INC.,
WILLIAM L. NEEDLER & ASSOCIATES, LTD.,

Appellants,

v.

CHARLES E. RENDLEN, III, U.S. Trustee,

Appellant and Cross-Appellee,

and

PINNACLE BANK,

Appellee.

ON APPEAL FROM THE UNITED STATES
DISTRICT COURT OF NEBRASKA

BRIEF FOR CHARLES E. RENDLEN, III, U.S. Trustee, Appellant for Jurisdiction Only

PETER D. KEISLER
Assistant Attorney General

WILLIAM KANTER
(202) 514-4575
SANDRA WIEN SIMON
(202) 514-1923
Attorneys
Appellate Staff, Civil Division
Department of Justice
601 D Street, N.W. Room 9146
Washington, D.C. 20530-0001

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SUMMARY OF THE CASE

In this case, a bankruptcy court denied a chapter 11 debtor-in-possession's application under 11 U.S.C. 327(a) to retain counsel. The debtor and the professional appealed to the United States District Court for the District of Nebraska. The district court dismissed their appeal holding that the decision of the bankruptcy court was not a final appealable order. We believe that the district court's decision dismissing the appeal from the bankruptcy court's order was a final order, and that this Court has jurisdiction under 28 U.S.C. 158(d) to determine whether the district court erred in dismissing the order of the bankruptcy court.

The U.S. Trustee has consistently taken the position that orders granting or denying a retention application under Section 327(a) are final. Although the courts of appeals have split on the issue, the test for finality in the bankruptcy context in this Circuit supports the U.S. Trustee's position. Retention orders resolve a discrete segment of the bankruptcy proceeding and are thus final.

The government believes that the issue of the court's jurisdiction is adequately presented in the briefs and that oral argument is not necessary. The government stands ready to present oral argument, however, if the Court believes that argument will facilitate its deliberations in this case.

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IN THE UNITED STATES COURT OF APPEALS
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v.

CHARLES E. RENDLEN, III, U.S. Trustee,

Appellant and Cross-Appellee,

and

PINNACLE BANK,

Appellee.

BRIEF FOR CHARLES E. RENDLEN, III,
U.S. Trustee, Appellant for Jurisdiction Only

STATEMENT OF JURISDICTION

The Bankruptcy Court had jurisdiction over Big Mac Marine Inc.'s ("Big Mac Marine") chapter 11 bankruptcy case under 28 U.S.C. 157(b). During this case, on July 10, 2003, the bankruptcy court issued an order pursuant to 11 U.S.C. 327(a), denying Big Mac Marine, as a chapter 11 debtor-in-possession, authorization to retain the law firm of William Needler and Associates ("Needler") as counsel in the chapter 11 proceeding. Big Mac Marine and Needler appealed this order to the United States District Court of Nebraska. On February 13, 2004, the district court (Bataillon, J.) held that the bankruptcy court's order was not final, and declined to grant leave to appeal the interlocutory order. Needler filed a timely notice of appeal on March 11, 2004, and the U.S. Trustee filed a timely notice of appeal on March 31, 2004.[1] Pursuant to this Court's order of March, 30, 2004, the parties have been "directed to file briefs addressing the question of this court's jurisdiction to consider this appeal." We believe that this Court has jurisdiction pursuant to 28 U.S.C. 158(d).

STATEMENT OF THE ISSUE

Whether this Court has jurisdiction to review the district court's decision holding that the bankruptcy court's order denying a chapter 11 debtor-in-possession's application under 11 U.S.C. 327(a) to retain counsel is not a final order.

A. Decisions:

In re Woods Farmers Co-op. Elevator Co., 983 F.2d 125, 127 (8th Cir. 1993).

In re Apex Oil Co., 884 F.2d 343, 347 (8th Cir. 1989).

B. Statutes and Rules:

11 U.S.C. 158(a) and (d).

11 U.S.C. 327(a).

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[1] The clerk's office has advised us that the two appeals will be consolidated when our appeal is docketed by the Court.

STATEMENT OF THE CASE

Big Mac Marine, a chapter 11 debtor-in-possession, filed an application to retain Needler as counsel under 11 U.S.C. 327(a). The bankruptcy court denied the application. Needler and Big Mac Marine appealed to the district court, which dismissed the appeal on the grounds that the bankruptcy court's decision was not a final appealable order. Needler appealed the district court's decision to the Eighth Circuit, which ordered the parties to brief its jurisdiction to hear the appeal. On March 31, 2004, Charles Rendlen, III, U.S. Trustee also filed a notice of appeal for jurisdictional purposes only.[2]

STATEMENT OF FACTS

A. Statutory Framework.

1. Section 327(a) of the Bankruptcy Code authorizes courts to approve the appointment of a bankruptcy professional if the professional does "not hold or represent an interest adverse to the estate" and the professional is "disinterested." 11 U.S.C. 327(a). A person lacks disinterestedness if they are a creditor, an equity holder or an insider. 11 U.S.C. 101(14)(A). They also lack disinterestedness if they were an officer, director or employee of the debtor in the two years preceding bankruptcy. 11 U.S.C. 101(14)(D). Finally, a person is not disinterested if he possesses "an interest materially adverse to the interest of the

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[2] Pursuant to R. 43(c), Fed. R. App. P., Charles Rendlen, III should be substituted for Jerry L. Jensen, Attorney Advisor.

estate or of any class of creditors * * * by reason of any direct or indirect relationship to, connection with, or interest in, the debtor * * * or for any other reason." 11 U.S.C. 101(14)(E).

In addition, section 327(c) allows a creditor or the United States Trustee to object when a debtor seeks to employ an attorney who has represented a creditor. The court must deny "such employment if there is an actual conflict of interest." Id.

District courts shall have jurisdiction to hear bankruptcy appeals from "final judgments, orders, and decrees." 28 U.S.C. 158(a)(1). In addition, courts of appeals shall have jurisdiction of appeals from "all final decisions, judgments, orders, and decrees" entered under section 158(a). 28 U.S.C. 158(d).

B. Facts.

Big Mac Marine filed for bankruptcy under chapter 11 of the Bankruptcy Code in April 2003. See 11 U.S.C. 1101, et seq. Big Mac Marine was wholly owned by Edward and Shirley Schmidt. The Schmidts were chapter 11 debtors-in-possession in their own personal bankruptcy when Big Mac Marine filed for bankruptcy protection. The Schmidts' chapter 11 counsel was Needler. Big Mac Marine filed an application under 11 U.S.C. 327(a) seeking authorization also to employ Needler as its counsel.[3] The

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[3] Because the Bankruptcy Code provides that, with exceptions not relevant here, a debtor-in-possession "shall have all the rights * * * and powers, and shall perform all the

application represented that Needler had no interest adverse to the debtor-in-possession and its bankruptcy estate. However, in a declaration submitted with the application, Needler stated that he represented Edward and Shirley Schmidt in their chapter 11 bankruptcy case, that the Schmidts owned 100% of Big Mac Marine, and that the Schmidts were creditors of Big Mac Marine.

Pinnacle Bank, a creditor of Big Mac Marine and the Schmidts, objected to the debtor's application to employ Needler. Pinnacle asserted, <u>inter alia</u>, that Needler was representing the Schmidts in their personal chapter 11 case and would have to pursue their rights as shareholders and creditors against Big Mac Marine. Pinnacle argued that Needler's representation of persons who had potential disputes with Big Mac Marine, who were not disinterested under 11 U.S.C. 101(14)(A),(D) and (E), made Needler himself not disinterested, and thus precluded his employment as counsel for Big Mac Marine under 11 U.S.C. 327(a). The United States Trustee requested the court consider whether Needler represented an adverse interest to the Big Mac Marine estate because of Needler's representation of the Schmidts in

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functions and duties * * * of a trustee," 11 U.S.C. 1107(a), the limitations on employment of professional persons imposed by Section 327(a) apply equally to trustees and to debtors-in-possession. <u>See</u> 11 U.S.C. 1107(a) and (b); <u>In re First Jersey Sec., Inc.</u>, 180 F.3d 504, 509 (3d Cir. 1999).

their chapter 11 proceeding, which included an adversary proceeding against Pinnacle Bank.[4]

C. Bankruptcy Court Order.

On July 10, 2003, the bankruptcy court denied Big Mac Marine's application to employ Needler under Section 327(a). A copy of the Order is in Addendum A to this brief. The court found that Needler's representation of the debtor's creditors, the Schmidts, in another bankruptcy proceeding, which included an adversary proceeding against Pinnacle Bank, precluded approval of Needler as counsel for Big Mac Marine because Needler represented interests adverse to the bankruptcy estate.

The court also determined that if the Schmidt adversary proceeding against Pinnacle Bank was completed, and if the Schmidts withdrew any claims they have in the Big Mac Marine case, then Needler might not have a conflict of interest. But until that occurred, the court prohibited Needler from representing Big Mac Marine.

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[4] The United States Trustee - not to be confused with the private individual who is appointed as bankruptcy trustee for a particular case - is an Executive Branch official who is responsible for "protecting the public interest and ensuring that bankruptcy cases are conducted according to the law." H.R. Rep. No. 95-595, 95th Cong., 2d Sess. 109 (1978), <u>reprinted in</u> 1978 U.S.C.C.A.N. 5963, 6070; <u>see</u> 28 U.S.C. 586; 11 U.S.C. 307: H.R. Rep. No. 99-764, 99th Cong., 2d Sess. 27 (1986), <u>reprinted in</u> 1986 U.S.C.C.A.N. 5227, 5240; <u>U.S. Trustee v. Waterhouse</u>, 19 F.3d 138, 141 (3d Cir. 1994).

D. District Court Decision.

Big Mac Marine and Needler appealed the denial of the retention application to the United States District Court for the District of Nebraska. Pinnacle filed a motion to dismiss the action for lack of finality. The United States Trustee did not address the finality issue in the district court. The district court held that the bankruptcy court's decision was not a final order. Big Mac Marine, Inc. v. Jensen, 305 B.R. 309 (D. Neb. 2004).

The court noted that an order entered before the conclusion of a bankruptcy proceeding is not appealable unless it finally resolves a discrete segment of that proceeding, citing In re Woods Farmers Co-op. Elevator Co., 983 F.2d 125, 127 (8th Cir. 1993). 305 B.R. at 311. It then articulated the test to determine whether an order in a bankruptcy proceeding is final to be "'the extent to which (a) the order leaves the bankruptcy court nothing to do but execute the order; (2) delay in obtaining review would prevent the aggrieved party from obtaining effective relief; and (3) a later reversal on that issue would require recommencement of the entire proceeding,'" quoting from In re Apex Oil Co., 884 F.2d 343, 347 (8th Cir. 1989). Ibid. The court, however, did not apply these factors but instead concluded, without further analysis, that "[o]rders regarding appointment of counsel are generally regarded as interlocutory," and then dismissed the appeal as interlocutory. Ibid. The court further declined to hear this appeal under Bankruptcy Rule 8001(b) which permits a district court to exercise its discretion to consider interlocutory appeals. Ibid.

SUMMARY OF ARGUMENT

The ultimate jurisdictional question for the Court is whether the bankruptcy court's order denying the application for the retention of a professional under 11 U.S.C. 327(a) is final. If it was, then the district court's order was final because it disposed of a final order of the bankruptcy court which was appealable under 11 U.S.C. 158(a). Thus, this Court has jurisdiction under 11 U.S.C. 158(d) to determine that the district court erroneously dismissed the appeal of the bankruptcy court's order. Because the district court erred in dismissing the appeal of the bankruptcy court order, this Court should reverse and remand the case for the district court to consider the merits of the appeal.

The U.S. Trustee has consistently taken the position that orders granting or denying a retention application are final. Although the courts of appeals have split on the issue, the test for finality in the bankruptcy context in this Circuit supports the U.S. Trustee's position in this case. This Court's test for finality is whether (1) the order leaves the bankruptcy court with nothing to do but execute the order; (2) delay in obtaining review would prevent the aggrieved party from obtaining effective relief; and (3) a later reversal on that issue would require recommencement of the proceeding. See, e.g., In re Apex Oil Co., 884 F.2d 343, 347 (8th Cir. 1989). For counsel who are denied retention, the bankruptcy court's order is in reality final; a later appeal at the close of the case will do them little good since the debtor will have moved on and retained other counsel. Similarly, for counsel who are granted retention, a later appeal alleging they had an impermissible adverse interest or lacked disinterestedness would mean a debtor would have been receiving advice about important strategic calls from a lawyer who labored under an impermissible conflict, and that tainted advice could not be undone at the end of the case because it would be practically impossible to unwind or relitigate the entire bankruptcy case.

STANDARD OF REVIEW

This Court reviews issues of jurisdiction "de novo." In re Minnesota Mut. Life Ins. Co., 346 F.3d 830, 834 (8th Cir. 2003); Hansen v. United States, 248 F.3d 761, 763 (8th Cir. 2001).

ARGUMENT

THIS COURT HAS JURISDICTION TO DETERMINE THAT THE DISTRICT COURT ERRED IN DISMISSING THE APPEAL FROM A FINAL ORDER OF THE BANKRUPTCY COURT.

1. District courts have jurisdiction to hear bankruptcy appeals from final judgments, orders and decrees. 28 U.S.C. 158(a)(1). The courts of appeals, in turn, have jurisdiction over appeals from all final decisions, judgments, orders, and decrees entered by the district courts. 28 U.S.C. 158(d). The U.S. Code, however, does not specify which bankruptcy court orders are final and provides no test for determining finality. Ultimately, this Court's jurisdiction turns on whether the bankruptcy court's decision was a final decision appealable to the district court. If it was, then the district court had jurisdiction and should have exercised it. This Court has jurisdiction to determine that the district court's decision was final and that it erred in holding that the bankruptcy court's order was not final. If this Court determines that the decision of the bankruptcy court was a final order, this case should be remanded to the district court to consider the merits.

Section 327(a) of the Bankruptcy Code specifically prohibits the retention of counsel who are not "disinterested" or who have a conflict of interest. Unless this Court determines that the bankruptcy's court's decision prohibiting the retention of Needler as counsel to Big Mac Marine is final and subject to review, Needler cannot represent Big Mac Marine in its bankruptcy proceedings. Although the U.S. Trustee agrees with the bankruptcy court's decision in this particular case, that Needler is not a "disinterested" person and should not be retained as counsel, the principle of finality should be resolved by this Court.[5]

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[5] The U.S. Trustee, an appellee in the district court, did not take a position on the finality question. We nonetheless are appealing this question, because the matter is jurisdictional,

In practical terms, appointment decisions cannot be reviewed effectively if they are treated as interlocutory. Allowing counsel who are not "disinterested" to represent debtors-in-possession by preventing the prompt appeal of appointment orders would undermine confidence in the fair and impartial administration of bankruptcy cases. Reviewing such appointments after conflicted counsel have represented debtors in no way ameliorates this problem. Even though counsel improperly appointed ultimately might be ordered to disgorge their fees, it would be practically impossible to undo the many actions taken by the debtor based on the advice of conflicted counsel. Similarly, counsel who are unjustly not appointed lose a valid business opportunity, and the client may be denied better representation than other available counsel. Allowing appeals of appointment decisions at the end of the entire case is no answer because the work would have already been performed by other counsel. Thus, if a retention decision is deferred to the end of the bankruptcy proceeding, the United States Trustee will have no meaningful opportunity to carry out the function assigned to him by

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and is important to the government. Moreover, the Bankruptcy Code gives the U.S. Trustee very broad standing to raise issues in the courts, and this is the kind of issue that warrants participation by the U.S. Trustee. <u>See</u> 11 U.S.C. 307 ("The United States trustee may raise and may appear and be heard on any issue in any case or proceeding under this title but may not file a [reorganization] plan pursuant to section 1121(c) of this title."). <u>See also</u>, <u>In re Pillowtex</u>, 304 F.3d 246, 250 (3d Cir. 2002) (The U.S. Trustee has standing to appeal a retention order).

Congress, of policing the integrity of the bankruptcy system and ensuring that the letter of the Bankruptcy Code is observed in bankruptcy proceedings. See In re Revco D.S., Inc., 898 F.2d 498, 499 (6th Cir. 1990); In re Plaza de Diego Shopping Ctr., Inc., 911 F.2d 820, 825-826 (1st Cir. 1990).

There is no principled distinction for finality purposes between judicial orders authorizing appointment of counsel and those that refuse such authorization as in this case. See In re Kurtzman, 194 F.3d 54, 56 (2d Cir. 1999). For example, if a bankruptcy court errs in such decisions, it is possible, if there is no review of that decision, that counsel who are disinterested might be denied work unfairly. In such cases, however, the debtor usually proposes a substitute, who is usually disinterested. Thus, in case of error, the only party with harm from a denial of retention is often only the professional. More importantly, though, an unlawful appointment will taint the entire proceeding with unresolvable doubts about the "disinterest" of the debtor-in-possession's attorney. The only post hoc remedy available would be to deny the firm all compensation for its work, an extreme remedy that cannot retroactively remove the taint cast over the proceeding by the firm's "interest."

2. This Court, like other circuit courts, has recognized that in bankruptcy proceedings courts take "a more liberal view of what constitutes a separate dispute for purposes of appeal."

In re Woods, 983 F.2d 125, 127 (8th Cir. 1993) (citation omitted). See, e.g., In re Arochem Corp., 176 F.3d 610, 619 (2d Cir. 1999); In re Devlieg, Inc., 56 F.3d 32, 33 (7th Cir. 1995) (per curiam) ("[M]yriad are the cases which say that finality is to be interpreted more liberally in bankruptcy cases."). The reason for this is because to apply the concept of "finality" used in ordinary civil litigation, such that the order closing the entire bankruptcy proceeding would be the only "final" order in the entire process, would be "absurd," 1 KING ET AL., COLLIER ON BANKRUPTCY ¶507[1][b], at 5-23 (15th ed. rev. 1997), because a bankruptcy proceeding is in reality not a unitary adversary proceeding between two parties, but a "conglomeration of separate adversary proceedings." In re James Wilson Assoc., 965 F.2d 160, 166 (7th Cir. 1992). Instead, courts have adhered to the concept of "finality" described by one of the drafters of the Bankruptcy Reform Act of 1978, whereby any "'proceeding arising in or related to'" a bankruptcy case, including any "adversary proceeding, contested matter, administrative matter, proceeding in bankruptcy or controversy arising in a proceeding in bankruptcy" is appealable when finally resolved by the bankruptcy court. Richard P. Levin, Bankruptcy Appeals, 58 N.C. L. Rev. 967, 985 (1980); accord In re Louisiana World Exposition, Inc., 832 F.2d 1391, 1396 (5th Cir. 1987); see also In re Johns-Manville Corp., 920 F.2d 121, 126 (2d Cir. 1990) ("'orders in bankruptcy cases may be immediately appealed if they finally dispose of discrete disputes within the larger case;'" accord In re Saco Local Dev. Corp., 711 F.2d 441, 443-446 (1st Cir. 1983).

An application to retain counsel triggers a contested matter under Fed. R. Bankr. P. 9014 and thus is "final," as Professor Levin notes above. Bankruptcy Rule 9014(a) provides that contested matters typically are triggered by motions. Rule 9013 explains that an application is the functional equivalent to a motion. The Advisory Committee Note to Rule 9013 specifically provides that "an application under Rule 2014 for approval of the employment of a professional," is an "[e]xcept[ion]" to the general rule that a "request [] for court action must be made by motion." Thus, under rules 9013 and 9014, Big Mac Marine's application to employ Needler triggered a contested matter, and the bankruptcy court's denial of that motion was a final order for purposes of 28 U.S.C. 158(a)(1).

Although this Circuit has not determined whether appointment decisions under Section 327(a) are final, it has addressed various bankruptcy finality issues.[6] In doing so, this Court has

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[6] See, e.g., In re Yukon Energy Corp., 138 F.3d 1254 (8th Cir. 1998) (Order finding that lien on debtor's assets had no value was final); In re Koch, 109 F.3d 1285 (8th Cir. 1997) (Dismissal and conversion orders under 11 U.S.C. 707(b) are final); In re Popkin & Stern, 105 F.3d 1248 (8th Cir. 1997) (order denying jury trial in bankruptcy proceeding not final); Cochrane v. Vaquero Invs., 76 F.3d 200 (8th Cir. 1996) (order sustaining objections filed by creditors to a claimed exemption not final); In re Huebner, 986 F.2d 1222 (8th Cir. 1993) ("[M]ost" orders granting or denying claimed exemptions are final), cert. denied, 510 U.S. 900 (1993) ; In re Woods Farmers Co-op. Elevator Co., 983 F.2d 125 (8th Cir. 1993) (orders remanding for further proceedings not final); In re Apex Oil Co.,

noted that an order entered before the conclusion of a bankruptcy proceeding may be appealed under Section 158(d) if it "finally resolves a discrete segment of that proceeding." In re Woods, 983 F.2d at 127.

To determine whether a bankruptcy order is final, this Circuit considers the following factors: "the extent to which (1) the order leaves the bankruptcy court nothing to do but execute the order; (2) delay in obtaining review would prevent the aggrieved party from obtaining effective relief; and (3) a later reversal on that issue would require recommencement of the entire proceeding." In re Apex Oil Co., 884 F.2d 343, 347 (8th Cir. 1989). This is a "more liberal standard of finality" than is generally applied to nonbankruptcy proceedings. In re Yukon Energy Corp., 138 F.3d 1254, 1258 (8th Cir. 1998).

Applying the above factors to this case, this Court should determine that the order denying the application for employment was final because the bankruptcy court's order resolved a discrete segment of the proceeding, and nothing remains for the bankruptcy court to do because it has already executed the order denying appointment. First, the bankruptcy court is left with nothing more to do to prevent Needler from acting as counsel to Big Mac Marine. See, Lamie v. United State Trustee, 124 S. Ct.

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884 F.2d 343 (8th Cir. 1989) (Order declining to order relief from automatic stay under 11 U.S.C. 362(d) is final); In re Bestmann, 720 F.2d 484 (8th CiO. 1983) (Order determining adversary proceeding concerning hog ownership was final).

1023, 1030 (2004) ("A debtor's attorney not engaged as provided by § 327 is simply not included within the class of persons eligible for compensation" from the debtor's estate in a bankruptcy case.). Second, delay would require use of other counsel even though Needler might ultimately be determined to be "disinterested." Finally, a later reversal could, in theory, require relitigating the entire complex chapter 11 case. This is unlikely to happen because it would not be practical. The expense and delay of relitigating the case makes such an event unlikely to occur. Thus, this Court should conclude that the bankruptcy court's decision was final and appropriate for review by the district court.[7]

Other circuits have split on the issue of whether appointment decisions under Section 327(a) are final. The Second, Third, Fourth, and Sixth Circuits treat orders regarding professional employment as appealable. See, e.g., In re Pillowtex, Inc., 304 F.3d 246, 250 (3d Cir. 2002); In re Arochem Corp., 176 F.3d at 619-620; In re Federated Dep't. Stores, Inc., 44 F.3d 1310 (6th Cir. 1995); and In re Harold & Williams Dev.

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[7] The bankruptcy court's order stated it would reconsider the motion to employ Needler if "the Schmidt adversary proceeding against Pinnacle Bank is completed, and if the Schmidts withdraw any claims they have in the Big Mac Marine case." July 10, 2003 order at 2. There is no indication either would ever happen. To the contrary, the Schmidts need to press their claims to protect their own chapter 11 case. Thus, there is at most a very speculative chance Big Mac Marine could reapply to appoint Needler. But, unless and until these unlikely results came about, the debtor could not use Needler and he would not be employed.

Co., 977 F.2d 906 (4th Cir. 1992). The Fifth, Seventh, and Ninth Circuits, however, have treated such orders as interlocutory. See, e.g., In re SS Retail Stores Corp., 162 F.3d 1230 (9th Cir. 1998); In re Firstmark Corp., 46 F.3d 653, 657-659 (7th Cir. 1995); In re Delta Servs., Indus., 782 F.2d 1267 (5th Cir. 1986).

In sum, the "proceeding" on review in this case is the debtor-in-possession's request for permission to employ Needler to represent it in the chapter 11 reorganization; this proceeding involves a "discrete dispute" over whether Needler is eligible to fill that position under the Bankruptcy Code. The bankruptcy court's order denying authorization of the employment of Needler, following a hearing at which the United States Trustee and others had a full opportunity to state their objections, finally disposed of this discrete dispute, and thus is "final" and appealable to the district court under Section 158(a). 11 U.S.C. 158(a). The district court's dismissal of the appeal was a final order and this Court has jurisdiction under Section 158(d) to determine that the dismissal was in error.

If this Court determines that the district court's order is final and appealable, it should not reach the merits but should remand the case to the district court to consider the merits in the first instance since the district court did not address the merits. If, however, the Court determines to reach the merits, we will be a cross-appellee. We will argue that the application to appoint Needler should be denied because of his several conflicts of interest.

CONCLUSION

For the foregoing reasons, this Court has jurisdiction to consider this appeal.

PETER D. KEISLER
Assistant Attorney General

WILLIAM KANTER
(202) 514-4575
SANDRA WIEN SIMON
(202) 514-1923
Attorneys
Appellate Staff, Civil Division
Department of Justice
601 D Street, N.W. Room 9146
Washington, D.C. 20530-0001

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I certify that on this 14th day of April 2004, I caused to be sent via Federal Express one (1) original and ten (10) copies (nine paper and one on 3-1/2 inch diskette) of the foregoing Brief for Appellant to this Court at the following address:

Mr. Michael E. Gans
Clerk, United States Court of Appeals
for the Eighth Circuit
Thomas F. Eagleton Courthouse
111 South 10th Street, Room 24.329
St. Louis, MO 63102

I further certify that on this day I caused to be served via Federal Express three (3) true and correct copies (two paper and one on 3-1/2 inch diskette) of the foregoing brief properly addressed to counsel at the following addresses:

Big Mac Marine, Inc.
c/o Ed and Shirley Schmidt
400 Crestview Dr.
Ogallala, NE 69153
(308) 284-6579
(308) 284-6316 (Fax)

William L. Needler
William L. Needler and Associates, Ltd.
106 West First
P.O. Box 177
Ogallala, NE 69153
(308) 284-4505
(308) 284-3813 (Fax)

John O'Brien
Kerr Brosseau Bartlett O'Brief, LLC
1600 Broadway, Suite 1600
Denver, CO 80202
(303) 812-1200
(303) 812-1212 (Fax)

Sandra Wien Simon
SANDRA WIEN SIMON
Attorney

CERTIFICATE OF COMPLIANCE

Pursuant to Rule 32(a)(7)(C) of the Federal Rules of Appellate Procedure, and Eighth Circuit Rule 28A(c), I certify that the foregoing brief was prepared with WordPerfect 9.0 software and complies with the type-volume limitation in Rule 32(a)(7)(B) as follows: the type face is Courier New monospaced, twelve-point font (ten characters per inch), contains 4747 words and 642 lines.

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Sandra Wien Si

SANDRA WIEN SIMON
Attorney

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1. **("TI")** ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]* — Blausey v. Kistler, UST

2. **("CO")** ***CURRENT*** COURT *[E.g., "CTA9"]* — CTA 9

3. **("CCN")** ***CURRENT*** CASE NO. — No.: 07-15955

4. **("PCN")** ***PRIOR*** CASE NO. & COURT *[IF ANY]* — No.: 06-10826
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(UST/OGC: 202-307-1399/FAX-2397)

8. **("TO")** ***TOPIC*** — **BANKRUPTCY**

9. **("SU")** ● ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***

● Does the court lack jurisdiction over the appeal because debtors-appellants have failed to file a petition for permission to appeal as required by Section 1233(b)(4) of the BAPCPA? Even if it could exercise jurisdiction would the court decline to do so under 28 USC 158(d)(2)(A)

√ **Background:**

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IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

JOHN CHARLES BLAUSEY and
DEANN JANINE BLAUSEY,

Debtors-Appellants,

v.

SARA L. KISTLER,
Acting United States Trustee,

Trustee-Appellee.

No. 07-15955

ACTING UNITED STATES TRUSTEE'S MOTION TO REMAND TO BANKRUPTCY COURT WITH INSTRUCTIONS

I. INTRODUCTION.

Pursuant to Fed. R. App. P. 27 and Cir. R. 27-1 and 27-11, appellee Sara L. Kistler, Acting United States Trustee (hereinafter "U.S. Trustee"), respectfully requests that this Court remand the above-captioned matter to the bankruptcy court with instructions to transmit the notice of appeal and the record to the United States District Court for the Northern District of California. As set forth below, this Court should do so on the following grounds: (1) The Court lacks jurisdiction over the appeal because debtors-appellants have failed to file a petition for permission to appeal as required by Section 1233(b)(4) of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA"), Pub. L. No. 109-8, 119 Stat. 23 (2005), see 28 U.S.C. § 158 Note; or (2) even if it could exercise jurisdiction, the Court, in its discretion, would decline to do so under 28 U.S.C. § 158(d)(2)(A).

II. STATUTORY AND REGULATORY BACKGROUND.

A. Relevant Statutory Provisions.

1. On April 20, 2005, Congress enacted BAPCPA. See Pub. L. 109-8, 119 Stat. 23 (2005). As relevant to the present case, BAPCPA amended Section 158 of Title 28 to provide courts of appeals, under specified conditions, with jurisdiction to hear direct appeals from bankruptcy court orders or judgments.

Under Section 158(d), a bankruptcy court, district court, or bankruptcy appellate panel “shall” make a certification to the court of appeals if it determines, “on its own motion or on the request of a party” that at least one of the following three circumstances exists:

> (i) the judgment, order, or decree involves a question of law as to which there is no controlling decision of the court of appeals for the circuit or of the Supreme Court of the United States, or involves a matter of public importance;
>
> (ii) the judgment, order, or decree involves a question of law requiring resolution of conflicting decisions; or
>
> (iii) an immediate appeal from the judgment, order or decree may materially advance the progress of the case or proceeding in which the appeal is taken.

28 U.S.C. § 158(d)(2)(A), (B)(i). The court of appeals has jurisdiction over the appeal if the bankruptcy court, district court, bankruptcy appellate panel involved, or “all the appellants and appellees (if any) acting jointly, certify” that at least one of these three circumstances exists, **and** “if the court of appeals authorizes the direct appeal of the judgment, order, or decree.” 28 U.S.C. § 158(d)(2)(A). Thus, even if a

court or the parties make a certification, the court of appeals will not take jurisdiction of the appeal unless it exercises its discretion to authorize a direct appeal. Id.

2. Section 1233(b) of BAPCPA, which is uncodified and appears in 28 U.S.C. § 158 Note, sets forth "[p]rocedural [r]ules" that apply to appeals under Section 158(d) until "a rule of practice and procedure" applicable to such appeals is promulgated or amended. Pub. L. 109-8, § 1233(b)(1), 28 U.S.C. § 158 Note. Because no such rules have yet been promulgated, Section 1233(b) applies here.

Section 1233(b) provides that an appeal pursuant to Section 158(d)(2)(A) "shall be taken in the manner prescribed" in Federal Rule of Appellate Procedure 5(a)(1),(b),(c),(d). The statute further makes clear that a petition that complies with the requirements of Fed. R. App. P. 5 must "be filed with the circuit clerk not later than 10 days after the certification is entered on the docket" of the court that issued the certification. Pub. L. 109-8, § 1233(b)(3),(4), 28 U.S.C. § 158 Note.

Under Fed. R. App. P. 5, where, as here, "an appeal is within the court of appeals' discretion," a party must "file a petition for permission to appeal" in the court of appeals, which includes the "facts necessary to understand the question presented"; the "question itself"; the "relief sought"; and "the reasons why the appeal should be allowed and is authorized by statute or rule." Fed. R. App. P. 5(a)(1), (b)(1)(A)-(D). A copy of the relevant order or judgment and any related opinion or memorandum and a copy of the certification must be attached to the petition. Fed. R. App. P. 5(b)(1)(E).

B. Applicable Rules.

The Committee on Rules of Practice and Procedure of the Judicial Conference of the United States and the Judicial Conference of the United States have approved Interim Bankruptcy Rules to implement the changes mandated by BAPCPA. Courts have since adopted the Interim Rules as local rules in most districts, including the Northern District of California. Under Interim Rule 8001(f), where a bankruptcy court certifies a judgment under 28 U.S.C. § 158(d)(2), the certification “shall not be treated” as “entered on the docket within the meaning of” BAPCPA Section 1233(b)(4)(A) “until a timely appeal has been taken” in accordance with Federal Rule of Bankruptcy Procedure (“Bankruptcy Rule”) 8001(a) or (b), and “the notice of appeal has become effective under Rule 8002.” Interim Rule 8001(f)(1). Thus, the 10-day time period for filing a petition for permission to appeal with the court of appeals does not begin to run until a timely notice of appeal from the bankruptcy court’s judgment has become effective. Under Bankruptcy Rules 8001 and 8002, to appeal a bankruptcy court order or judgment to the district court or bankruptcy appellate panel, a party must file a notice of appeal with the bankruptcy court within 10 days of the order or judgment. Fed. R. Bankr. P. 8001(a), 8002.

II. PROCEDURAL BACKGROUND.

On November 15, 2006, debtors John Charles Blausey and Deann

Janine Blausey filed a voluntary petition for relief under Chapter 7 of the Bankruptcy Code in the United States Bankruptcy Court for the Northern District of California. Bankruptcy Court Docket Record ("R.") 1. The U.S. Trustee moved to dismiss debtors' case pursuant to 11 U.S.C. § 707(a), or, in the alternative § 707(b)(2) or (3). R. 20. Before the bankruptcy court ruled on that motion, the U.S. Trustee filed a first amended motion to dismiss the case pursuant to 11 U.S.C. § 707(b)(2), or, in the alternative, § 707(b)(3)(B). R. 23. In her motion, the U.S. Trustee argued that debtors' case was presumptively an abuse of chapter 7 under Section 707(b)(2), or, in the alternative, that the totality of the circumstances of debtors' financial situation demonstrated abuse under Section 707(b)(3)(B).[1] The U.S. Trustee contended that debtors should have -- but did not -- include the $4,000 per month that Mrs. Blausey receives from a disability insurance policy as current monthly income in their Statement of Current Monthly Income and Means Test Calculation.

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[1] Under BAPCPA, cases may be dismissed for abuse under Section 707(b)(1) following an analysis under either Section 707(b)(2) or 707(b)(3). Section 707(b)(2) provides objective standards – the "Means Test" – for courts to determine whether a case is presumed to be an abuse of chapter 7. If a case is presumed abusive, it will be dismissed without the need for further evidence unless the debtor can show "special circumstances" to rebut the presumption. See 11 U.S.C. § 707(b)(2)(B)(i). If the presumption of abuse does not arise or is rebutted, the U.S. Trustee may still bring a motion seeking dismissal for abuse under Section 707(b)(3), either because the debtor filed a petition in bad faith or the totality of the circumstances of the debtor's financial situation demonstrates abuse. See 11 U.S.C. § 707(b)(3)(A),(B).

Pursuant to Section 101(10A)(A) of the Bankruptcy Code "current monthly income" "means the average monthly income from all sources that the debtor receives * * * without regard to whether such income is taxable income," and, under Section 101(10A)(B), "includes any amount paid by any entity other than the debtor * * * on a regular basis for the household expenses of the debtor or the debtor's dependents." 11 U.S.C. § 101(10A)(A),(B). The U.S. Trustee thus argued that contrary to debtors' position, regardless of whether disability insurance payments fall within the definition of "gross income" under the Internal Revenue Code, such payments qualify as "current monthly income" under the Bankruptcy Code. See R. 29. (U.S. Trustee Reply). The U.S. Trustee explained that when the disability insurance payments are included in debtors' income, a proper calculation of debtors' disposable income under Sections 707(b)(2)(A)(ii),(iii), and (iv) demonstrates that the presumption of abuse arises under Section 707(b)(2)(A)(i), and that debtors have sufficient income to pay their scheduled liabilities in full. See R. 23.

On April 30, 2007, after briefing from the parties and a hearing, the bankruptcy court issued a Memorandum re Inclusion of Disability Payments in Current Monthly Income, R. 30, and, on May 3, 2007, in accordance with the memorandum, issued an order granting the motion to dismiss. R. 31. The court held that Mrs. Blausey's disability insurance payments must be included as "current monthly income" under Section 101(10A), and therefore the presumption of abuse arose under Section 707(b)(2). R. 30.

On May 10, 2007, debtors filed a timely notice of appeal from the bankruptcy court's dismissal of their case. R. 34. Consistent with the Official Bankruptcy Form for a notice of appeal, debtors did not specify the court to which they were appealing. See Official Form 17. In addition, debtors filed a statement of election to have their appeal heard by the district court (as opposed to the bankruptcy appellate panel). R. 36. That same day, debtors filed a request for certification of the bankruptcy court's order for direct appeal to this Court under 28 U.S.C. § 158(d)(2). R. 35. The debtors' statement of election to have the appeal heard in district court accordingly noted that they had filed a request for certification for direct appeal, and would "have the appeal heard at the Ninth Circuit if so allowed." R. 36. Debtors also moved for a stay of the dismissal order pending appeal. R. 37.

The bankruptcy court docketed the notice of appeal as a "notice of appeal to 9th Circuit Court (Direct Appeal)," even though, as noted, debtors had not referenced the court to which they were appealing, and had filed a statement of election to have the appeal heard in district court. See R. 34. On May 22, 2007, the bankruptcy court granted debtors' request for certification of its dismissal order for direct appeal pursuant to 28 U.S.C. § 158(d)(2). R. 42. The court found that certification was appropriate because its order "involves questions of law for which there is no controlling authority and are a matter of public importance." Id. The bankruptcy court also forwarded the record on appeal directly to this Court. R. 43. The record reflects that the bankruptcy court sent this Court "the Notice of Appeal, certified copy of the docket and order being appealed to form the record on appeal for assignment to a Ninth Circuit Court of Appeals Judge."[2] Id.

Thus, the bankruptcy court never transmitted the notice of appeal to the district court in accordance with Bankruptcy Rule 8007(b), which provides that "[w]hen the record is complete for purposes of appeal, the clerk shall transmit a copy thereof forthwith to the clerk of the district court." Bankr. R. 8007(b). The case therefore has never been docketed in district court.

On June 1, 2007, this Court docketed the appeal, assigned it a case number, and set a briefing schedule. According to the schedule, appellant's opening brief would be due on September 7, 2007.[3] See Docket, Blausey v. U.S Trustee, 9th Cir. No. 07-15955.

III. DISCUSSION

For the reasons set forth below, this Court should remand the appeal to the bankruptcy court with instructions to transmit the notice of appeal and the record to the district court. This Court should do so on one of the following grounds: (1) it lacks jurisdiction over the appeal because debtors failed to comply

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[2] After the transmittal of the certified copy of the docket to this Court, on June 21, 2007, the bankruptcy court granted debtors' motion to stay. R. 46.

[3] Circuit Rule 27-11(a)(3) provides that a motion requesting a full remand "shall stay the schedule for record preparation and briefing pending the court's disposition of the motion."

with the statutory requirement that they file a petition for permission to appeal within 10 days of entry of the certification on the docket; or (2) even if it could exercise jurisdiction, the Court, in its discretion, would decline to do so because the issues presented would benefit from further litigation in district court prior to any possible appeal to this Court.

A. Debtors’ Appeal Cannot Proceed In This Court Because They Have Failed To Comply With The Requirement In BAPCPA Section 1233(b) That A Party File A Petition For Permission To Appeal In Accordance With Fed. R. App. P. 5.

Under Section 1233(b) of BAPCPA, a party must file a petition for permission to appeal in the court of appeals “not later than 10 days after the certification is entered on the docket of the bankruptcy court.” Pub. L. No. 109-8, § 1233(b)(4); 28 U.S.C. § 158 Note. The petition must comply with Fed. R. Civ. P. 5, and thus must include the “facts necessary to understand the question presented”; the “question itself”; the “relief sought”; and “the reasons why the appeal should be allowed and is authorized by statute or rule.” Id. at § 1233(b)(3)-(5); Fed. R. App. P. 5(b)(1)(A)-(D).

Since Section 1233(b) specifies that direct appeals under Section 158(d) “shall be taken in the manner prescribed in” the relevant provisions of Fed. R. App. P. 5, which, in turn, applies to petitions for permission to take an interlocutory appeal under 28 U.S.C. § 1292(b), case law regarding the petition requirement under that statute is relevant here. In In re Benny, 812 F.2d 1133 (9th Cir. 1987), cert. denied, 510 U.S. 1029 (1993), this

Court held that “[t]he timely filing of a petition for leave to appeal following district court certification pursuant to 28 U.S.C. § 1292(b) is jurisdictional.” Id. at 1136. The Court had thus dismissed an earlier appeal in the same case for lack of jurisdiction because “the Department’s petition for leave to appeal was filed more than ten days after the district court’s certification of the case for interlocutory appeal under 28 U.S.C. § 1292(b).” Id.

Here, although debtors filed a timely notice of appeal and request for certification, they failed to file a petition for permission to appeal in accordance with Rule 5 as required by Section 1233(b) of BAPCPA. Thus, under the reasoning in Benny, this Court lacks jurisdiction to authorize a direct appeal under Section 158(d)(2).

The Supreme Court’s recent decision in Bowles v. Russell, — U.S. –, 127 S. Ct. 2360 (2007), also supports this conclusion. In that case, the Court addressed the requirements of 28 U.S.C. § 2107(c), which provides the district court with “statutory authority to grant motions to reopen the time for filing an appeal for 14 additional days” after it enters the order to reopen if specified conditions are met. Id. at 2363. In Bowles, the district court erroneously reopened the filing period for more than 14 days, and petitioner filed his notice of appeal outside the statutory 14-day period, but within the time allowed by the district court. See id. The Supreme Court held that the court of appeals lacked jurisdiction over the appeal because “statutory time limits for taking an appeal” are “jurisdictional.” Id. at 2364. In so holding, the Court emphasized that its precedent has “recognized the jurisdictional significance of the fact that a time limitation is set forth in a statute.” Id. Indeed, as the Supreme Court noted, this Court also has found that “‘[t]he distinction between jurisdictional rules and inflexible but not jurisdictional timeliness rules * * * turns largely on whether the timeliness requirement is or is not grounded in a statute.’” Id. at 2365 n.3 (quoting United States v. Sadler, 480 F.3d 932, 936 (9th Cir. 2007)).

Like the time limits at issue in Benny and Bowles, supra, the 10-day limit for filing a petition for permission to appeal under 28 U.S.C. § 158(d)(2) is statutory in nature. The petition requirement, and the 10-day time period for fulfilling it, are set forth in Section 1233(b) of BAPCPA, which appears in 28 U.S.C. § 158 Note. See Pub. L. No. 109-8, § 1233(b)(4); 28 U.S.C. § 158 Note. Where, as here, a statute delineates when a court of appeals has jurisdiction over a direct appeal from the bankruptcy court, statutory prerequisites –- unlike claim-processing rules -- would limit the category of cases that the court can hear, and thus are jurisdictional in nature. See Sadler, 480 F.3d at 936-37. Moreover, that the statute applies only “until a rule of practice and procedure relating to such provision and such appeals is promulgated or amended” does not change the result. Pub. L. 109-8, § 1233(b)(1), 28 U.S.C. § 158 Note. Unless or until rules of practice and procedure supercede

Section 1233(b), the 10-day limit for filing a petition for permission to appeal indisputably is grounded in a statute enacted by Congress. This Court therefore lacks jurisdiction over debtors' appeal.[4]

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[4] This Court's decision in Amalgamated Transit Union Local 1309 v. Laidlaw Transit Serv., Inc., 435 F.3d 1140 (9th Cir. 2006), which involved the Class Action Fairness Act (CAFA), does not cast doubt on this conclusion. In that case, this Court held that Fed. R. App. P. 5 applied to 28 U.S.C. § 1453(c)(1) of the CAFA, which provides that "'a court of appeals may accept an appeal from an order of a district court granting or denying a motion to remand a class action to the State court from which it was removed if application is made to the court of appeals not less than 7 days after entry of the order.'" 435 F.3d at 1142-45 (quoting 28 U.S.C. § 1453(c)(1)) (emphasis added). The Court further held that Congress actually meant the opposite of what the plain language states – i.e., that Congress intended that "application" to the court of appeals (in the form of a petition under Rule 5) must be made "not more than 7 days" after entry of the district court order. Id. at 1146. This Court found that it had "construed the statute to require a procedural framework that is not readily apparent from the statutory text or its legislative history" and had "changed the statutory deadline for seeking to appeal to the opposite of what the plain language of the statute says." Id. Under this interpretation, "plaintiffs' timely notice of appeal is ineffectual," and "their subsequent petition for permission to appeal was filed too late." Id. The Court held, however, that "[t]o avoid the serious unfairness and potential due process violation that applying our holdings to this case might raise," it would "construe plaintiffs' timely notice of appeal and untimely petition for permission to appeal as together constituting one timely and proper petition for permission to appeal." Id. at 1146-47.

In contrast, the requirements in Section 1233(b) are entirely clear, and they derive directly from the plain language of the statute itself. Indeed, the statute expressly refers to Rule 5, and expressly requires that "[a] petition requesting permission to appeal, that is based on a certification * * * shall * * * be filed with the circuit clerk not later than 10 days after the certification is entered on the docket of the bankruptcy court[.]" Pub. L. 109-8, § 1233(b)(3),(4); 28 U.S.C. § 158 Note. Moreover, although debtors' notice of appeal was timely in this case, it was filed prior to the certification, so it cannot in any way substitute for a timely petition to appeal, and, in any case, debtors have never filed a petition, untimely or otherwise, in this Court.

In any event, even assuming *arguendo* it were not jurisdictional, the requirement in BAPCPA that a party file a petition for permission to appeal in accordance with Fed. R. App. P. 5 is mandatory, and must be strictly enforced so that both the parties and the Court are on notice of what issues the petitioner will raise, and why it is necessary or appropriate for the court of appeals to address such issues in the first instance without prior review by the district court or bankruptcy appellate panel.[5] See, e.g., Eberhart v. United States, 546 U.S. 12, 126 S. Ct. 403, 407 (2005) (mandatory claim-processing rules such as time limits in Federal Rules of Criminal Procedure “assure relief to a party properly raising them”). The bankruptcy court’s certification of its order was entered on the docket on May 22, 2007. To our knowledge, no petition to this Court has been filed by any party, and the 10-day time limit has long since expired.[6] Indeed, because no petition was filed, the U.S. Trustee has not had the opportunity to respond to the petition, and the Court has

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[5] Debtors’ Request for Certification filed in bankruptcy court included a statement of the issues and a discussion in support of their request for certification. See R. 35. This does not fulfill the separate, statutory requirement in Section 1233(b) of filing a petition for permission to appeal in this Court, however. Indeed, although the U.S. Trustee did not oppose the certification, as we acknowledge that this case meets one of the criteria for certification of a direct appeal, for the reasons discussed in the text, *infra* pp. 15-18, we would have filed an opposition to a petition for permission to appeal in this Court.

[6] The deadline for filing a petition in this Court was June 6, 2007. See Fed. R. App. P. 26(a)(2) (exclude “intermediate Saturdays, Sundays, and legal holidays when the period is less than 11 days, unless stated in calendar days”; 10 days from May 22nd excluding weekends and holidays is June 6th).

not had the opportunity to consider whether, in its discretion, it would be appropriate to assume jurisdiction over the appeal.[7]

In short, debtors' failure to file a petition for permission to appeal under Section 1233(b) deprives this Court of jurisdiction over debtors' appeal. We emphasize, however, that a refusal by this Court to hear the case -- on jurisdictional grounds or otherwise –- should not leave debtors without a valid appeal. To the contrary, the appeal may still proceed in district court. Debtors did timely comply with the Rules of Bankruptcy Procedure in filing their notice of appeal, and the bankruptcy court erred by failing to transmit that notice of appeal to the district court. See Fed. R. Bankr. P. 8007(b). The applicable bankruptcy rules make clear that even when a bankruptcy court certifies an order for direct appeal, a debtor must proceed with the normal process of appealing to the district court or bankruptcy appellate panel. Indeed Interim Bankruptcy Rule 8001(f) provides that a certification of an order for direct appeal to a court of appeals under Section 158(d)(2) "shall not be treated as a certification entered on the docket within the

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[7] In addition, the bankruptcy court's error in forwarding the notice of appeal and the record to this Court, rather than the district court, appears to have led the clerk's office to docket this case as an ordinary appeal and erroneously enter a briefing schedule without allowing this Court first to determine whether to exercise discretionary jurisdiction under Section 158(d)(2). Had the bankruptcy court properly sent the notice and record to the district court, and had debtors properly filed a petition for permission to appeal in accordance with Section 1233(b), this Court would have been on notice that it should determine whether to exercise jurisdiction prior to setting a briefing schedule on the merits.

meaning of § 1233(b)(4)(A) of [BAPCPA] until a timely appeal has been taken in the manner required by subdivisions (a) or (b) of this rule and the notice of appeal has become effective under Rule 8002.” Interim Fed. R. Bankr. P. 8001(f)(1). Rules 8001 and 8002 outline the procedures for ordinary appeals from the bankruptcy court to the district court or bankruptcy appellate panel. See Fed. R. Bankr. P. 8001, 8002.

Here, debtors filed their notice of appeal within the 10-day time limit set in accordance with Bankruptcy Rule 8001(a). It was the bankruptcy court, not debtors, that construed the filing as a notice of appeal to the Ninth Circuit. Compare Notice of Appeal with Bankr. Docket Entry R. 34. Moreover, Congress made clear in BAPCPA that a certification of a judgment for direct appeal under Section 158(d) does not stay proceedings in the bankruptcy court, district court, or bankruptcy appellate panel, and thus, in essence, required the timely filing of a notice of appeal under Rule 8001 in order for appellants to preserve their rights should the court of appeals decline to authorize a direct appeal. 28 U.S.C. § 158(d)(2)(D).

This Court should therefore vacate the briefing schedule and remand the case to the bankruptcy court with instructions to transmit the notice of appeal and the record to district court.

B. Regardless Of Any Jurisdictional Or Procedural Defects, This Court Should, In Its Discretion, Decline To Exercise Jurisdiction Over The Appeal.

In the alternative, this Court could also rule that even if it had jurisdiction over the appeal, it would decline to exercise it at this stage of the litigation. See, e.g., Sinochem Int’l Co. Ltd. v. Malaysia Int’l Shipping Corp. 127 S. Ct. 1184 (2007). As the Supreme Court recently reaffirmed, “a federal court has leeway to choose among threshold grounds for denying audience to a case on the merits.” Id. at 1191 (internal quotations omitted). The Court noted that, for example, “a district court declining to adjudicate state-law claims on discretionary grounds need not first determine whether those claims fall within its pendent jurisdiction.” Id.

Similarly, this Court may decline to adjudicate the merits of the current appeal on discretionary grounds without first determining whether, due to the debtors’ failure to file a petition, it lacks appellate jurisdiction. Indeed, “[j]urisdiction is vital only if the court proposes to issue a judgment on the merits.” Sinochem, 127 S. Ct. at 1191-92. As noted, even where, as here, the bankruptcy court certifies that its order satisfies at least one of the three statutory criteria for direct appeal, this Court has discretion whether to exercise jurisdiction. 28 U.S.C. 158(d)(2)(A); see Weber v. United States Trustee, 484 F.3d 154, 157, 161 (2d Cir. 2007) (“Congress has explicitly granted us plenary authority to grant or deny leave to file a direct appeal, notwithstanding the presence of one, two, or all three of the threshold conditions”).

Here, the bankruptcy court certified its order holding that Mrs. Blausey’s disability insurance payments must be included as “current monthly income” under Section 101(10A) for direct appeal on the ground that the order involves "questions of law for which there is no controlling authority" and which are "a matter of public importance." R. 42. The U.S. Trustee does not dispute the lack of controlling authority on whether monthly disability insurance payments are "current monthly income" as defined in 11 U.S.C. § 101(10A). In fact, the U.S. Trustee is unaware of *any* published district court or court of appeals decision addressing the issue. That, however, suggests that the parties' arguments should be fully aired and considered by at least one Article III district court judge before they are presented to this Court.

And although the U.S. Trustee also does not dispute that the issue is important, this case does not involve questions that are of such great public importance that a direct appeal is necessary, or even advisable. To the contrary, the bankruptcy court's order involves a narrow and focused dispute over whether a particular type of private insurance payment falls under the broad statutory definition of "current monthly income." Lower courts and, if necessary, this Court, can address this issue in the ordinary appellate process.

Moreover, this Court would benefit from lower courts' views on this issue should it ever reach the circuit level. See Weber, 484 F.3d at 160 ("In many cases involving unsettled areas of bankruptcy law, review by the district court would be most helpful. Courts of appeals benefit immensely from reviewing the efforts of the district court to resolve such questions."). Much like the Supreme Court's discretion to deny review by writ of certiorari where an important issue has not sufficiently "percolated" in the lower courts, this Court has discretion to deny an immediate appeal where the issue would benefit from further analysis in the district courts or other fora. Indeed, "[p]ermitting direct appeal too readily might impede the development of a coherent body of bankruptcy case-law." Weber, 484 F.3d at 160. For these reasons, this Court should not authorize a direct appeal in the present case.

IV. CONCLUSION

For the foregoing reasons, this Court should remand the case to the bankruptcy court with instructions to transmit the notice of appeal and the record to the district court.[8]

Respectfully submitted,

Of Counsel:

ROBERTA A. DEANGELIS
Acting General Counsel
P. MATTHEW SUTKO
Office of the General Counsel
Executive Office for
U.S. Trustees
U.S. Department of Justice
20 Massachusetts Ave., N.W.
Suite 8100
Washington, D.C. 20530
JAMES A. SHEPHERD
Office of the U.S. Trustee
235 Pine Street, Suite 700
San Francisco, CA 94104

WILLIAM KANTER
(202) 514-4575

STEPHANIE R. MARCUS
(202) 514-1633
Attorneys
Appellate Staff, Civil Division
U.S. Department of Justice
950 Pennsylvania Ave., N.W.
Room 7642
Washington, D.C. 20530

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[8] In the alternative, this Court could transmit the notice of appeal and the record to the district court directly; however, since the case has never been docketed in district court, there is likely to be less confusion caused by remanding to the bankruptcy court with instructions.

CERTIFICATE OF SERVICE

I hereby certify that on this 26th day of June, 2007, I served the foregoing Acting United States Trustee’s Motion To Remand To Bankruptcy Court With Instructions by causing a copy to be sent to the following counsel by Federal Express:

David N. Chandler, Jr.
David N. Chandler, p.c.
1747 Fourth St.
Santa Rosa, CA 95404

____
Stephanie R. Marcus

BRIEF BANK — "SUMMARY SHEET" *Printed Thu-10/16/08 16:36*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]* — Bowman v. United States Trustee

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]* — W.D. Va.

3. ("CCN") ***CURRENT*** CASE NO. — No.: 7:08-cv-00339-SGW

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]* — No.: 07-00701

Court: Bankr. W.D. Va.

(Identify judge & cite, if any)

5. ("SO") ***SOURCE*** — **U.S. TRUSTEES**

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]* — Filed: October 15, 2008

Type: Brief of the United States Trustee

7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]* — John Robert Byrnes

(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC*** — **BANKRUPTCY**

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***

• Whether the bankruptcy court erred when it issued an order imposing sanctions against appellant for violations of Rule 9011 of the Federal Rules of Bankruptcy Procedure.

10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)

11. DO YOU RECOMMEND POSTING IN UST BRIEFBANK? | x | YES | | NO

NAME: Linda Figueroa

DATE:

IN THE
UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF VIRGINIA
Roanoke, Division

Civil Action No. 7:08-cv-00339-SGW

GARY M. BOWMAN

Appellant/Respondent,

UNITED STATES TRUSTEE,

Participant,

APPEAL FROM THE UNITED STATES BANKRUPTCY COURT FOR THE WESTERN DISTRICT OF VIRGINIA

BRIEF OF UNITED STATES TRUSTEE

John Robert Byrnes, (Wisconsin State Bar No. 1015262)
Office of the United States Trustee
210 First Street, Suite 505
Roanoke, Virginia 24011
(540) 857-2806
John.Byrnes@usdoj.gov

Counsel for the United States Trustee

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TABLE OF AUTHORITIES

Cases

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I. Statement of Issues and Standard of Review[1]

The United States Trustee asserts that additional issues requiring review in this matter are whether the appellant waived his right to appeal findings that he violated Fed. R. Bankr. Proc. 9011 in view of his repeated admissions of such violations before the trial Court.

Sanctions should be reviewed for abuse of discretion. Morris v. Wachovia Securities, 448 F.3d 268, 277 (4th Cir. 2006); Brickwood Contractors, Inc. v. Datanet Engineering, 369 F.3d 385, 390 (4th Cir. 2004). A court abuses its discretion only if the "'court below committed a clear error of judgment in the conclusion it reached upon a weighing of the relevant factors." Morris at 277, citing Westberry v. Gislaved Gummi AB, 178 F.3d 257, 261 (4th Cir. 1999)

The applicable standard of review was set forth in In re Gallagher, 388 B.R. 694, 697 (W.D.N.C. 2008):

> The decision of the Bankruptcy Court is reviewed by a two-step process. Reversal of the findings of fact of the Bankruptcy Court may occur only where such findings are clearly erroneous. See Educational Credit Mgmt. Corp. v. Frushour (In re Frushour), 433 F.3d 393, 398 (4th Cir.2005). The Bankruptcy Court's legal conclusions, however, are subject to a *de novo* standard of review. See Schlossberg v. Barney, 380 F.3d 174, 178 (4th Cir. 2004). "Findings of fact are clearly erroneous 'when, although there is evidence to support [them], the reviewing court on the entire evidence is left with the definite and firm conviction that a mistake has been committed.' " McGahren v. First Citizens Bank & Trust Co. (In re Weiss), 111 F.3d 1159, 1166 (4th Cir. 1997) (quoting Green v. Staples (In re Green), 934 F.2d 568, 570 (4th Cir.1991)), cert. denied, 522 U.S. 950, 118 S.Ct. 369, 139 L.Ed.2d 287 (1997). As stated by the Supreme Court:

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[1] The United States Trustee notes that appellant's brief fails to comply with the requirements of Fed. R. Bankr. Proc. 8010(a)(1)(C), in that he fails to specify any applicable standard of appellate review. The United States Trustee also notes that the brief of appellant exceeds the page limitation requirements of Fed. R. Bankr. Proc. 8010(c).

> If the [lower court's] account of the evidence is plausible in light of the record viewed in its entirety, the [appellate court] may not reverse it even though convinced that had it been sitting as the trier of fact, it would have weighed the evidence differently. Where there are two permissible views of the evidence, the factfinder's choice between them cannot be clearly erroneous. Anderson v. Bessemer City, 470 U.S. 564, 573-74, 105 S.Ct. 1504, 84 L.Ed.2d 518 (1985).

Generally, issues not raised before the trial court may not be raised on appeal. Acstar Ins. Co. v. Harden, 16 Fed. Appx. 213 (4th Cir. 2001), In re Lane, 991 F.2d 105 (4th. Cir 1993).

II. Statement of Facts

The United States Trustee asserts that the facts relied on by the Bankruptcy Court in imposing sanctions are clearly and succinctly set out in its memorandum opinion and in the supporting documentation supplementing its opinion. App. Docs. 14, 15, 16.

The United States Trustee notes that the lengthy supplemental documents included in the opinion of the Bankruptcy Court include correspondence between Mr. Bowman and the Court. Most significant therein is Judge Stone's letter of August 28, 2007 setting forth his reasoning for commencing formal proceedings against Mr. Bowman. App. Doc.14, unnumbered page, third from the last.

In addition, the supplemental documents include the Court's invitation to Mr. Bowman to request a hearing on the Order to Show Cause and Mr. Bowman's acknowledgment of the Court's willingness to hold a hearing and his willingness to forego hearing. "It is my understanding, based on the Court's previous letters, that the three judges of the Court will consider my proposed resolution of the show cause matter, and that no hearing will be held. *That procedure is agreeable to me."* App.Doc.14, last two pages. (emphasis added) (It should also be noted that at the time Mr. Bowman sent this letter he clearly knew that all three judges of the Bankruptcy Court would participate in the final decision and made no objection to the participation of Chief Judge Krumm either in his letter or by motion.)

The Appellant's brief here contains a lengthy recitation of "facts" without citations to the actual record. Many of the factual assertions made on appeal appear to amplify personal explanations rejected by the Bankruptcy Court and may not be appropriate for consideration on appeal if they were not raised before the Bankruptcy Court. It is not necessary for this Court to engage in the cumbersome process of parsing the record to compare the current "facts" with those provided in the original Response to Order to Show Cause in view of the fact that Mr. Bowman admitted at least three violations of Fed. R. Bankr. Proc. 9011, as set forth in detail below.

III. **Argument**

A. Summary of Argument

The matter before this Court is the appeal of an Order of the United States Bankruptcy Court imposing sanctions against appellant, Attorney Gary M. Bowman, (hereafter "Mr. Bowman") for violations of Rule 9011 of the Federal Rules of Bankruptcy Procedure.

The proceedings in Bankruptcy Court were initiated by an Order to Show Cause issued *sua sponte* by United States Bankruptcy Court Judge William F. Stone, Jr. App. Doc. 4. The Order to Show Cause, which will be discussed at length below, required Mr. Bowman to explain why sanctions should not be imposed against him for violations of Rule 9011 in the Bousman (In re Michael and Sandra Bousman, No. 99-01086 (Bankr. W.D.V.A.)) and Perkins (In re Kim Perkins, No. 7-01-0418- WRS-13 (Bankr. W.D.V.A.)) cases and specified the matters to which Mr. Bowman was required to respond. Mr. Bowman responded by filing a Motion to Recuse Judge Stone, which was denied. App. Docs. 7, 12,13. He also filed a detailed reply to the Motion for Order to Show Cause.[2] App. Doc. 8 (attachments to response to order to show cause, App. Docs. 9-11.)

In his response, although he disputed many of the matters referred to in the Order to Show Cause, Mr. Bowman admitted that he had violated Rule 9011 in both Perkins and Bousman and that the imposition of sanctions was appropriate.[3]

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[2] Several requests for extensions of time were also filed, all of which were granted.

[3] Nowhere in the Appellant's brief to this Court does he mention, let alone attempt to explain, the fact that at the Bankruptcy Court he admitted three violations of Rule 9011.

Mr. Bowman acknowledged that the Motion to Reopen in Bousman contained a factual allegation which did not have evidentiary support and "thus violated Rule 9011(b)(3)." Mr. Bowman also acknowledged that, in a separate adversary proceeding in the same case, he requested relief against a secured creditor that could not be granted by the Court. "Therefore, the claim for relief violated Rule 9011(b)(2), which prohibits the filing of a claim which is not 'warranted by existing law.' " Response to Order to Show Cause, p.30 "For these reasons, I do not think that my inaccurate statements in the Bousman pleadings, *although improper and in violation of 9011*, were done for an entirely improper purpose because there was a legally justified goal which I was trying to achieve for my clients." Response to Order to Show Cause, p. 38, (italics added). Similarly in Perkins, Mr. Bowman admitted that the allegations of his adversary complaint "contained a statement in violation of Rule 9011(b)(3)":

> "The calculations that I had done in December indicated that the debtor had not made sufficient payments to pay off the lien, and the claim that the 'lien on the property is satsified and should be released' was not accurate. *This statement was a factual contention which did not have evidentiary support and violated Rule 9011(b)(3).*" App.Doc. 10, Response to Order to Show Cause, p.30 (emphasis added.)

The findings of the Bankruptcy Court relied both on its own independent analysis and on Mr. Bowman's admissions. Accordingly, Mr. Bowman has waived his right to appeal those findings.

In view of these admissions and the pattern of conduct discussed at length in its order, the Bankruptcy Court, with all three Bankruptcy Judges participating, imposed a sanction consisting of an admonition to comply with applicable federal law and state ethics requirements, a requirement that he certify within 90 days his familiarity with various rules and cases related thereto and a requirement that he take ethics courses approved by Chief United States Bankruptcy Judge Krumm.

Mr. Bowman was further barred from filing any new cases until he complied with the terms of the Order.[4] App. Doc. 16.

The sanction imposed was notably similar to what Mr. Bowman himself acknowledged would be an appropriate sanction in view of his admissions that he violated Fed. R. Bankr. Proc. 9011. Mr. Bowman recommended a probationary period of one year and an admonition against further misbehavior of the same kind. Mr. Bowman's recommendation was somewhat disingenuous since, at that time, he planned to discontinue his law practice anyway for at least one year while he was on active military duty. App. Doc. 9,Response to Order to Show Cause, p. 51.[5]

The actual sanction appears mild in view of the recurring pattern of conduct and basically set no probationary period as suggested by Mr. Bowman, but required proof of additional ethical education as a condition to filing new cases. Accordingly, Mr. Bowman "held the keys to the jail" and can recommence his bankruptcy practice at any time he completes the required education and review.

Ironically, in view of the basis of the sanction imposed by the Bankruptcy Court, the appellant's brief fails to make any mention of his admissions that he violated Fed. R. Bankr. Proc. 9011. His concerns before the Bankruptcy Court were apparently assuaged by the fact that he was not disbarred or sanctioned more severely. That, of course, does not entitle a party to re-litigate on appeal matters it has already admitted below. It appears that now that Mr. Bowman got

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[4] To date, Mr. Bowman has filed the certificate within the time frame required by the Court. Nothing appears of record to indicate compliance with the educational requirement. No new cases have been filed by Mr. Bowman since entry of the Order.

[5] The Brief of Appellant filed herein also fails to mention the fact that, before the Bankruptcy Court, he himself recommended the imposition of some discipline.

essentially what he requested and was neither suspended or disbarred, he wants to disavow everything he admitted before the Bankruptcy Court.

A careful reading of the order to show cause and the order entered pursuant to it, makes clear that after many years of dealing with specified cases where factual and legal allegations made by Mr. Bowman were found to be, at best, lacking in substance, the Court concluded that its repeated admonitions to Mr. Bowman were not resulting in the desired "correction of course" and that only a more serious action would cause him to change his ways. Mr. Bowman was given the opportunity to respond, which he did; and for a hearing, which he declined.[6]

The appellants brief fails to set forth any basis for reversal of the finding of the Bankruptcy Court. Instead it simply makes the same excuses (in many cases word for word) that failed in the trial court. In some cases, the excuses are amplified to include new factual explanations. These are unsupported by evidentiary matters in the record and are mostly a repetition of Mr. Bowman's dissatisfaction with the trial court's decision. Dissatisfaction with the decision of a trial court, particularly when great discretion is allowed by law, cannot be a substitute for a demonstration of abuse of discretion sufficient to justify reversing a decision on appeal.

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[6] The necessity for hearing to resolve any disputed facts was clearly vitiated by the Bowman admission that he had violated Fed. R. Bankr. Proc. 9011.

B. Specific Issues

1. Judge Stone's denial of the Motion for recusal was appropriate.

The appellant's initial complaint is that Judge Stone should have recused himself from hearing the case. Mr. Bowman alleged in his motion before the trial court that 28 U.S.C. §§ 455(a) and (b)(1) required recusal.[7] The requested relief relies upon a single dispute in a case arising before Judge Stone was appointed to the bench and a series of matters after he was on the bench, allegedly demonstrating a bias sufficient to require recusal under § 455.

In his opinion denying the motion for recusal, Judge Stone provides a lengthy history of the events proceeding his appointment to the bench, App. Doc. 12, p.3-8. Judge Stone notes that two years after the case in question, he invited Mr. Bowman to his investiture. He also points out that he held a favorable view of Mr. Bowman because of his continuing military service.

As noted in a recent case decided by United States District Court Judge Turk, "the issue is not whether the judge is impartial in fact but rather whether a reasonable person might question the impartiality of the judge under the surrounding facts and circumstances." United States v. $15,716 in U.S. currency, 2008 WL 4326491 (W.D. Va.) (citations omitted.) As Judge Widener noted in United States v. DeTemple, 162 F.3rd 279, 289 (4th Cir. 1998):

> Application of the objective standard thus requires a nuanced approach. On the one hand, we must keep in mind that the hypothetical reasonable observer is not a judge himself or a judicial colleague but a person outside the judicial system. Judges, accustomed to the process of dispassionate decision making and keenly aware of their Constitutional and

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[7] No motion under 28 U.S.C. §344 was made and, regardless, no affidavit was filed as required by that section.

> ethical obligations to decide matters solely on the merits, may regard asserted conflicts to be more innocuous than an outsider would. On the other hand, a reasonable outside observer is not a person unduly suspicious or concerned about a trivial risk that a judge may be biased. **There is always some risk of bias; to constitute grounds for disqualification, the probability that a judge will decide a case on a basis other than the merits must be more than "trivial."** (citation omitted) (emphasis added).

Nothing under the present circumstances would lead a reasonable person to conclude that Judge Stone was biased against Mr. Bowman. Only a single incident involving Mr. Bowman and Judge Stone prior to his appointment to the bench is cited. Active attorneys regularly have disagreements with other attorneys about the respective rights of their clients. In specific practice areas like bankruptcy in relatively sparsely populated parts of the country, it is virtually inconceivable that over the years attorneys representing clients would not have disagreements. United States v. DeTemple, 162 F.3d at 290. Adopting Mr. Bowman's views, with no additional showing of personal animosity, would virtually preclude any active practitioner from later performing their duties as a judge when doing so required them to rule in cases where previously opposing counsel appeared. There is no recitation that the sole dispute referred to was even particularly acrimonious. For example, neither side sought sanctions and no trial was held. Section 455(a) is not intended to provide parties with a "veto" power over the judge hearing a particular case or matter. Judge Stone's lengthy opinion denying the motion for recusal sets forth in considerable detail both the factual and legal matters relating to recusal here. App. Doc. 12, pp. 24-27. This sort of every day dispute among counsel representing clients is certainly not enough to allow a reasonable person to conclude that Judge Stone possessed a personal bias requiring recusal, particularly in view of Judge Stone's detailed recitation of the pre-appointment events which Mr. Bowman did not dispute.

The balance of Mr. Bowman's attempts to prove bias consists of a series of cases over the years in which Judge Stone questioned various factual and legal issues raised by Mr. Bowman. It is axiomatic that knowledge by the Judge gained relating to a matter or a party as result of cases cannot be the basis for recusal under § 455. Liteky v. U.S., 510 U.S. 540, 554(1994), United States v. DeTemple, 162 F.3d 279,(4th Cir. 1998); In re Beard, 811 F.2d 818 (4th Cir. 1987). As Judge Stone noted, an action brought pursuant to Fed. R. Bankr. Proc. 9011 by the Court implies some knowledge of the underlying circumstances including other matters handled inappropriately by counsel. App. Doc. 12, p. 22.

Mr. Bowman apparently believes that the incidents referred to in his previous cases with Judge Stone support his contention that, basically, Judge Stone was out to get him since before he took the bench.

Even assuming *arguendo* that issues raised by a Judge relating to specific cases can, by themselves, form the basis for claims under § 455, the facts here not only do not demonstrate ongoing bias-- they demonstrate exactly the opposite. In the instances cited by Mr. Bowman where his conduct was questioned, upon hearing Mr. Bowman's explanation, Judge Stone chose not to initiate formal proceedings against Mr. Bowman. As Judge Stone states, it was his ongoing hope and expectation that Mr. Bowman would correct his issues without formal court action. It was only when it became clear that performance not in accord with the applicable standards was continuing, that this formal proceeding was initiated. This ongoing judicial restraint demonstrates the Court's reluctance to take action unless and until pressed to the point where it became clear that informal admonitions were not likely to be effective. This is hardly the course of conduct of a judicial officer driven by bias over a minor matter occurring over ten years earlier. Section 455(a) "does not require recusal on the basis of suspicion or 'unsupported, irrational, or highly tenuous speculation." United States v. Black, 490 F. Supp. 2d 630, 656 (E.D.N.C. 2007). This is precisely the type of "trivial" allegation for which recusal is not required.

Mr. Bowman also alleges that Judge Stone was required to recuse himself pursuant to § 455(b)(1) because he had personal knowledge of facts which were unknown to him and not in the opinion. His complaint here relates to the content of a letter sent by Judge Stone to Mr. Bowman dated August 28, 2007. App.Doc. 14. This reckless allegation is unfortunately similar in nature to the sort of statement that resulted in Mr. Bowman's sanction. The comments Mr. Bowman refers to were general in nature and amply supported by minutely detailed recitations of particular incidents. His complaint that he received no "guidance which would have caused me to change my course" (App. Brief 29) simply ignores the previous incidents he had with Judge Stone. While not constituting formal actions by the Court, these incidents were sufficiently clear to indicate to any experienced practitioner that much stricter compliance to applicable legal and ethical standards requirements and attention to detail was required. This is hardly the type of underlying extra-judicial knowledge of facts for which recusal under § 455(b) is required.

2. The Bankruptcy Court appropriately initiated a disciplinary separate proceeding outside of the underlying case.

This argument was not raised at the trial court and was waived. Timely raising of this issue would have resolved it, if necessary, by re-opening cases for limited purposes.

Mr. Bowman contends that the Bankruptcy Court erred by reviewing his conduct in a miscellaneous proceeding separate from the underlying cases which gave rise to the current proceedings. Following Mr. Bowman's position to its logical conclusion, any attorney who engaged in egregious conduct in violation of Fed. R. Bankr. Proc. 9011 before the Bankruptcy Court could get away with it as long as such egregious conduct was not discovered before the case was closed. Additionally, his view appears to be that a court could not rely on similar conduct in prior closed cases in determining what the appropriate sanction should be. There is nothing in the language of the rule that limits action by the Court to enforce its provisions to open cases.[8] Keeping cases open indefinitely while allegations of violations of Fed. R. Bankr. Proc. 9011 matters were being resolved, particularly in a bankruptcy case, could have serious consequences for both debtors and their creditors.

The Supreme Court has upheld the jurisdiction of courts to issue Rule 11 sanctions in dismissed cases. Cooter & Gell v. Hartmarx Corp., 496 U.S. 384, 395 (1990), as well as in instances where the court was found to have lacked federal subject matter jurisdiction over the underlying case. Willy v. Coastal Corp., 503 U.S. 131, 138-39 (1991) (holding that Rule 11 sanctions may be imposed even where there is no subject matter jurisdiction over the merits of the related controversy, as the court's interest in having rules of procedure obeyed does not disappear); see also In re Whitney Place Partners, 123 B.R. 117, 120 (Bankr. N.D. Ga. 1991) (court may impose sanctions under Fed. R. Bankr. Proc. 9011 even after bankruptcy case is dismissed); Hunter v. Earthgrains Company Bakery, 281 F.3rd 144, 152 (4th Cir. 2002); In re Kuntsler 914 F.2d 505,517 (4th Cir. 1990); Red Carpet Studios Division of Source Advantage, Ltd. v. Sater, 465 F.3d 642, 645 (6th Cir.

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[8] The matter could have easily been raised by the Court as a violation of ethical rules.

2006) (upholding a sanction under 28 U.S.C. § 1927 even though the underlying lawsuit in which the sanction arose had been settled and voluntarily dismissed.).

3. Judge Krumm was not precluded from participating in resolution of the Order to Show Cause.

This allegation was not raised below and was thus waived. An appellant cannot challenge matters admitted in the court below through vague challenges to the lower court's overall decision or through ambiguous statements of issues not raised below. Korangy v. U.S. F.D.A., 498 F.3d 272, 275 (4th Cir. 2007). See also United States v. Benton, 523 F.3d 424, 428 (4th Cir. 2008)(rejecting an appeal of magistrate's findings because "a party must object to the [magistrate's] finding or recommendation ... with sufficient specificity so as reasonably to alert the district court of the true ground for the objection."); Telecommunications v. Commissioner of Internal Revenue, 104 F.3d 1229, 1233 (10th Cir. 1997) ("Propounding new arguments on appeal in an attempt to prompt us to reverse the trial court undermines important judicial values. In order to preserve the integrity of the appellate structure, we should not be considered a "second-shot" forum, a forum where secondary, back-up theories may be mounted for the first time").

Mr. Bowman contends that Chief Judge Krumm would have been precluded from participating in the resolution of the Order to Show Cause had the matter been initiated in the underlying case because Chief Judge Krumm routinely recuses himself from disputed matters relating to Wachovia Bank. Timely raising of this issue might have allowed Chief Judge Krumm to either provide the detailed type of explanation that Judge Stone provided or for Chief Judge Krumm to recuse himself, although under these circumstances he was not required to do so.

The United States Trustee acknowledges that Chief Judge Krumm recuses himself from resolving actual disputes involving Wachovia Bank. In many cases where Wachovia is a creditor but no actual disputes arise involving Wachovia, he does not recuse himself. The Order to Show Cause did not involve Wachovia. The Order to Show Cause did not relate to the amount, validity, or payment of any claim by Wachovia Bank. No legal authority is cited for the proposition that Judge Stone's recusal was required under these circumstances.

4 The Bankruptcy Court appropriately relied on Mr. Bowman's pattern of conduct in determining the appropriate sanction.

The appellant contends that the reliance on other instances involving inaccurate or misleading statements was not appropriate because he committed no wrongdoing in those cases.

The brief of appellant goes on at considerable length in its efforts to dispute the conclusions reached by the Court with regard to Mr. Bowman's conduct in prior cases. The recitation of "facts" now cited by Mr. Bowman fails to show that any of these "facts" were in evidence before the trial court or that any attempt to prove them before the trial court was improperly rejected. His explanations were rejected, based upon his admission of violations of Fed. R. Bankr. Proc. 9011, and the Court's determination arriving at a decision relating to the appropriate remedy did not require a painstaking analysis of Mr. Bowman's mental state at the time. Mr. Bowman does not agree with the Court's conclusions. A party's disagreement with a trial court decision is not a basis for overruling such decision. Mr. Bowman makes no showing that the reliance on other incidents in other cases constituted an abuse of discretion, particularly in view of his admitted violations.

Finally, the Bankruptcy Court did not "relitigate" anything; it simply relied on actual events that occurred in those cases.

5. The consideration by the Bankruptcy Court of Mr. Bowman's conduct was not an abuse of discretion.

In his final basis for appeal, Mr. Bowman continues his running disagreement with the Bankruptcy Court relating to its overall conclusions relating to his conduct. On appeal, this court is only called on to determine whether or not reversible error occurred. There is nothing in the rule that requires a demonstration of a pattern of conduct as a prerequisite to the imposition of sanctions. Even if there were, Mr. Bowman, does not dispute that sanctions were imposed upon him in a prior bankruptcy case.

Regardless, the trial Court specifically rejected the idea that it was finding that Mr. Bowman's actions were "designed to mislead the Court or a creditor." The Court specifically found that:

> In light of the disposition we determine to be appropriate under the circumstances presented here, we choose not to sift all relevant evidence in an effort to determine whether the Respondent consciously decided to file misleading and unsupported pleadings or that he recklessly did so without giving full consideration to what he was doing or that in his own mind he convinced himself that he was simply being a vigorous advocate on behalf of his clients and that it was the responsibility of other parties affected by his efforts to object to them if they believed themselves to be prejudiced. At the very least he can be charged with a negligent, although reckless seems much closer to the correct characterization, indifference or blindness to his responsibilities under Rule 9011(b) and the Court believes that it need not go beyond that, believing that a full evidentiary hearing would be the appropriate procedure to make any more damaging determination of his intent. App. Doc 16, 11-12.

The facts and circumstances of the prior cases were appropriately considered by the Bankruptcy Court for the limited purposes it described and did not constitute an abuse of discretion.

6. No error existed in the reference by the Bankruptcy Court to United States v. Shaffer.

Finally the appellant complains about the citation by the Bankruptcy Court to United States v. Shaffer, 11 F.3rd 450 (4th Cir. 1993). This case is a leading case in this Circuit setting forth the responsibilities of counsel. The trial Court cited it correctly for that proposition and does not say or imply that Mr. Bowman engaged in conduct identical to that criticized there. The suggestion that the citation to this case somehow shows a negative mind set on the part of the Court has no basis in fact or law.

IV. Conclusion

This appeal is a hodge podge of issues that were either not raised before the trial court or were rejected by it for sound reasons. No concise statement of issues showing abuse of discretion is attempted. No specification of erroneous findings of fact or conclusions of law is provided. New "facts" are alleged without reference to any record in a stream-of-consciousness manner that apparently this Court is supposed to figure out.

The real facts of this case are clear. After many years of informally attempting to motivate Mr. Bowman to be more careful, the Bankruptcy Court felt that more formal action was required. A very detailed Order to Show Cause was issued to which Mr. Bowman responded. He admitted violations of Rule 9011. Despite the fact that he had been both previously cautioned by the Court and had formal discipline imposed upon him for violations of Rule 9011, the Bankruptcy Court imposed a mild sanction, basically requiring him to demonstrate knowledge of his ethical and legal responsibilities and prohibiting him from filing new cases until he did.

The appellant has shown no abuse of discretion or other error warranting reversal by this Court. The Bankruptcy Court appropriately performed its duty; and set forth the important reasons for taking the action it did:

> They [the Bankruptcy Judges] have jointly concluded, based on the facts and applicable law noted in this opinion, their individual experiences with the Respondent in his practice in this Court over a period of years and after considering the representations and arguments made by him in his Response to the Show Cause Order, that an admonition to him accompanied by requirements that he take an appropriate professional responsibility course and complete a personal study and certification to the Court of Rule 9011(B), the case authority interpreting and applying the same, and pertinent Rules of Professional Conduct found in Part 6 of the Rules of the Supreme Court of Virginia, are likely to be sufficient to deter repetition of the conduct noted in this opinion or comparable conduct within the meaning of Bankruptcy

> Rule 9011(c)(2). It is not their intent to chill advocacy which is vigorous or innovative or both, so long as it is supported both factually and by good faith legal argument within the fair meaning of the Rule, and is not advanced in a manner which is reasonably likely to be misleading either to the other parties affected thereby or to the Court. Finally, the undersigned judges of this Court intend to put the Respondent on specific notice that any future material violation by him of Bankruptcy Rule 9011(Attorney B) or the Virginia Rules of Professional Conduct, Part 6 of the Rules of the Supreme Court of Virginia, in connection with any pleading filed or appearance made in this Court which occurs after this date will be considered by this Court as prima facie cause for the suspension or termination of his right to practice as a member of its bar. App.Doc. 15, p.21.

The decision of the Bankruptcy Court should be affirmed.

Dated: October 15, 2008

W. CLARKSON MCDOW, JR.
United States Trustee for Region Four

By: *<u>/s/ John Robert Byrnes</u>*
Assistant U.S. Trustee

John Robert Byrnes, (Wisconsin State Bar No. 1015262)
Office of the United States Trustee
210 First Street, Suite 505
Roanoke, Virginia 24011
Telephone: (540) 857-2806
Fax: (540) 857-2844
John.Byrnes@usdoj.gov

Counsel for the United States Trustee

BRIEF BANK — "SUMMARY SHEET" *Printed Thu-9/9/10 11:30*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*
Douglas Thomas Boyce v. United States Trustee (In re Douglas Thomas Boyce)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*
D. Or.

3. ("CCN") ***CURRENT*** CASE NO.
No.: 10-cv-06286-HO

4. ("PCN") ***PRIOR*** CASE NO. - & COURT *[IF ANY]*
No.: 08-64228
Court: Bankr. Or.
(Identify judge & cite, if any)

5. ("SO") ***SOURCE***
U.S. TRUSTEES

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*
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7. **("AU") *PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*
P. Rebecca Kamitsuka, Noah M. Schottenstein, P. Matthew Sutko
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***
• (1) Did the bankruptcy court abuse its discretion when it dismissed Mr. Boyce's chapter 7 bankruptcy case under 11 U.S.C. § 707(b)(3)(A) for bad faith? (2) Did the bankruptcy court abuse its discretion when it dismissed Mr. Boyce's chapter 7 bankruptcy case under 11 U.S.C. § 707(b)(3)(B) based on the totality of the financial circumstances?

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NAME: Linda Figueroa
DATE:

P. Rebecca Kamitsuka, OSB #93326
Trial Attorney
United States Department of Justice
405 E. 8th Avenue, Suite 1100
Eugene, Oregon 97401-2706
Telephone: (541) 465-6330

Noah M. Schottenstein
Trial Attorney
United States Department of Justice
20 Massachusetts Avenue, N.W., Suite 8100
Washington, D.C. 20530

UNITED STATES DISTRICT COURT

DISTRICT OF OREGON

EUGENE DIVISION

In re:	
Douglas Thomas Boyce,	Case No.: 10-cv-06286-HO
Debtor,	
Douglas Thomas Boyce, Appellant,	On appeal from the United States Bankruptcy Court for the District of Oregon, Case No. 08-64228
v.	
United States Trustee, Appellee.	

BRIEF FOR THE UNITED STATES TRUSTEE, APPELLEE

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INTRODUCTION

On October 28, 2008, Mr. Douglas Boyce filed for chapter 7 bankruptcy relief. The United States Trustee filed a motion to dismiss Mr. Boyce's case under 11 U.S.C. § 707(b)(3)(A) for bad faith and under 11 U.S.C. § 707(b)(3)(B) based on the totality of the financial circumstances. The bankruptcy court granted the motion, finding cause to dismiss under both sections 707(b)(3)(A) and (B). This appeal followed.

STATEMENT OF APPELLATE JURISDICTION

This Court has appellate jurisdiction under 28 U.S.C. § 158(a)(1), which confers jurisdiction on the district courts of the United States to hear appeals "from final judgments, orders, and decrees" of bankruptcy judges. The bankruptcy court's final order granting the United States Trustee's motion to dismiss Mr. Boyce's case under 11 U.S.C. § 707(b) was entered on April 8, 2010. Mr. Boyce timely filed a notice of appeal under 28 U.S.C. § 158(c)(2) and FED. R. BANKR. P. 8002(a) on April 22, 2010.

STATEMENT OF THE ISSUES

Did the bankruptcy court abuse its discretion when it dismissed Mr. Boyce's chapter 7 bankruptcy case under 11 U.S.C. § 707(b)(3)(A) for bad faith?

Did the bankruptcy court abuse its discretion when it dismissed Mr. Boyce's chapter 7 bankruptcy case under 11 U.S.C. § 707(b)(3)(B) based on the totality of the financial circumstances ?

STANDARD OF REVIEW

The bankruptcy court's conclusions of law are reviewed de novo and its factual findings are reviewed for clear error. Price v. U.S. Trustee (In re Price), 353 F.3d 1135, 1138 (9th Cir. 2004). A bankruptcy court's decision to dismiss a case under 11 U.S.C. § 707(b) is reviewed for abuse of discretion. Id. "A court abuses its discretion if it does not apply the correct law or if it bases its ruling on a clearly erroneous view of the facts." Reed v. Anderson (In re Reed), 422 B.R. 214, 220 (C.D. Cal. 2009). "The reviewing court cannot reverse for abuse of discretion unless it has a definite and firm conviction that there has been a clear error in judgment." Id.

STATEMENT OF THE CASE

I. Statutory framework of 11 U.S.C. § 707(b)

Most individual debtors choose between two forms of relief under the Bankruptcy Code: chapter 7 and chapter 13. In a chapter 7 case, the debtor receives an immediate discharge of debt in exchange for the liquidation of all non-exempt assets. See 11 U.S.C. § 701, et seq. In a chapter 13 case, the debtor retains non-exempt assets, but must repay creditors over a period of time. See 11 U.S.C. § 1301, et seq.

Congress enacted section 707(b) in response to "concerns that some debtors who could easily pay their creditors might resort to chapter 7 to avoid their obligations." H.R. Rep. 109-31 (2005) at 12, reprinted in 2005 U.S.C.C.A.N. 88, 92. As originally enacted in 1984, section 707(b) established a presumption in favor of granting a debtor's petition for bankruptcy relief. The bankruptcy court could overcome this presumption and dismiss the debtor's case if the court found that granting the debtor a chapter 7 discharge would constitute "substantial abuse." Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, § 312, 98 Stat. 355, 381 (1984). "Courts looked to the totality of the circumstances to make this substantial abuse determination." Egebjerg v. U.S. Trustee (In re Egebjerg), 574 F.3d 1045, 1048 (9th Cir. 2009).

In 2005, Congress found that section 707(b) was insufficient to control abuse of chapter 7 for several reasons, including confusion about what would permit the court to dismiss under the "substantial abuse" standard and the "presumption that favors granting a debtor a discharge." H.R. Rep. 109-31 at 12. In particular, Congress remained concerned about "the pursuit of Chapter 7 liquidations instead of Chapter 13 debt repayment plans by consumer debtors who could afford to repay some of their debts." Morse v. Rudler (In re Rudler), 576 F.3d 37, 40 (1st Cir. 2009) (citing 151 Cong. Rec. S2459, 2468-70 (daily ed. Mar. 10, 2005) (statement of Sen. Hatch).

Congress therefore enacted the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA"), Pub. L. No. 109-8, 119 Stat. 23, in order "to correct perceived abuses of the bankruptcy system." Milavetz, Gallop & Milavetz, P.A. v. United States, 130 S. Ct. 1324, 1329 (2010). Specifically, BAPCPA implemented "needs-based reforms" to shift debtors "into chapter 13 . . . as opposed to chapter 7." H.R. Rep. 109-31 at 12. "The heart of the bill's consumer bankruptcy reforms . . . is intended to ensure that debtors repay creditors the maximum they can afford." Id. at 2.

Congress substantially revised section 707(b) under BAPCPA. See Egebjerg, 574 F.3d at 1048 (describing BAPCPA as a "sea change" in the law). As amended, section 707(b) now states, "[a]fter notice and a hearing, the court . . . may dismiss a case filed by an individual debtor under this chapter whose debts are primarily consumer debts . . . if it finds that the granting of relief would be an abuse of the provisions of this chapter." 11 U.S.C. § 707(b)(1).

BAPCPA made four key changes to section 707(b):

First, Congress repealed the statutory presumption in favor of granting relief to the debtor. Compare 11 U.S.C. § 707(b) (1986) with 11 U.S.C. § 707(b)(1) (2006).

Second, Congress lowered the standard for dismissal from "substantial abuse" to mere "abuse." Id.

Third, Congress authorized dismissal when a mathematical formula based on the debtor's pre-petition income and expenses — the means test — indicates a presumption of abuse. 11 U.S.C. § 707(b)(2)(A)(I).

Fourth, Congress bifurcated the totality of the circumstances test into two separate and distinct tests for finding abuse that a bankruptcy court "shall consider" when section 707(b)(2)'s presumption of abuse does not arise or is rebutted. 11 U.S.C. § 707(b)(3). One test is if the debtor filed the petition in bad faith. 11 U.S.C. § 707(b)(3)(A). The other test is based on the totality of the circumstances of the debtor's financial situation. 11 U.S.C. § 707(b)(3)(B).

By enacting sections 707(b)(3)(A) and (B) disjunctively, Congress clarified that a debtor’s honesty and neediness are now separate and independent grounds for the dismissal or conversion of a debtor’s bankruptcy case. Reed, 422 B.R. at 233.

II. Statement of the facts

A. Mr. Boyce’s financial circumstances

Mr. Douglas Boyce is a claims adjuster for GEICO. Excerpt of Record (“ER”) at 39. Mr. Boyce receives two major sources of compensation from GEICO: a base salary of approximately $57,000 and an annual profit sharing payment. Id. That payment has varied from 18% to 28% of Mr. Boyce’s taxable income. Id. at 17. Mr. Boyce has received a profit sharing payment every year since 2002. ER at 63 (year 2010); Excerpt of Record-Supplement (“ER-S”) at 60 (years 2002-2009).

Under the profit sharing plan, GEICO pays eligible employees a percentage of the employee’s taxable income based upon two factors: (1) the rate of policy growth and (2) the company’s combined underwriting ratio. ER at 16. This payment is made every February. Id. at 21. The first 10% of a profit sharing payment is deposited into a retirement account and any remainder is distributed to the employee as cash. Id. at 23. Profit sharing payments are discretionary, but when GEICO has not met its growth targets in the past, it has still made profit sharing payments, although in reduced amounts. Id.

Mr. Boyce enjoys two other substantial benefits from GEICO. One is a series of miscellaneous cash incentive benefits. Id. at 64-65. The other is the ability to use his work vehicle for personal use. ER-S at 60. GEICO provided Mr. Boyce with a brand new Chevrolet Malibu in 2007. ER at 45. He may use 15% of the miles on that car for personal use. ER-S at 60. For personal mileage above 15%, amounts are deducted biweekly from his pay. Id. Through 2009, his personal use deduction was $48 per pay period. Id. In addition, GEICO pays for all of the maintenance and car insurance expenses on the vehicle. ER at 45.

In 2008, Mr. Boyce earned $67,961 in total cash compensation from GEICO. ER-S at 59. That figure includes an $8,519 profit sharing payment, which amounts to 12.5% of his total compensation. ER at 63. Previously, he had earned $63,560 in 2006 and $67,098 in 2007. ER-S at 26.

Mr. Boyce’s financial difficulties began in September 2007. While Mr. Boyce’s divorce was being finalized, he purchased his current residence in Salem, Oregon. Id. He financed this purchase by taking out a $194,500 mortgage and a $16,010 401(k) loan. Id. at 60. The total monthly payment is approximately $1,200 per month, which amounts to 21% of his income. ER at 119.

At the time Mr. Boyce purchased the house, he received roughly $600 per month in rent and utilities from a roommate. Id. at 61. This roommate moved out in March or April 2008. Id. Mr. Boyce obtained another roommate who paid $300 per month in rent from October until December 2008. Id. at 62.

On October 31, 2007, Mr. Boyce’s marriage was dissolved by a stipulated judgment. ER-S at 59. Neither parent pays child support. Id. Mr. Boyce and his former spouse share custody of their minor child, who lives with each parent on alternating weeks. Id. Pursuant to the stipulated judgment, Mr. Boyce assumed responsibility for $34,000 in student loans and two credit cards, each with a balance of $8,000. Id. at 60.

Except for the loss of his original roommate, Mr. Boyce documented no exceptional or unforseen circumstances that would have precipitated his bankruptcy filing. ER at 87 (testifying that he initially contemplated bankruptcy after his first roommate moved out). He has been continuously employed by GEICO since August 2000. ER at 39. He experienced no drop in income in the year he filed for bankruptcy, as he made $56,801 by October 16, 2008. ER-S at 26. And he did not expect an increase in his medical expenses prior to filing. ER at 115-16.

Instead, Mr. Boyce experienced financial difficulties because of his spending habits. He incurred $17,000 in new, unsecured credit card debt between October 2007 and when he filed for chapter 7 bankruptcy on October 28, 2008. Compare ER-S at 60 (listing $16,000 in credit card debt) with id. at 20 (listing $35,229 in credit card debt). For example, he took out a new credit card, charged $3,365, and never made a single payment on the account. ER at 69.

In March 2008 — around the same time Mr. Boyce lost his original roommate and first considered the possibility of bankruptcy — the lease on his Ford 150 pickup truck expired. Id. at 53. In response, he spent $2,000 on a down payment and incurred new monthly payments in the amount of $186 to purchase another Ford F350 pickup truck. ER-S at 61.

Mr. Boyce continued to spend after filing for bankruptcy. He surrendered the Ford F350 pickup truck and, in January 2009, borrowed $14,750 from his 401(k) account to purchase a Dodge Ram pickup truck from a friend in Wyoming. ER at 123; ER-S at 61. He then sold the Dodge Ram pickup truck in September 2009 and purchased a Chevrolet pickup truck. ER at 60. In addition, Mr. Boyce borrowed another $6,000 from his 401(k) account to purchase a towable recreational camper. ER at 138.

B. Omissions in Mr. Boyce’s bankruptcy petition

Mr. Boyce did not disclose all of his income and liabilities when he filed for bankruptcy.

First, Mr. Boyce admits that he did not disclose the existence of his annual profit sharing payment in his bankruptcy schedules. ER at 43; see ER-S at 23 (requiring that employment income not paid monthly should be prorated). Mr. Boyce reported earning $4,872 per month from GEICO, which amounts to $58,464 per year. ER-S at 23. But in his statement of financial affairs, he stated he had already earned $54,607 by September 26, 2008. Id. at 26. And his pay statements showed year-to-date earnings in the amount of $67,961 as of December 24, 2008. ER-S at 59. Mr. Boyce’s 2008 profit sharing payment, when prorated across 12 months, would increase his estimated monthly income by $710.

Second, even if Mr. Boyce’s profit sharing payment is excluded, he still did not report all of his income from GEICO. Without profit sharing, Mr. Boyce earned $48,281 as of October 16, 2008. His average monthly income, prorated by the number of pay periods, averaged $4,981. See ER-S at 39. That amount is $109 more than the $4,872 in monthly income that Mr. Boyce reported.

Third, Mr. Boyce did not disclose the rental income he received from both roommates in his statement of financial affairs. Id. at 62; see ER-S at 27 (requiring disclosure of all non-employment income received within the prior two years).

Finally, Mr. Boyce failed to schedule approximately $34,000 in student loan debt on his bankruptcy schedules. ER at 51-52. Mr. Boyce has never filed amended schedules to show his student loans. Id. at 118.

III. Statement of the proceedings below

The United States Trustee commenced a contested matter against Mr. Boyce on January 20, 2009.[1] ER at 1; see FED. R. BANKR. P. 9014 (stating the rules applicable to contested matters). That contested matter was brought under 11 U.S.C. § 707(b). It asked the bankruptcy court to dismiss Mr. Boyce's case.

The United States Trustee argued that Mr. Boyce's case should be dismissed for bad faith under section 707(b)(3)(A) because Mr. Boyce (1) misrepresented his financial situation by failing to report his profit sharing payments, rental income,

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[1] The United States Trustee is an official of the United States Department of Justice appointed by the Attorney General to supervise the administration of bankruptcy cases in this district. 28 U.S.C. § 581(a)(18). "The United States trustee may raise and may appear and be heard on any issue in any case or proceeding under this title but may not file a plan pursuant to section 1121(c) of this title." 11 U.S.C. § 307. Courts have repeatedly held that the United States Trustee has standing under section 307 to appear and be heard on any issue in any bankruptcy case, despite the lack of pecuniary interest in the outcome. See Morgenstern v. Revco D.S., Inc. (In re Revco D.S., Inc.), 898 F.2d 498, 500 (6th Cir. 1990); see also United Artists Theater Co. v. Walton (In re United Artists Theater Co.), 315 F.3d 217, 225 (3d Cir. 2003); Stanley v. McCormick (In re Donovan Corp.), 215 F.3d 929, 930 (9th Cir. 2000) ("The United States trustee may . . . intervene and appear at any level of the proceedings from the bankruptcy court on . . . as either a party or an amicus."); Scott v. U.S. Trustee, 133 F.3d 917 (4th Cir. 1997).

and student loans; (2) incurred substantial debts on the eve of bankruptcy; and (3) made unnecessary luxury purchases after filing for chapter 7 bankruptcy relief. ER-S at 51-54.

In the alternative, the United States Trustee argued that Mr. Boyce's case should be dismissed based on the totality of the circumstances under section 707(b)(3)(B) because Mr. Boyce has the financial capability, without hardship, to repay his creditors an average of $778 per month. Id. at 55-56 (averaging the amount of spare income Mr. Boyce may have in a year when he can claim his child as a dependent and in a year when he can not).

Mr. Boyce opposed dismissal of his case. ER at 3. Mr. Boyce argued that his filing was not in bad faith because (1) he did not need to include his profit sharing payments in his schedules because those payments were speculative; (2) no creditors had objected to his bankruptcy filing; and (3) "the United States government has encouraged him" to live beyond his means. Id. at 4. Mr. Boyce argued that he was not subject to dismissal based on his ability to repay his debts because his means test demonstrated he did not have the ability to repay. Id. at 5.

After the parties completed discovery, the bankruptcy court held an evidentiary hearing on April 6, 2010. Id. at 14. The court heard testimony from Ms. Irene Citron, a regional human resources director for GEICO, regarding

GEICO’s bonus policies, id. at 15; Mr. Kevin Files, a financial analyst with the United States Trustee, regarding Mr. Boyce’s ability to pay his debts, id. at 96; and Mr. Boyce, regarding his past, present, and future financial circumstances. Id. at 39, 114. At the conclusion of the hearing, the court decided the case should be dismissed on two alternative grounds — under section 707(b)(3)(A) for bad faith and under section 707(b)(3)(B) based on the totality of the financial circumstances. Id. at 166.

On the issue of bad faith, the court found that “the debtor has significantly understated his income.” Id. at 163. The court rejected Mr. Boyce’s contention that it was unlikely he would receive a bonus, stating, “I think that the far stronger basis of prediction was the history leading up to the time the debtor filed and not the rumor mill that every institution is subject to which takes a more pessimistic view of things.” Id. at 164. The court believed Mr. Boyce had “made choices that did not put the interest of creditors at the forefront, and that this is what a bad-faith filing actually is.” Id.

On the issue of Mr. Boyce’s financial circumstances, the bankruptcy court found that “the debtor is capable of making some payment . . . to his creditors, and that under the totality of these circumstances . . . it would be an abuse . . . to allow the case to go forward.” Id. The court did not “believe that it’s appropriate to effectively subordinate every other creditor to the 401(k) loan." Id. at 165. Furthermore, the court noted, "in this context the second car may be an expense that could be foregone because of the existence of the free car." Id. at 166.

The bankruptcy court concluded that "the fact that the debtor has a demonstrated ability to repay something and the fact that his schedules have materially misstated his income are together, and separately, grounds to allow the U.S. Trustee's motion to dismiss." Id. The court allowed Mr. Boyce to avoid dismissal by converting his case to one under chapter 13. Id.

On April 8, 2010, the bankruptcy court entered a separate order granting the United States Trustee's motion to dismiss. ER-S at 67. On April 22, 2010, Mr. Boyce timely filed a notice of appeal. Id. at 64.

SUMMARY OF THE ARGUMENT

In this case, the United States Trustee sought dismissal of Mr. Boyce’s chapter 7 bankruptcy case on two alternative theories: (1) under section 707(b)(3)(A) for bad faith because he misrepresented his income in his bankruptcy schedules and demonstrated bad faith in other respects; and (2) under section 707(b)(3)(B) because the totality of his financial circumstances demonstrated he has the ability to repay his creditors an average of $778 per month. The bankruptcy court, after considering the testimony and other evidence presented by the parties, agreed with the United States Trustee on both grounds. Accordingly, the court ordered Mr. Boyce’s case be dismissed or converted to chapter 13.

That order may be affirmed on either ground. First, the bankruptcy court did not abuse its discretion when it found that Mr. Boyce had filed his chapter 7 case in bad faith under section 707(b)(3)(A). The record shows Mr. Boyce’s omissions regarding his income and debt, numerous consumer purchases in the months before filing for bankruptcy, and continued spending after obtaining protection from his creditors under chapter 7 of the Bankruptcy Code. Mr. Boyce’s conduct demonstrates that he has sought to take advantage of the Bankruptcy Code, rather than use the bankruptcy process to work out a fair deal with his creditors.

Second, the bankruptcy court did not abuse its discretion when it found that

Mr. Boyce has the ability to repay his debts under section 707(b)(3)(B). The evidence in the record supports the court’s finding that Mr. Boyce was more likely than not to receive some form of profit sharing payment, and that Mr. Boyce had incurred an unnecessary vehicle expense by purchasing a second car when he had personal use of a corporate vehicle at a substantially reduced cost. These facts indicate that Mr. Boyce, on average, could pay his creditors up to $778 per month.

Finally, Mr. Boyce’s arguments on appeal are unpersuasive. He primarily argues that the bankruptcy court improperly deviated from the results of section 707(b)(2)’s means test when the court considered the motion to dismiss under section 707(b)(3). The text of the statute and the case law, however, demonstrate that the means test and the section 707(b)(3) inquiries are independent of each other.

Because the bankruptcy court’s factual determinations were based upon ample evidence in the record, its findings were not clearly erroneous and this Court should affirm the order entered below.

ARGUMENT

I. The bankruptcy court did not abuse its discretion when it dismissed Mr. Boyce's case under 11 U.S.C. § 707(b)(3)(A) for bad faith

Under section 707(b)(3)(A), a bankruptcy court "shall consider . . . whether the debtor filed the petition in bad faith." § 707(b)(3)(A). Although there is no Ninth Circuit law on what constitutes bad faith under section 707(b)(3)(A), as it is a new statute, bankruptcy courts agree that a case may be dismissed for bad faith if the circumstances indicate that the case is inconsistent with the purpose and spirit of the Bankruptcy Code, even if the purpose may otherwise be lawful. See In re Hageney, 422 B.R. 254, 260 (Bankr. E.D. Wash. 2009).

The bad faith analysis is a fact-specific inquiry that focuses on the debtor's intent and conduct in connection with the case, and not the debtor's financial circumstances. Hageney, 422 B.R. at 260. "[N]either malice nor fraudulent intent by the debtor is required for a finding of bad faith." In re Mitchell, 357 B.R. 142, 155 (Bankr. C.D. Cal. 2006). Rather, a case may be dismissed for bad faith when the debtor seeks an "impermissible head start at the expense of her creditors." Id. at 157.

Evidence of bad faith conduct may be found in both pre and post-petition facts and circumstances, and may include "factors such as the circumstances that precipitated the debtor's filing for bankruptcy, the debtor's intentions in filing for bankruptcy, and whether the debtor has honestly disclosed his financial conditions." U.S. Trustee v. Hilmes (In re Hilmes), No. 4:09-732, 2010 WL 3292807, at *6 (N.D. Tex. Aug. 19, 2010) (citing Mitchell, 357 B.R. at 155 (noting other considerations)).

The bankruptcy court did not abuse its discretion when it found that Mr. Boyce acted in bad faith because there is substantial evidence in the record to support finding that (1) he misrepresented his income and his liabilities in his bankruptcy documents; (2) he purchased consumer goods that he did not need and could not afford, both before and after he filed for bankruptcy; and (3) the circumstances precipitating his bankruptcy filing do not demonstrate a genuine need for relief.

A. There is substantial evidence in the record to support finding that Mr. Boyce misrepresented his income and liabilities in his bankruptcy petition

A debtor is required to report all income and liabilities when filing a petition for bankruptcy relief. On Schedule I, a debtor must state current income received from employment activities, prorated if not paid monthly, and note any changes in income "reasonably anticipated to occur within the year." FED. R. BANKR. P. OFFICIAL FORM 6 (Schedule I); see ER-S at 23 (Mr. Boyce's Schedule I). A debtor is also required to disclose in a statement of financial affairs all other sources of income received during the previous two years. FED. R. BANKR. P. OFFICIAL FORM 7; see ER-S at 26 (Mr. Boyce's statement of financial affairs). And on Schedule F, a debtor must list all unsecured debts. FED. R. BANKR. P. OFFICIAL FORM 6 (Schedule F); see ER-S at 19 (Mr. Boyce's Schedule F).

A debtor's misrepresentation of income and expenses is evidence of bad faith. Mitchell, 357 B.R. at 155; cf. Thomson v. Glenn (In re Glenn), 335 B.R. 703, 707 (Bankr. W.D. Mo. 2005) (denying a debtor a discharge under 11 U.S.C. § 727(a)(4) for making a false oath because the debtor failed to prorate and include in his Schedule I anticipated bonus income that he reasonably anticipated to receive post-petition). Here, there are five examples in the record of Mr. Boyce omitting income and expenses when he filed his bankruptcy petition. The first four examples were uncontested.

First, even if profit sharing is excluded, Mr. Boyce still failed to report $109 in monthly income from GEICO. ER-S at 39.

Second, Mr. Boyce failed to report approximately $11,700 in rental income derived from taking on roommates within the 24 month lookback period required by his statement of financial affairs. ER at 44, 61-62; ER-S at 61.

Third, Mr. Boyce failed to schedule $34,000 in student loan debt. ER at 118; ER-S at 60.

Fourth, Mr. Boyce never amended his schedules in order to correct these omissions prior to trial, despite being aware of their use against him — at the latest — in a joint stipulation of facts and in the United States Trustee's pre-trial memorandum. <u>See</u> ER at 118; ER-S at 27, 41, 60.

The fifth omission is Mr. Boyce's failure to disclose the existence of his annual profit sharing payments. ER-S at 23, 26. Mr. Boyce contends that he was not required to disclose the profit sharing payments because he did not believe he would receive future payments when he filed for bankruptcy. Appellant's Br. at 5. But the record supports the bankruptcy court's finding that Mr. Boyce's belief was not reasonable: the document that Mr. Boyce relies upon to support this belief does not state that annual profit sharing payments would not be made and Mr. Boyce had received profit sharing payments in previous years when the criteria had not been met.

First, as Mr. Boyce admits, the document that he produced to support omitting his profit sharing payments did not actually state that profit sharing payments would not be made. ER at 92-93. The document, issued by GEICO CEO Tony Nicely, stated that the current policy growth rate was projected at 7.8%, rather than the 8% target normally required for a profit sharing payment. Id. at 75-76. But it also asserted that the other factor in the equation, underwriting ratio, was "doing sensationally" and that the company was beating its profitability estimates through the quarter. Id. at 90.

The document continued to explain that a new monthly payment plan was "really helping sales and retentions" and growth in internet sales was improving efficiency. Id. at 91-92. And it concluded that a cash incentive program "has helped us get toward that eight percent growth that we all need . . . I'm going to bet that we make it because we're that close." Id. at 92.

Second, a GEICO human resources officer testified at trial that the company had paid profit sharing payments in reduced amounts when the 8% policy growth target had not been met. Id. at 23. Subsequently, Mr. Boyce admitted that in 2002, when growth was 4% — only half of the 8% growth target — he received a profit sharing payment, but in a reduced amount. Id. at 93.

After considering the GEICO document and the testimony of Mr. Boyce and the GEICO human resources officer, the bankruptcy court rejected Mr. Boyce's proffered testimony that "it seemed likely that [the profit sharing payment] was going to go way." Id. at 163. Instead, the bankruptcy court found, "the far stronger basis of prediction was the history leading up to the time the debtor filed and not the rumor mill that every institution is subject to which takes a more pessimistic view of things." Id. at 164. Accordingly, given the record before it, the bankruptcy court did not abuse its discretion when it found that Mr. Boyce should have reported his profit sharing payment in his bankruptcy schedules. ER at 163-64.

B. Mr. Boyce made substantial, unnecessary consumer purchases before and during his bankruptcy case

The purchase of consumer goods that a debtor does not need and could not reasonably afford is evidence of bad faith. Hageney, 422 B.R. at 262. This factor is particularly significant when the purchases occur at the expense of unsecured creditors, such as when a debtor incurs new secured debt prior to bankruptcy. Id.

For example, in Hageney, the bankruptcy court found that the debtors had acted in bad faith by purchasing a new motorcycle prior to filing for bankruptcy. Id. at 261. At the time, the debtors both had functional vehicles and were already experiencing difficulty meeting their monthly payment obligations. Id. at 261-62. The "purchase of this unnecessary luxury item merely worsened the debtors' insolvency and occurred at the expense of the debtors' unsecured creditors. Such a purchase must result in a determination of bad faith." Id. at 262.

Mr. Boyce has financial problems because of his spending habits. He incurred $17,000 in new, unsecured consumer credit card debt — doubling the total amount of credit card debt he was obligated to repay — in the year before filing for bankruptcy. Compare ER-S at 60 (listing approximately $16,000 in credit card debt) with id. at 20 (listing $35,229 in credit card debt).

Mr. Boyce also incurred unnecessary vehicle expenses. Mr. Boyce may take personal use of his brand new work vehicle, and GEICO would continue to pay all of the insurance and maintenance expenses. ER at 45; ER-S at 61. Yet, despite allegedly facing financial hardship, Mr. Boyce spent $2,000 on a down payment and incurred new monthly payments in the amount of $186, as well as insurance and maintenance expenses, to purchase a Ford F350 pickup truck. ER-S at 61.

After filing for bankruptcy, Mr. Boyce continued to purchase consumer goods he could not afford. In January 2009, two months after filing for bankruptcy, Mr. Boyce surrendered the Ford F350 pickup truck and borrowed $14,750 from his 401(k) account to purchase a Dodge Ram pickup truck from a friend in Wyoming. ER at 123; ER-S at 61. Mr. Boyce sold the Dodge Ram pickup truck in September 2009, alleging financial hardship, but then purchased a Chevrolet pickup truck. ER at 60. In addition, Mr. Boyce borrowed another $6,000 from his 401(k) account to purchase a towable recreational camper. ER at 138.

In total, Mr. Boyce has withdrawn approximately $38,000 from his 401(k) account to purchase consumer goods during the year before filing for bankruptcy and after obtaining the protection of chapter 7, but asserts that economic hardship prevented him from making a single payment on his $34,000 in student loans over the last five years. ER at 40-41.

Mr. Boyce's purchases were unnecessary and unaffordable under the state of facts Mr. Boyce swore to in his bankruptcy petition. Furthermore, Mr. Boyce financed these purchases using 401(k) loans that, in a chapter 13 bankruptcy, allow him to replenish his savings account rather than repay his unsecured creditors. <u>See infra</u> Part II.B. Like in <u>Hageney</u>, Mr. Boyce's purchases "merely worsened [his] insolvency and occurred at the expense of [his] unsecured creditors." Hageney, 422 at 262. Such purchases "must result in a determination of bad faith." Id.

C. The circumstances surrounding Mr. Boyce's filing indicate bad faith

Mr. Boyce attributes his need for bankruptcy relief to having his roommate move out in March or April 2008. ER at 86; ER-S at 61. But this explanation alone does not indicate a need for bankruptcy relief.

Mr. Boyce purchased his home in September 2007, the month before the stipulated judgment was entered in his divorce. ER-S at 60. Mr. Boyce applied for the loan solely using his own income, and his mortgage payment was approximately 21% of his gross annual income at the time he filed for bankruptcy. See ER at 89, 118; ER-S at 59. If the loss of a roommate alone caused Mr. Boyce to file for bankruptcy, then he purchased a home he knew he could not afford, which is indicative of bad faith. Mitchell, 357 B.R. at 155.

Furthermore, even under the most favorable projections, Mr. Boyce's lost income from having his roommate move out is nowhere close the amount of credit card debt that Mr. Boyce incurred in the year prior to filing for bankruptcy. Mr. Boyce received no rent for four months and $300 for three months. ER at 61; ER-

S at 60. At the time Mr. Boyce filed for bankruptcy, this left a $3,300 deficit against what he could have expected to receive if his original roommate had not left. Yet Mr. Boyce incurred $17,000 in new credit card debt around that period of time. Compare ER-S at 60 (listing approximately $16,000 in credit card debt) with id. at 20 (listing $35,229 in credit card debt).

There is no evidence of circumstances such as unexpected bills, unemployment, medical emergency, or some form of calamity justifying Mr. Boyce's increased spending and need for bankruptcy relief in the record. Mr. Boyce testified that he first contemplated filing for bankruptcy around March or April 2008 when his roommate moved out. ER at 86; ER-S at 61. But Mr. Boyce then waited around three months, until August 6, 2008, in order to obtain the credit counseling required to file for bankruptcy. ER at 87. Afterwards, Mr. Boyce waited almost three more months before filing for bankruptcy on October 28, 2008. ER-S at 1. Mr. Boyce's actions show that he was in no urgent need to obtain bankruptcy relief.

Mr. Boyce misrepresented his financial circumstances upon commencing his bankruptcy case and has taken advantage of his case in order to maintain his preferred lifestyle at the expense of his creditors. These are classic examples of bad faith behavior. See Mitchell, 357 B.R. at 142. Because the bankruptcy court carefully considered this evidence before rendering its decision, the court did not abuse its discretion when it found that Mr. Boyce acted in bad faith.

II. Alternatively, the bankruptcy court did not abuse its discretion when it dismissed Mr. Boyce's case under 11 U.S.C. § 707(b)(3)(B) based on his ability to repay his creditors

Under section 707(b)(3)(B), the bankruptcy court "shall consider . . . whether the totality of the circumstances . . . of the debtor's financial situation demonstrates abuse." § 707(b)(3)(B). There is no controlling law within the Ninth Circuit on what should be considered under section 707(b)(3)(B)'s totality of the financial circumstances test.

Courts within the Ninth Circuit have recognized that an ability to repay standing alone was sufficient to justify dismissal under the much higher, pre-BAPCPA, substantial abuse standard. See Price v. U.S. Trustee (In re Price), 353 F.3d 1135, 1140 (9th Cir. 2004) ("[A] debtor's ability to pay his debts will, standing alone, justify a section 707(b) dismissal.") (quoting Zolg v. Kelly (In re Kelly), 841 F.2d 908, 914 (9th Cir. 1988)). Because Congress has lowered the standard for dismissal to mere abuse, these courts agree that a debtor's ability to repay creditors remains sufficient to demonstrate abuse under the totality of the financial circumstances. See Reed v. Anderson (In re Reed), 422 B.R. 214, 220

(C.D. Cal. 2009) ("Section 707(b)(3)(B) . . . necessarily requires an examination of a debtors' ability to pay."); In re Stubblefield, 430 B.R. 639, 645 (Bankr. D. Or. 2010) (citing Price for the same).

A. Mr. Boyce has the actual ability to make substantial repayments to his creditors

The ability to pay analysis is based on the debtor's financial circumstances at the time of discharge, and is not limited to the facts present when the petition was filed. U.S. Trustee v. Cortez (In re Cortez), 457 F.3d 448, 455-56 (5th Cir. 2006). Thus, whether the debtor has an ability to repay his or her debts under section 707(b)(3)(B) is a question of fact that requires a bankruptcy court to scrutinize a debtor's actual income and expenses. Ross-Tousey v. Neary (In re Ross-Tousey), 549 F.3d 1148, 1162 (7th Cir. 2008). And in doing so, "courts may take into account both current and foreseeable circumstances." Morse v. Rudler (In re Rudler), 576 F.3d 37, 51 (1st Cir. 2009) (quoting In re Hartwick, 359 B.R. 16 (Bankr. D.N.H. 2007)); see In re Lamug, 403 B.R. 47, 54 (Bankr. N.D. Cal. 2009) (stating that a debtor's "actual current and future income and expenses, intentions, and resulting ability or inability to pay are crucial" to assessing the totality of the financial circumstances).

Bankruptcy courts within the Ninth Circuit, drawing upon the financial considerations under the pre-BAPCPA totality of the circumstances test, have considered a wide variety of factors when analyzing a debtor's actual income and expenses. See, e.g., Stubblefield, 430 B.R. at 645. These considerations may include:

The debtor's ability to reduce excessive or unreasonable expenses. Hageney, 422 B.R. at 263 (considering the debtors' ability to reduce their mortgage payments and surrender their luxury vehicles); Reed, 422 B.R. at 214 (considering the debtor's ability to reduce a $333 per month child care expense when one of the debtors was unemployed, living at home, and could not provide any reason why the expense was reasonable).

Future events or other mitigating factors that will affect the debtor's source of future income or actual expenses. Stubblefield, 430 B.R. at 646 (considering the debtor's expectation regarding future sales commissions and the stable earnings of the debtor's domestic partner).

And the debtor's ability to obtain relief through alternative measures. In re Maya, 374 B.R. 750, 754-55 (Bankr. S.D. Cal. 2007) (considering the debtor's eligibility for chapter 13 or chapter 11 bankruptcy); In re Baeza, 398 B.R. 692, 697-98 (Bankr. E.D. Cal. 2008) (considering the debtors' actual ability to repay creditors $479 per month, although they would not be required to pay anything through a chapter 13 repayment plan).

At trial, the United States Trustee produced documentary evidence and testimony demonstrating that Mr. Boyce would continue to receive profit sharing payments into the foreseeable future and had incurred unnecessary vehicle expenses. See supra Part I.A. The United States Trustee explained that, extrapolating from Mr. Boyce's current expenses and his 2009 profit sharing payment, Mr. Boyce could have an average of $778 per month to repay his creditors. ER-S at 55 (averaging the amount of spare income Mr. Boyce may have in a year when he can claim his child as a dependent and in a year when he can not).

The bankruptcy court agreed, finding that the "history leading up to the time the debtor filed" was "the far stronger basis" for predicting whether Mr. Boyce would receive his bonus. ER at 164. The court also found that Mr. Boyce's second vehicle was "an expense that could be foregone because of the existence of the free car." ER at 166.

This means Mr. Boyce could repay 100% of his unsecured debts after 47 months. See 11 U.S.C. § 1325(b)(4)(B) (allowing a chapter 13 repayment plan for a period under 5 years if it will repay the unsecured creditors in full).

B. The bankruptcy court appropriately considered the effects of Mr. Boyce’s 401(k) loan under the totality of the financial circumstances

Mr. Boyce states — without providing a citation to the record — that both the United States Trustee and the bankruptcy court acknowledge that he would not be required to pay anything to his unsecured creditors under a chapter 13 repayment plan because his 401(k) loan payments would reduce the amount of disposable income that he must commit to a chapter 13 repayment plan to almost zero. Appellant’s Br. at 4 (referring to 11 U.S.C. § 1322(f)). Therefore, he believes that he should be given chapter 7 bankruptcy relief. Appellant’s Br. at 14.

This is incorrect for two reasons. First, neither the United States Trustee nor the bankruptcy court stated that Mr. Boyce would not be required to pay anything in a chapter 13 bankruptcy. Second, the bankruptcy court considered the alternative form of chapter 13 relief within the totality of the circumstances and still found that dismissal, with the option of conversion to chapter 13, was appropriate because Mr. Boyce (1) was paying himself through his 401(k) loan payments while discharging the debts of his unsecured creditors, and (2) had the ability to repay his creditors under a chapter 13 repayment plan, even after taking his 401(k) loan payments into account.

A dismissal for abuse is not conditioned on whether a debtor would be required to pay his creditors through a chapter 13 plan. Under the totality of the financial circumstances test, "[t]he question before the court is not whether the Debtors would be required to pay anything to their unsecured creditors in a chapter 13, but rather, whether they have the ability to pay something substantial to their unsecured creditors." Baeza, 398 B.R. at 697. "Nothing in the text of section 707(b)(3)(B) requires the Court to anticipate what would happen if Debtors converted to chapter 13." Lamug, 403 B.R. at 57.

Mr. Boyce's 401(k) loan payments are "essentially a debt owed to himself — he has borrowed his own money." Egebjerg v. Anderson (In re Egebjerg), 574 F.3d 1045, 1049 (9th Cir. 2009). Should Mr. Boyce "fail to repay himself, the administrator has no personal recourse against him. Instead, the plan will deem the outstanding loan balance to be a distribution of funds, taxable as income, thereby reducing the amount available" to Mr. Boyce in the future. Egebjerg, 574 F.3d at 1049. For this reason, some courts have refused to consider the expense of 401(k) loan payments when determining abuse under the totality of the financial circumstances test. See Hilmes, 2010 WL 3292807, at *6 (holding that the debtor's 401(k) loan payments suggested abuse because the debtor "is essentially repaying herself while discharging her other debts"); In re Pandl, 407 B.R. 299, 302 (Bankr. S.D. Ohio 2009) (considering 401(k) loan repayments indicative of abuse because the debtor's decision to borrow from himself "should not insulate his actions to the prejudice of his creditors"); but see In re Latone, No. 08-3311, 2008 WL 5049460, at *2 (Bankr. D. Ariz. 2008) (finding that the debtor did not have an ability to repay because his monthly $1,483 401(k) loan payment could not be used to fund a chapter 13 repayment plan) (deciding prior to Egebjerg).

Here, in the year before filing for bankruptcy and afterwards, Mr. Boyce chose to withdraw roughly $22,000 from his 401(k) in order finance unnecessary recreational vehicles. ER at 137-18. Mr. Boyce also took out $16,010 from his 401(k) in order to purchase a house. ER-S at 60.

At trial, the court discussed with the parties the potential consequences of Mr. Boyce's 401(k) loans in a chapter 13 case. See ER at 143-62. Mr. Boyce argued that if he received no profit sharing, the dividend from a chapter 13 plan would only be $8 per month. Id. at 146. The United States Trustee disagreed, arguing that "[t]here needs to be some belt tightening . . . I think even with his 401(k) he could still - - there would still be money left over." Id. at 161.

The bankruptcy court agreed with the United States Trustee, stating it was "persuaded by the evidence presented that the debtor is capable of making some payment, whether under a chapter 13 plan or otherwise." Id. at 164. In addition, the court noted, “the second car may be an expense that could be foregone.” Id. at 166. And although the court was “not unmindful of the fact that there are tax consequences” associated with the failure to repay a 401(k) loan, it was not appropriate for Mr. Boyce “to effectively subordinate every other creditor to the 401(k) loan.” Id. at 165; see Pandl, 407 B.R. at 302 (stating that a debtor’s 401(k) loan payments “should not insulate his actions to the prejudice of his creditors”).

The bankruptcy court carefully considered the evidence and testimony offered by both parties at trial, and reviewed the exhibits and Mr. Boyce’s bankruptcy schedules before rendering its opinion. Id. at 163. Accordingly, the court did not abuse its discretion by finding “that the debtor is capable of making some payment, whether under a Chapter 13 plan or otherwise, to his creditors and that under the totality of these circumstances . . . it would be an abuse . . . to allow the case to go forward.” Id. at 164.

III. Mr. Boyce’s “current monthly income” under 11 U.S.C. § 707(b)(2) is irrelevant to dismissal under 11 U.S.C. § 707(b)(3)

Mr. Boyce states that the issue in this case concerns the standard for calculating current monthly income (“CMI”), a phrase defined by section 101(10A) of the Bankruptcy Code as “the average monthly income from all sources that the debtor receives . . . without regard to whether such income is taxable income, derived during the 6-month period" prior to the debtor's commencement of the bankruptcy case. 11 U.S.C. § 101(10A). He argues that, because his income under section 707(b)(2) is calculated using CMI, his income under section 707(b)(3) should be calculated the same way. Appellant's Br. at 8-9; 10-14. This position lacks a valid basis in the statute, and the courts that have considered the issue agree with the United States Trustee that CMI is irrelevant when deciding if a case should be dismissed under section 707(b)(3).

A. Bankruptcy courts are not required to consider only a debtor's "current monthly income" under section 707(b)(3)

Section 707(b)(2) contains the means test. The means test reduces a debtor's CMI by an amount of statutorily defined expenses in order to determine if a debtor's bankruptcy case is presumptively abusive. § 707(b)(2)(A)(I). If the means test indicates that the case is abusive, then the court may dismiss the case. § 707(b)(1).

If the means test does not indicate abuse, then "the court shall consider (A) whether the debtor filed the petition in bad faith; or (B) the totality of the circumstances . . . of the debtor's financial situation." § 707(b)(3). This means that the United States Trustee "can still request dismissal . . . under section

707(b)(3)." Ross-Tousey, 549 F.3d at1161-62; see Rudler, 576 F.3d at 51 ("[S]ection 707(b)(3) . . . remains a backup option when the Trustee is dissatisfied by the results of the means test."). In particular, section 707(b)(3)(B)'s totality of the financial circumstances test involves a broad inquiry into the financial affairs and the neediness of the debtor. This includes the debtor's actual income and expenses, which are separate from the "inflexible and divorced" income and expense figures that are utilized under the means test. Rudler, 576 F.3d at 51.

Had Congress wanted bankruptcy courts to rely upon "current monthly income" under section 707(b)(3), it could have required so. It did not, and for a good reason. The purpose of BAPCPA is to make "more funds available for the payment of unsecured creditors." See Schultz v. United States, 529 F.3d 343, 347 (6th Cir. 2008). Congress enacted the means test to provide an "easily applied formula for determining" when a case is abusive. In re Henebury, 361 B.R. 595, 603 (Bankr. S.D. Fla. 2007). In contrast, Congress enacted section 707(b)(3) in order to clarify that a debtor's case could be separately dismissed for either bad faith or lack of need. In re Srikantia, 417 B.R. 505, 508-09 (Bankr. N.D. Ohio 2009); see H.R. Rep. 109-31 (2005) at 12, *reprinted in* 2005 U.S.C.C.A.N. 88, 92 ("The standard for dismissal — substantial abuse — is inherently vague, which has lead to its disparate interpretation and application by the bankruptcy bench.").

Accordingly, sections 707(b)(2) and 707(b)(3) serve entirely different purposes. Section 707(b)(2) is a uniform "screening mechanism" that allows bankruptcy courts to dismiss a case for abuse when an objective set of criteria has been met. See H.R. Rep. 109-31 at 2, 12. In contrast, section 707(b)(3) is an individualized test that requires the courts to adjudicate the merits of granting the debtor chapter 7 relief. See Reed, 422 B.R. at 233.

The United States District Court for the Northern District of Texas recently confronted and rejected an argument similar to the one Mr. Boyce now raises. In Hilmes, the debtor argued that her income, for the purpose of assessing abuse, should be determined using her "disposable income" as calculated under the means test. 2010 WL 3292807, at *7.

The Hilmes court rejected this argument. "[A]s is clear by the section's language and structure, the means test of section 707(b)(2) and dismissal for abuse under section 707(b)(3) are separate analyses." Id. The district court described the debtor's argument as "simply nonsensical." Id. at *10. "A court's analysis under section 707(b)(3)(B) is not so limited . . . courts have recognized that the section allows for consideration of the debtor's actual income and expenses, notwithstanding what is considered under the means test." Id.; see In re Booker, 399 B.R. 662, 666 (Bankr. W.D. Mo. 2009) (holding that a court's section

707(b)(3)(B) analysis is not "bound by the itemization of expenses which the debtors are entitled to deduct from that current monthly income pursuant to section 707(b)(2)"); accord Ross-Tousey, 549 F.3d at1161-62; Rudler, 576 F.3d at 51.

Accordingly, there is no support in the text of the statute for applying CMI to section 707(b)(3). Mr. Boyce's arguments — that CMI should apply under section 707(b)(3), Appellant's Br. at 7-9; and that the means test and the ability to pay standard duplicate each other, id. at 11-14 — are therefore incorrect.

B. The Supreme Court's recent decision in Hamilton v. Lanning does not apply to this case

Mr. Boyce relies upon the Supreme Court's recent decision in Hamilton v. Lanning for his argument that the bankruptcy court applied the wrong standard when the court took his future profit sharing payments into consideration. Appellant's Br. at 8-9 (citing Hamilton v. Lanning, 130 S. Ct. 2464 (2010)). This reliance is unjustified.

The decision in Lanning concerns the definition of the phrase "projected disposable income" under 11 U.S.C. § 1325(b), which requires a chapter 13 debtor to commit all projected disposable income to unsecured creditors in a repayment plan. Although the Bankruptcy Code does not define projected disposable income, it does define the phrase "disposable income," which in turn looks to a debtor's

CMI as defined by section 101(10A). Lanning, 130 S. Ct. at 2469. In Lanning, the chapter 13 debtor had received a one time severance payout during the 6-month CMI period, but the debtor's income from her new job was insufficient to make the payments required under section 1325(b) based on her CMI. Id. at 2470.

The Supreme Court held that a bankruptcy court could deviate from CMI when projecting disposable income for the purpose of confirming a chapter 13 repayment plan under section 1325(b), but only in rare circumstances to account for changes "that are known or virtually certain at the time of confirmation." Id. at 2475-76. This prevented "senseless results that we do not think Congress intended," such as when the debtor's actual income is substantially higher or lower than CMI during the repayment period. Id.

Lanning is inapplicable because, in contrast to sections 1325(b) or 707(b)(2), section 707(b)(3)(B) never refers to projected disposable income, disposable income, CMI, section 101(10A), or any other language that could indicate congressional intent to restrict the scope of the court's analysis. See § 707(b)(3)(B). Instead, section 707(b)(3)(B) refers to the totality of the financial circumstances, which includes the debtor's actual income. See supra Part II. Mr. Boyce's attempt to utilize Lanning is inapposite.

If anything, Lanning undermines Mr. Boyce's argument that he would not be required to fund a viable chapter 13 plan and is therefore in greater need of chapter 7 relief under the totality of the financial circumstances. If Mr. Boyce chose to convert his case to one chapter 13, the bankruptcy court could adjust Mr. Boyce's payment obligation under a chapter 13 repayment plan to reflect the post-petition changes in his income. Lanning, 130 S. Ct. at 2475-76. This would allow the court to establish a payment obligation accounting for the profit sharing payments that Mr. Boyce received in 2009 and 2010, which occurred while the chapter 7 proceedings were pending. ER at 63.

CONCLUSION

For these reasons, the United States Trustee respectfully asks this Court to affirm the order entered below.

Dated: September 7, 2010

Respectfully submitted,

RAMONA D. ELLIOTT
General Counsel

P. MATTHEW SUTKO
Associate General Counsel

NOAH M. SCHOTTENSTEIN
Trial Attorney

United States Department of Justice
20 Massachusetts Avenue, N.W.
Washington, D.C. 20530

ROBERT D. MILLER, JR.
United States Trustee for Region 18

PAMELA J. GRIFFITH
Assistant United States Trustee

By: /s/ P. Rebecca Kamitsuka
P. Rebecca Kamitsuka, OSB # 93326
Trial Attorney

United States Department of Justice
405 E. 8th Avenue, Suite 1100
Eugene, Oregon 97401-2706
Telephone: (541) 465-6330

BRIEF BANK — 'SUMMARY SHEET" *Printed Fri-11/16/07 13:40*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]* — In re Bresnick (Bresnick v. UST)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]* — E.D.N.Y

3. ("CCN") ***CURRENT*** CASE NO. — No.: 07 Civ 3368

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]* — No.: 1-07-41580

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(Identify judge & cite, if any)

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(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC*** — **BANKRUPTCY**

9. ("SU") ● ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***

●Whether the Bankruptcy court abused it's discretion by finding that the UST established caused for the appointment of a Chapter 11 Trustee, based upon evidence properly admitted without objection from Bresnick?

√ **Background:**

10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)

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DATE:

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF NEW YORK

In re LARRY BRESNICK, Debtor

LARRY BRESNICK,
Appellant

v.

UNITED STATES TRUSTEE FOR REGION 2,
Appellee

On Appeal from the United States Bankruptcy Court
for the Eastern District of New York, Brooklyn Division
No. 07 Civ. 3368 (ILG)

BRIEF OF APPELLEE UNITED STATES TRUSTEE FOR REGION 2

Of Counsel:

Valerie Millman
Trial Attorney
Office of the United States Trustee
271 Cadman Plaza East, Suite 4529
Brooklyn, New York 11201
(718) 422-4960
Valerie.Millman@usdoj.gov

ATTORNEYS FOR APPELLEE
DIANA G. ADAMS,
U.S. TRUSTEE
FOR REGION 2

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<u>Legislative History</u>

PRELIMINARY STATEMENT

The Appellant Larry Bresnick ("Bresnick") appeals an order of the United States Bankruptcy Court for the Eastern District of New York (the "Bankruptcy Court"), entered on June 26, 2007, granting the United States Trustee's motion to appoint a Chapter 11 trustee in Bresnick's Chapter 11 case. Larry Bresnick, Case No. 07-41580 (CEC) (Bankr. E.D.N.Y. June 26, 2007). Bresnick Designation, No. 7. The Order should be affirmed by this Court. This brief is respectfully submitted by the United States Trustee in support of the Order.[1]

STATEMENT OF THE ISSUE

Whether the bankruptcy court abused its discretion by finding that the United States Trustee established cause for the appointment of a Chapter 11 trustee, based upon evidence properly admitted without objection from Bresnick, which established that: (i) Bresnick's bankruptcy schedules and statement of financial affairs contained material omissions, (ii) Bresnick was guilty of gross mismanagement, (iii) Bresnick failed to properly report his post-petition income, (iv) Bresnick failed to provide proof that he closed his pre-petition bank accounts, and (v) Bresnick could not account for large sums of monies he received prior to filing his Chapter 11 petition?

SUMMARY OF ARGUMENT

The bankruptcy court did not abuse its discretion when it found that cause existed for the appointment of a Chapter 11 trustee, based on Bresnick's failure to disclose assets and Bresnick's gross mismanagement of his operations. Bresnick's material omissions from his schedules and

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[1] Pursuant to 11 U.S.C. § 307, the United States Trustee may raise and may appear and be heard on any issue in any case or proceeding under the Bankruptcy Code.

his gross mismanagement, each constitute separate grounds for the appointment of a Chapter 11 trustee.

Bresnick omitted significant assets from his bankruptcy schedules. Disclosures in Bresnick's divorce case, made ten days prior to his bankruptcy filing, revealed that Bresnick failed to disclose, on his bankruptcy schedules, bank accounts, stock accounts, business interests, luxury automobiles, and other items with an estimated aggregate value in excess of $500,000.00.

Bresnick grossly mismanaged his operations and this gross mismanagement continued post-petition. He received significant sums of money within the two year period prior to filing for bankruptcy, yet claimed to have less than $30,000.00 in his bank accounts, in April 2007. He could not account for the dissipation of certain funds he received from sales of real estate and his bank records evidenced that he routinely ignored corporate formalities by co-mingling his personal assets with his corporate assets.

Subsequent to the filing of his bankruptcy case, Bresnick failed to accurately report his post-petition income in his first monthly operating report, failed to operate solely out of a debtor-in-possession account, and failed to provide proof to the United States Trustee that he closed his pre-petition bank accounts.

The bankruptcy court properly directed the appointment of a Chapter 11 trustee. At the evidentiary hearing, Bresnick did not offer any testimony in opposition to the United States Trustee's motion. The bankruptcy court, after reviewing the evidence, found that the United States Trustee had established "cause" for the appointment of a Chapter 11 trustee. The Order should be affirmed.

APPLICABLE STANDARD OF REVIEW

An order directing the appointment of a Chapter 11 trustee is a final order from which an appeal will lie. Silverman v. Tracar (In re American Preferred Prescription, Inc.), 255 F.3d 87, 92 (2d Cir. 2001) (dicta) (citing Cajun Elec. Power Coop., Inc. v. Central La. Elec. Co. (In re Cajun Elec. Power Coop., Inc.), 69 F.3d 746, 747-48 (5th Cir. 1995)).

In connection with appeals from a bankruptcy court, a district court reviews a bankruptcy court's conclusions of law de novo. Findings of fact made by a bankruptcy court may not be set aside unless clearly erroneous. See Fed. R. Bankr. P. 8013; Casse v. Key Bank Nat'l Ass'n (In re Robert E. Casse), 198 F.3d 327, 332 (2d Cir.1999) (bankruptcy court's factual findings will be accepted unless clearly erroneous); Gulf States Exploration Co. v. Manville Prods. Corp. (In re Manville Prods. Corp.), 896 F.2d 1384, 1388 (2d Cir. 1990). This deferential standard applies not only to credibility assessments but also to interpretations deriving from "physical or documentary evidence or inferences from other facts." Anderson v. City of Bessamer City, 470 U.S. 564, 574 (1985). A reviewing court may not "reverse the findings of the trier of fact simply because it is convinced that it would have decided the case differently." Anderson, 470 U.S. at 573 (1985). Given the wide discretion afforded the bankruptcy court, a decision should not be set aside "by a reviewing court unless it has a definite and firm conviction that the court below committed a clear error of judgment in the conclusion it reached upon a weighing of the relevant factors." G.M. v. New Britain Bd. of Educ., 173 F.3d 77, 80 (2d Cir.1999). In a frequently cited passage, the Seventh Circuit explained, "[t]o be clearly erroneous, a decision must strike us as more than just maybe or probably wrong; it must . . . strike us as wrong with the force of a five-week-old, unrefrigerated dead fish." Parts & Elec. Motors, Inc. v. Sterling Elec., Inc., 866 F.2d 228, 233 (7th Cir. 1988)

A bankruptcy court's ultimate determination to appoint a Chapter 11 trustee is reviewed for abuse of discretion. In re Sharon Steel Corp., 871 F.2d 1217, 1225 (3d Cir.1989) (appointment of trustee reviewed under abuse of discretion standard); In re Owen, 96 B.R. 427, 428 (N.D.N.Y. 1989) (abuse of discretion standard governs review of appointment of trustee).

STATEMENT OF FACTS

A. Statutory Framework

1. Authority to Remain as a Debtor-in-Possession

When a debtor files for bankruptcy under Chapter 11, see 11 U.S.C. § 1101, et seq., all of its assets are transferred to a new legal entity: the estate. See 11 U.S.C. 541(a). In re Bell, 225 F.3d 203, 215 (2d Cir. 2000). At that time, the debtor becomes the "debtor-in-possession" and is responsible for administering the estate. See 11 U.S.C. § 1107(a).

Affirmative disclosure by a debtor-in-possession is required because it protects the integrity of the bankruptcy process. Rosenshein v. Kleban, 918 F.Supp. 98, 104 (S.D.N.Y. 1996). A debtor-in-possession has an affirmative duty under section 521(a)(1) of the Bankruptcy Code to file schedules disclosing all assets and liabilities. In re Costello, 255 B.R. 110, 113 (Bankr.E.D.N.Y. 2000); 11 U.S.C. §1106(a)(2). A debtor-in-possession must also file monthly operating reports with the bankruptcy court. See, 11 U.S.C. §704(8) (made applicable by 11 U.S.C. §1106(a)(1); E.D.N.Y. Loc. R. 2015-1; 28 U.S.C. §586(a)(3)(D) (authorizing the United States Trustee to take action to ensure that all reports required under Title 11 are timely filed). In order to comply with its supervisory role (discussed below) under 28 U.S.C. §586(a), the United

States Trustee for each region has established Operating Guidelines and Reporting Requirements for Chapter 11 debtors and trustees. These guidelines require a debtor to close its pre-petition bank accounts and open new debtor-in-possession accounts.

The debtor, as a "debtor-in-possession," serves as a fiduciary to the creditors of the estate. Wolf v. Weinstein, 372 U.S. 633, 649-650 (1963). In that fiduciary role, the debtor must "refrain from acting in a manner which could damage the estate, or hinder a successful reorganization." In re Northwest Airlines Corp., 483 F.3d 160, 181 (2d Cir. 2007) (quoting In re Ionosphere Clubs, Inc., 113 B.R. 164, 169 (Bankr. S.D.N.Y.1990)). Full disclosure by a debtor-in-possession is of prime importance in a reorganization case. In re Momentum Mfg. Corp., 25 F.3d 1132, 1136 (2d Cir. 1994). "Open, honest and straightforward disclosure to the Court and creditors is intrinsic to the entire reorganization process and begins on day one, with the filing of the Chapter 11 petition." In re V. Savino Oil & Heating Co., 99 B.R. 518, 526 (Bankr. E.D.N.Y.1989). In addition, the debtor has an obligation to "protect and conserve property in its possession for the benefit of creditors." Ionosphere Clubs, 113 B.R. at 169.

Although the Bankruptcy Code provides the debtor with this opportunity to operate the bankruptcy estate, section 1104(a) of the Bankruptcy Code states that the debtor should be replaced by a Chapter 11 trustee in certain circumstances. "Section 1104 represents a protection that the Court should not lightly disregard or encumber with overly protective attitudes towards debtors-in-possession". Savino Oil, 99 B.R. at 525. Under section 1104, "[a]t any time after the commencement of the case but before confirmation of a plan, on request of a party in interest or the United States Trustee, and after notice and a hearing, the [bankruptcy] court shall order the appointment of a trustee":

> (1) for cause, including fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor by current management, either before or after the commencement of the case, or similar cause, but not including the number of holders of securities of the debtor or the amount of assets or liabilities of the debtor;
>
> (2) if such appointment is in the interests of creditors, any equity security holders, and other interests of the estate, without regard to the number of holders of securities of the debtor or the amount of assets or liabilities of the debtor.

11 U.S.C. § 1104(a).

If the bankruptcy court concludes that either of the above standards has been satisfied, the court is required to direct the United States Trustee to appoint, subject to the court's approval, a"disinterested person" to serve as the Chapter 11 trustee. 11 U.S.C. § 1104(d). In re Kashani, 190 B.R. 875, 883, n.8 (9th Cir. BAP 1995)

2. The United States Trustee's Role in Trustee Motions

Congress assigned the United States Trustee broad oversight responsibilities over bankruptcy cases. 28 U.S.C. § 586 (defining the United States Trustee's responsibilities). The United States Trustee for Region 2 is a senior official of the Department of Justice appointed by the Attorney General. 28 U.S.C. § 581(a)(2). She acts as the "watchdog" of the bankruptcy system and may be "compared . . . to a prosecutor" for cases that arise under Title 11 of the Bankruptcy Code. H.R. Rep. No. 95-595, at 109 (1977), as reprinted in 1978 U.S.C.C.A.N. 5963, 6049 (using "watchdog" analogy); 6071 (using "prosecutor" analogy). Within this district, the United States Trustee "supervise[s] the administration of cases under chapter 7, 11, 12, 13, or 15 of title 11." 28 U.S.C. § 581(a)(2) and 586(a)(3)(A). Therefore, the United States Trustee, as a party in interest, had standing to seek the appointment of a Chapter 11 trustee under section

1104 of the Bankruptcy Code. 11 U.S.C. § 1104 (providing that the United States Trustee may request the appointment of a Chapter 11 trustee).

B. Bresnick's Bankruptcy Filing

On March 30, 2007, Bresnick filed a voluntary petition for bankruptcy under Chapter 11. (Bankr. Case No. 07-41580), ECF Docket Entry No. 1. Bresnick's schedules and statement of financial affairs were filed on April 19, 2007. UST Designation, No. 1, ECF Docket Entry Nos. 14-17. Bresnick signed his schedules and statement of financial affairs, under penalty of perjury, attesting to the truth and accuracy of the information contained therein. UST Designation No. 1, ECF Docket Entry Nos. 14-17.

C. Bresnick's Divorce Proceedings

At the time he filed for bankruptcy, Bresnick's wife was suing him for divorce in Palm Beach County, Florida. UST Designation No. 1, Statement of Financial Affairs, Question 4, ECF Docket Entry No. 16. Bresnick filed several pleadings in the divorce action shortly before he filed his Chapter 11 petition. UST Designation Nos. 2-4.

Ten days prior to filing his Chapter 11 petition, Bresnick filed a second amended financial affidavit. UST Designation No. 2. Nine days prior to filing his Chapter 11 petition, Bresnick completed his responses to various interrogatories. UST Designation No. 3. Bresnick attested to the truth and accuracy of the information contained in both the interrogatories and the divorce financial affidavit. UST Designation Nos. 2 & 3. Approximately one month after he filed his bankruptcy case, Bresnick served a notice of detailed compliance with his wife's Request to Produce in the divorce proceeding. Bresnick's divorce financial affidavit, interrogatories and response to notice to produce provide a detailed picture of Bresnick's financial condition at the time he commenced his Chapter 11 case.

During the course of the divorce proceeding, on October 20, 2005, Circuit Judge William J. Berger entered an order enjoining Bresnick, or any business entities owned by him, from transferring assets located in two bank accounts. UST Designation No. 6, ¶1; Bresnick Designation No. 4, at 3, ¶10. On March 19, 2007, Bresnick served an affidavit in response to his wife's motion to disgorge funds, setting forth that he transferred monies out of his accounts, prior to learning about the injunction. UST Designation No. 6, ¶10. Bresnick transferred these funds to his attorneys' IOLA account. UST Designation No. 6, ¶10, Exhibit F.

D. Bresnick's Failure to Disclose Assets and Other Information

Although Bresnick's second financial affidavit in the divorce case was filed only ten days prior to the commencement of his bankruptcy case, the schedules and statements filed in Bresnick's bankruptcy case failed to disclose certain assets, claims, and other relevant information that was contained in the divorce financial affidavit.

1. Undisclosed Bank Accounts

A debtor is required to list any interest in checking, savings, or other financial accounts on his schedules. UST Designation No. 1, Schedule "B", Question 2. When he filed his bankruptcy schedules, Bresnick attested, under oath, that he had six bank accounts. The amounts in each of the bank accounts were left blank. There is a notation on the side of the page that indicates "Larry to furnish amounts." UST Designation No. 1, Schedule "B", Question 2 (ECF Docket Entry No. 15).

Although Bresnick swore in his bankruptcy schedules that he had only six bank accounts, Bresnick's divorce financial affidavit, attested to under oath, set forth that he had an interest in eighteen bank accounts, with an aggregate value of $241,423.00. UST Designation No. 2, Schedule "A". Bresnick claimed that four accounts were titled in the name of his wife, one account was a joint account, and thirteen accounts were titled in his name. UST Designation No. 2, Schedule "A".

In response to the United States Trustee's motion to appoint a trustee, Bresnick's matrimonial accountant asserted that the undisclosed bank accounts were not titled in Bresnick's name or the name of his corporations. Bresnick Designation No. 4, at 1, ¶A (ECF Docket Entry No. 49). He further alleged that the divorce financial affidavit reflected assets and liabilities to which Bresnick may not have title, but in which Bresnick alleged an interest because the asset was construed to be marital in nature. Bresnick Designation No. 4, at 1 (ECF Docket Entry No. 49)

A debtor is required to list any interest in alimony, maintenance, support or other property to which a debtor <u>may</u> be entitled. UST Designation No. 1, Schedule "B", Question 17. Additionally, a debtor must list any interest in other personal property that is not already set forth on Schedule "B". UST Designation No. 1, Schedule "B", Question 17. Bresnick did not disclose his interest in the alleged marital accounts in response to either question "17" or "34" on his bankruptcy petition. UST Designation No. 1, Schedule "B", Questions 17 & 34.

2. <u>Undisclosed Stock Interests</u>

A debtor is required to disclose all interests he has in stocks and all interests he has in incorporated and unincorporated businesses. UST Designation No. 1, Schedule "B", Question 13.

When he filed his bankruptcy schedules, Bresnick attested, under oath, that his only stock interests were his interests in the twelve corporations set forth on the schedule attached to his Schedule "B". UST Designation No. 1, Schedule "B", Question 13.

a. Additional Stock Interests

Although Bresnick swore in his bankruptcy schedules that he only had an interest in twelve corporations, his divorce financial affidavit, attested to under oath, revealed that he claimed an interest in sixteen corporations. UST Designation No. 2, Schedule B.

Bresnick's interrogatories reflect that Bresnick claimed a fifty percent interest in an Equity Membership at Boca Raton Resort & Hotel, with a fair market value of $45,000.00. This interest was not disclosed on Schedule "B" of Bresnick's bankruptcy petition. UST Designation No. 3, Question 5(b), UST Designation No. 1, Schedule "B", Question 13.

In response to the United States Trustee's motion to appoint a trustee, Bresnick's accountant asserted that the undisclosed stock interests were titled in his wife's name. Bresnick Designation No. 4., at 1, ¶B,C, at 2, ¶8(c-1&2) (ECF Docket Entry No. 49). Despite the fact that his interrogatories were signed under oath nine days prior to filing his bankruptcy petition, Bresnick claimed to be uncertain about any equity membership at the Boca Raton Resort and Hotel. Bresnick Designation No. 4., at 2, ¶8(c-4) (ECF Docket Entry No. 49).

Although Bresnick asserted an interest in these assets in the divorce proceeding, Bresnick did not disclose the existence of these alleged marital assets in response to either question "17" or "34" on Schedule "B" of his bankruptcy schedules. UST Designation No. 1, Schedule "B".

b. Dormant Corporations

Bresnick's divorce financial affidavit, attested to under oath, contained a schedule of nine (9) dormant corporations in which Bresnick still maintained an interest. UST Designation No. 2, Schedule C. Bresnick failed to list his interest in the dormant corporations on his bankruptcy schedules. UST Designation No. 1, Schedule "B", Question 13. Bresnick's ownership interest in these corporations was not contested. Bresnick Designation No. 4, at 2, ¶8(c)-3) (ECF Docket Entry No. 49).

c. Ameritrade Account

In the divorce proceeding, Bresnick claimed an interest in his wife's Ameritrade account, with a fair market value of $514,923.00, and his wife's Charles Schwab Account, with a fair market value of $83,917.00. UST Designation No. 2, Section IIIA. Neither of these accounts was listed in response to Question "2" (bank accounts), "13" (stock interests) or "17" (marital interests) on Schedule B of Bresnick's bankruptcy schedules. UST Designation No. 1, Schedule B.

3. Undisclosed Contingent and Unliquidated Claims

A debtor is required to disclose any contingent or unliquidated claims of every nature, including tax refunds, counterclaims of the debtor, and rights to setoff. UST Designation No. 1, Schedule B, Question 21. When he filed his schedules under oath, Bresnick claimed he had no contingent or unliquidated claims. UST Designation No. 1, Schedule B, Question 21.

Bresnick's disclosures in his divorce proceedings revealed that he was owed money by "Husband's Enterprise "A" - $480,000 Face Value, 6% Convertible Notes". UST Designation No. 2, Section IIIA.

4. Undisclosed Interests in Automobiles

A debtor is required to disclose all interests in automobiles. UST Designation No. 1, Schedule B, Question 17. When he filed his schedules under oath, Bresnick claimed an interest in only one automobile - a 2006 GMAC Truck with a fair market value of $23,750.00. UST Designation No. 1, Schedule B, Question 17.

Despite disclosing only one automobile in his bankruptcy schedules, Bresnick's divorce financial affidavit, attested to under oath, reflects that he also has an interest in two Mercury Mountaineers. UST Designation No. 2, Section IIIA. Although Bresnick leases one Mercury Mountaineer, this lease was not listed on Schedule G of his bankruptcy petition. UST Designation No. 11, UST Designation No. 1, Schedule G. Bresnick asserted that the second Mercury Mountaineer was totaled. UST Designation No. 3, Question 5(b); Bresnick Designation No. 4., at 3, ¶8(e) (ECF Docket Entry No. 49). However, Bresnick's loss of the second Mercury Mountaineer is not reflected in response to Question 8 of his Statement of Financial Affairs, which requires such disclosure. UST Designation No. 1, Statement of Financial Affairs, ¶8.

In the divorce proceedings, Bresnick also claimed to have a fifty (50%) percent interest in a 2001 Jaguar, with a fair market value of $19,350.00, and a fifty percent interest in a 2007 Lexus SUV, with an unknown fair market value. UST Designation No. 3, Question 5(b). Bresnick did not disclose the existence of these alleged marital assets in response to either line "17" or "34" on Schedule "B" of his bankruptcy petition.

5. Failure to Disclose Property Transfers

A debtor is required to disclose all property transfers within the two year period prior to the bankruptcy filing. UST Designation No. 1, Statement of Financial Affairs, ¶10. On his

Statement of Financial Affairs, Bresnick attested, under oath, that he had made no transfers within the two year period prior to the commencement of his case. UST Designation No. 1, Statement of Financial Affairs, ¶10.

Bresnick's divorce financial affidavit again conflicts with his statement of financial affairs. In his divorce financial affidavit, Bresnick disclosed that he transferred his sixty-six percent interest in Red Star Technologies, Inc., to Louise Merritt (6%), Chelsea Ann Bresnick (20%), Tara Michelle Bresnick (20%), and Julie Allysa Bresnick (20%) in 2005. UST Designation No. 2, Schedule B; Bresnick Designation No. 4, at 3, ¶8(g) (ECF Docket Entry No. 49).

Bresnick's statement of financial affairs also fails to reflect Bresnick's transfer of $3,500,000.00 from his personal bank account to his attorneys' IOLA account in October 2005. UST Designation No. 6, Exhibit F.[2]

6. Failure to Disclose Safety Deposit Boxes

A debtor is required to disclose all safety deposit boxes in which a debtor had cash or other valuables within the one year period prior to the bankruptcy filing. UST Designation No. 1, Statement of Financial Affairs, ¶12. On his Statement of Financial Affairs, Bresnick attested, under oath, that he had no safety deposit boxes. UST Designation No. 1, Statement of Financial Affairs, ¶12.

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[2] The United States Trustee's motion asserted that Bresnick failed to list either the existence or loss of a boat. Bresnick Designation No. 1. In opposition to the motion, Bresnick's accountant claimed the boat was totaled in Hurricane Bonnie. Bresnick Designation No. 4, at ¶8(f). As reflected in the record, the United States Trustee's attorney was unable to verity the date of Hurricane Bonnie, and properly advised the bankruptcy court at the hearing. Bresnick Designation No. 6, at 46, lns 19-25. A review of the transcript reveals that The bankruptcy court did not consider the omission of the boat when rendering its decision. Bresnick Designation No. 6, at 97.

Bresnick's response to interrogatories in the divorce proceeding reflected that he had three safety deposit boxes at Richmond County Savings Bank, Valley National Bank, and Nation's Bank. UST Designation No. 3, Question 5j.

Bresnick's accountant asserted that the safety deposit boxes held property owned by his brother. Bresnick Designation No. 4, at 3, ¶8(h) (ECF Docket No. 49). However, Bresnick answered "none" in response to the question on his statement of financial affairs requiring disclosure of property held for another person. UST Designation No. 1, Statement of Financial Affairs, ¶14.

E. Bresnick's Pre-Petition Transfers of Funds

The uncontroverted evidence established that Bresnick could not account for substantial sums of money he received prior to filing bankruptcy.

1. Bresnick's Accounting for the $3,500,000.00

In opposition to his wife's motion to disgorge funds, Bresnick provided an accounting of the dissipation of the $3,500,000.00 that was transferred to Gaines & Fishler, LLP. UST Designation No. 6, Exhibit F.

Fourteen days after entry of the injunction, the sum of $2,208,021.00 was used to satisfy two mortgages on properties owned by Bresnick's companies (Seven Oaks at Howell and Kommit Associates at New Durham, LLC). Neither mortgage had matured. UST Designation No. 6, Schedule "E", Bresnick Designation No. 4 at 4 ¶14 (ECF Docket Entry No. 49).

The accounting reflects that between January 19, 2006, and June 1, 2006, Bresnick transferred the sum of $201,395.00 to himself, and expended the sum of $801,847.00 for various corporate expenses. UST Designation No. 6, Exhibit "F" (delineated as Schedule E), Bresnick Designation No. 4, at 4, ¶¶17, 18 (ECF Docket Entry No. 49).[3]

2. Bresnick's Accounting for Dissipation of $3,000,000

In opposition to his wife's motion to disgorge funds, Bresnick also provided an accounting of the $3,000,000.00 removed from his Certificate of Deposit Account at Richmond County Savings Bank in violation of the injunction. UST Designation No. 6, Exhibit D. The accounting provides explanations for five of the withdrawals. Bresnick was unable to account for withdrawals in the aggregate amount of $411,983.00. UST Designation No. 6, Exhibit D, Bresnick Designation No. 4, at 5, ¶19 (ECF Docket Entry No. 49). The accounting provides that $138,000.00 was transferred to Bresnick on October 21, 2005. UST Designation No. 6, Exhibit D, Bresnick Designation No. 4, at 5, ¶19(ECF Docket Entry No. 49).

3. Bresnick's Accounting for Dissipation of $2,000,000

In opposition to his wife's motion to disgorge funds, Bresnick also provided an accounting of the $2,000,000.00 removed from his Certificate of Deposit Account at Independence Community Bank. UST Designation No. 6, Exhibit "G". The accounting provides that $100,000.00 was transferred to Bresnick on October 28, 2005. UST Designation No. 6, Exhibit G.

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[3] The United States Trustee's motion asserted that Bresnick transferred sums to Red Star Technologies, LLC, despite the fact that he transferred his interest in that company in 2005. Bresnick Designation No. 1, at ¶16. It appears that Bresnick transferred his interest in Red Star Technologies, Inc., and not the LLC. UST Designation No. 2, Schedule B. This issue was clarified by the objecting creditors at the hearing, and a review of the transcript reveals that the bankruptcy court did not consider this transfer when rendering its decision. Bresnick Designation No. 6 at 84, lns. 2-14, 97, lns. 3-19.

4. Bresnick's Additional Accountings

Bresnick filed amended schedules and an amended statement of financial affairs on June 24, 2007. UST Designation No. 12. Annexed to the statement of financial affairs, was an exhibit (delineated as "Exhibit Three") which provided an accounting of approximately $6.8 million that Bresnick received from the sale of real property in June 2005.[4] UST Designation No. 12. Bresnick did not account for $246,000.00 in disbursements made to him from the account. UST Designation No. 12; Bresnick Designation No. 4, Exhibit Three (ECF Docket Entry No. 51).

A second exhibit, designated as "Schedule II," reflects that between August 17, 2005 and June 1, 2006, transfers in the aggregate amount of $917,086.00 were made directly to Bresnick. Bresnick Designation No. 4, Schedule II (ECF Docket Entry No. 51); UST Designation No. 12. Despite receiving in excess of $900,000.00 within the one and one-half year period prior to filing his bankruptcy case, Bresnick's amended schedules reflected that as of April 22, 2007, he had only between $25,000 and $30,000 in his bank accounts. UST Designation No. 12, Schedule B. The schedule, which provides an accounting of funds, reflects that Bresnick did not account for $709,928.70. UST Designation No. 12.

F. Bresnick's Co-Mingling of Assets

Bresnick admitted co-mingling his personal and business assets and ignoring corporate formalities. Bresnick Designation No. 4, at 1, ¶F (ECF Docket Entry No. 49). All funds, whether corporate or personal, were co-mingled in Bresnick's individual bank account, and

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[4] This exhibit was also included as an attachment to the affidavit filed by Bresnick's accountant in opposition to the motion to appoint a trustee. Bresnick Designation No. 4, Exhibit Three (ECF Docket Entry No. 51).

Bresnick admitted using his personal accounts to pay business obligations. UST Designation No. 6, ¶6, and Exhibits "D" and "G" thereto.

G. Bresnick's Failure to Comply with Debtor-in-Possession Duties

Bresnick filed an operating report on May 23, 2007, which reflected income received and disbursements made for the period March 30, 2007 through May 22, 2007. UST Designation No. 7. Bresnick received a paycheck on April 13, 2007, in the net amount of $2,377.67. UST Designation No. 8. Although he was required to disclose all income he received during the reporting period, Bresnick's operating report did not reflect the monies he received on April 13th. UST Designation No. 7. Additionally, in violation of the United States Trustee's operating guidelines, Bresnick made deposits into a non debtor-in-possession account in April 2007. UST Designation No. 9.

Bresnick also failed to provide the United States Trustee with proof that he closed his pre-petition bank accounts. UST Designation No. 10. This fact was not contested. Bresnick Designation No. 6, at pgs. 61-63. When Bresnick filed amended schedules, the balances set forth in his bank accounts were dated as of April 22, 2007, three weeks after Bresnick filed his case. UST Designation No. 12, Schedule B.

H. The United States Trustee's Motion to Appoint a Trustee

Due to the vast omissions in Bresnick's schedules, his inability to account for funds, and his failure to comply with his duties as a debtor-in-possession, the United States Trustee filed a motion for the appointment of a Chapter 11 trustee. Bresnick Designation No. 1. On June 25, 2007, the Honorable Carla E. Craig, Chief United States Bankruptcy Judge for the Eastern District of New York, held a hearing on the United States Trustee's motion seeking the appointment of a Chapter 11 trustee, under section 1104(a)(1) or 1104(a)(2) of the Bankruptcy Code. Bresnick Designation No. 1 (ECF Docket No. 34).

The bankruptcy court concluded based on its review of all the documents, evidence, and argument presented, that cause existed for the appointment of a Chapter 11 trustee under section 1104(a) of the Bankruptcy Code. Bresnick Designation No. 6, at 97-98. The bankruptcy court specifically found:

> In short, I think the presentation from the United States Trustee's Office shows a failure to adequately disclose and account for the debtor's business activities that reflects I think by necessity incompetence or gross mismanagement or possibly dishonesty, but at least at the minimum incompetence and gross mismanagement.

Bresnick Designation No. 6, at 97, lns. 14-19.

The bankruptcy court, in a proper exercise of its discretion, granted the United States Trustee's motion directing the appointment of a Chapter 11 trustee.

Although Bresnick now disputes the admissibility of certain of the evidence relied on by the bankruptcy court, the documents relied upon by the United States Trustee were admitted at the hearing without objection. Bresnick's Brief, at 5, n.2, at 7; Bresnick Designation No. 6, at pg. 21. Although he questions the authenticity of the documents in the opening section of his brief, Bresnick concedes at the conclusion of his brief that the subject documents were admitted "without objection". Bresnick's Brief, at 5, n.2, and 38. In any event, contrary to Bresnick's characterization, the United States Trustee's attorney did not act as an "unsworn witness", but rather, at the bankruptcy court's request, guided the bankruptcy court through the information contained in the properly admitted documents. Bresnick's Brief, at 7; Bresnick Designation No. 6, at 23, ln. 12, pgs. 23-49. At the conclusion of the United States Trustee's case-in-chief, Bresnick's attorney made arguments in opposition to the motion. Bresnick Designation No. 6, at 50-67. At no time did Bresnick's attorney either request to put Bresnick on the stand, or proffer any rebuttal evidence to counter the evidence presented by the United States Trustee. Bresnick's Brief, at 7; Bresnick Designation No. 6, at 50-67. The bankruptcy court did not take testimony of Bresnick or any other party on Bresnick's behalf because no request for such testimony was made. Bresnick Designation No. 6, at 50-67. At the hearing, Bresnick failed to propound any admissible evidence, whether through documents, testimony, or proffer, in opposition to the United States Trustee's motion. Bresnick Designation No. 6, at 50-67.

Before rendering its decision, the bankruptcy court heard extensive argument from Bresnick's attorney, the attorney for the United States Trustee, the attorney for the Debtor's wife, and the attorney for a group of creditors that opposed the motion. The bankruptcy court also reviewed the various pleadings that had been filed in the case by the aforementioned parties.

On June 25, 2007, the bankruptcy court signed an order directing the appointment of a Chapter 11 trustee. Bresnick Designation No. 10 (ECF Docket Entry No. 54).

I. The Appeal

On June 27, 2007, Bresnick filed a Notice of Appeal from the Bankruptcy Court's June 25, 2007 Order. Bresnick Designation No. 8 (ECF Docket Entry No. 59).

ARGUMENT

The bankruptcy court granted the United States Trustee's motion and directed the appointment of a Chapter 11 trustee. In a proper exercise of its discretion, the bankruptcy court found that Bresnick's omissions from his bankruptcy schedules, his failure to account for funds, his co-mingling of assets, his failure to properly account for post-petition income, constituted cause for the appointment of a Chapter 11 trustee. Because the bankruptcy court did not abuse its discretion in finding "cause," the Order should be affirmed.

A. The Bankruptcy Court Did Not Abuse Its Discretion When it Found that Cause Existed for the Appointment of a Chapter 11 Trustee

The bankruptcy court did not abuse its discretion when it found that cause existed for the appointment of a Chapter 11 trustee. After reviewing the evidence, the bankruptcy court properly found that the United States Trustee established the requisite “cause” for the appointment of a Chapter 11 trustee under section 1104 of the Bankruptcy Code.

1. The Bankruptcy Court Followed the Correct Standard for the Appointment of a Chapter 11 Trustee

Taken as a whole, it appears Bresnick contends that the bankruptcy court erred by making findings against the weight of the evidence. Bresnick’s Brief at 28-29, 33-39. As articulated above, a bankruptcy court’s factual findings cannot be reversed or supplanted on appeal unless clearly erroneous. Federal Rule of Bankruptcy Procedure 8013. It is Bresnick’s burden to establish that the bankruptcy court abused its discretion, and it is improper for Bresnick to seek a *de novo* evidentiary hearing on appeal.

The bankruptcy court had wide discretion when considering the evidence. The bankruptcy court was free to give total, little, or no effect to any or all of the evidence presented. Contrary to Bresnick’s claims, the bankruptcy court did not accept mere representations of the United States Trustee. Bresnick’s Brief, at 29. Rather, the United States Trustee guided the bankruptcy court through the information contained in the myriad of documents that were properly admitted at the hearing. Bresnick Designation No. 6, at 23, ln. 12. The bankruptcy court was required to weigh that evidence, and to rule accordingly. As the trier of fact, the bankruptcy court was in the best position to determine the credibility of the evidence admitted. The record establishes that there was sufficient evidence to support a finding for the United States Trustee that cause existed for the appointment of a Chapter 11 trustee.

2. The United States Trustee Established Cause for the Appointment of a Trustee

Section 1104(a)(1) of the Bankruptcy Code compels the appointment of a trustee when the bankruptcy court finds fraud, dishonesty, incompetence, gross mismanagement, or other cause. 11 U.S.C. §1104. The appointment of a trustee under section 1104(a)(1) of the Bankruptcy Code is mandatory upon a finding of cause. Sharon Steel, 871 F.2d at 1226; Savino Oil, 99 B.R. at 525; In re The 1031 Tax Group, LLC., 374 B.R. 78, 86 (Bankr.S.D.N.Y. 2007); In re Bonded Mailings, 20 B.R. 781, 786 (Bankr.E.D.N.Y. 1982); In re McCordi Corp., 6 B.R. 172, 178 (Bankr.S.D.N.Y. 1980). "The decision to appoint a Chapter 11 trustee is a factual determination entrusted to the discretion of the bankruptcy judge", In re Adelphia Commc'ns Corp., 336 B.R. 610, 656 (Bankr.S.D.N.Y. 2006), and a judge has wide latitude in determining whether the conduct rises to the level of cause. 1031 Tax Group, 374 B.R. at 86.

The evidence presented by the United States Trustee established, and the bankruptcy court found, that: (i) Bresnick's schedules and statement of financial affairs contained material omissions, (ii) Bresnick was guilty of gross mismanagement, (iii) Bresnick failed to properly report his post-petition income, (iv) Bresnick failed to provide proof that he closed his pre-petition bank accounts, and (v) Bresnick could not account for large sums of monies he received prior to filing his Chapter 11 petition. Bresnick Designation No. 6, at 97-98. Taken separately, or as a whole, these findings warrant the appointment of a Chapter 11 trustee.

a. The Bankruptcy Court Did Not Abuse its Discretion When it Found that Bresnick's Material Omissions Constituted Cause for the Appointment of a Chapter 11 Trustee

Debtors are required to fully and completely disclose all relevant and material information at the outset of a case. Savino Oil, 98 B.R. at 526; see also, In re St. Vincents Catholic Medical Centers of New York, 2007 WL 2497287, at *16 (Bankr.S.D.N.Y. August 29, 2007) ("[c]omplete and timely disclosure of all relevant material information and documents lies at the heart of the bankruptcy process."). Recognizing this important principle, courts will direct the appointment of a Chapter 11 trustee under 11 U.S.C. §1104, when a debtor fails to disclose material and relevant information from his schedules. Tradex Corp. v. Morse, 339 B.R. 823, 832-33 (D.Mass. 2006); Savino Oil, 99 B.R. at 526; In re Deena Packaging Industries, Inc., 29 B.R. 705, 707-08 (Bankr.S.D.N.Y. 1983); In re Sanders, 2000 WL 329574, at *5 (Bankr.N.D.Ill. March 2, 2000).

The evidence presented at the hearing established that Bresnick failed to disclose material and relevant information in his bankruptcy schedules and statement of financial affairs.[5] This information was contained in documents filed by Bresnick in his divorce case, ten days before he filed his bankruptcy case. UST Designation Nos. 2-3. Although this information was readily available to him, Bresnick failed to include these assets on his schedules and statement of financial affairs.[6]

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[5] Although Bresnick contended that his non-disclosure of his interest in dormant corporations is immaterial, the disclosure has been held to be material. Bresnick Designation No. 4, at 2, ¶8(c)-3. Disclosure of dormant interests may lead to the discovery of assets. In re Beaubouef, 966 F.2d 174, 178-79 (5th Cir. 1992)

[6] Although not raised at the hearing, Bresnick now asserts that his interest in marital assets did not need to be included on the schedules. Bresnick's Brief, at 19-21. This assertion is incorrect. Question "17" on Schedule B of a debtor's bankruptcy schedules, requires disclosure of all marital interests, to which the debtor "is or may be

The bankruptcy court did not abuse its discretion when it found that the material omissions constituted cause for the appointment of a Chapter 11 trustee.

b. The Bankruptcy Court Did Not Abuse its Discretion When it Found that Bresnick's Amendments to His Bankruptcy Schedules did not Cure the Falsity of his Original Schedules

Bresnick filed amended schedules and an amended statement of financial affairs one day before the hearing on the United States Trustee's motion. UST Designation No. 12. He asserts that these amendments to his schedules and statement of financial affairs cured any deficiencies and that any omissions were rectified at the time of the hearing. Bresnick's Brief, at 19-21, 29, 35. Bresnick claims that the bankruptcy court ignored Federal Rule of Bankruptcy Procedure 1009, which permits a debtor to amend bankruptcy schedules at any time prior to the closing of the case. Bresnick's Brief, at 29-31, 34-35. These arguments ignore well-settled law.

As a result of Bresnick's material omissions, the bankruptcy court questioned whether Bresnick was trustworthy enough to maintain control of his operations. The bankruptcy court noted, "[i]n the absence of complete disclosure, I have no confidence that I'm being told the truth about what's coming in, what's going out". Bresnick Designation No. 6, at pg. 65, lines 19-22. The bankruptcy court's concern with Bresnick's veracity, was not cured by the last minute amendments to Bresnick's bankruptcy schedules.

A subsequent amendment of bankruptcy schedules does not cure the initial false statement or omission. See, In re Mellor, 226 B.R. 451, 459 (D.Co. 1998); In re Acuri, 116 B.R. 873, 882 (Bankr.S.D.N.Y. 1990), abrogated by Grogan v. Garner, 498 U.S. 279, 286, 111 S.Ct. 654, 659, 112 L.Ed.2d 755 (1991) (as to burden of proof) (debtor's amendment to schedules in

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entitled". UST Designation No. 1, Schedule B.

response to complaint seeking denial of discharge did not cure original false oath in schedules); In re Tovar, 2005 WL 2451684, at *2 (Bankr.S.D.Fl. April 19, 2005) (finding that a debtor's amendment of his schedules to disclose previously omitted assets did not cure the initial failure to disclose, for purposes of finding cause to dismiss case under section 1307 of the Bankruptcy Code). "The general rule is that an amendment 'does not expunge the falsity of an oath'". Acuri, 116 B.R. at 882, quoting, In re Cline, 48 B.R. 581, 585 (Bankr.E.D.Tenn. 1985).

Although Bankruptcy Rule 1009 provides Bresnick with the right to amend his schedules, the amendment did not cure the effect of Bresnick's initial failure to disclose. The bankruptcy court specifically found that the omissions in Bresnick's schedules " . . . were so pervasive and gross as to lead [the Court] to conclude that there [was] an inability on the part of [Bresnick] to function as a fiduciary in this case." Bresnick Designation No. 6, at 55, lns 18-21.

Bresnick's argument that his matrimonial accountant was to blame for the omissions in his schedules is without merit. Bresnick's Brief, at 35; Bresnick Designation No. 6, at 60, lns. 2-13. His alleged reliance on his matrimonial accountant to complete his schedules and statement of financial affairs was not reasonable. Bresnick had a duty to carefully review his schedules and statement of financial affairs as they were signed under penalty of perjury. In re Hatton, 204 B.R. 477, 484 (E.D.Va 1997); In re Eppers, 311 B.R. 826 (Bankr.D.N.M. 2004); In re Nazarian, 18 B.R. 143, 147 (Bankr.Md. 1982) (finding that reliance on counsel is not reasonable when it is self-evident that property should be scheduled). "A debtor cannot, merely by playing ostrich and burying his head deeply enough in the sand, disclaim all responsibility for statements which he has made under oath". In re Dubrowsky, 244 B.R. 560, 576 (E.D.N.Y. 2000), quoting, In re Tully, 818 F.2d 106, 111 (1st Cir. 1987).

The information omitted from the schedules and statement of financial affairs was contained in Bresnick's divorce financial affidavit which he signed ten days prior to filing bankruptcy, and should have been included in Bresnick's schedules. Any reliance on his matrimonial accountant was not reasonable, as it is self-evident that the omitted property and information should have been scheduled. The bankruptcy court recognized that Bresnick should have known both about his own business affairs, and about the information contained in the financial affidavit filed mere days before his bankruptcy case. Bresnick Designation No. 6, at 90, lns. 4-18. Although Bresnick's attorney asserted that he previously raised the omissions at a prior status conference, as the bankruptcy court acknowledged, the amendments were not filed until the day before the hearing, and only after the United States Trustee gave Bresnick a "road map". Bresnick Designation No. 6, at 59, lns. 9-16, pg. 90, lns. 16-18.

Bresnick claims that because the bankruptcy court did not find "bad faith" in the filing of the amendments, the amendments cannot be stricken. Bresnick's Brief, at 31. Bresnick's reliance on In re Corbi, 149 B.R. 325 (Bankr.E.D.N.Y. 1993), is misplaced, as that case involved a Chapter 7 trustee's motion to strike amendments to a debtor's schedules of exemptions. Id. Here, Bresnick's rights under Bankruptcy Rule 1009 are not disputed, and no party has moved to strike the amendments. However, the issue before the bankruptcy court was not whether Bresnick could amend his schedules, but rather whether his initial false disclosures called his veracity into question. The evidence presented at the hearing established that Bresnick's schedules and statement of financial affairs contained material omissions. Bresnick does not dispute the omissions, but rather seeks to place blame on his matrimonial accountant. This alleged reliance was not reasonable as the information missing from the bankruptcy schedules was readily available from the pleadings filed in his divorce case. Bresnick signed all of these documents under the penalty of perjury and is charged with the knowledge of the information they contained. Standing alone, Bresnick's material initial omissions constitute cause for the appointment of a Chapter 11 trustee, notwithstanding his eleventh-hour attempt to cure those omissions.

c. The Bankruptcy Court Did Not Abuse its Discretion When it Found that Bresnick's Actions Constituted Gross Mismanagement

A debtor's gross mismanagement of his business also establishes cause for the appointment of a trustee under section 1104(a)(1) of the Bankruptcy Code. Sharon Steel, 871 F.2d at 1226; In re McCorhill Pub, Inc., 73 B.R. 1013, 1017 (Bankr. S.D.N.Y. 1987). Courts can consider both a debtor's pre-petition and post-petition conduct in determining whether "cause" exists for the appointment of a trustee. In re Oklahoma Ref. Co., 838 F.2d 1133 (10th Cir. 1988) (pre-petition activity may be considered in an 1104(a) determination); 1031 Tax Group, 374 B.R. at 86 (citing, Midatlantic Nat'l Bank v. Anchorage Boat Sales, Inc. (In re Anchorage Boat Sales, Inc.), 4 B.R. 635, 644-45 (Bankr.E.D.N.Y.1980)). The record reflects, and the bankruptcy court did not err by finding, that Bresnick grossly mismanaged his operations.

Self-dealing, failing to maintain separate books and records for corporate entities, and a co-mingling of assets, rises to the level of gross mismanagement and warrants the appointment of a trustee under section 1104(a)(1). Anchorage Boat Sales, 4 B.R at 645; In re Paolino, 53 B.R. 399, 401 (Bankr. E.D.Pa. 1985); In re Philadelphia Athletic Club, Inc., 15 B.R. 60, 63-64 (Bankr.E.D.Pa 1981); In re Main Line Motors, Inc., 9 B.R. 782 (Bankr.E.D.Pa 1981).

Bresnick admitted co-mingling assets. Bresnick Designation No. 4, at 1, ¶6. He ignored corporate formalities by co-mingling his personal and corporate assets. He used his personal bank accounts to pay his corporate expenses, and it appears that all funds, whether corporate or personal, were co-mingled in his individual bank account. UST Designation No. 6, ¶6, and Exhibits "D" and "G" thereto. Bresnick admitted using his personal accounts to pay business obligations. UST Designation No. 6, ¶6. This rises to the level of gross mismanagement. Philadelphia Athletic, 15 B.R. at 64; Main Line Motors, Inc., 9 B.R. at 784.

Additionally, Bresnick could not account for the dissipation of significant sums of money he received prior to filing his case. He was unable to account for withdrawals in the aggregate amount of $411,983.00. UST Designation No. 6, Exhibit D, Bresnick Designation No. 4, at 5, ¶19 (ECF Docket Entry No. 49). He also could not account for $246,000.00 in disbursements made to him from his attorneys' IOLA account. Bresnick Designation No. 4, Exhibit Three (ECF Docket Entry No. 51). Bresnick received the sum of $917,086.00 between August 17, 2005 and June 1, 2006. Bresnick Designation No. 4, Schedule II (ECF Docket Entry No. 51). However, as of April 22, 2007, he only had between $25,000 and $30,000 in his bank accounts. UST Designation No. 12, Schedule B. Bresnick's inability to account for the dissipation of these funds constitutes gross mismanagement. In re Rivermeadows Assoc., Ltd., 185 B.R. 615 (Bankr.D.Wy. 1995) (debtor's pattern of intermingling funds, of expedient transfers, and absence of proper record keeping, evidenced lack of sound business management); McCorhill, 73 B.R. at 1017 (gross mismanagement will be found when a debtor fails to maintain complete and accurate financial records); In re Colby Construction Corp., 51 B.R. 113, 117 (Bankr.S.D.N.Y. 1985) (gross mismanagement found where debtor's records were in shambles and accounting system did not reflect debtor's true financial condition).

Bresnick could not provide the bankruptcy court with an explanation as to the dissipation of these funds. At the evidentiary hearing, the bankruptcy court questioned Bresnick's attorney regarding Bresnick's inability to account for funds that Bresnick transferred to his own attorney's IOLA accounts. Bresnick Designation No. 6, at 51, lns. 8-13. Bresnick's attorney's response was that Bresnick wanted to retain an accountant to help Bresnick "find these monies". Bresnick Designation No. 6, at 51, lns. 14-17**.** Bresnick also proposed that a creditors' committee could help locate the missing funds. Bresnick Designation No. 6, at 51-52, lns. 25, 1-5. Bresnick's failure to produce any records to account for these funds, and his attorney's admission that Bresnick needed to retain an accountant to find the monies supports the bankruptcy court's finding of gross mismanagement.

Although Bresnick failed to testify at the evidentiary hearing to explain his inability to account for funds, on appeal he attempts to explain the information contained in the accountings. Bresnick's Brief, at 10-13. He provides explanations that were not part of the record and should not be considered by the Court. Bresnick's Brief, at 12-13 (explaining transfers in the amount of $201,395.00). This Court cannot consider the legal effect of facts not raised below. Universal Church v. Geltzer, 463 F.3d 218, 299 (2d Cir. 2006). The documentary evidence regarding the monies received Bresnick and monies for which Bresnick could not account is clear and unambiguous. The documents establish that:

> (i) Bresnick transferred the sum of $3,500,00.00 from his accounts to his attorneys' IOLA account in October 2005. Between January 19, 2006, and June 1, 2006, Bresnick transferred the sum of $201,395.00 to himself. UST Designation No. 6, Exhibit F.

(ii) Bresnick removed $3,000,000.00 from his Certificate of Deposit Account at Richmond County Savings Bank in violation of the injunction. Bresnick's accounting provides that $138,000 was transferred to Bresnick on October 21, 2005. UST Designation No. 6, Exhibit D.

(iii) Bresnick was unable to account for withdrawals from the Richmond County Certificate of Deposit account the in the aggregate amount of $411,983.00. The notations provide "how disbursed is unknown at this time". UST Designation No. 6, Exhibit D.

(iv) Bresnick's accounting of the $3,000,000.00 removed from his Certificate of Deposit Account at Independence Community Bank provides that $100,000 was transferred to Bresnick on October 28, 2005. UST Designation No. 6, Exhibit G.

(v) Between August 17, 2005 and June 1, 2006, transfers in the aggregate amount of $917,086.00 were made directly to Bresnick. Bresnick Designation No. 4, Schedule II (ECF Docket Entry No. 51); UST Designation No. 12.

(vi) Bresnick's reconciliation of sale proceeds from property in Rockland County fails to account for $709,928.70. Bresnick Designation No. 4, Schedule II (ECF Docket Entry No. 51); UST Designation No. 12.

(vii) An accounting prepared for monies in Bresnick's attorneys' IOLA account reveals that Bresnick did not account for $246,000.00 in disbursements made to him from the account. UST Designation No. 12 (Exhibit Three annexed to end of schedules); Bresnick Designation No. 4, Exhibit Three (ECF Docket Entry No. 51).

(viii) Despite the funds received in the period before he filed bankruptcy, Bresnick's amended schedules reflected that as of April 22, 2007, he only had between $25,000 and $30,000 in his bank accounts. UST Designation No. 12, Schedule B.

Bresnick's failure to comply with corporate formalities, the admitted co-mingling of his corporate and personal assets, and his inability to account for withdrawals in the aggregate amount of $411,983.00 from his pre-petition certificate of deposit accounts and $709,928.70 from his attorney's IOLA account constitute gross mismanagement and warranted the appointment of a Chapter 11 trustee. <u>Anchorage Boat Sales</u>, 4 B.R at 645; <u>Paolino</u>, 53 B.R. at 401; <u>Philadelphia Athletic Club</u>, 15 B.R. at 63-64.

Bresnick argues that a Chapter 11 trustee was not warranted as the Debtors' professionals, Patricia Bresnick and the objecting creditors, could investigate Bresnick's actions. Bresnick's Brief, at 24, 39. Despite Bresnick's arguments to the contrary, the perceived ability of a third party to investigate Bresnick's pre-petition transfers would not alleviate the need for a Chapter 11 trustee. See, Sharon Steel, 871 F.2d at 1228 (affirming appointment of trustee and holding that appointment of creditors' committee would not have alleviated debtor's mismanagement); In re PRS Ins. Group, Inc., 274 B.R. 381, 388 (Bankr.D.Del. 2001) (court appointed trustee to pursue actions against insiders and found that transferring those rights to potential creditors' committee was not in best interests of creditors). Furthermore, as set forth above, once the bankruptcy court found "cause" under section 1104(a)(1) of the Bankruptcy Code, it was mandated to appoint a Chapter 11 trustee. Savino Oil, 99 B.R. at 525. Due to the mandatory nature of the statute, the bankruptcy court was not in a position to even consider whether a committee or Patricia Bresnick could investigate Bresnick's actions.

On the basis of a review of the evidence of record, it is clear that the bankruptcy court properly determined that Bresnick's failure to account for funds, his co-mingling of assets, his failure to properly account for post-petition income, constituted cause for the appointment of a Chapter 11 trustee, under section 1104(a)(1) of the Bankruptcy Code. This determination is supported by ample evidence of record and should be affirmed.

d. The Bankruptcy Court Did Not Abuse its Discretion When it Found that Bresnick was Responsible for His Own Gross Mismanagement

The bankruptcy court did not abuse its discretion when it found that Bresnick was responsible for his own gross mismanagement. On appeal, Bresnick attributes his pre-petition mismanagement solely to his wife, Patricia Bresnick. Bresnick's Brief, at 26-27, 35-36. He argues that a Chapter 11 trustee was not warranted, as Patricia was prior management, and Bresnick is now the current management. Bresnick's Brief, at 27, 35. This argument is belied by the evidence presented at the hearing.

First, Bresnick's co-mingling was admitted by Bresnick's matrimonial accountant. UST Designation No. 6, ¶6. In an effort to explain this admission, at the evidentiary hearing Bresnick's attorney advised that the co-mingling was "the nature of the real estate profession". Bresnick Designation No. 6, at 51, lns. 5-7. Despite the arguments raised by Bresnick in his appellate brief, Bresnick's affidavit submitted in opposition to the United States Trustee's motion fails to contain any assertion, under oath, that the co-mingling was due to Patricia Bresnick's actions. Bresnick Designation No. 5. Bresnick cannot raise this issue for the first time on appeal. Universal Church, 463 F.3d at 228.

Second, Bresnick's co-mingling of his personal and corporate assets is apparent from his own documents submitted in opposition to the disgorgement motion in the divorce action. UST Designation No. 6. Bresnick's accounting, which he prepared, evidenced that he transferred monies from his personal bank accounts to his attorneys' IOLA account and then directed the attorneys to pay both corporate and personal expenses. UST Designation No. 6, Exhibit F (Schedule E). Bresnick's accounting of his certificate of deposit account at Independence Community Bank, reflect that he transferred funds from this individual account to various corporate and personal accounts. UST Designation No. 6, ¶10 and Exhibit G. Finally, Bresnick admits in the affidavit filed in the divorce proceeding that " . . . hundreds of thousands of dollars regularly flowed through these accounts to pay [Bresnick's] ongoing business obligations". UST Designation No. 6, at ¶6.

Bresnick's reliance upon 1031 Tax Group in support of his argument that the bankruptcy court should not have directed the appointment of a Chapter 11 trustee as "prior management" had been replaced, is misplaced, as the specific facts of that case are inapposite to case at bar. Bresnick's Brief, at 25. In 1031 Tax Group, the Court held that the appointment of a Chapter 11 trustee was not warranted, as the debtor met its burden of establishing that the new management was " . . . unconflicted by any association with the tainted members of the governing body that made the selection or appointment". Id., at 88. The Court in 1031 Tax Group found that the debtor's new management was free from any taint associated with the prior management, as it had no prior relationship with the debtor's former management. Id., at 88-90. Thus, the facts of 1031 Tax Group, which presume a wholesale change in the identities of debtor's management, are plainly inapplicable to an individual chapter 11 case.

First, as set forth above, Bresnick did not preserve this argument for appeal, as he failed to attribute his pre-petition actions to Patricia Bresnick at the evidentiary hearing. However, even if this argument had been made to the bankruptcy court, Bresnick could not satisfy the standard enunciated in 1031 Tax Group. Bresnick claimed in his divorce proceeding, that he and Patricia Bresnick, worked jointly as real estate developers. UST Designation No. 6, at ¶3. As a result, even if the court had accepted Bresnick's unsubstantiated claim that all wrongdoing was solely attributable to Patricia Bresnick, Bresnick remained an active participant in the management of his own assets, and could not have demonstrated that he was "free from taint" in connection with his own affairs.

Bresnick's argument that Patricia Bresnick was "prior management" and thus responsible for Bresnick's failures, is further undermined by the evidence presented at the hearing that Bresnick's gross mismanagement continued post-petition. As the bankruptcy court recognized, Bresnick's omissions from his schedules were not a "one-time" mistake. Bresnick Designation No. 6, at 53, lns. 14-15. Bresnick failed to operate solely out of a debtor-in-possession account, failed to provide the United States Trustee with proof that he closed his pre-petition bank accounts, and filed inaccurate operating reports**.** UST Designation No. 7-10. These failures individually and collectively also establish cause for the appointment of a Chapter 11 trustee. See, In re Cohoes Indus. Terminal, Inc., 65 B.R. 918, 922-23 (Bankr.S.D.N.Y. 1986) (debtor's failure to comply with United States Trustee's operating guidelines constituted cause for appointment of Chapter 11 trustee), In re Ford, 36 B.R. 501, 504 (Bankr. Ky. 1983)(failure to file accurate financial reports constitutes grounds for the appointment of a Chapter 11 trustee).

Bresnick claims there was no evidence presented that he failed to close his pre-petition bank accounts. Bresnick's Brief, at 36. Contrary to Bresnick's arguments on appeal, Bresnick's admitted failure to provide proof of the closing of the pre-petition bank account was not the subject of a "mere colloquy" between the bankruptcy court and the attorney for the Office of the United States Trustee. Bresnick's Brief at 36. The letter sent to Bresnick's counsel advising of the failure to receive the proof of closure was admitted into evidence without objection. UST Designation No. 10. This letter confirmed that the proof had not been received. UST Designation No. 10. While there may have been an issue at the hearing regarding Bresnick's attorney's facsimile number, at numerous occasions throughout the hearing, Bresnick's attorney admitted that the proof had not been provided. Bresnick Designation No. 6, at 61, lns. 20-25; pg.

63, lns. 7-8, pg. 66, lns. 23-25. The bankruptcy court recognized that this routine obligation should have been fulfilled long before the hearing. Bresnick Designation No. 6, at 63, lns. 11-17. The bankruptcy court found that Bresnick's failure to provide his attorney with the proof in response to the motion evidenced Bresnick's disregard for his duties and responsibilities as a debtor-in-possession. Bresnick Designation No. 6, at 63, lns. 11-17, pg. 67, lns. 1-7.

Additionally, and most troubling to the bankruptcy court, was Bresnick's failure to disclose his bank account balances as of the date he filed his petition on March 30, 2007. Bresnick Designation No. 6, at 52, lns. 13-23. Bresnick's amended schedules, filed the day before the hearing on the motion, reflected bank account balances as of April 23, 2007. UST Designation No. 12, Exhibit B**.** The lack of information as to the sums of money in Bresnick's bank account on the day he filed his petition, coupled with the failure to provide proof that he closed his pre-petition accounts, prevented both the bankruptcy court and the United States Trustee from confirming that all of Bresnick's pre-petition funds were transferred into his debtor-in-possession accounts. The bankruptcy court was understandably concerned that there was a three week period " . . . post-petition where we don't know what was in [Bresnick's] bank account, what went in, what went out." Bresnick Designation No. 6, at 52, lns. 20-22.

The record reflects that the bankruptcy court did not abuse its discretion when it attributed Bresnick's gross mismanagement, to Bresnick.

B. The Bankruptcy Court Considered the Correct Statutory Standard

When rendering its decision, the bankruptcy court found that the United States Trustee established "ample cause" for the appointment of a Chapter 11 trustee. Bresnick Designation No. 6, at 97, lns. 3-5. Bresnick argues that the bankruptcy court erred because it was required to use a "clear and convincing evidence" standard of proof, rather than "ample cause". Bresnick's Brief, at 32-33. This argument is without merit.[7]

There is a split of authority as to the proper burden of proof under section 1104(a) of the Bankruptcy Code. Several bankruptcy courts within the Second Circuit have required the moving party to establish cause by "clear and convincing evidence", see, 1031 Tax Group, 374 B.R. at 85; In re Euro-American Lodging, Corp., 365 B.R. 421, 426 (Bankr.S.D.N.Y. 1997); Ionosphere Clubs 113 B.R. at 167, while others have imposed a "preponderance of the evidence" standard. In re Altman, 230 B.R. 6, 16-17 (Bankr.D.Conn. 1999), vacated in part on other grounds, 254 B.R. 509 (D.Conn. 2000). District and Circuit courts are also split on the issue. The Third Circuit has imposed a "clear and convincing" burden of proof upon the moving party, In re G-I Holdings, Inc., 385 F.3d 313 (3rd Cir. 2004), while a district court in the First Circuit has adopted a preponderance of the evidence standard. Tradex Corp, 339 B.R. at 832.[8]

The split of authority is irrelevant to this Court's determination of the appeal. A review of the complete record indicates that the United States Trustee established "cause" for the appointment of a Chapter 11 trustee, under either standard. Moreover, the bankruptcy court did not, as Bresnick suggests, reference "ample cause" as the applicable burden of proof. Rather, the

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[7] Bresnick failed to argue at the evidentiary hearing or in pleadings, that the bankruptcy court should require the United States Trustee to establish cause by "clear and convincing" evidence. This new issue should not be considered by the Court for the first time on appeal. Universal Church, 463 F.3d at 299.

[8] The United States Trustee submits that the proper burden of proof is preponderance of the evidence. In the absence of an express congressional direction to apply a higher standard of proof, the burden of proof in bankruptcy litigation should generally be the preponderance of the evidence. Grogan, 498 U.S. at 286. There is no express Congressional intent in the language of section 1104 of the Bankruptcy Code, which requires a higher standard of proof. Thus, the United States Trustee submits that the burden of establishing cause for the appointment of a Chapter 11 trustee, is by a preponderance of the evidence. Altman, 230 B.R at 16-17; Tradex Corp., 339 B.R. at 832.

bankruptcy court's reference to "ample cause" simply referred to the standard enumerated in the statutory text. See 11 U.S.C. §1104. By finding "ample cause", the bankruptcy court implicitly found that the United States Trustee had met her burden of proof.

Nor did the Bankruptcy Court err by not explicitly describing the burden of proof before finding that cause had been established. The cases cited by Bresnick support the United States Trustee's argument that the bankruptcy court was simply required to find "cause" and was not mandated to articulate the burden of proof required. In McCordi, the bankruptcy court found that the secured creditor had established "cause" for the appointment of a trustee, without referring to the moving party's burden of proof . McCordi, 6 B.R. at 178. Similarly, the Court in In re McCall, 34 B.R. 68 (Bankr.E.D.Pa 1983), appointed a Chapter 11 trustee, without reference to the burden of proof that the moving party was required to establish.

The bankruptcy court applied the correct standard in reaching its decision. The United States Trustee met her burden of establishing "cause" for the appointment of a Chapter 11 trustee, by either a preponderance of the evidence, or, by clear and convincing evidence. The bankruptcy court properly found that the United States Trustee established "cause" for the appointment of a Chapter 11 trustee, as required by the statutory text, and its decision should be affirmed.

CONCLUSION

For the reasons set forth above, the United States Trustee respectfully requests that the Court affirm the Order of the bankruptcy court and grant such other relief as the Court deems just and proper.

Dated: Brooklyn, New York
November 5, 2007

Respectfully submitted,

DIANA G. ADAMS
UNITED STATES TRUSTEE
FOR REGION 2

By: *s/ Valerie Millman*
VALERIE MILLMAN (VM-3127)
Trial Attorney
Office of the United States Trustee
271 Cadman Plaza East
Suite 4529
Brooklyn, New York 11201
Tel. No. (718) 422-4960

BRIEF BANK — "SUMMARY SHEET" *Printed Fri-3/12/10 15:19*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*
In re Larry Bresnick (Lawrence Morrison, P.C. v. Diana G. Adams, United States Trustee for Region 2)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*
E.D. N.Y.

3. ("CCN") ***CURRENT*** CASE NO.
No.: 09-03565 (CBA)

4. ("PCN") ***PRIOR*** CASE NO. - & COURT *[IF ANY]*
No.: 07-41580 (CEC)
Court: Bankr. E.D. N.Y
(Identify judge & cite, if any)

5. ("SO") ***SOURCE***
U.S. TRUSTEES

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*
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Type: Brief of Appellee the United States Trustee

7. **("AU") PRINCIPAL AUTHORS & OFFICE** *[E.g.,"UST/OGC"]*
Valerie Millman, Catherine B. Sevcenko, P. Matthew Sutko, Alicia M. Leonhard, Ramona D. Elliott
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***
- Whether the bankruptcy court erred when it denied the application in accordance with Lamie v. United States Trustee, 540 U.S. 526 (2004).

10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)

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IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF NEW YORK

In re:	:	
	:	
LARRY BRESNICK,	:	
	:	Civ. App. No. 09-03565 (CBA)
Debtor	:	
--	x	
	:	
LAWRENCE MORRISON, P.C.,	:	
	:	
Appellant,	:	
	:	Bankruptcy Case No. 07-41580 (CEC)
v.	:	
	:	
DIANA G. ADAMS, UNITED STATES TRUSTEE FOR REGION 2,	:	
	:	
	:	
Appellee.	:	
--	x	

BRIEF OF APPELLEE THE UNITED STATES TRUSTEE

Alicia M. Leonhard
Assistant United States Trustee
Valerie Millman
Trial Attorney
Office of the United States Trustee
U. S. Department of Justice
271 Cadman Plaza East, Suite 4529
Brooklyn, New York 11201
Phone: 718.422.4960
Facsimile: 718.422.4990
E-Mail: Alicia.M.Leonhard@usdoj.gov

Ramona D. Elliott
General Counsel
P. Matthew Sutko
Associate General Counsel
Catherine B. Sevcenko
Trial Attorney
Executive Office for United States Trustees
U. S. Department of Justice
20 Massachusetts Avenue, N.W., Suite 8100
Washington, D.C. 20530
Phone: 202.307.1399

Counsel for the United States Trustee

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I. INTRODUCTION AND STATEMENT OF JURISDICTION

Appellant Lawrence Morrison, P.C. ("Mr. Morrison"), counsel to chapter 11 debtor, Larry BRESNICK ("Mr. Bresnick" or the "Debtor"), appeals an order of the United States Bankruptcy Court for the Eastern District of New York, Brooklyn Division, entered on June 23, 2009 (the "Order"). [ER, Ex. B, at 3].[1] The Order denied Mr. Morrison's First and Final Application for Allowance of Compensation and Reimbursement of Expenses as Counsel to the Debtor (the "Application"), to the extent that it sought an award of fees incurred after the appointment of a chapter 11 trustee in Mr. Bresnick's case. [ER, Ex. G, at 102]. The United States Trustee respectfully requests that this Court affirm the Order.[2]

The bankruptcy court had jurisdiction over the Application under 28 U.S.C. §§ 157(b)(2)(A) and 1334. The Order is a final order under 28 U.S.C. § 158(a)(1). *See In re Yermakov*, 718 F.2d 1465, 1469 (9th Cir. 1983) (orders denying fees under § 330 are final orders if they conclusively determine the entire compensation to be paid to a professional). *See also In re Pegasus Agency, Inc.*, 101 F.3d 882, 885 (2d Cir. 1996) (a bankruptcy court order is final if it "completely resolve[s] all of the issues pertaining to a discrete claim, including issues as to the proper relief") (citations omitted). On July 2, 2009, Mr. Morrison filed a timely Notice of Appeal. [ER, Ex. A, at 1]. This Court, therefore, has jurisdiction to hear the appeal under 28 U.S.C. § 158(a)(1).

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[1] "ER" refers to the Excerpts from the Record on Appeal filed with the Appellee's Brief. "Ex. [x]" refers to the exhibit letter of the document in the ER, and "at #" refers to the consecutively numbered pages in the ER.

[2] Under 11 U.S.C. § 307, the United States Trustee may appear and be heard on any issue in any case or proceeding under the Bankruptcy Code.

II. STATEMENT OF THE ISSUE ON APPEAL

In *Lamie v. United States Trustee*, 540 U.S. 526 (2004), the Supreme Court unanimously ruled that federal bankruptcy law precludes the use of bankruptcy estate funds to pay a chapter 11 debtor's attorney for work that the attorney performs after the appointment of a chapter 7 trustee unless the trustee re-employs the attorney under 11 U.S.C. § 327(a). In this case, relying on *Lamie,* the bankruptcy court denied the Application with respect to services that Mr. Morrison rendered to Mr. Bresnick after the appointment of a chapter 11 trustee in Mr. Bresnick's case. [ER, Ex. C, at 9-10]. Therefore, the issue on appeal is whether the bankruptcy court erred when it denied the Application in accordance with *Lamie*.

III. STANDARD OF APPELLATE REVIEW

Appellate courts review a bankruptcy court's decision "independently, accepting its factual findings unless clearly erroneous, but reviewing its conclusions of law *de novo*." *Ball v. A.O. Smith Corp.*, 451 F.3d 66, 69 (2d Cir. 2006). *See also In re Ionosphere Clubs, Inc.*, 922 F.2d 984, 988 (2d Cir. 1990) (the appellate court reviews the bankruptcy court's conclusions of law *de novo* and its findings of fact for clear error). This appeal involves a question of law, which this Court must review *de novo*.

IV. SUMMARY OF ARGUMENT

This Court should affirm the Order because the bankruptcy court properly applied settled law to undisputed facts. The debtor in possession in this case, Mr. Bresnick, obtained court approval under 11 U.S.C. § 327 to employ Mr. Morrison as the lawyer for his chapter 11 bankruptcy estate. Mr. Bresnick could do that because he was the debtor in possession. 11 U.S.C. § 1107 (debtors in possession have the powers of a trustee, which includes hiring counsel under section 327). But Mr. Bresnick was later replaced by a chapter 11 trustee, which meant that the trustee took control of the estate, including the selection and retention of its counsel. *See* 11 U.S.C. § 1101(1) (trustee becomes the debtor in possession upon appointment); 11 U.S.C. § 1106 (trustee duties). *See also* 11 U.S.C. § 323(a) (the trustee represents the bankruptcy estate).

In *Lamie*, 540 U.S. at 532, the Supreme Court ruled that the appointment of a bankruptcy trustee "terminate[s]" the debtor's "status as debtor-in-possession and so terminate[s] [the lawyer's role] under § 327 as an attorney for the debtor-in-possession." For that reason, the Supreme Court ruled that the work the lawyer did after the appointment of the trustee could not be compensated from the estate, given that the lawyer was no longer employed by the estate, because the new trustee had not obtained a new appointment of the attorney as his lawyer under § 327 of the Code. *Lamie*, 540 U.S. at 538-39 (holding "[i]f the attorney [formerly hired by the deposed debtor in possession] is to be paid from estate funds under § 330(a)(1) in a chapter 7 case [for work done after a trustee is appointed], he must be employed by the trustee and approved by the court").

Lamie controls this case. Indeed, the facts are virtually identical. Both the *Lamie* lawyer and Mr. Morrison were employed by the debtor in possession under § 327. Both debtors in possession were later replaced by trustees. Neither trustee re-employed the lawyer under § 327 after the trustee was appointed. Both lawyers nonetheless did work after their non re-employment. The Supreme Court ruled the non re-employed lawyer in *Lamie* could not be compensated from estate funds for the post-trustee work. Mr. Morrison cannot either.

Lamie's bright line rule serves an important purpose. Absent a bright line, people could be confused about which lawyer speaks for the estate. *Lamie* removes that doubt. Only lawyers appointed by the trustee after the trustee's appointment can work or speak for the estate. Given the multitude of parties in large chapter 11 cases, that clarity protects both the estate and those that deal with it.

V. STATEMENT OF THE FACTS

A. Statutory Framework

1. The Bankruptcy Estate

When an entity files a bankruptcy case, all of its assets are transferred by operation of law to a bankruptcy estate. *See* 11 U.S.C. § 541(a)(1) (the filing of a bankruptcy petition "creates an estate . . . comprised [with some exceptions] of all legal or equitable interests of the debtor in property as of the commencement of the case").[3] *See also In re Bell*, 225 F.3d 203, 215 (2d Cir. 2000) (filing a bankruptcy petition constitutes the commencement of a case and creates a bankruptcy estate under § 541).

2. Chapter 11 Debtors in Possession

After the commencement of a case, chapter 11 debtors retain control of the bankruptcy estate and any business operations as "debtors in possession." *See* 11 U.S.C. §§ 1101(1) and 1108. Duties imposed on debtors in possession include accounting for estate property, disclosing their assets, liabilities and financial affairs, timely filing tax returns, preparing and filing periodic financial reports, and proposing plans of reorganization. *See* 11 U.S.C. §§ 1107(a), 521, 1106(a)(5) and (6), and 704(a)(2), (7) and (8).

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[3] The full text of 11 U.S.C. § 541 and other Bankruptcy Code provisions cited is attached as Exhibit 1.

3. Retention and Compensation of Professionals

The retention of professionals in chapter 11 cases is governed by 11 U.S.C. § 327, which provides, in part, that:

> (a) Except as otherwise provided in this section, the trustee, with the court's approval, may employ one or more attorneys, accountants, appraisers, auctioneers or other professional persons, that do not hold or represent an interest adverse to the estate, and that are disinterested persons, to represent or assist the trustee in carrying out the trustee's duties under this title.

11 U.S.C. § 327(a). Debtors in possession may, subject to court approval, retain professionals, including lawyers and accountants to represent them in their cases under 11 U.S.C. § 327. *In re AroChem Corp.*, 176 F.3d 610, 620-621 (2d Cir. 1999).

Retained professionals must apply to the bankruptcy court for the award of reasonable compensation and the reimbursement of actual and necessary expenses under 11 U.S.C. § 330, which provides, in part, that:

> (1) After notice to parties in interest and the United States trustee, the court may award a trustee, examiner, . . . or **a professional person employed under section 327 . . . --**
>
> (A) reasonable compensation for actual, necessary services rendered by the . . . professional person or attorney . . .; and
>
> (B) reimbursement for actual, necessary expenses.

11 U.S.C. § 330(a)(1) (emphasis added). Only professionals retained under 11 U.S.C. § 327 are entitled to receive compensation from estate funds under 11 U.S.C. § 330. *Lamie*, 540 U.S. at 538-539.

4. Appointment of Chapter 11 and Chapter 7 Trustees

11 U.S.C. § 1104 governs the appointment of chapter 11 trustees. Under § 1104,

> (a) At any time after the commencement of the case but before confirmation of a plan, on request of a party in interest or the United States trustee, the court

shall order the appointment of a trustee –

> (1) for cause, including fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor by current management, either before or after the commencement of the case, or similar cause . . . .
>
> (2) if such appointment is in the best interests of creditors, any equity security holders, and other interests of the estate . . . .; or
>
> (3) if grounds exist to convert or dismiss the case under § 1112, but the court determines that the appointment of a trustee . . . is in the best interests of creditors and the estate.

11 U.S.C. § 1104(a).

After the bankruptcy court has entered an order directing the appointment of a chapter 11 trustee, the United States Trustee appoints the trustee after consultation with parties in interest. *See* 11 U.S.C. § 1104(d). United States Trustees are officials of the Department of Justice appointed by the Attorney General to supervise the administration of bankruptcy cases and trustees. *See* 28 U.S.C. §§ 581-589 (specifying the powers and duties of United States Trustees).[4]

Under 11 U.S.C. § 701,

> (a)(1) Promptly after the order of relief under [chapter 7], the United States trustee shall appoint one disinterested person that is a member of the panel of private trustees established under section 586(a)(1) of title 28 . . . to serve as interim trustee in the case.

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[4] *See also In re Columbia Gas Sys., Inc.*, 33 F.3d 294, 296 (3d Cir. 1994) (United States Trustees oversee the bankruptcy process, protect the public interest, and ensure that bankruptcy cases are conducted according to law); *United States Trustee v. Revco D.S., Inc. (In re Revco D.S., Inc.)*, 898 F.2d 498, 499 (6th Cir. 1990) ("[t]he United States trustee, an officer of the Executive Branch, represents . . . [the] public interest"); *In re Castillo*, 297 F.3d 940, 950 (9th Cir. 2002) (the United States Trustee is the "'watchdog' of the bankruptcy system . . . charged with preventing fraud and abuse and with 'fill[ing] the vacuum' caused by possible creditor inactivity").

11 U.S.C. § 701(a)(1). If the creditors do not elect a trustee under 11 U.S.C. § 702, the interim trustee "shall serve as trustee in the case." 11 U.S.C. § 702(d).

5. The Effect of the Appointment of a Trustee

After the United States Trustee has appointed a chapter 7 or chapter 11 trustee, the trustee is the estate's sole representative. *See* 11 U.S.C. § 323(a) (the trustee in a case under this title is the representative of the estate). The duties of a chapter 7 trustee are set forth in 11 U.S.C. § 704 and include liquidating the estate, accounting for estate property, and investigating the debtor's financial affairs. *See* 11 U.S.C. § 704(a)(1), (2) and (4). Under 11 U.S.C. § 1106, the duties of a trustee likewise include accounting for the property of the estate, investigating the debtor's financial affairs and proposing a plan that calls for liquidation of the debtor's assets or reorganization of the debtor's financial affairs. 11 U.S.C. § 1106(a)(1), (3) and (5). Under § 327(a), trustees have the authority to retain professionals. *Lamie*, 540 U.S. at 531-32.

In a chapter 11 case, the appointment of a trustee, whether through conversion to chapter 7 or appointment of a trustee under § 1104, divests the debtor in possession of control of the estate. *See CFTC v. Weintraub*, 471 U.S. 343, 352-53 (1985) (holding that a trustee ousts corporate management and controls the corporate debtor, including its decisions relating to counsel). The services of the debtor in possession's professionals are terminated and the professionals are not entitled to compensation under § 330 for services rendered after the trustee's appointment. *Lamie*, 340 U.S. at 537. After the appointment of a trustee, only the trustee's retained professionals are entitled to compensation from estate funds. *Id.* The debtor in possession's terminated counsel would only be entitled to compensation under § 330 if the trustee retained them. *See id.* (§§ 327 and 330, "taken together, allow . . . trustees to engage attorneys, including debtors' counsel, and allow courts to award them fees").

B. Factual Background.

1. The Debtor

On March 30, 2007 (the "Petition Date"), Mr. Bresnick filed a chapter 11 petition in the Bankruptcy Court for the Eastern District of New York, Brooklyn Division. [ER, Ex. K, at 173, ECF Doc. No. 1]. On Schedule B, Personal Property, filed on April 19, 2007, Mr. Bresnick disclosed, among other things, that he held a fifty percent interest in Block 7094, LLC ("Block 7094) and Tower Hill at Springville, LLC ("Tower Hill"). [ER, Ex. J, at 120-171]. Tower Hill, a non-debtor, owns an undeveloped parcel of real property in Staten Island, New York (the "Tower Hill Property"). [ER, Ex. H, at 151, and Ex. I, at 168].

On April 24, 2007, the Debtor filed an application to retain Mr. Morrison as bankruptcy counsel under § 327(a). [ER, Ex. K, at 176, ECF Doc. No. 23]. On April 15, 2007, the bankruptcy court entered an order approving Mr. Morrison's retention effective as of the Petition Date. [ER, Ex. K, at 177, ECF Doc. No. 28]. On August 9, 2007, the United States Trustee appointed an official committee of unsecured creditors in the Debtor's case (the "Creditors' Committee"). [ER, Ex. K, at 185, ECF Doc. No. 80]. On September 24, 2007, the bankruptcy court approved the retention of Pick & Zabicki as counsel to the Creditors' Committee. [ER, Ex. K, at 190, ECF Doc. No. 108].

2. Block 7094

On March 30, 2007, Mr. Bresnick, as managing member, filed a chapter 11 petition on behalf of Block 7094 in the Bankruptcy Court for the Eastern District of New York, Brooklyn Division (Case No. 07-41576). On Schedule A, Real Property, filed on April 22, 2007, Block

7094 disclosed that it owned an undeveloped parcel of land on Staten Island (the "Block Property"). [ER, Ex. L, at 221]. The Block Property abuts the Tower Hill Property. [ER, Ex. D, at 19, Lines 1-7].

On May 11, 2007, the United States Trustee appointed an official committee of unsecured creditors (the “Block 7094 Creditors’ Committee”). [ER, Ex. M, at 227, ECF Doc. No. 24]. On June 1, 2007, the bankruptcy court approved the retention of Pick & Zabicki as counsel to the Block 7094 Creditors’ Committee. [ER, Ex. M, at 227, ECF Doc. No. 29].

3. Appointment of the Trustee

On June 5, 2007, the United States Trustee filed a motion, under 11 U.S.C. § 1104(a), seeking an order directing the appointment of a chapter 11 trustee, alleging, among other things, that the Debtor had failed to disclose assets and pre petition transfers of cash. [ER, Ex. K, at 178, ECF Doc. No. 34]. After an evidentiary hearing, the bankruptcy court granted the United States Trustee’s motion, on June 25, 2007, for cause under 11 U.S.C. § 1104(a)(1). [ER, Ex. K, at 181-182, ECF Doc. No. 54].

After consulting with parties in interest under 11 U.S.C. § 1104(d), the United States Trustee filed a notice of appointment of Gregory Messer as chapter 11 trustee (the “Trustee”) and an application for approval of the appointment of the Trustee on June 27, 2007. [ER, Ex. K, at 182, ECF Doc. Nos. 57 and 58]. The bankruptcy court entered an order approving the appointment on June 28, 2007. [ER, Ex. K, at 182, ECF Doc. No. 61].

On July 3, 2007, the Trustee filed an application to employ the firm of LaMonica, Herbst & Maniscalco, LLP (the “Lamonica Firm”), as bankruptcy counsel under 11 U.S.C. § 327(a). [ER, Ex. K, at 183, ECF Doc. No. 65]. On July 20, 2007, the bankruptcy court approved the

Lamonica Firm’s retention. [ER, Ex. K, at 184, ECF Doc. No. 73]. The Lamonica Firm was the only bankruptcy counsel that the Trustee retained. [ER, Ex. K, at 184-221].

4. The Sale of the Block Property and the Tower Hill Property

On January 28, 2008, Mr. Bresnick, Block 7094, the Creditors’ Committee and the Block 7094 Creditors’ Committee filed a joint motion seeking the entry of an order approving the sale of the Block Property and the Tower Hill Property. [ER, Ex. K, at 195, ECF Doc. No. 134]. On April 4, 2008, the Court entered an order (the "Sale Order") authorizing the sale of the Block Property and Tower Hill Property for $8.1 million. [ER, Ex. I, at 167]. Under the terms of the Sale Order, $7.1 million was allocated to the sale of the Block Property and $1 million was allocated to the sale of the Tower Hill Property (the "Tower Hill Sale Proceeds"). [ER, Ex. I, at 168-169].

5. Settlement of Claims and Dismissal of Mr. Bresnick’s Case

On March 13, 2009, the Bankruptcy Court approved a stipulation of settlement (the "Stipulation") resolving claims against Mr. Bresnick’s estate and providing for the dismissal of the case. [ER, Ex. H, at 148]. Under the Stipulation, estate funds in the Trustee’s possession would be used to pay professional fees and expenses approved by the bankruptcy court. [ER, Ex. H, at 155, ¶ 8]. The parties also agreed that the proceeds of the sale of the Tower Hill Property would be paid to the estate to satisfy any shortfall with respect to fee awards. [ER, Ex. H, at 155-156, ¶ 8]. In accordance with the terms of the Stipulation, the bankruptcy court dismissed Mr. Bresnick’s case on June 29, 2009. [ER, Ex. H, at 157-158, ¶ 15, and Ex. K, at 218, ECF Doc. No. 245]. The bankruptcy court retained jurisdiction to consider the professionals’ applications for compensation. [ER, Ex. H, at 155, ¶ 8].

6. The Application

Mr. Morrison filed the Application on April 23, 2009, seeking $11,455.00 in fees for time incurred prior to the appointment of the Trustee and $103,792.83 for work performed after the appointment of the Trustee. [ER, Ex. G, at 102]. On May 7, 2009, the United States Trustee filed an objection (the "Objection") to the request for fees incurred after the appointment of the Trustee, because, under *Lamie*, Mr. Morrison was not entitled to receive compensation from estate funds for services rendered to Mr. Bresnick after the appointment of the Trustee. [ER, Ex. F, at 89].

7. The Bankruptcy Court's Decision and Order

On May 21, 2009, the bankruptcy court entered an order awarding Mr. Morrison fees in the amount of $9,085 for work performed before the appointment of the Trustee. [ER, Ex. K, at 217, ECF Doc. No. 235]. On June 23, 2009, the bankruptcy court entered a decision and order denying the Application with respect to fees incurred following the appointment of the Trustee. [ER, Ex. B, at 4, and Ex. C, at 5]. The bankruptcy court, citing *Lamie*, 540 U.S. at 538, held that Mr. Morrison was not entitled to compensation for work performed for Mr. Bresnick after the Trustee was appointed in the case because "§ 330(a)(1) does not authorize compensation awards to debtors' attorneys from estate funds, unless they are employed as authorized under § 327(a)." [ER, Ex. C, at 9]. After the appointment of the Trustee, Mr. Bresnick lost his status as debtor in possession and Mr. Morrison's appointment as counsel terminated. [ER, Ex. C, at 9-10]. The Court, therefore, denied Mr. Morrison's request for fees in the amount of $103,792.83. [ER, Ex. B, at 4]. On July 2, 2009, Mr. Morrison filed a timely notice of appeal. [ER, Ex. A, at 1].

VI. ARGUMENT

A. The Bankruptcy Court Properly Followed the Supreme Court's Ruling in *Lamie* When It Denied Mr. Morrison's Request for Compensation Because Mr. Morrison's Role as Attorney for the Debtor in Possession Terminated Upon the Appointment of the Trustee.

The bankruptcy court properly followed *Lamie*, 540 U.S. at 532, 538-39, in denying Mr. Morrison's request for post-trustee compensation. Under *Lamie*, Mr. Morrison's role as attorney for the debtor-in-possession, *i.e.*, the Bresnick bankruptcy estate, terminated upon the appointment of the Trustee. *Id.* Given that Mr. Morrison was not retained by the Trustee to represent the estate post-appointment, *Lamie* precludes Mr. Morrison from receiving estate funds for services rendered after his non re-employment by the Trustee. *Id.* Because the bankruptcy court did not err in relying on *Lamie*, this Court should affirm the Order.

1. Only Professionals Re-Employed by a Trustee under 11 U.S.C. § 327 After a Trustee's Appointment Are Entitled to Represent the Trustee and the Bankruptcy Estate, and Receive Compensation From the Estate Under 11 U.S.C. § 330.

By enacting the Bankruptcy Code, Congress has established a comprehensive set of rules that dictate how attorneys may be retained at estate expense, how they are compensated by the estate, how they receive payment from the estate, and what priority their payment receives. *See* 11 U.S.C. §§ 327, 330, 503, and 507. In order to receive compensation from the bankruptcy estate, an attorney working as counsel for a chapter 11 debtor must meet two tests.

First, the attorney must be employed as counsel for the debtor in possession under 11 U.S.C. 327(a). *Lamie*, 540 U.S. at 538 ("Adhering to conventional doctrines of statutory interpretation, we hold that § 330(a)(1) does not authorize compensation awards to debtors' attorneys from estate funds, unless they are employed as authorized by § 327 . . . ."); *In re Crafts*

Retail Holding Corp., 378 B.R. 44, 49 (Bankr. E.D.N.Y. 2007) (denying fee application of attorneys hired by financial advisors, because the court had not previously approved law firm's retention by debtor). Section 327(a) of the Bankruptcy Code authorizes a debtor in possession, subject to court approval, to retain one or more professional persons to assist it in fulfilling its fiduciary duties, provided that the person 1) does not represent an interest adverse to the estate; and 2) is disinterested. *In re Leslie Fay Cos., Inc.*, 175 B.R. 525, 531 (Bankr. S.D.N.Y. 1994); *Rome v. Braunstein*, 19 F.3d 54, 58 (1st Cir. 1994).

Second, the bankruptcy court must award the attorney fees under 11 U.S.C. § 330(a). *Lamie*, 540 U.S. at 538-39. Section 330(a) grants a bankruptcy court broad discretion to pay debtor's counsel what the court determines to be a "reasonable" fee for "actual" services that are "necessary." 11 U.S.C. 330(a). *In re Cenargo Intern., PLC*, 294 B.R. 571, 596 (Bankr. S.D.N.Y. 2003).

Everyone concedes that Mr. Morrison could represent Mr. Bresnick's chapter 11 estate prior to the time that the Trustee was appointed by the court. That is so because Mr. Bresnick, in his role as the debtor in possession, obtained approval under 11 U.S.C. § 327 to use Mr. Morrison as the estate's attorney. 11 U.S.C. §§ 1101(1) (the debtor acts as the debtor in possession unless a trustee is appointed in the case) and 1107 (debtors in possession have the powers of a trustee, which includes hiring counsel under section 327). Everyone also agrees that Mr. Morrison can be paid from estate funds under 11 U.S.C. § 330 for the work he did on behalf of the estate prior to the time Mr. Bresnick was replaced by the Trustee.

But, as the bankruptcy court ruled, once Mr. Bresnick was replaced by the Trustee, the Trustee controlled the estate as a matter of federal law. *See* 11 U.S.C. § 323(a) (the trustee is the representative of the bankruptcy estate). At that juncture, the Trustee had to obtain court approval to retain Mr. Morrison's as trustee counsel under § 327(a) if Mr. Morrison were to act as the trustee's counsel or obtain compensation for post-trustee work under § 330. *See* 11 U.S.C. § 1101(1) (trustee becomes the debtor in possession upon appointment); 11 U.S.C. § 327(a) (trustee must apply to use counsel); 11 U.S.C. § 1106 (trustee duties). Because the Trustee chose to employ the Lamonica Firm, rather than to re-employ Mr. Morrison, Mr. Morrison cannot ask this estate's creditors to pay him for work he performed after the Trustee's appointment.

In *Lamie*, the Supreme Court confirmed that the appointment of a trustee "terminate[s]" the debtor's "status as debtor-in-possession and so terminate[s] [the lawyer's role] under § 327 as an attorney for the debtor-in-possession." *Lamie*, 540 U.S. at 532. And, under *Lamie*, any work such a lawyer performs post-trustee appointment cannot be compensated from the estate,. *Lamie*, 540 U.S. at 538-39 (holding "[i]f the attorney [formerly hired by the deposed debtor in possession] is to be paid from estate funds under § 330(a)(1) in a chapter 7 case [for work done after a trustee is appointed], he must be employed by the trustee and approved by the court").

Thus, under *Lamie*, Mr. Morrison cannot ask the Bresnick estate, *i.e.*, its creditors, to pay him for work he performed after the Trustee was appointed. As *Lamie* held, that was possible only if the Trustee had obtained a new appointment of Mr. Morrison as his counsel under § 327, which the trustee chose not to do - preferring the LaMonica Firm to Mr. Morrison.[5]

The similarities between the facts of this case and those of *Lamie* make clear that Mr. Morrison's failure to be employed by the Trustee precludes him from asking the estate to pay his

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[5] *Lamie* was decided well before Mr. Morrison, an experienced bankruptcy attorney, performed his post-trustee work in this case. Given its holding, Mr. Morrison proceeded at his own risk.

post-trustee fees. In *Lamie*, Mr. Lamie agreed to represent a debtor in its chapter 11 case. 540 U.S. at 531-32. So did Mr. Morrison. [ER, Ex. K, at 176, ECF Doc. No. 23]. Mr. Lamie's client filed an application under 11 U.S.C. 327(a) to employ Mr. Lamie as debtor's counsel in its chapter 11 bankruptcy case. 540 U.S. at 531-532. So did Mr. Morrison's client. [ER, Ex. K, at 176, ECF Doc. No. 23]. Mr. Lamie's retention in the chapter 11 case was approved by the bankruptcy court under section 327(a). 540 U.S. at 531-532. So was Mr. Morrison's. [ER, Ex. K, at 177, ECF Doc. No. 28]. Mr. Lamie performed services during his client's chapter 11 case. 540 U.S. at 531-532. So did Mr. Morrison. [ER, Ex. G. at 102]. Mr. Lamie's client's chapter 11 case was converted to a chapter 7 case and a chapter 7 trustee appointed. 540 U.S. at 531-532. In this case, a chapter 11 trustee was appointed. [ER, Ex. K, at 182, ECF Doc. Nos. 57 and 58]. The chapter 7 trustee never filed an application to employ Mr. Lamie under § 327. 540 U.S. at 532. The Trustee never filed an application to employ Mr. Morrison. [ER, Ex. K, at 184-221]. Without approval of his retention as trustee's counsel under section 327, Mr. Lamie did work after the appointment of the trustee. 540 U.S. at 532. Mr. Morrison also did work after the appointment of the Trustee. [ER, Ex. G. at 102]. Mr. Lamie then filed an application seeking final compensation under § 330 of the Bankruptcy Code. 540 U.S. at 532. So did Mr. Morrison. [ER, Exhibit G, at 102]. Mr. Lamie took the position that he was entitled to compensation for the work he did after the trustee's appointment. 540 U.S. at 533-542. Notwithstanding the *Lamie* precedent, so did Mr. Morrison. [ER, Exhibit G, at 102, and Ex. E, at 69].

Under these facts, the Supreme Court ruled that Mr. Lamie had no right to payment for services performed post-conversion because the trustee had not retained him under § 327. *Lamie,* 540 U.S. at 533-42. Given that, the bankruptcy court properly ruled that Mr. Morrison had no entitlement to compensation for any work he performed following the appointment of the Trustee because his role as attorney was terminated upon the appointment of the Trustee, and the Trustee had not retained Mr. Morrison under § 327.

Second Circuit precedent in related contexts is wholly consistent with *Lamie*'s requirement that an attorney obtain a court order authorizing his employment as a prerequisite to requesting and receiving compensation. *See United Merchants & Mfrs., Inc. v. Henry Schroder Bank and Trust Co. (In re United Merchants & Mfrs., Inc.)*, 597 F.2d 348 (2d Cir. 1979) (denying fee application submitted by counsel to indenture trustee, because the bankruptcy court had not previously entered an order authorizing the firm's employment); and *In re Keren Ltd. P'ship*, 189 F.3d 86, 88 (2d Cir. 1999) (denying real estate broker's request for commission, because it had not been employed).

And, also consistent with *Lamie*, the Second, Third, Seventh and Tenth Circuits have held that a § 330 award is the only way a professional may receive compensation from estate funds under the Bankruptcy Code and the right to such an award is conditioned upon a section 327(a) appointment. *See In re Milwaukee Engraving Co.*, 219 F.3d 635, 636 (7th Cir. 2000) (holding attorneys may not receive compensation under the Bankruptcy Code when their section 327(a) employment application is denied (*relying upon In re Singson*, 41 F.3d 316, 320 (7th Cir. 1994)); *F/S Airlease II, Inc. v. Simon,* 844 F.2d 99, 108-109 (3rd Cir. 1988) (same); *Keren*, 189 F.3d at 88 (same); *In re Albrecht*, 233 F.3d 1258, 1260 (10th Cir. 2000) (denying compensation because the court did not approve the retention under § 327).

2. Even if the Bankruptcy Court had been Free to Ignore the *Lamie* Ruling, the Applicable Bankruptcy Statutes Confirm that Mr. Morrison Has No Right to Receive Compensation from the Bresnick Estate Under 11 U.S.C. § 330 for his Post-Trustee Work.

After the commencement of a case, chapter 11 debtors retain control of the bankruptcy estate and any business operations as “debtors in possession” with the powers and duties of a trustee, including the power to retain professionals under § 327. *In re Worldcom*, 311 B.R. 151, 163 (Bankr. S.D.N.Y. 2004). *See also* 11 U.S.C. §§ 1101(1) and 1107. However, the appointment of a trustee terminates this debtor in possession status and divests the debtor of possession and control of the bankruptcy estate. *See* 11 U.S.C. §§ 323(a) (trustee is the representative of the estate) and1101(1) (defining a debtor in possession as the debtor, except when a person that has qualified under § 322 is serving a trustee). *See also Lamie*, 540 U.S. at 532 (appointment of chapter 7 trustee terminated debtor’s status as a debtor in possession) and *In re Footstar, Inc*., 323 B.R. 566, 571 (Bankr. S.D.N.Y. 2005) (once a trustee is appointed, the debtor is no longer a debtor in possession and the trustee succeeds to the rights and property of the debtor).

Upon his or her appointment, a chapter 7 or 11 trustee takes control of the estate’s assets and business and has full and sole authority to represent the estate and dispose of estate property. *Footstar*, 323 B.R. at 571 (citations omitted). *See also* 11 U.S.C. § 323(a) (the trustee in a case is the representative of the estate); 11 U.S.C. § 704 (duties of a trustee); 11 U.S.C. § 1101(1) (trustee becomes the debtor in possession); and 11 U.S.C. § 1106 (defining duties of a trustee). Sections 323(a), 1101(1) and 1106 give a chapter 11 trustee the sole right to decide whether the estate will hire lawyers, and who those lawyers should be. *Cf. Lamie*, 540 U.S. at 532, 538.

Consistent with the Code, the Supreme Court has squarely held that once a trustee is appointed in a case, he or she manages the corporate debtor and controls counsel. *CFTC v. Weintraub*, 471 U.S. 343 (1985). In *CFTC*, the Supreme Court held that “the Bankruptcy Code gives the trustee wide-ranging management authority over the debtor.” *Id*. at 352. The Court made clear that former corporate management’s role upon the appointment of a trustee “is to turn over the corporation's property to the trustee and to provide certain information to the trustee and to the creditors. Congress contemplated that when a trustee is appointed, he assumes control of the business, and the debtor's directors are ‘completely ousted.’" *Id.* at 352-53 (*quoting in part* H.R.Rep. No. 95-595, pp. 220-221 (1977)). As *CFTC* held, this transfer of power is so complete it even gives “ the trustee[] control of the corporation's attorney-client privilege with respect to prebankruptcy communications.” *Id*. at 353.

As the trustee completely controls the debtor upon appointment, the appointment of a trustee and the concomitant termination of debtor in possession status also terminates the services of the debtor in possession’s professionals retained under § 327. *Lamie*, 540 U.S. at 532, 538. After the services of the professionals have been terminated, the terminated attorney is not entitled to compensation under § 330 for services rendered after the termination. *Id.* at 534. The terminated lawyer may not be paid from estate funds even if the services were related to its prior retention as the debtor in possession’s counsel or provided benefit to the estate. *In re CK Liquidation Corp.*, 343 B.R. 376, 385 (D. Mass. 2006); *In re Anderson*, 362 B.R. 575, 584-85 (Bankr.E.D.N.Y. 2007). Likewise, the type or quality of services rendered is irrelevant because retention as § 327(a) counsel is terminated as a matter of law. *CK Liquidation*, 343 B.R. at 385, *citing Lamie*, 540 U.S. at 534.

This statutory scheme is fully consistent with the binding precedent enunciated by the Court in *Lamie*, that only if the Trustee had retained Mr. Morrison under § 327, would Mr. Morrison have been entitled to compensation from the estate. *See CFTC,* 471 U.S. 353 (trustee controls counsel and determines whether they waive the attorney-client privilege). However, the Trustee did not retain Mr. Morrison and only the Trustee's retained professionals are entitled to compensation under § 330. *See Lamie*, 540 U.S. at 538-539 (if a debtor's attorney is to be compensated from estate funds, he or she must be employed by the trustee). Instead, the Trustee chose the LaMonica Firm, which is entitled to compensation from the estate for its post-trustee work.

Mr. Morrison suggests a number of reasons why he should be entitled to compensation for services rendered after the appointment of the Trustee. First, he alleges that the parties in the case "explicitly and implicitly" treated him as the attorney for the debtor in possession after the appointment of the Trustee, including identifying him as counsel to the debtor in possession on the signature page of the Stipulation. *See* Brief of Appellant, at 11-12. Second, he claims that he assisted with the resolution of the case and no party objected to his involvement. *Id.*

However, Morrison ignores well-settled law cited above - *Lamie, Keren, F/S Airlease, Albrecht, Milwaukee Engraving,* which each held that an attorney not appointed under section 327(a) cannot be compensated under the Bankruptcy Code. And Mr. Morrison cites no authority for his contrary position. The fact that the parties might have dealt with him after the appointment of the Trustee or that he assisted the Trustee does not circumvent the holding of *Lamie* and the Bankruptcy Code that appointment of a trustee divests the debtor in possession of control over the estate, including the right to retain professionals under § 327 and to compensate them under § 330. *Lamie*, 540 U.S. at 532. *See also Footstar*, 323 BR at 571 (a trustee has full and sole authority over the estate).

Moreover, the parties' failure to object to Mr. Morrison's involvement did not have the effect of vitiating *Lamie*. *Cf. In re Bartmann*, 320 B.R. 725, 742 (Bankr. N.D. Okla. 2004) (trustee did not ratify or waive any right of the estate to challenge debtor's counsel's actions by seeking counsel's assistance). *See also In re Interwest Bus. Equip, Inc.*, 23 F.3d 311 (10th Cir. 1994) (rejecting argument that firm should be retained despite conflicts of interest because court "permitted" the firm to continue to represent debtors in possession although it was not retained under § 327); and *In re EBW Laser, Inc.*, 333 B.R. 351, 356 (Bankr. M.D.N.C. 2005) ("[u]napproved representation–even when expressly agreed to by the parties-- generally is not compensable by the bankruptcy estate").

"Professionals who render services to the estate without first obtaining an order authorizing their employment are effectively volunteers." *Bartmann*, 320 B.R. at 742. It is undisputed that following his termination as attorney for the debtor in possession, Mr. Morrison was never employed the Trustee under § 327. Therefore, the fact that Mr. Morrison continued providing services is irrelevant. *See Interwest*, 23 F.3d at 318 ("[i]f we were to reverse the denial of the [employment] applications in these cases simply because counsel chose to take a calculated risk and continue employment absent necessary authorization, it would effectively write § 327(a) out of the Bankruptcy Code").

Mr. Morrison claims that he deserves compensation for the valuable services he provided in this case. *See* Appellant's Brief, at 11-14. In *Lamie*, the terminated attorney similarly argued that compensation was warranted due to a debtor's need for counsel in a converted case, and basic fairness. *See* Brief of Petitioner in *Lamie v. United States Trustee*, 2003 WL 21295241, at 30-36. The Supreme Court, however, dismissed Mr. Lamie's policy arguments. Although it found the policy concerns advanced by Mr. Lamie unpersuasive, *Lamie*, 540 U.S. at 538, the Court rejected them for a more fundamental reason, the Court's "unwillingness to soften the import of Congress' chosen words even if [those words] lead to a harsh outcome." *Id.* Thus, the Court refused to rule for Mr. Lamie based upon the Court's "longstanding" unwillingness to rewrite statutes, an unwillingness that "result[ed] from deference to the supremacy of the Legislature . . . ." *Id*. (internal quotations omitted).

Notably, Mr. Morrison is not without recourse for the payment of its fees. As recognized by the bankruptcy court, although Mr. Morrison continued to be involved in the case, it was clear that he continued to represent Mr. Bresnick personally, as the debtor, rather than representing the trustee or debtor-in-possession. [ER, Ex. D, at 48, Lines 10-25, and 49, Lined 1-6.] The Court has dismissed Mr. Bresnick's case, [ER, Ex. K, at 218, ECF Doc. No. 245], and, except for the Tower Hill Proceeds, Mr. Bresnick's assets reverted to him upon the dismissal of his case under 11 U.S.C. §349(b)(3). Mr. Morrison may therefore seek the payment of any outstanding fees owed to hm by Mr. Bresnick directly from Mr. Bresnick.

Finally, *Lamie*'s bright line rule protects the public. Absent the bright line, people could be confused about which lawyer speaks for the trustee and the estate. *Lamie* removes that doubt. Only lawyers appointed by the trustee after the trustee's appointment can do work or speak for the estate. Given the multitude of parties in large chapter 11 cases, that clarity protects both the estate and those that deal with it.

3. *Lamie* Applies to the Appointment of Chapter 7 and 11 Trustees.

The only difference between *Lamie* and this case is that the *Lamie* trustee was a chapter 7 trustee, and the Trustee in this case is a chapter 11 trustee. *See* Appellant's Brief, at 13-14 (Mr. Morrison argues that the bankruptcy court erred in applying the holding of *Lamie* to a chapter 11 case, because *Lamie* involved the conversion of a case to chapter 7 and the appointment of a chapter 7 trustee).

However, that difference has no legal significance for four reasons. First, both types of trustees control the appointment of counsel. 11 U.S.C. 327(a). Second, § 327(a) lumps chapter 7 and 11 trustee appointments together, merely providing that "the trustee," regardless of chapter, "may employ one or more attorneys" "with the court's approval[.]" 11 U.S.C. § 327(a). Third, *Lamie* did not distinguish between chapter 7 and 11 trustees, which is not surprising given that both retain counsel the same way, and given that both control the estate. 11 U.S.C. §§ 323(a), 704, 1101(1), and 1106 (both types of trustees are the representative of the bankruptcy estate). Fourth, in both circumstances, the trustee is the sole representative of the bankruptcy estate, obtaining complete control of estate property. 11 U.S.C. §§ 323(a), 704, 1101(1) and 1106. *See, e.g., In re Johnson*, 397 B.R. 486, 490 (Bankr. E. D. Cal. 2008) (*Lamie* applies equally to chapter 11 cases because the underlying rationale is the debtor's loss of status as a debtor in possession). As the sole representative of the estate, only a trustee has the authority to retain counsel under § 327. *Lamie*, 540 U.S. at 533.

Given all this, it is not surprising that a recent decision, *In re Bay Voltex Corp.*, 2006 WL 3834300, at *1 (Bankr. N.D. Cal. December 29, 2006), held, in disallowing the fee request of the former counsel for the debtor in possession for services rendered after the appointment of a chapter 11 trustee, that the distinction between a chapter 11 and 7 trustee was irrelevant:

> Under § 323(a), the trustee is the representative of the estate. Neither a chapter 7 debtor nor a debtor out of possession is a trustee, and neither represents the estate. Section 330(a) makes no provision for compensation of professionals employed by a debtor that is not a trustee.

Id. *See also In re Del Monico*, 2006 WL 345013, at *2 (Bankr. N .D. Ill. February 15, 2006) (denying fees for debtor's counsel after the appointment of a chapter 11 trustee). *Bay* and *Del Monico* are consistent with pre-*Lamie* case law that disallowed fees for a debtor's attorney following the appointment of a chapter 11 trustee. *See In re Pro-Snax Distributors*, 157 F.3d 414, 424 (5th Cir. 1998) (holding that by deleting the words "to the debtor's attorney" from § 330 in the 1994 amendments, Congress indicated that debtor's attorneys could not be compensated from the estate after the appointment of a chapter 11 trustee).

B. The Tower Hill Proceeds are Property of the Bankruptcy Estate and May Not Be Used to Pay Mr. Morrison.

Mr. Morrison argues for the first time on appeal that *Lamie* is inapplicable because the funds used to pay professionals are not property of the estate. *See* Brief of Appellant, at 16-17. Specifically, Mr. Morrison claims that the Tower Hill Proceeds are not property of the estate, and because any shortfall is to be paid from them, he was not seeking compensation from estate funds. *See* Brief of Appellant, at 16.

Appellate courts will not consider an issue raised for the first time on appeal. *Allianz Ins. Co. v. Lerner*, 416 F.3d 109, 114 (2d Cir. 2005). The record on appeal shows that Mr. Morrison failed to present this argument in either his original fee application, his reply brief, or during the extensive hearing on the Application. [ER, Exhibit D, E, and G]. The United States Trustee specifically relied upon *Lamie* in her Objection to the Application. [ER, Ex. F, at 100, ¶¶ 42-44].

Although Mr. Morrison was on notice that the United States Trustee relied on *Lamie* as controlling precedent, he did not argue that he would be paid from non-estate funds. [ER, Exhibit D, E, and G]. Mr. Morrison is, therefore, barred from raising this issue for the first time on appeal. *See Allianz*, 416 F.3d at 114 (issue raised for the first time on appeal is waived). *See also Universal Church v. Geltzer*, 463 F.3d 218, 299 (2d Cir. 2006) (court will not consider any issues raised for the first time on appeal).

Even if Mr. Morrison had preserved this issue for appeal, the Tower Hill Estate Proceeds are property of the estate. Under the terms of the Stipulation, the parties agreed, and the Court directed, that the Tower Hill Sale Proceeds would be used to pay the balance of the allowed professional fees incurred in Mr. Bresnick's case. [ER, Ex. H, at 155-156, ¶ 8]. Mr. Bresnick, as owner of Tower Hill, assigned his interest in the Tower Hill Proceeds to the bankruptcy estate. [ER, Ex. H, at 56, ¶ 8]. *See In re Fry*, 2007 WL 7023829, at *8 (Bankr. S. D. Ga. March 23, 2007) (post-petition cause of action that debtor assigned to the trustee is property of the estate under § 541(a)(7)). Moreover, under the Stipulation, the funds were earmarked pay the balance of allowed professional fees, and they became estate property under the express terms of the Stipulation. [ER Ex. H, at 155-156, ¶ 8]. *See* 11 U.S.C. 541(a)(7) (defining property of the estate as property that the estate acquires after the commencement of the case). Therefore, despite Mr. Morrison's arguments to the contrary, the Tower Hill Sale Proceeds became estate property upon approval of the Stipulation.

Significantly, although Mr. Bresnick's case was dismissed, this dismissal neither altered the terms of the Stipulation nor re-vested Mr. Bresnick with title to the Tower Hill Sale Proceeds, and the proceeds remain property of the Bresnick estate. Section 349 of the Code governs the effect of dismissal of bankruptcy cases. 11 U.S.C. §349. Section 349(b)(2) of the Code provides that only certain orders are automatically vacated upon the dismissal of a bankruptcy case: (a) orders requiring the turnover of property to the trustee (§ 542) or to the debtor (§ 522(i)(1)), (b) orders avoiding the transfer of property (§ 550), and (c) orders permitting the exercise of set-off rights (§ 553). 11 U.S.C. § 349(b)(2). As the Stipulation does not fall within the delineated actions, it was not vacated upon the dismissal of Mr. Bresnick's case. *Norton v. Hoxie State Bank*, 61 B.R. 258 (Bankr. D. Kan. 1986) (holding that § 349(b)(2) affects only those actions delineated in the section). Additionally, the terms of the Stipulation explicitly provide that "the parties' obligations under this Stipulation shall survive the dismissal of Mr. Bresnick's bankruptcy case." [ER, Ex. H, at 157-158, ¶ 15].

Section 349(b)(3) likewise provides that unless the Court orders otherwise, a dismissal of a case revests estate property in the entity in which such property was vested prior to the bankruptcy case. 11 U.S.C. § 349(b)(3). In this case, however, the Tower Hill Sale Proceeds did not revest in Mr. Bresnick, because the distribution of the Tower Hill Sale Proceeds and the rights of Mr. Bresnick's professionals to receive the Tower Hill Sale Proceeds, was specifically provided for in the Stipulation. [ER, Ex. H, at 155-156, ¶ 8]. Therefore, notwithstanding the dismissal of Mr. Bresnick's case, the Stipulation continues to control the distribution of the Tower Hill Sale Proceeds. *See, e.g.*, *In re Witte*, 279 B.R. 585, 588 (Bankr. E.D. Cal. 2002) (holding that § 349(b) of the Code did not require turnover of sale proceeds to the debtor upon the dismissal of the debtor's chapter 13 case, because the order approving the sale controlled the distribution of the sale proceeds). Here, the Stipulation dictates the distribution of the Tower Hill Proceeds and the parties to the Stipulation specifically agreed and acknowledged that it would survive the dismissal of Mr. Bresnick's case. [ER, Ex. H, at 155-156, ¶ 8, and 157-158, ¶ 15]. *See Witte*, 279 B.R. at 589 (holding that an order directing distribution of sale proceeds survived dismissal of the debtor's chapter 13 case). The Tower Hill proceeds became property of Mr. Bresnick's estate and the terms of the Stipulation continue to control the distribution of the proceeds.

VII. CONCLUSION

For these reasons, the United States Trustee respectfully asks this Court to affirm the Order entered below.

Dated: Brooklyn, New York
March 9, 2010

Respectfully submitted,

DIANA G. ADAMS
UNITED STATES TRUSTEE

By: */s/ Alicia M. Leonhard*
Alicia M. Leonhard (AL-9928)
Assistant United States Trustee

/s/ Valerie Millman
Valerie Millman (VM-3127)
Trial Attorney
Office of the United States Trustee
U. S. Department of Justice
271 Cadman Plaza East
Suite 4529
Brooklyn, New York 11201
Phone: 718.422.4960
Facsimile: 718.422.4990
Alicia.M.Leonhard@usdoj.gov
Valerie.Millman@usdoj.gov

Ramona D. Elliott
General Counsel
P. Matthew Sutko
Associate General Counsel
Catherine B. Sevcenko
Trial Attorney
Executive Office for United States Trustees
U. S. Department of Justice
20 Massachusetts Avenue, N.W., Suite 8100
Washington, D.C. 20530
Phone: 202.307.1399

§ 307. United States trustee

The United States trustee may raise and may appear and be heard on any issue in any case or proceeding under this title but may not file a plan pursuant to section 1121 (c) of this title.

EXHIBIT 1

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TITLE 11 > CHAPTER 3 > SUBCHAPTER II > § 323

§ 323. Role and capacity of trustee

(a) The trustee in a case under this title is the representative of the estate.

(b) The trustee in a case under this title has capacity to sue and be sued.

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TITLE 11 > CHAPTER 3 > SUBCHAPTER II > § 327

§ 327. Employment of professional persons

(a) Except as otherwise provided in this section, the trustee, with the court's approval, may employ one or more attorneys, accountants, appraisers, auctioneers, or other professional persons, that do not hold or represent an interest adverse to the estate, and that are disinterested persons, to represent or assist the trustee in carrying out the trustee's duties under this title.

(b) If the trustee is authorized to operate the business of the debtor under section 721, 1202, or 1108 of this title, and if the debtor has regularly employed attorneys, accountants, or other professional persons on salary, the trustee may retain or replace such professional persons if necessary in the operation of such business.

(c) In a case under chapter 7, 12, or 11 of this title, a person is not disqualified for employment under this section solely because of such person's employment by or representation of a creditor, unless there is objection by another creditor or the United States trustee, in which case the court shall disapprove such employment if there is an actual conflict of interest.

(d) The court may authorize the trustee to act as attorney or accountant for the estate if such authorization is in the best interest of the estate.

(e) The trustee, with the court's approval, may employ, for a specified special purpose, other than to represent the trustee in conducting the case, an attorney that has represented the debtor, if in the best interest of the estate, and if such attorney does not represent or hold any interest adverse to the debtor or to the estate with respect to the matter on which such attorney is to be employed.

(f) The trustee may not employ a person that has served as an examiner in the case.

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TITLE 11 > CHAPTER 3 > SUBCHAPTER II > § 330

§ 330. Compensation of officers

(a)

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

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

(B) reimbursement for actual, necessary expenses.

(2) The court may, on its own motion or on the motion of the United States Trustee, the United States Trustee for the District or Region, the trustee for the estate, or any other party in interest, award compensation that is less than the amount of compensation that is requested.

(3) In determining the amount of reasonable compensation to be awarded to an examiner, trustee under chapter 11, or professional person, the court shall consider the nature, the extent, and the value of such services, taking into account all relevant factors, including—

(A) the time spent on such services;

(B) the rates charged for such services;

(C) whether the services were necessary to the administration of, or beneficial at the time at which the service was rendered toward the completion of, a case under this title;

(D) whether the services were performed within a reasonable amount of time commensurate with the complexity, importance, and nature of the problem, issue, or task addressed;

(E) with respect to a professional person, whether the person is board certified or otherwise has demonstrated skill and experience in the bankruptcy field; and

(F) whether the compensation is reasonable based on the customary compensation charged by comparably skilled practitioners in cases other than cases under this title.

(4)

(A) Except as provided in subparagraph (B), the court shall not allow compensation for—

(i) unnecessary duplication of services; or

(ii) services that were not—

(I) reasonably likely to benefit the debtor’s estate; or

(II) necessary to the administration of the case.

(B) In a chapter 12 or chapter 13 case in which the debtor is an individual, the court may allow reasonable compensation to the debtor’s attorney for representing the interests of the debtor in connection with the bankruptcy case based on a consideration of the benefit and necessity of such services to the debtor and the other factors set forth in this section.

(5) The court shall reduce the amount of compensation awarded under this section by the amount of any interim compensation awarded under section 331, and, if the amount of such interim compensation exceeds the amount of compensation awarded under this section, may order the return of the excess to the estate.

(6) Any compensation awarded for the preparation of a fee application shall be based on the level and skill reasonably required to prepare the application.

(7) In determining the amount of reasonable compensation to be awarded to a trustee, the court shall treat such compensation as a commission, based on section 326.

(b)

(1) There shall be paid from the filing fee in a case under chapter 7 of this title $45 to the trustee serving in such case, after such trustee's services are rendered.

(2) The Judicial Conference of the United States—

(A) shall prescribe additional fees of the same kind as prescribed under section 1914 (b) of title 28; and

(B) may prescribe notice of appearance fees and fees charged against distributions in cases under this title;

to pay $15 to trustees serving in cases after such trustees' services are rendered. Beginning 1 year after the date of the enactment of the Bankruptcy Reform Act of 1994, such $15 shall be paid in addition to the amount paid under paragraph (1).

(c) Unless the court orders otherwise, in a case under chapter 12 or 13 of this title the compensation paid to the trustee serving in the case shall not be less than $5 per month from any distribution under the plan during the administration of the plan.

(d) In a case in which the United States trustee serves as trustee, the compensation of the trustee under this section shall be paid to the clerk of the bankruptcy court and deposited by the clerk into the United States Trustee System Fund established by section 589a of title 28.

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TITLE 11 > CHAPTER 3 > SUBCHAPTER III > § 349

§ 349. Effect of dismissal

(a) Unless the court, for cause, orders otherwise, the dismissal of a case under this title does not bar the discharge, in a later case under this title, of debts that were dischargeable in the case dismissed; nor does the dismissal of a case under this title prejudice the debtor with regard to the filing of a subsequent petition under this title, except as provided in section 109 (g) of this title.

(b) Unless the court, for cause, orders otherwise, a dismissal of a case other than under section 742 of this title—

(1) reinstates—

(A) any proceeding or custodianship superseded under section 543 of this title;

(B) any transfer avoided under section 522, 544, 545, 547, 548, 549, or 724 (a) of this title, or preserved under section 510 (c)(2), 522 (i)(2), or 551 of this title; and

(C) any lien voided under section 506 (d) of this title;

(2) vacates any order, judgment, or transfer ordered, under section 522 (i)(1), 542, 550, or 553 of this title; and

(3) revests the property of the estate in the entity in which such property was vested immediately before the commencement of the case under this title.

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TITLE 11 > CHAPTER 5 > SUBCHAPTER I > § 503

§ 503. Allowance of administrative expenses

(a) An entity may timely file a request for payment of an administrative expense, or may tardily file such request if permitted by the court for cause.

(b) After notice and a hearing, there shall be allowed administrative expenses, other than claims allowed under section 502 (f) of this title, including—

(1)

(A) the actual, necessary costs and expenses of preserving the estate including—

(i) wages, salaries, and commissions for services rendered after the commencement of the case; and

(ii) wages and benefits awarded pursuant to a judicial proceeding or a proceeding of the National Labor Relations Board as back pay attributable to any period of time occurring after commencement of the case under this title, as a result of a violation of Federal or State law by the debtor, without regard to the time of the occurrence of unlawful conduct on which such award is based or to whether any services were rendered, if the court determines that payment of wages and benefits by reason of the operation of this clause will not substantially increase the probability of layoff or termination of current employees, or of nonpayment of domestic support obligations, during the case under this title;

(B) any tax—

(i) incurred by the estate, whether secured or unsecured, including property taxes for which liability is in rem, in personam, or both, except a tax of a kind specified in section 507 (a)(8) of this title; or

(ii) attributable to an excessive allowance of a tentative carryback adjustment that the estate received, whether the taxable year to which such adjustment relates ended before or after the commencement of the case;

(C) any fine, penalty, or reduction in credit relating to a tax of a kind specified in subparagraph (B) of this paragraph; and

(D) notwithstanding the requirements of subsection (a), a governmental unit shall not be required to file a request for the payment of an expense described in subparagraph (B) or (C), as a condition of its being an allowed administrative expense;

(2) compensation and reimbursement awarded under section 330 (a) of this title;

(3) the actual, necessary expenses, other than compensation and reimbursement specified in paragraph (4) of this subsection, incurred by—

(A) a creditor that files a petition under section 303 of this title;

(B) a creditor that recovers, after the court's approval, for the benefit of the estate any property transferred or concealed by the debtor;

(C) a creditor in connection with the prosecution of a criminal offense relating to the case or to the business or property of the debtor;

(D) a creditor, an indenture trustee, an equity security holder, or a committee representing creditors or equity security holders other than a committee appointed under section 1102 of this title, in making a substantial contribution in a case under chapter 9 or 11 of this title;

(E) a custodian superseded under section 543 of this title, and compensation for the services of such custodian; or

(F) a member of a committee appointed under section 1102 of this title, if such expenses are incurred in the performance of the duties of such committee;

(4) reasonable compensation for professional services rendered by an attorney or an accountant of an entity whose expense is allowable under subparagraph (A), (B), (C), (D), or (E) of paragraph (3) of this subsection, based on the time, the nature, the extent, and the value of such services, and the cost of comparable services other than in a case under this title, and reimbursement for actual, necessary expenses incurred by such attorney or accountant;

(5) reasonable compensation for services rendered by an indenture trustee in making a substantial contribution in a case under chapter 9 or 11 of this title, based on the time, the nature, the extent, and the value of such services, and the cost of comparable services other than in a case under this title;

(6) the fees and mileage payable under chapter 119 of title 28;

(7) with respect to a nonresidential real property lease previously assumed under section 365, and subsequently rejected, a sum equal to all monetary obligations due, excluding those arising from or relating to a failure to operate or a penalty provision, for the period of 2 years following the later of the rejection date or the date of actual turnover of the premises, without reduction or setoff for any reason whatsoever except for sums actually received or to be received from an entity other than the debtor, and the claim for remaining sums due for the balance of the term of the lease shall be a claim under section 502 (b)(6);

(8) the actual, necessary costs and expenses of closing a health care business incurred by a trustee or by a Federal agency (as defined in section 551 (1) of title 5) or a department or agency of a State or political subdivision thereof, including any cost or expense incurred—

(A) in disposing of patient records in accordance with section 351; or

(B) in connection with transferring patients from the health care business that is in the process of being closed to another health care business; and

(9) the value of any goods received by the debtor within 20 days before the date of commencement of a case under this title in which the goods have been sold to the debtor in the ordinary course of such debtor's business.

(c) Notwithstanding subsection (b), there shall neither be allowed, nor paid—

(1) a transfer made to, or an obligation incurred for the benefit of, an insider of the debtor for the purpose of inducing such person to remain with the debtor's business, absent a finding by the court based on evidence in the record that—

(A) the transfer or obligation is essential to retention of the person because the individual has a bona fide job offer from another business at the same or greater rate of compensation;

(B) the services provided by the person are essential to the survival of the business; and

(C) either—

(i) the amount of the transfer made to, or obligation incurred for the benefit of, the person is not greater than an amount equal to 10 times the amount of the mean transfer or obligation of a similar kind given to nonmanagement employees for any purpose during the calendar year in which the transfer is made or the obligation is incurred; or

(ii) if no such similar transfers were made to, or obligations were incurred for the benefit of, such nonmanagement employees during such calendar year, the amount of the transfer or obligation is not greater than an amount equal to 25 percent of the amount of any similar transfer or obligation made to or incurred for the benefit of such insider for any purpose during the calendar year before the year in which such transfer is made or obligation is incurred;

(2) a severance payment to an insider of the debtor, unless—

(A) the payment is part of a program that is generally applicable to all full-time employees; and

(B) the amount of the payment is not greater than 10 times the amount of the mean severance pay given to nonmanagement employees during the calendar year in which the payment is made; or

(3) other transfers or obligations that are outside the ordinary course of business and not justified by the facts and circumstances of the case, including transfers made to, or obligations incurred for the benefit of, officers, managers, or consultants hired after the date of the filing of the petition.

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TITLE 11 > CHAPTER 5 > SUBCHAPTER I > § 507

§ 507. Priorities

(a) The following expenses and claims have priority in the following order:

(1) First:

(A) Allowed unsecured claims for domestic support obligations that, as of the date of the filing of the petition in a case under this title, are owed to or recoverable by a spouse, former spouse, or child of the debtor, or such child's parent, legal guardian, or responsible relative, without regard to whether the claim is filed by such person or is filed by a governmental unit on behalf of such person, on the condition that funds received under this paragraph by a governmental unit under this title after the date of the filing of the petition shall be applied and distributed in accordance with applicable nonbankruptcy law.

(B) Subject to claims under subparagraph (A), allowed unsecured claims for domestic support obligations that, as of the date of the filing of the petition, are assigned by a spouse, former spouse, child of the debtor, or such child's parent, legal guardian, or responsible relative to a governmental unit (unless such obligation is assigned voluntarily by the spouse, former spouse, child, parent, legal guardian, or responsible relative of the child for the purpose of collecting the debt) or are owed directly to or recoverable by a governmental unit under applicable nonbankruptcy law, on the condition that funds received under this paragraph by a governmental unit under this title after the date of the filing of the petition be applied and distributed in accordance with applicable nonbankruptcy law.

(C) If a trustee is appointed or elected under section 701, 702, 703, 1104, 1202, or 1302, the administrative expenses of the trustee allowed under paragraphs (1)(A), (2), and (6) of section 503 (b) shall be paid before payment of claims under subparagraphs (A) and (B), to the extent that the trustee administers assets that are otherwise available for the payment of such claims.

(2) Second, administrative expenses allowed under section 503 (b) of this title, and any fees and charges assessed against the estate under chapter 123 of title 28.

(3) Third, unsecured claims allowed under section 502 (f) of this title.

(4) Fourth, allowed unsecured claims, but only to the extent of $10,000 for each individual or corporation, as the case may be, earned within 180 days before the date of the filing of the petition or the date of the cessation of the debtor's business, whichever occurs first, for—

(A) wages, salaries, or commissions, including vacation, severance, and sick leave pay earned by an individual; or

(B) sales commissions earned by an individual or by a corporation with only 1 employee, acting as an independent contractor in the sale of goods or services for the debtor in the ordinary course of the debtor's business if, and only if, during the 12 months preceding that date, at least 75 percent of the amount that the individual or corporation earned by acting as an independent contractor in the sale of goods or services was earned from the debtor.

(5) Fifth, allowed unsecured claims for contributions to an employee benefit plan—

(A) arising from services rendered within 180 days before the date of the filing of the petition or the date of the cessation of the debtor's business, whichever occurs first; but only

(B) for each such plan, to the extent of—

(i) the number of employees covered by each such plan multiplied by $10,000; less

(ii) the aggregate amount paid to such employees under paragraph (4) of this subsection, plus the aggregate amount paid by the estate on behalf of such employees to any other employee benefit plan.

(6) Sixth, allowed unsecured claims of persons—

(A) engaged in the production or raising of grain, as defined in section 557 (b) of this title, against a debtor who owns or operates a grain storage facility, as defined in section 557 (b) of this title, for grain or the proceeds of grain, or

(B) engaged as a United States fisherman against a debtor who has acquired fish or fish produce from a fisherman through a sale or conversion, and who is engaged in operating a fish produce storage or processing facility—

but only to the extent of $4,000 for each such individual.

(7) Seventh, allowed unsecured claims of individuals, to the extent of $1,800 for each such individual, arising from the deposit, before the commencement of the case, of money in connection with the purchase, lease, or rental of property, or the purchase of services, for the personal, family, or household use of such individuals, that were not delivered or provided.

(8) Eighth, allowed unsecured claims of governmental units, only to the extent that such claims are for—

(A) a tax on or measured by income or gross receipts for a taxable year ending on or before the date of the filing of the petition—

(i) for which a return, if required, is last due, including extensions, after three years before the date of the filing of the petition;

(ii) assessed within 240 days before the date of the filing of the petition, exclusive of—

(I) any time during which an offer in compromise with respect to that tax was pending or in effect during that 240-day period, plus 30 days; and

(II) any time during which a stay of proceedings against collections was in effect in a prior case under this title during that 240-day period, plus 90 days.[1]

(iii) other than a tax of a kind specified in section 523 (a)(1)(B) or 523 (a)(1)(C) of this title, not assessed before, but assessable, under applicable law or by agreement, after, the commencement of the case;

(B) a property tax incurred before the commencement of the case and last payable without penalty after one year before the date of the filing of the petition;

(C) a tax required to be collected or withheld and for which the debtor is liable in whatever capacity;

(D) an employment tax on a wage, salary, or commission of a kind specified in paragraph (4) of this subsection earned from the debtor before the date of the filing of the petition, whether or not actually paid before such date, for which a return is last due, under applicable law or under any extension, after three years before the date of the filing of the petition;

(E) an excise tax on—

(i) a transaction occurring before the date of the filing of the petition for which a return, if required, is last due, under applicable law or under any extension, after three years before the date of the filing of the petition; or

(ii) if a return is not required, a transaction occurring during the three years immediately preceding the date of the filing of the petition;

(F) a customs duty arising out of the importation of merchandise—

(i) entered for consumption within one year before the date of the filing of the petition;

(ii) covered by an entry liquidated or reliquidated within one year before the date of the filing of the petition; or

(iii) entered for consumption within four years before the date of the filing of the petition but unliquidated on such date, if the Secretary of the Treasury certifies that failure to liquidate such entry was due to an investigation pending on such date into assessment of antidumping or countervailing duties or fraud, or if information needed for the proper appraisement or classification of such merchandise was not available to the appropriate customs officer before such date; or

(G) a penalty related to a claim of a kind specified in this paragraph and in compensation for actual pecuniary loss.

An otherwise applicable time period specified in this paragraph shall be suspended for any period during which a governmental unit is prohibited under applicable nonbankruptcy law from collecting a tax as a result of a request by the debtor for a hearing and an appeal of any collection action taken or proposed against the debtor, plus 90 days; plus any time during which the stay of proceedings was in effect in a prior case under this title or during which collection was precluded by the existence of 1 or more confirmed plans under this title, plus 90 days.

(9) Ninth, allowed unsecured claims based upon any commitment by the debtor to a Federal depository institutions regulatory agency (or predecessor to such agency) to maintain the capital of an insured depository institution.

(10) Tenth, allowed claims for death or personal injury resulting from the operation of a motor vehicle or vessel if such operation was unlawful because the debtor was intoxicated from using alcohol, a drug, or another substance.

(b) If the trustee, under section 362, 363, or 364 of this title, provides adequate protection of the interest of a holder of a claim secured by a lien on property of the debtor and if, notwithstanding such protection, such creditor has a claim allowable under subsection (a)(2) of this section arising from the stay of action against such property under section 362 of this title, from the use, sale, or lease of such property under section 363 of this title, or from the granting of a lien under section 364 (d) of this title, then such creditor's claim under such subsection shall have priority over every other claim allowable under such subsection.

(c) For the purpose of subsection (a) of this section, a claim of a governmental unit arising from an erroneous refund or credit of a tax has the same priority as a claim for the tax to which such refund or credit relates.

(d) An entity that is subrogated to the rights of a holder of a claim of a kind specified in subsection (a)(1), (a)(4), (a)(5), (a)(6), (a)(7), (a)(8), or (a)(9) of this section is not subrogated to the right of the holder of such claim to priority under such subsection.

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[1] So in original. The period probably should be "; or".

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§ 541. Property of the estate

(a) The commencement of a case under section 301, 302, or 303 of this title creates an estate. Such estate is comprised of all the following property, wherever located and by whomever held:

- **(1)** Except as provided in subsections (b) and (c)(2) of this section, all legal or equitable interests of the debtor in property as of the commencement of the case.
- **(2)** All interests of the debtor and the debtor's spouse in community property as of the commencement of the case that is—
  - **(A)** under the sole, equal, or joint management and control of the debtor; or
  - **(B)** liable for an allowable claim against the debtor, or for both an allowable claim against the debtor and an allowable claim against the debtor's spouse, to the extent that such interest is so liable.
- **(3)** Any interest in property that the trustee recovers under section 329 (b), 363 (n), 543, 550, 553, or 723 of this title.
- **(4)** Any interest in property preserved for the benefit of or ordered transferred to the estate under section 510 (c) or 551 of this title.
- **(5)** Any interest in property that would have been property of the estate if such interest had been an interest of the debtor on the date of the filing of the petition, and that the debtor acquires or becomes entitled to acquire within 180 days after such date—
  - **(A)** by bequest, devise, or inheritance;
  - **(B)** as a result of a property settlement agreement with the debtor's spouse, or of an interlocutory or final divorce decree; or
  - **(C)** as a beneficiary of a life insurance policy or of a death benefit plan.
- **(6)** Proceeds, product, offspring, rents, or profits of or from property of the estate, except such as are earnings from services performed by an individual debtor after the commencement of the case.
- **(7)** Any interest in property that the estate acquires after the commencement of the case.

(b) Property of the estate does not include—

- **(1)** any power that the debtor may exercise solely for the benefit of an entity other than the debtor;
- **(2)** any interest of the debtor as a lessee under a lease of nonresidential real property that has terminated at the expiration of the stated term of such lease before the commencement of the case under this title, and ceases to include any interest of the debtor as a lessee under a lease of nonresidential real property that has terminated at the expiration of the stated term of such lease during the case;
- **(3)** any eligibility of the debtor to participate in programs authorized under the Higher Education Act of 1965 (20 U.S.C. 1001 et seq.; 42 U.S.C. 2751 et seq.), or any accreditation status or State licensure of the debtor as an educational institution;
- **(4)** any interest of the debtor in liquid or gaseous hydrocarbons to the extent that—
  - **(A)**
    - **(i)** the debtor has transferred or has agreed to transfer such interest pursuant to a farmout agreement or any written agreement directly related to a farmout agreement; and
    - **(ii)** but for the operation of this paragraph, the estate could include the interest referred to in clause (i) only by virtue of section 365 or 544 (a)(3) of this title; or
  - **(B)**
    - **(i)** the debtor has transferred such interest pursuant to a written conveyance of a production payment to an entity that does not participate in the operation of the property from which such production payment is transferred; and
    - **(ii)** but for the operation of this paragraph, the estate could include the interest referred to in clause (i) only by virtue of section 365 or 542 of this title;
- **(5)** funds placed in an education individual retirement account (as defined in section 530(b)(1) of the Internal Revenue Code of 1986) not later than 365 days before the date of the filing of the petition in a case under this title, but—
  - **(A)** only if the designated beneficiary of such account was a child, stepchild, grandchild, or stepgrandchild of the debtor for

the taxable year for which funds were placed in such account;

(B) only to the extent that such funds—

(i) are not pledged or promised to any entity in connection with any extension of credit; and

(ii) are not excess contributions (as described in section 4973(e) of the Internal Revenue Code of 1986); and

(C) in the case of funds placed in all such accounts having the same designated beneficiary not earlier than 720 days nor later than 365 days before such date, only so much of such funds as does not exceed $5,000;

(6) funds used to purchase a tuition credit or certificate or contributed to an account in accordance with section 529(b)(1)(A) of the Internal Revenue Code of 1986 under a qualified State tuition program (as defined in section 529(b)(1) of such Code) not later than 365 days before the date of the filing of the petition in a case under this title, but—

(A) only if the designated beneficiary of the amounts paid or contributed to such tuition program was a child, stepchild, grandchild, or stepgrandchild of the debtor for the taxable year for which funds were paid or contributed;

(B) with respect to the aggregate amount paid or contributed to such program having the same designated beneficiary, only so much of such amount as does not exceed the total contributions permitted under section 529(b)(7) of such Code with respect to such beneficiary, as adjusted beginning on the date of the filing of the petition in a case under this title by the annual increase or decrease (rounded to the nearest tenth of 1 percent) in the education expenditure category of the Consumer Price Index prepared by the Department of Labor; and

(C) in the case of funds paid or contributed to such program having the same designated beneficiary not earlier than 720 days nor later than 365 days before such date, only so much of such funds as does not exceed $5,000;

(7) any amount—

(A) withheld by an employer from the wages of employees for payment as contributions—

(i) to—

(I) an employee benefit plan that is subject to title I of the Employee Retirement Income Security Act of 1974 or under an employee benefit plan which is a governmental plan under section 414(d) of the Internal Revenue Code of 1986;

(II) a deferred compensation plan under section 457 of the Internal Revenue Code of 1986; or

(III) a tax-deferred annuity under section 403(b) of the Internal Revenue Code of 1986;

except that such amount under this subparagraph shall not constitute disposable income as defined in section 1325 (b)(2); or

(ii) to a health insurance plan regulated by State law whether or not subject to such title; or

(B) received by an employer from employees for payment as contributions—

(i) to—

(I) an employee benefit plan that is subject to title I of the Employee Retirement Income Security Act of 1974 or under an employee benefit plan which is a governmental plan under section 414(d) of the Internal Revenue Code of 1986;

(II) a deferred compensation plan under section 457 of the Internal Revenue Code of 1986; or

(III) a tax-deferred annuity under section 403(b) of the Internal Revenue Code of 1986;

except that such amount under this subparagraph shall not constitute disposable income, as defined in section 1325 (b)(2); or

(ii) to a health insurance plan regulated by State law whether or not subject to such title;

(8) subject to subchapter III of chapter 5, any interest of the debtor in property where the debtor pledged or sold tangible personal property (other than securities or written or printed evidences of indebtedness or title) as collateral for a loan or advance of money given by a person licensed under law to make such loans or advances, where—

(A) the tangible personal property is in the possession of the pledgee or transferee;

(B) the debtor has no obligation to repay the money, redeem the collateral, or buy back the property at a stipulated price; and

(C) neither the debtor nor the trustee have exercised any right to redeem provided under the contract or State law, in a timely manner as provided under State law and section 108 (b); or

(9) any interest in cash or cash equivalents that constitute proceeds of a sale by the debtor of a money order that is made—

(A) on or after the date that is 14 days prior to the date on which the petition is filed; and

(B) under an agreement with a money order issuer that prohibits the commingling of such proceeds with property of the debtor (notwithstanding that, contrary to the agreement, the proceeds may have been commingled with property of the debtor), unless the money order issuer had not taken action, prior to the filing of the petition, to require compliance with the prohibition.

Paragraph (4) shall not be construed to exclude from the estate any consideration the debtor retains, receives, or is entitled to receive for transferring an interest in liquid or gaseous hydrocarbons pursuant to a farmout agreement.

(c)

(1) Except as provided in paragraph (2) of this subsection, an interest of the debtor in property becomes property of the estate under subsection (a)(1), (a)(2), or (a)(5) of this section notwithstanding any provision in an agreement, transfer instrument, or applicable nonbankruptcy law—

(A) that restricts or conditions transfer of such interest by the debtor; or

(B) that is conditioned on the insolvency or financial condition of the debtor, on the commencement of a case under this title, or on the appointment of or taking possession by a trustee in a case under this title or a custodian before such commencement, and that effects or gives an option to effect a forfeiture, modification, or termination of the debtor’s interest in property.

(2) A restriction on the transfer of a beneficial interest of the debtor in a trust that is enforceable under applicable nonbankruptcy law is enforceable in a case under this title.

(d) Property in which the debtor holds, as of the commencement of the case, only legal title and not an equitable interest, such as a mortgage secured by real property, or an interest in such a mortgage, sold by the debtor but as to which the debtor retains legal title to service or supervise the servicing of such mortgage or interest, becomes property of the estate under subsection (a)(1) or (2) of this section only to the extent of the debtor’s legal title to such property, but not to the extent of any equitable interest in such property that the debtor does not hold.

(e) In determining whether any of the relationships specified in paragraph (5)(A) or (6)(A) of subsection (b) exists, a legally adopted child of an individual (and a child who is a member of an individual’s household, if placed with such individual by an authorized placement agency for legal adoption by such individual), or a foster child of an individual (if such child has as the child’s principal place of abode the home of the debtor and is a member of the debtor’s household) shall be treated as a child of such individual by blood.

(f) Notwithstanding any other provision of this title, property that is held by a debtor that is a corporation described in section 501(c)(3) of the Internal Revenue Code of 1986 and exempt from tax under section 501(a) of such Code may be transferred to an entity that is not such a corporation, but only under the same conditions as would apply if the debtor had not filed a case under this title.

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TITLE 11 > CHAPTER 7 > SUBCHAPTER I > § 701

§ 701. Interim trustee

(a)

(1) Promptly after the order for relief under this chapter, the United States trustee shall appoint one disinterested person that is a member of the panel of private trustees established under section 586 (a)(1) of title 28 or that is serving as trustee in the case immediately before the order for relief under this chapter to serve as interim trustee in the case.

(2) If none of the members of such panel is willing to serve as interim trustee in the case, then the United States trustee may serve as interim trustee in the case.

(b) The service of an interim trustee under this section terminates when a trustee elected or designated under section 702 of this title to serve as trustee in the case qualifies under section 322 of this title.

(c) An interim trustee serving under this section is a trustee in a case under this title.

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TITLE 11 > CHAPTER 7 > SUBCHAPTER I > § 702

§ 702. Election of trustee

(a) A creditor may vote for a candidate for trustee only if such creditor—

(1) holds an allowable, undisputed, fixed, liquidated, unsecured claim of a kind entitled to distribution under section 726 (a)(2), 726 (a)(3), 726 (a)(4), 752 (a), 766 (h), or 766 (i) of this title;

(2) does not have an interest materially adverse, other than an equity interest that is not substantial in relation to such creditor's interest as a creditor, to the interest of creditors entitled to such distribution; and

(3) is not an insider.

(b) At the meeting of creditors held under section 341 of this title, creditors may elect one person to serve as trustee in the case if election of a trustee is requested by creditors that may vote under subsection (a) of this section, and that hold at least 20 percent in amount of the claims specified in subsection (a)(1) of this section that are held by creditors that may vote under subsection (a) of this section.

(c) A candidate for trustee is elected trustee if—

(1) creditors holding at least 20 percent in amount of the claims of a kind specified in subsection (a)(1) of this section that are held by creditors that may vote under subsection (a) of this section vote; and

(2) such candidate receives the votes of creditors holding a majority in amount of claims specified in subsection (a)(1) of this section that are held by creditors that vote for a trustee.

(d) If a trustee is not elected under this section, then the interim trustee shall serve as trustee in the case.

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TITLE 11 > CHAPTER 7 > SUBCHAPTER I > § 704

§ 704. Duties of trustee

(a) The trustee shall—

(1) collect and reduce to money the property of the estate for which such trustee serves, and close such estate as expeditiously as is compatible with the best interests of parties in interest;

(2) be accountable for all property received;

(3) ensure that the debtor shall perform his intention as specified in section 521 (2)(B) of this title;

(4) investigate the financial affairs of the debtor;

(5) if a purpose would be served, examine proofs of claims and object to the allowance of any claim that is improper;

(6) if advisable, oppose the discharge of the debtor;

(7) unless the court orders otherwise, furnish such information concerning the estate and the estate's administration as is requested by a party in interest;

(8) if the business of the debtor is authorized to be operated, file with the court, with the United States trustee, and with any governmental unit charged with responsibility for collection or determination of any tax arising out of such operation, periodic reports and summaries of the operation of such business, including a statement of receipts and disbursements, and such other information as the United States trustee or the court requires;

(9) make a final report and file a final account of the administration of the estate with the court and with the United States trustee;

(10) if with respect to the debtor there is a claim for a domestic support obligation, provide the applicable notice specified in subsection (c);

(11) if, at the time of the commencement of the case, the debtor (or any entity designated by the debtor) served as the administrator (as defined in section 3 of the Employee Retirement Income Security Act of 1974) of an employee benefit plan, continue to perform the obligations required of the administrator; and

(12) use all reasonable and best efforts to transfer patients from a health care business that is in the process of being closed to an appropriate health care business that—

(A) is in the vicinity of the health care business that is closing;

(B) provides the patient with services that are substantially similar to those provided by the health care business that is in the process of being closed; and

(C) maintains a reasonable quality of care.

(b)

(1) With respect to a debtor who is an individual in a case under this chapter—

(A) the United States trustee (or the bankruptcy administrator, if any) shall review all materials filed by the debtor and, not later than 10 days after the date of the first meeting of creditors, file with the court a statement as to whether the debtor's case would be presumed to be an abuse under section 707 (b); and

(B) not later than 5 days after receiving a statement under subparagraph (A), the court shall provide a copy of the statement to all creditors.

(2) The United States trustee (or bankruptcy administrator, if any) shall, not later than 30 days after the date of filing a statement under paragraph (1), either file a motion to dismiss or convert under section 707 (b) or file a statement setting forth the reasons the United States trustee (or the bankruptcy administrator, if any) does not consider such a motion to be appropriate, if the United States trustee (or the bankruptcy administrator, if any) determines that the debtor's case should be presumed to be an abuse under section 707 (b) and the product of the debtor's current monthly income, multiplied by 12 is not less than—

(A) in the case of a debtor in a household of 1 person, the median family income of the applicable State for 1 earner; or

(B) in the case of a debtor in a household of 2 or more individuals, the highest median family income of the applicable State for a family of the same number or fewer individuals.

(c)

(1) In a case described in subsection (a)(10) to which subsection (a)(10) applies, the trustee shall—

(A)

(i) provide written notice to the holder of the claim described in subsection (a)(10) of such claim and of the right of such holder to use the services of the State child support enforcement agency established under sections 464 and 466 of the Social Security Act for the State in which such holder resides, for assistance in collecting child support during and after the case under this title;

(ii) include in the notice provided under clause (i) the address and telephone number of such State child support enforcement agency; and

(iii) include in the notice provided under clause (i) an explanation of the rights of such holder to payment of such claim under this chapter;

(B)

(i) provide written notice to such State child support enforcement agency of such claim; and

(ii) include in the notice provided under clause (i) the name, address, and telephone number of such holder; and

(C) at such time as the debtor is granted a discharge under section 727, provide written notice to such holder and to such State child support enforcement agency of—

(i) the granting of the discharge;

(ii) the last recent known address of the debtor;

(iii) the last recent known name and address of the debtor’s employer; and

(iv) the name of each creditor that holds a claim that—

(I) is not discharged under paragraph (2), (4), or (14A) of section 523 (a); or

(II) was reaffirmed by the debtor under section 524 (c).

(2)

(A) The holder of a claim described in subsection (a)(10) or the State child support enforcement agency of the State in which such holder resides may request from a creditor described in paragraph (1)(C)(iv) the last known address of the debtor.

(B) Notwithstanding any other provision of law, a creditor that makes a disclosure of a last known address of a debtor in connection with a request made under subparagraph (A) shall not be liable by reason of making such disclosure.

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TITLE 11 > CHAPTER 11 > SUBCHAPTER I > § 1101

§ 1101. Definitions for this chapter

In this chapter—

(1) “debtor in possession” means debtor except when a person that has qualified under section 322 of this title is serving as trustee in the case;

(2) “substantial consummation” means—

(A) transfer of all or substantially all of the property proposed by the plan to be transferred;

(B) assumption by the debtor or by the successor to the debtor under the plan of the business or of the management of all or substantially all of the property dealt with by the plan; and

(C) commencement of distribution under the plan.

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TITLE 11 > CHAPTER 11 > SUBCHAPTER I > § 1104

§ 1104. Appointment of trustee or examiner

(a) At any time after the commencement of the case but before confirmation of a plan, on request of a party in interest or the United States trustee, and after notice and a hearing, the court shall order the appointment of a trustee—

(1) for cause, including fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor by current management, either before or after the commencement of the case, or similar cause, but not including the number of holders of securities of the debtor or the amount of assets or liabilities of the debtor;

(2) if such appointment is in the interests of creditors, any equity security holders, and other interests of the estate, without regard to the number of holders of securities of the debtor or the amount of assets or liabilities of the debtor; or

(3) if grounds exist to convert or dismiss the case under section 1112, but the court determines that the appointment of a trustee or an examiner is in the best interests of creditors and the estate.

(b)

(1) Except as provided in section 1163 of this title, on the request of a party in interest made not later than 30 days after the court orders the appointment of a trustee under subsection (a), the United States trustee shall convene a meeting of creditors for the purpose of electing one disinterested person to serve as trustee in the case. The election of a trustee shall be conducted in the manner provided in subsections (a), (b), and (c) of section 702 of this title.

(2)

(A) If an eligible, disinterested trustee is elected at a meeting of creditors under paragraph (1), the United States trustee shall file a report certifying that election.

(B) Upon the filing of a report under subparagraph (A)—

(i) the trustee elected under paragraph (1) shall be considered to have been selected and appointed for purposes of this section; and

(ii) the service of any trustee appointed under subsection (d) shall terminate.

(C) The court shall resolve any dispute arising out of an election described in subparagraph (A).

(c) If the court does not order the appointment of a trustee under this section, then at any time before the confirmation of a plan, on request of a party in interest or the United States trustee, and after notice and a hearing, the court shall order the appointment of an examiner to conduct such an investigation of the debtor as is appropriate, including an investigation of any allegations of fraud, dishonesty, incompetence, misconduct, mismanagement, or irregularity in the management of the affairs of the debtor of or by current or former management of the debtor, if—

(1) such appointment is in the interests of creditors, any equity security holders, and other interests of the estate; or

(2) the debtor's fixed, liquidated, unsecured debts, other than debts for goods, services, or taxes, or owing to an insider, exceed $5,000,000.

(d) If the court orders the appointment of a trustee or an examiner, if a trustee or an examiner dies or resigns during the case or is removed under section 324 of this title, or if a trustee fails to qualify under section 322 of this title, then the United States trustee, after consultation with parties in interest, shall appoint, subject to the court's approval, one disinterested person other than the United States trustee to serve as trustee or examiner, as the case may be, in the case.

(e) The United States trustee shall move for the appointment of a trustee under subsection (a) if there are reasonable grounds to suspect that current members of the governing body of the debtor, the debtor's chief executive or chief financial officer, or members of the governing body who selected the debtor's chief executive or chief financial officer, participated in actual fraud, dishonesty, or criminal conduct in the management of the debtor or the debtor's public financial reporting.

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TITLE 11 > CHAPTER 11 > SUBCHAPTER I > § 1106

§ 1106. Duties of trustee and examiner

(a) A trustee shall—

(1) perform the duties of the trustee, as specified in paragraphs (2), (5), (7), (8), (9), (10), (11), and (12) of section 704;

(2) if the debtor has not done so, file the list, schedule, and statement required under section 521 (1) of this title;

(3) except to the extent that the court orders otherwise, investigate the acts, conduct, assets, liabilities, and financial condition of the debtor, the operation of the debtor’s business and the desirability of the continuance of such business, and any other matter relevant to the case or to the formulation of a plan;

(4) as soon as practicable—

(A) file a statement of any investigation conducted under paragraph (3) of this subsection, including any fact ascertained pertaining to fraud, dishonesty, incompetence, misconduct, mismanagement, or irregularity in the management of the affairs of the debtor, or to a cause of action available to the estate; and

(B) transmit a copy or a summary of any such statement to any creditors’ committee or equity security holders’ committee, to any indenture trustee, and to such other entity as the court designates;

(5) as soon as practicable, file a plan under section 1121 of this title, file a report of why the trustee will not file a plan, or recommend conversion of the case to a case under chapter 7, 12, or 13 of this title or dismissal of the case;

(6) for any year for which the debtor has not filed a tax return required by law, furnish, without personal liability, such information as may be required by the governmental unit with which such tax return was to be filed, in light of the condition of the debtor’s books and records and the availability of such information;

(7) after confirmation of a plan, file such reports as are necessary or as the court orders; and

(8) if with respect to the debtor there is a claim for a domestic support obligation, provide the applicable notice specified in subsection (c).

(b) An examiner appointed under section 1104 (d) of this title shall perform the duties specified in paragraphs (3) and (4) of subsection (a) of this section, and, except to the extent that the court orders otherwise, any other duties of the trustee that the court orders the debtor in possession not to perform.

(c)

(1) In a case described in subsection (a)(8) to which subsection (a)(8) applies, the trustee shall—

(A)

(i) provide written notice to the holder of the claim described in subsection (a)(8) of such claim and of the right of such holder to use the services of the State child support enforcement agency established under sections 464 and 466 of the Social Security Act for the State in which such holder resides, for assistance in collecting child support during and after the case under this title; and

(ii) include in the notice required by clause (i) the address and telephone number of such State child support enforcement agency;

(B)

(i) provide written notice to such State child support enforcement agency of such claim; and

(ii) include in the notice required by clause (i) the name, address, and telephone number of such holder; and

(C) at such time as the debtor is granted a discharge under section 1141, provide written notice to such holder and to such State child support enforcement agency of—

(i) the granting of the discharge;

(ii) the last recent known address of the debtor;

(iii) the last recent known name and address of the debtor’s employer; and

(iv) the name of each creditor that holds a claim that—

(I) is not discharged under paragraph (2), (4), or (14A) of section 523 (a); or

(II) was reaffirmed by the debtor under section 524 (c).

(2)

(A) The holder of a claim described in subsection (a)(8) or the State child enforcement support agency of the State in which such holder resides may request from a creditor described in paragraph (1)(C)(iv) the last known address of the debtor.

(B) Notwithstanding any other provision of law, a creditor that makes a disclosure of a last known address of a debtor in connection with a request made under subparagraph (A) shall not be liable by reason of making such disclosure.

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§ 1107. Rights, powers, and duties of debtor in possession

(a) Subject to any limitations on a trustee serving in a case under this chapter, and to such limitations or conditions as the court prescribes, a debtor in possession shall have all the rights, other than the right to compensation under section 330 of this title, and powers, and shall perform all the functions and duties, except the duties specified in sections 1106 (a)(2), (3), and (4) of this title, of a trustee serving in a case under this chapter.

(b) Notwithstanding section 327 (a) of this title, a person is not disqualified for employment under section 327 of this title by a debtor in possession solely because of such person's employment by or representation of the debtor before the commencement of the case.

§ 1108. Authorization to operate business

Unless the court, on request of a party in interest and after notice and a hearing, orders otherwise, the trustee may operate the debtor’s business.

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[E.g., "CTA9"]

3. ("CCN") ***CURRENT*** CASE NO. No.:

4. ("PCN") ***PRIOR*** CASE NO. & COURT
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9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s)
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2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	N.D. Ohio (Eastern Division)
3. ("CCN") ***CURRENT*** CASE NO.	No.: 5:01cv-1129, -1130, -1131 (Dowd, D.J.)
4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*	No.: 00-52012 Court: Bankr. N.D. Ohio (259 B.R. 884) (Shea-Stonum, B.J.) *(Identify judge & cite, if any)*
5. ("SO") ***SOURCE***	**U.S. TRUSTEES**
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7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*	John L. Daugherty (202-307-1399) Dean Wyman (216-522-7800) *(UST/OGC: 202-307-1399/FAX-2397)*
8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") ! ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	! Can bankruptcy trustees freely resign their positions or is the resignation subject to bankruptcy court approval? √ **Background:** Bankruptcy Court held that "Michael V. Demczyk will remain the Standing Chapter 12 Trustee in the above-captioned cases unless and until his resignation or removal is authorized by this Court after proper notice and hearing." *In re Brookover*, 259 B.R. 884, 895 (Bankr. N.D. Ohio 3/ 26/01). U.S. Trustee appealed to District Court.
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UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

DONALD M. ROBINER, U.S. Trustee	)	
	)	
Appellant,	)	
	)	**5:01 CV 1129**
v.	)	**Case Nos. 5:01 CV 1130**
	)	**5:01 CV 1131**
MICHAEL V. DEMCZYK,	)	
Chapter 12 Trustee,	)	**Judge Dowd**
	)	
Appellee.	)	

BRIEF FOR APPELLANT DONALD M. ROBINER, UNITED STATES TRUSTEE

JOSEPH A. GUZINSKI
Acting General Counsel
JOHN L. DAUGHERTY
Trial Attorney
U.S. Department of Justice
Executive Office for U.S. Trustees
901 E St. NW, Suite 780
Washington, DC 20530
(202) 307-1399
(202) 307-2397 facsimile
email: john.daugherty@usdoj.gov

June 1, 2001

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Basis of Appellate Jurisdiction

This court has jurisdiction over this appeal under 28 U.S.C. § 158. The United States Trustee timely elected to have this appeal heard by the District Court pursuant to 28 U.S.C. § 158(c)(1)(A).

Issue Presented and Standard of Review

Did the Bankruptcy Court err in holding that bankruptcy trustees cannot resign their positions in particular cases unless the bankruptcy court, upon motion by the trustee, elects to accept that resignation?

The issue presented is a pure question of law. On appeal to this Court, questions of law are reviewed de novo. E.g., Chrysler Financial Corp. v. Nolan (In re Nolan), 232 F.3d 528, 531 (6th Cir. 2000); Palmer v. U.S. (In re Palmer), 219 F.3d 580, 583 (6th Cir. 2000).

Statement of the Case and Statutory Framework

Appellee Michael V. Demczyk is the Chapter 12 Standing Trustee for the Eastern Division of the Northern District of Ohio. He attempted to resign as trustee, which resulted in the entry of a sua sponte order by the Bankruptcy Court enjoining him from resigning. Appellant Donald M. Robiner is the United States Trustee for Region 9 (Michigan and Ohio). Mr. Demczyk was appointed to his position as a Chapter 12 Standing Trustee by Mr. Robiner's predecessor as United States Trustee.

Statutory Background

A "chapter 12" case is one of the four principal types of bankruptcy cases under the Bankruptcy Code, commonly known as chapter 7, chapter 11, chapter 12, and chapter 13. In a chapter 7 case, a debtor's assets are liquidated for the benefit of creditors. 11 U.S.C. § 701, et seq. In a chapter 11 case, a debtor attempts to reorganize its business operations by implementing a plan of reorganization approved by the bankruptcy court. 11 U.S.C. § 1101, et seq. Cases under chapters 12 or 13 are similar. Both types of case allow debtors to repay their debts over a period of years pursuant to a repayment plan; the chapters differ principally in that chapter 12 applies only to family farmers and chapter 13 to individuals with regular income. Compare 11 U.S.C. § 1201, et seq. (adjustment of debts of a family farmer) with 11 U.S.C. § 1301, et seq. (adjustment of debts of an individual).

In every chapter 7, 12, and 13 case, an independent trustee is appointed to oversee the administration of the debtor's bankruptcy estate for the benefit of the debtor's creditors. Under the Bankruptcy Code, the United States Trustee appoints these trustees. See 28 U.S.C. §§ 586(a) ("Each United States trustee . . . shall (1) establish, maintain, and supervise a panel of private trustees . . . in cases under chapter 7"), and 586(b) ("If the number of cases under chapter 12 or 13 . . . so warrants, the United States trustee . . . may, subject to the approval of the Attorney General, appoint one or more individuals to serve as standing trustee."). See also 11 U.S.C. §§ 701(a)(1) (the "United States trustee shall appoint" an interim Chapter 7 trustee, who becomes the permanent trustee unless a different trustee is elected by the creditors), 1104(d) (if ordered by the court, the "United States trustee . . . shall appoint" a trustee in a chapter 11 case), 1202(a) (the "United States trustee shall appoint" the chapter 12 trustee), and 1302(a) (the "United States trustee shall appoint" the chapter 13 trustee).

United States Trustees such as Mr. Robiner are officials of the Department of Justice appointed by the Attorney General to supervise the administration of all bankruptcy cases and trustees within specified geographic regions. See 28 U.S.C. §§ 581-589 (specifying the powers of United States Trustees); United States Trustee v. Revco D.S., Inc. (In re Revco D.S., Inc.), 898 F.2d 498, 499 (6th Cir. 1990) ("[t]he United States trustee, an officer of the Executive Branch, represents . . . [the] public interest"). Congress established United States Trustees because it concluded that then-existing bankruptcy laws called the partiality of Bankruptcy Judges into question because the 1898 Act required them to fulfill incompatible roles as adjudicator and administrator. H.R. Rep. No. 95-595, at 89-91 (1977), reprinted in 1978 U.S.C.C.A.N. 5787, 6050-52. In response, the Congress established a pilot United States Trustee Program in the Executive Branch within the Department of Justice to relieve the bankruptcy judges of their current roles in the administration of bankruptcy cases. Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, § 101, 92 Stat. 2549, 2651-57 (1978). The United States Trustee Program was subsequently expanded nationwide. Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1986, Pub. L. No. 99-554, §§ 111-115, 201-230, 100 Stat. 3008, 3090-95, 3097-3103 (1986).

The law is settled that United States Trustees may terminate the eligibility of a panel trustee or standing trustee to receive any future cases. See, e.g., Joelson v. United States, 86 F.3d 1413, 1417-19 (6th Cir. 1996) (finding that a United States Trustee's decision to terminate a trustee's eligibility to receive future cases is committed to agency discretion).[1] The Code also expressly provides that bankruptcy courts may involuntarily "remove" trustees from pending cases if "cause" exists. 11 U.S.C. § 324(a).

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[1] Subsequent to the Joelson decision, the Justice Department promulgated a regulation, 28 C.F.R. § 58.6, granting trustees the right to obtain agency review, and thereafter district court review, of United States Trustees' decisions to terminate the eligibility of a trustee to receive future cases.

Trustees also frequently resign voluntarily from particular cases. They may do so because of a conflict of interest, a heavy caseload, or for personal reasons. The Bankruptcy Code does not specify how a trustee may resign or who accepts the resignation. Prior to the decision issued below, the right of trustees to freely resign was universally recognized. Bankruptcy Courts and United States Trustees typically followed a uniform practice when a trustee voluntarily resigned from a pending case: trustees resigned by notifying their United States Trustee, and the United States Trustee accepted, as a ministerial act, the resignation and appointed a successor trustee. The courts are free to adopt particular notice requirements but Bankruptcy Courts have not – until now – claimed the power to block a trustee's voluntary resignation.

Statement of Facts

Mr. Demczyk effected his resignation by sending a letter dated October 31, 2000 to the United States Trustee announcing his resignation as Chapter 12 Standing Trustee effective November 30, 2000. Brookover Docket #31 at 5-6, Montgomery Farms Docket #82 at 5-6, Giulitto Docket #64 at 5-6[2], reported as In re Brookover, 259 B.R. 884 (Bankr. N.D. Ohio 2001). The United States Trustee sent a letter to Mr. Demczyk accepting his resignation. B.Dkt. #14, M.F.Dkt. #75, G.Dkt. #56. Upon receipt of Mr. Demczyk's notice, the United States Trustee promptly notified all bankruptcy judges in the Northern District of Ohio of Mr. Demczyk's resignation. B.Dkt. #15, M.F.Dkt. #74, G.Dkt. # 57.

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[2] All references to the record shall be by original docket number, except for the Bankruptcy Court's Memorandum of Opinion and Order, which hereinafter will be referred to as "Memorandum Opinion," and the Transcript of the February 16, 2001 hearing, which hereinafter will be referred to as "Transcript." Other subsequent references to the record in the Brookover case shall be "B.Dkt.."; to the record in the Montgomery Farms case, "M.F.Dkt."; and to the Giulitto record, "G.Dkt."

After receiving the notice provided by the United States Trustee of Mr. Demczyk's resignation, the Bankruptcy Court entered identical orders in the three cases that are the subject of this appeal. B.Dkt. #16, M.F.Dkt. #76, G.Dkt. #58. By those orders, the Bankruptcy Court made clear that Mr. Demczyk could not resign unless he first asked for and received the Court's permission. The orders stated in part:

> Michael V. Demczyk is the Standing chapter 12 trustee in this case. . . . The Letters [of resignation and acceptance of resignation] raise a question about whether Mr. Demczyk wishes to continue to serve as the Chapter 12 Trustee. If a change is requested, the Court will await a motion filed and served on all parties in interest. . . . Mr. Demczyk is to continue to carry out his responsibilities in this case, absent a Court Order to the contrary.

Id. The United States Trustee filed a motion with the court on December 7, 2000 reiterating that Mr. Demczyk had resigned, and respectfully asking it to reconsider its order requiring Mr. Demczyk to continue serving as trustee notwithstanding his resignation. B.Dkt. #17, M.F.Dkt. #77, G.Dkt. #59.

The Bankruptcy Court conducted a hearing on the United States Trustee's motion in all three cases on February 16, 2001. At the hearing, Mr. Demczyk testified he had resigned voluntarily. Transcript, p. 11, line 21 to p. 13, line 5. After the conclusion of the hearing, the Bankruptcy Court on March 26, 2001 entered its Memorandum of Opinion and Order in the three cases denying the United States Trustee's Motion to Reconsider and ordering Mr. Demczyk to remain as Chapter 12 Standing Trustee.

The United States Trustee timely appealed this order. B.Dkt. #34, M.F.Dkt. #85, G.Dkt. #67.

Summary of Argument

It is basic to our way of life that people can quit their jobs. United States Trustees can resign from the Justice Department. Judges can retire or resign from the bench. Factory workers can walk off the shop floor. We can identify nothing in the law that diminishes the right of Chapter 12 Standing Trustees to resign. The Bankruptcy Court erred when it prohibited Mr. Demczyk from resigning.

Prior to the unprecedented decision of the Bankruptcy Court below, it was accepted within the bankruptcy community that trustees have the same power to resign that everyone else enjoys. United States Trustees perform the ministerial task of "accepting" these resignations. They do this because the United States Trustee is, as the Bankruptcy Court acknowledged, the party who must appoint the successor trustee. We do not view the function of accepting a resignation as conveying the power to block a resignation. When trustees resign, United States Trustees promptly notify courts and parties in interest of the old trustee's resignation and the successor trustee's appointment.

Argument

I. MR. DEMCZYK WAS FREE TO RESIGN HIS POSITION AS TRUSTEE AND THE BANKRUPTCY COURT ERRED WHEN IT ORDERED HIM TO CONTINUE TO SERVE AS TRUSTEE UNLESS AND UNTIL THE COURT DECIDED IT WAS APPROPRIATE FOR HIM TO RESIGN

A. A Trustee May Vacate His Office by Death, Resignation, or Removal, and Only Removal Requires Bankruptcy Court Action

The Bankruptcy Court concluded that its express statutory power under 11 U.S.C. § 324 to "remove" a trustee "for cause" implicitly allowed it to prohibit Mr. Demczyk from resigning his position as Chapter 12 trustee unless the court determined it was appropriate for him to do so.

Memorandum Opinion at 8-17. Although acknowledging that section 324 applies only to removal, not resignation, the court concluded this section also applied to resignation because section 324 "does not restrict the use of this procedure to only certain, specified cases, and does not prevent its use in cases of resignation." Id. at 8.

There is no support for the notion that a statute will be presumed to apply to things it does not mention. The Federal Deposit Insurance Act, for example, does not "prevent its use," to quote the decision below, in cases brought under the Migratory Birds Act, but its failure to prohibit such an application is meaningless. It would be impossible to draft a statute that enumerates everything to which a statute **does not** apply. The plain language of section 324 applies only to removals and should properly be limited to removals.

The court below also erred in ruling that its power to remove encompasses a power to block a resignation. "Remove" and "resign" have totally different meanings. To "remove" means "to force (one) to leave a place or to go away: as . . . to dismiss from office." Webster's Third New International Dictionary of the English Language Unabridged, p. 1921 (Merriam-Webster, Inc. 1993). To resign is "to give up, relinquish, or forswear one's office, rank, membership, post, or charge esp. formally and definitely." Id. at 1932. See also Webster's II New Riverside University Dictionary, p. 1000 (Riverside Pub. Co. 1988) (defining the word "resign" as "to give up a position, esp. by formal notification: QUIT.").[3] Removal requires a

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[3] Cf. Gresham v. Superior Court, 44 Cal.App.2d 664, 666, 112 P.2d 965, 967 (Ct. App. 1941) (in context of attorney discipline "To resign means to give up or surrender voluntarily the privilege of practicing law. This definition presupposes the voluntary act and volition of the attorney in relinquishing his privilege and does not connote any misconduct upon the part of the person resigning from the State Bar, it being presumed that he did so for reasons good and sufficient to him and not because of any misconduct on his part.").

second party who uses force to dismiss the office holder, while resignation requires only one actor who voluntarily gives up his office.

The Bankruptcy Code and Rules also carefully distinguish between the terms "remove" and "resign." The Code recognizes that the office of trustee in a particular case may from time to time become vacant, and expressly protects pending actions and proceedings initiated by a prior trustee. 11 U.S.C. § 325 (vacancy does not abate pending actions – successor trustee automatically substituted as party). Federal Rule of Bankruptcy Procedure 2012, which implements section 325, expressly provides that a successor trustee is automatically substituted when one of four things happens: the " trustee dies, **resigns**, is **removed**, or otherwise ceases to hold office" (emphasis added). Moreover, two other sections of the Bankruptcy Code, 703(a) and 1104(d), expressly list the terms "remove" and "resign" in the same sentence and separate them by the disjunctive "or." 11 U.S.C. §§ 703(a) and 1104(d) (noting a trustee can "die[] or resign[] during a case" or be "removed under section 324 of this title.").

On this point, the Sixth Circuit has said that "[i]t is a basic principle of statutory construction that terms joined by the disjunctive 'or' must have different meanings because otherwise the statute or provision would be redundant." United States v. Hill, 79 F.3d 1477, 1482-83 (6th Cir. 1996) (citing Garcia v. U.S., 469 U.S. 70, 73 (1984) (holding that "[c]anons of construction indicate that terms connected in the disjunctive in this manner be given separate meanings.")).[4] Given the Code's disjunctive separation of the terms "remove" and "resign," a

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[4] Accord Reiter v. Sonotone Corp., 442 U.S. 330, 339 (1979) ("Canons of construction ordinarily suggest that terms connected by a disjunctive be given separate meanings"); FCC v. Pacifica Found., 438 U.S. 726, 739-40 (1978) (words written in disjunctive, here "obscene, indecent, or profane," are implied to have different meanings); Central States, Southeast and Southwest Areas Pension Fund v. Reimer Express World Corp., 230 F.3d 934, 941 (7th Cir.

separation also found in Federal Rule of Bankruptcy Procedure 2012, it was error for the Bankruptcy Court to conclude that its power to "remove" trustees also gave it the power implicitly to prevent a trustee's voluntary resignation. This conclusion is also consistent with other rules of statutory construction. When interpreting section 324, one must presume that Congress "says in a statute what it means and means in a statute what it says." Connecticut National Bank v. Germain, 503 U.S. 249, 254 (1992). Here the statute grants the Bankruptcy Court the power over trustee removal – not resignation – and that language should be applied as written. Similarly, the Bankruptcy Court's interpretation violates the canon of expressio unius est exclusio alterius. "It is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion." Russello v. U.S., 464 U.S. 16, 23 (1983). Congress limited section 324 to trustee removal. Its inclusion excludes other acts creating a vacancy in the office of trustee such as a resignation.

The decision below also conflicts with the purposes underlying the Bankruptcy Code. As discussed above, Congress separated the administrative and judicial functions in the Bankruptcy Reform Act of 1978. United States Trustees were given the administrative duties of appointing and replacing trustees. Accepting a resignation is a similar task. The only purpose of acceptance is to memorialize the creation of a vacancy and prevent the subsequent withdrawal of a resignation having a future effective date. See Davis v. Marion County Engineer, 60 Ohio St.3d

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2000) ("Different words in a statute, in this case 'authorized' and 'consistent,' should be given different meanings unless the context indicates otherwise." (citing Bailey v. United States, 516 U.S. 137, 143 (1995)); United States v. Rouleau, 894 F.2d 13, 14 (1st Cir.1990) (a series of operative terms in a criminal statute must be read in the disjunctive and are distinct in their meaning); United States v. Behnezhad, 907 F.2d 896, 898 (9th Cir.1990) (a statute written in the disjunctive is generally construed as "setting out separate and distinct alternatives").

53, 55, 573 N.E.2d 51, 54 (1991) ("Absent acceptance in this manner [i.e., a in writing clearly indicating that the resignation was accepted by the party empowered to do so], the public employee should be free to withdraw his or her tender of resignation prior to its purported effective date."). This is fundamentally different from determining whether to remove a trustee for "cause" under section 324. The latter requires a judicial determination of whether cause exists. In order to make this determination, the court must give notice, conduct a hearing, receive and weigh evidence, and enter findings of fact and conclusions of law. The mere acceptance of a resignation contains none of these requirements.

The Bankruptcy Court's decision also diverges from the overwhelming weight of authority recognizing that trustees may freely resign. See 2A James W. Moore & Lawrence P. King, Collier on Bankruptcy ¶ 44.20 (14th ed.1978) ("The statute [Bankruptcy Act of 1898] does not specifically provide for the resignation of the trustee, although a trustee, of course, may resign."). Countless reported cases note the resignation of a trustee without comment. E.g., United States v. Curran, 967 F.2d 5, 6 (1st Cir. 1992); In re Stillwell, 12 F.2d 205, 206 (6th Cir. 1926); In re Carolina Cooperage Co., 96 F. 950, 952 (E.D.N.C.1899) (bankruptcy trustees "can relieve themselves of the burden [of office] without the nominal expense of a postage stamp, by a few lines resigning the trust, sent under a frank as official business.").

In fact, a trustee may voluntarily resign even in the face of removal. Resignation in these circumstances moots any pending motion to remove a trustee. See In re Grand Jury Proceedings, 119 B.R. 945, 947 (E.D. Mich. 1990) (bankruptcy court dismissed motion to remove trustee as moot because of trustee's voluntary resignation); Flournoy v. Hershner, 68 B.R. 165, 168 (M.D. Ga. 1986) (prosecution of pending removal motion became "unnecessary" due to standing trustee's voluntary resignation); In re Slodov, 28 B.R. 698, 706-7 (Bankr. N.D. Ohio 1983), aff'd, 849 F.2d 610 (6th Cir. 1988) (table) ("Had [former trustee] not resigned, it may well be that he would have been removed from office."). See also Petrino v. Graham (In re Graham), 946 F.2d 901, 1991 WL 204953 (10th Cir. Oct. 11, 1991) (removal action mooted by trustee's resignation).

B. A Trustee's Resignation is Effective When Received by the United States Trustee

The Bankruptcy Code and Rules are silent on the mechanics of resignation. Under the common law, the authority who exercises the power to appoint a successor also accepts the resignation of a public officer.[5] E.g., Rockingham County v. Luten Bridge Co., 35 F.2d 301, 306 (4th Cir. 1929) ("It is well-established law that, **in the absence of express statutory enactment**, the authority to accept the resignation of a public officer rests with the power to appoint a successor to fill the vacancy" (emphasis added)); Van Orsdall v. Hazard, 3 Hill 243, 247 (N.Y. Sup. Ct. 1842) ("the right to accept a resignation passes incidentally with a right to elect."). Therefore, a trustee wishing to voluntarily resign from the office of trustee must tender his resignation to the United States Trustee, the officer who appointed the trustee and who will appoint a successor. The resignation may be either "in writing or by parol, express, or even by implication." Van Orsdall, 3 Hill at 247. For obvious reasons, resignations in writing are preferred, and Mr. Demczyk, in a clear and unambiguous statement, resigned as standing trustee: "Please accept my resignation as the standing Chapter 12 trustee for the Northern District of

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[5] Section 325 refers to the "office" of trustee. See also In re Grand Jury Proceedings, 119 B.R. 945, 950 (E.D. Mich. 1990) ("the position of Chapter 7 Trustee is a public office").

Ohio, Eastern Division, effective November 20, 2000." Memorandum Opinion at 5-6. That would have been effective but for the court's sua sponte order to the contrary.

Mr. Demczyk, and any other bankruptcy trustee, may freely resign from the office of bankruptcy trustee. This doctrine, as applied to public officers generally, was first set forth in United States v. Wright, 28 F. Cas. 792 (C.C.D. Ohio 1839) (No. 16,775). In that case, Circuit Justice McLean stated:

> There can be no doubt that a civil officer has a right to resign his office at pleasure, and it is not in the power of the executive to compel him to remain in office. It is only necessary that the resignation should be received, to take effect, and this does not depend upon the acceptance or rejection of the resignation by the president.

Id. at 793. This view of resignation has been followed in a number of states, including Ohio. Reiter v. State ex rel. Durrell, 51 Ohio St. 74, 81, 36 N.E. 943, 945 (1894). In the bankruptcy context, one old case also appears to follow the view that a trustee resignation would be effective upon receipt. Carolina Cooperage, 96 F. at 952 (trustees "can relieve themselves of the burden without the nominal expense of a postage stamp, by a few lines resigning the trust, sent under a frank as official business.").

Another older line of authority states that a resignation is not complete unless "accepted" by the appointing power. E.g., Edwards v. U.S., 103 U.S. 471, 474 (1880) ("after an office was conferred and assumed, it could not be laid down without the consent of the appointing power."); Rockingham County, 35 F.2d at 306 ("[I]n the absence of statute regulating the matter, his resignation should be tendered to the tribunal or officer having power to appoint his successor."); Van Orsdall, 3 Hill at 247 ("One familiar method of vacation is by *resignation*; and I believe it has never been doubted that, independently or any statutory or constitutional provision, resignations may be effected by the concurrence of the incumbent and the appointing power."). The focus on "acceptance" derived from early laws requiring persons to assume a public office:

> In England a person elected to a municipal office was obliged to accept it . . . and he subjected himself to a penalty by refusal. An office was regarded as a burden with the appointee was bound . . . to bear. And from this it followed [that an appointee could not resign] without the consent of the appointing power. This was required in order that the public interests might suffer no inconvenience for the want of public servants to execute the laws.

Edwards, 103 U.S. at 473-74. Whether "acceptance" is required need not be resolved by this court.[6] Mr. Demczyk's resignation was promptly accepted by the United States Trustee: "I have received your letter of resignation as Chapter 12 Standing Trustee. . . . I accept your resignation. . . ." B.Dkt. #14, M.F.Dkt. #75, G.Dkt. #56.

C. The Procedure for Trustee Resignation Advanced by the Bankruptcy Court would Unduly Burden the Administration of Bankruptcy Cases

In addition to being in error as a matter of law, the resignation procedure created by the Bankruptcy Court (in effect no different than a motion to remove "for cause") would unduly burden the resigning trustee and the administration of bankruptcy cases as a whole. Under the regime envisioned by the Bankruptcy Court, a trustee seeking to resign must file a motion, provide notice to parties in interest, and must establish "cause" to remove himself. The delays created by following this procedure would further shorten the strict deadlines imposed by the Code and Rules upon a successor trustee. E.g., Fed. R. Bankr. P. 4003(b) (trustee must object to

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[6] If this issue required resolution, the bankruptcy court would have to decide whether to adopt state law as a rule of decision or follow federal common law. See In re Dittmer, 96 B.R. 154, 155 (Bankr. C.D. Ill. 1988) (discussion of Erie doctrine in context of bankruptcy).

claimed exemptions within 30 days after conclusion of meeting of creditors); 4004(a) (trustee must object to discharge within 60 days after first date set for meeting of creditors). The delay also interjects a period of uncertainty as to the trustee's future status. In contrast to the Bankruptcy Court's procedure, the present system of trustee resignation, whereby a resigning trustee tenders his resignation to the United States Trustee in writing, and the United States Trustee accepts and appoints a successor,[7] promotes judicial efficiency and certainty.

II. THE FACT THAT BANKRUPTCY TRUSTEES ARE REFERRED TO AS "OFFICERS OF THE COURT" IN OTHER CONTEXTS DOES NOT GIVE THE BANKRUPTCY COURT THE AUTHORITY TO PREVENT MR. DEMCZYK'S RESIGNATION

The Bankruptcy Court also held that it could prevent Mr. Demczyk's resignation because it had the inherent power to regulate him as an "officer of the court," and because Mr. Demczyk is an attorney. Memorandum Opinion at 18. As an "officer of the court" and attorney, the Bankruptcy Court held that Mr. Demczyk was bound by the Ohio Code of Professional Responsibility[8] as adopted by the Bankruptcy Court. Id. at 20-21. As a preliminary matter, this

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[7] The Bankruptcy Court makes much of the perceived lack of "transparency" surrounding Mr. Demczyk's resignation. Memorandum Opinion at 4. However, the Bankruptcy Court ignores the fact that the resignation was not yet effective, and that the United States Trustee fully intended to provide adequate "transparency" once the resignation became effective and a successor was appointed: "Notice will be filed with the Bankruptcy Court in each case of your resignation and my appointment as Chapter 12 interim trustee." B.Dkt. #14, M.F.Dkt. #75, G.Dkt. # 56. This orderly procedure was interrupted by the Bankruptcy Court's sua sponte order.

[8] The relevant section of the Ohio Code of Professional responsibility states that an attorney may generally not withdraw unless the attorney "has taken reasonable steps to avoid foreseeable prejudice to the rights of his client," and

> (1) His client:
>
> > (a) Insists upon presenting a claim or defense that is not warranted under existing law and cannot be supported by

argument fails because bankruptcy trustees are not required to be attorneys. 28 C.F.R. §§ 58.3(b) (qualifications of panel trustee), 58.4(b) (qualifications of standing trustee – "An individual need not be an attorney to be eligible for appointment as a standing trustee").

> > good faith argument for an extension, modification, or reversal of existing law.
> >
> > (b) Personally seeks to pursue an illegal course of conduct.
> >
> > (c) Insists that the lawyer pursue a course of conduct that is illegal or that is prohibited under the Disciplinary Rules.
> >
> > (d) By other conduct renders it unreasonably difficult for the lawyer to carry out his employment effectively.
> >
> > (e) Insists, in a matter not pending before a tribunal, that the lawyer engage in conduct that is contrary to the judgment and advice of the lawyer but not prohibited under the Disciplinary Rules.
> >
> > (f) Deliberately disregards an agreement or obligation to the lawyer as to expenses or fees.
>
> (2) His continued employment is likely to result in a violation of a Disciplinary Rule.
>
> (3) His inability to work with co-counsel indicates that the best interests of the client likely will be served by withdrawal.
>
> (4) His mental or physical condition renders it difficult for him to carry out the employment effectively.
>
> (5) His client knowingly and freely assents to termination of his employment.
>
> (6) He believes in good faith, in a proceeding pending before a tribunal, that the tribunal will find the existence of other good cause for withdrawal.

Ohio R. Prof. Resp. DR-110, adopted by LR 83.7 (N.D. Ohio) and LBR 2090-2 (Bankr. N.D. Ohio).

The Bankruptcy Court's decision on this point is also in error because the Bankruptcy Court's power to regulate the attorney-client relationship does not extend to the statutory office of bankruptcy trustee. In numerous cases, state courts have refused to extend the procedural requirements of their disciplinary rules to other offices absent misconduct on the part of the attorney reflecting on his fitness to practice law. E.g., In re Confidential, 664 A.2d 364, 366-68 (D.C. 1995) (disciplinary rule governing trust accounts not applicable to attorney acting as a stakeholder in private commercial transaction); In re Disciplinary Proceedings Against Jacobs, 161 Wis.2d 392, 409, 467 N.W.2d 783, 791 (1991) (lawyer acting as fiduciary outside attorney-client relationship not required to comply with disciplinary rule regarding handling of client funds); Layton v. State Bar, 50 Cal.3d 889, 904, 789 P.2d 1026, 1034, 268 Cal.Rptr. 845, 853 (1990) ("executor not required to be attorney, and executors are not, as such, subject to [disciplinary rules] that govern attorneys . . .").

The purpose behind regulating the withdrawal of attorneys from representation is to police the contract between attorney and client. An attorney undertaking representation of a client generally has an obligation to see the matter through to completion. E.g., Haines v. Liggett Group, Inc., 814 F. Supp. 414, 424 (D.N.J. 1993). An attorney qua "officer of the court"[9] is qualitatively different from other persons traditionally labeled "officers of the court." In the case of Cammer v. United States, 350 U.S. 399 (1956), the Supreme Court reviewed a citation for

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[9] Commentators have criticized the application of the term "officer of the court" to attorneys. See James A. Cohen, Lawyer Role, Agency Law, and the Characterization "Officer of the Court", 48 Buffalo L. Rev. 349 (2000) (use of term "mostly rhetoric, caused by self-love and self-promotion"); Eugene R. Gaetke, Lawyers as Officers of the Court, 42 Vand. L. Rev. 39 (1989) (term "vacuous and unduly self-laudatory").

criminal contempt entered against an attorney. The Supreme Court concluded that an attorney is not an "officer of the court" within the relevant contempt statute[10]:

> It has been stated many times that lawyers are "officers of the court." One of the most frequently repeated statements to this effect appears in Ex parte Garland, [71 U.S. 333 (1866)]. The Court pointed out there, however, that an attorney was not an "officer" within the ordinary meaning of that term. Certainly nothing that was said in Ex parte Garland or in any other case decided by this Court places attorneys in the same category as marshals, bailiffs, court clerks or judges. Unlike these officials a lawyer is engaged in a private profession, important though it be to our system of justice. In general he makes his own decisions, follows his own best judgment, collects his own fees and runs his own business. The word 'officer' as it has always been applied to lawyers conveys quite a different meaning from the word 'officer' as applied to people serving as officers within the conventional meaning of that term. . . . We see no reason why the category of 'officers' subject to summary jurisdiction of a court under § 401(2) should be expanded beyond the group of persons who serve as conventional court officers and are regularly treated as such in the laws. See 28 U.S.C. §§ 601 – 963.

Id. at 405. Therefore, the Bankruptcy Court cannot rely on its inherent power to police attorneys as "officers of the court" in their contractual relations with clients because attorneys as "officers of the court" are qualitatively different from other "officers of the court" such as trustees.

Three criminal statutes[11] include trustees in an enumerated list with "other officer of the court," but this fact alone does not place trustee resignation under the control of the Court. The

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[10] The current statute states that a "court of the United States" shall have the power to punish as contempt, inter alia, "Misbehavior of any of its officers in their official transactions." 18 U.S.C. § 401(2).

[11] 18 U.S.C. §§ 152(1) and (9) ("custodian, trustee, marshal, or other officer of the court"), 153 ("trustee, custodian, marshal, attorney, or other officer of the court"), 154 (custodian, trustee, marshal, or other officer of the court").

appointment and supervision of trustees were transferred to the United States Trustees by Congress. The use of the term "officer of the court" in an enumerated list with trustees, custodians, and marshals is merely a catchall, and possibly a vestige of the court's former power to appoint trustees. The only practical import of labeling trustees "officers of the court" is in the context of ascertaining whether a trustee enjoys immunity from suit. See In re DeLorean Motor Company, 991 F.2d 1236, 1241 (6th Cir. 1993) ("It is well settled that leave of the appointing forum must be obtained by any party wishing to institute an action in a non-appointing forum against a trustee, for acts done in the trustee's official capacity and within the trustee's authority as an officer of the court"); Kashani v. Fulton (In re Kashani), 190 B.R. 875, 883 (B.A.P. 9th Cir. 1995) ("As an officer of the court, the trustee is entitled to a form of derivative judicial immunity from liability for actions carried out within the scope of the trustee's official duties").

Finally, the Bankruptcy Court's conclusion that it may prevent Mr. Demczyk's resignation based upon his status as "officer of the court" is overbroad. The inherent power of the court "must be exercised with restraint and discretion," Chambers v. NASCO, 501 U.S. 32, 44 (1991) (citation omitted), and "is not a broad reservoir of power, ready at an imperial hand, but a limited source; an implied power squeezed from the need to make the court function." NASCO v. Calcasieu Television & Radio, 894 F.2d 696, 702 (5th Cir. 1990), aff'd, 501 U.S. 32 (1991). The Bankruptcy Court relief upon Local Bankruptcy Rule 2090-2 in forbidding Mr. Demczyk's resignation, Memorandum Opinion at 18 n.11, but this rule by its plain language only grants the Bankruptcy Court the authority to sanction "to control or eliminate disruptive, abusive, or unprofessional practices or conduct." The term "officer of the court" as applied in cases and statutes often includes persons under the control of the Executive Branch such as bankruptcy trustees and United States Marshals. See e.g., 18 U.S.C. § 153 (embezzlement by "trustee, custodian, marshal, attorney, or other officer of the court"). The Bankruptcy Court's reasoning concerning its authority over "officers of the court" has no limits, and could be used by a court in support of an order preventing the resignation of a United States Marshal, United States Attorney, United States Trustee, or any other Executive Branch official who perform a role in the administration of justice. Such an assertion of authority over so-called "officers of the court" would eviscerate the separation of powers enshrined in the Constitution. See generally Mistretta v. United States, 488 U.S. 361 (1989).

Conclusion

For the foregoing reasons, the United States Trustee respectfully requests that the Judgment of the Bankruptcy Court below be REVERSED.

Dated: June 1, 2001

Respectfully submitted,

DONALD M. ROBINER
United States Trustee

By: ______________________________
Joseph A. Guzinski
Acting General Counsel
John L. Daugherty
Trial Attorney
Department of Justice
Executive Office for
  United States Trustees
901 E St. NW, Suite 780
Washington, DC 20530
(202) 307-1399
(202) 307-2397 facsimile
email: john.daugherty@usdoj.gov

June 1, 2001

Certificate of Service

I hereby certify that a true and correct copy of the foregoing was mailed via first class mail this 1st day of June 2001 to: Michael Demczyk, Chapter 12 Standing Trustee, 12370 Cleveland Avenue, NW, P.O. Box 867, Uniontown, Ohio 44685.

____
John L. Daugherty

BRIEF BANK — "SUMMARY SHEET" Printed Thu.-10/9/3 (9:00)

WESTLAW CODES

1. ("TI") TITLE OF CASE
[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]

Donald M. Robiner, UST v. Michael V. Demczyk, Chap. 12 Trustee
(In re Brookover)

2. ("CO") CURRENT COURT
[E.g., "CTA9"]

6th Cir.

3. ("CCN") CURRENT CASE NO.

No.: 02-3237

4. ("PCN") PRIOR CASE NO. & COURT
[IF ANY]

No. & Court: 5:01cv-1129, -1130, -1131 (Dowd, D.J.) N.D. Ohio (Eastern Division)

No. & Court: 00-52012 Bankr. N.D. Ohio (259 B.R. 884) (Shea-Stonum, B.J.)

(Identify judge & cite, if any)

5. ("SO") SOURCE

U.S. TRUSTEES

6. ("DA") DATE OF FILING & TYPE OF BRIEF
[E.g., "Opening Brief," "Reply," "Amicus," etc.]

Filed: May 2002

Type: Proof Brief for Appellant, U.S. Trustee

7. ("AU") PRINCIPAL AUTHORS & OFFICE [E.g.,"UST/OGC"]

William Kanter & Wendy M. Keats. Appellate Staff Civil Division.
P. Matthew Sutko, UST/OGC
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") TOPIC

BANKRUPTCY

9. ("SU") • SUMMARY OF KEY ISSUE(s)

&

√ Any Miscellaneous BACKGROUND

• Can bankruptcy trustees freely resign their positions or is the resignation subject to bankruptcy court approval?

√ **Background:** Bankruptcy Court held that "Michael V. Demczyk will remain the Standing Chapter 12 Trustee in the above-captioned cases authorized by this Court after proper notice and hearing." In re Brookover, 259 B.R. 884, 895 884, 895 (Bankr. N.D. Ohio 3/ 26/01). U.S. Trustee appealed to District Court - **Affirmed.**

10. PATH TO FILE LOCATION:
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NAME: Steven Eggert
DATE: Wed.-10/1/3 (16:23)

IN THE UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

No. 02-3237

In re: DALE R. BROOKOVER; MONTGOMERY FARMS;
JACK GIULITTO;

Debtors.

IRA BODENSTEIN, United States Trustee,

Appellant.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF OHIO

PROOF BRIEF FOR THE APPELLANT

Statement Of Jurisdiction

The district court had jurisdiction under 28 U.S.C. 158(a)(1) & (c)(1)(A) over these consolidated appeals from a final collateral order of the bankruptcy court. This Court has jurisdiction pursuant to 28 U.S.C. 1291. *Lindsey v. O'Brien, Tanski, Tanzer & Young, et al. (In re Dow Corning Corp.)*, 86 F.3d 482, 488 (6th Cir. 1996), *cert. denied*, 519 U.S. 1071 (1997). The district court entered its judgment on October 24, 2001. This appeal was timely filed on December 21, 2001. R. 12, Apx. __.

Statement Of The Issue

Whether the voluntary resignation of a bankruptcy trustee in a pending case can be accepted by the United States Trustee as a ministerial act, or must be submitted to the bankruptcy court for approval, after an evidentiary hearing, as justified.

Statement Of The Case

A. Nature Of The Case, Course Of Proceedings, And Disposition Below.

This appeal arises from three cases filed under Chapter 12 of the Bankruptcy Code, 11 U.S.C. 1201 *et seq*., in the bankruptcy court in the Eastern Division of the Northern District of Ohio: *In re Dale R. Brookover, et al.*, N.D. Ohio Bankr. No. 00-52012; *In re Montgomery Farms*, N.D. Ohio Bankr. No. 95-50187; and *In re Jack Guilitto, et al.*, N.D. Ohio Bankr. No. 93-51659. The trustee for each case was Michael V. Demczyk, the standing Chapter 12 trustee appointed by the United States Trustee pursuant to 28 U.S.C. 586(b) & 11 U.S.C. 1202. In October 2000, Mr. Demczyk tendered his resignation as standing trustee in these cases to the United States Trustee, who accepted it and notified the bankruptcy court that a successor trustee would be substituted. Bankr. R. 14 (Trustee's Rejection Of Appointment), Apx. __; Bankr. R. 15 (Letter from U.S. Trustee To Bankruptcy Court), Apx. __.[1]

The bankruptcy court, *sua sponte*, issued an order in each case directing Mr. Demczyk to continue to serve as trustee, pending a court order to the contrary. Bankr. R. 16, Apx. __. The United States Trustee filed a motion for reconsideration. Bankr. R. 17, Apx. __. Following a hearing, the bankruptcy court issued a published decision in all three cases denying reconsideration. Bankr. R. 31, Apx. __; *In re Dale R. Brookover, et al.*, 259 B.R. 884 (Bankr. N.D. Ohio 2001).

The United States Trustee appealed the orders to the district court pursuant to 28 U.S.C. 158(a). D. Ct. R. 1 (Notice of Bankruptcy Appeal), Apx. __. The district court consolidated the three appeals, designating *In re Brookover* as the lead case, D. Ct. R. 8, and issued an order affirming the bankruptcy court. D. Ct. R. 10 (Mem. Opinion and Order), Apx. __; D. Ct. R. 11 (Judgment), Apx. __; *Robiner v. Demczyk*, 269 B.R. 167 (N.D. Ohio 2001).[2] Mr. Demczyk continues to serve as trustee pursuant to the bankruptcy court's order. The United States Trustee took this appeal.

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[1] All references herein to the Bankruptcy Court Record are to the bankruptcy court docket in *In re Brookover.* The documents referred to were filed in all three cases.

[2] This Court has re-styled the consolidated appeal as *In re Brookover, Montgomery Farms, and Guilitto*, to reflect that Mr. Demczyk is not an adverse party in this appeal. See D. Ct. R. 10 at 2-3 nn. 4, 6 & 7, Apx. __, nn. 4, 6 & 7, 269 B.R. at 168-69 nn. 4, 6 & 7.

B. Statutory Scheme: Bankruptcy Trustees And The U.S. Trustee.

A bankruptcy trustee is a disinterested professional (a lawyer, certified public accountant, or other qualified individual) appointed to administer the debtor's estate for the benefit of creditors. See 11 U.S.C. 704 & 1106 (duties of a trustee); 28 U.S.C. 586(d); 28 C.F.R. 58.3(b) & 58.4(b). Bankruptcy trustees are not government employees, and their compensation comes from the private bankruptcy estate, not from the government. The United States Trustee (UST) is an official appointed by the Attorney General with responsibility for supervising the administration of bankruptcy cases within a geographic region, including the selection, appointment and supervision of bankruptcy trustees. See 28 U.S.C. 581 *et seq*. The UST also has standing to raise any issue under the bankruptcy title and may appear and be heard on any bankruptcy issue. 11 U.S.C. 307.

The office of United States Trustee was created to improve bankruptcy administration, primarily by relieving the courts of responsibility for appointment and supervision of bankruptcy trustees, which did not work well and had created the appearance of bias. See *Morgenstern v. Revco D.S., Inc. (In re Revco D.S., Inc.)*, 898 F.2d 498, 500 (6th Cir. 1990). Congress specified that the United States Trustees "were to be independent of direct court supervision, as 'executives of the bankruptcy network,'" and "it likened the U.S. trustee's relation to that of a prosecutor." *Id.*

(citation omitted). This Court has noted that in creating the UST system, Congress "'sought to separate the administrative duties in bankruptcy from the judicial tasks, leaving the bankruptcy judges free to resolve disputes untainted by knowledge of administrative matters unnecessary and perhaps prejudicial to an impartial judicial determination.'" *Joelson v. United States*, 86 F.3d 1413, 1415 (6th Cir. 1996) (citation omitted).

Chapter 12 of the Bankruptcy Code, 11 U.S.C. 1201 *et seq*., under which the underlying cases were filed, provides for the adjustment of debts of family farmers with regular annual income. Chapter 12 is modeled after Chapter 13, 11 U.S.C. 1301 *et seq*., which provides for adjustment of debts of individuals with regular income. Both chapters allow debtors to repay their debts over a period of years pursuant to a repayment plan.

A trustee in a Chapter 12 or 13 case is appointed by the UST. See 11 U.S.C. 1202 & 1302. The UST either appoints a trustee for each individual case, or where the number of Chapter 12 or 13 cases brought in a particular region warrants, the UST may appoint a "standing trustee" to serve in all cases filed under such chapter. 28 U.S.C. 586(b); 11 U.S.C. 1202(a) & 1302(a). Either way, the trustee is supervised by the UST. 28 U.S.C. 586(a) & (b). The trustee must file a bond in favor of the

United States for the faithful performance of his or her duties, 11 U.S.C. 322, and the trustee is compensated out of the debtor's estate. 11 U.S.C. 326 & 28 U.S.C. 586(e).

The UST also appoints and supervises trustees in the two other principal types of bankruptcy, Chapter 7 (liquidation) and Chapter 11 (business reorganization).[3] In a Chapter 7 case, the UST appoints an interim trustee, 11 U.S.C. 701(a)(1) & 28 U.S.C. 586(a), who becomes the permanent trustee unless another trustee is elected by the creditors, see 11 U.S.C. 702 & 28 U.S.C. 586(a)(1). And in a Chapter 11 case, the court may order the UST to appoint a trustee, rather than the debtor, to manage the reorganization process, 11 U.S.C. 1104(a), and such a trustee is also supervised by the UST. 28 U.S.C. 586(a). Chapter 7 and Chapter 11 trustees must also file a bond in favor of the United States, and are also compensated out of the debtor's estate. 11 U.S.C. 322 & 326.

C. Statement Of The Facts.

1. Mr. Demczyk's Resignation.

In this case, Michael V. Demczyk was the standing Chapter 12 bankruptcy trustee serving in the Eastern Division of the Northern District of Ohio. In that

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[3] Chapters 7, 11, 12 and 13 are the four principal types of bankruptcy. The remaining type, Chapter 9 (adjustment of debts of a municipality), is not implicated here because there is no trustee in a Chapter 9 case and the UST has no role under Chapter 9.

capacity, he served as trustee in the three Chapter 12 cases giving rise to this appeal. On October 31, 2000, Mr. Demczyk sent a letter to the UST voluntarily resigning as standing Chapter 12 trustee, effective November 30, 2000. See Bankr. R. 14; see also Bankr. R. 31, Mem. Op., at 5-6, Apx. ____; 259 B.R. at 888. The UST accepted his resignation by letter dated November 17, 2000, in which the UST thanked Mr. Demczyk for his years of service and noted that "[t]here have been insufficient Chapter 12 case filings over the past few years to support a Standing Trustee operation, and we appreciate your willingness to administer these cases for minimal compensation." Bankr. R. 14, Apx.__ (UST Letter to Demczyk, Nov. 17, 2000). The UST stated that he would notify the bankruptcy court of Mr. Demczyk's resignation and of the UST's substitution as interim Chapter 12 trustee in all pending cases. *Id.* And, the UST stated that his staff would "be in contact with you regarding the transition of funds and files to our office," and anticipated "your full cooperation in this regard and in the filing of your final annual report." *Id.*

At the same time, the UST sent copies of this letter to all bankruptcy judges in the district and the court clerk. *Id.* The UST included a cover letter to the bankruptcy judge in these three cases further stating that "[o]n the active Chapter 12 cases, we anticipate appointing successor individual case trustees under 11 U.S.C. § 1202(a)." Bankr. R. 15, Apx. __ (UST Letter to Judge Shea-Stonum, Nov. 17, 2000).

2. The Bankruptcy Court Order, Motion To Reconsider, And Hearing.

On November 28, 2000, the bankruptcy court, sua sponte, issued an order in each of these cases, stating that if Mr. Demczyk wishes to resign as trustee, "the Court will await a motion filed and served on all parties in interest." Bankr. R. 16, Apx. __. Meantime, "Mr. Demczyk is to continue to carry out his responsibilities in [each case], absent a Court Order to the contrary." *Id.*, citing 11 U.S.C. 324.

The UST moved for reconsideration, asserting that it is within the UST's administrative authority under the Bankruptcy Code to accept trustee resignations, and there is no basis for judicial intervention. Bankr. R. 17, Apx. __, & Bankr. R. 20 (Mem. in Support). At the hearing on the motion, Mr. Demczyk testified that he resigned as standing Chapter 12 trustee on his own initiative. Bankr. R. 39 (Hearing Transcript) at 11, Apx. __. He testified that he told members of the UST staff at the time that he wished to resign because "the effort expected of me" to continue with the cases still pending "simply isn't reflected in the amount of compensation" he was receiving, *id.* at 12, Apx. __, and he "would prefer not to be burdened with the additional work effort." *Id.* at 13, Apx. __. The UST pointed out that the Bankruptcy Code assigns responsibility for appointing and supervising trustees to the UST, and the Code and Rules are silent on the mechanics of trustee resignation. Accordingly, the UST argued, the common law rule applies, which recognizes that the authority to accept the resignation of a public officer rests with the person having authority to appoint the successor, which in these circumstances is the UST. See Bankr. R. 20 (Mem. in Support of Motion); Bankr. R. 39 (Transcript of Hearing); Bankr. R. 29 (Supp. Mem. in Support of Motion).

3. **The Bankruptcy Court Ruling**.

The bankruptcy court denied reconsideration. Bankr. R. 31 (Mem. Opinion); Apx. __; *In re Dale R. Brookover*, 259 B.R. 884 (Bankr. N.D. Ohio 2001).[4] The court recognized that the UST has authority to appoint a trustee, to replace a trustee who has departed, or to discontinue using a standing trustee for future cases, but it disagreed that the Code is silent on the procedure for trustee resignations from pending cases. *Id.*, Mem. Op. at 7-15; Apx. ____; 259 B.R. at 889-92. Rather, the court held, trustee resignations come within 11 U.S.C. 324, which provides that "[t]he Court, after notice and a hearing, may remove a trustee * * * for cause." *Id.* In the court's view, the language of § 324 "does not prevent its use in cases of resignation." *Id.*, Mem. Op. at 8; Apx. _; 259 B.R. at 889. The court reasoned that this "plain" language, "clearly setting forth" the court's role when a trustee "seeks * * * removal" from a pending case, precludes resort to the common law. *Id.,* Mem. Op. at 9; Apx. _; 259 B.R. at 889-90. In addition, in the court's view, since 28 U.S.C. 586, which

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[4] The decision was entered for all three cases. *Id.*

sets forth the duties of a UST, does not mention a duty to accept a trustee's resignation from a pending case, "such duty can be presumed to be excluded." *Id.*, Mem. Op. at 15-17; Apx. ____; 259 B.R. at 892-94.

The bankruptcy court refused to recognize resignation and removal as distinct events under the Bankruptcy Code, as they are treated in 11 U.S.C. §§ 703(a) and 1104(d) (UST to appoint successor trustee in certain circumstances if a trustee under those Chapters "dies or resigns * * * or is removed under section 324"). The court reasoned that "Congress did not reiterate that same language in §1202," and this is a Chapter 12 case. *Id.*, Mem. Op. 10-11; Apx. ____; 259 B.R. at 890. Moreover, the court concluded that "for cause" removal under § 324 is broad enough to encompass a trustee's voluntary resignation, because a dictionary definition of "for cause" is not limited to wrongdoing but also "contemplates considerations of public policy and law," which the court held could not be adequately addressed without notice to interested parties and a judicial hearing. *Id.*, Mem. Op. at 11-12; Apx. ____; 259 B.R. at 890-91. The court also remarked that if such a hearing were held and elicited evidence similar to that at the hearing on the UST's motion for reconsideration, "this Court would have determined that there was nothing to justify allowing [Mr. Demczyk's] resignation from the pending cases." *Id.*, Mem. Op. at 5 n.2; Apx. __ n.2; 259 B.R.at 887 n.2.

Finally, the court stated that a bankruptcy trustee is "an officer of the court," and thus is subject to the court's "inherent power to regulate those officers of the court admitted before it." *Id.*, Mem. Op. at 18 & n.11; Apx. __ & n.11; 259 B.R. at 894 & n.11 (citing the court's inherent disciplinary authority over "any attorney or party" under Local Bankruptcy Rule 2090-2(c)). The court also invoked its "inherent power to control its docket as superintendent of its pending caseload." *Id.* And, it noted that although a bankruptcy trustee is not required to be an attorney, Mr. Demczyk "happens to be an attorney," and is therefore subject to the Code of Professional Responsibility and Local Civil Rule 83.9, under which an "attorney of record" may not withdraw from a pending case without notice to all parties and leave of the court. *Id.*, Mem. Op. 18-21 & n.12; Apx. _____& n.12; 259 B.R. at 894-95 & n.12.

Accordingly, the bankruptcy court directed that Mr. Demczyk "will remain the Standing Chapter 12 Trustee" in these cases "unless and until his resignation or removal is authorized by this Court after proper notice and hearing." *Id.*, Mem. Op. at 21; Apx. __; 259 B.R. at 895.

4. **The District Court Ruling**.

The district court affirmed, without separate analysis, "for the reasons set forth in the Bankruptcy Judge's well-reasoned opinion." D.Ct. R. 10 at 8; Apx. __; *Robiner* *v. Demczyk*, 269 B.R. 167, 171 (N.D. Ohio 2001). As stated, Mr. Demczyk continues to serve as trustee pursuant to the bankruptcy court's order.

Summary Of Argument

It is a common occurrence for bankruptcy trustees to resign voluntarily in pending cases, for any number of personal or professional reasons. Acceptance of such resignations, and the appointment of successor trustees, is handled expeditiously by United States Trustees as a routine ministerial act, with prompt notice to the court and all interested parties. This case appears to be the first instance in which a court has claimed the power to approve or block a trustee's voluntary resignation. Moreover, the procedure that the bankruptcy court would require – prior notice to all interested parties, an evidentiary hearing, and a judicial determination of whether the trustee's voluntary resignation is "justif[ied]" – creates a controversy where none exists and introduces needless delay. It would substantially burden the resigning trustee, protract the resolution of his status and replacement, and interfere with timely and efficient bankruptcy administration. And, since the ruling does not appear to be limited to resignations of Chapter 12 trustees, it has the potential to disrupt the efficient administration of bankruptcy cases filed under Chapters 7, 11 and 13 as well.

1. The bankruptcy court's ruling is not supported in law. The Bankruptcy Code itself specifies no procedure for the acceptance of a trustee's voluntary

resignation, whether by the court or anyone else. However, the Code does expressly provide that a trustee will be appointed and supervised by the United States Trustee. That power is broad enough to encompass acceptance of trustee resignations. Congress's purpose in creating the office of United States Trustee was expressly to take administrative responsibility for bankruptcy cases away from the courts, and place it with the UST. It is a well-established common law principle that, absent a specific statutory provision to the contrary, the authority to accept a public officer's resignation rests with the official having power to appoint the successor. Congress legislates against the backdrop of the common law and is presumed to be aware of its established principles. Accordingly, pursuant to established common law principles and principles of statutory interpretation, and consistent with Congress's intent in creating the UST, the UST's statutory authority to appoint and supervise extends to encompass the acceptance of a trustee's voluntary resignation, without intervention by a court.

2. The court's authority to remove a trustee for "cause" under 11 U.S.C. 324 is inapplicable to a trustee's voluntary resignation. In numerous statutes, including the Bankruptcy Code, Congress has consistently treated resignation and removal as separate and distinct events that may cause a vacancy in public office. Moreover, "removal" for "cause" is *in*voluntary, usually based on a shortcoming of the

officerholder, which is not true in the case of a voluntary resignation for the trustee's own reasons. Thus, contrary to the bankruptcy court's view, a court's role in the removal of a trustee for "cause" under 11 U.S.C. 324 cannot be stretched to cover a trustee's voluntary resignation.

3. There is no basis to construe the UST's statutorily enumerated duties to exclude the acceptance of a trustee's resignation. First, the UST's statutory duty to "supervise" trustees comfortably embraces the administrative authority to accept a trustee's resignation, particularly since Congress did not withhold such power from the UST or assign it to anyone else, such as the court. Moreover, the maxim *expressio unius est exclusio alterius* is only an interpretive aid, and cannot be used to override legislative intent. Applying it as the bankruptcy court would do here would defeat Congress's dominant purpose in creating the office of UST, which was to take over the administration of bankruptcy cases, and particularly the management of case trustees, *from the courts*.

4. Finally, there is no basis for judicial intervention in a trustee's resignation on the ground that a trustee is an "officer of the court." A trustee is not appointed by the court, is not a court employee or official, and is specifically not required to be a lawyer. Nor does the trustee function in a lawyer-client relationship. Accordingly, the bankruptcy court's reliance on disciplinary rules and canons applicable to the

attorney-client context is inapposite here. Although the trustee in this case happens to be a lawyer, Congress surely did not intend that the procedure governing a trustee's resignation would vary depending on whether a trustee is or is not an attorney. Moreover, because Congress has made it the UST's responsibility, and not the court's, to assure that trustees fulfill their responsibilities, and to substitute successor trustees when necessary, there is no need or occasion for a court to invoke its "inherent power" over its own functioning in order to conduct a purely speculative inquiry into the bona fides of a bankruptcy trustee's resignation.

Accordingly, as we show, the district court's judgment should be reversed.

Argument

Standard of Review. This is an appeal in a bankruptcy case raising questions of law only. Accordingly, review is de novo. *Mayor and City Council of Baltimore, Md., v. State of West Virginia, et al. (In re Eagle-Picher Indus., Inc.)*, 285 F.3d 522, 526-27 (6th Cir. 2002); *Barlow v. M.J. Waterman & Assocs., Inc. (In re M.J. Waterman & Assocs., Inc.)*, 227 F.3d 604, 607 (6th Cir. 2000).

THE UNITED STATES TRUSTEE, WHO APPOINTS AND SUPERVISES TRUSTEES UNDER THE BANKRUPTCY CODE, HAS INHERENT AUTHORITY TO ACCEPT A TRUSTEE'S RESIGNATION.

A. The Common Law Rule Applies Because It Is Consistent With Congress's Intent In Creating The UST And There Is No Contrary Provision In The Bankruptcy Code.

The Bankruptcy Code authorizes the United States Trustee to appoint and supervise bankruptcy trustees under all chapters of the Code. 28 U.S.C. 586; 11 U.S.C. 701, 1104, 1202 & 1302. The Code makes no specific provision for acceptance of a trustee's voluntary resignation. Therefore, consistent with common law principles and Congress's express purpose to relieve the courts of administrative duties in bankruptcy cases, see *Morgenstern* and *Joelson*, the UST's powers to appoint and to "supervise" are necessarily broad enough to subsume the authority to accept a trustee's voluntary resignation, as an administrative matter, without intervention by a court.

Under the common law, absent an express statutory provision to the contrary, a public officer[5] has the right to resign, and the authority to accept the resignation resides with the person or body having authority to appoint the successor. *Rockingham County v. Luten Bridge Co.*, 35 F.2d 301, 306 (4th Cir. 1929) ("in the

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[5] A bankruptcy trustee, being appointed and supervised by the UST to perform statutorily-prescribed duties, is clearly a public officer. See also 11 U.S.C. 325 (referring to "the office of trustee").

absence of express statutory enactment, the authority to accept the resignation of a public officer rests with the power to appoint a successor to fill the vacancy. The right to accept a resignation is said to be incidental to the power of appointment"); *McCarthy v. State*, 55 Ariz. 328, 337, 101 P.2d 449, 452 (1940); *Sawyer v. San Antonio*, 149 Tex. 408, 412-13, 234 S.W.2d 398, 401 (1950); *Tooele County v. De La Mare*, 90 Utah 46, 59 P.2d 1155, 1159 (1936). See 63C Am. Jur. 2d, Public Officers and Employees §§ 153 & 155 (1997). See also *Carlucci v. Doe*, 488 U.S. 93, 99 (1988) (citing the "general proposition" that where a public official has the statutory power to appoint others, "absent a 'specific provision to the contrary, the power of removal from office is incident to the power of appointment'") (citation omitted).

These common law principles apply here. *Astoria Fed. Sav. and Loan Ass'n v. Solimino*, 501 U.S. 104, 108 (1991) ("where a common-law principle is well established * * * the courts may take it as given that Congress has legislated with an expectation that the principle will apply except 'when a statutory purpose to the contrary is evident'") (quoting *Isbrandtsen Co. v. Johnson*, 343 U.S. 779, 783 (1952)). The bankruptcy court rejected the common law rule because it erroneously concluded that the Bankruptcy Code specifies a role for the court in accepting or refusing the voluntary resignation of a trustee. It does not.

The Bankruptcy Code and Rules make no explicit provision anywhere for acceptance of trustee resignations by anyone. However, the Code and Rules plainly contemplate that a trustee may resign – or die, or be removed – creating a vacancy that requires appointment of a successor. See 11 U.S.C. 325 ("[a] vacancy in the office of trustee during a case does not abate any pending action or proceeding, and the successor trustee shall be substituted as a party in such action or proceeding");[6] Bankr. Rule 2012(b) ("[w]hen a trustee dies, resigns, is removed, or otherwise ceases to hold office during the pendency of a case under the Code * * * the successor is automatically substituted"). See also 2A James W. Moore & Lawrence P. King, *Collier on Bankruptcy* ¶ 44.20 (14th ed. 1978) (the Bankruptcy Act of 1898 "does not specifically provide for the resignation of the trustee, although a trustee, of course, may resign.") And, as the bankruptcy court acknowledged, the UST unquestionably wields the sole authority to appoint and supervise successor Chapter 12 trustees, just as the UST has sole authority to appoint and supervise the original

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[6] See also *Hull v. Burr*, 64 Fla. 83, 86, 59 So. 787, 788 (Fla. 1912) ("[t]he purpose of [the former version of] this provision of the bankruptcy law [which actually only referred to death or disability] was to prevent the abatement of suits involving the estate of the bankrupt upon a vacancy in the office of the trustee, and it makes no difference how such vacancy occurs, *whether by the death, removal, or resignation* of the trustee") (emphasis added).

trustee. See Advisory Committee Note to Bankr. Rule 2012(b) ("a court order is not required for the appointment of a successor trustee").

Nor, contrary to the bankruptcy court's view (cf. Bankr. R. 31, Mem. Op. 10-11; Apx. __; 259 B.R. at 890), does it matter for this purpose that Chapters 7 and 11 of the Code expressly refer to the UST's role in appointing a successor for a trustee who "dies," *or* "resigns," *or* "is removed," whereas Chapter 12 (and Chapter 13, on which it was modeled) do not. It was necessary to specify the UST's role in appointing individual successor trustees under Chapters 7 and 11 because that role is contingent – in Chapter 7, on whether the creditors have exercised their right to elect a trustee,[7] and in Chapter 11, on whether the court ordered appointment of a trustee in the first instance (rather than allowing the debtor-in-possession to manage the reorganization).[8] The absence of any parallel provision in Chapters 12 and 13 specifying the UST's authority to appoint a successor to a trustee who either "dies," "resigns" or "is removed" is not surprising, since the Code already makes clear that the UST "shall appoint" the trustee under those chapters, or that a standing trustee

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[7] Chapter 7 provides that the UST shall appoint a successor trustee if a Chapter 7 trustee "dies or resigns * * * or is removed under [11 U.S.C.] 324" and the creditors fail to elect a successor trustee. 11 U.S.C. 703.

[8] Chapter 11 provides that the UST shall appoint a successor trustee if the court had ordered the UST to appoint a Chapter 11 trustee who later "dies or resigns * * * or is removed under [11 U.S.C.] 324." 11 U.S.C. 1104(d).

appointed by the UST under 28 U.S.C. 586(b) "shall serve" in the case, neither of which is contingent on any role for the court or creditors. See 11 U.S.C. 1202(a) & 1302(a).

Thus, under the common law rule, the UST, as the official with the authority to appoint successor trustees, has the administrative authority to accept a trustee's resignation, regardless of whether the trustee serves under Chapter 7, 11, 12 or 13.

B. The Court's Authority To Remove A Trustee "For Cause" Under 11 U.S.C. 324 Has No Bearing On A Trustee's Voluntary Resignation.

The removal provision, 11 U.S.C. 324, on which the bankruptcy court principally relied in rejecting the common law rule, is inapplicable to a trustee's voluntary resignation. Contrary to the court's assertion, its "plain" language addresses only "remov[al] * * * for cause," and cannot be stretched to encompass a trustee's voluntary resignation, any more than it can be stretched to cover a trustee's disability or death.

Congress has consistently treated resignation and removal as separate and distinct events that may cause a vacancy in a public office, both under the Bankruptcy Code, see 11 U.S.C. 703(a) & 1104(d), and Bankr. Rule 2012(b), and elsewhere.[9]

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[9] In addition to the Bankruptcy Code, the Constitution and numerous federal statutes treat "resignation" and "removal" as distinct events. See U.S. Const. Art. II § 1, cl. 5 ("Removal, Death, Resignation or Inability" of the President or Vice President);

Moreover, the terms have entirely different dictionary definitions: "resignation" is self-initiated, whereas "removal" is imposed by someone else. See *Webster's Third New International Dictionary of the English Language Unabridged* 1921 (1993) (to "remove" means "to force (one) to leave a place or to go away: as * * * to dismiss from office"); *id.* 1932 (to "resign" means "to give up, relinquish, or forswear one's office, rank, membership, post, or charge, esp. formally and definitely"). See also *Webster's II New Riverside University Dictionary* 1000 (1988) ("resign" means "[t]o give up a position, esp. by formal notification: QUIT"); *Black's Law Dictionary* 1164, 1177 (__ ed. DATE).[10] There is no basis in the Bankruptcy Code or Rules for

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3 U.S.C. 19(a)(1) (same); 7 U.S.C. 2009aa-1(c)(4) ("absence, death, disability, removal, or resignation of the Federal or State representative" on the Delta Regional Authority); 10 U.S.C. 3017 ("[i]f the Secretary of the Army dies, resigns, is removed from office, is absent, or is disabled"); 10 U.S.C. 5017 (same, Secretary of the Navy); 10 U.S.C. 8017 (same, Secretary of the Air Force); 15 U.S.C. 77kkk(a)(2) ("[a]ny indenture trustee who has resigned or been removed"); 19 U.S.C. 1330(c)(3)(C) ("death, resignation, removal from office" of chairman or vice-chairman of the International Trade Commission); 28 U.S.C. 152(b)(3) ("resignation, retirement, removal, or death" of a bankruptcy judge); 28 U.S.C. 561(d) (U.S. marshal to continue in office until his successor is appointed and qualifies "unless that marshal has resigned or been removed by the President"); 28 U.S.C. 566(g) (marshal's duties "[p]rior to resignation, retirement, or removal from office"); 28 U.S.C. 593(e) ("resignation, death, or removal of an independent counsel"); 29 U.S.C. 661(b) ("vacancy caused by the death, resignation, or removal of a member" of the Occupational Safety and Health Review Commission).

[10] See also *Gresham v. Superior Court*, 44 Cal. App. 2d 664, 666, 112 P.2d 965, 967 (Cal. App. 1941) (in context of attorney discipline, "[t]o resign means to give up or surrender voluntarily the privilege of practicing law. This definition presupposes the

departing from the common understanding of these separate terms, or for conflating the two types of events. Indeed, to do so would ascribe redundancy to numerous U.S. Code provisions.[11]

Moreover, "for cause" removal necessarily implies *involuntary* termination based on some fault or shortcoming of the person being removed, which is not true in the case of a voluntary resignation for the trustee's own reasons. The Bankruptcy Code does not define "cause," but the term, rooted in the common law, see *Arnett v. Kennedy*, 416 U.S. 134, 159-60 (1974), is commonly used in federal statutes and regulations relating to the involuntary removal of an officer or dismissal of an employee.[12] The "for cause" standard, in contrast to service "at will," requires a

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voluntary act and volition of the attorney in relinquishing his privilege and does not connote any misconduct upon the part of the person resigning from the State Bar, it being presumed that he did so for reasons good and sufficient to him and not because of any misconduct on his part").

[11] See previous note. Basic principles of statutory construction require that terms joined by the disjunctive "or" must have distinct meanings or they would be surplus and redundant. See *Walker v. Bain*, 257 F.3d 660, 667 (6th Cir. 2001) ("[e]very word in [a] statute is presumed to have meaning, and we must give effect to all the words to avoid an interpretation which would render words superfluous or redundant").

[12] See, *e.g.*, 5 U.S.C. 7513(a) (authorizing removal of a federal employee or suspension without pay "for such cause as will promote the efficiency of the service"); 14 U.S.C. 738(a) ("President may, for cause, remove the name of any officer from a list of selectees"); 12 U.S.C. 1422b(a)(2) (Federal Home Loan Bank Board may "suspend or remove for cause a director, officer, employee, or agent of any Federal Home Loan Bank or joint office"); 39 U.S.C. 3601(a) (Commissioners of Postal Rate Commission "may be removed by the President only for cause"); 18

ground for removal that is reasonably related to a failure by the officer or employee to fulfill the requirements of his or her position. That is how it is typically used in federal regulations,[13] and interpreted in case law.[14] A voluntary resignation for

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U.S.C. 3602(a) ("court may, for cause, remove a probation officer appointed to serve with compensation, and may, in its discretion, remove a probation officer appointed to serve without compensation"); 43 U.S.C. 1629e(b)(2)(B) (Native Corporation that has established Settlement Trust may "remove the trustees of the trust for cause").

[13] See 12 C.F.R. 563.39(b)(1) ("[t]ermination for cause" of an officer or employee of a federal savings association "shall include termination because of the officer or employee's personal dishonesty, incompetence, willful misconduct, breach of fiduciary duty involving personal profit, intentional failure to perform stated duties, willful violation of any law, rule, or regulation * * *"); 28 C.F.R. 600.7(d) ("[t]he Attorney General may remove a Special Counsel for misconduct, dereliction of duty, incapacity, conflict of interest, or for other good cause"); 32 C.F.R. 69.5(d)(6) (Department of Defense Dependent Schools board members "may be removed * * * for dereliction of duty, malfeasance, or other grounds for cause shown"); 45 C.F.R. 2552.53(a) (foster grandparent may be removed from Foster Grandparent Program "for cause," including "extensive and unauthorized absences; misconduct; inability to perform assignments; and failure to accept supervision").

[14] Compare *Youngblood v. City of Galveston*, 920 F. Supp. 103, 106 (S.D. Tex. 1996) ("Youngblood was an at-will employee and could be terminated without cause") with *Martin v. Corrections Cabinet*, 822 S.W.2d 858, 860 (S. Ct. Ky. 1991) ("cause relating to, and affecting, the administration of the office, must be restricted to something of a substantial nature directly affecting the rights and interests of the public"); *Morrison v. Department of Highways*, 85 So. 2d 51, 53, 229 La. 116, 120-21 (1955) ("'no "cause" is shown for the termination of the employment * * * where there is no proof of substantial shortcoming which renders continuance of the employee in employment in some way detrimental to the discipline or efficiency of the Civil Service'"); and *State ex rel. Ryan v. Board of Aldermen*, 43 Mont. 188, 196, 122 P. 569, 571 (1912) ("'"Cause for removal" means some substantial shortcoming which renders continuance in office or employment in some way detrimental to the discipline and efficiency of the service, and something which the law and a sound public opinion will recognize as a good cause for his no longer occupying the place")

personal reasons implies no such thing. When Congress uses a common law term with a settled meaning, the term must be given that meaning unless Congress indicates otherwise. *Nationwide Mut. Ins. Co. v. Darden*, 503 U.S. 318, 322 (1992). “Cause” is such a term, and nothing in the Bankruptcy Code suggests that it should be given other than its usual meaning.

C. The UST's Statutorily Enumerated Duties Do Not Exclude The Common Law Authority To Accept A Trustee's Voluntary Resignation.

The bankruptcy court also reasoned that, because acceptance of trustee resignations is not one of the UST's enumerated duties under 28 U.S.C. 586, the UST is barred from such a function under the maxim *expressio unius est exclusio alterius.* Bankr. R. 31, Mem. Op. at 15-17; Apx. ____; 259 B.R. at 893-94. There are several obvious flaws to this reasoning.

First and foremost, the UST's enumerated duties expressly *do* include the power to "supervise" bankruptcy trustees, 28 U.S.C. 586(a), and in particular, a standing Chapter 12 trustee. 28 U.S.C. 586(b). The power to "supervise" is certainly

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(quoting Dillon, *Municipal Corporations* § 477 (5th ed. 1911)). And see *In re Baker*, 38 B.R. 705 (D. Md. 1983) ("[m]ost of the case law concerning the removal of a trustee involves intentional misconduct or negligence," *id.* at 707, or "the best interests of the estate," *id.* at 708-09) broad enough to encompass the administrative authority to accept a trustee's voluntary resignation, particularly when that authority is not expressly withheld. See *Carlucci v. Doe*, 488 U.S. at 99 (statutory power to appoint implicitly encompasses power to remove, unless the statute specifically denies such power); *Rockingham County v. Luten Bridge Co.*, 35 F.2d at 306 (common law authority to accept resignations is subsumed in the authority to appoint).

Second, the court's *exressio unius* argument begs the question, if not the UST, then who can accept a trustee's resignation? Clearly not the court, since § 324 removal procedures do not apply to trustee resignations, and there is no other Code provision or Rule assigning such a duty to the court. Moreover, imputing such a role to the court in resignations is both contrary to the common law rule and, more significantly, defeats Congress's dominant purpose in creating the office of the United States Trustee in the first place, which was to take over the administration of bankruptcy cases, and particularly the management of case trustees, *from the courts*. *Expressio unius* is only a canon of statutory construction, to be used as an aid in determining legislative intent. *United States v. Barnes*, 222 U.S. 513, 519 (1912). "Such canons 'long have been subordinated to the doctrine that courts will construe the details of an act in conformity with its dominating general purpose.'" *Herman &*

MacLean v. Huddleston, 459 U.S. 375, 387 n.23 (1983), quoting *SEC v. Joiner Corp.*, 320 U.S. 344, 350-51 (1943).

Expressio unius also "'stands on the faulty premise that all possible alternatives or supplemental provisions were necessarily considered and rejected by the legislative draftsmen.'" *Abdullah v. American Airlines, Inc.*, 181 F.3d 363, 372-73 (3d Cir. 1999), quoting *National Petroleum Refiners Ass'n v. FTC*, 482 F.2d 672, 676 (D.C. Cir. 1973), *cert. denied*, 415 U.S. 951 (1974). Congress legislates against the backdrop of the common law. *Astoria Federal Sav. and Loan*, 501 U.S. at 108. The acceptance of trustee resignations is entirely consistent with the UST's other statutorily assigned duties for the appointment, supervision and general administrative management of trustees, and it is consistent with the common law. There is nothing to indicate that Congress consciously rejected the common law rule, or intended to preclude the UST from performing such a clearly related, common law administrative function – especially when it has not been assigned to anyone else. *Expressio unius* accordingly does not apply as a basis to negate the UST's authority to accept trustee resignations.

D. The Court Cannot Base Its Intervention In A Trustee's Voluntary Resignation On The Premise That A Trustee Is An "Officer Of The Court."

Labeling the trustee an "officer of the court" also provides no basis for judicial intervention in a trustee's voluntary resignation. The bankruptcy court asserted authority over trustee resignations based on its "inherent power to regulate those officers of the court admitted before it and to take appropriate action to assure that they live up to their obligations." Bankr. R. 31 at 18; Apx. __; 259 B.R. at 894.

However, "officer of the court" is an amorphous label, even when applied to lawyers. See generally Eugene R. Gaetke, *Lawyers As Officers Of The Court*, 42 Vand. L. Rev. 39 (1989). Moreover, a bankruptcy trustee is not appointed by the court, is not a court employee or official, and is specifically not required to be a lawyer. See 28 U.S.C. 586(d); 28 C.F.R. 58.3(b) & 58.4(b) (trustee may be a lawyer, certified public accountant or other person with educational and business qualifications to manage a bankruptcy estate). Rather, the trustee is a private individual appointed by the Executive Branch.

Furthermore, a court's "inherent power" to manage proceedings and participants before it is "not a broad reservoir of power, ready at an imperial hand, but a limited source; an implied power squeezed from the need to make the court function." *NASCO, Inc. v. Calcasieu Television and Radio, Inc.*, 894 F.2d 696, 702 (5th Cir. 1990), cited with approval in *Chambers v. NASCO, Inc.*, 501 U.S. 32, 42 (1991). There is no need to draw upon it here. Congress has deliberately taken administrative responsibility for trustees away from courts and placed it with the United States Trustee, making it the UST's responsibility, not the court's, to assure that trustees fulfill their obligations. 28 U.S.C. 586. A court's re-insertion of itself into trustee resignations undermines Congress's clear intent. The court also has no need to get involved in trustee resignations in order to "make the court function," because the Code already requires the UST to appoint a qualified successor trustee who is automatically substituted in the case, with no abatement of any pending action or proceeding. 11 U.S.C. 325.[15]

The court's citation (Bankr. R. 31, Mem. Op. at 18; Apx. __; 259 B.R. at 894) to two criminal statutes, 18 U.S.C. 153 & 154 – which provide criminal sanctions where fraud, embezzlement, self-dealing, concealment of documents, and other crimes are committed by virtue of an individual's participation in the administration of the bankruptcy estate as a "trustee, custodian, marshal, attorney, or other officer of the court" – adds nothing that would support court intervention in a trustee's

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[15] The UST also makes it standard practice to provide prompt notice to the courts and all interested parties regarding the resignation of a trustee and the assignment of a successor. The bankruptcy court's criticism of the adequacy and "transparency" of the UST's notice procedures in this case (see Bankr. R. 31, Mem. Op. 3-6 & n.1; Apx.___ & n.1; 259 B.R. at 886-87 & n.1) is inaccurate and unfair. The court's own opinion demonstrates that the UST provided prompt notice of Mr. Demczyk's resignation to all bankruptcy judges and the clerk's office, and was pretermitted from notifying other interested parties by the court's own order overriding Mr. Demczyk's resignation and requiring him to continue to serve. See *id*. & n.3.

voluntary resignation. The phrase "other officer of the court" does not necessarily imply that "trustee" is an officer of the court, since it could refer to an "attorney," the proverbial "officer of the court." Moreover, the "officer of the court" terminology is unchanged from the time when trustees were in fact appointed and supervised by the court, and in any event it does not suggest what obligations, beyond honest dealing with the property of the estate, that a trustee might owe to the court or anyone else, and that would not be adequately addressed by the criminal law. A crooked trustee is just as much subject to criminal prosecution whether or not he resigns, and he can be removed, pursuant to 11 U.S.C. 324, if he does not resign. Thus, potential criminal liability of a trustee as an "officer of the court" provides no premise for the court to reach out under its "inherent power" to involve itself in the purely administrative matter of a trustee's voluntary resignation.

The fact that the trustee in this case "happens to be an attorney" (Bankr. R. 31, Mem. Op. at 18-21 & n.12; Apx.____ & n.12; 259 B.R. at 894-95 & n.12) does not alter the equation. Congress surely did not intend that the procedure governing resignation of bankruptcy trustees would vary depending on whether or not a particular trustee happens to be an attorney. Mr. Demczyk is not acting as an attorney in these cases, but rather in an administrative capacity, as a trustee appointed by the UST to perform delegated statutory duties in which he is overseen by the UST. There is no attorney-client relationship. The bankruptcy court's citations (*id.*) to the Ohio disciplinary rule DR 2-110 and Ohio Local Civil Rule 83.9, which require court permission for an attorney to withdraw from representation of a client in a pending proceeding, are therefore inapposite.[16] And, if the court believes an attorney trustee has committed sanctionable misconduct under any other disciplinary rule, it is free to lodge such charges regardless of whether he resigns, just as it is presumably free to sanction him, like "any attorney or party," under N.D. Ohio Bankr. Local Rule 2090-2(c) (see Bankr. R. 31, Mem. Op. at 18 n.12; Apx.____ n.11; 259 B.R. at 894 n.12), "[w]hen necessary to control or eliminate disruptive, abusive, or unprofessional practices or conduct." That possibility, like the possibility of criminal liability under the criminal statutes, provides no reason for the court to get involved in the purely administrative process of resignation in order to conduct a wholly speculative inquiry into the resigning trustee's bona fides.

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[16] Indeed, a number of state courts have recognized that attorneys acting in a non-lawyer capacity are not subject to disciplinary rules governing attorney relationships to clients and client funds. See *In re Confidential*, 664 A.2d 364, 366-68 (D.C. 1995) (disciplinary rule governing trust accounts not applicable to attorney acting as a stakeholder in private commercial transaction); *In re Disciplinary Proceedings Against Jacobs*, 467 N.W. 2d 783, 791 (Wis. 1991) (lawyer acting as fiduciary outside attorney-client relationship not required to comply with disciplinary rule regarding handling of client funds); *Layton v. State Bar*, 789 P.2d 1026, 1034 (Cal. 1990) (executor not required to be an attorney, and executors are not, as such, subject to attorney disciplinary rules).

Conclusion

For the foregoing reasons, this Court should reverse the judgment of the district court, with instructions to direct the bankruptcy court to vacate its orders requiring Mr. Demczyk to continue to serve as Chapter 12 trustee in these cases.

Respectfully submitted,

ROBERT D. McCALLUM, JR.
Assistant Attorney General
Civil Division

EMILY M. SWEENEY
United States Attorney

WILLIAM KANTER
(202) 514-4575
WENDY M. KEATS
(202) 514-0265
Attorneys, Appellate Staff
Civil Division, Room 9152
Department of Justice
601 D Street, N.W.
Washington, D.C. 20530-0001

MAY 2002

BRIEF BANK — "SUMMARY SHEET" *Printed Thu-2/25/10 16:40*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*
Linda Coty Bullock v. Ronald L. Glass, Chapter 11 Trustee, and Donald F. Walton, United States Trustee, Region 21

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*
N.D. Ga.

3. ("CCN") ***CURRENT*** CASE NO.
No.: 4:10-cv-00014-HLM

4. ("PCN") ***PRIOR*** CASE NO. - & COURT *[IF ANY]*
No.: 08-43724
Court: Bankr. N.D. Ga.
(Identify judge & cite, if any)

5. ("SO") ***SOURCE***
U.S. TRUSTEES

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*
Filed: February 25, 2010
Type: Brief for the United States Trustee, Appellee

7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*
James H. Morawetz, Noah M. Schottenstein, P. Matthew Sutko, Guy G. Gebhardt
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***
● Whether the bankruptcy court abused its discretion by granting the chapter 11 trustee's motion to convert the appellant's bankruptcy case from chapter 11 to chapter 7 under 11 U.S.C. § 1112(b)(1), rather than dismissing the case, based on the court's factual finding that conversion was in the best interest of the creditors and the estate.

10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)

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NAME: Linda Figueroa
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IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF GEORGIA
ROME DIVISION

LINDA COTY BULLOCK,	:	CASE NO. 4:10-cv-00014-HLM
	:	
Appellant,	:	On appeal from the United States
v.	:	Bankruptcy Court for the
	:	Northern District of Georgia,
RONALD L. GLASS,	:	Case No. 08-43724
Chapter 11 Trustee,	:	
and	:	
DONALD F. WALTON,	:	
United States Trustee, Region 21,	:	
	:	
Appellees.	:	
....	:	
IN RE	:	
	:	
LINDA COTY BULLOCK,	:	
	:	
DEBTOR.	:	

BRIEF FOR THE UNITED STATES TRUSTEE, APPELLEE

Of Counsel	GUY G. GEBHARDT
RAMONA D. ELLIOTT	Assistant United States Trustee
General Counsel	JAMES H. MORAWETZ
P. MATTHEW SUTKO	Trial Attorney
Associate General Counsel	
NOAH M. SCHOTTENSTEIN	Office of the United States Trustee
Trial Attorney	Department of Justice
	Suite 362, Russell Federal Building
Executive Office for United States Trustees	75 Spring Street, SW
Department of Justice	Atlanta, GA 30303
20 Massachusetts, Ave. N.W., Suite 8100	Tel: (404) 331-4437
Washington, D.C. 20530	Fax: (404) 331-4464

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STATEMENT OF APPELLATE JURISDICTION

This Court has jurisdiction over the appeal under 28 U.S.C. § 158(a)(1), which confers jurisdiction on the district courts of the United States to hear appeals "from final judgments, orders, and decrees" of bankruptcy judges. An order converting a bankruptcy case from chapter 11 to chapter 7 is a final order subject to appeal. *Rosson v. Fitzgerald* (*In re Rosson*), 545 F.3d 764, 770 (9th Cir. 2008). The bankruptcy court's final order converting the appellant's chapter 11 bankruptcy case to a case under chapter 7 of the Bankruptcy Code was entered on December 17, 2009. [BC #115].[1] The appellant's notice of appeal was timely filed under 28 U.S.C. § 158(a)(2) and Fed. R. Bankr. P. 8002(a) on December 28, 2009, giving rise to this appeal.

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[1] Documents in the record transmitted to the district court by the bankruptcy court are identified by the designation "BC #" followed by the docket number assigned to the document by the clerk of the bankruptcy court.

STATEMENT OF THE ISSUES

The only issue presented in this appeal is whether the bankruptcy court abused its discretion by granting the chapter 11 trustee's motion to convert the appellant's bankruptcy case from chapter 11 to chapter 7 under 11 U.S.C. § 1112(b)(1), rather than dismissing the case, based on the court's factual finding that conversion was in the best interest of the creditors and the estate.

STANDARD OF REVIEW

This court reviews the bankruptcy court's decision to convert a case under 11 U.S.C. § 1112(b)(1) from chapter 11 to chapter 7 for abuse of discretion, which occurs when the "court's decision rests upon a clearly erroneous finding of fact, an errant conclusion of law, or an improper application of law to fact." *United States v. Baker*, 432 F.3d 1189, 1202 (11th Cir. 2005); *Lumber Exch. Bldg. Ltd. P'ship v. Mut. Life Ins. Co.* (*In re Lumber Exch. Bldg. Ltd. P'ship*), 968 F.2d 647, 648 (8th Cir. 1992) ("The bankruptcy court has broad discretion in deciding whether to dismiss or convert a Chapter 11 case."); *Kates v. Mazzocone*, 180 B.R. 782, 785 (E.D.Pa. 1995) (noting that the legislative history directs the bankruptcy court "to use its equitable powers to reach an appropriate result in individual cases").

This court reviews findings of fact for clear error and conclusions of law *de novo*. *Southtrust Bank of Alabama v. Thomas* (*In re Thomas*), 883 F.2d 991, 994 (11th Cir. 1989); *Whiting-Turner Contracting Co. v. Elec. Mach. Enter., Inc.* (*In re Elec. Mach. Enter., Inc.*), 479 F.3d 791, 795 (11th Cir. 2007); Fed. R. Bankr. P. 8013 ("Findings of fact . . . shall not be set aside unless clearly erroneous."). Cause to convert a bankruptcy case is a finding of fact, which is clearly erroneous only "when the record contains no evidence on which [the bankruptcy court] rationally could have based that decision." *Pioneer Liquidating Corp. v. U.S. Trustee* (*In re Consol. Pioneer Mortg. Entities*), 264 F.3d 803, 806-7 (9th Cir. 2001). A bankruptcy court's determination under section 1112(b)(1) that conversion, instead of dismissal, would better serve the interests of creditors and the estate is a factual finding reviewed for clear error. *Id.* at 808-09.

STATEMENT OF THE CASE

The appellant, Linda Coty Bullock, commenced this bankruptcy case by filing a voluntary petition for relief under chapter 11 of the Bankruptcy Code on November 3, 2008. Ms. Bullock filed her bankruptcy schedules on December 1, 2008, listing as assets of the estate twenty parcels of real property, including a horse farm, which she valued at $13,599,700, subject to secured claims totaling $4,024,350. [BC #26].

This was Ms. Bullock's second bankruptcy case in under 180 days. Ms. Bullock had previously filed for chapter 13 bankruptcy on July 1, 2008, and had voluntarily dismissed that case on September 10, 2008, after a secured creditor filed a motion for relief from the automatic stay. [BC #62]. Although Ms. Bullock was presumptively prohibited under these circumstances from filing another bankruptcy case for 180 days, the bankruptcy court nevertheless permitted her to proceed with the present case based on "a line of cases that ... permit the second filing under limited circumstances ..." [BC #148 at 15-16]; *see* 11 U.S.C. § 109(g)(2) (prohibiting an individual from being a debtor in a bankruptcy case if, at any time in the preceding 180 days, he or she requested and obtained the voluntary dismissal of a prior case following a request for relief from the automatic stay).

On June 25, 2009, the United States Trustee moved under 11 U.S.C. § 1112(b) and 28 U.S.C. § 586(a)(8) to dismiss or convert the case.[2] The United States Trustee alleged cause existed to convert or dismiss the case because Ms. Bullock (1) was not administering the estate in the interest of her creditors and had failed to maintain insurance on her properties to protect the interests of her creditors, (2) operated no meaningful business and generated no significant income, (3) had not taken any steps to sell her property in order to pay the claims against the estate, (4) had no cash to fund a reorganization plan, and (5) had not proposed a reorganization plan. [BC #65].

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[2] The United States Trustee is an official of the United States Department of Justice appointed by the Attorney General to supervise the administration of bankruptcy cases in this district. 28 U.S.C. § 581(a)(21). Under 11 U.S.C. § 307 "[t]he United States trustee may raise and may appear and be heard on any issue in any case or proceeding under this title but may not file a plan pursuant to section 1121(c) of this title." Courts have repeatedly held that the United States Trustee has standing under section 307 to appear and be heard on any issue in any bankruptcy case, despite the lack of pecuniary interest in the outcome. *See, e.g., United Artists Theater Co. v. Walton*, 315 F.3d 217, 225 (3d Cir.2003); *Scott v. U.S. Trustee*, 133 F.3d 917 (4th Cir. 1997); *In re Revco D.S., Inc.,* 898 F.2d 498, 500 (6th Cir. 1990); *In re Donovan Corp.*, 215 F.3d 929, 930 (9th Cir. 2000) ("The United States trustee may . . . intervene and appear at any level of the proceedings from the bankruptcy court on . . . as either a party or an amicus.") (internal quotations omitted). The United States Trustee is explicitly authorized to bring a motion for relief under section 1112 of title 11. 28 U.S.C. § 586(a)(8).

On July 21, 2009, the bankruptcy court, acting on a motion of a creditor, ordered the appointment of an independent chapter 11 trustee to administer the estate. [BC #74]; *see* 11 U.S.C. §§ 1104 and 1106 (allowing for the appointment and establishing the duties of chapter 11 trustees). Ms. Bullock did not appeal that order, nor does she contest it in this appeal. On July 29, 2009, the United States Trustee appointed Ronald Glass to serve as the chapter 11 trustee. [BC #77].

Mr. Glass investigated the assets of the estate and found that — contrary to Ms. Bullock's schedules — the properties were heavily encumbered and of limited market value, the estate had no cash, there was no operating business, and there was "no reasonable likelihood of rehabilitation." [BC #97]. On November 13, 2009, Mr. Glass filed a motion under 11 U.S.C. § 1112(b) to convert the case to chapter 7 in order to "eliminate . . . expenses unique to chapter 11, such as professional fees incurred in connection with the preparation and confirmation of a disclosure statement and plan and . . . U.S. Trustee fees," thereby "ensur[ing] that Debtor's assets, if any, will be distributed directly to the creditors" and "minimiz[ing] the delay in any distribution to creditors that might be caused by the plan process." *Id.*

The court held a hearing on this motion on December 16, 2009 [BC #148]. At the hearing, the court concluded that the bankruptcy case had “hit a dead end.” [*Id*. at 16]. The court expressed concern that Ms. Bullock was enjoying the protections of the Bankruptcy Code but had failed to propose a plan of reorganization. [*Id*. at 17]. The court also expressed concern regarding the “level of cooperation” that Ms. Bullock was providing to Mr. Glass and the United States Trustee and noted that the court still “did not know what the whole situation is” in regard to the nature and value of her property interests. [*Id*.].

The bankruptcy court determined that dismissal would be inappropriate under these circumstances because it would give Ms. Bullock the benefit of the protections of the Bankruptcy Code “without having to pay the price . . . which is to come clean and make sure that all of the assets are administered through the bankruptcy court.” [*Id*. at 18]. The court noted that in a chapter 7 liquidation, to the extent that Ms. Bullock’s property was worth more than Mr. Glass’s assessment, creditors would be paid and any excess value would be returned to Ms. Bullock. [*Id*.]. Therefore, the court found that it was in the interests of the creditors and Ms. Bullock to “get things drawn to a conclusion” because the ultimate result of the chapter 7 liquidation would benefit everyone. [*Id*. at 19-20].

As the court told Ms. Bullock, "[y]ou're on the same team. You're trying to get the creditors paid and the residual, if any, back to you." [*Id*.].

On December 17, 2009, the bankruptcy court entered its order converting the case to chapter 7. [BC #115]. On December 28, 2009, Ms. Bullock filed a timely notice of appeal. [BC #123].

SUMMARY OF ARGUMENT

Section 1112(b)(1) of title 11 provides that if, on motion by a party in interest, the court finds that cause exists to convert or dismiss a case, then, absent unusual circumstances, the court "shall convert a case under this chapter to a case under chapter 7 or dismiss a case under this chapter, whichever is in the best interests of the creditors and the estate ..." Ms. Bullock failed to fulfill her fiduciary obligations as a debtor in possession or to propose any plan of reorganization or liquidation during the pendency of the case in chapter 11, receiving the benefit of the protections offered by the Bankruptcy Code without producing any corresponding benefit to the bankruptcy estate and its creditors.

Based upon these facts, the bankruptcy court did not commit clear error when it found that conversion of the case to chapter 7 would be in the best interests of creditors because (1) dismissal would be unjust given Ms. Bullock's conduct, and (2) conversion to chapter 7 would force a speedy resolution of the bankruptcy case, thereby (a) preventing further diminution of the estate and increasing the amount available to creditors or ultimately distributed to Ms. Bullock, and (b) reducing further unnecessary delay in any distribution to the creditors.

On appeal, Ms. Bullock complains of Mr. Glass's conduct as chapter 11 trustee, suggesting that he engaged in religious, racial, and sexual discrimination. These baseless accusations were not raised in the bankruptcy court, are not supported by the record, and are not properly before this court in this appeal. The only arguments raised by Ms. Bullock that bear on the issue of whether the bankruptcy court abused its discretion in converting her case consist of unsubstantiated assertions that her property is worth more than its valuation by Mr. Glass and that creditors would be better off if she were allowed to negotiate a workout without the expense of paying a trustee to supervise the estate.

The question before this Court, however, is not whether Ms. Bullock's desired outcome is actually in the best interest of the creditors but whether the bankruptcy court abused its discretion when it decided that conversion rather than dismissal was in the best interest of the creditors. It did not. The bankruptcy court's findings are supported by the record, and the bankruptcy court carefully considered all of the arguments and evidence in the record before rendering its decision. Therefore, this Court should affirm the order entered below.

ARGUMENT

I. Statutory framework

Section 1112(b)(1) provides that if, upon motion by a party in interest, the court finds that cause exists to convert or dismiss a chapter 11 case, then, absent unusual circumstances, the court "shall convert a case under this chapter to a case under chapter 7 or dismiss a case under this chapter, whichever is in the best interests of the creditors and the estate." 11 U.S.C. § 1112(b)(1).

"Cause" is defined by 11 U.S.C. § 1112(b)(4) to include a list of factors, including "substantial or continuing loss to or diminution of the estate and the absence of a reasonable likelihood of reorganization," "gross mismanagement of the estate," and "failure to comply with an order of the court." However, this list is not exhaustive and the court may consider other factors as they arise. *In re Albany Partners, Ltd.*, 749 F.2d 670, 674 (11th Cir. 1984). Thus, the court is given judicial discretion to determine what factors shall constitute cause under the circumstances of each case. *Colonial Daytona Ltd. P'ship v. Am. Sav. of Florida*, 152 B.R. 996, 1001 (M.D. Fla. 1993); *All Denominational New Church v. Pelofsky* (*In re All Denominational New Church*), 268 B.R. 536, 538 (B.A.P. 8th Cir. 2001); *see also* 11 U.S.C. § 102(3) (" 'includes' and 'including' are not limiting"); *In re 3 Ram, Inc.*, 343 B.R. 113, 117 (Bankr. E.D. Pa. 2006) ("While the enumerated examples of 'cause' to convert or dismiss a chapter 11 case now listed in § 1112(b)(4) have changed under BAPCPA, the fact that they are illustrative, not exhaustive has not.") (internal citations omitted).

II. The bankruptcy court did not commit clear error when it found that conversion of Ms. Bullock's case from chapter 11 to chapter 7 was in the best interest of the creditors and the estate.

Section 1112(b)(1) of title 11 requires the bankruptcy court to determine whether conversion or dismissal is in the best interests of the creditors and the estate. In this case, the bankruptcy court found that conversion was in the best interest of the creditors and the estate because (1) dismissal would be unjust considering the length of time the case had been pending and Ms. Bullock's "level of cooperation" during that period [BC # 148 at 17], and (2) conversion to chapter 7 would force a speedy resolution to the bankruptcy case, thereby (a) preventing further diminution of the assets of the estate and increasing the amount available to creditors or ultimately returned to Ms. Bullock and (b) reducing further unnecessary delay in any distribution to creditors. Based on that finding, which was supported by the record, conversion of the case from chapter 11 to chapter 7 was appropriate.

During the nine months that Ms. Bullock was in control of the bankruptcy estate as a debtor in possession, she neither proposed any chapter 11 plan nor filed any motion pursuant to 11 U.S.C. § 363(b)(1) seeking authorization to sell any of her properties. The record contains nothing that would suggest she had any business to reorganize at the time the conversion order was entered. In fact, her operating reports filed in the case reveal that her only sources of income during the pendency of the case were rent and social security payments. [BC #35, 40, 49, 52, 54, 57, 71, 88, 89, and 109]. Thus, Ms. Bullock had been incurring the expenses associated with a chapter 11 reorganization for no valid purpose while delaying any distribution to the creditors.

In addition, the bankruptcy court considered Ms. Bullock's prior history as a bankruptcy debtor. The court noted that she had filed this case less than 180 days after voluntarily dismissing a previous chapter 13 case in the face of a creditor's motion for relief from the automatic stay. Although a bankruptcy petition is subject to dismissal pursuant to 11 U.S.C. § 109(g)(2) under these circumstances, the court had allowed the case to go forward based on "a line of cases that ... permit the second filing under limited circumstances." [BC #148 at 16]. The court expressed concern that despite this respite and although the case had been pending for over a year, Ms. Bullock still had not presented a clear picture of the nature and extent of her property interests — the horse farm business appeared to be non-existent — and had not provided Mr. Glass with a high level of cooperation during his administration of the case as chapter 11 trustee. [*Id*. at 16-17].

The bankruptcy court observed that "dismissing the case at this point really would give the debtor the benefit of an awful lot of things that go on in bankruptcy without having to pay the price of that, which is to come clean and make sure that all of the assets are administered through the bankruptcy court." [*Id*. at 17-18]. The court warned Ms. Bullock that failure to cooperate with the trustee in the chapter 7 proceedings could lead to denial of her discharge. [*Id*. at 20]. By converting the case to chapter 7 instead of dismissing it, the bankruptcy court was able to (1) prevent Ms. Bullock from using the successive dismissal of cases to frustrate creditors and (2) allow an independent trustee to conduct an effective administration of the estate, liquidating assets and expediting payment to creditors. *See* 11 U.S.C. § 704(a) (authorizing the chapter 7 trustee to liquidate the estate and use the funds to pay creditors).

The bankruptcy court carefully considered the facts in rejecting the option of dismissal. The court found that conversion to chapter 7 would "get things drawn to a conclusion" and would be in the best interests of everyone, including Ms. Bullock. [*Id*. at 19-20]. The court's finding that cause existed to dismiss or convert the case and its determination that conversion was in the best interest of the creditors and the estate are supported by the record and are not clearly erroneous.

III. Ms. Bullock does not demonstrate that dismissal would have been in the best interest of the creditors and the estate.

Ms. Bullock made no contention during the hearing that cause did not exist to convert the case. Instead, she simply expressed a preference for dismissal over conversion, based on her belief that there was equity in the properties and that "she'd be better equipped to ... to try to work out some kind of resolution [with creditors] outside of bankruptcy." [BC #148 at 13-15].

Section 1112(b)(1) provides that when cause for dismissal or conversion has been established, the choice between the two remedies will be guided by "whichever is in the best interests of creditors and the estate," not what is in the best interest of the debtor. In light of Ms. Bullock's refusal to identify and administer the assets of the estate while in chapter 11, the court had a justifiable basis to be skeptical of her stated desire to resolve the claims outside of bankruptcy and was authorized to find that a supervised liquidation under the provisions of chapter 7 was in the best interest of creditors. Ms. Bullock has offered this court no basis upon which to conclude that the bankruptcy court committed clear error in finding that conversion of the case from chapter 11 to chapter 7 would serve the interests of creditors and the bankruptcy estate better than dismissal.

CONCLUSION

For these reasons, the United States Trustee respectfully asks this Court to affirm the order entered below.

[Signature Page Follows]

Respectfully submitted,

Of Counsel

DONALD F. WALTON
UNITED STATES TRUSTEE
By: ***/s/ Guy G. Gebhardt***

GUY G. GEBHARDT
Georgia Bar No. 288550
Assistant United States Trustee
Email: Guy.Gebhardt@usdoj.gov

By: ***/s/ James H. Morawetz***
JAMES H. MORAWETZ
Georgia Bar No. 521900
Trial Attorney
Email: Jim.H.Morawetz@usdoj.gov

Office of the United States Trustee
United States Department of Justice

Suite 362, 75 Spring Street, SW
Atlanta, GA 30303
Telephone: (404) 331-4437
Facsimile: (404) 331-4464

RAMONA D. ELLIOTT
General Counsel

P. MATTHEW SUTKO
Associate General Counsel

NOAH M. SCHOTTENSTEIN
Trial Attorney

Executive Office for United States Trustees
United States Department of Justice

Suite 8100, 20 Massachusetts, Ave. NW
Washington, D.C. 20530

Date: February 23, 2010

CERTIFICATE OF SERVICE

I certify that I am over the age of 18 and that on this date I caused true and correct copies of the foregoing Brief to be deposited in the U.S. Mail, first class postage prepaid, addressed as follows:

Linda Coty Bullock
411 Billy Bullock Road
Dallas, GA 30175

Frank W. DeBorde, Esq.
Will Tate, Esq.
Morris. Manning & Martin, LLP
1600 Atlanta Financial Center
3343 Peachtree Road, NE
Atlanta. Georgia 30326

Kyle A. Cooper, Esq.
Chapter 7 Trustee
615 Colonial Park Drive, Suite 104
Roswell, Georgia 30075

Evan M. Altman, Esq.
Building 2, Northridge 400
8325 Dunwoody Place
Atlanta, GA 30350

Done this the 23rd day of February, 2010.

s/ *James H. Morawetz*
JAMES H. MORAWETZ
Trial Attorney
Georgia Bar No. 521900

BRIEF BANK — "SUMMARY SHEET"

Printed Wed-8/4/10 16:38

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	Linda Coty Bullock v. Kyle A. Cooper, Chapter 7 Trustee, and Donald F. Walton, United States Trustee, Region 21 (In re: Linda Coty Bullock)
2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	N.D. Ga.
3. ("CCN") ***CURRENT*** CASE NO.	No.: 4:10-cv-0096-HLM
4. ("PCN") ***PRIOR*** CASE NO. - & COURT *[IF ANY]*	No.: 08-43724 Court: Bankr. N.D. Ga. *(Identify judge & cite, if any)*
5. ("SO") ***SOURCE***	**U.S. TRUSTEES**
6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	Filed: July 28, 2010 Type: United States Trustee's Motion to Dismiss Appeal
7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*	James H. Morawetz, Noah Schottenstein, P. Mattew Sutko, Donald F. Walton *(UST/OGC: 202-307-1399/FAX-2397)*
8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	• Whether there is a basis for the district court to grant leave to appeal a discovery order.
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IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF GEORGIA
ROME DIVISION

LINDA COTY BULLOCK, Appellant, v. KYLE A. COOPER, Chapter 7 Trustee, and DONALD F. WALTON, United States Trustee, Region 21 Appellee.	:	CASE NO. 4:10-cv-0096-HLM On appeal from the United States Bankruptcy Court for the Northern District of Georgia, Case No. 08-43724
IN RE LINDA COTY BULLOCK, Debtor.	:	

UNITED STATES TRUSTEE'S MOTION TO DISMISS APPEAL

The United States Trustee seeks dismissal of this appeal on the ground that the bankruptcy court order from which the appeal is taken is not a final, appealable order, and there is no basis for the Court to grant leave for interlocutory review.[1]

---

[1] The United States Trustee is an official of the United States Department of Justice appointed by the Attorney General to supervise the administration of bankruptcy cases in this district. 28 U.S.C. § 581(a)(21). "The United States trustee may raise and may appear and be heard on any issue in any case or proceeding under this title but may not file a plan pursuant to section 1121(c) of this title." 11 U.S.C. § 307. The United States Trustee has standing under section

Background

Appellant Linda Coty Bullock filed a voluntary petition for relief under chapter 11 of the Bankruptcy Code on November 3, 2008. [BC #1]. Her case was converted to chapter 7 on December 17, 2009. [BC #115].

Pursuant to 11 U.S.C. § 343, the debtor in a bankruptcy case must "appear and submit to examination under oath at" a meeting of her creditors convened under 11 U.S.C. § 341 . Ms. Bullock failed to appear at any of the five such meetings scheduled in this case subsequent to its conversion to chapter 7. [BC #122, 150, 171, 176, 179, 191]. Therefore, on June 4, 2010, the chapter 7 trustee, Kyle A. Cooper, filed a motion to compel her to attend. [BC #182].

On June 7, 2010, the bankruptcy court granted the trustee's motion to compel and entered an order (the "Order") directing Ms. Bullock to attend the next scheduled section 341 meeting or be deemed in contempt of court. [BC #183]. In

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307 to appear and be heard on any issue in any bankruptcy case, despite the lack of pecuniary interest in the outcome. *See Morgenstern v. Revco D.S., Inc.* (*In re Revco D.S., Inc.*), 898 F.2d 498, 500 (6th Cir. 1990); *see also United Artists Theater Co. v. Walton* (*In re United Artists Theater Co.*), 315 F.3d 217, 225 (3d Cir. 2003); *Stanley v. McCormick* (*In re Donovan Corp.*), 215 F.3d 929, 930 (9th Cir. 2000) ("The United States trustee may . . . intervene and appear at any level of the proceedings from the bankruptcy court on . . . as either a party or an amicus."); *Scott v. U.S. Trustee*, 133 F.3d 917 (4th Cir. 1997).

response, Ms. Bullock timely filed a notice of appeal on June 21, 2010. [BC #188].

There is no basis for this Court to grant leave to appeal of the Order

The Order from which Ms. Bullock is appealing is not a final order, and there is no basis for this court to grant interlocutory review.

District courts have jurisdiction to hear appeals from final judgments, orders and decrees of bankruptcy judges and, "with leave of court, from ... interlocutory orders and decrees of bankruptcy judges ..." 28 U.S.C. § 158(a). Even if this Court were to construe Ms. Bullock's notice of appeal as a motion for such leave, the record does not demonstrate that any basis for interlocutory review exists.

Because 11 U.S.C. § 158(a) and Fed. R. Bankr. P. 8003 do not provide guidance for determining when to grant leave to appeal, district courts look to the standards set forth in 28 U.S.C. § 1292(b). *In re Brentwood Golf Club*, L.L.C., 329 B.R. 239, 242 (E.D. Mich. 2005). *Accord Matter of Ichinose*, 946 F.2d 1169, 1177 (5th Cir. 1991); *Roderick v. Levy*, 185 B.R. 601, 604 (B.A.P. 9th Cir.1995); *Patrick v. Dell Fin. Services*, 366 B.R. 378, 385 (M.D. Pa. 2007); *Delta Air Lines, Inc. v. A.I. Leasing II* (*In re Pan Am Corp.*), 159 B.R. 396, 401 (S.D.N.Y. 1993).

Under section 1292(b), an appeal from an interlocutory order may be granted when the order involves: "[1] a controlling question of law [2] as to which there is substantial ground for difference of opinion and [3] an immediate appeal [...] may materially advance the ultimate termination of the litigation[;] and [4] a court should consider whether denying leave to appeal would result in wasted litigation and expense." *Brentwood Golf Club*, 329 B.R. at 242, *supra* (citations omitted).

"In bankruptcy cases, movants for leave to appeal an interlocutory order have the burden of demonstrating that 'exceptional circumstances exist.'" *Gache v. Balaber-Strauss*, 198 B.R. 662, 664 (S.D.N.Y. 1996) (quoting *In re Johns-Manville Corp.*, 47 B.R. 957, 960 (S.D.N.Y. 1985)); s*ee also Orson, Inc. v. Miramax Film Corp.*, 867 F. Supp. 319, 320 (E.D. Pa. 1994). "Leave to appeal from interlocutory orders should be granted only in exceptional circumstances because to do otherwise would contravene the well-established judicial policy of discouraging interlocutory appeals and avoiding the delay and disruption which results from such piecemeal litigation." *In re Wicheff*, 215 B.R. 839, 844 (B.A.P. 6th Cir. 1997) ("The appellate court may deny the appeal for any reason, including docket congestion.").

The bankruptcy court's decision to compel Ms. Bullock to attend the section 341 meeting of creditors in her chapter 7 case did not involve any controlling question of law as to which there is a substantial ground for a difference of opinion. As a bankruptcy debtor, Ms. Bullock has a statutory obligation under 11 U.S.C. § 343 to attend and submit to examination under oath at such a meeting, and she raised no argument to the contrary in the bankruptcy court. "[T]he purpose of the section 341(a) meeting is discovery," *In re Chandler*, 66 B.R. 334, 337 (N.D. Ga. 1986), and under Eleventh Circuit law, "discovery orders are not appealable." *Carpenter v. Mohawk Indus., Inc.*, 541 F.3d 1048, 1052 (11th Cir. 2008).

In addition, Ms. Bullock's bankruptcy case would not be materially advanced if interlocutory review of the Order were granted. To the contrary, an immediate appeal would prolong the administration of the bankruptcy case and result in wasted time and expense. Ms. Bullock has neither established nor alleged any circumstances in connection with this matter, exceptional or otherwise, that would justify a departure from the basic policy of postponing appellate review until after the entry of a final judgment.

Conclusion

For the foregoing reasons, the United States Trustee respectfully requests that this Court dismiss Ms. Bullock's appeal.

DONALD F. WALTON
United States Trustee
Region 21

/s/ ***James H. Morawetz***
JAMES H. MORAWETZ
Trial Attorney
Georgia Bar No. 521900

United States Department of Justice
Office of the United States Trustee
362 Richard Russell Building
75 Spring Street
Atlanta, Georgia 30303
Tel: (404) 331-4437
Fax: (404) 331-4464
E-mail: jim.h.morawetz@usdoj.gov

CERTIFICATE OF SERVICE

I certify that I am over the age of 18 and that on this date I caused true and correct copies of the foregoing pleading to be deposited in the U.S. Mail, first class postage prepaid, addressed as follows:

Linda Coty Bullock
411 Billy Bullock Road
Dallas, GA 30175

Kyle A. Cooper, Esq.
Chapter 7 Trustee
615 Colonial Park Drive, Suite 104
Roswell, Georgia 30075

Done this the 28th day of July, 2010.

/s/ *James H. Morawetz*
JAMES H. MORAWETZ
Trial Attorney
Georgia Bar No. 521900

BRIEF BANK — “SUMMARY SHEET”

Printed Tue-9/22/09 16:26

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	In re Edward J. Burbank and Donna M. Burbank (John Boyajian v. Edward J. Burbank and Donna M. Burbank)
2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	1st Cir.
3. ("CCN") ***CURRENT*** CASE NO.	No.: 09-1776 consolidated with 09-1777
4. ("PCN") ***PRIOR*** CASE NO. - & COURT *[IF ANY]*	No.: 08-11620 Court: Bankr. R.I. *(Identify judge & cite, if any)*
5. ("SO") ***SOURCE***	**U.S. TRUSTEES**
6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	Filed: August 31, 2009 Type: Brief of the United States as Amicus Curiae Supporting Reversal
7. **("AU")** ***PRINCIPAL AUTHORS & OFFICE*** [E.g.,"UST/OGC"]	David I. Gold, P. Matthew Sutko, Ramona D. Elliott, Phoebe Morse *(UST/OGC: 202-307-1399/FAX-2397)*
8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	• Whether the bankruptcy court erred by holding that vehicle ownership expenses that the chapter 13 debtors did not incur, and secured debt payments on a home the debtors proposed to surrender, could be sued to reduce the debtors’ “projected disposable income” under 11 U.S.C. 1325(b)(1).
10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)	
11. DO YOU RECOMMEND POSTING IN UST BRIEFBANK?	☒ YES ☐ NO ***NAME:*** Linda Figueroa ***DATE:***

UNITED STATES COURT OF APPEALS
FOR THE FIRST CIRCUIT

NO. 09-1776

EDWARD J. BURBANK & DONNA M. BURBANK,
Debtors.

JOHN BOYAJIAN,
Appellant,

v.

EDWARD J. BURBANK & DONNA M. BURBANK,
Appellees.

NO. 09-1777

EDWARD J. BURBANK & DONNA M. BURBANK,
Debtors.

JOHN BOYAJIAN,
Appellant,

v.

EDWARD J. BURBANK & DONNA M. BURBANK,
Appellees.

ON DIRECT APPEAL FROM THE UNITED STATES BANKRUPTCY COURT FOR THE DISTRICT OF RHODE ISLAND

CASE NO. 08-11620-ANV

BRIEF OF THE UNITED STATES AS AMICUS CURIAE SUPPORTING REVERSAL

RAMONA D. ELLIOTT
General Counsel

P. MATTHEW SUTKO
Associate General Counsel
DAVID I. GOLD
Trial Attorney
Executive Office for United States Trustees
Department of Justice
20 Massachusetts Avenue, N.W.
Washington, D.C. 20530
Ph: (202) 307-1399
Fax: (202) 307-2397

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THE BANKRUPTCY COURT'S RULING MAY BE REVERSED ON EITHER OF TWO SEPARATE AND INDEPENDENT GROUNDS: (A) THE IMPROPER APPLICATION OF 11 U.S.C. § 1325(b)(1); AND (B) AN ERRONEOUS CONSTRUCTION OF 11 U.S.C. § 707(b)(2)(A)(ii)(I). IN EITHER CASE, THE BURBANKS ARE NOT ENTITLED TO DEDUCT PAYMENTS FOR EXPENSES THEY DO NOT HAVE AND WILL NEVER ACTUALLY MAKE.

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The United States submits this brief under Fed. R. App. P. 29, as *amicus curiae* in support of reversal of the bankruptcy court's order.

INTEREST OF THE UNITED STATES

This appeal involves a dispute over the interpretation of two provisions of the United States Bankruptcy Code, 11 U.S.C. §§ 1325(b) and 707(b)(2)(A). Together, these provisions determine whether debtors have met their statutory obligation to dedicate their projected disposable income to paying unsecured creditors through their chapter 13 plans.

The United States has a direct interest in the proper construction of these provisions because United States Trustees, who are Justice Department officials appointed by the Attorney General, supervise the administration of bankruptcy cases in all federal judicial districts within this circuit. *See* 28 U.S.C. § 581-589a. *See also* H.R. Rep. No. 95-595 at 88 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6049 (United States Trustees "serve as bankruptcy watch-dogs to prevent fraud, dishonesty, and overreaching in the bankruptcy arena").

The questions presented by this appeal affect the duties of United States Trustees for at least two reasons. First, under 28 U.S.C. § 586(a)(3)(C), United States Trustees monitor chapter 13 plans and file comments with the court in connection with plan confirmation hearings under section 1324 of the Bankruptcy Code. Second, United States Trustees have an interest in the proper interpretation of section 707(b)(2) because, in addition to its relevance in chapter 13 cases, that provision determines whether chapter 7 cases filed by above-median-income debtors are presumed to be abusive. *See* 11 U.S.C. § 707(b)(1), (2). Pursuant to section 704(b), United States Trustees are responsible for reviewing chapter 7 cases for abuse and seeking dismissal where appropriate. *See* 11 U.S.C. § 704(b); *Schultz v. United States*, 529 F.3d 343, 348 (6th Cir. 2008).

Given these interests, the United States submits this brief as *amicus curiae* in order to share its views on the application of sections 1325(b) and 707(b)(2). *See* 28 U.S.C. § 517 (authorizing Department of Justice "to attend to the interests of the United States in a suit pending in a court of the United States"); 11 U.S.C. § 307 (United States Trustee "may raise and may appear and be heard on any issue in any case or proceeding").

STATUTORY BACKGROUND

On April 20, 2005, Congress enacted the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005. *See* Pub. L. No. 109-8, 119 Stat. 23 (2005). The 2005 Act significantly altered how debtors obtain relief under chapters 7 and 13 of the Bankruptcy Code.

In a chapter 13 case, a debtor's unsecured creditors or trustee may insist that the debtor devote all of his "projected disposable income" to pay unsecured creditors. *See* 11 U.S.C. § 1325(b)(1)(B). The Bankruptcy Code partially defines the term "projected disposable income" by reference to section 1325(b)(2), which defines "disposable income" as "current monthly income received by the debtor . . . less amounts reasonably necessary to be expended. . . ." 11 U.S.C. § 1325(b)(2).[1]

Under the 2005 Act, above-median-income chapter 13 debtors, like the Burbanks, determine "amounts reasonably necessary to be expended . . . in accordance with" sections 707(b)(2)(A)(ii), (iii), and (iv) of the Bankruptcy Code. *See* 11 U.S.C. § 1325(b)(3) (incorporating those provisions). Deducting all allowed expenses from a debtor's current monthly income yields a net number – disposable income. However, because above-median-income chapter 13 debtors are required to pay their **projected** disposable income to unsecured creditors over the life of their chapter 13 plan, rather than merely pay their disposable income, the inquiry initiated under sections 707(b)(2)(A) and 1325(b)(3) does not end there. *See* 11 U.S.C. § 1325(b)(1)(B) (emphasis added). Instead, courts must determine a debtor's projected disposable income under section 1325(b)(1). *Id.*

At issue in this appeal is how the word "projected" in section 1325(b)(1) impacts a debtor's disposable income calculation when that calculation does not

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[1] "Current monthly income" is determined by calculating the debtor's average monthly income for the six month period preceding the month of the filing of the debtor's bankruptcy petition. *See* 11 U.S.C. § 101(10A).

reflect reality.

SUMMARY OF ARGUMENT

Section 1325(b)(1)(B) of the Bankruptcy Code requires chapter 13 debtors to devote all of their "projected disposable income" to the repayment of their unsecured creditors during the pendency of their plan. This provision reflects a "clear congressional intent . . . that debtors repay creditors the maximum they can afford." *Coop v. Frederickson (In re Frederickson)*, 545 F.3d 652, 657 (8th Cir. 2008), *petition for cert. denied*, 129 S. Ct. 1630 (2009) (internal citations omitted).

In this case, the Burbanks sought to reduce their projected disposable income by claiming, among other deductions, a $978 ownership expense for two vehicles, and a $2,615 mortgage expense on a second home. However, the Burbanks' schedules reflect that the two vehicles are not encumbered by a loan or lease, and their chapter 13 plan proposes to surrender their second home, for which they will no longer be making large mortgage payments.

The bankruptcy court committed an error of law in ruling all chapter 13 debtors can claim such expenses even when the debtors will not be paying such expenses over the life of their repayment plan. That ruling relied upon the Ninth Circuit's minority construction of section 1325(b)(1), which has been rejected in five precedential decisions issued by the Fifth, Seventh, Eight, and Ninth Circuits.

The bankruptcy court's ruling was erroneous as a matter of law because even if these expenses are properly included in the computation of the Burbanks' "disposable income" under sections 707(b)(2)(A) and 1325(b)(3), they are still excluded from the definition of "projected disposable income" under section 1325(b)(1)(B). This is so because "projected disposable income" is a forward-looking provision that directs courts to take into account changes in a debtor's income and expenses over the five year life of their plan, including, as in this case, the lack of any future payment obligations associated with the Burbanks' vehicles and second home. Thus, section 1325(b)(1) precludes the Burbanks from deducting expenses they will never actually pay over the life of their chapter 13 plan – expenses the Ninth Circuit correctly termed "fictitious," and the Seventh Circuit correctly termed "phantom," in *Ransom* and *Turner*. *See Ransom v. MBNA, America Bank, N.A. (In re Ransom)*, – F.3d–, 2009 WL 2477609, at *4 (9th Cir. Aug. 14, 2009); *In re Turner*, – F.3d –, 2009 WL 2136867, at *7 (7th Cir. July 20, 2009).

The Burbanks' phantom and fictitious expenses were improperly allowed for a second reason. They are both barred by section 707(b)(2)(A), which section 1325(b)(3) incorporates into the Burbanks' chapter 13 case. *See* 11 U.S.C. § 1325(b)(3) (expressly incorporating sections 707(b)(2)(A)(ii)(I) and 707(b)(2)(A)(iii)(I)). Under section 707(b)(2)(A)(ii)(I), a debtor with no installment or lease payments due on his vehicle has no "applicable" vehicle ownership expense under section 707(b)(2)(A)'s standardized transportation expense deductions because that debtor, literally, has no vehicle ownership expense capable of being applied. *Ransom*, – F.3d–, 2009 WL 2477609, at *4-6. Under section 707(b)(2)(A)(iii)(I), while this Court recently ruled that a chapter 7 debtor may deduct mortgage payments on property that the debtor intends to surrender, *see Morse v. Rudler (In re Rudler)*, – F.3d –, 2009 WL 2385469, at *10 (1st Cir. Aug. 5, 2009), this Court left open whether a similar result was dictated in chapter 13. It is not.

ARGUMENT

THE BANKRUPTCY COURT'S RULING MAY BE REVERSED ON EITHER OF TWO SEPARATE AND INDEPENDENT GROUNDS: (A) THE IMPROPER APPLICATION OF 11 U.S.C. § 1325(b)(1); AND (B) AN ERRONEOUS CONSTRUCTION OF 11 U.S.C. § 707(b)(2)(A)(ii)(I). IN EITHER CASE, THE BURBANKS ARE NOT ENTITLED TO DEDUCT PAYMENTS FOR EXPENSES THEY DO NOT HAVE AND WILL NEVER ACTUALLY MAKE.

I. Unlike the court below, most courts, including the Fifth, Seventh, Eighth, and Tenth circuits, read "projected disposable income" under section 1325(b)(1)(B) as allowing courts to alter the presumptive income and expenses determined under section 707(b)(2)'s means test when those amounts do not reflect reality.

Regardless of how a debtor's disposable income is calculated under sections 707(b)(2)(A) and 1325(b)(2) and (3), most courts, including the Fifth, Seventh, Eighth, and Tenth circuits, read "projected disposable income" under section 1325(b)(1)(B) to permit the consideration of credible evidence of changes in income and expenses that are likely over the life of a debtor's chapter 13 plan in order to reflect reality. *See, e.g., McCarty v. Lasowski (In re Lasowksi)*, – F.3d –, 2009 WL 2448246 (8th Cir. Aug. 12, 2009); *In re Turner*, – F.3d –, 2009 WL 2136867; *In re Nowlin*, – F.3d –, 2009 WL 2105356 (5th Cir. July 17, 2009); *Hamilton v. Lanning (In re Lanning)*, 545 F.3d 1269, 1278-82 (10th Cir. 2008), *pet. for cert. filed*, No. 08-998 (Feb. 3, 2009); *Frederickson*, 545 F.3d at 659-60; *Hildebrand v. Thomas (In re Thomas)*, 395 B.R. 914, 923 (B.A.P. 6th Cir. 2008); *Hildebrand v. Petro (In re Petro)*, 395 B.R. 369, 377-78 (B.A.P. 6th Cir. 2008); *Pak v. eCast Settlement Corp. (In re Pak)*, 378 B.R. 257, 262 (B.A.P. 9th Cir. 2007), *abrogated by Maney v. Kagenveama (In re Kagenveama)*, 541 F.3d 868 (9th Cir. 2008); *Kibbe v. Sumski (In re Kibbe)*, 361 B.R. 302, 314-15 (B.A.P. 1st Cir. 2007) (*per curiam*).

In our view, this forward-looking approach to section 1325(b)(1)(B) represents the better approach for three reasons:

First, the forward looking approach treats "projected disposable income" as a future-oriented concept, as required by the language of section 1325(b)(1)(B). Although the word "projected" is not defined under the Bankruptcy Code, the dictionary defines "project" as forward-looking. *See The Random House Dict. of English Lang.*, 1546 (2d ed. 1987) (defining to "project" as *inter alia*, "to set forth or calculate (some future thing); *They projected the building costs for the next five* *years*.”); *Webster’s Third New Int’l Dict.*, 1813 (1993) (defining “projected” as *inter alia*, “planned for future execution: contrived, composed,” as “[projected] outlays for new plant and equipment.”). This forward-looking meaning should therefore be imparted to the term “projected” in section 1325(b)(1)(B). *See Bailey v. United States*, 516 U.S. 137, 144-45 (1995) (turning to dictionary definition of a term to define its statutory meaning).

The statutory requirements that a chapter 13 plan include all of a debtor’s projected disposable income “to be received” during the plan period, and that these amounts “will be applied to make payments” to unsecured creditors also support this forward-looking reading. *See* 11 U.S.C. § 1325(b)(1)(B). A court must interpret a statute as a symmetrical and coherent regulatory scheme and fit, if possible, all parts into a harmonious whole. *See Food & Drug Admin. v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 1301 (2000). Each of these phrases anticipates future action during the life of a debtor’s plan. Thus, they reinforce the forward-looking nature of section 1325(b)(1)(B).

Second, the forward-looking approach to section 1325(b)(1)(B) is faithful to the definition of “disposable income” found in sections 1325(b)(2) and (3) as an historical number. This is so because it uses the historical income figures calculated under section 707(b)(2)(A)’s means test as a starting point prior to considering those figures within the context of section 1325(b)(1)(B). Thus, the phrase “projected disposable income” appropriately “embrace[s] a forward-looking view grounded in the present via the statutory definition of ‘disposable income’ premised on historical data.” *See In re Nowlin*, – F.3d –, 2009 WL 2105356, at *3.

Third, the forward-looking approach to section 1325(b)(1)(B) is consistent with Congress’ desire that section 707(b)(2)(A)’s means test merely serve as a stage-one “screening mechanism” under the Bankruptcy Code. *See* H.R. Rep. 109-31 (I) at 1(2005), *reprinted* in 2005 U.S.C.C.A.N. 88, 89. *See also Rudler*, – F.3d –, 2009 WL 2385469, at *10 (section 707(b)(3)(B)’s totality of the circumstances test “remains a backup option when the Trustee is dissatisfied by the results of [section 707(b)(2)’s] means test.”); *Blausey v. United States Trustee (In re Blausey)*, 552 F.3d 1124, 1127 n.1 (2009) (same); *Ross-Tousey v. Neary*, 549 F.3d 1148, 1161-62 (7th Cir. 2008) (same). Indeed, regardless of a contrary result under section 707(b)(2)’s means test, section 707(b)(3)(B) mandates the dismissal of a chapter 7 debtor’s case based upon an evaluation of a debtor’s actual income and expenses. *See Ross-Tousey*, 549 F.3d at 1161-62.

Similarly, section 1325(b)(1)(B) requires that a chapter 13 debtor make plan payments based upon his actual income and expenses (as projected over the life of his plan), and regardless of section 1325(b)(3)’s incorporation of section 707(b)(2)’s means test. In fact, to read section 1325(b)(1)(B) otherwise would elevate section 707(b)(2)'s means test from "screening mechanism" to final arbiter in section 1325(b), something Congress never intended.

II. The bankruptcy court's approach to section 1325(b)(1)(B), which principally relied on the Ninth Circuit's decision in *Kagenveama*, is flawed.

In its ruling, the bankruptcy court rejected the majority, forward-looking construction of section 1325(b)(1)(B) and construed "disposable income" and "projected disposable income" as identical concepts, concluding that "projected disposable income" would be determined as of a historical moment in time – specifically, the moment when the Burbanks filed for bankruptcy. *See In re Burbank*, 401 B.R. 67, 74 (Bankr. D.R.I. 2009) (*citing Kagenveama*, 541 F.3d at 868).

In addition to those reasons addressed in the preceding section of this brief, the bankruptcy court's ruling reflects a flawed reading of section 1325(b)(1)(B) for two reasons:

First, the bankruptcy court's construction of section 1325(b)(1)(B), like *Kagenveama*, fails to consider the term "projected" in its proper context. *See Hibbs v. Winn*, 542 U.S. 88, 101 (2004) (statutory words must be construed in context). As previously explained, the use of the term "projected" in the context of section 1325(b)(1)(B) suggests a forecast or estimate of an expected future financial reality. *See* United States Br., *supra*, at 6-10. While the calculation of "projected" financial data may well **begin** with historical data, it does not necessarily (or even usually) **end** there, nor does it entail a rigid and inviolable assumption, made by the bankruptcy court, that "projected" expenses will be identical with claimed expenses under section 707(b)(2)'s means test even when available facts demonstrate otherwise. The bankruptcy court's construction ignores this context of the statutory language.[2]

Second, *Kagenveama* – the case upon which the bankruptcy court principally relies – has led to troubling results in the Ninth Circuit. For example, in one post-*Kagenveama* case, the bankruptcy court confirmed a chapter 13

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[2] Indeed, Congress's use of the term "projected" in Section 1325(b)(1)(B) would be extremely odd if it had intended the "project[ion]" to be nothing more than the rote mathematical calculation – historic disposable income multiplied by the number of months in a debtor's plan – the bankruptcy court's construction requires. *See, e.g., Kagenveama*, 541 F.3d at 874 ("To get from the statutorily defined 'disposable income' to 'projected disposable income,' 'one simply takes the calculation ... and does the math.'"). "The word 'multiplied' is quite different from the word 'projected,'" *Kibbe*, 361 B.R. at 312 n.9, and Congress knew how to provide for the process of multiplication when it wanted to. *See* 11 U.S.C. § 1325(b)(3) (providing that debtor's current monthly income be "multiplied by 12" to determine whether debtor has above-median income); 11 U.S.C. § 1325(b)(4) (same); 11 U.S.C. § 704(b)(2) (same); 11 U.S.C § 707(b)(2)(A)(i) (providing that debtor's current monthly income be "multiplied by 60" to determine in part whether presumption of abuse arises); 11 U.S.C. § 1322(d)(1)-(2) (providing that debtor's current monthly income be "multiplied by 12" to determine length of plan); 11 U.S.C. § 1326(b)(3)(B)(ii) (providing that certain payments be "multiplied by 5 percent" to determine trustee compensation).

repayment plan that reduced plan payments to creditors by $7,185.00 per month for expenses related to two abandoned homes and a liquidated car that will never be paid.[3] *See In re Smith*, 401 B.R. 469 (Bankr. W.D. Wash. 2008), *appeal pending* Case No. 07-43853 (B.A.P. 9th Cir.). "A fixed debt that will disappear . . . is not intended to enrich the debtor at the expense of his unsecured creditors. It is intended to adjust the respective rights of a secured creditor . . . and the unsecured creditors." *In re Turner*, – F.3d –, 2009 WL 2136867, at *7. *See also* H.R. Rep. 109-31 (I) at 1 (2005), *as reprinted in* 2005 U.S.C.C.A.N. 88, 89 (section 707(b)(2)'s means test acts "to ensure that debtors repay creditors the maximum they can afford."). Those courts following *Kagenveama*, like the bankruptcy court below, would perpetuate these troubling results, and create "an incentive for the picaresque. . . ." *Kagenveama*, 541 F.3d 878 (Bea, J., dissenting). The majority of courts – like the Fifth, Seventh, Eighth, and Tenth Circuits which follow the forward looking approach to section 1325(b)(1)(B) – would not.

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[3] Cases following *Kagenveama* on the income side of the equation are just as troubling. *See, e.g., In re Stansell*, 395 B.R. 457 (Bankr. D. Idaho 2008) (requiring income received from debtor's deceased spouse to be included in debtor's calculation of "current monthly income"); *In re Featherstone*, Case No. 08-00016, 2008 WL 5217936 (D. Mont. Dec. 11, 2008) (denying confirmation of debtors' plan where debtors sought to exclude income received from one-time sale of livestock from their "projected disposable income" calculation).

III. *Turner*, the most analogous decision, has concluded that section 1325(b)(1) is forward-looking.

On July 20, 2009, the United States Court of Appeals for the Seventh Circuit decided *In re Turner*. *In re Turner*, – F.3d –, 2009 WL 2136867. *Turner* is one of five successive circuit decisions to consider, and reject, the Ninth Circuit's interpretation of section 1325(b)(1)(B) in *Kagenveama*. *Lasowski*, – F.3d –, 2009 WL 2448246, at *1 (8th Cir.); *Turner*, – F.3d –, 2009 WL 2136867, at *6-7 (7th Cir.); *Nowlin*, – F.3d –, 2009 WL 2105356, at *1 (5th Cir.); *Lanning*, 545 F.3d at 1269 (10th Cir.); *Frederickson*, 545 F.3d at 652 (8th Cir.). Moreover, *Turner*, like this case, interpreted section 1325(b)(1)(B) with respect to a claimed expense under section 707(b)(2)'s means test. In doing so, *Turner* articulated the same forward-looking approach to section 1325(b)(1)(B) that the Fifth, Eighth, and Tenth circuits employ.[4] *See Turner*, – F.3d –, 2009 WL 2136867, at *6-7.

Under this approach, a court determines, based on the evidence presented, whether a debtor has, and will continue to have, certain expenses going forward when determining projected disposable income under section 1325(b)(1)(B). *Id.*

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[4] On August 28, 2009, the Eighth Circuit, in *Washburn*, confirmed this forward-looking approach as the better approach to section 1325(b)(1)(B), but failed to reach the merits of the projected disposable income issue in that case because: (a) the parties failed to articulate a legal theory at trial under section 1325(b)(1)(B); and (b) the factual record at trial was undeveloped. *See Babin v. Washburn (In re Washburn)*, – F.3d –, 2009 WL 2634333, at *6-7 (8th Cir. Aug 28, 2009).

If a debtor does not have a current expense, or will not have the expense in the future, *Turner* dictates that such information should be considered as part of the projected disposable income calculation. *Id.* *Accord Lasowski*, – F.3d –, 2009 WL 2448246, at *3; *Nowlin*, – F.3d –, 2009 WL 2105356, at *6; *Frederickson*, 545 F.3d at 659. The lower court's ruling conflicts with this forward-looking approach because it refused to consider, as part of the projected disposable income calculation, that the Burbanks do not, and will not, make payments on their vehicles, and will not make payments on their second home. *See* Trustee's Designation of Record No. 4 (Chapter 13 Plan, at 3) (identifying no liens on vehicles and surrender of Woonsocket, RI property); Trustee's Appendix, at 25 (Schedule J, at lines 1, 17, 19) (identifying no payments on vehicles or second home, and failing to describe any increase in expenditures anticipated to occur within the year following the filing of Schedule J). Accordingly, should this court adopt the forward-looking approach to section 1325(b)(1) as articulated in *Turner*, reversal of the bankruptcy court's order is appropriate.

IV. Alternatively, under the "reasonably necessary" test of sections 707(b)(2) and 1325(b)(3), the Burbanks may not claim deductions for vehicle ownership expenses they will never actually make.[5]

If this Court agrees with the conclusions reached by the Fifth, Seventh, Eighth, and Tenth circuits that section 1325(b)(1)(B) permits courts to alter the presumptive income and expenses determined under section 707(b)(2)'s means test when those amounts do not reflect reality, then there is no need for this Court to address this subsidiary issue. Indeed, the Seventh Circuit followed just that course in *Turner*. *See Turner*, – F.3d –, 2009 WL 2136867 (reaching conclusion based on section 1325(b)(1)(B)'s language alone).

If, however, this court agrees with the opposite conclusion (*i.e.*, that the rigid approach to section 1325(b)(1)(B) articulated in *Kagenveama* and by the bankruptcy court below is the better approach), then the "reasonably necessary"

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[5] On August 5, 2009, this Court decided *Morse v. Rudler*. *See Rudler*, – F.3d –, 2009 WL 2385469. *Rudler* considered whether chapter 7 debtors may, under section 707(b)(2)(A)(iii)(I), deduct secured debt expenses notwithstanding that they are surrendering the collateral associated with those debts. *Id.* This Court found that they could. *Id.* While the government disagrees with *Rudler's* construction of section 707(b)(2)(A)(iii)(I), *Rudler* did not discuss the proper calculation of an above-median-income chapter 13 debtor's "projected disposable income." *Id.* at n.11. Rather, it addressed the distinct question whether a chapter 7 debtor's petition was subject to the presumption of abuse that arises when that debtor's "disposable income" exceeds a specific threshold. *Id.* Accordingly, *Rudler* does not foreclose the government's argument that section 1325(b)(1)(B) provides an independent basis for this Court to reverse the bankruptcy court's ruling as to the Burbanks' claimed secured debt expense. *See* United States Br., *supra*, at 6-14.

test of sections 707(b)(2) and 1325(b)(3) provides an independent basis for reversal. Subject to exceptions that are not relevant in this case, in calculating disposable income for an above-median-income debtor, like the Burbanks, the court must deduct from current monthly income "amounts reasonably necessary to be expended for the maintenance and support of the debtor and his dependents." 11 U.S.C. § 1325(b)(2). Only those claimed expenses that are among the deductions listed under section 707(b)(2) will it be treated as an "amount reasonably necessary to be expended" under section 1325(b)(3). *Id.* ("[a]mounts reasonably necessary to be expended . . . shall be determined in accordance with [section 707(b)(2)(A) and (B)]").

A. A vehicle ownership expense is "applicable" under section 707(b)(2)(A)(ii)(I) only when debtors make corresponding loan or lease payments on their vehicles.

1. For purposes of the chapter 7 means test, section 707(b)(2)(A)(ii)(I) permits above-median-income debtors, like the Burbanks, to claim a vehicle ownership expense amount only when that expense is "applicable." *See* 11 U.S.C. § 707(b)(2)(A)(ii)(I).[6]

The Bankruptcy Code does not define the term "applicable." Nor has the

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[6] Section 707(b)(2)(A)(ii)(I) provides that a debtor's "monthly expenses shall be the debtor's **applicable** monthly expense amounts specified under the . . . Local Standards . . . issued by the Internal Revenue Service. . . ." 11 U.S.C. § 707(b)(2)(A)(ii)(I) (emphasis added).

United States identified any controlling decision providing a definition in the bankruptcy court context. Accordingly, where, as here, a statutory term is undefined, the term should be given its ordinary meaning. *Smith v. United States*, 508 U.S. 223, 228 (1993) ("When a word is not defined by statute, we normally construe it in accord with its ordinary or natural meaning.").

The dictionary defines "applicable" to mean "capable of being applied: having relevance . . . fit, suitable, or right to be applied: APPROPRIATE" *Webster's Third New Int'l Dict.*, at 105 (1981) (emphasis in original). Such a meaning should therefore be imparted to the term "applicable" used in section 707(b)(2)(A)(ii)(I). *See Bailey*, 516 U.S. at 144-45 (turning to dictionary definition of a term to define its statutory meaning).

The bankruptcy court's interpretation of section 707(b)(2)(A)(ii)(I) is inconsistent with this ordinary meaning because it allows the Burbanks to claim a monthly vehicle ownership expense amount when they have no associated monthly loan or lease expenses. "Given the ordinary sense of the term 'applicable,' how is the vehicle ownership expense allowance **capable of being applied** to [a] debtor if he does not make any lease or loan payments on the vehicle?" *Ransom*, – F.3d–, 2009 WL 2477609, at *5 (*quoting Ransom*, 380 B.R. at 807-08) (emphasis in original). The answer is, it is not. "An 'ownership cost' is not an 'expense' – either actual or applicable – if it does not exist, period."

Ransom, – F.3d–, 2009 WL 2477609, at *4. *But see Tate v. Bolen (In re Tate)*, 571 F.3d 423 (5th Cir. 2009) (declining to apply the dictionary meaning of the word "applicable" during the course of statutory analysis and determining opposite); *Ross-Tousey*, 549 F.3d 1148 (same). If debtors, like the Burbanks, have no loan or lease payments on their vehicles, then there is simply no expense capable of being applied. For this reason alone, the lower court's orders should be reversed.

2. If there were ever any doubt regarding what Congress intended the term "applicable" to mean under section 707(b)(2)(A)(ii)(I), it would be answered in the next subsection of the Bankruptcy Code: subsection 707(b)(2)(A)(ii)(II). That subsection states, in relevant part, that a "debtor's monthly expenses may include, **if applicable**, the continuation of **actual** expenses paid by the debtor . . . for care and support of an elderly, chronically ill, or disabled household member or member of the debtor's immediate family. . . ." 11 U.S.C. § 707(b)(2)(A)(ii)(II) (emphasis added). Thus, Congress used the terms "applicable" and "actual" under section 707(b)(2)(A)(ii)(II) differently, employing the term "applicable" to only allow expenses to debtors if those expenses literally apply to that particular debtor.

Because it is a basic rule of statutory construction that "'identical words used in different parts of the same act are intended to have the same meaning[,]'" *Commissioner of Internal Revenue v. Lundy*, 516 U.S. 235, 250 (1996) (citations omitted), the same meaning of the term "applicable" in section 707(b)(2)(A)(ii)(II) should be given to the term "applicable" in section 707(b)(2)(A)(ii)(I).

B. The bankruptcy court's reading of section 707(b)(2)(A)(ii)(I) renders the word "applicable" superfluous.

The interpretation of section 707(b)(2)(A)(ii)(I) offered by the bankruptcy court suggests that the term "applicable" modifies the phrase "amounts specified under the . . . Local Standards" and not the debtor's "monthly expense." *See Burbank*, 401 B.R. at 71-72. However, the bankruptcy court's reading cannot be right because even if the word "applicable" were stricken from section 707(b)(2)(A)(ii)(I), the remaining words in section 707(b)(2)(A)(ii)(I) still lead debtors to the same line under the IRS Local Standards as follows:

> a "debtor's monthly expenses shall be the debtor's **~~applicable~~** monthly expense amounts specified under the . . . Local Standards . . . issued by the Internal Revenue Service. . . ."

See Ransom, – F.3d–, 2009 WL 2477609, at *5 (*quoting Ransom*, 380 B.R. at 808, for the proposition that such a construction would "read[] 'applicable' right out of the Bankruptcy Code."). Accordingly, the bankruptcy court's reading makes the word "applicable" superfluous.

Congress deliberately chose to include the term "applicable" in section 707(b)(2)(A)(ii)(I). Because "courts should strive to give operative meaning to every word in a statute," *see Cooper Indus., Inc. v. Aviall Servs., Inc.*, 543 U.S.

157, 167 (2004), the word “applicable” must be read as adding something to the statute. *See United States Trustee v. Deadmond (In re Deadmond)*, Case No. 07-15-H-CCL, 2008 WL 191165, at *4 (D. Mont. Jan. 22, 2008) (“The word [‘applicable’] must mean something, and if some monthly expenses are applicable, then other monthly expenses are not applicable.”). The United States’ construction does that. The bankruptcy court’s construction does not.

Further, contrary to the lower court’s belief, *see Burbank*, 401 B.R. 71-72 (*quoting Ross-Tousey*, 549 F.3d at 1158), the United States’ construction of section 707(b)(2)(A)(ii)(I) does not equate "applicable” with “actual.” Rather, its construction gives the words “applicable” and “actual” entirely *different* meanings. Vehicle expense amounts under section 707(b)(2)(A)(ii)(I) are not the debtor’s “actual,” or literal, vehicle ownership expenses. Rather, they are static, fixed amounts, drawn from the IRS Standards, used **regardless** of the debtor’s “actual” expenses. *See Fokkena v. Hartwick (In re Hartwick)*, 373 B.R. 645, 650 (D. Minn. 2007) (recognizing that a debtor’s “actual” expense does not control the amount of the vehicle ownership deduction under section 707(b)(2)(A)(ii)(I)). Under the IRS Standards, debtors currently receive $489 for the first vehicle that has an associated loan or lease payment, and $489 for the second. *See* Addendum attached hereto (true and correct copy of IRS National Vehicle Standards). These are the opposite of "actual" expenses.[7] *See Meade v. McVay (In re Meade)*, 384 B.R. 132, 136 (W.D. Tex. 2008) (explaining how the terms "applicable" and "actual" have different meanings under 707(b)(2)(A)(ii)(I))*; Wieland v. Thomas (In re Thomas)*, 382 B.R. 793, 798 (D. Kan. 2008) (finding that "the juxtaposition of 'applicable . . . amounts' and 'actual . . . expenses' in the statute is not inconsistent with the Court's interpretation" that vehicle ownership expense amounts are only applicable if a debtor is making loan or lease payments on a vehicle).

C. The lower courts' interpretation of Section 707(b)(2)(A)(ii)(I) yields inequitable results not contemplated by Congress.

In interpreting sections 707(b)(2)(A)(ii)(I) this Court may consider relevant legislative history to determine the statute's objectives and illuminate its text. *See Almendarez-Torres v. United States*, 523 U.S. 224, 228 (1998) ("We therefore look to the statute before us and ask what Congress intended. . . . In answering this question, we look to the statute's language, structure, subject matter, context, and history-factors that typically help courts determine a statute's objectives and

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[7] Even if the terms "applicable" and "actual" meant the same thing in section 707(b)(2)(A)(ii)(I), the Supreme Court has recognized that there is nothing wrong with two different words within a single section of a statute being synonymous. *See Wachovia Bank v, Schmidt*, 546 U.S. 303, 314 (2006) ("Congress may well have comprehended the words 'located' and 'established,' as used in [28 U.S.C.] § 1348, not as contrasting, but as synonymous or alternative terms.").

thereby illuminate its text."); *Crandon v. United States*, 494 U.S. 152, 158 (1990) ("In determining the meaning of the statute, we look not only to the particular statutory language, but to the design of the statute as a whole and to its object and policy.").

According to its legislative history, the 2005 Act seeks to "ensure that debtors repay creditors the maximum they can afford." H.R. Rep. No. 109-31 (I), at 1, 2005 U.S.C.C.A.N. at 89.[8] Congress felt this aspect of bankruptcy reform legislation was so important that it included this language in the first paragraph of the first page of the 2005 Act's legislative history. *Id.* Congress saw fit to reiterate this point when it addressed the legislative history to section 707(b). *Id.* at 97-100. Given how important this was to Congress, section 707(b)(2)(A)(ii)(I) should be interpreted in accordance with this overarching goal that underpins the 2005 Act.

The bankruptcy court's interpretation of section 707(b)(2)(A)(ii)(I) would frustrate the 2005 Act's goal of proper repayment by allowing above-median-income debtors, like the Burbanks, to claim a fictitious expense that does not apply to them. *See Ransom*, – F.3d–, 2009 WL 2477609, at *4 ("Ironic it would be indeed to diminish payments to unsecured creditors in this context on the basis

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[8] There is no Senate Report or Conference Report to the 2005 Act.

of a fictitious expense not incurred by a debtor."); *Thomas*, 382 B.R. at 798 ("If a debtor were permitted a car ownership allowance when he actually incurs no such expense, application of the means test would not accurately reflect the debtor's ability to repay creditors, and the purpose of the statute would be frustrated."). Indeed, under the lower courts' reading of section 707(b)(2)(A)(ii)(I), a higher-income debtor with an inoperable car could claim the ownership expense amount simply because the car is an automobile and he owns it. This statutory reading has been rejected because it "defies common sense." *Deadmond*, 2008 WL 191165, at *4. This Court should hold similarly.

D. Although there is a divergence of opinion on this issue, those courts allowing debtors a vehicle ownership expense under section 707(b)(2)(A)(ii)(I) do not articulate a valid basis for doing so.

Among those circuit courts to have considered the vehicle ownership expense within the context of section 707(b)(2)(A)(ii)(I), there is a split with respect to whether the expense should be allowed. *Compare Ransom*, – F.3d–, 2009 WL 2477609 (not allowing expense), *with Tate*, – F.3d –, 2009 WL 1608890 (allowing expense), *Ross-Tousey*, 549 F.3d at 1148 (same); and *Washburn*, – F.3d –, 2009 WL 2634333, at *3-6 (same) (split 2-1 decision).

Because the United States believes the decisions in *Tate*, *Ross-Tousey*, and the cases that follow them fail to articulate a valid basis for allowing the vehicle ownership expense under section 707(b)(2)(A)(ii)(I), it urges this Court to follow the line of decisions denying the expense.

Ross-Tousey primarily relied on interpretive conclusions reached by a divided Sixth Circuit bankruptcy appellate panel in *Kimbro*, whose decision was entered **after** briefing was completed in *Ross-Tousey*.[9] *See Ross-Tousey*, 549 F.3d at 1155-60 (*citing* and *quoting* extensively from *Hildebrand v. Kimbro (In re Kimbro)*, 389 B.R. 518 (B.A.P. 6th Cir. 2008)). *Tate* relied almost exclusively on the factual and legal reasoning used in *Ross-Tousey* and *Kimbro*. *See Tate*, –F.3d –, 2009 WL at 1608890 (*citing* and *quoting* extensively from *Ross-Tousey*, 549 F.3d at 1148, and *Kimbro*, 389 B.R. at 518). Accordingly, the government's concerns regarding *Kimbro*, each of which are discussed below, are equally applicable to *Ross-Tousey*, *Tate*, and the cases that follow them.

First, while the panels in *Ross-Tousey* and *Tate*, like the majority in *Kimbro*, concluded that the government's construction of section 707(b)(2)(A)(ii)(I) improperly gives the same meaning to the words "applicable" and "actual" in section 707(b)(2)(A)(ii)(I), the government's reading actually

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[9] *Kimbro* is currently on appeal to the Sixth Circuit. *See Hildebrand v. Kimbro (In re Kimbro)*, Case No. 08-5871 (6th Cir.). During that appeal the United States, as *amicus curiae*, has shared its views with the Sixth Circuit as to why the majority bankruptcy appellate panel's decision in *Kimbro* was wrongly decided. Had the government had the opportunity to address those concerns with the Seventh Circuit in *Ross-Tousey* it would have done so.

gives them different ones. *Compare Kimbro*, 389 B.R. at 523-24 *with* United States Br., *supra*, at 19-21. Indeed, this juxtaposition of terms was explained by the dissent in *Kimbro* when it stated that "Congress intended and used the phrases 'applicable monthly expense amounts' . . . and 'actual expenses' . . . simply in recognition of the differing ways in which the IRS uses the National Standards and Local Standards versus the Other Necessary Expense Categories." *Kimbro*, 389 B.R. at 533 (Fulton, J., dissenting).

Second, while the panels in *Ross-Tousey* and *Tate*, like the majority in *Kimbro*, erroneously concluded that the vehicle ownership amount was necessary to cover operating costs, a separate IRS expense standard governs those types of vehicle expenses. *Compare Kimbro*, 389 B.R. at 531 (referencing "depreciation, insurance, licensing fees and taxes") *with Ransom*, – F.3d–, 2009 WL 2477609, at *2 ("IRS's Local Standards include allowable transportation expenses . . . broken down into **two categories**: (1) operating costs and public transportation costs, and (2) 'ownership costs.'").

Third, while the panels in *Ross-Tousey* and *Tate*, like the majority in *Kimbro*, ruled that the phrase "monthly expenses of the debtor shall not include any payments for debts" justifies an ownership expense allowance, *see, e.g., Kimbro*, 389 B.R. at 523, it does not. Rather, debtors for whom the ownership expense is applicable receive a **fixed** standard allowance, not the dollar amount associated with a "payment for a debt." *See* United States Br., *supra*, at 20 (debtors receive $489 for the first vehicle that has an associated loan or lease payment, and $489 for the second).

Fourth, the panels in *Ross-Tousey* and *Tate*, like the majority in *Kimbro*, relied upon the legislative history of a statute never enacted in order to support their conclusions. *See, e.g., Kimbro*, 389 B.R. at 525-27. Such an approach has been rejected by the Supreme Court and at least three circuit courts of appeal because it opens the door to the potential subversion of statutory language actually voted on by Congress and signed into law by the President. *See, e.g., Mead Corp. v. Tilley*, 490 U.S. 714, 723 (1989) ("We do not attach decisive significance to the unexplained disappearance of one word from an unenacted bill because 'mute intermediate legislative maneuvers' are not reliable indicators of congressional intent."); *Com. of Puerto Rico v. Blumenthal*, 642 F.2d 622, 635 n.23 (D.C. Cir. 1980) ("[Appellant's] argument that we should not consider the legislative history of a bill that was never enacted represents a correct statement of the law."); *United States v. Lincoln Rochester Trust Co.*, 297 F.2d 891, 893 (2d Cir. 1962) (finding that portion of House report referring to language not included in Technical Amendments Act of 1958, as finally adopted, may not be relied on in interpreting Act), *cert. denied*, 369 U.S. 887 (1962); *Interstate Natural Gas Co. v. Federal Power Comm.*, 156 F.2d 949, 952 (5th Cir. 1946) ("the legislative history of a bill that was not adopted cannot be resorted to construe a bill that was.”), *aff’d*, 331 U.S. 682 (1947).

Fifth, the panels in *Ross-Tousey* and *Tate*, like the majority in *Kimbro*, erroneously declined to apply the dictionary meaning of the word “applicable.” *See Tate*, 571 F.3d at 423 (declining to apply the dictionary meaning of the word “applicable” during the course of statutory analysis in determining ownership expenses should be allowed); *Ross-Tousey*, 549 F.3d at 1148 (same); *Kimbro*, 389 B.R. at 518 (same). Had they done so, they would have had to question how the vehicle ownership expense allowance is “capable of being applied” to a debtor if the debtor does not make any lease or loan payments. *See, e.g., Ransom*, – F.3d–, 2009 WL 2477609, at *5. Accordingly, because the panels in *Ross-Tousey* and *Tate*, like the majority in *Kimbro*, failed to take this fundamental step as part of their statutory analysis, their construction of section 707(b)(2)(A)(ii)(I) is suspect and should not be followed by this Court.

CONCLUSION

For these reasons, the United States respectfully asks the Court to reverse the lower court's order.

August 31, 2009

Respectfully submitted,

/s/ David I. Gold
RAMONA D. ELLIOTT
General Counsel

P. MATTHEW SUTKO
Associate General Counsel
DAVID I. GOLD
Trial Attorney
Executive Office for United States
Trustees
Department of Justice
20 Massachusetts Avenue, N.W.
Washington, D.C. 20530
Ph: (202) 307-1399
Fax: (202) 307-2397

CERTIFICATE OF SERVICE

I, David I. Gold, do hereby certify that 1 paper copy and a CD Rom Disk containing the foregoing Brief of the United States as Amicus Curiae was served by first class U.S. mail, postage prepaid, this 31st day of August 2009 on the parties listed below:

John Boyajian, Esq.
182 Waterman Street
Providence, RI 02906

Peter Iascone, Esq.
117 Bellevue Avenue
Newport, RI 02840

I further certify that the original, 9 paper copies, and a CD Rom Disk containing the foregoing Brief of the United States as Amicus Curiae have been dispatched for filing with the Clerk of this Court this 31st day ofAugust 2009 via Federal Express Overnight Priority Mail at the address listed below:

Clerk's Office
United States Court of Appeals
John Joseph Moakley U.S. Courthouse
1 Courthouse Way, Suite 2500
Boston, MA 02210

/s/ David I. Gold
David I. Gold
Attorney for the United States
as Amicus Curiae

CERTIFICATE OF COMPLIANCE WITH RULE 32(a)

1. This brief complies with the type-volume limitation of Fed. R. App. P. 29 and 32(a)(7)(B) because:

this brief contains 6704 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii).

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August 31, 2009

/s/ David I. Gold
DAVID I. GOLD
Attorney for the United States
as Amicus Curiae

ADDENDUM

Local Standards: Transportation

Disclaimer: *IRS Collection Financial Standards are intended for use in calculating repayment of delinquent taxes. These Standards are effective on March 1, 2009 for purposes of federal tax administration only. Expense information for use in bankruptcy calculations can be found on the website for the U.S. Trustee Program.*

The transportation standards consist of nationwide figures for monthly loan or lease payments referred to as ownership costs, and additional amounts for monthly operating costs. The operating costs include maintenance, repairs, insurance, fuel, registrations, licenses, inspections, parking and tolls (These standard amounts do not include personal property taxes).

The ownership costs provide maximum allowances for the lease or purchase of up to two automobiles, if allowed as a necessary expense. A single taxpayer is normally allowed one automobile.

If a taxpayer has a car payment, the allowable ownership cost added to the allowable operating cost equals the allowable transportation expense. The taxpayer is allowed the amount actually spent, or the standard, whichever is less.

If a taxpayer has a car, but no car payment, only the operating costs portion of the transportation standard is used to figure the allowable transportation expense. The taxpayer is allowed the amount actually spent, or the standard, whichever is less.

There is a single nationwide allowance for public transportation based on Bureau of Labor Statistics expenditure data for mass transit fares for a train, bus, taxi, ferry, etc. Taxpayers with no vehicle are allowed the standard amount monthly, per household, without questioning the amount actually spent.

If a taxpayer owns a vehicle and uses public transportation, expenses may be allowed for both, provided they are needed for the health and welfare of the taxpayer or family, or for the production of income. However, the expenses allowed would be actual expenses incurred for ownership costs, operating costs and public transportation, or the standard amounts, whichever is less.

If the amount claimed is more than the total allowed by the transportation standards, the taxpayer must provide documentation to substantiate those expenses are necessary living expenses.

Public Transportation

National	$173

Ownership Costs

	One Car	**Two Cars**
National	$489	$978

Operating Costs

	One Car	**Two Cars**
Northeast Region	$235	$470
Boston	$225	$450
New York	$280	$560
Philadelphia	$235	$470
Midwest Region	$183	$366
Chicago	$217	$434
Cleveland	$186	$372
Detroit	$267	$534
Minneapolis-St. Paul	$187	$374
South Region	$201	$402
Atlanta	$226	$452
Baltimore	$217	$434
Dallas-Ft. Worth	$228	$456
Houston	$263	$526
Miami	$275	$550
Washington, D.C.	$230	$460
West Region	$211	$422
Los Angeles	$261	$522
Phoenix	$232	$464
San Diego	$244	$488
San Francisco	$261	$522

Seattle	$192	$384

The data for the Operating Costs section of the Transportation Standards are provided by Census Region and Metropolitan Statistical Area (MSA). The following table lists the states that comprise each Census Region. Once the taxpayer's Census Region has been ascertained, to determine if an MSA standard is applicable, use the definitions below to see if the taxpayer lives within an MSA (MSAs are defined by county and city, where applicable). If the taxpayer does not reside in an MSA, use the regional standard.

Northeast Census Region

Maine, New Hampshire, Vermont, Massachusetts, Rhode Island, Connecticut, Pennsylvania, New York, New Jersey		
MSA	**Counties**	
Boston	*in MA:*	Bristol, Essex, Hampden, Middlesex, Norfolk, Plymouth, Suffolk, Worcester
	in NH:	Hillsborough, Merrimack, Rockingham, Strafford
	in CT:	Windham
	in ME:	York
New York	*in NY:*	Bronx, Dutchess, Kings, Nassau, New York, Orange, Putnam, Queens, Richmond, Rockland, Suffolk, Westchester
	in NJ:	Bergen, Essex, Hudson, Hunterdon, Mercer, Middlesex, Monmouth, Morris, Ocean, Passaic, Somerset, Sussex, Union, Warren
	in CT:	Fairfield, Litchfield, Middlesex, New Haven
	in PA:	Pike
Philadelphia	*in PA*	Bucks, Chester, Delaware, Montgomery, Philadelphia
	in NJ:	Atlantic, Burlington, Camden, Cape May, Cumberland, Gloucester, Salem
	in DE:	New Castle
	in MD:	Cecil

Midwest Census Region

North Dakota, South Dakota, Nebraska, Kansas, Missouri, Illinois, Indiana, Ohio, Michigan, Wisconsin, Minnesota, Iowa		
MSA	**Counties (unless otherwise specified)**	
Chicago	*in IL:*	Cook, DeKalb, DuPage, Grundy, Kane, Kankakee, Kendall, Lake, McHenry, Will
	in IN:	Lake, Porter
	in WI:	Kenosh
Cleveland	*in OH:*	Ashtabula, Cuyahoga, Geauga, Lake, Lorain, Medina, Portage, Summit
Detroit	*in MI:*	Genesee, Lapeer, Lenawee, Livingston, Macomb, Monroe, Oakland, St. Clair, Washtenaw, Wayne
Minneapolis-St. Paul	*in MN:*	Anoka, Carver, Chisago, Dakota, Hennepin, Isanti, Ramsey, Scott, Sherburne, Washington, Wright
	in WI:	Pierce, St. Croix

South Census Region

Texas, Oklahoma, Arkansas, Louisiana, Mississippi, Tennessee, Kentucky, West Virginia, Virginia, Maryland, District of Columbia, Delaware, North Carolina, South Carolina, Georgia, Florida, Alabama		
MSA	**Counties (unless otherwise specified)**	
Atlanta	*in GA:*	Barrow, Bartow, Carroll, Cherokee, Clayton, Cobb, Coweta, DeKalb, Douglas, Fayette, Forsyth, Fulton, Gwinnett, Henry, Newton, Paulding, Pickens, Rockdale, Spalding, Walton
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Dallas-Ft. Worth	*in TX:*	Collin, Dallas, Denton, Ellis, Henderson, Hood, Hunt, Johnson, Kaufman, Parker, Rockwall, Tarrant

Houston	*in TX:*	Brazoria, Chambers, Fort Bend, Galveston, Harris, Liberty, Montgomery, Waller
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Seattle	*in WA:*	Island, King, Kitsap, Pierce, Snohomish, Thurston

References/Related Topics

- Collection Financial Standards
- Local Standards: Housing and Utilities
- National Standards: Food, Clothing and Other Items
- National Standards: Out-of-Pocket Health Care

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BRIEF BANK — "SUMMARY SHEET"

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WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*: In re Bruce A. Burton (Burton v. Fokkena, UST)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*: D. Ohio

3. ("CCN") ***CURRENT*** CASE NO.: No.: 08-0500

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*:
No.: 06-15606
Court: Bankr. N.D. Ohio
(Identify judge & cite, if any)

5. ("SO") ***SOURCE***: **U.S. TRUSTEES**

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*:
Filed: June 5, 2008
Type: Brief for the Appellee Habbo G. Fokkena, United States Trustee

7. **("AU") *PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*:
Amy L. Good, David A. Levine, P. Matthew Sutko,
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***: **BANKRUPTCY**

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***:
- Did the bankruptcy court abuse its discretion by dismissing the debtor's chapter 7 case for abuse under 11 U.S.C. 707(b)(1) and (3)(B) on the grounds that the income debtor was devoting to repaying a 401(k) loan gave him an ability to repay his debts that was sufficient to justify dismissal?

10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)

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NAME: Linda Figueroa

DATE:

Civ. Case No. 08-0500

In the
United States District Court
Northern District of Ohio

In re: Bruce A. Burton
Debtor

Bruce A. Burton

Appellant

v.

Habbo G. Fokkena
United States Trustee

Appellee

On Appeal from the United States Bankruptcy Court
for the Northern District of Ohio
Eastern Division

BRIEF OF THE APPELLEE HABBO G. FOKKENA UNITED STATES TRUSTEE

Counsel for Appellee Habbo G. Fokkena
United States Trustee

Amy L. Good
Trial Attorney
Office of the U.S. Trustee
U.S. Department of Justice
H.M. Metzenbaum U.S. Courthouse
201 Superior Avenue, East
Cleveland, Ohio 44114
(216) 522-7800

P. Matthew Sutko
David A. Levine
Office of the General Counsel
Executive Office for U.S. Trustees
United States Department of Justice
20 Massachusetts Avenue NW
Washington, D.C. 20530
(202) 307-1399

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STATEMENT OF JURISDICTION

The bankruptcy court had jurisdiction over debtor Bruce A. Burton's chapter 7 bankruptcy case under 28 U.S.C. §§ 157(a) and (b), and 1334(a) to decide the United States Trustee's [1] motion to dismiss Mr. Burton's bankruptcy case for abuse under 11 U.S.C. § 707(b)(1). The bankruptcy court granted the United States Trustee's motion to dismiss by order entered December 13, 2007, and denied Mr. Burton's motion for reconsideration on February 6, 2008. Mr. Burton timely appealed the order of dismissal and order denying reconsideration under 28 U.S.C. § 158(c)(2) and Fed. R. Bankr. P. 8002(a) and 8002(b) on February 15, 2008. This Court has jurisdiction over this appeal under 28 U.S.C. § 158(a)(1).

STATEMENT OF ISSUES PRESENTED

Whether the bankruptcy court abused its discretion in dismissing Mr. Burton's chapter 7 case for abuse under 11 U.S.C. 707(b)(1) and (3)(B) based on the totality of the circumstances of his financial situation.

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[1] Congress authorized the United States Attorney General to appoint 21 United States trustees, each to serve in a specific geographic region of the United States. See generally, 28 U.S.C. § 581 et. seq. (establishing the United States Trustee Program). The United States trustees are senior officials of the Department of Justice. Id. The United States trustees "supervise the administration of cases and trustees" in all bankruptcy cases within his or her region through the exercise of a range of oversight responsibilities. 28 U.S.C. §586(a)(3). See generally, Morgenstern v. Revco, D.C., Inc. (In re Revco D.S. Inc.), 898 F. 2d 498, 500 (6th Cir. 1990)(explaining that United States trustees oversee the bankruptcy process, protect the public interest, and ensure that bankruptcy cases are conducted according to law.). United States trustees may raise, appear, and be heard on any issue in any case or proceeding under Title 11. 11 U.S.C. § 307; See also, In re Revco, D.S, Inc., 898 F. 2d at 499-500 (upholding broad appellate standing of United States trustees). Section 707(b) explicitly authorizes United States Trustees to move to dismiss debtors' chapter 7 bankruptcy cases.

STANDARD OF REVIEW

On appeal, this Court reviews the bankruptcy court's findings of fact under the clearly erroneous standard and reviews conclusions of law de novo In re Isaacman, 26 F. 3d. 629, 631(6th Cir. 1994) (citing In re Zick, 931 F.2d 1124, 1126 (6th Cir.1991). Mixed questions of law and fact are separated and reviewed under the applicable standard. Since a dismissal for abuse under 11 U.S.C. § 707(b)(3) is an equitable determination, an appeal of the dismissal of a chapter 7 case for abuse under 11 U.S.C. § 707(b)(3) is reviewed by an abuse of discretion standard. See In re Behlke, 358 F. 3d 429 (6th Cir. 2004).

STATEMENT OF THE CASE

Appellant Bruce A. Burton filed a voluntary petition for relief under chapter 7 of the Bankruptcy Code on November 13, 2006. (Bankruptcy Court Docket No. 1).[2] The United States Trustee moved to dismiss Mr. Burton's case, asserting that his Chapter 7 case was abusive under 11 U.S.C. § 707(b)(2) and (3)(B). (Docket No. 15). After an initial hearing, the bankruptcy court denied that portion of the United States Trustee's motion requesting a dismissal based upon a presumption of abuse under 11 U.S.C. § 707(b)(2). The court scheduled an evidentiary hearing to consider the remaining portion of the United States Trustee's motion to dismiss for abuse under the totality of the circumstances provision in 11 U.S.C. § 707(b)(3)(B). (Docket Nos. 24, 25, and 26).

Counsel for Mr. Burton and the United States Trustee appeared at the hearing on September

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[2] References to pleadings in the Bankruptcy Court Docket or the Docket itself are hereinafter identified as "Docket No. ___" followed by the applicable docket number or docket entry date.

20, 2007 and indicated there were no remaining evidentiary issues.[3] The parties agreed the United States Trustee's dismissal motion would turn on whether income the debtor was taking from his pay check to repay 401(k) loan should be considered when evaluating the "totality" of the debtor's financial circumstances 11 U.S.C. § 707(b)(3)(B). (Docket Entry dated September 20, 2007; Docket No. 36 p. 1-2, Burton's Supplemental Brief; Docket No. 40, p. 2, Burton's Motion to Reconsider). After consideration of the parties' briefs and Mr. Burton's bankruptcy petition, schedules, and amended schedules of assets and liabilities, on December 13, 2007, the bankruptcy court granted the United States Trustee's motion to dismiss Mr. Burton's chapter 7 case based upon the totality of his financial circumstances under 11 U.S.C. § 707(b)(3)(B). (Docket Nos. 34, 35, 36, and 37). Mr. Burton filed a motion to reconsider the bankruptcy court's decision, which was denied. This appeal followed.

STATEMENT OF FACTS

1. Statutory Framework.

A. Section 707(b)(3)(B).

Congress enacted 11 U.S.C. § 707(b)(3) in the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("2005 Act"). Prior to the 2005 Act, section 707(b) authorized courts to dismiss cases when Chapter 7 relief would constitute "substantial abuse." 11 U.S.C. § 707(b) (superceded). In evaluating whether substantial abuse existed under the old section 707(b), courts simultaneously balanced both the debtor's conduct and the debtor's ability to pay his debts outside bankruptcy, or through a Chapter 13 repayment plan. In re Krohn, 886 F.2d 123, 126 (6th Cir. 1989);

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[3] The bankruptcy court did not conduct a hearing on the record but rather met with the parties in chambers.

Behlke v. Eisen (In re Behlke), 358 F.3d 429, 433 (6th Cir. 2004). See, also In re Kelly, 841 F.2d 908, 915 (9th Cir. 1988); In re Stewart, 175 F.3d 796 (10th Cir. 1999); In re Lamanna, 153 F.3d 1 (1st Cir. 1998). Most courts, including the Sixth Circuit, agreed that a debtor's ability to pay a portion of his debts was the predominate factor.

Congress substantially rewrote section 707(b) in the 2005 Act in three ways. See 11 U.S.C. § 707(b)(1), (2), and (3). First, Congress lowered the standard for dismissal under all subsections of new section 707(b) from "substantial abuse" to mere "abuse." See 11 U.S.C. § 707(b)(1) (cases are now dismissed for "abuse"); 11 U.S.C. § 707(b)(2) (subjecting cases to dismissal for abuse); 11 U.S.C. § 707(b)(3)(same).

Second, Congress authorized dismissal when a mathematical formula, known as the "means test," yields monthly disposable income that exceeds a statutory trigger. 11 U.S.C. § 707(b)(2).

Third, Congress enacted a new section 707(b)(3). This section allows courts to dismiss cases based upon either a debtor's bad faith, 11 U.S.C. § 707(b)(3)(A), or the totality of the debtor's financial circumstances, 11 U.S.C. § 707(b)(3)(B).

Sections 707(b)(3)(A) and (B) of the 2005 Act represent a significant departure from old section 707(b) because they mandate that cases can be dismissed either solely for misconduct, or solely based upon a debtor's ability to pay a portion of his debts. See, e.g., In re Henebury, 361 B.R. 595, 607 (Bankr. S.D. Fla. 2007) (By bifurcating section 707(b)(3)(A) and (B), "the debtor's total financial situation as a measure of ability to pay, and bad faith are separate and sufficient grounds for dismissal. Either ability to pay or bad conduct in connection with the bankruptcy will warrant dismissal for abuse under section 707(b)(3).").

Each prong of section 707(b)(3) is independent. Henebury, 361 B.R. at 607. If a debtor engages in bad faith, the debtor's case is dismissed under section 707(b)(3)(A). If, instead, the debtor can voluntarily repay a portion of his debt, dismissal is mandated by section 707(b)(3)(B).

B. The 2005 Act Provided Statutory Protection of Retirement Loan Repayments to Chapter 13 Debtors.

The 2005 Act incorporated a number of new provisions that govern the treatment of retirement savings in some types of cases and in some circumstances.

Foremost, Section 1322, which addresses the content of a chapter 13 plan, specifically provides that a chapter 13 plan may not modify the terms of a loan from a qualified retirement plan and excludes as disposable income, as defined in section 1325, the funds needed to repay such loans. See 11 U.S.C. § 1322(f). [4]

The 2005 Act did not extend the protections that section 1322(f) provides chapter 13 debtors to debtors, like Mr. Burton, who seek relief under chapter 7. Neither the Bankruptcy Code nor any applicable Rules and Official Forms, including the chapter 7 means test form, contain language analogous to section 1322(f) which permit debtors to exclude 401(k) loan repayments from their disposable income.

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[4] In addition, property of the estate was redefined to exclude certain retirement plans and articulated that contributions to such plans do not constitute disposable income in a chapter 13 case. 11 U.S.C. § 541(b)(7). Another protection included expanding the automatic stay provision to provide that the withholding of income to repay a qualified retirement plan loan does not violate the stay. See 11 U.S.C. § 362(b)(19). The automatic stay typically protects debtors by prohibiting the collection of pre-petition debts after the bankruptcy is filed. See 11 U.S.C. § 362(a). However, excluding qualified retirement plan loan repayments from the stay protects debtor's retirement accounts in bankruptcy.

2. Factual Background.

Mr. Burton, the Appellant, is an Applications Engineer who has been employed by UGS Corp. for over six years. (Docket No. 1, Schedule I; Docket No. 35, amended Schedule I). Mr. Burton filed his voluntary chapter 7 bankruptcy petition on November 13, 2006 and scheduled assets of $396,494.03, including a residence valued at $375,000, and 401(k) plan valued at $17,384.03. (Docket No. 1, Schedules A and B; Docket No. 37, p. 2, Memorandum Opinion). His combined scheduled liabilities totaled $459,587.75. These liabilities included a $14,126.74 statutory lien on the 401(K) savings plan with Vanguard Group, two mortgages, priority obligations of $2,577.87, and general unsecured debt of $70,832.77. (Docket No. 1, Schedules D, E, and F; Docket 37 p. 2, Memorandum Opinion, p. 2).

Shortly after his bankruptcy filing, Mr. Burton relocated to Texas, where he continues to work as an engineer for UGS. (Docket No.16; Docket No. 35; Docket No. 36, p. 2, Burton's Supplemental Brief and Docket No. 37, p.2, Memorandum Opinion). After the move, Mr. Burton earned gross monthly wages of $6,862.64 with a net of $4,283.64 per month. Each month, he voluntarily transfers $422.34 from his paycheck to pay down a 401(k) loan he borrowed from himself in 2005 . (Docket No. 1, Schedule D; Docket No. 35, amended Schedule I and J; Docket No. 37, p. 2, Memorandum Opinion). Mr. Burton has monthly living expenses of $4,363. (Docket No. 35, amended Schedule I and J).

Both parties agree Mr. Burton would have disposable income of $342.98 per month to pay creditors if he stopped using $422.34 of his monthly income to repay his retirement account. (Docket No. 36, Burton's Supplemental Brief, p. 2; Docket No. 37 p. 4, Memorandum Opinion).

The United States Trustee moved to dismiss Mr. Burton's chapter 7 case under both section 707(b)(2), on the ground the presumption of abuse arose in his case, and under section (b)(3)(B), on the ground he had the ability to repay a portion of his unsecured debts with the income allocated to repay the 401(k) loan. (Docket No. 15). Mr. Burton objected to the motion to dismiss. (Docket Nos. 18 and 23). The bankruptcy court determined that a presumption of abuse did not arise and scheduled an evidentiary hearing on the remaining section 707(b)(3)(B) portion of the motion. (Docket Nos. 24, 25, and 26).[5]

The parties stipulated that the dispositive issue before the bankruptcy court was whether the bankruptcy court could include the $422.34 in monthly income Mr. Burton was using to repay his 401(k) loan when determining the "totality" of Mr. Burton's financial situation under 11 U.S.C. § 707(b)(3)(B). (Docket entry dated September 20, 2007; Docket No. 36, p. 2, Debtor's Supplemental Brief). After considering the parties' post-hearing briefs on this issue, along with Mr. Burton's amended schedules of income and expenses, the bankruptcy court concluded it could consider all his income, including the $422.34, in determining the totality of Mr. Burton's financial situation.(Docket Nos. 34, 35, 36, 37, and 38).

After looking at all of Mr. Burton's income, the court concluded Mr. Burton could repay a portion of his debts and therefore dismissed his chapter 7 bankruptcy case under section 707(b)(3)(B). Id.

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[5] Although the United States Trustee does not agree with the bankruptcy court's analysis under section 707(b)(2), he has not raised the (b)(2) decision as an issue on appeal.

In reaching these conclusions, the bankruptcy court found Mr. Burton had $342.98 of disposable income after payment of his monthly expenses if he did not devote his $422.34 solely to repaying his own loan. (Docket No. 37, p. 4-8, Memorandum Opinion). In its analysis, the court noted that Mr. Burton had been employed by the same employer for a number of years and was earning income above the state median income. Relying on both pre- and post-2005 Act cases, the court held this debtor shall not make voluntary loan payments back to his 401(k) plan in lieu of using that excess income to pay creditors.

Mr. Burton filed a motion to reconsider the dismissal order, which was denied for failure to present any new evidence or demonstrate a clear error of law. (Docket No. 45). Mr. Burton timely appealed the bankruptcy court's orders dismissing his case and denying his motion to reconsider the dismissal order. (Docket No. 47).

SUMMARY OF ARGUMENT

The bankruptcy court did not abuse its discretion under 11 U.S.C. § 707(b)(3)(B) in dismissing Mr. Burton's chapter 7 case on the ground that the totality of Mr. Burton's financial situation allowed Mr. Burton to voluntarily repay a meaningful portion of his unsecured creditors in either a chapter 13 or 11 proceeding, or outside of bankruptcy.

In determining the amount of disposable income Mr. Burton could use to pay creditors, the bankruptcy court correctly treated the $422.34 of monthly income Mr. Burton was using to make loan repayments to his 401(k) as disposable income available to help pay all creditors. In making that determination, the bankruptcy court considered those factors that were relevant to totality of the circumstances of Mr. Burton's financial situation, including the stability of employment, whether the debtor was eligible for chapter 13 relief, and whether the debtor has any age or health related issues that would affect his income, and concluded such factors did not hinder or impair the debtor's ability to repay. As such, the court below did not abuse its discretion in dismissing Mr. Burton's chapter 7 case under section 707(b)(3)(B).

ARGUMENT

I. The bankruptcy court did not abuse its discretion in dismissing Mr. Burton's case under 11 U.S.C. § 707(b)(3)(B).

Under Section 707(b)(3)(B) of 2005 Act, a court deciding whether to dismiss a Chapter 7 case must consider whether "the totality of the circumstances . . . of the debtor's financial situation demonstrates abuse." 11 U.S.C. § 707(b)(3)(B). The Bankruptcy Code does not define the term "financial situation" used in section 707(b)(3)(B). However, as recognized by the Supreme Court, "[w]hen terms used in a statute are undefined, we give them their ordinary meaning." Asgrow Seed Co. v. Winterboer, 513 U.S. 179, 187 (1995)(citations omitted).

Both the ordinary meaning and the case law interpretation of "financial situation" support an understanding focusing on the financial factors of a debtor's (a) income, (b) expenses, (c) liabilities, and (d) assets. See, e.g., John A. E. Pottow, "The Totality of the Circumstances of the Debtor's Financial Situation in a Post-Means Test World," 71 Mo. L. Rev. 1053, 1066 (2006) (Under section 707(b)(3)(B)'s "totality of circumstances" of a debtor's "financial situation" test, courts must consider the debtors liabilities and assets, both exempt and non-exempt as well as income and expenses). Defined separately, the term "finance" is commonly understood to mean "relating to finance," and the term "situation" refers to "the way in which something is placed in relation to its surroundings." Webster's New Int'l Dictionary 851, 2129 (3d ed. 1981); Bailey v. United States, 516 U.S. 137, 144-45 (1995) (turning to dictionary definition of a term in order to determine its meaning). Where courts have had to evaluate the "financial situation" of the litigants before them, both within and outside the bankruptcy context, they have consistently applied an assets, income, liabilities, and expenses understanding of the term. Cf., Wisconsin Dep't Health and Family Servs., 534 U.S. 473, 491-92 (2002) (holding "income-first" method to calculate post-eligibility financial situation of a married couple seeking Medicaid eligibility permissible statutory interpretation).

Thus a full analysis of Mr. Burton's financial situation would by necessity include such liabilities as his 401(k) loan and his corresponding voluntary paycheck deduction each month to pay that particular debt at the expense of his other debts.

Mr. Burton argues that his voluntary repayment of one of his debts - his repayment of his 401(k) loan is a deduction that is "proper" for all debtors to exclude "per se "in all chapter 7 cases in a section 707(b)(3)(B) analysis because such deductions are protected under 11 U.S.C. § 1322(f). This argument is flawed.

Although the 2005 Act amended section 1322(f) to permit chapter 13 debtors to exclude retirement loan repayments from disposable income, Congress declined to extend this protection to chapter 7 debtors. The Bankruptcy Code contains no language permitting debtors to exclude 401(k) loan repayments from their disposable income. See Eisen vs. Thompson, (In re Thompson), 370 B.R. 762 (N.D. Ohio 2007).

To the contrary, the plain language of section 707(b)(3)(B) mandates that courts evaluate the totality of a debtor's financial situation when determining whether to dismiss his case under section 707(b)(3)(B).

In this case, the totality of Mr. Burton's financial situation includes the fact that Mr. Burton has more than $400 in monthly income he can spread among all creditors. It is understandable Mr Burton wants to shield this income from unaffiliated third-party creditors and use it to pay a debt he owes to himself, but nothing in chapter 7 of the Code mandates that.

Without question, there may be cases where a debtor's declining health or age means he must pay back a 401(k) loan in order to ensure an acceptable standard of living. In such a situation, a court could rule that the totality of that debtor's financial situation requires that debtor to continue repaying a 401(k) loan.

But that is not the case here. Mr. Burton is a well compensated, highly specialized engineer. He has steady employment. There is no reason from the record in this case to conclude he cannot continue to work for decades. Given this, the court below did not abuse its discretion in ruling that the totality of Mr. Burton's financial situation allowed him to divide this $400 income at this point in his life among all creditors.

Mr. Burton also suggests that 11 U.S.C. § 362(b)(19) allows him to repay himself rather than other creditors. (Appellant's Brief, p. 4). But section 362(a)(19), merely provides that the automatic stay does not apply to payroll deductions taken to repay 401(k) loans. That has no bearing on dismissing cases under section 707(b)(3)(B)'s totality of the debtor's financial circumstances test. Nor does it protect such repayments from being considered as disposable income. While section

362(a)(19) " is consistent with Congress' intent to preserve retirement accounts during the pendency of bankruptcy proceedings," the provision is "not inconsistent with characterizing the money used to repay 401(k) loans as income." See Eisen vs. Thompson, (In re Thompson), 370 B.R. 762, 770 (N.D. Ohio 2007).

Mr. Burton also suggests that dismissal under section 707(b)(3)(B) is proper only where a debtor is able to fund a chapter 13 plan. (Appellant's Brief p. 4). There is simply no textual support for reading the new statute as mandating dismissal only if a debtor can fund a chapter 13 plan. Instead, debtors' cases should be dismissed based on whether debtors can voluntarily repay a meaningful portion of their debt (a) outside bankruptcy, (b) through a chapter 11 repayment plan, or (c) through a chapter 13 repayment plan. See 11 U.S.C. 707(b)(1) (allowing a court to dismiss a case for abuse, or allowing the court and the debtor to agree that the case should be converted to chapter 11 or chapter 13 instead).

Furthermore, the default remedy for abuse under section 707(b)(3)(B) is dismissal, not conversion. See 11 U.S.C. 707(b)(1). Dismissal puts a debtor outside bankruptcy. The default remedy evidences a congressional intent to dismiss debtors' cases when they can voluntarily make meaningful payments outside bankruptcy. See H.R. Rep. 109-31 at 5 & n.18 (2005), reprinted in 2005 U.S.C.C.A.N. 88, 92 (Congress enacted section 707(b) to issue a "clear mandate requiring these debtors to repay their debts."). Accordingly, a debtor's case is "abusive" under section 707(b)(3)(B) when the debtor voluntarily can make meaningful payments to creditors outside bankruptcy. See, e.g., In re Henebury, 361 B.R. at 607 (ability to pay, standing alone, is sufficient for dismissal under section 707(b)(3)(B)); In re Pennington, 348 B.R. 647 (Bankr. D. Del. 2006) (below-median debtors to whom means test is inapplicable could have case dismissed for abuse given future projection of income where debtors had ability to pay more than 25% of unsecured debt). The common theme in such cases is the debtor's ability to pay his debts voluntarily outside of bankruptcy and not just within the context of funding a chapter 13 plan.

Here, the bankruptcy court examined Mr. Burton's financial situation in its totality of circumstances analysis by considering such factors as his job stability and his above-median annual income. (Docket No. 37, p. 6, Memorandum Opinion). The bankruptcy court determined, well within its broad discretion, that Mr. Burton could pay "a meaningful amount of his consumer debt with relative ease from future income" by no longer using $422.34 to repay himself. (Docket No. 37, Memorandum Opinion p. 8). Indeed, Mr. Burton stipulated he would have $342.98 a month in disposable income if he ceased preferring one obligation, his 401(k) loan, over his other obligations. This would enable him to pay over seventeen percent (17%) of his scheduled general unsecured debt outside of bankruptcy for thirty-six months or twenty-eight percent (28%) of his consumer obligations for over sixty months (Docket No. 37, p. 4, Memorandum Opinion). This equals $12,347.28 over three years and $20,578.80 over five years.

Mr. Burton therefore has viable options outside of bankruptcy. As previously described, he could cease making voluntary deductions from his paycheck to his 401(k) loan and use those funds to repay his unsecured creditors. Mr. Burton could attempt to work out forbearance agreements with his creditors to gradually repay his debts.

Even within bankruptcy, Mr. Burton is able to repay a significant portion of his debt through chapter 13. Mr. Burton's 401(k) loan obligation at filing was $14,126.74. (Doc. No. 1, Schedule D). In a chapter 13 proceeding, Mr. Burton could repay the 401(k) loan obligation in full with monthly pretax deductions in under 34 months[6]. Mr. Burton could thereafter repay a portion of his consumer debt during the remaining 26 months of a chapter 13 plan at a rate of $342.98 a month and pay $8,917.48, or more than ten percent (10%), of his consumer debt. Mr. Burton could therefore pay a meaningful portion of his debt in a chapter 13 proceeding.[7] See In re Davis, 378 B.R. 549, 549-50 (Bankr. N.D. Ohio 2007) (court held that debtor had ability to repay her creditors through chapter 13 because she would be able to pay off her thrift savings plan loan sooner than a prospective chapter 13 plan).

II. Mr. Burton's case would have been subject to dismissal even under the more debtor-friendly pre-2005 Act version of section 707(b).

The bankruptcy court's construction of section 707(b)(3)(B) is consistent with Sixth Circuit pre-2005 Act case law. Section 707(b)(3)(B) requires debtors to repay their debts when they can. Similarly, the pre-2005 Act case law mandated dismissal of chapter 7 cases when debtors had the ability to voluntarily pay a portion of their debt. See, e.g., In re Behlke, 358 F.3d 429 (6th Cir. 2004) (affirming dismissal when debtors had ability to pay creditors a part of debt); In re Lamanna, 153 F.3d 1 (1st Cir. 1998) (affirming dismissal when debtor had monthly disposable income to repay part of debt). Prior to the 2005 Act, dismissal under section 707(b) was predicated on a finding of "substantial abuse." Congress then removed "substantial," which lowered the amount of abuse

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[6] Mr. Burton has presumably been paying down his 401(k) loan since he filed his chapter 7 bankruptcy in November 2006. Therefore the amount of time he would need to pay off his loan while in a chapter 13 would be far less than 34 months, thereby freeing up even more income to pay creditors.

[7] Were Mr. Burton to convert to chapter 13, his applicable commitment period for a plan would be five years because his income is above his state median family income. The applicable commitment period for a chapter 13 plan is determined by comparing the debtor's annualized income with the median family income; if his annualized income is greater than the median family income, the applicable commitment is not less than five years unless the debtor can pay off his creditors within a shorter period of time. §1325(b)(4)(A)(ii).

necessary for dismissal. While pre-2005 Act case law applying the concepts may still be used in determining abuse, this case law addresses dismissal under a higher "substantial abuse" standard.[8] Thus the bankruptcy court's conclusion, which is consistent with pre-2005 Act case law, is also consistent with the higher "substantial abuse" standard for dismissal.

The Sixth Circuit Court of Appeals' opinions in Krohn and Behlke predicated dismissal either for lack of honesty or want of need. In re Krohn, 886 F.2d 123, 126 (6th Cir. 1989); In re Behlke, 358 F.3d 429, 433 (6th Cir. 2004). These two independent bases for dismissal are reflected in the post-2005 Act section 707(b)(3)(A) (dismissal for bad faith) and 707(b)(3)(B) (dismissal under totality of circumstances). But in analyzing want of need, Krohn listed several non-exclusive factors used to determine whether a case should be dismissed for the higher substantial abuse standard under the former section 707(b). 886 F.2d at 126. The primary factor was a debtor's ability to repay his debts. Id. at 126. The other factors, relating to the debtor's financial situation, included whether the debtor has a stable source of future income, his eligibility for Chapter 13 relief, the availability of state law and private negotiations to remedy his finances, and whether his expenses may be reasonably reduced. Id. at 126-27.[9]

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[8] Not all pre-2005 Act "totality of the circumstances" case law is consistent with the current section 707(b)(3)(B). See, e.g., In re Kelly, 841 F.2d 908, 914 (9th Cir. 1988)(debtor's ability to pay his debts, when due, as determined by his ability to fund a chapter 13 plan, is the primary factor to be considered in determining whether granting relief would be substantial abuse); In re Koch, 109 F.3d 1285, 1288 (8th Cir. 1997)(ability to pay for section 707(b) purposes is measured by evaluating debtors' financial condition in a hypothetical chapter 13 proceeding). These cases should be disregarded to the extent they base their analyses exclusively on a debtor's ability to repay through a chapter 13 plan.

[9] This construction of prior law is consistent with that of other courts within the Sixth Circuit, which have focused on the debtor's ability to pay debts while giving weight to other circumstances related to financial situation. See In re Stewart, __ B.R. __, 2008 WL 161357 (N.D. Ohio 2008); In re Wright, 364 B.R. 640, 643 (Bankr. N.D. Ohio 2007); In re Edighoffer, 375 B.R. 789 (Bankr. N.D. Ohio 2007); In re Mestemaker, 359 B.R. 849 (Bankr. N.D. Ohio, 2007); In re Simmons, 357 B.R. 480 (Bankr. N.D. Ohio 2006) (noting where presumption of abuse does not arise under (b)(2) ability to repay standard, a (b)(3) totality of the circumstances analysis may be considered).

Retirement loan repayments were also deemed disposable income in a totality of circumstances analysis prior to the 2005 Act. In Behlke, the Sixth Circuit Court of Appeals examined whether a debtor's voluntary repayment of her retirement loans should be treated as disposable income under the old section 707(b). Behlke v. Eisen (In re Behlke), 358 F.3d 429, 435 (6th Cir. 2004). Behlke, following Krohn, held that retirement loan repayments are disposable income because they are unnecessary for the "maintenance or support" of debtors.

The bankruptcy court did not abuse its discretion in discussing this pre-2005 Act case law, which, significantly, examined ability to pay under a higher "substantial abuse" standard. Nothing in section 707(b)(3)(B) suggests that this analysis should be narrowed. In lowering the standard from "substantial" to mere abuse and requiring consideration of "the totality of the circumstances . . . of the debtor's financial situation," Congress has mandated bankruptcy courts to consider all possible financial factors in weighing a debtor's ability to pay creditors.

CONCLUSION

For these reasons, the United States Trustee respectfully asks this Court to affirm the order entered below granting the United States Trustee's motion to dismiss under 11 U.S.C. § 707(b)(3)(B) and dismissing Mr. Burton's chapter 7 bankruptcy case.

Dated: Respectfully submitted,

/s/ Amy L. Good
Amy L. Good, Esq. (0055572)
Trial Attorney
Department of Justice
Office of the United States Trustee,
Suite 441, H.M. Metzenbaum U.S. Courthouse
201 Superior Avenue
Cleveland, Ohio 44114
amy.l.good@usdoj.gov

Attorney for U.S. Trustee Habbo G. Fokkena

Of Counsel

P. Matthew Sutko
David A. Levine
Executive Office for United States Trustees
Department of Justice
20 Massachusetts Avenue, N.W.
Suite 8000
Washington, D.C. 20530
(202) 307-1399

Certificate of Service

I certify that on June 5, 2008, a copy of the foregoing "Brief of the Appellee United States Trustee" was filed electronically. Notice of this filing will be sent by operation of the Court's electronic filing system to all parties indicated on the electronic filing receipt. All other parties will be served by regular U.S. mail. Parties may access this filing through the Court's system.

/s/ Amy L. Good
Amy L. Good

BRIEF BANK — "SUMMARY SHEET" *Printed Mon-5/4/09 14:15*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE
[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]
In re John G. Calhoun, Glenda R. Calhoun (Calhoun, et al. v. W. Clarkson McDow, Jr., United States Trustee)

2. ("CO") ***CURRENT*** COURT
[E.g., "CTA9"]
D. S.C.

3. ("CCN") ***CURRENT*** CASE NO.
No.: 3:09-cv-00822-CMC

4. ("PCN") ***PRIOR*** CASE NO. & COURT
[IF ANY]
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Court: Bankr. S.C.
(Identify judge & cite, if any)

5. ("SO") ***SOURCE***
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John Timothy Stack, Joseph Buzhardt, Thomas Kearns, Joseph Guzinski, P. Matthew Sutko, W. Clarkson McDow.
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s)

&

√ Any Miscellaneous ***BACKGROUND***

• Whether the bankruptcy court abused its discretion by dismissing the debtors' chapter 7 petition under 11 U.S.C. § 707(b)(3)(B), which allows courts to dismiss chapter 7 petitions when they totality of the circumstances of a debtor's financial situation demonstrates abuse.

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UNITED STATES DISTRICT COURT
DISTRICT OF SOUTH CAROLINA

In re:

JOHN G. CALHOUN,
GLENDA R. CALHOUN,

Debtors.
____/

JOHN G. CALHOUN,
GLENDA R. CALHOUN, Case No. C/A 3:09-cv-00822-CMC

Appellants.

vs.

W. CLARKSON MCDOW, JR.,
UNITED STATES TRUSTEE,

Appellee.
____/

BRIEF FOR THE APPELLEE

John Timothy Stack
Dist. Ct. I.D. No. 4272
Trial Attorney
Office of the United States Trustee
Department of Justice
1835 Assembly Street, Suite 953
Columbia, South Carolina 29201
John.T.Stack@usdoj.gov
(803) 765-5218

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UNITED STATES DISTRICT COURT
DISTRICT OF SOUTH CAROLINA

In re:

JOHN G. CALHOUN,
GLENDA R. CALHOUN,

Debtors.
____/

JOHN G. CALHOUN,
GLENDA R. CALHOUN,

Civil Case No.09-cv-00822-CMC

Appellants.

vs.

W. CLARKSON MCDOW, JR.,
UNITED STATES TRUSTEE,

Appellee.
____/

BRIEF FOR THE APPELLEE

JURISDICTIONAL STATEMENT

The bankruptcy court had jurisdiction under 28 U.S.C. §§ 157 (a) and (b), and 1334(a) to issue its final order granting the United States Trustee's motion to dismiss the Debtors' chapter 7 bankruptcy case. The bankruptcy court entered this order, which also gave the Debtors the option to file a motion to convert their case to a chapter 13 proceeding, on November 10, 2008. On November 20, 2008, the Debtors filed a Motion to Alter or Amend Judgment and to Grant New Trial and Request to be Heard; a Motion to Reconsider, to Grant Relief from Order, to Amend Findings of Fact or to Make Additional Findings of Fact and Request to be Heard; a Motion for

Reconsideration and for Relief from Order and Request to be Heard, and; a Motion to Stay Order Pending Reconsideration and Request to be Heard. The bankruptcy court granted the Debtors' Motion to Stay Order Pending Reconsideration. On January 15, 2009, the bankruptcy court entered an order denying the Debtors' Motion to Alter or Amend Judgment and to Grant New Trial and the Debtors' Motion for Reconsideration and for Relief from Order, and granting in part the Debtors' Motion to Reconsider, to Grant Relief from Order, to Amend Findings of Fact or to Make Additional Findings of Fact. The Debtors filed a notice of appeal, which is timely under 28 U.S.C. §§ 158(a) and (c)(2), on January 26, 2009. This Court has appellate jurisdiction under 28 U.S.C. § 158(a)(1), a statutory provision under which district courts have jurisdiction to hear appeals from final judgments, orders, and decrees of bankruptcy judges.

STATEMENT OF THE ISSUE

Whether the bankruptcy court abused its discretion by dismissing the Debtors' chapter 7 petition under 11 U.S.C. § 707(b)(3)(B), which allows courts to dismiss chapter 7 petitions when the totality of the circumstances of a debtor's financial situation demonstrates abuse.

STANDARD OF REVIEW

In an appeal taken from a bankruptcy court order, a district court reviews a bankruptcy court's conclusions of law *de novo* and its findings of fact for clear error. *See In re Merry-Go-Round Enterprises, Inc.*, 400 F.3d 219, 224 (4th Cir. 2005).

STATEMENT OF THE CASE

On February 27, 2008, the Debtors filed a voluntary bankruptcy petition under chapter 7 of the Bankruptcy Code, 11 U.S.C. § 701, *et seq*. On May 23, 2008, the United States Trustee[1] filed a motion to dismiss the Debtors' petition on the grounds that the totality of the Debtors' financial circumstances demonstrates abuse under 11 U.S.C. § 707(b)(3)(B) because the Debtors have sufficient means to repay a significant amount of their unsecured debts. Granting the motion to dismiss, the bankruptcy court agreed with the United States Trustee and found abuse under § 707(b)(3)(B). In its order, the bankruptcy court also gave the Debtors the opportunity to file a motion to convert their case to a chapter 13, as § 707(b)(1) allows it to do. The Debtors did not move to convert. Instead, they appealed the dismissal order to this Court.

STATEMENT OF THE FACTS

I. Statutory Background

The Bankruptcy Code establishes two primary forms of bankruptcy relief for individual debtors – chapter 7 and chapter 13. Under chapter 7, "an individual debtor receives an immediate unconditional discharge of personal liability for certain debts in exchange for relinquishing his or her nonexempt assets to a bankruptcy trustee for liquidation and distribution to creditors." H.R. Rep. 109-31(I), at 10; *see* 11 U.S.C. §§ 701-727. Under chapter 13, "a debtor commits to repay

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[1] United States Trustees "serve as bankruptcy watch-dogs to prevent fraud, dishonesty, and overreaching in the bankruptcy arena." H.R. Rep. No. 95-595, 1st Sess. 4, 88 (1977), *as reprinted in* 1978 U.S.C.C.A.N. 5963, 5966, 6071. The United States Trustee Program therefore acts in the public interest to promote and preserve the efficiency and integrity of the bankruptcy system. Congress has provided that "[t]he United States trustee may raise and may appear and be heard on any issue in any case or proceeding . . . ." 11 U.S.C. § 307. *See Thompson v. Greenwood*, 507 F.3d 416, n.3 (6th Cir. 2007) (stating "[t]he United States Trustee is an interested party by statute").

some portion of his or her financial obligations" over a specified period "in exchange for retaining nonexempt assets and receiving a broader discharge of debt than is available under chapter 7." H.R. Rep. 109-31(I), at 10; *see* 11 U.S.C. §§ 1321-1330.

The difference between chapter 7 and 13 is dramatic. In chapter 7 cases, creditors may look solely to debtors' pre-bankruptcy, non-exempt assets for payment. *See* 11 U.S.C. § 541 (limiting property of the estate to debtors' pre-petition assets). Debtors' post-bankruptcy income is not subject to creditor claims. *Id*. Subject to narrow exceptions, debtors receive a complete discharge of all their pre-petition debts in a chapter 7 case. *See* 11 U.S.C. § 727(b). Historically, in roughly 96% of chapter 7 cases, unsecured creditors received no payment. *See, e.g.*, Brief of the United States in *Lamie v. United States Trustee*, 2003 WL 21839367 at *38 (2003).

Chapter 13 is different because debtors must use post-petition income to fund a chapter 13 payment plan. *See* 11 U.S.C. § 1306(a)(2) (property of the bankruptcy estate also includes post-petition income); 11 U.S.C. § 1325(b) (projected disposable income applied to make payments to unsecured creditors). In chapter 13, debtors receive a discharge only after they have fully completed their chapter 13 repayment plans. *See* 11 U.S.C. §§ 1328(a) and (c); *see also* 11 U.S.C. § 1328(b) (listing exceptions to this rule).

Since 1984, Congress has enacted a series of tests that have allowed courts to dismiss chapter 7 cases, and thereby prevent unjust discharge of pre-petition debts. In 1984, Congress amended chapter 7 to permit dismissal of a chapter 7 bankruptcy petition under § 707(b) if a court found "substantial abuse." Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, § 312, 98 Stat. 333, 335. Congress enacted this amendment to respond "to concerns that some debtors who could easily pay their creditors might resort to chapter 7 to avoid their obligations." H.R. Rep. 109-31(I), at 12 (internal quotation omitted). Two years later, Congress again amended this provision to authorize the United States Trustee to seek dismissal of chapter 7 petitions for "substantial abuse." Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1986, Pub. L. No. 99-554, § 21, 100 Stat. 3088, 3101.

After twenty-years' experience, Congress found that these amendments were insufficient to control abuse of chapter 7. Congress identified, among other problems, the "inherent[] vague[ness]" of the "substantial abuse" standard, which led to disagreement in the courts about whether a debtor's ability to repay a significant portion of his or her debts out of future income[2] constitutes substantial abuse, meriting dismissal. H.R. Rep. 109-31(I), at 12. Another problem was that the Bankruptcy Code established "a presumption in favor of granting the relief requested by the debtor," which influenced courts' decisions whether to find substantial abuse. 11 U.S.C. § 707(b) (2000 suppl. 4); *See* H.R. Rep. 109-31(I), at 12.

Responding to these perceived shortcomings of the Bankruptcy Code, Congress held hearings over five years to identify what reforms it could adopt "to ensure that debtors repay creditors the maximum they can afford." H.R. Rep. 109-31(I), at 2, 12. The Bankruptcy Abuse

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[2] In evaluating whether substantial abuse existed, courts jointly considered both the debtor's conduct and the debtor's ability to pay his debts outside bankruptcy or through a chapter 13 repayment plan. *See, e.g., In re Stewart*, 175 F.3d 796 (10th Cir. 1999); *In re Lamanna*, 153 F.3d 1 (1st Cir. 1998); *In re Krohn*, 886 F.2d 123 (6th Cir. 1989); *In re Kelly*, 841 F.2d 908, 915 (9th Cir. 1988). Most courts recognized that a debtor's ability to pay a portion of his debt was the predominant factor when determining whether to dismiss a chapter 7 case. *Id.*

Prevention and Consumer Protection Act of 2005 (the "2005 Act" or "BAPCPA"), S. 256, Pub. L. No. 109-8, 119 Stat. 23, implemented the reforms Congress identified in four ways.

First, Congress repealed the statutory presumption in favor of granting relief to the debtor. *Compare* 11 U.S.C. § 707(b) (1986) *with* 11 U.S.C. § 707(b) (2005).

Second, Congress lowered the standard for dismissal under all subsections of new § 707(b) from "substantial abuse" to mere "abuse." *See* 11 U.S.C. § 707(b)(1) (cases are now dismissed for "abuse"); 11 U.S.C. § 707(b)(2) (subjecting cases to dismissal for abuse); 11 U.S.C. § 707(b)(3) (same).

Third, Congress authorized dismissal when a mathematical formula, known as the "means test," yields monthly disposable income that exceeds a statutory threshold. *See* 11 U.S.C. § 707(b)(2). The 2005 Act provides specific criteria which, if satisfied, require a court to presume the existence of abuse, requiring "dismissal [or conversion to chapter 13] based on a chapter 7 debtor's ability to repay." H.R. Rep. 109-31(I), at 15. To determine if abuse exists, a court first compares the debtor's annualized "current monthly income" to the "median family income" of a similarly-sized family in the debtor's state.[3] If the debtor's current monthly income is below the median, then the presumption of abuse does not arise. *See* 11 U.S.C. § 707(b)(7); H.R. Rep. 109-31(I), at 15. When a debtor's current monthly income is above the median and his or her monthly

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[3] "Current monthly income," a defined term, is used to calculate gross historical income for purposes of the means test. *See* 11 U.S.C. § 101(10A) (defining "current monthly income" as the debtor's average monthly income for the six-month period preceding the month of the filing of the debtor's petition). Section 707(b)(2) requires debtors to file a statement of current monthly income and other calculations disclosing whether a presumption of abuse arises. *See* 11 U.S.C. §§ 521(a)(1)(B)(ii), 707(b)(2)(C); Fed. R. Bankr. P. 1007(b)(1)(B).

disposable income meets or exceeds the statutory threshold amount, the presumption is triggered, and the debtor's case must be dismissed as abusive (or converted to chapter 13, if the debtor consents), absent an express showing of special circumstances by the debtor. *See* 11 U.S.C. § 707(b)(1) and (2).

Fourth, Congress enacted new § 707(b)(3). This section allows courts to dismiss cases based upon either a debtor's bad faith, 11 U.S.C. § 707(b)(3)(A), or the totality of a debtor's financial circumstances, 11 U.S.C. § 707(b)(3)(B). Thus, even if the presumption of abuse does not arise or is rebutted under § 707(b)(2), a chapter 7 petition should be dismissed for abuse under § 707(b)(3) when "the totality of the circumstances. . .of the debtor's financial situation demonstrates abuse." 11 U.S.C. § 707(b)(3)(B).

Sections 707(b)(3)(A) and (B) of the 2005 Act represent a significant departure from old § 707(b) because they clarify that cases can be dismissed either solely for misconduct, under § 707(b)(3)(A), or solely based upon the totality of the circumstances of a debtor's financial situation, under § 707(b)(3)(B). *See, e.g., In re Henebury*, 361 B.R. 595, 607 (Bankr. S.D. Fla. 2007) (by bifurcating § 707(b)(3)(A) and (B), "the debtor's total financial situation as a measure of ability to pay, and bad faith are separate and sufficient grounds for dismissal. Either ability to pay or bad conduct in connection with the bankruptcy will warrant dismissal for abuse under § 707(b)(3).").

II. Factual and Procedural Background

Mr. Calhoun is the former Chief Financial Officer of University Hospital in Augusta, Georgia. See Joint Stipulation. On February 27, 2008, he and his wife filed a voluntary chapter 7 bankruptcy petition, seeking to discharge $106,707 in unsecured debt. See Joint Stipulation, Schedule F, Notice of Chapter 7 Bankruptcy Case.

The Debtors live in a 3,300 square foot home, on three and a half acres of land, at 208 Tennis Ranch Rd. in Jackson, South Carolina. *See* Joint Stipulation and Schedule A.

The Debtors' joint income is 179% of the median for a household of two in South Carolina.[4] *See* Transcript of 10/1/08 hearing, page 11, and UST Exhibit # 4 (median income for households of two in South Carolina is $48,944.). Mr. Calhoun, who is retired and does not work, receives monthly retirement income totaling $7,313, or $87,756 annually. *See* Joint Stipulation. Mr. Calhoun also receives a monthly Social Security benefit of $1,459. *Id.* Mrs. Calhoun does not work. *Id.*

The Debtors currently have monthly mortgage payments totaling $2,151. *See* Joint Stipulation; Schedules D and J. According to local mortgage standards for Aiken County, South Carolina, which are based on IRS collection financial standards derived from the U.S. Census Bureau and Bureau of Labor Statistics data, the Debtors' monthly mortgage amount is almost 300% of the applicable maximum IRS housing standard of $750 for a family of two residing in Aiken County, South Carolina. *See* Transcript of 10/1/08 hearing, page 11, and UST Exhibit # 4.

The Debtors spend $930 per month for food, $439 per month on two life insurance policies which insure Mr. Calhoun's life for $800,000, $111 per month for satellite television, and $350 for transportation. *See* Schedules I and J.

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[4] 215% of the median for a household of two if the Debtors' Social Security income is included.

In the 22 months before the Debtors decided to attempt to discharge all their debts in chapter 7, they had been able to pay their unsecured creditors $2,638 per month through ClearPoint Credit Counseling Services. *See* Transcript of 10/1/08 hearing, page 21. During this period, the Debtors remained current on their other expenses, including their mortgage payments, their car payments, and their utilities. *See* Transcript of 10/1/08 hearing, pages 23 and 24. They also had the ability to maintain their lifestyle on their 3.5 acre property.

On May 23, 2008, the United States Trustee filed a motion to dismiss the Debtors' petition as an abuse of chapter 7 under 11 U.S.C. §§ 707(b)(1) and (b)(3)(B). *See* United States Trustee Mot. To Dismiss at 1. Not only did the Debtors' Schedules I and J show that the Debtors admitted they had, in their own estimation, monthly disposable income of $133, excluding Social Security income, but the United States Trustee alleged that with some modest belt-tightening the Debtors would have considerably more disposable income than reflected on their Schedule J. The United States Trustee argued that the totality of the Debtors' financial circumstances demonstrated abuse because the Debtors had the ability to repay a substantial portion of their debts. The United States Trustee also relied upon the fact that the Debtors had been able to pay creditors $2,638 per month for the 22 months prior to filing bankruptcy as evidence the Debtors had an ability to repay creditors.

On November 12, 2008, the United States Bankruptcy Court for the District of South Carolina entered an order dismissing the Debtors' bankruptcy case. The court found the totality of the Debtors' financial circumstances established abuse under 11 U.S.C. § 707(b)(3) because the Debtors could make payments to their creditors while maintaining a reasonable lifestyle. The bankruptcy court concluded that the Debtors' budget was excessive and that there was ample room for reduction of the Debtors' expenses, which the court found bordered on the extravagant. *See* Order re: Motion to Dismiss at page 10. Specifically, the bankruptcy court concluded that the Debtors have excessive expenses for housing, food, transportation and life insurance. *Id.*, pages 10 - 11. The bankruptcy court also found that the Debtors' Social Security "income should not...be excluded from consideration in analyzing ability to pay as a component of the totality of the debtor's financial circumstances under § 707(b)(3)." *Id.*, page 9.

As 11 U.S.C. § 707(b)(1) allows, the bankruptcy court gave the Debtors the option to convert their case to chapter 13. In a chapter 13 case, the Debtors could receive a discharge of their unsecured debts after five years simply by using their excess income during the period to make monthly payments to their creditors. 11 U.S.C. §§ 1321 - 1328. The Debtors declined to use excess income to fund a five-year chapter 13 repayment plan, electing instead to file a notice of appeal to this Court pursuant to 28 U.S.C. § 158(a).[5]

SUMMARY OF THE ARGUMENT

The bankruptcy court did not abuse its discretion in ruling the Debtors should not receive a chapter 7 discharge that would wipe out their debts. The court did so because the Debtors had excess income that would allow them to repay a portion of their debts. The court's ruling is substantially supported in the record before it. Among other things, the Debtors had shown they could repay creditors by having done so - they paid over $2,638 each month for 22 months prior to

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[5] Were the order below to be sustained on appeal, the Debtors could file a chapter 13 case at that time. Indeed, there is no bar to the Debtors filing a chapter 13 case today, although that would moot this appeal.

filing bankruptcy. The Debtors admit on their own schedules they have excess income, even without accounting for Social Security payments Mr. Calhoun receives.

Given this ability to repay, the court acted reasonably in giving the Debtors the option to obtain a discharge of their debts by paying what they could afford in a chapter 13 repayment plan. *See* 11 U.S.C. § 707(b)(1); *see also* 11 U.S.C. §§ 1321 - 1328.

The Debtors refused that offer. That is their right but, given it, the bankruptcy court's dismissal of the Debtors' chapter 7 petition should be affirmed because the bankruptcy court did not abuse its discretion in dismissing under § 707(b)(3)'s "totality of the circumstances" inquiry. **First**, the bankruptcy court correctly applied the statutory framework of § 707(b)(3)(B) when it found that the totality of the circumstances of the Debtors' financial situation demonstrated abuse because the Debtors have the financial ability to repay a portion of their unsecured debts. The Debtors' challenges to the bankruptcy court's dismissal misunderstand the relevant statutory provisions and rely on case law which has been superceded by statute or is at odds with the vast majority of courts that have considered § 707(b)(3)(B). Specifically, the Debtors fail to recognize that *In re Green*, 934 F. 2d 568 (4th Cir. 1991), was superceded by the 2005 Act. **Second,** in considering the totality of the circumstances, the bankruptcy court properly exercised its discretion in determining that the Debtors' bankruptcy filing was abusive, including Debtors' excessive expenses and consideration of Debtors' Social Security income. **Finally**, the bankruptcy court made no clear error in finding that the Debtors have the ability to pay a substantial amount to unsecured creditors.

ARGUMENT

I. The bankruptcy court did not abuse its discretion in dismissing the Debtors' chapter 7 petition based on the "totality of the circumstances" under § 707(b)(3)(B).

A. The bankruptcy court properly applied the statutory framework of § 707(b)(3)(b) when it found that the totality of the circumstances of the Debtors' financial situation demonstrated abuse because the Debtors have an ability to repay their unsecured debts.

1.

To determine whether providing chapter 7 relief to a debtor constitutes abuse under 11 U.S.C. § 707(b)(3)(B), a bankruptcy court considers the "totality of the circumstances" of the debtor's "financial situation." *See* 11 U.S.C. § 707(b)(3)(B). A bankruptcy court should "take into consideration a debtor's actual income and expenses" when determining whether to dismiss a debtor's case for abuse under § 707(b)(3)(B)'s "totality of circumstances" test. *In re Ross-Tousey*, 549 F.3d 1148 (7th Cir. 2008) (citing *In re Zaporski*, 366 B.R. 758, 768 (Bankr. E.D. Mich. 2007)). "The ability to pay, standing alone, is sufficient to warrant dismissal of a Chapter 7 case for abuse pursuant to 11 U.S.C. § 707(b)(3)(B)." *Henebury*, 361 B.R. at 607.

Both the written and oral record provide ample basis for the bankruptcy court's conclusion that the Debtors have an ability to repay their unsecured debts. The Debtors conceded that for the 22 months which preceded the filing of their bankruptcy case, they paid $2,638 per month to unsecured creditors through payments to ClearPoint Credit Counseling Services, and did so without falling behind in their mortgage payments or other expenses.[6] *See* Transcript of 10/1/08 hearing,

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[6] The Debtors argue that in attempting to repay their creditors through their pre-bankruptcy debt repayment plan, they had "attempted what the UST suggests and determined that they are not able

pages 21 - 24. The Debtors have not experienced a reduction in income from what they received during those 22 months, nor have they experienced a significant increase in expenses from those they paid during that period. *See* Transcript of 10/1/08 hearing, pages 23-25. The Debtors' own budget filed in their bankruptcy case reflects that they have monthly disposable income of $133.00, without including any Social Security income. *See* Schedules I and J.

Moreover, the court below did not err in concluding the Debtors' expenses are excessive. *See* Order re: Motion to Dismiss at pages 10 - 11. Debtors expend $406.35 per month for two life insurance policies on Mr. Calhoun's life. *See* Schedule J and Transcript of 10/1/08 hearing, pages 15 - 17. One of these policies provides coverage of $500,000 and costs $249.75 per month. *Id.* The second policy provides coverage of $300,000 and costs $156.60 per month. *Id.* Mr. Calhoun testified that the $300,000 policy was required so that Mrs. Calhoun would be able to pay off the mortgages on their home upon his death. *Id.* Mr. Calhoun testified that the $500,000 policy was required to provide for Mrs. Calhoun after his death. *Id.* However, Mrs. Calhoun is entitled to 75% of Mr. Calhoun's retirement income after his death and if the $300,000 policy remains in effect and pays off the home upon Mr. Calhoun's death, Mrs. Calhoun will no longer have to pay $2,151 per month on the mortgages that the Debtors now pay. Transcript of 10/1/08 hearing, pages 28-29. Therefore, with just the $300,000 policy in place, upon Mr. Calhoun's death, Mrs. Calhoun's gross annual income would exceed $65,000 and she would have no mortgage expenses. She would own

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to pay their creditors." In fact, the United States Trustee has not suggested, nor did the bankruptcy court find, that the Debtors have the disposable income to repay all of their debt or to make payments equal to the payments made pre-bankruptcy. The facts demonstrate, however, that the Debtors have disposable income to make substantial payments to their unsecured creditors.

a home worth over $250,000 free and clear. In short, the second insurance policy on Mr. Calhoun's life is an extravagant and unnecessary expense. *See, e.g., In re Schwenk*, No. 08-03055, 2009 WL 975160, at *6 (Bankr. M.D. Pa. 2009) (finding debtor's efforts to reduce income in order to provide for a future benefit for co-debtor spouse indicative of abuse in the absence of any evidence that co-debtor spouse will be unable to provide for her own support).

The Debtors also claim to spend $930.00 per month on food, an expense the bankruptcy found to be excessive. *See* Transcript of 10/1/08 hearing, page 13; UST Exhibit # 10; Order re: Motion to Dismiss at page 10. The Debtors' monthly satellite television bill includes $37.96 for a sports package, high definition reception, DVR (recording) services, and two additional receivers. *See* Transcript of 10/1/08 hearing, page 18 and UST Exhibit # 11. The Debtors also claim monthly transportation expenses of $360.00, although they do not have to travel to and from work. *See* Schedule J.

Having reviewed all of the facts, the bankruptcy court determined that the "[D]ebtors' family budget is excessive and there is ample room for reduction of expenses," and that the Debtors' expenses "border on the extravagant." See Order re: Motion to Dismiss at page 10**.** The bankruptcy court found that the Debtors did not justify their transportation expense in light of the reduced need for travel during retirement. *Id*., page 11. The bankruptcy court also found that "[t]he contention that the Debtors cannot now pay *any* dividend to the unsecured creditors is undermined by the fact that the Debtors made a significant payment for 22 months. The Debtors paid $2,638 to creditors without falling behind in payment of other household expenses. This undermines the credibility of the scheduled current living expenses and suggests that the expenses are significantly over-stated." *Id.*, at page 11 (Emphasis added.)**.**

In sum, the bankruptcy court was well within its discretion in finding abuse under § 707(b)(3)(B) because the totality of the circumstances of the Debtors' financial situation demonstrates an ability to repay unsecured creditors. *See, e.g., In re Behlke,* 358 F.3d 429 (6th Cir. 2004) (affirming dismissal under superceded § 707(b) when debtors had ability to pay creditors $634 per month); *In re Lamanna,* 153 F.3d 1 (1st Cir. 1998) (affirming dismissal under superceded § 707(b) when debtor had $771 in monthly disposable income); *Hebbring v. United States Trustee,* 463 F.3d 902 (9th Cir. 2006) (affirming dismissal under superceded § 707(b) because debtor had $615 available each month to pay creditors). The bankruptcy court should be affirmed.

2.

The Debtors argue that "[t]he means test provisions of the Bankruptcy Code[,] replace the ability to pay analysis" of § 707(b)(3)(B). *See* Appellant's Brief at page 5. The Debtors rely on *In re Nockerts*, 357 B.R. 497 (Bankr. E.D. Wis. 2006) for the proposition that cases cannot be dismissed under § 707(b)(3) if they pass the means test under section §707(b)(2). However, the Seventh Circuit effectively overruled *Nockerts* in *In re Ross -Tousey*, 549 F.3d at 1161-62 (holding debtors' cases can be dismissed under 11 U.S.C. § 707(b)(3) even if those cases survived review under § 707(b)(2)). This is obvious from the plain language of the statute, which provides that courts "shall" consider whether cases should be dismissed under § 707(b)(3) if they are not dismissed under § 707(b)(2). 11 U.S.C. § 707(b)(2).

When a debtor has an ability to pay but instead files under chapter 7, the case can be dismissed as abusive under § 707(b)(3)(B). This is because, as numerous courts have recognized, the terms "totality of [the] circumstances" and "financial situation" in the 2005 Act "clearly encompass a debtor's ability to pay." *In re Lenton*, 358 B.R. 651, 663 (Bankr. E.D. Pa. 2006); *see also In re Sullivan*, 370 B.R. 314, 321(Bankr. D. Mont. 2007) ("[T]he plain language of § 707(b)(3). . . compels a conclusion that a court must consider a debtor's actual debt-paying ability in ruling on a motion to dismiss based on abuse where the presumption does not arise or is rebutted" (quoting *In re Sorrell*, 359 B.R. 167 (Bankr. S.D. Ohio 2007)); *In re Pak*, 343 B.R. 239 (Bankr. N.D. Cal. 2006) ("It would be counterintuitive to construe 'totality of the circumstances' [in § 707(b)(3)] to exclude a consideration of the debtor's ability to pay.").

Next, relying upon a case that applied the superceded statute, *In re Green*, 934 F. 2d 568 (4th Cir. 1991), the Debtors argue that under §707(b)(3)(B) the "[a]bility to pay creditors, standing alone, is insufficient to require dismissal of a Chapter 7 case." *See* Appellant's Brief at page 6. However, the Debtors' argument fails to recognize that the 2005 Act supercedes *Green*.

Section 707(b)(3), as embodied in the 2005 Act, divides the prior § 707(b) into two separate grounds for dismissal. Section 707(b)(3)(A) now allows courts to dismiss a case for bad faith by the debtor. Section 707(b)(3)(B), in turn, allows courts to dismiss the case if the court finds abuse based on the totality of the circumstances *of the debtor's financial situation.* (Emphasis added) Thus, under the 2005 Act, the court may consider either the totality of the debtor's financial situation, including the debtor's ability to pay, *or* the debtor's bad faith. Because applying the *Green* analysis to the law as amended by the 2005 Act improperly conflates these factors, *see In re*

Green, 934 at 572-73, reliance on *Green* as binding precedent is misplaced. Indeed, recently, the Fourth Circuit Court of Appeals recognized the changes wrought by the 2005 Act, noting that "Congress undoubtedly did intend the BAPCPA to benefit unsecured creditors-by requiring those debtors with sufficient means to file under Chapter 13 rather than Chapter 7 . . .". *In re Price*, 2009 WL 975796, at *7 (4th Cir. April 13, 2009).

The legislative history of the 2005 Act supports the plain language reading of § 707(b)(3). In it, Congress stated that the 2005 amendments to § 707 were enacted "to ensure that debtors repay creditors the maximum they can afford." H.R. Rep. 109-31 at 1 (I) (2005). The bankruptcy court's application of the statute is consistent with Congress' stated purpose for enacting § 707. The Calhoun's proffered construction is not.

B. The bankruptcy court did not err in considering Debtors' Social Security income and monthly mortgage payment, in determining whether the totality of the circumstances of the Debtors' financial situation demonstrated abuse.

The Debtors argue that the bankruptcy court erred in considering benefits they received under the Social Security Act, noting that §101(10A) of the Bankruptcy Code defines "current monthly income" to specifically exclude any "benefits received under the Social Security Act." Based on this definition, Debtors argue that the court is therefore forbidden from considering Social Security income in determining the totality of the circumstances under § 707(b)(3)(B) . The Debtors ignore that, although § 707(b)(2) specifically refers to "current monthly income,"and thus excludes Social Security benefits, § 707(b)(3)(B) is silent as to whether courts may consider income items excluded from "current monthly income" (such as Social Security income) when determining a debtor's ability to pay under the totality of the circumstances.

The factual record below makes it clear that the court found that the Debtors have the ability to repay a substantial amount of their debts without consideration of their Social Security income. Nevertheless, it was within the bankruptcy court's discretion to consider the Debtors' income from Social Security in determining whether the Debtors' filing is abusive under § 707(b)(3)(B).

First, and as the bankruptcy court noted, in computing the means test under § 707(b)(2) and calculating disposable income for above-median chapter 13 debtors under § 1325,[7] Congress expressly excluded benefits received under the Social Security Act from "current monthly income." The enumeration of specific exclusions from the operation of a statute is an indication that the statute should apply to all cases not specifically excluded. *Blausey v. United States Trustee,* 552 F.3d 1124, 1133 (9th Cir. 2009). *A fortiori* if Congress did not want Social Security Act income considered as part of the "totality of the circumstances" in § 707(b)(3)(B), it would have expressly excluded it.

Second, there is no basis to conclude that this text: "totality of the circumstances of the debtor's financial situation," cannot include the consideration of all the income that the debtor receives. *See, e.g., In re Booker,* 399 B.R. 662, 667 (Bankr. W.D. Mo. 2009) (noting that

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[7] The Debtors argue under *In re Siegel*, No. 06-02291, 2006 WL 3483987 (Bankr. D.S.C. Nov. 20, 2006), that in a chapter 13 case they would not be required to fund a plan using Social Security income. The Debtors ignore that the default mechanism under § 707(b) is dismissal not conversion to chapter 13. 11 U.S.C. § 707(b)(1) (the court may dismiss or, with the debtor's consent, convert to chapter 11 or chapter 13). Moreover, even if the Debtors had elected to convert their case to Chapter 13, which they did not, in order to provide a return to unsecured creditors they could voluntarily fund a plan with Social Security income, *In re Siegel,* 2006 WL 3483987 at *2, or propose a plan that would not pay a dividend to unsecured creditors. *See In re Johns*, 342 B.R. 626, 629 (Bankr. E.D. Okla. 2006) (fact that debtor would propose zero-percent plan in chapter 13 is not a special circumstance in considering motion to dismiss under § 707(b)(2)(B)).

notwithstanding the definition of current monthly income, Social Security income is part of the totality of a debtor's financial circumstances). "It is well established that when the statute's language is plain, the sole function of the courts - at least where the disposition required by the text is not absurd - is to enforce it according to its terms." *Lamie v. U.S. Trustee*, 540 U.S. 526, 534 (2004) (internal quotation marks omitted). The phrase "totality of the circumstances of the debtor's financial situation" is not ambiguous, and necessarily it allows the bankruptcy court to consider income derived from Social Security.

Similarly, the Debtors contend that the amount of their mortgage payment should not be a part of the analysis under § 707(b)(3)(B) because debtors may deduct mortgage payments as an expense on the means test under § 707(b)(2), citing *In re Johnson*, 399 B.R. 72 (Bankr. S.D. Cal. 2008). This argument fails because the means test analysis under § 707(b)(2) and the totality of the circumstances analysis under § 707(b)(3)(B) are separate and distinct evaluations. Congress established the means test under § 707(b)(2) as a screen to determine whether in the first instance a case is abusive because, under the prescribed formula, a debtor is deemed able to pay unsecured creditors an amount set by Congress. However, Congress did not intend for the means test to be the end of the analysis to determine abuse. Rather, when the means test yields no presumption or the presumption is rebutted, § 707(b)(3)(B) requires a consideration of the totality of the circumstances of the debtor's financial situation, including the debtor's ability to pay unsecured creditors.

Congress directed the courts to consider all circumstances of the debtor's financial situation under a separate subsection of § 707(b), so that abuse which evaded the initial filter of the means test would be identified and such cases dismissed. *See, e.g., Ross -Tousey*, 549 F.3d at 1161-62 (where debtor's petition is not *presumed* abusive, the United States Trustee can still request dismissal based on the totality of circumstances, which includes the debtor's actual income and expenses) (emphasis in original); *In re Kaminiski*, 387 B.R. 190 (Bankr. N.D. Ohio 2008) (finding debtor's allocation of $1,856.12 for housing impermissibly high).

CONCLUSION

For the foregoing reasons, the order of the bankruptcy court should be affirmed.

W. CLARKSON MCDOW, JR.
UNITED STATES TRUSTEE
Region 4

By: s/ John Timothy Stack
John Timothy Stack
Dist. Ct. I.D. No. 4272
Trial Attorney
Office of the United States Trustee
Department of Justice
1835 Assembly Street, Suite 953
Columbia, South Carolina 29201
John.T.Stack@usdoj.gov
(803) 765-5218

Of Counsel:

Ramona D. Elliott
General Counsel

P. Matthew Sutko
Associate General Counsel

Thomas C. Kearns
Trial Attorney
Executive Office for the United States Trustee
United States Department of Justice

Joseph F. Buzhardt, III
Assistant United States Trustee
District of South Carolina

Dated: April 30, 2009

UNITED STATES DISTRICT COURT
DISTRICT OF SOUTH CAROLINA

In re:

JOHN G. CALHOUN,
GLENDA R. CALHOUN,

Debtors.
____/

JOHN G. CALHOUN,
GLENDA R. CALHOUN,

Appellants. Case No. C/A 3:09-cv-00822-CMC

vs.

W. CLARKSON MCDOW, JR.,
UNITED STATES TRUSTEE,

Appellee.
____/

CERTIFICATE OF SERVICE

I hereby certify that on April 30, 2009, I electronically filed the foregoing document with the Clerk of the Court using the ECF system which will send notification of such filing to the following: Joseph E. Mitchell, III, Esquire; and I hereby certify that I have mailed by United States Postal Service the document to the following, including, any non-ECF participants: Joseph E. Mitchell, III, Esquire, P. O. Box 2504, Augusta, GA 30903.

W. CLARKSON MCDOW, JR.
UNITED STATES TRUSTEE
Region 4

By: s/ John Timothy Stack
John Timothy Stack
Dist. Ct. I.D. No. 4272
Trial Attorney
Office of the United States Trustee
Department of Justice
1835 Assembly Street, Suite 953
Columbia, South Carolina 29201
John.T.Stack@usdoj.gov

(803) 765-5218

Dated: April 30, 2009

BRIEF BANK — "SUMMARY SHEET" *Printed Wed-12/23/09 15:50*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	In re John and Glenda Calhoun (John G. Calhoun and Glenda R. Calhoun v. W. Clarkson McDow, Jr., United States Trustee)
2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	4th Cir.
3. ("CCN") ***CURRENT*** CASE NO.	No.: 09-1646
4. ("PCN") ***PRIOR*** CASE NO. - & COURT *[IF ANY]*	No.: 3:09-cv-00822-CMC Court: D. S.C. *(Identify judge & cite, if any)*
5. ("SO") ***SOURCE***	**U.S. TRUSTEES**
6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	Filed: December 16, 2009 Type: Brief for Appellee United States Trustee
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8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") ● ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	● Whether the bankruptcy court abused its discretion in finding abuse under section 707(b)(3)(B)'s "totality of the financial situation" inquiry.
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NO. 09-1646

IN THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

In re JOHN AND GLENDA CALHOUN,
Debtors.

JOHN G. CALHOUN
GLENDA R. CALHOUN

Debtors-Appellants,
v.
W. CLARKSON McDOW, JR.,

United States Trustee-Appellee.

ON APPEAL FROM
THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF SOUTH CAROLINA

BRIEF FOR APPELLEE UNITED STATES TRUSTEE

W. CLARKSON MCDOW, JR.
United States Trustee
United States Department of Justice
1835 Assembly Street, Suite 953
Columbia, SC 29201

RAMONA D. ELLIOTT
General Counsel

P. MATTHEW SUTKO
Associate General Counsel

CATHERINE B. SEVCENKO
Trial Attorney

United States Trustee Program
Department of Justice
20 Massachusetts Avenue, N.W.
Washington D.C. 20530
Telephone: (202) 307-1399
Fax: (202) 307-2397

STATEMENT CONCERNING ORAL ARGUMENT

The United States Trustee respectfully requests that this Court hold oral argument in this matter.

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ISSUE PRESENTED

Under 11 U.S.C. § 707(b)(3)(B) may a debtor's chapter 7 bankruptcy case be dismissed, or converted to chapter 13, if the bankruptcy court, after considering the circumstances of the debtor's financial situation, determines that the debtor, although not acting in bad faith, has the ability to pay back a portion of debts owed to his or her creditors?

STATEMENT OF THE CASE

This is an appeal from a bankruptcy court order, affirmed by the district court, which held two debtors, John and Glenda Calhoun, have sufficient income to repay their creditors and thus are ineligible for a discharge of their debts under chapter 7 of the Bankruptcy Code. The parties dispute whether that issue should be decided under the test mandated by this Court's 1991 decision, *Green v. Staples (In re Green)*, 934 F.2d 568 (4th Cir. 1991) (Addendum). That case established the test for dismissal pursuant to a repealed version of 11 U.S.C. § 707(b) of the Bankruptcy Code, under a now-superseded "substantial abuse" standard. The massive changes made to the Bankruptcy Code in 2005 by the Bankruptcy Abuse Prevention and Consumer Protection Act ("2005 Act") cast the relevance of *Green* to post-2005 cases. This case will allow this Court to clarify what the new factors should be for determining whether a chapter 7 case should be dismissed under the new "financial" abuse standard of the current section 707(b)(3)(B).

A. Statutory Framework

1. Relief Available to Individual Debtors

The Bankruptcy Code establishes two primary forms of relief for individual debtors – chapter 7 and chapter 13. Under chapter 7, a debtor receives "an immediate unconditional discharge of personal liability" for consumer debts. In exchange, a bankruptcy trustee liquidates the debtor's non-exempt assets, if any, and distributes the proceeds to creditors. H.R. Rep. 109-31 (2005) at 10, *reprinted in* 2005 U.S.C.C.A.N. 88, 92; (Addendum); *see* 11 U.S.C. §§ 701-727. Under chapter 13, in contrast, "a debtor commits to repay some portion of his or her financial obligations" over a period of no more than five years. Under this scenario, the debtor retains non-exempt assets and, after completing the repayment plan, receives a discharge. H.R. Rep. 109-31 at 10; *see* 11 U.S.C. §§ 1321-1330.

The difference between chapter 7 and 13 is dramatic. In chapter 7 cases, creditors may look solely to a debtor's pre-bankruptcy, non-exempt assets for payment. *See* 11 U.S.C. § 541 (limiting property of the estate to a debtor's pre-petition assets). A chapter 7 debtor's post-bankruptcy income is not subject to creditor claims. *Id.* Subject to narrow exceptions, debtors receive a complete discharge of all their pre-petition debts in a chapter 7 case. *See* 11 U.S.C. § 727(b).

Chapter 13 is different because debtors must use post-petition income to fund a chapter 13 payment plan. *See* 11 U.S.C. § 1306(a)(2) (property of the bankruptcy estate includes post-petition income); 11 U.S.C. § 1325(b) (projected disposable income applied to make payments to unsecured creditors). In chapter 13, debtors typically receive a discharge only after they have fully completed their chapter 13 repayment plans. *See* 11 U.S.C. §§ 1328(a) and (c); *see also* 11 U.S.C. § 1328(b) (listing exceptions to this rule).

In 2005, Congress enacted a major revision of the Bankruptcy Code, known as the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005. Pub. L. 109-8, 119 Stat. 27 (Apr. 20, 2005) ("the 2005 Act").

2. Former Section 707(b): Dismissal of Chapter 7 Cases for Substantial Abuse

Beginning in 1984, Congress enacted a series of tests that have allowed courts to dismiss chapter 7 cases, and thereby prevent unjust discharge of pre-petition debts. In 1984, Congress amended chapter 7 to permit dismissal of a chapter 7 bankruptcy petition under Section 707(b) if a court found "substantial abuse." Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, § 312, 98 Stat. 333, 335. Congress enacted this amendment to respond "to concerns that some debtors who could easily pay their creditors might resort to chapter 7 to avoid their obligations." H.R. Rep. 109-31 at 12 (internal quotation omitted). Two years later, Congress again amended this provision to authorize United States Trustees to seek dismissal of chapter 7 petitions for "substantial abuse." Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1986, Pub. L. No. 99-554, § 21, 100 Stat. 3088, 3101.

After twenty-years of experience, Congress found that these amendments were insufficient to control abuse of chapter 7. Congress identified, among other problems, the "inherent[] vague[ness]" of the "substantial abuse" standard. The courts disagreed whether a debtor's ability to repay a significant portion of his or her debts out of future income, by itself, constituted substantial abuse, meriting dismissal. H.R. Rep. 109-31 at 12. Another problem was that the Bankruptcy Code established "a presumption in favor of granting the relief requested by the debtor," which influenced courts' decisions on whether to find substantial abuse. 11 U.S.C. § 707(b) (2000 suppl. 4); *see* H.R. Rep. 109-31; *Green*, 934 F.2d at 572.

Responding to these perceived shortcomings of the Bankruptcy Code, Congress held hearings over five years to identify what reforms it could adopt "to ensure that debtors repay creditors the maximum they can afford." H.R. Rep. 109-31 at 2, 12.

3. Changes Under the 2005 Act

The 2005 Act implemented four important reforms (*see* Addendum comparing statutes):

First, Congress repealed the statutory presumption in favor of granting relief to the debtor. *Compare* 11 U.S.C. § 707(b) (1986) *with* 11 U.S.C. § 707(b) (2005).

Second, Congress lowered the standard for dismissal under all subsections of new section 707(b) from "substantial abuse" to "abuse." 11 U.S.C. § 707(b)(1)-(3) (cases are now dismissed for abuse).

Third, Congress authorized dismissal when a mathematical formula, known as the "means test," yields monthly disposable income that exceeds a statutory threshold. 11 U.S.C. § 707(b)(2). The means test enacted pursuant to the 2005 Act provides specific criteria which, if satisfied, require a court to presume the existence of abuse, and if the presumption is not rebutted, requiring "dismissal [or conversion to chapter 13] based on a chapter 7 debtors' ability to repay." H.R. Rep. 109-31 at 15.

To determine if abuse exists under the means test, a court first compares the debtors' annualized "current monthly income" to the "median family income" of a similarly-sized family in the debtor's home state. 11 U.S.C. § 101(10A). If the debtors' current monthly income is below the median, then the presumption of abuse does not arise. 11 U.S.C. § 707(b)(7); H.R. Rep. 109-31 at 15. When a debtors' current monthly income is above the median after subtracting allowed expenses, and his or her monthly disposable income meets or exceeds the statutory threshold amount, the presumption is triggered. Then the debtors' case must be dismissed as abusive (or converted to chapter 13, if the debtor consents), absent an express showing of special circumstances by the debtor. 11 U.S.C. § 707(b)(1) and (2).

Fourth, Congress enacted new section 707(b)(3). This section allows courts to dismiss cases based upon either a debtor's bad faith, 11 U.S.C. § 707(b)(3)(A), or the totality of a debtor's financial circumstances, 11 U.S.C. § 707(b)(3)(B). Thus, even if the presumption of abuse does not arise, or is rebutted under section 707(b)(2), a chapter 7 petition should be dismissed for abuse under section 707(b)(3) when there is either bad faith or "the totality of the circumstances . . . of the debtor's financial situation demonstrates abuse." 11 U.S.C. § 707(b)(3)(B); *In re Ross-Tousey*, 549 F.3d 1148, 1161-62 (7th Cir. 2008).

Sections 707(b)(3)(A) and (B) of the 2005 Act represent a significant departure from old section 707(b) because they clarify that cases can be dismissed either solely for misconduct, under subsection 707(b)(3)(A), or solely based upon the totality of the circumstances of a debtor's financial situation, under section 707(b)(3)(B).

STATEMENT OF THE FACTS

The debtors, John and Glenda Calhoun, are a married couple, aged 64 and 57. JA at 113. Mr. Calhoun was the Chief Financial Officer of University Hospital in Augusta, Georgia until he retired in 1997. JA at 113, 202. He now volunteers at his local credit union. Mrs. Calhoun is not employed. JA at 113.

The Calhouns live in a 3,300 square foot home, with four bedrooms, three full baths, and a home office on three and a half acres of land, at 208 Tennis Ranch Rd. in Jackson, South Carolina. JA at 113-14. After their children left home, they tried briefly to sell the house and then decided to remodel instead to enable them to live there as they grew older. JA at 99, 197. They had counted on using the income from a retirement investment fund to pay for the renovations, but the stocks in the fund lost much of their value. JA at 208. Therefore, to finance the remodeling, they withdrew retirement funds and increased their mortgage. JA at 99.

The Calhouns' self-described "belt-tightening" measures included not maintaining their tennis court, which had been unused since 1997, when their son was on his high school tennis team. JA at 100, 204. They also stopped using their pool, and ultimately filled it in. JA at 99, 204-05.

The Calhouns' annual household income, $105,264, is 226 percent of the median income of $46,521 for a household of two in South Carolina. JA at 87, 120. Mr. Calhoun, who no longer works, receives monthly retirement income totaling $7,313, or $87,765 annually. Mr. Calhoun also receives a monthly social security benefit of $1,459. JA at 85, 113. Mrs. Calhoun has no independent source of income. JA at 198.

The Calhouns currently have monthly mortgage payments totaling $2,151. JA at 99. In September 2008, they owed $206,800 and $92,000 on their mortgages. JA at 114. The Calhouns' monthly mortgage payment amount is almost 300 percent of the applicable maximum IRS housing standard of $750 for a family of two residing in that area. JA at 128. The Calhouns spend $930 per month for food. JA at 46. They spend $439 per month on two life insurance policies which insure Mr. Calhoun's life for $800,000, although Mrs. Calhoun will receive 75 percent of Mr. Calhoun's pension, should he predecease her. JA at 46, 191-92, 221-22. They also pay $111 per month for cable television, $69 per month on internet, and $350 for transportation. JA at 46-47.

In the 22 months before the Calhouns filed their chapter 7 petition, from April 2006 to February 2008, they paid their unsecured creditors $2,638 per month through ClearPoint Credit Counseling Services. JA at 122. Even though they were paying their creditors $2,638 every month, the Calhouns remained current on their other expenses, including their mortgage and car payments, and utilities. They also were able to maintain their lifestyle on their 3.5 acre property. *Id.*

On February 27, 2008, Mr. Calhoun and his wife filed a voluntary chapter 7 bankruptcy petition, seeking to discharge $106,707 in unsecured debt. JA at 29-31. They did so based on Mr. Calhoun's internet research that they could pass the means test under § 707(b)(2) necessary for discharge. JA at 122. As Mr. Calhoun testified:

> A: Well, at that time, I, I went on the website, and national site for bankruptcy, and I said maybe there's relief for us. . . . I looked at what a Chapter 7 bankruptcy was. I saw the means test that was in there. I went through that process of calculating based on what's on the website. When I reached the bottom I said yes, we have the possibility of qualifying.

JA at 234-35.

On May 23, 2008, the United States Trustee filed a motion to dismiss the Calhouns' petition under 11 U.S.C. §§ 707(b)(1) and (b)(3)(B). JA at 84-87. The Calhouns themselves estimated on their Schedules I and J that they had monthly disposable income of $133, excluding social security income. JA at 46, 86. The United States Trustee alleged that with some modest belt-tightening the Calhouns would have considerably more disposable income to repay creditors than reflected on their Schedule J. JA at 86.

On November 12, 2008, the United States Bankruptcy Court for the District of South Carolina entered an order dismissing the Calhouns' bankruptcy case. *In re Calhoun*, 396 B.R. at 270, 277 (Bankr. D.S.C. 2008); JA at 118-129. It found the totality of the Calhouns' financial circumstances justified dismissal under 11 U.S.C. § 707(b)(3)(B). JA at 125. In doing so, the bankruptcy court held that "while the totality of the debtor's financial circumstances must be examined, the ability to pay a significant dividend to creditors and the failure to do so standing alone can be an abuse of chapter 7, absent mitigating factors." *Calhoun*, 396 B.R. at 276; JA at 125. Considering the Calhouns' schedules, the bankruptcy court found that they could pay their creditors significantly more each month than the $133 in disposable monthly income they claimed to have. *Id.* The court further found that the Calhouns were subtracting income from social security, "shielding it from creditors." *Calhoun*, 396 B.R. at 276; JA at 125-26. The court ruled the Calhouns' financial situation demonstrated they can repay a substantial portion of their debts, as demonstrated by the fact that they had been able to pay creditors $2,638 per month for the 22 months before filing bankruptcy. *Id.* at 276; JA at 128. These factors, two life insurance policies, and an excessive budget, led the bankruptcy court to order dismissal. *Id.* at 277; JA at 127-29.

The bankruptcy court gave the Calhouns the option to convert their case to chapter 13. 11 U.S.C. § 707(b)(1); JA at 129. Had they converted, they could have received a discharge of their unsecured debts after five years by paying their disposable income in monthly installments to their creditors. 11 U.S.C. §§ 1321 - 1330. The Calhouns declined to convert to chapter 13, electing first to seek reconsideration, JA at 130-34, and then to appeal the bankruptcy court's decision. JA at 151.

The United States District Court for the District of South Carolina affirmed the dismissal of the Calhouns' chapter 7 case. *In re Calhoun*, No. 3:09-822, slip op. at 1 (D.S.C. filed May 26, 2009); JA at 394-409. It rejected the Calhouns' argument that the means test is the only method to determine a debtor's ability to pay, thereby precluding a second consideration of ability to pay under section 707(b)(3)(B)'s "totality of financial situation" standard. *Id.* at 8; JA at 401;

accord Ross-Tousey, 549 F.3d at 1161-62. After reviewing the facts of the Calhouns' case, it held that the bankruptcy court did not err in finding that the Calhouns' expenses were excessive and "border[ed] on the extravagant." *Id.* at 14-15; JA at 407-08.

This appeal followed.

STANDARD OF REVIEW

When a district court has acted in its capacity as a bankruptcy appellate court, this Court reviews the bankruptcy court's decision independently. *Banks v. Sallie Mae Servicing Corp. (In re Banks)*, 299 F.3d 296, 300 (4th Cir. 2002). This Court reviews the bankruptcy court's factual findings for clear error and its legal conclusions *de novo*. *See Kielisch v. Educ. Credit Mgmt. Corp. (In re Kielisch)*, 258 F.3d 315, 319 (4th Cir. 2001).

In determining whether providing chapter 7 relief to a debtor would constitute abuse under 11 U.S.C. § 707(b)(3), bankruptcy courts apply a "totality of the circumstances" test to the debtor's financial situation. *See* 11 U.S.C. § 707(b)(3)(B). The "totality of the circumstances" test is a "fact-intensive determination" which is reviewed on appeal for abuse of discretion. *Cf. Hebbring v. U.S. Trustee*, 463 F.3d 902, 907-08 (9th Cir. 2006) (pre-2005 Act case).

SUMMARY OF THE ARGUMENT

The bankruptcy court's order dismissing the Calhouns' chapter 7 petition, which also gave them the opportunity to convert their case to chapter 13, should be affirmed. The bankruptcy court did not abuse its discretion in finding abuse under section 707(b)(3)(B)'s "totality of the financial situation" inquiry.

There are three reasons for affirming the bankruptcy court's dismissal. First, the bankruptcy court properly applied the statutory framework of new section 707(b)(3)(B) when it found that the totality of the circumstances of the Calhouns' financial situation demonstrated abuse. The court considered all circumstances pertinent to their financial situation and correctly concluded that they have the financial ability to repay a portion of their unsecured debts. The Calhouns' challenges to the bankruptcy court's dismissal are premised upon an incorrect understanding of these new statutory provisions and case law.

Second, the bankruptcy court did not need to analyze any of the non-financial factors listed in this Court's 1991 decision *Green v. Staples (In re Green)*, 934 F.2d 568, 570 (4th Cir.1991). *Green* was superseded by statute with the enactment of the 2005 Act. Under the 2005 amendment, non-financial facts are now relevant to section 707(b)(3)(A) bad faith cases, rather than section 707(b)(3)(B) "financial circumstances" cases.

Finally, the bankruptcy court did not abuse its discretion by including Mr. Calhoun's social security income in its analysis of the totality of his financial circumstances, even though that income would not be included in determining whether there was a presumption of abuse under section 707(b)(2) or what the Calhouns could pay under a chapter 13 plan.

ARGUMENT

I. Under the New Section 707(b)(3)(B), the Bankruptcy Court Did Not Abuse Its Discretion in Applying the "Totality of the Financial Situation" to Dismiss Calhouns' Chapter 7 Petition.

The issue in this appeal is whether, under the 2005 Act, a court may dismiss a case under section 707(b)(3)(B) when a debtor has an ability to pay a portion of his or her debts. The better interpretation of the statute suggests that result. Because the Calhouns can pay back their creditors, the orders entered below should be affirmed.

A. Analysis of a Debtor's "Financial Situation" under the 2005 Act is Limited to Consideration of Financial Factors.

1. <u>The Plain Meaning of the Section 707(b)(3) Shows congressional intent to allow dismissal on financial grounds</u>

Under the revised language of section 707(b)(3)(B), a court deciding whether to dismiss a chapter 7 case must consider whether "the totality of the circumstances (including whether the debtor seeks to reject a personal services contract and the financial need for such rejection as sought by the debtor) of the debtor's financial situation demonstrates abuse." 11 U.S.C. § 707(b)(3)(B). By inserting the phrase "financial circumstances" in the 2005 Act, Congress signaled a departure from, and narrowing of, the old totality of the circumstances test. *See Connecticut Nat'l Bank v. Germain*, 503 U.S. 249, 253 (1992) (stating that the interpretation of a statute should not render any word superfluous).

Two changes in the statutory language are particularly significant. First, the presumption against a finding of abuse is gone. *Compare* 11 U.S.C. § 707(b) (1986) *with* 11 U.S.C. § 707(b) (2005) (Addendum); *In re Wolf*, 390 B.R. 825, 831-32 (Bankr. D.S.C. 2008). The standard has been lowered from "substantial abuse" to "abuse." 11 U.S.C. § 707(b)(1)-(3). Accordingly, the best reading of section 707(b)(3)(B) is: if the debtor's financial circumstances demonstrate ability to pay a meaningful portion of his debts to his creditors, that fact should lead a court to dismiss a chapter 7 case for abuse.

Congress did not define the new term "financial situation." Therefore, this Court should give it its ordinary meaning. *Asgrow Seed Co. v. Winterboer*, 513 U.S. 179, 187 (1995) (citations omitted). Both the ordinary meaning and the case law interpretation of "financial situation" demonstrate that a bankruptcy court should dismiss a chapter 7 case when the financial factors of a debtor's income, expenses, assets, and liabilities so warrant.

As a starting point, a debtor's "financial situation" consists of the debtor's reasonable income and expenses. *Ross-Tousey*, 549 F.3d at 1162 (court may consider actual income and expenses); *In re Mestemaker*, 359 B.R. 849, 854-55 (Bankr. N.D. Ohio 2007). Within this inquiry, however, a court must determine and balance "multiple factors," constrained only to the extent that those factors must be economic. *In re Wolf*, 390 B.R. 825, 832 (Bankr. D.S.C. 2008); *In re Haar*, 373 B.R. 493, 500 (N.D. Ohio 2007).

Furthermore, the limitation to considering financial factors does not deprive bankruptcy courts of their discretion to weigh other financial factors. *Morse v. Rudler (In re Rudler)*, 576 F.3d 37, 51 (1st Cir. 2009) (describing section 707(b)(3)(B) as a totality of the circumstances inquiry that "remains a backup option when the Trustee is dissatisfied by the results of the means test.").

The "financial situation" factors that a bankruptcy court may consider include: the debtor's assets, liabilities, expenses, and expected future income, and whether any of the debtor's obligations are secured by unnecessary luxury goods. In short, financial factors that are relevant to the determination of the debtor's ability to pay creditors should fall under the bankruptcy's scrutiny. *Wolf*, 390 B.R. at 833 (Bankr. D.S.C. 2008) ("The plain meaning of "financial situation" must necessarily include the debtor's ability to pay creditors."); *Haar*, 373 B.R. at 500.

The intent behind the enactment of the statute bolsters this reading. The 2005 amendments were designed to "respond to many of the factors contributing to the increase in consumer bankruptcy filings, such as lack of personal financial accountability, the proliferation of serial filings, and the absence of effective oversight to eliminate abuse in the system." *Perlin v. Hitachi Capital Am. Corp.*, 497 F.3d 364, 371 (3d Cir. 2007) (quoting H.R. Rep. No. 109-31 at 2). By specifying "financial circumstances," Congress underscored its concern that chapter 7 be reserved for debtors who truly could not repay their creditors by amending the statute. *United States v. Am. Trucking Ass'ns*, 310 U.S. 534, 543 (1940) (stating that the words of a statute are the best indication of its purpose). This is borne out by the legislative history that expressed that debtors "will be channeled into chapter 13 of the Bankruptcy Code which requires people to repay a portion of their debt." 151 Cong. Rec. S 1856 (Mar. 1, 2005) (statement of Sen. Charles Grassley).

The bankruptcy court here did not ignore any financial factors in its analysis. It carefully considered the Calhouns income, expenditures, stability of income, need for life insurance, as well as money spent on items such as dry-cleaning, cable, and internet. Calhoun, 396 B.R. at 277; JA at 127-28. Rather, it simply balanced the Calhouns' financial factors in a way that they do not like.

2. <u>11 U.S.C. § 707(b)(3) now contains two independent analyses – one for bad faith and the other for the totality of the debtor's financial situation</u>.

Section 707(b)(3) allows a bankruptcy court to dismiss a case if either the totality of the debtor's financial circumstances or the debtor's bad faith so indicate. Congress limited analysis under section 707(b)(3)(B) to "financial" conditions. That modifier necessarily precludes courts from considering non-economic factors, such as debtor conduct, as part of the section 707(b)(3)(B) analysis.

The text of the new section 707 makes this plain. As the statute indicates, issues, such as whether the petition was filed accurately or in good faith, are addressed under section 707(b)(3)(A). In fact, the two analyses should be kept separate to avoid "collapsing the two separate justifications into one." *In re Booker*, 399 B.R. 662, 667 (Bankr. W.D. Mo. 2009).

This reading of the current statute is not necessarily a radical departure from pre-2005 Act "totality of the circumstances" analysis. Under the previous version of section 707(b), some courts evaluated whether "substantial" abuse existed by considering simultaneously both the debtor's conduct and the debtor's ability to pay his debts outside bankruptcy or through a chapter 13 repayment plan. *See, e.g., In re Stewart*, 175 F.3d 796 (10th Cir. 1999). Others took a different approach. The Sixth Circuit, for example, did not mandate both "bad faith" and "ability to repay" findings to support dismissal. Rather, the Sixth Circuit held that "substantial abuse can be predicated upon <u>either</u> lack of honesty or want <u>of</u> need." *In re Krohn*, 886 F.2d 123, 126 (6th Cir. 1989) (emphasis added). It also held in 2004 that bankruptcy courts could dismiss under superceded section 707(b) without making bad faith findings. *In re Behlke*, 358 F.3d 429, 435 (6th Cir. 2004) (affirming dismissal because "[t]he bankruptcy court committed no legal error in finding substantial abuse absent a finding of 'dishonesty'").

Congress codified the *Behlke* approach by disentangling bad faith cases from ability to repay cases. The Seventh Circuit recognized this distinction when it stated that the United States Trustee could seek dismissal under new section 707(b)(3) either for bad faith or under totality of the debtor's financial circumstances. *Ross-Tousey*, 549 F.3d at 1162.

Thus under the 2005 Act, if a debtor has an ability to repay and also engages in misconduct, then a bankruptcy court has two separate and independent grounds upon which to base an order granting a motion to dismiss – sections 707(b)(3)(A) and (B). However, if a debtor has an ability to repay, considering the entire financial situation, a portion of his debt, then dismissal is permissible, regardless of intent: "Thus the debtor's total financial situation as a measure of ability to pay, and bad faith are separate and sufficient grounds for dismissal." *In re Henebury*, 361 B.R. 595, 607 (Bankr. S.D. Fla. 2007); *see also Reed v. Anderson (In re Reed)*, No. 07-04357, slip op. at 24-25 (C.D. Cal. Nov. 24, 2009) (Addendum).

Accordingly, the bankruptcy court did not abuse its discretion when it determined that the Calhouns' financial factors, primarily their ample income and overly-generous budget, dictated that a chapter 7 discharge would be an abuse under section 707(b)(3)(B)..

II. The Holding and Rationale of *Green v. Staples* is Superseded by the 2005 Act.

Before 2005, old section 707(b) cases were reviewed under a combination of financial and non-financial factors. *Green*, 934 F.2d at 572. Now Congress has bifurcated these, so section 707(b)(3)(B) cases are reviewed based solely upon financial factors. Thus, a one court has held "nothing in the structure of the 'totality of the circumstances' test of § 707(b)(3) suggests that a debtor's ability to repay an obligation must, as a prerequisite for dismissal, be coupled with other [non-financial] factors." *In re Haar*, 373 B.R. at 499-500. Other courts have followed this logic. *In re Hoffman*, 413 B.R. 191, 195 (M.D. Pa. 2008) ("[T]he specific statutory provisions of § 707(b)(3) . . . provide that bad faith and the totality of the circumstances are separate, distinct bases for a finding of abuse."); *Wolf*, 390 B.R. at 832 ("Nevertheless, abuse is found, if at all, based on either bad faith or the totality of the circumstances.").

In *Green v. Staples (In re Green)*, this Court established the test in this Circuit to determine if a chapter 7 filing should be dismissed under the previous standard of "substantial abuse." This Court read the now-superseded language of the Bankruptcy Code to foreclose a finding of substantial abuse based solely on an ability to pay creditors. *Green*, 934 F.2d at 572. In doing so, this Court noted that substantial abuse "occurs under Section 707(b) when a debtor attempts to use the provisions of the Code to get a 'head start' rather than a 'fresh start.'" *Id.* at 570. In the 15 years since *Green* was decided, Congress has made the qualifications for obtaining that "fresh start" more demanding, requiring a reassessment of the *Green* decision.

As demonstrated above, having ability to pay may result in dismissal or conversion of a chapter 7 petition under new section 707(b)(3)(B) of the 2005 Act. Indeed, the lower courts in this case recognized that the *Green* rule requiring more than ability to pay for dismissal under new section 707(b)(3) is no longer viable. The bankruptcy court concluded that the new language of the 2005 Act 1) reducing the standard from "substantive abuse" to "abuse" and 2) removing the presumption in favor of the debtor, superseded the rule in *Green* that ability to pay, standing alone, was an insufficient basis for dismissing a chapter 7 case. *Calhoun*, 396 B.R. at 274-75; JA at 123-124. The district court agreed that the 2005 Act "likely undercut the holding in *Green*." Slip op. at 10; JA at 403; *see also In re Smith*, No. 09-691, 2009 WL 4262842, at *4, n.5 (Bankr. N.D. W.Va. Nov. 23, 2009) (" By citing to *Green* in this Memorandum Opinion, the court is not stating that *Green* continues to be good law following the changes to § 707.").

The *Green* decision also is no longer relevant because its conclusion that ability to pay alone cannot compel dismissal of a chapter 7 on the then-existing "statutory presumption that a debtor's Chapter 7 petition should be granted." *Green*, 934 F.2d at 572. The 2005 Act repealed that presumption and thus the statutory underpinnings for the *Green* decision. *Wolf*, 390 B.R. at 831-32.

The Calhouns' argument that ability to repay debts cannot be the sole basis for dismissal under section 707(b)(3) has no basis in the current statutory text. "[N]othing in the structure of the 'totality of circumstances' test of § 707(b)(3) suggests that a debtor's ability to repay an obligation must, as a prerequisite for dismissal, be coupled with other factors." *Haar*, 373 B.R. at 499-500. They mistakenly seek to read into § 707(b)(3)(B) a requirement that no longer exists. *Id.*

Furthermore, even before the 2005 reforms, some circuits determined that ability to pay standing alone can justify dismissal. "A court would not be justified in granting discharge if income allows distribution of consumer debts with relative ease." *In re Krohn*, 886 F.2d 123, 126 (6th Cir. 1989); *In re Lamanna*, 153 F.3d 1 (1st Cir. 1998) (ability to pay alone sufficient). The distinction among these cases was not whether ability to pay would be taken into consideration, but instead what weight it would be given.

The post-2005 *Green* factors that implicate bad faith are no longer relevant to determining whether the debtor has an ability to pay under § 707(b)(3)(B).[1] *See*

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[1] *In re Green* held that in addition to a debtor's ability to pay, courts were required to consider five additional factors: 1) whether the bankruptcy petition was filed because of sudden illness, calamity, disability or unemployment; 2) whether the debtor incurred cash advances and made consumer purchases far in excess of his ability to repay; 3) whether the debtor's proposed family budget is excessive or unreasonable; 4) whether the debtor's schedules and statement of current income and expenses reasonably and accurately reflect the true financial condition; and 5)

Henebury, 361 B.R. at 607 (stating that bad faith and financial circumstances are two independent grounds for dismissal of a chapter 7 case). Rather, the totality of the debtor's financial circumstances must govern this determination. 11 U.S.C. § 707(b)(3)(B).

Given that each debtor has unique circumstances, this must be a case-by-case analysis that assesses all factors related to the debtor's financial condition. Furthermore, "totality" is a broad term, suggesting that a court should consider not only income or expenditures but the long-term effect those payments and credits will have on the debtor's entire financial situation.

For example, a debtor who loses his $30,000 a year job will face a drastic decline in income, which almost certainly would foreclose an ability to pay debts under a totality of the circumstances analysis. However, if that same debtor wins $1,000,000 in the lottery the day after becoming unemployed, then the job loss would be meaningless. That debtor, although he is not working, can pay his debts and thus his chapter 7 case should be dismissed under section 707(b)(3)(B).

The same analysis applies to accidents or illness. If a debtor is diagnosed with cancer and faces debilitating treatment that will increase his expenses

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whether the petition was filed in good faith. *Green*, 934 F.2d at 572. Of these factors, only the first – sudden calamity – arguably relates to the totality of the financial circumstances. The rest are primarily, or completely, related to bad faith, which is covered under Section 707(b)(3)(A).

dramatically and prevent him from working, then discharge under chapter 7 is appropriate. If however, the debtor must miss work for a broken ankle that insurance covers, resulting in a temporary loss of income and minimum medical costs, then the totality of the financial circumstances would not necessarily warrant discharge, even in light of the temporary and modest loss of wages.

Similarly, a medical resident debtor finishing a contract for $30,000 a year might well not meet the totality of the financial circumstances test if the evidence showed that this debtor rejected employment as a physician for $150,000 annually.

Thus, under section 707(b)(3)(B), the relevant inquiry is whether past or upcoming events will affect the debtor's financial circumstances. *See Calhoun*, 396 B.R. at 276; JA at 125 (mentioning the importance of mitigating factors). That will be the case when the event will cause income or expenses to change, or assets or liabilities to be modified. When an event will not change income, expenses, assets or liabilities, it will not affect the debtor's financial situation and is not relevant to the section 707(b)(3)(B) analysis.

In sum, the *Green* factors should be bifurcated and those pertinent to analysis to a debtor's financial situation applied on a case-by-case basis under section 707(b)(3)(B). In this case, based on the Calhouns' financial factors, the bankruptcy court did not abuse its discretion in granting the United States

Trustee's section 707(b)(3)(B) motion. Neither their income – Mr. Calhoun's retirement and social security – nor their expenses will change significantly in the next five years. *Calhoun*, 396 B.R. at 277; JA at 128. Accordingly, the Calhouns did not present evidence of any factors that would indicate that their financial circumstances would prevent them from paying back a meaningful portion of their debts. Indeed, the Calhouns did not present evidence of any factors that would indicate that their financial circumstances would prevent them from paying back their debts. The bankruptcy court did not err to the extent it assessed the totality of the Calhouns' financial circumstances, including their $105,000 annual income and a generous family budget, to determine that they were not eligible for a chapter 7 discharge.

III. The Totality of the Calhouns' Financial Circumstances Supports Dismissal of Their Case.

A. The Bankruptcy Court Did Not Err in Determining That the Calhouns Are Able to Repay Their Creditors.

The bankruptcy court did not commit clear error in finding that granting the Calhouns' chapter 7 discharge would be an abuse based on their total financial circumstances. The following financial circumstances demonstrate that the Calhouns have money they could use to repay their creditors:

- The Calhouns were able to pay their creditors $2,638 per month before filing bankruptcy and their financial circumstances have not changed; JA at 126, 128

- The Calhouns enjoy an annual income of $105,264, and that is more than twice the median income for a household of two in South Carolina; JA at 114, 120, 127

- The Calhouns spend $439 per month for two life insurance policies. Cancelling one would provide funds for the Calhouns' creditors without undermining Mrs. Calhoun's financial situation as she will receive 75 percent of her husband's pension should he pre-decease her; JA at 127

- The Calhouns' housing costs, including upkeep for a four-bedroom home, and maintaining a John Deere tractor to handle the lawn-mowing; JA at 128; *In re Hoffman*, 413 B.R. 191, 196-97 (M.D. Pa. 2008) (citing cases for the proposition that housing costs two to three times the IRS allowances demonstrate abuse).[2]

The Calhouns listed 11 sources of credit on their Schedule F, with a total consumer indebtedness of $106,707. JA at 40-42. Mr. Calhoun blamed his financial problems on the "Universal Default" clause which allowed the credit card companies to increase interest rates on the five credit cards he and his wife used. JA at 208-210; JA at 121; 233 (testimony by Mr. Calhoun that interest rate increases on his credit card bills increased to a point that he "just couldn't pay them anymore"). Nor did the bankruptcy court commit clear error in finding that

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[2] The Calhouns are incorrect that a bankruptcy court may not consider housing costs. Calhoun Br. at 13. Consideration of propriety of housing expenses should include family size, cost of alternative housing, and "traditional ties to the homestead." *In re Crink*, 402 B.R. 159, 171 (M.D.N.C. 2009); *Shaw v. United States Bankr. Adm'r (In re Shaw)*, 310 B.R. 538, 541 (M.D.N.C. 2004) (high mortgage payment indicates inflated budget).

the Calhouns could make payments to their creditors. They stopped using credit cards in March 2006 and were able to pay $2,638 a month – a large sum of money – to their creditors for 22 months preceding filing their chapter 7 petition. JA at 121-22. Mr. Calhoun, a former CFO, has a sophisticated knowledge of business and must have understood the risks to obtaining multiple lines of credit.

The Calhouns argue that the loss of their retirement account should entitle them to chapter 7 relief because it was a financial calamity. Calhoun Br. at 12; *see Green*, 934 F.2d at 572. Mr. Calhoun testified that when he retired as Chief Financial Officer of the University Hospital in Augusta, he had a $154,000 retirement account that he converted into an IRA. JA. at 202. He managed the stock investments in the account until they reached a value of slightly less than $500,000 and then he began to lose money. JA at 203. Mr. Calhoun did not remove his money for one and a half to two years because, by his own admission, he was "overconfident" in his investing skills. *Id.*

The loss of the retirement account, although a financial set-back, does not change the Calhouns' financial situation. Fortunately, despite it, they can live well and still make large repayments to creditors. In any event, this loss is not a "calamity." As a comparison, even relocation across the country and purchase of a new home based on a promised job that does not materialize is not a "calamity."

In re Myers, No. 08-11744, 2009 WL 1456921, at *5 (Bankr. M.D.N.C. May 22, 2009). The Calhouns' situation is less dire. At the time that Mr. Calhoun lost his retirement fund, some of which was used to finance the $130,000 expended for house renovations, he and his wife still had a house with 3.5 acres of land, his retirement salary, and his social security benefits. JA at 99.

The bankruptcy court was correct not to deem the loss of the retirement account in light of the other relevant financial circumstances including the Calhouns' available disposable income, as a financial circumstance that would warrant a chapter 7 discharge. *See* JA at 127. The issue here is credit card interest that Mr. Calhoun feels he should not have to pay back, and the Calhouns' reluctance to impose a frugal budget upon themselves. JA at 240, 127-28. Although repaying debts rates can be burdensome, they are not calamitous, especially when the debt is accrued over several years.

IV. The Calhouns' Legal Arguments are Unavailing

A. The Section 707(b)(2) "Means Test" Is Irrelevant to the Totality of the Financial Circumstances Analysis under Section 707(b)(3)(B).

The 2005 Act creates a two-step financial analysis for determining if a chapter 7 petition should be dismissed. The first is a mechanical calculation under section 707(b)(2), known as the "means test." The second is a subjective analysis under section 707(b)(3)(B). The plain language of the statute demonstrates that these subsections perform two distinct functions in determining whether a debtor is eligible for a discharge.

The means test, namely the calculations mandated by section 707(b)(2)(A)(i)-(iv), reflects congressional intent that there be an "easily applied formula" to create a presumption of abuse. *Henebury*, 361 B.R. at 602-03. "Passing the means test" merely means that the court will not "presume abuse exists;" it is not a determination that the debtor is entitled to relief under chapter 7. 11 U.S.C. § 707(b)(2)(A)(i); *In re Lenton*, 358 B.R. 651, 660-61 (Bankr. E.D. Pa. 2006); *Booker*, 399 B.R. at 666 (stating that the results of the "means test" are "not dispositive").

The means test does more than identify abusive chapter 7 debtors. *In re Fowler*, 349 B.R. 414, 420 (Bankr. D. Del. 2006). It also establishes the burden of proof between the debtor and the moving party, usually the United States Trustee. *Lenton*, 358 B.R. at 660. If the debtor passes the means test, then the United States Trustee has the burden of proof to show abuse. *In re Parada*, 391 B.R. 492, 496 (Bankr. S.D. Fla. 2008). In contrast, debtors who fail the means test must show that a special circumstance exists that would make them eligible for chapter 7 relief. 11 U.S.C. § 707(b)(2)(B)(I). Therefore, the Calhouns' argument that the means test and section 707(b)(3)(B) duplicate each other is incorrect. Calhoun Br. at 7-8; *Ross-Tousey*, 549 F.3d at 1161-62.

Instead, the "developing body of case law" confirms a relationship between the means test and section 707(b)(3)(B) that amounts to an objective evaluation of a debtor's financial circumstances followed by a more subjective, flexible consideration of whether discharge is appropriate considering the financial circumstances. *In re McGillis*, 370 B.R. 720, 747 (Bankr. W.D. Mich. 2007).

The means test is a mechanical, objective application to determine only whether there is a presumption of abuse. *Rudler*, 576 F.3d at 51. It is not meant to be conclusive or comprehensive analysis of whether granting the debtor relief would be an abuse of chapter 7. Toward that end, Congress designed section 707(b)(3)(B) to be a subjective look at the totality of the debtor's financial circumstances. *See Krohn*, 886 F.3d at 126-27 (broad-ranging analysis).[3]

The majority of courts have rejected the Calhouns' argument that the means test replaces the ability-to-pay analysis mandated in section 707(b)(3)(B). Calhoun Br. at 7. *Ross-Tousey*, 549 F.3d at 1161-62 (post-2005 7th Circuit case ruling that passing the means test does not foreclose a section 707)(b)(3)(B)

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[3] Similarly, section 707(b)(3)(A) permits the court to look into whether the debtor filed the petition in bad faith.

analysis); *In re Crink*, 402 B.R. 159, 168-69 (M.D.N.C. 2009) (citing 13 cases). First, the statute mandates that the court "shall" consider a debtor's financial condition and circumstances if the presumption of abuse does not arise from the means test. 11 U.S.C. § 707(b)(3); *Reed*, No. 07-04357, slip op. at 21. If Congress had intended that the means test foreclose further consideration of ability to pay, it would not have required further analysis of petitions which passed that test. Instead, "a court must consider a debtor's actual debt-paying ability in ruling on a motion to dismiss based on abuse where the presumption does not arise or is rebutted." *Mestemaker*, 359 B.R. at 854-55; *Parada*, 391 B.R. at 498, n.4 (stating that analysis under section 707(b)(3)(B) "unambiguously presupposes that the debtor has 'passed' the means test"). If Congress had intended to eliminate consideration of ability to pay, "it would have done so expressly or by explicit references to § 707(b)(2)(A)." *Lenton,* 358 B.R. at 663.

The Calhouns rely on a single case, *In re Nockerts*, for their argument that the means test replaces the ability to pay analysis. Calhoun Br. at 7 (citing *In re Nockerts*, 357 B.R. 497, 507 (Bankr. E.D. Wis. 2006)). First, *Nockerts* is no longer good law. In 2007, the Seventh Circuit ruled that section 707(b)(3)(B) applies to debtors who passed the means test. *Ross-Tousey*, 549 F.3d at 1161-62. Second, the Calhouns misread *Nockerts*, which only holds – incorrectly – that ability to pay cannot be the sole basis for a section 707(b)(3)(B) dismissal. *In re McGillis*, 370 B.R. at 745; *In re Crink*, 402 B.R. at 169, n.8 (commenting that *Nockerts* is sometimes wrongly cited for proposition that debtor's ability to pay should not be considered under section 707(b)(3)(B)). In fact, "there is overwhelming support for consideration of this factor [ability to pay] within an analysis of the totality of the circumstances." *In re Hoffman*, 413 B.R. at 194 (citing cases); *Reed,* slip op. at 23-24 (rejecting *Nockerts*).

B. Courts May Consider Social Security Income as Part of the Analysis of the Totality of the Circumstances of a Debtor's Financial Situation.

The bankruptcy court properly considered Mr. Calhoun's $1400 per month in social security income when it determined that the totality of the Calhouns' financial situation indicated they could repay their creditors. *Calhoun*, 396 B.R. at 276; JA at 125-26. In the context of chapter 13 confirmation, this Court has determined that all "income that a debtor is actually receiving at the time of confirmation" is relevant to the income test under 11 U.S.C. § 1325(b). *Solomon v. Cosby (In re Solomon)*, 67 F.3d 1128, 1132 (4th Cir. 1995). Mr. Calhoun receives social security benefits and these payments constitute income and are thus relevant to the § 707(b)(3)(B) analysis. *Perlin*, 497 F.3d at 372-73.

As the Calhouns argue, it is certainly true that the definition of "current monthly income" excludes social security payments. 11 U.S.C. § 101(10A). The means test of section 707(b)(2) utilizes "currently monthly income," thus it is also true that social security income is not included in that calculation. Calhoun Br. at 9; *see In re Waters*, 384 B.R. 432, 436 (Bankr. N.D. W. Va 2008). But in the section 707(b)(3) context, Congress did not require bankruptcy courts to gauge the totality of the debtor's "current monthly income;" it required assessment of the totality of the debtor's "financial situation" – a much broader term. If Congress uses particular language in one section of the statute but not in another, it is "generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion." *Russello v. United States*, 464 U.S. 16, 23 (1983) (citation omitted); *Solomon*, 67 F.3d at 1132. The exclusion of social security in one part of the statute has no bearing on whether it should be considered in another.

The same is true of the Calhouns' argument that their social security income should not be considered because it would not be counted in a hypothetical chapter 13 plan. Calhoun Br. at 9; *see also* 11 U.S.C. § 1325(b)(2) (excluding social security from "currently monthly income"). The first, albeit obvious, point is that this is not a chapter 13 case. Secondly, no textual support exists to limit a finding of abuse under section 707(b)(3)(B) to an analysis of non-exempt income in chapter 13. *See In re Taylor*, 212 F.3d 395, 397 (8th Cir. 2000) (stating that whether a pension is exempt from creditors in chapter 13 is "wholly independent" from whether the pension is necessary to support the debtor). Third, courts can consider non-estate property when judging abuse under section 707(b)(3)(B). The Fifth Circuit held that "[i]f sufficient income to fund a Chapter 13 plan is anticipated, a complete discharge of the debtor's obligations would constitute a substantial abuse of Chapter 7." *United States Trustee v. Cortez (In re Cortez)*, 457 F.3d 448, 457 (5th Cir. 2006). This led to the conclusion that a court "can and should take into account for purposes of determining substantial abuse under § 707(b)" income, such as social security, that is not property of the estate. *Id.* at 458.

This conclusion makes logical sense. Social security income is designed to contribute toward ensuring that a person's basic needs are provided for after retirement. Once that safety net is in place, a retired debtor theoretically has enough income to maintain a basic standard of living. That debtor should not exclude funds to provide for his or her old age from the court's analysis of his or her ability to repay a second time. Allowing the Calhouns to shield social security from the analysis of their financial circumstances would allow them to remove funds for basic living expenses from the court's calculation of ability to pay twice – a double-counting that contradicts the purpose of the reforms in the 2005 Act. *See In re Schnabel*, 153 B.R. 809, 817 (Bankr. N.D. Ill. 1993) (stating under pre-2005 Act Code that if a debtor is assured of an income sufficient to meet his basic needs, then social security and pension benefits can be used to fund a chapter 13 plan).

Most fundamentally, the 2005 Act allows a court to consider the debtor's ability to repay creditors outside of bankruptcy under sections 707(b)(1) and (b)(3) and to dismiss a case if a debtor can voluntarily repay a meaningful portion of his or her debt outside bankruptcy or through a chapter 13 repayment plan. *See* 11 U.S.C. § 707(b)(1). The default remedy for abuse under section 707(b)(3)(B) is dismissal, not conversion to another chapter of the Code. *See* 11 U.S.C. § 707(b)(1). The default remedy evidences congressional intent to dismiss debtors' cases when they can voluntarily make meaningful payments outside bankruptcy. *See* H.R. Rep. 109-31 at 5 & n.18. (Congress enacted section 707(b) to issue a "clear mandate requiring these debtors to repay their debts."). The Calhouns' social security income contributes to their ability to make meaningful payments to creditors outside bankruptcy and thus is relevant to the section 707(b)(3)(B) analysis.

CONCLUSION

For the reasons outlined above, the United States Trustee respectfully requests that this Court affirm the lower courts' orders.

December 15, 2009

Respectfully submitted,

RAMONA D. ELLIOTT
General Counsel

P. MATTHEW SUTKO
Associate General Counsel

CATHERINE B. SEVCENKO
Trial Attorney

Executive Office for United States Trustees
United States Department of Justice
20 Massachusetts Avenue, N.W.
Washington, D.C. 20530
(202) 307-1399

W. CLARKSON MCDOW, JR.
United States Trustee
United States Department of Justice
1835 Assembly Street, Suite 953
Columbia, SC 29201
(803) 765-5250

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

No. 09-1646 **Caption:** Calhoun v. McDow (In re Calhoun)

CERTIFICATE OF COMPLIANCE WITH RULE 28.1(e) or 32(a)

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(s) Catherine Severello

Attorney for United States Trustee

Dated: Dec. 16, 2009

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing BRIEF OF THE APPELLEE UNITED STATES TRUSTEE was served upon the parties listed below through either the Notice of Electronic Filing from the Court's Electronic Filing System or by United States Mail, first class, postage on this the 16th day of December, 2009.

/s/ **Catherine B. Sevcenko**
CATHERINE B. SEVCENKO
Trial Attorney

Joseph E. Mitchell, III
Joseph E. Mitchell, III, P.C.
P.O. Box 2504
Augusta, Georgia 30903
(706) 826-1808

BRIEF BANK — “SUMMARY SHEET”

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WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*
In re Susan Lisa Campbell (Susan Lisa Campbell v. R. Michael Bolen, U.S. Trustee)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*
N.D. Miss.

3. ("CCN") ***CURRENT*** CASE NO.
No.: 2:09-cv-00025-WAP

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*
No.: 07-14692
Court: Bankr. N.D. Miss.
(Identify judge & cite, if any)

5. ("SO") ***SOURCE***
U.S. TRUSTEES

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*
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7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*
Sammye S. Tharp, John Sheahan, P. Matthew Sutko, R. Michael Bolen
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***
• Whether a bankruptcy court erred by enforcing a district court general order providing that attorneys could not be admitted before the Mississippi federal court unless they were also admitted to the Mississippi state bar, which did not contain a “grandfather” clause excepting non-Mississippi attorneys who had already been admitted to the Mississippi federal courts.

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BEFORE THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF MISSISSIPPI

In re	
	}
SUSAN LISA CAMPBELL,	} **Case No. 2:09-cv-00025-WAP**
	}
Debtor.	}
	} **Chapter 7**
	}
	}
SUSAN LISA CAMPBELL,	}
	}
Appellant,	}
v.	}
	}
R. MICHAEL BOLEN,	}
United States Trustee	}
For Region 5	}
	}
Appellee.	}

BRIEF OF APPELLEE

R. MICHAEL BOLEN
United States Trustee, Region 5
Districts of Mississippi and Louisiana

SAMMYE S. THARP, Trial Attorney
United States Department of Justice
Office of the United States Trustee
Suite 706, McCoy Federal Building
100 West Capitol
Jackson, MS 39269
(601) 965-4142
Miss. Bar. No. 10016

STATEMENT OF THE BASIS OF APPELLATE JURISDICTION

The bankruptcy court had jurisdiction over Susan Lisa Campbell's chapter 7 bankruptcy case under 28 U.S.C. § 157(b). Ms. Campbell's notice of appeal was timely filed under 28 U.S.C. § 158(c)(2) and Fed. R. Bankr. P. 8001(a).

The notice of appeal denominates Ms. Campbell as the appellant. However, the issues raised on appeal appear to relate exclusively to the rights of Ms. Campbell's attorney, William A. Cohn. Accordingly, to the extent that the Court finds that the designation of Ms. Campbell as appellant was erroneous, the Court may construe the notice of appeal as an appeal by Mr. Cohn individually. *Citizens Bank & Trust Co. v. Case (In re Case)*, 937, F.2d 1014 (5th Cir. 1991). Under such a circumstance, this Court would have jurisdiction to hear this appeal under 28 U.S.C. § 158(a)(1). To the extent the Court construes this appeal as an appeal by Ms. Campbell and not Mr. Cohn, however, the Court lacks Article III subject matter jurisdiction because the appeal does not allege any case or controversy by which Ms. Campbell is aggrieved. *Elk Grove Unified Sch. Dist. v. Newdow*, 524 U.S. 1, 11 (2004); *Scruggs v. Lowmann (In re Scruggs)*, 392 F.3d 124, 128 (5th Cir. 2004). As we explain in the Statement of Facts, Ms. Campbell's bankruptcy case is closed, and she can receive no further relief in her case through this appeal.

It is the United States Trustee's view that the notice of appeal erroneously designated Ms. Campbell, and this Court has appellate jurisdiction. Both below, and in the opening brief, Mr. Cohn has addressed issues relating solely to his right to act as counsel in future cases. The United States Trustee has always understood this appeal to involve legal claims pressed on behalf of Mr. Cohn, and not Ms. Campbell.

STANDARD OF APPELLATE REVIEW

The facts relevant to this appeal are not in dispute. This Court reviews the legal issues raised by Mr. Cohn *de novo*. *Young v. Repine (In re Repine)*, 536 F.3d 512, 518 (5th Cir. 2008).

STATEMENT OF THE CASE

On March 11, 2008, the bankruptcy court issued an order directing William A. Cohn to comply with Uniform Local Rule 83.1 by obtaining orders for admission *pro hac vice* in any future cases in which he appears in the bankruptcy court. On March 12, 2008, Mr. Cohn filed a timely notice of appeal.

STATEMENT OF FACTS

Mr. Cohn is a member of the state bar of Tennessee, but is not currently licensed to practice in the state courts of Mississippi. (Br. 6). However, Mr. Cohn contends that he was issued a certificate of admission by the clerk of the United States District Court for the Northern District of Mississippi in 1982, and further contends that the certificate has never been revoked through a disbarment proceeding. (Id. 7). Mr. Cohn's pleadings do not identify the local rule or other authority, if any, pursuant to which the clerk issued him the certificate of admission in 1982.

On or about December 27, 2007, Mr. Cohn or an employee of his firm, filed a bankruptcy petition for Susan Lisa Campbell in the United States Bankruptcy Court for the Northern District of Mississippi, using Mr. Cohn's electronic case filing login and password. (Dkt. 12 at 2). Although R. Chadwick Reeves, an associate of Mr. Cohn's firm, is admitted to practice in the state courts of Mississippi, Mr. Cohn has not sought authorization to appear on Ms. Campbell's case *pro hac vice*.

Rule 83.1 of the Uniform Local Rules of the United States District Courts for the Northern and Southern Districts of Mississippi provides that attorneys (other than attorneys representing the United States) may be admitted to practice before those district courts only if they: (1) are members of the Mississippi state bar, or (2) are admitted to practice *pro hac vice* to participate in a particular action. The current version of Uniform Rule 83.1 is substantially identical to the former General Rule G-1(3) of the Local Rules for the United States District Court for the Northern District of Mississippi, which would have been in effect at the time Mr. Cohn received his certificate to practice before the district court.

On July 18, 2006, the United States District Courts for the Northern and Southern Districts of Mississippi entered a General Order re: Pro Hac Vice Admissions (No. 3:85mc26) (the "General Order"). The General Order provides that Uniform Local Rule 83.1(A)(2) is the sole method by which an attorney not admitted to the Mississippi state bar may practice in the district courts. The General Order also expressly provides that there is no "grandfathering" provision applicable to non-Mississippi attorneys.[1]

---

[1] The relevant text of the General Order is as follows:

> UNIFORM RULE 83.1(A)(2) is the *only* authority permitting a non-resident attorney who is not a member of the Mississippi Bar and not admitted to practice before the Mississippi Supreme Court to practice in a United States district court serving Mississippi. The UNIFORM RULES provide no "grandfathering" provision allowing a non-resident attorney not a member of the Mississippi Bar to practice in a district court other than on a case-by-case *pro hac vice* admission.

General Order at 2.

On January 16, 2008, the United States Trustee filed a Motion to Examine Fees of Attorney and for Other Relief (Dkt. 12) (the "Motion"). In relevant part, the Motion requested that the bankruptcy court determine whether Mr. Cohn lacked authorization to file a bankruptcy petition in the Mississippi bankruptcy court, and if so, whether any portion of the fees received by Mr. Cohn should be returned to Ms. Campbell. The United States Trustee also requested that any associates of Mr. Cohn's law firm who are members of the Mississippi bar obtain their own electronic case filing logins and passwords, and that they use such logins and passwords for any future bankruptcy petitions and pleadings filed by Mr. Cohn's firm.

On January 29, 2008, Mr. Cohn filed a Response and Objection to the Motion (Dkt. 17) (the "Response"). The Response did not contest the factual allegations of the Motion, but rather argued only that the General Order was ineffective as applied to non-Mississippi lawyers who had already been admitted before the district court.

Following a hearing, the bankruptcy court issued an order granting the United States Trustee's Motion on March 11, 2008 (Dkt. 26). The order determined that Mr. Cohn was unauthorized to practice before the bankruptcy court, ordered that any future pleadings or documents in Ms. Campbell's case be filed under the login and password of Mr. Reeves, and further ordered that Mr. Cohn "shall be allowed to practice before this court only upon admission *pro hac vice* since Mr. Cohn is not a member of the Mississippi Bar." The Court did not order the disgorgement of fees or any further relief against Mr. Cohn.

On April 10, 2008, the chapter 7 trustee filed a Report of No Distribution in Ms. Campbell's case. On May 27, 2008, the bankruptcy court granted Ms. Campbell a chapter 7 discharge. (Dkt. 39). On information and belief, there are no longer any pending matters in Ms.

Campbell's bankruptcy case other than the present appeal.

SUMMARY OF ARGUMENT

Mr. Cohn's arguments provide no basis for overturning the bankruptcy court's order. Mr. Cohn objects to the order on two grounds: (1) application of Rule 83.1 and the General Order is impermissibly retroactive as to him, and (2) to the extent that Rule 83.1 and/or the General Order are applicable to him, their enforcement would violate the constitutional prohibition against *ex post facto* laws. Neither argument has merit. Because the bankruptcy court's application of Rule 83.1 and the General Order only affects cases filed after the effective date of those provisions, the bankruptcy court's order does not raise any retroactivity issues. In addition, because the bankruptcy court's order, the General Order, and Rule 83.1 are each civil and regulatory in nature, and because no criminal sanction is at issue, the constitutional prohibition against *ex post facto* laws is also inapplicable.

ARGUMENT

1. The bankruptcy court's application of the Rule 83.1 and the General Order to Mr. Cohn is not retroactive.

Mr. Cohn's primary argument on appeal is that by enforcing Rule 83.1 through the General Order, the bankruptcy court impermissibly applied those provisions retroactively. Mr. Cohn's argument fails, however, because nothing in the bankruptcy court's order gave those provisions retroactive effect.

As the Supreme Court has explained, a statute is retroactive only when it "would impair rights a party possessed when he acted, increase a party's liability for past conduct, or impose new duties with respect to transactions already completed." *Landgraf v. USI Film Products*, 511 U.S. 244, 280 (1994). In particular, in order for a regulation to be deemed retroactive, it must relate specifically to conduct occurring before the regulation's effective date. *See McAndrews v. Fleet Bank of Massachusetts*, 989 F.2d 13, 16 (1st Cir. 1993) (holding that "[t]he determination of whether a statute's application in a particular situation is prospective or retroactive depends upon whether the conduct that allegedly triggers the statute's application occurs before or after the law's effective date").

Conversely, a change in law affecting only future behavior does not raise retroactivity concerns. Thus, in *FDIC v. Faulkner*, 991 F.2d 262 (5th Cir. 1993), a district court imposed an injunction against the defendant in a fraud action pursuant to a federal statute that had not been enacted when the lawsuit was originally filed. The Fifth Circuit declined to characterize the district court's application of the injunction-statute as retroactive, noting that the injunction "implicates future conduct, in the sense that the asset freeze applies only to future transfers of the [defendants'] assets." *Id.* at 266; *see also Landgraf*, 511 U.S. at 269 (holding that statute is not retroactive "merely because it . . . upsets expectations based in prior law").

In this case, the bankruptcy court order interpreting the General Order and Rule 83.1 is not retroactive because its effect is on a case in which Mr. Cohn appeared after the General Order was adopted: whereas the General Order took effect in July 2006, Mr. Cohn did not file the instant matter on behalf of Ms. Campbell until over a year later, in December 2007. Thus, in this instance the order did not impose new duties or liabilities on Mr. Cohn relating to a case in which he had already appeared, nor attach any legal consequences to actions that he took while relying on the validity of his 1982 certificate. Accordingly, none of the orders or regulations that Mr. Cohn challenges have been applied retroactively.

2. The General Order is not an *ex post facto* Law.

The constitutional prohibition against *ex post facto* laws is also inapplicable to Rule 83.1 and to the orders at issue in this appeal. As the Supreme Court has explained, the *ex post facto* clause of the Constitution prohibits four types of enactments: (1) laws that make actions criminal that were not criminal at the time they were taken; (2) laws that retroactively aggravate the classification of a crime; (3) laws that retroactively increase the penalty for a crime; and (4) laws that retroactively alter the rules of evidence in order to convict an offender. *See Stogner v. California*, 539 U.S. 607, 612 (2003).

In this case, Rule 83.1 and the General Order violate none of these prohibitions. First, the rules regarding eligibility to practice in the federal courts are not a criminal statute, but a non-punitive civil regulation. As the Supreme Court has held, the *ex post facto* clause is inapplicable to such civil regulations. *See Smith v. Doe*, 538 U.S. 84, 92 (2002) (holding that because a sex offender registration statute was intended to regulate rather than punish, the statute did not raise *ex post facto* concerns). Secondly, even if a requirement that Mr. Cohn obtain admission *pro hac vice* were treated as a criminal sanction, for the reasons stated above, none of the orders and regulations at issue in this appeal have been applied retroactively. Mr. Cohn has not suffered any sanction or punishment based on actions he took in cases prior to July 2006. Indeed, the bankruptcy court order on appeal is wholly prospective in nature, and seeks to regulate only Mr.

Cohn's future conduct. Accordingly, Mr. Cohn's argument that enforcement of the General Order and Rule 83.1 would violate the *ex post facto* clause lacks merit.

CONCLUSION

For these reasons, this Court may affirm the order entered below.

Respectfully submitted,

R. MICHAEL BOLEN
United States Trustee

/s/ Sammye S. Tharp
Sammye S. Tharp
Department of Justice
Office of the United States Trustee
100 W. Capitol Street, Suite 706
Jackson, MS 39269

CERTIFICATE OF SERVICE

I, **SAMMYE S. THARP**, Trial Attorney for the Office of the U. S. Trustee, do hereby certify that a copy of the Brief of Appellee R. Michael Bolen, United States Trustee, has been served this day on the below-named individual(s) via first class U.S. Mail at the address(es) listed below or by Notice of Electronic Filing via the email address(es) on file with the court's CM/ECF system:

William A. Cohn
COHN LAW FIRM
291 Germantown Bend Cove
Cordova , TN 38018
lawvol1@cohnlawfirm.com

DATED, this the 31st day of March, 2009.

/s/ Sammye S. Tharp
Sammye S. Tharp

BRIEF BANK — "SUMMARY SHEET" *Printed Wed-5/19/10 15:32*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	In re: Susan Lisa Campbell (Susan Campbell v. R. Michael Bolen)
2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	5th Cir.
3. ("CCN") ***CURRENT*** CASE NO.	No.: 09-60788
4. ("PCN") ***PRIOR*** CASE NO. - & COURT *[IF ANY]*	No.: 2:09-cv-25-WAP Court: N.D. Miss. *(Identify judge & cite, if any)*
5. ("SO") ***SOURCE***	**U.S. TRUSTEES**
6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	Filed: May 18, 2010 Type: Brief for Appellee
7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*	Lowell V. Sturgill, John Sheahan, P. Matthew Sutko *(UST/OGC: 202-307-1399/FAX-2397)*
8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	• 1). Whether the district court correctly held that Local Rule 83.1 can be applied to attorney Cohn without violating the general presumption against retroactive application of laws or rules. 2). Whether the district court correctly held that Local Rule 83.1 can be applied to Mr. Cohn without violating the Constitution's *ex post facto* clause.
10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)	
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IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

In the Matter of: SUSAN LISA CAMPBELL,

Debtor

SUSAN CAMPBELL,

Appellant,

v.

R. MICHAEL BOLEN,

Appellee.

On Appeal From the United States District Court
for the Northern District of Mississippi

BRIEF FOR APPELLEE

Tony West
Assistant Attorney General

William C. Martin
United States Attorney

William Kanter
(202) 514-4575
s/Lowell V. Sturgill Jr.
(202) 514-3427
Attorneys, Appellate Staff
Civil Division, Room 7241

Department of Justice
950 Pennsylvania Avenue
Washington, D.C. 20530

Statement Regarding Oral Argument

Counsel for the Trustee believes that oral argument would be beneficial in helping the court resolve this case.

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TABLE OF AUTHORITIES

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Statement of Jurisdiction

1. The bankruptcy court had jurisdiction over Appellant Susan Campbell's Chapter 7 bankruptcy petition under 28 U.S.C. 157(b).

On March 11, 2008, the bankruptcy court issued an order concluding that one of Campbell's bankruptcy attorneys, Mr. William Cohn, is unauthorized to practice before that court because he is not a member of the Mississippi Bar, and because he has not applied for permission to appear in this case *pro hac vice*. Mr. Cohn filed a filed a timely notice of appeal from that order, naming Ms. Campbell as the appellant, on March 12, 2008. *See* District Court Record, USCA5 4.[1]

2. The district court construed the notice of appeal as an appeal by Mr. Cohn individually, since his appeal brief addressed only his own asserted rights to appear as counsel, and not any asserted rights belonging to Ms. Campbell. *See* Order of September 3, 2009, at 1 (USCA5 53).[2]

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[1] The notice of appeal stated that Campbell was appealing to the Fifth Circuit Court of Appeals Bankruptcy Panel. *See* USCA5 4. There being no Fifth Circuit Bankruptcy Panel, the appeal was docketed in the United States District Court for the Northern District of Mississippi.

[2] The district court's ruling on that point is consistent with applicable circuit precedent, since there is no indication in any of Mr. Cohn's pleadings in the courts below or in this Court that he is attempting to vindicate the interests of Ms. Campbell, rather than those of his own. *See Garcia* v. *Wash*, 20 F.3d 608, 610 (5th Cir. 1994); *In the Matter of George Milton Case*, 937 F.2d 1014, 1021 (5th Cir. 1991).

Reading the notice of appeal in that manner, the district court held that it had jurisdiction over the appeal pursuant to 28 U.S.C. 158(a)(1), which provides that "[t]he district courts of the United States shall have jurisdiction to hear appeals (1) from final judgments, orders, and decrees . . . of bankruptcy judges . . .." 28 U.S.C. 158(a)(1).

a. The district court did not explain why it thought the bankruptcy court's March 11, 2008, order falls within the terms of 28 U.S.C. 158(a)(1). Because that order did not resolve all the claims of all the parties,[3] or finally dispose of a discrete bankruptcy claim of any individual party,[4] the district court presumably concluded that the order was final under the collateral order doctrine.

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[3] Ms. Campbell's bankruptcy case was still pending when the bankruptcy court issued the order in question. Ms. Campbell's bankruptcy case was not closed until November 6, 2009. *See* No. 07-14692-DWH (U.S. Bank. Ct., N.S. Miss.) Docket No. 45. Mr. Cohn's notice of appeal from the bankruptcy court's March 11, 2008 order did not ripen into a timely notice of appeal upon the entering of the order closing Ms. Campbell's bankruptcy case. *See United States* v. *Cooper*, 135 F.3d 960 (5th Cir. 1980).

[4] As this Court noted in *In re Delta Services Industries/Foster Securities, Inc.* v. *Sandoz*, 782 F.2d 1267 (5th Cir. 1986), "courts properly view finality more flexibly under § 158(d) . . . than under [28 U.S.C.] 1291." *Id.* at 1269. As a result, "bankruptcy court orders that conclusively determine substantive rights of parties" are considered final and appealable, even if they do not resolve *all* the claims of *all* the parties. *Id.* at 1270. That rule, however, does not apply to orders disqualifying attorneys from participating in a bankruptcy proceeding. *See*, *e.g.*, *id.* at 1273 (holding that an order disqualifying an attorney from participating as counsel in a bankruptcy proceeding in federal court was not immediately appealable).

"The collateral order doctrine is a 'narrow exception' . . . whose reach is limited to trial court orders affecting rights that will be irretrievably lost in the absence of an immediate appeal." *Richardson-Merrell, Inc.* v. *Koller*, 472 U.S. 424, 430-31 (1985) (citations omitted). "To fall within the exception, an order must at a minimum satisfy three conditions: It must 'conclusively determine the disputed question,' 'resolve an important issue completely separate from the merits of the action,' and 'be effectively unreviewable on appeal from a final judgment." *Id.* at 431.

To the extent Mr. Cohn is challenging the bankruptcy court's order disqualifying him from participating as Ms. Campbell's lawyer in *this* case, that order is not immediately appealable under the collateral order doctrine. *See Richardson-Merrell*, 472 U.S. at 440 (holding that an order disqualifying counsel in a civil case is not a collateral order subject to immediate appeal). *Accord RCT* v. *Bright*, 6 F.3d 336, 340 n.5 (5th Cir. 1993) (applying *Richardson-Merrill* to a civil non-bankruptcy case). As we have already noted, this Court has held that this rule applies to bankruptcy cases. *See In re Delta Services*, 782 F.2d at 1273.

The order on appeal here, however, arguably goes beyond merely disqualifying Mr. Cohn from appearing as counsel in the Northern District of Mississippi in this case. It also recites that Mr. Cohn "shall be allowed to practice before this court only upon admission *pro hac vice* since Cohn is not a member of the Mississippi Bar." USCA5 23. That language could reasonably be understood as limiting Mr. Cohn's ability to appear before that court not only in this case, but also in *other* cases. In that respect, we believe the district court had jurisdiction to consider Mr. Cohn's appeal under the collateral order doctrine. The order is conclusive on that issue and separate from the merits of Ms. Campbell's bankruptcy petition, and it was effectively unreviewable on appeal from a final judgment insofar as it restricted Mr. Cohn's ability to practice before that court in other cases before Ms. Campbell's bankruptcy case was closed. *See Richardson-Merrell*, 472 U.S. at 431.[5]

b. We note that in *Gallo* v. *United States District Court for the District of Arizona*, 349 F.3d 1169 (9th Cir. 2003), *cert. denied*, 541 U.S. 1073 (2004), the Ninth Circuit held that it lacked jurisdiction to consider an appeal of a district court order which held that an attorney could no longer appear before the court without successfully completing a *pro hac vice* application. The attorney previously had been admitted to the district court's bar, but was later informed by the court clerk that,

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[5] Mr. Cohn has not specifically identified any court appearances he would have wished to make in other cases in the Northern District of Mississippi during the period between March 11, 2008 (when the order on appeal was issued) and November 6, 2009 (when Ms. Campbell's bankruptcy case was closed). We are unaware of any case authority that would require him to make such a showing in order to invoke the collateral order doctrine.

pursuant to a recent rules change, he could no longer practice before the court without either (1) becoming a member of the state bar in which the court sat, or (2) applying for admission *pro hac vice*. *See id.* at 1173. The Ninth Circuit, construing the attorney's objection to the clerk's letter as a petition for admission to the district court's bar, held that it lacked jurisdiction over the appeal because "the denial of a petition for admission to a district court bar is neither a final order appealable under 28 U.S.C. § 1291 . . . nor an interlocutory order appealable under 28 U.S.C. § 1291." *Id.* at 1176 (citing *In re Wasserman*, 240 F.2d 213 (9th Cir. 1956)). [6]

Wasserman, on which the Ninth Circuit relied in *Gallo*, held that the courts of appeals lack jurisdiction to review "routine orders of denial or granting of admission of attorneys where the District Court followed its own rules and did not violate any right of applicant." 240 F.2d at 216 (citing *Brooks* v. *Laws*, 208 F.2d 18 (D.C. Cir. 1953)). Subsequently, however, in *District of Columbia Ct. of Appeals* v. *Feldman*, 460 U.S. 462 (1983), the Supreme Court held that "[a] claim of a present right to admission to the bar of a state and a denial of that right is a controversy." *Id.* at 479. In light of *Feldman*, we believe the district court had jurisdiction over the bankruptcy

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[6] The Ninth Circuit went on to entertain the appeal pursuant to 28 U.S.C. 1651(a) because the plaintiff had, in the alternative, requested the court to treat his notice of appeal as a petition for a writ of mandamus. *See Gallo*, 349 F.3d at 1777. Mr. Cohn has made no such request in this case.

court's order applying Local Rule 83.1 to Mr. Cohn. That order is a judicial order which, under *Feldman*, was reviewable on appeal by the district court pursuant to 28 U.S.C. 158(a)(1). *See Matter of Palmisano*, 70 F.3d 483, 485 (7th Cir.) (concluding that *Feldman* implicitly overruled *Brooks* v. *Laws*, *supra*), *cert. denied*, 517 U.S.1223 (1995).

3. On September 18, 2009, Mr. Cohn filed a notice of appeal from the district court's September 3, 2009 order. *See* USCA5 55.[7] This Court has jurisdiction over this appeal pursuant to 28 U.S.C. 158(d), which provides that "[t]he courts of appeals shall have jurisdiction of appeals from all final decisions, judgments, orders, and decrees entered under subsections (a) and (b) of this section." That statute applies here because the district court's September 3 order finally disposed of the only issue that was before that court – Mr. Cohn's argument that the bankruptcy court incorrectly applied Local Rule 83.1 to him. *See Ichinose* v. *Homer National Bank*, 946 F.2d 1169, 1177 (5th Cir. 1991) (holding that the district court's reversal of an order of a bankruptcy court was a final order for appeal to this Court even though the bankruptcy court's order was interlocutory when appealed to the district court).

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[7] The notice of appeal identifies the appeal as being on behalf of the "debtor/appellant." USCA5 55. For the reasons explained above, however, the Court should construe this notice as having been filed on behalf of Mr. Cohn personally, since it is clear from the notice and all the pleadings regarding this issue that Mr. Cohn is raising his own rights rather those of Ms. Campbell.

Statement of the Issues

1. Whether the district court correctly held that Local Rule 83.1 can be applied to attorney Cohn without violating the general presumption against retroactive application of laws or rules.

2. Whether the district court correctly held that Local Rule 83.1 can be applied to Mr. Cohn without violating the Constitution's *ex post facto* clause.

Statement of the Case

Appellant William Cohn filed a bankruptcy petition on behalf of a debtor, Susan Campbell, in the U.S. Bankruptcy Court for the Northern District of Mississippi. Shortly after he filed that petition, the Bankruptcy Court issued an order advising Mr. Cohn that, pursuant to Local Rule 83.1 of Rules of the United States District Court for the Northern District of Mississippi, he could not appear as counsel before that court in this case, or in any future case, unless he either (1) becomes a member of the Mississippi bar, or (2) obtains permission to appear before the Northern District *pro hac vice*. Mr. Cohn immediately appealed that order, arguing that it is impermissibly retroactive as applied to him, and that it violates his rights under the Ex Post Facto Clause. The district court rejected those arguments, and Mr. Cohn filed this appeal to present the same arguments to this Court.

District Court Rule at Issue

1. As explained below, Attorney William Cohn filed a bankruptcy petition on behalf of Susan Lisa Campbell in the United States Bankruptcy Court for the Northern District of Mississippi on December 27, 2007. At that time, the admission of attorneys to the bar of the federal district court for the Northern District of Mississippi was governed by Local Rule 83.1, a copy of which is attached to this brief as an addendum. Local Rule 83.1, which became effective on September 1, 1998, provided that in order to be authorized to practice before that court, an attorney had to be either (1) a member of the Mississippi Bar, or (2) admitted *pro hac vice* to practice before that court in a particular case. *See* Local Rule 83.1(A)(1) & (2).[8]

On July 18, 2006, the Northern District of Mississippi entered a General Order which reiterated that the Local Rules governing that court and the Southern District of Mississippi "recognize[] two categories of attorneys (other than attorneys for the United States of America and federal agencies) who may practice in the United States district courts serving Mississippi:

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[8] The only exception to the above rule was for attorneys representing the United States. *See* Local Rule 83.1(A)(3). Local Rule 83.1 was amended effective December 1, 2009. The amended rule, which also is provided as an addendum to this brief, imposes the same requirements as the prior version of the Rule for attorneys who wish to practice before the Northern District of Mississippi.

> A. Attorneys who are members of the Mississippi Bar and have been formally admitted to practice in district court. Uniform Rule 83.1(A)(1).
>
> B. Non-resident attorneys who are not members of the Mississippi Bar and not admitted to practice before the Mississippi Supreme Court but have been admitted to practice *pro hac vice* in a particular case in district court. Uniform Rule 83.1(A)(2).

Order of July 18, 2006 (copy attached as addendum).[9] The Order goes on to state that "Uniform Rule 83.1(A)(2) is the *only* authority permitting a nonresident attorney who is not a member of the Mississippi Bar and not admitted to practice before the Mississippi Supreme Court to practice in a United States district court serving Mississippi." Order of July 18, 2006, ¶ 2 (emphasis in original). As the Order then explains, "[t]he Uniform Rules provide no 'grandfathering' provision allowing a non-resident attorney not a member of the Mississippi Bar to practice in a district court other than on a case-by-case *pro hac vice* admission." *Ibid.*

Effective December 1, 2009, the substance of General Order 3:85mc26 was added to the text of the Local Rules for the Northern District of Mississippi. *See* Local Rule 83.1(d)(2).

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[9] A copy of the General Order is electronically available on Pacer by accessing the Pacer site for the Northern District of Mississippi. The order appears as docket entry 14 in case number 3:85mc26.

2. Prior to 1998, admission to the Northern District of Mississippi Bar was governed by Local General Rule G-1 (copy attached as addendum), which became effective in 1980. That Rule also stated that an attorney had to be either a member of the Mississippi Bar or admitted *pro hac vice* for an individual case in order to practice before the Northern District of Mississippi. *See* General Rule G-1(2), (3). That Rule also provided, however, that graduates of the University of Mississippi Law School could be "admitted by a judge or the clerk of this court upon the representation of the University Law School that they have satisfactorily completed all requirements for a diploma of the Law School and have been duly admitted to practice by order of the Chancery Court of the county of the applicant's residence, or of the county in which applicant intends to practice, or Lafayette County." General Rule G-1(1).[10]

Statement of Facts

1. Bankruptcy Court Proceedings

On December 27, 2007, Susan Lisa Campbell filed a chapter 7 petition in bankruptcy in the United States Bankruptcy Court for the Northern District of Mississippi. *See* Case No. 07-14692-DWH (U.S. Bank. Ct., N.D. Miss.). The

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[10] Attorney Cohn has not argued that he was admitted to the Northern District's Bar pursuant to the above provision.

petition identified three attorneys who were representing Ms. Campbell in that proceeding: William A. Cohn, Jerry R. Givens, and G. Chadwick Reeves. All were members of the Cohn Law Firm in Cordova, Tennessee. *See id.*, Bankruptcy Petition, Docket No. 1, at 3.

In December of 2008, the U.S. Trustee notified the bankruptcy court that, upon information and belief, Mr. Cohn was not a member of the Mississippi Bar and that he had not been admitted *pro hac vice* for the purposes of handling Ms. Campbell's bankruptcy petition. *See* Motion to Examine Fees of Attorney and For Other Relief, p. 1 (USCA5 19). For those reasons, the U.S. Trustee pointed out, it appeared that Mr. Cohn lacked the authority to represent Ms. Campbell before that court pursuant to Local Rule 83.1.

In response, Mr. Cohn argued that the bankruptcy court should not apply Rule 83.1 to him because he had been admitted to the district court's bar prior to the issuance of that Rule, and because no disbarment proceedings had ever been instituted against him. *See* Response to and Objection to United States Trustee's Motion to Examine Fees of Attorney, p. 1-3, No. 07-14692-DWH (U.S. Bank. Ct., N.D. Miss.), Docket No. 12. In support of this argument, Mr. Cohn referred to a bar certificate that he had previously submitted as Exhibit 1 to Docket Number 8 in that proceeding. The certificate purports to attest to the admission of Mr. Cohn to the bar of the United States District Court for the Northern District of Mississippi on February 9, 1983, by Norman Gillespie, Clerk.[11]

The bankruptcy court held a hearing on the U.S. Trustee's motion on February 27, 2008, and issued an order granting the motion approximately two weeks later, on March 11, 2008. The order concluded "that the debtor's attorney, William Cohn, is not a member of the Mississippi Bar, is not licensed to practice law in Mississippi and is therefore unauthorized to practice before this court." Order on Motion to Examine Fee at 1 (USCA5 23). The order also recited that "William Cohn shall be allowed to practice before this court only upon admission *pro hac vice* since Cohn is not a member of the Mississippi Bar." *Ibid.* The order thus decreed that "all further pleadings or documents filed in this case shall be filed under the login and password of R. Chadwick Reeves, associate in the Cohn Law Firm and member of the Mississippi Bar," and that "[t]he court record should be amended to reflect R. Chadwick Reeves as counsel for the debtor." *Ibid.*

On March 12, 2008, Mr. Cohn filed a notice of appeal from the March 11, 2008 order on behalf of the "Debtor/appellant" to the "United States Fifth Circuit Court of

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[11] The bar certificate is not part of the official district court record on appeal, but can be accessed through PACER at the location noted above.

Appeals Bankruptcy Appellate Panel."[12] The notice is signed both by Mr. Cohn and by Mr. Reeves. *See* Debtor/Appellant's Notice of Appeal to Bankruptcy Appellate Panel, No. 07-14692-DWH (U.S. Bank. Ct., N.D. Miss.), Docket No. 28.

As of March 12, 2008, the bankruptcy court had not yet finally disposed of Ms. Campbell's bankruptcy proceeding. The court would not issue an order discharging Ms. Campbell until May 27, 2008. *See* No. 07-14692-DWH (U.S. Bank. Ct, N.D. Miss.) Docket No. 39. The bankruptcy court closed that bankruptcy proceeding by order of November 6, 2009. *See id.*, Docket No. 45.

2. District Court Proceedings

Mr. Cohn's appeal was docketed in the Northern District of Mississippi as case number 2:09-cv-00025-WAP. Thereafter, Mr. Cohn, under his own signature, filed a brief challenging the bankruptcy court's March 11, 2008 order. The brief argued that the March 11 order was entered in error because "[n]o disbarment proceedings have ever been instituted to divest [Mr. Cohn] of [the privilege of practicing before the U.S. District Court for the Northern District of Mississippi] as required under the 5th Amendment Due Process Clause," and because "no law or rule can be instituted under Article 1, Section 10 of the United States Constitution, proscribing ex post

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[12] As previously mentioned, there is no Bankruptcy Appellate Panel for the Fifth Circuit. Accordingly, the notice of appeal was docketed in the federal district court for the Northern District of Mississippi.

facto laws . . ..” Brief at 7 (USCA5 38).

The U.S. Trustee filed a brief defending the bankruptcy court’s ruling, and on September 3, 2009, the district court entered an order affirming that order and dismissing Mr. Cohn’s appeal. *See* USCA5 53-54. The court concluded that the bankruptcy court’s application of Local Rule 83.1(a)(2) to Mr. Cohn is not impermissibly retroactive because it “affect[s] only cases filed *after* the effective date of those provisions.” *See* USCA5 54 (citation omitted). The court held that the bankruptcy court’s order does not violate the ex post facto clause because Rule 83.1 is “civil and regulatory in nature.” *Ibid.* (citation omitted). On October 10, 2009, attorney Cohn, under his own signature, filed a notice of appeal on behalf of Ms. Campbell from the above order. *See* USCA5 55.

Summary of Argument

1. Mr. Cohn’s principal argument in this appeal is that Northern District of Mississippi Local Rule 83.1 is being applied to him retrospectively, in violation of the presumption against retroactivity recognized in *Landgraf* v. *U.S.I. Film Products*, 511 U.S. 244 (1994). That argument lacks merit because a General Order issued by the Northern District before Mr. Cohn filed the bankruptcy petition in this case contains an express command notifying members of the Northern District’s bar that they must satisfy Local Rule 83.1 in order to appear before that court.

As *Landgraf* makes clear, that kind of express command required the courts below to apply the Local Rule 83.1 to Mr. Cohn, without regard to whether applying that rule to him is considered prospective or retrospective.

2. Mr. Cohn also argues that the bankruptcy court's application of Local Rule 83.1 to him violates his rights under the Ex Post Facto Clause. The district court correctly rejected that claim, however, because the Ex Post Facto Clause only applies to laws that inflict criminal punishments. Rule 83.1 is a civil rule designed to regulate practice before the Northern District, and it does not impose anything that could be viewed as a criminal punishment. Mr. Cohn also appears to be raising a due process claim, though it is unclear whether he preserved that claim below or in this Court. If this Court were to consider that claim, it should reject it because there is a rational basis for Local Rule 83-1, and for applying that Rule to attorneys who were already members of the Northern District's bar when the Rule took effect.

Statement of the Standard of Review

Appellant's Brief raises purely legal issues pertaining to (1) the proper interpretation of the Local Rule in question and (2) whether those rules violate appellant's constitutional rights. The district court's rulings on those points are thus reviewable *de novo*. *See*, *e.g.*, *United States* v. *Green*, 508 F.3d 195, 202 (5th Cir. 2007), *cert. denied*, 128 S. Ct. 2871 (2008).

Argument

I. The District Court Correctly Held That Local Rule 83.1 Can Be Applied to Attorney Cohn Without Violating Statutory Interpretation Principles Regarding Retroactivity.

Mr. Cohn argues that Local Rule 83.1 may not be applied to him consistent with *Landgraf* v. *USI Film Products*, 511 U.S. 244 (1994), which holds that there is a general presumption against the retroactive application of statutes or rules. This argument has no basis. As explained below, General Order 3:85mc26 contains an express command that Rule 83.1 be applied in cases such as this one. Under *Landgraf*, that kind of express command is sufficient by itself, in terms of statutory construction, to require a court to apply a statute or rule in accordance therewith.

A. General Principles Governing the Alleged Retroactive Application of Statutes and Rules.

As *Landgraf* explains, there is a "presumption against retroactive legislation" that is "deeply rooted in our jurisprudence." 511 U.S. at 265 (footnote omitted) (noting that "[e]lementary considerations of fairness dictate that individuals should have an opportunity to know what the law is and to conform their conduct accordingly") (footnote omitted). "For that reason," *Landgraf* explains, "'the legal effect of conduct should ordinarily be assessed under the law that existed when the conduct took place . . ..'" *Ibid.* (citation omitted).

The presumption against retroactive legislation recognized in *Landgraf* flows from principles of statutory construction, not from any general requirement of the Constitution. *See Falek* v. *Gonzales*, 475 F.3d 285, 290 (5th Cir. 2007) (citation omitted).[13] As a result, the presumption does not apply where Congress, or some other government actor that issues a statute or rule, has "expressly prescribed the statute's proper reach." *Landgraf*, 511 U.S. at 280.

Where a statute or rule contains no such express command, courts examine a number of factors to determine whether the statute should not be applied to the conduct at issue, including "whether it would impair rights a party possessed when he acted, increase a party's liability for past conduct, or impose new duties with respect to transactions already completed." *Landgraf*, 511 U.S. at 280. As *Landgraf* also explains, however, "[a] statute does not operate 'retrospectively' merely because it is applied in a case arising from conduct antedating the statute's enactment." 511 U.S. at 269 (citation omitted). *Accord Republic of Austria* v. *Altmann*, 541 U.S. 677, 697 n.17 (2004).

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[13] As the Supreme Court explained in *Landgraf*, several provisions in the Constitution are triggered in part by retrospective application of government action, *see* 511 U.S. at 266, but no constitutional provision establishes the presumption against retroactivity that the Supreme Court adopted in that case. *See id.* at 267 (noting that "[a]bsent a violation of one of those specific [constitutional] provisions, the potential unfairness of retroactive civil legislation is not a sufficient reason for a court to fail to give a statute its intended scope").

B. There is No *Landgraf* Violation Here Because District Court General Order 3:85mc26 Expressly Requires That Rule 83.1 Be Applied In Cases Like This.

As noted above, where a statute or rule contains an "express command" that it applies to particular conduct, a court should so apply the statute or rule, without considering the factors *Landgraf* held otherwise determine whether a statute or rule may be applied retroactively. *See* 511 U.S. at 280.

Here, General Order 3:85mc26 of the United States District Court for the Northern District of Mississippi contains an "express command" that Local Rule 83.1 apply to all attorneys who seek to practice before that court in cases after the Rule's effective date, which was September 1, 1998. *See* p. 9, *supra*. As we have explained, General Order 3:85mc26, after reciting the text of Local Rule 83.1, emphasizes that the Rule "provide[s] no 'grandfathering' provision allowing a non-resident attorney not a member of the Mississippi Bar to practice in a district court other than on a case-by-case *pro hac vice* admission."

In this context, a "grandfathering" provision would be one that allows an attorney who was admitted to the bar of the Northern District of Mississippi prior to the adoption of Rule 83.1 to continue appearing in that court without having to satisfy the requirements imposed by that Rule. *See Gallo*, 349 F.3d at 1175 (discussing the nature of a "grandfather clause").

Since the General Order contains an express statement that Local Rule 83.1 contains no "grandfathering provision," it is a direct command that the Rule apply to an attorney, such as Attorney Cohn, who alleges he had been admitted to the Northern District of Mississippi Bar prior to Rule 83.1's effective date. As a result, therefore, pursuant to *Landgraf*, Local Rule 83.1 applies to Mr. Cohn, as a matter of statutory construction, regardless of whether it regulates past or future conduct on his part or disturbs any vested rights he may or may not have. Thus, this Court need not go on to consider the issues discussed in subsection C, below, in order to reject Mr. Cohn's claim that *Landgraf* bars the application of Rule 83.1 to him.

C. In the Alternative, Local Rule 83.1 Arguably Is Not Being Applied Retroactively to Mr. Cohn.

As the district court correctly observed, "[t]he Bankruptcy Court's application of Rule 83.1 and the General Order affect only cases filed *after* the effective date of those provisions." Order at 2 (USCA5 54). To reiterate briefly, Local Rule 83.1 became effective on September 1, 1998, and the General Order was issued on July 18, 2006. *See* p. 9, *supra*. Mr. Cohn filed the bankruptcy petition that initiated this case on December 27, 2007. *See* p. 10, *supra*.

1. Mr. Cohn does not explain why he considers the Bankruptcy Court's application of Rule 83.1 to him retroactive, other than to state that he was admitted to the bar of the Northern District of Mississippi in 1982 and that he has never been disbarred. For the following reasons, this Court could reasonably decide that Mr. Cohn's prior admittance to the Northern District's bar is not the relevant conduct this Court should consider in determining whether 83.1 Rule is being applied to him retroactively, and that the relevant conduct is his desire to appear as counsel before that court in this case and, presumably, future cases.

To begin, Rule 83.1 clearly does not impose any affirmative penalty on Mr. Cohn based on his 1982 bar admission, or impose any new obligations on him that arise out of his prior bar membership. *Cf. Landgraf*, 511 U.S. at 280.

Whether Rule 83.1 deprives Mr. Cohn of any "vested rights," *Landgraf*, 511 U.S. at 269 (citation omitted), is a more complex question. On the one hand, there is authority for the proposition that an attorney does not have vested interest in the terms and conditions of bar membership that exist when he or she is admitted to the bar. *See In re Isserman*, 345 U.S. 286, 289 (1953) (plurality opinion) ("There is no vested right in an individual to practice law. Rather, there is a right in the Court to protect itself, and hence society, as an instrument of justice"), *vacated on other grounds*, 348 U.S. 1 (1954); *Tinkoff* v. *United States*, 212 F.2d 18, 20 (7th Cir. 1954) (noting that "'[m]embership in the bar is a privilege burdened with conditions'") (quoting *In re Rouss*, 221 N.Y. 81, 84 (Ct. App. N.Y. 1917) (Cardozo, J.)).

Moreover, as this Court has observed, "[t]raditionally, courts enjoy broad discretion to determine who shall practice before them and to monitor the conduct of those who do." *United States* v. *Dinitz*, 538 F.2d 1214 (5th Cir. 1976) (noting that "[s]ince attorneys are officers of the courts before which they appear, such courts are necessarily vested with the authority, within certain limits, to control attorneys' conduct") (citations omitted). To conclude that *Landgraf* bars a court from imposing new conditions on attorneys who are already members of the bar of that court unless the rule in question contains an express "no grandfathering" clause could be viewed as substantially impairing a court's ability to control the practice of litigation before it.

For example, a court arguably should be able to impose reasonable fees upon members of its bar as a condition of continued bar membership, as many courts have done in order to provide additional needed sources of revenue, without triggering concerns related to whether the new rule is retroactive. Similarly, a court arguably should be able to impose upon its bar members new rules relating to ethical standards or inappropriate conduct (such as a prohibition against engaging in discrimination, sexual harassment, or other forms of unacceptable behavior) without triggering

Landgraf's presumption against retroactivity. Indeed, under Mr. Cohn's view of the law, a court could not require an attorney who is a member of that court's bar to participate in a case management/electronic filing program unless the Court's administrative rule concerning electronic filing expressly contains a "no grandfathering" clause. *Cf. Landgraf*, 511 U.S. at 275 (noting that "changes in procedural rules may often be applied in suits arising before their enactment without raising concerns about retroactivity").

In addition, Local Rule 83.1 does not deprive any attorney of his or her right to practice law in general; impose anything that could be construed as a penalty or punishment upon a lawyer, such as would be involved in a disbarment proceeding; or prevent an attorney from appearing before the Northern District either (1) by becoming a member of the Mississippi bar, or (2) by applying for admission *pro hac vice*. The current fee for appearing *pro hac vice* in the Northern District is only $100, *see* http://www.msnd.uscourts.gov/general.htm (fee schedules), an amount Mr. Cohn does not contend would prevent him from representing clients before that court, and there is at least one other lawyer in Mr. Cohn's firm who is a member of the Mississippi Bar and who could move Mr. Cohn's admission *pro hac vice* and attend legal proceedings with him. *See generally* Local Rule 83.1(d)(3) & (4).

As we have already explained, these rules were publicly available when Mr. Cohn agreed to file Ms. Campbell's bankruptcy petition in this case. Moreover, Mr. Cohn does not argue that the Northern District lacked statutory authority to promulgate those rules or to make them applicable to attorneys who had already been admitted to its bar. The Rules Enabling Act provides that "all courts established by Act of Congress may from time to time prescribe rules for the conduct of their business," 28 U.S.C. 2071(a), and that any such rule "shall take effect upon the date specified by the prescribing court *and shall have effect on pending proceedings as the prescribing court may order*." Id. 2071(b).

Thus, the unexplained reference to *Bowen* v. *Georgetown University Hospital*, 488 U.S. 204 (1988), in Appellant's Brief is inapt. *Bowen* held that "a statutory grant of legislative rulemaking authority will not, as a general matter, be understood to encompass the power to promulgate retroactive rules unless the power is conveyed by Congress in express terms." *Id.* at 472 (citation omitted). Here, as noted above, the Rules Enabling Act gives courts the authority to promulgate rules of procedure and to apply those rules to pending and future proceedings. As explained above, the bankruptcy court's application of its Northern District Local Rule 83.1 to Mr. Cohn does nothing more than that.

Moreover, as noted above, "[a] statute does not operate 'retrospectively' merely because it is applied in a case arising from conduct antedating the statute's enactment." *Landgraf*, 511 U.S. at 269 (citation omitted). Thus, where, as here, the court applied Rule 83.1 to Mr. Cohn's appearance in this and future cases, the fact that his prior admission to the court's bar allegedly occurred prior to the court's announcement that he must abide by the rule does not, by itself, make the court's action retrospective as to Mr. Cohn. For all the above reasons, therefore, it could be argued that an attorney who has been admitted to a federal district court bar holds not an "immediate fixed right of present or future enjoyment," *Fernandez-Vargas* v. *Gonzales*, 548 U.S. 30, 44 n.10 (2006) (citation omitted), but rather only a "contingent" interest, *ibid.*, in appearing in that court under terms and conditions set by Congress and the courts.

2. On the other hand, the Supreme Court has held that an attorney has a sufficient property interest in federal bar membership to assert due process rights in opposition to disbarment proceedings. *See In re Ruffalo*, 390 U.S. 544, 550 (1968). In addition, in *Gallo*, the Ninth Circuit ruled that an attorney who, like Mr. Cohn, was required to join the state bar in which a federal district court is located as a condition of retaining his or her membership in the federal court's bar had a property interest for due process clause purposes. *See* 349 F.3d at 1179.

Neither *Ruffalo* nor *Gallo* discussed whether an attorney's federal bar membership also constitutes a "vested right" for purposes of applying *Landgraf*.[14] This Court also need not address that question here, however, because, as we have explained, General Order 3:85mc26 contains an express command that Local Rule 83.1 applies to all attorneys, with no "grandfather" exception.

II. Rule 83.1 Does Not Violate the Ex Post Facto Clause or Any of Mr. Cohn's Rights Under the Due Process Clause.

The district court correctly held that the Bankruptcy Court's application of Local Rule 83.1 to Mr. Cohn does not violate any of his constitutional rights.

A. Rule 83.1 Does Not Violate the Ex Post Facto Clause.

As the district court correctly observed, *see* USCA5 54, the Ex Post Facto Clause[15] is applicable only to laws that inflict criminal punishments. *See*, *e.g.*, *Smith*

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[14] For purposes of applying the due process clause, however, *Gallo* did draw a distinction between the *disbarment* of a lawyer, which is "a punishment or penalty imposed on the lawyer," 349 F.3d at 1182 (citation omitted), and the adoption of a rule that requires an existing bar member to satisfy certain new conditions in order to maintain his or her federal bar membership. *See id.* at 1182-83.

[15] The Constitution actually contains two Ex Post Facto Clauses: one that applies to the federal government, *see* U.S. Const., Art. I, § 9, cl. 3 (providing that "[n]o Bill of Attainder or ex post facto Law shall be passed), and another that applies to the states. *See* U.S. Const., Art. I, § 10, cl. 1 ("[n]o State shall . . . pass any Bill of Attainder, ex post facto Law, or Law impairing the Obligation of Contracts"). This case obviously involves the federal provision. The Supreme Court has interpreted the two clauses synonymously. *See Stogner* v. *California*, 539 U.S. 607, 610 (2003).

v. *Doe*, 538 U.S. 84, 92 (2002). *Accord United States* v. *Young*, 585 F.3d 199, 204 (5th Cir. 2009). Mr. Cohn does not contend that Local Rule 83.1 imposes a criminal penalty or any other sanction that could be viewed as punitive under the Supreme Court's precedents, *see generally Doe*, 538 U.S. at 97, and the purpose and effect of the Rule are both plainly civil and regulatory – to ensure a minimum level of competence for lawyers practicing before the Northern District of Mississippi commensurate with local standards. *See Gallo*, 349 F.3d at 1180 (upholding a similar rule applied by the Arizona federal district court). Thus, the district court correctly held that Rule 83.1 does not violate the Ex Post Facto Clause as applied to Mr. Cohn in this case and any future appearances he may wish to make in the Northern District of Mississippi.

B. Rule 83.1 Also Does Not Violate Any of Mr. Cohn's Rights Under the Due Process Clause.

1. With respect to the Due Process Clause, it is not clear that Mr. Cohn has adequately presented or preserved any argument sufficient for this Court to review. Mr. Cohn's appeal brief (p. 7) states that "[n]o disbarment proceedings have ever been instituted to divest him of [the privilege of appearing in the Northern District of Mississippi] as required under the 5th Amendment Due Process Clause," but he fails to provide any supporting argument or to suggest why Rule 83.1 lacks a rational basis as applied to him. *See Adams* v. *Unione Medittanea Di Sicurta*, 364 F.3d 646, 653 (5th Cir.) ("Issues not raised or inadequately briefed on appeal are waived"), *cert. denied*, 543 U.S. 979 (2004).

2. Even if Mr. Cohn had preserved a due process argument, any such argument would fail. In *Gallo*, *supra*, the Ninth Circuit rejected a due process challenge to exactly the kind of local federal district court rule Mr. Cohn attacks here. In so doing, the Ninth Circuit explained that such a rule satisfies due process if it bears a rational relationship to a legitimate state interest, since it would not impair any fundamental rights and because lawyers are not a suspect class *See Gallo*, 349 F.3d at 1179. As was true of the rule at issue in *Gallo*, Northern District of Mississippi Local Rule 83.1 easily satisfies that standard because it "serves the legitimate interest of ensuring that all attorneys practicing before the [United States District Court for the Northern District of Mississippi] 'clear the standard required' by the respective state bar association[].'" *Id.* at 1181 (citing *Russell* v. *Hug*, 275 F.3d 812, 819 (9th Cir. 2002)).

As *Gallo* explains, "[h]istorically . . . 'the licensing and regulation of lawyers has been left exclusively to the states and the District of Columbia within their respective jurisdictions.'" 349 F.3d at 1180 (citation omitted). Thus, it follows that federal district courts "may rely on the infrastructure provided by state bar associations in meeting their own needs for monitoring attorney admission and practice in the federal courts." *Ibid.* (citing *Russell*, 275 F.3d 812). In addition, a federal district court's requirement that attorneys who practice before it be members of the local state bar is "rationally related to the federal court's legitimate interest 'in policing ethical conduct of the lawyers who practice law'" before it. *Gallo*, 349 F.3d at 1180 (quoting *Russell*, 275 F.3d at 820).

Every other decided case of which we are aware also rejects the idea that due process forbids a federal court from requiring attorneys who seek admission to its bar to be admitted to the bar of the state in which the court sits. *See Roberts* v. *Roberts*, 682 F.2d 105 (3d Cir. 1982); *In re Pawlak*, 1995 WL 723177 (E.D. Pa. 1995).[16] *See also Brown* v. *McGarr*, 774 F.2d 777 (7th Cir. 1985) (rejecting procedural due process challenge to federal district court bar rule requiring attorneys to demonstrate prior trial experience before being allowed to join a newly formed court "trial bar").[17]

Significantly, the Third Circuit in *Roberts* noted that tying district court admission to state bar membership "tends to protect the interests of the public."

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[16] *In re Pawlak* is an unpublished disposition. We cite the case not as controlling precedent, but for background purposes only.

[17] *Cf. Frazier* v. *Heebe*, 482 U.S. 641 (1987) (holding that a federal district court may not require an attorney who is a member of the bar of the state in which the court is located also to reside or maintain an office in that state in order to be admitted to the district court's own bar).

Roberts, 682 F.2d at 108. "For example," the Third Circuit noted, "when a choice of either a federal or a state forum is available in a particular case an attorney admitted only to the federal court may choose that forum solely for that reason, possibly disregarding the interests of his clients." *Ibid.*[18] In addition, the Third Circuit also has "expressed concern . . . that admission to the federal but not the state bar implies disapproval of the action of the state court, and undermines public confidence in the legal system and in the bar." *In re Pawlak*, 1995 WL 723177 *4 (citing *In re Abrams*, 521 F.2d 1094, 1106 (3d Cir.), *cert. denied*, 423 U.S. 1038 (1975)).

Moreover, we also note that the district court applied Local Rule 83.1 to Mr. Cohn only prospectively – that is, with respect to his appearance in this case and any future proceedings before the Northern District – and that, as explained above, the Rule does not deprive Mr. Cohn of the ability to practice law in general or to appear in the Northern District by admission *pro hac vice*. *See* p.22, *supra*.

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[18] The Third Circuit in *Roberts* also concluded that an attorney lacks a liberty or property interest in his or her membership in a federal court bar. *See* 682 F.2d at 107. The Ninth Circuit took the opposite view of that question in *Gallo*, *see* 349 F.3d at 1179, and the Supreme Court in *In re Ruffalo*, *supra*, appeared to take the same view as the Ninth Circuit did in *Gallo*, although the Supreme Court did not address the question in those precise terms. *See* p. 24, *supra.* This Court need not resolve that issue in order to resolve this appeal because there are numerous other grounds upon which the Court can reject Mr. Cohn's due process "argument," to the extent it can be called that.

For all the above reasons, therefore, this Court should conclude that Local Rule 83.1 has a rational basis as applied to Mr. Cohn in this case, and thus fully comports with the Due Process Clause.

3. Mr. Cohn also suggests that "no notice was given to the debtor's attorney to participate in such decisions." Appellant's Brief at 9. Mr. Cohn does not identify the "decisions" to which he refers, but he appears to point to the Northern District of Mississippi's "policy change," *ibid.*,[19] requiring membership in the Mississippi bar as a prerequisite to membership in the district court bar. As the Ninth Circuit explained in *Gallo*, however, that kind of rules change, which applies to all attorneys who wish to appear before the Northern District of Mississippi, satisfies the requirements of procedural due process "if the enacting body provides public notice and open hearings." *Gallo*, 349 F.3d at 1181. *Accord Brown* v. *McGarr*, 774 F.2d at 785 (due process did not require individual notice before application to attorney of new court rule requiring attorneys to demonstrate trial experience before they can appear alone in that court). *See also Gallo*, 349 F.3d at 1182 (distinguishing a disbarment proceeding, which is based on an allegation of attorney misconduct).

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[19] As explained above, Local Rule 83.1 in fact was substantially similar to the previous rule that governed admission to the bar of the Northern District, *see* p. 10, *supra*, and Mr. Cohn has failed to prove, or argue, why he could have been properly admitted under the former rule.

Mr. Cohn does not contend that Local Rule 83.1 did not result from appropriate proceedings or involve adequate opportunity for comment by the bar, and we are not aware of any reason to believe the Rule did not flow out of the process required by Fed. R. Civ. P. 83(a)(1) ("After giving public notice and an opportunity for comment, a district court, acting by a majority of its district judges, may adopt and amend rules governing its practice). Thus, Mr. Cohn is not constitutionally entitled to a pre-deprivation individual hearing concerning whether he may continue to appear before the Northern District of Mississippi in light of Rule 83.1. *See Gallo*, 349 F.3d at 1181-1183.

Conclusion

For the foregoing reasons, the district court's decision should be affirmed.

Respectfully submitted,

Tony West
Assistant Attorney General

William C. Martin
United States Attorney

William Kanter
(202) 514-4575
s/Lowell V. Sturgill Jr.
(202) 514-3427
Attorneys, Appellate Staff
Civil Division, Room 7241
Department of Justice
950 Pennsylvania Avenue
Washington, D.C. 20530

May 2010

Certificate of Service

I hereby certify that on this 18th day of May, 2010, I filed the foregoing Brief for Appellee by using the Court's CM/ECF system. A copy of the brief will be served on the following counsel by use of that system:

William A. Cohn
lawvoll@cohnlawfirm.com
The Cohn Law Firm
201 Germantown Bend Cove
Cordova, TN 38018-0000

s/Lowell V. Sturgill Jr.

Certificate of Compliance

I hereby certify that, according to the word count provided in Corel Wordperfect 13, the foregoing brief contains 7768 words. The text of the brief is composed in proportionally spaced, 14-point Times New Roman typeface, which has 10 characters per inch.

s/Lowell V. Sturgill Jr.

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WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*
In re Stanley J. Caterbone

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*
3rd Cir.

3. ("CCN") ***CURRENT*** CASE NO.
No.: 07-2151

4. ("PCN") ***PRIOR*** CASE NO. - & COURT *[IF ANY]*
No.: 06-cv-05012
Court: E. D. Pa.
(Identify judge & cite, if any)

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U.S. TRUSTEES

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8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***
- Whether the district court erred by dismissing the appeal as untimely or, alternatively, abused its discretion by dismissing appellant's bankruptcy appeal due to appellant's failure to comply with Fed. R. Bankr. P. 8006.

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In The United States Court of Appeals for the Third Circuit

IN RE CATERBONE

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

BRIEF FOR THE UNITED STATES TRUSTEE

TONY WEST
Assistant Attorney General

ZANE DAVID MEMEGER
United States Attorney

WILLIAM KANTER
(202) 514-4575
JEFFRICA JENKINS LEE
(202) 514-5091
Attorneys, Appellate Staff
Civil Division, Room 7537
Department of Justice
950 Pennsylvania Ave., NW
Washington, DC 20530-0001

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FOR THE THIRD CIRCUIT

IN RE CATERBONE

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

BRIEF FOR THE UNITED STATES TRUSTEE

JURISDICTIONAL STATEMENT

The bankruptcy court had jurisdiction pursuant to 28 U.S.C. § 157(b) over the appellant's voluntary petition for bankruptcy under chapter 11 of the Bankruptcy Code, 11 U.S.C. §§ 1101 *et seq*. The bankruptcy court's order dismissing the case was entered on October 3, 2006. Appellant's notice of appeal from the bankruptcy court's order, filed on October 19, 2006 (SA 19),[1] was therefore untimely. *See* Fed. R. 28 U.S.C.§ 158(c)(2) (adopting appeal time provided by Bankruptcy Rule 8002); Fed. R. Bankr. P. 8002(a) (establishing 10-day time period to file notice of appeal from entry of the judgment,

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[1] "SA" refers to the Supplemental Appendix filed by *amicus* counsel.

order, or decree appealed from).[2] Because appellant's notice of appeal was untimely, the district court lacked subject-matter jurisdiction over the appeal. *See Bowles v. Russell*, 551 U.S. 205, 207 (2007). Appellant's notice of appeal from the district court's order, filed April 16, 2007 (Dist. Ct. Docket Entry 3), is therefore a nullity. Because the

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[2] Citations to the Fed. R. Bankr. P. are to the version of the rules in effect in 2006 when appellant filed his notice of appeal. Fed. R. Bankr. P. 8002(a) was amended, effective December 1, 2009, to increase the time for filing a notice of appeal from 10 to 14 days. *See* Order Amending Federal Rules of Bankruptcy Procedure (S.Ct. March 26, 2009) ("The foregoing amendments to the Federal Rules of Bankruptcy Procedure shall take effect on December 1, 2009, and shall govern in all proceedings in bankruptcy cases thereafter commenced and, insofar as just and practicable, all proceedings then pending.") (accessible at: http://www.supremecourt.gov/orders/ courtorders/frbk09.pdf).

Given the posture of this case, where the period for filing an appeal has long passed, application of the new 14 day time period would appear impracticable. *See Landgraf v. USI Film Prod.*, 511 U.S. 244, 275 n.29 (1994) ("Of course, the mere fact that a new rule is procedural does not mean that it applies to every pending case," rather, the Court's orders approving amendments to federal procedural rules "reflect the commonsense notion that the applicability of such provisions ordinarily depends on the posture of the particular case."). But even assuming the new 14 day time period were applicable in this case, the outcome would be no different because Caterbone's notice of appeal was filed on the 16th day after entry of the bankruptcy court's order.

district court lacked subject-matter jurisdiction to hear the merits of appellant's appeal, this Court, too, lacks jurisdiction over appellant's appeal from the district court's dismissal of the case. *Bowles*, 551 U.S. at 207.

STATEMENT OF THE ISSUES

1. Whether any objection to appellant's untimely appeal to the district court was forfeited by the Trustee's failure to challenge it in the district court, *see Kontrick v. Ryan*, 540 U.S. 443 (2004), or whether the time-period for filing such an appeal is a jurisdictional time-constraint, not subject to such waiver, within the meaning of *Bowles v. Russell*, 551 U.S. 205 (2007).

2. Assuming this Court has appellate jurisdiction, did the district court abuse its discretion by dismissing appellant's bankruptcy appeal due to appellant's failure to comply with Fed. R. Bankr. P. 8006.

STATEMENT OF THE CASE

A. ***Nature of Case and Disposition Below***

In an order entered on October 3, 2006, the United States Bankruptcy Court for the Eastern District of Pennsylvania granted a motion by the United States Trustee to dismiss appellant Stanley J. Caterbone's (Caterbone) chapter 11 bankruptcy case for cause under 11 U.S.C. § 1112(b). On October 19, 2006, sixteen days after entry of the bankruptcy court's order, Caterbone filed an untimely notice of appeal from the bankruptcy court's order to the United States District Court for the Eastern District of Pennsylvania. The untimeliness of Caterbone's appeal was not brought to the district court's attention by the United States Trustee. However, the district court, acting on its own motion, dismissed the appeal on March 15, 2007, on the nonjurisdictional grounds that Caterbone had failed to comply with Fed. R. Bankr. P. 8006's requirement that he designate the contents of the record on appeal and file a statement of issues to be raised on appeal.

Caterbone filed a notice of appeal to this Court from the district court's order, and the United States Trustee has moved to dismiss the appeal for lack of subject-matter jurisdiction.

B. *Statutory and Regulatory Framework*

Bankruptcy protection under chapter 11 of the Code, 11 U.S.C. §§ 1101 *et seq.*, is designed to allow a financially distressed debtor the opportunity to reorganize. *See In re Philadelphia Newspapers, LLC*, 599 F.3d 298, 303 (3d Cir. 2010) ("Chapter 11 of the Bankruptcy Code strikes a balance between two principal interests: facilitating the reorganization and rehabilitation of the debtor . . . and protecting the value of the bankruptcy estate."); *see also United Sav. Ass'n v. Timbers of Inwood Forest Assocs.*, 484 U.S. 365, 376 (1988) ("There must be a reasonable possibility of a successful reorganization within a reasonable time.") (citation and internal quotation marks omitted).

While chapter 11 is typically used to reorganize a business, individuals may also file a voluntary petition for protection under chapter 11, as Caterbone did in this case. 11 U.S.C. § 301. After commencing a bankruptcy case, the debtor must comply with various document filing requirements mandated by the Federal Rules of Bankruptcy Procedure and the Bankruptcy Code. For instance, the debtor must file with the bankruptcy court: (1) schedules of assets and liabilities; (2) a schedule of current income and expenditures; (3) a schedule of executory contracts and unexpired leases; and (4) a statement of financial affairs. Fed. R. Bankr. P. 1007. If the debtor is an individual, there are additional document filing requirements. *See* 11 U.S.C. § 521 (detailing filing requirements). A written disclosure statement and a plan of reorganization typically must also be filed with the court. 11 U.S.C. §§ 1121, 1125. The debtor is also required to pay certain statutory fees upon commencing a bankruptcy case. *See* 28 U.S.C. § 1930(a)(3) & (6).

The United States Trustee plays a significant role in monitoring and supervising a chapter 11 case. The United States Trustee Program was established as a component of the United States Department of Justice to undertake certain statutorily mandated responsibilities with respect to bankruptcy cases. *See* 28 U.S.C. §§ 581-589. Thus, the United States Trustee "may appear and be heard on any issue in any case or proceeding" in bankruptcy. 11 U.S.C. § 307. *See also In re Columbia Gas Sys. Inc.*, 33 F.3d 294, 296 (3d Cir. 1994) (United States Trustees oversee the bankruptcy process, protect the public interest, and ensure that bankruptcy cases are conducted according to law.).

Part VIII of the Federal Rules of Bankruptcy Procedure prescribe the manner for appealing a bankruptcy court's final decision. In particular, Rule 8001 states that an appeal "from a judgment, order, or decree of a bankruptcy judge to a district court or bankruptcy appellate panel as permitted by 28 U.S.C. § 158(a)(1) or (a)(2) shall be taken by filing a notice of appeal with the clerk within the time allowed by Rule 8002." Fed. R. Bankr. P. 8001(a). The rule further provides that "[a]n appellant's failure to take any step other than timely filing a notice of appeal does not affect the validity of the appeal, but is ground only for such action as the district court . . .

deems appropriate, *which may include dismissal of the appeal.*" *Id.* (emphasis added). At the time Caterbone filed his appeal of the bankruptcy court's order to the district court in this case, the "time allowed" by Rule 8002 to appeal was ten days. *See also* 28 U.S.C. § 158(c)(2) (bankruptcy appeals "shall be taken . . . in the time provided by Rule 8002 of the Bankruptcy Rules").

C. *Factual and Procedural Background*

1. On May 23, 2005, Caterbone, acting *pro se*, filed a voluntary chapter 11 petition for bankruptcy in the bankruptcy court. On June 13, 2005, the bankruptcy court *sua sponte* entered an order dismissing the case for Caterbone's failure to timely file required documents. Caterbone appealed the dismissal to the district court and, on October 5, 2005, the district court ordered reinstatement of the case in the bankruptcy court, "provided that [Caterbone] comply with the rules and requirements applicable to all debtors seeking relief under the Bankruptcy Code." *In re Caterbone*, No. 05-3689 (E.D. Pa. Oct. 5, 2005).

2. Thereafter, on May 30, 2006, the United States Trustee filed a motion in the bankruptcy court to dismiss or convert the case to one under chapter 7. SA 09 (Bankr. Ct. Docket Entry No. 60). A hearing was held on the United States Trustee's motion on June 29, 2006. SA 10 (Bankr. Ct. Docket Entry No. 66). On October 3, 2006, the bankruptcy court dismissed Caterbone's chapter 11 case both for "cause" pursuant to 11 U.S.C. § 1112(b), and "due to Debtor's failure to defend." SA 01. In so doing, the bankruptcy court found that the United States Trustee met her burden of proving that cause existed to dismiss the case by establishing that Caterbone: (1) had been and was unable to propose and obtain confirmation of a viable plan of reorganization; (2) had failed to remain current with the filing of required financial reports pursuant to the United States Trustee Operating Guidelines and Local Bankr. R. 2015.1; and (2) had failed to pay the required statutory fees under 28 U.S.C. §1930(a)(6). As for Caterbone' failure to defend, the bankruptcy court noted that Caterbone did not file a brief in opposition to the United States

Trustee's motion to dismiss the case, and did not attend two hearings and a chapter 11 status conference. SA 02 n.4.

The bankruptcy court's order dismissing the case was entered that same day (October 3, 2006), and was served by the court clerk on October 5, 2006. Caterbone filed a notice of appeal to the district court from the bankruptcy court's order on October 19, 2006, sixteen days after the order was entered.

3. On March 15, 2007, the district court *sua sponte* issued an order dismissing the appeal and remanding the matter to the bankruptcy court, citing Caterbone's failure to file a designation of the contents of the record on appeal and statement of issues to be raised on appeal as required by Fed. R. Bankr. Proc. 8006. App. 1.[3] Caterbone filed a notice of appeal to this Court from the district court's order on April 16, 2007.

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[3] "App." denotes appendix submitted by appellant with his opening brief.

In a motion filed in this Court on June 8, 2007, the United States Trustee moved to dismiss Caterbone's appeal for lack of jurisdiction. In support of her motion, the United States Trustee pointed out that Caterbone's appeal of the bankruptcy court's October 3, 2006, order was untimely because the notice of appeal was filed on October 19, 2006, sixteen days after entry of the order. Under 28 U.S.C. § 158(c)(2) and Fed. R. Bankr. P. 8002, the United States Trustee noted, any notice of appeal with respect to the bankruptcy court's October 3, 2006, order was required to be filed within ten calendar days of the date of entry of the order; that is, by October 13, 2006. SA 23. Explaining that failure to comply with the bankruptcy rule's filing deadlines creates a jurisdictional defect barring appellate review, the United States Trustee asserted that the district court lacked jurisdiction over Caterbone's appeal. SA 24-25. Because the district court lacked jurisdiction over the appeal, the United States Trustee argued, this Court also lacks jurisdiction to entertain the merits of Caterbone's appeal under 28 U.S.C. § 158(d). SA 25.

4. By order of July 8, 2009, this Court referred the United States Trustee's motion to dismiss to a merits panel, and directed the clerk to locate and appoint *amicus* counsel on behalf of the Court. In a subsequent order entered on December 16, 2009, *amicus* counsel was appointed, with representation limited to addressing the jurisdictional issue.

SUMMARY OF ARGUMENT

1. In 28 U.S.C. § 158(c)(2), Congress established a mandatory and jurisdictional deadline for appealing a bankruptcy court's judgment through its explicit adoption of the "time provided by Rule 8002[a] of the Bankruptcy Rules." As such, Rule 8002(a) implicates a district court's subject-matter jurisdiction to hear bankruptcy appeals. The jurisdictional issue posed by the Court is whether any objection to appellant's untimely appeal to the district court was forfeited by the United States Trustee's failure to challenge it in the district court, *see Kontrick v. Ryan*, or whether the time-period for filing such an appeal is a jurisdictional time-constraint, not subject to

waiver, within the meaning of *Bowles v. Russell.* This case is governed by *Bowles*.

As the Supreme Court explained in *Bowles*, where Congress has by statute specifically established a time limit for taking an appeal, "that limitation is more than a simple 'claim-processing rule.'" 551 U.S. at 213. Caterbone's failure to file his notice of appeal in accordance with the congressionally-mandated time limit thus deprived the district court of its statutory power to adjudicate the case. Because "'[t]his . . . concept of subject-matter jurisdiction involves a court's power to hear a case, [it] can never be forfeited or waived." *United States v. Cotton*, 535 U.S. 625, 630 (2002). "Consequently, defects in subject-matter jurisdiction require correction regardless of whether the error was raised in district court." *Id.* (citations omitted).

Indeed, treating Rule 8002(a)'s appeal time limit as jurisdictional follows naturally from a examination of the requirement's text, context, and historical treatment. *See Reed Elsevier Inc. v. Muchnick*, 130 S. Ct. 1237, 1246 (2010). As we discuss, Rule 8002(a)'s timeliness condition, which is affirmatively incorporated by 28 U.S.C. § 158(c)(2), is located in the same section of the statute that grants district courts jurisdiction to hear bankruptcy appeals. *See* 28 U.S.C. § 158(a)-(b). Further, federal case law jurisprudence has for over 100 years treated time limits for filing a notice of appeal as jurisdictional. For instance, Rule 4(a) of the Federal Rules of Appellate Procedure, after which Rule 8002(a) was expressly modeled, has long been held to be "mandatory and jurisdictional." *See Browder v. Dir. of Corr. of Ill.*, 434 U.S. 257, 264 (1978). It was upon this basis that the Tenth Circuit recently reaffirmed its pre-*Kontrick* precedent which had consistently held that "Rule 8002(a) is jurisdictional." *See In re Latture*, 605 F.3d 830, 836 (10th Cir. 2010).

For all of these reasons, the Court should dismiss Caterbone's appeal for lack of subject-matter jurisdiction.

2. If, however, the Court is unpersuaded by our arguments (and those of *amicus* counsel) that jurisdiction is lacking, and proceeds to

a determination of the merits, then it should affirm the district court's dismissal of the appeal for failure to prosecute. As we discuss, dismissal of the appeal was warranted in this case because Caterbone did nothing more to sustain his challenge to the bankruptcy court's order than file a notice of appeal – and an untimely one at that. The Bankruptcy Rules are straightforward in their requirement that, ten (now fourteen) days after noticing an appeal, the appellant is required to file with the bankruptcy court a designation of the items to be included in the record on appeal and a statement of the issues to be raised. Fed. R. Bankr. P. 8006. Rule 8001(a) also clearly warns litigants that an appellant who fails to take any steps beyond filing a "timely notice of appeal" runs the risk of having his case dismissed by the district court. Fed. R. Bankr. P. 8001(a). Although Caterbone now recites a long list of reasons why his failure to comply with the Bankruptcy Rules constitutes "excusable neglect," the record instead suggests that his failures emanated from indifference and a cavalier attitude toward the requirements of the Rules.

In sum, if this Court finds that jurisdiction exists, then it should affirm the district court's judgment.

STANDARD OF REVIEW

The district court dismissed Caterbone's case without addressing its jurisdiction. It is well-settled that subject matter jurisdiction may be raised at any time during the same civil action, even if the issue is initially raised at the appellate level. *Kontrick*, 540 U.S. at 455. Indeed, courts have an independent obligation to determine whether subject-matter jurisdiction exists, even in the absence of challenge by any party. *Arbaugh v. Y&H Corp.*, 546 U.S. 500, 514 (2006).

Assuming the Court finds that it has jurisdiction over Caterbone's appeal, it must review the district court's dismissal order only for an abuse of discretion. *In re Jewelcor Inc.*, 11 F.3d 394, 397 (3d Cir. 1993).

ARGUMENT

I. CATERBONE'S APPEAL MUST BE DISMISSED FOR LACK OF SUBJECT-MATTER JURISDICTION

Pending before this Court is the motion of the United States Trustee to dismiss Caterbone's appeal for lack of subject-matter jurisdiction. In referring the motion to this merits panel, the Court raised the issue whether the Trustee forfeited the right to object to the untimeliness of Caterbone's appeal of the bankruptcy court's order by not raising the issue in district court, or whether the time-period for filing such an appeal is a nonwaivable jurisdictional time-constraint.[4] As we discuss below,[5] and as *amicus* counsel agrees, because the time allowed for appeal by Fed. R. Bankr. P. 8002(a) is embodied in statute (28 U.S.C. § 158(c)(2)), it is a nonwaivable time-constraint such that "this Court lacks subject matter jurisdiction over the appeal." *Amicus* Counsel Br. 4.

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[4] In his brief on appeal, appellant states that he "will not argue this issue." Appellant's Br. 8.

[5] *See also* Mot. of U.S. Trustee to Dismiss Appeal. SA 23-24 & n.3.

A. *Congress Authorized District Courts to Exercise Subject-Matter Jurisdiction Over Bankruptcy Appeals in 28 U.S.C. § 158, Which Expressly Incorporates the Time Provided in Fed. R. Bankr. P. 8002 for Taking Appeals*

Federal courts are courts of limited subject-matter jurisdiction. *See Kokkonen v. Guardian Life Ins. Co. of Am.*, 511 U.S. 375, 377 (1994). Thus, "[t]hey possess only that power authorized by Constitution and statute, . . . which is not to be expanded by judicial decree." *Id.* (citations omitted); *see* U.S. Const. Art. III, § 1. Congress, through 28 U.S.C. § 158, has authorized federal district courts to exercise subject-matter jurisdiction over appeals from final judgments, orders, and decrees of bankruptcy courts. In particular, § 158(c)(2) provides that an appeal "shall be taken in the same manner as appeals in civil proceedings generally are taken to the courts of appeals from the district courts and *in the time provided by Rule 8002 of the Bankruptcy Rules*." 28 U.S.C. § 158(c)2) (emphasis added). In 2006, Rule 8002 ("Time for Filing Notice of Appeal") stated in pertinent part:

> (a) TEN-DAY PERIOD. The notice of appeal shall be filed with the clerk within 10 days of the date

> of the entry of the judgment, order, or decree appealed from.

Fed. R. Bankr. P. 8002(a).

The Bankruptcy Rules permit a bankruptcy judge to extend the time for filing a notice of appeal by any party, provided that the "request to extend the time for filing a notice of appeal [is] made by written motion filed before the time for filing a notice of appeal has expired, except that such a motion filed not later than 20 days after the expiration of the time for filing a notice of appeal may be granted upon a showing of excusable neglect." Fed. R. Bankr. P. 8002(c)(2). It is not disputed that Caterbone neither sought, nor obtained, an extension of time to file an appeal from the bankruptcy court's October 3, 2006, final order. Thus, Caterbone's notice of appeal was out of time because it was filed on October 19, 2006, six days after the time to file a notice of appeal expired. The district court therefore lacked subject-matter jurisdiction over the appeal. Because the district court lacked subject-matter jurisdiction under 28 U.S.C. § 158(c), this Court also lacks jurisdiction under 28 U.S.C. § 158(d) to determine the merits of Caterbone's appeal. The appeal should be dismissed accordingly. As the Supreme Court has long held, "when an 'appeal has not been prosecuted in the manner directed, within the time limited by the acts of Congress, it must be dismissed for want of jurisdiction.'" *Bowles*, 551 U.S. at 213 (quoting *United States v. Curry*, 47 U.S. (6 How.) 106, 113 (1848)).

B. *Because Rule 8002's Time Limit is Mandatory and Jurisdictional, Objection to the Untimeliness of Caterbone's Appeal Cannot be Forfeited*

Rule 8002(a)'s time limit, adopted by Congress in 28 U.S.C. § 158(c)(2), thus implicates a district court's subject-matter jurisdiction to hear bankruptcy appeals. And because "subject-matter jurisdiction . . . involves a court's power to hear a case, [it] can never be forfeited or waived." *United States v. Cotton*, 534 U.S. at 630.

This Circuit has long regarded Rule 8002(a)'s time limit for filing an appeal to be mandatory and jurisdictional. *See e.g.*, *Shareholders v. Sound Radio, Inc.*, 109 F.3d 873, 879 (3d Cir. 1997) (Rule 8002(a)'s deadline "is strictly construed" and "[t]he failure to file a timely notice of appeal creates a jurisdictional defect barring appellate review.");

Whitemere Dev. Corp., Inc. v. Twp. of Cherry Hill, 786 F.2d 185, 187 (3d Cir. 1986) (The time limit under Rule 8002(a) "is strictly construed and is jurisdictional in effect."); *In re Universal Minerals, Inc.*, 755 F.2d 309, 311 (3d Cir. 1985) (It cannot be "doubted that [Rule 8002(a)] is jurisdictional in effect. The Advisory Committee's Note to Rule 8002 expressly states that it is 'an adaptation of Rule 4(a) of the Federal Rules of Appellate Procedure.'"). This Court's view is also in line with the decisions of other courts of appeals that have addressed the question. *See e.g., In re Siemon*, 421 F.3d 167, 169 (2d Cir. 2005) ("We . . . follow our sister circuits in holding that the time limit contained in Rule 8002(a) is jurisdictional, and that, in the absence of a timely notice of appeal in the district court, the district court is without jurisdiction to consider the appeal . . . ."); *In re Don Vicente Macias, Inc.*, 168 F.3d 209, 211 (5th Cir. 1999) (failure to file a timely notice of appeal under Rule 8002(a) deprived district court of jurisdiction; in turn, court of appeals lacked jurisdiction over merits raised on appeal); *In re Herwit*, 970 F.2d 709, 710 (10th Cir. 1992) (The "failure to file a timely notice of appeal [is] a jurisdictional defect barring appellate review" of a bankruptcy court's order); *In re Slimick*, 928 F.2d 304, 306 (9th Cir. 1990) ("The untimely filing of a notice of appeal is jurisdictional.").

C. *Treating The Time Limit Prescribed By Rule 8002(a) as Jurisdictional is Consistent with* ***Kontrick*** *and* ***Bowles***

The Supreme Court's decisions in *Kontrick* and *Bowles, supra*, reinforce and reaffirm the correctness of the courts of appeals' treatment of Rule 8002(a)'s time limit as jurisdictional. In *Kontrick*, the Court confronted the question of whether Fed. R. Bankr. P. 4004(a), which sets the time limit for filing objections to a debtor's discharge, and Fed. R. Bankr. P. 9006(b)(3), which instructs the court on the limits of its discretion to grant objection filing time extensions, are jurisdictional. In holding that they are not, the Court explained that "no statute . . . specifies a time limit for filing a complaint objecting to the debtor's discharge," rather, "[t]he time constraints applicable to objections to discharge are contained in Bankruptcy Rules prescribed by [the Supreme] Court for '[t]he practice and procedure'" in bankruptcy cases. *Kontrick*, 540 U.S. at 453 (quoting

28 U.S.C. § 2075). Declaring "it is axiomatic that such rules do not create or withdraw federal jurisdiction," *id.* (citation and internal quotation marks omitted), the Court concluded that "[i]n short, the filing deadlines prescribed in Bankruptcy Rules 4004 and 9006(b)(3) are claim-processing rules that do not delineate what cases bankruptcy courts are competent to adjudicate." *Id.* at 454. Because the debtor failed to raise the untimeliness of the creditor's late-filed objections until after the complaint was adjudicated on the merits, he forfeited his right to object.[6] *Id.* at 459.

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[6] Similarly, in *Eberhart v. United States*, 546 U.S. 13 (2005), the Court examined whether Federal Rules of Criminal Procedure 33(b) and 45(b)(2), which closely parallel the rules at issue in *Kontrick*, are jurisdictional. In holding that those rules, which set forth the time limits for a criminal defendant's motion for a new trial, are nonjurisdictional claim-processing rules, the Court reasoned that "[i]t is implausible that the Rules considered in *Kontrick* can be nonjurisdictional claim-processing rules, while virtually identical provisions of the Rules of Criminal Procedure can deprive federal courts of subject-matter jurisdiction." 546 U.S. at 16. Thus, the Court held that where a party fails to raise the defense of untimeliness under a claim-processing rule until after the district court has reached the merits, it forfeits the defense. *Id.* at 19. *Cf. Arbaugh*, 546 U.S. at 515 (holding that Title VII's employee numerosity (continued...)

In contrast here, a statutory provision, 28 U.S.C. § 158(c)(2), does set the time limit for filing a notice of appeal to the district court from a bankruptcy court's decision. Rule 8002(a) simply carries the statute into practice. In that regard, the question in our case is more akin to the issue in *Bowles*, where a district court had purported to extend a party's time for filing an appeal beyond the time limit permitted by statute. Stating that it has "long and repeatedly held that the time limits for filing a notice of appeal are jurisdictional in nature," the Court held that the petitioner's untimely notice of appeal – even though filed in reliance upon the district court's order – deprived the court of appeals of jurisdiction. 551 U.S. at 206-07. In so holding, the Court explained that 28 U.S.C. § 2107(a) establishes the time period for filing a notice of appeal in civil cases, and that Fed. R. App. P. 4(a) carries § 2107 into practice. *Id.* at 208.

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[6] (...continued)
requirement, 42 U.S.C. § 2000e(b), is not jurisdictional, but is simply an element of a plaintiff's claim for relief).

Opining further, *Bowles* pointed out that the Court has consistently held that the requirement of filing a timely notice of appeal is "'mandatory and jurisdictional.'" 551 U.S. at 207 (quoting Browder, 434 U.S. at 264). *See also Griggs v. Provident Consumer Disc. Co.*, 459 U.S. 56, 61 (1982) (*per curiam*). The Court remarked that even before creation of the circuit courts of appeal, it had regarded statutory limitations on the timing of appeals as limitations on its own jurisdiction. *Bowles*, 551 U.S. at 210. Indeed, the Supreme Court has treated statutory time limits for taking an appeal as jurisdictional for well over a century. *Id.* at 209-10. The courts of appeals, too, "[r]eflecting the consistency of th[e] Court's holdings, . . . routinely and uniformly dismiss appeals for lack of jurisdiction." *Id.* at 209.

The *Bowles* Court summed up the jurisdictional distinction between court-promulgated rules and limits enacted by Congress as follows:

> Jurisdictional treatment of statutory time limits makes good sense. Within constitutional bounds, Congress decides what cases the federal courts have jurisdiction to consider. Because Congress decides whether federal courts can hear cases at all, it can also determine when, and under what conditions, federal courts can hear them. Put another way, the notion of subject-matter jurisdiction obviously extends to classes of cases . . . falling within a court's adjudicatory authority, but it is no less jurisdictional when Congress prohibits federal courts from adjudicating an otherwise legitimate class of cases after a certain period has elapsed from final judgment.

Id. at 212-213 (citations and internal quotation marks omitted) (ellipsis in original).

As the Supreme Court recently elaborated in attempting to further clarify the distinctions between jurisdictional prescriptions and claim-processing rules, the jurisdictional analysis must focus on the "legal character" of the requirement, which the court must "discern[] by looking to the condition's text, context, and relevant historical treatment." *Reed Elsevier, Inc. v. Muchnick*, 130 S.Ct. 1237, 1246 (2010). In applying that approach to Rule 8002(a), the Tenth Circuit has concluded that *Kontrick* and its progeny "reaffirm our holding in *In re Herwit* . . . that Rule 8002(a) is jurisdictional." *In re Latture*, 605 F.3d at 836. The court of appeals elaborated:

> Congress . . . explicitly include[d] a timeliness condition in 28 U.S.C. § 158(c)(2) – the requirement that a notice of appeal be filed within the time provided by Rule 8002(a). Furthermore, the timeliness requirement contained in Section 158(c)(2) is located in the same section granting district courts and bankruptcy appellate courts jurisdiction to hear appeals from bankruptcy courts – Section 158(a)-(b).

Id. at 837. As the Tenth Circuit also explained, *Bowles* noted that "'time limits for filing a notice of appeal have been treated as jurisdictional in American law for well over a century.'" *Id.* (quoting *Bowles*, 551 U.S. at 210 n.2). The Tenth Circuit found it to be of no consequence that *Bowles* was discussing Fed. R. App. P. 4(a), and not the rules governing appeals from bankruptcy courts. *Id.* Indeed, in treating Rule 8002(a) as jurisdictional, the courts of appeals, including this Circuit, have relied on the fact the rule is modeled after Fed. R. App. 4(a), whose time limit is without question "mandatory and jurisdictional." *See e.g.*, *In re Siemon*, 421 F.3d at 169; *In re Universal*

Minerals, Inc., 755 F.2d at 311. Finally, in the looking to the rule's historical treatment, the court in *In re Latture* observed that "all circuits prior to *Kontrick* and its progeny uniformly treated Rule 8002(a) as jurisdictional." 605 F.3d at 837.

In light of the foregoing discussion, this Court, like the Tenth Circuit, should reaffirm its prior precedent in *In re Universal Minerals, Inc.* and its progeny and continue to treat Rule 8002(a)'s time limit as jurisdictional. Because Caterbone's notice of appeal was untimely, the appeal should be dismissed for lack of subject matter jurisdiction.

II. THE DISTRICT COURT DID NOT ABUSE ITS DISCRETION IN DISMISSING CATERBONE'S APPEAL FOR FAILURE TO PROSECUTE

If this Court determines that it has jurisdiction to entertain the merits of the district court's dismissal of Caterbone's bankruptcy case for failure to comply with Fed. R. Bankr. P. 8006, then it should affirm the district court's ruling. Rule 8006 provides in pertinent part:

Record and Issues on Appeal

> Within 10 days after filing the notice of appeal as provided by Rule 8001(a) . . . the appellant shall file with the clerk and serve on the appellee a designation of the items to be included in the record on appeal and a statement of the issues to be presented.

Fed. R. Bankr. P. 8006. As the bankruptcy court docket sheet reflects, Caterbone's notice of appeal was filed on October 19, 2006, and the clerk made a docket entry that same date stating, "Appellant Designation due by 10/30/2006." SA 14. The docket shows no entry reflecting that Caterbone filed a designation of items to be included in the record on appeal or a statement of the issues to be presented as required by Rule 8006. Nor does the docket reflect that Caterbone requested an extension of time to meet Rule 8006's requirements. *See* Fed. R. Bankr. P. 9006(b) (court may grant extension of time for performing act required by the rules). The district court *sua sponte* dismissed the appeal on March 15, 2007, approximately five months after the notice of appeal was filed.

Bankruptcy Rule 8001(a) empowers a district court to dismiss an appeal for failure to prosecute or otherwise follow the procedures established by the Bankruptcy Rules. Rule 8001(a) states: "An appellant's failure to take any step other than timely filing a notice of appeal does not affect the validity of the appeal, but is ground only for such action as the district court . . . deems appropriate, *which may include dismissal of the appeal.*" *Id.* (emphasis added). Fed. R. Bankr. P. 8001(a).

This Court "review[s] a dismissal for failure to prosecute only for an abuse of discretion, but the district court must have considered less severe sanctions." *In re Jewelcor Inc.*, 11 F.3d at 397. The district court's order does not elaborate on the factors it considered in dismissing the appeal in this case. It is clear from the record, however, that dismissal was warranted.

Caterbone's multiple failures to comply with the Bankruptcy Rules' deadlines "show negligence or indifference, or both." *In re YMR*

Fashions Corp., 173 B.R. 750, 753 (M.D. Ala. 1994).[7] First, Caterbone's notice of appeal of the bankruptcy court's order was untimely. Next, he did nothing to prosecute his appeal beyond filing the untimely notice. Further, the bankruptcy court's dismissal of Caterbone's case was itself based, in part, on Caterbone's failure to attend two hearings and his failure to file a responsive brief to the United States Trustee's motion to dismiss. SA 01-02. Moreover, Caterbone's bankruptcy case had earlier been dismissed by the bankruptcy court due to his failure to file the documents required by Fed. R. Bankr. P. 1007. The district court (Brody, J.) reinstated Caterbone's bankruptcy case, with the express admonishment that "Debtor-Appellant comply with the rules and requirements applicable to all debtors seeking relief under the Bankruptcy Code." *In re*

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[7] Although Caterbone has proceeded *pro se* throughout these proceedings, he is still obligated to fully comply with all relevant rules of procedure and substantive law. *See Faretta v. California*, 422 U.S. 806, 834 n.46 (1975) (The right to self-representation is not a "license not to comply with relevant rules of procedure and substantive law.").

Caterbone, No. 05-3689 (E.D. Pa. Oct. 5, 2005). It bears noting that the same district court judge who dismissed Caterbone's present appeal ordered reinstatement of the earlier case, with the directive that Caterbone comply with the rules and requirements of the Code. Given the district court's earlier warning, Caterbone's behavior exhibits "a cavalier attitude" regarding the requirements of the Bankruptcy Rules. *See In re YMR Fashions Corp.*, 173 B.R. at 753. Under these circumstances, the district court could have reasonably determined that a less severe sanction would be ineffective.

There is no merit to Caterbone's argument that the district court should have employed the lesser sanction of ordering the clerk to prepare a copy of the items to be included in the record on appeal, and to then charge him ".50 per page for [the] record." Appellant's Br. 7. Caterbone misplaces his reliance on Rule 8006 in support of this argument. Rule 8006 states that any party filing a designation of items to be included in the record on appeal "shall provide to the clerk a copy of the items designated or, if the party fails to provide the copy, the clerk shall prepare the copy at the party's expense." Fed. R. Bankr. P. 8006. Because Caterbone did not file a designation of any items to be included in the record on appeal, the clerk could not have prepared a copy of the items and then billed him for the expense.

Nor should this Court accept Caterbone's argument that his failure to comply with Rule 8006 should be deemed "excusable neglect." Appellant's Br. 8. The majority of Caterbone's assertions (Br. 8-10) regarding unrelated litigation that he is or has been engaged in since 1987 simply have no bearing on his failure to timely comply with Rule 8006.[8] Although Caterbone claims that he was "falsely imprisoned in the Lancaster County Prison" from October 30, 2006, (the date that the designation of record and statement of issues on appeal was due in bankruptcy court) until December 29, 2006, the

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[8] Indeed, the bulk of Caterbone's litany of excuses relates to reasons why he failed to file certain documents and failed to appear at various hearings in the bankruptcy court, which led up to the bankruptcy court's dismissal of his chapter 11 petition for "cause" and failure to defend. *See* Appellant's Br. 9-10.

district court did not dismiss his appeal until March 15, 2007. Caterbone does not explain why after his release he did not seek leave of court for an extension of time to comply with Rule 8006's filing requirements. *See* Fed. R. Bankr. P. 9006(b)(2) (The court may "on motion made after the expiration of the specified period permit the act to be done where the failure to act was the result of excusable neglect.").

CONCLUSION

For the foregoing reasons, the Court should dismiss the appeal for lack of jurisdiction, or, in the alternative, the district court's order dismissing the case for failure to prosecute should be affirmed.

Respectfully submitted,

TONY WEST
Assistant Attorney General

ZANE DAVID MEMEGER
United States Attorney

WILLIAM KANTER
(202) 514-4575

s/Jeffrica Jenkins Lee
JEFFRICA JENKINS LEE
DC Bar No. 392958
(202) 514-5091
Attorneys, Appellate Staff
Civil Division, Room 7537
Department of Justice
950 Pennsylvania Ave., NW
Washington, D.C. 20530-0001

AUGUST 2010

COMBINED CERTIFICATIONS

I certify as follows:

1. Counsel for the United States Trustee are federal government attorneys and are not required to be members of the bar of this Court.

2. Pursuant to Fed. R. App. P. 32(a)(7)(C), this brief complies with the type-volume limitation in Fed. R. App. P. 32(a)(7)(B), is proportionally spaced, uses Corel WordPerfect Bookman Old Style 14-point typeface and contains 6,278 words, exclusive of the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii).

3. The text of the hard copy of this brief and the text of the brief in electronic portable document format (PDF) are identical, except for an electronic signature. A virus check was performed on the PDF file brief, using Microsoft Forefront Client Security, Version 1.87.1373.0, created August 6, 2010, and no virus was detected.

5. On August 6, 2010, I caused a copy of the foregoing brief to be filed with the Clerk of the United States Court of Appeals for the Third Circuit by using the appellate CM/ECF system, which will send notice of the electronic filing to all registered Filing Users. I also caused ten copies of the brief to be dispatched to the Clerk *via* FedEx

overnight delivery and caused two copies to be sent *via* First Class U.S. mail, postage prepaid to:

Mr. Stanley J. Caterbone
1250 Fremont Street
Lancaster, PA 17603

Catherine L. Sakach, Esquire
Duane Morris LLP
1940 Route 70 East
Cherry Hill, NJ 08003

s/Jeffrica Jenkins Lee
JEFFRICA JENKINS LEE
Attorney for the Appellee

BRIEF BANK — "SUMMARY SHEET" *Printed Thu-6/24/10 15:4*

WESTLAW CODES

1. **("TI")** ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*
Connecticut Bar Assn, National Assn of Consumer Bankruptcy Atty, Charles A. Maglieri, Eugene S. Melchionne, Wayne A. Silver, IRS B. Charmoy, Jeffrey M. Sklarz, Gerald A. Roisman, Brown & Welsh PC, Anita Johnson)

2. **("CO")** ***CURRENT*** COURT *[E.g., "CTA9"]*
2nd Cir.

3. **("CCN")** ***CURRENT*** CASE NO.
No.: 08-4797-CV(1) consolidated with 08-5901-CV(con) and 09-0015-CV(xap)

4. **("PCN")** ***PRIOR*** CASE NO. - & COURT *[IF ANY]*
No.: 06-cv-729
Court: D. Conn.
(Identify judge & cite, if any)

5. **("SO")** ***SOURCE***
U.S. TRUSTEES

6. **("DA")** ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*
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Mark R. Freeman, Mark B. Stern, P. Matthew Sutko, Tony West
(UST/OGC: 202-307-1399/FAX-2397)

8. **("TO")** ***TOPIC***
BANKRUPTCY

9. **("SU")** • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***
• (1) Whether district court erred in declaring 11 U.S.C. § 528 unconstitutional "as applied" to attorneys for creditors. (2) Whether section 526(a)(4) constitutionally prohibits bankruptcy attorneys from encouraging their clients to abuse the bankruptcy system.

10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)

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IN THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

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Plaintiffs-Appellants/Cross-Appellees,

v.

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Defendants-Appellees/Cross-Appellants.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF CONNECTICUT

REPLY BRIEF FOR APPELLEES/CROSS-APPELLANTS

TONY WEST
Assistant Attorney General

NORA R. DANNEHY
Acting United States Attorney

MARK B. STERN
(202) 514-5089
MARK R. FREEMAN
(202) 514-5714
Attorneys, Appellate Staff
Civil Division, Room 7531
Department of Justice

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REPLY BRIEF FOR APPELLEES/CROSS-APPELLANTS

INTRODUCTION AND SUMMARY

In the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, Congress enacted a series of provisions designed to "strengthen[] professionalism standards for attorneys and others who assist consumer debtors with their bankruptcy cases." H.R. Rep. No. 109-31, pt. 1, at 17. Among those provisions are the measures that the district court below declared unconstitutional in whole or in part. Section 528 requires consumer bankruptcy attorneys and other "debt relief agencies" to include specified disclosures in their advertisements of bankruptcy-related services to the public, see 11 U.S.C. § 528(a)(4), (b)(2), and section 526(a)(4) precludes attorneys from advising their clients to amass new debt in contemplation of filing a petition for bankruptcy, see 11 U.S.C. § 526(a)(4).

In June 2009, after the parties filed their principal briefs in these appeals, the Supreme Court granted certiorari to determine the constitutionality of both of these provisions. Milavetz, Gallop & Milavetz, P.A. v. United States, S.Ct. Nos. 08-1119 & 08-1225 (consolidated) (cert. granted June 8, 2009). In addition, the Supreme Court indicated that it will consider the threshold statutory question, also raised in this case (see Gov. Br. 16-20), of whether attorneys for consumer debtors are "debt relief agencies" under the Bankruptcy Code. The Court's decision in Milavetz is therefore likely to control, if not resolve, nearly every issue raised in these appeals.

If this Court decides these appeals before the Supreme Court issues its decision in Milavetz, the district court's partial invalidation of the 2005 Act should be reversed. Nothing in the Constitution prohibits Congress from regulating the professional conduct of attorneys practicing in the federal courts in this manner. The district court's ruling to the contrary rests on faulty statutory premises and disregards fundamental principles of constitutional avoidance, which required the district court to refuse plaintiffs' invitation to interpret the Act as broadly as possible to invite constitutional difficulties.

The district court's declaration that the advertising disclosure requirements in section 528 are unconstitutional "as applied to attorneys representing clients other than consumer debtors filing for bankruptcy," JA96, is both mistaken and wholly unnecessary. The government explained in district court that the "debt relief agency" provisions of the 2005 Act, including section 528, have no application to attorneys for creditors and other non-debtor parties in bankruptcy. Nevertheless, disregarding basic principles of constitutional avoidance, the district court proceeded to adopt a constitutionally problematic interpretation of the 2005 Act rather than the reading that accords most naturally with the statutory text. As we explained in our opening brief (at 46-48), attorneys for creditors are not "debt relief agencies" under the Act, and plaintiffs' brief makes no serious effort to address our arguments on this score.

The district court similarly erred in invalidating section 526(a)(4), which prohibits an attorney from advising a debtor "to incur more debt in contemplation of such person filing a case under this title." As we explained in our opening brief, Congress enacted this provision in recognition of the fact that debtors frequently "load up" with new debt on the eve of bankruptcy in an effort to game the bankruptcy system. Plaintiffs do not suggest that attorneys enjoy a categorical First Amendment privilege to encourage their clients to subvert the bankruptcy process in this fashion. Instead, they insist that section 526(a)(4) is unconstitutional because, in their view, the statute must also be construed to prohibit advice to engage in entirely legitimate, good-faith transactions.

That interpretation is neither required by the statutory text nor consistent with Congress's purposes in the 2005 Act, and the district court erred in adopting it. As our opening brief explains (at 54-56), Congress and the federal courts have commonly described pre-petition debts amassed for improper purposes as debts incurred "in contemplation of" bankruptcy. That usage is consistent with the settled connotations of that phrase in the bankruptcy context. See, e.g., Black's Law Dictionary 336 (8th ed. 2004) (explaining that the phrase "contemplation of bankruptcy" typically connotes "the thought of declaring bankruptcy * * * often coupled with action designed to thwart the distribution of assets in a bankruptcy proceeding"). Plaintiffs make no effort to come to grips with these authorities, which establish that the statute is amenable to a construction that implicates no constitutional concerns. Section 526(a)(4) merely provides a bankruptcy-specific rule of professional conduct that precludes attorneys from encouraging their clients to engage in the well-recognized practice of "loading up" on new debt on the eve of bankruptcy in order to abuse the protections of the Code.

Plaintiffs' arguments to the contrary are without merit. Their suggestion that the government "plucked the term 'abuse' from thin air" (Br. 52) is difficult to fathom: "abuse" has been an established concept in bankruptcy law for decades, see 11 U.S.C. § 707(b), and the "debt relief agency" provisions were enacted as part of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005. Likewise, plaintiffs' claim that the government's interpretation of section 526(a)(4) renders the statute "entirely superfluous" (Br. 50) in light of state-law prohibitions on unethical attorney advice only underscores the error of plaintiffs' argument. Congress undoubtedly possesses the authority to provide uniform rules of professional conduct for attorneys in the federal bankruptcy system, and section 526 adds a new federal cause of action (and federal jurisdiction) for debtors to recover damages from attorneys whose abusive advice causes them harm.

ARGUMENT

I. THE DISTRICT COURT ERRED IN DECLARING 11 U.S.C. § 528 UNCONSTITUTIONAL "AS APPLIED" TO ATTORNEYS FOR CREDITORS.

As we explained in our opening brief (at 46-50), the district court had no basis for declaring the advertising disclosure requirements in 11 U.S.C. § 528 unconstitutional "as applied" to attorneys for creditors and other non-debtor parties in bankruptcy. See JA78-79, JA91-95. Even plaintiffs do not suggest that Congress intended to sweep such attorneys within the ambit of the statute, and the most natural reading of the statutory language excludes them.

Section 528 requires "debt relief agencies" to make certain advertising disclosures. The term "debt relief agency" includes "any person" who, for a fee, "provides any bankruptcy assistance to an assisted person." 11 U.S.C. § 101(12A). An "assisted person" is "any person whose debts consist primarily of consumer debts and the value of whose nonexempt property is less than" an inflation-adjusted sum, currently $164,250. Id. § 101(3). These provisions cannot plausibly be extended to cover attorneys for creditors. As discussed in our opening brief (at 47), and as plaintiffs do not dispute, the definition of "assisted person" speaks in terms relevant only to debtors under the Bankruptcy Code. Nothing in the Code turns on whether a creditor's own debts "consist primarily of consumer debts." Nor do creditors have "nonexempt property": the very concept of "exempt" property has application only to a debtor's property in a bankruptcy proceeding. See 11 U.S.C. § 522(b) (describing the property that "an individual debtor may exempt from the property of the estate" (emphasis added)). In the face of this textual evidence, it strains credulity to suggest that Congress intended to regulate attorneys for creditors as "debt relief agencies," and the government has consistently disavowed any such interpretation.

Plaintiffs' only response is that the definition of "assisted person" does not use the word "debtor." Congress accomplished its end just as clearly, however, by defining "assisted person" as one "whose debts consist primarily of consumer debts" and whose "nonexempt property" is less than a prescribed ceiling. Id. § 101(3). That Congress did not use the term "debtor" in the definition of "assisted person," moreover, is hardly surprising. The term "debtor" is defined in the Code as a person concerning whom a petition for bankruptcy relief has already been filed. See 11 U.S.C. § 101(13). Many of the provisions concerning debt relief agencies, by contrast, pertain not only to persons already in bankruptcy, but also to persons who may be considering bankruptcy. E.g., 11 U.S.C. § 528(a) (written contract requirement).

Plaintiffs likewise fail to address other relevant statutory language that makes clear that section 528 has no application to attorneys for creditors. Plaintiffs make no reference to the written-contract provision of section 528, for example, which provides that a contract must be signed within a specified period after "the first date on which such agency provides any bankruptcy assistance services to an assisted person, but prior to such assisted person's petition under this title being filed." 11 U.S.C. § 528(a)(1) (emphasis added). Similarly, section 527 requires debt relief agencies to provide "assisted persons" with information that is relevant only to debtors, see 11 U.S.C. § 527(b), and expressly cross-references provisions that are applicable only to debtors, see, e.g., 11 U.S.C. § 527(a)(1) (instructing debt relief agencies to provide assisted persons with the "notice required under section 342(b)(1)," a provision that applies only to "individual[s]" who "commence[] * * * a case under this title"). These provisions would make little sense if Congress intended the term "assisted person" to encompass creditors, and plaintiffs make no argument to the contrary.

Nor do plaintiffs make any effort to reconcile their theory with the relevant legislative history. The House Report accompanying the 2005 Act explained that Congress enacted the "debt relief agency" provisions to "strengthen[] professionalism standards for attorneys and others <u>who assist consumer debtors</u> with their bankruptcy cases." <u>House Report</u>, at 17 (emphasis added). Plaintiffs cite no evidence in the legislative history suggesting that Congress intended to regulate attorneys for creditors under the same provisions, and we are aware of none.

For all of these reasons, the district court erred in holding that attorneys for creditors and other non-debtor parties are subject to regulation as "debt relief agencies." Even if the meaning of the statutory language were in doubt, however, fundamental canons of constitutional avoidance required the district court to reject an interpretation that is, at a minimum, not compelled by the statutory text. <u>See, e.g.</u>, <u>John Doe, Inc. v. Mukasey</u>, 549 F.3d 861, 872 (2d Cir. 2008) ("It is well established that courts should resolve ambiguities in statutes in a manner that avoids substantial constitutional issues.").

In any event, even if section 528 were applicable to attorneys for creditors and other non-debtor parties, the statute would not be facially unconstitutional. Congress permitted debt relief agencies to substitute, in lieu of the two-sentence statement set forth in the statute, any "substantially similar" statement. 11 U.S.C. § 528(a)(4); id. § 528(b)(2)(B). As the Eighth Circuit has held, this flexibility is sufficient to avoid any facial constitutional defect, even if the statute applies to attorneys for creditors. See Milavetz, Gallop & Milavetz, P.A. v. United States, 541 F.3d 785, 789-92 (8th Cir. 2008), cert. granted, Nos. 08-1119 & 08-1225 (U.S. June 8, 2009). Such attorneys "can and should tailor their advertisement disclosure statements to factually represent the 'bankruptcy assistance' they provide." Ibid.

Plaintiffs resist this reasoning, urging that even a substantially similar alternative that correctly described attorneys for creditors — e.g., "We represent people in bankruptcy cases under the Bankruptcy Code" (see Gov. Br. 49 n.19) — would be unconstitutional because of erroneous "inference[s]" that might be drawn by the public. Br. 41. This objection only underscores that speculation regarding the advantages and disadvantages of various "substantially similar" statements is not a proper basis for declaring section 528 unconstitutional in a pre-enforcement, facial challenge. See Olsen v. Gonzales, 350 B.R. 906, 920 (D. Or. 2006), appeals pending, Nos. 07-35616 & 07-35762 (9th Cir.) (because the question whether a particular statement is "substantially similar" to the section 528 statutory statement "would require a case-by-case determination, a facial challenge is inappropriate"). Because the statute affords attorneys adequate flexibility to describe with accuracy the bankruptcy assistance services they provide, section 528 is facially constitutional even if (contrary to the best reading of the statutory text) it were applicable to attorneys for creditors and other non-debtor parties.

II. SECTION 526(a)(4) CONSTITUTIONALLY PROHIBITS BANKRUPTCY ATTORNEYS FROM ENCOURAGING THEIR CLIENTS TO ABUSE THE BANKRUPTCY SYSTEM.

In June 2009, after the parties filed their principal briefs in these appeals, the Supreme Court granted certiorari to resolve the circuit split over the constitutionality of 11 U.S.C. § 526(a)(4). See United States v. Milavetz, Gallop & Milavetz, P.A., S.Ct. No. 08-1225 (cert. granted June 8, 2009); compare Hersh v. United States ex rel. Mukasey, 553 F.3d 743, 752-64 (5th Cir. 2008) (upholding the statute), with Milavetz, 541 F.3d at 792-94 (8th Cir. 2008) (invalidating statute).[1] If this Court decides the question before the Supreme Court resolves the matter, it should make clear that the district court erred in

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[1] In addition, as we noted in our opening brief (at 50), an identical constitutional challenge to section 526(a)(4) has previously been briefed and argued to this Court. See Zelotes v. Adams, No. 07-1853 (2d Cir.) (argued Oct. 10, 2008).

interpreting section 526(a)(4) to sweep far beyond Congress's limited purpose, which was to prevent attorneys and other debt relief agencies from acting as the affirmative engines of bankruptcy abuse. See Hersh, 553 F.3d at 752-64; Milavetz, 541 F.3d at 797-801 (Colloton, J., dissenting).

1. As we established in our opening brief (at 52-53), Congress has long been aware that debtors commonly abuse the protections of the Bankruptcy Code by "loading up" with new debt on the eve of bankruptcy. See, e.g., House Report, at 15 (expressing concern that earlier legislative measures had not adequately restricted the ability of debtors to "knowingly load up with credit card purchases or recklessly obtain cash advances and then file for bankruptcy relief"); S. Rep. No. 98-65, at 9 (1983) (noting special problem posed by "'loading up' in contemplation of bankruptcy"); Report of the Commission on the Bankruptcy Laws of the United States, H.R. Doc. No. 93-137, pt. I, at 11 (July 1973) (concluding that "the most serious abuse of consumer bankruptcy is the number of instances in which individuals have purchased a sizable quantity of goods and services on credit on the eve of bankruptcy in contemplation of obtaining a discharge"). In hearings preceding the 2005 Act, moreover, Congress heard evidence that "misconduct by attorneys and other professionals" had been "consistently identified" by the U.S. Trustee Program as a source of abusive bankruptcy filings. See House Report, at 5 (citation omitted). It was

against this background that Congress enacted 11 U.S.C. § 526(a)(4).

None of this is controverted. Plaintiffs do not contend that attorneys enjoy a categorical First Amendment privilege to advise their clients to subvert the bankruptcy process. Nor do they deny that Congress possesses the authority to prohibit and punish abuses of the Bankruptcy Code, including by requiring bankruptcy attorneys to certify that their clients' petitions are not an "abuse" under 11 U.S.C. § 707. See Br. 51 (citing 11 U.S.C. § 707(b)(4)(C)-(D)). Nor do plaintiffs dispute that common ethical rules governing the advice that attorneys provide to clients are consistent with the First Amendment. See, e.g., Model Rule of Professional Conduct 1.2(d) (prohibiting lawyers from "counsel[ing] a client to engage * * * in conduct that the lawyer knows is criminal or fraudulent"); Conn. R. Prof. Conduct 1.2(d) (same). Plaintiffs' contention, instead, is that section 526(a)(4) must be read not merely to prohibit advice to engage in abusive conduct, but as expansively as possible to include even lawful and ethical attorney advice that Congress had no reason to disturb.

Such arguments turn the canon of constitutional avoidance on its head. Plaintiffs are not entitled to insist upon the broadest possible interpretation of section 526(a)(4) in order to secure its invalidation. As the Supreme Court recently reiterated, "judging the constitutionality of an Act of Congress is 'the gravest and most delicate duty that [a] Court is called on to perform.'" Northwest Austin Municipal Utility District Number One v. Holder, ___ U.S. ___, 2009 WL 1738645, at *9 (U.S. June 22, 2009) (quoting Blodgett v. Holden, 275 U.S. 142, 147-148 (1927) (Holmes, J., concurring)) (construing statutory definitions to avoid constitutional questions posed by § 5 of the Voting Rights Act). Basic principles of constitutional avoidance not only authorize, but require courts to adopt an available limiting construction of statute where necessary to preserve the statute's validity. See Boos v. Barry, 485 U.S. 312, 330-31 (1988). This Court has accordingly stressed that a federal court construing a federal statute "operat[es] under a broad charge: to save the statute's constitutionality if it c[an] through a 'fairly possible' limiting construction of the statutory language." Vermont Right to Life Committee, Inc. v. Sorrell, 221 F.3d 376, 390 (2d Cir. 2000) (citing Concrete Pipe & Prods. v. Construction Laborers Pension Trust, 508 U.S. 602, 629 (1993)).

2. Plaintiffs' boundless construction of section 526(a)(4) is clearly not compelled by the terms of the statute. As we explained in our opening brief (and as plaintiffs do not dispute), Congress and the federal courts have both commonly described pre-petition debts amassed for improper purposes as debts incurred "in contemplation of" bankruptcy. See Gov. Br. 54-56. That use of the phrase reflects settled connotations in the bankruptcy context. See Black's Law Dictionary 336 (8th ed.

2004) (explaining that the phrase "contemplation of bankruptcy" typically connotes "action designed to thwart the distribution of assets in a bankruptcy proceeding"). See also, e.g., United States v. Fox, 95 U.S. 670, 672 (1877) ("To legislate for the prevention of frauds * * * when committed in contemplation of bankruptcy, would seem to be within the competency of Congress."); In re Mercer, 246 F.3d 391, 421 n.43 (5th Cir. 2001) (en banc) (describing "loading up" as the practice of "incurring card debt in contemplation of bankruptcy"); In re Charles, 334 B.R. 207, 222 (Bankr. S.D. Tex. 2005) ("It is settled law that a debtor's good faith should be questioned if the debtor makes purchases in contemplation of a bankruptcy case."); cf. 18 U.S.C. § 152(7) (prohibiting fraudulent transfer or concealment of assets "in contemplation of a case under title 11").

Thus, as the Fifth Circuit has explained, "when enacting this statute Congress's focus was on instances of bankruptcy abuse to be prevented." Hersh, 553 F.3d at 758; see also Milavetz, 541 F.3d at 799 (Colloton, J., dissenting) ("American and English authorities construing the bankruptcy laws also support the proposition that the words 'in contemplation of' may be understood to require an intent to abuse the bankruptcy laws.") (citing cases).

Plaintiffs make no effort to reconcile their arguments with these authorities. Instead, plaintiffs rely on Conrad, Rubin & Lesser v. Pender, 289 U.S. 472 (1933), in which the Court gave a broad reading to the phrase "in contemplation of" bankruptcy. Br. 48. But that case only highlights the error of plaintiffs' argument. Pender involved section 60d of the former Bankruptcy Act of 1898, which granted bankruptcy courts the authority to reexamine transfers of property made to a debtor's attorney "in contemplation of filing a petition," and to direct that any "excess" payment be returned to the estate for the benefit of creditors. See Law of July 1, 1898, ch. 541, § 60(d), 30 Stat. 544, 562, repealed by Bankruptcy Reform Act of 1978, 92 Stat. 2549. Like section 526(a)(4), section 60d was manifestly directed to preventing abusive conduct by the debtor — in that case, preferential conveyances to the debtor's own attorney in order to frustrate the distribution of assets to creditors. Indeed, in a case decided before Pender, the Supreme Court explained that Congress enacted section 60d precisely because debtors' pre-petition payments to attorneys are "'capable of abuse.'" In re Wood, 210 U.S. 246, 251 (1908) (quoting Furth v. Stahl, 205 Pa. 439 (1903)); see also id. at 258 (purpose of section 60d was to "prevent the diminution of the estate").

Plaintiffs are thus wrong to assert that Pender precludes a limiting construction of section 526(a)(4). To the contrary, Pender underscores Congress's consistent use of the phrase "in contemplation of" bankruptcy in circumstances involving abusive pre-petition conduct by debtors. Moreover, nothing in Pender suggests that the phrase "in contemplation of" bankruptcy must invariably have the same broad meaning – particularly where, as here, there is additional textual evidence that Congress intended the phrase in a narrower sense in section 526(a)(4). See generally Gov. Br. 56-58.

In particular, plaintiffs disregard the statutory context in which Congress placed the provision. Cf. Field Day, LLC v. County of Suffolk, 463 F.3d 167, 177 (2d Cir. 2006) ("In interpreting statutes, this Court reads statutory language in light of the surrounding language and framework of the statute."). As we explained in our opening brief (at 57), section 526(a)(4) is one of four subsections of section 526(a). The other three subsections indisputably provide rules of professional conduct designed to protect debtors from abusive practices by bankruptcy attorneys and other debt relief agencies. See 11 U.S.C. § 526(a)(1) (debt relief agencies must perform all promised services); id. § 526(a)(2) (prohibiting debt relief agencies from advising debtors to make false or misleading statements to obtain bankruptcy relief); id. § 526(a)(3) (prohibiting debt relief agencies from misrepresenting to debtors the services to be provided or the costs or benefits of filing for bankruptcy relief). Construed in pari materia with these provisions, it is plain that Congress "did not enact 526(a)(4) as a sweeping prohibition on good faith, lawful, and ethical advice." Hersh, 553 F.3d at 761.

3. Properly construed, section 526(a)(4) provides a bankruptcy-specific rule of professional conduct that restricts attorneys from encouraging their clients to engage in the well-recognized abusive practice of "loading up" on new debt prior to filing for bankruptcy. Understood in this manner, there is little doubt that section 526(a)(4) satisfies the First Amendment. As the Supreme Court stressed in Gentile v. State Bar of Nevada, 501 U.S. 1030 (1991), attorneys are not merely agents of their clients but also officers of the courts, and for that reason may be "subject to ethical restrictions on speech to which an ordinary citizen would not be." Id. at 1071. The Court in Gentile quoted with approval Justice Stewart's dispositive concurrence in In re Sawyer, 360 U.S. 622 (1959), in which he rejected the notion "that a lawyer can invoke the constitutional right of free speech to immunize himself from even-handed discipline for proven unethical conduct," because "[a] lawyer belongs to a profession with inherited standards of propriety and honor, which experience has shown necessary in a calling dedicated to the accomplishment of justice. * * * Obedience to ethical precepts may require abstention from what in other circumstances might be constitutionally protected speech." Id. at 646-47 (Stewart, J., concurring in judgment); see Gentile, 501 U.S. at 1071.

Section 526(a)(4) provides a bankruptcy-specific rule of conduct akin to Model Rule of Professional Conduct 1.2(d), which states that an attorney may not "counsel a client to engage, or assist a client, in conduct that the lawyer knows is criminal or fraudulent." That rule has been applied to precisely the conduct that section 526(a)(4) addresses. See Attorney Grievance Comm'n of Maryland v. Culver, 381 Md. 241, 275-76 (2004) (attorney violated Rule 1.2(d) by advising a client to obtain credit card loans with the intent that the debt be discharged in bankruptcy). Moreover, Congress itself described the "debt relief agency" provisions of the 2005 Act as "professionalism standards for attorneys." See House Report at 17 (debt relief agency provisions "strengthen[] professionalism standards for attorneys and others who assist consumer debtors with their bankruptcy cases").

Plaintiffs assert that Congress could not have intended section 526(a)(4) as an ethical rule, urging that a federal restriction on abusive attorney advice would be "entirely superfluous" in light of existing state-law ethical rules and federal criminal sanctions. Br. 50. But Congress plainly has the power to provide uniform rules of professional conduct for attorneys in the federal bankruptcy courts, even where state law already supplies the underlying norm. Cf. U.S. Const., Art. I, § 8, cl. 4. Moreover, the statute does more than merely provide such a uniform rule. Section 526 supplies a federal cause of action for aggrieved debtors to recover their "actual damages" from improper attorney advice that violates the statute (together with federal jurisdiction to adjudicate such a claim irrespective of the amount in controversy). See 11 U.S.C. § 526(c). It is, in effect, a specialized federal remedy for a form of attorney malpractice that Congress determined was of particular concern to the integrity of the bankruptcy process. The Constitution does not bar Congress from regulating legal practice in the federal courts in this manner, irrespective of the potential availability of criminal sanctions in egregious cases or post-hoc malpractice remedies in state court.[2]

4. The district court's error in this respect was highlighted by its invalidation of section 526(a)(4) in its entirety, without separately analyzing the portion of the statute that precludes an attorney from advising a client to incur additional debt to pay the attorney's own fees. See 11 U.S.C. § 526(a)(4) (prohibiting advice "to incur more debt * * * to pay an attorney or bankruptcy petition preparer fee or charge for services performed as part of preparing for or representing a debtor in a case under this title"). It was manifestly improper

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[2] Plaintiffs thus fail to appreciate the significance of the fact that, as they emphasize, rules of professional conduct in every state already prohibit "advice to engage in fraudulent or improper conduct." Br. 50. These authorities do not establish, as plaintiffs believe, that section 526(a)(4) is "superfluous," but rather that a restriction on advice to engage in the abusive accumulation of new debt on the eve of bankruptcy is entirely consistent with the First Amendment. Cf. Hersh, 553 F.3d at 756 (noting that no court has questioned the constitutionality of the advice restrictions in Model Rule 1.2(d)).

for the district court to declare a federal statute unconstitutional and invalid on its face without even addressing half of the statutory provision at issue.

Plaintiffs do not suggest that the district court analyzed the second clause of section 526(a)(4), and their efforts to supply their own analysis provide no basis for invalidating the statute. Congress undoubtedly possesses the authority to prevent bankruptcy attorneys from abusing their positions as officers of the court and "trusted agents of their clients," Ohralik v. Ohio State Bar Ass'n, 436 U.S. 447, 460 (1978), by seeking preferential treatment for themselves in the bankruptcy process. An attorney who encourages a debtor to incur new (and almost certainly unsecured) debt in order to pay the attorney's own fees is effectively urging the debtor to exploit the bankruptcy system to shift the cost of the lawyer's services onto unsuspecting creditors. Nothing in the First Amendment prevents Congress from forbidding such deceptive practices by members of the bankruptcy bar. See Gentile, 501 U.S. at 1071.[3]

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[3] Plaintiffs argue that chapter 13 debtors often incur a debt to their attorneys as part of chapter 13 payment plans. Br. 56. Yet nothing in the 2005 Act or its legislative history indicates that, by prohibiting attorneys from advising debtors to incur "more debt * * * to pay an attorney," Congress meant to preclude payment arrangements with the attorney herself. Cf. 11 U.S.C. § 101(12A)(C) (excluding the debtor's own creditors from regulation as "debt relief agencies"). The attorneys-fee provisions of section 526(a)(4), like the other paragraphs of section 526(a), are concerned with abusive conduct – e.g., shifting the cost of the lawyer's services onto unsuspecting third-party creditors (such as by encouraging debtors to pay

Plaintiffs also contend that the attorney-fee provisions of section 526(a)(4) are unconstitutional because the statute inhibits the ability of debtors to hire legal representation, thereby stifling lawful advocacy. Br. 56-57. But section 526(a)(4) does not prohibit advice to hire a bankruptcy attorney. Rather, it prohibits attorneys from encouraging debtors to incur new debt — debt that will be discharged in bankruptcy — in order to pay the attorney's own fees, at the expense of other creditors. Nor, in any event, do restrictions on the ability of debtors to compensate their attorneys violate the Constitution. See generally Lamie v. U.S. Trustee, 540 U.S. 526 (2004) (discussing restrictions on compensation for debtors' attorneys under the Bankruptcy Code); cf. United States v. Kras, 409 U.S. 434, 446 (1973) ("There is no constitutional right to obtain a discharge of one's debts in bankruptcy.").

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their attorneys' fees by credit card). Where the attorney herself is the creditor, there is no risk of fraud or abuse because it is only the attorney who stands to lose if the debt is not repaid.

CONCLUSION

For the foregoing reasons, the district court's judgment should be reversed to the extent it holds that 11 U.S.C. § 526(a)(4) and 11 U.S.C. §§ 528(a)(3)-(4) and (b) violate the Constitution. In all other respects, the judgment should be affirmed.

Respectfully submitted,

TONY WEST
Assistant Attorney General

NORA R. DANNEHY
Acting United States Attorney

MARK B. STERN
(202) 514-5089
MARK R. FREEMAN /s/
(202) 514-5714
Attorneys, Appellate Staff
Civil Division, Room 7531
Department of Justice
950 Pennsylvania Ave., N.W.
Washington, D.C. 20530-0001

JUNE 2009

CERTIFICATE OF COMPLIANCE WITH
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I hereby certify that this brief complies with the type-face and volume limitations set forth in Federal Rule of Appellate Procedure 32(a)(7)(B) because the type face is Courier New, monospaced, twelve-point font (ten characters per inch), and the number of words in this brief is 4,800, according to the count of Corel Wordperfect 12.

/s/
Mark R. Freeman

CERTIFICATE OF SERVICE

I hereby certify that on June 24, 2009, I caused copies of the foregoing brief to be filed with the Court by Federal Express overnight delivery and by e-mail to agencycases@ca2.uscourts.gov. In addition, I caused copies to be served upon the following counsel by Federal Express overnight delivery and by e-mail:

Jonathan S. Massey
Massey & Gail LLP
1325 G. St., N.W.
Suite 500
Washington, D.C. 20005
202-652-4511
jmassey@masseygail.com

Barry S. Feigenbaum
Rogin Nassau LLC
CityPlace I, 22nd Floor
185 Asylum Street
Hartford, CT 06103-3460
860-278-7480
bfeigenbaum@roginlaw.com

/s/

Mark R. Freeman

ANTIVIRUS CERTIFICATION

Pursuant to Second Circuit Local Rule 32(a)(1)(E), I hereby certify that I have scanned for viruses the PDF version of the foregoing brief that was submitted in this case as an email attachment to agencycases@ca2.uscourts.gov and no viruses were detected.

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/s/

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June 24, 2009

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WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE
[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]
In re: CF&I Fabricators of Utah, Inc., et al.
(UST v. CF&I Fabricators of Utah, Inc., et al.)

2. ("CO") ***CURRENT*** COURT
[E.g., "CTA9"]
10th Cir.

3. ("CCN") ***CURRENT*** CASE NO.
No.: 97-4079

4. ("PCN") ***PRIOR*** CASE NO. & COURT
[IF ANY]
No.: 96-CV-920-C
Court: D. Utah
(Identify judge & cite, if any)

5. ("SO") ***SOURCE***
U.S. TRUSTEES

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Paul Bridenhagen, Martha Davis, Bruce Forrest
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***

• Whether Congress intended the quarterly fees set forth in 28 U.S.C. § 1930(a)(6) to be collected in ongoing cases where a reorganization plan was confirmed prior to the amendment of the statue on January 26, 1996.

Whether the imposition of the fees is unconstitutional under the due process clause or separation of powers doctrine.

√ **Background:**

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IN THE UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

No. 97-4079

In re: CF&I FABRICATORS OF UTAH, INC., et al.,

Debtors

****

UNITED STATES TRUSTEE,
Appellee,
v.

CF&I Fabricators of Utah, Inc., et al.,
Appellants.

BRIEF FOR THE APPELLEE

Of Counsel:

MARTHA L. DAVIS
General Counsel

PAUL BRIDENHAGEN
Attorneys
Office of General Counsel
Executive Office for
United States Trustees

WILLIAM KANTER
(202) 514-4575

BRUCE G. FORREST
(202) 514-3180
Attorneys, Appellate Staff
(202) 514-4575
Civil Division, Room 9552
Department of Justice
601 "D" Street, N.W.
Washington, D.C. 20530-0001

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Debtors

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UNITED STATES TRUSTEE,
Appellee,
v.

CF&I FABRICATORS,
Appellants.

On Appeal From The United States District Court
For The District Of Utah

JURISDICTION

The bankruptcy court had subject matter jurisdiction pursuant to 28 U.S.C. § 157. The district court had jurisdiction to hear the United States Trustee's appeal pursuant to 28 U.S.C. § 158(a).

Appellee agrees with appellants that this Court has appellate jurisdiction. Although, technically, the case was remanded for further proceedings (district court slip op., at 2), as a practical matter, there is nothing to do on remand but implement the legal holding of the district court. Because no significant future proceedings are contemplated on the quarterly fee issue, the district court's remand order should be regarded as final for purposes of 28 U.S.C. § 158(d). In re Buckner, 66

F.3d 263, 264 (9th Cir. 1995); In re Lederman Enterprises, Inc., 997 F.2d 1321, 1323 (10th Cir. 1993).

Alternatively, this Court has appellate jurisdiction under the "collateral order" doctrine. Cf., Cohen v. Beneficial Industrial Loan Corp., 337 U.S. 541 (1949).

STATEMENT OF THE QUESTIONS PRESENTED FOR REVIEW

In this Chapter 11 bankruptcy case, a reorganization plan was confirmed on February 12, 1993. By operation of 28 U.S.C. § 1930(a)(6) in effect at that time, quarterly fees ceased following confirmation. On January 26, 1996, § 1930(a)(6) was amended, deleting the reference to plan confirmation as an event effecting fees. The questions presented are:

1. Whether Congress intended the quarterly fees set forth in 28 U.S.C. § 1930(a)(6) to be collected in ongoing cases where a reorganization plan was confirmed prior to the amendment of the statute on January 26, 1996.

2. Whether the imposition of the fees is unconstitutional under the due process clause or separation of powers doctrine.

STATEMENT OF THE CASE

Nature of the Case and Course of Proceedings:

This is a dispute over the imposition of quarterly fees in certain Chapter 11 (reorganization) bankruptcy cases.

Based upon an amendment to the language of the statutory provision for quarterly fees, 28 U.S.C. 1930(a), as amended Pub. L. 104-99, § 211, 110 Stat. 26, 37-38 (January 26, 1996), the United States Trustee charged quarterly fees in all Chapter

11 cases pending subsequent to that date. Appellants essentially seek to "grandfather" the fee-free status of certain pending Chapter 11 cases; they contend that the fees should not be imposed in cases where a reorganization plan had been confirmed prior to the amendment date.

The bankruptcy court (Hon. Judith A. Boulden) agreed with the appellants. However, in a decision dated April 24, 1997, the district court (Hon. Tena Campbell) reversed, upholding the government's position on the applicability of the fees and the constitutionality of that application. Debtors, seeking to avoid the imposition of the quarterly fees, appeal from that determination.

<u>Statement of Facts</u>:

1. The Chapter 11 (reorganization) bankruptcy proceedings from which this fee dispute arises began in 1990 and a reorganization plan was approved on February 12, 1993. At that time, 28 U.S.C. § 1930(a)(6) provided, in pertinent part (emphasis added):

> In addition to the filing fee paid to the clerk, a quarterly fee shall be paid to the United States trustee, for deposit in the Treasury, in each case under chapter 11 of title 11 for each quarter (including an fraction thereof) <u>until a plan is confirmed or</u> the case is converted or dismissed, whichever occurs first.

Thus, since the reorganization plan in this case was confirmed by the bankruptcy court on February 12, 1993, bankruptcy fees were not chargeable for the next quarter, beginning April 1, 1993.

On January 26, 1996, however, Congress amended § 1930(a)(6), deleting the words "until a plan is confirmed or." Pub. L. 104-99, § 211, 110 Stat. 26, 37-38 (1996). The Conference Report contains this description of the amendment:

> The conference agreement includes section 111 as proposed in the House and Senate bills, which extends the quarterly fee payments for debtors under Chapter 11 of the Bankruptcy Code to include the period from which a reorganization plan is confirmed by the Bankruptcy Court until the case is converted or dismissed. The conferees intend that this fee will apply to both pending and new cases.

H.R. Conf. Rep. 104-378 at 101 (Dec. 1, 1995).[1]

2. Debtors paid the fees but, on June 10, 1996, debtors moved for an order directing the United States Trustee to refund them. The bankruptcy court granted the motion on September 5, 1996.

In the bankruptcy court's perspective, in assessing the fees, the United States Trustee was seeking a modification of the previously-confirmed reorganization plan. "The UST essentially asserts claims arising after the expiration of all applicable bar dates, against funds already allocated to creditors with allowed claims." Bankr. Ct. slip op., at 8. The bankruptcy court reasoned that only the proponent of a reorganization plan, or the reorganized debtor, may seek to modify it, and that party may do so only before substantial consummation, 11 U.S.C. § 1127(b).

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[1] The fees were based upon the level of disbursements made during the quarter. Nine of the debtors' estates were assessed $250, the minimum fee for a docket with disbursements of less than $15,000. A tenth estate was charged $3,750, indicating quarterly disbursements of between $300,000 and $1 million. 28 U.S.C. 1930(a)(6).

The United States Trustee was neither a plan proponent nor a debtor, and the reorganization plan had been substantially consummated. Accordingly, the bankruptcy court's characterization of the fees as proposed modifications to the plan precluded their application to these cases. Id., at 8-10. The bankruptcy court also stated that Congress did not, with sufficient clarity, show an intent to have the fees applied "retroactively." Id., at 18-26.

3. Shortly after the bankruptcy court decision (and, possibly, because of it), on September 30, 1996, Congress enacted a further clarification of 28 U.S.C. § 1930(a)(6). In § 109(d) of Title I of Pub. L. 104-208, Congress prescribed:

> Section 101(a) of Public Law 104-91, as amended by section 211 of Public Law 104-99, is further amended by inserting: "Provided further, That, notwithstanding any other provision of law, the fees under 28 U.S.C. 1930(a)(6) shall accrue and be payable from and after January 27, 1996, in all cases (including, without limitation, any cases pending as of that date), regardless of confirmation status of their plans" ***.

See, 110 Stat. 3009, 3009-19; 28 U.S.C. 1930 note.

4. In a decision dated April 24, 1997, the district court reversed the bankruptcy court decision. As to the intended reach of the amendment to § 1930(a)(6), the district court held that "[t]he clarifying amendment leaves no doubt, if there was any before, that Congress intended that § 1930(a)(6) apply to all pending Chapter 11 cases, including those with plans confirmed prior to the effective date of the statute." District court slip

op., at 4.

The district court rejected the contention that the United States Trustee was seeking an unlawful, post-confirmation plan modification: "The fees that debtors must pay are 'administrative expense[s] attendant to an open case.' In re McLean Square Associates, 201 B.R. 436, 441 (Bankr. E.D. Va. 1996) ***." District court slip op., at 6. The district court also found no constitutional infirmity, holding appellants' taking and separation of powers arguments to be without merit. Id., at 6-7.

SUMMARY OF THE ARGUMENT

1. That Congress intended coverage of the amendment to § 1930(a)(6) to include the instant bankruptcy cases cannot be seriously debated. In plain terms, § 1930(a)(6) requires the payment of quarterly fees until conversion or dismissal; the confirmation of a plan or reorganization no longer provides relief from the fee obligations. Appellants' alternative interpretation -- that the fees are not owed if there is a successful Chapter 11 reorganization -- is not tenable for several reasons. It ignores the requirement in § 1930(a)(6) that the fees must be collected on an ongoing basis. Appellants' interpretation would mean that no fees could be collected until a reorganization fails, a truly absurd result. It is also contrary to the legislative history, which confirms that Congress "expect[ed] that these fees will apply to all pending Chapter 11 cases with confirmed reorganization plans." H.R. Conf. Rep. 104-

378, 104th Cong., 1st Sess. (December 4, 1995); 141 Cong. Rec. H13894 (December 4, 1995) (emphasis added).

2. The application of the fees to Chapter 11 cases after a plan is confirmed does not create any constitutional problem.

a. At issue is a generally-applicable user fee applied across-the-board in bankruptcy cases. Including those cases in which a plan had already been confirmed does not create a taking. The impact here, estimated at more than $100,000, is a tiny fraction of the total disbursements and there is no severe disruption to commercial expectations. The statute does not create an unconstitutional taking of appellants' property. See, Ruckelshaus v. Monsanto Co., 467 U.S. 986, 1005 (1984); In re Prines, 867 F.2d 478, 485 (8th Cir.1989).

b. Appellants' contention that Congress has violated separation of powers principles is also wide of the mark. Plaut v. Spendthrift Farm, Inc., 514 U.S. 211 (1995), is easily distinguished since, in this case, the putative judgment (i.e., the confirmed plan) was on appeal and not final. This, alone, gave Congress free rein. See, 514 U.S. at 226-27. Moreover, the plan in this case expressly gave the bankruptcy court continuing authority to allow postconfirmation fee claims. ¶ 86; JA 203-04. Finally, and in any event, the Supreme Court's decision in Holywell v. Smith, 503 U.S. 47, 58-59 (1992), makes it clear that the imposition of fees on appellants' postconfirmation activities cannot be said to conflict with either the reorganization plan involved in this appeal or the Bankruptcy Code.

3. Appellants' contentions that the fees cause administrative difficulties and/or inconsistencies with other Bankruptcy Code provisions are legal non sequiturs. These assertions are unproven and, in our view, exaggerated. But, if there is, truly, an unavoidable conflict created by the amendment of § 1930(a)(6), the fees must be collected. Congress said "[n]otwithstanding any other law ***," and previous, inconsistent provisions were modified to the extent necessary to give effect to that directive.

STANDARD OF REVIEW

This appeal raises questions of law to be addressed by this Court on a de novo basis.

ARGUMENT

I. CONGRESS'S INTENT TO HAVE THE FEES APPLY TO THE BANKRUPTCY DOCKETS INVOLVED IN THIS APPEAL IS UNMISTAKABLE.

A. THE APPELLANTS' PROPOSED INTERPRETATION IS NOT PLAUSIBLE.

Toward the end of the Argument section of the appellants' initial brief (at 36-37), appellants somewhat tepidly contend that the language of 28 U.S.C. § 1930(a)(6), as amended, does not require that the quarterly fees be applied to the instant bankruptcy dockets, where a reorganization plan was confirmed prior to the statute's amendment in 1996. We address this statutory coverage contention first because, if the fees do not apply as a matter of statutory construction, then this Court will not need to reach appellants' constitutional arguments.

Appellants urge that the fee payments are required only until a Chapter 11 case is "converted or dismissed" and, since not all Chapter 11 bankruptcy cases will end in a conversion or dismissal, appellants argue that,

> [T]he current language of § 1930(a)(6) is not clear and can be interpreted as meaning that Congress intended that no quarterly fees be paid when a case is closed without having been converted or dismissed once a chapter 11 plan has been confirmed.

Appellants' initial brief, at 36, citing _In re Gryphon at the Stone Mansion, Inc._, 204 B.R. 460, 468 (Bankr. W.D. Pa. 1997), appeal pending W.D. Pa No. 97-345.

Appellants' interpretation violates fundamental principals of statutory construction.

First, it erroneously focuses upon a few words in insolation and ignores "the specific context in which that language is used, and the broader context of the statute as a whole." _Robinson v. Shell Oil Co._, 117 S. Ct. 843, 846 (1997). See, also, _United States National Bank of Oregon, Petitioner v. Independent Insurance Agents of America, Inc._, 508 U.S. 439, 454 (1993).

Looking to other words in § 1930(a)(6), it can be seen that the statute requires, by its unambiguous language, quarterly payments until something happens -- conversion or dismissal -- in "each case." With respect to the Chapter 11 bankruptcy cases at bar, none was converted or dismissed during the quarter for which the fees were charged. Accordingly, "The fee [was] payable on the last day of the calendar month following the calendar quarter for which the fee is owed." 28 U.S.C. § 1930(a)(6). Because the statute mandates ongoing fees, it is not plausible to read from this language that Congress "intended that no quarterly fees be paid when a case is closed without having been converted or dismissed once a chapter 11 plan has been confirmed." (Appellant's initial brief, at 36).

Second, appellants' construction would create totally absurd results. Unless and until a conversion or dismissal occurs, it cannot be known how a given Chapter 11 case will ultimately be resolved. Under appellants' construction, the fees would never be collectable while a Chapter 11 case is pending. Indeed, under such a construction, the only time fees would be collectible would be in unsuccessful Chapter 11 cases, in which cases there would not likely be any funds from which the fees could be paid. Such an improbable regime could not have been intended and, even if it were an arguable, alternative interpretation of the words in § 1930(a)(6), appellants' approach must be rejected. "Where the literal reading of a statutory term would 'compel an odd result,' we must search for other evidence of congressional intent to lend the term its proper scope." <u>Public Citizen v. Department of Justice</u>, 491 U.S. 440, 454 (1989), quoting <u>Green v. Bock Laundry Machine Co.</u>, 490 U.S. 504, 509 (1989). See, also, <u>Holy Trinity Church v. United States</u>, 143 U.S. 457, 459 (1892).

These obviously unintended results are easily avoided by reading the statute in a natural way: When a confirmed plan is successfully performed -- as hopefully will be the case here -- the case will be closed. No fees will be assessed where there is no open docket in which to assess the fees. It was, thus, not necessary for Congress, after deleting the words "a plan is confirmed or" to expressly add the possibility of successful closure to the events that would terminate the liability for additional fees. Section 1930(a)(6) may not be a textbook example of elegant legislative drafting, but its meaning is quite clear in the context in which it operates.

Third, appellant's proposed interpretation also ignores the "history of evolving congressional regulation in this area." Dunn v. Commodity Futures Trading Comm'n, 117 S. Ct. 913, 918 (1997). It would not be "faithful to the contemporary legal context in which the [statute] was drafted." Id., at 920 (internal quotation marks omitted).

The intent of Congress was to expand the fee scheme for Chapter 11 cases so that all pending cases were charged, not just those awaiting plan confirmation.

> The legislative history of the January amendment clearly establishes congressional intent that the fee amendment apply to all pending Chapter 11 cases. The initial House Report of the Committee on Appropriations recommended "an extension of the quarterly fee payments under Chapter 11 to include the period after a reorganization plan has been confirmed by the bankruptcy court until the case has been dismissed (i.e., the post-confirmation period)." H. R. Rep. No. 104-196, 104th Cong., 1st Sess., at 16 (1995). The Senate Committee on Appropriations made a similar recommendation. See S. Rep. No. 104-139, 104th Cong., 1st Sess., at 16 (1995). Also, the Joint Explanatory Statement of the Committee of Conference comments that "... the conferees ... expect that these fees will apply to all pending Chapter 11 cases with confirmed reorganization plans." 141 CONG. REC. H13894. "The conferees intend that this fee will apply to both pending and new cases." 141 CONG. REC. H13899.

In re Richardson Service Corporation, 210 B.R. 332, 334 (Bankr. W.D. Mo. 1997).[2]

B. APPELLANTS' RETROACTIVITY ARGUMENT IS WITHOUT MERIT.

1. The Statute Doe Not Operate Retroactively.

Appellants argue that the amendments to § 1930(a)(6) should not be applied in this case in order to avoid retroactivity. Appellants correctly state that there is a presumption against retroactive legislation, "[a]bsent plain language in a statute or clear legislative intent." Appellants' initial brief, at 37, citing Landgraf v. USI Film Products, 511 U.S. 244 (1994). Appellants, however, are incorrect in their application of this principle to this case. The collection of the fees in this and other Chapter 11 cases with confirmed plans cannot be properly characterized as retroactive legislation.

To determine whether a statute operates "retroactively" under Landgraf, one must examine "whether the new provision attaches new legal consequences to events completed before its enactment." 511 U.S. at 270. A statute does not operate retroactively "merely because it is applied in a case arising from conduct antedating the statute's enactment, or upsets

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[2] The amendment to § 1930(a) is part of a broader, ongoing trend in federal legislation to make the costs of government more directly borne by the persons utilizing the particular government service. Cf., Skinner v. Mid-America Pipeline Co., 490 U.S. 212 (1989). As this court recognized in Gallegos v. Lyng, 891 F.2d 788, 798 (10th Cir. 1989), it is incongruous to construe a revenue-enhancing measure to cause a reduction in revenues.

expectations based in prior law." Id. at 269 (citation omitted). As the court in McAndrews v. Fleet Bank of Massachusetts, 989 F.2d 13, 16 (1st Cir. 1993), put it:

> [A] statute may modify the legal effect of a present status or alter a preexisting relationship without running up against the retroactivity hurdle. The key lies in how the law interacts with the facts. So long as the neotonic law determines status solely for the purposes of future matters, its application is deemed prospective.

Under the amendments to § 1930(a)(6), the statute changes fees only for the post-January 27, 1996 quarters in which a bankruptcy case is open; it is not retroactively applied to quarters prior to the enactment of the amendments.

> Contrary to Debtors' arguments, the amendment to § 1930(a)(6) does not operate retroactively by imposing a quarterly fee on debtors with confirmed plans. The amendment does not provide for collection of fees from the date the plan was confirmed until entry of a final decree, and the U.S. Trustee does not seek to impose such fees in the present case. The amendment only triggers prospective assessment of fees from the amendment's effective date until entry of the final decree. See [In re Foxcroft Square Co., 198 B.R. 99, 104 (Bankr. E.D. Penn.1996); In re Upton Printing, 197 B.R. 616, 620 (Bankr. E.D. La.1996); In re Central Florida Electric, Inc., 197 B.R. 380, 381 (Bankr. M.D. Fla.1996).] This limitation is now expressly stated in the September 1996 amendment to § 1930(a)(6).

In re Richardson Service Corporation, 210 B.R. at 334.

2. Characterizing The Statute As "Retroactive" Would Not Change The Results In This Case.

Moreover, even if the application of these fees to an ongoing Chapter 11 case whose reorganization plan was confirmed prior to January 26, 1996 could be properly characterized as having some retroactive nature, that would not change the result in this case. Retroactivity is permissible so long as it is clearly intended and rationally based. Landgraf v. USI Film Products, 511 U.S. 244, 280-81, 286 (1994); U.S. v. Carlton, 512 U.S. 26-28 (1994). The intent of Congress to have the fees apply in cases such as the one at bar cannot be seriously debated.

> *** Equally clear is that the amendment is supported by a rational basis: the amendment was enacted to collect additional revenues to support the self-funded administration of bankruptcy cases. H. R. Rep. No. 104-196, at 4; Upton Printing, 197 B.R. at 620; see also, In re Prines, 867 F.2d 478, 485 (8th Cir. 1989) (U.S. Trustee Program is meant to be self-funded and to be paid for by the users of the bankruptcy system).

In re Richardson Service Corporation, 210 B.R. at 334.

II. THE ASSESSMENT OF THE FEES IN THESE CASES IS NOT UNCONSTITUTIONAL.

As previously shown, appellants' proffered interpretation of the statute to avoid the fees in controversy, is not a "fairly possible" one. Cf., Arizonans for Official English v. Arizona, 117 S. Ct. 1055, 1074 (1997). See, also, Reno v. American Civil Liberties Union, 117 S. Ct. 2329, 2350 (1997); Virginia v. American Booksellers Assn., Inc., 484 U.S. 383, 397 (1988), Ashwander v. Tennessee Valley Authority, 297 U.S. 288, 348 (1936) (Brandeis, J., concurring). Accordingly, unless the imposition of the fees is held to be unconstitutional, Congress's intent must be honored.

A. CONGRESS'S IMPOSITION OF FEES ON PENDING CHAPTER 11 CASES, INCLUDING THOSE WHERE REORGANIZATION PLANS HAVE BEEN CONFIRMED, IS NOT AN UNCONSTITUTIONAL TAKING.

Appellants point to no case precedent that would indicate that the imposition of new or increased administrative fees to a pending bankruptcy docket would be regarded as a taking. Appellants invoke (initial brief, at 37) the general considerations taken into account by the courts in taking controversies, as summarized in <u>Ruckelshaus v. Monsanto Co.</u>, 467 U.S. 986, 1005 (1984). These include "the character of the governmental action, its economic impact, and its interference with reasonable investment-backed expectations." 467 U.S. at 1005. Analysis of § 1930(a)(6), as amended, under these factors, shows that no taking has occurred in this case.

The character of the governmental action here is the expansion of a generally-applicable user fee, a type of revenue-enhancing measure that has not been historically equated with the condemnation-type governmental actions that typify public takings. The economic impact of the fees is relatively minor. Appellants predict (initial brief, at 39) a total cost of at least $100,000 in additional fees not contemplated at the time the reorganization plan was approved. This is but a small fraction of the disbursements involved. There is no record evidence cited to show that approval of the plan was based upon an expectation that new fees would not be applied before the cases were closed. Indeed, any such expectation would not have been a "reasonable" one; and the "interference" here — similar to a change in the Tax Code or and increase in postal rates — is so indirect and modest it is inconceivable that it should rise to the level of a "taking."

The invalidation of the fees sought by appellants cannot be reconciled with In re Prines, 867 F.2d 478, 485 (8th Cir. 1989), which is probably the most analogous appellate application of the Ruckelshaus v. Monsanto Co. factors to the case at bar. The debtors in Prines objected to the application of the fees in § 1930(a)(6) that were not in effect at the time they filed their bankruptcy petition. The Eighth Circuit rejected the notion that the debtors' expectations regarding Congressional action on fees in pending cases created property interests that could be "taken" for Fifth Amendment purposes. Although the taking argument presented in Prines was essentially identical to that presented here, and the district court below cited Prines in its decision, appellants fail to address it.

B. THE IMPOSITION OF FEES AT ISSUE HERE IS NOT AN IMPERMISSIBLE REOPENING BY CONGRESS OF A FINAL JUDGMENT.

In Plaut v. Spendthrift Farm, Inc., 514 U.S. 211 (1995), the Court considered the constitutional validity of an amendment to the Securities and Exchange Act of 1934 that reopened final, unappealed dismissal judgments. Such a measure, the Court held, impermissibly trenched upon the power of the Judicial Branch to decide cases or controversies. Contrary to appellants' argument, that principle is not implicated by Congress's imposition quarterly fees by amending § 1930(a)(6).

In the first place, when Congress amended § 1930(a)(6) on January 26, 1996, appellate proceedings over the confirmed plan in the instant case were still pending. See, United States v. Reorganized CF & I Fabricators of Utah, Inc., 116 S.Ct. 2106

(June 20, 1996). Because the confirmation order, itself, was on appeal (and therefor not final) when the amendment took effect, whatever problems Plaut might present in other cases with pre-amendment confirmed plans, it has no bearing here whatsoever. See, 514 U.S. at 226-27.

Moreover, the confirmed reorganization plan in this case provided ample space for allowing fees imposed by Congress after confirmation. Under the plan, the bankruptcy court retained jurisdiction --

> to enter any orders *** without limitation *** (a) to allow, disallow, *** or determine any Claim, including Fee Claims ***, (b) to hear and determine all Claims *** commenced before or after the confirmation date ***, and (l) to enter a final decree closing the Cases and making such administrative final provisions for the Cases as may be appropriate.

Plan of Reorganization dated December 1, 1992, ¶ 86; JA 203-04. Thus, the confirmed plan, by its own terms, is not a final decree that would bar accommodation of increased quarterly fees.

In this regard, the new fee is more appropriately viewed as a postconfirmation statutory fee, permissible under the terms of the plan. It is permissible, moreover, without regard to whether it was anticipated in the plan, and without regard to whether or not the United States Trustee can fairly be regarded "just as any other creditor."[3]

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[3] Appellants' initial brief, at 32. In our view, appellants seriously distort the role and interest of the United States Trustee in a Chapter 11 proceeding. See, id., at 16-19. The interest of appellee is administrative, not financial. See, 28 U.S.C. 586; In re Clark, 927 F.2d 793, 795 (4th Cir. 1991).

The argument that the fee is inconsistent with the plan (appellants' brief at 32-36) is, in any event, foreclosed by Holywell Corp. v. Smith, 503 U.S. 47, 58-59 (1992). In Holywell, the confirmed plan placed all of the debtor’s property in a trust and appointed a trustee to liquidate the trust assets and distribute the same to creditors of the debtors’ estates; the plan made no provision for the payment of post-confirmation taxes by the trustee or the filing of tax returns. The plan was confirmed by the Court, with no objection from the United States. When the IRS attempted to collect capital gains taxes, the trustee argued, inter alia, that the terms of the confirmed plan, which did not provide for the filing of tax returns or the payment of taxes post-confirmation, were binding on the United States and precluded the imposition of the taxes. 503 U.S. at 50-52.

The Supreme Court flatly rejected the trustee’s argument. The Court noted that the liability to pay the taxes did not accrue until the time for filing the returns, which was after the plan was confirmed in that case. The Court relied on the plain language of section 1141(a) of the Bankruptcy Code, which specifies that the plan is binding on the pre-confirmation claims of “creditors,” and section 101(10) of the Bankruptcy Code, which specifies that a “creditor” is an entity holding various pre-confirmation claims. The Court concluded that the plan could not bind the United States, or any other party, with respect to postpetition claims.

The post-confirmation fees at issue in the present case are no different than the post-confirmation taxes sought by the United States in Holywell. In each case, the liability did not accrue until events occurred post-confirmation.[4]

III. THE ASSESSMENT OF THE FEES IS NOT INCONSISTENT WITH THE OVERALL SCHEME OF BANKRUPTCY ADMINISTRATION.

Appellants argue that the postconfirmation imposition of the quarterly fee will create insurmountable difficulties in the administration of the bankruptcy process. This exposition is extensive, occupying the bulk of the appellants' Argument (initial brief, at 15-28). However, whatever administrative difficulties the new fees present, these matters are not a valid legal objection to the imposition of the fees.

Congress required that fees be imposed, to these bankruptcy cases, "notwithstanding any other provision of law ***." 110 Stat. 3009, 3009-19; 28 U.S.C. 1930 note (emphasis added). This phrase is deliberately used by legislators when writing in complex statutory territory to insure that a particular provision will prevail in any conflict with another provision. Cf., McCarty v. McCarty, 453 U.S. 210, 241 (1981).

Even if the amendment to Section 1930(a)(6) left some wiggle

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[4] Under Holywell, the government’s participation in a Chapter 11 proceeding cannot be realistically be characterized as a “contract” between the government and the other parties regarding the future course of legislation on taxes or fees. United States v. Winstar, 518 U.S. ___, 116 S.Ct. 2432 (1996), invoked by appellants (initial brief 32-36), has no bearing upon the instant controversy.

room, the most basic of stautory construction canons would still require the fees to be collected. Assuming arguendo that the new fees are incompatible with some pre-existing Bankruptcy Code provisions, it would not follow, as appellants presume, that the fees would not be collectable. Rather, the bankruptcy process would be adjusted to accommodate the new fees. As a general rule of statutory construction, the more specific fee provision would control the general bankruptcy provisions invoked by appellants. See, e.g., Radzanower v. Touche Ross & Co., 426 U.S. 148, 153 (1976); Morton v. Mancari, 417 U.S. 535, 550-551 (1974). And, the later-enacted amendment to § 1930(a)(6) statute would control the pre-enacted Bankruptcy Code provisions. See, e.g., Radzanower v. Touche Ross & Co., 426 U.S. at 154.

In sum, the fees trump any putative inconsistency with the preamendment bankruptcy laws. However "bad" one might think this policy is, it is not the role of the federal courts to re-write policy falling within Congress's constitutional purview. TVA v. Hill, 437 U.S. 153 (1978).

While legal irrelevancy is a complete answer to the appellants' incompatibility arguments, we wish to make clear our disagreement with the appellants' premise. The appellants' perspective is incorrect. In a large, lengthy reorganization process, increased expenses and other postconfirmation administrative obligations are not only normal, they are to be expected. A reorganized debtor is not immune from fee increases changed by law any more than it would be immune from increases in rent, attorneys fees, electricity, taxes or postal rates. Appellants' objection that the collection of the fees will "create a mess" (initial brief, at 24) is overstated, as the payment of fees in many other cases shows.

It is the duty of the federal courts to endeavor to accommodate both laws to the maximum extent possible; implied repeals are heavily disfavored in the law. See, e.g., Crawford Fitting Co. v. J.T. Gibbons, Inc., 482 U.S. 437, 444-45 (1987); Owen v. Magaw, 122 F.3d 1350 (10th cir. 1997); Crow Tribe v. Repsis, 73 F.3d 982, 989 (10th Cir. 1995), cert. denied 116 U.S. 1851 (1996). Appellants have not shown that Chapter 11 proceedings, including those whose reorganization plans had been confirmed before January 26, 1996, cannot accommodate the new fees.

Speculative assertions regarding funding problems should await the development of some actual controversy. But, again, if the imposition of the new fee prevents some reorganized debtor from successfully emerging from a Chapter 11 proceeding, that would not provide a basis for striking the fee.[5]

CONCLUSION

The decision of the district court should be affirmed.

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[5] Appellants' argument that the bankruptcy court lacked jurisdiction to enforce payment of the fees (initial brief at 22-23) is rebutted by the text of the reorganization plan itself, supra. Moreover, the bankruptcy court always retains jurisdiction to adjudicate postconfirmation disputes "related to" the bankruptcy case. 28 U.S.C. § 1334(b).

Respectfully submitted,

WILLIAM KANTER
(202) 514-4575

BRUCE G. FORREST
(202) 514-3180
Attorneys, Appellate Staff
(202) 514-4575
Civil Division, Room 9552
Department of Justice
601 "D" Street, N.W.
Washington, D.C. 20530-0001

Of Counsel:

MARTHA L. DAVIS
General Counsel

PAUL BRIDENHAGEN
Attorneys
Office of General Counsel
Executive Office for
United States Trustees

CERTIFICATE OF SERVICE

I hereby certify that I have caused a copy of this (corrected) BRIEF FOR THE APPELLEE to be served upon the counsel listed below by causing a copy to be mailed, first class, this 7th day of November, 1997. Our filing with the Court will also have been accomplished by first class mail the same date.

Weston L. Harris
Elaine A. Monson
Ray, Quinney & Nebeker
79 South Main Street, Sixth Floor
Post Office Box 45385
Salt Lake City, Utah 84145-0385

BRUCE G. FORREST

BRIEF BANK — "SUMMARY SHEET" *Printed Mon-5/23/11 11:32*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*

In re William Chadwick and Joyce Chadwick

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*

Bankr. S.D. Fla.

3. ("CCN") ***CURRENT*** CASE NO.

No.: 05-37014-BKC-PGH

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*

No.:

Court:

(Identify judge & cite, if any)

5. ("SO") ***SOURCE***

U.S. TRUSTEES

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*

Filed: February 11, 2009

Type: United States Trustee's Objection to Countywide Home Loans, Inc.'s Motion for Leave to Appeal Interlocutory Order

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Zana M. Scarlett, P. Matthew Sutko, Donald F. Walton

(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***

BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s)

&

√ Any Miscellaneous ***BACKGROUND***

- Whether a Rule 2004 order is final for purposes of obtaining district court review.

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UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF FLORIDA
MIAMI DIVISION

In re:

WILLIAM CHADWICK and
JOYCE CHADWICK,

Case No. 05-37014-BKC-PGH
Debtors
Chapter 13
_________________________________/

UNITED STATES TRUSTEE'S OBJECTION TO COUNTRYWIDE HOME LOANS, INC.'S MOTION FOR LEAVE TO APPEAL INTERLOCUTORY ORDER

Pursuant to 28 U.S.C. 158(a) and Fed. R. Bankr. P. 8001 and 8003, the United States Trustee objects to the motion ("Motion") [D.E. #88] filed by Countrywide Home Loans, Inc. ("Countrywide") for leave to appeal the bankruptcy court's December 10, 2007 order ("Order") [D.E. #86] overruling, in part, Countrywide's objection ("Objection") [D.E. #62] to the United States Trustee's second amended notice of 2004 examination ("Notice") [D.E. #55], because:

- the Order is interlocutory;
- the Order is not immediately reviewable under any exception to the final order doctrine; and, accordingly,
- the United States District Court lacks subject matter jurisdiction to consider the merits of Countrywide's appeal.

In support, the United States Trustee states:

FACTS

1. On October 13, 2005, William Chadwick and Joyce Chadwick (the "Debtors") filed a voluntary petition for relief under chapter 13 of the Bankruptcy Code.

2. On January 23, 2006, creditor Countrywide Home Loans, Inc. ("Countrywide") appeared in this case by filing its *Request for Service of Notices* [D.E. #12].

3. On or about February 9, 2006, Countrywide caused a proof of claim – Claim #9 (the "Proof of Claim") to be filed with this court in this case. In the Proof of Claim, Countrywide represented that it had a secured claim against the Debtors in the amount of $100,733.88. Countrywide further represented that $2,396.29 was the amount of an arrearage ("Arrearage") included in the secured claim at the time the case was filed. Despite this assertion, no breakdown of the Arrearage was filed with the Proof of Claim. Contrary to Fed.R.Bankr.P. 3001(d), the Proof of Claim was also not accompanied by evidence that Countrywide's security interest had been perfected.

4. On March 6, 2006, the Debtors filed an objection to Countrywide's Proof of Claim [D.E. #18] invoking a 30-day negative notice period for responding to the Objection to Claim.

5. In their objection to claim, the Debtors' asserted that all "prepetition mortgage payments" had been paid. The Debtors' also requested that the Arrearage component of the claim be stricken.

6. Countrywide did not file a response to the Debtor's objection. Accordingly, on April 17, 2006 - after the time to respond to the objection lapsed, the Debtors filed a *Certificate of No Response or Settlement and Request for Entry of Order* [D.E. #27] relating to the objection. Subsequently, on April 18, 2006, the Court entered its *Order Sustaining Objection to Claim* [D.E. #31] (the "Order Sustaining the Objection to Claim.").

7. Pursuant to the Order Sustaining the Objection to the Claim, the Arrearage contained in Countrywide's Proof of Claim was stricken.

8. The UST subsequently opened an inquiry into this matter in an effort to determine whether Countrywide's conduct in this particular case deviated from the standards established by the bankruptcy code and/or whether its particular actions threatened an abuse of the bankruptcy system or its procedures. 11 U.S.C. § 307; 28 U.S.C. § 586; *In re: A-1 Trash Pickup, Inc*., 802 F.2d 774, 775 (4th Cir. 1996) (Congress intended the U.S. Trustee to be an enforcer of bankruptcy laws).

9. In furtherance of its inquiry into this matter, the UST filed and served Countrywide with a *Second Amended Notice of Examination under Fed. R. Bankr. P. 2004 and Service of Subpoena (Duces Tecum)* [D.E. #55] (the "Notice") on October 24, 2007. Through this examination, the UST intends to ascertain, *inter alia*:

A. The factual and legal basis for Countrywide's representation that the Debtors owed a $2,396.29 mortgage arrearage at the time the proof of claim was filed;

B. Why Countrywide failed to appear to litigate their claim; and

C. If the Proof of Claim filed with this Court contained factual misrepresentations, what actions, if any were taken to correct the proof of claim.

10. On November 2, 2007, Countrywide filed *Countrywide Home Loans, Inc.'s Objections to Notice of Examination under Fed. R. Bankr. P. 2004 and Subpoena (Duces Tecum)* [D.E. # 55] (the "Objection"), and on November 28, 2007, Countrywide filed a *Memorandum of Law in Support* of the Objection [D.E. 73]. On November 29, 2007, the UST filed its *Response to the Objection of* Countrywide *to the Notice of Examination under Fed. R. Bankr. P. 2004 and Subpoena (Duces Tecum)* [D.E. # 76].

11. On December 3, 2007 the court heard oral argument on this matter. Countrywide's counsel asserted that the proof of claim was not truly at issue in this case, stating that "[a]t the time that the case was filed, Mr. and Mrs. Chadwick did indeed owe the

amount set forth in the proof of claim." See Transcript [D.E. # 81] (the "Transcript"), at 7, lines 2 - 4. In support of this assertion, Countrywide's counsel made the following representation:

> Due to the intervention of the bankruptcy amendments, subsequent to that date, the date of their filing, and the date that we were notified that they had filed, they made up their past-due payments post-petition, but at the time the case was filed, the proof of claim would have correctly reflected the amount the Chadwick's owed.

Transcript at 7, lines 4 - 9.

12. This explanation creates at least two possible scenarios: (1) either the proof of claim was accurate and Countrywide violated the automatic stay by accepting post-petition payments and applying them to a pre-petition debt; or (2) the proposed chapter 13 plan and the Debtors' schedules were accurate - ergo, the proof of claim was inaccurate. Under either scenario, the documents and representations that have been filed and/or made to this court by Countrywide raise issues regarding the administration of this case, and constitute "cause" to support an examination under Fed.R.Bankr.P 2004.

13. Given the above, the bankruptcy court was correct when it overruled Countrywide's Objection. See Transcript at 18. Specifically, the bankruptcy court found that the UST has the "right and duty to investigate any and all affairs of the debtor or the creditors in a case," that there is "authority under 28 U.S.C. 586 to conduct such an investigation," and to the extent necessary the bankruptcy court would exercise its "equitable

powers to authorize" the UST to "conduct this kind of investigation to insure the integrity of the bankruptcy system and to insure the equal and fair application of justice in this Court...." Transcript at 18-19.

14. The bankruptcy court entered its Order on December 10, 2007. In the Order, the court found that the UST was authorized to examine and to obtain documents from Countrywide under Fed. R. Bankr. P. 2004 per the Notice, pursuant to the UST's authority under 11 U.S.C. Section 307 and 28 U.S.C. Section 586. In overruling Countrywide's Objection, the court ordered that the term documents in the subpoena be deemed limited to the definition of "documents" in the Federal Rules of Civil Procedure, and further ordered that the UST's document requests be limited to all "documents evidencing the Debtors' payment history and any other documents evidencing the outstanding debt under the Debtors' mortgage as of the date Countrywide filed its proof of claim." Order, at 2-3. The Order also conditioned Countrywide's producing the documents described in Notice Exhibit "A" upon the United States Trustee's providing Countrywide with a certificate of compliance under the Right To Financial Privacy Act of 1978, 12 U.S.C. 3401 et seq.[1] Id. at 3.

15. Countrywide filed the Motion and its notice of appeal [D.E. #89] on December 20, 2007.

16. The sole issue implicated in the Order and presented for consideration on interlocutory appeal is whether the bankruptcy court abused its discretion in authorizing the United States Trustee, a party in interest in this case, to conduct discovery of Countrywide under Fed. R. Bankr. P. 2004. See Order.

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[1] The United States Trustee has done so.

ARGUMENT

THE DISTRICT COURT SHOULD DENY THE MOTION AND DISMISS THIS APPEAL, BECAUSE IT LACKS JURISDICTION TO HEAR AN APPEAL OF A NON-FINAL, INTERLOCUTORY DISCOVERY ORDER

A. As the intermediate appeals court, a district court can hear appeals only from final bankruptcy court orders.

17. A district court has jurisdiction to hear appeals only from final orders rendered by a bankruptcy court. 28 U.S.C. 158(a)(1); Int. Horizons, Inc. v. Committee of Unsecured Creditors (Matter of Int. Horizons, Inc.), 689 F.2d 996, 1000 (11th Cir. 1982) (interpreting the predecessor to 28 U.S.C. 158 and holding that bankruptcy court orders granting or denying discovery were not final, appealable orders, unless the appellant had either asserted an unprotected privilege or been found in contempt for failure to comply with an underlying discovery order). See 15B Charles Alan Wright et al., Fed. Prac. & Proc. Juris.2d § 3914.23 (2007 Supp.) (surveying cases). A district court also has discretionary jurisdiction to hear appeals of interlocutory orders, upon leave. Matter of Int. Horizons, Inc., 689 F.2d at 1000; 28 U.S.C. 158(a)(3).

18. A final order "is an order that concludes the litigation on the merits of the case and 'leaves nothing for the court to do but execute the judgment . . . .'" Spencer, Spencer, Depper & Guthrie v. Paskay (In re Hillsborough Holdings Corp.), 164 B.R. 673, 674 (S.D. Fla. 1994), citing Catlin v. United States, 324 U.S. 229 (1945). By contrast, an interlocutory order is "[a]n order that is final with regard to a particular issue, but does not end the litigation on the merits, is not a final order under Catlin and is not immediately appealable . . . ." Masters, Mates & Pilots Plans v. Lykes Bros. Steamship Co., Inc. (In re Lykes Bros. Steamship Co., Inc.), 200 B.R. 933, 937 (M.D. Fla. 1996). Limiting appellate jurisdiction to final orders – the final order doctrine - promotes both judicial efficiency and economy by preventing delay tactics and the concomitant increase in legal fees. Id.

19. Interlocutory appeals will not be granted absent "exceptional circumstances . . . [t]o do otherwise 'would contravene the well-established judicial policy of discouraging interlocutory appeals and avoiding the delay and disruption which results from such piecemeal litigation . . . .'" Escondido Mission Village L.P. v. Best Products Company (In re Escondido), 137 B.R. 114, 116 (S.D.N.Y. 1992) (citing In re Casco Bay Lines, Inc., 8 B.R. 784, 786 (B.A.P. 1st Cir.1981). See Colonial Bank v. Freeman (In re Pacific Forest Products Corp.), 335 B.R. 910, 919 (S.D. Fla. 2005) (stating that "[i]nterlocutory review is generally disfavored for its piecemeal effect on cases . . . ."). The party seeking immediate review of an interlocutory order "bears the burden of demonstrating exceptional circumstances . . . ." American Freight System, Inc. v. Transport Ins. Co. (In re American Freight System, Inc.), 194 B.R. 659, 661 – 662 (D. Kan. 1996) (denying motion for leave to appeal bankruptcy court order authorizing discovery of a creditor's "practices and procedures . . ." underlying its proof of claim).

B. Bankruptcy court discovery orders are interlocutory, not final, and they can be reviewed only in situations where a third party asserts a privilege of non-disclosure.

20. In a case directly on point here, the Eleventh Circuit observed that orders entered by a bankruptcy court granting or denying discovery are generally not final and appealable. Matter of Int. Horizons, Inc., 689 F.2d at 1000 – 1001, citing Rouse Construction International, Inc. v. Rouse Construction Corp., 680 F.2d 743, 745 (11th Cir. 1982). In Horizons, the creditors' committee sought access to documents and work papers in the possession of the debtor's accountant. The accountant refused, citing the protections of a state law accountant-client privilege. The bankruptcy court rejected the asserted privilege and directed the firm to produce the requested documents. Both the firm and the debtor appealed. Id. at 999.

21. Citing holdings of Fifth, Second, Ninth and Tenth Circuits, the court in Horizons stated that a person subject to a bankruptcy court discovery order has two choices – 1) to comply with it and to challenge the order at the conclusion of the case, when it is final, or 2) to refuse to comply and to challenge the order, if subsequently cited for contempt. Id. at 1001. The court recognized that a major exception to this rule occurs where the person subject to a discovery order "has custody of materials as to which another person may claim a privilege of non-disclosure . . . ." Id.

22. In Horizons, the court ultimately dismissed the appeal by the accountants, holding that the discovery order was not final and, therefore, not appealable, because the firm had not yet been cited for civil contempt arising from its refusal to produce the documents requested by the creditors' committee. Id. The court held that the discovery order was final and appealable as to the debtor, however, "because it claims a privilege of non-disclosure relating to materials that another party has been directed to produce . . . ." Id. at 1001 – 1002. After hearing the merits of the debtor's appeal, the court affirmed the lower courts' orders compelling production, finding that the accountant-client privilege was invalid under Fed. R. Evid. 501, federal common law and principles of comity. Id. at 1004 – 1005.

23. Here, Countrywide does not assert that its complying with the Order will jeopardize any asserted privilege. Motion. Therefore, it has two options. It can comply with the Notice and the Order by producing the documents requested by the United States Trustee and submitting its designated representative for examination on the dates indicated. It can then challenge the Order at the conclusion of the Debtors' case. Alternatively, it can refuse to comply and appeal the Order in the context of a subsequent civil contempt order. Matter of Int. Horizons, Inc., 689 F.2d at 1000 – 1001.

24. Countrywide's argument that the Order constitutes a final, appealable order overlooks controlling law in the Eleventh Circuit. Motion at 4 – 5. Inasmuch as the Order is interlocutory and not final, the Court should deny the Motion and dismiss the appeal. Id.[2]

C. The Order cannot be immediately appealed under any exception to the final order doctrine.

25. In the Eleventh Circuit, interlocutory orders issued by bankruptcy courts - other than discovery orders - can be immediately appealed to the district court under one of two exceptions to the final order doctrine – the Forgay-Conrad rule (also known as the doctrine of practical finality) and the Cohen (collateral order) doctrine. In re Lykes, 200 B.R. at 938; Lockwood v. Snookies, Inc. (In re Hickory House, Inc.), 60 F.3d 724, 726 – 727 (11th Cir. 1995). Countrywide argues that the Order fits within one or both of these exceptions. Motion at 5 – 6. Assuming that the controlling law in the Eleventh Circuit, as articulated in Horizons, does not proscribe interlocutory appeals of bankruptcy court discovery orders, the Order is nevertheless not constructively final, because it does not meet one or more of the required elements.

1. The Order is not appealable under the Forgay-Conrad rule.

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[2] Accord, Robinson v. Tanner, 798 F.2d 1378 (11th Cir. 1986), cert. den., 481 U.S. 1039 (1986) (holding than an order imposing sanctions for discovery abuses was not immediately appealable); Aetna Casualty & Surety Co. v. Glinka, 154 B.R. 862, 868 (D. Vt. 1993) (district court dismissed appeal from orders quashing subpoenas and directing third party to produce documents under Fed. R. 2004, because the orders were interlocutory. The court noted that "[t]he virtue of the contempt adjudication before allowing an appeal is that if affords the parties a 'second look' before determining whether to pursue or resist the discovery . . . ." (citation omitted)); First Nat. Bank of Atlanta v. AMR Group, Inc., 67 B.R. 311, 312 – 313 (S.D. Ga. 1986) (district court dismissed motion for leave to appeal order requiring appellant to produce documents, because the order was interlocutory and not immediately appealable under either 28 U.S.C. 1292(b), which governs the appeal of interlocutory orders issued by the district court to the court of appeals, or the collateral order doctrine, because the bankruptcy court had not yet issued a civil contempt order). See Firestone Tire & Rubber Co. v. Risjord, 449 U.S. 368, 377 (1981) (observing in dicta "we have generally denied review of pretrial discovery orders . . . Our rationale has been that in the rare case when appeal after final judgment will not cure an erroneous discovery order, a party may defy the order, permit a contempt citation to be entered against him, and challenge the order on direct appeal of the contempt ruling . . . .") (citations omitted) (holding that orders denying motions to disqualify opposing party's counsel in a civil case were not appealable prior to final judgment in underlying litigation).

26. The Forgay-Conrad rule permits review of an interlocutory order "that decides the right to the property in contest, and directs it to be delivered up by the defendant to the complainant, or directs it to be sold, or directs the defendant to pay a certain sum of money to the complainant, and the complainant is entitled to have such decree carried immediately into execution . . . ." (citations omitted). In re Hickory House, Inc., 60 F.3d at 726 – 727.

27. Countrywide concedes that the Order does not require Countrywide to deliver physical property to the United States Trustee. Motion at 5 – 6. As such, it is not constructively final for purposes of the Forgay-Conrad rule. In re Lykes, 200 B.R. at 938 (holding that an order denying a motion for appointment to the creditors' committee "does not require the immediate delivery of physical property, so this exception is not applicable . . . ."). See In re Hillsborough Holdings Corp., 164 B.R. at 675 (denying interlocutory review of interim fee award, because "money is not generally considered physical property . . . .").

2. The Order is not appealable under the Cohen doctrine.

28. Under the Cohen doctrine, a district court may review interlocutory orders "that '(1) finally determine a claim separate and independent from the other claims in the action; (2) cannot be reviewed after the final judgment because by then effective review will be precluded and rights conferred will be lost; and (3) are too important to be denied review because they present a significant and unresolved question of law . . . .'" Id. (citations omitted).

29. The Order neither determined a discrete claim nor precluded effective review, because there is yet much to be done in connection with the discovery. As a threshold matter, it is unclear whether Countrywide will comply with the subpoenas attached to the Notice. Assuming that Countrywide fails to do so, it is unclear whether the United States Trustee will move to compel compliance. It is equally unclear whether the bankruptcy court

would hold Countrywide in civil contempt if Countrywide were to fail to comply with an order compelling it to obey the Order. Aetna Casualty & Surety Co. v. Glinka, 154 B.R. at 868 (finding that the uncertainty regarding the target's future compliance with subpoenas, the movant's response and the bankruptcy court's possible enforcement actions rendered the orders interlocutory and nonappealable). Inasmuch as the Order does not conform with at least two of the three elements[3] of the Cohen doctrine, it is not constructively final, and the court should deny the Motion. See Atlantic Fed. Savings & Loan v. Blythe, 890 F.2d 371 (11th Cir. 1989) (dismissing appeal from an order imposing discovery sanctions for lack of jurisdiction, because the order did not fit within the Forgay-Conrad and Cohen exceptions to the final judgment rule).

3. The district court should not exercise discretionary review of the Order.

30. Countrywide further offers that the district court should exercise discretionary, interlocutory review of the Order. Motion at 6 – 9. A district court may do so using a three part test that is analogous to that governing appeals of interlocutory orders from the district court to the court of appeals under 28 U.S.C. 1292(b). In re Pacific Forest Products Corp., 335 B.R. at 919 (citations omitted). Under this test, a district court may review an interlocutory order "if the subject issue (1) involves a controlling question of law, (2) as to which there is a substantial ground for difference of opinion, and (3) is such that an immediate appeal would advance the ultimate termination of the litigation . . . If the party moving for leave to appeal fails to establish any of these three elements, then leave must be denied . . . ." Id.

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[3] The United States Trustee addresses the third element – a "significant and unresolved question of law" – infra at subsection 3 in the context of the district court's discretionary review of interlocutory orders.

31. The legal issue presented by the Motion – whether the bankruptcy court abused its discretion in partially denying the Objection and authorizing the United States Trustee, as a party in interest, to conduct discovery of the factual basis for Countrywide's proof of claim – presents no controlling, disputed question of law. Rather, issues concerning the scope of discovery under Fed. R. Bankr. P. 2004 are inherently interlocutory, present no controlling issues of law and "are left to the sound discretion of the court that is fully familiar with the entire proceeding – the bankruptcy judge . . . ." Hoffenberg v. Cohen (In re Towers Fin. Corp.), 164 B.R. 719, 720 (S.D.N.Y. 1994) (dismissing appeal of order denying motion for 2004 examination).

32. The Order did not finally adjudicate the validity of Countrywide's proof of claim under 11 U.S.C. 502. It merely authorized the United States Trustee to investigate its factual basis. See In re American Freight System, Inc., 194 B.R. at 662 (holding that discovery orders "do not present 'controlling issues of law' capable of significantly advancing the litigation . . . .'"). (citations omitted).

33. Moreover, as noted above, the controlling law in the Eleventh Circuit is clear – bankruptcy court discovery orders are interlocutory and not final and appealable. Matter of Int. Horizons, Inc., 689 F.2d at 1000 – 1001. "[W]here there is controlling authority in the jurisdiction where the order was rendered, there cannot be a substantial difference of opinion . . . ." In re Pacific Forest Products Corp., 335 B.R. at 922 (citations omitted).

34. Countrywide advances the theory that the United States Trustee lacks authority under 11 U.S.C. 307 and 28 U.S.C. 586 to conduct discovery of creditors and that this theory constitutes a disputed, controlling issue of law. Motion at 7 – 8.

35. This issue does not make the Order immediately reviewable under the District Court's discretionary authority, however. Under 11 U.S.C. 307, the United States Trustee

"may raise and may appear and be heard on any issue . . . ."[4] This broad grant of standing is not circumscribed by the United States Trustee's statutory duties, which are enumerated in 28 U.S.C. 586. In re Miles, 330 B.R. 848, 850 (Bankr. M.D. Ga. 2005) (overruling objection to a motion to transfer venue filed by the United States Trustee, stating that under section 307, "the U.S. Trustee is given the same right to be heard as a party in interest, but retains the discretion to decide when a matter of concern to the proper administration of the bankruptcy laws should be raised [under 28 U.S.C. 586] . . . ."). Countrywide cites no authority holding that otherwise interlocutory, nonappealable discovery orders in the Eleventh Circuit are converted to final, appealable orders owing to the involvement of the United States Trustee.

36. Countrywide has not met its burden of demonstrating that a substantial basis for difference of opinion exists on a controlling issue of law and that the Order presents issues materially different from routine discovery matters, which are not final and appealable in the Eleventh Circuit. In re American Freight System, Inc., 194 B.R. at 662. Accordingly, the Court should deny the Motion and dismiss this appeal.

PRAYER

For the foregoing reasons, the United States Trustee prays that this Court deny the Motion and dismiss the appeal.

Dated: May 23, 2011.

Respectfully submitted,

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[4] The UST is an official of the United States Department of Justice charged by statute with the duty to oversee and supervise the administration of bankruptcy cases. 28 U.S.C. § 586(a); In re Glados, Inc., 83 F.3d 1360, 1361 n.1 (11th Cir. 1996); See also United States Trustee v. Price Waterhouse, 19 F.3d 138, 141 (3d Cir. 1994); In re Donovan Corp., 215 F.3d 929, 930 (9th Cir. 2000); In re Clark, 927 F.2d 793, 796 (4th Cir. 1991); In re Plaza de Diego Shopping Center, 911 F.2d 820, 824 (1st Cir. 1990); In re Revco D.S., Inc., 898 F.2d 498, 500 (6th Cir. 1990); Thompson v. Greenwood, -- F.3d -- 2007 WL 3286743, at *7 n.3 (6th Cir. November 8, 2007).

Donald F. Walton
Acting United States Trustee
Region 21

By: */s/* __________________________
Zana M. Scarlett, Trial Attorney
Florida Bar No.: 626031
U.S. Trustee's Office
51 SW 1st Ave., Room 1204
Miami, FL 33030
Phone: (305) 536-7285
Fax: (305) 536-7360

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the foregoing Motion has been served on the following parties on May 23, 2011, electronically through CM/ECF, on parties having appeared electronically in the instant matter and that a copy hereof shall be served by U.S. Mail, postage prepaid, on parties not appearing electronically:

Leslie Auerbach, Esq.**
Robin Weiner, Trustee **
Joan Levit**

/s/ __________________________
Zana M. Scarlett, Trial Attorney

BRIEF BANK — “SUMMARY SHEET”

Printed Fri-8/20/10 8:56

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	Habbo G. Fokkena v. Damian Gerald Chapman & Melissa Ann Chapman (In re: Damian Gerald Chapman & Melissa Ann Chapman)
2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	8th Cir. BAP
3. ("CCN") ***CURRENT*** CASE NO.	No.: 10-6046
4. ("PCN") ***PRIOR*** CASE NO. - & COURT *[IF ANY]*	No.: 08-35303 Court: Bankr. Minn. *(Identify judge & cite, if any)*
5. ("SO") ***SOURCE***	**U.S. TRUSTEES**
6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	Filed: August 13, 2010 Type: Brief of Appellant, The United States Trustee
7. ("AU") *PRINCIPAL AUTHORS & OFFICE* *[E.g.,"UST/OGC"]*	Wendy Cox, P. Matthew Sutko, Ramona D. Elliott, James L. Snyder, Habbo G. Fokkena *(UST/OGC: 202-307-1399/FAX-2397)*
8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	• Whether the bankruptcy court erred in concluding that 11 U.S.C. § 707(b)(1) does not apply to a case that has been converted from chapter 13 to chapter 7 of the Bankruptcy Code.
10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)	

11. DO YOU RECOMMEND POSTING IN UST BRIEFBANK?

☒ YES ☐ NO

NAME: Linda Figueroa

DATE:

No. 10-6046

UNITED STATES BANKRUPTCY APPELLATE PANEL FOR THE EIGHTH CIRCUIT

In re DAMIAN GERALD CHAPMAN &
MELISSA ANN CHAPMAN,

Debtors.

HABBO G. FOKKENA,
UNITED STATES TRUSTEE,

Appellant,

v.

DAMIAN GERALD CHAPMAN &
MELISSA ANN CHAPMAN,

Appellees.

ON APPEAL FROM THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF MINNESOTA
Bankruptcy Case No. 08-35303

BRIEF OF APPELLANT, THE UNITED STATES TRUSTEE

RAMONA D. ELLIOTT
General Counsel

P. MATTHEW SUTKO
WENDY L. COX
Executive Office for United States Trustees
United States Department of Justice
20 Massachusetts Avenue N.W.
Washington, D.C. 20530
Telephone: (202) 307-1399

HABBO G. FOKKENA
United States Trustee

ROBERT B. RASCHKE
Assistant United States Trustee
MICHAEL RIDGWAY
Trial Attorney
1015 United States Courthouse
300 S. 4th Street
Minneapolis, Minnesota 55415
Telephone: (612) 664-5500

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JURISDICTIONAL STATEMENT

The bankruptcy court had jurisdiction under 28 U.S.C. §§ 157 (a) and (b), and 1334(a) to issue its order denying the United States Trustee's motion to dismiss the Chapmans' chapter 7 bankruptcy case. The bankruptcy court issued its opinion and entered its order on June 10, 2010. That order was a final order. *Stuart v. Koch (In re Koch)*, 109 F.3d 1285, 1287 (8th Cir. 1997). The United States Trustee filed a notice of appeal on June 23, 2010, which is timely under 28 U.S.C. §§ 158(a) and (c)(2) and Fed. R. Bankr. P. 8002. This Court has appellate jurisdiction under 28 U.S.C. § 158(a)(1) and (b), statutory provisions under which bankruptcy appellate panels have jurisdiction to hear appeals from final judgments, orders, and decrees of bankruptcy judges.

STATEMENT OF THE ISSUE

The sole issue in this appeal is whether the bankruptcy court erred in concluding that 11 U.S.C. § 707(b)(1) does not apply to a case that has been converted from chapter 13 to chapter 7 of the Bankruptcy Code.

STANDARD OF REVIEW

A bankruptcy court's findings of fact are reviewed for clear error and its conclusions of law are reviewed *de novo*. *In re Litzinger*, 322 B.R. 108, 112 (B.A.P. 8th Cir. 2005). In this case, the facts are undisputed, and the bankruptcy court's interpretation of 11 U.S.C. § 707(b)(1) is a conclusion of law subject to *de novo* review.

STATEMENT OF THE CASE

The Chapmans sought chapter 13 bankruptcy relief in the United States Bankruptcy Court for the District of Minnesota. *See* 11 U.S.C. § 1301 et seq. A year later, the Chapmans converted their case to chapter 7. *See* 11 U.S.C. § 1307(a). The United States Trustee moved to dismiss the Chapmans' chapter 7 case for abuse under 11 U.S.C. § 707(b)(1) on the grounds that a presumption of abuse arose and the totality of the Chapman's financial circumstances demonstrated abuse. *See* 11 U.S.C. § 707(b)(1), (2) & (3). The bankruptcy court held that section 707(b)(1) did not apply to cases that had not started in chapter 7 and denied the United States Trustee's motion to dismiss for that reason without considering the merits of the motion. The United States Trustee appealed.

STATEMENT OF FACTS

The Chapmans commenced this case by filing a petition for relief under chapter 13 of the Bankruptcy Code on October 10, 2008. [Chapter 13 Voluntary Petition, #1]. The Chapmans' plan was confirmed on January 29, 2009. [Confirmation Order, #23]. The Chapmans agreed to pay $1,150 per month to fully pay their unsecured creditors' claims and to separately make their home and car payments. [*See* Plan, #20]. The Chapmans made several plan payments, but did not make their mortgage and car payments, enabling their secured creditors to obtain relief from the automatic stay. [Debtors' Response to Motion to Dismiss, #46 at 2-3]. The Chapmans attribute their inability to pay to a reduction in Mrs. Chapman's overtime income and unanticipated personal expenses. [*Id.*]. The Chapmans did not seek to modify their confirmed plan to reduce or delay their payments.

Instead, the Chapmans converted their case to chapter 7 on October 16, 2009. [Notice of Conversion, #36]. They filed new schedules and a *Chapter 7 Statement of Current Monthly Income and Means-Test Calculation* in the converted case using income and expense figures that were current as of the time of conversion, instead of their average monthly income for the six months prior to the commencement of their chapter 13 case.[1] [#36 at 38-45; *see* Debtors' Response to Motion to Dismiss, #46 at 3]. They checked the box indicating that the presumption of abuse arose. [Means-Test Calculation, #36 at 38].

The United States Trustee moved to dismiss the Chapmans' chapter 7 case for abuse. [Motion to Dismiss, #43]. The United States Trustee's motion alleged that the elimination of Ms. Chapman's overtime had a negligible impact on her

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[1] *See* 11 U.S.C. § 101(10A)(A)(i).

income and did not rebut the presumption of abuse. [*Id.* at 3]. Further the motion alleged that the Chapmans' case should be deemed abusive under the totality of the circumstances because they had actual disposable income of over $1,400 per month that they could use to repay creditors. [*Id.* at 3-4].

In response to the United States Trustee's motion, the Chapmans also argued that additional special circumstances exist that rebut the presumption of abuse and they had no ability to repay their creditors. [Debtors' Response to Motion to Dismiss, #46 at 7-9]. The Chapmans also asserted that the Bankruptcy Code does not allow a court to dismiss a case initially filed under chapter 13 for abuse. [*Id.* at 4]. The bankruptcy court heard argument on the legal issue of whether section 707(b) applies to converted cases; no evidence was taken concerning the factual issues raised by the motion.

The bankruptcy court issued its decision denying the United States Trustee's motion on June 10, 2010. [Order, #47].[2] Because the decision only addressed whether the Bankruptcy Code authorizes dismissal of a case for abuse where the debtors initially file under chapter 13, it did not reach any conclusions with respect to whether the Chapmans' case was presumptively abusive or whether it should be deemed abusive under the totality of the circumstances. [*Id.*]. The

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[2] The bankruptcy court's decision has been published at 431 B.R. 216.

United States Trustee appealed. [Notice of Appeal, #49].

SUMMARY OF ARGUMENT

This appeal is not about whether the Chapmans' bankruptcy case would be an abuse of chapter 7, although the United States Trustee believes that it would. The bankruptcy court has yet to consider that issue. This appeal will decide whether debtors who initiate cases in one chapter and then convert them to chapter 7 will escape scrutiny for abuse under **(a)** section 707(b)(2)'s means test, **(b)** section 707(b)(3)(A)'s bad faith test, and **(c)** section 707(b)(3)(B)'s totality of the debtor's financial circumstances test.

The bankruptcy court found that section 707(b)(1) does not apply in a case originally commenced under chapter 13 and subsequently converted to chapter 7. [Order, #47]. The court did so because it read these words in section 707(b)(1) – "may dismiss a case *filed by an individual debtor under this chapter* whose debts are primarily consumer debts" – as unambiguously limiting dismissal under section 707(b) to cases originating under chapter 7. 11 U.S.C. § 707(b)(1) (emphasis added). [Order, #47 at 2].

But those words are anything but clear. Courts in approximately equal numbers have taken opposite views of the "plain meaning" of the statute.

One reading of section 707(b) is better though. The better reading permits a court to dismiss any chapter 7 case filed by an individual debtor with primarily consumer debts for abuse, regardless of how the case got to chapter 7. It is better because at least seven separate indications in the Code, its legislative history and relevant case law lead to the conclusion that section 707(b) applies to all chapter 7 cases. That body of law demonstrates this language does not exclude converted cases from scrutiny under section 707(b), but instead acts to limit the application of section 707(b) to chapter 7 cases involving individual debtors with primarily consumer debts. Those indicators outweigh any countervailing indications, making this interpretation the better one.

First, in the context of the Bankruptcy Code, cases that are converted to chapter 7 from chapter 13 are "deemed" to have been "filed under" chapter 7. *Resendez v. Lindquist*, 691 F.2d 397, 399 (8th Cir. 1982); *see* 11 U.S.C. § 348(a). This supports the conclusion that the phrase "filed . . . under this chapter" refers both to cases that originated under chapter 7 and those that were converted to chapter 7.

Second, sections 1112(b)(1), 1208(b), and 1307(b) of the Bankruptcy Code allow a court to "dismiss a case under this chapter." That language is the same as that found in section 707(b), except that section 707(b), unlike those sections, adds the words "filed by an individual debtor" to identify those cases pending in chapter 7 that can be dismissed under that subsection. Sections 1112(b), 1208(b), and 1307(b) serve the same purpose as 707(b), authorizing dismissal when the applicable statutory basis is met. There is no reason to read them more expansively than section 707(b).

Third, courts almost unanimously have interpreted the language "in a case filed under" in 11 U.S.C. § 1328(f) to include cases converted to the specified chapters. There is no reason to interpret the substantially similar phrase in section 707(b)(1) the opposite way.

Fourth, Congress explicitly excepted some chapter 7 cases from dismissal under section 707(b). But it did not explicitly except cases converted to chapter 7. Given that Congress knew how to create explicit exceptions to section 707(b) when it wished, there is no reason to find an implicit exception here.

Fifth, in section 704(b) of the Code, Congress required the United States Trustee to review materials submitted by individual debtors in chapter 7 cases and move to dismiss or convert the case under section 707(b) if the debtor's case would be presumed to be an abuse or explain why a motion would not be appropriate. Section 704(b) makes no exception for converted cases.

Sixth, for over twenty years prior to the enactment of the Bankruptcy Abuse

Prevention and Consumer Protection Act of 2005,[3] bankruptcy courts – relying on the same language at issue here – dismissed converted cases for substantial abuse under section 707(b) and routinely expressed the belief that converted cases could remain in chapter 7 only if it would not be a substantial abuse of that chapter. Given the textual indications of Congressional intent, it is not surprising that no one previously questioned section 707(b)'s applicability to converted cases. The language did not change in 2005, so the result should not either.

Seventh, the bankruptcy court's ruling would defeat the objective of section 707(b) to ensure that debtors with the ability to repay their creditors do so. Instead it would invite abuse by enabling debtors to obtain relief under chapter 7 simply by commencing their case in chapter 13 and then converting to chapter 7.

And it would discourage debtors who have some ability to pay but are unwilling or unable to make full payment under their current plan from engaging in necessary belt-tightening or attempting to modify their plans to obtain relief under chapter 13. Many such debtors would instead convert to chapter 7, wasting the time and resources already spent by the court, the parties and the trustee in chapter 13 and unnecessarily burdening the new chapter 7 trustee.

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[3] Pub. L. No. 109-8, 119 Stat. 23 (2005).

ARGUMENT

I. Although Section 707(b) is not artfully drafted, the Bankruptcy Code's language and structure, past practice under section 707(b), and section 707(b)'s purpose all establish that section 707(b) is best read as applying to converted cases.

A. Standing alone, section 707(b)(1) is ambiguous on the question of whether section 707(b) applies to converted cases.

The bankruptcy court held that the Chapmans' case could not be dismissed for abuse under section 707(b)(1) because that section did not apply to converted cases. [Order, #47]. The court interpreted the statutory language permitting it to dismiss for abuse "a case filed by an individual debtor under this chapter whose debts are primarily consumer debts " to limit the reach of section 707(b) to cases that began under chapter 7. 11 U.S.C. § 707(b)(1); [*see* Order, #47 at 2]. Although the bankruptcy court believed the statutory language unequivocally compelled that result, that decision diverged from a twenty-year, pre-BAPCPA practice of reviewing converted cases for substantial abuse under the identical statutory language.[4] And courts have continued to rule that section 707(b) applies to converted cases, in spite of several recent decisions to the contrary. *Justice v. Advanced Control Solutions, Inc.*, No. 07-5231, 2008 WL 4368668 (W.D. Ark.

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[4] In BAPCPA, Congress lowered the standard for dismissal under 707(b) from "substantial abuse" to "abuse," but the language at issue here remained unchanged. Pub. L. No. 109-8, 119 Stat. at 27.

Sept. 22, 2008) (holding that section 707(b) does apply to cases converted to chapter 7); *In re Willis*, 408 B.R. 803 (Bankr. W.D. Mo. 2009) (Hon. Jerry W. Venters) (same); *In re Kellett*, 379 B.R. 332 (Bankr. D. Or. 2007) (same); *In re Kerr*, No. 06-12302, 2007 WL 2119291 (Bankr. W.D. Wash. Jul. 18, 2007) (same); *In re Perfetto*, 361 B.R. 27 (Bankr. D.R.I. 2007) (same).

The bankruptcy court's difficulty in applying section 707(b) to converted cases is understandable. The language of section 707(b)(1) is anything but clear. The sixteen words at the heart of the controversy include

- five nouns, and
- three modifying phrases or clauses, but
- no punctuation.

Adding to the ambiguity, "under this chapter" sits haphazardly in the middle of the independent phrase "filed by a debtor . . . whose debts are primarily consumer debts."

But unlike the twenty-year practice under section 707(b), the bankruptcy court's reading goes against the language and structure of the Bankruptcy Code and the well-recognized purpose of that provision, as explained below. Taken in context, the better interpretation of the statute is that section 707(b) applies to all cases under chapter 7.

B. The language and structure of the Bankruptcy Code, however, lead to the conclusion that converted cases are subject to dismissal for abuse.

The relevant language in section 707(b) must be construed in the context of the Bankruptcy Code. *See McCarthy v. Bronson,* 500 U.S. 136, 139 (1991) (rejecting arguments relying on a "natural reading" of statutory language in isolation). Courts look at the design of the statute as a whole and to its object and policy, not just the particular statutory language, to determine its meaning. *Crandon v. United States,* 494 U.S. 152, 158, (1990). The language and structure of the Code and the history of section 707(b) show that section 707(b) applies to all cases under chapter 7.

1. The fact that the Eighth Circuit and other courts hold that section 348(a) treats converted cases as filed under the converted chapter supports the Government's reading.

While most civil cases are filed only once, bankruptcy cases are different. A single bankruptcy case can proceed under various chapters by conversion from one chapter to another. In that context, one bankruptcy case pend under more than one chapter.[5]

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[5] The term "filed under" is not defined in the Code. Merriam-Webster's online dictionary defines "file" among other things as "to place among official records as prescribed by law." *See* www.merriam-webster.com/dictionary/file (Aug. 9, 2010). Using that definition, the Chapmans' case was filed under chapter 13 when they filed their petition and then filed under chapter 7 when they filed their notice of conversion.

The Bankruptcy Code treats converted cases as if they were originally commenced under the chapter to which they are converted. Section 348, which governs the effect of conversion, states that:

> Conversion of a case from a case under one chapter of this title to a case under another chapter of this title constitutes an order for relief *under the chapter to which the case is converted*, but, except as provided in subsections (b) and (c) of this section, does not effect a change in the date of the filing of the petition, the commencement of the case, or the order for relief.

11 U.S.C. § 348(a) (emphasis added).[6] In other words, upon conversion, a case is treated as if it had been commenced under the new chapter at the time the original petition was filed. As the United States Bankruptcy Court for the Western District of Missouri has explained:

> [T]he clear intent of [section 348(a)] is to retain the original filing date as the date of the "filing of the petition," "commencement of the

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[6] Subsections (b) and (c) of section 348 provide:

> (b) Unless the court for cause orders otherwise, in section 701(a), 727(a)(10), 727(b), 728(a), 728(b), 1102(a), 1110(a)(1), 1121(b), 1121(c), 1141(d)(4), 1146(a), 1146(b), 1201(a), 1221, 1228(a), 1301(a), and 1305(a) of this title, "the order for relief under this chapter" in a chapter to which a case has been converted under section 706, 1112, 1208, or 1307 of this title means the conversion of such case to such chapter.
>
> (c) Sections 342 and 365(d) of this title apply in a case that has been converted under section 706, 1112, 1208, or 1307 of this title, as if the conversion order were the order for relief.

> case" or "order for relief" except in the circumstances provided for in subsections (b) and (c), where these terms are instead deemed to refer to the conversion date. Because Section 707(b) is not mentioned in either subsection (b) or (c) of Section 348, it follows that the original filing date is retained upon conversion, *but the case is otherwise treated as if the debtor had originally filed under the converted chapter*.

In re Willis, 408 B.R. at 808 (quoting *In re Kerr*, 2007 WL 2119291 at *3 (emphasis added)). *Cf. Justice*, 2008 WL 4368668 at *3-5; *Perfetto*, 361 B.R. at 30-31; *In re Kellett*, 379 B.R. at 335-40; *In re Kerr*, 2007 WL 2119291 at *2-*4.[7]

And it is the law of this circuit that debtors who convert their cases from chapter 13 to chapter 7 "are deemed to have filed a Chapter 7 case at the time the Chapter 13 case was filed." *Resendez*, 691 F.2d at 399.[8] *Accord In re Perfetto*, 361 B.R. at 31 (debtors who convert their cases to other chapters "are deemed to have 'filed under' the *converted to* chapter, as of the date the original petition was filed.") (italicized in original); *In re Sours,* 350 B.R. 261, 266-68 (Bankr. E.D. Va. 2006); *In re Grydzuk,* 353 B.R. 564, 568 (Bankr. N.D. Ind. 2006); *In re Capers,* 347 B.R. 169, 171-72 (Bankr. D.S.C. 2006).

So when the Chapmans' case was converted to chapter 7, it was "filed

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[7] Because section 707(b) does not refer to "the order for relief under this chapter," there would be no reason to reference it in section 348(b) in any event.

[8] Although the *Resendez* case did not address the precise issue before this court, it is instructive as to how the Code treats converted cases.

under" chapter 7, which supports the idea that it should be evaluated under section 707(b) for potential abuse. The bankruptcy court misconstrued section 348(a) when it reached the opposite conclusion.

2. The fact that other Code provisions providing for dismissal use similar language that includes converted cases without expressly saying so supports the Government's reading.

Provisions in various chapters of the Bankruptcy Code governing the dismissal of cases also support the conclusion that section 707(b) applies to all cases under chapter 7. *See* 11 U.S.C. § 1112(b), § 1208(b), and § 1307(b) of the Bankruptcy Code. Each of those sections allows a court to "dismiss a case under this chapter." And that language includes converted cases even though it does not expressly say so. Otherwise, there would no reason to expressly except certain converted cases from the reach of section 1208(b) and section 1307(b).[9]

That language is the same as that found in section 707(b), except that section 707(b), unlike those sections, adds a second qualifier, *i.e.* the case also must be "filed by an individual debtor . . . whose debts are primarily consumer debts" to be dismissed under that subsection. Sections 1112(b), 1208(b), and 1307(b) serve the same purpose as 707(b), authorizing dismissal when the

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[9] Section 1208(b) does not apply if the case has been converted under section 706 or 1112. Section 1307(b) does not apply if the case has been converted under section 706, 1112, or 1208. *See* 11 U.S.C. §§ 1208(b) & 1307(b).

applicable statutory basis is met. Thus, section 707(b) should be construed in the same way – as applying to converted cases – because it is a basic rule of statutory construction that "'identical words used in different parts of the same act are intended to have the same meaning.'" *Commissioner of Internal Revenue v. Lundy*, 516 U.S. 235, 250 (1996) (citations omitted). There is no reason to interpret it in an opposite manner, as the bankruptcy court did.

3. The fact that courts have interpreted the words "filed under" in the Code to encompass converted cases supports the Government's reading.

In BAPCPA, Congress used the phrase "filed . . . under" twice when it added 11 U.S.C. § 1328(f), prohibiting debtors from receiving a discharge in a chapter 13 case filed within specified periods of time after filing previous cases in which they had received a discharge. *See* 11 U.S.C. § 1328(f)(1) & (2).

The phrases "in a case *filed under* chapter 7, 11, 12 of this title" and "in a case *filed under* chapter 13" in section 1328(f) have been overwhelmingly interpreted to encompass cases converted to those chapters, as well as cases originally commenced under those chapters.[10] *In re Dalton*, No. 09-12024, 2010

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[10] Section 1328(f)(1) & (2) provide:

> Notwithstanding subsections (a) and (b), the court shall not grant a discharge of all debts provided for in the plan or disallowed under section 502, if the debtor has received a discharge–

WL 55499 (Bankr. M.D.N.C. Jan. 7, 2010) (debtor who commenced case under chapter 13 and then converted to chapter 7 and received chapter 7 discharge found to have "filed under" chapter 7 for the purpose of section 1328(f)); *Grice v. WE Energies (In re Grice)*, 373 B.R. 886, 888-89 (Bankr. E.D. Wis. 2007) (same); *In re Ybarra*, 359 B.R. 702 (Bankr. S.D. Ill. 2007) (same); *In re Sours*, 350 B.R. at 268 (same); *In re Capers*, 347 B.R. at 171-72 (same); *In re Knighton*, 355 B.R. 922 (Bankr. M.D. Ga. 2006) (same); *In re Grydzuk*, 353 B.R. 564 (same). *But see In re Hamilton*, 383 B.R. 469 (Bankr. W.D. Ark. 2008).[11]

There is no discernable reason to give those same words an opposite meaning in section 707(b)(1). Specific language within the Code should be interpreted the same way. *Lundy*, 516 U.S. at 250 (citations omitted). Therefore, the language in section 707(b) referring to "a case filed . . . under this chapter"

> (1) in a case *filed under* chapter 7, 11, or 12 of this title during the 4-year period preceding the date of the order for relief under this chapter, or
>
> (2) in a case *filed under* chapter 13 of this title during the 2-year period preceding the date of such order.

11 U.S.C. § 1328(f) (emphasis added).

[11] A Fourth Circuit decision that narrowly interpreted "filed" in section 1328(f) did not address how that section applied to converted cases. *See Branigan v. Bateman (In re Bateman)*, 515 F.3d 272 (4th Cir. 2008).

should be read as referring to both cases originating in chapter 7 and cases converted to chapter 7 like the substantially similar language in section 1328(f).

Other provisions in the Code buttress the conclusion that the term "filed under" encompasses cases converted to a chapter as well as those originating in that chapter. For example, in section 342(f), Congress provided that an entity may file a notice of address with a bankruptcy court to be used to provide notice to the entity in "all cases *under chapters 7 and 13*," and that the court will use the address provided to give notice in any case "*filed under chapter 7 or 13*" with certain caveats. 11 U.S.C. § 342(f)(1) & (2) (emphasis added). Using the bankruptcy court's narrow construction of the term "filed under," section 342(f) would have to be understood as inviting entities to request that the bankruptcy courts send notice to them at a specific address in *all* chapter 7 and 13 cases, but requiring the bankruptcy courts to honor those requests only in cases *originally commenced* under chapters 7 and 13. That makes no sense.

4. The fact that section 707(b) expressly excepts certain cases – but not converted cases – from section 707(b)(2) supports the Government's reading.

Although Congress did not choose to except converted cases expressly from the reach of section 707(b), it did choose to include other explicit exceptions to means testing in that section. *See* 11 U.S.C. § 707(b)(2)(D) (excluding precisely defined subsets of disabled combat veterans and national guardsmen and reservists).

Had Congress intended to create a similar exception for converted cases, it could have said so unequivocally in section 707(b)(1) or included the exception in section 707(b)(2)(D).[12] *See Sanchez v. Holder*, 560 F.3d 1028, 1032 (9th Cir. 2009).

The contrast between section 707(b)(2)(D)'s explicit exception, and section 707(b)(1)'s text could hardly be more profound. Not only does the former specifically define the exception, it carefully delineates its parameters. It does so in detail. It leaves no ambiguity, expressly providing that section 707(b)(2) "shall not apply" to a well-defined class of excepted cases. 11 U.S.C. § 707(b)(2)(D). And, because the exception is express and detailed, it is clear.

Given that Congress took great care to craft its express exception in section 707(b)(2)(D), there is no cause to presume it intended there to be any implicit exception in section 707(b). Because section 707(b)(2)(D)'s detailed nature underscores just how seriously Congress undertook its drafting of section 707(b), the lack of an express exception in section 707(b)'s text underscores that none

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[12] Congress did not avail itself of a second opportunity to include an express exception for converted cases when it amended section 707(b)(2)(D) after BAPCPA's passage. *See* Pub. L. No. 110-438 (2008).

exists.

5. The fact that Congress did not expressly or impliedly except converted cases from the scope of the United States Trustee's obligation under section 704(b) to review individual debtors' chapter 7 cases for presumptive abuse and take appropriate action under section 707(b) supports the Government's reading.

The bankruptcy court's conclusion that section 707(b) does not apply in converted cases cannot easily be reconciled with section 704(b). In fact, one decision, upon which the bankruptcy court relied, conceded that point. *See McDow v. Dudley (In re Dudley)*, 405 B.R. 790, 797 n.18 (W.D. Va. 2009), *appeal dismissed*, 428 B.R. 686 (W.D. Va. 2010). Section 704(b) expressly requires the United States Trustee to determine whether the presumption of abuse under section 707(b) arises "[w]ith respect to a debtor who is an individual in a case under [chapter 7]," and if it does to file either a motion to dismiss or convert under section 707(b) or a statement explaining why such a motion would not be appropriate. 11 U.S.C. § 704(b)(1) & (2). Because the statute refers to "a case under" chapter 7, it applies to any chapter 7 case no matter how it got there. So under section 704(b), the United States Trustee must review cases converted to chapter 7 by individual debtors for abuse and file a motion to dismiss or convert under section 707(b) if it believes that a presumption of abuse arises. Plainly, the United States Trustee cannot fulfill his mandatory statutory duties under section

704(b) if the bankruptcy court is correct in holding that section 707(b) does not apply to converted cases.

Admittedly, a similar tension exists between the United States Trustee's interpretation of section 707(b) and the clerk's duty under 11 U.S.C. § 342(d) to provide creditors notice within ten days of the filing of the petition if the presumption of abuse has arisen. As some have noted, that might not be possible in a converted case. But the other indicators outweigh that potential inconsistency, leading to the conclusion that the better reading of section 707(b) is that it applies in converted cases.

C. The fact that courts dismissed converted cases under section 707(b) for more than twenty years before BAPCPA supports the Government's reading.

The language at issue in this case has been in the statute unchanged since section 707(b) was added in 1984. *See* Pub. L. No. 98-353, 98 Stat. 333 (1984). For over 20 years before the enactment of BAPCPA, parties brought motions under section 707(b) to dismiss cases that had been converted to chapter 7 from other chapters – and bankruptcy courts granted those motions – without anyone questioning section 707(b)'s applicability to converted cases. *See, e.g., In re Beharry*, 264 B.R. 398, 399-400 (Bankr. W.D. Pa. 2001); *In re Morris*, 153 B.R. 559, 563-64 (Bankr. D. Or. 1993); *In re Traub*, 140 B.R. 286, 287-88, 291 (Bankr.

D.N.M. 1992) (dismissing case converted from chapter 11 to chapter 7 under section 707(b)). And courts assessing the potential for a chapter 13 debtor to abuse the bankruptcy system by converting to chapter 7 often identified section 707(b) as a mechanism to curb such abuse. *See, e.g., In re Fulton*, 211 B.R. 247, 260 n.14 (Bankr. S.D. Ohio 1997) (indicating that "if the debtor converts . . . under 11 U.S.C. § 1307(a), the debtor must be eligible to file a Chapter 7 which would include an analysis under § 707(b) as to whether a significant amount of disposable income indicates an abuse of the system").[13]

Pre-BAPCPA bankruptcy practice is significant because courts "will not read the Bankruptcy Code to erode past bankruptcy practice absent a clear indication that Congress intended such a departure." *Hamilton v. Lanning*, 130 S. Ct. 2464, 2473 (2010) (internal quotation omitted). Congress retained the term "filed under" in 2005 when it made significant changes to section 707(b). If

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[13] *Accord In re Murry-Hudson*, 147 B.R. 960, 964 (Bankr. N.D. Cal. 1992) (stating that "[w]hile § 1307(a) gives a debtor the unbridled right to convert to Chapter 7, it does not give him the unbridled right to remain there. If he has the ability to complete his Chapter 13 plan, or the Court otherwise finds that the granting of Chapter 7 relief would be a substantial abuse of the provisions of that chapter, his case could be dismissed pursuant to § 707(b)."); *In re Hargis*, 103 B.R. 912, 917 n.2 (Bankr. E.D. Tenn. 1989) (indicating that "a debtor who chooses to convert his or her chapter 13 case to a case under chapter 7 . . . would still be subject to the provisions of 11 U.S.C. § 707(b)"). The United States Trustee is not aware of any pre-BAPCPA case raising the issue of whether section 707(b) applies to converted cases.

Congress had intended section 707(b) to apply only in cases that originated in chapter 7, it would have said so expressly and unambiguously in BAPCPA.[14]

D. Only if every case under chapter 7 is reviewed for abuse will all debtors with the ability to repay their creditors be asked to do so.

Congress enacted the BAPCPA "'to ensure that debtors repay creditors the maximum they can afford.'" *Coop v. Frederickson (In re Frederickson)*, 545 F.3d 652, 657 (8th Cir. 2008) (quoting H.R. Rep. No. 109-31, pt.1, at 2 (2005), *reprinted in* 2005 U.S.C.C.A.N. 2005 88, 89). *See also* 151 Cong. Rec. S 2470 (March 10, 2005) ("The means test was intended to 'ensure that those who can afford to repay some portion of their unsecured debts [be] required to do so.'"). Congress was concerned that under the prior system, "some bankruptcy debtors are able to repay a significant portion of their debts" but are not required to do so. H.R. Rep. No. 109-31 (I), at 5, *reprinted in*, 2005 U.S.C.C.A.N. 88, 92. In amending section 707(b), Congress sought to close or reduce "the loopholes and incentives that allow and – sometimes – even encourage opportunistic personal

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[14] Congress knew how to refer unambiguously to cases originally commenced under a specific chapter and conversely, how to expressly exclude converted cases, but it did neither in section 707(b)(1). *See* 11 U.S.C. § 1112(a)(2) (referring to cases that "originally [were] commenced . . . under this chapter"); 11 U.S.C. § 706(a) (permitting a debtor to convert a case "if the case has not been converted under" specified sections), 11 U.S.C. § 1112(a)(3) (permitting conversion "unless the case was converted" involuntarily).

filings and abuse." *Id.*

The bankruptcy court's approach has the opposite effect. It encourages debtors to convert cases in an effort to escape scrutiny not only under 707(b)(2)'s test for presumption of abuse, but also under section 707(b)(3)(A)'s bad faith test and 707(b)(3)(B)'s test of the totality of the circumstances of the debtor's financial situation, giving those with a clear-cut ability to repay the opportunity to avoid having to repay anything at all. The bankruptcy court's interpretation would invite debtors with disposable income sufficient to repay their creditors in full to escape section 707(b) review simply by filing chapter 13 petitions and shortly thereafter converting their cases to chapter 7.

It would also encourage chapter 13 debtors, who might otherwise amend their chapter 13 plans, to convert to chapter 7 and eliminate their payments to creditors instead of utilizing the remedies available for such debtors under chapter 13. Those conversions would waste the time and effort expended by the court, the parties, and the chapter 13 trustees, and would unnecessarily create work for the new chapter 7 trustees who must review the debtors' filings and prepare for the section 341 meetings.

And while some courts suggest that parties may seek to dismiss converted cases for "bad faith" under section 707(a), that does not necessarily solve the problem for several reasons. First, in this circuit and some others, it has not been clearly established that bad faith constitutes "cause" under section 707(a) that warrants dismissal, posing a significant risk that debtors may strategically file in chapter 13 and convert to chapter 7 with impunity. *See In re Huckfeldt*, 39 F.3d 829, 832 (8th Cir. 1994). *See also In re Padilla*, 222 F.3d 1184, 1193 (9th Cir. 2000) (limiting the application of section 707(a)). Second, bad faith may be difficult to prove where dishonest debtors make a payment or two under a confirmed plan before converting to chapter 7. In addition, parties would still lose several of their three means of detecting and remedying abusive cases through dismissal – the means test of section 707(b)(2), a bad faith analysis under section 707(b)(3)(A), and consideration of the totality of the debtor's financial circumstances under section 707(b)(3)(B), leaving them no recourse against debtors with a meaningful ability to pay who convert to chapter 7 but whose conduct may not rise to the level of bad faith.

In spite of the potential abuses associated with conversion, the bankruptcy court concluded that it would be unfair and pointless to review converted cases for abuse because the means test calculation is based on income and expenses figures that predated the chapter 13 case. But that is only the starting point for section 707(b) review. Congress included a provision in section 707(b) that permits a debtor to allege special circumstances, including changes in their income or expenses, to rebut the presumption that their converted case would be abusive. *See* 11 U.S.C. § 707(b)(2)(B).[15] And the bankruptcy court considers the totality of the debtor's financial situation. *See Ross-Tousey v. Neary (In re Ross-Tousey)*, 549 F.3d 1148, 1162 (7th Cir. 2008). And, in a section 707(b)(3)(B) case, the conditions existing at discharge govern. *In re Cortez*, 457 F.3d 448, 458 (5th Cir. 2006). In addition, if a case is converted from chapter 13 to chapter 7, and the United States Trustee determines that the debtor has no ability to repay, he likely would decline to bring a motion to dismiss the debtor's case.[16] *See* 11 U.S.C. § 704(b)(2). So only a debtor with disposable income at the time of the conversion has any real risk of having his converted case reconverted or dismissed. That debtor *should* be denied chapter 7 relief if he still has an ability to make meaningful payments to his creditors, regardless of whether he converted his case from chapter 13.

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[15] Nothing in section 707(b)(2)(B) limits the special circumstances that a debtor may raise to those existing at the time he filed his original petition.

[16] In fiscal year 2009, the United States Trustees declined to seek dismissal in about 60 percent of the presumed abusive cases after considering the debtors' special circumstances – most frequently job losses. United States Trustee Program Report of Significant Accomplishments Fiscal Year 2009 at 15 (available at www.justice.gov/ust/public_affairs/annualreport/docs/ar2009.pdf).

One answer for an honest debtor who fails in chapter 13 because of deteriorating finances, but still has disposable income is to try to modify his plan.[17] *See* 11 U.S.C. § 1329. A debtor with a confirmed chapter 13 plan who is unable to afford payments under the plan may be able to modify the plan to reduce or postpone his monthly payments. And if modification is impracticable, the debtor may qualify for a hardship discharge under section 1328(b), obviating the need to convert to chapter 7.

Here, it appears that if the Chapmans had originally commenced a chapter 7 case at the time they converted their case, it would have been presumed to have been abusive based on numbers that were current as of the conversion provided by the Chapmans. And it appears that the Chapmans still have an actual ability to pay. So even if they cannot afford to make the monthly payments of $1,150 required by their plan, they may be able to make smaller, but still meaningful payments to their creditors as Congress intended.

If this Court holds that the section 707(b) applies to the Chapmans' case,

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[17] Previously, some chapter 13 debtors with deteriorating finances were unable to get a plan confirmed in chapter 13. That risk has been substantially reduced following the Supreme Court's pronouncement in *Lanning* that courts can consider changes in income and expenses that are known or virtually certain at the time of confirmation in calculating projected disposable income. 130 S. Ct. at 2478.

they will have the opportunity to prove that special circumstances exist based on their current financial situation that rebut the presumption of abuse and to show that they in fact have no ability to repay their creditors. If they are successful, they can remain in chapter 7. If not, they fall within the group of debtors that Congress has concluded are not in need of liquidation relief. *See Lanning*, 103 S. Ct. at 2484 n.7 (Scalia, J. dissenting). The Chapmans could request to reconvert and obtain relief under chapter 13 that fully takes into account their altered financial circumstances.

The United States Trustee simply seeks judicial review of *all* individual chapter 7 cases for abuse, regardless of what chapter the cases began in, and the ability to take appropriate action under section 707(b) if warranted.

CONCLUSION

For those reasons, the United States Trustee respectfully asks this Court to reverse the order entered by the bankruptcy court, and remand this case for further proceedings.

Respectfully submitted,
HABBO G. FOKKENA
United States Trustee

By: /s/Wendy L. Cox
Wendy L. Cox
DC Bar #429918

RAMONA D. ELLIOTT
General Counsel

P. MATTHEW SUTKO
Associate General Counsel
WENDY L. COX
Trial Attorney
Executive Office
for United States Trustees
20 Massachusetts Avenue N.W.
U.S. Department of Justice
Washington, D.C. 20530
Telephone: (202) 307-1399

ROBERT B. RASCHKE
Assistant United States Trustee
MICHAEL RIDGWAY
Trial Attorney
Office of the United States Trustee
1015 U.S. Courthouse
300 S. 4th Street
Minneapolis, MN 55415
Telephone: (540) 857-2699

Certification Required By L.R.BAP 8th Cir. 8008A(a):

The undersigned, counsel of record for the Appellant, Habbo G. Fokkena, United States Trustee, certifies that the original of the foregoing Brief of Appellant, United States Trustee was signed by Wendy L. Cox, counsel of record for Appellant, Habbo G. Fokkena, United States Trustee.

/s/Wendy L. Cox

Certification Required By L.R.BAP 8th Cir. 8010A(b)(2):

The undersigned, counsel of record for the Appellant, Habbo G. Fokkena, United States Trustee, certifies that to the best of her knowledge, the following constitute all of the pending cases related to this appeal:

1) *In re Maria C. Cruse*, No. 06-02892 (Bankr. S.D. Iowa)
2) *Habbo G. Fokkena v. Maria C. Cruse*, No. 10-6047 (B.A.P. 8th Cir.) (The *Cruse* appeal has been consolidated with the present appeal).
3) *In re Damian Gerald Chapman & Melissa Ann Chapman*, No 08-35303 (Bankr. D. Minn.)

/s/Wendy L. Cox

Certification Required By L.R.BAP 8th Cir. 8010A(c):

The undersigned, counsel of record for the Appellant, Habbo G. Fokkena, United States Trustee, certifies that the body of the foregoing brief, exclusive of the table of contents, tables of authorities, statement of appellate jurisdiction, statement of the issue and standard of review contains 6373 words. I relied upon the word count tool provided by my word processing program, WordPerfect 12, to obtain the word count.

/s/Wendy L. Cox

RELEVANT BANKRUPTCY COURT DOCUMENTS
(Filed in lieu of an appendix pursuant to L.R.BAP 8th Cir. 8009A)

Document	Docket Number
Chapter 13 voluntary petition (filed 10/10/08)	1
Modified chapter 13 plan (filed 12/18/08)	20
Confirmation order (entered 1/29/09)	23
Verified conversion from chapter 13 to chapter 7 w/ exhibits, attachments, schedules, statements and lists (filed 10/16/09)	36
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CERTIFICATE OF SERVICE

I hereby certify that on August 13, 2010, I electronically filed the foregoing with the Clerk of the Court by using the CM/ECF system. Participants in the case who are registered CM/ECF users will be served by the CM/ECF system.

I further certify that some of the participants in the case are not CM/ECF users. I have mailed the foregoing document by First-Class Mail, postage prepaid to the following non-CM/ECF participants:

Craig W. Andresen
Craig W. Andresen Law Office
2001 Killebrew Dr.
Suite 330
Bloomington, MN 55425
952-831-1995
Email: craigandresen@aol.com
Counsel for Debtors and Appellees

Damian Gerald Chapman
Melissa Ann Chapman
13545 Heather Hills Drive
Burnsville, MN 55337
Debtors and Appellees

/s/ Wendy L. Cox

BRIEF BANK — "SUMMARY SHEET" *Printed Wed-10/20/10 9:10*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	Habbo G. Fokkena, United States Trustee v. Damian Gerald Chapman and Melissa Ann Chapman (In re Damian Gerald Chapman and Melissa Ann Chapman) and Habbo G. Fokkena, United States Trustee v. Maria C. Cruse (In re Maria C. Cruse)
2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	BAP 8th Cir.
3. ("CCN") ***CURRENT*** CASE NO.	No.: 10-6046, 10-6047 Consolidated
4. ("PCN") ***PRIOR*** CASE NO. - & COURT *[IF ANY]*	No.: 08-35303, 06-02892 Court: Bankr. D. Minn. and Bankr. D. Iowa *(Identify judge & cite, if any)*
5. ("SO") ***SOURCE***	**U.S. TRUSTEES**
6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	Filed: October 15, 2010 Type: Consolidated Reply Brief of United States Trustee
7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*	Michael E. Ridgway, Wendy L. Cox, P. Matthew Sutko, Ramona D. Elliott, James L. Snyder, Robert B. Raschke, Habbo G. Fokkena *(UST/OGC: 202-307-1399/FAX-2397)*
8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	• Whether the bankruptcy court erred in concluding that 11 U.S.C. § 707(b)(1) does not apply to a case that has been converted from chapter 13 to chapter 7 of the Bankruptcy Code.
10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)	
11. DO YOU RECOMMEND POSTING IN UST BRIEFBANK?	| x | YES | | NO ***NAME:*** Linda Figueroa ***DATE:***

Nos. 10-6046, 10-6047

UNITED STATES BANKRUPTCY APPELLATE PANEL
FOR THE EIGHTH CIRCUIT

In re DAMIAN GERALD CHAPMAN & MELISSA ANN CHAPMAN, Debtors.	In re MARIA C. CRUSE, Debtor.
HABBO G. FOKKENA, UNITED STATES TRUSTEE, Appellant, v. DAMIAN GERALD CHAPMAN & MELISSA ANN CHAPMAN, Appellees.	HABBO G. FOKKENA, UNITED STATES TRUSTEE, Appellant, v. MARIA C. CRUSE, Appellee.

On Appeal From the United States Bankruptcy Court
For the District of Minnesota (Case No. 08-35303)

On Appeal From the United States Bankruptcy Court
For the Southern District of Iowa (Case No. 06-02892)

CONSOLIDATED REPLY BRIEF OF UNITED STATES TRUSTEE

RAMONA D. ELLIOTT
General Counsel

P. MATTHEW SUTKO
Associate General Counsel
WENDY L. COX
Trial Attorney
Executive Office for United States Trustees
United States Department of Justice
20 Massachusetts Avenue, N.W., Ste. 8100
Washington, D.C. 20530
Telephone: (202) 307-1399

HABBO G. FOKKENA
United States Trustee for Region 12

ROBERT B. RASCHKE
Assistant United States Trustee
MICHAEL E. RIDGWAY
Trial Attorney
1015 United States Courthouse
300 S. 4th Street
Minneapolis, Minnesota 55415
Telephone: (612) 334-1350

JAMES L. SNYDER
Assistant United States Trustee
210 Walnut Street, Room 793
Des Moines, Iowa 50309
Telephone: (515) 284-4982

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Cases

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I. The Orders Appealed From Were Final Under Eighth Circuit Precedent And the Decisions of Four Other Circuits.

The Appellees are incorrect when they argue that the orders on appeal are not final. The Eighth Circuit held in *Stuart v. Koch (In re Koch)*, 109 F.3d 1285, 1287-88 (8th Cir. 1997) that a bankruptcy court order denying dismissal pursuant to section 707(b) was a final, appealable order.[1] The Appellees do not attempt to distinguish *Koch*; they argue that *Koch* was wrongly decided and this Court should not follow the Eighth Circuit's holding. Appellees' brief at 8-9.

A bankruptcy appellate panel, however, is compelled to follow the precedent of its respective circuit court. *See Gonzales v. Conagra Grocery Prods. Co. (In re Furr's Supermarkets, Inc.)*, 373 B.R. 691, 707 (B.A.P. 10th Cir. 2007) ("[T]his court is compelled to follow the precedent of the Tenth Circuit. It does not have the authority to ignore or overrule such precedent."); *McDonald v. Checks-N-Advance, Inc. (In re Bobby Ferrell, Jr.)*, 358 B.R. 777, 791 (B.A.P. 9th Cir. 2006)

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[1] Although *Koch* was decided prior to the 2005 amendments to section 707(b), there is no reason to depart from its holding. Indeed, BAPCPA's addition of deadlines for filing motions to dismiss under section 707(b)(2) made such decisions *more* final because, as a practical matter, only one such motion can be made in a case. *See* 11 U.S.C. § 704(b) (deadline for filing section 707(b)(2) motions). *See also* Fed. R. Bankr. P. 1017(e)(1) (deadline for filing section 707(b)(3) motions).

(same), *aff'd*, 539 F.3d 1186 (9th Cir. 2008). In light of the Eighth Circuit's holding in *Koch*, this Court has jurisdiction to review these final orders.

Further, the clear weight of circuit law supports the conclusion that orders denying motions to dismiss under section 707(b) are final. Four circuits in addition to the Eighth Circuit have held that such orders are final, while only one circuit has disagreed. The First Circuit and Seventh circuits expressly have held that bankruptcy court orders denying section 707(b) motions to dismiss under the current version of the statute are final. *Morse v. Rudler (In re Rudler)*, 576 F.3d 37, 43-44 (1st Cir. 2009); *Ross-Tousey v. Neary (In re Ross-Tousey)*, 549 F.3d 1148, 1153 (7th Cir. 2008). In addition, the Third and the Fifth circuits have adjudicated appeals from orders denying section 707(b) motions to dismiss under the pre-2005 version of the statute. *See In re Christian*, 804 F.2d 46, 47-48 (3d Cir. 1986) (holding that an order denying a section 707(b) motion to dismiss for substantial abuse is final); *In re Cortez*, 457 F.3d 448, 453-54 (5th Cir. 2006) (treating as final an order denying the United States Trustee's section 707(b) motion to dismiss for substantial abuse).

The Appellees rely on the lone circuit court decision to hold otherwise, *Barben v. Donovan (In re Donovan)*, 532 F.3d 1134 (11th Cir. 2008). That decision did not address *Koch* and other contrary decisions directly on point, but relied instead on authority holding that motions to dismiss chapter 11 cases are not final. *Id.* at 1137. A case from another circuit cannot trump Eighth Circuit precedent.

II. The Government's Interpretation Furthers the Goals of Section 707(b) And Is More Consistent With the Bankruptcy Code As a Whole.

In his opening brief, the United States Trustee established two things. First, there is no reason why a debtor in a converted case who has the ability to repay creditors should be able to obtain a chapter 7 discharge. Second, the text of section 707(b)(1) and the Bankruptcy Code as a whole best support the government's reading, which would permit converted cases to be reviewed for abuse under section 707(b)(2) & (3). The Appellees' brief does not address the first point and fails to effectively rebut the second.

A. The Appellees Fail To Explain Why Congress Would Allow Debtors Who Have the Ability To Repay Their Creditors To Avoid Doing So.

The United States Trustee showed in his opening brief that the Appellees' interpretation of section 707(b) – which limits review for abuse to cases originally commenced under chapter 7 – would permit debtors in converted cases with an ability to repay their creditors to obtain a chapter 7 discharge. Not once in their brief do the Appellees explain why Congress would have wanted that result or suggest any reason to exempt converted cases from review under section 707(b).

Congress enacted section 707(b) in 1984 at the urging of consumer lenders to allow bankruptcy courts to dismiss cases when it would be a substantial abuse of chapter 7 to discharge the debtor's debts because the debtor could easily repay those debts. *In re Huckfeldt*, 39 F.3d 829, 831 (8th Cir. 1994); S. Rep. No. 65, 98th Cong, 1st Sess. 53, 54 (1983).[2] The Appellees have offered no reason – and the United States Trustee can think of none – why Congress would have wanted to shield cases converted to chapter 7 from scrutiny for substantial abuse.[3]

In 2005, Congress removed the presumption in favor of granting relief to debtors and lowered the standard for dismissal from "substantial abuse" to mere "abuse." The purpose of the 2005 amendments was to ensure that debtors repay creditors the maximum they can afford. H.R. Rep. No. 109-31, pt. 1 at 2 (2005).

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[2] Senate Report No. 65 is a report on an early draft of the 1984 Act. There is no Senate Report or House Report on the final version of the Act.

[3] The language at issue in these appeals was part of the original section 707(b) that Congress added to the statute in 1984. Congress did not change that language in BAPCPA, so it is appropriate to inquire whether Congress intended to except converted cases from review for substantial abuse when it added section 707(b).

The Appellees also fail to explain how their interpretation of section 707(b)(1) serves that purpose.

The Appellees imply that debtors in converted cases with the ability to repay their debts *should* be able to obtain a chapter 7 discharge, but they do not explain why. *See* Appellees' brief at 20 (asserting that it is appropriate that debtors in converted cases are not subject to dismissal based on ability to pay under either section 707(a) or 707(b)). But as explained above, the legislative history of section 707(b) shows that Congress wanted debtors who could repay their debts to do so. The only ones who benefit from Appellees' interpretation are the same debtors whom Congress believed did not belong in chapter 7 in the first instance.[4]

Some courts have rationalized that debtors who fail to repay their debts in chapter 13 should be able to obtain chapter 7 relief because they were unable to obtain chapter 13 relief. *See, e.g., In re Chapman*, 431 B.R. 216, 221 (Bankr. D. Minn. 2010). That reasoning is based on two flawed presumptions. First, this view assumes that all debtors who fail to complete their chapter 13 plans have no ability

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[4] The Appellees cite a portion of a 2005 floor debate as support for the notion that Congress intended that all converted cases could proceed under chapter 7 regardless of the debtor's ability to repay creditors. Appellees' brief at 15. In the cited passage, Representative Sensenbrenner notes that a debtor who wants to get out of chapter 13 can convert to chapter 7 under section 1307. But nowhere does he suggest that the converted case would not be subject to review for abuse. Thus, the passage does not bear on the issue on appeal.

to repay their creditors. Second, it misreads the Bankruptcy Code to conclude that section 707(a) alone can ensure that debtors with abusive cases do not convert to chapter 7 and receive discharges. Neither premise is true.

Debtors with an ability to repay may fail to follow through with their chapter 13 plans for some of the same reasons such debtors opted for chapter 7 pre-BAPCPA – they may not want to commit their future income to repay past debts or live for years under the budgetary constraints of chapter 13. Or those debtors may not be able to make full plan payments, but they may be able to make smaller payments.[5] Such debtors should not be allowed to circumvent the system through conversion to chapter 7 to obtain a benefit otherwise not available to them.

And section 707(a) does not eliminate the potential for abusive chapter 7 cases for two reasons. First, it has not been established in every circuit that bad faith constitutes "cause" for dismissal under section 707(a). *See In re Huckfeldt*, 39 F.3d at 832; *In re Padilla*, 222 F.3d 1184, 1193 (9th Cir. 2000). And second, even if that were the case, it only begs the question of what constitutes bad faith.

Not everyone with an ability to repay can be shown to have acted in bad faith by converting to chapter 7. The Appellees acknowledge that under this Circuit's

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[5] Those debtors may be able to modify their chapter 13 plans or obtain hardship discharges in chapter 13. *See* Appellant's *Chapman* brief at 26.

decision in *Huckfeldt*, a debtor's actual ability to repay creditors may not constitute cause for dismissal under section 707(a). Appellees' brief at 20. *Accord Perlin v. Hitachi Capital Am. Corp. (In re Perlin)*, 497 F.3d 364, 372 (3d Cir. 2007) (holding that ability to repay creditors is not a ground for dismissal under section 707(a)). So even if courts can dismiss cases converted to chapter 7 in bad faith, there still may be no way to prevent all debtors with the clear ability to repay their creditors from converting to chapter 7 and receiving discharges under the Appellees' reading of section 707(b)(1).

B. The Two Best Ways of Reading Section 707(b)(1) Support the Conclusion That Congress Did Not Intend Converted Cases To Escape Review For Abuse.

The United States Trustee established in his opening brief that under the better reading of section 707(b)(1), section 707(b) applies both to cases originally commenced under chapter 7 and to cases converted to chapter 7. This reading is supported by the text of the statute and the Bankruptcy Code as a whole.

1. The phrase "under this chapter," which Congress used in three other dismissal statutes has nothing to do with the separate and independent limitation that the case be "filed by an individual debtor."

The Appellees' interpretation hinges on the assumption that section 707(b) applies only to cases *filed under* chapter 7. But that is not what the provision says.

It says the court may "dismiss a case filed by an individual debtor under this chapter . . . ." 11 U.S.C. § 707(b)(1). Other Code provisions strongly suggest that the five words "filed by an individual debtor" were intended to limit the application of section 707(b) to individual debtors. Therefore, reading those words to exclude converted cases is unwarranted.

When Congress drafted statutes providing for dismissal in chapters 11, 12 and 13, it directed the court to "dismiss a case under this chapter." 11 U.S.C. §§§ 1112(b), 1208(b) and 1307(b). All of those provisions apply to converted cases except as otherwise expressly indicated in the statutes. And when Congress excluded certain converted cases from the reach of those statutes, it did so expressly and unambiguously. *See* 11 U.S.C. § 1208(b) (which applies "if the case has not been converted under section 706 or 1112"); § 1307(b) (which applies "if the case has not been converted under section 706, 1112, or 1208").

The following table sets out the relevant portions of the three dismissal statutes and the language of section 707(b)(1) at issue here. A comparison of those statutes shows that Congress used identical language in all four – but it added the five additional words to section 707(b) "filed by an individual debtor."

11 U.S.C. § 707(b)(1)	“the court . . . may **dismiss a case** [filed by an individual debtor] **under this chapter**”
11 U.S.C. § 1112(b)	“the court shall . . . **dismiss a case under this chapter** ”
11 U.S.C. § 1208(b)	“the court shall **dismiss a case under this chapter**.”
11 U.S.C. § 1307(b)	“the court shall **dismiss a case under this chapter**.”

(Emphasis and brackets added).

Those five words make up a self-contained limitation on the application of section 707(b), ensuring that only cases involving individual debtors can be dismissed for abuse. There is no indication in the text that Congress also intended those five words to change the meaning of the phrase “a case . . . under this chapter” from *including* converted cases to *excluding* those cases. If Congress wanted to exclude converted cases from dismissal for abuse under section 707(b), it could have done so expressly and unambiguously as it did in the other dismissal statutes.

2. Alternatively, even if section 707(b)(1) is read to apply only to a case filed under chapter 7, the Code indicates that Congress did not intend the word “filed” to exclude converted cases.

Even if this Court were to conclude that the text of section 707(b)(1) applies only to cases “filed . . . under” chapter 7, the United States Trustee established that when a bankruptcy case is converted to another chapter, it is deemed to have been "filed" under that new chapter. Appellant's *Chapman* brief at 11-14. The Eighth Circuit said so in *Resendez v. Lindquist*, 691 F.2d 397, 399 (8th Cir. 1982) (citing 11 U.S.C. § 348(a), the statutory provision governing the effect of conversion). The nearly unanimous view held by bankruptcy courts that the words "filed under" in section 1328(f) encompass converted cases buttress that conclusion. *See* cases cited in Appellant's *Chapman* brief at 15-16. And twenty years of pre-BAPCPA practice during which courts assumed that converted cases could be reviewed for substantial abuse provides further support that section 707(b) applies to converted cases. *See* Appellant's *Chapman* brief at 20-22.

The Appellees have no real response to these arguments. They assert that section 707(b) is not among the sections excepted from the general rule in section 348(a) that conversion does not change the date of the order for relief. Appellees' brief at 18. But that is a different issue. The Appellees fail to explain how that rebuts *Resendez* and the numerous bankruptcy court decisions holding that converted cases are deemed "filed" under the new chapter. *See* cases cited in Appellant's *Chapman* brief at 13.

Section 348(b) is essentially a timing provision. It says that the reference in certain provisions to "the order for relief under this chapter" will mean the date of conversion. Since section 707(b)(1) has no reference to "the order for relief under this chapter," there would be no reason to include it in section 348(b). In any event, the date of the order for relief is not an issue in this case. Section 348(a) squarely supports the government's position that converted cases are filed under the new chapter, as the Eighth Circuit stated in *Resendez*.

The Appellees do not dispute the Eighth Circuit's interpretation of section 348; they argue only that *Resendez* did not address the precise issue in these appeals. Appellees' brief at 18. Even if *Resendez* is not binding precedent on the present issue, it is persuasive authority for the United States Trustee's view that section 707(b)(1) applies to converted cases.

Further, the Appellees ignore the fact that courts almost unanimously have held that the term "filed under" in section 1328(f) of the Bankruptcy Code encompasses converted cases. Similar language in the Bankruptcy Code should be interpreted the same way. *Commissioner of Internal Revenue v. Lundy*, 516 U.S. 235, 250 (1996). The Appellees fail to explain why the language in section 707(b) should be read more narrowly than the identical language in section 1328(f).

The Appellees try to minimize the relevance of pre-BAPCPA practice, asserting that even though everyone assumed section 707(b) applied to converted cases before 2005, no court actually decided the issue. But whether or not courts directly confronted the issue on appeal, pre-BAPCPA practice undermines the

Appellees' argument that the word "filed" can only mean originally commenced. If that were so, it is difficult to imagine how section 707(b) could have been misinterpreted by bankruptcy courts and practitioners for over twenty years.

Contrary to the Appellees' contention, the government's reading does not render the words "filed" and "under this chapter" superfluous. Appellees' brief at 14, 17. Congress's word choice reflects its intent to include, rather than exclude converted cases from review for abuse.

Congress used the phrase "originally . . . commenced" when it meant only the initiation of the entire case. 11 U.S.C. § 1112(a)(2). It used the term "filed" to include both cases originally commenced under and cases converted to a particular chapter. 11 U.S.C. § 1328(f). Congress did not say "originally commenced" in section 707(b). It said "filed." The purpose of using that word together with the phrase "under this chapter" was to include all cases pending under chapter 7, both those that began in chapter 7 and those converted to that chapter.

C. There Is No Majority Position On This Issue.

The Appellees place great weight on their assertion that *the majority of courts* that have decided this issue agree with their interpretation of section 707(b). The Appellees cite five bankruptcy court decisions in addition to the two on appeal here. Appellees' brief at 16. But one of the cited decisions, *In re Miller*, 381 B.R.

736 (Bankr. W.D. Ark. 2008) (sustaining objections to chapter 13 debtors' plans) does not even involve a chapter 7 case, so its commentary on whether section 707(b) applies in converted cases is *dicta*. And the Appellees did not cite the most recent decision on this issue, which agreed that a case converted to chapter 7 may be scrutinized for abuse. *In re Kraft*, No. 09-21052, slip op. at 8-9 (Bankr. D. Wyo. Aug. 13, 2010). By the United States Trustee's count, there are six decisions going each way – hardly a compelling majority. Further, three of the decisions the Appellees rely on – the decisions below and *In re Dudley* – are currently on appeal.[6] And, the only reviewing court to consider the issue to date affirmed the applicability of section 707(b) to converted cases. *Justice v. Advanced Control Solutions, Inc.*, No. 07-5231, 2008 WL 4368668 (W.D. Ark. Sept. 22, 2008).

The lack of a clear majority on this issue weighs against relying on the supposedly plain and unequivocal meaning of the word "filed" as referring only to the commencement of a case. If "filed" actually were susceptible to only one interpretation, courts would not have interpreted it to mean something else for years and would not continue to do so today.

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[6] *In re Dudley*, 405 B.R. 790 (Bankr. W.D. Va. 2009), is currently on appeal to the United States District Court for the Western District of Virginia.

The courts that have held that section 707(b) applies in converted cases have not, as the Appellees allege, rejected the plain language of the statute. They simply have refused to base their statutory interpretation on a single word taken out of context. They have chosen instead to interpret the statute in the context of the Bankruptcy Code as a whole, in a way that not only respects the statutory language, but also effectuates its purpose of preventing debtors with a clear ability to pay to avoid doing so.

D. Including Converted Cases Within the Scope of Section 707(b) Does Not Lead to Absurd Results.

The Appellees argue that the broader interpretation of section 707(b) leads to absurd results for two reasons. First, the bankruptcy clerk might not be able to give timely notice of a presumption of abuse under section 342(d) in a converted case. And second, the means test might be based on outdated financial data in a converted case. Not only are those arguments not persuasive, but Appellees' own interpretation leads to an irreconcilable conflict within the Code and numerous other inconsistencies.

1. Debtors can be given adequate notice in converted cases that the presumption of abuse has arisen.

The Appellees' contention that the government's interpretation is absurd in light of section 342(d)'s notice requirement is unfounded. Appellees' brief at 17-

18. Even assuming that in some converted cases, bankruptcy clerks could not provide notice that the presumption of abuse arises within ten days of "the filing of the petition" as section 342(d) directs, there is no problem. Bankruptcy courts can use their power under section 102(1) to extend the time for notice in those cases. *See* 11 U.S.C. § 102(1) (defining "notice" as such notice as is appropriate in the particular circumstances). At least one bankruptcy court has considered and rejected the argument that section 342(d) supports the Appellees' interpretation, attributing the discrepancy simply to "sloppy drafting." *In re Kerr*, Nos. 06-12302, 06-12881, 2007 WL 2119291, at *4 (Bankr. W.D. Wash. July 18, 2007).

2. Application of the means test does not produce absurd results in converted cases.

Nor does application of the means test based on a previously filed form lead to absurd results as Appellees assert. Appellees' brief at 18. Under section 707(b)(2)(B), debtors can introduce evidence of special circumstances in connection with their means test if their financial circumstances have changed since they commenced their case. 11 U.S.C. § 707(b)(2)(B). Then where appropriate, their monthly income or expenses can be adjusted for purposes of rebutting the presumption of abuse. *Id.* Moreover, section 707(b)(3)(B)'s test of actual ability to pay relies on financial circumstances existing at discharge. *In re*

Cortez, 457 F.3d at 458. Also, if circumstances warrant, the United States Trustee could decline to file a motion to dismiss. 11 U.S.C. § 704(b)(2).

3. The Appellees' interpretation produces an irreconcilable conflict and numerous inconsistencies with other Code provisions.

And at a minimum, the Appellees' interpretation of section 707(b) is irreconcilable with one section of the Code and is inconsistent with numerous others. The United States Trustee has previously discussed in this reply how the Appellees' interpretation is inconsistent with sections 348(a), 1328(f), and three other dismissal provisions. In addition, the Appellees have failed to explain how their interpretation of section 707(b) can be reconciled with the United States Trustee's obligation under section 704(b) to review all individual debtors' cases under chapter 7 for abuse and take appropriate action. 11 U.S.C. § 704(b). Nor have they addressed the fact that Congress expressly and unequivocally excepted certain debtors, such as active duty military personnel, but did not expressly except converted cases from scrutiny for abuse under section 707(b). 11 U.S.C. § 707(b)(2)(D). They also have not explained why Congress used the term "originally commenced" in the Code rather than "filed" to refer exclusively to the initiation of a bankruptcy case. 11 U.S.C. § 1112(a)(2). In short, the United States

Trustee's interpretation is more consistent, makes better sense, and is the only interpretation that effectuates the purpose of the statute.

Respectfully submitted,
HABBO G. FOKKENA
United States Trustee

By: /s/ Wendy L. Cox
DC Bar #429918

RAMONA D. ELLIOTT
General Counsel

P. MATTHEW SUTKO
Associate General Counsel
WENDY L. COX
Trial Attorney
Executive Office for United States Trustees
United States Department of Justice
20 Massachusetts Avenue, N.W., Ste. 8100
Washington, D.C. 20530
Telephone: (202) 307-1399

ROBERT B. RASCHKE
Assistant United States Trustee
MICHAEL E. RIDGWAY
Trial Attorney
1015 United States Courthouse
300 S. 4th Street
Minneapolis, Minnesota 55415
Telephone: (612) 334-1350

JAMES L. SNYDER
Assistant United States Trustee
210 Walnut Street, Room 793
Des Moines, Iowa 50309
Telephone: (515) 284-4982

Certification Required By L.R.BAP 8th Cir. 8008A(a):

The undersigned, counsel of record for the Appellant, Habbo G. Fokkena, United States Trustee, certifies that the original of the foregoing Consolidated Reply Brief of United States Trustee was signed by Wendy L. Cox, counsel of record for Appellant, Habbo G. Fokkena, United States Trustee.

/s/ Wendy L. Cox

Certification Required By L.R.BAP 8th Cir. 8010A(c):

The undersigned, counsel of record for the Appellant, Habbo G. Fokkena, United States Trustee, certifies that the body of the foregoing brief, exclusive of the table of contents and table of authorities contains 3897 words. I relied upon the word count tool provided by my word processing program, WordPerfect 12, to obtain the word count.

/s/ Wendy L. Cox

CERTIFICATE OF SERVICE

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/s/ Wendy L. Cox

BRIEF BANK — 'SUMMARY SHEET" *Printed Wed-6/1/05 14:27*

WESTLAW CODES

1. **("TI")** *TITLE* OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	Morse (UST) v. Ropes & Gray, LLC (In re CK Liquidation, Inc.)
2. **("CO")** *CURRENT* COURT *[E.g., "CTA9"]*	D. Mass
3. **("CCN")** *CURRENT* CASE NO.	No.: 05-40062-NMG
4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*	No.: Court: Bankr. D. Mass. *(Identify judge & cite, if any)*
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6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	Filed: June 2005 Type: Brief of Appellant, UST
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8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") ● ***SUMMARY*** OF KEY ISSUE(s)	● Whether an attorney can use a pre-petition security retainer to create a state-law lien that allows the attorney to use estate funds to represent the debtor in a chapter 7 case notwithstanding the Supreme Court's ruling in Lamie v. United States Trustee, 540 U.S. 526 (2004)?
& √ Any Miscellaneous ***BACKGROUND***	√ **Background:**
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IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MASSACHUSETTS
WESTERN DIVISION

In re:

CK LIQUIDATION CORPORATION,

Debtor

Civ. App. No. 05-40062- NMG

PHOEBE MORSE,
UNITED STATES TRUSTEE,
REGION ONE,

Appellant

v.

ROPES & GRAY, LLC

Bk. Case No. 03-44906-HJB

Appellee

Brief of Appellant, the United States Trustee

Roberta A. DeAngelis
P. Matthew Sutko
Department of Justice
20 Massachusetts Ave., N.W.
Washington, D.C. 20530
phone: (202) 307-1399

Eric K. Bradford
Office of the United States Trustee
Department of Justice
10 Causeway Street, Room 1184
Boston, MA 02222-1043
phone: (617) 788-0400

Counsel for the United States Trustee

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Preliminary Statement: Why The Government Appeals.

Last year, a unanimous Supreme Court ruled that federal law prohibited an attorney who represented a chapter 11 bankruptcy-debtor from being paid by the debtor's bankruptcy estate for work the attorney performed after his client's chapter 11 case converted to chapter 7 because the chapter 7 trustee had not retained the attorney as chapter 7 counsel. Lamie v. United States Trustee, 540 U.S. 526 (2004).

The facts of this case mirror Lamie's so the result should have been the same. The court below, however, acting without the benefit of briefing by the parties, determined it could award under state law the very compensation that Lamie prohibited under federal law. The government appeals that erroneous ruling to uphold the rule of law pronounced in Lamie and thereby ensure that bankruptcy estate funds are used to pay lawyers only in the manner that Congress directed in the Bankruptcy Code.

The government also appeals because the decision below denies federal bankruptcy law its rightful primacy in federal bankruptcy cases. Through the Bankruptcy Code, Congress has enacted a comprehensive federal scheme for administering federal bankruptcy cases and compensating lawyers in those cases. The lower court's state law ruling interferes with this comprehensive federal scheme and is preempted by it.

Statement of Jurisdiction

The United States Bankruptcy Court for the District of Massachusetts had jurisdiction over Ropes & Gray's final fee application in the CK Liquidation Corporation bankruptcy case under 28 U.S.C. 157(a) (A479).[1] That court granted Ropes' application by order entered September 15, 2004 (A601). The bankruptcy court denied the United States Trustee's timely-filed motion for reconsideration (A614) by order entered February 28, 2005 (A682). The United States Trustee timely appealed the bankruptcy court's September 15, 2004, and February 28, 2005, orders by notice of appeal filed under 28 U.S.C. 158(c)(2) and Fed. R Bankr. P. 8002(b) on March 10, 2005 (A694). This Court has jurisdiction over this appeal under 28 U.S.C. 158(a)(1).

Standard of Review

The government does not appeal the lower court's $455,331 award to Ropes & Gray for work the firm performed while CK was a chapter 11 debtor. See In re CK Liquidation Corp., 321 B.R. 10, 12 (Bankr. D. Mass. 2005) (Ropes received $455,331 in fees and expenses for that work). The government suggests the lower court committed an error of law in relying upon Massachusetts lien law to award Ropes $7,820 for work it performed after the debtor converted from chapter 11 to chapter 7. Id. This Court reviews questions of law de novo. Smith v. Fitchburg Pub. Sch., 401 F.3d 16, 21 (1st Cir. 2005).

Statement of the Issues Presented for Review

1. Last year, the Supreme Court ruled unanimously that federal bankruptcy law forbids courts from using bankruptcy-estate money to pay a chapter 11 debtor's attorney for work the attorney performs after his client's case converts to chapter 7 unless the chapter 7 trustee re-

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[1] The government refers to the record below by citing to the appendix in the form A__.

employs the attorney under 11 U.S.C. 327(a). In this case, the lower court awarded Ropes & Gray $7,820 of estate funds for work performed after its client's chapter 11 case converted to chapter 7 even though the trustee did not employ Ropes as chapter 7 counsel. Did the lower court violate federal law in doing so?

2. Through the Bankruptcy Code, Congress has enacted comprehensive federal schemes for administering bankruptcy cases and awarding fees to bankruptcy professionals. The Supreme Court and the United States Court of Appeals for the First Circuit have consistently ruled that such federal bankruptcy law schemes preempt inconsistent state laws. Did the court below err by relying upon Massachusetts lien law to pay $7,820 to Ropes when those payments are inconsistent with the Bankruptcy Code?

3. Under Massachusetts lien law several conditions must be met before a party may impose a lien upon funds of another party. Assuming an attorney could rely upon Massachusetts lien law to obtain payment for post-conversion work when not employed under section 327(a), is it proper to allow Ropes to satisfy its $7,820 claim under Massachusetts lien law if those conditions have not been satisfied?

Statement of the Case

CK Liquidation Corporation filed a chapter 11 bankruptcy case in an effort to reorganize its business (A1). Acting under 11 U.S.C. 327(a), the bankruptcy court appointed Ropes & Gray to act as CK's chapter 11 bankruptcy counsel (A156).[2] CK could not successfully reorganize. On February 2, 2004, CK filed a motion under 11 U.S.C. 1112(a) to voluntarily convert its case

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[2] The government reprints the principal statutes we rely upon, 11 U.S.C. 323(a), 327, 330(a), 503, 507, 541(a), 542(a), and 704, in an addendum attached to this brief.

to a chapter 7 liquidation case (A433). See 11 U.S.C. 701, et seq. (federal statutes governing liquidation cases). The bankruptcy court granted that motion (A443), which had the effect under Lamie v. United States Trustee, 540 U.S. 526, 531-32 (2004) of "terminat[ing]" Ropes' employment.

Without being re-employed under section 327(a) in the chapter 7 case, Ropes provided modest services after the case converted to chapter 7, and then filed a final fee application under 11 U.S.C. 330 seeking $455,331 for its chapter 11 work and $7,820 for its chapter 7 work (A474). The United States Trustee did not object to Ropes' $455,331 fee request (A606). The United States Trustee opposed Ropes' request that it receive $7,820 for chapter 7 work on the ground that the Supreme Court had prohibited such compensation in Lamie v. United States Trustee, 540 U.S. 526 (2004) (A606-07). By order entered September 15, 2004, the bankruptcy court awarded Ropes all the fees it sought (A601). The United States Trustee asked the court to reconsider its award of post-conversion chapter 7 fees (A614). The bankruptcy court denied the reconsideration motion by a memorandum of decision and order entered February 28, 2005 (A682). This appeal followed.

Statement of the Facts

1. Statutory Framework. The Bankruptcy Code, 11 U.S.C. 101, et seq., regulates the retention, compensation and payment of bankruptcy professionals in chapter 7 and chapter 11 cases. The Code also gives chapter 7 trustees control over estate assets and the management and selection of counsel. Finally, the Code dictates that third parties possessing estate property, including professionals, must turn it over to the trustee upon the trustee's appointment.

Sections 327(a) and 1107(a) of the Bankruptcy Code allow chapter 11 debtors in possession to ask the bankruptcy court for permission to retain a lawyer to help represent the chapter 11 bankruptcy estate. See Lamie v. United States Trustee, 540 U.S. 526, 531-32 (2004) (construing and applying 11 U.S.C. 327(a) and 1107(a)). In order to receive compensation from a bankruptcy estate, attorneys in chapter 7 and chapter 11 cases must meet two tests. First, they must be employed under section 327(a). Lamie, 540 U.S. at 529 ("affirm[ing]" the lower court's ruling that attorneys may not be compensated from the estate "unless the attorney has been appointed under § 327 of the Code."). Second, they must receive a fee award under section 330. Id.

Section 330(a) fee awards are not self-executing. Section 503(b)(2) of the Code authorizes a bankruptcy estate to pay compensation awarded under section 330(a)(1) as an administrative expense. 11 U.S.C. 503(b)(2). This is significant because administrative expense awards receive first payment priority under section 507(a) of the Code. 11 U.S.C. 507(a)(1) (giving first priority to "administrative expenses allowed under section 503(b)").

The Bankruptcy Code does not authorize bankruptcy courts to award fees to attorneys who represent chapter 7 debtors unless the chapter 7 trustee retains the firm under 11 U.S.C. 327(a). Lamie, 540 U.S. at 538-39 ("we hold that § 330(a)(1) does not authorize compensation awards to debtors' attorneys from estate funds unless they are employed as authorized by § 327. If the attorney is to be paid in a chapter 7 case, he must be employed by the trustee and approved by the court.").

Under the Code, a lawyer's representation of a debtor in chapter 11 "terminate[s]" as a matter of federal law when the chapter 11 case converts to chapter 7 and thereafter the chapter 7 trustee controls the selection of new chapter 7 counsel. Lamie, 540 U.S. at 531-32. A "terminated" chapter 11 counsel may receive compensation from the estate for chapter 7 work only if the trustee re-employs terminated counsel under section 327 to perform chapter 7 work. Id.

Upon commencement of a chapter 7 case, all of the debtors' property becomes property of the bankruptcy estate. 11 U.S.C. 541(a). Under the Bankruptcy Code, all third parties - including "terminated" debtors' counsel - must turn over all property of the estate to the chapter 7 trustee. 11 U.S.C. 542(a). Under federal law, the chapter 7 trustee becomes the estate's sole representative. 11 U.S.C. 323(a). See CFTC v. Weintraub, 471 U.S. 343, 352-53 (1985) (holding a trustee ousts corporate management and controls the corporate debtor, including its decisions relating to counsel). The chapter 7 trustee's duties include taking possession of all estate property and liquidating it for division among the debtors' pre-petition creditors. 11 U.S.C. 704. If the trustee needs legal assistance in doing so, the trustee may file a motion under section 327 requesting authorization to retain counsel. 11 U.S.C. 327; Lamie, 540 U.S. at 531-32.

United States Trustees are officials of the Department of Justice appointed by the Attorney General to supervise the administration of bankruptcy cases and trustees. See 28 U.S.C. 581-589 (specifying the powers and duties of United States Trustees).[3] Congress instructed

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[3] See also In re Columbia Gas Sys., Inc., 33 F.3d 294, 296 (3d Cir. 1994) (United States Trustees oversee the bankruptcy process, protect the public interest, and ensure that bankruptcy cases are conducted according to law) (citing H.R. Rep. No. 95-595, 109 (1977)); United States Trustee v. Revco D.S., Inc. (In re Revco D.S., Inc.), 898 F.2d 498, 499 (6th Cir. 1990) ("[t]he United States trustee, an officer of the Executive Branch, represents . . . [the] public interest"); In re Castillo, 297 F.3d 940, 950 (9th Cir. 2002) ("The United States Trustee is the 'watchdog' of the bankruptcy system . . . charged with preventing fraud and abuse and with 'fill[ing] the

United States Trustees to “monitor” attorney employments applications “filed under section 327" of the Code and, “whenever the United States Trustee deems it to be appropriate, fil[e] with the court comments with respect to the approval of such applications.” 28 U.S.C. 586(a)(3)(H).

2. Factual Background.

Ropes & Gray is approved as CK’s chapter 11 counsel.

CK Liquidation Corporation, formerly known as Cadkey Corporation, sought relief under the debt reorganization provisions of chapter 11 of the Bankruptcy Code, 11 U.S.C. 1101, et seq., by petition filed August 22, 2003 (A1). CK immediately asked the bankruptcy court to appoint Ropes & Gray to act as chapter 11 bankruptcy counsel (A12).

The application sought authorization to employ Ropes only to do chapter 11 work (A16-18).[4] Similarly, in the “Wherefore” clause of its application CK sought permission to employ Ropes only “during the Chapter 11 case” (A23).

CK’s application was accompanied by the affidavit of Mr. James M. Wilton, a Ropes partner (A28). In it, Ropes disclosed it had received a pre-petition “security retainer” from CK (A39). Ropes told the court and the parties in interest that Ropes held the retainer “in connection with” the chapter 11 case, and Ropes never indicated that it wished to use the retainer to pay fees after the chapter 11 case terminated or if it subsequently converted to a chapter 7 case. Id.

In a February 19, 2003, pre-bankruptcy engagement letter signed by Ropes and CK, attached to Mr. Wilton’s affidavit, Ropes “acknowledge[d] that [CK] ha[d] delivered to us a

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vacuum’ caused by possible creditor inactivity.").

[4] Ropes represented that “[b]y this Application, the Debtor seeks to . . . employ . . . Ropes in connection with the filing of its chapter 11 petition and prosecution of its Chapter 11 Case” (A16).

[pre-petition] retainer in the amount of $81,715, which we are holding as security for payment of our invoices " (A43-44). The engagement letter provided that the retainer was restricted to legal work involving CK's "obligation to its creditors, Micro Control Systems, Inc. and Harold Bowers as well as a possible Chapter 11 filing by [CK] and sale of assets." Id. The retainer did not purport to transfer title to the retainer funds to Ropes. Id. The retainer did not purport to apply to any work Ropes might perform in a chapter 7 proceeding. Id. The retainer did not purport to give Ropes any rights different from or greater than it was entitled to receive as bankruptcy counsel in a bankruptcy case. Id. In the retainer, Ropes agreed that "[a]ny remaining portion of the amounts advanced will be refundable at the conclusion of our representation. . . ." Id.

Acting under 11 U.S.C. 327(a), the bankruptcy court appointed Ropes to act as CK's bankruptcy counsel (A156). The order did not purport to give Ropes any right to receive funds outside that allowed under sections 327, 330, 503 and 507 of the Bankruptcy Code.

After CK converts from chapter 11 to chapter 7, CK's chapter 7 trustee never employs Ropes as his chapter 7 counsel.

CK could not successfully reorganize. On February 2, 2004, CK filed a motion under 11 U.S.C. 1112(a) asking the court to convert its case to a chapter 7 liquidation case (A433), which the court promptly granted (A443). See generally 11 U.S.C. 701, et seq. (federal statutes governing chapter 7 cases).

John A. Burdick was appointed to act as the chapter 7 trustee to administer and liquidate the CK bankruptcy estate (A448). See 11 U.S.C. 323(a) (making Mr. Burdick the representative of the estate); 704 (specifying the duties of a chapter 7 trustee). By application filed March 5, 2004, Mr. Burdick sought permission under 11 U.S.C. 327(a) to appoint himself as legal counsel to the trustee (A450). The court granted the chapter 7 trustee's application by order entered March 19, 2004 (A462). The chapter 7 trustee also filed an application under section 327(e) asking the court to appoint Sherin and Lodgen LLP as special counsel to the chapter 7 trustee (A464). The court entered an order approving Sherin and Lodgen's appointment as special counsel (A599).

The chapter 7 trustee never filed an application - under section 327 or otherwise - seeking to appoint Ropes as chapter 7 counsel. The bankruptcy court never entered an order appointing Ropes to act as chapter 7 counsel.

Ropes never turned over the retainer funds in its possession to the chapter 7 trustee after CK's case converted to chapter 7. Although Ropes had not received an order under section 327 authorizing it to provide services in the chapter 7 case, Ropes did modest work in the chapter 7 case. CK, 321 B.R. at 12.

The bankruptcy court uses bankruptcy-estate funds to pay Ropes for its chapter 11 and its chapter 7 work.

Ropes subsequently filed a final fee application under 11 U.S.C. 330 (A479). In it, Ropes sought not only $455,331 for its chapter 11 work but also $7,820 for its chapter 7 work. Id. The United States Trustee did not oppose Ropes' $455,331 fee request but opposed its $7,820 request for chapter 7 fees on the ground that the Supreme Court had prohibited such compensation in Lamie v. United States Trustee, 540 U.S. 526 (2004) (A606-07). By order entered September 15, 2004, the bankruptcy court, with no analysis, awarded Ropes all the fees it sought (A601).

The bankruptcy court denies the United States Trustee's reconsideration motion.

The United States Trustee sought reconsideration of the court's $7,820 award of post-conversion chapter 7 fees on the ground the award was barred by the Bankruptcy Code as interpreted by the Supreme Court in Lamie (A614). The bankruptcy court denied the reconsideration motion by a memorandum of decision and order entered February 28, 2005 (A682). In re CK Liquidation Corp., 321 B.R. 10 (Bankr. D. Mass. 2005).

In that, decision, the court below rejected the two arguments that Ropes raised in support of its chapter 7 fee request, ruling both "fail[ed]" under Lamie. CK, 321 B.R. at 17. Instead, the court determined sua sponte that post-conversion compensation could be awarded despite Lamie because Ropes possessed a state law lien arising from its pre–petition retainer and that lien independently allowed Ropes to recover for post-conversion work. Id. In the lower court's view, Lamie never "suggest[ed] or intimate[ed] that compensation for necessary transition services [when a case converts from chapter 11 to chapter 7] could not be made from the balance of a pre-petition retainer." Id. at 19. The court instead surmised "the Supreme Court suggested the opposite," because the Court concluded that "section 330(a)(1) does not prevent a debtor from engaging counsel before a chapter 7 conversion and paying reasonable compensation in advance to ensure that the filing is in order." Id. at 19 (quoting in part Lamie, 540 U.S. at 537-38). The court determined this statement meant Ropes could collect and use a pre-petition retainer throughout the case, concluding "the Supreme Court could only have been referring [in the preceding passage] to a pre-petition payment made for legal services to be rendered in a Chapter 11 case and in the form of either a flat fee or security retainer." Id.

The Court next concluded that Ropes possessed a lien under Massachusetts law that encumbered estate assets sufficient to pay its post-conversion fees. Id. at 17-20 (relying upon ch. 106, Article 9 of the General Laws of the Commonwealth). The court suggested that "[i]n order for a security interest to attach [under that provision], value must be given, the debtor must have rights in the collateral (or the power to transfer those rights) and at least one of a number of other conditions must be met as set forth in § 9- 203(b), one of which is an authenticated security agreement. M.G.L. ch. 106, § 9-203(b)." Id. at 18.

In the court's view, "each of those requirements were met" in the CK case. Id. The court reasoned Ropes & Gray gave "value . . . by virtue of the legal services which R[opes] & G[ray] provided to the Debtor as a debtor in possession and was compelled to provide in the Chapter 7 case which followed." Id. The court concluded that "the Debtor had rights in the pre-petition funds transferred to R[opes] & G[ray] as a retainer, as well as the right to transfer those funds; and the written retainer agreement between the parties, evidencing the transfer of the moneys to the attorney as a retainer, served as a sufficient security agreement. Perfection of R[opes] & G[ray]'s security interest was satisfied by possession of the funds, notwithstanding the requirement to hold the monies in trust." Id. (citing Mass. Gen. Laws ch. 106, § 9-313(a)). Given that, the court concluded that Massachusetts law allowed Ropes to keep estate property after the chapter 7 case commenced, provide services post-petition without seeking or obtaining a court order under section 327, and to simply take payment from estate funds.

The court reached those legal conclusions without any briefing by the parties. In reaching its decision, the court did not address whether: **(A)** any rights Ropes had to the retainer terminated as a matter of federal law upon the institution of the chapter 7 case, or **(B)** federal bankruptcy law preempted the Massachusetts Uniform Commercial Code provisions the court sought to rely upon.

Summary of Argument

The court below used bankruptcy-estate funds to pay Ropes & Gray for work Ropes performed after its client's chapter 11 case converted to chapter 7. That decision merits reversal because it contradicts the Supreme Court's unanimous ruling last term in Lamie v. United States Trustee, 540 U.S. 526 (2004). Lamie held that conversion of a debtor's chapter 11 case to chapter 7 "terminate[s]" the chapter 11 counsel's representation and prohibits former chapter 11 counsel from receiving bankruptcy-estate funds for any work it performs in the ensuing chapter 7 case unless the chapter 7 trustee obtains an order under 11 U.S.C. 327 re-employing the firm to perform chapter 7 work. Ropes was not re-employed in CK's chapter 7 case so Lamie squarely prohibited the lower court's $7,820-award to Ropes for post-conversion services.

Alternatively, the lower court's decision merits reversal because federal law preempts the state law payment theory the lower court replied upon to negate Lamie. First, sections 327, 330, 503 and 507 of the Bankruptcy Code establish a comprehensive scheme that controls the retention of lawyers and governs their compensation and payment from bankruptcy-estate funds. These sections preempt the lower court's state law award because Ropes had not been retained in the chapter 7 case under section 327, which meant it could not receive a fee award under section 330 and could not receive payment from the bankruptcy estate under sections 503 and 507.

In addition, the Bankruptcy Code independently preempts the lower court's state law compensation theory because it conflicts with sections 323(a), 541(a), 542(a) and 704(1) and (2), which dictate how decisions in chapter 7 cases are made. These sections require everyone -

including Ropes - to turn over all estate funds to the chapter 7 trustee as soon as the chapter 7 case commences and then allows only the chapter 7 trustee to select the counsel that will work in the chapter 7 case. The lower court's state law award theory interferes with this scheme because it was premised upon Ropes' using estate funds that it had failed to turn over in violation of sections 541(a) and 542(a), and upon the erroneous notion that Ropes could perform chapter 7 work without a section 327 retention by the trustee even though that negated the trustee's power under sections 323 and 704, and conflicted with the Supreme Court's ruling in CFTC v. Weintraub, 471 U.S. 343 (1985), both of which authorize only the trustee to make counsel decisions for corporate-bankruptcy debtors - like CK - in cases managed by trustees.

Finally, even the court's construction of Massachusetts law is wrong. The court below, without any suggestion by Ropes, wrongly concluded that Ropes' retainer agreement satisfied the conditions precedent to Ropes having a valid lien under Massachusetts law. That erroneous interpretation of state laws forms a separate and independent basis for reversal.

Argument

Relying largely upon state law, the bankruptcy court awarded fees to a terminated chapter 11 debtor's counsel for work counsel performed after its client's case converted to chapter 7. The lower court's ruling merits reversal for four separate and independent reasons. First, it violates the Supreme Court's decision in Lamie v. United States Trustee, 540 U.S. 526 (2004). Second, federal law preempts the lower court's state law payment theory for two separate and independent reasons. Finally, the court's ruling fails even under state law.

A. The order entered below violated federal law, as the Supreme Court interpreted it in Lamie, because it awarded fees to a firm that had not been retained in the chapter 7 case under 11 U.S.C. 327.

This appeal is controlled by Lamie v. United States Trustee, which "held that § 330(a)(1) does not authorize compensation awards to debtors' attorneys from estate funds [for chapter 7 work], unless they are employed [in the chapter 7 case by the chapter 7 trustee] as authorized by § 327." Lamie v. United States Trustee, 540 U.S. 526, 529, 538 (2004). Lamie mandates reversal here.

Lamie held that Mr. John Lamie's section 327(a) appointment as chapter 11 debtor's counsel did not allow Mr. Lamie to be paid from bankruptcy-estate funds for work he performed after the chapter 11 case of his client, Equipment Services, converted to chapter 7. Lamie, 540 U.S. at 531-32. Lamie also held that the conversion of Equipment Services' case from chapter 11 to chapter 7 "terminated [Equipment Services'] status as a debtor-in-possession and so terminated [Mr. Lamie's] service under § 327 as an attorney for the debtor in possession." Id. Lamie then held that Mr. Lamie, as a terminated chapter 11 attorney, could not receive estate compensation for work he performed in Equipment Services' chapter 7 liquidation case because the chapter 7 trustee had not obtained a court order under section 327 authorizing Mr. Lamie's retention as counsel to the chapter 7 trustee. Id. at 529, 531-32.

Consistent with Lamie, the Second, Third, Seventh and Tenth circuits have held that a section 330 award is the only way a professional may receive compensation from estate funds under the Bankruptcy Code and the right to such an award is conditioned upon a section 327(a) appointment. In re Milwaukee Engraving Co., 219 F.3d 635, 636 (7th Cir. 2000) (holding attorneys may not receive compensation under the Bankruptcy Code when their section 327(a) employment application is denied (relying upon In re Singson, 41 F.3d 316, 320 (7th Cir. 1994)); F/S Airlease II, Inc. v. Simon, 844 F.2d 99, 108-109 (3rd Cir. 1988) (same); In re Keren Limited Partnership, 189 F.3d 86, 88 (2nd Cir. 1999) (same); In re Albrecht, 233 F.3d 1258, 1260 (10th Cir. 2000) (denying such compensation under the Bankruptcy Code).

Thus, under the Bankruptcy Code, a firm must be retained by the chapter 7 trustee under section 327(a) and subsequently receive an award under section 330 in order to have its chapter 7 fees paid by the estate. As Lamie, Milwaukee Engraving, Singson, F/S Airlease, Keren, and Albrecht hold, there are no exceptions under the Code to this two-part requirement.

The court below allowed post-conversion fees, in part, because it read Lamie as allowing fees in converted cases so long as the debtor made an anticipatory payment to its counsel prior to filing bankruptcy. CK, 321 B.R. at 19. This reading cannot be reconciled with Lamie's holding because Mr. Lamie received a pre-petition retainer at the same point in the Equipment Services case that Ropes received one in the CK case. That payment did not take Mr. Lamie outside the ambit of section 327(a). Lamie, 540 U.S. at 538. CK's payment does not take Ropes outside section 327(a) either.

There can be no serious question that the rule of law the Supreme Court announced in Lamie controls here because the facts of the two cases mirror one another. In Lamie, Mr. Lamie agreed to represent a corporate debtor in its chapter 11 case.[5] So did Ropes.[6] Mr. Lamie received

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[5] Lamie, 540 U.S. at 531-32.

[6] A156.

a security retainer from his client prior to filing a chapter 11 bankruptcy petition.[7] So did Ropes.[8] Mr. Lamie's client filed an application under 11 U.S.C. 327(a) to employ Mr. Lamie as debtor's counsel in its chapter 11 bankruptcy case.[9] So did Ropes' client.[10] Mr. Lamie's retention in the chapter 11 case was approved by the bankruptcy court under section 327(a).[11] So was Ropes'.[12] Mr. Lamie performed services during his client's chapter 11 case.[13] So did Ropes.[14] Mr. Lamie's client's chapter 11 case was converted to a chapter 7 case.[15] So was Ropes'. After conversion to chapter 7, a surplus remained in the security retainer held by Mr. Lamie.[16] Ropes' security retainer also had a post-conversion surplus.[17] Upon conversion, a chapter 7 trustee was appointed in Mr. Lamie's client's chapter 7 case.[18] That also occurred in Ropes' case.[19] Mr. Lamie failed to turn over estate property - the unused retainer balance - to the trustee under 11

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[7] Equipment Serv., 290 F.3d at 742, 747.

[8] A39, 43-44

[9] Lamie, 540 U.S. at 531-32.

[10] A12.

[11] Lamie, 540 U.S. at 531-32

[12] A156.

[13] Lamie, 540 U.S. at 531-32.

[14] CK, 321 B.R. at 11; A479.

[15] Lamie, 540 U.S. at 531-32.

[16] Equipment Serv., 290 F.3d at 742-43, 746.

[17] CK, 321 B.R. at 12 n.2, 20.

[18] Lamie, 540 U.S. at 532.

[19] A448.

U.S.C. 542(a).[20] Although Ropes admits the unused retainer was estate property it also failed to turn it over to the chapter 7 trustee.[21] The chapter 7 trustee never filed an application to employ Mr. Lamie in the chapter 7 case under section 327.[22] The CK trustee never filed an application to employ Ropes in this chapter 7 case.[23] Without court order and without having been retained under section 327, Mr. Lamie did modest work after his client's case converted to chapter 7.[24] So did Ropes.[25] Mr. Lamie then filed an application seeking final compensation under section 330 of the Bankruptcy Code.[26] So did Ropes.[27] Mr. Lamie took the position that he was entitled to compensation for the work he did after Equipment Service's conversion to chapter 7.[28] Despite the Lamie decision, so did Ropes.[29]

Under these facts, the Supreme Court ruled that Mr. Lamie had no right to draw upon the retainer to pay for any work he performed post-conversion because he had not been retained under section 327 by the chapter 7 trustee. Lamie, 540 U.S. at 533-42. The Supreme Court's

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[20] Equipment Serv., 290 F.3d at 747.

[21] CK, 321 B.R. at 12 n.2.

[22] Lamie, 540 U.S. at 532.

[23] CK, 321 B.R. at 20.

[24] Lamie, 540 U.S. at 532.

[25] CK, 321 B.R. at 12; A479.

[26] Lamie, 540 U.S. at 532.

[27] CK, 321 B.R. at 12; A479.

[28] Lamie, 540 U.S. at 533-42.

[29] CK, 321 B.R. at 12-13.

ruling controls in Ropes' case just as it did in Mr. Lamie's. For this reason, the court below erred in diverging from Lamie by awarding post-conversion fees.[30]

B. The lower court's arguments for distinguishing Lamie reprise arguments that were pressed before and rejected by the Supreme Court in Lamie.

The bankruptcy court premised its ruling, in part, on a series of policy judgments regarding its perception of counsel's ethical obligations in a converted case, a debtor's need for counsel in a converted case, and basic fairness.[31] CK, 321 B.R. at 12-15, 20. Ironically, Mr. Lamie advanced the same arguments before the Supreme Court, which rejected them. See Brief of Petitioner in Lamie v. United States Trustee, 2003 WL 21295241, at 30-36. Like the court

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[30] The court below also misread Lamie's dicta that section 330(a)(1) does not prevent attorneys from taking a pre-petition retainer "to ensure the [bankruptcy] filing is in order." CK, 321 B.R. at 19. The court's error stemmed from its failure to recognize the significance of the word "filing" in that sentence. The "filing" of a petition occurs before the case is commenced. 11 U.S.C. 301 (a bankruptcy case "is commenced by the filing" of the case). In the Lamie dicta, the Supreme Court was merely describing how law firms in chapter 7 cases get compensated for their pre-filing bankruptcy preparation work. This was a question that the United States and Mr. Lamie discussed extensively in their briefs. See, e.g., Brief of Respondent in Lamie v. United States Trustee, 2003 WL 21839367 at 38. Contrary to the inference drawn by the court below, the Supreme Court never suggested attorneys could evade Lamie's holding by siphoning-off estate property to fund a war-chest for post-petition work not authorized by the trustee or the Code. Nor are we aware of any other court having reached such an odd conclusion. And, as we explain below, this view conflicts not only with Lamie but with the Indian Motocycle, Equipment Services, and Mahendra circuit decisions as well. As we also explain below, the lower court's reading of this passage inarguably conflicts with Bankruptcy Code sections 327, 330, 503, 507, 542(a), 323(a) and 704, as well as with the Supreme Court's holdings in Lamie and CFTC.

[31] The bankruptcy court's decision states the United States Trustee agreed that Ropes "had continuing post-conversion duties." CK, 321 B. R. at 13. The court below inquired about this point during the hearing on the United States Trustee's reconsideration motion (A642-45). In response, the United States Trustee tried to explain that foremost these were the debtor's duties under section 521 of the Bankruptcy Code (643). More significantly, the government has not and does not take the position that counsel is necessary post-conversion. Section 521of the Bankruptcy Code imposes duties on the debtor, not its counsel, and management - not counsel, must perform those duties, which are mostly routine. Counsel's overriding duty upon conversion is to turn over all estate property in its possession. 11 U.S.C. 542(a).

below, Mr. Lamie contended that the government's construction of sections 327 and 330 would force lawyers to work for free in converted cases.[32] Id. at 33. In addition, Mr. Lamie specifically argued before the Supreme Court that converted cases should be treated with more leniency because, in his view, those debtors had a particular need for legal services.[33] Id. at 30-31.

In response, the government explained that these concerns were immaterial because few chapter 7 cases are converted chapter 11cases (only 0.26%). See Brief of Respondent in Lamie v. United States Trustee, 2003 WL 21839367 at 43. The government also explained that counsel, like Mr. Lamie - and Ropes - would not be unfairly saddled with excessive duties in converted cases. Id. (noting that "counsel may seek in advance to limit the scope of the representation to his services for the chapter 11 debtor-in-possession as approved by the court under Section 327(a) (citing the Model Rules of Professional Conduct Rule 1.2(c) (2002)).

Nor do debtors need counsel in order to perform the modest post-conversion duties that section 521 asks them to complete. In Lamie, for example, Mr. Lamie's post-conversion services

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[32] Mr. Lamie argued that "[a ruling for the government] creates in the attorney's mind the fear that he or she will be left working for free, in part because state law ethical obligations may require an attorney to continue to perform as counsel, regardless of the potential prohibition of payment. Fearing that the canons of ethics would prevent them from abandoning their client once a trustee entered the case, attorneys will stay away from the outset. Cf. Model Rules of Professional Conduct Rule 1.16(b) (permitting attorneys to withdraw from representing a client only 'if withdrawal can be accomplished without material adverse effect on the interests of the client' or if other unusual circumstances exist)." Id. at 33 (citation omitted).

[33] Mr. Lamie told the Court that "[t]he owners of Equipment Services, a small mine services company, had no capacity to prepare either the Chapter 11 filing or the adversary complaint that petitioner filed on behalf of the debtor. Nor would the debtor have been aware of either the significance of the conversion of the case to a Chapter 7 proceeding or its obligation to cooperate with the appointed trustee. Upon conversion, only counsel would have had the knowledge and experience either to arrange the 'Section 341' creditors meeting or to coordinate the proceedings on the adversary complaint." Id. at 30-31.

amounted to a mere $1,000. 2003 WL 21839367 at 3. Similarly, Ropes' post-conversion fees amount to a mere $7,820 (A623), and $3,567 of that are fees Ropes wants to charge for writing its bill (A630). This, perhaps as much as anything, belies the argument that debtors require massive assistance from sophisticated counsel to perform the simple tasks required of them in converted cases. And whenever terminated chapter 11 counsel's services are necessary in the chapter 7 case, CFTC[34] and Lamie allow the chapter 7 trustee to file a section 327 motion asking the court for permission to retain the "terminated" chapter 11 counsel in the chapter 7 case, something that did not happen here.

Furthermore, the Supreme Court's rationale for dismissing Mr. Lamie's policy arguments is significant. Although it found the policy concerns advanced by Mr. Lamie - the same concerns articulated by the court below - unpersuasive, Lamie, 540 U.S. at 538, the Court rejected them for a more fundamental reason, the Court's "unwillingness to soften the import of Congress' chosen words even if [those words] lead to a harsh outcome." Id. Thus, the Court refused to rule for Mr. Lamie based upon the Court's "longstanding" unwillingness to rewrite statutes, an unwillingness that "result[ed] from deference to the supremacy of the Legislature . . ." Id. (internal quotations omitted).

Just as Mr. Lamie's invitation to rewrite binding federal statutes was rebuffed by the Supreme Court, the lower court decision's to side-step Lamie and rewrite these statutes based, in part, upon policy rationale, merits reversal of the order entered below.[35]

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[34] CFTC v. Weintraub, 471 U.S. 343 (1985).

[35] As the government explained in its response brief in Lamie, those results are not actually harsh in the typical bankruptcy case And, as the Supreme Court explained, "[s]eeming order has attended the [government's] rule's application for five years in the Fifth Circuit and for

C. The lower court's reliance upon Massachusetts lien law to authorize payment that federal law prohibits violated the Supremacy and Bankruptcy clauses of the United States Constitution and was preempted by the Bankruptcy Code.

1. Introduction.

The court below readily conceded that Lamie would have barred the court from awarding Ropes fees for work it performed during the chapter 7 case but for its sua sponte conclusion that Ropes had a state law lien that allowed such compensation. CK, 321 B.R. at 16 (holding Ropes' "argument in support of payment for post-conversion services must fail [b]ut . . . [for] the availability of [its pre-petition] retainer [as a source] for payment" under Massachusetts law). Thus, in the court's view, Massachusetts lien law could authorize payment when federal law otherwise mandated a different result.

This ruling is plainly wrong. In this case, there are two separate and independent reasons why the Bankruptcy Code would preempt any right under state lien law to use a pre-petition contract between an attorney and a client to create a lien that allows the attorney to use the retainer to pay fees it generates during a chapter 7 case. First, that would be inconsistent with the Code's comprehensive scheme under 11 U.S.C. 327, 330, 503 and 507 for retaining, awarding and paying fees to attorneys from estate funds for work done in chapter 7 cases. Second, it would be inconsistent with the Bankruptcy Code's provisions governing the administration of estate assets in chapter 7 cases - 11 U.S.C. 323(a), 541(a), 542(a) and 704, which transfer title to all estate property to the chapter 7 estate, require all third parties to turn over all estate property to the trustee, and allow only the trustee to make decisions for the corporate debtor.

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four years in the Eleventh Circuit." Lamie, 540 U.S. at 537. Similarly, in the year since Lamie issued, the United States Trustee Program is not aware of any serious problems emanating from the Supreme Court's construction of federal law.

2. Under the Supremacy and Bankruptcy clauses of the United States Constitution federal bankruptcy law preempts inconsistent state laws.

It is beyond dispute under the Supremacy Clause of the United States Constitution that federal law preempts inconsistent state law.[36] The Supremacy Clause requires courts to follow federal, not state, law when Congress enacts a federal statute within the realm of its constitutional authority. Barnett Bank of Marion County, N.A. v. Nelson, 517 U.S. 25, 30 (1996).

As the Supreme Court recently reiterated in Crosby v. Nat'l Foreign Trade Counsel, inconsistent state laws must yield to congressional enactments when one of two tests is met, regardless of whether Congress has inserted a clause in legislation explicitly preempting state law. Crosby v. Nat'l Foreign Trade Council, 530 U.S. 363, 372-73 (2000). First, where Congress intends federal law to occupy a given field, state law in that area is preempted. Crosby, 530 U.S. at 372-73 (citations omitted). Second, even if Congress has not entirely displaced state regulation over the matter in question, state law is still preempted to the extent it actually conflicts with federal law. Id. This occurs when it is impossible to comply with both state and federal law, or when the state law stands as an obstacle to the accomplishment of the full purposes and objectives of Congress. Id.

Congress has satisfied these tests in the bankruptcy arena, where Congress has enacted a comprehensive and pervasive statutory scheme. See, e.g., Sherwood Partners, Inc. v. Lycos, Inc.,

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[36] The Supremacy Clause of the United States Constitution mandates that "the Laws of the United States . . . shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding." U. S. Const. art. VI, § 2. Thus, under the Supremacy Clause, federal legislation can preempt state or local laws. See M'Culloch v. Maryland, 17 U. S. (4 Wheat.) 316, 327 (1819).

394 F.3d 1198, 1201 (9th Cir. 2005) ("Bankruptcy law [preempts inconsistent state law] because it occupies a full title of the United States Code. It provides a comprehensive system of rights, obligations and procedures, as well as a complex administrative machinery that includes a special system of federal courts and United States Trustees.").

Bankruptcy is particularly federal because the Bankruptcy Clause of the Constitution, U. S. Const. art. I, § 8, grants Congress the power [t]o establish . . . uniform Laws on the subject of Bankruptcies throughout the United States." Congress has exercised that power by enacting the Bankruptcy Code, 11 U.S.C. 101, et seq. See, e.g., Sherwood, 394 F.3d at 1201 ("There can be no doubt that federal bankruptcy law is 'pervasive' and involves a federal interest 'so dominant' as to 'preclude enforcement of state laws on the same subject' - much like many other areas of congressional power listed in Article I, Section 8, of the Constitution, such as patents, copyrights, currency, national defense and immigration."); Eastern Equip. and Servs. Corp., v. Factory Point Nat'l Bank, Bennington, 236 F.3d 117, 120 (2d Cir. 2001) (same).

For these reasons, the First Circuit has repeatedly held that the Bankruptcy Code preempts state laws and private agreements that conflict with the Code. See, e.g., Commonwealth of Massachusetts v. Boston Reg'l Med. Ctr., Inc. (In re Boston Reg'l Med. Ctr., Inc.), 291 F.3d 111, 120 (1st Cir. 2002) (disregarding state law because the question "whether an obligation imposed by state law receives priority . . . under the Bankruptcy Code is a matter of federal, not state law") (citation omitted)); Bessette v. Avco Fin. Serv., Inc., 230 F.3d 439, 447 (1st Cir. 2000) (state law remedies for unjust enrichment to collect debt preempted by Bankruptcy Code); Patriot Portfolio, LLC v. Weinstein (In re Weinstein), 164 F.3d 677, 683 (1st Cir. 1999) (Massachusetts homestead statute preempted by 11 U.S.C. 522(c)); Summit Inv. and

Dev. Corp. v. Leroux, 69 F.3d 608, 610 (1st Cir. 1995) (Bankruptcy Code provision governing executory contracts preempted partnership agreement); Western Auto Supply Co. v. Savage Arms, Inc. (In re Savage Indus., Inc.), 43 F.3d 714, 723 (1st Cir. 1994) (explaining that state laws are preempted whenever they "pose[] a genuine threat to the legitimate operation of the Bankruptcy Code"); Corporacion de Servicios Medicos Hospitalirios v. Moro (In re Corporacion de Servicios Medicos Hospitalarios de Fajardo), 805 F.2d 440, 444 n.3 (1st Cir. 1986) (holding 11 U.S.C. 541(a), 362(a)(3) and 365 "clearly preempt any contradictory state law"). See also Fracasso v. Reder (In re Fracasso), 187 F.3d 621 (Table) (1st Cir. 1999) (unpublished) (state homestead statute preempted by 11 U.S.C. 522) (citing Patriot Portfolio, 164 F.3d at 683).

Similarly, the Supreme Court has held that the Bankruptcy Act preempted inconsistent state laws. See, e.g., Perez v. Campbell, 402 U.S. 637 (1971) (Bankruptcy Act of 1898 preempted inconsistent provisions of the Arizona Safety Responsibility Act). See also Butner v. United States, 440 U.S. 48, 54 n.9 (1979) (state laws are "suspended only to the extent of actual conflict with the system provided by the Bankruptcy Act of Congress") (citations omitted)).

a. The Bankruptcy Code's comprehensive federal scheme under sections 327, 330, 503 and 507 for retaining lawyers, awarding them fees and paying those fees preempts inconsistent Massachusetts lien law.

The professional compensation provisions of the Bankruptcy Code - 11 U.S.C. 327 330, 503, and 507 - collectively "reveal a clear, but implicit, preemptive intent," and "create a scheme of federal regulation 'so pervasive as to make reasonable the inference that Congress left no room for the States to supplement it." Crosby, 530 U.S. at 372-73. Accord Barnett, 517 U.S. at 31.

Significantly, the Supreme Court has long held that the federal statutory scheme governing the compensation of bankruptcy professionals in bankruptcy cases is a pervasive scheme of regulation that preempts inconsistent state laws. Brown v. Gerdes, 321 U.S. 178, 183 (1944) (Chandler Act amendments to the Bankruptcy Act of 1898 created "comprehensive supervision over compensation and allowances" under federal law and "provided centralized control" over attorney fees). This is because bankruptcy jurisdiction over professional fees in bankruptcy cases is "paramount and exclusive" and federal provisions governing professional compensation "cause any conflicting [state] procedure to give way." Brown, 321 U.S. at 183 (holding that under the Bankruptcy Act, bankruptcy courts, not state courts, fix compensation for attorneys representing the estate, even in state litigation) (citations omitted).

The Bankruptcy Code of 1978, like the former Bankruptcy Act construed by the Supreme Court in Brown, comprehensively governs the retention, fee award and compensation of lawyers from estate funds. Indeed, one of the most fundamental aspects of the Bankruptcy Code is this governance and control of administrative and professional expenses under 11 U.S.C. 327, 330, 503 and 507.[37] Cf. Rome v. Braunstein, 19 F.3d 54, 57 (1st Cir. 1994) (Bankruptcy Code imposes rigorous restraints upon employment of professionals in bankruptcy cases).

Through the Bankruptcy Code, Congress has established a comprehensive set of rules, which dictate: **(A)** how attorneys may be retained at estate expense - through the granting of a

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[37] The federal bankruptcy scheme controlling professional compensation is so comprehensive that section 329 of the Code requires bankruptcy court to review even those fees that attorneys charge before they file bankruptcy petitions, and which are not paid from estate funds. 11 U.S.C. 329. Under section 329, the court may order the return of those non-estate funds if the attorney's charges were unreasonable. See, e.g., Bethea v. Adams, 352 F.3d 1125 (7th Cir. 2003) (applying section 329).

section 327 employment motion; **(B)** how they are compensated by the estate - through a section 330 fee award; **(C)** how they receive payment from the estate - through the payment of their section 330(a) award under section 503(b)(2); and **(D)** what priority their payment receives - first administrative priority under section 507.

Section 327(a) allows trustees to retain attorneys in chapter 7 cases by court order. 11 U.S.C. 327(a). In turn, section 330(a) allows the court to award fees to an attorney but only if the attorney has been "employed under section 327."[38] 11 U.S.C. 330(a). Section 503(b)(2) allows an attorney to receive payment from the estate for his professional services but only if "compensation . . . [has been] awarded [to the attorney] under section 330(a)." 11 U.S.C. 503(b)(2). Finally, section 507(a)(1) gives an attorney fee award under section 503(b)(2) first priority of payment as an "administrative expense" of the estate. 11 U.S.C. 507(a)(1).

Significantly, Congress made these provision interdependent. For example, an attorney's right to payment under section 503(b)(2) is conditioned upon a section 330(a) fee award and the right to grant such a section 330(a) award is conditioned upon the attorney having been retained under section 327. In this way, the Code provides a cradle-to-grave scheme for compensating attorneys from estate funds.[39]

Consistent with this pervasive scheme, the United States courts of appeals for the First, Fourth and Eighth circuits have held that attorneys may not use the proceeds of security retainers

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[38] Section 330(a) also allows awards to attorneys who represent chapter 11 creditors' committees under section 1103(a), but that provision does not apply here.

[39] Even when professionals have a right to payment from the estate, the bankruptcy court may not subvert the priority scheme set forth by Congress by allowing professionals to receive more than their pro rata share from an administratively insolvent estate. See, e.g., Specker v. Eisen, 393 F.3d 659, 662-64 (6th Cir. 2004).

post-petition, holding instead that attorneys must receive compensation through valid section 330 orders. Indian Motocycle Assoc. III Partnership v. Massachusetts Housing Fin. Agency, 66 F.3d 1246, 1255 (1st Cir. 1995) (ruling "counsel would be required to file a section 330 fee application to withdraw [funds from a pre-petition security] retainer"); United States Trustee v. Equip. Serv., Inc. (In re Equip Serv., Inc.), 290 F.3d 739, 746-747 (4th Cir. 2002) (the portion of a security retainer in an attorney's possession becomes property of the chapter 7 bankruptcy estate and must be turned over to the estate), aff'd sub. nom. Lamie v. United States Trustee, 540 U.S. 526 (2004); Snyder v. Dewoskin (In re Mahendra), 131 F.3d 750, 755-56 (8th Cir. 1997) (attorney cannot use a pre-petition security retainer secured by a lien for post-petition services because the "[d]ebtor lost the right to authorize [the attorney's] legal services which could potentially further encumber this asset of the bankruptcy estate. Only the bankruptcy court could control further encumbrances of estate property" under a section 330 award) (8th Cir. 1997).

Significantly, the Eighth Circuit's Mahendra decision categorically repudiated the idea that a state law lien could authorize payment outside sections 327 and 330, holding the attorney's "lien - to the extent it was valid - was extinguished on the [bankruptcy] petition date with respect to any future advances." Mahendra, 131 F.3d at 755. Most recently, the Bankruptcy Appellate Panel for the Eight Circuit has specifically ruled that federal law prohibits an attorney from using a state law lien arising from a pre-petition security retainer to fund work in a chapter 7 case when the chapter 7 trustee had not retained the attorney under section 327 of the Code. In re On-Line Serv. Ltd, __ B.R. __, 2005 WL 600361 (B.A.P. 8th Cir. 2005) (following Lamie and Mahendra).

Also consistent with this pervasive scheme, the Second, Third, Seventh, and Tenth circuits have held that the only way attorneys may receive "payment" from bankruptcy estate funds is under subsection 503(b)(2), which requires as a condition precedent to payment that the attorney have an award under section 330 and an order of employment under section 327. Milwaukee Engraving Co., 219 F.3d at 636; Singson, 41 F.3d at 320; F/S Airlease II, Inc. v. Simon, 844 F.2d at 108-109; Keren, 189 F.3d at 88; Albrecht, 233 F.3d at 1260. Accord Lamie, 540 U.S. at 529, 538 (section 330 awards can be made in chapter 7 cases only to attorneys who had been lawfully retained under section 327).

In light of Congress' thorough regulation of all aspects of professional compensation, it is unquestionable that the bankruptcy court's application of the Massachusetts lien statute to circumvent that federal scheme was improper. Because the lower court's construction of Massachusetts law would allow recovery from the CK bankruptcy estate when sections 327, 330, 503 and 507 do not, the lower court's contrary application of Massachusetts lien law stands "as an obstacle to the accomplishment and execution of the full purposes and objectives . . . Congress" mandated in enacting the Bankruptcy Code and is preempted by the Bankruptcy Code. California Fed. Savings and Loan Assoc. v. Guerra, 479 U.S. 272, 281 (1987).

b. The Bankruptcy Code's comprehensive federal scheme for administering debtors under sections 323(a), 541(a), 542(a) and 704(1) also preempts Ropes' post-conversion claim because title to Ropes' retainer transferred to the estate; only the chapter 7 trustee could make decisions about the retainer after that; and Ropes had to turn the retainer over to the chapter 7 trustee - not retain it to unilaterally create a post-conversion secured claim against the estate for work it could not perform under the Code.

The court below erroneously ruled that Ropes could keep CK's pre-petition retainer after CK went into chapter 7 and use it to fund work not authorized under section 327(a) of the Code. That is wrong because the retainer became property of the bankruptcy estate under section 541(a) of the Code, which meant Ropes had a duty under section 542(a) to turn it over to the chapter 7 trustee. Under sections 323(a) and 704 of the Code, only the chapter 7 trustee could administer estate funds, including the retainer. Those sections also gave the trustee the sole right to decide whether the estate would hire lawyers in the chapter 7 case, and who those lawyers should be. This comprehensive federal scheme for administering bankruptcy assets and bankruptcy cases preempted the lower court's state-law theory, which interfered with this federal scheme.

Section 541(a) of the Code defines what constitutes property of the estate. 11 U.S.C. 541(a). Under that section, the commencement of a case "creates an estate" and "all" the debtor's property - subject to narrow exceptions not relevant here - becomes part of the estate. Id. Section 541(a) does not define what constitutes the debtor's property - it only directs that such property flows to the estate. Congress has the power to define property in the Bankruptcy Code but has not chosen to exercise it.[40] That means the Bankruptcy Code, through section 541(a), takes all the debtor's property and transfers it to the bankruptcy estate. 11 U.S.C. 541(a).

It is settled law that the balance in the CK-security-retainer, which Ropes held pre-conversion, became property of the CK chapter 7 estate under section 541(a). **First**, the court below squarely held that the CK retainer was property of the CK chapter 7 estate. CK, 321 B.R. at 16 n.5 (holding "a security retainer remains property of the debtor (or the estate) until properly applied by the attorney for services actually performed. There is no question but that, in this case, R[opes] & G[ray] held a security retainer"). **Second**, Ropes admitted its retainer was a "security retainer." (A39, 43-44). **Third**, the First Circuit has squarely held under

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[40] Butner v. United States, 440 U.S.48, 54-55 (1979) ("[t]he constitutional authority of Congress to establish 'uniform Laws on the subject of Bankruptcies throughout the United States' would clearly encompass a federal statute" defining a mortgagee's property interest in rents — but Congress chose not to exercise that power).

Massachusetts law that such security retainers are property of the chapter 7 estate. Indian Motocycle, 66 F.3d at 1254-55 (a Massachusetts pre-petition retainer becomes property of the bankruptcy estate upon the filing of a bankruptcy petition because, under state law, the debtor holds an interest in the retainer at the time its bankruptcy case is filed). See also Miller v. United States Trustee (In re Independent Engineering Co., Inc.), 232 B.R. 529, 533 (B.A.P. 1st Cir.) ("Thus, pursuant to the terms of the contract, the Debtor retained an interest in the unapplied retainer upon the filing of the petition, and the retainer became property of the estate."), aff'd, 197 F.3d 13 (1st Cir. 1999). Many other courts have similarly held that security retainers become property of the estate under section 541(a).[41]

Thus, the question before the court below was not whether the retainer was property of the estate - it was, but whether the court could use state law to allow Ropes to keep that estate property so Ropes could perform services during the chapter 7 case even though the chapter 7 trustee had not retained Ropes under section 327. In the court's view Ropes could keep this

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[41] See, e.g., Equipment Services, 290 F.3d at 746-747 (the portion of a security retainer in an attorney's possession becomes property of the chapter 7 bankruptcy estate); Mahendra, 131 F.3d at 756 (holding "[t]he debtor's equitable interest in the unearned portion of the retainer becomes property of the estate"); In re Downs, 103 F.3d 472, 478 (6th Cir.1996) ("Retainers paid to counsel for the debtor are to be held in trust for the debtor, and the debtor's equitable interest in the trust is property of the estate. As a consequence, "any attorney who unilaterally withdraws against a retainer while representing a debtor in bankruptcy proceedings is plainly in violation of the strictures of the Code" (citations omitted)); Specker Motor Sales Co. v. Eisen , 393 F.3d 659, 663 (6th Cir. 2004) ("retainers, which are held in trust for the estate . . . remain the property of the estate"); Tyler v. Prudoff (In re Prudoff), 186 B.R. 64, 65-66 (E.D. Va. 1995) (construing Virginia law to reach this result); In re McDonald Bros. Constr., Inc., 114 B.R. 989, 996 (Bankr. N.D. Ill. 1990) (applying Illinois law). As the Eighth Circuit has aptly explained, under section 541 a debtor's title to property transfers free of an attorney's claim to security in it because the property has not yet been "[]encumbered by [the attorney's] post-petition legal services." Mahendra, 131 F.3d at 756.

property, do post-petition work, and then demand payment by claiming its pre-bankruptcy agreement allowed it to impose secured claims post-petiton.

This is clearly wrong. First, section 542(a) of the Code commanded all third parties - including Ropes - to "deliver to the [chapter 7] trustee" all estate property. 11 U.S.C. 542(a). This section required Ropes to turn the retainer funds over to the new chapter 7 trustee. See, e.g., Indian Motocycle, 66 F.3d at 1255 ("the debtor's equitable "interest" in any unearned portion of the retainer, impressed with [a creditor's] perfected lien, would have become property of the estate on the date the chapter 11 petition was filed, see Bankruptcy Code § 541(a)(6), and presumably would remain subject to a turnover order in a section 542 action): Mahendra, 131 F.3d at 756 (section 542 empowers bankruptcy courts to "require debtor's counsel to surrender the unearned portion [of a security retainer] as 'property of the estate'"); In Dionne v. Colvin (In re Moore), 312 B.R. 902, 909-10 (Bankr. N.D. Ala. 2004) (holding section 542(a) requires a debtor's counsel to return estate funds in the attorney's possession).

Second, under the Bankruptcy Code, only the chapter 7 trustee - not Ropes - had the power to control and administer that retainer. Once a chapter 7 case commences, the trustee "is the representative of the estate." 11 U.S.C. 323(a). Finally, under the Bankruptcy Code, the trustee, as estate representative, manages the debtor's estate and collects and administers all estate property. 11 U.S.C. 704(1) and (2).

Consistent with the Code, the Supreme Court has squarely held that once a trustee is appointed in a case that trustee manages the corporate debtor and controls counsel. CFTC v. Weintraub, 471 U.S. 343 (1985). In CFTC, the Supreme Court held "the Bankruptcy Code gives the trustee wide-ranging management authority over the debtor." CFTC, 471 U.S. at 352. And the Court made clear that former corporate management's role upon the appointment of a trustee "is to turn over the corporation's property to the trustee and to provide certain information to the trustee and to the creditors. §§ 521, 343. Congress contemplated that when a trustee is appointed, he assumes control of the business, and the debtor's directors are 'completely ousted.'" Id. at 352-53 (quoting in part H.R.Rep. No. 95-595, pp. 220-221 (1977)). As CFTC held, this transfer of power is so complete it even gives " the trustee[] control of the corporation's attorney-client privilege with respect to prebankruptcy communications." Id. at 353.

Significantly, the Supreme Court relied upon this concept of trustee control in Lamie to buttress its holding that counsel shall not be paid for chapter 7 work unless the chapter 7 trustee hires them under section 327. Lamie, 540 U.S. at 537. Lamie explained that ""[s]ection 327's limitation on debtors' incurring debts for professional services without the chapter 7 trustee's approval is not absurd. In the context of a chapter 7 liquidation it advances the trustee's responsibility for preserving the estate." Id.

This makes it clear - beyond peradventure - that once Mr. John A. Burdick was appointed CK's chapter 7 trustee, only he made decisions for CK Liquidation - a corporate debtor. Under federal law, he controlled the retainer - neither Ropes nor the corporate debtor's management could exercise physical control over it under section 542(a). And only the trustee could decide whether the corporate-debtor needed legal services and who should be nominated under section 327 to succeed Ropes - who at that point was nothing more than CK's "terminated" chapter 11 counsel. See 11 U.S.C. 327(a); Lamie, 540 U.S. at 531-32 (conversion "terminated" Ropes employment); CFTC, 471 U.S. 353 (trustee controls counsel and determines whether they waive the attorney-client privilege).

But Mr. Burdick did not ask to use Ropes post-conversion. Instead, he sought and obtained permission under section 327 to use two other firms (A450, 462, 464, 599). Under Lamie and CFTC, Mr. Burdick's decision not to request permission to re-employ Ropes deprived that firm of authorization to act as debtors' counsel in the chapter 7 case under Lamie. For that reason, Ropes was not acting as chapter 7 counsel when it performed $7,820 in post-conversion services.

For these reasons, sections 323(a), 541(a), 542(a) and 704(1) and (2) preempted Ropes' ability under putatively contrary state law to keep estate property in violation of section 542(a), perform services that Mr. Burdick did not employ it to perform under section 327(a), and to encumber estate property with a lien for such post-conversion services. Thus, even if Ropes had a valid lien in a non-bankruptcy context that lien was employed here in derogation of those provisions, and in derogation of CFTC and Lamie and thus was preempted by federal law. Accord Mahendra, 131 F.3d at 754-55 (a lien on the unused security retainer is "extinguished" upon the commencement of the bankruptcy case, the balance must be turned over, and the attorney may receive fees only under section 330); Equipment Services, 290 F.3d at 746-747 (reaching the same result pre-Lamie); On-Line, __ B.R. __, 2005 WL 600361 (reaching the same result post-Lamie).

Unlike the Mahendra, Equipment Services, and On-Line appellate decisions, the decision entered below erred in concluding that Ropes could keep estate funds and use them post-chapter 7 to perform services even though the trustee did not retain the firm under section 327. As Lamie specifically held, the representation by firms like Ropes is "terminated" upon conversion. Lamie, 542 U.S. at 531-32. Upon conversion, the Code required Ropes to turn over the retainer under sections 541 and 542 so the trustee could use it to pay creditors, and it required Ropes, as terminated counsel, to respect the counsel decisions the Code empowered the trustee to make under sections 323 and 704. This comprehensive federal scheme for administering chapter 7 cases preempted contrary state law and the court below erred in relying upon that inconsistent state law in awarding $7,820 to Ropes for post-conversion work.[42]

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[42] The decision below merits reversal for at least three additional separaate and independent reasons:

First, Ropes' right to use a lien to impair estate property evaporated upon the commencement of CK's chapter 11 case. See, e.g, Mahendra, 131 at 756 (such liens are "extinguished). Under the Code, there is only one way Ropes could have a claim post-chapter 11 - by being appointed debtor in possession counsel under section 327(a). Lamie, 540 U.S. at 531-32. But in such situations section 330 controls how much Ropes could be "award[ed]" from estate funds. To our knowledge, no court has ever suggested otherwise and a contrary interpretation would wipe out section 327 and 330 because lawyers could use pre-petition security agreements to evade those sections' binding rules. Thus, Ropes' rights under a pre-petition security agreement vis-a-vis property of CK's estate for legal services terminated when CK went into chapter 11. Mahendra, 131 at 756. Going forward from that point, sections 327, 330, 503 and 507 governed Ropes' right to payment - as Ropes repeatedly acknowledged in its employment application and accompanying affidavit.

Second, no less than three subsections of the Bankruptcy Code's automatic stay provision combine to prohibit Ropes from using a lien to fund legal work in the chapter 7 case. 11 U.S.C. 362(a). First subsection 362(a)(3) prohibited Ropes from "exercis[ing] control over property of the estate" - here the retainer. Second, subsection 362(a)(4) prohibited Ropes from "creat[ing], perfect[ing], or enforc[ing] any [post-petition] lien against property of the estate." Third, subsection 362(a)(5) prohibited Ropes from "creat[ing], perfect[ing], or enforc[ing] against property of the debtor any lien to the extent that such lien secures a claim that arose before the commencement of the case under this title." Because Ropes' lien violates the automatic stay, it is preempted by it. Corporacion de Servicios Medicos Hospitalirios v. Moro (In re Corporacion de Servicios Medicos Hospitalarios de Fajardo), 805 F.2d 440, 444 n.3 (1st Cir. 1986) (holding 11 U.S.C. 541(a), 362(a)(3) and 365 "clearly preempt any contradictory state law").

Third, as a matter of federal law, a chapter 7 case discharges all claims that attorneys have to estate property based upon pre-petition obligations between the attorney and the client. Cf. Rittenhouse v. Eisen, 404 F.3d 395 (6th Cir. 2005) (holding "[a] debt for pre-petition legal services is" discharged in a chapter 7 case under 11 U.S.C. 727(b)); In re Fickling, 361 F.3d 172 (2nd Cir.2004) (same); Bethea v. Adams & Associates, 352 F.3d 1125 (7th Cir.2003) (same);

D. Alternatively, Massachusetts law did not create a lien on estate property that secured Ropes' post-conversion work.

Putting federal law aside, Ropes had no secured claim for its post-conversion work under the Massachusetts Commercial Code, Mass. Gen. Laws ch. 106, §§ 9-308 - 316, for five separate and independent reasons. As the court below noted, the Massachusetts Commercial Code allows a "secured party" to "perfect a security interest in negotiable documents, goods, instruments, money, or tangible chattel paper by taking possession of collateral." CK, 321 B.R. at 18. As the court below also understood, Ropes needed an authenticated security agreement under Mass. Gen. Laws ch. 106 § 9-203(b) in order to have a perfected security interest by mere possession under Mass. Gen. Laws ch. 106 § 9-313(a). Id.

The court found that agreement in "the written retainer agreement between the parties, evidencing the transfer of moneys to the attorney as a retainer." Id. But that agreement did not give Ropes rights post-conversion for five reasons:

First, the retainer gave Ropes no rights in the chapter 7 case because the retainer agreement did not cover chapter 7 work. To the contrary, the retainer agreement expressly restricted its retainer agreement to legal work involving CK's "obligation to its creditors, Micro Control Systems, Inc. and Harold Bowers as well as a possible Chapter 11 filing by [CK] and sale of assets." Id.

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and In re Biggar, 110 F.3d 685 (9th Cir.1997) (same). And even when an attorney has a claim for services actually performed before its client went into bankruptcy, that claim is a general unsecured claim not a secured claim like the court below granted to Ropes. Id.

This catalogue of additional errors is representative rather than exhaustive.

Thus, by its plain words, the retainer agreement did not purport to give Ropes a security interest for work performed during a chapter 7 proceeding. Id. Indeed, it did not even give Ropes a security interest for work performed in the chapter 11 proceeding. Instead, the agreement expressly restricted its application to the mere "filing" of the chapter 11 petition. The parties carefully drafted the agreement so it would not apply to any chapter 11 work that came after the petition was "fil[ed]" (A43).[43] Thus, even under state law, the retainer did not give Ropes a secured claim under Mass. Gen. Laws ch. 106 § 9-313(a) for the work Ropes performed in the chapter 7 case.

Ropes' statements in its section 327 chapter 11 employment application support this reading of the retainer agreement because the application never disclosed - in any way - that Ropes was seeking to use the retainer to secure a claim if CK ever went into chapter 7. To the contrary, the employment application represented to the court and to the parties in interest that the retainer was restricted to chapter 11 work (A16-18, 20-22). Indeed, the "Wherefore" clause of the application sought permission to employ Ropes only "during the Chapter 11 case" (A23).

Similarly, the affidavit that Ropes filed in support of its section 327 application did not contend that the retainer had any effect beyond the chapter 11 case (A28). Instead, Ropes' affidavit assured the court and the parties in interest that Ropes held the retainer "in connection with" the chapter 11 case (A39). Thus, the security retainer did not contractually enable Ropes to draw upon it for the purpose of performing chapter 7 work.

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[43] That may be because Ropes understood that the agreement could not give Ropes rights in the actual chapter 11 case. As we discuss above, federal law dictates whether counsel may be appointed in chapter 11 cases, and whether and how much they may be paid. 11 U.S.C. 327, 330, 503 and 507. Federal law preempted Ropes' retainer to the extent Ropes sought to use it to obtain more for its services in CK's chapter 11 case than it was allowed under those sections.

Second, Ropes' rights under the security retainer terminated upon the commencement of the initial chapter 11 case because Ropes ceased being CK's counsel unless it was subsequently re-hired under section 327 in the chapter 11 case. Indeed, Ropes' initial chapter 11 application repeatedly conceded that Ropes was not employed in the chapter 11 case unless and until the court approved its application under section 327(a). See, e.g., A17 (initial chapter 11 application concedes that "[t]he Debtor desires to employ R&G . . . in connection with the Debtor's Chapter 11 Case"); A12 (same); A16 (CK "seeks to employ" Ropes in the chapter 11), A23 (asks "the Court" to enter an order "authorizing the Debtor to employ" Ropes); A28 (same statements in Ropes' affidavit). As we discuss above, Ropes had no right to act as chapter 11 counsel unless it was appointed under section 327. If it were appointed, then its payment rights arose from sections 330 and 503(b)(2) of the Code - not the retainer. Thus, Ropes' pre-petition contractual representation actually terminated twice here - first when its client filed chapter 11, necessitating a subsequent section 327 appointment and when it "terminated" by operation of law when the case converted to chapter 7. Each operated under state law to lift any state law lien it had pre-chapter 11.

Third, the security retainer failed to give Ropes a state law secured claim post-conversion because Ropes agreed that "[a]ny remaining portion of the amounts advanced will be refundable at the conclusion of our representation. . . ." (A47). This is fatal to the court's state law analysis. As Lamie, held, Ropes' representation in the chapter 11 concluded - "terminated" in the words of the Supreme Court - when the CK chapter 11 case converted to chapter 7. Lamie, 540 U.S. at 531-32. Thus, the retainer agreement ceased operating as a security agreement under state law when the case converted to chapter 7. At that point, Ropes had a right to seek fees for the work it performed in the chapter 11 under section 330(a), and Ropes did so by filing a section 330 fee application (A479). But under the contractual language of Ropes' security agreement, conversion to chapter 7 "conclu[ded]" Ropes representation and its right to perform chapter 7 work, thereby depriving Ropes of a secured claim for such work under the terms of its agreement and accordingly under Massachusetts law.

Fourth, as the court below acknowledged, Massachusetts law required that the funds be transferred to Ropes. CK, 321 B.R. at 18. But they were not. They were placed in a separate interest-bearing account. See (A46) (Ropes' agreement with CK that these funds be put in a separate interest-bearing account); Indian Motocycle, 66 at 1254 (explaining that attorneys must hold such funds "in trust"). Thus, under state law those funds never transferred to Ropes so no lien attached to them.

Fifth, Ropes did not properly perfect its security interest in the retainer, assuming that it had one. In order to be enforceable against third parties, including a chapter 7 trustee, a security interest in a debtor's property must be perfected. Uniform Commercial Code at § 22-4. Perfection entails additional actions by a creditor to place third parties on notice of its interest, such as by filing a financing statement or taking possession or control of the property. Id.; See Mass. Gen. Laws ch. 106, §§ 9-308 – 9-316.

Citing no case authority, the lower court held that Ropes automatically perfected its security interest in the retainer under Mass. Gen. Laws ch. 106, § 9-313(a) by depositing the funds in its client funds account. CK, 321 B.R. at 18. The lower court implicitly found that the security retainer constituted "money" for purposes of section 9-313(a). Id. Mass. Gen. Laws ch. 106, § 1-201(24) defines "money" as "a medium of exchange authorized or adopted by a domestic or foreign government and includes a monetary unit of account established by an intergovernmental organization or by agreement between two or more nations. . . .”

Citing the companion statute in the North Carolina Uniform Commercial Code, a bankruptcy court recently held that the unapplied balance of a pre-petition security retainer given by a debtor to its chapter 11 counsel was not money that could be perfected through possession under section 9-313(a). In re E-Z Serve Convenience Stores, Inc., 299 B.R. 126, 131 (M.D.N.C. 2003). The court further held that the unapplied balance of the security retainer was not a deposit account, which could be perfected through control under section 9-314. Instead, it was a general intangible, which could be perfected only by filing a financing statement under section 9-310. Id. at 131 – 133; see Mass. Gen. Laws ch. 106, §§ 9-102(29), 9-310, 9-313 and 9-314.[44]

Thus, under Massachusetts UCC law and E-Z Service, Ropes did not have a valid, perfected security interest in its security retainer. The retainer constituted a general intangible. Ropes could have perfected its interest in it only if it had filed a UCC-1 statement per Mass. Gen. Laws ch. 106, § 9-310, which it did not.

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[44] Mass. Gen. Laws ch. 106, § 9-102(29) defines “deposit account” as “a demand, time, savings, passbook, or similar account maintained with a bank. The term does not include investment property or accounts evidenced by an instrument . . . .”

Conclusion

For these reasons, the United States Trustee respectfully asks this Court to reverse the order entered below and remand with instructions that the bankruptcy court deny Ropes' request that the CK chapter 7 bankruptcy estate pay Ropes $7,820 for services Ropes performed after the CK case converted to chapter 7.

Respectfully submitted,

____
Roberta A. DeAngelis
P. Matthew Sutko
Department of Justice
20 Massachusetts Ave., N.W.
Washington, D.C. 20530
phone: (202) 307-1399
fax: (202) 307-2397

Eric K. Bradford
Office of the United States Trustee
Department of Justice
10 Causeway Street, Room 1184
Boston, MA 02222-1043
phone: (617) 788-0400
fax: (617) 565-6368

CERTIFICATE OF SERVICE

I certify that on June 2, 2005, true and correct copies of the **BRIEF OF APPELLANT, THE UNITED STATES TRUSTEE** were served by United States mail, First Class postage pre-paid, or by email upon the individuals listed below and by ECF upon all persons having filed notices of appearance in the Court's ECF database.

By: __________________________

Eric K. Bradford BBO#560231
Department of Justice
Thomas P. O'Neill Jr. Federal Bldg.
10 Causeway Street, Room 1184
Boston, MA 02222
(617) 788-0415

Dated: June 2, 2005.

PARTIES TO APPEAL AND THEIR RESPECTIVE COUNSEL

CK Liquidation Corporation
33 Boston Post Road West
Suite 120
Marlboro, MA 01752
Tax id: 04-3079696
(Debtor)
dba
Baystate Technologies, Inc.
fka
Cadkey Corporation

/

James M. Wilton, Esq.
Erin T. Fontana, Esq.
Ropes and Gray LLP
One International Place
Boston, MA 02110-2624
617-951-7000
Fax : 617-951-7050
Email: jwilton@ropesgray.com <mailto:jwilton@ropesgray.com>
(Counsel to CK Liquidation Corp.)

John A. Burdick, Esq.
340 Main Street
Worcester, MA 01608
508-752-4633
(Chapter 7 Trustee)

Charles Azano, Esq.
Richard E. Mikels, Esq.
Mintz, Levin,Cohn, Ferris, Glovsky
and Popeo, P.C.
1 Financial Center
Boston, MA 02111
617-542-6000
Email: cazano@mintz.com <mailto:cazano@mintz.com>
(Counsel to Chapter 7 Trustee)

John F. Ward, Esq.
Bromberg & Sunstein, LLP
125 Summer Street
Boston, MA 02110
(Chair, Official Committee Of Unsecured Creditors)

Michael J. Goldberg, Esq.
Cohn Whitesell & Goldberg
101 Arch Street
Boston, MA 02110
(617) 646-2000
Email: goldberg@cwg11.com
(Counsel to the Official Committee of Unsecured Creditors)

Statutory Addendum

11 U.S.C. 323. Role and capacity of trustee

(a) The trustee in a case under this title is the representative of the estate.

(b) The trustee in a case under this title has capacity to sue and be sued.

11 U.S.C. 327. Employment of professional persons

(a) Except as otherwise provided in this section, the trustee, with the court's approval, may employ one or more attorneys, accountants, appraisers, auctioneers, or other professional persons, that do not hold or represent an interest adverse to the estate, and that are disinterested persons, to represent or assist the trustee in carrying out the trustee's duties under this title.

(b) If the trustee is authorized to operate the business of the debtor under section 721, 1202, or 1108 of this title, and if the debtor has regularly employed attorneys, accountants, or other professional persons on salary, the trustee may retain or replace such professional persons if necessary in the operation of such business.

(c) In a case under chapter 7, 12, or 11 of this title, a person is not disqualified for employment under this section solely because of such person's employment by or representation of a creditor, unless there is objection by another creditor or the United States trustee, in which case the court shall disapprove such employment if there is an actual conflict of interest.

(d) The court may authorize the trustee to act as attorney or accountant for the estate if such authorization is in the best interest of the estate.

(e) The trustee, with the court's approval, may employ, for a specified special purpose, other than to represent the trustee in conducting the case, an attorney that has represented the debtor, if in the best interest of the estate, and if such attorney does not represent or hold any interest adverse to the debtor or to the estate with respect to the matter on which such attorney is to be employed.

(f) The trustee may not employ a person that has served as an examiner in the case.

11 U.S.C. 330(a). Compensation of officers

(a)(1) After notice to the parties in interest and the United States Trustee and a hearing, and subject to sections 326, 328, and 329, the court may award to a trustee, an examiner, a professional person employed under section 327 or 1103--

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

(B) reimbursement for actual, necessary expenses.

(2) The court may, on its own motion or on the motion of the United States Trustee, the United States Trustee for the District or Region, the trustee for the estate, or any other party in interest, award compensation that is less than the amount of compensation that is requested.

(3)(A) In determining the amount of reasonable compensation to be awarded, the court shall consider the nature, the extent, and the value of such services, taking into account all relevant factors, including--

(A) the time spent on such services;

(B) the rates charged for such services;

(C) whether the services were necessary to the administration of, or beneficial at the time at which the service was rendered toward the completion of, a case under this title;

(D) whether the services were performed within a reasonable amount of time commensurate with the complexity, importance, and nature of the problem, issue, or task addressed; and

(E) whether the compensation is reasonable based on the customary compensation charged by comparably skilled practitioners in cases other than cases under this title.

(4)(A) Except as provided in subparagraph (B), the court shall not allow compensation for--

(i) unnecessary duplication of services; or

(ii) services that were not--

(I) reasonably likely to benefit the debtor's estate; or
(II) necessary to the administration of the case.

(B) In a chapter 12 or chapter 13 case in which the debtor is an individual, the court may allow reasonable compensation to the debtor's attorney for representing the interests of the debtor in connection with the bankruptcy case based on a consideration of the benefit and necessity of such services to the debtor and the other factors set forth in this section.

(5) The court shall reduce the amount of compensation awarded under this section by the amount of any interim compensation awarded under section 331, and, if the amount of such interim compensation exceeds the amount of compensation awarded under this section, may order the return of the excess to the estate.

(6) Any compensation awarded for the preparation of a fee application shall be based on the level and skill reasonably required to prepare the application.

11 U.S.C. 503. Allowance of administrative expenses

(a) An entity may timely file a request for payment of an administrative expense, or may tardily file such request if permitted by the court for cause.

(b) After notice and a hearing, there shall be allowed administrative expenses, other than claims allowed under section 502(f) of this title, including--

* * *

(2) compensation and reimbursement awarded under section 330(a) of this title;

11 U.S.C. 507(a). Priorities

(a) The following expenses and claims have priority in the following order:

(1) First, administrative expenses allowed under section 503(b) of this title, and any fees and charges assessed against the estate under chapter 123 of title 28.

11 U.S.C. 541(a). Property of the estate

(a) The commencement of a case under section 301, 302, or 303 of this title creates an estate. Such estate is comprised of all the following property, wherever located and by whomever held:

(1) Except as provided in subsections (b) and (c)(2) of this section, all legal or equitable interests of the debtor in property as of the commencement of the case.

(2) All interests of the debtor and the debtor's spouse in community property as of the commencement of the case that is--

(A) under the sole, equal, or joint management and control of the debtor; or

(B) liable for an allowable claim against the debtor, or for both an allowable claim against the debtor and an allowable claim against the debtor's spouse, to the extent that such interest is so liable.

(3) Any interest in property that the trustee recovers under section 329(b), 363(n), 543, 550, 553, or 723 of this title.

(4) Any interest in property preserved for the benefit of or ordered transferred to the estate under section 510(c) or 551 of this title.

(5) Any interest in property that would have been property of the estate if such interest had been an interest of the debtor on the date of the filing of the petition, and that the debtor acquires or becomes entitled to acquire within 180 days after such date--

(A) by bequest, devise, or inheritance;

(B) as a result of a property settlement agreement with the debtor's spouse, or of an interlocutory or final divorce decree; or

(C) as a beneficiary of a life insurance policy or of a death benefit plan.

(6) Proceeds, product, offspring, rents, or profits of or from property of the estate, except such as are earnings from services performed by an individual debtor after the commencement of the case.
(7) Any interest in property that the estate acquires after the commencement of the case.

11 U.S.C. 542(a) Turnover of property to the estate

(a) Except as provided in subsection (c) or (d) of this section, an entity, other than a custodian, in possession, custody, or control, during the case, of property that the trustee may use, sell, or lease under section 363 of this title, or that the debtor may exempt under section 522 of this title, shall deliver to the trustee, and account for, such property or the value of such property, unless such property is of inconsequential value or benefit to the estate.

11 U.S.C. 704. Duties of trustee

The trustee shall--

(1) collect and reduce to money the property of the estate for which such trustee serves, and close such estate as expeditiously as is compatible with the best interests of parties in interest;

(2) be accountable for all property received;

(3) ensure that the debtor shall perform his intention as specified in section 521(2)(B) of this title;

(4) investigate the financial affairs of the debtor;

(5) if a purpose would be served, examine proofs of claims and object to the allowance of any claim that is improper;

(6) if advisable, oppose the discharge of the debtor;

(7) unless the court orders otherwise, furnish such information concerning the estate and the estate's administration as is requested by a party in interest;

(8) if the business of the debtor is authorized to be operated, file with the court, with the United States trustee, and with any governmental unit charged with responsibility for collection or determination of any tax arising out of such operation, periodic reports and summaries of the operation of such business, including a statement of receipts and disbursements, and such other information as the United States trustee or the court requires; and

(9) make a final report and file a final account of the administration of the estate with the court and with the United States trustee.

BRIEF BANK — 'SUMMARY SHEET" *Printed Fri-6/29/07 14:41*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*
In Re: Close; Turner, UST v. Close

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*
United States District Court for the District of Kansas

3. ("CCN") ***CURRENT*** CASE NO.
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4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*
No.: 06-20195
Court: Bankruptcy Court for the District of Kansas
(Identify judge & cite, if any)

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Filed: 06/15/07
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P. Matthew Sutko, Melisssa R. Perry, David Levine, David Eron
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") ● ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***

● Whether or not deadline for filing chapter 7 dismissal motions begins to run under section 704(b)(1) of the Bankruptcy Code "after" the first meeting of creditors – even when the first meeting requires more than one day to complete

√ **Background:**

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IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF KANSAS

CASE NO. 07-CV-2076-KHV

Consolidated with
CASE NO. 07-CV-2096-KHV

In re DAVID DEWAYNE CLOSE, JR. AND JADA KATHLEEN CLOSE
Debtors.

FELICIA S. TURNER, UNITED STATES TRUSTEE
Appellant,

v.

DAVID DEWAYNE CLOSE, JR. AND JADA KATHLEEN CLOSE
Appellees.

ON APPEAL FROM THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF KANSAS

THE HONORABLE ROBERT D. BERGER, PRESIDING
Bankruptcy Case No. 06-20195-7

REPLY BRIEF OF THE APPELLANT FELICIA S. TURNER, UNITED STATES TRUSTEE

Of Counsel

ROBERTA A. DeANGELIS
Acting General Counsel

P. MATTHEW SUTKO
MELISSA R. PERRY
DAVID LEVINE
Department of Justice
Executive Office for United States Trustees
20 Massachusetts Avenue, NW
Washington, D.C. 20530

FELICIA S. TURNER
United States Trustee

DAVID P. ERON
Office of the United States Trustee
Department of Justice
301 N. Main Street, Suite 1150
Wichita, KS 67202
Telephone: (316) 269-6176
Fax: (316) 269-6182

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ARGUMENT

A. The Closes do not rebut the United States Trustee's four explanations why her deadline for filing chapter 7 dismissal motions does not begin to run under section 704(b)(1) of the Bankruptcy Code until "after" the first meeting of creditors – even when the first meeting requires more than one day to complete.

Section 704(b)(1)(A) and (2) establish a statutory deadline by which a United States Trustee must timely file a motion to dismiss a chapter 7 bankruptcy case. 11 U.S.C. § 704(b)(1)(A) and (2). Under those statutory provisions, that deadline begins to run "after the date of the first meeting of creditors." 11 U.S.C. § 704(b)(1)(A).

The United States Trustee's opening brief explained that her section 704 deadline did not begin to run under the Code in the Closes' case until "after" their multi-day first meeting ended, and explained why the bankruptcy court erred in ruling the deadline began running after day one of the meeting rather than after its end. Open. Br. at 15-17.

There are four reasons why this is so. **First**, the word "first" as used in the term "first meeting of creditors" in section 704(b)(1)(A) exists to clarify that the deadline begins to run "after" the first of several distinct creditor meetings recognized by the Bankruptcy Code and the Bankruptcy Rules. Open. Br. at 21. **Second**, this textual reading is consistent with the understanding of the term first meeting of creditors, as it has been historically used in bankruptcy for more than one hundred years, which recognizes that the first meeting can occur over multiple days. Open. Br. at 17-18. **Third**, the mandatory rule of construction set forth in section 102(7) of the Code fully supports this textual reading because it makes clear the word "date" in section 704(b)(1)(A) "includes" the word "dates." **Fourth**, this reading comports with sound notions of pubic policy. Open. Br. at 23-27.

In response, the Closes raise four principal arguments. **First**, although the Closes' merits arguments are not entirely clear to the United States Trustee, it appears they foremost suggest the "first meeting" of creditors can last only one day, so the United States Trustee's deadline in their case began to run from the first of the two days on which their meeting of creditors was held. Close Br. at 17-18, 19-21. **Second**, the Closes suggest the United States Trustee impermissibly raises new arguments on appeal. Close Br. at 16, 23, 27-28. **Third**, the Closes disagree with the United States Trustee's contention that her interpretation fosters the fair and efficient administration of bankruptcy cases. Close Br. at 24-27. **Finally**, the Closes suggest the United States Trustee's appeal is moot because the bankruptcy court entered an order granting them a discharge. Close Br. at 30-32. Each lacks merit.

1. Summary of the Closes' Merits Argument. Reduced to its essence, the Closes appear to argue that each day of a debtor's section 341 first meeting of creditors is a separate meeting. Close Br. at 17-18, 19-21. Their argument is inconsistent with **(a)** the fact that the term "first meeting" is used merely to distinguish the first meeting that occurs at the beginning of a bankruptcy case from subsequent meetings that can occur in the case, **(b)** the longstanding universal usage of the term "first" meeting, and **(c)** Bankruptcy Code section 102(7)'s rule of construction that the singular in a Code provision includes the plural, which takes away any doubt here whether a first meeting can occur on multiple dates.

2. The Closes Suggest Incorrectly that the First Day of a Multi-Day First Meeting of Creditors Starts The United States Trustee's Dismissal Deadline Running. The United States Trustee's opening brief established the Code and the Bankruptcy Rules provide for a first meeting of creditors, as well as a number of subsequent meetings. Open. Br. at 4-5, 16. Textually, the word "first" in section 704(b)(1)(A) thus exists merely to distinguish the first meeting from the later ones. For the reasons explained in the United States Trustee's opening brief, it does not mean, as the

Closes suggest, that the first day of a multi-day meeting constitutes a separate and distinct first meeting that commences the running of the United States Trustee's section 704(b)(1)(A) filing deadline.

In a related argument, the Closes suggest the term "first meeting of creditors" should be read as the "date first set." Close Br. at 20. But that does nothing other than impermissibly rewrite the statute. Adding the word "set" to section 704(b)(1)(A) would alter the section – not interpret it. That is impermissible. *Lamie v. United States Trustee*, 124 S. Ct. 1023, 1032 (2004) (rejecting an interpretation of a statute that "would have us read an absent word into the statute," producing not "'a construction of [the] statute, but, in effect, an enlargement of it by the court.'") (*quoting Iselin v. United States*, 270 U.S. 245, 251 (1926)).

Fully supporting the United States Trustee's conclusion on this point is the fact that at least four other deadlines enacted along with section 704(b)(1)(A) in The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 did use the terms date *first scheduled* or *first set for* the meeting of creditors. *See* 11 U.S.C. §§ 521(a)(2)(B), 521(e)(2)(A)(i), 1308(a), and 1308(b)(1). This underscores Congress knew how to use the term "first set" when it wanted to use it in the 2005 Reform Act, and that its failure to use it in section 704(b)(1)(A) supports the conclusion that term should not be engrafted upon section 704(b)(1)(A).[1]

3. <u>The Closes Fail to Appreciate the Significance of the Century-Long Understanding of the Term "First Meeting of Creditors"</u>. The Closes' proffered construction of section 704(b)(1)(A) also fails to recognize that the United States Trustee's construction of the word "first"

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[1] Moreover, the Reform Act of 2005 also sets three additional deadlines based on the *date of* the mandatory section 341 meeting. *See* 11 U.S.C. §§ 521(a)(6), 704(b)(1), and 1324(b). Contrary to the Closes' assertion, these phrases have different meanings, Close Br. at 20, and the use of these different terms indicates that these deadlines are based on different dates.

in the term "first meeting of creditors" is consistent with the longstanding bankruptcy usage of the term "first meeting of creditors." That term is a bankruptcy term of art that means the first mandatory meeting, including any continuances of that meeting.[2] UST Op. Br. at 16-17. Under the Bankruptcy Act of 1898, which was repealed in 1978, the phrase "first meeting of creditors" was used in sections 44, 55, and 57. Although the Bankruptcy Code of 1978 dropped that phrase from the statute, courts and practitioners continued to use the phrase. The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 reincorporated the phrase "first meeting of creditors" into the Bankruptcy Code in several places. Under accepted canons of statutory construction, that term should be given its historic meaning – the sometimes multi-day meeting that occurs at the beginning of a debtor's bankruptcy case. *Dewsnup v. Timm*, 502 U.S. 410, 419, 112 S.Ct. 773, 779 (1992) ("When Congress amends the bankruptcy laws, it does not write 'on a clean slate.'"); *Kelly v. Robinson*, 479 U.S. 36, 44, 107 S.Ct. 353, 358 (1986) (same). Thus, when, as in section 341, "Congress uses terms that have accumulated settled meaning under ... the common law, a court must infer, unless the statute otherwise dictates, that Congress means to incorporate the established meaning of these terms." *Neder v. United States*, 527 U.S. 1, 21 (1999). *See also*, *Nationwide Mut. Ins. Co. v. Darden*, 503 U.S. 318, 322-23 (1992); and *Standard Oil Co. of N.J. v. United States*, 221 U.S. 1, 59, 31 S.Ct. 502, 55 L.Ed. 619 (1911).

4. The Closes Misunderstand Why 11 U.S.C. § 102(7) Supports the United States Trustee's Textual Argument. The Closes' interpretation also cannot be reconciled with the rule of construction mandated by section 102(7) of the Bankruptcy Code. That rule provides the singular includes the plural. 11 U.S.C. § 102(7).

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[2] *See also* n. 3, *infra*, and the cases cited in it.

Applying this rule of construction to section 704(b)(1) causes it to be read as providing "the United States trustee . . . shall . . ., not later than 10 days after the date *or dates* of the first meeting of creditors, file with the court a statement as to whether the debtor's case would be presumed to be an abuse under section 707(b)." Thus, were there any textual ambiguity about the question whether a meeting can continue over multiple dates, this rule of construction would clarify that the "first meeting of creditors" can. Given that, the best reading of section 704(b)(1) is that the 10-Day statement deadline starts running ten days after the last of these dates.[3]

Nor is there anything surprising about any of this. Indeed, the first section of the United States Code similarly provides that singular words in the United States Code include the plural. 1 U.S.C. § 1 ("In determining the meaning of any Act of Congress, unless the context indicates otherwise-words importing the singular include and apply to several persons, parties or things[.]"). Not surprisingly, the Supreme Court has relied upon 1 U.S.C. § 1 to interpret a singular term as including the plural. *Barr v. United States*, 324 U.S. 83, 91 (1945) (relying, in part, upon 1 U.S.C. § 1 to interpret the term 'buying rate' as including buying rates).

Significantly, section 102(7) is even more compelling than 1 U.S.C. § 1 because it does not include the qualifying words "unless the context indicates otherwise" set forth in section 1 of title 1.

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[3] *See, e.g., In re Burrell*, 289 B.R. 109, 110, 112 (Bankr. C.D. Ill. 2002) (referencing the initial and two continued meeting of creditors, held on July 22, September 5, and October 10, 1996, as "first meeting of creditors"); *In re Lake States Commodities, Inc.*, 173 B.R. 642, 644 (Bankr. N.D. Ill. 1994) (referencing the continued meeting of creditors as "a continued first meeting of creditors"); *In re Spenler*, 212 B.R. 625, 627 (B.A.P. 9th Cir. 1997) ("The first meeting of creditors began on August 4, 1995, and, after two continuances, was concluded on September 29, 1995"); *In re Grand Jury Proceedings*, 497 F. Supp. 979, 980 (E.D. Pa. 1980) ("On March 6 and March 29, 1979, William Rosenthal . . . testified at the first meeting of creditors . . . . The first meeting of creditors resumed on March 20, 1979"); *In re Young*, 1 B.R. 387, 389 (Bankr. M.D. Tenn. 1979) ("although the attorney attended the continued first meeting of creditors . . . . attorney did not realize that his client had grounds for objecting to discharge until after the conclusion of the continued first meeting of creditors"); *In re Baker*, 299 F. Supp. 404, 406 (W.D. Mo. 1969) ("the first meeting of creditors was held on April 3, 1968 . . . ; that a continued first meeting was held on April 24, 1968 . . . . the first meeting was further continued to May 21, 1968 . . . ; that on that date it was further continued to June 3, 1968 . . . ; and that at the continued first meeting on June 3 . . ., the first meeting was further continued 'generally'").

Compare 1 U.S.C. § 1 with 11 U.S.C. § 102. Put simply, section 102(7) provides less interpretative discretion than even 1 U.S.C. § 1 does.

In an attempt to evade the rule of construction otherwise mandated by section 102 of title 11, the Closes suggest a different result is mandated by the Supreme Court's application of 1 U.S.C. § 1 in *First Nat. Bank in St. Louis v. Missouri*, 263 U.S. 640, 657, 44 S.Ct. 213, 68 L.Ed. 486 (1924) (applying 1 U.S.C. § 1). Close Br. at 24. This fails to appreciate that the text at issue in *St. Louis*, unlike 11 U.S.C. § 704(b)(1)(A), could not be read as a plural because it had a singular modifier that prohibited a plural reading. The statutory text at issue in *St. Louis* - "an office or banking house"), included a singular article – an. *Id*. As the Supreme Court noted, "the latter provision, employing, as it does, the article 'an' to qualify words in the singular number, would confine the association to one office or banking house." *Id*.

Section 704(b)(1)(A) is thus completely different from the statute at issue in *St. Louis*. As the court noted, rules of construction need not be followed when their application countermands "evident intent of the statute." Reading "an office or banking house" as "an offices or banking houses" obviously was not the intent of that statute because the reading was ungrammatical. But reading "after the date of the first meeting" as "after the dates of the first meeting" is not only grammatical but otherwise in accord with the statute's text. *Id*. *See also Universal Church v. Geltzer*, 463 F.3d 218, 223 (2nd Cir. 2006) (explaining *St. Louis* in no way reflexively precludes the application of section 102(7) in bankruptcy cases "because that subsection appears within the specific title under consideration; [so] its application is therefore more straightforward" that the general rule set forth in 1 U.S.C. § 1).

Finally, the Closes suggest application of section 102(7) to the word “first” would produce absurd results. Close Br. at 24. But their example does not support their argument. They suggest applying section 102(7) would also force the use of the plural for the word “meeting” in section 704(b)(1). *Id*. But such a reading is incorrect because Congress has explicitly indicated otherwise in section 704(b)(1) by modifying the word “meeting” with the singular word “first.” As used in the statute, it would not make grammatical or contextual sense to read “first meeting of creditors” as “first meetings of creditors” because that would mix the singular and the plural, something *St. Louis* counsels against absent some other basis for such a reading. In stark contrast, however, the word “date” is not modified by anything that indicates it should be read exclusively in the singular. Therefore, it must be read in a manner that includes the plural. 11 U.S.C. § 102(7).

5. <u>The Closes Mistakenly Suggest the United States Trustee’s Interpretation will Foster Abuse</u>. The Closes suggest allowing the historic practice of multi-day first meetings of creditors should not be allowed because chapter 7 trustees could abuse their ability to adjourn the required meeting of creditors under section 341. Close Br. at 21, 25-26. However, as delegates of the United States Trustee, chapter 7 trustees have *always* had similar discretion concerning the deadline for objecting to a debtor’s claim of exemptions in Bankruptcy Rule 4003(b), and United States Trustees – who are Justice Department officials – have not and would not allow such abuse to happen.

Certainly, the Closes cite no real world examples of such abuse having occurred, and we are not aware of any significant problems in this respect. To the contrary, adjourning first meetings allows trustees to gather additional information and ensure debtors are entitled to the exemptions they claim, to confirm debtors have not hidden assets, that debtors are eligible for bankruptcy relief, and for a host of other reasons. *See, e.g., In re Bernard*, 40 F.3d 1028, 1031 (9th Cir. 1994) (upholding a chapter 7 trustee's need to continue the meeting of creditors three times over a five and a half month period in order to investigate the debtor's claim of exemptions, and ruling such adjournments are legitimate because even in cases where a debtor attends the commencement of the meeting of creditors, the information provided by the debtor "may prove inadequate, or it may point to other sources."); *In re Brown*, 221 B.R. 902, 906 (Bankr. M.D. Fla. 1998)("Trustees need sufficient flexibility to freely continue meetings of creditors in order to investigate a debtor"); and *In re Cherry*, 341 B.R. 581, 587 (Bankr. S.D. Tex. 2006) (same).

B. The Factual and Procedural Objections Raised by the Closes Lack Merit

In addition to addressing the merits, the Closes raise four factual and procedural bases for affirming the lower court's order. None have merit.

1. The Closes Address Factual Disputes this Court need not Resolve in order to Determine the Question of Law Presented to this Court. In their brief, the Closes suggest the United States Trustee's opening brief misstates matters of fact. Close Br. at 3, 7, 9, 10, 12. Although the United States Trustee disagrees with the Closes' factual characterizations, those disputes are irrelevant to this appeal, which involves a question of law this Court can determine without adjudicating the parties' factual disagreements. Should the United States Trustee prevail on her appeal, the orders entered below would be vacated and this case remanded for further proceedings. On remand, the Closes would have a full and fair opportunity to argue the facts as part of an adjudication of the merits of the United States Trustee's dismissal motion.

2. The Closes Suggest Incorrectly that the United States Trustee Impermissibly Raises New Arguments on Appeal. The Closes also suggest the United States Trustee impermissibly raises new "arguments" on appeal, foremost the United States Trustee's citation to 11 U.S.C. § 102(7). Close Br. at 16, 23-24. But this confuses new *issues* with new *authorities*.

There is no bar to a party raising new or additional authority on appeal to support an argument raised in the bankruptcy court. *C.f. United States v. Nealy*, 232 F.3d 825, 830 (11th Cir. 2000) (distinguishing between new authorities and new issues). That is all the United States Trustee has done here.

In her brief and at oral argument below, the United States Trustee *specifically argued* that "date" in section 704(b)(1) referred to all dates of the meeting, including the concluding date. (ROA: Doc#: 35, p. 4-6; Doc#: 42, Transcript, p. 3-5, 21-28.) This is precisely the issue before this Court. Indeed, the United States Trustee even argued below that the common practice prior to the enactment of the 2005 Reform Act understood the "first meeting of creditors" to mean the first meeting held at the inception of the case. *Id*. The supportive authorities provided to this Court to establish those arguments are not new issues. Instead, they are "simply a new citation in support of a claim consistently urged throughout this case." *Garrett v. Morris*, 815 F.2d 509, 512 (8th Cir. 1987), *cert. denied sub nom.*, *Jones v. Garrett*, 484 U.S. 898 (1987). Therefore, the authorities relied upon by the United States Trustee in her opening brief are properly before this Court.[4]

3. The Closes' Public Policy Concerns are Misplaced. In her opening brief, the United States Trustee explained why the interpretation of section 704(b)(1) pressed by the Closes would

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[4] The Closes cite only one case for their assertion that the United States Trustee cannot raise new authorities on appeal—*Travelers Cas. and Sur. Co. of America v. Pacific Gas and Elec. Co.*, 127 S.Ct. 1199 (2007). But *Travelers* involved a new issue rather than new authorities in support of a legal proposition raised below. In *Travelers*, the parties whether creditor recovery was precluded by a Ninth Circuit federal common law rule. Before the Supreme Court one party raised a new argument – whether the creditor had a right to recovery under a federal statutory theory of recovery neither pressed nor passed upon below. Here, the United States Trustee's argument has been consistent – she timely filed her motion to dismiss within the deadline set by section 704(b)(1)(A). The authorities she cited below support that conclusion. So do the authorities cited to this Court.

disfavor both debtors and the bankruptcy system as a whole. Op. Br. at 23-27. In response, the Closes share their view that debtors will not be harmed by the lower court's interpretation of section 704(b)(1)(A)'s deadline because the United States Trustee can "simply move to continue the first meeting or file a statement of abuse anyway" to obtain additional time to gather necessary information. Close Br. at 25. The Closes do not explain how the United States Trustee can, under their reading of section 704(b)(1)(A), increase her time to obtain sufficient information by moving to continue the mandatory meeting of creditors under section 341. In fact, an adjournment of the section 341 meeting of creditors would only grant additional time to the United States Trustee under the *United States Trustee's* reading of the statute – that her 10-Day Statement is required on or before the 10th day after the first meeting is concluded. The Closes also do not explain how requiring the United States Trustee to initiate the process of moving to dismiss debtors' cases by filing a statement of abuse before obtaining sufficient information would prevent harm to debtors. Close Br. at 22, 27.

In the United States Trustee's view, the Closes fail to appreciate how damaging their suggested section 704(b) deadline would be for debtors navigating the bankruptcy system. Under their reading, United States Trustees would need to seek dismissal of cases before section 341 meetings are completed. Nor do the Closes dispute that debtors frequently fail to provide required financial information to United States Trustees until well after the meeting of creditors is convened (precisely what happened here.) Often, that information is not only relevant but essential to determining whether a presumption of abuse exists. A perfect example is the six months of payment advices that serve as the basis for debtors' current monthly income (11 U.S.C. §§ 101(10A) and

707(b)(2)(A)(i)), but which debtors provide to United States Trustees but do not have to file with the court (11 U.S.C. § 521(a)(1)(B)(iv)).[5]

Furthermore, under sections 521(i)(1) and 521(i)(3) of the Bankruptcy Code, debtors may be granted up to 90 days from the date of filing their petition to file their schedules, pay advices and other required documents before their case is automatically dismissed. 11 U.S.C. § 521(i)(1), (3). Based on the bankruptcy court's and the Closes' reading of section 704(b)(1)(A), the United States Trustee might have to make her determination as to whether the case is presumptively abusive and file her motion to dismiss before the debtor even files schedules or other vital documents. This cannot be correct and would unduly burden debtors with having to defend against motions to dismiss that could be avoided if section 704(b)(1) were instead interpreted in harmony with the rest of the Code.[6]

We agree with the Closes it is important that creditors receive prompt notice that the presumption of abuse arises in a debtor's case. Close Br. at 21. But the Closes fail to appreciate that the notice given to creditors must also be *meaningful*. Section 704(b)(1) places a duty on the United States Trustee to provide notice to creditors regarding whether the presumption of abuse arises, because that notice helps creditors decide whether to exercise their statutory right to file their own motions to dismiss the debtor's case. 11 U.S.C. § 707(b)(1). If the United States Trustee files a 10-Day Statement without first being able to gather sufficient information to ensure that the notice has meaning, the 10-Day Statement's utility would be diminished, something that would benefit no one.

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[5] Under section 521(a)(1)(B)(iv), debtors are only required to file pay advices for the 60 days pre-petition.

[6] Moreover, Interim Bankruptcy Rule 1017(e) requires the United States Trustee to state the circumstances alleged to constitute abuse with particularity in her motion to dismiss. Interim Fed. R. Bankr. Proc. 1017(e). If the debtor has not filed schedules or other documentation required for the United States Trustee to make a determination regarding the presumption, it would be impossible for the United States Trustee to comply with this Rule.

4. The Closes' Mootness Arguments Lack Merit. Finally, the Closes suggest the United States Trustee's appeal is moot. Close Br. at 30 – 32. That is incorrect for two reasons—**(a)** the appeal is not moot as a matter of fact; and **(b)** it is not moot as a matter of law.

Factually, the appeal is not moot because the Closes' bankruptcy case remains open, which means this Court can vacate the orders entered below and remand this case to the bankruptcy court for further proceedings relating to dismissal and discharge. Since the discharge itself is a subject of this appeal, the entry of the discharge cannot possibly moot the appeal of other issues.

Legally, the appeal is not moot for two separate and independent reasons. First, *Griggs v. Provident Consumer Disc. Co.*, 459 U.S. 56, 58 (1982) and its progeny (most significantly *In re Padilla*, 222 F.3d 1184, 1190 (9th Cir. 2000)) make clear that the lower court erred by entering a discharge order after the United States Trustee had filed a notice of appeal, because the court could not enter an order that adversely affected the United States Trustee's ability to obtain appellate review of the dismissal order. *See* Open. Br. at 27-28. As a result, the order reinstating the discharge order was and is void. *Id*.

Second, Fed. R. Bankr. P. 4004(c)(1)(D) did not allow the court below to enter a discharge order in the first place until after the United States Trustee's motion to dismiss was determined. That determination has not yet occurred because the order denying the motion to dismiss was not yet final *and non-appealable*. In other words, while the order denying the motion for reconsideration was a "final" order for purposes of appeal, the United States Trustee's motion to dismiss remained "pending" until that final order could no longer be appealed. *See Williams v. Cain*, 217 F.3d 303, 310-11 (5th Cir. 2000); and *Bradley v. School Bd. of Richmond*, 416 U.S. 696, 711 n. 14 (1974), *citing Linkletter v. Walker*, 381 U.S. 618, 622 n. 5 (1965). *Cf. Griffith v. Kentucky*, 479 U.S. 314, 326 (1987).

Finally, the Closes' mootness arguments prove too much. Were they valid, it is difficult to envision how any order in a civil case would not be moot unless the losing party obtained a stay. That is simply not the law, and the Closes cite no authority for that novel proposition. Nor would their proposed rule make sense, as it allows bankruptcy courts to *automatically* moot a host of legal issues, including all appeals from orders denying section 707(b) motion to dismiss, merely by entering a discharge immediately after entering the order denying the motion. Indeed, under that scenario, the moving party – including creditors and the Department of Justice - would not even have the opportunity to request a stay.

CONCLUSION

For these reasons, the United States Trustee respectfully asks this Court to reverse the orders entered below, and remand the case for further proceedings on the merits of the United States Trustee's motion to dismiss.

Respectfully submitted,

FELICIA S. TURNER
United States Trustee

s/ *David P. Eron*
DAVID P. ERON
Office of the United States Trustee
Department of Justice
California State Bar No. 223033
301 North Main, Suite 1150
Wichita, Kansas 67202
Telephone: 316/269-6176
Telecopier: 316/269-6182

BRIEF BANK — "SUMMARY SHEET" *Printed Tue-4/1/08 14:42*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*
In re: David Dewayne Close, Jr. and Jada Kathleen Close (UST v. David Close, et al.)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*
D. Kan.

3. ("CCN") ***CURRENT*** CASE NO.
No.: 07-CV-2076-KHV

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*
No.: 06-20195-7
Court: Bankr. Kan.
(Identify judge & cite, if any)

5. ("SO") ***SOURCE***
U.S. TRUSTEES

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*
Filed: May 21, 2007
Type: Brief of the Appellant, Felicia S. Turner, United States Trustee

7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*
David P. Eron, Melissa R. Burgess, David Levine, P. Matthew Sutko
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***

- Did the bankruptcy court err in ruling that the deadline imposed by 11 U.S.C. §704(b)(1)(A) for the UST to file a statement as to whether the Closes' case should be presumed an abuse of chapter 7 runs from the date of the meeting of creditors rather than after the conclusion of the meeting?

- Did the bankruptcy court err under Fed. R. Bankr. P. 4004(c)(1)(D) entering a discharge in this case before expiration of the UST's right to appeal the denial of her motion to dismiss, and further err in setting aside an order vacating the discharge the UST filed this appeal?

√ **Background:**

10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)

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THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF KANSAS

CASE NO. 07-CV-2076-KHV

Consolidated with
CASE NO. 07-CV-2096-KHV

IN RE: DAVID DEWAYNE CLOSE, JR. AND JADA KATHLEEN CLOSE
Debtors.

FELICIA S. TURNER, UNITED STATES TRUSTEE
Appellant,

v.

DAVID DEWAYNE CLOSE, JR. AND JADA KATHLEEN CLOSE
Appellees.

ON APPEAL FROM THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF KANSAS

THE HONORABLE ROBERT D. BERGER, PRESIDING
Bankruptcy Case No. 06-20195-7

BRIEF OF THE APPELLANT FELICIA S. TURNER, UNITED STATES TRUSTEE

Of Counsel

ROBERTA A. DeANGELIS
Acting General Counsel

P. MATTHEW SUTKO
MELISSA R. PERRY
DAVID LEVINE
Department of Justice
Executive Office for United States Trustees
20 Massachusetts Avenue, NW
Washington, D.C. 20530

FELICIA S. TURNER
United States Trustee

DAVID P. ERON
Office of the United States Trustee
Department of Justice
301 N. Main Street, Suite 1150
Wichita, KS 67202
Telephone: (316) 269-6176
Fax: (316) 269-6182

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JURISDICTIONAL STATEMENT

The United States Bankruptcy Court for the District of Kansas had jurisdiction over David and Jada Close's chapter 7 bankruptcy case under 28 U.S.C. §§ 157(a) and (b), and 1334(a). Those provisions also gave the bankruptcy court jurisdiction to decide the United States Trustee's motion to dismiss the debtors' bankruptcy case for abuse under 11 U.S.C. § 707(b).[1] The court denied the United States Trustee's motion by order entered October 19, 2006. The United States Trustee timely filed a motion to reconsider on October 27, 2006. FED. R. BANKR. P. 9023 and 9024. The bankruptcy court denied the motion to reconsider by order entered February 7, 2007. The United States Trustee timely appealed both orders under 28 U.S.C. § 158(c)(2) and Fed. R. Bankr. P. 8002(a) on February 20, 2007. FED. R. BANKR. P. 8002(b) and 9006(a).

The bankruptcy court entered another order on February 16, 2007, granting the debtors a discharge of their debts. Although that order was vacated on February 20, 2007, it was reinstated on February 21, 2007. The United States Trustee timely appealed the discharge order and the order reinstating the discharge. This Court has jurisdiction over both appeals under 28 U.S.C. § 158(a)(1).

STATEMENT OF THE ISSUES

1. Did the bankruptcy court err in ruling that the deadline imposed by 11 U.S.C. § 704(b)(1)(A) for the United States Trustee to file a statement as to whether the Closes' case should

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[1] United States Trustees are senior officials of the Department of Justice appointed by the Attorney General to supervise the administration of bankruptcy cases. 28 U.S.C. §§ 581-89; *See generally Morganstern v. Revco D.C. Inc. (In re Revco D.S., Inc.)*, 898 F.2d 498, 500 (6th Cir. 1990) (explaining that United States Trustees oversee the bankruptcy process, protect the public interest, and ensure that bankruptcy cases are conducted according to law.)

be presumed an abuse of chapter 7 runs from the date of the first session of the meeting of creditors rather than after the conclusion of the meeting?

2. Did the bankruptcy court err under Fed. R. Bankr. P. 4004(c)(1)(D) in entering a discharge in this case before expiration of the United States Trustee's right to appeal the denial of her motion to dismiss, and further err in setting aside an order vacating the discharge after the United States Trustee filed this appeal?

STANDARD OF REVIEW

Where "the issues on appeal pertain to the proper application of bankruptcy statutes and the interpretation of case law, . . . review is de novo." *In re Midkiff*, 342 F.3d 1194, 1197 (10th Cir. 2003) (citing *In re Tuttle*, 291 F.3d 1238, 1240 (10th Cir. 2002)). Whether the bankruptcy court properly interpreted the deadlines in 11 U.S.C. § 704(b) and whether the debtors should have received a discharge are issues of law subject to *de novo* review.

STATEMENT OF THE CASE

Recent amendments to the Bankruptcy Code direct each United States Trustee to review all chapter 7 bankruptcy cases to determine whether a debtor's disposable income exceeds a statutory trigger that renders his or her bankruptcy filing presumptively abusive and subject to dismissal. 11 U.S.C. §§ 704(b) and 707(b)(2). Before the bankruptcy court, Mr. and Ms. Close initially acknowledged their chapter 7 filing was presumptively abusive, although they later sought to withdraw that admission. (ROA, Doc#: 1, pg. 43.; ROA, Doc#: 25, pg. 1.) Because the Closes' case was abusive, the United States Trustee moved to dismiss it under two subsections of section 707, as a presumed abuse under section 707(b)(2) and for abuse based on the totality of the circumstances under section 707(b)(3). (ROA, Doc#: 20.) The Closes opposed the United States Trustee’s motion on the merits. (ROA, Doc#: 29.)

The Closes also argued the United States Trustee’s motion to dismiss was not timely filed under 11 U.S.C. § 704(b)(1)(A). The court below agreed and dismissed the United States Trustee’s count under section 707(b)(2) on that ground.[2] (ROA, Doc#: 40.) After denying the United States Trustee’s motion but before her time for appealing that order ran, the court below entered an order discharging the debtors of their debts, which the court withdrew, then later reentered. The United States Trustee appeals the denial of her motion to dismiss, and the orders granting these debtors a discharge of the debts they owe their creditors.

STATEMENT OF THE FACTS

A. Statutory Framework

1. Under the Bankruptcy Code, United States Trustees must file motions to dismiss certain types of chapter 7 cases within a statutorily specified number of days.

The United States Trustee is required by section 704(b) of the Bankruptcy Code to review all materials and determine if the debtor’s bankruptcy case is a presumed abuse of the provisions of chapter 7 under section 707(b)(2). If the United States Trustee’s review reveals that the debtor’s case is a presumed abuse, section 704(b)(1)(A) requires the United States Trustee to file a 10-Day Statement within 10 days “after the date of the first meeting of creditors.” 11 U.S.C. § 704(b)(1)(A). In turn, if the United States Trustee determines that a motion to dismiss under section 707(b)(2) is appropriate, the United States Trustee must file the motion within 30 days after the date of filing the 10-Day Statement. 11 U.S.C. § 704(b)(2). Accordingly, two very important deadlines regarding the

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[2] The United States Trustee withdrew the section 707(b)(3) portion of the motion to dismiss on November 1, 2006, while the motion to dismiss was still pending. (ROA, Doc#: 43; Doc#: 44.)

United States Trustee's motion to dismiss under section 707(b)(2) arise "after the date of the first meeting of creditors."

The "meeting of creditors" that triggers these deadlines is provided for by section 341 of the Bankruptcy Code, but the phrase "first meeting of creditors" does not appear in section 341. The Bankruptcy Act of 1898 that preceded the modern Bankruptcy Code, Bankruptcy Act of July 1, 1898, c. 541, ss 301-99, 30 Stat. 544 (formerly codified at 11 U.S.C. ss 701-99), repealed, Act of Nov. 6, 1978, Pub.L.No.95-598, s 401(a), 92 Stat. 2549 (hereinafter the "Bankruptcy Act") provided for a "first" meeting of creditors early in the progress of each bankruptcy case. Bankruptcy Act § 55(a). It also contained provisions for optional interim meetings after the "first meeting," and for a "final" meeting in some cases. Bankruptcy Act §§ 55(d) and (e).

The Bankruptcy Code continues to provide for one required meeting of creditors "within a reasonable time after" commencement of each case, 11 U.S.C. § 341(a), but lacks any express provisions for interim or final meetings. Section 341(c), however, continues to make reference to the possibility of a final meeting by providing that the court may not preside at any meeting commenced under section 341, "including any final meeting of creditors." 11 U.S.C. § 341(c). Bankruptcy Rules 2003(f) and (g) also provide for "special meetings" and a "final meeting" to be conducted under section 341. FED. R. BANKR. P. 2003(f), (g).

The "first meeting" under the Bankruptcy Act was designed as an occasion for creditors to meet together, establish their claims, and elect a trustee to administer a debtor's estate in bankruptcy, 3 Collier on Bankruptcy (14th ed. 1977) ¶ 55.01; *In re Vance*, 120 B.R. 181, 184 (Bankr. D. Okla. 1990). In modern bankruptcy practice, claims are usually made by filing proofs with the clerk and are determined through litigation. 11 U.S.C. §§ 501-502; FED. R. BANKR. P. 3001-3008. Although trustees may still be elected, chapter 7 trustees are now generally appointed by the United States Trustee or the court. 11 U.S.C. §§ 701, 702(d), 703(c). Therefore the "first" meeting of creditors has become less urgent and pivotal in bankruptcy administration than it once was under the old Bankruptcy Act. *Vance*, 120 B.R. at 184.

Nevertheless, the initial meeting of creditors under section 341 of the Bankruptcy Code still often is loosely referred to as the "first meeting of creditors" as a vestige of pre-Code practice under the Bankruptcy Act, and still provides an opportunity for parties in interest (the trustee, creditors, and any others) to meet with each other and to question the debtor regarding his or her financial affairs. It is still required by statute that the meeting be held, 11 U.S.C. § 341(a), and that the debtor "submit to interrogation under oath." 11 U.S.C. § 343.

In addition to the mandatory initial – or first – meeting, the Bankruptcy Court and the Bankruptcy Rules continue to recognize there may be "final" meetings or "special meetings" under section 341. 11 U.S.C. 341(a) (meeting of creditors); 341(b) (meeting of equity security holders) 341(c) (referencing "any" final meeting of creditors). *Cf. In re Duplante*, 204 B.R. 49 (Bankr. S.D. Cal. 1996) *rev'd,* 215 B.R. 444 (B.A.P. 9th Cir. 1997) (creditor did not attend the section 341 "final" meeting of creditors).

Adjournment or continuation of an initial meeting of creditors required under section 341 of the Code is governed by Bankruptcy Rule 2003(e). It provides that the meeting may "be adjourned from time to time." FED. R. BANKR. P. 2003(e).

2. The United States Trustee's duties under section 704(b)

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 37 ("BAPCPA"), became effective, in relevant part, on October 17, 2005. The Closes filed a voluntary petition under chapter 7 of the Bankruptcy Code on February 28, 2006. (ROA, Docket Report, pg. 9.) Thus, this case is governed by the BAPCPA.

The BAPCPA was the culmination of almost a decade of Congressional work to amend the 1978 Bankruptcy Code. A primary goal behind Congress' complete overhaul of the Bankruptcy Code was to ensure "that those debtors who can afford to repay some portion of their unsecured debts be required to do so... ." 151 CONG. REC. S2470 (March 10, 2005).

As it existed prior to BAPCPA, section 707(b) only authorized dismissal based on a finding that allowing the debtor relief constituted a "substantial abuse" of chapter 7. Further, section 707(b) prior to its amendment by BAPCPA required courts to presume that a debtor was entitled to relief under chapter 7 of the Bankruptcy Code. Section 707(b) now authorizes dismissal where the court finds that the granting of relief would be an "abuse" of chapter 7. As amended by the BAPCPA, section 707(b)(2) repealed the former presumption and replaced it with a new presumption: a case is an "abuse" of chapter 7 if a detailed mathematical formula set out in the statute, commonly referred to as the "means test," yields a minimum amount of monthly disposable income.

The means test uses a series of calculations to determine whether the section 707(b)(2) presumption of abuse arises. *See* 11 U.S.C. § 707(b)(2)(A). Specifically, the means test calculates a debtor's current monthly income, as defined under 11 U.S.C. § 101(10A) (hereafter "CMI"), based on the debtor's average income for the six calendar months preceding the month of the bankruptcy filing. If the debtor's CMI is above the applicable state median family income, as is the case here, 11 U.S.C. § 707(b)(2)(A) calculates the debtor's monthly disposable income available to repay creditors by reducing the CMI by certain expenses.

If a debtor's monthly disposable income, calculated by reducing the CMI by allowed expenses, is less than $100 per month (or $6,000 over 60 months), the presumption of abuse does not arise. 11 U.S.C. § 707(b)(2)(A).[3] If the debtor's monthly disposable income is equal to or exceeds $167 per month (or $10,000 over 60 months), the presumption of abuse does arise. *Id.* If the debtor's monthly disposable income is between $100 and $167 per month (between $6,000 and $10,000 over 60 months), the presumption of abuse arises if the disposable income, over 60 months, is sufficient to pay 25 percent of the debtor's nonpriority unsecured debt. *Id.*

If the presumption of abuse arises under section 707(b)(2) based on the means test, the debtor may attempt to rebut the presumption under 11 U.S.C. § 707(b)(2)(B) by demonstrating special circumstances that justify income or expense adjustments for which there is no reasonable alternative.

Each debtor with primarily consumer debts is required to file, in conjunction with his or her bankruptcy schedules and statement of financial affairs, a Statement of Current Monthly Income and Means Test Calculation, Official Form 22A of the Federal Rules of Bankruptcy Procedure ("Form 22A").[4] 11 U.S.C. § 521 and § 707(b)(2)(C). In chapter 7 cases the main purpose of the Form 22A is to calculate monthly disposable income (ability to pay) following the formula set forth in 11 U.S.C. § 707(b)(2), and determine whether the presumption of abuse arises.

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3 Under 11 U.S.C. § 104, the dollar amounts set forth in Title 11 and applicable to the threshold amounts for determining when the presumption of abuse arises under the means test were adjusted based on the consumer price index for cases filed on or after April 1, 2007. This case is not subject to the dollar amount adjustments

4 The Form was known as "B22A" at the time the Closes filed this case. We will use the current form name "22A" throughout.

Congress charged the United States Trustee with analyzing Official Form 22A and the other materials filed by debtors for the purpose of enforcing the provisions of section 707(b)(2). Section 704(b)(1)(A) requires the United States Trustee to review all materials filed by the debtor and then file a statement with the bankruptcy court as to whether the debtor's case should be presumed to be an abuse (the "10-Day Statement"). The 10-Day Statement must be filed by the United States Trustee "not later than 10 days *after the date of the first meeting of creditors*." 11 U.S.C. § 704(b)(1)(A) (emphasis added). If the presumption arises, as it did here, section 704(b)(2) requires the United States Trustee to file either a motion to dismiss or a statement indicating why the United States Trustee does not believe that a motion to dismiss is appropriate "not later than 30 days after the date of filing" the 10-Day Statement. 11 U.S.C. § 704(b)(2).

B. Case History

1. Mr. and Mrs. Closes' bankruptcy filing

The Closes filed their chapter 7 petition commencing this bankruptcy case on February 28, 2006. (ROA, Doc#: 1.) Mr. and Mrs. Close filed an Official Form 22A with their petition, which reflected that they had monthly disposable income of $192.96, or $11,577.60 over sixty months. (ROA, Doc#: 1, pg. 47.) Because that amount of disposable income creates a presumption of abuse under section 707(b)(2), Mr. and Mrs. Close checked the box at the top of their Official Form 22A that states, "The presumption arises." (ROA, Doc#: 1, pg. 43.)

Along with their bankruptcy petition, the Closes filed pay stubs for only two months prior to filing. (ROA, Doc#: 4, pg. 1-8.) Because section 101(10A) defines CMI as income received in the six months prior to filing, the United States Trustee could not verify the CMI reported on the Closes' means test form. Further, the United States Trustee identified certain expenses that Mr. and Mrs.

Close might have been entitled to deduct from their CMI but may have omitted on their Form 22A, including medical and dental insurance expenses. (ROA, Doc#: 1, pg. 28, 43, 46.)

The United States Trustee sent a letter to Mr. and Mrs. Close's attorney on March 14, 2006 requesting, among other things, pay stubs for the full six-month CMI period and inquiring about any health insurance expenses that may have been omitted as deductions on their Official Form 22A. (ROA, Doc#: 37, second part, pg. 1-2; Doc#: 39, pg. 2.) The letter requested a response no later than March 29, 2006, as required by D. Kan. LBR 4002.2(a). (ROA, Doc#: 37, second part, pg. 2.) The Closes' attorney received the United States Trustee's letter on March 17, 2006, (ROA, Doc#: 36, pg. 4) but did not respond prior to the beginning of the Closes' meeting of creditors.

2. The Meeting of Creditors required under section 341 of the Code took place on March 30 and April 27, 2006.

The meeting of the Closes' creditors under section 341 of the Bankruptcy Code was noticed for March 30, 2006. That was one day after the March 29 date by which the Closes' counsel had been asked to turn over additional documentary information to the United States Trustee for use in evaluating the debtors' bankruptcy case. (ROA, Doc#: 39, pg. 2.) Because the Closes did not provide that information as of March 29, 2006, the United States Trustee asked the chapter 7 trustee to adjourn the March 30 meeting in order to give Mr. and Mrs. Close additional time to produce the requested information and documentation. (ROA, Doc#: 36, pg. 4; Doc#: 39, pg. 2.) When the Closes appeared at the section 341 meeting on March 30, 2006, the chapter 7 trustee informed them that the meeting was being adjourned because they had not yet provided the information requested by the United States Trustee for use at that meeting. (ROA, Doc#: 36, pg. 4.) The chapter 7 trustee examined Debtors under oath on March 30, 2006. (ROA, Doc#: 29, pg. 2.)

By letter dated March 30, 2006, Mr. and Mrs. Close's attorney responded to the United States Trustee's March 14, 2006 letter. (ROA, Doc#: 36, pg. 4; Doc#: 37, third part, pg. 1.) The response did not attach the six months of pay stubs requested by the United States Trustee. (ROA, Doc#: 36, pg. 4.) Although the Closes indicated that they had health insurance, they did not indicate how much they paid for their insurance premiums and did not provide any documentation related to their health insurance that could substantiate an additional deduction. (ROA, Doc#: 35, pg. 2.) The United States Trustee subsequently left two telephone messages with the Closes' counsel to request the missing information and documentation. (ROA, Doc#: 35, pg. 2.) Mr. and Mrs. Close's counsel did not return either phone call. (ROA, Doc#: 35, pg. 2.)

The section 341 meeting of creditors was concluded on April 27, 2006, without appearance by the Closes or their attorney. (ROA, Doc#: 15.)

3. The United States Trustee seeks dismissal of the Closes' bankruptcy case.

Two business days after the section 341 meeting of creditors – on May 1, 2006 – the United States Trustee filed a Statement, under section 704(b)(1), that a presumption of abuse arose in the Close's bankruptcy case. (ROA, Docket Report, pg. 7.) On May 30, 2006, the United States Trustee moved to dismiss their case under two subsections of 707(b) of the Code, subsections 707(b)(2) and (b)(3).(ROA,Doc#:19.)

On June 20, 2006, three weeks after the United States Trustee filed her motion to dismiss, the Closes filed an amended Official Form 22A and indicated on the amended Form 22A that the presumption of abuse did not arise. (ROA, Doc#: 25, pg. 1.) The amended Form 22A reflected reduced income for Mr. Close. (ROA, Doc#: 25, p. . 1; Doc#: 29, pg. 2-4.) The Closes did not attach documentation to support any of the amendments, nor did they provide the United States

Trustee with the six months of pay stubs to verify their current monthly income that the United States Trustee had requested in her March 14 letter. (ROA, Doc#: 29; Doc#: 35, pg. 2; Doc#: 36, pg. 4; Doc#: 42, Transcript, pg. 10, ln. 7-12.) Mr. and Mrs. Close filed a Response to United States Trustee's motion to dismiss on July 5, 2006. In their Response, the Closes asserted, *inter alia*, that the United States Trustee's motion to dismiss was time-barred by section 704(b)(1)(A) because the 10-Day Statement was filed within ten days of the conclusion of the meeting of creditors instead of the first date of the meeting.

C. Procedural History Leading to this Appeal

By opposition filed July 5, 2006, Mr. and Mrs. Close argued that the United States Trustee's motion to dismiss their case as a presumed abuse of chapter 7 had not been timely filed. They claimed that section 704(b)(1)(A) required the United States Trustee to file the 10-Day Statement within 10 days of the first date of the first meeting of creditors, rather than within 10 days after the meeting of creditors was concluded. (ROA, Doc#: 29, pg. 5-7.) The bankruptcy court heard oral argument on the timeliness issue on September 20, 2006, after which the bankruptcy court took the matter under advisement. (ROA, Docket Sheet, pg. 4.)

On October 19, 2006, the Bankruptcy Court entered an order denying in part the United States Trustee's motion to dismiss; it concluded that the portion of the motion based upon the presumption of abuse under 11 U.S.C. § 707(b)(2) was time-barred. (ROA, Doc#: 40.) The United States Trustee filed a Motion to Reconsider the order on October 27, 2006, thus extending the time for filing this appeal under Fed. R. Bankr. P. 8002(b). (ROA, Doc#: 41.) While the motion to reconsider was pending, the United States Trustee withdrew the remaining portion of her motion to dismiss, which had sought dismissal under section 707(b)(3). (ROA, Doc#: 43; Doc#: 44.) The bankruptcy court denied the United States Trustee's motion to reconsider on February 7, 2007. (ROA, Doc#: 47.) Because the ten-day deadline for filing her appeal fell on a weekend, the United States Trustee filed this appeal on the next business day, February 20, 2007. (ROA, Doc#: 51.)

Just prior to the expiration of the deadline for the United States Trustee to file her appeal, on February 16, 2007, the bankruptcy court entered its Order Discharging Debtor. (ROA, Doc#: 49.) On the next business day, February 20, 2007, the court vacated that order. (ROA, Doc#: 53.) However, the following day the court entered an Order Setting Aside Order Vacating Discharge Order. (ROA, Doc#: 54.) Thus, Mr. and Mrs. Close have now received a discharge. The United States Trustee filed a notice of appeal from **(a)** the order discharging the debtor and **(b)** the order setting aside the order vacating the discharge order on February 26, 2007. (ROA, Doc#: 55.) The two appeals were consolidated by this Court on April 9, 2007.

SUMMARY OF THE ARGUMENT

1. The bankruptcy court denied the United States Trustee's motion to dismiss these debtors' chapter 7 bankruptcy case under 11 U.S.C. § 707(b)(2) on the ground that the United States Trustee's motion was filed beyond the deadline set forth in 11 U.S.C. § 704(b)(1)(A). The bankruptcy court erroneously interpreted section 704(b)(1)(A) of the Code to mean a United States Trustee must file a 10-Day Statement within 10 days after the beginning of the initial session of the 11 U.S.C. § 341meeting of creditors in order for it to be timely filed. If this were what the statute actually required, that would be one thing. But this is at odds with the statute's text and is not the way bankruptcy courts and practitioners commonly use the phrase "first meeting of creditors" in the context of bankruptcy cases. Rather, in the bankruptcy context, the phrase "first meeting of creditors" is a vestige remaining from pre-Bankruptcy Code practice under the Bankruptcy Act, which expressly provided for a "first" meeting. The phrase is now used simply to distinguish the initial required meeting of creditors from any subsequent meetings that the trustee may call under section 341 of the Code. 11 U.S.C. § 341(c); FED. R. BANKR. P. 2003(f) and (g). The Code, the Bankruptcy Rules and case law all recognize that the "first meeting" of creditors may, as here, occur on more than one date. *See* 11 U.S.C. § 341(d); FED. R. BANKR. P. 2003(e); *In re Bernard*, 40 F.3d 1028, 1031 (9th Cir. 1994); *In re Cherry*, 341 B.R. 581 (Bankr. S.D. Tex. 2006) (when a creditor's meeting is not concluded, it is "adjourned to a date announced at the meeting and each of those sessions is part of the meeting until it is announced that it is concluded.")

The bankruptcy court's interpretation fails to adhere to the Bankruptcy Code's Rule of Construction set out in 11 U.S.C. § 102(7), which mandates that the word "date" in section 704(b)(1)(A) must be read to include all of the "*dates*" on which an adjourned section 341 meeting is held. 11 U.S.C. § 102(7). The United States Trustee filed her 10-Day Statement in this case on May 1, 2006, within 10 days "after" the last of these *dates*. Therefore, she timely filed her 10-Day Statement under section 704(b)(1)(A).

The bankruptcy court's reading further fails to recognize the express requirement in section 704(b)(1)(A) that the 10-Day Statement must be filed "after" the required meeting of creditors is held. An adjourned meeting, like the one adjourned here, may encompass more than one date and section 704(b)(1)(A), read in compliance with section 102(7)'s rules of construction, requires that all *dates* of the meeting be accounted for. Accordingly, the United States Trustee's reading is the only interpretation that takes into account all of the important statutory language.

The bankruptcy court's reading of section 704(b)(1)(A) also frustrates the United States Trustee's statutory duty to enforce the goals of the BAPCPA amendments and harms debtors.

Allowing the United States Trustee 10 days after the conclusion of the section 341 meeting to review the debtor's material, including material produced at the section 341 meeting, ensures that the United States Trustee can make an informed decision regarding whether the debtor's case is presumptively abusive. The bankruptcy court's ruling needlessly truncates the review process and rewards debtors who fail to provide full disclosure. Moreover, requiring the United States Trustee to file 10-Day Statements and motions to dismiss before all of the information is reviewed will harm debtors by requiring them to defend against dismissal motions, the filing of which could have been prevented by allowing debtors time to provide necessary information.

2. The bankruptcy court's orders granting the Closes a discharge and then reinstating their discharge should also be reversed. The first order was entered before the United States Trustee's deadline to appeal the denial of her motion to dismiss had expired. The second order was entered after she had filed this appeal. Interim Fed. R. Bankr. P. 4004(c)(1) prohibits the bankruptcy court from entering a discharge while a motion to dismiss under section 707(b) is pending. "Pending" includes any motion to dismiss where an order has been entered, but the order has not become final. *Williams v. Cain*, 217 F.3d 303, 310-11 (5th Cir. 2000). Therefore, the bankruptcy court should not have entered the discharge.

ARGUMENT

A. The Bankruptcy Court's Interpretation of Section 704(b)(1)(A) Fails to Give Meaning to All Words of the Statute.

The bankruptcy court's order denying the United States Trustee's motion to dismiss the Close's case fails to give meaning to all parts of section 704(b)(1)(A) and should be reversed. The bankruptcy court's ruling would impose on the United States Trustee a duty not required by the statute to file the 10-Day Statement before all dates of the first meeting of creditors have occurred.

This misreads the Bankruptcy Code and would permit abusive debtors to evade the means test simply by dragging their feet and refusing to provide information critical to the United States Trustee's analysis of presumed abuse.

In this case, the court below failed to adhere to the language of section 704(b)(1)(A) in three respects. **First**, the bankruptcy court failed to adopt a contextually accurate interpretation of the phrase "first meeting of creditors" in section 704(b)(1)(A). **Second**, the bankruptcy court failed to read section 704(b)(1)(A) in conjunction with rules of construction set forth in section 102(7) of the Code, which provides that the word "date" in section 704(b)(1)(A) must include the plural "dates," and therefore includes *all* dates of the meeting. **Third**, the court below failed to give meaning to the language of section 704(b)(1)(A), which provides that the United States Trustee's 10-Day Statement shall be filed *after* the dates of the section 341 meeting. The court's reading is at odds with the plain text of the statute because it would effectively require the United States Trustee to file the 10-Day statement *during*, and not after, the required meeting of creditors.

1. The bankruptcy court's interpretation of "first meeting of creditors" is contextually inaccurate.

Although the court below held that the word "first" in "first meeting of creditors" refers to the *first date* of the meeting (ROA, Doc#: 40, pg. 5), such a reading is untenable. Statutory words must be construed in context. *Hibbs v. Winn*, 542 U.S. 88, 101 (2004). In the bankruptcy context, the term "first meeting of creditors" in section 704(b)(1)(A) echoes practice under the pre-Code Bankruptcy Act, and distinguishes the first meeting held under section 341 of the Code from any special or final meetings that may be called by the trustee under section 341 and Fed. R. Bankr. P. 2003. It does not refer to the first *date* of that meeting, as the bankruptcy court erroneously held.

The "meeting of creditors" refers to 11 U.S.C. § 341, which states, "[w]ithin a reasonable time after the order for relief . . ., the United States trustee shall convene and preside at a meeting of creditors." 11 U.S.C. § 341(a). The Federal Rules of Bankruptcy Procedure require the "meeting of creditors" under this section to be convened between 20 and 40 days after the case is filed. FED. R. BANKR. P. 2003(a). However, section 341 explicitly contemplates the possibility that the trustee may, but is not required to, call additional meetings of creditors. 11 U.S.C. § 341(c) (prohibiting the bankruptcy court from presiding at or attending "*any* meeting under this section including *any final* meeting of creditors.") (Emphasis added.) This is consistent with the Bankruptcy Rules, which allow the United States Trustee to call a "special meeting of creditors" or a "final meeting of creditors." 11 U.S.C. § 341(a), (b) and (c); FED. R. BANKR. P. 2003(f) and (g). Importantly, this is also consistent with widespread practice under the Bankruptcy Act, which expressly provided for a "first" meeting of creditors early in the progress of each bankruptcy case, as well as optional interim meetings and a "final" meeting in some cases. Bankruptcy Act §§ 55(a), (d) and (e).

Since there may be more than one type of "meeting of creditors," Congress likely continued use of the pre-Code term "first meeting" in section 704(b)(1)(A) to specify that the deadline to file a 10-Day Statement runs from "after" the end of the initial meeting of creditors required by section 341(a), rather than the other special or final meetings that may be held under section 341.

This is consistent with the way bankruptcy courts interpret the phrase. They frequently use the pre-Code phrase "first meeting of creditors" when referring to adjourned sessions of the required meeting convened under section 341, even though the word "first" does not appear anywhere in section 341 of the Code. *In re Burrell*, 289 B.R. 109, 110, 112 (Bankr. C.D. Ill. 2002)(referring to the "first" meeting of creditors as being resumed on a date other than that on which it was commenced); *In re Lake States Commodities, Inc.*, 173 B.R. 642, 644 (Bankr. N.D. Ill. 1994)(same); *In re Grand Jury Proceedings*, 497 F. Supp. 979, 980 (E.D. Pa. 1980) (same). *See also, In re Spenler*, 212 B.R. 625, 627 (B.A.P. 9th Cir. 1997)("first" meeting of creditors concluded on date different than commencement); and *In re Young*, 1 B.R. 387, 389 (Bankr. M.D. Tenn. 1979)(same).

Although it was express under the Bankruptcy Act, the term "first meeting of creditors" did not appear in the Bankruptcy Code until the BAPCPA amendments. One other reference in the current Code to the "first meeting of creditors" is found in § 521(e)(2). There, the new BAPCPA provision requires a debtor to provide the chapter 7 trustee with a copy of the tax return for the most recent tax year "no later than 7 days before the date first set for the first meeting of creditors." If "first meeting of creditors" really means the "first date" of the meeting of creditors, as the bankruptcy court concluded, then the usage of both terms in section 521(e)(2) would be redundant. *See Gustafson v. Alloyd Co.*, 513 U.S. 561, 574 (1995) (Court avoids interpreting statutes in a way that "renders some words altogether redundant.")

In the Closes' case, there were two sessions of the required section 341 meeting. The first took place on March 30 and the second on April 27. But they were part of a single event because the meeting of creditors was suspended on March 30, 2006 and was not concluded until April 27, 2007.

The Bankruptcy Rules underscore that it is one meeting because they also provide that the meeting "may be adjourned from time to time" and so may encompass more than one day. Fed. R. Bankr. Proc. 2003(e). The Ninth Circuit has also recognized that Rule 2003(e) contemplates that the "first meeting" under section 341 "can't always be completed in one session. It thus authorizes the trustee to adjourn the meeting 'to enable the debtor to give additional testimony or to enable creditors to conduct additional examination.'" *In re Bernard*, 40 F.3d 1028, 1031 (9th Cir. 1994) (rejecting argument that deadline under Rule 4003(b) for trustee or creditor to object to list of property claimed as exempt begins to run from date of "first session" of sec. 341 meeting and holding that time begins to run from date of "conclusion" of sec. 341 meeting); *see also In re Cherry*, 341 B.R. 581 (Bankr. S.D. Tex. 2006) (when a creditor's meeting is not concluded, it is "adjourned to a date announced at the meeting and each of those sessions is part of the meeting until it is announced that it is concluded.") Therefore, the "first" meeting of creditors referred to in section 704(b)(1)(A) does not refer to an event that has a single date, but rather one event that may occur on multiple dates.

2. The Bankruptcy Code's rules of statutory construction require courts to interpret section 704(b)(1)(A) to include all *dates* of the section 341 meeting of creditors.

Reading section 341 as authorizing a single initial meeting to transcend several dates draws substantial support from the rules of construction Congress mandated be used when interpreting the Bankruptcy Code. See 11 U.S.C. § 102(7) ("Rules of Construction"). One of those rules is found in section 102(7) of the Bankruptcy Code. It provides that "In this title– . . . the singular includes the plural." 11 U.S.C. § 102(7). Section 102(7) thus requires courts to read section 704(b)(1)(A) as follows:

> **the United States trustee . . . shall . . ., not later than 10 days after the *dates* of the first meeting of creditors, file with the court a statement as to whether the debtor's case would be presumed to be an abuse under section 707(b) . . .**

When properly construed in accordance with this section, the plain language of section 704(b)(1)(A) necessarily allows for the first meeting of creditors to occur on more than one date.

The legislative history to section 102(7) supports this reading. This legislative history provides that:

> Paragraph (7) specified that the singular includes the plural. The plural, however, generally does not include the singular. *The bill uses only the singular, even when the item in question most often is found in plural quantities, in order to avoid the confusion possible if both rules of construction applied*. When an item is specified in the plural, the plural is intended.

House Report No. 95-595, 95th Cong. 1st Sess. (1977) 316; Senate Report No. 95-989, 95th Cong., 2nd Sess. (1978) (italics added). Section 102(7) is also routinely applied by courts interpreting the Bankruptcy Code to read singular terms as including the plural, even though the plural is not specifically enumerated in the Code. For example, in *Universal Church v. Geltzer*, 463 F.3d 218, 223 (2nd Cir. 2006), the Second Circuit construed the term "transfer" in section 548(a)(2)[5] to include multiple "transfers" of charitable contributions. *Id.* (holding that section 102(7) is a "significant provision of the Bankruptcy Code"); *see also In re Hailes*, 77 F.3d 873, 875 (5th Cir. 1996) ("transfer" in section 547(c)(8) means "more than one transfer"); *In re Maus,* 282 B.R. 836, 840 (Bankr. N.D. Ohio 2002) (same).

Such construction is in harmony with section 341, which provides that "*Prior to the conclusion* of the meeting of creditors . . ., the trustee shall orally examine the debtor . . . ." 11 U.S.C. § 341(d). (Emphasis added.) In other words, if the trustee is not able to conduct a complete oral examination of the debtor on the date that the required meeting is convened, the required meeting must be adjourned and concluded on a different day. *See also* FED. R. BANKR. P. 2003(e).

Because the "first" meeting of creditors began on March 30, 2006 but was suspended until, and concluded on, April 27, 2006, the United States Trustee had 10 days from all of the **dates** of the

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[5] Section 548(a)(2) provides that the "transfer of a charitable contribution to a qualified religious or charitable entity or organization shall not be considered to be a transfer covered under paragraph (1)(B)...."

meeting, and not simply from the first session of the meeting, to comply with section 704. Accordingly, when section 704(b)(2)(A) is read in accordance with section 102(7), the bankruptcy court's holding must be reversed.

3. Section 704(b)(1)(A) requires the United States Trustee to file the 10-Day Statement *after* the meeting of creditors, not *during* the meeting.

The bankruptcy court concluded that the United States Trustee's deadline under section 704(b)(1)(A) to file the 10-Day Statement began to run as of the first session of the section 341 meeting of creditors on March 30, 2006, rather than after the last session on April 27, 2006. This conflicts with the statute's requirement that the 10-Day Statement be filed "after" the meeting. If the United States Trustee were required to file her 10-Day Statement within 10 days of the initial session of the required creditors' meeting in this case, it would have been due on April 10, 17 days before the conclusion of the meeting.[6] Nothing in section 704(b)(1)(A) requires that a 10-Day statement must be filed "during" the meeting, or at any time other than "after" the meeting. Accordingly, the bankruptcy court's ruling below imposes an additional burden on the United States Trustee that is not required by, and expressly conflicts with, section 704(b)(1)(A).

The Bankruptcy Code does not define the phrase "after the meeting of creditors," nor has the United States Trustee identified any Supreme Court decision that defines what the term "after" means. Where, as here, a statutory term is undefined, a basic principle of statutory construction provides that courts should give such terms their ordinary meanings. *E.g.*, *Smith v. U.S.*, 508 U.S. 223, 228 (1993) ("when a word is not defined by statute, we normally construe it in accordance with its ordinary or natural meaning.") The dictionary defines "after" to mean "subsequent in time to; at a

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[6] Ten days from March 30, 2007 was April 9, 2006. Since this date was a Sunday, the deadline would be the next business day, April 10, 2006.

later time than." *American Heritage Dictionary of the English Language* (4th ed. 2000). Accordingly, the same meaning should be imparted to the phrase "after the meeting of creditors" in section 704(b)(1)(A) absent clear indication that Congress meant to give such phrase a different meaning. *See Biodiversity Legal Found. V. Babbitt*, 146 F.3d 1249, 1254 (10th Cir. 1998) (noting that where Congress does not explain the specific meaning of a statutory phrase or term, a court may assume Congress intended the words to be given their ordinary meaning and determine such meaning through the use of dictionaries).

The bankruptcy court's decision is at odds with this ordinary, common sense definition because it effectively required the United States Trustee to file a 10-Day Statement on or before April 10, 2006, which was *during* the first meeting of creditors rather than *after* the meeting because the meeting was concluded on April 27. Bankruptcy Rule 2003(e) specifically provides that the trustee may *adjourn* the meeting from time to time, which plainly means that the meeting might not be completed on the day it begins.[7] Because the deadline runs after all *dates* of the first meeting under section 102(7), the only reading of section 704(b)(1)(A) that comports with the plain language is that the 10-Day Statement must be filed *after the meeting has concluded*, and not before.

The legislative history for section 704 strongly supports this conclusion, stating that the United States Trustee must file the 10-Day Statement "within ten days following the meeting of creditors held pursuant to section 341 of the Bankruptcy Code . . . ." House Report No. 109-31, Pt. 1, 109th Cong., 1st Sess. 52 (2005). The reference to the section 341 meeting of creditors being "held" indicates that the meeting of creditors has been concluded. *Cf. In re Stewart*, 2006 WL

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[7] According to the *American Heritage Dictionary of the English Language*, the word "adjourned" means "to suspend proceedings to another time or place." *American Heritage Dictionary of the English Language* (4th ed 2000).

4043319, 4 (Bankr. E.D. Va. 2006)(holding that deadline in Virginia statute that ran from the date that the section 341 meeting is "held" meant the conclusion of the meeting, not the first day on which the meeting was commenced), and *In re Shelton*, 343 B.R. 545 (Bankr. W.D. Va. 2006)(same). *See also* 6 Collier on Bankruptcy ¶704.17[1], p. 704-36 to 704-37 (rev. 15th ed. 2006)(stating that the "first meeting of creditors" refers to section 341(a) meeting of creditors and that reading the deadline as running from the conclusion of the meeting of creditors makes the most logical sense.)

In fact, two bankruptcy courts have recently held that the bankruptcy court's reasoning below was flawed, and the deadline in section 704(b)(1)(A) begins to run from the *conclusion* of the meeting of creditors. *See In re Williams,* Case No. 06-20116, slip op. at p. 3 (Bankr. S.D. Tex. May 14, 2007) (unpublished)[8] (on reconsideration, court held that *In re Close* was incorrectly decided and "the deadline for filing a presumption of abuse statement runs from the conclusion of the first meeting of creditors.") *See also In re Sloan*, Case No. 06-11490, slip op. at p. 4 (Bankr. W.D. Okla. Feb. 6, 2007) (unpublished) (disagreeing with the holding of *In re Close* and holding that Congress did not intend for the United States Trustee to be bound to file the 10-Day Statement within 10 days of the first date set for the section 341 meeting of creditors).[9] *But see In re Cline*, Case No. 06-25495, slip op. at 1 (Bankr. E.D. Wis. Mar. 26, 2007)(unpublished; currently on appeal) (holding 10-Day Statement must be filed within 10 days after the *date first set* for the section 341 meeting).

Here, there is no dispute that the meeting of creditors was suspended on March 30, 2006 and was concluded on April 27, 2006. The United States Trustee filed her 10-Day Statement on May 1, 2006, less than ten days after the conclusion of the meeting of creditors. She filed her motion to

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8 A copy of this opinion is attached hereto for the Court's convenience, in accordance with Fed. R. App. Proc. 32.1.

dismiss on May 30, 2006, within the deadline provided by section 704(b)(2). Therefore, the United States Trustee timely filed her motion to dismiss and the bankruptcy court's order denying the motion to dismiss as untimely should be reversed.

B. The Bankruptcy Court's Interpretation of Section 704(b)(1)(A) Would Require United States Trustees to File Motions Before Section 341 Meetings are Completed – Something that Would Benefit No One.

The required meeting under section 341 is an important investigative tool. It is designed to allow creditors and the trustee to confront the debtor face-to-face and inquire about his or her financial condition, the existence and location of assets, the condition of collateral and other matters bearing on the debtor's right to bankruptcy relief. *See* Ronald W. Goss, *Meetings of Creditors Under Section 341 of the Bankruptcy Code: A* Primer, 17 J. Contemp. L. at 1 (1991). The United States Trustee Program brought this appeal because prompt resolution of the recurring legal issue of when the United States Trustee is required to file her 10-Day Statement will benefit debtors, creditors, the Program, and the lower courts. The issue of whether the United States Trustee is time-barred from filing motions to dismiss under section 707(b)(2) if the statement required under section 704(b)(1) is filed after the *conclusion* of the meeting of creditors is of the utmost importance because the BAPCPA requires United States Trustees to conduct a means test analysis and determine whether the presumption of abuse arises for *every* chapter 7 debtor.

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9 A copy of this opinion is attached hereto for the Court's convenience, in accordance with Fed. R. App. Proc. 32.1.

The BAPCPA requires every United States Trustee to file a motion to dismiss every chapter 7 case in which the means test yields a calculation that specifies debtors can pay at least $10,000 over five years. 11 U.S.C. § 704(b)(2).[10] Prior to filing motions to dismiss, section 704(b)(1)(A) also requires the United States Trustee to file a statement as to whether the debtor's case should be presumed abusive for every chapter 7 debtor who can repay at least this amount. The United States Trustee would violate that statutory charge if she did not determine whether the Closes' monthly disposable income is more than $167 under the means test, or if she were to fail to move to dismiss their case once she concludes it exceeds $167.

Interpreting the ten day deadline as running from the date on which the section 341 meeting of creditors is initially convened will impair the United States Trustee's ability to conduct a thorough review of the materials filed by the debtor, as well as documents and information that support the materials filed by the debtor. If the debtor does not provide the requested information, whether because of willful intent or inability, the United States Trustee's review is restricted to only that information provided by the deadline.

In cases where the chapter 7 trustee discovers information that indicates abuse during the section 341 meeting, unless the meeting is held and concluded on the very same day, the bankruptcy court's interpretation may result in the United States Trustee being time-barred from pursuing a case as an abuse before it can reasonably even be discovered. This cannot be the best or most sensible reading of section 704(b)(1)(A). *See Williams*, *supra* p. 22, slip op. at 3 (holding that deadline for United States Trustee to file 10-Day Statement runs from the conclusion of the meeting off creditors because "Congress clearly did not intend" to allow debtors to simply drag their feet in providing

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10 Unless the debtor convinces the United States Trustee that the filing of a motion to dismiss is not appropriate,

information necessary for the United States Trustee to evaluate bankruptcy cases and thereby avoid the presumption of abuse.)

The significance of the timing of the United States Trustee's statutory responsibility to identify and seek dismissal of cases deemed abusive under the means test takes sharp focus when one reflects that more than 833,000 chapter 7 bankruptcy cases were filed in 2006. *Marrama v. Citizens Bank of Massachusetts*, 127 S. Ct. 1105, 1111, n. 10 (2007). In each such chapter 7 case, the Bankruptcy Code specifically requires the United States Trustee to review all materials filed in every non-business chapter 7 case to determine whether a presumption of abuse arises under section 707(b)(2)'s means test and to file a statement as to whether the case is a presumed abuse prior to moving to dismiss.

The bankruptcy court's reading of section 704(b)(1)(A) also has the potential to harm debtors by depriving them of time to provide necessary information to the United States Trustee and subjecting them to motions to dismiss that could be avoided if they had enough time to provide this information. Under the BAPCPA, a debtor must file schedules and statements with the bankruptcy court reflecting assets, liabilities, income, expenses, and financial affairs. 11 U.S.C. §521(a)(1). However, these schedules and statements need not be filed with the bankruptcy petition. Instead, a debtor may wait until 15 days after filing for bankruptcy before filing these materials. FED. R. BANKR. P. 1007(c). Many cases are filed without the required schedules and statements, especially by the most vulnerable debtors, including those without counsel. At times, debtors will seek court authority for additional time to file schedules and statements (including Official Form 22A) because of circumstances that prevent filing within the 15 day deadline. Moreover, the bankruptcy court may

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something that did not happen in this case. 11 U.S.C. § 707(b)(2).

authorize additional time to file the schedules and statements "for cause shown." INTERIM FED. R. BANKR. P. 1007(c).

Since the granting of additional time for debtors to provide documentation is explicitly authorized by the Bankruptcy Rules, and permitted by section 521, it should not represent a *per se* abuse of the bankruptcy system to obtain such an extension. If the bankruptcy court's reasoning is allowed to stand, the United States Trustee would be forced to oppose requests for extensions of the filing deadlines and/or move under section 707(a) to dismiss chapter 7 cases where the debtors do not file their schedules and statements soon after filing. This would effectively pit the Congressional mandate of section 704(b)(1)(A) against the permissiveness of section 521(a)(1)(B) and Interim Fed. R. Bankr. P. 1007(c). Further, it would penalize the unfortunate debtor who has legitimate need of additional time to file the required materials.

The bankruptcy court's ruling would also reward debtors who fail to provide full disclosure within 10-days of the convening of the meeting of creditors. *See Bernard*, 40 F.3d at 1031 (starting the period for objecting to a debtor's claimed exemptions after the initial session of the section 341 meeting instead of conclusion of the meeting "would create perverse incentives for debtors to withhold information"); *Williams, supra* p. 22, slip op. at 3 (to hold otherwise would allow debtors to "simply drag their feet" and avoid presumption of abuse, which Congress "clearly did not intend".) If the United States Trustee cannot pursue the presumption of abuse because the debtor refuses or is unwilling to provide information, the result of a debtor's failure to disclose under the bankruptcy court's ruling would be that the debtor is entitled to chapter 7 relief. Accordingly, the bankruptcy court's interpretation of section 704(b)(1)(A) should be rejected because it would frustrate the United States Trustee's duties under the Code in preventing abuse of the bankruptcy system and would cause harm to debtors.

C. The Court Should Order the Bankruptcy Court to Vacate the Order Granting Discharge.

On February 16, 2007, the bankruptcy court entered an order granting the Closes a discharge of their debts. (ROA, Doc#: 49.) On February 20, 2007, the bankruptcy court vacated that order. (ROA, Doc#: 53.) That same day, the United Sates Trustee filed her notice of appeal. (ROA, Doc#: 51.) The next day, February 21, 2007, the bankruptcy court entered an order setting aside its prior order vacating the Closes' discharge. (ROA, Doc#: 54.) The February 21 order is void because the bankruptcy court lacked jurisdiction to enter it after the United States Trustee filed her notice of appeal.

Once a notice of appeal is filed from a final judgment, the district court is divested of jurisdiction concerning the issues on appeal. *Walker v. City of Orem*, 451 F.3d 1139, 1146 (10th Cir. 2006) *citing Griggs v. Provident Consumer Disc. Co.*, 459 U.S. 56, 58 (1982). This rule applies with equal force to final orders issued by a bankruptcy court. *In re Visioneering Construction*, 661 F.2d 119, 123 n.6 (9th Cir. 1981). An order entered in violation of this rule, without jurisdiction, is void. *In re Padilla*, 222 F.3d 1184, 1190 (9th Cir. 2000). Applying *Orem* and *Griggs*, the bankruptcy court's February 21, 2007, order granting the Closes a discharge was improper because it relates to the same issues involved in the February 20, 2007 appeal taken by the United States Trustee – *i.e.*, whether the Closes should receive a discharge of their debts. For that reason, the discharge must be vacated

Even if the original February 16 discharge order controlled, it too was improper. Under the Bankruptcy Code and Rules, debtors do not receive discharges under section 727 while motions to dismiss under section 707(b) are pending, as provided in Interim Fed. R. Bankr. P. 1017 and 4004. Interim Bankruptcy Rule 4004(c)(1) specifically provides that "the court shall [not] grant the discharge [while] . . .a motion to dismiss the case under § 707(b) is pending . . ." Accordingly, as long as the United States Trustee has a pending motion to dismiss under section 707(b), the bankruptcy court should not enter a discharge order.

Black's Law Dictionary states that "an action or suit is 'pending' from its inception until the rendition of final judgment." *Black's Law Dictionary* 1134 (6th ed. 1990). *Cf. Griffith v. Kentucky*, 479 U.S. 314, 326 (1987) (cases on appeal are "pending cases" to which a new rule of decision applied). The Supreme Court has defined "final judgment" to mean "one where 'the availability of appeal' has been exhausted or has lapsed, and the time to petition for certiorari has passed." *Bradley v. School Bd. of Richmond*, 416 U.S. 696, 711 n. 14 (1974), *citing Linkletter v. Walker*, 381 U.S. 618, 622 n. 5 (1965). *See Williams v. Cain*, 217 F.3d 303, 310-11 (5th Cir. 2000) (defining "pending" under 28 U.S.C. § 2244(d)(2) to mean until appellate review was no longer available). Thus, the word "pending" under Interim Rule 4004(c) includes section 707(b) motions upon which a final, non-appealable order has been entered.

CONCLUSION

For these reasons, the United States Trustee respectfully asks this Court to reverse the orders entered below, and remand the case for further proceedings on the merits of the United States Trustee's motion to dismiss.

Respectfully submitted,

FELICIA S. TURNER
United States Trustee

s/ *David P. Eron*
DAVID P. ERON
Office of the United States Trustee
Department of Justice
California State Bar No. 223033
301 North Main, Suite 1150
Wichita, Kansas 67202
Telephone: 316/269-6176
Telecopier: 316/269-6182

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
CORPUS CHRISTI DIVISION

IN RE:	§	
JARED WILLIAMS, LISA J. WILLIAMS;	§	CASE NO: 06-20116
aka LISA J. SEITZ	§	
Debtor(s)	§	
	§	CHAPTER 7

ORDER GRANTING MOTION FOR RECONSIDERATION

On this day came on for consideration the Motion for Reconsideration filed by the United States Trustee ("UST"). The Court, having heard the arguments of counsel and having reviewed the requested briefs, finds that the Motion for Reconsideration should be granted.

BACKGROUND

Jared and Lisa Williams (the "Debtors") filed their Chapter 7 bankruptcy petition on February 23, 2006. The First Meeting of Creditors pursuant to 11 U.S.C. §341 was set for March 31, 2006. The First Meeting of Creditors was held on March 31, 2006, as scheduled, but was continued to May 24, 2006. The First Meeting of Creditors was again continued until June 21, 2006, at which time it was concluded. The UST filed its presumption of abuse notice pursuant to 11 U.S.C. §704(b)(1)(A) on June 23, 2006, and filed a Motion to Dismiss on July 21, 2006. Debtors responded arguing that the notice and the motion were untimely. A hearing was held on November 13, 2006.

Following a hearing, the Court denied the UST's Motion to Dismiss by Order entered February 6, 2007. The UST then filed a Motion for Reconsideration and the Court held a hearing after which additional briefing was requested.

DISCUSSION

The Bankruptcy Code requires that the UST "shall review all materials filed by the debtors and, not later than 10 days after the date of the first meeting of creditors, file with the court a statement as to whether the debtor's case would be presumed to be an abuse under section 707(b)." 11 U.S.C. §704(b)(1)(A). A motion to dismiss must then be filed "not later than 30 days after the date of filing a statement under [§704(b)(1)(A)].” 11 U.S.C. §704(b)(1)(B). The issue before the Court is when calculation of the 10-day notice time provided by 11 U.S.C. §704(b)(1)(A) and the subsequent 30-day notice time should begin. The UST argues that the 10-day notice time does not begin to run until the First Meeting of Creditors is concluded. The Debtors argue that the 10-day period begins to run on the first meeting date.

In a case directly on point, the bankruptcy court for the District of Kansas held that the plain meaning of the statute requires the UST to file its statement of abuse not later than 10 days after "the first meeting date and not some later date." *In re Close* , 353 B.R. 915, 918 (Bankr. D. Kan. 2006). This Court previously relied on *Close* opinion and held that the Motion to Dismiss filed by the UST should be denied as untimely. Although not articulated in its prior Order, the Court relied on the concept that the UST could ask the Court for additional time to file its presumption of abuse pleading if it did not obtain sufficient information at the time the first meeting of creditors was actually held. The Court still believes that such a procedure is the most sensible method of balancing the UST’s need for accurate information against a debtor’s need for finality.

However, the 10-day period is a statutory period and not a time limitation set forth in the Bankruptcy Rules. Accordingly, the 10-day time period cannot be extended by the Court. See, *In re Federated Food Courts, Inc.*, 222 B.R. 396 (Bankr.N.D.Ga. 1998); *In re Ott*, 343 B.R. 364

(Bankr. D. Colo. 2006); *In re Barnes*, 308 B.R. 77, 80-81 (Bankr. D. Colo. 2004). For this reason, the Court will reconsider its prior ruling.

Collier on Bankruptcy concludes that the deadline for a statement of presumed abuse runs from "the conclusion of the meeting of creditors, rather than the first date set for the meeting of creditors, which is specifically referenced in some other Code provisions enacted at the same time." 6 COLLIER ON BANKRUPTCY ¶ 704.17[1](15th Ed. Rev. 2006). To hold otherwise when there is no provision for extension of the deadline would prevent the UST from obtaining the necessary information to evaluate bankruptcy cases. Debtors could simply drag their feet in providing information requested by the UST and avoid the presumption of abuse. In drafting BAPCPA, Congress clearly did not intend to make it easier for debtors to remain in Chapter 7. Therefore, any other interpretation of this section defeats Congress' intent and cannot be imposed on the UST by this Court. The Court finds that the deadline for filing a presumption of abuse statement runs from the conclusion of the first meeting of creditors.

It is therefore ORDERED that the Motion for Reconsideration is hereby GRANTED.

It is further ORDERED that the Order Denying Trustee's Motion to Dismiss is hereby VACATED and the Motion is set for further hearing on the issue of substantial abuse on June 4, 2007, at 9:00 a.m.

SIGNED 05/14/2007.

RICHARD S SCHMIDT
United States Bankruptcy Judge

FILED

FEB 06 2007

GRANT PRICE
CLERK, U.S. BANKRUPTCY COURT
WESTERN DISTRICT OF OKLAHOMA
BY: ______, DEPUTY

UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF OKLAHOMA

IN RE:)
)
DONALD EVERETT SLOAN, and) CASE NO. 06-11490-WV
RHONDA KAYE SLOAN,)
)
Debtors.) Chapter 7

ORDER DENYING MOTION TO STRIKE AND DIRECTING A RESPONSE TO THE MOTION TO DISMISS

Before the court is the Debtors' Motion to Strike the Motion of the United States Trustee to Dismiss Case Pursuant to 11 U.S.C. § 707(b)(1) Based on the Presumption of Abuse Arising Under 11 U.S.C. § 707(b)(2) (the "Motion to Strike"), and the United States Trustee's response thereto. The court conducted oral arguments on the Motion to Strike on December 19, 2006, at the conclusion of which the court took the matter under advisement. After careful review of the parties' submissions and the applicable law, the court finds that the Motion to Strike should be denied, and the Debtors should file a response to the UST's Motion to Dismiss.

A brief chronology of the case is as follows:

1. On June 30, 2006, the Debtors, Donald Everett Sloan and Rhonda Kaye Sloan, commenced this case by filing a voluntary bankruptcy petition seeking relief under the provisions of chapter 7 of the Bankruptcy Code, as amended by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8 119 Stat. 37 ("BAPCPA").

2. On August 15, 2006, pursuant to this court's January 20, 2006, General Order entitled "Certification of Compliance with Required Filings," the Debtor's filed a

"Certificate of Compliance" certifying that they had filed all items required by 11 U.S.C. § 521(a)(1).[1]

3. The meeting of creditors pursuant to § 341 was set for August 21, 2006, but was continued by the panel trustee to September 6, 2006.

4. On August 25, 2006, the Debtors filed an Amended Schedule I as well as an Amended Official Form B22A, which is a chapter 7 Statement of Current Monthly Income and Means Test Calculation-Form 22A.

5. On September 6, 2006, the § 341 hearing was conducted, and the panel trustee filed his report of no distribution.

6. On September 18, 2006, the United States Trustee ("UST") filed her Statement of Presumed Abuse under § 704(b)(1)(A) ("Statement of Presumed Abuse"), and then on October 18, 2006, the UST filed a Motion to Dismiss the Debtor's bankruptcy case pursuant to § 707(b)(1) (the "Motion to Dismiss").

7. In response to the UST's Motion to Dismiss, on October 30, 2006, the Debtors' filed the Motion to Strike, arguing that the Statement of Presumed Abuse was filed outside the 10-day time limit of § 704(b)(1)(A), and, consequently, her Motion to Dismiss was also untimely filed and should be stricken.

Section 704(b) was added to the Bankruptcy Code by BAPCPA in 2005, and it charges the United States Trustee with certain duties in individual chapter 7 cases. In this regard, § 704(b)(1)(A) provides, in pertinent part:

> With respect to a debtor who is an individual in a case under this chapter . . . the United States Trustee . . . shall review all materials filed by the debtor and, not later than 10 days after the date of the first meeting of

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[1] Unless otherwise specified, all references to sections herein are to title 11 of the United States Code.

> creditors, file with the court a statement as to whether the debtor's case would be presumed to be an abuse under section 707(b). . . .

Id. Thus, the statutory language requires the UST to file the § 704(b) statement within "10 days after the date of the first meeting of creditors." *Id.* If the UST files a motion to dismiss under § 707(b), it must be filed within 30 days after the date of filing the statement under § 704(b)(1)(A). *See* § 704(b)(2).

In support of their Motion to Strike, the Debtors argue that the plain language of the statute required the UST to file the statement of presumed abuse no later than 10 days following the first date set for the meeting of creditors. The first meeting of creditors was originally scheduled in this case for August 21, 2006, and then continued by the panel trustee to September 6, 2006. Despite the continuance, the Debtors argue that the UST was required to file the statement of presumed abuse by August 31, 2006, and the § 707(b) motion to dismiss by October 2, 2006, 30 days later. Because the Motion to Dismiss was not filed until October 18, 2006, it is untimely and, the Debtors argue, it should be stricken. The Debtors cite the recently-decided case of *In re Close*, 353 B.R. 915 (Bankr. D. Kan. 2006) to support their position. In *Close*, the bankruptcy court held:

> Enforcing § 704(b)(1)(A) according to its plain terms ends the inquiry. The statute requires the UST to file a statement of presumed abuse not later than ten days after the date of the first meeting of creditors. The language is not vague or ambiguous and does not need extraneous verbiage to clarify its meaning. The plain ready of the phrase refers to the first meeting date and not some later date.

Id. at 918. Thus, the UST was required to file the § 704(b)(1)(A) statement not later than 10 days following the first date set for the meeting of creditors.

Having carefully reviewed the opinion in *Close* and its underlying rationale, the court respectfully disagrees with its holding and agrees with the discussion in the leading bankruptcy treatise that the language of § 704(b)(1)(A) is "somewhat unclear." In its discussion of the statutory language, the authors of the treatise conclude:

> The statement [of presumed abuse] must be filed within 10 days after the date of the "first meeting of creditors." The "first meeting of creditors" is a term sometimes used in the past to refer to the section 341(a) meeting of creditors. The language is somewhat unclear, but logically it makes sense to read this deadline as running from the conclusion of the meeting of creditors, rather than the first date set for the meeting of creditors, which is specifically referenced in some other Code provisions enacted at the same time.

6 ALAN N. RESNICK & HENRY J. SOMMER, COLLIER ON BANKRUPTCY ¶ 704.17[1] (15th ed. rev. 2006)(hereinafter "COLLIER").

Although COLLIER alludes to specific references in the BAPCPA amendments, this court notes that § 521 uses the specific phrases, "first date set for the meeting of creditors" or "date first set" no fewer than twice. *See* § 521 (a)(2)(B) & (e)(2)(A)(i). Thus, clearly Congress specified the application of the earlier date when it intended to do so, and its failure to do so in § 704(b)(1)(A) evidences its intent that the UST not be bound to file the statement of presumed abuse within 10 days of the first date set for the § 341 meeting.

The court further notes that § 341(a) provides for "a meeting of creditors" at which the debtor is required to appear and answer questions propounded by the trustee or a creditor. FED. R. BANKR. P. 2003 implements § 341 by establishing rules governing the meeting of creditors, including the date and place of the meeting. Subsection (e) of Rule 2003 authorizes the adjournment from time to time of the meeting of creditors by the trustee's announcement of such continuance at the meeting. Until it is concluded, this meeting, which may be continued from time to time, constitutes the § 341 meeting of creditors. Thus, the Bankruptcy Code and Rules provide that the meeting of creditors in a bankruptcy case may encompass meetings occurring on multiple dates. Reading § 704(b)(1)(A)'s language requiring the statement of presumed abuse to be filed within "10 days after the date of the first meeting of creditors" in light of § 341 and FED. R. BANKR. P. 2003, this court finds it clear that Congress intended the operative date under § 704(b) to be the conclusion, and not the commencement, of the § 341 meeting. If Congress had intended otherwise, it would have clearly specified. For these reasons, the court declines to follow the *Close* case, finding that the instant opinion more closely comports with the Bankruptcy Code and Rules which distinguish between "the first meeting of creditors" and the "first date set" or the "date first set."

While the court bases its decision on the language and structure of the Code and Rules, it also recognizes the policy implications of adopting the Debtors' argument as illustrated by the chronology of the instant case. August 21, 2006, was the date first set for the § 341 meeting. On that date, however, the Debtors had not yet filed their Amended Schedule I and Amended Official form B22A, which form the basis for the UST's Statement of Presumed Abuse (and the UST's Motion to Dismiss). Debtors filed their amendments on August 25, 2006, some four days after the 704(b)(1)(A)10-day time period began to run, under the Debtors' proffered argument, leaving the UST only 6 days within which to evaluate the amendments (without having had the benefit of the Debtors' testimony) and file the statement of presumed abuse. The court finds that this time frame is unduly restrictive and affects the UST's duty to conduct a thorough review of the Debtors' filings. Further, although the Debtors in this case filed their amendments prior to the expiration of the 10-day period, the Debtors' proffered argument could require the UST in some cases to complete her duties under § 704(b)(1) without possessing information necessary to her review because the debtors failed to file any bankruptcy schedules or appear for the § 341 meeting. This result is untenable as a matter of policy.

For these reasons, the court concludes that the Debtors' Motion to Strike should be and hereby is DENIED, and the Debtors are DIRECTED to file a response to the UST's Motion to Dismiss not later than February 26, 2007.

IT IS SO ORDERED this 6th day of February, 2007.

T M Weaver
T.M. Weaver
Chief Bankruptcy Judge

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CERTIFICATE OF SERVICE

I hereby certify that on the 6th day of February 2007, I transmitted a true and correct copy of the forgoing **Order Denying Motion to Strike and Directing a Response to the Motion to Dismiss** to the parties listed below.

Jerry D. Brown
5500 N. Western Ave., Suite 150
Oklahoma City, Ok. 73118

Charles E. Snyder
215 Dean A. McGee Ave, Fourth Floor
Oklahoma City, Ok. 73102

BRIEF BANK — "SUMMARY SHEET" *Printed Mon-5/23/11 11:34*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]* — Scott W. Coffin v. Ecast Settlement Corporation and Peter C. Fessenden

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]* — B.A.P. 1st Cir.

3. ("CCN") ***CURRENT*** CASE NO. — No.: 08-90

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*

No.: 07-20955-JBH

Court: Bankr. Me.

(Identify judge & cite, if any)

5. ("SO") ***SOURCE*** — **U.S. TRUSTEES**

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*

Filed: February 25, 2009

Type: Brief of the United States As Amicus Curiae Supporting Affirmance

7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]* — David L. Gold, P. Matthew Sutko, Ramona Elliott

(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC*** — **BANKRUPTCY**

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***

• Whether the bankruptcy court's ruling best interprets section 707(b)(2)(A)(ii)(I) of the Bankruptcy Code, properly applies section 1325 of the Bankruptcy Code, fulfills congressional goals related to the 2005 Act, and fosters sound public policy.

10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)

11. DO YOU RECOMMEND POSTING IN UST BRIEFBANK?

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NAME: Linda Figueroa

DATE:

UNITED STATES BANKRUPTCY APPELLATE PANEL
FOR THE FIRST CIRCUIT

BAP NO. EP 08-90

SCOTT W. COFFIN,
Debtor.

SCOTT W. COFFIN,
Appellant,

v.

ECAST SETTLEMENT CORPORATION,
and PETER C. FESSENDEN, Chapter 13 Trustee,
Appellees.

ON APPEAL FROM THE UNITED STATES BANKRUPTCY COURT FOR THE DISTRICT OF MAINE

CASE NO. 07-20955-JBH

BRIEF OF THE UNITED STATES AS AMICUS CURIAE SUPPORTING AFFIRMANCE

RAMONA D. ELLIOTT
General Counsel
P. MATTHEW SUTKO
Associate General Counsel
DAVID I. GOLD
Trial Attorney
Executive Office for United States Trustees
Department of Justice
20 Massachusetts Avenue, N.W.
Washington, D.C. 20530
Ph: (202) 307-1399
Fax: (202) 307-2397

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Legislative Materials:

Miscellaneous:

The United States submits this brief under Fed. R. App. P. 29,[1] as *amicus curiae* in support of affirmance of the bankruptcy court's order below.

INTEREST OF THE UNITED STATES

This appeal involves two statutory provisions affecting chapter 13 bankruptcy cases: 11 U.S.C. § 1325(b) and 11 U.S.C. § 707(b)(2)(A)(ii)(I). The latter also affects chapter 7 bankruptcy cases. The United States has a direct interest in the proper construction of these provisions because United States Trustees, who are Justice Department officials appointed by the Attorney General, supervise the administration of chapter 13 and 7 bankruptcy cases in all federal judicial districts within this circuit. *See* 28 U.S.C. §§ 581-589a. *See also* H.R. Rep. No. 95-595, at 88 (1977), *as reprinted in* 1978 U.S.C.C.A.N. 5963, 6049 (United States Trustees "serve as bankruptcy watch-dogs to prevent fraud, dishonesty, and overreaching in the bankruptcy arena.").

This case involves a dispute over the interpretation of "projected disposable income" under 11 U.S.C. § 1325(b) and the application of vehicle ownership expense deductions allowed by 11 U.S.C. § 707(b)(2)(A)(ii)(I). Together, these determine when debtors meet their statutory obligation to dedicate their projected disposable income to paying creditors through their chapter 13 plans. Resolution of this question affects the United States' interest for two reasons.

First, by interpreting section 1325(b), this Court will determine the amount above-median-income chapter 13 debtors must pay their creditors in their chapter 13 plans. The United States has an interest in that question because United States Trustees "supervise the administration of [chapter 13] cases and trustees," monitor chapter 13 plans, and file comments

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[1] This Court may apply Fed. R. App. P. 29 here pursuant to 1st Cir. BAP L.R. 8018-1.

with the court regarding such plans in connection with plan confirmation hearings under section 1324 of the Bankruptcy Code. 28 U.S.C. § 586(a)(3)(C).

Second, because section 1325(b) incorporates two parts of the chapter 7 means test – sections 707(b)(2)(A) and (B) – this appeal will also determine what expenses above-median-income chapter 7 debtors may claim when completing their means test. This is significant because the means test determines whether an above-median-income chapter 7 debtor's case should be dismissed as abusive. *See* 11 U.S.C. § 707(b)(1) and (2).

United States Trustees play a unique role in chapter 7 above-median-income cases because section 704(b) requires them to review all such cases and, whenever a case is deemed presumptively abusive under the means test, either: (a) seek its dismissal, or (b) file a statement declining to seek dismissal. *See* 11 U.S.C. § 704(b). *See also Schultz v. United States*, 529 F.3d 343, 348 (6th Cir. 2008) (describing the United States Trustees' enforcement of the chapter 7 means test).

Given these interests, the United States submits this brief to share its views on the application of sections 1325(b) and 707(b)(2)(A). *See* 28 U.S.C. § 517 (authorizing the Department of Justice "to attend to the interests of the United States in a suit pending in a court of the United States"). *See also* 11 U.S.C. § 307 ("The United States trustee may raise and may appear and be heard on any issue in any case or proceeding."); Fed. R. Bankr. P. 29(a) (United States may file briefs as *amicus curiae*).

STATUTORY BACKGROUND

On April 20, 2005, Congress enacted the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005. *See* Pub. L. No. 109-8, 119 Stat. 23 (2005). The 2005 Act significantly altered how debtors obtain relief under chapters 7 and 13 of the Bankruptcy Code.

In a chapter 13 case, a debtor's unsecured creditors or trustee may insist the debtor devote all of his projected disposable income to pay creditors. *See* 11 U.S.C. § 1325(b)(1). Although "projected disposable income" is not defined, "disposable income" is defined as a net number: historical income less prescribed expenses. *See* 11 U.S.C. § 1325(b)(2).

Under the 2005 Act, above-median-income debtors, like Mr. Coffin, determine disposable income by first calculating current monthly income.[2] Next, they deduct permitted expenses, which include "amounts reasonably necessary to be expended" for maintenance or support or necessary business expenses. 11 U.S.C. § 1325(b)(2) and (3). Above-median-income chapter 13 debtors determine "amounts reasonably necessary to be expended . . . in accordance with" sections 707(b)(2)(A)(ii), (iii), and (iv) of the Bankruptcy Code. 11 U.S.C. § 1325(b)(3) (incorporating those provisions). Deducting all allowed expenses from a debtor's current monthly income yields a net number – disposable income.

This appeal poses a question about a debtor's expense-side calculation of disposable income. Section 707(b)(2)(A)(ii) permits debtors to deduct, among other things:

> **(a)** certain prescribed "actual" expenses; and
>
> **(b)** other "applicable" expense amounts.

See 11 U.S.C. § 707(b)(2)(A)(ii)(I). "Applicable" expense amounts are not the debtor's actual expenses. Instead, they are the static amounts listed in the Internal Revenue Service's Local and National Standards. *See* 11 U.S.C. § 707(b)(2)(A)(ii)(I).

The IRS's Local Standards include expenses for transportation. *See* IRS Collection

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[2] The term "current monthly income," which is used to calculate gross historical income, *see* 11 U.S.C. § 1325(b)(2), is a defined term. *See* 11 U.S.C. § 101(10A)(defining "current monthly income" as the debtor's average monthly income for the six-month period preceding the month of the filing of the debtor's petition).

Financial Standards, under heading “Local Standards: Transportation,” *available at http://www.irs.gov/individuals/article/0,,id=96543,00.html.*[3] Transportation expenses are authorized in two standardized amounts. They are: (1) monthly expenses for costs associated with operating vehicles; and (2) monthly expenses for costs associated with purchasing or leasing vehicles. *Id.*

All debtors, including Mr. Coffin, receive monthly transportation expenses based on either public transportation costs or the costs associated with operating a vehicle. *Id.* The standard operating expense includes amounts for vehicle maintenance, fuel, state and local registration, required inspection, parking fees, tolls, and driver’s license fees. *Id.*

Ownership expenses, when applicable, include allowances based on the average cost of financing a vehicle as determined annually by the Federal Reserve Board. *Id.* Both operating and ownership expenses are limited to no more than two vehicles. *Id.*

At issue in this appeal is whether a standardized vehicle ownership deduction is “applicable” under section 707(b)(2)(A)(ii)(I) when Mr. Coffin has no associated vehicle ownership expenses, and if it is not applicable, as the bankruptcy court found, whether Mr. Coffin’s plan fails to commit all of his projected disposable income to making payments under his plan.

SUMMARY OF ARGUMENT

The bankruptcy court found Mr. Coffin has no applicable vehicle ownership expense amount to claim under section 707(b)(2)(A)(ii)(I) of the Bankruptcy Code because he has no associated loan or lease expenses on his vehicles. Thus, the bankruptcy court ruled that Mr.

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[3] A true and correct copy of the Collection Financial Standards applicable to this case, which the United States hereby incorporates by reference, can be found at United States Addendum “A”.

Coffin's plan failed to commit all of his projected disposable income to making payments under his plan. Because the bankruptcy court's ruling best interprets section 707(b)(2)(A)(ii)(I) of the Bankruptcy Code, properly applies section 1325 of the Bankruptcy Code, fulfills congressional goals related to the 2005 Act, and fosters sound public policy, it should be affirmed.

The bankruptcy court's ruling best interprets section 707(b)(2)(A)(ii)(I) for two reasons:

First, Mr. Coffin cannot claim a standardized vehicle ownership expense amount on his vehicles because section 707(b)(2)(A)(ii)(I) only allows a debtor to claim it when it is "applicable" to the debtor's vehicles. Reading the word "applicable" in section 707(b)(2)(A)(ii)(I) as limiting expense amounts to debtors who, unlike Mr. Coffin, actually have associated expenses is the best construction of this section because it uses the ordinary dictionary meaning of "applicable," and does so in a way that gives meaning to each word in the statute, something Mr. Coffin's construction does not.

Second, the 2005 Act's legislative history supports this interpretation of section 707(b)(2)(A)(ii)(I). It reveals Congress enacted the new law to ensure debtors would repay their debts when they were able. Conversely, Mr. Coffin's interpretation of section 707(b)(2)(A)(ii)(I) would yield inequitable results not contemplated by Congress.

As a separate, independent, and alternative basis for affirmance, this Court may affirm the bankruptcy court's ruling because it properly applies section 1325 of the Bankruptcy Code. Under section 1325(b)(1), a bankruptcy court may not confirm a chapter 13 plan over the chapter 13 trustee's objection unless "the plan provides that all of the debtor's *projected* disposable income *to be received* in the applicable commitment period . . . *will be applied to make payments* to unsecured creditors under the plan." 11 U.S.C. § 1325(b)(1) (emphasis added). Additionally, under section 1325(b)(2), a bankruptcy court may only consider expenses as part of its projected disposable income analysis that are "reasonably necessary *to be expended*." 11 U.S.C. § 1325(b)(2) (emphasis added). Each of these phrases anticipates future action during the life of a debtor's chapter 13 plan. Therefore, each independently precludes a debtor, like Mr. Coffin, from deducting an expense, such as a vehicle ownership expense, he will not have over the life of his chapter 13 plan.

Finally, because the bankruptcy court's ruling fulfills congressional goals related to the 2005 Act and fosters sound public policy, it should be affirmed. Congress passed the 2005 Act to maximize debtor repayment to creditors and to eliminate opportunities for bankruptcy abuse. Barring above-median-income debtors, like Mr. Coffin, from claiming inapplicable ownership expense amounts fulfills these goals. Moreover, such a result is fair because: (a) it prevents above-median-income debtors from claiming expenses they do not have; (b) does not hurt lower-income debtors because they are not subject to section 707(b)(2)(A)(ii)(I); and (c) allows creditors to receive payments on their debts when debtors have the financial ability to repay.

ARGUMENT

The bankruptcy court's ruling may be affirmed on either of two separate and independent bases. First, the bankruptcy court's ruling best interprets section 707(b)(2)(A)(ii)(I) of the Bankruptcy Code, which does not allow a debtor to claim an ownership expense deduction under his means test when he has no associated loan or lease expenses on his vehicles. Second, and independent of that, the bankruptcy court's ruling properly applies section 1325 of the Bankruptcy Code, which is forward-looking in nature and excludes non-existent future expenses, like Mr. Coffin's phantom $956.00 vehicle ownership expenses, from being deducted under the projected disposable income test. Either of these bases, standing alone, merits affirmance.

I. This Court Should Affirm Because A Vehicle Ownership Expense Amount is "Applicable" Under Section 707(b)(2)(A)(ii)(I) of the Bankruptcy Code Only When Debtors Make Corresponding Loan or Lease Payments on their Vehicles, Which Mr. Coffin Does Not.

A. Vehicle ownership expense amounts are not "applicable" to debtors who make no loan or lease payments.

1. The Bankruptcy Code permits above-median-income debtors, like Mr. Coffin, to claim a vehicle ownership expense amount in a set amount when that expense is "applicable." *See* 11 U.S.C. § 707(b)(2)(A)(ii)(I). Section 707(b)(2)(A)(ii)(I) provides that a debtor's "monthly expenses shall be the debtor's *applicable* monthly expense amounts specified under the . . . Local Standards . . . issued by the Internal Revenue Service. . . ." 11 U.S.C. § 707(b)(2)(A)(ii)(I) (emphasis added).

The Bankruptcy Code does not define the term "applicable." Nor has the United States identified any controlling decision providing a definition in the bankruptcy court context. Accordingly, where, as here, a statutory term is undefined, the term should be given its ordinary meaning. *Smith v. United States*, 508 U.S. 223, 228 (1993) ("When a word is not defined by statute, we normally construe it in accord with its ordinary or natural meaning."); *Telematics Int'l., Inc. v. NEMLC Leasing Corp.*, 967 F.2d 703, 706 (1st Cir. 1992) ("the task of interpretation begins with the text of the statute itself, and statutory language must be accorded its ordinary meaning.").

The dictionary defines "applicable" to mean "capable of being applied: having relevance . . . fit, suitable, or right to be applied: APPROPRIATE" *Webster's Third New Int'l Dict.*, at 105 (1981) (emphasis in original). Such a meaning should therefore be imparted to the term "applicable" used in section 707(b)(2)(A)(ii)(I). *See Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A.*, 530 U.S. 1, 6 (2000) ("when the statute's language is plain, the sole function of the courts-at least where the disposition required by the text is not absurd-is to enforce it according to its terms.") (internal quotations omitted). *See also Riva v. Commonwealth of Mass.*, 61 F.3d 1003, 1008 n.4 (1st Cir. 1995) ("Courts are free to use standard dictionary definitions to assist in determining the ordinary meaning of statutory language.").

The bankruptcy court's interpretation of section 707(b)(2)(A)(ii)(I) is consistent with this ordinary meaning because it does not allow debtors to claim a monthly vehicle ownership expense amount when they have no associated monthly loan or lease expenses.

As articulated by the Ninth Circuit bankruptcy appellate panel in *Ransom*, "[g]iven the ordinary sense of the term 'applicable,' how is the vehicle ownership expense allowance *capable of being applied* to [a] debtor if he does not make any lease or loan payments on the vehicle?" *Ransom v. MBNA America Bank, N.A. (In re Ransom)*, 380 B.R. 799, 807-08 (B.A.P. 9th Cir. 2007) (emphasis in original). The answer is, it is not. If a debtor, like Mr. Coffin, has no loan or lease payments on his vehicle, then there is simply no expense capable of being applied. For this reason alone, the lower court's order should be affirmed.

2. If there were ever any doubt regarding what Congress intended the term "applicable" to mean under section 707(b)(2)(A)(ii)(I), it would be answered in the next subsection of the Bankruptcy Code: subsection 707(b)(2)(A)(ii)(II). That subsection states, in relevant part, that a "debtor's monthly expenses may include, *if applicable*, the continuation of *actual* expenses paid by the debtor . . . for care and support of an elderly, chronically ill, or disabled household member or member of the debtor's immediate family. . . ." 11 U.S.C. § 707(b)(2)(A)(ii)(II) (emphasis added). Thus, Congress used the term "applicable" under section 707(b)(2)(A)(ii)(II) to only allow expenses to debtors if those expenses literally apply to that particular debtor.

Because it is a basic rule of statutory construction that "'identical words used in different parts of the same act are intended to have the same meaning[,]'" *Commissioner of Internal Revenue v. Lundy*, 516 U.S. 235, 250 (1996) (citations omitted), the same meaning of the term "applicable" in section 707(b)(2)(A)(ii)(II) should be given to the term "applicable" in section 707(b)(2)(A)(ii)(I).

3. Many appellate decisions agree with the bankruptcy court in this case that when debtors, such as Mr. Coffin, have no loan or lease expenses on their vehicles, they cannot deduct a monthly vehicle loan or lease expense amount on their means test form pursuant to section 707(b)(2)(A)(ii)(I). *See Babin v. Wilson (In re Wilson)*, 383 B.R. 729 (B.A.P. 8th Cir. 2008); *Grossman v. Sawdy (In re Sawdy)*, 384 B.R. 199 (E.D. Wis. 2008), *overruled sub nom. Ross-Tousey v. Neary*, 549 F.3d 1148 (7th Cir. 2008); *Wieland v. Thomas (In re Thomas)*, 382 B.R. 793 (D. Kan. 2008); *Meade v. McVay (In re Meade)*, 384 B.R. 132 (W.D. Tex. 2008); *United States Trustee v. Deadmond (In re Deadmond)*, Case No. 07-15-H-CCL, 2008 WL 191165 (D. Mont. Jan. 22, 2008); *Ransom*, 380 B.R. at 799, *appeal pending* Case No. 08-15066 (9th Cir. Jan. 4, 2008); *Fokkena v. Hartwick (In re Hartwick)*, 373 B.R. 645 (D. Minn. 2007). *But see Ross-Tousey*, 549 F.3d at 1148; *Hildebrand v. Kimbro (In re Kimbro)*, 389 B.R. 518 (B.A.P. 6th Cir. 2008), *appeal pending* Case No. 08-5871 (6th Cir. Aug. 24, 2008); *Clippard v. Ragle (In re Ragle)*, 395 B.R. 387 (E.D. Ky. 2008); *Brunner v. Armstrong (In re Armstrong)*, 395 B.R. 127 (E.D. Wash. 2008); *Musselman v. eCast Settlement Corp.*, 394 B.R. 801 (E.D.N.C. 2008).

B. Mr. Coffin's reading of Section 707(b)(2)(A)(ii)(I) renders the word "applicable" superfluous in that section.

Under Mr. Coffin's interpretation of section 707(b)(2)(A)(ii)(I), the term "applicable" modifies the phrase "amounts specified under the . . . Local Standards" not the debtor's "monthly expense." *See* Appellant's Brief, at 12-13. However, if that were so, Congress could just have easily stated in section 707(b)(2)(A)(ii)(I) that:

> a "debtor's monthly expenses shall be the debtor's ~~**applicable**~~ monthly expense amounts specified under the . . . Local Standards . . . issued by the Internal Revenue Service. . . ."

See Ransom, 380 B.R. at 808 (concluding that such a construction would "read[] 'applicable' right out of the Bankruptcy Code."). After all, striking out the word "applicable" would still lead debtors to the same line under the IRS Local Standards, and if that is all Congress intended, there was no need to use the word "applicable" at all. Instead, Congress deliberately chose to include the term "applicable" in section 707(b)(2)(A)(ii)(I). Accordingly, because "courts should strive to give operative meaning to every word in a statute," *see Cooper Indus., Inc. v. Aviall Servs., Inc.*, 543 U.S. 157, 167 (2004), *United States v. Ven-Fuel, Inc.*, 758 F.2d 741, 751-52 (1st Cir. 1985), the word "applicable" must be read as adding something to the statute, and Mr. Coffin's interpretation of section 707(b)(2)(A)(ii)(I) fails. *See Deadmond*, 2008 WL 191165, at *4 ("The word ['applicable'] must mean something, and if some monthly expenses are applicable, then other monthly expenses are not applicable.").

Because Mr. Coffin's reading of section 707(b)(2)(A)(ii)(I) renders the term "applicable" superfluous, the term *must* have a different meaning than the one he ascribes.[4] *See generally*

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[4] Mr. Coffin suggests that the bankruptcy court's construction of section 707(b)(2)(A)(ii)(I) reads "applicable" as meaning "actual." Appellant's Brief, at 12-13. However, the bankruptcy court's construction gives the words "applicable" and "actual" entirely *different* meanings. Under the bankruptcy court's construction, vehicle expense amounts under section 707(b)(2)(A)(ii)(I) are not the debtor's "actual," or literal, vehicle ownership expenses. Rather, they are static, fixed amounts, drawn from the IRS Standards, used *regardless* of the debtor's "actual" expenses. *See Hartwick*, 373 B.R. at 650 (recognizing that a debtor's "actual" expense does not control the amount of the vehicle ownership deduction under section 707(b)(2)(A)(ii)(I)). Debtors

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Cooper Indus., Inc., 543 U.S. at 167; *United States v. Ven-Fuel, Inc.*, 758 F.2d at 751-52. As we explain above, the word "applicable" does have a different meaning. Under its dictionary meaning, the word exists to allow debtors to claim a standard vehicle expense amount that is applicable because they have a loan or lease expense.

C. Mr. Coffin's interpretation of section 707(b)(2)(A)(ii)(I) would yield inequitable results not contemplated by Congress.

According to its legislative history, the 2005 Act seeks to "ensure that debtors repay creditors the maximum they can afford." H.R. Rep. No. 109-31 (I), at 1, 2005 U.S.C.C.A.N. at 89.[5] Mr. Coffin's interpretation of section 707(b)(2)(A)(ii)(I) would frustrate the 2005 Act's goal of proper repayment by allowing above-median-income debtors to claim phantom expenses that do not apply to them. Under Mr. Coffin's reading of section 707(b)(2)(A)(ii)(I), a higher-income debtor with an inoperable car could claim the ownership expense amount simply because the car is an automobile and he owns it. This statutory reading has been rejected because it "defies common sense." *Deadmond*, 2008 WL 191165, at *4.

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[4]...continue
receive $471.00 for the first vehicle that has an associated loan or lease payment, and $332.00 for the second. *See* United States Addendum "A." These are the opposite of "actual" expenses. Accordingly, because the terms "applicable" and "actual" have different meanings under section 707(b)(2)(A)(ii)(I), characterizing them as overlapping, as Mr. Coffin does, is erroneous. *See Thomas*, 382 B.R. at 793 (finding that "the juxtaposition of 'applicable . . . amounts' and 'actual . . . expenses' in the statute is not inconsistent with the Court's interpretation" that vehicle ownership expense amounts are only applicable if a debtor is making loan or lease payments on a vehicle); *Meade*, 384 B.R. at 136 (explaining how the terms "applicable" and "actual" have different meanings under 707(b)(2)(A)(ii)(I)).

Moreover, even if the terms "applicable" and "actual" meant the same thing in section 707(b)(2)(A)(ii)(I), the Supreme Court has recognized that there is nothing wrong with two different words within a single section of a statute being synonymous. *See Wachovia Bank v, Schmidt*, 546 U.S. 303, 314 (2006) ("Congress may well have comprehended the words 'located' and 'established,' as used in [28 U.S.C.] § 1348, not as contrasting, but as synonymous or alternative terms.").

[5] There is no Senate Report or Conference Report to the 2005 Act.

D. The Seventh Circuit's ruling to the contrary in *Ross-Tousey,* does not articulate a valid basis for rejecting the lower court's text-based reading of section 707(b)(2)(A)(ii)(I).

On December 17, 2008, the United States Court of Appeals for the Seventh Circuit decided *Ross-Tousey v. Neary*. *See Ross-Tousey v. Neary*, 549 F.3d 1148 (7th Cir. 2008). *Ross-Tousey* is the first circuit decision to interpret the word "applicable" in section 707(b)(2)(A)(ii)(I).[6] *Ross-Tousey* primarily relied on interpretive conclusions reached by a divided Sixth Circuit bankruptcy appellate panel in *Kimbro*, whose decision was entered *after* briefing was completed in *Ross-Tousey*. *See Ross-Tousey*, 549 F.3d at 1155-60 (*citing* and *quoting* extensively from *Kimbro*, 389 B.R. at 518). Accordingly, the Seventh Circuit did not have the benefit of the government's views regarding the *Kimbro* decision prior to reaching its own decision in *Ross-Tousey*.

Had the government had the opportunity to share those views with the Seventh Circuit it would have argued the following:

First, while the majority in *Kimbro* concluded that the government's construction of section 707(b)(2)(A)(ii)(I) improperly gave the same meaning to the words "applicable" and "actual" in section 707(b)(2)(A)(ii)(I), the government's reading actually gives them different ones. *Compare Kimbro*, 389 B.R. at 523-24 *with* United States' Brief, *supra.* at n.4. Indeed, this juxtaposition of terms was explained by the dissent in *Kimbro* when it stated that "Congress intended and used the phrases 'applicable monthly expense amounts' . . . and 'actual expenses' . . . simply in recognition of the differing ways in which the IRS uses the National Standards and Local Standards versus the Other Necessary Expense Categories." *Kimbro*, 389 B.R. at 533

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[6] The identical issue is currently on appeal in the Ninth and Sixth circuits. *See Ransom*, 380 B.R. at 799, *appeal pending* Case No. 08-15066 (9th Cir. Jan. 4, 2008); *Kimbro*, 389 B.R. at 518, *appeal pending* Case No. 08-5871 (6th Cir. Aug. 24, 2008).

(Fulton, J., dissenting).

Second, while the majority in *Kimbro* concluded that the vehicle ownership amount was necessary to cover operating costs, *see Kimbro,* 389 B.R. at 531 (referencing "depreciation, insurance, licensing fees and taxes"), that is factually wrong. A wholly different IRS expense standard governs those types of vehicle expenses. *See* United States' Brief, *supra.* at 3-4 (discussing vehicle ownership and *operating* expenses).

Third, while the *Kimbro* majority ruled that the phrase "monthly expenses of the debtor shall not include any payments for debts" found in section 707(b)(2)(A)(ii)(I) justifies an ownership expense allowance, *see Kimbro,* 389 B.R. at 523, it does not. Rather, debtors for whom the ownership expense is applicable receive a fixed standard allowance that is the dollar amount under the applicable standard, not the dollar amount associated with a "payment for a debt." *See* United States' Brief, *supra.* at n.4.

Fourth, the *Kimbro* majority relied upon the legislative history of a statute never enacted in order to support its conclusion. *See Kimbro,* 389 B.R. at 525-27. Such an approach has been expressly rejected by at least three circuit courts of appeal presumably because it opens the door to the potential subversion of statutory language actually voted on by Congress and signed into law by the President. *See, e.g., Interstate Natural Gas Co. v. Federal Power Comm.*, 156 F.2d 949, 952 (5th Cir. 1946) ("the legislative history of a bill that was not adopted cannot be resorted to construe a bill that was."), *aff'd.* 331 U.S. 682 (1947); *United States v. Lincoln Rochester Trust Co.*, 297 F.2d 891, 893 (2d Cir. 1962) (finding that portion of House report referring to language not included in Technical Amendments Act of 1958, as finally adopted, may not be relied on in interpreting Act), *cert. denied*, 369 U.S. 887 (1962); *Com. of Puerto Rico v. Blumenthal*, 642 F.2d 622, 635 n.23 (D.C. Cir. 1980) ("[Appellant's] argument that we should not consider the legislative history of a bill that was never enacted represents a correct statement of the law."). Morever, as we discuss below, the legislative history of the 2005 Act supports the statutory construction of the word "applicable" adopted by the lower court. *See* United States' Brief, *infra.* at 17-19.

Fifth, the *Kimbro* majority erroneously declined to apply the dictionary meaning of the word "applicable." *See Kimbro*, 389 B.R. at 522-23. Had it applied the definition, it would have invariably ended up asking how the vehicle ownership expense allowance is "capable of being applied" to a debtor if the debtor does not make any lease or loan payments on a vehicle. *See, e.g., Ransom*, 380 B.R. at 807-808. Accordingly, because the majority in *Kimbro* failed to take this fundamental step as part of its statutory analysis, its construction of section 707(b)(2)(A)(ii)(I) is suspect.

For each of these reasons, *Ross-Tousey*, which primarily relied on the majority opinion in *Kimbro*, should not be followed by this Court.

II. Alternatively, this Court Should Affirm Because Section 1325 of the Bankruptcy Code, Which is Forward-Looking in Nature, Excludes Non-Existent Future Expenses, Like Mr. Coffin's Claimed Vehicle Ownership Expenses, From Being Deducted Under the Projected Disposable Income Test.

In *Kibbe v. Sumski*, this Court adopted a forward-looking reading of section 1325 of the Bankruptcy Code. *See Kibbe v. Sumski (In re Kibbe)*, 361 B.R. 302, 314-15 (B.A.P. 1st Cir. 2007) (*per curium*). The Eighth and Tenth circuits have adopted this forward-looking reading of section 1325 as well. *See Hamilton v. Lanning (In re Lanning)*, 545 F.3d 1269, 1278-82 (10th Cir. 2008), petition for cert. filed Feb. 3, 2009; *Coop v. Frederickson (In re Frederickson*), 545 F.3d 652, 659-60 (8th Cir. 2008), petition for cert. filed Jan. 23, 2009. *But see Maney v. Kagenveama (In re Kagenveama*), 541 F.3d 868 (9th Cir. 2008).

Because section 1325 is forward-looking, it precludes debtors, like Mr. Coffin, from including phantom vehicle ownership expenses on their means test that they will not have over the life of their chapter 13 plans. Thus, section 1325 constitutes a separate and independent ground for affirmance, even if this panel were to reject the lower court's construction of section 707(b)(2)(A)(ii)(I).

Under section 1325(b)(1), a bankruptcy court may not confirm a chapter 13 plan over the chapter 13 trustee's objection unless "the plan provides that all of the debtor's *projected* disposable income *to be received* in the applicable commitment period . . . *will be applied to make payments* to unsecured creditors under the plan."[7] 11 U.S.C. § 1325(b)(1) (emphasis added). Thus, the use of the terms "projected," "to be received," and "will be applied to make payments" in section 1325(b)(1) makes that section forward-looking.

Although the word "projected" is not defined under the Bankruptcy Code, the dictionary defines "project" as forward-looking. *See The Random House Dict. of English Lang.*, 1546 (2d ed. 1987) (defining to "project" as *inter alia*, "to set forth or calculate (some future thing); *They projected the building costs for the next five years*."); *Webster's Third New Int'l Dict.*, 1813 (1993) (defining "projected" as *inter alia*, "planned for future execution: contrived, composed," as "[projected] outlays for new plant and equipment."). This forward-looking meaning should therefore be imparted to the term "projected" in section 1325(b)(1) absent a clear indication that Congress intended to give that term a different meaning. *See Bailey v. United States*, 516 U.S. 137, 144-45 (1995) (turning to dictionary definition of a term to define its statutory meaning). *Accord Kibbe*, 361 B.R. at 302; *Lanning*, 545 F.3d at 1269; *Frederickson*, 545 F.3d at 652.

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[7] Section 1325(b)(4) defines the term "applicable commitment period," with certain exceptions, as 3 years for below-median-income chapter 13 debtors, and not less than 5 years for above-median-income chapter 13 debtors like Mr. Coffin. *See* 11 U.S.C. § 1325(b)(4).

There is no such indication.

The statutory requirements that: (a) a chapter 13 plan include all of a debtor's projected disposable income "to be received" during the plan period; and that (b) these amounts "will be applied to make payments" to unsecured creditors, both support this forward-looking reading of section 1325. *See* 11 U.S.C. § 1325(b)(1)(B). A court must interpret a statute as a symmetrical and coherent regulatory scheme and fit, if possible, all parts into a harmonious whole. *See Food & Drug Admin. v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 1301 (2000). Each of these phrases anticipate future action during the life of a debtor's plan. Thus, they reinforce the forward-looking nature of section 1325.

Finally, the phrase "amounts reasonably necessary to be expended" is found in section 1325(b)(2). *See* 11 U.S.C. § 1325(b)(2). This phrase "requires debtors, and courts, to look into the future to determine, inasmuch as possible, what expenses the debtor will have during the life of the plan." *In re Van Bodegom Smith*, 383 B.R. 441, 455 (Bankr. E.D. Wis. 2008). To give this phrase meaning, one must consider whether the debtor will actually "expend" any amounts going forward. *Id.*; *In re Renicker*, 342 B.R. 304, 309 (Bankr. W.D. Mo. 2006) (concluding that "plain language of section 1325(b)(2) unambiguously indicates that prospective – not historical – expenses are to be used to calculate disposable income"). It is axiomatic that loan payments on property that is unencumbered, like Mr. Coffin's vehicles, will not be made in the future, and hence will never be "expended." Accordingly, this language provides additional textual support for this forward-looking reading of section 1325.

Applying section 1325 this way, as the bankruptcy court did, precludes Mr. Coffin from deducting a vehicle ownership expense he will not have over the life of his chapter 13 plan. *In re Coffin*, 396 B.R. 804, 809 (Bankr. D. Me. 2008) ("because Coffin is not incurring out-of-pocket ownership expenses, such expenses cannot fairly be ‘projected’ in a plan”). Because he has no loan or lease payments for his two vehicles, and therefore will not make payments on either of those vehicles in the future, Mr. Coffin is not entitled to claim the $956.00 deduction associated with this non-existent future expense on his means test form. *Cf. Kibbe*, 361 B.R. at 314-15 (adopting forward-looking reading of section 1325 of the Bankruptcy Code). Instead, Mr. Coffin should only be allowed to claim the standardized transportation *operating* expense deduction provided for those debtors who, like Mr. Coffin, do not have a loan or lease expense.[8] *See* 11 U.S.C. § 1325(b)(3) (incorporating section 707(b)(2)(A)(ii) of the Bankruptcy Code, which in turn provides for standardized vehicle operating expense under means test). Accordingly, because the bankruptcy court concluded as much, its ruling should be affirmed.

III. Affirming the Lower Court’s Reading of Sections 707(b)(2)(A)(ii)(I) and 1325 as Limiting Vehicle Ownership Expense Amounts to Debtors Who Have Loan or Lease Payments Fulfills Two Goals Congress Expressed in Enacting the 2005 Act: Ensuring That Above-Median Income Debtors Repay Their Debts When They Can, and Eliminating Abuse.

In interpreting sections 707(b)(2)(A)(ii)(I) and 1325, this Court may consider relevant legislative history to determine the statute’s objectives and illuminate its text. *See Almendarez-Torres v. United States*, 523 U.S. 224, 228 (1998) (“We therefore look to the statute before us and ask what Congress intended. . . . In answering this question, we look to the statute’s language, structure, subject matter, context, and history-factors that typically help courts determine a statute’s objectives and thereby illuminate its text.”); *Crandon v. United States*, 494

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[8] Mr. Coffin suggests that the bankruptcy court failed to account for vehicle registration, insurance, inspection fees, fuel, and maintenance expenses under his means test. *See* Appellant’s Brief, at 18-19. This is not correct. Those expense items were taken into account by the bankruptcy court in its analysis of Mr. Coffin’s means test, although in prescribed amounts that are less than what Mr. Coffin would prefer. *See* United States’ Brief, *supra*, at 4 (discussing application of vehicle *operating* expense deduction under the means test).

U.S. 152, 158 (1990) ("In determining the meaning of the statute, we look not only to the particular statutory language, but to the design of the statute as a whole and to its object and policy.").

The purpose of the 2005 Act was to "ensure that debtors repay creditors the maximum they can afford." H.R. Rep. No. 109-31 (I), at 1, 2005 U.S.C.C.A.N. at 89. *See also Schultz v. United States*, 529 F.3d 343, 347 (6th Cir. 2008) ("The centerpiece of the [2005 Act] is the imposition of a 'means test' for chapter 7 filers."). *Cf. Thomas*, 382 B.R. at 798 ("If a debtor were permitted a car ownership allowance when he actually incurs no such expense, application of the means test would not accurately reflect the debtor's ability to repay creditors, and the purpose of the statute would be frustrated.").

Congress felt this aspect of bankruptcy reform legislation was so important that it included this language in the first paragraph of the first page of the 2005 Act's legislative history. *See* H.R. Rep. No. 109-31 (I), at 1, 2005 U.S.C.C.A.N. at 89 ("The heart of the bill's consumer bankruptcy reforms consists of the implementation of an income/expense screening mechanism ('needs-based bankruptcy relief' or 'means testing'), which is intended to ensure that debtors repay creditors the maximum they can afford.")

Congress saw fit to reiterate this point when it addressed the legislative history to section 707(b).[9] *Id.* at 97-100. Given how important this was to Congress, sections 707(b)(2)(A)(ii)(I) and 1325 should be interpreted in accordance with the overarching goal that underpins the 2005 Act.

Further, the 2005 Act also sought to eliminate "loopholes and incentives" in the system

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[9] As previously noted, section 1325 incorporates large portions of section 707(b). *See* 11 U.S.C. § 1325(b)(3) (incorporating sections 707(b)(2)(A)(ii), (iii), and (iv) of the Bankruptcy Code).

"that allow and – sometimes – even encourage opportunistic personal filings and abuse." H.R. Rep. No. 109-31 (I), at 5, 2005 U.S.C.C.A.N. at 92.

Ensuring, as the lower court did here, that above-median-income debtors are eligible to claim standardized deductions for vehicle ownership expenses only when they have such expenses honors congressional intent that debtors repay their debts when they are able. *See Ransom*, 380 B.R. at 807 ("[W]hat is important is the payments that debtors actually make, not how many cars they own, because the payments that debtors make are what actually affect their ability to make payments to their creditors."); *Wilson*, 383 B.R. at 733 (noting that for above-median-income chapter 13 debtors, the "purpose" of the 2005 Act was to "require" such debtors "to make more funds available to their unsecured creditors"); *Hartwick*, 373 B.R. at 652.

IV. The Bankruptcy Court's Construction of Sections 707(b)(2)(A)(ii)(I) and 1325 Implements Sound Bankruptcy Policy.

A. The Bankruptcy Court's interpretation is fair to debtors and creditors alike.

The bankruptcy court's interpretation of sections 707(b)(2)(A)(ii)(I) and 1325 is fair to all debtors because it establishes a threshold – the existence of vehicle loan or lease payments – for claiming an ownership deduction that is consistent for all chapter 13 debtors.

First it prevents discrimination in favor of better off debtors. Just as below-median-income debtors must incur an expense before claiming a deduction, *see* 11 U.S.C. § 1325(b)(2) (allowing such debtors only "reasonably necessary" expenses), above-median-income debtors must also meet the threshold by claiming "applicable" expenses before shielding income from creditors.

Second, the bankruptcy court's interpretation does not hurt below-median-income debtors – those most likely to file bankruptcy petitions – because such debtors are not subject to section 707(b)(2)'s means test. *See* 11 U.S.C. § 1325(b)(3).

Third, the bankruptcy court's interpretation is fair to creditors because they will receive payments on their debts when above-median-income debtors have the financial ability to repay. In enacting the 2005 Act Congress was concerned that under the prior system, "some bankruptcy debtors are able to repay a significant portion of their debts" but are not required to do so. H.R. Rep. No. 109-31 (I), at 5, 2005 U.S.C.C.A.N. at 92. The bankruptcy court's reading of section 707(b)(2)(A)(ii)(I) is fair to creditors because it ensures that above-median-income debtors significantly repay their debts in chapter 13 plans when they are able.

B. Mr. Coffin's interpretation, by contrast, is unfair.

Mr. Coffin's interpretation of section 707(b)(2)(A)(ii)(I) is unfair because it would allow above-median-income debtors to deduct phantom expenses, something section 1325(b)(2) prevents below-median-income debtors from claiming. *See Wilson*, 383 B.R. at 729 (observing that below-median-income chapter 13 debtors, who are not subject to section 707(b)(2)(A)(ii)(I), are not entitled to deduct the ownership costs for unencumbered vehicles in determining projected disposable income).

Prior to the 2005 Act, above-median-income chapter 13 debtors, like Mr. Coffin, could not deduct vehicle payments when they had no ownership costs in the first place. *See* 11 U.S.C. § 1325(b)(2) (2004) (previously requiring that expenses for all chapter 13 debtors be "reasonably necessary") (subsequently amended by the 2005 Act). To read the 2005 Act as loosening the expense requirements for above-median-income debtors would benefit the very group of debtors that Congress enacted the 2005 Act to scrutinize more closely.

Moreover, Mr. Coffin's argument that requiring expenses to exist before expense amounts are "applicable" somehow discriminates against above-median-income debtors lacks merit for two reasons. Appellant's Brief, at 14-15. First, debtors who, like Mr. Coffin, own an unencumbered vehicle that is over 6 years old or with 75,000 or more miles are entitled to an additional $200.00 expense deduction to cover increased monthly operating expenses associated with their vehicle's age. *See* IRS Internal Revenue Manual, Part 5, Ch. 8, § 5.8.5.5.2, *available at http://www.irs.gov/irm/part5/ch08s05.html* (providing for additional $200.00 operating expense under specified conditions). *See also Ransom*, 380 B.R. at 808 (recognizing $200.00 additional allowance); *Hartwick*, 373 B.R. at 652 (same); *Wilson*, 383 B.R. at 732 (same). Second, if a debtor needs a new vehicle during the course of his chapter 13 plan, he can move to modify his plan to reduce payments to creditors to account for the new expense. *See* 11 U.S.C. § 1329(a); *Wilson*, 383 B.R. at 734 ("[I]n the event a debtor needs a new car during the course of a case, the debtor can move to modify the plan based on changed circumstances."); *In re Coffin*, 396 B.R. at 809 n.15 ("should circumstances after confirmation change, so that the debtors needed to replace (or repair) a vehicle, the court could fairly consider plan modification under § 1329(a).").

CONCLUSION

For these reasons, the United States respectfully asks the Court to affirm the lower court's order.

February 25, 2009

Respectfully submitted,

____
RAMONA D. ELLIOTT
General Counsel
P. MATTHEW SUTKO
Associate General Counsel
DAVID I. GOLD
Trial Attorney
Executive Office for United States Trustees
Department of Justice
20 Massachusetts Avenue, N.W.
Washington, D.C. 20530
Ph: (202) 307-1399
Fax: (202) 307-2397

CERTIFICATE OF SERVICE

I, David I. Gold, do hereby certify that a copy of the foregoing Brief of the United States as Amicus Curiae was served by first class U.S. mail, postage prepaid, this 25 day of February 2009 on the parties listed below:

Gilbert B. Weisman, Esq.
Andrews McNeal, Esq.
Becket & Lee LLP
16 General Warren Blvd.
P.O. Box 3001
Malvern, PA 19355

J. Scott Logan, Esq.
Jeffrey P. White and Associates, P.C.
243 Mt. Auburn Ave., S. B-1
Auburn, ME 04210

Peter C. Fessenden, Esq.
P.O. Box 429
Brunswick, ME 04011

I further certify that the original and 4 copies of the foregoing Brief of the United States as Amicus Curiae have been dispatched for filing with the Clerk of this Court this 25 day of February 2009 via Federal Express Overnight Priority Mail at the address listed below:

Clerk's Office
United States Bankruptcy Appellate Panel
John Joseph Moakley U.S. Courthouse
1 Courthouse Way, Suite 2500
Boston, MA 02210

____
David I. Gold
Attorney for the United States
as Amicus Curiae

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&
In re PTS Rehab, Inc.

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Eric K. Bradford, Attorney for U.S. Trustee for Region 1
(617-565-6360)
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") TOPIC
BANKRUPTCY

9. ("SU") • SUMMARY OF KEY ISSUE(s)

- A Chapter 11 plan is not confirmable if it seeks to traffic in corporate shells.

&

√ Any Miscellaneous BACKGROUND

√ **Background:**
Accord: 11 U.S.C. 1143(d) (prohibiting a corporation that liquidates its assets from receiving a discharge, so as to discourage trading in corporate shells).
See also: 11 U.S.C. 1129(a)(3) (plan that disproportionately benefits insiders of the debtors cannot be deemed to have been proposed in good faith).

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UNITED STATES BANKRUPTCY COURT
DISTRICT OF MASSACHUSETTS
EASTERN DIVISION

In re:	)	
CONSOLIDATED HEALTH CARE ASSOCIATES, INC.,	)	Chapter 11
Debtor	)	Case No. 00-11815-CJK
In re:	)	
PTS REHAB, INC.,	)	Chapter 11
Debtor	)	Case No. 00-11816-CJK

U.S. TRUSTEE'S OBJECTION TO DEBTORS' SECOND AMENDED, JOINT DISCLOSURE STATEMENT

Pursuant to 28 U.S.C. § 586(a)(3)(B), 11 U.S.C. §§ 307, 524, 1125, 1129 and 1141(d), Fed. R. Bankr. P. 3017 and MLBR 3017-1, the United States Trustee objects to the second amended, joint disclosure statement dated October 12, 2000 ("Disclosure Statement") and submitted by Consolidated Health Care, Inc. ("Consolidated") and PTS Rehab, Inc. ("PTS") (collectively "Debtors"), because it fails to provide adequate information regarding the Debtors' second amended, joint plan of reorganization ("Plan"), which, as proposed, is not confirmable:

i. under 11 U.S.C. § 1141(d)(3), insofar as the Debtors seek to discharge their pre-confirmation debts, notwithstanding that they will liquidate their remaining asset(s), they will not engage in business after consummation of the Plan and they, as corporations, would be denied a discharge under 11 U.S.C. § 727(a);

ii. under 11 U.S.C. § 1129(a)(3), insofar as it was not filed for the purpose of reorganizing the Debtors' affairs and disproportionately benefits insiders and others;

iii. under 11 U.S.C. § 1129(a)(7), insofar as the Plan is not in the best interest of creditors;

iv. under 11 U.S.C. § 1129(a)(11), insofar as the Plan is not feasible; and

v. under 11 U.S.C. § 1129(b)(1), insofar as the Plan, in substantively consolidating the Debtors' estates, discriminates unfairly and is not fair and equitable with respect to the consolidated holders of Class 4, general unsecured claims.

In support, the United States Trustee says:

I.
RELEVANT FACTS

1. The Debtors, individually and/or through multiple affiliates, provided "ancillary healthcare and outpatient services" until 1998, by which time they had liquidated substantially all of their assets and had "ceased operat[ing] . . ."[1/] The defunct Debtors did not wind up their affairs and dissolve under applicable State law. Consolidated's stock, which had traded OTC on the NASDAQ exchange, was de-listed in 1998.[2/]

[1/] *Disclosure Statement* at 12; *see* Report of Donald Lassman, Receiver of Consolidated Health Care dated April 30, 1998, which was attached to the United States Trustee's May 9, 2000 motions to convert the Debtors' chapter 11 cases to chapter 7.

[2/] *See Plan* at 6.

2. The Debtors state that their "only unencumbered asset is the value of the fact that the shares in Consolidated are publicly traded . . ." (sic).[3]

3. Renaissance, which holds the majority of the Consolidated's stock and "a partially secured claim of $1.2 million . . . ,"[4] is an insider of the Debtors.[5] Renaissance's liquidating trustee, Thomas W. Pauken, "now serves as President and Chairman of the Board for both of the Debtors . . ."[6] Other than Mr. Pauken, the Debtors have no other management. Renaissance, therefore, is the true Plan proponent.

4. The Debtors filed voluntary chapter 11 petitions on March 15, 2000. The Debtors are not operating and have no employees.[7] Since the Debtors have not filed tax returns for the years 1997 - 1999, they cannot yet confirm whether they owe pre-petition taxes.[8]

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[3] *Disclosure Statement* at 13. Other than its corporate shell, Consolidated's remaining assets currently consist of: a) its 100% ownership of the stock of PTS; and b) accounts receivable, "which have little or no value since all are over two years old . . ." and are subject to the perfected first lien security interest of Capital Factors, Inc. ("CFI"). *Id.* at 13. PTS's assets consist of: a) a note receivable from NovaCare Outpatient Rehabilitation, Inc. ("Note"), which it has agreed to surrender to CFI per the terms of a stipulation dated June 22, 2000; and b) $150,000 currently deposited in an escrow account ("Escrow Funds"), which is subject not only to claims asserted by the landlord plaintiff ("Landlord") in a breach of contract action pending in Norfolk County Superior Court but also to prior perfected security interests of CFI and Renaissance Capital Partners II, Ltd. ("Renaissance"). *Id.* at 12 and 13. On a consolidated basis, the Debtors are balance sheet insolvent. *See* Schedules. The Debtors apparently realized a consolidated loss on operations totaling $4,585,201 in 1997. *Disclosure Statement* at *Exhibit "B."*

[4] *See* Motion for Authority to Incur Debt With Administrative Priority dated May 3, 2000 and filed by Consolidated ("Borrowing Motion") at 2.

[5] *See* 11 U.S.C. § 101(31)(B).

[6] *Disclosure Statement* at 20.

[7] *Id.* at 12 - 13.

[8] *Id.* at 13.

5. Under the Plan, the Debtors propose, among other things:

   i. to consolidate substantively their bankruptcy estates, notwithstanding that they can neither quantify inter-company liabilities nor demonstrate that doing so will be fair to each company's creditors;[9]

   ii. to pay holders of general, unsecured claims (which, according to their schedules "F," collectively exceed $1,000,000 and are subsumed as Class 4) a *pro rata* share of a *de minimus* $10,000 "Plan Deposit," plus the balance of the Escrow Funds, *if any*, after liquidation and payment of the Landlord's claim;[10]

   iii. to conduct a "reverse merger" with an operating, non-debtor company, Business Partners Leasing, Inc. ("BPL") or a substitute, which will ultimately issue 90% of its stock ("Stock") to BPL's shareholders, 7% collectively to Founders Equity Group, Inc. ("Founders") and Renaissance[11] and 2.81% to holders of Class 4, general unsecured claims;[12]

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[9] *Id.* at 14 - 15 .

[10] *Id.* at 22. The schedule "F" creditors *exclude* those holding unsecured deficiency claims. The Plan suggests that there might not be *any* cash distribution to holders of Class 4 unsecured claims, other than the Plan Deposit, because the post-petition loan proceeds and the Escrow Funds exceeding the Landlord's recovery will be used to complete the reverse merger. "BPL shall be responsible for and pay the Post Confirmation Debtor's costs and expenses associated with the reverse merger transactions *if there are insufficient funds to do so from the Loan Amount and the Remaining Escrow Amount* . . ." *Plan* at 17 (emphasis added). The total cash dividend to holders of Class 4 unsecured claims might be as little as 1% ($10,000/$1,000,000).

[11] The Plan will be substantially consummated in a penultimate step, however - PTS will merge into Consolidated, which will issue 70% of its stock to Founders and Renaissance "in exchange for the release of their Administrative Claims for the Loan Amount. The remaining 30% of the Plan shares of the Post Confirmation Debtor will be issued to holders of Allowed Unsecured Claims on a pro rata basis . . ." *Plan* at 16. The merged entity – the so-called "Post Confirmation Debtor" – will itself conduct no business. *Id.*

[12] *Id.* at 15 - 17; *Plan* at 7. *Query*: Do the Debtors assert that the distribution of Stock to Class 4 general unsecured creditors will result in payment in full? *Assuming* that the Plan contemplates a true reorganization, and not a liquidation of the Debtors' assets, does the $14,000 post-petition loan advanced by Renaissance constitute "fresh capital" for purposes of evaluating whether it, in its capacity as a monopoly/majority shareholder, may receive property in violation of the absolute

iv. to change their name to BPL (or to that of the substituted company);[13] and

v. to discharge themselves, BPL, Founders and Renaissance of all of the Debtors' pre-petition debts and to enjoin creditors from pursuing any claims against BPL, Founders and Renaissance on any grounds.[14]

6. The Debtors will not engage in business following consummation of the Plan, because they currently have no business. Similarly, the so-called Post Confirmation Debtors will not conduct any business.

7. No one has agreed, or will presently agree, to "make a market" in the Stock, which, the Debtors' admit, will limit its value to holders of Class 4 unsecured claims.[15]

8. The Disclosure Statement states that "1999 was BPL's first fiscal year of operations . . ."[16] However, the notes to BPL's audited financial statements ("BPL Statements"), covering the calendar years 1998 and 1999, and the Disclosure Statement indicate that it began operating in 1997.[17] The BPL Statements state:

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priority rule? *See* 11 U.S.C. § 1129(b)(2)(B)(ii); *Bank of American Nat. Trust and Sav. Assn. v. 203 North LaSalle Street Partnership*, 119 S.Ct. 1411 (1999) (holding that creditors be afforded an opportunity to bid for the equity of a reorganized debtor under the fresh capital exception to the absolute priority rule).

[13] *Plan* at 7. Under the original, June 23, 2000 disclosure statement and plan, the Debtors proposed to "reverse merge" into Innovative Financial Systems, Inc.

[14] *Plan* at 20 - 21. *Disclosure Statement* at 31.

[15] *Id.* at 17; 19.

[16] *Disclosure Statement* at 21.

[17] *See Disclosure Statement* at 21 and *Exhibit "D."*

- that BPL's 1999 and 1998 net losses totaled ($53,680) and ($51,696), respectively;

- that BPL's total liabilities increased by $2,721,026 from 1998 to 1999;[18]

- that BPL is a highly leveraged company – its debt to equity ratio at December 31, 1999 was 12.7. Thus, its creditors hold a 92.7% interest in total assets, while equity holders maintain a 7.3% interest in total assets;

- that while total assets increased by $2,657,346 from 1998 to 1999, $1,704,458 of this increase came from finance lease receivables. Two customers represented 52.3% of the total finance lease receivable balance at December 31, 1999. According to the notes to the BPL's financial statements, BPL has assigned $1,747,329, or 86.7%, of these receivables to various financial institutions holding notes payable from BPL; and

- that Founders is a creditor and, possibly, an insider of BPL.[19]

9. Based upon information and belief, the purpose of the Plan is to traffic in the Debtors' corporate shell(s).[20]

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[18] $226,346 to $2,947,372. *See Disclosure Statement Exhibit "D."*

[19] *See Disclosure Statement* at *Exhibit "C,"* page 10.

[20] This has apparently been the Debtors' plan for almost three years. "According to Mr. Whitty [the Debtors' former president], Consolidated also hoped to engineer a sale of its publicly traded corporate shell. According to Mr. Whitty, negotiations have thus far been unsuccessful but are ongoing. Sale of the shell likely represents the best possibility for debt repayment to unsecured creditors . . ." *Lassman Report* at 3 - 4.

II.
ARGUMENT

A. The Court Should Deny Approval Of The Disclosure Statement, Because The Plan Is Not Confirmable

i. The Code prohibits a corporate debtor liquidating its assets from obtaining a discharge. In doing so, it prevents "trafficking" in corporate shells.

10. One of the reasons that section 1141(d) grants a broad discharge from pre-confirmation debts to a corporation *that confirms a plan of reorganization* is to encourage new investment in the company, consistent with the "fresh capital" exception to the absolute priority rule, which, in turn, promotes the company's continued operation. "If there is a possibility that a substantial portion of the debts that forced the corporation into bankruptcy will be nondischargeable, the likelihood that any new equity value would be contributed to the corporation would be diminished and liquidation would be the more viable alternative." In re *A.H. Robins Co., Inc.*, 59 B.R. 99, 104 (Bankr. E.D. Va. 1986).[21] With new investment, a reorganized company preserves its future earning capacity as a going concern, facilitating its paying a dividend to creditors. *Id.*

11. Section 1141(d)(3) specifically prohibits a corporation that *liquidates* its assets from receiving a discharge, however. In re *SIS Corp.*, 120 B.R. 93, 96 (Bankr. N.D. Ohio 1990). Section 1141(d)(3) states:

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[21] *See also* In re *White Motor Credit Corp.*, 37 B.R. 361 (N.D. Ohio 1984), *aff'd*, 761 F.2d 270 (6th cir. 1985).

> (3) The confirmation does of a plan does not discharge a debtor if –
>
> (A) the plan provides for the liquidation of all or substantially all of the property of the estate;
>
> (B) the debtor does not engage in business after consummation of the plan; and
>
> (C) the debtor would be denied a discharge under section 727(a) of this title if the case were a case under chapter 7 of this title.

12. In In re *Fairchild Aircraft Corp.*, 128 B.R. 976, 982 the bankruptcy court analyzed the reasons underlying Congress' prohibition against a *liquidating* corporation's obtaining a discharge.

> Congress designed Section 1141(d)(3) to discourage trading in corporate shells. H.R.Rep. No. 595, 95th Cong. 1st Sess. 384 (1977), U.S. Code Cong. & Admin. News 1978, p. 5787. It achieves that goal by freighting the shell with all the claims, so that any claims or portions of claims not paid by the liquidation will attach to the shell, making the shell much less attractive for use in starting up another enterprise. Thus, while there is no legal impediment to pursuing the corporation, there is precious little economic incentive . . . *The protection [against trafficking in corporate shells] is especially significant with respect to publicly traded companies. Without it, entities would be tempted to pick up the shell, issue new stock, and start a new business without the dead weight of old debt, undermining not only the integrity and bona fides of the bankruptcy system but also the underlying salutary function of the securities laws . . .*

In re *Fairchild Aircraft Corp.*, 128 B.R. at 982 and n.6 (emphasis added).[22/]

[22/] "[I]n a departure from pre-Code law, partnerships and corporations cannot receive a discharge in a liquidation case. The policy behind this provision is the prevention of trafficking in corporate shells and bankrupt partnerships. *A corporation may obtain relief from its debts through dissolution. But it does not need relief if it no longer has any assets* . . ." 6 COLLIER ON BANKRUPTCY, ¶ 727.01[3] (15th Ed. Rev. 2000) (emphasis added).

13. The Court cannot confirm the Plan, because it seeks to discharge the Debtors' pre-confirmation debts while violating section 1141(d)(3):

- first, the Plan requires the Debtors to liquidate their remaining asset(s) "of value" – Consolidated's corporate shell – through the sale to BPL, or to a substitute purchaser;

- second, insofar as the Debtors are not operating and have been defunct since 1998, they have no business to continue. The Debtors – merged or otherwise – will also not conduct business after the Plan is consummated[23/] – *i.e.* when the Debtors "fold" PTS into Consolidated and distribute "Plan Shares" in the melded entity to Renaissance, Founders and holders of Class 4 general unsecured claim, together with the *de minimus*, *pro rata* cash dividend; and

- third, the Debtors, as corporations, would be denied a discharge in chapter 7.

14. The Plan essentially traffics in the Debtors' corporate shell(s), which is prohibited by the Code. Accordingly, it cannot be confirmed.[24/]

[23/] Section 1101(2) defines "substantial consummation" as:

> (A) transfer of all or substantially all of the property proposed by the plan to be transferred;
>
> (B) assumption by the debtor or by the successor to the debtor under the plan of the business or of the management of all or substantially all of the property dealt with by the plan; and
>
> (C) commencement of distribution under the plan.

C/f Financial Security Assurance, Inc. v. T-H New Orleans, L.P. (In re T-H New Orleans, L.P.), 116 F.3d 790, 802 (5th Cir. 1997) (affirming that a plan requiring the corporate debtor to continue operating its hotel for two years following confirmation was not a liquidating plan).

[24/] *See In re Maxim Industries, Inc.*, 22 B.R. 611 (Bankr. D. Mass. 1982) (court denied confirmation of chapter 11 plan whose sole purpose was to use the debtor's shell to preserve tax attributes), discussed *Infra*. Moreover, a Chapter 11 case can be commenced only for reorganization purposes. *In re Coastal Cable T.V., Inc.*, 709 F.2d 762, 764 - 765 (1st Cir. 1983).

ii. Insofar as the Plan disproportionately benefits insiders of the Debtors, it has not been proposed in good faith under 11 U.S.C. § 1129(a)(3).

15. In a case presenting similar facts, the debtor, a shell corporation, had no operations, no employees and no assets, save a potential tax loss. In re *Maxim Industries, Inc.*, 22 B.R. at 611. The debtor proposed a plan of reorganization under which it agreed to acquire 100% of the stock of an operating company for $1,000,000, with the funding for stock purchase to be provided by the "target" itself. The plan provided that unsecured creditors would receive a dividend totaling as much as 10% over five years, based upon a percentage of the merged company's earnings. Notwithstanding that "the minimal payment which this plan provided to the unsecured creditors would be more than they would receive in liquidation since the debtor was a mere shell . . .,"[25] the court denied confirmation of the plan on grounds that it had not been proposed in a good faith attempt to reorganize the debtor's affairs, but rather to take advantage of the debtor's pre-petition net loss carry forwards. The court stated:

> The purpose of a Chapter 11 reorganization proceeding is to enable a business to rehabilitate itself and become a profitable going concern . . . Chapter 11 was not designed to permit the use of shell corporations for the personal benefit of the officers of the corporation. In fact, under the new Bankruptcy Code, a corporation or partnership is not entitled to a discharge in Chapter 7. 11 U.S.C. § 727. This change in policy from the old law was specifically aimed at avoiding trafficking in corporate shells and bankrupt partnerships . . . Bankruptcy is perceived as a haven for wistfulness and the optimist's Valhalla where the atmosphere is conducive to fantasy and miraculous dreams of the phoenix rising from the ruins. Unfortunately, this Court is not held during the full moon, and while the rays of sunshine sometimes bring the warming rays of the sun, they more often also bring the bright light that makes transparent and evaporates the elaboraD:\Web DW\XDOJ Net (-12)\briefs\ConPTS1.wpdD:\Web DW\XDOJ Net (-12)\briefs\ConPTS1.wpdte financial fantasies constructed of nothing more than the gossamer wings and of sophisticated tax legerdemain . . .

Id. at 613 - 614.

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[25] *Id.* at 611 - 612.

16. Here, the primary beneficiaries of the corporate shell locomotion proposed by the Plan are not pre-petition, unsecured creditors, who will receive a *de minimus* cash dividend and a *pro rata*, 2.81% distribution of stock having an speculative future worth, but rather an insider of the Debtors – Renaissance – and the stockholders of BPL:

> - Renaissance benefits, because it will merge one of its struggling borrowers/investments – BPL – into two of its moribund investments – the Debtors – securing 2.19% of new corporation's stock, all "in exchange" for its $14,000 post-petition loan.[26] Renaissance also gets a non-debtor discharge for all of the Debtors' pre-confirmation debts and injunctive relief against all parties on any causes of action relating to its involvement with the Debtors.[27]
>
> - The stockholders of BPL, apparently including Renaissance, benefit, because they receive a total of 90% of the stock in the reconstituted company, which, with the Court's imprimatur, they will launch "OTC," without the Security and Exchange Commission's customary vetting. BPL's stockholders will further benefit, because, as the Debtors admit, they will avoid "market risks" associated with conventional initial public offerings, "eliminate[] the time and expense associated with 'road shows . . . to brokers and underwriters . . ." and "[l]eave a higher portion of the company in [their] hands . . ." [28] Like Renaissance, BPL gets a broad, third-party, non-debtor discharge.

17. Renaissance and BPL also receive a benefit unavailable to Class 4 unsecured creditors by virtue of the sheer size of their positions in BPL's Stock – *viz.*, the ability to make a market for their shares OTC and ready access to those who might want to buy or sell it (themselves). Given BPL's dismal earnings record as a private company and its manifest reluctance to engage public equity markets, it is reasonable to assume that the only people willing to relieve creditors of their Stock will be Renaissance and BPL, who, having control of BPL anyway, might have no incentive

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[26] *Id.* at 9; 17. Renaissance equity investment in the Debtors, which it has characterized as undersecured "loans," entitling it to status as the Class 5 creditor, should be subordinated. See 11 U.S.C. § 510.

[27] It is unclear that Founders, Innovative and Renaissance can shield themselves from successor or alter ego liability for the Debtors' debts. *See N.L.R.B. v. Better Building Supply Corp.*, 837 F.2d 377 (9th Cir. 1988).

[28] *Id.* at 15 - 16.

– strategic, financial or otherwise – to do so. It follows that the market for the Stock will be exceedingly thin and that Class 4 creditors might never be able to redeem their shares for money or money's worth. Similarly, the Plan does not prevent BPL from diluting the creditors' position by issuing more Stock. Thus, the value of the Stock is highly speculative.

18. At bottom, the Plan benefits an insider – Renaissance – and BPL's stockholders disproportionately *vis a vis* unsecured creditors by giving them a controlling stake in a public company for which they are at nominal risk, coupled with a broad discharge and injunctive relief for which they have paid nothing. Class 4 creditors, on the other hand, might never realize any benefit from the Plan, other than a *de minimus* 1% cash distribution, because the bulk of their prescribed consideration – Stock – will be illiquid and, thus, of uncertain value to anyone other than Renaissance or BPL insiders, who might neither wish to buy it nor have any compunction against issuing new shares, which would dilute the value of the Stock. The Debtors/Renaissance have not proposed the Plan in good faith. 11 U.S.C. § 1129(a)(3). Accordingly, the Plan is not confirmable, and the Court should not approve the Disclosure Statement. *See In re Maxim Industries, Inc.*, 22 B.R. at 611.

iii. The Plan is not in the best interest of creditors.

19. The plan releases and permanently enjoins claims against non-debtors, including BPL, Renaissance and Founders, without their having provided any consideration, in violation of 11 U.S.C. § 524(e). *See Securities and Exchange Commission v. Drexel Burnham Lambert Group, Inc. (In re Drexel Burnham Lambert Group, Inc.)*, 960 F.2d 285, 293 (2d Cir. 1992); *In re Continental Airlines*, 203 F.3d 203, 211 - 213 (3d Cir. 2000). Accordingly, the Plan is not in the best interest of creditors, and the Court should not approve the Disclosure Statement. 11 U.S.C. § 1129(a)(7).

iv. The Plan is not feasible.

20 The Debtors admit that if the Stock in the ultimately merged entity is to have any value, it must, among other things, "raise additional debt and equity capital . . .", list the Stock on a "national securities exchange . . ." and receive a favorable market reception for the Stock.[29] Given BPL's extant debt-to-equity ratio of 12.7 and its cumulative losses for 1998 - 1999 totaling $105,376,[30] these contingencies might never occur within lives in being. Accordingly, the Plan cannot be confirmed, because it is not feasible, and the Court should not approve the Disclosure Statement. 11 U.S.C. § 1129(a)(11).

v. The Plan discriminates unfairly and is not fair and equitable.

21. The Disclosure Statement wholly fails to establish the factors necessary to support the Debtors' being substantively consolidated, including whether there has been "a disregard of corporate formalities and commingling of assets by various entities" and the relative harm to the Debtors' respective creditor groups. In re *Bonham, et al.*, __ F.3d __, 2000 WL 14768752 (9th Cir. 2000) at 37, *citing* In re *Reider*, 31 F.3d 1102, 1106 (11th Cir. 1994). The Plan discriminates unfairly and is not fair and equitable as to the general, unsecured creditors of the respective debtors. Accordingly, the Court should not approve the Disclosure Statement. 11 U.S.C. § 1129(b)(1).

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[29] *Id.* at 17.

[30] Ordinarily, a debtor's post-petition performance is relevant to the Court's analysis of whether a plan is feasible. *See* In re *Agawam Creative Marketing Assoc., Inc.*, 63 B.R. 612, 620 (Bankr. D. Mass. 1986), *citing* In re *Merrimac Valley Oil Co., Inc.*, 32 B.R. 485, 488 (Bankr. D. Mass. 1983). As discussed above, the Debtors have been defunct for two years. (The Debtors' monthly operating reports indicate that the Debtors have lost $35,727.29 since the petition date). Feasibility of the Plan, therefore, turns on the likelihood that BPL will operate profitably and attract both new investment and credit facilities. Given BPL's mediocre track record over last two years, it is reasonable to believe that none of the conditions precedent to the Stock's having value will ever occur.

22. When a plan is not confirmable on its face, the Court should not approve its supporting disclosure statement and subject the estate to further diminution by continuing the reorganization process. *See In re Bjolmes Realty Trust*, 134 B.R. 1000 (Bankr. D. Mass. 1991). Accordingly, the Court should deny the Disclosure Statement.

B. Deficiencies Per Section 1125

23. The Disclosure Statement is deficient in that it: i) fails to discuss Renaissance's apparent interest in BPL; ii) fails to discuss the impact of substantive consolidation upon each Debtor's respective creditors; iii) fails to discus why the Plan grants discharges and post-confirmation injunctive relief to non-debtor third parties, including Renaissance, who will pay no consideration for their tangible benefits; iv) fails to discuss how Class 4 creditors receiving Stock might reasonably expect to redeem their shares for money or money's worth; v) fails to discuss whether the Plan will restrict BPL's ability to dilute the value of Stock issued to Class 4 unsecured creditors; vi) fails to discuss why Renaissance has characterized its Class 5 claims for "loans" instead of wholly subordinated equity contributions; vii) fails to discuss why the Debtors never filed 1997 - 1999 tax returns; viii) fails to discuss Renaissance's connections with BPL's stockholders, Don Moorehead, George Moorehead, Tim Stone and Founders; ix) fails to disclose the current financial condition of Renaissance and Founders; x) fails to discuss Thomas Pauken's relationship with Founders, the Mooreheads and Mr. Stone; and xi) fails to discuss whether there are any inter-company liabilities between the Debtors. Without such information, creditors will be unable to make an informed decision regarding the Plan. *See In re Ferretti*, 128 B.R. 16, 19 (Bankr. D. N.H. 1991); *In re Adana Mortg. Bankers, Inc.*, 14 B.R. 29, 31 (Bankr. N.D. Ga. 1981).

III.
PRAYER

WHEREFORE, the United States Trustee prays that the Court enter an order denying approval of the Disclosure Statement and granting him general relief.

Respectfully submitted,

J. CHRISTOPHER MARSHALL
United States Trustee

By: ______________________________
Eric K. Bradford BBO#560231
United States Department of Justice
Thomas P. O'Neill Jr. Federal Bldg.
10 Causeway Street, Room 1184
Boston, MA 02222
(617) 565-6360

Dated: November 3, 2000

CERTIFICATE OF CONFERENCE

Pursuant to MLBR 3017-1, the undersigned certifies that as a follow up to his July 28, 2000 letter (which delimited interrelated disclosure and plan confirmation objections and is attached to the *Disclosure Statement* at *Exhibit "D"*), he met in person with counsel for Consolidated, Mark DeGiacomo, Esq., and his client representative, Mr. Pauken, on September 11, 2000 in a good faith effort to narrow areas of disagreement. At that time, the undersigned agreed to withhold confirmation objections until the Plan confirmation hearing. The parties have twice sought joint extensions of time so as to allow each of them to prepare its best possible work product. Each has also discussed the Plan with counsel for the Securities and Exchange Commission, Nat Fuchs, Esq.

The Debtors filed the Disclosure Statement on October 12, 2000. While the Disclosure Statement is an improvement upon its predecessor as to section 1125(a) issues, the United States Trustee has reluctantly concluded that the Plan cannot be confirmed as a matter of law and that proceeding to confirmation (*assuming* that the Debtors correct the deficiencies noted in paragraph 23 *supra*) is futile and will further deplete the Debtors' estate(s). Accordingly, the United States Trustee urges the Court in the foregoing Objection to deny approval of the Disclosure Statement, because, among other things, the Plan cannot be confirmed.

The undersigned unsuccessfully attempted to discuss the Objection – and the United States Trustee's changed position – with Attorney DeGiacomo on October 26, 2000.

____
Eric K. Bradford

CERTIFICATE OF SERVICE

The undersigned certifies that on November 3, 2000, true and correct copies of the foregoing statement were served via United States mail, First Class postage pre-paid, and facsimile, where indicated, upon the individuals listed below.

____
Eric K. Bradford

Gary W. Cruickshank, Esq.
21 Custom House
Boston, MA 02110
(Counsel for PTS)
(***Via Facsimile 330-1970***)

Mark DeGiacomo, Esq.
Roche, Carens & DeGiacomo, P.C.
99 High Street
Boston, MA 02110
(Debtor's Counsel)
(***Via Facsimile 482-3868***)

Joseph P. Bernardo, Esq.
655 Boston Road, Unit 3B
Billerica, MA 01821
(Counsel to Capital Factors)

Christopher T. Harkins, Esq.
Dangel & Fine, LLP
10 Derne Street
Boston, MA 02114

Frederick A. Busconi, Esq.
162 Cordaville Road, Suite 1190
Post Office Box 488
Southborough, MA 01772

United States Attorney
United States Courthouse
One Courthouse Way, Suite 9200
Boston, MA 02210

Donald R. Lassman, Esq.
Law Offices of Donald Lassman
P.O. Box 920385
Needham, MA 02492

Nat Fuchs, Esq.
Securities and Exchange Commission
7 World Trade Center
New York, N.Y. 10048
(***Via Facsimile 212-748-8554***)

BRIEF BANK — 'SUMMARY SHEET" *Printed Wed-9/28/05 12:39*

WESTLAW CODES

1. **("TI")** *TITLE* OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	Conway v UST (In re Conway)
2. **("CO")** *CURRENT* COURT *[E.g., "CTA9"]*	CTA6
3. **("CCN")** *CURRENT* CASE NO.	No.: 05-5225, 05-5227, 05-5358, & 05-5359
4. **("PCN")** *PRIOR* CASE NO. & COURT *[IF ANY]*	No.: Court: BAP6 *(Identify judge & cite, if any)*
5. **("SO")** *SOURCE*	U.S. TRUSTEES
6. **("DA")** *DATE* OF FILING *& TYPE* OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	Filed: Sept 2005 Type: Brief for Appellee, UST
7. **("AU")** *PRINCIPAL AUTHORS & OFFICE [E.g.,"UST/OGC"]*	Sean M. Hayes, Esq., AUST P. Matt Sutko, Esq., OGC *(UST/OGC: 202-307-1399/FAX-2397)*
8. **("TO")** *TOPIC*	BANKRUPTCY
9. **("SU")** ● *SUMMARY* OF KEY ISSUE(s) & √ Any Miscellaneous *BACKGROUND*	● Did the bankruptcy court commit clear error in denying Mr. Conway's Chapter 7 discharge given that he: 1) refused to testify at an October 30, 2002 deposition; refused to obey orders requiring him to respond to discovery requests approved by the bankruptcy court; refused to testify at his 11 U.S.C. § 341 Meeting of Creditors; and refused to be examined pursuant to F.R.B.P. 2004, in violation of 11 U.S.C. § 727(a)(6)(C); 2) concealed property of the Estate after the date of the filing of the petition in violation of 11 U.S.C. § 727(a)(2)(B); and 3) failed to explain a devaluation of assets of at least $690,400 in violation of 11 U.S.C. § 727(a)(5).
10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)	H:\seggert\My Files\BriefBank-Web\Conway\Conway0I.wpd
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No. 05-5225
(Consolidated for Briefing with 05-5227; 05-5358; and 05-5359)

In the
United States Court of Appeals
for the Sixth Circuit

In re Larry Conway,
Debtor.

Larry Conway,
Appellant,

v.

United States Trustee for Region 8, and Preston Wilson, Chapter 7 Trustee,
Appellees.

On Appeal from the Bankruptcy Appellate Panel
for the Sixth Circuit

Brief of Appellee, United States Trustee for Region 8

ROBERTA DeANGELIS,
Acting General Counsel

P. MATTHEW SUTKO
United States Department of Justice
Executive Office for United States Trustees

SEAN M. HAYNES
United States Department of Justice
Office of the United States Trustee
200 Jefferson Avenue, Suite 400
Memphis, TN 38103
(901) 544-3486

Counsel for Appellee,
Richard F. Clippard, United States Trustee

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Statement Regarding Oral Argument

We believe that, due to the nature of the issues involved in this case, oral argument will not materially aid the Court in deciding the case.

No. 05-5225
(Consolidated for Briefing with 05-5227; 05-5358; and 05-5359)

In the
United States Court of Appeals
for the Sixth Circuit

In re Larry Conway,
Debtor.

Larry Conway,
Appellant,

v.

United States Trustee for Region 8, and Preston Wilson, Chapter 7 Trustee,
Appellees.

On Appeal from the Bankruptcy Appellate Panel
for the Sixth Circuit

STATEMENT OF JURISDICTION

(a) The bankruptcy court had jurisdiction over Larry Paul Conway's Chapter 7 bankruptcy case and the United States Trustee's adversary proceeding seeking to revoke Mr. Conway's discharge, under 28 U.S.C. § 157(b) and § 1334. The bankruptcy court entered its final Order Denying Discharge on February 3, 2004.

(b) The Bankruptcy Appellate Panel of the Sixth Circuit ("BAP") had jurisdiction over Mr. Conway's appeal from the bankruptcy court's Order Denying Discharge under 28 U.S.C. § 158(a) and (b).

(c) This Court has jurisdiction over Mr. Conway's appeal from the BAP's Judgement affirming the bankruptcy court under 28 U.S.C. § 158(d).

STATEMENT OF THE ISSUE

Did the bankruptcy court commit clear error in denying Mr. Conway's Chapter 7 discharge given that he:

- refused to testify at an October 30, 2002 deposition; refused to obey orders requiring him to respond to discovery requests approved by the bankruptcy court; refused to testify at his 11 U.S.C. § 341 Meeting of Creditors; and refused to be examined pursuant to F.R.B.P. 2004, in violation of 11 U.S.C. § 727(a)(6)(C);

- concealed property of the Estate after the date of the filing of the petition in violation of 11 U.S.C. § 727(a)(2)(B); and

- failed to explain a devaluation of assets of at least $690,400 in violation of 11 U.S.C. § 727(a)(5).

STATEMENT OF THE CASE

On February 26, 2002, Mr. Larry Conway filed a voluntarily petition under Chapter 11 of the Bankruptcy Code.[1] BR 1-1. Mr. Conway's original schedules

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[1] Record citations to bankruptcy case docket entries are denoted herein as BR (docket number)- (page number of the document). Record citations to adversary proceeding docket entries are denoted herein as APR (docket number) -

represented under penalty of perjury that his Estate held approximately $13,882,267 in assets. BR 9-1. Upon a motion filed by the United States Trustee[2] (BR 130-1), the bankruptcy court converted the Chapter 11 case to a case under Chapter 7 on November 7, 2002. BR 209-1; Conv. Tr. 71; and see 11 U.S.C. §

(page number of the document). References to the November 4, 2002 conversion hearing are denoted Conv. Tr. (page number of transcript). References to the January 8, 2004 default judgment hearing transcript are denoted herein as D.J. Tr. (page number of transcript). References to the January 29, 2004 evidentiary hearing are denoted herein as Ev. Tr. (page number of transcript).

[2] United States Trustees are officials of the Department of Justice appointed by the Attorney General to supervise the administration of bankruptcy cases and trustees. See 28 U.S.C. § 581-589 (specifying the powers of United States Trustees); United States Trustee v Revco D.S., Inc. (In re Revco D.S., Inc.), 898 F.2d 498, 499 (6th Cir. 1990) ("[t]he United States trustee, an officer of the Executive Branch, represents... [the] public interest"); United States Trustee v. Columbia Gas Systems, Inc. (In re Columbia Gas Systems, Inc.), 33 F.3d 294, 296 (3d Cir. 1994)(United States Trustees oversee the bankruptcy process, protect the public interest, and ensure that bankruptcy cases are conducted according to law)

United States Trustees are appointed pursuant to 28 U.S.C. § 581. United States Trustees "may appear and be heard in any case or proceeding" in bankruptcy cases (with the sole exception of not being authorized to file a Chapter 11 plan). 11 U.S.C. § 307. Section 586 of title 28 mandates that United States Trustees "take such action" as necessary to ensure performance of duties by bankruptcy debtors. See 28 U.S.C. § 586(a)(3)(D). In cases pending under Chapter 11, United States Trustees are authorized to seek the appointment of a trustee (11 U.S.C. § 1104) or move for case dismissal or conversion of the Chapter 11 case to a case under Chapter 7 (11 U.S.C. § 1112(b)). In cases pending under Chapter 7, United States Trustees can seek case conversion or dismissal (11 U.S.C. §§ 706 and 707). United States Trustees can also object to the granting of a discharge to a Chapter 7 debtor. 11 U.S.C. § 727(c)(1).

1112(b) (authorizing a bankruptcy court to convert a Chapter 11 case to a case under Chapter 7). Mr. Conway appealed the conversion. BR 215-1. The United States District Court for the Western District of Tennessee affirmed the bankruptcy court's decision to convert. Conway v. Vergos, 02-2974-M1 (W.D. Tenn. October 1, 2003).[3] BR 392-1. Mr. Conway did not appeal from that decision.

On October 27, 2003, after completing a review of the relevant facts, the United States Trustee filed his Complaint Objecting to Discharge. BR 401-1; APR 1-1. The United States Trustee cited three bases for the denial of discharge: Mr. Conway's refusal to testify, in violation of 11 U.S.C. § 727(a)(6)(c); Mr. Conway's

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[3] When Mr. Conway filed his bankruptcy case (February 26, 2002), Ellen B. Vergos was the duly appointed United States Trustee for Region 8. On January 21, 2003, Richard F. Clippard was appointed as the new United States Trustee for Region 8. He was automatically substituted in Ms. Vergos' place in then-pending proceedings, per Rule 43(c)(2) of the Federal Rules of Appellate Procedure. Obviously, when the Complaint Objecting to Discharge was filed on October 27, 2003, Mr. Clippard, in his capacity as United States Trustee, was the Plaintiff. Mr. Clippard, in his capacity as United States Trustee, is the true party in interest/Appellee in appeal 05-5225. The styles of other appeals brought by Mr. Conway and consolidated with 05-5255 reference "Richard Clippard" and/or "Sean Haynes." Sean Haynes is a Trial Attorney employed by the United States Trustee. Neither Mr. Clippard, in his individual capacity, nor Mr. Haynes, in his individual or official capacities, are parties to any of the appeals or proceedings below. Certain allegations relating to federal officials (e.g., Appellant's Brief at 6, 7, 8, 22, 26, 28, 34, 39, and 41) are unsupported by the record and are inaccurate.

concealment of assets, in violation of 11 U.S.C. § 727(a)(2)(B); and Mr. Conway's failure to explain a massive devaluation of assets, in violation of 11 U.S.C. § 727(a)(5). BR404-1; APR 1-1. More than thirty days passed after service of the Complaint and Summons, but Mr. Conway did not answer the Complaint. APR 5-1. On December 15, 2003, the United States Trustee filed his Motion for Default Judgment. APR 4-1. On January 8, 2004, the bankruptcy court heard the United States Trustee's Motion for Default Judgment (D.J. Tr. 1-1) and ruled that a default would be entered against Mr. Conway (APR 8-1); however, the Court declined to enter a final judgment without an evidentiary hearing. D.J. Tr. 2.

On January 13, 2004, the bankruptcy court issued an Entry of Default (APR 8-1) and notified the parties that the bankruptcy court would conduct a January 29, 2004 evidentiary hearing to consider a final judgment against Mr. Conway. Id. On January 29, 2004 the bankruptcy court conducted an evidentiary hearing. Ev. Tr. 1. The bankruptcy court heard testimony and considered the trial exhibits introduced into evidence by the United States Trustee. Id.

At the conclusion of the January 29, 2004 hearing, the bankruptcy court ruled that it would deny Mr. Conway's discharge. Ev. Tr. 37-41. On February 3, 2004, the bankruptcy court entered its Order Denying Discharge. APR 10-1; BR 411-1. That Order referenced each of the three grounds alleged by the United States

Trustee (11 U.S.C. §§ 727(a)(2)(B), (a)(5), and (a)(6)(C)) as being bases for denial of discharge. Id. On February 11, 2004, Mr. Conway filed his Notice of Appeal, requesting adjudication by the BAP. BR 416-1. By its December 28, 2004 Judgement and Opinion ("BAP Opinion"), the BAP affirmed the bankruptcy court's Order Denying Discharge. BR 499-1.

On February 3, 2005, Mr. Conway filed his Notice of Appeal to this Court. By this Court's April 11, 2005 Order, this Court consolidated four of Mr. Conway's pending appeals: 05-5225; 05-5227; 05-5358; and 05-5359. By this Court's July 26, 2005 Order, the Court directed the United States Trustee to file a brief only with regard to appeal 05-5225.

STATEMENT OF FACTS

Mr. Conway commenced the instant bankruptcy case by filing a voluntary Chapter 11 petition on February 26, 2002. BR 1-1. This was the second personal Chapter 11 bankruptcy case filed by Mr. Conway in four months. BR 1-2 (disclosing Mr. Conway's prior case, 01-37379-JDL, filed November 7, 2001).

Under 11 U.S.C. 541(a), the commencement of Mr. Conway's bankruptcy case created an estate consisting of all non-exempt property held by Mr. Conway. Mr. Conway's Schedule A disclosed that he lives in a $1.76 million house. BR 9-8. Mr. Conway's Schedule B disclosed that he owned a Mercedes-Benz S 320 luxury automobile. BR 9-11. Mr. Conway did not disclose in his original Schedule B that he also owned a Lexus LS 400; Mr. Conway made that disclosure on his amended Schedule B. BR 170-13. Mr. Conway disclosed his possession of $170,000 in furniture; $980,000 in books, pictures, and artifacts; and $100,000 in furs and jewelry. BR 9-10. Without explanation, Mr. Conway lowered the value of those assets six months later, to $19,600; $490,000; and $50,000, respectively. BR 170-11. In aggregate numbers, Mr. Conway originally valued the furniture, books, pictures, artifacts, and jewelry at $1,160,000.00; his amended Schedule B decreased, without explanation, the valuation of those same assets to $559,600.00. That amendment, thus, diminished by $600,400.00 property of the Estate (under 11 U.S.C. § 541) that could have been liquidated to pay allowed claims of the creditors. See 11 U.S.C. § 704(1) (outlining duty of trustee to liquidate property to pay creditors).

On August 1, 2002, the United States Trustee moved to dismiss or, alternatively, convert Mr. Conway's case, under 11 U.S.C. § 1112(b). BR 130-1. In advance of the November 4, 2002 hearing on that motion, the United States Trustee noticed Mr. Conway's deposition and issued interrogatories and requests for production (collectively, the "Discovery Requests") to Mr. Conway. BR 193-1; Conv. Tr. 3-4. Because Mr. Conway did not appear for his deposition or substantively answer the Discovery Requests, the United States Trustee moved to compel Mr. Conway's compliance. BR 193-1. In consequence, the bankruptcy court entered an order (BR 196-1), compelling Mr. Conway to sit for deposition on October 30, 2002, and a second order (BR 204-1), compelling substantive responses to the Discovery Requests. Mr. Conway failed to appear for his October 30, 2002 deposition (Conv. Tr. 8), and Mr. Conway failed to give substantive responses to the Discovery Requests (Conv. Tr. 8-11).

On November 7, 2002, the bankruptcy court entered its order converting Mr. Conway's Chapter 11 case to a case under Chapter 7. BR 209-1. Immediately upon the conversion of Mr. Conway's Chapter 11 case to a case under Chapter 7, the United States Trustee appointed a Chapter 7 trustee, P. Preston Wilson. BR 211-1. Upon the conversion of his Chapter 11 case to one under Chapter 7, 11 U.S.C. 521(4) required Mr. Conway to surrender all property of the Estate to Mr. Wilson. Mr. Conway did not do that, however. Ev. Tr. 1 - 41.

Shortly after conversion, an 11 U.S.C. § 341 Meeting of Creditors was scheduled for December 4, 2002. BR unnumbered entry dated November 13, 2002. Mr. Conway did not appear on December 4, 2002 to testify. BR 228-1; Ev. Tr. 18. Mr. Wilson, therefore, continued Mr. Conway's Meeting of Creditors to January 8, 2003. BR 228-1; see Ev. Tr. 18.

Mr. Conway did not appear on January 8, 2003 to testify at his Meeting of Creditors. BR 243-1; Ev. Tr. 18. Mr. Wilson, accordingly, continued Mr. Conway's Meeting of Creditors to March 5, 2003. BR 243-1; see Ev. Tr. 18. On January 10, 2003, Mr. Wilson moved for entry of an order compelling Mr. Conway to appear and testify at his Meeting of Creditors. BR 245-1.

On February 4, 2004, the bankruptcy court entered its "Order Compelling Debtor to Attend 341 Meeting of Creditors." BR 266-1. The bankruptcy court found that Mr. Conway had posed no objection to Mr. Wilson's motion to compel, either in writing or in open court. Id.

Despite entry of the bankruptcy court's February 4, 2003 Order compelling him to testify at his Meeting of Creditors, Mr. Conway did not comply with that Order and did not appear at the March 5, 2003 setting of his Meeting of Creditors. Ev. Tr. 18, 25; BR 281-1. Mr. Conway, thus, failed three times to appear for his Meeting of Creditors. See Appellant's Brief at 10 ("there has never been a valid mandatory required meeting of creditors" held for Mr. Conway).

Additionally, on November 21, 2002, Mr. Wilson moved for an order directing Mr. Conway to submit to examination pursuant to F.R.B.P. 2004. BR 221-1. Mr. Wilson cited in his November 21, 2002 motion to a November 8, 2002 notification by Mr. Conway's then-lawyer that "the Debtor would not consent to" an inspection of his residence to prepare an inventory of the furnishings and artifacts listed in the schedules. BR 221-2. The bankruptcy court granted Mr. Wilson's request for a F.R.B.P. 2004 examination (a proceeding similar to a deposition, except with broader limits on the scope of inquiry). BR 240-1. Mr. Conway refused to comply, however, with the bankruptcy court's order. Ev. Tr. 18, 25.

In light of Mr. Conway's refusal to testify at his Meeting of Creditors, Mr. Conway's refusal to submit to an F.R.B.P. 2004 examination, and Mr. Conway's defiance of bankruptcy court orders compelling Mr. Conway's compliance, Mr. Wilson moved to dismiss (under 11 U.S.C. § 707) Mr. Conway's Chapter 7 bankruptcy case with prejudice. BR 283-1. The bankruptcy court, however, denied Mr. Wilson's motion to dismiss, finding that Mr. Conway's assets should be liquidated to pay creditors. BR 321-1; see Ev. Tr. 25 (Mr. Wilson affirming characterization of the bankruptcy court's ruling on his motion).

On August 13, 2003, Mr. Wilson filed a Motion for Writ of Entry to Conduct 2004 Examination of Premises, seeking renewed authority to access Mr. Conway's residence. BR 361-1. On August 28, 2003, the bankruptcy court granted Mr. Wilson's renewed request, and directed the United Sates Marshal to provide Mr. Wilson entry to "the Debtor's residence . . . by force if necessary." BR 373-1.

On the morning of August 29, 2003, Mr. Wilson, accompanied by an art appraiser and an estate appraiser, finally gained entry into Mr. Conway's house. Ev. Tr. 28-29. Approximately four or five deputy United States Marshals were present to escort Mr. Wilson. Ev. Tr. 29. While Mr. Wilson video-taped his findings, another videographer, apparently employed by Mr. Conway, followed and recorded everything that Mr. Wilson was doing. Id. at 30. At some point, Mr. Conway or his companions called the Memphis Police Department, apparently claiming that they were being burglarized or invaded, and two squad cars appeared at Mr. Conway's residence. Id at 30-31. The presence of the police officers reduced the tension that had built up. See id. at 31.

Mr. Wilson had an independent expert appraiser value the assets found in Mr. Conway's house. Ev. Tr. 31. Mr. Conway's original Schedule B valued those assets at $1,160,000.00. BR 9-10. Even his amended Schedule B valued those assets at $559,600.00. But the only assets found by Mr. Wilson had an appraised value of just $100,000.00 to $120,000.00. Ev. Tr. at 32. They sold at auction for only $76,647.50. BR 539-1. These are the only personal property assets that the Trustee has been able to locate and liquidate.

On October 27, 2003, the United States Trustee filed his Complaint objecting to the issuance of a discharge to Mr. Conway (BR 404-1; APR 1-1), citing three bases for denial of discharge: Mr. Conway's refusal to testify, in violation of 11 U.S.C. § 727(a)(6)(C); Mr. Conway's concealment of assets, in violation of 11 U.S.C. § 727(a)(2)(B); and Mr. Conway's failure to explain the massive devaluation of assets, in violation of 11 U.S.C. § 727(a)(5). Id.

The bankruptcy court issued the Summons (APR 2-1), and the United States Trustee served Mr. Conway at his residence at 6099 Shady Grove Road in Memphis, Tennessee (APR 3-1), where Mr. Conway resided until approximately July 25, 2005. See BR 560-1. (Notice of Change of Mr. Conway's address, filed by Mr. Wilson on July 25, 2005). Neither Mr. Conway nor any attorney for Mr. Conway filed an answer or even an appearance in the adversary proceeding. Mr. Conway never requested an extension of time to answer or file a motion to dismiss the Complaint. No claim was ever made in the bankruptcy court or BAP that Mr. Conway did not receive service or notice of the Summons and Complaint.

Mr. Conway never answered the United States Trustee's Complaint. APR 5-1. The United States Trustee, accordingly, moved for a judgment by default against Mr. Conway. APR 4-1. The bankruptcy court scheduled its hearing on the motion for default judgment for January 8, 2004, however, Mr. Conway did not appear for that hearing. APR 10-2. The bankruptcy court concluded a basis existed to enter a default judgment against Mr. Conway, but the court decided it would not enter default without first conducting an evidentiary hearing. D.J. Tr. 3-4; APR 8-1.

The bankruptcy court conducted its evidentiary hearing on January 29, 2004. APR 8-1; Ev. Tr. 1-1. The United States Trustee called Mr. Wilson, the Chapter 7 trustee[4], to testify about the history of the case and particularly Mr. Conway's refusal to cooperate with Mr. Wilson. Ev. Tr. 15-37. At the conclusion of the proof, the bankruptcy court made oral findings of fact, consistent with F.R.B.P. 7052 (incorporating F.R.C.P. 52).

At the close of the evidentiary hearing, the bankruptcy court orally ruled with regard to each of the United States Trustee's three claims, in light of the facts admitted into evidence. Ev. Tr. 37-41. The bankruptcy court specifically found that Mr. Conway had engaged in concealment ("There clearly has been concealment and it is a concealment of the truth"). Ev. Tr. 39. The bankruptcy court recited Mr. Conway's duties under 11 U.S.C. § 521. The court specifically found that, with regard to subsection (3), Mr. Conway had not cooperated with the Chapter 7 trustee. Id. at 39. That failure by Mr. Conway impeded the Chapter 7 trustee from

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[4] Section 704(1) of the Bankruptcy Code mandates that Chapter 7 trustees "collect and reduce to money the property of the [bankruptcy] estate...." Mr Wilson, thus, was statutorily obliged to take control of Mr. Conway's assets so that they could be liquidated for the benefit of creditors.

inventorying the Estate's assets. Id. at 40. The court also found that Mr. Conway had failed to turn over assets to the Chapter 7 trustee in violation of subsection (4). Id at 40.

The bankruptcy court also specifically found that Mr. Conway had failed to explain the significant devaluation of his assets (comparing Mr. Conway's original schedules with his amended schedules). Ev. Tr. 40.

Finally, the bankruptcy court specifically found that Mr. Conway had refused to testify. Ev. Tr. 40, 41. Among other things, the bankruptcy court expressly referred to Mr. Conway's failure to attend and testify at the October 30, 2002 deposition (Ev. Tr. 41); to respond to the Discovery Requests posed by the United States Trustee (Ev. Tr. 41; "the debtor has not responded to material questions"); to attend and testify at his meeting of creditors (Ev. Tr. 40); and to permit an inspection of his assets (Ev. Tr. 41).

The bankruptcy court, accordingly, entered a final judgment on behalf of the United States Trustee on all grounds alleged in his Complaint. See Ev. Tr. 37 - 41 (court setting forth its conclusions of fact and law with regard to each count). The bankruptcy court thereafter entered its February 3, 2004 Order Denying Discharge, in which the bankruptcy court memorialized in writing the specific statutory grounds under which it was denying Mr. Conway's discharge. APR 10-1.

SUMMARY OF THE ARGUMENT

The bankruptcy court properly denied Mr. Conway's discharge[5] because he failed to testify in violation of 11 U.S.C. § 727(a)(6)(C); concealed assets from the Chapter 7 trustee in violation of 11 U.S.C. § 727(a)(2)(B); and failed to explain a deficiency in assets to pay his debts, in violation of 11 U.S.C. § 727(a)(5).

Although Mr. Conway dislikes that the bankruptcy court denied his discharge, other parties in interest are not impaired in enjoying the benefits of Chapter 7. Creditors will be permitted to file claims as a source of payment of the debts owed them by Mr. Conway. 11 U.S.C. § 501. Mr. Wilson will be permitted to continue liquidating assets and pay allowed claims. 11 U.S.C. § 704(1). Upon

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[5] The United States Trustee's Complaint sought to deny Mr. Conway a discharge. Denial of a debtor's discharge is completely different from dismissal of a debtor's case. Compare 11 U.S.C. § 524 (effect of discharge) to 11 U.S.C. § 349 (effect of case dismissal). For example, dismissal of the bankruptcy case would have revested ownership of all property back to Mr. Conway (so that the property would no longer be owned by the bankruptcy Estate, per 11 U.S.C. § 541). 11 U.S.C. § 349(b)(3). Mr. Wilson, the Chapter 7 trustee, requested dismissal of the case (BR 283-1), but the bankruptcy court found it provident to deny that request in view of the significant benefits for creditors that could be gained by Mr. Wilson liquidating Mr. Conway's property. BR 321-1; See Ev. Tr 25 (Mr. Wilson affirming characterization of the bankruptcy court's ruling on his motion). Regardless of whether a bankruptcy court grants or denies a debtor's discharge, such decision does not truncate or interfere with a Chapter 7 trustee's liquidation of property of the Estate (so that creditors can be paid). See, e.g., 11 U.S.C. § 704 (compelling the trustee to take possession of and liquidate property of the estate in subsection (1), while simultaneously authorizing the trustee to object to a debtor's discharge in subsection (6)).

denial of discharge, the automatic stay was terminated (11 U.S.C. § 362(c)(2)(C)). All denial of discharge did was enable creditors to exercise their rights outside of bankruptcy court under applicable non-bankruptcy law. See Boatmen's Bank of Tennessee v. Embry (In re Embry), 10 F.3d 401 (6th Cir. 1993) (creditor permitted to garnish bank account without need to obtain relief from stay based on entry of nondischarable judgement). In summary, the bankruptcy court properly denied Mr. Conway's discharge in view of Mr. Conway's extreme misconduct. While Mr. Conway may be disappointed, denial of discharge does not impede the work of the Chapter 7 trustee, and does not truncate rights of Mr. Conway's creditors.

APPLICABLE STANDARD OF APPELLATE REVIEW

The issue on appeal involves mixed questions of fact and law. In reviewing an appeal from the bankruptcy appellate panel, the "review is of the bankruptcy court's decision." Corzin v. Fordu (In re Fordu), 201 F.3d 693, 696 n. 1 (6th Cir. 1999). This Court reviews the bankruptcy court's conclusions of law de novo and its factual determinations for clear error. See id.

ARGUMENT

1. The Bankruptcy Court did not Commit Clear Error by Concluding that Mr. Conway's Failure to Testify Justified a Denial of Discharge under 11 U.S.C. 727(a)(6)(C).

The bankruptcy court properly denied Mr. Conway's discharge because Mr. Conway unjustly and repeatedly refused to appear at his Meeting of Creditors (Ev. Tr. 18, 25, 37-41; BR 228-1; BR 245-1; BR 266-1; BR 281-1); refused to submit to examination pursuant to F.R.B.P. 2004 (BR 283-1; Ev. Tr. 18, 25, 37-41); refused to be deposed (BR 193-1; Conv. Tr. 8; Ev. Tr. 41); and refused to answer court-approved discovery requests issued by the United States Trustee (BR 193-1; BR 204-1; Conv. Tr. 8-11).[6] Section 727(a)(6)(C) mandates denial of discharge if the debtor has refused, in the case:

> (C) on a ground other than the properly invoked privilege against self incrimination, to respond to a material question approved by the court or to testify;

11 U.S.C. § 727 (a)(6)(C).

A. Pre-conversion refusal to testify

Pre-conversion, after Mr. Conway failed to appear for a deposition noticed by the United States Trustee, the bankruptcy court ordered Mr. Conway to appear for an October 30, 2002 deposition. BR 196-2. Mr. Conway did not appear. Conv. Tr.

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[6] The United States Trustee's Complaint (APR 1-1; BR 404-1) references Mr. Conway's refusal to testify at his Meeting of Creditors and refusal to submit to an F.R.B.P. 2004 examination by Mr. Wilson. APR 1-1; ¶ 17. The specific § 727 (a)(6)(C) allegations focus exclusively on the pre-conversion refusals by Mr. Conway to be deposed and provide genuine responses to the United States Trustee's Discovery Requests. APR 1-1, ¶¶ 19-25.

8; Ev. Tr. 41. Additionally, the bankruptcy court made an exhaustive, request-by-request ruling on the discovery issued by the United States Trustee. BR 204-1. The court directed Mr. Conway to answer those court-sanctioned questions prior to the November 4, 2002 hearing on conversion (BR 204-3). Mr. Conway did not, however. Conv. Tr. 8-13; Ev. Tr. 41.

B. Refusal to testify at post-conversion Meeting of Creditors

Mr. Conway did not appear for the December 4, 2002, January 8, 2003, or March 5, 2003 settings of his Meeting of Creditors. Ev. Tr. 18, 37-41; BR 228-1; BR 245-1; 266-1; BR 281-1. Mr. Conway defied the bankruptcy court's order compelling him to testify at his Meeting of Creditors. BR 266-1; Appellant's Brief at 31; Ev. Tr. 25.

C. Refusal to be examined by Chapter 7 trustee under F.R.B.P. 2004

Mr. Conway refused to submit to Mr. Wilson's request to examine him at his residence, and Mr. Conway defied the court's order with regard to Mr. Wilson's request. BR 221-1; BR 240-1; Ev. Tr. 25. Mr. Wilson gave detailed testimony concerning Mr. Conway's refusal to permit Mr. Wilson to inventory the Estate's assets. Ev. Tr. 18-37. Mr. Wilson had moved on November 21, 2002 for an order directing Mr. Conway to submit to examination pursuant to F.R.B.P. 2004. BR 221-1. Mr. Wilson cited in his November 21, 2002 motion to a November 8, 2002 notification by Mr. Conway's then-lawyer that "the Debtor would not consent to" an inspection of his residence to prepare an inventory of the furnishing and artifacts listed in the schedules. BR 221-2. The bankruptcy court granted Mr. Wilson's request for an F.R.B.P. 2004 examination (BR 240-1).

Mr. Wilson testified that he first scheduled the F.R.B.P. 2004 examination for February 18, 2003. Id. at 20. He testified that Mr. Conway stated that the examination should be rescheduled for February 28, 2003 (due to asserted inadequate notice), and Mr. Wilson acceded to that demand. Id.

Mr. Wilson testified that, on February 28, 2003, Mr. Conway notified him that a relative had died and that he (Mr. Conway) required a rescheduling of the examination. Id. at 20-21. Mr. Wilson requested that Mr. Conway contact him on March 3, 2003 to select a new date for the examination, but Mr. Conway contacted Mr. Wilson's office after it had closed. Id. at 21. Mr. Wilson testified about his efforts on March 4, 2003 to reschedule with Mr. Conway for an examination on March 10 or 11, 2003, and Mr. Conway's insisting that the inspection occur sometime the week of March 17, 2003. Id. Mr. Wilson had explained to Mr. Conway the need for the examination to occur on March 10, 2003 so that expert appraisers could accompany Mr. Wilson when he took his inventory, but Mr. Conway refused to identify a specific date when the examination could occur. Id. at

22. Consequently, Mr. Wilson informed Mr. Conway that the examination would occur on March 10, 2003. Id.

Mr. Wilson testified that, on March 10, 2003, he received a March 6, 2003 letter from Mr. Conway notifying Mr. Wilson that Mr. Conway refused to allow Mr. Wilson to come to his house. Ev. Tr. at 23. Not until Mr. Wilson filed a second request to conduct an examination under F.R.B.P. 2004 (BR 361-1), this time with the United States Marshal authorized to assist Mr. Wilson "by force if necessary," was Mr. Wilson able to gain entry into Mr. Conway's residence. Ev. Tr. at 28.

D. The court properly withheld Mr. Conway's discharge because he refused to testify.

Mr. Conway's refusal to submit to discovery parallels the conduct described in Golant v. Levy (In re Golant), 239 F.3d 931 (7th Cir. 2001). There, the debtor complied with discovery, but only in part. As a F.R.B.P. 7037 sanction, the bankruptcy court denied the debtor's discharge for failure to comply with discovery. The Seventh Circuit affirmed, noting:

> In spite of Golant's protestations, we fail to see how the bankruptcy court could have come to any other conclusion. Golant was ordered twice to comply with the bankruptcy court's production order. In spite of a warning regarding the severity of possible sanctions, Golant continued to ignore the bankruptcy court's order. Where a debtor in bankruptcy refuses to be completely forthright with information regarding his financial

> dealings and resources-information that is of paramount importance to an efficient and fair bankruptcy proceeding- the bankruptcy court is left with little recourse...

Id. at 937.

Here, even if Mr. Conway believed that he would have been justified in not answering particular questions at a deposition, he at least had to appear and state his objections. Likewise, his remedy for objectionable discovery requests would have been a protective order instead of proffering non-meritorious objections.

Collier on Bankruptcy, a leading bankruptcy treatise, notes that a court may deny a debtor's discharge when a debtor refuses to testify. 9 Collier on Bankruptcy, ¶ 4002.02[4][b] (15 ed. rev'd.). Id. (noting such alternative would be used in rare instances). Here, Mr. Conway refused to testify at a deposition in defiance of a bankruptcy court order compelling him to do so; he refused to answer court-approved interrogatories; he refused to appear at all three settings of his meeting of creditors (in defiance of a bankruptcy court order) and he refused to testify at a F.R.B.P. 2004 examination (in defiance of a bankruptcy court order). Given Mr. Conway's extreme misconduct in this case, the bankruptcy court did not abuse its discretion in denying discharge based upon the uncontroverted evidentiary record before it.

In reaching that decision, the bankruptcy court weighed the evidence before it. At the conclusion of proof on January 29, 2004, the bankruptcy court expressly pointed to Mr. Conway's failure to fulfill his duty to testify at a Meeting of Creditors [7] as grounds for denying discharge. Ev. Tr. 40. Also, the court pointed to Mr. Conway's refusal to answer the Discovery Requests posed by the United States Trustee and to attend the October 30, 2002 deposition. See Ev. Tr. 41 ("The debtor has not responded to material questions....The debtor has refused to appear for deposition"). Additionally, the bankruptcy court observed how Mr. Conway had failed to fulfil his duty to cooperate (under 11 U.S.C. § 521) with the Chapter 7 trustee, and how Mr. Conway's failure had impeded Mr. Wilson's fulfilment of his duties. "One of those duties, of course, is to obtain an inventory of the assets of the estate, and Mr. Conway certainly has not cooperated in Mr. Wilson's efforts to do that," and that "the debtor has refused to permit inspection of the assets of the estate." Id. at 40, 41.

The bankruptcy court reflected that it had earlier rejected case dismissal as a sanction for Mr. Conway's non-cooperation "because of the very high values that

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[7] The bankruptcy court cited 11 U.S.C. 524(d), requiring the debtor to appear at his discharge hearing. The statutory requirement to attend a meeting of creditors actually appears at 11 U.S.C. 343, as implemented by F.R.B.P. 4002(1). Of course, Mr. Conway also violated 11 U.S.C. § 524 (d) because he did not appear for the January 29, 2004 hearing on his discharge. Ev. Tr. 1.

Mr. Conway placed on his assets" and that it appeared "that there were creditors that needed to be paid and that there were assets from which those obligations could be paid." Ev. Tr. 38. The court, thus, carefully balanced the remedies for Mr. Conway's defiance with the need of his creditors to be paid by liquidation of his assets. The bankruptcy court, therefore, properly chose to deny Mr. Conway's discharge, under 11 U.S.C. § 727 (a)(6)(C), for his refusal to testify.

2. The Bankruptcy Court did not Commit Clear Error by Concluding that Mr. Conway's Concealment of Property Justified a Denial of Discharge under 11 U.S.C. § 727 (a)(2)(B).

The bankruptcy court properly found that Mr. Conway concealed property of the bankruptcy Estate, in violation of 11 U.S.C. § 727 (a)(2)(B). Section 727 (a)(2)(B) directs discharge denial if :

> (2) the debtor, with intent to hinder, delay, or defraud a creditor or an officer of the estate charged with custody of property under this title, has transferred, removed, destroyed, mutilated, or concealed, or has permitted to be transferred, removed destroyed, mutilated, or concealed–
>
> .... (B) property of the estate, after the date of the filing of the petition;

11 U.S.C. § 727 (a)(2)(B).

Section 521 (4) of the Bankruptcy Code provides that a debtor "shall surrender to the trustee all property of the estate." 11 U.S.C. § 521 (4). Despite

Mr. Conway's obligation to surrender property of the Estate, and despite Mr. Wilson's repeated requests simply to inventory Estate property, Mr. Conway refused. Ev. Tr. 15 - 37. Only after the bankruptcy court directed the United States Marshal to assist Mr. Wilson did Mr. Conway even allow the trustee to view the Estate's assets and, even then, Mr. Conway continued to refuse to turn them over. Ev. Tr. 28, 40. The record below, thus, establishes that Mr. Conway improperly sequestered Estate property at his residence from November 7, 2002 (date of conversion) until August 29, 2003 (date Mr. Wilson gained entry into Mr. Conway's residence), a period of 9 months, 16 days. Ev. Tr. 15 - 37. In fact, Mr. Conway did not turn over the property at any time prior to his discharge being revoked. Ev. Tr. 40. That prevented the trustee from liquidating assets for the creditors' benefit and, thus, delayed their receipt of payment in this case.

Mr. Conway's concealment mirrors the concealment described in the Sixth Circuit's decision, U. S. v. Wagner, 382 F.3d 598 (6th Cir. 2004). There, a subdivision developer built and owned "smart" houses (houses with features that automated various household chores). Id. at 603. The developer filed a voluntary petition under Chapter 11, but the bankruptcy court quickly converted his case to one under Chapter 7. Id. at 605.

The debtor defied the Chapter 7 trustee's efforts to sell the "smart" houses. Among other things, the debtor directed one of his employees to change the locks on the houses so that only the debtor would have a key for each home. Id. at 605-06. Shortly thereafter, a realtor hired by the Chapter 7 trustee could not show the home to a prospective buyer. The debtor claimed that he changed the locks because there was a rash of break-ins at the houses and he wanted to control all the outstanding keys to halt any future incidents, but the government presented contrary evidence that Wagner in fact changed the locks to interfere with Trustee French's efforts. Id. at 606.

The debtor was indicted and convicted for, among other things, alleged concealment of assets in violation of 18 U.S.C. § 152(1) by changing the locks on houses that were assets of the Chapter 7 trustee. Id. On appeal, the Sixth Circuit had to resolve the meaning of "conceal" as used in 18 U.S.C. § 152(1). Id. The court opined as follows:

> The narrow construction of "conceal" — "To hide, secrete, or withhold from the knowledge of others. . . . To cover or keep from sight. To hide or withdraw from observation, or prevent discovery of" — springs from its dictionary definition. Black's Law Dictionary 288 (6th ed. 1990); *see also* Random House Unabridged Dictionary 422 (2d ed. 1993) ("[T]o hide; withdraw or remove from observation; cover or keep from sight."). By depriving the Trustee of access to the house, Wagner concealed (*i.e.*, he hid, secreted, prevented discovery of, and withheld from the knowledge of the Trustee) the value of the property. That the Trustee knew of the house's

> existence does not alter our conclusion, because mere awareness of the property does not concomitantly reveal the property's value. Without access to the inside of the home, no prospective buyer could accurately assess the worth of the house and place a bid, which in turn prevented the Trustee from learning the value of the house and accordingly disposing of the estate. It would be no different if Wagner revealed to the Trustee the existence of a cache of diamonds in a locked box, but refused to give the Trustee the key to open the box, preventing a buyer (and consequently the Trustee) from assessing whether the diamonds were of pristine cut, color, and clarity such that they were worth $100,000 or were instead low-grade diamonds worth only $10,000. Like diamonds, the value of the smart house, as embodied in the sale price, cannot be known until a purchaser bids on the house, which provides the only true measure of the house's value. Few rational buyers would purchase a home without seeing the inside first. Thus, limiting access to the inside of the house effectively precluded any potential purchaser from making an informed decision, which in turn prevented the Trustee from learning the true value of the house. Such actions constitute concealment of an asset.

U.S. v. Wagner, at 607-08.

Wagner concerned "concealment's" definition in a criminal context (18 U.S.C. § 152(1)), while the bankruptcy court here had to apply "concealment" in a civil context (11 U.S.C. § 727(a)(2)(B)). That is a distinction without a difference, though. As *Collier on Bankruptcy* notes,

> Conduct that amounts to concealment from creditors or from an officer of the estate charged with custody of property [under § 727(a)(2)] will in general be the same as to that which constitutes a concealment under 18 U.S.C. § 152. Cases decided under 18 U.S.C. § 152 will afford helpful analogies in determining what amounts to concealment.

6 Collier on Bankruptcy, ¶ 727.02[6][b] (Matthew Bender 15th ed. rev'd).

The factual similarities in the Wagner case and the instant case are notable. Like the Wagner debtor (Wagner at 605-06), Mr. Conway questions the legality or authority of the Chapter 7 trustee. See, e.g., Appellant's Brief at 5. Like the Wagner debtor (Wagner at 605-06), Mr. Conway demonstrated to the Chapter 7 trustee that he had no intention of cooperating. Ev. Tr. 15-37. Like the Wagner debtor (Wagner at 606), Mr. Conway's conduct prevented the Chapter 7 trustee from gaining access to the debtor's property. Ev. Tr. 15-37. Like the Wagner debtor, Mr. Conway prevented the Chapter 7 trustee from determining the true value of the assets. Ev. Tr. 28. Only after Mr. Wilson obtained an order directing the United States Marshal to use "force if necessary" did he gain access to property that should have been turned over to him immediately upon conversion. Ev. Tr. 28.

Further, as in Wagner (Wagner at 610), Mr. Conway's preventing the Chapter 7 trustee from entering the property may have caused no economic loss. As the Wagner court points out, though, "such considerations are irrelevant; there is no materially requirement in § 152(1), and Wagner would have been no less criminally liable under § 152(1) if he had changed the locks knowingly and fraudulently but the realtor" had not made an effort to show the house to a potential buyer. Id. at 610. The Wagner view that, concealment does not require monetary loss transcends criminal law. The Sixth Circuit expressed the identical view, that financial loss is not a predicate to a finding of concealment, in Keeney v. Smith (In re Keeney), 227 F.3d 679, 685 (6th Cir. 2000) (citations omitted). The Keeney court affirmed a bankruptcy debtor's denial of discharge for concealment, in violation of 11 U.S.C. § 727(a)(2).

A bankruptcy court from this circuit noted recently, "once a prima facie case [of concealment] is established, the debtor 'must come forward with an explanation for the concealment that convinces a judge [otherwise]'." Buckeye Retirement Co. v. Heil (In re Heil), 289 B.R. 897, 907 (Bankr. E.D. Tenn 2003) (citations omitted). Mr. Conway never appeared in court to explain his beliefs or conduct, even though 11 U.S.C. § 524 (d) and F.R.B.P. 4002(2) mandated his appearance at the January 8, 2004 and/or January 29, 2004 hearings. Given that, the bankruptcy court had to base its findings upon Mr. Conway's acts. Those acts - refusal to turn over property, refusal to allow inspection, defiance of court orders - were more than sufficient to allow the court to decide that Mr. Conway was concealing property and therefore deny him a discharge under section 727(a)(2).

3. The Bankruptcy Court did not Commit Clear Error by Concluding that Mr. Conway's Failure to Explain Devaluation of Assets Justified a Denial of Discharge under 11 U.S.C. § 727(a)(5).

The bankruptcy court also did not abuse its discretion in determining that Mr. Conway failed to explain the loss or deficiency of assets to meet his liabilities, in violation of 11 U.S.C. § 727(a)(5). That section mandates denial of discharge if:

> (5) the debtor has failed to explain satisfactorily, before determination of denial of discharge under this paragraph, any loss of assets or deficiency of assets to meet the debtor's liabilities;

11 U.S.C. § 727(a)(5).

On March 14, 2002, Mr. Conway represented by Attorney Wanda Abioto, filed his original Schedule B. BR 9-1. On September 9, 2002, Mr. Conway amended his Schedule B, while he was still represented by counsel. BR 170-1. His amendments included the following:

Assets	Schedule B Value	Amended Schedule B Value	Variance
Furniture	$170,000.00	$19,600.00	-$150,400.00
Books, Pictures & Artifacts	$980,000.00	$490,000.00	-$490,000.00
Furs and Jewelry	$100,000.00	$50,000.00	-$50,000.00

Mr. Conway has never explained the material devaluation of assets for which he was effectively the bankruptcy trustee (as Debtor-In-Possession) between March 14, 2002 and September 9, 2002. See Ev. Tr. 33-35 (Mr. Wilson testifying as to varying valuations for which Mr. Conway has never made an explanation). The value of those assets is and always has been a material issue in the instant case. Mr.

Conway has always claimed that the majority of those assets are not encumbered by liens (all of Mr. Conway's real property is or has been encumbered by liens). See Schedule D (BR 9-15) (reflecting only small liens against non-automobile personal property). The value of Mr. Conway's personal property is particularly vital now in light of the foreclosure of every parcel of real property owned by Mr. Conway. See Appellant's Brief, 5-14 (identifying each foreclosure).

By refusing to testify at his Section 341 Meeting of Creditors, or at examinations scheduled pursuant to F.R.B.P. 2004, Mr. Conway has eschewed every opportunity (prior to the trial on his discharge) to explain the devaluation of the assets. The United States Trustee expressly alleged this § 727(a)(5) failing in the Complaint Objecting to Discharge (APR 1-3; BR 404-3), thus, Mr. Conway had yet another opportunity to explain the lack or deficiency in assets to pay his liabilities. Indeed, 11 U.S.C. § 524(d) and F.R.B.P. 4002(2) mandated that Mr. Conway appear at the hearing on the United States Trustee's Complaint objecting to discharge.[8] Mr. Conway chose, however, not to appear for the default hearing or evidentiary hearing with regard to the denial of his discharge. The bankruptcy court, thus, appropriately denied Mr. Conway's discharge for failing to explain the

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[8] In itself, Mr. Conway's failure to attend the January 29, 2004 hearing were grounds for denial of discharge. In re Hunn, 51 B.R. 981 (Bankr. M.D. Fla. 1985).

significant lack or deficiency of assets (especially because the devaluation occurred while Mr. Conway functioned as the Debtor-In-Possession).

4. The Bankruptcy Court Predicated Denial of Discharge on Its Factual Findings, Even Though the Bankruptcy Court had No Duty to Make Any Findings.

Mr. Conway asserts that the denial of his discharge was wrong. Appellant's Brief at 13 (discharge was "maliciously, pretextually, and retliatorily denied"). He mentions some of the allegations in the United States Trustee's Complaint Objecting to Discharge. Appellant's Brief at 39. It is not, however, until page 40 of his Brief that Mr. Conway says why he feels denial of his discharge was wrong:

> There has never been any proof or facts of any specific wrong doing on behalf of Mr. Conway to pretextually deny him a discharge. The court and trustee followed none of the law or rules to deny discharge.

Appellant's Brief at 40.

Mr. Conway fundamentally misunderstands the standards at play here, triggered by his voluntary decision not to file an answer, appear at the default judgment hearing, or appear at the evidentiary hearing. At the BAP, Mr. Conway made essentially the same argument that he makes before this Court, that the bankruptcy court failed to make specific findings and conclusions of law on the merits of the Complaint. BAP Opinion at 5. The BAP succinctly dealt with Mr. Conway's argument:

> Rule 52(a) of the Federal Rules of Civil Procedure, made applicable in bankruptcy adversary proceedings by Rule 7052 of the Federal Rules of Bankruptcy Procedure, does require findings and conclusions, but only "in actions tried upon the facts without a jury or with an advisory jury . . . . Findings of fact and conclusions of law are unnecessary on decisions of motions under Rule 12 or 56 or any other motion except as provided in subdivision (c) of this rule." The proceeding against [Mr. Conway] was not tried on the merits, so findings and conclusions on the merits were not necessary; the well-pleaded allegations of the complaint in effect constitute findings of fact. See, e.g., Adriana Int'l Corp. v. Thoeren, 913 F.2d 1406, 1414 (9th Cir. 1990); Brown v. Kenron Aluminum & Glass Corp, 477 F.2d 526, 531 (8th Cir. 1973); Westinghouse Elec. Corp. v. Rio Algom Ltd. (In re Uranium Antitrust Litig.), 473 F.Supp. 382, 390-91 (N.D. Ill. 1979), remanded on other grounds, 617 F.2d 1248 (7th Cir. 1980).

BAP Opinion at 5-6.

Assuming that findings and conclusions were required, the bankruptcy court made express findings on the record in open court.[9] Ev. Tr. 37-41. The bankruptcy court listened to the testimony of the Chapter 7 trustee and took into consideration

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[9] To the extent Mr. Conway means to suggest the court could not make its findings orally, he is wrong. Findings in bankruptcy cases are governed by Bankruptcy Rule 7052, which provides that "Rule 52 F.R.Civ.P. applies in adversary proceedings." Fed. R. Bankr. P. 7052. Civil Procedure Rule 52(a) expressly provides that "[i]t will be sufficient if the findings of fact and conclusions of law are stated orally." Fed. R. Civ. P. 52(a). The bankruptcy court did make such oral findings at the conclusion of the evidentiary hearing on January 29, 2004. Ev. Tr. 37 - 41.

the numerous documents introduced into evidence demonstrating the pattern of intimidation and non-cooperation by Mr. Conway. Ev. Tr. 15 - 37. At the conclusion of the January 29, 2004 evidentiary hearing, the bankruptcy court applied specific provisions of the Bankruptcy Code in light of the uncontroverted evidence presented during the hearing. Ev. Tr. 37 - 41. The bankruptcy court methodically interwove law and facts in reaching its conclusion.

The bankruptcy court insisted upon evidentiary protections to ensure that any denial of discharge would be based upon admissible evidence and not merely Mr. Conway's failure to object. The bankruptcy court declined on January 8, 2004 to enter a final judgment against Mr. Conway, even though Mr. Conway had not answered the Complaint; had not otherwise filed a response to the Complaint; and did not appear at the January 8, 2004 hearing (in direct contravention of § 524(d) and F.R.B.P. 4002(2)). D.J. Tr. 3. Instead, the bankruptcy court scheduled an evidentiary hearing for January 29, 2004. D.J. Tr. 4; APR 8-1. The court's findings were based upon an ample evidentiary record that fully supports the court's ruling.

In summarily stating that no "proof or facts of any specific wrong doing" exist (Appellant's Brief at 40), Mr. Conway fails to address the substantive, uncontroverted evidence presented on January 29, 2004. Among other things, the proof showed that Mr. Conway refused to appear and testify at three settings of his

Meeting of Creditors (Ev. Tr. 18, 40); that Mr. Conway failed to attend his October 30, 2002 deposition (Ev. Tr. 41); that Mr. Conway repeatedly refused to allow Mr. Wilson to inventory his assets (Ev. Tr. 20-28); that Mr. Conway defied bankruptcy court orders (Ev. Tr. 25); and that, in light of Mr. Conway's defiance and intimidation, Mr. Wilson had to obtain a Writ of Entry and the assistance of deputy United States Marshals to gain access to Mr. Conway's property (Ev. Tr. 25 - 28).

The bankruptcy court made findings of fact and conclusions of satisfactory under F.R.B.P. 7052, as if a trial on the merits had been necessary. The bankruptcy court carefully interwove Bankruptcy Code statutes, Bankruptcy Rules, and the facts admitted into evidence in making the court's January 29, 2004 ruling. Instead of denying Mr. Conway's discharge in light of his failures to answer and appear at the discharge hearings (in direct violation of 11 U.S.C. § 524(d) and F.R.B.P. 4002(2)), the bankruptcy court mandated that the United States Trustee introduce admissible evidence sufficient to demonstrate that Mr. Conway's discharge should be denied. The bankruptcy court instilled vital safeguards to ensure that denial of discharge would result from a careful exercise of the bankruptcy court's discretion. The critical point, though, is that findings and conclusions on the merits were not necessary; the well-pleaded allegations of the Complaint in effect constituted findings of fact.

5. Even after Denial of Mr. Conway's Discharge, Estate Administration can Continue and Creditors Continue to Enjoy Rights In and Out of the Bankruptcy Court.

Although Mr. Conway dislikes that the bankruptcy court denied his discharge, other parties in interest are not impaired in enjoying the benefits of Chapter 7. Creditors will be permitted to file claims as a source of payment of the debts owed them by Mr. Conway. 11 U.S.C. § 501. Mr. Wilson will be permitted to continue liquidating assets and pay allowed claims. 11 U.S.C. § 704(1). Mr. Wilson is entitled to receive a commission upon payment of claims allowed in this case. 11 U.S.C. § 326. Upon denial of discharge, the automatic stay was terminated (11 U.S.C. § 362(c)(2)(C)); consequently, creditors are now able to exercise their rights under applicable non-bankruptcy law to collect on the debts owed to them by Mr. Conway. See Boatmen's Bank of Tennessee v. Embry (In re Embry), 10 F.3d 401 (6th Cir. 1993) (creditor permitted to garnish bank account without need to obtain relief from stay based on entry of nondischarable judgement. In summary, the bankruptcy court properly denies Mr. Conway's discharge in view of Mr. Conway's extreme misconduct. While Mr. Conway may be disappointed, denial of discharge does not impede the work of the Chapter 7 trustee, and does not truncate rights of Mr. Conway's creditors.

CONCLUSION

For the foregoing reasons, the United States Trustee respectfully requests that the judgement of the BAP be affirmed.

Respectfully submitted,

____
SEAN M. HAYNES (#14881)
United States Department of Justice
Office of United States Trustee
200 Jefferson Avenue, Suite 400
Memphis, TN 38103
(901) 544-3486

ROBERTA DeANGELIS,
Acting General Counsel

P. MATTHEW SUTKO
United States Department of Justice
Executive Office for United States Trustees
20 Massachusetts Ave., N.W., Suite 8000
Washington, D.C. 20530
(202) 307-1399

Counsel for Appellee,
Richard F. Clippard, United States Trustee

CERTIFICATE OF COMPLIANCE

I certify that in compliance with the Federal Rules of Appellate Procedure and the Sixth Circuit Rules of Appellate Procedure, this brief is typed in proportionally spaced typeface in 14 point font and that, based on WordPerfect 9.0, this brief contains 9,570 words.

____
Sean M. Haynes

CERTIFICATE OF SERVICE

I certify that on September 16, 2005, I filed the foregoing brief with the Clerk by means of Federal Express delivery services, and I served the foregoing brief by causing two copies to be sent by First Class Mail to the following:

Larry and Marilyn Conway
6099 Shady Grove Rd.
Memphis, TN 38120

Larry and Marilyn Conway
111 S. Highland
Memphis, TN 38111

P. Preston Wilson, Chapter 7 Trustee
88 Union Ave., 14th Floor
Memphis, TN 381031

____
Sean M. Haynes

ADDENDUM

BRIEF BANK — "SUMMARY SHEET" *Printed Wed-8/13/08 10:37*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]* — Walton v. Cornerstone Ministries Investments, Inc., et al

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]* — N.D. Ga.

3. ("CCN") ***CURRENT*** CASE NO. — No.: 2:08-cv.00138-WCO

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]* — No.: 08-20355-REB

Court: Bankr. Ga.

(Identify judge & cite, if any)

5. ("SO") ***SOURCE*** — **U.S. TRUSTEES**

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]* — Filed: August 11, 2008

Type: Brief of United States Trustee As Appellant

7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** [E.g.,"UST/OGC"] — James H. Morawetz, Walter Theus, Guy G. Gebhardt, P. Matthew Sutko, Ramona Elliott

(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC*** — **BANKRUPTCY**

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***

- Whether 11 U.S.C. § 1104(c)(2) required the bankruptcy court to order the appointment of an examiner in this case because it is a case in which the debtor's fixed, liquidated unsecured debts, other than debts for goods, services, or taxes or owing to an insider, exceed $5,000,000.

10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)

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DATE:

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF GEORGIA
GAINESVILLE DIVISION

In re:	:	
	:	
DONALD F. WALTON, UNITED STATES TRUSTEE, Region 21	:	District Court Case No. 2:08-cv-00138-WCO
	:	
Appellant,	:	
	:	Bankruptcy Case No.
vs.	:	08-20355-REB
	:	
CORNERSTONE MINISTRIES INVESTMENTS, INC.,	:	
	:	
Appellee.	:	

BRIEF OF UNITED STATES TRUSTEE AS APPELLANT

On Appeal from the United States Bankruptcy Court
for the Northern District of Georgia

Of Counsel:

RAMONA ELLIOTT
General Counsel
P. MATTHEW SUTKO
WALTER THEUS
Office of the General Counsel

Executive Office for United States Trustees
United States Department of Justice
20 Massachusetts, Ave. NW, Ste 8100
Washington, D.C. 20530
Tel: (202) 307-1399

GUY G. GEBHARDT
Assistant United States Trustee
JAMES H. MORAWETZ
Trial Attorney

United States Department of Justice
Office of the United States Trustee
Suite 362, Russell Federal Building
75 Spring Street, SW
Atlanta, GA 30303
Tel: (404) 331-4437
Fax: (404) 331-4464

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INTRODUCTION AND STATEMENT OF BASIS OF APPELLATE JURISDICTION

The United States Trustee brings this appeal from an order (the "**Order**") (R-195)[1] entered by the United States Bankruptcy Court for the Northern District of Georgia (the "**Bankruptcy Court**") on June 12, 2008, denying his Motion for the Appointment of a Chapter 11 Examiner (the "**Examiner Motion**") (R-132). The United States Trustee is an official of the United States Department of Justice with responsibility for administering and enforcing the Bankruptcy Code, 11 U.S.C. §§ 101 - 1532. Under 11 U.S.C. § 307, the United States Trustee has standing to "raise and . . . be heard on any issue in any case or proceeding" under the Bankruptcy Code. *See* 28 U.S.C. § 586 (setting forth many duties of United States Trustee); *United States Trustee v. Columbia Gas Systems, Inc. (In re Columbia Gas Systems, Inc.)*, 33 F.3d 294, 295-299 (3d Cir. 1994).

This Court has jurisdiction over this appeal under 28 U.S.C. § 158(a), which provides, in pertinent part, as follows:

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[1] Unless otherwise indicated, all references to the record on appeal are to the docket number assigned the document by the Bankruptcy Court.

> (a) The district courts of the United States shall have jurisdiction to hear appeals
>
> (1) from final judgments, orders, and decrees; [and]
>
> ...
>
> (3) with leave of the court, from ... interlocutory orders and decrees;
>
> ... of bankruptcy judges entered in cases and proceedings referred to the bankruptcy judges under section 157 of this title. ...

28 U.S.C. § 158(a).

STATEMENT OF THE ISSUE

The issue on appeal is whether 11 U.S.C. § 1104(c)(2) required the bankruptcy court to order the appointment of an examiner in this case because it is a case in which the debtor's fixed, liquidated unsecured debts, other than debts for goods, services, or taxes or owing to an insider, exceed $5,000,000.

STANDARD OF REVIEW

"Factual findings by the bankruptcy court are reviewed under the limited and deferential clearly erroneous standard. .... In contrast, legal conclusions by the bankruptcy court ... are reviewed ... de novo." *Club Associates v. Consolidated Capital Realty Investors (In re Club Associates)*, 951 F.2d 1223, 1228 (11th Cir, 1992). *See also In re Electric Machinery Enterprises, Inc.*, 479 F.3d 791, 795 (11th

Cir.2007); *In re Sublett*, 895 F.2d 1381, 1383 (11th Cir. 1990); Fed. R. Bankr. P. 8013. This appeal raises only issues of law.

STATEMENT OF THE CASE

1. Procedural History

The Appellee/Debtor (hereinafter the "**Debtor**") commenced this bankruptcy case by filing a voluntary petition for relief under chapter 11 of the Bankruptcy Code (R-1) on February 10, 2008 (the "**Petition Date**") and has remained in control of the assets and business operations of the resulting bankruptcy estate since that date. On February 27, 2008, the United States Trustee appointed an Official Committee of Unsecured Creditors in the case (the "**Committee**") pursuant to 11 U.S.C. § 1102(a). (R-34). The Committee has retained counsel and a financial advisor and has been actively involved in the case.

The United States Trustee filed the Examiner Motion on April 25, 2008, and it came before the Court for a hearing on June 12, 2008. (R-206). The Bankruptcy Court entered an order denying the Examiner Motion on that same date, and the United States Trustee filed a timely notice of appeal on June 23, 2008. (R-210).

2. Factual Background

A. Debtor's business model and finances.

Debtor is in the business of making loans for real estate acquisition and development from operating capital raised primarily through the sale of bonds to the public (the "**Investor Bonds**") (R-13).[2] According to Debtor's bankruptcy schedules, there are several thousand holders of the Investor Bonds with claims totaling in excess of $142,000,000. (R-50, Attachment 1).

Debtor is the successor to Presbyterian Investors Fund, Inc. ("**PIF**"), a Georgia non-profit corporation formed in 1985. Debtor was incorporated as a Georgia for-profit corporation on March 18, 1996, and PIF was merged into it on December 29, 2000. (R-13 at ¶ 5.) Debtor made loans only to churches and non-profit organizations until the last quarter of 2004, when it began making loans to for-profit developers. (*Id.* at ¶ 4.) According to its CEO, "Debtor makes loans to for-profit sponsors if the project provides senior living, affordable housing programs that are similar to those of our non-profit borrowers." (*Id.*) However, as of February 11, 2008, the day after the Petition Date, Debtor continued to describe itself on its

---

[2] R-13 is a "Declaration ... in Support of First Day Applications and Motions" executed by Debtor's President and Chief Executive Officer, John T. Ottinger, Jr., and filed with the Bankruptcy Court on February 13, 2008.

Internet website as follows:

> Welcome to Cornerstone Ministries Investments (formerly PIF/Cornerstone Ministries Investments). We provide investment opportunities for people who desire to honor God by investing in the growth of churches and other faith-based organizations.
>
> We have a 17-year tradition of, and commitment to, helping faithful people benefit financially from sound investments in God's work here on earth.

(R-132, Exhibit "A").

By November of 2007, Debtor was experiencing cash shortfalls, resulting in "approximately $8.5 million in real estate loan draw requests which it was unable to fund and $300,000 in bond redemption commitments from October 2007 that it was holding pending receipt of cash." (R-13 at ¶ 6).

B. Debtor's management and transactions with related entities.

Since August of 2004, Debtor has been managed by a separate corporation, eNable Business Solutions, Inc. f/k/a Cornerstone Capital Advisors, Inc. ("**EBS**"), which also serves as its investment and financial advisor. (R-7, ¶¶ 5 & 6). Prior to the Petition Date, Debtor compensated EBS pursuant to an Advisory Agreement (the "**Advisory Agreement**") under which the fees paid to EBS were based on Debtor's gross revenues rather than its net earnings or operating income. In its Form 10-QSB filed with U.S. Securities and Exchange Commission for the nine-month period ending September 30, 2007 (the "**Form 10-QSB,**" R-206, Exhibit UST-1),[3] Debtor disclosed that the management and advisory fees payable to EBS under the Advisory Agreement rose from $1,085,332 for the nine months ending September 30, 2006, to $1,239,174 for the same period in 2007, an increase of $153,842, notwithstanding the deterioration of Debtor's financial position during 2007. (*Id.* at p. 35 of 49). Debtor also disclosed in the Form 10-QSB that it paid shareholder dividends of $517,931 during the nine-month period ending September 30, 2007, although it sustained net operating losses during that period of $417,183. (*Id.* at p. 8 of 49.)

The Form 10-QSB additionally reveals that a substantial portion of the loans made by Debtor were to related entities. For example:

- In September 2006, two of Debtor's officers and two EBS officers each acquired an 18.75% ownership interest in Wellstone LLC, the Debtor's largest borrower. (*Id.* at p. 17 of 49).

---

[3] R-206 is the transcript of the hearing on the Examiner Motion held on June 12, 2008, and Exhibit UST-1 is a copy of the Form 10-QSB printed from the SEC's Internet website, which was introduced into evidence at that hearing without objection. The hyperlink for this document on the SEC website is: http://www.sec.gov/Archives/edgar/data/1035270/000095000507000408/p20254form10q.htm.

- As of September 30, 2007, the outstanding principal on the loans to Wellstone LLC totaled over $76 million. Three of these loans, with outstanding principal totaling $6,574,991, were added after Wellstone LLC became a related party. (*Id.*).
- Debtor made nine loans totaling over $11 million to wholly-owned subsidiaries of Cornerstone Group Holdings, Inc. ("CGH"), at a time when two of its directors also served as directors of CGH. (*Id.* at p. 16 of 49).
- In March 2006, Debtor originated a loan to Castleberry Properties, LLC, which is 50% owned by EBS. As of September 30, 2007, the principal amount outstanding on that loan was $932,301. (*Id.*)

Debtor further disclosed in the Form 10-QSB that in August of 2006 it borrowed $1,589,000 from Wellstone Investment Fund, LLC ("WIF"), which is also managed by EBS. (*Id.* at p. 17 of 49).

On May 9, 2008, the Committee filed a motion for authorization to conduct examinations of certain entities and individuals pursuant to Fed. R. Bankr. P. 2004 (R-165), in which it represented as follows:

> [D]ocuments that have been publicly filed by the Debtor with the SEC show that the Debtor is part of an intricate web of inter-related entities

> that are borrowers from the Debtor, lenders to the Debtor, are in control of or are controlled by the Debtor, or otherwise have business relationships with the Debtor. Many of these inter-related entities are or have been controlled by the same, relatively small, group of individuals and have been advised by common sets of attorneys and accountants. Additionally, publicly available documents show that the Debtor is a party to, or otherwise involved in, a number of complex financing arrangements with what appear to be unrelated third parties.

(*Id.* at ¶ 1).

3. Scope of Requested Investigation.

The United States Trustee seeks the appointment of an examiner in this case to conduct an investigation into and provide a public, transparent and objective report on: 1) the events and circumstances leading to Debtor's shift in late 2004 from making loans only to churches and other non-profit organizations to making loans to for-profit developers, including related entities and/or entities with which it had other business relationships and/or shared common officers or directors; 2) the extent, if any, to which this shift in Debtor's business plan was motivated or influenced by self-dealing on the part of its officers, directors, or professional advisors; and 3) whether and to what extent purchasers of the Investor Bonds were notified of this shift in Debtor's business plan and whether and to what extent they may have claims against broker-dealers or others arising from their purchase and/or retention of the Investor Bonds.

4. The Bankruptcy Court's Ruling.

In its Order, the Bankruptcy Court articulated the following reasons for denying the Examiner Motion:

> Appointment of an examiner is unnecessary at this time and further, same would result in efforts potentially duplicative of the effort of the Official Committee of Holders Unsecured Claims, which is active and well-represented in this case, as well as burdening this estate with added cost and expense. Furthermore, it appears that each and every concern raised by the Trustee, such as corporate interrelationships, alleged self-dealing, issues associated with Debtor' s transition to a lender to for-profit entities, and examining certain bondholder claims are all being fully investigated by the Unsecured Creditors Committee.

(R-195).

SUMMARY OF THE ARGUMENT

Given that the amount of the Debtor's fixed, liquidated, unsecured debts, other than debts for goods, services, or taxes, or owing to insiders, is over 25 times greater than the threshold amount at which the appointment of an examiner becomes mandatory under 11 U.S.C. § 1104(c)(2), the Bankruptcy Court erred as a matter of law in denying the Examiner Motion.

ARGUMENT

I. THE PLAIN LANGUAGE OF 11 U.S.C. § 1104(c)(2) MANDATES THE APPOINTMENT OF AN EXAMINER.

11 U.S.C. § 1104(c) provides as follows:

> If the court does not order the appointment of a trustee under this section, then at any time before confirmation of a plan, on request of a party in interest or the United States trustee, and after notice and a hearing, the court shall order the appointment of an examiner to conduct such an investigation of the debtor as is appropriate, including an investigation of any allegations of fraud, dishonesty, incompetence, misconduct, mismanagement, or irregularity in the management of the affairs of the debtor of or by current or former management of the debtor, if –
>
> > (1) such appointment is in the interests of creditors, any equity security holders, and other interests of the estate; or
> >
> > (2) the debtor's fixed, liquidated, unsecured debts, other than debts for goods, services, or taxes, or owing to an insider, exceed $5,000,000.

11 U.S.C. § 1104(c).[4]

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[4] Some earlier case law refers to this subsection as 1104(b), because it was originally codified in the 1978 Bankruptcy Code as 11 U.S.C. § 1104(b). Subsections (b) and (c) of § 1104 were redesignated as subsections (c) and (d), respectively, by the Bankruptcy Reform Act of 1994, which added a new subsection (b), authorizing trustee elections in Chapter 11 cases. See Bankruptcy Reform Act of 1994, Pub. L. No. 103-394 (enacted October 22, 1994 and effective in cases filed after that date).

On Schedule F-1 of its bankruptcy schedules filed in the case (R-50, Attachment #1), Debtor lists fixed, liquidated unsecured debts to its bondholders totaling $142,864,129. There are several thousand of these scheduled bondholders, only a handful of whom are among the insiders listed at Item 21(b) of the Debtor's Statement of Financial Affairs. (R-50, pp. 24 & 25 of 48). Section 1104(c)(2) plainly and unambiguously mandates that the court "shall" order the appointment of an examiner upon request by a party in interest or the United States trustee where "the debtor's fixed, liquidated, unsecured debts, other than debts for goods, services, or taxes, or owing to an insider, exceed $5,000,000," provided only that no trustee is appointed and no plan has been confirmed. The record clearly establishes that all of these conditions are met in the present case. Indeed, there has been no contention to the contrary by any party.

"Where the word 'shall' appears in a statutory directive, 'Congress could not have chosen stronger words to express its intent that [the specified action] be mandatory....'" *Plaut v. Spendthrift Farm, Inc.*, 1 F.3d 1487, 1490 (6th Cir. 1993), *aff'd*, 514 U.S. 211, 115 S.Ct. 1447 (1995), quoting from *United States v. Monsanto*, 491 U.S. 600, 607, 109 S.Ct. 2657, 2662, 105 L.Ed.2d 512 (1989). *See also Lexecon Inc. v. Milberg Weiss Bershad Hynes & Lerach*, 523 U.S. 26, 35, 118 S.Ct. 956, 962

(1998) ("the mandatory 'shall' ... normally creates an obligation impervious to judicial discretion") (citing *Anderson v. Yungkau*, 329 U.S. 482, 485, 67 S.Ct. 428, 430, 91 L.Ed. 436 (1947)); *Barbieri v. RAJ Acquisition Corp. (In re Barbieri)*, 199 F.3d 616, 619 (2d Cir. 1999) ("The term 'shall,' ... generally is mandatory and leaves no room for the exercise of discretion by the trial court") ; *Hall Financial Group, Inc. v. DP Partners Ltd. Partnership (In re DP Partners Ltd. Partnership)*, 106 F.3d 667, 670-671 (5th Cir.), *cert. denied*, 522 U.S. 815, 118 S.Ct. 63 (1997) ("Use of the word 'shall' connotes a mandatory intent").

Congress' intention to make the appointment of an examiner mandatory where the conditions of section 1104(c)(2) are met is apparent not only from the use of the mandatory "shall" but also from the fact that "[u]nless § 1104([c])(2) requires the appointment of an examiner in such a case, it becomes indistinguishable from § 1104([c])(1)." *Morgenstern v. Revco D.S., Inc. (In re Revco D.S., Inc.)*, 898 F.2d 498, 501 (6th Cir. 1990). "Indeed, if paragraph (c)(2) were not mandatory, then § 1104(c) would have the following meaning: 'If specified debt is less than $5 million, it is in the court's discretion to appoint an examiner; and if specified debt is more than $5 million, it is in the court's discretion to appoint an examiner.'" *In re UAL Corp.*, 307 B.R. 80, 84, fn. 2 (Bankr. N.D. Ill. 2004).

The great majority of cases that have addressed the issue, including the only Court of Appeals decision on point, hold that section 1104(c)(2) is mandatory and must be enforced according to its plain terms. *See Morgenstern v. Revco D.S., Inc., supra,* 898 F.2d at 500-01 ("The provision plainly means that the bankruptcy court 'shall' order the appointment of an examiner when the total fixed, liquidated, unsecured debt exceeds $5 million, if the U.S. trustee requests one"); *In re UAL Corp., supra*, 307 B.R. at 84 (best reading of statute is that examiner appointment is mandatory if requirements of section 1104(c)(2) are satisfied, but court retains discretion to determine nature and scope of examiner's investigation). *See also In re Mechem Fin. of Ohio, Inc.*, 92 B.R. 760, 761 (Bankr. N.D. Ohio 1988); *In re The Bible Speaks*, 74 B.R. 511, 514 (Bankr. D. Mass.1987); *In re 1243 20th Street, Inc.*, 6 B.R. 683, 685 n.3 (Bankr. D.C. 1980); *In re Lenihan*, 4 B.R. 209, 211 (Bankr. D.R.I. 1980); *In re Loral Space & Communications, Ltd.*, 2004 WL 2979785, *4 (S.D.N.Y. 2004), rev'g 313 B.R. 577 (Bankr. S.D.N.Y. 2004) ("As stated in *Collier on Bankruptcy*, 'Section 1104(c)(2) does not leave any room for the court to exercise discretion about whether an examiner should be appointed, as long as the $5,000,000 threshold is met and a motion for appointment of an examiner is made by a party in interest,' 7 *Collier* 1104.03[2][b] at 1104-38.").

The Bankruptcy Court nevertheless concluded that it had such discretion in this case, based on the following three bankruptcy court decisions: *In re Rutenberg*, 158 B.R. 230, 232 (Bank M.D.F1a.1993), *In re GHR Companies, Inc.*, 43 B .R. 165 (Bankr. D.Mass. 1984), and *In re Shelter Resources Corporation*, 35 B.R. 304 (Bankr. N.D.Ohio 1983). However, as noted by the court in *In re UAL Corp.*, *supra*, 307 B.R. at 85, "none of [these three decisions] deal[s] with the problem of giving meaning to paragraph (c)(2)," and "[s]ince [they] all deny appointment of an examiner on the ground that appointment would not be in the interests of the estate, they impermissibly ignore the impact of paragraph (c)(2)'s debt threshold alternative."

The examiner motion at issue in *Rutenberg* was, as characterized by the bankruptcy court in that case, "truly unique" in that it was filed by an individual debtor. *Id.*, 158 B.R. at 230. It is, of course, nonsensical on its face for a chapter 11 debtor in possession, particularly an individual debtor in possession, to request the appointment of an examiner to investigate himself. In denying the motion, the *Rutenberg* court concluded that the only reason for the debtor to have brought it was to delay the administration of the Chapter 11 case by abating further proceedings on a plan of reorganization and disclosure statement he had filed. *Id.*, at 233. The court questioned whether, under these circumstances, the debtor could be considered a "party in interest" within the contemplation of the statute with standing to request an examiner. *Id.* at 232. However, the court also cited *In re GHR Companies, Inc.*, *supra*, 43 B.R. 165, for the proposition that "the use of the word 'shall' does not always mean that the action is mandatory just as 'may' at times may carry the meaning of 'must.'" *Id.*, 158 B.R. at 232.

In the *GHR Companies* case, the court concluded, based on an examination of the legislative history of section 1104(c)(2),[5] that the section "was enacted primarily to satisfy the needs and dictates of a public company operating under the protections and laws of Chapter 11," *Id.*, 43 B.R. at 170, and therefore should not be construed as requiring the appointment of an examiner in the case of a privately held debtor with more than $5 million in non-trade debt. *Id.* at 174-5. The court determined that the statute was a holdover from the provision of Chapter X of the Bankruptcy Act of 1898, as amended by the 1938 Chandler Act, mandating the appointment of a trustee in cases where the debtor's liabilities exceeded $250,000. Because Chapter X was adapted to the reorganization of large companies with publicly traded debt and/or

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[5] The court was actually construing former 11 U.S.C. § 151104(b), the language of which was identical to the language of § 1104(b) as it then existed. As indicated *supra*, at fn. 4, that language is now codified as § 1104(c).

stock, the court concluded that "[i]mplicit from ... the legislative history and the Supreme Court cases, is a finding that public security holders need extra protection ..." *Id.* at 175. Significantly, however, the *GHR Companies* court did not conclude from its review of the legislative history that Congress had intended for the statute to mean something other than what it says. Rather, the court stated simply that it had been unable to find anything in its review of the House and Senate bills leading up to the passage of the Bankruptcy Reform Act of 1978[6] that "satisfactorily explains" the provision, *Id.* at 174, and that it was still "struggling with the meaning of the legislative history because there is no clear expression of why the mandatory examiner section was enacted." *Id.* at 175.

The inability to find a "satisfactory" explanation for a statute's enactment in its legislative history is not, of course, a sufficient reason for refusing to enforce the statute according to its terms. In reaching its initial determination that consideration of the legislative history was appropriate, the *GHR Companies* court began with the propositions that "the process of interpretation should commence with consideration of the legislative history" and that "[c]ourts may rely upon legislative history to construe a statute in a manner contrary to its plain language when such is necessary

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[6] The conflicting bills were H.R. 8200, 95th Cong., 1st Sess. § 101 (1977) (reported by the House Judiciary Committee), and S. 2266, 95th Cong., 2nd Sess. § 101 (1978) (reported by the Senate Judiciary Committee).

to effectuate Congress' intent and understanding of a statute." *Id.* at 170-71 (citations and internal quotation marks omitted).

This theory of statutory construction is diametrically at odds with a consistent line of United States Supreme Court decisions, commencing with *United States v. Ron Pair Enterprises, Inc., supra*, 489 U.S. 235, 241, 109 S.Ct. 1026, 1030, 103 L.Ed.2d 290 (1989), holding that statutory interpretation begins with the language of the statute itself and, where the language is plain and unambiguous, ends there as well. As reiterated by the Supreme Court in *Lamie v. U.S. Trustee*, 540 U.S. 526, 534, 124 S.Ct. 1023, 1030 (2004), "[t]he starting point in discerning congressional intent is the existing statutory text, and not the predecessor statutes. ... It is well established that when the statute's language is plain, the sole function of the courts – at least where the disposition required by the text is not absurd – is to enforce it according to its terms." (Citations and internal quotation marks omitted.)[7]

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[7] See also *Zuni Public Schools Dist. No. 89 v. Department of Educ.*, ___ U.S. ___, 127 S.Ct. 1534, 1543, 167 L.Ed.2d 449, 75 USLW 4198 (2007) ("Under this Court's precedents, if the intent of Congress is clear and unambiguously expressed by the statutory language at issue, that would be the end of our analysis"); *Barnhart v. Sigmon Coal Co., Inc.*, 534 U.S. 438, 450, 122 S.Ct. 941, 950 (2002) ("[t]he inquiry ceases if the statutory language is unambiguous and the statutory scheme is coherent and consistent") (citations and internal quotation marks omitted); *Hartford Underwriters Ins. Co. v. Union Planters Bank, N. A.*, 530 U.S. 1, 6, 120 S.Ct. 1942, 147 L.Ed.2d 1 (2000); *Hughes Aircraft Co. v.*

Finally, in the third case cited by the Bankruptcy Court in its Order, *In re Shelter Resources Corp., supra*, the court simply treated the mandatory language of section 1104(c)(2) as discretionary without offering any explanation or analysis supporting such an interpretation, stating merely it was unwilling to "slavishly and blindly follow the so-called mandatory dictates of Section 1104([c])(2)" under the circumstances that existed in the case. *Id.*, 35 B.R. at 305. Those circumstances, as articulated by the *Shelter Resources* court, were similar to the circumstances articulated by the Bankruptcy Court in denying the Examiner Motion in the present case, i.e., that a creditors committee was in place with the power to conduct such investigations as might be appropriate and that the appointment of an examiner under such circumstances would give rise to a "possibility of duplicated effort" which would not be "in the spirit of economy of administration in the handling of bankruptcy estates." *Id.*

Quite obviously, a determination by a court that it would decline to grant relief under a statute if the relief were discretionary is not a valid reason to deny the relief where the statute mandates that it be granted. To construe a statute in a manner contrary to its plain wording without benefit of any principle of statutory construction

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Jacobson, 525 U.S. 432, 438, 119 S.Ct. 755, 142 L.Ed.2d 881 (1999); *Robinson v. Shell Oil Co.*, 519 U.S. 337, 340, 117 S.Ct. 843, 136 L.Ed.2d 808 (1997).

supporting such an interpretation is simply untenable.

II. THE LEGISLATIVE HISTORY OF THE STATUTE NEITHER REQUIRES NOR SUPPORTS AN INTERPRETATION AT ODDS WITH ITS PLAIN MEANING.

Even assuming for the purpose of argument that consideration of the legislative history of § 1104(c)(2) were appropriate, that history is in no way inconsistent with the plain wording of the statutory text. As previously indicated, the court in the *GHR Companies* case did not conclude from its analysis of the legislative history that Congress intended for the text of § 1104(c)(2) to mean something other than what it says. Rather, the court stated merely that it could find "no clear expression" in the legislative history of why the mandatory examiner provision was enacted. *Id.*, 43 B.R at 175. Other courts have, however, encountered no such difficulty in determining why the provision was enacted.

In *In re UAL Corp,. supra*, the court held that "[t]o the extent that the language of § 1104(c)(2) could be seen as ambiguous, the subsection's legislative history forcefully indicates that appointment of an examiner was intended to be mandatory in cases exceeding the debt threshold." *Id.*, 307 B.R. at 85. The *UAL* court summarized the legislative debate that gave rise to the provision as follows:

> [T]he focus of the debate over § 1104 was whether appointment of a trustee should be mandatory for public companies (as it was under

> Chapter X of the former Bankruptcy Act), or whether the debtor should remain in possession in all cases unless a trustee was appointed for cause. The enacted language of § 1104 resolved a disagreement between the Senate and the House of Representatives on this question. The compromise rejected mandatory appointment of a trustee, but, as its sponsors explained, it provided for mandatory appointment of an examiner in large cases as an alternative form of protection against corporate mismanagement.

Id. at 86, citing Leonard L. Gumport, *The Bankruptcy Examiner*, 20 Cal. Bankr.J. 71, 83-95 (1992). Accordingly, the court concluded, "the weight of precedent, the language of § 1104, and the legislative history all indicate that appointment of an examiner is mandatory" under conditions set forth in § 1104(c)(2). *Id.* The United States Trustee submits that this analysis is entirely correct.

CONCLUSION

Section 1104(c)(2) required the Bankruptcy Court to order the appointment of an examiner in this case because 1) the United States Trustee requested such relief; 2) no trustee has been appointed in the case; 3) no Chapter 11 plan has been confirmed; and 4) the Debtor's $140,000,000 in fixed liquidated, unsecured debt arising from its sale of Investor Bonds to thousands of purchasers is over 25 times greater than the amount at which the appointment of an examiner becomes mandatory under the plain and unambiguous wording of the statute. Accordingly, the United

States Trustee respectfully requests this Court to reverse the Order of the Bankruptcy Court denying the Examiner Motion.

Respectfully submitted,

s/ *Guy G. Gebhardt*
GUY G. GEBHARDT, ESQUIRE
Assistant United States Trustee

s/ *James H. Morawetz*
JAMES H. MORAWETZ, ESQUIRE
Trial Attorney

United States Department of Justice
Office of the United States Trustee
Suite 362, Russell Federal Building
75 Spring Street, SW
Atlanta, GA 30303
Tel: (404) 331-4437
Fax: (404) 331-4464
Of Counsel:

Ramona Elliott
General Counsel

P. Matthew Sutko
Walter Theus
Office of the General Counsel

Executive Office for United States Trustees
United States Department of Justice
20 Massachusetts, Ave. N.W., Suite 8100
Washington, D.C. 20530
Tel: (202) 307-1399

CERTIFICATE OF SERVICE

I hereby certify that on this date I electronically filed with the Clerk of Court the foregoing Brief of United States Trustee as Appellant using the CM/ECF system, which will automatically send email notification of such filing to the following attorneys of record:

J. Robert Williamson, Esq., Counsel for Debtor/Appellee

Dennis J. Connolly, Esq., Counsel for Official Committee of Unsecured Creditors

William Stewart Sugden, Counsel for Official Committee of Unsecured Creditors

Done this the 11th day of August, 2008.

s/ *James H. Morawetz*
JAMES H. MORAWETZ
Trial Attorney
Georgia Bar No. 521900

Office of the United States Trustee
Suite 362, Russell Federal Building
75 Spring Street, SW
Atlanta, GA 30303
Tel: (404) 331-4437
Fax: (404) 331-4464
E-mail: jim.h.morawetz@usdoj.gov

BRIEF BANK — "SUMMARY SHEET"

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WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*
In re Donald F. Walton, United States Trustee (Walton, UST v. Cornerstone Ministries Investments, Inc.)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*
D. Ga.

3. ("CCN") ***CURRENT*** CASE NO.
No.: 2:08-cv-00138-WCO

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*
No.: 08-20355-REB
Court: Bankr. Ga.
(Identify judge & cite, if any)

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U.S. TRUSTEES

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James H. Morawetz, Guy G. Gebhardt, Donald F. Walton, Walter Theus, P. Matthew Sutko
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***
• Whether a bankruptcy court may ignore the mandate of § 1104(c)(2) either by determining that no investigation is appropriate or by delaying indefinitely a ruling on a request for an examiner.

10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)

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UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF GEORGIA
GAINESVILLE DIVISION

In re:

DONALD F. WALTON,
UNITED STATES TRUSTEE,
Region 21

Appellant,

vs.

CORNERSTONE MINISTRIES
INVESTMENTS, INC.,

Appellee.

District Court Case No.
2:08-cv-00138-WCO

Bankruptcy Case No.
08-20355-REB

REPLY BRIEF OF UNITED STATES TRUSTEE AS APPELLANT

Of Counsel:

RAMONA D. ELLIOTT
General Counsel
P. MATTHEW SUTKO
WALTER THEUS
Office of the General Counsel

Executive Office for United States Trustees
United States Department of Justice
20 Massachusetts, Ave. NW, Ste 8100
Washington, D.C. 20530
Tel: (202) 307-1399

GUY G. GEBHARDT
Assistant United States Trustee
JAMES H. MORAWETZ
Trial Attorney

United States Department of Justice
Office of the United States Trustee
Suite 362, Russell Federal Building
75 Spring Street, SW
Atlanta, GA 30303
Tel: (404) 331-4437
Fax: (404) 331-4464

The United States Trustee respectfully submits the following response to the arguments advanced by the Debtor and the Official Committee of Unsecured Creditors (the "Committee") in their opposing briefs filed as Appellees in this appeal.

1. Interpreting the statute in accordance with its plain meaning does not lead to an absurd result in this case.

The Appellees contend that, given the Bankruptcy Court's determination that "each and every concern raised by the Trustee ... [was] being fully investigated by the Unsecured Creditors Committee" (R-195, p.1), adherence to the plain meaning of § 1104(c)(2) in this case would lead to an absurd result, because the "appropriate" scope of an examiner's investigation under such circumstances would be "nothing." (Brief of Committee, p. 1; Brief of Debtor, p. 8). Based on the proposition, as set forth in *Lamie v. U.S. Trustee*, 540 U.S. 526, 534, 124 S. Ct. 1023, 1030 (2004), that a court is not required to adhere to the plain language of a statute where "the disposition required by the text is ... absurd," the Appellees therefore contend that the Bankruptcy Court was correct in declining to follow the language of § 1104(c)(2) in this case. (Brief of Committee, p. 9; Brief of Debtor, p. 11).

Judicial invalidation of a statute on the basis of absurdity is rare, and the Appellees made no such attack on § 1104(c)(2) in the Bankruptcy Court. The standard for such an attack is exceedingly high. As stated by the Eleventh Circuit

Court of Appeals in *U.S. v. Nix*, 438 F.3d 1284 (11th Cir. 2006),

> [t]here is an absurdity exception to the plain meaning rule, but it is a very narrow exception that comes into play only where the result of adhering to the plain meaning rule is not just unwise but is clearly absurd ... and results in an absurdity that is so gross as to shock the general moral or common sense.

Id. at 1286 (Citations and internal quotation marks omitted). This exception to the plain meaning rule of statutory construction,

> is rarely applied, because the result produced by the plain meaning canon must be truly absurd before this principle trumps it. Otherwise, clearly expressed legislative decisions would be subject to the policy predilections of judges.

Merritt v. Dillard Paper Co., 120 F.3d 1181, 1185-86 (11th Cir. 1997). *See also Sturges v. Crowninshield*, 17 U.S. (4 Wheat.) 122, 202-03 (1819) (absurdity must be "so monstrous, that all mankind would, without hesitation, unite in rejecting" it); *C.B.S., Inc. v. PrimeTime 24 Joint Venture*, 245 F.3d 1217, 1228 (11th Cir. 2001).

The Bankruptcy Court did not find, nor could it have found, that the Committee's as-yet-to-be-completed investigation of the Debtor would be so thorough and far reaching that it would be impossible for anyone else to add anything to it. Rather, the basis for the Court's decision, as articulated in the Order denying the Examiner Motion (the "Order"), was that an investigation by an examiner would be "*potentially duplicative* of the effort of the Official Committee of Holders [of]

Unsecured Claims, which is active and well-represented in this case, as well as burdening this estate with added cost and expense." *Id*. (Emphasis supplied).[1] While there is no question that an investigation by an examiner would be "potentially duplicative" of the Committee's investigation, the Bankruptcy Court has the ability to minimize that potential by requiring the Committee and the examiner to coordinate their discovery efforts and setting ground rules to avoid undue duplication of effort.

The Appellees cannot seriously contend that it is presumptively absurd to appoint an examiner in any Chapter 11 case with an active creditors' committee. Examiners and creditors' committees serve entirely different roles. A creditors' committee has the power but not the duty under 11 U.S.C. § 1103(c)(2) to "investigate the acts, conduct, assets, liabilities, and financial condition of the debtor," while an examiner's sole function under 11 U.S.C. § 1104(c) is to conduct "such an investigation of the debtor as is appropriate ..." Unlike the creditors' committee, an examiner has no bias, and his or her duties run to all constituencies, including, for example, shareholders as well as creditors.

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[1] Appellees emphasize in this regard that the Committee has already moved for and obtained from the Bankruptcy Court authorization to examine numerous entities and individuals related to the Debtor pursuant to Bankruptcy Rule 2004; however, it is noteworthy that the Committee did not file the motion in question (R-165) until after the United States Trustee filed the Examiner Motion (R-132).

> The benefit of appointing an independent examiner is that he or she will act as an objective nonadversarial party who will review the pertinent transactions and documents, thereby allowing the parties to make an informed determination as to their substantive rights. ... In essence, an examiner's report paints a picture, his or her image of what happened in the case, and ends with that expert's opinion of what that story means, in legal terms. The report puts the story on paper and provides a context for debate.

In re Fibermark, 339 B.R. 321, 325 (Bankr. D. Vt. 2006) (citations omitted). An examiner's report can add value in a Chapter 11 case simply by providing an unbiased, public explanation of what caused the debtor to end up in chapter 11.

It is quite clear from the Order that the Bankruptcy Court did not decline to follow § 1104(c)(2) in this case based on a determination that the statute was absurd or that its application would lead to an absurd result. The word "absurd" does not appear in the Order. Rather, the Court declined to enforce the statute because it believed the cost of appointing an examiner in this case would outweigh its benefits, a consideration that the language of the statute plainly excludes.

2. A bankruptcy court may not ignore the mandate of § 1104(c)(2) either by determining that no investigation is appropriate or by delaying indefinitely a ruling on a request for an examiner.

At page 8 of its brief, the Committee argues that in interpreting the provision of § 1104(c) directing that the court "shall order the appointment of an examiner to conduct such an investigation of the debtor as is appropriate," the phrase "as is appropriate" should be read as qualifying the word "shall," with the result that the mandate to appoint an examiner does not arise if the court determines that no investigation of the debtor whatever is appropriate. This tortured construction of the statutory language violates the "last antecedent" rule of statutory construction, "according to which a limiting clause or phrase ... should ordinarily be read as modifying only the noun or phrase that it immediately follows ..." *Barnhart v. Thomas*, 540 U.S. 20, 26, 124 S. Ct. 376, 381 (2003). See also *Jama v. Immigration and Customs Enforcement*, 543 U.S. 335, 343, 125 S. Ct. 694, 701 (2005). The phrase "as is appropriate" as used in this provision of the statute clearly modifies the phrase "such an investigation" rather than the phrase "shall order the appointment." Thus, while the statute gives the court the power to limit the scope of an examiner's investigation, it does not authorize the court to direct the appointment of an examiner with no duties whatever.

The Committee additionally argues at page 8 of its brief that by denying the Examiner Motion "without prejudice to the Trustee['s right] to seek similar relief as appropriate at a later date," (R-195, p.2), the Bankruptcy Court "[f]unctionally ... simply deferred the issue of the appointment of an examiner and the scope of that examination to another day."[2] While the Committee seems to imply that the Bankruptcy Court could avoid the mandate of the statute by the expedient of declining indefinitely to rule on the Examiner Motion,[3] it cites no authority for such a proposition, and the United States Trustee submits that none exists. In any event, it is clear from the unambiguous language of the Order that the Bankruptcy Court denied the Examiner Motion outright rather than deferring a ruling on it to another day.

CONCLUSION

For the foregoing reasons and the reasons set forth in his previous Brief as Appellant, the United States Trustee contends that the arguments of the Appellees are without merit and respectfully reiterates his request that this Court reverse the Order of the Bankruptcy Court denying the Examiner Motion.

[Signatures of Counsel on Next Page]

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[2] To the extent this argument goes to the finality of the Order, it conflicts with the Committee's statement at page 1 of its Brief that it "does not dispute the Court's jurisdiction over this appeal or the Appellant's statement thereof."

[3] Even a finite delay by the bankruptcy court in ordering the appointment of an examiner could result in loss of its ability to grant such relief, because, as noted by the Debtor at page 17 of its brief, such an order is required by § 1104(c)(2) to be entered prior to confirmation of a plan.

Respectfully submitted,

s/ *Guy G. Gebhardt*
GUY G. GEBHARDT, ESQUIRE
Assistant United States Trustee

s/ *James H. Morawetz*
JAMES H. MORAWETZ, ESQUIRE
Trial Attorney

United States Department of Justice
Office of the United States Trustee
Suite 362, Russell Federal Building
75 Spring Street, SW
Atlanta, GA 30303
Tel: (404) 331-4437
Fax: (404) 331-4464

Of Counsel:

Ramona D. Elliott
General Counsel

P. Matthew Sutko
Walter Theus
Office of the General Counsel

Executive Office for United States Trustees
United States Department of Justice
20 Massachusetts, Ave. N.W., Suite 8100
Washington, D.C. 20530
Tel: (202) 307-1399

CERTIFICATE OF SERVICE

I hereby certify that on this date I electronically filed with the Clerk of Court the foregoing Brief of United States Trustee as Appellant using the CM/ECF system, which will automatically send email notification of such filing to the following attorneys of record:

J. Robert Williamson, Esq., Counsel for Debtor/Appellee

Dennis J. Connolly, Esq., Counsel for Official Committee of Unsecured Creditors

William Stewart Sugden, Counsel for Official Committee of Unsecured Creditors

Done this the 19th day of September, 2008.

s/ *James H. Morawetz*
JAMES H. MORAWETZ
Trial Attorney
Georgia Bar No. 521900

Office of the United States Trustee
Suite 362, Russell Federal Building
75 Spring Street, SW
Atlanta, GA 30303
Tel: (404) 331-4437
Fax: (404) 331-4464
E-mail: jim.h.morawetz@usdoj.gov

BRIEF BANK — 'SUMMARY SHEET" Printed Wed-11/30/05 9:49

WESTLAW CODES

1. ("TI") TITLE OF CASE [E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]
UST v Cortez (In re Cortez)

2. ("CO") CURRENT COURT [E.g., "CTA9"]
CTA5

3. ("CCN") CURRENT CASE NO.
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4. ("PCN") PRIOR CASE NO. & COURT [IF ANY]
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Tara Leigh Grove, Civil Div. Appellate Staff
P. Matthew Sutko, Esq. EOUST
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") TOPIC
BANKRUPTCY

9. ("SU") ● SUMMARY OF KEY ISSUE(s) & √ Any Miscellaneous BACKGROUND

● 1. Whether a bankruptcy court, in ruling on a motion to dismiss a Chapter 7 the bankruptcy case for "substantial abuse," should take into account post-petition events, such as a significant increase in a debtor's income level. 2. Whether the district court properly concluded, based on the record presented to that court, that debtors' bankruptcy case should be dismissed or, at the debtors' option, converted to a Chapter 13 proceeding.

√ **Background:**

10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)
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No. 05-10459

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

In Re: CARLOS VICENTE CORTEZ; SUZANNE HALLMAN CORTEZ,

Debtors.

UNITED STATES TRUSTEE,

Appellee,

v.

CARLOS VICENTE CORTEZ;
SUZANNE HALLMAN CORTEZ,

Appellants.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF TEXAS

BRIEF FOR THE APPELLEE

PETER D. KEISLER
Assistant Attorney General

RICHARD B. ROPER, III
United States Attorney

WILLIAM KANTER
(202) 514-4575
TARA LEIGH GROVE
(202) 514-1201
Attorneys, Appellate Staff
Civil Division, Room 7230
Department of Justice
950 Pennsylvania Ave., N.W.
Washington, D.C. 20530

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REQUEST FOR ORAL ARGUMENT

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REQUEST FOR ORAL ARGUMENT

Appellee believes that the district court’s determination is correct and should be affirmed. We stand ready to present oral argument if the Court would find argument to be of assistance.

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 05-10459

In Re: CARLOS VICENTE CORTEZ; SUZANNE HALLMAN CORTEZ,

Debtors.

UNITED STATES TRUSTEE,

Appellee,

v.

CARLOS VICENTE CORTEZ;
SUZANNE HALLMAN CORTEZ,

Appellants.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF TEXAS

BRIEF FOR THE APPELLEE

STATEMENT OF JURISDICTION

The bankruptcy court had jurisdiction under 28 U.S.C. §§ 157(a) and (b) to hear the underlying case, a voluntary petition under Chapter 7 of the Bankruptcy Code, 11 U.S.C. §§ 701, et seq. See also 28 U.S.C. §§ 151, 1334(a). On November 5, 2004, the bankruptcy court denied the United States Trustee's motion to dismiss the bankruptcy case under 11 U.S.C. § 707(b) for substantial abuse. Record on Appeal ("R."), Volume ("Vol.") 3, at 78-88; Record Excerpts ("Rec. Ex."), Tab 2, at 1-11. The bankruptcy court's decision constituted a final and immediately appealable order. See In re Koch, 109 F.3d 1285, 1287 (8th Cir. 1997); In re Christian, 804 F.2d 46, 47-48 (3d Cir. 1986).

On November 15, 2004, the United States Trustee filed a timely notice of appeal from that order to the district court. See R., Vol. 2, at 1; Fed. R. Bankr. P. 8002(a). The district court had jurisdiction to hear the appeal under 28 U.S.C. § 158(a). On March 9, 2005, the district court reversed. See Rec. Ex., Tab 4, at 1-7. The debtors Carlos Vicente Cortez and Suzanne Hallman Cortez subsequently filed a timely notice of appeal to this Court on April 7, 2005. This Court has jurisdiction to hear the appeal under 28 U.S.C. § 158(d).

STATEMENT OF THE ISSUES

1. Whether a bankruptcy court, in ruling on a motion to dismiss a Chapter 7 bankruptcy case for "substantial abuse," should take into account post-petition events, such as a significant increase in a debtor's income level.

2. Whether the district court properly concluded, based on the record presented to that court, that the debtors' bankruptcy case should be dismissed or, at the debtors' option, converted to a Chapter 13 proceeding.

STATEMENT OF THE CASE

On April 8, 2004, Carlos Vicente Cortez and Suzanne Hallman Cortez ("Mr. and Mrs. Cortez" or "debtors") jointly filed for bankruptcy protection under Chapter 7 of the Bankruptcy Code. Four days later, Mr. Cortez was offered a job with an annual salary of $95,000.

The United States Trustee filed a motion to dismiss the case under 11 U.S.C. § 707(b), asserting that it would be a "substantial abuse" of Chapter 7 to grant the debtors a discharge, when Mr. Cortez's new job would allow the debtors to repay a considerable portion of their outstanding debts. The bankruptcy court denied the United States Trustee's motion, concluding that it could not consider the post-petition change in the debtors' financial circumstances.

The district court reversed, concluding that, under 11 U.S.C. § 707(b), the bankruptcy court should consider such post-petition changes in a debtor's income level. The court further found that the bankruptcy court should have granted the United States Trustee's motion to dismiss. The court then remanded the case to the bankruptcy court, directing that the case be dismissed or, at the debtors' option, converted to a Chapter 13 proceeding. The debtors appealed.

STATEMENT OF FACTS

I. Statutory and Regulatory Background

A. Bankruptcy Protection for Individual Debtors

1. An individual who seeks to discharge his past debts may file a petition under Chapter 7 of the Bankruptcy Code. See 11

U.S.C. §§ 701, et seq. The debtor's assets are then transferred to a new legal entity: the "bankruptcy estate." See 11 U.S.C. § 541(a). A trustee is appointed to help with the administration and liquidation of the estate. See 11 U.S.C. §§ 701, 702, 704.

The Chapter 7 trustee sells the debtor's assets and distributes the proceeds to creditors who have filed claims against the estate. See 11 U.S.C. § 704(1). At the end of this process, the bankruptcy court issues an order, discharging most of the debtor's prior financial obligations. See 11 U.S.C. § 727.

2. An individual, under certain circumstances, may instead seek protection under Chapter 13 of the Bankruptcy Code. See 11 U.S.C. § 109(e) (an individual may file a Chapter 13 petition if he has a "regular income" and his debts do not exceed certain established sums).

"Chapter 13 . . . is a kind of 'personal reorganization' counterpart to the better-known Chapter 11[.]" In re Heath, 115 F.3d 521, 522 (7th Cir. 1997). Under Chapter 13, a debtor does not liquidate his existing assets in order to pay creditors. See In re Bartee, 212 F.3d 277, 284 (5th Cir. 2000). Instead, the debtor establishes a plan for paying a portion of his outstanding debts out of his future income. See Grubbs v. Houston First American Savings Association, 730 F.2d 236, 239 (5th Cir. 1984).

A Chapter 13 payment plan may last between three and five years. See 11 U.S.C. § 1322(d). At the end of that time period, the Chapter 13 debtor can generally discharge "all debts provided for by the plan[.]" 11 U.S.C. § 1328(a).

B. Dismissing a Chapter 7 Case For Substantial Abuse

1. Prior to 1984, a bankruptcy court could dismiss a Chapter 7 bankruptcy case only for "cause." See Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, § 707 (codified at 11 U.S.C. § 707); S. Rep. No. 95-989, at 94 (1978); H.R. Rep. No. 95-595, at 380 (1977). A bankruptcy court had "cause" to dismiss a case if, for example, the debtor had unreasonably delayed the proceedings in a manner that prejudiced his creditors. See Pub. L. No. 95-598, § 707(1) (codified at 11 U.S.C. § 707).

Congress did not, however, intend for a bankruptcy court to dismiss a case for "cause" simply because a debtor could repay a portion of his past debts. See S. Rep. No. 95-989, at 94 ("The section does not contemplate . . . that the ability of the debtor to repay his debts in whole or in part constitutes adequate cause for dismissal."); H.R. Rep. No. 95-595, at 380 (same).

2. In the early 1980s, Congress became concerned about a "dramatic[]" rise in the number of consumer bankruptcy cases, and, as a result, amended many provisions of the Bankruptcy Code pertaining to consumer bankruptcies. See Bankruptcy Amendments

and Federal Judgeship Act of 1984, Pub. L. No. 98-353 (1984); S. Rep. No. 98-65, at 3 (1983).

As part of these reforms, Congress expanded bankruptcy courts' authority to dismiss Chapter 7 consumer bankruptcy cases. See Pub. L. No. 98-353, § 312 (codified at 11 U.S.C. § 707(b)); S. Rep. No. 98-65, at 53. Congress sought to ensure that bankruptcy courts would have the authority to dismiss bankruptcy cases in which debtors could repay a substantial portion of their debts. See S. Rep. No. 98-65, at 53-54; In re Kornfield, 164 F.3d 778, 781 (2d Cir. 1999) (Congress was "[c]oncerned that debtors who could over time easily pay their creditors might resort to Chapter 7 to erase their legitimate obligations"); In re Stewart, 175 F.3d 796, 812-13 (10th Cir. 1999); In re Lamanna, 153 F.3d 1, 3 n.6 (1st Cir. 1998).

Accordingly, Congress enacted 11 U.S.C. § 707(b), which provides:

> After notice and a hearing, the court, on its own motion or on a motion by the United States trustee, but not at the request or suggestion of any party in interest, may dismiss a case filed by an individual debtor under this chapter whose debts are primarily consumer debts if it finds that the granting of relief would be a substantial abuse of the provisions of this chapter. There shall be a presumption in favor of granting the relief requested by the debtor.

11 U.S.C. § 707(b). The provision also states that, in determining whether to dismiss a case for "substantial abuse," a

bankruptcy court "may not take into consideration whether a debtor has made, or continues to make, charitable contributions[.]" Ibid.[1]

Thus, under 11 U.S.C. § 707(b), a bankruptcy court may, upon motion by the United States Trustee,[2] dismiss a consumer bankruptcy proceeding, if the court concludes that granting relief to the debtor would constitute a "substantial abuse" of Chapter 7 of the Bankruptcy Code. 11 U.S.C. § 707(b).

II. The Present Litigation

A. The Bankruptcy Proceedings

1. On April 8, 2004, Carlos Vicente Cortez and Suzanne Hallman Cortez jointly filed a voluntary petition for bankruptcy under Chapter 7. See R., Vol. 3, at 47, 72. In the years preceding the bankruptcy filing, the debtors had an annual income of over $140,000, most of which came from Mr. Cortez's annual

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[1] Congress, via the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, recently amended 11 U.S.C. § 707(b) in a number of respects. See Pub. L. No. 109-8, § 102(a)(2). The amendments will apply to bankruptcies that are filed on or after October 17, 2005. See id. § 1501. The revised statute does not, however, address the issue presented by this case: whether a bankruptcy court should consider post-petition events in evaluating a motion to dismiss under 11 U.S.C. § 707(b).

[2] United States Trustees are Justice Department officials appointed by the Attorney General to supervise the administration of bankruptcy cases. See 28 U.S.C. §§ 581-89; In re Columbia Gas Systems, Inc., 33 F.3d 294, 296 (3d Cir. 1994) (noting that United States Trustees oversee the bankruptcy process and ensure that bankruptcy cases are conducted according to law) (citing H.R. Rep. No. 99-764, at 24 (1986)).

salary. See R., Vol. 3, at 40 (in 2002 and 2003, Mr. Cortez earned over $120,000 and Mrs. Cortez earned approximately $20,000). During that period, the debtors accumulated over $85,000 in unsecured debt, the bulk of which was credit card debt. See R., Vol. 3, at 31-32.

When the debtors filed their bankruptcy petition in April 2004, Mr. Cortez was unemployed. See R., Vol. 3, at 35, 79. Mrs. Cortez worked as a registered nurse, earning a net monthly salary of $4,147.52. See R., Vol. 3, at 35. At that time, the debtors' monthly expenses exceeded their monthly income by approximately $1,200. See R., Vol. 3, at 35-36 (the debtors, at the time the bankruptcy petition was filed, earned $4,147.52 per month and spent $5,320.91 per month).

The debtors disclosed on their bankruptcy petition that Mr. Cortez expected to be employed later that month. See R., Vol. 3, at 35 ("[Mr. Cortez] believes he will be employed this month, but he has not started working yet"). And, four days after the debtors filed their Chapter 7 bankruptcy petition, Mr. Cortez was offered a job to serve as the Human Resources Director for a healthcare management company. See R., Vol. 3, at 72, 74-76. Mr. Cortez accepted the position and began work on April 26, 2004 – eighteen days after filing the bankruptcy petition. See R., Vol. 3, at 72.

In his new job, Mr. Cortez received an annual salary of $95,000 (a net monthly income of $5,896). See R., Vol. 3, at 72. In addition, after he had worked at the company for 60 days, Mr. Cortez received a $5,000 bonus. Ibid. He was also eligible to use a company car. Ibid.

After Mr. Cortez obtained this new job, Mrs. Cortez reduced the amount of hours that she worked as a nurse, and thereby reduced her net monthly income from $4,147.52 to $750. R., Vol. 3, at 72. The debtors' total net monthly income was then $6,646. See R., Vol. 3, at 73.

Mr. Cortez's new position substantially changed the debtors' financial position. Even after Mrs. Cortez reduced her working hours, the debtors' net monthly income ($6,646) was greater than their monthly expenses ($5,320.91). See R., Vol. 3, at 36, 73. The debtors' income exceeded their expenses by $1,325 per month. See R., Vol. 3, at 73.

2. On July 9, 2004, the United States Trustee filed a motion under 11 U.S.C. § 707(b) to dismiss the Chapter 7 bankruptcy case. See R., Vol. 3, at 54-55. The United States Trustee asserted that it would be a substantial abuse of Chapter 7 to allow the debtors to discharge their outstanding debts, when they "appear[ed] to have the means to repay a substantial portion of [those] debts through a Chapter 13 plan." R., Vol. 3, at 55.

B. The Bankruptcy Court's Decision

The bankruptcy court denied the motion to dismiss under 11 U.S.C. § 707(b). See R., Vol. 3, at 88; Rec. Ex., Tab 2, at 11.

The bankruptcy court stated that, if a debtor was "able to pay a significant amount to creditors out of the debtor's future income," that fact could be sufficient to justify dismissing the debtor's case for substantial abuse under 11 U.S.C. § 707(b). See R., Vol. 3, at 80-81; Rec. Ex., Tab 2, at 3-4. The court further determined that, after Mr. Cortez obtained a job with a $95,000 annual salary, the debtors "could make meaningful payments to creditors" out of that future income through a Chapter 13 reorganization plan. See R., Vol. 3, at 81; Rec. Ex., Tab 2, at 4.

The court nevertheless, in ruling on the United States Trustee's motion, declined to take into account the debtors' post-petition increase in income. See R., Vol. 3, at 82; Rec. Ex., Tab 2, at 5. The court held that, in determining whether to dismiss a case for "substantial abuse" under 11 U.S.C. § 707(b), "post-petition events" should generally "not be considered[.]" Ibid.[3]

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[3] The bankruptcy court crafted one exception to this general rule. The court stated that it would consider post-petition events if those events were "clearly in prospect" at the time the petition was filed. See R., Vol. 3, at 85-86; Rec. Ex., Tab 2, at 8-9. For example, the court explained, if Mr. Cortez had received the offer of employment prior to filing for bankruptcy,

(continued...)

The bankruptcy court's decision depended in large part on its interpretation of the term "relief" in 11 U.S.C. § 707(b). As the court observed, the provision authorizes a bankruptcy court to "dismiss a case . . . if it finds that the granting of relief would be a substantial abuse of the provisions of this chapter." 11 U.S.C. § 707(b); see R., Vol. 3, at 80; Rec. Ex., Tab 2, at 3. The bankruptcy court found that the "relief" contemplated by 11 U.S.C. § 707(b) constituted the benefits that a debtor obtains when he files a bankruptcy petition, such as the automatic stay of all debt obligations. See R., Vol. 3, at 82-83; Rec. Ex., Tab 2, at 5-6; see also 11 U.S.C. § 362 ("a [bankruptcy] petition . . . operates as a stay" that prevents creditors from collecting on outstanding debts).

Based on this interpretation of the term relief, the bankruptcy court concluded that, in ruling on the United States Trustee's motion, the court could take into account "only [] those circumstances actually existing" at the time the debtors filed their bankruptcy petition. See R., Vol. 3, at 88; Rec. Ex., Tab 2, at 11. The court found that, because the debtors at that time "did not have the ability to make significant payments

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[3] (...continued)
"it would be proper to consider" his $95,000 annual salary. See R., Vol. 3, at 86; Rec. Ex., Tab 2, at 9. However, because, at the time the petition was filed, Mr. Cortez merely "belie[ved]" that he would soon be employed, his employment was "not clearly in prospect," and thus should not be considered. See R., Vol. 3, at 87-88; Rec. Ex., Tab 2, at 10-11.

to creditors," the "granting of the relief requested by [the debtors] is not a substantial abuse of the Code." Ibid.

C. The District Court's Decision

The district court reversed the bankruptcy court's decision, concluding that, in ruling on a motion to dismiss under 11 U.S.C. § 707(b), a bankruptcy court should consider post-petition events. See Rec. Ex., Tab 4, at 1, 5-6.

The district court agreed with the bankruptcy court that a debtor's "ability to make significant payments to creditors from future income" could justify the dismissal of a case under 11 U.S.C. § 707(b). Rec. Ex., Tab 4, at 5. But, in contrast to the bankruptcy court, the district court found that, in determining whether a debtor could make those future payments, a court should take into account post-petition events that affected the debtor's "future income" level. See id. at 5-6.

The district court determined, based on the record in the case, that the debtors would have sufficient future income to "repay a significant portion of their debt[.]" See Rec. Ex., Tab 4, at 5. Accordingly, the district court held that the bankruptcy court should have granted the United States Trustee's motion to dismiss under 11 U.S.C. § 707(b). See Rec. Ex., Tab 4, at 5-6.

The district court thus reversed the bankruptcy court's decision, and remanded the case to that court. See Rec. Ex., Tab

4, at 6-7. The district court directed the bankruptcy court on remand to give the debtors ten days to voluntarily convert their case to a Chapter 13 proceeding and, if they failed to do so, to dismiss the bankruptcy case. See id. at 7.

The debtors subsequently filed the present appeal.[4]

STANDARD OF REVIEW

This appeal involves questions of law that this Court reviews de novo. See In re Ramba, Inc., 416 F.3d 394, 398 (5th Cir. 2005).

SUMMARY OF ARGUMENT

I. Section 707(b) of the Bankruptcy Code authorizes a bankruptcy court to dismiss a Chapter 7 consumer bankruptcy case if the court "finds that the granting of relief would be a substantial abuse of" Chapter 7. 11 U.S.C. § 707(b). The provision thus requires bankruptcy courts to evaluate whether it would be appropriate to grant a debtor the relief offered by Chapter 7: a discharge of his past debts. As courts of appeals have repeatedly concluded, in order to make that determination, a bankruptcy court must consider whether the debtor will have

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[4] The district court's remand order was a final decision for the purposes of appeal, because it did not require the bankruptcy court to conduct significant further proceedings, but instead directed it to perform purely ministerial functions (to allow the debtors to convert the case to a Chapter 13 proceeding and, if they failed to do so, to dismiss the case). See In re Caddo Parish-Villas South, Ltd., 174 F.3d 624, 627-28 (5th Cir. 1999); see also Koch, 109 F.3d at 1287-88.

sufficient future income to repay his past debts. Plainly, that inquiry mandates that a bankruptcy court consider post-petition events that affect a debtor's future income level.

Accordingly, as the district court here found, the bankruptcy court, in ruling on the United States Trustee's Section 707(b) motion to dismiss, should have taken into account the significant post-petition change in the debtors' financial circumstances. As the record here reveals, just four days after debtors Carlos Vicente Cortez and Suzanne Hallman Cortez filed their Chapter 7 petition, Mr. Cortez was offered a job with a $95,000 annual salary. As the bankruptcy court found – and the debtors never disputed – this post-petition change in the debtors' income would enable them to repay a considerable portion of their past debts. Such facts are plainly relevant to determining whether it would be appropriate to grant the debtors a Chapter 7 discharge.

The debtors offer no basis for freezing the inquiry under 11 U.S.C. § 707(b) at the date that the bankruptcy petition was filed. The debtors do not even attempt to defend the bankruptcy court's erroneous conclusion that the term "relief" in 11 U.S.C. § 707(b) required the court to focus on pre-petition events. Nor do the debtors provide any alternative rationale for the court's decision. The debtors cannot overcome the overwhelming appellate court precedent supporting the United States Trustee's position by pointing to isolated statements in a few bankruptcy court decisions. And the debtors' attempt to rely on recent amendments to the Bankruptcy Code (which do not apply to this case) is utterly without merit.

II. Both the district court and the bankruptcy court here found that, if they took into account the debtors' post-petition increase in income, the record in this case would be sufficient to justify granting the United States Trustee's motion to dismiss under 11 U.S.C. § 707(b). Accordingly, once the district court corrected the bankruptcy court's legal error, the district court reasonably directed the bankruptcy court to grant the motion, and further instructed that the case be dismissed or, at the debtors' option, converted to a Chapter 13 proceeding. The record before the district court plainly justified the court's disposition of this case. The debtors cannot now undermine the district court's correct determination by pointing to facts that were never presented to that court.

ARGUMENT

I. A Bankruptcy Court Should Consider Post-Petition Events In Evaluating A Motion To Dismiss A Case Under 11 U.S.C. § 707(b) For "Substantial Abuse."

A bankruptcy court, in determining whether to dismiss a Chapter 7 consumer bankruptcy case for "substantial abuse," should plainly take into account post-petition events, including any changes in a debtor's financial circumstances.

A. A Bankruptcy Court Must Consider Post-Petition Events In Determining Whether a Debtor Could Repay a Substantial Portion of His Debts Out of "Future Income."

Section 707(b) of the Bankruptcy Code authorizes a bankruptcy court to dismiss a Chapter 7 case that involves "primarily consumer debts," if the court "finds that the granting of relief would be a substantial abuse of the provisions of this chapter." 11 U.S.C. § 707(b).[5] A debtor obtains "relief" under Chapter 7 when his past debts are discharged. See In re Bruner, 55 F.3d 195, 197 (5th Cir. 1995) ("When a Chapter 7 debtor obtains bankruptcy relief, the general rule is that all debts arising prior to the filing of the bankruptcy petition will be discharged.") (citing 11 U.S.C. § 727(b)); In re Ichinose, 946 F.2d 1169, 1172 (5th Cir. 1991) ("The purpose of Chapter Seven of the Bankruptcy Code is to give individual debtors a 'fresh start,' and the heart of this goal is embodied in § 727's discharge provisions."). Accordingly, the issue under 11 U.S.C. § 707(b) is whether it would constitute a "substantial abuse" of Chapter 7 to discharge an individual's outstanding debts.

Courts of appeals have consistently held that, in determining whether it would be a "substantial abuse" of Chapter 7 to grant a debtor such a discharge, bankruptcy courts must

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[5] The parties here agree that the debts at issue are "primarily consumer debts." See R., Vol. 3, at 80; Rec. Ex., Tab 2, at 3.

consider whether the debtor could repay a substantial portion of his past debts. See In re Behlke, 358 F.3d 429, 434, 437 (6th Cir. 2004); In re Price, 353 F.3d 1135, 1140 (9th Cir. 2004); In re Stewart, 175 F.3d 796, 809 (10th Cir. 1999); In re Kornfield, 164 F.3d 778, 781, 784 (2d Cir. 1999); In re Lamanna, 153 F.3d 1, 4 (1st Cir. 1998); Fonder v. United States, 974 F.2d 996, 999 (8th Cir. 1992).[6]

Significantly, in determining whether a debtor could repay those prior debts, bankruptcy courts may not freeze the inquiry at the time the debtor filed his bankruptcy petition. Instead, bankruptcy courts must examine whether the debtor could repay his debts out of future income. See Behlke, 358 F.3d at 434 (in ruling on a Section 707(b) motion to dismiss, bankruptcy courts should consider a "debtor's 'ability to repay his debts out of future earnings'") (quoting Krohn, 886 F.2d at 126); Kornfield, 164 F.3d at 781, 784 (bankruptcy courts should take into account the "ability of the debtor to repay debts out of future income"); Lamanna, 153 F.3d at 4 ("courts should regard the debtor's ability to repay out of future disposable income as the primary . . . factor of 'substantial abuse'"); Fonder, 974 F.2d at 999

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[6] Indeed, a few courts of appeals have concluded that a debtor's ability to repay his debts is alone sufficient to justify dismissal for substantial abuse. See Price, 353 F.3d at 1140; In re Krohn, 886 F.2d 123, 126 (6th Cir. 1989).

(the "essential inquiry" is whether the debtor can "repay creditors with future income").[7]

In determining whether a debtor will have sufficient "future income" to repay a portion of his past debts, a bankruptcy court must necessarily consider any post-petition circumstances that affect the debtor's "future income" level. Accordingly, as the district court held, the bankruptcy court here erred in refusing to take into account such post-petition events.

B. The Consideration of Post-Petition Events Promotes Equity and Fairness In the Bankruptcy Process.

Section 707(b) was enacted in large part to promote "fairness to creditors . . . by 'stemming the use of Chapter 7 relief by unneedy debtors'" who could in fact repay a substantial portion of their debts. In re Koch, 109 F.3d 1285, 1288 (8th Cir. 1997) (quoting In re Walton, 866 F.2d 981, 983 (8th Cir. 1989)); see Stewart, 175 F.3d at 812-13. Accordingly, in keeping with the equitable purposes behind the provision, bankruptcy courts must take into account post-petition events that allow debtors to repay their debts.

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[7] And, as the Tenth Circuit has found, in determining whether a debtor could repay his debts out of future income, bankruptcy courts may look not only to a debtor's actual earnings, but also to his future earning potential. See Stewart, 175 F.3d at 809-10 (affirming the bankruptcy court's dismissal of a Chapter 7 case filed by a debtor physician, in part because of the physician's substantial "earning potential").

The record in this case illustrates the importance of considering such post-petition circumstances. Just four days after debtors Carlos Vicente Cortez and Suzanne Hallman Cortez filed their Chapter 7 bankruptcy petition, Mr. Cortez was offered a job with an annual salary of $95,000. See R., Vol. 3, at 72, 74. As the bankruptcy court here recognized, this "future income" would enable the debtors to "make meaningful payments to creditors[.]" See R., Vol. 3, at 81; Rec. Ex., Tab 2, at 4. This post-petition turn of events is plainly relevant to determining whether it would be appropriate to discharge the debtors' prior financial obligations. The bankruptcy court therefore erred in adopting a legal rule that precluded it from considering such facts.

Indeed, the bankruptcy court's approach would permit a debtor, who receives a windfall just after filing his bankruptcy petition, to nevertheless escape his prior financial obligations. For example, in one recent bankruptcy case, a debtor – just one month after filing his bankruptcy petition – won the lottery, and suddenly had $60 million with which to pay his prior debts. See In re Juan Rodriguez, Case No. 04-24790 (Bankr. E.D.N.Y.), Doc. Nos. 6,7. Under the bankruptcy court's approach, because this windfall occurred "post-petition," the court could not dismiss the lottery winner's bankruptcy case under 11 U.S.C. § 707(b). Such a result has no basis in law or logic.

Significantly, if a court dismisses a case under 11 U.S.C. § 707(b), that decision does not preclude the debtor from later seeking relief under Chapter 7. Thus, if a debtor loses his job, or suffers other additional financial setbacks, the debtor may file a new bankruptcy petition, seeking to discharge his debts. See 11 U.S.C. § 349(a) ("dismissal of a case" does not "prejudice the debtor with regard to the filing of a subsequent petition"); In re Hall, 304 F.3d 743, 746 (7th Cir. 2002).

C. The Debtors' Statutory Analysis Is Without Merit.

The debtors provide this Court with no basis for rejecting the district court's conclusion that a bankruptcy court, in ruling on a motion to dismiss under 11 U.S.C. § 707(b), should take into account post-petition events, including facts that affect a debtor's ability to repay debts out of future income.

1. Notably, the debtors do not ask this Court to adopt the bankruptcy court's erroneous statutory analysis. The bankruptcy court's decision depended in large part on its interpretation of the term "relief" in 11 U.S.C. § 707(b). See R., Vol. 3, at 82; Rec. Ex., Tab 2, at 5. The provision states that a bankruptcy court "may dismiss a case . . . if it finds that the granting of relief would be a substantial abuse of the provisions of this chapter." 11 U.S.C. § 707(b). The bankruptcy court found that the "relief" contemplated by 11 U.S.C. § 707(b) constituted the benefits that a debtor obtains as soon as he files a bankruptcy

petition, such as the automatic stay of all debt obligations. See R., Vol. 3, at 82-83; Rec. Ex., Tab 2, at 5-6; see also 11 U.S.C. § 362 ("a [bankruptcy] petition . . . operates as a stay" that prevents creditors from collecting on outstanding debts). Based on this interpretation of "relief," the bankruptcy court concluded that, in ruling on the United States Trustee's motion to dismiss, it had to focus on the facts existing when the debtors filed their petition and obtained such immediate "relief." See R., Vol. 3, at 82; Rec. Ex., Tab 2, at 5.

But, plainly, Section 707(b) is not focused on the benefits that a debtor receives upon filing a bankruptcy petition. Instead, the provision is directed at the ultimate relief offered exclusively by Chapter 7 of the Bankruptcy Code: the discharge of a debtor's past financial obligations. See 11 U.S.C. § 707(b) (the court must decide whether the "granting of relief would be a substantial abuse of the provisions of this chapter") (emphasis added); Bruner, 55 F.3d at 197 ("a Chapter 7 debtor obtains bankruptcy relief" when his debts are discharged). The bankruptcy court's determination that it could not consider post-petition events was therefore based on a fundamental misinterpretation of the statute.

2. The debtors make no attempt to defend the bankruptcy court's erroneous analysis. Nor do the debtors provide any alternative rationale to support the bankruptcy court's decision.

The debtors assert (Open. Br. 12-13, 17) that, because many aspects of a bankruptcy proceeding are determined as of the date the petition was filed, a motion to dismiss for substantial abuse should also be based on the facts existing at that time. The debtors do not even attempt to reconcile this assertion with courts of appeals' repeated statements that, in evaluating a Section 707(b) motion to dismiss, bankruptcy courts must consider a "debtor's 'ability to repay his debts out of future earnings.'" E.g., Behlke, 358 F.3d at 434 (quoting Krohn, 886 F.2d at 126) (emphasis added). As discussed, this inquiry clearly requires a bankruptcy court to consider any post-petition events that affect a debtor's expected future income.

The debtors do not attempt to grapple with this appellate court authority. Instead, the debtors point to a few bankruptcy court decisions, in which the courts stated that, in ruling on a motion to dismiss under 11 U.S.C. § 707(b), they would focus on the facts that existed at the time the bankruptcy petition was filed. See In re Pier, 310 B.R. 347, 354 (Bankr. N.D. Ohio 2004); In re Penny, 297 B.R. 737, 739 (Bankr. C.D. Ill. 2003); In re Mack, 2004 WL 856425 at *1 (Bankr. C.D. Ill. 2004).[8] These isolated statements in bankruptcy court rulings clearly cannot

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[8] Contrary to the debtors' contention (Open. Br. at 15-16), there is no suggestion in any of those cases that the United States Trustee urged those bankruptcy courts to adopt a rule precluding the consideration of post-petition events.

overcome the overwhelming line of appellate court authority supporting the United States Trustee's position.[9]

And, in any event, as the district court found, those cases are clearly distinguishable from the Cortez' situation. See Rec. Ex., Tab 4, at 5-6. In each case, the relevant debtor did not qualify for a Chapter 7 discharge at the time he filed his bankruptcy petition, but later (post-petition) suffered an "unforeseen" financial setback that might have made him eligible for such relief. See Pier, 310 B.R. at 353-55; Penny, 297 B.R. at 739-41; Mack, 2004 WL 856425 at *1. As the district court here recognized, those cases merely underscore that it is inappropriate for a debtor to file a Chapter 7 petition, and seek to take advantage of that Chapter's discharge provisions, at a time when he can repay his debts. See Rec. Ex., Tab 4, at 5. In such a situation, a bankruptcy court may conclude (as the courts did in Pier, Penny, and Mack) that it would be a "substantial abuse" of Chapter 7 to grant a discharge to such a debtor. See ibid. ("a later change in circumstances will not necessarily save a bankruptcy whose original filing was a substantial abuse of the provisions of Chapter 7").

The debtors' reliance (Open. Br. 18-20) on the recent amendments to the Bankruptcy Code is completely misplaced.

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[9] Two of those decisions (Penny and Mack) were authored by the same bankruptcy court judge. See Mack, 2004 WL 856425 at *1.

Congress, via the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, which will apply to bankruptcies filed on or after October 17, 2005, *expanded* bankruptcy courts' authority to dismiss consumer bankruptcies. *See* H.R. Rep. No. 109-31(I), at 11-15 (2005); *see also id*. at 2 ("the proposed reforms respond to many of the factors contributing to the increase in consumer bankruptcy filings, such as lack of personal financial accountability"). For example, Congress amended 11 U.S.C. § 707(b) to provide that a bankruptcy court may dismiss a Chapter 7 consumer bankruptcy case when granting a discharge would constitute "an abuse" (rather than a "substantial abuse") of that Chapter. *See* Pub. L. No. 109-8, § 102(a)(2) (2005).

The revised Code does not answer the question raised by this case: whether a bankruptcy court should consider post-petition events in ruling on a motion to dismiss under 11 U.S.C. § 707(b). But, clearly, the revised Code – which was designed in large part to *reduce* the number of Chapter 7 consumer bankruptcies – does not suggest that a bankruptcy court lacks the authority to dismiss a case for "abuse" or "substantial abuse," when a debtor, four days after filing for bankruptcy, obtains a $95,000-per-year job that enables him to repay a substantial portion of his debts.

II. The District Court Properly Directed That This Bankruptcy Case Be Dismissed Or, At The Debtors' Option, Converted To A Chapter 13 Proceeding.

The district court here directed the bankruptcy court to give the debtors ten days to voluntarily convert their case to a Chapter 13 proceeding and, if they failed to do so, to dismiss the bankruptcy case. See Rec. Ex., Tab 4, at 6-7. This Court reviews that determination by examining the record presented to the district court. See, e.g., Freeman v. City of Dallas, 186 F.3d 601, 610 (5th Cir. 1999) ("Our review encompasses only the record on which the district court based its ruling."). And, based on that record, the district court's disposition of this case was clearly appropriate.

Both the district court and the bankruptcy court here determined that, if a debtor could "pay a significant amount to creditors out of the debtor's future income," that fact was sufficient to justify the dismissal of a case under 11 U.S.C. § 707(b). See R., Vol. 3, at 80-81; Rec. Ex., Tab 2, at 3-4 (bankruptcy court decision); Rec. Ex., Tab 4, at 5 (district court decision). Both courts also agreed that, after Mr. Cortez obtained a job with a $95,000 annual salary, the debtors "could make meaningful payments to creditors" through a Chapter 13 reorganization plan. See R., Vol. 3, at 81; Rec. Ex., Tab 2, at 4 (bankruptcy court decision); Rec. Ex., Tab 4, at 5 (district court decision). The debtors have never challenged these findings.[10]

Based on this record, the district court reasonably concluded that, once the bankruptcy court took into account the debtors' post-petition increase in income, the bankruptcy court would have to grant the United States Trustee's motion to dismiss under 11 U.S.C. § 707(b). Accordingly, it was unnecessary to remand to the bankruptcy court for further proceedings. The district court could instead direct that the case be dismissed or, at the debtors' option, converted to a Chapter 13 proceeding. See In re Zedda, 103 F.3d 1195, 1205 (5th Cir. 1997) (when a "conclusion follows as a matter of law from the undisputed documents and testimony," a "remand for further finding [is] unnecessary").

The debtors do not challenge the district court's conclusion that, based on the record presented to it, the debtors' case should be dismissed under 11 U.S.C. § 707(b). Instead, the debtors object to the district court's disposition of the case (Open. Br. 21) by pointing to a fact that was never included in

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[10] The debtors, in a section of their brief entitled "Historical background of Section 707(b)," (Open. Br. 5-9) note that courts of appeals have adopted various tests to determine when a case should be dismissed for "substantial abuse" under 11 U.S.C. § 707(b). But the debtors do not ask this Court to adopt a particular test for determining "substantial abuse." Nor (as discussed below) do the debtors suggest that the district court erred in determining, based on the record before it, that dismissal of the debtors' case was appropriate.

the record below. According to the debtors (Open. Br. 4), a few days before the district court issued its decision in this case, Mr. Cortez lost his job. Notably, the debtors did not file a motion for reconsideration under Federal Rule of Civil Procedure 59(e) – or take any other measures – to alert the district court to this change in the debtors' financial circumstances.

The debtors cannot now claim error in the district court's decision based on facts that were never presented to that court. As noted above, this Court evaluates the district court's decision based solely on the record before that court. See Freeman, 186 F.3d at 610. If the debtors, in light of their more recent financial troubles, wish to seek Chapter 7 bankruptcy protection, they may file a new bankruptcy petition. See 11 U.S.C. § 349(a). But the debtors have presented this Court with no basis for rejecting the district court's decision.

CONCLUSION

For the foregoing reasons, the judgment of the district court, reversing the decision of the bankruptcy court, should be affirmed.

Respectfully submitted,

PETER D. KEISLER
Assistant Attorney General

RICHARD B. ROPER, III
United States Attorney

WILLIAM KANTER
(202) 514-4575
TARA LEIGH GROVE
(202) 514-1201

Attorneys, Appellate Staff
Civil Division, Room 7230
Department of Justice
950 Pennsylvania Ave., N.W.
Washington, D.C. 20530-0001

OCTOBER 2005

CERTIFICATE OF COMPLIANCE

In accordance with Fed. R. App. P. 32(a)(7)(C), I hereby certify that the foregoing Brief for the Appellee is monospaced in 12-point Courier New font and was produced on Corel Wordperfect 12. Exclusive of the portions exempted by Fed. R. App. P. 32(a)(7)(B)(iii), this brief contains 6,370 words, according to Corel Wordperfect 12.

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TARA LEIGH GROVE
Attorney for the Appellee

CERTIFICATE OF SERVICE

I hereby certify that on this 7th day of October 2005, I served the foregoing BRIEF FOR THE APPELLEE, along with a virus-free computer diskette containing the full text of the brief, upon the clerk of the Court of Appeals and upon counsel of record, by causing copies to be sent by Federal Express overnight mail to:

Behrooz P. Vida
Venable & Vida
3000 Central Drive
Bedford, TX 76021
(817) 358-9977

____
TARA LEIGH GROVE
Attorney for the Appellee

BRIEF BANK — "SUMMARY SHEET"

Printed Thu.-10/9/3 (9:11)

WESTLAW CODES

1. ("TI") TITLE OF CASE [E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]	Cotner v. OUST (In re Wilson)
2. ("CO") CURRENT COURT [E.g., "CTA9"]	WDMI
3. ("CCN") CURRENT CASE NO.	No.: 1:03-cv-00160
4. ("PCN") PRIOR CASE NO. & COURT [IF ANY]	No.: SG02-07643 Court: Bankr. WDMI Judge Stevenson (Identify judge & cite, if any)
5. ("SO") SOURCE	**U.S. TRUSTEES**
6. ("DA") DATE OF FILING & TYPE OF BRIEF [E.g., "Opening Brief," "Reply," "Amicus," etc.]	Filed: Oct. 1, 2003 Type: Appllee UST Brief
7. ("AU") PRINCIPAL AUTHORS & OFFICE [E.g.,"UST/OGC"]	Michael V. Maggio, UST (UST/OGC: 202-307-1399/FAX-2397)
8. ("TO") TOPIC	**BANKRUPTCY**
9. ("SU") • SUMMARY OF KEY ISSUE(s) & √ Any Miscellaneous BACKGROUND	• Did the bankruptcy court abuse its discretion by ruling under 11 U.S.C. § 329(b) that the appellant must refund to the debtors all compensation he received from the debtors as an attorney fee for the filing of the case? √ **Background:**
10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)	C:\WINNT\Profiles\rschnell\Desktop\post web files\Cotner1.wpd
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UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF MICHIGAN

In re:

Sam H. Wilson and
Yvonne M. Wilson,

Case No. SG02-07643
Chapter 7
Honorable Jo Ann C. Stevenson

Debtors./

Roger Cotner,

Appellant,

v.

District Court Case No.
1:03-cv-00160
Honorable Gordon J. Quist

Office of the United States Trustee,

Appellee.

/

APPELLEE UNITED STATES TRUSTEE'S BRIEF

Counsel for Appellee
Michael V. Maggio
Trial Attorney
Office of the U.S. Trustee
United States Department of Justice
330 Ionia NW, Suite 202
Grand Rapids, Michigan 49503
Tel: (616) 456-2002, ext. 14

Of Counsel
Joseph A. Guzinski
P. Matthew Sutko
Office of the General Counsel
Executive Office for United States
Trustees
United States Department
Of Justice
20 Massachusetts Avenue NW
Washington, D.C. 20530
(202) 307-1399

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STATEMENT OF THE BASIS OF APPELLATE JURISDICTION

Roger Cotner, (hereinafter, the "appellant") appeals as of right pursuant to 28

U.S.C. 158(a)(1) the bankruptcy court's January 16, 2003 Order Denying Motion For Reconsideration of the Order Granting the United States Trustee's Motion Requesting Review and Disgorgement of Attorney Compensation Under 11 U.S.C. Section 329(b) and Rule 2017. The order denied reconsideration of the bankruptcy court's order of November 4, 2002 which granted the United States Trustee's motion under 11 U.S.C. Section 329(b) and ordered the appellant to refund to the debtors all compensation he received for the filing of this bankruptcy case, except for the filing fee. (Bankruptcy Court Docket Sheet Documents No. 43 and 32.)[1] This was a final order of the bankruptcy court. The bankruptcy court had jurisdiction over this issue under 28 U.S.C. Section 157(b)(1).

STATEMENT OF THE ISSUE PRESENTED

The bankruptcy court did not abuse its discretion by ruling under 11 U.S.C. Section 329(b) that the appellant must refund to the debtors all compensation he received from the debtors as an attorney fee for the filing of this case.

STANDARD OF APPELLATE REVIEW

The bankruptcy court's finding of excessive attorney fees is a mixed question of

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[1] Hereinafter, this brief cites documents by the Bankruptcy Court docket sheet entry number as follows: "Docket Sheet Document No. __.")

law and fact. The factual findings are examined for clear error (i.e., "the most cogent evidence of mistake of justice"), while all conclusions of law are reviewed *de novo*. *Henderson v. Kisseberth (In re Kisseberth)*, 273 F.3d 714, 719 (6th Cir. 2001); *Mapother & Mapother, P.S.C. v. Cooper (In re Downs)*, 103 F.3d 472, 477 (6th Cir. 1996); *City of Baltimore v. State of West Virginia (In re Eagle-Pitcher Industries, Inc.)*, 285 F.3d 522, 527 (6th Cir. 2002); Federal Rule of Bankruptcy Procedure 8013. However, "[i]n reviewing a bankruptcy court's decision concerning the proper amount of attorney fees, we will not set aside its determination unless the court abused its discretion. [*In re Downs*, 103 F.3d 472, 478 (6th Cir. 1996)] We will find an abuse of discretion only upon a 'definite and firm conviction that the trial court committed a clear error of judgment.'" *In re Kisseberth*, 273 F.3d at 720 (quoting, *Logan v. Dayton Hudson Corp.*, 865 F.2d 789, 790 (6th Cir. 1989).)

STATEMENT OF THE CASE

The debtors filed their petition for relief under Chapter 7 of the Bankruptcy Code on July 9, 2002. 11 U.S.C. Section 701, et seq. The attorney for the debtors was Roger Cotner, Esq., the appellant. (Debtors' Voluntary Petition, Docket Sheet Document No. 1.)

Along with their petition, the debtors also filed their schedules and statement of affairs, and a mailing matrix (a list of mailing addresses for all parties involved in the case), as required by 11 U.S.C. Section 521 and Federal Rule of Bankruptcy Procedure 1007, and in accordance with the Official Forms that are part of the Federal Rules of

Bankruptcy Procedure, and the Local Rules of the Bankruptcy Court for the Western District of Michigan. (Debtors' Voluntary Petition, Docket Sheet Document No. 1.) *See, e.g.*, Official Form 6 (setting forth the schedules that must be filed by debtors). Section 521(1) provides that, "The debtor shall file a list of creditors, and unless the court orders otherwise, a schedule of assets and liabilities, a schedule of current income and current expenditures, and a statement of the debtor's financial affairs." Federal Rule of Bankruptcy Procedure 1007(a)(1) requires the debtor to file a list containing the name and address of each creditor unless the petition is accompanied by a schedule of liabilities, prepared according to the requirements of the Official Forms. The Official Forms require that the schedules give the name and address of each creditor. Fed. Rule of B. Proc. 1007(a)(1) and Official Form 6. Furthermore, Local Bankruptcy Rule 1007-2(b)(1) requires the debtor to file a master mailing matrix containing the names and addresses of all creditors and other entities required to be notified of the bankruptcy proceeding. All these documents were filed under penalty of perjury as required under Federal Rule of Bankruptcy Procedure 1008 and 28 U.S.C. Section 1746.

The debtors' Chapter 7 schedules listed two secured creditors on Schedule D; the name given for one with a lien of $10,000 on a vehicle valued at $6,950 was "Consumers." The address given for Consumers was "c/o Cotner Law Offices, P.O. Box 838, Grand Haven, Michigan 49417-0838." (Docket Sheet Document No. 1, Schedule

D.) The debtors listed about 64[2] creditors and representatives of creditors on Schedule F. (Docket Sheet Document No. 1, Schedule F.) The addresses of at least 15 of these unsecured creditors or their representatives were given as the address of the debtor's attorney, e.g.,"Chemical Bank, c/o Cotner Law Offices, P.O. Box 838, Grand Haven, Michigan 49417-0838." (Docket Sheet Document No. 1, Schedule F.) Other than Chemical Bank, the parties listed with the appellant's address include: Check N Go, aka Unifund; Finger Hut; First of America Bank; First Premier; GECS Flex; HRSI; LJ Ross for Plumb's (Plumb's itself is listed with an address of its own); Township of Eagle and Nationwide Collection for Township of Eagle; Verizon Wireless and Accent SVCCO for Verizon Wireless; West Michigan Emergency Services and CSB-CB Kalamazoo for West Michigan Emergency Services; and WF Financial. (One creditor, City Financial, was simply listed with the address of "Muskegon, Michigan.") (Docket Sheet Document No. 1., Schedule F.) The creditors listed above were also listed with the appellant's address on the mailing matrix. (Docket Sheet Document No. 1, Mailing Matrix.) In addition to the creditors listed above, the following creditors were listed on the mailing matrix with the debtor's attorney's address: AIB Auto Lane; American Investments Bank; and CB

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[2] There does appear to be a dispute as to the actual number of addresses that were missing, and the United States Trustee and the appellant do characterize the situation differently. The United States Trustee alleges that a total of at least 64 creditors and their agents are listed and that 19 addresses (16 on the schedules and mailing matrix, and three more found only on the mailing matrix) are incorrectly given as the appellant's. The appellant states that the debtors listed 44 creditors and 16 agents for creditors on their schedules, and that 11 of the 44 creditors and 5 of the 16 agents are listed with his address. (Debtor's Attorney's Response, page 4 , Docket Sheet Document No. 29.)

Cadillac.

On September 11, 2002, the United States Trustee[3] filed three motions: 1) the United States Trustee's Motion to Dismiss Pursuant to 11 U.S.C. Section 707(a)(or (b); 2) The United States Trustee's Motion for an order requiring the filing of an answer to the motion to dismiss and requiring the debtors to answer the United States Trustee's interrogatories and request for documents, accompanied by requests to be answered; and 3) the United States Trustee's Motion Requesting Review and Disgorgement of Attorney Compensation Under 11 U.S.C. Section 329(b) and Rule 2017. (Docket Sheet Documents No. 9, 13, 156 and 20.) The motion to dismiss alleged that the debtors' failure to list correct addresses for the creditors listed above constituted a denial of due process to those creditors in violation of 11 U.S.C. Section 521(1), Federal Rule of Bankruptcy Procedure 1007(a)(1), Official Bankruptcy Form 6, and Local Bankruptcy Rule 1007-2(b)(1), all of which require the filing of schedules and a mailing matrix containing the names and addresses of creditor. The United States Trustee therefore asked that this case be dismissed under 11 U.S.C. Section 707(a) for cause, or under 11 U.S.C. Section 707(b) as a substantial abuse of the provisions of Chapter 7. (Docket Sheet Document No. 9.) Alternatively, the motion to dismiss alleged that with reductions in the debtors' expenses

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[3] The United States Trustee is an officer of the United States Department of Justice. 28 U.S.C. Section 581 *et seq.* The United States Trustee is charged with the duty and authority to, *inter alia*, monitor the progress of cases under Title 11 and to supervise the administration of cases under chapters 7 and 11 of Title 11. 28 U.S.C. Section 586(a)(3) and (a)(3)(G). The United States Trustee may raise and may appear and be heard on any issue in any case or proceeding under Title 11, except that the United States Trustee may not file a plan of reorganization in a Chapter 11 case. 11 U.S.C. Section 307.

the debtors would have a monthly net income of $4,414.43 and expenses of $4,114, which would allow the debtors to pay $300 per month to a hypothetical Chapter 13 plan that would pay about 13% of the debtors' unsecured debt within 36 months. (Docket Sheet Document No. 9.) The United States Trustee therefore asked that the petition be dismissed as a substantial abuse of the provisions of Chapter 7 under 11 U.S.C. Section 707(b) and *In re Krohn*, 886 F.2d 123, 128 (6th Cir. 1989); *See also*, *Wilson v. United States Trustee (In re Wilson),* 125 B.R. 742, 746-747 (W.D. Mich. 1990).

The motion requesting review and disgorgement of the fee paid to the appellant also alleged that the filing of the debtors' schedules with the appellant's address for the creditors listed above constituted a denial of due process to those creditors, and requested that the appellant therefore not be compensated for the filing of his case. (Docket Sheet Document No. 13.)

On September 12, 2002 the bankruptcy court issued the order requiring the debtors to file an answer to the motion to dismiss two weeks before the hearing on the motion and answers to the United States Trustee's requests for information within 30 days from the date of service. (Docket Sheet Document No. 21.) The United States Trustee filed the proof of service for that order on September 20, 2002. (Docket Sheet Document No. 27.)

On September 18, 2002 the debtors filed an amendment changing the identification of "Consumers" to Consumer Finance Corp., and giving an address in McLean, Virginia for this creditor. (Docket Sheet Document No. 22.) No other corrections or changes were ever filed to Schedule F or the mailing matrix. (Bankruptcy Court Docket Sheet.)

On October 24, 2002, the appellant filed a motion to withdraw as attorney for the debtors. (Docket Sheet Document No. 28.) That same day the appellant also filed a response to the United States Trustee's motion for review and disgorgement of fees under 11 U.S.C. Section 329(b). (Docket Sheet Document No. 29.) The appellant's response to the motion for review and disgorgement admitted the creditors listed with his address had been denied due process, but denied that they would suffer substantial harm and denied that the debtors' attorney had any responsibility to obtain correct addresses for the creditors, or to correct the bad addresses. (Docket Sheet Document No. 29, page 6, paragraph 13; and page 7.)

No response was ever filed to the United States Trustee's motion to dismiss the case or to the United States Trustee's requests for information. (Bankruptcy Court Docket Sheet.)

The Bankruptcy Court heard the motion to dismiss and the motion for review and disgorgement of attorney compensation on October 28, 2002. The debtors were not represented by counsel, having discharged the appellant as their attorney. The appellant was represented by counsel. After hearing argument, the Bankruptcy Court dismissed the case, but kept jurisdiction to enforce an order under Section 329, and ordered the appellant to refund the $325 attorney fee that he received to the debtors. (Transcript of October 28, 2002, Docket Sheet Document No. 42.)

The orders dismissing the case (Docket Sheet Document No. 33) and ordering the appellant to refund to the debtors the fee he received (Docket Sheet Document No. 32) were entered by the Bankruptcy Court on November 4, 2002. *Id.*

The appellant filed the motion for reconsideration of the order requiring disgorgement under Section 329(b) on November 14, 2002. (Docket Sheet Document No. 37.)

The Bankruptcy Court convened the appellant's motion to withdraw as counsel to the debtors on November 18, 2002. The appellant did not appear and the motion to withdraw was denied for failure to appear. (Transcript of November 18, 2002, Docket Sheet Document No. 56.) The Bankruptcy Court entered the order denying the motion to withdraw on November 21, 2002. (Docket Sheet Document No. 41.)

The Bankruptcy Court heard the motion for reconsideration on January 13, 2003. (Transcript of January 13, 2003, Docket Sheet Document No. 55.) The Bankruptcy Court entered the order denying the motion for reconsideration on January 16, 2003. (Docket Sheet Document No. 43.)

The appellant filed his notice of appeal on January 27, 2003. (Docket Sheet Document No. 45.)

ARGUMENT

I. Introduction

The bankruptcy court did not abuse its discretion or commit an error in ordering under Section 329(b) that the appellant, who had filed a bankruptcy petition with schedules that he knew were inaccurate, must refund to the debtors the $350 fee he received. The appellant deliberately decided to file schedules and a mailing matrix that contained addresses he knew to be inaccurate. This deliberate decision impeded the administration of this case and adversely affected the debtors. The bankruptcy court properly required the appellant to disgorge his fee as a sanction for this conduct under 11 U.S.C. Section 329(b). Alternatively, the bankruptcy court's sanction should be affirmed as a proper exercise of the bankruptcy court's inherent authority to sanction attorneys for breaches of fiduciary obligations.

II. The Appellant's Conduct Impeded The Administration Of The Case And Adversely Affected The Debtors

It is uncontested that the appellant knew that the debtors' schedules and statement of affairs contained inaccurate addresses for many of the creditors. The appellant's letters of May 8, 2002 and July 22, 2002, attached as exhibits C and D to his response filed with the Bankruptcy Court (Docket Sheet Document No. 29), demonstrate this, and the appellant's brief also admits this. The appellant's brief makes it clear that it was the appellant's decision to insert his address for the creditors who he did not have addresses for. (Appellant's Brief, page 2.) In sanctioning the appellant, the bankruptcy court was not holding the appellant responsible for an error committed by his clients, nor did the bankruptcy court penalize an attorney who justifiably relied upon a representation by his clients which later proved to be false. Nor did the bankruptcy court impose an impossible burden upon the appellant. Finding these addresses was not an impossible or even an especially difficult task; the United States Trustee quickly found ten of the addresses from the Internet, directory assistance or the telephone book. (Transcript of January 13, 2003, pages 5-7, Docket Sheet Document No. 55.) The appellant's counsel admitted that he was able to find four or five addresses by simply looking in the telephone book, and probably could have found more if he had looked into his files. (Transcript of October 28, 2002, page 12, Docket Sheet Document No. 42.) Indeed, at that hearing the appellant's counsel conceded that if the debtors had twenty-five creditors but gave their attorney an address for only one of them, such a petition should not be filed.[4] (Transcript of January 13, 2003, page 5, Docket Sheet Document No. 55.) As a matter of logic, that distinction is untenable. If the appellant is correct, no attorney has any obligation to insure that the addresses, or in fact any of the information on the schedules or statement of affairs that they file on their client's behalf, is correct, and any attorney can file any document even when the attorney knows for a fact that the document is inaccurate.

This is not a bureaucratic insistence on form. The failure to list accurate addresses for creditors results in a denial of substantive rights for those creditors, and may impair the administration of the estate. Federal Rule of Bankruptcy Procedure 2002(g)(2) provides that unless a creditor files a request designating a different address for service, all notices shall be mailed to the address shown on the list of creditors or the schedule of liabilities, whichever is filed later. Therefore, all the notices for creditors listed with the

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[4] Apparently, the line between a permissible and an impermissible denial of due process lies somewhere between nineteen inaccurate addresses and twenty-four inaccurate addresses.

appellant’s address were sent to the appellant, not to the creditor. The filing of a voluntary petition under a chapter of the Bankruptcy Code constitutes the entry of an order for relief for the debtor under that chapter. 11 U.S.C. Section 301. Creditors are entitled to notice of the entry of the order of relief, and the clerk of the bankruptcy court is required to give creditors that notice. Federal Rule of Bankruptcy Procedure 2002(f)(1). The creditors who were listed with the appellant’s address did not receive notice of the bankruptcy filing. Without notice of the filing, the creditors may have continued their collection efforts, entailing a possible violation of the automatic stay under 11 U.S.C. Section 362(a), and useless expense and effort in collection efforts that may be null. The creditors listed with the appellant’s address were also denied notice of the time to file objections to the debtors’ discharge under 11 U.S.C. Section 727(b) or objections to the discharge of their particular debts under 11 U.S.C. Section 523. Federal Rules of Bankruptcy Procedure 4004, 4007 and 2002(f)(4) and (5). Without notice, these creditors did not have an opportunity to attend the meeting of creditors called under 11 U.S.C. Section 341 and to examine the debtors as to their assets and liabilities, as is the creditors’ right under 11 U.S.C. 343. Without notice, these creditors were not aware of the identity of the Chapter 7 Trustee and were unable to share with that trustee any information the creditors might have had about the debtors’ income and assets, subjects of vital interest to a Chapter 7 Trustee. (Although there are no allegations of hidden assets in this case, a decision that the attorney for the debtor can knowingly file schedules with inaccurate addresses for creditors could lead to serious abuses of the bankruptcy process.)

The appellant argued before the bankruptcy court (and has argued to this Court) that his procedure when debtors did not give him addresses for creditors was to insert his own address for those creditors so the mail would be returned to him as a reminder to again ask for the addresses. At the hearing before the Bankruptcy Court the appellant conceded that he could have done more, that the appellant could have attempted to find the addresses for these creditors but that he did not. (Transcript of October 28, 2002, pages 12 to 13, Docket Sheet Document No. 42; Transcript of January 13, 2003, page 3, Docket Sheet Document No. 55.) The appellant argues that it was not his responsibility to insure that the schedules were accurate, and that he need not have done more, because it is the debtor's responsibility under 11 U.S.C. Section 521, not the attorney's, to file accurate schedules.[5] The Bankruptcy Court properly found this procedure to be inadequate, and the Bankruptcy Court correctly held that the appellant could have either found the addresses himself or refused to file the bankruptcy petition. (Transcript of January 13, 2003, Docket Sheet No. 55.)

III. The Bankruptcy Court Properly Required The Appellant To Disgorge His Fee As

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[5] By this reasoning, if a client disclosed to an attorney that the debtor owned several valuable assets, and asked the attorney to file a bankruptcy petition that did not list those assets on the schedules, the appellant would apparently reason that the attorney had no obligation to refuse to file such a petition so long as the attorney fee was paid.

A Sanction Under 11 U.S.C. Section 329(b)

Section 329(a) of the Bankruptcy Code requires any attorney representing a debtor in a case under the Bankruptcy Code to file a statement of the compensation paid or agreed to be paid to the attorney for services rendered by the attorney for the debtor in contemplation of or in connection with the bankruptcy case. As to that compensation paid or agreed to be paid, Section 329(b) of the Bankruptcy Code provides as follows:

> (b) If such compensation exceeds the reasonable value of any such services, the court may cancel any such agreement, or order the return of any such payment, to the extent excessive, to-
> (1) the estate, if the property transferred-
> (A) would have been property of the estate; or
> (B) was to be paid by or on behalf of the debtor under a plan under chapter 11, 12, or 13 of this title; or
> (2) the entity that made such payment.

The legislative history of Section 329 sheds light on the intent of that section of the Code. The legislative history provides in part, "Payments to a debtor's attorney provide serious potential for evasion of creditor protection provisions of the bankruptcy laws, and serious potential for overreaching by the debtor's attorney, and should be subject to careful scrutiny." H.R. Rep. 595, 95th Cong. , 1st Sess.329 (1977); S.Rep. 989, 95th Cong., 2d Sess. 39 (1978). The Sixth Circuit has written of Section 329 that:

> The provisions of the Bankruptcy Code and the Bankruptcy Rules that regulate attorney fees are designed to protect both creditors and the debtor against overreaching attorneys. *In re Walters*, 868 F.2d 665, 668 (4th Cir. 1989). To ensure such protection, bankruptcy courts have broad and inherent authority to deny any and all compensation where an attorney fails to satisfy the requirements of the Code and Rules. *In re Downs*, 103 F.3d 472, 479 (6th Cir. 1996)...Disgorgement may be proper even though the failure to disclose resulted ...from negligence or inadvertence. *In re Park-Helena Corp.*, 63 F.3d 877,882 (9th

> Cir. 1995)("Even a negligent or inadvertent failure to disclose fully relevant information [in a Rule 2016 statement] may result in a denial of all requested fees.")

In re Kisseberth, 273 F.3d 721.

Section 329 is meant to protect the debtors from overreaching by the attorney. *In re Kisseberth*, 273 F.3d 721. Under Section 329(b), the question is whether the fee the debtors paid is excessive when compared with the value of the services they received. The sum involved in this case is not large, but the principle is the same as in the other cases involving larger fees. Debtors contemplating bankruptcy are vulnerable; they seek out an attorney for guidance, not a scrivener who simply types whatever they dictate. If the appellant had taken the extra step of finding the missing addresses himself, he would have protected his clients' interest. If he had declined to do that, but had also refused to file the case until the debtors had brought him all the required addresses, then he would at least have acted diligently to insure that his clients had fulfilled their statutory duties. The appellant did neither. Instead he took his fee and filed incomplete and inaccurate schedules, with a warning that the filing might not discharge the debts owed to the creditors with inaccurate addresses. (The appellant did not warn the debtors that in filing these documents they may have also been committing perjury under Federal Rule of Bankruptcy Procedure 1008 and 28 U.S.C. Section 1746.) This conduct does not meet the standard for compensation set forth in *In re Prudhomme*, 152 B.R. 91 (Bankr. W.D.La. 1993).

The filing of this bankruptcy petition left the debtors worse off than if they had never filed a bankruptcy petition. The motion to dismiss the debtors' case came on for hearing and no one appeared to defend the debtors' interests. The appellant sent an attorney to defend the appellant, but he did not send anyone to defend the debtors. True, the debtors had dismissed the appellant, but as of that hearing the bankruptcy court had not granted the appellant's motion to withdraw, and the appellant still had not been required to disgorge the fee that he received. On October 18, 2003, not one word was said in defense of the debtors. (Transcript of October 28, 2002, Docket Sheet Document No. 42.) When the bankruptcy court decided to dismiss this case, the debtors were out the $350 attorney fee and the $200 filing fee, their case was dismissed, and they did not receive a discharge of their debts. To paraphrase *Arens v. Boughton (In re Prudhomme)*, 43 F.3d 1000, 1003 n.1 (5th Cir. 1995), *affirming*, 176 B.R. 781 (W.D. La. 1993), *and* 152 B.R. 91 (Bankr. W.D.La. 1993), this is ample evidence to show that the appellant did not render any services that benefited the debtors or their estate, that the appellant's services were unsatisfactory, and that the appellant hurt the debtors more than helped them, and accordingly, the court did not clearly err in finding the fee unreasonable. But for the refund required by the Bankruptcy Court, the debtors would have paid $325 plus a $200 filing fee for a case that could not proceed under Chapter 7.

The appellant argues that the debtors did not cooperate and that requiring him to disgorge his fee is a windfall that inappropriately rewards their failure to cooperate. However, it is highly unlikely that the debtors paid $525 just to get $325 back someday. It is true that "A court must exercise its power to levy sanctions 'with restraint and discretion.'" *Kisseberth*, 273 F.3d at 720, quoting *Downs*, 103 F. 3d at 478. The bankruptcy court did act with restraint and discretion. The debtors paid $200 to file a bankruptcy case without giving their attorney all the addresses for the creditors, and the debtors paid $325 to obtain the assistance of an attorney who would make sure that the case proceeded successfully and the debtors received a Chapter 7 discharge of their debts. The debtors received the first, and the bankruptcy court did not require the appellant to refund the $200 filing fee to the debtors. The debtors, however, did not receive the assistance of an attorney. An attorney would have either found the addresses for the debtors or would have refused to file the case until the debtors found the addresses for themselves. The appellant did neither and therefore was not entitled to an attorney's compensation for filing the case. The debtors received no benefit from the filing of this bankruptcy case. The debtors received no benefit from the appellant's services. Therefore, any fee charged by the appellant was excessive and the bankruptcy court properly ordered the attorney fee refunded to the debtors under 11 U.S.C. Section 329(b).

IV. The Bankruptcy Court's Sanction Should Be Affirmed As A Proper Exercise Of The Bankruptcy Court's Inherent Authority

Section 329(b) compares the attorney fee paid by the debtors with the value of the services they received from the attorney. However, even if the debtors received full value for the fee they paid, the bankruptcy court has the inherent power to review the conduct of attorneys practicing before that court and to sanction improper conduct by attorneys.

As the Sixth Circuit held in *Downs*, "Bankruptcy courts, like Article III courts, enjoy inherent power to sanction parties for improper conduct. *In re Rainbow Magazine, Inc.*, 77 F.3d 278, 283-4 (9th Cir. 1996). It follows that the bankruptcy court is vested with the inherent power to sanction attorneys for breaches of fiduciary obligations. *See In re Arlan's Dep't Stores, Inc.*, 615 F.2d 925, 943 (2d Cir. 1979). " *Downs*, 103 F.3d 472. The power to sanction attorneys for breaches of fiduciary duties flows from the bankruptcy court's more general power to sanction parties for improper conduct.

Neither *Downs* nor *Kisseberth* limited the bankruptcy court's inherent authority to sanction attorneys to failures to comply with Section 329(a) and Rule 2016(a). The lack of such limits can be seen in *Downs*' citation of *In re Arlan's Dep't Stores, Inc.*, 615 F.2d 925, 943 (2d Cir. 1979) as authority. In that opinion the Second Circuit considered the appeal of attorneys who had been denied all compensation in a Chapter XI proceeding (the predecessor of the current Chapter 11 reorganization) for failure to comply with the fee disclosure rules then prevalent under the Bankruptcy Act, which was superceded by the current Bankruptcy Code and Rules in 1978. Although the attorneys had violated specific provisions of the then prevalent Act and Rules, those discrete violations were not the basis of the ruling:

> Our opinion, however, is bottomed not simply upon violations of particular bankruptcy statutes or rules but upon the status of counsel to Arlen's as officers of the court and fiduciaries. There is nothing novel at all about that consideration. In his first pronouncement from the woolsack in 1801, Lord Eldon expressed his deep concern over the abuses in bankruptcy proceedings which then prevailed. He commented: "Instead of solicitors attending to their duty as ministers of the court, for they are so, commissions of bankruptcy are treated as matters of traffic..." 6

Ves.Jr. 1, quoted in *In re Drake* (D.C.N.J. 1876), Fed.Cas.No. 4,058.

One hundred years ago the Supreme Court referred to the professional obligation of attorneys as follows:

> They are officers of the law, as well as the agents of those by whom they are employed. Their fidelity is guaranteed by the highest considerations of honor and good faith, and to these is superadded the sanction of an oath. The slightest divergence from rectitude involves the breach of all these obligations. None are more honored or more deserving than those of the brotherhood who, uniting ability with integrity, prove faithful to their trusts and worthy of the confidence reposed in them. Courts of justice can best serve both the public and the profession by applying firmly upon all proper occasions the salutary rules which have been established for their government in doing the business of their clients.

Baker v. Humphrey, 101 U.S. 494, 502, 25 L.Ed. 1065 (1879).

In re Arlen's Dep't Stores, Inc., 615 F.2d 943-44.

Downs also cited *In re Rainbow Magazine, Inc*., 77 F.3d 278, 283-4 (9th Cir. 1996).

In *Rainbow Magazine*, the Ninth Circuit found an alternative basis for the bankruptcy court's inherent power to sanction vexatious conduct in 11 U.S.C. Section 105(a), which provides that:

> The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title. No provision of this title providing for the raising of an issue by a party shall be construed to preclude the court from, sua sponte, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, *or to prevent an abuse of process.*

(Emphasis added.) Taken altogether, it is clear that the authority to sanction attorneys who practice before the bankruptcy court is not grounded solely upon a violation of a specific provision the Bankruptcy Code or Rules, but rather is based upon the attorney's role as an officer of the court.

The bankruptcy court in *In re Prudhomme*, 152 B.R. 91 (Bankr. W.D.La. 1993), required the disgorgement of a $75,000 prepetition retainer both because the attorney failed to properly disclose the retainer and because the attorney's work failed to meet the court's standard for quality of representation. The bankruptcy court looked at several factors from its local rules in making this determination, including whether the schedules and pleadings were accurate, complete and professional, the efficiency with which the case was conducted, and whether counsel had been diligent within the rules of professional responsibility to assure that his client fulfilled his statutory duties and his duties imposed by court order. 152 B.R. 114. Both the District Court and the Fifth Circuit affirmed. *Arens v. Boughton (In re Prudhomme)*, 43 F.3d 1000 (5th Cir. 1995), *affirming*, 176 B.R. 781 (W.D. La. 1993), *and* 152 B.R. 91 (Bankr. W.D.La. 1993). In affirming, the Fifth Circuit held, "Ample evidence showed that the [attorney] did not render any services that benefited any of the debtors or their estates, that the firm's services were unsatisfactory, and that counsel hurt the debtors more than helped them...Accordingly, the court did not clearly err in finding the fee unreasonable." 43 F.3d at 1003, n. 1. *See also, In re J.V. Knitting Service, Inc.*, 22 B.R. 543 (Bankr. S.D. Fla. 1982)(fees denied to debtor's attorney whose efforts were unsuccessful and in fact impeded and obstructed the administration of the case.)

The bankruptcy court's independent and inherent authority to sanction attorneys is recognized in the bankruptcy court's local rules. Federal Rule of Bankruptcy Procedure

9029 authorizes the district court in each district to make local bankruptcy rules, and to delegate that authority, subject to the requirements of Federal Rule of Civil Procedure 83, to the bankruptcy court for that district. The District Court for the Western District of Michigan has authorized the bankruptcy court to make local rules. W.D.Mich. LCivR 83.2(d). The bankruptcy court's Local Bankruptcy Rule 9010-1(c) authorizes the bankruptcy court to sanction improper conduct, as follows:

> A bankruptcy judge may impose discipline, except suspension or disbarment, on any attorney who engages in conduct violating the Rules of Professional Conduct; willfully violates these Rules, the Federal Rules of Bankruptcy Procedure, or orders of the Bankruptcy Court; or engages in other conduct unbecoming of a member of the bar of the Bankruptcy Court. Prior to the imposition of discipline, the attorney shall be afforded an opportunity to show good cause, within such time as the Bankruptcy Court shall prescribe, why the discipline should not be imposed. Upon the attorney's response to show cause, and after hearing, if requested and allowed by the bankruptcy judge, or upon expiration of the time prescribed for a response if no response is made, the Bankruptcy Court shall enter an appropriate order.

It is clear that the procedural requirements of LBR 9010-1(c) were met; the appellant had notice of the United States Trustee's motion and filed a response; a hearing was conducted upon that response and a second hearing was held upon the appellant's motion for reconsideration. It is also clear that the imposition of sanctions upon the appellant under the bankruptcy court's inherent authority was justified.

The appellant deliberately filed a mailing matrix and schedules that gave his address for that of at least sixteen parties. This decision impaired the administration of the estate be denying those parties their rightful notice under Federal Rule of Bankruptcy Procedure 2002(a)(1) and 2002(f)(1), (4), (5) of the filing of the case, the convening of the meeting of creditors, and the times fixed for objecting to the debtors' discharge or the discharge of a particular debt, and denied those parties their rights in this bankruptcy case to attend the meeting of creditors called under 11 U.S.C. Section 341 and to examine the debtors under 11 U.S.C. Section 343. The appellant's insertion of his own address violated 11 U.S.C. Section 521(1), Federal Rule of Bankruptcy Procedure 1007(a)(1), Official Form 6, and Local Bankruptcy Rule 1007-2(b)(1). In advising his clients to file these schedules, the appellant was also advising the debtors to file inaccurate schedules in violation of Federal Rule of Bankruptcy Procedure 1008 and 28 U.S.C. Section 1746.

The appellant's decision to insert his own address constituted conduct unbecoming of a member of the bar of the bankruptcy court, and an abuse of process, which, if not sanctioned, might encourage other attorneys to also insert incorrect addresses. If the appellant's conduct were not sanctioned, other attorneys might come to believe it was acceptable to file documents with inaccuracies and omissions that they were aware of. By the appellant's reasoning, any number of creditors' addresses may be omitted with impunity, and it is only a few short steps further before creditors and assets will be omitted as well. To prevent such abuses, the bankruptcy court properly exercised its inherent authority to sanction the appellant for improper behavior. The bankruptcy court's imposition of sanctions was not an abuse of its discretion.

CONCLUSION

For all the above reasons, the United States Trustee respectfully asks this Court to affirm the bankruptcy court's order requiring the appellant to refund to the debtors the attorney fee he received from the debtors.

Respectfully submitted,
SAUL EISEN
United States Trustee
Michigan/Ohio Region IX

Date:____________________

By:__________________________
Michael V. Maggio
Trial Attorney
Office of the U.S. Trustee
United States Department of Justice
330 Ionia NW, Suite 202
Grand Rapids, Michigan 49503
Tel: (616) 456-2002, ext. 14

BRIEF BANK — "SUMMARY SHEET" *Printed Wed-5/14/08 11:5*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*
Countrywide Home Loans, Inc. v. Office of the United States Trustee

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*
D. Pa.

3. ("CCN") ***CURRENT*** CASE NO.
No.: 2:08-cv-00617-DWA

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*
No.: 07-00204-TPA
Court: Bankr. Pa.
(Identify judge & cite, if any)

5. ("SO") ***SOURCE***
U.S. TRUSTEES

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*
Filed: May 13, 2008
Type: United States Trustee's Response in Opposition to Countywide Home Loans, Inc.'s Emergency Motion for Stay Pending Appeal

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Joseph S. Sisca, Norma Hildenbrand, T. Patrick Tinker, P. Matthew Sutko
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s)

&

√ Any Miscellaneous ***BACKGROUND***

●Whether the stay applicant has made a strong showing that he is likely to succeed on the merits; (2) whether the applicant will irreparably injured absent a stay; (3) Whether issuance of the stay will substantially injure the other parties interested in the proceeding; and (4) where the public interest lies.

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DATE:

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF PENNSYLVANIA

COUNTRYWIDE HOME LOANS, INC.,

Appellant,

v.

OFFICE OF THE UNITED STATES TRUSTEE,

Appellant.
______________________________________/

Case No. 2:08-cv-00617-DWA

THE HONORABLE
DONETTA W. AMBROSE

UNITED STATES TRUSTEE'S RESPONSE IN OPPOSITION TO COUNTRYWIDE HOME LOANS, INC.'S EMERGENCY MOTION FOR STAY PENDING APPEAL

Roberta A. DeAngelis, Acting United States Trustee for Region 3, by the undersigned counsel, files this response in opposition to *Countrywide Home Loans, Inc.'s Emergency Motion for Stay Pending Appeal Pursuant to Fed. R. Bankr. P. 8005* (the "Motion to Stay"), stating:

I. INTRODUCTION

The United States Trustee is an official of the United States Department of Justice charged with responsibility to "supervise the administration of cases and trustees in cases under chapter 7, 11, 12, 13 or 15 of title 11 . . . ." 28 U.S.C. 586(a)(3). "The United States trustee may raise and may appear and be heard on any issue in any case or proceeding under this title but may not file a plan pursuant to section 1121(c) of this title." 11 U.S.C. 307.

Rule 2004 of the Federal Rules of Bankruptcy Procedure provides a mechanism for discovery that is unique to bankruptcy cases. Although the Federal Rules of Bankruptcy Procedure incorporate by reference many of the discovery mechanisms set forth in the Federal Rules of Civil Procedure (see Fed. R. Bankr. P. 7026 through 7037), Fed. R. Bankr. P. 2004 provides a further tool for discovery, one that is generally used *prior* to the commencement of an adversary proceeding or the filing of a contested matter. Upon a showing of cause by any party in interest, the bankruptcy court "may order the examination of any entity." Fed. R. Bankr. P. 2004(a). That examination, however, may relate "only to the acts, conduct, or property or to the liabilities and financial condition of the debtor, or to any matter which may affect the administration of the debtor's estate, or the debtor's right to a discharge," Fed. R. Bankr. P. 2004(b).

The United States Trustee sought to conduct Rule 2004 examinations of Countrywide Home Loans, Inc. ("Countrywide"). Doc. No. 6.[1] Countrywide opposed the United States Trustee's Rule 2004 examinations and related subpoenas on the ground that the United States Trustee lacks authority to conduct such examinations. Doc. Nos. 12 and 13. After reviewing briefs, considering the evidence, and hearing arguments, the Bankruptcy Court entered a Memorandum Opinion and an order (the "Order") on April 1, 2008 (Doc. No. 64) holding that the United States Trustee had the power to conduct the Rule 2004 examinations and that she had shown good cause for the examinations. The Bankruptcy Court, however, limited the scope of the examinations and required that they be conducted within one specific bankruptcy case, *In re Hill*, Case No. 01-22574-JAD.

On April 11, 2008, Countrywide filed a notice of appeal from the Order (Doc. No. 66), a motion seeking leave for an interlocutory appeal (Doc. No. 68), and a motion seeking a stay from the Bankruptcy Court pending resolution of the appeal to this Court (Doc. No. 79) .

On May 2, 2008, the Bankruptcy Court denied Countrywide's motion seeking a stay pending appeal from the Bankruptcy Court (Doc. No. 98). Countrywide's motion for leave to appeal is pending in this Court.

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[1] Unless otherwise noted, all docket references are to the bankruptcy court docket for Miscellaneous Proceeding 07-204-TPA. Where specifically noted, we cite the docket for a related case, e.g *In re Hill*, Case No. 01-22574-JAD.

On May 9, 2008, Countrywide filed the Motion to Stay in this Court, as well as their brief in support of the Motion to Stay (D. Doc. Nos. 2, 3).

The United States Trustee respectfully submits that this Court should deny the Motion to Stay because Countrywide has failed to sustain its burden of demonstrating that: (i) it is likely to succeed on the merits of the appeal; (ii) it will be irreparably injured absent a stay; (3) issuance of the stay will not substantially injure the other parties interested in the proceeding; and (4) the public interest lies in favor of granting the stay.

In the following sections, the United States Trustee describes in further detail the somewhat complicated procedural history of this appeal, the general role of the United States Trustee in the administration of bankruptcy cases, and the nature and scope of Fed. R. Bankr. P. 2004. The United States Trustee then presents her argument that the Court should deny Countrywide's Motion to Stay.

II. PROCEDURAL HISTORY OF THIS APPEAL

A. MISCELLANEOUS PROCEEDING 07-204-TPA

On October 18, 2007, the United States Trustee filed notices of her intent to examine Countrywide Home Loans, Inc. f/k/a Countrywide Funding Corp. ("Countrywide") under Fed. R. Bankr. P. 2004 in ten bankruptcy cases. The Bankruptcy Court entered an Order on November 5, 2007 consolidating these matters and directed the United States Trustee to file a single notice of her intent to examine Countrywide in a single miscellaneous proceeding. Doc. No. 1. Following the commencement of that miscellaneous proceeding, the relevant bankruptcy cases are limited to seven:

In re Hill, Case No. 01-22574-JAD;
In re Benvenuto, Case No. 02-20946-JKF;
In re Stemple, Case No. 03-11792-WWB;
In re Karleski, Case No. 04-31355-JKF;
In re Bock, Case No. 04-32812-BM;

In re Olbeter, Case No. 04-33361-JKF; and
In re Topper, Case No. 05-20772-TPA.

These seven cases are hereafter referred to as "Context Cases". The miscellaneous proceeding is thus a consolidated proceeding in which the Bankruptcy Court addresses Countrywide's objection to the United States Trustee's Rule 2004 examinations in all seven Context Cases.

Pursuant to the Bankruptcy Court's order, on November 7, 2007 the United States Trustee filed her Notice Regarding 2004 Examination and Request for Production of Documents (the "Notice") as well as a subpoena seeking documents (the "Subpoena") in the miscellaneous proceeding. Doc. No. 6. On November 9, 2007, Countrywide filed its objection to the Notice and its motion to quash the related Subpoena. Doc. Nos. 12 and 13.

On November 20, 2007, the Bankruptcy Court entered an order directing the parties to brief issues pertinent to United States Trustee's examinations. The Bankruptcy Court stayed Countrywide's obligation to respond to the examinations pending further order of the Court. Doc. No. 26.

The United States Trustee filed briefs in support of her examinations (Doc. Nos. 31, 61), and Countrywide filed briefs opposing the examinations (Doc. Nos. 30, 34, 62). The United States Trustee and Countrywide also submitted extensive exhibit binders to provide a factual record in support of their respective positions. Doc. Nos. 58, 59.

On February 28, 2008, the Bankruptcy Court conducted a hearing to consider Countrywide's objections to the Rule 2004 examinations. On April 1, 2008, the Bankruptcy Court entered the Memorandum Opinion and the Order being appealed Doc. No. 64. The Order authorizes, in part, the United States Trustee's Rule 2004 examinations and related document production.

The Bankruptcy Court found and concluded that ". . . it is within the power of the UST to seek the production of documents and the examination of witnesses pursuant to *Rule 2004*. However, this authority is not unfettered." Memorandum Opinion at 26. The Bankruptcy Court therefore proceeded to consider whether the United States Trustee had sustained her burden of showing "good cause" under Rule 2004. Without making any finding that Countrywide did anything wrong in any of these cases, the Bankruptcy Court found that "the UST has made a showing of a common thread of potential wrongdoing in each of the cases that is sufficient to meet the general standard of good cause necessary for her to proceed under Rule 2004." *Id*. at 39.

Although the Bankruptcy Court found and concluded that the United States Trustee had shown good cause for the Rule 2004 examinations in the various Context Cases, the Bankruptcy Court nonetheless limited the forum within which the United States Trustee could conduct such discovery to the Hill case. The Bankruptcy Court reasoned that Countrywide's actions in the Context Cases could be the subject of discovery in the ongoing Hill litigation, permitted under Federal Rules of Evidence 401, 404 and 406. *Id.* at 48-49. The Court then held as follows:

> ". . . [F]or the sake of administrative convenience and to avoid any potential *res judicata* issues, the Court will stay the Notice of Examination and Subpoenas in all context cases except *In re Hill*, Case No. 01-22574-JAD. In that case, the Court will direct Countrywide to produce documents in Categories 5-12 as to each of the Debtors in the context cases and will direct Countrywide to make a witness or witnesses available to be examined on the topics identified by the UST."

Id. at 50.[2] The Bankruptcy Court's stay of the Rule 2004 examinations within the other Context Cases was expressly "pending further Order of the Court." Order at 2. In essence, the Bankruptcy Court channeled the United States Trustee's examinations into the ongoing *Hill* litigation, but reserved the issue of examinations in the other Context Cases pending further court order.

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[2] The Court also found that the document requests in categories 1-4 of the Subpoenas were moot and that Countrywide had waived any objection to the extent of the discovery being conducted in *Hill*. Opinion at 32-33, 35.

On April 14, 2008, Countrywide filed its Motion to Stay. The Bankruptcy Court denied the Motion to Stay in an order entered May 2, 2008.

B. IN RE HILL, CASE NO. 01-22574-JAD

On March 19, 2001, Sharon Diane Hill (the "Debtor") had filed her petition for relief under Chapter 13. Hill Doc. No. 1. The Bankruptcy Court entered an order discharging the Debtor on March 16, 2007 (Hill Doc. No. 49) and the Bankruptcy Court entered a final decree closing the case on May 18, 2007 (Hill Doc. No. 55).

On June 25, 2007, the Debtor filed a motion seeking to enforce the discharge against Countrywide (the "Motion to Enforce Discharge") based on alleged post-discharge collection activity by Countrywide. Hill Doc. No. 59.

On December 20, 2007, the Bankruptcy Court conducted a status conference on the Debtor's Motion to Enforce Discharge. At that status conference, the Debtor's counsel raised the issue of certain "recreated letters" provided by Countrywide to Debtor's counsel. The following day, on December 21, 2007, the Court entered an order which addresses, in part, those "recreated letters." The Court states in the Order that Countrywide's counsel

> "provided Debtor's Counsel with three documents that appear on their face to be copies of letters dating from 2003, 2004 and 2007, from [Countrywide] to the Debtor, with copies shown going to the Debtor's Counsel and the Chapter 13 Trustee, informing the Debtor of an increase in her escrow obligation under the mortgage. There is no dispute that, in fact, however, these documents were not copies of actual letters, but were generated by Respondent as 'recreated letters' which it said were designed to provide the Debtor and her Counsel with information regarding the escrow . . . Debtor's Counsel indicated that Counsel only became aware of the situation after suspicions were raised when it was noticed that the address for Debtor's Counsel's office shown on the 2003 document was one Counsel had not moved to until some time after the date shown on the 'recreated' document. Thus, significant factual issues exist . . . ."

Aside from discussing the “recreated letters,” the Court’s December 21, 2007 order established a discovery schedule with respect to the Motion to Enforce Discharge and stated “that the Chapter 13 Trustee and the United States Trustee, both of whom appeared at the status conference and expressed an interest in this matter shall also be permitted to engage in discovery pursuant to this Order.” Hill Doc. No. 103, at 2. Countrywide has not challenged the United States Trustee’s authority to conduct discovery under the December 21, 2007 order.

May 23, 2008 is currently the discovery cut-off date with respect to the Motion to Enforce Discharge. The final pretrial conference is set for June 24, 2008, to be followed soon thereafter by an evidentiary hearing. Hill Doc. Nos. 166, 179.

III. THE UNITED STATES TRUSTEE’S ROLE

Countrywide’s appeal challenges the role of the United States Trustee in bankruptcy cases. That role, however, is both broad and well-established.

In 1970 Congress enacted legislation creating a Commission on the Bankruptcy Laws of the United States and instructing the Commission to study the Bankruptcy Act of 1898 and propose amendments to strengthen the bankruptcy system. Act of July 24, 1970, Pub. L. No. 91-354, 84 Stat. 468. The Commission determined that longstanding and significant problems associated with the Bankruptcy Act of 1898 necessitated the creation of an agency that would supervise bankruptcy cases. *See Report of the Commission of the Bankruptcy Laws of the United States*, H.R. Doc. No. 137, 93d Cong. 1st Sess. (1973). Congress ultimately created the United States Trustee Program as part of the Bankruptcy Reform Act of 1978.[3] *See* P.L. 95-598, 92 Stat. 2549 (1978). The

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[3] The Reform Act initially created a pilot United States Trustee Program that served eighteen (18) of ninety-four (94) federal districts. *See* Reform Act § 224. Eight years later, after evaluating the pilot program, Congress expanded the United States Trustee Program nation-wide as part of the Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1986. *See* Pub.

Program has been a component of the Department of Justice for the past 30 years.

Congress gave the United States Trustees "important oversight and watchdog responsibilities to ensure honesty and fairness in the administration of bankruptcy cases and to prevent and ferret out fraud." H. Rep. No. 764, 99th Cong., 2d Sess. 18, *reprinted in* 1986 U.S. Code Cong. & Admin. News 5231. Congress created the Program to correct longstanding and systemic inadequacies in the administration of bankruptcy cases. These problems sprang from the fact that bankruptcy is fundamentally different from typical litigation, which involves only a few parties who actively protect their self-interest. In contrast, a bankruptcy case often involves debtors who lack the sophistication or financial wherewithal to protect their own interests, and creditors whose small stake in proceedings or distance from bankruptcy forums effectively denies them the ability to protect their rights. It has been said that "[t]he conduct of bankruptcy proceedings not only should be right but must seem right." *See In re Ira Haupt & Co.*, 361 F.2d 164, 168 (2d Cir. 1966). The United States Trustees protect the public interest by supervising the bankruptcy system so that it works honestly and efficiently, thereby fostering public confidence.

Each of the nation's 21 United States Trustees is a senior official of the United States Department of Justice, appointed by the Attorney General, to oversee and supervise the conduct of bankruptcy cases. *See* 28 U.S.C. §§ 581 and 586(a). When Congress expanded the United States Trustee Program from a pilot project in 1978 to a national program, Congress also amended the Bankruptcy Code, adding Section 307. That statute expressly provides that the United States Trustees may raise and be heard on any issue under Title 11. *See, e.g., United States Trustee v.*

L. No. 99-554, 100 Stat. 3088. The Program does not, however, operate in North Carolina and Alabama because those states are subject to bankruptcy administrators, judicial branch officials who share many of the United States Trustees' powers and responsibilities.

Price Waterhouse, 19 F.3d 138, 141 (3d Cir. 1994); *Thompson v. Greenwood*, 507 F.3d 416, 420 n.3 (6th Cir. 2007); *In re Donovan Corp.*, 215 F.3d 929, 930 (9th Cir. 2000); *In re Glados, Inc.*, 83 F.3d 1360, 1361 n.1 (11th Cir. 1996); *In re Clark*, 927 F.2d 793, 796 (4th Cir. 1991); *In re Plaza de Diego Shopping Center,* 911 F.2d 820, 824 (1st Cir. 1990); *In re Revco D.S., Inc*., 898 F.2d 498, 500 (6th Cir. 1990). That standing is subject to only one express exception, a United States Trustee may not file a reorganization plan under chapter 11. 11 U.S.C. § 307.

IV. FEDERAL RULE OF BANKRUPTCY PROCEDURE 2004

The filing of a voluntary petition in bankruptcy commences a bankruptcy case and creates an estate to be administered. 11 U.S.C. §§ 301, 541. Once the case is commenced, litigation may arise within the case, either by way of adversary proceedings or contested matters. *See In re Southern Indus. Banking Corp.*, 189 R.R. 697, 702 (E.D. Tenn. 1992) (distinguishing the bankruptcy case from adversary proceedings and contested matters which arise in a bankruptcy case). Discovery in adversary proceedings and contested matters is governed by rules generally analogous to, and to a large extent derived from, the discovery rules set forth in the Federal Rules of Civil Procedure. *See* Fed. R. Bankr. P. 7026 through 7037 (applicable to adversary proceedings); Fed. R. Bankr. P. 9014 (specifying which adversary proceeding rules may apply in contested matters).

Federal Rule of Bankruptcy Procedure 2004, by contrast, is unique to bankruptcy. It is generally a pre-litigation discovery mechanism. Rule 2004 examinations "are allowed for the purpose of discovering assets and unearthing frauds." *In re Sun Medical Management, Inc.*, 104 B.R. 522, 524 (Bankr. M.D. Ga. 1989); *In re Table Talk, Inc.,* 51 B.R. 143, 145 (Bankr. D. Mass. 1985).

Rule 2004 states:

> (a) Examination on motion
>
> On motion of any party in interest, the court may order the examination of any entity.
>
> (b) Scope of examination
>
> *The examination of an entity* under this rule or of the debtor under § 343 of the Code *may relate only to the acts, conduct, or property or to the liabilities and financial condition of the debtor, or to any matter which may affect the administration of the debtor's estate, or to the debtor's right to a discharge. In* a family farmer's debt adjustment case under chapter 12, *an individual's debt adjustment case under chapter 13*, or a reorganization case under chapter 11 of the Code, other than for the reorganization of a railroad, *the examination may also relate to* the operation of any business and the desirability of its continuance, the source of any money or property acquired or to be acquired by the debtor for purposes of consummating a plan and the consideration given or offered therefor, and *any other matter relevant to the case or to the formulation of a plan*.
>
> (c) Compelling attendance and production of documents
>
> The attendance of an entity for examination and for the production of documents, whether the examination is to be conducted within or without the district in which the case is pending, may be compelled as provided in Rule 9016 for the attendance of a witness at a hearing or trial. As an officer of the court, an attorney may issue and sign a subpoena on behalf of the court for the district in which the examination is to be held if the attorney is admitted to practice in that court or in the court in which the case is pending.

(emphasis added).

The permitted scope of a Rule 2004 examination is very broad. "It can be legitimately compared to a fishing expedition." *In re Drexel Burnham Lambert Group, Inc.*, 123 B.R. 702, 711(Bankr. S.D.N.Y. 1991) (*citing In re Vantage Petroleum Corp.*, 34 B.R. 650, 651 (Bankr. E.D.N.Y. 1983). The examination needs only to relate to the administration of the case or the bankruptcy estate. Given its broad scope, Rule 2004 is a very important mechanism for obtaining information prior to the commencement of litigation in a bankruptcy case. Once litigation is commenced as to a particular matter, discovery is generally conducted under the rules applicable in adversary proceedings and contested matters. *Int'l Fibercom, Inc.*, 283 B.R. 290, 292-93 (Bankr.

D. Ariz. 2002).

Persons subject to a Rule 2004 examination may seek a protective order to appropriately limit or preclude the examination. The bankruptcy court has jurisdiction over that matter pursuant to 28 U.S.C. § 1334 and 28 U.S.C. §§ 157(a) and (b)(2)(A), as it is a core proceeding concerning the administration of the estate. *In re Coffee Cupboard, Inc.*, 128 B.R. 509, 517 (Bankr. E.D.N.Y. 1991); *In re Drexel Burnham Lambert Group, Inc*., 123 B.R. 702, 703 n.1 (Bankr. S.D.N.Y. 1991).

When considering a motion for protective order, the bankruptcy court need only determine whether there is "good cause" for the examination to proceed. *See In re Wilcher,* 56 B.R. 428, 434 (Bankr. N.D. Ill. 1985). Good cause may ordinarily be shown if the examination and requested documents are necessary to establish the claim of the party seeking the examination, or if denial of the examination request would cause it undue hardship or injustice. *Id.*, at 434-35. The court, however, may limit the scope of an examination or provide other protections to ensure that examinations are properly conducted.

II. ARGUMENT

A. REQUIREMENTS FOR A STAY PENDING APPEAL

In considering a motion for stay pending appeal under Fed. R. Bankr. P. 8005, this Court must analyze four specific criteria:

> "(1) whether the stay applicant has made a strong showing that he is likely to succeed on the merits; (2) whether the applicant will be irreparably injured absent a stay; (3) whether issuance of the stay will substantially injure the other parties interested in the proceeding; and (4) where the public interest lies."

Republic of the Philippines v. Westinghouse Elec. Corp., 949 F.2d 653, 658 (3d. Cir. 1991) (quoting Hilton v. Braunskill, 481 U.S. 770, 777 (1987); *see also In re Hayden,* 2008 WL 400696, at 1 (W.D.

Pa. Feb. 11, 2008); *In re Bankruptcy Appeal of Allegheny Health, Education and Research Foundation (“AHERF”)*, 252 B.R. 309, 321 (W.D. Pa. 1999). These four factors structure the inquiry, however “no one aspect will necessarily determine its outcome. Rather, proper judgment entails a ‘delicate balancing of all elements.’” *AHERF*, 252 B.R. at 321 (*quoting In re Roth American, Inc.*, 90 B.R. 94, 95 (Bankr. M.D. Pa. 1988)). Because Countrywide has failed to meet its burden of demonstrating these conditions, the Court should deny Countrywide’s Motion.

B. COUNTRYWIDE HAS NOT MADE A STRONG SHOWING THAT IT IS LIKELY TO SUCCEED ON THE MERITS

1. Countrywide’s Appeal is Interlocutory

Countrywide should not be able to pursue the instant appeal at all, because the Order is not a final order. The District Court has jurisdiction to hear appeals from final orders entered by the Bankruptcy Court. 28 U.S.C. 158(a)(1); *Sterling Supply Corp. v. Mullinax*, 154 B.R. 660, 661 (E.D. Pa. 1993). “The finality requirement advances our interest in avoiding ‘piecemeal appeals’ during ongoing proceedings.” *In re Flat Grass Antitrust Litigation (MDL No. 1200)*, 288 F.3d 83, 87 (3d Cir. 2002) (citing *Firestone Tire & Rubber Co. v. Risjord*, 449 U.S. 368, 374 (1991)). The Order does not resolve all issues potentially arising in the underlying cases, indeed the United States Trustee has only commenced its investigation in *Hill* and the other Context Cases.

Although Countrywide argues in its motion seeking leave to appeal that the Order is appealable under the *Cohen* “collateral order” doctrine, the Order cannot fall within that doctrine. The Order “resolved a discovery dispute, intertwined with the merits of an underlying action. It is well-established that unless a party is seeking to prevent the disclosure of information on the basis of trade secrets or some traditionally-recognized privilege such as attorney-client or work product, the collateral order doctrine does not permit appeal from discovery orders.” *ADAPT of Philadelphia* *v. Philadelphia Housing Authority*, 417 F.3d 390, 395 (3d Cir. 2005) (*citing Powell v. Ridge*, 247 F.3d 520, 524 (3d Cir. 2001).

The United States Trustee argues further for dismissal of the appeal in her response to Countrywide's motion seeking leave to appeal. In regard to this Motion to Stay, the United States Trustee simply submits that no stay should be provided where the appeal itself should be summarily dismissed.

2. The United States Trustee has Broad Authority to Raise Issues and Take Action in Bankruptcy Cases

The United States Department of Justice, on behalf of the federal government, has Article III standing to appear in federal court to enforce federal law. *See Vermont Agency of Natural Resources v. United States* ex rel. *Stevens*, 529 U.S. 765, 771 (2000) (the United States has standing to redress an "injury to its sovereignty arising from violation of its laws"); *United States v. Raines*, 362 U.S. 17, 27 (1960) (Congress may authorize the Attorney General to bring suit in federal court to enjoin violations of federal law); *In re Debs*, 158 U.S. 564, 584 (1895) (the Government's "obligation[]" to prevent violations of federal law is "sufficient to give [it] a standing in court"), *disapproved on other grounds by Bloom v. State of Illinois*, 391 U.S. 194, 208 (1968); *see also Wyandotte Transp. Co. v. United States*, 389 U.S. 191, 201 (1967) ("Our decisions have established [] the general rule that the United States may sue to protect its interests.").

The United States Trustee Program is the division of the Department of Justice that enforces federal bankruptcy law. *See* 28 U.S.C. §§ 581-89; H.R. Rep. No. 95-595, at 110 (1977) (the United States Trustee has an "obligation to execute and enforce the bankruptcy laws"); *United Artists Theatre Co. v. Walton*, 315 F.3d 217 (3d Cir. 2003) (the United States Trustees are "officers of the Department of Justice who protect the public interest by aiding bankruptcy judges and monitoring certain aspects of bankruptcy proceedings"); *In re Glados, Inc.*, 83 F.3rd 1360,1361 n.1 (11th Cir.1996) ("The UST is an official of the United States Department of Justice charged by statute with the duty to oversee and supervise the administration of bankruptcy cases. 28 U.S.C. §586 (a)").

The Justice Department's representative in this case is the United States Trustee for Region 3, a senior Department official appointed by the Attorney General, 28 U.S.C. § 581(a)(3), and she has authority from the Attorney General to protect the federal government's interest in enforcing the Bankruptcy Code. *See* 28 U.S.C. § 517. As an Executive Branch official, a United States Trustee need not demonstrate any concrete, particularized injury in order to assert standing.[4] *See United Artist Theater Co. v. Walton*, 315 F.3d 217, 225 (3d Cir. 2003).

Even absent Section 307, the United States Trustee has standing to act where its actions advance the UST's interest in the administration of bankruptcy proceedings. *A-1 Trash Pickup v. United States Trustee (In re A-1 Trash Pickup)*, 802 F.2d 774, 775-76 (4th Cir. 1986) ("when Congress created the office of United States trustee, it expected the trustees to actively oversee the administration of bankruptcy cases and to intervene whenever particular actions threatened an abuse of the bankruptcy system or its procedures") (case decided prior to enactment of 11 U.S.C. § 307).

While the United States Trustee's authority is not premised on Section 307 alone, that statute certainly provides broad authority for the United States Trustee to raise issues and be heard in bankruptcy cases and proceedings as she takes such actions as she deems necessary in order to protect the public interest in the enforcement of federal bankruptcy law. *See United States Trustee v. Price Waterhouse*, 19 F.3d 138, 141 (3d Cir. 1994); *In re Glados, Inc.*, 83 F.3d 1360, 1361 n.1

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[4] This is in direct contrast to the showing a private plaintiff must make to establish standing. *See e.g., Lujan v. Defenders of Wildlife*, 504 U.S. 555, 560 (1992).

(11th Cir. 1996); *In re Donovan Corp.*, 215 F.3d 929, 930 (9th Cir. 2000); *In re Clark*, 927 F.2d 793, 796 (4th Cir. 1991); *In re Plaza de Diego Shopping Center*, 911 F.2d 820, 824 (1st Cir. 1990); *In re Revco D.S., Inc.*, 898 F.2d 498, 500 (6th Cir. 1990); *Thompson v. Greenwood*, -- F.3d -- 2007 WL 3286743, at *7 n.3 (6th Cir. November 8, 2007).

3. The United States Trustee May Take Rule 2004 Examinations Like Any Other Party in Interest in a Bankruptcy Case.

Fed. R. Bankr. P. 2004 does not narrowly circumscribe the persons authorized to take examinations under the rule, but rather provides that "any party in interest" may seek to conduct such an examination of any entity, though subject to the limitations regarding the scope of the examination and subject to the Court's authority to limit the examination in appropriate circumstances. The phrase "party in interest" is not defined in title 11 or in the applicable rules, but courts have generally construed the phrase in Rule 2004 liberally to effectuate the purpose of the rule. *See In re Summit Corp.*, 891 F.2d 1, 5 (1st Cir. 1989); *Matter of M4 Ents. Inc.*, 190 B.R. 471, 474 (Bankr. N.D. Ga. 1995) (adopting reasoning of *Summit*). The phrase is clearly broad enough to include the United States Trustee, particularly in light of the enactment of 11 U.S.C. § 307. *Thompson v. Greenwood*, 507 F.3d 416, 420 n.3 (6th Cir. 2007) (citing Section 307 for the proposition that the United States Trustee is an interested party by statute). Even prior to the enactment of Section 307 in 1986, the United States Trustee was considered a "party in interest" under the Bankruptcy Code. *See, e.g., A-1 Trash Pickup*, 802 F.2d at 777 (United States Trustee is "party in interest" under 11 U.S.C. § 1112(b), referencing Bankruptcy Rule X-10009 (since superseded), which stated that ". . . [t]he United States trustee may raise and appear and be heard on any issue relating to his responsibilities in a case under the Code.").

Countrywide could only succeed on the merits if 28 U.S.C. § 586 so narrowly constrains the

United States Trustee's scope of activity that the United States Trustee, unlike every other party in interest in a bankruptcy case, cannot investigate the assets, liabilities and financial affairs of debtors under Fed. R. Bankr. P. 2004. Countrywide fails to cite any good authority, *because none exists*, for the proposition that Section 586 sets such narrowly prescribed limits on the authority of the United States Trustee. Countrywide's reading of Section 586 ignores the express language of Section 586(a)(5), which states that the United States Trustee shall ". . . perform the duties prescribed for the United States trustee under title 11 and this title, *and such duties consistent with title 11 and this title as the Attorney General may prescribe.*" (emphasis added) And while many provisions of Section 586 set forth specific duties of the United States Trustee, that is not inconsistent with the United States Trustee's broader role in supervising the administration of bankruptcy cases. "[W]hen two statutes are capable of coexistence, it is the duty of the courts, absent a clearly expressed congressional intention to the contrary, to regard each as effective.'" *J.E.M. Ag. Supply, Inc. v. Pioneer Hi-Bred Int'l, Inc.,* 534 U.S. 124, 143-44 (2001) (*quoting Morton v. Mancari*, 417 U.S. 535, 551 (1974)). The legislative history of the statute, as well as Congress' enactment of Section 307, further belie Countrywide's narrow, constrictive reading of Section 586. Memorandum Opinion, at 11-16.

4. The Bankruptcy Court Correctly Found and Concluded that the United States Trustee Had Demonstrated Good Cause to Conduct the Rule 2004 Examinations

While the United States Trustee has the general authority and standing to conduct a Rule 2004 examination, the United States Trustee must nonetheless, like any party in interest, demonstrate "good cause" for such an examination. Memorandum Opinion, at 26-43. The United States Trustee thoroughly addressed these concerns in the proceeding below, seeking to conduct the Rule 2004 examinations based on substantial allegations of potential misconduct in each of the Context Cases. The Bankruptcy Court had "little difficulty concluding that the UST has met her initial burden of sufficient 'good cause' to proceed with the Countrywide *Rule 2004* exam . . . ." Memorandum Opinion, at 36. The Bankruptcy Court found that the United States Trustee "has made a showing of a common thread of potential wrongdoing in each of the cases that is sufficient to meet the general standard of good cause for her to proceed under *Rule 2004*."[5] Countrywide has not appealed that finding, nor has Countrywide raised any issue on appeal regarding the various other concerns it raised in the Bankruptcy Court with respect to the permitted scope of the examination and related document production. *See* Memorandum Opinion at 41 (disposing of such other issues raised by Countrywide). Notably, instead of arguing on appeal that it deserves protection that can be properly granted by the Bankruptcy Court under Rule 2004, Countrywide

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[5] Even if Countrywide were permitted to argue the absence of "good cause" as an issue on appeal, it is unlikely that Countrywide would prevail prevail where "[a] bankruptcy court's decision to order a Rule 2004 examination is reviewed for abuse of discretion." *In re Metiom, Inc.*, 318 B.R. 263, 267 (S.D.N.Y. 2004); *see also In re Mattera*, 2007 WL 1813763, *2 (Bankr. D.N.J. June 13, 2007) ("The permissive language of Rule 2004 connotes a court's discretion in deciding whether to grant a request for a Rule 2004 examination") *citing In re Enron Corp.*, 281 B.R. 836, 840 (Bankr. S.D.N.Y. 2002) ("the [bankruptcy court] has the discretion to grant a request for a 2004 examination").

simply raises again, with no genuine support in the case law, the specter of an "unauthorized expansion of power by an agency of the Executive branch" that "threatens the constitutional system of checks and balances." Countrywide Brief, at 13.

C. COUNTRYWIDE WILL NOT SUFFER IRREPARABLE INJURY IF A STAY IS NOT GRANTED

Countrywide suggests that because the United States Trustee's Rule 2004 examination "will be costly and intrusive to Countrywide," it will suffer irreparable harm. Motion to Stay, p.7. There is no support for that conclusion in the record below. Even if that naked assertion regarding costs were true, "the prospect of substantial financial loss does not establish irreparable harm." *MacElvain v. U.S.*, 867 F. Supp. 996, 1001 (M.D. Ala.1994); *see also OM Group, Inc. v.* Mooney, 2006 WL 68791, *9 (M.D. Fla. January 11, 2006) (noting that "financial loss" was "not a sufficient ground to establish irreparable harm warranting injunctive relief."); *Fluor Daniel Argentina, Inc. v. ANZ Bank*, 13 F.Supp.2d 562, 564 (S.D.N.Y. 1998) ("As a matter of law, monetary loss alone will generally not amount to irreparable harm"). Further, although Countrywide argues that the United States Trustee's "invasion of Countrywide's private business practices . . . cannot be undone once it has started . . . ," any order authorizing discovery – once complied with – has the same effect. Countrywide has failed to show that a particular injury will result from the examinations that the Bankruptcy Court has authorized. The provision of non-privileged information or material pursuant to discovery does not necessarily render a subsequent appeal moot even though the knowledge gained by the discovery cannot be "erased." *Adapt of Philadelphia v. Philadelphia Housing Authority*, 417 F.3d 390, 393-94 (3d Cir. 2005).

D. A STAY PENDING APPEAL WILL HARM THE PUBLIC INTEREST

The Bankruptcy Court's Order limited the United States Trustee's examination and related document production in the non-*Hill* context cases, by requiring that the examination be conducted within the *Hill* case and by staying the examination in the other context cases. This procedural limitation was imposed "for the sake of administrative convenience and to avoid any potential *res judicata* issues." Memorandum Opinion at 50. The discovery cut-off date in *Hill* is May 23, 2008, and the Bankruptcy Court has scheduled the final pretrial conference for June 24, 2008. By the time of that pre-trial conference, the litigation initiated by the Debtor's Motion to Enforce Discharge will have been pending almost exactly one year, and naturally that matter should not be stayed pending resolution of the instant appeal. Consequently, a stay pending appeal may preclude the United States Trustee from conducting the examinations within the pending litigation, though such examinations might be pursued later in the Hill case if it remains open.[6]

The United States Trustee has sought to conduct the Rule 2004 examinations for reasons having a potentially significant impact on the integrity of the bankruptcy process. Countrywide, as a nationwide servicer of mortgages, participates in a large number of bankruptcy cases nationwide. The United States Trustee seeks to determine, in the Context Cases, whether Countrywide's conduct has deviated from the standards established by the Bankruptcy Code. The Bankruptcy Court itself found that there is a common thread of *potential* wrongdoing in each of the

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[6] At page 12 of Countrywide's Brief, Countrywide argues that any harm caused by delay would be "self-inflicted" by the United States Trustee, referencing an alleged failure by the United States Trustee to timely conduct examinations in two Florida cases, *In re Chadwick* and *In re Del Castillo*. There is no factual record supporting this contention, either in this Court or in the Bankruptcy Court. Countrywide, indeed, is responsible for any delay in the Florida cases, having still failed to comply with the United States Trustee's demand for the underlying documents in the two cases *even after the District Court dismissed Countrywide's appeals*.

Context Cases. If the United States Trustee, through the Rule 2004 examinations, learns of systemic, inappropriate conduct by Countrywide *in fact*, then it is important that actions be taken to protect the public interest as expeditiously as possible.

CONCLUSION

For all of the foregoing reasons, the United States Trustee submits that this Court should deny the Motion to Stay.

ROBERTA A. DEANGELIS
ACTING UNITED STATES TRUSTEE

DATED: May 13, 2008

By: /s/ Joseph S. Sisca
Joseph S. Sisca
Assistant United States Trustee
PA ID 46719
Liberty Center, Suite 970
1001 Liberty Avenue
Pittsburgh, Pennsylvania 15222
(412) 644-4756 Telephone
(412) 644-4785 Facsimile

T. Patrick Tinker, Trial Attorney
(*Pro Hac Vice* Motion to be filed)
U.S. Trustee's Office
501 East Polk Street, Ste. 1200
Tampa, FL 33602
Phone: (813) 228-2173
Fax: (813) 228-2303

BRIEF BANK — "SUMMARY SHEET"

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WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	Countrywide Home Loans, Inc., v. United States Trustee
2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	11th Cir.
3. ("CCN") ***CURRENT*** CASE NO.	No.: 08-16701-E
4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*	No.: 1:08-mc-22551-CMA Court: S. D. Fla. *(Identify judge & cite, if any)*
5. ("SO") ***SOURCE***	**U.S. TRUSTEES**
6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	Filed: February 20, 2009 Type: Answer in Opposition to Appellant's Motion for Reconsideration
7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*	William Kanter, Teal Luthy Miller, Kelsi Brown Corkran, Matthew Sutko *(UST/OGC: 202-307-1399/FAX-2397)*
8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	• Does a circuit court have jurisdiction to hear an appeal from a district court order dismissing an appeal of a bankruptcy court order authorizing a Rule 2004 examination of a creditor?
10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)	
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No. 08-16701-E

IN THE UNITED STATES COURT OF APPEALS
FOR THE ELEVENTH CIRCUIT

COUNTRYWIDE HOME LOANS, INC.,

Appellant,

v.

UNITED STATES TRUSTEE,

Appellee.

On appeal from the United States District Court
for the Southern District of Florida
Civil Action Number: 1:08-MC-22551-CMA

ANSWER IN OPPOSITION TO APPELLANT'S MOTION FOR RECONSIDERATION

WILLIAM KANTER
(202) 514-5575
TEAL LUTHY MILLER
(202) 514-5048
KELSI BROWN CORKRAN
(202) 514-3159
Attorneys, Appellate Staff
Civil Division, Room 7216
U.S. Department of Justice
950 Pennsylvania Ave., N.W.
Washington, D.C. 20530-0001

CERTIFICATE OF INTERESTED PERSONS

In addition to the interested persons identified by Appellant in its Motion for Reconsideration:

1. Kelsi Brown Corkran, Esq., United States Department of Justice, Counsel of Record

INTRODUCTION

Countrywide's motion for reconsideration of the dismissal of its appeal should be denied. It is well-settled law that where, as here, a party seeks to challenge a district court order reviewing a non-final bankruptcy ruling, immediate review is unavailable because the district court order is itself not final. Countrywide has not and cannot demonstrate that the bankruptcy court and district court rulings in this case are final, and therefore offers no basis for this Court to reconsider its dismissal of Countrywide's appeal.

BACKGROUND

On July 19, 2007, Countrywide filed a proof of claim in the chapter 13 bankruptcy case of Manuel Del Castillo and Maria E. Pena (the "Debtors"). Countrywide represented that it held a claim of $287,902.23 secured by the Debtors' primary residence, and that the Debtors owed Countrywide pre-petition arrears of $16,417.67 and an insufficient funds fee of $682.88. Countrywide's proof of claim further stated that effective July 1, 2007, the Debtors' monthly payment to Countrywide would increase from $1,783.64 to $4,773.54.

On August 10, 2007, the Debtors objected to Countrywide's proof of claim, asserting that Countrywide failed to provide a breakdown of the claimed arrears and fees or to explain the basis for the increased monthly payment. Countrywide did not respond to the Debtors' objection. Accordingly, on August 28, 2007, the bankruptcy court entered an order sustaining the Debtors' objection and reducing Countrywide's claim.

Following the disallowance of Countrywide's claim, the United States Trustee commenced an inquiry into whether Countrywide's conduct in this case deviated from the standards established by the Bankruptcy Code and constituted an abuse of the bankruptcy system.[1] In furtherance of this investigation, the United States Trustee served Countrywide with a notice of examination and subpoena pursuant to Bankruptcy Rule 2004, seeking discovery regarding the factual basis for Countrywide's proof of claim. Countrywide objected, arguing that the United States Trustee lacked statutory authority to investigate the factual basis of the company's claim, and that the requested discovery exceeded the permissible scope of a Rule 2004 examination.

On November 20, 2007, the bankruptcy court entered an order that sustained Countrywide's objections on certain discrete topics, but rejected Countrywide's contention that the discovery as a whole was impermissible, and overruled

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[1] United States Trustees are Department of Justice Officials appointed by the Attorney General, who supervise the administration of bankruptcy cases. See 28 U.S.C. § 581-589(a); see also H.R. Rep. No. 95-595, at 88 (1977), as reprinted in 1978 U.S.C.C.A.N. 5963, 6049 (United States Trustees "serve as bankruptcy watch-dogs to prevent fraud, dishonesty, and overreaching in the bankruptcy arena.").

Countrywide's objection to a portion of the notice that sought all documents relating to the company's internal "policy and procedure" for filing bankruptcy claims. Countrywide filed a motion for leave to appeal the discovery order in the United States District Court for the Southern District of Florida. The district court denied the motion, holding that an order granting or denying discovery is, by its nature, not final, and that, under the facts of the Debtors' bankruptcy case, none of the recognized exceptions to the rule against interlocutory appeals applied.

On May 27, 2008, the United States Trustee filed a motion to expand discovery to include copies of internal audits that had been publicly announced by Countrywide during Congressional testimony by the company's Chief Executive for Loan Administration. On June 27, 2008, the bankruptcy court granted the motion over Countrywide's objections, but noted that in responding to discovery requests, Countrywide "may assert objections based upon privilege, subject to the U.S. Trustree's right to contest Countrywide's claim of privilege and this Court's determination regarding the applicability of such privilege," and that Countrywide "may object on the grounds of undue burden based on a particularized showing, and may seek relief from the [bankruptcy] [c]ourt." See Bankruptcy Court Order (Appellant's Record Excerpts ("R.E.") Tab 12) at 2-3.

Countrywide filed a notice of appeal to the district court, again arguing that such orders are appealable as of right, but in the alternative requesting leave to file an interlocutory appeal. On October 30, 2008, the district court denied the second appeal on substantially the same grounds as it had denied the first appeal. District Court Order (R.E. Tab 16) at 5-12. In particular, the court noted that although a discovery order may be considered final if it involves "a person who has custody of materials as to which another person may claim a privilege of non-disclosure," id. at 6 (internal quotation omitted), no such exception applied in this case because the Debtors did not assert any claim of privilege and did not oppose the United States Trustee's discovery requests. Id. at 7.

In addition, the district court held that the "collateral order" doctrine could not be satisfied because, among other things, if Countrywide were sanctioned in this proceeding, it would have ample opportunity to appeal. Id. at 9. Finally, the Court held that the record before it did not provide any basis for granting discretionary leave to appeal, explaining that "Countrywide has simply not demonstrated that the Order differs materially from routine discovery orders from which interlocutory appeals are discouraged as contravening the policy against piecemeal litigation." Id. at 12.

Countrywide subsequently filed a notice of appeal to this Court, and on January 14, 2009, filed its opening brief. On January 21, 2009, this Court dismissed the appeal for lack of jurisdiction, explaining that the district court's order was neither final nor immediately appealable. Countrywide now seeks reconsideration of that dismissal order.

REASONS FOR DENYING THE MOTION

This Court's dismissal of Countrywide's appeal is correct and Countrywide has offered no persuasive basis for reconsidering it. It is well-settled that where, as here, a bankruptcy court ruling is not final, a district court order reviewing the bankruptcy ruling is also not final and is therefore not subject to immediate appeal. District courts have jurisdiction to hear appeals from final judgments and orders of bankruptcy courts, 28 U.S.C. § 158(a)(1), and, "with leave of the court," to hear appeals "from other interlocutory orders and decrees," 28 U.S.C. § 158(a)(3). The courts of appeals have jurisdiction to hear "appeals from all final decisions, judgments, orders, and decrees" entered by the district court or a bankruptcy appellate panel. 28 U.S.C. § 158(d)(1). Accordingly, this Court has held that where a bankruptcy court ruling is not final, the district court order reviewing the bankruptcy ruling is also not final for purposes of 28 U.S.C. § 158(d). See Dzikowski v. Boomer's Sports & Recreation Center, Inc. (In re Boca Arena, Inc.), 184 F.3d 1285, 1286 (11th Cir. 1999). Indeed, every court of appeals to consider this issue has held that a district court order reviewing a non-final bankruptcy ruling is not subject to immediate appeal. See Stubbe v. Banco Central Corp. (In re Empresas Noroeste, Inc.), 806 F.2d 315, 316 (1st

Cir. 1986); Flor v. BOT Financial Group (In re Flor), 79 F.3d 281, 283 (2d Cir. 1996); Commerce Bank v. Mountain View Village, Inc., 5 F.3d 34, 36 (3d Cir. 1993); Sumy v. Schlossberg, 777 F.2d 921, 922-23 (4th Cir. 1985); Andrews & Kurth v. Family Snacks, Inc. (In re Pro-Snax Distributors, Inc.), 157 F.3d 414, 420 (5th Cir. 1998); Marlow v. Rollins Cotton Co. (In re Julien Co.), 146 F.3d 420, 422 (6th Cir. 1998); In re Rimsat Ltd., 212 F.3d 1039, 1044 (7th Cir. 2000); Lewis v. United States, Farmers Home Administration, 992 F.2d 767, 768, 772 (8th Cir. 1993); Stanley v. S.S. Retail Stores Corp. (In re S.S. Retail Stores Corp.), 162 F.3d 1230, 1232 (9th Cir. 1998); Simons v. FDIC (In re Simons), 908 F.2d 643, 644 (10th Cir. 1990) (per curiam); see also 1 Collier on Bankruptcy ¶ 5.09[2] (rev. 15th ed. 2001).

Although Countrywide asserts that the challenged discovery order is in fact final, this argument is plainly without merit. As the district court explained, discovery orders are by their nature non-final, and appellate review of discovery orders is strongly discouraged. See In re International Horizons, Inc., 689 F.2d 996, 1000-01 (11th Cir. 1982) (holding that "as a general proposition most orders granting or denying discovery are not final orders . . . and therefore are not immediately appealable" (internal quotation omitted)). Countrywide attempts to distinguish the challenged discovery order as "final" in the sense that it involves a "distinct dispute," but the same characterization could be made of any discovery dispute. Were

Countrywide's statement of law correct, even the most minute discovery order would by definition become immediately appealable as of right. As one court has observed, such an outcome "undermines the purpose of the finality rule" by creating "fragmented litigation, which clogs the appellate courts and causes unnecessary delay in the trial courts." Barrick Group, Inc. v. Moss, 849 F.2d 70, 72 (2d Cir. 1982).

The sole exception to the finality rule on which Countrywide now relies is the "collateral order" doctrine, under which an interlocutory order may be reviewed if each of three factors are present:

> (1) [T]he order must be independent and easily separable from the substance of other claims in the action, (2) it must present a need to secure prompt review in order to protect important interests of any party, and (3) it must be examined in the light of practical, rather than narrowly technical, consideration.

In re Tidewater Group, Inc., 734 F.2d 794, 796-97 (11th Cir. 1984).

As the district court properly concluded, Countrywide has failed to demonstrate that each of these elements is present. See District Court Order (R.E. Tab 16) at 6-9. In particular, Countrywide fails to explain why an appeal is necessary to protect the interests of any party. Nothing in the record indicates that any of the documents sought by the United States Trustee are subject to privileges held by third parties. And there is no reason to speculate, as Countrywide does, that the Rule 2004 examination will necessarily terminate all litigation involving Countrywide. Indeed, there have already been two discovery orders against Countrywide in the present case, and the challenged order expressly contemplates that in responding to the United States Trustee's discovery requests, Countrywide may assert additional "objections based upon privilege," "may object on the grounds of undue burden based on a particularized showing, and may seek relief from the [bankruptcy] [c]ourt." See Bankruptcy Court Order (R.E. Tab 12) at 2-3. Moreover, as Countrywide itself notes, the company is currently the subject of several pending investigations and sanctions proceedings arising out of its conduct in bankruptcy cases. See Appellant's Br. at 36-37. In any event, should sanctions or other similar relief prove to be warranted in this case, Countrywide would then have ample opportunity to appeal any adverse orders at the conclusion of the proceeding ordering such relief.

Countrywide asks in the alternative that this Court reverse as an abuse of discretion the district court's denial of Countrywide's motion for leave to file an interlocutory appeal. As already explained, however, a district court order regarding a non-final bankruptcy ruling is not subject to immediate review by the court of appeals because "there is no jurisdictional provision authorizing a court of appeals to hear an appeal from a district court's decision regarding a bankruptcy court's interlocutory order, whether it denies leave to appeal or renders a decision on the merits." In re Kassover, 343 F.3d 91, 94 (2d Cir. 2003); see also In re City of Desert

Hot Springs, 339 F.3d 782, 792 (9th Cir. 2003) (observing that the "exercise of discretion [not to grant leave to appeal under § 158(a)] is not subject to our review"); In re Ford Motor Co., 344 F.3d 648, 653-55 (7th Cir. 2002) (finding, in the analogous context of 28 U.S.C. § 1292(b), that the district court's refusal to grant leave to file an interlocutory appeal is "the end of the matter" and not subject to review by the court of appeals); In re American Colonial Broadcasting Corp., 758 F.2d 794, 801 (1st Cir. 1985) ("The district court's denial of leave to appeal an interlocutory order is itself interlocutory since the effect of the denial is to leave matters in the bankruptcy court in the same unfinished state they were prior to the attempted appeal.").[2]

In any event, the district court was well within its discretion in denying Countrywide's motion to file an interlocutory appeal of the challenged discovery order. Countrywide concedes that in declining to allow the interlocutory appeal, the

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[2] Although Countrywide cites In re Charter Co., 778 F.2d 617 (11th Cir. 1985), for the proposition that a district court's denial of leave to file an interlocutory appeal may be reviewed for abuse of discretion, see Appellant's Br. at 43 n.13, it does not appear from that opinion that the Court was asked to consider whether the denial of leave to file an interlocutory appeal may itself be appealed. Under these circumstances, the disposition of an issue is not controlling in future cases. See Bryant v. Avado Brands, Inc., 187 F.3d 1271, 1280 (11th Cir. 1999) (citing Webster v. Fall, 266 U.S. 507, 511 (1925), for the proposition that "[q]uestions which merely lurk in the record, neither brought to the attention of the court nor ruled upon, are not to be considered as having been so decided as to constitute precedents").

district court properly applied the standards set forth in 28 U.S.C. § 1292(b), which requires that (1) the challenged order involve a question of law; (2) there be a substantial ground for difference of opinion regarding the court's resolution of that question of law; and (3) an immediate appeal of the order may materially advance the ultimate termination of the litigation. See Appellant's Br. at 43; District Court Order (R.E. Tab 16) at 10 (citing McFarlin v. Conseco Servs., LLC, 381 F.3d 1251, 1259 (11th Cir. 2004)).

Countrywide contends that the dispositive issue raised by its appeal is whether the authorized discovery falls within the scope of Rule 2004. Countrywide continues to assert that its "private" business affairs fall outside the scope of Rule 2004 and argues that the requested discovery is not related to this bankruptcy case. See Appellant's Br. at 43-49. Countrywide fails to demonstrate, however, that there is any material difference of opinion among courts as to whether Rule 2004 is available to investigate the filing of possibly false or inaccurate claims by a creditor in a bankruptcy case, and there is no authority suggesting that Countrywide would be likely to prevail on the merits of an appeal. In this case, evidence of Countrywide's internal audits are directly relevant to the issue of whether the possible errors in the Debtors' bankruptcy case form part of a pervasive or systemic pattern of misconduct. That issue, in turn, may be highly relevant to the question of what remedy, if any, should be imposed in the event that the bankruptcy court determines that Countrywide has engaged in misconduct. Consequently, Countrywide cannot demonstrate that its theory on appeal holds sufficient merit to permit an immediate interlocutory appeal. See District Court Order (R.E. Tab 16) at 10-12 (explaining that the discovery issues raised by Countrywide "present no controlling questions of law and are left to the sound discretion of the court that is fully familiar with the entire proceeding — the bankruptcy judge" (internal quotation omitted)).

CONCLUSION

For the foregoing reasons, appellant's motion for reconsideration should be denied.

Respectfully Submitted,

WILLIAM KANTER
(202) 514-5575
TEAL LUTHY MILLER
(202) 514-5048
KELSI BROWN CORKRAN
(202) 514-3159
Attorneys, Appellate Staff
Civil Division, Room 7216
U.S. Department of Justice
950 Pennsylvania Ave., N.W.
Washington, D.C. 20530-0001

CERTIFICATE OF SERVICE

I hereby certify that on this 20th day of February, 2009, I served the foregoing Answer in Opposition to Appellant's Motion for Reconsideration upon counsel for appellant by causing a true copy to be mailed by overnight delivery to:

Marc Gottlieb
Joan Levit
AKERMAN SENTERFIT
Las Olas Centre II, Suite 1600
Fort Lauderdale, FL 33301

Thomas M. Hefferon
GOODWIN PROCTOR LLP
901 New York Avenue, NW
Washington, DC 20001

____
KELSI BROWN CORKRAN

CERTIFICATE OF COMPLIANCE PURSUANT TO RULES 5 AND 32

I certify that, pursuant to Federal Rules of Appellate Procedure 5 and 32, the attached Answer in Opposition to Petition to Appeal is proportionately spaced, in Times New Roman type, has a typeface of 14 points and contains 2569 words.

____
KELSI BROWN CORKRAN

BRIEF BANK — “SUMMARY SHEET”

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WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	In re Jose and Fanny Sanchez (Donald F. Walton, United States Trustee for Region 21 v. Countrywide Home Loans, Inc.)
2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	S. D. Fla.
3. ("CCN") ***CURRENT*** CASE NO.	No.: 08-cv-23337-ASG
4. ("PCN") ***PRIOR*** CASE NO. - & COURT *[IF ANY]*	No.: 1:01-bk-42230; 08-01176-AJC Court: Bankr. S.D. Fla. *(Identify judge & cite, if any)*
5. ("SO") ***SOURCE***	**U.S. TRUSTEES**
6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	Filed: June 26, 2009 Type: United States Trust’s Response to Motion of Countrywide Home Loans, Inc. for Reconsideration of Order Reversing and Remanding Bankruptcy Court Order [Dkt. 27]
7. **("AU")** ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*	Zana M. Scarlett, Donald F. Walton *(UST/OGC: 202-307-1399/FAX-2397)*
8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	• Whether the appellee’s request for reconsideration meets the exacting standards for relief under Rule 40 and, accordingly, Bankruptcy Rule 8015.
10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)	
11. DO YOU RECOMMEND POSTING IN UST BRIEFBANK?	☒ YES ☐ NO ***NAME:*** Linda Figueroa ***DATE:***

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF FLORIDA
MIAMI DIVISION

CASE NO.: 08-CV-23337-ASG

DONALD F. WALTON,
United States Trustee for Region 21,

Appellant.

vs.

COUNTRYWIDE HOME LOANS, INC.,

Appellee.
______________________________/

UNITED STATES TRUSTEE'S RESPONSE TO MOTION OF COUNTRYWIDE HOME LOANS, INC FOR RECONSIDERATION OF ORDER REVERSING AND REMANDING BANKRUPTCY COURT ORDER [Dkt. 27]

Appellant, Donald F. Walton, the United States Trustee for Region 21 (the "United States Trustee"), by and through his duly authorized counsel, hereby responds to the motion of Countrywide Home Loans, Inc. ("Countrywide") for reconsideration of the Court's order dated June 9, 2009, which reversed and remanded an order of the United States Bankruptcy Court for the Southern District of Florida dismissing the United States Trustee's adversary complaint against Countrywide. In support of this Response, the United States Trustee states as follows:

Countrywide's motion does not suggest it has been denied the opportunity to vigorously present its legal theories to this Court. Nor does Countrywide identify any newly discovered evidence supportive of its position. It does not suggest that there were are any questions on appeal for which this Court inadvertently failed to issue a ruling. Rather, the sole basis for Countrywide's motion appears to be Countrywide's belief that this Court's order is wrongly decided.

Countrywide had a full and fair opportunity to make its arguments to this Court before that order was entered. Countrywide filed two briefs and three other substantive pleadings, not counting the present motion for reconsideration.[1] Countryside's motion should be denied because it says nothing new.

As the Eleventh Circuit has repeatedly cautioned, a motion for reconsideration may not be used as a vehicle to relitigate issues already decided, or to raise new arguments that could have been (but were not) raised before judgment, as Countrywide does here. *Mincey v. Head*, 206 F.3d 1106, 1137 (11th Cir. 2000). Therefore, regardless whether this Court evaluates Countrywide's motion under Fed. R. Bankr. P. 8015, which is applicable here, or under Fed. R. Civ. P. 59, on which Countrywide incorrectly relies, there is no basis for the relief Countrywide seeks.

1. Because Countrywide has not alleged that the Court overlooked any pertinent fact or issue on appeal, it has not met the standard for reconsideration relief under Fed. R. Bankr. P. 8015 and Fed. R. App. P. 40.

When a district court exercises appellate jurisdiction over a bankruptcy court decision, motions for reconsideration are governed by Fed. R. Bankr. P. 8015. Although the Eleventh Circuit has yet to address the issue, other circuits have construed Bankruptcy Rule 8015 as incorporating the standards of Fed. R. App. P. 40, from which much of the text of the rule is borrowed. *See United States v. Fowler (In re Fowler)*, 394 F.3d 1208, 1215 (9th Cir. 2005)

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[1] Although Countrywide is the appellee in this appeal, having obtained full relief from the bankruptcy court, it nonetheless filed a purported "cross-appeal" that allowed it to file an additional brief in the case (Dkt. 14). In addition, prior to judgment in this appeal, Countrywide also filed a pleading in support of its alleged cross-appeal (Dkt. 11) and two substantive memoranda in reply to notices of supplemental authority filed by the United States Trustee (Dkts. 19, 25)

(looking to Appellate Rule 40 for "guidance" in construing Bankruptcy Rule 8015); *BCorp-HRT, LLC v. Lobb (In re Lobb)*, 66 Fed. Appx. 164, 167 (10th Cir. 2003) (holding that because Bankruptcy Rule 8015 is silent on standards for reconsideration, court would look to standards under parallel appellate rule).

Under Rule 40, reconsideration relief is available in just two narrow circumstances. In order to obtain relief, the movant must state with particularity and establish that the appellate court either misconstrued a fact in the record, or that it overlooked or failed to consider one of the arguments on appeal. *Easley v. Reuss*, 532 F.3d 592, 593 (7th Cir. 2008) (holding that Rule 40 motion "should alert the panel to factual or legal matters that the panel may have failed to address or may have misunderstood"); *United States v. Wiles*, 106 F.3d 1516, 1517 (10th Cir. 1997) (same); *see also Hitchcock v. Wright*, 777 F.2d 628, 629 (11th Cir. 1985) (Johnson, J., dissenting) (noting that the "focus of the petition for rehearing is . . . to enable the court to correct its mistakes"). Rule 40 does not, however, allow parties to relitigate issues that were already decided, nor does it permit a losing party to introduce new arguments in support of its position. *Easley*, 532 F.3d at 593 (noting that court "cannot have 'overlooked or misapprehended' an issue that was not presented to it").

Countrywide's request for reconsideration does not meet the exacting standards for relief under Rule 40 and, accordingly, Bankruptcy Rule 8015. Countrywide does not allege that there are any relevant facts that this Court ignored, and while it disagrees with this Court's conclusions, it cannot point to any argument on appeal that this Court neglected to address. Instead, Countrywide seeks to relitigate the Court's decision based on the same factual record and arguments that have already been considered. Such relief is not authorized by Rule 40. *See*

Wiles, 106 F.3d at 1517 (holding that a motion for rehearing "should be more than a restatement of arguments originally presented on appeal and a petition based on such is 'without merit.'") (internal citation omitted).

2. <u>Alternatively, Countrywide has not alleged any basis for relief under Fed. R. Civ. P. 59(e)</u>

Even if Countrywide's motion was properly framed as a request for relief under Fed. R. Civ. P. 59(e), the result is no different. As the Eleventh Circuit has long recognized, the mere fact that a party disagrees with a court's ruling is an insufficient basis for seeking reconsideration under Rule 59(e): "The function of a [Rule 59(e) motion] is not to serve as a vehicle to relitigate old matters or present the case under a new legal theory . . . [or] to give the moving party another 'bite at the apple' by permitting the arguing of issues and procedures that could and should have been raised prior to judgment." *Mincey v. Head*, 206 F.3d 1106, 1137 (11th Cir. 2000) (internal citation omitted).

In particular, under Eleventh Circuit law, "[t]he only grounds for granting [a motion for reconsideration] are newly-discovered evidence or manifest errors of law or fact." *Kellogg v. Schreiber (In re Kellogg)*, 197 F.3d 1116, 1119 (11th Cir. 1999). Countrywide does not meet this high standard. In this case, Countrywide does not identify any binding precedent that the Court failed to apply, nor is it able to cite a single factually apposite decision from any jurisdiction supportive of its arguments. Rather, Countrywide's motion simply asserts that this Court's ruling was wrongly decided. Without more, however, the fact that Countrywide disagrees with this Court does not warrant reconsideration. *See Michael Linet, Inc. v. Village of Wellington*, 408 F.3d 757, 763 (11th Cir. 2005) (noting that Rule 59(e) motion cannot be used to "relitigate old matters").

Conversely, to the extent the arguments raised in Countrywide's latest motion are construed as being somehow distinct from the arguments this Court has already considered and rejected, Countrywide's motion is improper because a Rule 59(e) motion cannot be used to introduce new theories. *See Wilchombe v. Teeve Toons, Inc.*, 555 F.3d 949, 957 (11th Cir. 2005) (holding that motion for reconsideration cannot be used to raise arguments that could have been raised prior to judgment); *Michael Linet*, 408 F.3d at 763 (same). As a result, regardless of how this Court construes Countrywide's motion, Countrywide is not entitled to relief.

3. Countrywide fails to demonstrate that this Court's order was wrongly decided.

Even if the merits of Countrywide's arguments were before this Court, Countrywide has not demonstrated that the Court erred by reversing the bankruptcy court. To the contrary, the Eleventh Circuit just issued a decision that both reinforces this Court's major holdings and forecloses a number of the principal theories relied on by Countrywide. *See Ginsberg v. Evergreen Security, Ltd. (In re Evergreen Security, Ltd.)*, Case No. 08-14064, 2009 WL 1622386 (11th Cir. June 11, 2009). In *Evergreen*, the Eleventh Circuit affirmed a bankruptcy court order, entered pursuant to section 105(a) of the Bankruptcy Code and the bankruptcy court's inherent authority, that imposed, among other sanctions, an injunction against an attorney in order to deter future misconduct. *Evergreen* conclusively resolves several of the key issues litigated in this case, including the power of the bankruptcy court to issue sanctions under section 105(a) and its inherent powers, the availability of injunctive sanctions to redress litigation misconduct, and the jurisdiction of bankruptcy judges to impose sanctions. On each of these issues, the Eleventh Circuit's decision is fully in accord with the Court's ruling in the present case.

Countrywide relegates *Evergreen* to a footnote, and attempts to distinguish that decision by arguing that the Eleventh Circuit only discussed sanctions that are “civil” and “coercive.” Motion at 4 n.4. But the misconduct alleged and the sanctions sought in the present case are indistinguishable from the misconduct and sanctions in *Evergreen*. Both cases involve litigation misconduct in the form of the filing of baseless, frivolous pleadings, and the remedy sought here by the United States Trustee, like the remedy affirmed in *Evergreen*, is for appropriate monetary and equitable sanctions sufficient to deter a repetition of such conduct in the future.

Evergreen makes clear that bankruptcy courts within this circuit possess jurisdiction and power to control parties, like Countrywide, either through monetary and injunctive relief. That is all the United States seeks in this case. The United States Trustee’s complaint simply asks the bankruptcy court to exercise its discretion to use its section 105(a) and inherent powers to ensure Countrywide stops filing improper pleadings and stops seeking improper relief. The complaint demands nothing; it simply identifies misconduct and asks the court below to determine whether that court wishes to use its power to remedy it.[2]

Countrywide’s additional arguments, even if they were properly before this Court, are equally unpersuasive. In particular, in what appears to be a new argument, Countrywide argues that the United States Trustee’s powers should be narrowly limited, relying on cases construing the statutory powers of agencies such as the EPA, the FCC, and the FDIC. Countrywide provides no explanation, however, for why the litigation authority of the Department of Justice would necessarily be the same as that of an independent agency such as the EPA, the FDIC, or the FCC.

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[2] *Evergreen* reaffirms that the United States Trustee’s request for monetary and injunctive relief is civil in nature, and is further reason to reverse the bankruptcy court’s decision in this case.

Section 307 underscores why Countrywide's argument is wrong. Section 307 is broadly written – United States Trustees can raise any issue. It is broad because bankruptcy cases present a myriad of issues and United States Trustees exist to ferret out misconduct relating to all of them. Certainly, none of the agencies whose statutes Countrywide mentions possess a general statutory authorization to appear and be heard that is as broad as section 307, and Countrywide fails to provide any relevant authority supporting its claim that section 307 should not be applied according to its plain terms.

If Congress had wanted United States Trustees to act under a narrower statute, one that limited them to bringing only certain prescribed causes of action, Congress might have modeled it upon the statutes Countrywide mentions in its motion. It speaks volumes that Congress did the opposite. It drafted a broad statute. And a broad statute was needed. Bankruptcy cases are unlike other civil litigation. They are comprised of various discrete substantive proceedings, including contested matters brought by motion or application and adversary proceedings commenced by complaint. They involve numerous constituents, including debtors, creditors, professionals, bankruptcy petition preparers, co-conspirators, and others. To combat all the various forms of misconduct that can arise in bankruptcy cases, it was necessary and appropriate for Congress to give United States Trustees broader statutory authority – authority as broad as the misconduct that occurs in bankruptcy cases. Thus, there are good reasons why section 307 is not like the statutes Countrywide mentions, and is not limited to combating only a narrow category of misconduct.

Countrywide's remaining arguments appear to be virtually identical to arguments that it has raised in its numerous previous briefs, and the United States Trustee submits that no further discussion of such arguments is necessary.

Wherefore, the United States Trustee requests that the Court deny the relief requested by Countrywide.

DATED: June 26, 2009.

Respectfully submitted,

Donald F. Walton
United States Trustee
Region 21

/s/ Zana Scarlett
Zana M. Scarlett, Trial Attorney
Florida Bar No.: 626031
U.S. Trustee's Office
51 SW 1st Ave.
Miami, FL 33130
Phone: (305) 536-7285
Fax: (305) 536-7360
Zana.M.Scarlett@usdoj.gov

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the foregoing has been served on the following parties on June 26, 2009, electronically through CM/ECF, on parties having appeared electronically in the instant matter and that a copy hereof shall be served by U.S. Mail, postage prepaid, on parties not appearing electronically:

Joan Levit, Esq.** Thomas A. Connop, Esq.** James A. Pardo, Jr.

**Parties that have appeared electronically.

/s/ Zana Scarlett
Zana M. Scarlett, Trial Attorney

BRIEF BANK — "SUMMARY SHEET" *Printed Tue-11/17/09 17:7*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	In re Marlynn Renee O'Neal (Daniel M. McDermott, United States Trustee for Region 9)
2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	N.D. Ohio
3. ("CCN") ***CURRENT*** CASE NO.	No.: 5:09-cv-2106
4. ("PCN") ***PRIOR*** CASE NO. - & COURT *[IF ANY]*	No.: 07-51027 Court: Bankr. N.D. Ohio *(Identify judge & cite, if any)*
5. ("SO") ***SOURCE***	**U.S. TRUSTEES**
6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	Filed: November 12, 2009 Type: Appellee Brief for the United States Trustee
7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*	Dean Wyman, Catherine Sevcenko, Noah M. Schottenstein, P. Matthew Sutko, Ramona Elliott, Daniel M. McDermott *(UST/OGC: 202-307-1399/FAX-2397)*
8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	• Does section 105(a) allow a bankruptcy court to prevent abuse by requiring a creditor to submit a summary with its proofs of claim in order to improve communication with local counsel and prevent it from continuing to submit inaccurate filings that increase the burden on debtor and the bankruptcy court system?
10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)	
11. DO YOU RECOMMEND POSTING IN UST BRIEFBANK?	| x | YES | | NO ***NAME:*** Linda Figueroa ***DATE:***

ATTACHMENT B

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

IN RE : } CHAPTER 13
}
MARLYNN RENEE O'NEAL, } CASE NO. 07-51027
}
Debtor. } ADVERSARY NO. 08-5031

……………………………………………………………………………………

DANIEL M. MCDERMOTT, }
United States Trustee for Region 9 }
}
Plaintiff/Appellee } NO. 5:09-cv-2106
}
v. }
} Judge: Sara Lioi
COUNTRYWIDE HOME LOANS, INC., }
}
Defendant/Appellant }

On Appeal from the United States Bankruptcy Court
for the Northern District of Ohio
The Honorable Marilyn Shea-Stonum
APPELLEE BRIEF FOR THE UNITED STATES TRUSTEE

Of Counsel:

RAMONA D. ELLIOTT
General Counsel
P. MATTHEW SUTKO
Associate General Counsel
CATHERINE SEVCENKO
NOAH M. SCHOTTENSTEIN
Trial Attorneys
United States Department of Justice
20 Massachusetts Ave, N.W.,
Suite 8000
Washington, D.C. 20530
Telephone: (202) 305-2757
Facsimile: (202) 307-2397

DANIEL M. MCDERMOTT
United States Trustee for Region 9

DEAN WYMAN #0007848
Senior Trial Attorney
Office of the United States Trustee
Suite 441
H.M. Metzenbaum U.S. Courthouse
201 Superior Avenue, East
Cleveland, Ohio 44114
216-522-7800, ext. 231
216-522-7193
Dean.P.Wyman@usdoj.gov

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INTRODUCTION

Countrywide regularly files bankruptcy proofs of claim and other pleadings in Judge Shea-Stonum's courtroom. The record in this case establishes that Countrywide's automated computer system and minimally-trained employees prevented Countrywide from filing accurate pleadings and prevented Countrywide from correcting errors brought to its attention. As Ms. O'Neal did in her case. Six times. Without success.

The law does not allow any entity to file incorrect papers in federal court, something Countrywide did twice in Ms. O'Neal's case and has done, as we explain below, in other cases as well. To the contrary, courts, including this Court, routinely protect themselves from vexatious litigants. Relying upon the plain language of a federal statute, 11 U.S.C. § 105(a), and on Federal Rule of Bankruptcy Procedure 9011, the court below took analogous action. It found that Countrywide's system is not up to the task of filing accurate information. That finding is not clearly erroneous, so this Court should affirm it.

Based on the evidence before it, the court has required Countrywide to share a summary worksheet ("Summary") so the court, debtors, other creditors and the United States no longer need to plow through entire bankruptcy files to verify pleadings that Countrywide files with the court as proper claims - but that too often are not. Accurate self reporting is the lifeblood of bankruptcy. When counsel, acting on client information, submit inaccurate bankruptcy court filings, the system breaks down. As it did here.

Section 105(a) gives bankruptcy courts express power, power drawn directly from the statute's text, to "prevent" that kind of an "abuse." 11 U.S.C. 105(a). Given its findings, the court below used its congressionally-bestowed statutory power to make a measured response.

There was nothing daring about that. Even absent a statute such as section 105, courts routinely take the analogous step of prohibiting vexatious litigants from filing pleadings. They also require pre-filing approval. Judge Shea-Stonum's remedy is far more modest than either of the remedies courts impose on vexatious litigants. The court merely required Countrywide to do two things. Countrywide must satisfy itself that it has engaged in what it deems to be appropriate due diligence before filing documents with the court that it represents to be correct. Then it must share a Summary that memorializes its due diligence review so others can spot check it. That costs Countrywide $9,000 a year. Money well spent to avoid having bankruptcy courts and others force it to correct avoidable errors.

There is absolutely nothing novel about requiring Countrywide to file a Summary. To the contrary, the Official Proof of Claim Form itself recognizes creditors may need to "attach a summary" to document their claims, or a second summary to document their secured status. Fed. R. Bankr. P. Official Form 10, ¶ 7. Because the evidence here led the court to find Countrywide cannot be confident about the accuracy of its proofs of claim, Countrywide must use the summary option - an option contemplated by the Official Form - until it addresses its claims filing problems and fixes them. Ironically, drafting either of the optional summaries authorized by Form 10 should have caused Countrywide to notice that its O'Neal proof of claim was wrong. Presumably, the lower court's mandated Summary will protect Countrywide in a similar fashion.

The court's response is even more measured because it is temporary. At any time, Countrywide can ask the court below to lift, or modify, these modest requirements simply by demonstrating it has mastered its own court filing system. It has the right to make constructive suggestions. It fact, the bankruptcy court practically begged it to do so. That offer presumably still stands. When Countrywide can satisfy the court below that its system has been reformed to fix errors effectively and quickly, it can move the bankruptcy court to lift its order. If the court refuses, Countrywide can appeal.

The court's response is also geographically restrained. Judge Shea-Stonum is protecting only her courtroom from Countrywide's inaccurate filings.

In the United States' view, the bankruptcy court used its powers under section 105(a) and Rule 9011 to create a Summary that will compel Countrywide to do the minimum – ensure the accuracy of its filings. In fact, the United States argued the bankruptcy court appropriately could have done more. Should this Court determine that a broader remedy is appropriate, it should remand the case so the court below can expand its remedy. But the lower court's remedy will ensure that Countrywide does the minimum anyone would expect. It should be affirmed.

COUNTER-STATEMENT OF THE ISSUES

1. Does section 105(a) allow a bankruptcy court to prevent abuse by requiring a creditor like Countrywide to submit a Summary with its proofs of claim in order to improve communication with local counsel and prevent it from continuing to submit inaccurate filings that increase the burden on debtors and the bankruptcy court system?

2. If so, did the bankruptcy court abuse its discretion in finding that the record demonstrated systematic weakness in Countrywide's handling of borrowers in bankruptcy that required remedial relief?

COUNTER-STATEMENT OF THE CASE

The United States filed a complaint against Countrywide alleging it mishandled the bankruptcy case of Marlynn O'Neal. Countrywide conceded at trial that it had filed two pleadings, a proof of claim and objection to Ms. O'Neal's chapter 13 plan, without justification. It based its defense on the contention that Ms. O'Neal's case was an isolated incident that would not recur, assertions the bankruptcy court rejected. After a careful review of the record, the bankruptcy court imposed a modest remedy, namely the requirement that Countrywide provide a Summary with its pending and future proofs of claim to facilitate review by debtors and the court. Countrywide requested that the bankruptcy court stay its order pending appeal, which, after briefing and hearing, the bankruptcy court denied. Before the bankruptcy court even ruled, however, Countrywide filed an "emergency motion" for a stay in the district court and again requested a stay. *Countrywide Home Loans, Inc. v. McDermott*, No. 5:09MC82, 2009 WL 3259131 at * 4, n.4 (N.D. Ohio Oct. 7, 2009) ("District Court Stay Op."). After an initial denial of the stay, this Court granted the stay pending review of the merits of Countrywide's appeal of the bankruptcy court's remedial relief. *Id.* at *5.

A. Factual Background

The first section of Countrywide's statement of facts is irrelevant to this case. Ms. O'Neal was apparently the victim of a mortgage foreclosure rescue scam, as outlined in Countrywide's statement of facts. Countrywide Br. at 3-4. The bankruptcy court, however, fundamentally rejected Countrywide's "blame the victim" defense. *McDermott v. Countrywide Home Loans, Inc.*, No. 08-5031, slip op. at 22 (N.D. Ohio May 1, 2009) ("Liability Op.") (stating no evidence in the record exists to support "that Ms. O'Neal was other than a victim of a predator whose business operations are enabled by and depend upon a mortgage servicing industry that is unconcerned with the accuracy of records and information"); Trial Tr. 300:14-301:25 (Apr. 24, 2009).

The bankruptcy court found that Countrywide's system is "reckless" and "designed to allow each actor in the process to act with indifference to the truth, and to rely solely on limited information made available at each step." Liability Op. at 21. The relevant facts relating to Ms. O'Neal's attempts to get her loan closed after Countrywide accepted a short sale of her property as payment in full support this conclusion.

1. Countrywide's failed efforts from October 2005 to February 2007 to code Ms. O'Neal's account as inactive

This is a case about what happened to Marlynn O'Neal after she became unable to make her mortgage payments and was forced to sell her home on Ira Avenue in Akron, Ohio. The bankruptcy court found, and the record supports, the following facts concerning Ms. O'Neal's mortgage and attempts to get her loan closed between September 2005, when Countrywide accepted a short sale of her property in full satisfaction of her mortgage, and April 2007, when she filed for bankruptcy. Liability Op. at 5 (finding of fact #14).[1]

After the sale of Ms. O'Neal's house was completed, Countrywide began the process of updating her account in October 2005 to reflect the sale and the cancellation of her indebtedness. Kevin Kilker, a Loan Administrator, sent an e-mail to his colleagues stating that "[w]e have received funds in the amount of $13,000" in satisfaction of Ms. O'Neal's mortgage. E-mail from K. Kilker (Oct. 28, 2005) (UST Ex. 16). The e-mail requested that the foreclosure process be

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[1] A short sale occurs when the mortgage company accepts a pay-off for property that is less than the existing balance on the mortgage and cancels the associated debt. *See United States v. Randall*, 157 F.3d 328, 330 n.3 (5th Cir. 1998).

stopped, Ms. O'Neal's credit report be updated, and that a reconveyance on the short sale be issued. *Id.*[2] Finally, the e-mail requested that "lockout code 3" be placed on the account, an indication that the property has been foreclosed upon or conveyed to a third party. Trial Tr. 81:3-18 (Apr. 24, 2009). Countrywide did not indicate on the note that it had been paid in full. Liability Op. at 9 (finding of fact #27). Updating the account to reflect the short sale required action by at least five people. E-mail from K. Kilker (Oct. 28, 2005) (UST Ex. 16).

In spite of the internal e-mail notification of the sale and satisfaction of the loan, the bankruptcy court found that "Ms. O'Neal's loan account was not properly coded to indicate within Countrywide's records that the loan was inactive." Liability Op. at 9 (finding of fact #29). Mr. Smith, Countrywide's Executive Vice President, admitted at trial that several Countrywide employees had recognized the error, which was memorialized in Countrywide's computer system. Trial Tr. 75:9-21 (Apr. 24, 2009). The bankruptcy court's findings of fact chronicle Ms. O'Neal's seven-month series of calls to Countrywide to get this mistake corrected.

Because her account was still open, Ms. O'Neal continued to receive billing statements from Countrywide. Trial Tr. 72:1-73:16 (Apr. 24, 2009). Starting in April 2006, six months after the short sale was completed and her loan cancelled, Ms. O'Neal began calling Countrywide to correct her account. From April 2006 until December 2006, Ms. O'Neal telephoned Countrywide at least six times to correct her account information to show payment in full so that Countrywide would stop sending her demands for payment. Liability Op. at 10 (finding of fact #31; *see generally* Trial Tr. 55-75. The bankruptcy court relied on the e-mails and notations in

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[2] A reconveyance releases Countrywide's lien on the property. Trial Tr. 41:8-13 (Apr. 24, 2009).

Ms. O'Neal's files related to these calls in making its determination of recklessness. *See* Liability Op. at 10-13 (findings of fact #32-43).

Initially the Countrywide employees recording Ms. O'Neal's calls acknowledged that the loan had been satisfied. April 24, 2006 comment entry into Countrywide's computer system by S. Cooper (UST Ex. 17) (stating "[l]oan notes showed we recvd funds for approved SPO but loan is still opened on the books"). Employees also acknowledged that the situation required corrective action on their part. E-mail from S. Cooper to P. Elizalde & K. Bradley (UST Ex. 18) (requesting assistance to correct account to reflect short sale); e-mail from K. Bradley to K. Kilker (UST Ex. 19) (same); e-mail from K. Kilker to S. Galvan (UST Ex. 20) (same). The e-mail chain requesting guidance on how to fix Ms. O'Neal's account ends four days later when Kristin Bradley, a Final Claims Analyst, noted that she had reviewed Ms. O'Neal's file and that "fees due still pending. will f/u [follow-up]." Comment entry into Countrywide's computer system (UST Ex. 22). That follow-up never happened.

Four months later, Countrywide fundamentally and incorrectly shifted its position to assert that it had never received the funds from the sale of Ms. O'Neal's home and therefore could not close her account. Comment entry into Countrywide's computer system by P. Jones (UST Ex. 23). For reasons not explained in the record, the Countrywide employee to whom Ms. O'Neal spoke could not find verification in the Countrywide computer system that Ms. O'Neal's loan had been satisfied. Ms. Jones noted that '[a]t this time, chl [Countrywide Home Loans] does not show funds received for the payoff." *Id.*; Liability Op. at 11 (findings of fact #36). Ms. Jones instructed Ms. O'Neal to get documentation from the title company that handled the sale to prove her contention that the loan had been paid. *Id.*

On September 9, 2006, Ms. O'Neal contacted Countrywide to say she was sending "paperwork" to resolve the issue. Comment entry into Countrywide's computer system by J. Silva (UST Exhibit 24). Six weeks later, and over a year after she sold her property, Ms. O'Neal called Countrywide and was informed that Countrywide's computer still did not show that the pay-off had been received. Comment entry into Countrywide's computer system by C. Ford on November 12, 2006 (UST Ex. 25); Liability Op. at 11 (findings of fact #38). Countrywide also informed her that the situation was affecting her credit. *Id.* Two days later, Ms. O'Neal called again; Ms. Porshi Jones informed her there had been no word from the title company and thus no change in the account status. Comment entry into Countrywide's computer system by P. Jones (UST Ex. 26).

Ms. O'Neal spoke with Ms. Jones again on December 6, 2006 stating that she was sending proof of the bank wire that had been sent to Countrywide. For the first time since Ms. O'Neal began contacting Countrywide seven months earlier, Ms. Jones, who had first spoken with Ms. O'Neal on August 29, 2006, decided to seek further information by sending a "lotus note to S. Galvan to get a status update." Comment entry into Countrywide's computer system by P. Jones (UST Ex. 27).

Ms. Galvan, a Workout Team Leader, forwarded the query to Kristin Bradley, the Final Claims Analyst who was supposed to follow-up on Ms. O'Neal's first inquiry seven months earlier. Ms. Bradley responded "I updated everything to reflect as a short sale, I'm just waiting for investor reimbursement for supplemental fees. Hopefully it will be fully closed out by the end of the year." E-mail from K. Bradley to S. Galvan, with cc: to P. Jones (Dec. 11, 2006) (UST Ex. 28-1). Ms. Jones called Ms. O'Neal that day to inform her that the short sale was in fact completed in October 2005, but that a pending investor reimbursement was preventing Ms. O’Neal’s account from being closed, and that the issue should be resolved by the end of the year. Comment entry into Countrywide’s computer system by P. Jones (Dec. 11, 2006) (UST Exhibit 29). Ms. Jones also promised to correct Ms. O’Neal’s credit report but was unsuccessful. *Id.* (“System shows not reported. will no change status.”).

At trial, Countrywide Vice President John Smith testified that the reconveyance that would release the lien and close Ms. O’Neal’s account did not occur in October 2005 because it “was not requested at that time [by Countrywide employees]. That wouldn’t be part of the procedure at this time.” Trial Tr. 41:20-42:24 (Apr. 24, 2009). Ms. O’Neal’s loan was part of a pooling and servicing agreement between Park Place Securities, Countrywide, and Wells Fargo Bank. Trial Tr. 80:21-81:2 (Apr. 24, 2009). In fact, Countrywide’s protocol for processing loans mandated that Ms. O’Neal’s account improperly be kept open until the claims process with the investor – a final division of the proceeds of the sale – was completed. Trial Tr. 80:3-80:20 (Apr. 24, 2009). On February 8, 2007, Ms. O'Neal's loan was reviewed by a Countrywide representative who noted “suppl funds still pending.” Comment entry into Countrywide’s computer system by W. Sharf (UST Ex. 30). No one told Ms. O’Neal this until a year after she sold her home.

Based on the evidence, the bankruptcy court concluded: “Notwithstanding these repeated inquiries, Countrywide did not properly correct its records to show that Countrywide had accepted the $13,000 payment being attributed to Wells Fargo [the investor in Ms. O’Neal’s loan].” Liability Op. at 13 (finding of fact #44).

2. Countrywide's participation in Ms. O'Neal's bankruptcy case

On April 11, 2007, Ms. O'Neal filed a chapter 13 bankruptcy petition. (UST Ex. 7-1) She appropriately did not schedule Countrywide Home Loans as a creditor. Liability Op. at 13-14 (finding of fact #48) (UST Ex. 7-14 to 7-24). Because Countrywide had not yet resolved her account with the investor, 19 months after it accepted a short-sale of her home in full satisfaction of her debt, her account was still listed as active which meant Countrywide treated her as still owing on the satisfied debt. Therefore, when Countrywide was notified that Ms. O'Neal had filed for bankruptcy, her account was sent to a bankruptcy technician for processing. Countrywide Br. at 4; Liability Op. at 13-14 (finding of fact #49). Ms. O'Neal's account was marked with "lock-out code 3." Countrywide Vice President John Smith testified that lockout code 3 was designed to prevent the automatic set-up of a bankruptcy case. Trial Tr. 81:19-82:8 (Apr. 24, 2009). He also admitted that the technician who reviewed Ms. O'Neal's case did not correctly interpret this lockout code and referred Ms. O'Neal's case to outside bankruptcy counsel in error. Trial Tr. 82:9-14 (Apr. 24, 2009). Mr. Smith stated he did not know how the error happened. Trial Tr. 31:7-18 (Apr. 24, 2009). The bankruptcy court found that the technician's failure to refer the case to management for further review "seems consistent with Countrywide's inability to correctly follow its internal operating procedures with respect to Ms. O'Neal's loan account . . . ." Liability Op. at 14, n.3

Countrywide assigned Ms. O'Neal's case to the local law firm when the bankruptcy technician sent an e-mail to counsel. Liability Op. at 13 (findings of fact #49-50); Trial Tr. 32:17-33:12; 34:7-9 (Apr. 24, 2009). That firm was never able to learn from Countrywide that Ms. O'Neal owed nothing, which led it to file an inappropriate claim. Ms. O'Neal's bankruptcy was handled according to protocol. The bankruptcy technician entered the data needed to complete a proof of claim and objection and posted it to a website that local counsel then downloaded. Trial Tr. 77:5-22; 100:25-101:21 (Apr. 24, 2009); Trial Tr. 415:4-6 (May 11, 2009) (counsel gets what technician sees). The bankruptcy court found that supporting documentation is posted to the website through an automated system. Liability Op. at 14 (finding of fact #50); Trial Tr. 33:13-34:3;34:10-12 (Apr. 24, 2009). Following procedures, no one pulled land records to confirm mortgage holder of record. *See* Liability Op. at 14-15 (finding of fact #49). Trial Tr. 418:8-419:8 (May 11, 2009). The system did not allow local counsel access to the loan history. Liability Op. at 14-15 (finding of fact #51). Trial Tr. 34:17-23 (Apr. 24, 2009).

On May 1, 2007, Countrywide Home Loans, Inc. filed a proof of claim, No. 4-1, on behalf of Wells Fargo Bank, N.A. in which it asserted that Ms. O'Neal was indebted to Countrywide in the amount of $88,859.06 by reason of a note and mortgage on Ms. O’Neal’s former home. Liability Op. at 15 (findings of fact #52-53). The proof of claim attached a copy of the note and mortgage but no evidence of an assignment to Countrywide, or the investor Wells Fargo, from the original mortgage-holder, Ameriquest. Liability Op. at 16 (findings of fact #55-57). The claim treated the note as outstanding, the opposite of the truth. The same day, Countrywide Home Loans Inc. also filed an objection to confirmation of Ms. O'Neal's chapter 13 repayment plan on the grounds that she had not made provision for re-payment of the mortgage that they claimed she still owed. Liability Op. at 16 (finding of fact #58).

Ms. O'Neal’s attorney immediately filed a response with documentation demonstrating that her house had been sold and that Countrywide had accepted a $13,000 short sale in satisfaction of the loan. Liability Op. at 16 (finding of fact #59). Instead of immediately correcting its error, Countrywide waited until the bankruptcy court sustained Ms. O'Neal's objection to its Proof of Claim on June 6, 2007. Liability Op. at 17 (finding of fact #60). Only the day before the scheduled hearing, did Countrywide “voluntarily” withdraw its objection to confirmation, prompting the bankruptcy court to cancel the hearing. *In re O’Neal*, No. 07-51027 (N.D. Ohio, filed Apr. 11, 2007) [Dkt. #28].

Countrywide’s handling of Ms. O’Neal’s case prompted the United States Trustee to file a complaint asking the court to enjoin Countrywide under its powers under 11 U.S.C. § 105 from engaging in abusive practices related to its preparation, verification, filing, and prosecution of proofs of claims and other filings in bankruptcy cases. The bankruptcy court held trial on April 24, 2009 and found Countrywide liable because the “cumulative impact of each of the errors in this case rises to the level of sanctionable conduct in this case.” Liability Op. at 21. The bankruptcy court held a hearing on sanctions on May 11-12 and on July 31 issued its remedies opinion requiring that Countrywide attach a Summary to each of its proofs of claim to verify the information provided. *McDermott v. Countrywide*, No. 08-5031, slip op. at 9-10 (N.D. Ohio July 31, 2009) (“Remedy Op.”). This appeal then followed.

During the pendency of this appeal and the litigation related to whether the bankruptcy court’s order should be stayed, Countrywide violated the order three times by submitting proofs of claim in Judge Shea-Stonum’s courtroom without the required Summary attached.

STANDARD OF REVIEW

The bankruptcy court's findings of fact are reviewed for clear error and its conclusions of law are reviewed *de novo*. *Hance v. Norfolk Southern Ry. Co.*, 571 F. 3d 511, 517 (6th Cir. 2009).

SUMMARY OF THE ARGUMENT

Countrywide concedes that its employees make mistakes. The evidence in this case shows that Countrywide's system commits errors and then compounds them repeatedly. Countrywide routinely relies on others to correct its mistakes, first and foremost the judicial system. Trial Tr. 304:6-9 (Apr. 24, 2009). Some debtors may have the financial wherewithal to fight Countrywide in court or occasionally a bankruptcy lawyer might get fed up enough to bring a frustrating case to the bankruptcy court's attention – as happened in this case – but Countrywide's system hurts many people. Debtors who do not have the resources to defend themselves in court can end up paying what they do not owe; over-burdened bankruptcy courts must sort out problems that never should have reached their courtrooms; chapter 13 trustees cannot close cases because of unwarranted plan objections; resolution of substantive disputes between creditors and debtors are delayed. Countrywide has no right to file wrong claims against any of the approximately 140,000 borrowers it has in bankruptcy.

Countrywide would limit the recourse that bankruptcy judges have to deal with erroneous filings in their courtrooms. Of course, Rule 9011 is designed to deal with such situations. Countrywide is incorrect, however, when it argues that 11 U.S.C. § 105(a) is not an alternate basis upon which a bankruptcy court can act. That position is wrong because it violates the plain language of title 11 of the United States Code.

The legal issue in this case is simple: can a bankruptcy court exercise its powers under 11 U.S.C. §105 to "prevent" an "abuse of process" – namely Countrywide's apparent inability to submit accurate filings to the court. The plain language of the statute says yes.

Once the bankruptcy court determined that the evidence demonstrated Countrywide had given the court inaccurate filings, it was free to fashion appropriate relief. *Hecht v. Bowles*, 321 U.S. 321, 329 (1943) ("The essence of equity jurisdiction has been the power of the chancellor to do equity and to mould each decree to the necessities of the particular case."). It did so here. The court's modest order is prophylactic, reasonable, and can easily be lifted once Countrywide demonstrates that it has reformed its systems and procedures to enable it to provide accurate information to the bankruptcy court. Individual judges place requirements on litigants as a matter of routine. Requiring modest documentation is analogous to a court placing pre-filing restrictions on a litigant who shown himself incapable of obeying the court's rules.

There is nothing novel about the court's remedy. Other federal courts have ordered remedies in similar bankruptcy cases against other mortgage lenders; one of them was recently upheld on appeal. *In re Stewart*, No. 08-3225, 2009 WL 2448054, at *12 (E.D. La. Aug. 7, 2009). The bankruptcy court here simply ordered Countrywide to provide information necessary to validate proofs of claim in a particular format to protect itself and the debtors before it. Its relief in this case is modest.

The bankruptcy court also properly imposed its requirement that Countrywide submit a Summary with its proofs of claim under Federal Rule of Bankruptcy 9011, which states that a bankruptcy court may impose an "appropriate sanction" on a party that is responsible for violating the rule that filings in the court be accurate. Fed. R. Bankr. P. 9011(c). Countrywide does not dispute that Rule 9011 covers the situation in this case, only that it did not receive adequate notice that it could be sanctioned on that basis. Countrywide did, however, receive adequate notice, providing another basis upon which this Court can affirm the decision below.

Countrywide's brief presents a jumble of arguments in order to draw attention away from the plain – and dispositive – language of section 105(a). Countrywide asks this Court rule that Rule of Bankruptcy Court Procedure 3001, which prescribes what a *creditor* must do to submit a *prima facie* valid proof of claim, strips a bankruptcy court's statutory power to regulate practice before it and to "prevent" "abuse." That is preposterous. 11 U.S.C. § 105(a); *see also Hecht*, 321 U.S. at 329; *United States v. E. I. du Pont de Nemours & Co.*, 366 U.S. 316, 328 n.9 (1961) ("Congress would not be deemed to have restricted the broad remedial powers of courts of equity without explicit language doing so in terms, or some other strong indication of intent."). The labels that Countrywide puts on the bankruptcy court's order – unauthorized local rule, bill of attainder, criminal sanction – do not change the fact that the order is a routine exercise of the court's power to regulate its docket under section 105(a), Rule 9011, and Supreme Court language.

Finally, Countrywide trots out again its arguments that 1) the United States does not have standing; 2) the United States improperly asked for criminal sanctions; and 3) the bankruptcy court did not have jurisdiction. Every court to consider these arguments in the context of creditor abuse has rejected them – including a district judge in this federal district.

The United States asks this Court to affirm the bankruptcy court's modest attempt to "prevent" Countrywide's abuses until such time as Countrywide can modify its claims filing system to do that itself.

ARGUMENT

I. THE BANKRUPTCY COURT'S SECTION 105(a) SUMMARY REQUIREMENT IS NOT A SANCTION BUT IS A PRE-FILING REQUIREMENT THAT COURTS ROUTINELY IMPOSE TO MANAGE THEIR DOCKETS.

A. The bankruptcy court did not punish Countrywide but protected itself as if Countrywide were a vexatious litigant.

Countrywide's system cannot reliably produce accurate information for court filings, making Countrywide analogous to a vexatious litigant who wastes a court's time and resources. *Compare* 11 U.S.C. § 105(a) *with* 28 U.S.C. § 1927.[3] Even if Countrywide does not deliberately make inaccurate representations, the number of its filings nationwide dwarfs the mischief that even the most assiduous vexatious litigant can inflict on the court system. Countrywide admits it filed a meritless proof of claim. Nevertheless, in this case alone, the bankruptcy court had to:

- process Countrywide's proof of claim and plan objection;
- review the proof of claim and Ms. O'Neal's objection;
- adjudicate the dispute over the proof of claim;
- schedule a hearing on Countrywide's objection to Ms. O'Neal's plan; and
- cancel that hearing when Countrywide pulled its objection less than 24 hours before it was scheduled to begin.

The bankruptcy court acted within its statutory discretion when it ordered Countrywide to submit a Summary with its proofs of claim, in essence imposing a modest pre-filing requirement. Bankruptcy courts have "inherent and statutory authority to impose sanctions upon parties for their abuse of the litigation process." *Maloof v. Level Propane Gasses, Inc.,* 316 Fed. Appx. 373, 376 (6th Cir. 2008) (citing *Rathbun v. Warren City Schools (In re Ruben)*, 825 F.2d 977, 982-84 (6th Cir.1987)); *Caldwell v. Unified Capital Corp.*, 77 F.3d 278, 284 (9th Cir 1996) (stating that bankruptcy courts have "inherent power to sanction vexatious conduct"). Logically, if a court

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[3] The United States Trustee's complaint relies on the former.

has the authority to sanction a party, it must also be able to take the less drastic step of imposing modest relief such as requiring verification of the accuracy of filings.

Nor is there a *de minimis* standard for incorrect filings. The Supreme Court has observed that "[e]very paper filed with the Clerk of this Court, no matter how repetitious or frivolous, requires some portion of the institution's limited resources. A part of the Court's responsibility is to see that these resources are allocated in a way that promotes the interests of justice." *In re McDonald*, 489 U.S. 180, 184 (1989) (ordering the Clerk not to grant any more of the petitioner's *in forma pauperis* requests for relief under an extraordinary writ). Rather, "the Court's responsibility is to see that [judicial] resources are allocated in a way that promotes the interests of justice." *Maxberry v. S.E.C.*, 879 F.2d 222, 224 (6th Cir. 1989).

The act of filing a complaint in and of itself can be considered vexatious, for example when a plaintiff attempts to re-litigate a case in a new forum. *Al-Beshrawi v. Chao*, No. 06-cv-369, 2007 WL 1203561, at *4 (N.D. Ohio Apr. 23, 2007); *see also Feathers v. Chevron U.S.A., Inc.*, 141 F.3d 264, 269-270 (6th Cir. 1998). Furthermore, repeated abusive filings can result in being permanently barred from filing any bankruptcy petition nationwide. *In re Freeman*, 224 B.R. 376, 280 (Bankr. S.D. Ohio 1998) (enjoining debtors who filed seven bankruptcy petitions in two and a half years without schedules or filing fees from further access to the bankruptcy courts).

This case is analogous. The bankruptcy court found that Countrywide's system is reckless. Recklessness, a lower standard than bad faith, means "deliberate action in the face of a known risk, the likelihood or impact of which the actor unexcusably [sic] underestimates or ignores." *Red Carpet Studios Div. of Source Advantage, Ltd. v. Sater*, 465 F.3d 642, 646 (6th

Cir. 2006) (quoting *United States v. Wallace*, 964 F.2d 1214, 1220 (D.C. Cir.1992)). Here, Countrywide filed a baseless proof of claim and objection to Ms. O'Neal's chapter 13 plan. It did not withdraw the proof of claim but made the bankruptcy court adjudicate the issue, although the record was crystal clear that it had no claim. Perhaps hedging its bets, it did not withdraw the objection to the chapter 13 plan until it had lost the proof of claim dispute and then only the evening before the hearing. Rather than regretting the misuse of the court's resources and time, Countrywide's defense was to blame Ms. O'Neal's lawyer for defending her interests in court. Countrywide Br. at 5 (citing Trial Tr. 275:21-277:9). Countrywide's behavior indicates reliance on others, primarily the bankruptcy court to fix the problems because its "reckless" claims-filing system cannot fix errors in a timely way but allows mistakes to compound mistakes until litigation is inevitable.

The bankruptcy court did not abuse its discretion in finding inadequate communication within Countrywide contributed to the problems in the *O'Neal* case. Countrywide's technicians, customer service representatives, and management do not communicate effectively with each other. Trial Tr. 300:16-17 (Apr. 24, 2009) (statement by Countrywide counsel that "our people should have figured this out. I'm not contending that they shouldn't have."); Trial Tr. 75:16-21 (Apr. 24, 2009) (statement by John Smith, a Countrywide Vice President, that a "number of people recognized" and "a number of entries" indicated that Ms. O'Neal was being improperly billed but the problem was not fixed). Trial testimony also revealed that the technician who assigned the case to local counsel was not expected to review the loan history or the notes in the computer loan file. Trial Tr. 77:23-78:15 (Apr. 24, 2009); Trial Tr. 416:13-418:7 (May 11, 2009) (testimony that technician only verifies payments and charges, not computer notes).

Nor is there any significant person-to-person communication between Countrywide and its local counsel. Countrywide's law firm that handled the *O'Neal* case did not have a protocol for communicating with Countrywide. For instance, Ted McClatchey, the lawyer for Countrywide, described his source for contact with Countrywide as a memorandum that described "the sort of pecking order of people if you needed to contact somebody about something." Otherwise McClatchey's firm received "general communications by email when there were particular issues that they wanted to address as a company in filing certain types of documents with the Courts and they might need advice from the law firms as to what the particulars were in each state." Trial Tr. 136:12-137:1 (Apr. 24, 2009).

In response to this evidence of recklessness, the bankruptcy court devised a simple way to minimize the problems caused by Countrywide's system, namely requiring Countrywide to submit a Summary that demonstrates the accuracy of the information in its filings. This requirement is far less than the bankruptcy court could have done. In contrast to the vexatious litigation cases cited above, Countrywide's access to the bankruptcy court is not impeded. Countrywide does not have to get permission to file in Judge Shea-Stonum's bankruptcy court – it just has to provide an extra Summary to do so.

B. Other improper filings in the bankruptcy court below demonstrate systemic problems.

Countrywide ignored the bankruptcy court's order during the time when it was in force. District Court Stay Op., 2009 WL 3259131 at * 4, n.7. Not only did it not provide the additional information, it continued to fail to meet the minimum requirements of Official Form 10 submissions. For instance, in the *Beal* case, Countrywide, in response to the Judge Shea-

Stonum's order, submitted a supplemental proof of claim.[4] *In re Beal*, No. 07-50413 (N.D. Ohio filed Sept. 8, 2009) [Claims Reg. #27-1]. The "Supplemental Proof of Claim Itemization" has no breakdown but consists of one figure:

Agreed upon arrears in agreed order	$ 11,685.46
TOTAL ARREARAGE	**$ 11,685.46**

The Amended Order from Relief from Stay in the *Beal* case demonstrates on its face Countrywide's systematic problems. It states the painfully obvious: "**The parties are in agreement that the Debtor should only pay and the Creditor should only receive what is actually owed, no more and no less."** The order also leaves room for the possibility that Countrywide's accounting may still not be accurate: **If it is discovered that certain payments or advances were not properly credited or accounted for, then the parties agree that the Agreed Order shall be modified to accurately reflect the status of the account.** *In re Beal*, No. 07-50413 (N.D. Ohio filed Sept. 9, 2009) (amended order) (emphasis in the original).

Furthermore, in the *Phillips* case, Countrywide did not attach a payment history to show the alleged eight month arrearage; nor any back-up documentation for fees entitled "foreclosure title work - $569;" "foreclosure title update - $50;" "filing fee - $370;" "process server - $110;" and "property inspection charges - $30." This contravenes the instructions on Official Form 10

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[4] Countrywide claims that the *Beal* proof of claim was ordered by Judge Shea-Stonum herself and therefore the Summary requirement did not apply. There is no grounds for that assumption. The judge did not indicate that her Summary requirement, which applied retroactively to all proofs of claim pending before her, was not in force. Nor did the attorney before her seek clarification – another example of Countrywide's inability to keep its local counsel up to date. Finally, Countrywide provides no legal or logical argument why it should assume that Shea-Stonum had *sub silentio* countermanded her own order when she required the supplemental proof of claim.

itself which states "[a]ttach copies of supporting documents, such as . . . purchase orders, invoices, itemized statements of running accounts . . . ." Official Form 10 at #8. *See also In re Wyatt*, No. 09-53277 (N.D. Ohio filed Sept. 29, 2009) ("The subject Proof of Claim [filed Sept. 22] is being withdrawn as it was filed in error."). These examples demonstrate that Countrywide is incapable of remedying the flaws in its system – even in the courtroom of a judge who is scrutinizing its performance.

Thus the bankruptcy court had ample evidence of systematic problems that would impose a burden on the court and other litigants for the foreseeable future. Accordingly, it acted within its statutory discretion to prevent such problems by requiring Countrywide to complete a Summary to force it to double-check its filings and give others confidence that the information provided is accurate.

II. THE BANKRUPTCY COURT'S STATUTORY POWER UNDER SECTION 105(a) ALLOWS IT TO REQUIRE COUNTRYWIDE TO SUBMIT AN ADDITIONAL SUMMARY WITH ITS PROOFS OF CLAIM.

A. Statutory analysis of 11 U.S.C. § 105(a) proves that the bankruptcy court did not act beyond its power as a matter of law.

Countrywide seeks reversal of an order that the bankruptcy court did not issue. This is not a case about rule-making, sanctions, bad faith, or any of the other myriad theories that Countrywide has presented multiple times to this, and other, courts. The order does not punish Countrywide; it does not impose a monetary penalty. The order does not impinge on Countrywide in any way that would implicate due process rights. *See* Liability Op. at 22-23 (listing potential court action). The bankruptcy court had statutory power to impose a much more drastic remedy but chose not to. Instead, it took one small step to protect its courtroom from Countrywide's recklessness.

This case presents one legal question: does the text of 11 U.S.C. § 105(a), which enables a court *sua sponte* to take any action "necessary or appropriate" to "prevent an abuse of process," authorize a bankruptcy court to require a party in interest with a track-record of inaccurate filings to submit an additional form summarizing information otherwise required by the Bankruptcy Code? The answer is yes.

Section 105(a) of title 11 is designed to give bankruptcy courts the necessary tools to "prevent" abuse by participants in the bankruptcy system. In the case of bankruptcy courts, this power is statutory: section 105 enables them to issue orders necessary to prevent an abuse of process, such as submitting misleading filings to the court. *Caldwell*, 77 F.3d at 284. It allows injunctive relief when a litigant threatens the integrity and functioning of the bankruptcy system. *In re DeLorean Motor Co.*, 991 F.2d 1236, 1242 (6th Cir. 1993); *In re Sanchez*, 372 B.R. 289, 311-12 (Bankr. S.D. Tex. 2007).[5]

Section 105(a)'s application is governed by its text. First, a bankruptcy court must determine that it should act to prevent an abuse of process. *In re Eagle-Picher Indus., Inc.*, 285 F.3d 522, 529 (6th Cir. 2002). Once it has made that determination, the court must craft an order that is reasonably calculated to prevent that abuse. *Jove Eng'g Inc. v. IRS*, 92 F.3d 1539,

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[5] Countrywide has cited *Pertuso v. Ford Motor Credit Co.*, 233 F.3d 417, 423 (6th Cir. 2000). *Petruso* simply held that a court cannot use 11 U.S.C. § 105(a) to create a federal common law mass tort money damages remedy where none exists. It says nothing about injunctive relief that prevents abuse. To read it in any other way makes *Pertuso* inconsistent with *DeLorean*, which was decided first. *See Darrah v. City of Oak Park*, 255 F.3d 301, 309 (6th Cir. 2001) ("A panel . . . cannot overrule the decision of another panel. The prior decision remains controlling authority unless . . . this Court sitting en banc overrules the prior decision.").

1554 (11th Cir. 1996) (plain meaning of Section 105 encompasses any order whether injunctive, compensatory, or punitive, if necessary to carry out provisions of the Bankruptcy Code). Unlike traditional injunctive relief, a bankruptcy court's power to act derives from the statute. Congress did not require that courts engage in special analysis or balancing tests to determine if the application of 105 powers would be appropriate. *See* 132 Cong. Rec. 28, 610 (1986) (statement of Sen. Hatch) (section 105(a) "allows a bankruptcy court to take any action on its own, or to make any necessary determination to prevent an abuse of process and to help expedite a case in a proper and justified manner").

This reading of section 105(a) is fully consistent with the Supreme Court's precedent governing a court's power to regulate practice before it. As the Court has held, "[t]hese powers are 'governed not by rule or statute but by the control necessarily vested in courts to manage their own affairs so as to achieve the orderly and expeditious disposition of cases.'" *Chambers v. NASCO*, 501 U.S. 32, 43 (1991) (quoting *Link v. Wabash R.R. Co*, 370 U.S. 626, 630-31 (1940)). For nearly 200 years the Supreme Court has recognized that the branches of government, including the judiciary, "must be left at liberty to exercise the powers which the people have intrusted to them. The interests and dignity of those who created them, require the exertion of the powers indispensable to the attainment of the ends of their creation." *Anderson v. Dunn*, 6 Wheat 204, 226 (1821). The bankruptcy system exists to balance the interests of creditors and debtors and to use its powers of equity to give debtors a "fresh start." A bankruptcy court cannot attain this "end[] of its creation" if it cannot ensure that the parties before it provide accurate information. *Id.*

Supreme Court precedent also confirms that a bankruptcy court's section 105(a) powers are broad. The Supreme Court held that "the broad authority granted to bankruptcy judges to take any action that is necessary or appropriate to prevent an abuse of process described in § 105(a) of the Code" included the power to override a debtor's statutory right to convert to chapter 13 if he acted in bad faith, in this case hiding assets, in his chapter 7 case. *Marrama v. Citizens Bank of Mass.*, 549 U.S. 365, 374-75 (2007); *see also dissent*, 549 U.S. at 382 (acknowledging breadth of 105(a) powers). The Court reasoned that the bankruptcy court should not have to go through the charade of letting a debtor convert to chapter 13 if the underlying bad faith would necessitate that his case be dismissed. *Id.* Accordingly, it abridged the provisions of the Code itself to avoid unnecessary and protracted litigation that would ultimately harm the creditors of the estate. *Id.*

The Supreme Court has also approved a court's ability to take other significant action, such as controlling its dockets by dismissing actions *sua sponte* for failure to prosecute. *Link*, 370 U.S. at 630-31. If a bankruptcy court can deny conversion or dismiss a case *sua sponte*, thus extinguishing a litigant's entire case, then it must be able to require a claimant to supply information in a particular format. There can be no doubt that the bankruptcy court had the power to issue the order placing a trivial burden on Countrywide to fill out an additional Summary after it determined that Countrywide's filings would require additional scrutiny.

The scope of section 105(a) gives a bankruptcy court broad latitude to regulate the parties in interest before it. Section 105(a) "puts no facial restriction on the structure of relief that the courts can fashion under it, as long as they are furthering a principle identifiable in the applicable substantive law of bankruptcy. Section 105(a) was enacted to promote such enforcement, through means that are tailored the innumerable scenarios of financial distress in bankruptcy cases." *In re Coleman Enter., Inc.*, 266 B.R. 423, 435 (Bankr. D. Minn. 2001).

Indeed, section 105(a) authorizes drastic action, including a permanent ban against two debtors against filing future petitions in any bankruptcy court in the country because of their egregious abuse of the system. *In re Freeman*, 224 B.R. at 379 (stating that bankruptcy courts have the authority to dismiss bankruptcy cases, enjoin future filings, and impose sanctions under §§ 105(a) and 109(g)(1)). Given this, section 105(a) can also be the basis for prophylactic action, such as requiring a law firm to certify changes to its billing system that would prevent the reoccurrence of improper withdrawals from a client's retainer account. *In re Palumbo Family Ltd. P'ship*, 182 B.R. 447, 479 (Bankr. E.D. Va. 1995).

Here, the bankruptcy court used section 105(a) merely to require Countrywide to complete a Summary, temporarily, to document that its claims processing system is in compliance with the Bankruptcy Code and Rules. Its action fell squarely within its section 105(a) powers.

B. The court below entered relief under section 105(a), a statute whose text makes no mention of bad faith, which means Countrywide's references to bad faith and related concepts in its brief are legally irrelevant and form no basis for reversal.

Countrywide argues repeatedly that the lower court's order must be reversed because Countrywide did not act in bad faith, willfully, maliciously, or with fraudulent intent. Countrywide Br. at 8, 25-26, 29-30. That is legally irrelevant. It is irrelevant because the lower court entered relief under section 105(a), which does not require a court to make a bad faith finding before taking action to “prevent” “abuse.” 11 U.S.C. § 105(a).

Countrywide makes the mistake of relying on the fact the bankruptcy court did not find bad faith because it confuses a bankruptcy court's power to sanction under its inherent authority with a court's statutory power to take action under section 105(a). Certainly, a bad faith finding justifies the imposition of an inherent power sanction. *Roadway Exp., Inc. v. Piper*, 447 U.S. 752, 765-66 (1980) (upholding award of attorney fee for bad faith litigation).

But this is not an inherent power case – as Countrywide recognizes on page 29 of its brief.

As explained above, the bankruptcy court acted under section 105(a). Nothing in the text of section 105(a) requires a bad faith finding as a condition precedent to employing section 105(a) to “prevent” “abuse.” See Liability Op. at 19 (recognizing this distinction). *See also In re Ruben*, 825 F.2d at 984 (noting that bad faith not required for imposing sanctions under 28 U.S.C. § 1927).

Because Countrywide confuses inherent power and section 105(a), it asks this Court to make an unprecedented ruling that the exercise of section 105(a) preventative powers must be based upon a showing “tantamount to fraud.” Countrywide Br. at 25. It would be an error of law to accept that argument.

The text of section 105(a) does not impose any bad faith requirement. It has no tantamount to fraud requirement. Nor would make sense to rewrite section 105(a) to limit its application to the prevention of bad faith and fraud. Section 105(a) designed to “prevent.” And the dictionary defines “prevent” as “to keep from happening or existing, esp. by precautionary measures.” *Webster’s Third New International Dictionary* 1798 (1981). Section 105(a) allows bankruptcy courts to ensure bankruptcy cases work. That can be a daunting task. Even the simplest chapter 7 case has many actors, one or more debtors, a chapter 7 trustee, the United States Trustee, multiple creditors, and a bankruptcy judge. When one of those participants files wrong pleadings, the system ceases to work for everyone. For that reason, the text of section 105(a) is written to prevent injurious conduct rather than to focus upon the culpability level of the party who is hurting everyone else with its mistakes.

Countrywide's conduct in this case underscores why Congress wrote section 105(a) as it did. Here, the court below found Countrywide was making mistakes in a reckless fashion. Liability Op. at 21. Even Countrywide admits it made mistakes. Trial Tr. 300:16-17 (Apr. 24, 2009); ("[O]ur people should have figured this out. I'm not contending that they shouldn't have."). The evidence was sufficient for the court to employ the plain language of section 105(a) to impose a non-punitive requirement that Countrywide document the due diligence review it engaged in before filing a claim with the court.

Were there any doubt whether section 105(a) has some sort of a hidden bad faith component, other Code sections would dispel it. That is so because Congress put a bad faith requirement in those Code sections where it wanted it to apply. *See* 11 U.S.C. § 707(b)(3)(A) (allowing dismissal of a chapter 7 petition if the debtor acts in bad faith). Given that Congress knew how to use the words "bad faith" in the Code, it is dispositive that it did not use them in this section. *Desert Palace, Inc. v. Costa*, 539 U.S. 90, 98-99 (2003) (stating that Congress's failure to include language requiring a heightened showing to prove discrimination in Title VII precluded imposition of such a standard).

Were there any doubt on these points, Sixth Circuit precedent dispels it. It is the law of this circuit that a bankruptcy court may order sanctions if a litigant has acted recklessly, or even with negligent inadvertence. The Sixth Circuit upheld the power of a bankruptcy court to order disgorgement of fees when an attorney failed to request authorization for payment under 11 U.S.C. § 329 and Federal Rule of Bankruptcy Procedure 2014. *In re Kisseberth*, 273 F.3d 714, 721 (6th Cir. 2001) (citing *In re Park-Helena Corp.*, 63 F.3d 877, 882 (9th Cir.1995)) ("Disgorgement may be proper even though the failure to disclose resulted . . . from negligence or inadvertence."). Countrywide has admitted that made a mistake when it filed papers in Ms. O'Neal's case. Trial Tr. 294:23-25 (Apr. 24, 2009) (Countrywide's actions in the *O'Neal* case were "incorrect."). Significantly, Countrywide's counsel suggested that Countrywide's unwarranted referral of Ms. O'Neal's case to its local counsel may have been negligent. Trial Tr. 297:4-7 (Apr. 24, 2009). Countrywide's own admission provides ample basis for the bankruptcy court's Summary requirement.

Thus, the evidence presented at trial, and the facts found by the lower court agree that the flaws in Countrywide's procedures for dealing with borrowers in bankruptcy necessitated the court to take action. *See United Mine Workers of Am. v. Bagwell*, 512 U.S. 821, 833 (1994) (listing courts alternatives for dealing with "a party's failure to comply with the rules of conduct governing the litigation process," including striking pleadings, assessing costs, excluding evidence, and entering default judgment). Nor must Countrywide comply with this order indefinitely. As soon as its claims-filing process is functioning properly, the order will no longer be appropriate. *See Taubman Co. v. Webfeats*, 319 F.3d 770,775 (6th Cir. 2003) (denying injunction for Lanham Act violation because there was no on-going violation because the offending website links had been taken down).

C. The bankruptcy court's order is not a criminal sanction.

Countrywide argues the lower court order constitutes criminal contempt, and bankruptcy courts cannot issue criminal contempt. Countrywide Brief at 14-15. But the court below did not hold Countrywide in contempt of a particular order; rather it used its statutory authority under section 105(a) to prevent abuse. That is inherently different from contempt proceedings. Indeed, not even a monetary sanction is treated as a proceeding for "criminal contempt" merely because it involves non-compensatory relief. *See In re DeVille*, 361 F.3d 539, 552 (9th Cir. 2004) (holding that proceeding for punitive sanctions under Bankruptcy Rule 9011 was not in the nature of criminal contempt, and bankruptcy court was not required to follow procedural protections applicable to criminal contempt proceeding).[6] In contrast, the Summary is among the mildest forms of relief ordered in comparison to other courts that have confronted similar conduct. *See e.g., In re DePugh*, No. 08-37521, 2009 WL 1657473 at *7 (Bankr. S.D. Tex. June 12, 2009) (forbidding amendments to proofs of claim without prior leave of court).

Countrywide's claim that the bankruptcy court's Summary, and proposed $300 sanction for its improper completion, is a criminal sanction is flawed. First, Countrywide concedes that a fine is civil if it compensates a party for costs associated with improper conduct. Countrywide Br. at 13 (citing *Bagwell*, 512 U.S. at 829). That is exactly what the bankruptcy court's order does. If Countrywide improperly completes the Summary, then the debtor is compensated a minimum of $300 for attorney costs related to

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[6] Section 105(a) expressly authorizes relief that will prevent abuse, the relief entered here. Countrywide has not attacked section 105(a)'s constitutionality, either on a facial or on an as applied basis, and may not do so for the first time on appeal.

litigation to correct Countrywide's compounded error. Remedy Op. at 10. That is a classic civil sanction.

Countrywide devotes several pages of its brief discussing the Fifth Circuit's decision in *In re Hipp*, which addresses criminal prosecutions under title 18. *In re Hipp*, 895 F.2d 1503 (5th Cir. 1990). In *Hipp*, the bankruptcy court enjoined a creditor from filing *lis pendens* notices against property of the estate, an order the creditor ignored. The chapter 11 trustee then brought criminal contempt of court charges against the creditor, which resulted in a sentence of three years imprisonment. *Id.* at 1505-06. The lengthy decision, which addresses a bankruptcy court's criminal contempt powers, is irrelevant to the question here: can a bankruptcy court require a party in interest to complete a Summary under its section 105 authority to prevent abuse of process? The Fifth Circuit has answered that question affirmatively. *Ingalls v. Thompson (In re Bradley)*, __F.3d__, No. 08-50587, 2009 WL 3757006 (5th Cir. Nov. 11, 2009) (distinguishing *Hipp* by recognizing that bankruptcy courts have civil contempt power and imposing a monetary sanction on a chapter 7 trustee for diversion of property); *Campbell v. Countrywide Home Loans, Inc.*, 545 F.3d 348, 356 n.1 (5th Cir. 2008) (noting, in *dicta*, that Section 105(a) could be used to enact remedies in order to prevent Countrywide from abusing the proof of claim process). Countrywide's discussion of *Hipp* is not relevant to analyzing the legal basis of the bankruptcy court's order in this case.

III. SUPREME COURT PRECEDENT PRECLUDES COUNTRYWIDE'S ARGUMENT THAT THE BANKRUPTCY COURT'S ORDER IS AN UNAUTHORIZED LOCAL RULE.

This case is only about the power of a bankruptcy court regulate its own docket – one of its core functions – by asking a party in interest who appears before it to comply with legal rules and requirements on its own. Countrywide argues that the bankruptcy court does not have that power in this case because the existing Form 10, which *creditors* must submit with the documentation that demonstrates the legitimacy of their claims, is sacrosanct and therefore prevents *bankruptcy judges* from regulating their dockets. Countrywide Br. at 9-10. The United States has found no authority for Countrywide's central proposition that a form promulgated by the Judicial Conference of the United States can prevent a bankruptcy court from exercising its lawful powers under title 11 of the United States Code. Countrywide's analysis provides none.

To the contrary, 28 U.S.C. § 2075 provides that bankruptcy rules cannot modify statutory rights. This rule of construction makes clear that statutes trump rules, so section 105(a) is not constrained by Rule 3001.

In addition, Countrywide's argument that the bankruptcy court's Summary is an improperly promulgated rule rests on stretching the meaning of legal terms beyond recognition. But words matter.[7] The dictionary defines a rule as "a prescribed, suggested or self-imposed

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[7] For the third time in briefing different stages of this case, Countrywide has equated the bankruptcy court's order with a Bill of Attainder. Countrywide Br. at 10. This is absurd, even for a rhetorical flourish, and would not be worthy of comment if it were not typical of the way Countrywide has litigated this case by twisting the definitions of accepted legal terms to fit its own purposes. The Bill of Attainder clause of the United States Constitution was intended as "a general safeguard against legislative exercise of the judicial function or more simply – trial by legislature." *United States v. Brown*, 381 U.S. 437, 442 (1965). The legislature prescribes general rules and "the application of those rules to individuals in society would seem to be the duty of other departments." *Id.* at 446 (citing *Fletcher v. Peck*, 6 Cranch 87,136 (1810)).

guide for conduct or action; a regulation or principle." *Webster's Third New International Dictionary* 1986 (1981). *Black's Law Dictionary* defines a rule as an "established standard, guide, or regulation." *Black's Law Dictionary* 1331 (6th ed. 1990). "A rule must necessarily be of general application. A regulation must apply impartially." *State ex rel. Villines v. Freeman*, 370 P.2d 307, 309 (Okla. 1962) (citation omitted).

The Summary in this case is the result of an adjudication. Adjudications differ from rule making in two ways. "First, adjudications resolve disputes among specific individuals in specific cases whereas rule making affects the rights of broad classes of unspecified individuals." *Yesler Terrace Community Council v. Cisneros*, 37 F.3d 442, 448 (9th Cir. 1994) (discussing APA adjudications). Second, because adjudications involve concrete disputes, they have an immediate effect on specific individuals . . . ." *Id.* (citations omitted). A rule applies to a particular group uniformly in a specific way. A rule directed at one person is a contradiction in terms. Nor does Countrywide cite a single case that supports its reading – and the United States has found none.

What Countrywide calls a rule is in fact an court order – and an unremarkable on at that. 11 U.S.C. § 105(a). Whether there was sufficient justification in the record to support the order is a question of fact that this Court reviews for abuse of discretion. That the bankruptcy court issued an order – not a rule – is beyond dispute.

Like any remedial order, the bankruptcy court's order fixes a problem – the basic purpose of an injunction, which is "to afford preventive relief, not to redress wrongs which have already been committed." *J. C. McFarland Co. v. O'Brien*, 6 F.2d 1016, 1018 (N.D. Ohio 1925). The

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Accusing a court of promulgating a Bill of Attainder is nonsensical, especially in this case when Countrywide has enjoyed extensive legal process: an interlocutory appeal, liability trial, separate remedy trial, three stay hearings, and now an appeal on the merits.

Sixth Circuit has adopted Pomeroy's definition from the fifth edition of *Equity Jurisprudence*: "'Whatever be its form, decree or order, the remedy by ordinary injunction is wholly preventive, prohibitory, or protective. * * *'" *Clemons v. Board of Ed. of Hillsboro*, 228 F.2d 853, 856 (6th Cir. 1956) (citation omitted); *see also Kazerooni v. Vanderbilt Univ.*, No. 3:06-0813, 2007 WL 965743, at *3 (M.D. Tenn. March 28, 2007) (order) (citing *Clemons*). Furthermore, a court has the power to "mould each decree to the necessities of the particular case." *Hecht*, 321 U.S. at 329; *E. I. du Pont,* 366 U.S. at 357 (Frankfurter, J., dissenting) (describing this rule as "a common-place, but one of compelling importance").

The bankruptcy court here identified a problem – Countrywide's inability to provide it with accurate information – and ordered Countrywide to take preventive measures to prevent such abuses in the future. The bankruptcy court's Summary is a modest requirement and thus is commensurate with the proven violation. *Cf. Murton v. Measurecomp*, LLC, No. 07-cv-3127, 2008 WL 5725628, at *6 (N.D. Ohio Dec. 2, 2008) (nullifying defendant's offer of judgment letters in a class action because of discovery violations). The bankruptcy court's power to take the action it did cannot be seriously challenged.

IV. COUNTRYWIDE REPRODUCES THE SAME ARGUMENTS ON STANDING AND JURISDICTION THAT HAVE FAILED TO SWAY ALL OF THE COURTS THAT HAVE CONSIDERED THEM IN THE CREDITOR ABUSE CONTEXT.

A. The bankruptcy court's power to require Countrywide to take action to prevent improper filings is law of this case.

1. Judge Gwin of this District Court held that the bankruptcy court had jurisdiction to take action against Countrywide in this case.

Countrywide's fundamental argument – that the bankruptcy court below acted without authority to remedy Countrywide's failure to provide accurate information – has been reviewed, and rejected, on appeal. The bankruptcy court's authority to prevent vexatious conduct is the law of the case. On August 20, 2008 the Honorable James S. Gwin issued an order denying Countrywide's motion to withdraw the mandate in this case. *Fokkena v. Countrywide Home Loans, Inc. (In re O'Neal)*, No. 08-0043 at 3-4 (N.D. Ohio filed Aug. 20, 2008). In that order Judge Gwin found that "the Trustee moved for sanctions against Countrywide for allegedly merit-less filings." Order at 3. He continued: "[t]here can be little doubt that bankruptcy courts have the inherent power to sanction vexatious conduct presented before the court." *Id.* (citing *In re Rainbow Magazine, Inc.*, 77 F.3d 278, 284 (9th Cir. 1996)). Judge Gwin concluded that the Trustee's motion "in the underlying bankruptcy proceeding falls within the jurisdiction of the Bankruptcy Court." Order at 4.

This Court does not need to consider whether the bankruptcy court had power to protect itself against Countrywide's vexatious conduct in submitting inaccurate filings. Judge Gwin determined that it does. Order at 3-4. Nor must this Court consider Countrywide's arguments that the bankruptcy court did not have subject matter jurisdiction to enter remedial action because it was seeking a sanction for criminal contempt. Judge Gwin considered, and rejected, these same arguments. *Id.* It is therefore the law of this case that the bankruptcy court has the authority to order Countrywide to take action to ensure that other debtors would be spared Ms. O'Neal's ordeal. *See Rouse v. DaimlerChrysler Corp.*, 300 F.3d 711, 715 (6th Cir. 2002) (stating general rule that "findings made at one point in the litigation become the law of the case for subsequent stages of that same litigation"). Judge Gwin's holding should not be "lightly disturbed." *Gillig v. Advanced Cardiovascular Sys., Inc.*, 67 F.3d 586, 590 (6th Cir. 1995). A court has a duty to correct any erroneous decision made earlier in the litigation, meaning that any review of a previous decision of a colleague-court must be done under an abuse of discretion standard. *Id.* Accordingly, the main task of this Court is to determine whether the court below abused its discretion when it required that Countrywide submit a Summary with its proofs of claim in her courtroom. The evidence will show that it did not.

B. Countrywide's argument that the United States Trustee lacks standing is precluded by Sixth Circuit precedent.

Countrywide argues that the United States Trustee does not have standing or authority to sue because the Code does not contain an explicit authorization for him to do so. Countrywide Br. at 17-18. This argument fails under Sixth Circuit precedent.

Relying on 11 U.S.C. § 307, the Sixth Circuit held that the United States Trustee had standing to challenge a debtor's petition filed in an improper venue. *Thompson v. Greenwood*, 507 F.3d 416, 420 n.3 (6th Cir. 2007). Neither title 28 nor the Bankruptcy Code explicitly bestows authority on the United States Trustee to challenge venue, yet the Sixth Circuit held section 307 allowed him to do so. *Id.* (also citing *In re Miles*, 330 B.R. 848, 849-51 (Bankr. M.D. Ga. 2004) (holding that the Trustee has standing to bring a motion to dismiss or transfer a Title 11 case due to improper venue)). Nor is the *Thompson* ruling less of a holding because it appears in a footnote. "Appellate opinions need not rehash settled law to enjoy respect by district courts. Brevity in stating a holding is a virtue, and a decision's central conclusion is no less a 'holding' for being succinct." *In re Milwaukee Engraving Co., Inc.*, 219 F.3d 635, 637 (7th Cir. 2000) (stating that an appellate court need not belabor a holding if it has endorsed the reasoning of another circuit court on the legal issue) (Easterbrook, J.). On this issue, the Sixth Circuit has spoken for itself. The Sixth Circuit has held explicitly that the language of section 307, the structure of the Code, and the legislative history demonstrate that the United States Trustee has authority to file suit. The Sixth Circuit has explained that the United States Trustee had standing to appeal to protect the public interest in a fair bankruptcy system because "a good watchdog guards the interests of those for whom it watches." *In re Revco D.S., Inc.*, 898 F.2d 498, 500 (6th Cir. 1990); *but see* Countrywide Br. at 23 (stating that Congress's "use of the term 'watch-dog' does not imply or suggest the UST has the power to file complaints against creditors for sanctions").

Countrywide's second argument that the United States Trustee is limited to the powers delineated in the Bankruptcy Code and 28 U.S.C. § 586 quickly falls apart – a conclusion reached by every court to consider that argument in the creditor abuse context. For instance, the Southern District of Florida, sitting in a bankruptcy appeal noted that "[c]ourts have repeatedly construed § 307 to hold that the United States Trustee has standing to appear and be heard on any issue in any case, despite the lack of pecuniary interest in the outcome of a bankruptcy proceeding." *Walton v. Countrywide Home Loans, Inc.*, No. 08-23337, 2009 WL 1905035, at *2 (S.D. Fla. June 9, 2009) (citing cases). The bankruptcy court of the Western District of Pennsylvania dismissed Countrywide's theory about the interaction between section 307 and 28 U.S.C. § 586 in no uncertain terms: "Countrywide's argument in this regard must fail. There is nothing whatsoever in the statutory language of Section 307 that supports Countrywide's argument. Countrywide has cited no other, substantial authority [other than a bar journal article] in support of such a construction." *In re Countrywide Home Loans*, *Inc.*, 384 B.R. 373, 384 (Bankr. W.D. Pa. 2008).

That has not changed in this case: Countrywide does not provide a single case citation from page 17 to the second full paragraph of page 19 to support its argument, save a single citation of *Hibbs v. Winn*, 542 U.S. 88, 101 (2004), for the unremarkable proposition that a court should not construe one statutory provision to render another superfluous. And even that point is misplaced here. Section 586(a)(5) of title 28 allows United States Trustees to "perform the duties prescribed for the United States Trustee under title 11 . . . ." One of these duties is "raising any issue" under 11 U.S.C. § 307, which is precisely what the United States Trustee did here.

C. Countrywide's argument that the bankruptcy court lacks jurisdiction is without merit.

Countrywide argues that the bankruptcy court lacked jurisdiction because it settled the underlying dispute with Ms. O'Neal, rendering the United States' adversary proceeding insufficiently "related to" a case under Title 11. Countrywide Br. at 12. Countrywide's argument is incorrect. This adversary complaint is a core proceeding arising under Title 11, which gives the bankruptcy court original jurisdiction to "hear and determine" the case, regardless of the status of the underlying bankruptcy estate. 28 U.S.C. § 157(b)(1). A core proceeding "either invokes a substantive right created by federal bankruptcy law or . . . could not exist outside of the bankruptcy." *Sanders Confectionery Prods. Inc. v. Heller Fin., Inc.*, 973 F.2d 474, 483 (6th Cir. 1992); 28 U.S.C. § 157(b)(2) (non-exclusive list of core proceedings).

Actions addressing the integrity of the bankruptcy process, such as this one, go "to the heart of the administration of a bankruptcy case" and are therefore core proceedings. *In re Seven Fields Dev. Corp.*, 505 F.3d 237, 262 (3d Cir. 2007). Specifically, a matter involving the discipline of a party for misconduct in a bankruptcy case is a core bankruptcy proceeding under

28 U.S.C. § 157 because it concerns the administration of the estate. *Southmark Corp. v. Coopers & Lybrand (In re Southmark)*, 163 F.3d 925, 930 (5th Cir. 1999); *see Cooter & Gell v. Hartmarx Corp.*, 496 U.S. 384,395 (1990) ("It is well established that a federal court may consider collateral issues after an action is no longer pending."). It makes no difference to jurisdiction whether the underlying bankruptcy case has settled. A court possesses "ever present" jurisdiction to regulate the conduct of parties appearing before it. *Red Carpet Studios*, 465 F.3d at 645 (upholding a sanction under 28 U.S.C. § 1927 even though the underlying lawsuit in which the sanction arose had been settled and voluntarily dismissed). This jurisdiction extends to bankruptcy cases. *In re Lowenbraun*, 453 F.3d 314, 321 (6th Cir. 2006) (approving the holding that "[t]here is no bright-line rule dictating that once an estate has been fully administered a trustee cannot avail himself of the federal court's bankruptcy jurisdiction") (citation omitted); *see In re Menk*, 241 B.R. 896, 905 (B.A.P. 9th Cir. 1999) (concluding that the status of a bankruptcy case is irrelevant to the exercise of jurisdiction in a core proceeding).

Here, the proceedings relate to Countrywide's inaccurate proof of claim and groundless objection to a plan confirmation, which are integral to bankruptcy administration. *Loomis Elec., Inc. v. Lucerne Products, Inc.*, 225 B.R. 381, 385-86 (N.D. Ohio 1998). Furthermore, Countrywide has already raised and lost this argument before Judge Gwin and other courts. *Fokkena*, No. 08-0043 at 3-4 (holding that the trustee's motion "falls within the jurisdiction of the Bankruptcy Court."); *Walton v. Countrywide Home Loans, Inc. (In re Sanchez)*, No. 08-23337, 2009 WL 1905035 at *6 (S.D. Fla. June 9, 2009) (holding that United States Trustee's enforcement proceeding against Countrywide for abuse of the proof of claim process and a frivolous motion for relief from the automatic stay were core proceedings because "[h]ad there been no bankruptcy, this proceeding could not have come about.”). This adversary complaint exists because Countrywide filed false papers in the court below, therefore the bankruptcy court had jurisdiction.

Countrywide relies on the Third Circuit's discussion in *Pacor v. Higgins* to argue that the bankruptcy court does not have “related to” jurisdiction in this case. Countrywide Br. at 12 (citing *Pacor v. Higgins*, 743 F.2d 984 (3d Cir. 1984)). Indeed, it does not: “related to” jurisdiction has nothing to do with this case. Here the court is acting under core jurisdiction from 11 U.S.C. § 105(a). Thus, Countrywide’s argument based on “related to” jurisdiction is wholly inapplicable to this circumstance. Proceedings “related to” the bankruptcy include 1) causes of action owned by the debtor which become property of the estate pursuant to 11 U.S.C. § 541, and 2) suits between third parties which have an effect on the bankruptcy estate.” *Celotex Corp. v. Edwards*, 514 U.S. 300, 307 n.5 (1995). Therefore, the question of whether “the outcome of that proceeding could conceivably have any effect on the estate being administered in bankruptcy,” is entirely irrelevant to the bankruptcy court’s jurisdiction over the proceedings. *Celotex*, 514 U.S. at 308 n.6. The bankruptcy court’s more limited “related to” jurisdiction has no role in this discussion. Bankruptcy courts have original jurisdiction over all core proceedings, and this jurisdiction is fully independent from the administration of the bankruptcy estate.

V. SUFFICIENCY OF THE EVIDENCE

A. Countrywide ignores evidence of its systematic failures contained in the record.

This Court must first determine if the bankruptcy court abused its discretion by determining that Countrywide's behavior in the *O'Neal* case and its imperviousness to sanctions resulting from three other instances of abusive practices gave the court sufficient grounds to take action to prevent future abuses in its court.[8] Included in the record are the three cases in which Countrywide ignored Judge Shea-Stonum's order while it was in effect, which can be considered as well. Secondly, this Court must determine if the remedy that the bankruptcy court ordered will address that identified problem. If the bankruptcy court did not abuse its discretion in identifying a problem and if its solution is designed to prevent further abuse, then this Court should affirm the decision below.

The bankruptcy court did not abuse its discretion by finding that the record demonstrated systematic abuse of process by Countrywide that required remedy. The United States introduced sufficient evidence at trial to show that Countrywide has unreliable channels of communication with its outside counsel who handle bankruptcy matters, resulting in erroneous and inaccurate filings. The bankruptcy court did not clearly err in concluding that requiring Countrywide to summarize additional relevant information would identify miscommunication and prevent needless litigation.

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[8] Countrywide devotes five pages of its brief to crying foul concerning the alleged bases for the bankruptcy court's decision. The United States does not concede that Countrywide's analysis is correct, nor does it waive any future argument on the propriety of a judge citing law review articles or taking judicial notice of her own experience in resolving a case. *See* Countrywide Br. at 35-40. This Court does not need to reach these issues, however.

Countrywide argues that the bankruptcy court below relied on inadmissible and otherwise improper evidence to craft its order. For instance, Countrywide would have this Court believe that the bankruptcy court's finding concerning Countrywide's referral of work to the outside law firm that handled the O'Neal bankruptcy "lack[s] evidentiary support." Countrywide Br. at 33. In fact, Mr. McClatchey, the local counsel in the *O'Neal* case, gave approximately 50 transcript pages of testimony in which described Countrywide's automated procedures for assigning bankruptcy cases to his firm in particular, and others in general. For example, Mr. McClatchey testified as follows:

> Q: And how were these instructions communicated to you?
>
> A: Rather indirectly. I had a paralegal that would log into the Countrywide website each day and any requests for filings on our part would be communicated to the website.
>
> Q: Do you know the name of the person then at Countrywide Home Loans, Inc. who instructed you to file a proof of claim?
>
> A: No, I do not.
>
> Q: But you were instructed to file the proof of claim through this website?
>
> A: Yes.

Trial Tr. 100:23-25, 101: 1-10 (Apr. 24, 2009). This testimony supports the bankruptcy court's finding of fact that "Countrywide and M& S [local counsel] had an arrangement whereby emails would be sent to M&S identifying new matters." It also demonstrates that critical client-attorney communication was made through an automated system controlled by a "technician" on the Countrywide side and a paralegal on the other. According to Countrywide's testimony, the technician, with no legal training, was responsible for the accuracy of the documents. Trial Tr.

406:14-407:6; 419:11-19 (May 11, 2009). In spite of this responsibility, the technician making the assignments does not review the loan history but only verifies payments and charges without considering any of the computer notes that would alert him or her to specific issues related to the particular loan. Trial Tr. 77:23-78:15 (Apr. 24, 2009); Trial Tr. 416:13-418:7 (May 11, 2009). The supporting documents are automatically uploaded to the website upon initiation of the referral. Trial Tr. 33:13-34:3 (Apr. 24, 2009); Trial Tr. 34:10-12 (Apr. 24, 2009); Trial Tr. 414:17-415:6 (May 11, 2009). The system runs on automatic pilot: Countrywide provides standing authorization to file proofs of claim; access to a website is seen as authorization to act on behalf of Countrywide. Trial Tr. 118:17-21 (Apr. 24, 2009). Based on this evidence, the bankruptcy court did not abuse its discretion in concluding that a system premised on automated exchange of documents between two non-lawyers as the basis of a proof of claim was reckless.

Countrywide would have this Court believe that the bankruptcy court committed clear error when it found that "Countrywide's bankruptcy counsel was not given access to O'Neal's loan history." Countrywide Br. at 33. The actual transcript of testimony by Countrywide Vice-President John Smith reads:

> Q: The attorney does not at that point have access to the loan history documents; is that correct?
>
> A: They would not.
>
> Q: And the attorney does not generally review the loan history documents; is that correct?
>
> A: I don't know that. They wouldn't have access to them.

Trial Tr. 34:17-34:23 (Apr. 24, 2009); *cf.* Liability Op. at 15 (finding of fact #51) ("The loan history, including the notes captured by Countrywide's AS 400 system, were not [provided to counsel].").

The bankruptcy court also did not abuse its discretion in concluding that Countrywide's system allows "each actor in the process to act with indifference to the truth, and to rely solely on the limited information made available at each step," in spite of Countrywide's protestations to the contrary. Countrywide Br. at 33. In fact, testimony and evidence at trial demonstrated that:

- Local counsel does not have access to the loan history. Trial Tr. 34:17-34:23 (Apr. 24, 2009).
- No one pulls land records to confirm mortgage holder of record. Trial Tr. 418:8-419:8 (May 11, 2009).
- Technician does not read notations in a borrower's loan history before referring to local counsel. Trial Tr. 77:23-78:15 (Apr. 24, 2009)
- Customer service representatives could not access accurate information about Ms. O'Neal's account. Trial Tr. 65:14-66:8 (Apr. 24, 2009) (Portia Jones); Trial Tr. 67:13-68:11 (Apr. 24, 2009) (Casey Ford).
- No one knew how to stop Ms. O'Neal from receiving bills from Countrywide. UST Ex. 20.
- It took customer service representatives seven months to make internal inquiries about the status of Ms. O'Neal's account. UST Ex. 27.

B. Countrywide's miscellaneous arguments at the end of its brief are baseless.

1. Vagueness

Countrywide argues that the bankruptcy court's order is improper because it does not provide adequate guidance. Countrywide Br. at 31 (citing *E.E.O.C. v. Wooster Brush Co. Employees Relief Ass'n*, 727 F.2d 566, 566[sic] (6th Cir. 1984)). *Wooster Brush* restates the uncontroversial point that unspecific "obey the law injunctions cannot be sustained." *Id.* at 576.

An injunction is impermissibly vague when a person of ordinary intelligence would not have adequate notice of what conduct is prohibited. *Schenck v. Pro-Choice Network W. N.Y.*, 519 U.S. 357, 383 (1997). A party's opportunistic interpretation does not make an order vague. For example, the Sixth Circuit rejected a creditor's vagueness challenge to the terms of a post-petition financing order that disfavored the creditor's position. *In re Pioneer Inv. Serv. Co.*, No. 92-6090, 1994 WL 134683 (6th Cir. Apr. 14, 1994). Counsel for the appellant appeared to be "the only one who has experienced difficulty in understanding the order," prompting the court to rule that if an interested party is truly confused, the remedy would be to approach the bankruptcy court for clarification. *Id.* at *2. In this case, Countrywide's first concerns about vagueness materialized in its appeal brief.

2. Evidentiary Issues

Countrywide cannot attempt to exclude evidence that is harmful to its case under the veneer of prejudice. Its argument that the evidence of other cases in which it has been sanctioned is unduly prejudicial misunderstands the meaning of unfair prejudice and the function of the Rule 403 balancing test. Countrywide Br. at 42. Under Rule 403, evidence that is normally admissible may be excluded when the probative value of the evidence is substantially outweighed by the danger of undue prejudice. A court reviewing a decision to admit evidence "takes a maximal view of the probative effect of the evidence and a minimal view of its unfairly prejudicial effect, and will hold that the district court erred only if the later outweighs the former." *United States v. Sassanelli*, 118 F.3d 495, 498 (6th Cir. 1997). "Unfair prejudice does not mean the damage to a defendant's case that results from the legitimate probative force of the evidence; rather it refers to evidence which tends to suggest decision on an improper basis."

Morris v. Shelby County Gov't, 172 F.3d 49, at *2 (6th Cir. 1998) (Table). Admitting evidence of other cases in which Countrywide was sanctioned may not put it in the best light, but that prejudicial effect does not outweigh the probative value to show that monetary sanctions do not change its behavior.

Nor did the admission of prior cases to show Countrywide is impervious to monetary sanctions violate Rule 404(b) of the Federal Rules of Evidence. Even if one particular use of evidence is prohibited, it still may be introduced for multiple alternative purposes. *United States v. Blankenship*, 775 F.2d 735, 739 (6th Cir. 1985). Specifically, 404(b) does not prohibit the introduction of prior acts to show intent or attitude. *United States v. Price*, 329 F.3d 903, 906 (6th Cir. 2003).

The evidence of these other three cases involving Countrywide properly shows that Countrywide is not deterred by monetary penalties and is not motivated to take responsibility for its actions. *In re Mann*, No. 03-82973, 2004 WL 574354 (Bankr. M.D.N.C. Mar. 8, 2004) (imposing $7,500 against Countrywide in punitive damages for "deliberate, unwarranted and egregious conduct," namely twice changing the locks on the debtor's property and destroying cherished personal property) (Ex. 34); *In re Ennis*, slip op., No. 05-11985, (Bankr. W.D. Pa. July 31, 2006) (Ex. 36) (imposing $500 in punitive damages after Countrywide filed a motion for relief from automatic stay on the false grounds that the debtors were delinquent in their chapter 13 payments, when, in fact, they were current). In the final case introduced into the record, Countrywide filed an objection to the debtor's chapter 13 plan that the court described as "grossly erroneous, and to anyone familiar with bankruptcy law, the objection is clearly legal nonsense." *In re Allen*, No. 06-60121, 2007 WL 115182, at *1 (Bankr. S.D. Tex. Jan. 9, 2007)

(Ex. 37). The record in this case demonstrates that Countrywide cannot make things right – even after it has landed up in court.

VI. THE BANKRUPTCY COURT PROPERLY RELIED ON FEDERAL RULE OF BANKRUPTCY PROCEDURE 9011 TO IMPOSE THE SUMMARY REQUIREMENT.

The bankruptcy court correctly used Federal Rule of Bankruptcy Procedure 9011 as an alternate basis for its Summary requirement in this case. It is beyond dispute a bankruptcy court has the power to take corrective action under Rule 9011 for filing inaccurate claims. It is also undisputed that Countrywide filed an inaccurate proof of claim and baseless objection to confirmation, precisely the conduct that Rule 9011 addresses. Countrywide argues, however, that it was not on notice that Rule 9011 sanctions were an option.

Countrywide had ample notice that sanctions under Rule 9011 were a possibility. It filed a baseless claim – a violation of Federal Rule of Bankruptcy 9011. The instructions to Federal Rule of Bankruptcy Procedure Official Form 10, which Countrywide argues governs this case, refer to Rule 9011. Fed. R. Bankr. P. Official Form 10, Instructions, ¶ 7 ("The person filing this proof of claim must sign and date it. FRBP 9011."). The United States Trustee included Local Rule 2090-2(c) in its complaint, which prohibits "unprofessional practices or conduct." Compl. at ¶ 7. The district court, when denying Countrywide's motion to withdraw the reference, concluded that the bankruptcy court had authority to mandate corrective action in part because of Rule 9011. *Fokkena*, No. 08-0043 at 3-4. Countrywide had adequate warning that the bankruptcy court might rely on Rule 9011.

Countrywide's argument that the bankruptcy court had to issue a show cause order in order to sanction it fails to recognize that the safe harbor provision does not apply when a court imposes sanctions *sua sponte*. Instead, a court must provide notice and an opportunity for the party facing sanctions to respond in writing. *Riccard v. Prudential Ins. Co.*, 307 F.3d 1277, 1294, n.14 (11th Cir. 2002). Furthermore, what constitutes adequate notice depends on "the knowledge the party has of the consequences of his own conduct." *Id.* (citing *Link*, 370 U.S. at 632). Countrywide knew what was at stake here.

Even if Countrywide could argue that it was not on notice that it could be subject to sanctions under Rule 9011 before the bankruptcy court issued its liability opinion, it certainly could not maintain that position afterwards. The court discussed Rule 9011 extensively in its liability order and ordered a "trial with respect to the issue of sanctions" with ten days notice. *Riccard*, 307 F.3d at 1294, n.14 (11 day response period satisfied due process). Countrywide is wrong that the bankruptcy court had to issue a show-cause order: "We see no basis for requiring that in all instances notice be in writing and with the formality of pleadings. But to avoid misunderstanding and permit appellate review, the notice given, or evidence of the giving of notice, should be made a part of the record." *Donaldson v. Clark*, 819 F.2d 1551, 1559-60 (11th Cir. 1987). Countrywide had the opportunity to prepare for the sanctions hearing; it did not ask for an extension of time. Since the bankruptcy court issued its order, Countrywide has had the benefit of reconsideration of its arguments in three separate stay hearings. Countrywide's due process rights have been met. The bankruptcy court properly used Rule 9011 as a secondary basis of its authority to take remedial action in this case.

CONCLUSION

For the reasons given above, the United States Trustee respectfully requests that this Court affirm the Order of the bankruptcy court.

Respectfully submitted,
DANIEL M. McDERMOTT
United States Trustee
Region 9

By: /s/Dean P. Wyman
Dean P. Wyman #0007848
Senior Trial Attorney
U.S. Department of Justice
Office of the U.S. Trustee
H.M. Metzenbaum U.S. Courthouse
201 Superior Ave., #441
Cleveland, Ohio 44114
(216) 522-7800 ext. 231 (direct dial)
(216) 522-7193 (facsimile)
Dean.P.Wyman@usdoj.

CERTIFICATE OF SERVICE

I hereby certify that on this 17th day of November, 2009, a copy of the foregoing Amended Brief of Appellee was served through the Court's ECF filing system and by regular United States Mail, postage pre-paid to the following:

Robert C. Folland
THOMPSON HINE LLP
3900 Key Center
127 Public Square
Cleveland OH 44114
(Attorney for Appellant
Countrywide Home Loans, Inc.)

Thomas A. Connop
LOCKE LORD BISSELL & LIDDELL LLP
2200 Ross Ave
Suite 2200
Dallas TX 75201
(Attorney for Appellant
Countrywide Home Loans, Inc.)

Robert M. Whittington, Jr. Esq.
159 S. Main St
Key Bldg
Suite 1023
Akron OH 44308

/s/ Dean P. Wyman
Dean P. Wyman

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1. ("TI") ***TITLE*** OF CASE
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Habbo G. Fokkena, United States Trustee v. Maria C. Cruse (In re: Maria C. Cruse)

2. ("CO") ***CURRENT*** COURT
[E.g., "CTA9"]

8th Cir. BAP

3. ("CCN") ***CURRENT*** CASE NO.

No.: 10-6047

4. ("PCN") ***PRIOR*** CASE NO. - & COURT
[IF ANY]

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Court: S. D. Iowa

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Wendy Cox, P. Matthew Sutko, Ramona D. Elliott, James L. Snyder, Habbo G. Fokkena

(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***

BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s)

&

√ Any Miscellaneous ***BACKGROUND***

• Whether the bankruptcy court erred in concluding that 11 U.S.C. § 707(b)(1) does not apply to a case that has been converted from chapter 13 to chapter 7 of the Bankruptcy Code.

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UNITED STATES BANKRUPTCY APPELLATE PANEL
FOR THE EIGHTH CIRCUIT

In re MARIA C. CRUSE,

Debtor.

HABBO G. FOKKENA,
UNITED STATES TRUSTEE,

Appellant,

v.

MARIA C. CRUSE,

Appellee.

ON APPEAL FROM THE UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF IOWA
Bankruptcy Case No. 06-02892

BRIEF OF APPELLANT, UNITED STATES TRUSTEE

RAMONA D. ELLIOTT
General Counsel

P. MATTHEW SUTKO
WENDY L. COX
Executive Office for United States Trustees
United States Department of Justice
20 Massachusetts Avenue N.W.
Washington, D.C. 20530
Telephone: (202) 307-1399

HABBO G. FOKKENA
United States Trustee

JAMES L. SNYDER
Assistant United States Trustee
210 Walnut Street, Room 793
Des Moines, IA 50309
Telephone: (515) 284-4982

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JURISDICTIONAL STATEMENT

The bankruptcy court had jurisdiction under 28 U.S.C. §§ 157(a) and (b), and 1334(a) to issue its order denying the United States Trustee's motion to dismiss the Debtor's chapter 7 bankruptcy case. The bankruptcy court entered its order on June 8, 2010. That order was a final order. *Stuart v. Koch (In re Koch)*, 109 F.3d 1285, 1287 (8th Cir. 1997). The United States Trustee filed a notice of appeal on June 22, 2010, which is timely under 28 U.S.C. §§ 158(a) and (c)(2) and Fed. R. Bankr. P. 8002. This Court has appellate jurisdiction under 28 U.S.C. § 158(a)(1) and (b), statutory provisions under which bankruptcy appellate panels have jurisdiction to hear appeals from final judgments, orders, and decrees of bankruptcy judges.

STATEMENT OF THE ISSUE

The sole issue in this appeal is whether the bankruptcy court erred in concluding that 11 U.S.C. § 707(b)(1) does not apply to a case that has been converted from chapter 13 to chapter 7 of the Bankruptcy Code.

STANDARD OF REVIEW

A bankruptcy court's findings of fact are reviewed for clear error and its conclusions of law are reviewed *de novo*. *In re Litzinger*, 322 B.R. 108, 112 (B.A.P. 8th Cir. 2005). In this case, the facts are undisputed, and the bankruptcy court's interpretation of 11 U.S.C. § 707(b)(1) is a conclusion of law subject to *de novo* review.

STATEMENT OF THE CASE

Maria Cruse sought chapter 13 bankruptcy relief in the United States Bankruptcy Court for the Southern District of Iowa. *See* 11 U.S.C. § 1301 et seq. Less than two years later, Ms. Cruse converted her case to chapter 7. *See* 11 U.S.C. § 1307(a). The United States Trustee moved to dismiss Ms. Cruse's chapter 7 case for abuse under 11 U.S.C. § 707(b)(1) on the grounds that a presumption of abuse arose and the totality of Ms. Cruse's financial situation demonstrated abuse. *See* 11 U.S.C. § 707(b)(1), (2) & (3). The bankruptcy court held that section 707(b)(1) did not apply to cases that had not started in chapter 7 and denied the United States Trustee's motion for that reason. The United States Trustee appealed.

STATEMENT OF FACTS

Ms. Cruse commenced this case by filing a petition for relief under chapter 13 of the Bankruptcy Code on December 18, 2006. [Chapter 13 Voluntary Petition, #1]. At the time, Ms. Cruse did not qualify for chapter 7 relief according to her counsel. [1/12/09 Transcript at 8]. Ms. Cruse's plan was confirmed on June 28, 2007. [Confirmation Order, #34]. The plan provided for full payment of the unsecured creditors' claims. [Modified Plan, #29 at 5].

In early 2008, Ms. Cruse quit working and started receiving short term disability benefits due to complications following surgery. Ms. Cruse did not try to modify her plan or obtain a hardship discharge. *See* 11 U.S.C. §§ 1329, 1328(b). The chapter 13 trustee moved to dismiss Ms. Cruse's case in August of 2008, alleging that she had failed to make plan payments. [Trustee Motion to Dismiss, #42]. Ms. Cruse then converted her case to chapter 7. [Notice of Conversion, #47].

Shortly before she converted her case, Ms. Cruse had married a surgeon with an annual income of over $300,000, but the amended schedules she filed after conversion did not reflect her husband's income. [Schedules, #60 at 5]. Ms. Cruse also filed a Chapter 7 Statement of Current Monthly Income and Means Test Calculation in which she excluded her husband's entire $22,959.99 gross monthly income as a marital adjustment on Line 17. [#67 at 2]. The resulting calculation indicated that no presumption of abuse arose. [*Id.* at 5]. In amended schedules I and J filed in early December, Ms. Cruse claimed monthly net family income of $21,211.54. [#71 at 1]. She also claimed $21,408.68 in monthly household expenses, resulting in negative monthly income of $197.14. [*Id.* at 2].

The United States Trustee moved to dismiss the case under 11 U.S.C. §

707(b)(1) for both presumptive abuse and abuse under the totality of Ms. Cruse's financial circumstances based on her failure to attribute any of her husband's income to the payment of household expenses in her Means Test Calculation and the excessive expenses claimed on Schedule J. [#72].

After raising the issue sua sponte, the bankruptcy court ruled that 11 U.S.C. § 707(b)(1) did not apply to cases converted to chapter 7. [Docket Text Ruling, #82]. The bankruptcy court subsequently denied the United States Trustee's motion to dismiss on that basis. [Docket Text Order, #85].

The bankruptcy court did not write an opinion explaining its decision, but instead entered a minute order that referenced its earlier docket text ruling stating that the court "generally adopts the reasoning set forth in McDow v. Dudley (In re Dudley), 405 B.R. 790 (Bankr. W.D. Va. 2009), In re Ryder, 2008 WL 3845246 (Bankr. N.D. Cal. Aug. 18, 2008) and In re Fox, 370 B.R. 639 (Bankr. D.N.J. 2007)." [*Id.*].

SUMMARY OF ARGUMENT

This appeal is not about whether Ms. Cruse's bankruptcy case would be an abuse of chapter 7, although the United States Trustee believes that it would. The bankruptcy court has yet to consider that issue. This appeal will decide whether a debtor who initiates a case in one chapter and then converts it to chapter 7 will escape scrutiny for abuse under **(a)** section 707(b)'s means test, **(b)** section 707(b)(3)(A)'s bad faith test, and **(c)** section 707(b)(3)(B)'s totality of the debtor's financial circumstances test.

The bankruptcy court found that section 707(b)(1) does not apply in a case originally commenced under chapter 13 and subsequently converted to chapter 7. [Docket Text #82, #85]. The court did so because it relied on the reasoning of three other bankruptcy courts who read the words in section 707(b)(1) – "may dismiss a case *filed by an individual debtor under this chapter* whose debts are primarily consumer debts" – as unambiguously limiting dismissal under section 707(b) to cases originating under chapter 7. 11 U.S.C. § 707(b)(1) (emphasis added). [Docket Text Ruling, #82].

Those words are anything but clear. Courts in approximately equal numbers have taken opposite views of the "plain meaning" of the statute.

But one reading is better. The better reading permits a court to dismiss any chapter 7 case filed by an individual debtor with primarily consumer debts for abuse, regardless of how the case got to chapter 7. It is better because at least seven separate indications in the Code, its legislative history and relevant case law lead to the conclusion that section 707(b) applies to all chapter 7 cases. That body of law demonstrates this language does not exclude converted cases from scrutiny under section 707(b), but instead acts to limit the application of section 707(b) to chapter 7 cases involving individual debtors with primarily consumer debts. Those indicators far outweigh the countervailing indications relied on by others, making this interpretation the better one.

First, in the context of the Bankruptcy Code, cases that are converted to chapter 7 from chapter 13 are "deemed" to have been "filed under" chapter 7. *Resendez v. Lindquist*, 691 F.2d 397, 399 (8th Cir. 1982); *see* 11 U.S.C. § 348(a). This supports the conclusion that the phrase "filed . . . under this chapter" refers both to cases that originated under chapter 7 and those that were converted to chapter 7.

Second, sections 1112(b)(1), 1208(b), and 1307(b) of the Bankruptcy Code allow a court to "dismiss a case under this chapter." That language is the same as that found in section 707(b), except that section 707(b), unlike those sections, adds the words "filed by an individual debtor" to identify those cases pending in chapter 7 that can be dismissed under that subsection. Sections 1112(b), 1208(b), and 1307(b) serve the same purpose as 707(b), authorizing dismissal when the applicable statutory basis is met. There is no reason to read them more expansively than section 707(b).

Third, courts almost unanimously have interpreted the language "in a case filed under" in 11 U.S.C. § 1328(f) to include cases converted to the specified chapters. There is no reason to interpret the substantially similar phrase in section 707(b)(1) the opposite way.

Fourth, Congress explicitly excepted some chapter 7 cases from dismissal under section 707(b). But it did not explicitly except cases converted to chapter 7. Given that Congress knew how to create explicit exceptions to section 707(b) when it wished, there is no reason to find an implicit exception here.

Fifth, in section 704(b) of the Code, Congress required the United States Trustee to review materials submitted by individual debtors in chapter 7 cases and move to dismiss or convert the case if the debtor's case would be presumed to be an abuse or explain why a motion would not be appropriate. Section 704(b) makes no exception for converted cases.

Sixth, for over twenty years prior to the enactment of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005,[1] bankruptcy courts – relying on the same language at issue here – dismissed converted cases for substantial abuse under section 707(b) and routinely expressed the belief that converted cases could remain in chapter 7 only if it would not be a substantial abuse of that chapter. The language did not change in 2005, so the result should not either.

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[1] Pub. L. No. 109-8, 119 Stat. 23 (2005).

Seventh, the bankruptcy court's ruling would defeat the objective of section 707(b) to ensure that debtors with the ability to repay their creditors do so. Instead it would invite abuse by enabling debtors to obtain relief under chapter 7 simply by commencing their case in chapter 13 and then converting to chapter 7.

And it would discourage debtors who have some ability to pay but are unwilling or unable to make full payment under their current plan to engage in necessary belt-tightening or attempt to modify their plans to obtain relief under chapter 13. Many such debtors instead would convert to chapter 7, wasting the time and resources already spent by the court, the parties and the trustee in chapter 13 and unnecessarily burdening the new chapter 7 trustee.

ARGUMENT

I. Although Section 707(b) is not artfully drafted, the Code's language and structure, past practice under section 707(b), and section 707(b)'s purpose all establish that section 707(b) is best read as applying to converted cases.

A. Standing alone, section 707(b)(1) is ambiguous on the question of whether section 707(b) applies to converted cases.

The bankruptcy court held that Ms. Cruse's case could not be dismissed for abuse under section 707(b)(1) because that section did not apply to converted cases. [#82, #85]. The court relied on three recent bankruptcy court decisions that interpreted the statutory language to permit dismissal for abuse of "a case filed by an individual debtor under this chapter whose debts are primarily consumer debts" to limit the reach of section 707(b) to cases that began under chapter 7. 11 U.S.C. § 707(b)(1). Those decisions diverged from a 20-year, pre-BAPCPA practice of reviewing converted cases for substantial abuse under the identical statutory language.[2] And despite those new decisions, other courts have continued to rule that section 707(b) applies to converted cases. *See Justice v. Advanced Control Solutions, Inc.*, No. 07-5231, 2008 WL 4368668 (W.D. Ark. Sept. 22, 2008) (holding that section 707(b) does apply to cases converted to chapter 7); *In re Willis*, 408 B.R. 803 (Bankr. W.D. Mo. 2009) (Hon. Jerry W. Venters) (same); *In re Kellett*, 379 B.R. 332 (Bankr. D. Or. 2007) (same); *In re Kerr*, No. 06-12302, 2007 WL 2119291 (Bankr. W.D. Wash. Jul. 18, 2007) (same); *In re Perfetto*, 361 B.R. 27 (Bankr. D.R.I. 2007) (same).

The three courts' difficulty in applying section 707(b) to converted cases is understandable. The language of section 707(b)(1) is anything but clear. The sixteen words at the heart of the controversy include

- five nouns and
- three modifying phrases or clauses, but

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[2] In BAPCPA, Congress lowered the standard for dismissal under 707(b) from "substantial abuse" to "abuse," but the language at issue here remained unchanged. Pub. L. No. 109-8, 119 Stat. at 27.

- no punctuation.

Adding to the ambiguity, "under this chapter" sits haphazardly in the middle of the independent phrase "filed by a debtor . . . whose debts are primarily consumer debts."

But unlike the 20-year practice under section 707(b), those three courts' rulings go against the language and structure of the Bankruptcy Code and the well-recognized purpose of that provision, as explained below. Taken in context, the better interpretation of the statute is that section 707(b) applies to all cases under chapter 7.

B. The language and structure of the Bankruptcy Code, however, lead to the conclusion that converted cases are subject to dismissal for abuse.

The relevant language in section 707(b) must be construed in the context of the Bankruptcy Code. *See McCarthy v. Bronson,* 500 U.S. 136, 139 (1991) (rejecting arguments relying on a "natural reading" of statutory language in isolation). Courts look at the design of the statute as a whole and to its object and policy, not just the particular statutory language, to determine its meaning. *Crandon v. United States,* 494 U.S. 152, 158, (1990). The language and structure of the Code and the history of section 707(b) show that section 707(b) applies to all cases under chapter 7.

1. The fact that the Eighth Circuit and other courts hold that section 348(a) treats converted cases as filed under the converted chapter supports the Government's reading.

While most civil cases are filed only once, bankruptcy cases are different. A single bankruptcy case can proceed under various chapters by conversion from one chapter to another. In that context, a single bankruptcy case can pend under more than one chapter.[3]

The Bankruptcy Code treats converted cases as if they were originally commenced under the chapter to which they are converted. Section 348, which governs the effect of conversion, states that:

> Conversion of a case from a case under one chapter of this title to a case under another chapter of this title constitutes an order for relief *under the chapter to which the case is converted*, but, except as provided in subsections (b) and (c) of this section, does not effect a change in the date of the filing of the petition, the commencement of the case, or the order for relief.

11 U.S.C. § 348(a) (emphasis added).[4] In other words, upon conversion, a case is

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[3] The term "filed under" is not defined in the Code. Merriam-Webster's online dictionary defines "file" among other things as "to place among official records as prescribed by law." *See* www.merriam-webster.com/dictionary/file (Aug. 9, 2010). Using that definition, Ms. Cruse's case was filed under chapter 13 when she filed her petition and then filed under chapter 7 when she filed her notice of conversion.

[4] Subsections (b) and (c) of section 348 provide:

(b) Unless the court for cause orders otherwise, in section 701(a), 727(a)(10), treated as if it had been commenced under the new chapter at the time the original petition was filed. As the United States Bankruptcy Court for the Western District of Missouri has explained:

> [T]he clear intent of [section 348(a)] is to retain the original filing date as the date of the "filing of the petition," "commencement of the case" or "order for relief" except in the circumstances provided for in subsections (b) and (c), where these terms are instead deemed to refer to the conversion date. Because Section 707(b) is not mentioned in either subsection (b) or (c) of Section 348, it follows that the original filing date is retained upon conversion, *but the case is otherwise treated as if the debtor had originally filed under the converted chapter*.

In re Willis, 408 B.R. at 808 (quoting *In re Kerr*, 2007 WL 2119291 at *3 (emphasis added)). *Cf. Justice*, 2008 WL 4368668 at *3-5; *Perfetto*, 361 B.R. at 30-31; *In re Kellett*, 379 B.R. at 335-40; *In re Kerr*, 2007 WL 2119291 at *2-*4.[5]

And it is the law of this circuit that debtors who convert their cases from

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727(b), 728(a), 728(b), 1102(a), 1110(a)(1), 1121(b), 1121(c), 1141(d)(4), 1146(a), 1146(b), 1201(a), 1221, 1228(a), 1301(a), and 1305(a) of this title, "the order for relief under this chapter" in a chapter to which a case has been converted under section 706, 1112, 1208, or 1307 of this title means the conversion of such case to such chapter.

(c) Sections 342 and 365(d) of this title apply in a case that has been converted under section 706, 1112, 1208, or 1307 of this title, as if the conversion order were the order for relief.

[5] Because section 707(b) does not refer to "the order for relief under this chapter," there would be no reason to reference it in section 348(b) in any event.

chapter 13 to chapter 7 "are deemed to have filed a Chapter 7 case at the time the Chapter 13 case was filed." *Resendez*, 691 F.2d at 399.[6] *Accord In re Perfetto*, 361 B.R. at 31 (debtors who convert their cases to other chapters "are deemed to have 'filed under' the *converted to* chapter, as of the date the original petition was filed.") (italicized in original); *In re Sours,* 350 B.R. 261, 266-68 (Bankr. E.D. Va. 2006); *In re Grydzuk,* 353 B.R. 564, 568 (Bankr. N.D. Ind. 2006); *In re Capers,* 347 B.R. 169, 171-72 (Bankr. D.S.C. 2006).

So when Ms. Cruse's case was converted to chapter 7, it was "filed under" chapter 7, which supports the idea that it should be evaluated under section 707(b) for potential abuse.

2. The fact that other Code provisions providing for dismissal use similar language that includes converted cases without expressly saying so supports the Government's reading.

Provisions in various chapters of the Bankruptcy Code governing the dismissal of cases support the conclusion that section 707(b) applies to all cases under chapter 7. *See* 11 U.S.C. § 1112(b), § 1208(b), and § 1307(b) of the Bankruptcy Code. Each of those sections allows a court to "dismiss a case under this chapter." And that language includes converted cases even though it does not

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[6] Although the *Resendez* case did not address the precise issue before this court, it is instructive as to how the Code treats converted cases.

expressly say so. Otherwise, there would no reason to expressly except certain converted cases from the reach of section 1208(b) and section 1307(b).[7]

That language is the same as that found in section 707(b), except that section 707(b), unlike those sections, adds a second qualifier, *i.e.* the case also must be "filed by an individual debtor . . . whose debts are primarily consumer debts" to be dismissed under that subsection. Sections 1112(b), 1208(b), and 1307(b) serve the same purpose as 707(b), authorizing dismissal when the applicable statutory basis is met. Thus, section 707(b) should be construed in the same way – applying it to converted cases – because it is a basic rule of statutory construction that "'identical words used in different parts of the same act are intended to have the same meaning.'" *Commissioner of Internal Revenue v. Lundy*, 516 U.S. 235, 250 (1996) (citations omitted). There is no reason to interpret it in an opposite manner, as the bankruptcy court did.

3. The fact that courts have interpreted the words "filed under" in the Code to encompass converted cases supports the Government's reading.

In BAPCPA, Congress used the phrase "filed . . . under" twice when it added 11 U.S.C. § 1328(f), prohibiting debtors from receiving a discharge in a

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[7] Section 1208(b) does not apply if the case has been converted under section 706 or 1112. Section 1307(b) does not apply if the case has been converted under section 706, 1112, or 1208. *See* 11 U.S.C. §§ 1208(b) & 1307(b).

chapter 13 case filed within specified periods of time after filing previous cases in which they had received a discharge. *See* 11 U.S.C. § 1328(f)(1) & (2).

The phrases "in a case *filed under* chapter 7, 11, 12 of this title" and "in a case *filed under* chapter 13" in section 1328(f) have been overwhelmingly interpreted to encompass cases converted to those chapters, as well as cases originally commenced under those chapters.[8] *In re Dalton*, No. 09-12024, 2010 WL 55499 (Bankr. M.D.N.C. Jan. 7, 2010) (debtor who commenced case under chapter 13 and then converted to chapter 7 and received chapter 7 discharge found to have "filed under" chapter 7 for the purpose of section 1328(f)); *Grice v. WE Energies (In re Grice)*, 373 B.R. 886, 888-89 (Bankr. E.D. Wis. 2007) (same); *In re Ybarra*, 359 B.R. 702 (Bankr. S.D. Ill. 2007) (same); *In re Sours*, 350 B.R. at

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[8] Section 1328(f)(1) & (2) provide:

> Notwithstanding subsections (a) and (b), the court shall not grant a discharge of all debts provided for in the plan or disallowed under section 502, if the debtor has received a discharge–
>
> > (1) in a case *filed under* chapter 7, 11, or 12 of this title during the 4-year period preceding the date of the order for relief under this chapter, or
> >
> > (2) in a case *filed under* chapter 13 of this title during the 2-year period preceding the date of such order.

11 U.S.C. § 1328(f) (emphasis added).

268 (same); *In re Capers*, 347 B.R. at 171-72 (same); *In re Knighton*, 355 B.R. 922 (Bankr. M.D. Ga. 2006) (same); *In re Grydzuk*, 353 B.R. 564 (same). *But see In re Hamilton*, 383 B.R. 469 (Bankr. W.D. Ark. 2008).[9]

There is no discernable reason to give those same words an opposite meaning in section 707(b)(1). Specific language within the Code should be interpreted the same way. *Lundy*, 516 U.S. at 250 (citations omitted). Therefore, the language in section 707(b) referring to "a case filed . . . under this chapter" should be read as referring to both cases originating in chapter 7 and cases converted to chapter 7 like the substantially similar language in section 1328(f).

Other provisions in the Code buttress the conclusion that both cases commenced under a specific chapter and cases converted to that chapter are "filed under" that chapter. For example, in section 342(f), Congress provided that an entity may file a notice of address with a bankruptcy court to be used to provide notice to the entity in "all cases *under chapters 7 and 13*," and that the court will use the address provided to give notice in any case "*filed under chapter 7 or 13* " with certain caveats. 11 U.S.C. § 342(f)(1) & (2) (emphasis added). Using the bankruptcy court's narrow construction of the term "filed under," section 342(f)

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[9] A Fourth Circuit decision that narrowly interpreted "filed" in section 1328(f) did not address how that section applied to converted cases. *See Branigan v. Bateman (In re Bateman)*, 515 F.3d 272 (4th Cir. 2008).

would have to be understood as inviting entities to request that the bankruptcy courts send notice to them at a specific address in *all* chapter 7 and 13 cases, but requiring the bankruptcy courts to honor those requests only in cases *originally commenced* under chapters 7 and 13. That makes no sense.

4. The fact that section 707(b) expressly excepts certain cases – but not converted cases – from section 707(b)(2) supports the Government's reading.

Although Congress did not expressly choose to except converted cases from the reach of section 707(b), it did choose to include other explicit exceptions to means testing in that section. *See* 11 U.S.C. § 707(b)(2)(D) (excluding precisely defined subsets of disabled combat veterans and national guardsmen and reservists). Had Congress intended to create a similar exception for converted cases, it could have said so unequivocally in section 707(b)(1) or included the exception in section 707(b)(2)(D). *See Sanchez v. Holder*, 560 F.3d 1028, 1032 (9th Cir. 2009).

The contrast between section 707(b)(2)(D)'s explicit exception, and section 707(b)(1)'s text could hardly be more profound. Not only does the former expressly define the exception, it carefully delineates its parameters. It does so in detail. It leaves no ambiguity, expressly providing that section 707(b)(2) "shall not apply" to a well-defined class of excepted cases. 11 U.S.C. § 707(b)(2)(D).

And, because the exception is express and detailed, it is clear.

Given that Congress took great care to craft its express exception in section 707(b)(2)(D), there is no cause to presume it intended there to be any implicit exception in section 707(b). Because section 707(b)(2)(D)'s detailed nature underscores just how seriously Congress undertook its drafting of section 707(b), the lack of an express exception in section 707(b)'s text underscores that none exists.

5. The fact that Congress did not expressly or impliedly except converted cases from the scope of the United States Trustee's obligation under section 704(b) to review individual debtors' chapter 7 cases for presumptive abuse and take appropriate action under section 707(b) supports the Government's reading.

The bankruptcy court's conclusion that section 707(b) does not apply in converted cases cannot easily be reconciled with section 704(b). In fact, one decision upon which the bankruptcy court relied conceded that point. *See McDow v. Dudley (In re Dudley)*, 405 B.R. 790, 797 n.18 (Bankr. W.D. Va. 2009), *appeal dismissed*, 428 B.R. 686 (W.D. Va. 2010). That section expressly requires the United States Trustee to determine whether the presumption of abuse under section 707(b) arises "[w]ith respect to a debtor who is an individual in a case under [chapter 7]," and if it does to file either a motion to dismiss or convert under section 707(b) or a statement explaining why such a motion would not be appropriate. 11 U.S.C. § 704(b)(1) & (2). Because the statute refers to "a case under" chapter 7, it applies to any chapter 7 case no matter how it got there. So under section 704(b), the United States Trustee must review cases converted to chapter 7 by individual debtors for abuse and file a motion to dismiss or convert under section 707(b) if it believes that a presumption of abuse arises.[10] Plainly, the United States Trustee cannot fulfill his mandatory statutory duties under section 704(b) if the bankruptcy court is correct in holding that section 707(b) does not apply to converted cases.

Admittedly, a similar tension exists between the United States Trustee's interpretation of section 707(b) and the clerk's duty under 11 U.S.C. § 342(d) to provide creditors notice within ten days of the filing of the petition if the presumption of abuse has arisen. As some have noted, that might not be possible in a converted case. But the other factors outweigh that potential inconsistency, leading to the conclusion that the better reading of section 707(b) is that it applies in converted cases.

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[10] All chapter 13 debtors are individual debtors (*see* 11 U.S.C. § 109(e)) so any cases they convert to chapter 7 fall within the purview of section 704(b).

C. The fact that courts dismissed converted cases under section 707(b) for more than twenty years before BAPCPA supports the Government's reading.

The language at issue in this case has been in the statute unchanged since section 707(b) was added in 1984. *See* Pub. L. No. 98-353, 98 Stat. 333 (1984). For over 20 years before BAPCPA was enacted, parties brought motions under section 707(b) to dismiss cases that had been converted to chapter 7 from other chapters – and bankruptcy courts granted those motions – without anyone questioning section 707(b)'s applicability to converted cases. *See, e.g., In re Beharry*, 264 B.R. 398, 399-400 (Bankr. W.D. Pa. 2001); *In re Morris*, 153 B.R. 559, 563-64 (Bankr. D. Or. 1993); *In re Traub*, 140 B.R. 286, 287-88, 291 (Bankr. D.N.M. 1992) (dismissing case converted from chapter 11 to chapter 7 under section 707(b)). And courts assessing the potential for a chapter 13 debtor to abuse the bankruptcy system by converting to chapter 7 often identified section 707(b) as a mechanism to curb such abuse. *See, e.g., In re Fulton*, 211 B.R. 247, 260 n.14 (Bankr. S.D. Ohio 1997) (indicating that "if the debtor converts . . . under 11 U.S.C. § 1307(a), the debtor must be eligible to file a Chapter 7 which would include an analysis under § 707(b) as to whether a significant amount of disposable income indicates an abuse of the system").[11]

Pre-BAPCPA bankruptcy practice is significant because courts "will not read the Bankruptcy Code to erode past bankruptcy practice absent a clear indication that Congress intended such a departure." *Hamilton v. Lanning*, 130 S. Ct. 2464, 2473 (2010) (internal quotation omitted). Congress retained the term "filed under" in 2005 when it made significant changes to that section, despite the widespread practice of reviewing converted cases for substantial abuse under section 707(b). If Congress had intended section 707(b) to apply only in cases that originated in chapter 7, it would have said so expressly and unambiguously in BAPCPA.[12]

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[11] *Accord In re Murry-Hudson*, 147 B.R. 960, 964 (Bankr. N.D. Cal. 1992) (declaring that "[w]hile § 1307(a) gives a debtor the unbridled right to convert to Chapter 7, it does not give him the unbridled right to remain there. If he has the ability to complete his Chapter 13 plan, or the Court otherwise finds that the granting of Chapter 7 relief would be a substantial abuse of the provisions of that chapter, his case could be dismissed pursuant to § 707(b)."); *In re Hargis*, 103 B.R. 912, 917 n.2 (Bankr. E.D. Tenn. 1989) (indicating that "a debtor who chooses to convert his or her chapter 13 case to a case under chapter 7 . . . would still be subject to the provisions of 11 U.S.C. § 707(b)"). The United States Trustee is not aware of any pre-BAPCPA case raising the issue of whether section 707(b) applies in converted cases.

[12] Congress knew how to refer unambiguously to cases originally commenced under a specific chapter and conversely, how to expressly exclude converted cases, but it did neither in section 707(b)(1). *See* 11 U.S.C. § 1112(a)(2) (referring to cases that "originally [were] commenced . . . under this chapter"); 11 U.S.C. § 706(a) (permitting a debtor to convert a case "if the case

D. Only if every case under chapter 7 is reviewed for abuse will all debtors with the ability to repay their creditors be asked to do so.

Congress enacted the BAPCPA "'to ensure that debtors repay creditors the maximum they can afford.'" *Coop v. Frederickson (In re Frederickson)*, 545 F.3d 652, 657 (8th Cir. 2008) (quoting H.R. Rep. No. 109-31, pt.1, at 2 (2005), *reprinted in* 2005 U.S.C.C.A.N. 88, 89). *See also* 151 Cong. Rec. S 2470 (March 10, 2005) ("The means test was intended to 'ensure that those who can afford to repay some portion of their unsecured debts [be] required to do so.'"). Congress was concerned that under the prior system, "some bankruptcy debtors are able to repay a significant portion of their debts" but are not required to do so. H.R. Rep. No. 109-31 (I), at 5, *reprinted in* 2005 U.S.C.C.A.N. 88, 92. In amending section 707(b), Congress sought to close or reduce "the loopholes and incentives that allow and – sometimes – even encourage opportunistic personal filings and abuse." *Id.*

The bankruptcy court's approach has the opposite effect. It encourages debtors to convert cases in an effort to escape scrutiny not only under 707(b)(2)'s test for presumption of abuse, but also under section 707(b)(3)(A)'s bad faith test

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has not been converted under" specified sections), 11 U.S.C. § 1112(a)(3) (permitting conversion "unless the case was converted" involuntarily).

and 707(b)(3)(B)'s test of the totality of the circumstances of the debtor's financial situation, giving those with a clear-cut ability to repay the opportunity to avoid having to repay anything at all. The bankruptcy court's interpretation would invite debtors with disposable income sufficient to repay their creditors in full to escape section 707(b) review simply by filing chapter 13 petitions and shortly thereafter converting their cases to chapter 7.

It would also encourage chapter 13 debtors, who might otherwise amend their chapter 13 plans, to convert to chapter 7 and eliminate their payments to creditors instead of utilizing the remedies available for such debtors under chapter 13. Those conversions would waste the time and effort expended by the court, the parties, and the chapter 13 trustees, and would unnecessarily create work for the new chapter 7 trustees who must review the debtors' filings and prepare for the section 341 meetings.

And while some courts suggest that parties may seek to dismiss converted cases for "bad faith" under section 707(a), that does not necessarily solve the problem for several reasons. First, in this circuit and some others, it has not been clearly established that bad faith constitutes "cause," under section 707(a) that warrants dismissal, posing a significant risk that debtors may strategically file in chapter 13 and convert to chapter 7 with impunity. *See In re Huckfeldt*, 39 F.3d

829, 832 (8th Cir. 1994). *See also In re Padilla*, 222 F.3d 1184, 1193 (9th Cir. 2000) (limiting the application of section 707(a). Second, bad faith may be difficult to prove where a dishonest debtor makes a payment or two under a confirmed plan before converting to chapter 7. In addition, parties would still lose several of their means of detecting and remedying abusive cases through dismissal – the means test of section 707(b)(2), a bad faith analysis under section 707(b)(3)(B), and consideration of the totality of the debtor's financial circumstances under section 707(b)(3)(B) – leaving them no recourse against debtors with a meaningful ability to pay who convert to chapter 7 but whose conduct may not rise to the level of bad faith.

In spite of the potential abuses associated with conversion, part of the reasoning behind the decisions on which the bankruptcy court relied was that it would be unfair and pointless to review converted cases for abuse because the means test calculation is based on income and expenses figures that predated the chapter 13 case. But that is only the starting point for section 707(b) review.

Congress included a provision in section 707(b) that permits a debtor to attempt to prove special circumstances, including changes in his income or expenses, to rebut the presumption that his converted case would be abusive. *See*

11 U.S.C. § 707(b)(2)(B).[13] And the bankruptcy court considers the totality of the debtor's actual financial situation. *See Ross-Tousey v. Neary (In re Ross-Tousey)*, 549 F.3d 1148, 1162 (7th Cir. 2008). And, in a section 707(b)(3)(B) case, the conditions existing at discharge govern. *In re Cortez*, 457 F.3d 448, 458 (5th Cir. 2006). In addition, if a case is converted from chapter 13 to chapter 7, and the United States Trustee determines that the debtor has no ability to repay, he likely would decline to bring a motion to dismiss the debtor's case.[14] *See* 11 U.S.C. § 704(b)(2). So only a debtor with disposable income at the time of the conversion has any real risk of having his converted case reconverted or dismissed. That debtor *should* be denied chapter 7 relief if he still has an ability to make meaningful payments to his creditors, regardless of whether he converted his case from chapter 13.

There is an answer for an honest debtor who fails to make plan payments in chapter 13 because of deteriorating finances, but still has disposable income – he

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[13] Nothing in section 707(b)(2)(B) limits the special circumstances that a debtor may raise to those existing at the time he filed his original petition.

[14] In fiscal year 2009, the United States Trustees declined to seek dismissal in about 60 percent of the presumed abusive cases after considering the debtors' special circumstances – most frequently job losses. United States Trustee Program Report of Significant Accomplishments Fiscal Year 2009 at 15 (available at www.justice.gov/ust/public_affairs/annualreport/docs/ar2009.pdf).

can try to modify his plan.[15] *See* 11 U.S.C. § 1329. A debtor with a confirmed plan who is unable to afford payments under his plan may be able to modify his plan to reduce or postpone his monthly payments. And if modification is impracticable, the debtor may qualify for a hardship discharge under section 1328(b), obviating the need to convert to chapter 7.

Here, it appears that Ms. Cruse may still have an actual ability to pay either because she could work or because some of her husband's sizable income could be used for their household expenses, freeing her income to repay her creditors. So even if she cannot afford to make the monthly payments of $665 required by her plan, she may be able to make smaller, but still meaningful payments to her creditors as Congress intended.

If this Court holds that the section 707(b) applies to Ms. Cruse's case, she will have the opportunity to prove that special circumstances exist based on her current financial situation that rebut the presumption of abuse and show that she in fact has no ability to repay her creditors. If she is successful, she can remain in

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[15] Previously, some chapter 13 debtors with deteriorating finances were unable to get plans confirmed in chapter 13. That risk has been substantially reduced following the Supreme Court's pronouncement in *Lanning* that courts can consider changes in income and expenses that are known or virtually certain at the time of confirmation in calculating projected disposable income. 130 S. Ct. at 2478.

chapter 7. If not, she falls within the group of debtors that Congress has concluded are not in need of liquidation relief. *See Lanning*, 103 S. Ct. at 2484 n.7 (Scalia, J. dissenting). Ms. Cruse could request to reconvert to chapter 13 and obtain relief under that chapter that takes full account of her current financial situation.

The United States Trustee simply seeks judicial review of *all* individual chapter 7 cases for abuse, regardless of what chapter the cases began in, and the ability to take appropriate action under section 707(b) if warranted.

CONCLUSION

For those reasons, the United States Trustee respectfully asks this Court to reverse the order entered by the bankruptcy court, and remand this case for further proceedings.

Respectfully submitted,

HABBO G. FOKKENA
United States Trustee

By: /s/ Wendy L. Cox
Wendy L. Cox
DC Bar #429918

RAMONA D. ELLIOTT
General Counsel

P. MATTHEW SUTKO
Associate General Counsel
WENDY L. COX
Trial Attorney
U.S. Department of Justice
Executive Office for United States Trustees
20 Massachusetts Avenue N.W.
Washington, D.C. 20530
Telephone: (202) 307-1399

JAMES L. SNYDER
Assistant United States Trustee
210 Walnut Street, Room 793
Des Moines, IA 50309
Telephone: (515) 284-4982

Certification Required By L.R.BAP 8th Cir. 8008A(a):

The undersigned, counsel of record for the Appellant, Habbo G. Fokkena, United States Trustee, certifies that the original of the foregoing Brief of Appellant, United States Trustee was signed by Wendy L. Cox, counsel of record for Appellant, Habbo G. Fokkena, United States Trustee.

/s/Wendy L. Cox

Certification Required By L.R.BAP 8th Cir. 8010A(b)(2):

The undersigned, counsel of record for the Appellant, Habbo G. Fokkena, United States Trustee, certifies that to the best of her knowledge, the following constitute all of the pending cases related to this appeal:

1) *In re Maria C. Cruse*, No. 06-02892 (Bankr. S.D. Iowa)
2) *Habbo G. Fokkena v. Damian Gerald Chapman et al.*, No. 10-6046 (B.A.P. 8th Cir.) (The *Chapman* appeal has been consolidated with the present appeal).
3) *In re Damian Gerald Chapman & Melissa Ann Chapman*, No 08-35303 (Bankr. D. Minn.)

/s/ Wendy L. Cox

Certification Required By L.R.BAP 8th Cir. 8010A(c):

The undersigned, counsel of record for the Appellant, Habbo G. Fokkena, United States Trustee, certifies that the body of the foregoing brief, exclusive of the table of contents, tables of authorities, statement of appellate jurisdiction, statement of the issue and standard of review contains 6275 words. I relied upon the word count tool provided by my word processing program, WordPerfect 12, to obtain the word count.

/s/ Wendy L. Cox

RELEVANT BANKRUPTCY COURT DOCUMENTS

(Filed in lieu of an appendix pursuant to L.R.BAP 8th Cir. 8009A)

Document	Docket Number
Chapter 13 voluntary petition (filed 12/18/06)	1
Modified chapter 13 plan (filed 5/30/07)	29
Order confirming plan (entered 6/28/07)	34
Notice of conversion (filed 10/09/08)	47
Amended schedules A, B, I, J (filed 10/15/08)	60
Chapter 7 statement of current monthly income and means test calculation (filed 11/03/08)	67
Notice that case should be presumed to be an abuse (entered 11/13/08)	68
Amended schedules I, J (filed 12/04/08)	71
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Debtor's objection to motion (filed 12/24/08)	75
Docket text order regarding motion ordering parties to file briefs on whether 11 U.S.C. § 348(a) is dispositive of motion (entered 1/12/09)	77
United States Trustee's brief on section 348(a) (filed 1/27/09)	78
Debtor's brief on section 348(a) (filed 2/23/09)	79

Transcripts of the 1/12/09 and 7/15/10 telephonic hearings are available on the docket of this appeal.[16]

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[16] Because no court report was present at the telephonic hearings, the United States Trustee had the transcripts prepared from audiotapes of the hearings he obtained from the clerk of the bankruptcy court.

CERTIFICATE OF SERVICE

I hereby certify that on August 13, 2010, I electronically filed the foregoing with the Clerk of the Court by using the CM/ECF system. Participants in the case who are registered CM/ECF users will be served by the CM/ECF system.

I further certify that some of the participants in the case are not CM/ECF users. I have mailed the foregoing document by First-Class Mail, postage prepaid to the following non-CM/ECF participants:

Nancy L. Thompson
309 Court Ave., Suite 217
Des Moines, IA 50309
(515) 875-4851
Email: nthompson
@thompsonlawoffice.net
Counsel for Debtor/Appellee

Maria C. Cruse
6813 NW 93d
Johnston, Iowa 50131
Debtor/Appellee

Donald Neiman
Chapter 7 Trustee
801 Grand Avenue, Suite 3700
Des Moines, Iowa 50309-8004
Chapter 7 Trustee

/s/ Wendy L. Cox

BRIEF BANK — "SUMMARY SHEET"

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WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*
In re Cherry Barbara Castillo (Nancy Curry, Chapter 13 Trustee, and Julie Feder v. Cherry Barbara Castillo and G. Thomas Leonard)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*
9th Cir.

3. ("CCN") ***CURRENT*** CASE NO.
No.: 00-55846

4. ("PCN") ***PRIOR*** CASE NO. - & COURT *[IF ANY]*
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Court: BAP 9th Cir.
(Identify judge & cite, if any)

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Barbara L. Herwig, E. Roy Hawkins, David W. Ogden
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***
- Whether contrary to the B.A.P.'s conclusion, a bankruptcy trustee is entitled to quasi-judicial immunity for all actions that are integral to the convening of a judicial hearing, including providing notice to the parties of the hearing.

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United States Court of Appeals,
Ninth Circuit.
In Re Cherry Barbara CASTILLO, Debtor.
Nancy CURRY, Chapter 13 Trustee, and Julie Feder, Appellants,
v.
Cherry Barbara CASTILLO and G. Thomas Leonard, Appellees.
No. 00-55846
August, 2000.

On Appeal from the United States Bankruptcy Appellate Panel for the Ninth Circuit

Brief for the United States as Amicus Curiae in Support of Appellants

David W. Ogden, Assistant Attorney General, Barbara L. Herwig, (202) 514-5425, E. Roy Hawkens, (202) 514-5714, Attorneys, Appellate Staff, Civil Division, Room 9544, Department of Justice, 601 D St., N.W. Washington, D.C. 20530-0001

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1** ***STATEMENT OF THE IDENTITY OF THE AMICUS CURIAE, ITS INTEREST IN THE CASE. AND THE SOURCE OF ITS AUTHORITY TO FILE

Identity of the Amicus Curiae: The United States is appearing as amicus curiae in support of Nancy Curry, the Chapter 13 Bankruptcy Trustee, and her staff attorney, Julie Feder.

Interest of the United States: The United States has a substantial interest in ensuring that absolute immunity is extended to private sector bankruptcy trustees in those limited circumstances where, as here, they perform functions that are integrally related to the judicial process.

Source of Authority to File: This brief is filed pursuant to Federal Rule of Appellate Procedure 29(a), which permits the United States to “file an amicus-curiae brief without the consent of the parties or leave of court.”

***2** *BACKGROUND*

The relevant facts in this case are undisputed. Appellee, Cherry Castillo (“debtor”), filed a Chapter 13 bankruptcy petition in September 1997. The purpose of such a filing is to enable a debtor to pay her debts in full or in part over a period of time pursuant to a plan that must be approved by the bankruptcy court (11 U.S.C. §§ 1322, 1325).

Administering a Chapter 13 case is time-consuming and entails numerous responsibilities, including reviewing the feasibility of a debtor's plan, investigating the financial affairs of debtor, ensuring that debtor performs her duties, examining and ensuring the validity of creditors' claims, accounting for property received, and furnishing interested parties with information regarding the estate and its administration (*infra* note 2). Prior to the enactment of the Bankruptcy Reform Act of 1978, bankruptcy judges (then known as referees) adjudicated bankruptcy cases and administered them in concert with trustees appointed by the court.

In the Bankruptcy Reform Act of 1978, however, Congress decided to "separate the administrative duties in bankruptcy from the judicial tasks, leaving the bankruptcy judges free to resolve disputes untainted by knowledge of administrative matters unnecessary and perhaps prejudicial to an impartial judicial determination" (H.R. Rep. No. 99-764, at 18 (1986), *reprinted in* 1986 U.S.C.C.A.N. 5227, 5230). To this end, Congress created the U.S. ***3** Trustee Program within the Department of Justice to assume administrative responsibility for bankruptcy cases (28 U.S.C. §§ 58l-589a).

Under the U.S. Trustee Program, the Attorney General appoints a U.S. Trustee in each of the 21 regions across the United States (28 U.S.C. § 581). A U.S. Trustee is a Department of Justice official who supervises the administration of bankruptcy cases. If the number of Chapter 13 bankruptcy cases in a region warrants, the U.S. Trustee for that region "may, subject to the approval of the Attorney General, appoint one or more individuals to serve as standing trustee" (28 U.S.C. § 586(b)), a position that is also referred to as "private trustee" (H.R. Rep. No. 95-595, at 101, 105-06 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6062, 6066-68).

Standing trustees must satisfy the eligibility requirements of 11 U.S.C. § 321, and qualify under 11 U.S.C. § 322 and 28 U.S.C. § 586. They do not serve pursuant to a fixed term of appointment, nor do they receive a federal salary or benefits. Rather, to fund their compensation, standing trustees collect a flat percentage of plan payments made by debtors in cases that they administer (28 U.S.C. § 586(e); *see also* 11 U.S.C. § 326(b)).[FN1]

FN1. The fee that a trustee may collect in each Chapter 13 case is established by the Department of Justice and shall not exceed ten percent of payments received under the plan (28 U.S.C. § 585(e)(1)(B)(i)). The funds collected pursuant to the percentage fee can be used only to pay the trustee's compensation and "actual, necessary expenses" (*id.* § 586(e)(1)). Excess funds must be turned over to the United States Trustee System Fund (*id.* § 586(e)(2)).

***4** Once appointed, the standing trustee - operating under the supervision of the U.S. Trustee and pursuant to legislative and judicial directives - performs many of the functions previously performed by bankruptcy judges. These functions may include actions that are integral to the convening of judicial hearings -namely, the scheduling and noticing of such hearings.[FN2]

FN2. The Chapter 13 standing trustee, in additional to performing acts that are integral to the judicial process, functions as a plan administrator, a trustee for the estate, and an advisor to debtor. Specifically, the trustee reviews and administers a debtor's plan, appears and argues in bankruptcy court at any hearing that concerns the confirmation or modification of a plan or the value of property subject to a lien, and makes a final report and files a final account of the administration of the estate with the bankruptcy court and the U.S. Trustee (11 U.S.C. § 302(b)). Additionally, the trustee must: (1) account for all property received; (2) ensure the debtor performs his duties; (3) investigate the financial affairs of the debtor; (4) examine and ensure the validity of creditors' claims; (5) oppose, where warranted, the discharge of the debtor; (6) furnish interested parties with information regarding the estate and its administration; (7) dispose of moneys received pursuant to regulations issued by the Administrative Office of the U.S. Courts; and (8) provide advice and assistance to debtors on matters other than legal questions. *See id.*

Appellant, Nancy Curry ("trustee"), was appointed as the standing trustee for debtor's Chapter 13 case.[FN3] On October 29, 1997, she presided at a section 341 hearing, which is attended by debtor's creditors and is designed, *inter alia*, to assist the standing trustee in determining the feasibility of debtor's plan. *See* 11 U.S.C. § 341; Fed. R. Bankr. P. 2002(a)(1) & 2003 (governing ***5** notice and conduct of section 341 meetings). At the section 341 hearing, debtor indicated that she wished to object to the claim of a particular creditor. Because the standing trustee could not determine the feasibility of debtor's proposed plan until the objection was decided by the court, the trustee noted on her worksheet that she would continue the section 341 hearing until January 20, 1998. *See* Vol. I Consolidated Excerpts of Record ("Con. ER") at 224.

FN3. For simplicity, references to appellant Ms. Curry as "trustee" in this brief include her staff attorney, Ms. Feder.

Due to a clerical error in the standing trustee's office, however, a hearing was set for December 3, 1997 before the bankruptcy judge regarding the confirmation of debtor's plan (11 U.S.C. § 1324), and neither the debtor nor her counsel was notified of the confirmation hearing (Vol. II Con. ER at 359). The function of scheduling and noticing this judicial hearing is judicially delegated to the standing trustee (*id.* at 359 n.3).[FN4]

FN4. Consistent with Bankruptcy Rule 2002(b), the "Notice of Commencement of Case Under Chapter 13 of the Bankruptcy Code" issued by the bankruptcy court in this case provides in pertinent part (Vol. I Con. ER at 207): "A hearing on confirmation of the debtor's plan will be scheduled by the chapter 13 trustee at the 341(a) meeting of creditors if the trustee objects to the plan, or a party in interest *** appears at the 341(a) meeting and requests a confirmation hearing. The trustee will only give written notice of a hearing on confirmation, if one is set, to all objecting and appearing parties."

Because they did not receive notice, neither the debtor nor her attorney appeared at the December 3, 1997 confirmation hearing before the bankruptcy judge. At the hearing, the trustee's staff ***6** attorney advised the judge that her records indicated the debtor was delinquent on a plan payment and, on behalf of the trustee and consistent with bankruptcy procedure, she therefore moved for dismissal (Vol. I Con. ER at 184). The bankruptcy court granted the motion and dismissed debtor's case on December 16, 1997 (Vol. II Con. ER at 360).

Notice of the dismissal was received by debtor and her counsel no later than December 22, 1997 (Vol. I Con. ER at 95). Debtor's counsel failed promptly to seek a vacatur of the dismissal order, however, and as a result, debtor's home was foreclosed upon on December 26, 1997 (Vol. II Con. ER at 360).

By motion filed on January 5, 1998, debtor's counsel moved to vacate the dismissal order and set aside the foreclosure sale (Vol. II Con. ER at 397). In February 1998, the bankruptcy court granted the motion to vacate the dismissal order, but it denied the belated request to set aside the foreclosure sale against the innocent third-party purchaser (*id.* at 360, 398). The court dismissed debtor's Chapter 13 case in November 1998 (*id.* at 399).

In January 1999, debtor moved the bankruptcy court for permission to pursue a civil damages action in state court against the standing trustee on the ground that the trustee was negligent in scheduling and noticing the confirmation hearing (Vol. II Con. ER at 400). The bankruptcy court granted the motion, rejecting, as ***7** relevant here, the trustee's argument that she was entitled to quasi-judicial immunity (*id.* at 360).

The standing trustee appealed to the Ninth Circuit Bankruptcy Appellate Panel (“B.A.P.”), which reversed to the extent the bankruptcy court granted debtor leave to sue the trustee in state court for actions in *scheduling* the confirmation hearing. Such conduct, held the B.A.P., is a quasi-judicial function that is entitled to absolute immunity (Vol. II Con. ER at 367). However, the B.A.P. held that immunity does not extend to the noticing aspect of the hearing, and it therefore affirmed the court's grant of leave to sue the trustee in state court based on the trustee's failure to provide debtor with notice (*id.* at 368, 371).

SUMMARY OF THE ARGUMENT

The common law long has recognized that judges are entitled to absolute immunity from damage suits arising from their exercise of judicial functions. The rationale behind absolute judicial immunity is that (1) the independent and impartial judgment vital to the judicial process could be impaired by exposure to civil damage suits, and (2) disappointed litigants should seek correction of errors that occur in the judicial process through ordinary appellate mechanisms of review. For these same reasons, the common law also extends absolute immunity beyond judges to individuals who perform functions that are closely related to the judicial process. This immunity, which is called quasi-judicial immunity, depends for ***8** its application on the function performed rather than the actor who performed it.

In this case, the B.A.P. held that the standing trustee's act of providing notice to a litigant on behalf of the court regarding a judicial hearing is a ministerial act that is not entitled to quasi-judicial immunity. We show that this holding violates Ninth Circuit precedent, which establishes that the function of providing notice to a litigant on behalf of the court is an “integral part [] of the judicial process,” and a mistake in the performance of such a function “does not abrogate [quasi-] judicial immunity, even if it results in ‘grave procedural errors”’ (*Mullis* v. *United States Bankr. Court for the Dist. of*

Nev., 828 F.2d 1385, 1390 (9th Cir. 1987) (quoting *Stump* v. *Sparkman*, 435 U.S. 349, 359 (1978)). *Accord* *Morrison* v. *Jones*, 607 F.2d 1269, 1273 (9th Cir. 1979), *cert. denied*, 445 U.S. 962 (1980) (holding that the function of providing notice to a party on behalf of the court is a "part of [the] judicial process *** clothed with quasi-judicial immunity").

Contrary to the B.A.P.'s conclusion, the decision in *Antoine* v. *Byers & Anderson, Inc.*, 508 U.S. 429 (1993), does not effectively overrule the above case law. *Antoine*, which held that a court reporter's statutory duty to produce a transcript of a federal criminal trial is not a quasi-judicial function, is readily distinguishable from this case, which involves providing notice of ***9** a judicial hearing - a function that *Antoine* does not address and that this Court has squarely held is so integrally related to the judicial process as to be deemed a quasi-judicial function.

Moreover, the B.A.P.'s analysis - which isolates the noticing function and analyzes it in a vacuum - contravenes this Court's *en banc* decision in *Ashelman* v. *Pope*, 793 F.2d 1072 (9th Cir. 1986), which held that when determining whether a function has a sufficiently close nexus to the judicial process to merit absolute immunity, a court should focus broadly on the "ultimate act" rather than dissecting the "ultimate act" into constituent parts. In the instant case, the "ultimate act" is properly characterized either as the convening of a judicial hearing that was unattended by the debtor, or the failure of the standing trustee to reschedule that judicial hearing - functions that unquestionably are judicial in nature. And Ninth Circuit precedent establishes that the component act of noticing a judicial hearing is integral to (*i.e.*, not meaningfully separable from) these functions and therefore entitled to quasi-judicial immunity.[FN5]

> FN5. The issue of whether the standing trustee is an "employee of the United States" (28 U.S.C. § 1671) for purposes of the Federal Tort Claims Act is not before this Court, because the trustee has not followed the procedures set forth in the Westfall Act (28 U.S.C. § 2679) for seeking certification by the Attorney General, nor has she attempted to raise the issue in this Court. *See* Standing Trustee's Opening Brief at 16-17 n.2. It is the Government's position that standing trustees are not federal employees. *See, e.g.*, *California State Bd. of Equalization* v. *Sierra Summit, Inc.*, 490 U.S. 844, 849-50 (1989); *In re Greene*, 980 F.2d 590, 597 (9th Cir. 1992), *cert. denied*, 510 U.S. 1039 (1994).

10** ***ARGUMENT

CONTRARY TO THE B.A.P.'S CONCLUSION, A BANKRUPTCY TRUSTEE IS ENTITLED TO QUASI-JUDICIAL IMMUNITY FOR ALL ACTIONS THAT ARE INTEGRAL TO THE CONVENING OF A JUDICIAL HEARING, INCLUDING PROVIDING NOTICE TO THE PARTIES OF THE HEARING.

A. *The Purpose And Scope Of Quasi-Judicial Immunity, And The Functional Approach Used By The Supreme Court In Applying It.*

1. Since the founding of the Republic, the common law has recognized a "sweeping form of immunity" for acts performed by judges that relate to the "judicial process" (*Forrester* v. *White*, 484 U.S. 219, 225 (1988); *accord* *Imbler* v. *Pachtman*, 424 U.S. 409, 423 n.20 (1976)). This absolute immunity insulates judges from charges of erroneous or irregular action, even when it is alleged that such action was driven by malicious or corrupt motives (*Forrester*, 484 U.S.

at 227-28). It also insulates them from liability for the exercise of judicial authority that is “flawed by the commission of grave procedural errors” (*Stump* v. *Sparkman*, 435 U.S. 349, 359 (1978)).

Clothing judges with absolute immunity for conduct that relates to the judicial process serves two compelling purposes. First, it protects “judicial independence by insulating judges from vexatious actions prosecuted by disgruntled litigants” (*Forrester*, 484 U.S. at 225). If judges were “threatened with personal liability for acts taken pursuant to their official duties, they may well be induced to act with an excess of caution or otherwise ***11** skew their decisions in ways that result in less than full fidelity to the objective and independent criteria that ought to guide their conduct *** [thus] detract[ing] from the rule of law instead of contributing to it” (*id.* at 223).

Second, insulating judges from damage claims for official acts relating to the judicial process discourages collateral attacks on final judgments, thus promoting the use of “appellate procedures as the standard system for correcting judicial error” (*Forrester*, 484 U.S. at 225). Notably, “[m]ost judicial mistakes or wrongs are open to correction through ordinary mechanisms of review” (*id.* at 227). Accordingly, disgruntled litigants have the “means through which [they] can protect themselves from the consequences of judicial error *** ‘and to those remedies they must, in such cases, resort.”’ (*id.* at 227, 228 (quoting *Bradley* v. *Fisher*, 80 U.S. (13 Wall.) 335, 354 (1872)).[FN6]

> FN6. As the Court explained in *Pierson* v. *Ray*, 386 U.S. 547, 554 (196.7):
> It is a judge's duty to decide all cases within his jurisdiction that are brought before him, including controversial cases that arouse the most intense feelings in the litigants. His errors may be corrected on appeal, but he should not have to fear that unsatisfied litigants may hound him with litigation charging malice or corruption.

2. Absolute immunity is not reserved solely for judges. Despite the Supreme Court's view that absolute immunity is a strong medicine that should be used sparingly (*Antoine* v. *Byers & Anderson, Inc.*, 508 U.S. 429, 432 n.4 (1993)), the Court consistently ***12** has declined to “diminish the traditional common-law protections extended to the judicial process” (*Forrester*, 484 U.S. at 225). To preserve the integrity of the judicial process, and in recognition of the fact that individuals who allege that they have been harmed in that process generally have appellate avenues for redressing the harm, the common law long has extended absolute immunity in appropriate circumstances to non-jurists “who perform functions closely associated with the judicial process” (*Cleavinger* v. *Saxner*, 474 U.S. 193, 200 (1985)). Such immunity is called quasi-judicial immunity.

In determining whether to grant quasi-judicial immunity, the Supreme Court looks to “'the nature of the function performed, not the identity of the actor who performed it”' (*Buckley* v. *Fitzsimmons*, 509 U.S. 259, 269 (1993) (quoting *Forrester*, 484 U.S. at 229)). Applying a functional approach to immunity, the Supreme Court has recognized that individuals, when performing the following quasi-judicial functions, are absolutely immune from suits seeking damages for injuries arising from decisions or actions relating to those functions: (1) prosecutors, when initiating a prosecution and presenting the state's case (*Imbler*, 424 U.S. at 431); (2) prosecutors, when taking acts and making decisions in preparation for the initiation of a prosecution or trial, including the application for, and presentation of evidence in support of, a search warrant (*Buckley*, 509 U.S. at 273; ***13***Burns* v. *Reed*, 500 U.S. 478, 492 (1991); (3) administrative law judges and agency hearing officers, when performing adjudicative functions within a federal agency (*Cleavinger*, 474 U.S. at 200; *Butz* v. *Economou*, 438 U.S. 478, 514 (1978)); (4) agency officials, when performing functions analogous to those of a prosecutor, such as deciding whether to initiate administrative proceedings against an individual or corporation (*Butz*, 438 U.S. at 515); (5) agency attorneys, in arranging for the presentation of evidence in the course of an administrative adjudication (*id.* at 517); and (6) individuals, when acting within the scope of their duties, who participate in the judicial process, including grand jurors, petit jurors, advocates, and witnesses (*id.* at 509, 512; *Burns*, 500 U.S. at 489-90).[FN7]

FN7. In his opinion concurring in the judgment in part and dissenting in part in *Burns*, 500 U.S. at 499, Justice Scalia observed that absolute immunity historically extended broadly to "all claims relating to the exercise of judicial functions." Specifically, it extended to (*id.* at 499-500 (quoting T. Cooley, *Law of Torts* 408-09 (1880)): [M]ilitary and naval officers in exercising their authority to order courts-martial *** or in putting their inferiors under arrest preliminary to trial; *** to grand and petit jurors in the discharge of their duties as such; to assessors upon whom is imposed the duty of valuing property for the purpose of a levy of taxes; to commissioners appointed to appraise damages when property is taken under the right of eminent domain; to officers empowered to lay out, alter, and discontinue highways; to highway officers in deciding that a person claiming exemption from a road tax is not in fact exempt, or that one arrested is in default for not having worked out the assessment; to members of a township board in deciding upon the allowance of claims; to arbitrators, and to the collector of customs in exercising his authority to sell perishable property, and in fixing upon the time for notice of sale.

14 B.** ***Extending Quasi-Judicial Immunity To The Trustee Is Consistent With Supreme Court Precedent.

It is not always a simple task to determine whether an actor has performed a function that may properly be characterized as judicial in nature and, therefore, entitled to absolute immunity. In making such a determination, a court should be guided by the following factors that are distilled from the Supreme Court precedent discussed *supra* Part A: (1) whether the challenged function is judicial in nature or has a sufficiently close nexus to the adjudicative process; (2) whether safeguards exist, aside from a damages suit, for correcting the alleged harm and that will serve to reduce the likelihood that the harm will recur; and (3) whether policy concerns support applying absolute immunity to the function. *See, e.g.*, *Antoine*, 508 U.S. at 432-37; *Burns*, 500 U.S. at 484-96; *Forrester*, 484 U.S. at 223-28; *Cleavinger*, 474 U.S. at 201-02; *Imbler*, 424 U.S. at 423-30; *Wagshal* v. *Foster*, 28 F.3d 1249, 1252 (D.C. Cir. 1994), *cert. denied*, 514 U.S. 1004 (1995) (applying 3-factor test for determining quasi-judicial immunity). As we now show, these factors support reversing the B.A.P.

1. The first factor militates in favor of granting this standing trustee absolute immunity, because, as this Court repeatedly has held (*infra* Part C), the challenged function - providing notice on behalf of the court to a party regarding a judicial hearing - is integrally related to the judicial process and, hence, entitled to quasi-judicial immunity. *See* ***15***Mullis* v. *United States Bankr. Court for the Dist. of Nev.*, 828 F.2d 1385 (9th Cir. 1987); *Morrison* v. *Jones*, 607 F.2d 1269 (9th Cir. 1979), *cert. denied*, 445 U.S. 962 (1980); *cf.* *Cleavinger*, 474 U.S. at 200 (the common law historically has provided absolute immunity for actors "who perform functions closely associated with judicial process").

The B.A.P. held, however, that the rationale in *Antoine* v. *Byers & Anderson. Inc.*, 508 U.S. 429 (1993), precludes characterizing the trustee's conduct as a quasi-judicial function. In the B.A.P.'s view, *Antoine* mandates a conclusion that the standing trustee's conduct - which the B.A.P, characterized narrowly as providing notice - was undeserving of absolute immunity because it does not require the exercise of discretionary judgment (Vol. II Con. ER at 368-69). This was error. The B.A.P.'s holding was not mandated by *Antoine* and is flatly inconsistent with governing precedent from this Court.

Antoine, which held that a court reporter's statutory duty to produce a transcript of a federal criminal trial is not a quasi-judicial function (508 U.S. at 434-35), is readily distinguishable from this case, which involves providing notice of a judicial hearing - a function that was not addressed in *Antoine* and that this Court explicitly has held is so integrally related to the judicial process as to be deemed a quasi-judicial function (*infra* Part C).

***16** Although the Court in *Antoine* opined that the touchstone for applying quasi-judicial immunity is the exercise of discretionary judgment (508 U.S. at 436), the B.A.P. erred in identifying the function to which that factor should be applied, and in failing to understand that the act of providing notice here was integrally related to a protected judicial function.

For example, in a post-*Antoine* case, the Seventh Circuit, in *Wilson* v. *Kelkhoff*, 86 F.3d 1438 (7th Cir. 1996), held that members of a prisoner review board were entitled to quasi-judicial immunity despite their failure to perform the following *mandatory and nondiscretionary* acts of providing a prisoner with (*id.* at 1444): (1) advance notice of a parole revocation hearing, (2) an opportunity to present witnesses and evidence, (3) an explanation of the purpose and potential result of the hearing, and (4) adequate notice of the reasons for revocation. The Seventh Circuit explained that *Antoine* does "not support the proposition that judicial acts that are part of the judicial function are excluded from absolute immunity because they could be characterized as nondiscretionary or even ministerial" (*id.*). Rather, *Antoine* stands for the proposition that immunity is not appropriate with respect to "ministerial acts *unrelated* to the function immunity is intended to protect are not covered by absolute immunity" (*id.*) (emphasis added). The B.A.P.'s decision - which failed to acknowledge that providing notice to a party regarding a judicial hearing is closely ***17** related to the judicial process and therefore deserving of immunity - cannot be reconciled with *Wilson*.[FN8]

FN8. As the Seventh Circuit cogently explained in *Wilson*, 86 F.3d at 1444-45:

> We reject[] the plaintiff's attempt to avoid the bar of absolute immunity by trying to characterize certain aspects of the judicial function as administrative and therefore not worthy of protection. We [hold] that conduct deserving of protection includes not only actual decisions, but also those mundane, even mechanical, tasks undertaken by judges that are related to the judicial process: "[T]he fact that the activity is routine or requires no adjudicatory skill renders that activity no less a judicial function."

The B.A.P. distinguished *Wilson* on the ground that prison review board members perform adjudicative functions and therefore are akin to judges who, in the B.A.P.'s view, would be accorded absolute immunity for failure to provide notice (Vol. II Con. ER at 369 n.5). This alleged distinction reveals a fundamental misunderstanding of the immunity doctrine. If, as the B.A.P. correctly stated, a judge would be immune for failing to provide notice of a judicial hearing, an individual performing that function on behalf of the judge - *e.g.*, a court clerk, a judicial clerk, or a standing trustee - would likewise be entitled to immunity (*Forrester*, 434 U.S. at 229).

Nor can the B.A.P.'s parsing of the judicial function into discrete components be reconciled with this Court's *en banc* decision in *Ashelman* v. *Pope*, 793 F.2d 1072, 1078 (9th Cir. 1986). In *Ashelman*, this Court held that when determining whether a function is judicial in nature, a court must focus on the "ultimate act" rather than the constituent parts of that act. In other words, a court should *not* dissect the "ultimate act" into a series of discrete components that, when viewed in isolation, may be characterized as non-discretionary; rather, *all* acts that are ***18** closely related to the judicial process must be protected, else the important purpose underlying absolute immunity will be vitiated (*id.*). Nothing in *Antoine* undermines this Court's *en banc* analysis in *Ashelman*.

Applying the *Ashelman* analysis here, the "ultimate act" was the convening of a judicial hearing, which plainly is a judicial function that involves the exercise of discretionary judgment. And Ninth Circuit precedent (*infra* Part C) establishes that the component act of noticing a judicial hearing is not meaningfully separable from the ultimate act. Absolute immunity is therefore warranted. *See* *Rodriquez* v. *Weprin*, 116 F.3d 62, 66-67 (2d Cir. 1997) (court clerks entitled to quasi-judicial immunity for harms related to scheduling an appeal, even if that discrete task is viewed as administrative, because "court's inherent power to control its docket is part of its [judicial] function"); *Wagshal* v. *Foster*, 28 F.3d 1249, 1253 (D.C. Cir. 1994), *cert. denied*, 514 U.S. 1004 (1995) (mediator entitled to quasi-judicial immunity from charge that he violated mandatory duty of neutrality and confidentiality, and case evaluator also immune from suit for pre-trial tasks that are integrally related to judicial process despite "their somewhat managerial character").

Alternately, the "ultimate act" at issue in this case can correctly be characterized as a failure by the standing trustee to re-schedule the judicial confirmation hearing in light of her con-***19** tinuation of the section 341 hearing (*supra* p. 5). By framing the relevant act as a failure to give notice, the debtor has "pleaded around" the legal principle that is undisputed in this appeal - namely, that the standing trustee is absolutely immune for her scheduling functions that relate to judicial hearings (Vol. II Con. ER at 367). Because the B.A.P.'s analysis improperly converts absolute immunity into a mere rule of creative pleading, reversal is required.

2. The second factor for determining whether this standing trustee should receive quasi-judicial immunity is likewise satisfied, because safeguards exist in the judicial process that obviate the need for relying on private damage actions for injuries arising from the failure to provide timely notice of a judicial hearing. Most failures analogous to the one at issue here can be corrected in later proceedings in the case. In this case itself, the failure of the trustee to send out notice of the judicial hearing could have been remedied when the notice of the dismissal was sent to the debtor and her attorney. The fact that debtor's attorney did not act on that notice in time to prevent the foreclosure on debtor's house is not due to a deficiency in the system and does not furnish a basis for depriving the trustee of the immunity to which she is entitled. *Cf.* *Lonneker Farms, Inc.* v. *Klobucher*, 804 F.2d 1096, 1097 (9th Cir. 1986) (holding that bankruptcy trustee is entitled to quasi-judicial immunity, and admonishing that disgruntled party ***20** from bankruptcy proceeding should seek redress through bankruptcy proceeding, not by suing trustee for damages). Moreover, mechanisms exist to monitor the performance of standing trustees and reduce the likelihood that the problem that occurred in this case will recur. *See* 11 U.S.C. § 324 (court can remove trustee in pending case); 28 C.F.R. § 58.6 (U.S. Trustee can terminate standing trustee's appointment); Vol. I Con. ER at 225 (corrective actions taken by standing trustee in this case).

3. Finally, compelling policy concerns support insulating the trustee with immunity for her conduct. If the notice function is not covered by quasi-judicial immunity, numerous officials -including other Chapter 13 trustees and clerks of court

- can be expected to be subject to disruptive and vexatious suits by litigants and others claiming that they were harmed by the failure of the official to perform some function that is prescribed by procedural rules. We are advised by the Office of the General Counsel of the Administrative Office of the U.S. Courts that in 1999 alone there were 340 suits (some involving multiple defendants) against federal judicial officials, often involving claims that the officials failed to perform duties that, when viewed in isolation, appear ministerial on their face, but in fact were -like the trustee's function here - closely related to the judicial process. If such officials are foreclosed from asserting quasi-judicial immunity, it is to be expected that the frequency of ***21** damage actions will significantly increase, and trustees and clerks will often be exposed to burdensome discovery and trial, as well as potential liability. As the Supreme Court has stated, "controversies sufficiently intense to erupt in litigation are not easily capped by a judicial decree. The loser in one forum will frequently seek another, charging the participants in the first with [misconduct]. Absolute immunity is thus necessary to assure that [actors who perform functions that are closely related to the judicial process] can perform their respective functions without, harassment or intimidation" (*Butz*, 438 U.S. at 512).[FN9]

[FN9] FN9. The office of the standing trustee in this case administers over 600 new Chapter 13 cases each month (Vol. I Con. ER at 225). Because the parties to bankruptcy litigation are not exempt from the passions that routinely inflame litigants, it is plainly foreseeable that, unless quasi-judicial immunity is granted for the type of claim raised by this debtor, trustees will become the frequent target of dissatisfied litigants in vexatious damage suits. *Cf. Sindram* v. *Suda*, 986 F.2d 1459, 1461 (D.C. Cir. 1993) (absent quasi-judicial immunity, disappointed litigants, unable to pierce a judge's absolute immunity, might seek retribution against clerks).

In short, the three factors for determining the applicability of quasi-judicial immunity are satisfied- and the standing trustee is therefore entitled to absolute immunity. The B.A.P.'s contrary decision is error.

*22 C. *Extending Quasi-Judicial Immunity To The Trustee Is Mandated By Ninth Circuit Precedent.*

For purposes of resolving the immunity question in the instant case, this Court need go no further than *Morrison* v. *Jones*, 607 F.2d 1269 (9th Cir. 1979), *cert. denied*, 445 U.S. 962 (1980), which squarely holds that providing notice to a party on behalf of the court is a quasi-judicial function that is clothed with absolute immunity. In *Morrison*, plaintiff sought custody of her young son to prevent him from being transported to Germany to live with his grandparents. The Superior Court of the County of Riverside held a hearing on May 1, 1975 to resolve plaintiff's custody request, and the court *denied* that request by order dated May 5, 1975 (507 F.2d at 1273). Neither plaintiff nor her attorney, however, was given notice of the court's order, and on May 9, 1975 unbeknownst to plaintiff - her son was transported to Germany (*id.*). As relevant here, plaintiff brought a damages action against the clerk of court, charging him with "responsibility for her failure to receive notice of the May 5, 1975, order" (*id.*). The district court held that the clerk was entitled to absolute immunity (*id.* at 1271), and this Court affirmed, holding that the clerk's failure "to perform a ministerial duty which was a part of judicial process is *** clothed with quasi-judicial immunity" (*id.* at 1273), That holding disposes of debtor's claim.[FN10]

[FN10] FN10. It matters not that in *Morrison* the person charged with providing notice was a court clerk, whereas the person charged with providing notice here is a bankruptcy trustee. The functional approach to absolute

> immunity looks to the "nature of the function performed, not the identity of the actor who performed it" (*Forrester*, 484 U.S. at 229). In light of this dispositive Ninth Circuit case law, the B.A.P.'s reliance (Vol. II Con. ER at 369) on decisions from other circuits, such as *McCray* v. *Maryland*, 456 F.2d 1 (4th Cir. 1972), was error.

***23** Indeed, *Morrison* is an *a fortiori* case for applying quasi-judicial immunity here. In *Morrison*, because plaintiff failed to receive any notice of the adverse judicial order until after her son had been transported to Germany, she had no practical remedy by recourse to judicial review procedures. By contrast, the record here reveals that debtor's counsel was provided with notice of the dismissal order in ample time to prevent the foreclosure proceedings; unfortunately for debtor, however, it seems that her counsel simply failed to take prompt action in support of his client's interest.

This Court's decision in *Mullis* v. *United States Bankr. Court for the Dist. of Nev.*, 828 F.2d 1385, 1390-91 (9th Cir. 1987), confirms that the standing trustee here is entitled to absolute immunity. In *Mullis*, the plaintiff sent his wife to the bankruptcy court with a bankruptcy petition that failed to identify the chapter of the Bankruptcy Code under which plaintiff intended to file. He instructed his wife to ask the clerks which chapter he could file under that would allow him subsequently to withdraw or dismiss the petition as a matter of right. Plaintiff alleged that the clerks failed to provide the requested information, but simply ***24** took the petition, filed it under the incorrect chapter, and that thereafter he was unable to withdraw or dismiss the petition, or file an amended petition. Plaintiff thereafter brought a damages action, alleging that he suffered constitutional harm "through a variety of acts relating to the treatment of his bankruptcy case" by the bankruptcy judges, the court clerks, and the bankruptcy trustee (828 F.2d at 1387). The district court held that the defendants were entitled to absolute immunity, and this Court affirmed, holding - as relevant here - that the trustee was clothed with quasi-judicial immunity for the following acts (*id.* at 1390): (1) refusing to enforce statutory requirements of the Bankruptcy Code, 11 U.S.C. §§ 301, 342(b); (2) refusing to acknowledge that the bankruptcy court lost jurisdiction when a notice of appeal was filed; (3) improperly preventing plaintiff from representing himself; and (4) communicating *ex parte* with the judges. *See also* *Lonneker Farms, Inc.* v. *Klobucher*, 804 F.2d 1096, 1097 (9th Cir. 1986) (bankruptcy trustee who acts within the scope of his bankruptcy duties is entitled to absolute immunity when "performing an integral part of the judicial process").[FN11]

> FN11. This Court opined in dicta in *Mullis* that the bankruptcy trustee "derives his immunity from the judge who appointed him" (828 F.2d at 1390). As stated *supra* p. 3, the standing trustee is now appointed by the U.S. Trustee, not the bankruptcy judge. Thus, the trustee's immunity is *not* simply a derivative immunity; rather, it is a quasi-judicial immunity based on the performance of functions that are (1) within her authority, and (2) closely related to the judicial process.

***25** Additionally, in *Mullis*, as in *Morrison*, this Court held that the failure to give proper notice to a party on behalf of the court is correctly "characterized as [an] integral part[] of the judicial process," and a mistake in the performance of such a function "does not abrogate [quasi-] judicial immunity, even if it results in 'grave procedural errors"' (828 F.2d at 1390 (quoting *Stump*, 435 U.S. at 359)). *Accord* *Moore* v. *Brewster*, 96 F.3d 1240, 1244 (9th Cir. 1996) (holding that court clerk is entitled to quasi-judicial immunity for allegedly "deceiv[ing plaintiff] regarding the status of the bond and improperly conduct[ing] hearings to assess costs"); *Sharma* v. *Stevas*, 790 F.2d 1486 (9th Cir. 1986) (holding that the "Clerk of the United States Supreme Court has absolute quasi-judicial immunity because his challenged activities were an integral part of the judicial process”).

In sum, this Court's decisions in *Morrison* and *Mullis* establish that the standing trustee's conduct in providing parties with notice on behalf of the court regarding a judicial hearing is an integral part of the judicial process that is entitled to quasi-judicial immunity. The B.A.P.'s contrary conclusion contravenes binding precedent and should be reversed.

26 *CONCLUSION

For the foregoing reasons, this Court should reverse the decision of the B.A.P., and remand with instructions that the B.A.P. direct the bankruptcy court to deny the requests to sue Curry and Feder in state court based on their actions relating to the scheduling and noticing of the confirmation hearing.

In Re Cherry Barbara CASTILLO, Debtor. Nancy CURRY, Chapter 13 Trustee, and Julie Feder, Appellants, v. Cherry Barbara CASTILLO and G. Thomas Leonard, Appellees.
2000 WL 34012328 (C.A.9) (Appellate Brief)

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1. ("TI") TITLE OF CASE [E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]	In re Dakota Minerals, Inc. — United States Trustee v. Randy Royal, Alan Thaler, Georg Jensen, et al.
2. ("CO") CURRENT COURT [E.g., "CTA9"]	U.S. District Court (D. Wyoming)
3. ("CCN") CURRENT CASE NO.	No.: 99-CV-088-D
4. ("PCN") PRIOR CASE NO. & COURT [IF ANY]	No.: 85-00073-BA Court: U.S. Bankruptcy Court (D. Wyoming) (Matheson, C.J., by designation) (Identify judge & cite, if any)
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8. ("TO") TOPIC	**BANKRUPTCY**
9. ("SU") • SUMMARY OF KEY ISSUE(s)	• Did the Bankruptcy Court err in denying the U.S. Trustee's request for an order compelling the initial Chap. 7 trustee & her counsel to disgorge prior compensation where the Court had found their activities far more detrimental than beneficial?
& **/** Any Miscellaneous BACKGROUND	/ **Background:** Case was filed as a Chap. 11 reorganization in 1985 and quickly converted to a Chap. 7 liquidation by Judge Mai based upon an apparent lack of equity in the Debtor's real properties and questionable prospects for a significant dividend to be paid to anyone other than the major secured creditor (FDIC). Yet, Chap.7 trustee pursued needless litigation & delayed liquidation of estate property, thereby creating no benefit & substantial harm to estate.
10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)	D:\My Docs-EM\BrfBank\To-West-Net\WPD To West-Law\Group04 West\Dakota-1.wpd
11. DO YOU RECOMMEND POSTING IN UST BRIEFBANK?	YES [✓] NO ☐ NAME: Leo M. Weiss DATE: Tue-5/25/99

Office of the United States Trustee
200 West 17th Street, Suite 310
Cheyenne, Wyoming 82001

UNITED STATES DISTRICT COURT

DISTRICT OF WYOMING

In re:

DAKOTA MINERALS, INC., BK Case No. 85-00073-BA

Debtor.
_______________________________________/

UNITED STATES TRUSTEE, Doc. No. 99-CV-088-D

Appellant,

v.

RANDY ROYAL, ALAN THALER,
GEORG JENSEN, HABERNIGG AND
SMITH, MYER AND WYSE, SCHWABE
WILLIAMSON AND WYATT, P.C.,
CHERIE NORMAN, DOUGLAS HESS,
RONALD TRIGGS, PATRICK M. HUNTER,

Appellees.
_______________________________________/

UNITED STATES TRUSTEE'S BRIEF

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Rules

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Statement Concerning Jurisdiction

The District Court has jurisdiction to hear this appeal pursuant to 28 U.S.C. §158(a)(1).

Statement of Issues on Appeal

The United States Trustee asserts the following issues on appeal:

1. Did the bankruptcy court abuse its discretion or err as a matter of law in awarding fees to chapter 7 trustee Cherie Norman under 11 U.S.C. §§ 326, 328, and 330?

2. Did the bankruptcy court abuse its discretion or err as a matter of law in awarding fees to attorney Ronald Triggs under 11 U.S.C. §§ 327, 328, and 330?

3 Did the bankruptcy court abuse its discretion or err as a matter of law in awarding fees to attorney Alan Thaler under 11 U.S.C. §§ 327, 328, and 330?

Standards of Appellate Review

The standard of review of fee awards by the bankruptcy court is an "abuse of discretion" standard. ***Rubner & Kutner, P.C. v. United States Trustee (In re Lederman Enterprises, Inc.)***, 997 F.2d 1321, 1323-24 (10th Cir. 1993); ***Land v. First National Bank of Alamosa (In re Land)***, 943 F.2d 1265, 1267-68 (10th Cir. 1991). The standard of review of the bankruptcy court's general conclusions of law is a "*de novo*" standard. ***Virginia Beach Federal Savings and Loan Ass'n v. Wood***, 901 F.2d 849, 851 (10th Cir. 1990). The general standard of review for the factual findings of the bankruptcy court is a "clearly erroneous" standard. Fed. R. Bankr. P. 8013.

Statement of the Case

The United States Trustee does not disagree with Chief Judge Matheson's findings of fact. She explicitly incorporates those factual findings. A synopsis of the most salient factual issues is presented to assist this court.

Dakota Minerals, Inc. filed its voluntary petition pursuant to chapter 11 of Title 11, United States Code, in 1985. The case was converted to a case under chapter 7 on December 12, 1986 by Judge Mai. This conversion was premised in some substantial measure on Judge Mai's assessment that Mr. Fowler, the Debtor's principal, had an unrealistic view of the estate's assets and that little if any equity existed in those assets. (EX1 p.2) The debtor, ("Debtor"), had an array of assets most of which had been acquired by way of a transaction with British American Mortgage Corporation. Those properties were generally referred to as the "BAMCO" properties. These properties included a number of parcels of real property and the assignment of a promissory note known as the Laurel Homes note. In large part, the BAMCO properties, including the Laurel Homes note, were encumbered and subject to mortgages in favor of Guaranty Bank. Ultimately, Guaranty Bank failed and was taken over by the Federal Savings and

Loan Insurance Corporation ("FSLIC"), and its successor, the Federal Deposit Insurance Corporation, ("FDIC") . The Debtor also had an interest in the Sunset Ranch Limited Partnership that had an ownership interest in some undeveloped land in California. The estate also included scheduled receivables in excess of $1,000,000 whose collection the Ms. Norman did not pursue. (EX 1 p. 29).

On conversion of the case to chapter 7, Cherie Norman was appointed to serve as the chapter 7 trustee. Ms Norman's primary focus in the case was the pursuit of largely unsuccessful litigation (EX 1 p.3). Only secondarily, did she focus on the largely untimely liquidation of the estate's BAMCO assets, including the Laurel Homes note, and the estate's "non-BAMCO" interest in the Sunset Ranch partnership.

In 1986, the debtor commenced an adversary proceeding against the FDIC to challenge its security interests. Ms. Norman, as the trustee, did not actively pursue this challenge to the FDIC's claim and delayed administering the estate's "hard assets," other than some oil and gas interests, which the Court characterized as having "nominal value." This delay was apparently due to Ms. Norman and her professionals "tilt[ing] at windmills in the hope of striking it rich" (EX 1 p.10). At the 1994 trial of this adversary, the court held that the FDIC had valid security interests in all BAMCO property save for the Riverside, California property, the Las Vegas property and the Puerto Vallarta, Mexico property. The assets held not to be encumbered by the FDIC in this adversary were ultimately liquidated for $112,000. (EX 1, p. 26) This was far less than the “hundreds of thousands of dollars” which Judge Matheson finds were accrued in the litigation. A judgment was entered in favor of the FDIC in the amount of $3,372,487. This judgment incidentally fixed the FDIC’s interest in “cash collateral” which included the proceeds of the “Laurel Homes” note.

The estate continued to pursue Dakota’s prepetition litigation involving the Laurel Homes note. Ms. Norman employed Patrick Hunter to assist in collecting the note. The obligor on the Laurel Homes note, North Coast Associates, filed for bankruptcy in California. Ms. Norman employed Alan Thaler, as local California counsel, to assist with collection activities in California against North Coast. The estate ultimately collected in excess of $2,000,000. The benefit of these collection activities was, however, illusory. Judge Matheson later found that these proceeds, which funded the administrative expenses in the case, were FDIC’s cash collateral which Ms. Norman did not have authority to use other than to pay the FDIC. Had Ms. Norman turned over the proceeds of the Laurel Homes note to the FDIC or, presumably, simply abandoned the asset to the FDIC, the lion’s share of the FDIC claim would have been paid from this asset. (EX 1 p. 11). This matter was responsible for much of the compensation ultimately awarded the Appellees despite the illusory benefits of these activities.

Another matter on which Ms. Norman focused her administrative efforts concerned the BAMCO real properties. These efforts took two tracks. One track focused on pursuing the largely unsuccessful litigation with the FDIC. Some efforts were made on a second track to market the estate's real property located in Oregon City, Oregon. This property partially secured the BAMCO debt. Ms. Norman did not sell this property during her tenure as trustee. Ms. Norman had received apparently bona fide offers to purchase this property for in excess of $5,000,000 about which Judge Matheson stated "none was pursued and certainly none was consummated." (EX 1, p.4) Had a sale been consummated on these terms this sale would have permitted a substantial dividend to be paid all creditors in the case. Subsequent to Ms. Norman's tenure, the Oregon City property was flooded and largely covered with mud slides as a result of which it lost much of its value. No insurance coverage was in place to cover this loss. ***See,* (**EX 1 p. 31). The property was ultimately sold for $2,000,000 by Mr. Royal, the current Chapter 7 trustee. The FDIC agreed to allow the estate to retain $180,000 of these proceeds even though its debt had not been paid in full.

The Oregon City property engendered a great deal of litigation during the estate's holding period. This litigation was of little or no benefit to the estate and resulted in the accrual of significant administrative expenses. Much of this litigation was related to matters which would not of arisen had Ms. Norman timely sold the property (*e.g.,* litigation of personal injury claims against the estate for postpetition injuries incurred while the property was uninsured).

The Dakota estate also owned a proportional ownership interest in Sunset Ranch, a California limited partnership with an ownership interest in undeveloped real estate, as well as an interest in a promissory note payable by the partnership in the amount of $800,000. Here too, Judge Matheson found that Ms. Norman's efforts focused on litigation rather than the sale of the estate's interest in the partnership. Ms. Norman's testimony was that she had received a $900,000 offer from the Sunset Ranch general partner to purchase the estate's interest in the partnership which she did not pursue. The estate ultimately derived no benefit from this asset, which was lost in foreclosure, and incurred substantial liabilities for administrative expenses associated with this litigation which Judge Matheson characterizes as lacking in merit.

Thus, despite Ms. Norman's failure to expeditiously liquidate the estate's hard assets which may have led to $5,900,000 or more in gross proceeds, plus whatever recovery could have been had from the receivables and avoidance actions which were not pursued, her use of cash collateral that she was not entitled to use, and her quixotic pursuit of non-meritorious litigation, the Court awarded Ms. Norman $61,851.25. Trustee's counsel, Messrs. Triggs and Thaler, were awarded final fees and expenses of $51,862.46 and $464,798.48 respectively, much of which had already inappropriately been paid from the FDIC's cash collateral. (See EX1, p. 16, 46.) The United States Trustee asserts that Chief Judge Matheson abused his discretion under these circumstances.

Summary of Argument

Detailed findings of fact were made by Judge Matheson which were well supported by the record. These findings establish that the Appellees' actions in this case were of far more detriment than benefit to the Debtor's estate. Thus, because "benefit to the estate" is a threshold requirement for compensation under 11 U.S.C. § 330(a), Judge Matheson abused his discretion by awarding the Appellees any fees and declining to order the Appellees to disgorge the funds which had previously been paid from the FDIC's cash collateral without its consent or a Court permitting the use of such cash collateral.

ARGUMENT

1. The fees allowed were not "reasonable" based upon the bankruptcy court's findings.

Cherie Norman

The duty to close a bankruptcy estate expeditiously is a bankruptcy trustee's "main duty" and "overriding responsibility." ***Yadkin Valley Bank & Trust Co. v. McGee (In re Hutchinson)***, 5 F.3d 750,753 (4th Cir. 1993). Section 704(1), 11 U.S.C. §704(1), imposes an affirmative duty to reduce the bankruptcy estate's property to **money** as expeditiously as is compatible with the interests of all parties in interest in the case. ***Id.*** *at* 754. Judge Matheson's findings of fact clearly establish that Ms. Norman failed to perform this duty.

Had Ms. Norman expeditiously administered the hard assets of the estate, or as Judge Matheson suggested and abandoned the encumbered assets to the FDIC, she may have not only been able to satisfy the FDIC's claims in full but been able to pay a small dividend to unsecured creditors. (EX 1, p. 11). Instead she speculated that the assets would later sell for as much as $20 million and pursued fruitless litigation. Much of the "blame" for this can be placed upon trustee's counsel who ran up large litigation expenses premised upon defective legal theories and analyses including their failure to recognize that the Laurel Homes note proceeds were the FDIC's cash collateral. However, because Ms. Norman failed to adequately supervise these professionals and to timely administer this case, she was appropriately penalized by Judge Matheson. [1/] ***See, Matter of Island Amusement, Inc.***, 74 B.R. 19, 21 (Bankr.P.R. 1987).

Once Ms. Norman received offers to purchase the Oregon City and Sunset Ranch interests she should have taken some action in response to these offers. Some affirmative act to resolve the offer by acceptance, counter-offer, negotiation or abandonment was required. ***In re Moore***, 110 B.R. 924,928 (Bankr.C.D.Cal. 1990). The possible sale of the Sunset Ranch interest was sent out to creditors on notice, but Ms. Norman failed to pursue either a sale or any other alternative after receiving an FDIC objection to the sale. This falls short of taking any

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[1/] Ms. Norman resided in Pago Pago, Samoa during much of her tenure as trustee. This may account for some of the apparent absence of effective oversight by Ms. Norman.

effective action on the sale. Offers on the Oregon City property were not even followed up or pursued to this extent.

Judge Matheson's litany of acts of misfeasance and nonfeasance by Ms. Norman at pages 28 through 32 detail a course of conduct riddled with detrimental consequences to parties in interest in this case. Judge Matheson appropriately found that:

A. The Sunset Ranch litigation was a ploy which cost the estate hundreds of thousands of dollars and produced no benefit for the estate;

B. Ms. Norman's litigation asserting that the FDIC's collection actions against the Bank's officers satisfied Dakota's debt was "specious and of no value;"

C. Ms. Norman failed to understand her absolute duty under §704(1) to "reduce to money the property of the estate . . . and to close such estate [expeditiously]" by effectuating a timely sale rather than to speculate on the increase in the value of the Oregon City property were she to act as a "developer;"

D. Ms. Norman failed to carry liability insurance on the Oregon City property exposing the estate to millions of dollars of potential liability and $70,000 of actual expense; [2/]

[2/] Ms. Norman's failure to insure the property against such losses may also state cause for her surcharge. ***See, In re Reich***, 54 B.R. 995 (Bankr.E.D.Mich.1985).

E. Ms. Norman breached her fiduciary obligations to parties in interest, including the FDIC by failing to disclose that she was attempting to sell the Sunset Ranch and Laurel Homes assets for $5 million while trying to negotiate a $1.5 million settlement with the FDIC;

F. Ms Norman inexcusably misused $332,728 of the FDIC's cash collateral;

G. She failed to comply with her reporting obligations to the United States Trustee; and

H. She failed to pursue the collection of the $1,000,000 in scheduled receivables or any avoidance actions that the estate may have had.

Implicitly, Judge Matheson also finds that the failure to timely market the Oregon City property led to the unfortunate loss of value to the estate due to its flooding. Judge Matheson further found that Ms. Norman's "negatives far outweigh [her] positive contributions." Yet, he awarded her $45,000 despite his findings that Ms. Norman's actions cost the estate hundreds of thousands of dollars on matters which yielded little or no benefit to the estate (EX 1, p.29) and exposed the estate to millions of dollars of potential liability.

"Equity tolerates in bankruptcy trustees no interest adverse to the trust. This is not because such interests are always corrupt but because they are always corrupting." ***Mosser v. Darrow***, 341 U.S. 267, 271, 95 L.Ed. 670, 671, 71 S.Ct. 680, 682 (1951). Here Ms. Norman acquired interests adverse to the estate by "tilting at windmills hoping to strike it rich" rather than attending to her duties as a trustee. ***See generally,*** **(**EX 1 pp.29-32). Ms. Norman and her hired professionals pursued a course of action seeking to extract value out of the BAMCO properties through litigation rather than sale. She embarked on a course of developing the Oregon City property rather than properly selling it in the speculative hope that Judge Mai was wrong when he found there to be little or equity in the property. She completely failed to pursue avoidance actions and the collection of receivables. She expended $60,000 in fees to research a claim against the FDIC which Judge Matheson characterizes as bordering on paranoia. (EX 1 p. 30). Awarding Ms. Norman compensation from the estate despite such adverse interests, misfeasance, and nonfeasance is contrary to the Supreme Court's mandate in ***Mosser***. Judge Matheson's own conclusions of law and findings of fact were that the detrimental effect of Ms. Norman's acts far exceeded any benefit therefrom. Under such circumstances the burden is on Ms. Norman to demonstrate that, on balance, she conferred a net benefit on the estate despite her breaches of fiduciary duty. ***See, Gray v. English***, 30 F.3d 1319 (10th Cir. 1994); ***Appeal of Arthur Winer, Inc. (Matter of Taxman Clothing Co.)***, 49 F.3d 310 (7th Cir. 1995). Ms. Norman failed to meet this burden. The United States Trustee therefore asserts that the Bankruptcy Court abused its discretion in awarding Ms. Norman any compensation in this case.

Trustee's Counsel

Ronald Triggs

The express language of the pre-October 22, 1994 version of 11 U.S.C. § 330(a), which is applicable to this case, placed all counsel on notice that any right to receive "reasonable compensation" was conditioned upon the benefit provided by and the "value of such services." ***In re Lederman Enterprises, Inc.,*** 997 F.2d at 1323. The Tenth Circuit Court of Appeals has consistently imposed tests of reasonableness on all fee applications subject to bankruptcy court approval. ***See, First National Bank of Lea County v. Niccum (In the Matter of Permian Anchor Services, Inc.)***, 649 F.2d 763 (10th Cir. 1981); ***See also, In re Jensen-Farley Pictures, Inc.***, 47 B.R. 557 (Bankr. D. Utah 1985); ***In re Duran Mercantile Co.***, 199 F. 961 (D. N.Mex. 1912).

The Court's obligation to review final fee applications at the conclusion of the case allows the Court "to judge the propriety of the fees under § 330 with facts that may come to light after the payments are rendered" and to consider "evidence that was not available to it earlier, which can further shed light on whether the professional knew or should have known that the services provided would be reasonably likely to benefit the estate." ***In re Unitcast, Inc.***, 214 B.R. 992, 1002 (Bankr. N.D. Ohio 1997). Further, a court can also evaluate "whether the professional has fulfilled fiduciary duties by having discovered and disclosed all relevant facts to the Court and creditors" which will be probative to the Court's determination of the reasonableness of fees. ***Id.**,* at p. 1001. Hence, a review of the ultimate benefit provided to the estate is required by § 330.

The trustee's attorneys were all fiduciaries of the estate. ***Matter of Taxman Clothing Co.**,* 49 F.3d at 314. As such, each attorney "was required as a fiduciary of the estate to make a careful judgment whether the number of billable hours he would be investing was commensurate with the expected gain." ***Id.***

Under the analysis suggested in the ***Taxman*** decision, it is clear that counsel's duty to maximize the estate included the obligation to forebear or discontinue efforts to collect a particular asset where cost of collection would exceed the asset's value. 49 F.3d at 315. Messrs. Triggs and Thaler, like the trustee, lost all perspective of the value of the litigation in which were engaged.

Judge Matheson found that Mr. Triggs provided services beyond the scope of his employment, ***see, In re New England Fish Co.***, 33 B.R. 413, 420 (Bankr.Me 1983)(Services outside scope of employment order non-compensable), represented the adverse interests of Mr. Hess while still employed by Ms. Norman, pursued a variety of ineffectual activities and failed to adequately document any of the fees or expenses sought by him. (EX 1, pp. 36-37). Judge Matheson makes even more denunciatory findings which raise questions about whether Mr. Triggs should have been denied all compensation under 11 U.S.C. §328(c) by his holdings that:

A. Any expectation of benefit from the Sunset Ranch related "Procopious" litigation was unrealistic and the estate was required to pay opposing counsels' fees of $40,000;

B. Mr. Triggs not only failed to obtain a favorable result in the FDIC litigation but was obstreperous, petulant and unprofessional;

C. Any expectation, which was encouraged by Mr. Fowler, the Debtor's principal, that a bonanza was to be had from the sale of the estate's assets was unrealistic and contrary to Judge Mai's explicit finding at the conversion hearing; and

D. Mr. Triggs had failed to demonstrate "any significant benefit other than the prosecution of fruitless litigation that he lost."

EX 1, pp. 37-38

Yet, Judge Matheson allowed Mr. Triggs to keep the $51,862.46 that he had already received despite the absence of any benefit from his activities. This is contrary to the Tenth Circuit's explicit holding in ***Lederman Enterprises***, which affirmed Judge Matheson's own decision, that "benefit to the estate" is a threshold requirement for the receipt of any compensation from the bankruptcy estate under 11 U.S.C. § 330. The United States Trustee asserts that Judge Matheson abused his discretion in awarding Mr. Triggs any compensation from the estate.

Alan B. Thaler

Many of the issues concerning Mr. Thaler's fees duplicate those of Mr. Triggs. Judge Matheson makes a number of findings which also demonstrate an abuse of discretion where Judge Matheson explicitly finds no cognizable "benefit to the estate" from Mr. Thaler's actions. Thus, although Judge Matheson finds that "Mr. Thaler achieved some level of success" in the Sunset Ranch and Laurel Homes litigation. (EX 1, p. 39). He also holds that "in the final analysis" it is "doubtful" that "any of the successes were of any value to the estate, other than the collection of the Laurel Homes note." ***Id.*** Even this success was counterbalanced by negative factors including:

A. Mr. Thaler billed at a higher rate than originally represented to the Court;

B. He failed to submit an adequate fee application;

C. He engaged in duplicative billing with his then apparent supervising partner;

D. He pursued the fruitless and non-meritorious Sunset Ranch litigation costing "hundreds of thousands of dollars," (EX 1 p. 11), based upon flawed theories while the real estate market in California started deteriorating eliminating any possible recovery from the litigation even had it been successful;

E. The partnership interest had apparently been marketable early on in the case; and

F. He had engaged in duplicative and largely unnecessary services outside the scope of his employment.

EX 1, pp.40-44.

Yet, despite these findings and the fact that the Laurel Homes note was the FDIC's cash collateral, which eviscerated much of the benefit of this litigation, Judge Matheson allowed Mr. Thaler to retain all the fees and costs previously allowed as his final compensation and reimbursement of expenses. The United States Trustee asserts that this was an abuse of discretion where no demonstrable net benefit was conferred on the estate by Mr. Thaler's efforts.

Patrick Hunter

The disallowances of the compensation and reimbursements sought by Mr. Hunter were quite modest (*i.e.*, he sought $68,007.59 and was awarded $67,062.99). Judge Matheson's rationale for these disallowances was the same as for the disallowances for other Appellees at bar. Judge Matheson's analysis of these fees and expenses suffers the same flaws as his awards for the other professionals.

<u>2. Interim orders are not final and must be reviewed in considering final applications.</u>

The Appellees previously advanced various theories to the Bankruptcy Court in support of their position that the bankruptcy court should not disturb their interim fee orders. These theories included: Judge Mai's explicitly "interim" orders were actually "final" orders; the law of the case doctrine; the orders were either res judicata and/or entitled to collateral estoppel and that the statute of limitations precludes any modification of the interim compensation orders .

These theories simply do not apply. Judge Matheson's cogent discussion at (EX 1 pp. 18-20) exposes the flaws in these arguments. At the time Dakota filed its Chapter 11 case, the Tenth Circuit Court of Appeals had ruled regarding the finality of interim fee orders under 11 U.S.C. § 331:

> The statute anticipates repeated application to the court for reimbursement and compensation, subjecting the award to amendment or modification at any time during the pendency of the bankruptcy proceeding. Interim awards of compensation, which are within the court's discretion, [citations omitted], are to be considered by the court in making a final award. [citations omitted]...Interim awards, too, are refundable to the estate in cases of misconduct. [citations omitted]. Interim awards, then, are in no respect final adjudications on the question of compensation. Such awards are therefore interlocutory... [T]he order does not conclusively determine any disputed question, nor is it effectively unreviewable on appeal from final judgment.

Callister v. Ingersoll-Rand Financial Corporation (In re Callister), 673 F.2d 305, 307 (10th Cir. 1982); ***see also, Continental Illinois Bank & Trust Co. of***

Chicago v. Wooten (In re Evangeline Refining Co.), 890 F.2d 1312, 1321 (5th Cir. 1989); ***Stable Mews Associates v. Togut (In re Stable Mews Associates)***, 778 F.2d 121, 123 (2d Cir. 1985); ***see also*** post-October 22, 1994 version of 11 U.S.C. §330(a)(5).

Under the clear and unequivocal authority set forth in ***Callister***, the United States Trustee could not, without the leave of the court to file an interlocutory appeal, appeal Judge Mai's interim awards. The Appellees' arguments to the contrary are simply unsupportable in light of ***Callister's*** unqualified mandates.

3. Appellees violated 11 U.S.C. § 363 by taking interim fees.

The express provisions of 11 U.S.C. § 363(c)(2) and (4) required Ms. Norman to either obtain an order allowing her use of cash collateral or the "affirmative express consent" of the FDIC. ***In re Gemel International, Inc.***, 190 B.R. 4, 10 (Bankr. D. Mass. 1995). Implied consent is insufficient to satisfy the requirements of Section 363(c)(2). ***Id.*** Section §363(c) and Fed.R.Bankr.Pro. 4001(b) and (d) place the burden of obtaining consent to use cash collateral on the trustee or debtor-in-possession. The creditor does not bear the burden of seeking an order of the court to prohibit such use of cash collateral. The unauthorized use of cash collateral by Ms. Norman and the receipt of portions of the funds by professionals was contrary to law and should not be condoned by the Court. ***See also,*** Judge Matheson's cogent discussion of applicable law at (EX 1, pp. 9-10).

If the Court allows the professionals to retain fees which were paid for services which did not provide benefit to the estate or, for the most part, to the FDIC, the professionals will be rewarded for two forms of conduct which are not sanctioned by the Bankruptcy Code -- acquiescence in the unauthorized use of cash collateral by Ms. Norman and Mr. Hess and being compensated and reimbursed for services and costs from which the Debtor's estate derived no benefit.

At least one other court has permitted a chapter 7 trustee to seek disgorgement of fees and reimbursement previously paid from a secured lender's cash collateral. ***Matz v. Hoseman (In re Matz)***, 197 B.R. 635, 641 (Bankr. N.D. Ill. 1996). In ***Matz***, the Court held that, for cause shown, the professionals could be compelled to disgorge these previously paid funds even though the secured lender, rather than the chapter 11 administrative claimants, might be entitled to receive all of the disgorged funds.

The fact that the FDIC has permitted Mr. Royal to retain $180,000 of its cash collateral for the payment of administrative and prepetition claims is irrelevant. Professionals should not be permitted to take advantage of the happenstance of a lender being willing to compromise its rights for the benefit of other creditors and claimants where, but for the inappropriate administration of this case by Ms. Norman and her counsel, such creditors would have been entitled to a larger dividend many years earlier. It is also inequitable to permit the Appellees to retain inappropriately paid compensation and reimbursement, rather than to compel disgorgement, simply because of the hardship on these parties caused by the long delayed administration of this case particularly where it is these parties who are largely responsible for the delay. Judge Matheson abused his discretion by failing to compel the Appellees to disgorge the funds inappropriately paid from the FDIC's cash collateral under these circumstances.

Conclusion

The District Court should remand this matter to the bankruptcy court for a determination of appropriate disallowances and disgorgements based upon the Bankruptcy Court's well documented findings that the Appellees provided little or no benefit to the estate. These parties were awarded interim fees which far exceed reasonable compensation for the minimal actual, necessary services they provided this estate. Sanctioning the unauthorized use of cash collateral and allowing the payment and retention of fees and expenses which resulted in no benefit to the bankruptcy estate rewards these professionals for their inappropriate administration of this case and the inordinate delays caused thereby. Such allowances establish dangerous precedent, are contrary to relevant case authority, and encourage trustees to speculate with estate assets delay their administration of cases.

Dated this 25th day of May, 1999

Respectfully submitted,
BARBARA A. SHANGRAW
United States Trustee

By:____________________________________
Leo M. Weiss, Colorado A.R. #15294
Attorney/Advisor
Office of the U.S. Trustee for Region 19
721 19th Street, Suite 408
Denver, CO 80202
(303) 844-5188

Certificate of Mailing

The undersigned certifies that on the 25th day of May, 1999, a true and accurate copy of the United States Trustee's Brief on Appeal, with Appendix, was served on the following persons by placing a true and accurate copy thereof in the United States mail, first class, postage prepaid, addressed as follows:

Ronald E. Triggs, Esq.
American National Bank Building
1912 Capitol Avenue, Suite 401
Cheyenne, Wyoming 82001

Randy Royal, Esq.
P.O. Box 551
Greybull, Wyoming 82426-0551

Cherie Shelton Norman, Esq.
6974 Wetheridge Dr
Cincinnati, OH 45230-3851

Alan V. Thaler, Esq.
18552 MacArthur, Suite 310
Irvine, California 92612

Patrick Hunter, Esq.
100 N Center, Suite 500
Casper, Wyoming 82601-1980

____
Leo M. Weiss,
Attorney/Advisor to the United States Trustee

APPENDIX

Statutes

11 U.S.C. § 326. Limitation on compensation of trustee

(a) In a case under chapter 7 or 11, the court may allow reasonable compensation under section 330 of this title of the trustee for the trustee's services, payable after the trustee renders such services, not to exceed 25 percent on the first $5,000 or less, 10 percent on any amount in excess of $5,000 but not in excess of $50,000, 5 percent on any amount in excess of $50,000 but not in excess of $1,000,000, and reasonable compensation not to exceed 3 percent of such moneys in excess of $1,000,000, upon all moneys disbursed or turned over in the case by the trustee to parties in interest, excluding the debtor, but including holders of secured claims.

(b) In a case under chapter 12 or 13 of this title, the court may not allow compensation for services or reimbursement of expenses of the United States trustee or of a standing trustee appointed under section 586(b) of title 28, but may allow reasonable compensation under section 330 of this title of a trustee appointed under section 1202(a) or 1302(a) of this title for the trustee's services, payable after the trustee renders such services, not to exceed five percent upon all payments under the plan.

(c) If more than one person serves as trustee in the case, the aggregate compensation of such persons for such service may not exceed the maximum compensation prescribed for a single trustee by subsection (a) or (b) of this section, as the case may be.

(d) The court may deny allowance of compensation for services or reimbursement of expenses of the trustee if the trustee failed to make diligent inquiry into facts that would permit denial of allowance under section 328(c) of this title or, with knowledge of such facts, employed a professional person under section 327 of this title.

11 U.S.C. § 327 Employment of professional persons

(a) Except as otherwise provided in this section, the trustee, with the court's approval, may employ one or more attorneys, accountants, appraisers, auctioneers, or other professional persons, that do not hold or represent an interest adverse to the estate, and that are disinterested persons, to represent or assist the trustee in carrying out the trustee's duties under this title.

(b) If the trustee is authorized to operate the business of the debtor under section 721, 1202, or 1108 of this title, and if the debtor has regularly employed attorneys, accountants, or other professional persons on salary, the trustee may retain or replace such professional persons if necessary in the operation of such business.

(c) In a case under chapter 7, 12, or 11 of this title, a person is not disqualified for employment under this section solely because of such person's employment by or representation of a creditor, unless there is objection by another creditor or the United States trustee, in which case the court shall disapprove such employment if there is an actual conflict of interest.

(d) The court may authorize the trustee to act as attorney or accountant for the estate if such authorization is in the best interest of the estate.

(e) The trustee, with the court's approval, may employ, for a specified special purpose, other than to represent the trustee in conducting the case, an attorney that has represented the debtor, if in the best interest of the estate, and if such attorney does not represent or hold any interest adverse to the debtor or to the estate with respect to the matter on which such attorney is to be employed.

(f) The trustee may not employ a person that has served as an examiner in the case.

11 U.S.C. 328. Limitation on compensation of professional persons

(a) The trustee, or a committee appointed under section 1102 of this title, with the court's approval, may employ or authorize the employment of a professional person under section 327 or 1103 of this title, as the case may be, on any reasonable terms and conditions of employment, including on a retainer, on an hourly basis, or on a contingent fee basis. Notwithstanding such terms and conditions, the court may allow compensation different from the compensation provided under such terms and conditions after the conclusion of such employment, if such terms and conditions prove to have been improvident in light of developments not capable of being anticipated at the time of the fixing of such terms and conditions.

(b) If the court has authorized a trustee to serve as an attorney or accountant for the estate under section 327(d) of this title, the court may allow compensation for the trustee's services as such attorney or accountant only to the extent that the trustee performed services as attorney or accountant for the estate and not for performance of any of the trustee's duties that are generally performed by a trustee without the assistance of an attorney or accountant for the estate.

(c) Except as provided in section 327(c), 327(e), or 1107(b) of this title, the court may deny allowance of compensation for services and reimbursement of expenses of a professional person employed under section 327 or 1103 of this title if, at any time during such professional person's employment under section 327 or 1103 of this title, such professional person is not a disinterested person, or represents or holds an interest adverse to the interest of the estate with respect to the matter on which such professional person is employed.

11 U.S.C. § 330. Compensation of officers (pre-October 22, 1994)

(a) After notice to any parties in interest and to the United States trustee and a hearing, and subject to sections 326, 328, and 329 of this title, the court may award to a trustee, to an examiner, to a professional person employed under section 327 or 1103 of this title, or to the debtor's attorney--

(1) reasonable compensation for actual, necessary services rendered by such trustee, examiner, professional person, or attorney, as the case may be, and by any paraprofessional persons employed by such trustee, professional person, or attorney, as the case may be, based on the nature, the extent, and the value of such services, the time spent on such services, and the cost of comparable services other than in a case under this title; and

(2) reimbursement for actual, necessary expenses.

(b) There shall be paid from the filing fee in a case under chapter 7 of this title $45 to the trustee serving in such case, after such trustee's services are rendered.

(c) Unless the court orders otherwise, in a case under chapter 12 or 13 of this title the compensation paid to the trustee serving in the case shall not be less than $5 per month from any distribution under the plan during the administration of the plan.

(d) In a case in which the United States trustee serves as trustee, the compensation of the trustee under this section shall be paid to the clerk of the bankruptcy court and deposited by the clerk into the United States Trustee System Fund established by section 589a of title 28.

11 U.S.C. § 330. Compensation of officers (post-October 22, 1994)

(a) (1) After notice to the parties in interest and the United States Trustee and a hearing, and subject to sections 326, 328, and 329, the court may award to a trustee, an examiner, a professional person employed under section 327 or 1103 -

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

(B) reimbursement for actual, necessary expenses.

(2) The court may, on its own motion or on the motion of the United States Trustee, the United States Trustee for the District or Region, the trustee for the estate, or any other party in interest, award compensation that is less than the amount of compensation that is requested.

(3) (A) In determining the amount of reasonable compensation to be awarded, the court shall consider the nature, the extent, and the value of such services, taking into account all relevant factors, including -

(A) the time spent on such services;
(B) the rates charged for such services;
(C) whether the services were necessary to the administration of, or beneficial at the time at which the service was rendered toward the completion of, a case under this title;
(D) whether the services were performed within a reasonable amount of time commensurate with the complexity, importance, and nature of the problem, issue, or task addressed; and
(E) whether the compensation is reasonable based on the customary compensation charged by comparably skilled practitioners in cases other than cases under this title.

(4) (A) Except as provided in subparagraph (B), the court shall not allow compensation for -

(i) unnecessary duplication of services; or
(ii) services that were not -
    (I) reasonably likely to benefit the debtor's estate; or
    (II) necessary to the administration of the case.

(B) In a chapter 12 or chapter 13 case in which the debtor is an individual, the court may allow reasonable compensation to the debtor's attorney for representing the interests of the debtor in connection with the bankruptcy case based on a consideration of the benefit and necessity of such services to the debtor and the other factors set forth in this section.

(5) The court shall reduce the amount of compensation awarded under this section by the amount of any interim compensation awarded under section 331,and, if the amount of such interim compensation exceeds the amount of compensation awarded under this section, may order the return of the excess to the estate.

(6) Any compensation awarded for the preparation of a fee application shall be based on the level and skill reasonably required to prepare the application.

(b) (1) There shall be paid from the filing fee in a case under chapter 7 of this title $45 to the trustee serving in such case, after such trustee's services are rendered.

(2) The Judicial Conference of the United States -

(A) shall prescribe additional fees of the same kind as prescribed under section 1914(b) of title 28; and

(B) may prescribe notice of appearance fees and fees charged against distributions in cases under this title; to pay $15 to trustees serving in cases after such trustees' services are rendered. Beginning 1 year after the date of the enactment of the Bankruptcy Reform Act of 1994, such $15 shall be paid in addition to the amount paid under paragraph (1).

(c) Unless the court orders otherwise, in a case under chapter 12 or 13 of this title the compensation paid to the trustee serving in the case shall not be less than $5 per month from any distribution under the plan during the administration of the plan.

(d) In a case in which the United States trustee serves as trustee, the compensation of the trustee under this section shall be paid to the clerk of the bankruptcy court and deposited by the clerk into the United States Trustee System Fund established by section 589a of title 28.

11 U.S.C. § 331. Interim compensation

A trustee, an examiner, a debtor's attorney, or any professional person employed under section 327 or 1103 of this title may apply to the court not more than once every 120 days after an order for relief in a case under this title, or more often if the court permits, for such compensation for services rendered before the date of such an application or reimbursement for expenses incurred before such date as is provided under section 330 of this title. After notice and a hearing, the court may allow and disburse to such applicant such compensation or reimbursement.

11 U.S.C. § 363. Use, sale, or lease of property

(c) (1) If the business of the debtor is authorized to be operated under section 721, 1108, 1203, 1204, or 1304 of this title and unless the court orders otherwise, the trustee may enter into transactions, including the sale or lease of property of the estate, in the ordinary course of business, without notice or a hearing, and may use property of the estate in the ordinary course of business without notice or a hearing.

(2) The trustee may not use, sell, or lease cash collateral under paragraph (1) of this subsection unless -

(A) each entity that has an interest in such cash collateral consents; or
(B) the court, after notice and a hearing, authorizes such use, sale, or lease in accordance with the provisions of this section.

(3) Any hearing under paragraph (2)(B) of this subsection may be a preliminary hearing or may be consolidated with a hearing under subsection (e) of this section, but shall be scheduled in accordance with the needs of the debtor. If the hearing under paragraph (2)(B) of this subsection is a preliminary hearing, the court may authorize such use, sale, or lease only if there is a reasonable likelihood that the trustee will prevail at the final hearing under subsection (e) of this section. The court shall act promptly on any request for authorization under paragraph (2)(B) of this subsection.

(4) Except as provided in paragraph (2) of this subsection, the trustee shall segregate and account for any cash collateral in the trustee's possession, custody, or control.

11 U.S.C. § 704. Duties of trustee

The trustee shall -

(1) collect and reduce to money the property of the estate for which such trustee serves, and close such estate as expeditiously as is compatible with the best interests of parties in interest;

(2) be accountable for all property received;

(3) ensure that the debtor shall perform his intention as specified in section 521(2)(B) of this title;

(4) investigate the financial affairs of the debtor;

(5) if a purpose would be served, examine proofs of claims and object to the allowance of any claim that is improper;

(6) if advisable, oppose the discharge of the debtor;

(7) unless the court orders otherwise, furnish such information concerning the estate and the estate's administration as is requested by a party in interest;

(8) if the business of the debtor is authorized to be operated, file with the court, with the United States trustee, and with any governmental unit charged with responsibility for collection or determination of any tax arising out of such operation, periodic reports and summaries of the operation of such business, including a statement of receipts and disbursements, and such other information as the United States trustee or the court requires; and

(9) make a final report and file a final account of the administration of the estate with the court and with the United States trustee.

28 U.S.C. §158(a)

(a) The district courts of the United States shall have jurisdiction to hear appeals [1]

(1) from final judgments, orders, and decrees;
(2) from interlocutory orders and decrees issued under section 1121(d) of title 11 increasing or reducing the time periods referred to in section 1121 of such title; and
(3) with leave of the court, from other interlocutory order and decrees;

and, with leave of the court, from interlocutory orders and decrees, of bankruptcy judges entered in cases and proceedings referred to the bankruptcy judges under section 157 of this title.

An appeal under this subsection shall be taken only to the district court for the judicial district in which the bankruptcy judge is serving.

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[1] So in original. Probably should be followed by a dash.

Bankruptcy Rules

Fed.R.Bankr.Pro. 4001. Relief from Automatic Stay; Prohibiting or Conditioning the Use, Sale, or Lease of Property; Use of Cash Collateral; Obtaining Credit; Agreements

(b) Use of cash collateral

(1) Motion; service

A motion for authorization to use cash collateral shall be made in accordance with Rule 9014 and shall be served on any entity which has an interest in the cash collateral, on any committee elected pursuant to S 705 or appointed pursuant to S 1102 of the Code or its authorized agent, or, if the case is a chapter 9 municipality case or a chapter 11 reorganization case and no committee of unsecured creditors has been appointed pursuant to S 1102, on the creditors included on the list filed pursuant to Rule 1007(d), and on such other entities as the court may direct.

(2) Hearing

The court may commence a final hearing on a motion for authorization to use cash collateral no earlier than 15 days after service of the motion. If the motion so requests, the court may conduct a preliminary hearing before such 15 day period expires, but the court may authorize the use of only that amount of cash collateral as is necessary to avoid immediate and irreparable harm to the estate pending a final hearing.

(3) Notice

Notice of hearing pursuant to this subdivision shall be given to the parties on whom service of the motion is required by paragraph (1) of this subdivision and to such other entities as the court may direct.

(c) Obtaining credit

(1) Motion; service

A motion for authority to obtain credit shall be made in accordance with Rule 9014 and shall be served on any committee elected pursuant to S 705 or appointed pursuant to S 1102 of the Code or its authorized agent, or, if the case is a chapter 9 municipality case or a chapter 11 reorganization case and no committee of unsecured creditors has been appointed pursuant to S 1102, on the creditors included on the list filed pursuant to Rule 1007(d), and on such other entities as the court may direct. The motion shall be accompanied by a copy of the agreement.

(2) Hearing

The court may commence a final hearing on a motion for authority to obtain credit no earlier than 15 days after service of the motion. If the motion so requests, the court may conduct a hearing before such 15 day period expires, but the court may authorize the obtaining of credit only to the extent necessary to avoid immediate and irreparable harm to the estate pending a final hearing.

(3) Notice

Notice of hearing pursuant to this subdivision shall be given to the parties on whom service of the motion is required by paragraph (1) of this subdivision and to such other entities as the court may direct.

(d) Agreement relating to relief from the automatic stay, prohibiting or conditioning the use, sale, or lease of property, providing adequate protection, use of cash collateral, and obtaining credit

(1) Motion; service

A motion for approval of an agreement (A) to provide adequate protection, (B) to prohibit or condition the use, sale, or lease of property, (C) to modify or terminate the stay provided for in S 362, (D) to use cash collateral, or (E) between the debtor and an entity that has a lien or interest in property of the estate pursuant to which the entity consents to the creation of a lien senior or equal to the entity's lien or interest in such property shall be served on any committee elected pursuant to S 705 or appointed pursuant to S 1102 of the Code or its authorized agent, or, if the case is a chapter 9 municipality case or a chapter 11 reorganization case and no committee of unsecured creditors has been appointed pursuant to S 1102, on the creditors included on the list filed pursuant to Rule 1007(d), and on such other entities as the court may direct. The motion shall be accompanied by a copy of the agreement.

(2) Objection

Notice of the motion and the time within which objections may be filed and served on the debtor in possession or trustee shall be mailed to the parties on whom service is required by paragraph (1) of this subdivision and to such other entities as the court may direct. Unless the court fixes a different time, objections may be filed within 15 days of the mailing of notice.

(3) Disposition; hearing

If no objection is filed, the court may enter an order approving or disapproving the agreement without conducting a hearing. If an objection is filed or if the court determines a hearing is appropriate, the court shall hold a hearing on no less than five days' notice to the objector, the movant, the parties on whom service is required by paragraph (1) of this subdivision and such other entities as the court may direct.

(4) Agreement in settlement of motion

The court may direct that the procedures prescribed in paragraphs (1), (2), and (3) of this subdivision shall not apply and the agreement may be approved without further notice if the court determines that a motion made pursuant to subdivisions (a), (b), or (c) of this rule was sufficient to afford reasonable notice of the material provisions of the agreement and opportunity for a hearing.

Fed. R. Bankr. Pro. 8013. Disposition of Appeal; Weight Accorded Bankruptcy Judge's Findings of Fact

On an appeal the district court or bankruptcy appellate panel may affirm, modify, or reverse a bankruptcy judge's judgment, order, or decree or remand with instructions for further proceedings. Findings of fact, whether based on oral or documentary evidence, shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the bankruptcy court to judge the credibility of the witnesses.

BRIEF BANK — "SUMMARY SHEET" *Printed Wed-6/24/09 14:2*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*
In re David Andrew Darrohn and Marguerite Mottola Darrohn (Henry E. Hildenbrand, III, Chapter 13 Trustee v. David Andrew Dorrohn and Marguerite Mottola Darrohn)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*
6th Cir.

3. ("CCN") ***CURRENT*** CASE NO.
No.: 09-5499

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*
No.: 08-09075
Court: M.D. Tenn.
(Identify judge & cite, if any)

5. ("SO") ***SOURCE***
U.S. TRUSTEES

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*
Filed: June 18, 2009
Type: Brief of the United States as Amicus Curiae Supporting Reversal

7. **("AU")** ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*
John P. Sheahan, P. Matthew Sutko, Ramona D. Elliott
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s)

&

√ Any Miscellaneous ***BACKGROUND***

• Whether the bankruptcy court erred by holding that mortgage payments on properties that the chapter 13 debtors proposed to surrender could be used to reduce the debtors' "projected disposable income" under 11 U.S.C. 1325(b)(1).

10. PATH TO FILE LOCATION:
(e.g., S:\OGC\BRFBANK\etc...)

11. DO YOU RECOMMEND POSTING IN UST BRIEFBANK?
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NAME: Linda Figueroa
DATE:

COURT OF APPEALS DOCKET NO. 09-5499

IN THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

In re: DAVID ANDREW DARROHN and
MARGUERITE MOTTOLA DARROHN,
Debtors.

HENRY E. HILDEBRAND, III
Chapter 13 Trustee - Appellant,

v.

DAVID ANDREW DARROHN and MARGUERITE MOTTOLA DARROHN ,
Debtors - Appellees.

ON APPEAL FROM THE UNITED STATES BANKRUPTCY COURT
FOR THE MIDDLE DISTRICT OF TENNESSEE

BRIEF OF THE UNITED STATES AS *AMICUS CURIAE* SUPPORTING REVERSAL

RAMONA D. ELLIOTT
General Counsel
P. MATTHEW SUTKO
Associate General Counsel
JOHN P. SHEAHAN
Executive Office for United States Trustees
Department of Justice
20 Massachusetts Avenue, NW
Washington, DC 20530
Telephone: (202) 307-1399
Facsimile: (202) 307-2397
email: john.sheahan@usdoj.gov
COUNSEL FOR THE UNITED STATES

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The United States submits this brief under Fed. R. App. P. 29 as *amicus curiae* in support of reversal of the bankruptcy court's order below.

INTEREST OF THE UNITED STATES

This appeal involves a dispute over the interpretation of two provisions of the United States Bankruptcy Code, 11 U.S.C. §§ 1325(b) and 707(b)(2)(A). Together, these provisions determine whether debtors have met their statutory obligation to dedicate their projected disposable income to paying unsecured creditors through their chapter 13 plans.

The United States has a direct interest in the proper construction of these provisions because United States Trustees, who are Justice Department officials appointed by the Attorney General, supervise the administration of bankruptcy cases in all federal judicial districts within this circuit. *See* 28 U.S.C. § 581-589a. *See also* H.R. Rep. No. 95-595 at 88 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6049 (United States Trustees "serve as bankruptcy watch-dogs to prevent fraud, dishonesty, and overreaching in the bankruptcy arena").

The questions presented by this appeal affect the duties of the United States Trustee for at least two reasons. First, under 28 U.S.C. § 586(a)(3)(C), United States Trustees monitor chapter 13 plans and file comments with the court in connection with plan confirmation hearings under section 1324 of the Bankruptcy

Code. Second, the United States has an interest in the proper interpretation of section 707(b)(2) because, in addition to its relevance in chapter 13 cases, that provision determines whether chapter 7 cases filed by above-median-income debtors are presumed to be abusive. *See* 11 U.S.C. § 707(b)(1), (2). Pursuant to section 704(b), United States Trustees are responsible for reviewing chapter 7 cases for abuse and seeking dismissal where appropriate. *See Schultz v. United States*, 529 F.3d 343, 348 (6th Cir. 2008).

Given these interests, the United States submits this brief as *amicus* in order to share its views on the application of sections 707(b)(2) and 1325(b). *See* 28 U.S.C. § 517 (authorizing Department of Justice "to attend to the interests of the United States in a suit pending in a court of the United States"); 11 U.S.C. § 307 (United States Trustee "may raise and may appear and be heard on any issue in any case or proceeding").

STATUTORY BACKGROUND

In a chapter 13 case, a debtor's unsecured creditors or trustee may insist that the debtor devote all of his "projected disposable income" to pay unsecured creditors. *See* 11 U.S.C. § 1325(b)(1). The Bankruptcy Code partially defines the term "projected disposable income" by reference to section 1325(b)(2), which defines "disposable income" as "current monthly income received by the debtor

. . . less amounts reasonably necessary to be expended" for, among other things, "the maintenance or support of the debtor." 11 U.S.C. § 1325(b)(2).[1]

Section 1325(b) further provides that, in the case of debtors with an above-median income, "amounts reasonably necessary to be expended . . . shall be determined in accordance with subparagraphs (A) and (B) of section 707(b)(2)." 11 U.S.C. § 1325(b)(3). A subcategory of such expenses, secured debts, is governed by subsection 707(b)(2)(A)(iii). *See* 11 U.S.C. § 707(b)(2)(A)(iii). It allows debtors to deduct "the total of all amounts scheduled as contractually due to secured creditors in each month of the 60 months following the date of the petition" divided by 60. *Id.* The Bankruptcy Code does not define the phrase "amounts scheduled as contractually due to secured creditors."

SUMMARY OF ARGUMENT

Section 1325(b)(1)(B) of the Bankruptcy Code requires chapter 13 debtors to devote all of their "projected disposable income" to the repayment of their unsecured creditors during the pendency of their plan. This provision reflects a "clear congressional intent . . . that debtors repay creditors the maximum they can afford." *Coop v. Frederickson (In re Frederickson)*, 545 F.3d 652, 657 (8th Cir.

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[1]/ "Current monthly income" is determined by calculating the debtor's average monthly income for the six month period preceding the month of the filing of the debtor's bankruptcy petition. *See* 11 U.S.C. § 101(10A).

2008), *cert. denied*, 129 S. Ct. 1630 (2009) (internal citations omitted).

In this case, chapter 13 debtors David and Marguerite Darrohn sought to reduce their projected disposable income by claiming, among other deductions, an expense of $2,894.78 for mortgage payments on two homes that they propose to surrender under the terms of their chapter 13 plan. Dkt. 5 at 6.[2] Neither of the properties in question was the Darrohns' residence as of the time they filed for bankruptcy. The first of the two properties at issue is a home in Illinois that the Darrohns formerly rented to Mr. Darrohn's father, who is now deceased, while the second property is a residence that the Darrohns vacated prior to their bankruptcy. Tr. at 22-24.

The United States submits this brief in order to express its view on the correct treatment of mortgage expenses for surrendered properties under the section 1325(b)(1) "projected disposable income" test.[3] The bankruptcy court's

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[2] Unless otherwise indicated, all docket citations are to the docket of the bankruptcy case no. 08-09075 in the United States Bankruptcy Court for the Middle District of Tennessee. References to the transcript of the bankruptcy court's confirmation hearing of December 15, 2008, which is attached as an exhibit to the chapter 13 trustee's opening brief, are denoted as "Tr. __."

[3] The chapter 13 trustee has also appealed the bankruptcy court's method for computing the earnings component of the Darrohns' projected disposable income. Br. 6-7. This topic raises the same legal issues as the bankruptcy court's ruling regarding the effect of section 1325(b)(1) on the Darrohns' expense computation, which is discussed below at section D.

ruling was erroneous because no fewer than three separate sections of the Bankruptcy Code independently prohibit the Darrohns from claiming a deduction for a phantom mortgage expense they will never actually pay. ***First***, the surrendered property payments cannot meet the threshold definition of "amounts reasonably necessary to be expended" under sections 1325(b)(3) and 707(b)(2) of the Bankruptcy Code, because those sections permit debtors to deduct only those expenses that will actually be paid. ***Second***, even if the Darrohns' surrendered property payments were somehow deemed to be "reasonably necessary" under section 1325(b)(3), those payments are excluded from the computation of "disposable income" under section 1325(b)(2) because they are not necessary for the "maintenance or support" of the Darrohns. ***Third***, even if those payments were included in the computation of the Darrohns' "disposable income," they are excluded from the definition of "projected disposable income" under section 1325(b)(1), which is a forward-looking provision that directs courts to take into account changes in the debtors' expenses over the life of their plan, including, in this case, the termination of two major payment obligations.

For each of these reasons, the Bankruptcy Code precludes the Darrohns from deducting an expense they will never actually pay over the life of their chapter 13 plan. Instead, the Darrohns should be allowed the same standardized housing expense deduction that is available to any other similarly-situated debtors who do not have a mortgage on their primary residence. *See* 11 U.S.C. § 1325(b)(3) (incorporating section 707(b)(2)(A)(ii) of the Bankruptcy Code). Based on the data reported on the Darrohns' bankruptcy petitions, this would entitle them to a standardized deduction of $1,088 per month, rather than the $2,894.78 that they claimed. *See* Dkt. 5 at 1. Because the Bankruptcy Court approved the plan, which deducted the higher expense number when calculating the Darrohns' projected disposable income, the bankruptcy court's order confirming the Darrohns' plan should be vacated. This case should be remanded for further consideration of whether the Darrohns have met the requirements for plan confirmation under section 1325 of the Bankruptcy Code.

ARGUMENT

I. <u>This Court Has Jurisdiction.</u>

The order of the bankruptcy court was entered on December 23, 2008. On January 2, 2009, the chapter 13 trustee filed a notice of appeal to district court. The same day, the parties jointly "certified" the order for direct appeal to the court of appeals under 28 U.S.C. § 158(d). On January 9, 2009, the parties jointly petitioned for permission to appeal to the court of appeals, which granted permission to appeal on April 23, 2009.

It is the position of the United States that this Court has jurisdiction, because all parties may jointly certify an order for direct review under section 158(d), without obtaining certification from the bankruptcy court itself. Section 158(d)(2) establishes jurisdiction in the court of appeals over appeals from a bankruptcy court, district court, or bankruptcy appellate panel if the judgment, order, or decree "involves a question of law as to which there is no controlling decision of the court of appeals for the circuit or of the Supreme Court of the United States, or involves a matter of public importance" or "involves a question of law requiring resolution of conflicting decisions," or if "an immediate appeal . . . may materially advance the progress of the case or proceeding in which the appeal is taken." 28 U.S.C. § 158(d)(2)(A). However, there also must be a certification that this condition obtains. The court of appeals has jurisdiction "if the bankruptcy court, the district court, or the bankruptcy appellate panel involved, acting on its own motion or on the request of a party to the judgment, order, or decree described in such first sentence, or all the appellants and appellees (if any) acting jointly, certify" the existence of the condition. *Id.* (emphasis added).

Although the underlined phrase is not entirely clear in context, and conceivably could indicate that the court may act on "the request of" all parties acting jointly, such a reading not only is hard to square with the statutory syntax, but also renders the phrase unnecessary. If a request of "a party" is sufficient, there would be no need to address the case in which the request is from all parties. The latter would be subsumed within the former. Thus, we believe the underlined phrase means that courts have the authority to certify orders for direct appeals but not the exclusive authority. In our view, the statutory language divides the possible cases into three: (i) a court "acting on its own motion," (ii) a court "acting . . . on the request of a party to the judgment, order, or decree," or (iii) "all the appellants and appellees (if any) acting jointly." Further support for this reading is found in the next paragraph of the statute, which requires the court to certify if (i) on its own motion or the request of a party it determines that the condition is met, or (ii) the court receives a request from "a majority of appellants and a majority of the appellees (if any)." 28 U.S.C. § 158(d)(2)(B). The case of a request by all parties is not addressed. The omission of that case makes little sense if all certifications must be made by a court, but it is fully consistent with a reading of section 158(d)(2)(A) that allows all parties jointly to certify.

II. The Bankruptcy Court Erred By Permitting The Darrohns To Reduce Their Projected Disposable Income Through A Phantom Mortgage Expense That Will Never Be Paid.

A. The Bankruptcy Code imposes three separate tests that must all be satisfied before claiming a deduction to projected disposable income, none of which the Darrohns are able to meet.

Chapter 13 of the Bankruptcy Code is an intricate statutory mechanism designed to "achieve the congressional intent of requiring above-median debtors to pay their unsecured creditors the maximum they can afford in every case." *Frederickson*, 545 F.3d at 658-69. A key provision of this chapter is section 1325(b)(1), which allows the chapter 13 trustee or any creditor to prevent confirmation of any plan unless the debtor commits to pay his unsecured creditors in full, or else devotes his entire "projected disposable income" to the repayment of unsecured creditors over the life of the plan. "Projected disposable income" is an amount, equal to current monthly income[4] less certain allowable expenses that the Bankruptcy Code permits debtors to deduct from their income, and represents the minimum monthly payment that a debtor must make in order to propose a confirmable plan under chapter 13. *See* 11 U.S.C. § 1325(b)(1), (2).

No single provision of the Bankruptcy Code defines what expenses may be

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[4] "Current monthly income" is defined in section 101(10A) of the Bankruptcy Code.

used to reduce a debtor's "projected disposable income." Rather, "projected disposable income" is defined in part by reference to section 1325(b)(2), which provides a definition of "disposable income." "Disposable income," in turn, is defined in part by section 1325(b)(3), which authorizes debtors to claim a deduction for "reasonably necessary" expenses, defined in terms of the chapter 7 means test set forth in section 707(b)(2).

Together, these provisions form three separate tests, all of which must be satisfied before a particular expense can be deducted when determining the debtor's projected disposable income. Using the chapter 7 means test as a starting point, these tests act as a series of filters that progressively narrow the types of expenses that can be deducted from a debtor's income. As a result, the universe of expenses that may be included in the "disposable income" computation under section 1325(b)(2) is narrower than the universe of "reasonably necessary expenses" defined by section 1325(b)(3). The expenses applicable to the "projected disposable income" test of section 1325(b)(1), in turn, are even more limited than those applicable to section 1325(b)(2).

1. *The "reasonably necessary" test [11 U.S.C. §§ 707(b)(2) and 1325(b)(3)]*

When determining whether an expense may be used in determining a debtor's projected disposable income, the first step of the analysis is to determine whether that expense is among the deductions listed under section 707(b)(2). The section 707(b)(2) deductions include, among other things, "[t]he debtor's average monthly payments on secured debt," which are defined as "amounts scheduled as contractually due to secured creditors in each month of the 60 months following the date of the petition." 11 U.S.C. § 707(b)(2)(A)(iii). If, and only if, a secured debt payment meets those criteria, it will be treated as an "amount reasonably necessary to be expended" under section 1325(b)(3).

2. *The "maintenance or support" test [11 U.S.C. § 1325(b)(2)(A)]*

If the expense satisfies the "reasonably necessary" test of section 707(b)(2) and 1325(b)(3), the next step of the analysis is to determine whether the expense is also a permissible deduction to "disposable income" under section 1325(b)(2). Except in the case of charitable contributions and business expenses, that section permits an expense to be deducted from disposable income only if both of two criteria are met: (1) the expense must be "reasonably necessary to be expended" *and* (2) it must be "for the maintenance or support of the debtor or a dependent of the debtor." 11 U.S.C. § 1325(b)(2)(A)(i). As a result, an expense that is not for "maintenance or support" cannot be included within a calculation of disposable income, even if it otherwise satisfies the definition of a "reasonably necessary" expense under sections 1325(b)(3) and 702(b)(2).

3. *The requirement that an expense be "projected" to occur over the duration of a debtor's chapter 13 plan [11 U.S.C. § 1325(b)(1)]*

If an expense is allowed as a deduction to the debtor's "disposable income," the final step of the analysis is to determine whether it also may be allowed as a deduction in calculating "projected disposable income" under section 1325(b)(1). Although the term "projected" is not defined in the Bankruptcy Code, the most natural reading of section 1325(b)(1) is that it is intended to be a forward-looking variation of the test for "disposable income" set forth in section 1325(b)(2). Accordingly, the expense must also be one that is "projected" to exist over the course of the debtor's plan, even if it is included within the calculation of a debtor's "disposable income," in order to offset a debtor's income under 1325(b)(1).

In this case, the bankruptcy court's decision did not follow the three-step analysis required by the Bankruptcy Code. Instead, the bankruptcy court limited its discussion to the question of whether the Darrohns' mortgage payments could be included in a section 707(b)(2) means test calculation, determined as of the moment the Darrohns filed for bankruptcy. Tr. 46-47. In so ruling, the bankruptcy court misapplied the section 1325(b)(3) "reasonably necessary" test, and did not consider either of the two remaining tests. Because all three of these tests independently preclude the Darrohns from deducting a phantom mortgage expense, the bankruptcy court's decision was erroneous.

B. Under the "reasonably necessary" test of sections 707(b)(2) and 1325(b)(3), the Darrohns may not claim a deduction for mortgage payments they will never actually make.

For purposes of the chapter 7 means test, section 702(b)(2)(A)(iii) permits debtors to claim a deduction for "the total of all amounts scheduled as contractually due to secured creditors in each month of the 60 months following the date of the petition," plus any additional amounts "necessary for the debtor . . . to maintain possession" of the property in question. 11 U.S.C. § 707(b)(2)(A)(iii)(I), (II). In this case, however, the Darrohns' surrender of their properties means that there is no longer any payment that is "contractually due" to a "secured creditor," and it will not be necessary for the Darrohns to make additional payments to "maintain possession" of properties they will not keep.

Although the bankruptcy court found that the Darrohns could deduct their mortgage expenses as a payment "contractually due to a secured creditor," it did so based on its assumption that sections 707(b)(2) and 1325(b)(3) require an artificial, static analysis of the Darrohns' finances, strictly determined according to events as they existed on the day the Darrohns filed for bankruptcy. Tr. 49. In so ruling, the bankruptcy court followed a decision of the Bankruptcy Appellate Panel for the Sixth Circuit holding that, for purposes of calculating section 707(b)(2) expense deductions, the chapter 7 means test does not permit a court to consider changes to the debtor's actual expenses that occur after the filing of the bankruptcy petition. *See Hildebrand v. Thomas (In re Thomas)*, 395 B.R. 914, 922 (B.A.P. 6th Cir. 2008).[5]

The question decided by *Thomas* has divided lower courts and is an issue of first impression before this Court.[6] *Compare Thomas*, 395 B.R. at 922 (holding, in connection with determination of projected disposable income in chapter 13 case, that payments on surrendered property could be deducted from income for section 702(b)(2) purposes); *Fokkena v. Hartwick*, 373 B.R. 645, 653-55 (D. Minn. 2007)

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[5] The bankruptcy court followed only a portion of the holding in *Thomas*. Although the bankruptcy court agreed with *Thomas*'s construction of sections 707(b)(2) and 1325(b)(3) as backward-looking, it declined to follow the second key holding of *Thomas*, which recognized that the term "projected" in section 1325(b)(1) requires a forward-looking construction. *Thomas*, 395 B.R. at 923.

[6] No court of appeals has yet ruled on the question of how to treat mortgage expenses for surrendered property under section 707(b)(2). However, appeals raising this same issue are currently pending before the First and Seventh Circuits. *See Morse v. Rudler (In re Rudler)*, Case No. 08-9007 (1st Cir.) (raising issue of interpretation of section 707(b)(2) in the chapter 7 context); *Brothers v. Turner (In re Turner*), Case No. 08-2163 (7th Cir.) (chapter 13 case).

(denying motion to dismiss chapter 7 debtor's case and holding that mortgage expenses for surrendered property could be deducted from income under section 707(b)(2) means test)*; with In re Naut*, No. 07-20280REF, 2008 WL 191297 at *9 (Bankr. E.D. Pa. Jan. 22, 2008) (holding that debtor could not "artificially" reduce income for chapter 7 means test purposes by deducting a phantom payment obligation on surrendered property); *In re Burden*, 380 B.R. 194, 202 (Bankr. W.D. Mo. 2007) (same); *In re Harris*, 353 B.R. 304, 308-10 (Bankr. E.D. Okla. 2006) (same); *In re Skaggs*, 349 B.R. 594, 599-600 (Bankr. E.D. Mo. 2006) (same).

This Court should reject the interpretation of section 707(b)(2) adopted by *Thomas* and the bankruptcy court for at least three reasons. ***First***, the premise that section 707(b)(2) requires the court to determine income based only on a pre-petition "snapshot" of the debtor's finances cannot be reconciled with the forward-looking language of the statute. Section 707(b)(2) does not direct the court to measure a debtor's obligations *as of* the date of the petition, but over the 60-month period *following* the petition. *See* 11 U.S.C. § 707(b)(2)(A)(iii)(I). For this reason, payments that will never be made "following" the petition are irrelevant to the section 707(b)(2) means test. *See Naut* at *9 (applying dictionary definition of "following" and concluding that loan payments must actually be due in each of the

60 months after the bankruptcy filing before debtor can claim expense on means test).

Second, the interpretation of section 707(b)(2)(A)(iii)(I) followed by *Thomas* and the bankruptcy court fails to account for Congress's use of the word "secured." As this Court has previously recognized, the surrender of the Darrohns' two properties, which is a requirement of their proposed chapter 13 plan, will extinguish any secured claim arising from those properties and will leave the Darrohns' lenders with, at most, an unsecured claim for any deficiency.[7] *See AmeriCredit Financial Services, Inc., v. Long (In re Long)*, 519 F.3d 288, 291-92 (6th Cir. 2008) (discussing remedies of lender following debtor's surrender of collateral in chapter 13 case). As a result, during the 60-month period to which 707(b)(2)(A)(iii)(I) refers, there will be no "secured creditors" associated with the properties for which the Darrohns claim a deduction, and the subsection is inapplicable by its own terms. In order to conform the bankruptcy court's result with the text of subsection (I), it would therefore be necessary to either delete the word "secured," or to modify the subsection by inserting the phrase "or formerly secured." Nothing in the text or history of section 707(b)(2) justifies such a

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[7] The record does not indicate whether the surrender contemplated by the Darrohns' plan has occurred, or whether the lenders to whom the properties are surrendered will have recourse against the Darrohns in the event of a deficiency.

revision of Congress's plain language.

Third, even if the language of subsection (I) were ambiguous, the "snapshot" construction of the phrase "scheduled as contractually due" given in *Thomas* creates a structural inconsistency with other related sections of the Bankruptcy Code, thereby violating the interpretive canon of *in pari materii*. *See Erlenbaugh v. United States*, 409 U.S. 239, 243 (1972) (canon of *in pari materia* "is but a logical extension of the principle that individual sections of a single statute should be construed together"). In particular, the "conjunctive partner" of section 707(b)(2)(A)(iii)(I) is section 707(b)(2)(A)(iii)(II). *Burden*, 380 B.R. at 202. That subsection, which permits debtors to deduct "additional payments . . . necessary for the debtor . . . to maintain possession of the property," would be meaningless unless it were given a forward-looking construction. Moreover, that subsection unequivocally presumes that the debtor who claims a deduction under section 707(b)(2)(A)(iii) is one who is maintaining, and not surrendering, the property in question. *Id.* (noting that subsection (II) "reinforces the conclusion that § 707(b)(2)(A)(iii)(I) applies only to payments on debts secured by collateral that a debtor intends to keep").

Because the Bankruptcy Code links the means test in section 707(b)(2) to the projected disposable income test in section 1325(b), the provisions of section

1325(b) are also relevant to the question of whether section 707(b)(2)(A)(iii)(I) requires a "snapshot" or a forward-looking analysis. Like the provisions of subsection 707(b)(2)(A)(iii)(II), the various provisions of section 1325(b)(1) are explicitly forward-looking. *See, e.g.,* 11 U.S.C. § 1325(b)(1)(B) (requiring debtor to commit "projected" disposable income to plan); (b)(2)(A)(i) (referring to domestic support orders that become payable after the date the petition is filed); (b)(2)(A)(ii) (limiting charitable contribution deductions based on debtor's income in year in which contributions are made); *see also Frederickson*, 545 F.3d at 659 (noting that section 1325(b)(1) "necessarily contemplates a forward-looking number"); *Hamilton v. Lanning (In re Lanning)*, 545 F.3d 1269, 1280 (10th Cir. 2008), *petition for cert. filed*, 77 U.S.L.W. 3449 (U.S. Feb. 03, 2009) (No. 08-998) (same).

As a result, in order to reconcile the result in *Thomas* with the remainder of section 707(b)(2), it would be necessary to conclude that Congress commanded courts to use one methodology when calculating deductions for principal and interest payments under the subsection (I) of section 707(b)(2)(A)(iii), but a significantly different methodology when calculating deductions for "additional payments" for the same mortgage under the next subsection and when applying that same information to the calculation of projected disposable income under section 1325(b). It is a basic rule of statutory construction, however, that courts should avoid interpreting separate parts of a single legislative enactment in such a contradictory manner. *See United Savings Assoc. of Texas v. Timbers of Inwood Forest Assocs.*, 484 U.S. 365, 371 (1988) (noting that interpretation of the Bankruptcy Code "is a holistic endeavor," and that a "provision that may seem ambiguous in isolation is often clarified by the remainder of the statutory scheme"). Accordingly, the bankruptcy court erred by including the Darrohns' phantom mortgage payments in its computation of "reasonably necessary" expenses under sections 707(b)(2) and 1325(b)(3).

C. Alternatively, under section 1325(b)(2), the Darrohns' expenses for surrendered property may not be used to reduce disposable income because they are not expenses for "maintenance or support."

Even if the Darrohns' payments on their discontinued mortgage obligations were deductible for means-testing purposes under section 707(b)(2), such payments are not necessarily also deductible from "disposable income" under section 1325(b)(2). That section imposes a double requirement that must be satisfied before such a deduction can be taken: not only must the expense be "reasonably necessary" (as determined by section the 707(b)(2) means test), but it must also fall into one of the categories described under subsections (A) or (B) of section 1325(b)(2). *See* 11 U.S.C. § 1325(b)(2), (3). Because the Darrohns are not engaged in business and their mortgage payments are not charitable contributions, the only such category applicable to the Darrohns is subsection (A)(i), which authorizes the deduction of an expense "for the maintenance or support of the debtor or a dependent of the debtor." *See* 11 U.S.C. § 1325(b)(2)(A)(i).

Here, the bankruptcy court's failure to even consider whether the Darrohns' surrendered properties were necessary for their "maintenance or support" warrants reversal for at least two reasons. ***First***, as an examination of the language and structure of section 1325(b)(2) demonstrates, Congress intended the "maintenance or support" test to be an additional requirement to the "reasonably necessary" test, which is applicable to both above-median as well as below-median debtors. ***Second***, the "maintenance or support" test precludes debtors from claiming a deduction for a mortgage payment that they will never actually make, or that relates to a property that is not a primary residence. In this case, the Darrohns do not intend to pay their mortgages, and neither of the homes at issue is the Darrohns' residence. As a result, those mortgage payments cannot be characterized as expenses for "maintenance or support."

1. *The "maintenance or support" requirement of section 1325(b)(2) is applicable to both above-median and below-median debtors.*

The Bankruptcy Code provides two different mechanisms for measuring "disposable income," depending on whether or not the debtor has a family income above the median for his state. *See In re Gonzalez*, 388 B.R. 292, 300 (Bankr. S.D. Tex. 2008). If the debtor is below-median, the court computes expenses based only on section 1325(b)(2), and will make a subjective determination of whether particular expenses are "reasonably necessary . . . for maintenance or support." 11 U.S.C. § 1325(b)(2). For above-median debtors, such as the Darrohns, the court must also look to section 1325(b)(3), which directs the court to determine "reasonably necessary" according to the objective criteria set out in section 707(b)(2).

One issue that remains unsettled among lower courts is whether the "maintenance or support" requirement of subsection (b)(2) retains any independent significance for above-median debtors. One group of cases has held that it does, and has required debtors to demonstrate both that their expenses are "reasonably necessary" under subsection (b)(3) and that they are for "maintenance or support" under subsection (b)(2). *See Gonzalez*, 388 B.R. at 301 (citing cases). Other courts, by contrast, have held that subsection (b)(3) displaces subsection (b)(2) entirely for above-median debtors, and have not required such debtors to demonstrate that their expenses are for "maintenance or support." *See In re Smith,* 401 B.R. 469, 473 (Bankr. W.D. Wash. 2008).

Both the text and purpose of section 1325(b) support the holding of *Gonzalez*. Had Congress intended for subsection (b)(3) and the chapter 7 means test to supplant subsection (b)(2)(A) for above-median debtors, or to supplant the "maintenance or support" component of that section, it would have provided so expressly. It did not, but instead used the means test to define only a single, narrow phrase within section 1325(b)(2) – "reasonably necessary to be expended." Congress's decision not to incorporate the full phrase "for maintenance or support" within 1325(b)(3) is significant. As the Supreme Court has noted, "Where Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion." *Dean v. United States*, 129 S. Ct. 1849, 1853 (2009), *quoting Russello v. United States*, 464 U.S. 16, 23 (1983). As a result, the structure of section 1325(b)(2) supports the conclusion that above-median debtors, as well as below-median debtors, must demonstrate that their claimed expenses are "for maintenance or support" for purposes of determining section 1325(b)(2) disposable income.

Although the statutory language is dispositive in this instance, as the court in *Gonzalez* noted, a contrary rule would also lead to inequitable practical results. In many cases, an expense may be deductible under section 707(b)(2) but not section 1325(b)(2) because it is not for "maintenance or support." In such a case, the result in *Smith* would deny the deduction to a below-median debtor, while allowing the very same deduction to an above-median debtor. *Gonzalez*, 388 B.R. at 302. Such an outcome could have the paradoxical effect of allowing higher-income debtors to devote less income to their chapter 13 plan than a lower-income debtor, and would be at odds with Congress's intention that debtors repay creditors the maximum they can afford.

2. *The Darrohns' mortgage payments for homes in which they do not reside are not expenses for "maintenance or support."*

The Bankruptcy Court's failure to consider the "maintenance or support" test in the Darrohns' case was significant because, based on the undisputed facts of this case, the Darrohns cannot satisfy that test with respect to their phantom mortgage payments. This is so for at least two reasons: first, because the Darrohns themselves do not intend to make such payments, and second, because those payments relate to the Darrohns' second and third homes, neither of which they are currently using as a primary residence. *See Gonzalez*, 388 B.R. at 303 (holding that "Payments on a home that the [debtors] will not use do not provide . . . maintenance or support").

This result would be the same even if the court adopted a static, "snapshot" analysis of the Darrohns' finances, based on facts as they existed on the day the Darrohns sought bankruptcy relief. Then, as now, neither of the two properties at issue was the Darrohns' primary residence. Tr. at 22-24. Non-primary residences, by definition, are not necessary for the maintenance or support of chapter 13 debtors. *See In re Short*, Case No. 08-11224, 2008 WL 5751873 at *4 (Bankr. N.D. Ohio Sept. 11, 2008) (listing "second homes" among categories of expenses which are not considered expenses for "maintenance or support"); *In re Cardillo*, 170 B.R. 490, 491-92 (Bankr. D.N.H. 1994) (holding that debtor's mortgage payments on investment property and second home were not for "maintenance or support"). Accordingly, the "maintenance or support" test of section 1325(b)(2) independently precludes the Darrohns from claiming a deduction for their phantom mortgage expenses.

D. The bankruptcy court erred by failing to consider changed circumstances when calculating projected disposable income under section 1325(b)(1).

The computations under sections 1325(b)(2) and (b)(3) result in an amount, "disposable income." However, for purposes of determining whether a chapter 13 plan may be confirmed, courts do not look directly to disposable income, but to a separate term, "projected disposable income." *See* 11 U.S.C. § 1325(b)(1).

In the decision below, the bankruptcy court split with the Eighth and Tenth Circuits and construed "disposable income" and "projected disposable income" as identical concepts, concluding that "projected disposable income" would be determined as of a historical moment in time – specifically, the moment when the Darrohns filed for bankruptcy, prior to the surrender of their real property. Tr. 47.

The bankruptcy court's ruling reflects a flawed reading of section 1325(b)(1). In particular, the bankruptcy court erred by refusing to give any meaning to the word "projected." Statutory words must be construed in context. *Hibbs v. Winn*, 542 U.S. 88, 101 (2004). In the context of section 1325(b)(1), the term "projected" refers to a forecast or estimate of an expected future financial reality.[8] Here, the interpretation of "projected" as requiring a future-oriented analysis of section 1325(b)(1) is also reinforced by the language of subsection (B) of that section, which refers to income that is "to be received" during the plan period, as well as amounts that "will be applied to make payments" to unsecured

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[8] *See The Random House Dict. of the English Lang.* 1546 (2d ed. 1987) (defining to "project" as, *inter alia*, "to set forth or calculate (some future thing"); *Webster's Third New Int'l Dict.* 1813 (1993) (defining "projected" as, *inter alia*, "planned for future execution: contrived, proposed").

creditors. *See* 11 U.S.C. § 1325(b)(1)(B).

Any interpretation of section 1325(b)(1), however, must take into account all of the language in the provision. If the interpretation cannot account for two phrases in the statute, which create serious interpretive issues in specific fact situations, the interpretation must be incorrect. It is well established that courts "must, if possible, construe a statute to give every word some operative effect." *Cooper Indus., Inc. v. Aviall Servs., Inc.*, 543 U.S. 157, 167 (2004) *(citing United States v. Nordic Village, Inc.*, 503 U.S. 30, 35-36 (1992)). Here, the bankruptcy court's interpretation of section 1325(b)(1) would require the Court to ignore this statutory maxim.

For this reason, as both the Eighth and Tenth Circuits have held, a better interpretation of section 1325(b)(1) is that it imposes a forward-looking test, which permits courts to consider a debtor's real financial circumstances instead of constraining itself to an artificial analysis of events as they existed at a past moment in time. *See Lanning*, 545 F.3d at 1280 (concluding that, based on an analysis of the statutory language, "the forward-looking approach [for interpreting section 1325(b)(1)] strikes us as the better one"); *Frederickson*, 545 F.3d at 659 (holding that analysis of projected disposable income "can take into consideration changes that have occurred in the debtor's financial circumstances").

In this case, the bankruptcy court rejected the analysis of *Frederickson* and *Lanning*, and stated that it would instead follow a contrary decision by the Ninth Circuit, *Maney v. Kagenveama (In re Kagenveama)*, 541 F.3d 868 (9th Cir. 2008). Tr. at 52-53. Even if this Court were to adopt that decision, however, *Kagenveama* is not dispositive of whether the Darrohns were authorized to claim a deduction for their mortgage expenses. The issue in *Kagenveama* was limited to the methodology for calculating a debtor's income, not expenses, under the chapter 13 projected disposable income test. *Kagenveama*, 541 F.3d at 871. *Kagenveama* therefore had no occasion to consider the prospective effects of sections 1325(b)(2)(A), 1325(b)(3), or 707(b)(2)(A)(iii), all of which are applicable only to expense calculations.[9]

In any event, to the extent that it is relevant here, this Court should decline to adopt the holding of *Kagenveama.* Apart from the fact that the *Kagenveama* construction frustrates the intent of Congress by reading the forward-looking phrases "projected" and "to be received" out of the Bankruptcy Code, the mechanical, backward-looking approach taken by *Kagenveama* has led to

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[9] For the same reason, *Kagenveama* is inapplicable to the arguments discussed in sections II and III of this brief, which involve statutory provisions related to the calculation of expenses, and which were consequently not addressed by the *Kagenveama* decision.

troubling consequences in the Ninth Circuit. In particular, it is not uncommon for debtors to receive a one-time increase in their income during the months before their bankruptcy, such as through a severance payment or by selling off their property. Under the *Kagenveama* holding, a court must use this artificially-inflated income as the basis for calculating a chapter 13 debtor's projected disposable income, even if it bears no relation to the debtor's actual income during the bankruptcy. This mechanical approach imposes an impossible burden on many chapter 13 debtors, and has led to inequitable results in the Ninth Circuit post-*Kagenveama*. *See, e.g.*, *In re Featherstone*, No. 08-00016, 2008 WL 5217936 (D. Mont. Dec. 11, 2008) (denying confirmation of the debtors' plan where the debtors sought to exclude income received from a one-time sale of livestock from their "projected disposable income" calculation); *In re Stansell*, 395 B.R. 457 (Bankr. D. Idaho 2008) (requiring income received from the debtor's deceased spouse to be included in the debtor's calculation of "current monthly income").

In this case, the projected disposable income analysis performed by the bankruptcy court was flawed because it was based on a phantom expense that will not continue over the course of the Darrohns' bankruptcy. By treating the Darrohns' mortgage obligations on surrendered property as if they would continue indefinitely, when in actuality the Darrohns will never again make such payments, the bankruptcy court reduced the amount that the Darrohns will be required to pay to their unsecured creditors. The bankruptcy court's ruling failed to give section 1325(b)(1) the forward-looking construction mandated by Congress, and as a result, its order confirming the Darrohns' plan should be reversed.

CONCLUSION

For these reasons, the United States respectfully asks this Court to reverse the order of the bankruptcy court confirming the Darrohns' plan, and to remand this case to the bankruptcy court for further consideration of whether the Darrohns have satisfied the requirements for plan confirmation under 11 U.S.C. § 1325(b)(1).

CERTIFICATE OF COMPLIANCE WITH FED. R. APP. P. 32(a)

I hereby certify that the foregoing brief complies with the typeface requirements in Fed. R. App. P. 32(a)(5) and the page and type-volume limitation in Fed. R. App. P. 32(a)(7). I also certify that the foregoing brief is proportionately spaced, using Times New Roman font, 14 point type. Based on a word count under Corel Word Perfect 12, this brief contains 6,640 words excluding the table of contents, table of authorities, and certificates of counsel.

/s/ John P. Sheahan
John P. Sheahan
Attorney for the United States
as Amicus Curiae

CERTIFICATE OF SERVICE

I hereby certify that on June 18, 2009, I served the foregoing Brief for the United States as *Amicus Curiae* in Support of Reversal on the following by sending two copies of the brief by overnight mail to:

James D. Nave
Marybeth Ausbrooks
Rothschild, Nave & Ausbrooks,
PLLC
1222 16th Ave S., Suite 12
Nashville, TN 37212-2926

Henry E. Hildebrand, III
P.O. Box 190664
Nashville, TN 37219-0422

DATED, this 18th day of June, 2009.

/s/ John P. Sheahan
John P. Sheahan
Attorney for the United States
as Amicus Curiae

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Amy L. Good, Wendy Cox, P. Matthew Sutko, Daniel McDermott
(UST/OGC: 202-307-1399/FAX-2397)

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In the
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In re: Deaconess Hospital

Deaconess Hospital LLC
Appellant
v.
Nour Management Company
Appellee

On Appeal from the United States Bankruptcy Court
for the Northern District of Ohio
Eastern Division

APPELLEE UNITED STATES TRUSTEE'S BRIEF IN OPPOSITION TO CROSS-APPELLANT NOUR MANAGEMENT COMPANY'S OBJECTIONS TO BANKRUPTCY COURT DECISION DATED JULY 22, 2004

Counsel for Appellee Daniel McDermott
United States Trustee

Amy L. Good
Trial Attorney
Office of the U.S. Trustee
U.S. Department of Justice
H.M. Metzenbaum U.S. Courthouse
201 Superior Avenue, East
Cleveland, Ohio 44114
(216) 522-7800

P. Matthew Sutko
Wendy Cox
Office of the General Counsel
Executive Office for U.S. Trustees
United States Department of Justice
20 Massachusetts Avenue, NW
Washington, D.C. 20530
(202) 307-1399

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Cases

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Statement of Jurisdiction

The Bankruptcy Court had jurisdiction over the debtors Deaconess Hospital LLC et al's chapter 11 bankruptcy case under 28 U.S.C. §§ 157(a) and (b), and 1334(a). It had jurisdiction to decide Deaconess' motion to pay Nour Management Company fees for management services and Nour Management Company's motion for fees for management services. The Bankruptcy Court denied both motions in its order entered on July 22, 2004. On July 30, 2004, the Deaconess debtors timely appealed the order denying its motion to pay Nour Management Company fees for future management services and Nour's motion for fees. On August 6, 2004, Nour Management Company filed a cross-appeal of the order denying its motion for fees for management services under 28 U.S.C. § 158(a). Due to delay in the transmittal, the appeals were not docketed in this Court until March 30, 2009. This Court has jurisdiction over this appeal under 28 U.S.C. § 158(a)(1).

Statement of Issues Presented

I. Whether Nour is foreclosed from arguing the Bankruptcy Court erred by concluding the agreement between Nour and the Deaconess debtors was outside of the ordinary course of business within the meaning of 11 U.S.C. § 363(b)(1).

II. Assuming Nour is not foreclosed, whether the Bankruptcy Court abused its discretion in denying Nour's management fees under 11 U.S.C. § 363(b).

A. Whether the Bankruptcy Court erred in analyzing the transaction between Nour and the Deaconess debtors under 11 U.S.C. § 363(b) as one outside of the ordinary course of business when the evidence presented at the hearing supports that conclusion.

B. Whether the Bankruptcy Court abused its discretion in finding Nour did not demonstrate extraordinary circumstances warranting nunc pro tunc approval of its fees under 11 U.S.C. § 363(b).

C. Whether the Bankruptcy Court properly determined a sound business reason did not warrant retroactive payment of management fees to an insider outside of the ordinary course of business under 11 U.S.C. § 363(b).

III. Whether the Bankruptcy Court's decision should be affirmed in any event because even if the management fees were in the ordinary course of business, Bankruptcy Court approval was still required under 11 U.S.C. §363(c)(2).

Standard of Review

On appeal, this Court reviews the bankruptcy court's findings of fact under a clearly erroneous standard and conclusions of law de novo. Mixed questions of law and fact are separated and reviewed under the applicable standard. City of Baltimore v. State of West Virginia (In re Eagle-Pitcher Industries, Inc.*)*, 285 F.3d 522, 527 (6th Cir. 2002); Fed. R. Bankr. P. 8013. Review of a transaction under 11 U.S.C.§ 363(b) is under an abuse of discretion standard. See In re Stephens Industries, Inc., 789 F. 2d 386, 388 (6th Cir. 1986). See also In re Montgomery Ward Holdings Corp., 242 B.R. 147, 152-153 (D. Del. 1999).

Statement of the Case

In this appeal, Nour Management Company ("Nour") challenges the Bankruptcy Court order denying its motion for retroactive approval of its management fees. Deaconess Hospital, LLC, Pearlview Square, Inc., and Indoga, Inc. (hereinafter "Deaconess" or "the Debtors") have not prosecuted their appeal of the order denying both its and Nour's motions.

Deaconess filed voluntary chapter 11 bankruptcy petitions under the Bankruptcy Code on November 23, 2003 (the "petition date"). (Bankruptcy Court Docket No. 1).[1] These related cases were jointly consolidated and administered together. (Bankruptcy Court Docket No. 13). George G. Saad, M.D. was the sole owner and person in control of Deaconess. Dr. Saad also owned and managed Nour.

On May 25, 2004, Nour filed a motion requesting bankruptcy court approval of management fees totaling $84,000 incurred postpetition on behalf of Deaconess from November 21, 2003 through May 7, 2004. (Bankr. Doc. No. 458). Deaconess also filed a motion to pay Nour for postpetition management services provided after May 7, 2004 in the amount of $5,000 a week. (Bankr. Doc. No. 463). The United States Trustee,[2] Official Committee of Unsecured

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[1] Citations to the Bankruptcy Court record are referred to as "Bankr. Doc. No. ___" and citations to the District Court record are referred to as "Dist. Ct. Doc. No. ___."

[2] Congress authorized the United States Attorney General to appoint 21 United States trustees, each to serve in a specific geographic region of the United States. See generally, 28 U.S.C. § 581 et. seq. (establishing the United States Trustee Program). The United States trustees are senior officials of the Department of Justice. Id. The United States trustees "supervise the administration of cases and trustees" in all bankruptcy cases within his or her region through the exercise of a range of oversight responsibilities. 28 U.S.C. §586(a)(3). See generally, Morgenstern v. Revco, D.C., Inc. (In re Revco D.S. Inc.), 898 F. 2d 498, 500 (6th Cir. 1990) (explaining that United States trustees oversee the bankruptcy process, protect the public interest, and ensure that bankruptcy cases are conducted according to law.). United States trustees may

Creditors, GE HFS Holdings, Inc, and Bank One, N.A. objected to the motions of Nour and Deaconess. (Bankr. Doc. No. 498, 508, 520, 521). After an evidentiary hearing, the Bankruptcy Court entered its Order dated July 22, 2004 and Memorandum of Opinion denying both motions. (Bankr. Doc. Nos. 589, 590).

On July 30, 2004, Deaconess filed a notice of appeal of the order denying both its motion to pay Nour for services rendered after May 7, 2004 and Nour's motion for management fees through May 7, 2004. (Bankr. Doc. No. 610). On August 6, 2004, Nour filed a notice of cross-appeal of the order denying its motion for management fees. (Bankr. Doc. No. 624).

Pursuant to Fed. R. Bankr. P. 8001, the United States Trustee and GE HFS Holdings, Inc. elected to have the appeals heard by the District Court. The Bankruptcy Appellate Panel entered an order on August 31, 2004 transferring the appeals to the District Court. (Bankr. Doc. No. 683). Due to delays incurred in the transfers, the appeal was docketed with the District Court on March 30, 2009. (Dist. Ct. Doc. No. 1). The United States Trustee filed a motion to dismiss the appeals on May 28, 2009 for lack of prosecution to which Nour objected. (Dist. Ct. Doc. Nos. 4, 8). The District Court denied the United States Trustee's motion to dismiss and established a briefing schedule. (Dist. Ct. Doc. entry dated October 7, 2009). After several extensions were granted, Nour filed its objection to the Bankruptcy Court decision of July 22, 2004 on November

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raise, appear, and be heard on any issue in any case or proceeding under Title 11. 11 U.S.C. § 307; See also, In re Revco, D.S, Inc., 898 F. 2d at 499-500 (upholding broad appellate standing of United States trustees).

27, 2009. (Dist. Ct. Doc. No. 11). As of this date, Deaconess has not filed any pleading in further prosecution of its appeal.

During the pendency of these appeals, on April 18, 2005, the Bankruptcy Court ordered the appointment of a chapter 11 trustee to administer Deaconess' chapter 11 proceeding. (Bankr. Doc. Nos. 898, 909). David O. Simon was appointed as the chapter 11 trustee. (Bankr. Doc. No. 919). On September 6, 2005, Mr. Simon moved to convert these chapter 11 proceedings to a chapter 7 liquidation proceeding which the Bankruptcy Court granted on October 3, 2005. (Bankr. Doc. No. 996). Mr. Simon has remained the chapter 7 trustee responsible for liquidating Deaconess' remaining assets for the benefit of creditors.

Statement of the Facts

1. Statutory Framework

When an entity files for chapter 11 bankruptcy protection, the debtor is deemed a debtor-in-possession, and unless ordered otherwise, the debtor has the authority to continue conducting its regular business operations as it did before the bankruptcy filing ("prepetition"). 11 U.S.C. §§ 363(c), 1107. However, any transactions outside of the ordinary course of the debtor's business must be approved, after notice and a hearing, by the bankruptcy court. 11 U.S.C. § 363(b).

In addition, a debtor may not use its cash collateral to pay for goods and services without the consent of the parties that have a security interest in the cash collateral unless the court approves of the use of cash collateral, after notice and a hearing. 11 U.S.C. § 363(c)(2). Cash collateral includes cash, negotiable instruments, documents of title, securities, deposit accounts, proceeds, accounts and rents in which the debtor and another party have an interest. 11 U.S.C.

§363(a). Any transaction outside of the ordinary course of business, regardless of whether or not it requires the use of cash collateral, must be approved by the Bankruptcy Court. 11 U.S.C. § 363(b).

The Bankruptcy Code specifically details the means by which a debtor may hire and pay professionals assisting with a bankruptcy proceeding and also clearly addresses the payment of wages, salaries, and commissions earned and owed to such employees. 11 U.S.C. §§ 327, 330, 331, 503, 507. However, the retention of managers and payment of management fees is not specifically addressed by the Bankruptcy Code. Only § 503(c)(3) provides guidance by stating that obligations shall not be allowed or paid as an administrative expense that are "incurred outside of the ordinary course of business and not justified by the facts and circumstances of the case, including transfers made to, or obligations incurred for the benefit of, officers, managers, or consultants hired after the date of the filing of the petition."

2. Factual Background

The Deaconess debtors filed their bankruptcy petitions on November 23, 2003 and at that time Deaconess owned and operated Deaconess Hospital in Old Brooklyn, Ohio. Dr. Saad was the sole owner and person in control of the Deaconess debtors on the petition date. (Bankr. Doc. Nos. 1, Petition; 11, Affidavit of Saad). Until the appointment of Mr. Simon as the chapter 11 trustee, Dr. Saad remained Deaconess' chief executive officer and the sole person responsible for Deaconess' bankruptcy efforts. (Bankr. Doc. Nos. 203, 207, 879, 880, 881, 882, 883, 884, Operating Reports signed by Dr. Saad).

Nour was an entity also solely owned by Dr. Saad that provided management services to Deaconess prior to its bankruptcy filing.

After the bankruptcy filing, Bankruptcy Court orders and stipulations were entered authorizing Deaconess to use funds that were the cash collateral of its secured creditors and borrow money in order to continue its business operations. The cash collateral and financing orders and related stipulations, all signed by counsel for Dr. Saad, specifically prohibited any payments to insiders. (Bankr. Doc. Nos. 31, para. 11, 32, para. 12, 52, 100, 227, 301, 310, 373, 419, 491). While the detailed budgets setting forth permissible expenditures of funds included a line item for Nour's management fees, a provision explicitly provided that "[m]anagement [f]ees shall not be paid, except upon further Court Order" and reserved parties' right to object to Nour's fees. (Bankr. Doc. No. 227, p. 3, para. 9 and p. 6).

Deaconess ceased operating the hospital and shut down immediately after it filed for bankruptcy. Efforts were then made to liquidate its assets which were sold in April, 2004. (Bankr. Doc. Nos. 396, 397, Memorandum of Opinion and Order authorizing sale).

On May 25, 2004, Nour filed its Motion by Nour Management Company for Fees for Management Services ("Fee Motion") in which Nour requested $84,000 for postpetition management services rendered to Deaconess from November 21, 2003 (two days before the bankruptcy filing) through May 7, 2004. (Bankr. Doc. No. 458). The Fee Motion did not cite any statutory provision authorizing such fees but rather, in support, stated the fees were allowed because the budget, approved by the Bankruptcy Court, provided for management services at a rate of $3,500 a week. (Bankr. Doc. No. 458 p. 3). After detailing the services provided, Nour requested management fees pursuant to the approved budget. (Bankr. Doc. No. 458 p. 4).

Deaconess also filed its Debtors' Motion to Pay Nour Management Company Fees for Management Services ("Deaconess Motion") on May 28, 2004 in which it requested authority pursuant to 11 U.S.C. § 363(b) to pay Nour for postpetition management services rendered after May 7, 2004 at a rate of $5,000 a week. (Bankr. Doc. No. 463).

The United States Trustee objected to Nour's Fee Motion as did the Official Committee of Unsecured Creditors, GE HFS Holdings, Inc., and Bank One, N.A. (Bankr. Doc. Nos. 498, 508, 520, para. 5, and 521). The United States Trustee argued the fees should be denied because 1) Nour was not and could not be retained as a professional under Bankruptcy Code §§ 327-331; 2) Deaconess did not assume any executory contract with Nour under 11 U.S.C. § 365 so that payment under this provision was not permissible; and 3) Nour's requested fees were incurred during a time when Deaconess was adequately staffed by employees and Deaconess did not benefit from, and should not be responsible for, Nour's requested fee. (Bankr. Doc. No. 498).

In reply to the objecting parties, Nour responded, in part, that the postpetition services were provided pursuant to a "extant prepetition agreement." (Bankr. Doc. No. 522 p. 1). Citing to cases supporting the doctrine that a debtor in possession may continue operations in the ordinary course of business, Nour argued Deaconess had the "right to manage and to pay for the management of its business without creditor interference . . . ." (Bankr. Doc. No. 522 p. 2).

The Bankruptcy Court conducted an evidentiary hearing on the Fee Motion and the Deaconess Motion on June 24, 2004 at which Nour was represented by its counsel Stewart Roll. (Bankr. Doc. No. 580, Hearing Transcript p. 3)[3]. At the outset of the hearing, Deaconess,

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[3] The Bankruptcy Court transcript of the hearing was filed with the Bankruptcy Court on July 19, 2004 and is hereinafter referred to as "Transcript p. ___" (Bankr. Doc. No. 580).

through counsel, conceded that the requested payments to Nour were outside of the ordinary course of business. (Transcript p. 22). While Nour's counsel questioned Dr. Saad at the hearing regarding the identity of and amount of time Nour staff provided services and Dr. Saad's understanding as to whether Nour would be paid, Nour's attorney did not otherwise make any statements or assert any arguments on behalf of Nour. (Transcript pp. 53-57, 130-132). Rather, in response to counsel's questions, Dr. Saad testified that on behalf of Nour he worked eight-ten (8-10) hours a day for Deaconess along with one other full-time employee from Nour. He stated that Nour performed duties that would have been performed by a chief financial officer and that he believed in retaining Nour, he fulfilled his fiduciary duties owed to Deaconess. (Transcript p. 53-57). He further indicated he thought Nour would be paid for the management services it provided to Deaconess. (Transcript p. 130-132).

Dr. Saad was the sole witness to testify at the hearing. At the conclusion of the hearing, the Bankruptcy Court requested the parties to file posthearing briefs on the two dispositive issues addressing 1) the effect of the cash collateral orders and stipulations on the pending requests and 2) the applicable standard under 11 U.S.C. § 363(b). Upon inquiry by Deaconess' counsel, the Bankruptcy Court clarified that the "Debtor is limited at this point to 363(b). That's what was briefed. That was the basis. That's what the parties questioned the witness based on, so that was the Debtor's choice." (Transcript p. 132-143).

At the trial, Nour did not oppose Deaconess' admission that the management fees were outside of the ordinary course of business. Nour did not request authority to brief this issue when the Bankruptcy Court articulated the narrow issue presented as to whether the fees should be approved outside of the ordinary course of business under 11 U.S.C. § 363(b). (Transcript pp. 22, 140-142).

After post-hearing briefs were filed by Nour, Deaconess, the United States Trustee and other objecting parties, the Bankruptcy Court denied Nour's Fee Motion and the Deaconess Motion. The Bankruptcy Court found there was no basis to grant nun pro tunc approval of Nour's fees and determined a sound business reason did not exist for Deaconess to continue utilizing the services of Nour. (Bankr. Doc. No. 589 p. 9-10).

In making its determination, the Bankruptcy Court noted that contracts in which Nour agreed to provide management services to Deaconess were not submitted into evidence, that no party sought to assume any such agreement or retain Nour after the bankruptcy filing, and that there was no "credible evidence to show the terms of such [management] agreements." (Bankr. Doc. No. 589 p. 2-3). The Court found Dr. Saad did not thoroughly investigate other potential management firms and Nour did not demonstrate its rates were reasonable. Stating the cash collateral and financing orders specifically precluded payments to insiders, the Bankruptcy Court discounted Dr. Saad's testimony that he was unaware of such provisions. The Court also determined during the time period in which Nour sought fees, Deaconess had shut down, was not operating, and retained employees to perform necessary administrative tasks. (Bankr. Doc. No. 589, p. 4-5).

In reaching its legal conclusion that the fees were not entitled to retroactive or nunc pro tunc payment as an administrative expense under 11 U.S.C. § 363(b), the Bankruptcy Court recognized the parties agreed the matter at hand was outside of the ordinary course of business.

(Bankr. Doc. No. 589, p. 7). Thus, the issue was whether a sound business reason existed to enter into the agreement with Nour under 11 U.S.C. § 363(b). (Bankr. Doc. No. 589, p. 6-7). The Bankruptcy Court found nunc pro tunc approval of Nour's Fee Motion was not warranted, after considering all the evidence. The Bankruptcy Court emphasized Nour knew it was not being paid for its services and was aware parties questioned the appropriateness of payment of its fees, yet Nour continued to render services. (Bankr. Doc. No. 589, p. 9). The Bankruptcy Court also noted Dr. Saad operated Deaconess and therefore was also aware of these facts. However, Deaconess never sought authorization from the Bankruptcy Court to retain Nour to provide management services to Deaconess. As such, the Bankruptcy Court determined Nour did not establish its fees should be allowed nunc pro tunc. (Bankr. Doc. No. 589 p. 9). The Bankruptcy Court also held that even if nunc pro tunc approval was warranted, Nour did not demonstrate Deaconess "used appropriate business judgment in continuing a relationship with Nour." (Bankr. Doc. No. 589 p. 9). Noting the insider relationship required greater scrutiny of the transaction, the Bankruptcy Court determined Dr. Saad did not sufficiently investigate alternatives to retaining Nour and his testimony did not establish Nour's services benefitted the estate or differed from the fiduciary duties imposed upon a debtor. Id. at 10.

The Bankruptcy Court also denied Deaconess' Motion to retain Nour to provide future services. It emphasized Deaconess and Nour lacked good faith because the limited administrative tasks to be undertaken fell within the fiduciary duties of Deaconess and there was insufficient evidence to show that Nour was the best party to render such services or that its rate was reasonable. (Bankr. Doc. No. 589, p. 11).

Deaconess has not prosecuted its appeal. In prosecution of its cross-appeal, Nour filed its objection to the Bankruptcy Court order on November 27, 2009. On cross-appeal, Nour raises the sole issue that the Bankruptcy Court erred, as a matter of law, because it did not consider the issue of whether the payment of management fees was an ordinary course transaction that did not require Court approval.

Summary of Argument

The Bankruptcy Court order denying Nour's motion for payment of its management fees should be affirmed. First, Nour is foreclosed from arguing the Bankruptcy Court erred in finding that payment of its fees was outside of the ordinary course of business. The record reflects the Bankruptcy Court properly dismissed consideration of whether or not the transaction was in the ordinary course of business because the parties were seeking fees under the statutory provision governing payment outside of the ordinary course of business and presented evidence in accordance with such provision. Moreover, Nour never addressed or raised the issue at trial.

Second, even if Nour is not foreclosed from arguing on appeal that the Bankruptcy Court improperly treated the transaction as outside of the ordinary course of business, the order should be affirmed because the record shows the management agreement was outside of the ordinary course of business and the Court did not err in denying payment after notice and a hearing. A review of the record supports the Bankruptcy Court's conclusion that the provision of purported management services by Nour to Deaconess was outside of the ordinary course of business under the horizontal industry test and vertical creditor expectation test, thereby requiring Court approval. In re Roth American, Inc., 975 F. 2d 949, 953 (3d Cir. 1992).

The Bankruptcy Court also properly concluded extraordinary circumstances did not warrant nunc pro tunc approval of the fees and that the fees incurred by Nour did not meet the standards for approval under 11 U.S.C. § 363(b). This section provides for the allowance of expenses incurred outside of the ordinary course of business, after notice and a hearing, if a sound business purpose exists. In this case, as evidenced by the record, neither Nour or Deaconess demonstrated a sound business reason justifying the retention and payment of Nour or that nunc pro tunc approval of the fees was warranted. In re Stephens Industries, Inc., 789 F. 2d 386 (6th Cir. 1986).

Third, even if the agreement for fees was within the ordinary course of business, court approval of the payment of Nour's fees was still required because secured creditors had a security interest in the funds that were available to pay Nour and they did not consent to such payments. 11 U.S.C. § 363(c)(2). As such, the Bankruptcy Court did not abuse its discretion in refusing to approve the requested fees.

Argument

I. Nour is Foreclosed from Arguing that The Bankruptcy Court Erred by Concluding that the Agreement between Nour and the Debtor was Outside the Ordinary Course of Business.

Nour alleges a single error in this appeal. Nour contends the Bankruptcy Court erred in making its threshold finding that the transaction between the debtor and Nour was one that was outside of the ordinary course of business thereby requiring court approval under 11 U.S.C. §363(b). In fact, the Bankruptcy Court made no such finding. The Bankruptcy Court limited its analysis to whether a sound business reason existed under 11 U.S.C. § 363(b) for approving Nour's fees nunc pro tunc because the parties' briefs, evidence and representations by counsel all indicated that “[t]he parties [agreed] that the transaction at issue is outside of the ordinary course.” (Bankr. Doc. No. 589 p. 7). Since Nour failed to raise the issue of whether the management agreement was a transaction in the ordinary course of business before the Bankruptcy Court, Nour is foreclosed from raising this issue on appeal.

Nour neglects to mention in its brief that the Court analyzed the transaction as one outside of the ordinary course of business because the parties agreed that they were seeking payment outside of the ordinary course of business. Section 363(b) of title 11 provides for the use of property of the estate outside of the ordinary course of business, after a notice and hearing. Section 363(c), by contrast, permits the debtor to enter into transactions in the ordinary course of business without prior notice and hearing.

In their motions filed with the Bankruptcy Court, Neither Nour nor Deaconess requested payment under 11 U.S.C. § 363(c). Nour and Deaconess did not specifically mention that provision in either of their other briefs. In its reply brief, Nour vaguely argues its fees did not need approval referencing cases supporting the proposition that its fees were in the ordinary course of business. (Bankr. Doc. No. 522 p. 2-3). However, at the hearing, counsel representing the Deaconess debtors, confirmed to the Bankruptcy Court that the management agreement between Deaconess and Nour was outside the ordinary course of business and therefore he was seeking payment pursuant to 11 U.S.C. § 363(b). (Transcript p. 22). Counsel for Nour did not take issue with that statement or otherwise indicate to the Bankruptcy Court that Nour was seeking payment under a different statutory provision. Id. At the conclusion of the testimony, the Bankruptcy Court reiterated its understanding that the movants were proceeding solely under section 363(b) and asked the parties to brief the applicability of that provision to the facts of the case. In response, Deaconess' counsel confirmed they were proceeding under 363(b). Again, Nour's counsel remain silent. Counsel representing Nour did not indicate any disagreement with the Bankruptcy Court's understanding of the legal basis of the motions. (Transcript pp. 140-142). Since Nour and the Debtors failed to raise section 363(c) as a basis for payment in the Bankruptcy Court, Nour has forfeited the issue of whether the transaction was in the ordinary course of business on appeal. See U.S. v. Ushery, 968 F. 2d 575, 582 fn. 2 (6th Cir. 1992); Fair Housing of Marin v. Combs, 285 F. 3d 899, 907-908 (9th Cir. 2002); Rainey v. International Harverster Credit Credit Corp., 59 B.R. 987, 989-990 (N.D. Ill. 1986); See also U.S. v. VanAllen, 524 F. 3d 814, 819 (7th Cir. 2008) (criminal defendant failed to preserve issue when did not move for acquittal at end of trial or in post trial brief).

II. This Court Should Affirm the Decision of the Bankruptcy Court Because the Record Evidence Establishes that the Management Agreement was Outside of the Ordinary Course of Business and the Bankruptcy Court Did Not Abuse Its Discretion in Denying Approval of the Payment, after Notice and a Hearing.

Even if Nour had properly moved for payment under § 363(c), asserting that the transaction was within the ordinary course of business, the record supports the Bankruptcy Court's conclusion that the transaction between Nour and Deaconess was outside of the ordinary course of business. Therefore, the order denying payment should be affirmed.[4]

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[4] A lower court decision may be affirmed on any ground that is supported by the record. Murphy v. National City Bank, 560 F. 3d 530, 535 (6th Cir. 2009) (dismissal of case affirmed on alternate grounds). On review, an appellate court may affirm a decision on alternate grounds or for other reasons as long as such grounds are supported in the record. See Friends of Tims Ford v. Tennessee Valley Authority, 585 F. 3d 955, 964 fn. 2 (6th Cir. 2009) (reviewing District Court dismissal for lack of standing, appellate court also considered whether statute of limitations barred claim).

A. The Evidence Showed that the Transaction was Outside of the Ordinary Course of Business.

The evidence adduced at trial established the management agreement between Deaconess and Nour was not in the ordinary course of business. The term "ordinary course of business" is not defined by the Bankruptcy Code. Rather, courts apply a two part test to determine whether a transaction is in the ordinary course of business. In re Roth American, Inc., 975 F. 3d 949, 952 (3d Cir. 1992). The two-prong test consists of 1) the horizontal or industry analysis and 2) the vertical or creditor expectation test.

The horizontal test focuses on whether the transaction is typical of companies in the same industry.[5] "The test is whether the post-petition transaction is of a type that other similar businesses would engage in as ordinary business. A transaction occurs in the debtor-in-possession's ordinary course of business when there is a showing that the transaction is the sort occurring in the day-to-day operation of the debtor's business." In re Lodge America, Inc., 259 B.R. 728, 732 (D. Kan. 2001) (debtor's postpetition repayment of loan obtained without authority not in ordinary course of business). Ordinary course generally includes those expenses incurred in daily business operations that are minor in nature. See In re Miller Mining, Inc., 219 B.R. 219, 222-223 (Bankr. N.D. Ohio 1998). The second vertical

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[5] Nour does not address the horizontal test in its brief but rather, relying on Martino v. First National Bank of Harvey, 186 B.R. 414, 424 (Bankr. N.D. Ill. 1995) argues that it does not apply to the type of transaction at issue. The Martino Court did recognize the widely accepted application of the horizontal test but rejected it in the context of considering whether a postpetition loan arising from overdraft protection extended by a bank was in the ordinary course of business under 11 U.S.C. §364(a). See also In re Hustling Land & Development, Inc., 255 B.R. 772, 778-779 (Bankr. D. Utah 2000). As the cases cited to in this brief show, the horizontal test is applicable to the transaction at hand.

test looks to whether the "'transaction subjects a creditor to economic risk of a nature different from those he accepted when he decided to extend credit.'" In re Git-N-Go, Inc., 322 B.R. 164, 172 (Bankr. N.D. Okla. 2004) citing In re Roth American, Inc., 975 F. 2d 949, 953 (3d Cir. 1992) (debtor convenient store agreement with Brinks to provide security services was within ordinary course of business).

The purpose of allowing ordinary course payments without court approval under Bankruptcy Code Section 363(c) is so that a business in bankruptcy may continue operating its daily business and enter into routine minor business transactions without the need to secure court approval or provide notice to creditors. See In re Miller Mining, 219 B.R. at 222. See also In re Roth American, Inc., 975 F. 2d at 952 (indicating purpose of ordinary course rule in 363 is to provide balance between routine daily business transactions that do not warrant greater scrutiny and those relating to bankruptcy case that affect bankruptcy estate assets). Employees involved in daily business operations that are not involved with and do not affect the administration of the bankruptcy may be hired and paid in the ordinary course of business. See In re CNH, Inc., 304 B.R. 177 (Bankr. N.D. Penn. 2004) (nursing home that hired and paid consultant to formulate and implement nursing policies and employed consultant on dietary, housekeeping and laundry issues acted in ordinary course). As shown in the record, Nour did not establish it met the horizontal industry standard test. At trial, neither Nour nor Deaconess set forth any evidence demonstrating that the industry standard in the hospital business is to retain an outside management firm.[6] (See

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[6] Testimony was elicited from Dr. Saad regarding typical rates charged by a management firm but not whether it routine for a hospital of comparable size to retain an outside management firm.

Transcript generally and pp. 53-57 and 130-132). The record also shows that immediately after the petition date, Deaconess closed down its normal business operations and was no longer conducting its regular operations. (Transcript p. 36-37.) Thus, even if Nour could establish at trial that it was the industry standard for a comparable hospital to retain and pay an outside management firm, Deaconess was not operating in a manner consistent with the industry standard. Rather it had shut down the hospital and was attempting to liquidate its assets. Accordingly, Nour did not show it met this element of the ordinary course of business test.

Nour also failed to meet the vertical creditor expectation test because Nour had no reasonable basis to believe it would be paid for its services. First, Nour and all of the parties agreed there would be no payments to insiders, including Nour's management fees, without Bankruptcy Court approval. (Bankr. Doc. Nos. 31, para. 11, 32, para. 12, 52, 100, 227, 301, 310, 373, 419, 491). At the hearing on the motions, Deaconess agreed the transaction was outside of the ordinary course of business. Nour never challenged Deaconess' admission or raised this issue at the trial. (<u>See</u> Transcript p. 22). Rather, Deaconess stated it would present evidence relating to the nature of services rendered by Nour, the benefit to the estate and reasonableness of rates, and elicited testimony from its sole witness, Dr. Saad. At trial, Nour followed the lead of Deaconess. (<u>See</u> Transcript at p. 12 and generally). Dr. Saad testified at the hearing that Nour had not been paid for its services by Deaconess since September, 2001 yet Nour continued to render management services to Deaconess.

(Transcript at p. 30, 39).

(Transcript p. 35-36). The unpaid prepetition management fees of Nour were treated as a capital contribution according to Dr. Saad. (Transcript p. 135).

Although Dr. Saad stated Nour would like to be paid for its postpetition services and that he was unaware that Nour would not be paid, Court orders signed by Nour's counsel prohibited such payments without approval. At a minimum, the record shows Nour was aware that there may be a challenge to the payment of its fees. Notwithstanding Nour rendered services from November 21, 2003 (two days before the petition date) through May 7, 2004 without payment. (Transcript pp. 89- 94, 131-133). Based upon these facts, Nour did not establish it met the vertical creditor expectation test and the Bankruptcy Court did not err in determining the transaction between Nour and Deaconess was outside of the ordinary course of business.

B. Nour Failed to Show Extraordinary Circumstances that Would Excuse Its Failure to Seek Prior Approval and Warrant Retroactive Approval of the Management Fees.

The moving parties did not set forth any factual or legal basis for retroactive approval of Nour's fees. Retroactive or nunc pro tunc approval of a transaction may be approved upon a showing of extraordinary circumstances. See In Re Platinum Power Co., 105 B.R. 381 (Bankr. N.D. Ohio 1989) (noting court must weigh whether factors in case sufficiently justify failure to seek prior approval of retention.) See also In re Marion Carefree Limited Partnership, 171 B.R. 584 (Bankr. N.D. Ohio 1994) (denying nunc pro tunc retention of manger); In re E-Tron Corp., 141 B.R. 49, 56-57 (D. N.J. 1992) (finding extraordinary circumstances standard applies to request for nunc pro tunc approval of loan outside ordinary course of business under §364.) Dr. Saad did not testify as to any extraordinary circumstances supporting such relief. Nor did Nour set forth in its pleadings any legal basis or factual support for retroactive approval of its fees. (See Transcript, generally and Bankr. Doc. No. 524, 535). As such, the Bankruptcy Court properly denied nunc pro tunc approval of Nour's fees.

C. The Bankruptcy Court Properly Determined that No Sound Business Reason Supported the Retroactive Payment of Nour's Management Fees Outside of the Ordinary Course of Business under 11 U.S.C. § 363(b).

A transaction outside of the ordinary course of business under 11 U.S.C.§ 363(b) may be approved after notice and a hearing if a sound business purpose exists. In re Stephens Industries, Inc., 789 F. 2d 386 (6th Cir. 1986) (sound business purpose existed warranting sale of substantially all of debtor's assets upon showing of articulated business reason). While this section has been most frequently relied upon to support a sale of assets outside of the ordinary course of business, it is applicable to any use, sale or lease of bankruptcy estate property outside of the ordinary course of business. See 11 U.S.C. § 363(b)(1). Bankruptcy courts have properly relied on this section to allow a debtor to retain consultants who do not otherwise fall within the definition of a bankruptcy professional under 11 U.S.C. § 327 as well as other transactions which are not within the debtor's routine daily business operations. See In re ITG Vegas, Inc., 2007 WL 1087212 (Bankr. S.D. Fla. 20007) (court authorized retention of political consultant providing lobbying services under 363(b)). See also In re Montgomery Ward, 242 B.R. at 147 (sound business purpose existed for approval of employee incentive program).

Courts consider a number of factors in determining if a sound business purpose exists warranting approval of a transaction outside of the ordinary course of business including if 1) a sound business purpose exists; 2) there was sufficient and reasonable notice; 3) the price of the transaction; and 4) whether the parties acted in good faith. See In re Country Manor of Kenton, Inc., 172 B.R. 217, 220-221 (Bankr. N.D. Ohio 1994). The test essentially is a business judgment test and the Bankruptcy Court has broad discretion to determine whether the particular facts of the case favor authorization of the transaction. In re Montgomery Ward, 242 B.R. at 153-155.

Nour, in its appeal, has not challenged the Bankruptcy Court's determination that Nour did not prove a sound business purpose existed supporting payment of its fees or that retroactive approval of its fees was not warranted. The Bankruptcy Court properly made this determination. In this case, neither Nour nor Deaconess demonstrated that a sound business purpose supported its retention. The parties also failed to show that retroactive approval of its fees was warranted. At trial, Dr. Saad acknowledged he was the sole owner of Nour as well as the sole owner and chief executive officer of Deaconess. He admitted he had fiduciary duties to the Deaconess debtors. (Transcript at 24-26). While he testified that, after the bankruptcy filing, he discussed with Deaconess' counsel alternatives to hiring Nour, Dr. Saad indicated he did not investigate or consider other management firms on or after the petition date. Rather, he stated that he thought Nour's fees would be less than an "outside firm." (Transcript at 38-40, 99, 125).

According to Dr. Saad, Nour provided services at the request of Deaconess. (Transcript at 41). Dr. Saad stated that Deaconess continued to employ a number of people after it closed its operations. He also stated that other than himself the employees of Nour did not have health care experience and that one other person from Nour, Jennie Gilchrist, provided full-time services to Deaconess. (Transcript at 47-49, 54). On cross examination, Dr. Saad testified that Nour's services were distinct from his duties as chief executive officer. However, upon detailed questioning as to what duties were performed by Nour as opposed to the services performed by Deaconess employees or Dr. Saad as chief executive officer, Dr. Saad did not clearly distinguish the services rendered by Nour. (Transcript p. 60-73, 78-89, 113-115).

Nour's insider status, along with the lack of evidence showing Deaconess considered other management firms, and the failure of Nour or Deaconess to establish the services rendered by Nour were distinct from those provided by Deaconess' personnel and different from the fiduciary duties of Dr. Saad as chief executive officer show that a sound business purpose did not support the retention of Nour.

III. Even if the Payments Sought Were in the Ordinary Course of Business, Court-Approval Was Still Required Because the Secured Creditors did not Consent to the Payments.

Even if Nour were able to show both that it is not precluded from arguing the payments under the management agreement were in the ordinary course of business and that the evidence supported a finding that the payments were in the ordinary course of business, the order of the Bankruptcy Court should still be affirmed. That is because, although § 363(c)(1) authorizes a debtor-in-possession[7] to enter into transactions and use property of

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[7] A debtor-in-possession has all of the rights of a trustee under 11 U.S.C. § 1107(a).

the estate in the ordinary course of business without a notice or a hearing, § 363(c)(2) places certain restraints on the use of cash collateral under 363(c)(1). Specifically, subsection 363(c)(2) states that: "[t]he [debtor-in-possession] may not use, sell, or lease cash collateral under paragraph [363(c)(1)] unless–(A) each entity that has an interest in such cash collateral consents; or (B) the court, after notice and a hearing, authorizes such use, sale, or lease in accordance with the provisions of this section." 11 U.S.C.§ 363(c)(2). That means that under section 363(c)(2), unless the debtor obtains the consent of the secured parties to use cash collateral to make payments, the debtor must obtain court approval to make such payments even in the ordinary course of business.

In this case, Deaconess did not produce any evidence that the secured creditors, Bank One, N.A. and GE HFS Holdings, Inc. consented to the use of the cash collateral to pay Nour for its managements services. To the contrary, both of those parties consistently objected to such payments. (Bankr. Doc. Nos. 31, 32, 52, 100, 227, 301, 310, 373, 419, 493, 508, 520, 532). They objected in the cash collateral orders and stipulations, and they specifically objected in response to the motions of Nour and Deaconess for payment. In the absence of such consent, the approval of the Bankruptcy Court was required to make payments to Nour under the management agreement. As shown above, the Bankruptcy Court did not err in declining to approve the payments. Moreover, Nour has not challenged the findings of the Bankruptcy Court that <u>nunc pro tunc</u> relief was not warranted and that the Deaconess debtors failed to prove that they used appropriate business judgment in continuing the relationship with Nour. Therefore, regardless of whether the postpetition business relationship between the Deaconess and Nour was in the ordinary course of business, the Bankruptcy Court did not abuse its discretion in refusing to approve the requested payments to Nour. Accordingly, this Court should affirm the decision of the Bankruptcy Court.

Conclusion

Based upon the foregoing, the United States Trustee respectfully requests this Court to affirm the Bankruptcy Court order denying the Motion of Nour's Management Company for Fees for Management Services.

Dated: December 28, 2009

Respectfully submitted,

/s/Amy L. Good
Amy L. Good (0055572)
Trial Attorney
Department of Justice
Office of the U.S. Trustee
H.M. Metzenbaum U.S. Courthouse
Suite 441
201 Superior Avenue
Cleveland, Ohio 44114
(216) 522-7800 ext. 236
amy.l.good@usdoj.gov

Attorney for U.S. Trustee Daniel M. McDermott

Of Counsel

P. Matthew Sutko
Wendy Cox
Executive Office for United States Trustee
Department of Justice
20 Massachusetts Avenue, N.W.
Suite 8000
Washington, D.C. 20530
(202) 307-1399

Certificate of Service

I certify that on December 28, 2009, a copy of the foregoing "Brief of the Appellee United States Trustee" was filed electronically. Notice of this filing will be sent by operation of the Court's electronic filing system to all parties indicated on the electronic filing receipt. All other parties will be served by regular U.S. mail. Parties may access this filing through the Court's system.

/s/ Amy L. Good
Amy L. Good

BRIEF BANK — 'SUMMARY SHEET" *Printed Thu-5/3/07 10:26*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	UST v. Deadmond
2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	United States District Court for the District of Montana Helena Division
3. ("CCN") ***CURRENT*** CASE NO.	No.: CV-07-15-H-CCL
4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*	No.: 06-60512-7 Court: THE UNITED STATES BANKRUPTCY COURT FOR THE DISTRICT OF MONTANA *(Identify judge & cite, if any)*
5. ("SO") ***SOURCE***	**U.S. TRUSTEES**
6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	Filed: April 23, 2007 Type: BRIEF FOR APPELLANT, UST
7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g., "UST/OGC"]*	P. Matthew Sutko, Thomas C. Kearns, Daniel P. McKay *(UST/OGC: 202-307-1399/FAX-2397)*
8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") ● ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	● Whether the bankruptcy court properly allowed Debtors to deduct an ownership expense under the means test when they had no loan or lease payments? √ **Background:**
10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)	
11. DO YOU RECOMMEND POSTING IN UST BRIEFBANK?	☐ YES ☐ NO ***NAME:*** ***DATE:***

DANIEL P. McKAY
Office of the United States Trustee
Department of Justice
301 Central Avenue, Suite 204
P.O. Box 3509
Great Falls, MT 59403
Telephone: (406) 761-8777
Facsimile: (406) 761-8895
e-mail: dan.p.mckay@usdoj.gov
State Bar I.D. no. 2422
(Attorney for the United States Trustee)

Of Counsel

Roberta A. DeAngelis
Acting General Counsel

P. Matthew Sutko
Thomas C. Kearns
Executive Office for
United States Trustees
Department of Justice
20 Massachusetts Ave., N.W.
Washington, D.C. 20530

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MONTANA
HELENA DIVISION

In re	)	Cause No. CV-07-15-H-CCL
	)	
WENDELL A. DEADMOND, JR.	)	Bankruptcy No. 06-60512-7
and RENAE A. DEADMOND,	)	
	)	
Debtors.	)	
	)	
	)	
UNITED STATES TRUSTEE,	)	
	)	
Appellant,	)	
	)	
vs.	)	BRIEF FOR APPELLANT,
	)	UNITED STATES TRUSTEE
WENDELL A. DEADMOND, JR.	)	
and RENAE A. DEADMOND,	)	
	)	
Appellees.	)	

ON APPEAL FROM THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF MONTANA

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JURISDICTIONAL STATEMENT

The United States Bankruptcy Court for the District of Montana has jurisdiction over the underlying case, initiated by Wendell A. Deadmond, Jr. and Renae A. Deadmond on June 29, 2006, by their filing of a voluntary petition under chapter 7 of the Bankruptcy Code,[1] 11 U.S.C. §§ 101, *et seq*. *See also* 28 U.S.C. §§ 157(b), 1334(a).

On February 27, 2007, the bankruptcy court denied the United States Trustee's motion to dismiss the bankruptcy case under 11 U.S.C. § 707(b)(1) for abuse. This appeal is taken from a final order that court entered on February 27, 2007, denying the United States Trustee's motion. The United States Trustee filed a timely notice of appeal from that order under 28 U.S.C. § 158(c)(2) and Fed. R. Bankr. P. 8002(a) on March 8, 2007.[2] This Court has jurisdiction over this appeal under 28 U.S.C. § 158(a)(1).

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[1] "Bankruptcy Code" refers to 11 U.S.C. §§ 101 - 1532.

[2] Congress has authorized the United States Attorney General to appoint 21 United States trustees, each to serve in a specific geographic region of the United States. *See generally* 28 U.S.C. § 581, *et seq.* (establishing the United States Trustee Program). The United States trustees are senior officials of the Department of Justice. *Id.* The United States trustees "supervise the administration of cases and trustees" in all bankruptcy cases within his or her region through the exercise of a range of oversight responsibilities. 28 U.S.C. § 586(a)(3). *See generally Morganstern v. Revco D.C. Inc. (In re Revco D.S., Inc.)*, 898 F.2d 498, 500 (6th Cir. 1990) (explaining that United States trustees oversee the bankruptcy process, protect the public interest, and ensure that bankruptcy cases are conducted according to law.). United States trustees may raise, appear, and be heard on any issue in any case or proceeding under Title 11. 11 U.S.C. § 307; *See also In re Revco D.S., Inc.*, 898 F.2d at 499-500 (upholding broad appellate standing of United States trustees).

STATEMENT OF THE ISSUES

The United States Trustee sought dismissal of these Debtors’ chapter 7 case alleging that it was an abuse of chapter 7 based upon the monthly disposable income calculation under the means test in 11 U.S.C. § 707(b)(2).

The issue presented to this Court for determination is whether the court below erred by ruling as a matter of law that the Debtors could claim an "automobile ownership expense” for debt financing that took the Debtors outside § 707(b)(2)’s statutory means test even though these Debtors had no “automobile ownership expense” because they owned their cars debt-free.

Should this Court determine the court below erred, this Court should reverse and remand for adjudication of the motion to dismiss on its merits.

STANDARD OF REVIEW

The bankruptcy court's findings on questions of law are reviewed *de novo*. *In re Emery*, 317 F.3d 1064, 1069 (9th Cir. 2003) (citing *In re Allen*, 300 F.3d 1055, 1058 (9th Cir. 2002)).

Whether the bankruptcy court properly allowed Debtors to deduct an ownership expense under the means test when they had no loan or lease payments is a question of law and is therefore subject to *de novo* review.

STATEMENT OF THE CASE

On June 29, 2006, Wendell A. Deadmond, Jr. and Renae A. Deadmond (the "Debtors") filed a petition for relief under chapter 7 of the Bankruptcy Code. On September 22, 2006, the United States Trustee filed a motion to dismiss the case under 11 U.S.C. § 707(b), asserting that it would be an abuse of chapter 7 to grant the Debtors a discharge.

The United States Trustee's motion was based in part on the statutory presumption, codified under 11 U.S.C. § 707(b)(2), that granting the Debtors a chapter 7 discharge is an abuse of chapter 7 of the Bankruptcy Code when the Debtors have sufficient disposable income to repay their unsecured creditors at least $166.67 per month. In particular, the United States Trustee argued that under the objective formula used to determine whether a chapter 7 debtor has an ability to pay and the bankruptcy case therefore is presumptively abusive, the Debtors could not qualify for an expense allowance for vehicles referred to as vehicle "ownership costs" under the Local Standards issued by the Internal Revenue Service. This expense standard, the United States Trustee asserted, does not apply to the Debtors who are not making monthly loan or lease payments because they own their vehicles free and clear.

On February 27, 2007, after an evidentiary hearing, the bankruptcy court denied the United States Trustee's motion to dismiss the case, concluding, consistent with the court's prior decision in an earlier chapter 13 case, *In re Naslund*, ___ B.R. ___, 2006 WL 4038608 (Bankr. D. Mont. November 16, 2006), that 11 U.S.C. § 707(b)(2)(A)(ii) authorized all debtors who own a vehicle, including the Debtors, to reduce their current monthly income by the IRS Local Transportation Expense Standard that the IRS allows for vehicle financing costs. As a consequence of allowing this deduction, the bankruptcy court held that the presumption of abuse did not arise. The United States Trustee timely filed this appeal.

STATEMENT OF THE FACTS

I. Statutory Framework

On October 17, 2005, most provisions of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (the "BAPCPA"), S. 256, Pub. L. No. 109-8, 119 Stat. 23, took effect, implementing significant changes to the Bankruptcy Code. As part of this effort, Congress amended § 707(b) of the Bankruptcy Code, which governs dismissal of chapter 7 bankruptcy cases. Analysis of the means test, as contained within section 707(b)(2), is underpinned by Congress' general goal behind the complete overhaul of §707(b), ensuring "that those who can afford to repay some portion of their unsecured debts be required to do so...". 151 CONG. REC. S2470 (March 10, 2005).

As it existed prior to BAPCPA, § 707(b) only authorized dismissal based on a finding that allowing the debtor relief constituted a "substantial abuse" of chapter 7. Further, § 707(b) prior to its amendment by BAPCPA required courts to presume that a debtor was entitled to relief under chapter 7 of the Bankruptcy Code. Section 707(b) now authorizes dismissal where the court finds that the granting of relief would be an "abuse" of chapter 7. As amended by the BAPCPA, § 707(b)(2) repealed the former presumption and replaced it with a new presumption: a case is an "abuse" of chapter 7 if a detailed mathematical formula set out in the statute, commonly referred to as the "means test," yields a minimum amount of monthly disposable income.

The means test uses a series of calculations to determine whether the § 707(b)(2) presumption of abuse arises. *See* 11 U.S.C. § 707(b)(2)(A). Specifically, the means test calculates a debtor's current monthly income, as defined under 11 U.S.C. § 101(10A) (hereafter "CMI"), based on the debtor's average income for the six calendar months preceding the month of the bankruptcy filing. If the debtor's CMI is above the applicable state median family income, as is the case here, 11 U.S.C. § 707(b)(2)(A) calculates the debtor's monthly disposable income available to repay creditors by reducing the CMI by certain categories of expenses identified in 11 U.S.C. § 707(b)(2)(A)(ii), (iii), and (iv). If a debtor's monthly disposable income, calculated by reducing the CMI by allowed expenses under 11 U.S.C. § 707(b)(2)(A)(ii) - (iv), is less than $100 per month (or $6,000 over 60 months), the presumption of abuse does not arise. 11 U.S.C. § 707(b)(2)(A)(I).[3] If the debtor's monthly disposable income is equal to or exceeds $167 per month (or $10,000 over 60 months), the presumption of abuse does arise. *Id.* If the debtor's monthly disposable income is between $100 and $167 per month (between $6,000 and $10,000 over 60 months), the presumption of abuse arises if the disposable income, over 60 months, is sufficient to pay 25 percent of the debtor's nonpriority unsecured debt. *Id.*

If the presumption of abuse arises under § 707(b)(2) based on the means test, the debtor may attempt to rebut the presumption under 11 U.S.C. § 707(b)(2)(B) by demonstrating special circumstances that justify income or expense adjustments for which there is no reasonable alternative.

Each debtor with primarily consumer debts is required to file, in conjunction with his or her bankruptcy schedules and statement of financial affairs, a Statement of Current Monthly Income and Means Test Calculation, Official Form 22A of the Federal Rules of Bankruptcy

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[3] Pursuant to 11 U.S.C. §104, the dollar amounts set forth in Title 11 and applicable to the threshold amounts for determining when the presumption of abuse arises under the means test will be adjusted based on the consumer price index for cases filed on or after April 1, 2007. This case is not subject to the dollar amount adjustments.

Procedure ("Form 22A"). 11 U.S.C. § 521 and §707(b)(2)(C). In Chapter 7 cases the main purpose of the Form 22A is to calculate monthly disposable income (ability to pay) following the formula set forth in 11 U.S.C. § 707(b)(2), and determine whether the presumption of abuse arises.

II. Factual Background

The Debtors filed a Form 22A with the petition commencing their case on June 29, 2006. (R-B) Because their "Annualized Current Monthly Income", on line 13 exceeded the applicable state median income for their household size, the Debtors completed the form to calculate monthly disposable income. The result of the Debtors' calculation was monthly disposable income of $114.23 and 60-month disposable income of $6,853.80. (R-B, lines 50 and 51) Because this latter amount is less than one quarter of their total non-priority unsecured debt, the Debtors checked the box at the top of the first page of the Form 22A indicating that the presumption of abuse did not arise.

The Debtors own a 1995 Dodge Ram and a 1983 GMC Suburban (R-A, Schedule B). The Debtors have no debts secured by the vehicles (R-A, Schedule D), and that they make no installment payments associated with them (R-A, Schedule J). On line 22 of the Form B22A the Debtors included a deduction of $420 for "transportation; vehicle operation" expense.(R-B) This expense amount, for two or more vehicles, is taken from the IRS Transportation Standards, Operating Costs and Public Transportation Costs, published by the IRS. On lines 23 and 24 of the Form B22A, the Debtors took deductions of $471 and $332, respectively, for "transportation ownership/lease expense." (R-B). This expense amount is taken from the IRS Transportation Standards, Ownership Costs, published by the IRS.

The United States Trustee recalculated the Debtors' monthly disposable income by: (a) eliminating the $471 and $332 deductions on lines 23 and 24; (b) allowing the Debtors an additional transportation vehicle operating expense totaling $400 on account of the age of the two vehicles;[4] (c) adding a deduction of $57.22 for "payment on priority claims"[5]; and (c) deducting $40.94 for "Chapter 13 administrative expenses" at line 45. (R-C) Under the United States Trustee's calculations, the Debtors' monthly disposable income was $419.07, which when multiplied by 60 months, substantially exceeds $10,000 and the presumption of abuse therefore arose.

Subsequent to the filing of the United States Trustee's motion to dismiss, the Debtors filed several amended 22A forms. The final one, and the one utilized by the bankruptcy court in determining whether the presumption of abuse arose, was filed by the Debtors on December 15, 2006 (R-D). That Form 22A differed from the means test prepared by the United States Trustee in the following respects: (a) it reduced line 20B from $8.47 to $0[6]; (b) it added the amount of $310.32 at line 21 for a claimed adjustment to the IRS standard deduction for housing and

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[4] The United States Trustee allows an additional $200 operating expense under the means test for each debtor who owns a vehicle that is six year old or older or with more than 75,000 miles, in conformity with the Internal Revenue Manual which allows such an additional vehicle operating expense. *See* Internal Revenue Manual, Part 5, (entitled Collecting Process), Chapter 8 § 5.8.5.5.2, Treatment of Non-Business Transportation Expenses, which may be found at the IRS website at http://www.irs.gov/irm/part5/ch08s05.html.

[5] The Debtors scheduled $3,433 of priority claims on Schedule E but did not take the appropriate deduction ($3,433 divided by 60) on their Form B22A, line 44.

[6] A debtor is allowed to deduct the greater of the allowable IRS mortgage/rent expense and the debtor's actual average mortgage/rent expense payable in the 60 months following the filing of the case. If the actual average expense is greater than the IRS allowance, line 20B is $0 and the full amount is deducted at line 42 of the Form B22A. Debtor Wendell A. Deadmond, Jr. testified that the Debtors' mortgage payment had increased to $833.32 as a result of a change in the escrow amount for taxes and insurance. (R-F)

utilities; (c) it continued to claim transportation ownership expenses of $471 and $332 on lines 22 and 23, respectively; (d) it reduced the line 32 telecommunications expense from $161 to $106; (e) it added a deduction of $37 at line 39 for "Additional food and clothing expense"; and (f) increased line 42 to $833.32 to reflect the increase in the mortgage payment. As a result the Debtors claimed that their monthly disposable income was a negative $270.63.[7] (R-D, line 50)

The bankruptcy court found that the Debtors had failed to provide any justification for the claimed $310.32 adjustment to the deduction for housing and utilities.(R-E, page 9) But the court determined that without this deduction and the claimed deduction of $37 for additional food and clothing expense, the Debtors' monthly disposable income would be $76.69, making their 60-month disposable income $4,601.40, below the threshold for the presumption of abuse under § 707(b)(2). (R-E, page 10)

If $403 - the difference between the $803 of vehicle ownership expense claimed by the Debtors and the $400 asserted by the United States Trustee to be allowable based on the age of Debtors' vehicles - is added to $76.69, the Debtors' monthly disposable income rises to $437.[8] Because this greater than $167, the presumption of abuse would arise under §707(b)(2).

SUMMARY OF THE ARGUMENT

The court below erred in denying the United States Trustee's motion to dismiss this bankruptcy case under 11 U.S.C. § 707(b)(2). Under § 707(b)(2), a debtor's case is presumed

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[7] The Debtors also claimed monthly expenses totaling $533 on line 56 which allows a debtor to list expenses the debtor contends should be additional deductions from CMI under 11 U.S.C. § 707(b)(2)(A)(ii)(I). The bankruptcy court did not address the issue of whether the Debtors are entitled to take these deductions in calculating monthly disposable income.

[8] This amount reflects a deduction from $479.69 ($76.69 + $403) of hypothetical chapter 13 administrative expenses which are deductible at line 45 of the B22A. In chapter 13 cases filed in Montana the applicable trustee's fee was 8.9 percent of the amount of payments made under a chapter 13 plan in cases filed before April 1, 2007.

abusive as a matter of law and must be dismissed absent special circumstances if the debtor fails § 707(b)(2)'s statutory "means test." Here the Debtors would have failed the means test but for the bankruptcy court's legal ruling, based on its earlier decision in *In re Naslund*, that the Debtors could claim an "automobile ownership expense" for vehicle debt financing even though the Debtors had no vehicle financing expense because they owned their vehicles debt-free.

The bankruptcy court erred as a matter of law by misinterpreting the automobile debt financing allowance. In its application of the means test, the bankruptcy court interpreted §707(b)(2) to allow the Debtors to subtract expenses that they do not incur on a monthly basis. Even though the Debtors do not make monthly payments to purchase or lease a car, the bankruptcy court ruled that in addition to a monthly car operating expenses allowance of $420, the Debtors were also entitled to subtract a monthly expense of $471 for car one and $332 for car two (totaling $803) in calculating Debtors' monthly disposable income. These additional expenses correspondingly reduced the Debtors' monthly disposable income under the means test by $403.[9] Allowing the Debtors to subtract ownership costs even though they have no applicable vehicle financing expenses stands the means test on its head, eliminating disposable income otherwise reported on Official Form 22A and available to repay creditors.

After disallowing a car financing expense the Debtors do not actually incur, the Debtors' monthly disposable income under the means test is $437 which is well above the $166.67 threshold amount, and the presumption of abuse arises. This case must therefore be remanded to the bankruptcy court for further evidentiary proceedings in accordance with § 707(b)(2),

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[9] When the United States Trustee recalculated the Debtors' Form B22A monthly disposable income, an additional $200 operating expense was allowed under the means test for each Debtor's primary vehicle. *See* fn. 4, *supra*.

including allowing debtors an opportunity to try and rebut the presumption by demonstrating that special circumstances exist that justify an income or expense adjustment and regarding which they have no alternative.[10]

ARGUMENT

The court below allowed the Debtors to reduce their current monthly income by the IRS Standard for vehicle financing costs for two vehicles, a total of $803 (or $403 if the Court would have allowed an additional $200 per vehicle operating expense), even though they have no monthly loan or lease payment obligation associated with their vehicles. That ruling merits reversal because it misreads 11 U.S.C. § 707(b)(2)(A)(ii)(I), and deviates from longstanding Internal Revenue Service practice.

Section 707(b)(2) of Title 11 does not allow debtors like the Deadmonds, who have no monthly loan or lease payments, to claim an IRS local standard vehicle acquisition expense.

A. 11 U.S.C. § 707(b)(2) limits the IRS local standards, including the local standard referred to as vehicle ownership expense, to debtors for whom the expense is "applicable."

Section 707(b)(2)(A)(ii)(I) of the Bankruptcy Code provides that a debtor's monthly expenses "shall be the debtor's *applicable* monthly expense amounts specified under the . . . Local Standards . . . issued by the Internal Revenue Service." 11 U.S.C. § 707(b)(2)(A)(ii)(I) (emphasis added). The statute thus specifically provides that before the specific IRS expense amounts may be included in the debtor's allowed monthly expenses, the expense itself must first

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[10] If this Court reverses the order entered below and remands for further proceedings, the debtor could ask the lower court on remand to determine whether special circumstances exist that justify an expense adjustment that rebuts the presumption of abuse. *See, e.g. In re Tranmer*, 355 B.R. 234, 251-52 (Bankr. D.Mont. 2006)(special circumstances denied); *In re Pederson*, ___ B.R. ___, 2006 WL 3000104, at *3-4 (Bankr. N.D. Iowa 2006)(special circumstance allowed).

be *applicable* to the debtor. The court below, in its *Naslund* decision, which was followed without discussion in this case, erred in concluding that the term "applicable" in §707(b)(2)(A)(ii) merely "references the National and Local Standards that apply to a particular debtor as determined by the debtor's family size and place of residence." ___ B.R. ___, 2006 WL 4038608, *10.

The Bankruptcy Code does not define the word "applicable." Nor has the United States Trustee identified any Supreme Court or 9th Circuit Court of Appeals decision that provides a definition. But the Seventh Circuit has made clear that "'Applicable' is a protean word that takes color from context; it lacks a single enduring meaning." *Sierra Club v. Environmental Protection Agency*, 375 F.3d 537, 541 (7th Cir. 2004). The dictionary defines "applicable" similarly: applying or capable of being applied; relevant; suitable; appropriate. *Random House Unabridged Dictionary* (2006).

The United States Trustee's construction of "applicable" in section 707(b)(2)(A)(ii)(I) comports with its use in the context of BAPCPA and with its dictionary definition. By using the word "applicable" in section 707(b)(2)(A)(ii)(I), Congress limited eligibility for expenses under the Local Standards to debtors for whom the expenses actually <u>apply</u>. *In re Devilliers,* ___ B.R. ___, 2007 WL 92504, *6 (Bankr. E.D. La. January 9, 2007). Only after "a determination is made as to the type of expenses allowed <u>and applicable</u> to the debtor" may the debtor claim the amount set forth under the IRS Local Transportation Standards. *Id.; see also In re Wiggs,* ___ B.R. ___, 2006 WL 2246432, *2-3 (Bankr. N.D. Ill. 2006) (in applying Section 707(b)(2)(A)(ii)(I) in context of Section 1325, court finds that the statute is "clear and unambiguous," and that the "term 'applicable' modifies the amounts specified to limit the expenses to only those that apply," such that debtors were not allowed to include the standard ownership expense for transportation ownership when they did not have a payment on the vehicle). *Accord, In re Demonica,* 345 B.R. 895, 904 (Bankr. N.D. Ill. 2006).[11]

Given that these debtors had no ownership or lease payments on their cars, the IRS Ownership Cost Standard was not applicable to them. By excluding that inapplicable expense, the court below improperly determined that the presumption of abuse did not arise. The order entered below should be reversed and this case remanded for further proceedings in light of the presumption of abuse under §707(b)(2).

B. The Internal Revenue Service's application of its own local standard for vehicle acquisition costs, and interpretive case law, support the United States Trustee's reading of 11 U.S.C. § 707(b)(2)(A)(ii)(I).

Construing the word "applicable" in the IRS Standards like the United States Trustee does draws substantial support from the Internal Revenue Service's longstanding application of the IRS Standards. When Congress developed the means test, it "could have started from scratch, and created a system that was rigid but easy to administer, such as how many view workers' compensation or social security schemes." *In re Slusher,* ___ B.R. ___, 2007 WL 118009, *12 (Bankr. D. Nev. January 17, 2007). Instead, Congress "incorporated into the Bankruptcy Code an existing, administrative system that the IRS had long had in place." *Id.* This incorporation "strongly suggests that courts should look to how the IRS determined those

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[11] *Demonica* is relied on by the bankruptcy court in *In re Fowler*, 349 B.R. 414 (Bankr. D. Del. 2006), a case that is cited by the court below in its *In re Naslund* decision. The *Fowler* court misconstrues *In re Demonica*. In fact, *In re Demonica*, like the *In re Wiggs* decision, held that a loan or lease payment was required in order to qualify for the IRS Transportation Ownership Expense Standard. The *Demonica* court allowed the debtor to take an expense adjustment because the debtor in that case established that he actually made payments on the vehicle at issue, even though he did not have a contractual liability on the vehicle loan. *In re Demonica*, 345 B.R. at 905.

standards; that is, as to how the IRS would have applied them in similar circumstances." *Id.* at *14. Thus, "if guidance is sought on the meaning of the IRS standards Congress incorporated into the Bankruptcy Code, practical reason would suggest that court should consider the full manner by which the IRS uses these standards." *Id.*

The legislative history of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 supports the conclusion that Congress intended for the IRS Standard to govern here. The House Report accompanying the 2005 Act provided that "[i]n addition to other specified expenses, the debtor's monthly expenses – exclusive of any payments for debts (unless otherwise permitted) – must be the applicable monthly amounts set forth in the Internal Revenue Service Financial Analysis Handbook as Necessary Expenses under the National and Local Standards categories...." H.R. Rep. No. 109-31(I), at 99-100 (2005).

Considering IRS practice in interpreting "applicable" expenses in section 707(b)(2)(A)(ii)(I) does not negate the section's later allowance of "actual" monthly expenses in the IRS categories of Other Necessary Expenses. Rather, "a natural reading" of Section 707(b)(2)(A)(ii)(I) indicates that the words "actual" and "applicable" limit the relevant expense deductions in different ways. *In re Slusher,* ___ B. R. ___, 2006 WL 118009 at *13. "Had Congress intended to indiscriminately allow all expense amounts specified in the National and Local Standards, it would have written section 707(b)(2)(A)(ii)(I) to read, 'The debtor's monthly expenses shall be the monthly amounts specified under the National Standards and Local Standards . . .' rather than 'The debtor's monthly expenses shall be *the debtor's applicable* monthly expenses amounts specified under the National and Local Standards.'" *In re Slusher,* 2007 WL 118009, *13 (Bankr. D. Nev. January 17, 2007) (emphasis in original). Given the

IRS' historic application of its National Standards and Local Standards up to the time of BAPCPA's enactment, "it would be quite odd if Congress intended to preclude courts from examining the context in which the authoring agency, the IRS, used and employed those standards." *Id.* Nothing compels such an odd reading, and the court below erred by interpreting the term contrary to the IRS.

The IRS' construction fully supports the United States Trustee's construction of the term "applicable". On page two of its Collection Financial Standards under the heading "Transportation" the IRS provides as follows:

> The transportation standards consist of nationwide figures for monthly loan or lease payments referred to as ownership costs, and additional amounts for monthly operating costs . . . . The ownership costs provide maximum allowances for the lease or purchase of up to two automobiles if allowed as a necessary expense . . . . If a taxpayer has a car payment, the allowable ownership cost added to the allowable operating cost equals the allowable transportation expense**.** **If a taxpayer has no car payment, or no car, the operating costs portion of the transportation standard is used to come up with the allowable transportation expense.**

See IRS Collection Standards (emphasis added), available at ww.irs.gov/individuals /article/0,,id=96543,00.html; *see also* Internal Revenue Manual, Financial Analysis Handbook, Pt. 5, ch. 15, § 5.15.1.7(4.B), available at www.irs.gov/irm/part5/ch15s01.html.

Thus, according to the IRS, if the debtor does not have a loan or lease payment obligation, then the Local Standard referred to as vehicle ownership costs is not "applicable." If the debtor's vehicle is subject to a monthly loan or lease payment obligation, however, then in addition to the vehicle "operating cost" expense, the "ownership cost" is also "applicable," and shall be the dollar amount specified by the IRS. This application of the means test is supported by the significant weight of bankruptcy court authority.[12]

In addition to the IRS Collection Financial Standards themselves, the IRS also publishes guidelines, including the Internal Revenue Manual. Those support a reading of Section 707(b)(2)(A)(ii)(I) that requires debtors to have an actual loan or lease payment obligation on a vehicle before the Local Standard referred to as ownership expense "applies." Recent revisions to the Collection Financial Standards also make clear that the "ownership cost" is calculated by the IRS based on the "**five-year average of new and used car financing data compiled by the Federal Reserve Board of Governors**." *See* IRS Collection Financial Standards, supra (emphasis added). As such, the "ownership cost" is intended to account for the reasonable expense of financing a vehicle over five years and is inapplicable if a debtor has no such acquisition financing expense. *See In re Devilliers*, 2007 WL 92504, *10 (Bankr. E.D. La. Jan. 9, 2007) (The ownership allowance "is not the equivalent of an allowance for depreciation or an invitation for a debtor to 'save' for the ultimate replacement of an existing vehicle. Instead, the deduction is designed to assist with the acquisition of a vehicle on credit.").

Accordingly, guidance in applying its expense standards published by the IRS makes

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[12] *See In re Barraza*, 346 B.R. 724, 728-29 (Bankr. N.D. Tex. 2006) (debtor not entitled to standard ownership allowance for vehicle without a loan or lease payment); *In re McGuire*, 342 B.R. 608, 613-14 (Bankr. W.D. Mo. 2006) (chapter 13 debtors not permitted standard ownership allowance for vehicle owned free and clear of liens). *See also*, *In re Harris*, 353 B.R. 304, 307-309 (Bankr. E.D. Okla. 2006); *In re Hardacre*, 338 B.R. 718, 723-24 (Bankr N.D. Tex. 2006); *In re Oliver*, 350 B.R. 294, 301 (Bankr. W.D. Tex. 2006); *In re Wiggs*, ___ B.R. ___, 2006 WL 2246432, at *2-3 (Bankr. N.D. Ill. August 4, 2006); *In re Carlin*, 348 B.R. 795 (Bankr. D. Or. 2006); *but see In re Fowler*, 349 B.R. 414 (Bankr. D. Del. 2006) (debtors may deduct ownership expenses for a vehicle for which they do not make car payments); *In re Haley*, 354 B.R. 340, 2006 WL 2987947 (Bankr. D. N.H. October 18, 2006) (same); *In re Farrar-Johnson*, 353 B.R. 224 (Bankr. N.D. Ill. 2006) (debtors entitled to deduct IRS Local Standard for housing even though they had no actual housing expense); *In re Zak*, ___ B.R. ___, 2007 WL 143065 (Bankr. N.D. Ohio January 12, 2007).

clear that the vehicle "ownership cost" portion of the Local Transportation Standards is intended to apply only in situations where the debtor has a monthly vehicle acquisition financing expense, *i.e.*, has a monthly vehicle lease or loan payment. *Cf. McGuire*, 342 B.R. at 613 ("Thus, if a debtor is not incurring expenses for the purchase or lease of a vehicle, the debtor cannot claim a vehicle ownership expense under the IRS standards.") "Because the Local Standards are issued by the IRS, it is instructive to refer to publications of that organization for guidance as to the types of 'debt payments' that can reduce allowances under the Local Standards." *Hardacre*, 338 B.R. at 726.

CONCLUSION

For these reasons, the United States Trustee respectfully asks this Court to reverse the February 27, 2007 Order entered by the bankruptcy court denying the United States Trustee's motion to dismiss, and remand this case to the bankruptcy court for further proceedings.

Respectfully this 23rd day of April, 2007.

/s/ Daniel P. McKay
DANIEL P. McKAY
Office of the United States Trustee
Department of Justice
Attorney for the United States Trustee

Of Counsel

Roberta A. DeAngelis
Acting General Counsel

P. Matthew Sutko
Thomas C. Kearns
Executive Office for
United States Trustees
Department of Justice
20 Massachusetts Ave., N.W.
Washington, D.C. 20530

CERTIFICATE OF MAILING

I, the undersigned, Attorney for Office of U.S. Trustee, do hereby certify under penalty of perjury that a copy of the within and foregoing Brief for Appellant, United States Trustee was mailed on the 23rd day of April, 2007, at Great Falls, Montana, and directed to the following:

R. Clifton Caughron
CAUGHRON LAW OFFICE
P.O. Box 531
Helena, MT 59624
(Attorney for Appellees)

/s/ Daniel P. McKay
Daniel P. McKay

BRIEF BANK — 'SUMMARY SHEET" *Printed Tue-7/31/07 11:26*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	In Re: Deadmond (UST v. Deadmond)
2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	United States District Court for the District of Montana
3. ("CCN") ***CURRENT*** CASE NO.	No.: CV-07-H-CCL
4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*	No.: 06-60512 Court: United States Bankruptcy Court for the District of Montana *(Identify judge & cite, if any)*
5. ("SO") ***SOURCE***	**U.S. TRUSTEES**
6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	Filed: July 26, 2007 Type: Reply brief for Appellant, UST
7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*	Daniel McKay, P. Matthew Sutko, Thomas Kearns *(UST/OGC: 202-307-1399/FAX-2397)*
8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") ● ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	●Whether the Bankruptcy Code allows debtors, as a matter of law, to deduct an expense for financing the purchase or lease of a vehicle even though they have no such expense? √ **Background:**
10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)	
11. DO YOU RECOMMEND POSTING IN UST BRIEFBANK?	☒ YES ☐ NO ***NAME:*** Holly Walter ***DATE:***

DANIEL P. McKAY
Office of the United States Trustee
Department of Justice
301 Central Avenue, Suite 204
P.O. Box 3509
Great Falls, MT 59401
Telephone: (406) 761-8777
Facsimile: (406) 761-8895
e-mail: dan.p.mckay@usdoj.gov
State Bar I.D. no. 2422
(Attorney for the United States Trustee)

Of Counsel

Roberta A. DeAngelis
Acting General Counsel

P. Matthew Sutko
Thomas C. Kearns
Executive Office for
United States Trustees
Department of Justice
20 Massachusetts Ave., N.W.
Washington, D.C. 20530

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MONTANA
HELENA DIVISION

In re

WENDELL A. DEADMOND, JR.
and RENAE A. DEADMOND,

Debtors.

UNITED STATES TRUSTEE,

Appellant,

vs.

WENDELL A. DEADMOND, JR.
and RENAE A. DEADMOND,

Appellees.

Cause No. CV-07-15-H-CCL

Bankruptcy No. 06-60512-7

REPLY BRIEF FOR APPELLANT, UNITED STATES TRUSTEE

ON APPEAL FROM THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF MONTANA

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ARGUMENT

This appeal presents a question of law involving the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005's amendments to the Bankruptcy Code. In the context of calculating disposable income under section 707(b)(2)’s means test, this Court must determine whether the Bankruptcy Code allows debtors, as a matter of law, to deduct an expense for financing the purchase or lease of a vehicle even though they have no such expense.

In our opening brief, we established that section 707(b)(2)(A)(ii)(I)’s allowance of “applicable” expenses makes the determination of allowable expenses under the IRS Local Standards a two step process. Opening Br. at 12-13**.** The first step is eligibility. Does the debtor qualify for the expense allowance in the category at issue? If so, then the second step is to quantify the expense amount. A debtor eligible for the vehicle acquisition expense, i.e., one who has a vehicle loan or lease payment on the date of bankruptcy filing, is allowed to deduct standard amounts that are specified in the IRS Standards based on the number of vehicles the debtor owns or leases and which are subject to a loan or lease payment.

I. The United States Trustee’s Interpretation of 11 U.S.C. § 707(b)(2)(A)(ii)(I) Gives Meaning to the Word “Applicable”, but Does Not Render the Terms “Applicable” and “Actual” Incompatible.

The Deadmonds argue that the plain language of section 707(b)(2)(A)(ii)(I) allows all debtors who simply own a vehicle to claim both the transportation operating expense and the transportation ownership expense categories under the IRS Local Standards. Appellees’ Br. at 4-5. To reach this conclusion, the Deadmonds posit that there is “no basis in the statutory language...for treating ownership costs differently from all other expense categories covered by the National and Local Standards.” Appellees’ Br. at 5. This analysis is flawed because it fails to give proper meaning to the word “applicable” in the context of section 707(b)(2)(A)(ii)(I).

A better reading of the statute, and the one adopted by the only United States District Court to decide the issue to date, allows debtors to deduct vehicle ownership expenses under the IRS Local Standards only if the debtor had a loan or lease on the date of filing. *In re Ross-Tousey*, Case No. 07-C-65, 2007 WL 1466647 at *3 (E.D. Wis. May 21, 2007). “Applicable” simply means that when a debtor has an automobile loan or lease payment, the deduction is not based on that actual monthly payment amount but on the allowance amount specified in the IRS Standards. *Id.* Section 707(b)(2)(A)(ii)(I) thus allows “applicable” monthly expense amounts specified under the IRS Local and National Standards, and “actual” monthly expense amounts for categories of “Other Necessary Expenses” issued by the IRS. *Id.* at *4.

The Deadmonds allege that the United States Trustee treats section 707(b)(2)(A)(ii)(I) as “a cap on the actual expenses of the Debtors” rather than an expense allowance. Appellees’ Br. at 6. The Deadmonds misstate the United States Trustee’s position. As outlined above and in our Opening Brief, in the context of section 707(b)(2)(A)(ii)(I) there is an initial eligibility predicate. If the debtor has a vehicle loan or lease payment, then the expense applies and the statute mandates that debtor is *allowed* the expense amount provided in the Local Standard regardless whether debtor’s monthly loan or lease payment is less than the Local Standard. This allowance is subject to the expense amount not being double deducted when considering debtor’s secured debt payments on the means test Official Form 22A, Line 42. *See, e.g.*, *In re Hardacre*, 338 B.R. 718, 727 (Bankr. N.D. Tex. 2006).

Here, because the Deadmonds had no automobile loan or lease payment on the date of filing the vehicle ownership expense was not *applicable* to them, and the vehicle ownership expense claimed by the Deadmonds must be excluded. The bankruptcy court's determination to the contrary should be reversed.

II. Denying Vehicle Ownership Expenses to Debtors Who Own Their Vehicles Free and Clear is Neither Arbitrary Nor Unfair, and Does Not Unfairly Discriminate Against Debtors.

In their Response Brief, the Deadmonds assert that allowing a vehicle ownership expense on the means test to every debtor who owns a car regardless of whether the debtor incurs such a cost "furthers the reasonable public policy objectives of Congress by acknowledging that older cars are more likely to need major repairs or replacement, by avoiding arbitrary distinctions between debtors, and by eliminating unfair bias against the poorest debtors." Appellees' Br. at 8. However, there is nothing in section 707(b)(2)(A)(ii)(I) or the legislative history thereto to support the assertion that Congress intended to allow ownership costs to be a substitute or supplement for operating costs for vehicles owned free and clear of liens or leases. *See In re Devilliers*, 358 B.R. 849, 864 (Bankr. E.D. La. 2007) (The ownership allowance "is not the equivalent of an allowance for depreciation or an invitation for a debtor to 'save' for the ultimate replacement of an existing vehicle. Instead, the deduction is designed to assist with the acquisition of a vehicle on credit."). Rather, and as we stated in our opening brief, on remand the Deadmonds will have the opportunity to show special circumstances under section 707(b)(2)(B) which justifies an adjustment relating to their motor vehicle expenses that rebuts the presumption of abuse under section 707(b)(2). See Opening Br. at 11.

The Deadmonds also suggest that limiting the vehicle ownership expense allowance to debtors with loan or lease payments will unfairly prejudice some debtors. Appellees' Br. at 8-9. The Deadmonds outline a scenario where a debtor has only one payment remaining on their vehicle on the date of filing yet still can claim an ownership deduction. *Id*. However, the debtor in this hypothetical stands a strong likelihood of having her case dismissed as an abuse under section 707(b)(3) based on the totality of the circumstances of this debtor's financial situation. The fact that this hypothetical debtor only has one car payment post-petition is a circumstance that would most likely suggest an ability to pay her unsecured debt at a level that demonstrates abuse. Where the presumption of abuse does not arise under section 707(b)(2), "the court must then consider a debtor's actual income and expenses in determining abuse based on ability to pay under section 707(b)(1) and (3)." *In re Mestemaker*, 359 B.R. 849, 854 (Bankr. N.D. Ohio 2007); *accord In re Haar*, 360 B.R. 759, 761, 765 (Bankr. N.D. Ohio 2007) (section 707(b)(3) is "completely independent from § 707(b)(2)," providing "an independent basis to dismiss a case for abuse"). In short, while debtors make decisions regarding their financial circumstances, such as the timing of a vehicle acquisition on credit, the Bankruptcy Code scrutinizes the appropriateness of these financial decisions for all debtors both through the "means test" under Section 707(b)(2) and the "totality of the circumstances" under Section 707(b)(3).

Finally, the Deadmonds argue that the means test discriminates against the "poorest of debtors" and those debtors who will need to acquire a vehicle during the term of a Chapter 13 plan. Appellees' Br. at 9-10. Importantly, the means test does not apply to the vast majority of debtors[1] whose income is below the median income for the household size of the debtor in the state in which the debtor resides at the time of filing. 11 U.S.C. Section 707(b)(7). Thus, "the poorest of debtors"

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[1] The United States Trustee Program has compiled data on the implementation of means testing, and from October 2005 through June 2007, only 7.9% of chapter 7 debtors had income above the applicable state median. Clifford J. White, *Making Bankruptcy Reform Work: A Progress Report in Year 2*, ABI Journal, June 2007, at 16.

are never subject to the means test. Moreover, debtors in chapter 13 are not "locked in" to a level payment for the life of the plan, and may modify the plan under appropriate circumstances to account for additional expenses such as may be associated with the acquisition of a motor vehicle. *See* 11 U.S.C. Section 1329(a)*; In re Slusher*, 359 B.R. 290 , 304 (Bankr.D.Nev. 2007)(section 1329(a) allows "party to seek modification of the chapter 13 plan after confirmation but 'before the completion of [plan] payments'")*; In re Nalls*, 2007 WL 988039, *3 (Bankr. N.D.Ala., April 2, 2007)(confirmed plan may be modified where changed circumstances exist).

CONCLUSION

For the reasons stated herein and in the United States Trustee's opening brief the United States Trustee respectfully asks this Court to reverse the February 27, 2007 decision of the bankruptcy court denying the United States Trustee's motion to dismiss, and remand this case to the bankruptcy court for further proceedings.

Respectfully this 26th day of July, 2007.

/s/ Daniel P. McKay
DANIEL P. McKAY
Office of the United States Trustee
Department of Justice
Attorney for the United States Trustee

Of Counsel

Roberta A. DeAngelis
Acting General Counsel

P. Matthew Sutko
Thomas C. Kearns
Executive Office for
United States Trustees
Department of Justice
20 Massachusetts Ave., N.W.
Washington, D.C. 20530

CERTIFICATE OF SERVICE

I, the undersigned, Attorney for the United States Trustee, do hereby certify under penalty of perjury that a copy of the within and foregoing Reply Brief for Appellant, United States Trustee was served on the 26th day of July, 2007 through the Court's ECF noticing system on the following:

R. Clifton Caughron
CAUGHRON LAW OFFICE
(Attorney for Appellees)

/s/ Daniel P. McKay
DANIEL P. McKAY
Office of the United States Trustee
Department of Justice
Attorney for the United States Trustee

BRIEF BANK — "SUMMARY SHEET" *Printed Tue-11/4/08 16:21*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*
In re: Manuel Del Castillo and Maria E. Pena

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*
Bankr. S.D. Fla.

3. ("CCN") ***CURRENT*** CASE NO.
No.: 07-13601-BKC-AJC

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*
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Court:
(Identify judge & cite, if any)

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U.S. TRUSTEES

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*
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Type: United States Trustee's Reponse in Opposition to Countrywide Home Loans, Inc.'s Memorandum Concerning Appellate Jurisdiction as of Right, or, In the Alternative, Motion for and Incorporated Memorandum in Support of Leave to Appeal

7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g., "UST/OGC"]*
Zana M. Scarlett, Nancy N. Herkert
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***
- Whether the court's prior ruling regarding the non-appealability of the bankruptcy court's discovery orders is the law of the case and cannot be re litigated by Countywide.

10. PATH TO FILE LOCATION:
(e.g., S:\OGC\BRFBANK\etc...)

11. DO YOU RECOMMEND POSTING IN UST BRIEFBANK?
| x | YES | | NO
NAME: Linda Figueroa
DATE:

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF FLORIDA
MIAMI DIVISION
www.flsb.uscourts.gov

In re:

MANUEL DEL CASTILLO and
MARIA E. PENA,

Case No. 07-13601-BKC-AJC
Chapter 13

Debtors.
_______________________________________/

UNITED STATES TRUSTEE'S RESPONSE IN OPPOSITION TO COUNTRYWIDE HOME LOANS, INC.'S MEMORANDUM CONCERNING APPELLATE JURISDICTION AS OF RIGHT, OR, IN THE ALTERNATIVE, MOTION FOR AND INCORPORATED MEMORANDUM IN SUPPORT OF LEAVE TO APPEAL

Donald F. Walton, United States Trustee for Region 21 (the "UST"), pursuant to 28 U.S.C. § 158(a) and Fed. R. Bankr. P. 8001 and 8003, hereby submits this response to the *Memorandum Concerning Appellate Jurisdiction as of Right, or, in the Alternative, Motion for and Incorporated Memorandum in Support of Leave to Appeal* of Countrywide Home Loans, Inc. ("Countrywide") [D.E. #242].[1]

Preliminary Statement

1. For the second time in eight months, Countrywide seeks appellate review of a bankruptcy court order upholding the right of the UST to seek discovery from Countrywide under Fed. R. Bankr. P. 2004. On February 8, 2008, this Court denied Countrywide's request to appeal an earlier version of the same discovery order now at issue, having found that the order

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[1] Although filed in the bankruptcy court, Countrywide's Memorandum is addressed to the United States District Court. Accordingly, the UST's Response follows the same convention. Except as otherwise noted, however, all references to docket entries refer to Bankruptcy Court Case No. 07-136091-BKC-AJC.

was interlocutory and that Countrywide could not demonstrate any reason for the Court to depart from the policy against piecemeal appeals of routine discovery orders. *See Countrywide Home Loans, Inc. v. Walton*, Case No. 08-mc-20020-CMA [D.E. # 6].

2. This Court should also deny Countrywide's subsequent attempt to appeal the bankruptcy court's expanded discovery order, and should dismiss its improperly filed notice of appeal, for at least two reasons. First, this Court's prior legal conclusions and findings of fact regarding the non-final nature of the bankruptcy court's discovery orders are now the law of the case and cannot be re-litigated by Countrywide. The Court's conclusions of law in its prior order are equally applicable to the present appeal, and Countrywide offers no persuasive argument distinguishing any of the facts on which this Court relied in that order. Second, even if the law of the case doctrine did not apply, the Court's February 8, 2008 order was correct on the merits. Like its previous version, the amended Rule 2004 order presently at issue is a routine discovery order not normally subject to interlocutory review, and Countrywide cannot demonstrate any unusual circumstances that would justify immediate appellate review of a discovery order in this case.

Statement of Facts

a. The First Discovery Order

3. On July 6, 2007, Countrywide filed a proof of claim in the chapter 13 bankruptcy case of Manuel Del Castillo and Maria E. Pena (the "Debtors"). By its claim, Countrywide represented that it held a claim of $287,902.23 secured by the Debtors' primary residence, and that the Debtors owed Countrywide pre-petition arrears of $16,417.67 and an insufficient funds fee of $682.88. Countrywide's proof of claim further stated that effective July 1, 2007, the

Debtors' monthly payment to Countrywide would increase from $1,783.64 to $4,773.54.

4. On August 10, 2007, the Debtors objected to Countrywide's proof of claim. [D.E. #48]. In relevant part, the Debtors' objection alleged that Countrywide failed to provide a breakdown of the claimed arrears and fees or to explain the basis for the increased monthly payment. Countrywide did not respond to the Debtors' objection. Accordingly, on August 28, 2007, the bankruptcy court entered an order sustaining the Debtors' objection and reducing Countrywide's claim. [D.E. #59].

5. On October 24, 2007, the UST filed and served a notice for a Rule 2004 examination of Countrywide, seeking discovery regarding the factual basis for Countrywide's proof of claim (the "First Rule 2004 Notice"). [D.E. #91]. Pursuant to the First Rule 2004 Notice, the UST sought, among other materials, "all documents . . . regarding drafting, verifying and filing proofs of claim." *Id.* at Exhibit A.

6. On November 2, 2007, Countrywide filed an objection to the First Rule 2004 Notice. [D.E. #101]. Among other arguments, Countrywide asserted that the UST lacked statutory authority to investigate the factual basis of Countrywide's claim. In addition, Countrywide argued that the requested discovery exceeded the permissible scope of a Rule 2004 examination.

7. On November 28, 2007, the bankruptcy court entered an order that largely denied Countrywide's objections to the First Rule 2004 Notice (the "First Discovery Order"). [D.E. #132]. Although the bankruptcy court sustained Countrywide's objections on certain discrete topics, the bankruptcy court rejected Countrywide's contention that the discovery as a whole was impermissible, and overruled Countrywide's objection to the portion of the First 2004 Notice

that sought all documents relating to Countrywide's internal "policy and procedure" for filing bankruptcy claims. *See* First 2004 Notice at Exhibit A, ¶4.

b. Countrywide's First Motion for Leave to Appeal

8. On December 10, 2007, Countrywide filed a motion for leave to appeal which, like the present motion, was captioned as a "Memorandum of Law in Support of Notice of Appeal of Final Order, or, in the Alternative, Motion for Leave to Appeal" (the "First Motion for Leave to Appeal"). [D.E. #141]. In its First Motion for Leave to Appeal, Countrywide took the position that the First Discovery Order was immediately appealable as of right, but that in the alternative the court should grant it leave to appeal.

9. In support of these contentions, Countrywide raised four principal arguments:

- First, Countrywide argued that the First Discovery Order was a final order for purposes of appeal because the UST's request for discovery is a "separate, distinct dispute" within the Debtors' bankruptcy case. *Id.* at 5.

- Second, Countrywide argued that it should be permitted to appeal under the "Forgay-Conrad" exception to the finality rule, because it would suffer irreparable harm if review was not granted, or alternatively, because the discovery order was a "collateral order" that was "independent and easily separable" from the remainder of the bankruptcy case. *Id.* at 5-6.

- Third, Countrywide argued that it should be granted discretionary leave to appeal because the issue of "whether there is any authority for the UST to examine a creditor's general corporate policies and procedures" is a controlling question of law about which there was "substantial ground for difference of opinion." *Id.* at 6-7.

- Fourth, Countrywide argued that this Court should exercise its discretion to permit an appeal because "an appellate ruling reversing the [First Discovery Order] will terminate the contested matter in its entirety." *Id.* at 9.

c. The Court's February 8, 2008, Order Denying Leave to Appeal

10. On February 8, 2008, this Court issued an order denying Countrywide's First Motion for Leave to Appeal (the "February 8 Order"). [Dist Ct. Case No. 08:mc-20020-CMA, D.E. #6]. Notably, the February 8 Order set forth several findings of fact and conclusions of law that specifically rejected the principal legal theories relied on by Countrywide both in the First Motion for Leave to Appeal as well as in the present motion . In particular, despite Countrywide's assertion that the First Discovery Order was a "separate, distinct" ruling that was final for purposes of appeal, the Court held that an order granting or denying discovery is, by its nature, not final. *Id.* at 5-6.

11. The Court next held that under the facts of the Debtors' bankruptcy case, none of the recognized exceptions to the rule against interlocutory appeals were applicable. In particular, although the Court noted that a discovery order may be considered final if its involves "a person who has custody of materials as to which another person may claim a privilege of non-disclosure," *Id.* at 6, the Court found that no such exception applied in this case because the Debtors did not assert any claim of privilege and did not oppose the UST's discovery requests. *Id.* at 7. The Court held further held that Countrywide's reliance on the "Forgay-Conrad" doctrine was misplaced, since that exception applied only in cases involving orders to deliver property to the complainant, and that no such relief had been sought by the UST. *Id.* at 8. In addition, the Court held that the "collateral order" doctrine could not be satisfied because there

remained a possibility that Countrywide could refuse to deliver the documents in question, which would give rise to the possibility of further proceedings before the bankruptcy court. *Id.* at 9. Finally, the Court held that Countrywide had not shown that immediate review was needed to protect the interests of any party, since "[i]t has not been shown that the Order cannot be reviewed after the final judgment or that a party's interests cannot be protected in the absence of immediate review." *Id.*

12. Next, the Court held that the record before it did not provide any basis for granting discretionary leave to appeal. Specifically, despite Countrywide's claim that the First Discovery Order presented a "controlling question of law" because it involved a challenge to the UST's authority, the Court noted that the relevant consideration was whether the order adjudicated Countrywide's proof of claim, which it did not. *Id.* at 11. Furthermore, the Court held that because the law regarding the non-final nature of discovery orders is "well established," Countrywide could not demonstrate a "substantial ground for differences of opinion regarding the questions presented." *Id.* Accordingly, the Court concluded, "Countrywide has simply not demonstrated that the Order differs materially from routine discovery orders from which interlocutory appeals are discouraged as contravening the policy against piecemeal litigation." *Id.* at 12.

d. The Motion to Expand Discovery and the Second Discovery Order

13. On May 27, 2008, the UST filed a Motion to Expand Discovery Pursuant to the Second Amended Notice of Examination Under Fed. R. Bankr. P. 2004 and Service of Subpoena (the "Motion to Expand Discovery"). [D.E. #215]. The Motion to Expand Discovery was filed in response to Congressional testimony by Steve Bailey, Chief Executive for Loan Administration for Countrywide Financial Corporation. *See Policing Lenders and Protecting Homeowners: Is Misconduct in Bankruptcy Fueling the Foreclosure Crisis?*: Hearing Before the Subcomm. on Admin. Oversight and the Courts of the S. Comm. On the Judiciary, 110th Cong. (May 6, 2008), http://judiciary.senate.gov/testimony.cfm?id-3327&wit_id=7156) (testimony attached as an exhibit to the Motion to Expand Discovery). This testimony revealed for the first time that Countrywide had conducted certain internal audits regarding errors in its mortgage servicing operations. *Id.* at 4. Because the content of these audits is directly relevant to the UST's investigation and evaluation of Countrywide's conduct in the Debtors' chapter 13 case, the UST filed its Motion to Expand Discovery in order to specifically request copies of the internal audits publicly announced by Countrywide in its Congressional testimony. Out of an abundance of caution, the UST sought a specific order regarding production of Countrywide's internal audits, notwithstanding that the bankruptcy court had already ordered production of those materials pursuant to the UST's request for "documents . . . regarding drafting, verifying and filing proofs of claim."

14. On June 27, 2008, the bankruptcy court issued an order granting the Motion to Expand Discovery and overruling Countrywide's objections (the "Second Discovery Order").

[D.E. #238]. It is from the Second Discovery Order that Countrywide now seeks leave to appeal.

Argument

a. This Court's prior ruling regarding the non-appealability of the bankruptcy court's discovery orders is the law of the case and cannot be relitigated by Countrywide

15. In seeking leave to file the current appeal, Countrywide raises virtually the same series of legal and factual arguments that this Court rejected in its February 8, 2008 Order. The legal conclusions and findings of fact set forth in that order are now the law of the case, and Countrywide is precluded from challenging this Court's holdings on a subsequent appeal. As stated by the Eleventh Circuit, "the law of the case doctrine, self-imposed by courts, operates to create efficiency, finality, and obedience within the judicial system, so that an appellate decision binds all subsequent proceedings in the same case." *United States v. Amedeo*, 487 F.3d 823, 829 (11th Cir. 2007) (internal quotation omitted); *see also United States v. Jordan*, 429 F.3d 1032, 1035 (11th Cir. 2005) (noting that "the law of the case doctrine bars relitigation of issues that were decided, either explicitly or by necessary implication, in an earlier appeal of the same case"). In particular, the law of the case doctrine precludes a party from relitigating the issue of whether a particular order is final and appealable, as Countrywide attempts to do here. *See Guardian ad Litem v. Logistics Partners Inc.*, No. 20873, 259 Fed. Appx. 644, 2007 WL 4375450 (5th Cir. Dec. 12, 2007) (holding that law of the case doctrine prohibited court from re-examining ruling that order was interlocutory and unappealable).

16. In this case, Countrywide seeks to appeal the Second Discovery Order, which expanded and modified the interlocutory and unappealable First Discovery Order. The First and Second Discovery Orders address the same subject matter and relate to the same underlying

litigation, and the rationale of this Court's February 8, 2008, Order is equally applicable to both orders. Significantly, Countrywide has not alleged any change in the facts that this Court previously found relevant to its determination of the finality of the order. The Debtors remain unopposed to the UST's discovery efforts and have not claimed privilege, the UST has not sought to recover property of Countrywide; Countrywide has not fully complied with the UST's discovery requests; and there has been no intervening change in the law relevant to interlocutory appeals.

17. For its part, Countrywide is able to identify only a single factor that differentiates its current appeal from its attempted appeal of the First Discovery Order. According to Countrywide, while its first appeal primarily related to the UST's standing, its current appeal challenges the scope of the UST's proposed discovery. *See* Motion at 15. Countrywide fails to explain, however, why an alleged difference in its legal theory on appeal should affect the interlocutory nature of the underlying order itself. In any event, Countrywide's effort to distinguish the two orders on this basis is unpersuasive. Even assuming that the UST was precluded from seeking discovery "beyond the issues raised in the Del Castillo/Pena bankruptcy," as Countrywide suggests, *id.*, the First Discovery Order also explicitly authorized such discovery over the objection of Countrywide. *See* First Discovery Order at Exhibit A ¶4 (authorizing discovery of general procedures employed by Countrywide). Accordingly, this Court's February 8, 2008 Order precludes the relief sought in the present Motion.

b. Even if the law of the case doctrine were not applicable, the February 8, 2008, Order was correctly decided

18. In the alternative, the Court should deny Countrywide's motion for leave to appeal the Second Discovery Order on the merits because that order is non-final, none of the exceptions permitting immediate appeals of interlocutory orders are applicable, and Countrywide has not established cause for discretionary leave to appeal.

19. As this Court correctly noted in its February 8, 2008, Order, discovery orders are by their nature non-final and appellate review of discovery orders is strongly discouraged. *See In re International Horizons, Inc.*, 689 F.2d 996, 1000-1001 (11th Cir. 1982) (holding that "as a general proposition most orders granting or denying discovery are not final orders . . . and therefore are not immediately appealable") (internal quotation omitted). Although Countrywide suggests that the UST's discovery request is a final order solely upon the grounds that the UST's request for discovery is a "distinct dispute," the same characterization could be made of any discovery dispute in a complex litigation. Were Countrywide's statement of law correct, even the most minute discovery order would by definition become immediately appealable as of right. As one court has observed, such an outcome "undermines the purpose of the finality rule" by creating "fragmented litigation, which clogs the appellate courts and causes unnecessary delay in the trial courts." *Barrick Group, Inc. v. Moss,* 849 F.2d 70, 72 (2d Cir. 1982).

20. The sole exception to the finality rule on which Countrywide now appears to rely is the "collateral order" doctrine, under which an interlocutory order may be reviewed if each of three factors are present:

> (1) [T]he order must be independent and easily separable from the substance of the other claims in the action, (2) it must present a need to secure prompt review in order to protect important interests of any party, and (3) it must be examined in the light of practical, rather than narrowly technical, consideration.

In re Hillsborough Holdings Corp., 164 B.R. 673, 674 (M.D. Fla. 1994) (internal citations omitted).

21. As this Court concluded in the February 8, 2008, Order in response to a virtually identical argument by Countrywide, Countrywide has failed to demonstrate that each of these elements is present. In particular, Countrywide fails to explain why an appeal is necessary to protect the interests of any party. Nothing in the record indicates that any of the documents sought by the UST are subject to privileges held by third parties. Moreover, there is no reason to speculate, as Countrywide does, that the Rule 2004 examination will necessarily terminate all litigation involving Countrywide. As Countrywide itself notes, Countrywide is currently the subject of several pending investigations and sanctions proceedings arising out of Countrywide's conduct in bankruptcy cases. *See* Motion at 13. Moreover, should sanctions or other similar relief prove to be warranted in this case, Countrywide would then have ample opportunity to appeal any adverse orders at the conclusion of the proceeding ordering such relief.

22. Finally, Countrywide has not demonstrated there are grounds for granting it discretionary leave to appeal. As Countrywide concedes, such leave to appeal is generally granted only if an issue on appeal is dispositive and there exists a substantial ground for difference of opinion regarding that issue. *See McFarlin v. Conseco Servs., LLC,* 381 F.3d 1251, 1259 (11th Cir. 2004).

23. Countrywide contends that the dispositive issue raised by its appeal is whether the authorized discovery falls within the scope of Rule 2004. Countrywide continues to assert that its "private" business affairs fall outside the scope of Rule 2004 and argues that the requested discovery is not related to this bankruptcy case. *See* Motion at 17-18. Countrywide, however, fails to demonstrate that there is any material difference of opinion among courts as to whether Rule 2004 is available to investigate the filing of false or inaccurate claims by a creditor in a bankruptcy case, and there is no authority suggesting that Countrywide would be likely to prevail on the merits of an appeal.

24. It is well-established that Rule 2004 permits examination of nearly any matter that is related to the administration of a bankruptcy case. *In re Drexel Burnham Lambert Group, Inc.*, 123 B.R. 702, 711 (Bankr. S.D.N.Y. 1991) (noting that Rule 2004 "can be legitimately compared to a fishing expedition"). This broad authorization for discovery contemplates examinations of creditors as well as debtors. *See Friedman v. Drucker (In re Sofro)*, 117 B.R. 745, 752 (Bankr. S.D. Fla. 1990) (sanctioning creditor for failure to comply with Rule 2004 order). Moreover, courts have agreed that the UST may properly invoke Rule 2004 to investigate abuses by creditors of the bankruptcy system. *See In re Parsley*, 384 B.R. 138, 147 (Bankr. S.D. Tex. 2008) (holding that "the UST was well within its authority to investigate the activities of Countrywide, Barrett Burke, and McCalla Raymer to determine if their activities undermined the integrity of the bankruptcy system").

25. In this case, evidence of Countrywide's internal audits are directly relevant to the issue of whether the possible errors in the Debtors' bankruptcy case form part of a pervasive or

systemic pattern of misconduct. That issue, in turn, may be highly relevant to the question of what remedy, if any, should be imposed in the event that the bankruptcy court determines that Countrywide has engaged in misconduct. Consequently, Countrywide cannot demonstrate that its theory on appeal holds sufficient merit to permit an immediate interlocutory appeal.

c. Because the Second Discovery Order is interlocutory and non-appealable, the Court should dismiss Countrywide's appeal for lack of jurisdiction

26. Despite this Court's previous holding that the bankruptcy court's Discovery Orders are interlocutory, Countrywide wrongly treats the order as final and has filed a notice of appeal in addition to seeking relief through its Motion. This Court, however, lacks jurisdiction to entertain an appeal of an interlocutory order where leave to appeal has not been granted. *See* 28 U.S.C. § 158(a); *Blum v. Bankatlantic Fin. Corp.*, 925 F.2d 1357, 1360 (11th Cir. 1991) (noting that appellate court "usually does not have jurisdiction over interlocutory appeals that have not been certified" by trial court). Accordingly, the Court should dismiss this appeal.

Conclusion

27. For all of the foregoing reasons, the Motion for Leave to Appeal should be denied and Countrywide's appeal should be dismissed.

DATED: July 25, 2008.

Donald F. Walton
United States Trustee
Region 21

/s/
Zana M. Scarlett, Trial Attorney
Florida Bar No.: 626031
U.S. Trustee's Office
51 SW 1st Ave.

Miami, FL 33130
Phone: (305) 536-7285
Fax: (305) 536-7360
Zana.M.Scarlett@usdoj.gov

T. Patrick Tinker, Trial Attorney
Florida Bar No.: 64874
U.S. Trustee's Office
501 East Polk Street, Room 1200
Tampa, FL 33602
Phone: (813) 228-2000
Fax: (813) 228-2303
Thomas. P.Tinker@usdoj.gov

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on July 25, 2008, a true and correct copy of the foregoing has been served; (i) electronically through CM/ECF, on parties having appeared electronically in the instant matter, and (ii) by U.S. Mail, postage prepaid, on parties not appearing electronically.

/s/______________________________
Zana M. Scarlett, Trial Attorney

BRIEF BANK — "SUMMARY SHEET" Printed Tue.-8/12/3 (10:14)

WESTLAW CODES

1. ("TI") TITLE OF CASE [E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]	R. Michael Bolen, U.S. Trustee (Region 5) v. Carl A. Dengel
2. ("CO") CURRENT COURT [E.g., "CTA9"]	U.S. Court of Appeals for the Fifth Circuit (CTA5)
3. ("CCN") CURRENT CASE NO.	No.: 02-30574 (5th Cir.)
4. ("PCN") PRIOR CASE NO. & COURT [IF ANY]	No.: 00-0783 (E.D.LA. 3/5/02) (sub nom Janice Taylor v. Carl Dengel) Court:U.S. District Court, Eastern District of Louisiana (D.J. Stanwood Duvall) (Identify judge & cite, if any)
5. ("SO") SOURCE	**U.S. TRUSTEES**
6. ("DA") DATE OF FILING & TYPE OF BRIEF [E.g., "Opening Brief," "Reply," "Amicus," etc.]	Filed:Oct. 2, 2002 Type:Brief for Appellee, United States Trustee
7. ("AU") PRINCIPAL AUTHORS & OFFICE [E.g.,"UST/OGC"]	Kathleen Kane & William Kanter, Civil Appellate (202-514-4575) Anthony J. Ciccone, EOUST (202-307-0003) (UST/OGC: 202-307-1399/FAX-2397)
8. ("TO") TOPIC	**BANKRUPTCY**
9. ("SU") • SUMMARY OF KEY ISSUE(s) & √ Any Miscellaneous BACKGROUND	• UST/Region 5 brought collection action to recover excess compensation taken by chapter 12 trustee Dengel in violation of Chapter 12 Handbook's "expense first" policy. After trial, Bankruptcy Court recommended holding for UST, with which District Court agreed on de novo review. Dengel appealed to 5th Circuit and also challenged D.Ct's. grant of Bank's motion to dismiss lender liability cross-claim. √ **Background:** On 8/11/03, 5th Circuit affirmed D.Ct., holding: (1) EOUST has authority under 28 U.S.C. 586(e) to interpret chapter 12 compensation scheme via Handbook; (2) Handbook's expense-first policy fills ambiguous gap in statute; (3) while Handbook gets no "Chevron" deference, its persuasiveness warrants judicial deference.
10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)	C:\WINNT\Profiles\rschnell\Desktop\New Folder\Dengel1.wpd
11. DO YOU RECOMMEND POSTING IN UST BRIEFBANK?	| x || |NAME:Anthony J. Ciccone YES NO DATE:Mon.-8/11/3 (16:05)

No. 02-30574

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

R. MICHAEL BOLEN, United States Trustee, Region 5

Plaintiff-Appellee,

v.

CARL A. DENGEL,

Defendant-Appellant.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF LOUISIANA

BRIEF FOR THE APPELLEE

ROBERT D. McCALLUM, JR.
Assistant Attorney General

JAMES LETTEN
United States Attorney

WILLIAM KANTER
(202) 514-4575
FREDDI LIPSTEIN
(202) 514-4815
KATHLEEN A. KANE
(202) 514-3972
Attorneys, Appellate Staff
Civil Division, Room 9102
Department of Justice
601 "D" Street, N.W.
Washington, D.C. 20530-0001

Of Counsel:

ANTHONY J. CICCONE
Trial Attorney
Exec. Office for
United States Trustees
Department of Justice
901 E St., N.W., Suite 780
Washington, D.C. 20530

CERTIFICATE OF INTERESTED PERSONS

There are no additional interested parties other than those listed by appellant.

____
Kathleen A. Kane
Attorney of record for
Plaintiff-Appellee

STATEMENT REGARDING ORAL ARGUMENT

Appellee R. Michael Bolen believes that the order of the district court is correct and should be affirmed. We stand ready to present oral argument if the Court would find oral argument to be of assistance.

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IN THE UNITED STATES COURT OF APPEALS

FOR THE FIFTH CIRCUIT

No. 02-30574

R. MICHAEL BOLEN, United States Trustee, Region 5

Plaintiff-Appellee,

v.

CARL A. DENGEL,

Defendant-Appellant.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT

FOR THE EASTERN DISTRICT OF LOUISIANA

BRIEF FOR THE APPELLEE

STATEMENT OF JURISDICTION

The district court had jurisdiction over this suit addressing compensation of standing trustees under federal bankruptcy law pursuant to 28 U.S.C. § 1334. The district court entered partial judgment in favor of the United States Trustee on March 5, 2002. That judgment, issued under Federal Rule of Civil Procedure 54(b), granted the relief sought in the U.S. Trustee's declaratory action. Dengel's counterclaims and third-party claims remained. Dengel's post-judgment motions were denied on

May 16, 2002, and he filed a timely notice of appeal on May 31, 2002. See Fed. R. App. P. 4(a). This Court has jurisdiction pursuant to 28 U.S.C. § 1291.

STATEMENT OF THE ISSUES

Appellant Carl Dengel served as a Chapter 12 standing trustee. Under the governing statute, 28 U.S.C. § 586, the Attorney General, acting through the United States Trustee, must fix standing trustees' compensation within certain limits enumerated in the statute. Section 586 requires annual compensation and reimbursement for expenses to be set at no more than ten percent of payments made under each debtor's plan, with no more than five percent going to compensation of the standing trustee. The U.S. Trustee's handbooks provide that, within the ten percent maximum fee, actual expenses must be reimbursed first and unpaid compensation may not be carried over from year to year.

The issues in this case are:

1. Whether the Attorney General and the U.S. Trustee acted within their authority in determining that standing trustees must be reimbursed for expenses first and then compensated from remaining funds available under the governing statute.

2. Whether the calculations of appellant's compensation were permissible and whether the U.S. Trustee may recover improperly withheld funds.

STATEMENT OF THE CASE

The U.S. Trustee, Region 5 brought this case as a non-core proceeding in bankruptcy court, seeking a declaratory judgment that certain funds retained by Dengel during his tenure as a Chapter 12 standing trustee were improperly withheld under the governing statute and handbook provisions. Dengel filed counterclaims and third party claims, and the reference to the bankruptcy court was withdrawn by the district court.

The district court retained jurisdiction, but referred the U.S. Trustee's declaratory judgment action back to the bankruptcy court. After that court conducted a trial and issued a report and recommendation pursuant to 28 U.S.C. § 157(c), the district court ruled on Dengel's objections to the report and rendered judgment in favor of the U.S. Trustee on his declaratory judgment action. That judgment was entered under Rule 54(b) of the Federal Rules of Civil Procedure, and Dengel appealed.

Dengel's counterclaims and third-party claims remained pending at the time of his notice of appeal in this case. Since that time, the third-party action against the bank holding the disputed funds has been rendered final against Dengel and appealed to this Court. That case is docketed as Fifth Circuit No. 02-30929. The district court has retained jurisdiction over Dengel's tort and constitutional counterclaims for final disposition.

STATEMENT OF FACTS

1. Statutory and Regulatory Scheme.

Prior to 1986, Chapter 12 of the Bankruptcy Code permitted the appointment of Chapter 12 standing trustees by the bankruptcy courts to facilitate the resolution of farmers' bankruptcies. In 1986, Congress effected a major overhaul of the bankruptcy system, a key component of which was the transfer of responsibility for appointing and supervising trustees from the bankruptcy courts to the Attorney General. With the passage of the Bankruptcy Judges, United States Trustees and Family Farmer Bankruptcy Act of 1986 (P.L. 99-554), the power to appoint standing trustees in bankruptcy cases was entrusted to the regional United States Trustees, subject to the approval of the Attorney General. 28 U.S.C. § 586(b).[1] The statute provides that such standing trustees must be supervised in the performance of their duties by the United States Trustee for the relevant region.

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[1] The United States Trustees are employees of the federal government, appointed for a term of five years by the Attorney General to oversee the administration of bankrupt estates in each of the several regions identified in the statute. The U.S. Trustees, in turn, may appoint standing trustees subject to the approval of the Attorney General where a high number of cases under Chapters 12 and 13 of the Bankruptcy Code warrant such a move. The standing trustees are not federal employees. Rather, they are private persons acting pursuant to the terms of compensation and performance contained in the statute, applicable handbook provisions, and individual compensation orders issued by the U.S. Trustee.

Under § 586, the Attorney General has broad authority to oversee bankruptcy trustees. In addition to appointing and supervising the U.S. Trustee for each region, the statute provides that the Attorney General "shall prescribe by rule qualifications . . . to serve as standing trustee in cases under chapter 12 . . . ." 28 U.S.C. § 586(d).

Included in the Attorney General's responsibilities under the statute is the requirement that, after consulting with the appointing U.S. Trustee, he fix compensation for Chapter 12 standing trustees. 28 U.S.C. § 586(e). The statute provides that the Attorney General shall fix a fee not to exceed ten percent of payments made by the debtor under any individual bankruptcy plan, to cover both the standing trustee's expenses and compensation. 28 U.S.C. § 586(e)(1).[2] A standing trustee's

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[2] The full text of § 586(e)(1)is as follows:

The Attorney General, after consultation with a United States trustee that has appointed an individual . . . to serve as standing trustee in cases under chapter 12 or 13 of title 11, shall fix–

(A) a maximum annual compensation for such individual consisting of–
  (i) an amount not to exceed the highest annual rate of basic pay in effect for level V of the Executive Schedule; and
  (ii) the cash value of employment benefits comparable to the employment benefits provided by the United States to individuals who are employed by the United States at the same rate of basic pay to perform similar services during the same period of time; and

(B) a percentage fee not to exceed–
  (i) in the case of a debtor who is not a family farmer, ten percent; or

(continued...)

compensation, as distinguished from reimbursement for expenses, may not exceed five percent of payments under any bankruptcy plan. 28 U.S.C. § 586(e)(2)(A). Section 586(e)(1)(A) also subjects compensation of standing trustees to an aggregate annual limit, under which compensation may not exceed the highest annual rate of pay in effect for level V of the Executive Service and the cash value of employment benefits provided by the United States to its employees to perform similar services. 28 U.S.C. § 586(e)(1)(A).

Within these statutory limits, the Attorney General and U.S. Trustee fix maximum compensation for each standing trustee by order. Under the statute, a standing trustee must pay to the United States Trustee, for deposit in the United States Trustee System Fund, any amount collected as compensation which exceeds five percent of payments under the bankruptcy plan, or which exceeds actual expenses or the actual compensation as adjusted by

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[2] (...continued)

(ii) in the case of a debtor who is a family farmer, the sum of–

(I) not to exceed ten percent of the payments made under the plan of such debtor, with respect to payments in an aggregate amount not to exceed $450,000; and

(II) three percent of payments made under the plan of such debtor, with respect to payments made after the aggregate amount of payments made under the plan exceeds $450,000;

based on such maximum annual compensation and the actual, necessary expenses incurred by such individual as standing trustee.

other provisions under the statute and reflected in the trustee's maximum compensation order. 28 U.S.C. § 586(e)(2)(A) and (B).[3]

The statute does not prescribe the manner in which the orders fixing compensation of standing trustees are to be calculated by the Attorney General and the U.S. Trustees or the order in which expenses and compensation are to be paid. The Executive Office for U.S. Trustees [EOUST] has provided handbooks to the regions and individual trustees in order to facilitate uniformity and efficiency of administration of bankrupt estates under the statute. As relevant to this case, EOUST promulgated two handbooks for Chapter 12 standing trustees in 1989 and 1992, respectively. Those handbooks fill in the statutory gap as to how compensation orders for standing trustees are to be fixed.

In developing the methods for calculating compensation, EOUST determined that standing trustees' compensation should be linked to the efficiency of their performance. The handbooks

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[3] 28 U.S.C. § 586(e)(2) provides, in pertinent part:

> [The standing trustee] shall pay to the United States trustee, and the United States trustee shall deposit in the United States Trustee System Fund -
>
> (A) any amount by which the actual compensation of such individual exceeds 5 per centum upon all payments received under plans in cases under chapter 12 or 13 of title 11 for which such individual serves as standing trustee; and
>
> (B) any amount by which the percentage for all such cases exceeds-
>
> (i) such individual's actual compensation for such cases, as adjusted under subparagraph (A) of paragraph (1); plus
>
> (ii) the actual, necessary expenses incurred by such individual as standing trustee in such cases. . . .

therefore provide that, within the parameters set by the statute, standing trustees may not receive compensation until their documented expenses have been reimbursed. See 1992 EOUST Handbook at 22. Thus, trustees have the incentive to keep expenses low, within five percent of total payments, in order to ensure that they will be able to collect their maximum allowable compensation under the statute and their compensation orders. Should expenses exceed the maximum fee of ten percent in any given year, they may be carried forward to subsequent years. Id. However, unpaid compensation may not be carried forward, again as an incentive to keep expenses low wherever possible. Id. at 25. A compensation order may be set at zero where allowable expenses will meet or exceed the ten percent maximum fee or other limits under Section 586.

2. Facts and Prior Proceedings.

a. Carl A. Dengel acted as a Chapter 12 standing trustee in Louisiana between the years of 1987 and 1995. Between 1987 and 1989, he acted as trustee under an appointment by the Bankruptcy Court for the Eastern District of Louisiana. During that time, Dengel claims he accrued an operating deficit of expenses carried forward from year to year.

As of 1990, with the advent of the United States Trustee system, Dengel served as a standing trustee appointed by the U.S. Trustee for Region 5. Proposed Findings of Fact and Conclusions of Law, Record Excerpt [RE] 6 at 2. Dengel's appointment was subject to EOUST's handbook provisions and his individual compensation orders. Dengel objected to the expenses first, funds available requirement in the EOUST handbooks, and expressed his dissatisfaction with the U.S. Trustee's compensation policy from the beginning of his service under his new appointment. Id. at 3. Although he criticized the methods of compensation under the U.S. Trustee system, Dengel nevertheless consented to the terms of the compensation orders for each year of his service. He also refused to adhere to the expenses-first policy, by carrying forward unpaid compensation from year to year and paying himself compensation before all the year's expenses had been reimbursed. Id.

b. Dengel brought an action in 1994 against the U.S. Trustee, seeking a resolution as to the proper ownership of the disputed compensation funds. In re Ozzie Travis Givens, Debtor, and Carl A. Dengel, Trustee v. Victoria E. Young, United States Trustee, E.D. La. (Bankr.) No. 94-1245. Dengel interpled the sum of $5,786.80, representing a ten percent fee from his pending Chapter 12 cases, and also set up an account with Bank One, into which he deposited the contested compensation as it accrued.[4] The bankruptcy court dismissed Dengel's suit, and Dengel never

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[4] That account is the subject of Dengel's third-party action against Bank One, now in this Court on Dengel's appeal as Fifth Circuit Case No. 02-30929.

appealed. See RE 6 at 5. The bankruptcy court found that, under 11 U.S.C. § 326(b), it lacked jurisdiction to determine compensation of a standing trustee. See 11 U.S.C. § 326(b)("the court may not allow compensation for services or reimbursement of expenses . . . of a standing trustee appointed under section 586(b) of Title 28").

The U.S. Trustee filed this case in bankruptcy court in 1998, seeking a declaration that the disputed compensation should not have been retained by Dengel and was, in fact, the property of the U.S. Trustee System Fund. Bankr. Dkt. # 1. Dengel filed counterclaims and third party claims, alleging tortious and unconstitutional conduct by members of the Region 5 U.S. Trustee's office. Bankr. Dkt. # 8. Dengel also brought a third-party claim against the bank in which the disputed funds were lodged. Bankr. Dkt. # 7.

Subsequent to Dengel's initiation of his counter- and third-party claims, the referral to the bankruptcy court was withdrawn. D.Ct. Dkt. # 4. On the U.S. Trustee's motion, however, the original declaratory action was remanded to the bankruptcy court for trial and issuance of a report and recommendations. D.Ct. Dkt. # 7.

After a two-day trial, the bankruptcy court issued its report, recommending that the district court find that the U.S. Trustee handbook provisions were an appropriate exercise of authority given the ambiguity as to the method of calculating compensation under the statute and that, therefore, the disputed funds were the property of the U.S. Trustee. RE 6.

Upon review of the report, the district court determined that the handbook was not entitled to deference under Chevron U.S.A. Inc. v. Natural Resources Defense Council, 467 U.S. 837 (1984), as the bankruptcy court had held, but rather under United States v. Mead Corp., 533 U.S. 218 (2001). RE 5 at 3. The district court adopted the bankruptcy court's report in all other respects, and accepted the recommendation in favor of rendering judgment for the U.S. Trustee. Id. at 6. Finding no cause for delay, the district court entered judgment in favor of the U.S. Trustee under Fed. R. Civ. P. 54(b). RE 4. After his motions to reconsider were denied, Dengel timely appealed this ruling on May 31, 2002. At that time, the tort and constitutional counterclaims, as well as the Bank One third-party claim, were pending. In the intervening months, Dengel's case against the Bank was dismissed. Dengel appealed that action, which is docketed as No. 02-30929 in this Court.[5] The remaining issues are still pending in the district court.

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[5] It is likely that the outcome of this case will moot Dengel's second appeal.

STANDARD OF REVIEW

The gravamen of this case is whether the U.S. Trustee's policies are permissible under the enabling statute. The district court's statutory interpretation is reviewed de novo. United States v. Rasco, 123 F.3d 222, 226 (5th Cir. 1997). To the degree that any factual determinations of the district court are in issue, they are reviewed for clear error. In re Miller, 290 F.3d 263, 266 n.2 (5th Cir. 2002).

SUMMARY OF ARGUMENT

1. Through its 1986 legislation, Congress made the Attorney General and the regional United States Trustees responsible for appointing Chapter 12 standing trustees and for fixing their compensation, up to a maximum level stated in 28 U.S.C. § 586. Other than setting a ceiling on standing trustees' compensation, the statute commits the actual calculation of appropriate compensation to the Attorney General and the U.S. Trustees. Although it provides for recoupment of expenses and for compensation, the statute is silent as to the order in which expenses and compensation should be paid.

In the context of this express grant of authority and the absence of any specific direction by Congress, the Executive Office for U.S. Trustees determined that requiring expenses to be paid before compensation would create an incentive for standing trustees to keep costs low, in accordance with the legislative purposes of § 586. This policy was enunciated in two successive Chapter 12 handbooks, issued to all standing trustees including appellant in this case.

Although it is not the product of formal notice and comment rulemaking, the U.S. Trustee's policy and the handbooks in which it is recorded are entitled to judicial deference. The EOUST's expenses-first policy fills a statutory gap as to the precise calculation and manner of payment of standing trustees' compensation. The policy furthers the legislature's goal of reducing costs and complexity for family farmers facing bankruptcy, and it is an appropriate exercise of the authority expressly granted to the Attorney General and the United States Trustee by the statute.

While recent Supreme Court cases indicate that Chevron deference applies to certain policy statements such as those embodied in the EOUST handbooks, the district court was correct in finding that the expenses-first policy should also be upheld under the lesser deference standard exemplified by United States v. Mead Corp., 533 U.S. 218 (2001), and Skidmore v. Swift & Co., 323 U.S. 134 (1944). The EOUST handbook policy is, at a minimum, entitled to respect to the extent that the interpretation of the statute it represents has the "power to persuade." Skidmore, 323 U.S. at 140. Given that the EOUST's expense-first policy is a reasonable interpretation of the statute and creates an incentive to keep costs low for bankrupt farmers, the policy passes muster both under Chevron and under the lesser deference articulated in Mead and Skidmore and applied by the district court. Therefore, the Court need not determine the appropriate deference to apply to the handbooks in order to affirm the judgment of the district court.

Dengel's statutory interpretation arguments, in which he contends that § 586 prohibits the EOUST's expenses-first policy, are unavailing. The doctrine of *expressio unius est exclusio alterius* does not apply to the portion of the statute in question. Congress did not illustrate one thing to the implied exclusion of others, but instead merely set a ceiling on standing trustees' compensation. The fact that Congress supplied a maximum limit to compensation does not create a right to receive that maximum every year. Nor should the Court accept Dengel's argument that we can infer from Congress' silence that the Attorney General is precluded from determining the order in which expenses and compensation should be paid. That silence on the order of payment cannot strip the Attorney General of the authority, conferred by the same statutory provision in issue, to fix appropriate compensation within the maximum.

2. The money improperly retained by Dengel as compensation, part of which has been kept in the Bank One account and the court registry, should be returned to the United States Trustee.

Section 586 provides that any amount over the percentage maximum or the actual compensation and expenses as adjusted under the statute must be returned to the United States Trustee System Fund. 28 U.S.C. § 586(e)(2).

The U.S. Trustee properly calculated the compensation to which Dengel was entitled for the years in question, which was less than five percent of payments under the estates he oversaw for certain years. Those calculations reflected expenses as submitted by Dengel and the adjustments to compensation required by the statute. Nonetheless, Dengel persisted in retaining a full five percent of payments in deliberate contravention of the U.S. Trustee's expenses-first policy and his own compensation orders. Under § 586, that money is now owing to the U.S. Trustee, and the district court's judgment declaring the U.S. Trustee's entitlement to the funds should be affirmed.

ARGUMENT

I. The U.S. Trustee Handbook's Provision Requiring Standing Trustees to be Reimbursed for Expenses First and Compensated After is Entitled to Judicial Deference as an Appropriate Interpretation of and Exercise of Authority Under the Statute.

A. The statute is silent as to the order in which compensation and expenses are to be paid to standing trustees.

The governing statute, 28 U.S.C. § 586(e), states that the Attorney General "shall fix" a fee for standing trustees not to exceed ten percent of payments under a family farmer's bankruptcy plan. The statute also dictates that the fee is to include both expenses and compensation, and that the compensation portion may not exceed five percent of payments under any bankruptcy plan.

The statute thus sets the outside parameters within which the Attorney General and U.S. Trustee may fix a standing trustee's fee and compensation, but it is silent as to how compensation should be calculated within those parameters. As the bankruptcy and district courts both found, nothing in 28 U.S.C. § 586 either demands or forbids the U.S. Trustee's policy requiring expenses to be paid first. See RE 5 at 3 and 5 (Order and Reasons in support of judgment issued March 5, 2002). See also In re: BDT Farms, Inc., 21 F.3d 1019, 1023 (10th Cir. 1994) (finding § 586 ambiguous as to the meaning of "payments"); Pelofsky v. Wallace, 102 F.3d 350, 354-55 (8th Cir. 1996) (same).

Indeed, the expenses-first policy is an implementation of § 586 under an express statutory grant of authority to the Attorney General to set a fee for standing trustees. That determining the appropriate fee is within the exclusive authority of the Attorney General and his agents is underscored by the prohibition on the courts' awarding compensation to standing trustees. See 11 U.S.C. § 326(b) ("In a case under chapter 12 or 13 of this title, the court may not allow compensation for services or reimbursement of expenses of . . . a standing trustee appointed under section 586(b) of title 28"); see also In re Schollett, 980

F.2d 639, 644-45 (10th Cir. 1992) (finding that the setting of standing trustees' compensation is the exclusive province of the Attorney General and not subject to alteration by the courts).

B. The U.S. Trustee's policy requiring expenses to be paid first is appropriate and entitled to deference.

1. The purpose of the U.S. Trustee's policy requiring expenses to be paid first is to create an incentive for standing trustees to keep expenses low. Under the U.S. Trustee's calculations, expenses may be carried forward year to year in order to ensure that trustees will be reimbursed for those extraordinary years where expenses are unavoidably higher than the statutory maximums allow. Permitting expenses to be carried forward, however, could create a disincentive to keep expenses low in any given year if the standing trustee is assured of both compensation for that year and eventual recoupment of his expenses in later years. Without the expenses-first policy, trustees could get the maximum compensation of five percent, regardless of how careless they may have been in running up expenses. The expenses-first, funds available policy thus serves the overall efficiency of the trustee system by creating an incentive to keep administrative expenses low.

Such an objective is clearly congruent with the goals of the enabling statute. A key purpose of bringing the trustee system under the direction of the Attorney General was to streamline the administration of bankrupt estates and to ensure the lowest possible costs to debtors and creditors alike. For example, the House Judiciary Committee described the policy underlying § 586 as follows: "The Attorney General will be able to utilize the private sector to provide personalized efficient service and to keep subordinate employees of the standing trustee off the public payroll. *The fee system is designed to encourage the standing trustees to keep costs low at the risk of reduced compensation* . . . . ." H.R. Rep. No. 95-595, at 107 (1978) [emphasis added], reprinted in 1978 U.S.C.C.A.N. 5963, 6068 and Collier on Bankruptcy App. Pt. 4-1196.[6] The U.S. Trustee's expenses-first policy thus dovetails with the legislative purpose behind § 586.

2. The expenses-first policy embodied in the U.S. Trustee's handbooks is entitled to judicial deference. Recent Supreme Court cases indicate that the EOUST handbooks should be entitled to deference under Chevron U.S.A., Inc. v. Natural Resources Defense Council, 467 U.S. 837 (1984) and progeny. However, as the district court found, the expenses-first policy should be upheld even where accorded the lesser deference described by United States v. Mead Corp., 533 U.S. 218 (2001) and Skidmore v. Swift & Co., 323 U.S. 134 (1944). Thus, while the EOUST

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[6] The 1978 Act, which established the U.S. Trustee system on an experimental basis, was the predecessor to the 1986 Act which formally and permanently established that system. Legislative history going to the purposes behind the 1978 Act is thus relevant to the 1986 Act as well.

handbooks' expenses-first provision shares the characteristics of other administrative policies that have been accorded Chevron deference in the absence of notice and comment rulemaking, the Court need not finally determine the precise level of deference to be applied to the handbooks in this case. The judgment of the district court, which rested on the less deferential standard, may be affirmed on the ground that any policy which should be upheld under Mead and Skidmore would, a fortiori, be upheld under Chevron.

a. Under Chevron and progeny, an agency's interpretation or implementation of a statute receives deference if the statute is silent or ambiguous on the point in issue and the agency's interpretation is based on a permissible construction of the statute. Henrikson v. Guzik, 249 F.3d 395, 397-98 (5th Cir. 2001). Chevron deference applies where Congress has delegated policymaking authority under a statute, including where that delegation is implicit. Texas v. U.S. Dept. of Health & Human Svcs., 61 F.3d 438, 440 (5th Cir. 1995). Such deference is appropriate because "[t]he power of an administrative agency to administer a congressionally created . . . program necessarily requires the formulation of policy and the making of rules to fill any gap left, implicitly or explicitly, by Congress." Id., quoting Chevron, 467 U.S. at 843-44.

In this case, § 586 contains an express delegation of authority to the Attorney General to set fees for standing trustees. The Attorney General and the U.S. Trustee, in implementing the statutory scheme, must therefore fill the gaps as to how those fees are to be calculated and paid, within the outside limits set by the statute. As discussed above, § 586(e) is ambiguous as to the order in which expenses and compensation should be paid: "For purposes of the Chevron analysis, . . . [a statute is ambiguous if] the agency must use its discretion to determine how best to implement the policy . . . .". United States v. Haggar Apparel Co., 526 U.S. 380, 393 (1999).

While the handbooks in issue in this case do not represent a formal, notice and comment rulemaking of the kind recognized in Chevron, the Supreme Court has recently clarified that formal notice and comment procedures are not required in order to secure deference. See Walton v. Barnhart, __ U.S. __, 122 S.Ct. 1265, 1271-72 (2002), citing Mead, 233 U.S. at 121, 230-31 ("the want of 'notice and comment' does not decide the case").

As the Supreme Court held in Walton, deference to an agency's interpretation is appropriate where it reasonably fills a statutory gap and represents the consistent view of the administrative body charged with implementing the statutory scheme. Id. Employing a similar approach, the Ninth Circuit recently applied Chevron deference to uphold "Policy Statements" issued by the Department of Housing and Urban Development. See Schuetz v. Banc One Mortg. Corp., 292 F.3d 1004, 1012 (9th Cir. 2002). The Ninth Circuit held that, even in absence of notice and comment rulemaking, the Policy Statements were entitled to Chevron deference where the Department of Housing and Urban Development has been charged with administering the statute and has expertise in the relevant area. See id.; see also, Heimmermann v. First Union Mortg. Corp., __ F.3d __, 2002 WL 31067330 (11th Cir. 2002) (upholding HUD Statements of Policy).

In this case, the EOUST handbook's expenses-first policy fills a statutory gap regarding the manner in which compensation is to be fixed and paid, and furthers the purposes of the enabling statute by keeping costs to family farmers facing bankruptcy as low as possible. The Attorney General and the U.S. Trustee have been charged with administering the complex bankruptcy trustee system, and the expenses-first policy is an integral part of the interrelated system of incentives and checks that provides for both adequate compensation of trustees and efficient administration of bankrupt estates. The compensation of standing trustees is thus within the particular expertise of the Attorney General and the EOUST, as were the Policy Statements upheld in Schuetz. Moreover, the expenses-first policy was enunciated at the inception of the U.S. Trustee system through the 1989 handbook, and was reaffirmed in the 1992 handbook. The policy has thus been in place since the origination of the U.S. Trustee system, and represents the consistent and long-standing policy of the agency. See Walton, 122 S.Ct. at 1271-72.[7] The handbooks are therefore appropriately subject to Chevron deference.

b. However, the Court need not finally decide whether Chevron applies to the expenses-first policy because the statutory implementation in the EOUST handbooks has "the power to persuade" under United States v. Mead Corp., 533 U.S. 218 (2001) and Skidmore v. Swift & Co., 323 U.S. 134 (1944). See, e.g., Edelman v. Lynchburg College, __ U.S. __, 122 S.Ct. 1145, 1150 (2002) (finding no need to reach the question of what level of deference is appropriate where the Court agrees with the agency's policy). Even without the benefit of Walton, which was decided after the court issued its ruling, the district court determined that the EOUST policy was entitled to deference and should be upheld under the lesser deference standard. Order and Reasons, RE 5 at 5-6.

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[7] The Supreme Court found Chevron deference appropriate where "the interstitial nature of the legal question, the related expertise of the Agency, the importance of the question to administration of the statute, the complexity of that administration, and the careful consideration the Agency has given the question over a long period of time all indicate that Chevron provides the appropriate legal lens through which to view the legality of the Agency interpretation here at issue". Walton, 122 S.Ct. at 1272, citing Mead, 533 U.S. at 231-234.

This Court has held that, in absence of full Chevron deference, additional weight should be given to an agency's implementation of its own statutory scheme. Thus, a guide and handbook issued by Department of Labor were accorded deference even though such publications do not fill a statutory gap under express Congressional authority and they were not issued through notice and comment rulemaking. Sykes v. Columbus & Greenville Railway, 117 F.3d 287, 294-95 (5th Cir. 1997). This Court gave the guide and handbook in Sykes "a measure of weight" because "considerable weight should be accorded to an executive department's construction of a statutory scheme it is entrusted to administer." Id. at 495 (quoting Chevron, 467 U.S. at 844). In this case, the EOUST handbooks implement the statutory scheme entrusted to the Attorney General: the supervision and appropriate compensation of standing trustees.

Where, as here, a governmental actor is required by statute to perform a certain task but the law does not specify the means by which it is to be accomplished, the governmental actor is presumed to have the authority to determine the best means by which to complete the task. See, e.g., Sid Peterson Mem. Hosp. v. Thompson, 274 F.3d 301, 312-13 (5th Cir. 2001) (administrative agency may issue prophylactic rules and policies as part of its authority to implement the enabling statute); see also United States v. Mead Corp., 533 U.S. 218, 229 (2001) ("Congress . . .

may not have expressly delegated authority or responsibility to implement a particular provision or fill a particular gap. Yet it can still be apparent from the agency's generally conferred authority and other statutory circumstances that Congress would expect the agency to be able to speak with the force of law when it addresses ambiguity in the statute or fills a space in the enacted law").

The reasons discussed above for according the handbooks Chevron deference apply with equal force to the persuasiveness of the policy under Mead and Skidmore. The express and exclusive grant of authority to the Attorney General to set fees for standing trustees, the complexity of the statutory scheme administered by the Attorney General and the U.S. Trustees, the fact that the expenses-first policy fills a statutory gap in a manner consistent with the goals of the statute, and the long-standing and consistent nature of the policy all counsel in favor of upholding the handbooks' expenses-first provision. Mead, 533 U.S. 228 ("The fair measure of deference to an agency administering its own statute has been understood to vary with the circumstances, and courts have looked to the degree of the agency's care, its consistency, formality, and relative expertness, and to the persuasiveness of the agency's position . . ."). Because the expenses-first policy plainly survives review under either Chevron or Skidmore and Mead, the Court may affirm the district court's judgment in favor of the U.S. Trustee without making a final determination as to the appropriate standard of deference.

C. Dengel's statutory arguments ignore the authority conferred upon the Attorney General by the statute and misapply certain canons of statutory interpretation.

Dengel argues that the statute's silence on the order in which expenses and compensation are to be paid should be interpreted as a prohibition of the U.S. Trustee's expenses-first policy. Br. of Appellant at 15 and 22. But such an argument ignores both the explicit grant of power to the Attorney General and U.S. Trustee under the statute and well-established interpretive rules in the administrative law context.

The statute's limits on a standing trustee's compensation do not occur in a vacuum, and cannot be read to imply that no other limits could be permissible. See Holloway v. United States, 526 U.S. 1, 7 (1999) (quoting Brown v. Gardner, 513 U.S. 115, 118 (1994), and King v. St. Vincent's Hospital, 502 U.S. 215, 221 (1991)) ("[T]he meaning of statutory language, plain or not, depends on context"). The statute explicitly states that its terms set only the *maximum* allowable compensation and fee. The statute thus does not create an entitlement to any particular amount of compensation, but rather merely establishes the ceiling which a trustee's compensation may not exceed. Moreover, the percentage limits to which Dengel cites occur in the provision granting the Attorney General the authority, among his other supervisory responsibilities, to set standing trustees' fees. Setting a trustee's fee, within the outer limits prescribed by the statute, is thus wholly within the Attorney General's discretion.

Dengel argues that the statute's mandatory language, i.e. "the Attorney General . . . *shall* fix" a fee not to exceed the maximum annual compensation and percentage limits, 28 U.S.C. § 586(e)(emphasis added), means that the Attorney General has no discretion whatsoever in calculating such a fee. However, the fact that the Attorney General must set *a* fee, does not mean that he is unable to determine the best methods for calculation and payment of that fee. The statute simply does not address how the Attorney General is to determine a standing trustee's fee within the maximum compensation and percentage limits set by § 586(e), and the Attorney General is therefore free to develop whatever methods best serve the trustee system. Cf. In re: BDT Farms, Inc., 21 F.3d 1019, 1023 (10th Cir. 1994) (finding § 586(e) ambiguous as to how to calculate percentage fees and deferring to the EOUST's reasonable construction of the statute); Pelofsky v. Wallace, 102 F.3d 350, 354-55 (8th Cir. 1996) (finding same provision ambiguous).

Dengel's argument that the statute's silence on the order in which expenses and compensation are to be paid forecloses the

U.S. Trustee's expenses-first policy ignores long-standing rules of statutory construction in the administrative context. See United States v. Wells, 519 U.S. 482, 496 (1997) (quoting NLRB v. Plasterers' Local Union No. 79, 404 U.S. 116, 129-130 (1971), and Girouard v. United States, 328 U.S. 61, 69 (1946)) ("[W]e have 'frequently cautioned that "[i]t is at best treacherous to find in congressional silence alone the adoption of a controlling rule of law"'").

Dengel cites to the interpretative canon *expressio unius est exclusio alterius* as support for his argument that the statute's identification of maximum limits on standing trustee compensation must mean that the Attorney General is unable to impose any other requirements on such compensation. But Congress did not illustrate one thing to the implied exclusion of others in § 586. Instead, that section merely sets a ceiling on standing trustees' compensation. The Attorney General, through the EOUST, is not exercising a new power not conferred on him by the statute, as was found to be the case in In re Brookover, 259 BR 884, 893 (Bankr. N.D. Ohio 2001) (Br. of Appellant at 22). Instead, the manner and order in which compensation and expenses are to be paid is precisely within the broad grant of statutory authority.

The Supreme Court, in Christensen v. Harris County, 529 U.S. 576 (2000), rejected an *expressio unius* argument similar to Dengel's. In Christensen, petitioners argued that a statutory provision requiring employers to permit employees to take compensatory time off implicitly prohibited employers from mandating that employees use their accrued compensatory time. The Supreme Court held that the statute spoke only to the situation in which employees requested compensatory time, and that the statute's silence regarding an employer requiring compensatory time to be taken could not be construed as a prohibition. Id. at 585.

In this case, the 1986 Act includes a specific requirement that the Attorney General set a fee for standing trustees within the parameters stated in the statute. As in Christensen, the statute's requirement that the Attorney General set a fee cannot be read as an implied prohibition on other actions taken by the Attorney General under his authority to supervise and remunerate standing trustees, so long as he complies with the specific limits in § 586.

II. The U.S. Trustee Correctly Calculated Dengel's Compensation and the U.S. Trustee System Fund is Entitled to Compensation Improperly Retained by the Standing Trustee.

The compensation orders set for the years 1990 to 1995 correctly calculated the compensation due to Dengel, as he acknowledged by accepting the terms of those orders through his direct assent and continued performance as a trustee. Though Dengel objected to the expenses-first policy, he elected to continue serving as a standing trustee with full knowledge that the policy would apply to him. The compensation orders reflect that policy, and Dengel does not contend that the U.S. Trustee erred in the application of its own policy, but rather that the policy should not have applied at all.

Dengel objects to the fact that in 1991 and 1992, his compensation was set at zero. Br. of Appellant at 26-28. As Dengel admits, his arguments on this point largely restate his attack on the EOUST's expenses-first, funds available policy, and they must fail for the reasons discussed above. In addition, the zero compensation orders were correctly calculated and are permissible, and even required, under the statute.

The compensation orders issued for each standing trustee each year reflect the statutory maximum limits in § 586 and the approved, budgeted expenses as submitted by the standing trustee. Where the projected expenses meet or exceed the level established by the maximum percentage fee and compensation under the statute, the compensation order will be set at zero. Zero compensation orders may thus be necessary in some circumstances in order to comply with the statutory caps on standing trustees' fees. In the two years in which Dengel received and accepted zero compensation orders, his submitted expenses left no room for compensation under the statutory maximum.

Contrary to Dengel's argument, the fact that the U.S. Trustee must approve expenses in order for them to be paid from the trust expense fund does not mean that the U.S. Trustee may not also seek to keep those expenses low. A proposed expense budget is approved based on information submitted by the standing trustee; the standing trustee thus retains the incentive under the expense-first policy to structure his budget in such a way that necessary expenses remain low enough to permit compensation.[8]

The standing trustee controls how his budget is presented, and knows his projected revenues for the year prior to submitting his budget. He is thus able to determine – based on his own estimates – whether, and to what extent, funds may be available for "compensation" after the payment of his projected expenses. Standing trustees are, or should be, fully aware of the trade-off between expenses and compensation under the statutory maximum, and should be bound by their decisions to accept compensation orders based on their own budgets. Allowing compensation to be paid first regardless of the level of expenses, as Dengel

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[8] For example, a standing trustee's proposed expenses may include costs for overhead items such as office computers. The U.S. Trustee may approve those costs because money for computers, within a reasonable range, is a common requirement of modern offices. However, the kind of computers, how frequently they are replaced, and the percentage of their use allocated to approved standing trustee activities are within the power of the standing trustee. The approval procedure would thus involve the U.S. Trustee approving computer costs as generally reasonable expenses. But the higher the expenses proposed by the standing trustee, the greater the risk that there would be insufficient funds left to pay him the maximum allowable compensation.

advocates, would provide no incentive to keep expenses low and refrain from carrying them forward year to year, to the cost of the farmer's estate.

28 U.S.C. § 586 states that money retained as compensation in excess of five percent of payments or the actual expenses and compensation as calculated under the statute must be returned to the U.S. Trustee System Fund. 28 U.S.C. § 586(e)(2). Thus, the money currently located in the Bank One "TF-12" account and court repository, which represents a portion of the amount withheld by Dengel in excess of his allowable compensation under the expenses-first policy, was properly found to be due and owing to the U.S. Trustee. Dengel argues that even if the money is not legally his, he is nonetheless entitled to it as a matter of property law. However, the disputed funds represent the over-withheld monies from family farmers' estates, and therefore must be returned to the U.S. Trustee directly under the statute.

CONCLUSION

For the foregoing reasons, this Court should affirm the decision of the district court.

Respectfully submitted,

ROBERT D. McCALLUM, JR.
Assistant Attorney General

JAMES LETTEN
United States Attorney

WILLIAM KANTER
(202) 514-4575
FREDDI LIPSTEIN
(202) 514-4815
KATHLEEN A. KANE
(202) 514-3972
Attorneys, Appellate Staff
Civil Division, Room 9102
Department of Justice
601 "D" Street, N.W.
Washington, D.C. 20530-0001

Of Counsel:

ANTHONY J. CICCONE
Trial Attorney
Exec. Office for
United States Trustees
Department of Justice
901 E St., N.W., Suite 780
Washington, D.C. 20530

OCTOBER 2002

CERTIFICATE OF SERVICE

I hereby certify that on this 2d day of October, 2002, I filed and served the foregoing BRIEF FOR THE APPELLEES by causing the signed original, six copies, and one disk copy to be sent to this Court by Federal Express for overnight delivery; and by causing two paper copies and one disk copy of the foregoing brief to be served by Federal Express upon:

Kevin O'Bryon
O'Bryon & Schnabel, PLC
1515 Poydras Street, Suite 830
New Orleans, LA 70112
(504) 799-4200
(Counsel for Appellant)

Brett P. Furr
8th Floor
Taylor, Porter, Brooks & Phillips
451 Florida Street
Bank One Building
Baton Rouge, LA 70801
(225) 387-3221
(Counsel for Bank One)

KATHLEEN A. KANE
Attorney for Plaintiff-Appellee

CERTIFICATE OF COMPLIANCE

I hereby certify that, pursuant to Fed. R. App. 32(a)(7)(C), the foregoing brief was prepared using WordPerfect 9, Courier Font, 12 point and contains 7149 words.

____
KATHLEEN A. KANE
Attorney for Plaintiff-Appellee

BRIEF BANK — "SUMMARY SHEET" *Printed Mon-11/3/08 14:17*

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1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	In re: Sam Dillon
2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	E.D. Tex.
3. ("CCN") ***CURRENT*** CASE NO.	No.: 9:07-cv-00120-TH
4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*	No.: 07-90017 Court: Bankr. E.D. Tex. *(Identify judge & cite, if any)*
5. ("SO") ***SOURCE***	**U.S. TRUSTEES**
6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	Filed: August 16, 2008 Type: Brief of Appellee the United States Trustee
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United States Department of Justice
Office of the United States Trustee
300 Plaza Tower
110 N. College
Tyler, Texas 75702
(903) 590-1450

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF TEXAS
LUFKIN DIVISION

	§	
In Re	§	
	§	
Sam Dillon, Appellant	§	No. 09:07-cv-00120
	§	
v.	§	
	§	Appeal from the Bankruptcy Court
United States Trustee, Appellee	§	

BRIEF OF APPELLEE THE UNITED STATES TRUSTEE

Respectfully submitted.

William T. Neary
United States Trustee

By: Timothy W. O’Neal
Assistant U.S. Trustee
Texas Bar 15283350
300 Plaza Tower
110 N. College
Tyler, Texas 75702
(903) 590-1450 Ext 215.
(903) 590-1461 (Fax)

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RULES

I. JURISDICTION

This court has jurisdiction over this appeal pursuant to 28 U.S.C. §158(a)(1) and 28 U.S.C. §1334. This matter is an appeal from an order of the United States Bankruptcy Court for the Eastern District of Texas, Lufkin Division, Hon. Bill Parker presiding, which dismissed the Appellant's Chapter 7 bankruptcy case by order of March 28, 2007.

II. PARTIES AND PROCEDURAL HISTORY

The Appellant, Sam Dillon, filed a *pro se* Chapter 7 bankruptcy petition, case no. 07-90017, in the United States Bankruptcy Court for the Eastern District of Texas, Lufkin Division, on January 16, 2007. The Appellee is the United States Trustee for Region 6, which is comprised of the Northern and Eastern Judicial Districts of Texas. Pursuant to 28 U.S.C. §586(a)(3), the United States Trustee is empowered to "...supervise the administration of cases and trustees in cases under chapter 7, 11, 12, 13 of title 11." Pursuant to 11 U.S.C. § 307, the United States Trustee has standing to "...raise and appear and be heard on any issue in any case or proceeding" under the United States Bankruptcy Code, 11 U.S.C. §§ 101-1532 (the "Bankruptcy Code").

On February 2, 2007, the United States Trustee moved to dismiss Dillon's chapter 7 bankruptcy case. Dillon filed a response to the Motion to Dismiss on February 15, 2007. Following an hearing conducted on March 27, 2007, the bankruptcy court granted the motion to dismiss by an order dated March 28, 2007. On April 9, 2007, Dillon filed his notice of appeal, and on May 4, 2007, the clerk of the bankruptcy court certified the transmission of the record on appeal to this Court.

III. STANDARD OF REVIEW

A district court sitting in review of a bankruptcy court employs the same standards of review as a federal court of appeal: the bankruptcy court's findings of fact are reviewed for clear error, and its conclusions of law are reviewed *de novo*. *See* 28 U.S.C. § 158(c); Fed.R. Bankr. P. 8013; *Robertson v. Dennis (In re Dennis),* 330 F.3d 696, 701 (5th Cir.2003); *Century Indem. Co. v. Nat'l Gypsum Co. Settlement Trust (In re National Gypsum Co.)*, 208 F.3d 498, 504 (5th Cir.), *cert. denied*, 531 U.S. 871, 121 S.Ct. 172, 148 L.Ed.2d 117 (2000); *In re T-H New Orleans Ltd. Partnership, 116 F.3d 790 (5th Cir.1997); and In re Consolidated Bancshares, Inc*., 785 F.2d 1249 (5th Cir. 1986).

IV. STATEMENT OF THE ISSUE

The sole issue before this Court is whether the bankruptcy court erred in dismissing Dillon’s chapter 7 bankruptcy case due to his failure to comply with section 109(h) of the Bankruptcy Code.

V. STATEMENT OF THE CASE

Dillon filed a petition for chapter 7 bankruptcy relief on January 16, 2007. Under the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, individual debtors are required either to obtain credit counseling prior to the filing of their bankruptcy petition, or must file a request to be excused from credit counseling requirements along with their bankruptcy petition. *See* 11 U.S.C. 109(h); Fed. R. Bankr. P. 1007(b)(3) [Interim]. Dillon did neither of these things. As a result, on February 7, 2007, the United States Trustee moved to dismiss Dillon’s bankruptcy case. [Dkt. 7]. Thereafter, on February 26, 2007, Dillon filed an untimely request to be excused from the credit counseling requirements of the Bankruptcy Code, alleging that he is both "incapacitated" and "disabled."[1]

On March 28, 2007, the bankruptcy court granted the United States Trustee's motion and dismissed Dillon's bankruptcy case. [Dkt. 16] At the hearing on the motion to dismiss, for which Dillon presented no testimony or evidence, the bankruptcy court observed that Dillon had been an "articulate representative" of his interests in proceedings before the bankruptcy court, and further noted that notwithstanding Dillon's claims of physical disability, he was able to personally appear in court and was "clearly capable of engaging in a telephone conversation with a credit counselor." As a result, the court found that Dillon's physical condition was not an "incapacity or disabilty" sufficient to relieve him from the Bankruptcy Code's credit counseling requirements. [Tr. of March 27, 2007, hearing at 9-10].

VI. ARGUMENT AND AUTHORITIES.

Section 109(h) of the Bankruptcy Code reflects a Congressional intention that bankruptcy relief should be available only to persons who have made a good-faith effort to seek credit counseling prior to making the decision to file for bankruptcy. In relevant part, section 109(h) provides that:

> [A]n individual may not be a debtor under this title unless such individual has, during the 180-day period preceding the date of filing of the petition by such individual, received from an approved nonprofit budget and credit counseling agency described in section 111(a) an individual or group briefing (including a briefing conducted by telephone or

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[1] Dillon's opening brief suggests that the United States Trustee's motion to dismiss "wrongfully" claimed that Dillon had not requested an exemption from credit counseling requirements. In fact, while Dillon eventually filed such a request, the docket of the bankruptcy case reflects that Dillon did not file this request until February 26, 2007– 19 days after the United States Trustee filed his motion to dismiss. In any event, as discussed above, Dillon was required to have filed his request for exemption along with his initial bankruptcy petition, which he failed to do.

> on the Internet) that outlined the opportunities for available credit counseling and assisted such individual in performing a related budget analysis.

11 U.S.C. § 109(h)(1).[2]

In seeking to be excused from the requirements of section 109(h)(1), Dillon relies on a limited exception under by section109(h)(4), which provides:

> The requirements of paragraph (1) shall not apply with respect to a debtor whom the court determines, after notice and hearing, is unable to complete those requirements because of incapacity, disability, or active military duty in a military combat zone. For the purposes of this paragraph, incapacity means that the debtor is impaired by reason of mental illness or mental deficiency so that he is incapable of realizing and making rational decisions with respect to his financial responsibilities; and **"disability" means that the debtor is so physically impaired as to be unable, after reasonable effort, to participate in an in person, telephone, or Internet briefing required under paragraph (1).**

11 U.S.C. §109(h)(4) (emphasis added).

Section 109(h)(4) does not exempt all debtors who claim a disability from the credit counseling requirements of section 109(h). Rather, by its plain terms, section 109(h)(4) is a narrow exception that applies in cases of disabilities that render the debtor unable, after reasonable effort, to participate in a credit counseling briefing. *See In re Hall*, 347 B.R. 532, 545 (Bankr. N.D.W.V. 2006) (noting that section 109(h)(4) was intended to address the “absurd situation” that would result if debtors suffering from Alzheimer’s disease or similar conditions were required to undergo credit counseling).

Furthermore, the debtor bears the burden of demonstrating that the section 109(h)(4) exception is applicable. *See In re Tulper,* 345 B.R. 322, 326 (Bankr. D. Colo. 2006). In particular, the debtor must demonstrate three elements: “(1) the debtor is severely physically

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[2] The United States Trustee Program has determined that adequate credit counseling services exist in the Eastern District of Texas. *See generally*, 11 U.S.C.§111. A list of approved non-profit credit counseling agencies is available to the public at the United States Trustee program’s website at: http://www.usdoj.gov/ust/eo/bapcpa/ccde/index.htm

impaired; (2) the debtor has made a reasonable effort, despite the impairment, to participate in the prepetition credit counseling; and (3) the debtor is unable, because of the impairment, to participate meaningfully in an in person, telephone, or Internet briefing prepetition." *Id.*

The bankruptcy court's finding that Dillon failed to satisfy the section 109(h)(4) test was not clearly erroneous. Although Dillon offered no evidence as to the nature or extent of his illness, the bankruptcy court determined, based on its own in-person observation, that Dillon was intelligent and articulate and, at the very minimum, fully capable of participating in a telephonic credit counseling session. [Tr. of March 27, 2007, hearing at 9-10]. The bankruptcy court's findings on this point are entitled to a considerable degree of deference. *See Reich v. Lancaster*, 55 F.3d 1034 (5th Cir. 1995) (noting that on appeal, trial judge's "unique perspective to evaluate witnesses and to consider the entire context of the evidence must be respected") (internal citations omitted). In addition, the record is devoid of any indication that Dillon has ever made a good faith effort to seek credit counseling notwithstanding his disability.

Based on the foregoing, Dillon was not eligible to be a debtor in a bankruptcy case under section 109(h) of the Bankruptcy Code. As a result, the bankruptcy court properly dismissed Dillon's chapter 7 case. *See In re Henderson*, 364 B.R. 906, 908 (Bankr. N.D. Tex. 2007) (holding that court may dismiss case where credit counseling requirements of section 109(h) are not satisfied); *accord In re Sosa*, 336 B.R. 113 (Bankr. W.D. Tex. 2005); *In re Jones*, 352 B.R. 813 (Bankr .S.D. Tex. 2006).

VII. CONCLUSION

For the foregoing reasons, the bankruptcy court's order dismissing Dillon's bankruptcy case should be affirmed.

Dated: August 16, 2007 Respectfully submitted,

/S/ Timothy W. O’Neal
William T. Neary
United States Trustee
By: Timothy W. O'Neal
Tx. Bar 15283350
300 Plaza Tower
110 N. College
Tyler, Texas 75702

Certificate of Service

The undersigned hereby certifies that a copy of the foregoing document was served on the following listed persons by First Class United States Mail, postage prepaid, this the day of 16th day of August, 2007.

/S/ Timothy W. O’Neal

Sam Dillon
PO Box 254
Timpson, TX 75975
Pro Se

BRIEF BANK — "SUMMARY SHEET" *Printed Mon-5/23/11 13:37*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]* In re Kenneth A. Dixon, et als. (Kenneth A. Dixon, et als. v. United States Trustee, Region 3)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]* E.D. Pa.

3. ("CCN") ***CURRENT*** CASE NO. No.: 09-cv-01451-JF

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]* No.: 08-10510

Court: Bankr. E.D. Pa.

(Identify judge & cite, if any)

5. ("SO") ***SOURCE*** **U.S. TRUSTEES**

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*

Filed: May 18, 2009

Type: Brief of the Appellee, United States Trustee

7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]* George Conway, Diarmuid Gorham, P. Matthew Sutko, Frederic Baker, Roberta A. DeAngelis

(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC*** **BANKRUPTCY**

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***

• 1) Whether the debtors challenged the order dismissing their case in their notice of appeal. 2) Whether the bankruptcy court abused its discretion in denying the debtors' motion for reconsideration because it properly found cause justifying dismissal of the bankruptcy petition.

10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)

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UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

In re: KENNETH A. DIXON, et als., Debtors

Chapter 13 Proceedings

Bankr. Case Nos. 08-10510

KENNETH A DIXON, et als.,
Debtors

Appellants,

v.

UNITED STATES TRUSTEE,
for Region 3

Appellee.

Appeal No. CA 09-1451

BRIEF OF THE APPELLEE, UNITED STATES TRUSTEE

Roberta A. DeAngelis,
ACTING UNITED STATES TRUSTEE

FREDERIC J. BAKER,
SENIOR ASSISTANT UNITED STATES TRUSTEE

George M. Conway,
Trial Attorney
Office of the U.S. Trustee
Department of Justice
Suite 500, 833 Chestnut Street
Philadelphia, PA 19107
Phone: (215) 597-4411
Fax: (215) 597-5795

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STATEMENT OF JURISDICTION

The United States Bankruptcy Court for the Eastern District of Pennsylvania had jurisdiction over the underlying bankruptcy case and this matter as a core proceeding under 28 U.S.C. § 1334 and 28 U.S.C. §157(b)(1), (b)(2)(A) & (B).

This Court has jurisdiction to adjudicate appeals from "final judgments, orders and decrees" of the bankruptcy court pursuant to 28 U.S.C. § 158(a)(1). The bankruptcy court's January 20, 2009 order dismissing the Dixons' bankruptcy case and February 26, 2009 order denying the Dixons' Motion for Reconsideration are final orders over which this Court has jurisdiction. *See In re BH & P, Inc.* 949 F.2d 1300, 1306-07 (3d Cir. 1991); *F/S Airlease II, Inc. v. Simon,* 844 F.2d 99, 103-05 (3d Cir. 1988).

STATEMENT OF APPELLEE'S RESPONSES TO ISSUES PRESENTED BY APPELLANTS

I. The Dixons did not challenge the order dismissing their case in their Notice of Appeal.

II. The Bankruptcy Court did not abuse its discretion in denying the Dixons' Motion for Reconsideration because it properly found cause justifying dismissal of the bankruptcy petition.

STANDARD OF REVIEW

A district court acting in its capacity as an appellate court reviewing the decision of a bankruptcy court applies an abuse of discretion standard to holdings involving matters within the bankruptcy court's discretion. *In re Ventietes Ltd.,* 845 F.2d 57, 58-59 (3d Cir. 1988); *In re Robbins*, 964 F.2d 3342 (4th Cir. 1992); *see also Fellheimer, Eichen & Braverman, P.C. v. Charter Technologies. Inc.*, 57 F3d 1215, 1223 (3d Cir. 1995). This Court reviews the bankruptcy court's legal determinations *de novo*. *See In re RBGSC Inv. Corp.*, 253 B.R. 352, 362 (E.D. Pa. 2000). *See* *also In re Trans World Airlines, Inc.*, 145 F.3d 124, 131 (3d Cir. 1998), *citing In re Continental Airlines*, 125 F.3d 120, 128 (3d Cir. 1997), *cert. denied*, 522 U.S. 1114, 118 S. Ct. 1049, 140 L.Ed.2d 113 (1998)); *Zolfo, Cooper & Co. v. Sunbeam-Oster Co., Inc.*, 50 F.3d 253, 257 (3d Cir. 1995). And this Court adheres to a "clearly erroneous" standard when reviewing the bankruptcy court's findings of fact. *See In re Morrissey*, 717 F.2d 100, 104 (3d Cir. 1983). *See also* Fed. R. Bankr. P. 8013.

STATEMENT OF THE CASE

Kenneth A. Dixon and Valerie D. Dixon filed a chapter 13 petition for relief on January 21, 2008.[1] This was Mr. Dixon's fourth bankruptcy case and the Dixons' second joint filing.[2] The Dixons initially filed inaccurate and incomplete schedules.[3] They failed to list all of their bank accounts, failed to accurately state the value of their accounts, failed to list two of the four automobiles they owned, and failed to correctly disclose Mr. Dixon's sole ownership interest in certain real property located at 820 South 56th Street, Philadelphia, Pennsylvania (the "Real Property").[4] Their original and amended schedules indicated that the Real Property was owned jointly by Kenneth Dixon and his mother when in fact it was titled solely in Kenneth Dixon's name.[5] Mr. Dixon affirmed this representation in testimony before the bankruptcy court in connection with thirteen separate motions filed by the Dixons seeking to avoid certain judgment liens.[6] The bankruptcy court relied on this testimony in rendering its decision on those motions.[7] The Dixons also gave conflicting testimony regarding the value of the Real Property, and gave conflicting

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1 Ch. 13 Vol. Pet., Docket No. 1.
2 Debtors' Mot. Reconsid., Docket No. 193 at ¶ 5.
3 Mem. Op., Jan. 20, 2009 at 2-4 and 6, Docket No. 185.
4 *Id.*
5 *Id.* at 2.
6 *Id.* at 2 and n. 2.

testimony with respect to the filing of tax returns.[8] Finally, the Dixons failed to produce all documents and information requested of them despite orders by the bankruptcy court. Even after multiple amendments to their schedules and a 2004 examination conducted by the United States Trustee, the Dixons' schedules were still not accurate and various questions regarding their financial affairs remained unanswered.[9]

On October 29, 2008 the United States Trustee filed a motion to dismiss the Dixons' bankruptcy case pursuant to 11 U.S.C. § 1307(c) alleging that the Dixons' repeated failure to file accurate schedules and provide complete and accurate information regarding their financial affairs demonstrated cause justifying dismissal of the case.[10]

After conducting a hearing, the bankruptcy court entered an Order (and Memorandum Opinion) dismissing the Dixons' bankruptcy case on January 20, 2009 (the "Dismissal Order").[11] The Dixons filed a Motion for Reconsideration and/or Motion to Vacate the Dismissal Order on January 30, 2009 ("Motion for Reconsideration").[12] The United States Trustee and Rachel Dorsey, a creditor, opposed the Motion for Reconsideration.[13] After a hearing, the bankruptcy court entered an Order denying the Dixons' Motion for Reconsideration on February 26, 2009 ("Order Denying Reconsideration").

On March 7, 2009, the Dixons filed a notice of appeal stating in pertinent part:

> Kenneth A. & Valerie D. Dixon, Debtors, appeals [*sic*] under 28 U.S.C. §158(a) or (b) from the judgment, order, or decree of Judge Diane W. Sigmund, U.S.

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[7] *Id*.
[8] *Id.* at 2-3.
[9] *Id.* at 6.
[10] U.S. Trustee Mot. Dismiss, Oct. 29, 2008, Docket No. 170.
[11] Docket Nos. 185 and 186. As a result of its findings, the bankruptcy court also vacated its orders with respect the lien avoidance motions because its conclusions were erroneously based on Mr. Dixon's misrepresentations regarding ownership of the Real Property. *See* Mem. Op., Jan. 20, 2009 at 2 and n. 2, Docket No. 185.
[12] Docket No. 193.
[13] Docket Nos. 195 and 196.

> Bankruptcy Judge, denying Debtors' Motion for Reconsideration and/or Motion to Vacate Dismissal Order, entered in this Bankruptcy case on the 26th day of February, 2009.

Not. of Appeal, March 7, 2009, Docket No. 203. The Dixons attached the Order Denying Reconsideration to the notice of appeal. The notice of appeal did not reference the Dismissal Order. The Dixons' March 31, 2009 statement of issues on appeal framed the issues on appeal as follows:

> a. Whether the Bankruptcy Court applied the wrong legal standard, application of fair market value [In re Miller, 299 F.3d 183, 186 (3d Cir. 2002] rather than speculate value to determine the Motions to Avoid, as a factor for dismissing the case.
> b. Whether the Bankruptcy Court applied the wrong legal standard, in that it should have applied the Atypical Debtors Conduct standard of Marrama vs. Citizens Bank of Mass., 549 U.S. 365 (2007) to determine whether to dismiss this case; and
> c. Whether the Bankruptcy Court, in the absence of fraudulent conduct, should have applied less drastic sanctions short of dismissal of this case.

Statement of Issues on Appeal, March 17, 2009, Docket No. 208.

ARGUMENT

I. *The Dixons did not challenge the order dismissing their case in their notice of appeal so they have forfeited arguments on the merits of that issue.*

Federal Rule of Appellate Procedure 3(c) requires that a notice of appeal "designate the judgment, order or part thereof appealed from." The Dixons' appeal "the judgment, order, or decree of Judge Diane W. Sigmund, U.S. Bankruptcy Judge, denying Dixons' Motion for Reconsideration and/or Motion to Vacate Dismissal Order, entered in this Bankruptcy case on the 26th day of February, 2009." Not. of Appeal, March 7, 2009, Docket No. 203.

Thus, the Dixons only challenged the Order Denying Reconsideration, not the Dismissal Order, and on appeal, they can challenge only the former, not the latter. *See Aybar v. Crispin-Reyes*, 118 F.3d 10 (1st Cir. 1997); *Irving Trust Co. Of New York v. Nelson* (*In re Schulte-United, Inc.*), 59

F.2d 553, 559 (8th Cir.1932) (holding that a motion to vacate an order, and an appeal from the denial of that motion, is not the equivalent of an appeal from the order itself, therefore, the reviewing court can only review the propriety of denying the motion to vacate).

The Dixons' opening brief fails to argue any basis supporting a finding of error in the bankruptcy court's denial of reconsideration of the Dismissal Order. They cite no manifest errors of law or fact that would support reconsideration of the Dismissal Order. *See Harsco Corp. v. Zlotnicki,* 779 F.2d 906, 908 (3d Cir. 1985) ("purpose of a motion for reconsideration is to correct manifest errors of law or fact or to present newly discovered evidence").

The Dixons substantively argue the merits of dismissal and seek to set aside the Dismissal Order. However, appellate review in this instance must be limited to the Order Denying Reconsideration, which should be affirmed given the absence of any basis supporting a finding that the bankruptcy court abused its discretion in denying reconsideration. *See, e.g., Max's Seafood Cafe v. Quinteros,* 176 F.3d 669, 673 (3d Cir. 1999) (decision to grant or deny motion for reconsideration reviewed under and abuse of discretion standard); *Marta Group v. County Appliance Co., Inc.,* 79 B.R. 200 (E.D. Pa. 1987) (standard of review of a bankruptcy judge's denial of a motion for reconsideration is whether the bankruptcy judge abused his discretion).

II. *The Bankruptcy Court did not abuse its discretion in denying the Dixons' Motion for Reconsideration because it properly found cause justifying dismissal of the bankruptcy petition.*

To the extent the Dixons' notice of appeal can be read to appeal the Dismissal Order, they appear to argue that the bankruptcy court applied the wrong legal standard in finding that "cause" existed under 11 U.S.C. § 1307 justifying dismissal of their case. Therefore, the bankruptcy court erred in denying reconsideration of the Dismissal Order. The Dixons further conflate these arguments with unsubstantiated contentions that the bankruptcy court's factual findings were erroneous.

The motion of the United States Trustee and the holding of the bankruptcy court were grounded upon 11 U.S.C. § 1307(c), which provides in pertinent part that "on request of a party in interest or the United States trustee and after notice and a hearing, the court may . . . dismiss a case under this chapter, whichever is in the best interests of creditors and the estate, for cause . . .." Section 1307 enumerates several non-exclusive factors establishing cause under section 1307.[14] The determination of cause under section 1307, as well as the resulting sanction, is subject to the

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[14] The factors enumerated in section 1307 include: (1) unreasonable delay by the debtor that is prejudicial to creditors; (2) nonpayment of any fees and charges required under chapter 123 of title 28; (3) failure to file a plan timely under section 1321 of this title; (4) failure to commence making timely payments under section 1326 of this title; (5) denial of confirmation of a plan under section 1325 of this title and denial of a request made for additional time for filing another plan or a modification of a plan; (6) material default by the debtor with respect to a term of a confirmed plan; (7) revocation of the order of confirmation under section 1330 of this title, and denial of confirmation of a modified plan under section 1329 of this title; (8) termination of a confirmed plan by reason of the occurrence of a condition specified in the plan other than completion of payments under the plan; (9) only on request of the United States trustee, failure of the debtor to file, within fifteen days, or such additional time as the court may allow, after the filing of the petition commencing such case, the information required by paragraph (1) of section 521; (10) only on request of the United States trustee, failure to timely file the information required by paragraph (2) of section 521; or (11) failure of the debtor to pay any domestic support obligation that first becomes payable after the date of the filing of the petition. 11 U.S.C. § 1307(c). Because section 1307 uses the word "including," these factors are illustrative rather than limiting. 11 U.S.C. 102(3) (Rule of construction for the word "including" in the Bankruptcy Code).

considerable discretion of the bankruptcy court. *See, e.g., In re Orawsky*, 387 B.R. 128, 137 and n. 15 (Bankr. E.D. Pa. 2008), citing *In re Kane,* No. 94-16181, 1998 WL 259945, at *3 (Bankr. E.D. Pa. May 18, 1998) ("the decision of whether to dismiss a case under § 1307(c) is within the discretion of the Court"); *In re Cottle,* 189 B.R. 591 (Bankr. E.D. Pa. 1995); *In re Samuel,* 77 B.R. 520 (Bankr. E.D. Pa. 1987); 8 *Collier on Bankruptcy,* ¶ 1307.04[4] (15th ed. rev.) ("As under the other subsections of section 1307(c) [i.e., sections other than § 1307(c)(4)], the court's power to dismiss or convert is discretionary"). The bankruptcy court weighs all relevant factors and determines whether individually, or collectively, they establish cause.

The bankruptcy court made numerous findings supporting its decision that the "totality of circumstances" justified dismissal of the Dixons' bankruptcy case for cause under section 1307.[15] Among other things, the bankruptcy court expressly found that:

> 1. "[T]he Debtors have played fast and loose with the Court;"[16]
> 2. "[T]he Debtors have at best adopted a cavalier attitude toward the filing of their schedules, leaving to the Court and creditors the unacceptable burden of fettering out the true facts;"[17]
> 3. "The original Schedules were replete with material inaccuracies, failing to disclose vehicles owned and bank accounts held and misstating the ownership of the 56th Street Property;"[18]
> 4. "[E]ven with the filing of amended schedules and Kenneth's submission to a Rule 2004 examination, the Debtors have still not provided accurate and complete

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[15] Mem. Op., Jan. 20, 2009 at 7, Docket No. 185. The Dixons also argue in their brief that the bankruptcy court applied improper valuation standards in determining the value of the Real Property. The merits of this argument are irrelevant because the Dismissal Order was based on an assessment of the totality of circumstances, not any one factor. The bankruptcy court recognized in its order denying reconsideration (while disagreeing with the Dixons' valuation position) that this issue would not have altered its decision. *See* Order Denying Mot. Reconsid., February 26, 2009, at n. 3, Docket No. 200.

[16] Mem. Op., Jan. 20, 2009 at 6, Docket No. 185.

[17] *Id.*

[18] *Id.*

information;”[19]

5. “The values of the real estate assets list have been impeached by contradicting evidence of values affixed by Debtors for insuring same assets. Kenneth’s testimony failed to put these disparities to rest;”[20]

6. “Bank documents requested have not been produced allegedly because the Debtors did not wish to incur cost, suggesting that they still do not comprehend their responsibilities in this case which has been pending for one year without confirmation of a Chapter 13 plan;”[21] and

7. “Parties in interest have still been unable to verify the assets held and their value.”[22]

Independently, each of these findings would be sufficient to establish cause for dismissal. Collectively, they make clear that the bankruptcy court did not abuse its discretion in dismissing the Dixons’ case for cause. The Dixons fail to cite anything in the record establishing that the bankruptcy court’s findings were clearly erroneous. Both the Dismissal Order and the accompanying Memorandum Opinion expressly indicate that the bankruptcy court dismissed the case for cause based on the “totality of the circumstances.” *Id.* at 7.

The Dixons suggest that the bankruptcy court erred in the application of its factual findings, by employing the improper legal standard in concluding that “[b]ased upon the totality of the circumstances as described above this Chapter 13 case shall be dismissed.” Mem. Op., Jan. 20, 2009 at 7, Docket No. 185. In challenging the bankruptcy court’s ruling, the Dixons focus exclusively on the issue of bad faith, claiming without support in the record, that the bankruptcy court’s findings were erroneous and dismissal was improper under *Marrama v. Citizens Bank*, 549 U.S. 365, 127 S. Ct. 1105 (2007).

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[19] *Id.*

[20] *Id.*

First, bad faith is but one reason to dismiss a chapter 13 case. 11 U.S.C. §§ 102(3) and 1307. The record in this case establishes that there were multiple bases for dismissal. For example, the bankruptcy court expressly noted that section 1307(c)(1) was implicated, explaining that "so long as there is doubt about the accuracy of the Dixons' disclosures, plan confirmation, which has been continued five times, shall elude and creditors shall be unreasonably delayed." Mem. Op., Jan. 20, 2009 at 6, Docket No. 185. This Court can affirm unless the bankruptcy court was clearly erroneous in finding each of them.

Second, *Marrama* does not stand for the proposition asserted by the Dixons that, as a pre-requisite to dismissal, the bankruptcy court was obligated to factually conclude that they engaged in conduct intended to defraud creditors. *See* App. Brief at 13. However, this conclusion is expressly contradictory to the language of section 1307(c), which is not limited to bad faith.

In *Marrama*, a chapter 7 debtor sought to convert his case to chapter 13 after the trustee and creditors discovered that he had materially misstated the value and ownership of certain real property in his schedules. *Marrama*, 549 U.S. at 368-69. The *Marrama* decision questioned whether the bankruptcy court could restrict the debtor's absolute right to convert under the bankruptcy code, to prevent an abuse of process. *Id.* at 374-75.

At best, the Court in *Marrama* noted in *dicta* (in a footnote) that it had "no occasion here to articulate with precision what conduct qualifies as 'bad faith' sufficient to permit a bankruptcy court judge to dismiss a Chapter 13 case . . .. It suffices to emphasize that a debtor's conduct must, in fact, be atypical. . . ." *Id.* at 375, n.11. Thus, the Dixons seem to further argue that unless their conduct was "atypical" the bankruptcy court erred in dismissing their case. *See* App. Brief at 13.

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21 *Id.*

The record clearly demonstrates that the conduct of the Dixons is anything but typical of chapter 13 debtors. A failure to disclose vehicles and bank accounts on schedules is not typical. A cavalier attitude by the Dixons toward the filing of their schedules, leaving to the Court and creditors the unacceptable burden of fettering out the true facts is not typical. The fact that the Dixons' original schedules were replete with material inaccuracies is not typical. The filing of amended schedules and Mr. Dixon's submission to a Rule 2004 examination, while still failing to provide accurate and complete information is not typical. *See* Mem. Op., Jan. 20, 2009 at 6, Docket No. 185. The inconsistencies with respect to the ownership and valuation of the Real Property are not typical. Bank documents requested but not being produced, allegedly because the Dixons did not wish to incur cost, is not typical. The case being pending for one year without confirmation of a Chapter 13 plan is not typical. The inability of parties in interest to verify the assets held and their value is not typical. The atypical conduct of the Dixons clearly supported the findings of the bankruptcy court.[23]

Although, the record reflects that the Dixons' conduct in this case was atypical, the conclusion is unnecessary, because the bankruptcy court never expressly ruled that its decision to dismiss was based solely on bad faith. While it recognized bad faith as one reason to dismiss, the court ruled that dismissal was warranted based on a number of several circumstances. *See* Mem. Op., Jan. 20, 2009 at 2, 5 and 7, Docket No. 185.

CONCLUSION

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22 *Id.*

23 The Dixons also cite *In re Tamecki*, 229 F.3d 205, 207 (3d Cir. 2000), for the proposition that "dismissal based on lack of good faith . . . should be confined carefully and is generally utilized only in those egregious cases that entail concealed or misrepresented assets and/or sources of income, lavish lifestyles, and intention to avoid a large single debt upon conduct akin to fraud, misconduct or gross negligence." The Dixons claim that their conduct does not rise to such level. However, the Dixons omit that the burden to demonstrate "good faith" is theirs. *Id.* at 207. S*ee also In re Zick*, 931 F.2d 1124, 1126-27 (6th Cir. 1991); *In re Marks*, 174 B.R. 37, 40 (E.D. Pa. 1994). The Dixons do not demonstrate their good faith or the bankruptcy court's failure to consider same. This failure on the Dixons' part to prove their good faith leaves this Court unable to find error with the bankruptcy court's ruling. *See In re Tamecki*, 229 F.3d 205 at 208.

For these reasons, the United States Trustee respectfully asks this Court to affirm the order of the bankruptcy court entered below.

Respectfully submitted,

ROBERTA A.DeANGELIS
ACTING UNITED STATES TRUSTEE
REGION 3

FREDERIC J. BAKER
Senior Assistant United States Trustee

George M. Conway
Trial Attorney
Office of the United States Trustee
Department of Justice
833 Chestnut Street, Suite 500
Philadelphia, PA 19107
Phone: (215) 597-4411

BRIEF BANK — "SUMMARY SHEET" Printed Tue.-8/10/99 (10:20)

WESTLAW CODES

1. ("TI") TITLE OF CASE [E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]
In re Donovon Corp. — Linda Ekstrom Stanley,
U.S. Trustee for Region 17 (Appellant) **v.**
McCormick, Barstow, Sheppard, Wayte & Carruth (Appellee)

2. ("CO") CURRENT COURT [E.g., "CTA9"]
CTA-9

3. ("CCN") CURRENT CASE NO.
No.: **98-17313**

4. ("PCN") PRIOR CASE NO. & COURT [IF ANY]
No.: **CV-F-98-5651-REC**
Court: **E.D. Cal.**
(Identify judge & cite, if any)

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Jeanne M. Crouse (UST/OGC)
Peter H. Carroll, Asst. U.S. Trustee (Fresno), Of Counsel
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") TOPIC
BANKRUPTCY

9. ("SU") • SUMMARY OF KEY ISSUE(s) & / Any Miscellaneous BACKGROUND

- Standing of U.S. Trustee to appeal under 11 U.S.C. 307

/ **Background:** Case trustee sought disgorgement of fees paid to counsel for debtor-in-possession & UST filed supportive pleadings. Bankruptcy Court denied motion, & UST appealed to D.Ct. However, D.Ct. dismissed UST as a party for "lack of standing," & UST appealed to CTA9.

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IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

No. 98-17313

IN RE DONOVON CORP., et al., Debtor.

***

LINDA EKSTROM STANLEY, UNITED STATES TRUSTEE
for Region 17, Appellant,
v.
McCORMICK, BARSTOW, SHEPPARD, WAYTE & CARRUTH, Appellee.

ON APPEAL FROM
THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF CALIFORNIA

BRIEF FOR THE APPELLANT, UNITED STATES TRUSTEE

LINDA EKSTROM STANLEY
United States Trustee for Region 17
U.S. Department of Justice
250 Montgomery Street, Suite 910
San Francisco, California 94104
(415) 705-3300

MARTHA L. DAVIS
General Counsel
JEANNE M. CROUSE
Attorney
U.S. Department of Justice
Executive Office for
United States Trustees
Office of the General Counsel
901 E St., N.W., Suite 780
Washington, D.C. 20530
(202) 307-1399

OF COUNSEL:
PETER H. CARROLL
Assistant United States Trustee
U.S. Department of Justice
1130 “O” Street
Suite 1110
Fresno, California 93721
(209) 498-7400

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IN THE UNITED STATES COURT OF APPEALS
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No. 98-17313

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LINDA EKSTROM STANLEY, UNITED STATES TRUSTEE
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v.

McCORMICK, BARSTOW, SHEPPARD, WAYTE & CARRUTH, Appellee.

ON APPEAL FROM
THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF CALIFORNIA

BRIEF FOR THE APPELLANT, UNITED STATES TRUSTEE

STATEMENT OF SUBJECT MATTER & APPELLATE JURISDICTION

The bankruptcy court had jurisdiction over the underlying chapter 7 case pursuant to 28 U.S.C. § 157 and 28 U.S.C. § 1334. Supervision of a case trustee and review of final distribution to claimants, including professionals, in a bankruptcy case constitute core proceedings under 28 U.S.C. §157(b)(2). Thus, the bankruptcy court's jurisdiction was properly based on 28 U.S.C. § 157(b)(1). On May 29, 1998, the bankruptcy court entered its order denying the disgorgement of fees previously paid to debtor's counsel. (Appellant United States Trustee's Excerpts of Record ("ER") 1-17.)

Pursuant to Fed. R. Bankr. P. 8002(a), the United States Trustee timely noticed her appeal from the bankruptcy court's order to the United States District Court for the Eastern District of California on June 8, 1998. (ER 18-20.) The district court, in reviewing the appeal, properly exercised its jurisdiction under 28 U.S.C. § 158(a). On August 13, 1998, the district court dismissed the United States Trustee's appeal for lack of standing. (ER 21-31.) The district court's order was a final, appealable ruling under 28 U.S.C. § 158(d) that conclusively determined that the United States Trustee had no standing to participate on appeal.

Pursuant to Fed. R. Bankr. P. 8015, the United States Trustee timely moved for rehearing of this decision on August 21, 1998. (ER 64, District Court Docket ("D.Ct.Dkt.")[1/] Nos. 23, 24, 25.) On September 22, 1998, the district court denied the motion for rehearing. (ER 32-37.) The United States Trustee filed her notice of appeal on November 19, 1998, which notice was timely pursuant to Fed. R. App.

[1/] All references to the record before the district court ("D.Ct.Dkt.") shall be to the docket number of the pleading and the page number if appropriate.

P. 4(a)(1). (ER 38-41.) This Court's jurisdiction is therefore based on 28 U.S.C. §§ 158(d) and 1291.

STATEMENT OF THE ISSUE

The issue presented by this appeal is as follows: Whether section 307 of the Bankruptcy Code authorizes a United States Trustee to appeal an order issued by the bankruptcy court.

STATEMENT OF THE CASE

A. Nature of the Case, Course of Proceedings and Disposition Below.

This appeal involves a district court's decision to deny the United States Trustee standing to participate on appeal. Before the bankruptcy court, the United States Trustee supervised actions taken by the private case trustee, including his proposed final report of distribution. Upon further review of the proposed report, the case trustee sought disgorgement of payments previously received by appellee McCormick, Barstow, Sheppard, Wayte & Carruth, counsel for the former debtor in possession (hereinafter, "McCormick, Barstow" or the "law firm"). Disgorgement was requested so that the case trustee could distribute the limited monies available to one class of administrative claimants on a pro rata basis as the Bankruptcy Code requires.

Because the motion raised substantive issues of statutory interpretation affecting the administration of bankruptcy cases, the United States Trustee filed supportive pleadings and argued the matter before the bankruptcy court. The bankruptcy court denied the motion. The United States Trustee appealed in order to correct the underlying substantive decision.

On appeal, McCormick, Barstow moved to dismiss the United States Trustee as a party to the appeal for lack of standing. The district court granted that motion and dismissed the United States Trustee as a party to the case. The United States Trustee appeals the district court's decision.

B. Statutory Background.

1. Bankruptcy Reform Act of 1978.

Through the Bankruptcy Reform Act of 1978, Congress revamped the federal bankruptcy system and established the general framework that currently exists. Congress overhauled the prior system to address three endemic problems: (1) the inherent conflict created when judges assumed judicial and administrative responsibilities; (2) the lack of creditor participation in the system; and (3) the perception of bias or actual cronyism that the existing framework fostered. H.R. Rep. No. 595, 95th Cong., 1st Sess. 96 (1977), reprinted in 1978 U.S.C.C.A.N. 6057.

To reform these fundamental problems, Congress established the United States Trustees in the Executive Branch as

> the principal administrative officers of the bankruptcy system. Bankruptcy judges, relieved of administrative responsibilities, will take a more passive role, consistent with their judicial responsibilities, which will serve to eliminate the institutional bias that exists in the bankruptcy system today.

H.R. Rep. No. 595, 95th Cong., 1st Sess. 101 (1977), reprinted in 1978 U.S.C.C.A.N. 6063. Because "active supervision [in bankruptcy cases] is essential," Congress observed that the United States Trustees also would "fill the vacuum of lack of creditor participation, where necessary to assure fair and efficient administration." H.R. Rep. No. 595, 95th Cong., 1st Sess. 88, 100 (1977), reprinted in 1978 U.S.C.C.A.N. 6050, 6061.

2. United States Trustees: "Watch-dogs" of the Bankruptcy System.

Congress created the United States Trustees as the new "watch-dogs" in the bankruptcy arena. The success of this system led Congress in 1986 to expand the United States Trustees from their original 18 pilot districts to a nationwide program housed permanently within the Department of Justice. Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1986, Pub. L. 99-554, 100 Stat. 3088 (1986).

The duties of the United States Trustee are set forth in 28 U.S.C. 586(a). Principally, a United States Trustee is required to "establish, maintain, and supervise a panel of private trustees that are eligible and available to serve as trustees in cases under chapter 7 of title 11" and to "supervise the administration of" all chapter 7, 11, 12, or 13 bankruptcy cases within a specified geographic region. 28 U.S.C. 586(a)(1) & (3)(A)-(H).

When it established the United States Trustees throughout the nation, Congress simultaneously enacted statutory language to empower these officials to fulfill their obligations. Through that language, which is codified in section 307 of the Bankruptcy Code,

> [t]he U.S. Trustee is given standing to raise, appear, and be heard on any issue in any case or proceeding under title 11, U.S. Code – except that the U.S. Trustee may not file a plan in a chapter 11 case. In this manner, the U.S. Trustee is given the same right to be heard as a party in interest, but retains the discretion to decide when a matter of concern to the proper administration of the bankruptcy laws should be raised.

H.R. Rep. No. 764, 99th Cong., 2d Sess. 27 (1986), reprinted in 1986 U.S.C.C.A.N. 5227, 5240.

C. Statement of Facts.

1. Proceedings Below In the Bankruptcy Court.

The underlying bankruptcy case began when the debtor, Donovon Corporation (the "debtor"), an electrical and general contractor, sought relief under the reorganization provisions of chapter 11 of the Bankruptcy Code on February 19, 1991. (ER 42; Bankruptcy Court Docket ("Bankr.Ct.Dkt.")[2/] No. 1.) On April 6, 1993, the debtor asked the court for permission to convert the case voluntarily to a liquidation under chapter 7. (ER 52; Bankr.Ct.Dkt. No. 70.) 11 U.S.C. § 1112(a). The court granted this request. (ER 52; Bankr.Ct.Dkt. No. 71.) On April 7, 1993, Patrick Kavanagh ("Mr. Kavanagh") was appointed Chapter 7 trustee. (ER 52; Bankr.Ct.Dkt. No. 72.)[3/]

[2/] "Bankr.Ct.Dkt." denotes references to the Clerk's Record in the bankruptcy court. Such references shall be to the docket number of the pleading and the page number if appropriate.

[3/] Before the case was converted, the then debtor in possession asked for and received permission to retain McCormick, Barstow as its counsel. (ER 2-3, 43; Bankr.Ct.Dkt. No. 5.) See 11 U.S.C. §§ 327, 1107(a). Both before and after conversion, the law firm filed applications to obtain fees under section 330 of the Bankruptcy Code for services that they had rendered to the estate. (ER 3-5.)

The United States Trustee and one creditor objected to the final fee application in part because payment of this claim was premature. (ER 5-6.) These parties contended that any award should be delayed until chapter 7 administrative expenses were determined so that payment could be made pro rata in accordance

After his appointment, Mr. Kavanagh administered the remaining assets of the estate. (See, e.g., ER 56; Bankr.Ct.Dkt. No. 110.) 11 U.S.C. § 704. He obtained sufficient funds to pay all chapter 7 administrative expenses in full but he did not obtain enough monies to pay all chapter 11 administrative expenses completely. (ER 7.) Pursuant to section 704(9) and the Memorandum of Understanding between the Executive Office for United States Trustees and the Administrative Office of the United States Courts Regarding Case Closing and Post Confirmation Chapter 11 Monitoring, Mr. Kavanagh submitted a proposed final report of distribution to the United States Trustee for her review. (ER 12; D.Ct.Dkt. No. 12, Appellant's Memorandum of Points and Authorities in Support of Objection to Motion to Dismiss Appeal, pp. 2-3.) The United States Trustee called to Mr. Kavanagh's attention that his proposed distribution of assets for the chapter 11 administrative claimants was not pro rata as required by section 726 of the Bankruptcy Code. (Id.) Upon further review and consultation with the United States Trustee, Mr. Kavanagh determined that he needed to seek disgorgement

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with the Code. At the hearing on this application, McCormick, Barstow represented that it was "seeking allowance of these fees, not payment," and the court granted the application subject to review later in the case when other expenses had been determined. (Id. See also D.Ct.Dkt. No. 13, Appellant's Request for Judicial Notice in Support of Objection to Motion to Dismiss, Ex. 2, pp. 9-10.) The final order stated that approval was "with confirmation of approval of all prior fees and expenses." (ER 6.)

from McCormick, Barstow so that all administrative claimants for the chapter 11 case could receive equal payments.

He filed a motion for disgorgement on January 9, 1998, and a hearing was scheduled. (ER 58; Bankr.Ct.Dkt. Nos. 124, 129.) On February 19, 1998, the United States Trustee filed pleadings supporting the motion. (ER 58-59; Bankr.Ct.Dkt. Nos. 127, 128, 133, 135.) The law firm also filed opposition pleadings, which addressed the merits of the United States Trustee's arguments. (ER 59; Bankr.Ct.Dkt. Nos. 131, 132.) McCormick, Barstow did not contend at any time before the bankruptcy court that the United States Trustee did not have standing to participate in this matter.

After a hearing, the bankruptcy court denied the trustee's motion by order entered on May 28, 1998. (ER 1-17.) The United States Trustee noticed her appeal on June 8, 1998. (ER 18-20.) The trustee joined in the appeal by notice filed on June 12, 1998. (ER 60; Bankr.Ct.Dkt. No. 144.)

2. Proceedings Before the District Court.

On appeal, McCormick, Barstow asked the district court to dismiss the United States Trustee's appeal for lack of standing.[4/] (ER 63; D.Ct.Dkt. Nos. 5, 6,

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[4/] Simultaneously, the law firm moved to dismiss the case trustee's appeal and moved to strike parts of the record designated by the United States Trustee. (ER

7.) McCormick, Barstow, ignoring the watchdog role of the United States Trustee, argued that she did not have a pecuniary interest in the case and that she had not demonstrated a sufficient public interest in the matter. The United States Trustee opposed the motion, relying on the plain language of section 307 and the existing case law, which unanimously holds that United States Trustees have standing to participate in a bankruptcy appeal. (ER 63; D.Ct.Dkt. Nos. 11, 12, 13.) After argument, the district court granted the motion, explaining its reasoning in one paragraph:

> The U.S. Trustee lacks standing to prosecute this appeal, either under 11 U.S.C. § 307 or Securities and Exchange Comm'n v. United States Realty & Improvement Co., 310 U.S. 434 (1940), because the "public interest" it seeks to protect is insufficient. The Chapter 7 Trustee's Motion could only affect seven creditors, all of whom had full notice of the hearing on the Motion, and have expressed no interest in the proceedings.

(ER 23.)

Pursuant to Fed. R. Bankr. P. 8015, the United States Trustee timely moved for rehearing of the court's decision. (ER 64; D.Ct.Dkt. Nos. 23, 24, 25.) McCormick, Barstow opposed the motion. (ER 65; D.Ct.Dkt. No. 30.) Before the

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63; D.Ct.Dkt. Nos. 8, 9, 10.) Those motions were denied and are not part of the merits of this appeal. (ER 21-31.) However, McCormick, Barstow did initially appeal these decisions to this Court (ER 64; D.Ct.Dkt. No. 26), which appeal was docketed as Case No. 98-16621. At the law firm's request, this Court dismissed the appeal by order entered November 2, 1998.

United States Trustee could file a reply, the district court cancelled oral argument and denied the motion for rehearing, finding that the United States Trustee had raised no new issues and her arguments "are properly made on appeal." (ER 34-35.) This appeal followed. (ER 38-41.)

SUMMARY OF ARGUMENT

In the appeal below, the district court ignored the plain language of the Bankruptcy Code and all published decisions on point in holding that the United States Trustee did not have standing to appeal a question of statutory interpretation. This conclusion contravenes the plain language of the Bankruptcy Code and the rationale for the very existence of the United States Trustees. The district court should be reversed and the case remanded so that the United States Trustee can participate on appeal before the district court as United States Trustees have in countless instances in similar cases.

STANDARD OF REVIEW

This case presents a pure question of law, which this Court reviews de novo. Committee of Dental Amalgam Mfrs. v. Stratton, 92 F.3d 807, 810 (9th Cir.), cert. denied, 117 S. Ct. 754 (1997); Sousa v. Miguel (In re United States Trustee), 32 F.3d 1370, 1372 (9th Cir. 1994) (citation omitted).

ARGUMENT

1. Section 307 Expressly Authorizes the United States Trustee to Participate In Any Bankruptcy Case.

The district court erred in concluding that section 307 does not permit the United States Trustee to participate in this appeal from a bankruptcy court order.[5] (ER 23.) Section 307 reads in full:

> The United States trustee may raise and may appear and be heard on any issue in any case or proceeding under this title but may not file a plan pursuant to section 1121(c) of this title.

All courts of appeals that have addressed the issue agree that a United States Trustee has standing to appeal bankruptcy court decisions. United States Trustee v. Columbia Gas Sys. Inc. (In re Columbia Gas Sys. Inc.), 33 F.3d 294, 295-299 (3d Cir. 1994) (holding U.S. Trustee has broad standing, including ability to challenge investment guidelines for chapter 11 debtor); United States Trustee v. Price Waterhouse, 19 F.3d 138, 141 (3d Cir. 1994) (finding United States Trustee has standing to appeal appointment of professionals in chapter 11 case); In re Clark, 927 F.2d 793, 795-96 (4th Cir. 1991) (finding standing to appeal denial of motion to dismiss); In re Plaza de Diego Shopping Ctr., Inc., 911 F.2d 820, 824

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[5] The issue of the United States Trustee's standing was raised in appellee's Motion to Dismiss Appeal and supporting papers (ER 63; D.Ct.Dkt. Nos. 5, 6, 7) and was ruled upon by the district court at ER 21-37.

(1st Cir. 1990) (standing to appeal appointment of trustee); Morganstern v. Revco D.S., Inc. (In re Revco D.S., Inc.), 898 F.2d 498, 499 (6th Cir. 1990) (standing to appeal decision refusing to appoint examiner).[6] See also St. Angelo v. Victoria Farms, Inc., 38 F.3d 1525, 1535 (9th Cir. 1994), modified, 46 F.3d 969 (1995) (holding United States Trustee had standing to bring appeal involving constitutional and statutory issues).

The district court's conclusion that the United States Trustee could not participate on appeal ignored the express language of section 307. Below, the district court reviewed this case pursuant to 28 U.S.C. § 158(a), which permits district courts to hear appeals from cases initiated under title 11. The plain language of section 307 vests the United States Trustee with the ability to appear and be heard in any title 11 case. When a statute's language is plain, "'the sole function of the courts is to enforce it according to its terms.'" United States v. Ron Pair Enters., Inc., 489 U.S. 235, 241, 109 S. Ct. 1026, 1030 (1989) (citation omitted). Because this appeal involves a title 11 case, the United States Trustee may appear and be heard. Cf. Bernard v. Coyne (In re Bernard), 31 F.3d 842, 844 (9th Cir.

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[6] See United States Trustee v. Fishback (In re Glados, Inc.), 83 F.3d 1360, 1361 n.1 (11th Cir. 1996) (noting United States Trustee has standing under section 307 to raise issues concerning calculation of compensation and statutory construction under section 726).

1994) (noting United States Trustee "may also intervene and appear at any level of the proceedings from the bankruptcy court on, 11 U.S.C. § 307, as either a party or amicus.") (dictum).

The rationale for section 307 is straightforward. The United States Trustee, whose job it is to protect the public interest, has standing to appeal when the public interest may be at stake. Clark, 927 F.2d at 795; Plaza de Diego, 911 F.2d at 824; Revco, 898 F.2d at 499. The substantive question before the district court -- the proper distribution of monies in a chapter 7 case as required by section 726 of the Bankruptcy Code -- involves the public interest. Indeed, the United States Trustee successfully appealed this very issue (the interpretation of section 726) to the Eleventh Circuit in Glados. In that case, the Eleventh Circuit acknowledged the United States Trustee's standing to maintain that appeal. 83 F.3d at 1361 n.1.

Even if this Court were to decide that the relevant statute is not clear, the legislative history amply reinforces the deduction that section 307 authorizes a United States Trustee to participate in appeals of bankruptcy cases. The House Report states:

> The U.S. Trustee is given standing to raise, appear, and be heard on any issue in any case or proceeding under title 11, U.S. Code – except that the U.S. Trustee may not file a plan in a chapter 11 case. In this manner, the U.S. Trustee is given the same right to be heard as a party in interest, but retains the discretion to decide when a matter of con-

> cern to the proper administration of the bankruptcy laws should be raised.

H.R. Rep. No. 764, 99th Cong., 2d Sess. 27 (1986), reprinted in 1986 U.S.C.C.A.N. 5227, 5240.

The structure of the Code itself bolsters this conclusion. Other sections of the Bankruptcy Code permit other agencies to raise and appear and be heard on any issue in a bankruptcy case. 11 U.S.C. §§ 1109(a) (Securities & Exchange Commission), 1164 (Interstate Commerce Commission and Surface Transportation Board). However, these sections explicitly withdraw those agencies' rights to appeal from "any judgment, order, or decree entered in the case." Id. In contrast, section 307 contains no such limiting language. The courts of appeals that have addressed this question have concluded that when these sections are read "with reference to one another, we find . . . that Congress did not intend to limit the U.S. trustee's appellate standing." Revco, 898 F.2d at 500. Accord Clark, 927 F.2d at 796; Plaza de Diego, 911 F.2d at 824.

Finally, the district court's decision not only contravenes the language of section 307; it violates the basic tenet of statutory construction that, if a statute specifies one exception to its general application, other exceptions must be excluded. See, e.g., United States v. Goldbaum, 879 F.2d 811, 813 (10th Cir. 1989).

Cf. Andrus v. Glover Constr. Co., 446 U.S. 608, 616-17 (1980) (Where exceptions to a statutory prohibition are expressly provided for, additional exceptions shall not be implied in the absence of contrary legislative intent). The relevant statute — section 307 — contains only one restriction on the United States Trustee's participation in bankruptcy cases. That exception prohibits a United States Trustee from filing a plan in a chapter 11 case, an action not at issue here. 11 U.S.C. § 307. In finding that the United States Trustee had to demonstrate a "sufficient" public interest in order to appeal, the district court engrafted an additional restriction onto the language of section 307 and thus violated this fundamental rule of statutory construction. The district court's decision should be reversed.

2. The District Court Erred As A Matter of Law in Dismissing the United States Trustee From the Appeal of a Bankruptcy Court Order for Lack of a Sufficient Public Interest.

In two sentences, the district court summarily dismissed the United States Trustee from the appeal, reasoning that she had not demonstrated a "sufficient" public interest to participate. (ER 23.) The district court never identified the origin of this "sufficient" public interest criterion or any factors that a court should consider in determining sufficiency.

Under traditional standing analysis, courts look to whether a party is "aggrieved." This determination encompasses pecuniary and other interests, including the public interest. Securities & Exchange Comm'n v. United States Realty & Improvement Co., 310 U.S. 434, 459-60 (1940).

The United States Trustee, created to serve as the watchdog of the bankruptcy system, has standing to appeal when the public interest may be at stake. Plaza de Diego, 911 F.2d at 824; Revco, 898 F.2d at 499. "Congress specified that the U.S. trustees were to be independent of direct court supervision, as 'executives of the bankruptcy network'; it likened the U.S. trustee's relation to that of a prosecutor." Revco, 898 F.2d at 500 (citation omitted). A "good watchdog guards the interests of those for whom it watches; the roles [of watchdog and advocate] are not incompatible." Id.

The lower court, in dismissing the United States Trustee, relied on the "fact" that the ruling potentially affected only seven creditors, none of whom had expressed any interest in the proceedings. (ER 23.) The lack of creditor participation in this situation is precisely why Congress created the United States Trustees. When it revised the system to accommodate its perceived need for active bankruptcy case supervision, Congress acknowledged:

> Creditor control in bankruptcy cases is a myth. Creditors take little interest in pursuing a bankrupt debtor. They are unwilling to throw good money after bad. As a result, creditor participation in bankruptcy cases is very low. . . . [I]f there are assets available in a case, the vacuum created by the lack of creditor interest in the case is not in

> fact filled by the bankruptcy judge, and the result is not innocuous. In practice, creditor control has become attorney control, and the bankruptcy system operates more for the benefit of attorneys than for the benefit of creditors.

H.R. Rep. No. 595, 95th Cong., 1st Sess. 92 (1977), reprinted in 1978 U.S.C.C.A.N. 6053.

Accordingly, Congress made the United States Trustees responsible for "protecting the public interest and ensuring that bankruptcy cases are conducted according to the law." H.R. Rep. No. 595, 95th Cong., 1st Sess. 109 (1977), reprinted in 1978 U.S.C.C.A.N. 6070. Because a disinterested administrator was critical to the success of the revised system, Congress promulgated section 307 when it expanded the United States Trustees nationwide, thus ensuring the United States Trustees' effective participation. Congress' decision should not be readily diluted.

Finally, the holding that the public interest is not at stake in this case is wrong. Nothing could be more central to the administration of a chapter 7 case than the question of distribution of estate assets to creditors. The United States Trustee appealed what she believes to be an erroneous interpretation of the Bankruptcy Code. Questions of statutory interpretation, including the underlying question here, raise implications far beyond one bankruptcy case. Inexplicably, the district court ignored the plain language of section 307 and all apposite case law in dismissing the United States Trustee from this appeal. The district court's decision should be reversed.

3. The District Court's Reasoning Is Inconsistent and Not Supportable.

The court's analysis is not only inexplicable, it is internally inconsistent. First, no one disputes that the United States Trustee participated below on the merits of the order that was appealed. Nor did the bankruptcy court determine that the United States Trustee lacked standing to participate before it. Under the district court's analysis, the United States Trustee's standing apparently evaporated once a final decision was rendered. Such a conclusion does not comport with the language of section 307 or traditional standing analysis.

Second, the district court found that the United States Trustee was a party for purposes of filing a timely appeal. (ER 23-24.) When the law firm moved to dismiss the United States Trustee's appeal, it also asked the court to dismiss Mr. Kavanagh's appeal as untimely.[7] (ER 63; D.Ct.Dkt. No. 5, 6, 7.) It reasoned as follows: Notices of appeal must be filed within 10 days after the challenged order is entered on the docket. Fed. R. Bankr. P. 8002(a). In this case, the original notice

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[7] The merits of this issue have not been appealed.

of appeal was due on June 8, 1998, the date on which the United States Trustee noticed her appeal. Mr. Kavanagh as case trustee noticed his appeal five days later. Because the United States Trustee had no standing to appeal, the law firm argued, Mr. Kavanagh's appeal was not timely filed. (ER 63; D.Ct.Dkt. No. 6, Memorandum of Points and Authorities In Support of Motion to Dismiss, at 9.)

The district court rejected this argument, correctly finding that the case trustee's notice was timely under Rule 8002(a). (ER 23-24.) That rule reads in pertinent part: "If a timely notice of appeal is filed by a party, any other party may file a notice of appeal within 10 days of the date on which the first notice of appeal was filed, ..." (Emphasis added). Because the United States Trustee's notice was timely, the district court concluded that Mr. Kavanagh's notice, filed within 10 days of the first notice, was also timely filed. (ER 24.) Nonetheless, it is difficult to understand how the United States Trustee can be construed to be a "party" who timely filed under Rule 8002 if she never had standing to appeal. See, e.g., Voisenat v. Decker (In re Serrato), 117 F.3d 427, 429 (9th Cir. 1997) (Construing "party" in Fed. R. App. P. 4(a) to mean "'a participant in the particular controversy which led to the appeal.'") (citation omitted).

CONCLUSION

For the foregoing reasons, the district court's holding that the United States Trustee does not have standing to participate in a bankruptcy appeal should be reversed and the case should be remanded for further proceedings in which the United States Trustee can participate.

Dated: January 26, 1999

Respectfully submitted,

LINDA EKSTROM STANLEY
United States Trustee
Region 17
U.S. Department of Justice
250 Montgomery Street
Suite 910
San Francisco, California 94104
(415) 705-3300

MARTHA L. DAVIS
General Counsel

____
JEANNE M. CROUSE
Attorney
U.S. Department of Justice
Executive Office for
United States Trustees
Office of the General Counsel
901 E St., N.W., Suite 780
Washington, D.C. 20530
(202) 307-1399

OF COUNSEL:
PETER H. CARROLL
Assistant United States Trustee
1130 "O" Street
Suite 1110
Fresno, California 93721
(209) 498-7400

STATEMENT OF RELATED CASES

The Appellant is not aware of any related cases currently pending before this Court.

STATEMENT REGARDING THE BANKRUPTCY COURT

This appeal arises from a proceeding that was initially decided by a bankruptcy court. Therefore, pursuant to Ninth Circuit Rule 28-2.9, the Appellant hereby informs this Court that the initial order in this matter was issued by the Honorable Whitney Rimel, Judge, United States Bankruptcy Court for the Eastern District of California, 2416 U.S. Courthouse, 1130 O Street, Fresno, California, 93721.

CERTIFICATE OF COMPLIANCE

Pursuant to Ninth Circuit Rule 32(e)(4), I hereby certify that this brief is in compliance with the rules of the Ninth Circuit. This brief is double-spaced and uses a proportionately-spaced typeface. The font used is Times New Roman, the point size used is 14, and the word count is 3,730.

Date: January 26, 1999

____
Jeanne M. Crouse

CERTIFICATE OF SERVICE

I HEREBY CERTIFY, that on the 26th day of January, 1999, I filed the foregoing Brief for the Appellant United States Trustee by causing the original and 15 copies to be sent by Federal Express, for next-day delivery, to the Clerk, U.S. Court of Appeals for the Ninth Circuit and I also certify that I sent two true and correct copies of the Brief for the Appellant United States Trustee by Federal Express, for next-day delivery, to:

Scott M. Reddie, Esq.
McCormick, Barstow, Sheppard,
Wayte & Carruth, LLP
5 River Park Place East
Fresno, California 93720
Appellees

Patrick Kavanagh
Law Office of Patrick Kavanagh
1331 “L” Street
Bakersfield, California 93301
Chapter 7 Trustee.

____
Jeanne M. Crouse

ADDENDUM

11 U.S.C. § 307

28 U.S.C. § 158

28 U.S.C. § 586

Fed. R. Bankr. P. 8002

BRIEF BANK — “SUMMARY SHEET”

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WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*

Douglas Asphalt Company v. Donald F. Walton (In re: Douglas Asphalt Company)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*

S.D. Ga.

3. ("CCN") ***CURRENT*** CASE NO.

No.: 5:10-cv-00055-LGW-JEG

4. ("PCN") ***PRIOR*** CASE NO. - & COURT *[IF ANY]*

No.: 09-51272-JSD

Court: Bankr. S.D. Ga.

(Identify judge & cite, if any)

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U.S. TRUSTEES

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Joel Paschke, Catherine B. Sevcenko, P. Matthew Sutko, Matthew E. Mills, Ramona D. Elliott, Donald F. Walton

(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***

BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***

• Whether the bankruptcy court abused its discretion in converting debtor Douglas Asphalt’s chapter 11 case to chapter 7 on the basis that (1) the United States Trustee had established “cause” to convert the case under section 1112(b)(4)(A) of title 11 And (2) the creditors and the estate were best served by converting the case to chapter 7.

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UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF GEORGIA
WAYCROSS DIVISION

IN RE:	§	
DOUGLAS ASPHALT COMPANY	§	
DOUGLAS ASPHALT COMPANY Appellant,	§	CASE NO. 5:10-CV-00055-LGW-JEG
v.	§	ON APPEAL FROM BANKRUPTCY CASE NO. 09-51272-JSD
DONALD F. WALTON, UNITED STATES TRUSTEE, REGION 21 Appellee.	§	

ON APPEAL FROM THE UNITED STATES BANKRUPTCY COURT FOR THE SOUTHERN DISTRICT OF GEORGIA

RESPONSE BRIEF OF APPELLEE DONALD F. WALTON, UNITED STATES TRUSTEE

RAMONA D. ELLIOTT
General Counsel

P. MATTHEW SUTKO
Associate General Counsel

CATHERINE B. SEVCENKO
Trial Attorney
Executive Office for United States Trustees
Department of Justice
20 Massachusetts Avenue, N.W.
Washington, D.C. 20530
Phone: (202) 307-1399
Fax: (202) 307-2397

DONALD F. WALTON
United States Trustee for Region 21

MATTHEW E. MILLS
Assistant United States Trustee

JOEL PASCHKE
Trial Attorney
Office of the United States Trustee
222 W. Oglethorpe Ave., Suite 302
Savannah, GA 31401
Phone: (912) 652-4112
Fax: (912) 652-4123

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STATEMENT OF APPELLATE JURISDICTION

This Court has jurisdiction over this appeal under section 158(a)(1) of title 28, which confers jurisdiction on the district courts of the United States to hear appeals "from final judgments, orders, and decrees" of bankruptcy judges. A final order in bankruptcy ends a particular controversy within the case as a whole. *Charter Co. v. Prudential Ins. Co. of Am. (In re Charter Co.)*, 778 F.2d 617, 621 (11th Cir. 1985). An order converting a bankruptcy case from chapter 11 to chapter 7 is a final order. *Rosson v. Fitzgerald* (*In re Rosson*), 545 F.3d 764, 770 (9th Cir. 2008); *In re Jacobsen*, No. 09-40023, – F.3d – , 2010 WL 2388425, at *4 (5th Cir. Jun. 16, 2010).

The bankruptcy court's final order converting the chapter 11 case of Douglas Asphalt to a chapter 7 case was entered on April 12, 2010. Its notice of appeal was timely filed on April 21, 2010, giving rise to this appeal. 28 U.S.C. § 158(c)(2); Fed. R. Bankr. P. 8002(a).

STATEMENT OF THE ISSUE

The issue is whether the bankruptcy court abused its discretion in converting debtor Douglas Asphalt's chapter 11 case to chapter 7 on the basis that (1) the United States Trustee had established "cause" to convert the case under section 1112(b)(4)(A) of title 11 and (2) the creditors and the estate were best served by converting the case to chapter 7.

STANDARD OF REVIEW

Findings of fact are reviewed for clear error. Fed. R. Bankr. P. 8013; *In re Electric Machinery Enters., Inc.*, 479 F.3d 791, 795 (11th Cir. 2007). Legal determinations are subject to *de novo* review. *Id*. Whether there is cause to dismiss or convert a case to chapter 7 is a finding of fact subject to review under the "clearly erroneous" standard. *In re Phoenix Piccadilly, Ltd.*, 849 F.2d 1393, 1394 (11th Cir. 1988). "A finding is clearly erroneous when 'although there is evidence to support it, the reviewing court on the entire evidence is left with a definite and firm conviction that a mistake has been committed.'" *Robinson v. Tyson Foods, Inc*., 595 F.3d 1269, 1275 (11th Cir. 2010) (quoting *United States v. Oregon State Medical Society*, 343 U.S. 326, 339 (1952)).

The bankruptcy court's determination whether dismissal or conversion best serves creditors and the estate is subject to "abuse of discretion" review. *In re Loop Corp*., 379 F.3d 511, 517 (8th Cir. 2004); *see also In re Bal Harbour Club, Inc*., 316 F.3d 1192, 1194-95 (11th Cir. 2003) (dismissal); *In re Mobile Freezers Inc*., 146 B.R. 1000, 1001 (S.D. Ala. 1992) (denial of trustee's motion to convert reviewed for abuse of discretion). "A bankruptcy judge abuses his discretion if he fails to apply the correct legal standard or his factual findings are clearly erroneous." *In re Celotex Corp*., 227 F.3d 1336, 1338 (11th Cir. 2000) (citations omitted).

STATEMENT OF THE CASE

A. Statutory Framework

Commencement of a bankruptcy case creates an estate comprised of the debtor's assets. *See* 11 U.S.C. § 541(a)(1) (the filing of a bankruptcy petition "creates an estate . . . comprised [with some exceptions] of all legal or equitable interests of the debtor in property as of the commencement of the case"). The automatic stay halts litigation against the debtor and prevents creditors from obtaining or exercising control over property of the estate. 11 U.S.C. § 362(a).

After the commencement of a case, a chapter 11 debtor retains control of the bankruptcy estate and any business operations as a "debtor in possession." 11 U.S.C. §§ 1101(1) and 1108. Duties imposed on a debtor in possession include accounting for estate property; disclosing assets, liabilities and financial affairs; timely filing tax returns; preparing and filing periodic financial reports; and proposing plans of reorganization. 11 U.S.C. §§ 1107(a); 521; 1106(a)(5) and (6); and 704(a)(2), (7) and (8). In contrast, a chapter 7 bankruptcy case involves the orderly liquidation of a debtor corporation's assets by a neutral chapter 7 trustee. 11 U.S.C. § 704(a).

At issue in this appeal is the bankruptcy court's decision to grant the United States Trustee's motion to convert the debtor's chapter 11 case to chapter 7. The United States Trustee may request dismissal or conversion of a chapter 11 case. *See* 28 U.S.C. § 586(a)(8) (authorizing U.S. Trustees to file motions pursuant to §

1112(b)). Motions to dismiss or convert are governed by section 1112(b) of the Bankruptcy Code, which provides:

> Except as provided in paragraph (2) of this subsection, subsection (c) of this section, and section 1104(a)(3), on request of a party in interest, and after notice and a hearing, absent unusual circumstances specifically identified by the court that establish that the requested conversion or dismissal is not in the best interests of creditors and the estate, the court shall convert a case under this chapter to a case under chapter 7 or dismiss a case under this chapter, whichever is in the best interests of creditors and the estate, if the movant establishes cause.

11 U.S.C. § 1112(b)(1). Thus, the bankruptcy court "shall" dismiss the subject chapter 11 case, convert the case to chapter 7, or appoint a chapter 11 trustee if the movant establishes cause and relief would benefit the creditors and the estate. *See* 11 U.S.C. §§ 1112(b)(1) and 1104(a)(3). Determination of cause rests with the discretion of the bankruptcy court. *In re Albany Partners, Ltd.*, 749 F.2d 670, 674 (11th Cir. 1984) (summarizing legislative history). The form of relief to be granted depends on which remedy best serves the creditors and the estate. *See* 11 U.S.C. §§ 1112(b)(1) and 1104(a)(3).

If a party in interest establishes cause, the debtor in certain circumstances may try to show that unusual circumstances dictate against conversion or dismissal. Section 1112(b)(2) outlines what constitutes "unusual circumstances." That section provides:

> (2) The relief provided in paragraph (1) shall not be granted absent unusual circumstances specifically identified by the court that establish that such relief is not in the best interests of creditors and the estate, if the debtor or another party in interest objects and establishes that–

> (A) there is a reasonable likelihood that a plan will be confirmed within the timeframes established in sections 1121(e) and 1129(e) of this title, or if such sections do not apply, within a reasonable period of time; **and**
>
> (B) the grounds for granting such relief include an act or omission of the debtor **other than under paragraph (4)(A)**–
>
>> (I) for which there exists a reasonable justification for the act or omission; and
>>
>> (ii) that will be cured within a reasonable period of time fixed by the court.

11 U.S.C. § 1112(b)(2) (emphasis added).

Paragraph (4)(A) establishes that either diminution of the estate or absence of a reasonable chance of rehabilitation constitute reasons to dismiss or convert a chapter 11 case. 11 U.S.C. § 1112(b)(4)(A). Therefore, a debtor may not attempt to prove unusual circumstances that could prevent conversion or dismissal if a party in interest has demonstrated the conditions of subsection 1112(b)(4)(A) as grounds for cause.

If the grounds for conversion or dismissal do not involve diminution of the estate's value and the lack of likelihood of rehabilitation, then a debtor must make three showings in order to remain in chapter 11. First, the debtor must show that it can propose a reorganization plan within a reasonable amount of time. 11 U.S.C. § 1112(b)(2)(A). Second, the debtor must show that there is a reasonable explanation for the existence of cause to convert. Third, the debtor must show that the reason for the existence of cause can be cured. 11 U.S.C.§ 1112(b)(2)(B)(ii).

B. Statement of the Facts

Douglas Asphalt, the debtor in this case, was formerly one of the larger road construction and paving companies operating in southern and central Georgia. It was the prime contractor on a number of state and federal highway construction projects. Mot. Hr'g Tr., 61, Apr. 1, 2010. Mr. Joel Spivey is its president and 51% owner. *Id.*, 37; Statement of Financial Affairs, Bankr. Dkt. #63. Mr. Spivey founded the company in 1971. Hr'g Tr., 101. The company had 550 employees and gross revenues of approximately $140 million at its peak in 2006. *Id.*, 61, 64, 104, 127.

Douglas Asphalt's difficulties began when an industrial testing company, Applied Technical Services, reported that the lime content in the asphalt that Douglas Asphalt was using did not meet state specifications. Hr'g Tr., 79. This action started the chain of events that led to Douglas Asphalt's ultimate collapse. The companies that issued the performance bonds on those road projects took control of the jobs. *See id.*, 95. They completed the work at their own expense, generating millions of dollars of claims against Douglas Asphalt. Schedule F, Bankr. Dkt. #60; Hr'g Tr., 69, 113. The bond companies then proceeded to get judgments against Douglas Asphalt for the outstanding amounts owed. *See* Hr'g Tr., 64, 70, 112, 121-23. At the same time, Douglas Asphalt could not get new work to cover these debts, eventually forcing it to shut down.

In September 2007, Douglas Asphalt dismissed its remaining employees, closed its doors, and shut down its business. Hrg. Tr., 43, 61. In the years that followed, it was primarily occupied with disposing of its construction equipment and pursuing lawsuits against third parties over past construction jobs. *Id.*, 43-44. Foremost was a lawsuit against Applied Technical Services, the testing company that prompted Douglas Asphalt's demise, which resulted in a $150 million judgment in Douglas Asphalt's favor. *Id.*, 47.

On December 2, 2009, Douglas Asphalt's largest creditors (the bond companies) filed an involuntary chapter 7 bankruptcy petition against it. Bankr. Dkt. #1. Their claims totaled approximately $162 million. *Id*. Douglas Asphalt responded by filing a motion for relief under chapter 11, which was granted on December 28, 2009. Bankr. Dkt. #12, #13. In its bankruptcy schedules, the debtor reported debts totaling approximately $220 million. Summary of Schedules, Bankr. Dkt. #59.

On October 1, 2009, after presentation of the evidence in the lawsuit against Applied Technical Services, but before the jury returned a verdict, Douglas Asphalt and its co-plaintiffs entered a settlement agreement with Applied Technical Services and two of its insurance companies. Ex. B, Bankr. Dkt. #53. ATS and its professional liability insurer each agreed to pay $1 million in satisfaction of the debtor's claims against them. *Id*. If the jury returned a verdict for the plaintiffs in excess of $2 million, Applied Technical Services agreed to assign to plaintiffs its claims against its general liability insurer and the Georgia Department of Transportation. *Id*. Subsequently, due to pending disputes as to who was entitled to the funds, the two million dollars from Applied Technical

Services and its professional liability insurer was paid into the bankruptcy court registry. Hr'g Tr., 50, 85.

On January 14, 2010, the bond companies filed a motion to appoint a chapter 11 trustee. They asserted various grounds, including that a disinterested trustee was required in order to investigate transactions between Douglas Asphalt and its principals that may constitute fraudulent transfers. Bankr. Dkt. #53.

On February 5, 2010, the U.S. Trustee's office conducted the meeting of creditors. At the meeting, the United States Trustee confirmed that:

a. The debtor owned two parcels of real property, but there was no equity in either of them. Schedule A, Bankr. Dkt. #59; Hr'g Tr., 39;

b. There was virtually no equity in the equipment held by Douglas Asphalt. Hr'g Tr., 41, 117-118;

c. Douglas Asphalt had no employees, no construction contracts, and no significant cash flow; *see generally*, Hr'g Tr., 51-61.

d. Douglas Asphalt reported total debt of approximately $220 million. This consisted of general unsecured debts of approximately $197 million, secured debts of approximately $21.7 million, and priority unsecured debts consisting primarily of delinquent tax claims totaling over $1 million. Summary of Schedules, Bankr. Dkt. #59;

e. At the meeting of creditors, Mr. Spivey, Douglas Asphalt's president, stated he considered his chapter 11 case to be a liquidation case. His primary aims were to dispose of his remaining equipment and to pursue various pending lawsuits and reduce any judgments to cash. 2004 Exam Tr., 31-32, Mar. 12, 2010, Bankr. Dkt. #254; Mot. Hr'g Tr., 52, 65.

On February 17, 2010, the United States Trustee filed a response to the bond companies' motion to appoint a chapter 11 trustee. Bankr. Dkt. #124. Given the lack of any ongoing business operations, the United States Trustee asserted that it would be more appropriate to convert the case so that a chapter 7 trustee could perform an orderly liquidation. Resp., ¶10. On February 18, 2010, the United States Trustee's office filed a motion to convert the case to chapter 7 pursuant to 11 U.S.C. § 1112(b). Bankr. Dkt. #130. The United States Trustee asserted that cause existed to convert the case pursuant to § 1112(b)(4)(A) because the debtor had no significant assets or revenue with which to satisfy its post-petition obligations going forward. Conversion Mot., ¶13, Feb. 18, 2010, Bankr. Dkt. #130. Furthermore, there was no reasonable prospect for rehabilitation of the debtor's business. *Id.*, ¶18.

At the hearing on the motion to convert on April 1, 2010, Mr. Spivey testified to give a more detailed picture of Douglas Asphalt's status. Hr'g Tr., 115. He confirmed that Douglas Asphalt had dismissed its employees and shut down its operations in September 2007. Hr'g Tr., 44. He also testified that since then Douglas Asphalt had been engaged primarily in disposing of its remaining construction equipment. It was subject to the secured claims of equipment vendors and Douglas Asphalt appeared to have no equity in it. *Id.*, 117-118. By these sales efforts, Douglas Asphalt had reduced its equipment debt from $20 million to $5 million. *Id.*, 45; 2004 Exam Tr., 22. Nevertheless, Douglas Asphalt was required to make adequate protection payments to its remaining equipment vendors totaling approximately $47,500.00 per month. Hr'g Tr., 109-110, 125-26 (testimony of former Douglas Asphalt comptroller Angelique Box).

The company's on-going business operations consisted of two business arrangements with the Douglas Asphalt Paving Company, an entity founded by Mr. Spivey's ex-wife and son approximately seven months before Douglas Asphalt ceased operations. Hr'g Tr., 89-90, 127. Douglas Asphalt Paving Company rented office space in a building owned by Douglas Asphalt. *Id.*, 119-120. The rent was equal to the mortgage payment, resulting in no surplus cash flow. *Id.* In addition, Douglas Asphalt sub-leased its remaining equipment to Douglas Paving on an ad hoc basis. *Id.*, 45-46; 2004 Exam Tr., 54. The equipment rent Douglas Paving paid was roughly equivalent to (or less than) what the debtor was required to pay the equipment vendors under the relevant contracts.[1] *Id.*, 46.

Douglas Asphalt's other main activity was pursuing legal claims against various third parties. Mr. Spivey confirmed that the primary asset of the bankruptcy estate was the $150 million judgment against Applied Technical Services and the claims that Applied Technical Services assigned to the debtor by means of the October 1, 2009 settlement agreement. Hr'g Tr. at 47, 50. The prospects for collecting funds from these assignments are vague, as Mr. Spivey testified:

Q: Have you talked to them [special counsel pursuing the ATS litigation] about the prospects for collecting additional monies under the 150 million dollar judgment?

A: Yes, sir.

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[1] The monthly operating reports that the debtor filed with the bankruptcy court did not disclose any income from subleasing equipment to Douglas Paving. Appellee's Designation, Dist. Ct. Dkt. #3, Attachments 17 & 18 (operating reports).

Q: Have they given you any type of indication as to how much they think they can get in further collection efforts under the 150 million dollar judgment?

A: Well we are going to pursue the entire amount.

Q: . . . Have they attempted to put a dollar figure on how much they think they can collect towards the balance of the 150 million that is still owed?

A: We will try to pursue collecting it all. I have not heard anything myself. They have not told me we are going to take anything less. *Id.*, 51.

Douglas Asphalt also had claims that were unrelated to the Applied Technical Services litigation, including claims against Martin Marietta and the Georgia Department of Transportation totaling approximately $36 million. Hr'g Tr., 47-49, 52; Schedule B, Bankr. Dkt. #59. The debtor reported that all of its personal property (including legal claims) was worth approximately $190 million– an amount which is some $30,000,000 less than the $220,000,000 Douglas Asphalt owes all its creditors. *See* Hr'g Tr., 49; Schedule B, Bankr. Dkt. #59.

Mr. Spivey also testified about his prospects for generating work and revenue for Douglas Asphalt. The company's 550 employees had all been let go, but Mr. Spivey believed he would be able to recruit some of his former workers back. Hr'g Tr., 104. He admitted he had no construction contracts, but testified that his colleagues in the industry had promised to consider him for work. *Id.*, 102-04. Mr. Spivey explained that he could not obtain a performance bond, was not pre-qualified to submit bids to the Georgia Department of Transportation on publicly funded road construction projects, and had obtained no financing with which to commence construction operations. *Id.*, 52-53, 58-59. Nevertheless, Mr.

Spivey was confident that by sub-contracting with other companies, he could work around these problems. Hr'g Tr., 102-04.

As an example, Mr. Spivey testified that Fender Chevrolet would hire Douglas Asphalt to perform a small demolition contract, although no formal agreement had been signed as of the hearing date. *Id.*, 55-57. According to Mr. Spivey, the anticipated contract would require Douglas Asphalt to hire three employees, would be completed in four to five weeks, and would net approximately $20,000.00 after expenses. *Id.*, 55-57, 60, 63, 100-01. Mr. Spivey expected that he would be able to arrange more jobs of a comparable size. *Id.*, 108-09.

At the hearing, the attorneys representing several bond companies that were owed approximately $162 million in the aggregate supported the motion to convert to chapter 7. Hr'g Tr., 4, 23, 135; Bankr. Dkt. #1. Douglas Asphalt's total indebtedness to them exceeds the amount of its primary asset – the $150 million judgment against Applied Technical Services. And the $150 million is far less than the 220 million in claims submitted against it.

After brief closing arguments, the bankruptcy court granted the United States Trustee's motion to convert the case to chapter 7 from the bench. *Id.*, 153. The court found that a rehabilitation of Douglas Asphalt was not possible. *Id.*, 151-153. It found that the company had no employees, one pending contract, and that its equipment was "sitting idle." *Id.*, 152. To the extent that bankruptcy protection was being used for a pass-through equipment lease to Douglas Paving, the arrangement was "not authorized or justified under the Code." *Id.* The court found that the unclear nature of the relationship between Douglas Asphalt and Douglas Paving meant that "[i]t is time for a dispassionate view of a chapter 7 trustee." *Id.* Accordingly, the court found conversion was in the "best interest of the creditors in this case and the estate as a whole." *Id.*

Orders granting the United States Trustee's motion to convert the case to chapter 7 and denying the bond companies' motion to appoint a chapter 11 trustee were subsequently entered on April 12, 2010. Bankr. Dkt. #220, #221. A chapter 7 trustee was appointed to administer the case on the same date. Bankr. Dkt. #223.

Douglas Asphalt timely filed a notice of appeal on April 21, 2010. Bankr. Dkt. #246. It also filed an emergency motion for a stay pending appeal, Bankr. Dkt. #247, which was denied on May 3, 2010. Bankr. Dkt. #257.

SUMMARY OF THE ARGUMENT

The bankruptcy court did not abuse its discretion when it converted Douglas Asphalt's case from chapter 11 to chapter 7. A bankruptcy court "shall" convert a case when requested by a party in interest if that party (1) shows "cause;"(2) conversion is in the best interests of the creditors and the estate; and (3) the debtor cannot show "unusual circumstances." 11 U.S.C. § 1112(b). In this case, all three conditions are met and the statutory exception allowing a debtor to successfully oppose a motion to convert despite establishment of cause does not apply.

1. Cause is not defined in chapter 11. Section 1112(b) has a non-exclusive list of causes for conversion, however. The first named cause applies in this case: “continuing loss or diminution of the estate” combined with “no reasonable likelihood of rehabilitation [of the company].” 11 U.S.C. § 1112(b)(4)(A). The bankruptcy court did not abuse its discretion in finding cause to convert for two reasons.

First, continuing the chapter 11 case will result in continuing losses to the estate. Douglas Asphalt’s current business operation - leasing office space to Douglas Paving - covers only its mortgage costs. It has no income to pay the $47,500 monthly cost of adequate protection payments to the equipment vendors. Every month that the company retains the equipment, its debts increase.

Second, the evidence demonstrated that Douglas Asphalt has no realistic chance of reentering the paving business on any significant scale. It closed its doors in 2007. It has no employees, no significant contracts, and no cash flow. It cannot obtain a bond that would enable it to be a prime contractor on a project. At the time of the hearing, its sole business prospect was a demolition contract that would net it $20,000 - a tiny amount compared to its $220 million dollars in debt. Even Mr. Spivey, Douglas Asphalt’s president, admitted that the best case scenario would have the company earning $200,000 per year in the near term.

2. The bankruptcy court did not abuse its discretion when it found that conversion to chapter 7 would be in the best interests of Douglas Asphalt’s creditors for four reasons. First, it took 40 years for Douglas Asphalt to grow from

a one-man company to a multi-million dollar entity. The creditors will be better off being repaid from the liquidation of the company and settlement of legal claims than waiting decades for Douglas Asphalt to be in a position to repay the millions of dollars it owes.

Douglas Asphalt's primary asset is a $150 million dollar judgment against Applied Technical Services, whose test results led to Douglas Asphalt going out of business. However, Douglas Asphalt settled with the testing company and its professional liability insurer in exchange for $2 million in cash, now held in the bankruptcy court, and an assignment of the testing company's claims against its general liability insurer and the Georgia Department of Transportation. Even if Douglas Asphalt could collect another $148 million from these third parties, and there is no evidence to support such a conclusion, it would still owe the bond companies $12 million. Moreover, even if the company collected full judgments on all its other lawsuits, it still would be millions of dollars in debt. There is no evidence that were Douglas Asphalt to go back into business, it could generate sufficient income to make any meaningful contribution to that deficit. Instead, trying to revive the business would drain resources away from the recovery effort in the courts.

Second, liquidation under the supervision of a chapter 7 trustee will ensure an orderly and equitable division of any funds that become available.

Third, the chapter 7 trustee will be able to investigate and recover any preferential payments or transfers in the business dealings between Douglas

Asphalt and the Douglas Asphalt Paving Company, which is run by Mr. Spivey's ex-wife and son.

Fourth, the major creditors themselves favor conversion to chapter 7. They are in the best position to calculate what is in their best interests.

3. Douglas Asphalt is not eligible to attempt to show that there are unusual circumstances that should prevent a bankruptcy court from ordering conversion. Section 1112(b)(1) allows a debtor to ask a court not to convert or dismiss a case if the debtor proves unusual circumstances. But section 1112(b)(2)(B) states that a debtor may only attempt to make this showing if the estate is not facing continuing loss or diminution and there is a reasonable chance of rehabilitation. 11 U.S.C. § 1112(b)(2)(B) (incorporating 11 U.S.C. § 1112(b)(4)(A)) In this case, the United States Trustee demonstrated cause for conversion because Douglas Asphalt was continuing to lose money and had no reasonable likelihood of rehabilitation.

Moreover, even if section 1112(b)(2)(B) applied in this case, Douglas Asphalt has not met the statutory requirements. In order to successfully oppose a motion to convert after a party in interest has shown cause for conversion, a debtor must show that its chapter 11 plan will be confirmed within a reasonable period of time. 11 U.S.C. § 1112(b)(2)(B)(i). Douglas Asphalt has not even submitted a plan. The bankruptcy court did not abuse its discretion when it found that rehabilitation would not be possible, thus precluding even the possibility of a confirmable plan. In addition, the debtor must show that it can cure the act or omission that provides grounds for conversion. 11 U.S.C. § 1112(b)(2)(B)(ii). Douglas Asphalt has not attempted to make this showing.

The bankruptcy court did not commit clear error when it ordered that Douglas Asphalt's bankruptcy case be converted from chapter 11 to chapter 7. The United States Trustee requests that this Court affirm the bankruptcy court's order.

ARGUMENT

I. THE BANKRUPTCY COURT DID NOT COMMIT CLEAR ERROR IN FINDING THAT CAUSE HAD BEEN ESTABLISHED TO CONVERT DOUGLAS ASPHALT COMPANY'S CASE TO CHAPTER 7.

The bankruptcy court did not commit clear error when it found that cause existed to convert Douglas Asphalt's chapter 11 case to chapter 7. Section 1112 allows for conversion if there is a "substantial or continuing loss to or diminution of the estate and the absence of a reasonable likelihood of rehabilitation[.]" 11 U.S.C. § 1112(b)(4)(A). The purpose of this subsection is to "'preserve estate assets by preventing the debtor in possession from gambling on the enterprise at the creditors' expense when there is no hope of rehabilitation.'" *In re Loop Corp.*, 379 F.3d 511, 516 (8th Cir. 2004) (quotation omitted). The bankruptcy court did not abuse its discretion when it found that the Douglas Asphalt estate would continue to lose value and that Mr. Spivey had no realistic chance to revive his business.

A. <u>Douglas Asphalt faces continuing losses and diminution of the estate.</u>

The bankruptcy court did not abuse its discretion when it found that diminution of the Douglas Asphalt estate would continue were the case to remain under chapter 11. A chapter 11 debtor that is not generating revenue has, at a minimum, administrative costs that drain value from the estate. Negative cash flow alone "is sufficient to establish a continuing loss to or diminution of the estate." *Loop Corp*., 379 F.3d at 515-16. Inactivity also establishes diminution of value. *In re Vallambrosa Holdings*, LLC, 419 B.R. 81, 88-89 (Bankr. S.D. Ga. 2009) (continuing loss to or diminution of the estate is established when there is no equity in the debtor's property, the debtor has ceased business operations, and the debtor has no money on hand to pay administrative expenses). Since 2007, Douglas Asphalt has had both on-going administrative costs and has not engaged in any business activity.

The evidence also demonstrated that Douglas Asphalt would generate continuing losses in chapter 11. Douglas Asphalt shut down its operations in September 2007. Hr'g Tr., 43. Its regular income consists of lease payments for office space that offset its mortgage payments. *Id.*, 72. There is no significant equity in any of the company's property. *Id.*, 39, 41, 117-18. It has no substantive contracts, no employees, no cash flow, no financing or ability to obtain financing. Furthermore, it does not have a performance bond or ability to obtain one, and therefore cannot submit bids on publicly-funded road construction projects which previously constituted the majority of its work. *Id.*, 52-54, 58-59, 61, 102-04.

The equipment currently held by Douglas Asphalt is a drain on the company's resources. Douglas Asphalt has insufficient income to meet its obligations going forward, including the adequate protection payments to equipment vendors totaling $47,500.00 per month. *Id.*, 125-26. That ongoing obligation alone is sufficient to lead to the accumulation of further indebtedness at the expense of the estate's existing creditors to warrant conversion. *In re Loop Corp.*, 379 F.3d at 515-16. *See also* 11 U.S.C. § 507(b); *cf. In re Carpet Center Leasing Company, Inc.*, 991 F.2d 682, 686 (11th Cir. 1993) (holding that creditor could claim administrative expense for the chapter 11 debtor's use of equipment collateral). Based on this evidence, the bankruptcy court did not clearly err in finding that a continuing loss to or diminution of the estate had been established.

B. Douglas Asphalt has no reasonable likelihood of rehabilitation.

The bankruptcy court did not abuse its discretion when it found that Mr. Spivey has no realistic chance of restoring Douglas Asphalt to its previous size and profitability. "Courts have consistently understood 'rehabilitation' to refer to the debtor's ability to restore the viability of its business." *Loop Corp.*, 379 F.3d at 516; *Vallambrosa*, 419 B.R. at 89 (stating "[r]ehabilitation 'contemplates the successful maintenance or re-establishment of the debtor's business operations . . . .'"). The test for rehabilitation is objective: the debtor must be able to propose a plan that "can be executed as a practical matter under the facts." *In re Clarkson*, 767 F.2d 417, 420 (8th Cir. 1985); *In re LG Motors, Inc.*, 422 B.R. 110, 116

(Bankr. N.D. Ill. 2009) (stating that test is whether the debtor's business prospects justify continuing the reorganization effort).

Mr. Spivey testified that there is a reasonable likelihood that his business could be rehabilitated based on evidence that Fender Chevrolet had agreed to hire Douglas Asphalt to perform a small demolition job. Hr'g Tr., 55-57. Although no contract had been signed as of the hearing date, Mr. Spivey testified that the job would require three employees to complete over four to five weeks and would generate approximately $20,000 in net revenue. *Id.*, 55-75, 60, 63, 100-01. In contrast, Douglas Asphalt employed over 550 people and generated approximately $140 million in annual gross revenue when it was a healthy business. *Id.*, 61, 64, 104, 127. The bankruptcy court did not abuse its discretion when it found that a single potential contract for a net $20,000 does not demonstrate a reasonable likelihood that Douglas Asphalt could be restored to a business capable of repaying $220 million to its creditors.

Mr. Spivey expresses a desire to repay Douglas Asphalt's creditors and wants to rebuild this company. But a sincere desire to reorganize "means little without the Debtor's actual ability to reorganize." *Colonial Daytona Ltd. P'ship v. Am. Sav. of Fla., F.S.*, 152 B.R. 996, 1003 (M.D. Fla.1993) (citing *Tenn. Pub. Co. v. Am. Nat'l Bank*, 299 U.S. 18, 22 (1936)). The bankruptcy court was correct when it determined that Mr. Spivey cannot repay his creditors and rebuild his company under chapter 11. *In re Tiana Motel Inc.*, 749 F.2d 146, 151 (2d Cir. 1984) ("boundless confidence" not enough to allow debtor to maintain a chapter 11 case). Douglas Asphalt's ongoing operations will generate losses and the further accumulation of debt to the detriment of its creditors. The bankruptcy court was correct, furthermore, that rebuilding from the ground up is not rehabilitation. Hr'g Tr., 153 (bankruptcy court ruling); *see Loop Corp*., 379 F.3d at 516. The bankruptcy court did not clearly err when it found that rehabilitation of Douglas Asphalt would be impossible.

Nor does the existence of the judgment against Applied Technical Services alter this conclusion. The judgment currently consists of $2 million in the bankruptcy court and additional claims against third parties which may or may not be liable to Douglas Asphalt. Even if Douglas Asphalt were to collect the full $150 million, which is very unlikely, it would still owe the bondholders $12 million. Douglas Asphalt cannot obtain performance bonds. Hr'g Tr., 54. It is not pre-qualified to do work for the Georgia Department of Transportation. *Id.*, 52-52. It simply does not have access to jobs that can generate enough revenue to make meaningful repayments to its creditors and which would warrant keeping this case in chapter 11.

II. THE BANKRUPTCY COURT DID NOT ABUSE ITS DISCRETION IN DETERMINING THAT CONVERSION OF THE DEBTOR'S CASE TO CHAPTER 7 BEST SERVED THE INTERESTS OF CREDITORS AND THE ESTATE.

As the bankruptcy court found, Douglas Asphalt's creditors will be better served by liquidation. Liquidation provides the Douglas Asphalt creditors with four advantages. First, liquidation will be much quicker than waiting for Mr.

Spivey to grow the company from an empty shell into the multi-million dollar enterprise it once was. Hr'g Tr., 64 (statement by Mr. Spivey that he cannot rebuild "overnight"). The primary assets of the Douglas Asphalt estate are the $150 million Applied Technical Services judgment and several other legal claims. As of the hearing date, special counsel had already been hired to pursue collection on that judgment and to initiate actions in pursuit of the estate's other claims. *See* Hr'g Tr. 131, 146, 149-50. In contrast, Mr. Spivey estimated that Douglas Asphalt could generate a net income of $200,000 per year in the foreseeable future. *Id.*, 93. Accordingly, the special counsel will be able to reduce Douglas Asphalt's claims to cash for the benefit of creditors before the company could become an enterprise again capable of generating the multi-million dollar income needed to make a significant repayment to its creditors.

Second, liquidation in chapter 7 ensures that all similarly situated creditors will be treated fairly and equally. *See Reliant Energy Servs., Inc. v. Enron Canada Corp.*, 349 F.3d 816, 825 (5th Cir. 2003) (stating that one purpose of the automatic stay is to promote equity of distribution among creditors). An orderly liquidation of the estate's assets in chapter 7 would benefit all creditors by preventing the race to state court that would otherwise result if the case were dismissed and creditors were left to their remedies at state law.

Third, conversion ensures the oversight of a chapter 7 trustee. The creditors allege that Mr. Spivey, other Spivey family members, and Douglas Asphalt Paving Company, the corporation owned by the debtor's ex-wife, may have received preferential or fraudulent transfers from Douglas Asphalt. Hr'g Tr., 25-26, 29-30, 81, 139. They contend that these could be avoided and recovered for the benefit of creditors. *See* 11 U.S.C. §§ 547, 548 and 551. Because Mr. Spivey has an inherent conflict of interest in investigating and pursuing these allegations against himself and his family members, a neutral trustee will benefit creditors. *See* Hr'g Tr., 83-84. *See In re Intercat, Inc.*, 247 B.R. 911, 922-23 (Bankr. S.D. Ga. 2000) (Davis, J.) (stating a trustee is necessary when a debtor's principal owner/manager is the target of potential investigations and/or actions to recover transfers for the benefit of creditors). Naming a chapter 7 trustee would be more beneficial than appointment of a chapter 11 trustee because there is no business to operate. *See In re Fiesta Homes of Georgia, Inc.*, 125 B.R. 321, 326 (Bankr. S.D. Ga. 1990) (Davis, J.) (noting that if there is no business to operate, conversion to chapter 7 is the obvious choice).

Fourth, the creditors who are owed the majority of the unsecured debt at issue in the case supported the United States Trustee's motion to convert. *See e.g.*, Hr'g Tr. at 23. *See In re Loop Corp.*, 290 B.R. 108, 115 (D. Minn. 2003), *aff'd* 379 F.3d 511 (8th Cir. 2004) (noting that it is appropriate to consider whether creditors favor conversion or dismissal when determining the best interests of creditors). If the creditors themselves favor conversion, the bankruptcy court could not have abused its discretion in determining that conversion to chapter 7 best served the interests of creditors and the estate.

III. DOUGLAS ASPHALT CANNOT DEMONSTRATE THAT THERE ARE UNUSUAL CIRCUMSTANCES INDICATING THAT CONVERSION WOULD BE DETRIMENTAL TO CREDITORS AND THE ESTATE.

The United States Trustee met his burden to show cause that Douglas Asphalt's chapter 11 case should be converted to chapter 7. *In re Woodbrook Assocs*., 19 F.3d 312, 317 (7th Cir. 1994). Under sections 1112(b)(1) and (2), if the movant establishes cause, then the burden shifts to the debtor to prove the existence of "unusual circumstances" such that conversion would be detrimental to creditors and the estate. *Id.*; *In re Roan Valley, LLC*, No. 09-13229, 2009 WL 6498118, at *2 (Bankr. N.D. Ga. Nov. 25, 2009) (delineating burdens of proof); *In re Prods. Int'l Co.*, 395 B.R. 101, 109 (Bankr. D. Ariz. 2008) (relying on 7 Collier on Bankruptcy, ¶ 1112.04[3], p. 1112-26, 1112-27 (15th ed. rev.)).

In this case, Douglas Asphalt is not eligible to attempt to make a section 1112(b)(1) and (2) showing of unusual circumstances. These Code provisions require that a debtor show that "the grounds for granting such relief [denial of conversion due to unusual circumstances] include an act or omission of the debtor **other than under paragraph (4)(A).** 11 U.S.C. § 1112(b)(2)(B) (emphasis added). Subsection 1112(b)(4)(A) states that cause for conversion includes "substantial or continuing loss to or diminution of the estate and the absence of a reasonable likelihood of rehabilitation." The plain language of section 1112(b) precludes overriding the establishment of cause to convert if that cause is diminution of the estate and unlikelihood of rehabilitation – the precise grounds for conversion in this case

Here the bankruptcy court based its decision to convert on section 1112(b)(4)(A). Therefore, section 1112(b)(2)(B) prevents Douglas Asphalt from raising an unusual circumstances defense to block conversion.

Even if Douglas Asphalt were eligible to make such an argument, it would fail. Douglas Asphalt's brief omits the language in the statute that explains what a debtor must do to prevent conversion even after a party in interest has established cause and lack of unusual circumstances. *See* Douglas Asphalt Br. at 8. First, a debtor must show that "there is a reasonable likelihood that a plan will be confirmed within the time frames established in sections 1121(e) and 1129(e) of this title, or if such sections do not apply, within a reasonable period of time[.]" 11 U.S.C. § 1112(b)(2)(A). Second, that debtor must also show that its acts or omissions that caused grounds for conversion are justifiable. 11 U.S.C. § 1112(b)(2)(B)(i**).** Third, it must show it can cure the grounds that would justify conversion. 11 U.S.C. § 1112(b)(2)(B)(ii).

Douglas Asphalt has shown none of these. It has not submitted a plan or maintained that it could submit a plan that would be confirmed within a reasonable time. It also did not argue that the motion to convert was based on a reasonably justified act or omission that it could cure in a reasonable time. Accordingly, even if section 1112(b)(2) were applicable in this case, Douglas Asphalt has not even tried to establish the two elements necessary to invoke it.

Given Douglas Asphalt's dire financial straits and lack of significant operations, it cannot propose a feasible plan to successfully retire $220 million in debt over any reasonable period of time. Moreover, the debtor lacks the support of its major creditors, the bond companies, whose votes would be necessary to confirm a consensual plan. For these reasons, confirmation of a plan is not likely to occur, and every dollar Douglas Asphalt spends fighting to confirm a plan is a dollar wasted. Creditors have every right to cut their losses and insist upon an orderly liquidation, which is what they have done in this case by supporting the United States Trustee's motion to convert.

CONCLUSION

For the foregoing reasons, the United States Trustee requests that this Court affirm the bankruptcy court's order converting Douglas Asphalt Company's case from chapter 11 to chapter 7.

Respectfully submitted,

RAMONA D. ELLIOTT
General Counsel

P. MATTHEW SUTKO
Associate General Counsel

CATHERINE B. SEVCENKO
Trial Attorney
Executive Office for United States
Trustees
Department of Justice
20 Massachusetts Avenue, N.W.
Washington, D.C. 20530
Ph: (202) 307-1399
Fax: (202) 307-2397

/s/ Matthew E. Mills
DONALD F. WALTON
United States Trustee for Region 21

MATTHEW E. MILLS
Assistant United States Trustee

JOEL PASCHKE
Trial Attorney
Office of the United States Trustee
222 W. Oglethorpe Ave., Suite 302
Savannah, GA 31401
Phone: (912) 652-4112
Fax: (912) 652-4123

July 13, 2010

CERTIFICATE OF SERVICE

The undersigned hereby certifies that the within and foregoing RESPONSE BRIEF OF APPELLEE DONALD F. WALTON, UNITED STATES TRUSTEE has this day been served upon the following by mailing a copy of the same through the United States Mail bearing sufficient postage thereon. In addition, electronic service will be received by those parties that are entitled to receive such service in this case through the electronic filing system of this Court.

Douglas Asphalt Company
101 North Peterson Avenue, Suite 201
Douglas, GA 31533

C. James McCallar, Jr.
McCallar Law Firm
P.O. Box 9026
Savannah, GA 31412

William E. Dillard, III
Brennan & Wasden LLP
P.O. Box 8047
411 East Liberty Street
Savannah, GA 31412

Kathleen Horne
Inglesby Falligant Horne Courington & Chisholm
P.O. Box 1368
Savannah, GA 31402

Date: July 13, 2010

/s/ Matthew E. Mills
Matthew E. Mills
Assistant United States Trustee

Office of United States Trustee
222 West Oglethorpe Avenue, Suite 302
Savannah, Georgia 31401
(912) 652-4112

BRIEF BANK — "SUMMARY SHEET" *Printed Wed-6/11/08 12:9*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]* — In re Geoff Paul Draisey, et al. (Fokkena, UST v. Draisey)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]* — B.A.P. 8th Cir.

3. ("CCN") ***CURRENT*** CASE NO. — No.: 08-6016

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]* — No.: 07-31204

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(Identify judge & cite, if any)

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(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC*** — **BANKRUPTCY**

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***

• Did the bankruptcy court err in denying the United States Trustee's motion to dismiss the Draiseys' bankruptcy case for abuse under section 707(b)(3) because the United States Trustee did not file the statement or motion within the time limits specified in section 704(b)?

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BEFORE THE UNITED STATES BANKRUPTCY APPELLATE PANEL
FOR THE EIGHTH CIRCUIT

CASE NO. 08-6016

In re GEOFF PAUL DRAISEY and KRISTIN DENISE DRAISEY,

Debtors.

HABBO FOKKENA,

United States Trustee-Appellant,

v.

GEOFF PAUL DRAISEY and KRISTIN DENISE DRAISEY,

Debtors-Appellees.

ON APPEAL FROM THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF MINNESOTA
BANKRUPTCY CASE NO. 07-31204

BRIEF OF APPELLANT, HABBO FOKKENA, UNITED STATES TRUSTEE

ROBERTA A. DEANGELIS
Acting General Counsel
RAMONA D. ELLIOTT
Deputy General Counsel
P. MATTHEW SUTKO
Associate General Counsel
DAVID LEVINE
Executive Office for
United States Trustees
Department of Justice
20 Massachusetts Ave., N.W.
Washington, DC 20530

HABBO FOKKENA
United States Trustee
Region 12

MICHAEL E. RIDGWAY
Office of the U.S. Trustee
Department of Justice
300 South Fourth Street
Suite 1015
Minneapolis, MN 55415
Telephone: (612) 664-5500
Facsimile: (612) 664-5516

WILLIAM L. COURSHON
Office of the U.S. Trustee
Department of Justice
700 Stewart Street
Suite 5103
Seattle, WA 98101-1271
Telephone: (206) 553-2000
Facsimile: (206) 553-2566

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STATEMENT OF APPELLATE JURISDICTION

The United States Bankruptcy Court for the District of Minnesota had jurisdiction over Geoff and Kristin Draisey's bankruptcy case under 28 U.S.C. §§ 157 and 1334. The bankruptcy court denied the United States Trustee's section 707(b)(3) motion to dismiss by order entered April 8, 2008. The United States Trustee timely appealed that order on April 15, 2008, under 28 U.S.C. § 158(c)(2) and Fed. R. Bankr. P. 8002(a).

This Court has jurisdiction over this appeal under 28 U.S.C. § 158(a). The bankruptcy court's order denying the United States Trustee's section 707(b) motion is a final, appealable order. *See Stuart v. Koch (In re Koch)*, 109 F.3d 1285, 1287 (8th Cir. 1997) (order denying section 707(b) motion to dismiss is final).

STATEMENT OF THE ISSUE AND STANDARD OF REVIEW

Under section 704(b) of the Bankruptcy Code, United States Trustees file (a) a statement whether an individual debtor's chapter 7 case is presumptively abusive under section 707(b), and (b) any motion to dismiss the debtor's case based on presumed abuse under 11 U.S.C. § 707(b)(2), within specified time limits.

The question presented is: Did the bankruptcy court err in denying the United States Trustee's motion to dismiss the Draiseys' bankruptcy case for abuse under section 707(b)(3) because the United States Trustee did not file the statement or motion within the time limits specified in section 704(b)?

This Court reviews findings of fact for clear error and conclusions of law *de novo*. *In re M & S Grading, Inc.*, 457 F.3d 898, 899 (8th Cir. 2006). Issues of statutory construction are reviewed *de novo*. *Stuart v. Carter (In re Larsen)*, 59 F.3d 783, 785 (8th Cir. 1995). This appeal is subject to *de novo* review because it involves a statutory construction question.

STATEMENT OF THE CASE

This appeal involves the interpretation of provisions added to the Bankruptcy Code by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23 (2005). The 2005 Act included provisions mandating the dismissal of bankruptcy cases filed by consumer debtors seeking chapter 7 relief if the court determines granting relief would be an abuse of chapter 7. 11 U.S.C. § 707(b). The 2005 Act added provisions requiring the United States Trustee to file a statement whether a bankruptcy case would be presumed to be an abuse under section 707(b), and to file any motion to dismiss the debtor's case based on presumed abuse, within specified time limits. 11 U.S.C. § 704(b).

The Draiseys filed a voluntary chapter 7 petition. The United States Trustee filed a motion to dismiss the Draiseys' chapter 7 case for abuse under 11 U.S.C. § 707(b)(1) and (3), based on the totality of the Draiseys' financial circumstances. The United States Trustee did not seek dismissal under 11 U.S.C. § 707(b)(2) because no presumption of abuse arose in the case. In response, the Draiseys asserted that the section 707(b)(3) motion was untimely because the United States Trustee did not file a statement whether the Draiseys' case would be presumed to be an abuse and did not file the motion within the time limits specified in section 704(b). The bankruptcy court agreed with the Draiseys and entered an order denying the motion without addressing its merits. The court concluded that the motion was time-barred because timely compliance with section 704(b) was a prerequisite for the United States Trustee to bring any motion under section 707(b), not just motions seeking relief under section 707(b)(2). This appeal followed.

STATEMENT OF THE FACTS

I. Statutory Framework

A. Overview of Section 707(b)

The 2005 Act made significant changes to section 707(b) of the Bankruptcy Code, which provides a mechanism for policing the bankruptcy system for abuse, to ensure "that those who can afford to repay some portion of their unsecured debts be required to do so ..." 151 Cong. Rec. S2470 (March 10, 2005). First, Congress lowered the legal standard for dismissal under section 707(b) from "substantial abuse" to "abuse." Second, Congress eliminated the prior statutory presumption that debtors were entitled to relief and replaced it with a statutory presumption of abuse mandating dismissal under section 707(b)(2) or, with the debtor's consent, conversion to a chapter 13 debt repayment case. The section 707(b)(2) presumption arises when debtors can pay more than $182.50 per month to their creditors as calculated under a "means test" formula set out in section 707(b)(2)(A).

B. The United States Trustee's Duties Under Section 704(b)

Under the 2005 Act, the United States Trustees review and analyze the means test form and other materials filed by all consumer chapter 7 debtors. Section 704(b)(1)(A) requires United States Trustees to file not later than 10 days after the date of the first meeting of creditors a statement whether the debtor's case would be presumed to be an abuse under section 707(b) ("10-Day Statement"). 11 U.S.C. § 704(b)(1)(A). The bankruptcy court must provide a copy of the 10-Day Statement to all creditors of the debtor within 5 days after receiving the statement. 11 U.S.C. § 704(b)(1)(B).

Section 704(b)(2) specifies that "if the United States Trustee determines that the debtor's case should be presumed to be an abuse under section 707(b)" and the debtor's current monthly income is above the applicable state median family income, the United States Trustee must file either a motion to dismiss or convert under section 707(b) or a statement setting forth the reasons the United States Trustee does not consider such a motion to be appropriate, within 30 days after the date of filing the 10-Day Statement. 11 U.S.C. § 704(b)(2).

C. Dismissal for Abuse Under Section 707(b)(3)(B) Based on Totality of the Circumstances

Section 707(b)(3)(B) allows courts to dismiss debtors' cases when the totality of the circumstances of their financial situation demonstrates abuse. 11 U.S.C. § 707(b)(3). United States Trustees are authorized to seek dismissal under section 707(b)(3)(B). *See* 11 U.S.C. § 707(b)(1).

D. Interim Bankruptcy Rule 1017(e)

Prior to the effective date of the 2005 Act, Rule 1017(e)(1), Fed. R. Bankr. P., governed the time limit for the United States Trustee to file a motion to dismiss a consumer chapter 7 debtor's case for substantial abuse under former section 707(b). Under Rule 1017(e)(1), the United States Trustee was required to file a motion to dismiss for substantial abuse within 60 days after the first date set for the meeting of creditors, unless the court extended the time for filing the motion for cause on request filed by the United States Trustee before the time expired. Fed. R. Bankr. P. 1017(e)(1).

Interim Bankruptcy Rule 1017(e)(1), applicable to cases filed on or after October 17, 2005, provides that a motion to dismiss for abuse is subject to the same 60-day filing deadline specified in former Rule 1017(e), "except as otherwise provided in section 704(b)(2)." Interim Bankruptcy

Rule 1017(e)(1).[1]

II. Factual Background

A. The Draiseys' Bankruptcy Filing

On April 10, 2007, the Draiseys filed a voluntary chapter 7 petition. Appellant's App., pp.5-49. The Draiseys had $137,234 in unsecured debt.[2] *Id.*, p.30. The record in this case evidences that the Draiseys enjoyed higher income both before and immediately after the filing of their bankruptcy case than they did at the moment of filing, which necessitated further inquiry by the United States Trustee regarding the Draiseys' financial circumstances. *Id.*, pp.2, 33, 67. The Draiseys' statement of financial affairs listed annual gross wages of $75,533 in 2006 and $92,000 in 2005. *Id.*, p.33. Their schedules of current income (Schedule I) and current expenses (Schedule J), however, indicated that Ms. Draisey was unemployed at the moment of filing and that the Draiseys had gross monthly income of $3,366.67 ($40,400.04 annually) and monthly expenses of $5,158.47. *Id.*, pp.27-28. The Draiseys' means test form showed current monthly income of $5,365.88 ($64,390.56

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[1] Following the enactment of the 2005 Act, the Advisory Committee on Bankruptcy Rules prepared and recommended for local court adoption Interim Bankruptcy Rules designed to implement changes made by the 2005 Act. The Interim Rules apply until the Federal Rules of Bankruptcy Procedure are amended to implement the 2005 Act amendments. The Interim Rules are effective only in cases commenced on or after October 17, 2005, and only in the judicial districts that have adopted them by local rule or court order. 9 Collier on Bankruptcy, p.1017-2 (Alan N. Resnick & Henry J. Sommer eds., 15th ed. rev. 2006). On September 27, 2005, the bankruptcy judges in the District of Minnesota adopted the Interim Bankruptcy Rules for application in that district. Appellant's App., p.106. On April 23, 2008, the United States Supreme Court adopted amendments to the Federal Rules of Bankruptcy Procedure implementing changes made by the 2005 Act, effective December 1, 2008. The text of amended Rule 1017, as adopted by the Supreme Court, is identical to that of Interim Bankruptcy Rule 1017. Rule 1017, Fed. R. Bankr. P., as amended effective December 1, 2008.

[2] The Draiseys' petition reflects that their debts are primarily consumer debts. Appellant's App., pp.19-24.

annually), which was below the applicable state median family income of $70,908, and therefore indicated that the presumption of abuse did not arise. *Id.*, pp.44-45.

The Draiseys' mandatory 11 U.S.C. § 341(a) meeting of creditors was held on May 11, 2007. *Id.*, p.51. On May 21, 2007, the United States Trustee filed with the bankruptcy court a 10-Day Statement indicating that he was unable to determine whether the presumption of abuse arose under 11 U.S.C. § 707(b)(2) in the Draiseys' bankruptcy case.[3] *Id.*, pp.2-3. On June 19, 2007, after the United States Trustee received additional documents from the Draiseys and completed his means test review, the United States Trustee filed a supplemental statement under section 704(b)(1) indicating that the presumption of abuse did not arise.[4] *Id.*, p.3.

As a result of his investigation of the Draiseys' financial affairs, the United States Trustee learned that Ms. Draisey was unemployed from December 2006 through March 2007. *Id.*, pp.57, 80. In April 2007, shortly before the Draiseys' bankruptcy filing, however, the Draiseys' financial circumstances changed significantly when Ms. Draisey found new employment at an annual gross salary of more than $45,000. *Id.*, pp.57, 63, 103. Based on the Draiseys' current wage statements, which included Ms. Draisey's wages from her new job, the United States Trustee calculated that the

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[3] The 10-Day Statement provided: "The United States Trustee has determined that the debtor has not filed nor transmitted all of the required means testing documents and that without these documents, the United States Trustee cannot make a determination as to whether debtor's case is presumed abusive under section 707(b)." Appellant's App., pp.2-3.

[4] The supplemental section 704(b)(1) statement provided: "The United States Trustee previously filed a statement under section 704(b)(1)(A) of the Bankruptcy Code indicating an inability to determine whether this case would be presumed to be an abuse. The United States Trustee has reviewed all materials filed and submitted by the Debtor, including certain additional documents received after the filing of the United States Trustee's initial statement under section 704(b)(1)(A). Based on this review, the United States Trustee has determined that the Debtor's case is not presumed to be an abuse under section 707(b)(2)." Appellant's App., p.3.

Draiseys' monthly gross income had increased to $7,560.38 ($90,724.56 annually). *Id.*, pp.57, 67, 70. The United States Trustee determined that, as a result of the Draiseys' increased income, they had sufficient disposable income to repay a portion of their unsecured debts. *Id.*, pp.57-58, 73.

B. The United States Trustee's Motion to Dismiss Under Section 707(b)(3)(B)

On July 9, 2007, the United States Trustee filed a motion to dismiss the Draiseys' chapter 7 case for abuse under 11 U.S.C. § 707(b)(1) and (3) based on the totality of the circumstances of the Draiseys' financial situation. *Id.*, pp.54-83. The United States Trustee sought dismissal because Ms. Draisey's new job changed the Draiseys' financial circumstances and increased their ability to repay their debts. *Id.*, pp.57-58, 80, 103-104. *See, e.g., In re Cortez,* 457 F.3d 448, 458 (5th Cir. 2006) (pre-2005 Act case holding courts can consider postpetition improvements in earnings in ruling on a motion to dismiss under section 707(b)); *In re Pak*, 343 B.R. 239, 246-247 (Bankr. N.D. Cal. 2006) (court should take into account any post-filing changes in income in determining abuse under section 707(b)(3)(B)).

On August 31, 2007, the Draiseys responded to the motion, raising both substantive and procedural objections. Most importantly, for purposes of this appeal, the Draiseys asserted that the motion was untimely because the United States Trustee did not file the 10-Day Statement and the motion within the time limits specified in section 704(b). Appellant's App., pp.89-90.

On September 6, 2007, the United States Trustee filed a supplement to his motion, asserting that section 704(b) does not apply to this case because the United States Trustee did not determine that the Draiseys' case should be presumed to be an abuse under section 707(b)(2) and the Draiseys' current monthly income did not exceed the applicable state median. *Id.*, pp.99-100. The United States Trustee also explained that Interim Bankruptcy Rule 1017(e)(1), not section 704(b), governs the timeliness of a motion to dismiss for abuse based on section 707(b)(3)(B), because the latter is restricted only to section 707(b)(2) presumed abuse claims. *Id.*, p.100.

On September 11, 2007, the bankruptcy court conducted a hearing on the motion, at which the Court heard argument on the threshold issue whether the motion was time-barred under section 704(b). *Id.*, pp.113-118; TR., pp.1-22. At the conclusion of the hearing, the court took the matter under advisement. *Id.*, pp.116-118; TR., pp.16-22.

C. The Bankruptcy Court's Order Denying the Motion

On April 8, 2008, the bankruptcy court entered an order denying the United States Trustee's motion to dismiss for abuse under sections 707(b)(1) and 707(b)(3)(B), concluding that the motion was time-barred because the United States Trustee did not file a statement whether the Draiseys' case would be presumed to be an abuse and did not file the motion within the time limits specified in section 704(b).[5] *Id.*, pp.106, 108, 109. The bankruptcy court read section 704(b) as requiring United States Trustees to file 10-Day Statements in every individual chapter 7 case and file all motions to dismiss for abuse under section 707(b) within 30 days after the filing of the 10-Day Statements, regardless whether the presumption of abuse arises in the case or whether the debtor's annualized current monthly income exceeds the applicable state median. *Id.*, pp.106, 108.

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[5] In its April 8, 2008 order, the bankruptcy court found that the United States Trustee never filed a 10-Day Statement addressing the existence of the presumption of abuse in the Draiseys' case. Appellant's App., pp.103, 104. Although the United States Trustee does not believe he was required to file a 10-Day Statement in this case, he in fact filed two statements. *Id.*, pp.2-3. In any event, the United States Trustee has not raised this issue on appeal because his attorney, in light of the bankruptcy court's decision in *In re Robertson*, 370 B.R. 804 (Bankr. D. Minn. 2007), advised the court at the September 11, 2007, hearing that the United States Trustee did not file a definitive 10-Day Statement as to whether the presumption arose in the Draiseys' case. Appellant's App., p.115; TR., p.11. The United States Trustee disagrees with *Robertson's* holding, but does not press that issue in this appeal.

SUMMARY OF ARGUMENT

The bankruptcy court denied the United States Trustee's section 707(b)(3) motion to dismiss on a procedural ground, one that turned on two legal conclusions the court made. Both were necessary to the court's holding.

First, the bankruptcy court ruled section 704(b)(1)'s requirement that United States Trustees file 10-Day Statements applies in every chapter 7 case, not just cases in which a presumption of abuse arises under section 707(b)(2). Second, because the court ruled section 704(b)(1)'s 10-Day Statement deadline was triggered in every case, it ruled that the United States Trustee needed to file his section 707(b)(3) motion by the deadline created by section 704(b)(2) rather than the longer deadline established by Interim Fed. R. Bankr. P. 1017(e). In reaching that conclusion, the court rejected the United States Trustee's alternative legal argument that, even if section 704(b)(1) applies in all cases, section 704(b)(2)'s deadline nonetheless applies only to motions asserting claims under section 707(b)(2), not section 707(b)(3) claims.

The bankruptcy court's order merits reversal if either of these subsidiary legal rulings is incorrect. Both are.

The bankruptcy court ruled incorrectly that Section 704(b)(1)'s 10-day deadline for filing a statement of presumed abuse applies in every case. Section 704(b)(1) is best read as requiring United States Trustees to file 10-Day Statements only when a presumption of abuse arises. Accordingly, the bankruptcy court erred in concluding that a 10-Day Statement was a prerequisite to the United States Trustee's motion to dismiss asserting a claim under section 707(b)(3)(B). In this case, the United States Trustee was not required to file a 10-Day Statement because the section 707(b)(2) presumption of abuse did not arise. There was thus no need for the United States Trustee to comply with section 704(b)(2)'s deadline because that deadline applies only when the section 704(b)(1) deadline is triggered.

Even if United States Trustees must file the statement mentioned in section 704(b)(1) when no presumption of abuse arises, the bankruptcy court's ruling would nonetheless merit reversal because the section 704(b)(2) deadline that section 704(b)(1) triggers applies only to motions asserting a claim under section 707(b)(2) for presumed abuse. This reading is supported by section 704(b)(2)'s text, which focuses only on a presumption of abuse, not the totality of the circumstances of the debtor's financial situation,[6] which is relevant in section 707(b)(3)(B) cases like the Draiseys'. Indeed, the bankruptcy court's reading cannot be the correct one because it would render superfluous all the words in section 704(b)(2) that follow the word "if."

ARGUMENT

I. THE UNITED STATES TRUSTEE'S SECTION 707(b)(3)(B) MOTION WAS NOT UNTIMELY UNDER SECTION 704(b)(2) BECAUSE SECTION 704(b)(1) APPLIES ONLY WHEN A PRESUMPTION OF ABUSE ARISES UNDER SECTION 707(b)(2), WHICH WAS NOT THE CASE HERE.

Section 704(b)(1)(A) requires each United States Trustee to file "a statement as to whether the debtor's case would be presumed to be an abuse under section 707(b)." The bankruptcy court, in denying the section 707(b)(3)(B)-based motion, concluded that this language requires United States Trustees to file 10-Day Statements in all individual chapter 7 cases, regardless whether the presumption of abuse arises. Appellant's App., p.108. Given section 704(b)'s language, which focuses solely upon presumed abuse under section 707(b)(2), section 704(b)(1) is better read as requiring United States Trustees to file 10-Day Statements only where the presumption of abuse

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[6] Section 704(b)(2) is also not relevant in bad faith cases under section 707(b)(3)(A).

arises.

First, the text supports this reading. Section 704(b)(1) does not expressly require a statement that the presumption does not arise. It exists only to trigger section 704(b)(2)'s filing deadline for motions to dismiss based on presumed abuse, and only requires an affirmative statement as to "whether" the presumption of abuse arises. Had Congress intended to require a 10-Day Statement to be filed whether or not the United States Trustee determined that the presumption of abuse arose, it could easily have done so.

Second, this reading best implements the primary purpose of the statute, which is to provide preliminary notice to creditors that the United States Trustee has determined a presumption of abuse arises. *See In re Cadwallder,* 2007 WL 1864154 at *8 (Bankr. S.D. Tex. 2007). This is evidenced by section 704(b)(1)(B)'s text, which requires the clerk's office to provide a copy of the 10-Day Statement to creditors, but not to the debtor. *Id.* (explaining that the notice requirement suggests the 10-Day Statement is intended primarily for the information and benefit of creditors and the court, not for the debtor); *cf.* 6 Collier on Bankruptcy, ¶ 704.17[1], p. 704-37 (Alan N. Resnick & Henry J. Sommer eds., 15th ed. rev. 2006) (section 704(b)(1)(B) is "intended to give creditors an opportunity to file their own motions under 707(b)(2), if they are eligible to do so").

Third, requiring clerks' offices to provide copies of 10-Day Statements in cases filed by below-median-income debtors such as the Draiseys makes little sense because courts cannot dismiss cases filed by below-median debtors based on the presumption of abuse and creditors lack standing to seek dismissal under section 707(b) against any below-median-income debtor. 11 U.S.C. § 707(b)(6) and (7).

The issue takes sharp focus when one reflects that approximately 90% of the 451,011 consumer chapter 7 cases filed during fiscal year 2007 were filed by below-median-income debtors.[7] Requiring bankruptcy court clerks to provide copies of 10-Day Statements to creditors in every below-median income consumer chapter 7 case would necessitate the mailing of millions of additional documents to creditors, resulting in vast expenditures of time, money, and other court resources for no apparent purpose.

By way of example, the Draiseys' bankruptcy schedules list twenty-three creditors. Under the bankruptcy court's interpretation of section 704(b)(1), based on approximately 406,000 chapter 7 cases filed by below-median-income debtors during fiscal year 2007, and assuming, conservatively, an average of ten creditors per case, clerks' offices nationwide would have been required to provide at least 4,060,000 copies of 10-Day Statements to creditors in cases where the creditors lacked any standing to seek dismissal under section 707(b).

Thus, the statute's text and purpose support the conclusion that Congress did not intend to require United States Trustees to file 10-Day Statements in every chapter 7 case, and certainly not in cases filed by debtors whose historical income was below median. Nor does the text or policy lead to the conclusion that Congress intended to force bankruptcy court clerks' offices to mail millions of documents to creditors annually advising creditors that the section 707(b)(2) presumption of abuse did not arise, given that creditors lack standing to pursue relief under section 707(b)(2) or (b)(3) against below-median-income debtors.

Because the United States Trustee was not required to file a 10-Day Statement in this case,

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[7] During fiscal year 2007, according to data collected by the Administrative Office of the U.S. Courts, 451,011 consumer chapter 7 cases were filed nationwide, excluding the judicial districts in Alabama and North Carolina. *See* 28 U.S.C. § 581(a) (excluding the federal judicial districts in Alabama and North Carolina from the United States Trustee Program). Of these 451,011 cases, approximately 10% or 45,000 were filed by debtors with above-median income.

the bankruptcy court erred by denying the United States Trustee's motion to dismiss for failure to file a 10-Day Statement.

II. ALTERNATIVELY, EVEN IF UNITED STATES TRUSTEES MUST FILE A 10-DAY STATEMENT WHEN THE PRESUMPTION OF ABUSE DOES NOT ARISE, THE 30-DAY DEADLINE IN SECTION 704(b)(2) APPLIES ONLY TO MOTIONS BASED ON SECTION 707(b)(2)'S PRESUMPTION OF ABUSE, NOT TO SECTION 707(b)(3) MOTIONS, WHICH ARE SUBJECT TO THE DEADLINE IN INTERIM BANKRUPTCY RULE 1017(e).

The bankruptcy court concluded that section 704(b)(2)'s directive that the United States Trustee "file a motion to dismiss or convert under section 707(b)" was not expressly limited to section 707(b)(2) motions based on a presumption of abuse and accordingly, also applied to motions based on section 707(b)(3). Appellant's App., p.106. It did so because the section uses the term "707(b)" rather than "707(b)(2)." This construction, however, fails to give meaning to all the statute's words, which make clear Congress's intent to limit section 704(b)(2)'s applicability to motions to dismiss based on presumed abuse under section 707(b)(2).

Congress enacted section 704(b) as part of the 2005 Act to implement the new provisions of section 707(b)(2) requiring bankruptcy courts to dismiss debtors' chapter 7 cases based on presumed abuse. Its purpose is to inform the court and parties in interest whether United States Trustees have determined the presumption of abuse arises under section 707(b)(2). All the words in section 704(b) make clear that the 30-day deadline in section 704(b)(2) applies only to motions based on section 707(b)(2) .

First, section 704(b)(1)(A) requires United States Trustees to file 10-Day Statements "as to whether the debtor's case would be presumed to be an abuse under section 707(b)." 11 U.S.C. § 704(b)(1)(A). This relates to section 707(b)(2)'s means test. Second, section 704(b)(1)(B) requires the court to provide a copy of any 10-Day Statement to all creditors within 5 days after receiving the statement. 11 U.S.C. § 704(b)(1)(B). Third, section 704(b)(2) then provides that the United States Trustees shall file, not less than 30 days after the date of filing the 10-Day Statement, either a motion to dismiss under section 707(b) or a statement setting forth the reasons why a motion is inappropriate, "**if** the United States Trustee determines that the debtor's case **should be presumed to be an abuse under section 707(b)** and [the debtor's current monthly income exceeds the applicable state median family income]."[8] 11 U.S.C. § 704(b)(2) (emphasis added). Again, that provision applies only to section 707(b)(2) motions predicated on the presumption of abuse.

The court's conclusion that timely compliance with section 704(b)(2) was a prerequisite for the United States Trustee to bring a section 707(b)(3)-based motion renders the second half of that provision superfluous.[9] The second half of section 704(b)(2) provides that the 30-day filing deadline (after filing the 10-Day Statement) applies only if the United States Trustee determines that the presumption of abuse arises and if the debtor's annualized current monthly income exceeds the median.[10]

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[8] At least one court has held that section 704(b) is "a mandate for U.S. Trustee action imposed for the benefit of the Court and other parties in interest, not a deadline" and that "even if the U.S. Trustee had not met the § 704(b) deadlines, the motion would not be time barred merely for that reason." *In re Cadwallder*, 2007 WL 1864154 at *9 (Bankr. S.D. Tex. 2007).

[9] Section 704(b)(2) reads:

> The United States trustee ... shall, not later than 30 days after the date of filing a statement under paragraph (1), either file a motion to dismiss or convert under section 707(b) or file a statement setting forth the reasons the United States trustee ... does not consider such a motion to be appropriate, if the United States trustee ... determines that the debtor's case should be presumed to be an abuse under section 707(b) and the product of the debtor's current monthly income, multiplied by 12 [exceeds the applicable state median family income].

[10] In this case, the Draiseys' annualized current monthly income was below the median. Appellant's App., p.45.

That portion of section 704(b)(2)'s text makes clear the provision does not set a deadline for section 707(b)(3)(B)-based motions. If Congress intended for all section 707(b) motions to be filed within 30 days after filing a 10-Day Statement (and not just motions based on the section 707(b)(2) presumption), then everything after the word "if" in section 704(b)(2) would be meaningless.

Given this, the bankruptcy court's reading of section 704(b)(2) conflicts with the rule of statutory construction that courts should not interpret one provision of a statute in a manner that renders other sections of the same statute inconsistent, meaningless, or superfluous. *Cody v. Hillard*, 304 F.3d 767, 776 (8th Cir. 2002); *see also Darling v. Bowen*, 878 F.2d 1069, 1076 (8th Cir. 1989), *cert. denied sub nom. Stangler v. Darling*, 494 U.S. 1066 (1990) (in interpreting a statute, courts must seek to adopt a construction which gives effect to all of its provisions). Where, as here, a statute admits a reasonable construction which gives effect to all of its provisions, the court should decline to adopt a strained reading which renders one part a mere redundancy.[11] *Beef Nebraska, Inc. v. United States*, 807 F.2d 712, 717 (8th Cir. 1986), *citing Jarecki v. G.D. Searle & Co.*, 367 U.S. 303, 307-308 (1961).

Last, the bankruptcy court's reading of section 704(b) also conflicts with the decisions of all other courts that have considered this issue. In the two-and-one-half years since the effective date of the 2005 Act, no other court has read the statute this way. Every other court has held that section

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[11] The court also misread section 704(b)(1) to require the United States Trustee to file a 10-Day Statement in all consumer chapter 7 cases because the 10-Day Statement functions primarily to trigger the 30-day deadline for filing motions based on presumed abuse. Appellant's App., p.108. The Draiseys had initially disclosed on their means test form that the presumption did not arise and that the Draiseys' current monthly income was below the median. *Id.*, pp.44-45, 51. Section 704(b) contains no language requiring the United States Trustee to file a 10-Day Statement as a prerequisite for filing a section 707(b)(3) motion, which is not based on presumed abuse. *See In re Byrne*, 376 B.R. 700, 704 (Bankr. W.D. Ark. 2006) ("the ten day statement under § 704(b)(1) is superfluous to a filing under § 707(b)(3) if a determination has otherwise been made that a presumption of abuse does not arise").

704(b)(2) does not apply to section 707(b)(3)-based motions; and even the bankruptcy judges in Minnesota now are split on this issue. *See In re Close*, 384 B.R. 856, 871 (D. Kan. 2008), *aff'g* 353 B.R. 915 (Bankr. D. Kan. 2006); *In re Ansar*, 383 B.R. 344, 348 (Bankr. D. Minn. 2008) ("[n]othing in § 704(b) prevents the [United States Trustee] from filing a motion to dismiss under § 707(b)(3) where the burden of proof will rest on the [United States Trustee]"); *In re Sandifer*, 2008 WL 618799 at *1 n.1 (Bankr. N.D. Cal. 2008); *In re Perrotta*, 378 B.R. 434, 438 (Bankr. D. N.H. 2007); *In re Byrne*, 376 B.R. 700, 703-704 (Bankr. W.D. Ark. 2007); *In re Littman*, 370 B.R. 820, 827 n.20 (Bankr. D. Idaho 2007); *In re dePellegrini*, 365 B.R. 830, 831 (Bankr. S.D. Ohio 2007); *In re Singletary*, 354 B.R. 455, 465 (Bankr. S.D. Tex. 2006); *see also* Interim Bankruptcy Rule 1017(e)(1) (providing for deadline of 60 days after the first date set for meeting of creditors for filing motions to dismiss for abuse under section 707(b) "except as otherwise provided in § 704(b)(2)").[12]

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[12] It is not surprising that the other courts, including another bankruptcy judge in Minnesota, also have held unanimously that Interim Rule 1017(e)(1), not section 704(b)(2), governs the filing deadline for motions based on section 707(b)(3). *See In re Ansar*, 383 B.R. 344, 348 (Bankr. D. Minn. 2008); *In re Perrotta*, 378 B.R. 434, 438 (Bankr. D. N.H. 2007); *In re Byrne*, 376 B.R. 700, 703-704 (Bankr. W.D. Ark. 2007); *In re dePellegrini*, 365 B.R. 830, 831 (Bankr. S.D. Ohio 2007).

CONCLUSION

For these reasons, the United States Trustee respectfully asks this Court to reverse the bankruptcy court's order denying the United States Trustee's motion to dismiss for abuse under section 707(b)(3), and to remand the case to the bankruptcy court for further proceedings on the merits of the motion.

DATED this 3rd day of June, 2008.

Of Counsel:

ROBERTA A. DEANGELIS
Acting General Counsel
RAMONA D. ELLIOTT
Deputy General Counsel
P. MATTHEW SUTKO
Associate General Counsel
DAVID LEVINE
Executive Office for
United States Trustees
Department of Justice
20 Massachusetts Ave., N.W.
Washington, DC 20530

Respectfully submitted,

HABBO FOKKENA
United States Trustee, Region 12

/s/ William L. Courshon for
MICHAEL E. RIDGWAY
Office of the United States Trustee
Department of Justice
300 South Fourth Street, Suite 1015
Minneapolis, MN 55415
Telephone: (612) 664-5500
Facsimile: (612) 664-5516

WILLIAM L. COURSHON
Office of the United States Trustee
Department of Justice
700 Stewart Street, Suite 5103
Seattle, WA 98101-1271
Telephone: (206) 553-2000
Facsimile: (206) 553-2566

Attorneys for Appellant,
United States Trustee

CERTIFICATE OF COMPLIANCE

I hereby certify, pursuant to L.R.BAP 8th Cir. 8010A(a), as follows:

1. On June 3, 2008, I sent by Federal Express, for next business day delivery, a CD-ROM containing the full text of the foregoing Brief of Appellant, Habbo Fokkena, United States Trustee, to the Office of the Clerk, United States Bankruptcy Appellate Panel for the Eighth Circuit, Thomas F. Eagleton Courthouse, Room 24.329, 111 South 10th Street, St. Louis, MO 63102.

2. The above-referenced CD-ROM has been scanned for viruses and is virus-free.

3. The foregoing brief was prepared on Corel WordPerfect 12 software and copied to the above-referenced CD-ROM in PDF format utilizing Adobe Acrobat 7.0 Professional software.

4. The foregoing brief complies with the word limitation of L.R.BAP 8th Cir. 8010A(b) because the brief contains 5,352 words, excluding the parts of the brief exempted by L.R.BAP 8th Cir. 8010A(b).

DATED: June 3, 2008

/s/ William L. Courshon
William L. Courshon
Office of the United States Trustee
Department of Justice
700 Stewart Street, Suite 5103
Seattle, WA 98101-1271
Telephone No.: (206) 553-2000
Facsimile No.: (206) 553-2566

Attorney for Appellant, United States Trustee

ADDENDUM

INDEX TO ADDENDUM TO BRIEF OF APPELLANT, UNITED STATES TRUSTEE

11 U.S.C. § 704(b)

(b)(1) With respect to a debtor who is an individual in a case under this chapter--

> **(A)** the United States trustee (or the bankruptcy administrator, if any) shall review all materials filed by the debtor and, not later than 10 days after the date of the first meeting of creditors, file with the court a statement as to whether the debtor's case would be presumed to be an abuse under section 707(b); and
>
> **(B)** not later than 5 days after receiving a statement under subparagraph (A), the court shall provide a copy of the statement to all creditors.

(2) The United States trustee (or bankruptcy administrator, if any) shall, not later than 30 days after the date of filing a statement under paragraph (1), either file a motion to dismiss or convert under section 707(b) or file a statement setting forth the reasons the United States trustee (or the bankruptcy administrator, if any) does not consider such a motion to be appropriate, if the United States trustee (or the bankruptcy administrator, if any) determines that the debtor's case should be presumed to be an abuse under section 707(b) and the product of the debtor's current monthly income, multiplied by 12 is not less than--

> **(A)** in the case of a debtor in a household of 1 person, the median family income of the applicable State for 1 earner; or
>
> **(B)** in the case of a debtor in a household of 2 or more individuals, the highest median family income of the applicable State for a family of the same number or fewer individuals.

11 U.S.C. § 707(b)(1), (2), (3), (6), and (7)

(b)(1) After notice and a hearing, the court, on its own motion or on a motion by the United States trustee, trustee (or bankruptcy administrator, if any), or any party in interest, may dismiss a case filed by an individual debtor under this chapter whose debts are primarily consumer debts, or, with the debtor's consent, convert such a case to a case under chapter 11 or 13 of this title, if it finds that the granting of relief would be an abuse of the provisions of this chapter. In making a determination whether to dismiss a case under this section, the court may not take into consideration whether a debtor has made, or continues to make, charitable contributions (that meet the definition of “charitable contribution” under section 548(d)(3)) to any qualified religious or charitable entity or organization (as that term is defined in section 548(d)(4)).

(2)(A)(i) In considering under paragraph (1) whether the granting of relief would be an abuse of the provisions of this chapter, the court shall presume abuse exists if the debtor's current monthly income reduced by the amounts determined under clauses (ii), (iii), and (iv), and multiplied by 60 is not less than the lesser of--

> **(I)** 25 percent of the debtor's nonpriority unsecured claims in the case, or $6,575, whichever is greater; or
>
> **(II)** $10,950.
>
> **(ii)(I)** The debtor's monthly expenses shall be the debtor's applicable monthly expense amounts specified under the National Standards and Local Standards, and the debtor's actual monthly expenses for the categories specified as Other Necessary Expenses issued by the Internal Revenue Service for the area in which the debtor resides, as in effect on the date of the order for relief, for the debtor, the dependents of the debtor, and the spouse of the debtor in a joint case, if the spouse is not otherwise a dependent. Such expenses shall include reasonably necessary health insurance, disability insurance, and health savings account expenses for the debtor, the spouse of the debtor, or the dependents of the debtor. Notwithstanding any other provision of this clause, the monthly expenses of the debtor shall not include any payments for debts. In addition, the debtor's monthly expenses shall include the debtor's reasonably necessary expenses incurred to maintain the safety of the debtor and the family of the debtor from family violence as identified under section 309 of the Family Violence Prevention and Services Act, or other applicable Federal law. The expenses included in the debtor's monthly expenses described in the preceding sentence shall be kept confidential by the court. In addition, if it is demonstrated that it is reasonable and necessary, the debtor's monthly expenses may also include an additional allowance for food and clothing of up to 5 percent of the food and clothing categories as specified by the National Standards issued by the Internal Revenue Service.

(II) In addition, the debtor's monthly expenses may include, if applicable, the continuation of actual expenses paid by the debtor that are reasonable and necessary for care and support of an elderly, chronically ill, or disabled household member or member of the debtor's immediate family (including parents, grandparents, siblings, children, and grandchildren of the debtor, the dependents of the debtor, and the spouse of the debtor in a joint case who is not a dependent) and who is unable to pay for such reasonable and necessary expenses.

(III) In addition, for a debtor eligible for chapter 13, the debtor's monthly expenses may include the actual administrative expenses of administering a chapter 13 plan for the district in which the debtor resides, up to an amount of 10 percent of the projected plan payments, as determined under schedules issued by the Executive Office for United States Trustees.

(IV) In addition, the debtor's monthly expenses may include the actual expenses for each dependent child less than 18 years of age, not to exceed $1,650 per year per child, to attend a private or public elementary or secondary school if the debtor provides documentation of such expenses and a detailed explanation of why such expenses are reasonable and necessary, and why such expenses are not already accounted for in the National Standards, Local Standards, or Other Necessary Expenses referred to in subclause (I).

(V) In addition, the debtor's monthly expenses may include an allowance for housing and utilities, in excess of the allowance specified by the Local Standards for housing and utilities issued by the Internal Revenue Service, based on the actual expenses for home energy costs if the debtor provides documentation of such actual expenses and demonstrates that such actual expenses are reasonable and necessary.

(iii) The debtor's average monthly payments on account of secured debts shall be calculated as the sum of--

(I) the total of all amounts scheduled as contractually due to secured creditors in each month of the 60 months following the date of the petition; and

(II) any additional payments to secured creditors necessary for the debtor, in filing a plan under chapter 13 of this title, to maintain possession of the debtor's primary residence, motor vehicle, or other property necessary for the support of the debtor and the debtor's dependents, that serves as collateral for secured debts;

divided by 60.

(iv) The debtor's expenses for payment of all priority claims (including priority child support and alimony claims) shall be calculated as the total amount of debts entitled to priority, divided by 60.

(B)(i) In any proceeding brought under this subsection, the presumption of abuse may only be rebutted by demonstrating special circumstances, such as a serious medical condition or a call or order to active duty in the Armed Forces, to the extent such special circumstances that justify additional expenses or adjustments of current monthly income for which there is no reasonable alternative.

(ii) In order to establish special circumstances, the debtor shall be required to itemize each additional expense or adjustment of income and to provide--

(I) documentation for such expense or adjustment to income; and

(II) a detailed explanation of the special circumstances that make such expenses or adjustment to income necessary and reasonable.

(iii) The debtor shall attest under oath to the accuracy of any information provided to demonstrate that additional expenses or adjustments to income are required.

(iv) The presumption of abuse may only be rebutted if the additional expenses or adjustments to income referred to in clause (i) cause the product of the debtor's current monthly income reduced by the amounts determined under clauses (ii), (iii), and (iv) of subparagraph (A) when multiplied by 60 to be less than the lesser of--

(I) 25 percent of the debtor's nonpriority unsecured claims, or $6,000, whichever is greater; or

(II) $10,000.

(C) As part of the schedule of current income and expenditures required under section 521, the debtor shall include a statement of the debtor's current monthly income, and the calculations that determine whether a presumption arises under subparagraph (A)(i), that show how each such amount is calculated.

(D) Subparagraphs (A) through (C) shall not apply, and the court may not dismiss or convert a case based on any form of means testing, if the debtor is a disabled veteran (as defined in section 3741(1) of title 38), and the indebtedness occurred primarily during a period during which he or she was--

(i) on active duty (as defined in section 101(d)(1) of title 10); or

(ii) performing a homeland defense activity (as defined in section 901(1) of title 32).

(3) In considering under paragraph (1) whether the granting of relief would be an abuse of the provisions of this chapter in a case in which the presumption in subparagraph (A)(i) of such paragraph does not arise or is rebutted, the court shall consider--

(A) whether the debtor filed the petition in bad faith; or

(B) the totality of the circumstances (including whether the debtor seeks to reject a personal services contract and the financial need for such rejection as sought by the debtor) of the debtor's financial situation demonstrates abuse.

. . .

(6) Only the judge or United States trustee (or bankruptcy administrator, if any) may file a motion under section 707(b), if the current monthly income of the debtor, or in a joint case, the debtor and the debtor's spouse, as of the date of the order for relief, when multiplied by 12, is equal to or less than--

(A) in the case of a debtor in a household of 1 person, the median family income of the applicable State for 1 earner;

(B) in the case of a debtor in a household of 2, 3, or 4 individuals, the highest median family income of the applicable State for a family of the same number or fewer individuals; or

(C) in the case of a debtor in a household exceeding 4 individuals, the highest median family income of the applicable State for a family of 4 or fewer individuals, plus $575 per month for each individual in excess of 4.

(7)(A) No judge, United States trustee (or bankruptcy administrator, if any), trustee, or other party in interest may file a motion under paragraph (2) if the current monthly income of the debtor, including a veteran (as that term is defined in section 101 of title 38), and the debtor's spouse combined, as of the date of the order for relief when multiplied by 12, is equal to or less than--

(i) in the case of a debtor in a household of 1 person, the median family income of the applicable State for 1 earner;

(ii) in the case of a debtor in a household of 2, 3, or 4 individuals, the highest median family income of the applicable State for a family of the same number or fewer individuals; or

(iii) in the case of a debtor in a household exceeding 4 individuals, the highest median family income of the applicable State for a family of 4 or fewer individuals, plus $575 per month for each individual in excess of 4.

(B) In a case that is not a joint case, current monthly income of the debtor's spouse shall not be considered for purposes of subparagraph (A) if--

(i)(I) the debtor and the debtor's spouse are separated under applicable nonbankruptcy law; or

(II) the debtor and the debtor's spouse are living separate and apart, other than for the purpose of evading subparagraph (A); and

(ii) the debtor files a statement under penalty of perjury--

(I) specifying that the debtor meets the requirement of subclause (I) or (II) of clause (i); and

(II) disclosing the aggregate, or best estimate of the aggregate, amount of any cash or money payments received from the debtor's spouse attributed to the debtor's current monthly income.

Interim Bankruptcy Rule 1017(e)

(e) Dismissal of an Individual Debtor's Chapter 7 Case or Conversion to a Case Under Chapter 11 or 13 for Abuse

The court may dismiss or, with the debtor’s consent, convert an individual debtor's case for abuse under § 707(b) only on motion and after a hearing on notice to the debtor, the trustee, the United States trustee, and any other entities as the court directs.

(1) Except as otherwise provided in § 704(b)(2), a motion to dismiss a case for abuse under § 707(b) or (c) may be filed only within 60 days after the first date set for the meeting of creditors under § 341(a), unless, on request filed before the time has expired, the court for cause extends the time for filing the motion to dismiss. The party filing the motion shall set forth in the motion all matters to be considered at the hearing. A motion to dismiss under § 707(b)(1) and 93) shall state with particularity the circumstances alleged to constitute abuse.

(2) If the hearing is set on the court's own motion, notice of the hearing shall be served on the debtor no later than 60 days after the first date set for the meeting of creditors under § 341(a). The notice shall set forth all matters to be considered by the court at the hearing.

CERTIFICATE OF SERVICE

I hereby certify that on June 3, 2008, a copy of the foregoing Brief of Appellant, Habbo Fokkena, United States Trustee, was served by Federal Express, for next business day delivery, on William L. Bodensteiner, Esq., Attorney for Appellees, 202 W. Oakland Avenue, Austin, MN 55912.

DATED: June 3, 2008

/s/ William L. Courshon
William L. Courshon
Office of the United States Trustee
Department of Justice
700 Stewart Street, Suite 5103
Seattle, WA 98101-1271
Telephone No.: (206) 553-2000
Facsimile No.: (206) 553-2566

Attorney for Appellant, United States Trustee

BRIEF BANK — "SUMMARY SHEET"

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WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	In re Geoff Paul Draisey (UST v.Draisey)
2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	BAP 8th Cir.
3. ("CCN") ***CURRENT*** CASE NO.	No.: 08-6016
4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*	No.: 07-31204 Court: Bankr. Minn. *(Identify judge & cite, if any)*
5. ("SO") ***SOURCE***	**U.S. TRUSTEES**
6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	Filed: July 7, 2008 Type: Reply Brief of Appellant, Habbo Fokkena, United States Trustee
7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g., "UST/OGC"]*	William L. Courshon, Michael E. Ridgway, David Levine, P. Matthew Sutko *(UST/OGC: 202-307-1399/FAX-2397)*
8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	• Whether the Draisey's assertion that section 704(b)(1) requires the filing of 10-Day Statements in all chapter 7 cases is without merit and contrary to purpose of the text and the statue. Whether the Draisey's contention that section 704(b)(2)'s 30-day deadline applies to all section 706(b) motions is incorrect and misinterprets the statue.
10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)	
11. DO YOU RECOMMEND POSTING IN UST BRIEFBANK?	| x | YES | | NO ***NAME:*** Linda Figueroa ***DATE:***

BEFORE THE UNITED STATES BANKRUPTCY APPELLATE PANEL
FOR THE EIGHTH CIRCUIT

CASE NO. 08-6016

In re GEOFF PAUL DRAISEY and KRISTIN DENISE DRAISEY,

Debtors.

HABBO FOKKENA,

United States Trustee-Appellant,

v.

GEOFF PAUL DRAISEY and KRISTIN DENISE DRAISEY,

Debtors-Appellees.

ON APPEAL FROM THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF MINNESOTA
BANKRUPTCY CASE NO. 07-31204

REPLY BRIEF OF APPELLANT, HABBO FOKKENA, UNITED STATES TRUSTEE

RAMONA D. ELLIOTT
General Counsel
JOHN P. FITZGERALD III
Acting Deputy Gen. Counsel
P. MATTHEW SUTKO
Associate General Counsel
DAVID LEVINE
Executive Office for
United States Trustees
Department of Justice
20 Massachusetts Ave., N.W.
Washington, DC 20530

HABBO FOKKENA
United States Trustee
Region 12

MICHAEL E. RIDGWAY
Office of the U.S. Trustee
Department of Justice
300 South Fourth Street
Suite 1015
Minneapolis, MN 55415
Telephone: (612) 664-5500
Facsimile: (612) 664-5516

WILLIAM L. COURSHON
Office of the U.S. Trustee
Department of Justice
700 Stewart Street
Suite 5103
Seattle, WA 98101-1271
Telephone: (206) 553-2000
Facsimile: (206) 553-2566

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INTRODUCTION

Section 704(b) requires United States Trustees to file a "statement as to whether" an individual chapter 7 debtor's case "would be presumed to be an abuse under section 707(b)." 11 U.S.C. § 704(b)(1)(A). It also establishes a statutory deadline by which United States Trustees must file motions to dismiss chapter 7 cases for presumed abuse. 11 U.S.C. § 704(b)(2). The United States Trustee did not file a motion to dismiss for presumed abuse, but instead moved to dismiss the Draiseys' bankruptcy case based on the totality of the circumstances of their financial situation under section 707(b)(3)(B).

The United States Trustee's opening brief explained that he was not required to file the statement described in section 704(b)(1)(A) ("10-Day Statement") because he did not seek dismissal for presumed abuse. Appellant's Br., pp. 10-11. Alternatively, the United States Trustee explained that even if he were required to file a 10-Day Statement, section 704(b)(2)'s deadline only applies to motions to dismiss for presumed abuse, and not to motions under section 707(b)(3). Appellant's Br., pp. 13-16.

In response, the Draiseys raise two principal arguments. First, they argue that section 704(b)(1)'s text expressly requires United States Trustees to file 10-Day Statements in all chapter 7 cases. Appellees' Br., p. 2. Second, the Draiseys argue that section 704(b)(2)'s 30-day deadline applies to all section 707(b) motions, whether or not based on presumed abuse, because that provision refers to motions under section 707(b) generally rather than to section 707(b)(2). Appellees' Br., pp. 2-3. The Draiseys' arguments, however, misconstrue section 704(b) and fail to address the statute's entire text and purpose, both of which support the United States Trustee's position. Accordingly, each lacks merit.

ARGUMENT

I. THE DRAISEYS' ASSERTION THAT SECTION 704(b)(1) REQUIRES THE FILING OF 10-DAY STATEMENTS IN ALL CHAPTER 7 CASES IS WITHOUT MERIT AND CONTRARY TO THE TEXT AND PURPOSE OF THE STATUTE.

The Draiseys assert the requirement that United States Trustees must file a statement as to "whether" the debtor's case would be presumed to be an abuse extends to filing a statement that the presumption either arises or does not arise in every chapter 7 case. Appellees' Br., p. 2. The statute, however, does not say this. Section 704(b)(1) exists only to trigger section 704(b)(2)'s 30-day filing deadline for motions to dismiss based on presumed abuse, which are brought under section 707(b)(2). If the presumption does not arise, then there is no reason for filing a 10-Day Statement. Section 704(b)(1)(A) does not expressly require a statement that the presumption does not arise. Had Congress intended to require such a statement, it could easily have done so. It did not, so the section 704(b)(1) deadline has no relevance for "abuse" motions brought under section 707(b)(3)(A) or (B).

Not surprisingly, the United States Trustee cannot identify any bankruptcy court decision that has adopted the Draiseys' reading of section 704(b)(1); and, contrary to that reading, a number of courts have determined that section 704(b)'s deadlines are inapplicable when United States Trustees seek relief under section 707(b)(3). *See In re Close*, 384 B.R. 856, 871 (D. Kan. 2008), *aff'g* 353 B.R. 915 (Bankr. D. Kan. 2006) (where no presumption of abuse arises, 30-day deadline imposed by section 704(b)(2) does not apply, and section 704(b)(1)(A) statement is not prerequisite for filing); *In re Perrotta*, __ B.R. __, 2008 WL 2485568, at *4 (Bankr. D. N.H. June 17, 2008) (where United States Trustee is seeking dismissal under section 707(b)(1) or (b)(3) without invoking presumption of abuse, the statement and time limitations under section 704(b) do not apply); *In re*

Ansar, 383 B.R. 344, 348 (Bankr. D. Minn. 2008) (nothing in § 704(b) prevents United States Trustee from filing motion to dismiss under section 707(b)(3) where burden of proof will rest on United States Trustee); *In re Byrne*, 376 B.R. 700, 701 (Bankr. W.D. Ark. 2007) (section 704(b)(1) is not applicable to motion to dismiss under section 707(b)(3)).

Less than three weeks ago, a bankruptcy court denied a debtor's motion to dismiss the United States Trustee's section 707(b)(3) claim for abuse, expressly rejecting the Minnesota bankruptcy court's ruling under review in this appeal[1] and finding that court's rationale to be contrary both to the plain meaning of the statute and to Congress's intent in adding the means test to section 707(b). *In re Perrotta*, __ B.R. __, 2008 WL 2485568, at *2 (Bankr. D. N.H. June 17, 2008) ("*Perrotta II*").[2] In *Perrotta II*, the debtor, like the Draiseys, argued that section 704(b)(1)(A) requires United States Trustees to file 10-Day Statements in all cases, regardless whether the presumption arises. *Id.* The *Perrotta* court recognized that the presumption of abuse can arise only under the provisions of section 707(b)(2) and is based on objective criteria which are made part of the record in the debtor's initial court filings. *Id.* at *4. For this reason, the court concluded that the only interpretation of section 704(b) consistent with the policy changes enacted by Congress under the 2005 Act is that section 704(b)(1)'s 10-Day Statement requirement and the associated 30-day deadline under section

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[1] *See In re Draisey*, 385 B.R. 274 (Bankr. D. Minn. 2008).

[2] In a prior decision, the *Perrotta* court denied the United States Trustee's motion to dismiss the debtor's case based on presumed abuse under section 707(b)(2) because the United States Trustee did not file a definitive 10-Day Statement under section 704(b)(1)(A). *In re Perrotta*, 378 B.R. 434, 438 (Bankr. D. N.H. 2007) ("*Perrotta I*"). In *Perrotta I*, the court nonetheless permitted the scheduling of a hearing on the United States Trustee's alternative motion to dismiss under section 707(b)(3), having acknowledged that the 30-day deadline under section 704(b)(2) does not apply in cases where the presumption of abuse does not arise. *Id.* at 438-439.

704(b)(2) apply only where the presumption of abuse arises under section 707(b)(2). *Id.* The *Perrotta* court further observed that the debtor's interpretation would frustrate Congressional intent in codifying the totality of circumstances test in section 707(b)(3), which permits bankruptcy courts to consider postpetition events in determining abuse. *Id.*; *see, e.g.*, *In re Pak*, 343 B.R. 239, 246-247 (Bankr. N.D. Cal. 2006) (court should take into account any post-filing change in circumstances, such as increased or decreased income, in determining abuse under section 707(b)(3)(B)). The *Perrotta* court thus concluded that where the United States Trustee is seeking dismissal under section 707(b)(3) without invoking a presumption of abuse, the statement and time limitations under section 704(b) do not apply. *Perrotta II*, 2008 WL 2485568, at *4. This court's decision is well-reasoned, and the United States Trustee believes it sets out the correct framework for analyzing this issue.

The Draiseys also mistakenly suggest that requiring 10-Day Statements in all cases is consistent with Congressional intent to require United States Trustees to give creditors early notice if they intend to bring any motion under section 707(b), regardless whether the presumption of abuse arises. Appellees' Br., p. 3. The Draiseys misstate Congress's intent. Congress enacted section 704(b) under the 2005 Act specifically to implement the Act's new means testing provisions. Congress required each United States Trustee to file a 10-Day Statement "as to whether the debtor's case should be presumed to be an abuse" under section 704(b)(1)(A), and required the court to provide a copy of the statement to all creditors under section 704(b)(1)(B), to give preliminary notice to creditors that the United States Trustee has determined a presumption of abuse arises, not that it does not arise. *See In re Cadwallder*, 2007 WL 1864154 at *8 (Bankr. S.D. Tex. 2007); *cf.* 6 Collier on Bankruptcy, ¶ 704.17[1], p. 704-37 (Alan N. Resnick & Henry J. Sommer eds., 15th ed.

rev. 2006) (section 704(b)(1)(B) is "intended to give creditors an opportunity to file their own motions under 707(b)(2), if they are eligible to do so"). Congress could not have intended to truncate the time period in which United States Trustees may file section 707(b)(3) motions because this purpose would conflict directly with Congress's intent in codifying the totality of circumstances test in section 707(b)(3)(B) to permit bankruptcy courts to consider postpetition events in determining abuse. *See Perrotta II*, 2008 WL 2485568, at *4.

For these reasons, the Draiseys' reading of section 704(b)(1) is incorrect; and this Court should adopt the majority view, most recently articulated in *Perrotta II*, which is fully consistent with both the statute's text and purpose.

II. THE DRAISEYS' CONTENTION THAT SECTION 704(b)(2)'S 30-DAY DEADLINE APPLIES TO ALL SECTION 707(b) MOTIONS IS INCORRECT AND MISINTERPRETS THE STATUTE.

The Draiseys also contend that the 30-day deadline in section 704(b)(2) is not expressly limited to section 707(b)(2) motions because section 704(b)(2) uses the term "707(b)" rather than "707(b)(2)." Appellees' Br., pp. 2-3.

The United States Trustee's opening brief explained that section 704(b)(2)'s 30-day deadline, which section 704(b)(1) triggers, applies only to motions asserting a claim under section 707(b)(2) for presumed abuse. This is so because all of the words in section 704(b)(2) that follow the word "if" focus solely upon a presumption of abuse. A "presumption of abuse" motion is brought under section 707(b)(2). Thus, the "if" clause makes clear that 704(b)(2)'s directive that the United States Trustee must "file a motion to dismiss or convert under section 707(b)" or a statement explaining why the United States Trustee is not filing such a motion affects only the United States Trustee's ability to file section 707(b)(2) "presumption of abuse" motions, not section 707(b)(3) "abuse" motions. Appellant's Br., pp. 13-15.

Section 704(b)(2) directs United States Trustees to file "either" a motion to dismiss or a statement setting forth the reasons why a motion would not be appropriate. This "either" clause is modified by the "if" clause, requiring the motion or statement to be filed only "if" the United States Trustee determines that the case "should be presumed to be an abuse under section 707(b)" and determines the debtor's annualized income exceeds the applicable median family income for the debtor's household size. Thus, the "either" clause is triggered only when the "if" clause applies. The "either" clause does not apply here because the United States Trustee determined that the presumption of abuse did not arise. This means the United States Trustee had no duty to file either a motion or a statement. Given that, the United States Trustee's section 707(b)(3) motion was properly filed.

The Draiseys contend, to the contrary, that the "if" clause modifies only the second half of the "either" clause, which refers to the filing of a statement explaining why a motion is not being filed. Appellees' Br., p. 3. This argument is not supported by the plain language of the statute.

Indeed, *Perrotta II* rejected this very argument. *In re Perrotta*, __ B.R. __, 2008 WL 2485568, at *3 (Bankr. D. N.H. June 17, 2008). The *Perrotta* court concluded that "the only reasonable grammatical construction of section 704(b)(2) is the one argued by the [United States Trustee]." *Id.* The court found that the "if" clause in section 704(b)(2) modifies "the binary choice Congress imposed on the [United States Trustee]" to file either a motion or a statement, requiring one or the other only when a presumption of abuse arises and has been timely disclosed by a statement under section 704(b)(1)(A). *Id.* The *Perrotta* court further found that although section 704(b)(2) refers to "section 707(b)" and not section 707(b)(2), "this distinction makes no difference because a presumption of abuse can only arise under the provisions of [section] 707(b)(2)." *Id.* The court in *Perrotta II* rejected the reading of section 704(b) promoted by the Draiseys, and concluded that Interim Rule 1017(e), not section 704(b)(2), governs the filing deadline for motions brought by the United States Trustee under section 707(b)(3). *Id.* at *5.

All other courts agree with *Perotta II* on this point. *See In re Close*, 384 B.R. 856, 871 (D. Kan. 2008), *aff'g* 353 B.R. 915 (Bankr. D. Kan. 2006); *In re Ansar*, 383 B.R. 344, 348 (Bankr. D. Minn. 2008); *In re Byrne*, 376 B.R. 700, 704 (Bankr. W.D. Ark. 2007); *In re dePellegrini*, 365 B.R. 830, 831 (Bankr. S.D. Ohio 2007); *In re Singletary*, 354 B.R. 455, 465 (Bankr. S.D. Tex. 2006); *see also* Interim Bankruptcy Rule 1017(e)(1) (providing for deadline of 60 days after the first date set for meeting of creditors for filing motions to dismiss for abuse under section 707(b) "except as otherwise provided in § 704(b)(2)").

The Draiseys' reading of section 704(b), in contrast, has no support in the statute's text or legislative history, and would reduce the statute to a formulaic exercise.

CONCLUSION

For these reasons, the United States Trustee respectfully asks this Court to reverse the bankruptcy court's order denying the United States Trustee's motion to dismiss for abuse under section 707(b)(3)(B), and to remand the case to the bankruptcy court for further proceedings on the merits of the motion.

DATED this 7th day of July, 2008.

Of Counsel:

RAMONA D. ELLIOTT
General Counsel
JOHN P. FITZGERALD III
Acting Deputy General Counsel
P. MATTHEW SUTKO
Associate General Counsel
DAVID LEVINE
Executive Office for
United States Trustees
Department of Justice
20 Massachusetts Ave., N.W.
Washington, DC 20530

Respectfully submitted,

HABBO FOKKENA
United States Trustee, Region 12

/s/ William L. Courshon for
MICHAEL E. RIDGWAY
Office of the United States Trustee
Department of Justice
300 South Fourth Street, Suite 1015
Minneapolis, MN 55415
Telephone: (612) 664-5500
Facsimile: (612) 664-5516

WILLIAM L. COURSHON
Office of the United States Trustee
Department of Justice
700 Stewart Street, Suite 5103
Seattle, WA 98101-1271
Telephone: (206) 553-2000
Facsimile: (206) 553-2566
Attorneys for Appellant,
United States Trustee

CERTIFICATE OF COMPLIANCE

I hereby certify, pursuant to L.R.BAP 8th Cir. 8010A(a), as follows:

1. On July 7, 2008, I e-mailed the full text of the foregoing Reply Brief of Appellant, Habbo Fokkena, United States Trustee, to the Office of the Clerk, United States Bankruptcy Appellate Panel for the Eighth Circuit, Attention: Cindy Harrison, Panel Coordinator, at: cindy_harrison@ca8.uscourts.gov

2. The foregoing brief was prepared on Corel WordPerfect 12 software and copied to PDF format utilizing Adobe Acrobat 7.0 Professional software.

3. The foregoing brief complies with the word limitation of L.R.BAP 8th Cir. 8010A(b) because the brief contains 2,440 words, excluding the parts of the brief exempted by L.R.BAP 8th Cir. 8010A(b).

DATED: July 7, 2008

/s/ William L. Courshon
William L. Courshon
Office of the United States Trustee
Department of Justice
700 Stewart Street, Suite 5103
Seattle, WA 98101-1271
Telephone No.: (206) 553-2000
Facsimile No.: (206) 553-2566

Attorney for Appellant, United States Trustee

CERTIFICATE OF SERVICE

I hereby certify that on July 7, 2008, a copy of the foregoing Reply Brief of Appellant, Habbo Fokkena, United States Trustee, was served by first class United States mail on William L. Bodensteiner, Esq., Attorney for Appellees, 202 W. Oakland Avenue, Austin, MN 55912.

DATED: July 7, 2008

/s/ William L. Courshon
William L. Courshon
Office of the United States Trustee
Department of Justice
700 Stewart Street, Suite 5103
Seattle, WA 98101-1271
Telephone No.: (206) 553-2000
Facsimile No.: (206) 553-2566

Attorney for Appellant, United States Trustee

BRIEF BANK — 'SUMMARY SHEET" *Printed Tue-4/18/06 10:12*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	In re Attorneys at Law and Debt Relief Agencies
2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	S.D. Georgia
3. ("CCN") ***CURRENT*** CASE NO.	No.: 4:05-cv-00206
4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*	No.: 05-00400 Court: Bankr. Ct. S.D. Georgia *(Identify judge & cite, if any)*
5. ("SO") ***SOURCE***	**U.S. TRUSTEES**
6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	Filed: April 2006 Type: Brief for the Appellant- UST re Standing
7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*	P. Matthew Sutko, OGC *(UST/OGC: 202-307-1399/FAX-2397)*
8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	**• 1 THIS COURT POSSESSES JURISDICTION TO VACATE THE BANKRUPTCY COURT'S ORDER BECAUSE THE BANKRUPTCY COURT DID NOT HAVE CONSTITUTIONAL STANDING TO ENTER IT DUE TO THE ABSENCE OF A CASE OR CONTROVERSY. 2) THE UNITED STATES TRUSTEE POSSESSES STANDING TO SEEK VACATION OF THE BANKRUPTCY COURT'S ORDER. 3) THIS COURT POSSESSES JURISDICTION TO VACATE THE BANKRUPTCY COURT ORDER EVEN IF THE UNITED STATES TRUSTEE LACKED STANDING TO PRESS THIS APPEAL.** **√ Background:**
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UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF GEORGIA
SAVANNAH DIVISION

In re:

ATTORNEYS AT LAW AND
DEBT RELIEF AGENCIES

District Court Case No. 4:05-cv-00206-WTM

Docketed in Bankruptcy Court as
Miscellaneous Proceeding No. 05-00400

______________________________/

FELICIA S. TURNER,
UNITED STATES TRUSTEE,

Appellant.

______________________________/

THE UNITED STATES TRUSTEE'S BRIEF ANALYZING THE UNITED STATES TRUSTEE'S STANDING TO PRESS THIS APPEAL

B. AMON JAMES, ESQUIRE
Assistant United States Trustee
United States Department of Justice
Office of the United States Trustee
222 West Oglethorpe Avenue, Suite 302
Savannah, GA 31401
(912) 652-4112

Of Counsel
Roberta A. DeAngelis
Acting General Counsel

P. Matthew Sutko
Office of the General Counsel
Executive Office for United States Trustees
United States Department of Justice
20 Massachusetts, Ave. N.W., Suite 8100
Washington, D.C. 20530
(202) 307-1399

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FEDERAL STATUTES

MISCELLANEOUS

INTRODUCTION

The government files this supplemental brief in response to the Court's request for additional briefing on the United States Trustee's standing to press this appeal.

ARGUMENT

A. THIS COURT POSSESSES JURISDICTION TO VACATE THE BANKRUPTCY COURT'S ORDER BECAUSE THE BANKRUPTCY COURT DID NOT HAVE CONSTITUTIONAL STANDING TO ENTER IT DUE TO THE ABSENCE OF A CASE OR CONTROVERSY.

The government's opening and reply briefs explained that the bankruptcy court lacked jurisdiction to enter its October 17, 2005, order due to the absence of a case or controversy. Those briefs also explained this Court possesses jurisdiction to vacate that order.[1]

This Court can exercise that jurisdiction in either of two ways. First, this Court can grant the government's appeal, which the United States Trustee possesses standing to prosecute. Alternatively, this Court can exercise its supervisory power over the bankruptcy court to vacate the order independent of the government's request for such relief

B. THE UNITED STATES TRUSTEE POSSESSES STANDING TO SEEK VACATION OF THE BANKRUPTCY COURT'S ORDER.

1. The United States Department of Justice on behalf of the federal government has Article III standing to appear in federal court to enforce federal law. *See Vermont Agency of Natural Resources v. United States* ex rel. *Stevens*, 529 U.S. 765, 771 (2000) (the United States

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[1] *See*, *e.g.*, *United States v. Corrick*, 298 U.S. 435, 440 (1936) (court had "jurisdiction on appeal, not of the merits, but merely for the purpose of correcting the error of the lower court in entertaining the suit" (footnotes omitted) (*quoted in Arizonans for Official English and Robert D. Park v. Arizona*, 520 U.S. 43, 73 (1997) (vacating with remand for dismissal for lack of case or controversy)). *See also Steel Co. v. Citizens For A Better Environment*, 523 U.S. 83, 110 (1998) (vacating with remand for dismissal for lack of case or controversy).

has standing to redress an "injury to its sovereignty arising from violation of its laws"); *United States v. Raines*, 362 U.S. 17, 27 (1960) (Congress may authorize the Attorney General to bring suit in federal court to enjoin violations of federal law); *In re Debs*, 158 U.S. 564, 584 (1895) (the Government's "obligation[]" to prevent violations of federal law is "sufficient to give [it] a standing in court"), *disapproved on other grounds by Bloom v. State of Illinois*, 391 U.S. 194, 208 (1968); *see also Wyandotte Transp. Co. v. United States*, 389 U.S. 191, 201 (1967) ("Our decisions have established [] the general rule that the United States may sue to protect its interests.").

The United States Trustee Program is the division of the Department of Justice that enforces federal bankruptcy law. *See* 28 U.S.C. §§ 581-89; H.R. Rep. No. 95-595, at 110 (1977) (the United States Trustee has an "obligation to execute and enforce the bankruptcy laws"). The Justice Department's representative in this case is the United States Trustee for Region 21, a senior Department official appointed by the Attorney General. 28 U.S.C. § 581(a)(21). *See In re Glados, Inc.*, 83 F.3rd 1360,1361 n.1 (11th Circuit 1996) ("The UST is an official of the United States Department of Justice charged by statute with the duty to oversee and supervise the administration of bankruptcy cases. 28 U.S.C. §586 (a)").

Like any federal official, the United States Trustee's standing to sue to protect the public interest is not derived solely from a statute like 11 U.S.C. § 307. To the contrary, as the Fourth Circuit acknowledged in a case decided **before** section 307 became law, United States Trustees possess standing when - as here - they act to protect the public interest. *A-1 Trash Pickup v. United States Trustee (In re A-1 Trash Pickup)*, 802 F.2d 774, 776 (4th Cir. 1986) (even absent section 307, "a United States trustee can move for conversion or dismissal under § 1112(b), at least where the motion advances the trustee's interest in administration of the bankruptcy proceedings.”).

The United States Trustee possesses standing to pursue this appeal to protect the federal government’s interest in enforcing the Bankruptcy Code. *See* 28 U.S.C. §§ 517, 586(c). As *Wyandotte*, *Vermont Agency*, *Raines*, *Debs*, and *A-1* demonstrate, the federal government can sue to protect the pubic interest and to remedy violations of law, so its standing does not require the type of particularized injury in fact that private parties need. In this case, the United States Trustee possesses standing because the order entered below purports to interpret provisions of the Bankruptcy Code pertaining to debt relief agencies. As discussed, Congress determined that these provisions, which require debt relief agencies to abide by detailed disclosure and advertising requirements, *see* 11 U.S.C. §§ 527, 528, as well as specified standards of professional conduct, *see id.* § 526(a), would “strengthen[] professionalism standards for attorneys and others who assist consumer debtors with their bankruptcy cases.” *See* H.R. Rep. No. 109-31(I) at 17 (2005).

The bankruptcy court’s order impairs the United States’ capacity to protect and enforce these provisions of the Bankruptcy Code. The bankruptcy court, without the benefit of a complaint or a suit by any party, *sua sponte* issued an order declaring that attorneys in this district are “not covered by the provisions of the Code regulating debt relief agencies, . . . and are excused from compliance with any of those requirements or provisions[.]” *See In re Attorneys at Law and Debt Relief Agencies*, 332 B.R. 66, 71 (Bankr. S.D. Ga. 2005).

That has particular significance here because Congress explicitly empowered senior Justice Department officials, the United States Trustees, to seek relief against debt relief agencies. 11 U.S.C. § 526(c)(5). The order below interferes with the Justice Department's power to act under section 526(c)(5) because it purports to absolve lawyers from complying with Congress' debt relief provisions even though lawyers constitute the overwhelming majority of debt relief agencies within this district.

By preemptively and prospectively exempting a class of persons from the requirements of federal law, the bankruptcy court's order injures the federal government's well-established interest in enforcing federal law, *see Debs*, 158 U.S. at 586, and the United States Trustee's specific interest in enforcing federal bankruptcy law, *see Clark*, 927 F.2d 793,796 (4th Cir. 1991) ("if a trustee alleges that the bankruptcy court's ruling . . . has interfered with his ability to enforce the law . . . , then he has standing to appeal that ruling"); *see also ASARCO, Inc. v. Kadish*, 490 U.S. 605, 617-18 (1989) (concluding that a state court order itself caused an Article III injury-in-fact). Bankruptcy attorneys practicing in the Southern District of Georgia are likely to rely on the order, and thus fail to abide by the Code's disclosure and advertising provisions, and perhaps even its standards of professional conduct – all of which are designed to ensure that consumer debtors are well informed of their legal rights and obligations and to protect the public interest in the proper functioning of the Bankruptcy System. *See* H.R. Rep. No. 109-31(I) at 17 (these provisions will "strengthen[] professionalism standards for attorneys and others who assist consumer debtors"); *id.* at 2 (the purpose of the Bankruptcy Abuse Prevention and Consumer Protection Act is to "improve bankruptcy law and practice . . . and ensure that the system is fair for both debtors and creditors"). The United States Trustee has standing to appeal this order, which undermines the agency's ability to fulfill its statutory "obligation to execute and enforce" these provisions of the Bankruptcy Code. H.R. Rep. No. 95-595, at 110.

Moreover, the Justice Department, acting through the United States Trustee, could sue here even if the government needed injury in fact because the bankruptcy court's order injures the United States, and four other classes of individuals as well:

- The order hinders the United States' ability to sue debt relief agencies under 11 U.S.C. § 526(c)(5), which specifically authorizes United States Trustees to seek injunctions and other "appropriate civil penalt[ies]" against debt relief agencies when they intentionally violate section 526 or violate it through a "clear and consistent pattern or practice[]. . . ." The bankruptcy court's order injures the federal government because it interferes with a Justice Department official's express statutory power to sue debt relief agencies under section 526(c)(5). That impairs the federal government's ability to perform its federal statutory enforcement responsibilities within this judicial district. Vacating the order will **(a)** foster the United States' enforcement of federal law, **(b)** free the Justice Department and her attorneys from the potential nuisance of defending motions for civil contempt when it does, and **(c)** ensure bankruptcy courts within this district address the merits of the Justice Department's enforcement actions rather than dismiss them as contrary to the order entered below.

- The order interferes with the State of Georgia's statutory right to sue debt relief agencies under 11 U.S.C. §§ 526(c)(3)(A), (B), and (C). It also harms Georgia citizens because Georgia can recover damages on their behalf under these sections.[2]

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[2] Under those statutory provisions, Georgia may sue debt relief agencies, and may sue "on behalf of its residents to recover the[ir] actual damages." 11 U.S.C. § 526(c)(3)(A) - (C).

- The order impairs debtors' statutory rights under section 526(c)(1) - (3) to sue lawyers who violate sections 526, 527, and 528, and denies them the substantive protections Congress gave them in sections 526, 527 and 528.

- The order denies creditors the right Congress gave them to have debtors' attorneys counsel their clients in conformity with sections 526, 527, and 528, and thereby minimize the risk that inaccurate or incomplete advice will reduce creditors' recoveries in bankruptcy cases.

- The order also risks engendering confusion nationally. The order is published in the *West's Bankruptcy Reporter*. It purports to have prospective effect in all bankruptcy cases filed in this judicial district. Perhaps due to its unprecedented nature, the order has received national attention, and debtors' attorneys across the country have asked other courts to follow it. Although all other courts have steadfastly refused to do so, the order will continue to engender confusion until this Court vacates or reverses it.

The United States' responsibility to protect these important public interests gives the United States Trustee standing in this case.

2. Moreover, section 307 of title 11 confers standing on the United States Trustee to sue here. In section 307, Congress expressly authorized United States Trustees to "appear and be heard" in federal court whenever they determine that "a matter of concern to the proper administration of the bankruptcy laws should be raised." H.R. Rep. No. 99-764, at 27 (1986). *See* 11 U.S.C. § 307 ("[t]he United States trustee may raise and may appear and be heard on any issue in any case or proceeding under this title"); H.R. Rep. No. 99-764, at 27 (1986) (the United

States Trustee has "standing" to raise any "matter of concern to the proper administration of the bankruptcy laws").

The bankruptcy court's decision to commence and decide Case No. 05-00400 (Bankr. S.D. Ga.) without notification or the opportunity to respond, does not deprive the United States Trustee of standing under section 307. Section 307 bestows standing upon United States Trustees in any case or proceeding involving an issue under title 11. The case pending before this Court is such a case or proceeding. The United States Trustee has standing and proper party status in it under section 307 because attorney compliance with sections 526 through 528 of the Code "involves an issue . . . under . . . title" 11. *Cf. In re Donovan Corp.*, 215 F.3d 929, 930 (9th Cir. 2000) ("The United States trustee may also intervene and appear at any level of the proceedings from the bankruptcy court on, 11 U.S.C. § 307, as either a party or an amicus" (internal quotations and citations omitted)). That is particularly true because the order below interferes with the government's enforcement rights under a federal statute - 11 U.S.C. § 526(c)(5).[3]

This conclusion draws substantial support from decisions issued by various United States Courts of Appeal broadly construing section 307. As the 11th Circuit observed, the United States Trustee "is expressly given standing under 11 U.S.C. § 307 to raise and be heard on any issue under Title 11...". *In re Glados, Inc.*, at 1361 n.1; *see, In re Pillowtex,* 304 F.3d 246, 250, 255 n.7 (3d Cir. 2002) (quoting *In re Columbia Gas Systems, Inc.*, 33 F.3d 294, 296 (3d Cir. 1994)) ("'[i]t is difficult to conceive of a statute that more clearly signifies Congress's intent to confer

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[3] The government establishes in footnote one above and in its merits briefs that this Court possesses jurisdiction to vacate the order entered below.

standing.'"); *In re Donovan Corp.*, 215 F.3d at 930 (upholding the standing of the United States Trustee); *United States Trustee v. Price Waterhouse*, 19 F.3d 138, 141 (3d Cir. 1994) (same); *In re Clark*, 927 F.2d at 796 (same); *In re Plaza de Diego Shopping Center*, 911 F.2d 820, 824 (1st Cir. 1990) (same); *In re Revco D.S., Inc.*, 898 F.2d 498, 500 (6th Cir. 1990) (same).

In contrast to the showing a private plaintiff must make to establish standing, the United States Trustee need not demonstrate any concrete, particularized injury in order to appeal a bankruptcy court's decision.[4] *See, e.g.*, *United Artist Theatre Co. v. Walton*, 315 F.3d 217, 225 (3d Cir. 2003) ("A lack of pecuniary interest in the outcome of a bankruptcy proceeding does not deny the U.S. Trustee standing."). Instead, as is true of the federal government generally,[5] the United States Trustee may appeal a court decision in order to protect the public interest in the enforcement of federal bankruptcy law. *See Clark*, 927 F.2d at 796 (the United States Trustee has standing "to enforce the law in the public interest"); *Plaza de Diego*, 911 F.2d at 824 (the United States Trustee's standing flows "from [its] statutory responsibility to represent and protect the public"); *Revco*, 898 F.2d at 500 (same; concluding that "Congress did not intend to limit the U.S. trustee's appellate standing").

These circuit decisions upholding United States Trustees' standing to protect the public interest are further reflected in the law of the Eleventh Circuit, which recognizes that the United States has a legitimate interest in enforcing federal law. *See, e.g., EEOC v. Pemco Aeroplex,*

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[4] Private parties may appeal a bankruptcy court's order only if it has caused them a direct pecuniary injury. *See In re Westwood Community Two Association, Inc.*, 293 F.3d 1332, 1335 (11th Cir. 2002) (private parties have standing to "appeal only when they are directly and adversely affected pecuniarily") (internal quotation marks omitted).

[5] *See Vermont Agency of Natural Resources*, 529 U.S. at 771, and other decisions cited above.

Inc., 383 F.3d 1280, 1290-91 (11th Cir. 2004) (observing that "the United States has an interest in enforcing federal law that is independent of any claims of private citizens," and that this "public interest function . . . distinguishes governmental agencies from private litigants") (quoting *United States v. East Baton Rouge Parish Sch. Bd.*, 594 F.2d 56, 58 (5th Cir. 1979)).

3. Appellee Leiden & Leiden asserts (Appellee's Opening Br. at 3-7) that the United States Trustee lacks standing because the bankruptcy court here issued a "general order" providing procedural guidelines for attorneys practicing in the Southern District of Georgia. This is wrong for three reasons. First, as the United States Trustee's Reply Brief discusses (at 1-8), the court did not promulgate any such general order, but instead clearly sought to issue a substantive interpretation of federal law. *See In re Attorneys at Law*, 332 B.R. at 67 ("[t]he issue before the Court is whether amendments to the Bankruptcy Code . . . regulating Debt Relief Agencies apply to attorneys"). Second, as the United States Trustee also explained in her principal briefs (Opening Br. 6-8; Reply Br. at 5-6 & n.4), the bankruptcy court lacked the authority - under its general order power or otherwise - to issue such a substantive interpretation of federal law outside the context of an Article III case or controversy, but that is nonetheless what the court sought to do. Third, even if true, section 307's only criteria - the existence of a case or a proceeding, and an issue involving title 11 - would continue to be met by this appeal to this Court.

Leiden & Leiden likewise errs in asserting (Br. 3-4) that the bankruptcy court's failure to issue this order in the context of a bankruptcy case deprives the United States Trustee of statutory standing to appeal. The law firm argues section 307 of the Code authorizes the United States Trustee to "oversee and supervise the administration of bankruptcy *cases*" and the United

States Trustee is without power to object here because the bankruptcy court issued its order interpreting the statute *sua sponte* and outside the context of a typical bankruptcy case.

This is wrong for four reasons. First, as the government discusses above, the Justice Department, acting through the United States Trustee has standing to protect federal law. Second, the Justice Department has injury in fact here because the order interferes with its enforcement powers under 11 U.S.C. § 526(c)(5). Third, there is a case involving title 11 here - the case before this Court bearing case number 4:05-cv-00206-WTM. That case clearly involves “an issue” under title 11 - attorneys’ duty to comply with three title 11 provisions, 11 U.S.C. §§ 526, 527 and 528 and the Justice Department’s power to enforce section 526(c)(5). Thus, the United States Trustee has standing to press this case or proceeding before this Court. 11 U.S.C. § 307.

Fourth, the order entered below merits vacation given Leiden and Leiden’s argument that the bankruptcy court issued a decision interpreting substantive federal provisions and ordered prospective relief without a bankruptcy case or proceeding. Under 28 U.S.C. 1334 and 157, bankruptcy courts exercise jurisdiction only over bankruptcy cases and proceedings. If there was no bankruptcy case or proceeding, then the court lacked statutory jurisdiction to enter its October 17 order under the foregoing provisions. If there was a bankruptcy case or proceeding, then the United States Trustee clearly has standing under 11 U.S.C. §307. **Either way the order must be vacated.**

The absence of statutory jurisdiction under 28 U.S.C. 1334 and 157 would also have prevented the bankruptcy court from acting under 11 U.S.C. § 105(a). The court could not have relied upon section 105(a) because that section cannot be used to alter or deviate from sections

526, 527 and 528 of the Code.[6] *See, e.g.*, *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 206 (1988) ("whatever equitable powers remain in the bankruptcy courts must and can only be exercised within the confines of the Bankruptcy Code"); *In re Cox*, 338 F.3d 1238, 1243 (11th Cir.2003) ("the bankruptcy court's equitable powers [] do not allow it to override the specific statutory language..."); *In re Sanford*, 979 F.2d 151, 1514 and n.7 (11th Cir. 1992) (applying *Worthington* to section 105).

Leiden & Leiden also fails to recognize that the United States Trustee Program is a component of the Department of Justice that Congress has directed "to execute and enforce the bankruptcy laws," H.R. Rep. No. 95-595, at 110. The United States Trustee therefore has standing to appeal any order that impairs the Department's ability to perform this law enforcement function, either as the designee of the Attorney General, *see* 28 U.S.C. § 517 ("any officer of the Department of Justice [] may be sent by the Attorney General . . . to attend to any [] interest of the United States"), or as the agency charged by Congress with ensuring compliance with the Bankruptcy Code, *see* 11 U.S.C. §§ 307, 526. *See also Donovan*, 215 F.3d at 930 (United States Trustees may protect or enforce federal law by participating in a dispute for the first time as an appellant prosecuting an appeal).

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[6] Attorneys are not excluded from the reach of federal bankruptcy laws simply by virtue of the fact that they are also subject to regulations governing qualifications for the practice of law. Sections 526-528 are not licensing provisions; instead they impose a separate and distinct set of obligations upon attorneys who choose to practice in the area of bankruptcy law. If an attorney practices bankruptcy and violates section 526, 527 or 528, he can be sanctioned under these provisions. Hence these provisions do not serve as licensing provisions, as section 526(d)(2) makes clear. Although a court may choose to disbar an attorney for violations under sections526-528, these provisions neither compel nor prohibit disbarment. Sanctions for violating sections 526, 527 and 528 are wholly distinct from licensing.

C. THIS COURT POSSESSES JURISDICTION TO VACATE THE BANKRUPTCY COURT ORDER EVEN IF THE UNITED STATES TRUSTEE LACKED STANDING TO PRESS THIS APPEAL.

As the government explains above, courts possess jurisdiction to vacate orders that lower courts enter without jurisdiction. In the government's respectful view, the United States Trustee could conceivably lack standing to appeal here only if this Court were to rule that the bankruptcy court's order is, on its face, so plainly without legal force or effect that no bankruptcy attorney could plausibly rely on it to avoid compliance with the Code provisions governing debt relief agencies. Accordingly, the government respectfully suggests this Court could not conclude the United States Trustee lacks standing without also concluding that the bankruptcy court's order is invalid and without *any* legal or practical significance. In that event, the government would ask this Court to exercise its supervisory power by vacating the order below as being entered without constitutional jurisdiction due to the absence of a case or controversy. *See* 28 U.S.C. § 151 (the bankruptcy court is "a unit of the district court"); *In re Parklane/Atlanta Joint Venture*, 927 F.2d 532, 538 (11th Cir. 1991) (noting the district court's "supervisory function over the bankruptcy courts"); *Grant v. George Schumann Tire & Battery Co.*, 908 F.2d 874, 884 (11th Cir. 1990) (district courts are responsible for overseeing the bankruptcy courts). For that reason, the order entered below merits vacation by this Court even if this Court were to conclude the government lacked standing.

CONCLUSION

For these reasons, and for the reasons stated in the government's opening and reply briefs, the United States Trustee respectfully asks this Court to vacate or, in the alternative, reverse the order from which this appeal is taken.

Respectfully submitted,

____
B. AMON JAMES, ESQUIRE
Assistant United States Trustee
United States Department of Justice
Office of the United States Trustee
222 West Oglethorpe Avenue, Suite 302
Savannah, GA 31401
(912) 652-4112

Of Counsel:

Roberta A. DeAngelis
Acting General Counsel
P. Matthew Sutko
Office of the General Counsel
Executive Office for United States Trustees
United States Department of Justice
20 Massachusetts, Ave. N.W., Suite 8100
Washington, D.C. 20530
(202) 307-1399

CERTIFICATE OF SERVICE

I hereby certify that this ___ day of April, 2006, a true and correct copy of the foregoing **THE UNITED STATES TRUSTEE'S BRIEF ANALYZING THE UNITED STATES TRUSTEE'S STANDING TO PRESS THIS APPEAL** was this day deposited in the U.S. Mail, properly addressed and with correct first-class postage prepaid to the following:

Christian J. Steinmetz, III, Esq.
Clark, Clark & Steinmetz
P.O. Box 8151
Savannah, GA 31412-8151

Frank J. Perch, III, Esq.
Hunter, Maclean, Exley & Dunn, PC
P.O. Box 9848
Savannah, GA 31412-0048

Terry P. Leiden, Esq.
Leiden & Leiden
330 Telfair Street
Augusta, GA 30901

Kate Dodson Strain, Esq.
Hunter, Maclean, Exley & Dunn, PC
P.O. Box 9848
Savannah, GA 31412-0048

Mark Bulovic, Esq.
McCallar & Associates
P.O. Box 9026
Savannah, GA 31412-9026

B. AMON JAMES
Assistant United States Trustee

STATUTORY ADDENDUM

BRIEF BANK — "SUMMARY SHEET"

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WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]* — In re David Dudley & Ann M. Dudley (W. Clarkson McDow, Jr., United States Trustee for Region 4 v. David D. Dudley & Ann M. Dudley)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]* — W.D. Va.

3. ("CCN") ***CURRENT*** CASE NO. — No.: 7:09-cv-00336-SGW

4. ("PCN") ***PRIOR*** CASE NO. - & COURT *[IF ANY]* — No.: 08-71561

Court: Bankr. W.D. Va.

(Identify judge & cite, if any)

5. ("SO") ***SOURCE*** — **U.S. TRUSTEES**

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]* — Filed: September 29, 2009

Type: Brief for the United States, Appellant

7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]* — John R. Byrnes, Joseph A. Guzinski, David I. Gold, P. Matthew Sutko, W. Clarkson McDow, Jr.

(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC*** — **BANKRUPTCY**

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***

- Whether the bankruptcy court erred in concluding that 11 U.S.C. § 707(b)(1) does not apply to a case that has been converted from chapter 13 to chapter 7 of the Bankruptcy Code.

10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)

11. DO YOU RECOMMEND POSTING IN UST BRIEFBANK? — | x | YES | | NO

NAME: Linda Figueroa

DATE:

District Court Case No. 7:09-CV-00336-SGW

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF VIRGINIA

In re DAVID D. DUDLEY &
ANN M. DUDLEY,

Debtors.

W. CLARKSON MCDOW, JR.,
UNITED STATES TRUSTEE
FOR REGION FOUR,

Appellant,
v.

DAVID D. DUDLEY &
ANN M. DUDLEY,

Appellees.

ON APPEAL FROM THE UNITED STATES BANKRUPTCY COURT
FOR THE WESTERN DISTRICT OF VIRGINIA
Bankruptcy Case No. 08-71561

BRIEF FOR THE UNITED STATES TRUSTEE, APPELLANT

RAMONA D. ELLIOTT
General Counsel

P. MATTHEW SUTKO
DAVID I. GOLD
Executive Office
for United States Trustees
United States Department of Justice
20 Massachusetts Avenue N.W.
Washington, D.C. 20530

W. CLARKSON McDOW, JR.
United States Trustee

JOHN ROBERT BYRNES
Assistant United State Trustee
JOSEPH A. GUZINSKI
Trial Attorney
First Campbell Square
210 First Street, S.W.
Roanoke, Virginia 24011
Telephone: (540) 857-2699

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JURISDICTIONAL STATEMENT

The bankruptcy court had jurisdiction under 28 U.S.C. §§ 157 (a) and (b), and 1334(a) to issue its final order granting the Debtors' motion for summary judgment on the United States Trustee's motion to dismiss the Debtors' chapter 7 bankruptcy case. The bankruptcy court issued its opinion and entered an order granting the Debtors' motion for summary judgment on June 17, 2009. The United States Trustee filed a notice of appeal on June 26, 2009, which is timely under 28 U.S.C. §§ 158(a) and (c)(2). This Court has appellate jurisdiction under 28 U.S.C. § 158(a)(1), a statutory provision under which district courts have jurisdiction to hear appeals from final judgments, orders, and decrees of bankruptcy judges.

STANDARD OF REVIEW

A bankruptcy court's findings of fact are reviewed for clear error and its conclusions of law are reviewed *de novo*. *In re White*, 487 F.3d 199, 204 (4th Cir. 2007). In this case, the facts are undisputed, and the bankruptcy court's interpretations of 11 U.S.C. §§ 707(b)(1) and 707(b)(2) are conclusions of law subject to *de novo* review.

STATEMENT OF THE ISSUE

The sole issue in this appeal is whether the bankruptcy court erred in concluding that 11 U.S.C. § 707(b)(1) does not apply to a case that has been converted from chapter 13 to chapter 7 of the Bankruptcy Code.

STATEMENT OF THE CASE

On August 18, 2008, the Debtors sought chapter 13 bankruptcy relief in the United States Bankruptcy Court for the Western District of Virginia. *See* 11 U.S.C. § 1301 et seq. On October 8, 2008, the Debtors filed a motion to convert their case to a liquidation case under chapter 7 of the Bankruptcy Code. *See* 11 U.S.C. § 1307(a). After conversion of this case to chapter 7, the United States Trustee filed a motion to dismiss the Debtors' case for abuse under 11 U.S.C. § 707(b)(1). *See* 11 U.S.C. § 707(b)(1). On January 9, 2009, the Debtors filed a motion for summary judgment in connection with the United States Trustee's motion to dismiss. On June 17, 2009, the bankruptcy court entered an order granting the Debtors' motion for summary judgment and denying the United States Trustee's motion to dismiss. This appeal followed.

STATEMENT OF FACTS

I. Statutory Framework.

The Bankruptcy Code establishes two primary forms of bankruptcy relief for individual debtors – chapter 7 and chapter 13. Under chapter 7, "an individual debtor receives an immediate unconditional discharge of personal liability for certain debts in exchange for relinquishing his or her nonexempt assets to a bankruptcy trustee for liquidation and distribution to creditors." H.R. Rep. 109-31 (I) at 10 (2005), *reprinted* in 2005 U.S.C.C.A.N. 88, 98; *see* 11 U.S.C. §§ 701-727. Under chapter 13, "a debtor commits to repay some portion of his or her financial obligations" over a specified period "in exchange for retaining nonexempt assets and receiving a broader discharge of debt than is available under chapter 7." H.R. Rep. 109-31(I), at 10; *see* 11 U.S.C. §§ 1321-1330.

The difference between chapter 7 and 13 is dramatic. In chapter 7 cases, creditors may look solely to debtors' pre-bankruptcy, non-exempt assets for payment. *See* 11 U.S.C. § 541 (limiting property of the estate to debtors' pre-petition assets). Debtors' post-bankruptcy income is not subject to creditor claims. *Id*. Subject to narrow exceptions, debtors receive a complete discharge of all their pre-petition debts in a chapter 7 case. *See* 11 U.S.C. § 727(b). Historically, in roughly 96% of chapter 7 cases, unsecured creditors received no payment. *See, e.g.*, Brief of the United States in *Lamie v. United States Trustee*, 2003 WL 21839367 at *38 (2003).

Chapter 13 is different because debtors must use post-petition income to fund a chapter 13 payment plan. *See* 11 U.S.C. § 1306(a)(2) (property of the bankruptcy estate also includes post-petition income); 11 U.S.C. § 1325(b) (projected disposable income applied to make payments to unsecured creditors). In chapter 13, debtors receive a discharge only after they have fully completed their chapter 13 repayment plans. *See* 11 U.S.C. §§ 1328(a) and (c); *see also* 11 U.S.C. § 1328(b) (listing exceptions to this rule).

Notwithstanding these differences, chapter 13 and 7 cases are interconnected in significant ways as well. To begin with, the Bankruptcy Code provides that a debtor may convert his case from chapter 13 to chapter 7, and vice versa, at any time. *See* 11 U.S.C. § 1307(a) (providing that chapter 13 debtor may convert case to chapter 7 at any time); 11 U.S.C. § 706(a) (providing that chapter 7 debtor may convert case to chapter 13 at any time). Thus, while a bankruptcy case may begin in one chapter it may not necessarily remain there. Further, as explained in more detail below, certain provisions of the Bankruptcy Code related to a debtor's ability to repay are utilized in both chapter 7 and 13. *See* 11 U.S.C. § 1325(b)(3) (incorporating section 707(b)(2) of the Bankruptcy Code); 11 U.S.C. §§ 707(b)(2) and 1325(b)(2) (incorporating the phrase "current monthly income" which is defined under section 101(10A) of the Bankruptcy Code).

A. The Historical Development of Substantial Abuse.

Since 1984, Congress has enacted a series of tests that have allowed courts to dismiss chapter 7 cases, and thereby prevent the unjust discharge of pre-petition debts. In 1984, Congress amended chapter 7 to permit the dismissal of a chapter 7 bankruptcy petition under section 707(b) if a court found "substantial abuse."[1] Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, § 312, 98 Stat. 333, 335. Congress enacted this amendment to respond "to concerns that some debtors who could easily pay their creditors might resort to chapter 7 to avoid their obligations." H.R. Rep. 109-31(I), at 12 (internal quotation omitted). As explained by one bankruptcy court:

> Congress originally enacted the statute to limit access to chapter 7 to debtors who are honest and who need the remedy to preserve a decent standard of living for themselves and their dependents. By this enactment, persons who have primarily consumer debts and who have the financial resources in excess of their basic needs would be forced to seek relief under a reorganization chapter or to otherwise attempt to repay their creditors.

In re Goddard, 323 B.R. 231, 233-34 (Bankr. S.D. Ohio 2005) (internal citations omitted).

After twenty-years' experience, Congress found that these amendments were insufficient to control abuse of chapter 7. Congress identified, among other problems, the "inherent[] vague[ness]" of the "substantial abuse" standard, which led to disagreement in the courts about

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[1] Two years later, Congress again amended this provision to authorize United States Trustee to seek dismissal of chapter 7 petitions for "substantial abuse." Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1986, Pub. L. No. 99-554, § 21, 100 Stat. 3088, 3101.

whether a debtor's ability to repay a significant portion of his or her debts out of future income constitutes substantial abuse,[2] meriting dismissal. H.R. Rep. 109-31(I), at 12. Another problem was that the Bankruptcy Code established "a presumption in favor of granting the relief requested by the debtor," which influenced courts' decisions whether to find substantial abuse. 11 U.S.C. § 707(b) (2000); H.R. Rep. 109-31(I), at 12.

Responding to these perceived shortcomings of the Bankruptcy Code, Congress held hearings over five years to identify what reforms it could adopt "to ensure that debtors repay creditors the maximum they can afford." H.R. Rep. 109-31(I), at 2, 12. The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (the "2005 Act"), Pub. L. No. 109-8, 119 Stat. 23, implemented the reforms Congress identified.

B. The 2005 Act

On October 17, 2005, most provisions of the 2005 Act took effect, thereby implementing significant changes to the Bankruptcy Code. In enacting the 2005 Act, Congress:

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[2] In evaluating whether substantial abuse existed, courts jointly considered both the debtor's conduct and the debtor's ability to pay his debts outside bankruptcy or through a chapter 13 repayment plan. *See, e.g., In re Stewart*, 175 F.3d 796 (10th Cir. 1999); *In re Lamanna*, 153 F.3d 1 (1st Cir. 1998); *In re Krohn*, 886 F.2d 123 (6th Cir. 1989); *In re Kelly*, 841 F.2d 908, 915 (9th Cir. 1988). Most courts recognized that a debtor's ability to pay a portion of his debt was the predominant factor when determining whether to dismiss a chapter 7 case. *Id.*

> concluded that the complete overhaul of § 707(b) was necessary, with clear, non discretionary requirements imposed on the bankruptcy court to reject the notion that debtors were entitled to a discharge as a matter of right without regard to their ability to pay and to assure that in practice those with the ability to pay would not be entitled to chapter 7 relief.

146 Cong. Rec. S11700 (December 7, 2000) (*citing,* Sen. Rep. No. 253, 105th Cong., 2nd Sess., and Sen. Rep. No. 540, 105th Cong., 2nd Sess); *see also* 151 Cong. Rec. S1856 (Mar. 1, 2005). Congress enacted the section 707(b) amendments to curb bankruptcy abuse by, *inter alia*, dismissing chapter 7 cases filed by debtors seeking to have their debts discharged despite having the ability to repay their creditors. *See* 151 Cong. Rec. S1856 (Mar. 1, 2005) (statement of Sen. Charles Grassley).[3] To effectuate this goal, Congress took four important steps.

First, Congress repealed the statutory presumption in favor of granting relief to the debtor. *Compare* 11 U.S.C. § 707(b) (1986) *with* 11 U.S.C. § 707(b) (2005).

Second, Congress lowered the standard for dismissal under all subsections of new section 707(b) from “substantial abuse” to mere “abuse.” *See* 11 U.S.C.

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[3] In his statement, Senator Grassley explained the purpose behind the section 707(b) amendments as follows: “[i]t is this simple: if repayment is possible, then [a debtor] will be channeled into chapter 13 of the Bankruptcy Code which requires people to repay a portion of their debt. . . .” *Id.*

§ 707(b)(1) (cases are now dismissed for "abuse"); 11 U.S.C. § 707(b)(2) (subjecting cases to dismissal for abuse); 11 U.S.C. § 707(b)(3) (same).

Third, Congress enacted new section 707(b)(3). This section allows courts to dismiss cases based upon either a debtor's bad faith, 11 U.S.C. § 707(b)(3)(A), or the totality of a debtor's financial circumstances, 11 U.S.C. § 707(b)(3)(B). Thus, even if a presumption of abuse does not arise or is rebutted under section 707(b)(2), a chapter 7 petition should still be dismissed for abuse under section 707(b)(3) when "bad faith" is demonstrated or "the totality of the circumstances . . . of the debtor's financial situation demonstrates abuse." 11 U.S.C. § 707(b)(3)(A) and (B).

Fourth, Congress authorized dismissal when a mathematical formula, known as the "means test," yields monthly disposable income that exceeds a statutory threshold. *See*
11 U.S.C. § 707(b)(2). The 2005 Act provides specific criteria which, if satisfied, require a court to presume the existence of abuse and to dismiss (or if the debtor consents convert) a case "based on a chapter 7 debtor's ability to repay." H.R. Rep. 109-31(I), at 15. To determine if abuse exists, a court first compares the debtor's annualized "current monthly income" [4] to the "median family income" of

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[4] "Current monthly income," a defined term, is used to calculate gross historical income for purposes of the means test. *See* 11 U.S.C. § 101(10A) (defining "current monthly income" as the debtor's average monthly income for the six-month period preceding the month of the filing of the debtor's petition).

a similarly-sized family in the debtor's state. If the debtor's current monthly income is below the median, then the presumption of abuse does not arise. *See* 11 U.S.C. § 707(b)(7); H.R. Rep. 109-31(I), at 15.

If a debtor's current monthly income is above the median, and his or her monthly disposable income meets or exceeds the statutory threshold amount, the presumption is triggered and the debtor's case must be dismissed as abusive (or converted to chapter 13, if the debtor consents) absent an express showing of special circumstances by the debtor. *See* 11 U.S.C. § 707(b)(1) and (2).

The "means test" is implemented in chapter 7 through section 707(b)(2)(C). Section 707(b)(2)(C) provides that "[a]s part of the schedule of current income and expenditures required under § 521, the debtor shall include a statement of the debtor's current monthly income, and the calculations that determine whether a presumption arises under" section 707(b)(2)(A)'s means test. 11 U.S.C. § 707(b)(2)(C). This provision is consistent with Bankruptcy Rule 1007(b)(4), which requires that all individual debtors "in" chapter 7 cases file Official Bankruptcy Form 22A.[5] *See* Fed. R. Bankr. P. 1007(b)(4).

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[5] Bankruptcy Rule 1007(b)(4) provides, in relevant part: "Unless § 707(b)(2)(D) applies, an individual debtor in a chapter 7 case with primarily consumer debts shall file a statement of current monthly income prepared as prescribed by the appropriate Official Form, and, if the debtor has current monthly income greater than the applicable median family income for the applicable state and household size, the calculations in accordance with § 707(b), prepared as prescribed by the appropriate Official Form." Fed. R. Bankr. P. 1007(b)(4).

Additionally, while chapter 13 does not utilize the "means test" to determine whether a presumption of abuse arises, it does incorporate the "means test" to determine whether a chapter 13 debtor is devoting all of his "projected disposable income" towards the repayment of his unsecured creditors.[6] *See* 11 U.S.C. § 1325(b)(2) (incorporating the phrase "current monthly income" which is defined under section 101(10A) of the Bankruptcy Code); 1325(b)(3) (incorporating sections 707(b)(2)(A) and (B) of the Bankruptcy Code). This use of the "means test" in chapter 13 is consistent with Bankruptcy Rule 1007(b)(6), which requires that all debtors "in" chapter 13 cases file Official Bankruptcy Form 22C.[7] *See* Fed. R. Bankr. P. 1007(b)(6).

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[6] Pursuant to section 1325(b)(1) of the Bankruptcy Code, a chapter 13 debtor's standing trustee or unsecured creditors may object to confirmation of the debtor's proposed repayment plan, and the court may not approve such a plan, if the plan fails to provide for repayment in full to the debtor's unsecured creditors, or fails to devote all of the debtor's "projected disposable income" to the debtor's unsecured creditors. While the phrase "projected disposable income" is not defined under the Bankruptcy Code, a debtor's "disposable income" is determined utilizing sections 101(10A) and 707(b)(2) of the Bankruptcy Code. *See* 11 U.S.C. § 1325(b)(2) (incorporating the phrase "current monthly income" which is defined under section 101(10A) of the Bankruptcy Code); 11 U.S.C. § 1325(b)(3) (incorporating section 707(b)(2) of the Bankruptcy Code).

[7] Bankruptcy Rule 1007(b)(6) provides, in relevant part: "A debtor in a chapter 13 case shall file a statement of current monthly income, prepared as prescribed by the appropriate Official Form, and, if the current monthly income exceeds the median family income for the applicable state and household size, a calculation of disposable income made in accordance with § 1325(b)(3), prepared as prescribed by the appropriate Official Form." Fed. R. Bankr. P. 1007(b)(6).

Form 22A is similar to Official Bankruptcy Form 22C in that they both calculate a debtor's income and expenses. However, the forms contain important differences that reflect the differences between chapters 7 and 13 and the disposable income calculations under each chapter. For example, because Form 22C calculates disposable income under section 1325(b), it excludes certain support payments from a chapter 13 debtor's disposable income. *See* 11 U.S.C. § 1325(b)(2)(A)(i). In addition, since sections 541(b)(7) and 1322(f) exclude retirement contributions and loan repayments from a debtor's disposable income, Form 22C contains a line item allowing debtors to exclude qualified retirement deductions. Similarly, since section 707(b)(2)(D)[8] exempts certain disabled veterans, reservists, and national guardsmen from means testing, Form 22A contains a declaration for qualifying debtors. Finally, Form 22C does not contain information necessary to determine whether the presumption of abuse arises, as required by section 707(b)(2)(C). Nor does Form 22C contain the box located at the top of Form 22A indicating whether the presumption of abuse arises.[9]

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[8] Section 707(b)(2)(D) provides, in relevant part, that sections 707(b)(2)(A) – (C) "shall not apply, and the court may not dismiss or convert a case based on any form of means testing, if the debtor is a disabled veteran ... and the indebtedness occurred primarily during a period during which he or she was – (i) on active duty... or (ii) performing a homeland defense activity. . . ." 11 U.S.C. § 707(b)(2)(D).

[9] Clerk's offices use this box as the basis to give notice to creditors that the presumption of abuse has arisen as required by section 342(d). *See* 11 U.S.C. § 342(d) (providing, in relevant part, that "[i]n a case under chapter 7 . . . in which

II. Factual and Procedural Background.

On August 18, 2008, the Debtors commenced this case by filing a petition for relief under chapter 13 of the Bankruptcy Code. *See* Appellant's Designation of Record ("Appellant Rec.") No. 1. That same day, the Debtors filed their proposed chapter 13 repayment plan. *See* Appellant Rec. No. 2. The Debtors' plan proposed, *inter alia*, to surrender real property located at 469 Woods Edge Drive in Rocky Mount, Virginia. *Id.* At the time this case was filed, the Woods Edge property was valued by the Debtors in the amount of $330,400.00 with secured claims against it in the amount of $511,399.94. *See* Appellant Rec. No. 1. At the time this case was filed, the Debtors' general unsecured debt totaled $233,234.63, not including any deficiency that might arise in connection with the undersecured Woods Edge property. *Id.* Notwithstanding that the Debtors intended to surrender the Woods Edge property, their Form 22C included $3,691.26 in secured debt expense deductions for that property. *Id.*

On September 25, 2008, eCast Settlement Corporation, one of the Debtors' unsecured creditors, objected to the Debtors' proposed repayment plan. *See* Appellee's Designation of Record ("Appellee Rec.") No. 1. Among other things, eCast argued that because the Debtors sought to deduct secured debt expenses for

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the debtor is an individual and in which the presumption of abuse arises under section 707(b), the clerk shall give written notice to all creditors not later than 10 days after the date of the filing of the petition that the presumption of abuse has arisen.").

the Woods Edge property on their Form 22C, the Debtors improperly calculated their disposable income and hence failed to devote all of their "projected disposable income" to their unsecured creditors. *Id.*; 11 U.S.C. § 1325(b).

Thirteen days later, and before the bankruptcy court conducted a hearing on eCast's objection to the Debtors' proposed repayment plan, the Debtors filed a motion to convert their case to a liquidation under chapter 13 of the Bankruptcy Code. *See* Appellant Rec. No. 4, 21; 11 U.S.C. § 1307(a). Debtors conceded they were converting their case because eCast objected to their proposed repayment plan. *See* Appellant Rec. No. 4. On October 9, 2008, the bankruptcy court converted the Debtors' case to one under chapter 7. *See* Appellant Rec. No. 5.

After the conversion of the Debtors' case to chapter 7, the United States Trustee filed a motion to dismiss the Debtors' case for abuse. *See* Appellant Rec. No. 11. The United States Trustee's motion argued that because the Debtors sought to deduct secured debt expenses for the Woods Edge property on their Form 22C, their disposable income calculation was inflated. *Id.* The United States Trustee's motion went on to argue that if the Debtors limited their mortgage expense to the $1,530.00 payment associated with their new home, as opposed to the substantially higher payment associated with their surrendered home, the Debtors would have disposable income in excess of $2,000 per month, thereby indicating a presumption of abuse. *Id.* Finally, the United States Trustee's motion alleged that even if the court did not find a presumption of abuse in the Debtors' case, the Debtors' case should nevertheless be deemed abusive under the totality of the circumstances. *Id.*

On January 9, 2009, the Debtors filed a motion for summary judgment in connection with the United States Trustee's motion. *See* Appellant Rec. No. 12. The summary judgment motion sought relief on two grounds: (a) that the Debtors are entitled to deduct secured debt expenses for the Woods Edge property on their Form 22C; and (b) that the Bankruptcy Code does not authorize dismissal of a case for abuse where the debtors initially file under chapter 13. *Id.* On February 25, 2009, the United States Trustee filed a response to the Debtors' summary judgment motion that addressed both arguments. *See* Appellant Rec. No. 15. On June 17, 2009, the bankruptcy court issued its decision granting the Debtors' motion. *See* Appellant Rec. No. 19.[10] Because the decision only addressed whether the Bankruptcy Code authorizes dismissal of a case for abuse where the debtors initially file under chapter 13, it failed to reach any conclusions with respect to the secured debt expense issue or whether the Debtors' case should be deemed abusive under the totality of the circumstances. *Id.* To preserve his right to appeal, the United States Trustee timely filed a notice of appeal on June 26, 2009. *See* Appellant Rec. No. 20.

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[10] The bankruptcy court's decision is published at *In re Dudley*, 405 B.R. 790 (Bankr. W. D. Va. 2009).

SUMMARY OF ARGUMENT

The bankruptcy court found that section 707(b) does not apply in a case originally commenced under chapter 13, and subsequently converted to chapter 7. *In re Dudley*, 405 B.R. 790 (Bankr. W. D. Va. 2009). The court did so because it read these words in section 707(b)(2) - “may dismiss a case filed by an individual debtor under this chapter” - as implicitly limiting dismissal under section 707(b) to cases originally filed in chapter 7.

The lower court’s reading is unsustainable for five reasons:

First, Congress explicitly excepted some chapter 7 cases from dismissal under section 707. But it did not explicitly except chapter 7 cases. Given that Congress knew how to create explicit exceptions to section 707(b) when it wished, there is no reason to find an implicit exception here. And Congress also created other explicit exceptions to dismissal in other parts of the Code, which makes the absence of such an explicit exception in section 707(b) even more telling.

Second, the court below misread the word “filed” as modifying the clause “under this chapter,” leading it to conclude only cases originally filed under chapter 7 could be dismissed under section 707(b). But filed does not modify that clause. Instead, it modifies the four words that immediately follow it: “by an individual debtor.” All filed does in section 707(b) is limit dismissal under that subsection to cases filed by individuals, rather than cases filed by corporations, partnerships, and the like.

Were there any doubt about that, sections 1112(b)(1), 1208(b), and 1307(b), dispel it. Each allows a court to "dismiss a case under this chapter," which is every case pending under each of those chapters. This language is the same as that found in section 707(b), except that section 707(b), unlike those sections, adds the words "filed by an individual debtor" to identify those cases pending in chapter 7 that can be dismissed under that subsection. Sections 1112(b), 1208(b), and 1307(b) serve the same purpose as 707(b), authorizing dismissal when the applicable statutory basis is met. There is no reason to read them more expansively than section 707(b).

Third, the lower court's reading would, without any obvious rationale, create two chapter 7's for similarly situated debtors. Debtors who originally file in chapter 7 would be subject to dismissal under section 707(b)'s "means test," bad faith test, and totality of financial circumstances test. 11 U.S.C. §§ 707(b)(2) and (b)(3)(A) - (B). But identical debtors who park their cases briefly in chapters 11, 12 or 13 would not. There is no evidence that Congress enacted such an illogical scheme, and we cannot identify any reason why it would have wished to do so.

Fourth, these debtors' converted chapter 7 case should not escape section 707(b) review - even if the court below correctly read "filed" as modifying the term "under this chapter" in section 707(b). That is so because this term incorporates converted cases, as a number of bankruptcy courts have held in a variety of contexts. Thus, even under the lower court's reading of section 707(b)(1), the order entered below merits reversal.

Fifth, the bankruptcy court's reading would make chapter 13 more expensive for creditors and chapter 13 trustees. Under that reading, chapter 13 debtors could convert if creditors challenged their proposed chapter 13 plans. And they would be encouraged to do so because they would be secure in the knowledge that their ability to repay their debts, which sections 707(b)(2) and (b)(3)(B) police, would never be applied to them. Indeed, this case is a paradigm of that: the debtors converted to chapter 7 only after a creditor spent its time and money objecting to the debtors' deficient chapter 13 plan. That conduct should not be rewarded by allowing these debtors, unlike non-converting chapter 7 debtors, to escape section 707(b) review.

ARGUMENT

I. Given that section 707(b) (2)(D) explicitly lists the cases that are excluded from dismissal under section 707(b)(2), the court below erred when it interpreted section 707(b)(1) as creating an additional, implicit, exception.

A. In ascertaining the meaning of section 707(b), courts "must look to the particular statutory language at issue, as well as the language and the design of the statute as a whole." *McCarthy v. Bronson,* 500 U.S. 136, 139 (1991) (rejecting arguments relying on a "natural reading" of statutory language in isolation); *Crandon v. United States,* 494 U.S. 152, 158, (1990) (in determining the meaning of the statute, courts look not only to the particular statutory language, but to the design of the statute as a whole and to its object and policy).

Section 707(b)'s text is significant here because it contains no express prohibition against the application of section 707(b) to debtors whose cases were filed in chapter 13. 11 U.S.C. § 707(b).

But, in stark contrast, section 707(b)(2)(D), contains explicit exceptions to means testing under the Bankruptcy Code,[11] is silent with respect to debtors who originally filed their cases under chapters 11 or 13 but subsequently converted to chapter 7. 11 U.S.C. § 707(b)(2)(D). Had Congress intended to create the

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[11] Section 707(b)(2)(D) expressly exempts certain disabled combat veterans who primarily incurred indebtedness while on active duty or performing a homeland defense activity, as well as national guardsmen and reservists called to active duty or performing a homeland defense activity for a specified period of time, from the requirements of means testing. *See* 11 U.S.C. § 707(b)(2)(D).

exception the bankruptcy court below advocates, it would have included it in section 707(b)(2)(D). *See Sanchez v. Holder* , 560 F.3d 1028, 1032 (9th Cir. 2009).

The contrast between section 707(b)(2(D)'s explicit exception, and section 707(b)(1)'s text could hardly be more profound. Not only does the former explicitly define the exception, it carefully delineates its parameters. It does so in detail. It leaves no ambiguity, expressly providing that section 707(b)(2) "shall not apply" to a well defined class of excepted cases. 11 U.S.C. § 707(b)(2)(D). And, because the exception is express and detailed, it is clear.

Given that Congress took great care to craft its express exception in section 707(b)(2)(D), there is no cause to presume it intended there to be any implicit exceptions in section 707(b). Because section 707(b)(2(D)'s detailed nature underscores just how seriously Congress undertook its drafting of section 707(b), the lack of an express exception in section 707(b)'s text, underscores that none exists.

Section 707(b)(2)(C) supports this reading. It imposes an unequivocal obligation on debtors to file a statement of current monthly income and the calculations that determine whether a presumption arises under subparagraph (A)(i), which must demonstrate how each amount is calculated. 11 U.S.C. § 707(b)(2)(C). Section 707(b)(2)(C) modifies debtors' obligations under section

521, but it contains no express language excepting cases filed under another chapter from the means test requirement. *Id.* If Congress had intended to create such an exception, it would have included it in section 707(b)(2)(C). *See Sanchez v. Holder*, 560 F.3d at 1032 ("Congress has demonstrated that it knows how to create an exception . . . when it wants to").

B. Other sections of the Code support the conclusion that the word "filed" in section 707(b) modifies only "by an individual debtor," and does not, for no discernable reason, allow converted cases to escape section 707(b) scrutiny.

For example, the phrase "under this chapter" also appears in sections 706(a) and 1112(a) of the Bankruptcy Code. *See* 11 U.S.C. § 706(a) (providing that a debtor may convert "a case under this chapter" to a case under chapter 11, 12, or 13) (emphasis added); 11 U.S.C. § 1112(a) (providing that a "debtor may convert a case under this chapter to a case under chapter 7.").

But, unlike section 707(b) both of these sections **expressly** prohibit their use in converted cases. 11 U.S.C. § 706(a) (providing for conversion from chapter 7 to chapters 11, 12, or 13 if the case has not been previously converted from chapters 11, 12, or 13); 11 U.S.C. § 1112(a) (providing for conversion from chapter 11 to chapter 7 if the case has previously not been converted to chapter 11 on the debtor's request). Had Congress intended to create the exception the bankruptcy court below advocates, it would have included similar prohibitions in section 707(b)(1) of the Bankruptcy Code. *See Sanchez*, 560 F.3d at 1032.

II. Not only did Congress create no explicit exception for converted cases in section 707(b), but three other Code sections, 11 U.S.C. §§ 1112(b), 1208(b) and 1307(b), further clarify that "filed" in section 707(b) modifies only the four words that immediately follow it, "by an individual debtor," and therefore do not enable debtors in converted cases to escape review under sections 707(b)(2), (b)(3(A) and (b)(3)(B).

The court below misread the word "filed" as modifying the clause "under this chapter," leading it to conclude only cases originally filed under chapter 7 could be dismissed under section 707(b). *Dudley*, 405 B.R. at 793-95. But filed does not modify that clause. Instead, it modifies the four words that immediately follow it: "by an individual debtor." All filed does in section 707(b) is limit dismissal under that subsection to cases filed by individuals, rather than cases filed by corporations, partnerships, and the like.

Were there any doubt about that, sections 1112(b)(1), 1208(b), and 1307(b), dispel it. 11 U.S.C. §§ 1112(b), 1208(b), and 1307(b). Each section allows a court to "dismiss a case under this chapter," *i.e.*, every case pending under those chapters. This language is the same as that found in section 707(b), except that section 707(b), unlike those sections, adds the words "filed by an individual debtor" to identify those cases pending in chapter 7 that can be dismissed under that subsection. Sections 707(b), 1112(b), 1208(b), and 1307(b) serve the same purpose as 707(b), authorizing dismissal when the applicable statutory basis is met. Thus, they should be applied in the same way.

III. These debtors' case does not escape section 707(b) review, even if the court below correctly read "filed" as modifying the term "under this chapter" in section 707(b), because cases agree this term incorporates converted cases.

Debtors who convert their cases between chapters "are deemed to have 'filed under' the *converted to* chapter, as of the date the original petition was filed." *In re Perfetto,* 361 B.R. 27, 30-31 (Bankr. D. R.I. 2007) (italicized in original); *see also In re Sours,* 350 B.R. 261, 266-68 (Bankr. E.D. Va. 2006); *In re Grydzuk,* 353 B.R. 564, 567 (Bankr. N.D. Ind. 2006); *In re Capers,* 347 B.R. 169, 170 (Bankr. D. S.C. 2006).

For example, section 1328(f) of the Bankruptcy Code, which utilizes the phrase "in a case **filed under** chapter 7, 11, 12 of this title" has been unanimously interpreted to encompass both converted and non-converted cases. *See In re Willis*, 408 B.R. 803, 808 (Bankr. W.D. Mo. 2009) ("Courts considering effect of a conversion on a debtor's eligibility for discharge under § 1328 have unanimously (by this Court's research) concluded that the phrase "filed under chapter 7. . . ." applies to cases converted to Chapter 7); 11 U.S.C. § 1328(f) (emphasis added).

Indeed, the Fourth Circuit has noted with approval that "[b]ankruptcy courts in this circuit have rejected the idea that the word 'filed' in §§ 1328(f)(1) and (f)(2) is used to differentiate cases filed under one chapter of the Bankruptcy Code, but converted to a different chapter under which the discharge is ultimately granted." *Branigan v. Bateman (In re Bateman)*, 515 F.3d 272, 277 n.7 (4th Cir. 2008).

Similarly, section 348(a) explicitly prescribes such a result when it states that:

> Conversion of a case from a case under one chapter of this title to a case under another chapter of this title constitutes an order for relief **under the chapter to which the case is converted**, but except as provided in subsections (b) and (c) of this section, does not effect a change in the date of the filing of the petition, the commencement of the case, or the order for relief.

11 U.S.C. § 348(a) (emphasis added). *Cf. Willis*, 408 B.R. at 805-10; *Justice v. Advanced Control Solutions*, Case No. 07-5231, 2008 WL 4368668 at *3-5 (W. D. Ark., Sept. 22, 2008); *Perfetto*, 361 B.R. at 30-31; *In re Kellett*, 379 B.R. 332, 335-40 (Bankr. D. Or. 2007); *In re Kerr*, 2007 WL 2119291 at *2-*4 (Bankr. D. Wash., July 18, 2007).

Thus, even if the court below construed the words "filed . . . . under this chapter" correctly, section 707(b) would nonetheless apply in this case.

Supporting this notion is the fact that Fed. R. Bankr. P. 1007(b)(4), which bankruptcy courts use to implement section 707(b)(2), provides, with certain prescribed exceptions not implicated here, that "an individual debtor **in** a chapter 7 case with primarily consumer debts shall file a statement of current monthly income prepared as prescribed by the appropriate Official Form . . . ." Fed. R. Bankr. P. 1007(b)(4) (emphasis added). Had the Rules Committee concluded that Congress intended to treat cases originally filed in chapter 13 differently than cases originally filed under chapter 7, Rule 1007(b)(4) would contain an express exception for cases initially brought in other chapters, but subsequently converted to a proceeding under chapter 7. No such exception exists. *Id.*

IV. The bankruptcy court's interpretation of section 707(b) would lead to inequitable results.

A. The bankruptcy court's interpretation of section 707(b) would allow debtors with disposable income sufficient to repay 100% of their creditors to escape section 707(b) review simply by doing what the Debtors did here: file a chapter 13 petition, then convert their case to chapter 7.

This would create two chapter 7's for similarly situated debtors. Those who file chapter 7 initially would be subject to the three distinct abuse provisions of section 707(b) (*i.e.*, the "means test," bad faith dismissal, and dismissal based on the totality of the debtor's financial circumstances). But, debtors who initiate their cases in chapter 13 would be subject to dismissal only for bad faith under section 707(a).

There is no evidence that Congress enacted such an illogical scheme, and as explained above, the Bankruptcy Code's text does not support it. Nor, can we imagine why anyone would create such an arbitrary and unfair system.

In enacting the 2005 Act, Congress was concerned that under the prior system, "some bankruptcy debtors are able to repay a significant portion of their debts" but are not required to do so. H.R. Rep. No. 109-31 (I), at 5, 2005 U.S.C.C.A.N. at 92. In amending section 707(b), Congress sought to close or reduce "the loopholes and incentives that allow and – sometimes – even encourage opportunistic personal filings and abuse." *Id*. The bankruptcy court's approach would have the opposite effect. It would give those with a clear-cut ability to repay every opportunity to avoid having to repay anything at all.

The bankruptcy court suggested this unfair result could be mitigated by allowing parties to seek to dismiss converted cases for "bad faith" theory under section 707(a). *Dudley*, 405 B.R. at 800. But that denies parties 67% of their remedies under section 707 - means test dismissal under section 707(b)(2), and totality of the debtor's financial circumstances dismissal under section 707(b)(3)(B).

And it is unfair to debtors who start their cases in chapter 7. Their cases can be dismissed under section 707(a), and can also have their cases dismissed for bad faith under section 707(b)(3)(A). But they face the added prospect of dismissal under section 707(b)(2) and (b)(3)(B).

Such disparate treatment among similarly situated parties, ones who seek the same relief - a chapter 7 discharge, is unfair to those debtors who, unlike the

Debtors here, commenced their cases in chapter 7. And it is unfair to creditors, who could seek repayment from the debtor who originally files in chapter 7 but not the similarly situated debtor who converts.

B. Nor is it any answer to suggest, as the court below did, that this problem can be rectified by dismissing bad faith conversions under section 707(a).

First, that would still allow debtors whose conduct does not rise to bad faith to avoid scrutiny under section 707(b) even though all good faith debtors who originally file in chapter 7 would be subject to that section. There is no logical reason to treat those similarly situated debtors differently.

Second, there are sound reasons to allow dismissal of conversions under section 707(b) rather than section 707(a). Where a debtor has disposable income that would give rise to a finding of "bad faith" in a case converted from chapter 13, Section 707(b)(2)'s mathematical means test makes it a quicker and less costly way to obtain dismissal. Conversely, proving bad faith under section 707(a), could require courts to hold full trials, obligate the parties to conduct discovery and engage in trial, and force courts to make extensive findings of fact and conclusions of law. Given that Congress created the means test in 2005 to streamline dismissal, and bring some objectivity to the process, there is no reason to presume Congress crafted a statutory scheme that defeats that.

Third, requiring parties to seek dismissal of converted cases with disposable income under a "bad faith" theory via section 707(a) “undercuts the intention of Congress that such issues be handled under 707(b).” 6 Collier on Bankruptcy, ¶ 707.03[2] (15th ed. Rev. 2006). This is particularly true when one considers that section 707(b)(3)(A) currently provides for “bad faith” dismissal of a debtor’s case. *See* 11 U.S.C. § 707(b)(3)(A).

C. Finally, the bankruptcy court’s reading of the statute would make chapter 13 more costly and less efficient. This is so because other parties, including standing chapter 13 trustees and creditors, are intimately involved in the chapter 13 reorganization process. For example, in this case, the Debtors’ standing chapter 13 trustee conducted the Debtors’ meeting of creditors. *See* Appellant’s Rec. No. 3. Likewise, eCast, was required to file a detailed objection to the Debtors’ proposed repayment plan. *See* Appellee’s Rec. No. 1. Such activities involve time, effort, and money. To provide debtors with an incentive to file under chapter 13 merely to later convert to chapter 7 is inherently unfair to these parties, who serve as honest participants in the chapter 13 process.

CONCLUSION

For these reasons, the United States Trustee respectfully asks this Court to reverse the order entered below, and remand this case for further proceedings.

{Signature on Next Page}

Respectfully submitted,
W. CLARKSON McDOW, JR.
United States Trustee

By: */s/ Joseph A. Guzinski*

RAMONA D. ELLIOTT
General Counsel

P. MATTHEW SUTKO	JOHN ROBERT BYNES
Associate General Counsel	Assistant United States Trustee
DAVID I. GOLD	JOSEPH A. GUZINSKI
Trial Attorney	Trial Attorney
Executive Office for United States Trustees	Office of the United States Trustee First Campbell Square
20 Massachusetts Avenue N.W.	210 First Street, S.W.
U.S. Department of Justice	Roanoke, Virginia 24011
Washington, D.C. 20530	Telephone: (540) 857-2699

CERTIFICATE OF SERVICE

I hereby certify that on September 28, 2009, I electronically filed the foregoing with the Clerk of the Court and transmitted a true and correct copy through the electronic case filing system, and by first class mail, postage pre-paid, to the following:

William J. Charboneau, Esq.
Magee, Foster, Goldstein & Sayers
P. O. Box 404
Roanoke,, VA 24003
(540) 343-9800
Email: jcharboneau@mfgs.com

Counsel for Debtors and Appellants

/s/ Joseph A. Guzinski

Joseph A. Guzinski

Trial Attorney

BRIEF BANK — "SUMMARY SHEET" *Printed Mon-11/23/09 16:22*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	In re David D. Dudley & Ann M. Dudley (W. Clarkson McDow, Jr., United States Trustee for Region Four v. David D. Dudley & Ann M. Dudley)
2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	W.D. Va.
3. ("CCN") ***CURRENT*** CASE NO.	No.: 7:09-cv-00336-SGW
4. ("PCN") ***PRIOR*** CASE NO. - & COURT *[IF ANY]*	No.: 08-cv-71561 Court: Bankr. W. D. Va. *(Identify judge & cite, if any)*
5. ("SO") ***SOURCE***	**U.S. TRUSTEES**
6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	Filed: November 20, 2009 Type: Reply Brief for the United States Trustee, Appellant
7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*	Joseph A. Guzinski, John R. Byrnes, David I. Gold, P. Matthew Sutko, Ramona D. Elliott, W. Clarkson McDow *(UST/OGC: 202-307-1399/FAX-2397)*
8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	• Whether the United Trustee's construction of section 707(b)(1) equate the conversion of a case with the filing of a petition under the bankruptcy code.
10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)	
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District Court Case No. 7:09-CV-00336-SGW

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF VIRGINIA

In re DAVID D. DUDLEY &
ANN M. DUDLEY,

Debtors.

W. CLARKSON MCDOW, JR.,
UNITED STATES TRUSTEE
FOR REGION FOUR,

Appellant,
v.

DAVID D. DUDLEY &
ANN M. DUDLEY,

Appellees.

ON APPEAL FROM THE UNITED STATES BANKRUPTCY COURT
FOR THE WESTERN DISTRICT OF VIRGINIA
Bankruptcy Case No. 08-71561

REPLY BRIEF FOR THE UNITED STATES TRUSTEE, APPELLANT

RAMONA D. ELLIOTT
General Counsel

P. MATTHEW SUTKO
Associate General Counsel
DAVID I. GOLD
Trial Attorney
Executive Office for United States Trustees
United States Department of Justice
20 Massachusetts Avenue N.W.
Washington, D.C. 20530

W. CLARKSON McDOW, JR.
United States Trustee

JOHN ROBERT BYRNES
Assistant United States Trustee
JOSEPH A. GUZINSKI
Trial Attorney
Office for United States Trustee
First Campbell Square
210 First Street, S.W.
Roanoke, Virginia 24011
Telephone: (540) 857-2699

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ARGUMENT

In their brief, the Debtors make five principal arguments. First, the Debtors assert that section 707(b)(1) must be enforced according to its terms because the language of the statute is plain. *See* Appellee's Br. at 5-7. Second, the Debtors argue that because the United States Trustee's construction of section 707(b)(1) relies upon the "last antecedent" doctrine, his interpretation fails. *Id.* at 8-14. Third, the Debtors contend that the United States Trustee's construction of section 707(b)(1) somehow equates the conversion of a case with the filing of a petition under the Bankruptcy Code. *Id.* at 15-27. Fourth, the Debtors assert that Congress intended section 707(b)(1) to only apply to cases originally filed under chapter 7 of the Bankruptcy Code. *Id.* at 27-31. Fifth, the Debtors suggest that this Court's adoption of the United States Trustee's construction of section 707(b)(1) would lead to absurd and inequitable results. *Id.* at 31-35. Each of these arguments are addressed below.[1]

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[1] The Debtors also suggest that the United States Trustee has waived several of his arguments before this Court. *See* Appellee's Br. at n.5. That is simply inaccurate. The United States Trustee has properly preserved the issue on appeal, and the matters addressed were raised before the bankruptcy court below. In the case below, the United States Trustee argued for his interpretation of section 707(b)(1) based on the language of the statute itself, the policies behind the 2005 Act, and the practical results that would arise from excluding cases converted to chapter 7 from another chapter from the abuse analysis. *See* R. at 63-64; 115-118. The United States Trustee's brief expands upon these arguments, but the arguments were raised below.

I. The plain language of section 707(b)(1).

The Debtors assert that section 707(b)(1) must be enforced according to its terms because the language of the statute is plain. *See* Appellee's Br. at 5-7. The United States Trustee agrees. The language at the core of this appeal is contained in section 707(b)(1) of the Bankruptcy Code. It provides that the court "may dismiss a case filed by an individual debtor under this chapter whose debts are primarily consumer debts. . . ." 11 U.S.C. § 707(b)(1). Thus, section 707(b) relates to a "case" – a term broad enough to encompass both cases converted to chapter 13 and those originally filed in chapter 7.

As the United States Trustee demonstrates, section 707(b)(1)'s language regarding the types of cases subject to dismissal is practically identical to the language contained in other, similar provisions of the Bankruptcy Code. *See* Appellant's Br. at 21-22, referencing sections 1112(b), 1208(b), and 1307(b) of the Bankruptcy Code).[2] The Debtors do not dispute that these other, similar provisions apply to cases converted from other chapters. *See* Appellee's Br. at 4-35. Indeed, the Debtors fail to address these corresponding provisions at all. *Id.* Accordingly,

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[2] The only difference between these provisions and section 707(b)(1) is the phrase "filed by an individual debtor." However, as explained by the United States Trustee in his principal brief, this additional phrase is found in section 707(b)(1) because Congress sought to limit dismissal for abuse under section 707(b)(1) to cases filed by consumer debtors who are not corporations, partnerships, or limited liability companies, and not because Congress sought to limit dismissal to cases originally filed under chapter 7. *See* Appellant's Br. at 15-16.

because it is a basic rule of statutory construction that "'identical words used in different parts of the same act are intended to have the same meaning[,]'" *Commissioner of Internal Revenue v. Lundy*, 516 U.S. 235, 250 (1996) (citations omitted), section 707(b)(1) should be applied in the same manner as sections 1112(b), 1208(b), and 1307(b). When that occurs, it is self-evident that section 707(b)(1) – just like sections 1112(b), 1208(b), and 1307(b) – fails to contain any exception for previously converted cases, and the lower court's reading fails.[3]

II. Reliance upon the "last antecedent" doctrine.

The Debtors distort the United States Trustee's construction of section 707(b)(1) by implying that it rests entirely on the application of the "last antecedent doctrine" and then applying that doctrine in an absurd fashion. *See* Appellee's Br. at 8-10. The Debtors develop this theory by taking issue with the district court's analysis in *Justice v. Advanced Control Solutions*, Case No. 07-5231, 2008 WL 4368668 (W. D. Ark. Sept. 22, 2008). *Justice* is the **only** appellate decision to have considered the issue before this Court, and *Justice* concluded **opposite** of the bankruptcy court below. *Id.* Accordingly, it is not surprising that

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[3] The fact that sections 707(b)(2)(C) and (D) neglect to provide for the express exception announced by the bankruptcy court below also supports this conclusion. Presumably, had Congress intended to create such an exception it would have included it in these sections of the Bankruptcy Code, yet the exception is nowhere to be found. *See Sanchez v. Holder*, 560 F.3d 1028, 1032 (9th Cir. 2009) ("Congress has demonstrated that it knows how to create an exception . . . when it wants to").

the Debtors take issue with *Justice*.[4]

Justice is not the flawed decision that the Debtors make it out to be. While the Debtors suggest that the *Justice* court inappropriately applied the "last antecedent doctrine" in its analysis, and therefore urge its rejection by this Court, basic grammar belies the Debtors position. The phrase "whose debts are primarily consumer debts" does not, as the Debtors suggest, modify the word "chapter." Rather, the word "whose" modifies the phrase "debts are primarily consumer debts." This is so because the word "whose" is a relative pronoun that refers to the term "individual debtor" in section 707(b)(1), and the phrase "debts are primarily consumer debts" in section 707(b)(1) operates as an adjective clause that describes the "individual debtor." The *Justice* court's application of the "last antecedent doctrine" is therefore well-reasoned and supported by basic grammatical construction.

III. The United States Trustee's construction of section 707(b)(1) does not equate the conversion of a case with the filing of a petition under the Bankruptcy Code.

The Debtors contend that the United States Trustee's construction of section

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[4] Ironically, the United States Trustee's principal brief does not even cite *Justice* for the proposition articulated by the Debtors (*i.e.*, that the "last antecedent doctrine" is determinative of the issue in this case). Rather, the United States Trustee cites *Justice*, along with several other bankruptcy court decisions, for the proposition that section 348(a) of the Bankruptcy Code explicitly prescribes the result sought by the United States Trustee. *See* Appellant's Br. at 23.

707(b)(1) somehow equates the conversion of a case with the filing of a petition under the Bankruptcy Code. *See* Appellee's Br. at 15-27. The Debtors are wrong. The filing of a petition in bankruptcy consists of submitting a seven page pre-printed form to the bankruptcy court. *See* Official Bankruptcy Form B1. This act has the legal significance of commencing a bankruptcy "case."[5] *See* 11 U.S.C. § 301. It only occurs once.

While the United States Trustee does take the position that debtors who convert their cases between chapters are **deemed** to have filed under the chapter to which they have converted as of the date the original petition was filed, *see* Appellant's Br. at 22, he has never taken the position that the conversion of a case equates to actual filing of a second petition in a case. Indeed, to do so would mean to ignore the plain language of section 348(a) of the Bankruptcy Code, which expressly references only **one** petition. *See* 11 U.S.C. § 348(a) ("conversion . . . does not effect a change in the date of the filing of the petition"). To the contrary, the United States Trustee position tracks section 348(a), which states that the conversion of a case under one chapter of the Bankruptcy Code to another chapter of the Bankruptcy Code "**constitutes** an order for relief under the chapter to which

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[5] The term "case" is broadly defined in bankruptcy. It "embraces all controversies determinable by the court of bankruptcy and all matters of administration arising during the pendency of the case. . . ." 2 Collier on Bankruptcy ¶ 301.03 (15th ed. Rev. 2009) (quoting former Bankruptcy Rule 101 Advisory Comm. Note); *In re Caldor Corp,* 303 F.3d 161, 168 (2d Cir. 2002).

the case is converted. . . ." *Id.* (emphasis added). Accordingly, the "legal fiction" the Debtors so readily accuse the United States Trustee of engaging in is dictated by statute. *Id.*

IV. Congress did not intend section 707(b)(1) to only apply to cases originally filed under chapter 7 of the Bankruptcy Code.

The Debtors contend that Congress intended section 707(b)(1) to only apply to cases originally filed under chapter 7 of the Bankruptcy Code. *See* Appellee's Br. at 27-31. In support of this theory, the Debtors argue that: (a) had Congress meant to include converted cases within the ambit of section 707(b)(1) it would have deleted the word "filed" in section 707(b) as part of the amendments to section 707(b) under the 2005 Act; and (b) a floor statement by the Hon. James Sensenbrenner somehow acknowledges that section 707(b)(1) does not apply to converted cases. *Id.* The Debtors are wrong on both accounts.

First, as explained in the United States Trustee's principal brief, the inclusion of the word "filed" in section 707(b)(1) is not fatal to the United States Trustee's position. Those courts that have interpreted the word "filed" with respect to other provisions of the Bankruptcy Code have been unanimous in interpreting the term as encompassing both converted and non-converted cases. *See In re Willis*, 408 B.R. 803, 808 (Bankr. W.D. Mo. 2009). Moreover, the Fourth Circuit has noted with approval that "[b]ankruptcy courts in this circuit have rejected the idea that the word 'filed' in §§ 1328(f)(1) and (f)(2) is used to differentiate cases filed under one chapter of the Bankruptcy Code, but converted to a different chapter under which the discharge is ultimately granted." *Branigan v. Bateman (In re Bateman),* 515 F.3d 272, 277 n.7 (4th Cir. 2008). Thus, powerful evidence exists to suggest that Congress **did not** intend section 707(b)(1) to only apply to cases originally filed under chapter 7 of the Bankruptcy Code.

Second, the floor statement cited by the Debtors fails to mention section 707(b)(1)'s applicability **at all**. Rather, it merely acknowledges that under section 1307(a) of the Bankruptcy Code – which was not amended under the 2005 Act – a debtor has the right to convert her case to one under chapter 7 of the Bankruptcy Code. Accordingly, the floor statement is not the smoking gun the Debtors make it out to be.[6]

V. The United States Trustee's construction of section 707(b)(1) will not lead to absurd and inequitable results.

In a last ditch effort to salvage their position, the Debtors engage in the hypothetical, arguing that the United States Trustee's construction of section 707(b)(1) will somehow lead to absurd and inequitable results. *See* Appellee's Br.

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[6] Even if that were not so, and the floor statement did mention section 707(b)(1)'s applicability, it should not be relied upon by this Court. If the intent of Congress is clear and unambiguously expressed by the statutory language at issue – which, as discussed above and in the United States Trustee's principal brief is the case when it comes to section 707(b)(1) – that should be the end of the Court's analysis. *See Zuni Public School Dist. No. 89 v. Department of Educ.* 550 U.S. 81, 94 (2007).

at 31-35. Essentially, the Debtors argue that in cases where a debtor initially seeks chapter 13 relief but later chooses to convert to chapter 7 due to an inability to fund a plan, the United States Trustee's position would place the debtor in the position of having her case dismissed because section 707(b)(2)'s means test calculation is based on prior, not current, income levels. *Id*. The Debtors argument lacks merit for two reasons. First, in the event that a case is converted from chapter 13 to chapter 7, and it is determined that the debtor has no true ability to repay, the United States Trustee would likely **decline to bring a motion to dismiss** the debtor's case. *See* 11 U.S.C. § 704(b)(2). Second, the argument ignores the fact that, in this case, the Debtors **have an actual ability to pay** based on the roughly $2,000 aggregate reduction in their monthly housing expense.[7] *See* Appellant's Br. at 12-13. Accordingly, it is the position adopted by the bankruptcy court below, not the position adopted by the United States Trustee, that will lead to absurd and inequitable results.

CONCLUSION

For these reasons, the United States Trustee respectfully asks this Court to reverse the order below, and remand this case for further proceedings.

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[7] As the Debtors acknowledge in their brief, the bankruptcy court never reached the question of whether this expense should be allowed. *See* Appellee's Br. at 33.

Respectfully submitted,

OF COUNSEL

RAMONA D. ELLIOTT
General Counsel

P. MATTHEW SUTKO
Associate General Counsel
DAVID I. GOLD
Trial Attorney
Executive Office for United States Trustees
United States Department of Justice
20 Massachusetts Avenue N.W.
Washington, D.C. 20530

W. CLARKSON McDOW, JR.
United States Trustee

By: */s/ Joseph A. Guzinski*
JOHN ROBERT BYRNES
Assistant United States Trustee
JOSEPH A. GUZINSKI
Trial Attorney
Office for United States Trustee
First Campbell Square
210 First Street, S.W.
Roanoke, Virginia 24011
Telephone: (540) 857-2699

Certificate of Service

I hereby certify that on November 20, 2009, I electronically filed the foregoing with the Clerk of the Court and transmitted a true and correct copy through the electronic case filing system, and by first class mail, postage pre-paid, to the following:

William J. Charboneau, Esq.
Magee, Foster, Goldstein & Sayers
P. O. Box 404
Roanoke,, VA 24003
(540) 343-9800
Email: jcharboneau@mfgs.com
Counsel for Debtors and Appellants

/s/ Joseph A. Guzinski
Joseph A. Guzinski
Trial Attorney

BRIEF BANK — "SUMMARY SHEET" *Printed Thu-12/9/10 15:35*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*
W. Clarkson McDow, Jr., United States Trustee for Region 4 v. David V. Dudley and Anne M. Dudley (In re: David V. Dudley and Anne M. Dudley)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*
4th Cir.

3. ("CCN") ***CURRENT*** CASE NO.
No.: 10-1732

4. ("PCN") ***PRIOR*** CASE NO. - & COURT *[IF ANY]*
No.: 7:09-cv-00336-sgw
Court: W. D. Va.
(Identify judge & cite, if any)

5. ("SO") ***SOURCE***
U.S. TRUSTEES

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7. **("AU") *PRINCIPAL AUTHORS & OFFICE*** [E.g.,"UST/OGC"]
Wendy L. Cox, P. Matthew Sutko, John R. Byrnes, Joseph A. Guzinski
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s)

&

√ Any Miscellaneous ***BACKGROUND***

• Whether the bankruptcy court's order granting the Dudleys summary judgment and terminating forever the United States Trustee's action to dismiss their case for abuse under 11 U.S.C. §§ 707(b)(2) & (b)(3) was a final order appealable as of right under section 158(a)(1).

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No. 10-1732

IN THE UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

IN RE: DAVID V. DUDLEY & ANNE M. DUDLEY, Debtors.

W. CLARKSON MCDOW, JR., United States Trustee for Region 4,
Appellant,

v.

DAVID V. DUDLEY & ANNE M. DUDLEY,
Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF VIRGINIA AT ROANOKE

BRIEF FOR THE APPELLANT, THE UNITED STATES TRUSTEE

RAMONA D. ELLIOTT
General Counsel
P. MATTHEW SUTKO
Associate General Counsel
WENDY L. COX
Trial Attorney
Executive Office for United States Trustees
Department of Justice
20 Massachusetts Ave., N.W.
Washington, D.C. 20530
Telephone: (202) 307-1399

W. CLARKSON MCDOW, JR.
United States Trustee for Region 4

JOHN R. BYRNES
Assistant United States Trustee
Office of the United States Trustee
Department of Justice
First Campbell Square
201 1st Street, S.W., Suite 505
Roanoke,VA 24011
Telephone: (540) 857-2838

JOSEPH A. GUZINSKI
Assistant United States Trustee
Office of the United States Trustee
Department of Justice
115 South Union Street, Room 210
Alexandria, VA 22314
Telephone: (703) 557-7176

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STATEMENT OF JURISDICTION

The bankruptcy court had jurisdiction under 28 U.S.C. § 157(a) and (b) over David and Anne Dudley's bankruptcy case. 11 U.S.C. § 101 *et seq*. *See also* 28 U.S.C. §§ 151, 1334(a). On December 15, 2008, the United States Trustee commenced a contested matter in that case. *See* Fed. R. Bankr. P. 9014. He alleged that the Dudleys' case was abusive on two alternative grounds and should be dismissed. *Joint Appendix "J. A." 32-38* (moving to dismiss the case under 11 U.S.C. § 707(b)(2) or (b)(3)). The United States Bankruptcy Court for the Western District of Virginia entered an order on June 17, 2009, granting the Dudleys summary judgment as to the United States Trustee's claims. *J. A. 51*.

The United States Trustee appealed that order to the United States District Court for the Western District of Virginia on June 26, 2009. *J. A. 68*. That order was timely under 28 U.S.C. § 158(c)(2) and Fed. R. Bankr. P. 8002. The district court dismissed the appeal on April 28, 2010, holding it to be interlocutory and declining to grant the United States Trustee leave to take an interlocutory appeal pursuant to 28 U.S.C. § 158(a)(3). *J. A. 75, 81*. On June 25, 2010, the United States Trustee filed a timely notice of appeal from the district court's dismissal of the appeal to this Court pursuant to Fed. R. App. P. 4(a)(1)(B). *J. A. 82*.

This Court has jurisdiction to review the district court's ruling as to the finality of the bankruptcy court's order under 28 U.S.C. § 158(d)(1). *See, e.g., BancTexas Dallas, N.A. v. Chateaugay Corp. (In re Chateaugay Corp.)*, 876 F.2d 8, 9 (2d Cir. 1989) (holding that court of appeals had jurisdiction to review district court's determination that bankruptcy court's decision was interlocutory); *In re Brown*, 916 F.2d 120 (3d Cir. 1990) (reviewing district court order dismissing appeal as interlocutory); *Smith v. Seaside Lanes (In re Moody)*, 825 F.2d 81, 89 n.11 (5th Cir. 1987) (same); *In re Sun Valley Foods Co.*, 801 F.2d 186, 189-90 (6th Cir. 1986) (same).

STATEMENT OF THE ISSUE PRESENTED FOR REVIEW

Section 158(a)(1) of title 28 gives district courts jurisdiction over appeals "from final judgments, orders, and decrees" of bankruptcy courts. 11 U.S.C. § 158(a)(1). The sole issue in this appeal is whether the bankruptcy court's order granting the Dudleys summary judgment and terminating forever the United States Trustee's action to dismiss their case for abuse under 11 U.S.C. §§ 707(b)(2) & (b)(3) was a final order appealable as of right under section 158(a)(1).

STATEMENT OF THE CASE

The United States Attorney General appoints United States Trustees to supervise the administration of bankruptcy cases and trustees. *See* 28 U.S.C. §§ 581-589a. United States Trustees "serve as bankruptcy watch-dogs to prevent fraud, dishonesty, and overreaching in the bankruptcy arena." H.R. Rep. No. 95-595, at 88 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6049.

One of the United States Trustees' statutory duties is to review chapter 7 bankruptcy cases to determine whether the case is presumptively abusive based on specific statutory criteria. *See* 11 U.S.C. § 704(b)(1)(A). When, as here, the United States Trustee concludes that the debtor's case should be presumed to be an abuse under section 707(b)(2), the United States may file a civil action to dismiss the case. 11 U.S.C. § 707(b)(1) & (b)(2). But the United States Trustee must do that before the Bankruptcy Code's statutory deadline for such actions expires. 11 U.S.C. § 704(b)(2).

The United States Trustee did that in this case. After the debtors, David V. Dudley and Anne M. Dudley, converted their bankruptcy case to chapter 7 from chapter 13, the United States Trustee timely moved to dismiss the case as presumptively abusive under 11 U.S.C. § 707(b)(2), and as abusive under 11 U.S.C. § 707(b)(3). *J. A. 32*.

The bankruptcy court granted the Dudleys' motion for summary judgment on the United States Trustee's suit and the United States Trustee appealed the bankruptcy court's decision to the United States District Court for the Western District of Virginia. *J. A. 51, 68*. On its own motion, the district court dismissed the appeal as interlocutory. *J. A. 75, 81.* The United States Trustee then brought this appeal seeking review of the district court's determination that the bankruptcy court's summary judgment order was not final. *J. A. 82.*

STATEMENT OF FACTS

I. Statutory Background

A. 11 U.S.C. § 707(b)

This appeal involves an action brought by the United States Trustee under 11 U.S.C. §§ 707(b)(2) & (b)(3). These causes of action were created in the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("2005 Act") Pub. L. No. 109-8, 119 Stat. 23 (2005). Congress passed the 2005 Act "to improve bankruptcy law and practice by restoring personal responsibility and integrity in the bankruptcy system and ensure that the system is fair for both debtors and creditors." H.R. Rep. No. 109-31(I), at 2 (2005), *reprinted in* 2005 U.S.C.C.A.N. 88, 89.

The 2005 Act authorizes bankruptcy courts to grant motions seeking to dismiss chapter 7 cases. It may do so when "it finds that the granting of relief would be an abuse of the provisions of this chapter" under section 707(b)(2) or (b)(3).[1] 11 U.S.C. § 707(b)(1). Section 707(b)(2) specifies when a chapter 7 case is presumed to be abusive, while section 707(b)(3) sets forth two additional grounds for finding actual abuse. Prior to the 2005 Act, section 707(b) did not include the causes of action now set forth in sections (b)(2) and (b)(3), but authorized the dismissal of cases only for "substantial abuse." 11 U.S.C. § 707(b)(2004).

B. Deadlines for alleging abuse

Under the 2005 Act, United States Trustees have only 10 days from the first meeting of creditors[2] to "review all materials filed by the debtor" and file a statement with the court as to whether the debtor's case is presumed abusive under section 707(b)(2). 11 U.S.C. § 704(b)(1). When a United States Trustee determines a chapter 7 bankruptcy case is presumptively abusive under the statute, the United States Trustee must either seek its dismissal under section 707(b)(1) and (b)(2), or file a detailed statement explaining why dismissal is not

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[1] The "relief" to which Congress referred is a discharge (with certain exceptions) of all of the debtor's prepetition debts. *See* 11 U.S.C. § 727(b).

[2] Congress provided that the United States Trustee must hold a meeting of creditors of the debtor "[w]ithin a reasonable time" after the bankruptcy case is filed or converted. 11 U.S.C. § 341(a).

appropriate.[3] *See* 11 U.S.C. § 704(b)(2). The United States Trustee has only 30 days to do that. *Id.*

A United States Trustee may alternatively seek to dismiss an individual debtor's case under section 707(b)(3). In a section 707(b)(3) action, the United States Trustee must bring suit within 60 days after the first meeting of creditors. Fed. R. Bankr. P. 1017(e)(1).

C. 28 U.S.C. § 158

Congress gave the United States district courts jurisdiction to hear appeals "from final judgments, orders, and decrees . . . of bankruptcy judges." 28 U.S.C. § 158(a). The district courts may also hear appeals from certain interlocutory orders and decrees of the bankruptcy courts as of right and from all others with leave of court. *Id.*

II. This Proceeding

The Dudleys filed a voluntary petition for bankruptcy relief under chapter 13 on August 18, 2008. *J. A. 20.* In chapter 13 cases, debtors use their income to repay creditors over a number of years through a chapter 13 plan. 11 U.S.C.

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[3] A debtor may also consent to the conversion of his case to one under chapter 11 or 13 of the Bankruptcy Code. *See* 11 U.S.C. § 707(b)(1).

§§ 1301-1330. The chapter 13 trustee[4] objected to the confirmation of the Dudleys' chapter 13 plan because he believed that they were seeking to underpay their creditors by claiming unreasonably high expenses and improper deductions. *J. A. 23-24*. The trustee moved to dismiss or convert the Dudleys' case. *J. A. 23.* Faced with that motion, the Dudleys converted their case to a chapter 7 liquidation case.[5] *J. A. 26-29.*

The United States Trustee then sued to dismiss the Dudleys' chapter 7 case for abuse under section 707(b)(2) and (b)(3). *J. A. 32-38*. The United States Trustee contended that if the Dudleys had properly excluded mortgage payments they were claiming on a house they intended to give up to the mortgage holder, then a presumption of abuse mandating dismissal of their chapter 7 case would have arisen under section 707(b)(2). *J. A. 35-36.*

Alternatively, the United States Trustee argued under section 707(b)(3)(B) that the totality of the circumstances of the Dudleys' financial situation demonstrated abuse because the Dudleys had the ability to repay their creditors. *J. A. 37-38*. The Dudleys responded that section 707(b) – which provides that the

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[4] Chapter 13 trustees are non-governmental fiduciaries who administer chapter 13 cases. *See* 11 U.S.C. § 1302.

[5] In a chapter 7 case, a debtor's non-exempt assets are liquidated to pay creditors, but the debtor gets to keep all his post-petition income for himself.

court "may dismiss a case filed by an individual debtor under this chapter whose debts are primarily consumer debts" – did not apply to a case like theirs that had been converted to chapter 7 from chapter 13. 11 U.S.C. § 707(b)(1). *J. A. 44-48.* They sought summary judgment dismissal of the United States Trustee's action against them on that ground.

Although the bankruptcy court observed that the majority of courts that have addressed the issue have held that section 707(b) applies to cases converted to chapter 7, it held that the plain language of the provision limited its application to cases originally filed under chapter 7. *J. A. 54, 66.* Accordingly, the court granted summary judgment to the Dudleys, and denied the United States Trustee's motion to dismiss their case. *J. A. 67.*

The United States Trustee filed a timely notice of appeal to the district court. *J. A. 68.* The district court on its own motion dismissed the appeal for lack of jurisdiction under 28 U.S.C. § 158(a)(1) with no briefing on the jurisdictional issue, and without reaching the merits of the bankruptcy court's summary judgment. *J. A. 77, 80, 81.* The court held that it lacked jurisdiction over the appeal because the bankruptcy court's order denying the United States Trustee's motion to dismiss was not final under 28 U.S.C. § 158(a)(1). *J. A. 77, 80.* The court expressly relied on what it believed to be the weight of circuit authority regarding the finality of such orders, but only one of the authorities it cited involved a section 707(b) motion, and none involved claims of abuse under section 707(b)(2) or (b)(3). *J. A. 78.* The district court's opinion failed to address or even mention the two circuit court decisions holding that orders denying section 707(b) motions under the 2005 Act were final.

The court acknowledged that a liberal interpretation of finality often applied to bankruptcy appeals, under which bankruptcy court orders that "conclusively determine[] a separable dispute" without disposing of the entire case can be considered final. *J. A. 78.* But it held that the order appealed from here was not final even under this relaxed standard because it is "susceptible to being overtaken or superseded by other proceedings in the Bankruptcy Court" such as a proceeding "in which the Bankruptcy Court might refuse to grant the debtor a discharge despite having declined to dismiss this case under § 707(b)." *J. A. 79.* The district court did not explain why this might be so and did not identify any other proceedings that might "overtake" the order declining to dismiss the case for abuse.

SUMMARY OF ARGUMENT

Both United States courts of appeals to consider whether the denial of section 707(b)(2) or (b)(3) motions under the 2005 Act are final have held they are. *Morse v. Rudler (In re Rudler)*, 576 F.3d 37, 43 (1st Cir. 2009); *Ross-Tousey v. Neary (In re Ross-Tousey)*, 549 F.3d 1148, 1152 (7th Cir. 2008). The district court's contrary ruling is wrong and should be reversed.

The First and Seventh circuits' rulings make sense because, as almost every circuit has held, more orders entered in bankruptcy cases are final than in other types of cases. This is so because the language of the United States Code's bankruptcy-specific jurisdictional statute makes more types of orders final than section 1291 of title 28 does. *Compare* 28 U.S.C. § 158(a)(1) *with* 28 U.S.C. § 1291. And it is written more broadly because bankruptcy involves many separate and unrelated disputes between different parties, and no purpose would be served by delaying review of decisions resolving those separate disputes until the end of the entire case.

An action commenced by a United States Trustee to obtain the dismissal of a bankruptcy case under sections 707(b)(2) and (3) is a separate dispute between the United States Trustee and the debtor. It alleges a statutory cause of action against the debtor on which the United States Trustee bears the burden of proof. The bankruptcy court's order granting the Dudleys summary judgment and denying the United States Trustee's motion was a final judgment as to the United States Trustee's claim of abuse in this case because it finally and forever resolved that two-party dispute. Because of the applicable statutory and rule-based deadlines, neither the United States Trustee nor anyone else can seek dismissal of the Dudleys' case on those grounds again. Therefore, the bankruptcy court's summary judgment order was final.

Pragmatic considerations independently support immediate review of orders overruling actions to dismiss chapter 7 cases. This is so for two reasons:

First, immediate appellate review of orders denying section 707(b) motions will ensure that abusive cases are dismissed expeditiously so that limited institutional resources are not needlessly expended on abusive cases. If the order denying section 707(b) relief is not final, the parties may have to wait until the end of the chapter 7 case to obtain appellate review of the order denying dismissal. All the time and resources invested in the chapter 7 case by the parties, the trustee, and the bankruptcy court will have been wasted.

Second, if an order denying dismissal for abuse is not itself, a final, appealable order, then it can be reviewed only in connection with a subsequent final order. But there is not one, readily-identifiable, final order under which the section 707(b) order can be reviewed. The result is total confusion as to which final order the United States Trustee must appeal to obtain appellate review of the section 707(b) order.

This confusion will engender unnecessary litigation. If a United States Trustee could not directly appeal a section 707(b) order, he would have to appeal from every subsequent order in the case that could potentially be the appropriate final order. If he does not, he may inadvertently forfeit his right to appellate review of the section 707(b) order. Permitting immediate review of the section 707(b) order would avoid this quandary and prevent an unnecessary proliferation of bankruptcy appeals.

ARGUMENT

I. Standard of Review

This court reviews the legal conclusions of the district court *de novo*. *In re Kirkland*, 600 F.3d 310, 314 (4th Cir. 2010). Whether subject matter jurisdiction exists is a question of law that is reviewed de novo. *Id.*

II. The Order Granting Summary Judgment to the Dudleys And Denying the United States Trustee's Action Seeking Dismissal Was Final Under 11 U.S.C. § 158(a)(1).

A. The circuit courts unanimously have held that orders denying motions to dismiss under section 707(b)(2) or (b)(3) of the 2005 Act, like this one, are final.

Both United States courts of appeals to consider the issue – the First Circuit and the Seventh Circuit – agree that bankruptcy court orders overruling United States Trustee actions to dismiss chapter 7 cases under the current version of section 707(b) are final and immediately appealable. *In re Rudler*, 576 F.3d at 43-44; *In re Ross-Tousey*, 549 F.3d 1152-53. Such orders are final under section 158(a)(1) because the 2005 Act created statutory deadlines for United States Trustees to identify and move to dismiss presumptively abusive cases, meaning such motions could only be made and considered once in a chapter 7 case. 11 U.S.C. § 704(b). *See also* Fed. R. Bank. P. 1017(e)(1). When, as here, those deadlines have passed, this two-party dispute can never be revisited in the case, and the order terminating it – here a summary judgment order– is immediately appealable.

Even under the predecessor version of section 707, which had no statutory deadline for bringing such actions, two out of three circuits held that bankruptcy court orders denying former section 707(b) motions to dismiss were final. *Stuart v. Koch (In re Koch)*, 109 F.3d 1285, 1288 (8th Cir. 1997); *In re Christian*, 804 F.2d 46, 47-48 (3d Cir. 1986). And the Fifth Circuit treated as final a bankruptcy court order denying the United States Trustee's section 707(b) motion to dismiss under the predecessor statute, without expressly addressing the issue. *See In re Cortez*, 457 F.3d 448, 453-54 (5th Cir. 2006) (affirming district court's reversal of bankruptcy court's order denying United States Trustee's motion to dismiss under section 707(b)).

The bankruptcy court did not cite any cases considering the finality of orders denying motions to dismiss under section 707(b) of the 2005 Act. The case the bankruptcy court relied on, *Barben v. Donovan (In re Donovan)*, 532 F.3d 1134, 1137 (11th Cir. 2008) involved an order denying a motion to dismiss under the predecessor statute. That decision did not address the finality of orders denying dismissal under section 707(b)(2) and (b)(3). Nor did it discuss the circuit court decisions holding that orders denying motions to dismiss under section 707(b) are final.[6]

The Eleventh Circuit's inapposite decision relied chiefly on decisions holding that orders denying motions to dismiss for cause in chapter 11 cases under 11 U.S.C. § 1112(b) are interlocutory.[7] *See In re Donovan*, 532 F.3d at 1137 (*citing In re Jartran*, 886 F.2d 859, 864 (7th Cir. 1989); *In re 405 N. Bedford Dr. Corp.*, 778 F.2d 1374, 1379 (9th Cir. 1985)). But those decisions are not relevant

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[6] The two circuit court cases holding that orders denying motions to dismiss under the predecessor of the current section 707(b) were decided prior to the Eleventh Circuit's decision in *In re Donovan*. *See In re Koch*, 109 F.3d 1285; *In re Christian*, 804 F.2d 46. The opinion does not mention *In re Koch*. It cites, but does not rebut, the Third Circuit's holding in *In re Christian*.

[7] In addition, while the Eleventh Circuit found that the order did not conclusively resolve a claim, it apparently considered only the creditor's monetary claim against the estate and not her separate and distinct claim of abuse against the debtor. *See In re Donovan*, 532 F.3d 1137 & n.2.

to the issue here because significant differences between section 1112(b) motions and section 707(b) motions make orders resolving the former less final than the latter. Under section 1112(b), a party may move to dismiss or convert a chapter 11 reorganization case for "cause." 11 U.S.C. § 1112(b)(1). The statute provides a non-exclusive laundry list of circumstances or events that constitute "cause" for dismissal. 11 U.S.C. § 1112(b)(4). And parties also bring section 1112(b) motions to dismiss based on the alleged bad faith of the debtor. *In re 15375 Memorial Corp. v. Bepco, L.P.*, 589 F.3d 605, 618-19 & n.7 (3d Cir. 2009).

"Cause" for dismissal under section 1112(b) may arise throughout a chapter 11 case, unlike grounds for a motion to dismiss for abuse under section 707(b).[8] Because there are no statutory or rule-based deadlines for filing motions under section 1112(b), nothing prevents a party in a chapter 11 case from filing multiple motions to dismiss. *See* 11 U.S.C. § 1112(b) (permitting dismissal of chapter 11 case for "cause" but establishing no deadlines for seeking such dismissal; the Bankruptcy Rules also set no relevant deadline). Thus, the bankruptcy court may have to revisit the issue of whether a chapter 11 case should be dismissed for

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[8] For example, a chapter 11 case may be dismissed within months of filing for failure to attend the section 341(a) meeting of creditors, or years after filing for inability to effectuate substantial consummation of a confirmed plan. *Compare* 11 U.S.C. § 1112(b)(4)(G) *with* 11 U.S.C. § 1112(b)(4)(M).

cause throughout the case. And it is not uncommon for multiple motions to dismiss to be filed before the case is actually dismissed or converted. *See, e.g.*, *In re Huff*, 54 B.R. 746, 754 (Bankr. D.N.D. 1985) (granting third motion to dismiss under section 1112(b)); *Faden v. Faden*, No. 90-2863, 1990 WL 191861, at *1 (D.N.J. Nov. 5, 1990) (affirming order granting fifth motion to convert under section 1112(b)).

By contrast, the grounds for dismissal under section 707(b) are limited and as a practical matter, only one motion to dismiss for abuse may be decided in a chapter 7 case because of the statutory and rule-based deadlines. An order denying a motion to dismiss for cause in a chapter 11 case consequently lacks the finality of the order denying the motion to dismiss here.[9]

The Seventh Circuit implicitly recognized this difference when it held that orders denying motions to dismiss under the current section 707(b) are final despite previously having held that an order denying a motion to dismiss under section 1112(b) was not. *Compare In re Ross-Tousey*, 549 F.3d at 1152-53 *with In*

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[9] In addition, immediate review of a chapter 11 motion to dismiss could interfere with the reorganization process, a concern that does not exist in a chapter 7 liquidation case. *See In re 405 N. Bedford Dr. Corp.*, 778 F.2d at 1379 ("[C]lassifying the denial of a motion to dismiss for bad faith filing as a final order would have an undesirable impact on the reorganization process.").

re Jartran, 886 F.2d at 863-64.[10] Because of the inherent differences between the motions, decisions finding motions to dismiss under section 1112(b) to be interlocutory do not provide persuasive authority as to the finality of the order on appeal. They certainly cannot trump unanimous circuit authority that is directly on point.[11]

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[10] Even the Eleventh Circuit does not treat all denials of motions to dismiss as interlocutory. The Eleventh Circuit, sitting en banc after its decision in *In re Donovan*, reached the merits of an appeal from an order denying a motion to dismiss a chapter 7 case under a different provision. *Trusted Net Media Holdings, LLC v. Morrison Agency (In re Trusted Net Media Holdings, LLC)*, 550 F.3d 1035 (11th Cir. 2008). It could not have done so had it concluded that the underlying order was interlocutory. *Walden v. Walker (In re Walker)*, 515 F.3d 1204, 1210 (11th Cir. 2008) (court of appeals has jurisdiction over only final judgments and orders arising from bankruptcy proceeding, whereas district court may review interlocutory judgments and orders as well). The United States, acting as amicus raised the issue of whether denials of motions to dismiss are always interlocutory and cited the *In re Donovan* opinion, but the court declined to address the finality issue in its opinion. *See* En Banc Brief for the United States as Amicus Curiae Supporting Appellee at 8-11, filed Sept. 17, 2008 in *In re Trusted Net Media Holdings, LLC*, No. 07-13429 (11th Cir.).

[11] For the same reason, this Court's non-precedential decision holding that an order denying a debtor's motion to voluntarily dismiss his own bankruptcy case without prejudice to renewal was not final is inapposite to the issue on appeal. *See Culver v. Molinario*, No. 94-1974, 1995 WL 570437 (4th Cir. Sept. 28, 1995) (unpublished). A debtor may move to voluntarily dismiss his bankruptcy case more than once. Indeed, in *Culver* the bankruptcy court invited the debtor to renew his motion after certain events had occurred. 1995 WL 570437, at *1. Because the bankruptcy court could grant a subsequent motion by the debtor seeking dismissal, the order appealed in *Culver* did not finally resolve a discrete dispute, unlike the order on appeal here. When the Seventh Circuit decided *In re Ross-Tousey*, it considered the effect of its binding, precedential decision in a case

B. The bankruptcy court's order was final because it finally resolved the United States Trustee's discrete claim of abuse.

Congress gave the United States district courts jurisdiction to hear appeals from "final judgments, orders, and decrees" of the bankruptcy courts. 28 U.S.C. § 158(a)(1). Nearly all of the circuits agree that more determinations are final in bankruptcy cases than in other types of cases. *In re Computer Learning Ctrs., Inc.*, 407 F.3d 656, 660 (4th Cir. 2005); *In re Rudler*, 576 F.3d at 43; *In re Penn Traffic Co.*, 466 F.3d 75, 77-78 (2d Cir. 2006); *In re Prof'l Ins. Management*, 285 F.3d 268, 279 (3d Cir. 2002); *In re Bartee*, 212 F.3d 277, 282 (5th Cir. 2000); *Winget v. JPMorgan Chase Bank*, 537 F.3d 565, 578 (6th Cir. 2008), *cert. denied*, 129 S. Ct. 2159; *In re Ross-Tousey*, 549 F.3d at 1152; *Ritchie Special Credit Inv., Ltd. v. U.S. Trustee*, 620 F.3d 847, 852 (8th Cir. 2010); *In re Rosson*, 545 F.3d 764, 769 (9th Cir. 2008); *In re Baldwin*, 593 F.3d 1155, 1159 (10th Cir. 2010); *In*

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similar to *Culver*. The Seventh Circuit previously had held that an order denying a debtor's motion to voluntarily dismiss his bankruptcy case was not final. *In re Vlasek*, 325 F.3d 955 (7th Cir. 2003). Nevertheless, in *Ross-Tousey* that court held that an order denying a section 707(b) motion to dismiss was final, finding that *In re Vlasek* was not controlling on that issue. *In re Ross-Tousey*, 549 F.3d at 1153 n.2. The debtor's ability to renew his motion in *Culver* meant the order deciding the motion did not conclusively resolve the matter. The opposite is true here. The order denying the United States Trustee's section 707(b) motion cannot be "renew[ed]" because the statutory and rule-based deadlines have passed. Thus, even were it precedential, this Court's decision in *Culver* is not relevant to the issue on appeal.

re Donovan, 532 F.3d at 1136.

One reason for that is section 158(a)'s text, which allows district courts to hear appeals not merely from "final decisions," as 28 U.S.C. § 1291 does, but from:

- final judgments,
- final orders, and
- final decrees

of bankruptcy judges. 11 U.S.C. § 158(a).

Section 158(a) is written more broadly than section 1291 because bankruptcy cases typically involve numerous two party controversies bearing only a slight relationship to each other, and postponing review of orders resolving the separate controversies until the end of the entire bankruptcy case could waste time and resources. *See A.H. Robins Co. v. Piccinin*, 788 F.2d 994, 1009 (4th Cir. 1986) (explaining multiparty nature of bankruptcy cases); *In re Northwood Properties, LLC*, 509 F.3d 15, 21(1st Cir. 2007) (same). A classic, civil action is one two-party dispute. But, bankruptcy cases often have many two party-disputes. So there are more final orders in bankruptcy, something the text of section 158(a) acknowledges.

As a result, this Court, like other circuit courts, has repeatedly held that bankruptcy orders do not have to resolve the entire bankruptcy case to be final. *A.H. Robins*, 788 F.2d at 1009; *Turshen v. Chapman*, 823 F.2d 836, 839 (4th Cir. 1987); *Sumy v. Schlossberg*, 777 F.2d 921, 923 (4th Cir. 1985). In this circuit, it is well-established that "orders in bankruptcy cases may be immediately appealed if they finally dispose of discrete disputes within the larger case." *In re Computer Learning Ctrs.*, 407 F.3d at 660 (*quoting In re Saco Local Dev. Corp.*, 711 F.2d 441, 444 (1st Cir. 1983)). That is the law elsewhere, too. *In re Rudler*, 576 F.3d at 43 ("To be final, a bankruptcy order need not resolve all of the issues in the proceeding, but it must finally dispose of all the issues pertaining to a discrete dispute within the larger proceeding.") (internal quotation omitted); *In re Ross-Tousey*, 549 F.3d at 1152 ("[A]n adjudication by the bankruptcy court is definitive because it cannot be affected by the resolution of any other issue in the proceeding, and therefore no purpose would be served by postponing the appeal to the proceeding's conclusion.") (internal quotation omitted).

And as this Court has recognized, most Rule 7001 adversary proceedings and Rule 9014 contested matters in bankruptcy constitute discrete disputes within the larger case. *Sumy*, 777 F.2d at 923. Thus, an order that *conclusively* resolves an adversary proceeding or contested matter will usually be appealable. *See, e.g.*, *Turshen*, 823 F.2d at 839-40 (holding that order denying petition seeking removal of chapter 7 trustee was final for purposes of collateral estoppel); *Sumy*, 777 F.2d at 923 (grant or denial of a claimed exemption is final, appealable order). But an order that is subject to reevaluation or modification by the bankruptcy court is interlocutory and cannot be appealed until the issue has been conclusively resolved. *See, e.g., In re Computer Learning Ctrs.*, 407 F.3d at 660 (holding that order granting interim fees was interlocutory).

The bankruptcy court's decision granting the Dudleys summary judgment and denying the United States Trustee's motion to dismiss their case falls squarely within section 158(a)(1) and this Court's bankruptcy finality jurisprudence. Such a motion alleges a cause of action under section 707(b), initiating a "contested matter"[12] within the larger bankruptcy case. And the bankruptcy court fully resolved all issues concerning the United States Trustee's claim of abuse when it denied the motion, holding that section 707(b) did not even apply to the Dudleys' case. *See In re Rudler*, 576 F.3d at 44 & n.10; *In re Ross-Tousey*, 549 F.3d at 1153.

And the question of whether the Dudleys' case should be dismissed as an

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[12] *See* Federal Rule of Bankruptcy Procedure 9014 (in "a contested matter not otherwise governed by these rules, relief shall be requested by motion"); *see also* Fed. R. Bankr. P. 1017(f)(1) (Rule 9014 governs proceedings to dismiss a case).

abuse of chapter 7 could never be relitigated because the United States Trustee's statutory and rule-based deadlines for filing a motion to dismiss under section 707(b)(2) and (b)(3) had long passed when the court entered its order denying the motion to dismiss. *See* 11 U.S.C. § 704(b)(2) (establishing a 30-day deadline for the United States Trustee to file a motion to dismiss); Fed. R. Bankr. P. 1017(e)(1) (establishing that a motion to dismiss for abuse under Section 707(b)(3) must be brought within 60 days after the first date set for the meeting of creditors).[13] So there was no possibility that the order denying the United States Trustee's motion to dismiss could be impacted by future decisions in the underlying case. The bankruptcy court's order thus finally disposed of all the issues pertaining to a "discrete dispute[] within the larger case," and is a final, appealable order. *In re Computer Learning Ctrs.*, 407 F.3d at 660.

It appears that the district court may not have understood the fundamental differences between a section 707(b) motion to dismiss in a bankruptcy case and more typical motions to dismiss, such as a 12(b)(6) motion. *See* Fed. R. Civ. P.

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[13] The first meeting of creditors was held on November 4, 2008. *See J. A. 4* (Doc. # 20). Although, the chapter trustee and other interested parties also may bring motions to dismiss abusive cases under section 707(b), those parties must adhere to deadlines set forth in Fed. R. Bankr. P. 1017(e) for bringing such motions. As a practical matter, however, the United States Trustee brings the vast majority of motions to dismiss chapter 7 cases for abuse.

12(b)(6). Despite its name, a motion to dismiss under section 707(b) is the polar opposite of a motion to dismiss in a civil action.

When the United States Trustee files a section 707(b) motion, he does not seek dismissal of a claim against the United States; he initiates an action against the debtor. The motion acts as the functional equivalent of a complaint. It alleges a statutory claim of abuse against the debtor and asks for relief, instituting a contested matter under Fed. R. Bankr. P. 9014. And like any plaintiff or moving party, the United States Trustee must establish the legal basis for his claim and must prove by admissible evidence each of the elements that support his cause of action to obtain the requested relief. *See In re Meade*, 420 B.R. 291, 303 (Bankr. W.D. Va. 2009); *In re Lamug*, 403 B.R. 47, 53 (Bankr. N.D. Cal. 2009); *In re Witek*, 383 B.R. 323, 326 (Bankr. N.D. Ohio 2007).

C. Prompt review of denials of section 707(b) motions will conserve the limited resources of the court, the trustee, and the parties and prevent unnecessary appeals.

Pragmatic concerns also warrant immediate appeal of orders denying motions to dismiss for abuse. *See A.H. Robins Co.*, 788 F.2d at 1009 (considerations of fairness and judicial efficiency may also justify immediate appealability under the pragmatic view of finality); *In re Walker*, 515 F.3d at 1210 (same). As the First, Third and Eighth circuits all have recognized, delaying appellate consideration of whether a debtor's case is abusive "may frustrate both principles of judicial economy and Congress's goal of ensuring that debtors allocate as much of their resources as possible toward repaying their debts." *In re Rudler*, 576 F.3d at 43.

That is because if a motion to dismiss for abuse is not immediately appealable, bankruptcy proceedings "must be completed before it can be determined whether they were proper in the first place," thereby causing a waste of the parties' and the court's resources. *In re Christian*, 804 F.2d at 48. Indeed, "[r]equiring trustees to complete Chapter 7 proceedings before appealing denial of their § 707(b) motions wastes debtor resources that should be used to pay creditors, and forces trustees and bankruptcy courts to expend their scarce institutional resources on abusive Chapter 7 petitioners." *In re Koch*, 109 F.3d at 1288.

Immediate review also can prevent the chapter 7 trustee from wasting time and effort in:

- examining the creditors' proofs of claims and objecting to improper claims,
- investigating the debtor's finances,
- collecting and liquidating the debtor's non-exempt assets, and

- distributing those assets to creditors of the estate

in a case that should have been dismissed. *See* 11 U.S.C. § 704 (prescribing a chapter 7 trustee's duties). And it may obviate the need for the bankruptcy court to expend its limited time and resources overseeing and resolving disputes in a potentially abusive case.

Moreover, if an erroneous section 707(b) order is promptly reversed and the case dismissed before the estate has been administered, creditors may proceed against the debtor outside of bankruptcy while the debtor still retains assets subject to attachment. However, if reversal is delayed, creditors must wait for the trustee's liquidation of the estate to take its course, collecting little, if anything at all, in the typical chapter 7 case.

In addition, holding that such orders are not final will result in the unnecessary proliferation of appeals. Because no single final order obviously resolves an entire chapter 7 case, it is not clear which subsequent order in the bankruptcy case must be appealed to obtain review of the denial of the section 707(b) motion.[14] As a result, United States Trustees will be compelled to appeal

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[14] In *In re Donovan*, the Eleventh Circuit stated that it could "see no reason why [the proponent of the motion to dismiss] could not have obtained meaningful appellate review upon a final judgment." 532 F.3d at 1137 n.1. That court, however, neglected to identify what would constitute a final judgment in a chapter 7 bankruptcy case.

all subsequent orders that might be the appealable final order and litigate the jurisdictional issue merely to preserve their right to appellate review.[15]

In any chapter 7 case, no less than three separate classes of orders could be considered the "final" order into which the abuse order, if interlocutory, would merge for purposes of appeal:

- an order either granting or denying the debtor's discharge (*see* 11 U.S.C. § 727(a); Fed. R. Bankr. P. 4004),
- an order approving the trustee's final report and final account or the trustee's no distribution report, and discharging the trustee (*see* 11 U.S.C. § 704(a)(9)), and
- an order closing the case (see 11 U.S.C. § 350(a); Fed. R. Bankr. P. 5009).

None is an obvious choice because none bears any relationship to the United States Trustee's claim of abuse, although any of them could be characterized as resolving the bankruptcy case as a whole.

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[15] Appellate review of such orders is essential both to preserve the integrity of the bankruptcy system and to obtain judicial clarification on widely-applicable issues of statutory interpretation.

CONCLUSION

For these reasons, the United States Trustee requests that the judgment of the district court be reversed and this case be remanded to the district court with instructions for that court to review the merits of the bankruptcy court's order denying the United States Trustee's motion to dismiss the Dudleys' case for abuse.

REQUEST FOR ORAL ARGUMENT

Because of the complexity of the jurisdictional issue on appeal and the importance of that issue to the United States Trustee's ability to effectively perform his statutory duties, the United States Trustee requests oral argument.

RAMONA D. ELLIOTT
General Counsel
P. MATTHEW SUTKO
Associate General Counsel
WENDY L. COX
Trial Attorney
Executive Office for United States Trustees
Department of Justice
20 Massachusetts Ave., N.W.
Washington, D.C. 20530

JOSEPH A. GUZINSKI
Assistant United States Trustee
Department of Justice
115 South Union Street, Room 210
Alexandria, VA 22314

Respectfully submitted,

W. CLARKSON MCDOW, JR.
United States Trustee for Region 4

By: /s/ Wendy L. Cox

JOHN R. BYRNES
Assistant United States Trustee
Office of the United States Trustee
Department of Justice
First Campbell Square
201 1st Street, S.W., Suite 505
Roanoke, VA 24011

CERTIFICATE OF COMPLIANCE WITH RULE 32(a)

1. This brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B) because this brief contains 6364 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii). I relied on the WordCount tool in my WordPerfect 12 software to obtain the word count.

2. This brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6) because it has been prepared in a proportionately spaced typeface using WordPerfect 12 in 14 point font Times New Roman style typeface.

/s/ Wendy L. Cox
Attorney for W. Clarkson McDow
United States Trustee for Region 4

Dated: December 3, 2010

ADDENDUM

1501 of Pub. L. 109–8, set out as a note under section 101 of Title 11.

EFFECTIVE DATE OF 1994 AMENDMENT

Amendment by Pub. L. 103–394 effective Oct. 22, 1994, and not applicable with respect to cases commenced under Title 11, Bankruptcy, before Oct. 22, 1994, see section 702 of Pub. L. 103–394, set out as a note under section 101 of Title 11.

EFFECTIVE DATE OF 1986 AMENDMENT

Amendment by Pub. L. 99–554 effective 30 days after Oct. 27, 1986, see section 302(a) of Pub. L. 99–554, set out as a note under section 581 of this title.

§ 158. Appeals

(a) The district courts of the United States shall have jurisdiction to hear appeals[1]

(1) from final judgments, orders, and decrees;

(2) from interlocutory orders and decrees issued under section 1121(d) of title 11 increasing or reducing the time periods referred to in section 1121 of such title; and

(3) with leave of the court, from other interlocutory orders and decrees;

and, with leave of the court, from interlocutory orders and decrees, of bankruptcy judges entered in cases and proceedings referred to the bankruptcy judges under section 157 of this title. An appeal under this subsection shall be taken only to the district court for the judicial district in which the bankruptcy judge is serving.

(b)(1) The judicial council of a circuit shall establish a bankruptcy appellate panel service composed of bankruptcy judges of the districts in the circuit who are appointed by the judicial council in accordance with paragraph (3), to hear and determine, with the consent of all the parties, appeals under subsection (a) unless the judicial council finds that—

(A) there are insufficient judicial resources available in the circuit; or

(B) establishment of such service would result in undue delay or increased cost to parties in cases under title 11.

Not later than 90 days after making the finding, the judicial council shall submit to the Judicial Conference of the United States a report containing the factual basis of such finding.

(2)(A) A judicial council may reconsider, at any time, the finding described in paragraph (1).

(B) On the request of a majority of the district judges in a circuit for which a bankruptcy appellate panel service is established under paragraph (1), made after the expiration of the 1-year period beginning on the date such service is established, the judicial council of the circuit shall determine whether a circumstance specified in subparagraph (A) or (B) of such paragraph exists.

(C) On its own motion, after the expiration of the 3-year period beginning on the date a bankruptcy appellate panel service is established under paragraph (1), the judicial council of the circuit may determine whether a circumstance specified in subparagraph (A) or (B) of such paragraph exists.

(D) If the judicial council finds that either of such circumstances exists, the judicial council may provide for the completion of the appeals then pending before such service and the orderly termination of such service.

(3) Bankruptcy judges appointed under paragraph (1) shall be appointed and may be reappointed under such paragraph.

(4) If authorized by the Judicial Conference of the United States, the judicial councils of 2 or more circuits may establish a joint bankruptcy appellate panel comprised of bankruptcy judges from the districts within the circuits for which such panel is established, to hear and determine, upon the consent of all the parties, appeals under subsection (a) of this section.

(5) An appeal to be heard under this subsection shall be heard by a panel of 3 members of the bankruptcy appellate panel service, except that a member of such service may not hear an appeal originating in the district for which such member is appointed or designated under section 152 of this title.

(6) Appeals may not be heard under this subsection by a panel of the bankruptcy appellate panel service unless the district judges for the district in which the appeals occur, by majority vote, have authorized such service to hear and determine appeals originating in such district.

(c)(1) Subject to subsections (b) and (d)(2), each appeal under subsection (a) shall be heard by a 3-judge panel of the bankruptcy appellate panel service established under subsection (b)(1) unless—

(A) the appellant elects at the time of filing the appeal; or

(B) any other party elects, not later than 30 days after service of notice of the appeal;

to have such appeal heard by the district court.

(2) An appeal under subsections (a) and (b) of this section shall be taken in the same manner as appeals in civil proceedings generally are taken to the courts of appeals from the district courts and in the time provided by Rule 8002 of the Bankruptcy Rules.

(d)(1) The courts of appeals shall have jurisdiction of appeals from all final decisions, judgments, orders, and decrees entered under subsections (a) and (b) of this section.

(2)(A) The appropriate court of appeals shall have jurisdiction of appeals described in the first sentence of subsection (a) if the bankruptcy court, the district court, or the bankruptcy appellate panel involved, acting on its own motion or on the request of a party to the judgment, order, or decree described in such first sentence, or all the appellants and appellees (if any) acting jointly, certify that—

(i) the judgment, order, or decree involves a question of law as to which there is no controlling decision of the court of appeals for the circuit or of the Supreme Court of the United States, or involves a matter of public importance;

(ii) the judgment, order, or decree involves a question of law requiring resolution of conflicting decisions; or

(iii) an immediate appeal from the judgment, order, or decree may materially advance the progress of the case or proceeding in which the appeal is taken;

and if the court of appeals authorizes the direct appeal of the judgment, order, or decree.

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[1] So in original. Probably should be followed by a dash.

(B) If the bankruptcy court, the district court, or the bankruptcy appellate panel—

(i) on its own motion or on the request of a party, determines that a circumstance specified in clause (i), (ii), or (iii) of subparagraph (A) exists; or

(ii) receives a request made by a majority of the appellants and a majority of appellees (if any) to make the certification described in subparagraph (A);

then the bankruptcy court, the district court, or the bankruptcy appellate panel shall make the certification described in subparagraph (A).

(C) The parties may supplement the certification with a short statement of the basis for the certification.

(D) An appeal under this paragraph does not stay any proceeding of the bankruptcy court, the district court, or the bankruptcy appellate panel from which the appeal is taken, unless the respective bankruptcy court, district court, or bankruptcy appellate panel, or the court of appeals in which the appeal in[2] pending, issues a stay of such proceeding pending the appeal.

(E) Any request under subparagraph (B) for certification shall be made not later than 60 days after the entry of the judgment, order, or decree.

(Added Pub. L. 98–353, title I, §104(a), July 10, 1984, 98 Stat. 341; amended Pub. L. 101–650, title III, §305, Dec. 1, 1990, 104 Stat. 5105; Pub. L. 103–394, title I, §§102, 104(c), (d), Oct. 22, 1994, 108 Stat. 4108–4110; Pub. L. 109–8, title XII, §1233(a), Apr. 20, 2005, 119 Stat. 202.)

REFERENCES IN TEXT

The Bankruptcy Rules, referred to in subsec. (c)(2), are set out in the Appendix to Title 11, Bankruptcy.

AMENDMENTS

2005—Subsec. (c)(1). Pub. L. 109–8, §1233(a)(1), substituted "Subject to subsections (b) and (d)(2)," for "Subject to subsection (b),".

Subsec. (d). Pub. L. 109–8, §1233(a)(2), designated existing provisions as par. (1) and added par. (2).

1994—Subsec. (a). Pub. L. 103–394, §102, which directed the amendment of subsec. (a) by striking "from" the first place it appears and all that follows through "decrees," and inserting pars. (1) to (3), was executed by making the insertion and striking after "appeals" "from final judgments, orders, and decrees,", which is through "decrees," the first place appearing, to reflect the probable intent of Congress.

Subsec. (b)(1). Pub. L. 103–394, §104(c)(3), added par. (1) and struck out former par. (1) which read as follows: "The judicial council of a circuit may establish a bankruptcy appellate panel, comprised of bankruptcy judges from districts within the circuit, to hear and determine, upon the consent of all the parties, appeals under subsection (a) of this section."

Subsec. (b)(2). Pub. L. 103–394, §104(c)(3), added par. (2). Former par. (2) redesignated (4).

Subsec. (b)(3). Pub. L. 103–394, §104(c)(1), (3), added par. (3) and struck out former par. (3) which read as follows: "No appeal may be referred to a panel under this subsection unless the district judges for the district, by majority vote, authorize such referral of appeals originating within the district."

Subsec. (b)(4). Pub. L. 103–394, §104(c)(1), (2), redesignated par. (2) as (4) and struck out former par. (4) which read as follows: "A panel established under this section shall consist of three bankruptcy judges, provided a bankruptcy judge may not hear an appeal originating within a district for which the judge is appointed or designated under section 152 of this title."

Subsec. (b)(5), (6). Pub. L. 103–394, §104(c)(4), added pars. (5) and (6).

Subsec. (c). Pub. L. 103–394, §104(d), designated existing provisions as par. (2) and added par. (1).

1990—Subsec. (b)(2) to (4). Pub. L. 101–650 added par. (2) and redesignated former pars. (2) and (3) as (3) and (4), respectively.

EFFECTIVE DATE OF 2005 AMENDMENT

Amendment by Pub. L. 109–8 effective 180 days after Apr. 20, 2005, and not applicable with respect to cases commenced under Title 11, Bankruptcy, before such effective date, except as otherwise provided, see section 1501 of Pub. L. 109–8, set out as a note under section 101 of Title 11.

EFFECTIVE DATE OF 1994 AMENDMENT

Amendment by Pub. L. 103–394 effective Oct. 22, 1994, and not applicable with respect to cases commenced under Title 11, Bankruptcy, before Oct. 22, 1994, see section 702 of Pub. L. 103–394, set out as a note under section 101 of Title 11.

PROCEDURAL RULES

Pub. L. 109–8, title XII, §1233(b), Apr. 20, 2005, 119 Stat. 203, provided that:

"(1) TEMPORARY APPLICATION.—A provision of this subsection shall apply to appeals under section 158(d)(2) of title 28, United States Code, until a rule of practice and procedure relating to such provision and such appeals is promulgated or amended under chapter 131 of such title.

"(2) CERTIFICATION.—A district court, a bankruptcy court, or a bankruptcy appellate panel may make a certification under section 158(d)(2) of title 28, United States Code, only with respect to matters pending in the respective bankruptcy court, district court, or bankruptcy appellate panel.

"(3) PROCEDURE.—Subject to any other provision of this subsection, an appeal authorized by the court of appeals under section 158(d)(2)(A) of title 28, United States Code, shall be taken in the manner prescribed in subdivisions (a)(1), (b), (c), and (d) of rule 5 of the Federal Rules of Appellate Procedure. For purposes of subdivision (a)(1) of rule 5—

"(A) a reference in such subdivision to a district court shall be deemed to include a reference to a bankruptcy court and a bankruptcy appellate panel, as appropriate; and

"(B) a reference in such subdivision to the parties requesting permission to appeal to be served with the petition shall be deemed to include a reference to the parties to the judgment, order, or decree from which the appeal is taken.

"(4) FILING OF PETITION WITH ATTACHMENT.—A petition requesting permission to appeal, that is based on a certification made under subparagraph (A) or (B) of section 158(d)(2) shall—

"(A) be filed with the circuit clerk not later than 10 days after the certification is entered on the docket of the bankruptcy court, the district court, or the bankruptcy appellate panel from which the appeal is taken; and

"(B) have attached a copy of such certification.

"(5) REFERENCES IN RULE 5.—For purposes of rule 5 of the Federal Rules of Appellate Procedure—

"(A) a reference in such rule to a district court shall be deemed to include a reference to a bankruptcy court and to a bankruptcy appellate panel; and

"(B) a reference in such rule to a district clerk shall be deemed to include a reference to a clerk of a bankruptcy court and to a clerk of a bankruptcy appellate panel.

"(6) APPLICATION OF RULES.—The Federal Rules of Appellate Procedure shall apply in the courts of appeals

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[2] So in original. Probably should be "is".

title. Any waiver of the right to convert a case under this subsection is unenforceable.

(b) On request of a party in interest and after notice and a hearing, the court may convert a case under this chapter to a case under chapter 11 of this title at any time.

(c) The court may not convert a case under this chapter to a case under chapter 12 or 13 of this title unless the debtor requests or consents to such conversion.

(d) Notwithstanding any other provision of this section, a case may not be converted to a case under another chapter of this title unless the debtor may be a debtor under such chapter.

(Pub. L. 95–598, Nov. 6, 1978, 92 Stat. 2606; Pub. L. 99–554, title II, § 257(q), Oct. 27, 1986, 100 Stat. 3115; Pub. L. 103–394, title V, § 501(d)(22), Oct. 22, 1994, 108 Stat. 4146; Pub. L. 109–8, title I, § 101, Apr. 20, 2005, 119 Stat. 27.)

Historical and Revision Notes

LEGISLATIVE STATEMENTS

Section 706(a) of the House amendment adopts a provision contained in the Senate amendment indicating that a waiver of the right to convert a case under section 706(a) is unenforceable. The explicit reference in title 11 forbidding the waiver of certain rights is not intended to imply that other rights, such as the right to file a voluntary bankruptcy case under section 301, may be waived.

Section 706 of the House amendment adopts a similar provision contained in H.R. 8200 as passed by the House. Competing proposals contained in section 706(c) and section 706(d) of the Senate amendment are rejected.

SENATE REPORT NO. 95–989

Subsection (a) of this section gives the debtor the one-time absolute right of conversion of a liquidation case to a reorganization or individual repayment plan case. If the case has already once been converted from chapter 11 or 13 to chapter 7, then the debtor does not have that right. The policy of the provision is that the debtor should always be given the opportunity to repay his debts, and a waiver of the right to convert a case is unenforceable.

Subsection (b) permits the court, on request of a party in interest and after notice and a hearing, to convert the case to chapter 11 at any time. The decision whether to convert is left in the sound discretion of the court, based on what will most inure to the benefit of all parties in interest.

Subsection (c) is part of the prohibition against involuntary chapter 13 cases, and prohibits the court from converting a case to chapter 13 without the debtor's consent.

Subsection (d) reinforces section 109 by prohibiting conversion to a chapter unless the debtor is eligible to be a debtor under that chapter.

Amendments

2005—Subsec. (c). Pub. L. 109–8 inserted "or consents to" after "requests".

1994—Subsec. (a). Pub. L. 103–394 substituted "1208, or 1307" for "1307, or 1208".

1986—Subsec. (a). Pub. L. 99–554, § 257(q)(1), inserted references to chapter 12 and section 1208 of this title.

Subsec. (c). Pub. L. 99–554, § 257(q)(2), inserted reference to chapter 12.

Effective Date of 2005 Amendment

Amendment by Pub. L. 109–8 effective 180 days after Apr. 20, 2005, and not applicable with respect to cases commenced under this title before such effective date, except as otherwise provided, see section 1501 of Pub. L. 109–8, set out as a note under section 101 of this title.

Effective Date of 1994 Amendment

Amendment by Pub. L. 103–394 effective Oct. 22, 1994, and not applicable with respect to cases commenced under this title before Oct. 22, 1994, see section 702 of Pub. L. 103–394, set out as a note under section 101 of this title.

Effective Date of 1986 Amendment

Amendment by Pub. L. 99–554 effective 30 days after Oct. 27, 1986, but not applicable to cases commenced under this title before that date, see section 302(a), (c)(1) of Pub. L. 99–554, set out as a note under section 581 of Title 28, Judiciary and Judicial Procedure.

§ 707. Dismissal of a case or conversion to a case under chapter 11 or 13

(a) The court may dismiss a case under this chapter only after notice and a hearing and only for cause, including—

(1) unreasonable delay by the debtor that is prejudicial to creditors;

(2) nonpayment of any fees or charges required under chapter 123 of title 28; and

(3) failure of the debtor in a voluntary case to file, within fifteen days or such additional time as the court may allow after the filing of the petition commencing such case, the information required by paragraph (1) of section 521, but only on a motion by the United States trustee.

(b)(1) After notice and a hearing, the court, on its own motion or on a motion by the United States trustee, trustee (or bankruptcy administrator, if any), or any party in interest, may dismiss a case filed by an individual debtor under this chapter whose debts are primarily consumer debts, or, with the debtor's consent, convert such a case to a case under chapter 11 or 13 of this title, if it finds that the granting of relief would be an abuse of the provisions of this chapter. In making a determination whether to dismiss a case under this section, the court may not take into consideration whether a debtor has made, or continues to make, charitable contributions (that meet the definition of "charitable contribution" under section 548(d)(3)) to any qualified religious or charitable entity or organization (as that term is defined in section 548(d)(4)).

(2)(A)(i) In considering under paragraph (1) whether the granting of relief would be an abuse of the provisions of this chapter, the court shall presume abuse exists if the debtor's current monthly income reduced by the amounts determined under clauses (ii), (iii), and (iv), and multiplied by 60 is not less than the lesser of—

(I) 25 percent of the debtor's nonpriority unsecured claims in the case, or $6,000, whichever is greater; or

(II) $10,000.

(ii)(I) The debtor's monthly expenses shall be the debtor's applicable monthly expense amounts specified under the National Standards and Local Standards, and the debtor's actual monthly expenses for the categories specified as Other Necessary Expenses issued by the Internal Revenue Service for the area in which the debtor resides, as in effect on the date of the order for relief, for the debtor, the dependents of the debtor, and the spouse of the debtor in a joint case, if the spouse is not otherwise a dependent.

Such expenses shall include reasonably necessary health insurance, disability insurance, and health savings account expenses for the debtor, the spouse of the debtor, or the dependents of the debtor. Notwithstanding any other provision of this clause, the monthly expenses of the debtor shall not include any payments for debts. In addition, the debtor's monthly expenses shall include the debtor's reasonably necessary expenses incurred to maintain the safety of the debtor and the family of the debtor from family violence as identified under section 309 of the Family Violence Prevention and Services Act,[1] or other applicable Federal law. The expenses included in the debtor's monthly expenses described in the preceding sentence shall be kept confidential by the court. In addition, if it is demonstrated that it is reasonable and necessary, the debtor's monthly expenses may also include an additional allowance for food and clothing of up to 5 percent of the food and clothing categories as specified by the National Standards issued by the Internal Revenue Service.

(II) In addition, the debtor's monthly expenses may include, if applicable, the continuation of actual expenses paid by the debtor that are reasonable and necessary for care and support of an elderly, chronically ill, or disabled household member or member of the debtor's immediate family (including parents, grandparents, siblings, children, and grandchildren of the debtor, the dependents of the debtor, and the spouse of the debtor in a joint case who is not a dependent) and who is unable to pay for such reasonable and necessary expenses.

(III) In addition, for a debtor eligible for chapter 13, the debtor's monthly expenses may include the actual administrative expenses of administering a chapter 13 plan for the district in which the debtor resides, up to an amount of 10 percent of the projected plan payments, as determined under schedules issued by the Executive Office for United States Trustees.

(IV) In addition, the debtor's monthly expenses may include the actual expenses for each dependent child less than 18 years of age, not to exceed $1,500 per year per child, to attend a private or public elementary or secondary school if the debtor provides documentation of such expenses and a detailed explanation of why such expenses are reasonable and necessary, and why such expenses are not already accounted for in the National Standards, Local Standards, or Other Necessary Expenses referred to in subclause (I).

(V) In addition, the debtor's monthly expenses may include an allowance for housing and utilities, in excess of the allowance specified by the Local Standards for housing and utilities issued by the Internal Revenue Service, based on the actual expenses for home energy costs if the debtor provides documentation of such actual expenses and demonstrates that such actual expenses are reasonable and necessary.

(iii) The debtor's average monthly payments on account of secured debts shall be calculated as the sum of—

(I) the total of all amounts scheduled as contractually due to secured creditors in each month of the 60 months following the date of the petition; and

(II) any additional payments to secured creditors necessary for the debtor, in filing a plan under chapter 13 of this title, to maintain possession of the debtor's primary residence, motor vehicle, or other property necessary for the support of the debtor and the debtor's dependents, that serves as collateral for secured debts;

divided by 60.

(iv) The debtor's expenses for payment of all priority claims (including priority child support and alimony claims) shall be calculated as the total amount of debts entitled to priority, divided by 60.

(B)(i) In any proceeding brought under this subsection, the presumption of abuse may only be rebutted by demonstrating special circumstances, such as a serious medical condition or a call or order to active duty in the Armed Forces, to the extent such special circumstances that justify additional expenses or adjustments of current monthly income for which there is no reasonable alternative.

(ii) In order to establish special circumstances, the debtor shall be required to itemize each additional expense or adjustment of income and to provide—

(I) documentation for such expense or adjustment to income; and

(II) a detailed explanation of the special circumstances that make such expenses or adjustment to income necessary and reasonable.

(iii) The debtor shall attest under oath to the accuracy of any information provided to demonstrate that additional expenses or adjustments to income are required.

(iv) The presumption of abuse may only be rebutted if the additional expenses or adjustments to income referred to in clause (i) cause the product of the debtor's current monthly income reduced by the amounts determined under clauses (ii), (iii), and (iv) of subparagraph (A) when multiplied by 60 to be less than the lesser of—

(I) 25 percent of the debtor's nonpriority unsecured claims, or $6,000, whichever is greater; or

(II) $10,000.

(C) As part of the schedule of current income and expenditures required under section 521, the debtor shall include a statement of the debtor's current monthly income, and the calculations that determine whether a presumption arises under subparagraph (A)(i), that show how each such amount is calculated.

(D) Subparagraphs (A) through (C) shall not apply, and the court may not dismiss or convert a case based on any form of means testing, if the debtor is a disabled veteran (as defined in section 3741(1) of title 38), and the indebtedness occurred primarily during a period during which he or she was—

(i) on active duty (as defined in section 101(d)(1) of title 10); or

(ii) performing a homeland defense activity (as defined in section 901(1) of title 32).

(3) In considering under paragraph (1) whether the granting of relief would be an abuse of the

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[1] See References in Text note below.

provisions of this chapter in a case in which the presumption in subparagraph (A)(i) of such paragraph does not arise or is rebutted, the court shall consider—

(A) whether the debtor filed the petition in bad faith; or

(B) the totality of the circumstances (including whether the debtor seeks to reject a personal services contract and the financial need for such rejection as sought by the debtor) of the debtor's financial situation demonstrates abuse.

(4)(A) The court, on its own initiative or on the motion of a party in interest, in accordance with the procedures described in rule 9011 of the Federal Rules of Bankruptcy Procedure, may order the attorney for the debtor to reimburse the trustee for all reasonable costs in prosecuting a motion filed under section 707(b), including reasonable attorneys' fees, if—

(i) a trustee files a motion for dismissal or conversion under this subsection; and

(ii) the court—

(I) grants such motion; and

(II) finds that the action of the attorney for the debtor in filing a case under this chapter violated rule 9011 of the Federal Rules of Bankruptcy Procedure.

(B) If the court finds that the attorney for the debtor violated rule 9011 of the Federal Rules of Bankruptcy Procedure, the court, on its own initiative or on the motion of a party in interest, in accordance with such procedures, may order—

(i) the assessment of an appropriate civil penalty against the attorney for the debtor; and

(ii) the payment of such civil penalty to the trustee, the United States trustee (or the bankruptcy administrator, if any).

(C) The signature of an attorney on a petition, pleading, or written motion shall constitute a certification that the attorney has—

(i) performed a reasonable investigation into the circumstances that gave rise to the petition, pleading, or written motion; and

(ii) determined that the petition, pleading, or written motion—

(I) is well grounded in fact; and

(II) is warranted by existing law or a good faith argument for the extension, modification, or reversal of existing law and does not constitute an abuse under paragraph (1).

(D) The signature of an attorney on the petition shall constitute a certification that the attorney has no knowledge after an inquiry that the information in the schedules filed with such petition is incorrect.

(5)(A) Except as provided in subparagraph (B) and subject to paragraph (6), the court, on its own initiative or on the motion of a party in interest, in accordance with the procedures described in rule 9011 of the Federal Rules of Bankruptcy Procedure, may award a debtor all reasonable costs (including reasonable attorneys' fees) in contesting a motion filed by a party in interest (other than a trustee or United States trustee (or bankruptcy administrator, if any)) under this subsection if—

(i) the court does not grant the motion; and

(ii) the court finds that—

(I) the position of the party that filed the motion violated rule 9011 of the Federal Rules of Bankruptcy Procedure; or

(II) the attorney (if any) who filed the motion did not comply with the requirements of clauses (i) and (ii) of paragraph (4)(C), and the motion was made solely for the purpose of coercing a debtor into waiving a right guaranteed to the debtor under this title.

(B) A small business that has a claim of an aggregate amount less than $1,000 shall not be subject to subparagraph (A)(ii)(I).

(C) For purposes of this paragraph—

(i) the term "small business" means an unincorporated business, partnership, corporation, association, or organization that—

(I) has fewer than 25 full-time employees as determined on the date on which the motion is filed; and

(II) is engaged in commercial or business activity; and

(ii) the number of employees of a wholly owned subsidiary of a corporation includes the employees of—

(I) a parent corporation; and

(II) any other subsidiary corporation of the parent corporation.

(6) Only the judge or United States trustee (or bankruptcy administrator, if any) may file a motion under section 707(b), if the current monthly income of the debtor, or in a joint case, the debtor and the debtor's spouse, as of the date of the order for relief, when multiplied by 12, is equal to or less than—

(A) in the case of a debtor in a household of 1 person, the median family income of the applicable State for 1 earner;

(B) in the case of a debtor in a household of 2, 3, or 4 individuals, the highest median family income of the applicable State for a family of the same number or fewer individuals; or

(C) in the case of a debtor in a household exceeding 4 individuals, the highest median family income of the applicable State for a family of 4 or fewer individuals, plus $525 per month for each individual in excess of 4.

(7)(A) No judge, United States trustee (or bankruptcy administrator, if any), trustee, or other party in interest may file a motion under paragraph (2) if the current monthly income of the debtor, including a veteran (as that term is defined in section 101 of title 38), and the debtor's spouse combined, as of the date of the order for relief when multiplied by 12, is equal to or less than—

(i) in the case of a debtor in a household of 1 person, the median family income of the applicable State for 1 earner;

(ii) in the case of a debtor in a household of 2, 3, or 4 individuals, the highest median family income of the applicable State for a family of the same number or fewer individuals; or

(iii) in the case of a debtor in a household exceeding 4 individuals, the highest median family income of the applicable State for a family of 4 or fewer individuals, plus $525 per month for each individual in excess of 4.

(B) In a case that is not a joint case, current monthly income of the debtor's spouse shall not be considered for purposes of subparagraph (A) if—

(i)(I) the debtor and the debtor's spouse are separated under applicable nonbankruptcy law; or

(II) the debtor and the debtor's spouse are living separate and apart, other than for the purpose of evading subparagraph (A); and

(ii) the debtor files a statement under penalty of perjury—

(I) specifying that the debtor meets the requirement of subclause (I) or (II) of clause (i); and

(II) disclosing the aggregate, or best estimate of the aggregate, amount of any cash or money payments received from the debtor's spouse attributed to the debtor's current monthly income.

(c)(1) In this subsection—

(A) the term "crime of violence" has the meaning given such term in section 16 of title 18; and

(B) the term "drug trafficking crime" has the meaning given such term in section 924(c)(2) of title 18.

(2) Except as provided in paragraph (3), after notice and a hearing, the court, on a motion by the victim of a crime of violence or a drug trafficking crime, may when it is in the best interest of the victim dismiss a voluntary case filed under this chapter by a debtor who is an individual if such individual was convicted of such crime.

(3) The court may not dismiss a case under paragraph (2) if the debtor establishes by a preponderance of the evidence that the filing of a case under this chapter is necessary to satisfy a claim for a domestic support obligation.

(Pub. L. 95–598, Nov. 6, 1978, 92 Stat. 2606; Pub. L. 98–353, title III, §§312, 475, July 10, 1984, 98 Stat. 355, 381; Pub. L. 99–554, title II, §219, Oct. 27, 1986, 100 Stat. 3100; Pub. L. 105–183, §4(b), June 19, 1998, 112 Stat. 518; Pub. L. 109–8, title I, §102(a), (f), Apr. 20, 2005, 119 Stat. 27, 33.)

HISTORICAL AND REVISION NOTES

LEGISLATIVE STATEMENTS

Section 707 of the House amendment indicates that the court may dismiss a case only after notice and a hearing.

SENATE REPORT NO. 95–989

This section authorizes the court to dismiss a liquidation case only for cause, such as unreasonable delay by the debtor that is prejudicial to creditors or nonpayment of any fees and charges required under chapter 123 [§1911 et seq.] of title 28. These causes are not exhaustive, but merely illustrative. The section does not contemplate, however, that the ability of the debtor to repay his debts in whole or in part constitutes adequate cause for dismissal. To permit dismissal on that ground would be to enact a non-uniform mandatory chapter 13, in lieu of the remedy of bankruptcy.

REFERENCES IN TEXT

Section 309 of the Family Violence Prevention and Services Act, referred to in subsec. (b)(2)(A)(ii)(I), was redesignated section 320 of the Act by Pub. L. 108–36, title IV, §415(5), June 25, 2003, 117 Stat. 830, and is classified to section 10421 of Title 42, The Public Health and Welfare.

The Federal Rules of Bankruptcy Procedure, referred to in subsec. (b)(4)(A), (B), (5)(A), are set out in the Appendix to this title.

AMENDMENTS

2005—Pub. L. 109–8, §102(a)(1), substituted "Dismissal of a case or conversion to a case under chapter 11 or 13" for "Dismissal" in section catchline.

Subsec. (b). Pub. L. 109–8, §102(a)(2), designated existing provisions as par. (1), substituted "trustee (or bankruptcy administrator, if any), or" for "but not at the request or suggestion of" and "an abuse" for "a substantial abuse", inserted ", or, with the debtor's consent, convert such a case to a case under chapter 11 or 13 of this title," after "consumer debts", struck out "There shall be a presumption in favor of granting the relief requested by the debtor." before "In making", and added pars. (2) to (7).

Subsec. (c). Pub. L. 109–8, §102(f), added subsec. (c).

1998—Subsec. (b). Pub. L. 105–183 inserted at end "In making a determination whether to dismiss a case under this section, the court may not take into consideration whether a debtor has made, or continues to make, charitable contributions (that meet the definition of 'charitable contribution' under section 548(d)(3)) to any qualified religious or charitable entity or organization (as that term is defined in section 548(d)(4))."

1986—Subsec. (a)(3). Pub. L. 99–554, §219(a), added par. (3).

Subsec. (b). Pub. L. 99–554, §219(b), substituted "motion or on a motion by the United States trustee, but" for "motion and".

1984—Pub. L. 98–353 designated existing provisions as subsec. (a) and in pars. (1) and (2) substituted "or" for "and", and added subsec. (b).

EFFECTIVE DATE OF 2005 AMENDMENT

Amendment by Pub. L. 109–8 effective 180 days after Apr. 20, 2005, and not applicable with respect to cases commenced under this title before such effective date, except as otherwise provided, see section 1501 of Pub. L. 109–8, set out as a note under section 101 of this title.

EFFECTIVE DATE OF 1998 AMENDMENT

Amendment by Pub. L. 105–183 applicable to any case brought under an applicable provision of this title that is pending or commenced on or after June 19, 1998, see section 5 of Pub. L. 105–183, set out as a note under section 544 of this title.

EFFECTIVE DATE OF 1986 AMENDMENT

Effective date and applicability of amendment by Pub. L. 99–554 dependent upon the judicial district involved, see section 302(d), (e) of Pub. L. 99–554, set out as a note under section 581 of Title 28, Judiciary and Judicial Procedure.

EFFECTIVE DATE OF 1984 AMENDMENT

Amendment by Pub. L. 98–353 effective with respect to cases filed 90 days after July 10, 1984, see section 552(a) of Pub. L. 98–353, set out as a note under section 101 of this title.

SCHEDULES OF REASONABLE AND NECESSARY EXPENSES

Pub. L. 109–8, title I, §107, Apr. 20, 2005, 119 Stat. 42, provided that: "For purposes of section 707(b) of title 11, United States Code, as amended by this Act, the Director of the Executive Office for United States Trustees shall, not later than 180 days after the date of enactment of this Act [Apr. 20, 2005], issue schedules of reasonable and necessary administrative expenses of administering a chapter 13 plan for each judicial district of the United States."

ADJUSTMENT OF DOLLAR AMOUNTS

For adjustment of dollar amounts specified in subsec. (b)(2)(A)(i), (ii)(IV), (5)(B), (6)(C), (7)(A) of this section by the Judicial Conference of the United States, see note set out under section 104 of this title.

CERTIFICATE OF SERVICE

I certify that on December 3, 2010, I filed and served the foregoing brief by causing eight copies to be sent to the Clerk of the Court and two copies to the Appellees' counsel by Federal Express Next Business Day Delivery to the following addresses:

Patricia S. Connor, Clerk
U.S. Court of Appeals for the Fourth Circuit
1100 East Main Street, Suite 501
Richmond, Virginia 23219-3517
Telephone: 804-916-2700

Andrew S. Goldstein, Esquire,
Magee Goldstein Lasky & Sayers, PC
310 First Street, SW, Suite 1200
Roanoke, Virginia 24011
Telephone: 540-343-9800
Counsel for Appellees

/s/ Wendy L. Cox
Attorney for W. Clarkson McDow
United States Trustee for Region 4

Dated: December 3, 2010

BRIEF BANK — "SUMMARY SHEET" *Printed Wed-1/19/11 14:5*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE
[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]

W. Clarkson McDow, Jr., United States Trustee for Region 4 v. David V. Dudley and Anne M. Dudley (In re: David V. Dudley and Anne M. Dudley)

2. ("CO") ***CURRENT*** COURT
[E.g., "CTA9"]

4th Cir.

3. ("CCN") ***CURRENT*** CASE NO.

No.: 10-1732

4. ("PCN") ***PRIOR*** CASE NO. - & COURT
[IF ANY]

No.: 7:09-cv-00336-sgw

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Joseph A. Guzinski, Wendy L. Cox, P. Matthew Sutko, Ramona D. Elliott, John R. Byrnes, W. Clarkson McDow

(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***

BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s)

&

√ Any Miscellaneous ***BACKGROUND***

• Whether the bankruptcy court's order granting the Dudleys summary judgment and terminating forever the United States Trustee's action to dismiss their case for abuse under 11 U.S.C. §§ 707(b)(2) & (b)(3) was a final order appealable as of right under section 158(a)(1).

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No. 10-1732

IN THE UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

IN RE: DAVID V. DUDLEY & ANNE M. DUDLEY, Debtors.

W. CLARKSON MCDOW, JR., United States Trustee for Region 4,
Appellant,

v.

DAVID V. DUDLEY & ANNE M. DUDLEY,
Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF VIRGINIA AT ROANOKE

REPLY BRIEF OF THE UNITED STATES TRUSTEE

RAMONA D. ELLIOTT
General Counsel
P. MATTHEW SUTKO
Associate General Counsel
WENDY L. COX
Trial Attorney
Executive Office for United States Trustees
Department of Justice
20 Massachusetts Ave., N.W., Suite 8100
Washington, D.C. 20530
Telephone: (202) 307-1399

W. CLARKSON MCDOW, JR.
United States Trustee for Region 4

JOHN R. BYRNES
Assistant United States Trustee
Office of the United States Trustee
Department of Justice
First Campbell Square
201 1st Street, S.W., Suite 505
Roanoke,VA 24011
Telephone: (540) 857-2838

JOSEPH A. GUZINSKI
Assistant United States Trustee
Office of the United States Trustee
Department of Justice
115 South Union Street, Room 210
Alexandria, VA 22314
Telephone: (703) 557-7176

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ARGUMENT

I. The Dudleys Do Not Address The Vast Majority Of The Statutory And Policy Reasons In The United States Trustee's Opening Brief That Establish This Order Is Final.

The United States Trustee's opening brief detailed at least four statutory and rule-based reasons why orders denying relief under section 707(b) are final.

- The statutory bases for such motions are limited. *See* 11 U.S.C. § 707(b);
- Section 704(b) provides short deadlines for identifying and moving to dismiss presumptively abusive cases. 11 U.S.C. § 704(b);
- Rule 1017(e) provides a sixty day deadline for filing motions under section 707(b)(3). Fed. R. Bankr. P. 1017(e); and
- The text of section 158(a) of title 28, which applies specifically to bankruptcy appeals and allows appeals from "final judgments, orders, and decrees," is more broadly worded than section 1291, which permits appeals from "final judgments" of the district courts. *Compare* 28 U.S.C. § 158(a) *with* 28 U.S.C. § 1291.

United States Trustee's opening brief at 13, 16, 18-22.

The brief included at least six additional policy based reasons such orders are final:

- Immediate review would conserve the limited resources of the bankruptcy court by preventing unnecessary litigation in abusive cases;
- Immediate review would benefit debtors by permitting the dismissal of abusive cases before the liquidation of estate assets;
- Immediate review would permit creditors to seek recourse outside of bankruptcy sooner in abusive cases and with great probability of success;
- Immediate review would save the trustee the effort of administering the estate unnecessarily in abusive cases;
- Immediate review would prevent the filing of multiple appeals to ensure appellate review by eliminating confusion as to the appealable order; and
- Finality is interpreted flexibly and pragmatically in the bankruptcy context. *A.H. Robbins Co. v. Piccinin*, 788 F.2d 994, 1009 (4th Cir. 1986).

United States Trustee's opening brief at 18-20, 23-26.

Finally, the United States Trustee's brief distinguished section 707(b) orders from denials of motions to dismiss under section 1112(b) on at least four bases.

- Section 1112(b) includes a non-exclusive list of circumstances constituting cause for dismissal. 11 U.S.C. § 1112(b);
- There are no statutory or rule-based deadlines for such motions;
- Immediate review of section 1112(b) orders might disrupt the reorganization process; and
- Section 707(b) determines a claim against the debtor – the abuse claim.

United States Trustee's opening brief at 14-17.

The Dudleys' brief does not respond to the vast majority of the United States Trustee's arguments.[1] The Dudleys' brief concedes that the concept of finality is flexible in the bankruptcy context, but ignores the implications here. Appellees' brief at 5. And while the Dudleys vigorously assert that the order is interlocutory, they do not explain when an order denying section 707(b) relief must be appealed. Many of the arguments for which the Dudleys had no response have convinced the

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[1] Although the Dudleys assert that a few of the policy considerations are not relevant in this case, they do not argue that would be true in most cases. Appellees' brief at 7-9. That is because Bankruptcy Rule 4004(c)(1)(D) precludes the entry of a discharge before the abuse issue has been completely resolved on appeal. Fed. R. Bankr. P. 4004(c)(1)(D).

other circuits that orders denying section 707(b) orders were final and merited immediate review. *See, e.g., Morse v. Rudler (In re Rudler)*, 576 F.3d 37, 43-44 (1st Cir. 2009); *Ross-Tousey v. Neary (In re Ross-Tousey)*, 549 F.3d 1148, 1152-53 (7th Cir. 2008).

II. The Dudleys' Arguments Lack Merit.

A. The Dudleys' analysis ignores unanimous circuit precedent on the finality of orders denying relief under section 707(b)(1), (2) & (3) in favor of decisions involving the finality of other types of orders.

The Dudleys' analysis is flawed because it requires this Court to disregard the unanimous circuit precedent on the precise issue before the Court and rely instead on decisions involving other types of orders. The sole issue on appeal is whether bankruptcy court orders overruling actions by the United States Trustee to dismiss chapter 7 cases under section 707(b)(1), (2) & (3) are final and immediately appealable. The First and Seventh Circuits have addressed this precise issue and concluded that they are. *Rudler*, 576 F.3d at 43-44; *Ross-Tousey*, 549 F.3d at 1152-53. In addition, the Eighth Circuit and the Third Circuit held that orders denying relief under section 707(b) were final even under the predecessor version of section 707(b), which had no statutory deadlines.[2] *Stuart v.*

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[2] Prior to the 2005 Act, section 707(b) had no subparts. In the 2005 Act, Congress redesignated section 707(b) as section 707(b)(1) and added subparts (b)(2) - (b)(7). *Compare* 11 U.S.C. § 707(b)(2006) *with* 11 U.S.C. § 707(b)(2004).

Koch (In re Koch), 109 F.3d 1285, 1288 (8th Cir. 1997); *In re Christian*, 804 F.2d 46, 47-48 (3d Cir. 1986). And the Fifth Circuit has treated such orders as final. *In re Cortez*, 457 F.3d 448, 453-54 (5th Cir. 2006) (affirming district court's reversal of bankruptcy court's order denying United States Trustee's motion to dismiss under section 707(b)).

The Dudleys ask this Court to reject this directly relevant circuit precedent. But with one exception, they cite only decisions concerning the finality of orders denying motions to dismiss under separate and unrelated provisions of the Bankruptcy Code. Appellees' brief at 5-7. Based on those cases, the Dudleys argue categorically that all orders denying motions to dismiss are interlocutory. But none of those cases are persuasive authority regarding the issue in this appeal.

The first, *Culver v. Molinario*, involved an order denying the debtor's motion to dismiss his own bankruptcy case, but inviting the debtor to renew his motion at a later time. No. 94-1974, 1995 WL 570437, at *1 (4th Cir. Sept. 28, 1995) (unpublished). That order was not final because it did not conclusively resolve a discrete dispute; the debtor could ask the court to consider the issue again. *See* United States Trustee's opening brief at 17-18 n.11.

The 2005 Act also added statutory deadlines for identifying and bringing motions to dismiss under section 707(b)(2). 11 U.S.C. § 704(b).

The second, *Barben v. Donovan (In re Donovan)*, involved a motion to dismiss under the predecessor version of section 707(b). 532 F.3d 1134, 1136 (11th Cir. 2008). The *Donovan* decision has not been followed by any other circuit court and was criticized in *Rudler*. 576 F.3d at 43. Further, it is not clear what status *Donovan* holds even within the Eleventh Circuit. That court, sitting *en banc,* subsequently decided a case over which it appeared to lack jurisdiction under *Donovan's* narrow interpretation of finality, even though the United States expressly raised the jurisdictional issue and cited the *Donovan* decision.[3] *See En Banc Brief for the United States as Amicus Curiae Supporting Appellee* at 9, *Trusted Net Media Holdings, LLC v. Morrison Agency, Inc. (In re Trusted Net Media Holdings, LLC),* 550 F.3d 1035 (11th Cir. 2008). At a minimum, the *en banc* decision shows that when, as here, there is an important question of law to be decided, overly restrictive finality jurisprudence should not bar its resolution.

Finally, the Dudleys cite the concurring opinion in a Third Circuit decision in which the panel held that an order denying a motion to dismiss under 11 U.S.C. § 1112(b) was *final*. *In re Am. Capital Equip., LLC,* 296 F. App'x 270, 273 n.1 (3d Cir. 2008). The concurrence opined that orders denying motions to dismiss under

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[3] Two of the three members of the panel that decided *Donovan* participated in the *en banc* review.

section 1112(b) were interlocutory. *Id.* at 275. But section 1112(b) orders lack the finality of the section 707(b) order here because section 1112(b) motions can be, and often are, brought multiple times during the chapter 11 case. *See* United States Trustee's opening brief at 14-16.

The Dudleys' brief ignores the significant distinctions identified in the United States Trustee's opening brief between the orders they cited and the order on appeal here. And it fails to address the fact that the Seventh Circuit held that orders denying relief under section 707(b) are final, even though it had held previously that orders denying a motion for voluntary dismissal and a motion to dismiss under section 1112(b) were interlocutory. *Compare Ross-Tousey*, 549 F.3d at 1152-53 *with In re Vlasek*, 325 F.3d 955, 960-61 (7th Cir. 2003) *and Fruehauf Corp. v. Jartran, Inc. (In re Jartran, Inc.)*, 866 F.2d 859, 864 (7th Cir. 1989). Taken together, these decisions establish that section 707(b) orders are fundamentally different in character and therefore, final.[4]

The Seventh Circuit expressly acknowledged that "normally a denial of a

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[4] The Dudleys' reliance on *Promenade Nat'l Bank v. Phillips (In re Phillips)*, 844 F.2d 230 (5th Cir. 1988) is similarly misplaced. To the contrary, the Fifth Circuit's decisions in *Cortez* and *Phillips* lend further support to the idea that section 707(b) orders are more final than other orders denying motions to dismiss. *Compare Cortez*, 457 F.3d at 453-54 (impliedly finding that an order dismissing a 707(b) motion was final) *to Phillips*, 844 F.2d 230, 231, 235-36 (holding that order denying motion to dismiss under 11 U.S.C. § 109(g) is interlocutory).

motion to dismiss is not an appealable final order." *Ross-Tousey*, 549 F.3d at 1152. But that court and the others identified reasons why section 707(b) orders are final nonetheless. An order denying a section 707(b) motion finally determines the United States Trustee's claim of abuse of chapter 7 against the debtor. That issue will not be revisited in the bankruptcy case absent a reversal of the order on appeal. *See* United States Trustee's opening brief at 21-22. Both the post-2005 Act decisions – *Rudler* and *Ross-Tousey* – rely on this practical reality. *See Rudler*, 576 F.3d at 44; *Ross-Tousey*, 549 F.3d at 1153. And that sets apart orders denying relief under section 707(b) and makes them more final than orders denying motions to dismiss under other Code sections.

Orders denying section 707(b) relief warrant immediate review as a practical matter because Congress plainly envisioned that the issue of whether the case was abusive under section 707(b) would be fully resolved early in the case. The statutory and rule-based deadlines for bringing section 707(b) motions, as well as Bankruptcy Rule 4004(c)(1)(D)'s prohibition against the entry of a discharge while a section 707(b) motion is pending demonstrate that intent. 11 U.S.C. § 704(b); Fed. R. Bankr. P. 1017(e), 4004(c)(1)(D).

In *Ransom v. FIA Card Services*, the Supreme Court just explained that the purpose of section 707 is to ensure debtors pay the most they can. *Ransom v. FIA*

Card Servs., N.A., No. 09-907, __ U.S. __, 2011 WL 66438, at *3 (Jan. 11, 2011). The bankruptcy court's denial here of the United States motion to dismiss due to the happenstance that the Dudleys initially filed their case under chapter 13, strays from that purpose.[5] This case should be remanded so the district court can decide whether the Dudleys' case is abusive.

B. The differences between this case and *Rudler, Ross-Tousey, Koch* and *Christian* have nothing to do with finality, but highlight the reasons why this case should be decided in favor of finality.

The Dudleys argue that this Court should not follow *Rudler*, *Ross-Tousey, Koch,* and *Christian* because the reasoning of those cases does not apply here due to the unusual procedural posture of this case. Appellees' brief at 7-11. The Dudleys cite several events that have occurred in this case, but presumably had not occurred in the others when the section 707(b) order was reviewed, including the United States Trustee's objection to the debtors' discharge, the entry of the discharge, and the appeal from the discharge order. *Id.* But all of the cited events occurred well after the entry of the section 707(b) order in this case. So they could

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[5] The bankruptcy court's conclusion that section 707(b) only applies in cases that are originally commenced under chapter 7 formed the basis for the denial. *In re Dudley*, 405 B.R. 790, 801 (Bankr. W.D. Va. 2009). The Dudleys began their case under chapter 13 and then converted it to chapter 7.

not have had any effect on the finality of that order.[6]

Just like the similar orders entered in *Rudler*, *Ross-Tousey*, *Koch* and *Christian*, the section 707(b) order here was final when it was entered. Subsequent events that occurred much later in the case cannot, and did not, change that.

The unnecessary litigation in this case flowing from the dismissal of the United States Trustee's appeal demonstrates exactly why orders denying relief under section 707(b) are final and immediately reviewable. In *Rudler*, *Ross-Tousey*, *Koch*, and *Christian*, the bankruptcy courts' orders denying relief under section 707(b) were immediately reviewed on appeal, meaning that the abuse issue could be reviewed and resolved before the debtors' debts were discharged.

That was not the case here. The bankruptcy judge entered the Dudleys' discharge over the United States Trustee's objection that Bankruptcy Rule 4004(c)(1)(D) precluded the entry of discharge while his motion for relief under section 707(b) was still pending on appeal. Fed. R. Bankr. P. 4004(c)(1)(D) (precluding entry of discharge while section 707(b) motion is "pending").

Although the United States Trustee sought immediate appeal of the order

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[6] Nor did they enter into the district court's finality analysis because they occurred after the district court dismissed the appeal.

denying relief under Section 707(b), his appeal was dismissed. *McDow v. Dudley*, 428 B.R. 686 (W.D. Va. 2010). The bankruptcy court then entered the Dudleys' discharges even though the section 707(b) order had not been reviewed. *See Joint Appendix* at 17 (Docket Entry No. 127).

Those actions precipitated the United States Trustee's second appeal to the district court, styled *McDow v. Dudley*, No. 7:10-cv-00416-sgw (W.D. Va.). The United States Trustee contends the discharge order should be reversed because the bankruptcy court erred by granting the Dudleys' discharge while the United States Trustee's appeal of the 707(b) order was "pending" before this Court. *See* Fed. R. Bankr. P. 4004(c)(1)(D). Bankruptcy Rule 4004(c)(1)(D) is clear – a discharge should not be entered while a section 707(b) dispute is pending. The reason for this is obvious. If the case merits dismissal as an abuse, then a discharge would violate the Code and Congressional intent, and it would deny creditors any ability to recover outside of bankruptcy.

The bankruptcy court's decision to enter the discharge order is further undermined by the *Griggs* doctrine, and the Ninth Circuit's application of that doctrine in *Padilla*. *Griggs v. Provident Consumer Discount Co.*, 459 U.S. 56 (1982); *Neary v. Padilla (In re Padilla)*, 222 F.3d 1184 (9th Cir. 2000). *Griggs* teaches that lower courts are to be respectful when issues are on appeal. *See*

Griggs, 459 U.S. at 58 ("The filing of a notice of appeal . . . confers jurisdiction on the court of appeals and divests the district court of its control over those aspects of the case involved in the appeal."). And *Padilla* held that the entry of discharge and the closure of a bankruptcy case, which is far more conclusive than a discharge order, did not preclude appellate review of a section 707 appeal. *Padilla*, 222 F.3d at 1189-90.

But for the entry of discharge in violation of Rule 4004(c)(1)(D) and the second appeal it precipitated, this case is exactly like *Christian*, *Koch*, *Rudler* and *Ross-Tousey*. And this Court should follow the holdings of the Third, Eighth, First and Seventh Circuits in those cases.

C. This appeal is not moot.

If the United States Trustee wins this appeal, the debtors' case could be dismissed. Therefore, this appeal is not moot. The Dudleys assert that this appeal is moot because the section 707(b) order can be more efficiently reviewed in connection with the United States Trustee's appeal of the bankruptcy court's discharge order. Appellees' brief at 12. But neither the Dudleys' premise nor their conclusion is true.

The burden of demonstrating mootness rests on the party asserting mootness and it is a heavy one. *Los Angeles County v. Davis*, 440 U.S. 625, 631 (1979).

The pendency of a parallel action does not make an appeal moot. *Connectu LLC v. Zuckerberg*, 522 F.3d 82, 89 (1st Cir. 2008) ("[A]n action is not automatically rendered moot by the mere existence of a similar pending action.").

A case is moot "when the issues presented are no longer 'live' or the parties lack a legally cognizable interest in the outcome." *Powell v. McCormack*, 395 U.S. 486, 496 (1969); *see also DeFunis v. Odegaard*, 416 U.S. 312, 316 (1974) (stating that federal courts are "without power to decide questions that cannot affect the rights of litigants in the case before them."). Likewise, changes in circumstances that prevent the court from granting any meaningful relief can moot an appeal. *See United States v. Munsingwear, Inc.*, 340 U.S. 36 (1950). That is not the case here. The United States Trustee retains an interest in his appeal of the section 707(b) order because he believes that order was erroneous and reversal of that order could lead to the dismissal of the Dudleys' case for abuse.

Dismissal of the Dudleys' case would have a number of legal effects. First, their case would be dismissed. Second, the Dudleys would be found to be abusive debtors. That might lead the bankruptcy court in this case to enter a refiling bar under 11 U.S.C. § 349(a) (entitled "Effect of Dismissal"). *See In re Mitchell*, 357 B.R. 142, 157-58 (C.D. Cal. 2006) (granting refiling bar under section 349(a) in case dismissed under section 707(b)); *In re Siegenberg*, No. 06-16263, 2007 WL

6371956, at *7-8 (C.D. Cal. July 30, 2007) (same). *See also In re Jolly*, 143 B.R. 383, 387 (E.D. Va. 1992), *aff'd*, 45 F.3d 426 (4th Cir. 1994) (debtor may be prejudiced from filing subsequent bankruptcy petitions for cause under section 349(a)). The other subsections of section 349 list additional effects of dismissal. 11 U.S.C. § 349.

And significantly, a "dismiss[al]" in this case under section 707(b) will reduce the automatic stay protection the Dudleys can receive if they refile a chapter 7 case within a year, as many debtors do. 11 U.S.C. § 362(c)(3)(A) - (C) (limiting the automatic stay when the debtor has had a case dismissed under section 707(b) within the past year).[7]

Given all this, the United States Trustee's appeal is not moot. *See Church of Scientology of California v. United States*, 506 U.S. 9, 12-13 (1992) (holding that the availability of a remedy prevented case from being moot). There is a live dispute between the parties about the propriety of dismissal and this Court's decision in this appeal will help resolve it.

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[7] The United States Trustee believes that the discharge order should be reversed on appeal by the district court. But regardless of how the appeal of the discharge order ultimately is resolved, the United States Trustee retains a significant interest in the resolution of this appeal because dismissal has implications for this case - and beyond.

III. Deciding This Recurring Finality Issue Now Will Benefit Everyone Who Participates In Bankruptcy Cases Within This Circuit.

The finality issue before this Court is settled law in the First, Third, Seventh, Eighth, and Eleventh circuits, and perhaps within the Fifth. Lower courts and litigants in those circuits no longer have to address finality each time a United States Trustee appeals an adverse section 707(b) order. Likewise, the lower courts and the parties within this circuit will no longer have to address finality after this Court decides the issue here. The finality issue has been fully briefed and is ripe for decision in this appeal. Given that relief can be granted on remand – the Dudleys' case can be dismissed – there are good reasons for deciding this question of law now.

This appeal has practical ramifications for bankruptcy courts, the United States Trustee, and debtors far beyond this case. Its resolution will provide clarity as to when the United States Trustees must file notice of appeals of orders denying relief under section 707(b). Without such clarity, in each case within this Circuit where a bankruptcy judge denies section 707(b) relief, the United States Trustee will have to file appeals from 1) the 707(b) order; 2) the discharge order; and 3) other potentially final orders, such as the case closing order. That is because confusion now exists within this Circuit about when the 707(b) order can be appealed.

Without a clear answer as to finality, some debtors likely will move to dismiss appeals of orders denying relief under section 707(b) as interlocutory based on the district court's holding. Others may assume such orders are final based on *Rudler, Ross-Tousey, Christian* and *Koch* and move to dismiss appeals of subsequent orders as untimely as to the 707(b) order. Fed. R. Bankr. P. 8002(a). Unless the United States Trustee appeals from the proper order, he may unintentionally forfeit his right to appellate review. *See Dick v. Lim (In re Dick),* No. 98-2089, 1999 WL 617966, at *1-2 (6th Cir. Aug. 12, 1999) (deadline for filing appeal is jurisdictional). By deciding this appeal, this Court can help prevent the lower courts, the Government, and debtors from having to expend limited resources on unnecessary appeals.

Deciding this issue will also help resolve more quickly the interpretive issues that surround section 707(b)(1) - (3). The 2005 Act amendments to section 707(b) have spawned a number of hotly-disputed, interpretative questions. Just last week, the Supreme Court decided one – the meaning of the word "applicable" in section 707(b)(2)(A)(ii)(I). *Ransom*, 2011 WL 66438. But other important interpretive questions remain, including the issue concerning the applicability of section 707(b) to converted cases that the district court in this case declined to adjudicate. Were this Court to address the finality question before this Court now and find the order on appeal to be final, it would expedite the resolution of these questions of law in this case and others.

CONCLUSION

For the foregoing reasons, the United States Trustee requests that the district court's dismissal of his appeal be reversed and the appeal be reinstated in the district court.

RAMONA D. ELLIOTT
General Counsel
P. MATTHEW SUTKO
Associate General Counsel
WENDY L. COX
Trial Attorney
Executive Office for United States Trustees
Department of Justice
20 Massachusetts Ave., N.W.
Washington, D.C. 20530

JOSEPH A. GUZINSKI
Assistant United States Trustee
Department of Justice
115 South Union Street, Room 210
Alexandria, VA 22314

Respectfully submitted,

W. CLARKSON MCDOW, JR.
United States Trustee for Region 4

By: /s/ Wendy L. Cox

JOHN R. BYRNES
Assistant United States Trustee
Office of the United States Trustee
Department of Justice
First Campbell Square
201 1st Street, S.W., Suite 505
Roanoke, VA 24011

CERTIFICATE OF COMPLIANCE WITH RULE 32(a)

1. This brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B) because this brief contains 3,890 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii). I relied on the WordCount tool in my WordPerfect 12 software to obtain the word count.

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/s/ Wendy L. Cox
Attorney for W. Clarkson McDow
United States Trustee for Region 4

Dated: January 18, 2011

CERTIFICATE OF SERVICE

I certify that on January 18, 2011, I filed and served the foregoing brief by causing eight copies to be sent to the Clerk of the Court and two copies to the Appellees' counsel by Federal Express Next Business Day Delivery to the following addresses:

Patricia S. Connor, Clerk
U.S. Court of Appeals for the Fourth Circuit
1100 East Main Street, Suite 501
Richmond, Virginia 23219-3517
Telephone: 804-916-2700

Andrew S. Goldstein, Esquire,
Garren R. Laymon, Esquire
Magee Goldstein Lasky & Sayers, PC
310 First Street, SW, Suite 1200
Roanoke, Virginia 24011
Telephone: 540-343-9800
Counsel for Appellees

/s/ Wendy L. Cox
Attorney for W. Clarkson McDow
United States Trustee for Region 4

Dated: January 18, 2011

BRIEF BANK — “SUMMARY SHEET” *Printed Tue-7/8/08 17:0*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*
In re Charles Clifton Earle, IV (UST v. Earle)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*
BAP 1st Cir.

3. ("CCN") ***CURRENT*** CASE NO.
No.: 08-0014

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*
No.: 05-15532
Court: Bankr. R.I.
(Identify judge & cite, if any)

5. ("SO") ***SOURCE***
U.S. TRUSTEES

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*
Filed: July 7, 2008
Type: Brief of Appellee, United States Trustee

7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*
Phoebe Morse, Robert Scheider, Sandra Nicholls, Gary Donahue, P. Matthew Sutko
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***
• (1) As a matter of law, did the bankruptcy court properly deny the debtor’s motion to extend time to file an appeal finding no excusable neglect? (2) Did the bankruptcy court abuse its discretion by denying the debtor’s motion to extend time to file a notice of appeal?

10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)

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UNITED STATES BANKRUPTCY APPELLATE PANEL
FOR THE FIRST CIRCUIT

BAP NO. EP 08-0014

CHARLES CLIFTON EARLE, IV,
Debtor.

CHARLES CLIFTON EARLE, IV,
Appellant,

v.

PHOEBE MORSE, United States Trustee,
Appellee.

ON APPEAL FROM THE UNITED STATES BANKRUPTCY COURT FOR THE DISTRICT OF RHODE ISLAND

CASE NO. 05-15532
Adversary Proceeding No. 06-01060

BRIEF OF APPELLEE, UNITED STATES TRUSTEE

Ramona Elliott
General Counsel
P. Matthew Sutko
Associate General Counsel for Appellate Practice
United States Department of Justice
Executive Office for United States Trustee
20 Massachusetts Avenue, NW
Washington, DC 20530

Phoebe Morse
United States Trustee
Sandra Nicholls
Trial Attorney
United States Department of Justice
Office of the United States Trustee
10 Dorrance Street, Room 910
Providence, RI 02903
Tel: (401) 528-5551, ext. 101

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STATEMENT OF ISSUES PRESENTED

1. As a matter of law, did the bankruptcy court properly deny the debtor's motion to extend time to file an appeal finding no excusable neglect?

2. Did the bankruptcy court abuse its discretion by denying the debtor's motion to extend time to file a notice of appeal?

STATEMENT OF APPELLATE JURISDICTION

The United States Bankruptcy Court for the District of Rhode Island had jurisdiction under 28 U.S.C. §§ 157(b) and 1334(a) over the bankruptcy case initiated on October 16, 2005, by Charles Clifton Earle, IV. This appeal is taken from a final order of the bankruptcy court entered on February 13, 2008, denying Mr. Earle's motion to reconsider the court's January 10, 2008, order denying Mr. Earle's motion to extend time to file an appeal. This Panel has jurisdiction over this appeal of the January 10, 2008, and February 13, 2008, orders under 28 U.S.C. § 158(a) and (b)(1).

This Panel lacks jurisdiction to review all other orders entered below, including but not limited to the September 7, 2007, order granting the United States Trustee's motion for a default judgment, the September 21, 2007, order denying Mr. Earle's chapter 7 discharge, and the November 5, 2007, orders denying reconsideration of the September 7, 2007, and September 21, 2007 orders.

STANDARD OF REVIEW

Reviewing courts apply a clearly erroneous standard to a bankruptcy court's findings of fact and a *de novo* standard to conclusions of law. *See TI Fed. Credit Union v. DelBonis*, 72 F.3d 921, 928 (1st Cir. 1995); *Western Auto Supply Co. v. Savage Arms, Inc. (In re Savage*

Indus., Inc.), 43 F.3d 714, 719-20 n.8 (1st Cir. 1994). Under Fed. R. Bankr. P. 8013, a bankruptcy court's findings of fact "shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the bankruptcy court to judge the credibility of the witnesses."

A bankruptcy court's denial of a motion to extend time to file a notice of appeal is reviewed for abuse of discretion. *See Balzotti v. RAD Invs., LLC (In re Shepherds Hill Dev. Co., LLC)*, 316 B.R. 406, 413 (B.A.P. 1st Cir. 2004). The question of whether "excusable neglect" has been shown for purposes of Federal Rule of Bankruptcy Procedure 8002(c)(2) is a question of law, which is subject to *de novo* review. *Id.* Orders denying reconsideration are reviewed for manifest abuse of discretion. *See In re Augustin*, 383 B.R. 359, 361 (D. Mass. 2008); *Aguiar v. Interbay Funding, LLC (In re Aguiar)*, 311 B.R. 129, 132 (B.A.P. 1st Cir. 2004) (citations omitted).

STATEMENT OF THE CASE

Mr. Earle filed for protection under the Bankruptcy Code on October 16, 2005. On April 27, 2006, the United States Trustee filed a complaint to deny Mr. Earle's discharge under 11 U.S.C. §§ 727(a)(3), (a)(4) and (a)(5). Subsequently, Mr. Earle repeatedly failed to comply with discovery orders, so the United States Trustee moved for a default judgment. The bankruptcy court granted the motion for default judgment on September 7, 2007, and entered a final order denying Mr. Earle's discharge on September 21, 2007.

Rather than appeal the final order denying his discharge, Mr. Earle filed an untimely motion to reconsider, which the bankruptcy court denied on November 5, 2007. Thirty days later, Mr. Earle filed a motion to extend time to file an appeal of the reconsideration order. The bankruptcy court denied the motion because Mr. Earle failed to show the "excusable neglect" required for a late-filed motion under Fed. R. Bankr. P. 8002(c)(2). Mr. Earle filed a timely motion for reconsideration, which the bankruptcy court also denied. Mr. Earle then filed a notice of appeal of the order denying his motion to extend the time to file an appeal and the order denying his motion to reconsider that order.

STATEMENT OF FACTS

I. Factual Background

At the time he filed his bankruptcy petition Mr. Earle was a thirty eight year old college educated computer programmer. App. 88. He was the sole owner of World Mail Direct, Inc., a company that offered web hosting services for people who wanted to send bulk e-mail and for which he kept no corporate records. App. 107-109. Mr. Earle also operated a website, "024store.com" that sold a topical pain reliever. App. 107. In the years before his filing Mr. Earle also engaged in day trading in the stock market, built and sold computers, and facilitated web based commercial enterprises, all ventures for which he also kept no records. App. 96, 89, 88. Although Mr. Earle has earned income since at least 1996, he has never filed a federal or state tax return. App. 116.

Mr. Earle filed a skeletal petition under chapter 13 of the Bankruptcy Code on October 16, 2005.[1] Bankr. Case No. 05-15532, Docket No. 1. Thereafter, on October 28, 2005, Mr.

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[1] All references to the "Bankruptcy Code" or "Code" are to the Bankruptcy Code, as amended, 11 U.S.C. § 101, *et. seq*.

Earle converted his case to one under chapter 7 of the Code. On April 27, 2006, the United States Trustee initiated an adversary proceeding by filing a complaint to deny Mr. Earle's discharge under 11 U.S.C. §§ 727(a)(3) (concealing, destroying, or falsifying records), (a)(4) (knowingly making a false oath or account), and (a)(5) (failing to satisfactorily explain the loss of assets to meet liabilities). Adv. Pro. No. 06-01060, Docket No. 1. The bankruptcy court entered a scheduling order on July 12, 2006, setting the close of discovery for November 13, 2006. Adv. Pro. No. 06-01060, Docket No. 15. On November 20, 2006, Mr. Earle's counsel moved to withdraw from representation. Adv. Pro. No. 06-01060, Docket No. 22. On January 3, 2007, the bankruptcy court allowed Mr. Earle's counsel to withdraw. Adv. Pro. No. 06-01060, Docket No. 26. Discovery was further extended to January 12, 2007. Adv. Pro. No. 06-01060, Docket No. 19.

During the next eight months, Mr. Earle failed to comply with multiple orders to obtain counsel and comply with discovery. App. 20 (minutes of 1/24/07 hearing), 23 (minutes of 5/16/07 hearing); Adv. Pro. No. 06-01060, Docket Nos. 32, 35, 36, 50, 51, 53. On April 9, 2007, and again on July 5, 2007, the United States Trustee filed motions for default judgment against Mr. Earle, seeking denial of his discharge under 11 U.S.C. § 727(a)(6)(A) for failing to respond to discovery. Adv. Pro. No. 06-01060, Docket Nos. 34, 43. On August 15, 2007, Mr. Earle delivered two hundred pounds of documents to the United States Trustee. Appellant's brief at 24. At a hearing before the bankruptcy court on August 16, 2007, the United States Trustee argued that the documents proffered by Mr. Earle were disorganized and an insufficient response to the ordered discovery. App. 25 (minutes of 8/16/07 hearing). Mr. Earle agreed to take the documents back and organize them properly, and to supply amended responses and production by August 30, 2007. *Id.*

II. Procedural History

A. The Default Order

Mr. Earle did not supply further documents or answers to interrogatories, however, so on September 7, 2007, the bankruptcy court granted the United States Trustee's motion for default judgment (the "Default Order").[2] Adv. Pro. No. 06-01060, Docket No. 60. On September 17, 2007, Mr. Earle filed a timely motion to reconsider the Default Order.[3] Adv. Pro. No. 06-01060, Docket No. 64. The bankruptcy court entered an order on November 5, 2007, denying Mr. Earle's motion to reconsider the Default Order, finding that Mr. Earle had merely repeated arguments he had previously made, had not met his burden under Fed. R. Civ. P. 59(e), and had not acted in good faith. Adv. Pro. No. 06-01060, Docket No. 75.

B. The Discharge Denial Order

On September 21, 2007, the bankruptcy court entered an order denying Mr. Earle's discharge (the "Discharge Denial Order"). Adv. Pro. No. 06-01060, Docket No. 65. On the same date, the bankruptcy court entered a separate order granting judgment for the United States Trustee. Adv. Pro. No. 06-01060, Docket No. 66. Rather than appeal the Discharge Denial Order, on October 1, 2007, Mr. Earle filed a motion requesting an extension of the time to appeal pending the outcome of his September 17, 2007, motion to reconsider the Default

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[2] The bankruptcy court entered the Default Order only. The bankruptcy court did not enter a separate order, as is required for final judgments under Fed. R. Civ. P. 58 (made applicable to bankruptcy proceedings by Fed. R. Bankr. P. 9021).

[3] Because the motion to reconsider was filed within ten days of the Default Order, the bankruptcy court treated it as a motion to alter or amend the judgment under Fed. R. Civ. P. 59(e). Adv. Pro. No. 06-01060, Docket No. 75.

Order. Adv. Pro. No. 06-01060, Docket No. 69. On October 15, 2007, the bankruptcy court denied Mr. Earle's motion for extension of time to appeal the Discharge Denial Order as moot, citing Fed. R. Bankr. P. 8002(b) and stating that the time for filing a notice of appeal would not begin to run "until the Court rules on the Defendant's pending Motion for Reconsideration" of the Default Order. Adv. Pro. No. 06-01060, Docket No. 73.

On October 11, 2007, twenty days after the entry of the Discharge Denial Order, Mr. Earle filed a motion to reconsider that order. Adv. Pro. No. 06-01060, Docket No. 72. On November 5, 2007, in the same order that denied reconsideration of the Default Order, the bankruptcy court denied the motion to reconsider the Discharge Denial Order.[4] Adv. Pro. No. 06-01060, Docket No. 77.

C. The Motion to Extend Time to Appeal

On December 5, 2007, thirty days after the entry of the order denying reconsideration of the Default Order and the Discharge Denial Order, Mr. Earle filed a motion to extend the time to file an appeal of that order citing excusable neglect under Fed. R. Bankr. P. 8002(c)(2). Adv. Pro. No. 06-01060, Docket No. 84. In his motion, Mr. Earle asserted that he "cannot attest one way or the other" as to when notice of the order denying reconsideration of the Discharge Denial Order was delivered to his home address because he was allegedly out of town for several days prior to November 19, 2007, the date he claimed he became aware of the order. *Id*. He also acknowledged that he did not closely monitor the docket for his case to see whether the bankruptcy court had ruled on his motion, allegedly based on a discussion with

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[4] The bankruptcy court treated the two motions for reconsideration as "one and the same" because both "stem from the granting of the UST's motion for entry of default." Adv. Pro. No. 06-01060, Docket No. 77 at n.1.

clerk's office personnel regarding internal dates for monitoring case status. *Id*. On January 10, 2008, after notice and a hearing, the bankruptcy court entered an order denying Mr. Earle's motion to extend time to file an appeal (the "Extension Denial Order"), finding that Mr. Earle had not met his burden to show excusable neglect under *Pioneer Investment Services Co. v. Brunswick Associates, L.P.*, 507 U.S. 380 (1993). Adv. Pro. No. 06-01060, Docket No. 88.

On January 22, 2008, Mr. Earle filed a timely motion to reconsider the Extension Denial Order.[5] Adv. Pro. No. 06-01060, Docket No. 90. The United States Trustee filed an objection which pointed out that Mr. Earle's motion to reconsider recited many of the same facts and circumstances cited in his motion to extend time to appeal, made unsupported allegations, and relied on an inapplicable, unreported opinion from the District of Idaho. Adv. Pro. No. 06-01060, Docket No. 91. On February 13, 2008, the bankruptcy court denied the motion to reconsider the Extension Denial Order for the reasons stated in the United States Trustee's objection. Adv. Pro. No. 06-01060, Docket No. 92. Mr. Earle filed a timely notice of appeal from that order on February 25, 2008.[6] Adv. Pro. No. 06-01060, Docket No. 94.

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[5] A notice of appeal or a motion to alter or amend the Extension Denial Order was due within ten days of the entry of the order. As the tenth day fell on Sunday, January 20, 2008, and the following day, January 21, 2008, was a federal holiday, the notice of appeal filed on January 22, 2008, was timely.

[6] Pursuant to Fed. R. Bankr. P. 8002(a), a notice of appeal from the Extension Denial Order was due on January 22, 2008. *See* Fed. R. Bankr. P. 8002(a). The filing of the motion to reconsider the Extension Denial Order on January 22, 2008, tolled the time for filing a notice of appeal until ten days after the entry of an order on the motion to reconsider. *See* Fed. R. Civ. P. 59(e) (made applicable to bankruptcy proceedings by Fed. R. Bankr. P. 9006(b)(2)). After the bankruptcy court denied reconsideration of the Extension Denial Order on February 13, 2008, Mr. Earle then had ten days to appeal both the Extension Denial Order and the order denying reconsideration. *See id.*. As a result, the notice of appeal filed on February 25, 2008, was timely.

SUMMARY OF ARGUMENT

Although Mr. Earle attempts to appeal all prior orders of the bankruptcy court, this Panel only has jurisdiction over the appeal of the Extension Denial Order and the order denying reconsideration of that order. All other issues raised by Mr. Earle are, at best, issues that could be raised on remand if the Panel reverses the Extension Denial Order.

As for the issue actually before this Panel, the bankruptcy court properly denied Mr. Earle's request to extend the time to file an appeal because Mr. Earle did not establish excusable neglect for his failure to file either a timely notice of appeal or a timely request to extend the appeal period. Nor did the bankruptcy court abuse its discretion in denying Mr. Earle's request to extend the period for appeal because, on the record before it, the court's decision was well supported.

ARGUMENT

I. The Extension Denial Order and the Order Denying its Reconsideration are the Only Orders Subject to This Appeal

Mr. Earle's brief reargues orders for which no timely notice of appeal was ever filed.[7] The timely filing of a notice of appeal is "mandatory and jurisdictional." *Yamaha Motor Corp. v. Perry Hollow Mgmt. Co., Inc. (In re Perry Hollow Mgmt. Co., Inc.),* 297 F.3d 34, 38 (1st Cir. 2002). If notice of appeal of a final order is not timely filed, a bankruptcy appellate

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[7] Mr. Earle's Form 17 (Notice of Appeal) seeks review only of the "Order Denying Defendant's Motion to Reconsider" entered on February 13, 2008. In addition to Form 17, Mr. Earle filed a longer document also titled "Notice of Appeal," in which he sought review of the "order entered on 2/13/2008 denying defendant's motion to reconsider the 1/10/2008 order denying defendant's motion to extend time to file appeal" and "all prior orders . . . including but not limited to" the November 5, 2007, order, the Default Order, and the Discharge Denial Order.

panel does not have jurisdiction to review the order. *Colomba v. Solomon (In re Colomba),* 257 B.R. 368, 369 (B.A.P. 1st Cir. 2001).

As the underlying Extension Denial Order was a final appealable order, the order denying reconsideration is also final and appealable. *See Vicenty v. Sandoval (In re Sandoval),* 327 B.R. 493, 505 (B.A.P. 1st Cir. 2005) (citations omitted)*; Bradshaw v. I.R.S., (In re Bradshaw),* 283 B.R. 814, 817 (B.A.P. 1st Cir. 2002); *see also Fiffy v. Nickless (In re Fiffy),* 293 B.R. 550, 554 (B.A.P. 1st Cir. 2003). The appeal period for all previous final orders entered by the bankruptcy court has expired, however, so this Panel's jurisdiction is limited to a review of the Extension Denial Order and the order reconsidering that order.[8] All other issues raised in Mr. Earle's brief are, at best, issues that could be raised on remand if the Panel reverses the Extension Denial Order.

II. Mr. Earle Did Not Establish That His Neglect Was Excusable

The central question presented by this appeal is whether the bankruptcy court correctly decided that Mr. Earle did not make an adequate showing of excusable neglect in his attempt to obtain an additional twenty days beyond the ten allowed to appeal the court's earlier decisions to deny reconsideration of the Default Order and the Discharge Denial Order.

The bankruptcy court entered the order denying the Default Order and Discharge Denial Order on November 5, 2007, yet Mr. Earle did not file an appeal of that order within the

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[8] The Discharge Denial Order was a final appealable order. *See Aoki v. Atto Corp. (In re Aoki),* 323 B.R. 803, 811 (B.A.P. 1st Cir. 2005). Mr. Earle did not file his motion to reconsider the Discharge Denial Order until twenty days after it was entered, after the denial of his discharge had become final and the appeal period had expired. Because a motion for reconsideration must be filed within ten days of the underlying order and that deadline may not be enlarged, post-judgment relief under Fed. R. Civ. P. 59(e) as to that order was not available to Mr. Earle, so the motion to reconsider the Discharge Denial Order did not toll the time for appeal. *See Dugan. v. Wyvern Aviation Consulting (In re FlightTime Corp.)*, 302 B.R. 114, 118 (B.A.P. 1st Cir. 2003); Fed. R. Civ. P. 59(e); Fed. R. Bankr. P. 9023, 9006(b)(2).

ten days allowed by Fed. R. Bankr. P. 8002(a), nor did he request an extension of time for appeal within that ten-day period pursuant to Fed. R. Bankr. P. 8002(c)(2). Instead, Mr. Earle filed his motion to extend the deadline for appeal on December 5, 2007, exactly twenty days after the ten-day period to file a notice of appeal had expired. Thus, under Fed. R. Bankr. P. 8002(c)(2), Mr. Earle was required to make a showing of excusable neglect.

The United States Supreme Court in *Pioneer Investment Services Co. v. Brunswick Associates, L.P.*, 507 U.S. 380 (1993) established a test for determining whether excusable neglect has been established for purposes of Fed. R. Bankr. P. 9006(b)(1). The factors to be considered include: (i) the length of the delay and its potential impact on judicial proceedings; (ii) the danger of prejudice; (iii) the movant's good faith; and (iv) the reason for the late filing, including a consideration of whether the circumstances were beyond the control of the late filer. *See Pioneer,* 507 U.S. at 395. The Supreme Court expressly stated in *Pioneer* that "inadvertence, ignorance of the rules, or mistakes construing the rules do not usually constitute 'excusable' neglect." *Id*. at 392.

Courts generally apply the *Pioneer* standard to analyze "excusable neglect" in other rules in which that term appears, including Fed. R. Bankr. P. 8002(c)(2). *See Balzotti v. RAD Invs., LLC (In re Shepherds Hill Dev. Co., LLC),* 316 B.R. 406, 415 (B.A.P. 1st Cir. 2004). The First Circuit has noted that the excusable neglect inquiry involves "a significant equitable component and must give due regard to the totality of relevant circumstances surrounding the movant's lapse." *Bennett v. City of Holyoke,* 362 F.3d 1, 5 (1st Cir. 2004). Nevertheless, the First Circuit stands with the majority of courts in holding that "[t]he four *Pioneer* factors do not carry equal weight; the excuse given for the late filing must have the greatest import. While prejudice, length of delay, and good faith might have more relevance in a closer case, the reason-for-delay factor will always be critical to the inquiry." *Graphic Communications Int'l Union v. Quebecor Printing Providence, Inc.*, 270 F.3d 1, 5-6 (1st Cir. 2001) (internal citations and quotations omitted). As a result, "[w]hen a party's or counsel's misunderstanding of clear law . . . is the reason for the delay in filing the notice of appeal," the First Circuit continues "to uphold findings of 'no excusable neglect' where the [lower] court cited the absence of unique or extraordinary circumstances." *Id.* at 6 (citing *Mirpuri v. ACT Mfg., Inc.*, 212 F.3d 624, 631 (1st Cir. 2000)).

When the factors set forth in *Pioneer* are applied here, Mr. Earle's neglect was not excusable. Even if the other three factors are presumed to favor Mr. Earle, his reasons for late filing constitute precisely the kind of inadvertence, ignorance, and mistake that "do not usually constitute 'excusable' neglect." *Pioneer*, 507 U.S. at 392. Mr. Earle has not cited any circumstance that is "unique" or "extraordinary" in explaining his neglect of the docket in his case; he simply chose not to monitor the docket or arrange to have his mail checked while he was out of town. Although he has suggested that the clerk's office might not have provided timely notice of entry of the order denying his motion to reconsider, Mr. Earle has acknowledged that he has no idea when the notice was actually delivered to his home address.

Mr. Earle's alleged reliance on the clerk's office and the mail system strains credulity. As a *pro se* litigant who has nevertheless managed to file a multitude of motions on the last day allowed pursuant to Fed. R. Bankr. P. 9006, Mr. Earle is not so unsophisticated as to believe that his rights turn on the timely delivery of the United States Mail. He is, moreover, a computer programmer and consultant, so any suggestion that he was unaware dockets could be monitored electronically is simply not credible. Even assuming that Mr. Earle's arguments are credible, the fact that he acknowledged receiving the Discharge Denial Order on November 19, 2007, yet waited to file his motion to extend time until December 5, 2007, militates against him.

In any event, Mr. Earle's "lack of notice" argument is unavailing even if true, as the First Circuit has held that "mere lack of notice does not constitute excusable neglect." *Citibank N.A. v. Roanca Realty, Inc. (In re Roanca Realty, Inc.)*, 747 F.2d 816, 817 (1st Cir. 1984); *see also In re Mayhew*, 223 B.R. 849, 856 (D.R.I. 1998) ("Quite simply, the 'I didn't receive notice' defense doesn't work in federal court."); *Balzotti v. RAD Invs., LLC (In re Shepherds Hill Dev. Co., LLC)*, 316 B.R. at 415 ("whether the appellant had notice of the order does not affect . . . the date on which the notice of appeal should have been filed"). In addition, Mr. Earle's failure to monitor the docket cannot be excused, as it is "an abecedarian rule of civil practice [that] parties to an ongoing case have an independent obligation to monitor all developments in the case and cannot rely on the clerk's office to do their homework for them." *Witty v. Dukakis*, 3 F.3d 517, 520 (1st Cir. 1993).

Courts in other jurisdictions also regularly hold that the alleged failure to receive notice of entry of an order is not excusable neglect given each party's duty to monitor the docket for their case. *See, e.g., Kuhn v. Sulzer Orthopedics, Inc.*, 498 F.3d 365, 371-72 (6th Cir. 2007) (failure to monitor docket not excusable neglect); *Delaney v. Alexander (In re Delaney*), 29 F.3d 516, 518 (9th Cir. 1994) (no excusable neglect where clerk allegedly did not provide notice of entry of order); *Silivanch v. Celebrity Cruises, Inc*., 333 F.3d 355, 365-68 (2d Cir. 2003) (no excusable neglect where appellant relied on opposing counsel's erroneous calculation of the appeal period); *In re Spiegel, Inc.*, 385 B.R. 35, 40 (S.D.N.Y. 2008) (failure to monitor docket precludes finding of excusable neglect where party allegedly did not receive order until after appeal period); *Warrick v. Birdsell (In re Warrick)*, 278 B.R. 182, 187 (B.A.P. 9th Cir. 2002) (no excusable neglect where clerk allegedly failed to provide notice, as *pro se* litigant had duty to monitor the docket); *In re Davenport*, 342 B.R. 482, 500 (Bankr. S.D. Tex. 2006) (no excusable neglect where appellant had difficulty receiving notice but could have monitored the docket electronically); *Investors & Lenders, Ltd. v. Field (In re Investors & Lenders, Ltd.)*, 169 B.R. 546, 551 (Bankr. D.N.J. 1994) (where party failed to monitor docket, no excusable neglect even though opposing party mailed order just before appeal period was to expire); *Rozich v. Cruey (In re Cruey)*, 158 B.R. 66, 69-71 (Bankr. W.D. Va. 1993), *aff'd* 37 F.3d 1493 (4th Cir. 1994) (table) (denial of receipt of order does not rebut presumption created by clerk's office's certificate of mailing, so no excusable neglect shown). Mr. Earle has cited no case to the contrary in his brief.

In sum, Mr. Earle's conduct in failing to make arrangements to have his mail reviewed or to otherwise monitor the docket was certainly neglect, but it was not excusable neglect. The bankruptcy court's finding that Mr. Earle's neglect was not excusable is amply supported by the case law, the facts on the record, and the bankruptcy court's own determination of Mr. Earle's credibility based on its observations made throughout the bankruptcy case and adversary proceeding. *See Balzotti v. RAD Invs., LLC (In re Shepherds Hill Dev. Co., LLC)*, 316 B.R. at 416 (good faith is called into question where failure to file timely appeal is "part of an ongoing pattern of obstruction and delay").

In light of the foregoing, the bankruptcy court did not err in denying Mr. Earle's motion to extend time to file an appeal. In addition, as the motion for reconsideration did not raise any issue of fact or law that would justify reconsideration, the bankruptcy court did not err in denying the motion to reconsider the Extension Denial Order. As a result, the bankruptcy court's orders should be affirmed.

CONCLUSION

Mr. Earle has failed to meet his burden on appeal. Accordingly, the bankruptcy court's order denying Mr. Earle's motion to extend time to appeal, and the order denying reconsideration of that order, should be affirmed.

Respectfully submitted,

PHOEBE MORSE
United States Trustee

By: ___________________________
Phoebe Morse
United States Trustee
Sandra Nicholls
Trial Attorney
United States Department of Justice
Office of the United States Trustee
10 Dorrance Street Room 910
Providence, RI 02903
Tel: (401) 528-5551, ext. 101
Fax:(401) 528-5163
Email: sandra.nicholls@usdoj.gov

Dated this ___ day of July, 2008

CERTIFICATE OF SERVICE

The foregoing Brief of Appellee was served upon Charles Clifton Earl, IV, 1800 Mineral Springs Avenue #222, N. Providence, RI 02904 by U.S. Mail postage prepaid on July 7, 2008.

____

Gary L. Donahue

BRIEF BANK — 'SUMMARY SHEET" *Printed Wed-1/30/08 8:38*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]* — In re: Patrick Joseph Edgin (UST v. Crocker)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]* — M.D. Tenn.

3. ("CCN") ***CURRENT*** CASE NO. — No.: 1:07-cv-00065

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*

No.: 01-09738-MH1-7

Court: Bankr. M.D. Tenn.

(Identify judge & cite, if any)

5. ("SO") ***SOURCE*** — **U.S. TRUSTEES**

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*

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7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]* — P. Matthew Sutko, Sean E. Martin, Beth Roberts Derrick, Richard F. Clippard

(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC*** — **BANKRUPTCY**

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***

- Did the Bankruptcy Court err in its determination that administrative expenses, including the chapter 7 trustee compensation, accrue interest pursuant to 11 U.S.C. § 726(a)(1) and (5)?
- Did the Bankruptcy Court err in ignoring the limitation on trustee compensation in 11 U.S.C. § 326?
- Did the Bankruptcy Court err in awarding the trustee and his law firm interest from the date of the commencement of the debtor's bankruptcy case?

√ **Background:**

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IN THE UNITED STATES DISTRICT COURT FOR THE
MIDDLE DISTRICT OF TENNESSEE
COLUMBIA DIVISION

)
RICHARD F. CLIPPARD,)
U.S. TRUSTEE, REGION 8,)
Appellant,) Judge Trauger
) Case No. 1:07-cv-65
v.)
)
SAMUEL K. CROCKER, Trustee,)
Appellee.)
)
)
IN RE:)
PATRICK JOSEPH EDGIN) BK NO 01-09738-MH1-7
DEBTOR)

APPELLANT’S BRIEF

RICHARD F. CLIPPARD
UNITED STATES TRUSTEE
UNITED STATES DEPARTMENT OF JUSTICE
Office of the United States Trustee
701 Broadway, Suite 318
Nashville, TN 37203
(615) 736-2254 (telephone)
(615) 736-2260 (facsimile)
Beth Roberts Derrick
Assistant United States Trustee

SEPTEMBER 6, 2007

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INTRODUCTION

The United States Trustee for Region 8 respectfully submits this brief in support of reversal of the July 12, 2007, order of the Honorable Marian F. Harrison, which granted the motion of Samuel K. Crocker, Chapter 7 Trustee, for summary judgment and allowed the payment of interest on Mr. Crocker's trustee compensation and on the attorneys fees awarded to Mr. Crocker's law firm, with the interest to accrue from the date of the commencement of the bankruptcy case. Based on an analysis of the applicable provisions of the United States Code, the legislative history, the case law, and pertinent policy considerations, the decision of Judge Harrison was in error as a matter of law and should be reversed.

STATEMENT OF JURISDICTION

The Bankruptcy Court had jurisdiction over this proceeding under 28 U.S.C. § 1334(a) and § 157(b). The District Court has jurisdiction over the appeal of the final order of the Bankruptcy Court under 28 U.S.C. §§ 1334(a) and 158(a).

STATEMENT OF THE ISSUES

The issues presented for review are:

a) Did the Bankruptcy Court err in its determination that administrative expenses, including the chapter 7 trustee compensation, accrue interest pursuant to 11 U.S.C. § 726(a)(1) and (5)?
b) Did the Bankruptcy Court err in ignoring the limitation on trustee compensation in 11 U.S.C. § 326?
c) Did the Bankruptcy Court err in awarding the trustee and his law firm interest from the date of the commencement of the debtor's bankruptcy case?

STATEMENT OF THE CASE

This appeal arises from an order of the Bankruptcy Court which granted the Chapter 7 Trustee's request in his Supplemental Final Report and Proposed Distribution ("Supplemental Final Report") for interest to be paid on his trustee compensation and on his law firm's attorneys' fees. The addition of the interest to the amount already paid to the chapter 7 trustee as trustee compensation causes the amount to exceed the cap on trustee compensation set forth in 11 U.S.C. § 326(a). The order of the Bankruptcy Court also established the commencement date of the bankruptcy case as the beginning date for the accrual of the interest.

Patrick Joseph Edgin ("Debtor") filed a voluntary petition for relief under chapter 7 of the Bankruptcy Code on August 31, 2001. On September 4, 2001, Samuel K. Crocker ("Trustee") was appointed as the Chapter 7 trustee to administer the Debtor's bankruptcy estate. The case was converted to a case under chapter 13 on June 20, 2003 and then re-converted to a chapter 7 case by order entered October 16, 2003. Mr. Crocker was re-appointed chapter 7 trustee in the case on October 22, 2003. On March 30, 2006, the Trustee's Final Report and Proposed Distribution ("Final Report") was filed with the court. The Trustee's Supplemental Final Report was filed on October 30, 2006. The United States Trustee objected on November 6, 2006 to the Supplemental Final Report. Cross Motions for Summary Judgment were filed by the trustee and the United States Trustee on April 23, 2007. Argument was held on May 1, 2007. After taking the matter under advisement, an order was docketed July 12, 2007 denying the United States Trustee's Motion for Summary Judgment and Granting the Motion for Summary Judgment of the Chapter 7 Trustee. A timely notice of appeal was filed by the United States Trustee on July 18, 2007.

STATEMENT OF UNDISPUTED MATERIAL FACTS[1]

Patrick Joseph Edgin ("Debtor') filed his chapter 7 bankruptcy case on August 31, 2001 ("petition date").(JPS, ¶ 1). Samuel K. Crocker was appointed chapter 7 trustee on September 4, 2001.(JPS, ¶ 3). The meeting of creditors was held October 10, 2001. (JPS, ¶ 4). At this meeting, the Trustee learned of an interest in real estate which was owned by the Debtor, but not scheduled in the sworn statements and schedules filed by the Debtor.(JPS, ¶ 4).

On August 2, 2002, the Trustee filed a motion for approval of the compromise and settlement of pre-petition state court litigation for $4,791.50. (JPS, ¶¶ 6, 7). No objections were filed and an order was entered September 30, 2002, granting the motion. (JPS, ¶ 6). The settlement funds were deposited into the Trustee's estate account on November 1, 2002.(JPS, ¶ 7). A Report of Assets was filed on June 18, 2003.(JPS, ¶ 8).

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[1] The motions for summary judgment were presented to the bankruptcy court on Stipulations of Fact contained within the Joint Pretrial Statement filed on March 1, 2007, Docket Entry Number 85. References to the Joint Pretrial Statement will be abbreviated as JPS.

On June 20, 2003, the Debtor converted his case from a case under chapter 7 to a case under chapter 13.(JPS, ¶ 9). The case was later re-converted to chapter 13 upon the chapter 13 trustee's motion.(JPS, ¶ 10). Samuel K. Crocker was re-appointed chapter 7 trustee on October 22, 2003. (JPS, ¶ 11). Debtor received a chapter 7 discharge on August 27, 2004.(JPS, ¶ 12). On March 9, 2005, the Trustee filed a complaint against Lisa Edgin Hanna and the Debtor seeking partition and sale of the property about which Mr. Edgin had testified during the initial meeting of creditors on October 10, 2001.(JPS, ¶ 14). By order entered June 27, 2005, the Trustee's motion for approval of compromise and settlement of the partition suit was granted.(JPS, ¶ 14). On August 29, 2005, the Trustee received $68,625.00 in settlement proceeds.(JPS, ¶ 15).

The Trustee is a member of the law firm, Crocker & Niarhos.(JPS, ¶ 24). By order entered February 2, 2006, Crocker & Niarhos was paid attorneys fees and reimbursement of expenses.(JPS, ¶ 21).

On March 30, 2006, the Trustee submitted his Final Report and it was approved by the court on May 30, 2006 over the Debtor's objection.(JPS, ¶ 16). The total funds received by the estate for distribution was $74,090.77.(JPS, ¶ 19). Originally, the estate funds were insufficient to pay all creditors in full; however, when the Internal Revenue Service returned the funds it received in the distribution, the estate was able to pay all creditors' claims in full as well as surplus funds to the Debtor.(JPS, ¶ 20). The trustee submitted a Supplemental Final Report on October 30, 2006, and proposed to pay the balance of all unsecured claims, interest on the compensation previously awarded to himself and his law firm, and surplus funds to the Debtor.(JPS, ¶ 17; Supplemental Final Report, docket # 80). The United States Trustee objected to the Supplemental Final Report on November 6, 2006, because of the Trustee's request for interest on his trustee compensation and upon his attorneys fees and expenses.(JPS, ¶ 18).

The Trustee was paid trustee compensation in the amount of $6,954.54 on June 5, 2006.(JPS, D¶ 17)[2]. The Trustee thereafter reimbursed the estate in the amount of $9.89, resulting in total trustee compensation of $6,944.65 paid to the Trustee.(JPS, D¶ 17). The maximum amount of trustee compensation allowable under

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[2] An error was made in the numbering of the paragraphs in the JPS; duplicate numbered paragraphs 17 - 20 will be noted as duplicates by a **D** prior to the para graph number.

§ 326 in this case after the refund from the Internal Revenue Service is $6,749.07.(JPS, D¶ 18). The Trustee has been overpaid $195.58 in trustee compensation.(JPS, D¶ 18).[3]

Administrative claims allowed and paid in this case and the requested interest are as follows:

Samuel K. Crocker, Trustee	$6,954.54 trustee compensation paid June 5, 2006; interest requested $1,231.06
Crocker & Niarhos	$13,606.25 attorney fees and expenses paid February 2, 2006; Interest requested $2,481.23
Teri Hasenour Gordon	$1,400 attorneys fees paid June 6, 2006
Bankruptcy Court	$150 fees and costs paid March 6, 2005
International Sureties	$7.23 in bond premiums paid throughout the case

(JPS, ¶ 21). The interest requests are calculated at the rate of 3.44 percent per day from the petition date though December 18, 2006.(JPS, D¶¶ 19, 20). Surplus funds to the Debtor in the projected amount of $4,118.35 have not been paid.(JPS, ¶ 23).

STANDARD OF REVIEW

A bankruptcy court's findings of facts are upheld by the appellate court unless they are clearly erroneous; the bankruptcy court's conclusions of law are reviewed de novo. Michel v. Federated Dept. Stores, Inc., 44 F.3d 1310, 1315 (6th Cir. 1995). The issues on this appeal arise from the bankruptcy court's conclusions of law and therefore a de novo review is appropriate.

RELEVANT STATUTORY FRAMEWORK

A. Overview of Chapter 7 Case Administration

Chapter 7 of the Bankruptcy Code, 11 U.S.C. § 701[4] et seq., is a liquidation provision. Shortly after the chapter 7 bankruptcy petition is filed, the United States Trustee appoints a chapter 7 bankruptcy trustee

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[3] The overpayment was a result of a math error and will be resolved by the United States Trustee and Mr. Crocker without dispute upon resolution of the appeal.

[4] All statutory references are to Title 11, United States Code, unless otherwise noted.

to administer the debtor's estate. See § 704 (duties of a trustee); 28 U.S.C. § 586(d). The trustee is a representative of the estate and is charged with specific statutory duties necessary to collect and reduce to money property of the estate. §§ 323(a); 704(1)-(9). A trustee is authorized to seek court permission to employ professionals to assist in the performance of those duties, including attorneys, accountants, and auctioneers. § 327.

B. Allowance of Compensation of Trustees and Professionals Under 11 U.S.C. § 503(b)(2) and Payment under § 503(a)

Neither chapter 7 bankruptcy trustees nor professionals employed by the estate are government employees, and their compensation comes from the private bankruptcy estate. In order to receive payment, a trustee or a professional must be properly employed under either §§ 701 and 702(d) (trustee appointment) or § 327 (professional employment), and her compensation must be awarded under § 330(a). Lamie v. United States Trustee, 124 S. Ct. 1023, 1027 (2004); see also Fed. R. Bankr. P. 2016(a) (application for compensation for services).

Section 503(b) authorizes the allowance of "administrative expenses" that arise after a bankruptcy petition is filed. § 503(b). Section 503(b)(2) specifically authorizes the allowance of compensation that has been awarded to a trustee or a professional under § 330(a).[5] § 503(b)(2). Under § 503(a), an entity with an administrative expense may file a "request for payment" of such an administrative expense claim.

C. Priorities Under 11 U.S.C. § 507(a)

In most chapter 7 bankruptcy cases there are not enough funds generated from the liquidation of estate assets to pay all claims in full. In recognition of this, Congress has established a "priority" of payment system mandating that specifies claims receive full payment as a prerequisite to claims in lower categories receiving any payment. See § 507(a) (establishing priorities). Under that scheme, trustee and professional fees receive first priority. Id. Under§ 507(a)(1), certain filing fees, and administrative expense claims approved under § 503(b)(2), receive "priority" over all other types of claims. § 507(a)(1). In turn, § 503(b)(2) authorizes the

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[5] The amount of trustee fees that the court may award is limited by 11 U.S.C. § 326(a).

payment of “compensation and reimbursement awarded [to trustees and professionals] under section 330(a).” § 503(b)(2). See Texas v. Lowe (In re H.L.S. Energy Co., Inc.), 151 F.3d 434, 437 (5th Cir. 1998) (conceptual justification for administrative expense priority is that creditors must pay for those expenses necessary to produce distribution to which they are entitled).

The remainder of § 507(a)(1) lists eight categories of claims that are entitled to lesser priority such as pre-petition employee wages and salaries, alimony and claims related to contributions to an employee benefit plan. See § 507(a)(2)-(9). Other than administrative expense claims and court fees under § 507(a)(1), all other priority claims are pre-petition obligations of the debtor. See § 507(a)(1)-(9). Priority is the same whether the case is under chapter 7, 11, 12, or 13. See § 103. Administrative expenses, including trustee and professional compensation, retain top priority for payment whether they are paid shortly after they are incurred or paid at the same time as final distribution to creditors under § 726(a).

D. Distribution to Creditors Under 11 U.S.C. § 726(a)

At the conclusion of a chapter 7 liquidation case, the chapter 7 trustee submits to the United States Trustee and files with the court a final report and account of the administration of the estate. See § 704(9). Once the court resolves any objections to the final report, the trustee distributes funds generated from the liquidation of estate property to creditors in accordance with § 726 of the Bankruptcy Code.

Section 726(a) provides for the distribution of estate property in chapter 7 cases. The first four categories consist of various unsecured claims. See § 726(a)(1)-(4). The fifth category applies to the payment of post-petition interest “on any claim paid under” the first four categories. § 726(a)(5). Finally, any surplus property is distributed to the debtor. § 726(a)(6).

Of relevance in this appeal is § 726(a)(1), which provides that estate property is first distributed in payment of § 507 priority claims for which a proof of claim has been filed under § 501. § 726(a)(1). Prior to the Bankruptcy Reform Act of 1994 (“the Act”), 108 Stat. 4106, § 726(a)(1) provided for the distribution of property of the estate to priority claimants, specifically, “in payment of claims of the kind specified in and in the order specified in” § 507. Effective for cases filed after October 22, 1994, § 726(a)(1) Congress added the language "proof of which [claim] is timely filed under section 501 of [Title 11] or tardily filed before the date on which the trustee commences distribution under [§ 726]." § 726(a)(1). Only "creditors" and indenture trustees may file proofs of claims under § 501. § 501(a). "Creditor" is an "entity that has a claim against the debtor that arose at the time of or before the order for relief concerning the debtor."[6] § 101(10)(A). A "proof of claim" is defined by the Bankruptcy Rules as "a written statement setting forth a creditor's claim." Fed. R. Bankr. P. 3001(a). A proof of claim must substantially conform to Official Form 10 and generally must be executed by the creditor.[7] Fed. R. Bankr. P. 3001(a), (b); Fed. R. Bankr. P. Official Form 10. Under the Bankruptcy Code and Rules, the procedures with respect to proof of claims apply only to creditors.[8] A pre-petition claim of a creditor, "proof of which is filed under section 501," is "deemed allowed" absent an objection. § 502. Compare with 11 U.S.C. § 503(b)(2) (trustee and professional administrative fees may be allowed and paid only after notice and a hearing).

SUMMARY OF ARGUMENT

As the United States Court of Appeals for the Fifth Circuit has squarely held, the plain meaning of § 726(a)(1) prohibits the payment of interest on administrative expenses, including trustee compensation. Tarbox v. United States Trustee (In re Reed), 405 F.3d 338 (5th Cir. 2005).[9] Payment of interest to trustees

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[6] 11 U.S.C. § 101(10)(B) and (C) also give creditor status to holders of certain specialized claims that are not at issue in this appeal.

[7] The exception to this rule, which is not relevant in this appeal, is under certain circumstances where a creditor fails to file a proof of claim, the debtor, codebtor, or trustee may file the proof of claim on behalf of the creditor. *See* Fed. R. Bankr. P. 3004, 3005.

[8] See, e.g., § 501 (creditor may file proof of claim); Fed. R. Bankr. P. 3001 (proof of claim sets forth creditor's claim) (proof of claim executed by creditor); Fed. R. Bankr. P. 3002 (creditor must file proof of claim for it to be allowed); Fed. R. Bankr. P. 3003(c) (creditor in chapter 11 may file proof of claim); Fed. R. Bankr. P. 3004 (debtor or trustee may file proof of claim where creditor fails to do so); Fed. R. Bankr. P. 3005 (where creditor fails to file a proof of claim); Fed. R. Bankr. P. 3006 (creditor may withdraw claim); Fed. R. Bankr. P. Official Form 10 (Proof of Claim). Further, the "Proof of Claim" form specifically states that it "should not be used to make a claim for an administrative expense" and that a "'request' for payment of an administrative expense may be filed pursuant to [section] 503." Fed. R. Bankr. P. Official Form 10.

[9] Mr. Crocker, the trustee requesting interest on his trustee compensation and on the fees paid to his law firm in this case, acted as amicus counsel in Reed. The same arguments he made to the

and other administrative claimants is at odds with many other bankruptcy statutes as well as the stated intention of Congress.

ARGUMENTS AND AUTHORITIES

1. Administrative expenses are excluded from payment of interest under § 726(a)(5).

The statutory subsections crucial to the determination of the issue~~s~~ before the court are found in § 726(a) which provides, in pertinent part:

> (a) Except as provided in section 510 of this title, property of the estate shall be distributed –
> (1) first, in payment of **claims** of the kind specified in, and in the order specified in, section 507 of this title**, proof of which is timely filed under section 501 of this title** or tardily filed before the date on which the trustee commences distribution under this section;
> . . . .
> (5) fifth, in payment of interest at the legal rate from the date of the filing of the petition, on any **claim paid under paragraph (1)**, (2), (3), or (4) of this subsection....

[Emphasis added.]

The Fifth Circuit Court of Appeals decision in (In re Reed), 405 F.3d 338, is directly on point and should be followed in this district. The Court analyzed §§ 101(10), 101(17), 501, 503(b)(2), 507, 726(a)(1) and (5) and determined that the plain language of the relevant statutes precluded the payment of interest on trustee compensation and other administrative expenses. 405 F.3d at 342–3. The Court focused on the reference in § 726(a)(1) to "payment of claims of a kind specified ... in section 507 [of title 11], proof of which is timely filed under section 501" and determined that because administrative claimants do not file claims under § 501 they do not hold "claims paid under paragraph (1) of [§ 726(a)]" as required by § 726(a)(5).

The Bankruptcy Court in this case relied upon In re Hembree, 297 B.R. 515 (Bankr. M.D. Tenn. 2002) for its ruling. Notwithstanding the claim of the Hembree bankruptcy court to have relied upon the "straightforward reading of the language of the relevant statutes," the court ignored the specific language of § 726(a)(1) referencing claims filed under § 501. Moreover, the Bankruptcy Court in In re Hembree, relied upon In re Smith, 267 B.R. 770 (Bankr. W.D. Tex. 2001) in finding that § 726(a)(5) allows payment of interest

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Bankruptcy Court were rejected by the Fifth Circuit.

on chapter 7 trustee compensation. However, In re Smith has since been abrogated by the Fifth Circuit's opinion in Reed.

The legislative history of § 726(a) clearly states that only pre-petition claims are included in § 726(a)(1). The 1978 Bankruptcy Code was first enacted § 726(a). As reported in Senate Report 95-989 and in the 1978 U.S. Code Congressional and Administrative News 5787, 5883:

> [P]aragraph (5) [of § 726(a)] provides that post-petition interest on **pre-petition** claims is also to be paid to the creditor in a subordinated position. Like pre-petition penalties, such interest will be paid from the estate only if and to the extent that a surplus of assets would otherwise remain for return to the debtor at the close of the case.

[emphasis added]. The drafters' intent to include only pre-petition claims in § 726(a)(1) has never wavered. See 1984 U.S.Code Cong. & Adm. News, p. 576; 1994 U.S. Code Cong. & Adm. News, p.3340. This legislative history is consistent with the plain meaning of § 726(a)(1) that only pre-petition claims were ever intended by Congress to be included in the claims to receive interest.

Hembree was a case of first impression in the Sixth Circuit; prior to that decision, neither trustees nor administrative claimants in the Middle District of Tennessee were awarded interest under § 726(a)(5). However, prior to the 1994 amendment to § 726(a)(1), which added "payment of claims of a kind specified ... in section 507 [of title 11], proof of which is timely filed under section 501 or tardily filed before the date on which the trustee commences distribution" to § 726(a)(1), some courts had held that the general reference to § 507 in § 726(a)(1) allowed the payment of interest to administrative claimants. See e.g., Boldt v. Crake (In re Riverside-Linden Inv. Co.), 945 F.2d 320 (9th Cir. 1991): United States Trustee v. Fishback (In re Glados, Inc.), 83 F.3d 1360 (11th Cir. 1996). In re Reed is the only Circuit Court of Appeals to have addressed the issue since the 1994 amendment. It is well reasoned and should be followed in this district and circuit.

The 1994 amendment to § 726(a)(1) which requires a proof of claim filed under § 501 is consistent with the prior legislative history of § 726(a)(1) and clarifies that interest is to be paid only upon pre-petition priority and unsecured claims.[10] As evidenced by the well reasoned decision of In re Reed, that amendment erased any previous ambiguity in § 726(a)(1). 405 F.3d at 342-3.

Plain meaning interpretation of statutes is mandated except in the "rare cases [in which] the literal application of a statute will produce a result demonstrably at odds with the intent of its drafters." United States v. Ron Pair Enter., Inc., 489 U.S. 235, 242, 109 S.Ct. 1026, 1031, 103 L.Ed.2d 290 (1989) (quoting Griffin v. Oceanic Contractors, Inc., 458 U.S. 564, 571, 102 S.Ct. 3245, 2350, 73 L.Ed. 2d 973 (1982)); Palmer v. Internal Revenue Service (In re Palmer), 219 F.3d 580, 586-7 (6th Cir. 2000). The plain meaning of §§ 726(a)(1); 726(a)(5); 507; 501; and 101(10)(A) is that interest is to be paid only on pre-petition claims - not trustee compensation or other administrative expenses. In re Reed, 405 F.3d at 342. Further, the plain language of § 726(a)(1) must be applied unless it produces an absurd result.[11] See, e.g., Lamie v. United States Trustee, 124 S. Ct. 1023, 1030, 540 U.S. 526 (2004). There is nothing absurd about restricting the payment of interest to allowed pre-petition claims.

The analysis in In re Reed is supported by a Second Circuit decision holding the phrase "proof of which is filed under section 501" appearing in § 502(a) excludes post-petition administrative expense claims. Nostas Assocs. v. Costich (In re Klein Sleep Products, Inc.), 78 F.3d 18 (2d Cir. 1996). In Klein Sleep, the Second Circuit held that a damage claim for future rent arising from a trustee's rejection of an assumed lease was an administrative expense. Klein Sleep, 78 F.3d at 28. The court then ruled that § 502(b)(6)'s cap on future rent was inapplicable to administrative expense claims because § 502(a) applies only to claims "proof of which is filed under section 501[,]" and administrative expense claims are not such claims. Id. Because

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[10] Although the legislative history to the 1994 amendment to § 726(a)(1) explains that it was to conform to the amendments to 1129(a)(3) [which overruled In re New Valley Corp., 168 B.R. 73 (Bankr. D.N.J. 1994)] and 502(b) [which overruled In re Hausladen, 146 B.R. 557 (Bankr. D. Minn. 1992)], in fact it also eliminated any doubt of Congress's intent to limit the payment of interest to pre-petition creditors. See 1994 U.S. Code Cong. & Adm. News, p.3340.

[11] The standard to establish absurdity is extraordinarily high. Sturges v. Crowninshield, 17 U.S. (4 Wheat.) 122, 202-03 (1819) ("so monstrous, that all mankind would, without hesitation, unite in rejecting" it); Robbins v. Chronister, 435 F.3d 1238, 1241 (10th Cir. 2006) ("so gross as to shock the general moral or common sense") (internal quotations and citation omitted); Sigmon Coal Co. v. Apfel, 226 F.3d 291, 308 (4th Cir. 2000) (same), *aff'd* 534 U.S. 438 (2002).

§ 726(a)(1) uses the same phrase, it should be interpreted the same way. See, e.g., Ratzlaf v. United States, 510 U.S. 135, 143 (1994) (term appearing in several statutes should be read the same way).

The bankruptcy court below also relied upon Specker Motor Sales Co. v. Eisen, 393 F.3d 659 (6th Cir. 2004) in support of her award of interest to the Trustee and his lawfirm:

> Because interim compensation must be disgorged when necessary to achieve pro rata distribution of a chapter 7 bankruptcy estate where there are insufficient funds to pay administrative claims in full, it follows that interest should be paid where a surplus of funds is available.

Specker Motor, however, holds that the Bankruptcy Code requires the equitable treatment of all claimants with an equal level of priority.

> "Equality of distribution among creditors is a central policy of the Bankruptcy Code. According to that policy, creditors of equal priority should receive *pro rata* shares of the debtor's property." Begier v. Internal Revenue Service, 496 U.S. 53, 58, 110 S.Ct. 2258, 110 L.Ed.2d 46 (1990). Equality of distribution would be vitiated if one equally situated administrative claimant - Bays - received more than his *pro rata* share. . . . . But his position is no different from that of anyone who provides services or credit to a bankrupt firm. Indeed, as an administrative claimant, his position is better than most.

Specker Motor 393 F.3d at 664. Clearly, § 726(a)(1) does not disrupt the priority scheme of § 507. Specker Motor in no way supports the allowance of interest on administrative expenses.

The trustee argues for interest on his administrative claims because he and his law firm have waited until the end of the case to be paid and that surplus funds cases exist because of the successful administration of the estate. As shown by the facts in In re Hembree, 297 B.R. 515 (Bankr. M.D. Tenn. 2002), relied upon the Court and trustee, surplus funds may be created by third parties. The Hembree bankruptcy case was initially filed September 27, 1995. The bankruptcy estate included a cause of action pending in the state court at the time the bankruptcy petition was filed. The law suit was ultimately litigated and won post petition by special counsel, Merkel & Cocke, resulting in a payment of $300,000 to the trustee on behalf of the estate. Merkel & Cocke were awarded and paid fees on September 21, 2001. Although the Trustee argued he was entitled to interest on his trustee compensation of $16,000 from the date of the commencement of the case (even though it began as a chapter 13 case), the state court attorneys who had been involved pre-petition and for six years post-petition and who were responsible for the surplus in the case were not included in the

Trustee's request for payment of interest apparently because they were paid prior to the close of the case. That seems hardly fair or consistent with any reading of § 726(a).

In this case, the Trustee learned at the October 10, 2001 meeting of creditors of the estate's interest in real estate which the debtor had failed to list on his sworn schedule of assets. No action was taken on this information prior to the conversion of the bankruptcy case to a chapter 13 on June 20, 2003. On August 27, 2004, eighteen months after the case re-converted to a chapter 7, the Trustee finally filed a complaint to partition and sell the property interest revealed at the October 10, 2001 meeting. Meanwhile the Debtor received his chapter 7 discharge on August 27, 2004. The Trustee argued a denial of the discharge would have no benefit to creditors since they received 100 percent of their claims; however, the IRS did not return its distribution (which made the case a surplus case) until after March 2006 - 18 months after the discharge of the debtor was entered by the court..

For all of the reasons set forth above, it is clear from the plain meaning and legislative history of § 726(a)(1) and (5) that interest is not paid on administrative expenses.

2. The award of interest to a trustee cannot cause the trustee compensation to exceed the maximum limitation on trustee compensation in § 326.

The trustee's request for interest would cause his compensation in this case to exceed the statutory cap in § 326 by the amount of the interest - $ 1,231.06. Excluding administrative expenses from § 726(a)(5) maintains the integrity of the cap on trustee compensation contained in § 326. In re Motley, 150 B.R. 16, 19 (Bankr. E.D. Va. 1992). ["The unambiguous language of § 326(a) places a maximum limitation on compensation for trustees and does not allow for any exceptions. In re Orient River Investments, Ltd., 133 B.R. 729, 731 (Bankr. E.D. Pa. 1991)"]. As stated by the Supreme Court's mandate in United States v. Ron Pair Enter., Inc., 489 U.S. at 242, plain meaning interpretation of statutes is dictated except in the "rare cases [in which] the literal application of a statute will produce a result demonstrably at odds with the intent of its drafters. [citations omitted]."

Section 326 is a specific statute which should not be overridden by the more general provisions of § 726(a)(5). When construing a general enactment and, within the same statute, a more particular enactment, the more specific should be given effect. In re Gallenstein v. U.S., 975 F.2d. 286, 290 (6th Cir. 1992). Citing United States v. Chase, 135 U.S. 255, 260, 10 S.Ct. 756, 757, 34 L.Ed. 117 (1890) and Estate of Flanigan v. Commissioner, 743 F.2d 1526, 1532-33 (11th Cir.1984). Absent a clearly stated intent to affect the cap on trustee compensation under § 326, no such Congressional intent should be found by the Court to be contained within § 726(a)(5).

Moreover, § 326(a) already compensates the trustee for payment of interest to the creditors.

> Section 326(a) calculates a trustee's fee based on the distribution to creditors. Assets remaining in the estate after payment of all claims allow for the payment of interest on those claims under § 726(a)(5). If the trustee pays § 726(a)(5) interest on claims, ... the trustee earns a fee on the interest paid on the creditors' claims by virtue of the fee formula of § 326(a). Then allowing [trustee] Ames' claim for interest on the fees provided by 326(a) would amount to two bites of the apple and would result in a disincentive for trustees to distribute assets in a timely manner. Under [trustee] Ames['] reading of the Code and cases, a trustee could delay final distribution, as was done in this six-year-old case, allow the interest earned on assets converted to cash to accumulate in escrow, earn a fee on the distribution of those assets (which now include earned interest) in satisfaction of claims, and as a part of his compensation, petition for interest on his fee under § 726(a)(5). ... [T]he Code fairly provides for the trustee to benefit from a commission earned from the payment of interest on claims of creditors. [footnote omitted.]

Motley, 150 B.R. at 20. The vast majority of the trustees would not intentionally delay the closing of a case in order to generate additional income for themselves. However, the appearance of impropriety and the ability of trustees to take advantage of such an interpretation of the provision supports the argument that § 326(a) should not be overruled by § 726(a)(5).

No statutory or policy consideration supports the addition of interest to the trustee compensation such that it would exceed the limitation set forth in § 326. The appearance of impropriety of the Trustee benefitting from administrative delay; the risk that the award of interest to administrative claimants would significantly decrease the award of interest to unsecured creditors; and the "two bites of the apple" explained by Motley all support the denial of interest to the extent it would cause the trustee compensation to exceed the § 326 cap.

3. An award of interest on administrative expenses which accrues from the petition date is illogical.

The Fifth Circuit Court of Appeals in In re Reed should be followed in this circuit so that interest is not allowed to the trustee or his law firm. Moreover, the bankruptcy court's award of the chapter 7 trustee interest on his fees and the fees of his law firm from the date of the filing of the petition in this case renders an illogical result. The bankruptcy court's decision awards interest on the full amount of trustee compensation and law firm fees even before any services were provided and before any right to compensation existed. However, interest cannot accrue on fees for services which have not yet been performed and approved by the court. In re Riverside-Linden Inv. Co., 945 F.2d at 323-24; Glados, 83 F.3d. at 1365-6[12]. The Court in In re Glados pointed out the problems:

> For instance, if the attorney for the trustee is not employed until two years into the administration of the case it would, in effect, permit the attorney to earn interest on those fees when he did not perform any work. Equally, the trustee would be encouraged to delay the administration of the estate to allow the accrual of interest in a surplus [funds] case.

In re Glados, 83 F.3d at 1365, citing In re Brown, 190 B.R. 689, 691. See also, In re Keller, 198 B.R. 630, 632 (Bankr. M.D. Fla. 1996)("The trustee has no cognizable right to payment upon his appointment, other than his entitlement to a statutory allowance of $60."). To pay interest from the commencement of the case would be tantamount to finding that the Trustee had a right to $6,954.54 trustee compensation upon the filing of the Debtor's bankruptcy case. In the Glados case, the trustee would have received interest on his full compensation for one year and four months before the case converted from chapter 11to chapter 7. 83 F.3d. at 1361.

While the United States Trustee does not argue in this case that the delay in this case was intentionally caused by the Trustee, it is clear that the Trustee was in control of the time line for administration of the estate. The cooperation of the Debtor may ease the Trustee's job, but the Bankruptcy Code provides the Trustee with sufficient tools to efficiently and timely administer an estate.

In summary, administrative claimants should not receive interest under § 726(a)(5). An award of interest from the beginning of the case prior to rendition of any services is illogical and should be reversed.

CONCLUSION

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[12] As noted earlier, Glados and Riverside-Linden were decided before the 1994 amendment to § 726(a)(1) which added the reference to proof of claims filed under section 501.

Based on an analysis of the applicable provisions of the United States Code, the legislative history, the case law, and pertinent policy considerations, the decision of Judge Harrison should be reversed.

Respectfully Submitted

RICHARD F. CLIPPARD
UNITED STATES TRUSTEE, REGION 8

/s/ Beth Roberts Derrick, BPR 7138

Beth Roberts Derrick
Assistant U.S. Trustee
United States Department of Justice
701 Broadway, Suite 318
Nashville, TN 37203
Phone: 615-736-2254
Fax: 615-736-2260
Email: beth.r.derrick@usdoj.gov

CERTIFICATE OF SERVICE

I, Beth Roberts Derrick, certify that a true and correct copy of this brief was served September 10, 2007, via United States Mail, postage prepaid to:

SAMUEL K CROCKER
CROCKER & NIARHOS
611 COMMERCE ST, SUITE 2720
NASHVILLE, TN 37203

and also was served via email to Mr. Crocker.

/s/ Beth Roberts Derrick #7138

Beth Roberts Derrick

BRIEF BANK — “SUMMARY SHEET” *Printed Thu-7/23/09 10:2*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	In re Anne F. Edwards (Anne F. Edwards v. United States Trustee)
2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	M.D. Ga.
3. ("CCN") ***CURRENT*** CASE NO.	No.: 5:09-cv-0163-HL
4. ("PCN") ***PRIOR*** CASE NO. - & COURT *[IF ANY]*	No.: 08-53080 Court: Bankr. *(Identify judge & cite, if any)*
5. ("SO") ***SOURCE***	**U.S. TRUSTEES**
6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	Filed: July 17, 2009 Type: Brief of Appellee Donald F. Walton, United States Trustee, Region 21
7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** [E.g.,"UST/OGC"]	Robert G. Fenimore, Elizabeth Hardy, Amy Quandt, P. Matthew Sutko *(UST/OGC: 202-307-1399/FAX-2397)*
8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	• Did the bankruptcy court err in dismissing debtor’s case for cause under 11 U.S.C. § 707(a) due to the debtor’s refusal to attend her meeting of creditors, and her refusal to cooperate with the case trustee?
10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)	
11. DO YOU RECOMMEND POSTING IN UST BRIEFBANK?	| x | YES | | NO ***NAME:*** Linda Figueroa ***DATE:***

IN THE UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF GEORGIA
MACON DIVISION

IN RE: : CIVIL ACTION NO. 5:09-cv-00163-HL
:
ANNE F. EDWARDS, :
:
APPELLANT :
vs. :
:
UNITED STATES TRUSTEE, :
:
APPELLEE :

On Appeal from the United States Bankruptcy Court
for the Middle District of Georgia

BRIEF OF APPELLEE DONALD F. WALTON, UNITED STATES TRUSTEE, REGION 21

Of Counsel:

RAMONA D. ELLIOTT
General Counsel
P. MATTHEW SUTKO
Office of the General Counsel
Executive Office for United States Trustees
United States Department of Justice
20 Massachusetts, Ave. NW, Ste 8100
Washington, D.C. 20530
Tel: (202) 307-1399

ROBERT G. FENIMORE
Trial Attorney
Georgia Bar No. 205202
Office of the United States Trustee
440 MLK Jr. Blvd.
Suite 302
Macon, Georgia 31201
(478) 752-3545

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STATEMENT OF JURISDICTION

This appeal arises from a final order issued by the United States Bankruptcy Court for the Middle District of Georgia (Robert F. Hershner, Jr.) on February 3, 2009, dismissing chapter 7 debtor Anne F. Edwards' case pursuant to 11 U.S.C. § 707(a). This Court has jurisdiction over this appeal pursuant to 28 U.S.C. section 158(a).

STATEMENT OF ISSUE PRESENTED

Did the Bankruptcy Court err in dismissing Ms. Edwards' case for cause under 11 U.S.C. § 707(a)?

STANDARD OF APPELLATE REVIEW

Appellate courts review factual findings of the bankruptcy court for clear error, and they apply a de novo standard of review for conclusions of law. In re Chase & Sanborn Corp., 904 F.2d 588, 593 (11th Cir. 1990). See also Fed. R. Bankr. P. 8013 (standard of appellate review).

STATEMENT OF FACTS

On October 27, 2008, Ms. Edwards filed a petition for relief under chapter 7 of title 11 of the United States Code. [Bankr. Court Docket. No. 1 (Petition)]. Ms. Edwards filed her case pro se. [Bankr. Court Docket. No. 1 (Petition)]. The first meeting of creditors, pursuant to 11 U.S.C. § 341 ("341 Meeting"), was scheduled for December 3, 2008. [Bankr. Court Docket No. 4]. The 341Meeting was attended by Ms. Edwards, a representative of Ms. Edwards' largest creditor and a trial attorney for the United States Trustee.[1] [Bankr. Court Docket No. 22 (UST Motion to Dismiss, para. 2)]. Shortly after the 341 Meeting was commenced, however, Ms. Edwards requested that the meeting be continued, citing the need to obtain an attorney. Id. Pursuant to Ms. Edwards' request, the 341 Meeting was continued to December 22, 2008. [Bankr. Court Docket No. 17].

On December 19, 2008, Ms. Edwards filed a motion to continue the 341 Meeting scheduled for December 22, 2008. [Bankr. Court Docket No. 19]. She did not request a hearing on the motion, and the bankruptcy court did not enter an order granting a continuance. Id. Ms. Edwards did not appear for the 341 Meeting, which was called on December 22, 2008. [Bankr. Court Docket No. 22 (UST Motion to Dismiss, para. 2)]. Based on Ms. Edwards' failure to appear, the chapter 7 trustee continued the 341 meeting to January 14, 2009. [Bankr. Court Docket No. 20].

On January 7, 2009, Ms. Edwards filed a motion to continue the 341 meeting scheduled for January 14, 2009. [Bankr. Court Docket No. 21]. Like her previous

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[1] The representative of Ms. Edwards' largest creditor traveled approximately eighty-five miles, from Decatur to Macon, Georgia, to appear for the 341 meeting.

motion for a continuance, this motion did not request a hearing, and the bankruptcy court did not enter an order on the motion. Id. The chapter 7 trustee called the 341 Meeting on January 14, 2009, and Ms. Edwards did not appear. [Bankr. Court Docket No. 22 (UST Motion to Dismiss, para. 2)]. A representative of Ms. Edwards' largest creditor and a trial attorney for the United States Trustee were present at the 341 Meetings which were called on December 22, 2008 and January 14, 2009. Id.

On January 16, 2009, the United States Trustee filed a motion to dismiss Ms. Edwards' case pursuant to section 707(a) of the Bankruptcy Code. [Bankr. Court Docket No. 22]. In support of the motion to dismiss, the United States Trustee cited Ms. Edwards' repeated failure to appear at the continued 341 Meetings, as well as the fact that she did not provide the chapter 7 trustee with a copy of her most recent tax return, as required by 11 U.S.C. § 521(e)(2)(A). [Bankr. Court Docket No. 22 (UST Motion to Dismiss, paras. 2,6)]. The motion to dismiss also noted that Ms. Edwards had filed a previous bankruptcy case in the Middle District of Georgia on May 5, 2008, which was dismissed as a result of her failure to file documents in a timely manner. Id. at para. 4. A hearing on the motion to dismiss was scheduled for February 19, 2009. [Bankr. Court Docket No. 23].

Ms. Edwards did not file an objection to the motion to dismiss. Rather, on

February 12, 2009, she filed a document titled “Motion to Discharge,” which indicated that she did not intend to appear at the hearing scheduled for the motion to dismiss and requested that the court enter a discharge in her case. [Bankr. Court Docket No. 24]. The bankruptcy court scheduled a hearing to address Ms. Edwards’ request with the United States Trustee’s motion to dismiss on February 19, 2009. [Bankr. Court Docket Entry 2/17/09]. Ms. Edwards did not appear at the hearing on February 19, 2009, and the bankruptcy court entered an order granting the motion to dismiss based on the docket entries, written submissions and the proffer of the trial attorney for the United States Trustee, who was present at all of the scheduled 341 Meetings. [Bankr. Court Docket No. 25].

ARGUMENT

I. THE BANKRUPTCY RECORD SUPPORTS THE DECISION TO DISMISS MS. EDWARDS’ PETITION BASED ON HER FAILURE TO APPEAR AT THE 341 MEETING AND PRODUCE HER MOST RECENT TAX RETURN

The issue on appeal is whether the Bankruptcy Court erred by entering an order dismissing Ms. Edwards’ case for cause under 11 U.S.C. § 707(a). Pursuant to 11 U.S.C. § 707(a)(1), the court may dismiss a chapter 7 case for cause, including “unreasonable delay by the debtor that is prejudicial to creditors.” This provision “prevents [a] debtor from filing a petition to take advantage of the protection of the bankruptcy court and subsequently failing to appear or file necessary schedules, or otherwise failing to take any necessary steps for the proper administration of the estate." 6 Collier on Bankruptcy ¶ 707.03[1][a], p. 707-15 (rev. 15th ed. 2008).

Section 341(a) of the Bankruptcy Code requires that a meeting of creditors be convened within a reasonable time after a voluntary petition for relief is filed. 11 U.S.C. § 341(a); Peres v. Sherman, 530 F.3d 372, 377 (5th Cir. 2008). The meeting of creditors provides an opportunity for creditors and the bankruptcy trustee to examine the debtor. United States v. Manfredi, No. Civ. S. 06-416 FCD, 2008 WL 686859, *1 (E.D. Ca. March 11, 2008). According to section 343 of the Bankruptcy Code, "[t]he debtor *shall* appear and submit to examination under oath at the meeting of creditors under section 341(a) of this title" (emphasis added). The purpose of the 341 Meeting and the importance of the debtor's attendance are best explained as follows:

> the primary purpose of the § 341 meeting is the examination of the debtor. The § 341 meeting permits the creditors to rigorously question the debtor on issues relating to dischargeability, estate administration, and the debtor's financial affairs. The meeting also allows the trustee to query about possible recoveries under the avoiding powers. Thus, the debtor's presence at the § 341 meeting is not merely ceremonial, but instead plays a pivotal role in providing the creditors and the trustee with valuable information regarding the debtor's financial situation.

In re Cochener, 360 B.R. 542, 576 (S.D. Tex. 2007) (citing In re Moore, 309 B.R. 725, 726 (Bankr. N.D. Tex 2002).

With regard to the production of tax returns, section 521(e)(2)(A)(i) imposes the following obligation:

> the debtor shall provide not later than 7 days before the first date set for the first meeting of creditors, to the trustee a copy of the Federal income tax return required under applicable law . . . for the most recent tax year ending immediately before the commencement of the case and for which a Federal income tax return was filed.

Additionally, section 521(a)(3) of the Bankruptcy Code requires the debtor to "cooperate with the trustee as necessary to enable the trustee to perform the trustee's duties under this title." Bankruptcy courts routinely dismiss cases in which debtors fail to appear at 341 Meetings or neglect to file or produce documentation, such as tax returns. See In re Casey, 274 Fed. Appx. 205, 206-07 (3d Cir. 2008) (affirming district and bankruptcy court decisions dismissing case for failure to produce tax returns as required by 11 U.S.C. § 521(e)(2)(A)(I)); Simmons v. Cosby, 256 B.R. 578, 579 (D. Md. 2001) (stating that debtor's failure to appear for rescheduled 341 Meeting serves as independent ground for dismissal of case); In re Duarte, 277 B.R. 791, 791-92 (Bankr. S.D. Fla. 2002) (declining to reopen debtor's case which was dismissed for failure to appear at 341 meeting); In re Hall, 266 B.R. 659, 660 (Bankr. W.D. Ky. 2001) (dismissing case based on debtor's failure to attend 341 meeting and noting that "rescheduling the 341 meeting inconveniences creditors and creates administrative problems for the court"); cf.

Montgomery v. Ryan (In re Montgomery), 37 F.3d 413, 414-16 (8th Cir. 1994) (holding that, under 11 U.S.C. § 109(g)(1), debtor was not eligible to be a debtor because dismissal of previous case for failure to attend 341 Meeting constituted a "willful failure . . . to abide by the orders of the court . . ."); In re Russell, 392 B.R. 315, 358-359 (Bankr. E.D. Tenn. 2008) (explaining that production of documents and attendance at 341 Meeting are crucial to working of bankruptcy system).

In the instant matter, the bankruptcy court dismissed Ms. Edwards' case based on her failure to appear at the continued 341 Meetings and her neglect in providing the chapter 7 trustee with a copy of her most recent tax return. Ms. Edwards' conduct throughout the pendency of this case has reflected a desire to stall its progress, rather than comply with the minimum requirements to obtain a discharge. As set forth above, Ms. Edwards appeared for her first 341 Meeting but, shortly after it was commenced, requested that it be continued. The chapter 7 trustee accommodated Ms. Edwards and continued the 341 Meeting. Despite the fact that Ms. Edwards had requested the continuance, she did not even appear on the rescheduled date. Once again, the chapter 7 trustee continued the 341 Meeting and, again, Ms. Edwards failed to appear. The chapter 7 trustee afforded Ms. Edwards every opportunity to pursue the goal of bankruptcy relief, but Ms. Edwards simply refused to satisfy even the most basic requirements imposed on her. See Plagakis v.

Gleberg (In re Plagakis), No. 03-CV-0728(S.J.), 2004 WL 203090, *5 (E.D.N.Y. Jan. 27, 2004) (“in failing to appear at a meeting of creditors under 11 U.S.C. § 341(a), or to provide the Trustee with any of the documents required by [the local rule], Debtor failed to comply with the most minimal responsibilities of a person legitimately seeking bankruptcy protection”). Rather, as the bankruptcy record reflects, Ms. Edwards’ only participation in this case was limited to the filing of repeated letters with the court, requesting numerous continuances and adjournments.

Ms. Edwards’ refusal to appear at the continued 341 Meetings and her failure to provide a copy of her most recent tax return prohibited the chapter 7 trustee from fulfilling his statutory obligations in administering the estate. Specifically, the chapter 7 trustee did not have the opportunity to question Ms. Edwards regarding her assets and liabilities, the circumstances of her bankruptcy filing, and her income and disbursements. The administration of her estate was halted by Ms. Edwards’ repeated attempts to delay, and her creditors suffered a direct harm as a result.

Ms. Edwards’ conduct also directly impacted those parties that appeared at her 341 Meeting to question her in accordance with 11 U.S.C. § 343. As indicated above, representatives from Ms. Edwards’ largest creditor and the United States Trustee appeared on each of the dates scheduled for the 341 Meetings. Ms.

Edwards’ failure to appear for the continued meetings prohibited the creditor that was present from obtaining answers relating to its claim, and it frustrated the United States Trustee’s efforts to satisfy the statutory obligations imposed by 11 U.S.C. § 704(b)(1).

Ms. Edwards’ repeated refusal to appear for her 341 Meetings, her failure to produce a copy of her most recent tax return and her general attempts to delay the progress of her case created an unreasonable delay which was prejudicial to her creditors. The circumstances of this case are a classic example of those that 11 U.S.C. § 707(a) was drafted to address. For these reasons, the bankruptcy court’s decision to dismiss Ms. Edwards’ case, pursuant to 11 U.S.C. § 707(a), was supported by the relevant facts and the bankruptcy record.

II. MS. EDWARDS DOES NOT DISPUTE THE BASES UPON WHICH THE BANKRUPTCY COURT DISMISSED HER CASE

Neither the bankruptcy court record nor Ms. Edwards' brief before this Court states anything to indicate that Ms. Edwards disputes the bases upon which her case was dismissed. As set forth above, Ms. Edwards did not file an objection to the United States Trustee's motion to dismiss her bankruptcy case. Instead, she filed a document titled "Motion to Discharge," which requested that the court enter a discharge in her case. Similarly, Ms. Edwards' brief, filed in connection with this appeal, does not dispute the fact that she did not provide the chapter 7 trustee with a copy of her most recent tax return and she failed to appear for the continued 341 Meetings. Consequently, Ms. Edwards has not provided this Court with a basis upon which to reverse the bankruptcy court's decision to dismiss her case.

CONCLUSION

For the foregoing reasons, the order entered by the bankruptcy court dismissing Ms. Edwards' case pursuant to 11 U.S.C. § 707(a) should be affirmed.

Respectfully submitted this 17th day of July, 2009.

/s/Robert G. Fenimore
Robert G. Fenimore
Trial Attorney
GA Bar No. 205202

440 Martin Luther King Jr. Blvd.
Suite 302
Macon, Ga 31201-7910
(478) 752-3545

CERTIFICATE OF SERVICE

I hereby certify that I have served the foregoing Motion either through the Court's electronic filing system, or by placing true and correct copies with the United States Postal Service with adequate postage affixed to assure first class delivery and addressed to:

Anne Edwards
P.O. Box 27976
Macon, GA 31221

Done this 17th day of July, 2009.

/s/Robert G. Fenimore
Robert G. Fenimore
Trial Attorney
GA Bar No. 205202

440 Martin Luther King Jr. Blvd.
Suite 302
Macon, Ga 31201-7910
(478)752-3545

BRIEF BANK — 'SUMMARY SHEET"

Printed Wed-7/30/08 11:48

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*
Egebjerg v. Anderson, UST

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*
BAP 9th Cir.

3. ("CCN") ***CURRENT*** CASE NO.
No.: 08-55301

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*
No.: 06-28079
Court: Bankr. C.D. Cal.
(Identify judge & cite, if any)

5. ("SO") ***SOURCE***
U.S. TRUSTEES

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*
Filed: 07/03/08
Type: Brief of the Appellee

7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*
Ramona Elliott, P. Matthew Sutko, Gregory Katsas, William Kanter, Kelsi Corkson
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***

• Whether the Bankruptcy Court Dismissal of the Debtor's Chapter 7 petition maybe affirmed on the ground that evidence of the debtor's income and debts demonstrates that his disposable income gives rise to a presumption of abuse under 11 USC 707(b)(2)

Whether the Bankruptcy Court properly exercised its discretion in dismissing the debtor's chapter 7 petition pursuant to 11 USC 707(b)(3)(B) which allows courts to dismiss chapter 7 petitions when the totality of the circumstances of a debtor's financial situation demonstrates abuse

10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)

11. DO YOU RECOMMEND POSTING IN UST BRIEFBANK?
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NAME: Holly Walter
DATE:

No. 08-55301

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

SCOTT LEE EGEBJERG,

Debtor-Appellant,

v.

PETER C. ANDERSON, United States Trustee,

Trustee-Appellee.

On Appeal from the United States Bankruptcy Court
for the Central District of California
B.K. No. SV-06-28079-GM

BRIEF FOR THE APPELLEE

OF COUNSEL:

RAMONA D. ELLIOTT
General Counsel

P. MATTHEW SUTKO
Associate General Counsel
Executive Office for the United States Trustee
Department of Justice
20 Massachusetts Avenue, N.W.

GREGORY G. KATSAS
Acting Assistant Attorney General

WILLIAM KANTER
(202) 514-4576
KELSI BROWN CORKRAN
(202) 514-3159
Attorneys, Appellate Staff
Civil Division, Room 7216
Department of Justice
950 Pennsylvania Avenue, N.W.

Washington, D.C. 20530 Washington, D.C. 20530

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IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

No. 08-55301

SCOTT LEE EGEBJERG,

Debtor-Appellant,

v.

PETER C. ANDERSON, United States Trustee,

Trustee-Appellee.

On Appeal from the United States Bankruptcy Court
for the Central District of California
B.K. No. SV-06-28079-GM

BRIEF FOR THE APPELLEE

STATEMENT OF JURISDICTION

Debtor-appellant Scott Lee Egebjerg filed a voluntary petition under chapter 7 of the Bankruptcy Code, 11 U.S.C. § 701 et seq., in the United States Bankruptcy Court for the Central District of California, which had jurisdiction over the petition pursuant to 28 U.S.C. §§ 151, 157, and 1334(a). On August 24, 2007, the bankruptcy court dismissed the Debtor's petition as an abuse of chapter 7 under 11

U.S.C. § 707(b)(3). The Debtor filed a timely notice of appeal on September 3, 2007. At the request of the Debtor, the bankruptcy court entered an order certifying its decision for direct appeal to this Court pursuant to 28 U.S.C. § 158(d)(2). The Debtor then filed in this Court a petition for permission to appeal. See Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA" or "2005 Act"), Pub. L. No. 109-8, § 1233(b), 119 Stat. 23 (2005) (providing that a prospective appellant under 28 U.S.C. § 158(d)(2)(A) must petition the court of appeals for permission to appeal pursuant to Fed. R. App. P. 5). This Court granted the Debtor's petition for permission to appeal on December 19, 2007, and has jurisdiction over the appeal under 28 U.S.C. § 158(d)(2).

STATEMENT OF THE ISSUES PRESENTED FOR REVIEW

(1) Whether the bankruptcy court's dismissal of the Debtor's chapter 7 petition may be affirmed on the ground that evidence of the Debtor's income and debts demonstrates that his disposable income gives rise to a presumption of abuse under 11 U.S.C. § 707(b)(2).

(2) Whether the bankruptcy court properly exercised its discretion in dismissing the Debtor's chapter 7 petition pursuant to 11 U.S.C. § 707(b)(3)(B), which allows courts to dismiss chapter 7 petitions when the totality of the circumstances of a debtor's financial situation demonstrates abuse.

STATEMENT OF THE CASE

On December 31, 2006, the Debtor filed a voluntary bankruptcy petition under chapter 7 of the Bankruptcy Code, 11 U.S.C. § 701 et seq. On June 26, 2007, the U.S. Trustee[1] filed a motion to dismiss the Debtor's petition on two independent grounds: (1) the Debtor's monthly disposable income, when properly calculated, was sufficient to create a presumption of abuse under 11 U.S.C. § 707(b)(2); and (2) the totality of the Debtor's financial circumstances demonstrated abuse under 11 U.S.C. § 707(b)(3) because the Debtor had sufficient means to repay a meaningful portion of his debts. Granting the motion to dismiss, the bankruptcy court rejected the U.S. Trustee's first argument regarding section 707(b)(2), but found abuse under section 707(b)(3).

The Debtor filed a notice of appeal and requested that the bankruptcy court enter an order certifying its decision for direct appeal to this Court pursuant to 28 U.S.C. § 158(d)(2). The bankruptcy court entered the certification order and this Court subsequently granted the Debtor permission to bring the direct appeal.

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[1] The United States Trustees "serve as bankruptcy watch-dogs to prevent fraud, dishonesty, and overreaching in the bankruptcy arena." H.R. Rep. No. 95-595, at 88 (1977). The United States Trustee Program thus acts in the public interest to promote the efficiency, and to protect and preserve the integrity, of the bankruptcy system. To this end, Congress has provided that "[t]he United States trustee may raise and may appear and be heard on any issue in any case or proceeding." 11 U.S.C. § 307. See In re Donovan Corp., 215 F.3d 929, 930 (9th Cir. 2000).

STATEMENT OF THE FACTS

I. Statutory Background

The Bankruptcy Code establishes two basic forms of bankruptcy for individual debtors. Under chapter 7, "an individual debtor receives an immediate unconditional discharge of personal liability for certain debts in exchange for relinquishing his or her nonexempt assets to a bankruptcy trustee for liquidation and distribution to creditors." H.R. Rep. 109-31(I), at 10; see 11 U.S.C. §§ 701–727. By contrast, under chapter 13, "a debtor commits to repay some portion of his or her financial obligations" over a specified period "in exchange for retaining nonexempt assets and receiving a broader discharge of debt than is available under chapter 7." H.R. Rep. 109-31(I), at 10; see 11 U.S.C. §§ 1321–1330. Under the Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549, a debtor could freely choose whether to file for bankruptcy under chapter 7 or chapter 13. See H.R. Rep. 109-31(I), at 11.

In 1984, Congress amended chapter 7 to permit dismissal of a bankruptcy petition filed under that chapter if a court found "substantial abuse." Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, § 312, 98 Stat. 333, 335, codified as amended at 11 U.S.C. § 707(b)(1) (1988). Congress enacted this amendment to respond "to concerns that some debtors who could easily pay their creditors might resort to chapter 7 to avoid their obligations." H.R. Rep. 109-31(I), at 12 (internal quotation omitted). Two years later, Congress again amended this provision to authorize the U.S. Trustee to seek dismissal of chapter 7 petitions for "substantial abuse." Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1986, Pub. L. No. 99-554, § 21, 100 Stat. 3088, 3101; codified at 11 U.S.C. § 707(b)(1) (1988).

After twenty-years' experience, Congress found that these amendments were insufficient to control abuse of the chapter 7 bankruptcy process. Congress identified, among other problems, the "inherent[] vague[ness]" of the "substantial abuse" standard, which led to disagreement in the courts about whether a debtor's ability to repay a significant portion of his or her debts out of future income constitutes substantial abuse, meriting dismissal. H.R. Rep. 109-31(I), at 12. Another problem was that the Bankruptcy Code established "a presumption in favor of granting the relief requested by the debtor," which influenced courts' decisions whether to find substantial abuse. 11 U.S.C. § 707(b) (2000 suppl. 4); see H.R. Rep. 109-31(I), at 12.

Responding to these perceived shortcomings of the Bankruptcy Code, Congress held hearings over five years to determine what measures it could adopt "to ensure that debtors repay creditors the maximum they can afford." H.R. Rep.

109-31(I), at 2; see id. at 12. As a result of those hearings, Congress determined that it should adopt “needs-based reforms,” which would limit the availability of chapter 7 relief to those who Congress believed could not afford to repay a portion of their debts out of future income. Id. at 12.

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (“BAPCPA” or “2005 Act”) implemented these need-based reforms. To address the vagueness of the “substantial abuse” standard, the Act authorizes the bankruptcy court to dismiss a petition filed under chapter 7 or, with the debtor’s consent, to convert such a petition to a case under chapters 11 or 13 “if it finds that the granting of relief would be an abuse of the provisions of this chapter.” 11 U.S.C. § 707(b)(1). The 2005 Act then provides specific criteria which, if satisfied, require a court to presume the existence of abuse, requiring “dismissal [or conversion to chapter 13] based on a chapter 7 debtor’s ability to repay.” H.R. Rep. 109-31(I), at 15.

First, a court is to compare the debtor’s annualized “current monthly income” to the “median family income” of a similarly sized family in the debtor’s state. If the debtor’s current monthly income is below the median, then the presumption of abuse does not arise. 11 U.S.C. § 707(b)(7); see H.R. Rep. 109-31(I), at 15. Where the debtor’s current monthly income exceeds the median family income, a means test is used to calculate the debtor's monthly disposable income. If the debtor's monthly disposable income is less than $100 per month (or $6,000 over 60 months), the presumption of abuse does not arise. If the debtor's monthly disposable income is equal to or exceeds $166.67 per month (or $10,000 over 60 months), the presumption of abuse arises. If the above median income debtor's monthly disposable income is between $100 and $166.67 per month, the presumption of abuse arises if that amount, over 60 months, is sufficient to pay at least 25% of the debtor's nonpriority unsecured debt. 11 U.S.C. § 707(b)(2)(A)(i).

The amount of the debtor's monthly disposable income is determined by following a formula, set forth in 11 U.S.C. § 707(b)(2), which subtracts certain necessary expenses from the debtor's current monthly income, such as the cost of food, clothing, housing, utilities and health care. See id. § 707(b)(2)(A)(ii). In addition, the debtor may deduct "monthly payments on account of secured debts," averaged over the 60 months following the date of the petition. Id. § 707(b)(2)(A)(iii).

The presumption of abuse under section 707(b)(2) can be rebutted if the debtor establishes "special circumstances, such as a serious medical condition or a call or order to active duty in the Armed Forces" and demonstrates that necessary expenses associated with those special circumstances reduce the debtor's current monthly income below the specified benchmarks. Id. § 707(b)(2)(B).

Even if the presumption of abuse does not arise or is rebutted under section 707(b)(2), a chapter 7 petition may be dismissed for abuse under section 707(b)(3), which requires the bankruptcy court to consider whether "the totality of the circumstances . . . of the debtor's financial situation demonstrates abuse."[2] Id. § 707(b)(3)(B).

Congress enacted enforcement provisions to ensure that these reforms would be implemented. Under the 2005 Act, the U.S. Trustee (or the bankruptcy administrator) reviews a chapter 7 debtor's petition and files with the court a statement explaining whether the presumption of abuse arises under section 707(b). Id. § 704(b)(1). If the U.S. Trustee determines that the presumption of abuse arises, he then files either a motion to dismiss or convert the chapter 7 petition, or a statement explaining why he believes such a motion is not appropriate. Id. § 704(b)(2).

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[2] Section 707(b)(3) also requires the court to consider "whether the debtor filed the petition in bad faith." 11 U.S.C. § 707(b)(3)(A).

II. Factual and Procedural Background

On December 31, 2006, the Debtor filed a voluntary chapter 7 bankruptcy petition with the United States Bankruptcy Court for the Central District of California. Appellant's Excerpts of the Record ("E.R.") 1. In conjunction with the petition, he filed a Statement of Current Monthly Income and Means Test Calculation with the court that listed his monthly disposable income under section 707(b)(2) as $-244.99. Id. at 45-50.

The U.S. Trustee subsequently filed a motion to dismiss the Debtor's petition as an abuse of chapter 7 on two independent grounds. Id. at 132-47. First, the U.S. Trustee argued that the Debtor's monthly disposable income, when properly calculated, was sufficient to create a presumption of abuse under 11 U.S.C. § 707(b)(2). Id. at 137-44. The U.S. Trustee explained that although the Debtor listed his monthly disposable income as $-244.99, his calculations improperly included a deduction of $733.90 for payments the Debtor was making to repay a loan the Debtor had taken on his 401(k) savings account. Id. at 135. This deduction was improper, the U.S. Trustee explained, because section 707(b)(2) only allows a deduction for loan payments on account of "secured debts," calculated with reference to amounts due to "secured" creditors. 11 U.S.C. § 707(b)(2)(A)(iii). The overwhelming majority of courts to consider the issue have held that retirement loans are not "debt" under the Bankruptcy Code because the retirement plans have no right of recourse against the debtor. E.R. 138-42. Once the 401(k) loan payments are removed from the Debtor's list of deductible expenses, his monthly disposable income is $489.91 and a presumption of abuse arises under section 707(b)(2). Id. at 137-38.

The U.S. Trustee also explained that even if the presumption of abuse did not arise in this case under section 707(b)(2), the totality of the Debtor's financial circumstances demonstrates abuse under 11 U.S.C. § 707(b)(3) because the Debtor has sufficient means to repay a meaningful portion of his debts. Id. at 144-46. Adjusting the Debtor's Means Test to reflect only necessary expenses demonstrates that the Debtor has over $489.00 in excess monthly income that would allow him to repay 85% of his unsecured debt over 60 months of a chapter 13 plan. Id. at 146. Moreover, even if the Debtor were to repay his 401(k) loan in full, his loan repayment schedule relieves him of payment beginning in October 2008. Accordingly, he would still have over $489.00 in excess monthly income for 47 of the 60 months of a chapter 13 plan, allowing him to repay approximately 67% of his unsecured debts during that period. Id. at 144-46.

The bankruptcy court granted the U.S. Trustee's motion to dismiss the Debtor's petition as an abuse of chapter 7. Id. at 328. The court concluded that the

Debtor could properly list his 401(k) loan as secured debt and thus had no disposable income for the purposes of section 707(b)(2), but agreed with the U.S. Trustee that chapter 7 relief would be an abuse under section 707(b)(3)'s totality of the circumstances inquiry. Id. at 325-26. The court noted that other than the 401(k) loan, the Debtor's only secured debts were on a car and a timeshare, and that the Debtor is single, has no alimony or child support obligations, and has been employed by the same company for 27 years. Id. at 326. The court also explained that because the Debtor's 401(k) repayment was scheduled to end in September 2008, the Debtor could propose a chapter 13 plan with minimum payments until that time, at which point he would be able to pay significantly more toward his unsecured debts. Accordingly, the court held, the totality of the Debtor's financial circumstances demonstrated that chapter 7 relief would be an abuse under section 707(b)(3). Id. at 326.

The Debtor filed a notice of appeal and requested that the bankruptcy court enter an order certifying its decision for direct appeal to this Court pursuant to 28 U.S.C. § 158(d)(2). The bankruptcy court entered the certification order and this Court subsequently granted the Debtor permission to bring the direct appeal.

SUMMARY OF ARGUMENT

The bankruptcy court's dismissal of the Debtor's chapter 7 petition should be affirmed on either of two independent grounds. First, it may be affirmed the ground that his disposable income, when properly calculated, gives rise to a presumption of abuse under section 707(b)(2). Although the Debtor listed his monthly disposable income as below zero, his calculations improperly included a large deduction for payments he was making to his employer in order to repay a loan he took from his 401(k) savings account. As an overwhelming majority of courts have held, such a deduction is improper because a debtor's obligation to repay a loan from his retirement account is neither a "secured debt" nor a "necessary expense" within the meaning of the Bankruptcy Code. Furthermore, the Debtor cannot claim his 401(k) loan as a "special circumstance" sufficient to rebut the presumption of abuse because he failed to comply with the procedural requirements set forth in section 707(b)(2)(B), and because retirement plan loans do not fall within the category of special circumstances contemplated by that section.

The bankruptcy court's dismissal of the Debtor's chapter 7 petition may also be affirmed on the ground that the bankruptcy court did not abuse its discretion in finding abuse under section 707(b)(3)'s "totality of the circumstances" inquiry.

The bankruptcy court properly concluded that because the totality of the Debtor's financial situation demonstrates that he has the ability repay a meaningful portion of his debt, granting relief in this case would be an abuse of chapter 7. The Debtor's various challenges to this determination reflect a misunderstanding of the relevant statutory provisions and are contrary to the vast majority of case law addressing the scope of the "totality of the circumstances" inquiry under section 707(b)(3).

STANDARD OF REVIEW

This Court reviews the bankruptcy court's legal conclusions de novo, including its construction of the Bankruptcy Code. In re Fowler, 394 F.3d 1208, 1212 (9th Cir. 2005). In determining whether providing chapter 7 relief to a debtor would constitute abuse under 11 U.S.C. § 707(b)(3), bankruptcy courts apply a "totality of the circumstances" test to the debtor's financial situation. See 11 U.S.C. § 707(b)(3)(B). The "totality of the circumstances" test is a "fact-intensive determination" which is reviewed on appeal for abuse of discretion. Hebbring v. U.S. Trustee, 463 F.3d 902, 907-08 (9th Cir. 2006).

ARGUMENT

I. Dismissal of the Debtor's Petition May Be Affirmed on the Ground that the Debtor's Disposable Income Gives Rise to a Presumption of Abuse under Section 707(b)(2)

Although the bankruptcy court correctly determined that the Debtor's financial situation demonstrated abuse under 11 U.S.C. § 707(b)(3) and dismissed his petition on that ground, the U.S. Trustee also argued before the bankruptcy court that the Debtor had sufficient disposable income to give rise to a presumption of abuse under 11 U.S.C. § 707(b)(2). Because the amount of disposable income under section 707(b)(2) is a threshold determination that occurs prior to any assessment of the Debtor's financial situation under section 707(b)(3), the U.S. Trustee urges this Court to rely on section 707(b)(2) in affirming dismissal of the Debtor's petition. See Massachusetts Mut. Life Ins. Co. v. Ludwig, 426 U.S. 479, 480-81 (1976) (per curiam) (reciting "the inveterate and certain rule . . . that the appellee may, without taking a cross-appeal, urge in support of a decree any matter appearing in the record, although his argument may involve an attack upon the reasoning of the lower court or an insistence upon matter overlooked or ignored by it" (internal quotation omitted)).

Dismissal of the Debtor's petition under section 707(b)(2) is proper in this case because his monthly disposable income, when properly calculated, is sufficient to create a presumption of abuse under section 707(b)(2). Although the Debtor listed his monthly disposable income as $-244.99, his calculations improperly included a deduction of $733.90 for payments he was making to his employer in order to repay a loan he had taken on his 401(k) savings account. An "overwhelming majority" of courts have held that such deductions are improper under section 707(b)(2), McVay v. Otero, 371 B.R. 190, 195 (W.D. Tex. 2007), for the reasons explained below.

A. An Obligation to Repay a 401(k) Loan is Not a "Debt" within the Plain Meaning of the Bankruptcy Code

Section 707(b)(2) only allows a deduction for loan payments made on account of "secured debts." 11 U.S.C. § 707(b)(2)(A)(iii). As defined by the Bankruptcy Code, the term "debt" means "liability on a claim." Id. § 101(12). In turn, the Bankruptcy Code defines the term "claim" broadly, to mean

> (A) right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured; or
>
> (B) right to an equitable remedy for breach of performance if such breach gives rise to a right to payment, whether or not such right to an equitable remedy is reduced to judgment, fixed, contingent, matured, unmatured, disputed, undisputed, secured, or unsecured.

Id. § 101(5). The definitions of "claim" and "debt" are "coextensive." Pennsylvania Dept. of Public Welfare v. Davenport, 495 U.S. 552, 558 (1990); Johnson v. Home State Bank, 501 U.S. 78, 84-85 n.5 (1991); S. Rep. No. 989, 95th Cong. 2d Sess. 23 (1978) reprinted in 1978 U.S. Code Cong. & Admin. News, pp. 5787, 5809 ("The terms 'debt' and 'claim' are coextensive: a creditor has a 'claim' against the debtor; the debtor owes a 'debt' to the creditor").

Courts have consistently ruled that a debtor's obligation to repay a loan from his or her retirement account is not a "debt" under the Bankruptcy Code. See In re Esquivel, 239 B.R. 146, 152 (Bankr. E.D. Mich. 1999) ("There is a clear consensus that an individual's pre-petition borrowing from his retirement account does not give rise to a secured or unsecured 'claim,' or a 'debt' under the Bankruptcy Code."); see also Eisen v. Thompson, 370 B.R. 762, 769 (N.D. Ohio 2007) (explaining that the "majority view . . . developed over the past 25 years" is that retirement plan loans are not secured debts under the Bankruptcy Code); McVay v. Otero, 371 B.R. 190, 195 (W.D. Tex. 2007) (observing that the "overwhelming majority of courts that have addressed this issue" have held that retirement plan loans are not secured debts under the Bankruptcy Code). Indeed, in holding otherwise, the bankruptcy court in this case relied on a decision that has since been reversed. E.R. 325 (citing In re Thompson, 350 B.R. 770 (Bankr. N.D. Ohio 2006), rev'd, 370 B.R. 769 (N.D. Ohio 2007)).

This clear consensus is based, in part, on the fact that employer retirement plans generally lack the power to commence collection actions against the debtor, and hence have no enforceable "right to payment" against the debtor, as required by 11 U.S.C. § 101(5). The earliest and most frequently cited case on this point is In re Villarie, 648 F.2d 810 (2d Cir. 1981), a Second Circuit case in which the debtor borrowed money from his account with the state retirement system and listed the retirement system as a "secured creditor." After the debtor filed for bankruptcy, the retirement system sought declaratory relief that the loan was not a "debt" within the meaning of the Bankruptcy Code. The Second Circuit analogized the transaction to "an annuitant's withdrawal from the savings account of his annuity fund" or "an insured's advance from the reserve fund of his insurance policy," and held that it did not create a debtor-creditor relationship that gave rise to a claim under the Bankruptcy Code because the retirement system had no right to sue the debtor if he failed to repay the loan. Id. at 812.

The Sixth Circuit adopted this same reasoning in Mullen v. United States, 696 F.2d 470 (6th Cir. 1983). In Mullen, the debtor had received a "readjustment allowance" from his employer, the U.S. Air Force, pursuant to 10 U.S.C. § 687, when he was released following a force reduction. The statute provided, inter alia, that if the debtor returned to the military, he would not receive any retirement pay until he repaid 75% of the readjustment allowance. The debtor later returned to the military and retired after completing the necessary term of service, but without repaying the readjustment balance. Shortly after he left military service, the debtor filed a chapter 7 bankruptcy petition, and then filed a motion to hold the U.S. Air Force in contempt for violating the automatic stay[3] against collection efforts by continuing to withhold his retirement benefits. The Sixth Circuit rejected the debtor's argument, relying on both Villarie and the legislative history of 11 U.S.C. § 101, which notes that

> [the] definition of "debt" and the definition of "claim" on which it is based, proposed 11 U.S.C. § 101(4), will not include a transaction such as a policy loan on an insurance policy. Under that kind of transaction, the debtor is not liable to the insurance company for repayment; the amount owed is merely available to the company for setoff against any benefits that become payable under the policy. As such, the loan will not be a claim (it is not a right to payment) that the company can assert against the estate; nor will the debtor's obligation be a debt (a liability on a claim) that will be discharged under proposed 11 U.S.C. § 523 or 524.

Mullen, 696 F.2d at 472 (quoting H.R. No. 595, 95th Cong., 2d Sess. 310, reprinted in 1978 U.S. Code Cong. & Ad. News 5787, 6267).

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[3] The "automatic stay," codified in 11 U.S.C. § 362, automatically and broadly enjoins any creditor collection actions upon a debtor's bankruptcy filing.

Like the Air Force in Mullen, a debtor's retirement plan administrator has no right to recover any unpaid portion of the 401(k) loan from any source other than the debtor's vested retirement account balance, which is akin to the "prepaid retirement benefit" at issue in that case. As one district court explained,

> Retirement plan loans are qualitatively different than secured debts such as home mortgages and car loans. The retirement plan administrator does not loan the plan participant the administrator's money. It simply deducts the requested loan amount from the participant's own account, and credits the loan payments and interest back to the participant's account. If the participant defaults on the loan, the plan administrator deducts the amount owed from the vested account balance, and repays the loan with this deduction. The participant must treat this deduction as a distribution which is taxable as income to the participant in the default year. The participant may also be subject to an early withdrawal penalty. But, the plan administrator has no right to payment under the Bankruptcy Code.

Thompson, 370 B.R. at 768 n.10.

Numerous district courts and bankruptcy courts have adopted this reasoning and concluded that retirement loan repayments are not debts within the meaning of the Bankruptcy Code. See, e.g., In re Cohen, 246 B.R. 658, 667 (Bankr. D. Colo. 2000) (explaining that a retirement loan is in essence a debt to oneself); In re Fulton, 211 B.R. 247, 264 (Bankr. S.D. Ohio 1997); Esquivel, 239 B.R. at 149-52; In re Scott, 142 B.R. 126, 127-31 (Bankr. E.D. Va. 1992); In re Jones, 138 B.R. 536, 537-38 (Bankr. S.D. Ohio 1991).

Because a debtor's obligation to repay his retirement loan does not constitute a "claim" or a "debt" under the Bankruptcy Code, the vast majority of courts to consider the issue post-BAPCPA have held that debtors may not include payments on such loans as a deduction on their means test under section 707(b)(2).[4] See, e.g., In re Smith, — B.R. —, 2008 WL 2485424, at *1 (Bankr. C.D. Ill. June 20, 2008); In re Watkins, 2008 WL 2475749, at *6 (Bankr. D. Ariz. June 18, 2008); In

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[4] Although most courts have not found it necessary to reach this issue, a 401(k) loan is also not "secured" within the meaning of the Bankruptcy Code. See Thompson, 370 B.R. at 770. 11 U.S.C. § 506(a) applies to all chapter 7 bankruptcy cases, see 11 U.S.C. § 103(a), and provides a general framework for assessing whether and to what extent a creditor's claim is secured for bankruptcy purposes, see, e.g., In re Miller, 907 F.2d 80, 82 (8th Cir. 1990). Section 506(a)(1) provides, in relevant part, that "[a]n allowed claim of a creditor secured by a lien on property in which the estate has an interest , or that is subject to setoff under section 553 of this title, is a secured claim to the extent that the value of such creditor's interest in such property." 11 U.S.C. § 506(a)(1). In other words, a secured claim under the Bankruptcy Code refers to a claim secured by a lien on property in which the debtor's *bankruptcy estate* owns an interest. See In re Foremost Mfg. Co., 137 F.3d 919, 924 (6th Cir. 1998). A debtor's interest in his 401(k) retirement plan is not property of the debtors' bankruptcy estate because section 541 defines what property is included and excluded from a debtor's bankruptcy estate under section 541(c)(2), and "any interest in a plan or trust that contains a transfer restriction enforceable under any relevant nonbankruptcy law" is excluded from property of the estate. Patterson v. Shumate, 504 U.S. 753, 758-60 (1992). Moreover, section 541(b)(7) broadly excludes from "property of the estate" "any amount (A) withheld by an employer from the wages of employees for payment as contributions (i) to – (I) an employee benefit plan that is subject to . . . [ERISA] . . ." or "(B) received by an employer from employees for payment as contributions (i) to . . . an employee benefit plan that is subject to [ERISA] . . . ." 11 U.S.C. § 541(b)(7). Under this section, any of the Debtor's contributions to his 401(k) account are not property of the debtors' bankruptcy estate. See Fulton, 211 B.R. at 263-64.

re Mowris, 384 B.R. 235, 237-38 (Bankr. W.D. Mo. 2008); Otero, 371 B.R. at 195-97; Thompson, 370 B.R. at 768-72; In re Masur, 2007 WL 3231725, at *4-5 (Bankr. D. S.D. Oct. 30, 2007); In re Mordis, 2007 WL 2962903, at *4 (Bankr. E.D. Mo. Oct. 9, 2007); In re Turner, 376 B.R. 370, 376 (Bankr. D. N.H. 2007). These decisions rely both on the plain language of the Bankruptcy Code and on two basic canons of statutory construction.

The first canon requires courts to "presume that Congress is aware and understands past judicial interpretation and practice when it amends the Code." Mordis, 2007 WL 2962903, at *3 (citing Dewsnup v. Timm, 502 U.S. 773, 779 (1992)). Because the overwhelming majority of pre-BAPCPA opinions held that retirement plan loans were not "debt" under the Code, courts "must assume that Congress was aware of this judicial interpretation when it enacted BAPCPA and intended to preserve it." Id. at *4; see also Thompson, 370 B.R. at 771 ("Because overwhelming case law preceding the 2005 Act held that 401(k) loans were not 'debts' under the Code, and because Congress has not expressly said otherwise, the Court must presume that 'debt' retains its pre-2005 Act meaning."); Mowris, 384 B.R. at 238; Otero, 371 B.R. at 202-03.[5]

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[5] Indeed, Congress explicitly preserved that interpretation when it added section 362(b)(19), which provides that the automatic stay does not apply to automatic deductions from a debtor's wages to repay a retirement plan loan, but expressly states

The second relevant canon requires courts to presume that "when Congress includes particular language in one section of statute but omits it in another section of the same Act, . . . Congress acted intentionally in that exclusion." Mordis, 2007 WL 2962903, at *4 (citing KP Permanent Make-Up, Inc. v. Lasting Impression I, Inc., 543 U.S. 111, 118 (2004)). In enacting the 2005 Act, Congress expressly gave chapter 13 debtors the ability to deduct 401(k) loan payments from their disposable income calculation, see 11 U.S.C. § 1322(f), but did not include any similar exemption for chapter 7 debtors. As one court observed, "[i]n light of the amendments sprinkled throughout the Code [addressing 401(k) loans] — especially section 1322(f) — the lack of a 401k provision in section 707 is a glaring indication that Congress did not intend 401k loan repayments to be deducted in Chapter 7." Turner, 376 B.R. at 376; see also Masur, 2007 WL 3231725, at *5 ("Obviously, Congress knew well how to craft direct language requiring courts to treat 401(k) loans as secured debts for purposes of the means test, [but declined to do so.]"). Congress's decision to treat 401(k) loan payments differently under chapter 13 than chapter 7 is consistent with two of the 2005 Act's

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that "nothing in this paragraph may be construed to provide that any loan made under . . . a contract or account under section 403(b), of the Internal Revenue Code of 1986 constitutes a claim or debt under this title." 11 U.S.C. § 362(b)(19); see also Mowris, 384 B.R. at 238.

primary goals: protecting an individual's retirement savings while also "redirect[ing] chapter 7 petitioners into chapter 13 proceedings in order to 'ensure that those who can afford to repay some portion of their unsecured debts [be] required to do so.'" Otero, 371 B.R. at 201 (quoting 151 Cong. Rec. S2470 (daily ed. Mar. 10, 2005)); see also Thompson, 370 B.R. at 771 ("Such an approach serves both the Congressional intent to protect retirement contributions and to ensure that debtors repay creditors an amount they can afford, a primary goal of the 2005 Act.").

B. The Debtor's 401(k) Loan Repayment is Not a "Necessary Expense" under Section 707(b)(2)(A)(ii)

Because the Debtor also argued below that his 401(k) loan repayment qualifies as a deductible necessary expense under section 707(b)(2)(A)(ii), a brief explanation of the scope of "other necessary expenses" under chapter 7 is warranted. For the purposes the means test, debtors may deduct their "actual monthly expenses for the categories specified as Other Necessary Expenses issued by the Internal Revenue Service." 11 U.S.C. § 707(b)(2)(A)(ii)(I). Section 5.15.1.10 of the IRS's Internal Revenue Manual identifies fifteen categories of "Other Expenses" allowed if they meet the "necessary expense test" because they provide for the taxpayer's health and welfare or for the production of income.[6] None of these categories include 401(k) loan repayments. The Debtor asserted, however, that his 401(k) loan repayments qualify as necessary expenses because he "has no authority to stop the automatic deductions." E.R. 266.

Although the Internal Revenue Manual identifies "involuntary deductions" as a category of necessary expenses, an expense qualifies as an "involuntary deduction" only if it "a requirement of the job; i.e., union dues, uniforms, work shoes." For example, an employee's failure to pay union dues or wear a required uniform or shoes may result in the employee losing his job. See, e.g., St. John's Mercy Health Systems v. N.L.R.B., 436 F.3d 843, 844 (8th Cir. 2006). The Debtor's agreement to repay his retirement loan via automatic payroll deduction is simply not a job requirement. See In re Barraza, 346 B.R. 724, 730-31 (Bankr. N.D. Tex. 2006)(holding debtor's 401(k) loan repayment did not qualify as an "other necessary expense"); In re Lenton, 358 B.R. 651, 658 (Bankr. E.D. Pa. 2006) ("The fact that Debtor took a loan . . . under loan terms that mandate repayment by payroll deduction does not change the nature of the funds when Debtor repays them."). Because the Debtor voluntarily contributed funds to his

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[6] Section 5.15.1.10 of the Internal Revenue Manual is available at http://www.irs.gov/irm/part5/ch15s01.html#d0e182570.

401(k) account, and voluntarily borrowed those funds from the plan, his repayment of amounts borrowed "represent repayment of voluntary retirement contributions" and cannot be deducted as a necessary expense under section 707(b)(2)(A)(ii). Lenton, 358 B.R. at 658; see also In re Watkins, 2008 WL 2475749, at *7 (Bankr. D. Ariz. June 18, 2008); In re Mowris, 384 B.R. 235, 239 (Bankr. W.D. Mo. 2008); In re Mordis, 2007 WL 2962903, at *2 (Bankr. E.D. Mo. Oct. 9, 2007).

C. The Debtor's 401(k) Loan Repayment is Not a "Special Circumstance" under Section 707(b)(2)(B)

In the alternative, the bankruptcy court stated that even if the Debtor's 401(k) loan was not a secured claim, it could be properly included as a "special circumstance" sufficient to rebut the presumption of abuse under section 707(b)(2)(B). Specifically, that section provides:

> In any proceeding brought under this subsection, the presumption of abuse may only be rebutted by demonstrating special circumstances, such as a serious medical condition or a call or order to active duty in the Armed Forces, to the extent such special circumstances . . . justify additional expenses or adjustments of current monthly income for which there is no reasonable alternative.

11 U.S.C. § 707(b)(2)(B). As an initial matter, the bankruptcy court's finding of special circumstances in this case is procedurally erroneous. Section 707(b)(2)(B) imposes strict requirements on a debtor seeking to establish special circumstances:

> (ii) In order to establish special circumstances, the debtor shall be required to itemize each additional expense or adjustment of income and to provide –
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> (I) documentation for such expense or adjustment to income; and
>
> (II) a detailed explanation of the special circumstances that make such expenses or adjustment to income necessary and reasonable.
>
> (iii) The debtor shall attest under oath to the accuracy of any information provided to demonstrate that additional expenses or adjustments to income are required.

Id. §§ 707(b)(2)(B)(ii)-(iii). In addition, where the claim of special circumstances is contested, a court must consider evidence before determining whether a debtor has sufficiently rebutted the presumption of abuse. Fed. R. Bankr. P. 9014 (requiring testimony on disputed issues of material fact). None of these procedural requirements were satisfied in this case. The Debtor failed to provide the requisite documentation or testify under oath, and the bankruptcy court never held an evidentiary hearing on the matter. As such, the bankruptcy court could not properly conclude that the Debtor demonstrated special circumstances sufficient to rebut the presumption of abuse under section 707(b)(2).

In any event, even if the Debtor had satisfied the applicable procedural requirements, his 401(k) loan does not qualify as a special circumstances under section 707(b)(2)(B). Congress did not provide an exhaustive list of "special circumstances" but, rather, specifically stated that the statutory presumption of abuse may only be rebutted by "special circumstances *such as* a serious medical condition or a call or order to active duty in the Armed Forces." 11 U.S.C. § 707(b)(2)(B) (emphasis added).[7] Under the canon of *ejusdem generis*, "where general words follow specific words in a statutory enumeration, the general words are construed to embrace only objects similar in nature to those objects enumerated by the preceding specific words." Woods v. Simpson, 46 F.3d 21, 23 (6th Cir. 1995) (internal quotation omitted). Accordingly, only circumstances that are similar in nature to a "serious medical condition" or "a call or order to active duty in the Armed Forces" are sufficient to rebut the statutory presumption of abuse. See In re Hanks, 362 B.R. 494, 501-02 (Bankr. D. Utah 2007) (applying the doctrine of *ejusdem generis* to hold that a post-bankruptcy reduction in income following a job change did not qualify as a special circumstance within the meaning of section 707(b)(2)(B)).

Applying the doctrine of *ejusdem generis*, numerous bankruptcy courts have

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[7] The use of the phrase "such as" is significant. Typically, when Congress wants to provide a non-exhaustive list that contains unrelated bases for taking an action, it uses the word "includes" or "including" which section 102(3) of the Bankruptcy Code expressly defines as "not limiting." 11 U.S.C. § 102(3). See, e.g., 11 U.S.C. § 1112(b)(4) (chapter 11 conversion or dismissal); 11 U.S.C. § 1208(c) (chapter 12 conversion or dismissal); 11 U.S.C. § 1307(c) (chapter 13 conversion or dismissal); 11 U.S.C. § 1104(a)(1) (appointment of a chapter 11 trustee for cause).

held that section 707(b)(2)(B) limits “the sphere of permissible special circumstances” to situations bearing “similar traits and characteristics” to the examples listed in § 707(b)(2). In re Castle, 362 B.R. 846, 851 (Bankr. N.D. Ohio 2006). A “serious medical condition” and “a call to active duty” share “a commonality [as] they both constitute situations which not only put a strain on a debtor’s household budget, but they arise from circumstances normally beyond the debtor’s control.” Id.; see also, e.g., In re Smith, — B.R. —, 2008 WL 2485424, at *2 (Bankr. C.D. Ill. June 20, 2008) (“The similarity in nature of the two examples is that they are life circumstances that directly and unavoidably affect one’s earning capacity or give rise to necessary, additional expenses.”); In re Naut, 2008 WL 191297, at *10 (Bankr. E.D. Pa. Jan. 22, 2008); In re Mowris, 384 B.R. 235, 240 (Bankr. W.D. Mo. 2008).

The fact that the Debtor’s employer automatically deducts 401(k) loan repayments from his paycheck is not the kind of extraordinary, non-routine expense that Congress identified as “special circumstances.” As one court explained, “[r]etirement plan loans are neither extraordinary nor rare; many individuals take loans for many different reasons, and they are all required to repay the loans. Without more, a situation as common as the withdrawal of one’s retirement funds cannot be a ‘special circumstance’ within the accepted definition of this term." Eisen v. Thompson, 370 B.R. 762, 773 (N.D. Ohio 2007); see also Smith, 2008 WL 2485424, at *2 ("[T]he fact that [the debtor] borrowed from [his] retirement funds and now wishes to pay the loans back is not a life altering circumstance of the kind referenced in the statute. It is simply the consequence of a prior financial decision."); Naut, 2008 WL 191297, at *10; Mowris, 384 B.R. at 235; In re Johns, 342 B.R. 626, 629 (Bankr. E.D. Okla. 2006).

Moreover, in addition to demonstrating "special circumstances," section 707(b)(2)(B)(i) requires that such circumstances be those "for which there is no reasonable alternative." See, e.g., In re Lightsey, 374 B.R. 377, 381-82 (Bankr. S.D. Ga. 2007) (section 707(b)(2)(B) does "not permit every conceivable unfortunate or 'unfair' circumstance to rebut the presumption of abuse, but includes only those circumstances that cause higher household expenses or adjustments of income 'for which there is no reasonable alternative,' i.e., they are unforeseeable or beyond the control of the debtor"); In re Renicker, 342 B.R. 304, 310 (Bankr. W.D. Mo. 2006); In re Tranmer, 355 B.R. 234, 237 (Bankr. D. Mont. 2006). The Debtor here has other reasonable alternatives, such as directing the administrator of his 401(k) plan to repay the loan out of the balance of the funds in his retirement account. See Smith, 2008 WL 2485424, at *2 ("[A] retirement plan borrower has the right not to repay the loan. Nonpayment comes with liability for income taxes and penalties, but nonpayment is a valid, lawful alternative."). Another option is converting his case to chapter 13 and confirming a repayment plan under that chapter. Under chapter 13, 401(k) loan repayments are excluded form a debtor's disposable income calculations. 11 U.S.C. § 1322(f). Accordingly, the Debtor cannot claim his 401(k) loan as a "special circumstance" under section 707(b)(2).

II. The Bankruptcy Court Did Not Abuse Its Discretion in Dismissing the Debtor's Petition Based on the "Totality of the Circumstances" under Section 707(b)(3)

In determining whether providing chapter 7 relief to a debtor would constitute abuse under 11 U.S.C. § 707(b)(3), bankruptcy courts must consider the "totality of the circumstances" of the debtor's "financial situation." See 11 U.S.C. § 707(b)(3)(B). Under section 707(b)(3)(B), a court must evaluate the totality of the debtor's financial situation, including the debtor's assets, liabilities, reasonable expenses, and current and future income, to determine whether the debtor has the ability to repay a meaningful portion of his debts. If the debtor can, the debtor's case merits dismissal under section 707(b)(3)(B). An inquiry into the totality of a debtor's financial circumstances is a "fact-intensive determination" which is reviewed on appeal for abuse of discretion. Hebbring v. U.S. Trustee, 463 F.3d 902, 907-08 (9th Cir. 2006).

In this case, the bankruptcy court reasonably concluded that under the totality of the circumstances of the Debtor's financial situation, chapter 7 relief would constitute abuse. The court explained that aside from the 401(k) loan, the Debtor's only secured payments were on a car and a timeshare, the latter of which was "an unnecessary luxury" that the Debtor intended to abandon. E.R. 326. The court observed that the Debtor's obligations were "primarily consumer in nature," and that the Debtor was single and had no alimony or child support obligations. Id. The court also noted that the Debtor had been working for the same employer for 27 years, and that he did not demonstrate any extenuating circumstances that suggested the U.S. Trustee's estimation of his future disposable income was overstated. Id.

The court went on to explain that if the Debtor converted his petition to chapter 13, he could propose a payment plan that would allow him to repay his 401(k) loan in whole while also repaying a substantial portion of his unsecured debt. The court suggested that the Debtor propose a plan with minimal payments (such as $10 a month) until he finished repaying his 401(k) loan, at which point he could pay a larger amount for the remainder of the plan. Id.

As demonstrated by its opinion, the bankruptcy court was well within in its discretion in finding abuse under section 707(b)(3) in this case, and the Debtor's arguments to the contrary are easily dismissed.

A. The Debtor's Ability to Propose a Viable Chapter 13 Plan Does Not Turn on Whether He Has Disposable Income Under Section 707(b)(2)

The Debtor's first assertion that because his means test indicated that he had no disposable income at the time he filed his petition, the bankruptcy court erred in concluding that he could propose a viable payment plan under chapter 13. See Appellant's Br. 12. To the contrary, however, courts frequently confirm chapter 13 plans proposed by debtors with no disposable income under section 707(b)(2). See, e.g., Kagenveama v. Tandy, 527 F.3d 990, 993 (9th Cir. 2008). And, courts frequently confirm chapter 13 plans that propose *no* payments to unsecured creditors because the debtor has negative monthly projected disposable income. See, e.g., In re Alexander, 344 B.R. 742 (Bankr. E.D. N.C. 2006); see also In re Shelton, 370 B.R. 861, 864-68 (Bankr. N.D. Ga. 2007) (discussing the circumstances under which courts will confirm "a [chapter 13] plan that pays no dividend (a so-called '0% plan') to general unsecured creditors"). In short, the Debtor is plainly wrong that he cannot propose a confirmable chapter 13 plan.

Moreover, dismissal under the "totality of the circumstances" test does not actually require that the debtor be able to propose a viable payment plan under chapter 13. Although a debtor's ability to fund a chapter 13 plan was evidence of abuse under the old, pre-2005 chapter 7 framework, see, e.g., In re Price, 353 F.3d 1135, 1140 (9th Cir. 2004), there is no textual support for reading section 707(b)(3)(B) as hinging a finding of abuse on whether the debtor can fund a chapter 13 plan. To the contrary, the default remedy for abuse under section 707(b)(3)(B) is dismissal, not conversion. See 11 U.S.C. § 707(b)(1). If abuse under section 707(b)(3)(B) were determined solely by evaluating whether the debtor could fund a hypothetical chapter 13 plan, the "totality of the circumstances" analysis required by section 707(b)(3)(B) would, in many cases, be superfluous to the means test analysis required by section 707(b)(2): both would determine abuse based solely on the debtor's income and expenses. Cf. Fed. R. Bankr. P. Official Form 22A (the chapter 7 means test form) to Fed. R. Bankr. P. Official Form 22C (the chapter 13 means test form). To the contrary, an analysis of "the totality of the circumstances . . . of the debtor's financial situation" must look not only at income and expenses, but also assets and liabilities. See John A.E. Pottow, The Totality of the Circumstances of the Debtor's Financial Situation in a Post-Means Test World, 71 Mo. L. Rev. 1053, 1066 (2006); see also, e.g., In re Zaporski, 366 B.R. 758, 773 (Bankr. E.D. Mich. 2007)

B. The Bankruptcy Court Properly Considered the Debtor's Ability to Repay His Unsecured Debts Once He Completed Repayment of His 401(k) Loan

Although the Debtor asserts that the bankruptcy court erred in "consider[ing] future income in determining there was chapter 7 abuse rather than [the Debtor's] income and expenses on the date the petition was filed," Appellant's Br. 10, he apparently concedes that future income is relevant to dismissal under section 707(b)(3) where chapter 13 is a "valid alternative," id. at 12-13 (citing with approval In re Lenton, 358 B.R. 651 (Bankr. E.D. Pa. 2006)). As explained above, the Debtor could propose a chapter 13 payment plan with as little as $0 payments to unsecured creditors until he finishes paying his 401(k) loan, and larger payments for the remainder of the commitment period. As such, the Debtor's arguments regarding the relevance of future income appear to be moot.

In any event, there is simply no basis for limiting the section 707(b)(3)(B) inquiry to a "snapshot" view of the debtor's income and expenses at the time of filing rather than the actual "totality" of the debtor's financial circumstances, which by its plain meaning includes any available information about the debtor's future financial resources. Indeed, the courts of appeals repeatedly instructed bankruptcy courts to consider a debtor's "reasonably reliable future financial resources"when evaluating the totality of their circumstances under the pre-2005 chapter 7 framework. In re Reynolds, 425 F.3d 526, 532 (8th Cir. 2005); see also, e.g., In re Price, 353 F.3d 1135, 1139 (9th Cir. 2004) (explaining that "the totality of the [debtor's] circumstances" includes the "likelihood of sufficient future income" that the debtor can use to pay unsecured claims); In re Behlke, 358 F.3d 429, 434 (6th Cir. 2004); In re Kornfield, 164 F.3d 778, 781-84 (2d Cir. 1999); In re Lamanna, 153 F.3d 1, 4 (1st Cir. 1998). Where, as here, Congress uses a term with "settled meaning" in the courts, "Congress presumably knows and adopts . . . the meaning its use will convey to the judicial mind unless otherwise instructed." Beck v. Prupis, 529 U.S. 494, 500-01 (2000).

The Debtor's sole basis for challenging the bankruptcy court's consideration of his future income under section 707(b)(3) is a handful of bankruptcy court decisions addressing whether a debtor may include on his means test a debt secured on collateral that he intends to surrender. Appellant's Br. 13-15. Given that the Debtor was in fact allowed to deduct his 401(k) loan payments on his means test under section 707(b)(2), these cases have no relevance to the Debtor's challenge. The question presented by the Debtor is whether the totality of the Debtor's financial circumstances for the purposes of section 707(b)(3) includes the fact that he will soon be relieved of his 401(k) loan payments. The cases cited by the Debtor have no bearing on this question because they turn solely on the meaning of the phrase "scheduled as contractually due" in section 707(b)(2)(A)(iii). See In re Nockerts, 357 B.R. 497, 500 (Bankr. E.D. Wis. 2006);

In re Walker, 2006 WL 1314125, at *4 (Bankr. N.D. Ga. May 1, 2006); see also In re Haar, 373 B.R. 493, 500-02 (Bankr. N.D. Ohio 2007) (explaining that the "'snapshot' approach" of the means test is "entirely different" than "§ 707(b)(3)'s approach, [which] is grounded in equity"). Likewise, this Court's recent decision in Kagenveama v. Tandy, 527 F.3d 990 (9th Cir. 2008), turned on the proper construction of the phrase "projected disposable income" in chapter 13, see 11 U.S.C. § 1325(b)(1).[8]

In stark contrast, the operative phrase in section 707(b)(3) is "the totality of the circumstances . . . of the debtor's financial situation." 11 U.S.C. § 707(b)(3)(B). As explained above, the "totality of the circumstances" inquiry has always included consideration of future income in the bankruptcy context, and the Debtor has not and cannot provide any reason that this ordinary understanding of the "totality" of a debtor's financial circumstances should not apply in the context

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[8] Because the Debtor in this case focuses so heavily on his ability to propose a viable chapter 13 plan, it is worth noting that although Kagenveama limits the parties' discretion to challenge a proposed chapter 13 plan based on future income, the decision in no way precludes a debtor from voluntarily proposing a chapter 13 plan with escalating payments due to an anticipated increase in financial resources during the plan period. For this reason, the bankruptcy court's suggestion that the Debtor convert his petition to chapter 13 is unaffected by Kagenveama. Moreover, as emphasized earlier, the propriety of dismissal under section 707(b)(3) does not turn on the debtor's ability to fund a chapter 13 plan. See supra pp. 30-31 (explaining that the default remedy for abuse under chapter 7 is dismissal, not conversion).

of section 707(b)(3). See Haar, 373 B.R. at 502 (concluding that "evidence of a debtor's future income and expenses has always been a proper subject of §707(b) analysis" and that there is "no reason why this practice should not be afforded viability post-BAPCPA . . . under § 707(b)(3)"); In re Pennington, 348 B.R. 647, 651 (Bankr. D. Del. 2006) ("There is no indication in the language of [section 707(b)(3)] or the legislative history that Congress meant to limit temporally the Court's consideration of the Debtors' financial condition when determining whether to dismiss a case for abuse").

C. The Bankruptcy Court Properly Based Its Decision on the Debtor's Ability to Repay His Debts

Asserting that "something other than an ability to pay" is required for dismissal under section 707(b)(3)'s totality of the circumstances inquiry, the Debtor next argues that the bankruptcy court erred in relying on his ability to repay his debts as a basis for finding abuse. Appellant's Br. 17 (quoting Nockerts, 357 B.R. at 505). The Debtor's basic claim is that because an above-median income debtor has already had his financial situation "scrutinized through the means test" under section 707(b)(2), dismissal for ability to pay under section 707(b)(3) is improper. Id. at 16-18. This argument is contrary to the plain language of the provision and to the "overwhelming" recognition of courts and commentators that "section 707(b)(3) 'totality of the circumstances' analysis requires a bankruptcy court to undertake an analysis of a debtor's actual debt-paying ability independent of the means test analysis under section 707(b)(2)." In re Hoffner, 2007 WL 4868310, at *3 (Bankr. D. N.D. Nov. 21, 2007).[9]

As numerous courts have observed, section 707(b)(3) "explicitly mandates that the totality of the circumstances of the Debtor's financial situation be considered in determining whether there is an abuse when the presumption of abuse under paragraph (b)(2) does not arise or is rebutted." In re Paret, 347 B.R. 12, 15 (Bankr. D. Del. 2006). The broad terms "totality of circumstances" and "financial situation" "clearly encompass a debtor's ability to pay." In re Lenton, 358 B.R. 651, 663 (Bankr. E.D. Pa. 2006); see also In re Sullivan, 370 B.R. 314, 321 (Bankr. D. Mont. 2007) ("[T]he plain language of § 707(b)(3) . . . is clear and compels a conclusion that a court must consider a debtor's actual debt-paying

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[9] The Debtor's brief relies primarily on one of the few decisions going the other way on this issue, In re Nockerts, 357 B.R. 497, 505-07 (Bankr. E.D. Wis. 2006). The Nockerts court, however, based its decision on a line of pre-BAPCPA decisions expressly rejected by this Court in Zolg v. Kelly, 841 F.2d 908, 914 (9th Cir. 1988). Specifically, Nockerts relies heavily on pre-BAPCPA case law holding that under the old section 707(b), the totality of the circumstances test did not permit bankruptcy courts to dismiss a chapter 7 petition based solely on the debtor's ability to repay his debts. See Nockerts, 357 B.R. at 506 (discussing with approval Green v. Staples, 934 F.2d 568 (4th Cir. 1991) and In re Ontiveros, 198 B.R. 284 (C.D. Ill. 1991)). Given that this Court was squarely on the other side of the split over this issue, see Kelly, 841 F.2d at 914 (holding that the totality of the circumstances test *did* permit dismissal based solely on ability to pay), the analysis in Nockerts is not viable in this Circuit.

ability in ruling on a motion to dismiss based on abuse where the presumption does not arise or is rebutted" (quoting In re Sorrell, 359 B.R. 167 (Bankr. S.D. Ohio 2007)); In re Pak, 343 B.R. 239 (Bankr. N.D. Cal. 2006) ("It would be counterintuitive to construe 'totality of the circumstances' [in section 707(b)(3)] to exclude a consideration of the debtor's ability to pay.").[10]

The Debtor concedes that the totality of a debtor's "financial situation" includes his ability to repay his debts, but claims that such ability cannot be the sole basis for dismissal under section 707(b)(3).[11] Appellant's Br. 18. This contention simply has no basis in the statutory text. "[N]othing in the structure of the 'totality of circumstances' test of § 707(b)(3) suggests that a debtor's ability to repay an obligation must, as a prerequisite for dismissal, be coupled with other factors." In re Haar, 373 B.R. 493, 499-500 (Bankr. N.D. Ohio 2007). If

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[10] Although the Debtor attempts to distinguish Pak on the ground that it involved a below-median income debtor, see Appellant's Br. 16, many bankruptcy courts have reached the same conclusion in cases involving above-median debtors. See, e.g., In re Haar, 373 B.R. 493, 498-500 (Bankr. N.D. Ohio 2007); In re Henebury, 361 B.R. 595, 605-07 (Bankr. S.D. Fla. 2007); Hoffner, 2007 WL 4868310, at *3-4; In re Mestemaker, 359 B.R. 849, 853-56 (Bankr. N.D. Ohio 2007); In re Zaporski, 366 B.R. 758, 769-71 (Bankr. E.D. Mich. 2007); Lenton, 358 B.R. at 662-64, 666 n. 27.

[11] As an aside, the notion of ability to pay as a single factor supporting dismissal is somewhat misleading. As one court observed, "When conducting any 'ability to pay' analysis, a court is often considering multiple factors," Haar, 373 B.R. at 500, such as the debtor's assets, liabilities, and expected future income, and whether any of his debts are secured by unnecessary luxury goods.

Congress had intended to impose such a requirement, "it would have done so expressly or by explicit references to § 707(b)(2)(A)." Lenton, 358 B.R. at 663; see also Haar, 373 B.R. at 500 ("[T]he Court will not read into § 707(b)(3) a requirement that does not exist.").

The Debtor attempts to avoid this plain language approach to section 707(b)(3) by arguing that it results "in the means test being nothing but surplusage." Appellant's Br. 18. This argument misunderstands the different functions served by section 707(b)(2) and section 707(b)(3). The means test in section 707(b)(2) compares a debtor's historic income over a limited six month period against a set of standardized expense allowances and some actual expenses. It does not purport to analyze all aspects of a debtor's financial situation, but instead serves a filter for identifying cases in which a presumption of abuse is appropriate. The means test is "simply a mechanism for generating a presumption" and "does not result in any final determination" of abuse. Hoffner, 2007 WL 4868310, at *4; see also Mestemaker, 359 B.R. at 854; Haar, 373 B.R. at 499.

If a presumption of abuse arises under section 707(b)(2), the debtor may rebut a finding of abuse by demonstrating "special circumstances" under section 707(b)(2)(B). If a presumption of abuse does not arise under section 707(b)(2), section 707(b)(3) requires the bankruptcy court to determine whether the debtor's *actual* ability to pay, based on the totality of his financial resources and liabilities, indicates an abuse of chapter 7. In other words, section 707(b)(2)(B) provides for circumstances where the debtor has *fewer* financial resources than suggested by the means test, and section 707(b)(3) provides for circumstances where the debtor has *greater* financial resources than suggested by the means test. See Mestemaker, 359 B.R. at 854 ("Congress has recognized th[e] reality [that the means test is fallible] and has thus provided for rebuttal of the presumption of abuse in cases of actual higher expenses and/or lower income."); Eugene R. Wedoff, Judicial Discretion to Find Abuse Under Section 707(b)(3), 71 Mo. L. Rev. 1035, 1042 (2006) ("The means test . . . does not replace judicial assessment of disposable income. Rather, it sets out a rule for determining disposable income that is only presumptively applicable. When the results of that rule are challenged, either by a debtor under section 707(b)(2) or a creditor under section 707(b)(3), the court is required to make a determination of actual disposable income under judicially defined standards.").

In contrast to the"snapshot" view of income and expenses provided by the means test, section 707(b)(3) requires bankruptcy courts to consider not only the debtor's income and expenses at the time of filing, but also the debtor's assets and liabilities, and any anticipated changes in the debtor's financial situation not reflected on the means test. See In re McUne, 358 B.R. 397, 399 (Bankr. D. Or. 2006) (contrasting the "bright line" approach of section 707(b)(2) with the "generalized review" of section 707(b)(3)); Haar, 373 B.R. at 499 (same). This holistic assessment of the debtor's finances is not only compelled by the plain text and structure of section 707(b), but is consistent with one of Congress's primary goals in reforming the bankruptcy system: ensuring that debtors who actually have the ability to repay a significant portion of their debt do so. See H.R. Rep. No. 109-31(I), at 2-5 (2005) (discussing the importance of debtors repaying creditors "the maximum they can afford"); see also Mestemaker, 359 B.R. at 855.

As a final related matter, the Debtor asserts that the dismissal of his petition under section 707(b)(3) runs afoul of section 707(b)(2)(A)(i), which generates a presumption of abuse when an above-median debtor's disposable income is "25 percent of the debtor's nonpriority unsecured claims in the case, or $6,575 whichever is greater." 11 U.S.C. § 707(b)(2)(A)(i). As discussed throughout this brief, however, the threshold set forth in section 707(b)(2) merely establishes a presumption regarding abuse that is independent from the analysis required by section 707(b)(3). Moreover, the bankruptcy court's calculations actually put the Debtor above the section 707(b)(2) threshold: the court concluded that even being "very generous to the Debtor," the numbers indicated that he would have $8,085 available in disposable income during the applicable chapter 13 commitment period, which is above $6,575 and amounts to 25.9% of the Debtor's unsecured debt. E.R. 136 (listing the Debtor's total unsecured debt as $31,130). In emphasizing the bankruptcy court's observation that the Debtor could repay at 20% of his unsecured debt, see Appellant's Br.10-20, the Debtor fails to recognize that the bankruptcy court arrived at that percentage after deducting administrative fees and attorney fees from his disposable income. E.R. 322. The threshold set forth in section 707(b)(2) applies to disposable income prior to any deduction for administrative fees or attorney fees. As such, the Debtor's comparison between the bankruptcy court's calculation and the threshold in section 707(b)(2) is misplaced.

CONCLUSION

For the foregoing reasons, the order of the bankruptcy court should be affirmed.

Respectfully submitted,

OF COUNSEL:

RAMONA D. ELLIOTT
General Counsel

P. MATTHEW SUTKO
Associate General Counsel
Executive Office for the United States

GREGORY G. KATSAS
Acting Assistant Attorney General

WILLIAM KANTER
(202) 514-4575
KELSI BROWN CORKRAN
(202) 514-3159
Attorneys, Appellate Staff

Trustee Department of Justice 20 Massachusetts Ave., N.W. Washington, D.C. 20530	Civil Division, Room 7216 Department of Justice 950 Pennsylvania Ave., N.W. Washington, D.C. 20530

JULY 2008

STATEMENT OF RELATED CASES

Counsel for respondent is not aware of any related cases, as defined in Ninth Circuit Rule 28-2.6.

CERTIFICATE OF COMPLIANCE

Counsel for respondent hereby certifies that the foregoing Brief for Appellee satisfies the requirements of Federal Rule of Appellate Procedure 32(a)(7) and Ninth Circuit Rule 32-1. The brief was prepared in Times New Roman 14 point font, has 10.5 or fewer characters per inch, and contains 10,477 words.

____
Kelsi Brown Corkran
Counsel for Appellee

CERTIFICATE OF SERVICE

I hereby certify that on this 3rd day of July, 2008, I filed and served the foregoing Brief for Appellee by causing the original and fifteen copies to be sent to this Court by overnight delivery, and by causing two copies to be served upon the following counsel by electronic mail and priority mail:

Michael R. Totaro
Maureen J. Shanahan
P.O. Box 789
Pacific Palisades, CA 90272
mstotaro@aol.com

____
Kelsi Brown Corkran
Counsel for Appellee

BRIEF BANK — “SUMMARY SHEET”

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1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	In re Keith R. Ellis
2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	E.D. Mich.
3. ("CCN") ***CURRENT*** CASE NO.	No.: 10-50910-pjs
4. ("PCN") ***PRIOR*** CASE NO. - & COURT *[IF ANY]*	No: N/A Court: N/A *(Identify judge & cite, if any)*
5. ("SO") ***SOURCE***	**U.S. TRUSTEES**
6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	Filed: March 16, 2011 Type: The United States Trustee’s Response to HSBC Mortgage Corporation (USA)’s Motion for Leave to Appeal
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UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF MICHIGAN
SOUTHERN DIVISION

In re:	Case No. 10-50910-PJS
KEITH R. ELLIS,	Chapter 13
Debtor.	HON. PHILLIP J. SHEFFERLY
/	District Court Case No. 2:11-cv-10860-VAR-PJK

THE UNITED STATES TRUSTEE'S RESPONSE TO HSBC MORTGAGE CORPORATION (USA)'S MOTION FOR LEAVE TO APPEAL

Daniel M. McDermott, the United States Trustee for Region 9 (the "United States Trustee"), by and through undersigned counsel, files this response to HSBC Mortgage Corporation (USA)'s ("HSBC") Motion for Leave to Appeal (the "Motion for Leave"). (Bankr. Dkt. 99). The United States Trustee opposes HSBC's Motion for Leave, and for the reasons set forth in the attached Brief, respectfully requests that the Motion be denied.

Respectfully submitted,
DANIEL M. McDERMOTT
UNITED STATES TRUSTEE
Region 9

By: /s/ Kelley Callard (P68537)
Kelley.Callard@usdoj.gov
Trial Attorney
Office of the U.S. Trustee
211 West Fort St - Suite 700
Detroit, Michigan 48226
(313) 226-6773

Dated: March 16, 2011

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF MICHIGAN
SOUTHERN DIVISION

In re:	Case No. 10-50910-PJS
KEITH R. ELLIS,	Chapter 13
Debtor.	HON. PHILLIP J. SHEFFERLY
____/	District Court Case No. 2:11-cv-10860-VAR-PJK

THE UNITED STATES TRUSTEE'S BRIEF IN OPPOSITION TO HSBC MORTGAGE CORPORATION (USA)'S MOTION FOR LEAVE TO APPEAL

INTRODUCTION

HSBC's request to appeal a discovery order should be denied for three reasons. First, the order is a routine, non-final discovery order that does not bring an end to litigation on the merits. Second, Sixth Circuit law prohibits immediate review of discovery orders under the collateral-order doctrine because they are not sufficiently urgent or effectively unreviewable on appeal from a final judgment. Third, Sixth Circuit law also prohibits discretionary interlocutory review of discovery orders because they are reviewed for abuse of discretion, and discretionary rulings are not appropriate for interlocutory review. In short, this Court should follow its recent decision in *In re Gray*, No. 2:11-10640, slip op. (E.D. Mich. Mar. 15, 2011) (Cook, J.) (Exhibit A), and hold that HSBC may not appeal a Rule 2004 order immediately under any theory of appellate jurisdiction.

FACTUAL AND PROCEDURAL BACKGROUND

The United States Trustee, an officer of the United States Department of Justice, sought discovery from HSBC after HSBC filed a proof of claim asserting a pre-petition escrow shortage on a loan that was not subject to escrow. *See* United States Trustee's Motion for Order Authorizing

Examination of HSBC Mortgage Corporation USA and Requiring Production of Documents Pursuant to Bankruptcy Rule 2004 (the "Rule 2004 Motion"). (Bankr. Dkt. 68.)

The United States Trustee is an official designated by Congress to be the "watchdog" who guards against fraud and abuse of the bankruptcy system. *See* H.R. Rep. No. 95-595 at 87 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6049 ("The proposed United States Trustees will . . . serve as bankruptcy watch-dogs to prevent fraud, dishonesty, and overreaching in the bankruptcy arena."). United States Trustees "are responsible for 'protecting the public interest and ensuring that bankruptcy cases are conducted according to law.'" *Adams v. Zarnel (In re Zarnel)*, 619 F.3d 156, 162 (2d Cir. 2010) (quoting *Morgenstern v. Revco D.S., Inc. (In re Revco D.S., Inc.)*, 898 F.2d 498, 499 (6th Cir. 1990)). In light of the widespread concern that mortgage servicers have failed to verify the accuracy of documents submitted to courts, United States Trustees throughout the country are carefully reviewing the proofs of claims and other filings by mortgage servicers.

In this case, HSBC filed a proof of claim asserting a pre-petition escrow shortage of $15,903.39. *See* Claims Register for Case No. 10-50910, Claim 12-1. The debtor objected because there is not "an escrow account associated with this mortgage, and [the debtor] is not aware one ever existing." (Bankr. Dkt. 37 at 5). Despite the escrow shortage amounting to more than half of HSBC's total arrearage claim of $28,973.51, HSBC did not oppose the debtor's objection. The bankruptcy court sustained the objection and reduced HSBC's arrearage to $13,070.12. (Bankr. Dkt. 62).

Subsequently, the United States Trustee sought information from HSBC by way of a document production and an examination under Federal Rule of Bankruptcy Procedure 2004 ("Rule 2004"). That rule allows, upon motion of any party in interest, for "any entity" to be examined regarding "any matter which may affect the administration of the debtor's estate." Fed. R. Bankr.

P. 2004(a), (b). Such an examination is very similar to a deposition. The scope of discovery permitted under Rule 2004, however, is broader than that permitted under the Federal Rules of Civil Procedure. *In re Wilcher*, 56 B.R. 428, 433 (Bankr. N.D. Ill. 1985). Indeed, a Rule 2004 examination is "commonly recognized as permitting discovery in the nature of a 'fishing expedition.'" *In re Washington Mutual, Inc.*, 408 B.R. 45, 50 (Bankr. D. Del. 2009) (citation omitted); *see Teleglobe USA, Inc. v. BCE, Inc. (In re Teleglobe Commc'ns Corp)*, 493 F.3d 345, 354 (3d Cir. 2007) (describing Rule 2004 as allowing parties in interest to "conduct discovery" regarding potential causes of action).

The Rule 2004 Motion explained that the inaccurate proof of claim raised questions concerning "HSBC's bankruptcy procedures in this case." (Bankr. Dkt. 68 at 6). The Rule 2004 Motion also explained that "[t]he attempt to collect [the] escrow shortage by including it in the Proof of Claim may be an abuse of the bankruptcy process." *Id.* at 3. With respect to these concerns, the United States Trustee sought information from HSBC regarding:

- The total arrearage on the debtor's account;
- The validity of the escrow shortage charged to the debtor's account;
- The debtor's objection to HSBC's Proof of Claim in this case;
- HSBC's policies and procedures applicable to the debtor's account, for referring a proof of claim; and
- The documents or other information relied on in referring the Proof of Claim.

Id.

HSBC opposed the discovery, (Bankr. Dkt. 70), but the bankruptcy court issued an order granting the Rule 2004 Motion after a hearing (the "Rule 2004 Order"). (Bankr. Dkt. 90). HSBC now seeks leave to appeal this interlocutory discovery order. (Bankr. Dkt. 99.[1])

STATUTORY FRAMEWORK

Federal district courts have jurisdiction to hear appeals from final judgments, orders, and decrees entered by bankruptcy judges, and, under the collateral-order doctrine, appeals from a narrow class of bankruptcy orders that would otherwise be considered interlocutory. 28 U.S.C. § 158(a)(1). Interlocutory orders, i.e., orders that are not final, issued by bankruptcy judges may be appealed only where the district court grants leave to appeal, a decision wholly within the district court's discretion. *See* 28 U.S.C. § 158(a)(3).

A party seeking leave to appeal an interlocutory bankruptcy order may file a motion for leave under Federal Rule of Bankruptcy Procedure 8003 ("Rule 8003"). The motion is filed in the bankruptcy court, but decided by the district court. Fed. R. Bankr. P. 8003(b). This Court analyzes a motion for leave under Rule 8003(b) using the standards applicable to requests for interlocutory appeals under 28 U.S.C. § 1292(b), which provides in pertinent part:

> When a district judge, in making in a civil action an order not otherwise appealable under this section, shall be of the opinion that such order involves a controlling question of law as to which there is substantial ground for difference of opinion and
>
> that an immediate appeal from the order may materially advance the ultimate termination of the litigation, he shall so state in writing in such order.

28 U.S.C. § 1292(b); *In re ASC Inc.*, 386 B.R. at 195 (applying section 1292(b) standards in analyzing whether to allow an interlocutory bankruptcy appeal).

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[1] HSBC also filed a motion to stay the Rule 2004 Order. On March 8, 2011, the bankruptcy court denied this motion. (Bankr. Dkt. 110.)

ARGUMENT

A. The bankruptcy court's order granting discovery under Rule 2004 is not a final, appealable order.

"A final decision generally is one which ends the litigation on the merits and leaves nothing for the court to do but execute the judgment." *United States ex rel. Pogue v. Diabetes Treatment Centers of Am., Inc.*, 444 F.3d 462, 471 (6th Cir. 2006); *Am. Specialty Cars Holdings, LLC v. Official Comm. of Unsecured Creditors of ASC Inc. (In re ASC Inc.)*, 386 B.R. 187, 193-94 (E.D. Mich. 2008). The final judgment rule is important because it "prevents 'piecemeal appeals,' the allowance of which can undermine the independence of the district judge, obstruct the resolution of just claims by means of harassment and cost, or generally prevent efficient judicial administration." *Id.*

Under the "flexible and pragmatic approach to finality," an order is final in bankruptcy when it "disposes of a discrete dispute within the larger case" and "end[s] litigation on the merits." *Winget v. JP Morgan Chase Bank, N.A.*, 537 F.3d 565, 578 (6th Cir. 2008) (citing *Morton v. Morton (In re Morton)*, 298 B.R. 301, 303 (B.A.P. 6th Cir. 2003)); *accord Zedan v. Habash*, 529 F.3d 398, 402 (7th Cir. 2008) ("[T]he test we have utilized to determine finality . . . is whether an order resolves a discrete dispute that, but for the continuing bankruptcy, would have been a stand-alone suit."). This approach accounts for how a single bankruptcy case may contain distinct sub-proceedings, "many of which may constitute individual lawsuits had a bankruptcy petition never been filed." *Jove Eng'g, Inc. v. IRS*, 92 F.3d 1539, 1547-48 (11th Cir. 1996) (citation omitted) (holding that an order granting relief based on a violation of the automatic stay is a final, appealable order because it resolves the debtor's claim for relief against a creditor for the violation).

An order granting discovery under Rule 2004 is not a final order because it does not render a decision that brings litigation on the merits to a close. *In re Gray*, No. 2:11-10640, slip op. at 12 (E.D. Mich. Mar. 15, 2011) (Cook, J.) (Exhibit A). Instead, a Rule 2004 examination is a "far-ranging" investigatory tool that is commonly used to reveal evidence prior to initiating litigation within the bankruptcy case, whereupon the discovery provisions of the Federal Rules of Civil Procedure — as incorporated through Fed. R. Bankr. P. 9014(c) (contested matters) and 7026-37 (adversary complaints) — apply. 9 Collier on Bankruptcy § 2004.01[1]. *See Teleglobe*, 493 F.3d at 354 (describing Rule 2004 as allowing parties in interest to "conduct discovery" regarding potential causes of action); *see also In re Symington,* 209 B.R. 678, 684 (Bankr. D. Md. 1997) (explaining Rule 2004 examinations).

Rule 2004 examinations allow parties in interest to discover assets, examine transactions, and determine whether wrongdoing has occurred. *In re Enron Corp.*, 281 B.R. 836, 840 (Bankr. S.D.N.Y. 2002). This tool is used by creditors, debtors, and the United States Trustee alike, and is integral to routine matters of case administration, including:

- Obtaining relief from bankruptcy petition preparers. 11 U.S.C. § 110.
- Determining whether professional fees are reasonable. 11 U.S.C. §§ 329, 330.
- Obtaining relief from violations of the automatic stay. 11 U.S.C.§ 362.
- Objecting to proofs of claim and administrative expenses. 11 U.S.C.§ 502.
- Determining whether a debt is exempt from discharge. 11 U.S.C. § 523.
- Recovering property of the estate held by third parties. 11 U.S.C. § 542.
- Recovering preferential payments to creditors. 11 U.S.C. § 547.
- Recovering fraudulent transfers or obligations. 11 U.S.C. § 548.
- Dismissing or converting a chapter 7 case. 11 U.S.C. § 707.
- Objecting to the debtor's discharge. 11 U.S.C. § 727.

- Investigating matters relevant to a reorganization plan. 11 U.S.C. § 1103(c)(2).
- Requesting the appointment of a chapter 11 trustee. 11 U.S.C. § 1104.
- Dismissing or converting a chapter 11 case. 11 U.S.C. § 1112(b).
- Requesting sanctions for litigation misconduct. Fed. R. Bankr. P. 9011.

Rule 2004 provides an efficient and inexpensive mechanism for potential litigants to evaluate whether an action should be brought. But an order permitting or denying a Rule 2004 examination is not a final order because it does not allow or foreclose any litigant's right to bring or maintain such bankruptcy causes of actions.

Furthermore, the Sixth Circuit's concerns about "piecemeal appeals" are even more heightened in the bankruptcy context. *Diabetes Treatment Centers of Am.*, 444 F.3d at 471. Time is of the essence under the Bankruptcy Code and Rules, which establish short, fixed deadlines for many causes of action, including:

- If the United States Trustee seeks to have an individual chapter 7 case dismissed for abuse, the motion must be brought no later than 40 days after the meeting of the creditors. 11 U.S.C. § 704(b).
- Any action by a case trustee to recover property of the estate under sections 547 or 548 must be brought no later than two years after the case was filed, one year after the trustee was first appointed, or before the case is closed. 11 U.S.C. § 546.
- A complaint objecting to a chapter 7 debtor's discharge must be brought no later than 60 days after the meeting of the creditors. Fed. R. Bankr. P. 4004(a).

Allowing immediate appeals of Rule 2004 orders would have severe consequences for the administration of bankruptcy cases. Litigants could then bring appeals to the district court one discovery order at a time, which would (1) obstruct the ability for opposing parties to meet such statutory deadlines and (2) dramatically increase the cost and time required to administer the estate. *See Hyundai Translead, Inc. v. Jackson Truck & Trailer Repair, Inc. (In re Trailer Source, Inc.)*, 555 F.3d 231, 236 (6th Cir. 2009) (emphasizing the importance of the "efficient and orderly administration of estates”).

Despite this, HSBC argues that the Rule 2004 Order is sufficiently final because (1) it resolves “the only present dispute” between HSBC and the United States Trustee and (2) “there is nothing left” for the bankruptcy court to do with respect to the Rule 2004 order, so there will be no later opportunity for an appeal. Bankr. Dkt. 99 at 11. Both arguments are without merit.

The first argument fails because, as this Court recently held in a directly analogous case, a Rule 2004 discovery order does not “finally dispose of [a] discrete dispute.” *Gray*, slip op. at 12 (citing *In re Dental Profile, Inc.*, No. 09-C-6160, 2010 WL 431590, at *2 (N.D. Ill. Feb. 1, 2010) (Exhibit B) (“[T]he order granting leave to conduct a Rule 2004 examination in no way ‘resolves a discrete dispute’ but is only a discovery order for information that will allow both sides to present evidence in the dispute.”). Similarly, this Court has also observed that a bankruptcy order providing “for discovery . . . suggest[s] that no final judgment or decree has been entered.” *In re Smelser,* 327 B.R. 815, 817 (E.D. Mich. 2005) (dismissing interlocutory appeal). HSBC’s status as a third party to the bankruptcy case does not change the default rule that discovery orders are not final, appealable orders. *See Cunningham v. Hamilton Cnty.*, 527 U.S. 198, 204 n.4 (1999) (“[W]e have repeatedly held that a witness subject to a discovery order, but not held in contempt, generally may not appeal the order.”).

The second argument fails because HSBC may appeal after a final order is entered later in the case. “[T]he law is well settled that an appeal from a final judgment draws into question all prior non-final rulings and orders.” *McLaurin v. Fischer*, 768 F.2d 98, 101 (6th Cir. 1985).
At that point — after a contested matter, adversary proceeding, contempt citation, or the closing of the case — HSBC will be able to obtain effective review of the discovery order. *See Mohawk Indus., Inc. v. Carpenter*, 130 S. Ct. 599, 606-07 (2009) (explaining how “post-judgment appeals generally

suffice to protect the rights of litigants" with respect to discovery orders).

This Court has held that a Rule 2004 order is not a final, appealable order because "issues might arise that require further action from the Bankruptcy Court." *Gray*, slip op. at 12. Other courts around the country that agree. *See In re Vance*, 165 F.3d 34 (Table), 1998 WL 783728, *1 (7th Cir. Nov. 2, 1998)(Exhibit C) (citing *In re Towers Fin. Corp.*, 164 B.R. 719, 720 (S.D.N.Y. 1994)); *Aetna Cas. & Sur. Co. v. Glinka*, 154 B.R. 862, 868 (D. Vt. 1993); *In re Blinder, Robinson & Co.*, 127 B.R. 267, 272 (D. Colo. 1991));[2] *see also Kaiser Group Int'l, Inc. v. Mittal Steel Ostrava, a.s. (In re Kaiser Group Int'l, Inc.)*, 400 B.R. 140, 145 (D. Del. 2009) (holding order denying a Rule 2004 examination was not final and not appealable as of right or under the criteria for allowing interlocutory appeals); *In re Midwest Video Games, Inc.*, No. 98-C-3836, 1998 WL 395152, at *1 (N.D. Ill. July 9, 1998) (Exhibit D) (same with respect to an order granting a Rule 2004 examination); *Gache v. Balaber-Strauss,* 198 B.R. 662, 664-65 (S.D.N.Y. 1996) (same).

And in other appeals like this one, courts have rejected attempts by mortgage lenders to obtain interlocutory review of orders granting the United States Trustee discovery under Rule 2004. *See Countrywide Home Loans, Inc. v. Office of the United States Trustee*, No. 08-617, 2008 WL 2388285, *4-*6 (W.D. Pa. June 11, 2008)(Exhibit E) (dismissing appeal from Rule 2004 exam order as non-final, rejecting mortgage lender's arguments for appeal under collateral-order doctrine and 28 U.S.C. §§ 158(a)(1) and (3), and observing, "I find no reason to depart from the general rule disallowing appeals as of right of discovery orders, even under the more liberal bankruptcy perspective on

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[2] In *Blinder*, the court held that a Rule 2004 order was not a final, appealable order, but stated in dictum that "[t]his is not to say that all appeals from Rule 2004 orders are non-final." *Blinder*, 127 B.R. at 272. The *Blinder* court did so because it observed that, in 1991, there was little authority analyzing the non-finality of Rule 2004 orders. That is no longer the case in 2011, when courts routinely hold that Rule 2004 orders are not final. Courts subsequently considering this language in *Blinder* have expressly labeled it as dictum. *See Towers Fin. Corp.*, 164 B.R. at 720 ("Since appellants have been unable to find a case in which an order denying a Rule 2004 examination was considered a final order, they rely on dictum in *Blinder* to argue that bankruptcy court discovery orders are not always interlocutory.") (citation omitted).

finality."); *In re Del Castillo*, Case No. 08-20020-mc-Altonaga (S.D. Fla. Feb. 8, 2008) (Exhibit F) (finding that an order overruling mortgage lender's objections to a similar Rule 2004 Notice of Examination and Subpoena *Duces Tecum* served by the United States Trustee was neither final nor appealable).

The two cases that HSBC relies upon provide no basis for treating the Rule 2004 Order here any differently. Bankr. Dkt. 99 at 11-12. *Buckner v. Okla. Tax. Comm'n (In re Buckner)*, No. 00-073, 2001 WL 992063, at *2 (B.A.P. 10th Cir. Aug. 30, 2001) (Exhibit G), concerned a Rule 2004 examination that was (1) ordered after the chapter 13 reorganization plan had been confirmed and (2) in a separate proceeding after the case had come to an end. The unusual state of facts in *Buckner* makes any comparison to this case inapposite. *In re Palmquist*, No. 94-1475, 1995 U.S. Dist. LEXIS 9464 (W.D. Wash. June 15, 1995), does not even discuss the issue of finality. Instead, it merely states that a Rule 2004 examination is a final judgment and cites *Blinder*. *Id.* at *2.

Therefore, this Court should hold that it does not have jurisdiction over HSBC's appeal under 28 U.S.C. § 158(a)(1) because the Rule 2004 Order is not a final, appealable order.

B. The bankruptcy court's order granting discovery under Rule 2004 is not appealable under the collateral-order doctrine.

This Court should not hold that jurisdiction exists under the collateral-order doctrine. Generally, the collateral-order doctrine allows for interlocutory appellate review of a narrow class of non-final orders that "finally determine claims of right separable from, and collateral to, rights asserted in the action, too important to be denied review and too independent of the cause itself to require the appellate consideration be deferred until the whole case is adjudicated." *Cohen v. Beneficial Indus. Loan Corp.*, 337 U.S. 541, 546 (1949).

Under the collateral-order doctrine, a party may take an appeal from a non-final order if it "(1) conclusively determines a disputed issue; (2) resolves an issue separate from the merits of the action that is too important to be denied review; *and* (3) will be effectively unreviewable on appeal from a final judgment." *Mohawk Indus.*, 130 S. Ct. at 605 (emphasis added). Here, the Rule 2004 Order fails this test. *See Gray*, slip op. at 14.

1. Routine discovery disputes do not "conclusively determine a disputed issue" are not "too important to be denied review."

The Rule 2004 Order fails the first requirement because a " Rule 2004 order does not finally or conclusively determine a claim of right." *Gray*, slip op. at 14. After all, HSBC does not explain how the order determines or infringes upon a right. (Bankr. Dkt. 99 at 13.)

The Rule 2004 Order also fails the second requirement because the movant must show "sufficiently urgent questions to merit an exception to the traditional final-judgment rule." *Swanson v. DeSantis*, 606 F.3d 829, 833 (6th Cir. 2010). *Compare id.* (holding that the issue of whether a habeas corpus petition should be dismissed for the petitioner's failure to comply with the "total exhaustion" requirement was not significant enough to merit interlocutory review) *with Lowe v. Hamilton Cnty. Dep't of Job & Family Serv.*, 610 F.3d 321, 323 (6th Cir. 2010) (holding that the denial of a claim of sovereign immunity is significant enough to merit interlocutory review because it provides an immunity from trial).

Again, HSBC does not even contend that the order raises "sufficiently urgent" questions in any way — such as by requiring the production of privileged documents — that would elevate this matter above the level of a routine discovery dispute. (Bankr. Dkt. 99 at 13.) Nor could it, as a protective order is in place. (Bankr. Dkt. 109.) Thus, this discovery dispute does not provide justification "sufficiently strong to overcome the usual benefits of deferring appeal until litigation concludes." *See Diabetes Treatment Centers of Am., Inc.*, 444 F.3d at 473 (noting that while some circuits apply the collateral-order doctrine to interlocutory discovery appeals involving privilege, the Sixth Circuit has not allowed such interlocutory appeals and "has traditionally viewed mandamus as the sole method by which we might review a discovery order involving a claim of privilege.").

2. HSBC may obtain effective review of the Rule 2004 Order after final judgment.

As to the third requirement, there is no risk that the discovery order here would be effectively unreviewable until after a final judgment is entered. After all, HSBC may pursue an immediate appeal using the traditional method for obtaining immediate appellate review of discovery orders, which remains unchanged for over 100 years and is equally applicable to a Rule 2004 examination order — a party "seeking to appeal a discovery order must first disobey the order and suffer a contempt citation," and then appeal from the contempt order. *Id.* at 471 (citing *Alexander v. United States*, 201 U.S. 117 (1906)).[3]

HSBC does not appeal from a contempt order here. And nothing prevents HSBC from pursuing an effective post-judgment appeal. Although it argues that producing any documents before it can have its appeal heard may render the appeal moot, (Bankr. Dkt. 99 at 14), it fails to demonstrate why an appellate court could not provide relief after a final order has been entered.

In cases where a discovery order is reversed after the discovery has already been provided, courts may order the return of documents, enjoin any future use of the discovery, and remand for a new trial with the documents excluded from evidence. *Mohawk Indus.*, 130 S. Ct. at 606-07 (holding that even the improper disclosure of privileged material may be remedied in this manner); *see, e.g.*,

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[3] Exceptions to this rule are narrow. For instance, the Supreme Court permitted the President to appeal a district court's refusal to quash a subpoena *duces tecum* without his first being held in contempt because it would have been unseemly for the court to require the head of a coordinate branch of government to subject himself to contempt as a prerequisite for appeal. *See United States v. Nixon*, 418 U.S. 683, 691 (1974). Under Sixth Circuit law, the only alternative to contempt review is a petition for a writ of mandamus. *Diabetes Treatment Centers of Am.*, 444 F.3d at 472-73. HSBC has not sought mandamus here.

Church of Scientology of Cal. v. United States, 506 U.S. 9, 15 n.9 (1992) (holding, in an appeal from a discovery order where discovery already had been produced, "this case is not moot because if the summons were improperly issued or enforced a court could order that the [produced] copies of the tapes be either returned or destroyed").

For those reasons, the law of the Sixth Circuit prohibits the review of discovery orders under the collateral order doctrine. "Discovery orders are not reviewable on an interlocutory basis . . . under the collateral order doctrine." *In re Professionals Direct Ins. Co.,* 578 F.3d 432, 438 (6th Cir. 2009); *Diabetes Treatment Centers of Am., Inc.*, 444 F.3d at 472 ("This court has repeatedly held, however, that discovery orders are generally not appealable under the collateral order doctrine.") (reviewing the case law).

Rather, apparently conceding that *Mohawk* precludes appeal under the collateral-order doctrine, HSBC asks this Court to relax the standard "[b]ecause this case involves a bankruptcy court ruling." (Bankr. Dkt. 99 at 14 n.5.) That is no basis for such an exception. The Supreme Court and Sixth Circuit authority is uniform in emphasizing that the collateral-order doctrine should be interpreted narrowly. *See Mohawk Indus.*, 130 S. Ct. at 605 ("[W]e have stressed that it must never be allowed to swallow the general rule."); *Will v. Hallock*, 546 U.S. 345, 350 (2006) ("[W]e have not mentioned applying the collateral order doctrine without emphasizing its modest scope."); *Swanson*, 606 F.3d at 833 (stating that "courts have vigilantly preserved the narrow confines of the collateral order doctrine").

Accordingly, this Court has previously held that orders granting or denying Rule 2004 exams are not appealable under the collateral-order doctrine. *Gray*, slip op. at 14. Other courts across the country agree. *See, e.g.*, *Countrywide Home Loans, Inc.*, 2008 WL 2388285, *4-*6 (Exhibit E) (rejecting mortgage lender's arguments for appeal under collateral-order doctrine). Therefore, this

Court should hold that the collateral-order doctrine is inapplicable here.

C. The criteria for a discretionary interlocutory appeal are not met.

This Court uses the criteria found in 28 U.S.C. § 1292(b) to determine whether to grant a discretionary interlocutory bankruptcy appeal under 28 U.S.C. § 158(a)(3). *See In re ASC Inc.*, 386 B.R. at 195 (applying section 1292(b) standards in analyzing whether to allow an interlocutory bankruptcy appeal). Section 1292(b) requires that (1) the order involve a controlling question of law, (2) as to which there is substantial ground for difference of opinion, and that (3) an immediate appeal from the order may materially advance the ultimate termination of the litigation. 28 U.S.C. § 1292(b). Review "is granted sparingly and only in exceptional cases." *W. Tenn. Chapter of Assoc. Builders & Contractors, Inc. v. City of Memphis*, 293 F.3d 345, 350 (6th Cir. 2002). Here, none of those requirements exist.

1. There are no "controlling issues of law" in this case; HSBC instead complains that the factual record did not provide sufficient cause to order the discovery.

In analyzing the first factor of the test for interlocutory appeals, this Court must determine whether there is a "controlling question of law." A controlling question of law is "a 'pure' question of law rather than merely an issue that might be free from a factual contest." *Ahrenholz v. Bd. of Trustees of Univ. of Ill.*, 219 F.3d 674, 677 (7th Cir. 2000). It is "something the court of appeals could decide quickly and cleanly without having to study the record . . . [not an issue that] requires hunting through the record . . . ." *Id.* A "controlling question of law" is an "an abstract issue of law, . . . suitable for determination by an appellate court without a trial record." *Id.*; *In re Brentwood Golf Club, L.L.C.*, 329 B.R. 239, 243 (E.D. Mich. 2005) (denying discretionary interlocutory review under 28 U.S.C. § 158(a)(3) and citing *Ahrenholz*, 219 F.3d at 676-77).

An "allegation of abuse of discretion on an evidentiary ruling does not create a legal issue under section 1292(b)." *City of Memphis*, 293 F.3d at 351; *see* 8 Fed. Prac. & Proc. Civ. § 2006 (3d ed.) ("Ordinarily it is difficult to believe that a discovery order will present a controlling question of law or that an immediate appeal will materially advance the termination of the litigation."). Because discovery rulings are discretionary, they are not appropriate for interlocutory review under section 1292(b). *Mortg. Elec. Registration Sys., Inc. v. Jones*, No. 09-10321, 2009 WL 646623, *2 (E.D. Mich. March 11, 2009) (citing *City of Memphis*) (Exhibit H); *see, e.g.*, *Proctor v. U.S. Dep't of Educ.*, 196 Fed. App'x 345, 347 (6th Cir. 2006) (stating that a trial court "enjoys broad discretion in handling discovery disputes").

Although HSBC argues that this appeal presents controlling issues of law, its contentions of legal error challenge the bankruptcy court's application of discretion to a factual dispute. Nothing in the Rule 2004 Order purports — as HSBC claims — to order discovery outside of the scope of Rule 2004 or to allow a Rule 2004 examination without showing good cause. (Bankr. Dkt. 99 at 15-16.) Rather, as HSBC's argument on the second factor reveals, these issues are fact-driven inquiries. The first argument it raises is whether the discovery order regarding HSBC's policies and procedures has a bearing on the administration of the bankruptcy case. *Id.* The second is whether there was an insufficient showing of good cause. *Id.* But these are factual disputes that require an examination of the record to resolve. Even HSBC admits that the question it is attempting to present on appeal is "whether the bankruptcy court abused its discretion" by ordering discovery. (Bankr. Dkt. 99 at 9.)

As this Court has held in an analogous case, the Rule 2004 Order "is not the type of pure legal issue that counsels for interlocutory review." *Gray*, slip op. at 16. And because there is no controlling question of law at issue, there can be no substantial ground for a difference of opinion about it. C*f. Ahrenholz,* 219 F.3d at 676 (stopping analysis after finding no "controlling question of law" and stating "[u]nless *all* these criteria [for interlocutory appeal under 28 U.S.C.

§ 1292(b)] are satisfied, the district court may not and should not certify its order . . . for an immediate appeal").

2. Immediate appeal will not advance the ultimate termination of the litigation.

HSBC's final argument also fails. It contends that immediate appeal will advance the ultimate termination of the litigation because this discovery dispute is "the only dispute pending between the UST and HSBC." (Bankr. Dkt. 99 at 18.) But HSBC overlooks that the proceedings below may still continue. Although Rule 2004 is a discovery tool with similarities to discovery under Fed. R. Civ. P. 26, it is a discovery tool that allows for *pre-litigation* discovery. A Rule 2004 examination is undertaken before the filing of an adversary proceeding or a motion, and is normally conducted in the absence of a pending adversary proceeding or contested matter. *See supra* Part A.

As this Court held in *Gray*, "in light of the role of Rule 2004 examinations in pre-litigation discovery, the current appeal, if permitted, would prolong rather than hasten the termination of the litigation." *Gray*, slip op. at 16. *See, e.g.*, *White v. Nix*, 43 F.3d 374, 378 (8th Cir. 1994) (stating that the resolution of a "discovery dispute does little to advance the ultimate termination of the litigation and results only in delay"). A Rule 2004 examination advances the ultimate termination of the litigation no more than any other discovery order in non-bankruptcy civil litigation. That is to say, it does not. It remains entirely possible that an adversary complaint or contested matter may arise between the United States Trustee and HSBC. An immediate appeal would not terminate such litigation — it would protract it. *Gray*, slip op. at 16.

CONCLUSION

For all of these reasons, this Court should deny HSBC's motion for leave to appeal. The majority of courts, including a recent decision by this Court in an analogous courts, have denied similar motions for interlocutory appeal. So, too, should this Court.

Respectfully submitted,
DANIEL M. McDERMOTT
UNITED STATES TRUSTEE
Region 9

By: /s/ Kelley Callard (P68537)
Kelley.Callard@usdoj.gov
Trial Attorney
Office of the U.S. Trustee
211 West Fort St - Suite 700
Detroit, Michigan 48226
(313) 226-6773

Dated: March 16, 2011

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF MICHIGAN
SOUTHERN DIVISION

In re:	Case No. 10-50910-PJS
KEITH R. ELLIS,	Chapter 13
Debtor.	HON. PHILLIP J. SHEFFERLY
_______________________________________/	District Court Case No. 2:11-cv-10860-VAR-PJK

EXHIBIT LIST

1. Exhibit A - *In re Gray*, No. 2:11-10640, slip op. (E.D. Mich. Mar. 15, 2011)

2. Exhibit B - *In re Dental Profile, Inc.*, No. 09-C-6160, 2010 WL 431590, at *2 (N.D. Ill. Feb. 1, 2010)

3. Exhibit C - *In re Vance*, 165 F.3d 34 (Table), 1998 WL 783728, *1 (7th Cir. Nov. 2, 1998)

4. Exhibit D - *In re Midwest Video Games, Inc.*, No. 98-C-3836, 1998 WL 395152, at *1 (N.D. Ill. July 9, 1998)

5. Exhibit E - *Countrywide Home Loans, Inc. v. Office of the United States Trustee*, No. 08-617, 2008 WL 2388285, *4-*6 (W.D. Pa. June 11, 2008)

6. Exhibit F - *In re Del Castillo*, Case No. 08-20020-mc-Altonaga (S.D. Fla. Feb. 8, 2008)

7. Exhibit G - *Buckner v. Okla. Tax. Comm'n (In re Buckner)*, No. 00-073, 2001 WL 992063, at *2 (B.A.P. 10th Cir. Aug. 30, 2001)

8. Exhibit H - *Mortg. Elec. Registration Sys., Inc. v. Jones*, No. 09-10321, 2009 WL 646623, *2 (E.D. Mich. March 11, 2009)

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF MICHIGAN
SOUTHERN DIVISION

In re:

DERRICK GRAY,

Debtor.

Case No. 11-10640
Honorable Julian Abele Cook, Jr.

ORDER

On June 29, 2010, the debtor, Derrick Gray, filed a voluntary bankruptcy petition under Chapter 13 of the bankruptcy code. Wells Fargo Bank, N.A. ("Wells Fargo") - a secured creditor by virtue of holding and servicing a mortgage loan secured by Gray's real property - filed a proof of claim in which it itemized fees that it claimed Gray owed. This itemization included certain fees - denominated "Inspection Fees" and "Other Advance - Property Preservation" - the necessity and reasonableness of which the United States Trustee ("Trustee") questioned. The Trustee filed a motion in which he requested an order from the Bankruptcy Court for Wells Fargo to produce certain documents and appear for an examination pursuant to Bankruptcy Rule 2004. Wells Fargo opposed the motion. After a hearing, the Bankruptcy Judge granted the Trustee's request. Currently before the Court is Wells Fargo's motion for leave to appeal the Bankruptcy Court's order.

I.

Before the Trustee filed the Rule 2004 motion in the Bankruptcy Court, he sent a letter to Wells Fargo in which he requested clarification of the nature of $105 in fees denominated

"Other Advance - Property Preservation." Wells Fargo responded to this request by listing the dates on which property preservation services were performed and providing "all of the invoices, work orders, and inspection reports for each of the seven property inspections that made up the $105 charge." (Appellant's Mot. for Leave at 3). It appears that inspections performed before foreclosure were charged as "Inspection Fees," but inspections performed after foreclosure were charged as "Property Preservation" fees.

The Trustee questioned whether so many inspections were necessary and whether the associated fees were reasonable, and thus filed his Rule 2004 motion for document production and an examination. The Trustee sought to examine Wells Fargo on the following topics: (1) the total arrearage on Gray's account; (2) the reasonableness of the inspection fees imposed against Gray's account; (3) Wells Fargo's policies and procedures applicable to Gray's account in (a) ordering an inspection and (b) referring a proof of claim; and (4) documents and other information relied on in referring the proof of claim. In addition, the Trustee sought a subpoena *duces tecum* compelling Wells Fargo to produce the following documents: (1) all communication sent to Gray between May 1, 2009, and June 29, 2010; (2) all documents constituting Wells Fargo's records of Gray's account; (3) all aspects of any agreements between Wells Fargo and a default servicer associated with the Gray case; (4) Wells Fargo's policies and procedures applicable to the Gray case concerning (a) the ordering of and accounting for inspections and property preservation fees; (b) filing proofs of claims on its accounts; and (5) all documents that Wells Fargo relied upon in referring the Gray account for a proof of claim.

At a hearing on the Rule 2004 motion, the Trustee acknowledged that the motivation behind his letter to Wells Fargo - to wit, his concern that Wells Fargo was "double dipping" by charging twice, once under each denominated category of fees, for home inspections - was alleviated by Wells Fargo's responsive letter. (1/19/11 Hr'g Tr. at 4:14-21, attached as Ex. B to Appellant's Mot. for Leave). However, the Trustee stated that he continued to be concerned about the reasonableness of those fees as well as the necessity of performing so many home inspections. (Trustee's Resp. at 2). Wells Fargo objected to the examination, arguing that the "double dipping" theory lacked legal or factual basis and therefore the Trustee had not demonstrated the "good cause" required to support a request for Rule 2004 examination. Moreover, Wells Fargo maintained that the documents and topics encompassed by the request exceeded the permissible scope of a Rule 2004 examination.

In response, the Trustee argued that - even leaving aside the "double dipping" issue - there was still good cause for the examination because: (1) Wells Fargo's labeling of inspections differently depending on whether they were done before or after foreclosure lacked transparency and made it difficult for parties to determine if fees were reasonable; (2) a pre-foreclosure inspection was performed in early December and a post-foreclosure inspection was performed in late December, which appears, on its face, to be unreasonable; and (3) the existence of separate tracking systems pre- and post-foreclosure may - as here - result in unnecessary inspections and raise the specter of Well Fargo attempting to collect unreasonable fees through the bankruptcy process. (1/19/11 Hr'g Tr. at 4:14-5:23).

During the hearing, the Bankruptcy Judge inquired whether the fact that Wells Fargo filed a proof of claim might not be sufficient, by itself, to constitute good cause for a Rule 2004 examination. Separately, the Bankruptcy Judge referred to academic studies that demonstrated that approximately half of mortgage claims contain errors, and suggested that that fact, by itself, might be sufficient to constitute not only good cause - but an obligation - for the Trustee to investigate the reasonableness of the fees reflected in the claim.

On February 10, 2011, the Bankruptcy Court entered an order in which it granted the Trustee's request for a Rule 2004 examination and the issuance of a subpoena *duces tecum*. Wells Fargo presents three questions on appeal; to wit, whether the Bankruptcy Court (1) erred as a matter of law by permitting the Trustee to proceed with a Rule 2004 examination that exceeds the permissible scope of a Rule 2004 exam; (2) erred as a matter of law by not requiring the Trustee to demonstrate good cause for the requested examination; and (3) abused its discretion in finding that the Trustee had met his burden of demonstrating good cause.

Wells Fargo timely filed a notice of appeal of, and motion for leave to appeal, the Rule 2004 order, and has separately filed the following motions related to its appeal: (1) emergency motion to stay the Rule 2004 order pending this appeal; (2) motion to expedite the motion to stay; and (3) motion for leave to file a reply brief in further support of its motion to appeal. In a prior order, the Court granted the last-listed motion.

Wells Fargo argues that its appeal to this Court is proper on three separate bases: (1) the Rule 2004 order is a final decision as to which Wells Fargo has an appeal of right and over which the District Court properly has jurisdiction, 28 U.S.C. § 158(a)(1); (2) the challenged order is appealable as of right under the collateral order doctrine of *Cohen v. Beneficial Industrial Loan Corp.*, 337 U.S. 541 (1949); and (3) even if the challenged order is interlocutory, the Court should grant leave to appeal under 28 U.S.C. § 158(a)(3). The Court will consider each argument seriatim.

II.

A federal district court has jurisdiction to hear appeals - and an aggrieved litigant may appeal as of right - from "final judgments, orders, and decrees" of a bankruptcy court. 158 U.S.C. § (a)(1). In the Sixth Circuit, "finality 'is considered in a more pragmatic and less technical way in bankruptcy cases than in other situations.'" *Winget v. JP Morgan Chase Bank, N.A.*, 537 F.3d 565, 578 (6th Cir. 2008) (quoting *Lindsey v. O'Brien, Tanksi, Tanzer & Young Health Care Providers of Conn. (In re Dow Corning*), 86 F.3d 482, 541-42 (6th Cir. 1996)); *see also Millers Cove Energy Co. v. Moore (In re Millers Cove Energy Co.*), 128 F.3d 449, 451 (6th Cir. 1997) (citation and internal quotation marks omitted) ("[T]he concept of finality applied to appeals in bankruptcy is broader and more flexible than the concept applied in ordinary civil litigation."). This is so because "[b]ankruptcy cases frequently involve protracted proceedings with many parties participating. . . . [Therefore] courts have permitted appellate review of orders that in other contexts might be considered interlocutory." *Dow Corning*, 86 F.3d at 488 (quoting *A.H. Robins Co. v. Piccinin*, 788 F.2d 994, 1009 (4th Cir. 1986)).

The test for finality in the bankruptcy context has often been stated as requiring a showing that the challenged order "finally dispose[s] of discrete disputes within the larger case." *E.g., id.* (quoting *In re Saco Local Dev. Corp.*, 711 F.3d 441, 444 (1st Cir. 1983)); *Intercontinental Enters., Inc. v. Keller (In re Blinder, Robinson & Co. Inc.),* 127 B.R. 267, 271 (D. Colo. 1991) (quoting *Adelman v. Fourth Nat'l Bank & Trust Co., N.A. (In re Durability, Inc.),* 893 F.2d 264, 265 (10th Cir. 1990)) ("The concept of finality . . . . applies 'not in the overall case, but rather the particular adversary proceeding or discrete controversy pursued within the broader framework cast by the petition.'"). This test has also been said to require a showing that the order "ends the litigation on the merits and leaves nothing for the court to do but execute the judgment." *E.g.*, *In re Barrett*, 337 B.R. 896 (6th Cir. B.A.P. 2006), *aff'd*, 487 F.3d 353 (6th Cir. 2007); *In re Smelser*, 327 B.R. 815, 817 (E.D. Mich. 2005).

Analyzing nearly identical language in 28 U.S.C. § 158(d) regarding the jurisdiction of the courts of appeal, the Seventh Circuit has drawn a distinction between "discrete disputes" and "discrete issues," with only the former being subject to immediate appeal. *In re Comdisco, Inc.*, 538 F.3d 647, 651-52 (7th Cir. 2008). A discrete dispute is one that is essentially separable from the larger case, and "disposition of a claim that would be final as a stand-alone suit outside of bankruptcy is also final under § 158(d) in bankruptcy." *Id.* at 651 (quoting *In re Morse Elec. Co.*, 805 F.2d 262, 265 (7th Cir. 1986)). On the other hand, "a decision or order that resolves only an issue that arises during the administration of a bankruptcy estate is too small a litigation unit to justify treatment as a final judgment." *Id.*; *see also Zedan v. Habash*, 529 F.3d 398, 402 (7th Cir. 2008) ("[T]he test we have utilized to determine finality under § 158(d) is whether an order resolves a discrete dispute that, but for the continuing bankruptcy, would have been a stand-alone suit by or against the trustee.").

Wells Fargo and the Trustee have each provided the Court with a list of cases that purportedly support their respective positions with respect to the finality of a Rule 2004 order. After examination of these - and many more - opinions, the Court concludes that those opinions that determine that a Rule 2004 order is not a final judgment are significantly more persuasive.

Most of the cases cited by Wells Fargo are distinctly unpersuasive. Several engage in no analysis of the jurisdictional issue whatsoever, and there is no evidence that the courts even considered the possibility that jurisdiction might not be proper. *See First Nat'l Bank v. Scaccia*, no. 88-3369, 1988 WL 123332 (E.D. La. Nov. 10, 1988) (accepting review of Rule 2004 order without any jurisdictional analysis); *Keene Corp. v. Johns-Manville Corp. (In re Johns-Manville Corp.)*, 42 B.R. 362 (S.D.N.Y. 1984) (same). Others simply accept that a Rule 2004 order is a final order without any consideration of the relevant tests. *See In re Palmquist*, No. C94-1475C, 1995 U.S. Dist. LEXIS 9464 (W.D. Wash. June 15, 1995) (citing *Blinder, Robinson* for the proposition that an "order permitting the taking of the Rule 2004 examination is a final judgment," and engaging in no further jurisdictional analysis, despite the fact that this is not an accurate description of *Blinder, Robinson*'s holding); *Euro.-Am. Bank & Trust Co. v. GATX Aircraft Corp. (In re Hawley Coal Mining Corp.)*, 47 B.R. 392, 393 (S.D.W. Va. 1984) (referring, without analysis, to a Rule 2004 order as a final order); *see also Blinder, Robinson*, 127 B.R. at 272 (noting that *Hawley Coal*, *Scaccia*, and *Johns-Manville* all failed to engage the jurisdictional question).

Of the cases cited by Wells Fargo, only *Buckner v. Oklahoma Tax Commission (In re Buckner)*, No. 00-073, 2001 WL 992063, at *2 (10th Cir. B.A.P. Aug. 30, 2001),[1] engaged in any jurisdictional analysis. There, the bankruptcy panel held that, where a Rule 2004 motion was filed nearly two years after confirmation of the bankruptcy plan, "the postconfirmation Rule 2004 examination [was] a separate proceeding and there [was] no indication that further action by the bankruptcy court [would] be forthcoming." The panel concluded that the Rule 2004 order was "final for the purposes of appeal under § 158(d)."

On the other hand, the cases cited by the Trustee recognize and - in varying depths - analyze the jurisdictional question. *Vance v. Lester (In re Vance)*, No. 98-1470, 1998 WL

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[1] *Buckner* notes that the order "has no precedential value and may not be cited, except for the purposes of establishing the doctrines of law of the case, res judicata, or collateral estoppel." 2001 WL 992063, at n.*.

783728, at *1 (7th Cir. Nov. 2, 1998) ("Although neither the district court nor the parties address the issue, we first consider whether we have jurisdiction to review the bankruptcy court's order granting a Rule 2004 examination. A majority of courts that have considered the issue have held that orders granting or denying Rule 2004 examinations are, like discovery orders, interlocutory."); *In re Kaiser Grp. Int'l, Inc.*, 400 B.R. 140, 144 (D. Del. 2009) ("The Debtors also contend that orders denying discovery pursuant to Bankruptcy Rule 2004 are inherently final. However, the majority of courts have reached a contrary conclusion."); *In re Midwest Video Games, Inc.*, No. 98 C 3836, 1998 WL 395152, at *1 (N.D. Ill. July 9, 1998) ("The court declines to accept the appellants' invitation to find that the bankruptcy judge's [Rule 2004] discovery order is final because the bankruptcy judge has indicated that he does not intend to revisit his ruling, as the order is clearly interlocutory, even under the more relaxed standards of finality applicable to bankruptcy cases."); *Gache v. Balaber-Strauss*, 198 B.R. 662 (S.D.N.Y. 1996) (order granting Rule 2004 examination was not final because, among other reasons, a motion to compel debtor's presence at the exam was still pending before the bankruptcy court); *Towers Fin.*, 164 B.R. 719 (denial of Rule 2004 order was not final, and even if *Blinder, Robinson* created exception to general rule that bankruptcy discovery orders are not appealable, it would not be applicable there because the possibility existed that the bankruptcy court would take further action); *Aetna Cas. & Sur. Co. v. Glinka*, 154 B.R. 862, 865 (D. Vt. 1993)("[T]his Court concludes that the [Rule 2004] Examination Order . . . was an interlocutory order. It served as an initial authorization to pursue broad discovery under

Bankruptcy Rule 2004.”).[2]

Wells Fargo and the Trustee each claim that *Blinder, Robinson* supports their respective position. There, the court considered the finality of two bankruptcy court orders, one granting the trustee’s motion for Rule 2004 examinations of various persons and entities that had done business with the debtor, and one granting a motion to close certain of those examinations to other parties on the basis of attorney-client privilege. The court noted that, at that time, there were few cases involving appeals of Rule 2004 orders, and even among those few, the results were inconsistent. 127 B.R. at 272. The court determined that the finality of Rule 2004 orders should be determined not by hard-and-fast rule, but rather on a case-by-case basis. *Id.* at 272-73. “Where the dispute has been narrowed and there is no indication that further action by the bankruptcy court will be forthcoming, an order concerning Rule 2004 examinations should properly be considered final.” *Id.* at 273. Applying this test, the court determined that the order granting the Rule 2004 motion was not final because the bankruptcy court had subsequently ruled on a motion related to the scope of the Rule 2004 exam. *Id.* (“[T]he [Rule 2004] order simply gave the Trustee initial authorization to commence Rule 2004 examinations . . . . It did

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[2] Wells Fargo asserts that cases such as *Vance* and *Midwest Video* are distinguishable because they involved orders for Rule 2004 exams of *debtors*, who will have later opportunity to appeal because they will remain in the litigation. However, Well Fargo’s argument is significantly undermined by the fact that many other cases - cases that Wells Fargo does not acknowledge - involve Rule 2004 exams of creditors or other third parties. Wells Fargo also suggests that the Court should discount *Vance* and *Midwest Video* because the courts had merely “summarily concluded” that Rule 2004 orders to be non-final. In light of the discussion above regarding Wells Fargo’s case citations, this argument is not well taken. Moreover, this argument is misleading in at least two respects: (1) Wells Fargo ignores the fact that *Midwest Video* did engage in a substantive analysis and critique of *Blinder, Robinson* in light of the rationale for the finality requirement; and (2) Wells Fargo fails to acknowledge the many other cases that came to the same result after engaging in extensive analysis.

not finally resolve on the merits [appellant's] dispute regarding the permissible scope to the Rule 2004 examinations."). Conversely, the court determined that the order closing certain of the examinations to other parties was a final order. *Id.* at 277 ("[T]his appeal involves the discrete issue of the Trustee's entitlement to closed Rule 2004 examinations, and the bankruptcy court's order appears to have fully resolved the parties' dispute.").

As a general matter, discovery orders are interlocutory and not immediately appealable. *E.g.*, *United States ex rel. Pogue v. Diabetes Treatment Ctrs. of Am., Inc.*, 444 F.3d 462, 471 (6th Cir. 2006) ("Discovery orders generally are not final decisions and cannot be reviewed unless the trial court enters a final judgment disposing of all claims."); *Kaiser Grp. Int'l*, 400 B.R. at 143 ("Generally, pretrial discovery decisions are not considered to be final decisions subject to immediate appeal, even under ["bankruptcy's"] flexible approach to finality."); *Hoffenberg v. Cohen (In re Towers Fin. Corp.)*, 164 B.R. 719, 720 (S.D.N.Y. 1994) ("Bankruptcy court orders granting or denying discovery do not finally dispose of an entire claim on which relief may be granted, and therefore are generally treated as interlocutory and not appealable as of right."). Moreover, the "majority of courts that have considered the issue have held that orders granting or denying Rule 2004 examinations are, like discovery orders, interlocutory." *Vance*, 1998 WL 783728, at *1 (listing cases).

Instead of immediate appellate review, "[g]enerally, a party challenging a discovery order has two options: to comply with the order and challenge it at the conclusion of the case; or to refuse to comply with the order and contest its validity if subsequently found in contempt for such refusal." *Countrywide Home Loans, Inc. v. Office of the U.S. Trustee*, No. 08-617, 2008 WL 2388285 (W.D. Pa. June 11, 2008); *see also Aetna Cas. & Sur. Co. v. Glinka*, 154 B.R.

862, 867 (D. Vt. 1993) ("To obtain appellate review of an order compelling production or testimony in the rare case when an appeal after final judgment would not cure an erroneous ruling, a witness must refuse to obey the subpoena and suffer an order imposing a contempt penalty."). The Sixth Circuit has recognized the continuing vitality of this rule. *Pogue*, 444 F.2 at 471 ("The rule laid out in [*Alexander v. United States*, 201 U.S. 117, 121-22 (1906)] - that an individual seeking to appeal a discovery order must first disobey the order and suffer a contempt citation - remains the general rule today."). Wells Fargo argues that "[s]urely, the [Trustee] does not seriously suggest that a national mortgage service must incur the stigma and negative publicity of a contempt finding by a Bankruptcy Court just to obtain appellate review of a Rule 2004 order." (Reply at 3). However, Wells Fargo fails to explain why a national mortgage service should receive different treatment than any other entity or individual.

In support of its claim that the Rule 2004 order is a final judgment, Wells Fargo argues that the Rule 2004 examination is the only present dispute between Wells Fargo and the Trustee, and the Bankruptcy Court definitively resolved that dispute by ordering the examination. Thus, according to Wells Fargo, there is nothing left for the Bankruptcy Court but to execute the order. However, several courts have rejected exactly this argument, reasoning that the Rule 2004 examination is a potential beginning - not a definitive end - of a dispute. *E.g. Countrywide Home Loans*, 2008 WL 2388285, at *4 (finding that a Rule 2004 order is not final because, among other reasons, "additional questions may arise as the U.S. Trustee conducts the examinations such as the permissible scope of the examinations and the consequences of any refusal by [the party to be examined] to comply with the examination."). Rule 2004 examinations "allow the court to gain a clear picture of the condition and whereabouts of the bankrupt's estate." *Johns-Manville*, 42 B.R. at 364. Necessarily, the permissible scope encompasses "[t]he examination of witnesses having knowledge of the debtor's acts, conduct, *liabilities*, assets, etc. . . . and the inquiry may 'cut a broad swath through the debtor's affairs, those associated with him, and those who might have had business dealings with him.'" *Id.* (emphasis added) (citation omitted) (quoting *In re Mantolesky*, 14 B.R. 973, 976 (Bankr. D. Mass. 1981)). Courts have frequently stated that Rule 2004 authorizes parties to engage in "fishing expedition[s]." *E.g. Blinder, Robinson*, 127 B.R. at 274. The Court cannot predict what, if any, issues may arise as a result of the examinations, nor can it predict whether Wells Fargo will comply with the Rule 2004 order. The fact that issues might arise that require further action from the Bankruptcy Court is sufficient to establish that the Rule 2004 order did not finally dispose of the discrete dispute between Wells Fargo and the Trustee. *See, e.g.*, *In re Dental Profile, Inc.*, No. 09 C 6160, 2010 WL 431590, at *2 (N.D. Ill. Feb. 1, 2010) ("[T]he order granting leave to conduct a Rule 2004 examination in no way 'resolves a discrete dispute' but is only a discovery order for information that will allow both sides to present evidence in the dispute."); *Glinka*, (because district court could not predict whether party ordered to submit to Rule 2004 examination would comply with order, and, if not, whether bankruptcy court would issue contempt order, "require[d] a finding that the [challenged] order was indeed interlocutory"). The Court thus determines that the Rule 2004 is not a final order.

III.

Wells Fargo next argues that it has an appeal as of right pursuant to the collateral order doctrine articulated by the Supreme Court in *Cohen v. Beneficial Industrial Loan Corp.*, 337 U.S. 541, 546 (1949) (immediate appellate review available for that "small class [of decisions] which finally determine claims of right separable from, and collateral to, rights asserted in the action, too important to be denied review and too independent of the cause itself to require that appellate consideration be deferred until the whole case is adjudicated."). Under this doctrine, an interloctutory order may nevertheless be immediately appealable if it "(1) conclusively determines the disputed question; (2) resolves an important question completely separate from the merits of the action; and (3) is effectively unreviewable on appeal from final judgment." *Dow Corning*, 86 F.3d at 488 (citing *Cohen*). As with the rule of finality discussed above, these factors are also applied flexibly in the bankruptcy context. *Id.* ("These three factors are equally fluid and are applied flexibly in determining whether an order involving a bankruptcy proceeding is reviewable."). However,"if there is doubt whether an order is collateral, the matter should be resolved in favor of finding a nonappealable controversy." *In re M.T.G., Inc.*, 298 B.R. 310, 314 n.8 (E.D. Mich. 2003).

The Sixth Circuit has "repeatedly held . . . that discovery orders are generally not appealable under the collateral order doctrine." *Pogue*, 444 F.3d at 472. Instead, "to obtain review from this court, a complaining party must disobey the discovery order and incur an appealable contempt citation if that party is able to do so." *Id.*; *see also, e.g.*, *Bowen v. Zach*, Nos. 96-4156, 96-4226, 1996 WL 668558, at *1 (citations omitted) ("The typical discovery order does not fall within the 'small class' of orders contemplated by *Cohen*. Discovery orders need not evade review, and they do not necessarily present the final word on the issue. A party may obtain review of a discovery order by violating the order and incurring sanctions or a finding of contempt. That order is then appealable.").

Wells Fargo's argument founders on the first prong of the *Cohen* test because, as discussed above, the Rule 2004 order does not finally or conclusively determine a claim of right. Nor is the Rule 2004 order "effectively unreviewable." Again, as discussed above, if Wells Fargo were to refuse to comply with the order, and the Bankruptcy Court adjudged it in contempt, it could seek review of the contempt order. The conclusion that review of a Rule 2004 order cannot be had pursuant to the collateral order doctrine is in accord with other courts that have considered this precise question. *See, e.g.*, *In re Del Castillo*, No. 08-20020 (S.D. Fla. Feb. 8, 2008) (collateral order doctrine inapplicable to Rule 2004 order because it was unclear whether the bankruptcy court would take further action - for example, by issuing a contempt order - and the appellant had not demonstrated that it could not seek later review); *Glinka*, 154 B.R. 868 n.8 ("Application of the collateral order doctrine requires a finding that the order [denying motion to quash and directing production of documents for Rule 2004 examination] is effectively unreviewable. The issues raised in this appeal are reviewable in an appeal from a contempt sanction, should one be entered in this case."). The Court thus concludes that the collateral order doctrine is inapplicable here.

IV.

Finally, Wells Fargo argues that the Court should exercise its discretion to grant leave to appeal under 28 U.S.C. § 158(a)(3) ("The district courts of the United States shall have jurisdiction to hear appeals . . . with leave of the court, from other interlocutory orders and decrees [of bankruptcy courts.]"). Section 158 does not establish any standards to guide the district courts' discretion, but, "[i]n the absence of such guidance within the Bankruptcy Rules, appellate courts reviewing the decisions of bankruptcy courts have applied the standards found in 28 U.S.C. § 1292(b)." *In re Wicheff*, 215 B.R. 839, 844 (6th Cir. B.A.P. 1998). "Under §

1292(b), an appellant seeking review of an interlocutory order must show: (1) the question involved is one of law; (2) the question is controlling; (3) there is substantial ground for difference of opinion respecting the correctness of the [bankruptcy] court's decision; and (4) an immediate appeal would materially advance the ultimate termination of the litigation." *Id.* (citation omitted). Moreover, because interlocutory appeals "contravene the judicial policy opposing piecemeal litigation and the disadvantages of delay and disruption associated with it," *In re Am. Freight Sys., Inc.*, 194 B.R. 659, 661 (D. Kan. 1996), "[r]eview under § 1292(b) should be sparingly granted and then only in exceptional cases," *Wicheff*, 215 B.R. at 844; *see also In re A.P. Liquidating Co.*, 350 B.R. 752, 755 (E.D. Mich. 2006) (citation and internal quotation marks omitted) ("The discretion of the district court should be used sparingly, since interlocutory bankruptcy appeals should be the exception, rather than the rule.").

Wells Fargo submits that its appeal presents three controlling questions of law; to wit, (1) whether a bankruptcy court can order a Rule 2004 examination concerning a creditor's general policies and procedures that are not tethered to a debtor's estate; (2) whether a bankruptcy court can order a Rule 2004 examination without requiring that the requesting party demonstrate good cause for the examination, and (3) whether the Bankruptcy Court abused its discretion by ordering a Rule 2004 examination when the Trustee had not affirmatively demonstrated good cause for the examination. The Trustee disputes Wells Fargo's characterization of the Bankruptcy Court's actions, arguing that the challenged order does not purport to order discovery without requiring a showing of good cause.

The Court concludes that these questions do not present, as required, "pure" or "abstract" issues of law "suitable for determination by an appellate court without a trial record."

Ahrenholz v. Bd. of Trs. Of Univ. of Ill., 219 F.3d 674, 677 (7th Cir. 2000); *see also In re Am. Specialty Cars, Inc.*, 386 B.R. 187, 196 (E.D. Mich. 2008) (citations and internal quotation marks omitted) ("A legal question of the type envisioned in § 1292(b) . . . generally does not include matters within the discretion of the trial court. Interlocutory appeals are intended for situations in which the court of appeals can rule on a pure, controlling question of law without having to delve beyond the surface of the record in order to determine the facts."); *In re Brentwood Country Club, LLC*, 329 B.R. 239, 242-43 (E.D. Mich. 2005) ("With reference to 28 U.S.C. § 1292(b) the term 'question of law' refers to a 'pure' question of law and not just an issue that is free from factual disputes."). To answer the questions that Wells Fargo has posed, the Court would have to first determine whether the Bankruptcy Court did the things alleged before it would proceed to determining whether it erred or abused its discretion in doing so. *See Brentwood*, 329 B.R. at 243 (refusing to review an interlocutory order where the appellant "ask[ed] this [c]ourt to review the oral arguments, the parties' pleadings and the record to determine if the bankruptcy court exceeded its authority"). This is not the type of pure legal issue that counsels for interlocutory review.

Nor does the Court believe that granting Wells Fargo leave to appeal would materially advance the ultimate termination of the litigation. On the contrary, and in light of the role of Rule 2004 examinations in pre-litigation discovery, the current appeal, if permitted, would prolong rather than hasten the termination of the litigation. *See Del Castillo*, No. 08-20020, at *11 (finding no controlling question of law that would advance litigation because the challenged Rule 2004 order did not finally adjudicate the validity of the creditor-appellant's claim, but rather simply allowed the trustee to conduct discovery regarding the creditor's factual support for the claim); *In re Hecker*, No. 10-1904, 2010 WL 1875553 (D. Minn. May 10, 2010) ("The [c]ourt declines to exercise its discretion to decide this case with a limited record and the possibility of ongoing proceedings, such as contempt proceedings, which could resolve or narrow the issues raised on appeal."). The Court thus declines to exercise its discretion to grant Wells Fargo leave to appeal the Rule 2004 order.

V.

For the reasons that have been set forth above, the Court (1) denies Wells Fargo's motion for leave to appeal; and (2) denies Wells Fargo's motions to stay pending appeal and to expedite consideration of same as moot.

IT IS SO ORDERED.

Dated: March 15, 2011
Detroit, Michigan

s/Julian Abele Cook, Jr.
JULIAN ABELE COOK, JR.
United States District Court Judge

CERTIFICATE OF SERVICE

The undersigned certifies that the foregoing Order was served upon counsel of record via the Court's ECF System to their respective email addresses or First Class U.S. mail to the non-ECF participants on March 15, 2011.

s/ Kay Doaks
Case Manager

Only the Westlaw citation is currently available.

United States District Court,

N.D. Illinois,
Eastern Division.
In re DENTAL PROFILE, INC., et al., Debtors.
No. 09 C 6160.

Underlying Case Nos. 08-17148, 08-17149.
Feb. 1, 2010.
West KeySummary**Bankruptcy 51 🔑 3768**

51 Bankruptcy

51XIX Review
51XIX(B) Review of Bankruptcy Court
51k3766 Decisions Reviewable
51k3768 k. Interlocutory orders; collateral order doctrine. Most Cited Cases

A district court did not have jurisdiction to hear a Chapter 11 debtor's interlocutory appeal regarding the bankruptcy court's order for discovery regarding the debtor's financial institutions. The order was not likely to affect the outcome or the further course of the litigation and was likely only to delay the ultimate resolution of the case. 28 U.S.C.A. § 1292(b).

MEMORANDUM OPINION AND ORDER

MARVIN E. ASPEN, District Judge.

***1** Appellants Dr. Husam Aldairi, Husgus, LLC, and Aya Dental, Ltd. filed a notice of appeal from the bankruptcy court's September 13, 2009, order granting creditor Nereida Mendez's motion for permission to conduct a Bankruptcy Rule 2004 examination of Dr. Aldairi and his various businesses. Presently before us is Mendez's motion to dismiss the appeal for lack of subject matter jurisdiction. For the reasons stated below, we grant the motion.[FN1]

I. BACKGROUND

This appeal arises out of the Chapter 11 bankruptcy proceeding involving Dental Profile, Inc., et al. ("Debtors"), entities owned and controlled by Appellant Dr. Husam Aldairi. Debtors filed their bankruptcy petition under Chapter 11 on July 2, 2008. Creditor Nereida Mendez holds a significant claim against Debtors, the basis of which is a judgment for Mendez in a federal lawsuit. Mendez secured her $81,436.01 claim through a garnishment of Debtors' accounts. After receiving notice of this garnishment, Debtors filed for bankruptcy. As of the date of this opinion, Debtors remain in possession under Chapter 11. One reason Debtors remain in possession is that the U.S. Trustee objected to the reorganization plan, finding it not to be in good faith. (Sur-resp., Ex. 2.) The U.S. Trustee made this objection, in part, because the plan appeared to be a "vehicle for the personal profit of the debtor's owners" and did not seek to recover insider preference loans made to Aldairi by Debtors. (Surresp., Ex. 2 ¶¶ 15-16.)

On September 13, 2009, Bankruptcy Judge Jacqueline P. Cox granted a motion by Mendez to conduct a Federal Rule of Bankruptcy Procedure 2004 examination of the finances of Debtors, Aldairi and other entities. The order stated in relevant part: "It is hereby ordered that motion for permission to conduct a 2004 examination of Debtor's financial institutions and to issue subpoenas and obtain records concerning the property and financial affairs of Debtors; Dr. Husam Aldairi; Husgus, LLC; Aya Dental, Ltd.; and any other related business of Dr. Aldairi." (Reply, Ex. 1, 9/13/09 Order.) Mendez requested this order because Dr. Aldairi, Husgus, LLC; and Aya Dental, Ltd. (collectively, "Appellants") have continually refused to turn over requested financial information, despite Judge Cox's denial of their motion to stay enforcement of the September 13 order, and the instigation of contempt hearings against them. Now, Appellants have filed a notice of appeal of the September 13 order in this court. Upon this notice of appeal, Mendez filed a motion to dismiss for lack of jurisdiction under Federal Rule of Civil Procedure 12(b)(1).

[FN1] FN1. In addition, we deny Appellants' Motion to Strike Creditor Nereida Mendez's Response to Dr. Aldairi's Sur-Reply, Dkt. No. 52, as moot.

EXHIBIT B

II. STANDARD OF REVIEW

A motion to dismiss under Federal Rule of Civil Procedure 12(b) (1) requires dismissal of claims over which the federal court lacks subject matter jurisdiction. Jurisdiction is the "power to decide," and must be conferred upon a federal court in order for it to hear a case or controversy. *In re Chicago, Rock Island & Pacific R.R. Co.,* 794 F.2d 1182, 1188 (7th Cir.1986). In reviewing a 12(b)(1) motion to dismiss for lack of subject matter jurisdiction, the court may look beyond the complaint to pertinent evidence submitted by the parties. *See United Transp. Union v. Gateway W. Ry. Co.,* 78 F.3d 1208, 1210 (7th Cir.1996). A plaintiff faced with a properly supported 12(b)(1) motion to dismiss bears the burden of proving that the jurisdictional requirements have been met. *See Kontos v. U.S. Dep't of Labor,* 826 F.2d 573, 576 (7th Cir.1987).

III. ANALYSIS

***2** Our jurisdiction over bankruptcy appeals is governed by statute. Relevant to this case, "[t]he district courts of the United States shall have jurisdiction to hear appeals (1) from final judgments, orders, and decrees ... and (3) with leave of the court, from other interlocutory orders and decrees ....“ 28 U.S.C. § 158(a). From this jurisdictional grant, there appear to be three possible avenues of jurisdiction. First, Appellants argue that the bankruptcy court's order granting a Rule 2004 examination was a "final order" within the meaning of § 158(a)(1) and thus is appealable. Second, Appellants argue that if the order is not final, it falls within a narrow exception to the finality requirement known as the "collateral order" doctrine set out in *Cohen v. Beneficial Industrial Loan Corporation,* 337 U.S. 541, 61 S.Ct. 1221 (1941). Third, even if this appeal is not a "collateral order" under *Cohen,* we may grant leave [FN2] and accept jurisdiction over interlocutory bankruptcy appeals at our discretion, guided by the principles set forth by the Seventh Circuit.

> FN2. Mendez seems to assume that the absence of formal leave is dispositive of this case, either because "the court" in § 158(a) (3) refers to the bankruptcy court, (Reply ¶¶ 47-48), or because this court has not formally granted leave to appeal. However, the Seventh Circuit has held that "with the leave of the court" in § 158(a)(3) refers "obviously [to the] district court." *In re Jartran, Inc.,* 886 F.2d 859, 866 (7th Cir.1989). Furthermore, Federal Rule of Bankruptcy Procedure 8003 specifically allows a district court to consider a motion to appeal, taken improperly, without leave, as a motion for a leave to appeal and instructs that a district court denying such a motion "shall consider the notice of appeal as a motion for leave to appeal." Fed. R. Bankr.P. 8003©; *see Matter of Forty-Eight Insulations, Inc.,* 115 F.3d 1294, 1299 (7th Cir.1997). Therefore, when analyzing our jurisdiction under Section 158(a)(1), we will consider the Appellants' motion to appeal as a motion for leave to appeal.

A. September 13 Order Not Final

Finality in the bankruptcy context is "considerably more flexible than in an ordinary civil appeal." *Zedan v. Habash,* 529 F.3d 398, 402 (7th Cir.2008) (quoting *In re Gould,* 977 F.2d 1038, 1040-41 & n. 2 (7th Cir.1992)). Analyzing the almost identical language of Section 158(d)(1), the Seventh Circuit determined that the test of finality "is whether an order resolves a discrete dispute that, but for the continuing bankruptcy, would have been a stand-alone suit by or against the trustee." *Zedan,* 529 F.3d at 402; *see also In re Rimsat, Ltd.,* 212 F.3d 1039, 1044 (7th Cir.2000) ("Where an order terminates a discrete dispute that, but for the bankruptcy, would be a stand-alone suit ..., the order will be considered final and appealable."). In the present case, the order granting leave to conduct a Rule 2004 examination in no way "resolves a discrete dispute" but is only a discovery order for information that will allow both sides to present evidence in the dispute.

Discovery orders, including those pursuant to Bankruptcy Rule 2004, have been considered interlocutory orders by the Seventh Circuit and other courts that have addressed this issue. In *Matter of Vance,* the Seventh Circuit held that an "order granting the trustee's motion for a Rule 2004 examination [wa]s not a final order." 165 F.3d 34 (Table), 1998 WL 783728, at *2 (7th Cir. Nov.2, 1998). Many other cases in this circuit have also either expressly determined or simply assumed that discovery orders are interlocutory orders and proceeded to address whether they should be heard as interlocutory appeals. *See, e.g., Allendale Mut. Ins. Co. v. Bull Data Sys., Inc.,* 32 F.3d 1175, 1177 (7th Cir.1994); *Reise v. Bd. of Regents of Uni. of Wis. Sys.,* 957 F.2d 293, 294-95(7th Cir.1992); *Harrisonville Tel. Co. v. Ill. Commerce Comm'n,* 472 F.Supp.2d 1071, 1080-81 (S.D.Ill.2006).

***3** Appellants attempt to distinguish *Matter of Vance* because the Rule 2004 examination in this case seeks information from not only the Debtors, but also Aldeiri and his various businesses. According to Appellants, by requiring Aldeiri to submit to this examination, the September 13 order "conclusively determine[s] substantive rights and issues in a discrete unit in the larger case." (Resp. at 4.) We disagree. The order does not "conclusively determine" anything, but merely seeks to compel information necessary to determine a critical issue in the underlying bankruptcy case-whether the Appellants are truly separate financial entities from the Debtor. The argument that "Appellants personal information is not in any way relevant to the Debtors acts, conduct, property, liability, financial conditions, or right to a discharge," (Resp.4), misses the point. We do not know yet whether this information is relevant because it has not yet been made available for review.

This case seems to fall clearly with in the Seventh Circuit's distinction between a "discrete dispute" and a "discreet issue" in *In re Comdisco, Inc.,* when it denied an appeal under Section 158(a)(1) because the "ruling ... fail[ed] to qualify as a separable dispute." 538 F.3d 647, 651 (7th Cir.2008). Therefore, the discovery order in this case is not a final order for the purposes of Section 158(a)(1).

B. September 13 Order Not a "Collateral Order"

In *Cohen v. Beneficial Industrial Loan Corporation,* the Supreme Court established that an appellate court may hear an appeal of an order "which finally determine[s] claims of right separate from, and collateral to, rights asserted in the action, too important to be denied review and too independent of the cause itself to require that appellate jurisdiction be deferred until the whole case is adjudicated." 337 U.S. at 598-99, 69 S.Ct. at 1226; *see Fidelity Nat'l Title Ins. Co. of N.Y. v. Intercounty Nat'l Title Ins. Co.,* 310 F.3d 537, 539 (7th Cir.2002) ("Because an order compelling a lawyer to work without prospect of compensation is unrelated to the merits of the dispute, cannot be rectified at the end of the case, and has a potential to cause significant hardship, ... the order is immediately appealable as a collateral order."). For many of the same reasons stated in the previous analysis, Appellants fail to meet this standard in the present case. Despite Appellants repeated assertions that the financial information "is not in any way relevant" to the bankruptcy case and "entirely separate" from the progress of the case, (Resp.5, 7), we accept the finding of the bankruptcy judge to the contrary. Judge Cox, who is intimately acquainted with all of the facts in the case, determined that "Dr. Aldairi is an integral part of the affairs of these debtors," (Reply ¶ 27 (citing Tr. at 5, R. at 31)), and we see no reason to question that conclusion.

Furthermore, an "essential element of the collateral order doctrine" is that an "immediate appeal is required to ward off irreparable harm." *Matter of Devlieg, Inc.,* 56 F.3d 32, 34 (7th Cir.1995). Appellants argue that permitting the Bankruptcy Rule 2004 examinations will substantially and irreversibly affect their rights because it will allow federal discovery of information that may be relevant to a pending state case in Cook County attempting to pierce the corporate veil of the Debtors. However, we agree with Judge Cox that no irreparable harm will result from allowing federal discovery, especially in light of the fact that in the federal bankruptcy action Mendez is pursuing adversary complaints of fraudulent transfers, insider preferences, and piercing the corporate veil. Accordingly, we find that the September 13 order is not a "collateral order," and thus we do not have jurisdiction under *Cohen* to hear the appeal.

C. September 13 Order Not an Appealable Interlocutory Order

***4** Finally, we address whether the present appeal satisfies the requirements of an appealable interlocutory order. When evaluating discretionary interlocutory bankruptcy appeals, the standard set forth in 28 U.S.C. § 1292(b) for interlocutory appeals from the district court to the court of appeals is instructive. *See In re Automotive Prof'ls, Inc.,* 379 B.R. 746, 751 (N.D.Ill.2007); *Trustee of Jartan, Inc. v. Winston & Strawn,* 208 B.R. 898, 900

(N.D.Ill.1997). Section 1292(2) permits an interlocutory appeal when it "(1) involves a controlling question of law; (2) over which there is substantial ground for difference of opinion; and (3) an immediate appeal from the order may materially advance the ultimate termination of the litigation." 28 U.S.C. § 1292(b); *see In re Capen Wholesale, Inc.,* 184 B.R. 547, 549 (N.D.Ill.1995).

The September 13 Order fails all three prongs of this test. It is not a controlling issue of law because its resolution is not "quite likely to affect the outcome or the further course of litigation, even if it not certain to do so." *Trustees of Jartan,* 208 B.R. at 900-01 (citing *Sokaogon Gaming Enters. Corp. v. Tushie-Montgomery Assoc.,* 86 F.3d 656, 659 (7th Cir.1996)). In fact, we cannot determine how the order and the consequent Bankruptcy Rule 2004 examination will affect the outcome of the litigation until the information sought by the order is produced.

With regard to the second element, the "substantial ground for difference of opinion" has been interpreted to require a "substantial likelihood ... that the interlocutory order will be reversed on appeal." *Trustees of Jartan, Inc.,* 208 B.R. at 901. Because "almost all interlocutory appeals from discovery orders ... end in affirmance (the district court possesses discretion, and review is deferential)," there is not a substantial likelihood of this order being overturned and not a substantial ground for difference of opinion. *Reise,* 957 F.2d at 295.

Finally, allowing an immediate appeal in this case would not "materially advance the ultimate termination" of the case, but would probably only delay the ultimate resolution. The financial information sought by the order addresses the history of transactions between Appellants and Debtor and offers insight into the independence of the parties. These facts seem to be the issue currently hindering the resolution of the case and the trustee's approval of reorganization. Allowing an appeal from this discovery order would only result in more delays and costs. Because Appellants' appeal does not meet any of the requirements of Section 1292(b), we decline to grant Appellants leave to appeal the September 13 Order, and as such, grant Mendez's motion to dismiss for lack of jurisdiction.

III. Conclusion

For the foregoing reasons, we grant Mendez's motion to dismiss this appeal for lack of subject matter jurisdiction.[FN3]

[FN3] Mendez, in passing, requests that we grant her fees and costs, but she does not offer any legal argument or legal precedent to justify such a request. We deny this request.

It is so ordered.

N.D.Ill.,2010.

In re Dental Profile, Inc.
Not Reported in F.Supp.2d, 2010 WL 431590 (N.D.Ill.)
END OF DOCUMENT

EXHIBIT B

H

NOTICE: THIS IS AN UNPUBLISHED OPINION.
(The Court's decision is referenced in a "Table of Decisions Without Reported Opinions" appearing in the Federal Reporter. Use FI CTA7 Rule 53 for rules regarding the citation of unpublished opinions.)

United States Court of Appeals, Seventh Circuit.

In the Matter of: Clarence L. VANCE, Debtor.
Clarence L. VANCE, Appellant,
v.
Thomas LESTER, Trustee, Appellee.
No. 98-1470.

Submitted Oct. 15, 1998 [FN*].

FN* After an examination of the briefs and the record, we have concluded that oral argument is unnecessary, and the appeal is submitted on the briefs and the record. *See* Fed. R.App. P. 34(a); Cir. R. 34(f).

Decided Nov. 2, 1998.

Appeal from the United States District Court for the Northern District of Illinois, Western Division. No. 97 C 50334. Philip G. Reinhard, Judge.

Before Hon. KENNETH F. RIPPLE, Hon. DANIEL A. MANION, Hon. MICHAEL S. KANNE, Circuit Judges.

ORDER

***1** Clarence Vance voluntarily filed for bankruptcy pursuant to Chapter 7 of the Bankruptcy Code. The bankruptcy court entered postdischarge orders disallowing Vance's claimed exemption of his interest in a personal trust and granting the trustee's motion that Vance be required to submit to a Rule 2004 examination. The district court affirmed both orders, finding that the bankruptcy court retained postdischarge authority to issue the orders and that the trustee timely had objected to Vance's claimed exemption. We affirm.

In his petition for relief pursuant to § 301 of the Bankruptcy Code, Vance listed as exempt personal property his interest in the "Clarence Vance Trust." Thomas Lester (the "trustee") filed an objection to Vance's personal trust exemption on June 18, 1997. The creditors met as required by Rule 2003 of the Bankruptcy Rules on June 12, 1997. As there were no objections to Vance's discharge, the bankruptcy court entered a discharge order dated July 10, 1997, releasing Vance from all dischargeable debts and enjoining creditors from "instituting or continuing any action to collect the debtor's discharged debts and personal liabilities." At the time of the discharge, the trustee's objection to Vance's claimed exemption was still pending. Subsequently, the court entered an August 6, 1997, order disallowing Vance's claimed exemption for his personal trust. In a second post-discharge order dated September 2, 1997, the bankruptcy court granted the trustee's motion for an examination of Vance pursuant to Rule 2004 of the Bankruptcy Rules. The trustee sought in that motion to obtain tax returns, the trust agreement and other documents relating to Vance's personal trust.

Vance appeals the district court's determination, arguing first that the discharge order enjoined the trustee from reaching the purportedly exempt property. He further argues that the trustee waived his objection to Vance's claimed exemption by failing to object to discharge. The trustee counters that discharge does not abrogate a trustee's statutory responsibility to administer the bankruptcy estate, and that he properly objected to Vance's claimed exemption.

We review the bankruptcy court's findings of fact for clear error. *In re Paeplow,* 972 F.2d 730, 733 (7th Cir.1992). The bankruptcy court's conclusions of law are reviewed de novo. *Id.* This appeal exclusively involves questions of law.

Although neither the district court nor the parties

EXHIBIT C

address the issue, we first consider whether we have jurisdiction to review the bankruptcy court's order granting a Rule 2004 examination. A majority of courts that have considered the issue have held that orders granting or denying Rule 2004 examinations are, like discovery orders, interlocutory. *See* *In re Towers Fin. Corp.,* 164 B.R. 719, 720 (S.D.N.Y.1994); *Aetna Cas. & Sur. Co.,* 154 B.R. 862, 868 (D.Vt.1993); *In re Blinder Robinson Co.,* 127 B.R. 267, 272 (D.Colo.1991). This court does not have jurisdiction to consider appeals from interlocutory orders in bankruptcy proceedings, *see* 28 U.S.C. § 158(d); indeed, we have jurisdiction only in cases where both the bankruptcy court and the district court have entered final orders. *In re Devlieg, Inc.,* 56 F.3d 32, 33 (7th Cir.1995); *In re Behrens,* 900 F.2d 97, 99 (7th Cir.1990). Because the order granting the trustee's motion for a Rule 2004 examination is not a final order, we do not have jurisdiction to consider Vance's challenge to that order. Therefore, the part of Vance's appeal that asks us to review the bankruptcy court's order granting a Rule 2004 examination must be dismissed for lack of jurisdiction. However, because the order disallowing Vance's claimed exemption is final, we address the merits of Vance's claims as to that order only.

***2** The trustee of a bankruptcy estate is charged with collecting and liquidating the property of the estate to satisfy creditors' claims. 11 U.S.C. § 704(1). In addition, the trustee is responsible for investigating the financial affairs of the debtor, and opposing discharge "if advisable." *Id.* § 704(4), (6). Nothing in § 704, or the discharge provision, *see* *id.* § 727, or any other relevant section of the Bankruptcy Code suggests that these duties are terminated or altered by discharge of the debtor.

The district court held that the trustee timely objected to Vance's claimed exemption. Objections to claimed exemptions must be filed within 30 days after the meeting of creditors held pursuant to Rule 2003. Bankr.R. 4003. Because the meeting of creditors was held June 12, 1997, the trustee met the prescribed deadline by filing his objection six days later, on June 18. Because the trustee filed his objection to the claimed exemption before the discharge order was entered, the discharge order could not have enjoined the trustee from raising that objection. In any event, the discharge order would not bar the trustee's actions because, by its express terms, the discharge order only prohibits "creditors" from initiating or continuing actions to "collect debts as personal liabilities of the debtor." Nonexempt property belongs to the estate, not the debtor, and it is the trustee's statutory duty to ensure that exempt property remains in the bankruptcy estate.

Vance's waiver argument is likewise without merit. As the district court recognized, discharge and exemption are governed by two distinct rules that prescribe correspondingly different periods for objections. *Compare* Bankr.R. 4003(b) (objection to exemption must be filed within 30 days after the meeting of the creditors) *with* Bankr.R. 4004(a) (complaint objecting to discharge must be filed within 60 days of the scheduled meeting of the creditors). Exemption and discharge also have different consequences. A Chapter 7 discharge releases the debtor from "all liabilities arising prior to the filing of the bankruptcy petition." *In re Birkenstock,* 87 F.3d 947, 950 (7th Cir.1996). By contrast, exemptions immunize property which would otherwise belong to the estate from "seizure or attachment for satisfaction of debts incurred prior to the bankruptcy proceeding." *In re Scarpino,* 113 F.3d 338, 340 (2d Cir.1997). Accordingly, Vance's contention that the trustee was required to object to discharge to preserve his right to object to the claimed exemptions must fail.

Vance's second contention on appeal is that the bankruptcy court did not have authority to enter the orders after he was discharged from bankruptcy. This argument merits little discussion because discharge of the debtor does not terminate a bankruptcy court's jurisdiction. *See, e.g.,* 11 U.S.C. § 727(d) (bankruptcy court may revoke discharge if the debtor has committed a fraud or failed to report the acquisition of property after the petition was filed). Therefore, the bankruptcy court had authority to enter both orders after Vance's discharge.

***3** For the foregoing reasons, Vance's appeal from the bankruptcy court order granting a Rule 2004 examination is DISMISSED, and the order disallowing Vance's claimed exemption is AFFIRMED.

EXHIBIT C

C.A.7 (Ill.),1998.

Matter of Vance
165 F.3d 34, 1998 WL 783728 (C.A.7 (Ill.))
END OF DOCUMENT

EXHIBIT C

C

Only the Westlaw citation is currently available.

United States District Court, N.D. Illinois.

In re: MIDWEST VIDEO GAMES, INC., Debtor.

No. 98 C 3836.

July 9, 1998.

MEMORANDUM AND ORDER

MANNING, District Court J.

***1** Appellants Bernice Ackerman, Melvin Ackerman, John O'Brien, and Lisa O'Brien seek to stay a bankruptcy court order setting dates for examinations pursuant to Bankruptcy Rule 2004 pending resolution of the merits of their appeal. For the following reasons, this appeal is dismissed for lack of jurisdiction, the appellants' stay motion is denied as moot, and counsel for the appellants and the Creditors' Committee are directed to show cause why they should not be sanctioned for failure to comply with the briefing schedule set by the court.

Background

The appellants seek to stay discovery pursuant to Bankruptcy Rule 2004 that is scheduled to commence later this week. According to the appellants, the Official Committee of Unsecured Creditors filed an adversary complaint against them which alleges that, through their transactions and dealings with Midwest Video Games, they "engaged in 'fraudulent' transfers, obtained 'preferences' and treated the Debtor as their 'alter ego." ' (Motion at 1). The appellants claim that the bankruptcy court erred in allowing discovery under Bankruptcy Rule 2004 in light of the pending adversary proceeding against them. Specifically, they argue that, because an adversary proceeding against them is pending, discovery must occur under Bankruptcy Rule 7026, *et seq.,* rather than Bankruptcy Rule 2004.

Jurisdiction

The court's consideration of the appellants' stay motion begins and ends with its consideration of its jurisdiction to consider this appeal in the first instance. Bankruptcy appeals as of right are limited to "final judgments, orders, and decrees ... of bankruptcy judges." 28 U.S.C. § 158(a). Here, the appealed-from order relates to discovery. The appellants nevertheless contend that this order is final, citing *In re Blinder, Robinson & Co., Inc.,* 127 B.R. 267 (D.Colo.1991). In *Blinder,* the court held that an order compelling discovery under Rule 2004 was interlocutory, but stated that:

> [t]his is not to say that all appeals from Rule 2004 orders are non-final. This question should be resolved on a case-by-case basis. Where the dispute has been narrowed and there is no indication that further action by the bankruptcy court will be forthcoming, an order concerning Rule 2004 examinations should properly be considered final.

Id. at 272-73.

EXHIBIT D

Notably, the *Blinder* court explained why the discovery order appealed in that case was interlocutory. It did not, however, explain why a discovery order would become appealable simply because the bankruptcy judge definitively resolved that motion. The court declines to accept the appellants' invitation to find that the bankruptcy judge's discovery order is final because the bankruptcy judge has indicated that he does not intend to revisit his ruling, as the order is clearly interlocutory, even under the more relaxed standards of finality applicable to bankruptcy cases. *See, e.g., In re Jartran, Inc.,* 886 F.2d 859, 861-64 (7th Cir.1989) (discussing parameters of finality in bankruptcy cases); *Sante Fe Industries, Inc. v. Yorke,* No. 90 C 5359, 1991 WL 18483 *1 (N.D.Ill. Feb.11, 1991), *citing Union Carbide Corp. v. U.S. Cutting Service, Inc.,* 782 F.2d 710, 712 (7th Cir.1986) ("The general and very salutary rule is that discovery orders are not appealable until the end of the case"); *In re S.N.A. Nut Co.,* No. 96 C 181, 1996 WL 411290 *4 (N.D.Ill. Jul.19, 1991) (collecting cases regarding the non-appealability of discovery orders in bankruptcy cases); *In re Towers Financial Corp.,* 164 B.R. 719, (S.D.N.Y.1994) (criticizes *Blinder* rule and collects cases regarding the non-appealability of discovery orders in bankruptcy cases).

***2** The court also notes that the holding of *Blinder* requires a case-by-case determination as to the finality of a Rule 2004 order. It thus is susceptible to a variety of interpretations and, therefore, is at odds with the Seventh Circuit's recent admonition that jurisdictional rules in bankruptcy cases should be "simple and precise so that judges and lawyers are spared having to litigate over not the merits of a legal dispute but where and when those merits shall be litigated." *In re Lopez,* 116 F.3d 1191, 1194 (7th Cir.), *cert. denied,* 522 U.S. 1014, 118 S.Ct. 599, 139 L.Ed.2d 488 (1997). In addition, the appellants have failed to present a convincing reason why allowing an appeal as of right from a discovery order would not completely eviscerate the finality requirement, even when viewing finality from the more liberal bankruptcy perspective. For these reasons, the court finds that the bankruptcy court's Rule 2004 order is not final.

Thus, jurisdiction over this appeal is proper only if the court grants leave for the appeal to proceed. *In re Jartran,* Inc., 886 F.2d at 866; *In re Lifschultz Fast Freight Corp.,* 127 B.R. 418 (N.D.Ill.1991). Consideration of this question is governed by the familiar § 1292(b) factors, which authorize an appeal if: (1) the interlocutory order involves a controlling question of law; (2) as to which there is a substantial ground for difference of opinion; (3) and an immediate appeal will materially advance the ultimate termination of the litigation. 28 U.S.C. § 1292(b); *In re Lifschultz Fast Freight Corp.,* 127 B.R. at 418; *Sante Fe Industries, Inc.,* 1991 WL 18483 at *1.

The court finds that resolution of the parties' dispute concerning the scope of discovery fails to present a controlling question of law, as resolution of this "discovery matter is not likely to be dispositive of any of the material issues in this case." *Sante Fe Industries, Inc.,* 1991 WL 18483 at *1; *In re S.N.A. Nut Co.,* 1996 WL 411290 at *4 (bankruptcy court order regarding discovery was not controlling); *In re Lifschultz Fast Freight Corp.,* 127 B.R. at 419 (same). In addition, the appellants' disagreement with orders entered by the bankruptcy court with respect to discovery directed at them does not demonstrate that there is a substantial ground for difference of opinion. *See Sante Fe Industries, Inc.,* 1991 WL 18483 at *1. Finally, resolution of this discovery matter will multiply, as opposed to streamline, the proceedings.

Accordingly, the court exercises its discretion and declines to grant leave to file an interlocutory appeal. This appeal is, therefore, dismissed for lack of jurisdiction, and the appellants' stay motion is denied as moot. The court notes that, by declining jurisdiction, the court does not express an opinion as to the propriety of the bankruptcy court's order. *See Sante Fe Industries, Inc.,* 1991 WL 18483 at *2.

EXHIBIT D

Counsel's Failure to Comply With the Briefing Schedule Set by the Court

***3** On July 1, 1998, when the appellants presented their stay motion, the court ordered the Creditors' Committee to file their response by July 6, 1998 at 12:00 p.m. and ordered the appellants to file their reply by July 7, 1998 at 12:00 p.m. The court, however, received its courtesy copy of the response on the morning of July 7, 1998, and received its copy of the reply at approximately 2:30 p.m. on July 7, 1998. Neither side explained the reason for the delay or sought leave to file their pleading instanter. Adherence to filing deadlines set by the court is not discretionary. Accordingly, counsel for the appellants and the Creditors' Committee are directed to show cause why they should not be sanctioned for failure to comply with the briefing schedule set by the court.

Conclusion

This appeal is dismissed for lack of jurisdiction, and the appellants' stay motion [2-1 and 2-2] is denied as moot. Counsel for the appellants and the Creditors' Committee are each directed to file a brief memorandum by no later than July 15, 1998, addressing why they should not be sanctioned for failure to comply with the briefing schedule set by the court.

N.D.Ill.,1998.

In re Midwest Video Games, Inc.

Not Reported in F.Supp., 1998 WL 395152 (N.D.Ill.)

END OF DOCUMENT

EXHIBIT D

H

Only the Westlaw citation is currently available.

United States District Court,

W.D. Pennsylvania.

In re COUNTRYWIDE HOME LOANS, INC.,
Appellant,

v.

OFFICE OF THE UNITED STATES TRUSTEE,
Appellee.

Civil Action No. 08-617.

June 11, 2008.

SYNOPSIS

AMBROSE, Chief Judge.

***1** Appellant Countrywide Home Loans, Inc. ("Appellant" or "Countrywide") appeals an April 1, 2008 Order of the United States Bankruptcy Court for the Western District of Pennsylvania denying Countrywide's Motion to Quash and overruling in part Countrywide's Objections to a Notice of Examination Under Fed. R. Bankr.P.2004 and Subpoena (*Duces Tecum*) (the "2004 Notice") served by Appellee, the Executive Office of the United States Trustee ("Appellee" or "US Trustee"). (Docket No. 1). In the alternative, Countrywide seeks leave to appeal the Order pursuant to Bankruptcy Rules 8001 and 8003. *Id.* The U.S. Trustee opposes Countrywide's Motion for Leave to Appeal. (Docket No. 1, Ex. 7). Also pending is Countrywide's Emergency Motion for Stay Pending Appeal Pursuant to Fed. R. Bankr.8005 (Docket No. 2), and Countrywide's Emergency Motion for Temporary Stay Pending Determination of Its Motion for Stay Pending Appeal (Docket No. 12). After careful consideration of the submissions of the parties, and for the reasons discussed below, Countrywide's Motion for Leave to Appeal (Docket No. 1) is denied and Countrywide's Motions for Stay Pending Appeal and for Temporary Stay Pending Determination of Its Motion for Stay Pending Appeal (Docket Nos. 2 and 12) are denied as moot.

OPINION AND ORDER OF COURT

I. *BACKGROUND*

The U.S. Trustee is an official of the United States Department of Justice charged with responsibility to "supervise the administration of cases and trustees in cases under chapter 7, 11, 12, 13 or 15 of title 11 ...." 28 U.S.C. § 586(a)(3). Section 307 of the Bankruptcy Code provides that the U.S. Trustee "may raise and may appear and be heard on any issue in any case or proceeding under this title but may not file a plan pursuant to section 1121(c) of this title." 11 U.S.C. § 307. On October 18, 2007, the U.S. Trustee for this region filed notice of her intent to examine Countrywide under Federal Rule of Bankruptcy Procedure 2004 ("Rule 2004") and Subpoenas (*Duces Tecum*) in ten bankruptcy cases described by the bankruptcy court as "context cases." [FN1] On November 5, 2007, the Bankruptcy Court; entered a Consolidation Order for Examination Notices consolidating these ten Notices of Examination and Subpoenas into a single miscellaneous proceeding (Bankruptcy Docket Misc. No. 07-204 TPA) for the purpose of efficiently resolving issues regarding the Notices and Subpoenas and the U.S. Trustee's investigation of Countrywide. [FN2]

EXHIBIT E

FN1. Fed. R. Bankr.P.2004 is a pre-litigation discovery mechanism unique to bankruptcy. Rule 2004 provides in pertinent part:

> (a) Examination on Motion
>
> On a motion of any party in interest, the court may order the examination of any entity.
>
> (c) Scope of Examination
>
> The examination of any entity under this rule or of the debtor under § 303 of the Code may relate only to the acts, conduct, or property or to the liabilities and financial condition of the debtor, or to any matter which may affect the administration of the debtor's estate, or to the debtor's right to a discharge. In ... an individual's debt adjustment case under chapter 13, ... the examination may also relate to the operation of any business and the desirability of its continuance, the source of any money or property acquired or to be acquired by the debtor for purposes of consummating a plan and the consideration given or offered therefor, and any other matter relevant to the case or to the formulation of a plan.
>
> (c) Compelling attendance and production of documents
>
> The attendance of an entity for examination and for the production of documents, whether the examination is to be conducted within or without the district in which the case is pending, may be compelled as provided in Rule 9016 for the attendance of a witness at a hearing or trial. As an officer of the court, an attorney may issue and sign a subpoena on behalf of the court for the district in which the examination is to be held if the attorney is admitted to practice in that court or in the court in which the case is pending.

FN2. Following the commencement of the miscellaneous proceeding, the relevant context cases are limited to seven: *In re Hill,* Case No. 01-22574-JAD; *In re Benvenuto,* Case No. 02-20946-JKF; *In re Stemple,* Case No. 03-11792-WWB; *In re Karleski,* Cas No. 04-31355-JKF; *In re Bock,* Case No. 04-32812-BM; *In re Olbeter,* Case No. 04-33361-JKF; and *In re Topper,* Case No. 05-20772-TPA.

Pursuant to the Consolidation Order, the U.S. Trustee filed on November 7, 2007 a single Notice of Examination Under Rule 2004 and Service of Subpoena (*Duces Tecum*) in the miscellaneous proceeding. On November 9, 2007, Countrywide filed its objection to the Rule 2004 Notice and its motion to quash the related Subpoena. After the parties briefed any issues pertinent to the Rule 2004 examinations, the bankruptcy court conducted a hearing on February 28, 2008 to consider Countrywide's objections to the examinations. On April 1, 2008, the bankruptcy court entered the Memorandum Opinion and Order that are the subject of this appeal, partially denying Countrywide's objections and motion to quash. The April 1, 2008 Order authorized, in part, the U.S. Trustee's Rule 2004 examinations and related document production.

***2** In the April 1, 2008 Memorandum Opinion, the bankruptcy court concluded, over Countrywide's

EXHIBIT E

objection, that the U.S. Trustee had the authority to seek the production of documents and the examination of witnesses pursuant to Rule 2004. The court, however, limited the scope of the examinations and required that the U.S. Trustee conduct the examinations within the context of one specific bankruptcy case, *In re Hill,* Case No. 01-22574-JAD. Specifically the Court stated:

> [F]or the sake of administrative convenience and to avoid any potential *res judicata* issues, the Court will stay the Notice of Examination and Subpoenas in all context cases except *In re Hill,* Case No. 01-22574-JAD. In that case, the Court will direct Countrywide to produce documents in Categories 5-12 as to each of the debtors in the context cases and will direct Countrywide to make a witness or witnesses available to be examined on the topics identified by the [US Trustee].

(April 1,2008 Mem. Op. at 50).[FN3]

[FN3] FN3. The *In re Hill* case was the only case in which another matter (a Motion to Enforce Discharge against Countrywide) was then pending. Although the bankruptcy court stayed each of the context cases except *In re Hill,* it ruled that Countrywide's actions in all of the context cases nevertheless could be the subject of discovery in the *In re Hill* case pursuant to Federal Rules of Evidence 401, 404, and 406.

On or about April 11, 2008, Countrywide filed the instant Motion for Leave to Appeal pursuant to Federal Rules of Bankruptcy 8001 and 8003, subject to its Notice of Appeal filed contemporaneously therewith, seeking leave to appeal from the bankruptcy court's April 1, 2008 Order. Specifically, Countrywide urges me to consider the following questions on appeal:

> a. Whether the Bankruptcy Court has subject matter jurisdiction to authorize an examination pursuant to Rule 2004 of the Federal Rules of Bankruptcy Procedure when there is no connection between the proposed examination and any effect upon a debtor's estate;
>
> b. Whether the Bankruptcy Court erred in holding that the U.S. Trustee is a "party in interest" for the purposes of Rule 2004 of the Federal Rules of Bankruptcy Procedure;
>
> c. Whether the Bankruptcy Court erred in holding that the U.S. Trustee has the power to take an examination pursuant to Rule 2004 of the Federal Rules of Bankruptcy Procedure in the absence of a contested matter; and
>
> d. Whether the Bankruptcy Court erred in finding that 11 U.S.C. § 307 does not require that there be a contested matter for the U.S. Trustee to appear and be heard.

See Mot. for Leave at 5. The U.S. Trustee opposes Countrywide's Motion for Leave on the grounds that the appeal is interlocutory and does not merit consideration at this time.

On April 14, 2008, Countrywide filed a Motion to Stay Pending Appeal in the bankruptcy court seeking to stay the court's April 1, 2008 Order pending the outcome of this appeal. On May 2, 2008, the bankruptcy court denied the Motion to Stay. (Docket No. 11). On May 9, 2008, Countrywide filed the instant Emergency Motion for Stay Pending Appeal Pursuant to Fed. R. Bankr.P. 8005 (Docket No. 2), seeking a similar stay. On May 13, 2008, the U.S. Trustee filed its response in opposition to the Emergency Motion to Stay (Docket No. 5), to which Countrywide replied, with leave of court (Docket No. 10). On June 9, 2008, Countrywide filed an Emergency Motion for Temporary Stay Pending Determination of Its Motion for Stay Pending Appeal, after the U.S. Trustee demanded that Countrywide comply with the Bankruptcy Court's April 1, 2008 Order. The issues in all three motions are now ripe for my review.

II. *LEGAL ANALYSIS*

***3** Federal district courts have appellate jurisdiction over the final judgments, orders, and decrees of bankruptcy courts. 28 U.S.C. § 158(a)(1). District courts also have discretionary jurisdiction to hear appeals of interlocutory orders. *Id.* § 158(a)(3). Countrywide's position is that the bankruptcy court's April 1, 2008 Order overruling Countrywide's objections to the Rule 2004 Notice and its motion to quash the related Subpoena is a final order subject to immediate appellate review. Alternatively, Countrywide seeks leave to appeal the Order pursuant to 28 U.S.C. § 158(a)(3), governing interlocutory orders. The U.S. Trustee argues that the April 1, 2008 Order is a non-final, interlocutory discovery order not subject to immediate appellate review.

A. *Final Order*

Countrywide first argues that leave to appeal is not necessary because the bankruptcy court's April 1, 2008 Order is final and, therefore, appealable as of right under 28 U.S.C. § 158(a)(1). I disagree.

28 U.S.C. § 158(a)(1) provides that this court has jurisdiction to hear appeals "from final judgments, orders, and decrees" of the bankruptcy court. The concept of "finality" is viewed flexibly in the bankruptcy context. *See, e.g., In re Truong,* 513 F.3d 91, 93-94 (3d Cir.2008); *In re Edison Bros. Stores, Inc.,* No. Civ. A. 96-177-SLR, 1996 WL 363806, at *2 (D. Del. June 27, 1996); *In re Columbia Gas Sys.,* 146 BR. 106, 110 (D.Del.1992), *aff'd* 50 F.3d 233 (3d Cir.1995). As one court within this Circuit has explained,

> It is well settled in the Third Circuit ... that 'considerations unique to bankruptcy appeals have led us consistently in those cases to construe finality in a more pragmatic, functional sense than with the typical appeal," which generally requires an order to 'dispose of all issues as to all parties to the case' before such an order can be considered final.

Baron & Budd, P.C. v. Unsecured Asbestos Claimants Comm., 321 B.R. 147, 155 (D.N.J.2005) (citing *In re Prof'l Ins. Mgmt.,* 285 F.3d 268, 279 (3d Cir.2002)).

Here, however, the appealed-from order relates to discovery. Even under the more relaxed standards of finality applicable to bankruptcy cases, discovery orders generally are held to be interlocutory and non-appealable. *See In re Jeannette Corp.,* 832 F.2d 43, 46 (3d Cir.1987) ("In civil litigation, discovery orders are, with rare exception, non-appealable.... A similar approach applies in bankruptcy cases.") (citing *In re Int'l Horizons, Inc.,* 689 F.2d 996, 1000-01 (11th Cir.1982)); *see also, e.g., In re Midwest Video Games, Inc.,* No. 98 C 3836, 1998 WL 395152, at * *1-2 (N.D.III. July 9, 1998) (citing cases). Generally, a party challenging a discovery order has two options: to comply with the order and challenge it at the conclusion of the case; or to refuse to comply with the order and contest its validity if subsequently found in contempt for such refusal. *See Int'l Horizons, Inc.,* 689 F.2d at 1000-01; *In re Jeannette Corp.,* 832 F.2d at 46; *Aetna Cas. & Sur. Co. v. Glinka,* 154 B.R. 862, 867-68 (D.Vt.1993).

EXHIBIT E

***4** After careful review of the submissions of both parties, I find no reason to depart from the general rule disallowing appeals as of right of discovery orders, even under the more liberal bankruptcy perspective on finality. Countrywide may comply with the April 1, 2008 Order and challenge it at the conclusion of the underlying case, or Countywide may refuse to comply and appeal the Order if and when the bankruptcy court issues a contempt order in the face of such refusal. For all of these reasons, I find that the April 1, 2008 Order was not a final order for purposes of 28 U.S.C. § 158(a) (1). *See, e.g., Aetna Cas. & Sur. Co.,* 154 B.R. at 868 (order defining scope of Rule 2004 subpoenas *duces tecum* and denying motion to quash subpoenas and for protective order was interlocutory); *In re Midwest Video Games, Inc.,* 1998 WL 395152, at **1-2 (bankruptcy court's Rule 2004 examination order was not final).[FN4]

Countrywide's argument that the April 1, 2008 Order was final because it resolved the only existing issue in the miscellaneous proceeding that the bankruptcy court created to address the U.S. Trustee's Rule 2004 Notice is not persuasive. As set forth in the background section above, the bankruptcy court opened the miscellaneous number for the purpose of efficiently resolving issues regarding the U.S. Trustee's investigation of Countrywide after the U.S. Trustee filed Rule 2004 Notices and Subpoenas in *ten* separate bankruptcies. Pursuant to the Consolidation Order, the U.S. Trustee filed on November 7, 2007 a single Notice of Examination Under Rule 2004 and Service of Subpoena (*Duces Tecum*) in the miscellaneous proceeding. Thus, even if the miscellaneous proceeding technically had concluded, the underlying bankruptcy to which the April 1, 2008 Order and the U.S. Trustee's investigation primarily relate, the *In re Hill* bankruptcy, has not. In addition, the bankruptcy court expressly stayed the Rule 2004 examinations in the remaining six underlying context cases, “pending further Order of the Court,” a further indication that all existing issues have not been resolved. Finally, as touched on above, additional questions may arise as the U.S. Trustee conducts the examinations such as the permissible scope of the examinations and the consequences of any refusal by Countrywide to comply with the examination.

B. *Collateral Order*

Countrywide next argues that, even if the April 1, 2008 Order is not final, it is nevertheless appealable under the collateral order doctrine established in *Cohen v. Beneficial Indus. Loan Corp.,* 337 U.S. 541 (1949). Again, I disagree.

The Court of Appeals for the Third Circuit has applied *Cohen* to provide:

> “a narrow exception to the general rule permitting appellate review only of final orders. An appeal of a nonfinal order will lie if (1) the order from which the appellant appeals conclusively determines the disputed question; (2) the order resolves an important issue that is completely separate from the merits of the dispute; and (3) the order is effectively unreviewable on appeal from a final judgment..... To this end, as a doctrinal matter, orders that meet the three prongs described above are deemed to be ‘final decisions' within the meaning of the statute.”

***5** *Baron & Budd, P.C.,* 321 B.R. at 155-56 (quoting

FN4. The United States District Court for the Southern District of Florida reached the same conclusion in finding that an order overruling Countrywide's objections to a similar Rule 2004 Notice of Examination and Subpoena Duces Tecum served by the Office of the United States Trustee on Countrywide in a different bankruptcy case was not final. *See In re Del Castillo,* Case No. 08-20020-mc-Altonaga (S.D.Fla. Feb. 8, 2008).

Petroleos Mexicanos Refinacion v. M/T King A (EX-TIBLISI), 377 F.3d 329, 334 (3d Cir.2004)). In the context of discovery orders, however, the Court of Appeals has found the collateral order doctrine applicable only in two very limited circumstances: where the information sought is either privileged or a trade secret. *See* *Bacher v. Allstate Ins. Co.,* 211 F.3d 52, 53, 57 (3d Cir.2000). As the U.S. Trustee notes in her response, the April 1, 2008 Order Countrywide seeks to appeal does not authorize the U.S. Trustee to seek any information or material that is privileged or a trade secret. Thus, the collateral order doctrine does not apply.

C. ***Interlocutory Order***

Even if the Order at issue is not appealable as of right, I have discretionary jurisdiction over certain interlocutory appeals under 28 U.S.C. § 158(a)(3). Because that statute does not provide any standards to apply, courts generally have looked to the language of 28 U.S.C. § 1292(b), which governs the scope of appellate jurisdiction over interlocutory appeals from district courts. *See* *Sterling Supply Corp. v. Mullinax,* 154 B.R. 660, 662 (E.D.Pa.1993). Under section 1292(b), an appellate court has jurisdiction "over non-final orders (1) that involve a controlling question of law (2) about which there is a substantial basis for a difference of opinion, (3) the resolution of which will materially advance the ultimate termination of the litigation." *Sterling Supply Corp.,* 154 B.R. at 662. Interlocutory appeals "contravene the judicial policy opposing piecemeal litigation and the disadvantages of delay and disruption associated with it." *In re Am. Freight Sys., Inc.,* 194 B.R. 659, 661 (D.Kan.1996). Thus, interlocutory bankruptcy appeals generally are reserved for cases presenting exceptional circumstances. *See id.* (citing cases); *see also* *Dal-Tile Int'l, Inc. v. Color Tile, Inc.,* 203 B.R. 554, 557 (D.Del.1996); *In re Neshaminy Office Bldg. Assocs.,* 81 B.R. 301, 303 (E.D.Pa.1987). Countrywide, as the party seeking an interlocutory appeal, bears the burden of demonstrating exceptional circumstances. *See* *In re Am. Freight Sys., Inc.,* 194 B.R. at 661-62.

Here, Countrywide has not made a showing that meets the section 1292(b) standard. As one court aptly has explained:

> Questions that arise during the course of a bankruptcy proceeding concerning the appropriate scope of discovery and that do not involve controlling questions of law are left to the sound discretion of the court that is fully familiar with the entire proceeding-the bankruptcy judge.

In re Towers Fin. Corp., 164 B.R. 719, 721 (S.D.N.Y.1994). Here, Countrywide has not demonstrated that the bankruptcy court's April 1, 2008 Order denying its objections to the Rule 2004 examination and motion to quash subpoena differs significantly from routine discovery orders from which interlocutory appeals are discouraged.[FN5] Accordingly, I do not find any reason to exercise my discretion to entertain Countrywide's interlocutory appeal.

[FN5] Even if the issue of the U.S. Trustee's authority to conduct a Rule 2004 examination of Countrywide under the facts of this case was a controlling issue of law, which it is not, Countrywide has not shown that it is a question about which there is a substantial basis for a difference of opinion. Indeed, Countrywide has not pointed to any case law in direct support of its position. To the contrary, courts that have discussed the U.S. Trustee's powers under 11 U.S.C. § 307 have held that the statute provides the U.S. Trustee with very broad standing and that the U.S. Trustee is the equivalent of a party in interest in bankruptcy. *See, e.g.,* *Thompson v. Greenwood,* 507 F.3d 416, 420 n. 3 (6th Cir.2007); *In re Miles,* 330 B.R. 848, 849-50 (M.D.Ga.2005).

III. *CONCLUSION*

***6** In sum, for the reasons set forth above, I find that the April 1, 2008 Order of the Bankruptcy Court partially denying Countrywide's objection to the Rule 2004 Notice and denying its motion to quash the related Subpoena was not a final order within the meaning of 28 U.S.C. § 158(a). Further, in the exercise of my discretion, I decline to grant Countrywide leave to file an interlocutory appeal. Accordingly, Countrywide's Motion for Leave to Appeal is denied, and Countrywide's Motion for Stay Pending Appeal and Motion for Temporary Stay Pending Resolution of Its Motion for Stay Pending Appeal are denied as moot. Countrywide's appeal is dismissed for lack of jurisdiction.

ORDER OF COURT

AND NOW, this 11th day of June, 2008, after careful consideration, it is ordered that Countrywide Home Loans, Inc.'s Motion for Leave to Appeal (Docket No. 1) is DENIED. Countrywide's Emergency Motion for Stay Pending Appeal Pursuant to Fed. R. Bankr.P. 8005 (Docket No. 2) and Emergency Motion for Temporary Stay Pending Determination of Its Motion for Stay Pending Appeal (Docket No. 12) are DENIED as moot. Countrywide's appeal is dismissed for lack of jurisdiction.

W.D.Pa.,2008.

Countrywide Home Loans, Inc. v. Office of the U.S. Trustee

Not Reported in F.Supp.2d, 2008 WL 2388285 (W.D.Pa.)

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EXHIBIT E

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF FLORIDA
MIAMI DIVISION

CASE NO. 08-20020-mc-ALTONAGA

In re:

MANUEL DEL CASTILLO,
MARIA E. PENA,

Debtors.
______________________________/

COUNTRYWIDE HOME
LOANS INC.,

Appellant,
v.

OFFICE OF THE UNITED
STATES TRUSTEE,

Appellee.
_______________________________/

ORDER

Countrywide Home Loans, Inc. ("Countrywide") appeals an Order Overruling in Part the Objections of Countrywide to the Second Amended Notice of Examination Under Federal Rule of Bankruptcy Procedure 2004 and Subpoena Duces Tecum served by Appellee, Office of the United States Trustee (the "Trustee"), entered by the United States Bankruptcy Court for the Southern District of Florida (the "bankruptcy court"). (*See* R. 132).[1] In the alternative, Countrywide seeks leave to appeal the Order pursuant to Bankruptcy Rules 8001 and 8003.

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[1] References to the record on appeal are indicated by "R," followed by the docket entry number from the bankruptcy court.

I. BACKGROUND

On May 14, 2007, Debtors, Manuel Del Castillo and Maria E. Pena, filed a joint voluntary petition for relief under Chapter 13 of Title 11 of the United States Code in the bankruptcy court. Countrywide is a secured creditor by virtue of a promissory note and a mortgage recorded against the Debtors' residence as security for the promissory note. (*See Appellants' Mem. of Law in Support of Notice of Appeal* [D.E. 1-2], p. 1). Countrywide asserted a secured claim of $287,902.23, pre-petition arrearages totaling $16,417.67, and an insufficient funds fee of $682.88. (*See Appellee's Objection to Countrywide's Mot. for Leave to Appeal* [D.E. 1-2], p. 2). Countrywide further claimed that Debtors' "'Regular Monthly Installments of $1,783.64 . . .' would increase to $4,773.54 'Effective 7/1/2007' and that it might be entitled to future costs of collection, including attorney's fees." (*Id.* (citing R. 14)).

Debtors filed their first amended Chapter 13 plan (the "Plan") on July 19, 2007. (*See id.*). Under the Plan, Debtors proposed to repay creditors' claims over a period of 60 months. Debtors proposed to pay Countrywide's first and second lien claims outside the Plan. (*See id.*). The bankruptcy court scheduled a confirmation hearing on the Plan for January 29, 2008.

Debtors also filed an Objection to Countrywide's claim on August 10, 2007, arguing that Countrywide had failed to provide a breakdown of the claimed arrearages and insufficient funds fee. (*See id.* (citing R. 48)). Debtors requested "'a breakdown of the increase of the new monthly payment of $4,773.54'" and an award of attorney's fees from Countrywide, noting that Debtors' counsel "'has been forced to file his Objection to Claim in response to creditor's filing of an incorrect and/or improper Proof of Claim . . . .'" (*Id.*). Debtors also objected to Countrywide's claim for future attorney's fees. (*See id.* at 3).

Countrywide did not respond to Debtors' Objection, and the bankruptcy court entered an Order sustaining Debtors' Objection on August 28, 2007 (the "Objection Order"). (*See id.* (citing R.59)). The Objection Order reduced Countrywide's secured claim to $266,295.50, "struck 'the portion of the claim labeled pre-petition escrow advance in the amount of $11,923.85 and the insufficient funds fee in the amount of $682.88 . . .' and reserved jurisdiction to award attorneys' fees." (*Id.*). The Objection Order also disallowed any future attorney's fees claimed by Countrywide. (*See id.*).

Thereafter, on November 6, 2007, Countrywide, in agreement with Debtors, filed a Motion to Reconsider Debtors' Objection to Claim, stating it had provided Debtors with backup documentation to support the proof of claim, reduced the amount of the regular payment to $2,448.41, and paid attorney's fees to Debtors' attorney as necessitated by the circumstances. (*See id.* at 4; *see also Appellant's Mem.*, p. 2). The bankruptcy court subsequently entered an Agreed Order Granting the Motion to Reconsider.

Earlier, on October 23, 2007, the Trustee filed a Second Amended Notice of Taking Rule 2004 Examination Duces Tecum of Corporate Representative of Countrywide with Subpoena Duces Tecum (the "Notice"). Through the Notice, the Trustee sought to conduct discovery regarding the factual basis for Countrywide's proof of claim. (*See Appellee's Objection* [D.E. 1-2], p. 3). On November 2, 2007, Countrywide filed an Objection to the Notice. Countrywide argued that the Trustee lacked authority under 11 U.S.C. § 307 and 28 U.S.C. § 586 to investigate the factual basis for Countrywide's proof of claim. Countrywide also asserted that the requested discovery exceeded the scope of Federal Rule of Bankruptcy Procedure 2004[2] and that some of the document requests impinged on the attorney-client and work product privileges. According to Countrywide, the document requests in general constituted an "impermissible fishing expedition ." (*See id.*).

Following a hearing on Countrywide's Objection to the Trustee's Notice, the bankruptcy court issued the Order under review, partially sustaining and partially denying Countrywide's Objection. In its Order, the bankruptcy court found that 28 U.S.C. § 586 does not limit the Trustee's ability "to raise, appear and be heard on any issue in any case or proceeding under title 11." (R. 132). The bankruptcy court further held that the Trustee is authorized to issue a subpoena and conduct an examination of Countrywide pursuant to Rule 2004, in accordance with the authority granted the Trustee under 11 U.S.C. § 307 and 28 U.S.C. § 586. Additionally, the court determined there is a pending issue in the case upon which the Trustee may appear and be heard. (*See id.* (citing 11 U.S.C. § 307)).[3]

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[2] Federal Rule of Bankruptcy Procedure 2004 provides in pertinent part

> (a) Examination on motion
>
> On a motion of any party in interest, the court may order the examination of any entity.
>
> (b) Scope of examination
>
> The examination of any entity under this rule or of the debtor under § 343 of the Code may relate only to the acts, conduct, or property or to the liabilities and financial condition of the debtor, or to any matter which may affect the administration of the debtor's estate . . . .

See also In re Recoton Corp., 307 B.R. 751, 755 (S.D.N.Y. 2004) (citing Fed. R. Bankr. P. 2004(b)). "The purpose of a Rule 2004 examination is to assist a party in interest in determining the nature and extent of the bankruptcy estate, revealing assets, examining transactions and assessing whether wrongdoing has occurred." *Id.* (citation omitted).

[3] The Order conditioned Countrywide producing the documents upon the Trustee providing Countrywide with a certificate of compliance under the Right to Financial Privacy Act of 1978, 12 U.S.C. §§ 3401 *et seq.* (*See id.*). The Trustee has provided the requisite certificate. (*See Appellee's Objection* [D.E. 1-2], p. 5).

Countrywide has identified the following issues it wishes to pursue:

1. Whether the bankruptcy court erred in finding that the Trustee possesses the authority to issue a subpoena and conduct and examination of Countrywide pursuant to Rule 2004.

2. Whether the bankruptcy court erred in finding that the Trustee possesses the authority to issue a subpoena and conduct an examination of Countrywide pursuant to 11 U.S.C. § 307 and 28 U.S.C. § 586.

3. Whether the bankruptcy court erred in finding there is a pending issue in this case upon which the Trustee may be heard pursuant to 11 U.S.C. § 307.

4. Whether the bankruptcy judge should have disqualified himself from hearing Countrywide's Objection pursuant to 28 U.S.C. § 455 (a) on the grounds that his impartiality might reasonably be questioned.

II. ANALYSIS

District courts have appellate jurisdiction over the final judgments, orders, and decrees of bankruptcy courts. 28 U.S.C. § 158(a)(1). A district court also has discretionary jurisdiction to hear appeals of interlocutory orders, upon leave. 28 U.S.C. § 158(a)(3). Countrywide contends the Order Overruling in Part the Objections of Countrywide Home Loans, Inc. to the Second Amended Notice of Examination Under Federal Rule of Bankruptcy Procedure 2004 and Subpoena Duces Tecum served by Appellee is a final bankruptcy order subject to immediate appellate review. In the alternative, Countrywide seeks leave to appeal the Order as an interlocutory appealable order under section 158(a)(3). The Trustee maintains the Order is a non-final, interlocutory discovery order not subject to immediate appellate review.

1. *Whether a final, appealable order was entered*

Countrywide argues that in bankruptcy proceedings, a final order is one which resolves a particular controversy. Countrywide contends that its Objection to the Trustee's Notice is a separate, distinct dispute within the Del Castillo Chapter 13 proceeding. The initial issue the undersigned addresses is whether in resolving the matter in favor of the Trustee, the Order is final and appealable.

A final order "'is an order that concludes the litigation on the merits of the case and 'leaves nothing for the court to do but execute the judgment.'" *In re Hillsborough Holdings Corp.*, 164 B.R. 673, 674 (M.D. Fla. 1994) (citing *In re Sunstate Dairy*, 1992 WL 161138 (M.D. Fla. 1992) (quoting *Catlin v. United States*, 324 U.S. 229, 233 (1945)). By contrast, an interlocutory order is "[a]n order that is final with regard to a particular issue, but does not end the litigation on the merits, is not a final order under *Catlin* and is not immediately appealable." *In re Lykes Bros. S.S.Co., Inc.*, 200 B.R. 933, 937 (M.D. Fla. 1996) (internal citations and quotations omitted).[4]

"'As a general proposition most orders granting or denying discovery are not final orders . . . and therefore are not immediately appealable.'" *Matter of International Horizons, Inc.*, 689 F.2d 996, 1000-1001 (11th Cir. 1982) (quoting *Rouse Construction International, Inc. v. Rouse Construction Corporation*, 680 F.2d 743, 745 (11th Cir. 1982)). A party challenging a discovery order generally has two choices: (1) to comply with the order and challenge it at the conclusion of the case or (2) to refuse to comply with the order and contest its validity if subsequently cited for contempt for refusing to obey. *Id.* An exception to this rule exists where an order "'is directed to a person who has custody of materials as to which another person may claim a privilege of non-disclosure.'" *Id.* at 1001 (quoting *Branch v. Phillips Petroleum Co.*, 638 F.2d 873, 878 n.3 (5th Cir. 1981)). Under those circumstances, "'the person who holds the privilege may seek immediate review

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[4] The Supreme Court in *Catlin*, 324 U.S. at 233, held a "'final decision' generally is one which ends the litigation on the merits and leaves nothing for the court to do but execute the judgment." (citation omitted).

of the disclosure order.'" *Id.*

In *International Horizons*, 689 F.2d 996, a creditors' committee sought access to documents and work papers in the possession of the debtors' accounting firm. The accounting firm refused to disclose the work papers, asserting the accountant-client privilege. The bankruptcy court rejected the accounting firm's claim of privilege and ordered the firm to produce the documents. On appeal, the court found that because the bankruptcy court had not yet entered a civil contempt order against the accounting firm for refusing to produce the documents, the discovery order was not final and appealable. *Id.* at 1001. According to the *International Horizons* court, the accounting firm, as the holder of the allegedly privileged material, could appeal only if and when it was adjudged in civil contempt. The *International Horizons* court determined, however, that because the debtor did not have custody of the allegedly privileged materials, the debtor could immediately appeal the order directing disclosure of the documents because the debtor claimed a privilege of non-disclosure relating to materials that another party had been directed to produce. *Id.* at 1001-02.

Here, Countrywide holds the documents at issue and Debtors have not objected to the Order, much less asserted a privilege relating to the documents in Countrywide's possession. Countrywide does not claim that its compliance with the Order will jeopardize any asserted privilege. Indeed, the bankruptcy court sustained Countrywide's objection to the Notice regarding production of documents involving attorney-client communications. (*See* R. 125; *Nov. 20, 2007 Hearing Trans.,* p. 67). Countrywide may comply with the Notice and the Order and challenge the Order at the conclusion of Debtors' case, or it may refuse to comply and appeal the Order in the context of a subsequent civil contempt order. Consequently, Countrywide has failed to demonstrate that the Order is a final order or otherwise subject to immediate appellate review.

2. *Whether the non-final Order is nevertheless subject to immediate appellate review*

Three recognized exceptions to the final judgment rule allow interlocutory orders to be immediately reviewed: (1) the *Forgay-Conrad* rule (also known as the doctrine of practical finality), (2) the Cohen (or collateral order) doctrine, and (3) where the question presented is fundamental to further conduct of the case. *See In re F.D.R. Hickory House, Inc.*, 60 F.3d 724, 726-27 (11th Cir. 1995); *see also In re Lykes*, 200 B.R. at 938. Countrywide argues that the Order fits within either the *Forgay-Conrad* rule or the Cohen doctrine.[5] Application of these exceptions is examined in turn.

Under the *Forgay-Conrad* rule, an interlocutory order may be reviewed by an appellate court when the order

> decides the right to the property in contest, and directs it to be delivered up by the defendant to the complainant, or directs it to be sold, or directs the defendant to pay a certain sum of money to the complainant, and the complainant is entitled to have such decree carried immediately into execution.

In re Hickory House, Inc., 60 F.3d at 726-27 (quoting *Forgay v. Conrad*, 47 U.S. (6 How.) 201, 204 (1848); *Atlantic Federal Sav. & Loan Ass'n v. Blythe Eastman Paine Webber, Inc.*, 890 F.2d 371, 376 (11th Cir. 1989)). Because the Order does not compel Countrywide to deliver property to the Trustee, the *Forgay-Conrad* exception is inapplicable. *See In re Lykes*, 200 B.R. at 938 (noting that an order denying a motion for appointment to the creditors' committee "does not require immediate delivery of physical property, so [the *Forgay-Conrad*] exception is not applicable.").

Similarly, Countrywide fails to establish that the Order is subject to immediate appellate

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[5] The record under review does not demonstrate a need for immediate review of the Order for the "further conduct of the case."

review under the Cohen doctrine. Under this doctrine, three factors must be present:

> (1) [T]he order must be independent and easily separable from the substance of the other claims in the action, (2) it must present a need to secure prompt review in order to protect important interests of any party, and (3) it must be examined in the light of practical, rather than narrowly technical, consideration.

In re Hillsborough Holdings, Corp., 164 B.R. at 675 (quoting *In re Tidewater Group, Inc.*, 734 F.2d 794, 795-96 (11th Cir. 1984)).

In support of its claim that the Order is subject to immediate appellate review under the Cohen doctrine, Countrywide maintains this contested matter is independent and easily separable from the remainder of the Del Castillo case and has no bearing on Debtors. The Trustee, however, asserts it is unclear whether Countrywide will comply with the subpoenas. Further, assuming Countrywide fails to comply, "it is unclear whether the United States Trustee will move to compel." (*Appellee's Objection* [D.E. 1-2], p. 11). Additionally, it is equally unclear whether the bankruptcy court will hold Countrywide in civil contempt if Countrywide fails to comply with the Order. Given these uncertainties, the Trustee argues, the Cohen doctrine is not satisfied.

Countrywide has not shown that there is a need to secure prompt review in order to protect important interests of any party. It has not shown that the Order cannot be reviewed after the final judgment or that a party's interests cannot be protected in the absence of immediate review. *See In re Hillsborough Holdings, Corp.*, 164 B.R. at 675. Having failed to satisfy any of the recognized exceptions to the final judgment rule, Countrywide has not demonstrated that immediate appellate review is warranted.

3. *Whether the request for leave to appeal should be granted*

In the alternative, and as previously stated, Countrywide seeks leave to appeal the Order.

Courts generally apply the standards listed in 28 U.S.C. § 1292(b) when determining whether to grant a request for leave to appeal from an interlocutory order under 28 U.S.C. § 158(a). *See In re Ashoka Enterprises, Inc.*, 156 B.R. 343, 346 (S.D. Fla. 1993) (noting the bankruptcy statute does not provide district courts with criteria to apply when determining whether to grant leave to appeal under section 158(a), and courts therefore apply the standards in section 1292(b)); *see also In re Celotex Corp.*, 187 B.R. 746, 749 (M.D. Fla. 1995) (recognizing that when determining whether to exercise its discretionary authority to review interlocutory orders under section 158(a), a district court will look to the standards in section 1292(b)) (citing *In re Charter Co.*, 778 F.2d 617, 620 (11th Cir. 1985)).

Under section 1292(b), the court may allow a party to take an interlocutory appeal of an order where (1) the order involves a controlling question of law; (2) there is a substantial ground for difference of opinion regarding the court's resolution of that question of law; and (3) an immediate appeal of the order may materially advance the ultimate termination of the litigation. Section 1292(b) appeals "were intended, and should be reserved, for situations in which the court of appeals can rule on a pure, controlling question of law without having to delve beyond the surface of the record in order to determine the facts." *McFarlin v. Conseco Servs., LLC*, 381 F.3d 1251, 1259 (11th Cir. 2004).

> The legal question must be stated at a high enough level of abstraction to lift the question out of the details of the evidence or facts of a particular case and give it general relevance to other cases in the same area of law. And the answer to that question must substantially reduce the amount of litigation left in the case.

Id.

In support of its request for leave to appeal, Countrywide contends its appeal relates to "pure legal questions, e.g., whether there is any authority for the [Trustee] to examine a creditor's general corporate policies and procedures when no issue exists between the creditor and the debtor or under any other circumstances," and "whether the Bankruptcy Judge, in light of the testimony he gave before a Congressional sub-committee on October 2, 2007, should have disqualified himself on the grounds that his impartiality might reasonably be questioned." (*Appellant's Mem.* [D.E. 1-2], pp. 6-7). According to the Trustee, issues concerning the scope of discovery under Rule 2004 are inherently interlocutory, present no controlling issues of law and "'are left to the sound discretion of the court that is fully familiar with the entire proceeding – the bankruptcy judge . . . .'" (*Appellee's Objection* [D.E. 1-2], p. 12 (citing *In re Towers Fin. Corp.*, 164 B.R. 719, 720 (S.D.N.Y. 1994)). The undersigned agrees with the Trustee's characterization.

The Order does not finally adjudicate the validity of Countrywide's proof of claim. Rather, the Order allows the Trustee to conduct discovery relating to Countrywide's factual support for the proof of claim. No controlling question of law is presented that would serve to advance the ultimate termination of the proceeding. *See In re American Freight System, Inc.*, 194 B.R. 659, 662 (D. Kan. 1996) (noting bankruptcy court's discovery order, by itself, had no bearing on the merits of the proceedings, finding order was interlocutory in nature, and denying leave to appeal); *see also State of Fla. ex rel. Butterworth v. Industrial Chemicals, Inc.*, 145 F.R.D. 585, 589 (N.D. Fla. 1991) ([G]enerally "discovery orders do not present controlling questions of law, capable of significantly advancing litigation so as to justify interlocutory appeal.") (internal citations omitted).

Further, Countrywide has not shown the existence of a substantial ground for differences of opinion regarding the question presented. As noted, it is well recognized that bankruptcy court discovery orders are interlocutory and not final appealable orders. *See In re International Horizons,* *Inc*., 689 F.2d at 1000-1001. When there is binding authority on the question presented, there is no substantial difference of opinion. *See In re Pacific Forest Products Corp*., 335 B.R. 910, 922 (S.D. Fla. 2005) ("[W]here there is controlling authority in the jurisdiction where the order was rendered, there cannot be a substantial difference of opinion.") (citation omitted)). Countrywide has simply not demonstrated that the Order differs materially from routine discovery orders from which interlocutory appeals are discouraged as contravening the policy against piecemeal litigation.

Lastly, Countrywide did not file a written motion seeking the bankruptcy judge's recusal and thus this claim, when reviewed, will be examined under the plain error standard. *See U.S. v. Marrero*, 219 Fed. Appx 892, 896 (11th Cir. 2007). Under plain error review, appellant must show error that is plain and that affected substantial rights. *See U.S. v. Monroe*, 353 F.3d 1346, 1349 (11th Cir. 2003) (citations omitted). That showing has not been made.

Accordingly, it is **ORDERED AND ADJUDGED** that Countrywide's notice of appeal or, in the alternative, request for leave to appeal, is **DENIED**. The Clerk of Court is instructed to **CLOSE** the case.

DONE AND ORDERED in Chambers, at Miami, Florida, this 8th day of February, 2008.

Cecilia M. Altonaga

CECILIA M. ALTONAGA
UNITED STATES DISTRICT JUDGE

cc: Hon. A. Jay Cristol
counsel of record

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NOTICE: THIS IS AN UNPUBLISHED OPINION.

(The Court's decision is referenced in a "United States Bankruptcy Appellate Panel for the Tenth Circuit Decisions Without Reported Opinions" table appearing in the Bankruptcy Reporter. Use FI CTA10 BAP Rule 8018-6 for rules regarding the citation of unpublished opinions.)

United States Bankruptcy Appellate Panel of the Tenth Circuit.

In re Lawrence Mack BUCKNER and Barbara Jean Buckner, Debtors.
Lawrence Mack BUCKNER and Barbara Jean Buckner, Appellants,
v.
OKLAHOMA TAX COMMISSION and William Mark Bonney, Trustee, Appellees.
No. EO-00-073.

Aug. 30, 2001.

Pro se Chapter 13 debtors filed motion to quash and motion in limine regarding Rule 2004 examination of debtors' bankruptcy schedules and tax returns. The United States Bankruptcy Court for the Eastern District of Oklahoma denied the motions. Debtors appealed. The Bankruptcy Appellate Panel, Pusateri, J., held that: (1) bankruptcy court's orders denying the motions were final and appealable, and (2) failure to provide transcripts of bankruptcy court hearings precluded appellate review.

Affirmed.

West Headnotes

[1] Bankruptcy 51 🔑 3784

51 Bankruptcy

51XIX Review
51XIX(B) Review of Bankruptcy Court
51k3784 k. Discretion. Most Cited Cases

A decision to allow the bankruptcy trustee to conduct a Rule 2004 examination of debtors is reviewed for an abuse of discretion. Fed.Rules Bankr.Proc.Rule 2004, 11 U.S.C.A.

[2] Bankruptcy 51 🔑 3766.1

51 Bankruptcy

51XIX Review
51XIX(B) Review of Bankruptcy Court
51k3766 Decisions Reviewable
51k3766.1 k. In General. Most Cited Cases

As a general rule, discovery orders are not appealable until the end of the case.

[3] Bankruptcy 51 🔑 3767

51 Bankruptcy

51XIX Review
51XIX(B) Review of Bankruptcy Court
51k3766 Decisions Reviewable
51k3767 k. Finality. Most Cited Cases

An order is not "final," as basis for appeal, unless it ends the litigation on the merits, leaving nothing for the court to do but execute the judgment.

[4] Bankruptcy 51 🔑 3767

51 Bankruptcy

51XIX Review
51XIX(B) Review of Bankruptcy Court
51k3766 Decisions Reviewable
51k3767 k. Finality. Most Cited Cases

Bankruptcy court's order allowing trustee to conduct Rule 2004 examination of debtors was "final" and therefore appealable; the postconfirmation Rule 2004

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examination was a separate proceeding, and there was no indication that further action by the bankruptcy court would be forthcoming. 28 U.S.C.A. § 158; Fed.Rules Bankr.Proc.Rule 2004, 11 U.S.C.A.

[5] Attorney and Client 45 62

45 Attorney and Client

45II Retainer and Authority
45k62 k. Rights of Litigants to Act in Person or by Attorney. Most Cited Cases

Pro se litigants must follow the same rules of procedure as other litigants.

[6] Bankruptcy 51 3777

51 Bankruptcy

51XIX Review
51XIX(B) Review of Bankruptcy Court
51k3777 k. Record; Assignments of Error; Briefs. Most Cited Cases

The appellate court may decline to review an issue when a party does not fulfill its responsibility to provide a document necessary for the consideration and determination of the issue.

[7] Bankruptcy 51 3777

51 Bankruptcy

51XIX Review
51XIX(B) Review of Bankruptcy Court
51k3777 k. Record; Assignments of Error; Briefs. Most Cited Cases

Bankruptcy Appellate Panel would not review bankruptcy court's orders regarding Chapter 13 debtors' objections to Internal Revenue Service's (IRS) proof of claim, their motion to abate the Rule 2004 examination, and IRS' motion for summary judgment, where the appellant debtors did not include the orders in the record on appeal. Fed.Rules Bankr.Proc.Rule 2004, 11 U.S.C.A.

[8] Bankruptcy 51 3774.1

51 Bankruptcy

51XIX Review
51XIX(B) Review of Bankruptcy Court
51k3774 Notice of Appeal; Time
51k3774.1 k. In General. Most Cited Cases

The time limits established for filing a notice of appeal are mandatory and jurisdictional.

[9] Federal Civil Procedure 170A 927.5

170A Federal Civil Procedure

170AVII Pleadings and Motions
170AVII(I) Motions in General
170Ak927.5 k. Motions in Limine. Most Cited Cases

(Formerly 170Ak2011)

A motion in limine is designed to aid the trial process by enabling the court to rule in advance of trial on the relevance of certain forecasted evidence as to issues that are definitely set for trial, without lengthy argument at, or interruption of, the trial.

[10] Bankruptcy 51 3784

51 Bankruptcy

51XIX Review
51XIX(B) Review of Bankruptcy Court
51k3784 k. Discretion. Most Cited Cases

Abuse of discretion is defined as an arbitrary, capricious, whimsical, or manifestly unreasonable judgment.

[11] Bankruptcy 51 3040.1

51 Bankruptcy

51IX Administration
51IX(A) In General
51k3040 Examination and Discovery
51k3040.1 k. In General. Most Cited Cases

As a general rule, examinations under Rule 2004 are allowed for the purpose of discovering assets, examining transactions, and determining whether wrongdoing has

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occurred. Fed.Rules Bankr.Proc.Rule 2004, 11 U.S.C.A.

[12] Bankruptcy 51 3047(1)

51 Bankruptcy

51IX Administration
51IX(A) In General
51k3040 Examination and Discovery
51k3047 Scope and Extent of Inquiry
51k3047(1) k. In General. Most Cited Cases

Rule 2004 examinations cannot be used for the purpose of abuse or harassment, and the examination cannot go beyond the bounds of what is, or may be, relevant to the inquiry. Fed.Rules Bankr.Proc.Rule 2004, 11 U.S.C.A.

[13] Bankruptcy 51 3047(1)

51 Bankruptcy

51IX Administration
51IX(A) In General
51k3040 Examination and Discovery
51k3047 Scope and Extent of Inquiry
51k3047(1) k. In General. Most Cited Cases

Examinations under rule 2004 should not be used to annoy, embarrass, or oppress the debtor. Fed.Rules Bankr.Proc.Rule 2004, 11 U.S.C.A.

[14] Bankruptcy 51 3777

51 Bankruptcy

51XIX Review
51XIX(B) Review of Bankruptcy Court
51k3777 k. Record; Assignments of Error; Briefs. Most Cited Cases

Bankruptcy Appellate Panel would not review bankruptcy court's denial of Chapter 13 debtors' motion to quash Rule 2004 examination and their motion in limine to limit the scope of the Rule 2004 examination, where appellant debtors did not provide the Panel with a transcript of the bankruptcy court's findings from the hearing on the motion in limine or the hearing on the motion to quash; absence of transcripts frustrated any attempt to apply the abuse of discretion standard of review. Fed.Rules Bankr.Proc.Rule 2004, 11 U.S.C.A.

[15] Bankruptcy 51 3789.1

51 Bankruptcy

51XIX Review
51XIX(B) Review of Bankruptcy Court
51k3789 Determination and Disposition; Additional Findings
51k3789.1 k. In General. Most Cited Cases

As a general rule, failure to provide a trial transcript warrants affirmance of the trial court decision on appeal, where the issue on appeal requires the appellate court to review the record in the trial court.

[16] Bankruptcy 51 3047(1)

51 Bankruptcy

51IX Administration
51IX(A) In General
51k3040 Examination and Discovery
51k3047 Scope and Extent of Inquiry
51k3047(1) k. In General. Most Cited Cases

Inquiry by a bankruptcy trustee regarding preparation of a debtor's bankruptcy schedules and tax returns is within the broad scope permitted a Rule 2004 examination. Fed.Rules Bankr.Proc.Rule 2004, 11 U.S.C.A.

Appeal from the United States Bankruptcy Court for the Eastern District of Oklahoma.

Before PUSATERI, BOULDEN, and KRIEGER, Bankruptcy JJ.

ORDER AND JUDGMENT [FN*]

PUSATERI, Bankruptcy Judge.

***1** After examining the briefs and appellate record, the Court has determined unanimously that oral argument would not materially assist in the determination of this appeal. *See* Fed.R.Bankr.P. 8012; 10th Cir. BAP L.R. 8012-1(a). The case is therefore ordered submitted without oral argument.

Lawrence and Barbara Buckner ("Debtors") appeal from a bankruptcy court order allowing the Trustee to conduct a Rule 2004 examination of Debtors. We affirm.

I. Jurisdiction and Standard of Review.

A bankruptcy appellate panel, with the consent of the parties, has jurisdiction to hear appeals from final judgments, orders, and decrees of bankruptcy judges within this circuit. 28 U.S.C. § 158(a), (b)(1), (c)(1). As none of the parties have opted to have this appeal heard by the District Court for the Eastern District of Oklahoma, they are deemed to have consented to jurisdiction. 10th Cir. BAP L.R. 8001-1(d).

[1] The Bankruptcy Appellate Panel may affirm, modify or reverse a bankruptcy court's judgment, order or decree, or remand with instructions for further proceedings. Findings of fact shall not be set aside unless clearly erroneous. Fed.R.Bankr.P. 8013; *see First Bank v. Reid (In re Reid),* 757 F.2d 230, 233-34 (10th Cir.1985). Conclusions of law are reviewed *de novo. Pierce v. Underwood,* 487 U.S. 552, 558, 108 S.Ct. 2541, 101 L.Ed.2d 490 (1988). Decisions under Fed.R.Bankr.P. 2004 are reviewed for an abuse of discretion. *In re Charters Int'l Co., Inc.,* Civ. A. No. 89-2231-O, 1990 WL 81764 (D.Kan. May 21, 1990).

II. Background.

Debtors are pro se debtors in a Chapter 13 case. Their sixty-month plan was confirmed in November 1998. Debtors and the IRS settled a claim dispute for approximately $48,000.

On August 24, 2000, the Trustee, William Bonney ("the Trustee"), filed a motion to conduct 2004 exam of Debtors. The motion requested testimony on all documents relating to the preparation of the Debtors' schedules and used in the preparation of Debtors' 1998 and 1999 tax returns. On August 28 the bankruptcy court entered ex parte orders granting the motion and setting the examination of Debtors for September 13, 2000.

On September 11, 2000, Debtors filed a motion to quash on the grounds that they were not provided adequate notice of the Trustee's motion and that the 2004 exam exceeded the scope of the Trustee's duties. The matter was set for evidentiary hearing on September 20, 2000. The Trustee filed a notice of intent to present evidence at the hearing. Debtors filed a notice of waiver of oral argument and requested the court vacate the hearing. The court advised the parties that the evidentiary hearing would be conducted as scheduled and directed the Debtors and all parties to appear and participate. Debtors responded by filing an objection to the Trustee calling witnesses at the hearing.

Based on the record made at the hearing, the bankruptcy court denied the motion to quash and directed Debtors to appear for a continued 2004 exam on October 3, 2000. Debtors did not include a copy of the transcript from this hearing in the record on appeal.

***2** Debtors appeared at the 2004 exam with lockboxes, but they refused to answer any questions and read a statement that said, "Mr. Mather [Trustee's counsel], will you go on the record here that if I provide you with this information that I have here in this box, that it will not be used against me outside of this bankruptcy proceeding?" The Trustee declined, and the examination was continued.

On October 5, 2000, Debtors filed a Motion in Limine requesting the bankruptcy court limit the scope of the 2004 exam to inquiry into the financial affairs of the Debtors and prohibit questions regarding assistance in preparing their bankruptcy petition and schedules as well as tax returns. They also filed a "Notice of Supplementation of Rule 2004 Hearing held October 3, 2000," to which they attached an Exhibit of the written statement in their lockboxes, which said, in effect, that any assistance in preparing their bankruptcy pleadings and schedules came from God. The Trustee responded to the motion in limine, arguing that it was inappropriate outside of jury trial matters.

At the hearing held November 1, 2000, the

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bankruptcy court denied the motion in limine based on the record made at the hearing. The court ordered Debtors to proceed with the 2004 exam immediately afterwards in the court's library. Debtors did not include a transcript from this hearing in the record on appeal.

Teresa Trissell, a trial attorney for the Justice Department appeared at the Rule 2004 examination as well as the attorney for the Trustee. Debtors testified that they used several websites to assist in preparation of their bankruptcy documents. They also attended a "freedom rally," where they purchased materials on tax and estate planning issues. Debtors testified that they had help from Dr. Tom Smith, a "legal research doctor," in preparing pleadings. Ms. Trissell also questioned Debtors about payments they had made to any of these individuals.

Debtors filed a Notice of Appeal on November 3, 2000, appealing the bankruptcy court decision regarding the Debtors' objection to the proof of claim of the IRS; Debtors' Motion in Limine; Debtors' motion to abate the proceedings; and the Motion of the IRS for summary judgment, all issued on November 1, 2000 [FN1]. The only order included in the record on appeal is the order denying the motion in limine and directing continuation of the 2004 exam.

III. Discussion.

[2][3][4] As a threshold matter, the Court addresses whether it has jurisdiction to hear this appeal. As a general rule, discovery orders are not appealable until the end of the case. *See* *Union Carbide Corp. v. U.S. Cutting Service, Inc.,* 782 F.2d 710, 712 (7th Cir.1986). It is well-settled in this circuit that an order is not final unless it ends the litigation on the merits, leaving nothing for the court to do but execute the judgment. *See* *In re Magic Circle Energy Corp.,* 889 F.2d 950, 953 (10th Cir.1989). In this case, the Debtors' Chapter 13 plan was confirmed in 1998. Because the postconfirmation Rule 2004 examination is a separate proceeding and there is no indication that further action by the bankruptcy court will be forthcoming, we conclude the matter is final for purposes of appeal under § 158(d).

***3** [5][6][7] The Court notes that this case is rife with procedural problems, most likely attributable to Debtors' pro se status. However, pro se litigants must follow the same rules of procedure as other litigants. *Nielsen v. Price,* 17 F.3d 1276, 1277 (10th Cir.1994). Debtors specifically appealed from the order regarding their objection to the proof of claim of the IRS, their motion to abate the proceedings, and the motion, but not order, of the IRS for summary judgment. Not one of these orders, however, is included in the record on appeal. The Court may decline to review an issue when a party does not fulfill its responsibility to provide a document necessary for the consideration and determination of the issue. *See* *Gowan v. United States Dept. of Air Force,* 148 F.3d 1182, 1192 (10th Cir.1998); *see also* *Rios v. Bigler,* 67 F.3d 1543, 1553 (10th Cir.1995) ("It is not this court's burden to hunt down the pertinent materials. Rather, it is Plaintiff's responsibility as the appellant to provide us with a proper record on appeal."). This Court cannot review the bankruptcy court's determination on these matters without reviewing the pleadings and orders. *See, e.g.,* *United States v. Vasquez,* 985 F.2d 491, 494 (10th Cir.1993) ("When the record on appeal fails to include copies of the documents necessary to decide an issue on appeal, the Court of Appeals is unable to rule on that issue.").

[8] The Court further notes that Debtors did not specifically appeal from the preliminary order allowing the Rule 2004 exam or the order denying motion to quash. The time limits established for filing a notice of appeal are " 'mandatory and jurisdictional.' " *Browder v. Director, Dept. of Corrections,* 434 U.S. 257, 264, 98 S.Ct. 556, 54 L.Ed.2d 521 (1978) (quoting *United States v. Robinson,* 361 U.S. 220, 229, 80 S.Ct. 282, 4 L.Ed.2d 259 (1960)). Rule 8002 requires that a notice of appeal be filed within ten days of the entry of the judgment appealed. Fed.R.Bankr.P. 8002(a).

In this case, the order granting motion for 2004 exam was entered August 28, 2000. The Debtors did not file a motion to quash until September 11, 2000, more than ten days later. The motion to quash states that the 2004 exam exceeds the scope of the Trustee's duties. The order denying the motion to quash was entered September 22, 2000. The Debtors did not file a notice of appeal or motion to reconsider, but rather, a motion in limine on

October 5, 2000, also more than ten days later. The order denying the motion in limine was entered November 3, 2000, and the notice of appeal was filed the same day. Debtors did not appeal the initial order granting the motion for 2004 exam or the order denying the motion to quash. Accordingly, the only order timely appealed appears to be the order denying the Debtors' motion in limine and directing continuation of the 2004 examination.

[9] A motion in limine is designed to aid the trial process by enabling the court to rule in advance of trial on the relevance of certain forecasted evidence as to issues that are definitely set for trial, without lengthy argument at, or interruption of, the trial. In this case, there were no issues definitely set for trial; Debtors were apparently attempting to pre-empt any future use of information gathered at the Rule 2004 examination.

***4** [10] Although incorrectly captioned, the motion in limine appears to be and will be construed by the Court as another attempt to limit scope of the 2004 exam. As a preliminary matter, we note again that our review is limited. A bankruptcy court's order regarding a Rule 2004 examination must be affirmed unless it constitutes an abuse of discretion. Reversal is appropriate only if the court " 'based its ruling on an erroneous view of the law or on a clearly erroneous assessment of the evidence.' " *Hughes v. City of Fort Collins,* 926 F.2d 986, 988 (10th Cir.1991) (quoting *Cooter & Gell v. Hartmarx Corp.,* 496 U.S. 384, 405, 110 S.Ct. 2447, 110 L.Ed.2d 359 (1990)). In this circuit, abuse of discretion is defined as " 'an arbitrary, capricious, whimsical, or manifestly unreasonable judgment.' " *F.D.I.C. v. Oldenburg,* 34 F.3d 1529, 1555 (10th Cir.1994) (quoting *United States v. Hernandez-Herrera,* 952 F.2d 342, 343 (10th Cir.1991) (further quotation omitted)). It is with this standard in mind that we review Debtors' arguments.

[11][12][13] The Debtors argue that the Trustee exceeded the scope of his duties in conducting a "fishing expedition" during the Rule 2004 examination. They request that this Court reverse the bankruptcy court order allowing the examination to proceed and strike the information and transcript from the record. As a general rule, examinations under Rule 2004 are allowed for the purpose of discovering assets, examining transactions, and determining whether wrongdoing has occurred. *In re Duratech Indus., Inc.,* 241 B.R. 283, 289 (E.D.N.Y.1999). Necessarily, the scope of Rule 2004 is extremely broad, and the rule itself is " 'peculiar to bankruptcy law and procedure because it affords few of the procedural safeguards that an examination under Rule 26 of the Federal Rules of Procedure' offers." *In re Strecker,* 251 B.R. 878, 882 (Bankr.D.Colo.2000) (quoting *In re GHR Energy Corp.,* 33 B.R. 451, 454 (Bankr.D.Mass.1983)). In fact, Rule 2004 exams have been characterized as "fishing expeditions," although they are not without bounds. *In re Buick,* 174 B.R. 299, 305 (Bankr.D.Colo.1994). Rule 2004 examinations cannot be used for the purpose of abuse or harassment, and the examination cannot go beyond the bounds of what is, or may be, relevant to the inquiry. *In re Symington,* 209 B.R. 678, 684-85 (Bankr.D.Md.1997). Examinations under rule 2004 should not be used to annoy, embarrass or oppress the debtor. *In re Coffee Cupboard, Inc.,* 128 B.R. 509, 514 (Bankr.E.D.N.Y.1991).

[14][15] Again, the Court notes a procedural error. Debtors' failure to provide the Court with a transcript of the bankruptcy court's findings from the hearing on the motion in limine or the hearing on the motion to quash frustrates any attempt to apply the abuse of discretion standard of review. As a general rule, failure to provide a trial transcript warrants affirmance of the trial court decision on appeal where the issue on appeal requires the appellate court to review the record in the trial court. *In re Rambo,* 209 B.R. 527, 530 (10th Cir.BAP1997). Debtors' failure to supply the court with a transcript of the hearings makes it impossible for the Court to determine whether the bankruptcy court's order allowing the 2004 examination and declining to limit the scope of the examination was an abuse of discretion.

***5** [16] Although we premise our affirmance of the bankruptcy court's order denying the motion in limine and ordering the Rule 2004 examination to proceed without limiting the scope on Debtors' failure to provide an adequate record for review, we have, to the extent possible, considered Debtors' arguments, and we find them to be without merit. Certainly, inquiry by a Trustee

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regarding preparation of a debtor's bankruptcy schedules and tax returns is within the broad scope permitted a Rule 2004 examination. Accordingly, we hold that the bankruptcy court did not abuse its discretion in allowing the examination to proceed as requested.

IV. Conclusion.

The decision of the trial court is AFFIRMED.

FN* This order and judgment has no precedential value and may not be cited, except for the purposes of establishing the doctrines of law of the case, res judicata, or collateral estoppel. 10th Cir. BAP L.R. 8010-2.

FN1. On September 18, 2000, Debtors filed an objection to the claim of the IRS and the Oklahoma Tax Commission. The IRS apparently prevailed on summary judgment, but it does not appear that Debtors appeal from any such order.

10th Cir.BAP (Okla.),2001.

In re Buckner
271 B.R. 213, 2001 WL 992063 (10th Cir.BAP (Okla.)), 88 A.F.T.R.2d 2001-6415
END OF DOCUMENT

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Only the Westlaw citation is currently available.

This decision was reviewed by West editorial staff and not assigned editorial enhancements.

United States District Court,

E.D. Michigan,
Southern Division.
MORTGAGE ELECTRONIC REGISTRATION SYSTEMS, INC., as nominee for lender, Appellant,
v.
Kimbertly A. JONES and Sheryl C. Jones, Appellees.
No. 09-10321.

March 11, 2009.
Kimbertly A. Jones, Las Vegas, NV, pro se.

William D. Johnson, Acclaim Legal Services, Southfield, MI, for Appellees.

ORDER

JULIAN ABELE COOK, JR., District Judge.

***1** On May 20, 2008, the Appellees, Kimbertly A. Jones and Sheryl C. Jones, filed for protection under Chapter 7 of the United States Bankruptcy Code. On July 11, 2008, the Appellant, Mortgage Electronic Registration Systems, Inc. filed an adversary proceeding against the Appellees in the United States Bankruptcy Court for the Eastern District of Michigan.

Nearly two months later (September 26th), the Appellant submitted several discovery requests to the Appellees in the form of interrogatories, requests to produce, as well as requests for admission. On November 7th, the Appellant filed a motion for the entry of a summary judgment in the Bankruptcy Court, contending that (1) the Appellees had failed to answer its requests for admissions, and (2) by virtue of Fed.R.Civ.P. 36(b), "all matters contained therein [were] deemed admitted." Moreover, the Appellant points out that "a matter admitted under this rule is conclusively established unless the court, on motion, permits the admission to be withdrawn or amended." The Appellees, after filing a response in opposition to the pending motion on November 11th, submitted their answers to the Appellant's various discovery requests on December 5th. Following a hearing on December 18th, Bankruptcy Judge Walter Shapero rejected the Appellant's dispositive request for the entry of a summary judgment. It was his belief that a summary judgment was not warranted inasmuch as the Appellees had now filed their answers to the Appellant's discovery requests, albeit untimely.

On January 27, 2009, the Appellant filed a motion for leave to file an interlocutory appeal in this federal district court. In support of its request, the Appellant contends that (1) the question to be determined is one of law, (2) the Appellees' failure to respond to its discovery requests establishes their liability, and (3) a decision on this issue in its favor would greatly expedite this litigation. In their opposition papers of February 18, 2009, the Appellees argue that the Appellant's motion is unwarranted because it has failed to establish that Bankruptcy Judge Shapero abused his discretion when rendering his decision.

Over fifteen years ago, the Sixth Circuit Court of Appeals cautioned that interlocutory appeals should be granted only in "exceptional cases," *Vitols v. Citizens Banking Co.,* 984 F.2d 168, 170 (6th Cir.1993) (internal citations omitted), because of the disruption and delay that is inherent in the immediate appeal of an order. *United States v. Bilsky,* 664 F.2d 613, 615 (6th Cir.1981).

When determining whether an interlocutory appeal from a bankruptcy court order is appropriate, district courts are encouraged to examine (1) 28 U.S.C. § 1292(b) [FN1] and (2) the standards that have been adopted by the Sixth Circuit Court of Appeals when deciding whether or not to hear interlocutory appeals from federal district courts. *In the Matter of PHM Credit Corp.,* 99 B.R. 762, 767 (E.D.Mich.1989). When evaluating the propriety of an interlocutory appeal, the Sixth Circuit Court of Appeals seeks to determine if (1) the challenged order involves a controlling legal question; (2) there is substantial ground

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for a difference of opinion relating to the issue under review; and (3) an immediate appeal would materially advance the termination of the litigation. *W. Tenn. Chapter of Assoc. Builders & Contractors, Inc. v. City of Memphis,* 293 F.3d 345, 350 (6th Cir.2002).

FN1. 28 U.S.C. § 1292(b) provides, in part:

> When a district judge, in making in a civil action an order not otherwise appealable under this section, shall be of the opinion that such order involves a controlling question of law as to which there is substantial ground for difference of opinion and that an immediate appeal from the order may materially advance the ultimate termination of the litigation, he shall so state in writing in such order. The Court of Appeals which would have jurisdiction of an appeal of such action may thereupon, in its discretion, permit an appeal to be taken from such order ....

***2** A question of law is controlling "if it could materially affect the outcome of the case." *Id.* (citing *In re Baker & Getty Fin. Servs., Inc. v. Nat'l Union Fire Ins. Co.,* 954 F.2d 1169, 1172 n. 8 (6th Cir.1992). Moreover, the type of legal questions that are addressed in 28 U.S.C. § 1292(b) do not include issues which fall within the discretion of the trial court. *Id.* (citing *White v. Nix,* 43 F.3d 374, 377 (8th Cir.1994)).

Here, the Court does not believe that the Appellant's request for an interlocutory appeal is warranted for two reasons. First, the denial of a summary judgment by a Bankruptcy Judge is not immediately appealable. *See McMullen v. Meijer, Inc.,* 355 F.3d 485, 489 (6th Cir.2004). Secondly, there is no purely legal and controlling question of law at issue. The denial of the Appellant's motion for summary judgment by Bankruptcy Judge Shapero was based on his conclusion that the Appellees' answers to interrogatories, though untimely, should be considered in conjunction with the entire case. While recognizing that the Appellees' discovery responses were late, he did not "think the ... appropriate response [would be] the granting of a judgment." As such, Judge Shapero's denial of the Appellant's motion for a summary judgment, as well as his order which authorized the Appellees' late discovery filings, are reviewable on an abuse of discretion standard. *See Romstadt v. Allstate Ins. Co.,* 59 F.3d 608, 615 (6th Cir.1995) (denial of summary judgment reviewed for abuse of discretion); *Proctor v. USDE,* 196 Fed. Appx. 345, 347 (6th Cir.2006) ("court enjoys broad discretion in handling discovery disputes"). As noted above, issues that fall within the discretion of the court are not appropriate for interlocutory review. *W. Tenn. Chapter of Assoc. Builders & Contractors, Inc.,* 293 F.3d at 350. Finally, the Court, when assessing the issues as a whole, does not believe that Judge Shapero abused his discretion under the circumstances that appear on this record.

Accordingly and for the reasons that have been stated above, the Court must, and does, deny the Appellant's motion for leave to file an interlocutory appeal.

IT IS SO ORDERED.

E.D.Mich.,2009.

Mortgage Electronic Registration Systems, Inc. v. Jones
Slip Copy, 2009 WL 646623 (E.D.Mich.)
END OF DOCUMENT

EXHIBIT H

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF MICHIGAN
SOUTHERN DIVISION

In re:	Case No. 10-50910-PJS
KEITH R. ELLIS,	Chapter 13
Debtor.	HON. PHILLIP J. SHEFFERLY
______________________________________/	District Court Case No. 2:11-cv-10860-VAR-PJK

CERTIFICATE OF SERVICE

I hereby certify that on March 16, 2011, I served copies as follows:

1.	Documents Served:	*The United States Trustee's Response to HSBC Mortgage Corporation (USA)'S Motion for Leave to Appeal, Brief and Certificate of Service.*
2.	Served Upon:	Keith R. Ellis 51438 Cart Drive Macomb, MI 48042-4342 Jeremy Salter McCalla Raymer, LLC National Bankruptcy Dept. 1544 Old Alabama Road Roswell, GA 30076
3.	Method of Service:	First Class Mail

DANIEL M. McDERMOTT
UNITED STATES TRUSTEE
Region 9

By: /s/ Barbara Rygiel
Barbara.Rygiel@usdoj.gov
Paralegal Specialist
Office of the U.S. Trustee
211 West Fort St. - Suite 700
Detroit, MI 48226
313.226.4543

Dated: March 16, 2011

BRIEF BANK — 'SUMMARY SHEET" *Printed Wed-11/8/06 14:40*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	Adams, UST v Finlay
2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	DC SD NY
3. ("CCN") ***CURRENT*** CASE NO.	No.: : 06 Civ. 6039
4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*	No.: Court: Bankr. SD NY *(Identify judge & cite, if any)*
5. ("SO") ***SOURCE***	**U.S. TRUSTEES**
6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	Filed: August 23, 2006 Type: Brief of the Appellee, UST
7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*	Eric J. Small, Esq., Trial Ayttorney, Office of the UST, Albany, NY *(UST/OGC: 202-307-1399/FAX-2397)*
8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") ● ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	● Under section 301 of the Bankruptcy Code, the filing of a petition commences a bankruptcy case. In a variety of contexts, federal courts routinely dismiss cases that lack merit, including cases brought in the absence of subject matter jurisdiction. Given that law, did the court below err when it ruled that Ms. Elmendorf, Ms. Finlay and Ms. Zarnel's petitions had not commenced cases, and terminated the bankruptcy proceedings by striking the cases on its own initiative, while denying the motions to dismiss the cases.
10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)	\\UST00EOSVR01\users\seggert\My Files\BriefBank-Web\Elmendorf\elmendorf01.wpd
11. DO YOU RECOMMEND POSTING IN UST BRIEFBANK?	| X | YES | | NO ***NAME:*** Steven Eggert ***DATE:*** Wed-11/8/06 14:36

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

---x
DIANA G. ADAMS : BANKRUPTCY APPEALS
ACTING UNITED STATES TRUSTEE :
: 06 Civ. 6039 (CLB)
Appellant. :
: Related Cases: 06 Civ. 6040 (CLB)
-against- : 06 Civ. 6041 (CLB)
: 06 Civ. 6042 (CLB)
DIANA M. FINLAY : 06 Civ. 6072 (CLB)
: 06 Civ. 6077 (CLB)
Appellee. :
---x

BRIEF OF THE APPELLANT UNITED STATES TRUSTEE

DIANA G. ADAMS
ACTING UNITED STATES TRUSTEE
FOR REGION 2

Eric J. Small, Esq.
Trial Attorney
United States Department of Justice
Office of the United States Trustee
74 Chapel Street
Albany, NY 12207
(518) 434-4553

Of Counsel
Roberta A. DeAngelis
Acting General Counsel

P. Matthew Sutko
Lisa A. Tracy
Larry E. Wahlquist
Office of the General Counsel
Executive Office for United States Trustees
United States Department of Justice
20 Massachusetts, Ave. N.W., Suite 8100
Washington, D.C. 20530
(202) 307-1399

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STATEMENT OF JURISDICTION

The United States Bankruptcy Court for the Southern District of New York had jurisdiction over the Chapter 7 case of Lena M. Elmendorf, and the Chapter 13 cases of Diana M. Finlay and Shayna H. Zarnel under 28 U.S.C. 157(b). These appeals are taken from a Memorandum Opinion that court entered on July 18, 2006 directing the striking of the three bankruptcy cases over the objection of the United States Trustee, whose motion had sought dismissal of the cases, as well as from the subsequent orders entered on July 28, 2006 striking the cases. The United States Trustee filed timely notices of appeal in each case from the Memorandum Opinion on July 27, 2006 and from the orders on July 28, 2006 under 28 U.S.C. 158(c)(2) and Fed. R. Bankr. P. 8002(a).[1] This Court has jurisdiction over these appeals under 28 U.S.C. 158(a)(1).

STATEMENT OF THE ISSUE

Under section 301 of the Bankruptcy Code, the filing of a petition commences a bankruptcy case. In a variety of contexts, federal courts routinely dismiss cases that lack merit, including cases brought in the absence of subject matter jurisdiction. Given that law, did the court below err when it ruled that Ms. Elmendorf, Ms. Finlay and Ms. Zarnel's petitions had not commenced cases, and terminated the bankruptcy proceedings by striking the cases on its own initiative, while denying the motions to dismiss the cases?

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[1] Congress has authorized the United States Attorney General to appoint 21 United States trustees, each to serve in a specific geographic region of the United States. *See generally* 28 U.S.C. 581 et seq. (establishing United States Trustee Program). The United States trustees are senior officials of the Department of Justice. *Id*. United States Trustees "supervise the administration of cases and trustees" in all bankruptcy cases within his or her region through the exercise of a range of oversight responsibilities. 28 U.S.C. 586(a)(3).

STATEMENT OF THE CASE

This appeal presents an important recurring issue that has arisen under the new Bankruptcy Code as amended by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA). That new law requires individuals to obtain credit counseling from an approved agency before seeking bankruptcy relief. *See* 11 U.S.C. 109(h). On November 29, 2005, Ms. Elmendorf filed her petition under Chapter 7 of the Bankruptcy Code without satisfying the Code's pre-filing credit counseling requirement, or seeking the temporary exemption afforded by the statute under certain circumstances. *See* 11 U.S.C. § 109(h)(3). On March 13, 2006, Ms Zarnel filed her petition under Chapter 13 of the Bankruptcy Code and sought a temporary exemption, which the bankruptcy court denied. On April 3, 2006, Ms. Finlay filed her petition under Chapter 13 of the Bankruptcy Code and sought a temporary exemption, which the bankruptcy court also denied. The United States Trustee filed motions to dismiss all three cases, which were unopposed by any party. Neither the bankruptcy court nor any party has contested the assertion that failure to satisfy the credit counseling requirement renders Ms. Elmendorf, Ms. Zarnel and Ms. Finlay ineligible to be debtors. The sole issue is whether the cases should have been stricken, as determined in a July 18, 2006 Memorandum Opinion and ordered by the bankruptcy court on July 28, 2006, or dismissed, as sought by the United States Trustee. The United States Trustee sought dismissal, and opposed striking of the cases because the nature of the relief granted could have a substantial impact upon Ms. Elemendorf, Ms. Zarnel and Ms. Finlay's creditors. The United States Trustee timely filed these appeals.

STATEMENT OF FACTS

1. Statutory Framework

Chapter 3 of the Bankruptcy Code, 11 U.S.C. 301, *et seq*., governs the commencement and administration of bankruptcy cases. Under section 301, “a voluntary case under a chapter of [the Bankruptcy Code] is commenced by the filing with the bankruptcy court of a petition under such chapter by an entity that may be a debtor under such chapter.” 11 U.S.C. 301. The commencement of a case under section 301 is significant for many reasons. For example, under 28 U.S.C. 1930(a), “parties commencing a case under title 11" are required to pay the clerk of the bankruptcy court a fee for a case commenced under chapter 7 of the Bankruptcy Code. 28 U.S.C. 1930(a). When a debtor commences a chapter 7 case under section 301, the court issues a notice of the debtor’s bankruptcy filing to the debtor’s creditors, assigning the debtor a case number and advising the debtor’s creditors that “the filing of the bankruptcy case automatically stays certain collection and other actions against the debtor.” (ER. at 5; Notice of Chapter 7 Bankruptcy Case, Meeting of Creditors, & Deadlines; ZR. at 4; Notice of Chapter 13 Bankruptcy Case, Meeting of Creditors and Fixing of Dates; FR. at 4; Notice of Chapter 13 Bankruptcy Case, Meeting of Creditors and Fixing of Dates).[2] In addition, in the Chapter 7 case under 11 U.S.C. § 701, the United States Trustee must appoint a disinterested person to “serve as interim trustee in the case.” 11 U.S.C. 701(a)(1). Under 11 U.S.C. § 1302(a) the United States Trustee must appoint either the standing trustee appointed under 28 U.S.C. § 586(b) to serve in cases

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[2] “ER. at __” refers to the official docket number in the bankruptcy court’s case docket for Lena M. Elmendorf. ZR. at __ refers to the official docket number in the bankruptcy court’s case docket for Shayna H. Zarnel. FR. at __ refers to the official docket number in the bankruptcy court’s case docket for Diana M. Finlay.

under Chapter 13, or a disinterested person to serve as trustee in the case.[3]

Section 109 establishes rules that govern eligibility to be a debtor under the Bankruptcy Code. This section includes general rules that affect the eligibility of individuals to proceed as debtors under each chapter of the Bankruptcy Code. For example, under section 109(g), no individual may be a debtor under the Bankruptcy Code if that individual had a case pending at any time during the preceding 180 days if the prior case "was dismissed by the court for willful failure of the debtor to abide by orders of the court." 11 U.S.C. 109(g). Section 109 also places restrictions on the types of individuals who may proceed as debtors under specific chapters of the Bankruptcy Code. *See* 11 U.S.C. 109. For example, only individuals with regular income who have unsecured debts of less than $307,675 and secured debts of less than $922,975 may be debtors under chapter 13 of the Bankruptcy Code. *See* 11 U.S.C. 109(e).

The BAPCPA amended Section 109 in 2005 to require, as an additional element of eligibility to be a debtor under any chapter of the Bankruptcy Code, that all individuals receive credit counseling during the 180-day period prior to filing a petition in bankruptcy. *See* 11 U.S.C. 109(h)(1). [4]

Section 707, of Chapter 7, entitled *Dismissal of a case or conversion to a case under chapter 11 or 13,* establishes that "a court may dismiss a case under [Chapter 7] . . . for cause..."

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[3] The United States Trustee may also serve as trustee in the case.

[4] Under this new provision, debtors may seek an extension of the pre-filing requirement of up to forty-five days after filing if they can establish, among other things, that exigent circumstances required that they file for bankruptcy protection before obtaining the required credit counseling. *See* 11 U.S.C. 109(h)(3). In addition, upon notice and a hearing, a debtor may seek waiver of the credit counseling requirement altogether if the debtor can establish that he or she is incapacitated, disabled or on active military duty in a military combat zone. *See* 11 U.S.C. 109(h)(4). Those sections are not at issue in this appeal.

11 U.S.C. 707(a). It includes a nonexhaustive list of reasons that may constitute cause to dismiss a Chapter 7 bankruptcy case. *See* 11 U.S.C. 707(a). Section 1307, of Chapter 13, entitled *Conversion or dismissal*, establishes that a debtor may convert a case to Chapter 7 at any time, that the court shall dismiss a case upon request of a debtor whose case has not previously been converted from another chapter, and that "...the court may convert a case under [Chapter 13] to a case under Chapter 7 of [Title 11], or may dismiss a case under [Chapter 13], whichever is in the best interest of creditors and the estate, for cause..." 11 U.S.C. § 1307. It also includes a nonexhaustive list of reasons that may constitute cause to convert or dismiss a Chapter 13 case.

2. Factual Background

a. Lena M. Elmendorf

Ms. Elmendorf filed a petition for relief under Chapter 7 of the Bankruptcy Code on November 29, 2006. (ER. at 1; Voluntary Petition). The Court received a filing fee and assigned Case No. 05-55048. (ER. at 1; Receipt of Voluntary Petition; ER. at 5, Notice of Chapter 7 Bankruptcy Case, Meeting of Creditors and Deadlines). Ms. Elmendorf was assisted in the preparation and filing of her bankruptcy petition by her bankruptcy counsel.(ER. at 1; Voluntary Petition) The Bankruptcy Code requires a debtor to file a certificate from the approved credit counseling agency as proof that the debtor has fulfilled the credit counseling requirement of 11 U.S.C. 109(h). *See* 11 U.S.C. 521(b)(1). Interim Rules 1007(b)(3) and (c) require that the certificate of credit counseling be filed with the bankruptcy petition in a voluntary case.[5] *See* Int. R. Fed. Bankr. P.1007(b)(3) and (c). Ms. Elmendorf neither filed a

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[5] The Interim Bankruptcy Rules were prepared by the Advisory Committee on Bankruptcy Rules and recommended for local court adoption to implement changes made by the BAPCPA. Pursuant to a standing order dated October 11, 2005, the Bankruptcy Court for the

certificate of credit counseling, nor a motion for a temporary exemption from the requirement. (ER. at 7; Motion to Dismiss Chapter 7 Case for Cause Pursuant to 11 U.S.C. §§ 109(h), 521(b) and 707(a) at Par. 6-7; ER. at 12; Memorandum Opinion at p. 4).

The United States Trustee filed a motion to dismiss Ms. Elmendorf's case on the basis that she was ineligible to be a debtor. (ER. at 7-8; Motion to Dismiss Chapter 7 Case for Cause Pursuant to 11 U.S.C. §§ 109(h), 521(b) and 707(a) and Memorandum of Law). The United States Trustee also filed a supplemental memorandum of law opposing the striking of the case, and further supporting dismissal. (ER. at 11; Memorandum of Law in Further Support of Motion of the United States Trustee to Dismiss Chapter 7 Case)("the Supplemental Memorandum of Law"). No party appeared, or in any way opposed the motion to dismiss the case, and no party sought the striking of the case. (*See generally*, Lena M. Elmendorf docket; Transcript of May 16, 2006 hearing).

b. Shayna H. Zarnel

Ms. Zarnel filed a *pro se* petition for relief under Chapter 13 of the Bankruptcy Code on March 13, 2006. (ZR. at 1; Voluntary Petition). This case was her first bankruptcy filing, but her husband, Alfred R. Zarnel, had filed five bankruptcy petitions since January, 2004 ," ...in continuance of Mr. Zarnel's pattern of instituting a bankruptcy filing, without making any meaningful attempt to reorganize or comply with the provisions of the bankruptcy code, and upon any subsequent dismissal, re-filing within two months to stay scheduled foreclosure sales." (ZR. at 28; Memorandum Opinion at pp. 6-7). The Court received a partial filing fee, and

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Southern District of New York adopted the Interim Rules in their entirety as the local rules of the court. *See* October 11, 2005 General Order M-308 on Adoption of Interim Bankruptcy Rules and Official Forms.

assigned Case No. 06-35189. (ZR. at 1, Voluntary Petition; ZR. at 4; Notice of Chapter 13 Case, Meeting of Creditors, and Fixing of Dates). The bankruptcy court granted Ms. Zarnel's application to pay the filing fee in installments. (ZR. 3 and 9; Application to Pay Filing Fee in Installments and Order Allowing Payment of Filing Fee in Installments). Ms. Zarnel filed a motion to extend time for credit counseling. (ZR. at 2; Motion to Extend Time for Credit Counseling). She also filed a certificate reflecting receipt of credit counseling on March 21, 2006, after the bankruptcy case filing date. (ZR. at 13; Certificate of Credit Counseling). The United States Trustee filed a motion to dismiss Ms. Zarnel's Chapter 13 case on the basis that she was ineligible to be a debtor. (ZR. at 16-17; Motion to Dismiss Chapter 13 Case for Cause Pursuant to 11 U.S.C. §§ 109(h), 521(b) and 1307(c) and Memorandum of Law). No party appeared, or in any way opposed the motion to dismiss the case, and no party sought the striking of the case. (*See generally,* Shayna H. Zarnel docket; Transcript of May 30, 2006 hearing). By order dated May 23, 2006, the bankruptcy court denied Ms. Zarnel's request for an extension of time to meet the credit counseling requirement, on the basis that she failed to demonstrate the exigent circumstances required by 11 U.S.C. § 109(h)(3)(A)(i). (ZR. at 18). At the hearing on the United States Trustee's motion to dismiss the case held on May 30, 2006, the bankruptcy court indicated that it would consider arguments and the Supplemental Memorandum of Law filed in connection with the Lena M. Elmendorf case, and make a joint ruling on the United States Trustee's motion in that case, Ms. Zarnel's case and that of Diana M. Finlay. (*See* Transcript of May 30, 2006 hearing).

c. Diana M. Finlay

Ms. Finlay filed a *pro se* petition for relief under Chapter 13 of the Bankruptcy Code on

April 3, 2006. (FR. at 1; Voluntary Petition). This is Ms. Finlay's third bankruptcy filing in the past year. (FR. at 15; Memorandum Opinion, p. 5.) The Court received a filing fee, and assigned Case No. 06-35274. (FR. at 1, Voluntary Petition; FR. at 4; Notice of Chapter 13 Case, Meeting of Creditors, and Fixing of Dates). Ms. Finlay filed a motion to extend time for credit counseling. (FR. at 2; Motion to Extend Time for Credit Counseling). By order dated April 5, 2006, the bankruptcy court denied Ms. Finlay's request for an extension of time to meet the credit counseling requirement, on the basis that she failed to demonstrate that she had requested credit counseling services from an approved credit counseling agency and that she was unable to obtain those services during the five day period following the request, as required by 11 U.S.C. § 109(h)(3)(A)(ii). (FR. at 6; Order Denying Motion to Extend Time for Credit Counseling.). Ms. Finlay's secured lender, Ameriquest Mortgage Company, obtained an order on May 9, 2006 pursuant to 11 U.S.C. § 362(j), confirming that no stay came into effect upon the filing of the bankruptcy case in accordance with 11 U.S.C. § 362(c)(4) due to the two prior filings. (FR. at 13; Order Confirming That No Stay is in Effect; FR. at 15; Memorandum Opinion at p. 6).

The United States Trustee filed a motion to dismiss Ms. Finlay's Chapter 13 case on the basis that she was ineligible to be a debtor. (FR. at 11-12; Motion to Dismiss Chapter 13 Case for Cause Pursuant to 11 U.S.C. §§ 109(h), 521(b) and 1307(c) and Memorandum of Law). No party appeared, or in any way opposed the motion to dismiss the case, and no party sought the striking of the case. (*See generally*, Diana M. Finlay docket; Transcript of May 30, 2006 hearing). At the hearing on the United States Trustee's motion to dismiss the case held on May 30, 2006, the bankruptcy court indicated that it would consider arguments and the Supplemental Memorandum of Law filed in connection with the Lena M. Elmendorf case, and make a joint ruling on the United States Trustee's motion in that case, Ms. Finlay's case and that of Shayna H. Zarnel. (*See* Transcript of May 30, 2006 hearing).

3. The Bankruptcy Court's Ruling

On July 18, 2006 the bankruptcy court issued its Memorandum Opinion on Various Motions to Dismiss Chapter 13 Cases for Cause Pursuant to 11 U.S.C. §§ 109(h)(1), 521(a) and (b) and 707(a)/1307(c)[6] (ER. at 12; ZR. at 28; FR. at 15; Memorandum Opinion). The bankruptcy court held that a bankruptcy case is not commenced under 11 U.S.C. § 301 unless an entity is eligible to be a debtor, and since Ms. Elmendorf, Ms. Zarnel and Ms. Finlay did not comply with the credit counseling requirements of 11 U.S.C. § 109(h), and were thus ineligible to be debtors, no cases were commenced.[7] (Memorandum Opinion at p. 15). Relying upon its equitable power under 11 U.S.C. § 105(a), and its inherent docket management powers, the bankruptcy court denied the United States Trustee's motions to dismiss the cases, and directed that the cases be "stricken." In so holding, the bankruptcy court noted that neither 11 U.S.C. § 707(a) nor 11 U.S.C. § 1307(c) specifically list debtor ineligibility as a specific cause for dismissal, and rejected the reasoning of the "...many courts [that] have held that ineligibility to be a debtor is the definitive 'cause' for dismissal, pursuant to 11 U.S.C. §§ 707(a) and 1307(c)." (Memorandum Opinion at p. 25.) On July 28, 2006, the bankruptcy court entered orders striking the three cases. The United States Trustee timely filed notices of appeal from both the

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[6] As corrected by a July 19, 2006 Errata Order.

[7] In *dicta*, the bankruptcy court also expressed its view that no automatic stay under 11 U.S.C. § 362(a) arose as a result of the filing of the bankruptcy petitions. (Memorandum Opinion at p. 19.)

Memorandum Opinion and the orders to this Court.[8]

There is no factual issue that the requirements of section 109(h) were not met and that Ms. Elmendorf, Ms. Zarnel and Ms. Finlay's bankruptcy cases cannot proceed. (Memorandum Opinion, pp. 15-16, 28-29). The question raised, however, is the proper disposition of the case once an individual is determined to be ineligible to be a debtor under the Bankruptcy Code.

SUMMARY OF THE ARGUMENT

Federal courts dismiss improperly filed cases - they do not strike them. Courts dismiss cases for many reasons, including lack of jurisdiction, and failure to state a claim upon which relief may be granted. The same has always been true in bankruptcy. Under section 301 of the Bankruptcy Code, the filing of a petition commences a bankruptcy case. The Bankruptcy Code, consistent with other federal law, makes no provision for striking petitions or cases as a method of disposing of bankruptcy cases.

Despite this, the court below denied the United States Trustee's motions to dismiss Ms. Elmendorf, Ms. Zarnel and Ms. Finlay's bankruptcy cases, even though there is no question that the cases were filed improperly. Instead, the court, on its own initiative, entered orders striking them even though no federal statute professes to authorize the closure of federal cases by

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[8] The Memorandum Opinion contained a certification of the cases for direct appeal to the U.S. Court of Appeals for the Second Circuit pursuant to 28 U.S.C. § 158(d)(2)(A)(ii). (Memorandum Opinion at pp. 29-30.) The bankruptcy court transmitted notices of the certifications to the Court of Appeals on July 21, 2006. (ER. at 14; ZR. at 30; FR. at 17; Notice of Certification of Bankruptcy Court Decision to Second Circuit Court of Appeals.). The United States Trustee advised the bankruptcy court and thereafter the U.S. Court of Appeals that the United States Trustee was not requesting certification, and would not be filing a petition for authorization of such a direct appeal, and setting forth the United States Trustee's belief that United States District Court review would be beneficial prior to any possible appeal to the Second Circuit.

striking. That was error.

That error circumvents important statutory directives, and harms both debtors and creditors. It also engenders confusion because the Bankruptcy Code explains in detail what happens to dismissed cases and how dismissal affects the rights of the various parties to a bankruptcy case, but it says nothing about the effect of striking. See 11 U.S.C. 349. For these reasons, this case should be remanded with instructions that the court below dismiss Ms. Elmendorf, Ms. Zarnel and Ms. Finlay's improperly filed bankruptcy cases.

STANDARD OF REVIEW

Federal Rule of Bankruptcy Procedure 8013 provides that findings of fact, whether based upon oral or documentary evidence, shall not be set aside unless clearly erroneous. Conclusions of law are subject to *de novo* review. *See In re U.S. Lines, Inc.*, 318 F.3d 432, 435 (2d Cir. 2003)*; Mulligan v. Sobiech*, 131 B.R. 917 (S.D.N.Y. 1991). This appeal presents only a legal question*. De novo* review of legal questions requires this Court to review questions of law independent of the bankruptcy court's determination of the law. *In re Schaffrath*, 214 B.R. 153, 154 (6th Cir. BAP 1997) (citations omitted). *See also In re Lion Capital Group,* 63 B.R. 199, 203 (S.D.N.Y. 1985).

ARGUMENT

1. Dismissal Is the Only Proper Disposition of Ms. Elmendorf, Ms. Zarnel and Ms. Finlay's Improperly Filed Bankruptcy Cases.

Federal district courts routinely dismiss improperly pleaded cases under Fed. R. Civ. P. 12(b) - they do not strike them.[9] *See, e.g., Electronics Communications Corp. v. Toshiba*

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[9] Bankruptcy courts are units of the district courts. 28 U.S.C. 151

America Consumer Products, Inc., 129 F.3d 230 (2d Cir. 1997)(Second Circuit affirmed district court's dismissal of case for failure to state a claim upon which relief could be granted)*; Harrod v. Uunet Tech., Inc*., 22 Fed.Appx. 570, 571 (6th Cir. 2001) (Sixth Circuit affirmed district court's dismissal of case for failure to state a claim upon which relief could be granted pursuant to Fed.R.Civ.P. 12(b)(6)); *Universal Express, Inc. v. U.S. S.E.C.*, 2006 WL 1004381, slip op. (11th Cir. 2006) (a "motion to dismiss may be granted for defect in jurisdictional, venue, or process, see Fed.R.Civ.P. 12(b)(1)-(5), or for failure to state a claim, see id. R. 12(b)(6)"); *Cont'l Cas. Co. v. American Nat. Ins. Co.,*417 F.3d 727, 733 (7th Cir. 2005); ("[t]he district court ultimately dismissed this case because the forum selection clauses in the [contract] required arbitration in other districts... [w]e have held dismissal under these circumstances to be appropriate"); *Miller v. Yokohama Tire Corp.,* 358 F.3d 616, 618 (9th Cir. 2004) (Ninth Circuit affirmed district court's dismissal of case under Rule 12(b)(6)); *ProEnglish v. Bush,* 70 Fed.Appx. 84 (4th Cir. 2003) (Fourth Circuit affirmed district court's dismissal of case for lack of ripeness).

Indeed, the United States Code makes clear that even cases filed without jurisdiction are dismissed. *See* 28 U.S.C. 1919 (governing the imposition of costs in district court cases "dismissed" for "want of jurisdiction"). *See also*, *Luckett v. Bure,* 290 F.3d 493 (2d Cir. 2002)(affirming Fed. R. Civ. P. 12(b)(1) dismissal of claims for lack of subject matter jurisdiction)*; Makarova v. United States,* 201 F.3d 110 (2d Cir. 2000)(same). *Close v. State of New York,* 125 F.3d 31 (2d Cir. 1997)(same)*; Wake v. United States,* 89 F.3d 53 (2d Cir. 1996)(same).

Bankruptcy is no different. The filing of a petition commences a case. 11 U.S.C. 301. Every chapter of the Bankruptcy Code includes a separate section expressly providing for the "dismissal" of debtors' cases for "cause" when it is improper for the case to proceed. See 11 U.S.C. 707(a) (providing for "dismiss[al]" of a chapter 7 case for "cause"); see also 11 U.S.C. 1112(b) (providing for dismissal or conversion of a chapter 11 case for "cause"); see also 11 U.S.C. 1208 (providing for dismissal or conversion of a chapter 12 case for "cause"); see also 11 U.S.C. 1307(c) (providing for dismissal or conversion of a chapter 13 case for "cause").[10]

In fact, prior to changes made by the BAPCPA, bankruptcy courts routinely dismissed cases where individuals were determined to be ineligible to be debtors by operation of 11 U.S.C. 109. The government has reviewed over 800 decisions entered prior to the enactment of the BAPCPA where eligibility under section 109 was at issue, and it is not aware of a single case or petition that was stricken as a method of disposing of the underlying case. Bankruptcy courts have consistently dismissed cases when individuals or entities were ineligible to be debtors. *See, e.g., In re Hubbard*, 333 B.R. 377, 388 (Bankr. S.D. Tex. 2005)(noting that "[t]his Court and others have generally 'dismissed' cases that were filed by ineligible debtors").

Historically, bankruptcy courts, like district courts, have dismissed cases for a variety of reasons, including jurisdictional defects and improper venue. *See* Fed. R. Bankr. P. 1014 (providing that cases filed in an improper district shall either be dismissed or transferred); see

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[10] Each section contains a non-exclusive list of grounds for dismissal. The terms "includes" and " including" in those sections are not limiting. 11 U.S.C. § 102(3). *See In re C-TC 9th Avenue Partnership*, 113 F.3d 1304, 1311 (2d Cir. 1997); *In re Griffieth*, 209 B.R. 823, 827 (Bankr. N.D.N.Y. 1996; *In re Zick*, 931 F.2d 1124, 1126-1127 (6th Cir. 1991); *In re Prud'Homme*, 161 B.R. 747, 749 (Bankr. E.D.N.Y. 1993). *Cf. In re Eclair Bakery, Ltd.*, 255 B.R. 121, 137 (Bankr. S.D.N.Y. 2000)(in context of motion for relief from stay, observing that each of Code sections 707(a), 1112(b), 1307(c) and 362(d)(1) states that the authority it provides--dismissal or relief from stay, respectively--may be granted for "cause," and lists one or more examples of cause, each precedes the list with the word "includes," and none of those lists is exhaustive).

also 28 U.S.C. §1930(d)(providing that “[w]henever any case or proceeding is dismissed in any bankruptcy court for want of jurisdiction, such court may order the payment of just costs”) (emphasis added).

Given this settled law, it is not surprising that the vast majority of courts have dismissed cases upon concluding the person seeking bankruptcy protection was ineligible to be a debtor under 11 U.S.C. 109(h). *See, e.g., Dixon v. LaBarge, Jr. (In re Dixon)*, 338 B.R. 383, 389 (8th Cir. B.A.P. 2006). In addition, most courts that have considered the issue have dismissed rather than struck cases in which individuals have been ineligible to be debtors because they did not obtain credit counseling. *See In re Seaman*, 340 B.R. 698 (Bankr. E.D.N.Y. 2006); *In re Ross*, 338 B.R. 134 (Bankr. N.D. Ga. 2006); *In re Mills*, 341 B.R. 106 (Bankr. D. Colo. 2006); *In re Bell*, 2006 WL 1132907, slip op. (Bankr. D. Colo. 2006); *In re Taylor*, 2006 Bankr. LEXIS 689 (Bankr.N.D.Cal. 2006); *In re Racette*, 343 B.R. 200 (Bankr. E.D. Wis. 2006); *In re Tomco*, 339 B.R. 145 (Bankr. W.D. Pa. 2006); *In re Wilson*, No. 06-60870, 2006 WL 2055742 (Bankr. N.D.N.Y. 2006); *In re Westover*, No. 06-10183, 2006 WL 1982751, slip op. (Bankr. D. Vt. 2006); But see *In re Carey*, 341 B.R. 798 (Bankr. M.D. Fla. 2006); *In re Hubbard*, 333 B.R. 373 (Bankr. S.D. Tex. 2005); *In re Salazar*, 339 B.R. 622 (Bankr. S.D. Tex. 2006); *In re Rios*, 336 B.R. 177 (Bankr. S.D.N.Y. 2005); *In re Thompson*, No. 06-01031, 2006 WL 1766528 (Bankr. S.D. Ind. 2006).

The bankruptcy court identified no provision of the Bankruptcy Code or other federal law that specifically allows courts to terminate federal bankruptcy cases by striking the pleading that commenced the case while leaving the underlying case in limbo. Nor can they, because no such provision exists.[11] The lower court decision cited only one statute, 11 U.S.C. 105(a).[12] However, both its plain language and Second Circuit precedent make clear that this provision cannot be used, as the court would use it here, to deviate from the use of dismissal to terminate improperly filed cases.

By its terms, section 105 nowhere authorizes courts to dispose of cases by striking. To the contrary, it only authorizes courts to take actions that are consistent with the Code. As the

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[11] In addition, the only reference to the "striking" of any document in the Federal Rules of Bankruptcy Procedure is found in Fed. R. Bankr. P. 7012(b) and 9011. Rule 7012(b), incorporates by reference Fed. R. Civ. P. 12(e) and (f). Rule 12(e) allows a court to strike a pleading where there is a prior existing order to amend the pleading and the order has not been obeyed. Rule 12(f) allows for motions to strike in the context of adversary proceedings. According to this rule, such motions may be made by a party before responding to a pleading or by a court on its own initiative, and the court may "order stricken from any pleading any insufficient defense or any redundant, immaterial, impertinent, or scandalous matter." Fed. R. Civ. P. 12(f). Motions to strike, however, are not favored. *Salcer v. Envicon Equities Corp.*, 744 F.2d 935, 939 (2d Cir. 1984), *cert. granted and judgment remanded on other grounds*, 478 U.S. 1015 (1986); *FDIC v. Abel, et al.*, 1995 WL 716729 at * 12 (S.D.N.Y. 1995); *Brokke v. Stauffer Chem. Co.*, 703 F. Supp. 215, 223 (D. Conn. 1988). A motion to "strike" under Rule 12(f) also only pertains to the striking of material contained in a pleading. *In re Kershaw*, 59 B.R. 618, 620 (Bankr. D. Tenn. 1986). Moreover, such motions are not intended to raise substantial, disputed questions of law. *Mohegan Tribe v. Conn.*, 528 F. Supp. 1359, 1362 (D. Conn. 1982) ("The presence of a substantial or seriously disputed question of law will preclude a district court from granting a motion to strike."). Rule 9011 requires that papers filed in bankruptcy courts be signed by at least one attorney of record or by the party herself if she is unrepresented. Rule 9011(a) provides that "an unsigned paper shall be stricken unless omission of the signature is corrected promptly after being called to the attention of the attorney or party." Fed. R. Bankr. P. 9011(a).

[12] Section 105 provides:

> The court may issue any order, process, or judgment that is *necessary or appropriate to carry out the provisions of this title*. No provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, sua sponte, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process.

11 U.S.C. 105(a) (emphasis added).

Second Circuit and many other courts have held, section 105 cannot be employed to deviate from federal law. *See Federal Deposit Insurance Corporation v. Colonial Realty Corporation*, 966 F.2d 57, 59 (2d Cir. 1992)(noting that by its very terms, section 105 limits the bankruptcy court's equitable powers, which "must and can only be exercised within the confines of the Bankruptcy Code*."*)(citations omitted); *In re Aquatic Development Group, Inc.*, 352 F.3d 671, 680 (2d Cir. 2003)*(*Straub, J., concurring*)(*observing that "...this Court has repeatedly cautioned that § 105(a) does not authorize the bankruptcy courts to create substantive rights that are otherwise unavailable under applicable law, or constitute a roving commission to do equity...")*(*citations omitted*).; In re Barbieri*, 199 F.3d 616, 620-621 (2d Cir. 1999); *See also Pertuso v. Ford Motor Credit Co.*, 233 F.3d 417, 423 (6th Cir. 2000) (establishing that a bankruptcy court may not use section 105(a) to legislate additional remedies that are otherwise unavailable under applicable law.); *Matter of Kelvin Publishing, Inc.*, 72 F.3d 129 (6th Cir. 1995)); see also *United States v. Sutton*, 786 F.2d 1305, 1308 (5th Cir.1986) (citing *Southern Ry. Co. v. Johnson Bronze Co.*, 758 F.2d 137, 141 (3d Cir.1985) (same).

As discussed above, improperly filed federal cases are dismissed, not stricken, and each chapter of the Bankruptcy Code contains a provision for dismissing - not striking - improperly filed cases. As Second Circuit authority underscores, section 105 cannot be used to deviate from that law.

2. Section 109 is Not a Jurisdictional Statute and Even if it Were, Cases Filed in Violation of Section 109 Would Need to be Dismissed Rather than Stricken.

Although the court below expressly held that it had jurisdiction, some bankruptcy courts have erroneously stricken cases because they believe (1) section 109(h) is a jurisdictional statute and (2) courts must strike petitions filed without jurisdiction under section 109. Both of these conclusions are wrong.

Supreme Court precedent makes clear that eligibility statutes like section 109 are not jurisdictional. Instead, jurisdictional provisions are those that actually define the jurisdiction of federal courts, most typically those set forth in title 28 of the United States code. Most recently in *Arbaugh v. Y & H Corp.*,--- U.S. ----, 126 S.Ct. 1235, 163 L.Ed.2d 1097 (Feb. 22, 2006), the Supreme Court ruled that eligibility provisions in federal statutes do not confer or contract subject-matter jurisdiction. In *Arbaugh*, the Supreme Court was asked to determine whether an employee-numerosity requirement in Title VII for establishing a defendant/restaurant's "employer" status was jurisdictional, or whether it was merely an element of a bartender/waitress's claim for relief under Title VII. *Id.* The Court held that the definition of an "employer" in the statute was an element of the plaintiff's claim for relief, the satisfaction of which the defendant employer conceded when it failed to raise the issue prior to the trial on the merits. *Id*. at 1245. The Supreme Court declined to find that the defendant's status as an "employer" was a jurisdictional requirement that could be questioned at any stage of litigation. *Id*. In making its determination, the Supreme Court noted that courts have an obligation to determine whether subject-matter jurisdiction exists, even in the absence of a challenge from any party. *Id*. It concluded that nothing in Title VII's text indicated that Congress intended courts, on their own motion, to assure that the employee-numerosity requirement is met. *Id*. at 1244.

In rendering its decision, the Supreme Court commented that courts have been imprecise regarding jurisdictional issues noting that "[s]ubject matter jurisdiction in federal-question cases is sometimes erroneously conflated with a plaintiff's need and ability to prove the defendant bound by the federal law asserted as the predicate for relief-a merits-related determination." *Id*. at 1242 (quoting 2 J. Moore et al., MOORE'S FEDERAL PRACTICE § 12.30[1], p. 12-36.1 (3d ed. 2005). In addition, in order to avoid the "'unfair[ness]" and 'waste of judicial resources. . . entailed in tying the employee-numerosity requirement to subject-matter jurisdiction," the Supreme Court advised courts to "to refrain from constricting § 1331 or Title VII's jurisdictional provision, 42 U.S.C. § 2000e-5(f)(3), and to leave the ball in Congress' court." *Arbaugh*, 126 S.Ct. at 1245. It noted that Congress is free to instruct that certain elements of a claim for relief "shall count as jurisdictional, ... [b]ut when Congress does not rank a statutory limitation on coverage as jurisdictional, courts should treat the restriction as nonjurisdictional in character." *Id*.

Nothing under Title 11 indicates that Congress intended courts, on their own motion, to assure that the debtor eligibility provisions are satisfied. In addition, 28 U.S.C. 1334 and 157 are the jurisdictional statutes that confer bankruptcy jurisdiction. *See, e.g., Rudd v. Laughlin*, 866 F.2d 1040, 1041 (8th Cir. 1989); *Promenade Nat'l Bank v. Phillips (In re Phillips)*, 844 F.2d 230, 235-36 n.2 (5th Cir. 1988); *In re Republic Trust & Savings Co.*, 59 B.R. 606, 609 (N.D. Okla. 1986). Section 109 does not speak in jurisdictional terms, and does not refer in any way to the jurisdiction of the bankruptcy courts. *Arbaugh*, 126 S.Ct. at 1245. Therefore, Ms. Elmendorf, Ms. Zarnel and Ms. Finlay commenced cases under the Bankruptcy Code despite the fact that they were ineligible to be debtors, and the bankruptcy court possessed the jurisdiction to dispose of the cases under the Bankruptcy Code.

3. Other Federal Statues Make Clear that Ms. Elmendorf, Ms. Zarnel and Ms. Finlay Filed Bankruptcy Cases, and Everything That Happened in Their Cases Underscores That Fact.

Other federal statutes and the administration of Ms. Elmendorf, Ms. Zarnel and Ms. Finlay's cases make clear they had bankruptcy cases that needed to be dismissed. Among other things, (i) a "case" number was been assigned to their cases,[13] (ii) trustees were appointed to supervise their cases,[14] (iii) the bankruptcy court accepted filing fees under 28 U.S.C. 1930(a),[15] and (iv) the debtors' creditors were advised that in most instances the "filing of the bankruptcy case" operates as a stay of certain actions they may take to collect any debts owed by the

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[13] *See* ER. at 1; Receipt of Voluntary Petition; ER. at 5; Notice of Chapter 7 Bankruptcy Case, Meeting of Creditors and Deadlines (assigning "Case" number 05-55048 to Ms. Elmendorf's case); (ZR. at 1, Voluntary Petition; ZR. at 4; Notice of Chapter 13 Case, Meeting of Creditors, and Fixing of Dates (assigning Case No. 06-35189 to Ms. Zarnel's case); (FR. at 1, Voluntary Petition; FR. at 4; Notice of Chapter 13 Case, Meeting of Creditors, and Fixing of Dates) (assigning Case No. 06-35274 to Ms. Finlay's case).

[14] *See* ER. at 5; Notice of Chapter 7 Bankruptcy Case, Meeting of Creditors and Deadlines (noting the assignment of Paul L. Banner as trustee); ZR. at 3;(adding Trustee Jeffrey L. Sapir to the "case"); ZR. at 4; Notice of Chapter 13 Case, Meeting of Creditors, and Fixing of Dates (noting assignment of Jeffrey L. Sapir as trustee); FR. at 1; (adding Trustee Jeffrey L. Sapir to the "case"); FR. at 4; Notice of Chapter 13 Case, Meeting of Creditors, and Fixing of Dates (noting assignment of Jeffrey L. Sapir as trustee).

[15] Under 28 U.S.C. 1930(a), "parties commencing a case under title 11" are required to pay the clerk of the bankruptcy court a fee for a case commenced under chapter 7 or 13 of the Bankruptcy Code. 28 U.S.C. 1930(a). The Bankruptcy Court collected a filing fee of $274 from Ms. Elmendorf when she commenced her case. (ER. at 1); collected a partial filing fee of $40.00 from Ms. Zarnel when she commenced her case; (ZR. at 1); and granted Ms. Zarnel's application to pay the remainder of the filing fee in installments; (ZR. at 9); and collected a filing fee of $189.00 from Ms. Finlay when she commenced her case; (FR. at 1)

debtor.[16] Each of these actions underscores the obvious fact that Ms. Elmendorf, Ms. Zarnel and Ms. Finlay's' decision to file bankruptcy petitions commenced bankruptcy cases.

4. Striking Petitions Creates Substantial Uncertainty under the Bankruptcy Code That Is Harmful to Debtors and Creditors Alike, and Creates Confusion Regarding the Rights of Interested Parties.

The Bankruptcy Code dedicates an entire section of the Code, 11 U.S.C. 349, to explaining the effect of a dismissed case on the rights of the various parties to a bankruptcy proceeding. *See* 11 U.S.C. 349. Section 349 provides, among other things, that: (i) dismissal of a bankruptcy case reinstates any proceeding or custodianship superseded under section 521; (ii) dismissal vacates any order under sections 522(i)(1), 542, 550, or 553, and (iii) dismissal revests the property of the estate in the entity in which such property was vested immediately before commencement of the case. 11 U.S.C. 349. Therefore, terminating a case through striking rather than dismissal will engender substantial confusion and potential prejudice because there are no corresponding instructions in the Code or elsewhere regarding the impact of striking a petition.[17]

5. Striking Petitions Circumvents Statutory Restrictions Upon Debtors Who Have Previously Had a Bankruptcy Case Dismissed.

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[16] *See* ER. at 5; Notice of Chapter 7 Bankruptcy Case, Meeting of Creditors and Deadlines; ZR. at 4; Notice of Chapter 13 Case, Meeting of Creditors, and Fixing of Dates; FR. at 4; Notice of Chapter 13 Case, Meeting of Creditors, and Fixing of Dates) (advising Ms. Elmendorf, Ms. Zarnel and Ms. Finlay's creditors that "In most instances the filing of the bankruptcy case automatically stays certain collection and other actions against the debtor...").

[17] In addition, striking a case, rather than dismissing creates substantial uncertainty about the rights and obligations of debtors and creditors in stricken cases. *See, e.g., In re Ross*, 338 B.R. 134, 139 (Bankr. N.D. Ga. 2006)(explaining that striking cases could have an unintended result of harming debtors who have had their homes foreclosed due to the absence of the stay in a voided case).

Congress amended the automatic stay provisions of section 362 of the Bankruptcy Code in 2005 in order to limit a debtor's right to operate under the automatic stay when the debtor has previously had a case "dismissed" by a bankruptcy court. 11 U.S.C. 362(c)(3) (imposing these new restrictions in cases succeeding previously "dismissed" cases). Congress did so because it concluded it was unfair to allow debtors to file multiple bankruptcy cases and automatically reap the substantial benefits of the automatic stay of creditor actions in each case. *See* H.R. Rep. No. 109-31, pt. 1, at 2 (2005), U.S. Code Cong. & Admin. News 2005, pp. 88, 89 (setting forth Congress' conclusions on this point).

Section 362(c)(3) provides that where a debtor has had a prior case "dismissed" within the preceding one-year period, the automatic stay in the next case shall terminate automatically on the thirtieth day after the filing of that case unless a debtor is able to establish by motion that the later case is in good faith as to the creditors to be stayed. See 11 U.S.C. 362(c)(3).

By striking rather than dismissing Ms. Elmendorf, Ms. Zarnel and Ms. Finlay's cases, the orders entered below risk circumventing section 362(c)(3)'s new limitation by disposing of a case without "dismissing" it. Some courts have concluded that striking a case rather than dismissing it - the term employed in section 362(c)(3) - frees debtors from section 362(c)(3)'s restrictions upon the use of the automatic stay in a subsequent case. In the government's view, it is not appropriate to vitiate Congress' mandate in section 362(c)(3) by refusing to dismiss cases filed in violation of section 109. For the Bankruptcy System to function optimally, creditors and debtors alike must have faith that time-honored procedures - like dismissing improperly filed cases - will be neutrally applied in all cases. Conversely, faith in the Bankruptcy System will diminish were parties in interest to conclude that neutral bankruptcy rules were being ignored simply to evade policy dictates mandated by Congress that a particular court might deem unwise.

That is not to say Ms. Elmendorf, Ms. Zarnel and Ms. Finlay cannot take full advantage of the automatic stay in a subsequent bankruptcy case. To the contrary, section 362 allows debtors to obtain the full benefit of the stay in a subsequent case if they prove their first case was filed in "good faith." *See* 362(c)(3) (allowing a debtor to obtain the full benefit of the stay if the debtor establishes the first case was filed in "good faith"). *See also In re Seaman,* 340 B.R. 698, 706 (Bankr. E.D.N.Y. 2006) (discussing this point). As some courts have stated, "a dismissal under Section 109(h) . . . does not appear to establish any lack of good faith." *Id. See also In re Carr,* 344 B.R. 776 (Bankr. N.D.W.Va. 2006) (concluding a debtor's second filed bankruptcy case was in good faith so as to warrant extension of the automatic stay beyond 30 days as provided in section 362(c)(3)). Under those courts' rationale, Ms. Elmendorf, Ms. Zarnel and Ms. Finlay might well be able to take full advantage of the automatic stay notwithstanding the dismissal of their prior cases if they can demonstrate good faith to the court. If they are unable to demonstrate such good faith, then the absence of a stay in the subsequent case is appropriate. At a minimum, the necessity under section 362(c)(3) of filing a motion to extend the stay in a second case is the procedure Congress mandated. This carefully conceived balance should not be vitiated by striking rather than dismissing bankruptcy cases.

CONCLUSION

For these reasons, the United States Trustee respectfully asks this Court to reverse the order entered below and remand this case with instructions to the bankruptcy court to enter orders dismissing Ms. Elmendorf, Ms. Zarnel and Ms. Finlay's bankruptcy cases.

Dated: August 23, 2006 Respectfully submitted,

DIANA G. ADAMS

ACTING UNITED STATES TRUSTEE, REG. 2

BY: /s/ Eric J. Small (ES5231)
Office of the United States Trustee
United States Department of Justice
74 Chapel Street, Suite 200
Albany, NY 12207
(518) 434-4553

ADDENDUM

11 U.S.C. 109 – Who may be a debtor

(a) Notwithstanding any other provision of this section, only a person that resides or has a domicile, a place of business, or property in the United States, or a municipality, may be a debtor under this title.

(b) A person may be a debtor under chapter 7 of this title only if such person is not--

(1) a railroad;

(2) a domestic insurance company, bank, savings bank, cooperative bank, savings and loan association, building and loan association, homestead association, a New Markets Venture Capital company as defined in section 351 of the Small Business Investment Act of 1958, a small business investment company licensed by the Small Business Administration under section 301 of the Small Business Investment Act of 1958, credit union, or industrial bank or similar institution which is an insured bank as defined in section 3(h) of the Federal Deposit Insurance Act, except that an uninsured State member bank, or a corporation organized under section 25A of the Federal Reserve Act, which operates, or operates as, a multilateral clearing organization pursuant to section 409 of the Federal Deposit Insurance Corporation Improvement Act of 1991 may be a debtor if a petition is filed at the direction of the Board of Governors of the Federal Reserve System; or

(3)(A) a foreign insurance company, engaged in such business in the United States; or

(B) a foreign bank, savings bank, cooperative bank, savings and loan association, building and loan association, or credit union, that has a branch or agency (as defined in section 1(b) of the International Banking Act of 1978 in the United States.

(c) An entity may be a debtor under chapter 9 of this title if and only if such entity--

(1) is a municipality;

(2) is specifically authorized, in its capacity as a municipality or by name, to be a debtor under such chapter by State law, or by a governmental officer or organization empowered by State law to authorize such entity to be a debtor under such chapter;

(3) is insolvent;

(4) desires to effect a plan to adjust such debts; and

(5)(A) has obtained the agreement of creditors holding at least a majority in amount of the claims of each class that such entity intends to impair under a plan in a case under such chapter;

(B) has negotiated in good faith with creditors and has failed to obtain the agreement of creditors holding at least a majority in amount of the claims of each class that such entity intends to impair under a plan in a case under such chapter;

(C) is unable to negotiate with creditors because such negotiation is impracticable; or

(D) reasonably believes that a creditor may attempt to obtain a transfer that is avoidable under section 547 of this title.

(d) Only a railroad, a person that may be a debtor under chapter 7 of this title (except a stockbroker or a commodity broker), and an uninsured State member bank, or a corporation organized under section 25A of the Federal Reserve Act, which operates, or operates as, a multilateral clearing organization pursuant to section 409 of the Federal Deposit Insurance Corporation Improvement Act of 1991 may be a debtor under chapter 11 of this title.

(e) Only an individual with regular income that owes, on the date of the filing of the petition, noncontingent, liquidated, unsecured debts of less than $307,675 [FN1] and noncontingent, liquidated, secured debts of less than $922,975 [FN1], or an individual with regular income and such individual's spouse, except a stockbroker or a commodity broker, that owe, on the date of the filing of the petition, noncontingent, liquidated, unsecured debts that aggregate less than $307,675 [FN1] and noncontingent, liquidated, secured debts of less than $922,975 [FN1] may be a debtor under chapter 13 of this title.

(f) Only a family farmer or family fisherman with regular annual income may be a debtor under chapter 12 of this title.

(g) Notwithstanding any other provision of this section, no individual or family farmer may be a debtor under this title who has been a debtor in a case pending under this title at any time in the preceding 180 days if--

(1) the case was dismissed by the court for willful failure of the debtor to abide by orders of the court, or to appear before the court in proper prosecution of the case; or

(2) the debtor requested and obtained the voluntary dismissal of the case following the filing of a request for relief from the automatic stay provided by section 362 of this title.

(h)(1) Subject to paragraphs (2) and (3), and notwithstanding any other provision of this section, an individual may not be a debtor under this title unless such individual has, during the 180-day period preceding the date of filing of the petition by such individual, received from an approved nonprofit budget and credit counseling agency described in section 111(a) an individual or group briefing (including a briefing conducted by telephone or on the Internet) that outlined the opportunities for available credit counseling and assisted such individual in performing a related budget analysis.

(2)(A) Paragraph (1) shall not apply with respect to a debtor who resides in a district for which the United States trustee (or the bankruptcy administrator, if any) determines that the approved nonprofit budget and credit counseling agencies for such district are not reasonably able to provide adequate services to the additional individuals who would otherwise seek credit counseling from such agencies by reason of the requirements of paragraph (1).

(B) The United States trustee (or the bankruptcy administrator, if any) who makes a determination described in subparagraph (A) shall review such determination not later than 1 year after the date of such determination, and not less frequently than annually thereafter. Notwithstanding the preceding sentence, a nonprofit budget and credit counseling agency may be disapproved by the United States trustee (or the bankruptcy administrator, if any) at any time.

(3)(A) Subject to subparagraph (B), the requirements of paragraph (1) shall not apply with respect to a debtor who submits to the court a certification that--

(i) describes exigent circumstances that merit a waiver of the requirements of paragraph (1);

(ii) states that the debtor requested credit counseling services from an approved nonprofit budget and credit counseling agency, but was unable to obtain the services referred to in paragraph (1) during the 5-day period beginning on the date on which the debtor made that request; and

(iii) is satisfactory to the court.

(B) With respect to a debtor, an exemption under subparagraph (A) shall cease to apply to that debtor on the date on which the debtor meets the requirements of paragraph (1), but in no case may the exemption apply to that debtor after the date that is 30 days after the debtor files a petition, except that the court, for cause, may order an additional 15 days.

(4) The requirements of paragraph (1) shall not apply with respect to a debtor whom the court determines, after notice and hearing, is unable to complete those requirements because of incapacity, disability, or active military duty in a military combat zone. For the purposes of this paragraph, incapacity means that the debtor is impaired by reason of mental illness or mental deficiency so that he is incapable of realizing and making rational decisions with respect to his financial responsibilities; and "disability" means that the debtor is so physically impaired as to be unable, after reasonable effort, to participate in an in person, telephone, or Internet briefing required under paragraph (1).

11 U.S.C. 301 – Voluntary cases

(a) A voluntary case under a chapter of this title is commenced by the filing with the bankruptcy court of a petition under such chapter by an entity that may be a debtor under such chapter.

(b) The commencement of a voluntary case under a chapter of this title constitutes an order for relief under such chapter.

11 U.S.C. 707(a) – Dismissal of a case or conversion to a case under chapter 11 or 13

(a) The court may dismiss a case under this chapter only after notice and a hearing and only for cause, including--

(1) unreasonable delay by the debtor that is prejudicial to creditors;

(2) nonpayment of any fees or charges required under chapter 123 of title 28; and

(3) failure of the debtor in a voluntary case to file, within fifteen days or such additional time as the court may allow after the filing of the petition commencing such case, the information required by paragraph (1) of section 521, but only on a motion by the United States trustee.

11 U.S.C. § 1307(c) - Dismissal or Conversion.

(c) Except as provided in subsection (e) of this section, on request of a party in interest or the United States trustee and after notice and a hearing, the court may convert a case under this chapter to a case under chapter 7 of this title, or may dismiss a case under this chapter, whichever is in the best interests of creditors and the estate, for cause, including--

(1) unreasonable delay by the debtor that is prejudicial to creditors;

(2) nonpayment of any fees and charges required under chapter 123 of title 28;

(3) failure to file a plan timely under section 1321 of this title;

(4) failure to commence making timely payments under section 1326 of this title;

(5) denial of confirmation of a plan under section 1325 of this title and denial of a request made for additional time for filing another plan or a modification of a plan;

(6) material default by the debtor with respect to a term of a confirmed plan;

(7) revocation of the order of confirmation under section 1330 of this title, and denial of confirmation of a modified plan under section 1329 of this title;

(8) termination of a confirmed plan by reason of the occurrence of a condition specified in the plan other than completion of payments under the plan;

(9) only on request of the United States trustee, failure of the debtor to file, within fifteen days, or such additional time as the court may allow, after the filing of the petition commencing such case, the information required by paragraph (1) of section 521;

(10) only on request of the United States trustee, failure to timely file the information required by paragraph (2) of section 521; or

(11) failure of the debtor to pay any domestic support obligation that first becomes payable after the date of the filing of the petition.

28 U.S.C. 157 – Procedures

(a) Each district court may provide that any or all cases under title 11 and any or all proceedings arising under title 11 or arising in or related to a case under title 11 shall be referred to the bankruptcy judges for the district.

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

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

(A) matters concerning the administration of the estate;

(B) allowance or disallowance of claims against the estate or exemptions from property of the estate, and estimation of claims or interests for the purposes of confirming a plan under chapter 11, 12, or 13 of title 11 but not the liquidation or estimation of contingent or unliquidated personal injury tort or wrongful death claims against the estate for purposes of distribution in a case under title 11;

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

(D) orders in respect to obtaining credit;

(E) orders to turn over property of the estate;

(F) proceedings to determine, avoid, or recover preferences;

(G) motions to terminate, annul, or modify the automatic stay;

(H) proceedings to determine, avoid, or recover fraudulent conveyances;

(I) determinations as to the dischargeability of particular debts;

(J) objections to discharges;

(K) determinations of the validity, extent, or priority of liens;

(L) confirmations of plans;

(M) orders approving the use or lease of property, including the use of cash collateral;

(N) orders approving the sale of property other than property resulting from claims brought by the estate against persons who have not filed claims against the estate;

(O) other proceedings affecting the liquidation of the assets of the estate or the adjustment of the debtor-creditor or the equity security holder relationship, except personal injury tort or wrongful death claims; and

(P) recognition of foreign proceedings and other matters under chapter 15 of title 11.

(3) The bankruptcy judge shall determine, on the judge's own motion or on timely motion of a party, whether a proceeding is a core proceeding under this subsection or is a proceeding that is otherwise related to a case under title 11. A determination that a proceeding is not a core proceeding shall not be made solely on the basis that its resolution may be affected by State law.

(4) Non-core proceedings under section 157(b)(2)(B) of title 28, United States Code, shall not be subject to the mandatory abstention provisions of section 1334(c)(2).

(5) The district court shall order that personal injury tort and wrongful death claims shall be tried in the district court in which the bankruptcy case is pending, or in the district court in the district in which the claim arose, as determined by the district court in which the bankruptcy case is pending.

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

(2) Notwithstanding the provisions of paragraph (1) of this subsection, the district court, with the consent of all the parties to the proceeding, may refer a proceeding related to a case under title 11 to a bankruptcy judge to hear and determine and to enter appropriate orders and judgments, subject to review under section 158 of this title.

(d) The district court may withdraw, in whole or in part, any case or proceeding referred under this section, on its own motion or on timely motion of any party, for cause shown. The district court shall, on timely motion of a party, so withdraw a proceeding if the court determines that resolution of the proceeding requires consideration of both title 11 and other laws of the United States regulating organizations or activities affecting interstate commerce.

(e) If the right to a jury trial applies in a proceeding that may be heard under this section by a bankruptcy judge, the bankruptcy judge may conduct the jury trial if specially designated to exercise such jurisdiction by the district court and with the express consent of all the parties.

28 U.S.C. 1334 – Bankruptcy cases and proceedings

(a) Except as provided in subsection (b) of this section, the district courts shall have original and exclusive jurisdiction of all cases under title 11.

(b) Except as provided in subsection (e)(2), and notwithstanding any Act of Congress that confers exclusive jurisdiction on a court or courts other than the district courts, the district courts shall have original but not exclusive jurisdiction of all civil proceedings arising under title 11, or arising in or related to cases under title 11.

(c)(1) Except with respect to a case under chapter 15 of title 11, nothing in this section prevents a district court in the interest of justice, or in the interest of comity with State courts or respect for State law, from abstaining from hearing a particular proceeding arising under title 11 or arising in or related to a case under title 11.

(2) Upon timely motion of a party in a proceeding based upon a State law claim or State law cause of action, related to a case under title 11 but not arising under title 11 or arising in a case under title 11, with respect to which an action could not have been commenced in a court of the United States absent jurisdiction under this section, the district court shall abstain from hearing such proceeding if an action is commenced, and can be timely adjudicated, in a State forum of appropriate jurisdiction.

(d) Any decision to abstain or not to abstain made under subsection (c) (other than a decision not to abstain in a proceeding described in subsection (c)(2)) is not reviewable by appeal or otherwise by the court of appeals under section 158(d), 1291, or 1292 of this title or by the Supreme Court of the United States under section 1254 of this title. Subsection (c) and this subsection shall not be construed to limit the applicability of the stay provided for by section 362 of title 11, United States Code, as such section applies to an action affecting the property of the estate in bankruptcy.

(e) The district court in which a case under title 11 is commenced or is pending shall have exclusive jurisdiction--

(1) of all the property, wherever located, of the debtor as of the commencement of such case, and of property of the estate; and

(2) over all claims or causes of action that involve construction of section 327 of title 11, United States Code, or rules relating to disclosure requirements under section 327.

BRIEF BANK — 'SUMMARY SHEET" *Printed Thu-5/3/07 10:40*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE
[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]

In re: Innovative Communication Company
In re: Emerging Communications

2. ("CO") ***CURRENT*** COURT
[E.g., "CTA9"]

DISTRICT COURT OF THE VIRGIN ISLANDS
DIVISION OF ST. THOMAS AND ST. JOHN

3. ("CCN") ***CURRENT*** CASE NO.

No.: 2007-36 and 2007-37

4. ("PCN") ***PRIOR*** CASE NO. & COURT
[IF ANY]

No.: 06-30008 (JKF) 06-30007 (JFK)

Court: the District Court of the Virgin Islands Division of St. Thomas and St. John, Bankruptcy Division

(Identify judge & cite, if any)

5. ("SO") ***SOURCE***

U.S. TRUSTEES

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF
[E.g., "Opening Brief," "Reply," "Amicus," etc.]

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Felicia S. Turner, Guy G. Gebhardt, James H. Morawetz, P. Matthew Sutko

(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***

BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s)
&
√ Any Miscellaneous ***BACKGROUND***

- Whether the Bankruptcy Court abused its discretion in ordering the appointment of a chapter 11 trustee?

Whether the Bankruptcy Court erred in denying Appellants' motion for the appointment of a "Responsible Officer." ?

Whether section 43a of title 30 of the Virgin Islands Code precluded the appointment of a federal bankruptcy trustee in this federal bankruptcy case?

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IN THE DISTRICT COURT OF THE VIRGIN ISLANDS
DIVISION OF ST. THOMAS AND ST. JOHN

In re:	:	D.C. APP. CIVIL NO. 2007-36
	:	
INNOVATIVE COMMUNICATION COMPANY, LLC,	:	Bankr. Case No. 06-30008 (JKF)
	:	
Debtor.	:	
....	:	
In re:	:	D.C. APP. CIVIL NO. 2007-37
	:	
EMERGING COMMUNICATIONS, INC.,	:	Bankr. Case No. 06-30007 (JKF)
	:	
Debtor.	:	

BRIEF OF UNITED STATES TRUSTEE AS APPELLEE

On Appeal from the District Court of the Virgin Islands
Division of St. Thomas and St. John, Bankruptcy Division

GUY G. GEBHARDT
Assistant United States Trustee
Georgia Bar No. 288550

JAMES H. MORAWETZ
Trial Attorney
Georgia Bar No. 521900

United States Department of Justice
Office of the United States Trustee
362 Richard B. Russell Building
75 Spring Street, SW
Atlanta, GA 30303
(404) 331-4437

Attorneys for Appellee Felicia S. Turner
United States Trustee, Region 21

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This Court has jurisdiction over these appeals under 28 U.S.C. § 158(a).

STATEMENT OF ISSUES

The issues before this Court on appeal are:

1. Whether the Bankruptcy Court abused its discretion in ordering the appointment of a chapter 11 trustee.

2. Whether the Bankruptcy Court erred in denying Appellants' motion for the appointment of a "Responsible Officer."

3. Whether section 43a of title 30 of the Virgin Islands Code precluded the appointment of a federal bankruptcy trustee in this federal bankruptcy case.

APPLICABLE STANDARD OF REVIEW

A district court applies a clearly erroneous standard to a bankruptcy court's findings of fact and conducts a *de novo* review of conclusions of law. *See* Fed. R. Bankr. P. 8013. *See, e.g., In re Winthrop Nurseries, Inc.*, 50 F.3d 72, 73 (1st Cir. 1995); *Resyn Corp. v. United States*, 851 F.2d 660, 664 (3d Cir.1988); *In re Jersey City Medical Center*, 817 F.2d 1055, 1059 (3d Cir.1987). A district court reviews a bankruptcy court's decision to appoint a chapter 11 trustee for abuse of discretion "under either section of [11 U.S.C.] § 1104(a) . . . . " *In re G-I Holdings, Inc.*, 295 B.R. 502, 508 (D. N.J. 2003), *affirmed, Official Committee of Asbestos Claimants v. G-I Holdings, Inc. (In re G-I Holdings, Inc.)*, 385 F.3d 313, 318 (3d Cir. 2004).

STATEMENT OF THE CASE

Appellants Emerging Communications, Inc. ("**Emerging**"), and Innovative Communication Company, LLC ("**ICC, LLC**") (collectively, the "**Corporate Debtors**"), commenced these cases by filing voluntary petitions for relief under chapter 11 of the Bankruptcy Code in the Bankruptcy Division of this Court (the "**Bankruptcy Court**") on July 31, 2006.[1] The Corporate Debtors' principal, Jeffrey J. Prosser ("**Prosser**"), likewise filed a voluntary petition in the Bankruptcy Court on that date for relief under chapter 11 of the Bankruptcy Code and has joined with the Corporate Debtors in filing these appeals.

On February 10, 2006, prior to the commencement of these cases, creditors Greenlight Capital Qualified, L.P., Greenlight Capital, L.P., and Greenlight Capital Offshore, Ltd. (collectively, the "**Greenlight Entities**"), filed involuntary petitions for relief under chapter 11 of the Bankruptcy Code against the Appellants in the United States Bankruptcy Court for the District of Delaware (the "**Delaware Court**"). On February 13, 2006, the Appellants filed motions in the Delaware Court to transfer venue of these involuntary cases to the Bankruptcy Court, and on December 14, 2006, the two courts entered orders granting those motions. (R-203).[2]

As acknowledged at page 12 of their brief, the Corporate Debtors are holding companies with no business operations or employees. Prosser owns 100% of the stock of Appellant ICC, LLC, which in turn owns or controls 100% of the stock of Appellant Emerging, 52% through

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[1] Each petition is identified as Docket No. R-1 in the record of its respective case.

[2] Virtually all the documents comprising the record on appeal were filed in both bankruptcy cases and assigned separate docket numbers in the two cases. For example, the order determining that venue is proper in this Court was filed as Docket No. 203 in the Emerging case (No. 06-30007) and as Docket No. 193 in the ICC, LLC case (No. 06-30008). Unless otherwise noted, references to such documents in this brief are to the docket number assigned to the document in the Emerging case (No. 06-30007), without any reference to that case number.

direct ownership and the remaining 48% through its ownership of the remaining shareholder, Innovative Communications Subsidiary Company, LLC. Through non-debtor subsidiaries, the Corporate Debtors own or control various operating entities including Vitelco, the Virgin Islands telephone company. *Id.* Vitelco is a public utility operating under a franchise granted by the U.S. Virgin Islands government and is regulated by the Virgin Islands Public Services Commission (the "**PSC**").

In a Memorandum Opinion entered with the orders that are the subject of these appeals, the Bankruptcy Court found as an undisputed fact that the Greenlight Entities and the Rural Telephone Finance Corporation (the "**RTFC**") together hold at least 90 percent of the outstanding debt against the Corporate Debtors. (R-448, p. 8).[3] The claim of the Greenlight Entities derives from two judgments entered in the Delaware Chancery Court, one for $28.5 million against Emerging and the other for $56 million against ICC, LLC, Prosser, and a dissolved U.S. Virgin Islands corporation referred to by the parties as "Old ICC."[4] *Id.*, pp.3-5. The RTFC's claim arises from loans to New ICC in excess of $500 million that are secured by, *inter alia*, guarantees and stock pledges from the Corporate Debtors and Prosser. The Greenlight Entities and the RTFC assert judgment liens against the Appellants for these claims. *Id.*, p.4.

Between the filing of the involuntary petitions in Delaware and the filing of the voluntary petitions that commenced the present cases, the Appellants, New ICC, the Greenlight Entities and the RTFC entered into a settlement agreement (the "**Settlement**") providing, *inter alia*, that Appellants would have until July 31, 2006, to make a discounted payment to the Greenlight

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[3] This Memorandum Opinion will hereafter be cited as "**Mem. Op.**," followed by the page number.

[4] Old ICC was the predecessor in interest to Innovative Communications Corporation (referred to by the parties as "**New ICC**"), a nondebtor subsidiary of Emerging that owns a number of cable and telecommunications companies, including Vitelco.

Entities in the amount of $402 million in full satisfaction of their respective claims. Mem. Op., p. 6. Since the execution of that agreement, the Appellants have been attempting to secure financing to fund the Settlement. Appellants filed their voluntary chapter 11 petitions on July 31, 2006, when they were unable to secure such financing, and therefore unable to make the discounted payment contemplated by the Settlement, by that date. At that time, Appellants advised the Bankruptcy Court that they intended to use the sixty-day window afforded by 11 U.S.C. § 108[5] to continue their efforts to secure financing to fund the Settlement. *Id.*, p. 7.

Although they had not yet secured binding financing commitments, the Corporate Debtors filed a joint motion to assume the Settlement on September 25, 2006. (R-24). On September 28, 2006, the Bankruptcy Court entered a scheduling order setting a hearing on that motion for November 27, 2006, and directing the Corporate Debtors to file an amended assumption motion on or before November 3, 2006, with a binding commitment that had no financing contingencies or unsatisfied due diligence conditions. (R-26). The Corporate Debtors filed an amended assumption motion on November 3, 2006 (R-82), but without the required binding commitment. On November 8, 2006, after a hearing, the Bankruptcy Court denied the Corporate Debtors' request to assume the Settlement agreement due to "impossibility of

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[5] 11 U.S.C. § 108 provides, in pertinent part, as follows:

> (b) Except as provided in subsection (a) of this section, if applicable nonbankruptcy law, an order entered in a nonbankruptcy proceeding, or an agreement fixes a period within which the debtor or an individual protected under section 1201 or 1301 of this title may file any pleading, demand, notice, or proof of claim or loss, cure a default, or perform any other similar act, and such period has not expired before the date of the filing of the petition, the trustee may only file, cure, or perform, as the case may be, before the later of--
>
> > (1) the end of such period, including any suspension of such period occurring on or after the commencement of the case; or
> >
> > (2) 60 days after the order for relief.

performance." (R-99).

On November 22, 2006, the Corporate Debtors filed a joint motion to extend the period in which they had the exclusive right to file a chapter 11 plan and disclosure statement. (R-133). In that motion, the Corporate Debtors revealed that they had terminated the letter of intent upon which their amended motion to assume the Settlement was predicated so they could pursue a transaction with the government of the Virgin Islands to sell assets of the subsidiary operating companies on which the value of the stock held by Appellants is predicated. On December 4, 2006, during a hearing on their motion to extend the exclusivity period, the Bankruptcy Court, "noting the distrust existing between the major constituencies in this matter and the … continuing inability [of the Appellants] to obtain any commitment for the sale of assets, suggested that the appointment of a trustee might be appropriate in these cases."[6] The Corporate Debtors responded by filing a "Joint Motion For Entry of an Order Appointing a Responsible Officer for the Corporate Debtors" (the "**Responsible Officer Motion**") on December 7, 2006. (R-186).[7] The United States Trustee, the Greenlight Entities and the RTFC filed objections to the Responsible Officer Motion (R-275, R-229, R-258), and on December 19, 2006, the United States Trustee filed a motion seeking the appointment of a chapter 11 trustee (the "**Trustee Motion**") (R-209), in which the Greenlight Entities and the RTFC later joined. (R-212, R-256). After full evidentiary hearings, briefing, and argument, the Court entered orders denying the Responsible Officer Motion (R-449) and granting the Trustee Motion (R-450) on February 13,

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[6] Mem. Op., p.8; Transcript of December 4, 2006, Hearing, pp. 71-72, 93-94 (R-198).

[7] In addition, Appellants filed a joint Plan of Reorganization (the "**Plan**") on January 8, 2007 (R-294), but without the disclosure statement required under 11 U.S.C. § 1125 to enable them to solicit votes in favor of confirmation of the Plan. At a subsequent hearing held on January 19, 2007, Appellants' counsel stipulated that the Plan "as currently drafted" was not, in any event, confirmable. Transcript of January 19, 2007 hearing, p. 103 (R-394).

2007,[8] accompanied by the Memorandum Opinion. Appellants filed their respective notices of appeal on February 20, 2007.[9]

SUMMARY OF ARGUMENT

Bankruptcy courts possess broad discretion when determining whether to appoint chapter 11 trustees. The court below did not abuse that discretion in this case. **First**, there was broad consensus that a trustee was needed. The entities holding over 90% of the debt in the case wanted a trustee, as did the United States Trustee, the federal watchdog official charged with supervising the administration of bankruptcy cases.[10] **Second**, the animosity and lack of cooperation between the bankrupt entities and their creditors supported the appointment of a trustee under well-established Third Circuit precedent. **Third,** the existence of conflicts of interests between Prosser and the bankruptcy estates supported the appointment of a trustee. **Fourth**, the bankrupt entities' improper calculation of the claims against the Corporate Debtors justified a trustee. **Last**, were there any question on this point, Appellants' motion asking that a neutral "Responsible Officer" be appointed by the Bankruptcy Court constitutes an admission of

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[8] The Court also entered an order on that date denying a motion by the Greenlight Entities to convert Prosser's individual chapter 11 case, *In re Jeffrey J. Prosser*, Case No. 06-30009 (JFK), to chapter 7. Instead, the Court ordered the appointment of an examiner in that case.

[9] On February 21 and February 22, 2007, the PSC, as "Intervenor," also filed notices of appeal from these orders. The PSC's notice of appeal in the Emerging case appears as R-472 in the record of that case, and that appeal is docketed in this Court as D.C.APP. Civ. No. 2007-38. The PSC's notice of appeal in the ICC, LLC case appears as R-451 in the record of that case, and that appeal is docketed in this Court as D.C.APP. Civ. No. 2007-39. The PSC has not prosecuted either appeal.

[10] United States Trustees are officials of the Department of Justice appointed by the Attorney General to supervise the administration of bankruptcy cases. *See* 28 U.S.C. §§ 581-89; *In re Columbia Gas Systems, Inc.*, 33 F.3d 294, 296 (3d Cir. 1994) (noting that United States Trustees oversee bankruptcy process, protect public interest, and ensure bankruptcy cases are conducted according to law) (citing H.R. Rep. No. 95-595 at 109 (1977)).

their inability to negotiate a resolution of the disputes impeding resolution of these cases without the type of impartial oversight that a trustee brings to a bankruptcy case. Although Appellants contend that the Bankruptcy Court erred in declining to appoint a Responsible Officer rather than a trustee, the Bankruptcy Code does not provide for the appointment of any such undefined entity to administer a chapter 11 case, and the court appropriately followed federal law by appointing a statutory trustee instead.

Finally, appellants make the remarkable suggestion that section 43a of title 30 of the Virgin Islands Code conflicts with and supersedes the federal statute, 11 U.S.C. § 1104(a), that authorizes the bankruptcy court to appoint a trustee in a federal bankruptcy case. The Virgin Islands statute in question provides that "[n]o person or corporation ... shall sell, acquire or transfer control, either directly, or indirectly of any public utility organized and doing business in this Territory, without first securing authorization from the [Public Services] Commission." 30 V.I.C. § 43a(a). First, neither of the Corporate Debtors is a regulated utility. Rather, each is a non-regulated holding company. Second, any change of control with respect to the Corporate Debtors that took place as a result of the Bankruptcy Court's decision to appoint a trustee resulted not from a "transfer" by a "person or corporation" but from an order of the Bankruptcy Court in a case under its jurisdiction. Third, if there were any conflict between Virgin Islands law and section 1104(a) of the Bankruptcy Code, section 1104(a) would control under the Supremacy Clause.

ARGUMENT

I. THE BANKRUPTCY COURT DID NOT ABUSE ITS DISCRETION IN ORDERING THE APPOINTMENT OF A TRUSTEE.

The standards governing the appointment of a trustee in a chapter 11 case are set forth in section 1104(a) of the Bankruptcy Code, as follow:

> (a) At any time after the commencement of [a chapter 11] case but before confirmation of a plan, on request of a party in interest or the United States trustee, and after notice and a hearing, the court *shall* order the appointment of a trustee:
>
>> (1) for cause, including fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor by current management, either before or after the commencement of the case, or similar cause, but not including the number of holders of securities of the debtor or the amount of assets or liabilities of the debtor;
>>
>> (2) if such appointment is in the interests of creditors, any equity security holders, and other interests of the estate, without regard to the number of holders of securities of the debtor or the amount of assets or liabilities of the debtor; or
>>
>> (3) if grounds exist to convert or dismiss the case under section 1112, but the court determines that the appointment of a trustee or an examiner is in the best interests of creditors and the estate.

11 U.S.C. § 1104 (emphasis supplied). If a bankruptcy court orders the appointment of a chapter 11 trustee pursuant to section 1104(a), then 11 U.S.C. § 1104(d) requires the United States Trustee to appoint, after consultation with parties in interest and subject to the court's approval, a "disinterested person" to serve in that capacity.

The Third Circuit has held that " '[t]he party moving for appointment of a trustee ... must prove the need for a trustee under either subsection [1104(a)(1) or 1104(a)(2)] by clear and convincing evidence,' " *Official Committee of Asbestos Claimants v. G-I Holdings, Inc. (In re G-I Holdings, Inc.)*, 385 F.3d *supra*, at 317-18, quoting *In re Marvel Entertainment Group, Inc.*, 140 F.3d 463, 473 (3d Cir. 1998),[11] but that "determining whether the moving party has satisfied its burden under either subsection is committed to the court's discretion." *Id.*, 385 F.3rd at 318.

"The Court has particularly wide discretion under subsection (a)(2), [which] sets forth a flexible standard for appointment of a trustee even when no cause exists." *In re Bellevue Place Associates*, 171 B.R. 615, 623 (Bankr. N.D.Ill. 1994). *Accord In re Ionosphere Clubs, Inc.*, 113 B.R. 164, 168 (Bankr. S.D.N.Y. 1990) ("Code § 1104(a)(2) creates a flexible standard and allows the appointment of a trustee even when no 'cause' exists"), citing *In re Sharon Steel Corp.*, 871 F.2d 1217, 1226 (3d Cir. 1989); *In re V. Salvino Oil & Heating* Co., 99 B.R. 518, 527, n. 11 (Bankr. E.D.N.Y. 1989) ("factors constituting a basis for appointing a trustee under section 1104(a)(2) are amorphous, diverse and necessarily involve a great deal of judicial discretion"). Further, "[i]n considering what is in the interests of creditors in connection with [a section 1104(a)(2) motion], 'a bankruptcy judge has broad discretion to take judicial notice of the entire file ... and the outcome of previous proceedings brought before the court.'" *In re U.S. Mineral Products Co.*, 105 Fed.App'x. 428, 431 (2004 WL 1758499, p.2) (3d Cir. 2004), quoting from Barry Russell, *Bankruptcy Evidence Manual* § 201.6 (2004).

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[11] There is no statutory basis for requiring clear and convincing evidence to establish the need for the appointment of a trustee in a chapter 11 case. See 2 Queenan, CHAPTER 11 THEORY AND PRACTICE § 14.04. Requests for the appointment of trustees in chapter 11 cases are brought by motion as contested matters under Rule 9014, as are all matters not specified in Rule 7001. *See* Fed. R. Bankr. P. 9014(a). There is no good reason to subject a request for a trustee under Rule 9014 to a heightened standard of proof. To the contrary, the Supreme Court has stated that civil matters typically need not be decided under such heightened standards. *Grogan v. Garner,* 498 U.S. 279, 286, 111 S.Ct. 654, 659, 112 L.Ed.2d 755 (1991) ("... we presume that ... [the preponderance] ... standard is applicable in civil actions between private litigants unless 'particularly important individual interests or rights are at stake.'"). The question of whether to appoint a trustee in a chapter 11 case is not such an important matter as to require a heightened standard of proof, particularly since Congress allows chapter 11 trustees to be appointed without cause under subsection 1104(a)(2). However, the applicability of the clear and convincing evidence standard is not determinative of the outcome of this appeal, inasmuch as the Bankruptcy Court applied that standard. See, e.g., Mem. Op., pp.14, 16, & 17.

Among the factors courts consider in determining whether to appoint a chapter 11 trustee under section 1104(a)(2) are: (1) the trustworthiness of the debtor; (2) the debtor's past and present performance and prospects for the debtor's reorganization; (3) confidence, or lack thereof, of the business community and creditors in present management; and (4) the benefits derived by appointment of a trustee, balanced against the costs of appointment. *See In re Ionosphere Clubs, Inc., supra*, 113 B.R. at 168; *In re Colorado-Ute Elec. Ass'n, Inc.*, 120 B.R. 164, 176 (Bankr. D.Colo. 1990).

"Section 1104(a) represents a potentially important protection that courts should not lightly disregard or encumber with overly protective attitudes towards debtors-in-possession." *In re V. Salvino Oil & Heating* Co., *supra*, 99 B.R. at 525. *Accord In re Nartron Corp.*, 330 B.R. 573, 591-2 (Bankr.W.D.Mich. 2005) (while "[t]here is a strong presumption in Chapter 11 cases that the debtor-in-possession should be permitted to remain in control of the corporation absent a showing of need for the appointment of a trustee ... [n]evertheless, in the appropriate case, the appointment of a trustee is a power which is critical for the court to exercise in order to preserve the integrity of the bankruptcy process and to insure that the interests of creditors are served."). Indeed, "the Court is *required* to appoint a trustee [under subsection (a)(2)] when doing so addresses 'the interests of the creditors, equity security holders and other interests of the estate.'" *In re Bellevue Place Associates*, supra, 171 B.R. at 623, citing *Committee of Dalkon Shield Claimants v. A.H. Robins Co., Inc.*, 828 F.2d 239, 240 (4th Cir. 1987) (emphasis supplied).

A. The Evidence of Record Established Ample Support for a Determination that the Appointment of a Trustee Was in the Interests of the Bankruptcy Estate and Its Creditors.

" '[A]n abuse of discretion exists where the district court's decision rests upon a clearly erroneous finding of fact, an errant conclusion of law, or an improper application of law to fact.'

In re SGL Carbon Corp., 200 F.3d [154], at 159 [(3d Cir. 1999)] (quoting *ACLU v. Black Horse Pike Reg'l Bd. of Ed.*, 84 F.3d 1471, 1476 (3d Cir. 1996))." *In re Integrated Telecom Express, Inc.*, 384 F.3d 108, 118 (3d Cir. 2004). The Bankruptcy Court clearly did not predicate its decision to appoint a trustee in this case upon on any erroneous finding of fact, errant conclusion of law, or improper application of law to fact. The Bankruptcy Court articulated the following reasons for its decision to direct the appointment of a trustee, all of which were supported by the evidence of record and any one of which was sufficient by itself to support that decision.

1. Animosity and lack of cooperation and trust between Appellants and their major creditors.

The Bankruptcy Court observed that there had been a notable lack of progress in resolving disputes over the amount and status of the claims in the cases and in negotiating a sale or refinancing of the assets of the non-debtor operating entities in order to generate funds to pay those claims, stating:

> The parties quite candidly argue that the case is all about control of the negotiation process. The creditors have no confidence in Prosser, and Prosser has no trust in them. Thus, the only way to get all parties to cooperate is to put a neutral person in charge of the process. Cooperation is vital to the reorganization of the Debtors. If the parties cannot agree to the amount and status of the claims, the cases may be in litigation for many more years, while Debtors make no payments on the judgments or on accruing interest or even on the $402 million that was agreed to under the Terms and Conditions. Further, no buyer has stepped forward with an offer to show what the fair value of the enterprise is, no one has tried to value the components of the enterprise to determine just how much of the allegedly secured claims are really supported by value and, in general, the process is mired.
>
> Thus, until someone other than Prosser or the creditors assumes the responsibility for finalizing a deal, it appears that one will never be reached.

Mem. Op., p.11. In addition, the Court observed:

> Debtors have appeared before the court numerous time[s], ... each time reporting that a binding commitment was forthcoming. To date, despite all of Debtors'

> assurances, no binding commitment has been obtained and none is any longer promised. The record, therefore, clearly and convincingly refutes Debtors' assertions of “progress” and shows, instead, efforts that have led to nothing more than a holding pattern. ...
>
> [U]nfortunately, the parties are now embarked on a course of litigation in these cases which, coupled with the acrimony between them, clearly and convincingly demonstrates to the court that a neutral party is needed to investigate and determine whether or not to pursue (or defend, as the case may be) actions on behalf of the estates.

Id., p.16.

These concerns were well supported by the record. As previously indicated, Appellants filed these cases because they were unable to obtain the financing necessary to make the discounted payment in the amount of $402 million needed to satisfy the claims of the Greenlight Entities and the RTFC under the terms of the pre-petition Settlement. At page 13 of their brief, Appellants assert that their “primary goal in these chapter 11 cases has been to obtain [such] financing ...” They have yet, however, to demonstrate that this goal is within their reach. They were unable obtain such financing either before the expiration of the deadline established by the Settlement or within the additional 60-day window they contend 11 U.S.C. § 108 provided them, and they were likewise unable to obtain a commitment for such financing to support their amended motion to assume the Settlement filed on November 4, 2006, long after that 60-day window had closed. On December 3, 2006, after the Bankruptcy Court denied their motion to assume the Settlement based on “impossibility of performance,” the Corporate Debtors filed a motion for sanctions against the RTFC, alleging, *inter alia*, that the RTFC had “engaged in a lengthy and deliberate pattern of underhanded stratagems designed to prevent the Debtors from reorganizing in these proceedings” and had engaged in “a transparent effort ... to sabotage the Debtors’ stated goal of selling their Virgin Islands business operations to the Government of the

Virgin Islands, in order to effect a reorganization." (R-165).[12] Thereafter, on January 8, 2007, Appellants filed a joint Plan of Reorganization (R-294) that they conceded, at a hearing held on January 19, 2007, was not confirmable. (R-394, p. 103).

Courts have repeatedly held that mistrust, lack of cooperation and acrimony between a chapter 11 debtor and its creditor constituency may support the appointment of a chapter 11 trustee when such circumstances create an obstacle to progress in the case. See *In re Marvel Entertainment Group, Inc., supra*, 140 F.3d at 472-5 (court may exercise its discretion to direct appointment of trustee when parties are "sharply divided on many issues, and are presently incapable of resolving them") (internal quotation marks omitted); *In re U.S. Mineral Products Co., supra*, 105 Fed. App'x. at 430, 2004 WL 1758499, p.2 (upholding *sua sponte* order directing appointment of trustee "based on the length of time the proceedings had been pending, the size of the case, the contentious and acrimonious nature of the relationships among the parties, the lack of trust, the lack of progress, and the need for a neutral party to 'maximize value and construct a plan ... acceptable to creditors' "); *Petit v. New England Mortg. Services Inc.*, 182 B.R. 64, 70 (D.Me. 1995) ("deep-seeded conflict and animosity between a debtor and its creditors provides a basis for the appointment of a trustee"); *In re The Bible Speaks*, 74 B.R. 511, 512 (Bankr. D.Mass. 1987) (citing, as lead reason for appointment of trustee, "[f]riction ... between the Debtor and the Creditors' Committee which threatens to engulf this estate in costly and legalistic bickering over the entire range of the reorganization process").

As acknowledged at page 12 of their brief on appeal, the Corporate Debtors are holding

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[12] The Bankruptcy Court denied this motion without prejudice on December 4, 2006, because it was not filed in accordance with a Case Management Order entered in the case, and the Appellants filed another such motion on December 18, 2006 (R-207). The Bankruptcy Court entered an order withdrawing that motion with prejudice on February 6, 2007.

companies with no business operations or employees. The only personal property assets listed in their bankruptcy schedules filed in the case consist of stock in other companies. R-37 (Case No. 06-30007); R-38 (Case No. 06-30008). The parties agree that the only way to achieve a successful disposition of these cases is to assess the value of that stock, obtain cash for it through a sale or refinancing of the non-debtor subsidiaries, determine the amount and priority of the claims in the cases, and distribute the funds to creditors.[13] The Bankruptcy Court was fully authorized to determine from the extensive record before it whether and to what extent Appellants were making progress towards these goals and whether and to what extent the mistrust, lack of cooperation and acrimony between the parties constituted an obstacle to such progress. While Appellants complain that the Court was placing unrealistic expectations on them "to close a complex telecommunications sale transaction in an extremely short time period," Appellants' Brief, p. 21, there is nothing in the Memorandum Opinion that supports this assertion. Rather, it is apparent that all the Court was looking for was progress towards a sale or refinancing of the assets and a resolution of the claims disputes. See, e.g., Mem. Op., p.16.

2. Conflicts of interest.

The Court also ordered a trustee due to the danger that Prosser's personal economic interest in realizing income from the Corporate Debtors and the non-debtor subsidiaries would conflict with the interests of creditors in effectuating a prompt sale:

> [A]lthough ... Prosser's investment banker ... testified that he has not seen Prosser refuse to negotiate with entities that express no interest in retaining him in some capacity, the court heard no evidence from anyone as to what Prosser would do for income in the event that the companies are all sold out from under him. He has substantial personal debts and contributes to the payment of his wife's debts.

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[13] At page 13 of their brief on appeal, Appellants assert that their "primary goal in these chapter 11 cases has been to obtain financing (whether through a sale of stock or assets, or a refinancing) that will permit [them] to enforce the Settlement Agreement."

> His wife is not employed but many of the assets valued at several million dollars (and subject to debts of millions of dollars) are titled in her name. Because of this circumstance, the court is not convinced that Prosser can distance himself from the negotiations sufficiently to consider the obligations he owes his creditors before his own interests.
>
> This is not to say that a neutral negotiator should not also consider Prosser's interests. Those interests should be considered and be part of the chapter 11 plan negotiation process. However, they should not have a more predominant role than any other factor. A trustee with fiduciary status is needed to insure that there is fundamental fairness to all concerned.

Mem. Op., p.13. The Bankruptcy Court additionally observed:

> The audited consolidated financial statements show "net advances" to Prosser of approximately $13 million in 2005 and 2004 and of over $14 million in 2003, at a time when Prosser was personally indebted to New ICC in an amount in excess of $156 million. Prosser testified that ICC LLC, not he, was the recipient of all of the net advances except annual advances of approximately $1 to $2 million … Even if true, Prosser is the sole owner of ICC LLC and directly benefits from advances to it by utilizing it as a "check the box" corporation which he reports on his personal tax returns. Moreover, Prosser admits that neither he nor ICC LLC can repay the advances.

Id., pp.25-6 (footnotes omitted).

The Court clearly did not abuse its discretion by concluding that these undisputed facts weighed in favor of the appointment of a trustee. The existence of such potential conflicts of interest may constitute sufficient cause for the appointment of a chapter 11 trustee, regardless of whether there is evidence that the debtor has taken action contrary to the interests of the estate. *See In re Cajun Elec. Power Coop., Inc.*, 74 F.3d 599, 600 (5th Cir. 1996), *cert. denied*, 519 U.S. 808 (117 S.Ct. 51, 136 L.Ed.2d 15) (1996). *Accord In re Marvel Entertainment Group, Inc., supra*, 140 F.3d at 473.

3. By filing the Responsible Officer Motion, Appellants acknowledged that it was in the best interests of the bankruptcy estate and its creditors for Prosser to cede control of the negotiations for a sale and/or refinancing.

The Court was certainly authorized to conclude, as it did at page 8 of the Memorandum Opinion, that in filing the Responsible Officer Motion the Corporate Debtors had acknowledged the need for an independent fiduciary to replace Prosser at the negotiating table and otherwise assume control over the administration of the case. As a result of this motion, the Court was not faced with a choice between appointing a chapter 11 trustee or allowing the Corporate Debtors to remain in possession but with a choice between replacing Prosser with a "Responsible Officer," with powers and duties to be defined by agreement of the parties, or replacing him with a chapter 11 trustee with powers and duties defined by the Bankruptcy Code.

As it turned out, of course, the parties were unable to agree on what the powers and duties of the proposed "Responsible Officer" would be. At page 44 of their brief on appeal, however, Appellants assert that Prosser "was prepared to cede ultimate control of the sale or financing process to the Responsible Officer …," and in the Responsible Officer Motion filed on December 7, 2006, they proposed that the powers of the Responsible Officer would be as follows:

> The Responsible Officer will be an officer of the Court. The Responsible Officer will have the sole power and authority to agree, on behalf of the Debtors or any of the Debtors' affiliates, to sell or otherwise dispose of the shares of common stock in the Virgin Islands Telephone Company ("Vitelco"). The Responsible Officer will be entitled to be present at, and involved in, all negotiations conducted by the Debtors or their agents in connection with the sale of the Debtors' direct or indirect assets in Vitelco.

(R-186, pp.5-6, ¶14.

Remarkably, while maintaining that they intended for the Responsible Officer to assume complete control of the negotiations for the sale or refinancing of the assets of the non-debtor subsidiaries, Appellants state at pages 42-43 of their brief that they did not intend for the Responsible Officer to act as an independent fiduciary for creditors. In the face of Appellants' unwillingness to allow these negotiations to be conducted by someone with a legal obligation to act for the benefit of creditors, the Bankruptcy Court clearly did not abuse its discretion in concluding that it was in the interests of the bankruptcy estate and its creditors to appoint a trustee.

B. The Bankruptcy Court Did Not Err in Considering Appellants' Failure to Account for the Accrual of Interest on the Debts of the RTFC and the Greenlight Entities as a Factor Weighing in Favor of a Trustee.

Appellants contend at page 24 of their brief on appeal that the Bankruptcy Court erred in considering their failure to account for the accrual of interest on the claims held by the RTFC and the Greenlight Entities as a factor militating in favor of the appointment of a trustee. In this regard, the Court stated:

> There are other issues that must be addressed by someone outside the Prosser organization. One issue involves the financial statements of the Prosser parties. Witnesses experienced in accounting principles testified that financial statements must continue to reflect accumulated interest until there is a final determination that the obligation underlying the interest is no longer due. This is so even though the company may dispute the obligation to pay interest. In this case, Prosser disputes the obligation to pay interest due to the negotiated $402 million discounted payment. However, whether the discount is still applicable is itself in dispute. Nonetheless, the consolidated financial statements for the Prosser entities are no longer reflecting accumulating and unpaid interest on the final judgments that likewise remain unpaid. … Not reporting the dispute or reflecting the possibility that [interest] will be added to the debt of the Debtors (either as principals or as guarantors) is clearly a material matter that requires someone with no tie to Prosser to investigate. The independence of a trustee is needed for this purpose.

Mem. Op., pp.11-12 (footnotes omitted).

Appellants contend that the Court erred in considering this issue because the claims in question had been accelerated, with the result that the RTFC and the Greenlight Entities were seeking "unmatured interest," which is not allowed under 11 U.S.C. § 502(b)(2). However, assuming for purposes of argument that this contention is correct, it does not follow that the RTFC and the Greenlight Entities do not have valid claims in these cases for matured interest. Appellants cannot reasonably contend that the filing of these cases had the effect of eliminating the continued accrual of interest on over $500 million in secured debt.[14] The Bankruptcy Court did not err in treating the issue of whether and to what extent the Appellants should account for the accrual of interest on these claims as a "material matter that requires someone with no tie to Prosser to investigate."

C. In Reaching its Decision to Appoint a Trustee, the Bankruptcy Court Quite Clearly Weighed the Benefits Against the Cost of Doing So.

Appellants contend at page 38 of their brief that "[t]he Bankruptcy Court abused its discretion in failing to consider the harm that the appointment of a trustee would have on the Debtors and their various constituencies." First, it is not clear what "constituencies" are at risk in these bankruptcy cases other than Appellants' creditors and Prosser. The Corporate Debtors' continued business operations are not in jeopardy since they are holding companies that have no business operations.[15] Their material assets consist of stock in other companies, and a trustee does not jeopardize Appellants' financial stake in those companies. Moreover, the RTFC and the Greenlight Entities, which joined in the Trustee Motion, hold over 90% of the debt in the cases. It is presumably in the economic interest of these creditors to pursue a course that maximizes the value of the non-debtor operating entities on which the value of their asserted

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[14] Whether and to what extent there is sufficient value to pay such interest is, of course, a different question.

[15] Appellants' brief, p. 12.

liens on the Corporate Debtors' stock depends, and they have evidently concluded that the appointment of a trustee will have a more salutary effect on that value than would the Corporate Debtors' continued administration of the cases as debtors in possession. For the reasons set forth *supra* in this brief, the Bankruptcy Court was authorized to conclude that the appointment of a trustee would assist in realizing the "sale of stock or assets or a refinancing" that Appellants concede is central to the success of these cases.[16] Appellants' contention at page 38 of their brief that as a result of the Bankruptcy Court's decision to appoint a trustee "the PSC will likely take action against New ICC and the [non-debtor operating entities] for violating 30 V.I.C. § 43a" is addressed in Section III of this Brief, *infra*.

II. THE BANKRUPTCY COURT DID NOT ERR IN DENYING APPELLANTS' MOTION FOR THE APPOINTMENT OF A "RESPONSIBLE PERSON."

Although some courts have allowed it, the appointment of a "Responsible Officer," as opposed to a trustee, to assume the administration of a chapter 11 case from a debtor in possession is not a remedy contemplated by the Bankruptcy Code. *See In re SunCruz Casinos, LLC*, 298 B.R. 821, 832 (Bankr. S.D.Fla. 2003) ("The Code does not contemplate appointment of a 'Responsible Person' to perform the duties of a trustee."). As noted by the Bankruptcy Court at page 9 of the Memorandum Opinion, in cases in which this device has been employed, either the debtor had no existing management, as in *Matter of FSC Corporation*, 38 B.R. 346 (Bankr. W.D.Pa. 1983), or no party lodged an objection to it, as in *Matter of Gaslight Club, Inc.*, 782 F.2d 767 (7th Cir. 1986). *Accord In re Communication Options, Inc.*, 299 B.R. 481, 482 (Bankr. S.D.Ohio 2003). Appellants have cited no authority supporting the appointment of a "Responsible Officer" to take over the administration of a chapter 11 case from a debtor in

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[16] See Appellants' brief, p. 13.

possession where, as here, the United States Trustee and creditors opposed the request and instead sought the appointment of a chapter 11 trustee under 11 U.S.C. § 1104, and existing authority is in fact to the contrary. *See, e.g., In re Stratesec, Inc.*, 324 B.R. 158, 160-161 (Bankr. D.D.C. 2004) (declining to appoint receiver for debtor corporation as responsible officer absent proof that all creditors supported motion). *See also In re Adelphia Communications Corp.*, 336 B.R. 610, 668 (Bankr. S.D.N.Y. 2006) (characterizing request for appointment of non-trustee fiduciary to act on behalf of estate as "back-door means of circumventing the statutory requirements, and case law, applicable to the appointment of trustees under section 1104") ; *In re Freedlander, Inc.*, 86 B.R. 66, 68 (Bankr. E.D. Va. 1988) ("A review of case authority allowing the substitution of management as an alternative to proceeding with a hearing on the appointment of a trustee reflects that such an alternative is only available when there is a consensus to such a course of action.").

III. SECTION 43A OF TITLE 30 OF THE VIRGIN ISLANDS CODE DID NOT PROHIBIT THE APPOINTMENT OF A CHAPTER 11 TRUSTEE, AND EVEN IF IT HAD, FEDERAL BANKRUPTCY LAW WOULD SUPERCEDE IT UNDER THE SUPREMACY AND BANKRUPTCY CLAUSES.

Appellants contend that the appointment of a chapter 11 trustee was void under the following provision of Section 43a of Title 30 of the Virgin Islands Code:

> (a) No person or corporation, whether or not organized under the laws of the Territory, shall sell, acquire or transfer control, either directly, or indirectly of any public utility organized and doing business in this Territory, without first securing authorization from the [Public Services] Commission. Any such acquisition or control without prior authorization shall be void and of no effect.

30 V.I.C. § 43a(a).

This contention lacks merit for three reasons. First, Appellants cite no authority – and we can find none – for the proposition that a change in control of a parent company operates as a change in control of its subsidiaries, particularly where, as here, the parent company does not exercise any day-to-day operational control over the subsidiaries.[17] As noted by this Court last year in *Virgin Islands Telephone Corp. v. Rural Telephone Finance Co-op. Greenlight Capital Qualified, L.P.P.*, 2006 WL 319002, p.4 (D.V.I., February 10, 2006), "there are at least two layers between [Appellants] and Vitelco," and "it is well settled that 'absent unusual circumstances, the property of the debtor's subsidiary is not considered property of the debtor by virtue of the debtor's sole ownership of the subsidiary.'"

Second, even assuming for purposes of argument that the appointment of a trustee to administer these chapter 11 cases did effect a change in control of Vitelco or any other non-debtor entity connected with the cases, such change of control clearly did not result from a "transfer" by a "person[18] or corporation" within the meaning of 30 V.I.C. § 43a. Rather, it resulted from an order entered by the Bankruptcy Court pursuant to 11 U.S.C. § 1104 in a case under its jurisdiction. In taking the position that the court-ordered appointment of a federal bankruptcy trustee under federal law in a federal bankruptcy case involving a regulated utility constitutes a transfer of control of the utility for regulatory purposes, the PSC appears to be unique among regulatory agencies in the United States, which uniformly regard the entry of such

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[17] Mem. Op., p.21 (R-448).

[18] As defined by 1 V.I.C. § 41, the term person includes "corporations, companies, associations, joint stock companies, firms, partnerships, and societies, as well as individuals ..." It does not, however, include bankruptcy courts.

As defined by 11 U.S.C. § 101(41), "[t]he term 'person' includes individual, partnership, and corporation, but [subject to certain exceptions] does not include governmental unit ..." This definition likewise does not encompass bankruptcy courts.

an order as a *pro forma* event with no regulatory consequences.[19] Appellants have cited no judicial authority that remotely supports the PSC's interpretation of 30 V.I.C. § 43a in this regard.

Finally, an interpretation of 30 V.I.C. § 43a purporting to limit or restrict the ability of a bankruptcy court to direct the appointment of a trustee in a chapter 11 case would obviously conflict with section 1104 of the United States Bankruptcy Code and accordingly would impermissibly interfere with Congress' power to enact bankruptcy legislation under the Bankruptcy Clause. U.S. Const. art. I, sec. 8, cl. 4. It also would violate the Supremacy Clause of the United States Constitution, under which the laws of the United States constitute "the supreme Law of the Land ... any Thing in the Constitution or Laws of any State to the Contrary notwithstanding." U.S. Const. art. VI, cl. 2.[17]

As the Supreme Court reiterated in *Crosby v. Nat'l Foreign Trade Counsel*, 530 U.S. 363, 372-73, 120 S.Ct. 2288 (2000), inconsistent state laws must yield to congressional enactments when one of two tests is met, regardless of whether Congress has inserted a clause in legislation explicitly preempting state law. First, where Congress intends federal law to occupy a given field, it preempts state law in that area. *Id*., 530 U.S. at 372-73. Second, even if Congress has not entirely displaced state regulation over the matter in question, federal law still preempts state law to the extent that state law actually conflicts with federal law. *Id*. This

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[19] The United States Trustee bases this assertion on the authorities cited by the RTFC in its brief filed on January 11, 2007, in support of the Trustee Motion and in response to the PSC's opposition to the Trustee Motion (R-330).

[17] The principles of preemption arising from the Supremacy Clause "are made applicable to the laws of the Virgin Islands through the Revised Organic Act, which authorizes the Virgin Islands legislature to enact territorial laws that are 'not inconsistent with ... the laws of the United States made applicable to the Virgin Islands.' 48 U.S.C. § 1574(a)." *St. Thomas--St. John Hotel & Tourism Ass'n, Inc. v. Government of U.S. Virgin Islands*, 218 F.3d 232, 237-8 (3d Cir. 2000).

occurs when it is impossible to comply with both state and federal law, or when the state law stands as an obstacle to the accomplishment of the full purposes and objectives of Congress. *Id*. Accord *Edgar v. MITE Corp.*, 457 U.S. 624, 631, 102 S.Ct. 2629, 2635 (1982).

Congress has quite clearly satisfied these tests in the bankruptcy arena, where it has enacted a comprehensive and pervasive statutory scheme that "occupies a full title of the United States Code" and "provides a comprehensive system of rights, obligations and procedures, as well as a complex administrative machinery that includes a special system of federal courts and United States Trustees." *Sherwood Partners, Inc. v. Lycos, Inc.*, 394 F.3d 1198, 1201 (9th Cir. 2005). Bankruptcy is particularly federal because the Bankruptcy Clause of the Constitution, U.S. Const. art. I, § 8, cl. 4, grants Congress the power "[t]o establish . . . uniform Laws on the subject of Bankruptcies throughout the United States." Congress has exercised that power by enacting the Bankruptcy Code. See, e.g., *Sherwood, supra*, 394 F.3d at 1201 ("There can be no doubt that federal bankruptcy law is 'pervasive' and involves a federal interest 'so dominant' as to 'preclude enforcement of state laws on the same subject' – much like many other areas of congressional power listed in Article I, Section 8, of the Constitution, such as patents, copyrights, currency, national defense and immigration"); *Eastern Equip. and Servs. Corp. v. Factory Point Nat'l Bank, Bennington*, 236 F.3d 117, 120 (2d Cir. 2001) (same).

Nowhere in section 1104 or elsewhere in the Bankruptcy Code is there a "regulatory exception" that conditions or limits the authority of bankruptcy judges to direct the appointment of a trustee in a case involving a regulated entity. As observed by the Supreme Court in *Federal Communications Comm'n v. Nextwave Personal Communications, Inc.*, 537 U.S. 293, 302, 123 S.Ct. 832 (2003), "where Congress has intended to provide regulatory exceptions to provisions of the Bankruptcy Code, it has done so clearly and expressly ..." An example of such a clear and express exception is section 362(b)(4) of the Bankruptcy Code, which specifies that the automatic stay otherwise applicable under 11 U.S.C. § 362(a)(1), (2), (3) & (6) to, *inter alia*, the commencement or continuation of judicial or administrative actions or proceedings against the debtor is inapplicable to

> the commencement or continuation of an action or proceeding by a governmental unit ... to enforce such governmental unit's or organization's police and regulatory power, including the enforcement of a judgment other than a money judgment, obtained in an action or proceeding by the governmental unit to enforce such governmental unit's or organization's police or regulatory power ...

11 U.S.C. § 362(b)(4). *See Village of Rosemont v. Jaffee*, ___ F.3d ___, 2007 WL 967046, p. 11 (7th Cir. 2007) (holding that this section "forbids the bankruptcy court from interfering with the government's police and regulatory powers"). There is, however, nothing in section 362(b)(4) or in any other provision of the Bankruptcy Code that restricts the bankruptcy court's ability to direct the appointment of a trustee in a chapter 11 case involving a regulated utility, nor is there any provision limiting or restricting the powers and duties of a trustee appointed pursuant to section 1104 in such a case. While 11 U.S.C. § 362 exempts from the purview of the automatic stay actions or proceedings by regulatory agencies to enforce their police and regulatory powers, such police and regulatory powers do not and cannot operate to restrict the powers and duties of bankruptcy courts either to oversee the administration of bankruptcy cases or to impose remedies in such cases that the Bankruptcy Code specifically authorizes or requires.

There is no suggestion in these cases that the Bankruptcy Court has ever sought to enjoin or otherwise interfere with any regulatory action or proceeding by or before the PSC. Compare *In re Yellow Cab Cooperative Association*, 132 F3d. 591 (10th Cir. 1997) (holding that bankruptcy court exceeded its authority in enjoining Public Utility Commission from restricting transfer of debtor's license to operate taxicabs, where Commission had based its decision on legitimate regulatory considerations). Cf. *Village of Rosemont v. Jaffee*, *supra* (upholding bankruptcy court's refusal to enjoin proceedings before Illinois Gaming Board to revoke debtor's riverboat gambling license). To the contrary, in its order granting the Trustee Motion the Bankruptcy Court specified that "the United States Trustee, upon entry of an order appointing a Chapter 11 trustee, shall advise said Chapter 11 Trustee of his/her obligation to confer with the PSC in all matters subject to the PSC's regulatory authority. *See* 30 V.I.C. 43(a)." R-450. In the event the PSC takes some future action to revoke Vitelco's franchise, terminate its license or otherwise restrict its ability to operate, the parties will be free to seek a ruling from the Bankruptcy Court at that time on the issue of whether and to what extent such action constitutes a lawful exercise of the PSC's "police and regulatory power" within the contemplation of section 362(b)(4). Clearly, however, the present appeals present no such issue.

CONCLUSION

For the foregoing reasons, the United States Trustee respectfully requests the Court to enter an order affirming the Bankruptcy Court's orders granting the Trustee Motion and denying the Responsible Officer Motion.

Respectfully submitted,
FELICIA S. TURNER
UNITED STATES TRUSTEE

By: ______________________________
Guy G. Gebhardt
Georgia Bar No. 288550
Assistant United States Trustee

____
James H. Morawetz
Georgia Bar No. 521900
Trial Attorney

United States Department of Justice
Office of the United States Trustee
Suite 362, 75 Spring Street, SW

Atlanta, GA 30303
Telephone: (404) 331-4437
Facsimile: (404) 331-4464
Email: Guy.Gebhardt@usdoj.gov

Dated: May 3, 2007

BRIEF BANK — "SUMMARY SHEET"

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WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*
In re Innovative Communication Company, LLC (UST v. Innovative) and
In re Emerging Communication, Inc. (UST v. Emerging)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*
D. V.I.

3. ("CCN") ***CURRENT*** CASE NO.
No.: 2007-36 & 2007-37

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*
No.: 06-30008 & 06-30007
Court: D. V.I.
(Identify judge & cite, if any)

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U.S. TRUSTEES

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*
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(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s)
&
√ Any Miscellaneous ***BACKGROUND***

•(1)Whether the Bankruptcy Court abused its discretion in ordering the appointment of a chapter 11 trustee. (2) Whether the Bankruptcy Court erred in denying Appellants' motion for the appointment of a "Responsible Officer." (3) Whether section 43a of title 30 of the Virgin Islands Code precluded the appointment of a federal bankruptcy trustee.

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IN THE DISTRICT COURT OF THE VIRGIN ISLANDS
DIVISION OF ST. THOMAS AND ST. JOHN

In re:	D.C. APP. CIVIL NO. 2007-36
INNOVATIVE COMMUNICATION COMPANY, LLC,	Bankr. Case No. 06-30008 (JKF)
Debtor.	
In re:	D.C. APP. CIVIL NO. 2007-37
EMERGING COMMUNICATIONS, INC.,	Bankr. Case No. 06-30007 (JKF)
Debtor.	

BRIEF OF UNITED STATES TRUSTEE AS APPELLEE

On Appeal from the District Court of the Virgin Islands
Division of St. Thomas and St. John, Bankruptcy Division

GUY G. GEBHARDT
Assistant United States Trustee
Georgia Bar No. 288550

JAMES H. MORAWETZ
Trial Attorney
Georgia Bar No. 521900

United States Department of Justice
Office of the United States Trustee
362 Richard B. Russell Building
75 Spring Street, SW
Atlanta, GA 30303
(404) 331-4437

Attorneys for Appellee Felicia S. Turner
United States Trustee, Region 21

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STATEMENT OF BASIS OF APPELLATE JURISDICTION

This Court has jurisdiction over these appeals under 28 U.S.C. § 158(a).

STATEMENT OF ISSUES

The issues before this Court on appeal are:

1. Whether the Bankruptcy Court abused its discretion in ordering the appointment of a chapter 11 trustee.
2. Whether the Bankruptcy Court erred in denying Appellants' motion for the appointment of a "Responsible Officer."
3. Whether section 43a of title 30 of the Virgin Islands Code precluded the appointment of a federal bankruptcy trustee in this federal bankruptcy case.

APPLICABLE STANDARD OF REVIEW

A district court applies a clearly erroneous standard to a bankruptcy court's findings of fact and conducts a *de novo* review of conclusions of law. *See* Fed. R. Bankr. P. 8013. *See, e.g., In re Winthrop Nurseries, Inc.*, 50 F.3d 72, 73 (1st Cir. 1995); *Resyn Corp. v. United States*, 851 F.2d 660, 664 (3d Cir.1988); *In re Jersey City Medical Center*, 817 F.2d 1055, 1059 (3d Cir.1987). A district court reviews a bankruptcy court's decision to appoint a chapter 11 trustee for abuse of discretion "under either section of [11 U.S.C.] § 1104(a) . . . . " *In re G-I Holdings, Inc.*, 295 B.R. 502, 508 (D. N.J. 2003), *affirmed*, *Official Committee of Asbestos Claimants v. G-I Holdings, Inc. (In re G-I Holdings, Inc.)*, 385 F.3d 313, 318 (3d Cir. 2004).

STATEMENT OF THE CASE

Appellants Emerging Communications, Inc. ("**Emerging**"), and Innovative Communication Company, LLC ("**ICC, LLC**") (collectively, the "**Corporate Debtors**"), commenced these cases by filing voluntary petitions for relief under chapter 11 of the Bankruptcy Code in the Bankruptcy Division of this Court (the "**Bankruptcy Court**") on July 31, 2006.[1] The Corporate Debtors' principal, Jeffrey J. Prosser ("**Prosser**"), likewise filed a voluntary petition in the Bankruptcy Court on that date for relief under chapter 11 of the Bankruptcy Code and has joined with the Corporate Debtors in filing these appeals.

On February 10, 2006, prior to the commencement of these cases, creditors Greenlight Capital Qualified, L.P., Greenlight Capital, L.P., and Greenlight Capital Offshore, Ltd. (collectively, the "**Greenlight Entities**"), filed involuntary petitions for relief under chapter 11 of the Bankruptcy Code against the Appellants in the United States Bankruptcy Court for the District of Delaware (the "**Delaware Court**"). On February 13, 2006, the Appellants filed motions in the Delaware Court to transfer venue of these involuntary cases to the Bankruptcy Court, and on December 14, 2006, the two courts entered orders granting those motions. (R-203).[2]

As acknowledged at page 12 of their brief, the Corporate Debtors are holding companies with no business operations or employees. Prosser owns 100% of the stock of Appellant ICC,

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[1] Each petition is identified as Docket No. R-1 in the record of its respective case.

[2] Virtually all the documents comprising the record on appeal were filed in both bankruptcy cases and assigned separate docket numbers in the two cases. For example, the order determining that venue is proper in this Court was filed as Docket No. 203 in the Emerging case (No. 06-30007) and as Docket No. 193 in the ICC, LLC case (No. 06-30008). Unless otherwise noted, references to such documents in this brief are to the docket number assigned to the document in the Emerging case (No. 06-30007), without any reference to that case number.

LLC, which in turn owns or controls 100% of the stock of Appellant Emerging, 52% through direct ownership and the remaining 48% through its ownership of the remaining shareholder, Innovative Communications Subsidiary Company, LLC. Through non-debtor subsidiaries, the Corporate Debtors own or control various operating entities including Vitelco, the Virgin Islands telephone company. *Id*. Vitelco is a public utility operating under a franchise granted by the U.S. Virgin Islands government and is regulated by the Virgin Islands Public Services Commission (the "**PSC**").

In a Memorandum Opinion entered with the orders that are the subject of these appeals, the Bankruptcy Court found as an undisputed fact that the Greenlight Entities and the Rural Telephone Finance Corporation (the "**RTFC**") together hold at least 90 percent of the outstanding debt against the Corporate Debtors. (R-448, p. 8).[3] The claim of the Greenlight Entities derives from two judgments entered in the Delaware Chancery Court, one for $28.5 million against Emerging and the other for $56 million against ICC, LLC, Prosser, and a dissolved U.S. Virgin Islands corporation referred to by the parties as "Old ICC."[4] *Id.*, pp.3-5. The RTFC's claim arises from loans to New ICC in excess of $500 million that are secured by, *inter alia*, guarantees and stock pledges from the Corporate Debtors and Prosser. The Greenlight Entities and the RTFC assert judgment liens against the Appellants for these claims. *Id.*, p.4.

Between the filing of the involuntary petitions in Delaware and the filing of the voluntary petitions that commenced the present cases, the Appellants, New ICC, the Greenlight Entities and the RTFC entered into a settlement agreement (the "**Settlement**") providing, *inter alia*, that

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[3] This Memorandum Opinion will hereafter be cited as "**Mem. Op.**," followed by the page number.

[4] Old ICC was the predecessor in interest to Innovative Communications Corporation (referred to by the parties as "**New ICC**"), a nondebtor subsidiary of Emerging that owns a number of cable and telecommunications companies, including Vitelco.

Appellants would have until July 31, 2006, to make a discounted payment to the Greenlight Entities in the amount of $402 million in full satisfaction of their respective claims. Mem. Op., p. 6. Since the execution of that agreement, the Appellants have been attempting to secure financing to fund the Settlement. Appellants filed their voluntary chapter 11 petitions on July 31, 2006, when they were unable to secure such financing, and therefore unable to make the discounted payment contemplated by the Settlement, by that date. At that time, Appellants advised the Bankruptcy Court that they intended to use the sixty-day window afforded by 11 U.S.C. § 108[5] to continue their efforts to secure financing to fund the Settlement. *Id.*, p. 7.

Although they had not yet secured binding financing commitments, the Corporate Debtors filed a joint motion to assume the Settlement on September 25, 2006. (R-24). On September 28, 2006, the Bankruptcy Court entered a scheduling order setting a hearing on that motion for November 27, 2006, and directing the Corporate Debtors to file an amended assumption motion on or before November 3, 2006, with a binding commitment that had no financing contingencies or unsatisfied due diligence conditions. (R-26). The Corporate Debtors filed an amended assumption motion on November 3, 2006 (R-82), but without the required binding commitment. On November 8, 2006, after a hearing, the Bankruptcy Court denied the

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[5] 11 U.S.C. § 108 provides, in pertinent part, as follows:

> (b) Except as provided in subsection (a) of this section, if applicable nonbankruptcy law, an order entered in a nonbankruptcy proceeding, or an agreement fixes a period within which the debtor or an individual protected under section 1201 or 1301 of this title may file any pleading, demand, notice, or proof of claim or loss, cure a default, or perform any other similar act, and such period has not expired before the date of the filing of the petition, the trustee may only file, cure, or perform, as the case may be, before the later of--
>
> > (1) the end of such period, including any suspension of such period occurring on or after the commencement of the case; or
> >
> > (2) 60 days after the order for relief.

Corporate Debtors' request to assume the Settlement agreement due to "impossibility of performance." (R-99).

On November 22, 2006, the Corporate Debtors filed a joint motion to extend the period in which they had the exclusive right to file a chapter 11 plan and disclosure statement. (R-133). In that motion, the Corporate Debtors revealed that they had terminated the letter of intent upon which their amended motion to assume the Settlement was predicated so they could pursue a transaction with the government of the Virgin Islands to sell assets of the subsidiary operating companies on which the value of the stock held by Appellants is predicated. On December 4, 2006, during a hearing on their motion to extend the exclusivity period, the Bankruptcy Court, "noting the distrust existing between the major constituencies in this matter and the … continuing inability [of the Appellants] to obtain any commitment for the sale of assets, suggested that the appointment of a trustee might be appropriate in these cases."[6] The Corporate Debtors responded by filing a "Joint Motion For Entry of an Order Appointing a Responsible Officer for the Corporate Debtors" (the "**Responsible Officer Motion**") on December 7, 2006. (R-186).[7] The United States Trustee, the Greenlight Entities and the RTFC filed objections to the Responsible Officer Motion (R-275, R-229, R-258), and on December 19, 2006, the United States Trustee filed a motion seeking the appointment of a chapter 11 trustee (the "**Trustee Motion**") (R-209), in which the Greenlight Entities and the RTFC later joined. (R-212, R-256). After full evidentiary hearings, briefing, and argument, the Court entered orders denying the

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[6] Mem. Op., p.8; Transcript of December 4, 2006, Hearing, pp. 71-72, 93-94 (R-198).

[7] In addition, Appellants filed a joint Plan of Reorganization (the "**Plan**") on January 8, 2007 (R-294), but without the disclosure statement required under 11 U.S.C. § 1125 to enable them to solicit votes in favor of confirmation of the Plan. At a subsequent hearing held on January 19, 2007, Appellants' counsel stipulated that the Plan "as currently drafted" was not, in any event, confirmable. Transcript of January 19, 2007 hearing, p. 103 (R-394).

Responsible Officer Motion (R-449) and granting the Trustee Motion (R-450) on February 13, 2007,[8] accompanied by the Memorandum Opinion. Appellants filed their respective notices of appeal on February 20, 2007.[9]

SUMMARY OF ARGUMENT

Bankruptcy courts possess broad discretion when determining whether to appoint chapter 11 trustees. The court below did not abuse that discretion in this case. **First**, there was broad consensus that a trustee was needed. The entities holding over 90% of the debt in the case wanted a trustee, as did the United States Trustee, the federal watchdog official charged with supervising the administration of bankruptcy cases.[10] **Second**, the animosity and lack of cooperation between the bankrupt entities and their creditors supported the appointment of a trustee under well-established Third Circuit precedent. **Third,** the existence of conflicts of interests between Prosser and the bankruptcy estates supported the appointment of a trustee. **Fourth**, the bankrupt entities' improper calculation of the claims against the Corporate Debtors justified a trustee. **Last**, were there any question on this point, Appellants' motion asking that a

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[8] The Court also entered an order on that date denying a motion by the Greenlight Entities to convert Prosser's individual chapter 11 case, *In re Jeffrey J. Prosser*, Case No. 06-30009 (JFK), to chapter 7. Instead, the Court ordered the appointment of an examiner in that case.

[9] On February 21 and February 22, 2007, the PSC, as "Intervenor," also filed notices of appeal from these orders. The PSC's notice of appeal in the Emerging case appears as R-472 in the record of that case, and that appeal is docketed in this Court as D.C.APP. Civ. No. 2007-38. The PSC's notice of appeal in the ICC, LLC case appears as R-451 in the record of that case, and that appeal is docketed in this Court as D.C.APP. Civ. No. 2007-39. The PSC has not prosecuted either appeal.

[10] United States Trustees are officials of the Department of Justice appointed by the Attorney General to supervise the administration of bankruptcy cases. *See* 28 U.S.C. §§ 581-89; *In re Columbia Gas Systems, Inc.*, 33 F.3d 294, 296 (3d Cir. 1994) (noting that United States Trustees oversee bankruptcy process, protect public interest, and ensure bankruptcy cases are conducted according to law) (citing H.R. Rep. No. 95-595 at 109 (1977)).

neutral “Responsible Officer” be appointed by the Bankruptcy Court constitutes an admission of their inability to negotiate a resolution of the disputes impeding resolution of these cases without the type of impartial oversight that a trustee brings to a bankruptcy case. Although Appellants contend that the Bankruptcy Court erred in declining to appoint a Responsible Officer rather than a trustee, the Bankruptcy Code does not provide for the appointment of any such undefined entity to administer a chapter 11 case, and the court appropriately followed federal law by appointing a statutory trustee instead.

Finally, appellants make the remarkable suggestion that section 43a of title 30 of the Virgin Islands Code conflicts with and supersedes the federal statute, 11 U.S.C. § 1104(a), that authorizes the bankruptcy court to appoint a trustee in a federal bankruptcy case. The Virgin Islands statute in question provides that “[n]o person or corporation ... shall sell, acquire or transfer control, either directly, or indirectly of any public utility organized and doing business in this Territory, without first securing authorization from the [Public Services] Commission.” 30 V.I.C. § 43a(a). First, neither of the Corporate Debtors is a regulated utility. Rather, each is a non-regulated holding company. Second, any change of control with respect to the Corporate Debtors that took place as a result of the Bankruptcy Court’s decision to appoint a trustee resulted not from a “transfer” by a “person or corporation” but from an order of the Bankruptcy Court in a case under its jurisdiction. Third, if there were any conflict between Virgin Islands law and section 1104(a) of the Bankruptcy Code, section 1104(a) would control under the Supremacy Clause.

ARGUMENT

I. THE BANKRUPTCY COURT DID NOT ABUSE ITS DISCRETION IN ORDERING THE APPOINTMENT OF A TRUSTEE.

The standards governing the appointment of a trustee in a chapter 11 case are set forth in section 1104(a) of the Bankruptcy Code, as follow:

> (a) At any time after the commencement of [a chapter 11] case but before confirmation of a plan, on request of a party in interest or the United States trustee, and after notice and a hearing, the court *shall* order the appointment of a trustee:
>
>> (1) for cause, including fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor by current management, either before or after the commencement of the case, or similar cause, but not including the number of holders of securities of the debtor or the amount of assets or liabilities of the debtor;
>>
>> (2) if such appointment is in the interests of creditors, any equity security holders, and other interests of the estate, without regard to the number of holders of securities of the debtor or the amount of assets or liabilities of the debtor; or
>>
>> (3) if grounds exist to convert or dismiss the case under section 1112, but the court determines that the appointment of a trustee or an examiner is in the best interests of creditors and the estate.

11 U.S.C. § 1104 (emphasis supplied). If a bankruptcy court orders the appointment of a chapter 11 trustee pursuant to section 1104(a), then 11 U.S.C. § 1104(d) requires the United States Trustee to appoint, after consultation with parties in interest and subject to the court's approval, a "disinterested person" to serve in that capacity.

The Third Circuit has held that " '[t]he party moving for appointment of a trustee ... must prove the need for a trustee under either subsection [1104(a)(1) or 1104(a)(2)] by clear and convincing evidence,' " *Official Committee of Asbestos Claimants v. G-I Holdings, Inc. (In re G-I Holdings, Inc.)*, 385 F.3d *supra*, at 317-18, quoting *In re Marvel Entertainment Group, Inc.*, 140 F.3d 463, 473 (3d Cir. 1998),[11] but that "determining whether the moving party has satisfied its burden under either subsection is committed to the court's discretion." *Id.*, 385 F.3rd at 318.

"The Court has particularly wide discretion under subsection (a)(2), [which] sets forth a flexible standard for appointment of a trustee even when no cause exists." *In re Bellevue Place Associates*, 171 B.R. 615, 623 (Bankr. N.D.Ill. 1994). *Accord In re Ionosphere Clubs, Inc.*, 113 B.R. 164, 168 (Bankr. S.D.N.Y. 1990) ("Code § 1104(a)(2) creates a flexible standard and allows the appointment of a trustee even when no 'cause' exists"), citing *In re Sharon Steel Corp.*, 871 F.2d 1217, 1226 (3d Cir. 1989); *In re V. Salvino Oil & Heating* Co., 99 B.R. 518, 527, n. 11 (Bankr. E.D.N.Y. 1989) ("factors constituting a basis for appointing a trustee under section 1104(a)(2) are amorphous, diverse and necessarily involve a great deal of judicial discretion"). Further, "[i]n considering what is in the interests of creditors in connection with [a section 1104(a)(2) motion], 'a bankruptcy judge has broad discretion to take judicial notice of the entire file ... and the outcome of previous proceedings brought before the court.'" *In re U.S. Mineral Products Co.*, 105 Fed.App'x. 428, 431 (2004 WL 1758499, p.2) (3d Cir. 2004), quoting from Barry Russell, *Bankruptcy Evidence Manual* § 201.6 (2004).

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[11] There is no statutory basis for requiring clear and convincing evidence to establish the need for the appointment of a trustee in a chapter 11 case. See 2 Queenan, CHAPTER 11 THEORY AND PRACTICE § 14.04. Requests for the appointment of trustees in chapter 11 cases are brought by motion as contested matters under Rule 9014, as are all matters not specified in Rule 7001. *See* Fed. R. Bankr. P. 9014(a). There is no good reason to subject a request for a trustee under Rule 9014 to a heightened standard of proof. To the contrary, the Supreme Court has stated that civil matters typically need not be decided under such heightened standards. *Grogan v. Garner*, 498 U.S. 279, 286, 111 S.Ct. 654, 659, 112 L.Ed.2d 755 (1991) ("... we presume that ... [the preponderance] ... standard is applicable in civil actions between private litigants unless 'particularly important individual interests or rights are at stake.'"). The question of whether to appoint a trustee in a chapter 11 case is not such an important matter as to require a heightened standard of proof, particularly since Congress allows chapter 11 trustees to be appointed without cause under subsection 1104(a)(2). However, the applicability of the clear and convincing evidence standard is not determinative of the outcome of this appeal, inasmuch as the Bankruptcy Court applied that standard. See, e.g., Mem. Op., pp.14, 16, & 17.

Among the factors courts consider in determining whether to appoint a chapter 11 trustee under section 1104(a)(2) are: (1) the trustworthiness of the debtor; (2) the debtor's past and present performance and prospects for the debtor's reorganization; (3) confidence, or lack thereof, of the business community and creditors in present management; and (4) the benefits derived by appointment of a trustee, balanced against the costs of appointment. *See In re Ionosphere Clubs, Inc.*, *supra*, 113 B.R. at 168; *In re Colorado-Ute Elec. Ass'n, Inc.*, 120 B.R. 164, 176 (Bankr. D.Colo. 1990).

"Section 1104(a) represents a potentially important protection that courts should not lightly disregard or encumber with overly protective attitudes towards debtors-in-possession." *In re V. Salvino Oil & Heating* Co., *supra*, 99 B.R. at 525. *Accord In re Nartron Corp.*, 330 B.R. 573, 591-2 (Bankr.W.D.Mich. 2005) (while "[t]here is a strong presumption in Chapter 11 cases that the debtor-in-possession should be permitted to remain in control of the corporation absent a showing of need for the appointment of a trustee ... [n]evertheless, in the appropriate case, the appointment of a trustee is a power which is critical for the court to exercise in order to preserve the integrity of the bankruptcy process and to insure that the interests of creditors are served."). Indeed, "the Court is *required* to appoint a trustee [under subsection (a)(2)] when doing so addresses 'the interests of the creditors, equity security holders and other interests of the estate.'" *In re Bellevue Place Associates*, supra, 171 B.R. at 623, citing *Committee of Dalkon Shield Claimants v. A.H. Robins Co., Inc.*, 828 F.2d 239, 240 (4th Cir. 1987) (emphasis supplied).

A. The Evidence of Record Established Ample Support for a Determination that the Appointment of a Trustee Was in the Interests of the Bankruptcy Estate and Its Creditors.

" '[A]n abuse of discretion exists where the district court's decision rests upon a clearly erroneous finding of fact, an errant conclusion of law, or an improper application of law to fact.'

In re SGL Carbon Corp., 200 F.3d [154], at 159 [(3d Cir. 1999)] (quoting *ACLU v. Black Horse Pike Reg'l Bd. of Ed.*, 84 F.3d 1471, 1476 (3d Cir. 1996))." *In re Integrated Telecom Express, Inc.*, 384 F.3d 108, 118 (3d Cir. 2004). The Bankruptcy Court clearly did not predicate its decision to appoint a trustee in this case upon on any erroneous finding of fact, errant conclusion of law, or improper application of law to fact. The Bankruptcy Court articulated the following reasons for its decision to direct the appointment of a trustee, all of which were supported by the evidence of record and any one of which was sufficient by itself to support that decision.

1. Animosity and lack of cooperation and trust between Appellants and their major creditors.

The Bankruptcy Court observed that there had been a notable lack of progress in resolving disputes over the amount and status of the claims in the cases and in negotiating a sale or refinancing of the assets of the non-debtor operating entities in order to generate funds to pay those claims, stating:

> The parties quite candidly argue that the case is all about control of the negotiation process. The creditors have no confidence in Prosser, and Prosser has no trust in them. Thus, the only way to get all parties to cooperate is to put a neutral person in charge of the process. Cooperation is vital to the reorganization of the Debtors. If the parties cannot agree to the amount and status of the claims, the cases may be in litigation for many more years, while Debtors make no payments on the judgments or on accruing interest or even on the $402 million that was agreed to under the Terms and Conditions. Further, no buyer has stepped forward with an offer to show what the fair value of the enterprise is, no one has tried to value the components of the enterprise to determine just how much of the allegedly secured claims are really supported by value and, in general, the process is mired.
>
> Thus, until someone other than Prosser or the creditors assumes the responsibility for finalizing a deal, it appears that one will never be reached.

Mem. Op., p.11. In addition, the Court observed:

> Debtors have appeared before the court numerous time[s], ... each time reporting that a binding commitment was forthcoming. To date, despite all of Debtors' assurances, no binding commitment has been obtained and none is any longer

> promised. The record, therefore, clearly and convincingly refutes Debtors' assertions of "progress" and shows, instead, efforts that have led to nothing more than a holding pattern. ...
>
> [U]nfortunately, the parties are now embarked on a course of litigation in these cases which, coupled with the acrimony between them, clearly and convincingly demonstrates to the court that a neutral party is needed to investigate and determine whether or not to pursue (or defend, as the case may be) actions on behalf of the estates.

Id., p.16.

These concerns were well supported by the record. As previously indicated, Appellants filed these cases because they were unable to obtain the financing necessary to make the discounted payment in the amount of $402 million needed to satisfy the claims of the Greenlight Entities and the RTFC under the terms of the pre-petition Settlement. At page 13 of their brief, Appellants assert that their "primary goal in these chapter 11 cases has been to obtain [such] financing ..." They have yet, however, to demonstrate that this goal is within their reach. They were unable obtain such financing either before the expiration of the deadline established by the Settlement or within the additional 60-day window they contend 11 U.S.C. § 108 provided them, and they were likewise unable to obtain a commitment for such financing to support their amended motion to assume the Settlement filed on November 4, 2006, long after that 60-day window had closed. On December 3, 2006, after the Bankruptcy Court denied their motion to assume the Settlement based on "impossibility of performance," the Corporate Debtors filed a motion for sanctions against the RTFC, alleging, *inter alia*, that the RTFC had "engaged in a lengthy and deliberate pattern of underhanded stratagems designed to prevent the Debtors from reorganizing in these proceedings" and had engaged in "a transparent effort ... to sabotage the Debtors' stated goal of selling their Virgin Islands business operations to the Government of the

Virgin Islands, in order to effect a reorganization." (R-165).[12] Thereafter, on January 8, 2007, Appellants filed a joint Plan of Reorganization (R-294) that they conceded, at a hearing held on January 19, 2007, was not confirmable. (R-394, p. 103).

Courts have repeatedly held that mistrust, lack of cooperation and acrimony between a chapter 11 debtor and its creditor constituency may support the appointment of a chapter 11 trustee when such circumstances create an obstacle to progress in the case. See *In re Marvel Entertainment Group, Inc.*, *supra*, 140 F.3d at 472-5 (court may exercise its discretion to direct appointment of trustee when parties are "sharply divided on many issues, and are presently incapable of resolving them") (internal quotation marks omitted); *In re U.S. Mineral Products Co.*, *supra*, 105 Fed. App'x. at 430, 2004 WL 1758499, p.2 (upholding *sua sponte* order directing appointment of trustee "based on the length of time the proceedings had been pending, the size of the case, the contentious and acrimonious nature of the relationships among the parties, the lack of trust, the lack of progress, and the need for a neutral party to 'maximize value and construct a plan ... acceptable to creditors' "); *Petit v. New England Mortg. Services Inc.*, 182 B.R. 64, 70 (D.Me. 1995) ("deep-seeded conflict and animosity between a debtor and its creditors provides a basis for the appointment of a trustee"); *In re The Bible Speaks*, 74 B.R. 511, 512 (Bankr. D.Mass. 1987) (citing, as lead reason for appointment of trustee, "[f]riction ... between the Debtor and the Creditors' Committee which threatens to engulf this estate in costly and legalistic bickering over the entire range of the reorganization process").

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[12] The Bankruptcy Court denied this motion without prejudice on December 4, 2006, because it was not filed in accordance with a Case Management Order entered in the case, and the Appellants filed another such motion on December 18, 2006 (R-207). The Bankruptcy Court entered an order withdrawing that motion with prejudice on February 6, 2007.

As acknowledged at page 12 of their brief on appeal, the Corporate Debtors are holding companies with no business operations or employees. The only personal property assets listed in their bankruptcy schedules filed in the case consist of stock in other companies. R-37 (Case No. 06-30007); R-38 (Case No. 06-30008). The parties agree that the only way to achieve a successful disposition of these cases is to assess the value of that stock, obtain cash for it through a sale or refinancing of the non-debtor subsidiaries, determine the amount and priority of the claims in the cases, and distribute the funds to creditors.[13] The Bankruptcy Court was fully authorized to determine from the extensive record before it whether and to what extent Appellants were making progress towards these goals and whether and to what extent the mistrust, lack of cooperation and acrimony between the parties constituted an obstacle to such progress. While Appellants complain that the Court was placing unrealistic expectations on them "to close a complex telecommunications sale transaction in an extremely short time period," Appellants' Brief, p. 21, there is nothing in the Memorandum Opinion that supports this assertion. Rather, it is apparent that all the Court was looking for was progress towards a sale or refinancing of the assets and a resolution of the claims disputes. See, e.g., Mem. Op., p.16.

2. Conflicts of interest.

The Court also ordered a trustee due to the danger that Prosser's personal economic interest in realizing income from the Corporate Debtors and the non-debtor subsidiaries would conflict with the interests of creditors in effectuating a prompt sale:

> [A]lthough ... Prosser's investment banker ... testified that he has not seen Prosser refuse to negotiate with entities that express no interest in retaining him in some capacity, the court heard no evidence from anyone as to what Prosser would do for income in the event that the companies are all sold out from under him. He

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[13] At page 13 of their brief on appeal, Appellants assert that their "primary goal in these chapter 11 cases has been to obtain financing (whether through a sale of stock or assets, or a refinancing) that will permit [them] to enforce the Settlement Agreement."

> has substantial personal debts and contributes to the payment of his wife's debts. His wife is not employed but many of the assets valued at several million dollars (and subject to debts of millions of dollars) are titled in her name. Because of this circumstance, the court is not convinced that Prosser can distance himself from the negotiations sufficiently to consider the obligations he owes his creditors before his own interests.
>
> This is not to say that a neutral negotiator should not also consider Prosser's interests. Those interests should be considered and be part of the chapter 11 plan negotiation process. However, they should not have a more predominant role than any other factor. A trustee with fiduciary status is needed to insure that there is fundamental fairness to all concerned.

Mem. Op., p.13. The Bankruptcy Court additionally observed:

> The audited consolidated financial statements show "net advances" to Prosser of approximately $13 million in 2005 and 2004 and of over $14 million in 2003, at a time when Prosser was personally indebted to New ICC in an amount in excess of $156 million. Prosser testified that ICC LLC, not he, was the recipient of all of the net advances except annual advances of approximately $1 to $2 million … Even if true, Prosser is the sole owner of ICC LLC and directly benefits from advances to it by utilizing it as a "check the box" corporation which he reports on his personal tax returns. Moreover, Prosser admits that neither he nor ICC LLC can repay the advances.

Id., pp.25-6 (footnotes omitted).

The Court clearly did not abuse its discretion by concluding that these undisputed facts weighed in favor of the appointment of a trustee. The existence of such potential conflicts of interest may constitute sufficient cause for the appointment of a chapter 11 trustee, regardless of whether there is evidence that the debtor has taken action contrary to the interests of the estate. *See In re Cajun Elec. Power Coop., Inc.*, 74 F.3d 599, 600 (5th Cir. 1996), *cert. denied*, 519 U.S. 808 (117 S.Ct. 51, 136 L.Ed.2d 15) (1996). *Accord In re Marvel Entertainment Group, Inc.*, *supra*, 140 F.3d at 473.

3. By filing the Responsible Officer Motion, Appellants acknowledged that it was in the best interests of the bankruptcy estate and its creditors for Prosser to cede control of the negotiations for a sale and/or refinancing.

The Court was certainly authorized to conclude, as it did at page 8 of the Memorandum Opinion, that in filing the Responsible Officer Motion the Corporate Debtors had acknowledged the need for an independent fiduciary to replace Prosser at the negotiating table and otherwise assume control over the administration of the case. As a result of this motion, the Court was not faced with a choice between appointing a chapter 11 trustee or allowing the Corporate Debtors to remain in possession but with a choice between replacing Prosser with a "Responsible Officer," with powers and duties to be defined by agreement of the parties, or replacing him with a chapter 11 trustee with powers and duties defined by the Bankruptcy Code.

As it turned out, of course, the parties were unable to agree on what the powers and duties of the proposed "Responsible Officer" would be. At page 44 of their brief on appeal, however, Appellants assert that Prosser "was prepared to cede ultimate control of the sale or financing process to the Responsible Officer …," and in the Responsible Officer Motion filed on December 7, 2006, they proposed that the powers of the Responsible Officer would be as follows:

> The Responsible Officer will be an officer of the Court. The Responsible Officer will have the sole power and authority to agree, on behalf of the Debtors or any of the Debtors' affiliates, to sell or otherwise dispose of the shares of common stock in the Virgin Islands Telephone Company ("Vitelco"). The Responsible Officer will be entitled to be present at, and involved in, all negotiations conducted by the Debtors or their agents in connection with the sale of the Debtors' direct or indirect assets in Vitelco.

(R-186, pp.5-6, ¶14.

Remarkably, while maintaining that they intended for the Responsible Officer to assume complete control of the negotiations for the sale or refinancing of the assets of the non-debtor subsidiaries, Appellants state at pages 42-43 of their brief that they did not intend for the Responsible Officer to act as an independent fiduciary for creditors. In the face of Appellants' unwillingness to allow these negotiations to be conducted by someone with a legal obligation to act for the benefit of creditors, the Bankruptcy Court clearly did not abuse its discretion in concluding that it was in the interests of the bankruptcy estate and its creditors to appoint a trustee.

B. The Bankruptcy Court Did Not Err in Considering Appellants' Failure to Account for the Accrual of Interest on the Debts of the RTFC and the Greenlight Entities as a Factor Weighing in Favor of a Trustee.

Appellants contend at page 24 of their brief on appeal that the Bankruptcy Court erred in considering their failure to account for the accrual of interest on the claims held by the RTFC and the Greenlight Entities as a factor militating in favor of the appointment of a trustee. In this regard, the Court stated:

> There are other issues that must be addressed by someone outside the Prosser organization. One issue involves the financial statements of the Prosser parties. Witnesses experienced in accounting principles testified that financial statements must continue to reflect accumulated interest until there is a final determination that the obligation underlying the interest is no longer due. This is so even though the company may dispute the obligation to pay interest. In this case, Prosser disputes the obligation to pay interest due to the negotiated $402 million discounted payment. However, whether the discount is still applicable is itself in dispute. Nonetheless, the consolidated financial statements for the Prosser entities are no longer reflecting accumulating and unpaid interest on the final judgments that likewise remain unpaid. … Not reporting the dispute or reflecting the possibility that [interest] will be added to the debt of the Debtors (either as principals or as guarantors) is clearly a material matter that requires someone with no tie to Prosser to investigate. The independence of a trustee is needed for this purpose.

Mem. Op., pp.11-12 (footnotes omitted).

Appellants contend that the Court erred in considering this issue because the claims in question had been accelerated, with the result that the RTFC and the Greenlight Entities were seeking “unmatured interest,” which is not allowed under 11 U.S.C. § 502(b)(2). However, assuming for purposes of argument that this contention is correct, it does not follow that the RTFC and the Greenlight Entities do not have valid claims in these cases for matured interest. Appellants cannot reasonably contend that the filing of these cases had the effect of eliminating the continued accrual of interest on over $500 million in secured debt.[14] The Bankruptcy Court did not err in treating the issue of whether and to what extent the Appellants should account for the accrual of interest on these claims as a “material matter that requires someone with no tie to Prosser to investigate.”

C. In Reaching its Decision to Appoint a Trustee, the Bankruptcy Court Quite Clearly Weighed the Benefits Against the Cost of Doing So.

Appellants contend at page 38 of their brief that “[t]he Bankruptcy Court abused its discretion in failing to consider the harm that the appointment of a trustee would have on the Debtors and their various constituencies.” First, it is not clear what “constituencies” are at risk in these bankruptcy cases other than Appellants’ creditors and Prosser. The Corporate Debtors’ continued business operations are not in jeopardy since they are holding companies that have no business operations.[15] Their material assets consist of stock in other companies, and a trustee does not jeopardize Appellants’ financial stake in those companies. Moreover, the RTFC and the Greenlight Entities, which joined in the Trustee Motion, hold over 90% of the debt in the cases. It is presumably in the economic interest of these creditors to pursue a course that maximizes the value of the non-debtor operating entities on which the value of their asserted liens on the Corporate Debtors’ stock depends, and they have evidently concluded that the

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[14] Whether and to what extent there is sufficient value to pay such interest is, of course, a different question.

[15] Appellants’ brief, p. 12.

appointment of a trustee will have a more salutary effect on that value than would the Corporate Debtors' continued administration of the cases as debtors in possession. For the reasons set forth *supra* in this brief, the Bankruptcy Court was authorized to conclude that the appointment of a trustee would assist in realizing the "sale of stock or assets or a refinancing" that Appellants concede is central to the success of these cases.[16] Appellants' contention at page 38 of their brief that as a result of the Bankruptcy Court's decision to appoint a trustee "the PSC will likely take action against New ICC and the [non-debtor operating entities] for violating 30 V.I.C. § 43a" is addressed in Section III of this Brief, *infra*.

II. THE BANKRUPTCY COURT DID NOT ERR IN DENYING APPELLANTS' MOTION FOR THE APPOINTMENT OF A "RESPONSIBLE PERSON."

Although some courts have allowed it, the appointment of a "Responsible Officer," as opposed to a trustee, to assume the administration of a chapter 11 case from a debtor in possession is not a remedy contemplated by the Bankruptcy Code. *See In re SunCruz Casinos, LLC*, 298 B.R. 821, 832 (Bankr. S.D.Fla. 2003) ("The Code does not contemplate appointment of a 'Responsible Person' to perform the duties of a trustee."). As noted by the Bankruptcy Court at page 9 of the Memorandum Opinion, in cases in which this device has been employed, either the debtor had no existing management, as in *Matter of FSC Corporation*, 38 B.R. 346 (Bankr. W.D.Pa. 1983), or no party lodged an objection to it, as in *Matter of Gaslight Club, Inc.*, 782 F.2d 767 (7th Cir. 1986). *Accord In re Communication Options, Inc.*, 299 B.R. 481, 482 (Bankr. S.D.Ohio 2003). Appellants have cited no authority supporting the appointment of a "Responsible Officer" to take over the administration of a chapter 11 case from a debtor in possession where, as here, the United States Trustee and creditors opposed the request and

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[16] See Appellants' brief, p. 13.

instead sought the appointment of a chapter 11 trustee under 11 U.S.C. § 1104, and existing authority is in fact to the contrary. *See, e.g., In re Stratesec, Inc.*, 324 B.R. 158, 160-161 (Bankr. D.D.C. 2004) (declining to appoint receiver for debtor corporation as responsible officer absent proof that all creditors supported motion). *See also In re Adelphia Communications Corp.*, 336 B.R. 610, 668 (Bankr. S.D.N.Y. 2006) (characterizing request for appointment of non-trustee fiduciary to act on behalf of estate as "back-door means of circumventing the statutory requirements, and case law, applicable to the appointment of trustees under section 1104") ; *In re Freedlander, Inc.*, 86 B.R. 66, 68 (Bankr. E.D. Va. 1988) ("A review of case authority allowing the substitution of management as an alternative to proceeding with a hearing on the appointment of a trustee reflects that such an alternative is only available when there is a consensus to such a course of action.").

III. SECTION 43A OF TITLE 30 OF THE VIRGIN ISLANDS CODE DID NOT PROHIBIT THE APPOINTMENT OF A CHAPTER 11 TRUSTEE, AND EVEN IF IT HAD, FEDERAL BANKRUPTCY LAW WOULD SUPERCEDE IT UNDER THE SUPREMACY AND BANKRUPTCY CLAUSES.

Appellants contend that the appointment of a chapter 11 trustee was void under the following provision of Section 43a of Title 30 of the Virgin Islands Code:

> (a) No person or corporation, whether or not organized under the laws of the Territory, shall sell, acquire or transfer control, either directly, or indirectly of any public utility organized and doing business in this Territory, without first securing authorization from the [Public Services] Commission. Any such acquisition or control without prior authorization shall be void and of no effect.

30 V.I.C. § 43a(a).

This contention lacks merit for three reasons. First, Appellants cite no authority – and we can find none – for the proposition that a change in control of a parent company operates as a change in control of its subsidiaries, particularly where, as here, the parent company does not exercise any day-to-day operational control over the subsidiaries.[17] As noted by this Court last year in *Virgin Islands Telephone Corp. v. Rural Telephone Finance Co-op. Greenlight Capital Qualified, L.P.P.*, 2006 WL 319002, p.4 (D.V.I., February 10, 2006), "there are at least two layers between [Appellants] and Vitelco," and "it is well settled that 'absent unusual circumstances, the property of the debtor's subsidiary is not considered property of the debtor by virtue of the debtor's sole ownership of the subsidiary.'"

Second, even assuming for purposes of argument that the appointment of a trustee to administer these chapter 11 cases did effect a change in control of Vitelco or any other non-debtor entity connected with the cases, such change of control clearly did not result from a "transfer" by a "person[18] or corporation" within the meaning of 30 V.I.C. § 43a. Rather, it resulted from an order entered by the Bankruptcy Court pursuant to 11 U.S.C. § 1104 in a case under its jurisdiction. In taking the position that the court-ordered appointment of a federal bankruptcy trustee under federal law in a federal bankruptcy case involving a regulated utility constitutes a transfer of control of the utility for regulatory purposes, the PSC appears to be unique among regulatory agencies in the United States, which uniformly regard the entry of such an order as a *pro forma* event with no regulatory consequences.[19] Appellants have cited no

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[17] Mem. Op., p.21 (R-448).

[18] As defined by 1 V.I.C. § 41, the term person includes "corporations, companies, associations, joint stock companies, firms, partnerships, and societies, as well as individuals ..." It does not, however, include bankruptcy courts.

As defined by 11 U.S.C. § 101(41), "[t]he term 'person' includes individual, partnership, and corporation, but [subject to certain exceptions] does not include governmental unit ..." This definition likewise does not encompass bankruptcy courts.

[19] The United States Trustee bases this assertion on the authorities cited by the RTFC in its brief filed on January 11, 2007, in support of the Trustee Motion and in response to the PSC's opposition to the Trustee Motion (R-330).

judicial authority that remotely supports the PSC's interpretation of 30 V.I.C. § 43a in this regard.

Finally, an interpretation of 30 V.I.C. § 43a purporting to limit or restrict the ability of a bankruptcy court to direct the appointment of a trustee in a chapter 11 case would obviously conflict with section 1104 of the United States Bankruptcy Code and accordingly would impermissibly interfere with Congress' power to enact bankruptcy legislation under the Bankruptcy Clause. U.S. Const. art. I, sec. 8, cl. 4. It also would violate the Supremacy Clause of the United States Constitution, under which the laws of the United States constitute "the supreme Law of the Land ... any Thing in the Constitution or Laws of any State to the Contrary notwithstanding." U.S. Const. art. VI, cl. 2.[17]

As the Supreme Court reiterated in *Crosby v. Nat'l Foreign Trade Counsel*, 530 U.S. 363, 372-73, 120 S.Ct. 2288 (2000), inconsistent state laws must yield to congressional enactments when one of two tests is met, regardless of whether Congress has inserted a clause in legislation explicitly preempting state law. First, where Congress intends federal law to occupy a given field, it preempts state law in that area. *Id.*, 530 U.S. at 372-73. Second, even if Congress has not entirely displaced state regulation over the matter in question, federal law still preempts state law to the extent that state law actually conflicts with federal law. *Id.* This occurs when it is impossible to comply with both state and federal law, or when the state law stands as an obstacle to the accomplishment of the full purposes and objectives of Congress. *Id.* Accord *Edgar v. MITE Corp.*, 457 U.S. 624, 631, 102 S.Ct. 2629, 2635 (1982).

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[17] The principles of preemption arising from the Supremacy Clause "are made applicable to the laws of the Virgin Islands through the Revised Organic Act, which authorizes the Virgin Islands legislature to enact territorial laws that are 'not inconsistent with ... the laws of the United States made applicable to the Virgin Islands.' 48 U.S.C. § 1574(a)." *St. Thomas--St. John Hotel & Tourism Ass'n, Inc. v. Government of U.S. Virgin Islands*, 218 F.3d 232, 237-8 (3d Cir. 2000).

Congress has quite clearly satisfied these tests in the bankruptcy arena, where it has enacted a comprehensive and pervasive statutory scheme that "occupies a full title of the United States Code" and "provides a comprehensive system of rights, obligations and procedures, as well as a complex administrative machinery that includes a special system of federal courts and United States Trustees." *Sherwood Partners, Inc. v. Lycos, Inc.*, 394 F.3d 1198, 1201 (9th Cir. 2005). Bankruptcy is particularly federal because the Bankruptcy Clause of the Constitution, U.S. Const. art. I, § 8, cl. 4, grants Congress the power "[t]o establish . . . uniform Laws on the subject of Bankruptcies throughout the United States." Congress has exercised that power by enacting the Bankruptcy Code. See, e.g., *Sherwood*, *supra*, 394 F.3d at 1201 ("There can be no doubt that federal bankruptcy law is 'pervasive' and involves a federal interest 'so dominant' as to 'preclude enforcement of state laws on the same subject' – much like many other areas of congressional power listed in Article I, Section 8, of the Constitution, such as patents, copyrights, currency, national defense and immigration"); *Eastern Equip. and Servs. Corp. v. Factory Point Nat'l Bank, Bennington*, 236 F.3d 117, 120 (2d Cir. 2001) (same).

Nowhere in section 1104 or elsewhere in the Bankruptcy Code is there a "regulatory exception" that conditions or limits the authority of bankruptcy judges to direct the appointment of a trustee in a case involving a regulated entity. As observed by the Supreme Court in *Federal Communications Comm'n v. Nextwave Personal Communications, Inc.*, 537 U.S. 293, 302, 123 S.Ct. 832 (2003), "where Congress has intended to provide regulatory exceptions to provisions of the Bankruptcy Code, it has done so clearly and expressly ..." An example of such a clear and express exception is section 362(b)(4) of the Bankruptcy Code, which specifies that the automatic stay otherwise applicable under 11 U.S.C. § 362(a)(1), (2), (3) & (6) to, *inter alia*, the commencement or continuation of judicial or administrative actions or proceedings against the debtor is inapplicable to

> the commencement or continuation of an action or proceeding by a governmental unit ... to enforce such governmental unit's or organization's police and regulatory power, including the enforcement of a judgment other than a money judgment, obtained in an action or proceeding by the governmental unit to enforce such governmental unit's or organization's police or regulatory power ...

11 U.S.C. § 362(b)(4). *See Village of Rosemont v. Jaffee*, ___ F.3d ___, 2007 WL 967046, p. 11 (7th Cir. 2007) (holding that this section "forbids the bankruptcy court from interfering with the government's police and regulatory powers"). There is, however, nothing in section 362(b)(4) or in any other provision of the Bankruptcy Code that restricts the bankruptcy court's ability to direct the appointment of a trustee in a chapter 11 case involving a regulated utility, nor is there any provision limiting or restricting the powers and duties of a trustee appointed pursuant to section 1104 in such a case. While 11 U.S.C. § 362 exempts from the purview of the automatic stay actions or proceedings by regulatory agencies to enforce their police and regulatory powers, such police and regulatory powers do not and cannot operate to restrict the powers and duties of bankruptcy courts either to oversee the administration of bankruptcy cases or to impose remedies in such cases that the Bankruptcy Code specifically authorizes or requires.

There is no suggestion in these cases that the Bankruptcy Court has ever sought to enjoin or otherwise interfere with any regulatory action or proceeding by or before the PSC. Compare *In re Yellow Cab Cooperative Association*, 132 F3d. 591 (10th Cir. 1997) (holding that bankruptcy court exceeded its authority in enjoining Public Utility Commission from restricting transfer of debtor's license to operate taxicabs, where Commission had based its decision on legitimate regulatory considerations). Cf. *Village of Rosemont v. Jaffee*, *supra* (upholding bankruptcy court's refusal to enjoin proceedings before Illinois Gaming Board to revoke debtor's riverboat gambling license). To the contrary, in its order granting the Trustee Motion the Bankruptcy Court specified that "the United States Trustee, upon entry of an order appointing a Chapter 11 trustee, shall advise said Chapter 11 Trustee of his/her obligation to confer with the PSC in all matters subject to the PSC's regulatory authority. *See* 30 V.I.C. 43(a)." R-450. In the event the PSC takes some future action to revoke Vitelco's franchise, terminate its license or otherwise restrict its ability to operate, the parties will be free to seek a ruling from the Bankruptcy Court at that time on the issue of whether and to what extent such action constitutes a lawful exercise of the PSC's "police and regulatory power" within the contemplation of section 362(b)(4). Clearly, however, the present appeals present no such issue.

CONCLUSION

For the foregoing reasons, the United States Trustee respectfully requests the Court to enter an order affirming the Bankruptcy Court's orders granting the Trustee Motion and denying the Responsible Officer Motion.

Respectfully submitted,
FELICIA S. TURNER
UNITED STATES TRUSTEE

By: ______________________________
Guy G. Gebhardt
Georgia Bar No. 288550
Assistant United States Trustee

____
James H. Morawetz
Georgia Bar No. 521900
Trial Attorney

United States Department of Justice
Office of the United States Trustee
Suite 362, 75 Spring Street, SW
Atlanta, GA 30303
Telephone: (404) 331-4437
Facsimile: (404) 331-4464
Email: Guy.Gebhardt@usdoj.gov

Dated: April 20, 2007

BRIEF BANK — "SUMMARY SHEET" *Printed Wed-10/8/08 11:17*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*
In re Empire State Business, LLC (Empire State Business, LLC v. Donald F. Walton, UST)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*
11th Cir.

3. ("CCN") ***CURRENT*** CASE NO.
No.: 08-13941-G

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*
No.: 2:08-cv-00062-LGW
Court: S.D. Ga.
(Identify judge & cite, if any)

5. ("SO") ***SOURCE***
U.S. TRUSTEES

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*
Filed: October 2, 2008
Type: Response of Appellee, the United States Trustee, to the Court's Memorandum Requesting Briefing on the Question of Whether Court has Jurisdiction over Appeal.

7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g., "UST/OGC"]*
Matthew E. Mills, Donald Walton, P. Matthew Sutko
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***
• Response of Appellee, the United States Trustee, to the 11th Circuit's request for briefing on the question of whether the 11th Circuit has jurisdiction over an appeal filed by a non-attorney on behalf of a corporate appellant.

10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)

11. DO YOU RECOMMEND POSTING IN UST BRIEFBANK?
| x | YES | | NO ***NAME:*** Linda Figueroa
DATE:

IN THE UNITED STATES COURT OF APPEALS
FOR THE ELEVENTH CIRCUIT

IN RE:

EMPIRE STATE BUSINESS, L.L.C.

Appellant

v.

Appeal No. 08-13941-G

DONALD F. WALTON,
UNITED STATES TRUSTEE,
REGION 21

Appellee

RESPONSE OF APPELLEE, THE UNITED STATES TRUSTEE, TO THIS COURT'S MEMORANDUM DATED SEPTEMBER 23, 2008, REQUESTING BRIEFING ON THE QUESTION WHETHER THIS COURT HAS JURISDICTION OVER THS APPEAL

1. On September 23, 2008, this Court asked the parties to address whether this Court has jurisdiction over this appeal. In this case, a non-attorney, Michael Fernando, filed the notice of appeal on behalf of the corporate appellant, Empire State Business, LLC. Historically, this Court has allowed non-attorneys to file notices of appeal on behalf of corporate appellants so long as the corporate-appellants promptly retained counsel thereafter. Most circuits follow this approach. Under that approach, this appeal should be dismissed if counsel of record does not promptly enter an appearance on behalf of Empire State.

2. A corporation may participate in legal proceedings only through counsel. Palazzo v. Gulf Oil Corp., 764 F.2d 1381 (11th Cir. 1985) (corporation is required to be represented by counsel and officer could not raise claims of corporation in his pro se capacity); Stirzaker v. Howard, 197 Fed. Appx. 852 (11th Cir. 2006) (corporate entity must be represented by counsel on appeal). This rule applies even when the person seeking to represent the corporation is its president and major stockholder. Palazzo, 764 F.2d at 1385.

3. At least twice, this Court has allowed non-parties to file notices of appeals on behalf of corporate appellants, but required the appellants to promptly retain counsel in order for their appeals to proceed. In re K.M.A., Inc., 652 F.2d 398 (5th Cir. 1981) (concluding "[i]t is not clear, however, whether the filing of the corporation's notice of appeal by someone who is not an attorney is sufficient to deprive this Court of its jurisdiction to consider the appeal," and allowing such an appeal to proceed if "within 30 days of the entry of this order an attorney admitted to practice before this Court files an appearance to represent the corporate appellant.").[1] See also F.T.C. v. Gem Merchandising Corp., 1995 WL 623168 (11th Cir. 1995) (allowing such an appeal to proceed if an

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[1] In re K.M.A., Inc. is precedential because it was decided prior to October 1, 1981. Bonner v. City of Pritchard, 661 F.2d 1206 (5th Cir. 1981).

attorney entered an appearance within thirty days).

4. This Court's practice is consistent with that employed by most other circuits. Harrison v. Wahatoyas, L.L.C., 253 F.3d 552 (10th Cir. 2001) (corporate appellants' notice of appeal was not invalid simply because it was signed and filed by a corporate officer rather than by counsel, but corporation must retain attorney in time to perform all other necessary, substantive legal work for appeal); Instituto de Educacion Universal Corp. v. U.S. Dept. of Educ., 209 F.3d 18 (1st Cir. 2000) (corporate officer may sign and file notice of appeal on behalf of corporation so long as the corporation promptly retains counsel to prosecute the appeal); Bigelow v. Brady, 179 F.3d 1164, 1165-66 (9th Cir. 1999) (stating "[w]e fail to see any compelling reason to refuse to recognize a corporation's notice of appeal, signed and filed by a corporate officer, so long as a lawyer promptly thereafter enters a formal appearance on behalf of the corporation and undertakes the representation"). But see U.S. v. Green, 966 F.2d 1445 (4th Cir. 1992) (holding notice of appeal filed on behalf of corporation by non-attorney was invalid, dismissing appeal and stating "[i]t is well established that a corporation is an artificial entity that cannot appear pro se, and must be represented by counsel").

5. Under this Court's practice, Empire State's appeal would not be dismissed

simply because it was filed by a non-attorney, but the appeal would be dismissed unless Empire promptly retains counsel and that counsel enters an appearance in this case. To trigger that practice in this case, this Court could enter an order providing Empire's appeal will be dismissed unless counsel enters an appearance on Empire's behalf within 30 days.

Respectfully submitted this 2nd day of October 2008.

DONALD F. WALTON
UNITED STATES TRUSTEE, REGION 21

By:____________________________
Matthew E. Mills
Assistant United States Trustee
Office of United States Trustee
Department of Justice
222 West Oglethorpe Avenue, Suite 302
Savannah, Georgia 31401
(912) 652-4112

CERTIFICATE OF SERVICE

I, the undersigned, hereby certify that a copy of the foregoing *Response of Appellee, the United States Trustee to this Court's Memorandum Dated September 23, 2008, Requesting Briefing on the Question Whether This Court has Jurisdiction over this Appeal*, has this day been served upon the following parties by mailing a copy of the same through the United States Mail bearing sufficient postage thereon. In addition, electronic service will be received by those parties that are entitled to receive such service in this case through the electronic filing system of this Court.

Empire State Business, LLC
c/o Michael Fernando
2002 Commercial Drive South
Brunswick, GA 31525

This the 2nd day of October 2008.

Matthew E. Mills

222 West Oglethorpe Avenue, Suite 302
Savannah, Georgia 31401
(912) 652-4112

BRIEF BANK — "SUMMARY SHEET"

Printed Mon.-1/11/99 (16:36)

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	**IN RE EMS DEVELOPMENT CORP.** **(APPEAL OF SACHS KAMHI & KUSHNER, P.C.)**
2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	E.D.N.Y.
3. ("CCN") ***CURRENT*** CASE NO.	No.: 97-CIV-3428 (District Judge Wexler)
4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*	No.: Bankr. No. 895-86448-478 (Chapter 11) Court: Bankr. E.D.N.Y. (Bankruptcy Judge Eisenberg) *(Identify judge & cite, if any)*
5. ("SO") ***SOURCE***	**U.S. TRUSTEES**
6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	Filed: SEPTEMBER 26, 1997 Type: UST'S APPELLEE BRIEF
7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*	Jeanne M. Crouse (UST/OGC) Stan Y. Yang (UST/REGION 2-NEW YORK) *(UST/OGC: 202-307-1399/FAX-2397)*
8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") ! ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	! Attorney fees under 11 U.S.C. 330(a)(3)-(4) should discount time spent pursuing objectives other than protection of the bankruptcy estate. Here, fee for debtor's counsel was properly reduced for time spent protecting debtor's principals, rather than debtor's estate. √ **Background:** By slip opinion issued May 26, 1998, District Judge Wexler affirmed Bankruptcy Judge Eisenberg's fee reduction, as sought by the UST.
10. PATH TO FILE LOCATION: (e.g., S:\GENERAL COUNSEL\BRFBANK\etc...)	S:\GENERAL COUNSEL\BrfBank\To-West-Net\GROUP03 West-Net\EMS1.wpd
11. DO YOU RECOMMEND POSTING IN UST BRIEFBANK?	| x | YES | | NO ***NAME:*** Anthony J. Ciccone ***DATE:*** Thu.-11/12/98 (17:19)

THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF NEW YORK

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In re: EMS DEVELOPMENT CORP., DEBTOR.	Bankruptcy Case No. 895-86448-478 Chapter 11
In re: Appeal of Sachs Kamhi & Kushner, P.C., Appellant.	97 Civ. 3428 Judge Leonard D. Wexler

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APPELLEE’S BRIEF

By: Stan Y. Yang, Esq.

OFFICE OF THE UNITED STATES TRUSTEE
825 EAST GATE BOULEVARD
SUITE 304
GARDEN CITY, NEW YORK 11530

SEPTEMBER 26, 1997

TABLE OF CONTENTS

STATUTES

STATEMENT OF ISSUES

1. WHETHER the Bankruptcy Court's decision was proper and within its sound discretion under applicable case law.

2. WHETHER the Bankruptcy Court applied the proper legal standards when it reviewed the Appellant's fee application.

3. WHETHER the Bankruptcy Court's findings of fact in regard to the appellant's fee request were clearly erroneous.

PRELIMINARY STATEMENT

Sachs Kamhi & Kushner, P.C. (hereinafter the “Appellant” or the “ the Sachs firm”) has appealed from an order of Judge Dorothy Eisenberg of the United States Bankruptcy Court for the Eastern District of New York dated May 14, 1997 (see the Appellant’s Designation of the Record on Appeal[1] filed by the Sachs firm, as Exhibit “1”) which awarded the Appellant final fees in the amount of $165,000. The basis of the Sachs firms appeal is that the Court abused its discretion when it: (i) failed to apply the proper legal standard adopted by the Second Circuit with respect to compensation awards for professionals retained in a bankruptcy proceeding; (ii) failed to follow the proper procedures in conducting a hearing on Appellant’s Final Application for fees; and (iii) rendered a decision based on a findings of fact which the Appellant contends were clearly erroneous.

The Appellant asks this Court to: (i) determine that the Bankruptcy Court abused its discretion thereby warranting a reversal of its decision; and (ii) hold a hearing to determine the amount of the award for the Appellant’s final fee application. As demonstrated below, the Bankruptcy Court’s rulings were not an abuse of discretion, the Bankruptcy Court applied the proper standards and followed the proper procedures in determining the amount to award the Appellant for its final fee application. Moreover, the Court’s factual conclusion was not erroneous. Given the facts and circumstances which are more fully developed in this brief, it is submitted that the Bankruptcy Court’s ruling was well within the boundaries of the law and its sound discretion, and as such, it should be upheld in all respects.

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[1] References appearing in parenthesis with “A” followed by a “number” are references to the specific document contained in the Appellant’s Designation of the Record on Appeal.

STATEMENT OF FACTS

The debtor, EMS Development Corporation (hereinafter "EMS"), filed a voluntary Chapter 11 petition pursuant to Title 11 of the United States Code (hereinafter "Bankruptcy Code") with the United States Bankruptcy Court for the Eastern District of New York on November 2, 1995. The case was assigned to Judge Dorothy Eisenberg, with a case number 895-86448-478. Pursuant to an Order of the Court dated November 20, 1995, the Sachs firm retention as counsel for the debtor was approved. On January 28, 1997, an official committee of creditors (hereinafter the "Committee") was appointed by the Office of the United States Trustee (hereinafter the "UST"). Pursuant to an Order of the Court dated February 10, 1997, the retention of the law firm of Larry I. Glick, P.C., as counsel for the Committee, was approved.

On or about January 9, 1997, the Sachs firm filed an application for interim allowance of compensation pursuant to Sections 330 and 331 of the Bankruptcy Code for services rendered on behalf of the debtor for the period between November 2, 1995 and December 23, 1996. A hearing on the Sachs firm's fee application was scheduled for January 24, 1997. The UST, Ward Leonard Electric Company, Inc.[2/] (hereinafter "Ward"), and Farmingdale Corporation[3/] (hereinafter "Farmingdale"), filed objections to the Sachs firm's fee request. In its objection, the

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[2/] Ward Leonard Electric Company, Inc., based in Mount Vernon, New York, is a manufacturer of specialty electrical and electro mechanical products, primarily for the defense industry. Ward contacted the debtor prior to this Chapter 11 filing, and expressed interest in acquiring or investing in EMS.

[3/] Farmingdale Corporate Center is the former landlord of the debtor and holds an unsecured pre-petition claim of approximately $945,000 and unsecured post-petition claim of approximately $16,000. Upon information and belief, Farmingdale Corporate Center is the largest unsecured creditor of this Chapter 11 estate and is the chairman of the unsecured creditors' committee.

UST raised the issue of undue delay in the reorganization process because the debtor refused to provide essential financial information to Ward for the completion of Ward's competing plan of reorganization. In addition, the UST asserted that the Sachs firm failed to meet its burden of proof since it did not show that its efforts in assisting the debtor had benefitted the estate and that a decision to award compensation to Sachs should be deferred until such time as the prospects for the debtor's reorganization became more likely.

On January 24, 1997, the Court held a hearing on the Sachs firm's fee application, and all parties who filed objections appeared and stated their respective objections on the record. At the hearing, the Court did not rule on the merits of the Sachs firm's fee application since the Court determined that it was premature to entertain fee requests at the time. Nevertheless, the Court awarded the Sachs firm $50,000 as interim compensation and an Order approving the interim award was signed by the Court on January 29, 1997. The determination regarding "benefit" and "reasonableness"of the services rendered by the Sachs firm was reserved for the final fee hearing.

On or about April 14, 1997, Appellant filed a final fee application seeking final compensation in the amount of $247,000 for fees and $13,582.87 for reimbursement of out-of-pocket expenses. The UST, the Committee, Farmingdale, and Rodale Electronics, Inc.,[4] filed objections to the Sachs firm's fee request. On April 25, 1997, all professionals' fee applications[5]

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[4] Rodale Electronics, Inc., based in Garden City, New York is a manufacturer of specialty electrical and electro mechanical products, primarily for the defense industry. Rodale contacted the debtor prior to this Chapter 11 filing, and expressed interest in acquiring or investing in EMS.

[5] Fee applications include Sachs Kamhi & Kushner, Attorney for the debtor; Jerome Rosenberg, CPA, Accountant for the debtor; Holmes, Schwartz & Gordon, Esqs., Special Counsel for the debtor; Sanders W. Gropper, Special Financial Consultant for the debtor; Larry I. Glick, P.C., Counsel for the Unsecured Creditors' Committee; Ward Leonard

were heard by the Court. The UST's objections to the Sachs firm's application questioned the benefit of Appellant's services to the estate as well as the manner in which such services were performed. The UST argued that Sachs' services were often not time efficient, burdened the debtor's estate as a result of the level of professional who acted on a specific task, were overall inefficient, and of questionable benefit. <u>See</u> "A-4". In fact, the UST's objections to the Sachs firm's final application were similar to the objections raised to the Sachs' interim fee request in January, 1997. <u>See</u> the Appellee's Designation of Item, Exhibit "A"[6].

In addition to the objections filed by the UST, Rodale also filed an objection which stated:

> . . . the time and expenses incurred by the Appellant pursuing improper goals which includes creating improper impediments to the receipt by Ward and Rodale of due diligence information necessary for their competing plans of reorganization, did not benefit the debtor's estate or its creditors and increased Applicant's professional fees and expense substantially beyond that which is reasonable in a case of this size and complexity. Moreover, Applicant's tactics increased the amount of fees and expenses Ward and Rodale now seek in their application . . .

"A-6".

Furthermore, Farmingdale, a creditor of the debtor's estate, objected to Sachs' final fee request stating that:

> . . . a substantial portion of counsel's time sought to be compensated in the Fee Application has been spent attempting to frustrate third parties, including Ward Leonard and Rodale, from purchasing the Debtor and improperly placing the interest of the Debtor's

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Electric Company, Inc, a proponent of the competing plan of reorganization; Rodale Electric, Inc., a proponent of the competing plan of reorganization.

[6] References appearing in parenthesis with "UST" followed by a "letter" are references to the specific document contained in the Appellee's Designation of Item to be Included in the Record of Appeal.

> present owners over its creditors. Sachs, Kamhi cannot be compensated for representing the owners of the Debtor in a manner which is adverse to, or does not benefit, the estate or the creditors. See In re DN Assoc., 144 B.R. 195, 199 (Bankr. D. Me. 1992), aff'd, 3 F.3d 512 (1st Cir. 1993).

"A-5".

Moreover, the Committee objected to Sachs' final fee request of $247,000 because the Committee stated that it was misled by the Sachs firm's representation which estimated its administrative claim for professional fees at $150,000. Based upon that representation, the Committee negotiated the terms of the competing plans filed by Ward and Rodale, and ultimately supported the Ultra Electronics Holdings, P.L.C.[7] (hereinafter "Ultra") plan of reorganization. Had the Committee known the Sachs firm's fee request was $247,000, it would not have supported the Ultra plan. See "A-7".

At the April 25, 1997 hearing, the Court heard argument from all parties regarding their respective fee applications and all opposition. In the Court's analysis of the Sachs firm's fees, it reviewed the services rendered, determined whether the manner in which they were performed was cost efficient, and then awarded what it believed was equitable under the circumstances. The Court, after reviewing the fee applications and the objections, determined that the fee request was excessive and should be reduced accordingly.

> . . . [T]his Court, under Section 330, employs a three prong review of an attorney's fee application. One is, are the services properly compensable as legal services. Two, were the services necessary,

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[7] Ultra Electronics Holdings, P.L.C., is a part of an international group of businesses specializing in the design, manufacture and support of electronic and electro mechanical products for aerospace and defense markets worldwide. Ultra became a creditor of this estate when EBL Service, Inc., transferred and assigned its claim to Ultra. Ultra is a co-proponent of the debtor's plan of reorganization.

> and is performance documented. And three, how the services will be valued, i.e., were the necessary services performed within a reasonable amount of time and what is the reasonable value of that time . . .

“A- 2", p. 127, lines 12-19

The Court applied the Lodestar standard and examined all events took place in this Chapter 11 matter.

> . . . I find that there was a waste of legal time spent by debtor’s counsel in regard to production of documents, confidentiality issues, economic espionage issues, and there was additional delaying tactics and an effort, probably on behalf of debtor’s principals, to impede the efforts of Ward in their quest for equal access to the information so that they could prepare a proper opposing plan . . . Prior to Ultra coming into the scene, which was only within the last few months, many of the actions by the debtor and debtor’s counsel were to delay and obstruct . . .

“A-2", p. 128, lines 5-14

The Court further found that there was an issue of conflict of interest when the Sachs firm acted on behalf of the debtor’s principals and not the debtor by thwarting Ward’s efforts to complete its competing plan. The debtor’s principals were fearful that they would lose control over the debtor if Ward’s plan was confirmed.

> . . . In this regard, when counsel to the debtor listens to and even considers and acts with what a principal wants, which may not necessarily benefit the estate and may even create an impression of conflict of interest, raises some doubt as to some of the legal time spent. Counsel to a DIP should seek the best plan and the best return for the — for the debtor and its creditors, not necessarily the best benefit to debtor’s principals . . .

“A-2", p. 128, line 22-p. 129, line 4

In addition, the Court examined the time that the Sachs firm spent on: (1) objecting to the landlord's claim and claims of other creditors; (2) obtaining proceeds of a letter of credit from Fleet Bank; (3) reviewing and objecting to the disclosure statement of Rodale; and (4) negotiating the amended plan. The Court found that there was "an extreme excess of legal fees for those four major items, even if you look at the time records." See "A-2", p. 129, lines 15-17

Based upon the arguments made and objections filed regarding the Sachs firm's fee application, the Court awarded the Sachs firm $165,000 as final compensation and reserved decision on the reimbursement of the out-of-pocket expenses.

PROCEDURAL HISTORY OF THE CASE

On November 2, 1995, the debtor filed a voluntary petition under Chapter 11 of the Bankruptcy Code with the Bankruptcy Court. At the time of filing, EMS operated a business manufacturing mine-counter measures for ships of the United States Navy and navies of several foreign countries.

On September 30, 1996, the debtor filed a plan of reorganization and disclosure statement which proposed a ten (10%) percent distribution to the general unsecured creditors.

On October 28, 1996, Ward sent a letter to the debtor's counsel and made an offer to acquire EMS through a Chapter 11 plan of reorganization. However, the debtor expressed no interest in Ward's proposal.

On November 18, 1996, Ward filed a competing plan and disclosure statement which proposed an estimated fifteen (15%) percent distribution to the unsecured creditors. In addition, Ward filed objections to the debtor's proposed plan and disclosure statement.

On November 24, 1996, the debtor filed objections to the Ward plan and disclosure statement.

On November 26, 1996, a hearing to consider the adequacy of the respective disclosure statements was held. At the hearing, the Court directed both the debtor and Ward to amend their respective disclosure statements on or before December 27, 1996.

Shortly thereafter, Ward made a request to the Court for additional time to file a joint proposed plan of reorganization and disclosure statement with Rodale. The time to file the amended plan and disclosure statement was extended to January 16, 1997.

On December 20, 1997, the debtor filed its first amended plan and disclosure statement. On January 16, 1997, Ward and Rodale (hereinafter "W/R") filed their joint plan and disclosure statement with the Court. Objections to the debtor's first amended plan and disclosure statement were filed by Ward on January 13, 1997 and Rodale on January 14, 1997. Objections to the W/D joint plan and disclosure statement were filed by the debtor and the EMS employees on January 24, 1997, and January 22, 1997, respectively. In the debtor's objections to the W/R joint plan and disclosure statement, the debtor asserted, among other things, that the W/D joint plan contained inadequate assumptions of EMS's financial status.

On January 24, 1997, the Court held a hearing to consider the adequacy of both the debtor's amended disclosure statement and the W/R disclosure statement, and once again directed the parties to amend their respective disclosure statement.

On February 3, 1997, W/R filed an amended plan and disclosure statement which provided an immediate twenty (20%) percent distribution to the general unsecured creditors. At the same time, the debtor withdrew its proposed plan and requested an extension of time to file a new plan, which was granted by the Court.

On February 11, 1997, the debtor and Ultra proposed a joint plan of reorganization wherein it was stated that $1,500,000 would be made available to all of the creditors of the estate. A hearing to consider the adequacy of the Ultra disclosure statement and W/R amended disclosure statement was held on February 19, 1997, and the Court directed the parties to make further amendments to their respective disclosure statement.

Shortly after the hearing, Ward withdrew its proposed plan and disclosure statement and Rodale continued filing its own proposed plan and disclosure statement which provided for a thirty (30%) percent distribution to the unsecured creditors.

On March 17, 1997, a hearing to consider the adequacy of the Ultra disclosure statement and the Rodale disclosure statement was held. The Committee supported the Ultra plan and disclosure statement. As a result, the Ultra disclosure statement was approved and the Rodale disclosure statement was not approved. On April 25, 1997, the Bankruptcy Court confirmed the Ultra plan of reorganization.

ARGUMENT

I. The Court did not abuse its discretion when it reviewed and modified the Sachs firm's fee request

The Bankruptcy Court did not abuse its discretion when it reduced the fee request of the Sachs firm by $82,000 because the Court applied legal standards and proper procedures when it made factual findings to support its ruling. "The standard for judicial review on appeal of a fee award from a bankruptcy court is that the decision of the bankruptcy judge has abused his discretion-i.e., failed to apply proper procedures or legal standards, or made factual findings that were clearly erroneous." In the Matter of Cena's Fine Furniture, Inc., 109 B.R. 575, 580 (E.D.N.Y. 1990), citing In re Ferkauf, Inc., 56 B.R. 774, 775 (S.D.N.Y. 1985); See also In re

Shades of Beauty, Inc., 95 B.R. 17, 18 (E.D.N.Y. 1988).

In the case at bar, the UST submits to this Court that the Bankruptcy Court applied the proper procedures, and the proper legal standards for fee review before it made factual findings of facts that supported its decision. The facts and circumstances of the Court's findings will be fully developed in this brief. Therefore, the Bankruptcy Court's findings of the Sachs firm's fee award should be affirmed since the Court did not abuse its discretion when it modified the Sachs firm's fee request.

A. The Bankruptcy Court applied the proper legal standards when it reviewed the Sachs firm's fee request

1. The Bankruptcy Court applied the Lodestar method when it reviewed the Sachs firm's fee request

Contrary to the Appellant's argument, the Bankruptcy Court applied the lodestar method of fee review before it awarded compensation to the Sachs firm. The Bankruptcy Court recognized that this district adheres to the lodestar method of fee evaluation. "The lodestar amount represents the number of hours reasonably worked on a case multiplied by the reasonable hourly rate." In re Cena's Fine Furniture, Inc., 109 B.R. 575, 581 (E.D.N.Y. 1990), citing Wells v. Bowen, 855 F.2d 37, 43 (2nd Cir. 1988). In fact, in the case at bar, the Court started its review of the Sachs firm's fee application by applying the lodestar method. See "A-2", p. 127, line 20- p. 128, line 1. The Court went further with its analysis on the Appellant's fee application because it recognized that the lodestar method, which is a strict mathematical analysis of number of hours reasonably worked multiplied by the reasonable hourly rate, did not end the fee request analysis. See Lindy Brothers Builders, Inc., v. American Radiator and Standard Sanitary Corp., 487 F. 2d. 161, 167 (3d Cir. 1973).

Therefore, contrary to the Appellant's argument, the Bankruptcy Court applied the lodestar method to determine the Sachs firm's fee request.

2. The Bankruptcy Court applied other factors of fee review in conjunction with the lodestar method before it awarded the Sachs firm's fee request

It has been held by the Second Circuit Court of Appeals that a District Court has the discretion to adjust the "lodestar" amount based on the results obtained. See United States Football League v. National Football League, 887 F.2d 408 (2d Cir. 1989). Other factors for a court to consider in awarding fees are: (1) time and labor required to perform services; (2) novelty and difficulty of the case; (3)skill required to perform legal services; (4) preclusion of other employment by an attorney during the pending case; (5) customary fee charged; (6) amount involved; (7) results obtained; (8) ability of counsel and awards in similar cases. See Johnson v. Georgia Highway Express, Inc., 488 F. 2d 714 (5th Cir. 1974). Accordingly, the additional factors that were considered by the Court in Johnson remain relevant for the purpose of adjusting the lodestar. See Blanchard v. Bergros, 489 U.S. 87 (1989).

The United States Circuit Courts of Appeals have upheld decisions of lower courts which have adjusted fees for a variety of factors after the basic lodestar analysis is completed. While the court in United States Football League allowed fee adjustments in this Circuit, other Circuits are more specific in the further analysis used after a lodestar analysis is completed. For example, the First Circuit has held that the lodestar can be adjusted based on the quality of the representation in a case. See Boston and Maine Corp. v. Moore, 776 F. 2d 2, 7 (1st Cir. 1985). Other factors such as delay in payment, quality of representation considering the rates charged and overall performance by counsel are often considered. See Furtado v.Bishop, 635 F.2d 915, 920 (1st Cir. 1980).

In the case at bar, after the Bankruptcy Court applied the lodestar method of fee evaluation, it took a step further in its analysis and adopted the additional factors for fee review consideration articulated in Johnson v. Georgia Highway Express, Inc. The Court's finding on April 25, 1997, reveals that it carefully examined the Sachs firm's time records, the history of the case, and the narrative describing services that were performed by the Sachs firm. The Court record further reveals that the Court also considered factors such as the time and labor provided by the Appellant, the complexity of the issues dealing with sensitive national security information, the skill of the Sachs firm, and the total fee requested verses the result achieved. Therefore, it is evident that not only did the Bankruptcy Court apply the lodestar method of fee review, it also utilized the Johnson factors in its analysis before awarding the Sachs firm on compensation.

It is the position of the UST that the evidence of the present case is clear that the Bankruptcy Court applied the proper legal standards of fee review before it rendered a decision on the Sachs firm's fee award. See "A-2", p. 127, lines 12-19. In fact, the Sachs firm acknowledges in its Appellant's Brief to this Court that the Bankruptcy Court recognized the proper legal standards when it reviewed the Appellant's fee application at the April 25, 1997, hearing. See Appellant's Brief, p. 16.

B. The Bankruptcy Court followed the proper procedures when it reviewed the Sachs firm's fee application

1. The Bankruptcy Court followed the requirements pursuant to Section 330 of the Bankruptcy Code when it reviewed the Appellant's fee application

The Bankruptcy Court followed the proper procedure when it applied the requirements of

Section 330[8] of the Bankruptcy Code before it determined the Sachs firm's fee award. "Under 11 U.S.C. Section 330(a), the Court must establish, initially, whether the billed service is compensa-

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[8] Section 330 provides:

> (a)(1) After notice to the parties in interest and the United States trustee and a hearing, and subject to sections 326, 328, and 329, the court may award to a trustee, an examiner, a professional person employed under section 327 or 1103-
>
> (A) reasonable compensation for actual, necessary services rendered by the trustee, examiner, professional person, or attorney and by any paraprofessional person employed by any such person; and
>
> (B) reimbursement for actual, necessary expenses.
>
> (2) The court may, on its own motion or on the motion of the United States Trustee, the United States Trustee for the District or Region, the trustee for the estate, or any other party in interest, award compensation that is less than the amount of compensation that is requested.
>
> (3)(A) In determining the amount of reasonable compensation to be awarded, the court shall consider the nature, the extent, and the value of such services, taking into account all relevant factors, including-
>
> (A) the time spent on such services;
>
> (B) the rates charged for such services;
>
> (C) whether the services were necessary to the administration of, or beneficial at the time at which the service was rendered toward the completion of, a case under this title;
>
> (D) whether the services were performed within a reasonable amount of time commensurate with the complexity, importance, and nature of the problem, issue, or task addressed; and
>
> (E) whether the compensation is reasonable based on the customary compensation charged by comparably skilled practitioners in cases other than cases under this title.
>
> (4)(A) Except as provided in subparagraph (B), the court shall not allow compensation for-
>
> (I) unnecessary duplication of services; or
>
> (ii) services that were not-
>
> (I) reasonably likely to benefit the debtor's estate; or
>
> (II) necessary to the administration of the case.

11 U.S.C. Section 330 (1997)

ble; secondly, whether it was actual and necessary; and finally, whether the amount charged is reasonable based on the nature, extent, and value of the services." In re S.T.N. Enterprises, Inc., 70 B.R. 823, 832 (Bankr. D. Vt. 1987).

In the case at bar, the Bankruptcy Court followed all legal procedures required by Section 330 of the Bankruptcy Code when it reviewed the Sachs firm's fee application. The notice of the fee applications hearing, held on April 25, 1997, was given to all creditors of this estate. All applicants and several parties in interest appeared at the hearing. The Court gave opportunities to all parties who appeared at the hearing to present oral representations and other forms of evidence to the Court. The Court examined the Sachs firm's fee application and time records. The Court also conducted an analysis to see whether the Sachs firm's services rendered in this case were: (1) compensable; (2) actual and necessary; (3) reasonable based on the nature, extent and value of the services; and (4) beneficial to the creditors and the debtor's estate. In fact, the UST submits to this Court that the argument raised by the Appellant is focused on the Court's findings of fact, instead of the Court's failure to follow the requirements pursuant to Section 330 of the Bankruptcy Code in fee review.

Moreover, the burden of proof to show entitlement to requested fees is always on the applicant. In re Oberreich, 109 B.R. 936, 938 (Bankr. E.D. Wis. 1990). In order for a Court to award fees and expenses, the applicant must demonstrate that services rendered made a substantial contribution to the Chapter 11 reorganization. See In re Jack Winter, Inc., 119 B.R. 629, 632 (E.D. Wis. 1990). Courts are hesitant to award requests for compensation which make little sense in light of the size of the estate and necessity of services rendered. It is widely held that the court must perform a cost/benefit analysis when reviewing fee requests. See In re Wildman, 72

B.R. 700, 707 (Bankr. N.D. Ill. 1987). In particular, courts discourage professionals from running up a tab without considering the maximum probable recovery for creditors. Unsecured Creditors' Committee v. Puget Sound Plywood, Inc., 924 F. 2d 955, 958 (9th Cir. 1991).

In the case at bar, despite the requirement of the applicant's burden of proof to show the Court that it is entitled to the fee requested, the Sachs firm failed to meet its burden of proof either in its papers or during the lengthy hearing that was held on its final fee application. In light of the Sachs firm's failure to establish evidence in support of its fee request, the Court could only rely on the time records presented by the Sachs firm for its determination regarding the fee award. After reviewing the Sachs firm's interim and final fee applications, the objections to the applications, and all of the arguments and representations made in Court, the Bankruptcy Court followed the proper procedures for fee review and concluded that the Sachs firm should be awarded only $165,000 in compensation. Since the Appellant agrees that the Court used the proper legal procedures in awarding its fees, this is not an issue that this Court must decide. Accordingly, the Bankruptcy Court's decision on the award of the Sachs firm's fee request should be affirmed, as it applied the appropriate legal procedures.

2. The Bankruptcy Court offered opportunities to the Sachs firm at the April 25, 1997 hearing, to present evidence in support of its fee request, but the Sachs firm failed to do so which resulted the reduction of $82,000 from its final fee request

The Appellant contends that there was a lack of opportunity to conduct an evidentiary hearing before the Bankruptcy Court prior to it rendered a decision on the Sachs firm's fee request. The Transcript of the April 25, 1997, hearing reveals that the Court gave the Sachs firm at least three (3) opportunities to present its case and put evidence before the Court in support of its fee application, especially dealing with the issue of "benefit to this estate". See "A-2", p. 55, lines 12-14; p. 61, lines 4-6; p.64, lines 22-23. However, the Sachs firm failed to present evidence that addressed the Court's concern. From the review of the Transcript of the April 25, 1997 hearing, it is clear that the burden of proof of whether the services rendered by the Appellant in this case were beneficial to this estate, was not met by the Sachs firm, despite ample opportunities given. Furthermore, the Sachs firm failed to request the Court for an evidentiary hearing or reconsideration on the reduction of $82,000 from its fee request. Therefore, the Bankruptcy Court did not abuse its discretion when it rendered a decision on the Sachs firm's fee request based upon the evidence, or the lack thereof, presented by the Sachs firm at the April 25, 1997, hearing.

Based upon the Transcript of the hearing held before the Bankruptcy Court on April 25, 1997, the objections filed by the various parties on the Sachs firm's fee application, the record of the entire Chapter 11 proceeding, and the evidence presented by the Sachs firm in support of its fee request, the Bankruptcy Court made a clear findings of facts when it awarded $165,000 to the Sachs firm. It is the position of the UST that the Court's decision is consistent with applicable standards established by case law and the conduct and actions of the Sachs firm in this case. Therefore, the Bankruptcy Court did not abuse its discretion.

C. The Bankruptcy Court's findings of fact in support of the its decision to modify the Appellant's fee request, were not erroneous

1. The Bankruptcy Court clearly expressed the findings of fact in support of its decision on the Appellant's fee award

Contrary to the allegations of the Sachs firm, the Court indeed made findings of fact that were not erroneous and did base its opinion on these findings. Although the Bankruptcy Court did not delineate its findings of fact as such, it is abundantly clear from a review of the opinion in this case that the requirements of Federal Rules of Bankruptcy Procedures 7052[9] (hereinafter "F.R.B.P.") are fully met. F.R.B.P. 7052 only requires that findings of facts be clearly stated, as they are in the case at bar. In addition, "F.R.C.P. Rule 52(a) does not require elaborately detailed findings; the findings need only be sufficient to discern the basis of the Court's decision." In re Farwell, 77 B.R. 198, 199 (N.D. Ill. 1987). Furthermore, it is unnecessary for the Court to make findings as to how many hours and what hourly rates were appropriate before awarding fee request. However, the Court must review the applicant's fee request and make a determination regarding its excessiveness in light of the requirements of the case, of which the Court had first-hand knowledge. In re Farwell, 77 B.R. at 200.

In the case at bar, the Bankruptcy Court fulfilled the requirements of F.R.B.P. 7052 and

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[9] F.R.B.P. 7052 provides:

> (a) Effect. In all actions tried upon the facts without a jury or with an advisory jury, the court shall find the facts specially and state separately its conclusions of law thereon, and judgment shall be entered pursuant to Rule 58; and in granting or refusing interlocutory injunctions the court shall similarly set forth the findings of fact and conclusions of law which constitute the grounds of its action. Requests for findings are not necessary for purposes of review. Findings of fact, whether based on oral or documentary evidence, shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses. The findings of a master, to the extent that the court adopts them, shall be considered as the findings of the court. It will be sufficient if the findings of fact and conclusions of law are stated orally and recorded in open court following the close of the evidence or appear in an opinion or memorandum of decision filed by the court. Findings of fact and conclusions of law are necessary on decisions of motions under Rule 12 or 56 or any other motion except as provided in subdivision (c) of this rule.

Federal Rules of Bankruptcy Procedure 7052 (1997).

F.R.C.P. 52(a) by (1) reviewing the Appellant's interim and final fee applications; (2) considering all the factors under the applicable standards of fee review; (3) analyzing all matters transpired in this Chapter 11 case; (4) determining the excessiveness of services rendered by the Sachs firm since they were unnecessary and unreasonable; and (5) expressing findings of fact sufficient to clearly understand the basis for the Court's opinion. Therefore, in light of the foregoing, the Bankruptcy Court clearly expressed its findings of fact in support of its decision on the Appellant's fee award.

a. The Bankruptcy Court determined that some of the services rendered by the Sachs firm were unnecessary

The Court found that a number of the services rendered by the Appellant was unnecessary and thus should not be compensated. A Bankruptcy Court should look at the applicant's contemporaneous time records because they disclose whether a service was actually performed, and the explanations accompanying each listed service justify their necessity. See In re S.T.N. Enterprises, Inc., 70 B.R. at 832. In the case at bar, the Court was fully familiar with the facts of this Chapter 11 case. In fact, the docket entries of this Chapter 11 matter indicates that there were forty-one (41) hearings held before the Bankruptcy Court on this case prior to the April 25, 1997, confirmation and fee applications hearings. The UST raised concerns regarding the necessity of an over-qualified attorney who billed $350 for tasks that could have been achieved by a less senior personnel. See "A-4", p.6-7. Moreover, Farmingdale objected to the Sachs firm spending "tremendous amount of time to deter, chill and stymie prospective purchasers' effort to obtain necessary financial and operational information so as to formulate a competing plan." "A-5", p. 2. Furthermore, Rodale also raised objections because "the Sachs firm wasted many unnecessary hours to: (1) oppose Ward and Rodale's plans; (2) create improper impediments to the receipt by Ward and Rodale of due diligence information necessary for their competing plans of reorganization; and (3) research and respond to 'confidentiality' and 'economic espionage' issues because such work was a thinly veiled attempt to frustrate Ward and Rodale in their due diligence efforts." "A-6", p. 1-2.

The Bankruptcy Court questioned the necessity of some of the duplicated services performed by the Sachs firm and stated:

> ". . . And that was after all the disputes because I had made it clear many, many times what was appropriate and what was not. And I found myself repeating myself because the same issue kept coming before the court more than once. And although I have said it originally, it wasn't followed and there were continuous disputes about it. I'm not going to — I'm not going to pay for that. I'm not going to allow money for all that duplicate disputes. . ."

"A-2" p.62, lines 4-11.

Therefore, based upon its review and recollection of what took place in this case, in conjunction with all arguments heard at the hearing, the Court determined that some of the time spent by the Appellant in this case was unnecessary and held that

> ". . . there was a waste of legal time spent by debtor's counsel in regard to production of documents, confidentiality issues, economic espionage issues, and there was additional delaying tactics and an effort, probably on behalf of debtor's principals, to impede the efforts of Ward in their quest for equal access to the information so that they could prepare opposing plan."

"A-2", p. 128, lines 5-11. Therefore, the Bankruptcy Court reduced the Sachs firm's fee request because it determined that a portion of the services rendered by the Sachs firm were unnecessary.

b. The Bankruptcy Court determined that based on the nature, extent, and value of the services, the amount charged by the Sachs firm was unreasonable

The Court found that the amount charged by the Appellant was unreasonable based on the nature, extent, and value of the services rendered in this case. In order for a Bankruptcy Court to review the reasonableness of a fee application, it must look to "the explanation of each task in relation to the case, and the time expended and amount charged for performing the task, allow us to assess the reasonableness of the attorney's fees in light of the nature, extent, and value of the work." In re S.T.N. Enterprises, Inc., 70 B.R. at 832. In the present case, the Sachs firm argued that the fees in this case were reasonable because of the successful confirmation of the Ultra plan of reorganization. However, the Sachs firm failed to address the concern raised by the various parties and the Court as to why it expended an unreasonable amount of time on tasks which did not warrant the same. For example, at the time of the interim fee request the UST objected to the request for compensation for numerous intra-office conferences and services rendered by two or more members of the firm who billed $250-$350 per hour. See "UST-A", p. 4. The UST also objected to the unreasonableness of the Appellant's final fee request due to the excessiveness of the Sachs firm's mixed hourly rate in this Chapter 11 matter. See "A-4", p. 6.

When the Court reviewed the issue of reasonableness of the Appellant's fee request, it found that

> . . . the debtor's counsel indicates that they incurred $43,000 in time, and $5,000 in disbursements because of, (1) objecting to the landlord's claim and claims of others, obtaining proceeds of a letter of credit from Fleet Bank, reviewing and objecting to the disclosure statement of Rodale, and negotiating the amended plan. It seems to me that this an extreme excess of legal fees for those four major items, even if you look at the time records.

“A-2", p. 129, lines 10-17. Therefore, in light of the foregoing, the Bankruptcy Court found that based on the nature, extent, and value of the services, the amount requested by the Sachs firm was unreasonable.

c. The Bankruptcy Court found a conflict of interest when a substantial amount of time the Appellant spent in impeding the efforts of Ward and Rodale to obtain necessary information, was orchestrated on behalf of the debtor’s principals, officers and shareholders

The Court found a conflict of interest when the Appellant performed services on behalf of the principals of the debtor corporation which was adverse to the interest of the creditors of this estate, and thus the Sachs firm should not be compensated for the same. “Counsel for corporate Chapter 11 debtor in possession owes a fiduciary duty to the corporate entity estate--the client--and represents its interest, not those of the entity’s principals.” In re Wilde Horse Enterprises, Inc., 136 B.R. 830, 840 (Bankr. C.D. Cal. 1991); See also In re Grabill Corp, 113 B.R. 966, 970 (Bankr. N.D. Ill. 1990), citing In re Overmeyer Telecasting Co., 23 B.R. 823, 931 (Bankr. N.D. Ohio 1982), aff’d, 750 F.2d 31 (6th Cir. 1984).

An attorney for the debtor-in-possession owes its complete loyalty to the debtor corporation, and not its principals. In the present case, during the process of filing competing plans, the debtor withheld vital information from Ward and Rodale which deterred them from successfully proposing a plan of reorganization. Rodale objected to the Sachs firm’s fee request and raised the issue of conflict of interest since the unnecessary delay caused in providing essential information of EMS to both Ward and Rodale was orchestrated by the Appellant at the behest of the debtor’s officers and shareholders. See “A-6", p. 2. In addition, Farmingdale objected to the Sachs firm’s fee application and asserted that “a substantial portion of counsel’s time sought to be compensated in the fee application has been spent attempting to frustrate third parties, including Ward Leonard and Rodale, from purchasing the debtor and improperly placing the interest of the debtor's present owners over its creditors." "A-5" p.3. The Sachs firm conceded at the April 25, 1997 hearing that ". . . I didn't have a choice. The debtor said — the debtor said to counsel, 'counsel, these services have to be performed because, if they're not performed, the existing contracts which we have may be terminated for violations.' And we pointed out that to the court." "A-2", p.59, lines 7-12. It is clear that the delay tactics that were used by the debtor and its counsel were solely for the benefit of the principals, officers and shareholders of EMS. It is also evident that the efforts of the Sachs firm had significantly attributed to this unnecessary delay. The Sachs firm, acting on behalf of the principals of the debtor, chose an adversarial and litigious posture during this case. It now expects to be fully rewarded for that choice.

The First Circuit has affirmed a lower court decision regarding denial of fee request by counsel for the debtor in a matter that counsel represented the interests of the principals of the debtor in a manner which was adverse to the creditors of the estate. "A debtor-in-possession's attorney cannot be compensated for representing the interest of the debtor or the debtor's directors, officers and/or shareholders in a manner which is adverse to, or does not benefit, the estate or the creditors." In re DN Associates, 144 B.R. 195, 199 (Bankr. D.Me. 1992), aff'd, 3 F. 3d 512 (1st Cir. 1993), See also, In re Office Products of Am., Inc., 136 B.R. 983, 989 (Bankr. W.D.Tex. 1992). In the case at bar, the Bankruptcy Court determined that there was a conflict of interest.

> . . . And although there was some small basis for some disagreement with the — with the Ward plan; rather than negotiate with them, which might have resulted in a negotiated plan that

> would have been — which would have avoided a lot of the acrimony and additional disputed matters, I believe that debtor's principals saw this as a means of another party taking control of their own business. . . In this regard, when counsel to the debtor listens to and even considers and acts with what a principal wants, which may not necessarily benefit the estate and may even create an impression of conflict of interest, raises some doubt as to some of the legal time spent. Counsel to a DIP should seek the best plan and the best return for the — for the debtor and its creditors, not necessarily the best benefit to debtor's principals.

"A-2", p. 128, line 14-p. 129, line 4. In light of the authorities cited above, the Court could have applied the reasoning stated in In re DN Associates and denied the Appellant's fee request. However, the Court awarded the Sachs firm $165,000 for compensation. Therefore, the Court's findings of fact were not erroneous since it held that there was a conflict of interest and a portion of the fee request for services rendered on behalf of the debtor's principals, directors, officers and shareholders which was adverse to the creditors of this estate, must not be compensated by the estate.

In summary, the Bankruptcy Court did not abuse its discretion when it modified the Appellant's fee request. As it has been established above, the Court applied the proper legal standards when it used the lodestar method in conjunction with the additional factors articulated in Johnson v. Georgia Highway Express, Inc.. Furthermore, the Court followed the proper procedures in reviewing fee applications pursuant to Section 330 of the Bankruptcy Code. It conducted a lengthy hearing on April 25, 1997, and offered at least three (3) opportunities to the Sachs firm to present its case. Nevertheless, the Sachs firm failed to offer burden of proof in support of its fee request. At the hearing, the Court found (1) a portion of the services rendered by the Sachs firm was unnecessary, (2) the amount charged by the Sachs firm was unreasonable based on the nature, extent, and value of the services rendered in the case, and (3) there was a conflict of interest when the Sachs firm acted on behalf of the principals which was adverse to the interest of the creditors of the estate. Therefore, the UST respectfully submits to this Court that in light of the foregoing, the Bankruptcy Court did not abuse its discretion when it rendered a decision to award the Sachs firm $165,000 which was $82,000 less than the amount requested.

CONCLUSION

For the reasons set forth above, the United States Trustee for the Eastern District of New York respectfully submits that the final order of the Honorable Dorothy Eisenberg, United States Bankruptcy Judge, dated May 14, 1997, (i) awards appropriate compensation under 11 U.S.C. Section 330 to the Sachs firm, (ii) is based on proper legal theories and standards which are correct and appropriate, (iii) does not deny the Sachs firm due process of law, and (iv) contains clear findings of fact and conclusions of law sufficient to discern the basis of the Court's decision to the extent the same are necessary at all. Accordingly, it is respectfully submitted that the decision of the United States Bankruptcy Court should be upheld in all respects.

Respectfully Submitted,

CAROLYN S. SCHWARTZ
United States Trustee

Stan Y. Yang
Attorney
825 East Gate Boulevard
Garden City, New York 11530
(516) 228-9220

Dated: September 26, 1997

Endy I

(Cite as: 1995 WL 1016523 (USTBRIEFS))

[*1] Title (TI):	IN RE PATRICK & LILIA ENDY (U.S. TRUSTEE V. ENDY) — BRIEF FOR APPELLANT, U.S. TRUSTEE
Court (CO):	CTA9, U.S. Court of Appeals (9th Cir.)
Current-Case (CCN):	No. 95-17060
Previous-Case (PCN):	District Court # CV-S-94-490-DWH (RLH); Bankr. Court # BK- S-90-24316-RCJ
Source (SO):	U.S. TRUSTEES
Date-of-Filing (DA):	December 11, 1995
Author (AU):	Julie A. DiCamillo & Paul Bridenhagen (202-307-1399)
Topic (TO):	BANKRUPTCY — Titles 11 & 28 require the payment of Court fees & UST quarterly fees.
Summary (SU):	Code sections 507(a)(1) & 726(b) require that quarterly fees be paid pro rata with Chapter 7 administrative expenses in a case converted from Chapter 11. In contrast, the District Court's decision subordinates quarterly fees to Chapter 7 administrative expenses & contravenes the self-funding nature of the USTP. Accord: U.S. Trustee v. Endy, 104 F.3d 1154 (9th Cir. 1997) (held, as a matter of first impression, that UST quarterly fees have priority equal to that of Chapter 7 expenses & superior to Chapter 11 expenses, & must thus be first ratably paid).

UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

IN RE:)
)
PATRICK & LILIA ENDY,)
Debtors.)
)
UNITED STATES TRUSTEE,) CASE NO. 95-17060
)
Appellant,)
v.)
)
PATRICK ENDY, et al.,)
Appellees.)

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF NEVADA

DISTRICT COURT NO. CV-S-94-490-DWH (RLH)
BANKRUPTCY COURT NO. BK-S-90-24316-RCJ

BRIEF OF APPELLANT, UNITED STATES TRUSTEE

LINDA EKSTROM STANLEY
United States Trustee
R. PALMER CUNDICK
Assistant United States Trustee
BARRY H. JENKINS
Attorney-Advisor
Office of the United States Trustee
600 Las Vegas Boulevard, S, #430
Las Vegas, Nevada 89101

MARTHA L. DAVIS
General Counsel
JULIE A. DICAMILLO
Attorney
Executive Office for United States Trustees
901 E St., N.W., Suite 780
Washington, D.C. 20530
(202) 307-1399

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Boyd v. Dock's Corner Assoc. (In re Great Northern Forest Prods., Inc.), 135 B.R. 46 (Bankr. W.D. Mich. 1991)
Carpenters Health and Welfare Trust Funds For California v. Robertson (In re Rufener Constr., Inc.), 53 F.3d 1064 (9th Cir. 1995)
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STATUTES:

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11 U.S.C. § 507(a)(1)
11 U.S.C. § 726(a)

11 U.S.C. § 726(a)(1)
11 U.S.C. § 726(b)
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28 U.S.C. § 1930(a)
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OTHER AUTHORITIES:

Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1986, Pub. L. No. 99-554, 100 Stat. 3088, (the "1986 Act")
H.R. Rep. No. 764, 99th Cong., 2d Sess. 22 reprinted in 1986 U.S.C.C.A.N. 5227, 5234

NAME, ADDRESS, AND COURT OF BANKRUPTCY JUDGE

The name and address of the Bankruptcy Court that issued the underlying Order is:

Honorable Robert Clive Jones
U.S. Bankruptcy Court for District of Nevada
[*3] 300 Las Vegas Boulevard South
Las Vegas, Nevada 89101

STATEMENT OF JURISDICTION

The subject matter jurisdiction of the bankruptcy court is based on 28 U.S.C. § 157(b)(1), and the jurisdiction of the district court is based on 28 U.S.C. § 158(a)(1). The appeal is taken from a final order of the United States District Court for the District of Nevada, entered on May 19, 1995, affirming the bankruptcy court's final order denying the United States Trustee's motion to have quarterly fees paid as a priority chapter 7 claim. The issue on appeal in the district court arose under 28 U.S.C. § 1930(a)(6), and under sections 726 and 507(a) of title 11 of the United States Code, 11 U.S.C. § 101 et seq. (the "Bankruptcy Code").

This Court has jurisdiction over this appeal under 28 U.S.C. §§ 158(d) and 1291. The notice of appeal to the district court was timely filed on May 12, 1994, and the notice of appeal to this Court was timely filed on July 14, 1995. This appeal is timely pursuant to Rule 4(a) and 6(b) of the Federal Rules of Appellate Procedure.

STATEMENT OF THE ISSUE

Whether, in a bankruptcy case that has been converted from chapter 11 to chapter 7 of the Bankruptcy Code, quarterly fees owed to the United States Trustee should be treated in the same manner as and paid pro rata with chapter 7 administrative expenses.

STATEMENT OF THE STANDARD OF REVIEW

The applicable standard of review on appeal is clearly erroneous as to findings of fact and de novo as to conclusions of law. In re Siriani, 967 F.2d 302 (9th Cir. 1992). Because the instant case presents a question of law, the proper standard of review is de novo.

STATEMENT OF THE CASE AND STATEMENT OF THE FACTS

This appeal is taken from the final order of the United States District Court for the District of Nevada (Hagen, J.), entered on May 19, 1995, affirming the bankruptcy court's order denying the United States Trustee's motion for an order directing that quarterly fees be paid pro rata with chapter 7 administrative expenses. Appellant's Excerpts of Record ("E.R.") at 25, 43. On December 12, 1990, Patrick and Lilia Endy (the "debtors") filed a voluntary petition under chapter 11 of the Bankruptcy Code, seeking reorganization of their debts. E.R. at 31. While the case was pending under chapter 11, the debtors incurred $700 in unpaid quarterly fees pursuant to 28 U.S.C. § 1930(a)(6). E.R. at 4, 10.

The case was converted to the liquidation provisions of chapter 7 of the Bankruptcy Code on November 12, 1991, and Mr. Larry L. Bertsch was appointed the chapter 7 trustee. E.R. at 33-34. On January 13, 1992, the United States Trustee filed a proof of claim for $700 in unpaid quarterly fees. E.R. at 10. The case was closed as having no assets on October 7, 1992, but was subsequently reopened on motion of the chapter 7 trustee when assets were discovered. E.R. at 37. The trustee filed a Final Report on July 7, 1993, proposing to pay court fees and quarterly fees owed to the United States Trustee pro rata with chapter 7 administrative expenses. E.R. at 1-4, 37. After a hearing on September 14, 1993, the trustee submitted to the bankruptcy court an Order Settling Trustee's Final

Report and Order For Payment of Dividends. E.R. at 11.

[*4] By memorandum to the United States Trustee dated December 14, 1993, the clerk of the bankruptcy court declined to approve the Order without further direction of the court. E.R. at 15. The memorandum stated that the clerk would hold the orders of distribution pending issuance of a ruling regarding the priority status of quarterly fees owed to the United States Trustee. Id. The memorandum did not appear to question the payment priority of court fees.

On February 16, 1994, the United States Trustee filed a Motion for an Order Directing Payment of United States Trustee Quarterly Fees as a Priority Chapter 7 Claim Pursuant to Section 507(a)(1). E.R. at 16, 18, 37. On April 28, 1994, the bankruptcy court denied the United States Trustee's motion. Specifically, the bankruptcy court denied the United States Trustee's motion to have fees paid as a priority expense with chapter 7 administrative expenses, holding instead that in a case converted from chapter 11 to chapter 7, the quarterly fees should be subordinated to chapter 7 administrative expenses. E.R. at 22, 38.

The United States Trustee filed a notice of appeal to the district court on May 12, 1994, and also filed a Notice of Objection to the Ninth Circuit Bankruptcy Appellate Panel. E.R. at 23, 38, 39. The trustee made no distribution of the funds pending appeal to the district court.

By order entered May 19, 1995, the district court affirmed the decision of the bankruptcy court on alternative grounds. E.R. at 25-26, 43. The district court found that while quarterly fees should not be subordinated to chapter 7 administrative expenses, they should not be given priority over administrative expenses incurred in chapter 11. E.R. at 26. Accordingly, the court held that quarterly fees should be paid pro rata with all administrative expenses, whether incurred in chapter 7 or chapter 11. Id. Although neither the district court nor the bankruptcy court explicitly addressed the payment priority of court fees, the rulings presumably apply to those fees as well.

The United States Trustee and the chapter 7 trustee entered a stipulation that the funds would not be distributed pending the United States Trustee's appeal to this Court. E.R. at 43. The United States Trustee filed a notice of appeal of the district court's decision on July 14, 1995. E.R. at 27, 43.

SUMMARY OF ARGUMENT

Section 507 of the Bankruptcy Code establishes the priority of distribution for various types of claims. Section 507(a)(1) affords first priority of payment to "administrative expenses allowed under section 503(b) of [title 11], and any fees and charges assessed against the estate under chapter 123 of title 28." 11 U.S.C. § 507(a)(1). The various fees that can be assessed under chapter 123 of title 28 include quarterly fees payable to the United States Trustee under section 1930, as well as other types of court fees. See generally 28 U.S.C. §§ 1911-31.

In a distribution under chapter 7, all section 507(a)(1) claims are ordinarily paid first. 11 U.S.C. § 726(a)(1). If there are insufficient funds to pay all 507(a)(1) claims in full, then they are to be paid on a pro rata basis, with one exception: if the case has converted to chapter 7 from another chapter of the Bankruptcy Code, section 726(b) specifies that the administrative expenses incurred in chapter 7 are to be paid ahead of the administrative expenses incurred in any other chapter. 11 U.S.C. § 726(b). Consequently, in the instant situation, where the case has been converted from chapter 11 to chapter 7, the United States Trustee's claim for unpaid quarterly fees, which receives first priority under section 507(a)(1), is entitled to share pro rata with chapter 7 administrative expenses.

[*5] The lower courts incorrectly interpreted the statutes whereby Congress protected the United States Trustee's right to quarterly fees. The bankruptcy court erred in treating quarterly fees as if they were chapter 11 administrative expenses, and subordinating them to the chapter 7 administrative expenses. On appeal, the district court properly recognized the priority given to quarterly fees to participate pro rata with chapter 7 administrative expenses, but it erred in diluting that priority by expanding the class of ratable expenses to include, in addition to chapter 7 administrative expenses, all chapter 11 administrative expenses.

In summary, neither the bankruptcy court's nor the district court's decision is supported by the statutes, and both undermine congressional intent to make the United States Trustee program self-sustaining through payment of title 28 fees. Section 726(b) does not imply that chapter 7 administrative expenses are paid ahead of fees incurred under chapter 123 of title 28 (i.e., quarterly fees and court fees). The plain meaning of the relevant statutes and case law mandates payment of United States Trustee fees pro rata with chapter 7 administrative expenses.

ARGUMENT

I. TITLE 28 REQUIRES PAYMENT OF COURT FEES AND UNITED STATES TRUSTEE QUARTERLY FEES

By way of background, the Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1986, Pub. L. No. 99-554, 100 Stat. 3088, (the "1986 Act") established a nationwide system of United States Trustees to supervise the administration of bankruptcy cases. Congress established a self- funding structure based upon its conclusion that users of the bankruptcy system ought to pay for it. H.R. Rep. No. 764, 99th Cong., 2d Sess. 22 reprinted in 1986 U.S.C.C.A.N. 5227, 5234. See also United States Trustee v. Prines (In re Prines), 867 F.2d 478, 480 (8th Cir. 1989); United States Trustee v. Hirsch (In re Ehrman), 184 B.R. 362, 365

(D. Ariz. 1995). The United States Trustee Program is designed to be supported by a percentage of the filing fee paid to the bankruptcy court by all debtors under chapters 7, 11, 12, and 13 of the Bankruptcy Code, and by a quarterly fee payable in all chapter 11 cases to the United States Trustee. See 28 U.S.C. § 1930(a). This system of self-funding is implemented through chapter 123 of title 28, which governs the judiciary and judicial procedure.

The amount owed for quarterly fees is based on the level of disbursements in the chapter 11 case. See 28 U.S.C. § 1930(a)(6). [**FN**1] The amount of the fees and the obligation to pay them arise by operation of law, and no judicial act is required to fix the amount due or to require its payment. In re K & M Printing and Lithographing, Inc., 135 B.R. 404, 406 (Bankr. D. Or. 1992). See also Coley v. Rose Truck Brokers, Inc. (In re Rose Truck Brokers, Inc.), 166 B.R. 179, 180 (M.D. Fla. 1992). [**FN**2]

II. SECTIONS 507(a)(1) AND 726(b) OF THE BANKRUPTCY CODE REQUIRE THAT QUARTERLY FEES BE PAID PRO RATA WITH CHAPTER 7 ADMINISTRATIVE EXPENSES IN A CASE THAT HAS CONVERTED FROM CHAPTER 11

[*6] Section 726 of the Bankruptcy Code governs the distribution of property of the estate in all chapter 7 cases. Specifically, section 726(a) provides in pertinent part:

> (a) ... property of the estate shall be distributed --
> (1) first, in payment of claims of the kind specified in, and in the order specified in, section 507 of this title....11 U.S.C. § 726(a).

Section 507 of the Bankruptcy Code, referenced in section 726(a), establishes the priority of distribution for various types of claims. Section 507(a) provides:

> (a) The following expenses and claims have priority in the following order:
> (1) First, administrative expenses allowed under section 503(b) of this title, and any fees and charges assessed against the estate under chapter 123 of title 28.

11 U.S.C. § 507(a). [**FN**3]

As is discussed supra, part I, quarterly fees are owed to the United States Trustee under 28 U.S.C. § 1930(a)(6), which is found in chapter 123 of title 28. Therefore, quarterly fees are "fees" within the meaning of section 507(a)(1), and, along with court fees, have equal priority with administrative expenses incurred under the Bankruptcy Code.

Section 726(b) of the Bankruptcy Code governs the payment of claims when there are insufficient funds to pay all claims in full. Section 726(b) provides:

> Payment on claims of a kind specified in paragraph (1) ... of section 507(a) of this title ... shall be made pro rata among claims of the kind specified in each such particular paragraph, except that in a case that has been converted to this chapter ... a claim allowed under section 503(b) of this title incurred under [chapter 7] after such conversion has priority over a claim allowed under section 503(b) of this title incurred under any other chapter of this title...

11 U.S.C. § 726(b) (emphasis added).

Section 726(b) initially provides that claims within a class, such as administrative expenses incurred under the Bankruptcy Code and title 28 fees, are to be paid pro rata. If the case has been converted to chapter 7 from another chapter, however, section 726(b) provides that the administrative expenses incurred in chapter 7 are to be paid ahead of administrative expenses incurred in the other chapters.

Because quarterly fees are not administrative expenses, but are fees incurred under title 28, section 726(b) does not alter their first priority status as expressly granted by section 507(a)(1). Accordingly, when read together, sections 726(b) and 507(a)(1) make clear that quarterly fees should be paid pro rata with chapter 7 administrative expenses. The only circuit court to have decided this issue has so held. Huisinga v. Carter (In re Juhl Enters., Inc.), 921 F.2d 800 (8th Cir. 1990). In Juhl, the Eighth Circuit stated:

> [s]ection 726(a) places the Trustee's fee and the § 503(b) administrative expenses on the same footing. But § 726(b) removes the Chapter 11 § 503(b) expenses from that lofty status. It does not mention the Trustee's quarterly fees. The only possible result of this omission is that the Trustee's quarterly fee payments have the same priority as the Chapter 7 administrative expenses.

[*7] Juhl, 921 F.2d at 803 (emphasis added).

In a recent decision by the District Court for the District of Arizona, the court emphasized that the language of section 507(a) makes clear that charges and fees incurred under title 28 are distinct from administrative expenses incurred under the Bankruptcy Code. In re Ehrman, 184 B.R. at 364, 366 (reversing bankruptcy court's ruling that quarterly fees do not get paid pro rata with chapter 7 administrative expenses). Rejecting the minority view that quarterly fees are subordinated to chapter 7 administrative expenses and are paid pro rata with chapter 11 administrative expenses, the Ehrman court held that section 726 operates to subordinate only administrative claims incurred in chapters other than chapter 7. Id. at 365-66. Therefore, section 726 leaves unaffected quarterly fees incurred under title 28. In re Ehrman, 184 B.R. at 365-66. See also In re Lochmiller Indus., Inc., 178 B.R. 241, 250 (Bankr. S.D. Cal. 1995) ("[t]he only dictate in the Code which applies to the fees of the U.S. Trustee is section 507(a)(1) which affords them first priority").

All the courts to have addressed this issue except one have agreed that quarterly fees should be paid pro rata with chapter 7 administrative expenses after a case has converted from chapter 11 to chapter 7. See Ross v. Kanaga (In re Darmstadt Corp.), 164 B.R. 465, 470-71 (D. Del. 1994); In re Metro Transp. and Health Referral, Inc., 165 B.R. 832, 834 (Bankr. N.D. Ohio 1994); In re Bancroft Laundry Ctr., Inc., 164 B.R. 586, 588 (Bankr. N.D. Ohio 1994); In re Seacoast Carpet & Tile of Naples, Inc., 151 B.R. 962, 963 (Bankr. M.D. Fla. 1993); In re K & M Printing & Lithographing, Inc., 135 B.R. 404, 407 (Bankr. D. Or. 1992); In re AM-PM Photo Camera Fashions, Inc., 116 B.R. 222, 222 (Bankr. D. Idaho 1990). But see Reitmeyer v. Wetmore (In re Wetmore), 117 B.R. 201, 201-02 (Bankr. W.D. Pa. 1990) (holding that quarterly fees and filing fees are administrative expenses under section 507(a)(1), and are therefore subordinated to chapter 7 administrative expenses).

Here, the district court properly acknowledged the majority line of cases which correctly holds that section 726 does not subordinate quarterly fees to chapter 7 administrative expenses. [**FN**4] The court further stated, however, that the majority view grants quarterly fees "an unwarranted priority over § 503(b) administrative expenses incurred prior to conversion." United States Trustee v. Endy (In re Endy), 181 B.R. 526, 529 (D. Nev. 1995). The district court consequently adopted the novel approach that quarterly fees should share pro rata with all section 503(b) administrative expenses, whether incurred in chapter 7 or chapter 11. Id. at 529. [**FN**5]

In concluding that quarterly fees should not be given an "unwarranted priority," the district court failed to afford quarterly fees the "priority" to which they are indisputably entitled. Section 507(a)(1) states unequivocally that charges assessed under chapter 123 of title 28 (i.e., quarterly fees and court fees) are to be treated in the same manner as administrative expenses allowed under section 503. Section 726(b) provides only that administrative expenses incurred in chapter 7 are to be paid ahead of administrative expenses incurred in other chapters of the Bankruptcy Code. It does not otherwise affect or purport to affect the first payment priority of quarterly fees and other chapter 123, title 28 charges.

[*8] The first priority status of quarterly fees remains intact regardless of whether a conversion has occurred. The statutes require that quarterly fees be paid pro rata with allowed administrative expenses (i.e., those that have not been subordinated by another provision of the Bankruptcy Code). In light of the clear statutory language, the district court's assertion that quarterly fees not be given an "unwarranted priority" lacks foundation. See In re Lochmiller, 178 B.R. at 250 (because section 507(a)(1) affords quarterly fees first priority, "[t]he question ... is not whether the fees of the U.S. Trustee should be elevated, but rather whether they should be subordinated").

In addition, a closer examination of the court's decision suggests that it is more far-reaching than it first appears. Although the court did not directly address the payment priority of court fees, its analysis would apply to all fees and expenses assessed under chapter 123 of title 28. This means that all court fees, whether incurred in chapter 11 or chapter 7, would be denied pro rata treatment with chapter 7 administrative expenses in a converted case.

The district court decision simply does not comport with congressional intent as set forth in the statutes. In examining statutory language, "[a] fundamental canon of statutory construction is that ... words will be interpreted as taking their ordinary ... common meaning." Perrin v. United States, 444 U.S. 37, 42 (1979). In examining the plain meaning of the statutes, the relevant provisions must be read as a whole. Carpenters Health and Welfare Trust Funds For California v. Robertson (In re Rufener Constr., Inc.), 53 F.3d 1064, 1067 (9th Cir. 1995). Here, section 726(b) states merely that chapter 7 administrative claims have priority over administrative expenses incurred under another chapter of the Bankruptcy Code. The district court's alternative scheme of distribution interferes with the plain meaning of the statutes when read as a whole. As the district court in Ehrman observed, the court's ruling in Endy reads into section 726 an additional step for determining the priority of payment. In re Ehrman, 184 B.R. at 366 (concluding that the result of the Endy decision is to "alter the plain meaning of § 507(a)"). Accordingly, in examining the applicable statutes, it is apparent that the district court's ruling constitutes a far-reach from the plain statutory language, and should be reversed.

III. THE DISTRICT COURT'S DECISION RESULTS IN QUARTERLY FEES NOT BEING PAID PRO RATA WITH CLAIMS WITHIN THE SAME CLASS, AND IN EFFECT SUBORDINATES QUARTERLY FEES TO CHAPTER 7 ADMINISTRATIVE EXPENSES

As discussed, section 726(b) provides the statutory basis for requiring claims within a class to be paid pro rata if there are insufficient funds to pay all claims in full. This principle is fundamental to the usual scheme of distribution contemplated in a chapter 7 case. See, e.g., Begier v. Internal Revenue Service, 496 U.S. 53, 58 (1990) ("creditors of equal priority should receive pro rata shares of the debtor's property"); In re Swann, 149 B.R. 137, 145 (Bankr. D.S.D. 1993) ("[a] fundamental policy of the Bankruptcy Code is equality of distribution"); Boyd v. Dock's Corner Assoc. (In re Great Northern Forest Prods., Inc.), 135 B.R. 46, 66 (Bankr. W.D. Mich.

1991) ("all claimants whose claims are entitled to the same class of distribution shall be reimbursed pro-rata").

[*9] In its simplest terms, pro rata means that each claimant within a class must have an equal percentage of his or her claim paid. The error of the district court's decision is manifested by the fact that it disrupts the system of pro rata distribution and results in quarterly fees being paid a smaller percentage of their claim than chapter 7 administrative claimants.

Under the district court's analysis, discussed supra note 5, the United States Trustee would be paid $2,000 of its $5,000 claim for quarterly fees, amounting to 40% of its claim, while chapter 7 administrative claimants would receive $4,000 of their $5,000 claims -- or 80% of their claims. See In re Endy, 181 B.R. at 529 n.3. Insofar as quarterly fees are paid a smaller percentage of their claim than are chapter 7 administrative claims, they are placed in a less favorable position for the distribution of funds, and for all practical purposes are subordinated. Although the district court correctly agreed that quarterly fees should not be subordinated to chapter 7 administrative expenses, the practical effect of the court's analysis accomplishes just that -- it subordinates the United States Trustee's claim to the chapter 7 administrative expenses.

While the district court's analysis results in a greater distribution for quarterly fees than does the "minority view," which would pay all chapter 7 expenses prior to paying any quarterly fees and chapter 11 expenses, the court's scheme nonetheless presents an impermissible statutory interpretation. See In re Lochmiller, 178 B.R. at 250 (concluding that there exists no statutory authority to support the subordination of quarterly fees after a case has converted from chapter 11 to chapter 7). The district court diluted the priority afforded to quarterly fees by expanding the class of administrative expenses that get paid pro rata. The net effect of the court's analysis scheme of distribution envisioned by the Bankruptcy Code in a case converted from chapter 11 to chapter 7, this Court should reverse the ruling below.

IV. THE DISTRICT COURT'S HOLDING IS CONTRARY TO THE SELF-FUNDING NATURE OF THE UNITED STATES TRUSTEE PROGRAM

In establishing a self-funded United States Trustee Program, Congress also enacted various statutory means to achieve that goal. For example, the 1986 Act amended section 1112(b) of the Bankruptcy Code to provide that "nonpayment of any fees or charges required under chapter 123 of title 28" would be an additional ground for converting or dismissing a chapter 11 case. Congress clearly envisioned that nonpayment of these fees in chapter 11 could result in the case being converted to chapter 7. Consequently, it would be reasonable to assume that had it intended to remove the first priority afforded them by section 507(a), it could have done so through section 726(b). Notably, Congress made no decision to alter the current meaning of these provisions in the Bankruptcy Reform Act of 1994. In re Ehrman, 184 B.R. at 366.

[*10] Congress also granted special treatment to quarterly fees in chapter 11 plans. The 1986 Act amended section 1129(a) of the Bankruptcy Code to include, as a prerequisite for confirmation, that "[a]ll fees payable under section 1930 of title 28, as determined by the court at the hearing on confirmation of the plan, have been paid or the plan provides for the payment of all such fees on the effective date of the plan." 11 U.S.C. § 1129(a)(12). Therefore, Congress recognized the payment priority of quarterly fees even in chapter 11 cases.

Here, the debtors benefitted from the protections afforded by chapter 11 for almost one year. Over this time period, the debtor incurred $700 in quarterly fees, which they did not pay. Now that the case has converted to chapter 7, the United States Trustee is entitled to exercise her first priority right in funds of the estate to ensure the financial stability of the United States Trustee Program. There is no doubt that Congress intended this result, and accordingly, the statutory provisions give effect to this purpose. As the Eighth Circuit has stated, "[t]he primary objective of statutory construction is to determine legislative intent." In re Prines, 867 F.2d at 484. Congress' intent is clearly enunciated by the plain meaning of the statutes relevant in this case. "[W]here, as here, the statute's language is plain, 'the sole function of the courts is to enforce it according to its terms.' " United States v. Ron Pair Enters., Inc., 489 U.S. 235, 241 (1989) (citation omitted).

CONCLUSION

For the foregoing reasons, the United States Trustee respectfully requests this Court to reverse the district court order entered May 19, 1995, affirming the bankruptcy court's order denying the United States Trustee's motion to have quarterly fees be paid pro rata with chapter 7 administrative expenses.

Respectfully submitted,
LINDA EKSTROM STANLEY
United States Trustee
R. PALMER CUNDICK
Assistant United States Trustee

Barry H. Jenkins
Attorney-Advisor
Office of the United States Trustee
600 Las Vegas Boulevard, S, #430

Las Vegas, Nevada 89101

MARTHA L. DAVIS
General Counsel
By: JULIE A. DICAMILLO
Attorney
Executive Office for United States Trustees
901 E St., N.W., Suite 780
Washington, D.C. 20530
(202) 307-1399

DATED: December 11, 1995

STATEMENT OF RELATED CASES AND PROCEEDINGS

The appellant, the United States Trustee, is not aware of any cases in this Circuit that are related to this action.

LINDA EKSTROM STANLEY
United States Trustee
R. PALMER CUNDICK
Assistant United States Trustee
Barry H. Jenkins
Attorney-Advisor
Office of the United States Trustee
600 Las Vegas Boulevard, S, #430
Las Vegas, Nevada 89101

MARTHA L. DAVIS
General Counsel
By: JULIE A. DICAMILLO
Attorney
Executive Office for United States Trustees
[*1]1 Suite 780
901 E St., N.W.
Washington, D.C. 20530
(202) 307-1399

DATED: December 11, 1995

CERTIFICATE OF SERVICE

I hereby certify that on this 11th day of December, 1995, I have served a copy of the foregoing Appellant's brief by prepaid first class mail upon the following persons:

Larry L. Bertsch, Esq.
1455 E. Tropicana #470
P.O. Box 448
Las Vegas, Nevada 89119

Patrick and Lilia Endy
2120 Industrial Road
Las Vegas, Nevada 89102

Joshua Landish, Esq.
818 E. Charleston
Las Vegas, Nevada 89104

Patricia Gray
Clerk of the U.S. Bankruptcy Court
U.S. Bankruptcy Court
District of Nevada
300 Las Vegas Boulevard South
Las Vegas, Nevada 89101

Julie A. DiCamillo

DATED: December 11, 1995

FOOTNOTES

FN1. When cases are commenced under chapter 11, the United States Trustee Program is entitled to receive a fee each quarter until a plan is confirmed or the case is converted or dismissed, whichever occurs first. 28 U.S.C. § 1930(a)(6).

FN2. Cf. Perroton v. Gray (In re Perroton), 958 F.2d 889, 893-94, 896 (9th Cir. 1992) (holding that because a bankruptcy court is not a "court of the United States," it lacks authority under 28 U.S.C. § 1915(a) to waive payment of statutorily required filing fees).

FN3. "Administrative expenses" are distinct from "fees and charges" incurred under chapter 123 of title 28. The use of the word "and" in the statute creates two independent categories of first priority claims: one for title 11 "administrative expenses" and the other for title 28 "fees and charges." Huisinga v. Carter (In re Juhl Enters., Inc.), 921 F.2d 800, 803 (8th Cir. 1990). This distinction is supported by the language of section 503(b), which lists allowable title 11 administrative expenses, and makes no mention of court fees or quarterly fees. Id.

FN4. In this respect, the district court disagreed with the bankruptcy court's conclusion. In re Endy, 166 B.R. 438, 439 (Bankr. D. Nev. 1994).

FN5. Footnote 3 of the district court opinion provides a numerical illustration of its scheme of distribution, and compares it with both the majority and minority views. See In re Endy, 181 B.R. at 529 n.3. Under the district court's method, if $6,000 were available for distribution, and if chapter 7 and chapter 11 administrative claims each totalled $5,000, and quarterly fees totalled $5,000, then the pro rata share for quarterly fees would be 1/3 of $6,000, or $2,000. Of the remaining $4,000 available for distribution, the chapter 7 administrative claims would be entitled to $4,000, leaving nothing for chapter 11 administrative claims. Although the district court's interpretation results in a greater distribution for quarterly fees than does the minority view, it results in a smaller distribution than the majority view.

1995 WL 1016523 (USTBRIEFS)

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BRIEF BANK — "SUMMARY SHEET" *Printed Tue-12/23/08 17:33*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE
[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]

In re: English Sheppard Realty (English Sheppard Realty Corp. and Phillip D. Miller v. Charles E. Simpson, English Sheppard Realty Corp. and Diana G. Adams, UST)

2. ("CO") ***CURRENT*** COURT
[E.g., "CTA9"]

2nd Cir.

3. ("CCN") ***CURRENT*** CASE NO.

No.: 07-5295

4. ("PCN") ***PRIOR*** CASE NO. & COURT
[IF ANY]

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Court: E.D.N.Y.

(Identify judge & cite, if any)

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Eric Bradford, Bill Curtin, Walt Theus, P. Matthew Sutko

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8. ("TO") ***TOPIC***

BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s)

&

√ Any Miscellaneous ***BACKGROUND***

• Whether the bankruptcy court erred in denying fees to an attorney for work in a chapter 11 case where the attorney was never retained under section 327(a), did not establish a right to fees under section 330(a), and improperly took estate funds to pay himself, which justified disgorgement of all fees as a sanction?

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Case No. 07-5295-bk

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

IN RE:)
)
ENGLISH SHEPPARD REALTY CORP.)
)
Debtor.)
-)
PHILLIP D. MILLER,)
)
Creditor/)
Appellant,)
v.)
)
CHARLES E. SIMPSON, ENGLISH)
SHEPPARD REALTY CORP.,)
)
DIANA G. ADAMS, UNITED STATES)
TRUSTEE, REGION 2,)
)
Appellees.)

APPEAL FROM THE UNITED STATES
DISTRICT COURT FOR THE
EASTERN DISTRICT OF NEW YORK

BRIEF OF APPELLEE, DIANA G. ADAMS, UNITED STATES TRUSTEE, REGION 2

P. Matthew Sutko
Walter W. Theus, Jr.
Executive Office for United States Trustees
Department of Justice
20 Massachusetts Ave., N.W.
Washington, D.C. 20530
Phone: (202) 307-1399
Fax: (202) 307-2397

Eric K. Bradford
Office of the United States Trustee
Department of Justice
10 Causeway Street, Room 1184
Boston, MA 02222-1043
Phone: (617) 788-0415
Fax: (617) 565-6368

William E. Curtin
Office of the United States Trustee
Department of Justice
271 Cadman Plaza East, Suite 4529
Brooklyn, NY 11201
Phone: (718) 422-4960
Fax: (718) 422-4990

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STATEMENT OF JURISDICTION

The United States Bankruptcy Court for the Eastern District of New York had jurisdiction over the English Sheppard Realty Corp. (“ESR”) chapter 11 bankruptcy case under 28 U.S.C. 157(a) and (b) and 1334(a). MA 1 - 22; 919 – 939; 1036 – 1041; AUS Ex. 22.[1] On June 19, 2006 (“June 19, 2006 Order”), the bankruptcy court denied the fee application of Phillip D. Miller, Esq. (“Miller”) and directed him to disgorge $298,000 that he had taken from an estate escrow account. AUS Ex. 22.

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[1] Miller did not comply with Second Cir. R. App. P. 6(b)(i) by re-designating the record and re-stating the issues on appeal from the district court. On September 26, 2008, Miller filed with the Court a three volume, 1,552 page “joint” appendix under Second Cir. R. App. P. 30, consisting of selected portions of the record below, as well as extraneous documents which were neither entered on the bankruptcy court docket nor considered by the lower courts. Miller’s appendix omitted his March 25, 2003 fee application (Docket #77) and the transcript of the May 16, 2006 bankruptcy court hearing (Docket #116), which set forth the findings of fact and conclusions of law memorialized in the June 19, 2006 Order. The United States Trustee did not contribute to Miller’s appendix under Second Cir. R. App. P. 30(b)(1). On October 6 and 27, 2008, Miller supplemented his joint appendix with special appendices under Second Cir. R. App. P. 32(d). The bankruptcy court did not consider any of these documents in connection with the June 19, 2006 Order, and none of them constitutes a “rule of law, including any constitutional provision, treaty, statute, ordinance . . . .” under Second Cir. R. App. P. 32(d). Inasmuch as “the entire record is available to the [C]ourt . . .” under Fed. R. App. P. 30(b)(1), the United States Trustee refers to the record by citing to Miller’s appendix as “MA __” and to the United States Trustee’s district court appendix, which consists of 24 tabbed exhibits, as “AUS Ex. __.”

On June 29, 2006, Miller timely appealed the June 19, 2006 Order to the United States District Court for the Eastern District of New York. MA 22; 1035; 1026 - 1029. The district court had jurisdiction under 28 U.S.C. 158(a)(1). MA 1097 – 1106.

On September 25, 2007, the district court affirmed the June 19, 2006 Order in all respects. MA 1097 – 1106. Miller timely appealed the district court's order to this Court on November 26, 2007. MA 1539 - 1541. This Court has jurisdiction over this appeal under 28 U.S.C. 158(d)(1).

STANDARD OF REVIEW

On appeal of an intermediate order affirming a bankruptcy court decision, this Court reviews "the bankruptcy court decision independently, accepting its factual findings, unless clearly erroneous but reviewing its conclusions of law de novo . . . ." Casse v. Key Bank, N.A. (In re Casse), 198 F.3d 327, 332 (2d Cir. 1999). It reviews orders denying and disgorging attorneys' fees for abuse of discretion. In the Matter of Arlan's Dept. Stores, Inc., 615 F.2d 925 (2d Cir. 1979). "An abuse of discretion arises where (1) the bankruptcy judge fails to apply the proper legal standard or follows improper procedures in determining the fee award, or (2) bases an award on findings of fact that are clearly erroneous . . . ." In re JLM, Inc., 290 B.R. 19, 23 (B.A.P. 2d Cir. 1997). (citations omitted).

STATEMENT OF THE ISSUE PRESENTED FOR REVIEW

In order to receive compensation from the bankruptcy estate, an attorney working as counsel for a chapter 11 debtor must meet two tests. First, he must be employed under 11 U.S.C. 327(a). Second, the bankruptcy court must award him fees under 11 U.S.C. 330(a). The bankruptcy court never entered an order under section 327(a) approving Miller's employment as ESR's counsel. It also never entered a fee order. The court directed Miller to hold sale proceeds of estate property in an escrow account. Miller instead converted the funds, which he had commingled with other clients' funds in a common trust account, and used them to pay himself and for other purposes. Did the bankruptcy court abuse its in discretion directing Miller to disgorge the fees he paid himself and denying his fee request?

STATEMENT OF THE CASE

Miller filed a chapter 11 bankruptcy case on behalf of ESR in January, 1999 so that it might reorganize its business. MA 30 – 31. The bankruptcy court never approved Miller's employment as ESR's general bankruptcy counsel under 11 U.S.C. 327(a). MA 2 – 3; 40 – 45; 56. AUS Ex. 6 at 3 – 4. It also never awarded him fees under 11 U.S.C. 330(a)(1)(A). MA 1277; AUS Ex. 9; 13; 19; 21.

On January 26, 2000, the bankruptcy court authorized ESR to sell its sole asset, an apartment building, and it directed Miller to deposit the net sale proceeds, which totaled $281,811.63, into an escrow account pending further court order. MA 108 – 115. Miller deposited the net sale proceeds into a commingled IOLA account. He then violated the escrow order by converting the funds to engage in unauthorized transactions, including paying himself fees.

The United States Trustee moved the bankruptcy court for an order requiring Miller to disgorge all fees. AUS Ex. 6; 7; 11; 12; 14; 18; 20. The bankruptcy court entered the June 19, 2006 Order, which direct Miller to disgorge $298,000. It also denied his request for a fee award. MA 22; 919 – 939; 1036 – 1041; AUS Ex. 22.

On June 29, 2006, Miller appealed the bankruptcy court's June 19, 2006 Order. MA22; 1035. Finding no abuse of discretion, the district court affirmed on September 25, 2007. MA 28 – 29; 1097 – 1106. This appeal followed. MA 29; 1539.

STATEMENT OF THE FACTS

A. Statutory Framework

Upon commencement of a chapter 11 case, all of the debtor's property becomes property of the bankruptcy estate. 11 U.S.C. 541(a). Under the Bankruptcy Code, all third parties - including the debtor's pre-petition counsel - must turn over all property of the estate to the debtor. 11 U.S.C. 542(a).

The Bankruptcy Code provides a comprehensive and exclusive scheme governing the retention, compensation and payment of bankruptcy professionals, such as attorneys, in chapter 11 and 7 cases. It grants bankruptcy courts significant discretion in approving professional employment and compensation in order to protect estate assets and to promote the integrity of the bankruptcy system.

Section 327(a) authorizes a chapter 11 debtor to hire attorneys to assist it in fulfilling its responsibilities "with the court's approval . . . ." 11 U.S.C. 327(a). In order to be employed under 11 U.S.C. 327(a), a proposed attorney must demonstrate that he is disinterested and that he neither has nor represents an interest adverse to estate.

Section 330(a) authorizes a bankruptcy court to pay a debtor's attorney "reasonable" compensation for his "actual and necessary services." 11 U.S.C. 330(a)(1)(A). The court may authorize reimbursement of the attorney's "actual" expenses if they are "necessary." 11 U.S.C. 330(a)(1)(B).

A debtor’s attorney bears the burden of demonstrating his entitlement to fees and expenses under 11 U.S.C. 330(a). If an attorney fails to meet his burden of proof under 11 U.S.C. 330(a), the bankruptcy court, with or without an objection from a party in interest, may award compensation “less than the amount of compensation that is requested . . . .” 11 U.S.C. 330(a)(2). Section 330(a)(4) prohibits the bankruptcy court from awarding compensation for “unnecessary duplication of services . . . or . . . services that were not . . . reasonably likely to benefit the debtor’s estate . . . or . . . necessary to the administration of the estate . . . .” 11 U.S.C. 330(a)(4). Section 331 authorizes bankruptcy professionals to seek interim compensation on the same basis as under section 330(a).

In order to receive compensation under 11 U.S.C. 330(a), a debtor’s attorney must meet two tests. First he must be employed under 11 U.S.C. 327(a). Second, regardless of the source of compensation, the bankruptcy court must grant a fee award. Estate professionals are entitled to first priority payment under 11 U.S.C. 503(a) and 507(a)(1) ahead of general unsecured creditors.

United States Trustees are officials of the Department of Justice appointed by the Attorney General to supervise the administration of bankruptcy cases and trustees. <u>See</u> 28 U.S.C. 581-589 (specifying the powers and duties of United States

Trustees).[2] Congress has expressly authorized United States Trustees to comment upon and object to fee applications filed by bankruptcy professionals. 28 U.S.C. 586(a)(3)(A); 11 U.S.C. 307 and 330(a)(2). The United States Trustees have issued guidelines regarding bankruptcy professional fee applications in chapter 11 and 7 cases. 28 C.F.R. Pt. 58, App. A (1996).

B. Factual Background.

Miller filed a voluntary chapter 11 petition on behalf of ESR on January 11, 1999, commencing a case under the debt reorganization provisions of chapter 11 of the Bankruptcy Code, 11 U.S.C. 1101, et seq.[3] MA 30 - 31. Dr. Josephine English signed the petition in her capacity as president and 100% owner of ESR. MA 31 – 32. In its schedules and statement of financial affairs, ESR stated that it owned as its sole asset a 27 unit apartment building located at 1325 Union Street, Brooklyn, NY ("1235 Union Street").

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[2] See also In re Columbia Gas Sys., Inc., 33 F.3d 294, 296 (3d Cir. 1994) (United States Trustees oversee the bankruptcy process, protect the public interest, and ensure that bankruptcy cases are conducted according to law) (citing H.R. Rep. No. 95-595, 109 (1977)); United States Trustee v. Revco D.S., Inc. (In re Revco D.S., Inc.), 898 F.2d 498, 499 (6th Cir. 1990) ("[t]he United States trustee, an officer of the Executive Branch, represents . . . [the] public interest . . . ."); In re Castillo, 297 F.3d 940, 950 (9th Cir. 2002) ("The United States Trustee is the 'watchdog' of the bankruptcy system . . . charged with preventing fraud and abuse and with 'fill[ing] the vacuum' caused by possible creditor inactivity . . . .").

[3] The United States Trustee reprints the principal statutes upon which it relies, 11 U.S.C. 327(a), 330(a), 503 and 507, as well as E.D.N.Y. L. Bankr. R. 2013-1 and 2014-1, in an addendum ("Add. __") attached to this brief.

Miller submitted a draft ex parte order and his proposed employment application as debtor's counsel under E.D.N.Y. L. Bankr. R. 2014-1(c) to the bankruptcy court clerk on March 22, 1999.[4] The rule required professionals seeking ex parte employment to send a "proposed order and supporting documentation . . . to the United States Trustee for review prior to filing with the Clerk . . . ." Add. at 4.

The clerk forwarded Miller's order and application to the United States Trustee for review on or about March 25, 1999. MA 40 – 45; 56; AUS Ex. 6 at 3 - 4. The United States Trustee did not endorse Miller's proposed ex parte order. Id. Miller did not thereafter file the proposed application with the clerk or request a hearing on his employment application. MA 2 – 3. The bankruptcy court never entered an order on the docket approving his employment. Id.

On January 26, 2000, the bankruptcy court entered an order ("Escrow Order") authorizing ESR to sell 1325 Union Street for $670,000. MA 108 – 115. The Escrow Order required the Debtor to pay the first lien mortgagee $394,617.21 at closing, "plus $85.32 for each day after January 18, 2000, subject to confirmation . . . ." MA 112. It explicitly directed Miller to escrow the sale

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[4] The blackline version of the rule contained in the attached Addendum shows changes effective May 28, 2008. Add. at 4. The 2008 amendments did not alter ex parte employment procedures.

proceeds, net of the payment to the mortgagee, ("Net Sale Proceeds"), pending further court order. The Escrow Order stated that "[t]he remaining portion of the sale proceeds shall be paid to the Debtor by payment to Debtor's counsel to be held in escrow pending confirmation of Debtor's Chapter 11 Plan of Reorganization . . . and distribution pursuant to Court Order . . . ." Id. (emphasis added). Miller deposited Net Sale Proceeds totaling $281,811.63 into his commingled IOLA account at Chase Bank. He did not establish a segregated escrow account for ESR's benefit. MA 649; 1435.

The bankruptcy court entered an order under 11 U.S.C. 327(a) dated May 1, 2001 appointing Windels Marx Lane & Mittendorf, ("Windels") as ESR's counsel. MA 29 – 31. On July 20, 2001, ESR, through Windels, filed a motion ("Turnover Motion") to compel Miller to account for and to turn over the Net Sale Proceeds. MA173–182. The Turnover Motion also sought to compel Miller to file a fee application for his work during ESR's chapter 11 case. Id. The bankruptcy court granted the Turnover Motion on October 9, 2001. MA 184 - 186.

On December 7, 2001, Miller provided an accounting to Windels, which he supplemented on January 31, 2002 ("Miller Accounting"). MA 1117; AUS Ex. 13, A-13. That same day, Miller gave Windels a check drawn on his commingled IOLA account for $35,447.42. MA 1117. This amount was $246,364.21 less than the Net Sale Proceeds that he received from the buyer of 1325 Union Street.[5] Id. Miller filed his fee application ("Fee Application") on March 25, 2003. MA 14.

On October 24, 2001, the United States Trustee filed a motion ("Disgorgement Motion") to compel Miller to disgorge all fees for ESR legal work that he had received from the Debtor, Dr. English and any entity related to the Debtor. AUS Ex. 6. The United States Trustee supplemented the Disgorgement Motion on December 9, 2003.[6] AUS Ex. 6; 7; 12.

In his responsive pleadings, Miller admitted that the bankruptcy court had not authorized his employment under 11 U.S.C. 327(a) or awarded him fees under 11 U.S.C. 330(a). He further admitted that he had almost entirely dissipated the Net Sale Proceeds by engaging in unauthorized transactions on behalf of ESR,

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[5] Miller attached the Miller Accounting to a February 13, 2004 memorandum supporting his March 25, 2003 fee application. AUS Ex. 13; 23 at 2. On November 15, 2001, the court authorized ESR to retain the accounting firm of Gruber & Palumberi, P.C. ("Gruber") in order to "determine the disposition of the Debtor's assets . . . [and] what, if any, sale proceeds are available or have been dissipated by Miller . . . ." MA 8; 336 – 337; 354. Gruber prepared a review dated May 2, 2002 ("Gruber Review") of the Miller Accounting. ERS attached the Gruber Review to its May 5, 2004 response to Miller's objection to the Disgorgement Motion. MA 18; AUS 31 – 33.

[6] ESR joined the Disgorgement motion and objected to Miller's Fee Application on December 9, 2003 (collectively "ESR Objection"). It supplemented the ESR Objection on February 17, 2004 and May 5, 2004 (attaching the Gruber Review). AUS Ex. 8; 11; 14; 18.

settling litigation on behalf of non-debtors and paying himself fees. AUS Ex. 9; 13; 19; 21. See Amended Brief at 13; MA 1117.

Judge Duberstein conducted a hearing on the Disgorgement Motion, the ESR Objection and Miller's Fee Application on March 11, 2004. MA 18; 919 – 939. The court confirmed that it had not entered an order authorizing Miller's employment under section 327(a). MA 922. It denied Miller's Fee Application and ordered him to disgorge. MA 929. Judge Duberstein did not enter an order finalizing the amount to be disgorged before he died, however. The ESR case was reassigned to Judge Eisenberg on December 29, 2005. MA 20.

Judge Eisenberg conducted a second hearing on the Disgorgement Motion, the ESR Objection and Miller's Fee Application on May 16, 2006. AUS Ex. 22. The Miller Accounting and the Gruber Review, which the court reviewed at the hearing, showed that Miller had written checks to himself and others from his commingled IOLA account totaling $298,124.36. AUS Ex. 13, A-13; 18. They demonstrated that, of this amount, Miller had written checks to himself totaling $53,500 for "attorneys' fees." Id. They also showed that Miller had written checks to himself for an additional $85,174.78 without explanation, either in the form of book entries or notations on the checks themselves. Id.

In response to the court's questions, Miller failed to explain entries in the Miller Accounting showing that ESR had used $220,000 of the Net Sale Proceeds to purchase stock in a non-debtor company. He also failed to explain why he had made certain disbursements both to himself and to Dr. English. AUS Ex. 22 at 57; 61 - 62; 69 – 70.

Miller conceded that the bankruptcy court had issued no orders authorizing him to disburse the Net Sales Proceeds for any purpose, including paying himself fees. Id. at 10; 17 – 19; 24 – 26; 33 – 36; 49 -51; 61; 63; 68. He offered no evidence demonstrating that his services were necessary and benefited the ESR estate. Id.

In granting the Disgorgement Motion and denying the Miller Fee Application, the court found that Miller "misinterpreted, at the very least, the Court order to put the money into a separate account in the name of the debtor, and not doing so is a violation of a number of things, including probably something that the Bar Association might want to look at . . . .)." AUS Ex. 22 at 56. The court determined that while Miller might have been representing Dr. English, he had not been retained to represent ESR (Id. at 74), that Miller's expenditures from the commingled IOLA account "did not inure to the benefit of this debtor's estate . . ." (Id. at 70) and that the Miller Accounting was "flawed by indicating payments from his general account to various parties not necessarily on behalf of this debtor's estate . . . ." Id. at 74 – 75. It found that Miller had violated the Escrow

Order by failing to establish an escrow account and to separate the Net Sale Proceeds from other clients' funds. Id. at 56 – 57; 74.

The court concluded that "[i]t is clear that a lot of things were done outside of the Bankruptcy Court and without authorization by the Bankruptcy Court, and Mr. Miller may have some claim against Ms. English . . . but certainly not in this case . . . and the money that was to be held on behalf of this debtor should come back to this estate . . . ." Id. at 76.

The June 19, 2006 Order, which memorialized the court's rulings at the May 16, 2006 hearing, required Miller to "disgorge . . . the sum of $298,000.00 representing funds from the sale of the Debtor's real property not previously turned over by Phillip D. Miller, Esq. . . . ." ("June 19, 2006 Order"). AUS 23. This amount apparently represented funds that Miller had disbursed in violation of the Escrow Order, including fees for ESR work that he had paid to himself without prior court authorization under 11 U.S.C. 330(a). Id.

Miller appealed the June 19, 2006 Order on June 29, 2006. MA 1035; 1026 - 1029. He did not request a stay pending appeal. MA 22 – 23. Finding no reversible error, the district court affirmed the order on September 25, 2007. MA 1097 – 1106.

Miller appealed the district court's affirmance on November 26, 2007. MA 29; 1539.

SUMMARY OF ARGUMENT

The bankruptcy court did not abuse its discretion in denying Miller's Fee Application and requiring him to disgorge funds that he had 1) converted from the estate and 2) used to pay himself, because the bankruptcy court had never entered an order employing Miller as ESR's attorney under 11 U.S.C. 327(a). Even assuming for sake of argument that the bankruptcy court had authorized Miller's employment, disgorgement was nevertheless appropriate on the alternate ground that Miller converted estate funds and did not obtain a fee award under 11 U.S.C. 330(a). Affirmance is also appropriate, because Miller failed to meet its burden of proving that his services to ESR were "necessary" and that his fees were "reasonable" under 11 U.S.C. 330(a).

None of Miller's four principal arguments supporting reversal has merit. Miller's argument that 11 U.S.C. 363(b)(1) authorized his converting the Net Sale Proceeds fails, because that section does not pertain to professional compensation in bankruptcy cases. Sections 330(a) and 331 specifically and exclusively govern fee awards under Title 11. Section 363(b)(1) does not override them.

Miller's argument that New York state law provides him with a lien securing his fees fails for three separate and independent reasons. First, Miller adduced no evidence that he had complied with New York law. Second, he had no right to impose a lien on bankruptcy estate property for legal work he performed during the bankruptcy case. It is hornbook law that only a fee order creates a right to payment. A lien secures an existing right. See 11 U.S.C. 506. Miller had no right to payment for post-bankruptcy work, because such an award must be made under section 330(a). Inasmuch as Miller had no existing right to payment – a fee award under 11 U.S.C. 330(a) - he can assert no lien. Third, the automatic stay provided by 11 U.S.C. 362(a) independently prevented Miller from asserting a lien on any estate property, including the Net Sale Proceeds.

Miller's argument that the June 19, 2006 Order violated his Fifth Amendment rights fails, because his claim for fees creates no cognizable right in estate property that could be taken from him. Miller waived his right to an evidentiary hearing. Miller's suggestion that the bankruptcy court approved his employment application at a March 25, 1999 hearing is not corroborated by the record.

Miller's argument that the bankruptcy court ratified his conversion of the Net Sales Proceeds in 2002 - when it approved the sale of estate property and confirmed ESR's plan of reorganization - fails, because he did not completely disclose his actions until 2008.

Although this Court should affirm the June 19, 2006 Order, it should remand for one limited purpose. The June 19, 2006 Order required that Miller disgorge an amount that exceeded the amount of Net Sales Proceeds that he diverted from

ESR's escrow funds. The Court should remand the matter to the bankruptcy court for the limited purpose of determining how much Miller received as fees in the ESR case and requiring that he disgorge that amount. While additional theories might justify Miller's disgorging an amount greater than the Net Sale Proceeds, none of those theories was raised in the Disgorgement Motion or relied upon by the bankruptcy court in the June 19, 2006 Order and none is presented in this appeal.

ARGUMENT

I. The Bankruptcy Court Did Not Abuse Its Discretion by Denying Miller's Fee Application and Directing Him to Disgorge Fees That He Paid Himself Without Prior Court Authorization

A. Miller has no right to fees, because he was never retained under 11 U.S.C. 327(a)

In order to receive compensation from the bankruptcy estate, an attorney working as counsel for a chapter 11 debtor must meet two tests.

First, he must be employed as counsel for the debtor in possession under 11 U.S.C. 327(a). Lamie v. U.S. Trustee, 540 U.S. 526, 538 (2004) ("Adhering to conventional doctrines of statutory interpretation, we hold that § 330(a)(1) does not authorize compensation awards to debtors' attorneys from estate funds, unless they are employed as authorized by § 327 . . . ."); In re Crafts Retail Holding Corp., 378 B.R. 44, 49 (Bankr. E.D.N.Y. 2007) (denying fee application of attorneys hired by financial advisors, because the court had not previously approved law firm's retention by debtor). Section 327(a) of the Bankruptcy Code authorizes a debtor in possession, subject to court approval, to retain one or more professional persons to assist it in fulfilling its fiduciary duties, provided that the person: 1) does not represent an interest adverse to the estate; and 2) is disinterested. In re Leslie Fay Cos., Inc.,175 B.R. 525, 531 (Bankr. S.D.N.Y. 1994); Rome v. Braunstein, 19 F.3d 54, 58 (1st Cir. 1994).[7]

Second, the bankruptcy court must award him fees under 11 U.S.C. 330(a). Lamie, 540 U.S. at 538-39. Section 330(a) grants a bankruptcy court broad discretion to pay debtor's counsel what the court determines to be a "reasonable" fee for "actual" services that are "necessary." 11 U.S.C. 330(a). In re Cenargo Intern., PLC, 294 B.R. 571, 596 (Bankr. S.D.N.Y. 2003); In re Busy Beaver Building Centers, Inc., 19 F.3d 833, 840 (3rd Cir. 1994).

Miller recollects that the bankruptcy court conducted a hearing on his employment application on March 25, 1999 and that it orally overruled objections by the United States Trustee to his retention. Amended Brief at 39; 47. No docket entries, pleadings or court orders corroborate Miller's argument. It also contradicts

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[7] A debtor-in-possession assumes the rights and powers of a trustee per 11 U.S.C. 323(a) and 1107(a) and, therefore, is a fiduciary of the estate and its constituents, including creditors. Commodity Futures Trading Com'n v. Weintraub, 473 U.S. 343, 354 (1985); Smart World Technologies, LLC Juno Online Services, Inc. (In re Smart World Technologies, LLC, 423 F.3d 166, 174 – 175 (2d Cir. 2005).

his admissions below that the court never approved his employment. AUS Ex. 9 at 1 – 2; AUS Ex. 22 at 33; 49.

The record clearly demonstrates that Miller applied for, but did not obtain, a bankruptcy court order approving his employment as ESR's attorney under 11 U.S.C. 327(a). MA 40 – 45; 56; AUS Ex. 6 at 3 - 4. It was Miller's responsibility to ensure that he had been retained before rendering services to the estate. In re Crafts Retail Holding Corp., 378 B.R. at 49. He could have requested a hearing on his application, but for unexplained reasons, he did not do so. The local rules did not relieve Miller of his responsibility to obtain employment under 11 U.S.C. 327(a). E.D.N.Y. L. Bankr. R. 2014-1(c). Add. at 6. They also did not shift his responsibility to the United States Trustee, as he suggests. Amended Brief at 39 – 40.

Because he failed to obtain employment under 11 U.S.C. 327(a), Miller has no right to receive compensation from the estate under 11 U.S.C. 330(a). Lamie v. U.S. Trustee, 540 U.S. at 538. The requirement that an attorney obtain a court order authorizing his employment as a prerequisite to his requesting and receiving compensation is a "per se rule" in the Second Circuit. In re 245 Associates, LLC, 188 B.R. at 749. See United Merchants & Mfrs., Inc. v. Henry Schroder Bank and Trust Co. (In re United Merchants & Mfrs., Inc.), 597 F.2d 348 (2d Cir. 1979) (denying fee application submitted by counsel to indenture trustee, because the bankruptcy court had not previously entered an order authorizing the firm's employment); In re Keren Ltd. P'ship, 189 F.3d 86, 88 (2d Cir. 1999) (denying real estate broker's request for commission, because it had not been employed).[8]

The bankruptcy court did not abuse its discretion in entering the June 19, 2006 Order, because Miller had never been employed as ESR's counsel under 11 U.S.C. 327(a). Accordingly, the Court should affirm the orders below.

B. Even if Miller had been retained, he has no right to pay himself fees from the Net Sale Proceeds, because he never obtained a fee award

Even if the bankruptcy court had approved Miller's employment application, he has no right to fees in the ESR case, because he did not receive a fee award under 11 U.S.C. 330(a) and he improperly took estate funds and paid himself from them. This is an alternate ground on which to sustain the orders below. Maritime Asbestos Legal Clinic, Inc. v. United States Lines, Inc. (In re United States Lines, Inc.), 216 F.3d 228, 233 (2d Cir. 2000) (holding that this Court may affirm on any grounds in the record, regardless of whether the lower courts relied upon them).

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[8] The Third, Seventh and Tenth circuits have likewise held that the only way attorneys may receive payment from bankruptcy estate funds is under subsection 503(b)(2), which requires as a condition precedent to payment that the attorney have an award under section 330 and an order of employment under section 327. In re Milwaukee Engraving Co., 219 F.3d 635, 636 (7th Cir. 2000); Matter of Singson, 41 F.3d 316, 320 (7th Cir. 1994); F/S Airlease II, Inc. v. Simon, 844 F.2d 99, 108-109 (3d Cir. 1988), cert. denied, 488 U.S. 852 (1988); In re Albrecht, 233 F.3d 1258, 1260 (10th Cir. 2000).

An attorney for a chapter 11 debtor has a right to payment for work done in the case only if he obtains a fee award under 11 U.S.C. 330(a). Lamie, 540 U.S. at 538-39. Miller did not do so.

Instead, as he admits, Miller used a two-step process to get fees. First, he took estate funds – the Net Sale Proceeds – without motion, without notice, and without hearing, and transferred them out of the estate. Amended Brief at 13 - 14. Second, he used the funds to engage in unauthorized transactions and to pay himself fees.[9]

Miller's course of action was inappropriate for three reasons. First, his removal of property from the estate is the exact opposite of what the Bankruptcy Code requires. Entities with possession of estate property are required to turn that property over to the estate fiduciary for administration. 11 U.S.C. 542(a). Instead, Miller engaged in transactions with the Net Sales Proceeds that removed them from the estate. Second, Miller violated the specific constraints of the Escrow

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[9] In an affidavit supporting his July 15, 2008 motion to disqualify Windels, Miller stated that he used $220,000 of the Net Sale Proceeds to "purchase 100% of the stock of a non-bankruptcy corporation owned by Dr. Josephine English, ABSR Realty Corp. . . . ." He claimed that he used the money to purchase two lots for ESR from Dr. English. MA 1117. In his Amended Brief, Miller stated that he effectuated these transactions "while acting in his capacity through a power of attorney for the benefit of [Dr]. English . . . ." Amended Brief at 13. Miller admitted in his November 26, 2001 objection to the Disgorgement Motion that he paid himself fees, but he argued that he did not need bankruptcy court approval to pay himself, because the "payments were not derived from the bankruptcy estate funds of ESR . . . ." AUS Ex. 9 at 3 – 4.

Order requiring him to hold the funds in escrow pending a further order of the court. Finally, Miller acted contrary to the principle that fee awards under 11 U.S.C. 330(a) are not self-executing. An attorney must obtain court permission before receiving compensation from any source, including the estate, creditors or insiders. In re Chapel Gate Apts., Inc., 64 B.R 569, 572 (Bankr. N.D. Tex. 1986).

This Court, like the First, Fifth, Sixth and Ninth circuits, has uniformly held that debtors' attorneys must disgorge fees when that they have paid themselves without first obtaining a section 330 fee order or have otherwise breached their duties under the Bankruptcy Code. Futronics Corp. v. Arutt, Nachamie & Benjamin (In re Futronics Corp.), 655 F.2d 463, 470 (2d Cir. 1981), cert. denied, 455 U.S. 941 (1982) (ordering disgorgement of fees paid by debtor to special counsel and shared with general bankruptcy counsel without prior court authorization); In the Matter of Arlan's Dep't Stores, Inc., 615 F.2d at 940 (affirming order requiring attorneys to disgorge fees that they had deducted from an escrow account holding asset sale proceeds, because they had not obtained a fee award). Accord Miller v. U.S. Trustee (In re Independent Engineering), 197 F.3d 13, 16 (1st Cir. 1999) (affirming orders directing debtor's counsel to disgorge all draws on a pre-petition security retainer that he had taken without court approval under 11 U.S.C. 330(a) and denying his fee application); Arens v. Boughton (In re Matter of Prudhomme), 43 F.3d 1000, 1002 (5th Cir.1995) (affirming total disgorgement, where debtors' counsel failed to disclose pre-petition payment arrangements); Mapother & Mapother v. Cooper (In re Downs), 103 F.3d 472, 477 – 478 (6th Cir. 1996) (requiring debtors' attorney to disgorge all fees taken without prior court authorization); Franke v. Tiffany (In re Lewis), 113 F.3d 1040, 1045 – 1046 (9th Cir. 1997) (affirming bankruptcy court order disgorging counsel's fees, because firm misrepresented when it received a security retainer and failed to supplement its initial disclosure of compensation paid under Fed. R. Bankr. P. 2016(b) to reflect post-petition payments); In re Kisseberth, 273 F.3d 714, 721 (6th Cir. 2001) (affirming disgorgement order, where debtor's counsel failed to disclose pre-petition fee arrangement and post-petition fee payments). Second Circuit bankruptcy courts have ordered disgorgement for the same reasons. See Matter of Kero-Sun, Inc., 58 B.R. 770, 780 – 781 (Bankr. D. Conn. 1986) (ordering debtor's counsel to return to the estate, with interest, fees paid by secured creditor post-petition without notice and prior court approval under 11 U.S.C. 329(a) and 330(a)); In re Laferriere, 286 B.R. 520, 531 (Bankr. D. Vt. 2002) (granting the United States Trustee's disgorgement motion, where debtor's counsel failed to disclose pre-petition and post-petition payments); Cohn v. United States Trustee (In re Ostas), 158 B.R. 312 (N.D.N.Y. 1993) (upholding on appeal bankruptcy court order directing return of fees for failure to disclose pre-petition payment arrangements).

Rather than obtaining a fee order under 11 U.S.C. 330(a), Miller violated his duties under the Bankruptcy Code by paying himself without a fee award. This Court can affirm the June 19, 2006 Order on this basis.

C. Miller failed to demonstrate that his fees were reasonable and necessary under section 330(a)

Alternatively, this Court can sustain the orders below, because Miller failed to meet his burden under section 330(a) of proving that his fees were reasonable and that his services were necessary. See In re United States Lines, Inc., 216 F.3d at 233. This result is fully supported by the record.

In determining "reasonable" compensation under 11 U.S.C. 330(a), a bankruptcy court must consider a non-exclusive list of five "relevant factors" pertaining to the "nature, the extent and the value" of the services rendered, "including — (A) the time spent on such services; (B) the rates charged for such services; (C) whether the services were necessary to the administration of, or beneficial at the time at which the services were rendered toward the completion of, a case under this title; (D) whether the services were performed within a reasonable amount of time . . . ; and (E) whether the compensation is reasonable based on the customary compensation charged by comparably skilled practitioners in cases other than cases under this title . . . ." 11 U.S.C. 330(a)(3). In re Northwest Airlines Corp., 382 B.R. 632, 644 – 645 (Bankr. S.D.N.Y. 2008).

Section 330(a)(1) requires that a bankruptcy court determine whether a professional's services are "necessary" prior to quantifying "reasonable" fees. In re Keene Corp., 205 B.R. 690, 696 (Bankr. S.D.N.Y. 1997) (holding that "necessary" services include only those that benefit the estate). Section 330(a)(2) expressly authorizes bankruptcy courts, in the exercise of their discretion, to "award compensation that is less than the amount requested . . . ." Id. Section 330(a)(4) prohibits the bankruptcy court from awarding compensation for "unnecessary duplication of services . . . or . . . services that were not . . . reasonably likely to benefit the debtor's estate . . . or . . . necessary to the administration of the estate . . . ." Id.

Miller introduced no evidence at the March 11, 2004 and May 16, 2006 hearings demonstrating that his services were necessary and that his fees, as retroactively requested, were reasonable. MA 18; 919 – 939; AUS Ex. 22. Miller failed to meet his burden under 11 U.S.C. 330(a). Based upon the record, the bankruptcy court could have awarded Miller less than he requested or nothing at all. 11 U.S.C. 330(a)(2) and (4).

This Court can affirm on this basis. See, e.g., Caplin & Drysdale Chartered v. United States Trustee (In re Babcock & Wilcox Co.), 526 F.3d 824, 827 (5th Cir. 2008) (affirming denial of requested fees, because debtor's attorney failed to meet its burden of proof).

D. Miller's principal arguments justifying his conversion of the Net Sale Proceeds to pay himself unilaterally were unlawful and do not support reversal

Miller advances four principal arguments in support of his request for reversal. None of them has merit.

Section 541 provides that the commencement of a bankruptcy case creates an estate, to be comprised of "all legal and equitable interests" of the debtor, "wherever located and by whomever held." 11 U.S.C. 541(a). "The scope of this section is broad, and it is intended to maximize the amount of property available for distribution to creditors according to priorities established by the Code . . . Any property of the debtor upon which a judgment creditor might obtain a lien under state law flows to the bankruptcy estate . . . ." Musso v. Ostashko, 468 F.3d 99, 104 - 105 (2d Cir. 2006). Upon the filing of a Chapter 11 petition, title to all estate property is transferred to the debtor, and all third parties are required to turn over all estate property to the debtor. 11 U.S.C. 541(a) and 542(a). The Net Sale Proceeds constituted estate property. In re Ames Dept. Stores, Inc., 287 B.R. 112, 119 (Bankr. S.D.N.Y. 2002).

First, Miller suggests that his converting the Net Sale Proceeds in order to pay himself was allowed by 11 U.S.C. 363(b)(1) as an exercise of ESR's "ordinary course of business." Amended Brief at 36 – 38. Whatever application section 363(b)(1) may have in other contexts involving the operation of a debtor's business, it does not pertain to professional compensation. See, e.g., Medical Malpractice Ins. Assoc. v. Hirsch (In re Lavgine), 114 F.3d 384 – 385 (2d Cir. 1997) (analyzing debtor's cancellation of insurance policy as an "ordinary course" transaction under 11 U.S.C. 363(b)(1)).

By its plain language, 11 U.S.C. 330(a) constitutes the sole cognizable basis for awarding fees in bankruptcy cases.[10] In re Crafts Retail Holding Corp., 378 B.R. at 50. Section 363(b)(1) cannot be used to override the specific professional compensation provisions of 11 U.S.C. 330(a). "It is well settled that the bankruptcy court lacks the power to grant, and the policy of the Bankruptcy Act is against compensation [and reimbursement of expenses] not expressly provided for by the Act . . . ." In re United Merchants & Mfrs., Inc., 597 F.2d at 349. Inasmuch as 11 U.S.C. 363(b)(1) does not purport to affect, let alone to grant, fee awards, Miller cannot use it as a basis for rationalizing his converting estate property to pay himself without court permission.

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[10] Interim fee awards under 11 U.S.C. 331 are evaluated on the same basis as final fee awards under 11 U.S.C. 330. See In re Teraforce Technology Corp., 347 B.R. 838, 846 – 847 (Bankr. N.D. Tex. 2006).

Second, Miller asserts that he had an attorney's lien on the assets of the estate and did not require a court order to make distributions to himself.[11] Amended Brief at 41 - 46. This argument is wholly without merit.

Assuming arguendo that the Escrow Order prohibiting disbursement had never been signed, that the Debtor had never filed a bankruptcy petition and that state law would have governed rather than title 11, even under New York law, Miller did not have a charging lien under Judiciary Law § 475. The plain language of that statute provides that in order to assert a charging lien, the attorney must make an application to the court to determine and to enforce the lien. Id. Miller made no such application to any court – state or federal – and no such determination was ever rendered.

Even if Miller made such a state law application, it would have been summarily denied. In New York, a lawyer "may not impose a lien for his fee on

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[11] Under New York law, an attorney is given a charging lien for fees and costs out of a judgment or settlement obtained in a suit in which the attorney performed legal services. Section 475 of the New York Judiciary Law provides for this lien stating, "from the commencement of an action of special proceeding . . . , or the service of an answer containing a counterclaim, the attorney who appears for a party has a lien upon his client's cause of action, claim or counterclaim, which attaches to a verdict, report, decision, judgment or final order in his client's favor and the proceeds thereof in whatever hands they may come; and the lien can not be affected by any settlement between parties before or after judgment or final order. The Court upon petition of the client or attorney must determine and enforce the lien." N.Y. Judiciary Law § 475. The lien relates back to the initiation of the action. In re E.C. Ernst, Inc., 4 B.R. 317, 320 (Bankr. S.D.N.Y. 1980).

escrow funds he holds for a client and another." Nassau County Bar Association Opinion No. 85-7 (1985) citing Marsano v. State Bank, 279 N.Y.S.2d 817 (3rd Dep't 1967). The attorney does not receive the funds in his capacity as an attorney; they are received in his role as an escrow agent. "Absent specific authorization to draw upon the funds for the payment of legal services claimed to be due him, [the attorney] is not entitled to a retaining lien on the fund." United States v. J.H.W. Gitlitz Deli & Bar, Inc., et al., 499 F.Supp 1010, 1015 (S.D.N.Y. 1980). Miller neither requested nor received any specific authorization.

Conversion of a client's funds held in escrow is not excused by the fact that an attorney had provided legal services for which he has not been compensated. In the Matter of Robert I. Hodes, 469 N.Y.S.2d 371, 373 (1st Dep't 1983), appeal denied, 475 N.Y.S.2d 281 (1984). Therefore, Miller's after-the-fact rationale as to why he was entitled to convert estate assets without court order must fail, because no charging lien was ever created under New York law.[12]

More significantly, Miller had no Federal law lien that would be enforceable under the Bankruptcy Code, because he had no existing right to payment. It is hornbook law that only a fee order creates a right to payment. 11 U.S.C. 330(a);

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[12] See United States Trustee v. Ropes & Gray (In re CK Liquidation Corp.), 343 B.R. 376, 385 (D. Mass. 2006) (interpreting Lamie and holding "[w]here the Supreme Court has interpreted § 330(a)(1) as preventing payment from the debtor's estate to counsel not appointed under § 327, authorization of such payment on the basis of state law is forbidden by the Supremacy Clause . . . .")

Lamie, 540 U.S. at 538-39. A lien secures an existing right. See 11 U.S.C. 506; 4 Lawrence P. King, et al. Collier on Bankruptcy, ¶506.02 (15th Ed. 2008).

Miller had no right to payment for post-bankruptcy work, because such an award must be made under section 330(a). Inasmuch as Miller had no existing right to payment – a fee award under 11 U.S.C. 330(a) - he can assert no lien.

Lastly, Miller's attempt to put a lien on estate property violated the automatic stay provided by 11 U.S.C. 362(a) . See Musso v. Ostashko, 468 F.3d 99, 104 – 105. Under Section 362(a)(3), Miller was stayed from taking "any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate." Under section 362(a)(4), Miller was precluded from taking any act to create, perfect or enforce any lien against the property of the estate." Under section 362(a)(5), Miller was stayed from performing "any act to create, perfect or enforce against property of the debtor any lien to the extent that such lien secures a claim that arose before the commencement of the case. . . . " 11 U.S.C. § 326(a)(5).

Inasmuch as Miller's alleged lien would encumber property of the estate, the Net Sale Proceeds, it would violate the automatic stay. 11 U.S.C. 362(a). Therefore, it would be void. Id.

Third, Miller claims that the bankruptcy court ratified his actions in 2002, when it approved certain asset sales and confirmed ESR's plan of reorganization.

Amended Brief at 40. The problem with this argument is that Miller did not disclose until 2008 that it was he who, exercising a "power of attorney," assumed control of ESR's operations after the sale of 1325 Union Street closed and used the Net Sale Proceeds to purchase the property from a non-debtor and to pay himself fees. He did these things without prior court authorization. MA 1117; Amended Brief at 13. The bankruptcy court could not have known of Miller's actions at the time it approved the sale of these assets and confirmed ESR's plan in 2002. Accordingly, it could not have ratified them, nor could it have ratified any fee order under 11 U.S.C. 330(a).

Fourth, Miller claims that the bankruptcy court violated his Fifth Amendment rights by depriving him of property without due process of law in two ways – first by not adjudicating the Disgorgement Motion, the Miller Fee Application and the ESR Objection in the context of an adversary proceeding; and, second, by not providing him with the transcript of the alleged March 25, 1999 hearing on his employment application. Amended Brief at 46 – 56. These arguments fail.

As a threshold matter, Miller had no cognizable state law interest in estate property. In re CK Liquidation Corp., 343 B.R. at 385. He merely had the right to request payment from it upon the terms set forth in section 330(a). 11 U.S.C. 330(a). And even if a 330 award is granted, priority and right to payment are governed by sections 503 and 507 of the Code. These, not self help, govern fees in bankruptcy cases. As a result, in denying Miller's Fee Application and ordering him to disgorge, the bankruptcy court did not "take" anything from him.

Moreover, matters arising under sections 329 and 330(a) are brought by motion. Motions are contested matters under Fed. R. Bankr. P. 9014 to which all of the procedural protections provided by the Federal Rules of Civil Procedure apply, including discovery under Fed. R. Civ. P. 26. Fed. R. Bankr. P. 9014. A bankruptcy court's review of an attorney's fees under 11 U.S.C. 329(b) and Fed. R. Bankr. P. 2017 does not give rise to an adversary proceeding under Fed. R. Bankr. P. 7001 and, separately, implicates no right to jury trial under the Seventh Amendment. In re Rheuban, 128 B.R. 551, 558 – 229 (Bankr. C.D. Ca. 1991).

Miller implicitly argues that the denial of his due process rights arises from the lack of an evidentiary hearing. Amended Brief at 46 – 56. However, Miller had at almost five years to prepare for the hearings on the Disgorgement Motion, his Fee Application and the ESR Objection, and the docket reflects that he undertook no discovery during that time. He called no witnesses at the May 16, 2006 hearing and offered no documents into evidence, relying upon the admissions in his pleadings. AUS 22. To the extent that Miller had a right to an evidentiary hearing on May 16, 2006, he waived it.

In Arlan's Dep't Stores, Inc., this Court rejected a similar argument by a fee applicant, who claimed that the bankruptcy court, in conducting a non-evidentiary hearing on his fee application, denied him due process. The Court affirmed that the applicant had waived his right to an evidentiary hearing, because it adduced no evidence at the fee hearing, despite being given the opportunity to do so, and that it could not deny admissions in its pleadings on the controlling fact – viz., that it accepted post-petition payments without prior court authorization. In the Matter of Arlan's Dep't Stores, Inc., 615 F.2d at 942 – 943.

Miller's due process argument with respect to the March 25, 1999 hearing transcript fails. Nothing in the record indicates that his section 327(a) employment application was heard on March 25, 1999. MA 3. The bankruptcy court recalled that it was not and that no application was ever approved. MA 922. Miller's current recollection also contradicts both his written responses and oral argument at the May 16, 2006 hearing, where he conceded that the bankruptcy court never entered an order approving his retention as ESR's counsel. AUS Ex. 9 at 1 – 2; AUS Ex. 22 at 33; 49. Under these circumstances, Miller's due process rights were never implicated.

Insofar as Miller's four principal arguments fail, the Court should affirm the June 19, 2006 Order.

E. The Court should affirm the June 19, 2006 Order and direct a limited remand to quantify the amount of fees that Miller should disgorge

In its Disgorgement Motion, the United States Trustee requested disgorgement of fees that Miller had received in connection with the ESR case. AUS Ex. 6; 7; 12. In the June 19, 2008 Order, the bankruptcy court directed Miller to disgorge $298,000. MA 22; 919 – 939; 1036 – 1041; AUS Ex. 22. There is no evidence in the record demonstrating that Miller paid himself $298,000 as fees for the ESR case, however. The total amount of Net Sales Proceeds that Miller did not turn over was $246,364.21; there is likewise no evidence in the record demonstrating that Miller paid himself this amount as fees for the ESR case. While there may be additional theories supporting Miller's disgorgement of an amount equal to or greater than the Net Sale Proceeds (e.g. as a sanction for violating the Escrow Order or as a voidable, post-petition transfer under 11 U.S.C. 549), none of them were raised by the Disgorgement Motion or relied upon by the bankruptcy court in the June 19, 2006 Order.

Accordingly, the United States Trustee requests that the Court: i) affirm the June 19, 2006 Order; and ii) remand this matter to the bankruptcy court, with instructions that it quantify Miller's fees and order Miller to disgorge that amount, and to entertain such additional disgorgement actions as any party may wish to lodge.

CONCLUSION

For these reasons, the United States Trustee respectfully asks this Court to affirm the June 19, 2006 Order and that it remand the case to the bankruptcy court to calculate the amount of fees to be disgorged by Miller under the June 19, 2006 Order.

Respectfully submitted,

Ramona D. Elliott
General Counsel

P. Matthew Sutko
Walter W. Theus, Jr.
Executive Office for United States Trustees
Department of Justice
20 Massachusetts Ave., N.W.
Washington, D.C. 20530
Phone: (202) 307-1399
Fax: (202) 307-2397

/s/ William E. Curtin
William E. Curtin
Office of the United States Trustee
Department of Justice
271 Cadman Plaza East, Suite 4529
Brooklyn, NY 11201
Phone: (718) 422-4960
Fax: (718) 422-4990

Eric K. Bradford
Office of the United States Trustee
Department of Justice
10 Causeway Street, Room 1184
Boston, MA 02222-1043
Phone: (617) 788-0415
Fax: (617) 565-6368

CERTIFICATE OF COMPLIANCE

This brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B) and Second Cir. R. App. P. 32(a)(7)(B), because, according to Word Perfect, it contains approximately 8,421 words and 726 lines, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii). It also complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6) and Second Cir. R. App. P. 32(a)(5)(A), because it is typed in Times New Roman 14 point typeface.

/s/ William E. Curtin
William E. Curtin
Office of the United States Trustee
Department of Justice
271 Cadman Plaza East, Suite 4529
Brooklyn, NY 11201
Phone: (718) 422-4960
Fax: (718) 422-4990

CERTIFICATE OF SERVICE

I certify that on December 19, 2008, true and correct copies of the **BRIEF OF APPELLEE, DIANA G. ADAMS, UNITED STATES TRUSTEE, REGION 2** were served by United States mail, First Class postage pre-paid upon the individuals listed below.

/s/ William E. Curtin
William E. Curtin
Office of the United States Trustee
Department of Justice
271 Cadman Plaza East, Suite 4529
Brooklyn, NY 11201
Phone: (718) 422-4960
Fax: (718) 422-4990

Francis D. Terrell, Esq.
50 Main Street, Suite 1000
White Plains, NY 10606
(Counsel for Appellant)

Charles E. Simpson, Esq.
Windels Marx Lane & Mittendorf, LLP
156 West 56th Street
New York, NY 10019
(Appellee)

BRIEF BANK — "SUMMARY SHEET"

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WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*
Phillip D. Miller, Esq. v. Tracy Hope Davis, United States Trustee for Region 2 (In re English Sheppard Realty Corp.)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*
E.D. N.Y.

3. ("CCN") ***CURRENT*** CASE NO.
No.: 10-cv-02864-JS, 10-cv-03340-JS

4. ("PCN") ***PRIOR*** CASE NO. - & COURT *[IF ANY]*
No.: 799-10393-DTE
Court: Bankr. E. D. N.Y.
(Identify judge & cite, if any)

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William E. Curtin, Noah Schottenstein, P. Matthew Sutko, Ramona D. Elliott, Alicia M. Leonhard
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s)
• Did the bankruptcy court err when it reduced the amount of attorney's fees Mr. Miller must disgorge to $146,000?

&

√ Any Miscellaneous ***BACKGROUND***

10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)

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FOR THE EASTERN DISTRICT OF NEW YORK

In re:	:	
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ENGLISH SHEPPARD REALTY CORP.,	:	Bankruptcy Case No. 99-10393-DTE
	:	
Debtor.	:	
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	:	
PHILLIP D. MILLER, ESQ. v. TRACY HOPE DAVIS, UNITED STATES TRUSTEE FOR REGION 2,	:	Civ. App. Nos. 10-cv-02864-JS 10-cv-03340-JS
	:	
Appellee.	:	
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BRIEF OF APPELLEE THE UNITED STATES TRUSTEE

Alicia M. Leonhard
Assistant United States Trustee
William E. Curtin
Trial Attorney
Office of the United States Trustee
United States Department of Justice
271 Cadman Plaza East, Suite 4529
Brooklyn, New York 11201
Phone: 718.422.4960
Facsimile: 718.422.4990
E-Mail: Alicia.M.Leonhard@usdoj.gov
William.E.Curtin@usdoj.gov

Ramona D. Elliott
General Counsel
P. Matthew Sutko
Associate General Counsel
Noah Schottenstein
Trial Attorney
Executive Office for United States Trustees
United States Department of Justice
20 Massachusetts Avenue, N.W., Suite 8100
Washington, D.C. 20530
Phone: 202.307.1399

Counsel for the United States Trustee

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INTRODUCTION

Mr. Phillip D. Miller paid himself attorney's fees out of the proceeds from the sale of an apartment building, in violation of an order directing him to hold the sale proceeds in escrow. After discovering what Mr. Miller had done, the bankruptcy court ordered him to disgorge the entire $298,000 in sale proceeds. On appeal, the Second Circuit held that Mr. Miller had to return the amount he took for his attorney's fees, but not the amount of the sale proceeds that went to others. It vacated and remanded the portion of the judgment specifying the amount to be disgorged. On remand, the bankruptcy court found that Mr. Miller had paid himself $146,000 out of the sale proceeds and ordered disgorgement in that amount. This appeal followed.

STATEMENT OF APPELLATE JURISDICTION

This Court has appellate jurisdiction under 28 U.S.C. § 158(a)(1). The bankruptcy court's final order requiring Mr. Miller to disgorge $146,000 in attorney's fees was entered on April 13, 2010. Mr. Miller timely filed a notice of appeal from that order under 28 U.S.C. § 158(c)(2) and Fed. R. Bankr. P. 8002(a) on April 27, 2010.

The bankruptcy court's final order denying Mr. Miller's motion to alter or amend the April 13, 2010, disgorgement order under Fed. R. Bankr. P. 7052 and 9023 was entered on June 15, 2010. Mr. Miller timely filed a notice of appeal from that order under 28 U.S.C. § 158(c)(2) and Fed. R. Bankr. P. 8002(a) on June 29, 2010.

STATEMENT OF THE ISSUES

1. Did the bankruptcy court abuse its discretion when it found that Mr. Miller must disgorge $146,000?

2. Did the bankruptcy court abuse its discretion when it denied Mr. Miller's motion to alter or amend the order directing Mr. Miller to disgorge $146,000?

SUMMARY OF THE ARGUMENT

This case is on remand from the Second Circuit on one narrow ground, which is to determine how much Mr. Miller took for his own attorney's fees out of the $281,000 that the bankruptcy court in the English Sheppard Realty Corporation ("ESR") bankruptcy case had ordered Mr. Miller to hold in escrow. On remand, the bankruptcy court determined that Mr. Miller took $146,000 in fees and ordered him to return that amount. Mr. Miller did not dispute that $146,000 is the amount that he took from the sale proceeds for himself, so the bankruptcy court faithfully followed the Second Circuit's remand order and its ruling should be affirmed.

Mr. Miller acted improperly. He took the money from Dr. English, who was ESR's principal and sole shareholder. He did that in two steps. First, he sold $3 million of Dr. English's property to ABSR, a holding company that Mr. Miller created. In exchange for this property, Mr. Miller gave Dr. English $10 and an agreement to assume approximately $61,000 in property tax liability. Second, Mr. Miller then had ESR purchase ABSR for $246,341.21. Mr. Miller paid ABSR out of the money he held in escrow for ESR. Mr. Miller then transferred $146,000 to himself. Mr. Miller never disclosed these activities to the bankruptcy court or the United States Trustee.

After Mr. Miller's scheme was discovered, Dr. English fired Mr. Miller as both her personal counsel and as ESR's counsel. The bankruptcy court then ordered Mr. Miller to return all of the money he had been ordered to hold in escrow. The Second Circuit, however, held that although Mr. Miller must return the fees that he paid to himself, the bankruptcy court had erroneously ordered him to return funds that went to others. On remand, the bankruptcy court found that Mr. Miller had paid himself only $146,000 and ordered him to return that amount. This reduced the amount of money that Mr. Miller must give back by over $150,000.

On appeal, Mr. Miller does not contest the bankruptcy court's determination that he took $146,000 for his fees. Nor could he. The record primarily consists of Mr. Miller's admissions, including his testimony, his cashed checks, and the accounting statements that he created.

Instead, Mr. Miller primarily seeks to relitigate whether he should be required to restore any fees at all. He cannot, however, because of the mandate rule, which precludes relitigating issues decided by an appellate court when a case is on remand. The Second Circuit held that Mr. Miller paid himself fees in violation of the escrow order and now must return that money. It remanded the case for the sole purpose of determining the amount of fees that Mr. Miller paid himself. Mr. Miller's arguments exceed the limited scope of Second Circuit's remand order.

Because Mr. Miller cannot establish that the bankruptcy court clearly erred when it found that he paid himself $146,000 in fees from the sale proceeds, the order requiring him to return that amount should be affirmed.

STANDARD OF REVIEW

This Court reviews a bankruptcy court's factual determinations for clear error. Lubow Mach. Co. v. Bayshore Wire Prod. Corp. (In re Bayshore Wire Prod. Corp.), 209 F.3d 100, 103

(2d Cir. 2000). The clearly erroneous standard requires an appellate court to uphold any finding of fact that is plausible "in light of the record viewed in its entirety." Cooter & Gell v. Hartmax Corp., 496 U.S. 384, 400 (1990).

This Court reviews a bankruptcy court's decision to modify a judgment under Fed. R. Bankr. P. 7052 and 9023 for abuse of discretion. Sequa Corp. v. GBJ Corp., 156 F.3d 136, 143 (2d Cir. 1998); see Fed. R. Bankr. P. 9014 (applying Fed. R. Bankr. P. 7052, which incorporates Fed. R. Civ. P. 52, to contested matters in a bankruptcy case); Fed. R. Bankr. P. 9023 (incorporating Fed. R. Civ. P. 59). A bankruptcy court abuses its discretion when it bases its decision on "an error of law or a clearly erroneous finding of fact, or a decision that, 'though not necessarily the product of legal error or a clearly erroneous factual finding[,] cannot be located within the range of permissible decisions.'" Jasco Tools, Inc. v. Dana Corp. (In re Dana Corp.), 574 F.3d 129, 145 (2d Cir. 2009) (citations omitted).

STATEMENT OF THE CASE

I. Statement of the Facts

This appeal concerns a single finding of fact made pursuant to the Second Circuit's vacatur and remand order in this case. See Miller v. Simpson, 325 F. App'x 25 (2d Cir. 2009). That order remanded the case for the limited purpose of determining the amount of money Mr. Miller paid to himself out of the sale proceeds in violation of the bankruptcy court's escrow order.

Although very few facts are necessary for this Court to review the decision below, Mr. Miller's principal brief makes numerous statements referring to facts and circumstances that occurred throughout the ten years this case has been pending. To assist the Court with the voluminous record in this appeal, the United States Trustee has provided an extended statement of the facts that explains the history and key events of the case.

A. Dr. Josephine English and her wholly-owned corporation, English Sheppard Realty Corporation, retain Mr. Miller as counsel.

Dr. Josephine English, age 90, is a physician. She opened her first medical practice in Brooklyn, New York, in 1955 and has been dedicated to her community for over fifty years. In the 1980's, Dr. English led Brooklyn's Fort Greene community revitalization efforts by personally financing numerous real estate development projects, including a clinic for low-income patients and a theatre. [Errol Louis, Josephine English, one of first black, female OB/GYNs, not stopping at 89, New York Daily News (June 24, 2010), available at http://tinyurl.com/2e985lp, ER, Vol. 4, Ex. 27, at 585-86]. Dr. English developed financial difficulties in the 1990's and has struggled to save her properties from tax foreclosure ever since. [Austin Evans Fenner, Rally to Rescue Med Clinic Planned, New York Daily News (Oct. 3, 1995), available at http://tinyurl.com/2b6hzqv, ER, Vol. 4, Ex. 26, at 584].

The English Sheppard Realty Corporation ("ESR"), a single-asset real estate holding company, is one of those properties. ESR filed a voluntary petition for relief under chapter 11 of the Bankruptcy Code on January 11, 1999. [ER, Vol. 3, Ex. 19, at 455-56]. ESR's sole asset was an apartment building located at 1325 Union Street, Brooklyn, New York. Dr. English signed the petition in her capacity as ESR's president and Mr. Miller filed the petition as ESR's attorney. [ER, Vol. 3, Ex. 19, at 455-56].

In addition to representing ESR, Mr. Miller was also Dr. English's personal attorney. Mr. Miller represented Dr. English with respect to (1) the other properties that she owned and (2) her personal affairs, including tax and medical malpractice actions. [ER, Vol. 4, Ex. 22, at 451-52; ER, Vol. 2, Ex. 10, at 182-90].

Throughout much of Mr. Miller's representation for Dr. English, he acted as an attorney-in-fact for both Dr. English and ESR. [ER, Vol. 2, Ex. 10, at 129-30]. That meant he conducted Dr. English's business without her participation and engaged in many legal transactions without her signature. He bought and sold real estate using Dr. English's name. [ER, Vol. 2, Ex. 10, at 129-30]. He received deposits on Dr. English's behalf, including proceeds from sales of her properties. [ER, Vol. 2, Ex. 10, at 184-87; ER, Vol. 3, Ex. 14, at 237]. He signed corporate documents in Dr. English's name and used an irrevocable power of attorney to operate her real estate businesses. [ER, Vol. 3, Ex. 16, at 372-436]. He commingled all of the funds for Dr. English and her various companies, including ESR, in his Interest on Lawyer Account ("IOLA"). [ER, Vol. 2, Ex. 10, at 191].

Although Mr. Miller testified that he took these actions under a power of attorney, he never produced any documentation in the ESR case to support this statement. [ER, Vol. 2, Ex. 10, at 129-30]. Similarly, Mr. Miller was unable to produce a copy of the retainer agreement pertaining to his representation for ESR. [ER, Vol. 2, Ex. 10, at 118]. Mr. Miller did, however, testify that Dr. English paid him a total of $32,500 for services related to ESR's bankruptcy. [ER, Vol. 2, Ex. 10, at 155].

Furthermore, Mr. Miller was never retained under 11 U.S.C. § 327 to act as ESR's bankruptcy counsel, although he did make the unsubstantiated claim that the bankruptcy court verbally approved his employment at a hearing for which no transcript is available. [ER, Vol. 2, Ex. 10, at 177; ER, Vol. 4, Ex. 23, at 535-38 (No retention order appears on ECF Docket)].

Notwithstanding, Mr. Miller appeared in the case on behalf of ESR for almost two and a half years without the bankruptcy court's approval.

B. Mr. Miller violates the bankruptcy court's order directing him to hold the proceeds from the sale of 1325 Union Street in escrow.

On January 26, 2000, the bankruptcy court entered an order approving ESR's sale of the 1325 Union Street apartment building. [ER, Vol. 3, Ex. 17, at 437]. In the sale order, the court directed Mr. Miller to hold the sale proceeds "in escrow pending confirmation of Debtor's Chapter 11 Plan of Reorganization ("Plan"), and distribution pursuant to Court Order." [ER, Vol. 3, Ex. 17, at 437]. Mr. Miller received a total of $287,743.59: $42,500 from the bid deposit, and two payments of $26,381.25 and $218,862.34. [ER, Vol. 2, Ex. 10, at 157-58; ER, Vol. 3, Ex. 15, at 244, Lines 6, 17-18]. After paying closing costs, Mr. Miller held net equity proceeds from the sale in the amount of $281,805.63. [ER, Vol. 3, Ex. 15, at 245, Line 22].

Rather than holding the sale proceeds in escrow until they could be distributed pursuant to a court order, Mr. Miller deposited the money into his IOLA and recorded the funds as an unrestricted deposit in ESR's accounting ledger. [ER, Vol. 2, Ex. 10, at 157; ER, Vol. 3, Ex. 15, at 244].

C. Mr. Miller incorporates ABSR Realty Holding Corporation to receive property from Dr. English.

Approximately six months after ESR filed for bankruptcy, and six months before the sale of 1325 Union Street closed, Mr. Miller incorporated a new holding company for Dr. English, ABSR Realty Holding Corporation. [ER, Vol. 3, Ex. 16, at 376]. Dr. English was listed as the sole shareholder, president, and director of ABSR, but signed none of the papers. [ER, Vol. 3, Ex. 16, at 380]. Mr. Miller exercised unfettered control over ABSR, without any documented participation by Dr. English. Upon incorporation, Mr. Miller designated himself attorney-in-fact for ABSR and assigned himself the authority to perform all of the duties and functions necessary for managing the corporation. [ER, Vol. 3, Ex. 16, at 380].

Although Dr. English owned ABSR, her signature never appears on any of ABSR's corporate records. [ER, Vol. 3, Ex. 16, at 373-475]. This includes documents (1) purporting to assign Mr. Miller a power of attorney and control of the corporation, [ER, Vol. 3, Ex. 16, at 380]; and (2) transferring two lots of property from Dr. English to ABSR for $10.00 each, to be sold to a third party, with ABSR to retain the proceeds. [ER, Vol. 3, Ex. 16, at 430-35].

Mr. Miller also waived ABSR's annual shareholder meeting. [ER, Vol. 3, Ex. 16, at 409-10]. And Mr. Miller conducted the first meeting of ABSR's board of directors as the sole attendee. [ER, Vol. 3, Ex. 16, at 412]. At this meeting, Mr. Miller gave himself authority to conduct all of ABSR's financial transactions out of his IOLA, where ABSR's funds were commingled with both Dr. English's and ESR's funds. [ER, Vol. 3, Ex. 16, at 413]. While ABSR was under Mr. Miller's control, Dr. English only appears in ABSR's records as the occasional recipient of payments between $5,000 and $10,000. [ER, Vol. 3, Ex. 15, at 238-43].

D. Mr. Miller has ESR purchase ABSR from Dr. English

Two months after he received the sale proceeds, Mr. Miller — acting alone — had ESR use the proceeds to purchase ABSR in a simultaneous three-party transaction.

Mr. Miller transferred from Dr. English to ABSR (1) all of the outstanding shares of ABSR, (2) an irrevocable power of attorney for Mr. Miller to act as attorney-in-fact with respect to ABSR, and (3) two vacant lots of property located in Brooklyn. [ER, Vol. 3, Ex. 16, at 424-26]. In exchange for this, Dr. English received $10 and the assumption of any claims against Dr.

English arising from the properties. [ER, Vol. 3, Ex. 16, at 424-27]. The value of that assumption was $60,910.09, based on tax liens on the properties in the amount of $26,341.21 and $34,568.88. [ER, Vol. 3, Ex. 15, at 240, Line 45; ER, Vol. 3, Ex. 15, at 243, Line 83].

Mr. Miller paid $61,000 for Dr. English's properties, but at the same time he had ESR take ownership of the properties by buying all of ABSR's shares in exchange for $220,000. [ER, Vol. 3, Ex. 16, at 427]. In addition, ABSR agreed that it would not "assign, transfer, sell, or otherwise encumber the [Brooklyn lots] without the express written approval and/or consent from ESR." [ER, Vol. 3, Ex. 16, at 427].

E. Mr. Miller violates the escrow order by taking $246,341.21 out of the proceeds held in escrow to pay for the deal, but never transfers the properties to ABSR or ESR.

Mr. Miller then had ESR transfer $246,341.21 out of the estate in violation of the escrow order in two payments, one in the amount of $220,000 and a second in the amount of $26,341.21. [ER, Vol. 3, Ex. 15, at 245, Lines 23-24]. Mr. Miller — yet again, acting alone — deducted $246,341.21 from the $281,805.63 of sale proceeds recorded under ESR's accounting ledger. [ER, Vol. 3, Ex. 15, at 245, Lines 23-24].

Mr. Miller never transferred the title to the two lots of Brooklyn property from Dr. English to ABSR, which is the company that ESR had purchased. This meant ESR paid almost $250,000 for a shell company. According to New York City's property records, Dr. English retained title to the two lots until July 31, 2002, which was after Mr. Miller had been removed as ESR's counsel. [ER, Vol. 4, Ex. 22, at 481]; see ACRIS Detailed Document Information for Brooklyn, Block 2120, Lots 43 and 48, available at http://a836-acris.nyc.gov/Scripts/DocSearch.dll/BBL. After Mr. Miller's removal, ESR's new counsel was able to obtain title and then sell the two lots for $3 million, which provided a significant return to its creditors. [ER, Vol. 4, Ex. 25, at 581-83].

Those transactions violated the escrow order. First, Mr. Miller distributed the sale proceeds without obtaining a post-confirmation court order. In addition, Mr. Miller did not notify the bankruptcy court about the distribution, or receive court authorization to make a distribution inconsistent with the terms of the escrow order. [ER, Vol. 3, Ex. 17, at 437; ER, Vol. 4, Ex. 22, at 518]. Despite using approximately 87% of ESR's cash to purchase two vacant lots of property, Mr. Miller never disclosed his activities to the bankruptcy court, the United States Trustee, or ESR's creditors. [ER, Vol. 3, Ex. 17, at 437; ER, Vol. 4, Ex. 22, at 518].

Second, Mr. Miller's signature is the only signature that appears on the documentation for this deal. Mr. Miller executed both transactions as the attorney-in-fact for the respective parties, signing on behalf of Dr. English, ABSR, and ESR in each instance. [ER, Vol. 3, Ex. 15, at 426, 429]. Nothing in the record indicates that Dr. English was aware of Mr. Miller's activities on her behalf.

Third, no money or property ever changed hands. Mr. Miller conducted all of the financial transactions for Dr. English, ABSR, and ESR out of his IOLA. [ER, Vol. 2, Ex. 10, at 191]. Although Mr. Miller described the payment from ESR to ABSR as a transfer, no money ever left Mr. Miller's commingled IOLA. Rather, Mr. Miller moved a total of $246,341.21 from ESR's accounting ledger to ABSR's accounting ledger. [ER, Vol. 3, Ex. 15, at 245, Lines 23-24]. Every distribution that Mr. Miller made when conducting the business of Dr. English and her holding companies had been drawn (1) solely by him and (2) solely from his general purpose, commingled IOLA. [ER, Vol. 3, Ex. 15, at 250-324].

Finally, there is nothing in the record to differentiate the finances of Dr. English, ESR, and ABSR. Since ABSR was formed, Mr. Miller used it interchangeably with Dr. English's other assets. For example, Mr. Miller used ABSR's money to pay himself attorney's fees for representing Dr. English in a medical malpractice lawsuit. [ER, Vol. 3, Ex. 15, at 239, Line 15]. ESR's accounting ledger only reveals transactions pertaining to the sale of 1325 Union Street and the purchase of ABSR. [ER, Vol. 3, Ex. 15, at 244-45]. And after the sale of ABSR to ESR was completed, Mr. Miller continued to conduct transactions on behalf of Dr. English and ESR under ABSR's accounting ledger. [ER, Vol. 3, Ex. 15, at 238-43].

F. Mr. Miller pays himself $146,000 in attorney's fees in violation of the escrow order and without notice to or authorization from the bankruptcy court.

Over the course of 2000-2001, Mr. Miller used the sale proceeds in his IOLA to pay himself $146,000 for a variety of purported legal matters. [ER, Vol. 3, Ex. 15, at 241-43; ER, Vol. 2, Ex. 10, at 168-78]. Mr. Miller made the following 13 payments:

Date	**Amount**	**Reason for Payment**
April 13, 2000	$5,000	p miller atty fee tax research/estate plan
May 12, 2000	$5,000	p miller esq retainer greene v english med mal case
June 5, 2000	$15,000	p miller esq retainer greene v english med mal case
June 9, 2000	$5,000	p miller atty fee greene v english med mal case
June 9, 2000	$5,000	p miller atty fee gerard v english
June 29, 2000	$11,000	p miller atty fee greene v english
September 14, 2000	$10,000	p miller atty fee litton v english
November 6, 2000	$25,000	p miller atty greene v english med mal case
November 27, 2000	$5,000	p miller atty fee gerard v english
February 13, 2001	$10,000	p miller atty fee client tax matters

Date	Amount	Reason for Payment
March 21, 2001	$25,000	p miller atty greene v english
June 23, 2001	$5,000	p miller atty fee litton v english
June 25, 2001	$20,000	p miller atty fee lot foreclosure cases

[ER, Vol. 3, Ex. 15, at 241-43; ER, Vol. 2, Ex. 10, at 168-78].

Mr. Miller also made other payments from the sale proceeds, such as (1) remittances to Dr. English, see, e.g., [ER, Vol. 3, Ex. 15, at 242, Line 66 ($10,000 remittance to Dr. English)]; (2) payments to third-parties for expenses related to ESR, see, e.g., [ER, Vol. 3, Ex. 15, at 242, Line 79 ($5,000 payment to settle a lawsuit against ESR)]; and (3) payments relating to other property holding companies owned by Dr. English, see, e.g., [ER, Vol. 3, Ex. 15, at 242, Line 74 ($20,000 payment for "stuyvesant ave realty corp ch 11")].

By executing these transactions, Mr. Miller violated the escrow order. Nor did he obtain other authorization from the bankruptcy court to make any distributions. And he did not disclose his activities to the court and other interested parties. [ER, Vol. 2, Ex. 10, at 214-16].

G. Dr. English fires Mr. Miller after discovering what had been done.

Mr. Miller continued to represent ESR until the bankruptcy court told Dr. English it was concerned about the quality of Mr. Miller's representation. [ER, Vol. 4, Ex. 22, at 483]. The court explained that Mr. Miller was not familiar with bankruptcy law and had made numerous mistakes when handling the case, and advised her to seek new counsel. [ER, Vol. 4, Ex. 22, at 483]. Dr. English sought counsel from Windels, Marx, Lane, & Mittendorf, who then investigated and discovered the full scope of Mr. Miller's activities. [ER, Vol. 4, Ex. 22, at 485].

Dr. English substituted Windels Marx as counsel for ESR. [ER, Vol. 4, Ex. 23, at 538]. Windels Marx then took action against Mr. Miller in the bankruptcy court. Mr. Miller subsequently turned over his accounting records and $35,447.42 to Windels Marx, which was the balance of ESR's accounting ledger, but no more. [ER, Vol. 3, Ex. 15, at 245, Line 25]. Windels Marx also obtained title to the two lots, and sold them for $3,000,000. [ER, Vol. 4, Ex. 25, at 581-83].

H. Mr. Miller's license to practice law is suspended based on his professional misconduct in this case.

After Dr. English dismissed Mr. Miller as counsel, she filed a professional misconduct complaint with the Grievance Committee for the Second Judicial Department, which suspended him for six months. [ER, Vol. 4, Ex. 22, at 483-84, 487]; see In re Miller, 907 N.Y.S.2d 218, 221-22 (App. Div. 2010). The state court found that Mr. Miller had (1) breached his fiduciary duties to maintain and preserve funds that his client and the bankruptcy court had entrusted to him, (2) engaged in conduct prejudicial to the administration of justice, and (3) had misappropriated client funds. Id.

II. Statement of the Proceedings Below

A. The bankruptcy court orders Mr. Miller to disgorge $298,000.

Based on the above, the United States Trustee and ESR jointly moved to compel Mr. Miller to disgorge the improperly disbursed funds. [ER, Vol. 4, Ex. 23, at 539-40]. After a hearing on March 11, 2004, the bankruptcy court granted the motion. [ER, Vol. 4, Ex. 23, at 550]. But before the court could finalize the amount to be disgorged, the presiding bankruptcy judge, Chief Judge Duberstein, passed away. The case was reassigned to Judge Eisenberg, who conducted the second hearing on the disgorgement motion on May 16, 2006. [ER, Vol. 4, Ex. 23, at 555].

At the May 2006 hearing, the bankruptcy court made several findings: (1) Mr. Miller had never been lawfully retained under 11 U.S.C. § 327 to represent ESR, [ER, Vol. 4, Ex. 22, at 483]; (2) Mr. Miller's expenditures from the commingled IOLA "did not inure to the benefit of this debtor's estate," [ER, Vol. 4, Ex. 22, at 514]; (3) Mr. Miller's accounting was "flawed by indicating payments from his general account to various parties not necessarily on behalf of this debtor's estate," [ER, Vol. 4, Ex. 22, at 518-19]; and (4) Mr. Miller had violated the escrow order and that the bankruptcy court had not ratified his transactions in violation of the escrow order by later approving ESR's sale of the two Brooklyn lots. [ER, Vol. 4, Ex. 22, at 500-01, 518]. Therefore, the court denied Mr. Miller's fee application and ordered him to return all $298,000 of the sale proceeds. [ER, Vol. 4, Ex. 24, at 574-80].

B. The Second Circuit holds that Mr. Miller must return the money he took for his attorney's fees, but remanded on the amount to be returned.

Mr. Miller appealed the disgorgement order to this Court, which affirmed the order of the bankruptcy court on September 25, 2007. In re English Sheppard Realty Corp., No. 06-4742 (E.D.N.Y. Sept. 19, 2007). Mr. Miller then appealed to the United States Court of Appeals for the Second Circuit, which affirmed the "portion of the order requiring Miller to disgorge attorney fees he paid to himself from the Net Sale Proceeds," but vacated and remanded on the issue of the amount to be returned. Miller v. Simpson, 325 F. App'x 25, 26 (2d Cir. 2009).

The Second Circuit held, "we have no doubts that disgorgement of fees was appropriate for at least two reasons." Id. at 27. First, Mr. Miller "violated that portion of the Escrow Order requiring him to retain the proceeds in an escrow account 'pending confirmation of Debtor's Chapter 11 Plan of Reorganization ("Plan") and distribution pursuant to Court Order.'" Id. Second, Mr. Miller "did not obtain a fee award as required by 11 U.S.C. § 330(a)" to pay himself from the funds of the estate without prior bankruptcy court authorization. Id.

But the Second Circuit also held that the bankruptcy court clearly erred when it determined the amount Mr. Miller must return. The bankruptcy court did not account for the $35,447.42 that Mr. Miller previously returned. Id. Furthermore, "it is also clear that the payments related to the Lots transactions were not [Mr. Miller's] fees" and accordingly those payments "did not fall within the amounts for which the Trustee sought disgorgement." Id. at 28.

Finally, the Second Circuit rejected the other arguments that Mr. Miller raised in the appeal. Because of Mr. Miller's "serious breaches of his fiduciary obligations to the court," the bankruptcy court did not err when it denied his fee application. Id. And there was no merit to his state law or Fifth Amendment due process claims. Id.

The bankruptcy court was given the following instruction on remand: "to conduct an evidentiary hearing to quantify said fees and direct Miller to disgorge that amount." Id. at 27.

C. On remand, the bankruptcy court finds that Mr. Miller paid himself $146,000 in violation of the escrow order.

On remand, the bankruptcy court held an evidentiary hearing to determine the amount Mr. Miller paid to himself. [ER, Vol. 2, Ex. 10, at 90]. The bankruptcy court heard testimony from Mr. Miller and reviewed (1) the accounting records Mr. Miller had previously prepared, which included copies of the checks written against his IOLA; (2) ABSR's corporate records, which were also prepared by Mr. Miller; and (3) correspondence between Mr. Miller and Dr. English. [ER, Vol. 2, Ex. 10, at 225-28].

At the hearing, the United States Trustee examined Mr. Miller about the 13 transactions that were listed as payments to Mr. Miller for either attorney's fees or retainers. [ER, Vol. 2, Ex. 10, at 167-77]. Mr. Miller admitted that those payments were for legal fees. [ER, Vol. 2, Ex. 10, at 167-77, 209].

In opposition, Mr. Miller renewed his argument that the transactions were legitimate and had been ratified by the bankruptcy court. [ER, Vol. 2, Ex. 10, at 145-47]. He maintained that he did not he did not violate the escrow order and thus was not subject to disgorgement. [ER, Vol. 2, Ex. 10, at 148, 151-54].

The bankruptcy court rejected Mr. Miller's arguments because they were "not germane" to determining how much Mr. Miller paid himself in attorney's fees. [ER, Vol. 2, Ex. 10, at 146-48]. The court found that, out of the $246,341.21 Mr. Miller had transferred in violation of the escrow order, he had made 13 payments to himself for attorney's fees, for a total of $146,000. In re English Sheppard Realty Corp., No. 99-10393, 2010 WL 1492272, at *4 (Bankr. E.D.N.Y. Apr. 13, 2010).

The bankruptcy court concluded that Mr. Miller "used the Debtor's funds to pay his legal fees despite never being approved by the Court as bankruptcy counsel, and never being authorized to use the estate's funds to pay himself, and despite the clear terms of the Sale Order." Id., at *5. It also found that Mr. Miller's actions demonstrated a "continuous pattern of misconduct as to how he was compensated in this case" and showed "a flagrant disregard for the Court and the Bankruptcy Code. Such actions cannot be countenanced by the Court." Id.

On April 27, 2010, Mr. Miller timely filed a notice of appeal from the April 13, 2010, disgorgement order to this Court. [ER, Vol. 1, Ex. 1, at 1]. Mr. Miller also filed a motion to alter or amend that order that raised new challenges to the underlying merits of the disgorgement order and contested the factual basis for the bankruptcy court's determination that Mr. Miller had paid himself $146,000. [ER, Vol. 1, Ex. 7, at 66].

At the hearing on the motion to alter or amend judgment, the bankruptcy court held that Mr. Miller's legal arguments were improperly brought. [ER, Vol. 1, Ex. 4, at 26]. First, the court explained that a motion to alter or amend could not be used to relitigate issues that had already been decided or could have been raised before. [ER, Vol. 1, Ex. 4, at 26]. Second, even if the court wanted to consider the merits, the remand from the Second Circuit was for the purpose of determining the amount Mr. Miller paid himself and thus the bankruptcy court could not revisit other issues. [ER, Vol. 1, Ex. 4, at 26]. Third, Mr. Miller's new legal argument was "irrelevant" because Mr. Miller took the money in violation of the court's escrow order and that the Bankruptcy Code did not permit him to "do with [the money] as he and Dr. English saw fit." [ER, Vol. 1, Ex. 4, at 26].

The bankruptcy court also rejected Mr. Miller's factual argument, finding that "the $146,000 dollar number came from Mr. Miller's own documents and records" and there was no evidence of any substantive errors. [ER, Vol. 1, Ex. 4, at 26]. Although some minor revisions were necessary, they did not provide a basis for granting Mr. Miller relief from judgment. [ER, Vol. 1, Ex. 4, at 26].

Accordingly, the bankruptcy court entered its final order denying Mr. Miller's motion to alter or amend the disgorgement order on June 15, 2010. [ER, Vol. 1, Ex. 3, at 5]. Mr. Miller timely filed a notice of appeal from that denial to this Court on June 29, 2010.

On December 15, 2010, the United States Trustee filed motions to consolidate the two appeals. The Court has not yet ruled on the motions.

ARGUMENT

I. The bankruptcy court did not clearly err when it reduced the amount of attorney's fees Mr. Miller must disgorge to $146,000.

A. The bankruptcy court correctly calculated the amount of attorney's fees Mr. Miller paid himself in violation of the escrow order.

A trial court does not clearly err by relying upon uncontested evidence and admissions. "[S]tatements in papers submitted to the court may constitute judicial admissions." Schwan-Stabilo Cosmetics GmbH & Co. v. Pacificlink Intern. Corp., 401 F.3d 28, 35 (2d Cir. 2005). The court may treat such admissions as binding fact. Purgess v. Sharrock, 33 F.3d 134, 144 (2d Cir. 1994). When a party makes a clear and unambiguous admission of fact, it may obviate the need for any further proof with respect to the existence of the admitted fact. United States v. McKeon, 738 F.2d 26, 30 (2d Cir. 1984).

Earlier in this case, the Second Circuit ordered the bankruptcy court "to conduct an evidentiary hearing to quantify said fees and direct Miller to disgorge that amount." Miller v. Simpson, 325 F. App'x at 27. On remand, the bankruptcy court found that Mr. Miller had transferred $246,341.21 in violation of the escrow order and had paid himself $146,000 out of those proceeds. English Sheppard, 2010 WL 1492272, at *4.

That determination was based on accounting records and check records that Mr. Miller prepared and submitted in response to the bankruptcy court's 2001 accounting and turnover order. [ER, Vol. 4, Ex. 23, at 539; ER, Vol. 3, Ex. 15, at 238-43; ER, Vol. 2, Ex. 10, at 107]. Mr. Miller has testified to the accuracy of each payment evidenced within those records. [ER, Vol. 2, Ex. 10, at 168-78]. And he does not contest the amount the bankruptcy court found. Therefore, bankruptcy court is entitled to rely upon Mr. Miller's clear and unambiguous admissions of fact. McKeon, 738 F.2d at 30.

B. The bankruptcy court correctly rejected Mr. Miller's request for equitable relief.

Instead, Mr. Miller argues he should not be held accountable for equitable reasons because (1) his actions were taken in the best interests of Dr. English and ESR, and (2) ESR eventually benefitted from the transactions. Appellant's Br. at 7. Indeed, the Second Circuit stated that the bankruptcy court should "pay due attention to the fact that . . . the Lots were ultimately sold for $3 million, and that ESR . . . described the Lots transactions as being to ESR's benefit." Miller, 325 F. App'x at 27-28. The bankruptcy court duly considered this, and was correct to deny Mr. Miller's request for equitable relief based on his "continuous pattern of misconduct" and actions "in clear violation" of the escrow order, which showed a "flagrant disregard for the Court and the Bankruptcy Code." English Sheppard, 2010 WL 1492272, at 5.

The evidence in the record provides no support for Mr. Miller's purported belief that he acted with good faith to "preserve a valuable asset" and to keep ESR operating in "the business of real estate." Appellant's Br. at 7. First, Mr. Miller cannot take credit for the $3 million that the properties eventually raised for ESR because he never transferred the properties ESR purchased from Dr. English through its acquisition of ABSR. Mr. Miller had ESR pay almost

$250,000 for ABSR, but he never completed the deal by transferring the properties to ABSR or ESR. Although over a year had elapsed from when Mr. Miller took the money from ESR until Dr. English fired him, the record does not show that Mr. Miller made any effort to transfer the property to ABSR or ESR. Mr. Miller took ESR's money, but gave it an empty promise in return.

Meanwhile, Mr. Miller had no such problem giving himself money. While Mr. Miller began writing himself checks from that money right away, ESR's accounting ledger went dormant until Mr. Miller was fired a year later and he was required to transfer the balance of ESR's funds to ESR's new counsel, Windels Marx. Compare [ER, Vol. 3, Ex. 15, at 241, Line 49] with [ER, Vol. 3, Ex. 15, at 245, Lines 24-25]. It was only after Dr. English fired Mr. Miller and retained new counsel that ESR was able to obtain control over the properties it had purchased and sell them for its benefit. [ER, Vol. 4, Ex. 22, at 481]; see ACRIS Detailed Document Information for Brooklyn, Block 2120, Lots 43 and 48, available at http://a836-acris.nyc.gov/ Scripts/DocSearch.dll/BBL.

Thus, there is no reason to believe that Mr. Miller intended the transaction to benefit ESR, or to attribute any later benefit to his conduct. Mr. Miller was unwilling or unable to provide ESR with the property it purchased or to keep the company a going concern in the real estate business. Had Mr. Miller not been caught, it seems unlikely that those circumstances would have ever changed.

Second, it is unclear how Mr. Miller's actions were intended to improve Dr. English's financial status. [ER, Vol. 4, Ex. 22, at 455]. Mr. Miller sold $3 million worth of Dr. English's properties and in return gave her $10 in cash and the assumption of $60,000 in property tax liability. [ER, Vol. 3, Ex. 15, at 240, Line 45, and 243, Line 83; Ex. 16, at 424-26]. He then turned around and sold that same property to ESR, through its acquisition of ABSR, for $246,341.21, and paid himself $146,000.

There is no evidence in the record to prove how Dr. English personally gained by selling those two properties at 2% of their value so they could be sold in bankruptcy. That exposed her equity in the properties to ESR's creditors, which makes no sense when she could have sold the lots herself, paid off her tax liability and other debts, and used the proceeds for other purposes, such as recapitalizing ESR outside of bankruptcy. And considering that Dr. English fired Mr. Miller and filed a professional misconduct complaint against him after she discovered what happened, it is reasonable to state that Mr. Miller did not design this transaction in Dr. English's best financial interests after all. See In re Miller, 907 N.Y.S.2d at 221-22 (suspending Mr. Miller).

What is clear is that Mr. Miller substantially benefitted from the transaction at the expense of Dr. English and ESR. Dr. English risked losing approximately $2.93 million. ESR and its bankruptcy estate — at least before it obtained honest counsel willing to enforce its rights — risked losing $246,341.21. Mr. Miller, to the opposite, gave himself an excuse to take money out of the protection of ESR's bankruptcy estate. Within 14 days of transferring the money, he begin paying himself $146,000 in legal fees that might otherwise have gone unpaid. [ER, Vol. 3, Ex. 15, at 241, Line 49]. It is beyond the pale for Mr. Miller to suggest that the equities of the case should "ameliorate the unexpected rigidity" of the law, Appellant's Br. at 7, when the only reason any benefit ultimately inured to ESR was because (1) Mr. Miller caused Dr. English to lose nearly $3 million in assets and (2) Mr. Miller's self-dealing was unexpectedly revealed.

Therefore, in light of the record viewed in its entirety, the bankruptcy court's decision requiring Mr. Miller to disgorge the $146,000 he took for his own fees was not clearly erroneous. Cooter & Gell, 496 U.S. at 400.

II. Mr. Miller's legal arguments should not be considered because they exceed the scope of the Second Circuit's remand order.

On appeal, Mr. Miller continues his scattershot approach to attacking the validity of the disgorgement order, raising nine different reasons why he should not be required to return the money he took. This Court need not consider his arguments because they are not allowed under the mandate rule.

On remand, a court is bound by the mandate rule. Jam. Shipping Co. v. Orient Shipping Rotterdam, B.V. (In re Millenium Seacarriers, Inc.), 458 F.3d 92, 97 (2d Cir. 2006). Within the Second Circuit, "[t]he mandate rule ordinarily forecloses relitigation of all issues previously waived by the [appellant] or decided by the appellate court." United States v. Quintieri, 306 F.3d 1217, 1225 (2d Cir. 2002); see Amado v. Microsoft Corp., 517 F.3d 1353, 1361 (Fed. Cir. 2008) ("The mandate rule provides that issues actually decided on appeal — those within the scope of the judgment appealed from, minus those explicitly reserved or remanded by the court — are foreclosed from further consideration.").

This rule prevents relitigation "not only of matters expressly decided by the appellate court, but [it] also precludes relitigation of issues impliedly resolved by the appellate court's mandate." Yick Man Mui v. United States, 614 F.3d 50, 53 (2d Cir. 2010). "In other words, the trial court is barred from reconsidering or modifying any of its prior decisions that have been ruled on by a court of appeals." United States v. Minicone, 994 F.2d 86, 89 (2d Cir. 1993).

The trial court's "authority on remand is limited to those issues left open by the mandate." Burrell v. United States, 467 F.3d 160, 165 (2d Cir. 2006); see Quintieri, 306 F.3d at 1225 (stating that the mandate rule does not foreclose relitigation when the appellate court specifically remands for de novo proceedings). To determine whether an issue may be considered on remand, a trial court "should look to both the specific dictates of the remand order as well as the broader spirit of the mandate." Yick Man Mui, 614 F.3d at 53; see, e.g., In re Ingersoll, 562 F.3d 856, 863 (7th Cir. 2009) (making the "unremarkable observation that where the remanding court identifies a discrete or particular issue, the lower court is generally limited to that question.").

Here, the mandate rule precludes Mr. Miller's renewed challenge to the merits of the disgorgement order. Mr. Miller had a full and fair opportunity to litigate the merits of his position in 2006 in the bankruptcy court. He lost, and the Second Circuit affirmed "the portion of the order requiring Miller to disgorge attorney fees he paid to himself from the Net Sale Proceeds," observing that "we have no doubts that disgorgement of fees was appropriate." Miller, 325 F. App'x at 27. And the Second Circuit's instructions for the bankruptcy court on remand were specific: "to conduct an evidentiary hearing to quantify said fees and direct Miller to disgorge that amount." Id.

Nothing in the "specific dictates" or "broader spirit" of that order suggests that any issue is open except the amount of money that Mr. Miller must return. Yick Man Mui, 614 F.3d at 53. Accordingly, there is no authority to reconsider the merits of the disgorgement order. Burrell, 467 F.3d at 165.

III. The bankruptcy court did not abuse its discretion when it denied Mr. Miller's motion to alter or amend the disgorgement order.

Nor did the bankruptcy court abuse its discretion when it denied Mr. Miller's motion to alter or amend the judgment. There are three grounds that justify reconsideration: "an intervening change of controlling law, the availability of new evidence, or the need to correct a clear error or prevent manifest injustice." Virgin Atl. Airways, Ltd. v. Nat'l Mediation Bd., 956 F.2d 1245, 1255 (2d Cir. 1992). Here, no new evidence became available and there had been no change in the controlling authority. Mr. Miller cannot relitigate issues that have been decided by the Second Circuit. Yick Man Mui, 614 F.3d at 53; see supra Part II, at 21-23. And as explained above, requiring Mr. Miller to return the money he took in violation of the escrow order was an equitable decision. See supra Part I.B., at 18-21.

CONCLUSION

For these reasons, the United States Trustee respectfully asks this Court to affirm the orders entered below.

Dated: Brooklyn, New York
January 12, 2011

Respectfully submitted,

TRACY HOPE DAVIS
UNITED STATES TRUSTEE

By: /s/ William E. Curtin
William E. Curtin
Trial Attorney
Alicia M. Leonhard
Assistant United States Trustee
Office of the United States Trustee
United States Department of Justice
271 Cadman Plaza East, Suite 4529
Brooklyn, New York 11201
Phone: 718.422.4960
Facsimile: 718.422.4990
William.E.Curtin@usdoj.gov

Ramona D. Elliott
General Counsel
P. Matthew Sutko
Associate General Counsel
Noah Schottenstein
Trial Attorney
Executive Office for United States Trustees
United States Department of Justice
20 Massachusetts Avenue, N.W., Suite 8100
Washington, D.C. 20530
Phone: 202.307.1399

Certificate of Service

Under penalty of perjury, I declare that, on January 12, 2011, I caused a copy of this document, together with the United States Trustee's Record on Appeal, to be mailed via First Class Mail in the State of New York with proper postage affixed and addressed as follows:

Phillip D. Miller, Esq.
555 Rutland Street
Westbury, New York 11590

Charles E. Simpson, Esq.
Windels Marx Lane & Mittendorf LLP
156 West 56th Street
New York, NY 10019

/s/ William E. Curtin
William E. Curtin

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1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	United Student Aid Funds, Inc. v. Frances J. Espinosa
2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	United States Supreme Court
3. ("CCN") ***CURRENT*** CASE NO.	No.: 08-1134
4. ("PCN") ***PRIOR*** CASE NO. - & COURT *[IF ANY]*	No.: 06-16421 Court: 9th Cir. *(Identify judge & cite, if any)*
5. ("SO") ***SOURCE***	**U.S. TRUSTEES**
6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	Filed: September 3, 2009 Type: Brief for the United States as Amicus Curiae Supporting Petitioner
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8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") ● ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	● Whether the bankruptcy court's discharge order discharged respondent's student loan debt because the court did not find, pursuant to the procedures specified in the bankruptcy rules, that failure to do so would create undue hardship for the debtor and his dependents.
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No. 08-1134

In the Supreme Court of the United States

UNITED STUDENT AID FUNDS, INC., PETITIONER

v.

FRANCISCO J. ESPINOSA

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE SUPPORTING PETITIONER

ELENA KAGAN
Solicitor General
Counsel of Record
TONY WEST
Assistant Attorney General
MALCOLM L. STEWART
Deputy Solicitor General
TOBY J. HEYTENS
Assistant to the Solicitor General
WILLIAM KANTER
PETER R. MAIER
Attorneys

Department of Justice
Washington, D.C. 20530-0001
(202) 514-2217

QUESTION PRESENTED

Whether the confirmation and subsequent completion of respondent's plan under Chapter 13 of the Bankruptcy Code had the effect of discharging his student loan debt, notwithstanding his failure to initiate an adversary proceeding to determine dischargeability and the lack of any determination by the bankruptcy court that "excepting [the] debt from discharge * * * would impose an undue hardship on the debtor and the debtor's dependents." 11 U.S.C. 523(a)(8).

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In the Supreme Court of the United States

No. 08-1134

UNITED STUDENT AID FUNDS, INC., PETITIONER

v.

FRANCISCO J. ESPINOSA

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE SUPPORTING PETITIONER

INTEREST OF THE UNITED STATES

The United States is both a direct lender and a guarantor of student loans. The government's current loan portfolio is worth approximately $618 billion. The Court's resolution of this case also may have implications for various other debts that are owed to the federal government and are non-dischargeable in bankruptcy, including taxes or customs duties; non-tax fines, penalties, and forfeitures; and restitution orders. The United States therefore has a significant interest in this case.

STATEMENT

1. a. Chapter 13 of the Bankruptcy Code permits "individual debtors [to] obtain adjustment of their indebtedness through a flexible repayment plan approved by a bankruptcy court." *Nobelman* v. *American Sav. Bank*, 508 U.S. 324, 327 (1993). To proceed under Chapter 13, a debtor must have "regular income" and his indebtedness must be below certain statutory limits. 11 U.S.C. 109(e).

A debtor initiates a Chapter 13 proceeding by filing a petition with the appropriate bankruptcy court, 11 U.S.C. 301(a), and he must file a proposed plan within 15 days after filing the petition, 11 U.S.C. 1321; Fed. R. Bankr. P. 3015(b). The bankruptcy court holds a confirmation hearing, 11 U.S.C. 1324, and must confirm the plan if it satisfies certain criteria, 11 U.S.C. 1325. The debtor must then make all payments required under the plan, 11 U.S.C. 1326, a process that takes between three and five years. 11 U.S.C. 1322(d), 1325(b)(4). If the debtor completes the plan, the bankruptcy court enters a discharge order under 11 U.S.C. 1328(a), which "operates as an injunction against" efforts to "collect, recover or offset any * * * debt" that was "discharged under [that] section." 11 U.S.C. 524(a)(1) and (2).

b. A full-compliance discharge under Chapter 13 "is broader than the discharge received in any other chapter" of the Bankruptcy Code. 8 *Collier on Bankruptcy* ¶ 1328.01, at 1328-5 (Alan N. Resnick & Henry J. Sommer, eds., 15th ed. rev. Sept. 2005) (*Collier*). Certain debts, however, remain non-dischargeable even in a Chapter 13 proceeding. In particular, Chapter 13 incorporates 11 U.S.C. 523(a)(8), which provides that a discharge order "does not discharge an individual debtor from" most student loan debt "unless excepting such debt from discharge * * * would impose an undue hardship on the debtor and the debtor's dependents." See 11 U.S.C. 1328(a)(2).[1]

c. The Federal Rules of Bankruptcy Procedure (Bankruptcy Rules) establish certain procedures for "determin[ing] the dischargeability of a debt." Fed. R. Bankr. P. 7001(6). "Because student loan debts are not automatically dischargeable," those Rules "require the debtor to file an 'adversary proceeding' against" the relevant creditor in order to obtain a discharge. *Tennessee Student Assistance Corp.* v. *Hood*, 541 U.S. 440, 451 (2004) (*Hood*).

Although an adversary proceeding "is considered part of the original bankruptcy case," *Hood*, 541 U.S. at 452, it "has all the trappings of civil litigation," *Educational Credit Mgmt. Corp.* v. *Mersmann (In re Mersmann)*, 505 F.3d 1033, 1043 (10th Cir. 2007) (en banc). The debtor initiates an adversary proceeding by filing a complaint, Fed. R. Bankr. P. 7003, which must satisfy the requirements of Federal Rule of Civil Procedure 8, see Fed. R. Bankr. P. 7008, and must be served on the creditor along with a summons issued by the clerk. Fed. R. Bankr. P. 7004. In addition to the methods of service permitted by the Federal Rules of Civil Procedure, the Bankruptcy Rules also authorize service by mail. Fed. R. Bankr. P. 7004(b). If the creditor is a corporation, service must be made on "a managing or general agent, or * * * any other agent authorized by appointment or

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[1] At the time of the discharge order in this case, Section 523(a) also provided for discharge of any student loan debt that first became due more than seven years before the filing of the bankruptcy petition. 11 U.S.C. 523(a)(8)(A) (1994). That provision is not at issue here because respondent filed his bankruptcy petition less than five years after receiving his first student loan. Pet. App. 60-61.

by law to receive service of process." Fed. R. Bankr. P. 7004(b)(3). If the federal government is a creditor, as often is the case with student loan debts, service must be made on the Attorney General, the local United States Attorney, and the appropriate federal agency. Fed. R. Bankr. P. 7004(b)(4) and (5).

The procedures for providing notice of a Chapter 13 plan are considerably less rigorous. The clerk must give all parties in interest at least 25 days' written notice of the deadline for filing objections and the date of the confirmation hearing. Fed. R. Bankr. P. 2002(b). That notice need not include a copy of the plan itself; "a summary of the plan" is sufficient. Fed. R. Bankr. P. 3015(d). In addition, unlike an adversary complaint, notice under Bankruptcy Rule 2002(b) need not be directed to an agent authorized to receive service of process. Instead, notice may be "mailed to the address shown on the list of creditors or schedule of liabilities" filed by the debtor along with the bankruptcy petition. Fed. R. Bankr. P. 2002(g)(2).

2. During 1988 and 1989, respondent obtained four federally guaranteed student loans that totaled $13,250 and accrued interest at varying rates. Pet. App. 52, 60-61. On December 7, 1992, respondent filed a Chapter 13 petition and a proposed plan. *Id.* at 61. The only specific indebtedness identified in respondent's bankruptcy petition was his student loan debt. J.A. 15-20. The plan proposed to repay only the principal on that debt, and it stated that "[a]ny amounts or claims for student loans unpaid by this Plan shall be discharged." J.A. 26. The plan did not assert that failing to discharge the interest on respondent's student loan debt would impose an "undue hardship" on respondent and his dependents, nor

did it suggest that plan confirmation would constitute an "undue hardship" finding by the bankruptcy court.

Respondent did not initiate an adversary proceeding in order to determine the dischargeability of the interest on his student loan debt. Instead, the clerk of the bankruptcy court mailed a one-page notice form and a copy of respondent's proposed plan to petitioner at the post office box. Pet. App. 14 n.4, 71; J.A. 34 (copy of notice). Immediately below the caption, the plan stated: "WARNING IF YOU ARE A CREDITOR YOUR RIGHTS MAY BE IMPAIRED BY THIS PLAN." J.A. 23. The plan also listed the deadline for filing a proof of claim, J.A. 26–27, and stated that "[o]bjections, by any creditor, must be filed seven (7) days prior to the hearing on Confirmation of [the] Plan." J.A. 26.

The clerk's notice was stamped "REC'D" by petitioner's litigation department on December 18, 1992. J.A. 34. On January 8, 1993, petitioner filed a proof of claim for $17,832.15, which represented both the principal and accrued interest on respondent's student loans. J.A. 35 & n.**; Pet. App. 62 n.2. Petitioner did not object to confirmation of the plan, and respondent did not object to petitioner's proof of claim. *Id.* at 62, 72.

On May 6, 1993, the bankruptcy court entered an order stating that respondent's "Chapter 13 plan is approved and the Debtors are ordered to comply therewith." J.A. 43. The court made no finding that failing to discharge the interest on respondent's student loan debt would impose undue hardship on respondent and his dependents. Petitioner was not provided with a copy of the bankruptcy court's confirmation order. Pet. App. 62.

A month after the bankruptcy court entered its confirmation order, the Chapter 13 Trustee mailed petitioner a pre-printed form labeled "TRUSTEE'S NO-

TICE TO CREDITOR." J.A. 44. That form had a box checked stating that "[t]he amount of the claim filed differs from the amount listed for payment in the plan" and that "[y]our claim will be paid as listed in the plan." *Ibid.* The form also stated that "[i]f an interested party wishes to dispute the above stated treatment of the claim, it is the responsibility of the party to address the dispute" by notifying the trustee. *Ibid.* Petitioner did not respond to that notice. Pet. App. 63.

Respondent completed all payments provided for in the plan, including the $13,250 designated for payment to petitioner. Pet. App. 63. On May 30, 1997, a second bankruptcy judge entered a one-page order stating that respondent was "discharged from all debts provided for by the plan or disallowed under 11 [U.S.C.] § 502, *except*" for six specified categories of debt. J.A. 46 (emphasis added). The third category listed included "any debt * * * for a student loan." J.A. 46. Respondent neither sought reconsideration of the discharge order nor filed a notice of appeal. Pet. App. 52.

3. Pursuant to a reinsurance agreement, respondent's loans were assigned to the United States Department of Education, which commenced collection efforts. Pet. App. 63. In 2003, respondent reopened his bankruptcy case, and he later filed a motion asking the bankruptcy court, *inter alia*, to order various entities, including petitioner, to cease all collection efforts. C.A. E.R. 39-43. Petitioner opposed that motion and filed a cross-motion for relief from the bankruptcy court's confirmation order, arguing that the order had been entered in violation of the Bankruptcy Code and Rules and that respondent's student loan debt had not been discharged. Pet. App. 6; C.A. E.R. 72-87. Petitioner also requested a recall of respondent's loans from the Department of

Education, which was completed on June 3, 2004. Pet. App. 63.

On August 12, 2004, a third bankruptcy judge granted respondent's motion in relevant part, denied petitioner's cross-motion, and ordered all claimants to "cease and desist all collection activity against" respondent. Pet. App. 79.

Petitioner appealed to the district court, which reversed. Pet. App. 60-70. The district court concluded that the bankruptcy court's confirmation order was "void," and it remanded "for an adversary hearing to determine whether [respondent] qualifies under the 11 U.S.C. § 523(a)(8) exception for the discharge of his student loan." *Id.* at 60.

4. The court of appeals reversed and remanded. Pet. App. 1-27.

a. In an initial per curiam opinion, the court of appeals remanded the case to the bankruptcy court for the limited purpose of addressing whether its discharge order—which, as noted above, specifically excluded student loan debt from discharge—"was entered as a result of a clerical error and, if so, whether to correct it so as to conform to [respondent's] Chapter 13 plan." Pet. App. 59. The court of appeals observed that such a limitation on discharge was "inconsistent with" the confirmed plan's terms, and it hypothesized that the clerk of the bankruptcy court may have generated the discharge order without tailoring it to "the facts of [respondent's] case." *Id.* at 57-58 (internal quotation marks and citation omitted).

b. On remand, the bankruptcy judge who had ruled on the 2003 motions issued a new order. The bankruptcy court found that the language excepting respondent's student loan debt from discharge "was inserted because of a clerical mistake, because it was the clear intent of the Court, as reflected in the Chapter 13 Plan, as approved by the Court, that all student loan-related obligations were to be discharged if the debtor successfully performed and completed the Plan." J.A. 48. The bankruptcy court ordered the relevant paragraph stricken from the discharge order, and further ordered that respondent "be * * * discharged from all obligations of any nature whatsoever arising from or relating to the Student Loans listed in" respondent's bankruptcy petition. *Ibid.*

c. Following the remand, the court of appeals reversed the district court's decision and remanded the case to the bankruptcy court with directions to reinstate its order enjoining any attempt to collect the unpaid portion of respondent's student loan debt. Pet. App. 26-27. The court framed the issue as "[w]hether a debtor may obtain discharge of a student loan by including it in a Chapter 13 plan, if the creditor fails to object after notice of the proposed plan." *Id.* at 5. It concluded that such a discharge was consistent both with the Bankruptcy Code and Rules, *id.* at 8-18, and with the Due Process Clause, *id.* at 18-25.

The court of appeals determined that its previous decision in *Great Lakes Higher Education Corp.* v. *Pardee (In re Pardee)*, 193 F.3d 1083 (9th Cir. 1999) was "on all fours with our case" and "foreclose[d]" petitioner's statutory argument. Pet. App. 8. The court observed that petitioner could have "insist[ed] on the special procedures available to student loan creditors by objecting to the plan on the ground that there ha[d] been no undue hardship finding," but that petitioner had raised no such objection. *Id.* at 10; see *id.* at 14-15. The court also stated that "[a] bankruptcy discharge order is a final judgment" and that "[e]rrors committed during the course of litigation must be corrected by way of a timely appeal." *Id.* at 11.

The court of appeals also rejected petitioner's argument "that the discharge order is void because [petitioner] was denied due process." Pet. App. 18. The court stated that a party who "is adequately notified of a pending lawsuit * * * is deemed to know the consequences of responding or failing to respond." *Id.* at 20. Because petitioner "receive[d] actual notice of [respondent's] bankruptcy case," the court of appeals concluded that it had suffered no violation of its rights under the Due Process Clause. *Id.* at 21.[2]

SUMMARY OF ARGUMENT

Respondent's student loan debt has not been discharged because petitioner did not waive or forfeit its right to contest discharge and the bankruptcy court has not made the undue hardship finding that is an essential prerequisite to discharge of such debt.

A. The court of appeals held that petitioner had waived its objection to discharge of a portion of respondent's student loan debt by failing either to object to the discharge in the bankruptcy court proceedings or to appeal the confirmation or discharge order. Under the Bankruptcy Code, however, the debtor must affirmatively secure an undue hardship finding in order to ob-

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[2] The court of appeals noted that some bankruptcy judges had announced that they would not confirm plans that purported to discharge student loan debts and that one bankruptcy judge had suggested that including such provisions in a proposed plan might subject a debtor's counsel to sanctions. Pet. App. 25-26. The court disapproved both practices, stating that "student loan debts can be discharged by way of a Chapter 13 plan" and that bankruptcy judges "have no business standing in the way" if a creditor fails to object. *Id.* at 26.

tain a discharge of student loan debt. The Bankruptcy Rules establish a procedure for obtaining such a finding, and the debtor is responsible for initiating that procedure. The court of appeals' waiver analysis has the practical effect of shifting to the creditor the burden that the Code and Rules place upon the debtor. By contrast, another provision of the same statutory section provides that certain non-dischargeable debts—but not student loan debts—are covered by a discharge order unless a creditor requests a hearing. The court of appeals' approach effectively subjects student loan debt to the same procedural regime, notwithstanding Congress's evident intent that the two categories of debt be treated differently.

Petitioner was not required to appeal from the confirmation or discharge order to preserve its right to seek repayment of respondent's remaining student loan debt after the plan was completed. The Bankruptcy Code states that a discharge order "does not discharge an individual debtor from" most student loan debt "unless excepting such debt from discharge * * * would impose an undue hardship on the debtor and the debtor's dependents." 11 U.S.C. 523(a) and (8). This provision is framed as a self-executing limitation on the effect of a discharge order rather than as a directive to bankruptcy courts about what plans to confirm. By contrast, numerous other provisions of the Bankruptcy Code are framed as directives to the bankruptcy court. To the extent that Section 523(a) is ambiguous in this regard, construing that provision as a limitation on the legal effect of a discharge order serves Congress's purposes by preventing debtors from circumventing statutory bans on the discharge of other categories of debt, such as domestic support obligations.

B. Discharge of student loan debt without an undue hardship finding is inconsistent with the background and purposes of Section 523(a)(8). For more than 30 years, Congress has acted repeatedly to restrict the discharge of student loan debt in bankruptcy, both to prevent abuses of the student loan system by debtors and to safeguard the financial integrity of the government entities and nonprofit institutions that participate in it.

C. Treating an undue hardship finding as a precondition to discharge is fair to both debtors and creditors. Because student loan debt is presumptively non-dischargeable, it makes sense to place the onus on debtors to request an undue hardship determination rather than on creditors to scrutinize every one of the vast number of Chapter 13 plans that they receive. There is no reason to believe that involved proceedings will be necessary every time a debtor seeks an undue hardship determination. Requiring a debtor to obtain such a determination in order to discharge a student loan debt also avoids creating ethical quandaries for debtors' attorneys.

D. Because respondent did not initiate an adversary proceeding and the bankruptcy court made no undue hardship finding in this case, respondent's student loan debt has not been discharged, and petitioner did not violate the discharge injunction by seeking to collect that debt. The Court therefore need not address the question whether or under what circumstances the waiver rule announced by the Ninth Circuit might violate the Due Process Clause.

ARGUMENT

THE BANKRUPTCY COURT'S DISCHARGE ORDER DID NOT DISCHARGE RESPONDENT'S STUDENT LOAN DEBT BECAUSE THE COURT DID NOT FIND, PURSUANT TO THE PROCEDURES SPECIFIED IN THE BANKRUPTCY RULES, THAT FAILURE TO DO SO WOULD CREATE UNDUE HARDSHIP FOR THE DEBTOR AND HIS DEPENDENTS

A. Petitioner Was Not Required To Demand An Adversary Proceeding Or To Appeal From The Confirmation Or Discharge Order To Preserve Its Right To Collect The Remainder Of Respondent's Student Loan Debt After Respondent's Chapter 13 Plan Was Completed

Respondent's Chapter 13 plan proposed to pay $13,250 to petitioner in satisfaction of respondent's student loan debt and to discharge the remainder of that debt. J.A. 26. Respondent did not contend, however, that a failure to discharge the remaining debt would subject him to undue hardship; he did not initiate the adversary proceeding that the Bankruptcy Rules specify as the required mechanism for resolving issues of dischargeability; and the bankruptcy court made no undue hardship finding. In holding that the bankruptcy court's discharge order nevertheless precluded petitioner from attempting to collect the remaining debt, the court of appeals found that petitioner had forfeited its right to insist that the statutory prerequisite to discharge be satisfied by failing (a) to object to the plan during the bankruptcy court proceedings and (b) to appeal from the confirmation and discharge orders. Pet. App. 10-11, 14-16. That analysis is erroneous.

1. Petitioner did not waive its right to an undue hardship determination by failing to object to respondent's plan or to demand an adversary proceeding

The court of appeals stated that, when a creditor receives notice of a proposed Chapter 13 plan that provides for the discharge of student loan debt, the creditor can "insist on the special procedures available to student loan creditors by objecting to the plan on the ground that there has been no undue hardship finding." Pet. App. 10. The court further indicated that a creditor who fails to "insist" on an adversary proceeding in these circumstances thereby "waive[s] or forfeit[s]" any objection to discharge of the debt. *Ibid.* That analysis is inconsistent with the Bankruptcy Code, the Bankruptcy Rules, and this Court's decision in *Tennessee Student Assistance Corp.* v. *Hood*, 541 U.S. 440 (2004).

a. Section 523(c) provides that "the debtor shall be discharged" from debts that fall within three of the 19 categories of non-dischargeable debt specified in Section 523(a) "unless" the creditor requests a hearing to determine whether a particular debt falls within a relevant category. 11 U.S.C. 523(c).[3] Student loan debt, however, is not among the categories of debt to which Subsection (c) applies. The logical inference is that a creditor need not request a hearing in order to prevent student loan debt from being discharged in the absence of an undue hardship finding. Accord S. Rep. No. 989, 95th Cong., 2d Sess. 79 (1978) (*Senate Report*) (stating that,

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[3] The three categories are debts for things obtained by fraud or false pretenses (11 U.S.C. 523(a)(2)), debts "for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny" (11 U.S.C. 523(a)(4)), and debts "for willful and malicious injury by the debtor to another entity or to the property of another entity" (11 U.S.C. 523(a)(6)). See 11 U.S.C. 523(c).

under Section 523(a)(8), "[t]he lender or institution is not required to file a complaint to determine the nondischargeability of any student loan"). The court of appeals' approach, which treats a student loan creditor's failure to "insist" on an adversary proceeding as a waiver of the creditor's objection to discharge, effectively subjects student loan debt to the same procedural regime that applies to the debts specified in Section 523(c), notwithstanding Congress's evident intent to distinguish between the two categories.

b. The Bankruptcy Rules specify the procedures for resolving questions of dischargeability, including questions as to the presence or absence of "undue hardship" in student loan cases. Those Rules place the burden on the *debtor* to initiate an adversary proceeding through the filing of a complaint and service of the complaint and a summons. Fed. R. Bank. P. 7003, 7004. The practical effect of the court of appeals' approach is to reverse that burden by requiring the *creditor* either to demand an adversary proceeding or to forfeit his objection to discharge. Unlike notice of the plan itself, moreover, the summons and complaint must be specifically directed to an agent of the creditor who is "authorized by appointment or by law to receive service of process." Fed. R. Bankr. P. 7004(b)(3); see pp. 3-4, *supra*. Like the requirement that the debtor initiate the adversary process, that heightened notice requirement is effectively negated if providing notice of the plan to some *other* agent transfers to the student loan creditor the burden of objecting to the discharge.

The court of appeals found that, so long as petitioner had constitutionally adequate notice of respondent's Chapter 13 plan, its failure to demand an adversary proceeding could appropriately be treated as a waiver of any challenge to the dischargeability of respondent's student loan debt. Pet. App. 21. But the fact that an interested party has actual knowledge of pending legal proceedings does not mean, in and of itself, that the party's failure to assert its rights can be treated as a waiver. Rather, the determination whether a waiver has occurred may depend on whether the party has received the *type* of notice required by applicable law. See *City of New York* v. *New York, New Haven & Hartford Railroad*, 344 U.S. 293, 297 (1953) (holding, under the former Bankruptcy Act, that "even creditors who have knowledge of a reorganization have a right to assume that the statutory 'reasonable notice' will be given them before their claims are forever barred"); *Martin* v. *Wilks*, 490 U.S. 755, 765 (1989) (Under the Federal Rules of Civil Procedure, "[j]oinder as a party, rather than knowledge of a lawsuit and an opportunity to intervene, is the method by which potential parties are subjected to the jurisdiction of the court and bound by a judgment or decree."); *Ruehle* v. *Educational Credit Mgmt. Corp. (In re Ruehle)*, 412 F.3d 679, 685 (6th Cir. 2005) (positing a hypothetical situation in which a plaintiff purported to commence a civil action by filing a motion and mailing it to the defendant). That principle applies with particular force here, where the Bankruptcy Rules squarely place the burden of initiating an adversary proceeding upon the debtor, and the effect of the court of appeals' waiver analysis is to shift that burden to the creditor.

c. This Court's decision in *Hood* confirms that it is the debtor's obligation to obtain an undue hardship finding rather than the creditor's obligation to insist on one. The Court in *Hood* held that "a proceeding initiated by a debtor to determine the dischargeability of a student loan debt [owed to a State] is not a suit against the State for purposes of the Eleventh Amendment." 541 U.S. at 443. In reaching that conclusion, the Court observed that, because a student loan debtor must "affirmatively secure[] a hardship determination" in order to obtain a discharge, "the major difference between the discharge of a student loan debt and the discharge of most other debts" is that student loan creditors who decline to participate in the bankruptcy proceedings "might still receive some benefit: The debtor's personal liability on the loan may survive the discharge." *Id.* at 450. The Court also noted, with apparent approval, the debtor's concession that "even if [the creditor] ignores the summons and chooses not to participate in the proceeding the Bankruptcy Court cannot discharge her debt without making an undue hardship determination." *Id.* at 453-454.

The Court in *Hood* thus recognized that an actual undue hardship finding by the bankruptcy court is an essential prerequisite to discharge of a student loan debt, even when the debtor properly initiates an adversary proceeding and the creditor does not object to discharge. It follows *a fortiori* that a debtor who does *not* initiate an adversary proceeding cannot obtain a discharge of his student loan debt without an undue hardship finding simply because the creditor does not "insist" on a proceeding that it is the debtor's duty to invoke.[4]

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[4] The court of appeals cited *Hood*'s observation "that an adversary proceeding initiated by complaint and summons is not a statutory or constitutional prerequisite to adjudication of the discharge of a student loan." Pet. App. 17-18 (internal quotation marks and citation omitted); accord *Hood*, 541 U.S. at 453 ("The text of § 523(a)(8) does not require a summons, and absent [Federal Rule of Bankruptcy Procedure]

2. Petitioner was not required to appeal the confirmation or discharge order to preserve its right to collect respondent's remaining debt because, under the terms of the applicable Bankruptcy Code provisions, a discharge order does not discharge student loan debt in the absence of an undue hardship determination

The court of appeals also suggested (Pet. App. 10-11) that petitioner's failure to appeal either the confirmation or discharge order independently precluded it from seeking to collect respondent's remaining debt after the completion of respondent's plan. An appeal was unnecessary, however, because the discharge order ultimately entered in this case did not have the effect of discharging respondent's student loan debt.

a. The Bankruptcy Code provides that a discharge order "does not discharge" a covered student loan debt "unless excepting such debt from discharge * * * would impose an undue hardship on the debtor and the

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7001(6) a debtor could proceed by motion."). But while the details of the procedural scheme are set forth in the Rules rather than the Code, the Court in *Hood* made clear that the *statute* imposes the basic requirement that the debtor must "affirmatively secure[] a hardship determination." *Id.* at 450. The court of appeals' approach, under which the debtor's submission of a plan that provides for discharge of student loan debt shifts to the creditor the burden of objecting, is thus inconsistent with the Code as well as with the Rules. In addition, the heightened notice requirements described above still would apply even if the Bankruptcy Rules *did* permit a debtor to seek to discharge a student loan debt by filing a motion rather than commencing an adversary proceeding. See Fed. R. Bankr. P. 9014(b) (providing that a "motion shall be served in the manner provided for service of a summons and complaint by Rule 7004").

debtor's dependents." 11 U.S.C. 523(a) and (a)(8).[5] This provision is not framed as a directive to the bankruptcy court. Instead, it is a "self-executing" limitation on the effect of a discharge order. *Hood*, 541 U.S. at 450; accord *Senate Report* 79 (describing Section 523(a)(8) as "self-executing"). Accordingly, the most natural reading of Section 523(a)(8) is that, "[u]nless the debtor affirmatively secures a hardship determination, the discharge order will not include a student loan debt." *Hood*, 541 U.S. at 450; see *id.* at 444 (describing Section 523(a)(8) as providing that covered student loans "are not included in a general discharge order unless the bankruptcy court" makes an "undue hardship" finding).

Unlike Section 523(a), other provisions of the Bankruptcy Code *are* framed as directives to the bankruptcy court. Another provision in the same statutory Section provides that "the court shall" award costs and fees to the debtor in certain circumstances and "shall not award" costs and fees in other circumstances. 11 U.S.C. 523(d). Other provisions of the Bankruptcy Code, including provisions in Chapter 13, also provide that bank-

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[5] Section 523(a)(8) is not by its terms directly applicable to Chapter 13 cases in which the debtor successfully completes performance under a confirmed plan. Instead, Section 523(a)(8) is incorporated via Section 1328, which provides that "the court shall grant the debtor a discharge of all debts provided for by the plan or disallowed under section 502 of this title, except any debt * * * of the kind specified in" eight enumerated paragraphs of Section 523(a). 11 U.S.C. 1328(a) and (a)(2). "The effect of this [provision] is to exclude from the full-compliance discharge [under Chapter 13] those debts for educational loans that are nondischargeable under section 523(a)(8)." 8 *Collier* ¶ 1328.02[3][h], at 1328-20; accord Br. in Opp. 6 n.3 (describing Section 1328(a)(2) as "making § 523(a)(8) applicable in Chapter 13 cases").

ruptcy courts "shall not"[6] or "may not"[7] do certain things. Another provision states that an action "does not" have a certain effect "[u]nless the [bankruptcy] court, for cause, orders otherwise." 11 U.S.C. 349. In contrast, Section 523(a)(8) states that a discharge order "does not" have a certain effect "unless" a particular condition is satisfied.

That difference is significant. As the court of appeals explained, a final judgment is ordinarily binding, and an injunction must be obeyed, even if the issuing court has exceeded its authority or has committed legal error in the course of adjudicating the suit. Pet. App. 10-11. "[A] final judgment cannot be ignored or set aside just because it was the result of an error," but rather "must be corrected by way of a timely appeal." *Id.* at 11; see *Travelers Indem. Co.* v. *Bailey*, 129 S. Ct. 2195, 2205 (2009). Under the statutory provisions governing discharge of student loan debt, however, petitioner was not required to appeal either the confirmation or the discharge order in order to preserve its right to collect respondent's debt after the Chapter 13 plan had been completed. Such an appeal was unnecessary because, in the absence of an undue hardship finding, a bankruptcy discharge "does not discharge an individual debtor from any debt" (11 U.S.C. 523(a)) for student loans covered by Section 523(a)(8).

The court of appeals emphasized that a "discharge injunction" comes "into force by operation of law upon entry of the discharge" and "preclud[es] the creditor, on

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[6] 11 U.S.C. 330(a)(4)(A), 366(c)(1)(B), 1328(f) and (g)(1).

[7] 11 U.S.C. 105(b), 326(b), 341(c), 505(a)(2), 706(c), 707(b)(1), (b)(2)(D) and (c)(3), 904, 921(e), 1112(c), 1129(d), 1222(c), 1225(b)(1), 1228(f), 1229(c), 1307(f), 1322(d)(2), 1325(b)(1), 1328(h), 1329(c), 1501(d), 1521(d).

pain of contempt, from taking *any* actions to enforce the discharged debt." Pet. App. 13. As the court of appeals' own description recognizes, however, the discharge injunction under the Bankruptcy Code is limited by its terms to "actions to enforce the *discharged* debt." *Ibid.* (emphasis added); see 11 U.S.C. 524(a)(1) (referring to "any debt discharged under section * * * 1328 of this title"), 524(a)(2) (discharge "operates as an injunction against" any act "to collect, recover or offset any such debt"). Because the effect of Section 523(a)(8) was to prevent the discharge from encompassing respondent's student loan debt in the absence of an undue hardship finding, the discharge injunction likewise did not cover that debt.

b. To the extent that the statutory language is otherwise ambiguous, this reading of Section 523(a) effectuates the intent of Congress by preventing debtors from evading statutory prohibitions on the discharge of other categories of debt. For example, Section 523(a)(1)(B)-(C) provides that a discharge order "does not discharge" specified types of tax debt; Section 523(a)(5) provides that it "does not discharge * * * any debt * * * for a domestic support obligation"; and Section 523(a)(9) provides that it "does not discharge" debts "caused by" the debtor's unlawful operation of a motor vehicle while impaired by drugs or alcohol. See 11 U.S.C. 1328(a)(2) (making those provisions applicable to Chapter 13 proceedings such as this one). As with student loan debt, those debts are not among the categories for which Section 523(c)(1) requires the creditor to object to discharge.

By rendering certain debts completely non-dischargeable, those provisions reflect Congress's determination that the compelling societal interests in the satisfaction of such obligations should take precedence over the debtor's interest in obtaining a fresh start in bankruptcy. The Ninth Circuit's analysis, however, invites debtors to attempt to escape liability for debts within those categories as well as for student loan debt (which can lawfully be discharged if the debtor initiates an adversary proceeding and the bankruptcy court makes an undue hardship finding). As here, the debtor could include language in a proposed bankruptcy plan stating that confirmation of the plan would extinguish the relevant debts. Then, if the creditor did not object and the plan was confirmed and subsequently completed, the debtor could argue that the debts had been discharged and that the discharge (though illegal) was not subject to later reexamination. In a prior decision, the Ninth Circuit acknowledged that possibility but stated only that it "d[id] not address any of the public policy concerns that might impact the dischargeability of such obligations as alimony or child support." *Great Lakes Higher Educ. Corp.* v. *Pardee (In re Pardee)*, 193 F.3d 1083, 1087 n.6 (1999). In contrast, no such difficulties arise if Section 523(a) is understood to limit the legal effect of a discharge order rather than to provide direction to bankruptcy courts about what plans to confirm.

c. On the facts of this case, it is particularly clear that petitioner's failure to take an appeal did not effect a forfeiture of its right to collect the unpaid portion of respondent's student loan debt after the completion of the plan. The discharge order entered in May 1997 expressly *excluded* "any debt * * * for a student loan" from the categories of debts being discharged. J.A. 46. A different bankruptcy judge subsequently concluded that this exclusion was a "clerical mistake," J.A. 48, and the court of appeals accepted that characterization. It is at least equally plausible, however, that the bankruptcy court in issuing the discharge order recognized (perhaps belatedly) that, in the absence of an undue hardship finding, any unpaid student loan debt could not be discharged. In any event, petitioner's failure to appeal a discharge order that specifically excluded the debt at issue here cannot reasonably be viewed as a waiver of its right to pursue continued collection efforts.

d. The court of appeals relied (Pet. App. 35) on 11 U.S.C. 1327(a), which states that "[t]he provisions of a confirmed plan bind the debtor and each creditor, whether or not the claim of such creditor is provided for by the plan, and whether or not such creditor has objected to, has accepted, or has rejected the plan." The issue before the Court, however, does not involve whether the plan was binding on petitioner and respondent, since respondent does not contend that petitioner violated the plan's terms while it was in effect. Instead, the question here involves the legal effect of the discharge order that the bankruptcy court entered upon respondent's completion of the plan. With respect to that question, Section 523(a)(8), not Section 1327(a), is the controlling provision.

In any event, any possible tension between Section 523(a)(8) and Section 1327(a) is properly resolved by the "commonplace of statutory construction that the specific governs the general." *Morales* v. *TWA*, 504 U.S. 374, 384 (1992). Section 523(a)(8) is the more specific provision because it directly addresses the circumstances under which a bankruptcy court's discharge order discharges a particular type of presumptively non-dischargeable debt. In contrast, Section 1327(a) prescribes the general effects of plan confirmation as between the debtor and creditor, and it does not address any limits on the legal effect of a bankruptcy court's discharge order.[8]

B. Permitting Discharge Of Student Loan Debt Without An Undue Hardship Finding Is Inconsistent With The Background And Purposes Of Section 523(a)(8)

Until 1977, student loans were dischargeable in bankruptcy on the same terms as other debts. See 11 U.S.C. 35 (1976) (listing non-dischargeable debts). Since then, Congress has acted repeatedly to restrict the discharge of student loan debt in bankruptcy. The history and purposes of those enactments confirm that a discharge order does not discharge a student loan debt unless the bankruptcy court finds that failure to do so will result in undue hardship to the debtor and his dependents.

1. In 1976, Congress enacted legislation "making it more difficult for debtors to discharge student loans guaranteed by States." *Hood*, 541 U.S. at 449. That statute provided that such debt "may be released by a discharge in bankruptcy * * * only if" (1) the loan had been outstanding for more than five years as of the discharge date, or (2) "the court in which the proceeding [was] pending determine[d] that payment from future income or other wealth w[ould] impose an undue hardship on the debtor or his dependents." Education

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[8] Neither the court of appeals nor respondent has relied upon Section 1327(b) or (c), which together provide that confirmation of a Chapter 13 plan generally "vests all of the property of the estate in the debtor" and does so "free and clear of any claim or interest of any creditor provided for by the plan." 11 U.S.C. 1327(b)-(c). Like Section 1327(a), these provisions do not specifically address debts that are excepted from discharge by Section 523(a).

Amendments of 1976, Pub. L. No. 94-482, § 439A(a), 90 Stat. 2141.

In 1978, Congress replaced the Bankruptcy Act with the Bankruptcy Code, which contained a provision whose wording closely paralleled current Section 523(a)(8). That provision stated that "[a] discharge under" three specified sections of the Bankruptcy Code "d[id] not discharge an individual debtor from any debt * * * to a governmental unit, or a nonprofit institution of higher education, for an educational loan, unless" one of two conditions was met. Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, § 101, 92 Stat. 2590-2591. The first basis for discharge under the original Bankruptcy Code was that the "loan first became due before five years * * * before the date of the filing of the petition." 11 U.S.C. 523(a)(8)(A) (1982). The second basis was worded identically to current Section 523(a)(8): "unless * * * excepting such debt from discharge * * * will impose an undue hardship on the debtor and the debtor's dependents." *Ibid.*

Since 1978, Congress has consistently expanded the scope of non-dischargeability of student loan debt. In 1990, Congress extended Section 523(a)(8)'s restrictions to discharge orders entered under Section 1328(a), which governs discharges (like the one at issue here) entered following completion of a Chapter 13 plan. Student Loan Default Prevention Initiative Act of 1990, Pub. L. No. 101-508, § 3007(b), 104 Stat. 1388-28. That same year, Congress also increased the required waiting period in the absence of undue hardship from five years to seven years. Federal Debt Collection Procedures Act of 1990, Pub. L. No. 101-647, § 3621(1)-(2), 104 Stat. 4964-4965. In 1998, Congress eliminated the provision authorizing time-based discharge of student loan debt, thus creating the current regime under which all discharges of such debt require an undue hardship finding. Higher Education Amendments of 1998, Pub. L. No. 105-244, § 971(a), 112 Stat. 1837.[9]

2. The consistent direction of these changes and the reasons underlying them refute any suggestion that debtors can obtain a discharge of student loan debt without an undue hardship determination. "[S]tudent loans are enabling loans [that] allow[] individuals to improve their own human capital and increase their income potential." *Educational Credit Mgmt. Corp.* v. *Mersmann (In re Mersmann)*, 505 F.3d 1033, 1042 (10th Cir. 2007) (en banc) (internal quotation marks and citation omitted). Because the principal benefit of student loans—that is, an education—cannot be seized in the event of a default, policymakers feared that, without federal guarantees, "most lenders would * * * refuse to fund a student's pursuit of higher education." *Ibid.* (quoting Seth J. Gerson, *Separate Classifications of Student Loans in Chapter 13*, 73 Wash. U. L.Q. 269, 280 (1995)). As a result, the United States "insures or guarantees lenders and guarantors that the government will repay student loans in the event of a borrower's default." *Ibid.*

The current restrictions on dischargeability of student loan debt in bankruptcy thus serve two fundamental purposes. First, they "prevent[] abuses of the educational loan system by restricting the ability to discharge a student loan shortly after a student's graduation." 4 *Collier* ¶ 523.14[1], at 523-101 (June 2007). Second, they "safeguard[] the financial integrity of governmental

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[9] Because the bankruptcy court's discharge order was entered in 1997, see J.A. 47, the 1998 amendments are not directly applicable to this case. There is no dispute, however, that respondent was ineligible for a time-based discharge under the pre-1998 version of the statute.

entities and nonprofit institutions that participate in educational loan programs." *Ibid.*

Permitting debtors to discharge student loan debt without obtaining the undue hardship determination mandated by Section 523(a)(8) is inconsistent with both purposes. So long as the immediate creditor fails to object, the Ninth Circuit's approach would permit a debtor to obtain a binding discharge of student loan debt immediately upon his graduation and without any determination of undue hardship. Indeed, respondent appears to be precisely the sort of debtor for whom Congress did not intend to authorize a discharge of student loan debt. Respondent sought bankruptcy protection less than five years after he *obtained* his first student loan. Pet. App. 60-61. At the time he filed for bankruptcy, moreover, respondent was employed, J.A. 21, did not assert that he had any dependents, and identified no specific debts beyond his student loans, J.A. 7.

C. Treating An Undue Hardship Finding As A Precondition To Discharge Is Fair To Both Debtors And Creditors

1. Requiring a Chapter 13 debtor to "affirmatively secure[] a hardship determination" (*Hood*, 541 U.S. at 450) in order to discharge a student loan debt makes sense because, as a practical matter, student loan creditors cannot conduct a timely and thorough review of every Chapter 13 plan that they receive. See *Ruehle*, 412 F.3d at 681 (noting that student loan creditors "receive tidal waves of mail"). We are advised that Chapter 13 plans often are mailed only to payment service subcontractors, and that those subcontractors cannot practicably forward those plans promptly enough to permit timely scrutiny by knowledgeable staff members before the date of the confirmation hearing. See Fed. R.

Bankr. P. 2002(b) (providing that notice must be given "not less than 25 days" before the deadline for filing objections). And even when those staff members do timely receive Chapter 13 plans for review, thorough scrutiny of the plan may be impracticable because "there is no fixed form that [the] plan must take, and debtors are allowed to tailor their plans to meet their own needs and circumstances." 8 *Collier* ¶ 1322.01, at 1322-6 to 1322-6.1 (Sept. 2006). In contrast, the procedures for commencing an adversary proceeding are designed to ensure that the appropriate individuals receive prompt and effective notice of the debtor's intent to seek discharge of a presumptively non-dischargeable student loan debt. See, *e.g.*, Fed. R. Bankr. P. 7004(b)(3) (requiring service on "an officer, a managing or general agent, or * * * any other agent authorized by appointment or by law to receive service of process"); Fed. R. Bankr. P. 7008 (incorporating Federal Rule of Civil Procedure 8, and thus requiring that an adversary complaint contain "a short and plain statement of the claim" (Fed. R. Civ. P. 8(a)(2) and "a demand for the relief sought" (Fed. R. Civ. P. 8(a)(3)).

Requiring the debtor to seek an undue hardship determination will not necessitate lengthy or complicated proceedings. A creditor may choose not to contest undue hardship once the issue properly is raised if it concludes that such a finding is warranted or that the costs of contesting the existence of undue hardship would exceed the benefits. Cf. 34 C.F.R. 682.402(i)(1)(iii) (Department of Education regulation permitting, but not requiring, a guaranty agency to refrain from opposing an undue hardship determination if it concludes that "the expected costs of opposing the discharge petition would exceed one-third of the total amount owed on the loan"). The Federal Rules of Bankruptcy Procedure do not forbid stipulations, and they expressly authorize requests for admission, Fed. R. Bankr. P. 7036, default judgments, Fed. R. Bankr. P. 7055, and summary judgment, Fed. R. Bankr. P. 7056. Although the bankruptcy court must make an explicit undue hardship finding to discharge student loan debt even if the creditor does not object (see p. 16, *supra*), that finding can be made expeditiously.

2. The conclusion that debtors may not discharge a student loan debt simply by including language in a proposed Chapter 13 plan also avoids creating ethical difficulties for debtors' attorneys. As this Court stated in *Hood*, the Bankruptcy Rules "require[] the debtor to file an 'adversary proceeding' against [a creditor] in order to discharge his student loan debt," and the Bankruptcy Code provides that a "Bankruptcy Court cannot discharge [such a] debt without making an undue hardship determination." 541 U.S. at 451, 453-454.

The Ninth Circuit's approach encourages debtors' attorneys to seek to evade both of those requirements by including "plainly illegal provision[s]" in bankruptcy plans. *Ruehle*, 412 F.3d at 681. Doing so, however, would implicate Federal Rule of Bankruptcy Procedure 9011(b)(2), which states that, by presenting a document to a bankruptcy court, an attorney certifies that "the claims, defenses, and other legal contentions therein are warranted by existing law or by a nonfrivolous argument for the extension, modification, or reversal of existing law." In addition, the approach approved by the court of appeals depends for its success on the prospect that the bankruptcy court will not become aware of the illegal provisions in time to perform its independent duty to confirm only those plans that "compl[y] with the provisions of" the Bankruptcy Code. 11 U.S.C. 1325(a)(1); see *Johnson* v. *Home State Bank*, 501 U.S. 78, 87 (1991) (stating that "[a] bankruptcy court is authorized to confirm a [Chapter 13] plan *only* if the court finds" that it complies with the requirements set forth in Section 1325(a)) (emphasis added). The Bankruptcy Code should not be construed to encourage "practice by ambush." *Whelton* v. *Educational Credit Mgmt. Corp.*, 432 F.3d 150, 153 (2d Cir. 2005) (citation omitted).

3. The principle that "student loan debt remains due until there is a determination that the loan is dischargeable," 4 *Collier* ¶ 523.14[2], at 523-102, is fair to the debtor's other creditors and to the debtor himself. Because a debtor does not receive a discharge under Chapter 13 until after performance under the plan is complete, 11 U.S.C. 1328(a), a subsequent determination that the discharge order did not effectively discharge the debtor's student loan debt will not affect payments made under the plan to other creditors. The Bankruptcy Code, moreover, imposes no time limit within which an undue hardship determination must be made. Accordingly, a debtor who legitimately qualifies for a discharge of student loan debt but has failed to secure the necessary hardship determination need only do what he should have done in the first place: return to the bankruptcy court and commence an adversary proceeding. See Pet. App. 60 (district court remanding to the bankruptcy court for an undue-hardship determination). In contrast, a debtor who cannot demonstrate undue hardship is prevented from obtaining a windfall to which he is not entitled.

D. Because Respondent Did Not Initiate The Appropriate Procedure For Securing An Undue Hardship Finding And The Bankruptcy Court Made No Such Finding In This Case, Respondent's Student Loan Debt Has Not Been Discharged And The Court Need Not Address The Constitutional Question Presented In The Petition

This Court need not address petitioner's additional contention (Br. 51-58) that the notice it received of respondent's Chapter 13 plan failed to satisfy constitutional due process requirements. Consistent with the Constitution, Congress could have included student loan debt among the debts listed in Section 523(c)(1), for which a creditor must either raise or forfeit its objection to dischargeability. See p. 13 & n.3, *supra*. Had Congress done so, it also could have provided that mailing a student loan creditor notice of a proposed plan at an appropriate address is sufficient to trigger the creditor's duty to contest discharge. See *Jones* v. *Flowers*, 547 U.S. 220, 225-226 (2006) (stating that "due process does not require actual notice" and noting "this Court's ample precedent condoning notice by mail"). Thus, the procedural regime that effectively results from the court of appeals' ruling here would raise no substantial constitutional concerns if Congress had enacted it into law, thereby giving student loan creditors fair warning of the steps needed to preserve their rights to payment.

As explained above, however, the Bankruptcy Code does not require creditors to object to the debtor's plan to preserve the non-dischargeability of student loan debt, but rather places upon student loan debtors an affirmative duty to secure an undue hardship finding as a prerequisite to discharge. In addition, the Bankruptcy Rules require a particular type of notice (service of an adversary complaint upon specified agents of the creditor) in order to commence proceedings to adjudicate the dischargeability of a student loan debt, and they provide that a creditor's obligation to respond within the context of such a proceeding does not arise until a complaint "is duly served." Fed. R. Bankr. P. 7012(a). The Code and Rules thus assure student loan creditors that their right to full payment will not be placed at issue unless and until the creditor is informed, in compliance with the Rules' heightened notice requirement, that the debtor has sought an undue hardship finding. The gravamen of petitioner's constitutional challenge is that respondent's failure to initiate an adversary proceeding as required by the Code and Rules deprived petitioner of the process it was due. See Pet. Br. 54-55.

The Code and Rule provisions on which petitioner relies make clear, however, that petitioner did not waive its right to pursue continued collection efforts by failing to insist on an adversary proceeding. See pp. 13-16, *supra*. And under Section 523(a)(8), the proceedings in the bankruptcy court did not effect a discharge of respondent's unpaid student loan debt. See pp. 17-23, *supra*. It is therefore unnecessary for the Court to decide whether petitioner would have suffered a deprivation of constitutional magnitude if its right to seek further repayment had been abrogated without the notice and procedures that the Code and Rules require for a discharge of student loan debt.

This Court's usual practice is to avoid deciding constitutional questions whenever possible, see, *e.g.*, *Northwest Austin Mun. Util. Dist. No. One* v. *Holder*, 129 S. Ct. 2504, 2508, 2513 (2009), and there is no reason to depart from that practice here. To the contrary, withholding decision on any constitutional issue would be particularly appropriate because of the atypical facts of this case. It is undisputed that petitioner's litigation department received *actual* notice of respondent's Chapter 13 plan, the deadline for filing objections, and the date of the confirmation hearing. Pet. App. 21; see J.A. 34. In many other cases, however, it will not be possible to show that the creditor received actual notice. See pp. 26-27, *supra*.

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted.

ELENA KAGAN
Solicitor General

TONY WEST
Assistant Attorney General

MALCOLM L. STEWART
Deputy Solicitor General

TOBY J. HEYTENS
Assistant to the Solicitor General

WILLIAM KANTER
PETER R. MAIER
Attorneys

SEPTEMBER 2009

BRIEF BANK — "SUMMARY SHEET" Printed Tue.-10/5/99 (14:44)

WESTLAW CODES

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U.S. TRUSTEE v. ETCHEVERRY (In Re AURELIO ETCHEVERRY, JR.)

2. ("CO") CURRENT COURT [E.g., "CTA9"]
U.S. DISTRICT COURT (D. COLO.)

3. ("CCN") CURRENT CASE NO.
No.: 98-AP-1345

4. ("PCN") PRIOR CASE NO. & COURT [IF ANY]
No.: 97-28659-RJB (221 B.R. 524) (decided June 16, 1998)
Court: U.S. BANKRUPTCY COURT (BANKR. D. COLO.) (Brumbaugh, B.J.)
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Leo M. Weiss (UST/R19)
(UST/OGC: 202-307-1399/FAX-2397)

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9. ("SU")
- SUMMARY OF KEY ISSUE(s)

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/ Any Miscellaneous BACKGROUND

- Whether the Bankruptcy Court erred, as a matter of law, in holding that "bad faith" can never be "cause" for dismissal under 11 U.S.C. § 707(a).

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APPELLANT'S OPENING BRIEF AND APPENDIX

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO

No. 98-AP-1345

In Re AURELIO ETCHEVERRY, JR.,
Debtor.

BARBARA A. SHANGRAW,
UNITED STATES TRUSTEE,
Appellant,
v.

AURELIO ETCHEVERRY, JR.,
Appellee.

ON APPEAL FROM THE UNITED STATES
BANKRUPTCY COURT FOR THE DISTRICT OF COLORADO
(Bankruptcy Judge Brumbaugh)

BRIEF FOR APPELLANT,
UNITED STATES TRUSTEE

OF COUNSEL:

BARBARA A. SHANGRAW
United States Trustee
LEO M. WEISS
Attorney, Bar #15294
Office of the U.S. Trustee for Region 19
721 19th Street (Suite 408)
Denver, Colorado 80202
303-844-5188/FAX-5230

August 28, 1998

MARTHA L. DAVIS
General Counsel

ANTHONY J. CICCONE
Attorney
Executive Office for U.S. Trustees
Department of Justice
901 E Street, N.W. (Suite 780)
Washington, D.C. 20530
202-307-0003/FAX-2397

Attorneys for United States Trustee

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UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO

IN RE:
AURELIO ETCHEVERRY, JR.
(SSN 265-87-1194),
Debtor.

Chapter 7 Case No. 97-28659 RJB
(Bankruptcy Judge Brumbaugh)

BARBARA A. SHANGRAW,
UNITED STATES TRUSTEE,
Appellant,
v.

AURELIO ETCHEVERRY, JR.,
Appellee.

Civil Action No. 98-AP-1345

BRIEF FOR APPELLANT, UNITED STATES TRUSTEE

The United States Trustee respectfully submits this opening brief in support of her appeal from the bankruptcy court's June 16, 1998 order and judgment denying her motion to dismiss under 11 U.S.C. § 707(a).[1]

STATEMENT OF JURISDICTION

The bankruptcy court had jurisdiction over this matter pursuant to 28 U.S.C. §§ 157(b) and 1334. On June 19, 1998, the United States Trustee filed a timely notice of appeal (App. 8) from the bankruptcy court's June 16th judgment, in accordance with Rule 8002 of the Federal Rules of

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[1] The June 16, 1998 decision, published in In re Etcheverry, 221 B.R. 524 (Bankr. Colo. 1998), is reproduced, for the Court's convenience, in the attached Bates-stamped appendix ("App.") at 1-7. Future references to materials reproduced in the appendix will be designated "App. __."

Bankruptcy Procedure ("Fed. R. Bankr. P."). This Court possesses jurisdiction over the appeal by virtue of 28 U.S.C. § 158(a).

STATEMENT OF THE ISSUE

Whether the bankruptcy court erred, as a matter of law, in holding that "bad faith" can never constitute "cause" for dismissal of a bankruptcy petition under 11 U.S.C. § 707(a).

STATEMENT OF THE STANDARD OF REVIEW

On appeal, findings of fact may not be set aside unless clearly erroneous, but a bankruptcy court's conclusions of law and statutory interpretations are subject to *de novo* review. Hall v. Vance, 887 F.2d 1041, 1043 (10th Cir. 1989); Branding Iron Motel, Inc. v. Sandlian Equity Co., Inc. (In re Branding Iron Motel, Inc.), 798 F.2d 396, 399-400 (10th Cir. 1986); *accord* Fed. R. Bankr. P. 8013. The disposition of a motion to dismiss under 11 U.S.C. § 707(a) is reviewed for abuse of discretion. *E.g.*, Industrial Insurance Services, Inc. v. Zick (In re Zick), 931 F.2d 1124, 1126 (6th Cir. 1990), *citing* In re Atlas Supply Corp., 857 F.2d 1061, 1063 (5th Cir.1988).

STATEMENT OF THE CASE

I. Nature Of The Case

Dr. Etcheverry filed a chapter 7 liquidation petition on December 19, 1997, seeking to discharge his debts. *See* Appellate Exhibit 3, at App. 10, *et seq*. At that time, his bankruptcy schedules listed assets and debts of $51,479 and $670,702, respectively (App. 21, Summary of Schedules). The single largest unsecured debt for which there is a scheduled amount involves a claim of approximately $113,048 (App. 26, Schedule F), arising from a Florida state court judgment entered on September 5, 1996 in a tort case against the debtor involving an automobile accident. McBeath v.

Etcheverry, No. 94-5520-CA-25 (11th Jud. Cir., Dade County). The chapter 7 bankruptcy trustee assigned to administer the estate notified the United States Trustee's Office that dismissal might be warranted because the debtor had apparently understated assets, overstated expenses, and filed bankruptcy primarily to evade his Florida judgment creditor. The United States Trustee filed a motion to dismiss the petition for bad faith under 11 U.S.C. § 707(a), but the bankruptcy court held, as a matter of law, that bad faith can never constitute "cause" for dismissal under section 707(a).

II. Statement Of The Facts

Debtor is the sole shareholder of a closely-held professional corporation — "Aurelio Etcheverry, D.O., P.C." — by which he and his (non-debtor) wife have been employed as physician and office manager, respectively. Dr. and Mrs. Etcheverry reside at 290 Chinle Court, Grand Junction, a sizable house of approximately 3,000 square feet, with a three-car garage and pool, built in 1994. App. 29-30. Their home is located in a fashionable neighborhood and has an appraised value of at least a quarter-million dollars according to local land records, although the debtor admits that his residence is mortgaged for over $367,000.[2/] *Accord* App. 25 (Schedule D).

According to the Statement of Financial Affairs in his December 1997 bankruptcy schedules, the debtor's "W-2 wages" in 1997 and 1996, respectively, were $105,000 and $73,500. App. 15. Although the schedules required debtor to disclose his gross income "during the two years immediately preceding this calendar year," *id.*, Dr. Etcheverry neglected to state his 1995 income. When pressed

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[2/] *See, e.g.,* Transcript ("Tr.") of June 8, 1998 hearing on motion to dismiss, *reproduced at* App. 54-58; *accord* Mesa County Assessor's Office real estate records, App. 31; *see also* Massachusetts v. Westcott, 431 U.S. 322, 323 n.2 (1977) (public records "may be judicially noticed") on this point at a January 16, 1998 creditors' meeting pursuant to 11 U.S.C. § 341 ("341 Meeting" at 9, *reproduced at* App. 78), the debtor ultimately disclosed that $195,552 in income from his medial practice had been reported to the Internal Revenue Service in 1995.[3/] The debtor could not explain at the § 341 meeting why his reported income dropped so significantly between 1995 and 1996-97. See 341 Meeting at 7-8, App. 76-77. However, debtor subsequently acknowledged in a May 1998 affidavit that:

> [m]y income has not changed substantially in the last several years, although it is now reported differently for tax purposes since my medical practice changed in 1995 from a sole-proprietorship to a professional corporation.

See Debtor's May 28, 1998 affidavit in Adversary Proceeding No. 98-1204-PAC (Bankr. D. Colo.), at 1, ¶ 4, *reproduced at* App. 47.

On September 5, 1996 — about a year before filing for bankruptcy — a final judgment for $199,900 was entered against the debtor by a Florida state court in the McBeath personal injury action.[4/] That judgment states, in pertinent part, as follows:

> PURSUANT to Demand for Judgment . . . it is hereby:
>
> ORDERED AND ADJUDGED that Plaintiff, Denise DePasquale McBeath . . . recover from Defendant, Aurelio Etcheverry, the sum of One Hundred Ninety-Nine Thousand Nine Hundred Dollars ($199,900.00), that shall bear interest at the rate of ten percent (10%) per year, for which sum let execution issue.

[3/] See Debtor's 1995 IRS Form 1040 (line 12) and Amendment to Statement of Financial Affairs (Jan. 26, 1998), *reproduced in* Appellate Exhibits 7-8, at App. 33-34.

[4/] See Appellate Exhibit 11 (App. 50), *reproducing* Final Judgment dated September 5, 1996 in McBeath v. Etcheverry, No. 94-5520-CA-25 (11th Jud. Cir., Dade County).

App. 50. After his insurance carrier paid $100,000 of the Florida judgment, the debtor offered to contribute only $25,000 toward the balance of the judgment, which offer was rejected by the judgment creditor. See, e.g., Tr. at App. 67-71; *accord* Sept. 16, 1996 letter at App. 51-52. On or about December 5, 1997, a writ of garnishment was issued by the Mesa County District Court against the debtor's bank account, which allegedly held a $3,435.36 paycheck from his medical professional corporation. Two weeks later, on December 19, 1997, the debtor filed for bankruptcy. *See* Tr. at App. 72-73; *accord* 341 Meeting at App. 75, & Schedules at App. 17, ¶ 4b.

By February 1998, the United States Trustee's Office became concerned that dismissal of the petition might be warranted because, among other things, the debtor's income seemed to be understated in the schedules while certain expenses appeared overstated, the debtor had made no significant adjustments to a lavish pre-petition lifestyle, and the filing appeared principally designed to thwart the efforts of debtor's judgment creditor to collect on her personal injury award. In March 1998, after further review, the United States Trustee filed a § 707(a) motion to dismiss "for cause" because of bad faith associated with the filing of debtor's petition. *See* App. 89, *reproducing* 11 U.S.C. § 707.

For example, while Dr. Etcheverry purportedly transferred all his title to the family home to his wife — by quit claim deed, for no consideration, on September 28, 1994 (App. 32) — his bankruptcy schedules list home mortgage payments, totaling about $3,447 per month, among Dr. Etcheverry's personal debts.[5/] His schedules also reflect indebtedness for monthly homeowner's insurance

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[5/] *See* App. 45, listing monthly payments of $2,435.21 for a first mortgage, $807.47 for a second mortgage, and $205 for a "home loan" (*reproducing* Amended Bankruptcy Schedule J, "Current Expenditures of Individual Debtor").

premiums, the cost of two house-cleaners, as well as lawn and pool maintenance payments, all in connection with a house he claims is ***not*** his property.[6]

On the other side of the ledger, the debtor's bankruptcy schedules did not list any vehicles among his assets. Yet, the debtor and his wife enjoy the use of two late-model luxury motor vehicles — a 1996 Saab and 1996 Toyota Land Cruiser — which the professional corporation began leasing in March and June 1996. Tr. at App. 64-66. Although the debtor admitted at the § 341 meeting that he has possession of both vehicles every day and that they are parked in his garage every night, neither vehicle was listed among his assets, either as property owned outright or as property held for another.[7] Nonetheless, while nominally rented by his private corporation, the debtor lists debts of $36,805.74 and $33,543.95 as his personal "Guarantee[s] of Professional Corporation automobile lease[s]." App. 26 (Schedule F).

Moreover, the debtor incredulously valued his joint "general household furnishings" at a mere $1,500 — notwithstanding that he and his wife reside in a fashionable neighborhood of luxury homes valued at or over a quarter-million dollars. Indeed, Schedule F of the debtor's bankruptcy petition

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[6] E.g., App. 45, listing $446.10 per month for joint homeowner and auto insurance (*reproducing* Amended Schedule J); *accord* App. 16, listing weekly payments to two house-cleaners in the range of $50-$200 apiece (*reproducing* Statement of Financial Affairs at 2); *see also* Tr. at App. 57 ("Q. So you pay to clean the house that your wife owns, is that correct? A. That's correct. Q. Two women? A. Yes. Q. And they come on the same days? A. Yes.").

[7] *See, e.g.,* App. 79-80 (341Creditors Meeting); *accord* App. 20, *reproducing* Statement of Financial Affairs, ¶ 14 ("Property held for another person: _x_ *None*") (italics added).

reflects a debt of $3,930.87 alone for his satellite dish, which appears to be included within the schedules' definition of the term "[h]ousehold goods and furnishings."[8]

Based upon such questionable entries in the debtor's bankruptcy schedules and an apparent lack of good faith in filing, the United States Trustee lodged a motion to dismiss under 11 U.S.C. § 707(a), as next briefly addressed.[9]

III. Course Of Proceedings And Decision Below

In her March 27, 1998 motion to dismiss, the United States Trustee "assert[ed] that this case should be dismissed under 11 U.S.C. § 707(a) in that the petition is not brought in good faith." Motion to Dismiss at 1, ¶ 4. Based upon the schedules and other evidence recounted above, the United States Trustee alleged that the "[d]ebtor maintains a lavish lifestyle a[nd] exhibits the income with which he can pay his current debt," and that a review of the schedules suggests that the "debtor's income is understated . . . [and his] expenses are overstated" — as the court below itself apparently recognized

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[8] *See* App. 22, Schedule B, ¶ 4 (requiring a valuation of "Household goods and furnishings, includ[ing] audio, video and computer equipment") (emphasis added); *accord* App. 24, Schedule C, ¶ 4 (listing $1,500 as "current market value" of "[h]ousehold goods"); cf. App. 27, Schedule F at 2 (listing a Sept. 1994 home loan of $3,930.87 for debtor's satellite dish).

[9] This case was not appropriate for a § 707(b) motion to dismiss for "substantial abuse," because subsection (b) only applies in cases involving "primarily consumer debts," as defined in 11 U.S.C. § 101(8). Here, by contrast, most debts appeared to be non-consumer debts, such as the $113,000 balance due on the Florida judgment, pending malpractice litigation in an unknown amount, related legal fees, business credit lines, about $70,000 in guarantees for vehicles leased to debtor's corporation, and $102,044 for repayment of an income-guarantee agreement with a community hospital. E.g., App. 18, 26-27.

at the hearing.[10] Furthermore, the debtor's bankruptcy petition (which was filed just two weeks after his Florida accident victim garnished a paycheck) appears to have been designed to preclude recovery by one creditor, while maintaining the debtor's lifestyle unaltered in most other respects. *Id.* at 2, ¶ 10; *accord* Tr. at App. 61-65.

Following a June 8 hearing, the bankruptcy court denied the United States Trustee's motion to dismiss on June 16, 1998 as a matter of law and without even reaching the facts. Guiding the court's decision was the (erroneous) legal view that there is no good-faith requirement in 11 U.S.C. § 707(a), notwithstanding substantial case law to the contrary. Indeed, in so ruling, Bankruptcy Judge Brumbaugh expressly acknowledged that "Judge Brooks of this Court has held that there is such a requirement" in two prior cases in this District, *i.e.*: In re Hammonds, 139 B.R. 535 (Bankr. Colo. 1992), and In re Tanenbaum, 210 B.R. 182 (Bankr. Colo. 1997). *See* Memorandum Opinion and Order ("slip op.") at 1 (June 16, 1998), *reproduced at* App. 1 & 6. The court explained its legal conclusion that there is no "good faith" requirement in § 707(a) in the following terms:

> There is absolutely no provision in the Bankruptcy Code that would prevent or deter a debtor from filing a Chapter 7 case if he had the ability to repay some debt and could still maintain a comfortable lifestyle. . . . [It] is not for the courts to insert that "means test" into the Code. In fact, at this very moment, Congress is debating whether or not it should write such a provision in the Code.

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[10] *Id.* at 1-2, ¶¶ 4-8; *accord* Tr. at App. 59-60 ("THE COURT: . . . You're listing expenses, but you're not listing those PC payments on your income Schedule. Your income -- you're drawing seven grand a month, less withholding. DR. ETCHEVERRY: Right. THE COURT: But the PC is paying for a lot of this other stuff that is really income to you. DR. ETCHEVERRY: That's correct. THE COURT: But you don't list that as income. DR. ETCHEVERRY: Well -- THE COURT: So your income is not $4,964.50 a month, it's $4,964.50 a month, plus whatever payments the PC is making on your behalf. DR. ETCHEVERRY: That is true.") (emphasis added).

* * *

> . . . If Congress had wanted a "substantial abuse" provision in § 707(a)[,] they could have inserted it as they did in § 707(b), but they did not do so. . . . [T]his Court holds that there is not a "good faith" requirement contained in 11 U.S.C. § 707(a). Rather, this Court adopts . . . the reasoning of . . . In re Latimer, 82 B.R. 354 (Bankr. E.D. Penn.1988), and In re Landes, 195 B.R. 855 (Bankr. E.D. Penn. 1996).

Id. at 3, App. 3 & 6-7 (emphasis added).

The court further suggested that, in lieu of a § 707(a) motion to dismiss, any relief must be limited to more "specific" Code remedies, "such as disallowance of claimed exemptions, determination of non-dischargeability, or denial or revocation of a discharge" pursuant, e.g., to 11 U.S.C. §§ 522, 523, 727. Slip op. at 2, App. 2, *citing* In re Khan, 172 B.R. 613 (Bankr. D. Minn. 1994). Because the bankruptcy court seriously erred as a matter of law, the United States Trustee filed this appeal to resolve the intra-district conflict created by the decision below.

SUMMARY OF THE ARGUMENT

Section 707(a) of the Bankruptcy Code authorizes dismissal of a chapter 7 petition "for cause." As used in the statute, "cause" for dismissal includes (but is not limited to) a debtor's unreasonable delay, nonpayment of fees, and/or failure to file required schedules of assets-and- liabilities and the like. Thus, far from having an unlimited right to liquidate their debts, debtors can be denied relief under chapter 7 if a petition reflects an improper use of the Code.

The narrow question presented by this case is whether a dismissal "for cause" under § 707(a) can ever be based upon a debtor's "bad faith." The court below broadly answered this question in the negative, holding that — as a pure matter of law and without even considering the facts of this case —

there is no clean-hands requirement in chapter 7, and a debtor's bad faith can never warrant dismissal under § 707(a). In so ruling, the court below not only departed from two prior bankruptcy decisions within this District reaching precisely the opposite result, but it also erred as a matter of law. This Court should thus reverse and remand with instructions that the bankruptcy court specifically address the facts of record and dismiss debtor's petition if it was, indeed, tainted by bad faith, as more fully demonstrated below.

ARGUMENT

I. Bad Faith Is A Ground For Dismissal "For Cause" Under 11 U.S.C. § 707(a) And The Court Below Erred, As A Matter Of Law, In Holding Otherwise

Section 707(a) of the Bankruptcy Code of 1978, as amended, 11 U.S.C. § 101, *et seq.*, provides that a bankruptcy court

> may dismiss a case under this chapter only after notice and a hearing and only for cause, including —
> (1) unreasonable delay by the debtor that is prejudicial to creditors;
> (2) nonpayment of any fees or charges required under chapter 123 of title 28; and
> (3) failure of the debtor in a voluntary case to file . . . the information required by paragraph (1) of section 521, but only on a motion by the United States Trustee.

11 U.S.C. § 707(a) (emphasis added); *accord* 11 U.S.C. § 521(1) ("The debtor shall . . . file a list of creditors, . . . a schedule of assets and liabilities, a schedule of current income and current expenditures, and a statement of the debtor's financial affairs"). As its plain text states, section 707(a) permits a case to be dismissed upon any ground constituting "cause," and the statute sets out a few non-exclusive examples — such as unreasonable delay, nonpayment of fees, or failure to provide required schedules and other information. The legislative history of section 707(a), too, makes it clear that the list of

grounds supporting a "for cause" dismissal is merely "illustrative," not "exhaustive." *E.g.*, H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 380 (1977) & S. Rep. No. 95-989, 95th Cong., 2d Sess. 94 (1978), *reprinted in* 1978 USCCAN 5787, 5880, 6336.

Many courts, including the United States Supreme Court, have held that good faith is, and has long been, a prerequisite to bankruptcy relief. Bankruptcy courts are courts of equity, and bankruptcy relief is intended for "the honest but unfortunate debtor." Brown v. Felsen, 442 U.S. 127, 128 (1979). Consistent with this reasoning, numerous courts have recognized that bad faith can, indeed, be "cause" for dismissal of a bankruptcy petition. For instance, as the Sixth Circuit squarely held with respect to § 707(a) dismissals:

> We agree . . . that "[a]lthough the jurisdictional requirement of good faith is not explicitly stated in the statute, it is inherent in the purposes of bankruptcy relief. . . . Bankruptcy protection was not intended to assist those who, despite their own misconduct, are attempting to preserve a comfortable standard of living at the expense of their creditors. . . . The bankruptcy laws are grounded on the fresh start concept. There is no right, however, to a head start."

Industrial Insurance Services, Inc. v. Zick (In re Zick), 931 F.2d 1124, 1129 (6th Cir. 1990).[11]

Or, as the Fifth Circuit has also observed in an analogous context, the Bankruptcy Code is "endowed with requirements of good faith in the construction of many of its provisions," and "[e]very bankruptcy statute since 1898 has incorporated literally, or by judicial interpretation, a standard of good faith for the commencement, prosecution, and confirmation of bankruptcy proceedings." In re

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[11] Id., *quoting* In re Jones, 114 B.R. 917, 926 (Bankr. N.D. Ohio 1990), *and citing* Local Loan v. Hunt, 292 U.S. 234, 244 (1934) (bankruptcy "gives to the honest but unfortunate debtor who surrenders for distribution [his] property . . . a new opportunity").

Little Creek Development Co., 779 F.2d 1068, 1071-72 (5th Cir.1986). There, the court held that good faith is an inherent condition-precedent to the Code's "automatic stay" provisions, and that bad faith may be "cause" for lifting the stay under 11 U.S.C. § 362(d), which provides for relief from the automatic stay — like § 707(a) — "for cause." *Id.*; *see also* In re Davidoff, 185 B.R. 631, 634 (Bankr. S.D. Fla. 1995) ("Absence of good faith is generally held to be sufficient cause for dismissal under § 707(a)").

Likewise, in this District, two prior bankruptcy court decisions have expressly held that bad faith can be "cause" for dismissal under § 707(a). First, In re Hammonds, 139 B.R. 535 (Bankr. D. Colo. 1992), followed settled case law for the proposition that "[t]he instances of 'cause' set forth in Section 707(a) are merely illustrative and are not an exhaustive listing." *Id.* at 541. Then, citing a host of supporting decisions, the court concluded as follows:

> A debtor's good faith is an implicit jurisdictional prerequisite to the filing of a case under the Bankruptcy Code. . . . Absence of good faith is generally held to be sufficient cause for dismissal.
>
> * * *
>
> The Bankruptcy Code is intended to serve those persons who, despite their best efforts, find themselves hopelessly adrift in a sea of debt. If, instead, a debtor seeks to discharge debts by shielding his wealth, "such an individual is not seeking a 'fresh start,' but is requesting the Court to permit him to continue living 'like a king.'"

Id. at 541, *quoting* In re Brown, 88 B.R. 280, 285 (Bankr. D. Haw. 1988), *and citing*, *inter alia*, In re Campbell, 124 B.R. 462, 464 (Bankr. W.D. Penn. 1991); In re Doss, 133 B.R. 108, 109 (Bankr. N.D. Ohio 1991); In re Rognstad, 121 B.R. 45, 49 (Bankr. D. Haw. 1990); In re Ravick Corp., 106 B.R. 834, 842 (Bankr. D.N.J. 1989); In re Bingham, 68 B.R. 933, 935 (Bankr. M.D. Penn. 1987).

And, just last year, Bankruptcy Judge Brooks reaffirmed Hammonds, holding that "[t]he absence of good faith of a debtor is also sufficient cause for dismissal under Section 707(a)." In re Tanenbaum, 210 B.R. 182, 185 (Bankr. D.Colo. 1997). As in Hammonds, the court also reiterated that "[o]nce the question of good/bad faith has been put at issue, the debtor bears the burden of proving that the petition was brought in good faith." Tanenbaum, 210 B.R. at 185; *accord* Hammonds, 139 B.R. at 541.

To be sure, § 707(a)'s "for cause" standard has been applied in varying circumstances and under varying rubrics. Thus, while the Sixth Circuit in Zick squarely held that "lack of good faith is a valid basis for decision in a 'for cause' dismissal," 931 F.2d at 1127, the Eighth Circuit has ruled that it prefers dismissals based upon misconduct or improper use of the Code to be called "for cause," rather than "bad faith," reasoning as follows:

> [F]raming the issue in terms of bad faith may tend to misdirect the inquiry away from the fundamental principles and purposes of Chapter 7. Thus, we think the § 707(a) analysis is better conducted under the statutory standard, "for cause."

Huckfeldt v. Huckfeldt (In re Huckfeldt), 39 F.3d 829, 832 (8th Cir. 1994). But the terminology is interchangeable for purposes of § 707(a). In Huckfeldt, a debtor's bad motives for filing a chapter 7 petition — evasion of debts imposed by a divorce decree, and an attempt to "unload" the debts incurred in a 12-year marriage to his spouse — were deemed to be "cause" for dismissal. *Id.* at 830, 832-33. Such motives also patently evidence bad faith. Thus, whatever the label, the dispositive point is that § 707(a) protects against improper use of the bankruptcy system.

Here, by contrast, the court below expressly held that, as a matter of law, "bad faith" can never be "cause" for dismissal under § 707(a). In so ruling, it relied solely upon two decisions by Chief Bankruptcy Judge Scholl of Philadelphia: In re Latimer, 82 B.R. 354 (Bankr. E.D. Penn.1988), and In re Landes, 195 B.R. 855 (Bankr. E.D. Penn. 1996). Even Latimer, however, recognized that a debtor's "good faith" may be an issue in deciding a § 707(a) motion to dismiss, although it viewed that concept narrowly, holding that

> any concept of "good faith," even where it is applicable, should embrace only the narrow concepts of fraudulent misrepresentations or serious non-disclosures of material facts. . . . Our foregoing analysis may raise a question as to what is within the scope of "cause," per § 707(a), in addition to the specific instances recited therein. We believe that included therein is a large category of conduct which expressly violates Code provisions. . . . Also, there may be instances where debtors unjustifiably fail to comply with specific orders of this court.

Id. 82 B.R. at 364 (emphasis added). Moreover, as the Latimer court later acknowledged in Landes, the "local district court has, at least in dictum, honored" a good faith filing requirement under § 707(a) — ***contra*** to the crimped Latimer approach that Judge Brumbaugh adopted here. 195 B.R. at 860, *citing* In re Marks, 174 B.R. 37, 40 & n.3 (E.D. Penn. 1994) (a "petition filed in bad faith may be dismissed for cause under § 707(a)" and "the good faith requirement is broader than that suggested in In re Latimer") (emphasis added).

Even those courts that have most narrowly construed § 707(a) still generally recognize that "cause" for dismissal may include a debtor's "bad faith" in filing. For example, while finding no express statutory requirement of good faith under chapter 7, the court in In re Khan, 172 B.R. 613 (Bankr. D. Minn. 1994), was nonetheless compelled to

> concede that, on motion . . . , a court may inquire into a debtor's motivation for filing as a test of whether to allow the debtor to go forward in bankruptcy . . . [and] a creditor may raise a debtor's bad faith as "cause" for dismissal under § 707(a).

Id., 172 B.R. at 622 (emphasis added). And although Khan disfavored dismissal under § 707(a) in cases where the Code offered lighter sanctions — such as disallowance of discharge under 11 U.S.C. §§ 523, 727 — it nonetheless deemed dismissal to be an appropriate remedy where a debtor exhibited manifest bad faith in filing for bankruptcy.[12/]

To like effect is Padilla v. United States Trustee (In re Padilla), 214 B.R. 496 (Bankr. 9th Cir. 1997), *appeal pending,* 9th Cir. No. 98-55099. In that case, "the record indicate[d] the Debtor performed a credit card 'bust-out,'" which is essentially "a practice where consumer debt is incurred in anticipation of filing a petition for relief." *Id.* 214 B.R. at 499 & n.5. Although the Bankruptcy Appellate Panel set aside the bankruptcy court's dismissal — finding that, in the particular facts at bar, the debtor's conduct did not exhibit such bad faith as to constitute "cause" under § 707(a) — the Panel nonetheless acknowledged that the "[l]ack of good faith in filing has developed as a cause for dismissal." *Id.* at 498 (emphasis added); *accord id.* at 500 (§ 707(a) "allows the UST to seek dismissal for lack of good faith"). Here, by contrast, the bankruptcy court totally eviscerated any "good faith" requirement from § 707(a) of the Code.

[12/] *E.g.*, Khan, 172 B.R. at 625-26 (noting that bad faith may be evidenced "by a vindictive motivation to use bankruptcy solely as a 'scorched-earth' tactic against a pressing creditor" or where a "debtor is seeking to use the Bankruptcy Court's jurisdiction to hide from an adjudication of contempt in a nonbankruptcy court, without justification in the form of true financial distress").

As Zick observed, "[d]ismissal based on lack of good faith must be undertaken on an *ad hoc* basis . . . [and] should be . . . utilized only in those egregious cases that entail concealed or misrepresented assets and/or sources of income, and excessive and continued expenditures, lavish lifestyle, and intention to avoid a large single debt based on conduct akin to fraud, misconduct, or gross negligence." *Id.,* 931 F.2d at 1129. Other courts have similarly outlined factors that may warrant a § 707(a) dismissal for bad faith. For example, in In re Cappucetti, 172 B.R. 37, 39 (Bankr. E.D. Ark. 1994), it was deemed particularly relevant whether, *inter alia*,

> the debtor made no life-style adjustments or continued living an expensive or lavish life-style[;] the debtor filed the case in response to a judgment . . . or collection action; there is an intent to avoid a large, single debt[;] . . . the debtor is paying debts of insiders[;] the debtor transferred assets[;] . . . the debtor employed a deliberate and persistent pattern of evading a single major creditor[; or] the debtor failed to make candid and full disclosure.

Id. at 39-40 (dismissing case where "the Chapter 7 petition was filed in response to collection activities by the IRS" and "the debt to the IRS alone constitutes ninety percent of the total debt"). Likewise, in In re Maide, 103 B.R. 696 (Bankr. W.D. Penn. 1989), the court dismissed a case for bad faith where, among other things, the debtor had transferred a $108,000 marital home some 18 months pre-petition — holding that "the fact that the transfer . . . was made for no consideration to a co-obligor nondebtor spouse and . . . left the debtor with insignificant assets . . . indicates a lack of good faith and militates for dismissal of this case for cause pursuant to § 707(a)" — even though the transfer evidently occurred outside the "voidable preference" period specified by 11 U.S.C. § 547(b). *Id.*, 103 B.R. at 698. In these cases, as here, the totality of facts showed bad faith by the debtor and, thus, constituted sufficient "cause" for dismissal under § 707(a).[13]

The dispositive point is simply this: While the outcome of each § 707(a) case is necessarily fact specific, the court below improperly ignored the facts here in favor of propounding a broad new legal rule that a debtor's bad faith can *never* be cause for dismissal under that statute. This is contrary to the vast majority of case law and should be set aside with instructions that the bankruptcy court specifically examine the ample evidence of bad faith in the record and determine whether it constitutes "cause" for dismissal under 11 U.S.C. § 707(a), as the United States Trustee strongly contends.

CONCLUSION

For the foregoing reasons, the court below erred, as a matter of law, in holding that bad faith can never constitute "cause" for dismissal under 11 U.S.C. § 707(a). This Court should thus reverse and remand the case for consideration of whether the particular facts here warrant dismissal of the debtor's bankruptcy petition.

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[13] To like effect, a leading bankruptcy treatise suggests that while a debtor's ability to repay, standing alone, may constitute grounds for dismissal under § 707(b), "cause" for dismissal under § 707(a) requires something more. *See, e.g.,* 6 Collier on Bankruptcy, ¶ 707.03[1] (15th Ed. Rev. 1998) ("both the House and Senate Reports state that: 'The section does not contemplate, however, that the ability of the debtor to repay his debts in whole or in part constitutes adequate cause for dismissal'"); *accord* Cappucetti, 172 B.R. at 39 ("under section 707(a), an ability to repay debts is not alone cause for dismissal," unlike section 707(b) cases, in which the issue of "whether the debtor has an ability to pay his debts is the primary factor warranting dismissal"); *cf*. First Trust Co. v. Frisch (In re Frisch), 76 B.R. 801, 804 (Bankr. D. Colo. 1987) (Votolato, J., sitting by designation) (declining to apply § 707(b)'s "substantial abuse" test to a § 707(a) motion to dismiss, while finding that "debtor has met his burden of establishing good faith").

Respectfully submitted,

MARTHA L. DAVIS
General Counsel

ANTHONY J. CICCONE
Attorney
Executive Office for U.S. Trustees
Department of Justice
901 E Street, N.W. (Suite 780)
Washington, D.C. 20530
202-307-0003/FAX-2397

Attorneys for United States Trustee

OF COUNSEL:

BARBARA A. SHANGRAW
United States Trustee
LEO M. WEISS
Attorney, Bar #15294
Office of the U.S. Trustee for Region 19
721 19th Street (Suite 408)
Denver, Colorado 80202
303-844-5188/FAX-5230

August 28, 1998

CERTIFICATE OF SERVICE

I certify under penalty of perjury that on August 28, 1998, I caused to be served, via Federal Express or United States mail (first-class, postage-prepaid), copies of the foregoing "BRIEF FOR APPELLANT, UNITED STATES TRUSTEE," addressed to the following persons in the following manner:

Via Federal Express

Herbert A. Delap, Esq.
Counsel for Appellee
1776 Lincoln Street, #1300
Denver, CO 80203

Via United States Mail

David Palmer, Esq.
P.O. Box 4244
Grand Junction, CO 81502-4244

Via United States Mail

Douglas Larson, Esq.
422 White Avenue, #323
Grand Junction, CO 81501

____
Anthony J. Ciccone
Executive Office for U.S. Trustees
Department of Justice
901 E Street, N.W. (Suite 780)
Washington, D.C. 20530
202-307-0003/FAX-2397

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2. ("CO") CURRENT COURT [E.g., "CTA9"]	U.S. DISTRICT COURT (D. COLO.)
3. ("CCN") CURRENT CASE NO.	No.: 98-AP-1345
4. ("PCN") PRIOR CASE NO. & COURT [IF ANY]	No.: 97-28659-RJB (221 B.R. 524) (decided June 16, 1998) Court: U.S. BANKRUPTCY COURT (BANKR. D. COLO.) (Brumbaugh, B.J.) (Identify judge & cite, if any)
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9. ("SU") • SUMMARY OF KEY ISSUE(s) & / Any Miscellaneous BACKGROUND	• Whether the Bankruptcy Court erred, as a matter of law, in holding that "bad faith" can never be "cause" for dismissal under 11 U.S.C. § 707(a). / **Background:**
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IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO

No. 98-AP-1345

In Re AURELIO ETCHEVERRY, JR.,
Debtor.

BARBARA A. SHANGRAW,
UNITED STATES TRUSTEE,
Appellant,
v.

AURELIO ETCHEVERRY, JR.,
Appellee.

ON APPEAL FROM THE UNITED STATES
BANKRUPTCY COURT FOR THE DISTRICT OF COLORADO
(Bankruptcy Judge Brumbaugh)

REPLY BRIEF FOR APPELLANT, UNITED STATES TRUSTEE

MARTHA L. DAVIS
General Counsel

ANTHONY J. CICCONE
Attorney
Executive Office for U.S. Trustees
Department of Justice
901 E Street, N.W. (Suite 780)
Washington, D.C. 20530
202-307-0003/FAX-2397

Attorneys for United States Trustee

OF COUNSEL:

BARBARA A. SHANGRAW
United States Trustee
LEO M. WEISS
Attorney, Bar #15294
Office of the U.S. Trustee for Region 19
721 19th Street (Suite 408)
Denver, Colorado 80202
303-844-5188/FAX-5230

October 2, 1998

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UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO

IN RE: AURELIO ETCHEVERRY, JR. (SSN 265-87-1194), Debtor.	Chapter 7 Case No. 97-28659 RJB (Bankruptcy Judge Brumbaugh)
BARBARA A. SHANGRAW, UNITED STATES TRUSTEE, Appellant, v. AURELIO ETCHEVERRY, JR., Appellee.	Civil Action No. 98-AP-1345

REPLY BRIEF FOR APPELLANT, UNITED STATES TRUSTEE

PRELIMINARY STATEMENT

In our opening brief, we explained why the bankruptcy court erred, as a matter of law, in categorically ruling that “bad faith” can never be “cause” for dismissal under 11 U.S.C. § 707(a). Its decision not only ignores the plain language of the Bankruptcy Code, but also creates an intra-district conflict and apparently goes farther than any other case to have construed § 707(a). The United States Trustee therefore seeks reversal and remand, so that the bankruptcy court can be instructed to exercise its duty to weigh all the evidence of bad faith adduced at trial — as briefly summarized in our opening brief — and determine whether it warrants dismissal of the debtor’s bankruptcy petition “for cause,” as we firmly maintain.

In response, the debtor has not (and cannot) cite any case law directly disputing our sole legal thesis, *i.e.,* that bad faith may, indeed, be cause for dismissal under § 707(a). Instead, the debtor skirts the issue by raising a smokescreen of tangential arguments. More precisely, debtor appears to argue that: (1) far from any outright fraud or other indicia of bad faith, debtor merely has an "ability to repay" his debts which, alone, does not warrant dismissal; (2) it would be unfair "double jeopardy" to dismiss debtor's petition under § 707(a) when his judgment-creditor has, thus far, failed to bar discharge under more specific Code provisions; and (3) because two bills are pending in Congress that would block chapter 7 liquidations by affluent individuals such as debtor, he suggests that nothing in the current Code can stop such potential misuse of the system, unless and until new legislation is actually signed into law. As next shown, the debtor's arguments lack merit and provide no basis upon which to affirm the decision below.

ARGUMENT

I. Debtor's "Ability To Pay" Argument Is Merely An Attempt To Divert The Court From The Real Issue

At the outset at least, debtor correctly notes that "the factual nature of this case is irrelevant since . . . [t]he lower court never considered the United States Trustee's factual contentions." *See* Debtor's Br. 2.[1/] Rather, the sole issue on appeal is whether it was legal "error to conclude that 'cause' . . . [under] § 707(a) does not include 'bad faith.'" *Id.* at 1.

[1/] As used below, *Debtor's Br.* and *UST Br.* refer, respectively, to (1) the September 22, 1998 "Answer Brief For Appellee, Aurelio Etcheverry Jr.," and (2) our August 28, 1998 "Brief For Appellant, United States Trustee."

Yet, debtor then launches into an extensive factual critique from which he argues that, far from any bad faith, "[t]he veiled or unspoken 'cause' for dismissal . . . is [simply] that he has the present and future income to repay his debts." Id. at 6. With such a "straw man" thus erected, debtor attempts to shift this Court's focus away from the real issue.

Whether a chapter 7 case can be dismissed under § 707(a), based solely on a debtor's repayment ability, is ***not*** the issue here.[2/] The facts adduced at trial reflect far more than an ability-to-repay. They also established a *prima facie* case of bad faith by demonstrating, e.g., that debtor's income appeared "understated in the schedules while certain expenses appeared overstated, the debtor had made no significant adjustments to a lavish pre-petition lifestyle, and the filing appeared principally designed to thwart the efforts of debtor's judgment creditor to collect on her personal injury award." (UST Br. 5.) In fact, at the hearing, the trial court found on the record that debtor's income had, indeed, been under-reported in his bankruptcy schedules. (UST Br. 7, n.10.)

Without belaboring the facts, the dispositive point is that the bankruptcy court erred by wholly failing to even *consider* whether any of the facts of record constituted cause for dismissal, based upon its erroneous legal opinion that "bad faith," even if proven at trial, can never justify dismissal under § 707(a).

[2/] While that issue may be debatable, the United States Trustee acknowledged in her opening brief that there appears to be some authority for it. *See* UST Br. at 15 n.13, *citing*, *e.g.*, In re Cappucetti, 172 B.R. 37, 39 (Bankr. E.D. Ark. 1994) ("under section 707(a), an ability to repay debts is not alone cause for dismissal," unlike section 707(b) cases where the issue of "whether the debtor has an ability to pay his debts is the primary factor warranting dismissal"), *and* 6 Collier on Bankruptcy, ¶ 707.03[1] (15th Ed. Rev. 1998) (quoting legislative history of § 707(a)).

In so ruling, the bankruptcy court not only departed from the view of "cause" adopted by most other courts (including two prior bankruptcy cases in this district),[3] but it also apparently went farther than any other case known to have construed § 707(a). Indeed, as our opening brief points out, even the two cases upon which the lower court relied — In re Latimer, 82 B.R. 354 (Bankr. E.D. Penn.1988), and In re Landes, 195 B.R. 855 (Bankr. E.D. Penn. 1996) — recognized that bad faith may sometimes be an issue under § 707(a).[4] And, if that were not enough to extinguish all legal support for the decision below, there is an even more compelling argument against affirmance here. As Latimer and Landes concede, the United States District Court in Pennsylvania rejected their crimped view of § 707(a), stating that

> [a] petition filed in bad faith ***may*** be dismissed for cause under § 707(a) . . . [and] the good faith requirement is ***broader*** than that suggested in In re Latimer.

In re Marks, 174 B.R. 37, 40 & n.3 (E.D. Penn. 1994) (italics added), *cited in* In re Landes, 195 B.R. at 860.

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[3] In re Hammonds, 139 B.R. 535, 541 (Bankr. D. Colo. 1992) ("Absence of good faith is generally held to be sufficient cause for dismissal"); In re Tanenbaum, 210 B.R. 182, 185 (Bankr. D.Colo. 1997) ("absence of good faith of a debtor is also sufficient cause for dismissal under Section 707(a)" and "[o]nce the question of good/bad faith has been put at issue, the debtor bears the burden of proving that the petition was brought in good faith"), *cited in* UST Br. 11-12.

[4] *Accord* In re Khan, 172 B.R. 613, 622 (Bankr. D. Minn. 1994) ("conced[ing] that . . . a court may inquire into a debtor's motivation for filing, . . . [and] a creditor may raise a debtor's bad faith as 'cause' for dismissal under § 707(a)"); Padilla v. United States Trustee (In re Padilla), 214 B.R. 496, 498, 500 (Bankr. 9th Cir. 1997), *appeal pending,* 9th Cir. No. 98-55099 ("[l]ack of good faith in filing has developed as a cause for dismissal," and § 707(a) "allows the UST to seek dismissal for lack of good faith"). (UST Br. 13-14.)

Consequently, in holding that bad faith may never be cause for dismissal under § 707(a), the court below plainly erred, as a matter of law, as is evident from a review of cases such as Industrial Insurance Services, Inc. v. Zick (In re Zick), 931 F.2d 1124, 1129 (6th Cir. 1990), and its progeny, which we fully discussed in our opening brief. (UST Br. 10-12.)

II. Nothing In The Bankruptcy Code Precludes § 707(a) From Being Used In Conjuction With Other Remedies

Next, arguing that "the bankruptcy code must be construed liberally in favor of the debtor and strictly against the creditor" (Debtor's Br. 2), Dr. Etcheverry argues that dismissal of his petition under § 707(a) would amount to "a sort of quasi-criminal double-jeopardy . . . without good cause" where, as here, debtor has managed to evade the attempts of a judgment-creditor to bar his discharge under sections 523 and 727 of the Code.[5/] Further, debtor complains that dismissal under § 707(a) may deny him all bankruptcy relief if, as he contends, "he does not fit a Chapter 13 and a Chapter 11 is too expensive to warrant consideration." (Debtor's Br. 8.)

Again, these arguments miss the narrow point of the pending appeal. The issue here is simply the scope of "cause" as a basis for dismissal under § 707(a) — not debtor's eligibility for relief under

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[5/] *See* Debtor's Br. 10-11, *citing* First Trust Co. v. Frisch (In re Frisch), 76 B.R. 801, 804 (Bankr. D. Colo. 1987) (Votolato, J., sitting by designation). *See also* 11 U.S.C. §§ 523, 727. As pertinent here, § 523 allows an individual creditor to challenge the dischargeability of any particular debt "for money, property, services, or . . . credit, to the extent obtained by false pretenses, a false representation, or actual fraud" (§523(a)(2)), or "for willful and malicious injury by the debtor" (§ 523(a)(6)). Similarly, § 727 allows actions to deny a debtor a discharge in its entirety if, *inter alia*, the debtor has concealed financial documents, made false claims, or evidenced an intent to defraud a particular creditor or evade certain debts.

the chapter 11 reorganization, or chapter 13 wage-earner, provisions of the Bankruptcy Code. Moreover, the fact that the Code may be liberally construed in debtors' favor

> is correct as far as it goes, but it does not go far enough. In particular, it overlooks the fact that bankruptcy courts have traditionally drawn upon their powers of equity to prevent abuse of the bankruptcy process and to ensure that a "case be commenced in 'good faith' to reflect the intended policies of the Code." [Citation omitted.] . . . Congress has made it clear . . . that misuse of the bankruptcy process should not be countenanced.

Kestell v. Kestell (In re Kestell), 99 F.3d 146, 147-48 (4th Cir. 1996). Indeed, as the Supreme Court has long made clear, "[t]here is no constitutional right to bankruptcy protection" in the first instance. Fonder v. United States, 974 F.2d 996, 999 n.4 (8th Cir. 1992), *citing* United States v. Kras, 409 U.S. 434, 446-47 (1973). Thus, any rule of construction that liberally construes the Code in debtors' favor cannot trump their duty to enter bankruptcy court (like any other court of equity) with "clean hands," lest they forfeit any claim to relief under the Bankruptcy Code.

Nor, contrary to debtor's argument, does anything in the Code preclude objections to an improper bankruptcy petition under any and all applicable Code provisions — such as § 707 dismissals, § 727 challenges to discharge, and/or § 523 exceptions to the dischargeability of particular debts. If anything, Congress has steadily increased, not reduced, the number of avenues by which to challenge improper petitions. Thus, in 1984, Congress added subsection (b) to § 707, which allows dismissal for "substantial abuse" in cases of "primarily consumer debts." As the Sixth Circuit explained the 1984 amendments in In re Krohn, 886 F.2d 123 (6th Cir. 1989):

> These amendments were passed in response to an increasing number of Chapter 7 bankruptcies filed each year by non-needy debtors. . . . Under prior practice, aside from potential § 523(a) exceptions,

> § 707(a) dismissals, and § 727(a) objections to discharge, debtors enjoyed an unfettered right to a "fresh start" under Chapter 7, in exchange for liquidating their nonexempt assets for the benefit of their creditors. . . . Section 707(b) introduces an additional restraint upon a debtor's ability to obtain Chapter 7 relief.

Id. at 126 (emphasis added).[6] Or, as the Fourth Circuit has likewise observed: "In some Code provisions, enumerated circumstances of abuse are addressed. In others, general phrases such as 'for cause' provide broad coverage for unenumerated instances of misuse." In re Kestell, 99 F.3d at 148. Stated simply, the mere existence of more *specific* remedies does not bar *general* challenges to bankruptcy petitions "for cause" or "substantial abuse" under sections 707(a) or (b).[7]

Debtor's reliance upon In re Frisch, *supra*, for a contrary view is wholly inapposite. (Debtors' Br. 11.) There, a visiting bankruptcy judge in this District found that a creditor

> intentionally subjected the debtor to a sort of quasi-criminal double jeopardy, without good cause, . . . [because the creditor improperly tried to] mix and match sections . . . , that is, § 707(b) issues using evidence most relevant to § 523 to find § 707(a) "cause."

76 B.R. at 804. By law, only the U.S. Trustee, or the court *sua sponte*, may seek dismissal under § 707***(b)***. Frisch basically involved a case where the court chastised a creditor for trying to evade this

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[6] *Accord* In re Snow, 185 B.R. 397, 399-400 & n.3 (Bankr. D. Mass. 1995) ("§ 707(b) . . . was one of a collection of new provisions imposing constraints on consumer bankruptcies . . . [along with] §§ 342(b), 523(a)(2)(C), 523(a)(9), 521(1), 1325(b), [and] 1329(a)"); Waites v. Braley, 110 B.R. 211, 217 (E.D. Va. 1990) ("Sections 523 and 727 . . . allow dismissal for fraud and misrepresentation, and a narrow construction of Section 707(b) would render it superfluous ").

[7] *See, e.g.*, Coughlin v. Cataldo (In re Cataldo), _ B.R. _, 1998 WL 637501 (Bankr. 9th Cir. 1998) (noting that although a creditor "was unsuccessful in her Section 523 action, . . . it is unclear whether . . . a complaint under Section 727 or . . . dismissal of the case under Section 707(a) . . . would be better suited to giving . . . relief"). As noted in our opening brief, § 707(b) was inapplicable here for lack of "primarily consumer debts." (UST Br. 6 n.9.)

statutory limitation — expressly finding that "the debtor has met his burden of establishing good faith," and that the creditor's "motion is not well grounded in either fact or law." *Id.*

That is not the case before this Court. Here, the United States Trustee determined that debtor's resort to chapter 7 evidenced bad faith, filed a timely motion to dismiss for cause under § 707(a), and adduced supporting evidence at trial. Yet, without even reviewing the evidence of bad faith, the lower court simply denied the U.S. Trustee's motion based upon the unprecedented and improper view that bad faith can never be cause for dismissal.

By adopting this patently incorrect legal interpretation of § 707(a), the court below erred — and that error warrants reversal wholly irrespective of what, if any, alternative remedies may be available to Dr. Etcheverry's creditors under Code provisions like sections 727 and 523. Indeed, whatever relief may be available to private creditors, the U.S. Trustee is independently obliged to challenge cases, such as this, that threaten the integrity of the bankruptcy system.[8/]

[8/] Congress established the office of the United States Trustee in the Bankruptcy Reform Act of 1978 to "protect[] the public interest and ensur[e] that bankruptcy cases are conducted according to the law." H. Rep. No. 95-595, 95th Cong., 2d Sess. at 109 (Sept. 8, 1977), *reprinted in* 1978 U.S. Code Cong. & Admin. News 5787, 5963, 6070. Congress declared that the U.S. Trustee "may be compared with . . . a prosecutor," and stated in no uncertain terms that United States Trustees "serve as bankruptcy watch-dogs to prevent fraud, dishonesty, and overreaching in the bankruptcy arena." *Id.* at 6071 and 6049; *accord* In Re Clark, 927 F.2d 793, 795-96 (4th Cir. 1991) ("The trustee serves the role of 'protecting the public interest and ensuring that bankruptcy cases are conducted according to law'"); In Re Revco D.S. Inc., 898 F.2d 498, 499-500 (6th Cir. 1990); In Re Columbia Gas Sys. Inc., 33 F.3d 294, 296-97 (3d Cir. 1994).

III. Nor, Finally, Does The Pendency Of New Legislation Have Any Bearing Upon The Motion *Sub Judice* Here

As debtor notes, in the final days before adjournment, Congress is considering new legislation to further restrict chapter 7 filings. From this, debtor argues that "the fact that Congress is presently attempting to enact legislation, i.e. House Bill 3150 . . . and Senate Bill 1030 *[sic]*, . . . both of which might add significant new changes to the Bankruptcy Code instituting a 'means test', is a clear indication that such a provision is not now in the Bankruptcy Code." (Debtor's Br. 12.) However, as discussed below, these bills have absolutely no bearing upon the present appeal.

The two bills in question are H.R. 3150, the Bankruptcy Reform Act of 1998, and S.1301, the Consumer Bankruptcy Reform Act of 1998. They were passed by the House and Senate on June 10 and September 23, 1998, respectively, but have not yet been harmonized by a committee of conference. As pertinent here, each bill contemplates a different formulation to ensure that only the neediest individuals may proceed with chapter 7 liquidation and obtain a discharge. If such a debtor could repay his creditors, he would be ineligible to proceed under chapter 7 and would either have his case dismissed or converted to chapter 13 for formulation of a repayment plan.[9]

Most notably, neither bill would amend § 707(a). Rather, they would toughen subsection (b) of § 707 to ensure dismissal of chapter 7 cases by debtors who possess a quantifiable ability to repay, or whose use of chapter 7 could otherwise be shown to constitute misuse of the Code. As debtor

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[9] See generally H. Rep. No. 105-540, 105th Cong., 2d Sess. at 69 & 74 (May 18, 1998); accord S. Rep. No. 105-253, 105th Cong., 2d Sess. at 34-35 (July 21, 1998).

concedes, however, "§ 707(b) . . . focused clearly on consumer debtors, a definition which does not apply in this case." Debtor's Br. 12 (emphasis added).

Consequently, the proposed amendments to § 707***(b)*** patently have no bearing upon the pending appeal, which deals only with § 707***(a)*** and which has repeatedly been held to be broad enough, as written, to allow dismissals for bad faith or other "cause."[10/]

CONCLUSION

For the foregoing reasons, as well as those set forth in our opening brief, this Court should: (1) find that the bankruptcy court erred, as a matter of law, in holding that bad faith can never constitute "cause" for dismissal under 11 U.S.C. § 707(a); and (2) reverse and remand the case for consideration of whether the facts adduced at trial established a *prima facie* case of bad faith or other cause for dismissal..

Respectfully submitted,

MARTHA L. DAVIS
General Counsel

ANTHONY J. CICCONE
Attorney
Executive Office for U.S. Trustees
Department of Justice
901 E Street, N.W. (Suite 780)
Washington, D.C. 20530
202-307-0003/FAX-2397

OF COUNSEL:

BARBARA A. SHANGRAW
United States Trustee
LEO M. WEISS
Attorney, Bar #15294
Office of the U.S. Trustee for Region 19
721 19th Street (Suite 408)
Denver, Colorado 80202
303-844-5188/FAX-5230

[10/] In any event, as the Supreme Court has long held, post-hoc comments on existing laws warrant little, if any, weight. See, e.g., County of Washington v. Gunther, 452 U.S. 161, 176 (1981) ("We are normally hesitant to attach much weight to comments made after the passage of legislation"), *citing* Teamsters v. United States, 431 U.S. 324, 354, n.39 (1977).

October 2, 1998 Attorneys for United States Trustee

CERTIFICATE OF SERVICE

I certify under penalty of perjury that on October 2, 1998, I caused to be served by United States mail (first-class, postage-prepaid), copies of the foregoing "REPLY BRIEF FOR APPELLANT, UNITED STATES TRUSTEE," addressed as follows:

Herbert A. Delap, Esq.
Counsel for Appellee
1776 Lincoln Street (#1300)
Denver, CO 80203-1030
[303-837-8521/FAX 830-2832]

David A. Palmer, Trustee
Palmer & Burkey
225 N. 5th Street (#701)
Post Office Box 4244
Grand Junction, CO 81502-4244
[970-241-1924 /FAX-8575]

Douglas E. Larson, Esq.
Foster, Larson, Laiche & Griff
422 White Avenue (#323)
Grand Junction, CO 81501
[970-245-8021/FAX-0590]

Anthony J. Ciccone
Executive Office for U.S. Trustees
Department of Justice
901 E St., N.W. (Suite 780)
Washington, D.C. 20530
202-307-0003/FAX-2397

BRIEF BANK — "SUMMARY SHEET" *Printed Fri.-6/30/0 (11:46)*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	U.S. TRUSTEE v. ETCHEVERRY (In Re AURELIO ETCHEVERRY, JR.)
2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	10th CIRCUIT (10th Cir.)
3. ("CCN") ***CURRENT*** CASE NO.	Appeal No.: 00-1080
4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*	No.: 98-AP-1345 (D. Colo.), 242 B.R. 503 (Dec. 22, 1999); & 97-28659-RJB (Bankr. D. Colo.), 221 B.R. 524 (June 16, 1998) Court: U.S. District Court (Daniel, D.J.) & U.S. Bankruptcy Court (Brumbaugh, B.J.) *(Identify judge & cite, if any)*
5. ("SO") ***SOURCE***	**U.S. TRUSTEES**
6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	Filed: April 10, 2000 Type: Appellant UST's Memorandum Brief re Finality & Appealability
7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g., "UST/OGC"]*	E. Roy Hawkens (Civil/Appellate 202-514-5714) Anthony J. Ciccone (UST/OGC) & Leo M. Weiss (UST/R19) *(UST/OGC: 202-307-1399/FAX-2397)*
8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") ! ***SUMMARY*** OF KEY ISSUE(s) & ***/*** Any Miscellaneous ***BACKGROUND***	! Whether denial of the UST's motion to dismiss a Chapter 7 petition for bad faith is appealable, under the 10th Circuit's traditional view of finality, pursuant to the *Cohen* "collateral order doctrine," 337 U.S. 541 (1949). ***/*** **Background:** The UST's appeal to the 10th Circuit arises out of the decision of the Bankruptcy Court, as affirmed by the District Court, holding as a matter of law that "bad faith" can never be "cause" for dismissal under 11 U.S.C. § 707(a).
10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)	S:\general counsel\Web Briefs\OGC Master List\etch03.wpd
11. DO YOU RECOMMEND POSTING IN UST BRIEFBANK?	☒ YES ☐ NO ***NAME:*** Anthony J. Ciccone ***DATE:*** Fri.-6/30/00

IN THE UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

No. 00-1080

In Re AURELIO ETCHEVERRY, JR.,

Debtor.

WILLIAM T. NEARY,
UNITED STATES TRUSTEE,

Appellant,
v.

AURELIO ETCHEVERRY, JR.,

Appellee.

MEMORANDUM BRIEF FOR THE APPELLANT

Introduction. This memorandum brief is submitted pursuant to this Court's order of March 13, 2000 directing the parties to address the following jurisdictional issue: "Whether the district court order affirming the bankruptcy court's order denying the motion to dismiss is a final order appealable to this Court." As we show below, the district court's order -- which holds that Congress in 11 U.S.C. § 707(a) divested bankruptcy courts of their historic authority to dismiss a petition that is filed in bad faith -- is appealable pursuant to the Cohen collateral order doctrine (Cohen v. Beneficial Indus. Loan Corp., 337 U.S. 541 (1949)).[1]

BACKGROUND

Bankruptcy Court And District Court Proceedings. Debtor, Dr. Etcheverry, filed a voluntary Chapter 7 liquidation petition in December 1997 seeking a discharge of his debts. His bankruptcy schedules listed assets of $51,479 and debts of $670,702. The single largest unsecured debt reported by debtor was a claim against him of about $113,000 arising from a Florida state court judgment in tort arising from an automobile accident.

The Chapter 7 bankruptcy trustee assigned to administer the case notified the U.S. Trustee's Office that dismissal of debtor's petition may be warranted because debtor appeared to have understated assets, overstated expenses, and filed a bankruptcy petition primarily to evade his Florida judgment creditor. The U.S. Trustee is a Department of Justice official who is responsible for overseeing the administration of bankruptcy cases.[2]

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[1] For this Court's convenience, we have appended to this memorandum brief a copy of the decision of the district court (Attachment A) and the bankruptcy court (Attachment B).

[2] The U.S. Trustee Program was established by the Bankruptcy Reform Act of 1978 (11 U.S.C. §§ 101 et seq.). Its primary function is to serve as the "watchdog over the bankruptcy process" (H.R. Rep. No. 95-595, at 88, reprinted in 1978 U.S.C.C.A.N. 5787, 5963, 6049).

After further review, the U.S. Trustee moved to dismiss debtor's petition pursuant to the "for cause" provision of 11 U.S.C. § 707(a).[3] The U.S. Trustee argued that debtor's petition was not brought in good faith, as evidenced by the following: (1) debtor's schedules erroneously understated his income and overstated his expenses; (2) debtor's petition was filed just two weeks after his Florida judgment creditor garnished a paycheck, thus suggesting that the petition was designed to thwart recovery by that creditor; and (3) debtor maintained a lavish lifestyle and exhibited the income with which he could pay his current debts.

The bankruptcy court denied the motion to dismiss as a matter of law and without reaching or resolving any factual disputes. Notwithstanding extensive case law to the contrary, the court held that section 707(a) does not contain a "good faith requirement" (221 B.R. at

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[3] 11 U.S.C. § 707(a) provides:

> (a) The court may dismiss a case under this chapter only after notice and a hearing and only for cause, including--
>
> > (1) unreasonable delay by the debtor that is prejudicial to creditors;
> >
> > (2) nonpayment of any fees or charges required under chapter 123 of title 28; and
> >
> > (3) failure of the debtor in a voluntary case to file, within fifteen days or such additional time as the court may allow after the filing of the petition commencing such case, the information required by paragraph (1) of section 521, but only on a motion by the United States trustee.

526), and courts therefore lack authority to dismiss petitions that have "bad faith characteristics" (221 B.R. at 525).

From this order, the U.S. Trustee appealed to the district court pursuant to 28 U.S.C. § 158(a), which authorizes district courts to review orders of bankruptcy judges. The district court affirmed, holding that Congress did not include a good faith requirement for Chapter 7 liquidation filings and, accordingly, "bad faith is not a ground for dismissal 'for cause' under 11 U.S.C. § 707(a)" (slip op. at 3).

The U.S. Trustee appeals that order pursuant to 28 U.S.C. § 158(d). As we now show, the district court's order falls within that class of interlocutory orders that may be immediately appealed, because they "finally determine claims of right separable from, and collateral to, rights asserted in the action, too important to be denied review and too independent of the cause itself to require that appellate jurisdiction be deferred" (Cohen, 337 U.S. at 546).

ARGUMENT

THIS COURT HAS JURISDICTION PURSUANT TO THE *COHEN* COLLATERAL ORDER DOCTRINE

The district court's order affirming the bankruptcy court's denial of the U.S. Trustee's motion to dismiss under section 707(a) is immediately appealable under the collateral order doctrine articulated in Cohen v. Beneficial Indus. Loan Corp., 337 U.S. 541 (1945). See In re Magic Circle Energy Corp., 889 F.2d 950, 954 (10th Cir. 1989) (recognizing that Cohen collateral order doctrine applies in bankruptcy context). Pursuant to that doctrine, a district court's interlocutory order is immediately reviewable if three conditions are met: (1) it conclusively determines the disputed question; (2) it resolves an important issue completely separate from the merits of the action; and (3) it is effectively unreviewable on appeal from final judgment. The order in the instant case satisfies these requirements.

1. With respect to the first requirement, the district court's order conclusively determines whether the debtor will be permitted to proceed with a Chapter 7 liquidation proceeding notwithstanding that his petition was evidently filed in bad faith.[4] The district court held not only that it will *not* dismiss the case (slip op. at 7-8), but that it lacks authority under 11 U.S.C. § 707(a) to dismiss despite debtor's putative bad faith, because section 707(a) does "not incorporate a good faith requirement" (slip op. at 5). Because the district court's resolution of this issue of law is *not* "open, unfinished or inconclusive" (Cohen, 337 U.S. at 546), it satisfies the first Cohen doctrine requirement.

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[4] Neither the district court nor the bankruptcy court made findings of fact; rather, both held as a matter of law that section 707(a) does not, *under any circumstances*, authorize dismissals of Chapter 7 liquidation petitions that are filed in bad faith.

2. As to the second requirement, the district court's order decides an issue that is (i) important, and (ii) separate from the merits of the case. Plainly, the district court's decision that bankruptcy courts lack authority under section 707(a) to dismiss Chapter 7 liquidation petitions that are filed in bad faith is important. The court's decision not only determines the conditions and limitations that Chapter 7 imposes on debtors who file bankruptcy petitions, it also affects -- indeed, significantly cabins -- the equitable authority that bankruptcy courts historically have exercised. See In re Zick, 931 F.2d 1124, 1129 (6th Cir. 1991) ("'[g]ood faith and candor are necessary prerequisites to obtaining a fresh start [under the Bankruptcy Code]"); In re Little Creek Dev. Co., 779 F.2d 1068, 1071-72 (5th Cir. 1986) ("[e]very bankruptcy statute since 1898 has incorporated literally, or by judicial interpretation, a standard of good faith for the commencement, prosecution, and confirmation of bankruptcy proceedings"). Additionally, by precluding the use of section 707(a) as a basis for dismissal of Chapter 7 petitions that are filed in bad faith, the court's decision impairs the ability of U.S. Trustees to perform their statutory mission of policing the bankruptcy system for fraud and abuse.[5]

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[5] The district court's decision conflicts with at least two bankruptcy court decisions *in this Circuit* that have sustained the authority of the U.S. Trustee under section 707(a) to seek dismissal of petitions that are filed in bad faith. See In re Tanenbaum, 210 B.R. 182, 185 (Bankr. Colo. 1997); In re Hammonds, 139 B.R. 535, 541 (Bankr. Colo. 1992).

This important issue is also wholly separate from the merits of the Chapter 7 liquidation proceeding. The district court denied the U.S. Trustee's dismissal motion based on a conclusion of law -- that the court lacks authority *under any circumstances* to dismiss for bad faith under section 707(a) -- and that conclusion will have no bearing whatsoever on the liquidation proceedings on remand, which will focus on consolidation and distribution of debtor's assets. Moreover, from the U.S. Trustee's perspective, whether debtor's petition in the instant case should be dismissed under section 707(a) is the only issue in the case; once that issue has been decided, the U.S. Trustee effectively ceases to be a litigant in this phase of the case. In short, consistent with the second Cohen requirement, the district court's order resolves an important issue that does not contribute "toward final disposition of the merits of the case" (337 U.S. at 546).

3. Third, absent immediate review, the district court's order will be effectively unreviewable. A principal purpose of section 707(a) is to authorize dismissal at the outset of the Chapter 7 liquidation proceeding and thereby spare creditors the burden, expense, and delays inherent in seeking recovery in a protracted bankruptcy proceeding where the petition was filed for purposes of delay. Indeed,

section 707(a)(1) specifically lists unreasonable delay prejudicing creditors as a reason for dismissal.[6]

Denying a motion to dismiss under section 707(a) can thus properly be analogized to the denial of a motion to dismiss based on qualified immunity, which would be immediately appealable. See Johnson v. Jones, 515 U.S. 304, 309-11 (1995); Mitchell v. Forsyth, 472 U.S. 511, 525-27 (1985). In both circumstances, the right that is being denied -- the right to avoid the burden and delays caused by the litigation itself -- cannot be restored after final judgment; rather, once the right is denied and the burden and delay are imposed, the right is lost forever. See Forsyth, 472 U.S. at 525-27.

Not only would creditors' statutory rights be irreparably harmed absent immediate review, but subsequent events may render the district court's order unreviewable. For example, the issue presented in this

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[6] Significantly, section 707(a) -- which is set out in full supra note 3 -- does *not* purport to establish an exhaustive list of reasons that may justify dismissal. Rather, it provides that a court may dismiss a case "for cause" and gives several illustrative examples, "*including (1) unreasonable delay by the debtor that is prejudicial to creditors*" (11 U.S.C. § 707(a)(1)) (emphasis added). If Congress intended to authorize dismissals for unintentional, but unreasonable, delays caused by debtors that are prejudicial to creditors, surely Congress also intended to authorize dismissals for petitions that are filed in bad faith that likewise cause unreasonable delays and are prejudicial to creditors. See In re Little Creek Dev. Co., 779 F.2d at 1072 ("[r]equirement of good faith prevents abuse of the bankruptcy process by debtors whose overriding motive is to delay creditors without benefitting them in any way or to achieve reprehensible purposes").

appeal arguably would become moot if the debtor obtains a discharge, voluntarily withdraws his bankruptcy petition, or converts it to another chapter of the Bankruptcy Code. Cf., e.g., In re Cook, 730 F.2d 1324 (9th Cir. 1984) (appellants' request to reverse bankruptcy court's decree of forfeiture issued during Chapter 11 proceeding is moot in light of bankruptcy court's subsequent Chapter 7 discharge order); In re Cantwell, 639 F.2d 1050 (3d Cir. 1981) (where discharge that appellants sought to stay has been granted, appellants' challenge to denial of stay is moot); Chief Bankruptcy Judge Tamara Mitchell, Dismissal of Cases Via 11 U.S.C. § 707: Bad Faith and Substantial Abuse, 102 Com. L.J. 355, 377-78 (1997) (citing cases where motion to dismiss under section 707(a) has been rendered moot by discharge order). That events may render the district court's order unreviewable is a compelling factor that militates in favor of immediate review, especially where, as here, the question presented is a pure issue of law that is wholly collateral to the issues that will be considered on remand. Cf. In re Rex Montis Silver Co., 87 F.3d 435, 438 (10th Cir. 1996) ("if matters on remand are 'unlikely either to generate a new appeal or to affect the issue that the disappointed party wants to raise on appeal from the order of remand,' the district court's order is considered final").

Finally, Circuit precedent does *not* foreclose the U.S. Trustee from pursuing an appeal in this case pursuant to the Cohen collateral order doctrine. The two cases that, at first glance, appear to be similar to this case are, upon closer examination, easily distinguishable. In In re Cascade Energy & Metals Corp., 956 F.2d 935 (10th Cir. 1992), this Court held that a district court's order reversing a bankruptcy court's order dismissing for lack of subject matter jurisdiction did not satisfy the finality requirement of 28 U.S.C. § 158(d). And in In re Magic Circle Energy Corp., 889 F.2d 950 (10th Cir. 1989), this Court held that a district court's denial of a writ of prohibition to prohibit the bankruptcy court from exercising jurisdiction did not satisfy the finality requirement of 28 U.S.C. § 158(d). However, unlike this case, the record in those cases did *not* support a claim that important rights would be "irretrievably lost in the absence of an immediate appeal" (In re Magic Circle Energy Corp., 889 F.2d at 954).

Here, in contrast, the denial of the section 707(a) motion not only diminishes the equitable authority of bankruptcy courts and the statutory authority of the U.S. Trustee, it deprives creditors of the very right that section 707(a) was designed to create -- a right to avoid the burden, expense, and delay associated with participation in a bad faith bankruptcy proceeding. Absent immediate review, "it will be too late effectively to review the present order and the rights conferred by the statute * * * will have been lost" (Cohen, 337 U.S. at 546).[7]

CONCLUSION

For the foregoing reasons, this Court has jurisdiction to review the district court's order affirming the bankruptcy court's denial of the U.S. Trustee's motion to dismiss for bad faith pursuant to 11 U.S.C. § 707(a).

Respectfully submitted,

DAVID W. OGDEN
Acting Assistant Attorney General

WILLIAM KANTER
(202) 514-4575
E. ROY HAWKENS
(202) 514-5714
Attorneys, Appellate Staff
Civil Division, Room 9544
Department of Justice
601 "D" St., N.W.
Washington, D.C. 20530-0001

OF COUNSEL:
MARTHA L. DAVIS
General Counsel
ANTHONY J. CICCONE
Executive Office
for U.S. Trustees
LEO M. WEISS
Office of the U.S. Trustee
for Region 19

APRIL 2000

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[7] It bears emphasizing that Congress established the office of the U.S. Trustee to "'protect[] the public interest and ensure[] that bankruptcy cases are conducted according to law'" (In re Clark, 927 F.2d 793, 795 (4th Cir. 1991); see In re Columbia Gas Sys. Inc., 33 F.3d 294, 296-99 (3d Cir. 1994); In re Revco D.S. Inc., 898 F.2d 498, 500 (6th Cir. 1990)). In moving for dismissal pursuant to section 707(a), the U.S. Trustee acts as a "gate-keeper" who, at the outset of bankruptcy proceedings, identifies debtors whose petitions should be dismissed for bad faith because -- in derogation of congressional intent -- they seek to bilk their creditors, abuse the Bankruptcy Code, and flout the integrity of the judicial process. See In re Huckfeldt, 39 F.3d 829 (8th Cir. 1994) (holding that petitioner's bad faith was cause for dismissal under section 707(a)); In re Zick, 931 F.2d 1124 (6th Cir. 1991) (same).

STATEMENT REGARDING PRIOR AND RELATED APPEALS

Pursuant to Tenth Circuit Rule 27.2(B)(3), counsel state that this case has not previously been appealed. Similar issues are raised in In re Padilla, No. 98-55099 (9th Cir.) (argued Oct. 6, 1999). Counsel are not aware of other cases on appeal raising similar issues.

CERTIFICATE OF SERVICE

I hereby certify that on this 10th day of April 2000, I served the foregoing Memorandum Brief For The Appellant by causing copies to be mailed overnight delivery, postage prepaid, to the Tenth Circuit and to counsel at the following addresses:

Herbert A. Delap, Esquire
Herbert A. Delap & Associates
1700 Broadway, Suite 1006
Denver, Colorado 80290

David A. Palmer, Trustee
Palmer & Burkey
225 North 5th Street, Suite 701
Grand Junction, Colorado 81502

Douglas E. Larson, Esquire
Foster, Larson, Laiche & Griff
422 White Avenue
Grand Junction, Colorado 81501

E. ROY HAWKENS
Attorney

BRIEF BANK — 'SUMMARY SHEET"

Printed Mon-5/23/11 11:19

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	In re E-Toys (Alber v. Arsht and Turnell)
2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	3rd Cir.
3. ("CCN") ***CURRENT*** CASE NO.	No.: 07-2360
4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*	No.: 06-17231 Court: D. Del. *(Identify judge & cite, if any)*
5. ("SO") ***SOURCE***	**U.S. TRUSTEES**
6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	Filed: Sep. 2007 Type: Brief of Appellee
7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*	Andrew Vara, Mark Kenney, P. Matthew Sutko *(UST/OGC: 202-307-1399/FAX-2397)*
8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	●Did the district court abuse its discretion in dismissing Mr. Alber's appeal for failure to prosecute after he disobeyed three orders establishing deadlines for him to file his opening appeal brief? √ **Background:**
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NAME: Holly Walter

DATE:

No. 07-2360

IN THE UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

IN RE: ETOYS, INC.
Debtor

ROBERT K. ALBER

Appellant

v.

MORRIS NICHOLS ARSHT & TUNNELL, et al.

Appellees

On Appeal from the United States District Court
for the District of Delaware

BRIEF OF APPELLEE THE UNITED STATES TRUSTEE

Counsel for Appellee The United States Trustee

Andrew R. Vara
Mark S. Kenney
Office of the United States Trustee
United States Department of Justice
J. Caleb Boggs Federal Building
844 King Street, Suite 2207
Lockbox 35
Wilmington, DE 19801
(302) 573-6491

Roberta A. DeAngelis
P. Matthew Sutko
Office of the General Counsel
Executive Office for U.S. Trustees
United States Department of Justice
20 Massachusetts Avenue NW
Washington, D.C. 20530
(202) 307-1399

CORPORATE DISCLOSURE STATEMENT
PURSUANT TO FED. R. APP. P. 26.1

United States Trustees are officials of the Department of Justice appointed by the Attorney General to supervise the administration of bankruptcy cases and trustees. *See* 11 U.S.C. §§ 581-589; *United States Trustee v. Revco, D.S., Inc. (In re Revco D.S., Inc.)*, 898 F.2d 498, 499 (6th Cir. 1990) ("[t]he United States trustee, an officer of the Executive branch, represents ... [the] public interest."). As a governmental party, the United States Trustee is not required to submit a statement pursuant to Fed. R .App. P. 26.1.

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TABLE OF AUTHORITIES

FEDERAL CASES

FEDERAL STATUTES

STATEMENT OF JURISDICTION

This appeal involves a core proceeding (as defined in 28 U.S.C. § 157(b)(2)) arising under title 11 of the United States Code, over which the United States Bankruptcy Court for the District of Delaware had jurisdiction pursuant to 28 U.S.C. § 157(b)(1). The United States District Court for the District of Delaware had jurisdiction over Appellant Robert K. Alber's appeal from the bankruptcy court's October 4, 2005 order pursuant to 28 U.S.C. § 158(a)(1), as it was an appeal from a final order of the bankruptcy court. Mr. Alber timely filed a notice of appeal of the district court's February 27, 2007 final order dismissing his appeal to the district court. Accordingly, this Court has jurisdiction over Mr. Alber's appeal pursuant to 28 U.S.C. § 158(d).

STATEMENT OF ISSUE PRESENTED

Did the district court abuse its discretion in dismissing Mr. Alber's appeal for failure to prosecute after he disobeyed three orders establishing deadlines for him to file his opening appeal brief?

STATEMENT OF THE CASE

Appellant Robert K. Alber appeals from the district court's dismissal with prejudice of his appeal from a final bankruptcy court order which, among other things, (i) approved the settlement of the United States Trustee's motion for sanctions against the law firm of Traub Bonacquist & Fox ("TBF") and (ii) to the extent Mr. Alber sought relief beyond that provided in the settlement between the United States Trustee and TBF, denied Mr. Alber's motion for an order disqualifying TBF, TBF's partners, and plan administrator Barry Gold and directing them to disgorge all compensation received in the chapter 11 bankruptcy case of eToys, Inc. (collectively with its debtor affiliates, the "Debtor").[1/]

Mr. Alber disobeyed the district court's scheduling orders dated September 22, 2006, October 23, 2006 and January 5, 2007, directing him to file his opening brief. Dist. D.I. 28, 39 and 44, respectively.[2/] After Mr. Alber failed to comply with the October 23, 2006 scheduling order, TBF, MNAT, and Mr. Gold moved to dismiss Mr. Alber's appeal for failure to prosecute it. Motion to Dismiss, Dist. D.I. 42. Mr. Alber did not oppose the motion to dismiss. On February 27, 2007, after Mr. Alber failed to timely comply with a third order establishing a deadline for him to file his opening brief, the district court entered a memorandum order granting the pending motion to

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[1/] The bankruptcy court order which was the subject of Mr. Alber's district court appeal also ordered partial disgorgement of compensation by debtors' counsel, Appellee Morris Nichols Arsht & Tunnell ("MNAT") in connection with Mr. Alber's January 25, 2005 motion alleging conflicts of interest by MNAT, and approved a settlement between the post-effective date committee of unsecured creditors and Goldman Sachs & Co. The United States Trustee did not assert a position in the bankruptcy court or the district court appeal regarding those two matters and does not address them herein.

[2/] References in the form "Dist. D.I. ___" are to docket items in the district court.

dismiss, with prejudice. Dismissal Order, Dist. D.I. 55. Despite his lack of opposition to the motion to dismiss, Mr. Alber moved for reconsideration of the dismissal order on March 15, 2007. Alber Motion for Reconsideration, Dist. D.I. 57. While his motion for reconsideration was pending, Mr. Alber timely filed a notice of appeal to this Court on April 30, 2007. Notice of Appeal, Dist. D.I. 59. The district court entered a memorandum order denying reconsideration on June 12, 2007. Order Denying Reconsideration, Dist. D.I. 63.

STATEMENT OF THE FACTS

The Debtor filed its voluntary petition for relief under 11 U.S.C. § 1101 *et seq.* on March 7, 2001. Voluntary Petition, Bankr. D.I. 1.[3/] The official committee of unsecured creditors selected TBF as its counsel, and the bankruptcy court approved TBF's employment pursuant to 11 U.S.C. § 1103 on April 25, 2001. Order Approving Employment of TBF, Bankr. D.I. 246. Mr. Alber, an eToys shareholder, actively participated in the chapter 11 case and filed over two dozen pleadings therein. *See, e.g.*, Letter of Objection, Bankr. D.I. 1118; Motion for Discovery, Bankr. D.I. 1119; Objection to Plan Confirmation, Bankr. D.I. 1373. The bankruptcy court confirmed the Debtor's liquidating plan of reorganization on November 1, 2002, and the plan

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[3/] References in the form "Bankr. D.I. ___ are to docket items in the bankruptcy court.

became effective on November 2, 2002. Order Confirming Plan, Bankr. D.I. 1385; Notice of Effective Date, Bankr. D.I. 1406. By order dated February 27, 2003, the bankruptcy court approved final compensation of estate professionals, including TBF. Omnibus Final Compensation Order, Bankr. D.I. 1772.

On December 20, 2004, Mr. Alber filed an emergency motion seeking disqualification of TBF as counsel for the post-effective date committee of unsecured creditors ("PEDC"), removal of Mr. Gold as sole officer and director of the reorganized Debtor and plan administrator under the liquidating plan, and disgorgement of all compensation paid to TBF and Mr. Gold since the commencement of the bankruptcy case. Motion for Disgorgement and Removal, Bankr. D.I. 2145. Mr. Alber's motion alleged conflicts of interest arising from the joint ownership of a consulting firm, Asset Disposition Advisors ("ADA") by Mr. Gold and TBF partner Paul Traub. ADA was not involved in the eToys bankruptcy case; however, shortly after TBF's employment as counsel for the creditors' committee, the Debtor employed Mr. Gold individually as a wind-down coordinator and ultimately as its President. Although TBF disclosed its relationship with Mr. Gold and ADA in numerous other bankruptcy cases in Delaware and elsewhere, TBF did not amend its statement pursuant to FED.R.BANKR.P. 2014(a) in the eToys case to disclose its relationship with Mr. Gold. Mr. Alber alleged that TBF, its partners and Mr. Gold had conflicts of interest which disabled them from serving in the eToys case. *Id.*

On February 15, 2005, after conducting her own investigation, the United States Trustee moved for an order directing TBF to disgorge up to the full amount of fees paid to TBF as counsel to the eToys creditors' committee from the time the Debtor hired Mr. Gold until the effective date of the confirmed Chapter 11 plan, as a sanction for TBF's violation of its FED.R.BANKR.P. 2014(a) disclosure obligations. The United States Trustee's motion did not suggest a sanctions amount. The United States Trustee did not seek sanctions against Mr. Gold, whom eToys had hired as an employee under corporate governance principles rather than as a professional person under 11 U.S.C. § 327(a). United States Trustee's Motion for Disgorgement ,Bankr. D.I. 2195.

After the United States Trustee filed her motion against TBF, the United States Trustee and TBF agreed to settle the motion, subject to bankruptcy court approval, for disgorgement by TBF of $750,000 of compensation previously awarded. The United States Trustee moved for bankruptcy court approval of the proposed settlement on February 24, 2005. Motion to Approve Settlement, Bankr. D.I. 2201. Under the proposed settlement, the $750,000 would be returned to the Debtor's estate, which was being liquidated for the benefit of creditors. *Id.*, Ex. A.

The bankruptcy court conducted a day-long hearing on March 1, 2005, where Mr. Alber participated and cross-examined witnesses in connection with his and the United States Trustee's motions. After the hearing and review of post-hearing submissions, the bankruptcy court issued a written opinion and entered a final order on October 4, 2005, *inter alia,* approving the settlement between the United States Trustee and TBF and denying Mr. Alber's motion to the extent it sought relief against Mr. Gold or relief against TBF and its partners beyond that provided in the settlement between the United States Trustee and TBF.[4/] Bankruptcy Court Opinion, Bankr. D.I. 2319; Bankruptcy Court Order, Bankr. D.I. 2320.

Mr. Alber timely filed a notice of appeal from the bankruptcy court's order on October 14, 2005. Notice of Appeal to District Court, Bankr. D.I. 2327. Mr. Alber also timely filed a designation of the record on appeal pursuant to FED.R.BANKR.P. 8006. First Record Designation, Dist. D.I. 2. Mr. Alber's original designation included numerous items that were not a part of the record in the bankruptcy court. TBF, MNAT and Mr. Gold each moved to strike Mr. Alber's record designation in December 2005. Motions to Strike Record Designation, Dist. D.I. 8, 11, and 12,

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[4/] The bankruptcy court also granted in part Mr. Alber's separate motion to disqualify, and for disgorgement of fees by MNAT, and approved a settlement between the post-effective date committee and Goldman Sachs & Co. Bankruptcy Court Opinion at 55-56, Bankr. D.I. 2319; Bankruptcy Court Order, D.I. 2320.

respectively. The district court appeal did not proceed while the motion to strike Mr. Alber's designation of the record was pending. On August 30, 2006, the district court granted the motions to strike Mr. Alber's designation, finding that the items listed in the designation were not sufficiently identified to determine whether they were part of the record before the bankruptcy court. Order Striking Designation at 2, Dist. D.I. 22.

The district court entered a scheduling order on September 20, 2006, directing Mr. Alber to file his opening brief by September 27, 2006. Scheduling Order, Dist. D.I. 25. Mr. Alber immediately requested a one-week extension. First Extension Request, Dist. D.I. 27. By agreement of all parties, the district court entered a September 22, 2006 amended consolidated scheduling order which, *inter alia*, directed Mr. Alber to file his opening brief by October 4, 2006. Amended Consolidated Scheduling Order, Dist. D.I. 28.

Mr. Alber did not file his opening brief by the district court's October 4, 2006 deadline. On October 9, 2006, MNAT moved for a status conference to address Mr. Alber's failure to timely file an opening brief, and requested a stay of the deadlines by which the appellees were required to file their briefs. Motion for Status Conference, Dist. D.I. 29. The district court scheduled a telephonic status conference with the parties for October 16, 2006. On the morning of October 16, 2006, twelve days after his opening brief was due, Mr. Alber responded to MNAT's motion for a status conference by filing a 22 page response with over 20 exhibits, requesting a second extension of time to file his opening brief. Request for Second Extension, Dist. D.I. 35. Mr. Alber's response justified his request for more time on the grounds he had been busy with the eToys case and with other litigation involving an individual named Johann Hamerski. *Id.* at 6-17. Mr. Alber asserted that he was unable to complete his opening brief due to the stress that had produced. *Id.* at 2-3; 17. Mr. Alber attached an October 6, 2006 letter from a nurse practitioner stating that Mr. Alber was "experiencing extreme stress and anxiety" and asking if "these legal matters could be put on hold for a time, allowing Mr. Alber time for a respite." *Id.*, Ex. A.

During the October 16, 2006 status conference, the district court expressed concern that Mr. Alber was able to generate a 22-page document with numerous attachments explaining why he needed an extension of time to file his opening brief, but claimed to be unable to generate an opening brief articulating his position on appeal. Transcript of October 16, 2006 Status Conference at 5, 9, Dist. D.I. 37. Nonetheless, the district court entered an order granting Mr. Alber an additional 30 days to file his opening brief. The district court instructed Mr. Alber that the court would entertain a motion for a further extension if he could not prepare his brief within the 30 days because of his mental or emotional state, but would require Mr.

Alber to submit to examination by an independent mental health practitioner to determine whether he was "genuinely unable to proceed." *Id.* at 10-12. The district court entered a second amended consolidated scheduling order on October 23, 2006, directing Mr. Alber to file his opening brief by November 15, 2006. Second Amended Consolidated Scheduling Order, Dist. D.I. 39.

Mr. Alber did not comply with the second amended consolidated scheduling order. He did not file his opening brief by November 15, 2006, nor did he move for an extension of time to file his brief as directed by the district court at the October 16, 2006 status conference. Mr. Alber instead sent a November 16, 2006 e-mail message to some of the appellees indicating his intent to move for an extension until November 27, 2006 to file his opening brief. Mr. Alber also indicated that his health was "greatly improved after the time off" and he was "in a mental state able to continue without break for the foreseeable future." Mr. Alber's e-mail suggested that his failure to comply with the November 15, 2006 deadline was not due solely to health concerns but was also due to the burden of other litigation, and potential criminal issues.

> [I]t's been a struggle since I've been served with 24 documents from the previously named 'associates' of some of you in the Arizona case, and, coincidentally, just a few days prior to my November 15th deadline they took steps to have me arrested. Those actions culminated with the local police visiting me, and my having to defend myself from yet more perjurious

> allegations, which necessitates my drafting a filing (albeit a short filing which will only take me a day or two at most) to deal with these new criminal allegations against me.

Motion to Dismiss, Ex. C, Dist. D.I. 42.

On November 17, 2006, TBF, MNAT, and Mr. Gold moved to dismiss Mr. Alber's appeal for failure to prosecute. Motion to Dismiss, Dist. D.I. 42. Mr. Alber did not oppose the motion, and still did not file his opening brief.

A magistrate judge of the district court entered an order on January 5, 2007 granting Mr. Alber a final opportunity to file his opening brief. Third Scheduling Order, Dist. D.I. 44. The order noted that Mr. Alber had not complied with the second amended consolidated scheduling order's November 15, 2006 filing deadline and that a motion to dismiss the appeal had been filed on November 17, 2006. The January 5, 2007 order stated that if Mr. Alber did not file his opening brief on or before January 18, 2007, the appeal would be dismissed for lack of prosecution. *Id.*. Mr. Alber did not comply with this deadline.

Mr. Alber's opening brief was not filed until January 23, 2007, five days after the deadline set forth in the January 5, 2007 "last chance" order. Alber District Court Brief, Dist. D.I. 49. He mailed copies of this brief to the parties on January 19, 2007 and sent copies by e-mail late in the day on January 22, 2007. TBF, MNAT and Mr. Gold immediately contacted the district court by letter and requested that it act on the pending motion to dismiss the appeal or, alternatively, schedule a telephonic conference to establish remaining briefing deadlines. Request for Action on Motion to Dismiss, Dist. D.I. 48 . On February 5, 2007, TBF, MNAT and Mr. Gold filed their Emergency Motion to (A) Clarify the Absence of Briefing Deadlines; (B) Defer Appeal Briefing Pending Decision of Appellees' Motion to Dismiss, or in the Alternative, (C) Establish Briefing Schedule to Govern These Procedurally Consolidated Appeals. Motion to Clarify, Dist. D.I. 51. Mr. Alber did not oppose the motion.

On February 27, 2007, the district court entered a memorandum order granting the pending motion by TBF, MNAT and Gold to dismiss Mr. Alber's appeal, with prejudice. Dismissal Order, Dist. D.I. 55. The district court reviewed each of the six factors set forth in *Poulis v. State Farm Fire & Cas. Co.*, 747 F.2d 863 (3d Cir. 1984) and found that (i) Mr. Alber was personally responsible for failure to pursue his appeal in a timely manner; (ii) his repeated failure to comply with court orders imposed additional burdens on the appellees and the district court and prevented timely resolution of the appeal; (iii) Mr. Alber had demonstrated a history of dilatory behavior; (iv) Mr. Alber's conduct was not consistent with an interest in or respect for the appellate process; (v) alternative sanctions short of dismissal would not be effective; and (vi) in challenging the bankruptcy court's decisions on matters in which the bankruptcy court had broad discretion, Mr. Alber had only minimal probability of success. Dismissal Order at 4-6, Dist. D.I. 55. The district court therefore determined that "the factors identified in *Poulis* weigh in favor of dismissal with prejudice." *Id.* at 6.

Non-party Steven Haas moved for reconsideration on March 12, 2007. Haas Motion for Reconsideration, Dist. D.I. 56. Mr. Alber moved for reconsideration on March 15, 2007. Alber Motion for Reconsideration, Dist. D.I. 57. The district court denied both motions on June 12, 2007, noting that the motions did not demonstrate grounds to warrant reconsideration. Order Denying Reconsideration, Dist. D.I. 63. Mr. Alber timely filed a notice of appeal of the district court's February 27, 2007 dismissal order on April 30, 2007, while the motions for reconsideration were pending. Notice of Appeal, Dist. D.I. 59.

STATEMENT OF RELATED CASES AND PROCEEDINGS

The bankruptcy court order from which Mr. Alber appealed to the district court was also appealed by Steven Haas, in his capacity as President of administrative claimant Collateral Logistics, Inc. ("CLI"). By order dated August 30, 2006, the district court dismissed Mr. Haas's appeal for lack of standing (because the bankruptcy court's order affected CLI's interests, not those of Mr. Haas) and for CLI's failure to retain counsel.

Mr. Haas timely appealed the district court’s dismissal order to this Court on October 2, 2006, under Case No. 06-4308. On March 23, 2007, this Court dismissed the appeal as to CLI for failure to prosecute because CLI had not retained counsel. On May 16, 2007, this Court entered an order summarily affirming the district court’s order of dismissal as to Mr. Haas, agreeing with the district court’s analysis and decision that Mr. Haas lacked standing to appeal.

STANDARD OF REVIEW

This Court reviews dismissal orders, whether imposed as a sanction for violation of court orders or for failure to prosecute, under an abuse of discretion standard, recognizing that such relief should be entered sparingly. *See Mindek v. Rigatti*, 964 F.2d 1369, 1373 (3d Cir. 1992) (dismissal for failure to comply with orders; “[T]he scope of *our* review is restricted to determining whether the district court abused *its* discretion. How we imagine we might have exercised our own discretion had we been in the district court judge's robe is entirely irrelevant.”)(emphasis in original); *Poulis v. State Farm Fire & Cas. Co.*,747 F.2d 863, 868 (3d Cir. 1984)(dismissal for failure to comply with court-ordered deadlines); *Adams v. Trustees of the New Jersey Brewery Employees’ Pension Trust Fund*, 29 F.3d 863, 870 (3d Cir. 1994) (failure to prosecute; question is not whether the reviewing court would as an original matter have dismissed; it is whether district court abused its discretion in so doing.); *Jewelcor v. Asia Commercial Co., Ltd. (In re Jewelcor, Inc.)*, 11 F.3d 394, 397 (3d Cir. 1993) (standard for reviewing dismissal of appeal for failure to prosecute is abuse of discretion, but district court must have considered less severe sanctions).

SUMMARY OF ARGUMENT

The district court's dismissal of Mr. Alber's appeal for lack of prosecution did not constitute an abuse of discretion. The district court appropriately considered each of the *Poulis* factors, as this Court requires. Based on that review, it determined dismissal was the only effective means of addressing Mr. Alber's continued failure to meet mandatory filing deadlines.

This was not an abuse of discretion. Mr. Alber violated no less than three district court-imposed deadlines to file an opening brief. The district court generously gave him additional chances to file his brief. Only when Mr. Alber repeatedly failed to do so did the court dismiss for failure to prosecute. That was not an abuse of discretion.

ARGUMENT

THE DISTRICT COURT DID NOT ABUSE ITS DISCRETION BY DISMISSING MR. ALBER'S APPEAL GIVEN MR. ALBER'S FAILURE TO PROSECUTE IT.

The district court dismissed Mr. Alber's appeal for failure to prosecute because he failed to comply with three separate orders requiring him to file his opening appeal brief by the dates specified in those orders. It is universally understood that courts may dismiss cases for defiance of rules and of court orders. *See Chambers v. NASCO, Inc.*, 501 U.S. 32, 49 (1991) ("The authority of a court to dismiss *sua sponte* for lack of prosecution has generally been considered an 'inherent power,' governed not by rule or statute but by the control necessarily vested in courts to manage their own affairs so as to achieve the orderly and expeditious disposition of cases" (citations omitted)); *Carnegie-Mellon University v. Cohill*, 484 U.S. 343, 360 (1988) ("Courts have historically possessed an inherent power to dismiss suits for discretionary reasons such as failure to prosecute" (*citing Link v. Wabash R. Co.*, 370 U.S. 626, 629-31 (1962))*; Degen v. United States*, 517 U.S. 820, 827 (1996) ("A federal court has at its disposal an array of means to enforce its orders, including dismissal in an appropriate case."); *Young v. Gordon*, 330 F.3d 76, 81 (1st Cir. 2003) ("When noncompliance occurs, the ordering court should consider the totality of events and then choose from the broad universe of available sanctions in an effort to fit the punishment to the severity and circumstances of the violation.")

The law in the Third Circuit is no different. A district court may dismiss a case for failure to abide by court orders or failure to prosecute. *See, e.g., Mindek, supra*, 964 F.2d at 1373; *Poulis, supra*, 747 F.2d at 868; *New Jersey Brewery Employees' Pension Trust Fund, supra*, 29 F.3d at 870; *Jewelcor, supra*, 11 F.3d at 397 However, before determining that dismissal is an appropriate sanction for disobedience of its orders, the district court is required to balance the six factors enumerated in *Poulis, supra*: "(1) the extent of the *party's* personal *responsibility*; (2) the *prejudice* to the adversary caused by the failure to meet scheduling orders and respond to discovery; (3) a *history* of dilatoriness; (4) whether the conduct of the party or the attorney was *willful* or in *bad faith*; (5) the effectiveness of sanctions other than dismissal, which entails analysis of *alternative sanctions*; and (6) the *meritoriousness* of the claim or defense." 747 F.2d at 868 (emphasis in original).

Although the district court must consider each of the *Poulis* factors, it is not necessary that all of those factors weigh against the noncompliant party to find that dismissal is warranted. *Hicks v. Feeney*, 850 F.2d 152, 156 (3d Cir. 1988), *cert. denied*, 488 U.S. 1005, 109 S.Ct. 786 (1989). The standard of review from such a dismissal is deferential, and the scope is narrow. This Court has held that its role is limited to determining whether the district court properly balanced the *Poulis* factors and whether the record supports its findings. *Livera v. First Nat. State Bank of New Jersey*, 879 F.2d 1186, 1194 (3d Cir. 1989), *citing Hicks, supra*. Importantly, it is not relevant that this Court might have ruled differently upon its own consideration of the *Poulis* factors. As this Court has stated, "the decision to dismiss constitutes an exercise of the district court judge's discretion and must be given great deference by this Court-a court which has had no direct contact with the litigants and whose orders, calendar, docket and authority have not been violated or disrupted." *Mindek, supra*, 964 F.2d at 1373.

The district court properly balanced the *Poulis* factors, and the record amply supports the court's findings in that regard.

A. The District Court Did Not Abuse its Discretion in Finding Mr. Alber Was Personally Responsible.

With respect to personal responsibility for failure to comply with rules or court orders, this Court has expressed a preference for "visiting sanctions directly on the delinquent lawyer rather than on a client who is not actually at fault." *Adams v. Trustees of the New Jersey Brewery Employees' Pension Trust Fund, supra*, 29 F.3d at 873. In this case, Mr. Alber bears full responsibility for his failure to timely file his opening brief. He is not the sympathetic "innocent client" of a delinquent attorney;

he has instead acted *pro se* from the inception of the eToys, Inc. bankruptcy case and, as the district court noted in its memorandum order dismissing the appeal, "has been an effective advocate in the bankruptcy proceedings." Dismissal Order at 4, Dist. D.I. 55.

Mr. Alber's *pro se* status means only that he has no attorney to whom he can point as the cause of the delay; he bears the responsibility himself. *Adams v. Trustees of the New Jersey Brewery Employees' Pension Trust Fund, supra*, 29 F.3d at 873. Moreover, Mr. Alber is not entitled to any special dispensation as a *pro se* litigant. Court rules and orders apply with equal force to *pro se* parties as to other litigants. *See Nielsen v. Price*, 17 F.3d 1276, 1277 (10th Cir. 1994).

Mr. Alber's alleged health issues do not excuse his failure to comply with the district court's orders. During the October 16, 2006 telephonic status conference, the district court instructed Mr. Alber that it would entertain a motion for a further extension of the briefing deadline if he could not prepare his brief within 30 days because of his health, with the caveat that he would be required to submit to an independent examination. Transcript of October 16, 2006 Status Conference at 11, 13, Dist. D.I. 37. Mr. Alber had ample opportunity to move for a further extension of the briefing deadlines, but did not avail himself of such opportunity and did not submit himself for independent examination. He also had ample opportunity to alert the district court to his allegedly continuing health issues by, *inter alia*, answering the motion to dismiss filed by TBF, MNAt and Mr. Gold on November 17, 2006.

The district court did not abuse its discretion in determining that Mr. Alber was personally responsible for his failure to timely file an opening brief.

B. The District Court Did Not Abuse its Discretion in Finding The Appellees Have Been Prejudiced.

The district court noted in its memorandum order dismissing Mr. Alber's appeal, that Mr. Alber's repeated failure to comply with the court's orders, and the motion practice caused by such failure, have imposed additional burdens on the appellees and on the court itself. The district court further noted that given the nature of Mr. Alber's complaints against the appellees, timely resolution of the appeal was thwarted by Mr. Alber's conduct. Dismissal Order at 4, Dist. D.I. 55. This was not an abuse of discretion.

Prejudice includes the burden a party must bear when forced to file motions in response to an adversary's delay tactics. *See Ware v. Rodale Press, Inc.*, 322 F.3d 218, 223-24 (3d Cir. 2003). Mr. Alber's repeated failure to timely file his opening brief was in and of itself prejudicial to the appellees, who were forced to file motions in response to Mr. Alber's delay tactics.

Here, several of the appellees had to file no fewer than three motions responding to Mr. Alber's failure to file a timely brief. The district court held a status conference which counsel for TBF, MNAT, Mr. Gold and the United States Trustee attended. None of this would have been necessary had Mr. Alber timely prosecuted his appeal.

C. The District Court Did Not Abuse its Discretion in Finding Mr. Alber Has Demonstrated a History of Dilatoriness.

The district court found that Mr. Alber had demonstrated a history of dilatory behavior in the case, starting with his improper designation of the record on appeal and ending with the untimely filing of his opening brief. Dismissal Order at 4-5, Dist. D.I. 55. The court did not abuse its discretion in making this finding. *See Adams v. Trustees of the New Jersey Brewery Employees' Pension Trust Fund*, 29 F.3d 863, 874 (3d Cir. 1994) (Excessive or repeated delay or delinquency constitutes a history of dilatoriness, such as consistent tardiness in complying with court orders.); *Jewelcor, supra*, 11 F.3d at 874 (same, *citing Poulis, supra,* 747 F.2d at 868).

Mr. Alber initially delayed the proceedings in the district court appeal by submitting a patently inadequate and inappropriate designation of the record on appeal pursuant to FED.R.BANKR.P. 8006. First Record Designation, Dist. D.I. 2. Mr. Alber's original designation included many items that were not a part of the record in the bankruptcy court. TBF, MNAT and Mr. Gold each moved to strike Mr. Alber's record designation in December 2005. Dist. D.I. 8, 11, 12. The district court appeal did not progress while the motion to strike Mr. Alber's designation was pending. On August 30, 2006, the district court granted the motions to strike Mr. Alber's designation, finding that the items listed in the designation were not sufficiently identified to determine whether they were part of the record before the bankruptcy court. Order Striking Designation at 2, Dist. D.I. 22. Mr. Alber's improper and inadequate record designation delayed the progress of the district court appeal for approximately eight months.

Mr. Alber also demonstrated a history of dilatory behavior by his serial defiance of scheduling orders. Even after the district directed Mr. Alber to move for an additional extension of time if his health so required (and advised him that he would need to undergo an independent mental health examination to support such a motion), Mr. Alber repeatedly elected to allow briefing deadlines to expire without moving for extensions. When Mr. Alber's health permitted him to prepare his opening brief, he elected to delay preparing such a brief while he pursued other legal proceedings. Motion to Dismiss, Ex. C, Dist. D.I. 42. The district court's finding that Mr. Alber demonstrated a history of dilatoriness is well-supported by the record and, at a minimum, does not constitute an abuse of discretion.

D. The District Court Did Not Abuse its Discretion in Ruling Mr. Alber's Conduct Was Willful.

The district court determined that Mr. Alber's conduct in the appeal had not been consistent with an interest in, or respect for, the appellate process. Dismissal Order at 5, Dist. D.I. 55. Willfulness can involve intentional or self-serving behavior. *New Jersey Brewery Employees' Pension Trust Fund*, *supra*, 29 F.3d at 875. In some instances a history of dilatoriness also suffices to demonstrate willfulness and/or bad faith. *See Ware v. Rodale Press, Inc., supra*, 322 F.3d at 224 (3d Cir. 2003).

Here, Mr. Alber demonstrated willful disrespect for the appellate process and the district court itself by repeatedly disobeying scheduling orders. Mr. Alber also acted willfully when he elected to delay preparing his opening brief while he pursued his other legal proceedings in Arizona. In doing so, he chose to serve his interests in the Arizona litigation at the expense of complying with deadlines in the eToys appeal.

E. The District Court Did Not Abuse Its Discretion in Finding Sanctions Other Than Dismissal Would Not Be Effective.

The district court found that no sanction short of dismissal would be effective "given the threat of sanctions communicated at the October 16, 2006 status conference and through the January 5, 2007 order." Dismissal Order at 5, Dist. D.I. 55.

Mr. Alber asserts that the district court did not threaten him with sanctions on October 16, 2006, but instead granted his request for an extension of time to file his opening brief and told him more time would be granted if necessary. *See* Appeal Brief at 9. Mr. Alber is correct that the district court did not threaten him with "sanctions." The district court advised Mr. Alber at the October 16, 2006 status conference that the price of any further delay (beyond November 15, 2006) in filing his opening brief would be submission to an independent mental health examination, for which he might be required to bear some or all of the cost. Transcript of October 16, 2006 Status Conference at 10-12, Dist. D.I. 37. In considering the effectiveness of sanctions other than dismissal, the district court may have viewed this "price of delay" as a sanction. If this was error, it was harmless.

Mr. Alber appears to have been undaunted by the prospect of submitting to an independent mental health examination, because he apparently had no intention of so submitting. Instead of moving for an extension of time beyond November 15, 2006 and paying the "price" described by the district court, Mr. Alber simply took additional time without authorization by disobeying the second amended scheduling order, unconcerned about how the appellees and the court would respond.

Mr. Alber also suggests that the magistrate judge who entered the "last chance" order of January 5, 2007 acted without "standing." *See* Mr. Alber's Appeal Brief at 9. Mr. Alber appears to suggest, albeit implicitly, that he could ignore that order with impunity because the magistrate judge had no means to enforce the threat of severe sanctions. The implied corollary of this suggestion is that the risk of sanctions less severe but more certain to be imposed by a district judge would somehow have induced Mr. Alber to comply with the district court's orders. However, by the time the "last chance" order was entered, Mr. Alber had already disobeyed two scheduling orders entered by district court judges, and a motion to dismiss his appeal had been pending for seven weeks. Mr. Alber's failure to move for a further extension of the November 15, 2006 briefing deadline, to oppose the motion to dismiss his appeal, to file his opening brief promptly after the motion to dismiss was filed, or even to challenge the magistrate judge's scheduling order, already demonstrated that Mr. Alber was unconcerned about dismissal, let alone lesser sanctions, that might be imposed.

Finally, the order dismissing Mr. Alber's appeal was not entered by the magistrate judge; it was entered by a judge of the district court. The issue of the magistrate judge's authority to act is not before this Court. Moreover, even if the magistrate judge lacked authority to enter a dismissal order, nothing precluded her from entering case management orders such as the January 5, 2007 scheduling order. In fact, the magistrate judge's January 5, 2007 order actually extended the time for Mr. Alber to file his delinquent brief. If that order was a nullity, then Mr. Alber filed his brief 69 days late rather than five days after the "last chance" deadline.

Mr. Alber's conduct demonstrated that he was unconcerned about sanctions. Accordingly, no sanction short of dismissal of the appeal would have been effective, and the district court did not abuse its discretion in so finding.

E. The District Court Did Not Abuse Its Discretion in Finding Mr. Alber's Appeal Lacks Merit.

In considering the final *Poulis* factor, whether the case or appeal is meritorious, the district court reviewed the bankruptcy court's opinion and the order from which Mr. Alber appealed. Although the district court considered Mr. Alber's likelihood of success on appeal when conducting its *Poulis* analysis, the court did not necessarily analyze the merits to the same degree it would have had the court been considering a fully briefed appeal on the merits rather than a motion to dismiss for failure to prosecute. This was an appropriate exercise of the district court's discretion, supported by the record.

How this Court might have exercised its own discretion in considering the merits of Mr. Alber's appeal and its likelihood of success is not the relevant test; the scope of this Court's review is restricted to determining whether the district court abused its discretion in determining that Mr. Alber's likelihood of success on appeal was minimal. *See Mindek v. Rigatti, supra*, 964 F.2d at 1373. If this Court affirms the district court's dismissal order, it need not address the underlying merits of Mr.

Alber's appeal. If this Court reverses the dismissal order, it should remand the case to the district court for a decision on the merits. The United States Trustee briefly discusses the merits herein only for the purpose of demonstrating that the district court properly considered the final *Poulis* factor.

The district court correctly observed that Mr. Alber was challenging the bankruptcy court's exercise of discretion in matters over which bankruptcy courts possess broad discretion. Dismissal Order at 5-6, Dist. D.I. 55. The court further observed that in matters where the bankruptcy court has broad discretion, the likelihood of a successful challenge to the exercise of that discretion is minimal. *Id.* It is well-settled that bankruptcy courts have broad discretion to fashion an appropriate remedy when confronted with an estate professional's violation of the Bankruptcy Code's disinterestedness requirements or a breach of the professional's disclosure obligations under FED.R.BANKR.P. 2014(a). *See United States Trustee v. Price Waterhouse*, 19 F.3d 138 (3d Cir. 1994) (construing section 328(c) of the Bankruptcy Code to give the bankruptcy court discretion over the disallowance of fees when an estate professional is not a disinterested person at any time during his employment). A court's power to order disgorgement of a professional's fees and expenses is not to be applied woodenly. It should instead be "exercised with restraint and discretion;" in exercising that discretion, the court "should apply principles of equity, as other courts have done." *Matter of Olsen Indus., Inc.*, 222 B.R. 49, 62 (Bankr. Del. 1997), *citing In re Downs*, 103 F.3d 472, 478 (6th Cir. 1996). The nature of the sanction "should be determined with a view to its deterrent value, not necessarily limited to the harm caused litigants." *Pearson v. First NH Mortgage Corp.*, 200 F.3d 30, 42 n.7 (1st Cir. 1999).

It is similarly well-settled that stipulations in bankruptcy are favored as a means of minimizing litigation, expediting the administration of the estate, and providing for the efficient resolution of bankruptcy cases. *In re Martin*, 91 F.3d 389, 393 (3d Cir. 1996); *In re Coram Healthcare Corp.*, 315 B.R. 321, 329 (Bankr. D. Del. 2004). A bankruptcy court should approve a stipulation if its is fair and equitable and is in the best interest of the estate. *In re Cajun Electric Power Cooperative, Inc.*, 119 F.3d 349, 355 (5th Cir. 1997). To make this determination, the bankruptcy court "must assess and balance the value of the claim that is being compromised against the value to the estate of the acceptance of the compromise proposal." *Id.* at 356; *Martin, supra*, 91 F.3d at 393. Under *Martin*, the bankruptcy court is required to consider four discrete criteria: (1) the probability of success in litigation; (2) the likely difficulties in collection; (3) the complexity of the litigation involved and the expense, inconvenience and attendant delay; and (4) the paramount interest of the creditors. *Martin, supra*, 91 F.3d at 393.

In this case, with respect to the settlement of the United States Trustee's motion for sanctions against TBF, the bankruptcy court specifically addressed all four of the *Martin* factors. Most important was the bankruptcy court's finding regarding probability of success in litigation, as the court found that while there was a strong probability that the United States Trustee would succeed *in part* on its sanctions motion (because of TBF's admitted FED.R.BANKR.P. 2014(a) disclosure violation), there was a risk of not succeeding on the issue of actual conflict of interest if that issue were litigated. The bankruptcy court also found that the paramount interest of creditors was served by the settlement, as TBF's $750,000 disgorgement was a substantial penalty, and that the settlement furthered the deterrent goal of a sanctions motion. Bankruptcy Court Opinion at 41-42, Bank. D.I. 2319.

The bankruptcy court also specifically addressed its decision not to impose sanctions on Mr. Gold (whose status as an employee of the Debtor was not an issue), as it held that executive employees of a debtor are not professionals who must be employed under section 327(a) of the Bankruptcy Code. Bankruptcy Court Opinion at 50, Bank. D.I. 2319.

The bankruptcy court's order underlying Mr. Alber's district court appeal, as well as the accompanying opinion, reflect thorough consideration of the evidence presented, painstaking legal analysis, and careful application of the law to the facts.

In sum, they demonstrate the bankruptcy court's sound exercise of judicial discretion. Accordingly, the district court did not abuse its discretion in determining that Mr. Alber's likelihood of a successful challenge to the exercise of the bankruptcy court's discretion was minimal.

CONCLUSION

For these reasons, the United States Trustee respectfully asks this Court to affirm the district court order dismissing Mr. Alber's appeal.

Respectfully submitted,

KELLY BEAUDIN STAPLETON
UNITED STATES TRUSTEE

By: ___________________________
Andrew R. Vara
Mark S. Kenney (PA Bar ID 43640)
Office of the United States Trustee
United States Department of Justice
J. Caleb Boggs Federal Building
844 King Street, Suite 2207, Lockbox 35
Wilmington, DE 19801
(302) 573-6491

Counsel for Appellee, *The United States Trustee*

OF COUNSEL:

Roberta A. DeAngelis
P. Matthew Sutko
Office of the General Counsel
Executive Office for U.S. Trustees
United States Department of Justice
20 Massachusetts Avenue NW
Washington, D.C. 20530
(202) 307-1399

CERTIFICATE OF COMPLIANCE WITH FED. R. APP. P. 32(a)

CERTIFICATION OF COMPLIANCE WITH TYPE-VOLUME LIMITATION, TYPEFACE REQUIREMENTS AND TYPE STYLE REQUIREMENTS

This brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B) because this brief contains 6,968 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii).

This brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6) because this brief has been prepared in a proportionally spaced typeface using Corel WordPerfect version 12 in 14 point Times New Roman.

Dated: September 21, 2007 ________________________________

Mark S. Kenney
Trial Attorney
Office of the United States Trustee
United States Department of Justice
J. Caleb Boggs Federal Building
844 King Street, Suite 2207, Lockbox 35
Wilmington, DE 19801
(302) 573-6491

Counsel for Appellee, The United States Trustee

CERTIFICATION OF BAR MEMBERSHIP (L.A.R. 46.1)

Pursuant to Third Circuit Local Appellate Rule 46.1, I hereby certify that I am a member of the bar of the United States Court of Appeals for the Third Circuit.

Dated: September 21, 2007

____
Mark S. Kenney
Trial Attorney
Office of the United States Trustee
United States Department of Justice
J. Caleb Boggs Federal Building
844 King Street, Suite 2207, Lockbox 35
Wilmington, DE 19801
(302) 573-6491

Counsel for Appellee, The United States Trustee

CERTIFICATION PURSUANT TO L.A.R. 31.1(c)

Pursuant to Third Circuit Local Appellate Rule 31.1(c), I hereby certify as follows:

1. The text of the electronic version of this brief is identical to the text in the paper copies of this brief.

2. A virus check was performed on the PDF file of the foregoing Brief for Appellee The United States Trustee prior to filing, using Computer Associates eTrust Antivirus version 7.1.501.

Dated: September 21, 2007

Mark S. Kenney
Trial Attorney
Office of the United States Trustee
United States Department of Justice
J. Caleb Boggs Federal Building
844 King Street, Suite 2207, Lockbox 35
Wilmington, DE 19801
(302) 573-6491

Counsel for Appellee, The United States Trustee

CERTIFICATE OF SERVICE

I, Mark S. Kenney, Esquire, hereby certify that on September 21, 2007, a true and correct copy of the foregoing Brief for Appellee The United States Trustee was electronically filed with the Court and two (2) copies were served upon the following parties by first class mail, postage pre-paid.

Robert K. Alber
17685 DeWitt Avenue
Morgan Hill, CA 95037-4007
Pro Se Appellant

Frederick B. Rosner, Esquire
DUANE MORRIS LLP
1100 North Market Street, Suite 1200
Wilmington, DE 19801-1246
Counsel for Appellee Traub Bonacquist & Fox LLP

Ronald R. Sussman, Esquire
Michael Klein, Esquire
COOLEY GODWARD KRONISH LLP
1114 Avenue of the Americas
New York, NY 10036-7798
Co-Counsel for Appellee Traub Bonacquist & Fox LLP

Derek C. Abbott, Esquire
Gregory W. Werkheiser, Esquire
MORRIS, NICHOLS, ARSHT & TUNNELL LLP
1201 North Market Street
P.O. Box 1347
Wilmington, DE 19899
Counsel for Appellee Morris, Nichols, Arsht, & Tunnell

Mark Minuti, Esquire
SAUL EWING LLP
222 Delaware Avenue
P.O. Box 1266
Wilmington, DE 19899-1266
Counsel for Appellee Barry Gold

Dated: September 21, 2007 ________________________________

Mark S. Kenney
Trial Attorney
Office of the United States Trustee
United States Department of Justice
J. Caleb Boggs Federal Building
844 King Street, Suite 2207, Lockbox 35
Wilmington, DE 19801
(302) 573-6491

Counsel for Appellee, The United States Trustee

BRIEF BANK — "SUMMARY SHEET"

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WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	In re Edward P. Fahey
2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	S.D. Tex.
3. ("CCN") ***CURRENT*** CASE NO.	No.: 5:09-cv-00100
4. ("PCN") ***PRIOR*** CASE NO. - & COURT *[IF ANY]*	No.: 09-00501 Court: Bankr. S. D. Tex. *(Identify judge & cite, if any)*
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IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
LAREDO DIVISION

In re EDWARD P. FAHEY
Civil No. 5:09-cv-100

On Appeal from the United States Bankruptcy Court
for the Southern District of Texas
Laredo Division

BRIEF OF THE APPELLEE CHARLES F. McVAY UNITED STATES TRUSTEE

CHARLES F. McVAY
UNITED STATES TRUSTEE
REGION 7

Kevin M. Epstein
Trial Attorney
Department of Justice
Office of the U.S. Trustee
615 E. Houston St., Room 533
P.O. Box 1539
San Antonio, Texas 78295-1539
(210) 472-4640
(210) 472-4649 Fax

Of Counsel

Ramona D. Elliott
P. Matthew Sutko
Catherine Sevcenko
Executive Office for United States Trustees
Department of Justice
20 Massachusetts Avenue, N.W.
Suite 8000
Washington, D.C. 20530
(202) 307-1399

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STATEMENT OF JURISDICTION

The United States Bankruptcy Court for the Southern District of Texas had jurisdiction under 28 U.S.C. § 157 to rule on the Order to Open Miscellaneous Docket for Consideration of Disciplinary Action and for Consideration of § 526(c)(5) and Other Orders. This Court has jurisdiction under 28 U.S.C. § 158(a)(1) to decide Mr. Fahey's timely appeal from the Bankruptcy Court's Injunction Under Bankruptcy Code § 526 and Referral to Chief District Judge for Disciplinary Action and to State Bar of Texas.

STATEMENT OF ISSUE PRESENTED

The issue before this Court on appeal is whether the court below erred in enjoining Edward Fahey from providing "Bankruptcy Assistance" to "Assisted Persons" (as those terms are defined in the Bankruptcy Code) until he demonstrated the ability and intent to represent clients competently and to comply with the Bankruptcy Code and all applicable rules.

STATEMENT OF THE CASE

This is a case about attorney discipline. After repeated admonitions and warnings about the substandard quality of Mr. Fahey's representation of his clients, United States Bankruptcy Judge Wesley Steen issued an order setting a hearing on whether the Court should impose appropriate civil penalties against Mr. Fahey for what appeared to be a pattern of conduct showing "incompetence or bad faith filing and prosecution of cases." (Dkt. No. 1 at 8).[1] At the hearing, the United States Trustee[2] and the chapter 13 trustee, William Heitkamp, offered

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[1] All references to the record in this case are to the entry number on the bankruptcy court's docket and are denoted as "Dkt. No. _."

[2] United States Trustees are senior Justice Department officials appointed by the Attorney General to supervise the administration of bankruptcy cases and trustees. *See* 28 U.S.C. §§ 581-589 (specifying the powers and duties of United States Trustees); *Curry v. Castillo (In re Castillo)*, 297 F.3d 940, 950 (9th Cir. 2002) ("The United States Trustee is the 'watchdog' of the

unrebutted evidence that showed that the cases Mr. Fahey filed were dismissed at a far greater rate than other practitioners and that Mr. Fahey consistently filed bankruptcy petitions with inaccuracies and without his signature. (Dkt. Nos. 2 and 3). Mr. Fahey stipulated to all this evidence and offered none of his own.

After considering all the evidence and argument presented, the court concluded that Mr. Fahey demonstrated a clear and consistent pattern of (1) failing to file information required by Bankruptcy Code § 521[3] when he filed cases, (2) inadequate representation of clients, (3) lack of expertise in bankruptcy law, (4) unreasonable delegation of authority and responsibility to a contract paralegal that resulted in harm to debtors, (5) filing pleadings with false statements, and (6) failure to comply with the Bankruptcy Code and applicable rules. (Dkt. No. 16 at 1). For the "protection of the public," the Court enjoined Mr. Fahey from representing "assisted persons," as that term is defined in section 101(3) of the Bankruptcy Code, based on his authority under sections 105 and 526 of the Bankruptcy Code, the Court's inherent powers, and Federal Rule of Bankruptcy Procedure 9011. (*Id.*)

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bankruptcy system . . . charged with preventing fraud and abuse and with 'fill[ing] the vacuum' caused by possible creditor inactivity."). Congress explicitly provided that United States Trustees possess standing to raise and be heard on any issue in any bankruptcy case. 11 U.S.C. § 307.

[3] Section 521(a)-(c) of the Bankruptcy Code requires debtors to file various documents including a schedule of assets and liabilities, a schedule of current income and current expenditures, and a statement of the debtor's financial affairs. These documents must be filed within 15 days of the commencement of the case unless the court grants an extension of time. Fed. R. Bankr. P. 1007(c). Failure to file the documents required under section 521(a)(1) within 45 days may result in automatic dismissal of the case. 11 U.S.C. § 521(i).

STATEMENT OF THE FACTS

I. Statutory Framework - Overview of 11 U.S.C. § 526

In 2005, Congress passed the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA or 2005 Act), Pub. L. No. 109-8, 119 Stat. 23. The 2005 Act was "a comprehensive package of reform measures" designed "to improve bankruptcy law and practice by restoring personal responsibility and integrity in the bankruptcy system and ensure that the system is fair for both debtors and creditors." H.R. Rep. No. 31, 109th Cong., 1st Sess. Pt. 1, at 2 (2005) (*House Report*). Described by the House Committee as "the most comprehensive set of [bankruptcy] reforms in more than 25 years," *id.* at 3, the 2005 Act both modified the substantive standards for bankruptcy relief and adopted new measures intended to curb a variety of abusive practices that Congress concluded had come to pervade the bankruptcy system.

After extensive hearings, Congress determined that misleading and abusive practices by bankruptcy professionals, including attorneys, had become a substantial cause of unnecessary bankruptcy petitions and had sometimes jeopardized debtors' ability to obtain a discharge of their debts. For example, Congress heard evidence that a civil enforcement initiative undertaken by the United States Trustee Program had "consistently identified *** misconduct by attorneys and other professionals" as among the sources of abuse in the bankruptcy system. *House Report* at 5 (citation omitted). Congress responded to that evidence by "strengthening professionalism standards for attorneys and others who assist consumer debtors with their bankruptcy cases." *Id.* at 17.

The 2005 Act added or enhanced a variety of regulations on bankruptcy professionals' conduct. Those regulations are intended to protect the clients and prospective clients of bankruptcy professionals, the creditors of clients who do enter bankruptcy, and the bankruptcy system. The regulations require additional disclosures to clients about their rights and the professional's responsibilities; they protect clients against being overcharged, or charged for services never provided; and they discourage misuse of the bankruptcy system. *See*, *e.g.*, 11 U.S.C. § 110(b)-(h), 11 U.S.C. §§ 526-528, 11 U.S.C. § 707(b)(4)(C)-(D).

Many of the regulations apply to debt relief agencies. Under the Bankruptcy Code's definition, "any person" becomes a debt relief agency by providing "any bankruptcy assistance" for a fee to a consumer debtor, known as an "assisted person." 11 U.S.C. § 101(12A). An "assisted person" is "any person whose debts consist primarily of consumer debts and the value of whose nonexempt property is less than" an inflation-adjusted sum, currently $164,250. 11 U.S.C. § 101(3); *see* 11 U.S.C. § 104(a); 72 Fed. Reg. 7082 (2007). "Bankruptcy assistance" includes, *inter alia*, "advice, counsel, document preparation, or filing, or attendance at a creditors' meeting or appearing in a case or proceeding on behalf of another or providing legal representation with respect to a case or proceeding under this title." 11 U.S.C. § 101(4A).

Section 526 of title 11 sets out four basic rules of professional conduct for debt relief agencies, each of which protects clients against specific unethical practices. Section 526(a)(1) requires debt relief agencies to perform all promised services. Section 526(a)(2) prohibits debt relief agencies from advising assisted persons to make statements that are untrue or misleading in seeking bankruptcy relief. Section 526(a)(3) precludes debt relief agencies from misrepresenting the services they will provide or the benefits and risks attendant to filing for bankruptcy. Section 526(a)(4) restricts debt relief agencies from advising an assisted person or prospective assisted person to incur more debt in contemplation of such person filing a bankruptcy case. The United States Supreme Court has granted certiorari to determine whether attorneys are debt relief agencies and whether section 526(a)(4) is constitutional. *Milavetz, Gallop & Milavetz, P.A. v. United States*, 129 S. Ct. 2766 (2009).

The principal remedy for violations of section 526 is a civil action by the debtor to recover his “actual damages,” including any fees already paid. 11 U.S.C. § 526(c)(2). For violations of section 526, the statute also authorizes state attorneys general to sue for debtors' actual damages or for injunctive relief to prevent violations. 11 U.S.C. § 526(c)(3). For intentional or recurring violations of that provision, the bankruptcy court may also impose an injunction or “an appropriate civil penalty,” either on its own motion or at the request of the United States Trustee or the debtor. 11 U.S.C. § 526(c)(5).

II. Factual Background

A. The Court Entered an Order Setting a Hearing and Detailing the Court’s Concern with Mr. Fahey’s Conduct and Setting Forth Possible Penalties.

On June 29, 2009, United States Bankruptcy Judge Wesley Steen issued an Order to Open Miscellaneous Docket for Consideration of Disciplinary Action and for Consideration of § 526(c)(5) and Other Orders and requested participation by the United States Trustee and the chapter 13 trustee. In the order, the court stated that it had noticed that clients represented by Mr. Edward Fahey “almost uniformly fail to obtain confirmation of their chapter 13 plans.” (Dkt. No. 1 at 1). To confirm this observation, the Court reviewed the publicly available docket sheets to compare all chapter 13 cases filed by Mr. Fahey from January 1, 2006 to March 31, 2009 to chapter 13 cases filed by two other Laredo attorneys who file “almost all” the remaining chapter 13 cases in Laredo. (*Id.*). The Court noted that the results were “striking.” (*Id.*). Of Mr. Fahey’s 62 cases filed during that period, 92 percent had been dismissed, compared to 28 percent of the 226 cases that the other two attorneys filed. In addition, the Court stated that 47 percent of the cases were dismissed for failure to file documents required by section 521 of the Bankruptcy

Code and 61 percent were dismissed within 90 days after the petition commencing the case was filed. For the other attorneys, the percentages for those categories were **two percent and six percent respectively**. (*Id.*).

The Court noted that this order was not the first notice that Mr. Fahey had of the Court's concerns with his practice. It stated that in August 2008, the Court had warned Mr. Fahey that if "this conduct persists the Court will refer the matter to the Chief District Judge with the recommendation that Mr. Fahey be removed from the list of attorneys allowed to practice in this Court. In addition, the Court may take action under 11 U.S.C. § 526 to enjoin Mr. Fahey and his paralegal from violating provisions of that section." (Dkt. No. 1 at 5).

Following that admonition, from September 1, 2008 through March 31, 2008, the Court noted that all 11 of the chapter 13 cases that Mr. Fahey had filed had been dismissed. In contrast, the other two Laredo attorneys had only two percent of their 47 cases filed during that time dismissed. (Dkt. No. 1 at 5-6).

The Court then noted the costs to debtors and the system when bankruptcy cases are not filed correctly. (Dkt. No. 1 at 6-7). The Court noted that Mr. Fahey's clients file second and third cases approximately 15 times more frequently than other attorneys. (*Id.*). In addition to increasing the work required by the Clerk's office and the chapter 13 trustee's office, when cases are dismissed and have to be refiled, debtors must pay another $274 filing fee. (*Id.*). Moreover, debtors may lose the valuable benefit of the automatic stay in a second or third case. 11 U.S.C. § 362(c)(3)-(4). (*Id.* at 7)

B. The Court Considered and Denied Mr. Fahey's Pre-Hearing Motions.

Prior to the hearing, Mr. Fahey filed three motions: (1) A Motion for Recusal, which he amended in Respondent's First Amended Motion for Recusal, (Dkt. Nos. 4, 5) (2) Respondent's

Motion to Dismiss for Want of Subject Matter Jurisdiction, (Dkt. No. 6) and (3) Respondent's Motion to Dismiss for Insufficiency of Process and Insufficiency of Service of Process. (Dkt. No. 7).

At the hearing on July 15, 2009, prior to considering any evidence, the court heard the three motions and denied them all. (Dkt. No. 9 at 19-28). The bankruptcy court spent significant time explaining its ruling on subject matter jurisdiction. The court recognized that section 526 of the Bankruptcy Code did not itself provide jurisdiction but that the Court had jurisdiction to act under section 526 through 28 U.S.C. §§ 1334(b) and 157 and the standing order of the Court referring bankruptcy cases to the bankruptcy judges and matters related to them. (*Id.* at 19). Specifically, the court noted that 28 U.S.C. § 1334 provides that district courts have jurisdiction under all proceedings arising under title 11, the United States District Court for the Southern District of Texas has referred all proceedings arising under title 11 to the bankruptcy courts pursuant to 28 U.S.C. § 157, and that this action under section 526 of the Bankruptcy Code was a proceeding arising under title 11. (*Id.* at 19-20). The Court also noted that the miscellaneous proceeding was also filed under the Code of Judicial Conduct, the ethical responsibilities to report misconduct that apply to Judge Steen as an attorney in the State of Texas, under Fed. R. Bankr. P. 9011, and under Section 105 of the Bankruptcy Code. (*Id.* at 22).

In discussing the recusal motion, the Court noted that the motion contained innuendo, incomplete statements, and misleading statements. (Dkt. No. 9 at 23). The Court iterated that it had no animosity for Mr. Fahey. (*Id.* at 25) Instead, it stated that it has had to issue a number of orders against Mr. Fahey because he has not changed his behavior after several warnings. (*Id.*)

> The essence of your motion is that you think I have some deep seated and real animosity against you. I do not. What you are confusing is that I expect you on behalf of your client to file pleadings and to file complete pleadings and to file correct pleadings and to file them on time. . . .

> When I issued these orders, and I . . . began to issue them a long time ago, I expected that things would change, and they didn't.
>
> . . .
>
> What I did in the order that opened this miscellaneous docket number was to track your case filings from September 1, '08 through the end of April to see if the conduct and the performance had been any different. They were not.
>
> …
>
> I find conduct that's largely the same as it was before August of 2008 and that's why I want to give you an opportunity today to show me that I'm wrong.

(*Id.* at 25-27).

C. The Evidence Revealed That Mr. Fahey's Cases Were Dismissed at Far Greater Rates than His Counterparts and That Many of His Bankruptcy Petitions Contained Inaccuracies.

As part of the order setting the hearing, the Bankruptcy Court invited the chapter 13 trustee and the U.S. Trustee to participate. Both the chapter 13 trustee and the U.S. Trustee filed exhibit lists with the Court before the hearing, and Mr. Fahey stipulated to the admission of all the evidence. (Dkt. Nos. 2, 3, and 6 at 29, 33.)

The evidence submitted by the U.S. Trustee and the chapter 13 trustee showed:

- 86 percent of chapter 13 cases filed by Mr. Fahey from July 1, 2006 through July 1, 2009 had been dismissed compared to 35.6 percent of all other chapter 13 cases filed in Laredo during that time. (Dkt. No. 2, Exhs. 2-3)
- 70 percent of chapter 13 cases filed by Mr. Fahey from July 1, 2006 through July 1, 2009 were dismissed before confirmation compared to 26.4 percent of all other chapter 13 cases filed in Laredo during that time. *Id.*[4]

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[4] These statistics require a little math. The chapter 13 trustee provided two charts - Exhibit 2 showing the results of Mr. Fahey's chapter 13 cases and Exhibit 3 showing the results of all Laredo chapter 13 cases, including Mr. Fahey's cases. By subtracting Mr. Fahey's numbers from the Laredo cases, one can calculate the percentages for all non Fahey cases.

- Of the 12 consumer chapter 7 cases filed by Mr. Fahey from January 1, 2006 through July 1, 2009, nine (75%) were dismissed for failure to cure a deficiency or pay the filing fee. (Dkt. No. 3, Exh. 4)
- In 23 bankruptcy petitions, either Pedro Lopez, Mr. Fahey's paralegal, signed the petitions above Mr. Fahey's name with the notation, "with permission," or the petition contained no signature in the box where the attorney is required to sign. (Dkt. No. 3, Exh. 4, Dkt. No. 2, Exh. 5, Dkt. No. 9 at 31, 35)
- In seven petitions, debtors did not disclose previous filings. (Dkt. No. 14 at 3)
- In 12 cases, the petition stated that the full filing fee was attached, but it was not paid upon filing. (*Id.*)
- 16 petitions stated that the debtor had taken a credit counselling course but no certificate was filed before the case was dismissed. (*Id.*)

Mr. Fahey did not dispute the evidence; he only argued that it did not show he was at fault. (Dkt. No. 9 at 74) He explained his high dismissal rate as a factor of dealing "on the border with people who are largely uneducated" and "most of them don't even speak English." (*Id.*).

When the Court asked him how to explain his high dismissal rate compared to that of other Laredo attorneys, he blamed "the very small sample size" even though the bankruptcy court had compared all of his 66 cases with all 226 cases filed by two other attorneys. (*Id.* at 76).

D. The Court Made Detailed Findings About Mr. Fahey's Failures and Inadequacies to Support the Need for an Injunction.

The court's findings were detailed. The court found that Mr. Fahey demonstrated a clear and consistent pattern of (1) failing to file information required by Bankruptcy Code § 521 when he filed cases, (2) inadequate representation of clients, (3) lack of expertise in bankruptcy law,

(4) unreasonable delegation of authority and responsibility to a contract paralegal that resulted in harm to debtors, (5) filing pleadings with false statements, and (6) failure to comply with the Bankruptcy Code and applicable rules. (Dkt. No. 16 at 1).

Among the many facts upon which the court based its findings, the Court found that Mr. Fahey's chapter 13 cases were dismissed at far higher rates than his colleagues. (Dkt. No. 16 at 2-3). The Court found that only about 23 percent of his individual chapter 7 cases resulted in discharges for his clients. (*Id.* at 4).

From testimony elicited from Mr. Fahey's paralegal, Pedro Lopez, the Court concluded that most of the work and decisions related to Mr. Fahey's clients were delegated to Mr. Lopez without substantial supervision. (Dkt. No. 16 at 4). The court found that 16 of the 18 petitions introduced into evidence by the chapter 13 trustee were "problematic or outright false" because they (1) stated filing fees had been paid when they had not, (2) failed to disclose previous bankruptcy cases, or (3) certified that the debtor had received credit counseling but the required certificate was never filed. (*Id.* at 3). The court found that Mr. Fahey repeatedly violated the court's ECF Procedures. (*Id.* at 5-6). Finally, the court listed the repeated admonitions to counsel about problems in his practice. (*Id.* at 8-11).

Based on these findings, the Court concluded that "[c]ounsel has displayed, and continued to display, incompetence and disregard for the statutes and rules that govern bankruptcy practice." (Dkt. No. 16 at 12). The Court thus found that the "protection of the public" required that Mr. Fahey be enjoined from further bankruptcy practice until he can comply with the "statute, rules, and ethics requirements" for attorneys. *Id.* The Court then enjoined Mr. Fahey from representing "Assisted Persons" based on his authority under sections

105 and 526 of the Bankruptcy Code, the Court's inherent powers, and Fed. R. Bankr. P. 9011. (*Id.*)

STANDARD OF REVIEW

On appeal "conclusions of law are reviewed *de novo*, findings of fact are reviewed for clear error, and mixed questions of fact and law are reviewed *de novo*." *In re National Gypsum Co.*, 208 F. 3d. 498, 503 (5th Cir. 2000). Mr. Fahey's issues four through seven raise only legal issues and should be reviewed *de novo*. Motions for recusal are reviewed for abuse of discretion. *Andrade v. Chojnacki*, 338 F.3d 448 (5th Cir. 2003). A judge abuses his discretion in denying recusal where "a reasonable man, cognizant of the relevant circumstances surrounding a judge's failure to recuse would harbor legitimate doubts about that judge's impartiality." *United States v. Bremers*¸ 195 F.3d 221, 226 (5th Cir. 1999). Mr. Fahey's issue six states that the evidence was insufficient to support the penalty. That issue raises a question of fact and should be reviewed for clear error.

SUMMARY OF ARGUMENT

The bankruptcy court did not err in enjoining Mr. Fahey from providing "Bankruptcy Assistance" to "Assisted Persons" under its inherent powers, under sections 105 and 526 of the Bankruptcy Code, and under Fed. R. Bankr. P. 9011.

Mr. Fahey's complaints fall into four categories. First, he argues that the Court did not have the authority to issue its ruling because it lacked jurisdiction. That argument fails, however, because the Court had jurisdiction under 28 U.S.C. § 157(a) and (b). Further courts have the inherent authority to fashion appropriate sanctions for conduct that abuses the judicial process. *Chambers* v. *NASCO, Inc.*, 501 U.S. 32, 43 (1991). Bankruptcy courts also have authority to issue appropriate sanctions for abuse of the judicial process under 11 U.S.C. § 105. *Marrama v.*

Citizens Bank of Mass., 549 U.S. 365 (2007). Federal Rule of Bankruptcy Procedure 9011 allows bankruptcy courts to sanction attorneys on the court's own initiative. Finally, Congress specifically provided that "[n]otwithstanding any other provision of Federal law and in addition to any other remedy provided under Federal or State law," the Court could on its own motion impose "an appropriate civil penalty" if it found that a person "engaged in a clear and consistent practice" of violating 11 U.S.C. 526. Thus, not only did the bankruptcy court have jurisdiction to consider the matter, it had explicit authority upon which it based its ruling.

Second, Mr. Fahey argues that the facts do not support the ruling. However, Mr. Fahey has waived this argument by failing to raise it in the bankruptcy court and by failing to include it in his statement of the issues on appeal. Mr. Fahey did not object to any of the evidence submitted by the U.S. Trustee or the chapter 13 trustee nor did he object to the evidence put forth by the Court in setting the hearing. The facts showed that 86 percent of chapter 13 cases filed by Mr. Fahey from July 1, 2006 through July 1, 2009 had been dismissed compared to 35.6 percent of all other chapter 13 cases filed in Laredo during that time. (Dkt. No. 2, Exhibits 2-3). Moreover, 70 percent of those cases filed by Mr. Fahey from July 1, 2006 through July 1, 2009 were dismissed before confirmation compared to 26.4 percent of all other chapter 13 cases filed in Laredo during that time. (*Id.*). The facts also showed that the petitions Mr. Fahey filed were often inaccurate and either signed by his paralegal or no one at all. Based on these facts and much more, the court did not clearly err in determining that Mr. Fahey had shown a clear and consistent pattern of not providing proper services to his clients.

Mr. Fahey then complains that he was not personally served with a summons and a complaint. However, section 526 of the Bankruptcy Code provides that courts may act on their own motion. In bankruptcy parlance, that makes this matter a "contested matter" instead of an "adversary proceeding." While an adversary proceeding requires a complaint and service of a summons pursuant to Fed. R. Bankr. P. 7003 and 7004, a contested matter is governed by Fed. R. Bankr. P. 9014 and does not require service of a complaint or summons. Likewise, proceedings under the courts' inherent powers, 11 U.S.C. § 105, or Federal Rule of Bankruptcy Procedure 9011 do not require a complaint or a summons. Here, the Bankruptcy Court's detailed order setting forth the time of the hearing and the matters that would be considered provided Mr. Fahey with sufficient notice.

Finally, Mr. Fahey argues that Judge Steen should have recused himself. However, recusal is not required where the court's opinions are formed from court related matters. Here all of Judge Steen's concerns arose from actions taken by Mr. Fahey as a bankruptcy lawyer representing clients in his court. Thus recusal was not required.

ARGUMENT

I. The Bankruptcy Court Had Jurisdiction and Authority to Enter the Order.

Mr. Fahey argues that the Bankruptcy Court lacked subject matter jurisdiction to hear the proceeding involving him. That contention lacks merit. The Bankruptcy Court had jurisdiction under 28 U.S.C. §§ 1334(b) and 157(a) and (b) because it arose under title 11. The Bankruptcy Court also had the authority to initiate the proceeding and to enjoin Mr. Fahey for his pattern of violating 11 U.S.C. § 526. The U.S. Supreme Court's precedents have "recognized the 'well-acknowledged' inherent power of a court to levy sanctions in response to abusive litigation practices." *Roadway Express, Inc.* v. *Piper*, 447 U.S. 752, 765 (1980) (citing *Link* v. *Wabash R.R.*, 370 U.S. 626, 632 (1962)). "It has long been understood that '[c]ertain implied powers must necessarily result to our Courts of justice from the nature of their institution,' powers 'which cannot be dispensed with in a Court, because they are necessary to the exercise of all others.'" *Chambers* v. *NASCO, Inc.*, 501 U.S. 32, 43 (1991) (quoting *United States* v. *Hudson*, 11 U.S. (7 Cranch) 32, 34 (1812)).

"A primary aspect" of a court's inherent powers is "the ability to fashion an appropriate sanction for conduct which abuses the judicial process." *Chambers*, 501 U.S. at 44-45. A court thus confronted with a party's bad faith misconduct in the course of proceedings has the discretion to respond with a variety of sanctions. *Id.* at 45. And just as courts can sanction parties for their bad faith conduct, so too can courts sanction parties' counsel for the same types of misconduct. *Roadway Express*, 447 U.S. at 766 ("The power of a court over members of its bar is at least as great as its authority over litigants."). Here, the bankruptcy court imposed a sanction—suspending Mr. Fahey from accepting new cases before that court until he demonstrates his ability and intent to represent clients competently and to comply with the Bankruptcy Code and applicable rules.

A bankruptcy court also has the power to regulate the practice of bankruptcy law before it under 11 U.S.C. § 105 ("Power of Court"). In particular, subsection (a) allows a bankruptcy court to take "any action or mak[e] any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process." *Id.* These powers can be exercised when "necessary or appropriate" to carry out the provisions of Title 11, a broad grant of authority. *United States v. Sutton*, 786 F.2d 1305, 1308 (5th Cir. 1986); *In re Sadkin*, 36 F.3d 473, 479 (5th Cir. 1994) (stating that section 105(a) "provides equitable powers for the bankruptcy court to use at its discretion"). This power is only circumscribed to the extent that it cannot be used in contradiction to another provision in the Bankruptcy Code. *Marrama v. Citizens Bank of Massachusetts*, 549 U.S. 365, 375 (2007).

The key word in this subsection of 105 is "prevent," which is a forward-looking concept. Congress gave bankruptcy courts the authority to take prophylactic measures to prevent a party from engaging in future abuse. *Bessette v. Avco Fin. Serv., Inc.*, 230 F.3d 439, 444-45 (1st Cir. 2000); *see In re Sanchez,* 372 B.R. 289, 311-12 (Bankr. S.D. Tex. 2007). The legislative history of section 105(a) provides support for this broad interpretation. The House Report concerning the 1978 Bankruptcy Code, which superseded the Bankruptcy Act, states that section 105(a) was enacted to remove any doubt concerning the power of the new bankruptcy courts. Section 105(a) was enacted "for the sake of continuity from current law and ease of reference, and to cover any powers traditionally exercised by a bankruptcy court that are not encompassed by the All Writs [Act]." H.R. Rep. No. 95-595, at 316-17 (1978), reprinted in 1978 U.S.C.C.A.N. 5963, 6273-74. Such broad power to protect the integrity of the bankruptcy system includes barring an attorney from practicing before a court until he or she can demonstrate a proper level of competence.

In addition, section 526(c)(5) provides that bankruptcy courts can take precisely the actions the bankruptcy court took here.

> Notwithstanding any other provision of Federal law and in addition to any other remedy provided under Federal or State law, if the court on its own motion . . . finds that a person intentionally violated this section, or engaged in a clear and consistent pattern or practice of violating this section, the court may
> . . .
> (B) impose an appropriate civil penalty against such person.

Congress contemplated here that courts could bring their own motion when they saw a clear and consistent pattern or practice of violating section 526(c).[5] Mr. Fahey argues that a

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[5] Contrary to Mr. Fahey's assertion, the term "court" includes the bankruptcy court. In the same Act that created section 526, Congress amended a similar provision that provides penalties for people who negligently or fraudulently prepare bankruptcy petitions. *See* 11 U.S.C. § 110. Congress struck the requirement that the bankruptcy court certify the matter to the district court

court may not raise this issue unless an action is already pending by a debtor or state attorney general under section 526. The "[n]otwithstanding" clause and the "in addition to" clause, however, provide that the actions and remedies set forth in this provision are independent of, and not limited by, other rules or statutes. Section 526(c)(5) stands on its own as a source of authority for courts to control problem attorneys. *See In re Norman,* No. 06-70859-A, 2006 WL 3053309 (Bankr. E.D. Va. October 24, 2006) (rejecting argument that only state official can bring enforcement action because section 526(c)(5) states that the court and U.S. trustee may do so as well); *In re Reyes*¸ No. 07-20689-CIV, 2007 WL 6082567 (S.D. Fla. Dec. 19, 2007) (recognizing that bankruptcy courts have jurisdiction under section 526(c)(5) to "initiate enforcement actions and punish violations of the debt relief provisions.").

Mr. Fahey suggests that the provisions of 11 U.S.C § 526 do not apply to him because lawyers are not "debt relief agencies." However, the Fifth Circuit has held that attorneys are debt relief agencies. *Hersh v. United States,* 553 F.3d 743 (5th Cir. 2008).[6]

Finally, Federal Rule of Bankruptcy Procedure 9011(c) provides authority for bankruptcy courts to enter appropriate sanctions upon attorneys. Possible sanctions under Rule of Bankruptcy Procedure 9011 include suspending an attorney from practicing before the bankruptcy courts in the district. *In re Brooks-Hamilton*, 400 B.R. 238, 249 (B.A.P. 9th Cir. 2009), *citing Weissman v. Quail Lodge, Inc.*, 179 F.3d 1194, 1997 (9th Cir. 1999).

Based on all these sources of authority, the bankruptcy court thus had both jurisdiction and authority to enjoin Mr. Fahey from practicing before the bankruptcy court until he

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so that the district court could assess statutory penalties and provided that "the court" shall assess the penalty, thereby authorizing the bankruptcy court to handle the matter itself. *See* BAPCPA, Pub. L. No. 109-8, 119 Stat. 23, 61 (2005).

[6] This issue is currently pending before the United States Supreme Court in the case of *Milavetz, Gallop & Milavetz, P.A. v. United States*, 129 S. Ct. 2766 (2009).

demonstrated the ability and intent to represent clients competently and to comply with the Bankruptcy Code and all applicable rules.

II. The Court Had Sufficient Evidence to Support Its Actions.

A. Mr. Fahey has waived this issue on appeal.

Mr. Fahey contends that the evidence presented in the miscellaneous proceeding was insufficient to support the court's decision to enjoin him from practice. Mr. Fahey has forfeited that issue on appeal because he did not raise it in the bankruptcy court. "It is a bedrock principle of appellate review that claims raised for the first time on appeal will not be considered." *Steward Glass & Mirror, Inc. v. U.S. Auto Glass Discount Ctrs., Inc.*, 200 F.3d 307, 316-17 (5th Cir. 2000); *see also Hormel v. Helmering*, 312 U.S. 552, 556 (1941) ("Ordinarily an appellate court does not give consideration to issues not raised below.")

In addition, the Fifth Circuit has held that an issue is not preserved for appeal under Federal Rule of Bankruptcy Procedure 8006 unless the appellant includes the issue in its statement of issues on appeal, even if the issue had been argued in the bankruptcy court and ruled on by that court. *Zimmerman v. Jenkins (In re GGM, P.C.)*, 165 F.3d 1026, 1031-32 (5th Cir. 1999). Pursuant to Rule 8006, Mr. Fahey filed his statement of the issues to be presented. He stated, "Appellant's principal issue on appeal is whether the initiation and prosecution of the proceeding were beyond the bankruptcy court's power to act." (Dkt. No. 23). Mr. Fahey's argument regarding the sufficiency of the evidence is unrelated to the "bankruptcy court's power to act." Therefore, he has waived that issue on appeal.

B. The Evidence in the Record Supported the Court's Ruling.

Mr. Fahey objects that there was insufficient evidence to support the finding that he should be enjoined from representing consumer debtors until such time as he demonstrated the ability and intent to represent clients competently and to comply with the Bankruptcy Code and all applicable rules. (Appellant's Brief at 22). To the contrary, the evidence was overwhelming.

The evidence showed:

- 86 percent of chapter 13 cases filed by Mr. Fahey from July 1, 2006 through July 1, 2009 had been dismissed compared to 35.6 percent of all other chapter 13 cases filed in Laredo during that time. (Dkt. No. 2, Exhs. 2-3)
- 70 percent of chapter 13 cases filed by Mr. Fahey from July 1, 2006 through July 1, 2009 were dismissed before confirmation compared to 26.4 percent of all other chapter 13 cases filed in Laredo during that time. *Id.*
- Of the 12 consumer chapter 7 cases filed by Mr. Fahey from January 1, 2006 through July 1, 2009, nine (75%) were dismissed for failure to cure a deficiency or pay the filing fee. (Dkt. No. 3, Exh. 4)
- In 23 bankruptcy petitions, either Pedro Lopez, Mr. Fahey's paralegal, signed the petitions above Mr. Fahey's name with the notation, "with permission," or the petition contained no signature in the box where the attorney is required to sign. (Dkt. No. 3, Exh. 3, Dkt. No. 2, Exh. 5, Dkt. No. 9 at 31, 35)
- In seven petitions, debtors did not disclose previous filings. (Dkt. No. 14 at 3)
- In 12 cases, the petition stated that the full filing fee was attached, but it was not paid upon filing. (*Id.*)
- 16 petitions stated that the debtor had taken a credit counselling course but no certificate was filed before the case was dismissed. (*Id.*)

The evidence showed that Mr. Fahey neglected his cases. The significant disparity between the number of his cases that were dismissed and the number of other practitioners' cases that were dismissed could lead a court to only one conclusion – that Mr. Fahey engaged in a clear and consistent pattern or practice of providing poor representation to his clients. Here, the court need only find that the bankruptcy court did not clearly err in reaching this conclusion.

III. The Court Was Not Required to File a Complaint or Serve a Summons To Consider Sanctions Against Mr. Fahey for His Conduct in Cases Before the Court.

Mr. Fahey complains that he was not personally served with a summons and a complaint. However, Section 526 provides that courts may act on their own motion. While an adversary proceeding in a bankruptcy case requires a complaint and service of a summons pursuant to Fed. R. Bankr. P. 7003 and 7004, motions in bankruptcy cases are governed by Federal Rules of Bankruptcy Procedure 9013 and 9014 and do not require service of a complaint or summons. Instead, motions need only be "served in the matter provided for service of a summons and complaint by Rule 7004" and must provide reasonable notice and an opportunity for a hearing. Fed. R. Bankr. P. 9014(a), (b). Here, the Bankruptcy Court's detailed order setting forth the time of the hearing, the matters that would be considered, and the potential sanctions provided Mr. Fahey with sufficient notice.

Likewise, Federal Rule of Bankruptcy Procedure 9011 does not require an adversary proceeding. Instead, by its terms it only requires "notice and a reasonable opportunity to respond." Fed. R. Bankr. P. 9011(c). As explained above, the Court's order setting the hearing and the hearing, itself, provided sufficient notice and opportunity to respond. In any event, Mr. Fahey never argued that he did not have notice or a reasonable time to respond. Moreover, section 105 allows courts to act *sua sponte* to prevent an abuse of process. 11 U.S.C. 105(a). Thus, the Court did not err in issuing the injunction without the filing of a complaint or service of a summons.

IV. The Bankruptcy Court Did Not Abuse Its Discretion in Denying Applicant’s Motion for Recusal.

A party may request the recusal of a judge in two situations. First, recusal is required if a judge has a “personal bias or prejudice concerning a party, or personal knowledge of disputed evidentiary facts concerning the proceeding,” 28 U.S.C. § 455(b)(1). Second, recusal is required when a judge’s “impartiality might reasonably be questioned.” 28 U.S.C. § 455(a). Whenever a judge's partiality might reasonably be questioned, “recusal is required under § 455(a), irrespective whether the circumstance is covered by § 455(b).” *Andrade v. Chojnacki*, 338 F.3d 448, 454 (5th Cir. 2003) *citing Liljeberg v. Health Servs. Acquisition Corp.,* 486 U.S. 847, 860 n.8 (1988).

The origin of a judge's alleged bias is critical. *See Andrade*, 338 F.3d at 454. The U.S. Supreme Court applied a common-law doctrine commonly called the “extrajudicial source” doctrine to the interpretation of section 455. *Liteky v. United States*, 510 U.S. 540, 554 (1994). This rule distinguishes events occurring, or opinions expressed, in the course of judicial proceedings from those that take place outside of the litigation context and holds that the former “rarely require recusal.” *Andrade*, 338 F.3d at 455. “[O]pinions formed by the judge on the basis of facts introduced or events occurring in the course of the current proceedings, or of prior proceedings, do not constitute a basis for a bias or partiality motion unless they display a deep-seated favoritism or antagonism that would make fair judgment impossible.” *Liteky*, 510 U.S. at 554.

Recusal was unnecessary in this case because Judge Steen’s views about Mr. Fahey were based only on conduct by Mr. Fahey in cases before him, not extrajudicial evidence. The evidence shows that Judge Steen questions about the quality of Mr. Fahey’s representation of his clients always arose in cases that were filed in his court. Nothing in the record suggests that

Judge Steen's action in this case were based on anything extrajudicial. Previous contempt citations do not render a judge unfit to try a party for new misconduct. *In re Marshall*, 549 A.2d 311, 314 (D.C. 1988) (citing cases). Even the complaint that Mr. Fahey filed against Judge Steen does not require his recusal. *See In re Mann*, 229 F.3d 657, 658 (7th Cir. 2000) (judge is not required to automatically disqualify herself simply because a disgruntled litigant has filed a misconduct complaint against her). Such a rule would permit a litigant to manipulate the system to obtain a judge he perceives as more sympathetic by alleging judicial misconduct against the judge assigned to his case. *Id.* Therefore Judge Steen did not abuse his discretion in denying the motion for recusal.

CONCLUSION

For these reasons, the United States Trustee respectfully asks this Court to affirm the order enjoining Edward Fahey from providing Bankruptcy Assistance to Assisted Persons (as those terms are defined in the Bankruptcy Code) until he demonstrates the ability and intent to represent clients competently and to comply with the Bankruptcy Code and all applicable rules.

Dated: November 20, 2009　　Respectfully submitted,

CHARLES F. McVAY
UNITED STATES TRUSTEE
REGION 7

By: **/s/ Kevin M. Epstein**
KEVIN M. EPSTEIN
Trial Attorney
Department of Justice
Attorney-in-Charge
Texas Bar No. 00790647
Southern District No. 437129
Office of the U.S. Trustee
615 E. Houston St., Room 533
P.O. Box 1539
San Antonio, Texas 78295-1539
(210) 472-4640
(210) 472-4649 Fax

Of Counsel

Ramona D. Elliott, General Counsel
P. Matthew Sutko, Assoc. General Counsel
Catherine Sevcenko, Trial Attorney
Executive Office for United States Trustees
Department of Justice
20 Massachusetts Avenue, N.W.
Suite 8000
Washington, D.C. 20530
(202) 307-1399

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing **BRIEF OF THE APPELLEE CHARLES F. McVAY UNITED STATES TRUSTEE** was served upon the parties listed below through either the Notice of Electronic Filing from the Court's Electronic Filing System or by United States Mail, first class, postage prepaid on this the 20th day of November, 2009.

/s/ Kevin M. Epstein
KEVIN M. EPSTEIN
Trial Attorney

Edward P. Fahey, Jr.
1800 Victoria, Suite 2
Laredo, TX 78040

William Heitkamp
Chapter 13 Trustee
9821 Katy Freeway, Suite 590
Houston, TX 77024

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WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE
[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]
In re Edward P. Fahey (Edward P. Fahey v. United States Trustee)

2. ("CO") ***CURRENT*** COURT
[E.g., "CTA9"]
S. D. Tex.

3. ("CCN") ***CURRENT*** CASE NO.
No.: 5:09-cv-00100

4. ("PCN") ***PRIOR*** CASE NO. - & COURT
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Kevin M. Epstein, Noah Schottenstein, Catherine B. Sevcenko, P. Matthew Sutko, Ramona D. Elliott, Charles F. McVay
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s)
&
√ Any Miscellaneous ***BACKGROUND***

- Whether the U.S. Trustee had standing to participate in this appeal.

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UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF TEXAS
LAREDO DIVISION

IN RE:	§	
	§	**CIVIL ACTION NO. 5:09-cv-00100**
EDWARD P. FAHEY	§	
	§	**BANKRUPTCY CASE 5:09-MP-501**
APPELLANT	§	

OBJECTION TO FAHEY'S MOTION TO STRIKE APPELLATE BRIEF OF U.S. TRUSTEE

COMES NOW, CHARLES F. MCVAY, THE UNITED STATES TRUSTEE for Region 7 ("UST"), through the undersigned counsel, and files this objection to Fahey's Motion to Strike Appellate Brief of U.S. Trustee. In support of this objection, the UST would show as follows:

1. Mr. Fahey has a history of alleged inadequate representation of his clients before the United States Bankruptcy Court for the Southern District of Texas. *See* Dkt. No. 16 at 8-12.[1] Following alleged misconduct in two active bankruptcy cases — In re Hernandez, No. 09-50070, and In re Armendariz, No. 09-50069 — the bankruptcy court opened a miscellaneous docket to consider disciplinary action against Mr. Fahey. *Id.* at 1. The Court asked for the participation of the United States Trustee in its show-cause order. Dkt. No. 1.

I. THE UNITED STATES TRUSTEE HAD STANDING TO PARTICIPATE BELOW AND IN THIS APPEAL.

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[1] All references to the record in this brief are to the entry number on the bankruptcy court's docket and are denoted as "Dkt. No. _."

2. Mr. Fahey argues that the United States Trustee did not have standing to appear below and does not have standing to be heard on this appeal because a proceeding concerning misconduct before the bankruptcy court and non-compliance with the Bankruptcy Code and Rules is not a proceeding that arises under title 11. He argues that no petition seeking bankruptcy relief was filed in the miscellaneous docket to which his disciplinary action was assigned, meaning it cannot be considered a bankruptcy case.

3. Mr. Fahey's brief appears to confuse two concepts: jurisdiction and standing. If the bankruptcy court has jurisdiction to open a miscellaneous docket, and it does under 28 U.S.C. 1331 and 28 U.S.C. 157, then the United States Trustee has standing to participate in the docketed proceeding. 11 U.S.C. 307.

4. The issue of whether the bankruptcy court had jurisdiction has already been briefed by both Fahey and the U.S. Trustee. Briefly, the acts giving rise to the disciplinary hearing occurred within bankruptcy cases, so this matter is a core proceeding under the jurisdiction of the bankruptcy court. *In re Southmark Corp.*, 163 F.3d 925, 930 (5th Cir. 1999) (recognizing that a core proceeding exists when (1) a substantive provision of title 11 is asserted or (2) if the proceeding could only arise within the context of the bankruptcy system). To the extent that Mr. Fahey is trying to re-visit the jurisdiction issue under the guise of an attack on the U.S. Trustee's standing, his motion is improper and should be denied.

5. To the extent that Mr. Fahey is attacking the U.S. Trustee's standing itself, his argument is without merit. Section 307 of title 11 states that "[t]he United States trustee may raise and may appear and be heard on any issue in any case or proceeding under this title." As Congress has stated, the United States Trustees are the watchdogs of the

bankruptcy system, with a role like "that of a prosecutor" responsible for enforcing the bankruptcy laws and "ensuring that bankruptcy cases are conducted according to law." H.R. Rep. No. 95-595 at 109, *reprinted in* 1978 U.S.C.C.A.N. 5963, 6070-72.

6. All the circuit courts that have interpreted section 307 have held that the statute confers standing upon the United States Trustee like that of a party in interest. *Thompson v. Greenwood*, 507 F.3d 416, 420 n.3 (6th Cir. 2007) ("The United States Trustee is an 'interested party by statute.'"). Accordingly, the United States Trustee has standing to protect the public interest in a fair bankruptcy system because "a good watchdog guards the interests of those for whom it watches." *In re Revco D.S., Inc.*, 898 F.2d 498, 500 (6th Cir. 1990). Furthermore, under section 307, the United States Trustee may appear at any stage of the proceedings, as either a party or amicus. *Stanley v. McCormick, Barstow, Sheppard, Wayte & Carruth (In re Donovan Corp.)*, 215 F.3d 929, 929-30 (9th Cir. 2000); *see also United States Trustee v. Price Waterhouse*, 19 F.3d 138, 141 (3d Cir. 1994) (Alito, J.) (holding that because the United States Trustee may appear and be heard on any issue, the United States Trustee had standing to appeal). Accordingly, the United States Trustee has a statutory right to participate in any case or proceeding arising under title 11, including this appeal.

7. In particular, the United States Trustee has an important role to play in disciplinary matters. For instance, the United States Trustee can move for the disgorgement of attorney fees if a debtor's attorney has not provided necessary and beneficial services to the debtor. 11 U.S.C. § 330. The United States Trustee can also move for an order to show cause why sanctions should not be imposed on an attorney or debtor. *See Wayland v. McVay (In re Tbyrd Enters. LLC)*, No. 08-41104, 2009 WL

3199593 (5th Cir. Oct. 7, 2009) (affirming imposition of sanctions initially sought by the United States Trustee in *In re Tbyrd Enters., L.L.C.*, Case No. 06-30078 (Bankr. S.D. Tex.), Docket Nos. 22, 39, and 83). Making sure that debtors receive adequate representation during bankruptcy is a core function of the United States Trustee.

II. *ATTORNEYS AT LAW & DEBT RELIEF AGENCIES* IS NOT ON POINT AND DOES NOT SUPPORT MR. FAHEY'S ARGUMENT.

8. In contrast to the body of case law cited above, Mr. Fahey relies on one federal case from the District Court of Southern District of Georgia for the proposition that a collateral proceeding does not concern title 11 unless a bankruptcy petition has been filed under that docket number. *In re Attorneys at Law and Debt Relief Agencies*, 353 B.R. 318 (S.D. Ga. 2006). In that case, on the day most of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 became effective, the bankruptcy court opened a miscellaneous docket to issue a standing order interpreting the phrase "debt relief agency" in 11 U.S.C. § 101(12A) to exclude bankruptcy attorneys. *Id.* at 320. The United States Trustee objected to the court's reading of the 2005 Act. *Id.* The district court held that the United States Trustee did not have standing because he was challenging a general order. *Id.* at 323. It then dismissed the case because it could not consider the construction of the new statutory provision until a case or controversy arose from its enforcement. *Id.*

9. Mr. Fahey's cited authority is not relevant to this appeal. *Attorneys at Law* differs markedly from this case. It involved a pre-emptive interpretation of the 2005 bankruptcy reforms unrelated to any specific bankruptcy case – in essence a *sua sponte* advisory opinion. *Attorneys at Law* was issued without notice to anyone, without a hearing, without evidence or argument by counsel, and did not address anyone's conduct in any bankruptcy cases. In contrast, Mr. Fahey received notice of this disciplinary proceeding,

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the court held an evidentiary hearing and entertained argument at the hearing and through briefs, and the court addressed specific conduct related to alleged misconduct in various bankruptcy proceedings. The two cases are not comparable.

III. CONCLUSION

10. For the reasons stated above, the brief of the United States Trustee should not be struck.

WHEREFORE, the U.S. Trustee requests that this Court enter an order denying the Motion to Strike and for all other relief as is just and proper.

Respectfully submitted,

CHARLES F. McVAY
UNITED STATES TRUSTEE
REGION 7

By: **/s/ Kevin M. Epstein**
Kevin M. Epstein
Attorney-in-Charge
Texas Bar No. 00790647
Southern District No. 437129
Office of the U.S. Trustee
615 E. Houston St., Room 533
P.O. Box 1539
San Antonio, TX 78295-1539
(210) 472-4640
(210) 472-4649 Fax

Of Counsel

Ramona D. Elliott, General Counsel
P. Matthew Sutko, Assoc. General Counsel
Catherine Sevcenko, Trial Attorney
Department of Justice
20 Massachusetts Avenue, N.W., Suite 8000
Washington, D.C. 20530
(202) 307-1399

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing **OBJECTION TO FAHEY'S MOTION TO STRIKE APPELLATE BRIEF OF U.S. TRUSTEE** was served upon the parties listed below through either the Notice of Electronic Filing from the Court's Electronic Filing System or by United States Mail, first class, postage prepaid on this the 23rd day of December, 2009.

/s/ Kevin M. Epstein
KEVIN M. EPSTEIN
Trial Attorney

Edward P. Fahey, Jr.
1800 Victoria, Suite 2
Laredo, TX 78040

William Heitkamp
Chapter 13 Trustee
9821 Katy Freeway, Suite 590
Houston, TX 77024

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WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*
In re Harold J. Farris (Harold J. Farris v. Donald F. Walton, United States Trustee, Region 21)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*
11th Cir.

3. ("CCN") ***CURRENT*** CASE NO.
No.: 09-10354-AA

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*
No.: 1:08-cv-3722-CAP
Court: N.D. Ga.
(Identify judge & cite, if any)

5. ("SO") ***SOURCE***
U.S. TRUSTEES

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*
Filed: June 3, 2009
Type: Brief of the Appellee Donald F. Walton, United States Trustee, Region 21

7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*
James H. Morawetz, John Sheahan, P. Matthew Sutko, Guy G. Gebhardt
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***
• 1.) Did the bankruptcy court abuse its discretion in denying the appellant's motions to reset the hearing on the motions to dismiss his bankruptcy case? 2.). Assuming the issue has been preserved for review by this court, did the bankruptcy court abuse its discretion in dismissing the case?

10. PATH TO FILE LOCATION:
(e.g., S:\OGC\BRFBANK\etc...)

11. DO YOU RECOMMEND POSTING IN UST BRIEFBANK?
| x | YES | | NO
NAME: Linda Figueroa
DATE:

APPEAL NO. 09-10354-AA

UNITED STATES COURT OF APPEALS
FOR THE ELEVENTH CIRCUIT

IN RE: HAROLD J. FARRIS,

DEBTOR.

HAROLD J. FARRIS,

Appellant,

v.

DONALD F. WALTON, UNITED STATES TRUSTEE, REGION 21,

Appellee.

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF GEORGIA (Case No.1:08-CV-3722-CAP)

BRIEF OF APPELLEE DONALD F. WALTON, UNITED STATES TRUSTEE, REGION 21

GUY G. GEBHARDT
Assistant United States Trustee
JAMES H. MORAWETZ
Trial Attorney
United States Department of Justice
Office of the United States Trustee
Suite 362, Russell Federal Building
75 Spring Street, SW
Atlanta, GA 30303
Tel: (404) 331-4437
Fax: (404) 331-4464

Farris v. Walton, Appeal No. 09-10354-AA

CERTIFICATE OF INTERESTED PERSONS

Pursuant to Eleventh Circuit Rule 26.1-1, Appellee Donald F. Walton, United States Trustee, Region 21, submits the following list of trial judges, attorneys, and others who have an interest in the outcome of this appeal:

1. Farris, Harold J., Appellant.
2. Gebhardt, Guy G., Assistant United States Trustee.
3. Marshall, James R., chapter 7 trustee for Harold J. Farris.
4. Morawetz, James H., Trial Attorney.
5. Murphy, Margaret H., United States Bankruptcy Judge.
6. Ochs, Martin P., Trial Attorney.
7. Pannell, Charles A., Jr., United States District Judge.
8. Walton, Donald F., United States Trustee for Region 21, Appellee.

DATED: June 3, 2009.

/s/ ***James H. Morawetz***

James H. Morawetz, Trial Attorney
Georgia Bar No. 521900
United States Department of Justice
Office of the United States Trustee
Suite 362, Russell Federal Building
75 Spring Street, SW
Atlanta, GA 30303
Tel: (404) 331-4437
Fax: (404) 331-4464

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FEDERAL RULES

STATEMENT OF BASIS OF APPELLATE JURISDICTION

This is an appeal from a final order of the United States District Court for the Northern District of Georgia entered under 28 U.S.C. § 158(a)(1), affirming an order of the United States Bankruptcy Court for the Northern District of Georgia denying motions by the Appellant to reset a hearing on two motions to dismiss his chapter 7 bankruptcy case. This Court has jurisdiction over the appeal under 28 U.S.C. §§ 158(d)(1) and 1291.

STATEMENT OF ISSUES

1. Did the bankruptcy court abuse its discretion in denying the Appellant's motions to reset the hearing on the motions to dismiss his bankruptcy case?

2. Assuming the issue has been preserved for review by this Court, did the bankruptcy court abuse its discretion in dismissing the case?

STATEMENT OF THE CASE

This appeal arises from the dismissal of the Appellant's chapter 7 bankruptcy case pending in the United States Bankruptcy Court for the Northern District of Georgia. The Appellant, Harold J. Farris ("**Farris**" the "**Debtor**," or the "**Appellant**"), commenced the case by filing a *pro se* petition for relief under chapter

13 of the Bankruptcy Code on August 2, 2004. (BC# 1).[1] On May 18, 2007, the bankruptcy court entered an order converting the case to a chapter 7 case. (BC# 184). In doing so the court noted that Farris had filed a motion to dismiss the chapter 13 case but had withdrawn that motion after being advised by the court that, because a creditor in the case had filed a motion for relief from the automatic stay, a voluntary dismissal would result in his being ineligible under 11 U.S.C. § 109(g) to file another bankruptcy case for 180 days.[2] *Id.*

On August 29, 2008, the chapter 7 trustee filed a motion to dismiss the case based on allegations that Farris had failed and refused during the period of more than a year that the case had been pending in chapter 7 to submit to examination under oath at a section 341(a) meeting of creditors. (BC# 265). Along with that motion to

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[1] The United States Trustee has been advised that the record before this Court consists of the entire record in the district court, including those portions of the bankruptcy court record that were transmitted to the district court by the bankruptcy court. Documents filed of record in the bankruptcy court are identified by the designation, "BC#," followed by the docket number assigned to the document by the clerk of the bankruptcy court.

[2] 11 U.S.C. § 109(g) provides, in pertinent part, as follows:

> Notwithstanding any other provision of this section, no individual or family farmer may be a debtor under this title who has been a debtor in a case pending under this title at any time in the preceding 180 days if —
> ...
> (2) the debtor requested and obtained the voluntary dismissal of the case following the filing of a request for relief from the automatic stay provided by section 362 of this title.

dismiss, the chapter 7 trustee filed a notice scheduling a hearing on the motion for October 7, 2008, at 2:45 p.m. (BC# 266), and a certificate of service stating that he had served this notice on "all parties in interest as shown on the mailing matrix maintained by the Clerk of this Court." (BC# 267).

On September 2, 2008, the United States Trustee filed a motion to dismiss the case on the same grounds alleged by the chapter 7 trustee.[3] (BC# 268). The United States Trustee likewise filed a notice scheduling a hearing on his motion for October 7, 2008 at 2:45 p.m., along with a certificate of service certifying that he had served Farris with a copy of the notice by mail at 1577 South Gordon Street, Atlanta, GA 30310. (BC# 269). As shown by the respective case dockets, that address (the "**South Gordon Street Address**") was Farris's address of record throughout the pendency of the case in the bankruptcy court, and it has continued to be his address of record on appeal, both in the district court and in this Court.

On September 11, 2008, the bankruptcy court entered its own notice scheduling a hearing on the two motions to dismiss for October 7, 2008, at 2:45 p.m. (BC# 270), and on September 13, 2008, the clerk of the bankruptcy court filed a certificate of service certifying that Farris had been served with a copy of that hearing notice by

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[3] In the alternative, the United States Trustee requested an extension of the deadlines for filing a motion to dismiss for abuse under 11 U.S.C. § 707(b), *see* Fed. R. Bankr. P. 1017(e) , or a complaint objecting to Farris's discharge under 11 U.S.C. § 727, *see* Fed. R. Bankr. P. 4004(b).

mail at the South Gordon Street Address. (BC# 271).

A hearing was held on the motions to dismiss on October 7, 2008, as scheduled and noticed. (BC# 285). The chapter 7 trustee and counsel for the United States Trustee appeared at that hearing, but Farris did not. (BC# 273, 285). On October 8, 2008, one day after that hearing and prior to the entry of the order granting the motions, Farris filed a "Motion to Reset Hearing," in which he asserted that the copy of the hearing notice mailed to him by the bankruptcy court had not reached him until the evening of October 7, 2008, making it impossible for him to attend the hearing. (BC# 272). Farris attached to this motion a copy of an envelope stamped with the notation, "Return to Sender, Not Deliverable as Addressed, Unable to Forward," which he asserted was the envelope in which his service copy of the court's hearing notice had been enclosed. This envelope was not, however, addressed to Farris. Rather, it was addressed "First Family Financial, 4362 Peachtree Road, Atlanta, GA." (BC# 272). Farris did not allege that the additional notices mailed to him by the chapter 7 trustee and the United States Trustee were in any way defective nor, for that matter, has he ever asserted that he did not receive those notices in a timely manner.

The bankruptcy court entered an order dismissing the case on October 14, 2008. (BC# 273). On October 21, 2008, Farris filed a "Motion for Reconsideration and Renewed Motion to Reset Hearing Date" (BC# 275), in which he reiterated his request that the hearing on the motions to dismiss be reset. The bankruptcy court entered its order denying that request on October 28, 2008, finding that Farris had "failed to allege any facts to rebut the presumption that he received proper and timely notice of the October 7, 2008 hearing." (BC# 277). On November 7, 2008, Farris filed a timely notice of appeal from that order. (The "**Notice of Appeal**," BC# 279). The only ruling to which the Notice of Appeal makes reference is the "Order Denying Debtor's Motion to Reset Hearing" entered on October 28, 2008 (BC# 277).

The district court entered an order affirming the decision of the bankruptcy court on January 14, 2009 (DC# 6),[4] and on January 16, 2009, the Appellant filed a timely notice of appeal to this Court from that order. (DC# 9).

Farris did not file an opening brief in this Court. Instead, on April 20, 2009, he filed a "Petition for Rehearing En Banc" (the "**En Banc Petition**"), in which he alleged various acts of bias and misconduct by the judges and trustees both in the present bankruptcy case and in a 1995 bankruptcy case in which he was the debtor. In the En Banc Petition, Farris appears to challenge the dismissal of the present bankruptcy case on grounds of judicial bias and inadequate legal representation. In addition, he appears to argue that the bankruptcy court erred in the present case by

---

[4] Documents in the record on appeal that were originally filed in the district court are identified by the designation, "DC#," followed by the docket number assigned to the document by the clerk of the district court.

refusing to conduct hearings on his allegations of fraud pertaining to his prior bankruptcy case.

On April 28, 2009, this Court dismissed the present appeal based on Farris's failure to file a timely opening brief. On April 29, 2009, Farris filed a "Motion and Brief To Set Aside Dismissal" in this Court in which he requested that his En Banc Petition be treated as an opening brief. On May 4, 2009, this Court granted that request and reinstated the appeal.

STATEMENT OF FACTS

There are no facts of record in this case tending to refute the three certificates of service showing that Farris received timely notice of the October 7, 2008, hearing on the motions to dismiss filed by the chapter 7 trustee and the United States Trustee. Further, Farris acknowledges at pages 4 through 5 of his En Banc Petition that, although he attended each of the four meeting of creditors that were scheduled during the period of more than a year that the case was pending as a chapter 7 case, he failed to be sworn and examined at any of those meetings.

APPLICABLE STANDARD OF REVIEW

In an appeal arising from an order entered by the bankruptcy court in a bankruptcy case, both the district court and the court of appeals apply a clearly erroneous standard to the bankruptcy court's findings of fact and conduct a *de novo* review of conclusions of law. *See* Fed. R. Bankr. P. 8013; *In re Omine*, 485 F.3d 1305, 1311 (11th Cir. 2007); *In re Paschen*, 296 F.3d 1203, 1205 (11th Cir. 2002).

SUMMARY OF ARGUMENT

The sole issue presented for review by this appeal is whether the bankruptcy court correctly determined that Farris received proper notice of the hearing on the motions to dismiss.[5] The bankruptcy court's finding that Farris had failed to rebut the presumption that he received proper and timely notice of the hearing (BC #277) is supported by the record and was not "clearly erroneous." Moreover, even assuming the bankruptcy court's order dismissing the case is before this Court for review in this appeal, that ruling likewise is supported by the record and did not constitute an abuse of the court's discretion.

---

[5] Although Farris raises numerous issues in his En Banc Petition, the only order of the bankruptcy court to which his notices of appeal to the district court (BC #279) and to this Court (DC #90) make reference is the bankruptcy court's October 28, 2008 order denying his requests to reset the hearing on the motions to dismiss. Farris did not appeal the underlying order of the bankruptcy court dismissing his case. Consequently, his various allegations of judicial bias and misconduct are not properly before this Court.

ARGUMENT

A. The Bankruptcy Court Did Not Abuse Its Discretion in Denying Farris's Motions to Reset the Hearing on the Motions to Dismiss.

The record shows that the chapter 7 trustee, the United States Trustee, and the bankruptcy court each mailed a notice to Farris advising that a hearing on one or both of the motions to dismiss his case was scheduled for October 7, 2008, at 2:45 p.m. According to the certificates of service, these notices were mailed on August 29, 2008 (BC# 267), September 2, 2008 (BC# 269), and September 13, 2008 (BC# 271), respectively.

Service by mail was authorized by Fed. R. Bankr. P. 9014, which was applicable to the motions to dismiss pursuant to Fed. R. Bankr. P. 1017(f)(1), which provides as follows: "Rule 9014 governs a proceeding to dismiss or suspend a case, or to convert a case to another chapter, except under §§ 706(a), 1112(a), 1208(a) or (b), or 1307(a) or (b)." The statutory basis for the motions to dismiss in this case was 11 U.S.C. § 707(a), which authorizes bankruptcy courts to dismiss chapter 7 cases after notice and hearing "for cause," including "unreasonable delay by the debtor that is prejudicial to creditors ..." *See* p. 11, *infra*.

Fed. R. Bankr. P. 9014 applies to "contested matters," and subsection (b) of that Rule provides that motions commencing such matters "shall be served in the manner provided for service of a summons and complaint by Rule 7004." Under Fed. R.

Bankr. P. 7004 (b)(9), service may be made upon the debtor after a voluntary petition is filed and until the case is dismissed or closed "by mailing a copy of the summons and complaint to the debtor at the address shown in the petition or to such other address as the debtor may designate in a filed writing." Fed. R. Bankr. P. 9014(b) further provides that "[a]ny paper served after the motion shall be served in the manner provided by Rule 5(b) F.R.Civ.P." One manner in which a paper may be served pursuant to Fed. R. Civ. P. 5(b)(2) is by "(C) mailing it to the person's last known address – *in which event service is complete upon mailing*." (Emphasis supplied). Likewise, Fed. R. Bankr. P. 9006(e) provides that "[s]ervice of process and service of any paper other than process or of notice by mail is complete on mailing."

"Proper mailing creates a presumption of receipt." *Rendina v. Northrop*, 399 B.R. 376, 380 (Bankr. D. Vt. 2008) (citing *Hagner v. United States*, 285 U.S. 427, 430, 52 S. Ct. 417, 76 L. Ed. 861 (1932)). *Accord Konst v. Florida East Coast Ry. Co.*, 71 F.3d 850, 851 (11th Cir. 1996) ("The common law has long recognized a rebuttable presumption that an item properly mailed was received by the addressee.") An allegation of non-receipt is not, by itself, sufficient to rebut this presumption. *Id. See also In re Botello*, 86 F. App'x. 330, 331 (9th Cir. 2004) (citing *Osborn v. Ricketts (In re Ricketts)*, 80 B.R. 495, 497 (B.A.P. 9th Cir. 1987)). Instead,

> [t]he presumption may be overcome only by evidence that the mailing was not accomplished. ... To determine if a mailing was accomplished,

> courts consider such facts as whether the notice was correctly addressed, was properly mailed, and included proper postage, whether a proper certificate of service was filed, and whether the notice was returned to the clerk's office.

Rendina v. Northrop, 399 B.R. at 380 (citations omitted).

As noted by the bankruptcy court in its Order Denying Debtor's Motion to Reset Hearing (BC# 277), Farris offered no explanation of the relevance of the envelope attached to his original Motion to Reset Hearing (BC# 272), which was not addressed to him but rather to "First Family Financial, 4362 Peachtree Road, Atlanta, GA." While the clerk's certificate of service shows that a copy of the bankruptcy court's hearing notice was mailed to First Family Financial at that address, it also shows that a copy was mailed to Farris at the South Gordon Street Address, which was his address of record throughout the bankruptcy case and has continued to be his address on appeal, both in the district court and it this Court. Farris has cited to nothing in the record that refutes any of the three certificates of service reciting that three separate notices were mailed to him at his address of record advising him of the time and date of the hearing on the motions to dismiss, nor has he otherwise provided this Court with any basis upon which to conclude that he did not receive proper notice of the hearing. The bankruptcy court's determination that Farris was provided with proper notice of the hearing was supported by the record and was not "clearly erroneous."

B. There Is No Basis for the Court to Reverse the Bankruptcy Court's Order Dismissing the Case.

Even if he had preserved the issue for review on appeal, Farris has likewise provided this Court with no basis to conclude that the bankruptcy court abused its discretion in dismissing his bankruptcy case.

11 U.S.C. § 707(a) provides, in pertinent part, that the court may dismiss a chapter 7 case "only after notice and a hearing and only for cause, including — (1) unreasonable delay by the debtor that is prejudicial to creditors ..."[6] This section "does not articulate an exclusive list of factors a court is to consider in making a determination of whether cause exists for dismissing a bankruptcy case, or to limit the court's discretion." *In re Hess,* 347 B.R. 489, 496 (Bankr. D. Vt. 2006) (citing *In re Zick,* 931 F.2d 1124, 1126 (6th Cir. 1991), *In re Atlas Supply Corp.*, 857 F.2d 1061, 1063 (5th Cir. 1988), and *In re Horan*, 304 B.R. 42, 48 (Bankr. D. Conn. 2004)).

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[6] The entire text of § 707(a) is as follows:

> (a) The court may dismiss a case under this chapter only after notice and a hearing and only for cause, including —
>
> (1) unreasonable delay by the debtor that is prejudicial to creditors;
>
> (2) nonpayment of any fees or charges required under chapter 123 of title 28; and
>
> (3) failure of the debtor in a voluntary case to file, within fifteen days or such additional time as the court may allow after the filing of the petition commencing such case, the information required by paragraph (1) of section 521, but only on a motion by the United States trustee.

It is well settled that the decision to grant or deny a motion to dismiss a chapter 7 case lies within the discretion of the bankruptcy court. *See In re Sherman*, 441 F.3d 794, 813 (9th Cir. 2006); *In re Zick*, 931 F.2d at 1126; *In re Atlas Supply Corp.*, 857 F.2d at 1063; *Maixner v. Surratt-States (In re Maixner)*, 288 B.R. 815, 817 (B.A.P. 8th Cir. 2003); *In re Marra*, 179 B.R. 782, 785 (M.D. Pa. 1995); *In re Hess*, 347 B.R. at 496; *In re Foster*, 316 B.R. 718, 72 (Bankr. W.D. Mo. 2004). "An abuse of discretion arises when the district court's decision rests upon a clearly erroneous finding of fact, an errant conclusion of law, or an improper application of law to fact." *United States v. Baker*, 432 F.3d 1189, 1202 (11th Cir. 2005).

Farris has offered this Court no basis upon which to conclude that the bankruptcy court predicated its decision to dismiss his chapter 7 case upon a clearly erroneous finding of fact, an errant conclusion of law, or an improper application of law to fact. This case was pending in the bankruptcy court for over four years before it was dismissed, almost three years as a chapter 13 case and another 17 months as a chapter 7 case. At page 7 of his En Banc Petition, Farris asks this Court to "remand this case to the U.S. Bankruptcy Court and assign it to another Judge as a Chapter 13 case." However, Farris himself moved to dismiss the case while it was pending under chapter 13 and withdrew that motion only upon being informed by the bankruptcy court that, because a motion for relief from the automatic stay had been filed, a voluntary dismissal would result in his being ineligible under 11 U.S.C. § 109(g) to file another bankruptcy case for 180 days. (BC# 184).

Farris acknowledges at pages 4 through 5 of his En Banc Petition that he failed to be sworn and examined at any of the four meetings of creditors scheduled in the case during the period of more than a year that it was pending as a chapter 7 case. Farris had a statutory duty under 11 U.S.C. § 521(a)(3) to cooperate with the chapter 7 trustee[7] and a statutory duty under 11 U.S.C. § 343 to submit to examination under oath at the section 341(a) meeting of creditors.[8] These obligations are part and parcel of a debtor's duty to "fully disclose all information relevant to the administration of the bankruptcy case." *Eastern Diversified Distributors, Inc. v. Matus (In re Matus)*, 303 B.R. 660 (Bankr. N.D. Ga. 2004). The fulfillment of this duty is "crucial to the

---

[7] 11 U.S.C. § 521(a)(3) provides as follows:

> (a) The debtor shall –
>
> ...
>
> (3) if a trustee is serving in the case or an auditor serving under section 586 (f) of title 28, cooperate with the trustee as necessary to enable the trustee to perform the trustee's duties under this title ...

[8] 11 U.S.C. § 343 provides as follows:

> The debtor shall appear and submit to examination under oath at the meeting of creditors under section 341 (a) of this title. Creditors, any indenture trustee, any trustee or examiner in the case, or the United States trustee may examine the debtor. The United States trustee may administer the oath required under this section.

working of the bankruptcy system" and is a "cost imposed on the debtor for the benefit of obtaining bankruptcy relief." *In re Russell*, 392 B.R. 315, 358 (Bankr. E.D. Tenn. 2008).

Farris's repeated failure over the course of a year to submit to examination under oath at the section 341 meeting of creditors provided the bankruptcy court with ample basis to determine that cause existed for the dismissal of the case. *See In re Steinmetz Group Ltd.*, 85 B.R. 633 (Bankr. S.D. Fla. 1988) ("Debtor's attendance and availability for examination under oath at the meeting of creditors is mandatory") (citations omitted); *In re Martin-Trigona*, 35 B.R. 596, 601-02 (Bankr. S.D.N.Y. 1983); *In re McClure*, 69 B.R. 282, 286 (Bankr. D.Ind. 1987). *Accord In re Moses*, 792 F. Supp. 529, 531-32 (E.D. Mich. 1992) ("Case law ... supports the conclusion that dismissal may be premised on a debtor's failure to provide a trustee with necessary information"); *In re Peklo*, 201 B.R. 331, 333 (Bankr. D. Conn. 1996).

CONCLUSION

For these reasons, the United States Trustee respectfully requests the Court to enter an order affirming the district court's order affirming the order of the bankruptcy court.

Respectfully submitted this the __3d__ of June, 2009.

Prepared and submitted by:

By: ***/s/ Guy G. Gebhardt***
GUY G. GEBHARDT
Assistant United States Trustee
Georgia Bar No. 288550

By: ***/s/ James H. Morawetz***
JAMES H. MORAWETZ
Trial Attorney
Georgia Bar No. 521900

United States Department of Justice
Office of the United States Trustee
Suite 362, Russell Federal Building
75 Spring Street, SW
Atlanta, GA 30303
Tel: (404) 331-4437
Fax: (404) 331-4464

CERTIFICATE OF SERVICE

I certify that I am over the age of 18 and that on this date I caused two copies of the foregoing Brief of Appellee Donald F. Walton, United States Trustee, Region 21, to be deposited in the U.S. Mail, first class postage prepaid, addressed as follows:

Harold J. Farris
1577 South Gordon Street
Atlanta, GA 30310

This the 3d day of June, 2009.

/s/ ***James H. Morawetz***
JAMES H. MORAWETZ
Georgia Bar No. 521900
Attorney for Donald F. Walton,
United States Trustee , Region 21
E-mail: jim.h.morawetz@usdoj.gov
Tel: (404) 331-4437

BRIEF BANK — "SUMMARY SHEET"

Printed Mon-4/14/08 14:3

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*
U.S. Trustee v. Fieldstone Mortgage Company (UST v. In re Fieldstone Mortgage Company)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*
D. Md.

3. ("CCN") ***CURRENT*** CASE NO.
No.: 1:08-cv-00755-CCB

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*
No.: 1:06-cv-02055-CCB
Court: Bankr. Md.
(Identify judge & cite, if any)

5. ("SO") ***SOURCE***
U.S. TRUSTEES

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*
Filed: April 9, 2008
Type: Brief for the United States Trustee

7. **("AU")** ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*
Hugh M. Bernstein, Mark Neal, Walt Theus, P. Matthew Sutko
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s)

•Whether the bankruptcy court erred in authorizing Fieldstone to implement the KERP and thereby pay seven of its duly appointed corporate officers retention bonuses in excess of $400,000 without demonstrating compliance with § 503(c)(1) of the Bankruptcy Code.

&

√ Any Miscellaneous ***BACKGROUND***

10. PATH TO FILE LOCATION:
(e.g., S:\OGC\BRFBANK\etc...)

11. DO YOU RECOMMEND POSTING IN UST BRIEFBANK?
| x | YES | | NO
NAME: Linda Figueroa
DATE:

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MARYLAND
(Baltimore Division)

IN RE

FIELDSTONE MORTGAGE COMPANY,

DEBTOR.

Case No.: 1:08-cv-00755-CCB

BRIEF OF THE UNITED STATES TRUSTEE

W. Clarkson McDow, Jr.
United States Trustee
Region Four

Mark A. Neal
Assistant U.S. Trustee

Hugh M. Bernstein
Trial Attorney

Office of the United States Trustee
Baltimore Division
101 W. Lombard Street, Suite 2625
Baltimore, Maryland 21201
(410) 962-4300
Fax (410) 962-3537

Roberta A. DeAngelis
Acting General Counsel

P. Matthew Sutko
Associate General Counsel for Appellate Practice

Executive Office of the United States Trustee
Department of Justice
20 Massachusetts Avenue, N.W.
Washington D.C. 20530
(202) 307-1405

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TABLE OF AUTHORITIES

Cases

Statutes

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Other Authorities

W. Clarkson McDow, Jr., The United States Trustee for Region Four, which includes the District of Maryland (the "United States Trustee"), pursuant to Rules 8009 and 8010 of the Federal Rules of Bankruptcy Procedure, files this Brief of the United States Trustee.[1]

INTRODUCTION

In light of "glaring abuses of the bankruptcy system by the executives ... who lined their own pockets but left thousands of employees and retirees out in the cold,"[2] Congress enacted § 503(c)(1) of the Bankruptcy Code as part of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005. That provision placed significant restrictions upon the use of "Key Employee Retention Plans" ("KERPs"), a then-commonly used vehicle by which bankrupt corporations paid large bonuses to key executives under the guise of retaining necessary employees during reorganization. By enacting § 503(c)(1), Congress prohibited retention bonus payments by bankrupt corporations to their own corporate officers and other "insiders" absent the existence of statutorily enumerated circumstances.

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[1] United States Trustees are senior officials of the Department of Justice appointed by the Attorney General of the United States to "supervise the administration of [bankruptcy] cases." 28 U.S.C. §581 - 589. *See generally Morgenstern v. Revco D.S. Inc. (In re Revco D.S., Inc.)*, 898 F.2d 498, 500 (6th Cir 1990). United States Trustees serve as bankruptcy "watchdogs ... prevent[ing] fraud, dishonesty, and overreaching in the bankruptcy arena." *A-1 Trash Pickup v. United States Trustee (In re A-1 Trash Pickup)*, 802 F.2d 774, 775 (4th Cir. 1986) (quoting 989, 95th Cong.2d Sess. 88, 1978 U.S.C.C.A.N. 5787, 5963, 6049). As such, United States Trustees act in the "public interest ... ensuring that bankruptcy cases are conducted according to law." *In re Clark*, 927 F.2d 793, 795 (4th Cir. 1991). To this end, Congress has provided that "[t]he United States trustee may raise and may appear and be heard on any issue in any case or proceeding" under Title 11 of the United States Code. 11 U.S.C. 307. *See Clark*, 927 F.2d at 796.

[2] *See In re Dana Corp.*, 358 B.R. 567, 575 (Bankr. S.D.N.Y. 2006) (quoting floor statement of March 1, 2005, *reprinted in* 151 Cong. Rec. S 2200-02 at S2201).

In the latter half of 2007, Fieldstone Mortgage Company ("Fieldstone"), a sub-prime mortgage lender with over $121 Million in debts, laid off approximately 1,000 employees, filed bankruptcy, and promptly sought to institute a KERP paying seven of its highest ranking and highest paid officers retention bonuses exceeding $400,000 in exchange for 44 days' work. Because the KERP involved payments to corporate officers, the United States Trustee objected to its implementation on the grounds that the requisite showing under § 503(c)(1) was not made.

Rather than requiring compliance with § 503(c)(1), the bankruptcy court re-defined the term "officer" to exclude high level vice presidents, senior vice presidents and other generally recognized corporate officers who had been duly appointed by Fieldstone's board of directors as officers in accordance with Maryland law. The bankruptcy court's novel definition of the term "officer" ignores well-accepted principles of statutory construction, severely undercuts the Congressionally created protections of § 503(c)(1) and opens the flood-gates to excessive litigation and inconsistent determinations regarding the Bankruptcy Code's definitions in contravention of the Fourth Circuit's "clear preference for bright-line rules in this area of the law."[3]

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[3] *Butler v. David Shaw, Inc.*, 72 F.3d 437, 442 (4th Cir. 1996).

BASIS OF APPELLATE JURISDICTION

This Court has jurisdiction over this appeal under 28 U.S.C. § 158(a)(1) which provides: "[t]he district courts of the United States shall have jurisdiction to hear appeals ... from final judgments, orders and decrees."[4]

STATEMENT OF ISSUES PRESENTED AND STANDARD OF REVIEW

The issue presented for appeal in this case is whether the bankruptcy court erred in authorizing Fieldstone to implement the KERP and thereby pay seven of its duly appointed corporate officers retention bonuses in excess of $400,000 without demonstrating compliance with § 503(c)(1) of the Bankruptcy Code. As described below, the issue turns on a discrete legal question: Is a corporate officer who has been duly appointed by the corporation's board of directors an "insider" as that term is defined in § 101(31) of the Bankruptcy Code? Because the issue is a question of law, the standard of review is *de novo*. *Wolff v. United States*, 372 B.R. 244, 248-49 (D. Md. 2007).

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[4] The order being appealed is a final order because it fully and entirely disposed of the dispute over whether Fieldstone can implement and make payments under the KERP. In the bankruptcy context, the concept of finality "has traditionally been applied 'in a more pragmatic and less technical way ... than in other situations.'" *In re Computer Learning Ctrs., Inc.*, 407 F.3d 656, 660 (4th Cir. 2005) (quoting *A.H. Robbins Co., Inc. v. Piccinin*, 788 F.2d 994, 1009 (4th Cir. 1986), *and In re Amatex Corp*, 755 F.2d 1034, 1039 (3d Cir. 1985). "[O]rders in bankruptcy cases may be immediately appealed if they finally dispose of discrete disputes within the larger case." *Computer Learning Ctrs.*, 407 F.3d at 660 (quoting *In re Saco Local. Dev. Corp.*, 711 F.2d 441, 444 (1st Cir. 1983 (Breyer, J.)); *Steinberg v. Watt, Tieder, Hoffar,& Fitzgerald, LLP* (*In re Kora & Williams Corp.*), 348 B.R. 52, 55 (D. Md 2006).

STATEMENT OF THE CASE

A. Procedural History.

Fieldstone initiated this bankruptcy case on November 23, 2007, by filing a voluntary petition under Chapter 11 of the United States Bankruptcy Code. (*See* Petition, dkt. no. 1, at 1.) On January 10, 2008, Fieldstone filed a motion titled "Motion for Order Authorizing Debtor to Implement Employee Incentive Plan Pursuant to Sections 105, 363 and 503 of the Bankruptcy Code" (The "KERP Motion"). (*See* KERP Mot., dkt. no. 121.) The KERP Motion initially requested authorization to pay twenty-three of Fieldstone's remaining employees bonuses totaling $1,114,985.[5] (*Id.* at Ex. A) On February 6, 2008, the United States Trustee filed an opposition to the KERP Motion asserting that at least some of the employees subject to Fieldstone's request were "insiders" as that term is defined by the Bankruptcy Code and that with respect to those employees (i) the requested payments were subject to the requirements of § 503(c)(1) of the Bankruptcy Code, and (ii) Fieldstone failed to demonstrate compliance with that provision. (*See* Opp. to KERP Mot., dkt. no. 186 at ¶¶ 7, 16-20.)

Subsequent to Fieldstone's filing of the KERP Motion, but before the bankruptcy court's hearing on the KERP Motion, Fieldstone voluntarily withdrew its request with respect to two of its employees. (*See* Order Authorizing Retention Payments dated Feb. 8, dkt. no. 196.) Thereafter, Fieldstone and the United States Trustee agreed that fourteen

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[5] Prior to filing its petition, Fieldstone terminated approximately 1,000 employees. (*See* KERP Mot., dkt. no. 121, at ¶ 7; Tr. at 55, 65, 117.) The KERP Motion does not request authorization to make any payments to these employees. (*See* Tr. at 117.)

employees Fieldstone represented were not officers were not "insiders" and, thus, payments to those fourteen employees was not subject to the limitations of § 503(c)(1). *Id.* Fieldstone and the United States Trustee submitted a proposed consent order authorizing payment to the fourteen non-insider employees. *Id.* The bankruptcy court granted that consent order and it was entered on February 8, 2008. *Id.*

On February 20, 2008, the bankruptcy court held a hearing on the KERP Motion as it applied to the remaining seven employees. (*See* Tr. of Feb. 20, 2008 hearing, dkt. no. 373, hereinafter "Tr.", at 1.) On February 28, 2008, the bankruptcy court granted the KERP Motion.[6] (*See* Order Authorizing Debtor to Implement Employee Incentive Plan, dkt. no. 259.)

B. Statement of Facts.

Fieldstone is a corporation chartered in the State of Maryland. (*See* KERP Mot., dkt. no. 121 at ¶ 2.) Until the petition date, Fieldstone was a nationwide mortgage banking company originating and selling conforming and non-conforming (*i.e.*, sub-prime) mortgage loans secured by residential real property. (*See* KERP Mot., dkt. no. 121, at ¶¶ 3-5.)

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[6] In an effort to protect the assets of the bankruptcy estate from irretrievable dissipation, and to avoid the cost to the estate of potential litigation to recover those assets at a later date, the United States Trustee filed a motion for stay pending appeal. (*See* dkt. no. 261.) That motion was denied. (*See* dkt. no. 326.) Fieldstone has designated the stay motion, its opposition to the stay motion and the transcript of the hearing on the stay motion as part of the record of this appeal. Because all of these events occurred after the ruling on the KERP Motion, none of those materials were before the bankruptcy court when it made its decision. Thus, any attempt by Fieldstone to rely upon or cite to those materials is improper. *Alexander v. Jensen*, (*In re Alexander*), 239 B.R. 911, 913 (8th Cir. BAP 1999) (ordinarily, and absent extraordinary circumstances, an appellate court should only rely upon facts in existence at the time of the decision being appealed).

Fieldstone operated in all 50 states and the District of Columbia. As of July 2007, Fieldstone employed approximately 1,200 employees. (Tr. at 55, 116-17.)

Fieldstone's appearance of success, however, was an illusion. Like many sub-prime lenders, Fieldstone's excessive over-leveraging and failure to prepare for fluctuations in economic conditions landed it in what Fieldstone rather generously refers to as a "liquidity crisis." (*See* KERP Mot., dkt. no. 121 at ¶¶ 5-6.) Fieldstone's management initiated cost-cutting measures, including terminating more than 1,000 employees in late summer and fall of 2007. (*See* KERP Motion, dkt. no. 121, at ¶ 7; Tr. at 55, 65, 117.) Nevertheless, Fieldstone was unable to "resolve its liquidity crisis" and, on November 23, 2007, filed a voluntary petition under Chapter 11 of the Bankruptcy Code "to preserve and maximize the value of its assets for the benefit of creditors." (*See* KERP Motion, dkt. no. 121, at ¶ 8.) The corporate resolution authorizing Fieldstone to file for bankruptcy was executed by "Thomas S. Brennan, Secretary." (*See* Petition, dkt. no. 1, at 5.) At the time it filed for bankruptcy, Fieldstone owed creditors $121,342,790.00. (*See* Summary of Schedules, dkt. no. 105, at 1.)

In addition to its Petition, Fieldstone filed a Statement of Financial Affairs (the "SOFA") using official form 7. Page 10 of the SOFA provides, "I, declare under penalty of perjury that I have read the answers contained in the foregoing statement of financial affairs and any attachments thereto and that they are true and correct to the best of my knowledge information and belief." (*See* SOFA, dkt. no. 106, at 10.) The SOFA is signed, just below this statement, by "Michael J. Sonnenfeld, President and CEO." *Id.*

Question 21(b) on the SOFA asks Fieldstone to "list all officers and directors of the corporation." Among those listed in response to this question are the following employees:

Thomas Brennan	Vice President and Acting General Counsel[7]
Nancy Maradie	Vice President and Assistant Secretary Treasurer
Jennifer Bliden	Vice President
John Camp	Senior Vice President and Chief Information Officer
Jacqui Smith	Vice President
Bill Wolfe	Vice President
Teresa McDermott	Senior Vice President and Controller
Michael Sonnenfeld	President, CEO and Director
Walter Buczynski	Executive Vice President and Director.

(*See* SOFA, dkt. no. 106, at 9.) Each of these officers was covered by the KERP Motion.

Question 23 on the SOFA asks Fieldstone to "list all withdrawals or distributions credited or given to an insider ... during the one year immediately preceding the commencement of this case." *Id.* at 10 (emphasis omitted). As described, *infra*, the term "insider" is a defined term in the Bankruptcy Code. It is defined to include corporate officers. *See* 11 U.S.C. § 101(31). In response to Question 23, Fieldstone listed payments to, among others, the same officers identified above and covered by the KERP Motion:

Thomas Brennan	Vice President, Legal Counsel
Nancy Maradie	Vice President and Assistant Treasurer
Jennifer Bliden	Vice President, Systems
John Camp	Senior Vice President, CIO, Systems &Facilities
Jacqueline Smith	Vice President, Licensing
William Wolfe	Vice President, Facilities
Teresa McDermott	Senior Vice President, Controller
Michael Sonnenfeld	President and CEO
Walter Buczynski	Executive Vice President, Secondary Marketing.

(*See* SOFA, dkt. no. 106, at Ex. 23.)

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[7] It is undisputed that, in addition to these two positions, Mr. Brennan was also Fieldstone's Corporate Secretary. (*See* Tr. at 111, 116, 125.)

On January 10, 2008, Fieldstone filed the KERP Motion requesting court authorization to pay bonuses totaling $1,114,985.00 to twenty-three employees, including the those listed above. The stated purpose of these bonuses was "a retention program" designed to "retain and incentivize employees needed to maintain" Fieldstone's operations. (*See* KERP Mot., dkt. no. 121, at ¶ 9.) Under the plan requested in the KERP Motion, most of the employees covered by the motion would receive their bonuses in three equal installments - one on January 15, 2008, one on January 31, 2008, and the last one on February 28, 2008. *Id.* at ¶ 12 and Ex. A. In order to receive the bonuses, the employees covered by the KERP Motion "must have completed the services requested of it by [Fieldstone] and be in [Fieldstone's] employ as of the strike date ...." *Id.* at ¶ 12. In other words, the bonuses were designed to retain employees from January 15 through February 28, and any covered employee who remained employed for that forty-four days received the entire bonus.[8] The bonuses sought for the employees listed above who Fieldstone designated in its bankruptcy filings as corporate officers for this forty-four days' work were as follows:

Michael Sonnenfeld	$99,999
Walter Buczynski	$99,999
John Camp	$99,999
Teresa McDermott	$92,000
Thomas Brennan	$90,000
William Wolfe	$49,750
Jacqueline Smith	$45,000
Jennifer Bliden	$43,313
Nancy Maradie	$41,350.

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[8] Employees remaining only until January 15 would receive 1/3 of the bonus. Employees remaining until January 31 would receive 2/3 of the bonus. *Id.*

Id. at Ex. A.[9]

In response to an objection to the KERP Motion by the United States Trustee, Fieldstone voluntarily withdrew its request with respect to Sonnenfeld and Buczynski. Thereafter, Fieldstone and the United States Trustee agreed that fourteen employees Fieldstone represented were not officers were therefore not "insiders" and, thus, payment to those fourteen employees were not subject to the requirements of § 503(c)(1). (*See* Order Auth. Ret. Payments, dated Feb. 8, 2008, dkt. no. 196.) Fieldstone and the United States Trustee submitted a proposed consent order authorizing payment to the fourteen non-insider employees. *Id.* The bankruptcy court granted that consent order and it was entered on February 8, 2008. *Id.*

On February 20, 2008, the bankruptcy court held a hearing on the KERP Motion as it applied to the remaining seven employees. The sole testimony at the hearing was provided by Sonnenfeld. With respect to the seven employees at issue, Sonnenfeld's testimony was clear and unambiguous:

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[9] In addition to the bonuses being sought in the KERP Motion, these nine employees received the following compensation during the year preceding the bankruptcy (*i.e.*, the same time period during which Fieldstone terminated approximately 1,000 other employees):

Michael Sonnenfeld	$709,784
Walter Buczynski	$445,415
John Camp	$288,120
Teresa McDermott	$269,644
Thomas Brennan	$233,183
William Wolfe	$126,653
Jacqueline Smith	$109,554
Jennifer Bliden	$109,170
Nancy Maradie	$95,945.

(*See* SOFA, dkt. no. 106, at Ex. 23.)

Q: All of the seven are officers of the company appointed by the Board, is that correct?

A: Yes.

(*See* Tr. at 116.)

Despite the undisputed fact that each of these seven employees was appointed an officer by the board of directors, the bankruptcy court determined that they were not "officers" as that term is used in the Bankruptcy Code because they did not exercise sufficient control over the company or act like "traditional" officers, although the court did not express what such "traditional officers" actually do. (*See* Tr. at 140-43.)[10] The court expressed its reasoning as follows:

> [E]ven though the definition that [the United States Trustee] is pointing to identifies officers among a list of individuals who are characterized by the Bankruptcy Code definitions as insiders, the Court is not precluded by the terminology that is used from taking evidence from behind the titles that people hold in any given situation. And so I find, first of all, that these vice presidents, despite the title that they enjoy, are holders of honorary titles that have no relationship whatsoever to officers, traditional officers of a corporation or a company.
>
> * * * * *
>
> And so I understand what [The United States Trustee] was arguing about control, the question of whether they have control is not the issue. But the question is whether they are officers in the traditional sense, in the sense that they are making decisions,

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[10] Nowhere in the bankruptcy court's opinion or in Fieldstone's argument is the fact that these officers were appointed by Fieldstone's board of directors mentioned at all. Nevertheless, it does not appear that the bankruptcy court made a factual finding that the officers were not appointed by the board of directors. Given that the entirety of the evidence on the subject was the testimony by Fieldstone's president and CEO that all seven officers were, in fact, appointed by the board of directors and the admissions by Fieldstone in the SOFA that each was an officer, such a finding would be clearly erroneous. Fed. R. Bankr. P. 8013.

> they're acting on behalf of the corporation, they are in charge, they are insiders. And I find that none of these seven qualify as either officers or insiders.

(Tr. at 140-41.)

ARGUMENT

A. Statutory Framework.

Section 503(c)(1) of the Bankruptcy Code was enacted as part of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005. *In re Nellson Nutraceutical, Inc.*, 369 B.R. 787, 800 (Bankr. D. Del. 2007). It was enacted in response to "glaring abuses of the bankruptcy system by the executives of giant companies like Enron Corp, and WorldCom Inc. and Polaroid Corporation, who lined their own pockets but left thousands of employees and retirees out in the cold." (Floor Statement, quoted in *Dana Corp.*, 358 B.R. at 575.) The abuses at which the provision is aimed regularly manifest themselves in the guise of KERPs. *See* Lawrence P. King, *Collier on Bankruptcy*, § 503.17 (section 503(c)'s "purpose was to limit the scope of 'key employee retention plans'"). As one court has explained:

> All too often [KERPs] have been used to lavishly reward -- at the expense of the creditor body -- the very executives whose bad decisions or lack of foresight were responsible for the debtor's financial plight. But even where external circumstances rather than the executives are to blame, there is something inherently unseemly in the effort to insulate executives from the financial risks all other stakeholders face in the bankruptcy process.

In re U.S. Airways, Inc., 329 B.R. 793, 797 (Bankr. E.D. Va. 2005).

Section 503(c)(1) precludes payments under a KERP to "insiders" unless the payment is:

> (1) essential to the retention of the employee because the employee has a "bona fide job offer from another business at the same or greater rate of compensation";
>
> (2) the services provided by the employee are essential to the survival of the business; and
>
> (3) the amount of the payment is within the parameters set by the statute.

11 U.S.C. § 503(c)(1). Because, subject to only one exception, there was no evidence presented that any employee had a bona fide job offer from any other business, it is indisputable that if the seven officers are "insiders," the requirements of § 503(c)(1) were not satisfied in this case.[11]

The Bankruptcy Code defines the term "insider" by way of a non-exhaustive list. Pursuant to the Code, "insiders" of a corporation include, *inter alia*, any:

> (a) director of the debtor;
>
> (b) officer of the debtor;
>
> (c) person in control of the debtor; or
>
> (d) a relative of a director, officer or person in control of the debtor.

11 U.S.C. § 101(31). The list in § 101(31) is not exhaustive. *Butler v. David Shaw, Inc.*, 72 F.3d 437, 443 (4th Cir. 1996).

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[11] The one exception involved Thomas Brennan, Fieldstone's secretary and general counsel. Fieldstone's representative testified that Brennan received a job offer. (*See* Tr. 97.) No evidence was presented, however, as to the bona fides of that offer, the business that made the offer, or the amount of the offer. *Id.*

Persons expressly identified in § 101(31), *e.g.*, officers and directors, are referred to as "statutory insiders" and such persons always constitute "insiders." *In re Tarricone, Inc.*, 286 B.R. 256, 262 (Bankr. S.D.N.Y. 2002). Moreover, the statute is written disjunctively. Thus, directors and officers are "insiders" regardless of whether they are "in control of the debtor." *In re Public Access Technology.com, Inc.*, 307 B.R. 500, 505 (E.D. Va. 2004) ("[i]t is unnecessary for a court to determine whether an individual is ... both an officer and a person in control, as the statutory definition is clearly stated in the disjunctive"); *see also Magers v. Bonds (In re Bonds Distributing Co.)*, Case Nos. 97-52130C-7W; 98-6044, 2000 WL 33673768 at *3 (Bankr. M.D., March 31, 2000) (rejecting the argument that a corporate director who did not "act" like a director falls outside the plain meaning definition of an "insider").

B. Fieldstone's Officers are Subject to §§ 503(c)(1) and 101(31)(B)(ii) of the Bankruptcy Code Because they are Officers Under Maryland Law.

1. Section 503(c)(1) of the Bankruptcy Code imposes limitations upon the payments that can be made to "insiders." 11 U.S.C. § 503(c)(1). Under the Bankruptcy Code, corporate officers are insiders. 11 U.S.C. § 101(31)(B)(ii). Fieldstone's officers are insiders under § 101(31)(B)(ii) and subject to section 503(c)(1)'s restrictions because they are officers under Maryland law.

Maryland law applies to Fieldstone because it is a Maryland corporation. *See Miller v. U.S. FoodService, Inc.*, 405 F. Supp.2d 607, 615-16 (D. Md. 2005) (Maryland law controls the corporate governance of Maryland corporations); *Storetrax.com v. Gurland*, 397 Md. 37, 51-52, 915 A.2d 991, 999-1000 (Md. 2007) (same). Under Maryland law, Fieldstone's officers are just that - officers. Where a board of directors of a Maryland corporation appoints an officer, he or she is an officer under Maryland law. Md. Code Ann., Corps. & Ass'ns § 2-413(a) ("Unless the bylaws provide otherwise, *the board of directors shall elect the officers*") (emphasis added). Fieldstone's officers are board appointed so they are officers subject to §§ 101(31) and 503(c)(1) the Bankruptcy Code. (*See* Tr. at 116.)

There is nothing remarkable about this concept. "In corporate law, the term [officer] refers esp. to a person elected or appointed by the board of directors to manage the daily operations of a corporation, such as a CEO, president, secretary or treasurer." Bryan A. Garner, *Black's Law Dictionary* at 1117 (Eighth Ed. 2004). *Accord* 2 William Meade Fletcher, *Fletcher Cyclopedia of the Law of Private Corporations*, § 266 at 12 (Rev'd ed. 2006) ("[o]ne distinction between officers and agents of a corporation is the manner of their creation[; a]n office is created by the charter of the corporation, and the officers are appointed by the directors or the shareholders"). Here, the evidence is undisputed that each of the seven employees was duly appointed as a corporate officer by Fieldstone's board of directors. (*See* Tr. at 116.)

2. Both types of Fieldstone officers who seek payment under section 503(c)(1), vice presidents and the corporate secretary, are universally recognized as corporate officers. *See, e.g., Fletcher* § 269 at 30 ("[g]enerally, the officers of a corporation are enumerated in its bylaws and include a president, vice president, secretary, treasurer and sometimes others"); Harry G. Henn, *Handbook of the Law of Corporations and Other Business Enterprises*, at 433 (2d. ed. 1970) ("[t]he usual officers are president, one or more vice-presidents, treasurer, secretary, and in the case of a banking corporation, cashier"); 18B Am.Jur.2d, *Corporations*, § 1169 at 211 (2004) ("[v]arious positions within a corporation may be considered to be held by 'officers' and not mere employees -- such as president, vice president or certain managers"); *see also West of England Ship Owners Mut. Ins. Assoc (Luxemborg) v. McAllister Bros, Inc.*, 829 F. Supp. 122, 123 (E.D. Pa. 1993) ("[t]here is no serious dispute that an assistant vice president is an officer for purposes of service of process"). Thus, the bankruptcy court erred in concluding Fieldstone's vice presidents and corporate secretary were not officers. (*See* Tr. at 140: court below relied upon the erroneous belief that vice presidents are not corporate officers.)

Similarly, under numerous federal statutes the term "officer" is defined to include corporate vice presidents. *See, e.g.*, 12 U.S.C. § 24, (national banking associations may elect and define the duties of "vice presidents ... and other officers"). In creating the Agricultural Hall of Fame, the Aviation Hall of Fame, the Foundation of the Federal Bar Association, the National Council on Radiation Protection and Measurements, and the National Tropical Botanical Garden, all corporate bodies created under federal law, Congress specifically provided that those corporations' officers shall be:

> [A] president, *one or more vice presidents* ... a secretary, a treasurer, one or more assistant secretaries and assistant treasurers, and other officers as provided in the bylaws.

36 U.S.C. §§ 20104, 23104, 70504, 150904, 153504 (emphasis added). In creating the

National Education Association of the United States, another corporation created under federal law, Congress provided that the officers shall be:

> [A] president, *one or more vice presidents*, a secretary, a treasurer, and the members of a board of directors, an executive committee, and any other boards, councils, and committees, and other officers, as provided in the bylaws.

36 U.S.C. § 151104 (emphasis added). And, in establishing the Navy Sea Cadets Corp, yet another federally created corporation, Congress provided that the officers shall be:

> [A] president, *one or more vice presidents* as provided in the constitution and bylaws, a secretary, a treasurer, and other officers as provided in the constitution and bylaws.

36 U.S.C. § 154104 (emphasis added).

3. Finally, there can be no doubt on the status of Fieldstone's officers because Fieldstone affirmatively identified each of them on Fieldstone's SOFA, under penalty of perjury, as both a corporate officer and an "insider." (*See* SOFA, dkt. 106, at question 21 and Ex. 23.) One of them, Fieldstone's corporate secretary, even executed Fieldstone's corporate authorization to file bankruptcy in that capacity. (*See* Tr. at 111, 116; Petition, dkt. no. 1 at 5; *see also* Md. Code Ann. Corps. & Ass'ns § 2-412: "[e]ach Maryland corporation shall have the following officers: (1) A president; (2) A secretary; and (3) A treasurer").[12] Another is Fieldstone's Senior Vice President and Controller and a third is its Senior Vice President and Chief Information Officer. (Tr. at 83; SOFA, dkt. 106 at Ex. 23; Order Auth.

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[12] Notably, no evidence was presented that anyone other than Mr. Brennan was Fieldstone's secretary. (*See* Tr. at 125.)

Ret. Payments dated Feb. 8, 2008, dkt. no. 196, at Ex. A.)

C. The Court Improperly Excluded Fieldstone's Corporate Vice Presidents and Corporate Secretary From Section 503(c)(1)'s Restrictions By Defining Officers Under § 101(31) as Only Those Fieldstone Officers the Court Believed were Exercising Control Over the Debtor.

1. The bankruptcy court interpreted the term "officer" as limited to officers who are in control of the debtor. (*See* Tr. at 141: "the question is whether they are officers in the traditional sense .... [i]n the sense that they are making decisions, they are acting on behalf of the corporation .... [t]hey are in charge").

But § 101(31) disjunctively identifies four groups of persons who can be insiders: "**(a)** director of the debtor; **(b)** officer of the debtor; **(c)** person in control of the debtor; **or** **(d)** a relative of a director, officer or person in control of the debtor. 11 U.S.C. § 101(31). (emphasis added.)

What the bankruptcy court did, was require that persons who fit Category **(b) -** "officer of the debtor," also fit Category **(c) -** "person in control of the debtor," in order to be an insider under section 101(31). *Id.*

But the statute is not written that way. **First**, the list is disjunctive because the elements are set off by an "or." *Id*. When Congress uses the term "or," courts must apply the term "or" even if the court does not like the result. *See United States v. Jones*, 902 F.2d 1152, 1153 (4th Cir. 1990). (rejecting the substitution of the word "or" in 21 U.S.C. § 844(a) with an "and" because that constituted an "act of impermissible legislation."). **Second**, if the statute were truly conjunctive, the only insiders would be persons who fit categories **(a)**, **(b)**, **(c)** and **(d),** those who are: directors and officers and persons in control and persons who are related to an officer or a director or a person in control. Reading the statute this way makes no sense. Few if any persons would ever be subject to such a statute.

Not surprisingly then, courts that have addressed the disjunctive nature of § 101(31) have determined that corporate officers are "insiders" regardless of whether they are also "in control of the debtor." *See, e.g., Public Access,* 307 B.R. at 505. As that court held:

> It is unnecessary for a court to determine whether an individual is ... both an officer and a person in control, as the statutory definition is clearly stated in the disjunctive. A person's status as ... an officer is alone sufficient to establish that he is an insider ... to hold otherwise would not only do violence to the plain meaning of the statute, but would also unnecessarily complicate a straightforward factual inquiry in contradiction of the Fourth Circuit's "clear preference for bright-line rules" in bankruptcy law.

Id; *see also Miller Ave. Prof. & Promotional Serv., Inc. v. Brady* (*In re Enterprise Acquisition Partners*), 319 B.R. 626, 631 (9th Cir. BAP 2004) ("[t]he per se insider is considered to be close enough to the debtor to demand preferential treatment as a matter of law, regardless of whether the insider has any actual control over the actions of the debtor").

Given this, it is no surprise that many courts have applied § 101(31) to officers without finding it necessary to also consider whether they were any of the other things listed in that subsection. *See, e.g., In re N&D Properties, Inc.*, 799 F.2d 726, 731-32 (11th Cir. 1986); *In re Mid-South Auto, Inc.*, 290 B.R. 658, 662 (Bankr. E.D. Ark. 2003); *In re Uly-Pak, Inc.*, 128 B.R. 763, 768 (Bankr. S.D. Ill. 1991). The term "person in control of the debtor" in § 101(31) is written not to exclude officers but to include people who, although not officers or directors, actually have "control of the debtor." 11 U.S.C. § 101(31)(B)(iii).

2. The bankruptcy court's definition of "officer" under § 101(31) would render the term "officer" surplusage because that interpretation requires every officer to also be a "person in control of the debtor." Courts should not interpret a statute in a manner that renders any part of the statute superfluous. *United States v. Childress*, 104 F.3d 47 (4th Cir. 1996); *Virginia v. Browner*, 80 F.3d 869, 876 (4th Cir. 1996) ("[a] court should not ... construe a statute in a manner the reduces some of its terms to mere surplusage").

Moreover, by incorporating a control requirement into the definition of "officer," the bankruptcy court also replaces the term "or" with the term "and," requiring that for an officer to be an insider he or she must be both an officer *and* a person in control of the debtor. Such judicial amendment of legislation is prohibited. When Congress uses the term "or," the courts must apply the term "or" even if the court does not like the result. This was addressed by the Fourth Circuit in *United States v. Jones*, 902 F.2d 1152 (4th Cir. 1990).

In *Jones*, the District Court had to interpret the sentencing provisions of 21 U.S.C. § 844(a) which provided:

> [A] person convicted under this subsection for the possession of a mixture or substance which contains cocaine base shall be fined under Title 18, *or* imprisoned not less than 5 years and not more than 20 years or both.

(Emphasis added). The District Court concluded that the use of the word "or" was a drafting error and that the statute was meant to read "and," thus requiring it to impose both a fine and a prison sentence. *Id.* at 1153. In reversing the District Court, the Fourth Circuit characterized the substitution of the Congressionally enacted word "or" with the judicially imposed term "and" to be an "act of impermissible legislation." *Id.* at 1154. Such "impermissible legislation" is precisely what the bankruptcy court engaged in here.

3. In determining that the board-appointed officers at issue were not"officers" under § 101(31) and therefore not subject to § 503(c)(1), the bankruptcy court relied on the fact that these officers did not exhibit some undefined characteristics of corporate officers. This reasoning is wrong for two separate and alternative reasons:

First, it is legally irrelevant. Any failure on these duly appointed officers to act like officers does not change the fact that they are officers under Maryland law (and consequently, under § 101(31)). Nor does it change the fact that § 503(c)(1) applies to them as insiders because officers are insiders under section 101(31)(B)(ii).

Second, the conclusion contradicts the record and demonstrates the bankruptcy court's confusion between officers and directors. Fieldstone's testimony, relied upon by the bankruptcy court, actually focused upon whether these officers performed director - *not officer* - duties:

> Q: Did any of the seven that are here .... Did any of the seven participate or have roles in decision-making at any of the board meetings or either FMC or FIC at any time?
>
> A: We would have from time-to-time two senior vice presidents would give reports to the FIC board and then -- but they were not part of the decision process ....

Q: Okay. But you wouldn’t give any of the seven a vote in the board decisions of the company?

A: No.

(Tr. at 66-67.)

Q: Okay. And as the board were going to make decisions about ... strategic decisions about a type of business or a type of -- and I -- assume when I say products, there -- a product is a different type of mortgage. There’s ARMs and there’s five year ... and all sort of products. Would Ms. Bliden have any role in determining what the company products would be?

A: No.

Q: Would Mr. Wolfe, the VP of facilities?

A: No.

Q: Would any of the seven have any role in -- at any pont in time, pre-merger, post-merger, pre-petition, ever have any role in deciding what kind of business -- or what kind of products Fieldstone would offer to them?

A: No.

Q: Would they ever have a chance to set their own salaries?

A: No.

Q: Would they ever have a chance to set [the President and CEO’s] salary?

A: No.

Q: Would they ever have a chance to decide whether to or not to file bankruptcy?

A: No.

(Tr. at 68-69.)

A: Well, the Board had sole responsibility for approving the annual plan and the budget.

Q: Okay. So, vice presidents didn't have any control over the plan and budget, correct?

A: No.

Q: None of the seven --

A: Yes, that's correct.

Q: None of the seven had control over the annual plan or budget?

A: Within the Accounting Department, they would work on it, but they certainly had no ability to approve it.

(Tr. 73-74.) It is clear that the bankruptcy court, in reaching its decision that the definition of an officer includes corporate control was incorporating director duties into the definition of "officer." For example, the court asked Fieldstone's representative, this pointed question:

THE COURT: In other words, they weren't officers in the traditional sense as we think of officers as sitting around a table making decisions?

(Tr. at 77.)[13] Sitting around the table making decisions regarding corporate policy, however, is a traditional role of directors, not officers. *See Wharton v. Fidelity-Baltimore Nat'l Bank*, 222 Md. 177, 185, 158 A.2d 887, 891 (Md. 1960) ("[a] director is elected by the stockholders, and his duties ordinarily consist in attending meetings, exercising his judgment on propositions brought before the board and voting"). Officers are the men and women appointed by the board to run the day-to-day operations of a company. The day-to-day

---

[13] *See also* Tr. at 125-26, where the Court momentarily expressed concern that Thomas Brennan might be a "real Officer" because the Court thought the testimony had been that he "sat in on board meetings."

management of Fieldstone's operations is precisely what these board-appointed officers indisputably engaged in on Fieldstone's behalf.

Nor does the fact that the board placed limitations on the scope of these officers' powers render them non-officers. A corporate officer's power is always subject to limitation by the board of directors. As one commentator explains:

> Typically, the powers and duties of each officer are assigned to him by either the bylaws or the board of directors. Section 2-401(a) [of the Maryland Corporations Code] provides that "[t]he business and affairs of a corporation shall be managed under the direction of a Board of Directors." The individuals doing the "managing" of the corporation's "business and affairs" are typically the officers.
>
> * * * * *
>
> The board [of directors] frequently delegates specific duties to particular officers.

James J. Hanks, *Maryland Corporations Law*, § 6.19; *see also* Md. Code Ann., Corps & Assn's § 2-414 (limiting the powers and authority of an officer to that provided in the bylaws or determined by board resolution).

D. The Bankruptcy Court Misapplied The Only Case It Relied Upon; Analogous Case Law Supports the Conclusion that Fieldstone's Corporate Officers are Officers under § 101(31) and are Subject to the Payment Restrictions Congress Imposed in § 503(c)(1).

1. In finding that these officers were not "insiders," the Court relied heavily upon *In re NMI Sys., Inc.*, 179 B.R. 357 (Bankr. D.D.C. 1995). *NMI*, however, does not support the proposition that an officer, duly appointed by the board of directors, falls outside the definition of an "insider" if he or she does not exercise control over the debtor. Indeed, such a case was not before the *NMI* Court. What *NMI* holds is that a person who is *not* elected an officer and also does not have control over the debtor is not an "insider." Essential to the outcome in *NMI* was that the employee at issue was not elected or appointed as an officer by the board of directors and, thus, was not a "statutory insider."

NMI was a preference case[14] involving pre-petition payments to an employee named Pillard. Pillard was originally hired with the title of "Vice President -- Eastern Region," and he reported directly to the CEO of the company. *Id.* at 359-60. Despite his title, however, Pillard was never elected as an officer by the board of directors and the remaining evidence as to whether Pillard was an officer at the time of hiring was unclear. *Id.* at 360-64. Moreover, prior to the time of the allegedly preferential transfers, Pillard's duties and salaries were reduced and he began reporting to another officer of the company, subordinate to the

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[14] "Preference" is a term of art in the Bankruptcy Code. Pursuant to § 547 of the Bankruptcy Code, certain pre-petition transfers of property, defined as "preferential" transfers, may be undone post-petition. 11 U.S.C. 547(b). One of the elements of a "preferential" transfer is that it must occur within a statutorily-prescribed period of time prior to the filing of bankruptcy. 11 U.S.C. § 547(b)(4). If the recipient of the transfer is an "insider," then the statutory period is longer. *Id.* Thus, issues surrounding the definition of "insider" commonly arise in the context of "preference actions."

CEO.

In determining whether Pillard was an officer at the time of the transfer, the *NMI* Court focused in the first instance upon the fact that Pillard was not elected as an officer by the board of directors:

> [Pillard] does not appear at this juncture to have been an elected officer, one of the few blessed by a vote of the board of directors to be an officer. He thus did not enjoy that prestigious affinity that exists among elected officers that in appropriate circumstances may *per se* threaten preferential treatment vis a vis other creditors.
>
> * * * * *
>
> Here the plaintiffs put forth no evidence of the bylaws or charter of NMI and offered no board resolution electing Pillard an officer ... In selecting Pillard to carry the title of vice president the corporation did not follow corporate formalities that would be expected to be and were apparently usually observed in selecting officers.

Id. at 371.

Given that Pillard was not a duly elected officer and, thus, not a *de jure* officer, the *NMI* Court appropriately looked to whether Pillard carried any other indicia of *de facto* officer status, such as control of the company. Finding he had none, the court held that the vice president title alone was insufficient to confer officer status.

Here, the evidence is undisputed that each of the seven employees was duly appointed by the board of directors as an officer. They were, "of the few blessed by a vote of the board of directors to be an officer ... enjoy[ing] that prestigious affinity that exists among elected officers." *Id.* Moreover, each of the employees was identified as an officer on Debtor's own bankruptcy filings. (SOFA at Ex. 21, 23.)

Nothing in *NMI* supports the proposition that a person can be an *de jure* officer without being an "insider." Indeed, despite substantial research, the United States Trustee has been unable to find even one case in which a debtor's duly appointed or elected corporate officer was found not to be an "insider" as defined by § 101(31). The reason, of course, is that such a holding disregards the plain language of the statutory definition of "insider." *See In re Public Access Tech.com*, 307 B.R. at 505 ("[a] person's status as a director or an officer is alone sufficient to establish that he is an insider .... to hold otherwise would ... do violence to the plain meaning of the statute").[15]

2. Although there are very few cases addressing the newly enacted § 503(c)(1), at least one case considering the statute concluded that vice presidents are "insiders" subject to its limitations. In *In re Nellson Nutraceutical*, 369 B.R. 787 (Bankr. D. Del. 2007), the bankruptcy court considered the applicability of § 503(c)(1) to a KERP which covered 131 of the debtor company's employees. These 131 employees were grouped into six different categories as follows:

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[15] *Public Access* involved the same situation as *MNI*. There, although the employee at issue had the title of Executive Vice President, there were no "affidavits, articles of incorporation, corporate minutes, resolutions, or any other documents or evidence that shows this title makes Smith an officer of the corporation." 307 B.R. at 506. Here, however, the undisputed evidence is that Fieldstone's board of directors appointed each of the employees at issue to be corporate officer. (Tr. at 116.) This corporate formality, which both Fieldstone and the bankruptcy court continuously ignore, is the critical difference between this case and *NMI* and *Public Access*. Although the *Public Access* Court refrained from "proclaiming a rigid rule to determine who qualifies as a corporate officer," the statement was made in the context of determining whether a person who was not a *de jure* officer elected by the board of directors was, nevertheless, a *de facto* officer. *Public Access*, 307 B.R. at 506 n.4. The *Public Access* court's statement should not be read to countenance a finding that a true *de jure* officer may still not constitute an "officer" as defined by § 101(31).

Level I	Management level officers, including the CEO, CFO *and various vice presidents*
Level II	Operational directors including Director of Purchasing, Director of Manufacturing and Director of Finance
Level III	Managers, including R&D Managers, Materials Managers and Maintenance Managers
Sales Directors	Director level employees in charge of sales to customers
Sales Managers	Manager level employees in charge of sales to customers
Line Mangers/Office Staff	Employees responsible for managing the day-to-day tasks of the Debtor.

Id. at 792.[16] The Court had no trouble determining that § 503(c)(1) applies to all of the Level I employees as those employees (*i.e.*, debtor's "various vice presidents") constituted officers and therefore "insiders" under § 101(31). *Id.* at 801.

3. The argument advanced by Fieldstone and the bankruptcy court has also been rejected other contexts. *See, e.g., Magers v. Bonds* (*In re Bonds Distributing Company*), Case Nos. 97-52130C-7W; 98-6044, 2000 WL 33673768 at *3 (Bankr. M.D.N.C., March 31, 2000) (applying 11 U.S.C. § 547). In *Magers*, Donald Bonds had been the president, owner and sole director of Bonds Distributing Company until 1995 when he sold the Debtor to Steven Young ("Young"). Part of the purchase price consisted of a promissory note from the Debtor to Bonds and Bonds took back a security interest in all the Debtor's assets as collateral. Bonds remained a director of the Debtor but had no real involvement in its affairs. Instead, "Young became president of the Debtor, assumed control of the Debtor and managed

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[16] The *Nutraceutical* Court was careful to make clear that the title "director" as used here did not refer to members of the board of directors. *Id.* at 792 n.4.

the business operation of the Debtor." *Id.* at *1.

In 1997, the Debtor defaulted on the promissory note and Bonds foreclosed. Bonds purchased all of the Debtor's assets at the foreclosure sale. *Id.* Approximately two months after the foreclosure sale, an involuntary petition under Chapter 7 of the Bankruptcy Code was filed against the Debtor.

The Chapter 7 Trustee initiated a preference action against Bonds asserting that payments made to Bonds under the promissory note in the year prior to the Debtor's bankruptcy were avoidable because, as a director, Bonds was an insider of the Debtor. Like Fieldstone, Bonds argued that although he was a director in name, "since Bonds did not 'act' like a director, the plain language of § 101(31)(B) should not apply in this case." *Id.* at *3. Finding no legal support for such an argument, the *Bonds* Court held:

> The definition of "insider" contained in § 101(31) of the Bankruptcy Code clearly and unambiguously includes a director of a corporate debtor. Giving this statutory provision its plain meaning does not produce a result demonstrably at odds with the intentions of Congress in adopting this provision. Pursuant to the foregoing tenets of statutory interpretation, Bonds, as a director, must be regarded as an insider.

Id. Similarly, Fieldstone's officers -- its vice presidents, senior vice presidents, secretary, controller, CIO, etc. -- as duly appointed officers must also be regarded as "insiders", regardless of whether they exercised some undefined level of control or otherwise "acted" like officers. Each of the employees at issue in this case is an officer and as such, is an insider subject to the restrictions of § 503(c)(1).

What Fieldstone and the bankruptcy court have done in this case is incorrectly apply the test for determining whether an unappointed person is a *de facto* officer to persons who were appointed as *de jure* officers by Fieldstone's board of directors. Because these seven officers were actually appointed as officers by the Board of Directors, the *de facto* test has no applicability and its application constitutes error.

E. By Engrafting a New Control Restriction Upon the Definition of Officer in § 101(31), the Bankruptcy Court has Taken the Remarkable Step of Redefining the Scope of No Less than Fifteen Bankruptcy Code Provisions - Sections 101(14)(A), 101(51D), 303(b)(2), 502(a)(4), 503(c)(1), 522(d)(E)(i), 523(a)(2), 547(b)(4), 548(a), 550(c)(2), 702(a)(3), 727(a)(7), 741(1), 1104(c)(2), 1124(1)(D), and 1129(a).

The definition of "insider" affects more than just the § 503(c)(1). The scope of numerous additional provisions of the Bankruptcy Code is affected by the determination of whether someone is an insider. *See, e.g.,* 11 U.S.C. §§ 101(14)(A), 101(51D), 303(b)(2), 502(a)(4), 522(d)(E)(i), 523(a)(2), 547(b)(4), 548(a), 550(c)(2), 702(a)(3), 727(a)(7), 741(1), 1104(c)(2), 1124(1)(D), 1129(a). The statutory definition of §101(31)(B) cannot mean one thing for purposes of §503(c)(1) and another thing for these other provisions. If the bankruptcy court's interpretation is followed, every time the insider status of a president, a vice president, or any other corporate officer is in question, a court will have to engage in a detailed factual inquiry to determine what level of control the officer exercised or whether he or she acted like an Bankruptcy Code "officer."

Moreover, what level of control or what activities make an officer a novel § 101(31)-control "officer" is not clear from the bankruptcy court's ruling. Here, vice presidents and senior vice presidents with control over significant portions of Fieldstone's operations were held not to be Bankruptcy Code "officers" because the scope of their duties were limited to discrete portions of the business. Taken to its logical conclusion, this holding could mean that only a person who has control over the entire company constitutes a Bankruptcy Code "officer, " or that a company with both a manufacturing arm and a distributing arm might have no Bankruptcy Code "officers" if one officer is solely responsible for the manufacturing arm and the other is solely responsible for the distributing arm. Indeed, in any large company, the scopes of control of all but the most senior officers are necessarily limited to discrete portions of the business.

The Fourth Circuit Court of Appeals has indicated a "clear preference for bright-line rules" in bankruptcy law and particularly with respect to the determination of who constitutes an "insider." *Butler v. David Shaw, Inc.*, 72 F.3d 437, 442 (4th Cir. 1996); *see also Public Access*, 307 B.R. at 505. To require a complex fact-based inquiry to determine whether formally appointed and elected officers exercise sufficient control to be Bankruptcy Code "officers" contravenes that policy with little or no benefit to the aims of the Bankruptcy Code. To the contrary, the centralized form of corporate control required by the bankruptcy court's novel ruling in this case defeats the congressional aims of § 503(c)(1), particularly in the large corporations expressly targeted by the statute, since by their very size such large corporations must operate by delegating limited amounts of control to a significant number of officers. Although a fact-intensive inquiry may occasionally be unavoidable to determine if a person with a particular and unique relationship with the debtor is an insider, *see, e.g.*, *Flint Hill L.P. v. Prudential Ins. Co. (In re Flint Hill L.P.*), 213 B.R. 292, 298-300 (D. Md. 1997) (former business partner of debtor's principal who agreed to pay certain of debtor's debts), such an inquiry is both unnecessary and inappropriate when the person in question is a currently-serving corporate officer duly appointed by the debtor's board of directors.

F. The Seven Officers Meet Even the Bankruptcy Court's Revised Definition of the Term Officer.

Even if an officer appointed by the board of directors pursuant to a corporate resolution is still not a Bankruptcy Code "officer" absent some level of corporate control, the record here is clear that these officers meet that criterion. For example, Thomas Brennan was Fieldstone's Corporate Secretary. (*See* Tr. at 117, 123.) Maryland law, which governs this corporation, requires every corporation to maintain a secretary *as an officer*. Md. Code Ann. Corps & Assn's § 2-412(a). If Fieldstone's secretary -- an officer mandated by Maryland law -- does not constitute a corporate officer then the determination of officer status is rendered completely arbitrary. Indeed, Brennan wielded sufficient control and authority to execute the corporate resolution allowing Fieldstone to file for bankruptcy.

Theresa McDermott is a Senior Vice President and Fieldstone's Controller. (*See* SOFA, dkt. no. 106, at Ex. 23; Tr. at 92-93.)[17] She handles all of Fieldstone's critical financial reporting, including tax returns and 401(k) administration. (*See* Tr. at 92-95.) John Camp is a "Senior Vice President" and "Chief Information Officer." (*See* SOFA, dkt. no.

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[17] A "senior" vice president is "higher than a vice president." (Tr. at 62.)

106, at Ex. 23; Order Auth. Ret. Payments dated Feb. 8, 2008, dkt. no. 196 at Ex. A.; Tr. at 83.) Camp is responsible for both Fieldstone's IT department and its facilities group. (*See* Tr. at 83.) William Wolff is the Vice President for facilities. (*See* SOFA, dkt. no. 106, at Ex. 23; Order Auth. Ret. Payments dated Feb. 8, 2008, dkt. no. 196 at Ex. A.) He was responsible, at one time, for the operations of 90 locations with authority to negotiate lease terms with landlords for those 90 locations. (*See* Tr. at 79, 81.)

Even if their official appointment by the board of directors had not been sufficient to endow officer status, clearly these seven were and acted like "traditional" officers in any sense of the word. These are precisely the type of highly-compensated insiders at which § 503(c)(1) was directed and the KERP contains precisely the type of self-dealing retention bonuses that § 503(c)(1) was designed to prevent. By re-defining the term "officer" into an animal unrecognizable under any accepted definition, the bankruptcy court holding significantly weakens the Congressionally imposed protections of § 503(c)(1).

CONCLUSION

For these reasons, the United States Trustee respectfully asks this Court to vacate the February 28, 2008, order entered below and remand for further proceedings.

Respectfully submitted,

W. Clarkson McDow, Jr.
United States Trustee, Region Four

Date: April 9, 2008

By: **/s/*Mark A. Neal***
Mark A. Neal (Federal Bar No. 10658)
Assistant U.S. Trustee
mark.a.neal@usdoj.gov
Hugh M. Bernstein (Federal Bar No. 23489)
Trial Attorney
hugh.m.bernstein@usdoj.gov
101 W. Lombard Street, Suite 2625
Baltimore, Maryland 21201
(410) 962-4300
Fax (410) 962-3537

Roberta A. DeAngelis
Acting General Counsel
P. Matthew Sutko
Associate General Counsel for Appellate Practice
Executive Office for United States Trustees
Department of Justice
20 Massachusetts Avenue, N.W.
Washington, D.C. 20530
(202) 307-1405

CERTIFICATE OF SERVICE

I HEREBY CERTIFY, that on this 9th day of April, 2008, a copy of the foregoing Brief of the United States Trustee was filed electronically in the United States District Court for the District of Maryland and that according to the Court's CM/ECF system, all parties entitled to service of this brief were served as a result of said filing.

/s/ *Hugh M. Bernstein*
Hugh M. Bernstein

BRIEF BANK — "SUMMARY SHEET" *Printed Wed-5/19/10 15:39*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*

In re: FirstPlus Financial Group Inc. (William Maxwell, William Max, PLLC, Learned Assocs. Of North America LLC, Michael Cordova, Seven Hills Management, LLC, Svetlana Pelullo Revocable Deed of Trust, and LandL Holdings, LLC, v. Matthew D. Orwig, FirstPlus Financial Group, Inc., and William T. Neary, United States Trustee)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*

N. D. Tex.

3. ("CCN") ***CURRENT*** CASE NO.

No.: 3:10-cv-00433-k

4. ("PCN") ***PRIOR*** CASE NO. - & COURT *[IF ANY]*

No.: 09-33918-hdh-4

Court: Bankr. N.D. Tex.

(Identify judge & cite, if any)

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U.S. TRUSTEES

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*

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Type: Brief of Appellee William T. Neary, United States Trustee

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Erin Schmidt, Lisa Lambert, Anne W. Stukes, P. Matthew Sutko

(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***

BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***

- Whether the bankruptcy court abused its discretion when it determined that the chapter 11 trustee election dispute should be resolved in favor of Matthew D. Orwig remaining as chapter 11 trustee.

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IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

IN RE:	)	
	)	
FirstPlus Financial Group, Inc.,	)	
	)	
DEBTOR	)	**Civil No. 3:10-cv-00433-K**
	)	**JUDGE: THE HON. ED KINKEADE**
	)	
William Maxwell,	)	
William Maxwell, PLLC,	)	
Learned Assocs. of North America LLC,	)	
Michael Cordova,	)	
Seven Hills Management, LLC,	)	
Svetlana Pelullo Revocable Deed of	)	**On Appeal From**
Trust, and	)	
LandL Holdings, LLC,	)	
	)	
APPELLANTS	)	
VS.	)	**BANKRUPTCY CASE 09-33918-hdh-11**
	)	
Matthew D. Orwig and	)	
FirstPlus Financial Group, Inc.,	)	
	)	
APPELLEES	)	

ON APPEAL FROM THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF TEXAS

BRIEF OF APPELLEE WILLIAM T. NEARY, UNITED STATES TRUSTEE

RAMONA D. ELLIOTT
General Counsel

P. MATTHEW SUTKO
Associate General Counsel
ANNE W. STUKES
Trial Attorney
Executive Office for United States Trustees
Department of Justice
20 Massachusetts Avenue, N.W.
Washington, D.C. 20530
Ph: (202) 307-1399

WILLIAM T. NEARY
United States Trustee for Region 6

ERIN MARIE SCHMIDT
Trial Attorney
State Bar of Texas No. 24033042
LISA LAURA LAMBERT
Trial Attorney
State Bar of Texas No. 11844250
Department of Justice
1100 Commerce Street, Rm. 976
Dallas, TX 75242

Fax: (202) 307-2397 (214) 767-8967
(214) 767-8971 (fax)

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JURISDICTIONAL STATEMENT

The bankruptcy court had jurisdiction under 28 U.S.C. §§ 157(a) and 1334(a) to issue its final order resolving the election dispute. R. 6. The bankruptcy court issued its final order resolving the disputed chapter 11 trustee election on October 20, 2009. R. 6-10. This order was final given that it resolved the trustee election by determining that Matthew Orwig would remain the chapter 11 trustee because the election request had not meet the requirements of 11 U.S.C. § 702. R. 10. *See Path Science Laboratories v. Greene Co. Hosp. (In re Greene Co. Hosp.)*, 835 F.2d 589, 595 (5th Cir. 1988) ("[i]n order to be final in character, an order by a bankruptcy court must resolve a discrete unit in the larger case" and must "conclusively determine substantive rights"). Orders appointing a permanent trustee are final. *Cajun Elec. Power Co-op., Inc. v. Central Louisiana Elec. Co., Inc. (In re Cajun Elec. Power Co-op., Inc.)*, 69 F.3d 746, 748 (5th Cir. 1995).

William Maxwell, William Maxwell, PLLC, Learned Associates of North America, LLC, Michael Cordova, Seven Hills Management, LLC, Svetlana Pelullo Revocable Deed of Trust, LandL Holdings, LLC ("Appellants") filed their notice of appeal on December 7, 2009, which is timely under 28 U.S.C. §§ 158(a) and (c)(2). R. 1-2. This Court has appellate jurisdiction under 28 U.S.C. § 158(a)(1), a statutory provision under which district courts have jurisdiction to hear appeals from final judgments, orders, and decrees of bankruptcy judges.

STANDARD OF REVIEW

A district court functions as an appellate court when reviewing a bankruptcy court's decision and applies the standard of review generally applied in the federal courts of appeals. *Webb v. Reserve Life Ins. Co. (In re Webb)*, 954 F.2d 1102, 1103-04 (5th Cir. 1992).

On appeal "conclusions of law are reviewed *de novo*, findings of fact are reviewed for clear error, and mixed questions of law and fact are reviewed *de novo*." *Century Indem. Co. v. Nat'l Gypsum Co. Settlement Trust (In re Nat'l Gypsum Co.)*, 208 F. 3d 498, 504 (5th Cir. 2000). A bankruptcy court's resolution of a disputed trustee election is reviewed for abuse of discretion. *Berg v. Esposito (In re Oxborrow)*, 913 F.2d 751, 754 (9th Cir. 1990).

STATEMENT OF THE ISSUES PRESENTED

Whether the bankruptcy court abused its discretion when it determined that the chapter 11 trustee election dispute should be resolved in favor of Matthew D. Orwig remaining as chapter 11 trustee.

STATEMENT CONCERNING ORAL ARGUMENT

The United States Trustee respectfully submits that the facts and legal arguments are adequately presented in the briefs and record, and the decisional process would not be significantly aided by oral argument.

STATEMENT OF THE CASE

In this chapter 11 bankruptcy case, the debtor, FirstPlus Financial Group, Inc. ("FirstPlus"), filed for bankruptcy after the FBI executed a search warrant on its headquarters and two of its former officers, John Maxwell and William Handley, received grand jury target letters. r. 1559-64; 1655-56; 1663-64. This appeal involves a disputed trustee election that was requested by the appellants, a group suspected of colluding with FirstPlus' former management and led by John Maxwell's brother. R. 119-32. The appellants sought to supplant the appointment of a former United States Attorney, Matthew D. Orwig, whom the United States

Trustee[1] had appointed chapter 11 trustee. R. 1679.

Upon Mr. Orwig's appointment, a group of six creditors styling themselves the "Ad Hoc Creditors Committee" requested a trustee election. R. 172-80. The United States Trustee conducted the election on September 18, 2009 and filed his *Report of Election Controversy* on September 23, 2009. R. 39. After conducting a hearing at which testimony was presented, the bankruptcy court determined the election was not valid because the creditors who requested the election were not eligible to vote.

A trustee election is not valid if the creditors requesting the election are not eligible to vote. 11 U.S.C. § 702(b). The bankruptcy court's ruling should be affirmed because the creditors requesting the election were disqualified from voting under section 702(a) of the Bankruptcy Code. Because the election was not valid, Mr. Orwig is the permanent chapter 11 trustee. 11 U.S.C. § 702(d).

STATUTORY FRAMEWORK

I. Appointment of a Chapter 11 Trustee by the United States Trustee

At the commencement of a voluntary chapter 11 bankruptcy, the chapter 11 debtor serves as debtor-in-possession. 11 U.S.C. § 1101(1). In certain instances, however, the bankruptcy court may direct the appointment of a chapter 11 trustee. 11 U.S.C. § 1104(a). A trustee appointment may be appropriate when current management has committed fraud in managing the

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[1] United States Trustees "serve as bankruptcy watch-dogs to prevent fraud, dishonesty, and overreaching in the bankruptcy arena." H.R. Rep. No. 95-595, at 88 (1977), *as reprinted in* 1978 U.S.C.C.A.N. 5963, 5966, 6071. The United States Trustee Program therefore acts in the public interest to promote and preserve the efficiency and integrity of the bankruptcy system. Congress has provided that "[t]he United States trustee may raise and may appear and be heard on any issue in any case or proceeding ." 11 U.S.C. § 307. *See Thompson v. Greenwood*, 507 F.3d 416, 420 n.3 (6th Cir. 2007) (stating "[t]he United States Trustee is an interested party by statute").

debtor's financial affairs or has acted incompetently or otherwise mismanaged the bankruptcy estate. 11 U.S.C. § 1104(a)(1).

If the bankruptcy court finds cause for the appointment of a chapter 11 trustee, the court issues an order directing the United States Trustee to appoint a disinterested person as trustee. 11 U.S.C. § 1104(d). Once a chapter 11 trustee is appointed, the trustee controls property belonging to the bankruptcy estate. *See* 11 U.S.C. §§ 1101(1), 1106.

II. Procedure for Electing a Chapter 11 Trustee

Creditors who want a different trustee may request a chapter 11 trustee election. 11 U.S.C. § 1104(b)(1). Chapter 11 trustee elections are governed by the same Bankruptcy Code provisions and Rules as those regarding chapter 7 trustee elections. *See* 11 U.S.C. § 1104(b), which incorporates by reference 11 U.S.C. § 702(a), (b), and (c); *see also* Fed. R. Bankr. P. 2007.1(b)(2), which incorporates by reference Fed. R. Bankr. P. 2003(b)(3) and 2006. The United States Trustee presides over the election. Fed. R. Bankr. P. 2007.1(b)(2).

A creditor may vote in an election if, at or before the meeting, the creditor has "filed a proof of claim or a writing setting forth facts evidencing a right to vote pursuant to § 702(a) of the Code unless objection is made to the claim or the proof of claim is insufficient on its face." Fed. R. Bankr. P. 2003(b)(3). In addition, a creditor may vote in an election only if that creditor:

> (1) holds an allowable, undisputed, fixed, liquidated, unsecured claim of a kind entitled to distribution under section 726(a)(2), 726(a)(3), 726(a)(4), 752(a), 766(h), or 766(i) of this title;
>
> (2) does not have an interest materially adverse, other than an equity interest that is not substantial in relation to such creditor's interest as a creditor, to the interest of creditors entitled to such distribution; and
>
> (3) is not an insider.

11 U.S.C. § 702(a).

After the election, the United States Trustee files either 1) a report certifying the election or 2) a report of disputed election. 11 U.S.C. § 1104(b)(2)(A); Fed. R. Bankr. P. 2003(d)(2). If the election is disputed, the bankruptcy court resolves the dispute. 11 U.S.C. § 1104(b)(2)(C). The appointed chapter 11 trustee continues to serve as interim trustee until the dispute is resolved. Fed. R. Bankr. P. 2007.1(b)(1).

FACTUAL BACKGROUND

Criminal investigations at FirstPlus

FirstPlus is a publicly traded holding company with a number of wholly owned first-, second-, and third-tier subsidiaries. R. 12; 1317. On May 8, 2008, the FBI executed a search warrant on FirstPlus's headquarters in Irving, Texas and seized its books, records, and computer terminals. R. 1559-64. In the months following the May 2008 seizure, FirstPlus terminated chief executive officer John Maxwell and chief financial officer William Handley. R. 1639. Later Maxwell and Handley each received grand jury target letters in connection with their FirstPlus activities. R. 1655-56; 1663-64.

Matthew Orwig appointed chapter 11 trustee

On June 23, 2009, FirstPlus filed for chapter 11 bankruptcy in the United States Bankruptcy Court for the Northern District of Texas. R. 1313-15. Shortly thereafter, the United States Trustee moved for the appointment of a chapter 11 trustee because of allegations that FirstPlus's prior management had colluded with certain creditors to defraud its shareholders during the period June 2007 through May 2008 through the purchase of subsidiaries. R. 119-29.

FirstPlus agreed to the requested relief, and on July 24, 2009, the bankruptcy court directed the United States Trustee to appoint a chapter 11 trustee. R. 164. The United States Trustee appointed Matthew Orwig ("Orwig"), a former United States Attorney for the Eastern

District of Texas. R. 165-66, 171, 665.

Prior to appointing Orwig, the United States Trustee solicited nominations from other interested parties, including William Maxwell, as representative for the appellants who later requested a trustee election. R. 165; 199**.** Maxwell did not suggest a name.[2] R. 199. George Tarpley, counsel for the debtor-in-possession, nominated Orwig, whom the United States Trustee interviewed prior to appointment. R. 176.

Chapter 11 trustee election requested by insider-led "ad hoc" group

Six creditors who objected to Orwig's selection formed an unofficial, or ad hoc, creditors' committee ("Ad Hoc Creditors' Committee"). R. 172. The creditors were represented by William Maxwell, brother of John Maxwell, the former FirstPlus CEO. R. 172; 1477; 1559-64. The Ad Hoc Creditors' Committee was comprised of the appellants in this case: William Maxwell, P.L.L.C. ("William Maxwell, P.L.L.C."), Seven Hills Management, LLC ("Seven Hills"), LandL Holdings, LLC ("LandL), the Svetlana Pelullo Revocable Deed of Trust dated December 6, 1996 ("Svetlana Pelullo Revocable Deed of Trust"), Michael Cordova ("Cordova"), and Learned Associates of North America, LLC ("Learned Associates"). R. 241; 892. On August 11, 2009, the Ad Hoc Committee objected to Orwig's appointment and requested a trustee election. R. 172-80. In response to this request, the United States Trustee scheduled a special meeting of creditors for the purposes of conducting a trustee election. R. 894. Notice of this September 18, 2009 meeting was served on all creditors on August 25, 2009. R. 894-948.

September 18, 2009 chapter 11 trustee election and proposed trustee

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[2] Although the appellants complain about the procedure, the United States Trustee's process for selection of a chapter 11 trustee is not on appeal. Appellants' Brief at 10.

The United States Trustee conducted the chapter 11 election on September 18, 2009. R. 219; 2257. At the start of the meeting, William Maxwell presented a nomination form with the signatures of representatives from the six creditors who formed the “Ad Hoc Creditors’ Committee,” plus two others, ETCG and Woodson Smith Group. R. 241. Another creditor, REFI, appeared at the election through its representative Kevin Smith, a principal of ETCG and Woodson Smith Group. R. 241; 2274-76. ETCG, Woodson Smith Group, REFI and Kevin Smith are not appellants in this appeal.

These creditors nominated Gregory S. Milligan (“Proposed Trustee”), who had served as a chapter 11 trustee in another case, and so had previously qualified under the Bankruptcy Code and met all applicable requirements. R. 221-22; 242-52; 2270. The Proposed Trustee attended the election, represented that he maintained his office in Austin, Texas, and stated that he was disinterested in accordance with Federal Rule of Bankruptcy Procedure 2007.1(b)(3)(B). R.221-22; 2269-70.

Facts concerning the ineligibility of creditors who requested the election

Although the appellants requested a trustee election, the facts reveal that each member of the “Ad Hoc Creditors’ Committee” was either an “insider” (in the case of William Maxwell) or had a disputed claim that *the creditor put in dispute* by filing an adversary proceeding concerning the validity of its claim (all other appellants). Moreover, the three other creditors who voted with the appellants, ETCG, Woodson Smith Group, and REFI, each filed proofs-of-claim that either failed to state the amount of the claim or failed to allege a claim against FirstPlus.[3] A brief summary is below.

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[3] These facts are pertinent to the creditors’ eligibility to vote for a chapter 11 trustee. Under 11 U.S.C. § 702(a)(1), only holders of “undisputed” claims may vote. Under 11 U.S.C. § 702(a)(3),

William Maxwell, P.L.L.C. William Maxwell, P.L.L.C. is a law firm whose sole shareholder is William Maxwell, brother of former FirstPlus CEO and current criminal target John Maxwell. R. 1325; 1477; 1639; 1655. William Maxwell, P.L.L.C. had contracted with FirstPlus on June 7, 2007 to provide legal services, which included giving him "[a]ll legal authority for any matter involving the Corporation." R. 1477; 1545-55; 1552-54. This contract promised William Maxwell $100,000 per month for his services plus compensation for all expenses, including fees incurred from the hiring of other professionals. R. 608, 1548. William Maxwell received $677,640 from FirstPlus in 2007. R. 1477.

William Maxwell, while requesting the election, did not vote because of his role as an insider by virtue of his familial relationship with John Maxwell.[4] R. 2262. Mr. Maxwell's insider status did not, however, deter him from acting on behalf of other creditors and instigating the election. R. 172; 2262.

Learned Associates of North America, LLC Learned Associates filed proof of claim 35-1 averring that FirstPlus owed it $275,000 on a promissory note.[5] R. 996. Learned Associates placed its own claim in dispute, however, by filing an adversary proceeding against FirstPlus seeking a determination of FirstPlus's liability. R. 997. Learned Associates' adversary

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only non-"insiders" may vote. In addition, under Fed. R. Bankr. P. 2003(b)(3), a creditor may vote "unless objection is made to the claim or the proof of claim is insufficient on its face."

[4] The Bankruptcy Code specifically defines the term "insiders." 11 U.S.C. § 101(31)(B). In instances where a debtor is a corporation, insiders include "relatives of a general partner, director, officer, or person in control of the debtor." 11 U.S.C. § 101(31)(B)(vi).

[5] On September 18, 2009, the day of the election, Learned Associates filed amended proof of claim 35-2 which did not differ substantively from original claim 35-1. R. 227; 2209.

complaint alleged that it owned 750,000 shares of restricted stock in FirstPlus.[6] R. 989. In addition, according to Learned Associates, it filed a state court lawsuit against FirstPlus to collect on this debt and that the matter was still pending as of the bankruptcy filing. R. 999.

On September 17, 2009 Orwig objected to Learned Associates' claim 35-1 because 1) it was not clear that FirstPlus was actually liable on the debt given that Learned Associates had named all FirstPlus's affiliates on the complaint filed in state court; 2) Learned Associates admitted the claim was disputed by virtue of filing an adversary proceeding with the bankruptcy court to determine the validity of its claim; 3) the documents submitted with this claim did not support liability; and 4) the state court matter was still pending. R. 988-92.

Furthermore, on the day before the election, on September 17, 2009, Orwig filed a Schedule F[7] which listed Learned Associates' claim as disputed, contingent, unliquidated, and subject to setoff. R. 1303.

Michael Cordova Cordova's proof of claim 36-1 claimed he was owed $75,000 on a debt arising from the January 2008 sale of an entity called the Premier Group to FirstPlus

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[6] This fact is pertinent under 11 U.S.C. § 702(a)(2), which provides that a creditor may not vote in a trustee election if that creditor has "an interest materially adverse" to other creditors.

[7] Debtors have an affirmative duty to file schedules listing their assets and liabilities as well as a statement of financial affairs. 11 U.S.C. § 521(a). Because FirstPlus did not file schedules or statement of financial affairs, Orwig filed a Schedule F on its behalf, and the bankruptcy court relied on this schedule in deciding the issue that is on appeal. R. 6-10. Subsequent to the events surrounding this appeal, Orwig obtained court authority to prepare and file schedules and statement of financial affairs on FirstPlus's behalf since it defaulted on this requirement. *See* Fed. R. Bankr. P. 1007(k). The latter schedules and statement of financial affairs filed by Orwig are not part of the record on appeal because they were filed after the court issued its order resolving the election dispute. The Schedule F that Orwig filed on September 17, 2009 and upon which the bankruptcy court relied is in the record on appeal at R. 1797-98.

Enterprises, a non-debtor subsidiary.[8] R. 1106; 1108. Like Learned Associates, Michael Cordova placed his own claim in dispute by filing an adversary proceeding against FirstPlus seeking a determination of FirstPlus's liability. R. 1107. The complaint alleges that in January 2008, non-debtor subsidiary FirstPlus Enterprises, Inc. had executed two promissory notes in favor of Cordova in exchange for the purchase of a subsidiary company and that FirstPlus had guaranteed the debt. R. 1108. The complaint also states that Cordova filed a state court lawsuit against FirstPlus to collect on the debt but that the matter was still pending as of the date of the bankruptcy filing. R. 1109; 1116.

Orwig objected to claim 36-1 because 1) it was not clear that FirstPlus was actually liable on the debt given that Cordova named all of FirstPlus's affiliates on the complaint filed in state court; 2) Cordova admitted the claim was disputed by virtue of filing an adversary proceeding with the bankruptcy court to determine the validity of its claim; 3) the documents submitted with this claim did not support liability; and 4) FirstPlus responded to the state court lawsuit by denying the allegations and raising various affirmative defenses. R. 1098-1102.

In addition, Orwig listed Cordova's claim as disputed, contingent, unliquidated, and subject to set off on Schedule F. R. 1302.

Seven Hills Management, LLC Following the same pattern as other members of the "Ad Hoc Creditors' Committee," Seven Hills' claim was placed in dispute by Seven Hills itself. Its allegations are similar to Michael Cordova's. Seven Hills[9] filed proof of claim 37-1 for

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[8] On September 18, 2009, the date of the election, Cordova filed amended claim 36-2 which did not differ substantively from the original proof of claim. R. 227; 2210.

[9] On June 15, 2007, William Maxwell P.L.L.C. retained Seven Hills as a consultant for FirstPlus. R. 1538. Per their agreement, Seven Hills would receive $100,000 per month plus reimbursement for all expenses. R. 1539-40. Seven Hills has not filed a proof of claim for unpaid consultant fees.

$275,000 based on an alleged default on promissory notes for the sale of Premier Group to FirstPlus Enterprises, a non-debtor subsidiary.[10] R. 2210. Seven Hills placed its claim in dispute by filing an adversary proceeding against FirstPlus seeking a determination of FirstPlus's liability. R. 1049. The complaint alleges that in January 2008, non-debtor subsidiary FirstPlus Enterprises, Inc. executed two promissory notes in favor of Seven Hills in exchange for the purchase of a subsidiary company and that FirstPlus had guaranteed the debt. R. 1050. Seven Hills Management also received, as part of this transaction, 750,000 shares of restricted stock in FirstPlus.[11] R. 2267. The complaint also states that Seven Hills had filed a complaint for breach of contract, fraud, and fraudulent conveyance in Pennsylvania state court on December 16, 2008 and that the matter was still pending as of the date of the bankruptcy filing. R. 1051.

As with the others, Orwig objected to claim 37-1 because 1) Seven Hills admitted the claim was disputed by virtue of it having filed adversary proceeding number 09-03295 against FirstPlus in bankruptcy court; 2) the documents attached to the complaint evidence only $242,375 in claims and not $275,000; 3) it was not clear that FirstPlus was actually liable on the debt given that Seven Hills had named all of FirstPlus' affiliates on the complaint filed in state court; and 4) FirstPlus responded to the state court lawsuit by denying the allegations and raising various affirmative defenses. R. 1039-1097.

On Schedule F, Orwig listed $233,625 owed to Seven Hills as contingent, unliquidated, disputed, and subject to set off. R. 1303.

Svetlana Pelullo Revocable Deed of Trust The identical pattern continued with the

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[10] On September 18, 2009, Seven Hills filed amended claim 37-2, which appears identical to claim 37-1. R. 228; 2210.

[11] This fact is pertinent under 11 U.S.C. § 702(a)(2), which provides that a creditor may not vote in a trustee election if that creditor has "an interest materially adverse" to other creditors.

Svetlana Pelullo Revocable Deed of Trust's claim. The Deed of Trust filed proof of claim 108-1 for a $300,000 secured claim based on an alleged default on promissory notes.[12] R. 2230. Placing its own claim in dispute, the Deed of Trust filed adversary proceeding 09-3288 against FirstPlus seeking a determination of its debt. R. 1194. The complaint alleges that the Svetlana Pelullo Revocable Deed of Trust loaned $260,000 to FirstPlus and its subsidiaries through three separate promissory notes signed March 12-27, 2008. R. 1199. The complaint further alleges that the Svetlana Pelullo Revocable Deed of Trust filed a state court lawsuit against FirstPlus to collect on its debt and that this matter was pending at the time of the bankruptcy. R. 1195.

Orwig objected to claim 108-1 because 1) the Svetlana Pelullo Revocable Deed of Trust admitted the claim was disputed by virtue of it having filed adversary proceeding number 09-03295; 2) it was not clear that FirstPlus was actually liable on the debt given that the Deed of Trust named all of FirstPlus's affiliates on the complaint filed in state court; and 3) FirstPlus responded to the state court lawsuit by denying the allegations and raising various affirmative defenses. R. 1186-1190.

On Schedule F, Orwig listed the Deed of Trust's claim as $264,550 that was contingent, unliquidated, disputed, and subject to set off. R. 1303.

LandL Holdings, LLC Like other members of the "Ad Hoc Creditors' Committee," LandL Holdings put its own claims in dispute by filing adversary proceedings. R. 1151; 1166. In addition, LandL claimed to be a secured creditor.[13] R. 1151; 1166. LandL filed three

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[12] On September 18, 2009, the day of the election, the Svetlana Pelullo Revocable Deed of Trust filed amended claim 108-2 showing an unsecured claim for $300,000 on a promissory note. R. 223; 2230.

[13] This fact is pertinent because under 11 U.S.C. § 702(a)(1), a secured creditor is ineligible to vote in a trustee election. *See* 11 U.S.C. § 702(a)(1) (providing that only creditors with "unsecured claims" of a certain type may vote in a trustee election).

separate original proofs of claim: claim 34-1 for a $128,475 secured claim on a final judgment arising from non-payment of rent; claim 38-1 for a $224,908 secured claim on a final judgment arising from non-payment of rent; and claim 59-1 for a $365,270 secured claim on a final judgment. R.1150; 1165; 1180; 2209; 2210; 2216. On September 18, 2009, the day of the election, LandL filed three amended proofs of claims; each claim amount remained the same except the debts were listed as unsecured instead of secured. R. 229-230; 2209; 2210; 2216.

LandL filed two separate adversary complaints against FirstPlus for a determination of liability on its claims. R. 1151; R. 1166. In both complaints, LandL alleged, *inter alia*, that LandL filed a lawsuit in Texas state court against FirstPlus for breach of contract, and the lawsuit remained open with regards to FirstPlus as of the date the bankruptcy was filed. R. 1152; R. 1166-67. In addition, LandL alleged that it recovered judgment against FirstPlus in Pennsylvania state court for $224,908.02, but in support of this allegation LandL attached a Complaint in Confession of Judgment against a non-debtor subsidiary, FirstPlus Facility Services Company, LLC. R. 1169; 1181.

Orwig objected to LandL's three original proofs of claim on September 17, 2009 because 1) all three claims arise from the same facts and circumstances surrounding the alleged failure of a non-debtor subsidiary to pay rent; 2) the claims on their face are subject to litigation currently pending in Pennsylvania state court and before the bankruptcy court; 3) the claim amounts are not established because LandL filed three claims for the same liability in three amounts; and 4) the claims are duplicative. R. 1142-46.

Orwig listed LandL Holdings as a disputed, contingent, and unliquidated creditor on Schedule F. R. 1302.

ETCG As noted above, ETCG is one of three creditors who was not part of the "Ad

Hoc Creditors' Committee" (and is not an appellant) but voted with the ad hoc group at the trustee election. ETCG filed a proof of claim that was not against FirstPlus. R. 230-1; 241. On September 17, 2009, the day before the election, ETCG filed proof of claim 106-1, asserting an unsecured debt of $85,422.16 in connection with a sublease agreement with Rutgers Investment Group, a non-debtor subsidiary of FirstPlus. R. 1953-65; 305. Nothing in ETCG's proof of claim indicated that debtor FirstPlus was liable on the claimed debt. ETCG's debt is not listed on Schedule F. R. 1300-03.

Woodson Smith Group Woodson Smith Group is another non-member of the "Ad Hoc Creditors' Committee" (and non-appellant) who voted with that group at the trustee election. R. 231; 241. Woodson Smith filed two proofs of claim on September 17, 2009, neither of which documented the value of the alleged claim or a connection to FirstPlus. R. 1924; 1932; 2229. Claim 103-1 avers a $375,000 unsecured debt for "good will and work in progress," but no documentation of the claimed amount or its connection (if any) to FirstPlus were attached. R. 1924, 2228. Claim 104-1, which claims a fully secured claim of $250,000 for furnishings/computer hardware/décor/art, is accompanied by an inventory list that contains no values of any kind. R. 1932-35; 2228-29. Neither of Woodson Smith's debts is listed on Schedule F. R. 1300-03.

REFI REFI filed two proofs of claim on September 17, 2009. The first, claim 102-1, avers a $375,000 unsecured debt for "good will and work in progress." R. 1917; 2228. No writings documenting the claimed amount were attached. The second, claim 105-1, avers a $250,000 secured debt for furnishings/computer hardware/décor/art. R. 1937-47; 2229. The attached inventory lists equipment but does not indicate value amounts. R. 1944-46. REFI's debts were not listed on Schedule F. R. 1300-03.

Orwig's oral objections at the election

Orwig's representatives objected both to the election request and the requesting creditors' claims at the election. R. 2285, 2303-04. Specially, Orwig's attorney Peter Franklin stated that the trustee objected to the Ad Hoc Committee's members' claims on the basis that they already "were disputed on numerous grounds...they are insiders either by relationship or control and other bases." R. 2303. With regard to the claims "that we were not served prior to today," Mr. Franklin stated that "as to the claims that we were not served prior to today we feel and will probably file objections to many of them." R. 2304.

United States Trustee unable to certify election

The United States Trustee could not certify the election because of issues regarding 1) the eligibility of creditors to either request or vote in this election; 2) the calculation of the universe of claims permitted to vote under § 702(a)(1); and 3) the notation on the record that the election was disputed. 11 U.S.C. § 702(a) and (b). R. 214. The United States Trustee filed his *Report of Election Controversy* on September 23, 2009. R. 214-60.

October 9, 2009 election resolution hearing

Members of the "Ad Hoc Creditors' Committee" moved for a resolution of the election dispute under 11 U.S.C. § 1104(b)(2)(C). R. 264-273. The bankruptcy court heard the creditors' motions to resolve the election controversy on October 9, 2009. R. 911.

At the hearing, insider William Maxwell represented both himself and the "Ad Hoc Creditors Committee." R. 704-05. Maxwell called his brother, former FirstPlus CEO and criminal target John Maxwell, to the stand, who testified that the Ad Hoc Committee members' claims were valid. R. 752; 772. No documents supporting these claims, beyond those which had already been filed with the bankruptcy court, were entered into evidence.

As for the claims of ETCG, the Woodson Smith Group, and REFI, William Maxwell introduced testimony from two witnesses, Kevin Smith and Reginald Anderson, who testified that their dealings were with Jack Roubinek, the chief executive officer of non-debtor subsidiary Rutgers Investment Group, Inc. R. 727; 729-30; 742-45. Both witnesses testified that they had few documents supporting their claims because their papers had been seized from FirstPlus's offices by the FBI in May 2008. R. 732; 746. Kevin Smith testified that his claims for equipment and inventory were secured. R. 740.

The bankruptcy court holds that the trustee election was invalid

On October 20, 2009, the bankruptcy court entered its *Order on Motions for Resolution of Election Dispute* holding that the election was invalid and that Matthew Orwig would remain as chapter 11 trustee. R. 6-10. The bankruptcy court's *Order* held that the first step to resolve the election dispute was to determine the universe of voting creditors under 11 U.S.C. § 702(b). R. 7. The second step is to determine whether eligible creditors holding at least 20% of that amount requested the election. 11 U.S.C. § 702(b). R. 7.

Relying on the approach advocated in *In re Michelex Ltd.*, 195 B.R. 993, 1008 (Bankr. W.D. Mich. 1996), the court used the Debtor's schedules, as modified by eligible proofs of claim on file at the time of the election, to calculate the universe of claims eligible to vote. R. 7-8. The court thus determined that the total universe of claims eligible to vote was $8,810,672.53. R. 8. In calculating this figure, the court excluded claims 1) listed on Schedule F as contingent, unliquidated, or disputed and 2) claims listed on the register which were either duplicative of those listed on F, priority claims, insider claims, and claims objected to by the trustee. The court therefore determined that the amount of claims necessary to request an election was $1,762,134.50 ($8,810,673.53 x 0.20). R. 8.

The court then reviewed the claims of all creditors requesting the election and determined that none was eligible to vote under 11 U.S.C. § 702(a). R. 8-10. Going through each of the requesting creditors claims:

> **Learned Associates's** claim had been objected to and was listed on Schedule F as disputed, contingent, and unliquidated; Learned Associates also holds $750,000 shares of restricted stock in FirstPlus. R. 8.
>
> **Cordova's** claim had been objected to and was listed on Schedule F as disputed, contingent, and unliquidated. R. 9.
>
> **Seven Hills**'s claim had been objected to and was listed on Schedule F as disputed, contingent, and unliquidated; Seven Hills also holds $750,000 shares of restricted stock in FirstPlus. R. 9
>
> **Svetlana Pelullo Irrevocable Deed of Trust's** claim had been objected to and was listed on Schedule F as disputed, contingent, and unliquidated. R. 9.
>
> **LandL** had three claims against which objections were pending, and the claims have been listed on Schedule F as disputed, contingent, and unliquidated. R. 9.
>
> **Woodson Smith Group, REFI, and ETCG's** claims had been objected to by the trustee for lack of documentation and, in the case of ETCG, for lack of evidence or documentation that FirstPlus was responsible for a lease with one of its subsidiaries. R. 10.

The court thus concluded that the election contest should be resolved in Orwig's favor. R. 10. In the alternative, the court found that even if the election had been properly requested, the "only eligible votes cast were for Orwig and the election would have been certified in his favor."

R. 10.[14] The court did not reach the issue of whether the election was sought in bad faith because it had other grounds for finding that the election was not valid.

Ad hoc creditors committee requests amendment of findings of fact

Within ten days of the court's order, the six members of the Ad Hoc Creditors Committee (both individually and collectively) filed their *Request for or Alternatively Motion for Amended Findings of Fact and Conclusions of Law to Docket No. 238 and Subject There to Notice of Appeal.* R. 518-21. On November 19, 2009, the bankruptcy court denied the creditors' motion to alter or amend the findings of fact, holding that "[a]fter a review of the Motion, the Court finds that the Motion fails to show an error of law, mistake of fact, or newly discovered evidence." R. 63-64.

SUMMARY OF THE ARGUMENT

To have a valid trustee election, the creditors who vote must meet certain eligibility requirements set forth in 11 U.S.C. § 702(a). *See* 11 U.S.C. § 702(a) and (b). In this case, the bankruptcy court's order should be affirmed because none of the creditors requesting the election was eligible to do so.

Creditors whose claims are disputed may not vote. 11 U.S.C. § 702(a)(1). The claims of the "Ad Hoc Creditors' Committee" (Learned Associates, Michael Cordova, Seven Hills Management, the Svetlana Pelullo Irrevocable Deed of Trust, and LandL Holdings) all put their own claims in dispute by filing adversary proceedings about the validity of their claims. In addition, written objections were filed against the claims of each of these parties. Moreover, the chapter 11 trustee's representative orally objected to all the requesting creditors' claims at the

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[14] The court did not explain its finding as to why the only eligible votes cast were in Orwig's favor. R. 10.

election.

In addition, creditors whose claims are secured or are materially adverse to those of other creditors may not vote. 11 U.S.C. § 702(a)(1) and (2). Learned Associates and Seven Hills Management are shareholders of FirstPlus.

As for the three entities who were not part of the "Ad Hoc Creditors' Committee" (ETCG, Woodson Smith Group, and REFI), creditors whose claims are insufficient on their face may not vote. Fed. R. Bankr. P. 2003(b)(3). ETCG, Woodson Smith Group, and REFI held claims either against separate non-debtor entities or for inventories for which no dollar amounts had been listed. In addition, creditors whose claims are not fixed or liquidated may not vote. 11 U.S.C. § 702(a)(1). Woodson Smith Group and REFI held claims which were unfixed or unliquidated because they were for business damages claims which had not been adjudicated by a court.

Objections by an interim chapter 11 trustee are more than sufficient to create a disputed claim for purposes of a trustee election. Chapter 11 trustees have an affirmative duty to investigate claims filed against the estate and, if necessary, to object to these claims.

ARGUMENT

I. The bankruptcy court did not abuse its discretion when it held that the chapter 11 trustee election was invalid because the creditors requesting the election were not eligible to vote under 11 U.S.C. § 702(a).

A. Introduction.

The Bankruptcy Code and Rules impose specific eligibility requirements on creditors to both request and vote in a trustee election. *See* 11 U.S.C. § 702.[15] Creditors may vote only if

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[15] Chapter 11trustee elections, which are governed by section 1104(b) of the Bankruptcy Code and Federal Rule of Bankruptcy Procedure 2007.1(b), incorporate section 702 of the Bankruptcy

they 1) hold allowable, undisputed, fixed, liquidated, and unsecured claims; 2) do not have interests materially adverse (other than an unsubstantial equity interest) in relation to the interest of creditors entitled to such a distribution; and 3) are not insiders. 11 U.S.C. § 702(a). Only creditors who are eligible to vote may request an election. 11 U.S.C. § 702(b). Thus an analysis of whether a creditor is eligible to request an election turns on whether that same creditor is eligible to vote under 11 U.S.C. § 702(a).

These eligibility requirements are specific because trustee elections present opportunities for abuse by creditors seeking to choose their opponent. *In re Williams*, 277 B.R. 114, 119-20 (Bankr. C.D. Cal. 2002). In *Williams*, the court observed that "[t]he law does not sanction having [the creditor] choose her opponent on appeal any more than it allows her to select debtor's attorney." 277 B.R. at 119. Thus the eligibility requirements of section 702(a) are safeguards against creditors who seek an unfair advantage.

B. Every creditor who requested the trustee election has a disputed claim and is therefore ineligible under 11 U.S.C. § 702(a).

The bankruptcy court did not abuse its discretion in concluding that the election contest should be resolved in favor of Mr. Orwig remaining as chapter 11 trustee. As set forth in the facts above, every single creditor who requested the election held a disputed claim— and that rendered them all ineligible to vote.

1. Creditors who placed their own claims in dispute were ineligible to vote.

Code and Federal Rule of Bankruptcy Procedure 2003(b), which set out chapter 7 trustee elections procedures. 11 U.S.C.§§ 702, 1104; Fed. R. Bankr. P. 2003(b) and 2007.1(b). The issues presented in this appeal therefore turn primarily on section 702 and Federal Rule of Bankruptcy Procedure 2003(b). Because of the relative rarity of chapter 11 trustee elections, most of the case law regarding trustee elections arise from chapter 7 cases. The applicable Bankruptcy Code and Rule sections are included in Appendix 1 .

To begin with, five out of the six members of the "Ad Hoc Creditors' Committee" filed adversary complaints that *put their own claims in dispute*.[16] R. 997 (Learned Associates); R. 1107 (Michael Cordova); R. 1049 (Seven Hills Management); R. 1194 (Svetlana Pelullo Revocable Deed of Trust); R. 1151; 1166 (LandL Holdings). In each case, the creditor filed a complaint seeking a determination of the validity of its claim. Thus, within the plain language of 11 U.S.C. § 702(a)(1), which requires a creditor to have an "undisputed" claim before it may vote in a trustee election, none of the parties who made their own claims the subject of disputed adversary proceedings was eligible to vote.

Moreover, Orwig, as trustee, stepped into FirstPlus's shoes in the adversaries filed by the members of the "Ad Hoc Creditors' Committee." These creditors, by seeking a trustee election, should not be permitted to gain an unfair advantage by choosing their opponent. *See In re Williams,* 277 B.R. 114, 119-20 (Bankr. C.D. Cal. 2002).

For these reasons, this Court should find that the bankruptcy court did not abuse its discretion in holding the members of the "Ad Hoc Creditors' Committee" had disputed claims that rendered them ineligible to vote in the trustee election.

2. All of the creditors who requested the election were ineligible to vote because their claims had been objected to.

In addition to the creditors who are ineligible for placing their own claims in dispute, *all of the creditors* who attempted to vote at the trustee election were ineligible because objections were lodged as to *all* of their claims. A claim is considered disputed after a party objects. A creditor may neither request nor vote in an election under section 702(a) if an objection has been made to its proof of claim. Fed. R. Bankr. P. 2003(b)(3). *See also In re DB Drilling, Inc.*, 73

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[16] The sixth member, William Maxwell, PLLC, did not vote due to his insider status as the brother of the former CEO of FirstPlus, John Maxwell. R. 224.

B.R. 953, 955 (Bankr. N.D. Tex. 1987) (citing *In re Flexible Conveyor Co.,* 156 F. Supp. 164 (N.D. Ohio 1975)).

If a party has objected to a claim for voting purposes and the election is disputed, the bankruptcy court need not make a final adjudication on the validity of that claim; instead, the bankruptcy court need only find that the objection is not frivolous. *In re Williams*, 277 B.R. 114, 120 (Bankr. C.D. Cal. 2002). An objection need only "state the legal or factual basis for the objection." *In re QMECT, Inc.*, 2007 WL 219942, *4, No. 04-41044 (Bankr. N.D. Cal. Jan. 25, 2007) (objection valid even though it was filed on the day of the election and no notice was served on claimants until after the meeting).

In addition, given the need to conduct and resolve trustee elections as expeditiously as possible, objections to a proof of claim for purposes of a trustee election may be less formal and need not be in writing to be valid. *QMECT*, 2007 WL 219942 at *4 ("[t]he drafters of the rule obviously concluded that the need to conduct a trustee election promptly, if at all, made it necessary to dispense with more customary procedural protections"). Because claims are often not filed or presented until the meeting of creditors, a written objection may not be necessary for the claim to be deemed disputed, provided an oral objection is made to the claim at the meeting prior to voting. *See, e.g., In re Sforza*, 174 B.R. 656, 658 (Bankr. D. Mass. 1994) (holding that debtor's attorney's statement at meeting of creditors that creditors' claim was subject to counterclaim in state court litigation rendered claim disputed for voting purposes); *In re Valentine*, 296 B.R. 384, 387 (Bankr. E.D. Va. 2001) (oral objection sufficient basis for determination that creditor's claim disputed given that the objection was not frivolous, claim listed as disputed on the schedules, and the debtor later filed a written objection to the claim).

Members of the "Ad Hoc Creditors' Committee" Learned Associates, Michael Cordova, Seven Hills Management, Svetlana Pelullo Revocable Deed of Trust, and LandL Holdings were not eligible to request the election because — in addition to their self-imposed adversary proceedings calling their claims into dispute — Orwig objected to their claims in writing prior to the election.[17] R. 988 (Learned Associates); 1039 (Seven Hills); 1098 (Cordova); 1142 (LandL); 1186 (Trust). In each instance, the objections stated legal or factual bases for why the claim should be disallowed. R. 988 (Learned Associates); 1039 (Seven Hills); 1098 (Cordova); 1142 (LandL); 1186 (Trust). Furthermore, Orwig orally objected to these claims at the trustee election hearing on the grounds that they were either insiders or otherwise exercised control over the debtor. R. 2203-04; 2285; 2303.

As for the three other creditors who requested a trustee election, Orwig orally objected to the claims of ETCG, Woodson Smith Group, and REFI at the election proceeding. R. 2285; 2304. Notably, these creditors had filed their proofs of claim only the day before the election, which did not give Orwig much time to review the claims and upload an objection. R. 2229 (ETCG claim 106); 2228 (Woodson Smith Group claim 103); 2228-29 (Woodson Smith Group claim 104); 2228 (REFI claim 102); 2229 (REFI claim 105).

Given the undisputed factual record of Orwig's objections, the bankruptcy court did not abuse its discretion in concluding that all of the creditors requesting the election were ineligible to vote in the election because their claims were objected to. R. 8-10.

3. Non-frivolous objections by the interim chapter 11 trustee disqualify a creditor from voting.

The Appellants argue that Orwig has no standing to object to claims and any such

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[17] The bankruptcy court also looked to Orwig's Schedule F in its analysis as to whether the claims were disputed. R. 7-10. Schedule F is arguably duplicative to the analysis because, as established above, Orwig objected to all claims either in writing prior to the election, orally at the election, or both.

objections are made in bad faith. Appellants' Brief at 15. However, an interim trustee "is the optimal party to object to a creditor's claim for voting purposes since he is the representative of the estate." *In re Poage,* 92 B.R. 659, 663 (Bankr. N.D. Tex. 1988).[18] Chapter 11 trustees have an affirmative duty to "examine proofs of claims and object to the allowance of any claim that is improper." 11 U.S.C. §§ 1106(a)(1) and 704(a)(5). Chapter 11 trustees are also charged with investigating the acts and conduct of the debtor on any matter relevant to the bankruptcy case. 11 U.S.C. § 1106(a)(3). A chapter 11 trustee therefore not only has a duty to object to improper proofs of claim, but, given this investigative duty, may be the only party with the necessary information to object.

The majority of courts hold that an interim trustee has standing to object to a creditor's right to vote in an election.[19] *In re Poage,* 92 B.R. 659, 663 (Bankr. N.D. Tex. 1988); *In re Amherst Technologies, LLC,* 335 B.R. 502, 511 (Bankr. D.N.H. 2006); *In re Lindell Drop Forge Co.,* 111 B.R. 137, 141 (Bankr. W.D. Mich. 1990); *In re Metro Shippers, Inc.*, 63 B.R. 593, 598 (Bankr. E.D. Pa. 1986). Judge Felsenthal reasoned in *In re Poage* that interim trustees have standing to object to a creditor's right to participate in a trustee election given that 1) neither section 702(a) of the Bankruptcy Code nor Bankruptcy Rule 2003(b)(3) expressly prohibit

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[18] *Poage* was decided prior to the 1991 amendments to Federal Rule of Bankruptcy Procedure 2003(b)(3) but these amendments did not affect the legal principal cited herein.

[19] Only one court has held that an interim trustee does not have standing to challenge a creditor's right to vote in an election, but that decision has not been adopted by others. *In re G.I.C. Gov't Sec., Inc.*, 56 B.R. 105, 108 (Bankr. M.D. Fla. 1985). In *G.I.C.,* the bankruptcy court provided no reason for its finding that the interim trustee had no standing to challenge the election. *Id*. Courts which have examined *G.I.C.* have concluded this case was decided incorrectly. *See In re New York Produce American & Korean Auction Corp.*, 1990 WL 129197 at *3, No. 89-8550 (S.D.N.Y. August 31, 1990); *In re NNLC Corp.*, 96 B.R. 7, 9 (Bankr. D. Conn. 1989)*; In re Poage*, 92 B.R. 659, 663 (Bankr. N.D. Tex. 1988); *In re Metro Shippers, Inc.,* 63 B.R. 593, 598 (Bankr. E.D. Pa. 1986).

interim trustees from objecting and 2) the interim trustee is the party best positioned to lodge such objections given his unique role as representative of the estate. *Poage*, 92 B.R. at 663.

While, in theory, the potential exists for an unscrupulous interim trustee to seek to advance his own interests in an election by objecting to a creditor's right to vote, any concern about such a circumstance "can be easily addressed by the courts." *In re Sandhurt Sec., Inc.*, 96 B.R. 451, 457 (Bankr. S.D.N.Y. 1989). In this case, the bankruptcy court did not cite any cause for concern about Mr. Orwig's motives. R. 6-10. Neither should this Court find any cause for concern about Mr. Orwig's standing or bona fides in objecting.

4. Orwig's objections were valid.

Finally, the appellants argue that Orwig's written objections are not valid because they had amended their proofs of claim the day of the election. This Court should reject this argument because the amended claims filed by Learned Associates, Michael Cordova, and Seven Hills Management did not differ substantively from the original proofs of claim. R. 227 (Learned); R. 227 (Cordova); R. 228 (Seven Hills). Moreover, the amended proofs of claim for the Svetlana Pelullo Revocable Deed of Trust and LandL Holdings differed only in that the original claims filed by each indicated that these creditors held secured claims; the amended claims asserted that these creditors were wholly unsecured. R. 223 (Svetlana Pelullo); R. 229-230 (LandL).[20] Orwig should not be penalized for the manner and form of his objection to these late-amended claims. If creditors may obtain standing to request an election by filing a proof of claim immediately before the election, then parties should not be penalized for not having

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[20] Even if the Svetlana Pelullo Revocable Deed of Trust and LandL Holdings were unsecured, contrary to the secured status they claimed in their proofs-of-claim, these two creditors remain ineligible to vote because their claims are disputed, as established above.

enough time to investigate the validity of that claim. *QMECT*, 2007 WL 219942, at *4, No. 04-41044 Bankr. N.D. Cal. Jan. 25, 2007).

Furthermore, Orwig's written objections to the original proofs of claim were still applicable to the amended proofs of claims. The filing of an objection to a proof of claim initiates a contested matter, thereby putting all parties on notice that litigation is required to resolve the objection. *Internal Revenue Service v. Taylor (In re Taylor),* 132 F.3d 256, 261 (5th Cir. 1998); *see also* Fed. R. Bankr. P. 9014. The Fifth Circuit has held that creditors should not be permitted to amend their claims to circumvent bar dates. *Highlands Ins. Co., Inc. v. Alliance Operating Corp. (In re Alliance Operating Corp.),* 60 F.3d 1174, 1175 (5th Cir. 1995). The same reasoning applies to claim amendments filed to circumvent written objections for purposes of voting in an election, particularly in those instances where the creditors have amended their claims the same date as the election.

For all of these reasons, the bankruptcy court did not abuse its discretion in concluding that the trustee election dispute should be resolved in favor of Mr. Orwig because all of the creditors who requested the election were ineligible because their claims had been objected to.

C. The bankruptcy court did not abuse its discretion in holding Learned Associates and Seven Hills Management were disqualified from voting because they held stock in FirstPlus.

A creditor is disqualified from voting if the creditor holds a claim which is materially adverse to other creditors entitled to such distribution. 11 U.S.C. § 702(a)(2). A creditor holding an equity interest that is insubstantial in relation to that creditor's interest as a creditor is not disqualified from voting. 11 U.S.C. § 702(a)(2).

While "materially adverse" is not defined in the Bankruptcy Code, the legislative history reveals this requirement encompasses a conflict of interest rule. *In re NNLC Corp.,* 96 B.R. 7, 10 (Bankr. D. Conn. 1989*)* *(*citing H.R. Rep. No. 595, 95th Cong., 1st Sess. 378 (1977)). An equity holder's interests conflict with an unsecured creditor's because equity cannot receive a distribution until all other creditors, including unsecured creditors, have been satisfied.

The bankruptcy court did not abuse its discretion in concluding that Learned Associates and Seven Hills Management were disqualified from voting because each creditor — by its own admission — holds 750,000 shares of restricted stock in FirstPlus. R. 998 (Learned); R. 2267 (Seven Hills). While the Appellants argue that these creditors' equity interest is insubstantial compared with their claims, no evidence was presented at the election dispute hearing documenting that this equity interest was insubstantial compared with their unsecured claims. Accordingly, there is no basis in the record to find that the bankruptcy court abused its discretion. In addition, even if Learned Associates and Seven Hills could establish that their equity interests are insubstantial, their votes in the trustee election were still barred because their claims were objected to and disputed, as explained above.

D. The bankruptcy court did not abuse its discretion by concluding that creditors ETCG, Woodson Smith Group and REFI were barred from requesting or voting in a trustee election in view of the trustee's objection that their claims lacked documentation.

The bankruptcy court did not abuse its discretion in observing that creditors ETCG, Woodson Smith and REFI's claims had been objected to for lack of documentation. R. 10. Indeed, even if the existence of Orwig's non-frivolous objection alone were not enough to find these creditors ineligible, the bankruptcy court easily could have found the objection was well taken under the facts and law. A creditor is disqualified from voting if the proof of claim is insufficient on its face. Fed. R. Bankr. P. 2003(b)(3); *see also Cal. State Bd. of Equalization v. Off'l Unsecured Creditors' Comm. (In re Fidelity Holding Co., Ltd.),* 837 F.2d 696, 698 (5th Cir. 1988) (proof of claim which is insufficient on its face not given prima facie validity). For example, a proof of claim may be insufficient on its face if it does not substantially comply with the Official Bankruptcy Forms. *See* Fed. R. Bankr. P. 3001(a); *In re DB Drilling, Inc.*, 73 B.R. 953, 955 (Bankr. N.D. Tex. 1987). Instruction 7 for Official Form 10 provides that a creditor filing a proof of claim form must provide "redacted copies documenting the existence of the debt and of any lien securing the debt." A claim which does have an attached writing cannot vote or request a trustee election. *See* Fed. R. Bankr. P. 2003(b)(3); *In re Lindell Drop Forge Co.,* 111 B.R. 137, 142 (Bankr. W.D. Mich. 1990) (union disqualified from voting because proof of claim did not indicate how estimated amounts owed were calculated).

Moreover, creditors holding unfixed and unliquidated claims may not vote in a trustee election. A debt is liquid if "the amount due and the date on which it was due are fixed or certain, or when they are ascertainable by reference to (1) an agreement or (2) a simple mathematical formula." *In re Poage*, 92 B.R. 659, 665 (Bankr. N.D. Tex. 1988); *see also In re Klein,* 110 B.R. 862, 874 (Bankr. N.D. Ill. 1990)*, rev'd in part on other grounds,* 119 B.R. 971 (N.D. Ill. 1990) (claimants with nebulous or undefined claims should not be permitted to participate).

Woodson Smith Group's claim 103 and REFI's claim 102 both averred unsecured claims of $375,000 each for "goodwill and work in progress." R. 1924; 1917. However, these claims have not been fixed or liquidated. Neither indicate how Woodson Smith or REFI calculated damages for loss of goodwill and work in progress. Instead, the $375,000 amount appears to be an arbitrary value assigned to a possible cause of action against FirstPlus. A claim based on fraud or tort cannot be fixed and liquidated until the amount has been fixed by judicial award. *Denham v. Shellman Grain Elevator, Inc. (In re Denham),* 444 F.2d 1376, 1380 (5th Cir. 1971). Therefore Woodson Smith and REFI were ineligible to request the election, and therefore, even if the bankruptcy court had not found them ineligible because their claims were objected to, these creditors were ineligible to vote because their claims were not fixed or liquidated.

In addition, ETCG and Woodson Smith asserted claims that were insufficient on their face. Claim 106 filed by ETCG was insufficient on its face because its attachments did not document the existence of a debt; instead, they showed ETCG had a sublease agreement with a separate legal entity, a non-debtor subsidiary. R. 1953-65. While the documents attached to ETCG's proof of claim 106 referred to a debt between ETCG and Rutgers Investment Group, Inc., nothing in the documents indicates that FirstPlus is liable on this debt. R. 1952-65. Likewise, Woodson Smith Group's claim 103 and REFI's claim 102 should have been disallowed because neither claim has papers attached documenting the debt. R. 1917; 1924.

For these reasons, the bankruptcy court did not abuse its discretion in concluding that ETCG, Woodson Smith, and REFI were ineligible to vote in the trustee election.

CONCLUSION

The election was not valid because none of the creditors requesting the election was eligible to vote. 11 U.S.C. § 702(b); *see also* Appendix 2 (Summary of Creditors Requesting the Election and Bases for Ineligibility). Because the election was not valid, Orwig became the permanent trustee by virtue of his having been appointed by the United States Trustee. 11 U.S.C. § 702(d). *See Berg v. Esposito (In re Oxborrow),* 913 F.2d 751, 754 (9th Cir. 1990); *In re Ft. Worth Campbell & Assoc., Inc.*, 182 B.R. 748, 750 (Bankr. N.D. Tex. 1995). Therefore Orwig did not need any election votes to become trustee.

For all of the foregoing these reasons, the United States Trustee respectfully asks this Court to affirm the order entered by the bankruptcy court below.

RAMONA D. ELLIOTT WILLIAM T. NEARY

General Counsel

P. MATTHEW SUTKO
Associate General Counsel
ANNE W. STUKES
Trial Attorney
Executive Office for United States Trustees
Department of Justice
20 Massachusetts Avenue, N.W.
Washington, D.C. 20530
Ph: (202) 307-1399
Fax: (202) 307-2397

United States Trustee for Region 6
/s/ Erin Marie Schmidt
ERIN MARIE SCHMIDT
Trial Attorney
State Bar of Texas No. 24033042
Lisa Laura Lambert
Trial Attorney
State Bar of Texas No. 11844250
Department of Justice
1100 Commerce Street, Rm. 976
Dallas, TX 75242
(214) 767-8967
(214) 767-8971 (fax)

CERTIFICATE OF SERVICE

I certify that I forwarded a true and correct copy of the foregoing BRIEF OF APPELLEE WILLIAM T. NEARY, UNITED STATES TRUSTEE by prepaid first class mail to the persons listed below on May 3, 2010.

/s/ Erin Marie Schmidt

Erin Marie Schmidt

Appellants:

William Maxwell, PLLC

Learned Associates of North America, LLC

Michael Cordova

Seven Hills Management, LLC

Svetlana Pelullo Revocable Deed of Trust

LandL Holdings, LLC

Appellants' Counsel:

William Maxwell
William Maxwell PLLC
1300 McGowen
Houston , TX 77004

Appellee:

Matthew D. Orwig

Appellee's Counsel:

Jo Christine Miles
Sonnenschein Nath & Rosenthal LLP

1221 Avenue of the Americas
24th Floor
New York , NY 10020

Peter A Franklin , III
Franklin Skierski Lovall Hayward LLP
10501 N Central Expwy
Suite 106
Dallas , TX 75231

Karen C Corallo
Sonnenschein Nath & Rosenthal LLP
2000 McKinney Ave
Suite 1900
Dallas , TX 75201-1858

BRIEF BANK — "SUMMARY SHEET" Printed Thu.-6/3/99 (15:16)

WESTLAW CODES

1. ("TI") TITLE OF CASE [E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]
In re First Merchants Acceptance Corp., et al. —
J.C. Bradford & Co. v. First Merchants Acceptance Corp., et al.

2. ("CO") CURRENT COURT [E.g., "CTA9"]
CTA3

3. ("CCN") CURRENT CASE NO.
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No.: 97-1500 JJF
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(Identify judge & cite, if any)

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P. Matthew Sutko
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") TOPIC
BANKRUPTCY

9. ("SU") • SUMMARY OF KEY ISSUE(s) & / Any Miscellaneous BACKGROUND

• Whether 11 U.S.C. §§ 503(b)(3)(F) & (b)(4) let a member of a creditors committee tax the bankrupt estate for fees its personal lawyer charges for performing committee-related work, when the lawyer has not been appointed by the committee or approved by the court under § 1103(a).

/ **Background:** FMAC filed a Chap. 11 reorganization petition and the UST established a 7-member creditors committee under § 1102. While not opposing compensation for the duly authorized committee counsel, the UST objected to a creditor's request that its personal counsel also be compensated by the estate. The bankruptcy court agreed that § 503(b) does not allow a committee member to be compensated for personal legal expenses out of the bankrupt estate.

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No. 98-5377

IN THE UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

In re First Merchants Acceptance Corporation

J.C. Bradford & Co.,

Appellant,

v.

First Merchants Acceptance Corp., et al.,

Appellees.

On Appeal from the United States District
Court for the District of Delaware

BRIEF OF APPELLEE UNITED STATES TRUSTEE

PATRICIA A. STAIANO
United States Trustee

MARTHA L. DAVIS
General Counsel
P. Matthew Sutko
Department of Justice
Office of the General Counsel
Executive Office for
United States Trustees
901 E Street, N.W., Suite 780
Washington, D.C. 20530
(202) 307-1399

Frederic J. Baker
Senior Assistant U.S. Trustee
Daniel K. Astin
Department of Justice
Office of the United States Trustee
Curtis Center, Suite 950 West
601 Walnut Street
Philadelphia, PA 19106
(215) 597-4411

May 27, 1999

COUNSEL FOR UNITED STATES TRUSTEE

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IN THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

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BRIEF OF APPELLEE UNITED STATES TRUSTEE

STATEMENT OF JURISDICTION

The district court had jurisdiction over this case under 28 U.S.C. 1334(a). On July 16, 1998, appellant J.C. Bradford & Co. timely filed a notice of appeal, A926,[1] from the district court's June 26, 1998 final order, A925, denying Bradford's request that the bankruptcy estate be ordered to pay Bradford's legal fees. This Court has jurisdiction over this appeal under 28 U.S.C. 158(d).

STATEMENT OF THE ISSUE

Whether sections 503(b)(3)(F) and 503(b)(4) of the Bankruptcy Code authorize a member of a creditors committee to tax the bankruptcy estate for the fees its personal lawyer charges it for performing committee-related work when that lawyer has not been appointed by the committee or approved by the court, either to represent the committee or to perform services for it, pursuant to section 1103(a) of the Code?

STATEMENT OF THE CASE AND STATEMENT OF THE FACTS

A. Nature of the Case.

Bradford challenges the denial of its request, filed pursuant to section 503(b)(4) of the Bankruptcy Code, that the bankruptcy estate in this chapter 11 case pay Bradford for fees Bradford owes its personal counsel. The district court held Bradford's claim was barred as a matter of law. This appeal followed.

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[1] The citation form "A_" refers to the page on which this information is found in the Joint Appendix.

B. Factual Background and Proceedings Below.

First Merchants Acceptance Corporation (FMAC) purchases loans that automobile dealers make to customers who acquire pre-owned automobiles. A85; A309. Bradford is one of FMAC's general unsecured creditors. A273. Bradford's claims arise from notes it holds that FMAC issued in 1995 and 1996. A286. On June 30, 1997, LaSalle National Bank, the trustee for the notes, notified the noteholders that the 1996 notes were in default. A311-314. At least as early as July 8, 1997, Bradford, through its counsel, Lawrence R. Ahern, III, initiated efforts to minimize any losses Bradford might realize from FMAC's default.[2/] A315-317.

On July 11, 1997, FMAC filed a voluntary petition in the United States Bankruptcy Court for the District of Delaware under the debt reorganization provisions of chapter 11 of the Bankruptcy Code. A2; A69-82. On July 14, 1997, the FMAC case was assigned to the Honorable Joseph J. Farnan Jr., Chief Judge for the United States District Court for the District of Delaware. A4.

Section 1102(a)(1) of the Bankruptcy Code authorizes the United States

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[2/] Mr. Ahern was a member of Bass, Berry & Sims, PLC during most if not all of the time he provided legal services to Bradford in the FMAC bankruptcy case. A315; A285-303; A420-435; A863-873. Mr. Ahern is now a member of Gullett, Sanford, Robinson & Martin, PLLC. Appellant's brief at 30. For ease of reference, we refer to Mr. Ahern when discussing Bradford's counsel, as most of the fees at issue in this appeal were incurred by Bradford for work he performed. A426.

Trustee to appoint a committee of creditors holding unsecured claims in all chapter 11 cases.[3/] 11 U.S.C. 1102(a)(1). On July 29, 1997, the United States Trustee created a seven-member creditors committee in the FMAC case. A271. Bradford was one of the members. Id. On August 7, 1997, the United States Trustee modified the committee by adding an eighth member. A273.

Section 1103(a) of the Bankruptcy Code authorizes a creditors committee to select committee counsel at a scheduled meeting at which a majority of the members are present. 11 U.S.C. 1103(a). Such counsel may "represent or perform services" for the committee if the bankruptcy court subsequently approves its retention. Id.; see also Fed. R. Bankr. P. 2014(a) (specifying the method by which court approval is sought).

In the FMAC case, the creditors committee met on July 28, 1997 to interview prospective counsel. A274. "After giving full consideration to the matter," the

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[3/] United States Trustees are officials of the Department of Justice appointed by the Attorney General to supervise the administration of bankruptcy cases and trustees. See 28 U.S.C. 581-589 (specifying the powers of United States Trustees); United States Trustee v. Columbia Gas Systems, Inc. (In re Columbia Gas Systems, Inc.), 33 F.3d 294, 296 (3d Cir. 1994)(United States Trustees oversee the bankruptcy process, protect the public interest, and ensure that bankruptcy cases are conducted according to law)(citing H.R. Rep. No. 595, 95th Cong., 2d Sess. 109 (1977)); United States Trustee v. Revco D.S., Inc. (In re Revco D.S., Inc.), 898 F.2d 498, 499 (6th Cir. 1990) ("[t]he United States trustee, an officer of the Executive Branch, represents . . . [the] public interest").

committee authorized the selection and employment of two firms:

a. Pepper, Hamilton & Scheetz LLP;[4] and,

b. Faegre & Benson LLP.

Id. The committee selected those firms because they had "considerable experience in the bankruptcy and commercial law areas and [were] particularly well qualified to represent the Committee." Id.

Pursuant to section 1103(a) and Federal Rule of Bankruptcy Procedure 2014(a), the committee filed an application on August 8, 1997 seeking the court's permission to retain Pepper. A274-283. The application described the firm's expertise and asked that Pepper be authorized to provide legal advice to the committee with respect to the committee's duties and powers; assist the committee in its investigation of the debtor; consider whether the debtor should be sold; advise and participate in matters concerning the formulation of a plan; assist the committee in communicating with the general creditor body regarding the committee's recommendation of any proposed plan of reorganization; review and analyze all pleadings filed with the court in the case; and perform additional services, including litigating on behalf of the committee. A275.

The application pledged to use those Pepper attorneys who had the lowest

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[4] The firm has since become Pepper Hamilton LLP. A479.

billing rates in order “to minimize the expenses to the estates.” A276. The application disclosed the proposed hourly rates of the “attorneys, legal assistants and other professionals who may work on the case.” Id.

The committee notified “the parties” to the FMAC case about its application by formally serving it upon them. A280-283.

As required by Federal Rule of Bankruptcy Procedure 2014(a), the application was accompanied by the sworn affidavit of David B. Stratton, a partner at Pepper. A277-279. In it, Mr. Stratton disclosed the firm’s representation of two creditors in other matters, disclosed that those creditors had waived any conflict arising from Pepper’s representation of the committee, and represented that Pepper “has not and will not represent any of these creditors in this case.” A278. The affidavit also disclosed the firm’s proposed billing rates. A278-279. Finally, Mr. Stratton represented to the court that Pepper was “a ‘disinterested person’ within the meaning of Section 101(14) of the Bankruptcy Code and does not hold or represent an interest adverse to the interests of the estates.” Id. The affidavit was served upon the parties to the case. A280-283.

On August 19, 1997, the committee filed a second application, seeking permission to retain Faegre & Benson LLP as co-counsel. A357-368. It contained the same type of disclosures and findings set forth in the Pepper application, A357-

360, and was accompanied by the sworn affidavit of Michael R. Stewart, a Faegre & Benson partner. A361-364. Mr. Stewart's affidavit disclosed the same type of information that Mr. Stratton's had. Id. It also specifically promised to "utilize [those] professionals having the lowest billing rates to minimize the expense to the Debtor's bankruptcy estate" and represented it would coordinate with Pepper "to avoid unnecessary duplication." A363. The committee's application and Faegre's affidavit were served on the parties to the FMAC case.[5] A365-368.

The committee did not select Mr. Ahern to act as committee counsel. It did not seek court approval for Mr. Ahern to represent it or to perform services for it. No notice was served upon the parties to the case - by the committee, by Bradford, or by Mr. Ahern - that Mr. Ahern would be doing any committee-related work.[6]

Mr. Ahern did not file an affidavit with the court in 1997 specifying the work he intended to perform; disclosing which parties to the case he represented; disclosing his proposed billing rate; or representing that he would minimize his

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[5] The service page in the Joint Appendix erroneously states it served the application to employ Price Waterhouse as financial advisor. A365.

[6] Bradford retained Mr. Ahern in July 1997 "prior to the commencement of th[e] case," A421, "among other things, in connection with the performance of [Bradford's anticipated] duties" on the committee. A420-421. Ten months later, on May 19, 1998, Mr. Ahern sought court permission to appear on Bradford's behalf in the FMAC case, pro hac vice. A777-781.

charges or that he would coordinate with Pepper and Faegre.[7] Mr. Ahern did not swear under oath that he was disinterested under section 101(14) of the Code or that he did not hold or represent an interest adverse to the interests of the estate.

By order entered August 19, 1997, the court approved the committee's application to employ Pepper. A284. It did so based upon its finding that Pepper represented no interest adverse to the debtor or the estate, that the employment of Pepper was necessary and appropriate, and that Pepper was a disinterested person under 11 U.S.C. 101(14). Id. By order entered September 30, 1997, the court approved the committee's application to retain Faegre, after making similar findings. A398. No order was entered authorizing Mr. Ahern's retention.

Mr. Ahern participated in the FMAC case in his capacity as personal counsel to creditor Bradford and he represented Bradford's personal interests as a creditor. See, e.g., A285-322 (substantive pleading filed on Bradford's behalf opposing a settlement proposed by the debtor with third parties); A870-871 (Bradford's statement that counsel had participated in this case as Bradford's personal counsel); A897 (Mr. Ahern's representation to the court below that "[w]e acknowledge

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[7] Mr. Ahern did make a representation about his efforts to minimize costs after the work was completed. Compare A423, 426-435 (disclosing the work Mr. Ahern did from July 1997 through February 1998) with A420, 424, A55 (containing Mr. Ahern's April 30, 1998 representation that he had attempted to minimize costs).

that J.C. Bradford cannot seek reimbursement of all [my] professional compensation in connection with this case" because some involved personal creditor matters).

On April 30, 1998, Bradford filed an application with the court asking that the FMAC bankruptcy estate reimburse it $36,014.25 for work Mr. Ahern had provided to Bradford relating to creditors committee matters from July 1997 through February 1998. A420-435. Virtually all the charges were for making telephone calls, participating in intra-office meetings, reviewing materials, and charging the time it took to travel to meetings in Wilmington and Philadelphia. A426-435. Bradford contended that sections 503(b)(3)(F) and 503(b)(4) mandated that the bankruptcy estate pay for those services. A863-873.

The debtor-in-possession opposed Bradford's application based upon its conclusion that sections 503(b)(3)(F) and 503(b)(4) do not authorize a court to impose fees when a member of a creditors committee obtains advice from non-committee counsel. A782-791.

The Office of the United States Trustee filed a comment with the court setting forth its conclusion that Bradford's application lacked merit and should be denied. A874-876. The United States Trustee contended that only Pepper and Faegre, as "committee counsel [sh]ould receive the compensation" from the bankruptcy estate for work done on behalf of the committee. A875.

On June 22, 1998, a hearing was held on Bradford's application. A878-911. In an order and an unpublished opinion, both dated June 26, 1998, the court denied Bradford's application. A916-925. The court found that section 503(b) was ambiguous on the question whether an individual member of a committee could obtain reimbursement from a bankruptcy estate for services that its private counsel provided it in performing committee-related duties. A920-921. The court further found that the section's legislative history and sound notions of public policy support the conclusion that section 503(b) does not authorize a court to require a bankruptcy estate to reimburse a committee member for such personal legal expenses. A921-924. This appeal followed.

STATEMENT OF RELATED CASES AND PROCEEDINGS

The United States Trustee is unaware of any related cases or proceedings.

STATEMENT OF THE STANDARD OR SCOPE OF REVIEW

This appeal involves questions of law, over which this Court exercises plenary review. Adams v. Commissioner, 170 F.3d 173, 175 (3d Cir. 1999).

SUMMARY OF ARGUMENT

Bradford's contention that bankruptcy estates must pay committee members' personal attorneys fees lacks legal merit, would unnecessarily increase the cost of administering chapter 11 cases, and would impair the ability of creditors committees to effectively represent their constituents. Sections 1103(a) and 503(b) of the Code are best read as requiring a bankruptcy estate to pay only those creditors committee fees incurred by law firms that are committee-appointed and court-approved. An estate is not liable when, as here, an individual committee member independently seeks advice relating to committee matters from personal counsel. Setting section 1103(a) aside, the better reading of section 503(b) - standing alone - leads to the same conclusion, and that interpretation coincides with the plain language of its legislative history and sound notions of public policy.

ARGUMENT

I. Bradford's Construction Of Section 503(b) Should Be Rejected Because It Clashes With The Bankruptcy Code As A Whole.

Each participant in a bankruptcy case normally pays its own attorneys fees. Bradford's views notwithstanding, it has been generally accepted that section 1103(a) of the Bankruptcy Code is the only method by which a lawyer can obtain authorization to do committee-related work, and section 330(a) of the Code is the sole mechanism by which an estate can be taxed for that work.[8/]

[8/] The text of those sections is appended to this brief. We know of only one other case in which attorneys fees were sought for committee-related work under any other provision of the Code. In re County of Orange, 179 B.R. 195 (Bankr. C.D. Cal. 1995) (reimbursement unsuccessfully sought under section 503(b)).

Bradford believes this changed in 1994 when Congress enacted section 503(b)(3)(F).[9] Bradford interprets its plain language, when coupled with that of section 503(b)(4)'s, as requiring bankruptcy estates to fund an individual committee member's use of its personal lawyer to perform committee-related work without any prior disclosure or court approval.[10] Appellant's brief at 11-29.

Bradford's construction of section 503(b) should be rejected because it clashes with section 1103(a) and the Code as a whole. "It [is] fundamental that a section of a statute should not be read in isolation from the context of the whole Act." Richards v. United States, 369 U.S. 1, 10 (1962) (interpreting the Federal Tort Claims Act).

Put simply, "context counts." Regions Hospital v. Shalala, __ U.S. __, 118

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[9] Section 503(b)(3) provides for the allowance of:

> "The actual, necessary expenses, other than compensation and reimbursement specified in paragraph (4) of this subsection, incurred by-
>
> * * *
>
> (F) a member of a committee appointed under section 1102 of this title, if such expenses are incurred in the performance of the duties of such committee[.]"

[10] Section 503(b)(4) provides for the allowance of:

> "reasonable compensation for professional services rendered by an attorney or an accountant of an entity whose expense is allowable under paragraph (3). . . ."

S. Ct. 909, 917 n.5 (1998) (interpreting 42 U.S.C. 1395ww(h)). When "expounding a statute, [a court] must not be guided by a single sentence or member of a sentence, but look to the provisions of the whole law, and to its object and policy." Id. (quoting United States Nat. Bank of Ore. v. Independent Ins. Agents of America, Inc., 508 U.S. 439, 455 (1993) and United States v. Heirs of Boisdore, 8 How. 113, 122, 12 L.Ed. 1009 (1849)).

Bradford's construction of section 503(b) fails this test because it would allow committees to bypass section 1103(a)'s carefully crafted notice and approval requirements simply by having their members' personal lawyers perform committee-related work. When the Code is read as a whole, there is no reason to conclude that section 503(b)(3)(F) has created a mechanism which empowers committees and their members to evade all of section 1103(a)'s substantial protections.

Section 1103(a) ensures that all parties in interest may object to a committee's request to hire a lawyer at estate expense, and the court will have the final say in determining whether the lawyer may perform such work. See In re Arkansas Company, Inc., 798 F.2d 645, 649 (3d Cir. 1986) (analyzing the Code's legislative history and finding it "significant that Congress chose to place the requirement of [prior] court approval for the employment of an attorney [retained] by the creditors committee directly in [section 1103(a) of] the Bankruptcy Code"); S. Rep. No. 95-589, 95th Cong. 2d Sess. 114 (1978) (describing the purpose behind section 1103(a) and cautioning that "[n]ormally, one attorney should suffice" to represent a committee); H. Rep. No. 95-595, 95th Cong. 1st Sess. 402 (1977) (noting that the "normal standard" will be for committees to hire one attorney).

Under section 1103(a), only the full committee may "authorize" counsel's employment and it must do so at a scheduled committee meeting attended by a majority of its members. 11 U.S.C. 1103(a). If a committee determines to select counsel, Federal Rule of Bankruptcy Procedure 2014(a) requires the committee to file an application seeking court approval. Rule 2014(a) requires counsel to file an affidavit in support of the application. All parties in interest have the right to object to the committee's proposed retention. See Fed. R. Bankr. P. 9010(a) (authorizing parties in interest to participate in bankruptcy cases). The bankruptcy court must then determine whether to approve counsel's retention. 11 U.S.C. 1103(a). Unless the court approves, the estate may not be taxed. Arkansas, 798 F.2d at 648 (construing section 1103(a)).

Section 1103(a)'s procedural protections are crucial to the fair and efficient administration of bankruptcy cases. Arkansas, 798 F.2d at 648-50. In Arkansas, this Court held that a bankruptcy court could authorize the retroactive retention of an attorney by a creditors committee under section 1103(a) only in "exceptional circumstances." Id. at 646-50. In reaching that conclusion, this Court rejected a suggestion that retroactive approval should be granted if approval would have been granted had it been timely requested. Id. at 648. Arkansas held that "[s]uch a lenient rule would subvert Congress' purpose in imposing a prior approval requirement" in section 1103(a). Id. Prior approval is crucial under section 1103(a) because it ensures "that the court may know the type of individual who is engaged in the proceeding, their integrity, their experience . . . as well as their competency." Id. (quoting In re Hydrocarbon Chemicals, Inc., 411 F.2d 203, 205 (3d Cir.) (en banc), cert. denied, 396 U.S. 823 (1969)).

In this case, neither Bradford nor its counsel sought prior court approval, and they made none of the detailed disclosures or representations that the committee and Pepper and Faegre did. Instead, Bradford had Mr. Ahern perform work solely under Bradford's direction and supervision - and then sought payment once the work had been completed. A420-435. Not even the debtor knew Bradford was going to seek to tax its estate for Mr. Ahern's work.[11] A784.

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[11] Bradford contends Mr. Ahern performed some services with the knowledge of and, in some instances, at the request of, counsel for the committee. Appellant's brief at 7. The only support it cites is Mr. Ahern's statement below that he made a "number of [phone] calls" on the committee's behalf. A909-910.

Because Bradford did not comply with section 1103(a), the nature and scope

In Bradford's view, the 1994 amendment to section 503(b) creates a parallel world in which all of section 1103(a)'s protections can be sidestepped simply by having individual committee members hire counsel. In this world, no advance showing has to be made to the court; the bankruptcy estate need not be notified that it may be called upon to foot the bill (A784); the United States Trustee need not be informed; other creditors need no notice; and no one is given the opportunity to object to the members' chosen counsel.

But context does count. And context makes clear that this construction is wrong because it is "demonstrably at odds[12/]" with Congress' scheme for selecting creditors committee attorneys, and would render meaningless all of section 1103(a)'s carefully crafted requirements. Indeed, under Bradford's construction, a committee could even have one member use counsel that section 1103(b) of the Code would prohibit the committee from employing. See 11 U.S.C. 1103(b)

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of Mr. Ahern's work was not apparent until Bradford filed its April 1998 application seeking to tax the estate for his services. Although Mr. Ahern performed $36,000 of work from July 1997 through February 1998 (A420-435), he did not seek permission to appear in the case, pro hac vice, until May 19, 1998 (A777-781). The United States Trustee was not aware that Mr. Ahern was performing committee work, and there is no evidence in the record that the debtor or the court were either. See A784 (debtor's statement). This illustrates the unwelcome surprises that will arise if counsel are authorized to perform committee-related work without first complying with section 1103(a).

[12/] United States v. Ron Pair Enterprises, Inc., 489 U.S. 235, 242 (1989).

(which prohibits committees from retaining counsel who suffer from certain types of conflicts).

Bradford's proffered construction also is at odds with the Code because it presupposes that after-the-fact review adequately protects the parties in interest to a case. In Arkansas, however, this Court specifically "reject[ed] the notion that a complete and thorough post-application review may substitute for prior approval." Arkansas, 798 F.2d at 649. As this Court noted, such a construction "would render meaningless the structure of the Bankruptcy Code and Rules . . . requiring . . . prior approval of employment." Id. (referring to 11 U.S.C. 1103(a) and 330(a)).

It is axiomatic that the "preferred" construction of a complex statutory scheme, like the Bankruptcy Code, is the one that "lends greater meaning to all the provisions." Asgrow Seed Co. v. Winterboer, 513 U.S. 179, 189 (1995) (interpreting 7 U.S.C. 2541 and 2543). Construed within the broader context of the Bankruptcy Code, there is no reason to presume that Congress enacted section 503(b)(3)(F) in 1994 to radically alter existing counsel retention law, or to allow committees and their members to end-run section 1103(a)'s carefully designed structure for approving counsel. When considered in its entirety, Richards, 369 U.S. at 10, Shalala, __ U.S. __, 118 S.Ct. at 917 n.5, neither the Code's purpose nor its text supports Bradford's construction.

II Even If Construed In A Vacuum, The Better Reading Of Section 503(b) Does Not Allow Committee Members To Tax Bankruptcy Estates For The Fees Their Private Counsel Charge Them For Committee Work.

1. The language of section 503(b).

Bradford construes section 503(b) in a vacuum, making no reference to section 1103(a) or the congressional purpose behind it. Appellant's brief at x, 11-29; A420-435; A863-873; A894-A900; A909-911. Bradford contends its plain language unambiguously authorizes any committee member to charge the bankruptcy estate for all "fees [that are] related to [its] participation in a Committee appointed under 11 U.S.C. 1102." Appellant's brief at 21.

The better reading of section 503(b) does not support Bradford's conclusion. First, section 503(b)(3)(F) specifically limits a committee member's right to recover expenses to those "incurred in the performance of the duties of [a] committee." 11 U.S.C. 503(b)(3)(F). These words are significant. They allow a member to recover expenses only when performing duties "of" the committee - not merely duties that "pertain" or "relate" to the committee. That suggests section 503(b)(3)(F) only covers those expenses that involve formal committee work (work "of" the committee), not a member's informal or personal response to its formal committee appointment. Accordingly, a member's voluntary consultation with private counsel is not an allowable expense under section 503(b)(3)(F) because it is not "incurred in the performance of the duties of [the] committee," as that term is used in section 503(b)(3)(F). In turn, the absence of such an allowable expense under section 503(b)(3)(F) prevents recovery of fees under section 503(b)(4).[13]

This construction draws support from the language and purpose of sections 503(b)(3)(A)-(E). The first three sections, 503(b)(3)(A)-(C), allow creditors to recover expenses when they perform specific and well-defined tasks - filing an involuntary petition under section 303; recovering property for the benefit of the estate that was transferred or concealed by the debtor; or helping prosecute a criminal case involving the business or property of the debtor. 11 U.S.C. 503(b)(3)(A)-(C). The fourth provision, section 503(b)(3)(D), allows specified entities to recover expenses when they make a "substantial contribution" to a case. See Lebron v. Mechem Financial, Inc., 27 F.3d 937, 942-46 (3d Cir. 1994) (construing section 503(b)(3)(D)). Finally, section 503(b)(3)(E) allows a custodian who held property of the debtor, pre-petition, to recover associated expenses.

In each of these situations, fees are authorized because the parties who

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[13] This reading harmonizes section 503(b)(3)(F) with section 1103(a), which authorizes only properly appointed committee counsel to "represent" the committee or "perform services" for it. 11 U.S.C. 1103(a). Because a member's private counsel cannot perform work "of" the committee, a member also is not performing duties of the committee when using such counsel.

conferred those tangible benefits on the collective interests of the bankruptcy estate could not recover their attorneys fees but for section 503(b)(4). They stand in sharp contrast to a committee member because the member already has access to counsel whose fees will be paid by the bankruptcy estate. When a committee member does work of a committee there will be, in appropriate circumstances, committee counsel to help perform those tasks, and sections 1103(a) and 330(a) create a statutory mechanism to recover those fees from the estate. 11 U.S.C. 1103(a) and 330(a). Given this significant difference, it is reasonable to construe sections 503(b)(3) and (4) as creating a mechanism whereby those entities specified in sections (A) through (E) may recoup legal expenses, but committee members may not.

Finally, as the court below found, section 503(b) does not clearly provide that a member of a committee is an "entity" for purposes of section 503(b)(4), which is a condition prerequisite to any recovery of fees under that provision. See A920-922 (opinion below); County of Orange, 179 B.R. at 201(finding that the plain language of section 503(b) does not lead to the conclusion that a member of a committee is an entity).

Section 101(15) of the Code defines entity to include a person, and section 101(41) defines a person to include a corporation. 11 U.S.C. 101(15) and 101(41).

Bradford is a corporation and thus could be considered an entity for purposes of section 503(b)(4). However, Bradford does not seek recovery in its capacity as a corporation in this case. It seeks recovery in its status as a committee member. "Section 101(15) does not specifically include 'a member of a committee' as that phrase is specifically utilized in Section 503(b)(3)(F), [so a] court [should] not graft that language into the provision in the context of a Section 503(b)(4) application." A921 (opinion below); see also County of Orange, 179 B.R. at 201 (finding that this "statutory language is unclear").

Supporting this interpretation is the fact that section 503(b) does not provide that a member of a committee should be construed to be an entity, as that term is specifically used in section 503(b)(4). Accordingly, it is not clear that Bradford is an entity for purposes of section 503(b) when seeking counsel fees in its capacity as a committee member.[14/] For these reasons, the better reading of section 503(b)

[14/] Bradford also claims it is an entity because it is a creditor. Appellant's brief at 14-15. We agree that Bradford would have been an entity for purposes of section 503(b)(3)(D) had it sought recovery under that section as a creditor who made a "substantial contribution" to the case. See Lebron, 27 F.3d at 943-44 (applying that standard); see also A897, 899 (Bradford's admission that it did not seek recovery under that section because it might not have been able to meet its "onerous" standard). The fact that Bradford would have been an entity had it sought recovery under 503(b)(3)(D) does not change the fact it was not an entity when it sought recovery under section 503(b)(3)(F). Bradford's "administrative expense" argument fails for the same reason. See Appellant's brief at 15.

does not allow Bradford to recover the fees charged by its personal counsel.

2. The legislative history of section 503(b)(3)(F).

Section 503(b)(3)(F)'s legislative history plainly states that Congress did not intend for its adoption to authorize committee members to recover attorneys fees. See 140 Congr. Rec. H10764-71 (daily ed. Oct. 4, 1994) (statement of Chairman Brooks); see also County of Orange,179 B.R. at 201-02 (discussing section 503(b)(3)(F)'s legislative history); A921-922 (opinion below).

Section 503(b)(3)(F) was introduced in the House as section 110 of H.R. 5116, which became law on October 22, 1994 as the Bankruptcy Reform Act of 1994, Pub. L. No. 103-394 (Oct. 22, 1994). See 140 Congr. Rec. HR10752, H10754 (daily ed. Oct. 4, 1994) (text of section 110). There is no house, senate, or conference report for H.R. 5116. Instead, a section by section analysis of H.R. 5116 was appended to the floor remarks of House Judiciary Committee Chairman Brooks. See 140 Congr. Rec. H10764-71 (daily ed. Oct. 4, 1994) (statement of Chairman Brooks).

The House's analysis of section 110 plainly states that section 503(b)(3)(F)'s enactment does not authorize the reimbursement of attorneys fees:

> This section of the bill amends section 503(b) of the Bankruptcy Code to specifically permit members of chapter 11 committees to receive court-approved reimbursement of their actual and necessary out-of-pocket

> expenses. The new provision would not allow the payment of compensation for services rendered by or to the committee members.

140 Congr. Rec. H10765 (daily edition Oct. 4, 1994) (statement of Chairman Brooks).

The Senate considered and passed H.R. 5116 on October 6, 1994. See 140 Cong. Rec. S14461 (daily ed. Oct. 6, 1994) (Senate's consideration and adoption of H.R. 5116). It did not disagree with the House's construction of section 110.

3. Public policy.

The conclusion that section 503(b) does not allow individual members to recover attorneys fees is buttressed by sound notions of public policy. First, it ensures that the bankruptcy estate will not be charged for counsel fees unless fair warning is given by the filing of an application to employ counsel pursuant to section 1103(a) of the Code. Second, it guarantees that parties to a chapter 11 case will have the opportunity to object to all applications to retain counsel. Third, it guarantees that the court will have the opportunity to "know the type of individual who is engaged in the proceeding, their integrity, their experience . . . as well as their competency." Arkansas, 798 F.2d at 648.

This construction also enables bankruptcy courts to control the costs of administering bankruptcy estates. Chapter 11 cases are costly to administer. In some cases, the amount of expenses will determine whether a debtor successfully reorganizes. The costs of administering bankruptcy cases will increase measurably if every member of a committee is found to have a right to charge the estate for the advice it obtains from personal counsel. As the court below noted, allowing such a multiplicity of charges could be "life threatening" in a significant number of cases.[15] A923.

This construction also will enable United States Trustees to help ensure that committee-retained counsel are used in a cost-effective fashion. Congress has empowered United States Trustees to scrutinize the functioning of creditors committees. 28 U.S.C. 586(a)(3)(E). To fulfill that responsibility, United States Trustees review applications to appoint committee counsel, and they oppose unfounded requests. See 11 U.S.C. 307 (United States Trustees may raise and be heard on any issue in any bankruptcy case); Columbia Gas, 33 F.3d at 295-97

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[15] A detailed pre-appointment review process is necessary to prevent attorneys from performing inappropriate work. Contrary to its representation here (appellant's brief at 4 n.3), for example, Bradford is charging the FMAC estate for work that Mr. Ahern performed for Bradford in its capacity as creditor. See, e.g., the July 16, 1997 charge for hiring the local counsel that filed Bradford's August 14, 1997 pleading in its personal capacity (compare A426 (consultations with Mr. Graves of Bradford and with the firm that became local counsel) with A303 (brief local counsel filed)); and the July 27, 1997 charge for "study[ing]" FMAC's July 25, 1997 motion that Bradford opposed in its personal capacity (compare A430 with A238-A266 and A285-322). These examples are not exhaustive.

(construing section 307).

United States Trustees could not adequately review committee applications to retain counsel if individual members could hire personal counsel without prior notice or approval. The United States Trustee would face the impossible task of evaluating such committee requests without knowing how many professionals individual members might retain or the work the members might have them perform.

Our construction of section 503(b) also facilitates the efficient functioning of creditors committees. Under existing law, committees are run by majority rule. The committee selects counsel and counsel advises the committee. Members would have far less incentive to use official counsel if they could use their own for free. Bradford's interpretation would enable members who unsuccessfully seek the retention of personal counsel as committee counsel to ignore committee counsel, use their own, and force the estate to foot the bill. Disgruntled members also could use their personal lawyers to challenge the advice that committee counsel provides the committee. "One can only imagine the atmosphere at a committee meeting where the attendees included the committee members, their lawyers, their accountants and at least one lawyer and one accountant officially retained by the committee." A923 (decision below). We concur fully with the district court's conclusion that Bradford's construction of section 503(b) could "jeopardize the very functioning of an official committee." Id.

Finally, Bradford's construction conflicts with the accepted notion in our law that "each party in a civil litigation bears its own professional fees." In re County of Orange, 179 B.R. at 202 (citing Alyeska Pipeline Serv. Co. v. Wilderness Society, 421 U.S. 240, 247 (1975)). While Congress may change that rule by statute, "[e]xceptions to the American rule are narrowly construed." Id. Cf. Restatement of Restitution (A.L.I.) section 2 (1937) ("A person who officiously confers a benefit upon another is not entitled to restitution therefor.").

In this case, the Code's purpose and structure indicate that Congress has not authorized individual committee members to tax the bankruptcy estate for their personal attorneys fees. Congress would have spoken more clearly had it intended for its 1994 enactment of section 503(b)(3)(F) to radically transform the functioning of creditors committees and overrule the presumption that a party in a bankruptcy case must pay its own way.

CONCLUSION

For these reasons, the United States Trustee respectfully asks this Court to affirm the decision of the court below denying Bradford's fee application.

Respectfully submitted,
PATRICIA A. STAIANO
United States Trustee

Frederic J. Baker
Senior Assistant U.S. Trustee
Daniel K. Astin
Department of Justice
Office of the United States Trustee
Curtis Center, Suite 950 West
601 Walnut Street
Philadelphia, PA 19106
(215) 597-4411

MARTHA L. DAVIS
General Counsel
P. Matthew Sutko
Department of Justice
Office of the General Counsel
Executive Office for
United States Trustees
901 E Street, N.W., Suite 780
Washington, D.C. 20530
(202) 307-1399

By:______________________________

May 27, 1999 COUNSEL FOR UNITED STATES TRUSTEE

CERTIFICATE OF BAR MEMBERSHIP

I hereby certify that I am an attorney with the Department of Justice, licensed to practice law in the District of Columbia, and a member of the bar of the United States Court of Appeals for the Third Circuit.

P. MATTHEW SUTKO

CERTIFICATE OF COMPLIANCE

Pursuant to Federal Rule of Appellate Procedure 32 and Third Circuit Local Appellate Rule 32, I hereby certify that the text of this brief is double-spaced using a proportionately-spaced typeface and the footnotes are single-spaced using the same typeface. The font used is Times New Roman, the point size is 14, and the Department of Justice's WordPerfect8 software calculates this brief as having 6,360 words.

P. MATTHEW SUTKO

CERTIFICATE OF SERVICE

I hereby certify that on the 27th day of May 1999, I filed the foregoing Brief of Appellee United States Trustee by causing the original and ten copies to be sent by Federal Express, for next business day delivery, to the Clerk, United States Court of Appeals for the Third Circuit, and I also certify that I sent two true and correct copies of the Brief of Appellee United States Trustee by Federal Express, for next business day delivery, to:

Laura Davis Jones, Esquire
Young, Conaway, Stargatt
& Taylor
Eleventh Floor, Rodney Square North
P.O. Box 391
Wilmington, Delaware 19899-0391

and

Lawrence R. Ahern, III, Esquire
Gullett, Sanford, Robinson
& Martin, PLLC
3rd Floor, 230 4th Avenue North
P.O. Box 198888
Nashville, Tennessee 37219-8888

P. MATTHEW SUTKO

STATUTORY ADDENDUM

Section 1103. Powers and duties of committees

(a) At a scheduled meeting of a committee appointed under section 1102 of this title, at which a majority of the members of such committee are present, and with the court's approval, such committee may select and authorize the employment by such committee of one or more attorneys, accountants, or other agents, to represent or perform services for such committee.

Section 330. Compensation of officers

(a) (1) After notice to the parties in interest and the United States trustee and a hearing, and subject to sections 326, 328, and 329, the court may award to a trustee, an examiner, a professional person employed under section 327 or 1103 -

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

(B) reimbursement for actual, necessary expenses.

(2) The court may, on its own motion or on the motion of the United States Trustee, the United States Trustee for the District or Region, the trustee for the estate, or any other party in interest, award compensation that is less than the amount of compensation that is requested.

C. (A) In determining the amount of reasonable compensation to be awarded, the court shall consider the nature, the extent, and the value of such services, taking into account all relevant factors, including -

(A) the time spent on such services;

(B) the rates charged for such services;

(C) whether the services were necessary to the administration of, or beneficial at the time at which the service was rendered toward the completion of, a case under this title;

(D) whether the services were performed within a reasonable amount of time commensurate with the complexity, importance, and nature of the problem, issue, or task addressed; and

(E) whether the compensation is reasonable based on the customary compensation charged by comparably skilled practitioners in cases other than cases under this title.

(4) (A) Except as provided in subparagraph (B), the court shall not allow compensation for -

(i) unnecessary duplication of services; or

(ii) services that were not -

(I) reasonably likely to benefit the debtor's estate; or
(II) necessary to the administration of the case.

(B) In a chapter 12 or chapter 13 case in which the debtor is an individual the court may allow reasonable compensation to the debtor's attorney for representing the interests of the debtor in connection with the bankruptcy case based on a consideration of the benefit and necessity of such services to the debtor and the other factors set forth in this section.

(5) The court shall reduce the amount of compensation awarded under this section by the amount of any interim compensation awarded under section 331, and, if the amount of such interim compensation exceeds the amount of compensation awarded under this section, may order the return of the excess to the estate.

(6) Any compensation awarded for the preparation of a fee application shall be based on the level and skill reasonably required to prepare the application.

BRIEF BANK — "SUMMARY SHEET" *Printed Mon-4/19/10 16:51*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*
In re: Joseph R. Raymond Frank, Jr., Tanger R. Frank (Anthony T. Marshall v. R. Michael Bolen, United States Trustee

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*
E. D. La.

3. ("CCN") ***CURRENT*** CASE NO.
No.: 10-00881

4. ("PCN") ***PRIOR*** CASE NO. - & COURT *[IF ANY]*
No.: 09-11933
Court: Bankr. E. D. La.
(Identify judge & cite, if any)

5. ("SO") ***SOURCE***
U.S. TRUSTEES

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*
Filed: April 16, 2010
Type: Brief for R. Michael Bolen, United States Trustee, Appellee

7. ("AU") *PRINCIPAL AUTHORS & OFFICE* [E.g.,"UST/OGC"]
Noah M. Schottenstein, P. Matthew Sutko
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***
• Whether the bankruptcy court, after notice and hearing, abused its discretion by ordering a $500 reduction in attorney's fees when the appellant chose to accept the proposed $500 reduction in lieu of an additional evidentiary hearing into the reasonableness of his compensation.

10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)

11. DO YOU RECOMMEND POSTING IN UST BRIEFBANK?
| x | YES | | NO
NAME: Linda Figueroa
DATE:

No. 2:10-00881

IN THE UNITED STATES COURT DISTRICT COURT
FOR THE EASTERN DISTRICT OF LOUISIANA
NEW ORLEANS DIVISION

IN RE: JOSEPH RAYMOND FRANK, JR., TANGER R. FRANK

ANTHONY T. MARSHALL,
Appellant,
v.
R. MICHAEL BOLEN, UNITED STATES TRUSTEE,
Appellee.

ON APPEAL FROM THE UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF LOUISIANA
BANKRUPTCY CASE NO. 09-11933
THE HONORABLE JERRY BROWN, PRESIDING

BRIEF FOR R. MICHAEL BOLEN, UNITED STATES TRUSTEE, APPELLEE

Of Counsel

RAMONA D. ELLIOTT
General Counsel

P. MATTHEW SUTKO
Associate General Counsel

NOAH M. SCHOTTENSTEIN
Trial Attorney

Executive Office for United States Trustees
United States Department of Justice
20 Massachusetts, Ave. N.W., Suite 8100
Washington, D.C. 20530

R. MICHAEL BOLEN
United States Trustee

CAROLYN S. COLE (12496)
Trial Attorney

Office of the United States Trustee
United States Department of Justice
400 Poydras St.
Suite 2110, Texaco Center
New Orleans, LA 70130
Telephone no. (504) 589-4018
Direct telephone no. (504) 589-2593
Facsimile no. (504) 589-4096

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STATEMENT OF APPELLATE JURISDICTION

This Court has appellate jurisdiction under 28 U.S.C. § 158(a)(1), which confers jurisdiction on the district courts of the United States to hear appeals "from final judgments, orders, and decrees" of bankruptcy judges. The bankruptcy court's final order requiring the debtors' counsel to reduce his attorney's fees by $500 was entered on January 20, 2010. The appellant's notice of appeal was timely filed under 28 U.S.C. § 158(c)(2) and Fed. R. Bankr. P. 8002(a) on January 21, 2010.

STATEMENT OF THE ISSUES

The only issued presented in this appeal is whether the bankruptcy court, after notice and hearing, abused its discretion by ordering a $500 reduction in attorney's fees when the appellant chose to accept the proposed $500 reduction in lieu of an additional evidentiary hearing into the reasonableness of his compensation.

STANDARD OF REVIEW

This Court reviews a bankruptcy court's findings of fact for clear error and conclusions of law de novo. Caplin & Drysdale Chartered v. Babcock & Wilcox Co. (In re Babcock & Wilcox Co.), 526 F.3d 824, 826 (5th Cir. 2008). A bankruptcy court's award or denial of compensation is reviewed for abuse of discretion. Id. "A bankruptcy court abuses its discretion when it (1) applies an improper legal standard or follows improper procedures in calculating the fee award or (2) rests its decision on findings of fact that are clearly erroneous." Id. "Findings of fact may not be set aside unless they are clearly erroneous. In examining for clear error, we review the record as a whole and not just the evidence supporting the finding." Stanley v. U.S. Bank Nat'l Ass'n (In re TransTexas Gas Corp.), 597 F.3d 298, 304 (5th Cir. 2010).

STATEMENT OF THE CASE

Joseph and Tanger Frank retained Anthony Marshall, the appellant, as their bankruptcy counsel. On June 27, 2009, Mr. Marshall filed a voluntary petition on behalf of the debtors under chapter 13 of the Bankruptcy Code. (Docket entry # 1). The initial filing fee was not paid. (Transcript at 8).

On July 28, 2009, Mr. Marshall filed a chapter 13 repayment plan on behalf of the Franks. (Dkt. # 8). The repayment plan contained a request for the payment of $2,250.00 in attorney's fees over the life of the plan. Id. at 3. On September 8, 2009, the chapter 13 trustee filed a notice of deficiency regarding the repayment plan, because (a) Mr. Frank's proof of income was not up to date, (b) Mrs. Frank's income had been incorrectly calculated, and (c) the summary and analysis at the end of the plan showed 72 percent of the proceeds were to be distributed to unsecured creditors when the plan only provided for a 29 percent distribution. (Tr. at 7-8). Because of the delinquencies in providing Mr. Frank's proof of income, the debtors' 11 U.S.C. § 341 meeting of the creditors had to be continued twice, for a total of 56 days: from September 14, 2009 to October 19, 2009, and from October 19, 2009 to November 9, 2009. (Tr. at 8; dkts. #18, 20).

Because Mr. Marshall had failed to correct the deficiencies in the repayment plan that he filed with the court on the Franks' behalf, the hearing to confirm the plan also had to be continued twice: from October 7, 2009 to November 4, 2009, and from November 4, 2009 to December 2, 2009. (Tr. at 7). Mr. Marshall's motion to continue the confirmation hearing to

December 2, 2009 had referenced an incorrect case number and Mr. Marshall never submitted a proposed order granting the motion to continue for the court to sign. (Tr. at 8; dkt. #39 at 2).

On December 2, 2009, Mr. Marshall failed to appear at the confirmation hearing. (Tr. at 7). At the hearing, the chapter 13 trustee attempted to prosecute his objection to the proposed repayment plan, advising the court that the Franks were three payments behind on the proposed plan and that the plan should not be confirmed because it was not feasible and failed to meet the requirements of the Bankruptcy Code. (Tr. at 7, 14-15). The Franks, who appeared in person, stated they could present proof that payments had been made, but did not have the information with them. (Dkt. # 39 at 2). The Franks, on their own initiative, requested to come before the judge and speak about their dissatisfaction with Mr. Marshall's representation. (Tr. at 21). In response, the bankruptcy court continued the hearing to January 20, 2010 — almost three and a half months after the original hearing date — and directed the Franks to bring their proof to the continued hearing. (Dkt. # 39 at 2). The bankruptcy court suggested to the debtors that they could attempt to obtain new counsel, and referred the problems with Mr. Marshall to the United States Trustee for investigation. (Tr. at 4, 16).

On December 15, 2009, the United States Trustee filed a motion to examine the reasonableness of Mr. Marshall's proposed fees under 11 U.S.C. § 329 and Fed. R. Bankr. P. 2017(b) and requested the disgorgement of any unreasonable fees.[1] (Dkt. # 39). The United

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[1] The United States Trustee is an official of the United States Department of Justice appointed by the Attorney General to supervise the administration of bankruptcy cases in this district. 28 U.S.C. § 581(a)(5). Under 11 U.S.C. § 307 "[t]he United States trustee may raise and may appear and be heard on any issue in any case or proceeding under this title but may not file a plan pursuant to section 1121(c) of this title." Courts have repeatedly held that the United States Trustee has standing under section 307 to appear and be heard on any issue in any bankruptcy case, despite the lack of pecuniary interest in the outcome. *See, e.g., United Artists Theater Co. v. Walton*, 315 F.3d 217, 225 (3d Cir.2003); *Scott v. U.S. Trustee*, 133 F.3d 917 (4th Cir. 1997); *In re Revco D.S., Inc.*, 898 F.2d 498, 500 (6th Cir. 1990); *In re Donovan Corp.*, 215 F.3d 929, 930 (9th Cir. 2000) ("The United States trustee may . . . intervene and appear at any

States Trustee averred that the Franks expressed frustration with Mr. Marshall's prosecution of their bankruptcy case and the nature and quality of legal services rendered by Mr. Marshall, citing his failure to return phone calls, keep them informed about the progress of the case, and work with them to ensure the successful completion of their case. Id. at 2-3.

Mr. Marshall filed a motion in opposition on December 15, 2010, alleging his failure to appear at the December 2, 2009 hearing was because he thought the case was ready for confirmation and his appearance was unnecessary under a local rule that does not require appearance by counsel if the case is ready for confirmation. (Dkt. # 42). Furthermore, Mr. Marshall denied having any problems representing the Franks, informed the bankruptcy court that he had apologized to the Franks for missing the December 2, 2009 hearing, and submitted an affidavit by the Franks that broadly described his performance as acceptable and stated that they desired to retain him as their counsel. Id.

On January 20, 2010, the bankruptcy court held a hearing on the United States Trustee's motion. (Tr. at 1). The United States Trustee, Mr. Marshall, and the chapter 13 trustee participated in the hearing. (Tr. at 2). Mr. Marshall requested a continuance to better prepare a response to the United States Trustee's motion. (Tr. at 5). The bankruptcy court ordered that the hearing would start going forward, but took Mr. Marshall's request for a subsequent hearing under consideration. (Tr. at 6).

After hearing from all parties, the bankruptcy court turned to the question of remedies. (Tr. at 19). The United States Trustee suggested reducing the amount of Mr. Marshall's proposed fee request by $500, from $2,250 to $1,750. Id. Mr. Marshall's fees had been reduced

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level of the proceedings from the bankruptcy court on . . . as either a party or an amicus.") (internal quotations omitted). The United States Trustee is explicitly authorized to bring a motion to challenge compensation under section 330 of title 11. 11 U.S.C. § 330(a)(2).

by the same amount for similar conduct in a different case before the court on December 16, 2009. Id. The court stated that it was "inclined to impose that remedy," but offered Mr. Marshall the opportunity to "be heard additionally on that." Id. The court noted that "this is really at least a second recognizable incident of where you've not performed according to the standard expected . . . a $500 reduction is [sic] rather mild penalty, but I'll hear from you on that." Id. Mr. Marshall maintained his opposition to any examination or the proposed fee reduction due to the Franks' affidavit in support of his continued representation. (Tr. at 20).

The court then questioned Mr. Frank about Mr. Marshall's services. Mr. Frank acknowledged that he did complain to the court about Mr. Marshall's failure to communicate, stating "it was some miscommunication, misinterpretations . . . he was communicating with us, but it was a lot of misinterpretation and we couldn't get in contact with him, but he was - - he would call back." (Tr. at 23). Mr. Frank informed the court that Mr. Marshall had apologized and explained what had happened in regard to the December 2, 2009 hearing. Id.

At the conclusion of the January hearing, the bankruptcy court decided to stand by the $500 reduction. (Tr. at 24). It concluded "that's a very, very small price for you to pay for your handling of this case." Id.

But the bankruptcy court then told Mr. Marshall that if Mr. Marshall did not wish to accept the $500 fee reduction, the court would "set this down for a subsequent hearing and we'll take testimony." Id. The court also informed Mr. Marshall that the evidence might result in a fee reduction of "more than the $500. I'll give you your choice though." Id.

Mr. Marshall chose to accept the $500, stating "based upon your – just what you said, I have no choice but to take the $500." Id.

The bankruptcy court subsequently entered its final order reducing Mr. Marshall's fees by the amount agreed to in the hearing. (Dkt. # 50). Mr. Marshall now requests that this Court reverse the order of the bankruptcy court and remand the proceedings for an additional evidentiary hearing. (Appellant's Brief at 11).

SUMMARY OF THE ARGUMENT

Mr. Marshall made seven errors in his representation of the Franks: (1) Mr. Marshall failed to pay the filing fee when he filed the case on behalf of the Franks. (Tr. at 8). (2) Mr. Marshall failed to submit Mr. Frank's proof of income in a timely manner. (Tr. at 7-8). (3) Mr. Marshall failed to correctly calculate Mrs. Frank's income in the proposed chapter 13 repayment plan. Id. (4) Mr. Marshall failed to correctly calculate the amount of the proceeds distributed to unsecured creditors by the proposed chapter 13 repayment plan. Id. (5) Mr. Marshall failed to include the correct case number on a motion for a continuance. (Tr. at 8). (6) Mr. Marshall failed to submit a proposed order on a motion for a continuance, as requested by the bankruptcy court. Id. (7) Mr. Marshall failed to appear at the confirmation hearing on the proposed chapter 13 repayment plan. (Tr. at 7). These failures resulted in an almost three and a half month delay in the administration of the Franks' bankruptcy case. Based on these facts, the bankruptcy court did not abuse its discretion when it reduced Mr. Marshall's fee request by $500.

Attorneys have no absolute right to receive compensation from a chapter 13 bankruptcy estate. Section 330 of title 11 requires that the bankruptcy court approve all requests for compensation to ensure that the compensation is reasonable and for actual, necessary services rendered to the estate, and allows the bankruptcy court to reduce the amount of compensation requested. Section 329 of title 11 provides that the bankruptcy court may order a reduction in compensation to the extent that such compensation exceeds the reasonable value of the services. Federal Rule of Bankruptcy Procedure 2017(b) provides that a court must provide notice and a hearing before determining whether a fee arrangement would provide excessive compensation. "Notice and a hearing" means such notice or opportunity for a hearing as is appropriate in the particular circumstances or without an actual hearing if notice is given and not requested timely by a party in interest. 11 U.S.C. § 102(1).

The bankruptcy court received briefing and heard argument on the United States Trustee's motion to examine the reasonableness of Mr. Marshall's fee request and to reduce any excessive compensation. At the conclusion of this hearing, the bankruptcy court offered Mr. Marshall a choice, based upon the information in the record on the reasonable value of Mr. Marshall's professional services: the court would either reduce his fees by $500 or hold a subsequent evidentiary hearing to resolve the ultimate amount of the fee reduction. Mr. Marshall chose to accept the $500 reduction. He is precluded from asking this Court to order a different outcome.

Mr. Marshall received proper notice of the United States Trustee's motion challenging his compensation in the case, submitted briefing in opposition to the motion, provided an affidavit in support of his fees, and participated in oral argument at the hearing on the motion. When the bankruptcy court informed Mr. Marshall that it was inclined to reduce his fees, the court offered Mr. Marshall the opportunity to request an evidentiary hearing in lieu of the proposed $500 reduction. Mr. Marshall did not accept the court's offer to request an evidentiary hearing. Accordingly, the bankruptcy court rendered judgement based upon the facts in the record and followed the requirements the Bankruptcy Code and Rules when it entered its final order reducing Mr. Marshall's fee request.

The sole issue Mr. Marshall has raised on appeal is whether he is entitled to an evidentiary hearing prior to the reduction of his fee request. (App. Br. at 4). But Mr. Marshall was provided with notice of, and responded to, the United States Trustee's motion to reduce his fees. Mr. Marshall declined the bankruptcy court's offer to hold a subsequent evidentiary hearing on the reasonable value of his services. Mr. Marshall, having declined the opportunity for an evidentiary hearing in exchange for the $500 reduction — an amount that was apparently believed to be less than what would result from the evidentiary hearing — cannot now challenge the order based upon an issue he did not raise and had waived before the bankruptcy court.

For these reasons, this Court should affirm the order entered below.

ARGUMENT

I. Statutory framework

Under section 330 of the Bankruptcy Code, a bankruptcy court may award reasonable compensation for actual, necessary services rendered by a chapter 13 debtor's attorney. 11 U.S.C. § 330(a)(4)(B). As a means of efficiency, the bankruptcy court for the Eastern District of Louisiana allows for a standard or no-look fee in the amount of $2,250.00 for Chapter 13 cases in which the debtors are below the means test. Gen. Order No. 2007-2. This means the court will approve a request for attorney's fees up to $2,250 under section 330(a)(4)(B) unless a party in interest opposes the request. See In re Cahill, 428 F.3d 536, 541 (5th Cir. 2005) (affirming the use of precalculated fees).

Section 329 of the Bankruptcy Code provides that if the compensation for a debtor's attorney exceeds the reasonable value of the services rendered by the attorney, the court may cancel the fee agreement or order the return of the payment to the bankruptcy estate or the entity that made the payment, to the extent the fee received is found to be excessive. 11 U.S.C. § 329(b). Pursuant to Rule 2017(b), "on motion by the debtor, the United States trustee, or on the court's own initiative, the court after notice and a hearing may determine whether any payment of money . . . or agreement therefor, by the debtor to an attorney after entry of an order for relief in a case under the Code is excessive." Fed. R. Bankr. P. 2017(b).

The term "after notice and a hearing" is defined in section 102(1) of the Bankruptcy Code as "such notice as is appropriate in the particular circumstances, and such opportunity for hearing as appropriate in the particular circumstances, but authorizes an act without an actual hearing if such notice is given properly and if such a hearing is not requested timely by a party in interest." 11 U.S.C. § 102(1). Thus, the definition provides for flexibility as appropriate in particular circumstances, including action without a hearing at all. Id.

Under section 102(1)(A), notice and a hearing must be "appropriate in the particular circumstances." According to the Fifth Circuit, "[t]hese terms permit flexibility regarding the occasions in which a full hearing is required, while insuring that all persons who should have notice receive it . . . Parties in interest must receive notice and an opportunity to be heard before their interests may be adversely affected." Int'l Transactions, Ltd. v. Embotelladora Agral Regiomontana, SA de CV, 347 F.3d 589, 594 (5th Cir. 2003) (internal citation omitted).

II. Mr. Marshall has waived any potential right to a subsequent evidentiary hearing regarding the fee reduction.

The "sole issue" that Mr. Marshall has presented for review is whether he is entitled to have an evidentiary hearing prior to having his attorney's fees reduced. (App. Br. at 4). But Mr. Marshall did not raise this argument before the bankruptcy court. It is well established that a party who has failed to raise an argument before the trial court has waived the issue on appeal. Miller v. Tex. Tech Univ. Health Sci. Ctr., 421 F.3d 342, 348-49 (5th Cir. 2005).

But even if Mr. Marshall's request for a continuance could be considered as raising the argument before the bankruptcy court, he deliberately waived his interest in the evidentiary hearing by accepting the proposed reduction and is now bound by that decision. In Ergo Science, Inc. v. Martin, the Fifth Circuit described a situation where a litigant had agreed to relinquish an interest in exchange for a judgment limiting the litigant's liability on a claim. 75 F.3d 595, 598-99 (5th Cir. 1996). When the litigant attempted to reverse its position and claim the interest, the district court considered such statements as binding and the Fifth Circuit affirmed, holding that a court "is entitled to rely on statements made by counsel in open court." Id. at 600. Mr. Marshall relinquished the opportunity for an evidentiary hearing in exchange for a judgment limiting his fee reduction to $500. (Tr. at 24). Mr. Marshall is now bound by his waiver. Ergo Sci., Inc., 75 F.3d at 600.

III. A bankruptcy court is not required to hold an additional evidentiary hearing when the matter has adequately been heard.

Alternatively, the bankruptcy court did not err when it reduced Mr. Marshall's fee request by $500. Within the Fifth Circuit there is no question that a full hearing is not required in every circumstance. Int'l Transactions, 347 F.3d at 594. As long as the parties in interest have adequate notice and an opportunity to be heard, the bankruptcy court has the discretion to fashion the proceedings as appropriate for the circumstances. Tex. Extrusion Corp. v. Lockheed Corp. (In re Tex. Extrusion Corp.), 844 F.2d 1142, 1161 (5th Cir. 1988). Furthermore, the law of the Fifth Circuit has been unambiguous that "[w]here a matter has already been adequately argued before the bankruptcy judge, and the judge determines that no further hearings are necessary, then the debtor's due process rights are not violated when the judge decides the issue without further hearings." Sullivan Cent. Plaza I, Ltd. v. BancBoston Real Estate Capital Corp. (In re Sullivan Cent. Plaza I, Ltd.), 935 F.2d 723, 727 (5th Cir. 1991).

The record demonstrates that the matter was adequately heard and the bankruptcy court conducted the proceedings in accord with due process and the notice and hearing requirements of Rule 2017(b). In the present case, Mr. Marshall had notice that the United States Trustee was seeking to examine and disgorge a portion of his attorney's fees as unreasonable, and was prepared for the hearing on the motion. (Tr. at 5). Mr. Marshall submitted briefing in opposition and submitted an affidavit to support the reasonableness of his compensation. (Dkt. # 42). Mr. Marshall participated in the hearing, where he argued his position before the court. (Tr., *passim*). The bankruptcy court questioned Mr. Marshall's client about the adequacy of his legal services. (Tr. at 23).

Based upon the evidence presented by the parties, the bankruptcy court found that at least a $500 reduction was warranted. (Tr. at 19). No further hearing was necessary. Sullivan, 935 F.2d at 727. But the bankruptcy court allowed Mr. Marshall to present further arguments in his favor, (tr. at 19), and offered Mr. Marshall the opportunity to more thoroughly present his case in a subsequent evidentiary hearing. (Tr. at 24). Mr. Marshall declined the bankruptcy court's offer. Id. Thus, Mr. Marshall had adequate notice and an opportunity to be heard. 11 U.S.C. § 102(1)(B)(I); see Int'l Transactions, 347 F.3d at 594; cf. United Student Aid Funds, Inc. v. Espinosa, No. 08-1134, slip op., __ S. Ct. __, 2010 WL 1027825 at *9 (U.S. Mar. 23, 2010) ("Neither the Code nor the Rules prevent the parties from stipulating to the underlying facts . . . and neither prevents the creditor from waiving service of a summons and complaint).

Mr. Marshall fails to explain how the due process afforded by the bankruptcy court was an abuse of discretion, either by applying an improper legal standard or by resting its decision on findings of fact that are clearly erroneous. Caplin & Drysdale, 526 F.3d at 826.

Mr. Marshall provides no authority for his averment that "arguments made by counsel are not a substitute for a hearing," why the affidavit that Mr. Marshall submitted to the court could not be considered, or how the statement of Mr. Frank did not provide any benefit to the court. (App. Br. at 9). And although Mr. Marshall could have submitted additional evidence, Mr. Marshall does not explain how a subsequent hearing would be necessary to protect his due process rights after having waived them for the benefit of settling the issue. Because Mr. Marshall cannot support these arguments, they are waived. Rush Truck Center of Tex. v. Bouchie (In re Bouchie), 324 F.3d 780, 786 (5th Cir. 2003) (holding that failure to cite authority for a position results in waiver).

Nor is there any question whether the bankruptcy court abused its discretion by reducing Mr. Marshall's fee request from $2,250 to $1,750. Mr. Marshall made seven errors in his representation of the Franks: (1) Mr. Marshall failed to pay the filing fee when he filed the case on behalf of the Franks. (Tr. at 8). (2) Mr. Marshall failed to submit Mr. Frank's proof of income in a timely manner. (Tr. at 7-8). (3) Mr. Marshall failed to correctly calculate Mrs. Frank's income in the proposed chapter 13 repayment plan. Id. (4) Mr. Marshall failed to correctly calculate the amount of the proceeds distributed to unsecured creditors by the proposed chapter 13 repayment plan. Id. (5) Mr. Marshall failed to include the correct case number on a motion for a continuance. (Tr. at 8). (6) Mr. Marshall failed to submit a proposed order on a motion for a continuance, as requested by the bankruptcy court. Id. (7) Mr. Marshall failed to appear at the confirmation hearing on the proposed chapter 13 repayment plan. (Tr. at 7). These failures resulted in an almost three and a half month delay in the administration of the Franks' bankruptcy case. Id. Based upon this record, the bankruptcy court's decision to reduce Mr. Marshall's fee request was not clearly erroneous. Stanley, 597 F.3d at 304. Accordingly, Mr. Marshall fails to raise any point of reversible error.

CONCLUSION

For these reasons, the United States Trustee respectfully asks this Court to affirm the order entered below.

Respectfully submitted,

Of Counsel

RAMONA D. ELLIOTT
General Counsel

P. MATTHEW SUTKO
Associate General Counsel

NOAH M. SCHOTTENSTEIN
Trial Attorney

Executive Office for United States Trustees
United States Department of Justice
20 Massachusetts, Ave. N.W., Suite 8100
Washington, D.C. 20530

R. MICHAEL BOLEN
United States Trustee

By: /s/ Carolyn S. Cole
CAROLYN S. COLE (12496)
Trial Attorney

Office of the United States Trustee
United States Department of Justice
400 Poydras St.
Suite 2110, Texaco Center
New Orleans, LA 70130
Telephone no. (504) 589-4018
Direct telephone no. (504) 589-2593
Facsimile no. (504) 589-4096

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing document was served by first class mail, postage pre-paid this 16th day of April, 2010 upon:

Anthony T. Marshall
12320 Highways 44
Building 4, Suite A
Gonzales, LA 70737

S.J. Beaulieu, Jr.
Chapter 13 Trustee
433 Metairie Road
Suite 515
Metairie, LA 70005

by: *s/Carolyn S. Cole*
CAROLYN S. COLE (12496)
Trial Attorney

BRIEF BANK — "SUMMARY SHEET" *Printed Fri-10/9/09 10:38*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*

In re James Clinton Garland (United States Trustee and the Internal Revenue Service v. James Clinton Garland)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*

BAP 10th Cir.

3. ("CCN") ***CURRENT*** CASE NO.

No.: EO-08-040

4. ("PCN") ***PRIOR*** CASE NO. - & COURT *[IF ANY]*

No.: 05-73573

Court: Bankr. E.D. Okla.

(Identify judge & cite, if any)

5. ("SO") ***SOURCE***

U.S. TRUSTEES

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*

Filed: October 14, 2008

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7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*

David W. Newman, Richard A. Wieland

(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***

BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s)

&

√ Any Miscellaneous ***BACKGROUND***

• 1). Do pre-petition state court foreclosure judgments deprive the United States Bankruptcy Court of jurisdiction over the objection to Garland's bankruptcy discharge? 2). Do pre-petition foreclosure judgments in which the Internal Revenue Service was a defendant preclude the United States Trustee from litigating an objection to Garland's discharge?

10. PATH TO FILE LOCATION:
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11. DO YOU RECOMMEND POSTING IN UST BRIEFBANK?

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NAME: Linda Figueroa

DATE:

UNITED STATES BANKRUPTCY APPELLATE PANEL

OF THE TENTH CIRCUIT

IN RE JAMES CLINTON GARLAND,	BAP No. EO -08-040
Debtor.	
	Bankr. No. 05-73573 Adv. No. 06-08044 Chapter 7
UNITED STATES TRUSTEE and the INTERNAL REVENUE SERVICE,	
Plaintiffs - Appellees,	
v.	
JAMES CLINTON GARLAND,	
Defendant - Appellant.	

APPELLEE, UNITED STATES TRUSTEE'S BRIEF

ORAL ARGUMENT IS NOT REQUESTED

David W. Newman, OBA# 20952
Attorney for Appellee United States Trustee
United States Department of Justice
Office of the United States Trustee
720 Park Blvd., Suite 220
Boise, ID 83712
(208) 334-1300 [Telephone]
(208) 334-9756 [Facsimile]
david.w.newman@usdoj.gov

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I. STATEMENT OF APPELLATE JURISDICTION

This is an appeal of a final judgment and corresponding written opinion from the United States Bankruptcy Court for the Eastern District of Oklahoma denying James Clinton Garland's discharge under 11 U.S.C. § 727(a)(2), (4) and (5).[1] No party elected to have this appeal heard by the District Court. The Bankruptcy Appellate Panel has jurisdiction over this appeal under 28 U.S.C. § 158. *See also* FED. R. BANKR. P. 8002; 10th Cir. BAP L.R. 8001-1(a) & (d).

Appellant, James Clinton Garland, contends the *Rooker-Feldman* doctrine deprives the Bankruptcy Court of jurisdiction. The contention is not well founded. *See Lance v. Dennis*, 546 U.S. 459, 126 S.Ct. 1198, 163 L.Ed.2d 1059 (2006). A detailed discussion of the *Rooker-Feldman* argument is contained in the argument portion of this brief.

II. STATEMENT OF ISSUES PRESENTED AND STANDARD OF APPELLATE REVIEW

A. Issues On Appeal

1 Do pre-petition state court foreclosure judgments deprive the United States Bankruptcy Court of jurisdiction over the objection to Garland's bankruptcy discharge?

2. Do pre-petition foreclosure judgments in which the Internal Revenue Service was a defendant preclude the United States Trustee from litigating an objection to Garland's discharge?

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[1] The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA"), generally went into effect on October 17, 2005. Because the underlying bankruptcy case was filed on August 25, 2005, the changes effectuated by BAPCPA do not apply to this case, however, 11 U.S.C. § 727(a)(2), (4) & (5) were not changed by BAPCPA. Unless otherwise noted, citations to the Bankruptcy Code codified at Title 11 of the United States Code are to the Code before it was modified by BAPCPA.

3. Are the Bankruptcy Court's findings of fact which are based on stipulated facts, two days of testimony and over 200 admitted exhibits, clearly erroneous?

B. Standard of Review

The Bankruptcy Appellate Panel reviews the Bankruptcy Court's conclusions of law de novo. *See Mathai v. Warren (In re Warren)*, 512 F.3d 1241, 1248 (10th Cir. 2008). The Tenth Circuit Court of Appeals has noted the Bankruptcy Code should be construed liberally in favor of a debtor and strictly against a creditor objecting to a discharge. *See In re Warren*, 512 F.3d at 1248. Nevertheless, the bankruptcy discharge is intended for the "honest but unfortunate debtor." *See Grogan v. Garner*, 498 U.S. 279, 286-887, 111 S.Ct. 654, 112 L.Ed.2d 755 (1991). The Panel reviews the Bankruptcy Court's findings of fact for clear error.[2] *See id.*

A finding of fact is clearly erroneous if it is without factual support in the record or if, after reviewing all of the evidence, the reviewing court is left with the definite and firm conviction that a mistake has been made. *See Connolly v. Harris Trust Company of Calif. (In re Miniscribe Corp.)*, 309 F.3d 1234, 1240 (10th Cir. 2002). "The bankruptcy court's findings should not be disturbed absent the 'most cogent reasons in the record.'" *In re Miniscribe Corp.*, 309 F.3d at 1240. The facts are to be reviewed in the light most favorable to the trial judge's factual findings. *See Gillman v. Ford (In re Ford)*, 492 F.3d 1148, 1154 (10th Cir. 2007). What inferences, deductions and conclusions should be drawn from the evidence are left to the sound discretion of the trial judge. *See id.*

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[2] FED. R. BANKR. P. 7052 requires a bankruptcy court to make findings of fact and conclusions of law. This requirement is satisfied as long as the court's findings clearly show an appellate court the basis for the Bankruptcy Court's decision. *See Bell v. AT & T*, 946 F.2d 1507, 1510 (10th Cir. 1991). The United States Trustee bore the burden of proving his objection to discharge by a preponderance of the evidence. *See In re Warren*, 512 F.3d 1241.

III. STATEMENT OF THE CASE

A. Nature And Disposition Of The Case Below

James Clinton Garland, appeals the judgment and opinion denying his discharge under 11 U.S.C. § 727 (a)(2), (4) and (5) for: (1) Concealing his interest in various corporate entities, accounts and his equitable or beneficial interest in his ninety acre residence; (2) Making false oaths regarding the concealed interests; and (3) Failing to explain satisfactorily the loss or deficiency of his assets to meet his liabilities.

On August 25, 2005, Garland, an attorney, filed his voluntary chapter 7 petition. (Appx., Vol. 1, 25) Garland filed an adversary proceeding against the United States of America, Department of the Treasury, Internal Revenue Service (collectively referred to as the "IRS"). It seeks a determination under 11 U.S.C. § 523(a)(1) that his personal federal income tax liabilities, including penalties and interest, for the years 1992, 1993, 1995, 1998, 1999, and 2000, are dischargeable. (Appx. Vol. 1, 1-3) The complaint also requests the Bankruptcy Court permanently enjoin the IRS from attempting to collect the taxes. The IRS filed an answer to the complaint. (Appx. Vol. 1, 4-7)

The United States Trustee timely filed a complaint seeking to deny Garland's discharge under 11 U.S.C. § 727(a)(2), (4) and (5). (Appx. Vol. 1, 8-16; 24) It alleges Garland concealed his interest in, and made false oaths about, corporate entities and his residence and failed to satisfactorily explain any loss of assets or deficiency of assets to meet his liabilities. Garland filed an answer to the complaint. (Appx. Vol. 1, 17-19)

The two adversary proceedings were consolidated. (Appx. Vol. 1, 21, 24) Garland filed a motion for summary judgment. (Appx. Vol. 7167) He argued, among other things, the

Rooker-Feldman Doctrine, res judicata and collateral estoppel barred the IRS and the United States Trustee from asserting he had any interest in his residence or A-Don Corporation ("A-Don"). Garland's argument relied on pre-petition foreclosure judgments in favor of A-Don naming the IRS as a defendant. The second foreclosure judgment was entered pursuant to a settlement where A-Don actually paid the IRS. (Appx. Vol. 1, 28-29; Vol. XIV, 4767) The motion for summary judgment was denied.

A pretrial order was entered. (Appx. Vol. 1, 22-34) It included numerous factual stipulations and superceded all previous pleadings. At the commencement of trial, Garland's counsel advised the court he "intend[ed] to raise that objection again . . . ." (Appx. Vol 1, 192: 4-11) During the trial, Garland's counsel objected to admission of evidence regarding Garland's interests in his residence based on the issues raised in the motion for summary judgment. The court noted it rejected the arguments when it denied Garland's motion for summary judgment and allowed the evidence in. (Appx. Vol. 2, 337)

After a two day trial and admission of over 200 exhibits, the Bankruptcy Court issued a thirty-four page opinion detailing its factual findings and legal conclusions. (Appx. Vol. 1, 35-68) On March 31, 2008, the Bankruptcy Court entered the judgment denying Garland's discharge under 11 U.S.C. § 727(a)(2), (4) and (5). Because Garland's discharge was denied, the court did not rule on his claim that his federal taxes were dischargeable. On April 9, 2008, Garland filed a notice of appeal of the judgment and the corresponding opinion.

B. Statement Of Facts

The court's opinion describes Garland as one of the most interesting and complex persons to come before the Bankruptcy Judge during his fourteen years of service as a Bankruptcy Judge.

(Appx. Vol. 1, 42) Garland is an experienced attorney who handled class action litigation. (Appx. Vol. 1, 218:24-25; 219:1-5) Garland testified he also "handled a lot of tax evasion cases. . . ", "dealt extensively in money laundering cases" and keeps detailed income records. (Appx. Vol. 1, 219:6-18; 220:3-9; Vol. V, 1524:13-21) Although not disclosed in his schedule I, Garland is married and his wife has a seed business in Bogata, Columbia. (Appx. Vol. 1, 232:17-25; 233:1-12)

The court found Garland is not an "honest but unfortunate debtor." (Appx. Vol. 1, 62) Garland deliberately concealed assets and omitted information about them in his bankruptcy papers in order to appear destitute to his creditors. (Appx. Vol. 1, 64, 67)

Garland scheduled disputed federal tax obligations of $1,157,488 in schedule E. (Appx. Vol. V, 1286-1287) He listed debts totaling $560,046 in schedule F. (App. Vol. V, 1288-1291) Garland indicated in his schedule A that he had no legal or equitable interests in real estate when, in fact, he had an equitable or beneficial interest in his residence located on 90 acres of land. (Appx. Vol. 1, 5-8, 22, 57) Statement of financial affairs question 14 required him to "[l]ist all property owned by another person that the debtor holds or controls." He disclosed a 1992 and 1993 vehicle but failed to disclose his residence, held in his son's name, where Garland had lived continuously since 1981. (Appx. Vol. 1, 22; Vol. 1, 5-8; Vol. V. 1302)

Garland stated in schedule B that all of his personal property was only worth $3,000. (Appx. Vol. V, 1280-1282) He also stated he only had one bank account. (Appx. Vol. V, 1280) In fact, he was an authorized signer on various corporate bank accounts. (Appx. Vol. 1, 57-58; Vol. 2, 592-593; Vol. XIII, 4450- Vol. XIV, 4667) He used substantial funds from the accounts for his personal use, including making mortgage payments for the residence. (Appx. Vol. 1, 154-

156, 159, Vol. 2, 301-306:1-16; 589:8-13; 590:8-9, 14-20; 592:6-16; Vol. 3, 604; Vol. XVIII 6164-6299) He did not disclose his control of these accounts in statement of financial affairs question 14. (Appx. Vol. 1, 58)

Garland stated in schedule B that the only interest he had in any incorporated and unincorporated businesses was a worthless interest in James Clinton Garland, P.C. (Appx. Vol. 1, 199-200; Vol. V, 1281) Statement of financial affairs question 18 required information about all businesses in which Garland was an officer, director, partner, or managing executive of a corporation, sole proprietor, or self-employed within six years before filing bankruptcy. Garland marked "none" in response to this question. (Appx. Vol. V, 1304) He failed to disclose numerous entities through which he funneled money to himself. (Appx. Vol. V, 26, 51-52; Appx. Vol. Vol. XIII, 4450- Vol. XIV, 4667)

Garland stated in schedule I that he received monthly income of $1,150 from social security and $2,000 as "Counsel to Commercial Litigation Group." (Appx. Vol. V, 1294) He indicated in his statement of financial affairs questions 1 and 2 that his annual gross income from these sources for 2005, 2004 and 2003 were, respectively, $25,200, $35,776 and $20,331. His income from funds funneled through the various entities was actually substantially higher. (Appx. Vol. 1, 52; Vol. V, 1298-1299; Vol. XIX, 6329, 6334, 6340)

A summary of the court's findings is set forth below and is followed by a narrative summary of the evidence supporting the findings.

i. **Summary Of The Court's Section 727(a)(2) Findings**

Garland concealed his interests as a corporate officer or partner of Savol Enterprises, Inc. ("Savol"), A-Don, the Jagar Family Limited Partnership ("Jagar"), and Commercial Litigation

Group. (Appx. Vol. 1, 58) He also concealed his signature authority in undisclosed checking accounts and his equitable or beneficial interest in his residence. (Appx. Vol. 1, 56-57)[3]

Garland had an equitable or beneficial interest in his residence. (Appx. Vol. 1, 57) Garland alone exercised dominion and control over his residence. (Id.) He retained the benefits of ownership which, in part, included the right to live there rent free. (Id.) He employed many schemes to keep the residence in the family. (Appx. Vol. 1, 61-62) The various transfers of Garland's residence were not arm's length transactions and always involved family, friends or close business associates. (Appx. Vol. 1, 61) Garland has always resided there and remained in control. (Appx. Vol. 1, 62) "[T]he timing of these transfers was meant to keep Garland one step ahead of the IRS's collection action against him and planned with the intention of keeping the property out of reach of the IRS." (Appx. Vol. 1, 50)

Garland continuously concealed his interests in the business entities, accounts and residence during the year before he filed bankruptcy. (Appx. Vol.1, 59, 62; Vol. 2, 592-93) He continued his "scheme to defraud" by concealing his interests in the entities, accounts and residence when he filed his bankruptcy and failed to disclose them. (Appx. Vol. 1, 61) Garland did this because he wanted the trustee to believe his case was a simple no-asset case. (Appx. Vol. 1, 61) He intended to hinder, delay and defraud his creditors. (Appx. Vol. 1, 61-62)

ii. <u>Summary Of The Court's Section 727(a)(4)(A) Findings</u>

The United States Trustee established "by more than a preponderance of the evidence that Garland's omission of assets and ownership interests from his bankruptcy schedules and

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[3] Appx. Vol. V, 1279- 1282, 1298, 1299, 1301, 1302, 1304 [petition, schedules & statement of financial affairs] Schedules A & B, statement of financial affairs questions 1, 2, 10, 11, 14 & 18.

statement of financial affairs was a false oath made knowingly and fraudulently, and related to material facts." (Appx. Vol. 1, 66)

The court had an "ample opportunity to observe Garland over the course of the two day trial and assess his demeanor and credibility while he explained the reasons for the omissions from his schedules . . . ." (Appx. Vol. 1, 64) The court was "convinced the omissions were not the result of any confusion, ignorance, mistake, or carelessness." (Id.) "[T]he omissions were a result of a deliberate decision to withhold the information from [the] Court, the Bankruptcy Trustee, and Garland's creditors." (Id.)

Garland made material false oaths in his bankruptcy by failing to disclose his role as an officer in various business entities, his signature authority and control of various undisclosed bank accounts and his interest in his residence. (Appx. Vol. 1, 64-65) He admitted he signed his schedules and statement of financial affairs under penalty of perjury. (Appx. Vol. 1, 64)

Garland's omissions were material because they related to his business dealings, the discovery of assets, and the existence or disposition of his property. (Appx. Vol. 1, 65) The chapter 7 trustee would have investigated further if he had accurate information about Garland's financial affairs. (Appx. Vol. 1, 65)

iii. **Summary Of The Court's Section 727(a)(5) Findings**

The United States Trustee proved a loss or shrinkage of assets occurred. (Appx. Vol. 1, 6) Garland "had access to significant assets, specifically, the undisclosed checking accounts, the Residence, funds or loans from Patrick Walters and Dr. Bundren . . . " and he "diverted funds to his own personal use . . . " (Appx. Vol. 1, 66) He had significant income in the years in which the original taxes were assessed and he had sufficient income to pay the taxes. (Appx. Vol. 1,

67) Garland failed to satisfactorily explain the loss or deficiency of assets. (Id.)

Garland failed to explain why he reported total annual income ranging from $15,000 to $30,000 each year from 2002 through 2005 in his tax returns while the evidence showed he received payments from checking accounts ranging from about $27,000 to $71,000 during the same years. (Appx. Vol. 1, 67) Garland failed to reconcile the discrepancy between his tax returns and the checking account payments to himself, even though he testified accountants tediously went through the checking account records and counted all of the payments to him as income. (Appx. Vol. 1, 67)

Garland had access "to significant assets but chose to conceal those assets in order to appear destitute to his creditors . . . ." (Appx. Vol. 1, 67) Garland failed to object to or explain the IRS' summary of his personal expenses, evidencing "his personal expenses that were paid out of the concealed checking accounts, often with checks signed by Garland, [were] for the purpose of obscuring the true nature of his financial affairs." (Id.) The court was left to speculate how Garland lost his considerable income and assets. (Id.)

iv. Summary Of Supporting Evidence

The evidence in this case was extensive. An abbreviated summary of the evidence supporting the Bankruptcy Court's findings follows. A brief description of the bankruptcy case and key players is followed by a narrative summary. Many of the facts were stipulated to in the pretrial order. (Appx. Vol. 1, 23-29)

a. The Bankruptcy Schedules and Statement of Financial Affairs

Garland completed a client information worksheet for his bankruptcy attorney. (Appx.

Vol. 1, 221:22-25; 222:1-2; Vol. V, 1315)[4] He understood his bankruptcy attorney would use the information from the worksheet to complete his bankruptcy papers. (Appx. Vol. 1, 223:1-12) The information provided by Garland in the worksheets is generally consistent with the information in his petition, schedules and statement of financial affairs. (Appx. Vol. V, 1315-1336)

The worksheet stated "List all property OWNED by another person that the debtor (you or you and your spouse) holds or controls." [Emphasis contained in the original document.] Garland wrote "none" and "ask Ron."(Appx. Vol. 1, 226:11-25; 227:1-20; Vol. V, 1329) Ron Wright was Garland's bankruptcy attorney. (Appx. Vol. V, 1268) When asked to explain, Garland testified he asked his attorney about two vehicles he drove but which were owned by Commercial Litigation Group. (Appx. Vol. 1, 227:1-20)

When questioned why he didn't list his residence, for which title was held by his son, Garland testified he didn't think he "held" or "possessed" the residence. (Appx. Vol. 1, 29; 228:10-25; 229:1-10) He testified he disclosed two vehicles he "holds." (Appx. Vol. 1, 229:1-9) When asked how did he "hold" the vehicles, he testified he "used them." (Appx. Vol. 1, 229:9-10). He then testified as follows:

Q. Did you hold the residence in Tahlequah where you lived?

A. I sleep there.

Q. You sleep there. You do more than sleep there, don't you?

A. Well, I maintain the property.

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[4] Where transcripts are cited, page and line numbers are usually referenced, e.g., Appx. Vol. 1, 221 [Appendix page number]:22-25 [line numbers].

Q. You live there. That's your residence. In fact, it's a stipulated fact you've been there since the 1980's. Isn't that correct?

A. Since 1995, I have resided there.

Q. That's your home, isn't it?

A. It's not my home. It is where I reside.

Q. All the furniture in that residence is your furniture, is it not?

A. It is not.

Q. You use that furniture?

A. I use it .

. . . Q You've never moved out of there, have you, since 1995?

A. No.

Q. And in fact you oversaw the construction of a pool and a garage there, didn't you?

A. I did. . .

Q. You use that property don't you?

A. Of course I do.

Q. And that was the definition you just used in your own testimony to explain what holding means?

A. Well, that is --

Q. Let me finish the question. You understood at that time that you held that property and it needed to be disclosed didn't you?

A. No, I did not."

(Appx. Vol.1, 229:11-25; 230:1-22)

Garland verified the information in his schedules and statement of financial affairs by signing them under penalty of perjury. (Appx. Vol. 1, 25) No amendments were filed. (Appx. Vol. 1, 25) At his first meeting of creditors Garland testified under oath that he read his petition, schedules and statement of financial affairs before he signed them, he was personally familiar with the information in them, to the best of his knowledge the information in them was true and correct and that he disclosed all of his assets and liabilities. (Appx. Vol. 1, 25; 231:18-25; 232:1-10) Based on his representations, the chapter 7 trustee determined there would be no distribution to creditors and filed a no asset report. (Appx. Vol. 1, 25; 195:3-25; 196-204:1-11) Had there been accurate disclosures, the trustee would have investigated further. (Appx. Vol. 1, 195:3-25; 196-204:1-11)

Garland scheduled disputed federal tax debt of $1,157,488 and general unsecured debt of $560,046. (Appx. Vol. V, 1286-1291) He represented in his schedules that he has no interests in any real estate and only $3,000 worth of personal property. (Appx. Vol. V, 1279-1282) In fact, he enjoyed uninterrupted occupancy of his residence without paying rent. (Appx. Vol. 1, 26, 27, 29; Appx. Vol. V, 1295) Garland's response to statement of financial affairs question 14 failed to disclose he held or controlled his residence. (Appx. Vol. V, 1302)

Garland indicated in schedule B that he had only one bank account with a balance of $500.00. (Appx. Vol. V, 1280) In fact, he had signature authority on numerous bank accounts held in the names of Commercial Litigation Group, Jagar Family Limited Partnership, Savol Enterprises, Inc., Savol Enterprises, Inc., Special Escrow Account, Karen Hassler Trust and a social security account. (Appx. Vol. 1, 26; Vol. VI, 2396, 2398; Vol. XVII, 5901, 5908, 5910, 5919, 5921, 5945, 5946, 5957, 5958, 5965)

Garland indicated in schedule I that his only income was $1,150 from Social Security and $2,000 of "other" income from "Counsel to Commercial Litigation Group." (Appx. Vol. V, 1294) Statement of financial affairs question 1 indicates he made $16,000 in 2005, $21,976 in 2004 and $20,331 in 2003, all from Commercial Litigation Group. (Appx. Vol. V, 1294) Statement of financial affairs question 2 indicates the only other income he received in 2005 and 2004 was from social security. (Appx. Vol. V, 1299) In fact, Garland received substantial sums of money during these periods of time from the various undisclosed accounts for which he had signature authority. (Appx. Vol. 1, 254-258; 294 -300; Vol. 3, 602-606; Vol. XIII, 4450-4520; Vol. XIV 4521-4667; Vol. XVIII, 6067, 6295-6299)

In response to statement of financial affairs question 18, which requests information about businesses in which he was an officer, partner, etc., Garland marked "none." (Appx. Vol. V, 1304). In fact, he failed to disclose that at relevant times he was an officer or director of Southwest Industrial & Investment Enterprises, Inc., Savol Enterprises, Inc. (Appx. Vol. VI, 1938 -1942) Further, James Garland, P.C. had been a partner of Commercial Litigation Group during relevant times and, even after he claimed to have resigned, Garland had check writing authority for Commercial Litigation Group. (Appx. Vol. VI, 1940) The facts set forth below also indicate Garland controlled A-Don.

b. Patrick Walters

Patrick Walters and Garland have known each other since 1978. (Appx. Vol. 1, 267; Vol. V, 1496:22-25; 1497:1-25; 1498:17-25; 1499:1-7) Their relationship was very "integrated." (Appx. Vol. 2, 487:4-11) Garland believed Walters was his best friend. (Appx. Vol. 1, 273:2-6) Walters, a CPA, prepared Garland's tax returns since the 1970's, until around 2000 or 2001.

(Appx. Vol. 2, 492; 502) Walters prepared federal partnership returns for Jagar. (Appx. Vol. 19, 6465-6467, 6496, 6500, 6517, 6537) Walters referred clients to Garland. (Appx. Vol. 1, 273:6-9) Since 1998, Garland has received hundreds of thousands of dollars in "loans" from Walters. (Appx. Vol. 1, 267:11-14) These loans were made to Garland in his individual capacity. (Appx. Vol. 1, 267:15-18) According to Garland, some loans were never memorialized by a writing and specific terms were not agreed upon. (Appx. Vol. 1, 267:18-25; 268-270)

For example, in 1998, Walters loaned Garland about $200,000 from the Anthony Spencer Trust while Garland represented Anthony Spencer on an appeal from a conviction for tax evasion. (Appx. Vol. 1, 219:16-18; 269:4-11; 270:1-15, 24-25; 272; Vol. VII, 1999-2001) The same day Garland received the funds, he cut a check for $35,000.00 from the loan proceeds back to Walters. (Appx. Vol. 1, 273:19-25) Garland testified it did not seem unusual to him to receive a $200,000 loan without first agreeing to the terms of the loan and memorializing them in writing. (Appx. Vol. 1, 270:20-23) In fact, Garland used the loan, in part, to pay for his living expenses. (Appx. Vol. 1, 271:1-15) In February 2001, Walters, in his capacity as trustee of the Spencer Trust, "loaned" Garland another $35,000. (Appx. Vol. VII, 2156)

c. **Dr. Clark Bundren**

Dr. Clark Bundren and Garland have a longstanding relationship. Garland has represented Bundren in numerous matters since 1986. (Appx. Vol. 1, 77:22-25; 274:4-6)[5] In the year 2000, Garland represented Bundren before the Tax Court. (Appx. Vol. 1, 80:8-19; 274:7-9) In 2007 Garland represented Bundren on appeal. (Appx. Vol. 1, 77:21-24; 79:1-7; 80:7-8;

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[5] Bundren was unavailable to testify at trial. His deposition transcript was received into evidence by agreement.

274:10-13) Bundren, a physician, delivered two of Garland's children. (Appx. Vol. 1, 80:25; 274:20-22) Bundren and Garland have gone fishing together. (Appx. Vol. 1, 126:20-25; 274:23-25) Garland's family has been to Bundren's home. (Appx. Vol. 1, 81:12-13; 275:1-5)

Bundren and Walters have a longstanding relationship. (Appx. Vol. 2, 488:3-14) Bundren first contacted Walters for accounting services in 1982 and has worked closely with Walters to the present time. (Appx. Vol. 1, 82:1-3, 5-6; 276:17-24; Vol. 2, 488; 3-14)

d. The Transfers of the Residence

Garland stipulated in the pretrial order that he has continuously lived at his residence in Tahlequah, Oklahoma since at least 1981. (Appx. Vol 1, 5) He stipulated the residence consists of a house and ninety acres. (Appx. Vol. 1, 5) The house has over 5,000 square feet, a swimming pool, tennis courts, and a seven car garage. (Appx. Vol. 1, 233:13-15; Vol. 2, 466:12-25)

In November 1993, the IRS assessed Garland $54,903 in unpaid taxes for the 1992 tax year based on taxable income $154,419. (Appx. Vol. 2, 238:19-21; XVII, 5851-5852) In November 1994, the IRS assessed Garland $193,827 in unpaid taxes for the 1993 tax year based on taxable income of $601,762. (Appx. Vol. 2, 238:19-21; XVII, 5854-5855) He was later assessed unpaid federal income taxes for the years of 1995, 1998, 1999 and 2000. (Appx. Vol. 1, 23, 24; Vol. 17, 5851-5870)

1. Tax Problems And The Transfer To Jagar

In 1993, Garland formed the Jagar Family Limited Partnership ("Jagar"). (Appx. Vol. 1, 26, 244; Vol. VII, 2025-2041). He named himself and family members as limited partners. (Appx. Vol. 1, 26, 244; Vol. VII, 2025-2041) None of the family members made any capital contributions to Jagar. (Appx. Vol. 1, 105:2-8) Garland never caused Jagar to make any reports to its purported limited partners. (Appx. Vol. 1, 262:22-25, 263:1-4) Southwest Industrial Enterprises, Inc., also known as Southwest Industrial and Investment Enterprises, Inc ("Southwest"), was the general partner. (Appx. Vol. 1, 26) Since Garland was Southwest's president, he served as Jagar's general partner. (Appx. Vol. 1, 26) Garland signed a sworn statement in 1991 stating Southwest was his wholly owned company. (Appx. Vol. VII, 2021; Vol. 1, 235:20-23) Garland titled vehicles under Southwest's name over the course of several years when his federal income taxes were delinquent. (Appx. Vol. 1, 236, 237:1-13; Vol. VII, 2022; 2024)

In January 1994, Garland, as sole owner of the residence, signed a deed transferring it to Jagar. (Appx. Vol. 1, 26; Vol. XIV, 4671-4673) The deed was recorded on December 29, 1994. (Appx. Vol. XIV, 4673) The only consideration Garland received was a limited partnership interest in Jagar. (Appx. Vol. 1, 26) The residence was Jagar's only asset. (Appx. Vol. 1, 26) Garland continued to reside in the residence but did not pay rent to Jagar. (Appx. Vol. 1, 26)

In March 1995, the IRS recorded a Notice of Federal Tax Lien against Garland for the unpaid 1992 and 1993 taxes totaling $255,515. (Appx. Vol. 1, 26-27) Garland appointed Walters, his CPA, as attorney in fact to represent him before the IRS. (Appx. Vol. XIV, 4676)

In 1997, Garland executed a partnership agreement for a law firm known as Commercial Litigation Group. (Appx. Vol. VII, 2125-2130) In 1998 the firm consisted of James Clinton Garland, P.C., appellant's professional corporation, James C. Garland, III, P.C. and William Joseph Garland. (Appx. Vol. VII, 2131) Garland testified his class action litigation practice dried up after the IRS filed a pre-judgment garnishment against an anticipated attorney's fees award. (Appx. Vol. 1, 266:8-12; Vol. 2, 326:7-25; 327:1-11)

In October 1999, the IRS filed a Notice of Federal Tax Lien against Jagar as Garland's nominee. (Appx. Vol. 1, 27). In November 1999, Garland filed a request for a collection due process hearing contending the nominee tax lien was an abuse of discretion. (Appx. Vol. 1, 27) In September 2000, the IRS issued a Notice of Determination that the nominee tax lien was proper. (Appx. Vol. 1, 27). In October 2000, Garland filed a collection due process case in the United States Tax Court alleging the IRS erred by upholding the nominee tax lien. (Appx. Vol. 1, 27)

2. Garland Incorporates A-Don, It Acquires A Mortgage And Forecloses

In December 2000, Garland and his son, William Garland, incorporated A-Don. (Appx. Vol. 1, 267:1-7; Appx. Vol. 3, 607:12-15; Vol. VII, 2375) Garland testified he knew A-Don was being incorporated in order to purchase the mortgage secured against the residence and then foreclose. (Appx. Vol. 1, 266:1-25) The mortgage was senior to the IRS's tax liens. (Appx. Vol. 1, 27; Vol. XIV, 4681-4690) In January 2001, Walters was elected A-Don's president and William became its secretary, A-Don's only officers. (Appx. Vol. 1, 27; Appx. VIII, 2376) Garland was A-Don's agent for service of process. (Appx. Vol. VIII, 2374)

Garland testified Walters asked him to create A-Don. (Appx. Vol. 1, 265:2-12) Walters admitted at trial he was "involved in the design of this scheme for foreclosure" but also asserted Garland was involved and agreed to it. (Appx. Vol. 2, 496:16-17; 497:1-8, 23-25; 498:1) Walters testified he, Garland and holders of a mortgage "came up with a plan to form A-Don, put the mortgage in there, put the house and everything in there, clean up the problems with it and sell it, him pay it off, someone else buy it." (Appx. Vol. 2, 490:5-8)

One of the "problems" to clean up was the IRS' tax liens. (Appx. Vol. 2, 490:21-25; 491:5-21) This could be done by foreclosing on a mortgage senior to the IRS's tax liens. Walters was the trustee of Radiology Profit Sharing Plan, which held such a mortgage. (Appx. Vol. 1, 27; Vol. 2, 534:2-4; Vol. XIV, 4668-4670; 4678-4679; 4681) Its mortgage was originally made in 1988 with Walters, in his capacity as the Plan's trustee, as the mortgagor and Garland as the mortgagee. (Appx. Vol. XIV, 4668-4670) No mortgage payments were ever made under this mortgage. (Appx. Vol. 2, 534:8-10)

In March 2001, A-Don purchased the mortgage, secured against Garland's residence, from Profit Sharing Plan and Trust of Radiology, Inc. for $125,000. (Appx. Vol. 1, 27, 104:4-10; Vol. XIV 4681) The residence was worth over $365,000. (Appx. Vol. 1, 103:20-25:104:1-2; Vol. XIV, 4704) In fact, A-Don didn't pay Radiology Profit Sharing Plan until after the foreclosure was completed. (Appx. Vol. 2, 11-16)

In June 2001, A-Don filed an action to foreclose the mortgage. (Appx. Vol. 1, 27; Vol. XIV, 4682) Walters signed the verification for the foreclosure petition. (Appx. Vol. 2, 492:11-21; Vol. XIV, 4687) The legal description in the petition left out 20 acres. (Appx. Vol. 1, 28) The IRS denied the foreclosure petition's allegations except to admit it had an interest in the residence by virtue of its tax liens against Garland and Jagar and asked that their priority be determined. (Appx. Vol. 1, 27; Vol. XIX, 6567-6572) The journal entry of judgment entered on October 3, 2001, decreed the tax liens were inferior to the mortgage and indebtedness of A-Don. (Appx. Vol. 1, 27-28)

In July 2001, Garland signed a check from Commercial Litigation Group, to Walters for

$2,000 and Bundren for $8,000.00. (Appx. Vol. 1, 292:9-25; 293:1-17; Vol. VII, 2175) In a letter dated July 27, 2001, Bank of America advised Garland the amount required to pay off its mortgage secured against the residence was $21,020 plus daily interest of $4.19. (Appx. Vol. XIV, 4691) A-Don executed a promissory note dated July 30, 2001, in the amount of $21,029 in favor of Southwest. (Appx. Vol. VII, 2379) Garland controlled Southwest, as evidenced by a June 16, 2000, letter signed by Garland as Southwest's president. (Appx. Vol. VII, 2019) A-Don then paid off Bank of America's mortgage. (Vol., 1, 27; Vol. XIV, 4694)

In October 2001, the foreclosure judgment decreeing the IRS' tax liens were inferior to A-Don's mortgage was entered. (Appx. Vol. 1, 28; Vol. XIV, 4695, 4698) The judgment was signed off by an Assistant United States Attorney. (Appx. Vol. XIV, 4700) In November 2001, the notice of sheriff's sale was served. (Appx. Vol. XIV, 4701). In December 2001, the residence was appraised as being worth $385,000. (Appx. Vol. XIV, 4704) On December 26, 2001, A-Don obtained title to the residence, less the omitted 20 acres, by credit bidding $270,000. (Appx. Vol. 1, 28; Appx. Vol. XIV, 4726) In light of the foreclosure judgment, Garland's Tax Court proceeding challenging the tax liens was dismissed on January 29, 2002, as being moot. (Appx. Vol. XIV, 4725)

Walters testified he had a falling out with Garland and sold A-Don to Bundren for a mere $100. (Appx. Vol. 1, 28; Vol. 2, 498:5-11; 501:13-23; 502:8-25; 503:1-12) On December 4, 2001, Walters executed an assignment of A-Don's stock to American Reproductive Technologies, Inc., Bundren's corporation, dated December 4, 2001. (Appx. Vol. 2, 499:21-25; 500:1-14; Vol. VIII, 2380) Walters sold Southwest to Bundren for $100. (Appx. Vol. 2, 500:15-25; 501:1-9) Walters executed an assignment of Southwest's stock, dated March 2002, directly to Bundren. (Appx. Vol. 1, 98:21-25; 99:1-12; 100:3-18; 101:1-5; 104:4-19; 277:1-9; Vol. 2, 499:18-25; 500:15-25; 501:1-9; Vol. VIII, 2381) Nevertheless, Garland responded to a subpoena on behalf of Southwest as late as September 18, 2006. (Appx. Vol. VII, 2020)

In January 2002, Garland executed a resignation from Commercial Litigation Group. (Appx. Vol. VII, 2137) He continued to have signature authority on Commercial Litigation Group's accounts and write checks for his personal use. (Appx. Vol. 1, 294 - 300) The checks he signed included rent payments to A-Don from 2002 through 2005 and mortgage payments for the residence, even after he filed bankruptcy. (Vol. 3, 655:23-25; 656:1-25; Appx. Vol. VII, 2158-2173)

3. <u>A-Don Leases The Residence To Commercial Litigation Group</u>

On September 30, 2002, A-Don leased the residence to Commercial Litigation Group for a period of three years. (Appx. Vol. 1, 28; Vol. XIV, 4730) The lease states it is a "Commercial Cattle Ranch Lease" and the property shall not be used for any other purpose without prior written consent. (Appx. Vol. XIV, 4730, 4731) It makes no reference to Garland living at the residence. The residence has never been used as a cattle ranch. (Appx. Vol. 1, 278:16-18) Garland never paid rent to Commercial Litigation Group. (Appx. Vol. 1, 278:19-22) Garland did, however, sign numerous checks from Commercial Litigation Group to A-Don for rent from October 2002 through January 2005. (Appx. Vol. VII, 2158-2173)

A-Don also provided Commercial Litigation Group an assignable option to purchase the residence at the price of $175,000. (Appx. Vol. 1, 28; Appx. Vol. XIV, 4745) Commercial Litigation Group paid $10 for the assignable option. (Appx. Vol. 1, 28)

4. A-Don Forecloses The 20 Acres Left Out Of The First Foreclosure

On September 10, 2002, A-Don filed a second foreclosure petition to foreclose on the previously omitted 20 acres. (Appx. Vol. 1, 28; Vol. XIX, 6573-6581) Bundren signed the verification of the second foreclosure petition. (Appx. Vol. XIX, 6578) The second foreclosure action was removed by the IRS to the United States District Court. (Appx. Vol. 1, 28) The IRS asserted A-Don was an instrumentality of Garland and the foreclosure was a sham. (Appx. Vol. 1, 28; Vol. XIX, 6583-6586) At a settlement conference, the IRS settled with A-Don. (Appx. Vol. 1, 28; Vol. XXI, 7145-7146) The settlement required the parties to obtain an appraisal of the 20 acres and A-Don to pay the IRS for its tax liens against the 20 acres. (Appx. Vol. XXI, 7145). A-Don paid the IRS $8,000 pursuant to the settlement, the case was remanded back to state court and a journal entry of judgment was entered. (Appx. Vol. 1, 28-29; Vol. XIV, 4767) The judgment notes the settlement between the IRS and A-Don and makes no findings as to whether A-Don was Garland's instrumentality or whether the foreclosure was a sham. (Appx. Vol. XIV, 4767) A-Don acquired title to the 20 acres by credit bidding at the Sheriff's sale. (Appx. Vol. 1, 28-29) The Sheriff's deed was executed in July 2004. (Appx. Vol. XIV, 4779)

5. Douglas Buys The Residence From A-Don As A Straw Man

In the Fall of 2004 Garland's son, Douglas Garland, was approached by his brothers who suggested he exercise the option to purchase the residence from A-Don. (Appx. Vol. 2, 555:3-25; 556:1-12) He learned about his father's tax problems. (Appx. Vol. 1, 279:15-23) Douglas could not afford to exercise the option. (Appx. Vol. 2, 556:13-19) Douglas was not practicing law and was employed as an engineer. (Appx. Vol. 2, 426:14-25; 427:1-18; 538:13-14) He needed someone else to pay the down payment, closing costs, mortgage payments and pay off some of his loans so he could qualify for a mortgage to exercise the option. (Appx. Vol. 1, 280:7-13; Vol 2, 556:13-25; 557:1-21; Vol. 3, 625:12-16) For example, at Douglas's request, Garland wrote a check from Commercial Litigation Group for $2,500 to pay off one of Douglas' credit cards. (Appx. Vol. 2, 556:3-25)

In order for Douglas to qualify for the mortgage, a letter from Commercial Litigation Group was created stating he had access to funds in one of its accounts. (Appx. Vol. 1, 298:11-25; 299:1-5; Vol. 2, 549:10-11; 551:7-20; 569:24-25; 570:1-7) Douglas' name was signed on a signature card for one of Commercial Litigation Group's accounts. Douglas testified he was not aware he had signature authority on any Commercial Litigation Group accounts and his signature on the signature card was a forgery. (Appx. Vol. 2, 549:13-25; 550 - 552:23) In contrast, Garland initially testified Douglas gave his brother permission to sign Douglas' name on the signature card. (Appx. Vol. 1, 298:22-25; 1-24)

Douglas and A-Don entered into a real estate purchase contract dated December 16, 2004 for the residence. (Appx. Vol. XIV, 4781-4783) The stated purchase price was $225,000. (Appx. Vol. XIV, 4781) $11,250 was deposited with the mortgage company as a down payment, leaving the rest to be financed. (Appx. Vol. XIV, 4781) In fact, the true purchase price was only $175,000 and the $50,000 difference would be refunded. (Appx. Vol. 2, 558:14-25; 418:1-22) The $50,000 would be used to repay Commercial Litigation Group for the down payment, costs of sale and help make future mortgage payments. (Appx. Vol. 1, 29; Vol. 2, 558:14-25; 418:1-22)

In January 2005, Douglas obtained the mortgage, exercised the option and purchased the residence. (Appx. Vol. 1, 29) Garland's occupancy, which began in 1981, continued uninterrupted. (Appx. Vol. 1, 26) It is Garland's primary residence. (Appx. Vol. 2, 541:16-17) Garland does not pay rent. (Appx. Vol. 1, 29) Garland takes care of the residence as he wishes. (Appx. Vol. 2, 541:13-15)

Douglas does not live at the residence. (Appx. Vol. 2, 540:13-19) Douglas does not maintain a room at the residence. (Appx. Vol. 2, 539:24-25; 540:1-6) Douglas keeps no personal property at the residence. (Appx. Vol. 2, 542:3-5) The furniture is not his. (Appx. Vol. 2, 542:6-10) When Douglas visits, he knocks on the door before entering the house and he isn't even sure if he has a key to the door. (Appx. Vol. 2:19-24) If Douglas were visiting and his father asked him to leave, he "probably would." (Appx. Vol. 2, 569:6-23) Douglas has never paid any of the utility bills. (Appx. Vol. 2, 540:25; 541:1-6)

Commercial Litigation Group and other entities for which Garland has signature authority provided funds for mortgage payments. (Appx. Vol. 1, 29; Appx. Vol. 2, 560:2-25; 561- 567:1-8) Garland signed many of these checks. (Appx. Vol. 2, 560:2-25; 561- 567:1-8) Douglas testified if Commercial Litigation Group or someone else didn't pay the monthly mortgage payments, it would be painful for him and he would reconsider his ownership of the residence. (Appx. Vol. 559:11-22)

e. <u>The Undisclosed Income</u>

Garland had six years of unpaid federal income taxes when he filed bankruptcy in 2005. He sought a determination that these six of these nine years of federal income taxes were dischargeable. Shortly before filing bankruptcy, he tardily filed four years of federal income tax returns in August 2005, as required by the United States Bankruptcy Court for the Eastern District of Oklahoma. These returns indicate Garland's total income for the calendar years of

2003 and 2004, was respectively $20,785 and $21,976. (Appx. Vol. XIX, 6329, 6334, 6340; IRS Supplemental Appendix) Garland's statement of financial affairs questions 1 and 2 disclose total income from Commercial Litigation Group and Social Security of $20,331 for the year of 2003 and $35,776 for the year of 2004. (Appx. Vol. VI, 1298)

The IRS discovered six undisclosed bank accounts where Garland had signature authority. (Appx. Vol. 2:592:6-25; 593:1-10; Vol XVIII, 6067) They were held in the names of Savol, Commercial Litigation Group, Jagar, Karen Hassler Trust Commercial Litigation Group Trustee and James and William Garland social security account. (Appx. Vol. 1: 254-258, Vol. 3, 602-604; Vol. XVIII, 6067, 6295-6299) During the years of 2003 and 2004 Garland used funds from these accounts for his personal use, totaling, respectively, at least $60,386 and $61,151. (Appx. Vol. 2, 592-Vol. 3, 605; Vol. XVIII, 6234-6255, 6295-6297) He used these accounts to pay personal expenses such as his daughter's dance studio fees and mortgage payments for his residence. (Appx. Vol. 1, 254-258; Vol. 2, 592-600) Garland never explained why the income reported in his statement of financial affairs and tax returns was substantially less than the amounts of money he received from these accounts.

IV. SUMMARY OF THE ARGUMENT

Garland's arguments that the *Rooker-Feldman* doctrine, res judicata and collateral estoppel preclude the United States Trustee from asserting Garland concealed his interests in his residence and A-Don fails. First, the state foreclosure judgments only involve the foreclosure of Garland's residence. His discharge was denied for making false oaths about, and concealing, various other matters such as his interests in corporations and their accounts and failing to explain the loss and deficiency of his assets. Second, the *Rooker-Feldman* doctrine does not deprive the United States Bankruptcy Court of jurisdiction to adjudicate the denial of Garland's discharge, a matter of exclusive federal jurisdiction. Third, res judicata and collateral estoppel do not preclude adjudication of the facts underlying the judgment denying Garland's discharge. The foreclosure judgments in no way adjudicated whether Garland had any equitable or other interests in the residence at the time he filed bankruptcy nor do they address the other grounds upon which his discharge was denied.

Garland is not an "honest but unfortunate debtor" and his discharge was properly denied. *See Grogan*, 498 U.S. at 286-887. The numerous stipulated facts, voluminous exhibits and ample testimony in this case, contradict Garland's claim that the evidence does not support the Bankruptcy Court's findings. His argument focuses on his residence and A-Don. Garland fails to dispute other factual grounds for which his discharge was denied and instead argues that his other false statements were immaterial and he lacked fraudulent intent. The evidence, however, clearly established Garland's fraudulent intent and the materiality of his false statements.

V. ARGUMENT

A. Garland's *Rooker-Feldman* Doctrine And Preclusion Arguments Attack Only Some Of The Numerous Grounds Upon Which His Discharge Was Denied

Garland's *Rooker-Feldman* and preclusion arguments ignore the fact that his discharge was denied on grounds independent from facts adjudicated by the foreclosure judgments. The foreclosure judgments resulted in A-Don's foreclosure on the residence and a determination that its lien was senior to the IRS' tax liens. The United States Trustee did not dispute these facts. The foreclosure judgments did not adjudicate Garland's role in A-Don or whether he orchestrated the foreclosures. In fact, in the one foreclosure action where the IRS alleged a sham foreclosure, A-Don settled the allegation by paying the IRS.

Garland's discharge was denied on several grounds independent from the issues determined by the foreclosure judgments. For example, the foreclosure judgments are unrelated to Garland's failure to disclose required information about various corporations and partnerships in his statement of financial affairs and the undisclosed funds he funneled to himself through the undisclosed accounts. He also failed to disclose that he held or controlled the residence at the time filed bankruptcy. His son Douglas, didn't acquire the residence from A-Don until after the foreclosure judgments were entered. These independent grounds are not affected by the foreclosure judgments.

B. <u>The Foreclosure Judgments Did Not Deprive The Bankruptcy Court Of Jurisdiction Over The Objection To Discharge</u>

Garland's reliance on the *Rooker-Feldman* Doctrine is misplaced. The doctrine prevents lower federal courts from exercising jurisdiction over cases brought by 'state-court losers' challenging 'state court judgments' rendered before the federal proceedings commenced. *See Exxon Mobil Corp. v. Saudi Basic Industries Corp.*, 544 U.S. 280, 284, 125 S.Ct. 1517, 161 L.Ed.2d 454 (2005); *Dist. of Columbia Ct. of App. v. Feldman*, 460 U.S. 462, 482, 103 S.Ct. 1303, 75 L.Ed.2d 206 (1983); *Rooker v. Fid. Trust Co.*, 263 U.S. 413, 414-16, 44 S.Ct. 149, 68 L.Ed. 362 (1923). The doctrine is based on the Supreme Court's exclusive jurisdiction over appeals from state-court judgments. *See* 28 U.S.C. § 1257; *Lance*, 546 U.S. at 463.

The *Rooker-Feldman* doctrine is jurisdictional and should not be confused with preclusion rules. *See Lance*, 546 U.S. at 466; *Exxon Mobil Corp.*, 544 U.S. at 293; *compare Hill* *v. Putvin (In re Putvin)*, 332 B.R. 619, 623 - 624 (10th Cir. BAP 2005). The *Rooker-Feldman* doctrine cannot deprive the Bankruptcy Court of jurisdiction over the United States Trustee's objection to Garland's discharge. *See Exxon Mobil Corp.*, 544 U.S. at 292 - 293. This is true because the United States District Court has original and exclusive jurisdiction over the question of whether Garland's discharged should be denied.[6] 28 U.S.C. § 1334.

i. **The United States Trustee Did Not Challenge Any Claims Actually Decided Or Inextricably Intertwined With The Foreclosure Judgements**

The Supreme Court has "tended to emphasize the narrowness of the *Rooker-Feldman* rule." *See Lance, 546 U.S.* at 464, *citing Exxon Mobil*, 544 U.S. at 292. The doctrine may only be applied: "(1) to those federal claims actually decided by a state court, and (2) to those federal claims inextricably intertwined with a state court judgment." *Merrill Lynch Business Fin. Serv. v. Nudell*, 363 F.3d 1072, 1075 (10th Cir. 2004). Whether a claim is inextricably intertwined turns on "whether the injury alleged by the federal plaintiff resulted from the state court judgment itself or is distinct from the judgment." *Id*. at 1076. The United States Trustee's claims under 11 U.S.C. § 727 were not actually decided by the state court nor inextricably intertwined with the foreclosure judgments.

The state court did not actually decide whether the foreclosure was a sham. The foreclosure judgments did not decide what interests Garland had in A-Don. They did not decide what interests Garland had in the residence after his son purchased it in 2005 using funds from Commercial Litigation Group. They did not decide what interests Garland had in the residence

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[6] The District Courts refer bankruptcy cases to the United States Bankruptcy Courts. *See* 28 U.S.C. § 157.

when Garland signed checks for the mortgage payments.

The allegations that Garland orchestrated the foreclosures and had an interest in A-Don are not “inextricably intertwined” with the foreclosure judgments. *See Merrill Lynch Business Fin. Serv.*, 363 F.3d at 1075. Garland’s false oath and concealment of his interests in his residence and A-Don in his bankruptcy case are not injuries arising from the foreclosure judgments. The United States Trustee’s objection to discharge did not seek to review or overturn the foreclosure judgments. To the contrary, the United States Trustee alleged the judgments essentially eliminated the IRS’ tax liens on the residence which A-Don acquired by credit-bidding at the sheriff’s sale.

ii. The United States Trustee Was Not A Party To The Foreclosure Actions

Lastly, the United States Trustee was not a party to the state foreclosure actions. “The *Rooker-Feldman* doctrine does not bar actions by nonparties to the earlier state-court judgment even if, for purposes of preclusion law, they could be considered in privity with a party to the judgment.” *Lance*, 126 S.Ct. at 1201-02; *see Exxon Mobil*, 544 U.S. at 291. The United States Trustee had no right to appeal from the foreclosure judgments. *See Johnson v. DeGrandy*, 512 U.S. 997, 1005-1006, 114 S.Ct. 2647, 129 L.Ed.2d 775 (1994); *Karcher v. May*, 484 U.S. 72, 77, 108 S.Ct. 388, 98 L.Ed.2d 327 (1987)(“[T]he general rule [is] that one who is not a party or has not been treated as a party to a judgment has no right to appeal therefrom.”). The *Rooker-Feldman* doctrine did not deprive the Bankruptcy Court of jurisdiction to rule on these causes of action. Garland’s res judicata and collateral estoppel arguments are similarly flawed.

C. Res Judicata Does Not Bar The United States Trustee From Litigating Garland's Concealment Of His Interests In His Residence Or A-Don

Res judicata, e.g. claim preclusion, prevents a party from relitigating the same cause of action against the parties to a prior decision. *See United States v. Mendoza*, 464 U.S. 154, 162-163, 104 S.Ct. 568, 574, 78 L.Ed.2d 379 (1984). The United States Trustee's objection to Garland's discharge was not litigated in the foreclosure actions. The United States Trustee was not a party to the foreclosure actions. Consequently, Garland's claim preclusion argument fails.

The Supreme Court rejected similar claim preclusion arguments in litigation determining the dischargeability of debts under 11 U.S.C. § 523. *See Archer v. Warner*, 538 U.S. 314, 319-320, 123 S.Ct. 1462, 155 L.Ed.2d 454 (2003), *citing Brown v. Felsen,* 442 U.S. 127, 99 S.Ct. 2205, 60 L.Ed.2d 767 (1979). In *Archer*, a debtor contended a pre-petition settlement agreement precluded a creditor from litigating the dischargeability of the debt under 11 U.S.C. § 523. *Archer*, 538 U.S. at 314. Rejecting the argument, the Supreme Court noted that Congress intended the determination of whether a debt arises from fraud for purposes of 11 U.S.C. § 523 is "to take place in Bankruptcy Court, and not force it to occur earlier in state court at a time when non dischargeability concerns 'are not directly in issue and neither party has a full incentive to litigate them.'" *Archer*, 538 U.S. at 321, *quoting Brown*, 442 U.S. at 134.

Likewise, in *Brown* the Court found a stipulation and consent judgment in state court did not preclude the Bankruptcy Court from looking beyond the state court record in order to determine the dischargeability of the underlying debt. *See Brown,* 442 U.S. 127. The defendant's failure to establish the parties intended to resolve the issues of fraud for purposes of a later nondischargeability claim defeated any claim preclusion argument. *See Archer*, 428 U.S.

at 322. As in *Archer* and *Brown*, Garland cannot established that the parties to the foreclosure actions even remotely intended to resolve any later objection to discharge. There was no agreement or adjudication regarding Garland's ability to seek a bankruptcy discharge.

It is true that in the second foreclosure action, involving only 20 acres, the IRS alleged A-Don was an instrumentality of Garland and the foreclosure was a sham. That issue was not adjudicated. Instead, it was settled by A-Don paying the IRS $8,000. The Bankruptcy Court properly rejected Garland's claim preclusion argument.

D. The Foreclosure Judgments Do Not Collaterally Estop The United States Trustee

As already noted, the United States Trustee did not challenge the foreclosure judgments' findings. Even if the findings in the judgment denying Garland's discharge were somehow contrary to the foreclosure judgments' findings, collateral estoppel, or issue preclusion, would not apply in this case. While collateral estoppel may be applied to objections to discharge, its applicability against the Government is limited and its required elements are absent in this case. *See Grogan*, 498 U.S. at 284, n.12.

i. The United States Trustee Is Not Collaterally Estopped By A Foreclosure Judgment Naming The IRS As A Defendant

There are significant limitations to issue preclusion against the government. "Collateral estoppel, like the related doctrine of res judicata, serves to 'relieve parties of the cost and vexation of multiple lawsuits, conserve judicial resources, and, by preventing inconsistent decisions, encourage reliance on adjudication.'" *Hercules Carriers, Inc. v. State of Florida*, 768 F.2d 1558, 1578 (11th Cir. 1985), *quoting*, *Mendoza*, 104 S.Ct. at 571. Indiscriminate application of collateral estoppel against the government would defeat "the economy interests in whose name estoppel is advanced by requiring the government to abandon virtually any exercise of discretion in seeking to review judgments unfavorable to it . . . ." *Mendoza*, 104 S.Ct. at 574.

The Supreme Court explained it has:

> long recognized that the government is not in the same position as a private litigant, given the geographical breadth of the government litigation and the nature of the issues litigated by the government.

Hercules Carriers, Inc., 768 F.2d at 1578, *citing Mendoza*, 104 S.Ct. at 573. Because of the significant differences between the government and private litigants, collateral estoppel should not be applied against the United States Trustee. *See Mendoza*, 104 S.Ct. 568.

As stated by the Eleventh Circuit Court of Appeals:

> if *Mendoza* stands for anything, it must stand for the proposition that a government's agencies in pursuing their stated goals must not be put in the untenable position of collaterally estopping one another when they pursue the same issue for wholly different purposes.

Id. This reasoning is particularly applicable in this case.

The United States Trustee prosecuted his objection to Garland's discharge pursuant to his statutory duties to protect the integrity of the Bankruptcy System. *See* 11 U.S.C. §§ 307, 727; 28 U.S.C. § 586. In contrast, the Internal Revenue Service's interest in the foreclosure action was to collect taxes by virtue of its junior liens. These different interests militate against collateral estoppel. *See Hercules Carriers, Inc.*, 768 F.2d at 1578 - 1581. Any other result would hinder tax collection efforts since the IRS would be forced to carefully scrutinize every foreclosure involving a tax lien for the effects it might have on any possible future bankruptcy. It would likewise interfere with the United States Trustee's ability to protect the integrity of the bankruptcy system. Even if collateral estoppel could be applied against the United States Trustee, necessary elements are missing.

ii. The Foreclosure Judgments Do Not Decide Whether Garland Had Any Interests In A-Don Or Orchestrated The Foreclosures

Because the foreclosure judgments were entered by Oklahoma courts, Oklahoma's collateral estoppel law applies. *See Marrese v. American Academy of Orthopeadic Surgeons*, 470 U.S. 373, 380, 105 S.Ct. 1327, 84 L.Ed.2d 274 (1985).[7] Under Oklahoma law, collateral estoppel prevents the relitigation of an issue of ultimate fact if it has already been determined by a valid judgment in previous litigation between the same parties or their privies and they had a full and fair opportunity to litigate the issue. *See Merrill v. Merrill (In re Merrill)*, 252 B.R. 497, 504, 505 (10th Cir. BAP 2000). Whether Garland orchestrated the foreclosures and what interests he had in A-Don and the residence were never litigated in the foreclosure actions.

The foreclosure judgments state they are in rem judgments against the real estate and declare that any "right, title, or interest which the defendants, and each of them, may have or claimed to have in and to said real estate and premises is subsequent, junior and inferior to the mortgage and lien of the plaintiff [A-Don]." (Appx. Vol. XIV, 4695; 4698; 4766; 4768) It provides for a sheriff's sale and further orders that the IRS's tax liens are inferior to A-Don's

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[7] The Full Faith and Credit Act, 28 U.S.C. § 1738, "requires the federal court to 'give the same preclusive effect to a state-court judgment as another court of that State would give.'" *Exxon Mobil Corp.*, 544 U.S. at 293, *quoting Parsons Steel, Inc. v. First Alabama Bank,* 474 U.S. 518, 523 (1986).

mortgage and that the IRS retains its right of redemption. (Appx. Vol. XIV, 4695; 4698; 4769) The first foreclosure judgment states that upon entry of an order confirming the sheriff's sale, a deed shall be executed providing "all right, title, interest, estate, and equity of the defendants . . . [to the property]" to the purchaser and that the defendants are "forever barred, foreclosed, and enjoined from asserting or claiming any right, title or interest, estate [to the property]." (Appx. Vol. XIV, 4699) The second foreclosure judgment has similar language. (Appx. Vol. XIV, 4770)

These discrete facts do not help Garland's case. The foreclosure judgments do not adjudicate Garland's interests in or control of A-Don, his equitable or beneficial interests in the residence after the foreclosures were complete, or the numerous other factual grounds upon which his discharge was denied

E. **The Court's Findings Of Fact Are Supported By Two Days Of Testimony, Over 200 Admitted Exhibits And Numerous Stipulated Facts**

Garland's appeal argues the Bankruptcy Court's factual findings are clearly erroneous. On appeal, the facts are to be viewed in the light most favorable to the trial judge's factual findings. *See In re Ford*, 492 F.3d at 1154. The inferences, deductions and conclusions drawn from the evidence are left to the sound discretion of the trial judge.[8] The court's finding that Garland lacked credibility should not be disturbed on appeal. *See In re Ford*, 492 F.3d at 1154*;* *Anderson v. Bessemer City*, 470 U.S. 564, 575, 105 S.Ct. 1504, 84 L.Ed.2d 518 (1985); FED. R. BANKR. P. 8013.

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[8] The burden of proof is a preponderance of the evidence. *See In re Warren*, 512 F.3d at 1248.

i. The Court's 727(a)(2) Findings Are Supported By The Evidence

Garland fails to cite any evidence indicating the court's findings under 11 U.S.C. § 727(a)(2) are erroneous. Section 727(a)(2)(A) provides for denial of discharge where a debtor, with intent to hinder, delay or defraud a creditor or trustee has transferred or concealed property of the debtors within one year before filing a bankruptcy petition. Garland argues that he lacked fraudulent intent and he did not transfer or conceal anything during the year before he filed bankruptcy.

Because it is unlikely a debtor or co-conspirators will ever admit to fraudulent conveyances or concealment, other circumstantial evidence, frequently referred to as badges of fraud, are typically relied upon to prove the fraud. *See, e.g., Newton v. Essres*, 139 B.R. 958, 962 (D. Colo. 1992)(affirming denial of discharge where badges of fraud evidenced continuing concealment). Intent may be established trough circumstantial evidence and inferences from the debtor's pattern of conduct. *See In re Warren*, 512 F.3d at 1249; *Eastern Diversified Distr., Inc. v. Matus (In re Matus)*, 303 B.R. 660, 672 (Bankr. N.D.Ga. 2004).

Failure to disclose a transfer occurring more than a year before the bankruptcy is filed may still satisfy section 727(a)(2) timing requirement under the doctrine of continuing concealment. *See Rosen v. Bezner*, 996 F.2d 1527, 1532 (3d Cir. 1993); *Thibideaux v. Olivier (In re Olivier)*, 819 F.2d 550 (5th Cir. 1987). Continuing concealment claims typically involve (1) the transfer of property by a debtor who still retains a beneficial interest or equitable interest in the property; and (2) the debtor treating the property the same as before the transfer. *See Bank of Chester County v. Cohen (In re Cohen),* 142 B.R. 720, 726 (Bankr. E.D.Pa.1992). Continued concealment of the interest coupled with an "improper subjective intent" during the year before filing bankruptcy warrants application of the continuing concealment doctrine. *See Rosen*, 996 F.2d at 1533.

The evidence shows Garland concealed his interests in the residence, corporations and accounts well into the year before he filed bankruptcy. Concealment of the fact that he funneled money to himself through the various accounts while claiming he had no ownership interests also evidences continuing concealment. *See Doubet, L.L.C. v. Palermo (In re Palermo)*, 370 B.R. 599, 604 (Bankr. S.D.N.Y. 2007). Garland failed to disclose his interests in the corporations and partnerships, their accounts and his beneficial or equitable interest in the residence at the time he filed bankruptcy.

His fraudulent intent is evidenced by numerous badges of fraud such as inadequate consideration for transfers of the residence, close relationships to the transferees and Garland's retention of possession. *See The Cadle Co. v. Stewart (In re Stewart)*, 263 B.R. 608, 611 (B.A.P. 10th Cir. 2001). "There is little question that if an individual transfers title of an item but continues to exercise dominion over it, that fraud may be inferred." *Gullickson v. Brown (In re Brown)*, 108 F.3d 1290, 1293 (10th Cir. 1997).

It is undisputed Garland retained possession of his residence through the transfer to Jagar, A-Don's foreclosure, Commercial Litigation Group's lease and Douglas' ultimate purchase. The evidence clearly showed Garland's control of Jagar and that Garland transferred the residence to Jagar for inadequate consideration at a time when he owed substantial federal taxes. It demonstrated his agreement to form A-Don for the purpose of foreclosing on the residence and eliminating the IRS' tax liens recorded against the residence. It showed he never paid rent to Jagar, A-Don, Commercial Litigation Group or Douglas.

The evidence demonstrated Garland's long term and close connections to Walters and Bundren who assert they owned A-Don. It showed A-Don leased the residence to Commercial Litigation Group as a commercial cattle operation. It showed that A-Don gave Commercial Litigation Group an assignable option to buy the residence for substantially less than the appraised value. Commercial Litigation Group paid a mere $10 for the valuable option. It showed that even after Garland asserted he resigned as a partner of Commercial Litigation Group, he continued to write substantial checks for his personal use, including payments to enable Douglas to exercise the option. It shows Garland wrote checks to pay the mortgage payments enabling Douglas to purchased the residence. It established Douglas can not afford to make the mortgage payments and that Garland remains in possession and control of the residence. This control and possession occurred during the year before Garland filed bankruptcy. The evidence also demonstrated that Garland funneled money to himself from various undisclosed accounts during the year before he filed bankruptcy.

Garland discharge was properly denied under 11 U.S.C. § 727(a)(2).

ii. <u>The Court's 727(a)(4) Findings Are Supported By The Evidence</u>

A debtor's discharge will be denied where he knowingly and fraudulently made a false oath or account in his case. 11 U.S.C. § 727(a)(4). Garland's statements in his schedules or statement of financial affairs, including an omission, may constitute a false oath. *See Job v. Calder (In re Calder)*, 907 F.2d 953, 955 (10th Cir. 1990). Garland argues he made no false statements regarding his interests in the residence and A-Don and that any omissions in his statement of financial affairs regarding his holding or controlling the residence or the corporate entities lacked fraudulent intent and were immaterial. The evidence supporting the court's findings of Garland's interest in his residence, the corporate entities is sufficiently summarized above. His intent and materiality arguments also fail.

Garland knowingly and fraudulently made the false statements and omissions regarding his residence, the corporations and partnerships and their accounts. The court noted its ample opportunity to observe Garland during the trial and found him to be unbelievable. (Appx. Vol. 1, 65) The court disbelieved Garland's explanations of why he left information out of his schedules and statement of financial affairs. Further, "[w]here assets of some substantial value are omitted from the schedules" as Garland did here, "the conclusion that they were omitted purposefully with the fraudulent intent to conceal the assets in question may be warranted." *See Crews v. Topping (In re Topping)*, 84 B.R. 840, 842 (Bankr. M.D. Fla. 1988). Garland not only omitted information from his schedules and statement of financial affairs, he also failed to disclose the accounts in his responses to discovery in this case. (Appx. Vol. 2, 589:14-15; 590-591; 592:1-16, 21-25; 593:1-3) They were only discovered when banks responded to subpoenas served by the IRS as part of its discovery. His concealment of these accounts in his responses to discovery further evidences his fraudulent intent.

A pattern of errors or omissions, such as exists in this case, gives rise to an inference of an intent to deceive. *See Beaubouef v. Beaubouef (In re Beaubouef)*, 966 F.2d 174, 178 (5th Cir. 1992). "[R]eckless indifference to the truth has consistently been treated as the functional equivalent of fraud for purposes of denial of discharge under § 727 (a)(4)(A)." *Cadle Co. v. King (In re King)*, 272 B.R. 281, 302 (Bankr. N.D.Okla. 2002), *quoting Boroff v. Tully (In re Tully)*, 818 F.2d 106, 112 (1st Cir. 1987); *Congress Talcott Corp. v. Sicari (In re Sicari)*, 187 B.R. 861, 882 (Bankr. S.D.N.Y. 1994)("The cumulative effect of a number of false oaths by the debtor with respect to a variety of matters establishes a pattern of reckless and cavalier disregard for the truth.”). Additionally, Garland’s failure to disclose information about corporate entities in which he retained dominion or control evidences fraudulent intent. *See In re Calder*, 907 F.2d at 956.

It should be remembered that Garland filled out the questionnaire his attorney used to complete his bankruptcy papers. Garland testified he reviewed them before signing. Garland is an experienced attorney who represented people accused of tax evasion and money laundering. Certainly, he knew the importance of accuracy when verifying his bankruptcy papers under penalty of perjury. This fact further evidences Garland’s fraudulent intent. *See In re Calder*, 907 F.2d at 956.

“The false oath must relate to a material matter, that is, a matter that bears a relationship to the debtor’s business transactions or estate, or concerns the discovery of assets or the existence or disposition of property.” *See In re Calder*, 907 F.2d at 955. Garland’s false statements about his interests in the residence, his holding and controlling the residence and omission about the corporations and partnerships related to his business transactions, estate and disposition of property. Had they properly been disclosed, the trustee would have investigated further. Garland funneled large sums of money to himself through the undisclosed accounts while indicating in his schedule I that he had nominal income. Garland knowingly and fraudulently made material false statements under oath. His discharge was properly denied.

iii. **The Court’s 727(a)(5) Findings Are Supported By The Evidence**

Section 727(a)(5) provides for denial of Garland’s discharge where he fails to explain satisfactorily, before determination of denial of discharge any loss of assets or deficiency of assets to meet his liabilities. This subsection is designed "to prevent abuse of the bankruptcy process by the debtor obfuscating the true nature of [his] affairs, and then refusing to provide a credible explanation." *In re Palermo*, 370 B.R. at 613. A party objecting to a debtor's discharge under section 727(a)(5) has the burden of proving facts establishing that a loss or shrinkage of assets actually occurred. However, once the objecting party meets its initial burden of proof, the burden shifts to the debtor to explain the loss or deficiency of assets in a satisfactory manner. *See In re Stewart*, 263 B.R. at 618.

Garland argues that his records from the early 1990's are too old for him to be required to produce them and that he lost the residence because he class action practice failed. Garland's Opening Brief also incorrectly asserts that the only property referenced by the court under 11 U.S.C. § 727(a)(5) is the Residence. This is incorrect.

The court also found, among other things, "[t]he evidence also established that Garland had access to significant assets, specifically, the undisclosed checking accounts . . . funds or loans from Patrick Walters and Dr. Bundren . . . [and] Garland diverted funds to his own personal use . . . ." (Appx. Vol. 1, 66-67) The court also noted Garland failed to explain discrepancies between income reported on his 2002 through 2005 tax returns when compared to the evidence that he personally used funds from various checking accounts during those years. (Appx. Vol. 1, 33)

The court was left to "speculate about how Garland lost his considerable income and assets, and conclude that he actually had access to significant assets but chose to conceal those assets in order to appear destitute to his creditors." (Appx. Vol. 1, 33) His brief fails to address these issues, and, therefore denial of his discharge under 11 U.S.C. § 727(a)(5) should be affirmed.

Lastly, the evidence clearly established Garland had access to funds to pay the down payment for his son and make mortgage payments. He never explained how he could retain possession and control of his residence yet lack any assets to pay creditors. Because of this and his failure to challenge the court's other findings under 11 U.S.C. § 727(a)(5), the judgment denying his discharge must be affirmed.

VI. CONCLUSION

For the foregoing reasons, the judgment of the United States Bankruptcy Court denying James Clinton Garland's discharge should be affirmed.

Dated: October 14, 2008

RICHARD A. WIELAND
UNITED STATES TRUSTEE

David W. Newman, OBA# 20952
Attorney for United States Trustee
United States Department of Justice
Office of the United States Trustee
720 Park Blvd., Suite 220
Boise, ID 83712
(208) 334-1300 [Telephone]
(208) 334-9756 [Facsimile]
david.w.newman@usdoj.gov

CERTIFICATE OF SERVICE

I hereby certify that on October 14, 2008, I caused a true and correct copy of the foregoing brief and addendum to be served by U.S. First Class Mail, postage paid, as indicated below.

Ron Wright
Wright, Stout & Wilburn, PLLC
P.O. Box 707
Muskogee, OK 74402-0707

Mary E. Bielefeld
Olivia R. Hussey
U.S. Dept. of Justice
Tax Division
P.O. Box 7238
Ben Franklin Station
Washington, DC 20044

Dated: October 14, 2008

David W. Newman, OBA# 20952
Attorney for the United States Trustee
720 Park Blvd., Suite 220
Boise, ID 83712
(208) 334-1300 [Telephone]
(208) 334-9756 [Facsimile]

BRIEF BANK — "SUMMARY SHEET"

Printed Thu.-1/15/4 (9:33)

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*
Genesis Health Ventures, Inc., et al. v. DeAngelis (In re Genesis Health Ventures, Inc.)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*
CTA3

3. ("CCN") ***CURRENT*** CASE NO.
No.: 03-2722

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*
No.: 02-cv-01322
Court: U.S. Bankruptcy Court District of DE
(Identify judge & cite, if any)

5. ("SO") ***SOURCE***
U.S. TRUSTEES

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*
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7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*
Joseph J. McMahon, Trial Attorney Office of the U.S. Trustee
P. Matthew Sutko, Trial Attorney Executive Office for U.S. Trustees
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") ! ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***
! 28 U.S.C. §1930(a)(6) requires the payment of quarterly fees "in each case" inder chapter 11. Did the bankruptcy court correctly apply the plain meaning of the statute by ordering the payment of section 1930(a)(6) fees in each of the reorganized debtors' chapter 11 bankruptcy cases, give that the debtors made business decisions to keep these cases open?
√ Background:

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United States Court of Appeals

for the

Third Circuit

Case No. 03-2722

IN RE: GENESIS HEALTH VENTURES, INC.,

Debtor.

GENESIS HEALTH VENTURES, INC., *et al.*
-against-
ROBERTA A. DeANGELIS, ACTING UNITED STATES
TRUSTEE FOR REGION 3
(District of Delaware D.C. 02-cv-01322)

(For Continuation of Caption See Next Page)

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF DELAWARE

BRIEF FOR APPELLEE

FRANK J. PERCH III
ASSISTANT UNITED STATES TRUSTEE
ROBERT J. SCHNEIDER
JOSEPH J. MCMAHON, JR.
TRIAL ATTORNEYS
UNITED STATES DEPARTMENT OF JUSTICE
OFFICE OF THE UNITED STATES TRUSTEE
J. Caleb Boggs Federal Building
844 King Street, Suite 2207, Lockbox 35
Wilmington, DE 19801

- and -

JOSEPH A. GUZINSKI
GENERAL COUNSEL
PAUL WM. BRIDENHAGEN
P. MATTHEW SUTKO
TRIAL ATTORNEYS
UNITED STATES DEPARTMENT OF JUSTICE
EXECUTIVE OFFICE FOR UNITED STATES TRUSTEES
20 Massachusetts Avenue, N.W.
Suite 8000
Washington, D.C. 20530

Attorneys for Appellee

IN RE: MULTICARE AMC, INC.,

Debtor.

MULTICARE AMC, INC., *et al.*,

-against-

ROBERTA A. DeANGELIS, ACTING UNITED STATES TRUSTEE
FOR REGION 3
(District of Delaware D.C. 02-cv-01372).

Genesis Health Ventures, *et al.*, Multicare AMC, Inc., *et al.*,

Appellants.

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UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

Case No. 03-2722

GENESIS HEALTH VENTURES, INC., et al., and
MULTICARE AMC, INC., et al.

v.

ROBERTA A. DeANGELIS, Acting United States Trustee for Region 3.[1]

APPELLEE'S BRIEF

STATEMENT OF ISSUE PRESENTED

28 U.S.C. § 1930(a)(6) requires the payment of quarterly fees "in each case" under chapter 11. Did the bankruptcy court correctly apply the plain meaning of the statute by ordering the payment of section 1930(a)(6) fees in each of the reorganized debtors' chapter 11 bankruptcy cases, given that the debtors made business decisions to keep these cases open?

STATEMENT OF THE CASE

Congress enacted 28 U.S.C. § 1930(a)(6) as a funding mechanism for the United States Trustee Program. Under Section 1930(a)(6), fees must be paid in "each" open chapter 11 "case" in an amount scaled upon "disbursements" made in

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[1] Ms. DeAngelis is the successor to Donald F. Walton as Acting United States Trustee for Region 3. Accordingly, she is automatically substituted as party to this appeal by operation of Federal Rule of Appellate Procedure 43(c)(2).

the case. The minimum fee payable per case in any given quarter is $250 (for disbursements ranging from zero to $15,000), and the maximum 1930(a)(6) fee payable is $10,000 (for disbursements of $5 million or more).

Genesis Health Ventures, Inc., Multicare AMC, Inc., and their respective debtor-affiliates filed 352 separate chapter 11 bankruptcy cases beginning in June 2000. A chapter 11 debtor's primary goal is confirming a plan of reorganization that resolves competing claims to its assets. The Debtors' plan of reorganization was confirmed by the bankruptcy court in September 2001.

The Debtors did not ask the Bankruptcy Court to substantively consolidate their cases into a single case. Nevertheless, the Debtors forwarded a single, consolidated statement of their disbursements to the Office of the United States Trustee for the fourth quarter of 2001 and paid one fee based upon the statement. The Debtors refused to report their disbursements on a case-by-case basis and pay approximately $800,000 in 1930(a)(6) fee obligations for the fourth quarter of 2001. The United States Trustee moved to compel the reporting of disbursements on a case-by-case basis and payment of 1930(a)(6) fees in each of the open cases. The bankruptcy court granted the United States Trustee's motions and held that "each" open "case" had to pay 1930(a)(6) fees. The district court affirmed the bankruptcy court's ruling. These appeals ensued.

STATEMENT OF THE FACTS

The Debtors comprised 352 legally distinct corporations, partnerships and limited liability companies which operated a variety of businesses that provided healthcare and support services to the elderly. [United States Trustee Brief -- *Genesis/Multicare I* at 3, App. A-609]. The various Debtors owned, leased, or managed approximately 317 eldercare facilities spread across five geographic markets. [*Id.*] The Debtors also operated approximately 61 long-term care pharmacies, 23 medical supply/home medical equipment distribution centers, and 32 community-based pharmacies. [*Id.*] In addition, the Debtors provided rehabilitation therapy services through six certified rehabilitation agencies. [*Id.*].

With the exception of Healthcare Resources Corp., a Genesis Debtor that filed its voluntary petition on July 31, 2000, each of the Debtors filed a separate voluntary petition under chapter 11 of the Bankruptcy Code on June 22, 2000. [Disclosure Statement at 64, App. A-109]. The Debtors' 352 cases were jointly administered in two groups (the "Genesis Debtors" and "Multicare Debtors").[2/]

[2/] During the relevant time period, the Multicare Debtors were, directly or indirectly, subsidiary companies of Genesis Health Ventures, Inc. [Disclosure Statement at 51, App. A-98]. The Multicare Debtors were party to a number of agreements with Genesis; through those agreements, Genesis provided operational oversight, managed Multicare's inpatient facilities, and performed other services for its subsidiaries. [Disclosure Statement at 51, App. A-98]. The Genesis Debtors primarily provided pharmacy and medical supply services through their

[Disclosure Statement at 64, App. A-149]. The joint administration orders, entered on June 22, 2000, permitted administration of the Genesis Debtors under docket number 00-2692 and the Multicare Debtors under docket number 00-2494.[3]

The centerpiece of the reorganization process under chapter 11 is the confirmation of a plan of reorganization which resolves competing claims to the property of the Debtors' estates. The Debtors proposed a joint plan of reorganization during the summer of 2001 [Plan, App. A-175].

The plan did not provide for substantive consolidation of the Debtors' 352 cases into a single case. The only reference to any kind of "consolidation" in the plan is found at section 5.1 of the plan, titled "Deemed Consolidation for Plan

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subsidiaries. [Disclosure Statement at 52, App. A-99].

[3] Federal Rule of Bankruptcy Procedure 1015(b) states:

> If a joint petition or two or more petitions are pending in the same court by or against (1) a husband and wife, or (2) a partnership or one or more of its general partners, or (3) two or more general partners, or (4) a debtor and an affiliate, the court may order a joint administration of the estates . . . . FED. R. BANKR. P. 1015(b).

Purposes Only."[4] This "deemed consolidation" was limited to eliminating certain

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[4] Subsection 5.1(a) of the plan states as to the Genesis Debtors:

> Subject to the occurrence of the Effective Date, the Genesis Debtors shall be deemed consolidated for the following purposes under the Plan of Reorganization: (i) no distributions shall be made under the Plan of Reorganization on account of the Genesis Intercompany Claims; (ii) all guaranties by any of the Genesis Debtors of the obligations of any other Genesis Debtor arising prior to the Effective Date shall be deemed eliminated so that any Claim against any Genesis Debtor and any guaranty thereof executed by any other Genesis Debtor and any joint and several liability of any of the Genesis Debtors shall be deemed to be one obligation of the deemed consolidated Genesis Debtors; and (iii) each and every Claim filed or to be filed in the Reorganization Case of any of the Genesis Debtors shall be deemed filed against the deemed consolidated Genesis Debtors and shall be deemed one Claim against and obligation of the deemed consolidated Genesis Debtors.
>
> Such deemed consolidation, however, shall not (other than for purposes related to funding distributions under the Plan of Reorganization and as set forth above in this Section) affect: (i) the legal and organizational structure of the Reorganized Debtors; (ii) intercompany Claims by and among the Genesis Debtors or Reorganized Debtors; (iii) pre- and post-Commencement Date guaranties, liens, and security interests that are required to be maintained (A) in connection with executory contracts or unexpired leases that were entered into during the Genesis Reorganization Cases or that have been or will be assumed, (B) pursuant to the Plan of Reorganization, or (C) in connection with any financing entered into, or New Senior Notes issued, by the Reorganized Debtors on the Effective Date; and (iv) distributions out of any insurance policies or the proceeds of such policies.
>
> Notwithstanding anything contained in the Plan to the contrary, the deemed consolidation of the Genesis Debtors shall not have any

intercompany claims from the distributive scheme and enabling the treatment of secured bank debt claims, general unsecured claims, and senior subordinated note claims against the Genesis Debtors and the Multicare Debtors, respectively, as if they were being made against a single bankruptcy estate. As the Debtors expressly stated in section 5.1, the "deemed consolidations" (i) did not affect the legal and organizational structure of the Debtors; (ii) preserved intercompany claims; (iii) maintained the separateness of certain guaranties, liens, and security interests; and (iv) did not affect distributions from insurance policies or the proceeds of such policies. In addition, neither the plan nor the order confirming the plan closed any of the 352 cases. Rather, the plan contained a provision which reserved jurisdiction in the bankruptcy court to close their 352 cases at a later date. [Plan § 11(o), App. A-214].[5]

> effect on the Claims being reinstated and unimpaired in class G1 of the Plan, and the legal, equitable, and contractual rights to which the holders of any such claims is entitled shall be left unaltered by the Plan. [Plan § 5.1(a), App. A-200-01].

Subsection 5.1(b) of the plan provided for an identical "deemed consolidation" of the Multicare Debtors. [Plan § 5.1(b), App. A-201].

[5] Plan § 11(o) provided that the bankruptcy court retained jurisdiction to close "the Reorganization Cases." The term "Reorganization Cases" is defined in the plan as the "Genesis Reorganization Cases" and "Multicare Reorganization Cases." [Plan § 1.65, App. A-189]. The terms "Genesis Reorganization Cases" and "Multicare Reorganization Cases," in turn, are defined as the 352 entities that

During the course of their chapter 11 cases, the Debtors did not substantively consolidate their hundreds of cases into a single case. The Debtors' chief financial officer testified at the plan confirmation hearing that the Debtors considered this course of action and rejected it. [8/29/01 Tr. 217:10 - 218:8 (Hager); App. A-419-20]. The Debtors decided that the business disruption that would follow from the transfer of numerous health care licenses outweighed any benefits that would follow from substantive consolidation. [*Id.*].

Two creditors objected to confirmation of the Debtors' plan on grounds that the acquisition of Multicare by Genesis resulted in a *de facto* substantive consolidation. In response to this particular objection, the Debtors denied that the plan provided for substantive consolidation; the Debtors stated that "it is important to note that <u>no substantive consolidation is, in fact, taking place under the Plan</u>." [Debtors' Omnibus Response to Objections to Plan at 10 (emphasis added)].[6] The bankruptcy court agreed with the Debtors on this point and overruled the objection, stating that "there is no diversion of value from Genesis to Multicare, or

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filed for bankruptcy protection. [Plan § 1.34, App. A-185; Plan § 1.47, App. A-187].

[6] The United States Trustee will file motions to supplement the record and appendix to include this item and the item referenced in Footnote 7.

substantive consolidation of the two entities." [Confirmation Op. at 46, App. A-485].

The bankruptcy court confirmed the plan by order dated September 20, 2001 [Confirmation Order, App. A-493]. After their plan was confirmed, the Debtors submitted a single, consolidated report of their disbursements for the fourth quarter of 2001 to the Office of the United States Trustee and paid a single 1930(a)(6) fee for that period. [Mot. to Compel ¶ 5, App. A-644]. Given that the Debtors' hundreds of cases remained open, the United States Trustee moved to compel reporting of disbursements on a case-by-case basis and the payment of 1930(a)(6) fees in each of the open cases. [Mot. to Compel, App. A-643]. The Debtors objected to the motions, contending that the "deemed consolidations" described in section 5.1 of the plan substantively consolidated their cases into one case for 1930(a)(6) purposes. [5/14/02 Op. at 5, App. A-9].

After a hearing was held on the motions to compel and the bankruptcy court heard oral argument from counsel, the bankruptcy court granted the United States Trustee's motions by orders dated June 4, 2002 (the Genesis Debtors) [App. A-1] and July 9, 2002 (the Multicare Debtors) [App. A-3] and rejected the Debtors' objections. The bankruptcy court observed that,

> where substantive consolidation is effected in a reorganization process, and the individual debtor does

> not survive as a separate legal entity, then consolidated reporting and calculation of section 1930(a)(6) fees going forward would be based on a single consolidated case. However, that basic proposition does not extend to the "deemed consolidation" effected here, which did not change the legal and organizational structure of the individual debtors. [5/14/02 Op. at 6, App. A-10].

The bankruptcy court noted that "each separate pre-confirmation debtor emerged from the reorganization process as a separate post-confirmation legal entity with the same legal and corporate attributes it had prior to the plan confirmation." [5/14/02 Op. at 6, App. A-10]. Applying the plain language of section 1930(a)(6), the court concluded "each individual Genesis and Multicare debtor continued to constitute a 'case' within the meaning of the statute, requiring 1930(a)(6) fees to be paid by each separate debtor." [5/14/02 Op. at 6-7, App. A-10-11].

The bankruptcy court responded to the Debtors' argument that the "deemed consolidation" substantively consolidated the Debtors' cases into a single case. First, the bankruptcy court observed that the Debtors had never asked the bankruptcy court to enter such relief. [5/14/02 Op. at 6, App. A-10]. Second, the bankruptcy court rejected the idea that the mere invocation of the words "substantive consolidation" relieved the Debtors of their separate obligations to pay 1930(a)(6) fees. Rather, the bankruptcy court focused on the properties of the relief that was approved and concluded that

> [t]he crux of the issue, however, is not whether the debtors' reorganization plan constituted a substantive consolidation or a deemed consolidation. Rather, the issue is whether each of the legal entities which entered the Chapter 11 process as an individual "case" survived the process . . . . To the extent that a debtor remains a corporation, the separate "case" filed by the debtor remains a case, notwithstanding the pooling of assets and liabilities, and notwithstanding other effects of consolidation, be it substantive or deemed. [5/14/02 Op. at 6, App. A-10 (emphasis added)].

The Debtors appealed from the bankruptcy court's orders granting the United States Trustee's motions to compel. The district court affirmed the orders. The district court adopted the bankruptcy court's analysis, stating that "the issue is not whether the plan effectuated a substantive consolidation or a deemed consolidation, but whether under the plain language of Section 1930 a 'case' survived the Chapter 11 process such that a fee is due for that case." [3/31/03 Mem. Op. at 6, App. A-19]. The district court also noted that "the separate debtors who filed cases remained separate entities post-confirmation, [and] their separate cases remained separate cases and fees were appropriately assessed for each separate case under Section 1930."[7] [*Id.*]. The instant appeals followed.

STATEMENT OF RELATED CASES AND PROCEEDINGS

Appeals are pending before this Court, Civil No. 03-1225, regarding the Debtors' appeal of a Memorandum and Order dated November 15, 2002, in which the district court affirmed the orders of the bankruptcy court dated November 8, 2001 and November 28, 2001 sustaining the United States Trustee's objection to confirmation as it related to non-payment of 1930(a)(6) fees. The issue in those appeals is whether each Debtor is separately obligated to pay 1930(a)(6) fees based upon the payment of its respective "disbursements," including its operating expenses.

STATEMENT OF APPLICABLE STANDARD OF APPELLATE REVIEW

The lower courts' conclusion that 1930(a)(6) fees must be paid in each case constitutes a question of law that this Court reviews *de novo*. *See In re Trans World Airlines, Inc.*, 322 F.3d 283, 287 (3d Cir. 2003); *First Jersey Nat'l Bank v.*

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[7] Subsequent to the filing of these appeals, the Debtors moved to close 349 of the cases *nunc pro tunc* to the plan's Effective Date (October 2, 2001). [8/1/02 Final Decree Order]. The bankruptcy court denied the Debtors' request to close the cases nunc pro tunc to the Effective Date but permitted the cases to be closed as of June 30, 2002. [*Id.*]. The United States Trustee seeks no 1930(a)(6) fees in those closed cases for the period beginning July 1, 2002.

Brown (In re Brown), 951 F.2d 564, 567 (3d Cir. 1991). The bankruptcy court's determination that the 352 Genesis bankruptcy cases were not substantively consolidated into a single case constitutes a factual finding that this Court will set aside only if clearly erroneous. *See Trans World Airlines*, 322 F.3d at 287; *Stendardo v. Federal Nat'l Mortgage Ass'n (In re Stendardo)*, 991 F.2d 1089, 1094 (3d Cir. 1993).

STATUTORY BACKGROUND AND LEGISLATIVE HISTORY

The United States Trustee Program is not taxpayer-funded, but relies instead on the collection of various fees, including the 1930(a)(6) fee. The Program is a component of the Department of Justice charged with the responsibility of monitoring and performing certain other functions in bankruptcy cases, including the supervision of cases filed under chapter 11 of title 11, United States Code ("Bankruptcy Code"). *See* 28 U.S.C. § 586(a) (describing various duties of the United States Trustee).[8]

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[8] The United States Trustee Program was created as a pilot program as part of the Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (1978). Congress later extended the Program to a permanent nationwide program as part of the Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1986, Pub. L. No. 99-554, 100 Stat. 3088 (1986) (the "1986 Act"). United States Trustees are officials of the Department of Justice appointed by the Attorney General to supervise the administration of bankruptcy cases and trustees. *See* 28 U.S.C. §§ 581-589; *United States Trustee v. Columbia Gas Sys., Inc. (In re Columbia Gas Sys., Inc.)* (United States Trustees oversee the bankruptcy process,

To fund the United States Trustee Program, Congress created the United States Trustee System Fund . *See* 28 U.S.C. § 589a(a). A percentage of every fee paid by all debtors filing petitions under the Bankruptcy Code is deposited into the Fund. *See* 28 U.S.C. § 589a(b). If the amounts collected exceed the amount needed for a particular year, the money remains in the Fund for use in subsequent years as appropriated by Congress. *See* 28 U.S.C. § 589a(c). Conversely, if the costs of operating the Program in a particular year exceed the amounts available in the Fund, additional amounts may be appropriated from the Treasury to make up the difference. *See* 28 U.S.C. § 589a(e). The Attorney General is required to report to Congress every year on the amounts deposited in the Fund and expenditures made from it. *See* 28 U.S.C. § 589a(d). Congress has thus constructed a mechanism whereby it can either increase or reduce the fees paid, so that the amount collected for deposit in the Fund will never be unacceptably small or unreasonably large.

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protect the public interest, and ensure that bankruptcy cases are conducted according to law) (citing H.R. REP. NO. 95-595, 109 (1977)). "The United States Trustee is the 'watchdog' of the bankruptcy system * * * charged with preventing fraud and abuse and with 'fill[ing] the vacuum' caused by possible creditor inactivity." *In re Castillo*, 297 F.3d 940, 950 (9th Cir. 2002).

A significant portion of the Fund is made up of statutory fees paid every quarter in every Chapter 11 case pursuant to Section 1930(a)(6), which was enacted as part of the 1986 Act. Section 1930(a)(6) provides as follows:

> In addition to the filing fee paid to the clerk, a quarterly fee shall be paid to the United States trustee, for deposit in the Treasury, in each case under chapter 11 of title 11 for each quarter (including any fraction thereof) until the case is converted or dismissed, whichever occurs first. The fee shall be $250 for each quarter in which disbursements total less than $15,000; $500 for each quarter in which disbursements total $15,000 or more but less than $75,000; $750 for each quarter in which disbursements total $75,000 or more but less than $150,000; $1,250 for each quarter in which disbursements total $150,000 or more but less than $225,000; $1,500 for each quarter in which disbursements total $300,000 or more but less than $1,000,000; $5,000 for each quarter in which disbursements total $1,000,000 or more but less than $2,000,000; $7,500 for each quarter in which disbursements total $2,000,000 or more but less than $3,000,000; $8,000 for each quarter in which disbursements total $3,000,000 or more but less than $5,000,000; $10,000 for each quarter in which disbursements total $5,000,000 or more. The fee shall be payable on the last day of the calendar month following the calendar quarter for which the fee is owed.

28 U.S.C. § 1930(a)(6).

Congress developed the 1930(a)(6) fee so that the Program would be "self-funded by the users of the bankruptcy system – at no cost to the taxpayer." *See* H.R. REP. NO. 99-764, at 25 (1986), *reprinted in* 1986 U.S.C.C.A.N. 5227, 5238;

see also H.R. REP. NO. 99-764, at 22 (1986), *reprinted in* 1986 U.S.C.C.A.N. 5227, 5235 ("The U.S. Trustee Program should not have to be self-funding. It provides a great service to our country's bankruptcy system. However, in this time of budget deficit concerns, self-funding becomes a necessity.").

Until January 1996, 1930(a)(6) fees were due from the time a chapter 11 case was commenced until one of three events -- plan confirmation, dismissal, or conversion -- occurred. Congress amended the statute in January, 1996[9] to delete plan confirmation as an event that terminates the fee payment obligation. As a result of the January, 1996 amendment to Section 1930(a)(6), chapter 11 debtors are required to pay 1930(a)(6) fees on post-confirmation disbursements until a "case" is converted, dismissed or closed.[10]

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[9] Section 1930(a)(6) was amended on January 26, 1996, pursuant to section 211 of the Balanced Budget Downpayment Act, I, Pub. L. No. 104-99, 110 Stat. 26, 37-38 (1996). In a clarifying amendment enacted in September 1996, Congress emphasized that post-confirmation quarterly fees were payable in every chapter 11 case, "notwithstanding any other provision of law." *See* Omnibus Consolidated Appropriations Act for Fiscal Year 1997, Pub. L. No. 104-208, § 109(d) (1996).

[10] While case closure is not expressly listed as an event that terminates the obligation to pay fees under Section 1930(a)(6), courts have generally agreed that the section should be read to add case closure as an event that terminates the obligation; once a case is closed, it is no longer a case "under chapter 11," and there is no possibility of conversion or dismissal after closure. *See United States Trustee v. Gryphon at the Stone Mansion, Inc.*, 166 F.3d 552, 554 n.1 (3d Cir. 1999).

SUMMARY OF ARGUMENT

In these cases, 352 debtors filed 352 separate bankruptcy petitions, initiating 352 separate bankruptcy cases under chapter 11 of the Bankruptcy Code. These Debtors, advised by experienced counsel, made a business decision to reorganize without substantively consolidating these 352 cases into one. The courts below held correctly that the plain language of Section 1930(a)(6) required "each" of these open "case[s]" to pay its 1930(a)(6) fee.

The courts below did not commit clear error in concluding these Debtors did not substantively consolidate these 352 cases into one case. The Debtors' written response to creditor objections to its proposed reorganization plan admitted that "no substantive consolidation is, in fact, taking place under the Plan," and Genesis' chief financial officer testified that the Debtors had considered and rejected substantive consolidation. The Debtors' representations to the court and their testimony are fully consistent with the plan, which left the legal and organizational structures of the Debtors intact, preserved certain intercompany obligations, and expressly reserved jurisdiction in the bankruptcy court to close the hundreds of cases that the Debtors were leaving open.

The Debtors suggest incorrectly that the "deemed consolidation," which occurred under section 5.1 of the plan, permitted "each" of 352 live "case[s]" to stop paying 1930(a)(6) fees. All the "deemed consolidation" provision did was streamline the resolution of intercompany and other claims, and simplify the effect of cross-guarantees. The bankruptcy and district courts correctly determined this did not substantively consolidate the hundreds of cases into a single bankruptcy "case." The bankruptcy court later entered an order closing 349 of the Debtors' 352 cases as of June 30, 2002. Each Debtor individually owed fees prior to that time, and the lower courts committed no error in requiring that the fees be paid.

The lower court decisions are consistent with the United States Trustee Manual, which does nothing more than recite Section 1930(a)(6)'s plain language requirement that a fee be paid in each case. The decisions below are also fair. The Debtors were represented by sophisticated bankruptcy counsel. The Debtors considered the possibility of substantively consolidating their cases into a single case and decided against doing that. They must accept the legal consequences that flow from this decision, including the payment of 1930(a)(6) fees.

ARGUMENT

I. SECTION 1930(a)(6)'s PLAIN LANGUAGE IMPOSES FEES IN EACH OF THE DEBTORS' CASES

This case calls upon this Court to interpret Section 1930(a)(6)'s requirement that "a quarterly fee . . . be paid to the United States trustee . . . in each case under chapter 11 of title 11 . . . ." 28 U.S.C. § 1930(a)(6). The starting point in any question of statutory construction is the plain language of the statute. *Government of Virgin Islands v. Knight*, 989 F.2d 619, 633 (3d Cir. 1993) ("It is axiomatic that statutory interpretation begins with the language of the statute itself"). A statutory language analysis must precede any resort to legislative history or case law as "[t]here is, of course, no more persuasive evidence of the purpose of a statute than the words by which the legislature undertook to give expression to its wishes." *United States v. American Trucking Ass'ns*, 310 U.S. 534, 543 (1930). Where a statute's language is plain, the court's function is to enforce the statute according to its terms. *See United States v. Ron Pair Enters., Inc.*, 489 U.S. 235, 241 (1989) (citation omitted).

The obligation under Section 1930(a)(6) to pay fees in each case does not hinge on "consolidation," whether "deemed," "substantive," or otherwise. Rather, the fundamental determinant for liability under Section 1930(a)(6) is the existence of a "case." In each, "a quarterly fee shall be paid." These Debtors commenced 352 separate cases under chapter 11 beginning in June 2000. By the express terms of their plan, confirmation did not affect the existence of each of the 352 debtors and did not close any of the 352 cases. The Debtors' own witness and the

Debtors' own pleadings stated that the Debtors did not intend to substantively consolidate these cases into one.[11]

Under the Bankruptcy Code, the filing of a bankruptcy petition by a "debtor" eligible for protection under chapter 11 initiates a voluntary "case." *See* 11 U.S.C. §§ 109, 301.[12] In these cases, there were 352 "debtors" seeking

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[11] The "deemed consolidations" effected by the plan did not substantively consolidate the Debtors' cases into a single case. A number of courts have held that bankruptcy courts have inherent discretion to order substantive consolidation. *See, e.g., In re Bonham,* 229 F.3d 750, 765 (9th Cir. 2000) ("No uniform guideline for determining when to order substantive consolidation has emerged"); *Eastgroup Props. V. Southern Motel Assoc.*, 935 F.2d 245, 250 n.14 (11th Cir. 1991) (referring to "fact-specific nature of cases on substantive consolidation"). The bankruptcy court never sought to use such power and both the bankruptcy court and the district court held the Debtors' plan did not effect a substantive consolidation of the Debtors' cases into a single case. [5/14/02 Op. at 7, App. A-11; 3/31/03 Mem. Op. at 5 (as amended) App. A-18, 22]. The Second Circuit has held that "in ordering substantive consolidation, courts must . . . consider whether the interconnections between the entities to be consolidated are such that "no accurate identification and allocation of assets is possible." *See Union Savs. Bank v. Augie/Restivo Baking Co. (In re Augie/Restivo Baking Co.),* 860 F.2d 515, 519 (2d Cir. 1988). If separate corporate identities are maintained, and separate assets are "traceable" and "identifiable," then substantive consolidation is not warranted. *Id.* Here, the Debtors' chief financial officer testified that the Debtors were obligated to maintain their separate corporate identities for health care licensing purposes. [8/29/01 Tr. 217:10 - 218:8 (Hager); App. A-419-20]. Further, the Debtors' chief financial officer testified that the Debtors could trace operating expenses to specific legal entities. [8/29/01 Tr. 215:17 - 216:4 (Hager); App. A-417-18]. In sum, the testimony of the Debtors' witness establishes that their cases were not substantively consolidated.

[12] A "debtor" is a "person or municipality concerning which a case under this title [the Bankruptcy Code] has been commenced." 11 U.S.C. § 101(13)

protection under chapter 11 and thus there were 352 "cases." Because each of the 352 chapter 11 cases commenced by the Debtors remained an open "case" under Section 1930(a)(6), fees had to be paid in each.

II. THE "DEEMED CONSOLIDATION" PROVISIONS OF THE DEBTORS' CONFIRMED PLAN OF REORGANIZATION DID NOT COLLAPSE HUNDREDS OF CASES INTO A SINGLE "CASE"

The bankruptcy court correctly found as a factual matter that the "deemed consolidation" provisions of the plan did not merge the Debtors' 352 "cases" into a single "case" for purposes of determining 1930(a)(6) fees. Section 5.1 of the plan, entitled "Deemed Consolidation of Debtors for Plan Purposes Only," solely enabled certain claims against individual Debtors to be satisfied from common "pots." The Debtors carefully limited and qualified Section 5.1, explaining that the "deemed consolidations" *did not* affect: (1) the "legal and organizational structure of the Reorganized Debtors;" (2) intercompany claims; (3) guaranties, liens, and security interests that are required to be maintained by contract, the plan, or an exit financing instrument; and (4) distributions from insurance policies or the proceeds of such policies. [Plan § 5.1, App. A-200-01].

(bracketed text added). A "person" includes "individual, partnership, and corporation." 11 U.S.C. § 101(41).

The Debtors drafted the plan. [Disclosure Stmt. at 3, App. A-50]. Their own plan made clear they were not collapsing their 352 cases into a single case. Moreover, in resisting an objection to confirmation of the plan, the Debtors urged the bankruptcy court not to interpret the plan as effecting substantive consolidation. [Debtors' Omnibus Response to Objections to Plan at 10]. Finally, the Debtors' own chief financial officer testified regarding the Debtors' decision <u>not to consolidate their cases into one</u> because of the business disruption that "licensor change" would entail. [8/29/01 Tr. 217:10 - 218:8 (Hager); App. A-419-20]. Given this record, the bankruptcy court did not commit clear error in finding that no substantive consolidation into one case occurred here.[13]

Both the bankruptcy court and district court arrived at the only reasonable conclusion in light of this record, namely that the "deemed consolidations" effected by the plan did not result in a single "case." The bankruptcy court observed correctly that "each separate pre-confirmation debtor emerged from the reorganization process as a separate post-confirmation legal entity with the same

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[13] Indeed, the Debtors' representation to the court and their testimony estop them from asserting that the "deemed consolidations" resulted in one substantively consolidated case. *See, e.g., Ryan Operations, G.P. v. Santiam-Midwest Lumber Co.*, 81 F.3d 355, 360 (3d Cir. 1996); *see also Delgrosso v. Spang & Co.*, 903 F.2d 234, 241 (3d Cir. 1990); *Scarano v. Central R.R. Co.*, 203 F.2d 510, 513 (3d Cir. 1953); *In re Kindred Healthcare, Inc.*, No. 99-3199 (MFW), 2003 WL 22327933 (Bankr. D. Del. Oct. 9, 2003).

legal and corporate attributes it had prior to the plan confirmation." [5/14/02 Op. at 6, App. A-10]. Accordingly, under the plain language of Section 1930(a)(6), "each individual Genesis and Multicare debtor continued to constitute a 'case' within the meaning of the statute, requiring 1930(a)(6) fees to be paid by each separate debtor." [5/14/02 Op. at 6-7, App. A-10-11]. The district court correctly agreed with the bankruptcy court, noting that "the separate debtors who filed cases remained separate entities post-confirmation, [and] their separate cases remained separate cases and fees were appropriately assessed for each separate case under Section 1930." [3/31/03 Mem. Op. at 6, App. A-19].

III. THE UNITED STATES TRUSTEE MANUAL SUPPORTS THE UNITED STATES TRUSTEE'S POSITION BECAUSE IT SIMPLY REFLECTS SECTION 1930(a)(6)'S PLAIN LANGUAGE

The Debtors' reliance on Section 3-8.3.3 of the United States Trustee Manual (the "Manual") is misplaced, because contrary to Debtors' assertions, the Manual does not purport to modify Section 1930(a)(6) or define when multiple cases become one case.

Section 3-8.3.3 of the Manual states that "[s]ubstantively consolidated cases become one case and are subject to only one fee from the time the substantive consolidation order is docketed." [Manual § 3-8.3.3, App. A-702]. This short sentence does nothing more than note that if the court consolidates the cases into one case – which the bankruptcy court expressly declined to do in these cases – then only one fee is paid going forward from such order. However, it does not purport to define what constitutes consolidating multiple cases into one case, or state when the court should consolidate multiple cases into one case. Nor does this short sentence suggest, in any way, that a limited "deemed" consolidation for certain distributive purposes should be treated as equivalent to consolidating the cases into one case. It does not address the issue at all. Thus, the Manual provides no basis for the Debtors' mistaken attempt to use it to prove that substantive consolidation of their cases into a single case occurred here.

For similar reasons, the Debtors' citation to *Skidmore v. Swift*, 323 U.S. 134, 140 (1944), is unavailing. Under *Skidmore,* informal agency interpretations of statutes they are charged to administer which appear in agency manuals and similar documents are "'entitled to respect'" but only to the extent that they have the 'power to persuade.'" *See Christensen v. Harris Cty.*, 529 U.S. 576, 587 (2000). The persuasive power of such interpretations hinges on their consistency with the plain language and purpose of the statute. *See Madison v. Resources for Human Development,* 233 F.3d 175, 187 (3d Cir. 2000) (citing *Cleary v. Waldman*, 167 F.3d 801, 808 (3d Cir. 1999)).

"*Skidmore* deference," however, cannot add content to the Manual. The gap in the Debtors' argument is that they have failed to point to any relevant "agency interpretation" of Section 1930(a)(6) in the cited provision of the Manual, let alone one that should lead this Court to overturn the decisions of the courts below that follow the plain language of the statute and the undisputed facts of these cases. The Manual does not interpret Section 1930(a)(6), or engage in any substantive analysis of Section 1930(a)(6). It merely makes the unexceptional point that, if the bankruptcy court enters an order substantively consolidating the cases into one case, there is then only one "case" for 1930(a)(6) purposes.[14] As such, it is entirely consistent with the statute and supports the United States Trustee's position. Therefore, there was no reason for the courts below to "consider" the Manual,[15] and the Manual does not support a finding that the courts below erred.

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[14] The part of the United States Trustee's brief that the Debtors cite in support of their argument is equally unavailing. The United States Trustee refers to "substantively consolidated <u>cases</u>" in the brief. [United States Trustee Brief -- *Genesis/Multicare I* at 30, App. A-636].

[15] The Debtors' Brief, which argues that "the bankruptcy court's failure to consider [the Manual] was erroneous" [Debtors' Brief at 18] misleadingly creates the impression that the Debtors had cited the Manual to the bankruptcy court. In fact, the Debtors did not argue the application of the Manual to the bankruptcy court at all. Rather, the Debtors raised this argument for the first time at the district court level.

IV. APPLYING SECTION 1930(a)(6)'s PLAIN LANGUAGE TO IMPOSE FEES IN EACH CASE IS FAIR BECAUSE THESE SOPHISTICATED DEBTORS, REPRESENTED BY EXPERIENCED COUNSEL, MADE BUSINESS DECISIONS NOT TO CONSOLIDATE THEIR CASES INTO A SINGLE CASE, AND THEY MUST ACCEPT THE LEGAL CONSEQUENCES THAT FLOW FROM THOSE DECISIONS

As this Court has acknowledged, plain and unambiguous statutory language must be applied as written "except in the extraordinary case where a literal reading of the language produces an absurd result." *See Idahoan Fresh v. Advantage Produce, Inc.*, 157 F.3d 197, 202 (3d Cir. 1998). Section 1930(a)(6) mandates the payment of fees in each chapter 11 case, and the Debtors' plan expressly provided for the continued existence of 352 separate cases after confirmation. In light of the plain language of Section 1930(a)(6), the courts below correctly ruled that each of the Debtors' cases continues to owe a separate fee.

There is certainly nothing "absurd" about requiring a separate fee to be paid in each Debtor's case. Indeed, the Debtors' own decisions in structuring the cases and drafting the plan have led to this result. Throughout the course of their reorganization proceedings, the Debtors have been counseled by a sophisticated and experienced firm whose clients include the debtors in the historic chapter 11 cases of *Enron* and *WorldCom*. With the benefit of that counsel, the Debtors made the business decision not to seek substantive consolidation of their cases into a single case. The Debtors expressly made this choice so as to avoid the business interruption costs attendant to having to re-apply for various health care licences, which they determined they would have incurred had they been substantively consolidated into a single case. [8/29/01 Tr. 217:10 - 218:8 (Hager); App. A-219 -20].

The Debtors having made the business decision to keep all 352 cases in existence after confirmation, there is nothing unfair, much less "absurd," about requiring the Debtors to live with all of the legal ramifications of that decision. Indeed, the result in this case is mandated by the plain language of a federal statute Congress intended to apply in every chapter 11 case "notwithstanding any other provision of law." Omnibus Consolidated Appropriations Act for Fiscal Year 1997, Pub. L. No. 104-208, § 109(d) (1996). Given clear Congressional intent that post-confirmation Section 1930(a)(6) fees must be paid in every case, there is no equitable basis for allowing the Debtors to avoid the inevitable result of their business decisions to maintain 352 separate cases. *See, e.g., United States Trustee v. Columbia Gas Sys., Inc. (In re Columbia Gas Sys., Inc.)*, 33 F.3d 294, 300 (3d Cir. 1994) (court cannot circumvent unambiguous statutory requirements even if it agrees with the policy underlying debtor's arguments); *United States Trustee v. Price Waterhouse*, 16 F.3d 138, 141 (3d Cir. 1994) (court cannot use equitable principles to disregard unambiguous statutory language).

Section 1930(a)(6) makes no judgment about why any particular chapter 11 case exists – it simply imposes fees upon each chapter 11 case while it exists, for the entire duration of its existence. These sophisticated Debtors made a business decision not to seek substantive consolidation of their cases into a single case. Whether this decision proved unwise in retrospect is of no moment; the result of this decision was to keep open multiple cases, each of which is statutorily required to pay a Section 1930(a)(6) fee for as long as it remains in chapter 11. Accordingly, the well-reasoned decisions of the bankruptcy and district courts to require payment of Section 1930(a)(6) fees in each of the Debtors' open cases should be affirmed.

CONCLUSION

WHEREFORE the United States Trustee requests that this Court affirm the district court's Memorandum and Order dated March 31, 2003.

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Respectfully submitted,

ROBERTA A. DeANGELIS
ACTING UNITED STATES TRUSTEE

BY:

Frank J. Perch, III
Assistant United States Trustee
Robert J. Schneider
Joseph J. McMahon, Jr.
Trial Attorneys
United States Department of Justice
OFFICE OF THE UNITED STATES TRUSTEE
J. Caleb Boggs Federal Building
844 King Street, Suite 2207, Lockbox 35
Wilmington, DE 19801
Phone: (302) 573-6491
Fax: (302) 573-6497

- and -

Joseph A. Guzinski
General Counsel
Paul Wm. Bridenhagen
P. Matthew Sutko
Trial Attorneys
United States Department of Justice
EXECUTIVE OFFICE FOR
UNITED STATES TRUSTEES
20 Massachusetts Avenue, N.W., Suite 8000
Washington, DC 20530
Phone: (202) 307-1399
Fax: (202) 307-2397

Date: January 12, 2004

CERTIFICATION OF ADMISSION TO BAR

Frank J. Perch III certifies:

1. I am a member in good standing of the bar of the United States Court of Appeals for the Third Circuit.

2. Pursuant to 28 U.S.C. § 1746, I certify under penalty of perjury that the foregoing is true and correct.

Respectfully submitted,

Frank J. Perch III

Date: January 12, 2004

CERTIFICATE OF COMPLIANCE

I, Frank J. Perch III, hereby certify that the total word count in this brief is 6,642 words in Times New Roman, 14 pt. type, in compliance with Federal Rule of Appellate Procedure 32(a)(7).

Respectfully submitted,

Frank J. Perch III

Date: January 12, 2004

CERTIFICATE OF SERVICE

I certify that, on January 12, 2004, I caused to be served copies of the Appellee's Brief via overnight mail (Federal Express) to the persons listed below. Copies were sent to the court on the same date as above for filing via overnight mail.

Adam P. Strochak, Esquire
Jeffrey L. Cimbalo, Esquire
Weil, Gotshal & Manges LLP
1501 K Street, N.W.
Suite 100
Washington, D.C. 20005

Michael F. Walsh, Esquire
Gary T. Holtzer, Esquire
Weil, Gotshal & Manges LLP
767 Fifth Avenue
New York, NY 10153

Mark D. Collins, Esquire
Russell C. Silberglied, Esquire
Richards, Layton & Finger, P.A.
One Rodney Square
P.O. Box 551
Wilmington, DE 19899

Jill Bronson, Esquire
Counsel to Mellon Bank
Drinker Biddle & Reath LLP
One Logan Square
18th and Cherry Streets
Philadelphia, PA 19103-6996

David M. Friedman, Esquire
David S. Rosner, Esquire
Andrew K. Glenn, Esquire
Kasowitz, Benson, Torres & Friedman, LLP
1633 Broadway
New York, NY 10019-6799

Mark Minuti, Esquire
Norman L. Pernick, Esquire
J. Kate Stickles, Esquire
Saul Ewing LLP
222 Delaware Avenue, Suite 1200
P.O. Box 1266
Wilmington, DE 19899-1266

Teresa K.D. Currier, Esquire
Klett Rooney Lieber & Schorling
1000 West Street, Suite 1410
The Brandywine Building
Wilmington, DE 19801

Richard S. Toder, Esquire
Robert Schiebe, Esquire
Morgan Lewis & Bockius
101 Park Avenue
New York, NY 10178-0060

Delores A. Stump
Delores A. Stump
Legal Clerk

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2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]* DC ND Okla.

3. ("CCN") ***CURRENT*** CASE NO. No.: 05-725

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*
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David Newman, Trial Attorney, Tulsa
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC*** **BANKRUPTCY**

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***

- Whether the United States Bankruptcy Court abused its discretion under 11 U.S.C. § 350 in granting the motion to reopen the bankruptcy case in order for a bankruptcy trustee to determine whether to administer a previously undisclosed Malpractice Claim against Dr. Giddens for the benefit of creditors of the bankruptcy estate over Dr. Gidden's objection asserting judicial estoppel.

√ **Background:**

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UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF OKLAHOMA

In re:

REBECCA KREUTZER and
MICHAEL KREUTZER,

Debtors.

JIMMY GIDDENS, M.D.,

Appellant,

v.

REBECCA KREUTZER,
MICHAEL KREUTZER, and
MARY E. MAY in her capacity as the
UNITED STATES TRUSTEE,

Appellees.

Case No. 05-CV-725-CVE-FHM

Bankruptcy Case No. 03-02377-R
Chapter 7

UNITED STATES TRUSTEE'S BRIEF IN RESPONSE TO APPELLANT'S OPENING BRIEF

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I. BASIS OF APPELLATE JURISDICTION

"An appellate court has an independent duty to inquire into its jurisdiction over a dispute, even where neither party contests it and the parties are prepared and concede it." *Lopez v. Behles (In re American Ready Mix, Inc.)*, 14 F.3d 1497, 1499 (10th Cir. 1994). "Standing represents a jurisdictional requirement which remains open to review at all stages of the litigation." *National Org. For Women, Inc. v. Scheidler,* 510 U.S. 249, 255, 114 S.Ct. 798, 127 L.Ed.2d 99 (1994). Dr. Giddens, as the appellant, bears the burden of establishing his standing to appeal. *See In re American Ready Mix, Inc.*, 14 F.3d at 1499 (10th Cir. 1994). Only "persons aggrieved" by a bankruptcy court's order have standing to appeal. *See, e.g., id. at 1500; Weston v. Mann (In re Weston),* 18 F.3d 860, 863 (10th Cir. 1994). Dr. Giddens lacks standing because he is not a person aggrieved. Consequently, there is no appellate jurisdiction. The United States Trustee may appear and be heard in this appeal. 11 U.S.C. § 307.

A. Dr. Giddens Lacks Standing

Dr. Giddens is a physician. At the time Rebecca and Michael Kreutzer first sought Chapter 7 bankruptcy relief they held a malpractice claim against Dr. Giddens that they should have disclosed as an asset of their estate in their bankruptcy filing. Had they done so, the Chapter 7 trustee could have pursued that claim on behalf of the Kreutzers' creditors. Because the Kreutzers failed to disclose it, the creditors were wrongfully denied a potential recovery that could have helped satisfy their debts. The bankruptcy court's order under 11 U.S.C. 350 reopening the Kreutzers' Chapter 7 bankruptcy case rectifies that injustice because it allows the Chapter 7 trustee to sue Dr. Giddens on behalf of the creditors if the trustee determines the Kruetzers' claim against Dr. Giddens may have merit.

Dr. Giddens lacks standing to appeal the order reopening the Kruetzers' bankruptcy case. This is so because his "rights or interests are [not] directly and adversely affected pecuniarily" by the order reopening his case, as that order does not "diminish[] [his] property, increase[] [his] burdens, or impair[] [his] rights." *In re American Ready Mix*, 14 F.3d at 1500. Dr. Giddens cannot meet this burden.

The facts in the case of *Nintendo Company, Ltd. v. Patten (In re Alpex Computer Corp.)*, 71 F.3d 353 (10th Cir. 1995), are similar to the instant case. In that case, a defendant was named in a patent infringement suit brought by a former bankruptcy debtor. The defendant filed a motion to reopen the bankruptcy case in order to enforce the defendant's interpretation of the bankruptcy plan of reorganization which it contended would compel the plaintiff to discontinue the patent litigation and accept a settlement offer. The Tenth Circuit Court of Appeals reversed the district court's conclusion that the defendant had standing to appeal the order on the motion to reopen. It found that under the circumstances standing to appeal "was confined to debtors, creditors, or trustees, each with a particular and direct stake in reopening. . . " *Id*. at 356. The court noted that "an entity that owes a debt to the debtor [which] may affect the plan in terms of infusing or depleting assets . . . may challenge its status in an adversary proceeding . . ." *Id*. Nintendo's rights and liabilities derived from the patent litigation but it had no similar stake in the bankruptcy proceeding. *Id*.

Other courts have found that a potential defendant in a bankruptcy trustee's contemplated action, such as Dr. Giddens, is not a person aggrieved and, therefore, lacks standing to appeal. *Abbott v. Daff (In re Abbott),* 183 B.R. 198, 200 (B.A.P. 9th Cir. 1995)(potential defendant in bankruptcy trustee's contemplated action lacked standing to appeal an order reopening the underlying bankruptcy case) *citing Fondiller v. Robertson (In re Fondiller)*, 707 F.2d 441, 442 (9th Cir. 1983)(person with “only demonstrable interest in the order [authorizing employment of special counsel for bankruptcy estate was as] a potential party defendant in an adversary proceeding” is not a person aggrieved); *see Travelers Insurance Co. v. H.K. Porter Co., Inc.*, 45 F.3d 737 (3d Cir. 1995); *In re El San Juan Hotel*, 809 F.2d 151, 155 (1st Cir. 1987).

The Bankruptcy Appellate Panel for the Ninth Circuit Court of Appeals explained:

> While there might be an interest in defending against liability, the appellant is not prevented from doing so by the bankruptcy court’s order. Nor does the court’s order prevent the appellant from asserting any claims or defenses. . . . A motion to reopen is simply a mechanical device which can be brought ex parte and without notice. [citation omitted] It has no independent legal significance and determines nothing with respect to the merits of the case.

In re Abbott, 183 B.R. at 200.

Similarly, the Bankruptcy Appellate Panel for the Tenth Circuit recognized the limited effect that reopening a bankruptcy case has when it observed “‘the effect of [11 U.S.C. § 350(b)] is merely to resurrect the court file from the stacks of the closed cases, or even from the archives to enable it to receive a new request for relief.’” *GMX Resources v. Kleban (In re Petroleum Production Management, Inc.*), 282 B.R. 9, 15 (B.A.P. 10th Cir. 2002), *quoting Leach v. Buckingham (In re Leach)*, 194 B.R. 812, 815 (E.D. Mich. 1996), *quoting In re David*, 106 B.R. 126, 128 (Bankr. E.D. Mich. 1989).

The order reopening the bankruptcy case has no independent legal effect. It does not compel the Chapter 7 Trustee to pursue any action against Dr. Giddens nor does it adjudicate the merits of the claim. In the event that the Chapter 7 Trustee pursues the Malpractice Claim against Dr. Giddens, he will be free to defend the claim and to appeal any adverse orders or judgments. Until such time, he is not an aggrieved person and he lacks standing to appeal the order reopening the case.

B. The United States Trustee Has Standing To Be Heard In This Appeal

United States Trustees are officials of the Department of Justice appointed by the Attorney General to supervise the administration of bankruptcy cases and trustees. *See* 28 U.S.C. §§ 581-589 (specifying the powers and duties of United States Trustees). *See also United States Trustee v. Columbia Gas Sys., Inc. (In re Columbia Gas Sys., Inc.)*, 33 F.3d 294, 296 (3d Cir. 1994) (United States Trustees oversee the bankruptcy process, protect the public interest, and ensure that bankruptcy cases are conducted according to law), *citing* H.R. Rep. No. 95-595, 109 (1977); *United States Trustee v. Revco D.S., Inc. (In re Revco D.S., Inc.)*, 898 F.2d 498, 499 (6th Cir. 1990) ("[t]he United States trustee, an officer of the Executive Branch, represents . . . [the] public interest"); *Curry v. Castillo (In re Castillo)*, 297 F.3d 940, 950 (9th Cir. 2002) ("The United States Trustee is the 'watchdog' of the bankruptcy system . . . charged with preventing fraud and abuse and with 'fill[ing] the vacuum' caused by possible creditor inactivity."). The United States Trustee "may raise and may appear and be heard on any issue [but may not file a Chapter 11 plan] in any case or proceeding" under the Bankruptcy Code. 11 U.S.C.§ 307. Thus, the United States Trustee had standing to appear and be heard in this appeal.[1]

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[1] *See United States Trustee v. McCormick, Barstow, Sheppard, Wayte & Carruth (In re Donovan Corp.)*, 215 F.3d 929 (9th Cir. 2000) (11 U.S.C. § 307 confers broad standing on United States Trustees); *In re Columbia Gas Sys. Inc.*, 33 F.3d at 295-299 (holding United States Trustee has broad standing, including ability to challenge investment guidelines for Chapter 11 debtor); *United States Trustee v. Price Waterhouse*, 19 F.3d 138, 141 (3d Cir. 1994) (finding United States Trustee has standing to appeal appointment of professionals in Chapter 11 case); *United States Trustee v. Clark (In re Clark)*, 927 F.2d 793, 795-96 (4th Cir. 1991) (finding

II. ISSUE ON APPEAL

Whether the United States Bankruptcy Court abused its discretion under 11 U.S.C. § 350 in granting the motion to reopen the bankruptcy case in order for a bankruptcy trustee to determine whether to administer a previously undisclosed Malpractice Claim against Dr. Giddens for the benefit of creditors of the bankruptcy estate over Dr. Gidden's objection asserting judicial estoppel?

III. STATEMENT OF THE CASE

The underlying Chapter 7 bankruptcy petition was filed by Michael Shawn Kreutzer and Rebecca Dawn Kreutzer ("Debtors"), in the United States Bankruptcy Court for the Northern District of Oklahoma on April 30, 2003. (Order Granting Debtor's Motion To Re-Open Bankruptcy Case And Order Directing The Appointment Of A Trustee, "Order," ROP Part 9, p. 20 of 30)[2] The bankruptcy court's docket indicates that Steven W. Soule ("Chapter 7 Trustee") was appointed as the Chapter 7 trustee.[3] (ROP Part 2, p. 1 of 35) The Debtors did not disclose their Malpractice Claim against Dr. Giddens, which accrued prior to the filing of the bankruptcy, as an asset in their bankruptcy schedules. (Order, ROP Part 9, p. 20 of 30) On August 11, 2003,

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standing to appeal denial of motion to dismiss); *In re Plaza de Diego Shopping Ctr., Inc.*, 911 F.2d 820, 824 (1st Cir. 1990) (standing to appeal appointment of trustee); *In re Revco D.S., Inc.*, 898 F.2d at 499 (standing to appeal decision refusing to appoint examiner).

[2] The commencement of the bankruptcy case created a bankruptcy estate, generally comprised of all of the Debtors' legal or equitable interests in property. 11 U.S.C. § 541(a). Property of the estate includes claims for personal injury. *See Howe v. Richardson*, 193 F.3d 60 (1st Cir. 1999).

[3] In contrast to the United States Trustee, a bankruptcy trustee appointed under Chapter 7 of the Bankruptcy Code is a private individual appointed by the United States Trustee and charged with the duty of marshaling assets of the bankruptcy estate, liquidating non-exempt assets, making distributions to parties who have filed proofs of claim, etc. 11 U.S.C. §§ 701, 702(d), 704, 726.

the Kreutzers received a Chapter 7 bankruptcy discharge of their pre-bankruptcy debts and the case was closed on August 29, 2003. (*Id*. at p. 21 of 30)

"On June 27, 2003, the Debtors filed an action against Dr. Giddens in Tulsa County District Court, which was voluntarily dismissed on October 6, 2003, and refiled on February 12, 2004 (the "Malpractice Action.")." (*Id*.) Dr. Giddens filed a motion to dismiss the Malpractice Action asserting that the Debtors lacked standing, the Malpractice Claim was an unadministered asset of the Debtors' bankruptcy estate and that the Debtors should be judicially estopped from asserting the claim because they failed to list it in their bankruptcy schedules. (*Id*.)

The Debtors filed a motion under 11 U.S.C. § 350 to reopen their bankruptcy case "in order to amend their schedules to list the claim as an asset, to claim an exemption in the Malpractice Claim, and to allow the Chapter 7 trustee to administer the Malpractice Claim and distribute any non-exempt proceeds therefrom to creditors of the estate." (*Id*.) Dr. Giddens contended that the motion "should be denied under the doctrine of judicial estoppel as a penalty for the [Debtors'] failure to disclose the Malpractice Claim prior to the closing of their bankruptcy case." (*Id*.) The United States Trustee supported the motion to reopen asserting that the creditors of the bankruptcy estate are the real beneficiaries of the motion to reopen, not the Debtors, that the creditors should not "incur a penalty for a debtor's failure to list an asset that could be liquidated by the trustee for their benefit" and that although a penalty might be appropriate, the Debtors, not their creditors, "should bear the penalty, which may be a denial of their exemption in the asset or some other detriment specific" to the Debtors. (*Id*.) The Chapter

7 Trustee was given notice of the motion and did not oppose it or request application of judicial estoppel against the Debtors. (*Id*. at p. 26 of 30)[4]

Citing 11 U.S.C. § 350, the bankruptcy court found:

> [The Debtors] have clearly established statutory cause for reopening - an asset of the estate remains to be administered by the trustee for the benefit of creditors and the [Debtors] seek to claim an exemption in a portion of the unadministered asset.

(*Id.* at p. 22 of 30)

The bankruptcy court quoted *Mullendore v. United States (In re Mullendore),* 741 F.2d 306, 308 (10th Cir. 1984), for the proposition that it "is the duty of the court to reopen an estate whenever prima facie proof is made that [the estate] has not been fully administered." (*Id*.) The court noted that "all parties agree that the Malpractice Claim is currently an asset of the [Debtors'] bankruptcy estate because it was not administered or abandoned by the Chapter 7 trustee." (*Id*.)[5] The bankruptcy court then found that Dr. Giddens was not a creditor of the Debtors' bankruptcy estate. (*Id*. at p. 23 of 30) The court determined that the doctrine of judicial estoppel did not preclude reopening the case and found –

> (1) [T]here will be no 'prejudice of the party who has acquiesced in the position formerly taken' by the [Debtors] if they are allowed to reopen the case, and (2) the [Debtors] would not necessarily 'derive any unfair advantage' if the case is reopened, nor would reopening the case 'impose an unfair detriment on the opposing party'. . . ."

(*Id*. at p. 26 of 30)

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[4] 11 U.S.C. § 350(a) provides that a Chapter 7 Trustee is discharged before before a case is closed.

[5] The court quoted *Parker v. Wendy's Int'l, Inc.*, 365 F.3d 1268, 1272 (11th Cir. 2004)("At the close of a bankruptcy case, property of the estate that is not abandoned under § 554 and that is not administered in the bankruptcy proceedings remains property of the estate.")

The Order states:

> Dr. Giddens failed to show why it would be unfair to allow the Chapter 7 trustee to decide whether to pursue the Malpractice Claim against Dr. Giddens for the benefit of the [Debtors'] prepetition creditors, whose only claims against the [Debtors] have been discharged and whose only hope for any repayment derives from the potential proceeds of the Malpractice Claim.

(*Id*. at p. 27 of 30)

The bankruptcy court explained:

> Dr. Giddens was not a 'party who acquiesced in the position formerly taken" but rather it was the "Chapter 7 trustee [who] processed the case as a 'no asset case' and was deprived of the opportunity to administer the Malpractice Claim and distribute proceeds (if any) to creditors prior to closure of the case. While the trustee (and creditors) have been prejudiced by the omission, the [Debtors] seek to remedy that prejudice by reopening the bankruptcy case and disclosing the Malpractice Claim, subjecting the claim to administration by the trustee.

(*Id*.)

The court noted that "Dr. Giddens' counsel admitted at the hearing that Dr. Giddens would suffer no 'unfair detriment' if the [Debtors] were not estopped from reopening their case." (*Id*. at p. 28 of 30) The bankruptcy court found:

> Dr. Giddens would obtain an undeserved benefit (i.e., a potentially meritorious case against him would be dismissed on jurisdictional grounds) if he were to succeed in baring the [Debtors] from reopening their bankruptcy estate. Denying the Motion to Reopen would unjustifiably thwart the only party currently possessing standing to prosecute the Malpractice Action, the trustee, who is blameless, from administering the Malpractice Claim for the benefit of the estate.

(*Id*. at pp. 28-30 of 30)

The bankruptcy court observed that the Chapter 7 Trustee received notice of the motion and did not object. (*Id*. at p. 27 of 30) The court found it significant that the United States Trustee supported the motion and "urge[d] the court to give the Chapter 7 trustee the opportunity to administer the claim . . . and defer to a later date a determination as to whether any penalty should be imposed upon the [Debtors]. . . ." (*Id*. at p. 27 of 30)

The motion to reopen was granted on November 21, 2005, and directed the United States Trustee to appoint a Chapter 7 trustee. (Docket entry no. 21, ROP Part 1, p. 4 of 35; Order, ROP, Part 9, p. 29 of 30) On November 23, 2005, the notice of Steven W. Soule's appointment as Chapter 7 Trustee in the reopened case was filed. (Docket entry no. 22, ROP Part 1, p. 4 of 35). This appeal followed.

IV. ARGUMENT AND AUTHORITIES

Dr. Giddens asserts that judicial estoppel and the policy favoring full disclosure by debtors outweighs the principle that "it is the duty of the court to reopen an estate whenever prima facie proof is made that [the estate] has not been fully administered." *In re Mullendore*, 741 F.2d at 308 (interpreting predecessor to 11 U.S.C. § 350). Nevertheless, judicial estoppel based on the Debtors' failure to disclose assets should not be applied when it would prevent a Chapter 7 Trustee from administering the asset.

Even if judicial estoppel is applied in this case, Dr. Giddens fails to challenge the bankruptcy court's factual findings. Those findings demonstrate that the factors required for judicial estoppel are absent in this case. Likewise, the argument that allowing the case to be reopened encourages debtors to omit assets in their original schedules is flawed. Keeping the case closed would unfairly prejudice the Kreutzers' creditors - who will benefit from any recovery, perpetuate inaccurate information in this bankruptcy case, frustrate the purposes of the Bankruptcy Code and provide a windfall to Dr. Giddens.

A. Judicial Estoppel Is Inappropriate In This Case

The Tenth Circuit Court of Appeals recognized the doctrine of judicial estoppel in the case of *Johnson v. Linden City*, 405 F.3d 1065 (10th Cir. 2005), a case in which an arrestee who signed a plea agreement and admitted guilt was later judicially estopped from suing a police officer and city for unlawful arrest. The court noted that the doctrine is a "discretionary remedy" that courts may use to "'prevent improper use of judicial machinery.'" *Id*. at 1068 *quoting New Hampshire v. Maine*, 532 U.S. 742, 750, 121 S.Ct. 1808, 149 L.Ed.2d 968 (2001). It is employed when a party's inconsistent positions in court, if adopted by the courts, would "undermine the integrity of the judicial system." *Johnson*, 405 F.3d at 1070.

Judicial estoppel "'is probably not reducible to any general formulation of principle.'" *Johnson,* 405 F.3d 1068, *quoting New Hampshire*, 532 U.S. at 750. Nevertheless, the Tenth Circuit Court of Appeals has enumerated three factors. First, the "party's later position must be 'clearly inconsistent' with its earlier position." *Johnson*, 405 F.3d at 1069. Second, the party to be judicially estopped have persuaded the earlier court to accept the earlier factual position so that "judicial acceptance of an inconsistent position in a later proceeding would create the perception that either the first or second court was mislead." *Id., quoting New Hampshire,* 532 U.S. at 750. Third, "whether the party seeking to assert an inconsistent position would derive an unfair advantage or impose an unfair detriment on the opposing party if not estopped." *Johnson,* 405 F.3d at 1069, *quoting New Hampshire,* 532 U.S. at 751. These factors are not present in the instant case and estopping the reopening of this case would undermine the integrity of the judicial system.

It appears that the Tenth Circuit Court of Appeals has not addressed whether judicial estoppel should be applied in cases where debtors fail to disclose an asset in their original schedules and later bring a motion to reopen the bankruptcy in order to file amended schedules and allow the Chapter 7 trustee to administer the asset. The Eleventh Circuit Court of Appeals and the Ninth Circuit Bankruptcy Appellate Panel have concluded that judicial estoppel should not be applied if the result would be to bar a trustee from administering previously undisclosed claims. *See Parker,* 365 F.3d 1268; *Lopez v. Specialty Restaurants Corp. (In re Lopez)*, 283 B.R. 22, 24 (B.A.P. 9th Cir. 2002).

At least one other circuit appears, at first glance, to disagree.[6] *See, e.g., Superior Crewboats, Inc. v. Primary P& I Underwriters (In re Superior Crewboats, Inc.)*, 374 F.3d 330 (5th Cir. 2004)(claim was disclosed to the trustee at the first meeting of creditors and the trustee filed an abandonment of the asset); *Browning v. Mims (In re Coastal Plains, Inc.),* 179 F.3d 197 (5th Cir. 1999).[7] A close examination reveals that the third prong of the Fifth Circuit's test for

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[6] Dr. Giddens also cites *West v. Family Express Corp. (In re Bilstat, Inc.),* 314 B.R. 603 (Bankr. S.D. Tex 2004), for an example of a bankruptcy trustee being judicially estopped based on the debtor's non-disclosure. However, that case did not involve a bankruptcy trustee. The trustee was a trustee appointed by the court pursuant to a distribution trust agreement under a Chapter 11 plan and he was not a Chapter 11 or a Chapter 7 trustee. *See id.* at 607. The court also applied the inadvertence test in contrast to the Tenth Circuit's test. *See id.* at 608. Likewise, Dr. Giddens' reliance on *Autos, Inc. v. Gowin*, 330 B.R. 788 (D. Kan. 2005), is misplaced because that case involved judicial estoppel against the debtor and not a Chapter 7 trustee. That court found that although the "elements of judicial estoppel may be present" dismissing the undisclosed claims "would provide a windfall" to the defendant and would deprive creditors of the bankruptcy estate of an asset. *Id.* at 796. Instead, the court ordered the debtor to "distribute any and all damages recovered in the adversary action among the creditors" and denied her any personal recovery. *Id.*

[7] Two other Circuits have employed judicial estoppel to preclude a Chapter 11 debtor from pursuing causes of action that were not adequately disclosed; however, in those cases the debtors sought to prosecute the actions for their own interests, and the cases did not involve a

judicial estoppel is significantly different than the Tenth Circuit's. The Fifth Circuit's third factor is whether the non-disclosure was inadvertent. *See In re Superior Crewboats, Inc.*, 374 F.3d at 333, 335; *In re Coastal Plains, Inc.*, 179 F.3d at 206. This is in sharp contrast to the Tenth Circuit's inquiry as to whether the party asserting an inconsistent position would obtain an unfair advantage or would impose an unfair detriment on the opposing party.

Because the factors enumerated by the Tenth Circuit Court of Appeals for judicial estoppel must be employed, case law from other circuits applying judicial estoppel against Chapter 7 trustees under different standards is not persuasive. As discussed below, under the Tenth Circuit's factors, judicial estoppel is inappropriate in this case.

B. <u>The Motion To Reopen Was Made In The Original Case And Not In Later Litigation</u>

Judicial estoppel prevents inconsistent positions from being taken in a "later proceeding." *Johnson*, 405 F.3d at 1069, *quoting New Hampshire*, 532 U.S. at 750. The order reopening the Debtors' bankruptcy case was not entered in a later case. It is entered in the same bankruptcy case in which the inconsistent facts were set forth in the Debtors' schedules. Because this case does not involve a later proceeding but involves the same case, judicial estoppel is inappropriate.

Section 350 of the Bankruptcy Code, 11 U.S.C. § 350, is the proper rule of law to be applied when an undisclosed asset is subsequently revealed in a closed bankruptcy case. Section 350 specifically provides that a case may be reopened to administer an asset. Judicially

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Chapter 7 trustee. *See Krystal Cadillac-Oldsmobile GMC Trust, Inc. v. General Motors Corp.*, 337 F.3d 314 (3d Cir. 2003), *cert. denied*, 541 U.S. 1043, 124 S.Ct. 2172, 158 L.Ed.2d 732 (2004); *Payless Wholesale Distributors, Inc., v. Alberto Culver (P.R.), Inc.*, 989 F.2d 570 (1st Cir. 1993).

estopping the reopening of the case would run contrary to the plain language of this section. This is true, because assets listed in the debtor's schedules are abandoned or otherwise fully administered before a case is closed. 11 U.S.C. § 554. Assets that are not listed in the schedules are neither abandoned nor otherwise administered and remain property of the bankruptcy estate even after the case is closed. 11 U.S.C. § 554(c), (d); *Parker*, 365 F.3d at 1272. In short, section 350 was written to enable cases to be reopened so that undisclosed assets could be administered.

C. <u>The Bankruptcy Court Did Not Adopt The Debtors' Position</u>

In order for judicial estoppel to arise, the previous court must have adopted the prior factually inconsistent position. *See Johnson*, 405 F.3d at 1069. The bankruptcy court never adopted the facts asserted in the Debtors' schedule of assets, because entry of the discharge order is a ministerial act. *See In re Hicks*, 184 B.R. 954, 959 (Bankr. C.D. Cal. 1995). Applicable law requires that after the passage of certain deadlines the order discharging debts must be entered. No hearing is required before granting the discharge.

Section 727(a) provides that the bankruptcy court "shall grant the debtor a discharge, unless . . ." the debtor is not an individual, the debtor received a discharge within six years before the current bankruptcy case was filed[8], the court approves a written waiver of discharge or a party prevails on an adversary proceeding objecting to the discharge. Bankruptcy Rule 4004 provides:

> . . . on expiration of the time fixed for filing a complaint objecting to discharge and the time fixed for filing a motion to dismiss the case . . . the court shall forthwith grant the

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[8] The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, which generally went into effect on October 17, 2005, enlarges the time to eight years.

> discharge unless: (A) the debtor is not an individual, (B) a complaint objecting to the discharge has been filed, (C) the debtor has filed a waiver . . . (D) a motion to dismiss the case under § 707 is pending, (E) a motion to extend time for filing a complaint objecting to discharge is pending, (F) a motion to extend the time for filing a motion to dismiss the case . . . is pending, or (G) the debtor has not paid in full the filing fee . . . .

FED. R. BANKR. P. 4004.

Nowhere does the Rule provide that the bankruptcy court is required to determine whether the schedules are accurate before a debtor's discharge is entered. Clearly, unless one of the enumerated criterion is met, the bankruptcy court must enter an order discharging debts.

In the instant case, the time for these actions passed, no such actions were taken or existed, and the discharge was entered. No hearing was conducted – nor was a hearing required – as to whether the Debtors listed all of their assets. (Docket, ROP, Part 2, pp. 1-6 of 35) In short, the bankruptcy court did not rely on the Debtors' schedules or adopt their contents in granting the Debtors' discharge or in taking any other action before the case was closed. The second factor for judicial estoppel is not satisfied.

D. Dr. Giddens Will Not Suffer An Unfair Detriment Nor Will There Be An Unfair Advantage By Reopening The Case

Dr. Giddens does not cite to any part of the record on appeal to demonstrate that the bankruptcy court's factual conclusions are clearly erroneous. Rather, he simply argues, without support from the record, that the Debtors did not inadvertently fail to disclose the claim. He also asserts on appeal that the Debtors obtained an unfair advantage by obtaining a bankruptcy discharge. Because Dr. Giddens fails to demonstrate that the bankruptcy court's factual findings are clearly erroneous, they must be accepted on appeal. FED. R. BANKR. P. 8013.

As noted in the statement of facts above, the bankruptcy court found that there would be no prejudice to Dr. Giddens and that there would be no unfair advantage if the case is reopened. Further, the court noted that "Dr. Giddens' counsel admitted at the hearing that Dr. Giddens would suffer no 'unfair detriment' if the [Debtors] were not estopped from reopening their case." (Order, ROP, part 9, p. 28 of 30) In contrast, if judicial estoppel were applied "Dr. Giddens would obtain an undeserved benefit . . . ." (*Id*. pp. 28-30 of 30) The third factor for judicial estoppel is not met.

Judicial estoppel is inappropriate in this case.

E. The Chapter 7 Trustee Is Not The Party Taking An Inconsistent Position

It is undisputed that the Chapter 7 Trustee is the only one with standing to pursue the Malpractice Claim against Dr. Giddens.[9] Judicially estopping this case from being reopened would prevent the Chapter 7 Trustee from pursuing the claim against Dr. Giddens. Judicial estoppel should only be applied against the party that took an inconsistent position. *See Johnson*, 405 F.3d at 1069. The bankruptcy court found that the Chapter 7 Trustee was "blameless." (Order, ROP, Part 9, pp. 28-30 of 30) The Chapter 7 Trustee should not, therefore, be judicially estopped. *See Parker*, 365 F.3d 1268; *In re Lopez*, 283 B.R. at 24.

At page 5 of the Appellant's Brief, Dr. Giddens admits that the Chapter 7 Trustee and the creditors of the bankruptcy estate did not have notice of the Malpractice Claim against him. Even without notice, the Malpractice Claim became property of the estate. 11 U.S.C. § 541. And without notice, the Malpractice Claim could not be abandoned. *See Parker*, 365 F.3d at 1272.

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[9] The Chapter 7 trustee may bring an action in the bankruptcy court to enforce and collect a debt on behalf of the estate. 11 U.S.C. § 323; 28 U.S.C. § 157(b).

To require otherwise would shield a potential tort defendant from prosecution by a bankruptcy trustee.

The argument that the Chapter 7 Trustee is subject to any defenses that Dr. Giddens would have against the Debtors, including judicially estopped, is incorrect. Although *Paul v. Monts*, 906 F.2d 1468 (10th Cir. 1990), is cited by Dr. Giddens as general support of this proposition, it does not discuss or support judicial estoppel against a Chapter 7 trustee for undisclosed claims. *Paul* discusses equitable estoppel not judicial estoppel. *Id.* at 1474. *Paul* involved a case where a Chapter 11 case was converted to Chapter 7 and the Chapter 7 trustee prosecuted an action against a party which failed to perform an alleged contract to purchase the debtor's stock. The Tenth Circuit found that the elements of equitable estoppel were not satisfied for purposes of summary judgment. *Id.*

The Eleventh Circuit Court of Appeals explained why a debtor's failure to disclose a claim cannot be asserted as a defense in litigation brought by a Chapter 7 trustee. It stated:

> Although general bankruptcy law establishes that the trustee does not have any more rights than the debtor has [citation omitted] any post-petition conduct by [the debtor], including failure to disclose an asset, does not relate to the merits of the [ ] claim. This is because when the instant bankruptcy petition was filed, [the debtor's] claim against Wendy's became property of the bankruptcy estate under section 541 and [the Chapter 7 trustee] became the real party in interest."

Parker, 365 F.3d at 1272, fn. 3.

In short, once the underlying bankruptcy was filed the Malpractice Claim became property of the bankruptcy estate and the Chapter 7 Trustee was the real party in interest. The Debtors' failure disclose the Malpractice Claim in their bankruptcy schedules, to amend their schedules during the pendency of the bankruptcy to make the proper disclosure or otherwise advise the Chapter 7 Trustee of the Malpractice Claim are acts committed when the Debtors were not the real parties in interest. The Chapter 7 Trustee cannot, therefore, be charged with their failure to disclose.

F. Allowing This Case To Be Reopened Does Not Provide An Incentive For Debtors To Conceal Assets And Will Further The Purposes Of The Bankruptcy Code

Dr. Giddens' asserts that allowing debtors to reopen their case provides a disincentive for debtors to file accurate original schedules. This argument fails to recognize that by so doing debtors risk losing rights to claim an exemption, having their discharge revoked, and being exposed to criminal liability for concealing assets and making false oaths. *See* 11 U.S.C. § 727(d) (objection may be revoked within one year of discharge if obtained by debtor's fraud or if debtor acquires property of the estate and knowingly and fraudulently fails to report such to the trustee); 18 U.S.C. § 152 (crime of concealment of assets and making a false oath in a bankruptcy case); *In re Lopez*, 283 B.R. at 30.

The argument ignores the basic premise in Chapter 7 bankruptcy that assets should be liquidated for the benefit of creditors. It also ignores the fact that Congress has already spoken by enacting section 350 which explicitly provides for reopening a case in order to administer assets.

Dr. Giddens argues that the risks to a debtor in reopening a case to schedule an undisclosed asset are minimal. The statistical probability of a debtor being criminally prosecuted is well beyond the scope of the record on appeal and Dr. Giddens' conclusions should be disregarded. The fact remains that criminal prosecution remains a possibility.

Dr. Giddens also argues that the Debtors could receive proceeds from any litigation against him if the proceeds exceed the amount required to pay creditors and the costs of administration of the bankruptcy estate. He has cited to nothing in the record to indicate that this is anything but a hypothetical concern. Certainly, a court could fashion a judgment that would preclude any excess proceeds from going to the Debtors such as was done in *Autos, Inc.*, 330 B.R. at 796 (Chapter 13 Debtor who failed to disclose cause of action would be required to "distribute any and all damages recovered in the adversary action among the creditors" and be denied any personal recovery). However, this issue simply is not ripe for determination and should not preclude the reopening of this case. An appropriate remedy can be fashioned if and when the Chapter 7 Trustee litigates the claim.

The contention that the case should not be reopened in order to promote full disclosure in original schedules ignores the very reason why full disclosure is required - so that assets may be reviewed and administered by a Chapter 7 trustee. Dr. Giddens essentially argues that assets must be disclosed when a case is filed or they will be lost to the Chapter 7 trustee even if he later discovers them. Such a rule might serve the interests of a party who is liable to the bankruptcy estate, but would do little to promote the policies of the Bankruptcy Code or benefit creditors. Just as importantly, preventing the case from being reopened would assure that the schedules are never corrected.

V. CONCLUSION

For all of the foregoing reasons, the decision of the bankruptcy court to reopen the

Debtors' bankruptcy case should be affirmed.

DATED: Tue-3/14/06 12:7

Respectfully submitted,

MARY E. MAY
United States Trustee

/s/ David W. Newman
David W. Newman, CABA# 163286
Katherine Vance, OKBA# 9175
Paul R. Thomas, OKBA# 11546
Office of the United States Trustee
Department of Justice
224 South Boulder, Suite 225
Tulsa, OK 74103
(918) 581-6670
(918) 581-6674 (Fax)

BRIEF BANK — 'SUMMARY SHEET" *Printed Tue-5/30/06 14:8*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*
Giddens v Kreutzer (In re Kreutzer)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*
DC ND Okla.

3. ("CCN") ***CURRENT*** CASE NO.
No.: 05-725

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*
No.: Bankr. 03-2377
Court:
(Identify judge & cite, if any)

5. ("SO") ***SOURCE***
U.S. TRUSTEES

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*
Filed: May 26, 2006
Type: United States Trustee's Response to Appellant's Objection to Magistrate's Report and Recommendation

7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*
David Newman, Trial Attorney, Tulsa
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***
- Whether the United States Bankruptcy Court abused its discretion under 11 U.S.C. § 350 in granting the motion to reopen the bankruptcy case in order for a bankruptcy trustee to determine whether to administer a previously undisclosed Malpractice Claim against Dr. Giddens for the benefit of creditors of the bankruptcy estate over Dr. Gidden's objection asserting judicial estoppel.

√ **Background:**

10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)
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UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF OKLAHOMA

In re:	)	
	)	Case No. 05-CV-725-CVE-FHM
REBECCA KREUTZER and	)	
MICHAEL KREUTZER,	)	Bankruptcy Case No. 03-02377-R
	)	Chapter 7
Debtors.	)	
	)	
JIMMY GIDDENS, M.D.,	)	
	)	
Appellant,	)	
	)	
v.	)	
	)	
REBECCA KREUTZER,	)	
MICHAEL KREUTZER, and	)	
MARY E. MAY in her capacity as the	)	
UNITED STATES TRUSTEE,	)	
	)	
Appellees.	)	

UNITED STATES TRUSTEE'S RESPONSE TO APPELLANT'S OBJECTION TO MAGISTRATE'S REPORT AND RECOMMENDATION

Felicia S. Turner, the United States Trustee, responds to Appellant Jimmy Giddens, M.D.'s Objection To Magistrate's Report And Recommendation ("Report"), as set forth below.[1]

I. STANDARD OF REVIEW

This is an appeal from the United States Bankruptcy Court's order reopening the underlying bankruptcy case and directing the United States Trustee to appoint a Chapter 7 trustee to administer a previously undisclosed asset.[2] (Order, Record On Appeal "ROP" Part 9, p. 29 of 30) An appeal from the Bankruptcy Court is heard by the Bankruptcy Appellate Panel unless one of the parties elects to have the United States District Court hear it. 28 U.S.C. § 158(c). Dr. Giddens elected for the United States District Court to hear this appeal.

An order reopening a bankruptcy case under 11 U.S.C. § 350 is reviewed for abuse of discretion. *See Nintendo Company, Ltd. v. Patten (In re Alpex Computer Corp.)*, 71 F.3d 353, 356 (10th Cir. 1995). The Bankruptcy Court's findings of fact can only be set aside if they are clearly erroneous. FED. R. BANKR. P. 8013. The Bankruptcy Court's conclusions of law are subject to de novo review. *See Phillips v. White (In re White)*, 25 F.3d 931, 933 (10th Cir. 1994). On ". . . appeal the district court may affirm, modify or reverse a bankruptcy judge's judgment, order, or decree or remand with instructions for further proceedings." FED. R. BANKR. P. 8013.

The District Court referred this appeal to United States Magistrate Judge Frank M.

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[1] The United States Trustee's Brief In Response To Appellant's Opening Brief is incorporated herein by this reference. Mary E. May, the former United States Trustee for Region 20 has passed away. Felicia S. Turner has recently been appointed to the position.

[2] The United States Trustee Program is a component of the United States Department of Justice. A Chapter 7 trustee is a private party who is not an employee of the United States.

McCarthy who filed a Report and Recommendation. The Report recommends dismissal of the appeal because Dr. Giddens lacks standing since he is not a creditor or trustee and is not a person aggrieved by the order. It alternatively recommends that the District Court affirm the Bankruptcy Court's decision reopening the case and directing the appointment of a Chapter 7 trustee. As the Report notes, the bankruptcy creditors' only hope of repayment is from any proceeds from the malpractice action and Dr. Giddens' counsel admitted that he would not suffer any unfair detriment if the case were reopened.

Dr. Giddens filed an objection to the report pursuant to FED. R. CIV. P. 72(b). Dr. Giddens specifically objected to the following: (1) The finding that he lacks standing to appeal; (2) The manner in which the Report analyzes judicial estoppel; (3) The Report's lack of discussion of the Debtors' standing to bring the motion to reopen; and (4) The Report's handling of Dr. Giddens' public policy arguments. The United States Trustee did not object to the Report.

II. SUMMARY OF THE ARGUMENT

Tenth Circuit case law required this bankruptcy case to be reopened in order to administer a previously undisclosed asset - a lawsuit against Dr. Giddens. Dr. Giddens lacks standing on appeal because reopening the case was a ministerial act which had no direct impact on him. The factors identified by the Tenth Circuit for judicial estoppel militate against its use here. The Debtors clearly had standing to bring the motion to reopen. Lastly, a policy preventing cases from being reopened to administer assets not only contradicts 11 U.S.C. § 350, but it would also assure that the injustice suffered by the creditors in this bankruptcy case is never remedied.

III. THE BANKRUPTCY COURT WAS REQUIRED TO REOPEN THE CASE SO THAT AN ASSET COULD BE ADMINISTERED

11 U.S.C. § 350 provides that a bankruptcy case may be reopened to ". . . administer assets, to accord relief to the debtor, or for other cause." Section 350 recognizes that cases will be closed where assets have not been disclosed and administered. It was the ". . . duty of the court to reopen . . . " the bankruptcy case because an unadministered asset clearly existed. *See Mullendore v. United States (In re Mullendore),* 741 F.2d 306 (10th Cir. 1984).

Only a Chapter 7 trustee may administer an asset in a Chapter 7 bankruptcy case. 11 U.S.C. §§ 542(a), 704. The Chapter 7 Trustee was discharged when the case was closed. (Final Decree, ROP, Part 4, p. 4 of 10) Consequently, there was no Chapter 7 trustee at the time of the hearing on the motion to reopen. The only way to administer the asset was to reopen the bankruptcy case and appoint a Chapter 7 trustee. Under *In re Mullendore*, 741 F.2d 306, the Bankruptcy Court was required to reopen the case and appoint a Chapter 7 trustee.

IV. DR. GIDDENS LACKS STANDING

In the Tenth Circuit an appellant must be a "person aggrieved" to have standing on appeal. *See American Ready Mix, Inc. v. Behles (In re American Ready Mix),* 14 F.3d 1497, 1499 (10th Cir. 1994). Dr. Giddens is not a person aggrieved because his rights or interests are not directly and adversely affected pecuniarily by the order reopening the bankruptcy case and directing the appointment of a Chapter 7 trustee. *See id.* Standing in bankruptcy cases is generally ". . . confined to debtors, creditors, or trustees, each with a particular and direct stake in reopening. . . " *Nintendo Company, Ltd. v. Patten (In re Alpex Computer Corp.),* 71 F.3d 353

(10th Cir. 1995). Dr. Giddens is not a creditor, debtor or trustee. His only connection with the case is that once the bankruptcy case is reopened and a Chapter 7 trustee is appointed, the trustee may or may not decide to prosecute a malpractice suit against him in order to pay creditors. "[T]he effect of [reopening] is merely to resurrect the court file from the stacks of the closed cases, or even from the archives to enable [the court] to receive a new request for relief." *GMX Resources v. Kleban (In re Petroleum Production Management, Inc.*), 282 B.R. 9, 15 (B.A.P. 10th Cir. 2002). The Magistrate Judge correctly found that Dr. Giddens lacks standing.

V. JUDICIAL ESTOPPEL IS INAPPROPRIATE AGAINST THE CHAPTER 7 TRUSTEE

The Report correctly rejected Dr. Giddens' judicial estoppel argument. Judicial estoppel is a "discretionary remedy" that courts may use to " . . . prevent improper use of judicial machinery . . . " that would ". . . undermine the integrity of the judicial system." *Johnson v. Linden City*, 405 F.3d 1065, 1068, 1070 (10thCir. 2005), *quoting New Hampshire v. Maine*, 532 U.S. 742, 750, 121 S.Ct. 1808, 149 L.Ed.2d 968 (2001). The Eleventh Circuit Court of Appeals and the Bankruptcy Appellate Panel for the Ninth Circuit Court of Appeals have declared that judicial estoppel based on a debtor's misconduct should not be applied against a bankruptcy trustee. *See Reynolds v. Wendy's Int'l, Inc. (In re Parker),* 365 F.3d 1268 (11th Cir. 2004); *Lopez v. Specialty Restaurants Corp. (In re Lopez),* 283 B.R. 22, 24 (B.A.P. 9th Cir. 2002). In March of this year the Seventh Circuit Court of Appeals added its voice to this issue. *See Biesek v. Soo Line R.R.,* 440 F.3d 410 (7th Cir. 2006). The *Biesek* Court's dicta observed:

> [The Debtor's] nondisclsoure in bankruptcy harmed his creditors by hiding assets from them. Using the same nondislcosure to wipe out his [ ] claim would complete the job by denying creditors even the right to seek some share of the recovery. Yet the creditors have not contradicted themselves in court . . . . Judicial estoppel is an equitable doctrine, and using it to land another blow on the victims of bankruptcy fraud is not an equitable application.

Biesek, 440 F.3d at 413. The factors required for judicial estoppel are not present in this case. The Report correctly finds that judicial estoppel is inappropriate.

VI. DR. GIDDENS' OBJECTION FAILS TO APPLY TENTH CIRCUIT JUDICIAL ESTOPPEL LAW

Dr. Giddens' reliance on Fifth Circuit judicial estoppel case law is misplaced. As explained in the Report and the United States Trustee's Brief In Response To Appellant's Opening Brief, those cases do not apply Tenth Circuit judicial estoppel law and are otherwise distinguishable or unpersuasive. For example, the third factor identified by the Fifth Circuit focuses on whether the non-disclosure of an asset was inadvertent. *See Superior Crewboats, Inc. v. Primary P& I Underwriters (In re Superior Crewboats, Inc.)*, 374 F.3d 330, 335 (5thCir. 2004). In contrast, the Tenth Circuit's third factor is whether the party asserting an inconsistent position would obtain an unfair advantage or would impose an unfair detriment on the opposing party. *See Johnson*, 405 F.3d at 1069, *quoting New Hampshire*, 532 U.S. at 751.[3] Given this difference, Fifth Circuit case law is not persuasive.

Dr. Giddens, nevertheless, argues that the Report and the Bankruptcy Court focused on the wrong information when they noted the fact that Dr. Giddens' counsel admitted that he would suffer no unfair detriment if the case were reopened. Dr. Giddens contends that his lack of harm is unimportant and that the focus should be on the harm to the judicial process itself. (Appellant's Objection To Magistrate's Report And Recommendation p. 10 - 11, ". . . judicial

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[3] The first and second prong are, (1) the "party's later position must be 'clearly inconsistent' with its earlier position" and (2) the party to be judicially estopped must have persuaded the earlier court to accept the earlier factual position so that ". . . judicial acceptance of an inconsistent position in a later proceeding would create the perception that either the first or second court was mislead." *Johnson*, 405 F.3d at 1069.

estoppel does not look at whether the Debtors obtained unfair advantage 'over Dr. Giddens' . . . .") Dr. Giddens ignores the fact that the harm to this judicial process - an undisclosed asset never administered for the benefit of creditors - can only be remedied if the bankruptcy is reopened. Dr. Giddens seeks to profit from the harm rather than remedy it.

Judicial estoppel would also run contrary to the Bankruptcy Code. 11 U.S.C. § 350 provides that a case may be reopened to administer undisclosed assets. Assets disclosed prior to a case being closed are deemed abandoned when the case is closed and are, therefore, administered. 11 U.S.C. § 554. Assets that are not listed in the schedules are neither abandoned nor otherwise administered and remain property of the bankruptcy estate even after the case is closed. 11 U.S.C. § 554(c), (d); *see Reynolds v. Wendy's Int'l, Inc. (In re Parker)*, 365 F.3d 1268, 1272 (11th Cir. 2004). As a result the only time unadministered assets exist in a closed case is when the assets were undisclosed. In short, section 350 was written to enable cases to be reopened so that undisclosed assets could be administered.

VII. THE BANKRUPTCY COURT NEVER ADOPTED AN INCONSISTENT POSITION

Dr. Giddens contends that the report errs because it doesn't analyze whether the bankruptcy court accepted an inconsistent position when it granted the Debtors' discharge. "The requirement that a previous court has accepted the prior inconsistent factual position 'ensures that judicial estoppel is applied in the narrowest of circumstances.'" *Johnson*, 405 F.3d at 1069, *quoting Lowery v. Stovall*, 92 F.3d 219, 224 (4th Cir. 1996). The bankruptcy court never adopted the facts asserted in the Debtors' schedule of assets and statement of financial affairs, because entry of the discharge order is a ministerial act. *See In re Hicks*, 184 B.R. 954, 959 (Bankr. C.D. Cal. 1995).

Applicable law requires entry of the discharge order after the passage of certain deadlines. No hearing is required. 11 U.S.C. § 727(a) provides that the bankruptcy court ". . . shall grant the debtor a discharge, unless . . ." the debtor is not an individual, the debtor received a discharge within six years before the current bankruptcy case was filed[4], the court approves a written waiver of discharge or a party prevails on an adversary proceeding objecting to the discharge. *See also* FED. R. BANKR. P. 4004(c)(1). Further, there is no provision in the Bankruptcy Code or Federal Rules of Bankruptcy Procedure for a "no-asset" versus an "asset" discharge. The discharge is granted regardless of the existence or absence of assets. The Bankruptcy Court simply did not rely on the Debtors' representations regarding their interests in the malpractice action.

Dr. Giddens' objection also asserts that the Magistrate Judge committed error by stating that Dr. Giddens failed to establish he was a party who acquiesced to the Debtors' non-disclosure. This is not error. The Tenth Circuit noted that judicial estoppel may be applied based on a party's inconsistent position ". . . especially if it be to the prejudice of the party who has acquiesced in the position formerly taken by him . . . . " *Johnson*, 405 F.3d at 1069, *quoting Davis v. Wakelee*, 156 U.S. 680, 689, 15 S.Ct. 555, 39 L.Ed. 578 (1895). The Report properly considered this factor.

VIII. THE DEBTORS HAVE STANDING

Dr. Giddens argues that the Debtors lack standing because the Bankruptcy Code ". . . makes no provision for allowing a debtor to appear in these proceedings in an attempt to control

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[4] The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, which generally went into effect on October 17, 2005, enlarges the time to eight years.

property of the [bankruptcy] estate." (Appellant's Objection To Magistrate's Report And Recommendation p. 6) The argument misstates the issue. Reopening the case did not give the Debtors any control over the malpractice action since only a Chapter 7 trustee has that power. Reopening the case and directing the United States Trustee enabled a Chapter 7 trustee to prosecute or otherwise administer the action.

Dr. Gidden's argument is also contradicted by 11 U.S.C. § 350 which provides that a case may be reopened not only to administer assets but to accord relief to the Debtors. The Debtors sought to reopen the case to list the malpractice claim, have a Chapter 7 trustee appointed and to claim an exemption in the proceeds of the malpractice claim.[5] (Motion To Re-open Bankruptcy Case, ROP, Part 4, p. 6 of 10) They clearly sought relief. Additionally, FED. R. BANKR. P. 5010 provides that a ". . . case may be reopened on motion of the debtor . . . . " Debtors had standing to bring the motion.

IX. PUBLIC POLICY SUPPORTS THE REPORT

The creditors are victims of the Debtors' failure to disclose the asset, not Dr. Giddens. They received nothing as a result of the Debtors' non-disclosure. They should not be deprived of the opportunity to have the asset administered. The schedules indicate that the creditors are medical providers and consumer credit providers. (Schedule F, ROP Part 2, pp. 17 - 19 of 35) Although it is presently unclear how much the Chapter 7 trustee could recover from the malpractice action, the recovery could pay these creditors in full. To the extent the recovery exceeds the amount needed to pay the creditors and administrative bankruptcy costs, any

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[5] Once the case is reopened the Debtors can claim an exemption of up to $50,000 in a claim for bodily injury. 11 U.S.C. § 522; OKLA STAT. tit. 31, § 1 et. seq. The Chapter 7 trustee can then object to the exemption based on the earlier non-disclosure.

judgment in the action could be fashioned to preclude the Debtors from any personal recovery. *See Autos, Inc. v. Gowin*, 330 B.R. 788 (D. Kan. 2005)(ordering proceeds under a judgment in a previously undisclosed action be distributed to creditors and denying any personal recovery by the debtor).

Dr. Giddens' proposed policy also contradicts the Bankruptcy Code which expresses the public policy which Congress chose - bankruptcy cases should be reopened to administer assets. Congress also enacted civil and criminal penalties to deter misconduct by debtors in bankruptcy. *See* 11 U.S.C. § 727; 18 U.S.C. 152. The policy choice has been made.

X. CONCLUSION

11 U.S.C. § 350 and *Mullendore v. United States (In re Mullendore)*, 741 F.2d 306 (10th Cir. 1984), require the case be reopened in order to administer the asset. The Tenth Circuit's factors for judicial estoppel are not present in this case. Adopting Dr. Giddens' argument would only perpetuate false information in this bankruptcy case and assure that the injustice suffered by the creditors is never remedied. The Bankruptcy Court's order should be affirmed.

DATED: Tue-5/30/06 14:8

Respectfully submitted,
FELICIA S. TURNER
United States Trustee

/s/ David W. Newman
David W. Newman, OBA# 20952
Katherine Vance, OKBA# 9175
Paul R. Thomas, OKBA# 11546
Office of the United States Trustee
Department of Justice
224 South Boulder, Suite 225
Tulsa, OK 74103
(918) 581-6670
(918) 581-6674 (Fax)

CERTIFICATE OF SERVICE

I hereby certify that on the 26th day of May 2006, I caused the UNITED STATES TRUSTEE'S RESPONSE TO APPELLANT'S OBJECTION TO MAGISTRATE'S REPORT AND RECOMMENDATION to be electronically filed with the Clerk of the Court using the CM/ECF system, which will serve said document by e-mail on the parties listed below in conjunction with the electronic filing of the foregoing:

Amy Ellen Kempfert

Dan Wesley Ernst

Matthew Benjamin Free

I further certify that on the 26th day of May 2006, I caused a true and accurate copy of the foregoing document to be mailed with postage fully prepaid herein, via U.S. Mail, to the following parties:

Ben D. Catterlin
6216 S LEWIS AVE STE 200
TULSA, OK 74136

Christopher M. Hunt
Chris M. Hunt, PLLC
PO BOX 450939
GROVE, OK 74345-0939

Steven W. Soule
Hall Estill Hardwick Gable Golden & Nelson
320 S Boston
Ste 400
Tulsa, OK 74103-3708

/s/David W. Newman
David W. Newman, OBA# 20952
Office of the United States Trustee
Department of Justice
224 S. Boulder, Suite 225
Tulsa, OK 74103
(918) 581-6670 / (918) 581-6674 (FAX)

BRIEF BANK — "SUMMARY SHEET"

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WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	In re Rosemary Ann Gilroy (Gilroy v. United States Trustee)
2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	1st Cir.
3. ("CCN") ***CURRENT*** CASE NO.	No.: 08-9009
4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*	No.: 07-54 Court: 1st Cir. *(Identify judge & cite, if any)*
5. ("SO") ***SOURCE***	**U.S. TRUSTEES**
6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	Filed: March 5, 2009 Type: Brief of the Appellee the United States Trustee
7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*	Ann Marie Dirsa, Geraldine Karonis, Saleela Khanum Salahuddin, P. Matthew Sutko, Phoebe Morse *(UST/OGC: 202-307-1399/FAX-2397)*
8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	• Whether the bankruptcy court abused its discretion by dismissing the debtor's chapter 11 bankruptcy case under 11 U.S.C. § 1112(b)(1) and 11 U.S.C. § 1112(b)(4)(C) given that the debtor admittedly failed to maintain insurance on real property constituting the primary asset of the estate.
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| | NO

NAME: Linda Figueroa

DATE:

No. 08-9009

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIRST CIRCUIT

IN RE ROSEMARY ANN GILROY, DEBTOR.

ROSEMARY ANN GILROY, Appellant,

v.

PHOEBE MORSE, United States Trustee for the Districts of Maine,
Massachusetts, New Hampshire and Rhode Island, Appellee.

ON APPEAL FROM THE UNITED STATES
BANKRUPTCY APPELLATE PANEL FOR THE FIRST CIRCUIT

BRIEF OF THE APPELLEE, THE UNITED STATES TRUSTEE

Ramona D. Elliott,
General Counsel
P. Matthew Sutko,
Associate General Counsel
Saleela Khanum Salahuddin,
Trial Attorney
United States Department of Justice
Executive Office for United
States Trustees
20 Massachusetts Avenue, NW
Washington, DC 20530

Phoebe Morse,
United States Trustee
Geraldine Karonis,
Assistant United States Trustee
Ann Marie Dirsa,
Trial Attorney
United States Department of Justice
Office of the United States Trustee
1000 Elm Street, Suite 605
Manchester, NH 03101
Tel: (603) 666-7908
Fax: (603) 666-7913

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TABLE OF AUTHORITIES

OTHER AUTHORITIES

STATEMENT OF APPELLATE JURISDICTION

The United States Bankruptcy Court for the District of New Hampshire ("bankruptcy court") had jurisdiction under 28 U.S.C. §§ 157(b) and 1334(a) over the bankruptcy case of Rosemary Ann Gilroy ("Ms. Gilroy"). On August 16, 2007, the bankruptcy court granted the United States Trustee's motion for an order dismissing her chapter 11 case for cause under 11 U.S.C. § 1112(b). Ms. Gilroy filed a timely notice of appeal from that order to the United States Bankruptcy Appellate Panel for the First Circuit ("appellate panel") on August 20, 2007.[1] The bankruptcy court's order was a final, appealable order. The appellate panel had jurisdiction to hear the appeal under 28 U.S.C. §§ 158(a) and 158(b)(1). On August 1, 2008, the appellate panel affirmed the bankruptcy court's order granting the United States Trustee's motion to dismiss. On August 26, 2008, Ms. Gilroy filed a timely notice of appeal to this Court. This Court has jurisdiction to hear the appeal under 28 U.S.C. § 158(d).

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[1] Ms. Gilroy filed a notice of appeal on August 10, 2007, six days before the bankruptcy court entered its order dismissing her case. *See* Appellee's Appendix (hereinafter "(UST App. ___)") at 244. On August 20, 2007, she filed a "Debtor's Emergency Motion To Request Debtor Be Allowed To File New Notice of Appeal with Corrected Date and Related Documents," (UST App. 251-255), which the appellate panel construed as an amended notice of appeal. (UST App. 310; BAP Docket entry No. 2 dated 10/4/07).

STATEMENT OF ISSUE PRESENTED

The issue to be decided in this appeal is whether the bankruptcy court abused its discretion by dismissing Ms. Gilroy's chapter 11 bankruptcy case under 11 U.S.C. § 1112(b)(1) and 11 U.S.C. § 1112(b)(4)(C) given that Ms. Gilroy admittedly failed to maintain insurance on real property constituting the primary asset of the estate.

STATEMENT OF THE CASE

Ms. Gilroy is a *pro se* debtor whose primary asset is a single building in Amherst, New Hampshire ("Property"). The Property consists of five condominium units, including Ms. Gilroy's residence. Ms. Gilroy initially sought relief under chapter 13 of the Bankruptcy Code, but the case was subsequently converted to a chapter 11 reorganization case because Ms. Gilroy had too much debt under 11 U.S.C. § 109(e) to be a chapter 13 debtor.

After conversion, the United States Trustee moved to dismiss Ms. Gilroy's case under 11 U.S.C. § 1112(b)(4)(C) for her failure to maintain insurance on the Property, because the failure to insure the Property put estate assets at risk. On August 16, 2007, the bankruptcy court granted the United States Trustee's motion to dismiss.

Ms. Gilroy filed a timely notice of appeal to the appellate panel. On appeal, Ms. Gilroy did not contest that she allowed insurance on the Property to lapse following the filing of the case and failed to reinstate the policy. Instead, Ms. Gilroy offered explanations for her failure to maintain insurance and raised issues unrelated to the status of insurance coverage on the date of dismissal.

Finding no error, the appellate panel affirmed the bankruptcy court's order on August 1, 2008. This appeal followed.

STATEMENT OF FACTS

I. Statutory Framework – Overview of 11 U.S.C. § 1112(b)

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, S. 256, Pub. L. No. 109-8, 119 Stat. 23, amended 11 U.S.C. § 1112(b) to provide that, absent unusual circumstances establishing that it is not in the best interest of the creditors and the estate, a bankruptcy court shall dismiss or convert a chapter 11 bankruptcy case if it finds cause. Section 1112(b)(4) provides a non-exhaustive list of factors constituting cause for dismissal or conversion. *See* House Report No. 595, 95th Cong. 1st Sess. 405-406 (1977); Senate Report No. 989, 95th Cong. 2d Sess. 117-118 (1978). Such factors include a chapter 11 debtor's "failure to maintain appropriate insurance that poses a risk to the estate or to the public." 11 U.S.C. § 1112(b)(4)(C).

II. Factual Background

Ms. Gilroy filed a voluntary *pro se* chapter 13 petition on July 11, 2006. (UST App. 2). Ms. Gilroy's principal asset is the Property in Amherst, New Hampshire.The Property consists of her residence and four contiguous condominium units, which she valued at $2,345,000.[2] (UST App. 43, 46). Ms. Gilroy listed secured claims against the Property of $1,240,816.[3] (UST App. 51-52). Because Ms. Gilroy's debts exceeded the amount allowed in a chapter 13 case, the chapter 13 trustee filed a motion to dismiss or convert her case to one under chapter 7 or chapter 11. (UST App. 25-26). On November 17, 2006, Ms. Gilroy filed a motion to convert her case to one under chapter 11. (UST App. 27). That motion was granted on November 20, 2006. (UST App. 6; Bankruptcy Court Docket No. 46).

Following the conversion of the case to chapter 11, Ms. Gilroy refiled schedules itemizing her assets and liabilities, a statement of current monthly

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[2] Ms. Gilroy valued her residence (Unit #1) at $650,000 and the other four units as follows: Unit #2 - $435,000; Unit #3 - $380,000; Unit #4 - $435,000; and Unit #5 - $445,000. (UST App. 43, 46).

[3] Among other debts, Ms. Gilroy reported that Ameriquest Mortgage Company ("Ameriquest") holds mortgages totaling $944,000 on Units # 1, #2, and #4, and that as of the date of filing, she owed arrearages of $40,450 on the Ameriquest mortgages. (UST App. 51).

income and a statement of financial affairs. (UST App. 28-83). Ms. Gilroy's required schedules and statements disclosed the following:

- Ms. Gilroy receives $754 per month in Social Security benefits. (UST App. 60);
- Ms. Gilroy has no other income except for funds borrowed from relatives for living expenses. (UST App. 159);
- Ms. Gilroy has not yet completed her conversion of the Property from commercial to residential condominiums, nor has she obtained occupancy permits. (UST App. 162-163, 259-260, 271); and
- Ms. Gilroy estimated the value of her equity in the Property as $1.2 million. (UST App. 98, 263).

Ms. Gilroy receives no income from the Property. (UST App. 60, 86). Because she has no source of income apart from her Social Security payments and funds borrowed from relatives for living expenses, Ms. Gilroy's chapter 11 plan provided for the repayment of creditors through the refinancing and/or sale of the Property. (UST App. 144-149). Ms. Gilroy made numerous efforts to sell or refinance the Property but failed to sell any of the condominium units. (UST App. 259-263; *see also* UST App. 5-12; Bankruptcy Court Docket Nos. 36, 71, 82, 104).

Although the Property is the only significant asset in the chapter 11 estate, Ms. Gilroy allowed the insurance to lapse following the filing of the case, and failed to reinstate the policy. (UST App. 86, 130-131, 202-220, 223, 232, 236-241, 289-293, 301-304).

III. Procedural History

On January 10, 2007, the United States Trustee moved to dismiss Ms. Gilroy's case under 11 U.S.C. § 1112(b)(1) and § 1112(b)(4)(A), (C), (F), and (K). (UST App. 84-88). The United States Trustee asserted that Ms. Gilroy's liability insurance for the Property was in danger of being cancelled for nonpayment of the premium, and further asserted that she lacked the ability to reorganize under chapter 11. *Id.* The United States Trustee argued that Ms. Gilroy knew she had to maintain insurance on the assets of the estate and failed to pay premiums due for property insurance, thereby risking cancellation of the policy for non-payment. (UST App. 86-87).

The bankruptcy court issued seven continuances of the United States Trustee's Motion to Dismiss over a four month period. (UST App. 16, 113, 121-127, 133, 189-220, 231, 236-242, 281-282, 289-294, 298) Despite the extensions, all of which the bankruptcy court provided at Ms. Gilroy's request, Ms. Gilroy failed to obtain insurance. (UST App. 130-131, 202-220, 223, 232, 236-241, 247, 289-293, 301-304).

On March 26, 2007, the bankruptcy court conducted a hearing on the United States Trustee's motion to dismiss, continuing the hearing to May 1, 2007. (UST App. 113, 281-282). Insurance on the Property lapsed on April 18, 2007. (UST App. 129-132). On April 25, 2007, Ms. Gilroy filed an emergency motion asking the bankruptcy court to delay the hearing to a later date. (UST App. 121-127). The United States Trustee objected to Ms. Gilroy's motion. (UST App. 129-132). On April 30, 2007, the bankruptcy court granted Ms. Gilroy's motion and rescheduled the hearing for June 12, 2007. (UST App. 133). On June 12, 2007, the bankruptcy court granted another motion to continue filed by Ms. Gilroy and continued the hearing to June 19, 2007. (UST App. 16; Bankruptcy Court Docket No. 143). Ms. Gilroy failed to appear at the June 19, 2007 hearing. (UST App. 285-286). On that same date, Ms. Gilroy again asked for a continuance. (UST App. 189-199). On June 21, 2007, the bankruptcy court granted her request and continued the hearing to June 26, 2007. (UST App. 200).

At the continued hearing on June 26, 2007, Ms. Gilroy conceded that she could not afford the premiums required to insure the Property, produced no proof of insurance, and asked for another continuance. (UST App. 289-293). Ms. Gilroy offered evidence that forced-placed insurance had been obtained by Ameriquest up to the value of its investment in three of the five condominium units (Units #1, #2 and #4). (UST App. 290). However, Ms. Gilroy did not provide evidence that the entire Property and her $1.2 million equity in it had been insured.

The bankruptcy court ordered Ms. Gilroy to obtain insurance by July 13, 2007, informing her that her case would be dismissed upon receipt of an affidavit by the United States Trustee that the Property was not insured by that date. (UST App. 201, 292-293).

On July 13, 2007, the United States Trustee filed an affidavit certifying that Ms. Gilroy failed to produce proof of insurance on the Property. (UST App. 223). On the same date, Ms. Gilroy filed an emergency motion for an extension of two weeks to provide insurance. (UST App. 202-220).[4] On July 24, 2007, the bankruptcy court held a hearing on Ms. Gilroy's motion dated July 13, 2007, and ordered Ms. Gilroy to provide the United States Trustee with proof of insurance by July 31, 2007, failing which the bankruptcy court would dismiss her case. (UST App. 231, 292-294, 298).

On July 31, 2007, the United States Trustee filed another affidavit certifying to the bankruptcy court that Ms. Gilroy failed to produce proof of insurance on the Property. (UST App. 232). On August 1, 2007, after the deadline to obtain insurance had already passed, Ms. Gilroy filed an emergency motion requesting additional time to obtain insurance. (UST App. 236-241). On

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[4] In her motion, Ms. Gilroy stated that on June 29, 2007, Appletree Insurance Company provided her with a copy of an insurance binder for the Property effective June 13, 2007, but that it cancelled the coverage because she failed to pay the required premium. (UST App. 202-207). Ms. Gilroy attached documentation showing cancellation of coverage effective July 12, 2007. (UST App. 216).

August 2, 2007, the bankruptcy court, stating that it would not accept any further motions for extensions of time, ordered Ms. Gilroy to file a certificate of insurance with the bankruptcy court by August 3, 2007, at 12:00 p.m., or her case would be dismissed. (UST App. 242). Ms. Gilroy failed to file a certificate of insurance for the Property, and on August 16, 2007, the bankruptcy court granted the United States Trustee's motion to dismiss. (UST App. 247).

Ms. Gilroy filed a notice of appeal on August 10, 2007, six days before the bankruptcy court entered its order dismissing her case. (UST App. 244). On August 20, 2007, Ms. Gilroy filed a "Debtor's Emergency Motion To Request Debtor Be Allowed To File New Notice of Appeal with Corrected Date and Related Documents," (UST App. 251-255), which the appellate panel construed as an amended notice of appeal. (UST App. 310; BAP Docket entry No. 2 dated 10/4/07.) Finding no error, the appellate panel affirmed the bankruptcy court's order on August 1, 2008. (Addendum (hereinafter "Add.__") 1; UST App. 414-426).

Ms. Gilroy filed a timely notice of appeal from the appellate panel's order on August 26, 2008. (UST App. 427). She also filed a motion to proceed *in forma pauperis* with this Court on November 12, 2008. That motion is currently pending.

SUMMARY OF ARGUMENT

The bankruptcy court did not abuse its discretion in dismissing Ms. Gilroy's case under 11 U.S.C. § 1112(b)(1) and 11 U.S.C. § 1112(b)(4)(C). Section 1112(b)(4)(C) allows courts to dismiss cases where debtors fail to maintain insurance, thereby "posing a risk to the estate." 11 U.S.C. § 1112(b)(4)(C). Despite being given seven extensions to obtain insurance, all at her own request, over a four month period, Ms. Gilroy failed to obtain insurance for the principal asset of the bankruptcy estate. It is undisputed on appeal that Ms. Gilroy allowed the insurance on the Property to lapse following the filing of the case and failed to reinstate the policy. Given this unrebutted evidence, the bankruptcy court did not abuse its discretion in dismissing this case in the face of Ms. Gilroy's protracted failure to insure the Property.

STANDARD OF REVIEW

This appeal raises a question of fact as to whether cause existed under 11 U.S.C. § 1112(b) to dismiss. A "bankruptcy court's findings of fact, 'whether based on oral or documentary evidence,' are not to be set aside unless 'clearly erroneous.'" *Western Auto Supply Co. v. Savage Arms, Inc. (In re Savage Indus., Inc.)*, 43 F.3d 714, n.8 (1st Cir. 1994) (quoting Fed. R. Bankr. P. 8013); *see also In re Gonic Realty Trust*, 909 F.3d 624, 626 (1st Cir. 1990). The bankruptcy court's factual finding that there was cause to dismiss Ms. Gilroy's case under

11 U.S.C. § 1112(b) given the lack of insurance on the Property is therefore reviewed under the clearly erroneous standard.

ARGUMENT

I. The Bankruptcy Court Did Not Abuse Its Discretion Under 11 U.S.C. § 1112(b)(4)(C) in Dismissing Ms. Gilroy's Case Given That Ms. Gilroy Failed, over Many Months, to Obtain Insurance on the Primary Asset of the Bankruptcy Estate.

The bankruptcy court's finding that Ms. Gilroy failed to maintain appropriate insurance is supported by the record, and constituted cause for dismissal under 11 U.S.C. § 1112(b)(1) and 11 U.S.C. § 1112(b)(4)(C).

Section 1112(b)(4)(C) provides that cause to dismiss includes circumstances where a debtor fails to maintain appropriate insurance that poses a risk to the estate or to the public. 11 U.S.C. § 1112(b)(4)(C).[5]

Insurance is important because it protects for the equity of the estate and provides liability protection against risk to personal injury claims and damage to adjacent structures. *Cf. Reading v. Brown*, 391 U.S. 471, 485 (1968) (holding that a negligence claim for tort damages arising from a fire at a bankrupt's property was allowable as an actual and necessary expense of the bankruptcy estate and entitled to administrative priority).

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[5] "[T]he court shall convert a case under this chapter to a case under chapter 7 or dismiss a case under this chapter . . . if the movant establishes failure to maintain appropriate insurance that poses a risk to the estate or to the public." 11 U.S.C. § 1112(b)(4)(C).

Ms. Gilroy did not obtain insurance, even though the bankruptcy court provided her with seven extensions over a four month period to do so. The need to insure property in this case was particularly acute because the primary, if not only, asset of the bankruptcy estate consisted of Ms. Gilroy's reported $1.2 million equity in the Property. Ms. Gilroy conceded that she had not obtained insurance, and that she could not afford to pay the premiums required to insure the Property. (UST App. 236-241, 289-292, 301-304).

Ms. Gilroy's failure to maintain appropriate insurance also posed an unacceptable risk to the estate and to the public in breach of her fiduciary duties as a chapter 11 debtor in possession. *In re Daniels*, 362 B.R. 428, 435-436 (Bankr. S.D. Iowa 2007); *In re Emergystat of Sulligent, Inc.,* No. 07-51394, 2008 WL 597613 (Bankr. E.D. Tenn. Feb. 29, 2008). Had the Property suffered damage from fire, flood, vandalism or any other form of insurable loss, it would have effectively diminished or obliterated any dividend to the creditors of the estate. *Cf. Reading*, 391 U.S. at 485.

Although Ms. Gilroy resided in Unit #1 and had no other tenants, her efforts to sell the condominium units included inviting potential buyers or investors to the Property for inspections and walk-throughs. (UST App. 259-261, 264, 270-271). By failing to maintain appropriate insurance, Ms. Gilroy exposed the estate to the risk of personal injury claims brought by any party injured on the premises, which remained under renovation and lacked occupancy permits throughout the bankruptcy proceeding. (UST App. 162-163, 259-260, 271). The lack of insurance also jeopardized the estate by exposing it to the risk of third party claims should a fire, flood, or similar event on the Property damage adjacent structures. Under the *Reading* doctrine, such third party claims would be considered administrative expenses and given administrative priority. *Cf. Reading*, 391 U.S. at 485.

Where Ms. Gilroy failed to insure the Property despite being granted seven extensions over a four month period, could not make the mortgage payments, was unable to sell or refinance the Property in the 13 months since she filed for bankruptcy protection, and the lack of insurance on the Property posed a liability risk to the estate, the bankruptcy court did not abuse its discretion in dismissing her case.

II. The Arguments Raised by Ms. Gilroy on Appeal Lack Merit or Have No Basis in Fact.

Ms. Gilroy's arguments on appeal[6] concerning insurance coverage can be

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[6] Ms. Gilroy's list of 28 separate issues presented on appeal (*see* Appellant's Brief at 1-6) appear to concern the status of her homestead rights, allegations of improper conduct by secured lenders, and her mistaken belief that, upon foreclosure, her mortgagees would retain the full value of the Property over and above the amount of their secured interests. The appellate panel rejected Ms. Gilroy's arguments on these same issues in affirming the bankruptcy court's order dismissing her case. This brief addresses Ms. Gilroy's arguments concerning her inability to obtain insurance on the Property, and whether this constituted a factual basis for the bankruptcy court to dismiss her case under 11 U.S.C. § 1112(b)(4)(C).

broken down into three component parts: (1) that Ameriquest had fully insured the Property; (2) that Ms. Gilroy did not receive appropriate notice of the court order requiring insurance; and (3) that Ms. Gilroy had obtained an insurance binder from Appletree Insurance.

Each of these contentions lacks merit or has no basis in fact.

A. Ameriquest's Forced-Placed Insurance Did Not Protect the Estate.

Ms. Gilroy contends that the bankruptcy court erred in dismissing her case because the Property had "already been insured" by Ameriquest under a forced-placed insurance plan. Appellant's Brief at 17.

Ms. Gilroy's contention misunderstands the nature of forced-placed insurance. This is because forced-placed insurance is solely for the protection of a lender, and is put into place by a lender only when a borrower fails or refuses to produce evidence of property insurance. *See Baker v. ZC Sterling Ins. Agency, Inc.*, No. 07-8747, 2009 WL 249757, *1 (E.D. La. Feb. 3, 2009) ("The type of policy at issue in this case is a "forced-placed" policy, which is requested by a lender/mortgagee to protect its interest in the property."); *Riley v. Southwest Bus. Corp.*, No. 06-4884, 2008 WL 4286631, *3 (E.D. La. Sept. 17, 2008) ("As with all forced placed policies, Midwest initiated coverage in order to protect its own security interest in the property, not to provide any sort of benefit for the mortgagor. Indeed, the very purpose of a forced placed policy is to cover the uninsured portion of the mortgagee's interest."); *Wahl v. Am. Sec. Ins. Co.*, No. 08-00555, 2008 WL 2444802, *1 (N.D. Cal. June 16, 2008) ("Forced placed insurance policies are those ordered by lenders to insure mortgaged residential properties when borrowers fail to obtain or maintain coverage as required by the terms of their loans."); *see also* Christopher L. Peterson, *Federalism and Predatory Lending: Unmasking the Deregulatory Agenda*, 78 Temp. L. Rev. 1, 22-23 (2005) (discussing forced-placed insurance).[7]

Thus, Ameriquest's forced-placed insurance would have only provided coverage for Ameriquest's interest in three of the five condominium units that constituted the entire Property, an interest which totaled $944,000. (UST App. 51, 290). But, according to Ms. Gilroy's schedules, the Property was worth $2,345,000. (UST App. 43, 46). And the forced-placed insurance would not have protected the estate from *Reading*-type claims for third party property damage or personal injury. *Cf. Reading*, 391 U.S. at 485; Larry M. Arnold et

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[7] Ms. Gilroy's misunderstanding appears to be based on her "disbelief" that Ameriquest would obtain forced-placed insurance only on those units for which it held mortgages and only up to the amount of its mortgage interests. (*See* Appellant's Brief at 17). However, that is the very nature of forced-placed insurance – it is put in place only to protect the interest of the lender when a borrower fails or refuses to provide evidence of property insurance. Ms. Gilroy does not explain to this court why Ameriquest would pay additional costs to obtain more insurance than necessary to protect its interest in the property.

al., *The Ebb and Flow of the Forced-Placed Claim*, 109 Ins. Advocate 16 (1998) (discussing the legal parameters underlying claims developing from forced-placed property insurance). As the attorney for Ameriquest certified to the bankruptcy court during the June 26, 2007 hearing, "at best the mortgagee's interest [was insured], but nothing more." (UST App. 290).

Ms. Gilroy's contention that Ameriquest had fully insured the Property is insufficient to meet her burden of demonstrating that the bankruptcy court erred in dismissing her case for failure to obtain insurance.

B. Ms. Gilroy had Ample Notice of the Impending Dismissal.

Ms. Gilroy contends that the bankruptcy court erred in dismissing her case because she did not have notice of the impending dismissal. *See* Appellant's Brief at 2, 16. She takes the position that she did not have notice of the August 2, 2007 order[8] granting her a three-day extension of the July 31, 2007 deadline until after August 3, 2007, the date on which the three-day extension expired.

Ms. Gilroy's lack of notice argument is not persuasive. Ms. Gilroy filed an emergency motion on August 1, 2007 requesting an extension of the July 31, 2007 deadline to obtain insurance. This means that her deadline to obtain

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[8] The Deputy Clerk of the bankruptcy court certified service of the order by first class mail, postage prepaid, on August 2, 2007. (UST App. 243).

insurance had already passed at the time she filed her emergency motion. When the bankruptcy court issued its three-day extension on August 2, 2007, it could have just as well dismissed her case for failure to obtain insurance by the deadline.

Moreover, at the time the bankruptcy court issued its three-day extension, Ms. Gilroy had already spent eight months as a chapter 11 debtor-in-possession and had received seven extensions over a four month period – all at her own request – to obtain insurance, and was repeatedly informed that her case would be dismissed if she did not obtain insurance. As noted by the appellate panel, Ms. Gilroy's lack of notice argument is "wholly disingenuous given that the bankruptcy court first threatened to dismiss the Debtor's case on March 26, 2007, and then continually gave her more opportunities to obtain appropriate insurance." (Add. 12-13; UST App. 425-426).

Even if it is the case that Ms. Gilroy did not have notice of her impending dismissal until August 3, 2007, there was no harm in the delay as the bankruptcy court did not actually dismiss Ms. Gilroy's case until August 16, 2007, six days *after* Ms. Gilroy filed her notice of appeal on August 10, 2007.

The record makes clear that the bankruptcy court provided Ms. Gilroy with ample notice of the impending dismissal of her case if she did not obtain insurance, and it acted properly in dismissing Ms. Gilroy's case for failing to obtain insurance.

C. Ms. Gilroy's Insurance Binder Lapsed More Than One Month before the Bankruptcy Court's Order of Dismissal Entered.

Ms. Gilroy suggests that the appellate panel erred in affirming the bankruptcy court's dismissal of her case because, unbeknownst to her, Appletree Insurance Company issued an insurance binder for the premises effective from June 13, 2007, to July 12, 2007.

Ms. Gilroy's argument concerning the insurance binder lacks merit. As Ms. Gilroy acknowledged on the record, the insurer cancelled her coverage because she neither paid, nor could afford to pay, the initial installment required for the issuance of a policy. (UST App. 202-220). Ms. Gilroy also admitted on the record that she did not notify the bankruptcy court of the coverage until after the insurer had cancelled coverage for nonpayment. *Id.* Moreover, the bankruptcy court granted Ms. Gilroy two further extensions of time to obtain insurance after such coverage lapsed. (UST App. 231, 242).

In light of these undisputed facts, the bankruptcy court did not abuse its discretion in dismissing because, at the time of dismissal, there was no insurance. As the appellate panel noted, "the fact that the properties were insured for one month is irrelevant, as the properties remained uninsured thereafter. Therefore, there was cause to dismiss or convert the petition." (Add. 11; UST App. 424).

CONCLUSION

For these reasons, the United States Trustee respectfully asks this Court to affirm the August 1, 2008 judgment of the appellate panel affirming the August 16, 2007 order of the bankruptcy court dismissing Ms. Gilroy's bankruptcy case.

Respectfully submitted,

PHOEBE MORSE
United States Trustee

By: ___________________________

GERALDINE KARONIS
ANN MARIE DIRSA
United States Department of Justice
Office of the United States Trustee
1000 Elm Street, Suite 605
Manchester, NH 03101
Tel: (603) 666-7908
Fax: (603) 666-7913

RAMONA D. ELLIOTT
P. MATTHEW SUTKO
SALEELA KHANUM SALAHUDDIN
United States Department of Justice
Executive Office for
United States Trustees
20 Massachusetts Avenue, NW
Washington, DC 20530

CERTIFICATE OF SERVICE

I certify that on March 5, 2009, I filed and served true and correct copies of the Brief and Appendix of Appellee, the United States Trustee, by causing nine copies together with a computer readable diskette to be sent by overnight delivery to the Clerk of the Court, and by causing two copies and a diskette to be sent by overnight delivery upon the individual listed below.

Rosemary Ann Gilroy
107 Ponemah Road, Unit #1
Amherst, NH 03031

____
Ann Marie Dirsa

CERTIFICATE OF COMPLIANCE

This brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B), because this brief contains 4,254 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii).

This brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6), because it has been prepared in a proportionally spaced typeface using Word Perfect 9 in 14 point Times New Roman.

____
Ann Marie Dirsa

ADDENDUM

STATUTES

SEP 21 1995

UNITED STATES COURT OF APPEALS
FOR THE ELEVENTH CIRCUIT

U.S. TRUSTEE,

Appellant, Case No. 95-2849

v.

JERE FISHBACK, et al.,

Appellees.

In re:

GLADOS, INC., D. Ct. No. 93-01905-CIV-T-23

Debtor.

APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF FLORIDA

UNITED STATES TRUSTEE'S
APPELLANT'S BRIEF

Martha L. Davis
General Counsel
Jeanne M. Crouse
Attorney
Executive Office for
United States Trustees
901 E Street, N.W., Ste. 780
Washington, D.C. 20530

Donald F. Walton
Acting U.S. Trustee

T. Patrick Tinker
Attorney
Office of the U.S. Trustee
4919 Memorial Hwy., Ste. 110
Tampa, FL 33634
(813) 243-5000

U.S. Trustee v. Fishback
Court of Appeals No. 95-2849

CERTIFICATE OF INTERESTED PERSONS

The following persons are, or may be, "interested persons" under Eleventh Circuit Rule 26.1-1:

Billy Ray Addison

Hon. Thomas E. Baynes, Jr.

Russell Blain

Cynthia Burnette

Jeanne M. Crouse

Martha L. Davis

Jere M. Fishback

Sara L. Kistler

Lawrence S. Kleinfeld

Kleinfeld & Fishback

Benjamin E. Lambers

Hon. Steven D. Merryday

Hon. Harvey E. Schlesinger

David Steen

Stichter, Riedel, Blain & Prosser, P.A.

T. Patrick Tinker

Donald F. Walton

T. Patrick
T. Patrick Tinker

STATEMENT REGARDING ORAL ARGUMENT

This appeal concerns the bankruptcy court's award of interest to professionals and creditors under 11 U.S.C. § 726(a). The legal issues and the factual circumstances are somewhat complex. The United States Trustee respectfully requests that the Court schedule oral argument for this appeal.

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TABLE OF CITATIONS

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STATEMENT OF JURISDICTION

This appeal arises from the bankruptcy case of Glados, Inc. (the "Debtor"). The appeal is taken from a final judgment of the United States District Court for the Middle District of Florida entered May 5, 1995, affirming a final order of the United States Bankruptcy Court for the Middle District of Florida entered September 30, 1993.

In the bankruptcy court, the United States Trustee's Objection to Trustee's Proposed Distribution and Request for Hearing initiated a core proceeding under 28 U.S.C. § 157(b)(2). Consequently, the bankruptcy court's jurisdiction was properly based on 28 U.S.C. § 157(b)(1).

The United States Trustee filed a timely notice of appeal on October 8, 1993. B-201, B-203.[1] Consequently, the district court properly exercised its jurisdiction under 28 U.S.C. § 158(a).

On July 3, 1995, the United States Trustee timely filed his notice of appeal from the district court's order. R1-13. This Court's jurisdiction is therefore based on 28 U.S.C. §§ 158(d) and 1291.

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[1] The bankruptcy court documents are contained in an exhibit folder in the district court record on appeal, and are hereinafter referenced according to the bankruptcy court's docket numbers. All other documents will be referenced by the district court volume and document numbers.

STATEMENT OF THE ISSUES

The United States Trustee raises the following issues on appeal:

1. Pursuant to 11 U.S.C. § 726(a)(5), may a trustee receive interest on his compensation in the case dating from the trustee's initial appointment?

2. May professionals other than the trustee receive interest under 11 U.S.C. § 726(a)(5) on their compensation dating from the professionals' submission of their fee applications?

STATEMENT OF THE CASE

On September 30, 1983, the Debtor filed its petition for relief under the reorganization provisions of chapter 11 of the Bankruptcy Code, 11 U.S.C. §§ 101 et seq. B-1. On February 8, 1985, the case was converted to a liquidation proceeding under chapter 7, and the bankruptcy court appointed Lawrence Kleinfeld to serve as the trustee in the case (the "Trustee"). B-62, 63.

Prior to conversion of the case, the Debtor's business had been destroyed by fire. Consequently, the Debtor commenced an action against Reliance Insurance Company to recover on an insurance policy in the United States District Court for the Middle District of Florida. B-177-2. The Trustee took over that litigation on behalf of the Debtor's estate, and sought to employ legal counsel. On September 5, 1985, the bankruptcy court approved the Trustee's employment of the Trustee's law firm, Kleinfeld & Fishback ("K&F"), to serve as counsel for the Trustee. B-92.

In June, 1986, the litigation resulted in a judgment in favor of the Trustee and the Debtor's estate. The Trustee then defended the estate on appeals taken by Reliance Insurance Company to the United States Court of Appeals for the Eleventh Circuit and the United States Supreme Court. Both appellate courts affirmed the judgment. B-201-2.

As part of the insurance litigation, two orders were entered with respect to attorneys' fees. On June 6, 1986, the district court awarded attorneys' fees to the Debtor's estate in the sum of $79,200. Id. On September 18, 1991, Reliance paid to the Debtor's estate this judgment amount, plus $50,202.12 in interest, for a total sum of $129,402.12. Id.

The second attorneys' fee order in the insurance litigation arose following the appeals. The Trustee and Reliance Insurance Company compromised the appellate attorneys' fee issue, and the bankruptcy court approved that compromise on January 23, 1992, in the amount of $80,000, which was paid into the estate. B-169; B-201-2.

On July 8, 1992, the Trustee submitted his Preliminary Report of Estate to the United States Trustee for review, along with the fee applications of the Trustee and K&F.[2] B-174. On July 21, 1992, the United States Trustee certified the Preliminary Report of Estate to the bankruptcy court. B-176. On September 9, 1992, the bankruptcy court issued a Notice of Preliminary Report of Estate Funds and Notice of Surplus Funds, informing creditors of the availability of surplus funds to pay additional claims if filed. B-183. On September 29, 1992, Stichter, Riedel, Blain & Prosser, P.A. ("Stichter, Riedel") filed its application for compensation as counsel for the Debtor in the chapter 11 proceeding. B-184.

In accordance with local practice, the bankruptcy court on February 25, 1993 communicated to the Trustee the allowed amounts of all administrative expenses, including the compensation awards for the Trustee and K&F as determined by the Court under 11 U.S.C. § 330. B-201-4. The bankruptcy court awarded $8,927.25 as Trustee's fees, plus $56.15 as expenses for the Trustee. B-201-5. The Trustee's compensation award is limited under 11 U.S.C. § 326(a), and the court's award was the maximum permitted under that provision.

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[2] The United States Trustee is an official of the United States Department of Justice, charged by statute with the duty to oversee and supervise the administration of bankruptcy cases. 28 U.S.C. § 586(a). The United States Trustee is expressly given standing under 11 U.S.C. § 307 to raise and be heard on any issue under title 11, except that the United States Trustee may not file a reorganization plan under chapter 11.

The bankruptcy court awarded $227,612.12 in fees and $1,515.02 in expenses to K&F, for its services as the Trustee's counsel. B-201-4. The K&F compensation award consisted of three distinct portions:

(i) the attorneys' fee judgment of $79,200 for K&F's services provided in the district court insurance litigation, plus the five years of judgment interest on that award in the amount of $50,202.12;

(ii) the previously approved $80,000 compromise sum for K&F's appellate services; and

(iii) the sum of $18,210 for the balance of services provided by K&F on behalf of the Trustee.

Id. For Stichter, Riedel's services as the Debtor's counsel in the chapter 11 proceeding, the Court awarded compensation of $4,991.32. Id.

After payment of all claims and administrative expense awards, it was apparent that the estate had surplus funds. The Trustee prepared a proposed distribution order which included the court's fee awards and allocated the surplus for the payment of interest under 11 U.S.C. § 726(a)(5). The United States Trustee then filed his objection to the proposed distribution of the surplus. B-194.

On August 23, 1993, the bankruptcy court conducted its hearing on the United States Trustee's objection to the proposed distribution. On September 30, 1993, the bankruptcy court entered its order holding that the Trustee was entitled to interest on his entire compensation award dating back to his appointment as trustee; the other professionals, in turn, were entitled to interest on their compensation awards dating back to the date that each fee application was submitted. B-201-7,8. From the surplus funds, the court allocated interest of $73,400.68 to K&F, interest of $4,008.42 to the Trustee, and interest of $302.72 to Stichter, Riedel. B-201-11. These distributions left no funds available to pay interest on general unsecured creditors' claims.

On May 5, 1995, the district court entered its judgment affirming the bankruptcy court's order. All the issues on appeal are issues of law subject to a de novo standard of review. Equitable Life Assurance Soc'y v. Sublett (In re Sublett), 895 F.2d 1381, 1383-84 (11th Cir. 1990).

SUMMARY OF THE ARGUMENT

Section 726(a)(5) of title 11 provides for the payment of interest to administrative expense claimants and creditors in cases where there is a surplus of funds available after payment of the underlying administrative expenses and claims. Although the statute specifically provides for the "payment of interest at the legal rate from the date of the filing of the petition...," the courts below and all of the published case law acknowledge that interest on administrative expenses cannot properly be calculated from the date of the filing of the petition. Such a result would be absurd because interest would then be paid on administrative expenses even before any services were provided, and before any right to compensation arose in the case. The published case law supports the conclusion that interest should be paid from the date of the award of compensation.

Contrary to all published decisions, the bankruptcy court in this case awarded interest dating from the Trustee's appointment and from the other professionals' submission of fee applications. The district court affirmed the lower court's order, reasoning that the Trustee and the other professionals possessed "claims" against the estate prior to the awards of compensation. The district court therefore treated the court's award of compensation as tantamount to a liquidation of claims that had existed from the time of the Trustee's appointment and the professionals' submission of fee applications. R1-10-9. The district court also found a policy justification for its decision, in the fact that the United States Bankruptcy Court for the Middle District of Florida generally does not award compensation to trustees and counsel until the closing of a chapter 7 case, thereby purportedly leaving such professionals uncompensated for the delay in payment of their administrative expense claims.

However, section 726(a)(5) provides for the award of interest on administrative expense claims only to the extent that they are compensable claims for administrative expenses under 11 U.S.C. §§ 503(b) and 507(a). In order to be compensable under those provisions, compensation must first be awarded under 11 U.S.C. § 330. Thus, the language of section 726(a) should be construed as providing for the payment of interest to professionals only as to compensation awards under section 330, which interest should be calculated from the date of the actual fee award. This result is appropriate, insofar as section 726(a)(5) provides a form of statutory or judgment interest.

ARGUMENT

I. SECTION 726(a)(5) PROVIDES FOR THE PAYMENT OF INTEREST ON PROFESSIONALS' ADMINISTRATIVE EXPENSE CLAIMS DATING ONLY FROM THE AWARDS OF COMPENSATION TO SUCH PROFESSIONALS UNDER SECTION 330.

In surplus cases, trustees and other professionals are entitled to interest on their fees from the time of the court's fee awards, not from the time that the trustee was appointed or the professionals filed their fee applications. In re Riverside-Linden Inv. Co., 945 F.2d 320, 323-24 (9th Cir. 1991), aff'g In re Riverside-Linden Inv. Co., 99 B.R. 439 (Bankr. 9th Cir. 1989); In re Chiapetta, 159 B.R. 152, 159 (Bankr. E.D. Pa. 1993); In re Motley, 150 B.R. 16, 19 (Bankr. E.D. Va. 1992); In re Commercial Consortium of California, 135 B.R. 120, 127 (Bankr. C.D. Cal. 1991). This conclusion is based on section 726(a)(5)'s reference to claims paid under section 726(a)(1), which in turn refers to claims as specified in 11 U.S.C. §§ 507 and 503(b). Pursuant to section 503(b)(2), professionals possess administrative expense claims under section 507 only after their compensation is awarded under 11 U.S.C. § 330. See Riverside-Linden, 945 F.2d at 324.

A. SECTION 726(a)(1) PROVIDES FOR THE PAYMENT OF PROFESSIONALS' ADMINISTRATIVE EXPENSE CLAIMS.

Section 726 sets forth the distribution scheme that governs the trustee's disbursement of funds at the close of a chapter 7 case. Subsection (a) sets forth the general priorities of the various types of claims against the estate, in paragraphs (1) through (4). Paragraph 5 provides for the payment of interest on such claims. After all these claims have been paid, together with any interest owing on the claims, then any remaining funds are distributed to the debtor pursuant to paragraph (6).

In order to determine the treatment of professionals' compensation under section 726, it is necessary to trace one's way back through several sections of the Bankruptcy Code. Section 726(a)(1) provides as follows:

> (a) Except as provided in section 510 of this title, property of the estate shall be distributed--
>
> (1) first, in payment of claims of the kind specified in, and in the order specified in, section 507 of this title.

Section 726(a)(1) thus does not expressly refer to professionals' compensation. Section 507, however, provides as follows:

> (a) The following expenses and claims have priority in the following order:
>
> (1) First, administrative expenses allowed under section 503(b) of this title, and any fees or charges assessed against the estate under chapter 123 of title 28. . . .

If we then turn to section 503(b)(2), that statute provides:

> (b) After notice and a hearing, there shall be allowed administrative expenses, other than claims allowed under section 502(f) of this title, including--
>
> . . .
>
> (2) compensation and reimbursement awarded under section 330(a) of this title; . . .

Thus, professionals' claims for compensation or reimbursement of expenses are claims "of the kind specified in ... section 507," to the extent that the claims are for "compensation and reimbursement awarded under section 330(a) of [title 11]."

B. SECTION 726(a)(5) PROVIDES FOR THE PAYMENT OF INTEREST ON CLAIMS PAID UNDER SECTION 726(a)(1) - (4).

The payment of interest at the close of a chapter 7 case is provided under section 726(a)(5):

> (a) Except as provided in section 510 of this title, property of the estate shall be distributed--
>
> (5) fifth, in payment of interest at the legal rate from the date of the filing of the petition, on any claim paid under paragraph (1), (2), (3), or (4) of this subsection . . . .

Because this provision expressly provides for the payment of interest on claims for administrative expenses paid under paragraph (1), interest can be paid on professionals' claims for compensation and expense reimbursement after they are allowed under section 330.

In affirming the bankruptcy court's decision, the district court analyzed the plain language of section 726(a)(5) and ended its reasoning with the language "any claim paid". In so doing, the district court ignored the phrase in section 503(b)(2) that reads "compensation and reimbursement <u>awarded</u> under section 330. . . ." (emphasis added). The court also ignored the fact that the Code provides elsewhere for retroactive treatment of certain post-petition claims, without including administrative claims for compensation. <u>See</u> 11 U.S.C. § 502(g)-(i). Finally, the lower courts gave insufficient consideration to apposite case law.

C. <u>THE PUBLISHED CASE LAW HOLDS THAT INTEREST ON PROFESSIONALS' FEES AND EXPENSES IS PAYABLE UNDER SECTION 726(a)(5) ONLY AS TO ALLOWED AMOUNTS UNDER SECTION 330, DATING FROM THE TIME OF THE FEE AWARDS.</u>

The Ninth Circuit's decision in <u>In re Riverside-Linden Investment Co.</u>, 945 F.2d 320, is the seminal case on the issue of when interest begins to accrue on professionals' fees under section 726(a)(5). As in the instant case, the Ninth Circuit addressed the payment of interest to trustee's counsel where surplus funds remained after the payment of all administrative expenses and creditors' claims. The Court also confronted the question whether the trustee's counsel may receive interest from the date that the counsel invoiced the estate.

First, the Ninth Circuit noted that section 726(a)(5) cannot be literally read as providing for interest to professionals dating from the commencement of the case:

> For claims existing prior to the filing of the bankruptcy petition, a date-of-filing accrual date is appropriate and mandated under the plain language of the statute. For a claim to Section 330(a) attorney's fees arising subsequent to filing, however, a literal application of the statute makes little sense; "[i]nterest cannot accrue on fees for services that have not yet been performed," Riverside-Linden II, 111 B.R. at 303. See, e.g., Bob Jones Univ. v. United States, 461 U.S. 574, 586, 103 S. Ct. 2017, 2025-2026, 76 L.Ed. 2d 157 (1983) ("[i]t is a well-established canon of statutory construction that a court should go beyond the literal language of a statute if reliance on that language would defeat the plain purpose of the statute"); . . . .

Riverside-Linden, 945 F.2d at 323-24; see also In re Colortex Industries, Inc., 19 F.3d 1371, 1377 (11th Cir. 1994) (noting the ambiguity in section 725(a)(5) that results from the availability of interest on post-petition claims) (dicta); In re Motley, 150 B.R. 16, 18 (Bankr. E.D. Va. 1992).

The Ninth Circuit then specifically considered the kind of administrative expense "claim" to which section 726(a)(5) applies:

> The provision which defines attorney's fees as a compensable administrative expense, Section 503(b) refers to "compensation and reimbursement awarded under section 330." 11 U.S.C. § 503(b)(2) (emphasis added). It is not until the fees have been awarded by the bankruptcy court pursuant to Section 330, therefore, that they become an administrative expense entitling them to treatment as a claim under Section 726(a)(5)."

945 F.2d at 324.

The Ninth Circuit's approach is consistent with all the published decisions under section 726(a)(5). See In re Chiapetta, 159 B.R. 152, 159 (Bankr. E.D. Pa. 1993) (trustee's counsel received a contingency fee after successfully pursuing a lawsuit, but counsel was not entitled to interest under section 726(a)(5) until after the award of fees at the close of the case); In re Motley, 150 B.R. 16, 19 (Bankr. E.D. Va. 1992) (trustee not entitled to pre-award interest under section 726(a)(5); In re Commercial Consortium of California, 135 B.R. 120, 127 (Bankr. C.D. Cal. 1991) (trustee's counsel may not receive pre-award interest under section 726(a)(5), but court awarded current, rather than historical, rates as compensation for the delay caused by the pendency of the estate's lawsuit). In addition, this position is consistent with the case law concluding that professionals employed on behalf of a bankruptcy estate have no right to the payment of compensation, or interest on such compensation, until the final fee awards are made under 11 U.S.C. § 330. See, e.g., In re Child World, Inc., 185 B.R. 14, 1995 WL 476171, at *3-5 (Bankr. S.D.N.Y. Aug. 9, 1995); In re Caribou Partnership III, 152 B.R. 733, 741 (Bankr. N.D. Ind. 1993); In re Energy Coop., Inc., 95 B.R. 961, 966 (Bankr. N.D. Ill. 1988).

If the above case law is rejected, then it is difficult to justify another date as the proper starting point for accruing interest. This is particularly clear as to the trustee's interest award in the lower courts. Both courts acknowledged that interest cannot be awarded under section 726(a)(5) dating back to filing of the bankruptcy petition, because that would produce the absurd result of professionals receiving interest on their claims for compensation even before they provided any services to justify compensation. However, the award of interest to the trustee from the date of his appointment produces the same illogical result that the lower courts wished to avoid.

II. THE DISTRICT COURT ERRED IN RELIANCE ON THE UNAVAILABILITY OF INTERIM COMPENSATION TO THE PROFESSIONALS, BECAUSE THE BANKRUPTCY COURT MAY NONETHELESS AWARD COMPENSATION FOR SIGNIFICANT PRE-AWARD DELAYS UNDER 11 U.S.C. § 330, AND SUCH COMPENSATION WAS AWARDED IN THIS CASE.

The district court attempted to distinguish the prior case law under 11 U.S.C. § 726(a)(5), by reference to the availability of interim compensation in those jurisdictions, and contrasting the unavailability of such compensation in the bankruptcy court in this case. R1-10-10. However, it is the statutory analysis of section 726(a)(5) and its related provisions that is of primary significance in the Riverside-Linden line of cases. That analysis should also govern the outcome here. Although the Riverside-Linden court did note that the professional in that case had not filed an interim fee application, those cases which cite Riverside-Linden or its progeny and emphasize the availability of interim compensation are generally *chapter 11* cases. See, e.g., In re Byrd, 151

B.R. 925 (D.S.D. 1993); Matter of Caribou Partnership III, 152 B.R. 733, 741 (Bankr. N.D. Ind. 1993).

The significance of interim compensation is understandably less in chapter 7 cases, where there is generally no operating business from which ongoing expenses can be paid. Chapter 7 cases frequently do not have sufficient funds available to pay interim compensation until near the end of a case, when all the assets of an insolvent debtor have been collected and liquidated, and any litigation is concluded. Interim fee applications would be superfluous in such circumstances. Furthermore, the thrust of chapter 7 is the expeditious administration of the estate for the benefit of creditors, and many courts are reluctant to award interim fees because such awards may dilute a trustee's incentive to administer the estate expeditiously. See In re Hutchinson, 5 F.3d 750, 753-54 (4th Cir. 1993) (trustee's main duty is to administer the estate expeditiously); In re Domino Investments, Ltd., 82 B.R. 608, 609 (Bankr. S.D. Fla. 1988) (denying interim compensation so as to encourage timely administration of the estate); cf. In re Commercial Consortium of California, 135 B.R. 120, 123-25 (Bankr. C.D. Cal. 1991).

Given the limited applicability of section 726(a)(5) to the rare chapter 7 case in which there is a surplus, it should be clear that professionals cannot generally expect interest from the dates on which they submit fee applications. The lower courts' rulings are likely only to encourage the frequent submission of interim fee applications in chapter 7 cases.

However, the unavailability of interim compensation does not preclude trustees and other professionals from being compensated in appropriate circumstances in a manner that recognizes their delay in payment. Pursuant to 11 U.S.C. § 330(a)(1), the bankruptcy court may award "reasonable compensation for actual, necessary services rendered by such trustee, examiner, professional person, or attorney, as the case may be, . . . based on the nature, the extent, and the value of such services, the time spent on such services, and the cost of comparable services other than in a case under this title; . . . ."[3] In awarding such compensation, the bankruptcy court exercises considerable discretion, and the court in appropriate circumstances may consider significant delay in payment. <u>See</u> <u>Grant v. George Schumann Tire & Battery Co.</u>, 908 F.2d 874, 877, 880 (11th Cir. 1990); <u>see also</u> <u>Norman v. Housing Authority of City of Montgomery</u>, 836 F.2d 1292, 1304 (11th Cir. 1988).

The bankruptcy court's decision in <u>Commercial Consortium of California</u>, 135 B.R. 120, 125-26 (Bankr. C.D. Cal. 1991), demonstrates one way in which a bankruptcy court has considered

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[3] Although this provision has been amended by the Bankruptcy Reform Act (Pub. L. No. 103-394 (1994)) since the bankruptcy court's award of compensation under section 330, the statutory changes do not affect the analysis in this case.

delay in payment. The court used the current hourly rates of trustee's counsel, rather than the hourly rates applicable at the time services were provided, in determining compensation under section 330. Id. at 122. The court noted that "Any earlier filing of a fee application would have been pointless and wasteful, for the trustee could not have paid any allowed fees before recovery on the claim." Id. at 126-127. Significantly, the same court concluded that it must deny interest to the professional under section 726(a)(5). Id. at 127.

The bankruptcy court in the instant case actually recognized delay in payment in awarding compensation under section 330. The bankruptcy court awarded $227,612.12 in fees and $1,515.02 in expenses to K&F, for their services as the Trustee's counsel. This sum included the amount of the attorneys' fee judgment of $79,200 for K&F's services provided in the district court insurance litigation, plus the five years of judgment interest on that award in the amount of $50,202.12.[4] In other words, K&F was awarded $50,202.12 as part of its compensation award under section 330. That award has not been challenged on appeal.

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[4] This award also was calculated to include a "contingency risk factor" that multiplied the attorneys' customary hourly rate. B-177-4.

III. THE AWARD OF INTEREST TO THE TRUSTEE IS CONTRARY TO THE LIMITATION OF TRUSTEE COMPENSATION BY 11 U.S.C. § 326(a).

The award of interest to the trustee dating from the time of the Trustee's appointment contravenes the intent and purpose of 11 U.S.C. § 326(a). Section 326(a) provides that a court "may allow reasonable compensation under section 330 of [title 11] of the trustee for the trustee's services . . . ," but limits such compensation to an amount determined by application of a detailed formula set forth in section 326(a). For purposes of the present case, it is significant that section 326 expressly limits the court's award of compensation under section 330. These limitations are strictly applied by the courts. See In re Orient River Inv., Ltd., 133 B.R. 729, 731 (Bankr. E.D. Pa. 1991).

The interrelationship of sections 326(a) and 726(a)(5) was specifically addressed in In re Motley, 150 B.R. 16 (Bankr. E.D. Vir. 1992). The court denied interest to the trustee, adopting the Riverside-Linden analysis, and concluded that the inconsistency between section 326(a) and section 726(a)(5) served as an additional ground for denying interest to the trustee under the latter provision. In the instant case, the bankruptcy court awarded to the trustee under section 330 the maximum compensation permitted by section 326. The lower courts' decisions under section 726(a)(5) effectively allow a trustee to avoid the limitations of section 326 by seeking an award of interest under section 726(a)(5) for services dating all the way back to the date of the trustee's appointment, rather than from the date of the award.

CONCLUSION

For all of the foregoing reasons, the United States Trustee requests that the Court reverse the decision of the district court, and requests such additional or alternative relief as the Court considers just and equitable.

Respectfully submitted,

Martha L. Davis
General Counsel

Jeanne M. Crouse
Attorney
Executive Office for
United States Trustees
901 E Street, NW, Ste. 780
Washington, D.C. 20530
(202) 307-1399

Donald F. Walton
Acting U.S. Trustee

Sara L. Kistler
Assistant U.S. Trustee

T. Patrick

T. Patrick Tinker
Attorney
Office of the U.S. Trustee
4919 Memorial Hwy., Ste. 110
Tampa, FL 33634
(813) 243-5000

CERTIFICATE OF SERVICE

I hereby certify that on this 21st day of September, 1995, I have served the United States Trustee's Appellant's Brief and Record Excerpts by pre-paid, first class United States Mail upon the following persons:

Lawrence S. Kleinfeld
8278 27th Avenue North
St. Petersburg, FL 33710

Jere M. Fishback
SouthTrust Bank Building, #1280
150-2nd Avenue North
St. Petersburg, FL 33701

Russell M. Blain
Stichter, Riedel, Blain & Prosser, P.A.
110 East Madison Street, Suite 200
Tampa, FL 33602-4700

Signed: T. Patrick T
T. Patrick Tinker
Office of the U.S. Trustee
4919 Memorial Hwy.
Suite 110
Tampa, FL 33634
(813) 243-5000

(Attorney for United States Trustee)

U.S. [illegible]
NOV 13 1995
ATLANTA, GA

NOV 13 1995

UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

U.S. TRUSTEE,

Appellant,

Case No. 95-2849

v.

JERE FISHBACK, et al.,

Appellees.

In re:

GLADOS, INC.,

D. Ct. No. 93-01905-CIV-T-23

Debtor.

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE MIDDLE DISTRICT OF FLORIDA

UNITED STATES TRUSTEE'S REPLY BRIEF

Martha L. Davis
General Counsel
Jeanne M. Crouse
Attorney
Executive Office for
United States Trustees
901 E Street, N.W., Ste. 780
Washington, D.C. 20530

Donald F. Walton
Acting U.S. Trustee

T. Patrick Tinker
Attorney
Office of the U.S. Trustee
4919 Memorial Hwy., Ste. 110
Tampa, FL 33634
(813) 243-5000

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ARGUMENT

I. THE APPELLEES' ASSERTION THAT INTEREST SHOULD BE AWARDED DATING FROM THE COMMENCEMENT OF THE CASE FINDS NO SUPPORT IN EITHER THE PUBLISHED CASE LAW OR THE LOWER COURTS' DECISIONS.

The Appellees assert that interest should be awarded to the trustee and trustee's counsel from the date that the petition was filed in the case. However, all of the published case law rejects that contention. Instead, those courts award interest from the date of the professionals' fee awards. See In re Riverside-Linden Inv. Co., 945 F.2d 320, 323-24 (9th Cir. 1991), aff'g In re Riverside-Linden Inv. Co., 99 B.R. 439 (Bankr. 9th Cir. 1989); In re Chiapetta, 159 B.R. 152, 159 (Bankr. E.D. Pa. 1993); In re Motley, 150 B.R. 16, 19 (Bankr. E.D. Va. 1992); In re Commercial Consortium of California, 135 B.R. 120, 127 (Bankr. C.D. Cal. 1991). Those courts' analysis follows from the statutory language of section 726(a)(5) and the related provisions, sections 507 and 503(b). The analysis is also consistent with the case law concluding that professionals employed on behalf of a bankruptcy estate have no right to the payment of compensation or interest until a court awards the fees. See, e.g., In re Child World, Inc., 185 B.R. 14, 15, 18 (Bankr. S.D.N.Y. Aug. 9, 1995); In re Caribou Partnership III, 152 B.R. 733, 741 (Bankr. N.D. Ind. 1993); In re Energy Coop., Inc., 95 B.R. 961, 966 (Bankr. N.D. Ill. 1988).

But it is not just the published cases and their statutory analysis that are contrary to the Appellee's position; both of the lower courts rejected the Appellees' argument as well.[1] The lower courts recognized that an award of interest from the petition date produces an absurd result: the professional would receive interest on his entire fee award from a date occurring before the provision of any services whatsoever. Indeed, the petition date in the instant case preceded the conversion of the case to chapter 7.

II. LIMITING INTEREST UNDER SECTION 726(a)(5) TO POST-AWARD COMPENSATION IS FULLY CONSISTENT WITH BANKRUPTCY PRACTICE.

In determining when interest should be awarded, the lower courts rejected the Riverside analysis, at least in part due to the frequent failure of the United States Bankruptcy Court for the Middle District of Florida to entertain interim fee applications under 11 U.S.C. § 331. Instead, the bankruptcy court in the Middle District waits

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[1] Regardless of their argument, the Appellees do not appear to be seeking compensation dating from the commencement of the case. At the conclusion of their Appellees' Brief, they request that the district court's judgment "be affirmed in all respects." The Appellees have not filed any cross-appeals.

until the conclusion of the case to award compensation. Interim fee applications would frequently serve little purpose in chapter 7 cases, where assets are not available for distribution until later in the case.

The Appellees describe the lower courts' decisions as presenting a "well-reasoned compromise," given the realities of practice in the Middle District of Florida, where interim fee applications would have been "futile." Appellees' Brief at 17, 21-22. However, a "compromise" with the applicable statutory provisions is not justified. While the courts must reject the Appellees' contention that the statute provides for interest from the date the petition was filed, the courts should nonetheless apply the rest of the statutory language, including the provisions of sections 503(b) and 507, to conclude that interest to professionals accrues from the date of any fee award.

Under the lower courts' decisions, section 726(a)(5) provides for an automatic award of statutory interest to the trustee and other professionals. The courts awarded interest from the dates of the trustee's appointment and the other professionals' various fee applications, in order to compensate for the delay in determining the fee awards. There is no discretion afforded to the bankruptcy court under section 726(a)(5). By contrast, in the appropriate circumstances, the bankruptcy court may properly exercise its discretion under section 330 to award compensation in an amount that reflects genuine, extensive delay that is not the fault of the professionals involved. In this very case, the court awarded compensation for much of the delay by incorporating the district court's award of interest into the bankruptcy court's section 330 award, and the United States Trustee does not dispute the latter award.

The Appellees' characterization of the section 330 compensation award is confused. According to the Appellees, the United States Trustee "insinuates that the Bankruptcy Court unwittingly doubled Trustee's counsel's 'compensation for delay in payment', when it awarded interest to Trustee's counsel under Section 726(a)(5)." Appellees' Brief at 28. Apparently, the Appellees view the bankruptcy court's award of the interest from the district court litigation as a conscious, well-founded determination of compensation under section 330. The United States Trustee neither agrees nor disagrees; the bankruptcy court did not expressly explain its duplication of interest. But that leaves open the real point being raised: Compensation for significant delay can be awarded outside section 726(a)(5), in the appropriate circumstances and within the discretion of the bankruptcy court under section 330, as we explained in our opening brief. Appellant's Brief at 16-17. To the extent that the bankruptcy court or the district court relied on their putative inability to award compensation for delay as part of the fee award process, that position is not supported by the facts of this case.[2]

CONCLUSION

For all of the foregoing reasons, the United States Trustee requests that the Court reverse the decision of the district court, and requests such additional or alternative relief as the Court considers just and equitable.

Respectfully submitted,

Martha L. Davis
General Counsel

Jeanne M. Crouse
Attorney
Executive Office for
United States Trustees
901 E Street, NW, Ste. 780
Washington, D.C. 20530
(202) 307-1399

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[2] We note that, although the Appellees state in their Summary of the Argument (Appellees' Brief at 8) that they dispute the contention that the interest award in this case exceeded the limits imposed by section 326, the Appellees do not discuss this issue anywhere in the body of their brief.

Donald F. Walton
Acting U.S. Trustee

Sara L. Kistler
Assistant U.S. Trustee

T. Patrick T

T. Patrick Tinker
Attorney
Office of the U.S. Trustee
4919 Memorial Hwy., Ste. 110
Tampa, FL 33634
(813) 243-5000

CERTIFICATE OF SERVICE

I hereby certify that on this 13th day of November, 1995, I have served the United States Trustee's Reply Brief by prepaid, first class United States Mail upon the following persons:

Lawrence S. Kleinfeld
8278 27th Avenue North
St. Petersburg, FL 33710

Jere M. Fishback
SouthTrust Bank Building, #1280
150-2nd Avenue North
St. Petersburg, FL 33701

Russell M. Blain
Stichter, Riedel, Blain & Prosser, P.A.
110 East Madison Street, Suite 200
Tampa, FL 33602-4700

Signed: T. Patrick T
T. Patrick Tinker
Office of the U.S. Trustee
4919 Memorial Hwy.
Suite 110
Tampa, FL 33634
Tel: (813) 243-5000
Fax: (813) 243-5022

(Attorney for U.S. Trustee)

BRIEF BANK — "SUMMARY SHEET" *Printed Thu-1/21/10 15:56*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*
Roy C. Gomez v. United State Trustee

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*
W.D. Va.

3. ("CCN") ***CURRENT*** CASE NO.
No.: 7:09-cv-00496-gec

4. ("PCN") ***PRIOR*** CASE NO. - & COURT *[IF ANY]*
No.: BK-09-72179
Court: Bankr. W.D. Va.
(Identify judge & cite, if any)

5. ("SO") ***SOURCE***
U.S. TRUSTEES

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*
Filed: January 19, 2010
Type: Brief for the United States Trustee, Appellee

7. **("AU") *PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*
Margaret K. Garber, John Robert Byrnes, Noah M. Schottenstein, W. Clarkson McDow, Jr.
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***
• Whether the bankruptcy court abused its discretion when it found the debtor's prior history of fraud and dishonesty established cause for the appointment of a chapter 11 trustee.

10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)

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District Court Case No. 7:09-cv-00496-GEC

IN THE UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF VIRGINIA

In re ROY C. GOMEZ
Debtor.

ROY C. GOMEZ,

Appellant,
v.

W. CLARKSON MCDOW, JR.,
UNITED STATES TRUSTEE
FOR REGION FOUR,

Appellee.

ON APPEAL FROM THE UNITED STATES BANKRUPTCY COURT
FOR THE WESTERN DISTRICT OF VIRGINIA
Bankruptcy Case No. 09-72179

BRIEF FOR THE UNITED STATES TRUSTEE, APPELLEE

RAMONA D. ELLIOTT	W. CLARKSON McDOW, JR.
General Counsel	United States Trustee
P. MATTHEW SUTKO	JOHN ROBERT BYRNES
Associate General Counsel	Assistant United States Trustee
NOAH M. SCHOTTENSTEIN	MARGARET K. GARBER
Trial Attorney	Trial Attorney
Executive Office for	Office for United States Trustee
United States Trustees	First Campbell Square
United States Department of Justice	210 First Street, S.W.
20 Massachusetts Avenue N.W.	Roanoke, Virginia 24011
Washington, D.C. 20530	Telephone: (540) 857-2699

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CASES

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STATEMENT OF APPELLATE JURISDICTION

This court has jurisdiction over this appeal pursuant to 28 U.S.C. § 158(a). The bankruptcy court's final order appointing a chapter 11 trustee was entered on October 16, 2009. The appellant's notice of appeal was timely filed on October 17, 2009, giving rise to this appeal.

STATEMENT OF THE ISSUES

Did the bankruptcy court err by appointing a chapter 11 trustee under 11 U.S.C. § 1104(a)(1) when it found that the debtor's conviction and forthcoming incarceration for two crimes of fraud and deception rendered him incapable of acting as a fiduciary for his bankruptcy estate?

STANDARD OF REVIEW

This court reviews the bankruptcy court's findings of fact for clear error and conclusions of law *de novo*. *Canal Corp. v. Finnman* (*In re Johnson*), 960 F.2d 396, 399 (4th Cir. 1992); *Travelers Ins. Co. v. Bryson Prop., XVIII* (*In re Bryson Prop., XVIII*), 961 F.2d 496, 499 (4th Cir. 1992). A bankruptcy court's order approving the appointment of a trustee is reviewed for abuse of discretion. *Comm. of Dalkon Shield Claimants v. A.H. Robins Co.,* 828 F.2d 239, 242 (4th Cir. 1987); *Fraidan v. Weitzman* (*In re Fraidan*), 43 F.3d 1466, 1994 WL 687306, at * 1 (4th Cir. 1994)("[T]he question here is not whether the court would have appointed a trustee had it been deciding the question in the first instance, but whether the bankruptcy court abused its discretion in appointing a trustee.").

STATEMENT OF THE CASE

On October 28, 2008, Roy C. Gomez was indicted by a grand jury empaneled in the United States District Court for the Western District of Virginia, Abingdon Division. *Transcript of hearing held on October 14, 2009, Exhibit 2.*[1] In each of its thirty-four counts, the indictment alleges that Gomez either acquired or attempted to acquire a controlled substance by misrepresentation, fraud, deception and subterfuge. *Id.*

On April 28, 2009, an information was filed adding two additional charges to those previously brought against Gomez. Count one of the information alleges that Gomez willfully failed to file reports of foreign bank accounts as required by law. *Tr. (October 14, 2009), Exhibit 3*. First, it alleges that Gomez failed to report that he had foreign financial accounts having a value greater than $10,000.00 over a three year period between 2005 and 2008. *Id.* Second, it alleges that Gomez wired funds in excess of $10,000.00 from the United States to his bank accounts in Singapore. *Id.* Finally, it alleges Gomez willfully violated the foregoing requirements while violating another law of the United States and as a part of a pattern of illegal activity. *Id.* Count two of the information alleges that Gomez willfully and knowingly filed a false tax return failing to reflect the financial transactions alleged in count one of the information. *Id.*

On April 28, 2009, a plea agreement between Gomez and the United States government was filed with this court. In that agreement, Gomez pled guilty to the charges in the indictment of obtaining controlled substances by fraud and both counts of the information. *Tr. (October 14, 2009), Exhibit 4*. Gomez stated that he was "...pleading guilty as described above because I am

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[1] References to court transcripts are indicated as *Tr. (October XX, 2009)* at __.

in fact guilty and because I believe it is my best interest to do so and not because of any threats or promises." *Id.* at 2. As part of the plea agreement, Gomez agreed to be sentenced to a period of confinement within the federal sentencing guidelines, the payment of $600,000 in lieu of forfeiture, the surrender of his medical license, and to never seek reinstatement of his medical license. *Id.*

On August 26, 2009, Gomez filed a voluntary, individual chapter 11 bankruptcy petition in the United States Bankruptcy Court for the Western District of Virginia. *In re Gomez*, No. 09-72179 (Bankr. W.D. Va. filed Aug. 26, 2009). On September 4, 2009, Gomez was sentenced to eight months of incarceration and two years of supervised release, *Tr. (October 14, 2009)* at 29, and on October 22, 2009, the debtor was confined to the Bureau of Prisons to begin serving his prison term.

After a review of the facts and circumstances surrounding this bankruptcy case, the United States Trustee filed a motion to appoint a chapter 11 trustee or to convert the case to chapter 7.[2] At the conclusion of the October 14, 2009, hearing on the motion to appoint or convert, the bankruptcy court found that cause existed to appoint a chapter 11 trustee pursuant to

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[2] United States Trustees are officials of the Department of Justice appointed by the Attorney General to supervise the administration of bankruptcy cases and trustees. See 28 U.S.C. 581-589; *In re Columbia Gas Sys., Inc.*, 33 F.3d 294, 296 (3d Cir. 1994) (United States Trustees oversee the bankruptcy process, protect the public interest, and ensure that bankruptcy cases are conducted according to law) (citing H.R. Rep. No. 95-595, 109 (1977)). "The United States Trustee is the 'watchdog' of the bankruptcy system * * * charged with preventing fraud and abuse and with 'fill[ing] the vacuum' caused by possible creditor inactivity." *Curry v. Castillo* (*In re Castillo*), 297 F.3d 940, 950 (9th Cir. 2002). Section 307 of the Bankruptcy Code authorizes the United States Trustee to appear and be heard on the propriety of retaining WEWR in this case. See 11 U.S.C. 307; *Stanley v. McCormick* (*In re Donovan Corp.*), 215 F.3d 929 (9th Cir. 2000) ("The United States trustee may * * * intervene and appear at any level of the proceedings from the bankruptcy court on, * * * as either a party or an amicus.") (internal quotation marks omitted).

11 U.S.C. § 1104(a)(1) because Gomez's conviction and incarceration for crimes of fraud and dishonesty called "into question Doctor Gomez's fitness to serve as a fiduciary in this case." *Tr. (October 14, 2009)* at 16.

Gomez subsequently filed a timely notice of appeal and a motion for a stay pending appeal. At the October 27, 2009, hearing on Gomez's motion for a stay, the bankruptcy court clarified that cause existed to appoint a chapter 11 trustee not just because Gomez had been convicted of a crime, but because the applicable charges involved fraud or deception as necessary elements of the crime, and the context and nature of Gomez's participation in the criminal activities warranted the finding. *Tr. (October 27, 2009)* at 21-23. Therefore, the bankruptcy court denied Gomez's motion for a stay pending appeal.

SUMMARY OF ARGUMENT

Section 1104(a)(1) of title 11 states that the court "shall order the appointment of a trustee . . . for cause, including fraud, dishonesty, incompetence, or gross mismanagement in the affairs of the debtor by current management, either before or after the commencement of the case." Roy Gomez was convicted of two crimes of fraud or dishonesty. After consideration of the crimes and the context in which they occurred, the bankruptcy court found that Gomez's history of fraud and dishonesty made him unfit to act as a fiduciary of his bankruptcy estate. For this reason, the bankruptcy court found cause to exist and held that a trustee must be appointed. Accordingly, the bankruptcy court did not abuse its discretion and its order appointing the chapter 11 trustee should be affirmed.

ARGUMENT

I. Statutory Framework

A bankruptcy court may appoint a chapter 11 trustee "for cause, including fraud, dishonesty, incompetence, or gross mismanagement in the affairs of the debtor by current management, either before or after the commencement of the case." 11 U.S.C. § 1104(a)(1). A court may also appoint a trustee "if such appointment is in the interests of the creditors." 11 U.S.C. § 1104(a)(2).

II. The bankruptcy court did not abuse its discretion when it found that Roy Gomez's prior history of fraud and dishonesty established cause for the appointment of a chapter 11 trustee.

A. A bankruptcy court is allowed to consider pre-petition conduct when determining if cause exists under section 1104(a)(1).

The plain language of § 1104(a)(1) and the law of the Fourth Circuit both direct the bankruptcy court to consider pre-petition conduct when determining if there is cause to appoint a trustee. Section 1104(a)(1) plainly contemplates the consideration of pre-petition misconduct, as it provides that the misconduct giving rise to cause may exist "either before or after the commencement of the case." 11 U.S.C. § 1104(a)(1). And the Fourth Circuit has affirmed the opinions of previous bankruptcy courts that have considered pre-petition misconduct of the debtor-in-possession. For example, in *Fraidan v. Weitzman* (*In re Fraidan*), 43 F.3d 1466, 1994 WL 687306 (4th Cir. 1994), the Fourth Circuit upheld the bankruptcy court's decision to appoint a chapter 11 trustee based upon a pre-petition conviction for theft and related dishonesty. In

Fraidan, the Fourth Circuit disregarded an argument parallel to the one that Gomez raises today: that the bankruptcy court had abused its discretion because there was no evidence of improper conduct in the bankruptcy case itself. Instead, the Fourth Circuit held that the dishonest conduct occurring prior to the bankruptcy sufficiently justified finding cause and the appointment of the trustee. *Id*. at *2. Accordingly, Gomez's contention that his felony convictions should not give rise to cause because they are "completely unrelated" to his bankruptcy case is entirely inconsistent with the plain meaning of the statute and the law of the Fourth Circuit. *Id*.

Furthermore, Gomez's re-characterization of his engagement in a three-year long scheme of fraudulent and dishonest criminal activity as "slight or immaterial" dishonesty is an unavailing attempt to establish credibility before the court. App. Br. at 5. The bankruptcy court was correct to consider Gomez's criminal convictions for fraud and dishonesty when determining if Gomez could be trusted to administer his property for the benefit of the estate and its creditors.

B. The bankruptcy court's determination that Roy Gomez could not meet his fiduciary duties as a debtor-in-possession is supported by the record.

The bankruptcy court did not commit error when it found that Gomez's crimes of fraud and dishonesty precluded his ability to serve as a fiduciary of the estate and required the appointment of a chapter 11 trustee.

A party seeking the appointment of a chapter 11 trustee pursuant to § 1104(a)(1) must show cause by a preponderance of the evidence. *Tradex Corp. v. Morse*, 339 B.R. 823, 829-30 (D. Mass. 2006). According to the Fourth Circuit, when making a finding of cause under § 1104(a)(1), a bankruptcy court should respect the "policy of flexibility [that] pervades the bankruptcy code with the ultimate aim of protecting creditors" and "due consideration must be given to the various interests involved in the bankruptcy proceeding." *Comm. of Dalkon Shield Claimants v. A.H. Robins Co., Inc.*, 828 F.2d 239, 242 (4th Cir. 1987). But upon a finding that cause exists, "there is no discretion; an independent trustee must be appointed." *In re V. Savino Oil & Heating Co., Inc.*, 99 B.R. 518, 525 (Bankr. E.D.N.Y. 1989).

When a debtor files for bankruptcy under chapter 11, all of its assets are transferred to a new legal entity — the estate. 11 U.S.C. § 541(a); *O'Dowd v. Trueger* (*In re O'Dowd*), 233 F.3d 197, 202 (3d Cir. 2000). At that time, the debtor becomes the "debtor-in-possession" and is responsible for administering the estate. 11 U.S.C. § 1107(a). The debtor-in-possession serves as a fiduciary to the estate and its creditors. *In re United Healthcare Sys., Inc.*, 200 F.3d 170, 177 n. 9 (3d Cir. 1999). The fiduciary obligations of the debtor-in-possession include "open, honest and straightforward disclosure to the Court and creditors . . . and the duty to protect and conserve property in its possession for the benefit of creditors." *In re Marvel Entm't Group, Inc.*, 140 F.3d 463, 474 (3d Cir. 1998) (internal citations omitted). As one bankruptcy court explained, the debtor-in-possession owes a duty of loyalty, which includes the avoidance of "self-dealing, conflicts of interest and the appearance of impropriety." *In re Bowman*, 181 B.R. 836, 843 (Bankr. D. Md. 1995).

The bankruptcy court found that Gomez's upcoming incarceration and the nature of the felonies upon which he was convicted established cause to appoint a chapter 11 trustee. *Tr. (October 14, 2009)* at 16. When reviewing the criminal records offered by the United States Trustee in support of its motion to appoint a chapter 11 trustee, the bankruptcy court carefully analyzed the elements of the crimes to which Gomez pled guilty. The bankruptcy court did not, as Gomez suggests, simply conclude that the felony convictions themselves constituted cause. As the record reflects, the bankruptcy court found that only two of the three crimes to which Gomez had pled guilty evidenced fraud, dishonesty or deception. *Id*. at 54. And as for the crimes that Gomez did commit, the bankruptcy court found that they "were not simply technical violations that he unfortunately was ensnared by and was not really personally guilty of much blame." *Id*. at 23. The bankruptcy court stated that the convictions "call into question Doctor Gomez's fitness to serve as a fiduciary in this case . . . I think that cause has been shown." *Id*. at 16. Because the bankruptcy court engaged in this careful review of the facts and its findings are supported by the record, the court did not abuse its discretion.

Gomez's remaining argument, that the bankruptcy court must find that the appointment is in the best interest of the creditors in order to find cause, appears to confuse 11 U.S.C. §§ 1104(a)(1) and (2). Section 1104(a)(1) lists "fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor by current management" as examples of cause, i.e., improper conduct, requiring the appointment of a trustee. 11 U.S.C. § 1104(a)(1). In contrast, the interests of the creditors are considered in a distinct inquiry under § 1104(a)(2). Because the bankruptcy court appointed the trustee pursuant to § 1104(a)(1), it was not required to find that the appointment of the trustee was in the interest of the creditors under § 1104(a)(2).

CONCLUSION

For these reasons, the United States Trustee respectfully asks this court to affirm the order entered below.

Respectfully submitted,

OF COUNSEL

RAMONA D. ELLIOTT
General Counsel
P. MATTHEW SUTKO
Associate General Counsel

W. CLARKSON McDOW, JR.
United States Trustee
JOHN ROBERT BYRNES
Assistant United States Trustee

By: /s/ Margaret K. Garber
MARGARET K. GARBER
Trial Attorney
Office for United States Trustee
First Campbell Square
210 First Street, S.W.
Roanoke, Virginia 24011
Telephone: (540) 857-2699

NOAH M. SCHOTTENSTEIN
Trial Attorney
Executive Office for United States Trustees
United States Department of Justice
20 Massachusetts Avenue NW
Washington, D.C. 20530

CERTIFICATE OF SERVICE

I hereby certify that on January 19, 2010 I electronically filed the foregoing with the Clerk of the Court and transmitted a true and correct copy through the electronic case filing system, and by first class mail, postage pre-paid, to the following:

Robert Tayloe Copeland
COPELAND & BIEGER PC
P. O. BOX 1296
ABINGDON , VA 24212
276-628-9525
Fax: 276-628-4711
Email: rcopeland@copelandbieger.com
Counsel for the Appellant

/s/ Margaret K. Garber
MARGARET K. GARBER
Trial Attorney

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WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE
[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]

In re Gootnick Family Trust (Wing Chiu Ng v. Office of the United States Trustee and Irwin Gootnick and Susan Gootnick)

2. ("CO") ***CURRENT*** COURT
[E.g., "CTA9"]

9st Cir.

3. ("CCN") ***CURRENT*** CASE NO.

No.: 07-16173

4. ("PCN") ***PRIOR*** CASE NO. & COURT
[IF ANY]

No.: 06-00412-SOM, 06-00540-SOM, 07-00042-SOM

Court: D. Haw.

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Paul W. Bridenhagen, P. Matthew Sutko, Carol K. Muranaka, Steven Jay Katzman

(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***

BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s)

&

√ Any Miscellaneous ***BACKGROUND***

• Whether the bankruptcy court erred in imposing monetary sanctions against Ng, either pursuant to Fed. R. Bankr. P. 9011 or, alternatively, its inherent power.

10. PATH TO FILE LOCATION:
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Appeal No. 07-16173

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

WING CHIU NG,

Appellant

v.

OFFICE OF THE UNITED STATES TRUSTEE;
IRWIN GOOTNICK and SUSAN GOOTNICK,

Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT COURT OF HAWAII

APPELLEE OFFICE OF THE UNITED STATES TRUSTEE'S ANSWERING BRIEF

STEVEN JAY KATZMAN
United States Trustee

CAROL K. MURANAKA
Assistant U.S. Trustee
Department of Justice
1132 Bishop Street, No. 602
Honolulu, Hawaii 96813
Telephone: (808) 522-8150
Fax: (808) 522-8156
General Counsel

Roberta DeAngelis
Acting General Counsel

PAUL W. BRIDENHAGEN
Attorney

Executive Office for
United States Trustees
20 Massachusetts Ave, NW
Washington, D.C. 20530
Telephone: (202) 307-1399
FAX: (202) 307-2397

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FOR THE NINTH CIRCUIT

No. 07-16173

WING CHIU NG,

Appellant

v.

OFFICE OF THE UNITED STATES TRUSTEE;
IRWIN GOOTNICK and SUSAN GOOTNICK,

Appellees.

APPELLEE OFFICE OF THE UNITED STATES TRUSTEE'S ANSWERING BRIEF

I. STATEMENT OF APPELLATE JURISDICTION

The bankruptcy court has jurisdiction over this chapter 7 case under 28 U.S.C. § 157(b) and issued a final order on June 26, 2006, granting the motion of the United States Trustee[1] for

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[1] The United States Trustee is an official of the United States Department of Justice, charged by statute with the duty to oversee and supervise the administration of bankruptcy cases. See 28 U.S.C. § 586(a). The United States Trustee is expressly given standing under 11 U.S.C. § 307 to raise and be heard on any issue under Title 11, except that the United States Trustee may not file a plan of reorganization under Chapter 11. *In re Castillo*, 297 F.3d 940, 950 (9th Cir.

sanctions against Eric Aaron Lighter ("Lighter") and Wing Chiu Ng ("Ng"). United States Trustee's Excerpts of Record ("UST EOR"), Vol. 1, Tab 1. Ng filed a timely notice of appeal on July 5, 2006. UST EOR Vol. 2, Tab 3. The district court had jurisdiction over that appeal under 28 U.S.C. § 158(a) and entered a final order affirming the bankruptcy court on May 17, 2007. Appellees Irwin and Susan Gootnick Excerpt of Record ("Gootnick EOR") at 45 - 67. Ng filed a *pro se* notice of appeal of the district court's order on June 14, 2007. UST EOR, Vol. 2, Tab 3. This Court has jurisdiction pursuant to 28 U.S.C. § 158(d).

2002).

II. ISSUE PRESENTED

Whether the bankruptcy court erred in imposing monetary sanctions against Ng, either pursuant to Fed. R. Bankr. P. 9011 or, alternatively, its inherent power.

III. STANDARDS OF REVIEW

The standard of appellate review for the bankruptcy court's order imposing sanctions under either Rule 9011 or its inherent power is abuse of discretion. *In re DeVille*, 361 F.3d 539, 547 (9th Cir. 2004). The standard of appellate review for the bankruptcy court's findings of fact is clear error and its conclusions of law are reviewed *de novo*. *In re Mantz*, 343 F.3d 1207, 1211 (9th Cir. 2003).

IV. STATEMENT OF THE CASE

This is an appeal from the district court's affirmance of the bankruptcy court's order imposing monetary sanctions pursuant to both Fed. R. Bankr. P. 9011 and the bankruptcy court's inherent power.[2] The bankruptcy court's order imposed a monetary sanction on the purported former trustee of the Trust, Lighter, and Ng, who was hired as counsel by Lighter to represent the Trust. Lighter has not appealed the district court's decision and only the sanctions as imposed on Ng are before this court. The bankruptcy court imposed sanctions because it found that Ng filed the case in bad faith, for an improper purpose and without an identifiable bankruptcy purpose.

Co-appellees, Irwin and Susan Gootnick, also defend the imposition of sanctions on Ng, pursuant to their motion, by the district court based on its finding that Ng's appeal was frivolous. The district court imposed sanctions in the amount of the Gootnick's attorneys fees related to the appeal, a matter addressed in co-appellees' brief and concerning which the United

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[2] The bankruptcy court granted the motions of the United States Trustee and the motion of co-appellees Irwin and Susan Gootnick. We defend only the former. We discuss the latter to give the court background to address the issues briefed here.

States Trustee does not comment herein. .

V. STATEMENT OF FACTS

This appeal is related to a civil lawsuit originally filed in California state court ("California Case") on May 18, 2005, by Irwin and Susan Gootnick, as individuals, and by Susan as trustee of the Gootnick Family Trust ("Trust"). Gootnick EOR at 1, ¶3. Appellant's Opening Brief, Appendix ("Appellant's Apx."), Tab 3, Exhibit 2. That lawsuit alleged that Eric Aaron Lighter, along with two companies controlled by him, defrauded the Gootnicks and improperly assumed control over the Trust and other Gootnick property. Appellant's Apx., Tab 3, Exhibit 2. The complaint sought a determination that the Gootnicks owned the disputed properties and that Susan Gootnick was the legitimate trustee. Appellant's Apx., Tab 3, Exhibit 2.

Lighter sought removal of that matter to the United States District Court for the Northern District of California, which was granted on July 7, 2005. Gootnick EOR, at 1, ¶3. Lighter then caused to be filed a motion to change venue for the lawsuit to the United States District Court for the District of Hawaii. Gootnick EOR, at 1, ¶3; UST EOR, Vol. 2, Tab 8, Dkt. 7 and 8. That motion was denied on November 9, 2005. Gootnick EOR, at 1 ¶3; Tab 8, Dkt. 43. The district court ordered Lighter to respond to the Gootnicks' complaint in the California Case by December 9, 2005. Gootnick EOR, at 1 - 2, ¶3; UST EOR, Vol 2, Tab 8, Dkt. 45.

On December 9, 2005, the date that Lighter was ordered to answer the complaint in the California Case, a chapter 11 bankruptcy petition (case no. 05-50023) was filed in the United States Bankruptcy Court for the District of Hawaii on behalf of the Trust under the name Quality Income Systems, Inc. ("QIS"), fka the Gootnick Family Trust. Gootnick EOR at 2, ¶3; UST EOR, Vol. 2, Tab 7. Ng filed the petition as attorney for the Debtor on behalf of Lighter, as the trustee of the Trust. *Id.* On December 21, 2005, Lighter caused to be filed a notice of automatic stay in the California Case, which identified Ng as counsel in the Hawaii bankruptcy and requested deferral of further proceedings and rulings. UST EOR, Vol. 2, Tab 8, Dkt. 53. On January 3, 2006, an adversary proceeding was filed by Ng in the bankruptcy case on behalf of QIS against Irwin and Susan Gootnick, challenging the Gootnicks' ownership and control of the Trust. UST EOR, Vol. 2, Tab 7, Dkt. 12.

The United States Trustee filed a motion to dismiss the QIS bankruptcy case under 11 U.S.C. § 1112(b) on the grounds that there was no entity to reorganize and that the petition was filed in bad faith. UST EOR, Vol. 2, Tab 7, Dkt. 23. Following a hearing on February 21, 2006, the bankruptcy court dismissed the QIS petition under section 1112(b) because (a) it was a two-party dispute; (b) it was filed without a legitimate bankruptcy purpose; and, (c) the filing of the case shortly after the denial of the venue motion in California district court evidenced bad faith. Gootnick EOR at 17 - 18, 24 - 26. The related adversary proceeding was also dismissed for lack of jurisdiction, as the main case was no longer pending. Gootnick EOR at 18, ll. 21 - 25. The bankruptcy court entered a written order incorporating its oral ruling on February 22, 2006. UST EOR, Vol. 2, Tab 7, Dkt. 43.

On February 15, 2006, six days prior to the hearing on the motion to dismiss in QIS, Ng filed a second bankruptcy petition in the United States Bankruptcy Court for the District of Hawaii on behalf of the Trust, this time under the name of the Gootnick Family Trust, aka Quality Income Systems, Inc. Gootnick EOR at 2, ¶6; UST EOR, Vol. 2, Tab 4. As in the QIS case, Ng filed the petition on behalf of Lighter, as the trustee for the Trust. UST EOR, Vol. 2, Tab 4. On February 21, 2006, Ng filed a notice of bankruptcy in the California Case in order to stay it. UST EOR, Vol. 2, Tab 8, Dkt. 64.

On March 13, 2006, less than one month after commencing this second bankruptcy case in Hawaii, Ng filed a motion to transfer that case to the Northern District of California. UST EOR, Vol. 2, Tab 4, at Dkt. 17. On March 29, 2006, in the California Case, Lighter's attorney filed a letter brief requesting the imposition of the automatic stay in that case based on the bankruptcy filing of the Gootnick Family Trust bankruptcy. Gootnick EOR at 2, ¶7; UST EOR, Vol. 2, Tab 8, at Dkt. 72. Ng executed an affidavit in support of that motion. UST EOR, Vol. 2, Tab 8, at Dkt. 86. On April 14, 2006, the district court in the California Case denied the motion for a stay. UST EOR, Vol. 2, Tab 8, at Dkt. 88. On April 17, 2006, three days after the district court in the California Case denied the motion to impose the stay, Ng filed an ex parte motion in the Gootnick Family Trust case in Hawaii to "Honor" the stay , asking the bankruptcy court to enforce the automatic stay in the California Case. UST EOR, Vol. 2, Tab 6, Dkt. 29. The United States Trustee opposed this motion on the grounds that the district court in the California Case had already denied the same request. UST

EOR, Vol. 2, Tab 6, Dkt. 41. The stay motion was denied by the Hawaii bankruptcy court orally at a hearing held on May 17, 2006, UST EOR, Vol. 2, Tab 6, Dkt. 57, and a formal order was entered denying the stay on June 1, 2006. UST EOR, Vol. 2, Tab 6, Dkt. 71.

On May 15, 2006, the United States Trustee filed a motion for sanctions against both Ng and Lighter, pursuant to 11 U.S.C. § 105(a) and Rule 9011 of the Federal Rules of Bankruptcy Procedure. UST EOR, Vol. 2, Tab 6, Dkt. 48. At a June 14, 2006 hearing, the bankruptcy court granted the United States Trustee’s motion for sanctions, finding that the sole purpose of the filing of the second bankruptcy case on behalf of the Trust was to obstruct improperly the litigation in the California Case and to invoke the automatic stay where none really existed. UST EOR, Vol. 2, Tab 2 at 4. The bankruptcy court further found that second bankruptcy case served no valid bankruptcy purpose, as the debtor was not eligible for a discharge and creditors would not benefit, as the only real creditors were taxing authorities, which had the ability to pursue collection of taxes on their own outside bankruptcy. UST EOR, Vol. 1, Tab 2 at 4-5. The court imposed the sanctions against Lighter and Ng jointly and severally. UST EOR, Vol. 1, Tab 2 at 18. The bankruptcy court entered a written order imposing the sanctions on June 26, 2006. UST EOR, Vol. 2, Tab 1.

On appeal, the district court ruled that Lighter and Ng failed to demonstrate that the bankruptcy court's finding of bad faith was clearly erroneous, or that the imposition of sanctions was an abuse of discretion. Gootnick EOR at 57 - 58. The district court held that the bankruptcy court did not clearly err in finding bad faith and in finding that the bankruptcy case was filed for the sole purpose of obstructing the litigation in the California Case. Gootnick EOR at 57 - 58. These findings, it concluded, were supported by "the timing of the filing of the underlying case, the bad faith QIS bankruptcy filing, the filing of an adversary proceeding raising the same issues being litigated in the California civil case, and the lack of a legitimate bankruptcy purpose." UST EOR, Vol. 1, Tab 2 at 14. The district court agreed with the bankruptcy court that the alleged tax issues did not justify the bankruptcy. *Id.*

VI.SUMMARY OF ARGUMENT

The bankruptcy court's order finding that Lighter and Ng deserved sanctions for filing in "bad faith" and for the "sole purpose of obstructing the litigation in the District Court in San Francisco and attempting to invoke an automatic stay where none really exists," merits affirmance because the court's findings are not clearly erroneous. As the record below amply demonstrates, the filing was part of a thoughtfully planned sequence of abusive legal maneuvers designed by Lighter and Ng to disrupt the California Case.

Given its express findings of bad faith and improper purpose, the bankruptcy court was well within its discretion under Ninth Circuit precedent to sanction Ng pursuant to both its inherent power and Fed. R. Bankr. P. 9011 for his abuse of the bankruptcy system. In his brief to this Court, Ng has marshaled no factual or legal arguments that demonstrate that the lower courts' level of clear error. Consequently, the bankruptcy court's findings were to imposed a sanction of $3,800 was not an abuse of discretion.

VII. ARGUMENT

The Bankruptcy Court's Findings That Lighter and Ng Filed The Second Case In Bad Faith And For The Improper Purpose Of Obstructing The California Case Are Not Clearly Erroneous.

The filing of a bankruptcy case to impede, delay, forum shop, or to obtain a tactical advantage regarding litigation in a non-bankruptcy forum is evidence of bad faith - whether that non-bankruptcy forum is a state court or a federal district court. *See Chambers v. NASCO, Inc.*, 501 U.S. 32 (1991) (sustaining the imposition of sanctions for abusive litigation tactics); *In re Silberkraus*, 253 B.R. 890, 905 (Bankr. C.D. Cal.

2000), aff'd 336 F.3d 864 (9th Cir. 2003). *See also Hernandez v. City of El Monte*, 138 F.3d 393, 398 (9th Cir. 1998) (bad faith abuse of process includes judge-shopping).

Courts can properly find bad faith in the filing of a petition by considering such factors as the timing of the petition, a delay of non-bankruptcy litigation and the lack of anything to reorganize, which suggests the debtor's intent in filing was to use the Bankruptcy Code as a means to escape to a forum perceived to be more friendly. *See In re St. Paul Self-Storage Ltd. Partnership*, 185 B.R. 580, 584 (BAP 9th Cir. 1995) (finding bad faith justifying dismissal). *See also Trident Assoc. Ltd. Partnership v. Metropolitan Life Insurance Co.* (*In re Trident Assoc. Ltd.), 52 F.3d 127, 131* (6th Cir. 1995) (filing of bankruptcy as a litigation tactic constitutes bad faith); *Phoenix Piccadilly, Ltd. v. Life Ins. Co. (In re Phoenix Piccadilly, Ltd.)*, 849 F.2d 1393, 1394 (11th Cir. 1988) (same).

Based upon the record before it, the bankruptcy court did not err in finding that this bankruptcy case was filed in bad faith and for an improper purpose. UST EOR, Vol. 1, Tab 2 at 4. The bankruptcy court concluded that Lighter and Ng filed this case for the improper purpose of disrupting non-bankruptcy litigation. The court found, as trier of fact, that the case was part of an improper scheme to impede the prosecution of the California Case. UST EOR, Vol. 1, Tab 2 at 4 - 5. The record provides substantial evidence to support the bankruptcy court's findings.

First, the record below reveals that the bankruptcy filing was one of a series of at least six pleadings in which Lighter and Ng attempted, in the substance and timing of those pleadings, to disrupt the California Case. Those pleadings included: 1) Lighter's motion to transfer venue of the California Case to the District of Hawaii;[3] 2) the filing of the first bankruptcy

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[3] Gootnick EOR at 1 - 2, ¶3.

petition on behalf of the Trust in the name of Quality Income Systems, Inc., on the date Lighter's answer to the complaint in the California case was due;[4] 3) the filing of the second case on behalf of the Trust, under the name In re Gootnick Family Trust aka Quality Income Systems, Inc., five days before the hearing on the motion to dismiss the first case;[5] 4) the motion to transfer the second case to the Northern District of California;[6] 5) the motion in the California Case for the imposition of the automatic stay due to the filing of the second bankruptcy case;[7] and, 6) moving three days after the denial of the requested stay in the California Case to have the Hawaii bankruptcy court impose the stay on the California Case. The evidence of such tactics demonstrate that the

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[4] Gootnick EOR at 1 - 2,¶3; UST EOR, Vol. 2, Tab 7 at Dkt. 1.

[5] UST EOR, Vol. 2, Tab 6, at Dkt. 1, 3.

[6] UST EOR, Vol. 2, Tab 6, at Dkt. 17.

[7] UST EOR, Vol. 2, Tab 6 at Dkt. 72; Gootnick EOR at 1, ¶7.

bankruptcy court did not err in finding that Lighter, with Ng's assistance, attempted in the substance and timing of those pleadings, to disrupt the California Case. UST EOR, Vol. 1, Tab 2 at 4 - 5.

Second, the bankruptcy court did not commit error in finding that Ng filed the second bankruptcy case in an effort to remove a two-party dispute to bankruptcy court to delay non-bankruptcy litigation. UST EOR, Vol. 1, Tab 2, at 4. *See In re St. Paul Self-Storage Ltd. Partnership*, 185 B.R. at 584 (considering the two party nature of dispute as weighing in favor of a finding of bad faith). The court found that this case essentially involved a two-party dispute between Lighter, Ng, and their related entities on one side and the Gootnicks and their related entities on the other. UST EOR, Vol. 1, Tab 2, at 14 - 15. This factor is often considered by courts to weigh in favor of finding bad faith. *See In re C-TC 9th Ave. Partnership*, 113 F.3d 1304, 1311-12 (2d Cir. 1997); *In re Laguna Assoc. Ltd.*

Partnership, 30 F.3d 734, 738 (6th Cir. 1994); *Matter of Little Creek Dev. Co.*, 779 F .2d 1068, 1073 (5th Cir. 1986).

Third, the record below makes clear that the bankruptcy court did not commit clear error by finding that it could not "see any legitimate bankruptcy purpose for [Ng's] commencement of this case[.]" UST EOR, Vol. 1, Tab 2 at 4 - 5. The Debtor was not an individual eligible to receive a Chapter 7 discharge. *See* 11 U.S.C. § 727(a). The filing would not enable an equitable distribution of assets to creditors since the threshold issue of who owns and controls the assets was still to be determined. Therefore, the bankruptcy did not serve either of the two primary purposes of bankruptcy. *See Sherwood Partners, Inc. v. Lycos, Inc.*, 394 F.3d 1198, 1203 (9th Cir. 2005) (chapter 7 embodies two ideals: (1) giving the individual debtor a fresh start, by giving him a discharge of most of his debts; and (2) equitably distributing a debtor's assets among competing creditors).

Each of these three independent findings would have justified the relatively modest sanction of $3,800 imposed on Ng. Collectively, they underscore why it was well within the bankruptcy court's discretion under *Chambers v. NASCO, Inc.*, 501 U.S. 32 (1991) and Fed. R. Bankr. P. 9011. Ng's argument that the filing of the petition stemmed from unresolved tax issues, Appellant's Brief at 26 - 27, falsely suggests that the alleged tax claims were separate from the dispute with the Gootnicks and therefore legitimized the bankruptcy filing by avoiding the "two-party dispute" label. Both the bankruptcy and district courts found this unpersuasive. The bankruptcy court rejected this argument, stating "[t]axing authorities have plenty of weapons in their arsenal to enforce their claims outside of bankruptcy, so they wouldn't be benefitted by the bankruptcy either." UST EOR, Vol. 1, Tab 2 at 4. The district court agreed. Gootnick EOR at 57 - 58. Thus, even assuming the existence of tax claims, the case still essentially involved the dispute between Lighter and Ng on one side and the Gootnicks on the other. Such disputes should be resolved through the normal litigation process in their original forums, and it is bad faith to file bankruptcy instead of continuing with the normal litigation process in the non-bankruptcy forums. *In re Silberkraus*, 253 B.R. at 906 (Bankr. C.D. Cal. 2000), aff’d, 336 F.3d 864 (9th Cir. 2003).

The bankruptcy court reviewed the second Gootnick Family Trust bankruptcy filing in the context of the California Lawsuit UST EOR, Tab 2 at 4 - 5, 14 - 15) and the previous bankruptcy case of *Quality Income Systems, Inc.* (UST EOR, Vol. 1, Tab 2 at 4-5). With the record outlined above, the bankruptcy court did not clearly err in finding that the filing of the petition in this case was in bad faith. . . . .

B.The Court Did Not Abuse Its Discretion In Exercising Its Inherent Power To Sanction Parties For Bad Faith Conduct And Engaging In An Abuse Of Process.

The bankruptcy court imposed sanctions based upon its finding that the sanctioned parties acted in "bad faith." UST EOR, Vol. 1, Tab 2 at 5. Given that finding, Supreme Court and authority in this Court's precedents make clear the bankruptcy court possessed inherent authority to impose monetary sanctions in this case. *Chambers v. NASCO, Inc.,* 501 U.S. 32 (1991). In *Chambers*, the U.S. Supreme Court affirmed a federal court's imposition of monetary sanctions in the form of compensatory attorney fees based on the court's "inherent authority" to sanction certain kinds of misconduct. The Supreme Court specifically held that federal courts are not limited to the sanctions permitted or required by express statutes and rules, but may impose sanctions pursuant their inherent authority.

As *Chambers* held, courts are not limited to the sanctions permitted or required by express statutes and rules. To the contrary, they possess "inherent" authority to redress misconduct:

"Courts of justice are universally acknowledged to be vested, by their very creation, with power

> to impose silence, respect, and decorum, in their presence, and submission to their lawful mandates." *Anderson v. Dunn,* 6 Wheat. 204, 227, 5 L.Ed. 242 (1821); *see also Ex parte Robinson,* 19 Wall. 505, 510, 22 L.Ed. 205 (1874). These powers are "governed not by rule or statute but by the control necessarily vested in courts to manage their own affairs so as to achieve the orderly and expeditious disposition of cases." *Link v. Wabash R. Co.,* 370 U.S. 626, 630-631, 82 S.Ct. 1386, 1388-1389, 8 L.Ed.2d 734 (1962).

501 U.S. at 43.

This Court similarly has held that a federal court's inherent power to sanction extends to the bankruptcy court. In *In DeVille v. Cardinale (In re DeVille),* 361 F.3d at 550 - 51, this Court held that where rules and statutes are inadequate to sanction the misconduct of an attorney who, in bad faith, files bankruptcy-related notices to delay a state court trial, the bankruptcy court may safely rely on its inherent power. *See also In re Rainbow Magazine, Inc.*, 77 F.3d 278, 282 (9th Cir. 1996)(bankruptcy courts have inherent power to sanction vexatious conduct) (individual in control of chapter 7 debtor sanctioned for bad faith filing of petition).

Ng was sanctioned for his bad faith conduct based solely upon the lower court's finding there was no legitimate purpose for the filing of the bankruptcy case, UST EOR, Vol. 1, Tab 2 at 4 - 5, which represented nothing other than an improper tactic designed solely to subvert the ongoing California district court litigation. UST EOR, Vol. 1, Tab 2 at 4. As outlined above, the *Gootnick Family Trust* bankruptcy filing was one of a series of pleadings in which Ng attempted to disrupt the California Case. Because Ng filed the Gootnick Family Trust bankruptcy petition in bad faith and for an improper purpose, the bankruptcy court was well within its inherent powers and its discretion to award sanctions and the district court properly affirmed.

C. The Bankruptcy Court Did Not Abuse Its Discretion By Imposing Sanctions, In the Alternative, Under Fed. R. Bankr. P. 9011.

Rule 9011 of the Federal Rules of Bankruptcy Procedure provides for sanctions against parties who sign, file, submit, or later advocate a bankruptcy petition. Fed. R. Bankr. P. 9011(c).

While invocation of a federal court's inherent power to sanction requires a finding of bad faith, the imposition of Rule 9011 sanctions, on the other hand, requires only a showing of objectively unreasonable conduct. Rule 9011(c) therefore allows a bankruptcy court to sanction attorneys, parties, and individuals that file bad-faith documents before the court. *In re Rainbow Magazine, Inc.*, 77 F.3d 278, 282 (9th Cir. 1996) (bankruptcy courts have discretion under Rule 9011 to sanction a party who files an incomplete document).

In addition to the bankruptcy court's invocation of its inherent powers, the bankruptcy court possessed ample discretionary authority under Rule 9011(c) to sanction Ng. The bankruptcy court found that Lighter and Ng caused the filing in bad faith and for the improper purpose of obstructing the California Lawsuit. UST EOR, Vol. 1, Tab 2 at 4 - 5. Ng has made no effort in his brief to this Court to refute the sequence of pleadings, outlined above, in which he, as counsel for the Trust, repeatedly attempted to delay the California Case. The court found that as with the *QIS* case, the *Gootnick Family Trust* case was filed to obstruct pending litigation and attempt to invoke the automatic stay where none existed. *Id.* Under the circumstances of this case, the bankruptcy court was well within its discretion in awarding sanctions and the district court properly affirmed.

Ng argues that the bankruptcy court applied the wrong standard in finding bad faith. Appellant's Brief at 13 - 16. Specifically, he cites *In re Marsch*, 36 F.3d 825, 829 (9th Cir. 1994), for the proposition that a determination of bad faith must be based on express findings of both improper purpose and frivolousness. Appellant's Brief at 14. Ng argues that both the bankruptcy and district courts failed to make any finding on frivolousness. *Id.* His argument in this regard is unavailing for three reasons.

First, Ng's initial premise is incorrect. *Marsch* does not make a finding of bad faith contingent on an analysis of improper purpose and frivolousness. Rather, it specifies the analysis necessary for the imposition of sanctions pursuant to Rule 9011. See *Marsch*, 36 F.3d at 830.

Second, contrary to Ng's contention, the bankruptcy court's finding that there was no legitimate purpose for the filing of the bankruptcy case in this matter easily satisfies the frivolousness prong of the Rule 9011 analysis.

Third, contrary to what Ng suggests, *Marsch*, does not merely require findings on both these criteria, but rather requires a relative assessment of each on a sliding scale, such that "the more compelling the showing as to one element, the less decisive need be the showing as to the other." *Appellant's Brief at 14* (quoting *Marsch*, 36 F.3d at 830). Consequently, *Marsch* does not provide any benefit to Ng in this matter. For the reasons set for the above, the record below makes a strong showing with respect to the improper purpose behind the filing of the bankruptcy petition and Ng’s argument that the filing was justified for tax reasons is flimsy at best.

Finally, even if Ng could successfully argue that the record does not support the imposition of sanctions pursuant to Rule 9011, the bankruptcy court’s monetary sanctions would nonetheless be sustainable in the alternative under its inherent power, which requires only a showing of bad faith, which is palpably evident in this record. *Chambers v. NASCO, Inc.*, 501 U.S. at 43.

VIII. CONCLUSION

For these reasons, the United States Trustee respectfully asks that the Court affirm the district court’s order affirming the bankruptcy court’s order imposing sanctions of $3,800 on Ng.

DATED: November 13, 2007.

Respectfully submitted,

STEVEN JAY KATZMAN
United States Trustee

PAUL W. BRIDENHAGEN
Attorney
Executive Office for United States Trustees
20 Massachusetts Ave, NW
Washington, D.C. 20530
Telephone: (202) 307-1399
FAX: (202) 307-2397

BRIEF BANK — "SUMMARY SHEET"

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WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	Estate of Julius Gray by Jeanine Gray, Surviving Spouse and Heir v. Daniel M. McDermott, United States Trustee
2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	E.D. Mich.
3. ("CCN") ***CURRENT*** CASE NO.	No.: 10-14412-SFC
4. ("PCN") ***PRIOR*** CASE NO. - & COURT *[IF ANY]*	No.: 10-67918-MBM Court: Bankr. E.D. Mich. *(Identify judge & cite, if any)*
5. ("SO") ***SOURCE***	**U.S. TRUSTEES**
6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	Filed: February 10, 2011 Type: Brief of Appellee, Daniel M. McDermott, United States Trustee
7. **("AU")** ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*	David K. Foust, Wendy Cox, P. Matthew Sutko, Ramona D. Elliott, Daniel M. McDermott *(UST/OGC: 202-307-1399/FAX-2397)*
8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	• Whether a decedent's Probate estate may file a petition for protection under the Bankruptcy Code.
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UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF MICHIGAN

In re:

ESTATE OF JULIUS GRAY by JEANINE GRAY, SURVIVING SPOUSE AND HEIR,

Debtor.

Case No. 10-67918-MBM

Chapter 7

HON. MARCI B. McIVOR
United States Bankruptcy Judge

ESTATE OF JULIUS GRAY by JEANINE GRAY, SURVIVING SPOUSE AND HEIR,

Appellant,

v.

DANIEL M. McDERMOTT,
United States Trustee,

Appellee.

Case No. 10-14412-SFC

HON. SEAN F. COX
United States District Judge

ON APPEAL FROM THE UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF MICHIGAN

BRIEF OF APPELLEE, DANIEL M. McDERMOTT, UNITED STATES TRUSTEE

RAMONA D. ELLIOTT
General Counsel

P. MATTHEW SUTKO
Associate General Counsel

WENDY COX
Trial Attorney
Executive Office for
United States Trustees
Department of Justice
20 Massachusetts Avenue, N.W.
Washington, D.C. 20530
Phone: (202) 307-1399
Fax: (202) 307-2397

DANIEL M. McDERMOTT
United States Trustee for Region 9

DAVID K. FOUST (P23450)
Trial Attorney
David.K.Foust@usdoj.gov
Office of the United States Trustee
Department of Justice
221 West Fort St. - Suite 700
Detroit, Michigan 48226
Phone: (313) 226-7954
Fax: (313) 226-7952

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STATEMENT CONCERNING ORAL ARGUMENT

The United States Trustee does not believe oral argument would materially assist this Court in determining this appeal, but stands ready to participate should this Court schedule it for argument.[1]

JURISDICTIONAL STATEMENT

This appeal is taken from a final order that the bankruptcy court entered on October 18, 2010, granting the United States Trustee's motion to dismiss Appellant's chapter 7 bankruptcy case. The Appellant filed a timely notice of appeal under 28 U.S.C. § 158(c)(2) and Fed. R. Bankr. P. 8002(a) on November 2, 2010. This Court has jurisdiction over this appeal under 28 U.S.C. § 158(a)(1).

STATEMENT OF THE ISSUE

The issue on appeal is whether a decedent's probate estate may file a petition for protection under the Bankruptcy Code.

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[1] The United States Trustee is an official of the United States Department of Justice appointed by the Attorney General to supervise the administration of bankruptcy cases. 28 U.S.C. §§ 581-589. "The United States trustee may raise and may appear and be heard on any issue in any case or proceeding under this title but may not file a plan pursuant to section 1121(c) of this title." 11 U.S.C. § 307. *See also Morgenstern v. Revco D.S., Inc. (In re Revco D.S., Inc.)*, 898 F.2d 498, 500 (6th Cir. 1990) (construing section 307).

STANDARD OF REVIEW

This appeal presents a question of law. This Court reviews questions of law de novo. *See, LPP Mortgage, LTD. v. Brinley (In re Brinley),* 547 F.3d 643, 647 (6th Cir. 2008).

STATEMENT OF THE CASE

This is an appeal from a bankruptcy court order which dismissed the Chapter 11 bankruptcy petition filed by the Estate of Julius Gray ("the Estate"), on the grounds that a probate estate is ineligible to be a debtor under the Bankruptcy Code. The parties dispute whether a decedent's probate estate may, as a matter of law, file a petition for protection under the Code. The U.S. Trustee argues on appeal that the lower court's holding should be affirmed in these proceedings.

STATEMENT OF FACTS

Julius Gray purchased real property located at 20946 Richmond Drive, Northville, Michigan 48167 ("the Real Property") in June of 2007. Mr. Gray's wife, Jeanine Gray, was not included on the title documents for the Real Property, nor was Mrs. Gray liable for either of the two mortgages on the property - a $1,000,000.00 first mortgage held by Fifth Third Mortgage-MI LLC ("the Bank"), and a $100,000.00 home equity line of credit held by Chase Bank. Mr. Gray - the only individual liable on the two mortgages - died on April 3, 2009. [The Estate's Brief, Doc. No. 16, ¶ 1 and 2].

Despite a sizeable amount of passive income, Mrs. Gray fell behind on the mortgages secured by the Real Property after her husband's death.[2] Negotiations between Mrs. Gray and the Bank continued off and on for the next year and a half, with no resolution between the parties reached. [The Estate's Brief, Doc. No. 16, ¶ 7].

In the meantime, Mr. Gray's estate ("the Estate") was fully probated in a Michigan state court and the Estate was found to be insolvent; its only asset was the Real Property, which by now was worth less than the debts owed on the two mortgages. [The Estate's Brief, Doc. No. 16, ¶ 4].

With no resolution achieved between Mrs. Gray and the Bank, and with arrearage amounts owed on the Real Property, a foreclosure sale was set for the Real Property at 10:00 a.m. on September 7, 2010 - roughly a year and a half after Mr. Gray's death. [The Estate's Brief, Doc. No. 16, ¶ 7]. Just before that sale, however, the Estate filed a Chapter 11 petition in the Eastern District of Michigan Bankruptcy Court. [*See* E.D. Mich. Bankr. Case No. 10-67918-MBM, Doc. No. 1]. For reasons more fully explained below, on September 10, 2010 the United States Trustee filed a motion to dismiss the Estate's bankruptcy petition [Doc. No. 8], arguing that the Estate was ineligible to be a "debtor" as defined in the Bankruptcy Code.[3] The

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[2] [The Estate's Brief, Doc. No. 16, ¶ 3] describes passive monthly income for Mrs. Gray in the amount of $13,600.00 - including, $4,100.00 per month in social security benefits, and $4,500.00 per month from a trust set up with insurance proceeds related to Mr. Gray's death.

[3] Pursuant to 11 U.S.C. § 307, "[t]he United States trustee may raise and appear and be heard on any issue in any case or proceeding under this title but may not file

Bankruptcy Court held a hearing on the United States Trustee's motion on October 12, 2010. An order granting the U.S. Trustee's motion was entered on October 18, 2010 [Doc. No. 24], and on November 1, 2010 the Estate filed a timely appeal. [Doc. No. 29].

The Estate has a second appeal pending in this case. On September 27, 2010, Fifth Third Bank filed its Motion to Dismiss Chapter 11 Case and to Declare the Automatic Stay Void Nunc Pro Tunc [Doc. No. 20]. The Estate filed its Response on October 18, 2010 [Doc. No. 25] and a hearing was held on November 6, 2010. On November 18, 2010, the Bankruptcy Court entered its Order Declaring Automatic Stay Void Nunc Pro Tunc [Doc. No. 35]. The Estate filed a timely appeal of this order on December 2, 2010. [Doc. No. 41]. The United States Trustee is not a party to this appeal and takes no position on the issue involved.

SUMMARY OF ARGUMENT

The relevant facts of the record below are not in dispute between the parties to this appeal. Rather, the central question to this appeal is one of law: whether a probate estate can file a petition for relief under the Bankruptcy Code. The plain language of the Bankruptcy Code does not allow them to be debtors, or to file bankruptcy petitions. And the case law considering this question has uniformly held

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a plan [in a Chapter 11 case]." See also *In re Revco D. S., Inc.,* 898 F. 2d 489 (6th Cir. 1990).

they cannot. Because the Bankruptcy Code does not allow estates to be debtors, the bankruptcy court's order dismissing this case should be affirmed.

ARGUMENT

A Probate Estate May not File for Protection Under the Bankruptcy Code.

The Bankruptcy Court dismissed the Estate's petition for relief, holding that a probate estate could not file for bankruptcy protection under the Code. [Doc No. 24] As no error exists in that holding as a matter of law, this Court should affirm.

Under the Bankruptcy Code, only a "person" is entitled to be a debtor under Chapter 11. 11 U.S.C. § 109(d). "Person" is a defined term within the Code, and has the following meaning:

> The term "person" includes individual, partnership, and corporation, but does not include [certain governmental units]. . . .

11 U.S.C. § 101(41). As noted by the Eleventh Circuit, "the Code does not *exclude* decedents' estates from the definition of 'person'; Congress' use of the word 'includes' in the definition of 'person' means that the definition is not limiting." *In re Goerg*, 844 F.2d 1562, 1566 (11th Cir. 1988)(emphasis in original). However, the Code separately defines the term "entity" to *include* estates. *See* 11 U.S.C. § 101(15) ("the term 'entity' includes person, estate, trust, or government unit, and the United States trustee"). In light of this definition, *Goerg* held as follows:

> If Congress had intended "person" to include "estate," there would have been no reason to list "estate" separately in the definition of "entity."

Goerg, 844 F.2d at 1566.

Congress' exclusion of probate estates from the definition of "person" was no mere oversight. Rather, Congress expressly recognized that "[t]he definition [of person] does not include an estate or a trust, which are included only in the definition of 'entity[.]'" H.R. Rep. No. 595, 95th Cong., 1st Sess. 313 (1977), *reprinted* in 1978 U.S.Code Cong. & Admin.News 5963, 6270; S.Rep. No. 989, 95th Cong., 2d Sess. 25 (1978), *reprinted in* 1978 U.S.Code Cong. & Admin.News 5787, 5811. Therefore, Congressional omission of probate estates from the definition of a "person" under the Code was intentional.

Federal courts have cited several "reasons why the probate estate of a decedent should be ineligible to initiate a request for relief under the Bankruptcy Code." *In re Estate of Roberts*, 2005 WL 3108224, *1 (Bankr. D. Md. Aug. 15, 2005). The *Estate of Roberts* court elaborated as follows:

> While an authorized representative of a probate estate may be an individual, he or she is not a debtor seeking a fresh start. Because the represented principal here is a probate estate, there is no fresh start available[.]

Id. at *1. Federal courts also rely upon the fact that "probate systems developed by the individual states are a comprehensive and specialized machinery to administer such estates." *In re Walters*, 113 B.R. 602, 604 (Bankr. D.S.D. 1990).

For these reasons, as the Estate concedes in its brief [Doc. No. 16], each and every federal court to consider the issue has held that a probate estate is not eligible to file a petition for relief under the Bankruptcy Code. *See In re Goerg*, 844 F.2d at 1566 (". . . the Code's definition of 'person,' and therefore its definition of 'debtor,' excludes insolvent decedents' estates. Other courts that have addressed this question have uniformly embraced this view")[4]; *see also Estate of Roberts*, 2005 WL 3108224, *2; *Walters*, 113 B.R. at 604; *In re Hancock*, 2009 WL 2461167 (Bankr. N.D. Okl. Aug. 10, 2009); *In re Seegers*, 2009 WL 2883019 (Bankr. D.D.C. July 30, 2009); *In re Estate of Patterson*, 64 B.R. 807 (Bankr. W.D. Tex. Sept. 9, 1986); *In re Jarrett*, 19 B.R. 413 (Bankr. M.D.N.C. 1982); *In re Estate of Brown*, 16 B.R. 128 (Bankr. D.D.C. 1981); *Matter of 299 Jack-Hemp Assocs.*, 20 B.R. 412 (Bankr. S.D.N.Y. 1982); *In re Bunch*, 249 B.R. 667 (Bankr. D. Md. 2000); *In re Perkins*, 381 B.R. 530 (Bankr. S.D Ill. 2007).

Arguing that the Court should nonetheless reverse the Bankruptcy Court's holding below, the Estate cites several cases which are not controlling of the issues in this appeal. As the Estate argues, "bankruptcy laws have always allowed for representatives of business trusts, guardians for incompetent individuals and representatives acting pursuant to a power of attorney to file petitions." [Appellant's Br., Doc. No. 16, p.6, citing *In re Kenneth Allen Knight Trust*, 303 F.3d 671 (6th Cir. 2002); *In re Zawisa*, 73 B.R. 929 (E.D. Pa. Bankr. 1987); *In re Gridley*, 131 B.R. 447 (D.S.D. Bankr. 1991)]. While true, the Code specifically includes these entities as

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[4] *In re Goerg* did draw a distinction between bankruptcy cases filed by a probate estate and ancillary proceedings filed by an estate in another jurisdiction. In *Goerg*, a probate estate filed for bankruptcy protection in West Germany - where probate estates were specifically allowed to file for bankruptcy protection. Citing the comity provisions of 11 U.S.C. § 304, the Eleventh Circuit allowed the probate estate to file ancillary proceedings in American bankruptcy courts to deal with some of that estate's real property in the United States. This case, however, is not an ancillary proceeding to another bankruptcy estate - but rather is a bankruptcy petition in chief.

"persons" entitled to file a bankruptcy petition - or, in some instances (such as incompetence or through a power of attorney) considers the individual filings to be the legal equivalent of the debtors themselves.

The Estate is also correct that in some instances a Bankruptcy Court may allow the continuation of a bankruptcy estate after the death of the debtor. [*See* Appellant's Br., Doc. No. 16, pp.6-7]. This authority is derived from the Federal Rules of Bankruptcy Procedure:

> Death or incompetency of the debtor shall not abate a liquidation case under chapter 7 of the Code. In such event the estate shall be administered and the case concluded in the same manner, so far as possible, as though the death or incompetency had not occurred. *If a reorganization, family farmer's debt adjustment, or individual's debt adjustment case is pending under chapter 11, chapter 12,* or chapter 13, *the case may be dismissed*; *or if further administration is possible and in the best interest of the parties, the case may proceed and be concluded in the same manner, so far as possible, as though the death or incompetency had not occurred.*

Fed. R. Bankr. P. 1016 (emphasis added). Thus, "Bankruptcy Rule 1016 expressly authorizes [that] a Chapter 11 reorganization may receive further administration as though the death. . . had not occurred if it is possible and in the best interest of the parties." *In re Walters*, 114 B.R. at 605. *Walters* further explains the policy rationale behind allowing such bankruptcy petitions to continue:

> Reorganization cases should be encouraged, and honest debtors who put forth their best efforts in paying creditors should be given the benefit of the doubt under Bankruptcy Rule 1016[.]

Id. at 606. These policy concerns are not raised in the instant matter, where Mr. Gray died *before* the Chapter 11 petition had been filed.

The Estate also appears to argue that the lower court's dismissal of the appeal was somehow due to the so-called "probate exception" to federal jurisdiction. [*See* Appellant's Br., Doc. No. 16, pp. 7-8, citing *Marshall v. Marshall*, 547 U.S. 293 (2006)]. As the Eleventh Circuit discussed in *Goerg*, however, this argument is unavailing:

> Before we begin our analysis, we note that Congress has the *power* to create bankruptcy jurisdiction over the administration of decedents' estates. Care should be taken not to confuse the question of the breadth of Congress' bankruptcy power with the so-called "probate exception" to statutory diversity jurisdiction. That exception relates only to 28 U.S.C. § 1332, and has no bearing on federal question jurisdiction, the jurisdiction involved in bankruptcy cases.

Goerg, 844 F.2d at 1565 (internal citations omitted)(emphasis in original). The Estate's arguments to the contrary lack merit. The probate exception "reserves to state probate courts the probate or annulment of a will and the administration of an estate; it also precludes federal courts from disposing of property that is in the custody of a state probate court." *Marshall*, 547 U.S. at 296. The Bankruptcy Court's dismissal of the Estate's Chapter 11 case was based not on the probate exception but on the fact that the Estate is not a "person"as the that word is defined in the Bankruptcy Code, and thus is ineligible to be a debtor under Chapter 11 of the Bankruptcy Code.

Finally, the Estate's reliance upon *In re Fay Assocs. L.P.*, 225 B.R. 1 (Bankr. D.D.C. 1998) and *In re Bunch*, 249 B.R. 667 (Bankr. D. Md. 2000) is misplaced. *Fay Associates* involved, as admitted by the Estate, a single asset Chapter 11 debtor. Asserting bad faith, a creditor moved for the conversion or dismissal of the case.

Bunch dealt with a Chapter 13 debtor whose inherited realty was property of the Chapter 13 estate. A mortgagee on the property improperly attempted to foreclose on the property without seeking relief from the automatic stay. Neither *Fay Associates* nor *Bunch* deal with a probate estate filing for bankruptcy protection under the Code and neither case deals directly with the definition of a "person" eligible to file a bankruptcy petition. However, *Bunch* supports the lower court's ruling in this case because the *Bunch* court was careful to caution that "(t)he debtor's eligibility to file a Chapter 13 bankruptcy petition as an individual is to be distinguished from the prohibited filing of a Chapter 13 petition by a decedent's estate." (Citations omitted.) *Bunch,* 249 B.R. at 671.

Although the Estate"advocates that [t]his Court evolve the precedent which prohibits an estate from filing bankruptcy because it is not a 'person'," [Appellant's Br., Doc. No. 16, p.10], the law does not allow that. Nor do the facts of this case warrant such a break from precedent. Mrs. Gray will not be liable for either the first mortgage or the home equity line of credit on the Real Property because she has no liability for those debts. Further, though not directly relevant to these proceedings, Mrs. Gray has adequate funds - $13,600.00 monthly in passive income - with which to secure housing. [The Estate's Brief, Doc. No. 16, ¶ 2]. For these reasons, the U.S. Trustee requests that the Court affirm the lower court's dismissal of the Estate's Chapter 11 petition.

CONCLUSION

For these reasons, the United States Trustee respectfully asks this Court to affirm the lower court's order dismissing the Appellant's Chapter 11 bankruptcy case.

Respectfully submitted,

RAMONA D. ELLIOTT
General Counsel

P. MATTHEW SUTKO
Associate General Counsel

WENDY COX
Trial Attorney
Executive Office for
United States Trustees
Department of Justice
20 Massachusetts Avenue, N.W.
Washington, D.C. 20530
Phone: (202) 307-1399
Fax: (202) 307-2397

Date: February 10, 2011

DANIEL M. McDERMOTT
United States Trustee for Region 9

/S/ DAVID K. FOUST
Trial Attorney
Office of the United States Trustee
Department of Justice
221 West Fort St. - Suite 700
Detroit, Michigan 48226
Phone: (313) 226-7954
Fax: (313) 226-7952
David.K.Foust@usdoj.gov
P23450

UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF MICHIGAN

In re:

ESTATE OF JULIUS GRAY by JEANINE GRAY, SURVIVING SPOUSE AND HEIR,

Debtor.

Case No. 10-67918-MBM

Chapter 7

HON. MARCI B. McIVOR
United States Bankruptcy Judge

ESTATE OF JULIUS GRAY by JEANINE GRAY, SURVIVING SPOUSE AND HEIR,

Appellant,

v.

DANIEL M. McDERMOTT,
United States Trustee,

Appellee.

Case No. 10-14412-SFC

HON. SEAN F. COX
United States District Judge

INDEX OF EXHIBITS

Exhibit	Description
	In re Goerg, 844 F.2d 1562 (11th Cir. 1988)
	In re Estate of Roberts, 2005 WL 3108224, *1 (Bankr. D. Md. Aug. 15, 2005)

I join in the court's judgment because it affirms the district court. I write separately because I am concerned about the mischief *Lance*'s flawed rationale is causing the orderly process of grand jury investigations.

In re Klaus Hubert GOERG, Debtor.

Klaus Hubert GOERG,
Plaintiff-Appellant,

v.

Edgardo L. PARUNGAO,
Defendant-Appellee.

No. 87-8161.

United States Court of Appeals,
Eleventh Circuit.

May 18, 1988.

Foreign bankruptcy trustee of estate of deceased German citizen petitioned for ancillary administration, and state court appointed administrator of decedent moved to dismiss. The Bankruptcy Court, 64 B.R. 321, granted motion to dismiss, and appeal was taken. The United States District Court for the Northern District of Georgia, No. C86-2096A, William C. O'Kelley, J., affirmed, and foreign trustee appealed. The Court of Appeals, Tjoflat, Circuit Judge, held that provision of Bankruptcy Code governing cases ancillary to foreign bankruptcy proceedings is applicable where entity that is subject of foreign proceedings qualifies for insolvency administration under foreign law, even though the entity does not fall within Bankruptcy Code's definition of "debtor."

Reversed and remanded.

1. Bankruptcy ⇨2341

Provision of Bankruptcy Code governing cases ancillary to foreign bankruptcy proceedings is applicable where entity that is subject of foreign proceedings qualifies for insolvency administration under foreign law, even though the entity does not fall within Bankruptcy Code's definition of "debtor." Bankr.Code, 11 U.S.C.A. § 304.

2. Bankruptcy ⇨2012

Congress has power to create bankruptcy jurisdiction over administration of decedents' estates. U.S.C.A. Const. Art. 1, § 8, cl. 4.

3. Bankruptcy ⇨2002

Owing to supremacy clause, federal bankruptcy law preempts state law. U.S.C.A. Const. Art. 6, cl. 2.

4. Bankruptcy ⇨2012

As one of Congress' enumerated powers, power to enact bankruptcy laws is limited only by substantive guarantees contained in Constitution. U.S.C.A. Const. Art. 1, § 8, cl. 4.

5. Bankruptcy ⇨2228

Bankruptcy Code's definition of "person" and therefore its definition of "debtor," excludes insolvent decedents' estates. Bankr.Code, 11 U.S.C.A. § 101(12, 35).

See publication Words and Phrases for other judicial constructions and definitions.

Thomas C. Shelton, Kilpatrick & Cody, Robert A. Goldstein, Dennis S. Meir, Allison Wade, Atlanta, Ga., for plaintiff-appellant.

Robert E. Hicks, Hicks, Maloof & Campbell, Atlanta, Ga., for defendant-appellee.

Appeal from the United States District Court for the Northern District of Georgia.

Before RONEY, Chief Judge, TJOFLAT, Circuit Judge, and CLEMON,* District Judge.

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* Honorable U.W. Clemon, U.S. District Judge for the Northern District of Alabama, sitting by designation.

TJOFLAT, Circuit Judge:

[1] This appeal presents a question of first impression for this court: whether section 304 of the Bankruptcy Code, 11 U.S.C. §§ 101–1330, opens United States bankruptcy courts to proceedings ancillary to foreign insolvency proceedings where the entity that is the subject of the foreign proceeding qualifies for insolvency administration under foreign law, but does not fall within the Bankruptcy Code's definition of "debtor." Both the bankruptcy court and the district court in this case answered the question in the negative, holding that a West German bankruptcy trustee was precluded from commencing a section 304 ancillary case because the debtor in the foreign case—an insolvent decedent's estate—did not qualify as a "debtor" under the Bankruptcy Code. We conclude that the courts below misconstrued the eligibility requirements for section 304 relief, and we accordingly reverse.

I.

Heinz Guenter Kaussen, a resident and citizen of the Federal Republic of Germany (West Germany), died in April 1985 owning substantial property in both Europe and North America. Although most of his holdings were located in West Germany, he also owned property in Canada, Ireland, California, and Georgia. At the time of his death, his liabilities exceeded the value of his assets by some $55 million. His business enterprises had been headquartered in Cologne, West Germany, and the vast majority of the estate's creditors are located in West Germany.

Shortly after Kaussen's death, probate proceedings were commenced in the local court of Cologne. That court appointed an administrator who, after determining that the estate was insolvent, petitioned the court to commence bankruptcy proceedings.[1] On January 24, 1986, the court entered an Order of Adjudication, finding that the estate was insolvent. The court appointed Klaus Hubert Goerg, appellant here, to serve as the bankruptcy trustee and authorized him to take possession of the decedent's property both in Germany and abroad. The adjudication of bankruptcy and the appointment of Goerg as trustee were affirmed by the Cologne Regional Court and the Cologne Higher Court of Appeals. The Higher Court of Appeals specifically held that "[i]n addition to the domestic property, the Debtor's bankrupt estate shall further include the Debtor's property located abroad. The latter, too, shall be placed in custody and used by the Trustee."[2]

Meanwhile, upon Kaussen's death, the Probate Court of Fulton County, Georgia had appointed Edgardo L. Parungao, appellee here, to serve as administrator of the Kaussen estate assets located in Georgia.[3] In June 1986, Goerg filed a petition pursuant to 11 U.S.C. § 304 (1982) in the United States Bankruptcy Court for the Northern District of Georgia, seeking to enjoin Parungao from prosecuting the Fulton County probate proceeding.[4] Under section 304, a United States bankruptcy court may, upon petition by the official representative of a foreign bankrupt in a foreign insolvency proceeding, enter an order staying the

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[1] West German law, like the law in many other foreign countries, permits bankruptcy proceedings to be brought with respect to insolvent decedents' estates. *See* Klocker, *Foreign Debtors and Creditors Under United States and West German Bankruptcy Laws: An Analysis and Comparison,* 20 Texas Int'l L.J. 55, 90 & n. 223 (1985); Nadelmann, *Insolvent Decedents' Estates,* 49 Mich.L.Rev. 1129, 1129 (1951).

[2] Appellant represents, and appellee does not dispute, that the Cologne Higher Regional Court of Appeals is the highest court of review with respect to matters involving insolvent decedents' estates.

[3] Under Georgia law, the probate court of the county in which a nonresident decedent's real property is located has jurisdiction over the administration of that property. *See Hungerford v. Spalding,* 183 Ga. 547, 189 S.E. 2, 3 (1936).

[4] The bankruptcy court reported that "[u]nder a settlement approved by Superior Court of Fulton County, Georgia and the Probate Court of Fulton County, Georgia, distributions from the estate are to be paid 20% to each of Kaussen's four children and Mrs. Ingelborg Skowronek, mother of the children and Kaussen's lifetime companion."

commencement or continuation of any action in the United States against property involved in the foreign proceeding. *Id.* § 304(b)(1)(A). The bankruptcy court may also stay the enforcement of any lien or judgment obtained against such property, *id.* § 304(b)(1)(B), and may order that such property be turned over for administration by the foreign court in which the principal bankruptcy case is pending. *Id.* § 304(b)(2). Finally, the bankruptcy court may order other relief deemed "appropriate." *Id.* § 304(b)(3). In his section 304 petition, Goerg requested the bankruptcy court to order that the Georgia property be turned over to him for distribution in the West German bankruptcy proceeding.

Based on its interpretation of the language of section 304 and the pertinent definitional sections, the bankruptcy court held that its jurisdiction to entertain section 304 petitions was limited to cases in which the subject of the foreign insolvency proceeding qualified as a "debtor" as that term is defined in the Bankruptcy Code. The bankruptcy court then concluded that an insolvent decedent's estate—the debtor in the foreign insolvency proceeding in this case—did not qualify as a "debtor" under the Code. Accordingly, the bankruptcy court dismissed Goerg's section 304 petition for lack of subject matter jurisdiction.[5] *In re Goerg,* 64 B.R. 321 (Bankr.N.D.Ga. 1986). The district court affirmed, and Goerg now appeals.

II.

Section 304 provides as follows:

> (a) A case ancillary to a foreign proceeding is commenced by the filing with the bankruptcy court of a petition under this section by a foreign representative.
>
> (b) Subject to the provisions of subsection (c) of this section, if a party in interest does not timely controvert the petition, or after trial, the court may—
>
> (1) enjoin the commencement or continuation of—
>
> (A) any action against—
>
> (i) a debtor with respect to property involved in such foreign proceeding; or
>
> (ii) such property; or
>
> (B) the enforcement of any judgment against the debtor with respect to such property, or any act or the commencement or continuation of any judicial proceeding to create or enforce a lien against the property of such estate;
>
> (2) order turnover of the property of such estate, or the proceeds of such property, to such foreign representative; or
>
> (3) order other appropriate relief.
>
> (c) In determining whether to grant relief under subsection (b) of this section, the court shall be guided by what will best assure an economical and expeditious administration of such estate, consistent with—
>
> (1) just treatment of all holders of claims against or interests in such estate;
>
> (2) protection of claim holders in the United States against prejudice and inconvenience in the processing of claims in such foreign proceeding;
>
> (3) prevention of preferential or fraudulent dispositions of property of such estate;
>
> (4) distribution of proceeds of such estate substantially in accordance with the order prescribed by this title;
>
> (5) comity; and
>
> (6) if appropriate, the provision of an opportunity for a fresh start for the

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[5] Although it felt compelled by the statutory language to dismiss the petition, the bankruptcy court expressed dismay at the outcome:

> Here we have German nationals [i.e., Mrs. Skowronek and Kaussen's four children, *see supra* note 4] who have lost their appeals to assert their interests in Kaussen's estate in the Courts of the Federal Republic of Germany, turning to the probate laws of the State of Georgia. In Georgia, they will receive what they could not from their own home courts.... As the facts now appear before the Court, this is mainly a contest between the German bankruptcy trustee and Kaussen's heirs. The heirs have lost in their own home courts and are now pursuing their claims in a more favorable forum, to wit: the Probate Court of Fulton County, Georgia. It does seem to be a great affront to the principles of comity to allow this to occur.

individual that such foreign proceeding concerns.

11 U.S.C. § 304 (1982).

In holding that it lacked jurisdiction to entertain Goerg's section 304 petition, the bankruptcy court engaged in the following analysis. First, it looked to the Code's definition of "foreign proceeding":

> "[F]oreign proceeding" means proceeding, whether judicial or administrative and whether or not under bankruptcy law, in a foreign country in which the debtor's domicile, residence, principal place of business, or principal assets were located at the commencement of such proceeding, for the purpose of liquidating an estate, adjusting debts by composition, extension, or discharge, or effecting a reorganization.

Id. § 101(22) (Supp. IV 1986). Because the definition of "foreign proceeding" makes reference to "the *debtor's* domicile, residence, principal place of business, or principal assets," the bankruptcy court concluded that its jurisdiction to entertain section 304 petitions was limited to cases in which the subject of the foreign proceeding qualified as a "debtor" under the Code.[6] The Code defines a "debtor" as a "person or municipality concerning which a case under this title has been commenced." *Id.* § 101(12) (1982). "Person," under the Code, "includes individual, partnership, and corporation, but does not include governmental unit." *Id.* § 101(35) (Supp. IV 1986). The bankruptcy court held that an insolvent decedent's estate is not a "person," and therefore not a "debtor," and that the court was consequently without jurisdiction to entertain Goerg's petition.

In evaluating the correctness of the bankruptcy court's ruling, our first task is to determine whether, as a general matter, the Code's definition of "debtor" excludes insolvent decedents' estates. If we conclude that it does, our task will then be to decide whether that exclusion applies in the context of a section 304 ancillary proceeding.

[2–4] Before we begin our analysis, we note that Congress has the *power* to create bankruptcy jurisdiction over the administration of decedents' estates. U.S. Const. art. I, § 8, cl. 4.[7] Care should be taken not to confuse the question of the breadth of Congress' bankruptcy power with the so-called "probate exception" to statutory diversity jurisdiction. That exception relates only to 28 U.S.C. § 1332 (1982),[8] and has no bearing on federal question jurisdiction, the jurisdiction invoked in bankruptcy cases. *Cf. Covell v. Heyman,* 111 U.S. 176, 179–80, 4 S.Ct. 355, 357, 28 L.Ed. 390 (1884) (property in custody of state court may be disturbed by federal court "exercis[ing] jurisdiction for the purpose of enforcing the supremacy of the Constitution and laws of the United States"). Owing to the supremacy clause, federal bankruptcy law preempts state law; as one of Congress' enumerated powers, the power to enact bankruptcy laws is limited only by the substantive guarantees contained in the Constitution. *Cf. Louisville Joint Stock Land Bank v. Radford,* 295 U.S. 555, 589, 601–02, 55 S.Ct. 854, 863, 869, 79 L.Ed. 1593 (1935). Whether Congress has actually exercised its bankruptcy power in a particular area is, of course, a matter of statutory construction.

Having said that, we turn to the question whether the Code's definition of "debtor" excludes decedents' estates. As the bankruptcy court correctly observed, the term "debtor" as defined by the Code means "person or municipality," and the term

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[6] As support for its holding, the bankruptcy court cited *Angulo v. Kedzep Ltd.,* 29 B.R. 417 (S.D.Tex.1983). In the course of discussing whether the foreign representative in that case had met the threshold prerequisites for application of section 304, the *Angulo* court stated that the foreign debtor "could be a debtor under Chapter 11." *Id.* at 418.

[7] Clause 4 provides that Congress shall have power "[t]o establish ... uniform Laws on the subject of Bankruptcies throughout the United States."

[8] The "probate exception" was developed at a time when the diversity statute granted jurisdiction over "suits of a civil nature in law or equity." Probate matters were deemed not to fit this description because such actions would have been heard in the ecclesiastical courts. *See* C. Wright, Law of Federal Courts § 25, at 143–46 (4th ed. 1983).

"person" "includes individual, partnership and corporation, but does not include governmental unit." Notably, the Code does not *exclude* decedents' estates from the definition of "person"; Congress' use of the word "includes" in the definition of "person" means that the definition is not limiting. *See* 11 U.S.C. § 102(3) (1982) (rules of construction).

Nevertheless, we find two indicia that Congress intended to exclude insolvent decedents' estates from the definition of "person." First, Congress defined "entity" to include "person, estate, trust, governmental unit, and United States trustee." *Id.* § 101(14) (Supp. IV 1986). If Congress had intended "person" to include "estate," there would have been no reason to list "estate" separately in the definition of "entity." Second, the legislative history expressly states that "[t]he definition [of person] does not include an estate or a trust." H.R.Rep. No. 595, 95th Cong., 2d Sess. 313, *reprinted in* 1978 U.S.Code Cong. & Admin.News 5963, 6270; S.Rep. No. 989, 95th Cong., 2d Sess. 25, *reprinted in* 1978 U.S.Code Cong. & Admin.News 5787, 5811.

[5] Based on these indicia, we conclude that the Code's definition of "person," and therefore its definition of "debtor," excludes insolvent decedents' estates. Other courts that have addressed this question have uniformly embraced this view. *See In re Estate of Whiteside,* 64 B.R. 99, 102 (Bankr.E.D.Cal.1986); *In re Estate of Patterson,* 64 B.R. 807, 808 (Bankr.W.D.Tex. 1986); *In re Jarrett,* 19 B.R. 413, 414 (Bankr.M.D.N.C.1982); *In re 299 Jack-Hemp Assocs.,* 20 B.R. 412, 413 (Bankr.S.D. N.Y.1982); *In re Estate of Brown,* 16 B.R. 128, 128 (Bankr.D.D.C.1981).[9] These courts generally have opined that Congress elected not to extend bankruptcy jurisdiction to insolvent decedents' estates because the individual states have developed, through their probate systems, a comprehensive and specialized machinery for the administration of such estates. *See Jarrett,* 19 B.R. at 414; *299 Jack-Hemp Assocs.,* 20 B.R. at 413. Some of the courts have also noted that the policy of the Bankruptcy Code is to give individuals a "fresh start" through discharge of their debts, and that this policy is not furthered by bankruptcy administration of decedents' estates. *See Jarrett,* 19 B.R. at 414; *cf. In re Estate of Hiller,* 240 F.Supp. 504, 504 (N.D.Cal.1965) (interpreting 1898 Bankruptcy Act); *Adams v. Terrell,* 4 F. 796, 801 (W.D.Tex.1880) (in the case of an insolvent decedent's estate, "death has already discharged [the decedent] of all personal liability").

As we indicated above, however, our conclusion that the Code's definition of "debtor" excludes decedents' estates does not end our inquiry: we must now determine whether that exclusion applies in the context of a proceeding ancillary to a foreign proceeding pursuant to section 304. As the bankruptcy court emphasized, the Code's definition of "foreign proceeding" does make reference to "the debtor."[10] However, that same definition states that " 'foreign proceeding' means proceeding ... *whether or not under bankruptcy law* ... for the purpose of *liquidating an estate,* adjusting debts by composition, extension, or discharge, or effecting a reorganization." 11 U.S.C. § 101(22) (Supp. IV 1986) (emphasis added). Thus, we are presented with an anomaly: although the inclusion of the term "debtor" in the definition of "foreign proceeding" suggests that the subject of the foreign proceeding must qualify as a "debtor" under United States bankruptcy law, the Code expressly provides that the foreign proceeding need not even be a

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[9] Courts addressing the issue under the predecessor of the current Bankruptcy Code, the 1898 Bankruptcy Act, reached the same conclusion. *See In re Estate of Hiller,* 240 F.Supp. 504, 504 (N.D.Cal.1965); *In re Morgan,* 26 F.2d 90, 91 (D.Mass.1928); *In re Fackelman,* 248 F. 565, 568 (S.D.Cal.1918); *see also Adams v. Terrell,* 4 F. 796, 801 (W.D.Tex.1880) (interpreting predecessor of 1898 Act). During the process leading to the enactment of the present Bankruptcy Code, the Commission on the Bankruptcy Laws recommended that the traditional exclusion of decedents' estates be continued. *See* H.R. Doc. No. 137, 93d Cong., 1st Sess., pt. I, at 185 (1973).

[10] We note that the text of section 304 itself also contains the term "debtor."

bankruptcy proceeding, either under foreign or United States law. Moreover, "foreign proceeding" includes a proceeding "for the purpose of liquidating an estate" [11]—yet, as we have seen, a decedent's estate does not qualify as a "debtor" under United States bankruptcy law.

The anomaly created by the inclusion of the term "debtor" in the otherwise expansive definition of "foreign proceeding" could be resolved in either one of two ways. First, we could adopt the position taken by the bankruptcy court: that the Code's narrow definition of "debtor" controls, notwithstanding the otherwise expansive definition of "foreign proceeding." Alternatively, we could adopt the view that the term "debtor" as used in the section 304 context incorporates the definition of "debtor" used by the forum in which the foreign proceeding is pending. Under this alternative view, the bankruptcy court has jurisdiction to entertain the section 304 petition provided that the debtor qualifies for relief under applicable foreign law, and provided further that the foreign proceeding to which the debtor is subject is "for the purpose of liquidating an estate, adjusting debts by composition, extension, or discharge, or effecting a reorganization."

At first blush, the former view seems the more attractive of the two; the term "debtor" is expressly defined by the Code, and general principles of statutory construction require us to assume that Congress intended that the definition apply each time the term appears. However, it is also a well established canon of statutory construction that "[a] statute susceptible of more than one meaning must be read in the manner which effectuates rather than frustrates the major purpose of the legislative draftsmen." *Schultz v. Louisiana Trailer Sales, Inc.*, 428 F.2d 61, 65 (5th Cir.1970). Because we find that the question of debtor eligibility for section 304 ancillary assistance is susceptible of two interpretations, we turn to an examination of the purposes behind section 304.

Section 304, which was enacted as part of the Bankruptcy Reform Act of 1978 and which had no predecessor in prior law,[12] "was intended to deal with the complex and increasingly important problems involving the legal effect the United States courts will give to foreign bankruptcy proceedings." *Cunard Steamship Co. Ltd. v. Salen Reefer Servs. AB*, 773 F.2d 452, 454 (2d Cir.1985); *see generally* Unger, *United States Recognition of Foreign Bankruptcies*, 19 Int'l Law. 1153 (1985). The filing of a section 304 petition does not commence a full bankruptcy case; a section 304 case is an ancillary case in which a United States bankruptcy court is authorized to apply its processes to give effect to orders entered in a foreign insolvency proceeding. Consistent with "[p]rinciples of internation-

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[11] The term "estate" is not defined in the definitional section of the Bankruptcy Code. The Code does use the term of art "property of the estate" to describe "all legal or equitable interests of the debtor in property as of the commencement of the case." 11 U.S.C. § 541(a)(1) (1982). However, the Code also uses the term "estate" in a sense that includes decedent's estates. *See id.* § 101(14) (Supp. IV 1986) (definition of "entity"). The use of the term "estate" in the definition of "foreign proceeding" is ambiguous, and could be interpreted as including insolvent decedents' estates, not just "estates" in the sense of the bankruptcy term of art "property of the estate." *See* 2 Collier on Bankruptcy ¶ 304.01, at 304–12 (15th ed. 1987) ("That a foreign administration of a decedent's estate is ... a 'foreign proceeding' is suggested by the expansive language of [section 101(22)] which includes within its scope proceedings under laws other than bankruptcy laws brought for the purpose of liquidating an estate.").

[12] *See* H.R. Doc. No. 137, 93d Cong., 1st Sess., pt. II, 69–71 (1973); *Bankruptcy Act Revision: Hearings on H.R. 31 and H.R. 32 Before the Subcomm. on Civil and Constitutional Rights of the House Comm. on the Judiciary*, 94th Cong., 2d Sess. 1443 (1976) (statement of Professor Kurt H. Nadelmann). Under section 2a(22) of the 1898 Bankruptcy Act, bankruptcy courts were authorized to "[e]xercise, withhold, or suspend the exercise of jurisdiction ... where a bankrupt has been adjudged bankrupt by a court of competent jurisdiction without the United States." Although the 1898 Act did not provide a mechanism whereby a foreign bankruptcy trustee could initiate a proceeding in a United States bankruptcy court, some United States courts did defer to foreign insolvency administrations as a matter of comity. *See, e.g., Cornfeld v. Investors Overseas Servs., Ltd.*, 471 F.Supp. 1255, 1259 (S.D.N.Y.), *aff'd*, 614 F.2d 1286 (2d Cir.1979).

al comity and respect for the judgments and laws of other nations," Congress intended that the bankruptcy courts have "maximum flexibility" in fashioning appropriate orders. H.R.Rep. No. 595, 95th Cong., 2d Sess. 325, *reprinted in* 1978 U.S. Code Cong. & Admin.News 5963, 6281. The ultimate purpose of the section 304 mechanism is to "prevent dismemberment by local creditors" of assets located in this country that are involved in a foreign insolvency proceeding. *Id.* at 324; S.Rep. No. 989, 95th Cong., 2d Sess. 35, *reprinted in* 1978 U.S.Code & Admin.News 5787, 5821.

It is thus clear that Congress enacted section 304 to help further the efficiency of foreign insolvency proceedings involving worldwide assets. In aid of such proceedings, federal bankruptcy courts may, within the constraints imposed by section 304, apply their processes and expertise to marshal property of the foreign debtor's estate located in this country. Because the focus is on making United States processes available in aid of foreign proceedings, not actual bankruptcy administration, it would make little sense to require that the subject of the foreign proceeding qualify as a "debtor" under United States bankruptcy law. *See* Boshkoff, *United States Judicial Assistance in Cross-Border Insolvencies,* 36 Int'l & Comp. L.Q. 729, 740–41 (1987); Klocker, *Foreign Debtors and Creditors Under United States and West German Bankruptcy Laws: An Analysis and Comparison,* 20 Texas Int'l L.J. 55, 90 (1985). Indeed, in light of the comity concerns that induced Congress to enact section 304, it would make eminent sense for Congress to define expansively the class of foreign insolvency proceedings for which ancillary assistance is available.

It bears emphasizing that a section 304 debtor does not receive the benefits of full bankruptcy administration under United States law. The legislative history expressly states that the filing of a section 304 petition "does not commence a full bankruptcy case." H.R.Rep. No. 595, 95th Cong., 2d Sess. 324, *reprinted in* 1978 U.S.Code Cong. & Admin.News 5963, 6281; S.Rep. No. 989, 95th Cong., 2d Sess. 35, *reprinted in* 1978 U.S.Code Cong. & Admin.News 5787, 5821. Thus, for example, the debtor is not entitled to the automatic stay under 11 U.S.C. § 362 (1982), nor is the debtor entitled to a discharge of its debts upon completion of the section 304 proceeding. Indeed, the section 304 debtor may ultimately receive no relief at all; it is within the discretion of the bankruptcy court, guided by the factors enumerated in section 304(c), to determine what relief, if any, is appropriate. That the section 304 debtor is denied the two main benefits accorded the debtor in a full bankruptcy proceeding—automatic stay and discharge—strongly suggests that Congress did not intend that "debtor" eligibility under the Code be a prerequisite to section 304 ancillary assistance.[13]

In light of these considerations, we conclude that the debtor in a section 304 proceeding need not qualify as a "debtor" under the Code's definition of that term. Rather, the debtor need only be properly subject, under applicable foreign law, to a proceeding commenced "for the purpose of liquidating an estate, adjusting debts by composition, extension, or discharge, or effecting a reorganization." Because that condition is met in this case, we reverse and remand with instructions that the bankruptcy court entertain Goerg's section 304 petition.[14]

REVERSED and REMANDED.

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[13] This analysis suggests that a full bankruptcy proceeding involving a foreign debtor may be commenced only if the foreign debtor qualifies as a "debtor" under the Code. *Cf.* 11 U.S.C. § 303(b)(4) (1982).

[14] The record is not clear as to whether the bankruptcy court has passed on all issues relevant to its jurisdiction to entertain Goerg's section 304 petition. In addition to establishing debtor eligibility, the section 304 petition must establish (1) a foreign proceeding against the debtor, (2) a foreign representative entitled to file the petition, and (3) presence within the district of property involved in the foreign proceeding. *See In re Stuppel,* 17 B.R. 413 (S.D.Fla. 1981). On remand, the bankruptcy court

Only the Westlaw citation is currently available.

United States Bankruptcy Court,
D. Maryland.
In re: ESTATE OF Marilyn E. ROBERTS, Debtor.

No. 05-26653 ESD.
Aug. 15, 2005.

Marilyn E. Roberts, Baltimore, MD, pro se.

MEMORANDUM AND ORDER DISMISSING, SUA SPONTE, CASE FILED BY A DECEDENT'S ESTATE

DERBY, J.

***1** On July 25, 2005, a Chapter 13 petition was filed on behalf of the Estate of Marilyn E. Roberts, by Marilyn Dorsey as the "Executor of the Estate of Marilyn E. Roberts." The petition was signed by Marilyn Dorsey in her capacity as executor of the Estate of Marilyn E. Roberts. The petition was not filed by Ms. Dorsey personally, but rather in her representative capacity on behalf of the probate estate of Marilyn E. Roberts.

The court will, *sua sponte,* dismiss this case. A decedent's estate, even when represented by a individual fiduciary, is not a person that may be a debtor under the Bankruptcy Code. Only a person may be a debtor. 11 U.S.C. § 109(a). A person includes individuals, partnerships and corporations. *Id.* at § 101(41). The definition of a person does not include a decedent's estate. *See Id.* at §§ 101(41), 101(9). Estate is included in the definition of entity. *Id.* at § 101(15). If Congress had intended to include estates in the definition of person, and thereby to allow estates to file a bankruptcy petition, estates would not have been specifically included only within the separate definition of entity. *In re Walters,* 113 B.R. 602, 604 (Bankr.D.S.D.1990), *citing In re Estate of Whiteside by Whiteside,* 64 B.R. 99, 100-01 (Bankr.E.D.Cal.1986). Other courts addressing the question of whether an insolvent decedent's estate is a person and therefore eligible for relief under the Bankruptcy Code have uniformly found that the definition of debtor excludes insolvent decedents' estates. *See, e.g., In re Goerg,* 844 F.2d 1562, 1566 (11th Cir.1988), *cert. denied,* 488 U.S. 1034, 109 S.Ct. 850, 102 L.Ed.2d 981 (1989)(dicta), and the cases cited therein. *See also In re Bunch,* 249 B.R. 667, 671 (Bkrtcy.D.Md.2000)(distinguishing between eligibility of individual heir to file a bankruptcy petition from prohibited filing by decedent's estate).

Congress expressly recognized that "[t]he definition [of person] does not include an estate or a trust, which are included only in the definition of 'entity'...." H.R.Rep. No. 595, 95th Cong., 1st Sess. 313 (1977), *reprinted in* 1978 U.S.Code Cong. & Admin.News 5963, 6270; S.Rep. No. 989, 95th Cong., 2d Sess. 25 (1978), *reprinted in* 1978 U.S.Code Cong. & Admin.News 5787, 5811). *See In re Goerg,* 844 F.2d at 1566; *In re Walters,* 113 B.R. at 604. The definition of person states that it "includes individual, partnership, and corporation." 11 U.S.C. § 101(41). The term "includes" is not limiting. *Id.* at § 102(3). Nevertheless, courts have long concluded Congress left no doubt that an estate was not included in the definition of person. *In the Matter of 299 Jack-Hemp Associates,* 20 B.R. 412, 413 (Bankr.S.D.N.Y.1982); *In re Brown's Estate,* 16 B.R. 128 (Bankr.D.D.C.1981).

There are other reasons why the probate estate of a decedent should be ineligible to initiate a request for relief under the Bankruptcy Code. While an authorized representative of a probate estate may be an individual, he or she is not a debtor seeking a fresh start. Because the represented principal here is a probate estate, there is no fresh start available. Further, this case was filed under Chapter 13. Only an individual may be discharged in Chapter 13, because only an individual may be a debtor under Chapter 13. 11 U.S.C. §§ 109(e), 1328. "Whereas the policy of the Bankruptcy Code is to provide debtors with a 'fresh start', this policy is not met by the Bankruptcy Court's administration of the estate of a deceased individual." *Matter of Jarrett,* 19 B.R. 413, 414 (Bankr.M.D.N.C.1982).

***2** The bankruptcy court should not assume control of the administration of a probate estate. Probate administration is specialized and greatly detailed within state law. *See, e.g.,* Md. Estates & Trusts Code Ann. (2001 Repl.Vol. and 2004 Supp.). No overriding bankruptcy policy or concern is furthered when a bankruptcy court enters this complicated arena. "The main reason cited by these [bankruptcy] courts in denying an insolvent probate estate access to bankruptcy is that Congress, through the Bankruptcy Code, elected not to extend bankruptcy to insolvent decedents' estates since probate systems developed by the individual states are a comprehensive and specialized machinery to administer such estates." *In re Walters,* 113 B.R. at 604. *Cf., In the Matter of 299 Jack-Hemp Associates,* 20 B.R. at 413; *Matter of Jarrett,* 19 B.R. at 414; *In re Brown's Estate,* 16 B.R. at 128. The bankruptcy court has no power or jurisdiction pursuant to the Bankruptcy Code to administer probate estates, and a probate estate must find recourse in the appropriate state court. *In re Brown's Estate, supra.*

The public purposes of probate administration and of bankruptcy administration are quite different. The laws of probate are designed to carry out the wishes of a testator expressed in a will or trust or in intestate statutes with respect to the distribution of property to survivors. Bankruptcy laws reallocate insufficient assets among present creditors. Where there are insufficient assets for creditors, the priority of distribution is different. *Compare, e.g.,* Md. Estates & Trusts Code Ann. § 8-105 (2001 Repl.Vol.) and 11 U.S.C. §§ 507, 727.

The court does not find that if an individual debtor had filed for bankruptcy before his or her death, the bankruptcy could not be completed and the debtor discharged. In that scenario the debtor's intention is ultimately carried out, because the bankruptcy petition would have been filed by the debtor before his death. "It is possible that the estate of an individual who files for bankruptcy and subsequently dies could be administered in a Chapter 7 or 11 case, depending on the circumstances. A decedent's estate, however, may not file bankruptcy or convert to a different chapter under the Bankruptcy Code." *In re Burner,* 109 B.R. 216, 222 n. 3 (Bankr.W.D.Tex.1989). Federal Rule of Bankruptcy Procedure 1016 specifically provides:

> Death or incompetency of the debtor shall not abate a liquidation case under chapter 7 of the Code. In such event the estate shall be administered and the case concluded in the same manner, so far as possible, as thought the death or incompetency had not occurred. If a reorganization, family farmer's debt adjustment, or individual's debt adjustment case is pending under Chapter 11, 12, or 13, the case may be dismissed; or if further administration is possible and in the best interests of the parties, the case may proceed and be concluded in the same manner, so far as possible, as though the death or incompetency had not occurred.

***3** In the instant case the decedent, when alive, did not file for bankruptcy. Consequently, the court does not have authority pursuant to Federal Rule of Bankruptcy Rule 1016 to administer the decedent's estate.

In conclusion, this probate estate is not a person or an individual. Therefore, the purported debtor is not eligible for relief. The administration of probate estates is specialized and greatly detailed within the laws of individual states, and this court will not disrupt those laws.

For the foregoing reasons, it is, by the United States Bankruptcy Court for the District of Maryland,

ORDERED, that the bankruptcy case of the Estate of Marilyn E. Roberts, Case No. 05-26653 ESD is dismissed, *sua sponte.*

Bkrtcy.D.Md.,2005.
In re Estate of Roberts
Not Reported in B.R., 2005 WL 3108224 (Bkrtcy.D.Md.)

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BRIEF BANK — "SUMMARY SHEET"

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WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	In re Derrick Gray
2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	E.D. Mich.
3. ("CCN") ***CURRENT*** CASE NO.	No.: 11-cv-10640-JAC-MKM
4. ("PCN") ***PRIOR*** CASE NO. - & COURT *[IF ANY]*	No.: 10-60999-SWR Court: Bankr. E.D. Mich. *(Identify judge & cite, if any)*
5. ("SO") ***SOURCE***	**U.S. TRUSTEES**
6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	Filed: March 1, 2011 Type: The United States Trustee's Response to Wells Fargo Bank, N.A.'s Motion for Leave to Appeal
7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*	Kelley Callard, Anne Stukes, P. Matthew Sutko, Daniel M. McDermott *(UST/OGC: 202-307-1399/FAX-2397)*
8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	• Whether an order granting a Rule 2004 may be appealed under 28 U.S.C. § 158(a) or 28 U.S.C. § 1292(b).
10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)	
11. DO YOU RECOMMEND POSTING IN UST BRIEFBANK?| x | YES | | NO	***NAME:*** Linda Figueroa ***DATE:***

UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF MICHIGAN
SOUTHERN DIVISION

In re:	Bankruptcy Case No. 10-60999-SWR
DERRICK GRAY,	Chapter 13
Debtor.	HON. STEVEN W. RHODES
________________________________/	District Court Case No. 2:11-cv-10640-JAC-MKM

THE UNITED STATES TRUSTEE'S RESPONSE TO WELLS FARGO BANK, N.A.'S MOTION FOR LEAVE TO APPEAL

Daniel M. McDermott, the United States Trustee for Region 9 (the "United States Trustee"), by and through undersigned counsel, files this response to Wells Fargo Bank, N.A.'s ("Wells Fargo") Motion for Leave to Appeal (the "Motion for Leave"). (Bankr. Dkt. 102). The United States Trustee opposes Wells Fargo's Motion for Leave, and for the reasons set forth in the attached Brief, respectfully requests that the Motion be denied.

Respectfully submitted,
DANIEL M. McDERMOTT
UNITED STATES TRUSTEE
Region 9

By: /s/ Kelley Callard (P68537)
Kelley.Callard@usdoj.gov
Trial Attorney
Office of the U.S. Trustee
211 West Fort St - Suite 700
Detroit, Michigan 48226
(313) 226-6773

Dated: March 1, 2011

UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF MICHIGAN
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In re:	Bankruptcy Case No. 10-60999-SWR
DERRICK GRAY,	Chapter 13
Debtor.	HON. STEVEN W. RHODES
________________________________/	District Court Case No. 2:11-cv-10640-JAC-MKM

THE UNITED STATES TRUSTEE'S BRIEF IN OPPOSITION TO WELLS FARGO BANK, N.A.'S MOTION FOR LEAVE TO APPEAL

FACTUAL AND PROCEDURAL BACKGROUND

Wells Fargo attempts to appeal a discovery order in this case. The United States Trustee, an officer of the United States Department of Justice, sought discovery from Wells Fargo when he noticed that Wells Fargo appeared to be charging irregular fees for monthly "inspections" of the chapter 13 bankruptcy debtor's home. *See* United States Trustee's Motion for Order Authorizing Examination of Wells Fargo and Requiring Production of Documents Pursuant to Bankruptcy Rule 2004 (the "2004 Motion"). (Bankr. Dkt. 73).

The United States Trustee is an official designated by Congress to be the "watchdog" who guards against fraud and abuse of the bankruptcy system. *See* H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 1, 88 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6049 ("The proposed United States Trustees will . . . serve as bankruptcy watch-dogs to prevent fraud, dishonesty, and overreaching in the bankruptcy arena."); *see also In re South Beach Secs., Inc.*, 606 F.3d 366, 371 (7th Cir. 2010) (Posner, J.) (the United States Trustee is "the congressionally ordained watchdog – he has a statutory interest in making sure that bankruptcy law isn't abused"). In light of the widespread concern that mortgage servicers have failed to pay sufficient attention to their paperwork, United States Trustees throughout the country are carefully reviewing the proofs of claims and other filings by mortgage servicers.

In this case, Wells Fargo filed a proof of claim for the mortgage on the residence of the debtor. *See* Claims Register for Case No. 10-60999, Claim 4-1 (the "Proof of Claim"). The Proof of Claim included charges for multiple, monthly home inspections. *See* Dist. Ct. Dkt. 5-3 (Letter Dated November 8, 2010, Wells Fargo's response to U.S. Trustee's letter of October 25, 2010). It was unclear from the Proof of Claim why so many home inspections were necessary and whether the claimed fees were reasonable. Accordingly, the United States Trustee sought information from Wells Fargo by way of a document production and an examination under Bankruptcy Rule 2004.

Pursuant to Rule 2004, upon motion of any party in interest, an entity may be examined under Rule 2004 regarding "any matter which may affect the administration of the debtor's estate." Fed. R. Bankr. P. 2004(a), (b). Such an examination is very similar to a deposition. However, the scope of discovery permitted under Rule 2004 is broader than that permitted under the Rules of Civil Procedure. *In re Wilcher*, 56 B.R. 428, 433 (Bankr. N.D. Ill. 1985). Indeed, a Rule 2004 examination is "commonly recognized as permitting discovery in the nature of a 'fishing expedition.'" *In re Washington Mutual, Inc.*, 408 B.R. 45, 50 (Bankr. D. Del. 2009) (citation omitted).

Here, the United States Trustee sought information from Wells Fargo concerning:

- The total arrearage on the Debtor's account;
- The reasonableness of fees imposed against the Debtor's account;
- Wells Fargo's policies and procedures applicable to the Debtor's account in ordering

an inspection;

- Wells Fargo's policies and procedures applicable to the Debtor's account, for referring a proof of claim; and
- The documents or other information relied on in referring the Proof of Claim.

(Bankr. Dkt. 73 at 4).

Wells Fargo opposed the discovery, (Bankr. Dkt. 78), but the bankruptcy court granted the United States Trustee's Rule 2004 motion after a hearing (Bankr. Dkt. 95). Wells Fargo now seeks leave to appeal this interlocutory discovery order. (Bankr. Dkt. 102). Since its notice of appeal has been pending, Wells Fargo has produced some documents in response to the United States Trustee's document requests.

STATUTORY FRAMEWORK

Federal district courts have jurisdiction to hear appeals from final judgments, orders, and decrees entered by bankruptcy judges, and in certain circumstances, appeals from interlocutory bankruptcy orders. 28 U.S.C. § 158(a)(1), (3). An order is final if it "ends the litigation on the merits and leaves nothing for the court to do but execute the judgment." *American Specialty Cars Holdings, LLC v. The Official Comm. of Unsecured Creditors of ASC Inc. (In re ASC Inc.)*, 386 B.R. 187, 193-94 (E.D. Mich. 2008) (citations omitted). Interlocutory orders (i.e., orders that are not final) issued by bankruptcy judges may be appealed only where the district court grants leave to appeal, a decision wholly within the district court's discretion. *See* 28 U.S.C. § 158(a)(3).

A party seeking leave to appeal an interlocutory bankruptcy order must file a motion for leave under Fed. R. Bankr. P. 8003. The motion is filed in the bankruptcy court, but decided by the district court. Fed. R. Bankr. P. 8003(b). This Court analyzes a motion for leave under Bankruptcy Rule

8003(b) using the standards applicable to requests for interlocutory appeals under 28 U.S.C. § 1292(b), which provides in pertinent part:

> When a district judge, in making in a civil action an order not otherwise appealable under this section, shall be of the opinion that such order involves a controlling question of law as to which there is substantial ground for difference of opinion and that an immediate appeal from the order may materially advance the ultimate termination of the litigation, he shall so state in writing in such order.

28 U.S.C. § 1292(b); *In re ASC Inc*., 386 B.R. at 195 (applying § 1292(b) standards in analyzing whether to allow an interlocutory bankruptcy appeal).

ARGUMENT

Despite Wells Fargo's arguments to the contrary, the bankruptcy court's order granting a Rule 2004 exam is a garden-variety, non-final discovery order that is not immediately appealable under 28 U.S.C. § 158(a)(1). Wells Fargo's appeal also does not fit within the collateral-order doctrine. Nor should discretionary leave to appeal be granted under 28 U.S.C. § 158(a)(3) because the interlocutory discovery order does not involve a controlling question of law, and immediate appeal will not materially advance the termination of the litigation. In short, Wells Fargo may not appeal immediately under any theory of appellate jurisdiction.

A. The bankruptcy court's order granting discovery under Bankruptcy Rule 2004 is not final.

As discussed above, an order granting or denying discovery under Bankruptcy Rule 2004 is a discovery order. In the Sixth Circuit, discovery orders are interlocutory and not immediately appealable. *United States ex rel. Pogue v. Diabetes Treatment Centers of America, Inc.,* 444 F.3d 462, 471 (6th Cir. 2006). To obtain appellate review, a party "seeking to appeal a discovery order must first disobey the order and suffer a contempt citation," then appeal from the contempt order.

Id. (citing *Alexander v. United States*, 201 U.S. 117 (1906)). Wells Fargo has not appealed from a contempt order.

Instead, Wells Fargo claims that a more "pragmatic approach to finality" should allow for immediate appeal of discovery orders in bankruptcy cases. Dkt. 102 at 6-7. That approach should not allow for immediate appeal of a routine discovery order, however. Indeed, this Court has observed that a bankruptcy order that "provides for discovery . . . suggest[s] that no final judgment or decree has been entered." *In re Smelser,* 327 B.R. 815, 817 (E.D. Mich. 2005) (dismissing interlocutory appeal).

Moreover, courts around the country that have considered this issue have held that orders granting or denying Rule 2004 examinations in bankruptcy cases are, like discovery orders in civil cases, interlocutory and not immediately appealable. *See In re Vance,* 165 F.3d 34 (Table), 1998 WL 783728, *1 (7th Cir. Nov. 2, 1998) (Exhibit A) (citing *In re Towers Fin. Corp.*, 164 B.R. 719, 720 (S.D.N.Y. 1994)); *Aetna Cas. & Sur. Co. v. Glinka*, 154 B.R. 862, 868 (D. Vt. 1993); *In re Blinder Robinson Co.*, 127 B.R. 267, 272 (D. Colo. 1991)); *see also Kaiser Group Int'l, Inc. v. Mittal Steel Ostrava, a.s. (In re Kaiser Group Int'l, Inc.)*, 400 B.R. 140, 145 (D. Del. 2009) (holding order denying a Rule 2004 exam was not final and not appealable as of right or under the criteria for allowing interlocutory appeals); *In re Midwest Video Games, Inc.*, No. 98 C 3836, 1998 WL 395152, at *1 (N.D. Ill. July 9, 1998) (Exhibit B) (same with respect to an order granting a Rule 2004 exam); *Gache v. Balaber-Strauss,* 198 B.R. 662, 664-65 (S.D.N.Y. 1996) (same).

In particular, in other appeals that are like this one, courts have rejected attempts by mortgage lenders to obtain interlocutory review of orders granting the United States Trustee discovery under Rule 2004. *See Countrywide Home Loans, Inc. v. Office of the United States Trustee*, No. 08-617, 2008 WL 2388285, *4-*6 (W.D. Pa. June 11, 2008) (Exhibit C) (dismissing appeal from Rule 2004 exam order as non-final, rejecting mortgage lender's arguments for appeal under collateral-order doctrine and 28 U.S.C. §§ 158(a)(1) & (3), and observing, "I find no reason to depart from the general rule disallowing appeals as of right of discovery orders, even under the more liberal bankruptcy perspective on finality."); *In re Del Castillo*, Case No. 08-20020-mc-Altonaga (S.D. Fla. Feb. 8, 2008) (finding that an order overruling mortgage lender's objections to a similar Rule 2004 Notice of Examination and Subpoena Duces Tecum served by the Office of the United States Trustee was neither final nor appealable) (Exhibit D).

Finally, Wells Fargo's suggestion that it "will not likely have any meaningful opportunity for appellate review" unless this Court grants leave to appeal is not true. (Dkt. 102 at 8, 12-13). Even if Wells Fargo will have provided discovery before its appeal can be heard — and indeed, it has produced some documents — an appellate court could provide relief (assuming Wells Fargo could establish appellate jurisdiction over this interlocutory matter). In cases where a discovery order is reversed after the discovery has already been provided, courts have ordered the return of documents and/or enjoined any future use of the discovery, as the Supreme Court has recognized. *See, e.g., Church of Scientology of California v. United States*, 506 U.S. 9, 15 & n.9 (1992) (holding, in an appeal from a discovery order where discovery already had been produced, "this case is not moot because if the summons were improperly issued or enforced a court could order that the [produced] copies of the tapes be either returned or destroyed").

For these reasons, this Court should conclude that it does not have jurisdiction over Wells Fargo's appeal under 28 U.S.C. § 158(a)(1) because the order from which Wells Fargo attempts to appeal is not final.

B. The discovery order is not appealable under the collateral-order doctrine.

Nor should this Court find jurisdiction under the collateral-order doctrine. Generally, the collateral-order doctrine allows for interlocutory appellate review of a narrow class of non-final orders that "finally determine claims of right separable from, and collateral to, rights asserted in the action, too important to be denied review and too independent of the cause itself to require the appellate consideration be deferred until the whole case is adjudicated." *Cohen v. Beneficial Indus. Loan Corp.*, 337 U.S. 541, 546 (1949). The Sixth Circuit has stated unequivocally that "[d]iscovery orders are not reviewable on an interlocutory basis . . . under the collateral order doctrine." *In re Professionals Direct Ins. Co.,* 578 F.3d 432, 438 (6th Cir. 2009) (citing *John B. v. Goetz,* 531 F.3d 448, 458 (6th Cir. 2008)); *Diabetes Treatment Centers of America, Inc.*, 444 F.3d at 472 ("This court has repeatedly held, however, that discovery orders are generally not appealable under the collateral order doctrine.") (collecting cases). This "is so because a party 'can obtain effective review of the district court order by failing to comply with the order and perfecting an appeal should the district court impose sanctions' or a contempt citation." *John B.*, 531 F.3d at 458 (quoting *Dow Chem. Co. v. Taylor*, 519 F.2d 352, 355 (6th Cir.1975)).

Courts around the country have refused to find orders granting or denying Rule 2004 exams appealable under the collateral-order doctrine. *See, e.g., Countrywide Home Loans, Inc.*, 2008 WL 2388285, *4-*6 (Exhibit C) (rejecting mortgage lender's arguments for appeal under collateral-order doctrine). And while Wells Fargo again expresses concern about mootness if it has to provide documents before it can have its appeal heard, Wells Fargo does not contend that anything in the documents is privileged or a trade secret that would elevate this matter above the level of a routine discovery dispute.[1] *Cf. Diabetes Treatment Centers of America, Inc.,* 444 F.3d at 473 (noting that while some circuits apply the collateral-order doctrine to interlocutory discovery appeals involving privilege, the Sixth Circuit has not allowed such interlocutory appeals and "has traditionally viewed mandamus as the sole method by which we might review a discovery order involving a claim of privilege."). Moreover, Wells Fargo has now produced documents. Accordingly, this Court should not find jurisdiction over Wells Fargo's interlocutory appeal under the collateral-order doctrine.

C. The criteria for a discretionary interlocutory appeal are not met.

As noted above, this Court uses the criteria found in 28 U.S.C. § 1292(b) to determine whether to grant a discretionary interlocutory bankruptcy appeal under 28 U.S.C. § 158(a)(3). *See In re ASC Inc.*, 386 B.R. at 195 (applying § 1292(b) standards in analyzing whether to allow an interlocutory bankruptcy appeal). Those criteria are: [1] the order involves a controlling question of law, [2] as to which there is substantial ground for difference of opinion, and that [3] an immediate appeal from the order may materially advance the ultimate termination of the litigation. 28 U.S.C. § 1292(b). The criteria are not met here.

1. There is no "controlling issue of law" in this case; Wells Fargo instead complains that the factual record did not provide sufficient cause to order the discovery.

In analyzing the first prong of the test for interlocutory appeals, this Court must determine whether there is a "controlling question of law." A controlling question of law is "a 'pure' question of law rather than merely an issue that might be free from a factual contest." *Ahrenholz v. Board of Trustees of Univ. of Illinois,* 219 F.3d 674, 677 (7th Cir. 2000). In other words, it "something the

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[1] The instructions included with the 2004 Motion specifically instructed Wells Fargo not provide privileged documents. *See* Bankr. Dkt. 73 at Ex. A. Instead, Wells Fargo was directed to, consistent with Fed. R. Civ. P. 45(d)(1)(D)(2)(A), prepare a privilege log. *Id.*

court of appeals could decide quickly and cleanly without having to study the record . . . [not an issue that] requires hunting through the record . . . ." *Id.* A "controlling question of law" is an "an abstract issue of law, . . . suitable for determination by an appellate court without a trial record." *Id.; In re Brentwood Golf Club, L.L.C.*, 329 B.R. 239, 243 (E.D. Mich. 2005) (denying discretionary interlocutory review under 28 U.S.C. § 158(a)(3) and citing *Ahrenholz*, 219 F.3d at 676-77).

Discovery rulings are discretionary, and issues that fall within the discretion of the court are not appropriate for interlocutory review. *Mortgage Electronic Registration Systems, Inc. v. Jones*, No. 09-10321, 2009 WL 646623, *2 (E.D. Mich. March 11, 2009) (Exhibit E) (citing *W. Tenn. Chapter of Assoc. Builders & Contractors, Inc. v. City of Memphis*, 293 F.3d 345, 350 (6th Cir. 2002)); *see generally Proctor v. USDE*, 196 Fed. Appx. 345, 347 (6th Cir. 2006) ("court enjoys broad discretion in handling discovery disputes").

Although Wells Fargo argues that this case presents a controlling issue of law, in reality, Wells Fargo is disputing the bankruptcy court's application of discretion to a factual dispute. Nothing in the Rule 2004 Order purports — as Wells Fargo claims — to order discovery without the requisite showing of "good cause." Instead, Wells Fargo simply believes that there was an insufficient showing of good cause, a factual dispute that requires examination of the record. It is beyond exaggeration to say that the bankruptcy court "order[ed] a Rule 2004 examination without requiring that the requesting party demonstrate good cause for the examination." Dkt. 102 at 14. It is more accurate to say that this appeal presents the question "whether the bankruptcy court abused its discretion" by ordering discovery. *Id.* But for that very reason, it does not present a controlling question of law. *See* 8 FED. PRAC. & PROC. CIV. § 2006 (3d ed.) ("Ordinarily it is difficult to believe that a discovery order will present a controlling question of law or that an immediate appeal will materially advance the termination of the litigation.”).

Accordingly, because there is no “controlling question of law,” there can be no substantial ground for difference of opinion as to the legal issues raised by Wells Fargo’s appeal. *Cf. Ahrenholz,* 219 F.3d at 676 (stopping analysis after finding no “controlling question of law” and stating “[u]nless *all* these criteria [for interlocutory appeal under 28 U.S.C. § 1292(b)] are satisfied, the district court may not and should not certify its order . . . for an immediate appeal”).

2. Immediate appeal will not advance the ultimate termination of the litigation.

Wells Fargo’s final argument also fails. It contends that immediate appeal will advance the ultimate termination of the litigation because this discovery dispute is “the only dispute pending between the UST and Wells Fargo.” Dkt. 102 at 18. But Wells Fargo overlooks that the proceedings below may continue because of the nature of Rule 2004. Although Rule 2004 is a discovery tool with similarities to discovery under Fed. R. Civ. P. 26, it is a discovery tool that allows for *pre-litigation* discovery. A Rule 2004 examination is undertaken before the filing of an adversary proceeding or a motion, and may even be conducted in the absence of a pending adversary proceeding or contested matter, although it obviously requires the pendency of a bankruptcy case. *See generally In re Symington,* 209 B.R. 678, 684 (Bankr. D. Md. 1997) (explaining Rule 2004 exams). Thus, it is entirely possible that an adversary complaint or contested matter may arise between the United States Trustee and Wells Fargo. An immediate appeal would not terminate the litigation — it would protract it.

CONCLUSION

For all of these reasons, this Court should deny Wells Fargo’s motion for leave to appeal. The majority of courts to consider motions like Wells Fargo’s deny interlocutory appeal. So, too, should this Court. *See In re Vance*, 1998 WL 783728, *1 (Exhibit A); *In re Towers Fin. Corp.*, 164 B.R. at 720; *Aetna Cas. & Sur. Co.*, 154 B.R. at 868; *In re Blinder Robinson Co.*, 127 B.R. at 272. *See also Countrywide Home Loans, Inc.*, 2008 WL 2388285, *4-*6 (Exhibit C); *In re Del Castillo*, Case No. 08-20020-mc-Altonaga (S.D. Fla. Feb. 8, 2008) (Exhibit D); *Kaiser Group Int'l, Inc.,* 400 B.R. at 145; *In re Midwest Video Games, Inc.*, 1998 WL 395152, at *1(Exhibit B); *Gache,* 198 B.R. at 664-65.

Respectfully submitted,
DANIEL M. McDERMOTT
UNITED STATES TRUSTEE
Region 9

By: /s/ Kelley Callard (P68537)
Kelley.Callard@usdoj.gov
Trial Attorney
Office of the U.S. Trustee
211 West Fort St - Suite 700
Detroit, Michigan 48226
(313) 226-6773

Dated: March 1, 2011

UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF MICHIGAN
SOUTHERN DIVISION

In re:	Bankruptcy Case No. 10-60999-SWR
DERRICK GRAY,	Chapter 13
Debtor.	HON. STEVEN W. RHODES
________________________________/	District Court Case No. 2:11-cv-10640-JAC-MKM

CERTIFICATE OF SERVICE

I hereby certify that on March 1, 2011, I served copies as follows:

1.	Documents Served:	*The United States Trustee's Response to Wells Fargo Bank, N.A.'s Motion for Leave to Appeal, Brief and Certificate of Service.*
2.	Served Upon:	Derrick Gray 4377 Audubon Detroit, MI 48224
3.	Method of Service	First Class Mail

DANIEL M. McDERMOTT
UNITED STATES TRUSTEE
Region 9

By: /s/ Barbara Rygiel
Barbara.Rygiel@usdoj.gov
Paralegal Specialist
Office of the U.S. Trustee
211 West Fort Street - Suite 700
Detroit, MI 48226
313.226.4543

Dated: March 1, 2011

UNITED STATES BANKRUPTCY COURT
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______________________________/	District Court Case No. 2:11-cv-10640-JAC-MKM

EXHIBIT LIST

1. Exhibit A - *In re Vance*, 165 F.3d 34 (Table), 1998 WL 783728, *1 (7th Cir. Nov. 2, 1998)

2. Exhibit B - *In re Midwest Video Games, Inc.*, No. 98 C 3836, 1998 WL 395152, at *1 (N.D. Ill. July 9, 1998)

3. Exhibit C - *Countrywide Home Loans, Inc. v. Office of the United States Trustee*, No. 08-617, 2008 WL 2388285, *4-*6 (W.D. Pa. June 11, 2008)

5. Exhibit D - *In re Del Castillo*, Case No. 08-20020-mc-Altonaga (S.D. Fla. Feb. 8, 2008)

6. Exhibit E - *Mortgage Electronic Registration Systems, Inc. v. Jones*, No. 09-10321, 2009 WL 646623, *2 (E.D. Mich. March 11, 2009)

NOTICE: THIS IS AN UNPUBLISHED OPINION.
(The Court's decision is referenced in a “Table of Decisions Without Reported Opinions” appearing in the Federal Reporter. Use FI CTA7 Rule 53 for rules regarding the citation of unpublished opinions.)

United States Court of Appeals, Seventh Circuit.

In the Matter of: Clarence L. VANCE, Debtor.
Clarence L. VANCE, Appellant,
v.
Thomas LESTER, Trustee, Appellee.
No. 98-1470.

Submitted Oct. 15, 1998 [FN*].

FN* After an examination of the briefs and the record, we have concluded that oral argument is unnecessary, and the appeal is submitted on the briefs and the record. *See* Fed. R.App. P. 34(a); Cir. R. 34(f).

Decided Nov. 2, 1998.

Appeal from the United States District Court for the Northern District of Illinois, Western Division. No. 97 C 50334. Philip G. Reinhard, Judge.

Before Hon. KENNETH F. RIPPLE, Hon. DANIEL A. MANION, Hon. MICHAEL S. KANNE, Circuit Judges.

ORDER

***1** Clarence Vance voluntarily filed for bankruptcy pursuant to Chapter 7 of the Bankruptcy Code. The bankruptcy court entered postdischarge orders disallowing Vance's claimed exemption of his interest in a personal trust and granting the trustee's motion that Vance be required to submit to a Rule 2004 examination. The district court affirmed both orders, finding that the bankruptcy court retained postdischarge authority to issue the orders and that the trustee timely had objected to Vance's claimed exemption. We affirm.

In his petition for relief pursuant to § 301 of the Bankruptcy Code, Vance listed as exempt personal property his interest in the “Clarence Vance Trust.” Thomas Lester (the “trustee”) filed an objection to Vance's personal trust exemption on June 18, 1997. The creditors met as required by Rule 2003 of the Bankruptcy Rules on June 12, 1997. As there were no objections to Vance's discharge, the bankruptcy court entered a discharge order dated July 10, 1997, releasing Vance from all dischargeable debts and enjoining creditors from “instituting or continuing any action to collect the debtor's discharged debts and personal liabilities.” At the time of the discharge, the trustee's objection to Vance's claimed exemption was still pending. Subsequently, the court entered an August 6, 1997, order disallowing Vance's claimed exemption for his personal trust. In a second post-discharge order dated September 2, 1997, the bankruptcy court granted the trustee's motion for an examination of Vance pursuant to Rule 2004 of the Bankruptcy Rules. The trustee sought in that motion to obtain tax returns, the trust agreement and other documents relating to Vance's personal trust.

Vance appeals the district court's determination, arguing first that the discharge order enjoined the trustee from reaching the purportedly exempt property. He further argues that the trustee waived his objection to Vance's claimed exemption by failing to object to discharge. The trustee counters that discharge does not abrogate a trustee's statutory responsibility to administer the bankruptcy estate, and that he properly objected to Vance's claimed exemption.

We review the bankruptcy court's findings of fact for clear error. *In re Paeplow,* 972 F.2d 730, 733 (7th Cir.1992). The bankruptcy court's conclusions of law are reviewed de novo. *Id.* This appeal exclusively involves questions of law.

Although neither the district court nor the parties address the issue, we first consider whether we have jurisdiction to review the bankruptcy court's order granting a Rule 2004 examination. A majority of courts that have considered the issue have held that orders granting or denying Rule 2004 examinations are, like discovery orders, interlocutory. *See In re Towers Fin. Corp.,* 164 B.R. 719, 720 (S.D.N.Y.1994); *Aetna Cas. & Sur. Co.,* 154 B.R. 862, 868 (D.Vt.1993); *In re Blinder Robinson Co.,* 127 B.R. 267, 272 (D.Colo.1991). This court does not have jurisdiction to consider appeals from interlocutory orders in bankruptcy proceedings, *see* 28 U.S.C. § 158(d); indeed, we have jurisdiction only in cases where both the bankruptcy court and the district court have entered final orders. *In re Devlieg, Inc.,* 56 F.3d 32, 33 (7th Cir.1995); *In re Behrens,* 900 F.2d 97, 99 (7th Cir.1990). Because the order granting the trustee's motion for a Rule 2004 examination is not a final order, we do not have jurisdiction to consider Vance's challenge to that order. Therefore, the part of Vance's appeal that asks us to review the bankruptcy court's order granting a Rule 2004 examination must be dismissed for lack of jurisdiction. However, because the order disallowing Vance's claimed exemption is final, we address the merits of Vance's claims as to that order only.

***2** The trustee of a bankruptcy estate is charged with collecting and liquidating the property of the estate to satisfy creditors' claims. 11 U.S.C. § 704(1). In addition, the trustee is responsible for investigating the financial affairs of the debtor, and opposing discharge "if advisable." *Id.* § 704(4), (6). Nothing in § 704, or the discharge provision, *see id.* § 727, or any other relevant section of the Bankruptcy Code suggests that these duties are terminated or altered by discharge of the debtor.

The district court held that the trustee timely objected to Vance's claimed exemption. Objections to claimed exemptions must be filed within 30 days after the meeting of creditors held pursuant to Rule 2003. Bankr.R. 4003. Because the meeting of creditors was held June 12, 1997, the trustee met the prescribed deadline by filing his objection six days later, on June 18. Because the trustee filed his objection to the claimed exemption before the discharge order was entered, the discharge order could not have enjoined the trustee from raising that objection. In any event, the discharge order would not bar the trustee's actions because, by its express terms, the discharge order only prohibits "creditors" from initiating or continuing actions to "collect debts as personal liabilities of the debtor." Nonexempt property belongs to the estate, not the debtor, and it is the trustee's statutory duty to ensure that exempt property remains in the bankruptcy estate.

Vance's waiver argument is likewise without merit. As the district court recognized, discharge and exemption are governed by two distinct rules that prescribe correspondingly different periods for objections. *Compare* Bankr.R. 4003(b) (objection to exemption must be filed within 30 days after the meeting of the creditors) *with* Bankr.R. 4004(a) (complaint objecting to discharge must be filed within 60 days of the scheduled meeting of the creditors). Exemption and discharge also have different consequences. A Chapter 7 discharge releases the debtor from "all liabilities arising prior to the filing of the bankruptcy petition." *In re Birkenstock,* 87 F.3d 947, 950 (7th Cir.1996). By contrast, exemptions immunize property which would otherwise belong to the estate from "seizure or attachment for satisfaction of debts incurred prior to the bankruptcy proceeding." *In re Scarpino,* 113 F.3d 338, 340 (2d Cir.1997). Accordingly, Vance's contention that the trustee was required to object to discharge to preserve his right to object to the claimed exemptions must fail.

Vance's second contention on appeal is that the bankruptcy court did not have authority to enter the orders after he was discharged from bankruptcy. This argument merits little discussion because discharge of the debtor does not terminate a bankruptcy court's jurisdiction. *See, e.g.,* 11 U.S.C. § 727(d) (bankruptcy court may revoke discharge if the debtor has committed a fraud or failed to report the acquisition of property after the petition was filed). Therefore, the bankruptcy court had authority to enter both orders after Vance's discharge.

***3** For the foregoing reasons, Vance's appeal from the bankruptcy court order granting a Rule 2004 examination is DISMISSED, and the order disallowing Vance's claimed exemption is AFFIRMED.

C.A.7 (Ill.),1998.

Matter of Vance
165 F.3d 34, 1998 WL 783728 (C.A.7 (Ill.))
END OF DOCUMENT

Only the Westlaw citation is currently available.

United States District Court, N.D. Illinois.

In re: MIDWEST VIDEO GAMES, INC., Debtor.

No. 98 C 3836.

July 9, 1998.

MEMORANDUM AND ORDER

MANNING, District Court J.

***1** Appellants Bernice Ackerman, Melvin Ackerman, John O'Brien, and Lisa O'Brien seek to stay a bankruptcy court order setting dates for examinations pursuant to Bankruptcy Rule 2004 pending resolution of the merits of their appeal. For the following reasons, this appeal is dismissed for lack of jurisdiction, the appellants' stay motion is denied as moot, and counsel for the appellants and the Creditors' Committee are directed to show cause why they should not be sanctioned for failure to comply with the briefing schedule set by the court.

Background

The appellants seek to stay discovery pursuant to Bankruptcy Rule 2004 that is scheduled to commence later this week. According to the appellants, the Official Committee of Unsecured Creditors filed an adversary complaint against them which alleges that, through their transactions and dealings with Midwest Video Games, they “engaged in ‘fraudulent’ transfers, obtained ‘preferences' and treated the Debtor as their ‘alter ego.” ’ (Motion at 1). The appellants claim that the bankruptcy court erred in allowing discovery under Bankruptcy Rule 2004 in light of the pending adversary proceeding against them. Specifically, they argue that, because an adversary proceeding against them is pending, discovery must occur under Bankruptcy Rule 7026, *et seq.,* rather than Bankruptcy Rule 2004.

Jurisdiction

The court's consideration of the appellants' stay motion begins and ends with its consideration of its jurisdiction to consider this appeal in the first instance. Bankruptcy appeals as of right are limited to “final judgments, orders, and decrees ... of bankruptcy judges.” 28 U.S.C. § 158(a). Here, the appealed-from order relates to discovery. The appellants nevertheless contend that this order is final, citing *In re Blinder, Robinson & Co., Inc.,* 127 B.R. 267 (D.Colo.1991). In *Blinder,* the court held that an order compelling discovery under Rule 2004 was interlocutory, but stated that:

> [t]his is not to say that all appeals from Rule 2004 orders are non-final. This question should be resolved on a case-by-case basis. Where the dispute has been narrowed and there is no indication that further action by the bankruptcy court will be forthcoming, an order concerning Rule 2004 examinations should properly be considered final.

Id. at 272-73.

EXHIBIT B

Notably, the *Blinder* court explained why the discovery order appealed in that case was interlocutory. It did not, however, explain why a discovery order would become appealable simply because the bankruptcy judge definitively resolved that motion. The court declines to accept the appellants' invitation to find that the bankruptcy judge's discovery order is final because the bankruptcy judge has indicated that he does not intend to revisit his ruling, as the order is clearly interlocutory, even under the more relaxed standards of finality applicable to bankruptcy cases. *See, e.g., In re Jartran, Inc.,* 886 F.2d 859, 861-64 (7th Cir.1989) (discussing parameters of finality in bankruptcy cases); *Sante Fe Industries, Inc. v. Yorke,* No. 90 C 5359, 1991 WL 18483 *1 (N.D.Ill. Feb.11, 1991), *citing Union Carbide Corp. v. U.S. Cutting Service, Inc.,* 782 F.2d 710, 712 (7th Cir.1986) ("The general and very salutary rule is that discovery orders are not appealable until the end of the case"); *In re S.N.A. Nut Co.,* No. 96 C 181, 1996 WL 411290 *4 (N.D.Ill. Jul.19, 1991) (collecting cases regarding the non-appealability of discovery orders in bankruptcy cases); *In re Towers Financial Corp.,* 164 B.R. 719, (S.D.N.Y.1994) (criticizes *Blinder* rule and collects cases regarding the non-appealability of discovery orders in bankruptcy cases).

***2** The court also notes that the holding of *Blinder* requires a case-by-case determination as to the finality of a Rule 2004 order. It thus is susceptible to a variety of interpretations and, therefore, is at odds with the Seventh Circuit's recent admonition that jurisdictional rules in bankruptcy cases should be "simple and precise so that judges and lawyers are spared having to litigate over not the merits of a legal dispute but where and when those merits shall be litigated." *In re Lopez,* 116 F.3d 1191, 1194 (7th Cir.), *cert. denied,* 522 U.S. 1014, 118 S.Ct. 599, 139 L.Ed.2d 488 (1997). In addition, the appellants have failed to present a convincing reason why allowing an appeal as of right from a discovery order would not completely eviscerate the finality requirement, even when viewing finality from the more liberal bankruptcy perspective. For these reasons, the court finds that the bankruptcy court's Rule 2004 order is not final.

Thus, jurisdiction over this appeal is proper only if the court grants leave for the appeal to proceed. *In re Jartran,* Inc., 886 F.2d at 866; *In re Lifschultz Fast Freight Corp.,* 127 B.R. 418 (N.D.Ill.1991). Consideration of this question is governed by the familiar § 1292(b) factors, which authorize an appeal if: (1) the interlocutory order involves a controlling question of law; (2) as to which there is a substantial ground for difference of opinion; (3) and an immediate appeal will materially advance the ultimate termination of the litigation. 28 U.S.C. § 1292(b); *In re Lifschultz Fast Freight Corp.,* 127 B.R. at 418; *Sante Fe Industries, Inc.,* 1991 WL 18483 at *1.

The court finds that resolution of the parties' dispute concerning the scope of discovery fails to present a controlling question of law, as resolution of this "discovery matter is not likely to be dispositive of any of the material issues in this case." *Sante Fe Industries, Inc.,* 1991 WL 18483 at *1; *In re S.N.A. Nut Co.,* 1996 WL 411290 at *4 (bankruptcy court order regarding discovery was not controlling); *In re Lifschultz Fast Freight Corp.,* 127 B.R. at 419 (same). In addition, the appellants' disagreement with orders entered by the bankruptcy court with respect to discovery directed at them does not demonstrate that there is a substantial ground for difference of opinion. *See Sante Fe Industries, Inc.,* 1991 WL 18483 at *1. Finally, resolution of this discovery matter will multiply, as opposed to streamline, the proceedings.

Accordingly, the court exercises its discretion and declines to grant leave to file an interlocutory appeal. This appeal is, therefore, dismissed for lack of jurisdiction, and the appellants' stay motion is denied as moot. The court notes that, by declining jurisdiction, the court does not express an opinion as to the propriety of the bankruptcy court's order. *See Sante Fe Industries, Inc.,* 1991 WL 18483 at *2.

EXHIBIT B

Counsel's Failure to Comply With the Briefing Schedule Set by the Court

***3** On July 1, 1998, when the appellants presented their stay motion, the court ordered the Creditors' Committee to file their response by July 6, 1998 at 12:00 p.m. and ordered the appellants to file their reply by July 7, 1998 at 12:00 p.m. The court, however, received its courtesy copy of the response on the morning of July 7, 1998, and received its copy of the reply at approximately 2:30 p.m. on July 7, 1998. Neither side explained the reason for the delay or sought leave to file their pleading instanter. Adherence to filing deadlines set by the court is not discretionary. Accordingly, counsel for the appellants and the Creditors' Committee are directed to show cause why they should not be sanctioned for failure to comply with the briefing schedule set by the court.

Conclusion

This appeal is dismissed for lack of jurisdiction, and the appellants' stay motion [2-1 and 2-2] is denied as moot. Counsel for the appellants and the Creditors' Committee are each directed to file a brief memorandum by no later than July 15, 1998, addressing why they should not be sanctioned for failure to comply with the briefing schedule set by the court.

N.D.Ill.,1998.

In re Midwest Video Games, Inc.

Not Reported in F.Supp., 1998 WL 395152 (N.D.Ill.)

END OF DOCUMENT

EXHIBIT B

Only the Westlaw citation is currently available.

United States District Court,

W.D. Pennsylvania.

In re COUNTRYWIDE HOME LOANS, INC.,
Appellant,

v.

OFFICE OF THE UNITED STATES TRUSTEE,
Appellee.

Civil Action No. 08-617.

June 11, 2008.

SYNOPSIS

AMBROSE, Chief Judge.

***1** Appellant Countrywide Home Loans, Inc. ("Appellant" or "Countrywide") appeals an April 1, 2008 Order of the United States Bankruptcy Court for the Western District of Pennsylvania denying Countrywide's Motion to Quash and overruling in part Countrywide's Objections to a Notice of Examination Under Fed. R. Bankr.P.2004 and Subpoena (*Duces Tecum*) (the "2004 Notice") served by Appellee, the Executive Office of the United States Trustee ("Appellee" or "US Trustee"). (Docket No. 1). In the alternative, Countrywide seeks leave to appeal the Order pursuant to Bankruptcy Rules 8001 and 8003. *Id.* The U.S. Trustee opposes Countrywide's Motion for Leave to Appeal. (Docket No. 1, Ex. 7). Also pending is Countrywide's Emergency Motion for Stay Pending Appeal Pursuant to Fed. R. Bankr.8005 (Docket No. 2), and Countrywide's Emergency Motion for Temporary Stay Pending Determination of Its Motion for Stay Pending Appeal (Docket No. 12). After careful consideration of the submissions of the parties, and for the reasons discussed below, Countrywide's Motion for Leave to Appeal (Docket No. 1) is denied and Countrywide's Motions for Stay Pending Appeal and for Temporary Stay Pending Determination of Its Motion for Stay Pending Appeal (Docket Nos. 2 and 12) are denied as moot.

OPINION AND ORDER OF COURT

I. *BACKGROUND*

The U.S. Trustee is an official of the United States Department of Justice charged with responsibility to "supervise the administration of cases and trustees in cases under chapter 7, 11, 12, 13 or 15 of title 11 ....“ 28 U.S.C. § 586(a)(3). Section 307 of the Bankruptcy Code provides that the U.S. Trustee "may raise and may appear and be heard on any issue in any case or proceeding under this title but may not file a plan pursuant to section 1121(c) of this title." 11 U.S.C. § 307. On October 18, 2007, the U.S. Trustee for this region filed notice of her intent to examine Countrywide under Federal Rule of Bankruptcy Procedure 2004 ("Rule 2004") and Subpoenas (*Duces Tecum*) in ten bankruptcy cases described by the bankruptcy court as "context cases." [FN1] On November 5, 2007, the Bankruptcy Court; entered a Consolidation Order for Examination Notices consolidating these ten Notices of Examination and Subpoenas into a single miscellaneous proceeding (Bankruptcy Docket Misc. No. 07-204 TPA) for the purpose of efficiently resolving issues regarding the Notices and Subpoenas and the U.S. Trustee's investigation of Countrywide. [FN2]

FN1. Fed. R. Bankr.P.2004 is a pre-litigation discovery mechanism unique to bankruptcy. Rule 2004 provides in pertinent part:

> (a) Examination on Motion
>
> On a motion of any party in interest, the court may order the examination of any entity.
>
> (c) Scope of Examination
>
> The examination of any entity under this rule or of the debtor under § 303 of the Code may relate only to the acts, conduct, or property or to the liabilities and financial condition of the debtor, or to any matter which may affect the administration of the debtor's estate, or to the debtor's right to a discharge. In ... an individual's debt adjustment case under chapter 13, ... the examination may also relate to the operation of any business and the desirability of its continuance, the source of any money or property acquired or to be acquired by the debtor for purposes of consummating a plan and the consideration given or offered therefor, and any other matter relevant to the case or to the formulation of a plan.
>
> (c) Compelling attendance and production of documents
>
> The attendance of an entity for examination and for the production of documents, whether the examination is to be conducted within or without the district in which the case is pending, may be compelled as provided in Rule 9016 for the attendance of a witness at a hearing or trial. As an officer of the court, an attorney may issue and sign a subpoena on behalf of the court for the district in which the examination is to be held if the attorney is admitted to practice in that court or in the court in which the case is pending.

FN2. Following the commencement of the miscellaneous proceeding, the relevant context cases are limited to seven: *In re Hill,* Case No. 01-22574-JAD; *In re Benvenuto,* Case No. 02-20946-JKF; *In re Stemple,* Case No. 03-11792-WWB; *In re Karleski,* Cas No. 04-31355-JKF; *In re Bock,* Case No. 04-32812-BM; *In re Olbeter,* Case No. 04-33361-JKF; and *In re Topper,* Case No. 05-20772-TPA.

Pursuant to the Consolidation Order, the U.S. Trustee filed on November 7, 2007 a single Notice of Examination Under Rule 2004 and Service of Subpoena (*Duces Tecum*) in the miscellaneous proceeding. On November 9, 2007, Countrywide filed its objection to the Rule 2004 Notice and its motion to quash the related Subpoena. After the parties briefed any issues pertinent to the Rule 2004 examinations, the bankruptcy court conducted a hearing on February 28, 2008 to consider Countrywide's objections to the examinations. On April 1, 2008, the bankruptcy court entered the Memorandum Opinion and Order that are the subject of this appeal, partially denying Countrywide's objections and motion to quash. The April 1, 2008 Order authorized, in part, the U.S. Trustee's Rule 2004 examinations and related document production.

***2** In the April 1, 2008 Memorandum Opinion, the bankruptcy court concluded, over Countrywide's objection, that the U.S. Trustee had the authority to seek the production of documents and the examination of witnesses pursuant to Rule 2004. The court, however, limited the scope of the examinations and required that the U.S. Trustee conduct the examinations within the context of one specific bankruptcy case, *In re Hill,* Case No. 01-22574-JAD. Specifically the Court stated:

> [F]or the sake of administrative convenience and to avoid any potential *res judicata* issues, the Court will stay the Notice of Examination and Subpoenas in all context cases except *In re Hill,* Case No. 01-22574-JAD. In that case, the Court will direct Countrywide to produce documents in Categories 5-12 as to each of the debtors in the context cases and will direct Countrywide to make a witness or witnesses available to be examined on the topics identified by the [US Trustee].

(April 1,2008 Mem. Op. at 50).[FN3]

On or about April 11, 2008, Countrywide filed the instant Motion for Leave to Appeal pursuant to Federal Rules of Bankruptcy 8001 and 8003, subject to its Notice of Appeal filed contemporaneously therewith, seeking leave to appeal from the bankruptcy court's April 1, 2008 Order. Specifically, Countrywide urges me to consider the following questions on appeal:

a. Whether the Bankruptcy Court has subject matter jurisdiction to authorize an examination pursuant to Rule 2004 of the Federal Rules of Bankruptcy Procedure when there is no connection between the proposed examination and any effect upon a debtor's estate;

b. Whether the Bankruptcy Court erred in holding that the U.S. Trustee is a “party in interest” for the purposes of Rule 2004 of the Federal Rules of Bankruptcy Procedure;

c. Whether the Bankruptcy Court erred in holding that the U.S. Trustee has the power to take an examination pursuant to Rule 2004 of the Federal Rules of Bankruptcy Procedure in the absence of a contested matter; and

d. Whether the Bankruptcy Court erred in finding that 11 U.S.C. § 307 does not require that there be a contested matter for the U.S. Trustee to appear and be heard.

See Mot. for Leave at 5. The U.S. Trustee opposes Countrywide's Motion for Leave on the grounds that the appeal is interlocutory and does not merit consideration at this time.

On April 14, 2008, Countrywide filed a Motion to Stay Pending Appeal in the bankruptcy court seeking to stay the court's April 1, 2008 Order pending the outcome of this appeal. On May 2, 2008, the bankruptcy court denied the Motion to Stay. (Docket No. 11). On May 9,

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FN3. The *In re Hill* case was the only case in which another matter (a Motion to Enforce Discharge against Countrywide) was then pending. Although the bankruptcy court stayed each of the context cases except *In re Hill,* it ruled that Countrywide's actions in all of the context cases nevertheless could be the subject of discovery in the *In re Hill* case pursuant to Federal Rules of Evidence 401, 404, and 406.

2008, Countrywide filed the instant Emergency Motion for Stay Pending Appeal Pursuant to Fed. R. Bankr.P. 8005 (Docket No. 2), seeking a similar stay. On May 13, 2008, the U.S. Trustee filed its response in opposition to the Emergency Motion to Stay (Docket No. 5), to which Countrywide replied, with leave of court (Docket No. 10). On June 9, 2008, Countrywide filed an Emergency Motion for Temporary Stay Pending Determination of Its Motion for Stay Pending Appeal, after the U.S. Trustee demanded that Countrywide comply with the Bankruptcy Court's April 1, 2008 Order. The issues in all three motions are now ripe for my review.

II. *LEGAL ANALYSIS*

***3** Federal district courts have appellate jurisdiction over the final judgments, orders, and decrees of bankruptcy courts. 28 U.S.C. § 158(a)(1). District courts also have discretionary jurisdiction to hear appeals of interlocutory orders. *Id.* § 158(a)(3). Countrywide's position is that the bankruptcy court's April 1, 2008 Order overruling Countrywide's objections to the Rule 2004 Notice and its motion to quash the related Subpoena is a final order subject to immediate appellate review. Alternatively, Countrywide seeks leave to appeal the Order pursuant to 28 U.S.C. § 158(a)(3), governing interlocutory orders. The U.S. Trustee argues that the April 1, 2008 Order is a non-final, interlocutory discovery order not subject to immediate appellate review.

A. *Final Order*

Countrywide first argues that leave to appeal is not necessary because the bankruptcy court's April 1, 2008 Order is final and, therefore, appealable as of right under 28 U.S.C. § 158(a)(1). I disagree.

28 U.S.C. § 158(a)(1) provides that this court has jurisdiction to hear appeals "from final judgments, orders, and decrees" of the bankruptcy court. The concept of "finality" is viewed flexibly in the bankruptcy context. *See, e.g., In re Truong,* 513 F.3d 91, 93-94 (3d Cir.2008); *In re Edison Bros. Stores, Inc.,* No. Civ. A. 96-177-SLR, 1996 WL 363806, at *2 (D. Del. June 27, 1996); *In re Columbia Gas Sys.,* 146 BR. 106, 110 (D.Del.1992), *aff'd* 50 F.3d 233 (3d Cir.1995). As one court within this Circuit has explained,

> It is well settled in the Third Circuit ... that 'considerations unique to bankruptcy appeals have led us consistently in those cases to construe finality in a more pragmatic, functional sense than with the typical appeal," which generally requires an order to 'dispose of all issues as to all parties to the case' before such an order can be considered final.

Baron & Budd, P.C. v. Unsecured Asbestos Claimants Comm., 321 B.R. 147, 155 (D.N.J.2005) (citing *In re Prof'l Ins. Mgmt.,* 285 F.3d 268, 279 (3d Cir.2002)).

Here, however, the appealed-from order relates to discovery. Even under the more relaxed standards of finality applicable to bankruptcy cases, discovery orders generally are held to be interlocutory and non-appealable. *See In re Jeannette Corp.,* 832 F.2d 43, 46 (3d Cir.1987) ("In civil litigation, discovery orders are, with rare exception, non-appealable.... A similar approach applies in bankruptcy cases.") (citing *In re Int'l Horizons, Inc.,* 689 F.2d 996, 1000-01 (11th Cir.1982)); *see also, e.g., In re Midwest Video Games, Inc.,* No. 98 C 3836, 1998 WL 395152, at * *1-2 (N.D.III. July 9, 1998) (citing cases). Generally, a party challenging a discovery order has two options: to comply with the order and challenge it at the conclusion of the case; or to refuse to comply with the order and contest its validity if subsequently found in contempt for such refusal. *See Int'l Horizons, Inc.,* 689 F.2d at 1000-01; *In re Jeannette Corp.,* 832 F.2d at 46; *Aetna Cas. & Sur. Co. v. Glinka,* 154 B.R. 862, 867-68 (D.Vt.1993).

***4** After careful review of the submissions of both parties, I find no reason to depart from the general rule disallowing appeals as of right of discovery orders, even under the more liberal bankruptcy perspective on finality. Countrywide may comply with the April 1, 2008 Order and challenge it at the conclusion of the underlying case, or Countywide may refuse to comply and appeal the Order if and when the bankruptcy court issues a contempt order in the face of such refusal. For all of these reasons, I find that the April 1, 2008 Order was not a final order for purposes of 28 U.S.C. § 158(a) (1). *See, e.g., Aetna Cas. & Sur. Co.,* 154 B.R. at 868 (order defining scope of Rule 2004 subpoenas *duces tecum* and denying motion to quash subpoenas and for protective order was interlocutory); *In re Midwest Video Games, Inc.,* 1998 WL 395152, at **1-2 (bankruptcy court's Rule 2004 examination order was not final).[FN4]

Countrywide's argument that the April 1, 2008 Order was final because it resolved the only existing issue in the miscellaneous proceeding that the bankruptcy court created to address the U.S. Trustee's Rule 2004 Notice is not persuasive. As set forth in the background section above, the bankruptcy court opened the miscellaneous number for the purpose of efficiently resolving issues regarding the U.S. Trustee's investigation of Countrywide after the U.S. Trustee filed Rule 2004 Notices and Subpoenas in *ten* separate bankruptcies. Pursuant to the Consolidation Order, the U.S. Trustee filed on November 7, 2007 a single Notice of Examination Under Rule 2004 and Service of Subpoena (*Duces Tecum*) in the miscellaneous proceeding. Thus, even if the miscellaneous proceeding technically had concluded, the underlying bankruptcy to which the April 1, 2008 Order and the U.S. Trustee's investigation primarily relate, the *In re Hill* bankruptcy, has not. In addition, the bankruptcy court expressly stayed the Rule 2004 examinations in the remaining six underlying context cases, “pending further Order of the Court,” a further indication that all existing issues have not been resolved. Finally, as touched on above, additional questions may arise as the U.S. Trustee conducts the examinations such as the permissible scope of the examinations and the consequences of any refusal by Countrywide to comply with the examination.

B. *Collateral Order*

Countrywide next argues that, even if the April 1, 2008 Order is not final, it is nevertheless appealable under the collateral order doctrine established in *Cohen v. Beneficial Indus. Loan Corp.,* 337 U.S. 541 (1949). Again, I disagree.

The Court of Appeals for the Third Circuit has applied *Cohen* to provide:

> “a narrow exception to the general rule permitting appellate review only of final orders. An appeal of a nonfinal order will lie if (1) the order from which the appellant appeals conclusively determines the disputed question; (2) the order resolves an important issue that is completely separate from the merits of the dispute; and (3) the order is effectively unreviewable on appeal from a final judgment..... To this end, as a doctrinal matter, orders that meet the three prongs described above are deemed to be ‘final decisions' within the meaning of the statute.”

***5** *Baron & Budd, P.C.,* 321 B.R. at 155-56 (quoting

FN4. The United States District Court for the Southern District of Florida reached the same conclusion in finding that an order overruling Countrywide's objections to a similar Rule 2004 Notice of Examination and Subpoena Duces Tecum served by the Office of the United States Trustee on Countrywide in a different bankruptcy case was not final. *See In re Del Castillo,* Case No. 08-20020-mc-Altonaga (S.D.Fla. Feb. 8, 2008).

Petroleos Mexicanos Refinacion v. M/T King A (EX-TIBLISI), 377 F.3d 329, 334 (3d Cir.2004)). In the context of discovery orders, however, the Court of Appeals has found the collateral order doctrine applicable only in two very limited circumstances: where the information sought is either privileged or a trade secret. *See* *Bacher v. Allstate Ins. Co.,* 211 F.3d 52, 53, 57 (3d Cir.2000). As the U.S. Trustee notes in her response, the April 1, 2008 Order Countrywide seeks to appeal does not authorize the U.S. Trustee to seek any information or material that is privileged or a trade secret. Thus, the collateral order doctrine does not apply.

C. ***Interlocutory Order***

Even if the Order at issue is not appealable as of right, I have discretionary jurisdiction over certain interlocutory appeals under 28 U.S.C. § 158(a)(3). Because that statute does not provide any standards to apply, courts generally have looked to the language of 28 U.S.C. § 1292(b), which governs the scope of appellate jurisdiction over interlocutory appeals from district courts. *See* *Sterling Supply Corp. v. Mullinax,* 154 B.R. 660, 662 (E.D.Pa.1993). Under section 1292(b), an appellate court has jurisdiction “over non-final orders (1) that involve a controlling question of law (2) about which there is a substantial basis for a difference of opinion, (3) the resolution of which will materially advance the ultimate termination of the litigation.” *Sterling Supply Corp.,* 154 B.R. at 662. Interlocutory appeals “contravene the judicial policy opposing piecemeal litigation and the disadvantages of delay and disruption associated with it.” *In re Am. Freight Sys., Inc.,* 194 B.R. 659, 661 (D.Kan.1996). Thus, interlocutory bankruptcy appeals generally are reserved for cases presenting exceptional circumstances. *See id.* (citing cases); *see also* *Dal-Tile Int'l, Inc. v. Color Tile, Inc.,* 203 B.R. 554, 557 (D.Del.1996); *In re Neshaminy Office Bldg. Assocs.,* 81 B.R. 301, 303 (E.D.Pa.1987). Countrywide, as the party seeking an interlocutory appeal, bears the burden of demonstrating exceptional circumstances. *See* *In re Am. Freight Sys., Inc.,* 194 B.R. at 661-62.

Here, Countrywide has not made a showing that meets the section 1292(b) standard. As one court aptly has explained:

> Questions that arise during the course of a bankruptcy proceeding concerning the appropriate scope of discovery and that do not involve controlling questions of law are left to the sound discretion of the court that is fully familiar with the entire proceeding-the bankruptcy judge.

In re Towers Fin. Corp., 164 B.R. 719, 721 (S.D.N.Y.1994). Here, Countrywide has not demonstrated that the bankruptcy court's April 1, 2008 Order denying its objections to the Rule 2004 examination and motion to quash subpoena differs significantly from routine discovery orders from which interlocutory appeals are discouraged.[FN5] Accordingly, I do not find any reason to exercise my discretion to entertain Countrywide's interlocutory appeal.

[FN5] Even if the issue of the U.S. Trustee's authority to conduct a Rule 2004 examination of Countrywide under the facts of this case was a controlling issue of law, which it is not, Countrywide has not shown that it is a question about which there is a substantial basis for a difference of opinion. Indeed, Countrywide has not pointed to any case law in direct support of its position. To the contrary, courts that have discussed the U.S. Trustee's powers under 11 U.S.C. § 307 have held that the statute provides the U.S. Trustee with very broad standing and that the U.S. Trustee is the equivalent of a party in interest in bankruptcy. *See, e.g.,* *Thompson v. Greenwood,* 507 F.3d 416, 420 n. 3 (6th Cir.2007); *In re Miles,* 330 B.R. 848, 849-50 (M.D.Ga.2005).

III. *CONCLUSION*

***6** In sum, for the reasons set forth above, I find that the April 1, 2008 Order of the Bankruptcy Court partially denying Countrywide's objection to the Rule 2004 Notice and denying its motion to quash the related Subpoena was not a final order within the meaning of 28 U.S.C. § 158(a). Further, in the exercise of my discretion, I decline to grant Countrywide leave to file an interlocutory appeal. Accordingly, Countrywide's Motion for Leave to Appeal is denied, and Countrywide's Motion for Stay Pending Appeal and Motion for Temporary Stay Pending Resolution of Its Motion for Stay Pending Appeal are denied as moot. Countrywide's appeal is dismissed for lack of jurisdiction.

ORDER OF COURT

AND NOW, this 11th day of June, 2008, after careful consideration, it is ordered that Countrywide Home Loans, Inc.'s Motion for Leave to Appeal (Docket No. 1) is DENIED. Countrywide's Emergency Motion for Stay Pending Appeal Pursuant to Fed. R. Bankr.P. 8005 (Docket No. 2) and Emergency Motion for Temporary Stay Pending Determination of Its Motion for Stay Pending Appeal (Docket No. 12) are DENIED as moot. Countrywide's appeal is dismissed for lack of jurisdiction.

W.D.Pa.,2008.

Countrywide Home Loans, Inc. v. Office of the U.S. Trustee

Not Reported in F.Supp.2d, 2008 WL 2388285 (W.D.Pa.)

END OF DOCUMENT

EXHIBIT C

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF FLORIDA
MIAMI DIVISION

CASE NO. 08-20020-mc-ALTONAGA

In re:

MANUEL DEL CASTILLO,
MARIA E. PENA,

Debtors.
_______________________________/

COUNTRYWIDE HOME
LOANS INC.,

Appellant,
v.

OFFICE OF THE UNITED
STATES TRUSTEE,

Appellee.
_______________________________/

ORDER

Countrywide Home Loans, Inc. ("Countrywide") appeals an Order Overruling in Part the Objections of Countrywide to the Second Amended Notice of Examination Under Federal Rule of Bankruptcy Procedure 2004 and Subpoena Duces Tecum served by Appellee, Office of the United States Trustee (the "Trustee"), entered by the United States Bankruptcy Court for the Southern District of Florida (the "bankruptcy court"). (*See* R. 132).[1] In the alternative, Countrywide seeks leave to appeal the Order pursuant to Bankruptcy Rules 8001 and 8003.

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[1] References to the record on appeal are indicated by "R," followed by the docket entry number from the bankruptcy court.

EXHIBIT D

I. BACKGROUND

On May 14, 2007, Debtors, Manuel Del Castillo and Maria E. Pena, filed a joint voluntary petition for relief under Chapter 13 of Title 11 of the United States Code in the bankruptcy court. Countrywide is a secured creditor by virtue of a promissory note and a mortgage recorded against the Debtors' residence as security for the promissory note. (*See Appellants' Mem. of Law in Support of Notice of Appeal* [D.E. 1-2], p. 1). Countrywide asserted a secured claim of $287,902.23, pre-petition arrearages totaling $16,417.67, and an insufficient funds fee of $682.88. (*See Appellee's Objection to Countrywide's Mot. for Leave to Appeal* [D.E. 1-2], p. 2). Countrywide further claimed that Debtors' "'Regular Monthly Installments of $1,783.64 . . .' would increase to $4,773.54 'Effective 7/1/2007' and that it might be entitled to future costs of collection, including attorney's fees." (*Id.* (citing R. 14)).

Debtors filed their first amended Chapter 13 plan (the "Plan") on July 19, 2007. (*See id.*). Under the Plan, Debtors proposed to repay creditors' claims over a period of 60 months. Debtors proposed to pay Countrywide's first and second lien claims outside the Plan. (*See id.*). The bankruptcy court scheduled a confirmation hearing on the Plan for January 29, 2008.

Debtors also filed an Objection to Countrywide's claim on August 10, 2007, arguing that Countrywide had failed to provide a breakdown of the claimed arrearages and insufficient funds fee. (*See id.* (citing R. 48)). Debtors requested "'a breakdown of the increase of the new monthly payment of $4,773.54'" and an award of attorney's fees from Countrywide, noting that Debtors' counsel "'has been forced to file his Objection to Claim in response to creditor's filing of an incorrect and/or improper Proof of Claim . . . .'" (*Id.*). Debtors also objected to Countrywide's claim for future attorney's fees. (*See id*. at 3).

Countrywide did not respond to Debtors' Objection, and the bankruptcy court entered an Order sustaining Debtors' Objection on August 28, 2007 (the "Objection Order"). (*See id*. (citing R.59)). The Objection Order reduced Countrywide's secured claim to $266,295.50, "struck 'the portion of the claim labeled pre-petition escrow advance in the amount of $11,923.85 and the insufficient funds fee in the amount of $682.88 . . .' and reserved jurisdiction to award attorneys' fees." (*Id*.). The Objection Order also disallowed any future attorney's fees claimed by Countrywide. (*See id*.).

Thereafter, on November 6, 2007, Countrywide, in agreement with Debtors, filed a Motion to Reconsider Debtors' Objection to Claim, stating it had provided Debtors with backup documentation to support the proof of claim, reduced the amount of the regular payment to $2,448.41, and paid attorney's fees to Debtors' attorney as necessitated by the circumstances. (*See id*. at 4; *see also Appellant's Mem.*, p. 2). The bankruptcy court subsequently entered an Agreed Order Granting the Motion to Reconsider.

Earlier, on October 23, 2007, the Trustee filed a Second Amended Notice of Taking Rule 2004 Examination Duces Tecum of Corporate Representative of Countrywide with Subpoena Duces Tecum (the "Notice"). Through the Notice, the Trustee sought to conduct discovery regarding the factual basis for Countrywide's proof of claim. (*See Appellee's Objection* [D.E. 1-2], p. 3). On November 2, 2007, Countrywide filed an Objection to the Notice. Countrywide argued that the Trustee lacked authority under 11 U.S.C. § 307 and 28 U.S.C. § 586 to investigate the factual basis for Countrywide's proof of claim. Countrywide also asserted that the requested discovery exceeded the scope of Federal Rule of Bankruptcy Procedure 2004[2] and that some of the document requests impinged on the attorney-client and work product privileges. According to Countrywide, the document requests in general constituted an "impermissible fishing expedition ." (*See id.*).

Following a hearing on Countrywide's Objection to the Trustee's Notice, the bankruptcy court issued the Order under review, partially sustaining and partially denying Countrywide's Objection. In its Order, the bankruptcy court found that 28 U.S.C. § 586 does not limit the Trustee's ability "to raise, appear and be heard on any issue in any case or proceeding under title 11." (R. 132). The bankruptcy court further held that the Trustee is authorized to issue a subpoena and conduct an examination of Countrywide pursuant to Rule 2004, in accordance with the authority granted the Trustee under 11 U.S.C. § 307 and 28 U.S.C. § 586. Additionally, the court determined there is a pending issue in the case upon which the Trustee may appear and be heard. (*See id.* (citing 11 U.S.C. § 307)).[3]

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[2] Federal Rule of Bankruptcy Procedure 2004 provides in pertinent part

> (a) Examination on motion
>
> On a motion of any party in interest, the court may order the examination of any entity.
>
> (b) Scope of examination
>
> The examination of any entity under this rule or of the debtor under § 343 of the Code may relate only to the acts, conduct, or property or to the liabilities and financial condition of the debtor, or to any matter which may affect the administration of the debtor's estate . . . .

See also In re Recoton Corp., 307 B.R. 751, 755 (S.D.N.Y. 2004) (citing Fed. R. Bankr. P. 2004(b)). "The purpose of a Rule 2004 examination is to assist a party in interest in determining the nature and extent of the bankruptcy estate, revealing assets, examining transactions and assessing whether wrongdoing has occurred." *Id.* (citation omitted).

[3] The Order conditioned Countrywide producing the documents upon the Trustee providing Countrywide with a certificate of compliance under the Right to Financial Privacy Act of 1978, 12 U.S.C. §§ 3401 *et seq.* (*See id.*). The Trustee has provided the requisite certificate. (*See Appellee's Objection* [D.E. 1-2], p. 5).

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Countrywide has identified the following issues it wishes to pursue:

1. Whether the bankruptcy court erred in finding that the Trustee possesses the authority to issue a subpoena and conduct and examination of Countrywide pursuant to Rule 2004.

2. Whether the bankruptcy court erred in finding that the Trustee possesses the authority to issue a subpoena and conduct an examination of Countrywide pursuant to 11 U.S.C. § 307 and 28 U.S.C. § 586.

3. Whether the bankruptcy court erred in finding there is a pending issue in this case upon which the Trustee may be heard pursuant to 11 U.S.C. § 307.

4. Whether the bankruptcy judge should have disqualified himself from hearing Countrywide's Objection pursuant to 28 U.S.C. § 455 (a) on the grounds that his impartiality might reasonably be questioned.

II. ANALYSIS

District courts have appellate jurisdiction over the final judgments, orders, and decrees of bankruptcy courts. 28 U.S.C. § 158(a)(1). A district court also has discretionary jurisdiction to hear appeals of interlocutory orders, upon leave. 28 U.S.C. § 158(a)(3). Countrywide contends the Order Overruling in Part the Objections of Countrywide Home Loans, Inc. to the Second Amended Notice of Examination Under Federal Rule of Bankruptcy Procedure 2004 and Subpoena Duces Tecum served by Appellee is a final bankruptcy order subject to immediate appellate review. In the alternative, Countrywide seeks leave to appeal the Order as an interlocutory appealable order under section 158(a)(3). The Trustee maintains the Order is a non-final, interlocutory discovery order not subject to immediate appellate review.

1. *Whether a final, appealable order was entered*

Countrywide argues that in bankruptcy proceedings, a final order is one which resolves a particular controversy. Countrywide contends that its Objection to the Trustee's Notice is a separate, distinct dispute within the Del Castillo Chapter 13 proceeding. The initial issue the undersigned addresses is whether in resolving the matter in favor of the Trustee, the Order is final and appealable.

A final order "'is an order that concludes the litigation on the merits of the case and 'leaves nothing for the court to do but execute the judgment.'" *In re Hillsborough Holdings Corp.*, 164 B.R. 673, 674 (M.D. Fla. 1994) (citing *In re Sunstate Dairy*, 1992 WL 161138 (M.D. Fla. 1992) (quoting *Catlin v. United States*, 324 U.S. 229, 233 (1945)). By contrast, an interlocutory order is "[a]n order that is final with regard to a particular issue, but does not end the litigation on the merits, is not a final order under *Catlin* and is not immediately appealable." *In re Lykes Bros. S.S.Co., Inc.*, 200 B.R. 933, 937 (M.D. Fla. 1996) (internal citations and quotations omitted).[4]

"'As a general proposition most orders granting or denying discovery are not final orders . . . and therefore are not immediately appealable.'" *Matter of International Horizons, Inc.*, 689 F.2d 996, 1000-1001 (11th Cir. 1982) (quoting *Rouse Construction International, Inc. v. Rouse Construction Corporation*, 680 F.2d 743, 745 (11th Cir. 1982)). A party challenging a discovery order generally has two choices: (1) to comply with the order and challenge it at the conclusion of the case or (2) to refuse to comply with the order and contest its validity if subsequently cited for contempt for refusing to obey. *Id.* An exception to this rule exists where an order "'is directed to a person who has custody of materials as to which another person may claim a privilege of non-disclosure.'" *Id.* at 1001 (quoting *Branch v. Phillips Petroleum Co.*, 638 F.2d 873, 878 n.3 (5th Cir. 1981)). Under those circumstances, "'the person who holds the privilege may seek immediate review

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[4] The Supreme Court in *Catlin*, 324 U.S. at 233, held a "'final decision' generally is one which ends the litigation on the merits and leaves nothing for the court to do but execute the judgment." (citation omitted).

of the disclosure order.'" *Id.*

In *International Horizons*, 689 F.2d 996, a creditors' committee sought access to documents and work papers in the possession of the debtors' accounting firm. The accounting firm refused to disclose the work papers, asserting the accountant-client privilege. The bankruptcy court rejected the accounting firm's claim of privilege and ordered the firm to produce the documents. On appeal, the court found that because the bankruptcy court had not yet entered a civil contempt order against the accounting firm for refusing to produce the documents, the discovery order was not final and appealable. *Id.* at 1001. According to the *International Horizons* court, the accounting firm, as the holder of the allegedly privileged material, could appeal only if and when it was adjudged in civil contempt. The *International Horizons* court determined, however, that because the debtor did not have custody of the allegedly privileged materials, the debtor could immediately appeal the order directing disclosure of the documents because the debtor claimed a privilege of non-disclosure relating to materials that another party had been directed to produce. *Id.* at 1001-02.

Here, Countrywide holds the documents at issue and Debtors have not objected to the Order, much less asserted a privilege relating to the documents in Countrywide's possession. Countrywide does not claim that its compliance with the Order will jeopardize any asserted privilege. Indeed, the bankruptcy court sustained Countrywide's objection to the Notice regarding production of documents involving attorney-client communications. (*See* R. 125; *Nov. 20, 2007 Hearing Trans.,* p. 67). Countrywide may comply with the Notice and the Order and challenge the Order at the conclusion of Debtors' case, or it may refuse to comply and appeal the Order in the context of a subsequent civil contempt order. Consequently, Countrywide has failed to demonstrate that the Order is a final order or otherwise subject to immediate appellate review.

2. *Whether the non-final Order is nevertheless subject to immediate appellate review*

Three recognized exceptions to the final judgment rule allow interlocutory orders to be immediately reviewed: (1) the *Forgay-Conrad* rule (also known as the doctrine of practical finality), (2) the Cohen (or collateral order) doctrine, and (3) where the question presented is fundamental to further conduct of the case. *See In re F.D.R. Hickory House, Inc.*, 60 F.3d 724, 726-27 (11th Cir. 1995); *see also In re Lykes*, 200 B.R. at 938. Countrywide argues that the Order fits within either the *Forgay-Conrad* rule or the Cohen doctrine.[5] Application of these exceptions is examined in turn.

Under the *Forgay-Conrad* rule, an interlocutory order may be reviewed by an appellate court when the order

> decides the right to the property in contest, and directs it to be delivered up by the defendant to the complainant, or directs it to be sold, or directs the defendant to pay a certain sum of money to the complainant, and the complainant is entitled to have such decree carried immediately into execution.

In re Hickory House, Inc., 60 F.3d at 726-27 (quoting *Forgay v. Conrad*, 47 U.S. (6 How.) 201, 204 (1848); *Atlantic Federal Sav. & Loan Ass'n v. Blythe Eastman Paine Webber, Inc.*, 890 F.2d 371, 376 (11th Cir. 1989)). Because the Order does not compel Countrywide to deliver property to the Trustee, the *Forgay-Conrad* exception is inapplicable. *See In re Lykes*, 200 B.R. at 938 (noting that an order denying a motion for appointment to the creditors' committee "does not require immediate delivery of physical property, so [the *Forgay-Conrad*] exception is not applicable.").

Similarly, Countrywide fails to establish that the Order is subject to immediate appellate

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[5] The record under review does not demonstrate a need for immediate review of the Order for the "further conduct of the case."

EXHIBIT D

review under the Cohen doctrine. Under this doctrine, three factors must be present:

> (1) [T]he order must be independent and easily separable from the substance of the other claims in the action, (2) it must present a need to secure prompt review in order to protect important interests of any party, and (3) it must be examined in the light of practical, rather than narrowly technical, consideration.

In re Hillsborough Holdings, Corp., 164 B.R. at 675 (quoting *In re Tidewater Group, Inc*., 734 F.2d 794, 795-96 (11th Cir. 1984)).

In support of its claim that the Order is subject to immediate appellate review under the Cohen doctrine, Countrywide maintains this contested matter is independent and easily separable from the remainder of the Del Castillo case and has no bearing on Debtors. The Trustee, however, asserts it is unclear whether Countrywide will comply with the subpoenas. Further, assuming Countrywide fails to comply, "it is unclear whether the United States Trustee will move to compel." (*Appellee's Objection* [D.E. 1-2], p. 11). Additionally, it is equally unclear whether the bankruptcy court will hold Countrywide in civil contempt if Countrywide fails to comply with the Order. Given these uncertainties, the Trustee argues, the Cohen doctrine is not satisfied.

Countrywide has not shown that there is a need to secure prompt review in order to protect important interests of any party. It has not shown that the Order cannot be reviewed after the final judgment or that a party's interests cannot be protected in the absence of immediate review. *See In re Hillsborough Holdings, Corp*., 164 B.R. at 675. Having failed to satisfy any of the recognized exceptions to the final judgment rule, Countrywide has not demonstrated that immediate appellate review is warranted.

3. *Whether the request for leave to appeal should be granted*

In the alternative, and as previously stated, Countrywide seeks leave to appeal the Order.

Courts generally apply the standards listed in 28 U.S.C. § 1292(b) when determining whether to grant a request for leave to appeal from an interlocutory order under 28 U.S.C. § 158(a). *See In re Ashoka Enterprises, Inc.*, 156 B.R. 343, 346 (S.D. Fla. 1993) (noting the bankruptcy statute does not provide district courts with criteria to apply when determining whether to grant leave to appeal under section 158(a), and courts therefore apply the standards in section 1292(b)); *see also In re Celotex Corp.*, 187 B.R. 746, 749 (M.D. Fla. 1995) (recognizing that when determining whether to exercise its discretionary authority to review interlocutory orders under section 158(a), a district court will look to the standards in section 1292(b)) (citing *In re Charter Co.*, 778 F.2d 617, 620 (11th Cir. 1985)).

Under section 1292(b), the court may allow a party to take an interlocutory appeal of an order where (1) the order involves a controlling question of law; (2) there is a substantial ground for difference of opinion regarding the court's resolution of that question of law; and (3) an immediate appeal of the order may materially advance the ultimate termination of the litigation. Section 1292(b) appeals "were intended, and should be reserved, for situations in which the court of appeals can rule on a pure, controlling question of law without having to delve beyond the surface of the record in order to determine the facts." *McFarlin v. Conseco Servs., LLC*, 381 F.3d 1251, 1259 (11th Cir. 2004).

> The legal question must be stated at a high enough level of abstraction to lift the question out of the details of the evidence or facts of a particular case and give it general relevance to other cases in the same area of law. And the answer to that question must substantially reduce the amount of litigation left in the case.

Id.

In support of its request for leave to appeal, Countrywide contends its appeal relates to "pure legal questions, e.g., whether there is any authority for the [Trustee] to examine a creditor's general

EXHIBIT D

corporate policies and procedures when no issue exists between the creditor and the debtor or under any other circumstances," and "whether the Bankruptcy Judge, in light of the testimony he gave before a Congressional sub-committee on October 2, 2007, should have disqualified himself on the grounds that his impartiality might reasonably be questioned." (*Appellant's Mem.* [D.E. 1-2], pp. 6-7). According to the Trustee, issues concerning the scope of discovery under Rule 2004 are inherently interlocutory, present no controlling issues of law and "'are left to the sound discretion of the court that is fully familiar with the entire proceeding – the bankruptcy judge . . . .'" (*Appellee's Objection* [D.E. 1-2], p. 12 (citing *In re Towers Fin. Corp.*, 164 B.R. 719, 720 (S.D.N.Y. 1994)). The undersigned agrees with the Trustee's characterization.

The Order does not finally adjudicate the validity of Countrywide's proof of claim. Rather, the Order allows the Trustee to conduct discovery relating to Countrywide's factual support for the proof of claim. No controlling question of law is presented that would serve to advance the ultimate termination of the proceeding. *See In re American Freight System, Inc.*, 194 B.R. 659, 662 (D. Kan. 1996) (noting bankruptcy court's discovery order, by itself, had no bearing on the merits of the proceedings, finding order was interlocutory in nature, and denying leave to appeal); *see also State of Fla. ex rel. Butterworth v. Industrial Chemicals, Inc.*, 145 F.R.D. 585, 589 (N.D. Fla. 1991) ([G]enerally "discovery orders do not present controlling questions of law, capable of significantly advancing litigation so as to justify interlocutory appeal.") (internal citations omitted).

Further, Countrywide has not shown the existence of a substantial ground for differences of opinion regarding the question presented. As noted, it is well recognized that bankruptcy court discovery orders are interlocutory and not final appealable orders. *See In re International Horizons,* *Inc.*, 689 F.2d at 1000-1001. When there is binding authority on the question presented, there is no substantial difference of opinion. *See In re Pacific Forest Products Corp.*, 335 B.R. 910, 922 (S.D. Fla. 2005) ("[W]here there is controlling authority in the jurisdiction where the order was rendered, there cannot be a substantial difference of opinion.") (citation omitted)). Countrywide has simply not demonstrated that the Order differs materially from routine discovery orders from which interlocutory appeals are discouraged as contravening the policy against piecemeal litigation.

Lastly, Countrywide did not file a written motion seeking the bankruptcy judge's recusal and thus this claim, when reviewed, will be examined under the plain error standard. *See U.S. v. Marrero*, 219 Fed. Appx 892, 896 (11th Cir. 2007). Under plain error review, appellant must show error that is plain and that affected substantial rights. *See U.S. v. Monroe*, 353 F.3d 1346, 1349 (11th Cir. 2003) (citations omitted). That showing has not been made.

Accordingly, it is **ORDERED AND ADJUDGED** that Countrywide's notice of appeal or, in the alternative, request for leave to appeal, is **DENIED**. The Clerk of Court is instructed to **CLOSE** the case.

DONE AND ORDERED in Chambers, at Miami, Florida, this 8th day of February, 2008.

Cecilia M. Altonaga

CECILIA M. ALTONAGA
UNITED STATES DISTRICT JUDGE

cc: Hon. A. Jay Cristol
counsel of record

EXHIBIT D

Only the Westlaw citation is currently available.

This decision was reviewed by West editorial staff and not assigned editorial enhancements.

United States District Court,

E.D. Michigan,
Southern Division.
MORTGAGE ELECTRONIC REGISTRATION SYSTEMS, INC., as nominee for lender, Appellant,
v.
Kimbertly A. JONES and Sheryl C. Jones, Appellees.
No. 09-10321.

March 11, 2009.

Kimbertly A. Jones, Las Vegas, NV, pro se.

William D. Johnson, Acclaim Legal Services, Southfield, MI, for Appellees.

ORDER

JULIAN ABELE COOK, JR., District Judge.

***1** On May 20, 2008, the Appellees, Kimbertly A. Jones and Sheryl C. Jones, filed for protection under Chapter 7 of the United States Bankruptcy Code. On July 11, 2008, the Appellant, Mortgage Electronic Registration Systems, Inc. filed an adversary proceeding against the Appellees in the United States Bankruptcy Court for the Eastern District of Michigan.

Nearly two months later (September 26th), the Appellant submitted several discovery requests to the Appellees in the form of interrogatories, requests to produce, as well as requests for admission. On November 7th, the Appellant filed a motion for the entry of a summary judgment in the Bankruptcy Court, contending that (1) the Appellees had failed to answer its requests for admissions, and (2) by virtue of Fed.R.Civ.P. 36(b), "all matters contained therein [were] deemed admitted." Moreover, the Appellant points out that "a matter admitted under this rule is conclusively established unless the court, on motion, permits the admission to be withdrawn or amended." The Appellees, after filing a response in opposition to the pending motion on November 11th, submitted their answers to the Appellant's various discovery requests on December 5th. Following a hearing on December 18th, Bankruptcy Judge Walter Shapero rejected the Appellant's dispositive request for the entry of a summary judgment. It was his belief that a summary judgment was not warranted inasmuch as the Appellees had now filed their answers to the Appellant's discovery requests, albeit untimely.

On January 27, 2009, the Appellant filed a motion for leave to file an interlocutory appeal in this federal district court. In support of its request, the Appellant contends that (1) the question to be determined is one of law, (2) the Appellees' failure to respond to its discovery requests establishes their liability, and (3) a decision on this issue in its favor would greatly expedite this litigation. In their opposition papers of February 18, 2009, the Appellees argue that the Appellant's motion is unwarranted because it has failed to establish that Bankruptcy Judge Shapero abused his discretion when rendering his decision.

Over fifteen years ago, the Sixth Circuit Court of Appeals cautioned that interlocutory appeals should be granted only in "exceptional cases," *Vitols v. Citizens Banking Co.,* 984 F.2d 168, 170 (6th Cir.1993) (internal citations omitted), because of the disruption and delay that is inherent in the immediate appeal of an order. *United States v. Bilsky,* 664 F.2d 613, 615 (6th Cir.1981).

When determining whether an interlocutory appeal from a bankruptcy court order is appropriate, district courts are encouraged to examine (1) 28 U.S.C. § 1292(b) [FN1] and (2) the standards that have been adopted by the Sixth Circuit Court of Appeals when deciding whether or not to hear interlocutory appeals from federal district courts. *In the Matter of PHM Credit Corp.,* 99 B.R. 762, 767 (E.D.Mich.1989). When evaluating the propriety of an interlocutory appeal, the Sixth Circuit Court of Appeals seeks to determine if (1) the challenged order involves a controlling legal question; (2) there is substantial ground for a difference of opinion relating to the issue under

EXHIBIT E

review; and (3) an immediate appeal would materially advance the termination of the litigation. *W. Tenn. Chapter of Assoc. Builders & Contractors, Inc. v. City of Memphis,* 293 F.3d 345, 350 (6th Cir.2002).

FN1. 28 U.S.C. § 1292(b) provides, in part:

> When a district judge, in making in a civil action an order not otherwise appealable under this section, shall be of the opinion that such order involves a controlling question of law as to which there is substantial ground for difference of opinion and that an immediate appeal from the order may materially advance the ultimate termination of the litigation, he shall so state in writing in such order. The Court of Appeals which would have jurisdiction of an appeal of such action may thereupon, in its discretion, permit an appeal to be taken from such order ....

***2** A question of law is controlling "if it could materially affect the outcome of the case." *Id.* (citing *In re Baker & Getty Fin. Servs., Inc. v. Nat'l Union Fire Ins. Co.,* 954 F.2d 1169, 1172 n. 8 (6th Cir.1992). Moreover, the type of legal questions that are addressed in 28 U.S.C. § 1292(b) do not include issues which fall within the discretion of the trial court. *Id.* (citing *White v. Nix,* 43 F.3d 374, 377 (8th Cir.1994)).

Here, the Court does not believe that the Appellant's request for an interlocutory appeal is warranted for two reasons. First, the denial of a summary judgment by a Bankruptcy Judge is not immediately appealable. *See McMullen v. Meijer, Inc.,* 355 F.3d 485, 489 (6th Cir.2004). Secondly, there is no purely legal and controlling question of law at issue. The denial of the Appellant's motion for summary judgment by Bankruptcy Judge Shapero was based on his conclusion that the Appellees' answers to interrogatories, though untimely, should be considered in conjunction with the entire case. While recognizing that the Appellees' discovery responses were late, he did not "think the ... appropriate response [would be] the granting of a judgment." As such, Judge Shapero's denial of the Appellant's motion for a summary judgment, as well as his order which authorized the Appellees' late discovery filings, are reviewable on an abuse of discretion standard. *See Romstadt v. Allstate Ins. Co.,* 59 F.3d 608, 615 (6th Cir.1995) (denial of summary judgment reviewed for abuse of discretion); *Proctor v. USDE,* 196 Fed. Appx. 345, 347 (6th Cir.2006) ("court enjoys broad discretion in handling discovery disputes"). As noted above, issues that fall within the discretion of the court are not appropriate for interlocutory review. *W. Tenn. Chapter of Assoc. Builders & Contractors, Inc.,* 293 F.3d at 350. Finally, the Court, when assessing the issues as a whole, does not believe that Judge Shapero abused his discretion under the circumstances that appear on this record.

Accordingly and for the reasons that have been stated above, the Court must, and does, deny the Appellant's motion for leave to file an interlocutory appeal.

IT IS SO ORDERED.

E.D.Mich.,2009.

Mortgage Electronic Registration Systems, Inc. v. Jones
Slip Copy, 2009 WL 646623 (E.D.Mich.)
END OF DOCUMENT

EXHIBIT E

BRIEF BANK — "SUMMARY SHEET"

Printed Wed.-9/22/99 (9:00)

WESTLAW CODES

1. ("TI") TITLE OF CASE [E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]	**HACKETT v. U.S. TRUSTEE (IN RE HACKETT)**
2. ("CO") CURRENT COURT [E.g., "CTA9"]	**CTA5**
3. ("CCN") CURRENT CASE NO.	No.: **99-30618**
4. ("PCN") PRIOR CASE NO. & COURT [IF ANY]	No.: **98-3819** Court: **E.D. LA.** (Identify judge & cite, if any)
5. ("SO") SOURCE	**U.S. TRUSTEES**
6. ("DA") DATE OF FILING & TYPE OF BRIEF [E.g., "Opening Brief," "Reply," "Amicus," etc.]	Filed: **SEPT. 20, 1999** Type: **BRIEF FOR APPELLEE, U.S. TRUSTEE**
7. ("AU") PRINCIPAL AUTHORS & OFFICE [E.g.,"UST/OGC"]	**JEANNE M. CROUSE (UST/OGC)** **ROBERT C. GRAVOLET (UST/REGION 5)** (UST/OGC: 202-307-1399/FAX-2397)
8. ("TO") TOPIC	**BANKRUPTCY**
9. ("SU") • SUMMARY OF KEY ISSUE(s) & / Any Miscellaneous BACKGROUND	**• WHETHER BANKRUPTCY COURT PROPERLY DISMISSED DEBTOR'S SECOND BANKRUPTCY PETITION PURSUANT TO 11 U.S.C. 109(g)(2) (WHICH PROVIDES THAT "NO INDIVIDUAL ... MAY BE A DEBTOR" IF HE HAD A CASE PENDING "IN THE PRECEDING 180 DAYS" & OBTAINED A VOLUNTARY DISMISSAL AFTER RELIEF FROM § 362's AUTOMATIC STAY WAS SOUGHT).** **/ Background:**
10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)	D:\Web Briefs\Bull Pen\Pending\Hackett1.wpd
11. DO YOU RECOMMEND POSTING IN UST BRIEFBANK?	| X | YES | | NO NAME: JEANNE M. CROUSE DATE: 9/21/99

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 99-30618

IN RE HACKETT, Debtor.

***

ROBERT L. HACKETT, Appellant,
v.
UNITED STATES TRUSTEE, et al., Appellees.

ON APPEAL FROM
THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF LOUISIANA

BRIEF FOR THE APPELLEE, UNITED STATES TRUSTEE

JANICE CHENIER TAYLOR
United States Trustee for Region 5
U.S. Department of Justice
400 Poydras Street
Suite 2110
New Orleans, Louisiana 70130
(504) 589-4018

MARTHA L. DAVIS
General Counsel
JEANNE M. CROUSE
Attorney
U.S. Department of Justice
Executive Office for U.S. Trustees
Office of the General Counsel
901 E St., N.W., Suite 780
Washington, D.C. 20530
(202) 307-1399

OF COUNSEL:

ROBERT C. GRAVOLET
Attorney
U.S. Department of Justice
400 Poydras Street
Suite 2110
New Orleans, LA 70130
(504) 589-2594

September 20, 1999

STATEMENT REGARDING ORAL ARGUMENT

Pursuant to 5th Cir. R. 28.2.4 and Fed. R. App. P. 34(a)(1), appellee the United States Trustee for Region 5 states that this appeal concerns questions of interpretation of the Bankruptcy Code and that oral argument should be scheduled if this Court believes such argument would clarify the issues on appeal.

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IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 99-30618

IN RE HACKETT, Debtor.

***

ROBERT L. HACKETT, Appellant,

v.

UNITED STATES TRUSTEE, et al., Appellees.

ON APPEAL FROM
THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF LOUISIANA

BRIEF FOR THE APPELLEE, UNITED STATES TRUSTEE

STATEMENT OF SUBJECT MATTER & APPELLATE JURISDICTION

The bankruptcy court had jurisdiction over the underlying chapter 13 and chapter 11 cases pursuant to 28 U.S.C. § 157. By Order entered on October 15, 1998, the bankruptcy court dismissed the debtor’s second bankruptcy case because it was filed in violation of 11 U.S.C. § 109(g) (R. 00145-146).[1] The determination of a debtor's eligibility to initiate a bankruptcy case constitutes a core proceeding under 28 U.S.C. §157(b)(2) and, thus, the bankruptcy court's jurisdiction was properly based on 28 U.S.C. § 157(b)(1).

On October 26, 1998, Mr. Hackett timely noticed his appeal from the bankruptcy court's final order to the United States District Court for the Eastern District of Louisiana (R. 00140). In reviewing the appeal, the district court properly exercised its jurisdiction over that order under 28 U.S.C. § 158(a).

The district court's Judgment, which was entered on the docket on May 11, 1999 (R. 00003), was a final, appealable ruling under 28 U.S.C. § 158(d). Mr. Hackett filed his notice of appeal on June 9, 1999 (R. 00001), which notice was timely under Fed. R. App. P. 4(a)(1). This Court's jurisdiction is therefore based on 28 U.S.C. §§ 158(d) and 1291.

STATEMENT OF THE ISSUE PRESENTED FOR REVIEW

The issue presented by this appeal is as follows:

Did the bankruptcy court properly dismiss the debtor's second bankruptcy case under 11 U.S.C. § 109(g) given that the debtor had sought and obtained

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[1] "R." denotes the page citation in Vol. 1 of the Official Record on Appeal, filed with this Court on July 2, 1999.

dismissal of a prior bankruptcy case after a creditor in the earlier case moved for relief from the automatic stay so that it could foreclose upon collateral securing a debt upon which the debtor had defaulted?

Appellant raised this issue in his opposition pleadings to the United States Trustee's motion to dismiss the second bankruptcy case and at the hearing on the motion (R. 00150 (Bankruptcy Court Docket (hereinafter "Bankr. Ct. Dkt.") Nos. 35 & 38); R00366-71). The issue was ruled upon and rejected by the bankruptcy court (R. 00145-56, 00371-72) and the district court (R. 00007-10).

STATEMENT OF THE STANDARD OF REVIEW

Pursuant to 5th Cir. R. 28.2.6, the standard of review of this appeal is as follows: " This Court, acting as a second review court, reviews the bankruptcy court's findings of fact under the clearly erroneous standard, and the bankruptcy court's conclusions of law de novo." Financial Sec. Assurance, Inc. v. T-H New Orleans Ltd. Partnership (Matter of T-H New Orleans Ltd. Partnership), 116 F.3d 790, 796 (5th Cir. 1997) (citation omitted). A finding of fact should be overturned only if "the reviewing court on the entire evidence is left with the definite and firm conviction that a mistake has been committed." Anderson v. City of Bessemer, 470 U.S. 564, 573-74 (1985).

In this appeal, Mr. Hackett contends the bankruptcy court committed legal error in applying section 109(g)(2). This Court's construction of section 109(g) is a matter that is reviewed de novo.

STATEMENT OF THE CASE

A. Nature of the Case.

This appeal arises from the dismissal of the second bankruptcy case initiated by appellant Robert L. Hackett, an attorney licensed to practice in Louisiana, who sought bankruptcy relief after his law firm dissolved. The bankruptcy court found that Mr. Hackett was ineligible under section 109(g)(2) of the Bankruptcy Code to seek relief because the second bankruptcy case was filed within 180 days after Mr. Hackett had requested and obtained dismissal of a prior bankruptcy case when a creditor in that case sought relief from the automatic stay. Accordingly, the court dismissed Mr. Hackett's second bankruptcy case under 11 U.S.C. § 109(g)(2). On appeal from the bankruptcy court, the district court affirmed in all respects. This appeal followed.

B. Statutory Background.

Central to this appeal is the application of section 109(g) of the Bankruptcy Code, which provides:

> Notwithstanding any other provision of this section, no individual or family farmer may be a debtor under this title who has been a debtor in a case pending under this title at any time in the preceding 180

> days if --
>
> * * * *
>
> (2) the debtor requested and obtained the voluntary dismissal of the case following the filing of a request for relief from the automatic stay provided by section 362 of this title.[2/]

Section 109(g)(2) was enacted pursuant to the Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, 98 Stat. 333 (1984).[3/] In the 1984 legislation, Congress addressed a number of issues raised by the consumer credit industry, including the contention that too many debtors were abusing the bankruptcy process. On the Senate floor, Senator Hatch cited Section 109(g) as an example of a provision designed to correct debtor abuses of serial requests for bankruptcy relief. 130 Cong. Rec. S8,891 (daily ed. June 29, 1984) (statement of Sen. Hatch), reprinted in 1984 U.S.C.C.A.N. 576, 597-98.

C. Statement of Facts.

On October 21, 1997, Mr. Hackett filed for bankruptcy relief under chapter 13 of the Bankruptcy Code.[4/] (R00339 (Bankr. Ct. Dkt. No. 1).) Mr. Hackett's

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[2/] Pursuant to Fed. R. App. P. 28(f), copies of the relevant statutes are provided in the Addendum to this Brief.

[3/] Subsection 109(g) was originally designated as subsection 109(f) and was redesignated as 109(g) by the Bankruptcy Judges, United States Trustees and Family Farmer Bankruptcy Act of 1986, Pub. L. No. 99-554, 100 Stat. 3088 (1986).

[4/] Chapter 13 debtors propose plans to repay their creditors over a three-year period unless the bankruptcy court, for cause, approves a longer period that cannot exceed five years. The repayment plans must meet certain requirements and must be confirmed by the court. 11 U.S.C. §§ 1322, 1325.

financial problems apparently had begun when he and a former law partner, David W. Oestreicher, ended their legal partnership[5] and Mr. Oestreicher subsequently filed suit to obtain monies allegedly due him (R. 00072; see also R00175-180 (appellate decision discussing background and underlying litigation), R00198-200 (correspondence regarding dissolution of first firm and creation of successor firm)).[6] On April 27, 1998, creditor Schwegmann Bank and Trust Co. filed its second motion to lift the automatic stay to proceed against secured collateral[7] (R. 00344 (Bankr. Ct. Dkt. No. 47)); and a hearing was scheduled on the motion for June 2, 1998, at 2:15 p.m. (R. 00344 (Bankr. Ct. Dkt. No. 48)). On the morning of June 2, 1998, before this motion was heard, Mr. Hackett filed his Ex Parte Motion To Dismiss Without Prejudice, stating that "Debtor wishes to voluntarily dismiss

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[5] According to Mr. Hackett's schedules, which he signed under penalty of perjury pursuant to 11 U.S.C. § 521(1), he had practiced law for 25 years as of the date of his first bankruptcy petition (R. 00226). See also Fed. R. Bankr. P. 1008 (requiring verification of schedules and other papers).

[6] Mr. Oestreicher represented to the district court that he initiated litigation against Mr. Hackett in state court in 1994, the litigation was fully adjudicated, and Mr. Hackett filed for bankruptcy relief after all appellate avenues were exhausted. (R00073.) Mr. Oestreicher also advised the district court that "[t]he progression of this litigation has been severely retarded by Hackett's Chapter 11 filings" (R00073) and that "Hackett's creditor's [sic] have been forced to participate in two (2) bankruptcy cases that were dismissed prior to the administration of Hackett's assets or payment of any of Hackett's debts" (R00077).

[7] Schwegmann had filed its first motion to lift the stay on January 21, 1998 (R. 00340 (Bankr. Ct. Dkt. No. 13)). The bank withdrew that motion when Mr. Hackett brought all post-petition payments current (R. 00210, R. 00343 (Bankr. Ct. Dkt. No. 32)).

his Chapter 13 bankruptcy proceeding." (R. 00237.) On June 3, the bankruptcy court granted the debtor's motion and dismissed the case. (R. 00346 (Bankr. Ct. Dkt. No. 64); see also R. 00238.)

Two days later, on June 5, 1998, Mr. Hackett filed a petition for relief under the reorganization provisions of chapter 11 of the Bankruptcy Code. (R. 00147 (Bankr. Ct. Dkt. No. 1).) The United States Trustee[8] conducted the initial meeting of creditors required by 11 U.S.C. § 341 and subsequently moved to dismiss the second case pursuant to 11 U.S.C. § 109(g)(2) on the basis that Mr. Hackett had dismissed a prior case after a creditor sought relief from the automatic stay within 180 days of his second bankruptcy filing.[9] After a hearing (R. 00362-72), the bankruptcy court granted the United States Trustee's motion and dismissed the case by order entered on October 15, 1998 (R. 00145-46, 00152 (Bankr. Ct. Dkt. No. 47)). The court found that Mr. Hackett had filed the second bankruptcy

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[8] United States Trustees are officials of the Department of Justice appointed by the Attorney General to supervise the administration of bankruptcy cases and trustees. See 28 U.S.C. §§ 581-589 (establishing the United States Trustee Program and the powers of United States Trustees); United States Trustee v. Columbia Gas Sys., Inc. (In re Columbia Gas Sys., Inc.), 33 F.3d 294, 296 (3d Cir. 1994)(United States Trustees oversee the bankruptcy process, protect the public interest, and ensure that bankruptcy cases are conducted according to law)(citing H.R. Rep. No. 595, 95th Cong., 2d Sess. 109 (1977)).

[9] Creditor United States Fidelity & Guaranty Co. ("USF&G"), which had posted the bond for Mr. Hackett's appeals from the state court litigation involving creditor Oestreicher, filed a memorandum supporting the United States Trustee's motion to dismiss. (R. 00353-58.)

petition within 180 days months after he moved to dismiss a bankruptcy case following a creditor's request to lift the automatic stay. The bankruptcy court concluded that the second bankruptcy case should be dismissed with prejudice pursuant to section 109(g)(2) of the Bankruptcy Code. (R00145-146, R00152 (Bankr. Ct. Dkt. No. 47).)

Mr. Hackett timely noticed his appeal pursuant to Fed. R. Bankr. P. 8002(a) on October 26, 1998. (R00140, R00152 (Bankr. Ct. Dkt. No. 53).) On appeal, the district court affirmed in all respects in an order entered on May 11, 1999 (R. 00003, 00005-15).[10/] The district court rejected Mr. Hackett's contentions that he filed the second bankruptcy petition in good faith and that no motion to lift the stay was pending when he voluntarily moved to dismiss his chapter 11 case. This appeal followed.

SUMMARY OF ARGUMENT

Throughout the Bankruptcy Code, Congress attempts to strike a balance between debtors' interests in a fresh financial start and creditors' interests in receiving payment on debts owed. In striking this balance, Congress has

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[10/] In addition to the United States Trustee, creditors USF&G and Oestreicher filed briefs on appeal (R. 00016-61, 00081-96, 00097-120). Oestreicher also moved to dismiss Mr. Hackett's appeal on the ground that the debtor had not timely filed his brief with the appellate court (R. 00071-80); the district court denied this motion (R. 00005).

determined that certain debtor behavior will not be countenanced. Specifically, in section 109(g)(2), Congress has prohibited debtors from refiling for bankruptcy relief for six months after they have dismissed a previous case voluntarily and prevented creditors from obtaining a hearing on motions for relief from stay.

In this appeal, the bankruptcy court appropriately dismissed Mr. Hackett's second bankruptcy case. Mr. Hackett had first sought bankruptcy relief in October 1997 under chapter 13. Six months later, one of his creditors moved for relief from the automatic stay. On the day that the hearing had been scheduled on this motion, Mr. Hackett asked the court to dismiss his chapter 13 case. Two days after he received this dismissal, he filed a second bankruptcy petition.

This case presents the precise circumstances that Congress sought to stop through section 109(g)(2). Mr. Hackett was ineligible to file his second bankruptcy petition; and the bankruptcy court's dismissal of that case should be affirmed.

ARGUMENT

1. The Bankruptcy Court Correctly Dismissed Mr. Hackett's Chapter 11 Case Under Section 109(g)(2).

The bankruptcy court properly dismissed Mr. Hackett's chapter 11 case, which was filed within two days after he voluntarily dismissed a chapter 13 filing to prevent a creditor's motion for relief from stay from being heard. Section 109(g), which establishes a debtor's eligibility for bankruptcy relief, provides:

> Notwithstanding any other provision of this section, no individual or family farmer may be a debtor under this title who has been a debtor in a case pending under this title at any time in the preceding 180 days if --
>
> * * * *
>
> (2) the debtor requested and obtained the voluntary dismissal of the case following the filing of a request for relief from the automatic stay provided by section 362 of this title.

11 U.S.C. § 109(g)(2). Where the statutory language is plain, that language must be applied as written. United States v. Ron Pair Enters., Inc., 489 U.S. 235, 241 (1989); see also Toibb v. Radloff, 501 U.S. 157, 160 (1991)(finding section 109's language "plain" on the question whether an individual may seek relief under chapter 11) . The language of section 109(g)(2) plainly precludes an individual from seeking bankruptcy relief when that individual "at any time in the preceding 180 days . . . requested and obtained the voluntary dismissal of the case following the filing of a request for relief from the automatic stay provided by section 362 of this title."

In the instant appeal, the facts clearly demonstrate that Mr. Hackett falls within section 109(g)(2)'s prohibition. On October 21, 1997, he sought relief under the provisions of chapter 13 (R00339 (Bankr. Ct. Dkt. No. 1)). While that case was pending, on April 27, 1998, a creditor-bank filed its second motion to lift the automatic stay to proceed against secured collateral (R. 00344 (Bankr. Ct. Dkt. No. 47)). On June 2, 1998 (R. 00344 (Bankr. Ct. Dkt. No. 48)), the very day that a hearing was scheduled on the motion, Mr. Hackett filed his Ex Parte Motion, asking to dismiss the case (R. 00237).[11/] On June 3, the bankruptcy court granted the debtor's motion and dismissed the case. ((R. 00346 (Bankr. Ct. Dkt. No. 64); see also R. 00238.) Two days after the court granted his voluntary motion to dismiss, Mr. Hackett filed a petition for relief under chapter 11 of the Bankruptcy Code. (R. 00147 (Bankr. Ct. Dkt. No. 1).)

In similar circumstances, this Court has declared, "The impropriety of [the debtor's] act is obvious." Moran v. Frisard (Matter of Ulmer), 19 F.3d 234, 236 (5th Cir. 1994). Clearly, under section 109(g)(2), Mr. Hackett was not eligible to seek bankruptcy relief when he filed his second petition. Only three days earlier and after a creditor's filing of a motion to lift the stay, Mr. Hackett had sought and obtained a voluntary dismissal of the prior bankruptcy case. Thus, the bankruptcy court correctly dismissed his second bankruptcy filing.

[11/] The hearing was scheduled for 2:15 p.m. on June 2 (R. 00344 (Bankr. Ct. Dkt. No. 48)). According to the date-stamped copy in the record on appeal, Mr. Hackett filed his motion to dismiss at 9:23 a.m on June 2 (R. 00237). The record does not reflect whether Mr. Hackett gave creditor's counsel notice of his ex parte motion to dismiss before the 2:15 p.m. hearing. However, it seems that the creditor's counsel, Mr. Mathis, did appear before the bankruptcy court at the scheduled hearing time for the motion (R. 00371 (court's statement suggesting Mr. Mathis did appear)).

This result comports with the rationale underlying section 109(g)(2). That subsection was drafted "to prevent debtors from frustrating creditors' efforts to recover funds owed them." Ulmer, 19 F.3d at 235 (footnote omitted). "Without the section, a debtor could move in and out of bankruptcy, forcing a creditor to pursue time and again the right to collect a debt." Id. (footnote omitted). Congress has outlined the requirements for a debtor's eligibility and those requirements should be upheld, as in this case. See also United States v. Kras, 409 U.S. 434, 446 (1973) ("no constitutional right to obtain a discharge of one's debts in bankruptcy").

In his brief before this Court, Mr. Hackett contends that the bankruptcy court erred in applying section 109(g) because the stay requested by the creditor had been "deemed lifted" as of the date on which he filed his voluntary motion for dismissal. (Hackett Corrected Br. at 9.) Mr. Hackett apparently bases this contention on section 362(e), which states that the automatic stay is terminated within 30 days after the filing of a request for relief unless the court "orders such stay continued in effect. . . ." 11 U.S.C. § 362(e).

In Ulmer, the appellant-attorney made a similar argument. Because the bankruptcy court had not decided the motion to lift stay "within the time frame . . . the Bankruptcy Code required," the appellant argued that the "motion for relief for stay was no longer before the court. . . ." Ulmer, 19 F.3d at 236.

The Ulmer Court rejected that analysis, finding no implicit withdrawal of the motion to lift stay and concluding that the bankruptcy court had not decided the motion when the request for voluntary dismissal was filed:

> Perhaps [the creditor] could have successfully urged the court to address his motion more quickly. His failure to do so and the court's failure, if any, to act promptly provide no basis, however, to conclude that [the creditor] no longer wished to recover the money Ulmer owed him or that the court would not allow [the creditor] to recover the money.

19 F.3d at 236.

Moreover, as the district court noted below, Mr. Hackett's emphasis on the necessity of a "pending" request for relief from stay has no basis in the statute (R. 00012-14). Nowhere does section 109(g)(2) contain a "pending" requirement for motions for relief from stay; it simply says that it applies in circumstances where the debtor requested and obtained voluntary dismissal "following" the filing of a motion to lift stay. To adopt Mr. Hackett's argument would engraft an additional requirement not contained in the statute and would dishonor the plain language.

Therefore, Mr. Hackett's argument, like the related argument in Ulmer, should be rejected. Creditor Schwegmann requested relief from the automatic stay on April 27, 1998 (R. 00344 (Bankr. Ct. Dkt. No. 47)). A hearing on the motion was scheduled for June 2, 1998, at 2:15 p.m. (R. 00344 (Bankr. Ct. Dkt. No. 48)). The morning of June 2, Mr. Hackett filed his Ex Parte Motion, seeking to dismiss the case (R. 00237). In this case, as in Ulmer, when the debtor asked to dismiss his bankruptcy case, the motion for relief from stay had not been decided. Nor had it been withdrawn. Because the voluntary motion for dismissal of the first bankruptcy case was filed after a creditor had moved for relief from stay, the bankruptcy court correctly applied section 109(g)(2) to dismiss Mr. Hackett's second bankruptcy filing.

Finally, before the district court, Mr. Hackett contended that he dismissed his chapter 13 case in good faith reliance on advice from counsel (R. 00370).[12/] As the district court observed below, a minority of courts apply a good-faith exception to section 109(g)(2) even though the plain language of the statute creates no such exemption (R. 00008). This Court has noted that section 109(g)(2) "seems to establish a clear rule, . . ." Ulmer, 19 F.3d at 236. The majority and better-reasoned approach is to apply the plain language and dismiss a subsequent case

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[12/] In his corrected brief to this Court, Hackett, who by his own admission has practiced law for more than 25 years, states only that he "followed the advice of counsel to voluntarily dismiss the Chapter 13 and refile." Hackett Corrected Br. at 9. Pursuant to Fed. R. App. P. 28, this Court could conclude that Mr. Hackett has failed to press this issue and thus has waived it on appeal. See Financial Sec. Assurance, Inc. v. T-H New Orleans Ltd. Partnership (Matter of T-H New Orleans Ltd. Partnership), 116 F.3d at 796 (citations omitted)("[C]ontentions not briefed are waived and will not be considered on appeal").

where the facts of the case satisfy the circumstances outlined in section 109(g)(2).

However, even if Congress had created such a safe harbor, Mr. Hackett could not demonstrate that he is entitled to invoke such a defense. As the district court correctly noted, "[r]eliance on the advice of counsel is simply not the type of situation courts use to justify an exception" under section 109(g)(2) (R. 00009-10)(citations omitted).

Rather than establishing a good-faith defense, the facts here demonstrate that Mr. Hackett is precisely the type of debtor Congress sought to restrain through section 109(g)(2). On the morning that a hearing was scheduled on a pending motion to lift the stay, Mr. Hackett asked the court to dismiss his chapter 13 case. Two days after the court granted his request, Mr. Hackett filed another bankruptcy petition. The bankruptcy court properly dismissed his second bankruptcy case and should be affirmed.

CONCLUSION

For the foregoing reasons, the United States Trustee respectfully asks this Court to affirm the decisions of the bankruptcy and district courts dismissing Mr. Hackett's bankruptcy case.

Dated: September 20, 1999

Respectfully submitted,

JANICE CHENIER TAYLOR
United States Trustee
Region 5
400 Poydras Street
Room 2110
New Orleans, Louisiana 70130
(504) 589-4018

MARTHA L. DAVIS
General Counsel

____
JEANNE M. CROUSE
Attorney
U.S. Department of Justice
Executive Office for
United States Trustees
Office of the General Counsel
901 E St., N.W., Suite 780
Washington, D.C. 20530
(202) 307-1399

OF COUNSEL:
ROBERT C. GRAVOLET
Attorney
400 Poydras Street
Room 2110
New Orleans, LA 70130
(504) 589-2594

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on the 20th day of September, 1999, I filed the Brief of Appellee United States Trustee by sending the original and 7 copies of the foregoing Brief and a copy of the brief on diskette pursuant to 5th Cir. R. 31.1 by Federal Express, next-day delivery, to the Clerk of the Court, United States Court of Appeals for the Fifth Circuit, and I served two true and correct copies of the foregoing Brief and one copy of the brief on diskette by Federal Express, next-day delivery, on:

Robert L. Hackett, Esq.
Law Offices of Robert L. Hackett
Suite 401
101 W. Robert E. Lee Blvd.
New Orleans, Louisiana 70124
Appellant Pro Se

David J. Krebs, Esq.
Alberta L. Adams, Esq.
Preaus, Roddy & Krebs, LLP
650 Poydras Street
Suite 1650
New Orleans, Louisiana 70130-0114
Counsel for Co-Appellee USF&G

Deborah W. Fallis, Esq.
Heller, Draper, Hayden & Horn, L.L.C.
650 Poydras Street
Suite 2500
New Orleans, Louisiana 70130-6103
Counsel for Co-Appellee David Oestreicher

Jeanne M. Crouse

ADDENDUM

11 U.S.C. § 109. Who may be a debtor

* * *

(g) Notwithstanding any other provision of this section, no individual or family farmer may be a debtor under this title who has been a debtor in a case pending under this title at any time in the preceding 180 days if —

(1) the case was dismissed by the court for willful failure of the debtor to abide by orders of the court, or to appear before the court in proper prosecution of the case; or

(2) the debtor requested and obtained the voluntary dismissal of the case following the filing of a request for relief from the automatic stay provided by section 362 of this title.

(Pub.L. 95-598, Nov. 6, 1978, 92 Stat. 2557; Pub.L. 97-320, Title VII, § 703(d), Oct. 15, 1982, 96 Stat. 1539; Pub.L. 98-353, Title III, §§ 301, 425, July 10, 1984, 98 Stat. 352, 369; Pub.L. 99-554, Title II, § 253, Oct. 27, 1986, 100 Stat. 3105; Pub.L. 100-597, § 2, Nov. 3, 1988, 102 Stat. 3028.)

BRIEF BANK — 'SUMMARY SHEET" *Printed Fri-3/2/07 13:23*

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1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*: Tom Hale v. UST

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*: CTA 9th Cir.

3. ("CCN") ***CURRENT*** CASE NO.: No.: 06-35349

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7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*: Gary L. McClendon, Matthew Sutko
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***: **BANKRUPTCY**

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***:

- Did the bankruptcy court abuse its discretion by ordering attorney Tom Hale to disgorge all of his attorney's fees to the debtor-clients under 11 U.S.C. § 329(b), where the court found that Mr. Hale provided an inadequate description and explanation of his legal services and failed to honor his legal and ethical obligations as attorney for the debtors?

Statement of Issues 2 and 3 can be found on page 2 of the brief

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In the United States Court of Appeals
for the Ninth Circuit

Case No. 06-35349

Tom Hale,
Appellant

v.

United States Trustee,
Appellee

Appellee United States Trustee's Brief

Gary L. McClendon
720 Park Blvd., Suite 220
Boise, Idaho 83712
(208) 334-1300

Of Counsel
Roberta DeAngelis
Acting General Counsel

P. Matthew Sutko
Executive Office for United States Trustees
United States Department of Justice
20 Massachusetts Ave. N.W. Suite 8000
Washington, D.C. 20530
(202) 307-1399

Counsel For Appellee
Ilene J. Lashinsky
United States Trustee
United States Department of Justice

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Statement of Jurisdiction

The United States Bankruptcy Court for the District of Idaho had subject matter jurisdiction over the debtors' chapter 7 bankruptcy case and the proceedings for the determination of compensation and sanctions against appellant, Tom Hale, under 28 U.S.C. §§ 157(b) and 1334. The United States District Court for the District of Idaho had jurisdiction over the appeal taken by appellant under 28 U.S.C. § 158(a).

The bankruptcy court's Memorandum of Decision entered March 22, 2004, and subsequent orders entered April 6, 2004, were final, appealable orders of that court under 28 U.S.C. § 158(a)(1). The district court's Memorandum Order entered March 15, 2006, was a final, appealable order under 28 U.S.C. § 158(d). On April 24, 2006, appellant timely filed a notice of appeal to this Court pursuant to Fed. R. App. P. 4(a)(1)(B). This Court has jurisdiction over this appeal under 28 U.S.C. § 158(d)(1).

Statement of the Issues on Appeal

Issue 1: Attorney Fees

Did the bankruptcy court abuse its discretion by ordering attorney Tom Hale to disgorge all of his attorney's fees to the debtor-clients under 11 U.S.C. § 329(b), where the court found that Mr. Hale provided an inadequate description and explanation of his legal services and failed to honor his legal and ethical obligations as attorney for the debtors?

Issue 2: Sanctions

Did Mr. Hale's failure to sign the debtors' bankruptcy petition and other misconduct warrant the imposition of sanctions under Bankruptcy Rule 9011(c)?

Issue 3: Right to a Jury Trial

Does the Seventh Amendment to the United States Constitution mandate that proceedings under 11 U.S.C. § 329 to determine whether bankruptcy attorney fees were reasonable must be determined by a jury, even though that provision does not require a jury trial, just as no other provision of the Bankruptcy Code requires that any of the dozens of other administrative matters routinely arising in bankruptcy cases be determined by juries?

Statement Regarding Oral Argument

Mr. Hale advances no novel legal theory, and the facts and legal arguments are adequately presented in the briefs and record. As a result, the decisional process would not be significantly aided by oral argument.

Standard of Appellate Review

- **Review of District Court's Decision on Appeal.** The standard of appellate review concerning a district court's decision on appeal from a bankruptcy court is *de novo*.[1]
- **Jury Trial.** Entitlement to a jury trial is a question of law that is reviewed *de novo.*[2]
- **Attorney Fees.** The standard of appellate review regarding the proper amount of legal fees to be awarded is abuse of discretion.[3]

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[1] *In re Dawson*, 390 F.3d 1139, 1145 (9th Cir. 2004)

[2] *In re Smith,* 205 B.R. 226 (B.A.P. 9th Cir. 1997), citing *Standard Oil Co. v. Arizona*, 738 F.2d 1021, 1022 (9th Cir. 1984), *cert. denied*, 469 U.S. 1132, 105 S.Ct. 815, 83 L.Ed.2d 807 (1985)

[3] *In re Park-Helena Corp.,* 63 F.3d 877, 880 (9th Cir. 1995), *cert. denied*, 516 U.S. 1049, 116 S.Ct. 712, 133 L.Ed.2d 667 (1996)

- **Sanctions.** The standard of appellate review concerning the award of sanctions is abuse of discretion.[4]
- **Findings of Fact.** The standard of appellate review for the bankruptcy court's factual finding is clear error.[5]
- **Conclusions of Law.** The standard of appellate review for the bankruptcy court's legal conclusions is *de novo.*[6]
- **Application of Law to Fact.** The standard of appellate review for the bankruptcy court's application of law to fact is clear error.[7]

Statement of the Case

This is an appeal from the district court's affirmance of the bankruptcy court's order imposing monetary and non-monetary sanctions, denying attorney's fees and requiring disgorgement of those fees, and denying motions for recusal and a jury trial.

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[4] *In re Hercules Enterprises,* 387 F.3d 1024, 1027 (9th Cir. 2004)

[5] *In re Mantz,* 343 F.3d 1207, 1211 (9th Cir. 2003)

[6] *In re Mantz,* 343 F.3d 1207, 1211 (9th Cir. 2003)

[7] *Security Farms v. International Brotherhood,* 124 F.3d 999, 1014 (9th Cir. 1997)

The bankruptcy court‘s order primarily addressed two related matters: (1) the court’s order requiring Tom Hale, Eric and Selina Jones’ initial bankruptcy attorney, to provide an accounting of all legal services rendered to the debtors so that the court could determine the reasonableness of compensation received by Mr. Hale in connection with the Joneses’ chapter 7 bankruptcy case under to 11 U.S.C. § 329(b); and (2) the United States Trustee’s motion for sanctions against Mr. Hale under Rule 9011 based upon his failure to sign the bankruptcy petition in the chapter 7 case and other misconduct. Mr. Hale did not appear at the evidentiary hearing on these matters.

The United States Trustee appeared through her counsel, presented testimony, and introduced documentary evidence. The bankruptcy court issued a written memorandum of decision and order upon completion of the hearing, finding Mr. Hale had provided inadequate services and engaged in improper conduct. Based on those finding, the court entered relief under section 329 and Rule 9011. Mr. Hale appealed to the district court, which affirmed in all respects. This appeal followed.

Statement of Facts

Debtors, Eric and Selina Jones ("Debtors") filed a voluntary bankruptcy petition under chapter 7 of the Bankruptcy Code , 11 U.S.C. 101, et seq., on September 25, 2001.[8] Tom Hale, an Idaho attorney, prepared and filed the bankruptcy petition, schedules, and statements on behalf of the Debtors.[9] Mr. Hale did not sign the petition that he prepared, but he signed and filed a compensation disclosure statement pursuant to Rule 2016(b), Fed. R. Bankr. P, evidencing his receipt of an attorney's fee of $250.[10]

On September 28, 2001, the bankruptcy court, *sua sponte*, entered an order directing Mr. Hale to provide additional information concerning the legal services he provided to the Debtors so the bankruptcy court could determine whether Mr. Hale's compensation was reasonable and appropriate under 11 U.S.C. § 329(b)[11]

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[8] Tab 1, Appellee's Supplemental Excerpts of Record

[9] Tab 1 and Tab 20, Transcript of Hearing, page 38, line 16, through page 40, line 5, Appellee's Supplemental Excerpts of Record

[10] Tab 2, Appellee's Supplemental Excerpts of Record

[11] **329. Debtor's transactions with attorneys**

(a) Any attorney representing a debtor in a case under this title, or in connection with such a case, whether or not such attorney applies for compensation under this title, shall file with the court a statement of the compensation paid or agreed to be paid, if such payment or agreement was made after one year before the date of the filing of the petition, for services rendered or to be rendered in contemplation of or and Rule 2017(a), Fed. R. Bankr. P.[12] On October 10, 2001, the United States Trustee[13] filed a notice of intent to request sanctions under Rule 9011, Fed. R. Bankr. P., unless Mr. Hale signed and filed an amended petition within 21 days from the date of the notice.[14]

Thereafter, Mr. Hale filed an itemization of attorney's fees, which the Court found in a preliminary order to be incomplete and not in full compliance with its prior order.[15] Mr. Hale then filed a supplemental itemization of fees; and the

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in connection with the case by such attorney, and the source of such compensation. **(b)** If such compensation exceeds the reasonable value of any such services, the court may cancel any such agreement, or order the return of any such payment, to the extent excessive, to–

(1) the estate, if the property transferred--
(A) would have been property of the estate; or
(B) was to be paid by or on behalf of the debtor under a plan under chapter 11, 12, or 13 of this title; or
(2) the entity that made such payment.

[12] Tab 3, Appellee's Supplemental Excerpts of Record

[13] The United States Trustee is an official of the United States Department of Justice, charged by statute with the duty to oversee and supervise the administration of bankruptcy cases. See 28 U.S.C. § 586(a). The United States Trustee is expressly given standing under 11 U.S.C. § 307 to raise and be heard on any issue under Title 11, except that the United States Trustee may not file a plan of reorganization under chapter 11. *See United States Trustee v. McCormick, Barstow, Sheppard, Wayte & Carruth (In re Donovan Corp.)*, 215 F.3d 929, 930 (9th Cir. 2000).

[14] Tab 4, Appellee's Supplemental Excerpts of Record

[15] Tabs 5 and 10, Appellee's Supplemental Excerpts of Record

Court, in turn, issued a supplemental order in which it found the disclosures still to be incomplete and ordered Mr. Hale to supplement the disclosures further within ten days.[16] Mr. Hale failed to provide any further itemization of legal services and expenses in compliance with the court's orders.

During this same time period, Mr. Hale contacted the Debtors and requested that they dismiss their bankruptcy case.[17] Mr. Hale prepared a motion to dismiss for the Debtors' signature, but the motion contained no provision for Mr. Hale to sign the document on behalf of the Debtors.[18] Mr. Hale did not explain to the Debtors why dismissal of their case was necessary.[19]

The Debtors became concerned that Mr. Hale's efforts to dismiss their bankruptcy case possibly could prejudice their interests, and as a result, they contacted a different attorney, J. Bart Green, III.[20] On October 25, 2001, the

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[16] Tabs 11 and 12, Appellee's Supplemental Excerpts of Record

[17] Tab 20, Transcript of Hearing, at page 40, line 6, through page 41, line 6, Appellee's Supplemental Excerpts of Record

[18] Tab 19, Hearing Exhibit 23, Appellee's Supplemental Excerpts of Record

[19] Tab 20, Transcript of Hearing, at page 34, line 3, through page 38, line 15, and page 58 line 13 through line 25, Appellee's Supplemental Excerpts of Record.

[20] Mr. Green later testified that dismissal of the case was not in the Debtors' best interest. Tab 20, Transcript of Hearing, at page 52, line 24, through page 54, line 21, Appellee's Supplemental Excerpts of Record.

Debtors appeared with Mr. Green at their meeting of creditors held pursuant to 11 U.S.C. § 341(a).[21] At the meeting, Mr. Green announced his appearance to the chapter 7 trustee and stated that the Debtors had just contacted him the previous day. Mr. Green further stated that it would be necessary to amend the Debtors' bankruptcy schedules that Mr. Hale had prepared and filed because they did not disclose significant assets.[22] The unscheduled property included two apartment complexes and a home in Pocatello, Idaho.[23]

Mr. Hale did not attend the meeting of creditors to help answer questions about the petition and schedules he had drafted for Mr. and Ms. Jones. The debtors also testified that Mr. Hale failed to advise the Debtors, prior to this meeting of creditors, about the complexities of the bankruptcy process so they could make an informed decision whether Mr. Hale should appear at the meeting of creditors and whether the debtors should appear without representation of counsel.[24]

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[21] Tabs 7, 8, and 9, Appellee's Supplemental Excerpts of Record

[22] Tab 6, Transcript of § 341(a) meeting, admitted as Exhibit 21, at page 3, line 13, through page 5, line 5, Appellee's Supplemental Excerpts of Record

[23] Tab 20, Transcript of Bankruptcy Court Hearing at page 7, line 17, though page 8, line 15, Appellee's Supplemental Excerpts of Record

[24] Tab 20, Transcript of Hearing, at page 34, line 3, through page 38, line 15, and page 58, lines 13-25, Appellee's Supplemental Excerpts of Record. Debtor, Selina Jones, later testified that she would not have retained Mr. Hale if she had known he would not appear at the meeting of creditors and fully represent them in

On January 22, 2002, in response to the bankruptcy court's and the United States Trustee's proceedings to investigate Mr. Hale's representation of the Debtors, Mr. Hale filed a "Motion to Recuse, Vacate, and Amended Jury Trial Demand."[25] On February 22, 2002, Mr. Hale filed an additional or supplemental pleading entitled "Motion and Affidavit to Recuse, Vacate Hearing, and Jury Trial Demand."[26] In these documents, Mr. Hale suggested that the bankruptcy court, and other judges on the court, labored under impermissible bias; but he failed to support those statements with any credible evidence.[27] On April 4, 2002, the bankruptcy court entered a memorandum of decision denying both motions.[28]

On March 5, 2003, the bankruptcy court set an evidentiary hearing on October 7, 2003, to review Mr. Hale's attorney's fees under 11 U.S.C. § 329(b) and consider the United States Trustee's request for Rule 9011 sanctions.[29]

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this case. Tab 20, at page 38, lines 4-7, Appellee's Supplemental Excerpts of Record.

[25] Tab 13, Appellee's Supplemental Excerpts of Record

[26] Tab 14, Appellee's Supplemental Excerpts of Record

[27] *See, e.g.*, Tab 13, at 1, 2, 5, 12, 22, Appellee's Supplemental Excerpts of Record

[28] Tab 15, Appellee's Supplemental Excerpts of Record

[29] Bankruptcy Docket Nos. 43 and 52

Following the completion of discovery, on August 20, 2003, the United States Trustee filed an amended motion for sanctions.[30] The amended motion sought sanctions against Mr. Hale for his breach of legal and ethical duties owed to the Debtors, including Mr. Hale's failure: (1) to sign the bankruptcy petition that he prepared, as required under Rule 9011(a), Fed. R. Bankr. P.; (2) to provide the Debtors with legal representation covering the normal, ordinary, and fundamental aspects of the bankruptcy case; (3) to obtain the informed consent of the Debtors to limit his representation of them; and (4) to prepare accurate and complete documents for filing in the case.

Based on 11 U.S.C. §§ 105(a) and 329(b), Fed. R. Bankr. P. 9011, and Idaho Rules of Professional Conduct 1.2(c) and 1.4(b), the United States Trustee requested both monetary and non-monetary sanctions, including: (1) disgorgement of all attorney's fees paid to Mr. Hale for legal services provided to the Debtors; and (2) an order limiting Mr. Hale's right to represent debtors in connection with bankruptcy cases filed in the District of Idaho and, in effect, require that he sign any bankruptcy petition that he prepares, attend the section 341(a) meeting of creditors, and otherwise provide reasonable and necessary services to represent a

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[30] Tab 16, Appellee's Supplemental Excerpts of Record

debtor in a bankruptcy case.[31]

The United States Trustee specifically provided notice to Mr. Hale that the amended motion would be heard on October 7, 2003, the same date previously set by the court.[32] On September 15, 2003, the United States Trustee filed a pre-hearing memorandum, which identified the evidence she intended to introduce and applicable law supporting the granting of sanctions and denial of attorney fees.[33] Further, on September 24, 2003, the United States Trustee filed a notice of her intent to present witnesses at the October 7, 2003 hearing.[34]

On October 5, 2003, Mr. Hale filed an omnibus "Motion to Dismiss, Response to Amended Motions, Request for Sanctions, Offer of Proof, and Renewed Request for a Jury Trial."[35] Mr. Hale advised the court in this pleading and in a separate document filed on the same date that he did not intend to appear at the October 7, 2003 hearing due to a medical ailment "that makes it almost impossible to travel," although he further stated that he intended to be in Salt Lake

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[31] Tab 16, Appellee's Supplemental Excerpts of Record

[32] Bankruptcy Docket No. 66

[33] Bankruptcy Docket No. 72

[34] Tab 17, Appellee's Supplemental Excerpts of Record

[35] Tab 18, Appellee's Supplemental Excerpts of Record

City, Utah, on the day of the hearing.[36] Mr. Hale specifically stated that he intended “to rest on the pleadings” and that “[m]y presence is not mandated or necessary to the adjudication of the issues, in my opinion.”[37] Although Mr. Hale had sought on at least one prior occasion to delay the proceedings due to alleged illness,[38] he did not request a continuance of the October 7, 2003 hearing.

Mr. Hale did not appear at the October 7, 2003 hearing. The United States Trustee called witnesses, who provided sworn testimony, and presented exhibits for admission into evidence. Based on the uncontroverted evidence, the bankruptcy court issued its memorandum of decision and order.[39]

Specifically, the bankruptcy court found that:

> The documents Hale prepared were inaccurate and poorly crafted.
>
> There was inadequate consultation and discussion with the Debtors.
>
> No real value was conferred on the Debtors for Hale’s efforts, and the Debtors had to hire new counsel to replicate virtually everything.[40]

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[36] Tab 18, at 6, Appellee’s Supplemental Excerpts of Record

[37] Tab 18, at 6, Appellee’s Supplemental Excerpts of Record

[38] Tab 21, at 8, Appellee’s Supplemental Excerpts of Record

[39] Tabs 21 and 22, Appellee’s Supplemental Excerpts of Record

[40] Tab 21, at 25, Appellee’s Supplemental Excerpts of Record

The evidence before the Court establishes that the Debtors did not provide informed consent to Hale's limited representation. Indeed, had they understood that Hale would perform no more services, and was attempting to disclaim further contractual duties or ethical obligations, they would have refused to proceed. That they ultimately refused to proceed was not because Hale explained adequately to them his proposal for limiting his legal duties. They balked because they were "scared" when Hale attempted to persuade them to dismiss their bankruptcy case, something again marked by inadequate explanation or discussion, and gave them a draft motion to sign that made untrue assertions attributable to the Debtors.[41]

The Court will not countenance Hale's exclusion of critical and necessary services, or endorse the pretense of adequately advised and informed consent in Hale's bankruptcy cases. The Court can little afford to devote judicial resources to engage in factual inquiry in each and every case brought before it by Hale to determine the quality and quantity of information given to his debtors or evaluate the adequacy of allegedly "informed" consent to Hale's limited services. Such policing unreasonably burdens the Court, the UST and panel trustees and redirects critical resources away from the thousands of Idaho citizens who are forced to file for bankruptcy relief each year and the creditors and parties in interest in their cases. Such a dedication of resources due simply to the fact that Hale is unwilling to acknowledge and adhere to his professional responsibilities is wholly

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[41] Tab 21, at 26, Appellee's Supplemental Excerpts of Record

unwarranted.[42]

Based on these findings, the bankruptcy court disallowed all compensation and directed Mr. Hale to disgorge and refund to the Debtors the entire attorney's fee of $250 paid by the Debtors. That decision was based on Mr. Hale's failure to provide the Debtors with competent legal representation, prepare adequate and complete documents for filing, obtain the informed consent of his clients to the purported limitations on representation, and provide adequate itemization of his legal services.[43]

Further, the bankruptcy court awarded the United States Trustee a sanction of $2,000 under Rule 9011(c) based on Mr. Hale's violation of Rule 9011(a) by failing to sign the Debtors' petition and other misconduct.[44] The bankruptcy court also imposed non-monetary sanctions against Mr. Hale under Rule 9011(c) in the form of an order restricting and limiting Mr. Hale's legal practice before the court to require that he sign any bankruptcy petition that he prepares, attend the § 341 meeting of creditors, and otherwise provide reasonable and necessary services to a

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[42] Tab 21, at 31-32, Appellee's Supplemental Excerpts of Record

[43] Tab 21, at 24-28, Appellee's Supplemental Excerpts of Record

[44] Tab 21, at 22-24, Appellee's Supplemental Excerpts of Record

debtor he represents in a bankruptcy case.[45]

In the same order, the bankruptcy court also denied Mr. Hale's renewed request for a jury trial, incorporating its prior order denying similar requests.[46]

Mr. Hale filed a motion to reconsider and vacate the bankruptcy court's memorandum decision and order, which the bankruptcy court denied.[47] Mr. Hale appealed to the district court, which affirmed the bankruptcy court's order.[48] Mr. Hale subsequently appealed the district court's order to this Court.[49]

Summary of Argument

Mr. Hale engaged in serious misconduct in this case. He gave bad advice to his clients, significantly misstated their financial condition in the legal papers he prepared and filed in their bankruptcy case, and failed to adequately represent them in their case. Mr. Hale then attempted to frustrate the bankruptcy court's investigation of his conduct by twice submitting what the court correctly found

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[45] Tab 21, at 30-33, Appellee's Supplemental Excerpts of Record

[46] Tab 21, at 18, and Tab 15, at 11-14, Appellee's Supplemental Excerpts of Record

[47] Bankruptcy Docket Nos. 91 and 92; Tab 23, Appellee's Supplemental Excerpts of Record

[48] Tab 24, Appellee's Supplemental Excerpts of Record

[49] Tab 25, Appellee's Supplemental Excerpts of Record

were inadequate descriptions of the services he had provided to them. After the court and the United States Trustee began proceedings to formally review his conduct in this case, Mr. Hale sought to derail that proceeding by advising his clients to dismiss their bankruptcy case, even though that was not in their best interests. Then Mr. Hale failed to appear at the evidentiary hearing the bankruptcy court conducted to adjudicate the propriety of his conduct in this case.

Given the nature and scope of Mr. Hale's poor performance and misconduct, as adjudicated at that hearing, the bankruptcy court acted well within its broad discretion under section 329(b) of the Bankruptcy Code by denying his fees and requiring disgorgement. As authorized by section 329(b), the court ordered those fees returned to the Joneses, the clients Mr. Hale so egregiously mis-served.

The bankruptcy court also properly exercised its discretion under Rule 9011 by imposing a modest $2,000 sanction against Mr. Hale for his failure to sign the Debtors' bankruptcy petition and for his other misconduct. This was particularly appropriate given Mr. Hale's history of similar violations and the need to protect future clients of Mr. Hale by deterring him from engaging in similar misconduct in future cases.

Finally, the bankruptcy court correctly denied Mr. Hale's request for a jury trial in connection with proceedings to determine bankruptcy attorney fees under

11 U.S.C. § 329(b). Neither the Bankruptcy Code nor the Seventh Amendment granted Mr. Hale the right to a jury trial in that proceeding. Mr. Hale's request for a jury trial under section 329(b) failed under the United States Supreme Court's three-part test in *Granfinanciera*. The review of bankruptcy attorney compensation is an integral part of the bankruptcy regulatory process and thus a "public right" that Congress assigned to bankruptcy courts to aid in the proper administration of bankruptcy cases. To require a jury trial to determine the reasonableness of bankruptcy attorney fees under section 329(a) and in any of the numerous other routine administrative matters that frequently come before the bankruptcy courts would place an undue burden on the bankruptcy system.

Argument

I. *The Bankruptcy Court Did Not Abuse Its Discretion by Disallowing and Requiring Disgorgement of All Attorney's Fees under 11 U.S.C. 329(b) that Hale Received from the Debtors in Connection with this Bankruptcy Case.*

Section 329(b) of the Bankruptcy Code provides that the court may order the return of any payment of compensation received by an attorney representing a debtor in a bankruptcy case, if such compensation exceeds the reasonable value of the legal services performed, to the extent excessive.[50] Rule 2017(a), Fed. R.

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[50] 11 U.S.C. § 329(b)

Bankr. P., further provides that on motion by any party in interest or on the court's own initiative, after notice and a hearing, the court may determine whether any payment of money or any transfer of property made by a debtor in contemplation of the filing of a bankruptcy petition to an attorney, for services rendered or to be rendered, is excessive.[51]

The initial burden under section 329(b) is upon the attorney to justify the compensation charged in connection with a bankruptcy case.[52] The court has broad discretion under section 329(b) to disallow and require disgorgement of attorney compensation found to be excessive.[53] Here, the bankruptcy court afforded Mr. Hale adequate notice of the court's intent to review the attorney's fee disclosed on the compensation disclosure statement that he filed under section 329(a) and its implementing rule - Fed. R. Bankr. P. 2016(b), and properly requested further itemization of Mr. Hale's legal services. Mr. Hale filed two itemizations to support the attorney's fees he charged in connection with this case.[54] The court found the

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[51] Fed. R. Bankr. P. 2017(a)

[52] *In re Jastrem*, 253 F.3d 438, 443 (9th Cir. 2001); *In re Mahendra*, 131 F3d 750, 757 (8th Cir. 1997); *In re Basham*, 208 B.R. 926, 931-932 (B.A.P. 9th Cir. 1997); *In re Xebec*, 147 B.R. 518, 524 (B.A.P. 9th Cir. 1992)

[53] *In re Clark*, 223 F3d 859, 863 (8th Cir. 2000)

[54] Tabs 5 and 11, Appellee's Supplemental Excerpts of Record

initial itemization to be incomplete because it failed to include a detailed and specific description of each service rendered in the case.[55] Thereafter, Mr. Hale filed a supplemental itemization,[56] which the court also found to be incomplete because it failed to identify the person who provided the service.[57] Thereafter, Mr. Hale failed to comply with the Court's order to provide further information. The majority of the services itemized by Mr. Hale could not be compensated because they were secretarial or clerical in nature, and their cost was included in the attorney's hourly rate.[58]

In addition to failing to provide proper itemization of his legal services, Mr. Hale failed to provide the Debtors with competent legal representation. He failed to prepare adequate and complete documents for filing, to attend the Debtors' section 341(a) meeting of creditors; to obtain the informed consent of the Debtors to the purported limitations on representation; and he attempted to dismiss the Debtors' bankruptcy case so he could avoid further court review. As a result, the Debtors were required to hire substitute counsel, at an additional cost of $1,000, to

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[55] Tab 10, Appellee's Supplemental Excerpts of Record

[56] Tab 11, Appellee's Supplemental Excerpts of Record

[57] Tab 12, Appellee's Supplemental Excerpts of Record

[58] *In re Castorena*, 270 B.R. 504, 516 (Bankr. D. Idaho 2001)

correct the many errors and omissions in their bankruptcy schedules and statements.[59] Based on the record below, the court properly concluded that Mr. Hale's legal services were of little or no value to the Debtors. The bankruptcy court correctly determined that Mr. Hale's attorney's fees were not reasonable and properly exercised its discretion to disallow and require disgorgement of such compensation under section 329(b).

II. *Mr. Hale's Failure to Sign the Debtors' Bankruptcy Petition and Other Misconduct Warrant the Imposition of Sanctions under Bankruptcy Rule 9011(c).*

Mr. Hale challenges both the authority of the bankruptcy court to impose sanctions against him and the procedures followed by the court in imposing such sanctions.[60] The bankruptcy court based its sanctions against Mr. Hale on Rule 9011(c), Fed. R. Bankr. P.[61] The court had broad discretion to impose sanctions

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[59] Tab 20, Hearing Transcript, at page 59, lines 12-22, and page 52, lines 4-15, Appellee's Supplemental Excerpts of Record

[60] Mr. Hale raises some of these issues for the first time in this appeal, for example, whether the court followed the proper procedure in issuing sanctions. *See* Appellant's Opening Brief, at 6-9. Generally, this Court will not consider an issue raised for the first time on appeal. *Bolker v. C.I.R.*, 760 F.2d 1039, 1042 (9th Cir. 1985).

[61] The bankruptcy court also recognized that the court has the inherent power to regulate the practice of law in cases before it and to sanction attorneys for bad faith conduct, but the court did not appear to invoke this power in the case below. Tab 21, at 17, 24, 30, Appellee's Supplemental Excerpts of Record; *see Chambers v. NASCO, Inc.*, 501 U.S. 32, 43, 50, 111 S.Ct. 2123, 2132, 2135, 115 L.Ed. 2d 27

under Rule 9011(c),[62] These sanctions included a monetary sanction of $2,000 based on Mr. Hale's failure to sign the bankruptcy petition that he prepared and filed on behalf of the Debtors in this case and other misconduct.[63]

Rule 9011(a) requires that every petition, pleading, written motion, and other paper shall be signed by at least one attorney of record in the attorney's individual name.[64] This is consistent with the official bankruptcy petition form filed in bankruptcy cases. Official Form 1 to the Federal Rules of Bankruptcy Procedure, at page 3, contains a section entitled Signature of Attorney. In that section, the debtor's attorney must sign his name, and provide the attorney's address and other identifying information.

Mr. Hale left that section blank even though he prepared and filed the petition on the Debtors' behalf and also filed a compensation disclosure statement under Rule 2016(b). Even standing alone, this was a serious misconduct because Bankruptcy Rule 9011(a) requires that "[e]very petition ... shall be signed by at

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(1991); *In re Deville*, 361 F.3d 539, 544-545 (9th Cir. 2004).

[62] *In re Deville*, 361 F3d 539, 553 (9th Cir. 2004); *In re D.C. Sullivan Co.*, 843 F2d 596, 599 (1st Cir. 1988)

[63] Tab 21, at 22-24, Appellee's Supplemental Excerpts of Record

[64] Fed. R. Bankr. P. 9011(a)

least one attorney of record in the attorney's individual name."[65]

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[65] Fed. R. Bankr. P. 9011(a); *In re Castorena*, 270 B.R. 504, 514 (Bankr. D. Idaho 2001) [holding that the attorney is responsible for what appears in the pleadings and his signature is a required certification under Rule 9011(b)]

Rule 9011(a)'s attorney signature requirement is buttressed by Bankruptcy Rule 9011(b), which independently provides that by presenting the petition to the court, whether by signing, filing, submitting, or later advocating the petition, the attorney is certifying that the petition is not being presented for any improper purpose, any legal contentions contained therein are warranted by applicable law, and any factual contentions have evidentiary support.[66]

Given Mr. Hale's failure to sign the petition he prepared and submitted for filing, the bankruptcy court acted appropriately by imposing a modest $2,000 sanction under Rule 9011. As the bankruptcy court properly recognized, Mr. Hale could not refuse to sign the documents he prepared as counsel.[67] That is particularly true here, where the record amply reveals that the bankruptcy petitions and schedules prepared by Mr. Hale contained numerous errors and omissions and that in fact he attempted to dismiss the bankruptcy case in an effort to avoid sanctions and disgorgement of his compensation, without regard to any injury that could have resulted to the Debtors from a dismissal of their case.

Rule 9011(c)(2) provides that a sanction imposed for violation of Rule 9011shall be limited to what is sufficient to deter repetition of such conduct or

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[66] Fed. R. Bankr. P. 9011(b)

[67] Tab 21, at 23-24, Appellee's Supplemental Excerpts of Record

comparable conduct by others similarly situated. The sanction may include "directives of a nonmonetary nature, an order to pay a penalty into court, or, if imposed on motion and warranted for effective deterrence, an order directing payment to the movant of some or all of the reasonable attorneys' fees and other expenses incurred as a direct result of the violation."[68]

The bankruptcy court properly exercised its discretion in imposing monetary sanctions against Mr. Hale under Rule 9011(c) in the view of his past history of similar violations,[69] the need to deter him and others from repeating such misconduct, and the attorney's time and expenses incurred by the United States Trustee in prosecuting her motion for sanctions.[70]

The bankruptcy court also properly exercised its discretion in imposing non-monetary sanctions against Mr. Hale Rule under 9011(c), based upon the court's finding that monetary sanctions would not be sufficient to rectify the problems Mr. Hale's misconduct presented, especially given the history of litigation in the bankruptcy court arising from similar conduct by Mr. Hale in multiple prior

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[68] Fed. R. Bankr. P. 9011(c)(2)

[69] *See In re Castorena*, 270 B.R. 504, 509-514 (Bankr. D. Idaho 2001)

[70] Tab 21, at 23-24, Appellee's Supplemental Excerpts of Record

cases.[71]

The record in this case reflects that Mr. Hale also failed to obtain the informed consent of the Debtors, which is required under the Idaho Rules of Professional Conduct before an attorney may properly limit his representation of clients.[72] Given that, the court acted within its discretion when it imposed non-monetary sanctions against Mr. Hale under Rule 9011(c) in the form of an order restricting and limiting Mr. Hale's legal practice before the court to require that he sign any bankruptcy petition that he prepares, attend the section 341(a) meeting of creditors, and otherwise provide reasonable and necessary services to represent a debtor in a bankruptcy case. The record here establishes it was not an abuse of discretion to conclude such non-monetary sanctions were necessary and appropriate to deter repetition of similar misconduct by Mr. Hale and others.

Contrary to Mr. Hale's assertions, the United States Trustee and the bankruptcy court followed the proper procedures under Rule 9011(c)(1) in requesting and imposing sanctions against Mr. Hale. At the outset of the case, the

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[71] Tab 21, at 30-33, Appellee's Supplemental Excerpts of Record; *see In re Castorena*, 270 B.R. 504, 532 (Bankr. D. Idaho 2001) (court ordered disgorgement of $125 in fees in each of 19 bankruptcy cases filed by Mr. Hale, in which he failed to sign petitions)

[72] Idaho Rules of Professional Conduct 1.2(c) and 1.4(b)

United States Trustee served notice on Mr. Hale of her intent to request sanctions if Mr. Hale did not sign an amended bankruptcy petition on behalf of the Debtors within 21 days from the date of the notice, in compliance with Rule 9011(c)(1). Following the completion of discovery, on August 20, 2003, the United States Trustee served her amended motion for sanctions on Mr. Hale, together with a notice setting a hearing on the amended motion on October 7, 2003, the same date previously set by the bankruptcy court for hearing on the court's proceedings to review Mr. Hale's compensation under section 329(a) and the United States Trustee prior request for sanctions.[73] The United States Trustee served her pre-hearing memorandum on Mr. Hale approximately three weeks before the hearing and her notice of intent to call witnesses approximately two weeks prior to the hearing.

On October 5, 2003, two days before the hearing, Mr. Hale advised the bankruptcy court that he did not intend to appear at the hearing due to a medical ailment that prevented him from traveling from his home in Pocatello, Idaho, to the

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[73] The amended motion related to the same document that was the subject of the original motion, i.e., the Debtors' original petition, which Mr. Hale prepared but failed to sign. Tab 16, Appellee's Supplemental Excerpts of Record. The amended motion was filed more than six weeks before the date of the hearing. Thus, notice of the amended motion was adequate and in compliance with Rule 9011(c)(1).

court in Boise, Idaho, although he was apparently able to travel to Salt Lake City, Utah, on the date of the hearing.[74] Moreover, Mr. Hale expressly stated that he intended "to rest on the pleadings" and that "[m]y presence is not mandated or necessary to the adjudication of the issues, in my opinion."[75] Mr. Hale's statements to the court clearly manifested his considered decision to rest on the pleadings of record and not appear at the October 7, 2003 hearing. Mr. Hale made no request to continue or vacate the hearing. Based on the record below, the court correctly concluded that it was proper to proceed with the presentation of evidence by the United States Trustee and the Debtors at the time of the scheduled hearing, notwithstanding Mr. Hale's absence.[76]

The bankruptcy court and the United States Trustee thus followed the proper procedures under Rule 9011(c)(1) and did not infringe on Mr. Hale's due process rights in any respect.

III. *The Seventh Amendment Does Not Grant Mr. Hale the Right to a Jury Trial in a Proceeding to Determine Bankruptcy Attorney Fees under 11 U.S.C. § 329.*

Finally, Mr. Hale suggests the Seventh Amendment requires that attorneys

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[74] Tab 18, at 6, Appellee's Supplemental Excerpts of Record

[75] Tab 18, at 6, Appellee's Supplemental Excerpts of Record

[76] Tab 21, at 21-22, Appellee's Supplemental Excerpts of Record

fees be determined by juries, not bankruptcy courts.[77] That suggestion is simply wrong.

A party's right to a trial by jury in a federal court derives from either of two sources: the Seventh Amendment to the United States Constitution or a federal statute.[78] As the Bankruptcy Code provides for no statutory right to a jury trial,[79] the only possible source upon which the right to a jury trial may be based is the Seventh Amendment to the United States Constitution.

Mr. Hale has no constitutional right to have his attorneys fees determined by a jury. The United States Supreme Court in the case of *Granfinanciera, S.A. v. Nordberg*[80] clarified many of the issues regarding the right to a jury trial in bankruptcy cases. In *Granfinanciera*, the Supreme Court established a three-part test for determining whether a Seventh Amendment right to a jury trial exists. The Supreme Court indicated that first, the trial court must compare the statutory cause of action with 18th-century English actions brought under common law at the time

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[77] Appellant's Opening Brief, page 3

[78] *In re Wencl*, 71 B.R. 879, 882 (Bankr. Minn. 1987); *In re McNaughton,* 171 B.R. 65, 66 (Bankr. W.D. Mo. 1994)

[79] *See McNaughton*, 171 B.R. at 66; *In re Rheuban*, 121 B.R. 368, 380 (Bankr. C.D. Cal. 1990)

[80] 492 U.S. 33, 109 S.Ct. 2782, 106 L.Ed.2d 26 (1989)

the Amendment was adopted. For the right to a jury trial to exist, the statutory action must be analogous to an 18th-century English common law cause of action that was tried at law.[81] Second, the trial court must review the remedy sought to determine whether it is legal or equitable in nature. Only if the remedy is legal does the right to a jury trial exist. The Supreme Court noted that greater weight should be given to the second part of the test.[82]

The Supreme Court went on to state that even if, on balance, the two factors above indicate that a party is entitled to a jury trial, Congress nonetheless may, by statute, assign the resolution of the claim to a non-Article III tribunal that does not use a jury as a fact finder if the cause of action involves a "public right." Under the "public rights doctrine," the applicable test to determine whether an action implicates a public right is whether "Congress, acting for a valid legislative purpose pursuant to its constitutional powers under Article I, [has] create[d] a seemingly 'private' right that is so closely integrated into a public regulatory

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[81] *Granfinanciera*, 492 U.S. at 42

[82] *Granfinanciera*, 492 U.S. at 42

scheme as to be a matter appropriate for agency resolution with limited involvement by the Article III judiciary."[83]

Mr. Hale's request for a jury trial in the bankruptcy court proceedings below failed under at least two of the three parts of the *Granfinanciera* test. First, a motion to review attorney's fees pursuant to 11 U.S.C. § 329(b) does not resemble any cause of action that would be heard in an 18th-century English court of law. The Supreme Court, in *Wood v. Henderson*,[84] addressed this issue in connection with section 60d of the Bankruptcy Act of 1898, a statutory predecessor to section 329. The Supreme Court held that the district court had jurisdiction over attorneys who resided in a different judicial district to determine the reasonableness of the compensation they charged the debtor in connection with a bankruptcy case. In reaching its decision, the Supreme Court determined that the district court's review of attorneys' fees did not resemble any cause of action which would be heard in an English court of law during the 18th century; the review was therefore not subject to a trial by jury.[85]

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[83] *Granfinanciera*, 492 U.S. at 54, quoting *Thomas v. Union Carbide Agricultural Products Co.*, 473 U.S. 568, 593-594, 105 S.Ct. 3325, 3339-3940, 87 L.Ed.2d 409 (1985)

[84] 210 U.S. 246 (1908)

[85] *Wood v. Henderson*, 210 U.S. at 253

Second, the review of compensation of debtors' attorneys under section 329(b) is so integral to the bankruptcy regulatory process as to be a "public right." Congress, in enacting section 329(b), assigned the determination of such compensation to the bankruptcy courts to aid in the proper administration of cases under the Bankruptcy Code. Court review and regulation of attorneys' fees charged or received by debtors' counsel has been a feature of the bankruptcy system under both the Bankruptcy Act of 1898 and the current Bankruptcy Code. This review is part of the delicate balancing of creditor and debtor interests that Congress undertook when enacting the Bankruptcy Code and represents an integral part of the overall statutory scheme to ensure that debtors receive competent representation at a reasonable cost to debtors, creditors, and the estate.

In short, Congress, under its legislative authority granted by the Constitution, created a "public right" when it enacted section 329, and no right to a jury trial attaches to a determination, by the bankruptcy court, under that provision.[86] To require a jury trial to determine the reasonableness of bankruptcy attorney fees under section 329(a) and in any of the numerous other routine administrative matters that frequently come before the bankruptcy courts would

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[86] *In re Rheuban,* 121 B.R. 368, 383 (Bankr. C.D. Cal. 1990)

place an undue burden on the bankruptcy system and threaten the continued efficient and economical operation of the bankruptcy courts.

This position is consistent with other circuit court rulings that have held in different contexts that attorney fees are determined by courts not juries. For example, the Fifth Circuit has held that a defendant in an action by the Resolution Trust Corporation to enforce a promissory note and guaranty agreement had no right to a jury determination of attorneys' fees awarded to the Resolution Trust Corporation.[87]

> In any event, the right to a trial by jury in federal courts is a matter of federal law. *Simler v. Conner,* 372 U.S. 221, 222, 83 S.Ct. 609, 610, 9 L.Ed.2d 691 (1963). Since there is no common law right to recover attorneys fees, the Seventh Amendment does not guarantee a trial by jury to determine the amount of reasonable attorneys fees. *Empire State Ins. Co. v. Chafetz,* 302 F.2d 828, 830 (5th Cir.1962). Although a jury as trier of fact *may* determine the amount of reasonable attorneys fees, *see, e.g., Toren v. Braniff, Inc.,* 893 F.2d 763, 767 (5th Cir.1990); *Farmland Indus. Inc. v. Andrews Transport Co.,* 888 F.2d 1066, 1067 (5th Cir.1989), Williams did not have an absolute right to have the issue decided by a jury.[88]

Similarly, the Second Circuit has held that there is no right to a jury trial to determine attorneys' fees in a stockholder's derivative suit to rescind a merger.[89]

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[87] *Resolution Trust Corp. v. Marshall*, 939 F.2d 274, 280 (5th Cir. 1991)

[88] *Resolution Trust Corp. v. Marshall,* 939 F.2d at 279

[89] *McGuire v. Russell Miller, Inc*., 1 F.3d 1306, 1316 (2nd Cir. 1993)

The court stated as follows:

> To compute a reasonable amount of attorneys' fees in a particular case requires more than simply a report of the number of hours spent and the hourly rate. The calculation depends on an assessment of whether those statistics are reasonable, based on, among other things, the time and labor reasonably required by the case, the skill demanded by the novelty or complexity of the issues, the burdensomeness of the fees, the incentive effects on future cases, and the fairness to the parties. Such collateral issues do not present the kind of common-law questions for which the Seventh Amendment preserves a jury trial right.[90]

Finally, many federal statutes authorize the award of attorney fees under certain circumstances. For example, 7 U.S.C. § 2565; 15 U.S.C. § 4304(a)(1); 16 U.S.C. § 470w-4; 17 U.S.C. § 505; and 28 U.S.C. § 3905(a) all allow for the award of attorney fees. If Mr. Hale's contention were correct, the amount of the fees to be awarded under those statutes might also have to be determined by juries. The United States Trustee is unaware of any reported case where a federal court has ever reached such a novel conclusion.

Accordingly, Mr. Hale had no right to a trial by jury to determine what relief should be imposed under section 329, as Congress statutorily delegated the duty to make that determination to the bankruptcy court. As a result, the bankruptcy court's ruling did not infringe upon Mr. Hale's Seventh Amendment rights.

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[90] *McGuire* ,1 F.3d at 1315-1316

Conclusion

For the foregoing reasons, the United States Trustee respectfully asks this Court to affirm the orders entered below.

Dated: Fri-3/2/07 13:23

Respectfully submitted,

Ilene Lashinsky
United States Trustee
United States Department of Justice

____
Gary L. McClendon
Department of Justice
Attorney for United States Trustee
United States Department of Justice
720 Park Blvd., Suite 220
Boise, Idaho 83720
(208) 334-1300
Fax (208) 334-9756
Idaho State Bar No. 1529

Certification Required by Circuit Rule 28-2.6

Tom Hale v. United States Trustee
Case No. 06-35349

The undersigned certifies that the following are known related cases as they involve the same parties and similar issues:

In Re Basham, 208 B.R. 926 (B.A.P. 9th Cir. 1997), *aff'd*, 152 F.3d 924 (9th Cir. 1998) (unpublished disposition)

In Re Castorena, 270 B.R. 502 (Bankr. Idaho 2001), *aff'd*, *Hale v. United States Trustee*, BAP No. ID-02-1013-MoBMa (B.A.P. 9th Cir. Aug. 29, 2002) (unpublished disposition)

Hale v. United States Trustee, 177 Fed Appx. 620 (9th Cir. 2006)

Dated: Fri-3/2/07 13:23

Ilene Lashinsky
United States Trustee
United States Department of Justice

____
Gary L. McClendon
Attorney for United States Trustee
United States Department of Justice

Certificate of Compliance Pursuant to FRAP 32(a)(7)(C) and Circuit Rule 32-1

I certify that pursuant to Federal Rule of Appellate Procedure 32(a)(7)(C) and Ninth Circuit Rule 32-1the attached answering brief is proportionately spaced, has a typeface of 14 points or more, and contains 8456 words in the text of the brief.

Dated: Fri-3/2/07 13:23

Ilene Lashinsky
United States Trustee
United States Department of Justice

____
Gary L. McClendon
Attorney for United States Trustee
United States Department of Justice

Addendum

Federal Statutes and Rules

Federal Rules

State Rules

§ 105. Power of court

(a) The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title. No provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, sua sponte, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process.

(b) Notwithstanding subsection (a) of this section, a court may not appoint a receiver in a case under this title.

(c) The ability of any district judge or other officer or employee of a district court to exercise any of the authority or responsibilities conferred upon the court under this title shall be determined by reference to the provisions relating to such judge, officer, or employee set forth in title 28. This subsection shall not be interpreted to exclude bankruptcy judges and other officers or employees appointed pursuant to chapter 6 of title 28 from its operation.

(d) The court, on its own motion or on the request of a party in interest–

(1) shall hold such status conferences as are necessary to further the expeditious and economical resolution of the case; and

(2) unless inconsistent with another provision of this title or with applicable Federal Rules of Bankruptcy Procedure, issue an order at any such conference prescribing such limitations and conditions as the court deems appropriate to ensure that the case is handled expeditiously and economically, including an order that--

(A) sets the date by which the trustee must assume or reject an executory contract or unexpired lease; or

(B) in a case under chapter 11 of this title–

(I) sets a date by which the debtor, or trustee if one has been appointed, shall file a disclosure statement and plan;

(ii) sets a date by which the debtor, or trustee if one has been appointed, shall solicit acceptances of a plan;

(iii) sets the date by which a party in interest other than a debtor may file a plan;

(iv) sets a date by which a proponent of a plan, other than the debtor, shall solicit acceptances of such plan;

(v) fixes the scope and format of the notice to be provided regarding the hearing on approval of the disclosure statement; or

(vi) provides that the hearing on approval of the disclosure statement may be combined with the hearing on confirmation of the plan.

329. Debtor's transactions with attorneys

(a) Any attorney representing a debtor in a case under this title, or in connection with such a case, whether or not such attorney applies for compensation under this title, shall file with the court a statement of the compensation paid or agreed to be paid, if such payment or agreement was made after one year before the date of the filing of the petition, for services rendered or to be rendered in contemplation of or in connection with the case by such attorney, and the source of such compensation.

(b) If such compensation exceeds the reasonable value of any such services, the court may cancel any such agreement, or order the return of any such payment, to the extent excessive, to–

(1) the estate, if the property transferred--

(A) would have been property of the estate; or

(B) was to be paid by or on behalf of the debtor under a plan under chapter 11, 12, or 13 of this title; or

(2) the entity that made such payment.

§ 341. Meetings of creditors and equity security holders

(a) Within a reasonable time after the order for relief in a case under this title, the United States trustee shall convene and preside at a meeting of creditors.

(b) The United States trustee may convene a meeting of any equity security holders.

(c) The court may not preside at, and may not attend, any meeting under this section including any final meeting of creditors. Notwithstanding any local court rule, provision of a State constitution, any otherwise applicable nonbankruptcy law, or any other requirement that representation at the meeting of creditors under subsection (a) be by an attorney, a creditor holding a consumer debt or any representative of the creditor (which may include an entity or an employee of an entity and may be a representative for more than 1 creditor) shall be permitted to appear at and participate in the meeting of creditors in a case under chapter 7 or 13, either alone or in conjunction with an attorney for the creditor. Nothing in this subsection shall be construed to require any creditor to be represented by an attorney at any meeting of creditors.

(d) Prior to the conclusion of the meeting of creditors or equity security holders, the trustee shall orally examine the debtor to ensure that the debtor in a case under chapter 7 of this title is aware of--

(1) the potential consequences of seeking a discharge in bankruptcy, including the effects on credit history;

(2) the debtor's ability to file a petition under a different chapter of this title;

(3) the effect of receiving a discharge of debts under this title; and

(4) the effect of reaffirming a debt, including the debtor's knowledge of the provisions of section 524(d) of this title.

(e) Notwithstanding subsections (a) and (b), the court, on the request of a party in interest and after notice and a hearing, for cause may order that the United States trustee not convene a meeting of creditors or equity security holders if the debtor has filed a plan as to which the debtor solicited acceptances prior to the commencement of the case.

§ 157. Procedures

(a) Each district court may provide that any or all cases under title 11 and any or all proceedings arising under title 11 or arising in or related to a case under title 11 shall be referred to the bankruptcy judges for the district.

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

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

(A) matters concerning the administration of the estate;
(B) allowance or disallowance of claims against the estate or exemptions from property of the estate, and estimation of claims or interests for the purposes of confirming a plan under chapter 11, 12, or 13 of title 11 but not the liquidation or estimation of contingent or unliquidated personal injury tort or wrongful death claims against the estate for purposes of distribution in a case under title 11;
(C) counterclaims by the estate against persons filing claims against the estate;
(D) orders in respect to obtaining credit;
(E) orders to turn over property of the estate;
(F) proceedings to determine, avoid, or recover preferences;
(G) motions to terminate, annul, or modify the automatic stay;
(H) proceedings to determine, avoid, or recover fraudulent conveyances;
(I) determinations as to the dischargeability of particular debts;
(J) objections to discharges;
(K) determinations of the validity, extent, or priority of liens;
(L) confirmations of plans;
(M) orders approving the use or lease of property, including the use of cash collateral;
(N) orders approving the sale of property other than property resulting from claims brought by the estate against persons who have not filed claims against the estate;
(O) other proceedings affecting the liquidation of the assets of the estate or the adjustment of the debtor-creditor or the equity security holder relationship, except personal injury tort or wrongful death claims; and

(P) recognition of foreign proceedings and other matters under chapter 15 of title 11.

(3) The bankruptcy judge shall determine, on the judge's own motion or on timely motion of a party, whether a proceeding is a core proceeding under this subsection or is a proceeding that is otherwise related to a case under title 11. A determination that a proceeding is not a core proceeding shall not be made solely on the basis that its resolution may be affected by State law.

(4) Non-core proceedings under section 157(b)(2)(B) of title 28, United States Code, shall not be subject to the mandatory abstention provisions of section 1334(c)(2)

(5) The district court shall order that personal injury tort and wrongful death claims shall be tried in the district court in which the bankruptcy case is pending, or in the district court in the district in which the claim arose, as determined by the district court in which the bankruptcy case is pending.

...

§ 158. Appeals

(a) The district courts of the United States shall have jurisdiction to hear appeals [FN1]

(1) from final judgments, orders, and decrees;

(2) from interlocutory orders and decrees issued under section 1121(d) of title 11 increasing or reducing the time periods referred to in section 1121 of such title; and

(3) with leave of the court, from other interlocutory orders and decrees;
and, with leave of the court, from interlocutory orders and decrees, of bankruptcy judges entered in cases and proceedings referred to the bankruptcy judges under section 157 of this title. An appeal under this subsection shall be taken only to the district court for the judicial district in which the bankruptcy judge is serving.

...

(d)(1) The courts of appeals shall have jurisdiction of appeals from all final decisions, judgments, orders, and decrees entered under subsections (a) and (b) of this section.

(2)(A) The appropriate court of appeals shall have jurisdiction of appeals described in the first sentence of subsection (a) if the bankruptcy court, the district court, or the bankruptcy appellate panel involved, acting on its own motion or on the request of a party to the judgment, order, or decree described in such first sentence, or all the appellants and appellees (if any) acting jointly, certify that--

(I) the judgment, order, or decree involves a question of law as to which there is no controlling decision of the court of appeals for the circuit or of the Supreme Court of the United States, or involves a matter of public importance;

(ii) the judgment, order, or decree involves a question of law requiring resolution of conflicting decisions; or

(iii) an immediate appeal from the judgment, order, or decree may materially advance the progress of the case or proceeding in which the appeal is taken;
and if the court of appeals authorizes the direct appeal of the judgment, order, or decree.

(B) If the bankruptcy court, the district court, or the bankruptcy appellate panel--

(I) on its own motion or on the request of a party, determines that a circumstance specified in clause (I), (ii), or (iii) of subparagraph (A) exists; or

(ii) receives a request made by a majority of the appellants and a majority of appellees (if any) to make the certification described in subparagraph (A);
then the bankruptcy court, the district court, or the bankruptcy appellate panel shall make the certification described in subparagraph (A).

(C) The parties may supplement the certification with a short statement of the basis for the certification.

(D) An appeal under this paragraph does not stay any proceeding of the bankruptcy court, the district court, or the bankruptcy appellate panel from which the appeal is taken, unless the respective bankruptcy court, district court, or bankruptcy appellate panel, or the court of appeals in which the appeal in pending, issues a stay of such proceeding pending the appeal.

(E) Any request under subparagraph (B) for certification shall be made not later than 60 days after the entry of the judgment, order, or decree.

§ 1334. Bankruptcy cases and proceedings

(a) Except as provided in subsection (b) of this section, the district courts shall have original and exclusive jurisdiction of all cases under title 11.

(b) Except as provided in subsection (e)(2), and notwithstanding any Act of Congress that confers exclusive jurisdiction on a court or courts other than the district courts, the district courts shall have original but not exclusive jurisdiction of all civil proceedings arising under title 11, or arising in or related to cases under title 11.

(c)(1) Except with respect to a case under chapter 15 of title 11, nothing in this section prevents a district court in the interest of justice, or in the interest of comity with State courts or respect for State law, from abstaining from hearing a particular proceeding arising under title 11 or arising in or related to a case under title 11.

(2) Upon timely motion of a party in a proceeding based upon a State law claim or State law cause of action, related to a case under title 11 but not arising under title 11 or arising in a case under title 11, with respect to which an action could not have been commenced in a court of the United States absent jurisdiction under this section, the district court shall abstain from hearing such proceeding if an action is commenced, and can be timely adjudicated, in a State forum of appropriate jurisdiction.

(d) Any decision to abstain or not to abstain made under subsection (c) (other than a decision not to abstain in a proceeding described in subsection (c)(2)) is not reviewable by appeal or otherwise by the court of appeals under section 158(d), 1291, or 1292 of this title or by the Supreme Court of the United States under section 1254 of this title. Subsection (c) and this subsection shall not be construed to limit the applicability of the stay provided for by section 362 of title 11, United States Code, as such section applies to an action affecting the property of the estate in bankruptcy.

(e) The district court in which a case under title 11 is commenced or is pending shall have exclusive jurisdiction--

(1) of all the property, wherever located, of the debtor as of the commencement of such case, and of property of the estate; and

(2) over all claims or causes of action that involve construction of section 327 of title 11, United States Code, or rules relating to disclosure requirements under section 327.

Rule 2016. Compensation for Services Rendered and Reimbursement of Expenses

...

(b) Disclosure of compensation paid or promised to attorney for debtor

Every attorney for a debtor, whether or not the attorney applies for compensation, shall file and transmit to the United States trustee within 15 days after the order for relief, or at another time as the court may direct, the statement required by § 329 of the Code including whether the attorney has shared or agreed to share the compensation with any other entity. The statement shall include the particulars of any such sharing or agreement to share by the attorney, but the details of any agreement for the sharing of the compensation with a member or regular associate of the attorney's law firm shall not be required. A supplemental statement shall be filed and transmitted to the United States trustee within 15 days after any payment or agreement not previously disclosed.

...

Rule 2017. Examination of Debtor's Transactions with Debtor's Attorney

(a) Payment or transfer to attorney before order for relief

On motion by any party in interest or on the court's own initiative, the court after notice and a hearing may determine whether any payment of money or any transfer of property by the debtor, made directly or indirectly and in contemplation of the filing of a petition under the Code by or against the debtor or before entry of the order for relief in an involuntary case, to an attorney for services rendered or to be rendered is excessive.

...

Rule 9011. Signing of Papers; Representations to the Court; Sanctions; Verification and Copies of Papers

(a) Signing of papers

Every petition, pleading, written motion, and other paper, except a list, schedule, or statement, or amendments thereto, shall be signed by at least one attorney of record in the attorney's individual name. A party who is not represented by an attorney shall sign all papers. Each paper shall state the signer's address and telephone number, if any. An unsigned paper shall be stricken unless omission of the signature is corrected promptly after being called to the attention of the attorney or party.

(b) Representations to the court

By presenting to the court (whether by signing, filing, submitting, or later advocating) a petition, pleading, written motion, or other paper, an attorney or unrepresented party is certifying that to the best of the person's knowledge, information, and belief, formed after an inquiry reasonable under the circumstances,--

(1) it is not being presented for any improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of litigation;
(2) the claims, defenses, and other legal contentions therein are warranted by existing law or by a nonfrivolous argument for the extension, modification, or reversal of existing law or the establishment of new law;
(3) the allegations and other factual contentions have evidentiary support or, if specifically so identified, are likely to have evidentiary support after a reasonable opportunity for further investigation or discovery; and
(4) the denials of factual contentions are warranted on the evidence or, if specifically so identified, are reasonably based on a lack of information or belief.

(c) Sanctions

If, after notice and a reasonable opportunity to respond, the court determines that subdivision (b) has been violated, the court may, subject to the conditions stated below, impose an appropriate sanction upon the attorneys, law firms, or parties that have violated subdivision (b) or are responsible for the violation.

(1) How initiated

(A) By motion

A motion for sanctions under this rule shall be made separately from other motions or requests and shall describe the specific conduct alleged to violate subdivision (b). It shall be served as provided in Rule 7004. The motion for sanctions may not be filed with or presented to the court unless, within 21 days after service of the motion (or such other period as the court may prescribe), the challenged paper, claim, defense, contention, allegation, or denial is not withdrawn or appropriately corrected, except that this limitation shall not apply if the conduct alleged is the filing of a petition in violation of subdivision (b). If warranted, the court may award to the party prevailing on the motion the reasonable expenses and attorney's fees incurred in presenting or opposing the motion. Absent exceptional circumstances, a law firm shall be held jointly responsible for violations committed by its partners, associates, and employees.

(B) On court's initiative

On its own initiative, the court may enter an order describing the specific conduct that appears to violate subdivision (b) and directing an attorney, law firm, or party to show cause why it has not violated subdivision (b) with respect thereto.

(2) Nature of sanction; limitations

A sanction imposed for violation of this rule shall be limited to what is sufficient to deter repetition of such conduct or comparable conduct by others similarly situated. Subject to the limitations in subparagraphs (A) and (B), the sanction may consist of, or include, directives of a nonmonetary nature, an order to pay a penalty into court, or, if imposed on motion and warranted for effective deterrence, an order directing payment to the movant of some or all of the reasonable attorneys' fees and other expenses incurred as a direct result of the violation.
(A) Monetary sanctions may not be awarded against a represented party for a violation of subdivision (b)(2).
(B) Monetary sanctions may not be awarded on the court's initiative unless the court issues its order to show cause before a voluntary dismissal or settlement of the claims made by or against the party which is, or whose attorneys are, to be sanctioned.

(3) Order

When imposing sanctions, the court shall describe the conduct determined to constitute a violation of this rule and explain the basis for the sanction imposed.

(d) Inapplicability to discovery

Subdivisions (a) through (c) of this rule do not apply to disclosures and discovery requests, responses, objections, and motions that are subject to the provisions of Rules 7026 through 7037.

(e) Verification

Except as otherwise specifically provided by these rules, papers filed in a case under the Code need not be verified. Whenever verification is required by these rules, an unsworn declaration as provided in 28 U.S.C. § 1746 satisfies the requirement of verification.

(f) Copies of signed or verified papers

When these rules require copies of a signed or verified paper, it shall suffice if the original is signed or verified and the copies are conformed to the original.

RULE 1.2: SCOPE OF REPRESENTATION

...

(c) A lawyer may limit the scope of the representation if the limitation is reasonable under the circumstances and the client gives informed consent.

RULE 1.4: COMMUNICATION

(a) A lawyer shall:

(1) promptly inform the client of any decision or circumstance with respect to which the clients informed consent, as defined in Rule 1.0(e), is required by these Rules;

(2) reasonably consult with the client about the means by which the clients objectives are to be accomplished;

(3) keep the client reasonably informed about the status of the matter;

(4) promptly comply with reasonable requests for information; including a request for an accounting as required by Rule 1.5(f); and

(5) consult with the client about any relevant limitation on the lawyers conduct when the lawyer knows that the client expects assistance not permitted by the Rules of Professional Conduct or other law.

(b) A lawyer shall explain a matter to the extent reasonably necessary to permit the client to make informed decisions regarding the representation

BRIEF BANK — 'SUMMARY SHEET" *Printed Mon-12/31/07 15:19*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*
Hancock v. Limor and UST

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*
M.D. Tenn

3. ("CCN") ***CURRENT*** CASE NO.
No.: 3:07-cv-0639

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*
No.:
Court: Bankr. M.D. Tenn
(Identify judge & cite, if any)

5. ("SO") ***SOURCE***
U.S. TRUSTEES

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*
Filed: August 2007
Type: Brief of Appellee

7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*
Roberta DeAngelis, P. Matthew Sutko, Sean Martin, Teresa Azan
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") ● ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***
●1) Did the bankruptcy court abuse it's broad discretion to deny an attorney's application for fees given the court found the attorney had "obscured" the source of his fees. 2) Assuming the bankruptcy court did not abuse it's broad discretion in denying fees, did the bankruptcy court err in ordering turnover of funds in the attorney's possession that were estate property? 3) If the bankruptcy court abused it's discretion in denying fees, does the attorney gain automatic priority for payment from estate funds because of a state law attorney lien.

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IN THE UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF TENNESSEE

WILLIAM CALDWELL HANCOCK,	)	
	)	
Appellant,	)	
	)	
v.	)	
	)	No. 3:07-cv-0639
SUSAN R. LIMOR, CHAPTER 7 TRUSTEE,	))	Judge Trauger Magistrate Brown
	)	
Appellee,	)	
	)	
RICHARD F. CLIPPARD, UNITED STATES TRUSTEE, REGION 8,	))	
	)	
Appellee.	)	

Brief of Appellee, the United States Trustee

Roberta A. DeAngelis
P. Matthew Sutko
Sean E. Martin
Executive Office for United States Trustees
United States Department of Justice
20 Massachusetts Ave., N.W.
Washington, D.C. 20530
phone: (202) 307-1399

Teresa C. Azan (TN BPR #14075)
Office of the United States Trustee
United States Department of Justice
701 Broadway, Room 318
Nashville, TN 37203
phone: (615) 736-2254
Fax: (615) 736-2260
Email: teresa.azan@usdoj.gov

Counsel for Richard F. Clippard,
United States Trustee

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STATEMENT OF JURISDICTION

The bankruptcy court had jurisdiction under 28 U.S.C. §§ 157(a) and (b) to hear the underlying case, a voluntary petition under chapter 7 of the Bankruptcy Code, 11 U.S.C. § 701, *et seq*. Under 28 U.S.C. §§ 157(b)(2)(A) and (E), the bankruptcy court had jurisdiction to hear and determine both William Caldwell Hancock's 11 U.S.C. § 330 application for attorney's fees and the chapter 7 trustee's 11 U.S.C. § 542 turnover complaint. In a decision entered March 7, 2007, the bankruptcy court awarded no fees to Mr. Hancock for his representation of the debtor in this bankruptcy case.[1] Adversary Record ("AR") 49. The court also granted the trustee's motion for summary judgment that funds be turned over. AR 50. On March 16, 2007, Mr. Hancock filed a timely motion to reconsider the March 7 decision and order. Bankruptcy Record ("BR") 82. On April 18, 2007, the bankruptcy court denied the reconsideration motion. AR 57. On April 30, 2007, Mr. Hancock filed a timely notice of appeal of the March 7 decision and order.[2] BR 86; *see* Hancock Opening Brief ("HOB") at 4. This Court has jurisdiction over this appeal under 28 U.S.C. § 158(a).

STATEMENT OF THE ISSUES

1. Did the bankruptcy court abuse its broad discretion to deny an attorney's application for fees given the court found the attorney had "obscured" the source of his fees?
2. Assuming the bankruptcy court did not abuse its broad discretion in denying fees, did the bankruptcy court err in ordering turnover of funds in the attorney's possession that were estate property?
3. If the bankruptcy court abused its discretion in denying fees, does the attorney gain automatic priority

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[1] The bankruptcy court made express findings of fact and conclusions of law in its memorandum opinion, but did not enter an order denying Mr. Hancock's fees. Therefore, by separate motion, the United States Trustee requests that this Court stay this appeal and order a limited remand, so the bankruptcy court can take the ministerial act of entering an order in the underlying bankruptcy case denying Mr. Hancock's fee application for the reasons stated in its memorandum opinion.

[2] Although Mr. Hancock's notice of appeal also cites the April 18 order denying the motion to reconsider, his opening brief makes no reference to or argument regarding this order. *See* BR 86, Hancock Opening Brief ("HOB"). Mr. Hancock has therefore waived appeal of the order. *See, e.g.*, McCalvin v. Yukins, 444 F.3d 713, 723 (6th Cir. 2006) ("It is well established that issues not raised by an appellant in its opening brief . . . are deemed waived.").

for payment from estate funds because of a state-law attorney's lien?

STATEMENT OF THE CASE

This appeal challenges (1) a bankruptcy court decision denying an attorney's application under 11 U.S.C. § 330 for fees for representing a debtor-company in its bankruptcy case, and (2) a bankruptcy court order requiring that the attorney turn over bankruptcy estate funds to the trustee in the case.

After the company's bankruptcy case converted from chapter 11 to chapter 7, the attorney filed an application under 11 U.S.C. § 330 for fees for his chapter 11 bankruptcy services. The chapter 7 trustee, arguing that the attorney had not properly disclosed the source of the retainer as required by 11 U.S.C. § 329(a). The trustee also moved for summary judgment on her turnover complaint under 11 U.S.C. § 542(a), arguing that the attorney must turn over the funds because it was property of the bankruptcy estate. After considering Mr. Hancock's statements and arguments, the bankruptcy court denied his fee application. The bankruptcy court also granted the trustee summary judgment on her turnover complaint. This appeal followed.

STATEMENT OF FACTS

I. Statutory Framework

A bankruptcy case is commenced by the filing of a petition. 11 U.S.C. § 301(a). By filing a petition, a company becomes a "debtor." *See* 11 U.S.C. § 101(13). When a petition is filed, practically all of the debtor's property as of that date becomes property of the bankruptcy estate. 11 U.S.C. § 541(a).

A petition filed under the reorganization provisions of chapter 11 of the Bankruptcy Code may be converted to a liquidation case under chapter 7 on request of the United States Trustee. *See* 11 U.S.C. §§ 1112(b),[3] 701, *et seq.* A private trustee serves in each chapter 7 case. *See* 11 U.S.C. §§ 701-704.

The chapter 7 trustee's duties include taking possession of all estate property and liquidating it for

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[3] This is the version of section 1112(b) that applied to cases filed prior to October 17, 2005, including this case. Section 1112(b) was amended for bankruptcy cases filed beginning October 17, 2005, by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005.

distribution among the creditors who have filed claims against the estate. *See* 11 U.S.C. § 704(1). All third parties in possession or control of property of the estate must turn over such property to the trustee. 11 U.S.C. § 542(a). Trustees can request turnover of estate property. Under Bankruptcy Rule 7001(1), they can file complaints to compel turnover if third parties violate their obligation under § 542(a) to turn over estate funds voluntarily. *See* Fed. R. Bankr. P. 7001(1).

The Bankruptcy Code also regulates the retention, compensation and payment of attorneys in bankruptcy matters. To request fees from bankruptcy estate funds, attorneys for debtors in chapter 11 cases must have been appointed by the bankruptcy court under 11 U.S.C. § 327(a) as debtor's counsel. 11 U.S.C. §§ 327(a), 1107(a); Lamie v. United States Trustee, 540 U.S. 526, 529 (2004) (affirming the lower court's ruling that attorneys may not be compensated from the estate "unless the attorney has been appointed under § 327 of the Code"). To be approved by the court under § 327, attorneys must be disinterested and have no adverse interest. 11 U.S.C. §§ 327(a), (c), 101(14).

If an attorney's employment is approved under § 327, a bankruptcy court "may" award fees under 11 U.S.C. § 330. *See* In re Airspect Air, Inc., 385 F.3d 915, 922 (6th Cir. 2004) (holding a bankruptcy judge "has the discretion to determine the amount of a professional's payment separately from authorizing the professional's employment" under section 327).

Section 330(a)(1) provides that a court's fee award is subject to 11 U.S.C. § 329. Under § 329(a), an attorney representing a debtor in a bankruptcy case has a statutory obligation to file a statement with the bankruptcy court disclosing all compensation paid and its source during the year preceding the commencement of a bankruptcy case. 11 U.S.C. § 329(a). Bankruptcy Rule 2016(b) implements § 329(a). Fed. R. Bankr. P. 2016(b). The rule requires "[e]very attorney for a debtor, whether or not the attorney applies for compensation," to file the "statement required by § 329 of the Code." Id.

Under § 329(b), the court may order the return to the estate of an attorney's compensation if the compensation is not reasonable. *See* 11 U.S.C. § 329(b).[4]

The United States Trustee is a senior Department of Justice official charged by Congress with responsibility for supervising the administration of bankruptcy cases. *See* 28 U.S.C. §§ 581, 586(a)(3). The United States Trustee may raise, appear, and be heard on any issue in a bankruptcy case. 11 U.S.C. § 307. *See generally* Morganstern v. Revco D.S. Inc. (In re Revco D.S., Inc.), 898 F.2d 498, 499-500 (6th Cir. 1990) (affirming the appellate standing of United States Trustees and explaining that United States Trustees oversee the bankruptcy process, protect the public interest, and ensure that bankruptcy cases are conducted according to law). Under 28 U.S.C. § 586(a)(3), the United States Trustee is required to review applications for compensation under 11 U.S.C. § 330 and file objections if appropriate.

II. Factual Background and Proceedings Below

A. The chapter 11 filing

On February 10, 2004, Innovative Entertainment Concepts, Inc. ("Innovative") filed a voluntary petition under chapter 11 of the Bankruptcy Code. BR 1. By motion filed April 27, 2004, Innovative sought court permission under 11 U.S.C. § 327(a) to employ Mr. Hancock as its bankruptcy counsel. BR 13.

Under 11 U.S.C. § 329(a) and Bankruptcy Rule 2016(b), Mr. Hancock was required to disclose all funds he received, and their source, for representing Innovative. On February 10, 2004, Mr. Hancock disclosed that he took a $10,000 pre-petition retainer from Innovative for services he might provide in the bankruptcy case. BR 1, Disclosure of Compensation. Mr. Hancock certified that there were no fees due him when the petition was filed. Id.

In his § 329(a) and Rule 2016(b) disclosure, Mr. Hancock certified that he was making "a complete statement of any agreement or arrangement for payment to me for representation of the debtor(s) in this bankruptcy proceeding." Id.

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[4] Under Bankruptcy Rule 2017(a), any party in interest may bring a motion asking the bankruptcy court to determine whether monies paid to an attorney in contemplation of the filing of a bankruptcy petition are excessive. Fed. R. Bankr. P. 2017(a).

As part of Innovative's request for court approval under 11 U.S.C. § 327 to employ Mr. Hancock as its attorney, Mr. Hancock certified that he had no interest adverse to the bankruptcy estate, was disinterested, and had "no connection of any kind with the debtor, creditors, or any other party in interest." BR 13. He also certified that he would not be paid from property of the estate until his fees had been approved by the court. Id.

Relying on Mr. Hancock's representations, the bankruptcy court approved his employment under 11 U.S.C. § 327(a) on June 10, 2004. BR 16.

B. Innovative's conversion to chapter 7

On August 13, 2004, the bankruptcy court converted Innovative's case to a chapter 7 liquidation on the unopposed motion of the United States Trustee. BR 24. In the chapter 7 case, Ms. Susan Limor was appointed the trustee. BR 25.

Because Mr. Hancock was holding estate funds in the retainer, and because he had never received authority under § 330 to take any estate funds for his chapter 11 work, the chapter 7 trustee filed a complaint under 11 U.S.C. § 542 in the bankruptcy court for turnover of the estate funds in the retainer. BR 36, AR 1. The trustee contended that the retainer was property of the estate and Mr. Hancock was not entitled to retain the retainer funds. Id.

Mr. Hancock did not file an answer to the complaint, and did not file any § 330 fee application. Therefore, on March 10, 2006, the chapter 7 trustee filed a motion for default judgment. AR 12. That same day, Mr. Hancock filed an answer to the complaint. AR 13. In a pretrial statement also filed March 10, Mr. Hancock contended for the first time that the retainer funds were borrowed by the debtor "specifically earmarked" for attorney fees. AR 14. He provided no documentation of any such agreement.

C. Mr. Hancock's § 330 fee application

On May 20, 2006, more than twenty months after Innovative's case converted to chapter 7, Mr. Hancock filed a "final" fee application under 11 U.S.C. § 330 for services he had provided in the chapter 11 case. BR 43. He asked for $16,590, including the $10,000 retainer. Id.

Despite his February 2004 certification under 11 U.S.C. § 329(a) and Bankruptcy Rule 2016(b) that Innovative was the source of the estate funds he held in the retainer, Mr. Hancock contended in the application, for the first time, that the $10,000 retainer was not Innovative's property. Id. Instead, he claimed that the mother of Innovative's president had given Mr. Hancock the funds in trust. Id. Mr. Hancock provided no documentation of any such arrangement. Mr. Hancock's notice on his § 330 fee application set a hearing date of June 20, 2006. Id.

On May 26, 2006, the chapter 7 trustee filed an objection to Mr. Hancock's § 330 application for fees. The trustee argued fees should be denied because Mr. Hancock's two certifications of the sources of his fees were in fundamental conflict. BR 44. The trustee also argued that, despite Mr. Hancock's certification in April 2004 that he had no conflicts of interest, Mr. Hancock had a conflict prohibited by § 327(a), if the source of Mr. Hancock's retainer was the mother of Innovative's president, as Mr. Hancock now claimed. That was so, the trustee argued, because the mother is a significant creditor of Innovative. Id. On May 26, the trustee also filed a motion for summary judgment on her § 542(a) turnover complaint. AR 21.

Mr. Hancock did not respond to the trustee's objection to his fee application. Mr. Hancock also failed to appear at the hearing on his application for fees. BR 46. On June 22, 2006, the bankruptcy court denied Mr. Hancock's fee application, based on "the trustee's objection, statements in court, and for good cause shown." Id. On June 22, the court also granted the trustee's motion for summary judgment on turnover. AR 25.

On July 3, 2006, Mr. Hancock asked the bankruptcy court to set aside the denial of his fee application, claiming he calendared the wrong date for the hearing. BR 49. Mr. Hancock alleged again that the mother of Innovative's president was the source of the retainer. Id. He also claimed that the retainer was not property of the estate. Id. The chapter 7 trustee and the United States Trustee opposed Mr. Hancock's motion. BR 51, 53. Mr. Hancock also moved to set aside the order granting summary judgment to the trustee on turnover. AR 26. The trustee opposed this motion. AR 29-30.

On September 8, 2006, the bankruptcy court set aside its denial of Mr. Hancock's fee application. BR 63. The court also set aside its summary judgment order. AR 35.

On November 14, 2006, Mr. Hancock filed a new disclosure statement under § 329(a) and Bankruptcy Rule 2016(b). BR 74. In it, Mr. Hancock alleged he had received misinformation from his client regarding the ownership of the retainer. Id. Mr. Hancock also admitted he knew before filing the petition that Innovative "had no funds to pay" a chapter 11 retainer. Id. Nevertheless, Mr. Hancock also concluded that his original February 2004 disclosure statement was accurate that Innovative paid the retainer. Id. Mr. Hancock conceded that the retainer is property of the estate. Id. These statements conflicted with Mr. Hancock's contentions earlier in 2006 that the retainer was paid by the mother of Innovative's president, that the retainer was held in trust, and that it was not Innovative's property. *Compare* id. with BR 43.

On December 8, 2006, Mr. Hancock filed a "verified" motion for summary judgment requesting dismissal of the trustee's § 542(a) turnover complaint. AR 46. While conceding that the retainer was estate property, Mr. Hancock argued turnover was precluded under state law. Id. He contended he had a state-law attorney's lien that rendered him a secured creditor and defeated the trustee's right to turnover. Id. In its financial schedules filed with the bankruptcy court, Innovative had not disclosed any secured creditors or claims, and did not disclose the existence of any person with an attorney's lien or any other statutory lien. BR 10, Schedule D.

On January 9, 2007, the bankruptcy court heard the merits of Mr. Hancock's § 330 fee application and the summary judgment motion on the trustee's § 542(a) turnover complaint. *See* AR 49, AR docket entry dated Jan. 9, 2007.

III. The Bankruptcy Court's Decision

Based on the record created by the parties and following the two hearings on Mr. Hancock's fee application, the bankruptcy court denied all of Mr. Hancock's requested fees under §§ 329 and 330 in a memorandum opinion entered March 7, 2007. AR 49.

The bankruptcy court ruled Mr. Hancock had no right to fees under § 330 because had violated his duty of disclosure under § 329(a) and Bankruptcy Rule 2016(b). Relying upon In re Downs, 103 F.3d 472 (6th Cir. 1996) and In re Kisseberth, 273 F.3d 714 (6th Cir. 2001), the bankruptcy court found that Mr. Hancock's conduct was not "a simple technical breach" of his disclosure obligations under § 329 and Rule 2016. AR 49 at 9.

Instead, the court found that Mr. Hancock's "shifting" explanations for the source of his retainer "seemed opportunistically to respond to challenges" raised by the trustee and United States Trustee. Id. at 9. Referring to Mr. Hancock's most recent explanation in November 2006, the bankruptcy court found that Mr. Hancock "knew that the debtor did not have funds to pay his retainer, and that the funds would have to come from elsewhere." Id. at 10. Nevertheless, it found that Mr. Hancock "obscured" the source of the retainer until he was pursued by the chapter 7 trustee. Id. Finally, the court found that some of Mr. Hancock's disclosures called his disinterestedness into question. Id.

The bankruptcy court concluded that Mr. Hancock "did not respect the duties imposed on attorneys by the Bankruptcy Code and Rules." Id. at 10. *See* 11 U.S.C. § 329(a); Fed. R. Bankr. P. 2016(b). Specifically, the bankruptcy court found the "[t]rustee and the United States Trustee have had to claw the facts out of Hancock." The result, the court found, was "a long and expensive litigation to get what Hancock was obligated to give in the first instance without compulsion: complete and accurate disclosure of the nature and source of the retainer." Id. at 9-10.

On March 7, 2007, the bankruptcy court also granted summary judgment for the trustee, ordering that Mr. Hancock turn over the $10,000 retainer to the trustee. *See* AR 50.

IV. The Hearing on Reconsideration

On March 16, 2007, Mr. Hancock filed a timely motion for reconsideration of the bankruptcy court's denial of his fees and the turnover order. BR 82. The trustee and the United States Trustee opposed the motion. AR 53,54.

At the April 10, 2007 hearing on Mr. Hancock's motion, the bankruptcy court denied reconsideration. It observed that there is "significant discretion" in bankruptcy courts to disallow fees under §§ 329 and 330. BR 91 at 2. Mr. Hancock had, the court observed, "exercised his full and fair opportunity to present his view of what happened." Id. at 3. The bankruptcy court also reiterated that the retainer is property of the estate and should be turned over to the trustee. Id. at 4.

STANDARD OF REVIEW

This Court reviews the bankruptcy court's determination of the proper amount of attorney's fees for an abuse of discretion. In re Kisseberth, 273 F.3d 714, 720 (6th Cir. 2001). It will find an abuse of discretion only upon a "definite and firm conviction that the trial court committed a clear error of judgment." Id. (internal quotation omitted). This Court reviews the bankruptcy court's factual findings for clear error. In re Brinley, 403 F.3d 415, 418 (6th Cir. 2005).

This Court reviews bankruptcy court orders granting summary judgment under a *de novo* standard. In re Cook, 457 F.3d 561, 565 (6th Cir. 2006).

SUMMARY OF ARGUMENT

The bankruptcy court properly exercised its broad discretion to deny fees under §§ 329 and 330. Because Mr. Hancock failed to meet his burden under § 329, the district court did not err in denying his § 330 fee application. The bankruptcy court was justified in denying fees given its findings that Mr. Hancock committed more than a "mere technical breach" of his § 329 disclosure duties and sought to deceive the chapter 7 trustee, the United States Trustee, and the court concerning the source of his fees.

As the bankruptcy court found, Mr. Hancock shifted his original account of the facts once his right to keep his fees was challenged. After Mr. Hancock's new account was challenged, he shifted the facts a second time. As the bankruptcy court recognized, Sixth Circuit precedent makes clear that bankruptcy courts have discretion to deny all fees under 11 U.S.C. § 329 when an attorney willfully disregards the disclosure duties of the Bankruptcy Code. In re Downs, 103 F.3d 472, 479 (6th Cir. 1996) . Denying Mr. Hancock's fees was within this standard. Even if this Court interprets the bankruptcy court as finding Mr. Hancock's violations were inadvertent or negligent, Sixth Circuit precedent permits bankruptcy courts discretion to deny all fees. Kisseberth, 273 F.3d at 721.

If the bankruptcy court did not abuse its discretion in denying Mr. Hancock's fees, Mr. Hancock has no ground to keep the retainer funds. He concedes that this money is property of the estate. *See* 11 U.S.C. § 541(a). Under federal law he had to turn over this property to the trustee. 11 U.S.C. § 542(a). The chapter 7 trustee had every right to compel turnover when Mr. Hancock refused to turn over the estate funds.

If this Court concludes that the bankruptcy court abused its discretion in denying Mr. Hancock's fees, it should leave consideration of Mr. Hancock's state-law lien argument for the bankruptcy court on remand, because it was not passed upon below. But should this Court reach this lien argument, it should reject it on the merits.

ARGUMENT

I. The bankruptcy court did not abuse its broad discretion to deny an attorney's § 330 application for fees under that section and § 329 when it found the attorney had "obscured" the source of his fees.

A. Given Mr. Hancock's pattern of shifting explanations for his retainer, the bankruptcy court acted within Sixth Circuit standards in denying all fees.

The bankruptcy court did not abuse its broad discretion under §§ 329 and 330 to completely deny fees given Mr. Hancock's pattern of shifting explanations for the source of his retainer. A court's ability to award fees under § 330 is subject to § 329. *See* 11 U.S.C. § 330(a)(1). Mr. Hancock failed to meet his

§ 329 burden. *See* In re Robinson, 189 Fed. Appx. 371 at *2 (6th Cir. 2006) ("The burden of proof on all issues under 11 U.S.C. § 329 is on the attorney.") (unpublished decision). Therefore, given this failure by Mr. Hancock, the court did not abuse its discretion in denying his § 330 fee application.

Section 329 of the Bankruptcy Code and Bankruptcy Rule 2016(b) set clear mandatory disclosure duties for bankruptcy attorneys and bankruptcy courts have broad powers to strictly enforce these duties. "An attorney in a bankruptcy case has an affirmative duty to disclose fully and completely all fee arrangements and payments." Kisseberth,73 F.3d 714 at 720. Section 329 and Bankruptcy Rule 2016(b), which require this complete disclosure, "are designed to protect both creditors and the debtor against overreaching attorneys." Id. at 721. To ensure such protection, bankruptcy courts have "broad" authority to deny "any and all compensation where an attorney fails to satisfy the requirement of the Code and Rules." Id; *see* Downs, 103 F.3d at 478 ("In cases involving an attorney's failure to disclose his fee arrangement under § 329 or Rule 2016 . . . the courts have consistently denied all fees.").[5]

In this case, the bankruptcy court's conclusion that Mr. Hancock violated these disclosure duties clearly reflects the record before the court. *See* AR 49 at 9-10. Mr. Hancock certified in February 2004 that Innovative was the source of his retainer and that he had made a complete statement of his fee arrangement. Id. at 2. *See* BR 1, Disclosure. Mr. Hancock's May 2006 fee application was, however, inconsistent with his certification. The application newly asserted, without accompanying evidence, that Innovative was not the source of the retainer. BR 43. Instead, Mr. Hancock claimed the retainer was actually someone else's property and was subject to a trust agreement. Id. In light of Mr. Hancock's statement that the mother of Innovative's president was the source of the retainer, the chapter 7 trustee objected to Mr. Hancock's application, stating that Mr. Hancock's employment in the case may have violated the disinterestedness requirement of § 327.

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[5] The Sixth Circuit's case law on this subject is consistent with other circuit court law. *See, e.g.,* In re Park-Helena Corp., 63 F.3d 877, 882 (9th Cir. 1995) ("Even a negligent or inadvertent failure to disclose fully relevant information may result in a denial of all requested fees.").

As a second hearing on his fee application approached, Mr. Hancock's explanations continued to shift. *See* BR 74. Abandoning his May 2006 account, he amended his disclosure statement in November 2006 to revert to his original certification that his retainer came from Innovative. Id. Conceding that the retainer was property of the estate, *see* id. and AR 46, Mr. Hancock nevertheless argued that the trustee had no right to take the retainer because he had a state-law attorney's lien in it. AR 46. But none of Innovative's filings with the court had disclosed any lien held by Mr. Hancock or any secured claim whatsoever.

Based on this record, the bankruptcy court did not clearly err in finding that (1) Mr. Hancock's violation of his disclosure duties was not a "mere technical breach," (2) Mr. Hancock did not respect his disclosure duties and basic disclosure facts had to be "claw[ed] out" of him, (3) Mr. Hancock had "obscured" the source of his retainer after knowing early on that Innovative lacked funds for a retainer, and (4) Mr. Hancock's explanations shifted opportunistically to respond to challenges raised by the chapter 7 trustee and United States Trustee.

Given these findings, the bankruptcy court did not abuse its discretion in denying all fees to Mr. Hancock. To the contrary, doing so complied fully with Sixth Circuit precedent. In Downs, the court held that a bankruptcy court abused its discretion in allowing an attorney to retain any fees, when the attorney "acted affirmatively" to conceal his fee arrangement and only disclosed the source of his retainer at the last possible opportunity. 103 F.3d at 479. Downs reasoned that this conduct was "willful disregard" of the "fiduciary duties" imposed by 11 U.S.C. § 329. Id. at 480. In Mr. Hancock's case, as in Downs, the finding of an intent to deceive supports denial of all fees.

Even if this Court interprets the bankruptcy court as finding that Mr. Hancock committed only inadvertent errors or simple negligence in his § 329 disclosure duties, Kisseberth establishes that the bankruptcy court still did not err in denying all fees. In Kisseberth, the Sixth Circuit held that a bankruptcy court did not abuse its discretion in denying an attorney's fees for incomplete disclosures, even though the attorney may not have intended to deceive the court or the debtors. 273 F.3d at 721. In Mr. Hancock's case, the bankruptcy court found that the disclosure violations were beyond a "mere technical breach," indicating that the violations were at the very least inadvertent or negligent. This finding provides ample support for its exercise of discretion in denying all fees.

B. Mr. Hancock's arguments mischaracterize controlling law and the facts of this case.

Mr. Hancock's argues that the bankruptcy court abused its discretion because it awarded him no fees. *See* HOB 17. But this is exactly what the Sixth Circuit empowered courts to do in Downs and Kisseberth. Even Mr. Hancock's opening brief concedes that his disclosures could be described as "confusing," "internally contradictory," and "disconcerting." HOB 17, 19. The Sixth Circuit in Kisseberth affirmed the denial of most of an attorney's fees without any finding of bad intent. Under Kisseberth, Mr. Hancock's concessions alone justify denial of fees. Mr. Hancock's suggestion that it was error to deny any of his fees is completely bereft of legal support. *See* Downs, 103 F.3d at 478; Kisseberth, 273 F.3d at 721.

Mr. Hancock also mischaracterizes his conduct as occurring only well after all chapter 11 services were provided. HOB 19. First, that is legally irrelevant. Second, in fact, the shifting disclosures that troubled the bankruptcy court date back to the day Mr. Hancock filed Innovative's chapter 11 petition. *See* BR 13. When Mr. Hancock filed a belated fee application, his account of the facts behind his retainer conflicted with those certified in his original disclosure. *See* BR 43.

Mr. Hancock relies heavily on an unpublished opinion that does not serve his case.[6] *See* In re McCrary & Dunlap Construction Co., 79 Fed. Appx. 770 (6th Cir. 2003) (unpublished decision). In McCrary, the Sixth Circuit issued a non-precedential opinion that noted a bankruptcy court has discretion to reduce a fee award rather than deny it entirely when the bankruptcy concludes a law firm's failures to provide complete disclosure were merely technical violations rather than actions showing willful disregard for the Code. Id. at 781. Thus, McCrary upheld bankruptcy court discretion. In Mr. Hancock's case, the

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[6] Unpublished opinions of the Sixth Circuit are not precedentially binding under the doctrine of *stare decisis*. United States v. Sanford, 476 F.3d 391, 396 (6th Cir.2007).

bankruptcy court similarly exercised discretion to deny all fees. This exercise of discretion should be upheld. The bankruptcy court expressly rejected the conclusion that Mr. Hancock's violations were not a "simple technical beach." AR 49 at 9. The bankruptcy court found, at a minimum, there was a negligent failure to disclose. Under Kisseberth, that was sufficient to deny all fees. McCrary could not and did not overrule this precedential decision. In fact, McCrary expressly recognized that Kisseberth established that a bankruptcy court does not abuse its discretion if it denies all fees for merely negligent violations of § 329 and Rule 2016(b). McCrary, 79 Fed. Appx. at 779. Thus, the bankruptcy court had ample discretion to deny fees given its findings.

Finally, Mr. Hancock claims wrongly that the bankruptcy court "demands perfection where perfection is unattainable." HOB 16. But the bankruptcy simply asked that he accurately disclose the source of his compensation. Mr. Hancock has specialized in bankruptcy law for more than 25 years. *See* BR 13 at 2. As the Sixth Circuit recognized in Kisseberth, the statutory disclosure requirements represent an objective means to prevent overreaching by attorneys. Mr. Hancock must be capable of garnering the fundamental facts necessary for proper representation under the Bankruptcy Code.

II. The bankruptcy court did not err in ordering turnover of funds that were property of the estate.

Assuming the bankruptcy court did not abuse its broad discretion in denying Mr. Hancock's § 330 fee application, Mr. Hancock has no right to the funds in the retainer. Under § 542(a), he must turn them over to the trustee.

The Sixth Circuit recently held that 11 U.S.C. § 330 "establishes the exclusive means of allowing a claim for professional fees in a bankruptcy proceeding." In re 5900 Assocs., Inc., 468 F.3d 326, 328 (6th Cir. 2006). In this case, the bankruptcy court denied Mr. Hancock's § 330 fee request under Downs and Kisseberth. Under federal law, there is no way he can be paid unless that denial were an abuse of discretion. As we explain above, it was not.

Moreover, it is undisputed that the $10,000 retainer Mr. Hancock took from the debtor before the debtor filed bankruptcy is property of the estate. *See* AR 46.[7] Because Mr. Hancock lost his § 330 application for fees, Mr. Hancock had no right under federal law to use estate property to pay his fees. Instead, 11 U.S.C. § 542 required Mr. Hancock to turn the retainer over to the trustee. For that reason, requiring turnover of the estate property was completely proper as a matter of law. Therefore, the bankruptcy court did not err in granting summary judgment to the trustee on her § 542 complaint.

III. Mr. Hancock lacked a valid attorney' s lien, and in any event could not use state law to supersede the Bankruptcy Code's priority scheme.

If this Court were to rule that the bankruptcy court abused its discretion in denying Mr. Hancock's fees, Mr. Hancock suggests this Court should bestow upon him a "priority right of payment." HOB 17. He suggests this is proper because he holds a supposed state-law attorney's lien over the $10,000 retainer.[8] Mr. Hancock is mistaken for two reasons. First, this issue was not passed on by the bankruptcy court and is a matter for the bankruptcy court on remand. Second, should this Court reach the argument, it lacks merit.

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[7] In light of Mr. Hancock's recognition that the retainer was Innovative's property and is property of the estate, it is unclear why he argues that mandatory joinder is necessary to account for others' claims to the retainer. *See* Fed. R. Bankr. P. 7019 (providing that Fed. R. Civ. P. 19 applies in adversary proceedings). Beyond Mr. Hancock and the trustee, there is no evidence in the record of any competing claimants to the funds in the retainer. Any such parties were certainly free to assert their rights to the bankruptcy court. If this case is remanded, these parties could also come forward to assert their rights.

[8] Mr. Hancock does not argue that a state-law lien grants him an independent right to priority payment outside 11 U.S.C. § 330. Nor could he, because governing law precludes any argument that he can be paid from estate property outside of a § 330 fee award. *See* In re 5900 Assocs., Inc., 468 F.3d 326, 330 (6th Cir. 2006) ("11 U.S.C. § 330 is the sole mechanism by which fees may be enforced."). Moreover, Mr. Hancock's application for employment states that he would not be paid from property of the estate until any request for such fees has been approved by the court. *See* BR 13.

A. Mr. Hancock has no rights under state law.

Looking to Tennessee state law, Mr. Hancock lacked a common-law retaining lien.[9] When Innovative's petition was filed, Mr. Hancock was due nothing for the services he rendered. *See* BR 1, Disclosure. His alleged lien did not even exist, because Innovative had paid for all services he had rendered to that date. *See* id. There was no balance due to him, and there was no dispute with Innovative over fees. *See* McDonald v. Charleston, C. & C. R. Co., 24 S.W. 252, 255 (Tenn. 1893) (possessory retaining lien applies "for a general balance due [the attorney] arising out of his professional employment"); Starks v. Browning, 20 S.W.3d 645, 650 (Tenn. Ct. App. 1999) (possessory retaining lien applies "until the attorney and client have settled their fee dispute or until the client has otherwise posted appropriate security for the outstanding fee").

On this point, Tennessee law follows the perhaps universal rule that a lien cannot exist without a present obligation. A lien is an "incident of" a debt or obligation secured, and therefore "cannot exist in the absence of the debt or obligation the payment of which it secures." 53 C.J.S. Liens § 4 (updated Feb. 2007). The lien asserted by Mr. Hancock could apply only to secure attorney fees and charges which are due for services rendered. *See* 7A C.J.S. Attorney & Client § 445 (updated Feb. 2007); Tri City Equipment Co. v. Modern Real Estate Investments, Ltd., 460 N.W. 2d 464, 466 (Iowa 1990) ("Under the general rule and the Iowa cases, a retaining lien is available only to secure the attorney's fees and charges which are due for services already rendered.").

Nor does Mr. Hancock have a Tennessee statutory attorney's lien. Such a lien only exists "from the date of the filing of the suit." *See* Tenn. Code. Ann. § 23-2-102 ("Attorneys and solicitors of record who begin a suit shall have a lien upon the plaintiff's or complainant's right of action from the date of the filing of the suit."). Filing a bankruptcy petition, however, expressly stays "any act to create, perfect, or enforce any lien" against property of the estate or property of the debtor. 11 U.S.C. §§ 362(a)(4), (5).

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[9] It is also noteworthy that none of Innovative's court filings disclosed any attorney lien or any type of secured claim against it.

Mr. Hancock cites only one case, a bankruptcy court decision outside this district, for his claim that his Tennessee state-law right to priority payment is "well-settled." *See* In re Appalachian Star Ventures, 341 B.R. 222 (Bankr. E.D. Tenn. 2006); HOB 17. In Appalachian Star, however, there was no question regarding the validity of the lien under state law. Instead, the case addressed whether a valid state-law lien would prevent the operation of 11 U.S.C. § 726(b). Appalachian Star, 341 B.R. at 226. Mr. Hancock's appeal does not involve section 726(b).[10]

B. Any right Mr. Hancock might claim under state law is preempted by federal law and would violate the Supremacy Clause.

Even assuming that Mr. Hancock somehow had a valid state-law lien, federal law directly addresses the priority of payments from bankruptcy estate funds and therefore would supersede any right to payment under state law. As the Sixth Circuit has squarely held, "[f]ees in a bankruptcy proceeding are governed by federal, not state, law." 5900 Assocs., 468 F.3d at 329.

Mr. Hancock's interpretation would violate the Supremacy Clause of the United States Constitution. *See* Hill v. Camacho, 2007 WL 2120891 *1 (D. Or. July 24, 2007) ("To apply state-lien law to permit payment of postpetition fees from estate funds seriously undermines the Bankruptcy Code and the *Lamie* decision."); In re CK Liquidation Corp., 343 B.R. 376 (D. Mass. 2006) (holding that authorizing payment under state law to a debtor's attorney from property of the estate "is forbidden by the Supremacy Clause").

If Mr. Hancock is entitled to a § 330 fee award from estate property, he need only look to the Bankruptcy Code to ascertain his priority right of payment. First, § 726(a)(1) provides that property of the estate is distributed in the order specified in § 507. *See* 11 U.S.C. § 726(a)(1). Second, § 507(a)(2) provides that administrative expenses under § 503(b) are second in the priority scheme. 11 U.S.C. § 507(a)(2); *see* Specker Motor Sales Co. v. Eisen, 393 F.3d 659, 662 (6th Cir. 2004) (recognizing that section 507(a) "establishes a hierarchy of creditors, describing the order in which they may lay claim to the assets of the

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[10] To the extent that Appalachian Star holds that state-law liens supersede the payment scheme of the Bankruptcy Code, the United States Trustee believes the case is wrongly decided.

bankrupt estate"). Third, § 503(b) provides that administrative expenses include fee awards under § 330(a). 11 U.S.C. § 503(b)(2).

Mr. Hancock's interpretation would conflict with the Bankruptcy Code's comprehensive priority scheme. Under his argument, a claim for attorney's fees with an attorney's lien would automatically jump to the top of the priority scheme, without regard for the system established by §§ 726, 507, 503, and 330 of the Bankruptcy Code.

There is one simple fact here – Mr. Hancock had no right to fees because the bankruptcy court denied his § 330 application. Unless this Court were to overturn that exercise of discretion, Innovative's creditors, not Mr. Hancock, are the lawful recipients of the bankruptcy estate's limited assets. Although modest in amount, the funds at issue here will help ensure at least some payment to the estate's creditors.

CONCLUSION

For these reasons, United States Trustee respectfully asks this Court to affirm the bankruptcy court's decision to deny Mr. Hancock's fees and its order granting summary judgment to the trustee on turnover.

Respectfully submitted,

RICHARD F. CLIPPARD
UNITED STATES TRUSTEE, APPELLEE

Dated: August 8, 2007

/s/ TERESA C. AZAN (TN BPR #14075)
Roberta A. DeAngelis
P. Matthew Sutko
Sean E. Martin
Executive Office for United States Trustees
United States Department of Justice
20 Massachusetts Ave., N.W.
Washington, D.C. 20530
phone: (202) 307-1399 fax: (202) 307-2397

Teresa C. Azan
Office of the United States Trustee
United States Department of Justice
701 Broadway, Room 318
Nashville, TN 37203
phone: (615) 736-2254 fax: (615) 736-2260
Email: teresa.azan@usdoj.gov

Certificate of Service

I certify that on August 8, 2007, I filed with the clerk of court, using CM/ECF, which also will cause to be served upon registered users and registered filers Appellee's (U.S. Trustee) Brief. In addition, the persons identified below were also served by U.S. Mail first class, postage prepaid the foregoing.

William Caldwell Hancock The Pilcher Building 144 Second Avenue, N Suite 300 Nashville, TN 37201	Susan R. Limor 2814 Dogwood Place Nashville, TN 37204	Wm. Caldwell Hancock The Hancock Law Firm Woodmont Center II 102 Woodmont Blvd at Harding Road, Ste 200 Nashville, TN 37205

/s/ Teresa C. Azan
TERESA C. AZAN (TN BPR #14075)

BRIEF BANK — "SUMMARY SHEET" *Printed Fri-3/19/10 14:58*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]* William Hancock v. Richard Clippard, United States Trustee, and Michael Gigandet

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]* 6th Cir.

3. ("CCN") ***CURRENT*** CASE NO. No.: 09-6203

4. ("PCN") ***PRIOR*** CASE NO. - & COURT *[IF ANY]* No.: 3:09-cv-0094

Court: M.D. Tenn.

(Identify judge & cite, if any)

5. ("SO") ***SOURCE*** **U.S. TRUSTEES**

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(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC*** **BANKRUPTCY**

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***

• 1) Whether the Bankruptcy Court abused its discretion by denying compensation to debtor because he failed to disclose his connections to three interested parties in violation of 11 U.S.C. § 327 and Fed. R. Bankr. P. 2014. 2) Whether the bankruptcy court abused its discretion in awarding the debtor's attorney no fees under 11 U.S.C. § 330 where the attorney failed to prove that his services were reasonable and necessary and the court found this conduct to be unprofessional and disruptive.

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No. 09-6203

IN THE UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

WILLIAM HANCOCK,
Appellant,

v.

RICHARD CLIPPARD, United States Trustee, and MICHAEL GIGANDET,
Appellees.

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE MIDDLE DISTRICT OF TENNESSEE (Case No. 3:09-cv-0094)

BRIEF FOR APPELLEE, RICHARD CLIPPARD, United States Trustee

Of Counsel:

Ramona D. Elliott
General Counsel
P. Matthew Sutko
Associate General Counsel
Wendy Cox
Trial Attorney
United States Department of Justice
Executive Office of the U.S. Trustee
20 Massachusetts Ave., N.W., Ste 8100
Washington, D.C. 20530
Telephone No.: (202)307-1399

Beth Roberts Derrick
Assistant United States Trustee
Lloyd E. Mueller
Trial Attorney
United States Department of Justice
Office of the United States Trustee
701 Broadway, Suite 318
Nashville, Tennessee 37203
Telephone No.: (615) 736-2254

Attorneys for Richard Clippard
United States Trustee

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STATEMENT REGARDING ORAL ARGUMENT

Appellee, United States Trustee, requests oral argument to assist the Court to decide this appeal.

STATEMENT OF JURISDICTION

The Bankruptcy Court had jurisdiction to rule on the fee application submitted by the Appellant, William Hancock, pursuant to 28 U.S.C. § 1334(a) and § 157(a) and (b). The Bankruptcy Court's order denying all fees to Mr. Hancock, entered December 12, 2008, was a final, appealable order of that court, which Mr. Hancock timely appealed to the District Court on December 18, 2008. The District Court had jurisdiction over the appeal of the Bankruptcy Court's judgment pursuant to 28 U.S.C. § 158(a)(1).

The District's Court's order summarily affirming the Bankruptcy Court's order, entered September 23, 2009, was a final, appealable order. Mr. Hancock timely filed his notice of appeal to this Court from that order on September 30, 2009. This Court has jurisdiction under 28 U.S.C. § 158(d) to review the District Court's order.

STATEMENT OF THE ISSUES ON APPEAL

1. Whether the Bankruptcy Court abused its discretion by denying compensation to Mr. Hancock because he failed to disclose his connections to three interested parties in violation of 11 U.S.C. § 327 and Fed. R. Bankr. P. 2014.

2. Whether the Bankruptcy Court abused its discretion by denying compensation to Mr. Hancock for services that he not only failed to prove were reasonable or necessary, but many of which the court found were needlessly disruptive and drove up the costs of the bankruptcy case.

3. Whether the Bankruptcy Judge erred by failing to recuse himself from the determination of the fee application when Mr. Hancock did not request recusal.

STATEMENT OF THE CASE[1]

This is an appeal from an order of the United States District Court for the Middle District of Tennessee ("District Court") summarily affirming an order entered by the United States Bankruptcy Court for the Middle District of Tennessee ("Bankruptcy Court") denying Mr. Hancock's application for attorney's fees. Mr. Hancock represented the debtor in possession in a Chapter 11 bankruptcy case for five months before the case was converted to a case under Chapter 7. He subsequently sought approval of compensation for his services under 11 U.S.C. § 330(a). The United States Trustee and the Chapter7 Trustee objected to the requested

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[1] In this brief, citations to "DR" refer to documents from the record in the District Court (Case No. 3:09-cv-0094), followed by the District Court docket number. Citations to "BR" refer to documents from the record in Bankruptcy Court (Case No. 3:07-bk-08948), followed by the Bankruptcy Court docket number. Citations to "App" refer to the Appendix filed in this appeal by the United States Trustee. Citations to "Appellant's Brief" refer to Mr. Hancock's Corrected Brief, filed January 14, 2010.

compensation because Mr. Hancock failed to disclose all of his connections to interested parties as required by 11 U.S.C. § 327 and Fed. Rule Bankr. P. 2014, and because the services Mr. Hancock provided were not reasonable and necessary, as required for compensation under 11 U.S.C. § 330.

The Bankruptcy Court held a five-day trial on Mr. Hancock's fee application. The Bankruptcy Court found that Mr. Hancock failed to disclose his connections to three interested parties and denied his fees for that reason. In addition, the Bankruptcy Court found that Mr. Hancock's failed to prove his services were reasonable or necessary due to his abusive and disruptive tactics and his inadequate and unreliable billing records.

On appeal, the District Court summarily affirmed the Bankruptcy Court's order after Mr. Hancock repeatedly failed to timely file a brief that conformed to the rules after being granted several extensions of time to do so. Mr. Hancock timely appealed the decision of the District Court to this Court.

STATEMENT OF THE FACTS

I. Statutory Framework.

A debtor in possession[2] must obtain court approval to employ an attorney in a bankruptcy case under Chapter 11. 11 U.S.C. § 327(a). Only attorneys "that do not hold or represent an interest adverse to the estate, and that are disinterested persons" qualify for such employment. *Id.* A "disinterested person" is one that does not have an interest materially adverse to the interest of the estate or of any class of creditors or equity security holders. 11 U.S.C. § 101(14)(C).[3]

To obtain an order approving the employment of an attorney, the debtor in possession must file an application accompanied by a verified statement of the attorney to be employed disclosing all of the attorney's connections to the debtor, creditors and other interested parties. Fed. R. Bankr. P. 2014. The United States Trustee reviews applications filed under section 327 and may object to the

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[2] A debtor in a Chapter 11 bankruptcy case is a "debtor in possession," except when a trustee is appointed in the case. *See* 11 U.S.C. § 1101(1). A debtor in possession has most of the rights, powers, and duties of a trustee serving in a Chapter 11 case. *See* 11 U.S.C. § 1107(a).

[3] Additionally, a person is not disinterested if she is a creditor, an equity security holder, or an insider, and a person is not disinterested if she is or was, a director, officer or employee of the debtor within 2 years before the filing of the bankruptcy petition. 11 U.S.C. § 101(14)(A) & (B).

employment.[4] *See* 28 U.S.C. § 586(a)(3)(I); 11 U.S.C. § 307(a). If at any time during a case, an attorney employed under section 327 is not disinterested or holds or represents an interest adverse to the estate, the court can deny the attorney compensation. 11 U.S.C. § 328(c).

A bankruptcy court may award an attorney employed under section 327 "reasonable compensation for actual, necessary services." 11 U.S.C. § 330(a)(1)(A). In determining "reasonable" compensation, a bankruptcy court must consider the "nature, the extent and the value" of the services rendered, taking into account all relevant factors. 11 U.S.C. § 330(a)(3). The bankruptcy court may award less compensation than requested. 11 U.S.C. § 330(a)(2). But, the court may not award any compensation for services that were not reasonably like to benefit the bankruptcy estate or were not necessary to the administration of the case. 11 U.S.C. § 330(a)(4)(A)(ii).

II. Procedural Background.

On December 3, 2007, Barnhill's Buffet, Inc. (the "Debtor") filed a voluntary petition under Chapter 11 of the Bankruptcy Code. BR 1. All of the Debtor's stock

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[4] The United States Trustee is an official of the United States Department of Justice, charged by statute with the duty to oversee and supervise the administration of bankruptcy cases and trustees. *See* 28 U.S.C. § 586(a).

was held by an entity known as Dynamic Acquisitions Group, LLC ("Dynamic Acquisitions" or "DAG"). BR 134 at 10. The Debtor operated 29 buffet style restaurants in six states. Hancock Testimony, DR 32 at 12. At that time, the Debtor reported total liabilities of $27,576,984.00 and assets valued at $3,661,333.00. BR 137 at 1. Wells Fargo Bank was its primary secured creditor. BR 137 at 1 and 8. W. Craig Barber was the Debtor's President and Robert M. Langford was the Debtor's Chief Executive Officer and a Director of the Debtor. BR 134 at 9 and 10.

The bankruptcy case was filed to obtain the best return to creditors through a controlled liquidation of the Debtor's assets, including the operating restaurants. Hancock Testimony, DR 32 at 11-12. On January 28, 2008, the Bankruptcy Court approved the sale of 16 of the Debtor's restaurants. BR 205. On February 29, 2008, the Bankruptcy Court approved the sale of four more restaurants. BR 317.[5]

On March 11, 2008, the parties negotiated a global settlement that determined how the property of the bankruptcy estate, including the proceeds from the sale of the restaurants, would be distributed. Kelly (Counsel for Wells Fargo) Testimony, DR 32 at 418-423. BR 401 at 3. On April 8, 2008, the Bankruptcy Court approved the settlement, which required the case to be converted to Chapter 7. BR 401 at 3. On

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[5] The Debtor rejected its leasehold interests in the remaining restaurants prior to conversion because it could not locate a purchaser on terms that would have been beneficial to the bankruptcy estate. BR 219.

April 28th, the Debtor filed a notice of conversion to Chapter 7. BR 447. Appellee, Michael Gigandet, was appointed Chapter 7 trustee on April 30th. BR 448. The Bankruptcy Court entered an order granting Mr. Hancock's motion to withdraw as Debtor's counsel on May 2, 2008, five months after the bankruptcy case was filed. BR 451.

Wells Fargo agreed to set aside an aggregate of $125,000.00 from the distribution it anticipated receiving from the sale of its collateral to pay Mr. Hancock if his fees were approved by the Bankruptcy Court (the "carveout"). BR 401 at 9. On June 3, 2008, Mr. Hancock filed his first fee application requesting interim compensation in the amount of $355,975.00 and $1,071.55 for expenses for the less than three-month period from December 3, 2007 through February 29, 2008. BR 487. The United States Trustee and the Chapter 7 trustee objected to the requested fees, based on Mr. Hancock's: (1) failure to file a final fee application, (2) inclusion of multiple days of facially excessive billing in his fee application, (3) failure to use proper billing format, (4) failure to establish that his fees were necessary, and (5) abusive behavior that unnecessarily increased his own and other parties' attorney's fees. BR 502 at 9. The Bankruptcy Court ordered Mr. Hancock to file a final fee application by July 3rd. BR 524. After the Bankruptcy Court granted his request for additional time, on July 7th, Mr. Hancock filed his final fee application seeking compensation in the amount of $356,554.50 and $1,071.55 for expenses. BR 541.

Mr. Hancock amended his final fee application on July 17th and requested compensation in the amount of $371,896.00 and $1,071.55 for expenses. BR 586. The United States Trustee objected to the amended final application on the following grounds: (1) Mr. Hancock failed to comply with the disclosure requirements of section 327(a) and Fed. R. Bankr. P. 2014(a) by failing to disclose his connections to interested parties, and he actively misrepresented his connections to those parties, (2) Mr. Hancock engaged in abusive communication and litigation tactics that unnecessarily increased the legal fees in this case, (3) Mr. Hancock's fee application was excessive given his lack of records, the disruption he caused in the case, and his request for fees for time spent after he was terminated as Debtor's counsel, and (4) Mr. Hancock interfered with the administration of the bankruptcy case by the Chapter 7 trustee. BR 636 and BR 717. The Chapter 7 trustee also objected to the fee application. BR 637. Although the Bankruptcy Court held two pretrial conferences, Mr. Hancock never asked Judge Paine to recuse himself from adjudicating the objections. BR 524 and BR 658.

The trial on Mr. Hancock's fee application began on October 23, 2008. Testimony was taken from eleven witnesses over five days and 166 exhibits were offered into evidence. DR 32 and BR 755. After considering the evidence, the Bankruptcy Court issued a detailed 26 page Memorandum Opinion ("Opinion") denying all fees to Mr. Hancock on two independent grounds: his failure to disclose his connections to interested parties and his failure to prove that his services were reasonable and necessary.[6] Opinion, BR 736 at 25-26. As to the first ground, the Bankruptcy Court found that Mr. Hancock had connections to three companies owned wholly or in part by Mr. Barber and Mr. Langford. *Id*. at 9. The Court noted that Mr. Hancock had been sanctioned for his failure to fully disclose in a prior case, nevertheless, he chose to deny the connections instead of opting for complete transparency. *Id.* at 13 and 26. As to the second ground, the Bankruptcy Court found Mr. Hancock repeatedly had engaged in disruptive and unprofessional tactics that wasted everyone's time. *Id.* at 22. In addition, the Bankruptcy Court cited many reasons to doubt the accuracy of Mr. Hancock's reconstructed billing records, such as proven overbilling, lack of contemporaneous time records, and conflicting testimony by a paralegal[7] who assisted in preparation of Mr. Hancock's fee

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[6] If the Court finds that the Bankruptcy Court properly denied Mr. Hancock's fee application because of his failure to disclose his connections to interested parties, it does not need to consider the alternative basis for denial of fees.

[7] Mr. Hancock employed a contract paralegal, Ms. Natalie Horel, to assist him with certain portions of the case and in preparing his fee application. Horel

application. *Id.* at 19 and 21. The Bankruptcy Court found that Mr. Hancock failed to prove his services were reasonable and necessary as required to award compensation under section 330(a). *Id.* at 18.

Following entry of the Bankruptcy Court's judgment, Mr. Hancock filed a notice of appeal and elected to have his appeal considered by the District Court. BR 740 and 741. Mr. Hancock was granted two extensions to file his opening brief in his appeal, yet he still failed to comply with the May 5, 2009 deadline. DR 6, 7, 8, and 9. Three months later, Mr. Hancock still had not filed his brief, so the District Court ordered Mr. Hancock to show cause why his appeal should not be dismissed for failure to prosecute. DR 10. Mr. Hancock did not respond to the order. Instead, on August 14th, he filed a 128 page opening brief, completely disregarding the District Court's 50 page limit. DR 11.

On August 31, 2009, the District Court ordered Mr. Hancock to file by September 21st, a revised brief that complied with the page limit and a third motion for an extension of time explaining why he did not file his brief in May. DR 13. After the deadline passed, he filed a 67 page brief printed in what appears to be a nine point font, with six point font footnotes, accompanied by a third motion for extension of time, explaining that he filed his brief nearly four months late because: (1) he was

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Testimony, DR 32 at 484-485.

waiting for the Supreme Court to issue an opinion on judicial recusal, (2) the District Court did not have the courage to overrule the Bankruptcy Court, and (3) presenting the matter to the District Court would be a waste of effort because this Court reviews the findings of the Bankruptcy Court *de novo*. DR 14 and 15.

On September 23, 2009, the District Court summarily affirmed the Memorandum and Order entered by the Bankruptcy Court. DR 16. The Court noted Mr. Hancock's conduct warranted the dismissal of his appeal with prejudice, but it would summarily affirm instead so that Mr. Hancock could obtain a decision on the merits of his appeal. *Id.* at 2.

III. Mr. Hancock's Undisclosed Connections.

The Debtor's President, Craig Barber, and the Debtor's CEO, Robert Langford, together partially or entirely owned three other companies: Dynamic Management LLC ("Dynamic Management"), Dynamic Acquisitions Group LLC ("Dynamic Acquisitions") and Dynamic Hospitality LLC ("Dynamic Hospitality") that had connections to the Debtor and Mr. Hancock (the "Dynamic Companies"). Based on the trial evidence, the Bankruptcy Court found the following connections between the Dynamic companies and the Debtor:

Dynamic Acquisitions	The parent company of the Debtor; Craig Barber and Bob Langford have some ownership interest in DAG.

	DAG was formed in 2005 for the purpose of acquiring Barnhill's Buffet, Inc. In 2005. Listed as a Co-debtor on Debtor's Bankruptcy Schedule H.
Dynamic Management	A Tennessee limited liability company wholly owned by Craig Barber (50%) and Bob Langford (50%). Listed as a Co-Debtor on Debtor's Schedule H
Dynamic Hospitality	A Tennessee limited liability company wholly owned by Craig Barber (50%) and Bob Langford (50%). Dynamic Hospitality was listed an insider receiving payments from the Debtor within one year of filing.

Opinion, BR 736 at 9; BR 134 at 9, 19; BR 136 at Statement of Financial Affairs 3. c.; BR 137 at 140; Langford Testimony, DR 32 at 352, 354-355, and 349-350.

A. Mr. Hancock's Declaration.

On December 19, 2007, Mr. Hancock filed a declaration, which he signed under penalty of perjury, with the Debtor's application for approval of his employment, purporting to disclose all of his connections with interested parties pursuant to Rule 2014(a) (the "Declaration"). BR 68 at 7. Paragraph three of Mr. Hancock's verified Declaration states:

> 3. To the best of my knowledge, no principal or affiliate of Mr. Hancock has any connection with the debtor, its creditors, or any other party in interest or their respective attorneys including the U.S. Trustee or any employee of the U.S. Trustee's Office in this District except that

> I have served as prepetition counsel to the debtor in bankruptcy and non-bankruptcy matters. In addition I formerly represented Robert M. Langford with regard to numerous personal matters during the period 2002 through 2005. That representation ended in 2005. None of the matters involved during that time period relate in any way to the matters to arise in this case under the proposed debtor representation.

Mr. Hancock disclosed his former connection to Mr. Langford in his Declaration, but he did not disclose any connections to the three Dynamic Companies.

B. Mr. Hancock's Undisclosed Connection to Dynamic Management.

A few months before Mr. Hancock filed the Debtor's bankruptcy petition, he represented Dynamic Management in a Florida state court action against the Debtor and Dynamic Management.[8] On May 30, 2007, Mr. Hancock asked the plaintiff's counsel for additional time to retain local counsel to assist him in the representation of the defendants. App at 158. Two months later, on July 23, 2007, local Florida counsel filed Mr. Hancock's sworn affidavit in the Florida case wherein Mr. Hancock stated:

> 3. I represent Barnhill's Buffet, Inc., a Tennessee corporation (hereinafter "Barnhill's).

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[8] W.D. Sales and Brokerage, LLC filed suit against the Debtor and Dynamic Management in the Circuit Court in and for Escambia County, Florida on April 13, 2007 in a case styled *W.D. Sales and Brokerage, LLC v. Barnhill's Buffet of Tennessee, Inc. d/b/a Barnhil's Buffet, Inc. And Dynamic Management Company, LLC*. App at 149.

> 4. I also represent Dynamic Management Company, LLC, a Tennessee limited liability company (hereinafter "Dynamic") which has no business relationship whatsoever with Barnhill's.

App at 160, 154, 165, and 173. Mr. Hancock continued to be involved in the Florida litigation even after the Debtor had filed for bankruptcy and the Florida case had been stayed as to the Debtor. App at 211, 277, 283, 285, 286, 288. Dynamic Management was listed on Schedule H of the Debtor's bankruptcy schedules as a co-debtor on debts owed to SCS General Contractors and W.D. Sales/Emerald Coast Brokerage, Inc. BR 137 at 140.

Mr. Hancock was an experienced bankruptcy attorney with over 30 years in bankruptcy practice. Hancock Testimony, DR 32, at 8-11. His fees had been denied in another bankruptcy case for failing to fully disclose the terms of his representation of the debtor just months before this case was filed. *Id.* at 58; BR 720 at 8. *See Limor v. Hancock (In re Innovative Entertainment Concepts, Inc.*), No. 04-01633, 2007 WL 5582055 (Bankr. M.D. Tenn. Aug. 10, 2007), *aff'd*, No. 07-0639, 2007 WL 4481436 (M.D. Tenn. Dec. 18, 2007) App at 204 and 224.

On December 19, 2007, Mr. Hancock filed his Declaration. BR 68. The Declaration did not disclose his connection to Dynamic Management. *Id.* On January 4, 2007, at the first meeting of creditors, Mr. Barber testified that Mr.Hancock had represented Dynamic Management before the Debtor's bankruptcy case was filed. Hancock Testimony, DR 32 at 65-67. Mr. Hancock did not acknowledge his prior representation of Dynamic Management, nor did he amend his Declaration to disclose his representation of Dynamic Management to the Bankruptcy Court. *Id.* at 160.

On August 6, 2008, the United States Trustee objected to Mr. Hancock's amended final fee application, citing Mr. Hancock's failure to disclose his connection to Dynamic Management. BR 636 at 12. The next day, August 7, 2008, Mr. Hancock transmitted a message to the U.S. Trustee which stated,

> I do not represent and have not represented Dynamic Management in any matter having anything to do with BBI [Barnhill's Buffet, Inc.], or in any other matter. . . . Bottom line: my disclosure is dead accurate comprehensive and complete.

App at 311.

On August 18, 2008, The United States Trustee again cited Mr. Hancock's failure to disclose his connection to Dynamic Management in his objection to Mr. Hancock's motion for the allowance of an interim distribution. BR 656 at 3. Still, Mr. Hancock did not amend his Declaration.

On September 5, 2008, Mr. Hancock e-mailed a proposed motion seeking sanctions against the United States Trustee and the Chapter 7 trustee because they questioned his failure to disclose his connections.[9] App at 317.

On September 25, 2008, the United States Trustee obtained an unsigned copy of Mr. Hancock's affidavit that had been filed in the Escambia County lawsuit. Poole (Analyst for the U.S. Trustee) Testimony, DR 32 at 804; App at 172. On October 8, 2008, Mr. Hancock refused to produce a signed copy of the affidavit to the United States Trustee, stating, "If you want it in you provide it. I don't have time to do your work for you." App at 331.[10]

The United States Trustee again raised Mr. Hancock's failure to disclose in its pretrial memorandum. BR 717. Mr. Hancock still did not amend his Declaration.

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[9] The Bankruptcy Court noted Mr. Hancock's explanation that:

> a rule 9011 motion was an "effective tool" and that he intended to file it if he did not get the results he was seeking to achieve. [Mr. Hancock] called such a tactic a "shot across the bow." He also testified that he believed motions such as this as well as reminders of criminal statutes were methods of "getting a case going."

Opinion, BR at 13.

[10] The U.S. Trustee later obtained a signed copy of the affidavit from Joseph V. Ferrelli, the individual who notarized the affidavit. App at 164.

C. Mr. Hancock's Undisclosed Connection to Dynamic Acquisitions Group.

In the Spring of 2007, Mr. Hancock represented Dynamic Acquisitions and the Debtor in connection with an escrow account dispute between the Debtor, Dynamic Aquisition and BBSA, LLC ("BBSA").[11] App at 236. On March 23, 2007, Mr. Barber e-mailed a representative of BBSA that Mr. Hancock was "[c]ounsel for Dynamic Acquisitions Group, LLC ("Dynamic") and Barnhill's Buffet, Inc. ("Barnhill's) relative to the Indemnification Fund and remaining payments from the Merger Fund . . . ." App at 148. One month later, on April 25, 2007, Mr. Hancock sent a letter to Martin W. Moore, Chief Manager of BBSA, on the his law firm's letterhead confirming his representation of Dynamic Acquisitions and the Debtor in that matter. App at 151.

Mr. Hancock did not disclose his connection with Dynamic Acquisitions in his verified Declaration.

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[11] BBSA was appointed as the agent for the former shareholders when Dynamic Acquisition acquired the Barnhill's Buffet restaurants in 2005. When that transaction closed, an Indemnification Fund was established to create a reserve against potential liabilities. The fund was a holdback from the purchase price owed to the former shareholders. Barber Testimony, DR 32 at 695. App at 236; BR 134 at 4.

On August 6, 2008, the United States Trustee and the Chapter 7 Trustee objected to Mr. Hancock's amended final fee application, citing Mr. Hancock's failure to disclose his connection to Dynamic Acquisitions. BR 636 at 12. Mr. Hancock did not amend his Declaration.

On August 18, 2008, the United States Trustee again cited Mr. Hancock's failure to disclose in his objection to Mr. Hancock's motion for the allowance of an interim distribution. BR 656 at 3. Still, Mr. Hancock did not amend his Declaration.

On October 20, 2008, the United States Trustee raised Mr. Hancock's failure to disclose in his pretrial memorandum. BR 717. Mr. Hancock still did not amend his Declaration.

D. Mr. Hancock's Undisclosed Connection to Dynamic Hospitality.

Mr. Hancock did not disclose any connection with Dynamic Hospitality in his Declaration. BR 68 at 7. Just before Mr. Hancock filed the Debtor's bankruptcy case, Mr. Barber conferred with Mr. Hancock about how to protect Dynamic Hospitality's interests in connection with the Debtor's bankruptcy case.[12] In the

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[12] On November 4, 2007, Mr. Barber transmitted a message to Mr. Hancock which contained the following statement, "We also need to make sure that the reimbursements to Dynamic Hospitality for accounting and IT employees (as contract labor) and for reimbursement of welfare benefits paid by Dynamic for Barnhill's employees gets covered if needed. Stacey is keeping us close on the sales and payroll taxes. Is there anything else we are missing to protect us *individually* or the services provided by *Dynamic*?" [Emphasis added]

Debtor's Statement of Financial Affairs, Dynamic Hospitality is listed as an insider having received $1,256,138.54 from the Debtor during the year before the bankruptcy case was filed. BR 134 at 2; BR 136 at Statement of Financial Affairs 3. c. Dynamic Hospitality, along with its owners, Mr. Barber and Mr. Langford, received at least $182,997.84 from the Debtor during the five months the Debtor was in Chapter 11. App at 303.

During his September 4, 2008 deposition, Mr. Langford testified that Mr. Hancock previously represented Dynamic Hospitality. Langford Testimony, DR 32 at 374. At his deposition, Mr. Langford produced a statement prepared from business records reflecting payments made by Dynamic Hospitality to Mr. Hancock. App at 315. The statement was admitted into evidence without objection as Trial Exhibit 128. Trial Transcript, DR 32 at 309.

Mr. Hancock did not amend his Declaration to disclose his connection to Dynamic Hospitality. Hancock Testimony, DR 32 at 274.

In its pretrial memorandum, the United States Trustee cited Mr. Hancock's failure to disclose his connection to Dynamic Hospitality as a basis for denying his fee application. BR 717 at 9. Still, Mr. Hancock did not amend his Declaration. Hancock Testimony, DR 32 at 274.

App at 234.

The Bankruptcy Court found that Mr. Hancock's failure to disclose his connections to Dynamic Management, Dynamic Acquisitions and Dynamic Hospitality could not be dismissed as technical or insignificant mistakes. Opinion, BR 736 at 12 n. 8. Both Mr. Barber and Mr. Langford collected their $275,000.00 annual salaries as long as the case remained pending in Chapter 11. *Id.* One of their wholly owned companies, Dynamic Hospitality, had a prepetition contractual relationship with the Debtor that continued as long as the case was pending under Chapter 11. *Id.* And, Mr. Barber testified that the Debtor did not perform a preference analysis while the case was pending under Chapter 11.[13] *Id.* A preference analysis would have involved reviewing the sums paid to Mr. Barber, Mr. Langford, the related companies, and Mr. Hancock before the bankruptcy case was filed.

IV. Mr. Hancock's Billing Practices and Time Records Maintenance.

Mr. Hancock was paid $50,000.00 by the Debtor before the bankruptcy case was filed for prepetition services. BR 68 at 8. When the Chapter 7 trustee asked Mr.

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[13] A preference analysis involves reviewing payments made by the Debtor before bankruptcy petition was filed to determine whether the entity receiving the payment should be required to return the funds to the bankruptcy estate because the entity received more than similarly situated creditors. *See* 11 U.S.C. § 547.

Hancock to produce time records to support the work performed against the prepetion payment, Mr. Hancock failed to do so and responded by e-mail that:

> I am unable to find any such papers. Given the practice we followed over the years I suspect there might not be any. That would be ordinary course for us. Bob [Langford, the CEO] doesn't like to see lawyers bills and I don't like the time and expense of preparing them so its quid pro quo.

App at 328; Hancock Testimony, DR 32 at 168-169.

The Bankruptcy Court found this practice unacceptable for a Debtor's attorney seeking payment in a Chapter 11 case. Opinion, BR 736 at 22.

Pursuant to the Bankruptcy Court's pretrial order, Mr. Hancock was required to produce all of his contemporaneous time records in support of his fee application. BR 658. The Bankruptcy Court found Mr. Hancock produced seven handwritten chargeable time slips reflecting hours; his telephone records, a log showing his e-mail traffic from December 3, 2007, to December 14, 2007, and a Docket Sheet for the case. Opinion, BR 736 at 21. The Bankruptcy Court found that the Barnhill's Buffet case time entries were dictated in May 2008, well after the events described in his fee application had taken place. Opinion, BR 736 at 21; Hancock Testimony, DR 32 at 179-180. Although Mr. Hancock testified that his paralegal discarded the notes he made during the case, (Hancock Testimony, DR 32 at 57) his paralegal testified that she did not discard any notes because she was not given any. Horel Testimony, DR

32 at 490-491. She also testified that she did not recall seeing any handwritten time records produced by Mr. Hancock. *Id.* at 496-497.

On June 3, 2008, two months after the Bankruptcy Court terminated his employment as Debtor's counsel, Mr. Hancock filed his first fee application requesting "interim" compensation for the work he did in this bankruptcy case during the first 89 days (including weekends) after the petition was filed and while it was still a Chapter 11 case. BR 487. Of those 89 days, Mr. Hancock sought compensation for more than 10 hours of work on 54 days, more than 15 hours of work on 32 days, more than 20 hours of work on 17 days, and more than 24 hours of work on two days. BR 502 at 10; App at 293 . Mr. Hancock filed the interim fee application even though his paralegal warned him that the fees billed on certain days exceeded 24 hours. Horel Testimony, DR 32 at 499. App at 290.

After the United States Trustee objected, Mr. Hancock amended his fee application and reduced the amount of compensation sought by $55,226.00. BR 502. App at 330. The amended fee application still included 51 days on which Mr. Hancock billed in excess of 10 hours and 25 days on which Mr. Hancock billed in excess of 15 hours. App at 297; Poole Testimony, DR 32 at 794-799.

The Bankruptcy Court found that Mr. Hancock's reaction to the objections was simply that of being "caught" and absent the objections, Mr. Hancock would have overbilled the bankruptcy estate by at least $55,226.00.[14] Opinion, BR 736 at 21. The Bankruptcy Court further noted that even if Mr. Hancock expended long hours on this case, his conduct was the leading cause of the time spent. *Id.* at 20.

V. Mr. Hancock's Conduct in the Case.

The Bankruptcy Court found that Mr. Hancock engaged in numerous instances of abusive conduct that unnecessarily increased the professional fees and costs in this bankruptcy case. *Id.* at 17-19. For example, it found that Mr. Hancock, without basis, threatened attorneys with criminal sanctions. *Id.* at 17. *See* Hancock Testimony, DR 32 at 88, 235, 257, 649 and 895; BR 176 at 4; BR 249 at 4; BR 586 Exhibit A at 26. He accused Wells Fargo counsel of fraud. Opinion, BR 736 at 17. *See* App at 259. When the United States Trustee and the Chapter 7 trustee objected to Mr. Hancock's fee application, he prepared and sent to each of them a proposed Rule 11 Motion charging them with misconduct. Opinion, BR 736 at 17. *See* App at 317. Mr. Hancock filed a motion seeking to appoint an examiner to review Wells Fargo Bank's financial activities, following Wells Fargo's efforts to exert control over its cash collateral. Opinion, BR 736 at 17. *See* BR 333. Mr. Hancock filed, but

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[14] Mr. Hancock attempted to place responsibility for errors in the interim fee application on Ms. Horel (App at 304), even though she warned him the interim fee application contained days of billing with more than 24 hours. App at 290.

never prosecuted, a motion to set aside the global settlement of the case and initially failed to convert the case to Chapter 7 as required, even though he and the Debtor had previously agreed to the settlement. Opinion, BR 736 at 18. *See* BR 401; BR 423. He counseled the Debtor to open an unauthorized "secret" bank account which contained $500,000.00, and refused to provide information to Wells Fargo Bank about where the funds in the account had come from and how they were spent. Opinion, BR 736 at 23-24. *See* Barber Testimony, DR 32 at 601-601; Kelly Testimony, DR 32 at 198-201; App at 258. This secret operating account was not reflected on the Debtor's monthly operating report. Poole Testimony, DR 32 at 788.

The Bankruptcy Court found that Mr. Hancock failed to timely respond to phone calls and emails from opposing counsel (App at 266), failed to show up for hearings (BR 353), abruptly left the courtroom immediately before a hearing (Kelly Testimony, DR 32 at 397-398), and asked for an expedited hearing on a motion and then left town for a week's vacation without providing representation for his client in his absence. Opinion, BR 736 at 3, 24-25; App at 245; BR 330. In addition, the evidence showed Mr. Hancock attempted to intimidate a witness under subpoena to testify at the fee hearing (App at 329; Kelly Testimony DR 32 at 448-449; BR 673; and BR 697), and after his employment as Debtor's counsel was terminated by the

Bankruptcy Court, offered to trade on knowledge obtained while Debtor's counsel to the detriment of the Debtor. App at 310.

The Bankruptcy Court was unable to find that Mr. Hancock's "services as Debtor's counsel were reasonable and necessary pursuant to 11 U.S.C. § 330," (Opinion, BR 736 at 18); finding instead that "[t]he overall course of this case has been contentious, disorganized and wasteful of the time and efforts of both this court and other counsel." *Id.* at 19. And Mr. Hancock's "intractable conduct . . . generated fees and problems in [the] case rather than progress, professionalism, and transparency that is expected of a chapter 11 Debtor's attorney." *Id.* at 24. The Bankruptcy Court concluded that "[w]hatever benefit Mr. Hancock provided in this case was completely eradicated and overcome by his unprofessional conduct and tactics." *Id.* at 25-26.

Given the extensive proof of Mr. Hancock's "unprofessional, dilatory actions and his fractious behavior" the Bankruptcy Court could not find that Mr. Hancock's services as Debtor's counsel were reasonable and necessary. *Id.* at 18.

SUMMARY OF ARGUMENT

The Bankruptcy Court found that Mr. Hancock, an experienced bankruptcy attorney who knew better, failed to disclose his connections to three interested parties and when "caught," tried to cover them up instead of amending his Declaration. That conduct alone warrants a total denial of fees under the law of this Circuit. If this Court affirms on that basis, it need not reach the Bankruptcy Court's second ground for denying Mr. Hancock's fee application.

A bankruptcy court is required by the Bankruptcy Code to ensure that the attorney for a Chapter 11 debtor is completely disinterested and does not represent a party with an adverse interest throughout the bankruptcy case. The only way the court can do that is if the attorney for the debtor is fully forthcoming in disclosing all connections with interested parties. For that reason, the attorney's duty to disclose under section 327(a) and Rule 2014 is broadly construed, strictly applied, and continues throughout the case. Because it is the court's prerogative to decide which connections require disqualification, an attorney must disclose all connections, not just those he decides are significant. A court may sanction an attorney's failure to disclose, even if the undisclosed connection would ultimately not be disqualifying.

Mr. Hancock knew that he had to fully disclose all his connections to interested parties and that he risked not getting paid if he did not; Mr. Hancock had forfeited his fees in a previous case where he failed to make complete disclosures. Nevertheless, Mr. Hancock failed to disclose his connections to three interested parties in his sworn Declaration and subsequently failed to amend his Declaration to make the required disclosures, despite numerous opportunities to do so. Instead, Mr. Hancock denied the connections and became combative.

On no less than four occasions, this Court has ruled that bankruptcy courts may deny all fees when, as here, an attorney failed to make required disclosures. *In Re Big Rivers Elec. Corp.*, 355 F.3d 415 (6th Cir. 2004); *Vergos v. Mendes & Gonzales PLLC* (*In re McCrary & Dunlap Const. Co.)*, No. 01-5355,79 Fed. Appx. 770, 2003 WL 22442934, at *9 (6th Cir. Oct. 27, 2003) (unpublished); *In re Kisseberth*, 273 F.3d 720-21; *Mapother & Mapother PSC v. Cooper (In re Downs)*, 103 F.3d 472, 477 (6th Cir. 1996). Given that Mr. Hancock not only failed to disclose three potential conflicts, but sought to deny their existence, despite having had all fees denied previously for failing to make adequate disclosures, the court below did not abuse its discretion in following those cases.

Mr. Hancock incorrectly alleges that he is not required to disclose past connections. To the contrary, the plain language of the rule requires the disclosure of all connections; it is not expressly limited to present connections. Courts construe the disclosure requirement broadly to include both present and past connections. Mr. Hancock's contention that he had no obligation to update his Declaration is equally unpersuasive. A Chapter 11 debtor's attorney has a duty to disclose his connections throughout the case to enable the Bankruptcy Court to fulfill its responsibility to ensure that the attorney remains disinterested and does not represent a party with an adverse interest.

Mr. Hancock attempts to shift his duty to disclose to the United States Trustee. He incorrectly contends the United States Trustee should have investigated and disclosed Mr. Hancock's connection to Dynamic Management to the Bankruptcy Court by objecting to Mr. Hancock's employment; therefore, the doctrines of res judicata, laches, estoppel and waiver prevented the United States Trustee from objecting to Mr. Hancock's fee application on the basis of his failure to disclose. Neither the United States Trustee nor the Bankruptcy Court, however, had an obligation to search through the record to root out undisclosed conflicts of interest that Mr. Hancock failed to properly disclose through his Declaration. That duty fell solely on Mr. Hancock. In any event, those doctrines do not apply in this case.

As a second, independent ground for denying all fees, the Bankruptcy Court concluded that Mr. Hancock was not entitled to fees under section 330 because based on the trial evidence, it was unable to find that the services were actual, reasonable and necessary as required by the statute.

This should have been a straight forward liquidation case. Yet in less than three months, Mr. Hancock billed more than $350,000. The Bankruptcy Court found that much of the time he billed was wasteful, unnecessary to the administration of the estate and due primarily to his own unprofessional conduct and disruptive litigation tactics. That finding was based on abundant evidence and was not clearly erroneous. In addition, the Bankruptcy Court found Mr. Hancock's evidence supporting the requested fees to be unreliable because of his inadequate billing practices, non-contemporaneous time records, disputed testimony and proven overbilling. An applicant requesting attorney's fees must prove to a high degree of certainty that his services were actual, reasonable and necessary. Mr. Hancock failed to provide such proof. Therefore, the Bankruptcy Court did not abuse its discretion by denying his fees.

Mr. Hancock contends that this case must be remanded because the Bankruptcy Court did not perform a lodestar analysis.[15] Mr. Hancock advocates a simple calculation consisting of hours spent multiplied by an hourly rate, but ignores the fact the court may only compensate time actually, reasonably, and necessarily expended on the case under section 330. The Bankruptcy Court could not find that Mr. Hancock's time was reasonably and necessarily spent; therefore, the Bankruptcy Court's lodestar calculation resulted in an award of no fees in this case.

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[15] Denial of fees based on a failure to disclose does not require a lodestar analysis.

Mr. Hancock also argues the denial of his fee application violated his constitutional rights. Specifically, he contends his First Amendment right to free speech has been violated because the Bankruptcy Court sanctioned him for offensive speech, and he has not been afforded due process in this case because the Bankruptcy Court failed to recuse itself. Neither of those arguments have any merit. The first argument fails because Mr. Hancock was not sanctioned for anything he said; his fees were denied first and foremost, for his failure to make required disclosures and secondarily, because he did not adequately prove that he provided actual, reasonable and necessary services in this case. Mr. Hancock waived the due process argument because he never requested the Bankruptcy Judge to recuse himself. Moreover, Mr. Hancock has offered no evidence of judicial bias. He relies solely on the Bankruptcy Court's decision as evidence of the court's bias, but that opinion merely sets forth the court's findings and conclusions based on the evidence. Any negative light it sheds on Mr. Hancock is due entirely to his conduct in this case and not to judicial bias.

STANDARD OF REVIEW

This Court reviews the bankruptcy court's determination of the proper amount of attorney's fees for an abuse of discretion. *Henderson v. Kisseberth* (*In re Kisseberth)*, 273 F.3d 714, 720 (6th Cir. 2001). It will find an abuse of discretion only upon a "definite and firm conviction that the trial court committed a clear error of judgment." *Id.* (internal quotation omitted). This Court reviews the bankruptcy court's factual findings for clear error and conclusions of law *de novo*. *Brinley v. LPP Mortgage, Ltd. (In re Brinley)*, 403 F.3d 415, 418 (6th Cir. 2005), *cert. denied*, 546 U.S. 1149 (2006).

ARGUMENT

I. The Bankruptcy Court Did Not Err in Denying All Fees to Mr. Hancock for His Continuing Failure to Disclose His Connections to Three Interested Parties as Required by 11 U.S.C. § 327(a) and Rule 2014.

A. The Bankruptcy Code and Bankruptcy Rules Require Complete Disclosure of All Connections Throughout the Case Regardless of Whether Those Connections Seem Significant to the Attorney Making the Disclosure.

The Bankruptcy Code and Rules impose a mandatory obligation on an attorney seeking employment by a Chapter 11 bankruptcy estate to fully disclose his relationships to the debtor and other interested parties and any potential conflicts involved in the representation. *See* 11 U.S.C. § 327(a); Fed. R. Bankr. P. 2014. Proper disclosure is necessary to enable a bankruptcy court to make an informed decision as to whether the attorney meets the statutory requirements for employment under section 327(a), i.e., that such person does not "hold or represent an adverse interest to the estate" and is a "disinterested person." *See* 11 U.S.C. § 327(a); *Neben & Starrett, Inc. v. Chartwell Fin. Corp. (In re Park-Helena Corp.)*, 63 F.3d 877, 881

(9th Cir. 1995), *cert. denied*, 516 U.S. 1049 (1996); *In re Granite Partners*, 219 B.R. 22, 35 (Bankr. S.D. N.Y. 1998).

To enable bankruptcy courts to determine properly whether attorneys or other professional persons comply with these requirements, Rule 2014(a), Fed. R. Bank. P., sets forth the following requirements for applications for employment under section 327:

> . . . **The application shall state** the specific facts showing the necessity for the employment, the name of the person to be employed, the reasons for the selection, the professional services to be rendered, any proposed arrangement for compensation, and, **to the best of the applicant's knowledge, all of the person's connections with the debtor, creditors, any other party in interest, their respective attorneys and accountants, the United States trustee, or any person employed in the office of the United States trustee. The application shall be accompanied by a verified statement of the person to be employed setting forth the person's connections with the debtor, creditors, any other party in interest, their respective attorneys and accountants, the United States trustee, or any person employed in the office of the United States trustee.** [Emphasis added.]

Rule 2014(a) requires all attorneys employed under section 327 to disclose all known connections with the debtor, creditors, and other parties in interest both in the application for employment and in an accompanying verified statement. *Kravit, Gass & Weber, S.C. v. Michel (In re Crivello)*, 134 F.3d 831, 836 (7th Cir. 1998). The duty to disclose "arises not solely by reason of the bankruptcy rules, but also is founded upon 'the fiduciary obligation owed by counsel for the debtor to the bankruptcy court.'" *Futuronics Corp. v. Arutt, Nachamie & Benjamin (In re Futuronics Corp.)*, 655 F.2d 463, 470 (2d Cir. 1981), *cert. denied*, 455 U.S. 941 (1982) (quoting *In re Arlan's Dep't Stores, Inc.*, 615 F.2d 925, 937 (2d Cir. 1979)).

Under Rule 2014(a), "[t]he scope of disclosure is much broader than the question of disqualification . . . The applicant and the professional must disclose all connections and not merely those that rise to the level of conflicts." *In re Keller Fin. Servs. of Fla., Inc*, 248 B.R. 859, 897 (Bankr. M.D. Fla. 2000) (quoting *In re Granite Partners*, 219 B.R. at 35); *accord In re Citation Corp.,* 493 F.3d 1313, 1321 (11th Cir. 2007); *In re Gulf Coast Orthopedic Ctr.*, 265 B.R. 318, 323 (Bankr. M.D. Fla. 2001). "The duty of professionals is to disclose all connections with the debtor, debtor-in-possession, insiders, creditors, and parties in interest . . . They cannot pick and choose which connections are irrelevant or trivial . . . No matter how old the connection, no matter how trivial it appears, the professional seeking employment must disclose it." *In re Park-Helena Corp.*, 63 F.3d at 882 (citation omitted). *Accord In re Citation Corp.,* 493 F.3d at 1321 (attorney must disclose all previous contacts with party in interest so court, not attorney, can determine which rise to level of actual or potential conflict); *Keller Fin. Servs.*, 248 B.R. at 897 ("The professional must disclose all facts that bear on his disinterestedness, and cannot usurp the court's function by unilaterally choosing which connections impact on his disinterestedness and which do not.”).

Because a professional person’s failure to comply with the requirements of section 327(a) at any time during such person’s employment may result in a denial of compensation, *see* 11 U.S.C. § 328(c), the courts have held that the duty to disclose is a continuing duty that survives the initial filing of the application for employment and requires professionals to reveal connections that arise or are discovered after their retention. *See In re Citation Corp.,* 493 F.3d at 1321; *In re Keller Fin. Servs.*, 248 B.R. at 898; *accord I.G. Petroleum, L.L.C. v. Fenasci (In re West Delta Oil Co.)*, 432 F.3d 347, 355 (5th Cir. 2005); *Rome v. Braunstein*, 19 F.3d 54, 57-58 (1st Cir. 1994) (“[T]he need for professional self-scrutiny and avoidance of conflicts of interest does not end upon appointment.”).

The courts of appeals have recognized the importance of the Bankruptcy Code’s disclosure requirements and the power of the bankruptcy courts to sanction attorneys for failing to comply with these requirements. *See, e.g.*, *In re West Delta Oil Co.*, 432 F.3d at 355; *In re Crivello*, 134 F.3d at 836; *In re Park-Helena Corp.*, 63 F.3d at 881-82 (9th Cir. 1995); *Rome*, 19 F.3d at 59-60. The disclosure rules are applied literally, even if the results are sometimes harsh.” *Id.* at 881. Negligent or inadvertent omissions “do not vitiate the failure to disclose.” *Id.* The failure to comply with the disclosure rules is a sanctionable violation, even if proper disclosure would have shown that the attorney had not actually violated any Bankruptcy Code provision or Bankruptcy Rule. *Id.* at 880.

B. The Bankruptcy Court's Findings That Mr. Hancock Had Connections to Three Interested Parties and That He Failed to Disclose Those Connections Were Not Clearly Erroneous.

The Bankruptcy Court found that Mr. Hancock had connections to three companies, which were owned wholly or in part by Mr. Barber, the Debtor's President, and Mr. Langford, the Debtor's CEO: Dynamic Management (the Debtor's co-debtor), Dynamic Acquisitions Group (the Debtor's co-debtor, and the Debtor's 100 percent shareholder), and Dynamic Hospitality (the Debtor's pre and post-petition creditor). Opinion, BR 736 at 9-15. That finding was amply supported by the trial evidence and was not clearly erroneous. The Bankruptcy Court further found, and the evidence showed Mr. Hancock did not disclose his connections to any of the three entities when he submitted his Declaration and he never amended his Declaration to disclose those connections. *Id.* at 8, 14. Therefore, Mr. Hancock failed to comply with the disclosure requirements of section 327 and Rule 2014(a).

Mr. Hancock contends that he was not required to disclose those connections for three reasons, all of which lack merit. First, he contends that he is only obligated to disclose present connections. Appellant's Brief at 36-39. Rule 2014, however, includes no such limitation but requires the disclosure of all connections. Courts interpreting the rule have confirmed that an attorney must disclose former connections. *See, e.g.*, *In re Park-Helena Corp.*, 63 F.3d at 882. Further, Mr. Hancock concedes former connections might raise issues as to whether an attorney is disinterested. Appellant's Brief at 39-40. That is exactly why Rule 2014 requires disclosure of former connections. Finally, Mr. Hancock's past actions are not consistent with his current position. Mr. Hancock's Declaration disclosed his former representation of Mr. Langford, which predated his connections to the three Dynamic companies. BR 68 at 7.

Second, Mr. Hancock contends that he had no duty to supplement his initial disclosure with connections of which he subsequently became aware. In the first place, Mr. Hancock's connections with the three interested parties already existed when he filed his Declaration and he should have disclosed them then. Further, courts have held that the duty to disclose is a continuing duty that survives the initial filing of the application for employment. *See In re Keller Fin. Servs.,* 248 B.R. at 898; *accord In re West Delta Oil*, 432 F.3d at 355; *Rome*, 19 F.3d at 57-58. Section 328(c) provides for the denial of fees if at any time the attorney is not disinterested or represents a party with an adverse interest.

Third, Mr. Hancock asserts that his connections to the three companies were too insignificant to disclose because he did not actually represent those entities. The Bankruptcy Court did not credit Mr. Hancock's testimony disputing the representations, describing it as "attempts to explain away whatever the proof showed otherwise." Opinion, BR 736 at 14. The court correctly found that Mr. Hancock should have disclosed those connections whether or not he represented the Dynamic companies. *Id.*

Mr. Hancock had no right to pick and choose which connections were worthy of disclosure. *See In re Park-Helena*, 63 F.3d at 882. Rule 2014(a) is not limited to the disclosure of persons and entities an attorney currently represents or has represented; it requires disclosure of all "connections." The court, not the disclosing attorney, determines if the connections are disqualifying. *See id.; In re Keller Fin. Servs.*, 248 B.R. at 897-98; *In re Gulf Coast Orthopedic Ctr.*, 265 B.R. at 323. By failing to disclose his connections with the Dynamic Companies, Mr. Hancock deprived the Bankruptcy Court of its ability to make a proper and timely determination of his eligibility for employment as counsel for the Debtor. Opinion, BR 736 at 14. That failure is sufficient basis for the denial of all compensation.

C. The Bankruptcy Court Did Not Abuse Its Discretion In Denying All Compensation to Mr. Hancock on the Basis of His Failure to Disclose.

A bankruptcy court's decision regarding the proper amount of attorney's fees to award will not be set aside unless the court abused its discretion. *In re Kisseberth*, 273 F.3d at 720. This Court has ruled in numerous cases that bankruptcy courts may deny all fees when, as here, an attorney failed to make required disclosures. *In Re Big Rivers Elec. Corp.*, 355 F.3d 415; *In re McCrary & Dunlap Const. Co.*, 2003 WL 22442934, at *9; *In re Kisseberth*, 273 F.3d at 720-21; *In re Downs*, 103 F.3d at 477.[16]

As the Bankruptcy Court noted, Mr. Hancock was well aware of the need for transparency and full disclosure because he had recently had his fees denied in another bankruptcy case. Opinion, BR 736 at 12-14. The Bankruptcy Court found that Mr. Hancock not only failed to disclose his connections when he filed his sworn Declaration, he refused to amend the Declaration to correct his errors when they were brought to his attention. *Id.* at 13-14. Instead, he denied the connections, affirmed

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[16] Those cases involved Fed. R. Bankr. P. 2016, which requires a debtor's attorney to disclose to the court their fees arrangements and any fees received in connection with the case. Together, Rules 2014 and 2016 enable the bankruptcy courts to identify potential conflicts of interest. The disclosure requirements of Rule 2014 are applied as strictly as those of Rule 2016 and failure to disclose under either may result in denial of all fees. *In re Park-Helena Corp.*, 63 F.3d at 882.

the accuracy of his initial disclosure and threatened the United States Trustee and the Chapter 7 Trustee with sanctions for suggesting that such connections existed.[17] Opinion, BR 736 at 12-14.

The Bankruptcy Court, comparing Mr. Hancock's actions in this case to his actions in the *Innovative* case, found:

> The Trustee and U.S. Trustee have had to claw the facts out of Hancock. And there were good reasons to do so. Hancock's serial disclosures were not consistent with each other. Some of the disclosures raised issue[s] with respect to Hancock's disinterestedness. The timing of the shifting explanations seemed opportunistically to respond to challenges from the Trustee and the U.S. Trustee. The result is long and expensive litigation to get what Hancock was obligated to give in the first instance without compulsion: complete and accurate disclosure . . .

Id. at 13 n.11 *(quoting In re Innovative Entertainment Concepts*, 2007 WL 5582055, at *7). Given that Mr. Hancock not only failed to disclose three potential conflicts,

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[17] The evidence shows Mr. Hancock denied any connection to the Dynamic Companies in an e-mail message to the United States Trustee dated August 7, 2008 and in a proposed motion for sanctions directed at the United States Trustee and the Chapter 7 trustee. App at 311, 317, and 327. And he never amended his sworn Declaration to disclose his connections to those companies even after being confronted with his own affidavit declaring his representation of Dynamic Management or e-mails declaring his representation of Dynamic Acquisitions.

but sought to deny their existence, the court below did not abuse its discretion in following those cases in this one.[18]

Mr. Hancock argues the denial of all fees was an abuse of discretion in response to what he incorrectly asserts was a negligent failure to disclose. First, Mr. Hancock's failure to disclose was not negligent. Even if he could credibly claim he was not aware he had to disclose his connections to the three entities when he filed his Declaration; his continuing refusal to amend his Declaration and his affirmation of its accuracy after being faced with evidence to the contrary cannot be attributed to negligence. Second, even a negligent failure to disclose may result in the forfeiture of fees. *In re Kisseberth*, 273 F.3d at 721 (affirming disgorgement for negligent failure to disclose). *Accord In re Park-Helena Corp.,* 63 F.3d at 882 (bankruptcy court did not abuse its discretion in denying all requested fees as sanction for attorney's failure to disclose); *see also West Delta Oil Co.,* 2005 WL 3220291, at 6 (quoting *Crivello*, 134 F.3d at 836) ("failure to disclose is sufficient grounds to revoke an employment order and deny compensation"); *Rome*, 19 F.3d at 59-60

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[18] Mr. Hancock's contention that total denial of fees is not within the zone of appropriate sanctions for his failure to disclose (*See* Appellant's Brief at 57-58) simply recasts his abuse of discretion argument. As explained above, this Court has found total denial of fees to be an appropriate sanction for failure to fully disclose and this case is a paradigm for why that is so.

(counsel's failure to make full and spontaneous disclosure of financial transactions between debtor and insiders provided sufficient ground for denial of compensation).

Mr. Hancock also contends that his failure to disclose should not result in the denial of his fees because it was merely a technical failure to disclose with no real ramifications. Appellant's Brief at 58. To the contrary, the Bankruptcy Court found full disclosure was important in this case because, as long as the case remained in Chapter 11, Mr. Langford and Mr. Barber continued to collect their $275,000 annual salaries from the Debtor, and Dynamic Hospitality continued to receive payments from the Debtor on a prepetition contract. Opinion, BR 736 at 14. Further, the Debtor never performed a preference analysis as to the payments made to Dynamic Hospitality, Mr. Barber, and Mr. Langford, which totaled $1,256,138.54. *Id.* And, most significantly, Mr. Hancock's failure to disclose information interfered with the Bankruptcy Court's ability to make an informed decision about whether Mr. Hancock's employment as the Debtor's counsel complied with the Bankruptcy Code. *Id.*

D. Mr. Hancock's Contentions That Res Judicata, Laches, Estoppel and Waiver Barred The Trustees' Objection To His Fee Application Based on His Failure to Disclose Are Wrong Because Those Doctrines Do Not Apply.

Mr. Hancock contends that the Bankruptcy Court's adjudication of the sufficiency of his pre-retention disclosure under Rule 2014(a) is barred by res judicata, laches, estoppel, and waiver because arguments concerning his failures to disclose were not raised in connection with the bankruptcy court's order approving Mr. Hancock's employment. Appellant's Brief at 46-53. However, Mr. Hancock's argument gets it exactly backward. If the United States Trustee expressed an interest in a specific undisclosed connection, it is all the more reason for Mr. Hancock to have disclosed that connection to the court. The relevant disclosures must appear in the employment application and accompanying affidavit filed pursuant to Rule 2014. *Quarles & Brady LLP v. Maxfield* (*In re Jennings)*, No. 05-15212, 199 Fed. Appx. 845, 2006 WL 2826947, at *2 (11th Cir. Oct. 4, 2006) (unpublished). *In re BH & P, Inc.*, 949 F.2d 1300, 1317 (3d Cir. 1991) ("It is not ... the obligation of the bankruptcy court to search the record for possible conflicts of interest. That obligation belongs to the party who seeks employment by the estate. . . ."); *In re Marine Outlet, Inc.*, 135 B.R. 154, 156 (Bankr. M.D. Fla. 1991) ("There is no duty placed on the United States Trustee or on creditors to search the record for the existence, vel non, of a conflict of interest of a professional sought to be employed"). *See also Kravit*, 134 F.3d at 839

("Bankruptcy courts have neither the resources nor the time to root out the existence of undisclosed conflicts of interest.").

In any event, laches and estoppel do not apply against the Government. *Hatchett v. United States*, 330 F.3d 875, 887 (6th Cir. 2003) (laches does not apply against United States); *Michigan Exp., Inc. v. United States*, 374 F.3d 424, 427 (6th Cir. 2004) (government cannot be estopped in the absence of affirmative misconduct). And no intentional relinquishment of known rights by the United States Trustee as required for a waiver has been asserted or established. *See Am. Locomotive Co. v. Chem. Research Corp.*, 171 F.2d 115, 121 (6th Cir. 1949), *cert. denied*, 336 U.S. 909 (1949).

Res judicata does not bar the United States Trustee and the Chapter 7 trustee from objecting to Hancock's fee application on the basis of his failure to disclose because the application of res judicata requires: (1) a final decision on the merits by a court of competent jurisdiction; (2) a subsequent action between the same parties; (3) an issue in the subsequent action that was litigated or should have been litigated in the prior action; and (4) an identity of the causes of action. *Bragg v. Flint Bd. of Educ.*, 570 F.3d 775, 776 (6th Cir. 2009). The first and third elements are lacking in this case. The order approving Mr. Hancock's employment was not a final order. *Cottrell v. Schilling (In re Cottrell)*, 876 F.2d 540, 542 (6th Cir. 1989). *Accord Spears* *v. U.S. Trustee*, 26 F.3d 1023, 1024 (10th Cir. 1994). And Mr. Hancock's failure to disclose his connections to parties in interest was not litigated in the context of the court's retention order and should not have been litigated in that context because no one was aware of the lack of disclosure.

II. Alternatively, The Bankruptcy Court Did Not Abuse its Discretion in Denying All Fees to Mr. Hancock Because It Could Not Find That the Requested Fees Were For Actual, Reasonable and Necessary Services.

As a second, independent ground, the Bankruptcy Court denied Mr. Hancock's fee application because he did not prove that the services for which he requested compensation were actual, reasonable and necessary. The Bankruptcy Court did not abuse its discretion in denying all fees pursuant to section 330.

Section 330 and the Bankruptcy Court have an overriding concern for minimizing administrative expenses to preserve as much of the estate as possible for creditors. Therefore, the compensation statute focuses on the benefits an attorney's services have offered the estate. *In re Citation Corp.,* 493 F.3d at 1321. Although a bankruptcy court may award an attorney who qualifies for employment and is properly retained under section 327(a) "reasonable compensation for actual, necessary services" under 11 U.S.C. § 330(a)(1)(A), the court is prohibited from compensating an attorney for any services that were not reasonably likely to benefit the estate or were unnecessary for the administration of the case. 11 U.S.C. § 330(a)(4)(A)(ii). To obtain compensation, an attorney must file a fee application, detailing his time spent on the case and the amounts sought. Fed. R. Bankr. P. 2016(a). The application must be supported by detailed contemporaneous time records. *In re Williams,* 384 B.R. 191, 195 (Bankr. N.D. Ohio 2007). The attorney seeking fees must prove that his services were actual, reasonable, and necessary to a high degree of certainty. *Imwalle v. Reliance Med. Prod., Inc.,* 515 F.3d 531, 553 (6th Cir. 2008) (key requirement for award of attorneys fees is documentation offered in support must be of sufficient detail and probative value to enable court to determine with high degree of certainty that such hours were actually and reasonably expended). *See, e.g., In re Wildman*, 72 B.R. 700, 708 (Bankr. N.D. Ill.1987) ("The burden of proof on all fee matters is on the applicant."). If he fails to do so, the bankruptcy court may "award compensation that is less than the amount of compensation that is requested . . . ." 11 U.S.C. § 330(a)(2).

Mr. Hancock failed to meet his burden for two reasons. First, the Bankruptcy Court found that Mr. Hancock's pervasive unprofessional, abusive, and dilatory conduct disrupted the case and created unnecessary billings that "completely eradicated" any benefit that Mr. Hancock might have provided. Opinion, BR 736 at 17-18, 26. That finding was amply supported by the evidence and not clearly erroneous.

The Bankruptcy Court found, and the evidence showed that Mr. Hancock tried to disrupt a global settlement agreement among the parties, first by requesting that the Debtor be a party to the settlement and signing off on the settlement himself and later filing, but not prosecuting a motion to set it aside a material provision of the settlement.[19] *Id.* at 18; App at 275; BR 401 at 5; BR 423. He advised the Debtor to open a secret, unauthorized operating account and when it was discovered, refused to provide information about where the half a million dollars in the account had come from and where it had been spent. Opinion, BR 736 at 23-24; Barber Testimony, DR 32 at 601-602; Kelly Testimony, DR 32 at 198-201; App at 258. He threatened attorneys with criminal sanctions with no basis (Hancock Testimony, DR 32 at 88, 235, 257, 649 and 895; BR 176 at 4; BR 249 at 4; and BR 423 at 5), accused Wells Fargo's counsel of fraud (App at 259), and prepared and sent Rule 11 motions to the United States Trustee and the Chapter 7 Trustee charging them with misconduct after they objected to his fee application on the basis of his failure to disclose his connections to interested parties. Opinion, BR 736 at 17; App at 317. When he became angry at Wells Fargo over their attempts to control their cash collateral, he filed a motion seeking to have an examiner appointed to examine Wells Fargo, without

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[19] The parties were able to reach this agreement in the first instance because Mr. Hancock was not present. Opinion, BR 736 at 25.

any legal basis for that action. Opinion, BR 736 at 17-18; BR 330; Kelly Testimony, DR 32 at 417-418; Mendes (Counsel to the Committee of Unsecured Creditors) Testimony, DR 32 at 664-665. In addition, Mr. Hancock failed to respond to other attorney's requests for information (App at 243; Kelly Testimony, DR 32 at 413-415), failed to return emails or phone calls when critical deadlines were looming (App at 266), failed to show up for hearings (Kelly Testimony, DR 32 at 416), stormed out of the courtroom immediately prior to the start of a hearing (Mendes Testimony, DR 32 at 656), left town without making arrangements for his client's representation (Kelly Testimony, DR 32 at 414-415, and filed objections and motions without pursuing them (BR 330 and BR 423). Opinion, BR 736 at 24-25.

The Bankruptcy Court found that Mr. Hancock's intractable conduct generated fees and problems rather than progress, and evidenced a lack of professionalism and the transparency that is expected of a Chapter 11 Debtor's attorney. *Id.* at 24. After reviewing Mr. Hancock's actions in this case, the Bankruptcy Court stated, "[t]he court cannot find, based on the extensive proof of Mr. Hancock's unprofessional, dilatory actions and his fractious behavior that his services as Debtor's counsel were reasonable and necessary pursuant to 11 U.S.C. § 330." *Id.* at 18.

Second, the Bankruptcy Court found that Mr. Hancock's billing practices and his billing records were inadequate to allow the Bankruptcy Court to make the findings necessary to compensate him from the bankruptcy estate. *Id.* at 22. That finding was amply supported by the evidence and not clearly erroneous.

The various indicia of the unreliability of Mr. Hancock's application included admitted overbilling, lack of contemporaneous time records, testimony from Mr. Hancock's paralegal that conflicted with Mr. Hancock's testimony, and Mr. Hancock's failure to prepare billing statements to justify the $50,000 he charged the Debtor before the case was filed. *Id.* at 19-22. Mr. Hancock's interim fee application requested $355,975 for less than three month's work. *Id.* at 19; BR 487. His fee application sought fees for 54 days where he purportedly worked over ten hours. Opinion, BR 736 at 20. Of those 54 days, he sought compensation for more than 15 hours of work on 32 of them, more than 20 hours of work on 17 of them and more than 24 hours of work on 2 of them. *Id.*; App at 293.

After the United States Trustee objected, Mr. Hancock amended his fee application and reduced the amount sought by $55,226.00. Opinion, BR 736 at 20; App at 330. Even then he sought compensation for more than 15 hours of work on 25 days and more than 10 hours of work on 51 days. Opinion, BR 736 at 20; App at 297. The Bankruptcy Court found that absent the objections, Mr. Hancock would have overbilled the bankruptcy estate by at least $55,226.00. Opinion, BR 736 at 21.

Moreover, the Bankruptcy Court found that Mr. Hancock produced seven handwritten chargeable time slips reflecting hours; his telephone records, a log showing his e-mail traffic from December 3, 2007, to December 14, 2007, and the Docket Sheet for the case in response to the Bankruptcy Court's pretrial order to produce all contemporaneous billing records. Opinion, BR 736 at 21 and BR 658. Mr. Hancock acknowledged that his time entries were dictated in May 2008, well after the events reflected in the fee application.[20] Opinion, BR 736 at 21; Hancock Testimony, DR 32 at 179-180**.** Although Mr. Hancock testified that he dictated the time entries from contemporaneous notes he had made during the case that his paralegal later discarded (Hancock Testimony, DR 32 at 57**)**, his paralegal testified that she did not discard any notes because she was not given any. Horel Testimony, DR 32 at 490-491. The Bankruptcy Court found that Mr. Hancock's recreated time logs were not contemporaneous and were inadequate to meet his burden to show he was entitled to the requested fees. Opinion, BR 736 at 22.

Mr. Hancock also failed to keep proper records to justify the $50,000.00 prepetition amount he was paid by the Debtor shortly before the bankruptcy case was

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[20] Even though the time entries were not contemporaneous with the work, Mr. Hancock was able to submit "2882 separate line entries . . . broken in tiny pieces" detailing how his time was spent from December 3, 2007 to April 30, 2008. Hancock Testimony, DR 32 at 36.

filed. When the Chapter 7 trustee asked Mr. Hancock to produce time records to support the work performed against the $50,000.00 he received from the Debtor before the case was filed, Mr. Hancock responded by e-mail that:

> I am unable to find any such papers. Given the practice we followed over the years I suspect there might not be any. That would be ordinary course for us. Bob [Langford, the Debtor's CEO] doesn't like to see lawyers bills and I don't like the time and expense of preparing them so its quid pro quo.

App at 328; Hancock Testimony, DR 32 at 168-169. Mr. Hancock's admitted billing practice with respect to the Debtor, which the Bankruptcy Court found "simply unacceptable," casts further doubt on the reliability of his fee application. Opinion, BR 736 at 22.

Mr. Hancock's litigation tactics and unprofessional conduct, which needlessly protracted the case and generated substantial unnecessary fees together with the unreliability of the proof of the time billed was fatal to his ability to meet his burden to prove to a high degree of certainty that the requested fees were for actual, reasonable and necessary services.[21] The Bankruptcy Court did not abuse its discretion in denying his fees for that reason.

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[21] Mr. Hancock's contention that the Bankruptcy Court found no deficiencies in the accuracy of his time descriptions (Appellant's Brief at 23) is belied by the myriad deficiencies identified by that court.

A bankruptcy case is not intended to be a feast for lawyers. While a total denial of fees seems harsh; it is equally harsh for the creditors to watch the estate being eaten up by unnecessary billings. Mr. Hancock is essentially asking the creditors to pay twice for his wasteful and unnecessary litigation tactics because they have already paid their own attorneys to respond to his tactics.

Mr. Hancock contends that the bankruptcy court abused its discretion by not providing a lodestar analysis of the fee application. Appellant's Brief at 25. Mr. Hancock focuses on a hourly rate multiplied by the number of hours billed. However, in a lodestar calculation only those hours that are reasonably expended are multiplied by the hourly rate. The Bankruptcy Court expressly considered the lodestar calculation as set forth in this Court's decision in *Boddy v. U.S. Bankruptcy Court*, 950 F.2d 334 (6th Cir. 1991). Opinion, BR 736 at 16. However, because it was unable to find that Mr. Hancock's services were reasonable or necessary, the lodestar calculation did not support an award of any compensation in this case under section 330(a)(1)(A). *See* Opinion, BR 736 at 18-19. *See also* 11 U.S.C. § 330(a)(4)(A)(ii) (prohibiting court from compensating attorney for services unnecessary to the administration of the case).

Mr. Hancock also contends that the Bankruptcy Court's opinion was unconstitutionally based on the content of three private e-mails and several pleadings

Mr. Hancock wrote and presented as evidence in the trial. Appellant's Brief at 8, 30-31. He asserts that the Bankruptcy Court's denial of fees was a sanctioning of free speech and is reversible error. That argument fails for three reasons. First, the Bankruptcy Court declined to compensate Mr. Hancock first and foremost, because of his failure to make required disclosures, which had nothing to do with Mr. Hancock's abusive conduct. Second, Mr. Hancock both understates the egregiousness of his conduct and misstates the basis of the court's decision. The court found that Mr. Hancock used a multitude of abusive tactics that unnecessarily disrupted the case, and generated excessive fees, making it impossible for the court to find that Mr. Hancock's services were reasonable and necessary as required for compensation under section 330. The referenced documents were just a few of the numerous examples cited by the court. To the extent that the court relied on the referenced documents at all, the court did not penalize Mr. Hancock for what he said or how he said it, the court simply held that because of the overwhelmingly disruptive effect of Mr. Hancock's conduct in the case, it could not find that the services he provided were reasonable and necessary as required for compensation under section 330. Opinion, BR 736 at 18. Third, as an attorney, Mr. Hancock had no First Amendment free speech right while representing his client in the courtroom. *Mezibov v. Allen*, 411 F.3d 712, 720-21 (6th Cir. 2005), *cert. denied*, 547 U.S. 1111 (2006). Even outside the courtroom, an attorney's First Amendment rights for speech likely to have a prejudicial effect on the outcome of a case are inherently circumscribed by the ethical implications and obligations of being an officer of the court. *See Gentile v. State Bar of Nevada*, 501 U.S. 1030, 1071-72 (1991). The Bankruptcy Court found that not only were Mr. Hancock's actions prejudicial to the efficient administration of the case, but they seemed to be intended to be so. Opinion, BR 736 at 18. Therefore, those actions contravened Mr. Hancock's duty to the court and were not protected as free speech.

III. Mr. Hancock's Due Process Rights Were Not Violated Because He Had Ample Opportunity To Present His Claims And There Was No Request, Nor Reason, For the Bankruptcy Judge to Recuse Himself.

A notice and a hearing is required prior to the award of compensation to professionals under section 330. 11 U.S.C. § 330(a). The hearing requirement means there shall be "such opportunity for a hearing as is appropriate in the particular circumstances." 11 U.S.C. § 102(1). Mr. Hancock received an appropriate hearing related to the consideration of his fee application by the Bankruptcy Court. The issues before the Bankruptcy Court were whether Mr. Hancock was entitled to fees from the bankruptcy estate, and if so, in what amount. The objections and trial memoranda filed by the United States Trustee and the Chapter 7 trustee clearly articulated their objections to Mr. Hancock's fee application.

Mr. Hancock was provided adequate time to prepare for trial. The August 20, 2008, pretrial order set the matter for hearing on September 29, 2008. At Mr. Hancock's request, the trial date was continued to October 23, 2008. He did not request a further continuance of the trial date. Mr. Hancock was afforded a full opportunity to present his evidence to the Bankruptcy Court, which took testimony from eleven witness over five days of trial. The Bankruptcy Court ultimately denied Mr. Hancock's fees based on the extensive evidence offered at trial.[22] No further process was due.

Mr. Hancock contends that he was denied due process because the bankruptcy judge did not recuse himself. That argument was forfeited because it Mr. Hancock never asked the Bankruptcy Judge to recuse himself. *See United States v. DiPina*, 230 F.3d 477, 486 (1st Cir. 2000) (defendant waived issue of bias on appeal by not moving

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[22] Mr. Hancock argues that the Bankruptcy Court improperly relied on Judge Lundin's findings in the *Innovative Entertainment* case, which Mr. Hancock alleges is extra-record, inadmissible propensity evidence. That argument is wrong for several reasons. First, given the overwhelming evidence offered in this case of Mr. Hancock's conduct, the Bankruptcy Court had no need to and did not rely on any evidence of Mr. Hancock's "propensity" to disregard his disclosure obligations. The Bankruptcy Court cited the *Innovative Entertainment* opinion as evidence that Mr. Hancock was aware of his disclosure obligation, a fact that Mr. Hancock testified to at trial. The court was entitled to take extra-judicial notice of the opinion, especially after it was referenced in the trial memoranda and in Mr. Hancock's testimony. *See Granader v. Pub. Bank*, 417 F.2d 75, 82-83 (6th Cir. 1969).

for judge's recusal or otherwise raising issue below). Further, the United States Supreme Court has found judicial recusal to be constitutionally warranted only under extraordinary circumstances, involving extremely limited factual scenarios where the judge has had either a direct, financial interest in the outcome of the case or a connection outside of the case with one of the parties that created an unconstitutional probability of bias. *Caperton v. A.T. Massey Coal Co.,* 129 S. Ct. 2252 (2009). This is not such a case. Mr. Hancock has asserted no outside connection between the bankruptcy judge and any party in this case, much less one that would warrant recusal. The Bankruptcy Court's proceedings did not create an unconstitutional probability of bias; the Bankruptcy Court's assessment of Mr. Hancock's conduct was determined after weighing the evidence presented at trial in its role as fact finder. *See Morgan v. Goldman (In re Morgan)*, 573 F.3d 615, 624 (8th Cir. 2009).[23] The opinion's portrayal of Mr. Hancock was attributable not to any bias on the part of the court, but to his own conduct.

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[23] *Morgan* applied the *Caperton* standards relied on by Mr. Hancock.

CONCLUSION

For these reasons, the United States Trustee respectfully asks this Court to affirm the orders entered below.

DATED: February 17, 2010.

Respectfully submitted,

RICHARD F. CLIPPARD
United States Trustee, Region 8

/s/ Lloyd E. Mueller

Of Counsel:

Ramona D. Elliott
General Counsel
P. Matthew Sutko
Associate General Counsel
Wendy Cox
Trial Attorney
United States Department of Justice
Executive Office of the U.S. Trustee
20 Massachusetts Ave., NW, Ste 8100
Washington, D.C. 20530
Telephone No.: (202) 307-1399

Beth Roberts Derrick
Assistant United States Trustee
Lloyd E. Mueller
Trial Attorney
United States Department of Justice
Office of the United States Trustee
701 Broadway, Suite 318
Nashville, Tennessee 37203
Telephone No.: (615) 736-2254

Attorneys for Appellee,
Richard Clippard
United States Trustee

CERTIFICATE OF COMPLIANCE WITH F.R.A.P. 32(a)

This brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B) because this brief contains 13,139 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii).

I relied on my word processor to obtain the word count and it is Corel WordPerfect12.

This brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and type style requirements of Fed. R. App. P. 32(a)(6) because this brief has been prepared in a proportionally spaced typeface in 14 point, Times New Roman style.

I certify that the information on this form is true and correct to the best of my knowledge and belief formed after a reasonable inquiry.

By: /s/ Lloyd E. Mueller
Lloyd E. Mueller

Attorney for Appellee
Richard Clippard
United States Trustee

CERTIFICATE OF SERVICE

I certify that on this 17th day of February, 2010, I caused the foregoing Brief of Appellee, Richard Clippard, United States Trustee, to be served electronically through this Court's ECF System on the following:

William Caldwell Hancock, Esq.
Appellant, Pro Se

and

Michael Gigandet, Esq.
Chapter 7 trustee
Appellee Pro Se

/s/ Lloyd E. Mueller
Lloyd E. Mueller, Esq.

Attorney for Appellee
Richard Clippard
United States Trustee

DESIGNATION OF RELEVANT DISTRICT COURT DOCUMENTS
Pursuant to Sixth Circuit Rule 30(b)

The following filings from the District Court ECF Docket, Case No. 3:09-cv-00094-AT) , are relevant documents:

Date	**ECF Docket No.**	**Title**
1/28/09	1	Appeal from Bankruptcy Court of Order dated December 9, 2008
1/29/09	2	Notice from the District Court Setting Briefing Deadlines
1/30/09	3	Notice from the District Court Cancelling the February 13, 2009 Appellant's Brief Deadline
3/12/09		Notice of Supplemental Record Received from the Bankruptcy Court: 2 Black Binders and 1 Expandable Folder of Exhibits and 2 Expandable Folders of Transcripts
3/12/09	4	Notice of Briefing Schedule
3/25/09	5	Emergency Motion for Extension of Time to File Appellant's Brief
3/26/09	6	Emergency Motion for Extension of Time to File Appellant's Brief Due March 27, 2009
3/26/09	7	Order Granting Motion for Extension of Time to File Appellant's Brief Due March 27, 2009
5/1/09	8	Second Motion for Extension of Time to File Appellant's Brief

5/11/09	9	Order Granting Motion for Extension of Time to File Appellant's Brief
8/5/09	10	Order to Show Cause: It is hereby ORDERED that, by 8/14/09, the Appellant shall show cause why this case should not be dismissed for failure to prosecute
8/14/09	11	Appellant's Brief
8/27/09	12	Motion to Dismiss Appeal, or in the Alternative, to Require Appellant to Comply with Briefing Page Limits Set in the Court's Prior Order, for Permission to File Expanded Appellees' Briefs, and for Extension of Time to File Appellees' Briefs
8/31/09	13	Order: the Appellee's Motion to Dismiss, or in the Alternative, to Require Appellant to Comply with Briefing Page Limits Set in the Court's Prior Order, for Permission to File Expanded Appellees' Briefs, and for Extension of Time to File Appellees Briefs is Granted in Part.
9/22/09	14	Appellant's Revised Brief
9/22/09	15	Motion for Extension of Time to File by William Caldwell Hancock
9/23/09	16	Order: This course of events fully justifies dismissal of this appeal with prejudice. However, the Court chooses, instead, to invoke Local Rule 81.01(a) to summarily affirm Judge Paine's Order, fully expecting the appellant to appeal further to the Sixth Circuit Court of Appeals, where he might receive a decision on the merits
9/23/09	17	Final Judgment

9/30/09	18	Notice of Appeal
10/9/09	19	Designation of Record on Appeal by William Caldwell Hancock
10/16/09	20	Designation of Record on Appeal by Richard F. Clippard, United States Trustee
12/22/09	21	Filing by William Caldwell Hancock - Bankruptcy Case Docket Sheet
12/22/09	22	Filing by William Caldwell Hancock - Debtor’s Application for Approval of Employment of Wm. Caldwell Hancock
12/22/09	23	Filing by William Caldwell Hancock - Order Approving Debtor’s Employment of Wm. Caldwell Hancock
12/22/10	24	Filing by William Caldwell Hancock - Amended First and Final Fee Application by Wm. Caldwell Hancock
12/22/09	25	Filing by William Caldwell Hancock - Emergency Request for Interim Fee Allowance by Wm. Caldwell Hancock
12/22/09	26	Filing by William Caldwell Hancock - Objection of United States Trustee to Emergency Request of Wm. Caldwell Hancock for Interim Allowance of Compensation
12/22/09	27	Filing by William Caldwell Hancock - Memorandum Opinion of Bankruptcy Court Denying All Fees

12/22/09	28	Filing by William Caldwell Hancock - Order Denying All Fees
12/22/09	29	Filing by William Caldwell Hancock - Trial Exhibit C
12/22/09	30	Filing by William Caldwell Hancock - Trial Exhibit D
12/22/09	31	Filing by William Caldwell Hancock - Various documents related to this appeal
12/22/09 `	32	Filing by William Caldwell Hancock - Trial Transcripts from the Bankruptcy Court Trial. The trial dates were: 10/23/08, 10/28/08, 10/29/08, 11/10/08, and 11/13/08.

DESIGNATION OF RELEVANT BANKRUPTCY COURT DOCUMENTS

Pursuant to Sixth Circuit Rule 30(b)

The following filings from the Bankruptcy Court ECF Docket, Case No. 07-08948, are relevant documents, (all documents designated as trial exhibits were admitted into evidence by the Bankruptcy Court during the trial on Mr. Hancock's fee application):

Date	ECF Docket No.	Title
12/3/07	1	Chapter 11 Voluntary Petition
12/5/07	24	Interim DIP Financing Order [Trial Exhibit No. 2]
12/21/07	88	Final DIP Financing Order [Trial Exhibit No. 3]
12/19/07	68	Debtor's Application to Employ Wm. Caldwell Hancock [Trial Exhibit No. 5]
1/3/08	134	Debtor's Statement of Financial Affairs [Trial Exhibit No. 6]
1/3/08	136	Attachment to Debtor's Statement of Financial Affairs reflecting responses to SOFA 3.b. pp. 1 - 24, and SOFA 3.c. p.1 [Trial Exhibit No. 6]
1/3/08	137	Debtor's Bankruptcy Schedules, A -H [Trial Exhibit No. 7]
1/16/08	173	Debtor's Monthly Operating Report
1/16/08	176	Complaint for Declaratory Judgment and Injunctive Relief against SCS General Contractors, Inc. [Trial Exhibit No. 8]
1/18/08	182	Agreed Cash Collateral Order [Trial Exhibit No. 9]

1/18/08	184	Order Approving the Employment of Wm. Caldwell Hancock [Trial Exhibit No. 10]
1/28/08	205	Order Approving Sale of 16 Restaurants [Trial Exhibit No. 11]
2/1/08	225	Second Agreed Cash Collateral Order [Trial Exhibit No. 12]
2/15/08	263	Third Agreed Cash Collateral Order [Trial Exhibit No. 13]
2/4/08	236	Debtor's Motion to Sell Four Restaurants [Trial Exhibit No. 15]
2/5/08	241	Order Setting the Motion to Sell the Four Restaurants for Hearing, entered on February 5, 2008 [Trial Exhibit No. 16]
2/8/08	249	First Amended Complaint for Declaratory Judgment against SCS General Contractors [Trial Exhibit No. 17]
2/15/08	267	Monthly Operating Report
2/19/08	276	Order Setting Debtor's Motion to Obtain Insurance Financing for Hearing, entered on February 19, 2008 [Trial Exhibit No. 18]
2/29/08	317	Order Approving the Sale of Four Restaurants [Trial Exhibit No. 19]
2/29/08	318	Order Overruling the Objections to the Sale of Four Restaurants [Trial Exhibit No. 20]

3/4/08	326	Expedited Motion of Wells Fargo Bank Prohibiting Use of Cash Collateral [Trial Exhibit No. 21]
3/4/08	329	Debtor's Response to the Motion of Wells Fargo Bank [Trial Exhibit No. 22]
3/5/08	330	Debtor's Motion for the Appointment of an Examiner to Investigate the Misconduct of Wells Fargo Bank [Trial Exhibit No. 23]
3/5/08	331	Letter from Wells Fargo Bank to Mr. Hancock dated February 29, 2008 [Trial Exhibit No. 24]
3/6/08	335	Order Setting the Expedited Motion of Wells Fargo Bank for Hearing on March 11, 2008 [Trial Exhibit No. 25]
3/5/08	333	Order Setting the Debtor's Expedited Motion to Appoint an Examiner to Investigate Wells Fargo Bank for Hearing on March 11, 2008 [Trial Exhibit No. 26]
3/10/08	344	Committee's Expedited Motion to Appoint Chapter 11 Trustee or Convert Case to Chapter 7 [Trial Exhibit No. 27]
3/10/08	345	Committee's Response to the Motion to Prohibit Use of Cash Collateral [Trial Exhibit No. 28]
3/13/08	353	Order Resolving Motion to Prohibit Use of Cash Collateral [Trial Exhibit No. 29]

3/11/08	350	Order Setting Hearing Committee’s Motion to Appoint Chapter 11 Trustee or Convert Case to Chapter 7 for Hearing [Trial Exhibit No. 30]
3/18/08	360	Expedited Motion to Approve Global Settlement Agreement [Trial Exhibit No. 31]
4/8/08	401	Order Approving Global Settlement Agreement [Trial Exhibit No. 32]
4/9/08	404	Certificate of Service, filed on April 9, 2008 [Trial Exhibit No. 33]
4/18/08	410	Mr. Hancock’s Motion to Withdraw as Debtor’s Counsel [Trial Exhibit No. 34]
4/22/08	414	Debtor’s Monthly Operating Report [Trial Exhibit No. 35]
4/23/08	415	Expedited Motion to Convert Case to Chapter 7 [Trial Exhibit No. 36]
4/23/08	418	Expedited Motion to Set the Motion of Debtor’s Counsel to Withdraw for an Expedited Hearing filed by the Unsecured Creditors’ Committee [Trial Exhibit No. 37]
4/23/08	421	Order Setting Hearing on the Expedited Motion to Convert Case to Chapter 7 filed by the unsecured Creditors’ Committee [Trial Exhibit No. 38]
4/23/08	423	Rule 60(b) Motion, filed by Mr. Hancock [Trial Exhibit No. 39]
4/23/08	429	Debtor’s Initial Objection to the Motion to Convert Case to Chapter 7 [Trial Exhibit No. 40]

4/28/08	437	Further Objection of the Committee to the Rule 60(b) Motion [Trial Exhibit No. 41]
4/28/08	438	Response of Wells Fargo Bank to the Rule 60(b) Motion [Trial Exhibit No. 42]
4/28/08	439	Response of Spirit Finance to the Rule 60(b) Motion [Trial Exhibit No. 43]
4/28/08	440	Response of Performance Food Group to the Rule 60(b) Motion [Trial Exhibit No. 44]
4/28/08	441	Notice of Conversion from Chapter 11 to Chapter 7
4/28/08	443	Notice of Withdrawal of Rule 60(b) Motion [Trial Exhibit No. 45]
4/30/08	447	Order Converting Case to Chapter 7 [Trial Exhibit No. 46]
5/2/08	451	Order Granting Motion of Debtor’s Counsel to Withdraw [Trial Exhibit No. 47]
4/30/08	448	Michael Gigandet Appointed Chapter 7 Trustee
6/3/08	479	Mr. Hancock’s Application for Interim Attorneys Fees [Trial Exhibit No. 48]
6/3/08	487	Mr. Hancock’s Amended Application for Interim Attorneys Fees [Trial Exhibit No. 49]
6/24/08	502	U.S. Trustee’s Objection to Mr. Hancock’s Application for Attorneys Fees [Trial Exhibit No. 50]

6/25/08	507	Motion for Expedited Hearing on the U.S. Trustee's Motion to Set Pretrial Hearing
6/26/08	513	Order Scheduling Hearing on the U.S. Trustee's Motion to Set Pretrial Conference
6/27/08	515	Chapter 7 Trustee's Motion to Compromise and Settle [Trial Exhibit No. 51]
7/2/08	521	Order Scheduling Hearing on Second Pretrial Conference and Setting Deadline for Wm. Caldwell Hancock to File Final Fee Application on or before July 3, 2008
7/2/08	524	Order Scheduling Hearing on Second Pretrial Conference and Setting Deadline for William Caldwell Hancock to File Final Fee Application
7/3/08	526	Mr. Hancock's Motion for Expedited Order on Application to Reschedule Final Fee Filing Deadline and Pretrial Conference
7/3/08	531	Order Granting Application (Related Docket # 526) that the final fee application shall be filed on or before 7/7/07
7/3/08	531	Order Granting Mr. Hancock's Request for Extension to File His Final Fee Application
7/7/08	541	Mr. Hancock's First and Final Fee Application [Trial Exhibit No. 52]
7/17/08	586	Notice of Amendment to Mr. Hancock's First and Final Fee Application [Trial Exhibit No. 53]

7/21/08	596	Mr. Hancock's Objection to the Chapter 7 Trustee's Motion to Compromise and Settle [Trial Exhibit No. 54]
7/25/08	623	Objection filed by the U.S. Trustee to Mr. Hancock's First and Final Fee Application [Trial Exhibit No. 55]
8/6/08	636	Objection filed by the U.S. Trustee to Mr. Hancock's Amended First and Final Fee Application [Trial Exhibit No. 56]
8/8/08	639	Mr. Hancock's Motion for Payment of Interim Distribution [Trial Exhibit No. 57]
8/18/08	656	U.S. Trustee's Objection to the Motion for Payment of Interim Distribution [Trial Exhibit No. 58]
8/20/08	658	Pretrial Order Concerning Fee Objection Hearing [Trial Exhibit No. 59]
8/29/08	663	Notice of Deposition of Robert Langford on 9/4/08
8/29/08	664	Notice of Deposition of Craig Barber on 9/9/08
9/8/08	670	Notice of Deposition of Natalie Horel on 9/10/08
9/12/08	673	The U.S. Trustee's Witness List [Trial Exhibit No. 60]
9/18/08	677	Mr. Hancock's Motion to Continue Hearing on His Fee Application

9/18/08	679	Objection of the U.S. Trustee to the Motion to Continue Hearing filed by William Caldwell Hancock
9/18/08	680	Order Continuing Hearing on Fee Objections to October 23, 2008 [Trial Exhibit No. 61]
9/18/08	683	Mr. Hancock's Notice of Withdrawal of Objection to the Chapter 7 Trustee's Proposed Settlement [Trial Exhibit No. 62]
9/23/08	693	Subpoena Return of Service on Robert M. Langford filed by the U.S. Trustee
9/23/08	694	Subpoena Return of Service on Robert J. Mendes filed by the U.S. Trustee
9/23/08	695	Subpoena Return of Service on Natalie Horel filed by the U.S. Trustee
9/23/08	696	Subpoena Return of Service on W. Craig Barber filed by the U.S. Trustee
9/23/08	697	Subpoena Return of Service on James R. Kelly filed by the U.S. Trustee
9/24/08	700	Order Granting U.S. Trustee's Motion to Modify Order Rescheduling Objection Trial Date and Requiring Witnesses to Appear at Rescheduled Trial
10/9/08	706	U.S. Trustee's Expedited Motion for a Protective Order Related to the October 23, 2008, Hearing on the Objections Filed by the U.S. Trustee and the Chapter 7 Trustee to the Fee Applications filed by William Caldwell Hancock

10/12/08	708	Motion for Protective Order filed on behalf of Trustee
10/13/08	709	Response to Motions of the U.S. Trustee and the Chapter 7 Trustee for Protective Order
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BRIEF BANK — "SUMMARY SHEET"

Printed Fri-1/22/10 13:31

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]* — Bobby Hardwick, doing business as Carol & Kisha Enterprises, Inc. v. Donald F. Walton United States Trustee, Region 21

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]* — S. D. Ga.

3. ("CCN") ***CURRENT*** CASE NO. — No.: 1:09-cv-00129-DHB-WLB

4. ("PCN") ***PRIOR*** CASE NO. - & COURT *[IF ANY]* — No.: 08-10280-SDB and 09-01011-SDB

Court: Bankr. S.D. Ga.

(Identify judge & cite, if any)

5. ("SO") ***SOURCE*** — **U.S. TRUSTEES**

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]* — Filed: January 14, 2010

Type: Brief of Appellee Donald F. Walton, United States Trustee, Region 21

7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]* — Matthew E. Mills, Anne Stukes, P. Matthew Sutko,

(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC*** — **BANKRUPTCY**

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND*** — • Does this court have jurisdiction to hear this appeal under 28 U.S.C. § 158(a)? In the alternative, did the bankruptcy court err in denying appellant's claims that 11 U.S.C. § 110 is unconstitutional; and did the bankruptcy court err in holding that appellant is a bankruptcy petition preparer as defined by said statute?

10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)

11. DO YOU RECOMMEND POSTING IN UST BRIEFBANK? — YES [✓ x] NO ☐ — ***NAME:*** Linda Figueroa ***DATE:***

IN THE UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF GEORGIA

CASE NO. CV1:09-129

BOBBY HARDWICK, doing business as
Carol & Kisha Enterprises, Inc.,

Appellant,

v.

DONALD F. WALTON, United States
Trustee, Region 21,

Appellee.

On Appeal from the United States Bankruptcy Court
for the Southern District of Georgia

BRIEF OF APPELLEE DONALD F. WALTON, UNITED STATES TRUSTEE, REGION 21

Of Counsel:

P. MATTHEW SUTKO
Office of the General Counsel
Executive Office for United States Trustees
United States Department of Justice
20 Massachusetts, Ave. NW, Ste 8100
Washington, D.C. 20530
Tel: (202) 307-1399

MATTHEW E. MILLS
Assistant United States Trustee
Georgia Bar No. 509718
Office of the United States Trustee
222 West Oglethorpe Avenue
Suite 302
Savannah, Georgia 31401
(912) 652-4112

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STATEMENT OF JURISDICTION

This appeal arises from an interlocutory order issued by the United States Bankruptcy Court for the Southern District of Georgia (Susan D. Barrett, J.) on September 11, 2009, denying Appellant Bobby Hardwick's motion to dismiss an adversary proceeding initiated by Appellee United States Trustee alleging that Appellant violated 11 U.S.C. § 110 in connection with the preparation of Suzette M. Wilson's ("Debtor") bankruptcy petition and schedules. This Court lacks jurisdiction over this appeal pursuant to 28 U.S.C. § 158(a) because the order appealed from is not final, leave for an interlocutory appeal was not obtained, and leave should not be granted.

STATEMENT OF ISSUES PRESENTED

Does this Court have appellate jurisdiction to hear this appeal under 28 U.S.C. § 158(a)?

In the alternative, did the bankruptcy court err in denying Appellant's claims that 11 U.S.C. § 110 is unconstitutional; and did the bankruptcy court err in holding that Appellant is a bankruptcy petition preparer as defined by said statute?

STANDARD OF APPELLATE REVIEW

This Court has an obligation to review its own jurisdiction *sua sponte*. In re

Donovan, 532 F.3d 1134, 1136 (11th Cir. 2008).

Where appellate jurisdiction exists, courts "independently review the bankruptcy court's decision, applying the 'clearly erroneous' standard to findings of fact and de novo review to conclusions of law'. . . . [Where the issue] poses a mixed question of law and fact, [the court applies] the clearly erroneous standard, unless the bankruptcy court's analysis was 'infected by legal error...'" In re Winthrop Old Farm Nurseries, Inc., 50 F.3d 72, 73 (1st Cir. 1995) (citations omitted). See also Fed. R. Bankr. P. 8013 (standard of appellate review).[1]

STATEMENT OF THE CASE

Appellant appeals from the interlocutory order denying his motion to dismiss, contending that the bankruptcy court erred in denying his claims that 11 U.S.C. § 110 is unconstitutional and erred in holding that he is a bankruptcy petition preparer and therefore subject to the provisions of said statute. Although Appellant filed a motion for leave to appeal in the bankruptcy court, that court did

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[1] A finding of fact is clearly erroneous "when although there is evidence to support it, the reviewing court on the evidence is left with the definite and firm conviction that a mistake has been committed . . . ." United States v. United States Gypsum Co., 333 U.S. 364, 395 (1948). "When the finding of fact is premised on an improper legal standard, or a proper one is improperly applied, that finding loses the insulation of the clearly erroneous rule . . . ." Wilson v. Huffman (In re Missionary Baptist Foundation of America, Inc.), 712 F.2d 206, 209 (5th Cir. 1983).

not rule upon the motion before transmitting the appellate record to this Court. Appellant did not file a motion for leave to appeal in this Court, but his notice of appeal may be construed as such a motion.

STATEMENT OF FACTS

Prior to filing for bankruptcy relief, debtor Suzette Wilson (hereinafter "Debtor") sought the assistance of Bobby Hardwick and/or his company Carol & Kisha Enterprises in preparing her bankruptcy petition. Appellant Hardwick acknowledges he is not an attorney and that he assisted Debtor in the preparation and filing of her bankruptcy petition and schedules. He also admits that Debtor provided him with $375.00 at the time of his assistance. However, he contends that the money does not constitute "compensation" as that term is used in 11 U.S.C. § 110(a), but merely a "donation." Appellant Hardwick signed Debtor's petition under penalty of perjury stating:

> I declare under penalty of perjury that: (1) I am a bankruptcy petition preparer as defined in 11 U.S.C. §110; (2) I prepared this document for compensation and have provided the debtor with a copy of this document and the notices and information required under 11 U.S.C. §§110(b), 110(h), and 342(b); and (3) if rules or guidelines have been promulgated pursuant to 11 U.S.C. §110(h) setting a maximum fee for services chargeable by bankruptcy petition preparers, I have given the debtor notice of the maximum amount before preparing any document for filing for a debtor or accepting any fee from the debtor, as required in that section. Official Form 19 is attached.

(Petition, underlying bankruptcy case No. 08-10280, Bankruptcy Court Docket No. 1, p. 3).

The United States Trustee filed an adversary complaint against Mr. Hardwick, asserting violations of 11 U.S.C. § 110. In Count I, the United States Trustee asserts Hardwick violated 11 U.S.C. §110(b)(2)(B) by failing to file the required notice informing Debtor about the legal limitations of a bankruptcy petition preparer. In Count II, the United States Trustee alleges Hardwick violated 11 U.S.C. § 110(c) by failing to provide his full social security number on the petition. In Count III, the United States Trustee asserts Hardwick violated 11 U.S.C. § 110(e) by giving legal advice to the Debtor. Count IV alleges a violation of 11 U.S.C. § 110(f) for using the word "legal" in advertisements. Count V seeks the turnover of fees Debtor paid Hardwick pursuant to 11 U.S.C. § 110(h), alleging the fees exceed the value of services rendered. Count VI seeks an injunction prohibiting Hardwick from acting as a bankruptcy petition preparer in the Southern District of Georgia.

In response to the United States Trustee's complaint, Hardwick filed a pro se counterclaim and motion to dismiss moving to dismiss the complaint "based on the fact that [11] U. S. C. [§]110. . .is unconstitutional in that it violate[s] [Hardwick's] First and 14th amendment right to freedom of expression and due process of and equal protection of the law." (Motion to Dismiss, Bankruptcy Dckt. No. 5). In his motion to dismiss and at the hearing thereon, Hardwick argued that § 110 is unconstitutional because it is vague, overly broad and fails to state a legitimate government interest. He also argued that even if the statute is constitutional, the statute is not applicable to him because he is not a bankruptcy petition preparer as defined by § 110 since he received a "donation," not compensation for his services.

The bankruptcy court denied Hardwick's motion to dismiss, holding that 11 U.S.C. § 110 is constitutional and that Hardwick is a bankruptcy petition preparer subject to said statute (hereinafter "Order Denying Motion to Dismiss").

SUMMARY OF ARGUMENT

This appeal should be dismissed for lack of jurisdiction. An order denying a motion to dismiss is not final and appealable under 28 U.S.C. § 158(a), nor is this a case appropriate for interlocutory review under 28 U.S.C. § 158(a)(3).

In the alternative, if the Court should find that it has appellate jurisdiction, the bankruptcy court's order should be affirmed.

ARGUMENT AND CITATION OF AUTHORITY

I. This case should be dismissed for lack of jurisdiction.

A threshold issue in any case is whether the Court has jurisdiction; the Court is obligated to consider jurisdiction even if it means raising the issue *sua sponte*. See In re Donovan, 532 F.3d 1134, 1136 (11th Cir. 2008).

In bankruptcy cases, district courts generally have jurisdiction to hear appeals from final judgments, orders, and decrees of bankruptcy courts, as well as, in certain circumstances, some interlocutory orders. 28 U.S.C. § 158(a). If the order under appeal is interlocutory, the appellant must obtain leave to appeal. 28 U.S.C. § 158(a)(3). In this case, there is no appellate jurisdiction because the order under appeal — a denial of a motion to dismiss — is not final, and leave to appeal was not obtained. Nor should leave to appeal be granted.

To be "final" under 28 U.S.C. § 158, an order must end the litigation on the merits, leaving nothing to be done but execute the judgment. Jove Eng'g v. IRS, 92 F.3d 1539, 1547-48 (11th Cir. 1996). Even in the bankruptcy context, where finality is given a more flexible interpretation, see id., "the particular adversary proceeding or controversy . . . must have been finally resolved" for an order to be considered "final." Commodore Holdings, Inc. v. Exxon Mobil Corp., 331 F.3d 1257, 1259 (11th Cir. 2003); accord In re Donovan, 532 F.3d at 1136 (finding denial of motion to dismiss non-final).

Appellant Hardwick seeks review of an order that denied his motion to dismiss an adversary proceeding. See Bankruptcy Dckt. Nos. 14 (order) and 18 (notice of appeal); see also Fed. R. Bankr. P. 7001 (defining adversary proceedings). An order denying a motion to dismiss bears none of the hallmarks of a final order. Rather than resolving the case or controversy, an order denying a motion to dismiss means that the case will continue. And indeed, in the bankruptcy court below, the adversary proceeding is continuing. In short, a denial of a motion to dismiss — which does not conclusively resolve any adversary proceeding or claim — is not final, and hence it is not appealable as of right under 28 U.S.C. § 158(a)(1). See In re Donovan, 532 F.3d at 1137 (holding that denial of a motion to dismiss a Chapter 7 bankruptcy case is not final and appealable under 28 U.S.C. § 158); see also In re Ted A. Petras Furs, Inc., No. 95-5056, 100 F.3d 943, 1996 WL 49255, *2 (2d Cir. Feb. 7, 1996) (holding that a denial of a motion to dismiss a bankruptcy adversary proceeding is not final).

Because an order denying a motion to dismiss an adversary proceeding is not final, it may be reviewed in an interlocutory appeal only with leave of court. See 28 U.S.C. § 158(a)(3). Under Rule 8003 of the Federal Rules of Bankruptcy Procedure, this Court may grant leave to appeal even if no motion for leave to appeal has been filed.[2] *See* Fed. R. Bankr. P. 8003(c).[3] In considering whether to

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[2] In the bankruptcy court, Appellant Hardwick filed a motion for leave to appeal, but the bankruptcy court did not rule on it and simply transmitted the record on appeal to this court. See Bankruptcy Dckt. Nos. 20 (motion), 50 (transmittal).

grant leave, courts use the same standards as govern the district courts' certification of interlocutory appeals to the circuit courts under 28 U.S.C. § 1292(b). See Ablitt & Caruolo, P.C. v. Michaud, 2006 WL 1788329, *1 (D.N.H. 2006) (denying leave to appeal from an order denying a motion to dismiss an adversary proceeding) (citing In re Bank of New Eng. Corp., 218 B.R. 643, 652 (1st Cir. B.A.P. 1998)). Accordingly, this Court should determine whether the bankruptcy court's order "involves a controlling question of law as to which there is substantial ground for difference of opinion and that an immediate appeal from the order may materially advance the ultimate termination of the litigation." 28 U.S.C. § 1292(b).

Regardless of whether the issues of law here might be controlling, allowing this immediate appeal will not materially advance the ultimate termination of the litigation. The adversary proceeding is still going forward in the bankruptcy court, and Appellant Hardwick may prevail, obviating the need for his appeal. See In re

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[3] Federal Rule of Bankruptcy Procedure 8003(c) provides in pertinent part:

> (c) *Appeal Improperly Taken Regarded as a Motion for Leave to Appeal.* If a required motion for leave to appeal is not filed, but a notice of appeal is timely filed, the district court or bankruptcy appellate panel may grant leave to appeal or direct that a motion for leave to appeal be filed. The district court or the bankruptcy appellate panel may also deny leave to appeal but in so doing shall consider the notice of appeal as a motion for leave to appeal. Unless an order directing that a motion for leave to appeal be filed provides otherwise, the motion shall be filed within 10 days of entry of the order.

Ted A. Petras Furs, Inc., 1996 WL 49255, *2 (finding no jurisdiction over interlocutory appeal). Moreover, if Mr. Hardwick should not prevail in the adversary proceeding, the issues he raises in this interlocutory appeal will be reviewable in an appeal from the final order. In short, there is no practical reason to hear the appeal now. Rather than expediting the termination of the litigation, allowing the appeal will prolong the case and create more work for the parties and the courts. And for the reasons discussed in the remaining sections of this brief, there is not "substantial ground for difference of opinion" about the questions of law presented by Appellant Hardwick.

Accordingly, the Court should dismiss this appeal for lack of jurisdiction under 28 U.S.C. § 158(a).

II. In the alternative, Appellant's arguments that 11 U.S.C. § 110 is unconstitutional are flawed.

If this Court should find that it has appellate jurisdiction, it should affirm the bankruptcy court's order.

Appellant's brief describes 11 U.S.C. § 110 as "vague," "overly broad," and inconsistent with "freedom of speech" and "equal protection." The brief does not contain sections that isolate and expand upon these claims; rather, the constitutional buzz words are placed in various parts of the brief with little or no legal development.[4] As such, Appellee United States Trustee will address Appellant's constitutional arguments here as an initial matter.

"When considering challenges to the constitutionality of a statute, the Court begins with the presumption that acts of Congress are constitutional." Martini v. We The People Forms & Serv. Ctr. USA, Inc. (In re Barcelo), 313 B.R. 135, 140 (Bankr. E.D. N.Y. 2004) quoting Usery v. Turner Elkhorn Mining Co., 428 U.S. 1, 15 (1976). "[L]aws regulating economic activity not involving constitutionally protected conduct are subject to a quite lenient test for constitutional sufficiency." Zolq v. Kelly (In re Kelly), 841 F.2d 908, 915 (9th Cir. 1988); Village of Hoffman Estates v. Flipside, Hoffman Estates, Inc., 455 U.S. 489, 494 (1982).

Vagueness

In different parts of his brief, Appellant refers to 11 U.S.C. § 110 as "vague" and therefore constitutionally invalid. For example, Appellant's brief at page 12 asserts that because 11 U.S.C. § 110(h) contains no maximum or minimum fee for

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[4] Pro se pleadings are to be reviewed liberally and held to a less stringent standard than those drafted by attorneys. Hughes v. Lott, 350 F.3d 1157, 1160 (11th Cir. 2003). However, courts will not act as de facto counsel for pro se parties or rewrite deficient pleadings. GJR Investments, Inc. v. County of Escambia, Fla., 132 F.3d 1359, 1369 (11th Cir. 1998). A party does not sufficiently raise an issue on appeal when he mentions the issue in his brief without providing specific arguments in support of the issue. Greenbriar, Ltd. v. City of Alabaster, 881 F.2d 1570, 1573, n.6 (11th Cir. 1989); see also Lovett v. Ray, 327 F.3d 1181, 1183 (11th Cir. 2003) (holding an argument raised for first time in pro se litigant's reply brief was not properly before appellate court).

bankruptcy petition preparers, it is vague and therefore constitutionally invalid. Appellant's brief at page 15 seems to assert that the entire statute is vague because it "does not lay out any requirements for a Bankruptcy Petition Preparer." Appellant's contention of vagueness is demonstrably incorrect.

A statute is not unconstitutionally vague if it gives a "person of ordinary intelligence a reasonable opportunity to know what is prohibited, so that he may act accordingly." See generally McConnell v. Federal Election Com'n, 540 U.S. 93, 170 n.64 (2003); see Scott v. United States (In re Doser), 412 F. 3d 1056, 1062 (9th Cir. Idaho 2005) (a statute is vague if "'men of common intelligence must necessarily guess at its meaning and differ as to its application'"), quoting United States v. Hugs, 384 F. 3d 762, 768 (9th Cir. 2004). "Fair notice is provided when prohibitions are clearly defined, but such definition does not limit courts to a mechanical application which would lack relevance to the subject of the regulation." Gould et. al. v. Clippard, 340 B.R. 861, 884 (M.D. Tenn. 2006).

Within this analytical framework, it is worthwhile to examine the individual subsections of 11 U.S.C. § 110. For purposes of this appeal, the relevant subsections are §§ 110(a) - (h).

Section 110(a) is not vague. It clearly defines a bankruptcy petition preparer as "a person, other than an attorney or an employee of an attorney, who prepares for compensation a document for filing in a bankruptcy case.” 11 U.S.C. §110(a).

Sections 110(b)(1) and (2) are also not vague. These subsections provide that notice must be given to the debtor that the bankruptcy petition preparer is not an attorney and that he may not give legal advice. These subsections unambiguously identify the party required to sign the notice and direct that the notice must be filed with court. 11 U.S.C. § 110(b)(1). Section 110(b)(2) provides specific language to include in the notice to the Debtor. There is no ambiguity as to what conduct is prohibited by these subsections.

Section 110(c) is not vague. It clearly requires the social security number of the bankruptcy petition preparer to be provided in the petition and if the bankruptcy petition preparer is a corporation then the social security number of the officer is required. 11 U.S.C. § 110(c).

Section 110(d) is not vague. It requires that “[a] bankruptcy petition preparer shall, not later than the time at which a document for filing is presented for the debtor’s signature, furnish to the debtor a copy of the document.” 11 U.S.C. § 110(d).

Section 110(e) is not vague. It provides that a bankruptcy petition preparer is prohibited from executing any document on behalf of a debtor. It also prohibits a petition preparer from giving legal advice to a debtor, including but not limited to whether to file bankruptcy, whether to file it in a particular chapter, whether debts will be discharged, whether the debtor will be able to retain a home or car, the tax consequences of a bankruptcy case, the advisability of reaffirmation agreements, and how to characterize the nature of the debtor's interests in property. 11 U.S.C. §110(e).

Section 110(f) unambiguously prohibits the use of the word "legal" in advertisements. Section 110(g), in a similar clear-cut fashion, prohibits a petition preparer from collecting any payment for filing fees.

Section 110(h) provides that the court "shall disallow and order the immediate turnover to the bankruptcy trustee of any fee . . . found to be in excess of the value of any services . . . ."[5]

Courts that have previously considered the challenges raised by Appellant Hardwick have found 11 U.S.C. § 110 clear and not unconstitutionally vague. As stated by the Ninth Circuit Court of Appeals, ". . . it is clear to whom the provisions of the statute apply and anyone performing the services of a Bankruptcy

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[5] Appellant contends that it is vague and arbitrary to allow the United States Trustee (and presumably a bankruptcy court) to determine what constitutes an "excessive" fee when the statute provides no parameters. This specific argument is addressed below in section VI.

Petition Preparer are on notice of what conduct is forbidden by statute." In re Doser, 412 F. 3d 1056, 1062 (9th Cir. 2005).

It is difficult to think of provisions that are *less* vague that the ones set forth in 11 U.S.C. § 110. Appellee United States Trustee is not aware of any cases holding any portion of 11 U.S.C. § 110 to be unconstitutionally vague. As stated in Gould:

> [N]umerous courts have carefully examined and parsed the text of the subsections [of 11 U.S.C. §110] and found that both the prohibited conduct and the resultant sanctions are clearly defined, identifiable under ordinary facts and circumstances, and amenable to application without a subjective analysis. In re Rose, 314 B.R. 663, 688-690 (Bankr. E.D. Tenn. 2004) (§110 not vague because ordinary person can deduce meaning); In re Barcelso, 313 B.R. 135, 144-45 (Bankr. E.D.N.Y. 2004) (general terms do not render statute unconstitutionally vague when it would be impossible for Congress to codify a list); In re Doser, 292 B.R. 652, 658 (D. Idaho 2003) (statute provides definitions which constitutionally place person of ordinary intelligence on notice of prohibited conduct); In re Moore, 290 B.R. 287, 297-98 (Bankr. E.D.N.C. 2003) (§110(h) clearly . . . limits [bankruptcy petition preparers] to typing documents as directed by customers); In re Bush, 275 B.R. 69, 84-85 (Bankr. D. Idaho 2002) (same); In re Guttierez, 248 B.R. 287, 299 (Bankr. W.D. Tex. 2000) (same).

Gould, 340 B.R. at 885.

In support of his assertion of vagueness, Appellant Hardwick urges the Court to follow Coates v. City of Cincinnati, 402 U.S. 611, 614 (1971), where the

Supreme Court held a city ordinance was unconstitutionally vague because it did not specify the type of "annoying" conduct that merited criminal prosecution. Coates, 402 U.S. at 614. The Supreme Court held the term "annoying" was overbroad and could encompass too many types of legally permissible conduct. As demonstrated above and unlike the ordinance in Coates, the individual subsections of 11 U.S.C. § 110 define the prohibited conduct with great specificity. Thus, Mr. Hardwick's assertions regarding vagueness should fail.

Overbreadth

In various parts of his brief, Appellant describes 11 U.S.C. § 110 as "broad" or "much to broad," but provides little or no development of this assertion. Courts addressing this specific issue have found § 110 to be constitutional and not overly broad. See In re Rose, 314 B.R. 663, 688-690 (Bankr. E.D. Tenn. 2004); In re Doser, 292 B.R. at 658. The Court in Doser explained:

> In the case of a statute where 'despite some possibly impermissible application, the remainder of the statute covers a whole range of easily identifiable and constitutionally proscribable conduct[,]' the Court will not strike the statute for being overbroad. Secretary of State of Maryland v. J.H. Munson Co., 467 U.S. 947, 964-65, 104 S.Ct. 2839, 2851, 81 L. Ed. 2d 786 (1984) (quotations omitted). Such is the case here. Section 110 is limited to proscribing unfair and deceptive conduct by [bankruptcy petition preparers]. The Court may easily construe §110 to avoid constitutional problems. New York v. Ferber, 458 U.S. 747, 769-70, 102 S. Ct. 3348, 3361-62, 73 L.Ed.2d 1113 (1982). Section 110 is limited to a narrow range of conduct, and the

Court concludes that §110 is not overbroad.

Doser, 292 B.R. at 658.

Other Assertions of Constitutional Invalidity

Appellant employs other constitutional buzz words like “equal protection” and “freedom of expression,” but as noted by the bankruptcy court, Appellant has no fundamental right to be a bankruptcy petition preparer without reasonable government regulation.[6] See Dent v. West Virginia, 129 U.S. 114, 121-22 (1889) (reasonable regulation is allowed to protect citizens from “ignorance and incapacity, as well as deception and fraud” and “there is no arbitrary deprivation of such right [to pursue a lawful occupation] where its exercise is not permitted because of a failure to comply with conditions imposed by the government for the protection of society”); In re Kaitangian, 218 B.R. 102, 107 (Bankr. S.D. Cal. 1998) (equal protection argument failed as there is no fundamental right to be a bankruptcy petition preparer). As stated by the bankruptcy court, section 110 “promotes the government’s legitimate interest in preventing fraud and deception upon unsophisticated debtors.”[7]

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[6] Order Denying Motion to Dismiss at page 29.

[7] Order Denying Motion to Dismiss at page 29.

III. Appellant's argument that Georgia law supercedes 11 U.S.C. § 110(f) was never raised in the bankruptcy court and is otherwise without merit.

Appellant's first enumerated argument is that 11 U.S.C. § 110(f)'s prohibition against the use of the word "legal" in advertisements by a bankruptcy petition preparer conflicts with Georgia law. This argument fails for two reasons. First, Appellant Hardwick never raised this issue in the underlying case. There is no mention of this argument in his bankruptcy-level pleadings, nor did he raise this argument orally at the hearing on his motion to dismiss.[8] At the hearing, he argued that 11 U.S.C. § 110(f) was unconstitutional because it violated his right to free speech,[9] but he never specifically argued that this Code section conflicted with Georgia law. His new argument on appeal involves the interplay between state law and federal law which implicates preemption and conflict of law issues. These issues were never addressed by the bankruptcy court because Appellant never raised them. Millennium Partners, L.P. v. Colmar Storage LLC, 494 F.3d 1293,

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[8] See Report and Recommendation to the United States District Court to Deny In Forma Pauperis to Movant, signed by Bankruptcy Judge Susan Barrett on October 9, 2009 (Bankruptcy Court Docket No. 38), at page 7, stating "Furthermore, Mr. Hardwick has failed to state a non-frivolous claim, as his appeal attempts to raise new issues or theories for the district court to consider on appeal which were not previously raised in the bankruptcy court. See Ford v. United States, 989 F.2d 450, 453 (11th Cir. 1993)."

[9] See Order Denying Motion to Dismiss, pages 19-20, refuting Appellant's argument. Appellant Hardwick also argued that he cannot notify people that he cannot give legal advice if he cannot use the word legal in advertisements, but he never mentioned any potential conflict with Georgia law. His argument that he cannot give proper notice without using the word "legal" in advertisements is specious.

1304 (11th Cir. 2007) (arguments raised for the first time on appeal are not properly before the court); In re J.H. Inv. Servs., Inc., 418 B.R. 413, 424 (M.D. Fla. 2009) (party appealing from bankruptcy court order to district court cannot raise issue for the first time on appeal).

Second, even if this issue had been raised in the underlying court, Appellant's contention is without merit. There is no conflict between 11 U.S.C. § 110(f) and O.C.G.A. § 15-19-51. The Bankruptcy Code section provides as follows:

> A bankruptcy petition preparer shall not use the word "legal" or any similar term in any advertisements, or advertise under any category that includes the word "legal" or any similar term.

11 U.S.C. § 110(f).

The Georgia law O.C.G.A. § 15-19-51, despite Appellant's contention, does not conflict with bankruptcy law. No provision of O.C.G.A. § 15-19-51 authorizes non-lawyers to use the word "legal" in advertisements.[10]

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[10] The Georgia law provides:

(a) It shall be unlawful for any person other than a duly licensed attorney at law:

> (1) To practice or appear as an attorney at law for any person other than himself in any court of this state or before any judicial body;
>
> (2) To make it a business to practice as an attorney at law for any person other than himself in any of such courts;

Appellant's brief at pages 3-4 implies that the Georgia statute *requires* non-attorneys to use the word "legal" in advertisements in order to notify the public that they cannot provide legal advice. To the contrary, the Georgia statute prohibits non-attorneys from holding themselves out as lawyers or as people who can provide legal advice. O.C.G.A. § 15-19-51. The Bankruptcy Code prohibition against using the word "legal" in an advertisement does not conflict with, but rather parallels, the Georgia statute. Section 110(f) seeks to avoid public confusion and prohibits advertisements that might mislead the public into thinking legal

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> > (3) To hold himself out to the public or otherwise to any person as being entitled to practice law;
> >
> > (4) To render or furnish legal services or advice;
> >
> > (5) To furnish attorneys or counsel;
> >
> > (6) To render legal services of any kind in actions or proceedings of any nature;
> >
> > (7) To assume or use or advertise the title of "lawyer," "attorney," "attorney at law," or equivalent terms in any language in such manner as to convey the impression that he is entitled to practice law or is entitled to furnish legal advice, services, or counsel; or
> >
> > (8) To advertise that either alone or together with, by, or through any person, whether a duly and regularly admitted attorney at law or not, he has, owns, conducts, or maintains an office for the practice of law or for furnishing legal advice, services, or counsel.
>
> (b) Unless otherwise provided by law or by rules promulgated by the Supreme Court, it shall be unlawful for any corporation, voluntary association, or company to do or perform any of the acts recited in subsection (a) of this Code section.

GA. CODE ANN. § 15-19-51.

services are provided by non-attorney bankruptcy petition preparers. In re Calzadilla, 151 B.R. 622, 626 (Bankr. S.D. Fla. 1993); In re Kaitangian, 218 B.R. 102 (Bankr. S.D. Cal. 1998). There is no conflict. Both statutes prohibit non-attorneys from holding themselves out as lawyers or as capable of providing legal counsel.

Taking a slightly different angle, Appellant contends that he cannot possibly notify the public that he cannot give legal advice (allegedly a requirement of Georgia law) if he is precluded from using the word "legal" in advertisements. This argument is specious. The bankruptcy law does not prevent Appellant Hardwick from using the word "legal" in any document whatsoever, but only in *advertisements*. Appellant Hardwick is free to notify his potential customers in other ways that he is not an attorney and that he cannot provide legal advice. Indeed, he is required to do so by separate notice pursuant to 11 U.S.C. § 110(b).

IV. Appellant's argument that his written contract with Debtor adequately notified Debtor that he is not an attorney and cannot give legal advice was never raised in the bankruptcy court and is not an issue for appeal.

Appellant Hardwick's second argument is that the contract executed between himself and the Debtor (which he calls the "Non-Attorney Contract or Disclaimer Contract") provided adequate notice to the Debtor that Appellant Hardwick was not an attorney and may not practice law or give legal advice.

Appellant admits that he did not provide a separate notice document as required by § 110(b)(2), but he argues his contract with Debtor provided the same essential information.

Appellant's contention may be correct or incorrect, but the issue has yet to be adjudicated by the bankruptcy court. That court never addressed whether Appellant's contract with Debtor fulfilled the notice requirements of 11 U.S.C. § 110(b)(2) because Appellant never raised this issue.

Even if he had raised this issue, it could not have been decided as part of a motion to dismiss because it is a factual issue relating to the specific language of the contract and what a reasonable Debtor would have understood. The bankruptcy court may find that Appellant violated the notice requirements of § 110(b) or the court may find that Appellant's contract fulfilled the requirements. But the court has yet to decide whether Appellant violated any section of 11 U.S.C. § 110 at all, and until it does, this issue is not properly on appeal.

V. Appellant's argument that the prohibition against petition preparers collecting and paying the bankruptcy filing fee infringes upon his freedom of expression is without merit.

Appellant Hardwick's third argument relates to the statutory requirement that "[a] bankruptcy petition preparer shall not collect or receive any payment from the debtor or on behalf of the debtor for the court fees in connection with filing the petition." 11 U.S.C. § 110(g). Appellant admits that he collected the filing fee from the Debtor and delivered it to the bankruptcy court, but he contends it was an "act of friendship between two consenting adults (a favor), which constituted an act of Freedom of expression which is protected by the US Constitution."[11] Appellant's brief goes on to say that "those documents is the property of the Debtor, and therefore, the Government does not have a right to dictate to her, or to a person such as the Appellant, as to who we should or should not delegate our personal property to."[12]

It is important to note that the main purpose of 11 U.S.C. § 110 is consumer protection. The legislative history states:

> Bankruptcy petition preparers not employed or supervised by any attorney have proliferated across the country. While it is permissible for a petition preparer to provide services solely limited to typing, far too many of them also attempt to provide legal advice and legal services to debtors. These preparers often lack the necessary legal training and ethics regulation to provide such services in an adequate and appropriate manner. These services may take unfair advantage of persons who are ignorant of their rights both inside and outside the bankruptcy system.

140 Cong. Rec. 10770 (October 4, 1994); <u>see</u> <u>also</u> <u>Dent v. West Virginia</u>, 129 U.S.

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[11] Appellant's Brief at page 10.

[12] Appellant's Brief at page 11.

114, 121-22 (1889) (reasonable regulation is allowed to protect citizens from "ignorance and incapacity, as well as deception and fraud"). As correctly stated by the bankruptcy court, 11 U.S.C. § 110 "promotes the government's legitimate interest in preventing fraud and deception upon unsophisticated debtors."[13]

The requirement that precludes the collection of any filing fee is designed to (1) protect debtors who need to make the final decision whether to file bankruptcy (as opposed to petition preparer filing the bankruptcy petition with the clerk) and (2) protect those who might not know the correct amount of the filing fee and thus are susceptible to unscrupulous petition preparers. There is an obvious nexus between the statute and a legitimate government interest.

The cases cited by Appellant are readily distinguishable.[14] Appellant cites Griswold v. Connecticut, 381 U.S. 479 (1965), for the proposition that the right to privacy includes the right to decide what happens to one's personal belongings. Griswold held that a Connecticut law forbidding the use of contraceptives unconstitutionally intrudes upon the right to marital privacy. It has no bearing on the requirement that petition preparers refrain from collecting a filing fee.

Appellant also cites Barrows v. Jackson, 346 U.S. 249 (1953) as support for

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[13] Order Denying Motion to Dismiss at page 29.

[14] Appellee United States Trustee could not locate the case cited by Appellant as "Lawrence-v-Teac 539 US (2003)".

his constitutional challenge. In Barrows, the Supreme Court held that when a state court upheld the validity of a restrictive covenant against the sale of real property to non-Caucasians it violated the Fourteenth Amendment's right to equal protection under the laws. Appellant fails to consider that 11 U.S.C. § 110 applies to all persons, regardless of skin color, age, religious creed or background. There is a legitimate government interest in protecting consumers from unethical practices and the rule in section 110(g) against collecting a filing fee applies uniformly to all petition preparers. There is no violation of equal protection. In re Kaitangian, 218 B.R. 102, 107 (Bankr. S.D. Cal. 1998) (equal protection argument failed as there is no fundamental right to be a bankruptcy petition preparer); see also Jeter v. Office of the United States Trustee (In re Adams), 214 B.R. 212, 218 (B.A.P. 9th Cir. 1997) (holding § 110 does not violate equal protection).

VI. The United States Trustee's decision to assert a claim against Appellant for charging an excessive fee does not violate his right to equal protection, nor is 11 U.S.C. § 110(h) overly broad or vague.

Appellant Hardwick's next argument relates to the claim made by Appellee United States Trustee that Appellant violated 11 U.S.C. § 110(h) by charging an excessive fee. Appellant contends that it was an arbitrary decision by the United States Trustee based on a federal statute that provides no "maximum or minimum allowable fee chargeable by a petition preparer for Bankruptcy."[15] Appellant argues that the claim against him is unconstitutional because it is based on a statute that is broad, vague and violates his right to equal protection.[16]

As noted by the bankruptcy court, while the statute does not define what constitutes an "excessive" fee, such a situation does not render the statute unconstitutionally vague or inconsistent with equal protection.[17] It is common for a bankruptcy court to make determinations regarding the reasonableness of fees. See 11 U.S.C. § 330 (awarding "reasonable" compensation for bankruptcy

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[15] Appellant's Brief at pages 11-12.

[16] The United States Trustee's decision to bring an adversary proceeding against Mr. Hardwick is unreviewable as a matter of prosecutorial discretion. The United States Trustee plays a unique role in this case: fulfilling his statutory role in monitoring and, if necessary, litigating against potentially abusive practices. The United States Trustee is an official of the United States Department of Justice charged by statute to oversee and supervise the administration of bankruptcy cases. 28 U.S.C. § 586(a). The United States Trustee acts as a "watchdog" whose role "may be compared with . . . a prosecutor." H.R. Rep. No. 95-595, 1st Sess. 4, 110 (1977), as reprinted in 1978 U.S.C.C.A.N. 5963, 5966, 6071. The legislative history regarding the creation of the United States Trustee Program describes the proposed United States Trustee as the "enforcer[] of the bankruptcy laws," and notes that the United States Trustee would be responsible for bringing "proceedings in the bankruptcy courts in particular cases in which a particular action taken or proposed to be taken deviate[d] from the standards established by the . . . bankruptcy code." H.R. Rep. No. 95-595, 1st Sess. 109 (1977), as reprinted in 1978 U.S.C.C.A.N. 5963, 6070. Accordingly, prosecutorial discretion applies to the United States Trustee's decisions to enforce the bankruptcy laws. See, e.g., In re Bays, Bankruptcy No. 01-05127, Adversary No. A03-05127, 2008 WL 153472, 15 (Bankr. E.D. Wash. Jan. 11, 2008) (finding a decision not to prosecute was within the prosecutorial discretion of United States Trustees Office); see also Wayte v. United States, 470 U.S. 598, 607 (1985) (explaining prosecutorial discretion standards and noting that "the decision to prosecute is particularly ill-suited to judicial review.").

[17] Order Denying Motion to Dismiss at page 16.

professionals). Bankruptcy courts are accustomed to assessing the reasonableness of fees and awarding compensation. Allowing a bankruptcy court to determine what is "excessive" for the services of a bankruptcy petition preparer is not unconstitutionally vague or arbitrary. See In re Rose, 314 B.R. 663, 689 (Bankr. E.D. Tenn. 2004).

Appellant cites City of Chicago v. Morales, 527 U.S. 41 (1999), which held that a loitering statute was unconstitutionally vague because it failed to provide fair notice of the prohibited conduct. Unlike the ordinance in Morales and as demonstrated in section II above, 11 U.S.C. § 110 defines the conduct proscribed for petition preparers with great specificity.

Appellant cites three more cases in this section of his brief, namely Grayned v. City of Rockford, 408 U.S. 104 (1972) (holding city ordinance prohibiting picketing within 100 feet of school, except peaceful picketing of school involved in labor dispute, violated right to equal protection); Gregory v. City of Chicago, 394 U.S. 111 (1969) (holding citizens marching from city hall to mayor's residence could not be convicted for disorderly conduct when they had not been disorderly and had not been charged with refusing to obey police officer); and City of Cleveland v. Anderson, 13 Ohio App. 83, 234 N.E.2d 304 (Ohio App. 1968) (holding ordinance forbidding persons from being part of noisy, boisterous or disorderly assemblage to be so vague and uncertain that it violated due process).

It is difficult to see how any of these cases apply to the inquiry at hand. Unlike the ordinances at issue in these cases, 11 U.S.C. § 110 is not a criminal statute. Nor does it define the prohibited conduct in a vague or uncertain manner.

VII. Appellant's argument that the requirement that bankruptcy petition preparers provide their social security numbers on the bankruptcy petition violates his right to privacy is without merit.

Appellant contends that the requirement in 11 U.S.C. § 110(c) that bankruptcy petition preparers provide their social security number on the petition violates his "right to protect his person, from Fraud and Theft of his personal identity, and privacy rights."[18] It appears that this argument has been rejected by every court addressing the issue. See Cassano v. Carb, 436 F.3d 74, 75 (2d Cir. 2006) (finding no constitutional right to privacy covering the collection of social security numbers); McElrath v. Califano, 615 F.2d 434, 441 (7th Cir. 1980) (stating "the contention that disclosure of one's social security number violates the right to privacy has been consistently rejected"). A social security number is not "inherently sensitive or intimate information and its disclosure does not lead directly to injury, embarrassment or stigma." Ferm v. United States Trustee (In re

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[18] Appellant's Brief at page 13.

Crawford), 194 F.3d 954, 960 (9th Cir. 1999).

As the bankruptcy court noted, even assuming there is a constitutionally protected right to privacy in one's social security number, the government's legitimate interest outweighs any such right. The court stated:

> The proper "inquiry is whether there is a legitimate state interest in disclosure that outweighs the threat to [one's] privacy interest. James v. City of Douglas, Ga., 941 F.2d 1539, 1544 (11th Cir. 1991). As the legislative history shows, Congress explicitly required the disclosure of bankruptcy petition preparers' social security numbers in an effort to prevent fraud on unsophisticated debtors and stop the proliferation of unscrupulous bankruptcy petition preparers. See 140 Cong. Rec. 10770 (October 4, 1994); Rausch II, 213 B.R. at 367 ("Congress enacted 11 U.S.C. § 110(c) as a consumer protection measure to police fraud and abuse by bankruptcy petition preparers.").

Order Denying Motion to Dismiss, page 23; see also In re Rose, 314 B.R. 663, 680 (Bankr. E.D. Tenn 2004) (stating "courts require strict compliance with § 110 in order to 'create a paper trail to identify non-attorneys who prepare documents to be filed by bankruptcy debtors.'") (internal cits. omitted); Jeter v. Office of the United States Trustee (In re Adams), 214 B.R. 212, 216 (B.A.P. 9th Cir. 1997) (there is a legitimate government interest in requiring bankruptcy petition preparers to provide their social security number); In re Turner, 193 B.R. 548, 553 (Bankr. N.D. Cal. 1996) (holding statutory requirement that bankruptcy petition preparer disclose his social security number on documents for filing did not violate constitutional right to privacy).

As stated in Ferm, section 110 “was enacted to remedy what was perceived to be widespread fraud and unauthorized practice of law in the BPP industry. . . . There is no doubt, moreover, that the gathering of [bankruptcy petition preparer social security numbers] directly serves this interest by facilitating the governmental monitoring and policing of individual BPPs.” Ferm, 194 F.3d at 960. Accordingly, Appellant Hardwick’s arguments are without merit.

VIII. Appellant’s argument that he is not a bankruptcy petition preparer because he did not receive compensation but merely a “donation” of $375.00 is disingenuous and flawed.

A bankruptcy petition preparer is defined as “a person, other than an attorney for the debtor or an employee of such attorney under the direct supervision of such attorney, who prepares *for compensation* a document for filing.” 11 U.S.C. § 110(a) (emphasis supplied). Appellant contends that he did not receive compensation but merely a “donation” from the Debtor. Thus, the argument goes, since he did not receive compensation, he is not a bankruptcy petition preparer and thus 11 U.S.C. § 110 is inapplicable.

Appellant’s argument is without merit for two reasons. First, Appellant Hardwick signed the petition under a section stating that (1) he is a bankruptcy petition preparer and (2) he prepared the document for compensation. He signed the following statement under penalty of perjury:

> I declare under penalty of perjury that: (1) I am a bankruptcy petition preparer as defined in 11 U.S.C. §110; (2) I prepared this document for compensation and have provided the debtor with a copy of this document and the notices and information required under 11 U.S.C. §§110(b), 110(h), and 342(b); and (3) if rules or guidelines have been promulgated pursuant to 11 U.S.C. §110(h) setting a maximum fee for services chargeable by bankruptcy petition preparers, I have given the debtor notice of the maximum amount before preparing any document for filing for a debtor or accepting any fee from the debtor, as required in that section. Official Form 19 is attached.

See Petition in bankruptcy case No. 08-10280, Bankruptcy Court Docket No. 1, p. 3); see also Order Denying Motion to Dismiss, page 3 (finding Appellant signed his name under this language).

Second, Appellant's contention that the $375.00 was a "donation" is disingenuous. He admits that he accepted $375.00 from the Debtor, but contends it was a donation because "the services needed by the Debtor was free, the Debtor did not want to wait for her free turn."[19] This ruse is an obvious attempt to avoid the requirements of 11 U.S.C. § 110. Curiously, on the next page, Appellant states that he has "prepared no more than three or less Bankruptcy for any Debtors within

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[19] Appellant's Brief, page 2.

the last ten years."[20] Query how long Debtor would have waited for her free turn but for the $375.00 payment to Appellant.

Moreover, even if Appellant and the Debtor intended the payment to be a donation, it was compensation within the meaning of 11 U.S.C. §110(a). See In re Paskel, 201 B.R. 511, 516 (Bankr. E.D. Ark. 1996) (stating fact that "debtor or [the defendant] may have intended the funds as a donation to another entity does not obviate the fact that [the defendant] prepared the documents in exchange for compensation," as the statute does not require the petition preparer personally benefit from the funds). Accordingly, Mr. Hardwick's argument cannot succeed.

CONCLUSION

For these reasons, the Appellee United States Trustee respectfully asks this Court to dismiss this appeal, and, in the alternative, if this Court concludes that it has jurisdiction, to affirm the order entered below.

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[20] Appellant's Brief, page 3.

Respectfully submitted this 14th day of January, 2010.[21]

DONALD F. WALTON, UNITED STATES
TRUSTEE, REGION 21

By: */s/ Matthew E. Mills*
Matthew E. Mills
Assistant United States Trustee
Office of the United States Trustee
222 West Oglethorpe Avenue, Suite 302
Savannah, Georgia 31401
(912) 652-4112

OF COUNSEL:

P. Matthew Sutko
Office of the General Counsel
Executive Office for United States Trustees
United States Department of Justice
20 Massachusetts, Ave. N.W., Suite 8100
Washington, D.C. 20530
Tel: (202) 307-1399

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[21] In calculating the time to file this brief, the United States Trustee referred to Fed. R. Bankr. P. 9006(f) and Fed. R. Civ. P. 6(d), which allow for three additional days to file after certain kinds of service, including service by mail per Fed. R. Civ. P. 5(b)(2)(C) and electronic mail per Fed. R. Civ. P. 5(b)(2)(E). Appellant Hardwick served his opening brief on the United States Trustee by regular mail, and this Court's ECF system served the brief by electronic mail. Hence, the three additional days apply.

CERTIFICATE OF SERVICE

The undersigned hereby certifies that the within and foregoing **BRIEF OF APPELLEE DONALD F. WALTON, UNITED STATES TRUSTEE, REGION 21** has this day been served upon the following parties by mailing a copy of the same through the United States Mail bearing sufficient postage thereon. In addition, electronic service will be received by those parties that are entitled to receive such service in this case through the electronic filing system of this Court.

Mr. Bobby Hardwick
P.O. Box 365
Augusta, Georgia 30903

This 14th day of January, 2010.

/s/ Matthew E. Mills
Matthew E. Mills, Asst. U.S. Trustee
Office of United States Trustee
222 W. Oglethorpe Avenue, Suite 302
Savannah, Georgia 31401
(912) 652-4112

BRIEF BANK — 'SUMMARY SHEET" *Printed Thu-5/3/07 11:26*

WESTLAW CODES

1. ("TI") *TITLE* OF CASE
[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]
Fokkena v. Hartwick

2. ("CO") *CURRENT* COURT
[E.g., "CTA9"]
U.S. District Court for the District of Minnesota

3. ("CCN") *CURRENT* CASE NO.
No.: **06-4433**

4. ("PCN") *PRIOR* CASE NO. & COURT
[IF ANY]
No.: 06-31241
Court: Bankruptcy Court for the District of Minnesota
(Identify judge & cite, if any)

5. ("SO") *SOURCE*
U.S. TRUSTEES

6. ("DA") *DATE* OF FILING & *TYPE* OF BRIEF
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7. ("AU") *PRINCIPAL AUTHORS & OFFICE* *[E.g.,"UST/OGC"]*
P. Matthew Sutko, David Levine, Michael E. Ridgway
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") *TOPIC*
BANKRUPTCY

9. ("SU") ● *SUMMARY* OF KEY ISSUE(s)

&

√ Any Miscellaneous *BACKGROUND*

● Whether Debtor can use all allowable expenses under the means test?

√ Background:

10. PATH TO FILE LOCATION:
(e.g., S:\OGC\BRFBANK\etc...)

11. DO YOU RECOMMEND POSTING IN UST BRIEFBANK?
| x | YES | | NO
NAME:
DATE:

IN THE UNITED STATES DISTRICT COURT
DISTRICT OF MINNESOTA
06-4433

HABBO G. FOKKENA
UNITED STATES TRUSTEE,

Appellant,

v.

DANA M. HARTWICK,

Appellee.

ON APPEAL FROM THE UNITED STATES BANKRUPTCY COURT FOR THE DISTRICT OF MINNESOTA, BANKRUPTCY COURT FILE NO. 06-31241
HONORABLE DONALD D. O'BRIEN

REPLY BRIEF OF APPELLANT

Of Counsel:

Roberta A. DeAngelis
Acting General Counsel

Matthew Sutko
David Levine
United States Department of Justice
Executive Office for United States Trustees
20 Massachusetts Avenue, NW
Washington, D.C. 20530
(202) 307-1399

Habbo G. Fokkena
United States Trustee

Michael E. Ridgway
Office of the United States Trustee
300 South Fourth Street, Suite 1015
Minneapolis, MN 55415
(612) 664-5500

ATTORNEYS FOR APPELLANT

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I. INTRODUCTION

Determining allowable expenses under the new means test is a two step process. The first step is eligibility - *i.e*, does the debtor qualify for an expense allowance in the category at issue? If so, then the second step is to quantify the expense amount the eligible debtor is allowed.

In his opening brief, the United States Trustee established that the bankruptcy court erred because the Debtor was not eligible for two of the expense categories under the means test – the vehicle acquisition expense under the IRS Local Standards and secured debt expense under section 707(b)(2)(A)(iii). The best interpretation of the means test is that this Debtor is not eligible for the IRS vehicle acquisition expense because she does not have a monthly payment to acquire a vehicle. Likewise, the Debtor may not claim expenses for post-petition payments to secured creditors, over and above the IRS Housing Standard, because long before she filed bankruptcy she stopped making payments to the mortgage holder.

The Debtor argues that the plain language mandates that she be allowed vehicle acquisition expenses and secured debt expenses she does not, and will not, incur. The Debtor ignores the eligibility requirement and simply assumes that <u>all</u> debtors are eligible. Allowing all debtors to deduct expenses regardless of whether the specific debtor actually incurs the expense type would make a mockery of the means test and may result in debtors receiving an immediate discharge of their debts regardless of their ability to repay.[1]

The United States Trustee's construction of section 707(b)(2) comports with the purposes that motivated Congress to enact the means test as a key component of the BAPCPA

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[1] *See e.g., In re Nockerts*, 2006 WL 3689465 (Bankr.E.D.Wis. Dec. 14, 2006)(on similar facts, finding that the results of the means test foreclosed further judicial inquiry into a debtor's ability to repay his debt under section 707(b)(3)(B) based on the totality of the circumstances of the debtor's financial situation).

amendments. The means test is designed to ensure some repayment to creditors when possible. And, should a debtor's repayment ability change, the Bankruptcy Code affords debtors relief that accommodates their changed circumstances. If this Court correctly concludes that the Debtor is not eligible for either of these two expense categories, this case should be remanded for a recalculation under the means test without deductions for those expenses.

II. FOR THE EXPENSE TO BE "APPLICABLE," A DEBTOR MUST BE ELIGIBLE TO CLAIM THE VEHICLE OWNERSHIP EXPENSE UNDER THE IRS LOCAL STANDARDS.

By using the word "applicable" in section 707(b)(2)(A)(ii)(I), Congress limited eligibility for expenses under the Local Standards to debtors for whom the expenses actually apply. Only after "a determination is made as to the type of expenses allowed and applicable to the debtor" may the debtor claim the amount set forth under the IRS Local Transportation Standards. *In re Devilliers*, 2007 WL 92504 at *6 (Bankr.E.D.La. Jan. 9, 2007).

Debtor asserts that the plain language of section 707(b)(2)(A)(ii)(I) allows all debtors who simply own a vehicle to claim the ownership expense category, which represents vehicle acquisition financing costs, under the IRS Local Standards. To reach this conclusion, the Debtor argues that the word "applicable" refers only to the debtor's location and number of owned vehicles.[2]

In interpreting the word "applicable" in section 707(b)(2)(A)(I), a bankruptcy court recently considered and correctly rejected each of the debtor's arguments. *See In re Slusher*,

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[2] Debtor also argues that Official Form B22A supports her position that section 707(b)(2)(A)(I) "mandates" application this IRS Standard as an allowance based upon mere car ownership. However, Line 23 of the Form only directs debtors to identify the number of vehicles "for which you **claim** an ownership/lease expense." (Emphasis added).

2007 WL 118009 (Bankr.D.Nev. Jan. 17, 2007). As explained by the *Slusher* court, when Congress developed the means test, it "could have started from scratch, and created a system that was rigid but easy to administer, such as how many view workers' compensation or social security schemes." *Id.* at *12. Instead, Congress "incorporated into the Bankruptcy Code an existing, administrative system that the IRS had long had in place." *Id.* This incorporation "strongly suggests that courts should look to how the IRS determined those standards; that is, as to how the IRS would have applied them in similar circumstances." *Id.* at * 14**.** Thus, "if guidance is sought on the meaning of the IRS standards Congress incorporated into the Bankruptcy Code, practical reason would suggest that court should consider the full manner by which the IRS uses these standards." *Id.*

The *Slusher* court also considered and rejected the notion entertained by some courts, *e.g. In re Fowler*, 349 B.R. 414 (Bankr.D.Del. 2006), and used by the court below, that considering IRS practice in interpreting "applicable" expenses in section 707(b)(2)(A)(ii)(I) would negate the section's later allowance of "actual" monthly expenses in the IRS categories of Other Necessary Expenses. As the *Slusher* court explained, "a natural reading" of section 707(b)(2)(A)(ii)(I) indicates that the words "actual" and "applicable" limit the relevant expense deductions in different ways. *In re Slusher*, 2006 WL 118009 at *13.

> .
> [O]ne is a limitless deduction within the specified categories of Other Necessary Expenses, and the other is a deduction limited to the amount and type specified by the IRS. Had Congress intended to indiscriminately allow all expense amounts specified in the National and Local Standards, it would have written section 707(b)(2)(A)(ii)(I) to read, "The debtor's monthly expenses shall be the monthly amounts specified under the National Standards and Local Standards . . ." rather than "The debtor's monthly expenses shall be *the debtor's applicable* monthly expenses amounts specified under the National and Local Standards." This distinction may not appear from the dictionary definitions of both terms, but it

> did, and does, belong to the IRS' historical and practical use of those standards at the time Congress adopted BAPCPA. In referring to such specialized standards, it would be quite odd if Congress intended to preclude courts from examining the context in which the authoring agency, the IRS, used and employed those standards. (Emphasis original).

Id.

The Debtor is not eligible for the IRS Local Standard for vehicle ownership expense under the IRS Local Standards because she is not making any loan payments on the vehicle. Because the Debtor is not eligible, the expense is not applicable to her. Accordingly, the court below erred by allowing the Debtor this expense under the means test.

III. DEBTOR'S RELIANCE ON BANKRUPTCY REFORM LEGISLATION PROPOSED IN 1998, BUT NEVER ENACTED, IS MISPLACED.

The Debtor relies heavily on bankruptcy reform legislation proposed, but not enacted, in 1998 (H.R. 3150). Specifically, the Debtor attaches special importance to the fact that section 707(b)(2)(A)(I) of BAPCPA defines allowable expenses under the means test differently than the proposed 1998 legislation, which included a specific reference to the IRS's financial analysis handbook.

As the 2005 legislative history clarifies, the IRS's Financial Analysis Handbook "has been expressly adopted by Congress in § 707(b)(2)(A)(ii)." *In re Lenton,* – B.R. –, 2006 WL 3850011 *5 at note 15 (Bankr.E.D.Pa. Dec. 15, 2006). In addition, the statutes are not so markedly different as to evidence any special Congressional intent to eliminate use of the IRS's application of its own expense standards. It is equally likely that the change in phrasing from "expense allowances under the applicable Local Standards as determined under the Internal Revenue Service financial analysis" in 1998 "to the debtor's applicable monthly expense amounts specified under the Local Standards" in 2005, merely restates the same methodology in a more summary fashion.

IV. ELIGIBILITY PREMISED UPON A LOAN OR LEASE PAYMENT WILL NOT LEAD TO UNFAIR DISTINCTIONS BETWEEN DEBTORS OR UNFAIRLY BIAS POOR DEBTORS.

The Debtor suggests that limiting vehicle ownership expense allowance to debtors with loan or lease payments will unfairly prejudice some debtors. To illustrate her argument, Debtor raises the following hypothetical:

> Debtor A and Debtor B own vehicles of the same make, model and year. However, Debtor A paid off her car loan the month before filing while Debtor B has one payment remaining after filing. Pursuant to the US Trustee's position, Debtor B is entitled to the car ownership allowance, but Debtor A is not.

Appellee's Brief at 14. However, the case of each debtor in this hypothetical might be dismissed as an abuse under §707(b)(1).

Absent a showing of special circumstances, Debtor A's case might be dismissed based upon the repayment ability calculated under §707(b)(2). Debtor B's case might be dismissed under §707(b)(3) because the totality of the circumstances of Debtor B's financial situation, including the fact Debtor B only has one car payment post-petition, could demonstrate abuse. Where the presumption of abuse does not arise under section §707(b)(2) "the court must then consider a debtor's actual income and expenses in determining abuse based on ability to pay under §707(b)(1) and (3)." *In re Mestemaker*, – B.R. –, 2007 WL 79306 at *5 (Bankr.N.D.Ohio Jan. 10, 2007).[3]

Debtor asserts that limiting the ownership allowance to debtors who make car payments may have "a disparate impact on" some debtors. As one court has noted, this "disparate impact argument ignores the fact that the means test merely creates a [rebuttable] presumption of abuse.

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[3] *But see In re Nockerts, supra* note 1.

. .” *In re Barraza*, 346 B.R. 724, 729 (Bankr. N.D.Tex. 2006). Equally important, the age of the car and whether it was purchased new or used, are irrelevant in determining eligibility. The distinguishing eligibility factor is whether the debtor has a monthly payment obligation with respect to the car, which can include used cars and older cars.

The Debtor acknowledges that under application of the IRS Financial Analysis handbook, the IRS allows an additional $200 operating expense for up to two vehicles that qualify based on age and/or mileage. The Debtor contends that the additional $200 allowance “merely represent[s] amounts necessary to keep the car running, not amounts necessary to replace the vehicle” and notes that the debtor’s car may break down within five years of filing. Appellee’s Brief at 13-14. The purpose of the ownership expense allowance, however, “is not the equivalent of an allowance for depreciation or an invitation for a debtor to ‘save’ for the ultimate replacement of an existing vehicle. Instead, the deduction is designed to assist with the acquisition of a vehicle on credit.” *In re Devilliers*, 2007 WL 92504 at *10.

V. SECURED DEBT

The U.S. Trustee asserts that whether a debt is “scheduled as contractually due” is determined by the debtor’s schedules and statements, and that such payments on secured debts must be due “in each month of the 60 months following the date of the petition.” The Debtor counters that the plain language of § 707(b)(2)(A)(iii) required her to deduct the amount of her monthly mortgage even though she: (1) had not made a payment for 18 months prior to filing bankruptcy; (2) had filed the Form stating that she would be surrendering her residence; (3) disclosed in her bankruptcy papers that she had no intention of making any monthly mortgage payments post-petition; and (4) vacated the premises on November 7, 2006. Appellee’s Brief at

19. This argument ignores the function of the means test in chapter 7.

The legislative history for §707(b)(2)(A)(iii) does not specify whether it is the existence of a contractual obligation on the petition date or a present intention to make payments, that is determinative of eligibility for this expense category. Congress did, however, articulate as a general goal behind its complete overhaul of §707(b), ensuring "that those who can afford to repay some portion of their unsecured debts be required to do so.." 151 CONG. REC. S2470 (March 10, 2005). A conference report to the bankruptcy reform package introduced in 2000 provided the best articulation of the goals of the means test: "To apply the means test, the debtor must complete revised schedules of income and expense similar to those now required, but revised to show net income determined in a particular way and a calculation of how much the debtor can afford to pay under the new means test. The means test should for the most part be self-enforcing." H.R. 2415 at 11702 (Dec. 7, 2000).

Thus, by completing Form B22A, the objective is for the debtor to roughly estimate the amount of monthly disposable income available and whether it is above the threshold amount deemed to be a meaningful repayment to unsecured creditors - at least $100 per month. This estimate is designed to steer debtors who have monthly disposable income above the threshold amount to file their petition under chapter 13 instead of under chapter 7. *In re Barraza*, 346 B.R. at 729. For Form B22A to have any utility, the debtor should be required to estimate the residual income available each month after the deduction of the **projected** monthly expenses at the time the case is filed. There would be no utility in permitting debtors to calculate their repayment ability by including past expense amounts that are not projected for future payment.

In her response, the Debtor focuses on the distinction between subsections (I) and (II) of

§707(b)(2)(A)(iii), and references the "negative pregnant" rule of statutory construction. However, limiting the allowance of additional amounts necessary to cure a default to amounts to maintain property necessary for the support of the debtor and debtor's dependents is not at all remarkable. It would be more noteworthy if Congress had allowed debtors to deduct, in addition to future current amounts under subsection (I), cure amounts under subsection (II) on property not necessary for the health and welfare of the debtor, such as payments to creditors who are secured by vacation homes, boats and other recreational type vehicles.

Excluding from the means test monthly payments the Debtor does not have any intention of paying would "'ensure that debtors repay creditors the maximum they can afford,' a primary goal of BAPCPA." *In re Lenton*, 2006 WL 3850011 at *5 , quoting H.R. Rep. 109-31, pt. 1 at 1, *as reprinted in* 2005 U.S.C.C.A.N. 88, 89 (2005). If the Debtor's case is dismissed and she later elects to redeem the residence, or if monthly payments on the redemption financing eliminate her ability to pay her debts, the debtor may file another case under chapter 7. See 11 U.S.C. §349; 11 U.S.C. §109(g). Alternatively, if the Debtor elects to convert her case to chapter 13 and redeem the property, she could include redemption financing payments in her chapter 13 plan. Conversely, granting a discharge to a debtor in chapter 7 based upon a repayment estimate that includes payments that the debtor will not make, defeats the goal of Congress in amending §707(b).

Dated: January 23, 2007

Respectfully submitted,

HABBO G. FOKKENA

UNITED STATES TRUSTEE
Region 12

/e/Michael E. Ridgway
Michael E. Ridgway
Trial Attorney
SD Atty I.D. No. 1456
Office of the United States Trustee
U.S. Courthouse
300 South Fourth Street
Minneapolis, MN 55415
(612) 664-5500

OF COUNSEL:

Roberta A. DeAngelis
Acting General Counsel

Matthew Sutko
David Levine
United States Department of Justice
Executive Office for United States Trustees
20 Massachusetts Avenue, NW
Washington, D.C. 20530
(202) 307-1399

IN THE UNITED STATES DISTRICT COURT
DISTRICT OF MINNESOTA
06-4433

HABBO G. FOKKENA
UNITED STATES TRUSTEE,

Appellant,

v.

DANA M. HARTWICK,

Appellee.

ON APPEAL FROM THE UNITED STATES BANKRUPTCY COURT FOR THE DISTRICT OF MINNESOTA, BANKRUPTCY COURT FILE NO. 06-31241
HONORABLE DONALD D. O'BRIEN

CERTIFICATION

I, Michael E. Ridgway, certify that the Reply Brief of Appellant United States Trustee complies with Local Rules 7.1(c) and 7.1(e) of the District Court for the District of Minnesota, Local Rule 8010-3 of the Bankruptcy Court for the District of Minnesota, and the Order of this Court dated January 12, 2007 (Docket Entry #16).

I further certify that this brief was prepared using Corel WordPerfect 12.0, and that this processing program has been applied specifically to include all text, including headings, footnotes, and quotations, but excluding the cover sheet, table of contents, table of authorities, signature line, and addendum, in preparing the following word count.

I further certify that this brief contains 2499 words.

/s/ Michael E. Ridgway
Michael E. Ridgway
SD Atty # 1456
Office of the U.S. Trustee
Suite 1015, U.S. Courthouse
300 South Fourth Street

Minneapolis, MN 55415

UNITED STATES DISTRICT COURT
DISTRICT OF MINNESOTA

In Re:

Dana M. Hartwick Bankruptcy No. 06-31241

Debtor.

Habbo G. Fokkena,
United States Trustee,

Appellant,

v.s. Civil No. 06-4433 (MJD)

Dana M. Hartwick

Appellee.

CERTIFICATE OF SERVICE

I Audrey Williams, declare under penalty of perjury that on January 23, 2007, a copy of the Reply Brief of Appellant, Habbo G. Fokkena, was served via-e-notice by the U.S. District Court to the following:

John D. Lamey	jlamey@lamevlaw.com	shari@lameylaw.com

I also served the Appellant's Reply Brief on the following by U.S. Mail postage prepaid:

Dana M. Hartwick
600 Inwood Avenue, Suite 200
Oakdale, MN 55128

Mary Jo A. Jensen-Carter
1339 East County Road D
Vadnais Heights, MN 55109

Dated: January 23, 2007

By:_/s/Audrey Williams_____
Audrey Williams
Legal Clerk

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WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*
In re Garland Terry Harvey (W. Clarkson McDow, Jr. United States Trustee for Region Four v. Garland Terry Harvey)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*
W.D. Va.

3. ("CCN") ***CURRENT*** CASE NO.
No.: 7:09-cv-00425-SGW

4. ("PCN") ***PRIOR*** CASE NO. - & COURT *[IF ANY]*
No.: 08-71684
Court: Bankr. W. D. Va.
(Identify judge & cite, if any)

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U.S. TRUSTEES

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Joseph A. Guzinski, John R. Byrnes, David I. Gold, P. Matthew Sutko, Ramona D. Elliott, W. Clarkson McDow
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***
● Whether mortgage payments can be deducted as "amounts scheduled as contractually due to secured creditors in each month of the 60 months following the date of the petition" when the debtor has made clear that he will not make those payments because the debt is secured by a mortgage on a home that he inends to surrender.

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IN THE UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF VIRGINIA

In re GARLAND TERRY HARVEY

Debtor.

W. CLARKSON MCDOW, JR.,
UNITED STATES TRUSTEE
FOR REGION FOUR,

Appellant,
v.

GARLAND TERRY HARVEY,

Appellee.

ON APPEAL FROM THE UNITED STATES BANKRUPTCY COURT
FOR THE WESTERN DISTRICT OF VIRGINIA
Bankruptcy Case No. 08-71684

BRIEF FOR THE UNITED STATES TRUSTEE, APPELLANT

RAMONA D. ELLIOTT
General Counsel

P. MATTHEW SUTKO
Associate General Counsel
DAVID I. GOLD
Trial Attorney
Executive Office for
United States Trustees
United States Department of Justice
20 Massachusetts Avenue N.W.
Washington, D.C. 20530

W. CLARKSON McDOW, JR.
United States Trustee

JOHN ROBERT BYRNES
Assistant United States Trustee
JOSEPH A. GUZINSKI
Trial Attorney
Office for United States Trustee
First Campbell Square
210 First Street, S.W.
Roanoke, Virginia 24011
Telephone: (540) 857-2699

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JURISDICTIONAL STATEMENT

The bankruptcy court had jurisdiction under 28 U.S.C. §§ 157 (a) and (b), and 1334(a) to issue its final order granting the Debtor's motion for summary judgment on the United States Trustee's motion to dismiss the Debtor's chapter 7 bankruptcy case. The bankruptcy court issued its opinion and entered an order granting the Debtor's motion for summary judgment on July 20, 2009. The United States Trustee filed a notice of appeal on August 20, 2009, which is timely under 28 U.S.C. §§ 158(a) and (c)(2) and under the Order Granting Motion to Extend Time to Appeal Under Rule 8002(3). This Court has appellate jurisdiction under 28 U.S.C. § 158(a)(1), a statutory provision under which district courts have jurisdiction to hear appeals from final judgments, orders, and decrees of bankruptcy judges.

STANDARD OF REVIEW

A bankruptcy court's findings of fact are reviewed for clear error and its conclusions of law are reviewed *de novo*. *In re White*, 487 F.3d 199, 204 (4th Cir. 2007). In this case, the facts are undisputed, and the bankruptcy court's interpretations of 11 U.S.C. §§ 707(b)(1) and (b)(2) are conclusions of law subject to *de novo* review.

STATEMENT OF THE ISSUE PRESENTED FOR REVIEW

Under 11 U.S.C. § 707(b)(2), a bankruptcy petition is presumptively abusive if, for the 60 months following the petition, the debtor's monthly income minus allowable expenses, as calculated by a statutory formula, would be equal to or greater than a specified threshold dollar amount. Section 707(b)(2)(A)(iii) defines the "debtor's average monthly payments on account of secured debts," which is one of the allowable expenses under the statutory formula, as "the sum of the total of all amounts scheduled as contractually due to secured creditors in each month of the 60 months following the date of the petition . . . divided by 60." 11 U.S.C. § 707(b)(2)(A)(iii). The debtor in this case included monthly payments on two mortgages in the calculation of his "average monthly payments on account of secured debts," even though his petition for bankruptcy was accompanied by a statement that he intended to surrender the home securing those mortgages.

The question presented is whether mortgage payments can be deducted as "amounts scheduled as contractually due to secured creditors in each month of the 60 months following the date of the petition" when the debtor has made clear that he will not make those payments because the debt is secured by a mortgage on a home that he intends to surrender.

STATEMENT OF THE CASE

The United States Attorney General appoints United States Trustees to supervise the administration of bankruptcy cases and trustees. *See* 28 U.S.C. §§ 581-589a. United States Trustees "serve as bankruptcy watchdogs to prevent fraud, dishonesty, and overreaching in the bankruptcy arena." H.R. Rep. No. 595, 95th Cong., 1st Sess. 88 (1977). Among the Unites States Trustees' duties is the duty to review petitions for bankruptcy filed under chapter 7 to determine whether a statutory presumption that the filing is an abuse of chapter 7 applies. *See* 11 U.S.C. § 704(b)(1)(A).

After debtor Garland Terry Harvey filed his petition for bankruptcy, United States Trustee W. Clarkson McDow, Jr. moved to dismiss the filing as an abuse of chapter 7 on the ground that the Debtor should not have deducted his monthly mortgage payments when he calculated his monthly income, because he intended to surrender the house securing those mortgages. The Debtor filed a motion for summary judgment in response to the United States Trustee's motion to dismiss. The bankruptcy court granted the Debtor's motion for summary judgement and denied the United States Trustee's motion to dismiss, concluding that the Debtor properly deducted the mortgage payments under 11 U.S.C. § 707(b)(2)(A)(iii), which defines the "debtor's average monthly payments on account of secured debts" as "the sum of the total of all amounts scheduled as contractually due to secured creditors in each month of the 60 months following the date of the petition . . . divided by 60." The United States Trustee timely appealed the bankruptcy court's order to this Court.

STATEMENT OF THE FACTS

I. Statutory Background

A. History of the Means Test

1. Before 1984, a bankruptcy court could dismiss a chapter 7 bankruptcy case only for "cause." *See* Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, § 707 (codified at 11 U.S.C. § 707); S. Rep. No. 95-989, at 94 (1978); H.R. Rep. No. 95-595, at 380 (1977). A bankruptcy court had "cause" to dismiss a case if, for example, the debtor had unreasonably delayed the proceedings in a manner that prejudiced his creditors. *See* Pub. L. No. 95-598, § 707(1) (codified at 11 U.S.C. § 707). Congress made clear, however, that "the ability of the debtor to repay his debts in whole or in part" did not "constitute[] adequate cause for dismissal." S. Rep. No. 95-989, at 94; H.R. Rep. No. 95-595, at 380 (same).

2. In the early 1980s, Congress became concerned about a "dramatic[]" rise in the number of consumer bankruptcy cases, and, as a result, it amended provisions of the Bankruptcy Code pertaining to consumer bankruptcies. *See* Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353 (1984); S. Rep. No. 98-65, at 3 (1983). As part of these reforms, Congress enacted 11 U.S.C. § 707(b), which gave a bankruptcy court, "on its own motion or on a motion by the United States Trustee," authority to "dismiss a case filed by an individual debtor under this chapter whose debts are primarily consumer debts if it finds that the granting of relief would be a substantial abuse of the provisions of this chapter." 11 U.S.C. § 707(b) (2004); Pub. L. No. 98-353, § 312; S. Rep. No. 98-65, at 53. By enacting section 707(b), Congress sought to ensure that bankruptcy courts would have the authority to dismiss bankruptcy cases in which debtors could repay a substantial portion of their debts. *See* S. Rep. No. 98-65, at 53-54; *In re Kornfield*, 164 F.3d 778, 781 (2d Cir. 1999) (Congress was "[c]oncerned that debtors who could over time easily pay their creditors might resort to chapter 7 to erase their legitimate obligations"); *In re Stewart*, 175 F.3d 796, 812-13 (10th Cir. 1999); *In re Lamanna*, 153 F.3d 1, 3 n.6 (1st Cir. 1998).

3. In 2005, again concerned about the rise in bankruptcy filings, Congress enacted the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (the "2005 Act"), Pub.L. No. 109-8, 119 Stat. 23 (2005). The 2005 Act removed the requirement that the party seeking dismissal show "substantial abuse," so that section 707(b) now requires a showing of "abuse" rather than "substantial abuse," 11 U.S.C. § 707(b)(1), and eliminated a presumption in favor of discharge. The 2005 Act also added a means test to identify chapter 7 cases that are presumptively abusive. Under the means test, there is a presumption that the case is an abuse of chapter 7 if the formula set out in section 707(b)(2)(A) reflects monthly disposable income equal to or greater than a specified threshold amount. *See* 11 U.S.C. § 707(b)(2)(A). In enacting these changes, Congress called "the implementation of an income/expense screening mechanism ('needs-based bankruptcy relief' or 'means testing')" the "heart of the [2005 Act's] consumer bankruptcy reforms," and it explained that the means test "is intended to ensure that debtors repay creditors the maximum they can afford." *See* H.R. Rep. No. 109-31 (I) at 1 (2005), reprinted in 2005 U.S.C.C.A.N. 88, 89.

B. The Means Test

The first step of the means test is determining whether the debtor's monthly income exceeds the state median family income for his family size. A debtor's current monthly income, as defined in 11 U.S.C. § 101(10A)(A), is based on the debtor's average monthly income from all sources for the six full calendar months immediately preceding the bankruptcy filing. If the debtor's monthly income is equal to or below the state median family income for the same household size, a safe harbor exists and a presumption of abuse will not arise. *See* 11 U.S.C. § 707(b)(7). If the debtor's current monthly income exceeds the state median income for the same household size, however, the debtor is an "above-median income debtor." Above-median income debtors are subject to the means test.

Under the means test, net monthly disposable income is calculated by deducting statutorily prescribed monthly expenses from current monthly income. If the resulting net monthly disposable income is above the amount specified in the statute, the bankruptcy case is presumptively abusive. The means test requires courts "presume abuse exists if the debtor's current monthly income reduced by the amounts determined under" the statute exceeds a threshold dollar amount specified in the statute and periodically adjusted by the Judicial Conference of the United States. 11 U.S.C. § 707(b)(2)(A)(i). At the time relevant to this case, that threshold was $182.50.[1]

The means test calls for the deduction of statutorily prescribed monthly expenses rather than actual expenses. Deductible expenses include living expenses as set forth in national and local standards prescribed by the Internal Revenue Service, *see*, *e.g.*, 11 U.S.C. § 707(b)(2)(A)(ii)(I); certain actual expenses subject to the requirement that they be "reasonably necessary," *see, e.g., id.* (allowing deduction for "reasonably necessary" health insurance and disability insurance expenses); and other actual expenses capped by a maximum allowable deduction, *see id.* at 707(b)(2)(A)(ii)(IV)(allowing deduction for actual expenses for a minor child "not to exceed" $1,650 a month).

In addition to the deduction of these monthly expenses, the means test also allows the deduction of projected monthly payments on account of secured debts and priority claims. *See* 11 U.S.C. § 707(b)(2)(A)(iii)-(iv). Section 707(b)(2)(A)(iii) defines the debtor's "average monthly payments on account of secured debts," the statutory term at issue in this case, as the sum of "the total of all amounts scheduled as contractually due to secured creditors in each month of the 60 months following the date of the petition" divided by 60. 11 U.S.C. § 707(b)(2)(A)(iii). The Code does not define the term "amounts scheduled as contractually due to secured creditors."

All individual chapter 7 debtors must file Schedule J, *Current Expenditures of Individual Debtor*, and Federal Rules of Bankruptcy Procedure Official Form 22A, *Statement of Current*

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[1] The $182.50 threshold is the result of dividing $10,950 by 60 under the formula set out in 11 U.S.C. 707(b)(2)(A)(i). Under Section 104 of the Bankruptcy Code, this dollar amount is increased by the Judicial Conference of the United States every three years to reflect changes in the Consumer Price Index. *See* 11 U.S.C. § 104(a). The last change occurred on April 1, 2007. *Id.*

Monthly Income and Means Test Calculation ("Form 22A"), with their schedules and Statement of Financial Affairs. *See* 11 U.S.C. §§ 521(a)(1)(B)(ii) and § 707(b)(2)(C). Debtors also must file a statement of intention as to whether they will retain or surrender property secured by debt within 30 days of the earlier of the filing date and the date of the meeting of creditors. *See* 11 U.S.C. § 521(a)(2)(A); *see also* Interim Fed. R. Bankr. P. 1017(b)(2) (requiring individual debtors in chapter 7 cases to file a statement of intent on the appropriate Official Form). The statement must specify whether the debtor intends to claim the property as exempt, redeem the property, or reaffirm debts secured by the property. *Id.* Section 521(a)(2)(B) requires debtors to perform their expressed intention within 30 days after filing the statement of intention.

The United States Trustee reviews these forms and all other materials to determine whether a presumption of abuse arises. *See* 11 U.S.C. § 704(b)(1)(A). The United States Trustee has 10 days from the meeting of creditors to "review all materials" filed by the debtor (including the statement of intent to surrender) and file a statement regarding whether the debtor's case is presumed abusive under Section 707(b). *Id.* When a chapter 7 case is presumed abusive under the statute, the United States Trustee must either file a motion to dismiss or convert, or file a statement declining to seek such relief. *See* 11 U.S.C. § 704(b)(2). The United States Trustee has an additional 30 days after filing the statement regarding abuse to file a motion to dismiss or convert for presumed abuse. *Id.* Because the meeting of creditors must be held "no fewer then 20" and up to 60 days after the order for relief (depending on the location of the meeting), *see* Federal Rule of Bankruptcy Procedure Rule 2003, which in a voluntary petition under chapter 7 is the date of the petition, *see* 11 U.S.C. 301(b), the United States Trustee should know whether a debtor intends to surrender real or personal property subject to a security interest before the United States Trustee's deadline to file a motion to dismiss for presumed abuse under Section 707(b)(2). *See* 11 U.S.C. §§ 521(a)(2), 704(b)(2). A debtor may attempt to rebut the presumption of abuse by showing "special circumstances" that justify an income adjustment or additional expenses. 11 U.S.C. § 707(2)(B)(i).

II. This Proceeding

The Debtor filed for chapter 7 bankruptcy relief in September 2008. *See* Appellant's Designation of Record ("Appellant Rec.") No. 1 (Chapter 7 Voluntary Petition and Accompanying Documents) at 1. His Form 22A (Chapter 7 Statement of Current Monthly Income and Means-Test Calculation) (the "Means Test") listed his gross monthly income as $5,342, *id.* at 46, but did not report the income of his non-filing spouse because he and his wife were legally separated. *Id*. His Schedule I reported his gross monthly income as $3,534, and the gross monthly income of his non-filing spouse as $2,840. *Id.* at 27. He owed a combined monthly payment of a little more than $1,500 on the two deeds of trust secured by his house. *Id.* at 30. The Debtor filed a statement of intention with his petition stating that he intended to surrender the house securing the deeds of trust. Appellant Rec. No. 1 at 39. His original schedules listed unsecured non-priority debts of roughly $22,000 for student loans incurred by his estranged wife, a deficiency on a 2005 Dodge Caravan, amounts owed on his estranged wife's credit cards, and miscellaneous other debts. *Id.* at 23-24. An amendment to his schedules listed approximately $239,000 in additional unsecured debts, including deficiencies on the mortgages, deficiencies on a repossessed car and motorcycle, and a balance owed on a student loan. Appellant Rec. No. 2 at 7 (Notice of Amendment to Debtor's Schedules of Creditors and/or Matrix).

Though the Debtor indicated his intent to surrender his house when he calculated his monthly disposable income on his Means Test, he deducted the $1,500 in monthly mortgage payments for the house from his income. *Id* at 51. This deduction, together with the deductions allowed under the means test for reasonable living expenses (as described above), resulted in monthly disposable income of negative $539. *Id.*

If the Debtor did not deduct the monthly mortgage payments on his Means Test, he would have a minimum of $800 per month in disposable income. That amount, would generate $48,000 over 60 months under the Means Test and would significantly exceed the $10,950 threshold for the presumption of abuse to arise.[2] The presumption of abuse arose by eliminating the secured debt payments on the Debtor's surrendered house from the Means Test, and instead claim only the statutory housing allowance. Accordingly, the United States Trustee moved to dismiss the Debtor's case under Section 707(b)(2). The United States Trustee argued that the Debtor should not have included the mortgage payments on his Means Test because he was surrendering his home and did not intend to make those payments in the future.

The bankruptcy court denied the motion to dismiss. Appellant Rec. No. 7; *In re Harvey*, 407 B.R. 867 (Bankr. W. D. Va. 2009). The bankruptcy court concluded that "the means test includes a deduction from current monthly income for all scheduled contractual payments to secured creditors regardless of a debtor's intent with respect to . . . actual payment of the secured debt," *Harvey*, 407 B.R. at 872 (*citing Morse v. Rudler (In re Rudler)*, 388 B.R. 433, 438 (B.A.P. 1st Cir 2008)).[3]

SUMMARY OF ARGUMENT

Section 707(b) of the Bankruptcy Code authorizes a bankruptcy court to dismiss a chapter 7 consumer bankruptcy case if the court "finds that the granting of relief would be an abuse of" chapter 7. 11 U.S.C. § 707(b). The provision thus requires bankruptcy courts to evaluate whether it would be appropriate to grant a debtor the relief offered by chapter 7 – a discharge of his past debts. In order to make that determination, a bankruptcy court must consider whether the debtor will have sufficient future income to repay his past debts. And to facilitate that inquiry, Congress has established a means test to identify cases that are presumptively abusive because the debtor has sufficient means to repay some of his debts.

The means test allows a debtor to deduct from his current monthly income his "average monthly payments on account of secured debt," and as relevant here it defines those payments as

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[2] The lower court's decision summarized the contentions of the United States Trustee, and assumed the accuracy of those contentions for purposes of deciding the Appellee's motion for summary judgment. Appellant Rec. No. 7 at 8-9 (Memorandum Decision and Order Granting Debtor's Motion for Summary Judgment).

[3] The bankruptcy appellate panel's decision in *Rudler* was affirmed subsequent to the bankruptcy court's decision in this case. *See Morse v. Rudler (In re Rudler)*, 576 F.3d 37 (1st Cir. 2009).

"the sum of the total of all amounts scheduled as contractually due to secured creditors in each month of the 60 months following the date of the petition . . . divided by 60." 11 U.S.C. § 707(b)(2)(A)(iii). The question in this case is whether the Debtor correctly deducted $1,500 in monthly mortgage payments from his income instead of taking the statutorily prescribed housing allowance, even though his petition made clear that he would never make the mortgage payments because the mortgage was secured by property that he intended to surrender. The question is significant, because if the Debtor properly took those deductions, then all of his debts will likely be discharged, but if the monthly mortgage payments were not properly deducted from his monthly disposable income, then his monthly disposable income would be at least $800 and his petition would be presumptively abusive. Assuming he could not rebut the presumption of abuse and opted to proceed under chapter 13, this disposable income would give him roughly $48,000 to repay his creditors over the course of a 60 month plan.

The lower court concluded that the Debtor was entitled to deduct his mortgage payments because the payments were and would remain "contractually due" even when the Debtor surrendered his property. But the bankruptcy court erred by focusing in isolation on the phrase "contractually due." Read as a whole, the statute allows the deduction only of payments that the Debtor actually intends to make.

By using the phrases "scheduled as contractually due" (rather than simply "contractually due") and "60 months following the date of the petition," the statute calls for a forward-looking assessment of which payments on secured debts will actually be made and are thus properly listed (or "scheduled") as "payments on account of a secured debt." Reading the means test this way makes it consistent with the mean's tests treatment of the Debtor's other expenses, which are also forward looking.

Contrary to the reasoning of the bankruptcy court, a forward looking assessment of payments on account of secured debt cannot include payments that the Debtor will never make. In many cases, when a debtor surrenders the collateral securing a debt, nothing remains "contractually due." Even in those situations where a debtor is liable for a deficiency, once title to the property securing the debt transfers, the remaining liability is not "contractually due to [a] *secured* creditor," as required by the statute. Accordingly, the Debtor will not be liable for any payments that fit within the statutory terms.

Finally, allowing debtors to deduct only those payments that they actually will make best serves Congress's purpose in enacting the means test. The 2005 Act established a means test to ensure that those who can afford to repay some portion of their unsecured debts be required to do so. That purpose is best served by limiting the Debtor to deductions that reflect his true financial circumstances rather than allowing him to shelter disposable income behind phantom payments on secured debt.

This Court should reverse the decision of the bankruptcy court and rule that the means test does not allow the Debtor to claim mortgage payments that he will never make. In that event, the Debtor's creditors will likely recover $48,000 of the debt that the Debtor owes them, while he will still be entitled to the standard IRS housing allowance provided by Section 707. Conversely, if this Court accepts the views of the bankruptcy court, debtors who surrender property will be allowed to claim payments on that property that they will never make, and many debts will be discharged in bankruptcy based upon that fiction. That inequitable result is contrary to the better reading of section 707(b)(2)(A), and it conflicts with Congress' stated purpose for enacting the 2005 Act.

ARGUMENT

I. SECTION 707(B)(2) DOES NOT ALLOW A DEBTOR TO DEDUCT MORTGAGE PAYMENTS THAT HE WILL NOT MAKE

Section 707(b) of the Bankruptcy Code authorizes a bankruptcy court to dismiss a chapter 7 case that involves "primarily consumer debts" (or with a debtor's consent, convert the case to chapter 13) if the court "finds that the granting of relief would be an abuse of the provisions of this chapter." 11 U.S.C. § 707(b). In the 2005 Act, Congress amended Section 707(b) to provide a means test to identify presumptively abusive filings. *See* 11 U.S.C. §

707(b)(2)(A). Congress called “the implementation of an income/expense screening mechanism (‘needs-based bankruptcy relief’ or ‘means testing’)” the “heart of the [2005 Act’s] consumer bankruptcy reforms,” and it explained that the means test “is intended to ensure that debtors repay creditors the maximum they can afford.” *See* H.R. Rep. No. 109-31 (I) at 1 (2005), reprinted in 2005 U.S.C.C.A.N. 88, 89.

The means test requires the court to assess a debtor’s current monthly income, reduced by projected allowable expenses for the period following the bankruptcy filing specified in 11 U.S.C. § 707(b)(2)(A)(ii)-(iv), and determine whether that income is above the threshold set out in the statute for presumptive abuse. Among these expenses are a debtor’s “average monthly payments on account of secured debts.” 11 U.S.C. 707(b)(2)(A)(iii). Section 707(b)(2)(A) defines “average monthly payments on account of secured debts” as the sum of “the total of all amounts scheduled as contractually due to secured creditors in each month of the 60 months following the date of the petition,” divided by 60. 11 U.S.C. § 707(b)(2)(A)(iii). Contrary to the conclusion of the bankruptcy court below, this definition of “average monthly payments on account of secured debt” does not include mortgage payments that a debtor will not make.

A. Read as a Whole, Section 707(b)(2)(A) Makes Clear That the Means Test Is Forward Looking

Section 707(b)(2)(A)(iii), like any statutory provision, must be read as a whole. *See Koons Buick Pontiac GMC, Inc.* v. *Nieh*, 543 U.S. 50, 60 (2004) (calling for a “holistic” approach to reading statutes). The phrases “scheduled as” and “following the date of the petition” call for a projection of what the Debtor’s payments on account of secured debt will be following bankruptcy. And in light of the means test’s more general approach to identifying allowable expenses, the phrase “average monthly payments on account of secured debt” must be understood to include only payments on account of secured debt that the Debtor actually will make.

1. While the bankruptcy court concluded that the phrase “scheduled as contractually due” required it to disregard the Debtor’s stated intentions with regard to his mortgage payments,

In re Harvey, 407 B.R. at 872, even read in isolation the phrase "scheduled as contractually due" is not best understood this way. Reading the phrase "scheduled as contractually due" to include all current contractual obligations fails to give independent meaning to the words "scheduled as."

If Congress meant for debtors to deduct all "contractually due" payments without regard to whether they would actually be made, it could have left out the phrase "scheduled as" and defined "payments on account of secured debts" as payments that are "contractually due . . . following the date of the petition" instead of "scheduled as contractually due . . . following the date of the petition." Reading the phrase "scheduled as contractually due" to call for a forward-looking assessment of whether the payments will actually be made gives separate effect to the term "scheduled as" in the phrase "scheduled as contractually due," and thus honors the rule that "courts should strive to give operative meaning to every word in a statute." *Cooper Indus., Inc. v. Aviall Servs., Inc.*, 543 U.S. 157, 167 (2004). By contrast, the bankruptcy court's reading gives no independent meaning to the phrase "scheduled as." As one court explained, considering the phrase "scheduled as contractually due" from section 707(b)(2)(A)(iii) in a chapter 13 case, the word "scheduled" is best understood to "contemplate[] a forward looking approach. That is, one schedules something which one expects to take place in the future and not an event which one plans to avoid." *In re Love*, 350 B.R. 611, 613-14 (Bankr. M.D. Ala. 2006).

The phrase "scheduled as contractually due" should also be read to mean something more specific than "contractually due" because the phrase "scheduled as" is a term of art in the Bankruptcy Code – the Code refers to a claim or debt being "scheduled as" due if the debt is properly listed on a debtor's bankruptcy schedules. *See In re Skaggs*, 349 B.R. 594, 599 (Bankr. E.D. Mo. 2006). The only provision of the Code other than section 707(b)(2)(A)(iii) that uses the phrase "scheduled as" is 11 U.S.C. § 1111(a). Section 1111(a) provides that a "proof of claim or interest is deemed filed under section 501 of this title for any claim or interest that appears in the schedules filed under . . . section 521(1) or 1106(a)(2) of this title, except a claim or interest that is **scheduled as** disputed, contingent, or unliquidated." 11 U.S.C. § 1111(a) (emphasis added). The second part of the provision excepts claims that are "**scheduled as** disputed, contingent, or unliquidated." *Id.* (Emphasis added). In context, "scheduled as" thus means "appears on the schedule" or "appended to" the schedule. Because of the "'normal rule of statutory construction,' that 'identical words used in different parts of the same act are intended to have the same meaning,'" *Commissioner* v. *Keystone Consol. Industries, Inc.*, 508 U.S. 152, 159 (1993) (internal citations omitted), "scheduled as contractually due" in section 707(b)(2)(A) should be read to include contractual obligations on secured debts that are properly listed on a bankruptcy schedule because the debtor intends to honor them.

The bankruptcy court rejected this argument on the basis of the First Circuit's bankruptcy appellate panel decision in *Rudler*, which was subsequently affirmed by the First Circuit Court of Appeals. In adopting the First Circuit bankruptcy appellate panel's interpretation, it rejected the interpretation of the only other bankruptcy court in the Fourth Circuit to address this issue, *In re Ray*, 362 B.R. 680 (Bankr. D.S.C. 2007), as well as the interpretation adopted by a number of other courts.

The lower court's decision in *Harvey*, the First Circuit's decision in *Rudler*, and similar decisions of other courts have ignored the importance of the phrase "scheduled as." According to the First Circuit, "[t]he word 'scheduled' ... does not connote the confirmation of payments to be made . . . but implies the contrary recognition that such payments, although 'scheduled' may in fact not be

made. . . ." *Rudler*, 576 F. 3d at 46. In doing so, the First Circuit recognized that its interpretation renders the term "scheduled as" as "surplusage" and simply accepted this anomaly. *Id*. ("The Trustee points out fairly, that under [the First Circuit's] interpretation, the term 'scheduled as' appears to play in no role in defining the payments covered by section 707(b)(2)(A)(iii)(I)"). The lower court, in this case, attempts in a footnote to address this gap in the First Circuit's reasoning by positing that the phrase "scheduled as" merely means "'appears on a debtor's bankruptcy schedules.'" *Harvey*, 407 B.R. at 872 n.5. However, both the First Circuit's interpretation and the lower court's attempt to address the phrase "scheduled as" results in an interpretation that is demonstrably **inconsistent** with the statutory language of section 707(b)(2)(A)(iii) and Congress' **clear intent** in drafting the 2005 Act's reforms.

2. Allowing a deduction for mortgage payments that will never be made on the basis that the payments remain "contractually due" also fails to take account of the phrase "*following* the date of the petition" in the statute. *See In re Naut*, No. 07-20280, 2008 WL 191297 at *9 (Bankr. E.D. Pa. Jan. 22, 2008) (unpublished disposition); *In re Harris*, 353 B.R. 304, 308-10 (Bankr. E.D. Okla. 2006); *Skaggs*, 349 B.R. at 599-600. The word "following," used as a preposition, means "subsequent to" or "after in time." *Webster's Third New International Dictionary*, 833 (1993). By requiring courts to look at payments due "subsequent to" or "after" the date of the petition, the statute makes clear that it contemplates a projection of future expenses rather than a snapshot of current expenses. Accordingly, the means test allows the Debtor to deduct from his current monthly income only those payments on account of secured debt that he actually will make after he files the petition. As the court explained in *Naut*, "[i]ncluding a loan payment as a deduction from income must be based on the loan payment actually being due in each of the 60 months after the bankruptcy petition is filed. Only this interpretation properly gives effect to every clause and word in the statute." *Naut*, 2008 WL 191297 at *9. *See also Ray*, 362 B.R. at 683 n.5.

3. The term "payments on account of secured debts" should also be read to call for a forward-looking assessment of what payments the debtor actually will make because that reading treats the deduction for payments on secured debts most consistently with the treatment of other expenses under the means test. It is a general rule of statutory construction that "'a word [in a statute] is known by the company it keeps,' a rule that 'is often wisely applied where a word is capable of many meanings in order to avoid the giving of unintended breadth to the Acts of

Congress.'" *Dolan* v. *United States Postal Serv.*, 546 U.S. 481, 486-487 (2006) (internal citations omitted).

The other deductions allowed by the means test are forward looking. Section 707(b)(2)(A)(ii) does not use actual expenses to define the expenses that the Debtor may deduct from current monthly income. Rather, it requires the Debtor to calculate and deduct only those expenses allowed under the statute. The statute sets allowable expenses using several different methods. For example, living expenses are based on Internal Revenue Service standards. *See* 11 U.S.C. § 707(b)(2)(A)ii)(I). The statute sets other expenses, such as health and disability insurance, as actual expenses subject to a "reasonably necessary" standard. *Id.* Finally, the statute sets expenses for a dependant child at actual expenses "not to exceed" a dollar amount specified in the statute and periodically adjusted. 11 U.S.C. § 707(b)(2)(A)(ii)(IV). By requiring the Debtor to project his expenses as defined under these rules and deduct only those expenses, rather than allowing him to deduct actual expenses, the statute calls for a forward-looking assessment of his disposable income in the months following bankruptcy. In light of these forward-looking definitions of allowable expenses, the definition of "payments on account of secured debt" is best read to be forward looking as well.

By focusing on the single term "contractually due" without giving due consideration to the phrases "scheduled as" and the phrase "following the date of the petition," the bankruptcy court "miss[ed] the actual meaning and the intent of § 707(b)(2)." *Skaggs*, 349 B.R. at 600. Read as a whole and in light of the other deductions allowed under the means test, section 707(b)(2)(A)(iii) requires a forward-looking assessment of the secured payments that the Debtor actually will make.

B. Looking Forward, Payments That the Debtor Will Not Make Cannot Be Considered "Payments on Account of a Secured Debt"

Contrary to the bankruptcy court's conclusion, the surrender and transfer of title of collateral securing a debt changes the nature of the debt, so that any remaining obligation on the debt is not an obligation "on account of a secured debt" and any payment would not be made to a "secured creditor," as required by the statute. Accordingly, the forward looking nature of the means test is critically important; it means that payments that are due on a secured debt but that the Debtor will never make cannot be deducted from monthly income under the means test.

While a debtor's obligation on account of a secured debt after he surrenders collateral varies under state law, surrender and transfer of title either eliminates the obligation or turns the debt into an unsecured debt. Some states are non-recourse states, in which a borrower may surrender property and will not be liable for any deficiency. *See* Baxter Dunaway, *State Laws and Practices Regarding Confirmation of Sale and Deficiency Judgments*, Appendix 19A, Law of Distressed Real Estate (2008). And, even in recourse states, once a debtor surrenders collateral and title transfers to the lender, the debt becomes an unsecured debt rather than a secured one, which means that any payment on a contractual obligation that follows would not be a "payment on account of [a] secured debt[]," and would not be made to a "secured creditor." *See In re Wright*, 492 F.3d 829 (7th Cir. 2007) (concluding that where debtors owed more on their purchase-money automobile loan than the car was worth, any shortfall had to be treated as an unsecured debt under the Bankruptcy Code, because the creditor was entitled only to an unsecured deficiency judgment after surrender of the car).

While the bankruptcy court in this case asserted that "[a] payment on a secured debt is still 'contractually due' regardless of the debtor's intent to surrender the encumbered property," *Harvey*, 407 B.R. at 872 (*citing Rudler*, 388 B.R. at 438), the court failed to recognize that any obligation that remains "contractually due" would not be due to a "secured creditor" as specified in the statute. Once the surrender (or foreclosure) takes place and title is transferred to the lender, any obligations become *unsecured*, and that fact is relevant to the Debtor's monthly expenses, and thus relevant to whether granting the Debtor a chapter 7 discharge would be an abuse. As one court has explained, when "a debtor surrenders collateral, the debtor is no longer required to make the scheduled installment payments. If there is a deficiency after application of the collateral proceeds to the indebtedness, an unsecured claim remains, but a secured debt no longer exists and no payment is due except for an unsecured deficiency balance." *In re Harris*, 353 B.R. at 309. "'Indeed, debtors return collateral to secured parties for the express purpose of lowering their monthly living expenses.'" *Id.* (*quoting Love*, 350 B.R. at 614-15).

A court assessing a motion to dismiss a filing as presumptively abusive will know whether the debtor intends to make payments on the debt or forfeit the collateral. A debtor must file a statement of intention as to whether he intends to retain or surrender property secured by debt within 30 days of the earlier of the chapter 7 petition date and the date of the meeting of creditors. *See* 11 U.S.C. § 521(a)(2)(A); Fed. R. Bankr. P. 1017(b)(2) (requiring individual debtors in chapter 7 cases to file a statement of intent on the appropriate form). This means that the latest possible date for a debtor to file the statement is 30 days after he files his chapter 7 petition. United States Trustees have 10 days from the meeting of creditors to "review all materials" filed by a debtor (including the statement of intent), and file a statement as to whether the debtor's case would be presumed abusive under section 707(b), and 30 days to file a motion to dismiss for presumed abuse. 11 U.S.C. § 704(b)(1) and (2). Because the meeting of creditors must be held "no fewer then 20 and no more than 40 days after the order for relief," *see* Fed. R. Bankr. P. 2003, which in a voluntary petition under chapter 7 is the date the petition is filed, *see* 11 U.S.C. 301(b), the United States Trustee and the court should know by the deadline for filing the statement on presumptive abuse whether the debtor intends to surrender property secured by debt.[4]

C. Disallowing Deductions for Payments That Will Never Be Made Best Serves the Purpose of the Means Test

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[4] Under similar circumstances in the chapter 13 context, the Seventh Circuit has stated that it "cannot see the merit in throwing out undisputed information, bearing on how much the debtor can afford to pay, that comes to light between the submission and approval of a plan of reorganization." *In re Tuner*, 574 F.3d 349, 362 (7th Cir. 2009). Surely, if such information can be considered by courts in the chapter 13 context, it should be considered by them in the chapter 7 context as well, especially when one considers that such information is readily available to them via the statement of intent.

1. Allowing a deduction only for mortgage payments that actually will be made is not only compelled by the statutory text, but also best serves Congress's purpose in enacting the means test. The 2005 Act established the means test – the "heart of the [2005 Act's] consumer bankruptcy reforms," H.R. Rep. No. 109-31 (I) at 1 (2005), reprinted in 2005 U.S.C.C.A.N. 88, 89 – to identify which debtors have the means to pay something to their creditors, and which do not. Congress intended the means test to ensure that those who can afford to repay some portion of their unsecured debts be required to do so. *See* H.R. Rep. No. 109-31 (I) at 1 (2005), reprinted in 2005 U.S.C.C.A.N. 88, 89 (stating intent to make certain that debtors "repay creditors the maximum they can afford."). That purpose is better served by allowing the Debtor to include only those payments that the Debtor actually will make. Reading the means test to allow the deduction of payments that the Debtor has no intention of making would make the means test a less accurate picture of the Debtor's "average monthly payments on account of secured debts." By contrast, reading the statute to allow only those payments that actually will be made gives a more accurate picture of what the Debtor's resources will be in the period following the petition, which is the key fact for determining whether the petition is presumptively abusive. In this case, the difference is stark. If the ruling below stands, the Debtor's debts will be discharged even though he has $800 in disposable income and could repay his creditors roughly $48,000 over the course of a 60 month chapter 13 plan.

The lower court's decision concluded that its interpretation of the statute served Congress's intent to "'reduce judicial discretion in the process.'" *Harvey*, 407 B.R. at 873 (*quoting*, *In re Randle*, 358 B.R. 360, 363 (Bankr. N.D. Ill. 2006)). The history of the 2005 Act makes clear, however, that Congress's primary intent in reducing judicial discretion and creating the means test was to decrease the number of abusive filings by ensuring that debtors "repay creditors the maximum they can afford," and its effort to make the means test a mechanical one was subsidiary to the effort to eliminate abuse. And in any event, the means test is more accurate, and no less mechanical, if it requires a court to take the Debtor's intent to surrender property securing a debt into account when projecting the debtors payments on account of secured debt in the 60 months following the filing of the bankruptcy petition.

2. An analogy to the factors for dismissing a chapter 7 petition prior to the 2005 Act also suggests that the means test should not be read to allow the deduction of payments on account of secured debt that will not be made. Prior to the 2005 Act, section 707(b) provided a presumption in favor of discharging the debts of a chapter 7 debtor, and a party seeking dismissal under section 707(b) was required to show that permitting the case to proceed under chapter 7 would be a "substantial abuse" of the provisions of chapter 7. The 2005 Act changed this statutory framework by removing both the presumption in favor of discharge and the term "substantial." A chapter 7 case may now be dismissed or converted upon a showing that the grant of relief under chapter 7 would be only an abuse (not a substantial abuse) of the provisions of chapter 7. 11 U.S.C. §§ 707(b)(1), 707(b)(2)(A).

Because Congress eliminated the presumption in favor of discharge and the requirement that the abuse of chapter 7 be "substantial," the standard for whether a bankruptcy petition should be dismissed under section 707(b) must now be understood to be less demanding than it was before the 2005 Act. If "substantial abuse" required, *inter alia*, the ability to repay a substantial portion of one's debts, *see In re Green*, 934 F.2d 568 (4th Cir. 1991), then simple abuse must require the ability to repay something less than a substantial amount of one's debts. But reading the means test to allow the deduction of payments on account of secured debt even though those payments will never be made would effectively allow the debtor to shelter a substantial portion of his income, which would make the standard for dismissal of a chapter 7 petition harder to meet, rather than easier. As one court has explained, the debtor "would be artificially reducing his current monthly income to defeat the purpose of the means test and to avoid paying his debts to his creditors, when he could in fact afford to pay." *Naut*, 2008 WL 191297, at *8.

CONCLUSION

The judgment of the bankruptcy court below should be reversed.

Respectfully submitted,

OF COUNSEL

RAMONA D. ELLIOTT
General Counsel

P. MATTHEW SUTKO
Associate General Counsel
DAVID I. GOLD
Trial Attorney
Executive Office for United States Trustees
United States Department of Justice
20 Massachusetts Avenue NW
Washington, D.C. 20530

W. CLARKSON McDOW, JR.
United States Trustee

By: */s/ Joseph A. Guzinski*
JOHN ROBERT BYRNES
Assistant United States Trustee
JOSEPH A. GUZINSKI
Trial Attorney
Office for United States Trustee
First Campbell Square
210 First Street, S.W.
Roanoke, Virginia 24011
Telephone: (540) 857-2699

CERTIFICATE OF SERVICE

I hereby certify that on November 20, 2009, I electronically filed the foregoing with the Clerk of the Court and transmitted a true and correct copy through the electronic case filing system, and by first class mail, postage pre-paid, to the following:

William J. Charboneau, Esq.
Magee, Foster, Goldstein & Sayers
P. O. Box 404
Roanoke,, VA 24003
(540) 343-9800
Email: jcharboneau@mfgs.com
Counsel for Debtors and Appellants

/s/ Joseph A. Guzinski
Joseph A. Guzinski
Trial Attorney

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John R. Byrnes, Joseph A. Guzinski, Anne W. Stukes, David I. Gold, P. Matthew Sutko, Ramona D. Elliott, W. Clarkson, Jr.

(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") ● ***SUMMARY*** OF KEY ISSUE(s)

&

√ Any Miscellaneous ***BACKGROUND***

● Whether section 707(b)(2)(A)(iii) provides for the inclusion of non-existent mortgage payments under the means test.

10. PATH TO FILE LOCATION:
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District Court Case No. 7:09-cv-00425-SGW

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF VIRGINIA

In re GARLAND TERRY HARVEY

Debtor.

W. CLARKSON MCDOW, JR.,
UNITED STATES TRUSTEE
FOR REGION FOUR,

Appellant,
v.

GARLAND TERRY HARVEY,

Appellee.

ON APPEAL FROM THE UNITED STATES BANKRUPTCY COURT
FOR THE WESTERN DISTRICT OF VIRGINIA
Bankruptcy Case No. 08-71684

REPLY BRIEF FOR THE UNITED STATES TRUSTEE, APPELLANT

RAMONA D. ELLIOTT
General Counsel

P. MATTHEW SUTKO
Associate General Counsel
DAVID I. GOLD
ANNE W. STUKES
Trial Attorneys
Executive Office for
United States Trustees
United States Department of Justice
20 Massachusetts Avenue N.W.
Washington, D.C. 20530

W. CLARKSON McDOW, JR.
United States Trustee

JOHN ROBERT BYRNES
Assistant United States Trustee
JOSEPH A. GUZINSKI
Trial Attorney
Office for United States Trustee
First Campbell Square
210 First Street, S.W.
Roanoke, Virginia 24011
Telephone: (540) 857-2699

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INTRODUCTION

In our principal brief, the United States Trustee established that section 707(b)(2)(A)(iii) of the Bankruptcy Code does not allow debtors, like the Debtor in this case, to deduct "phantom"[1] mortgage payments they will not make. *See* Appellant's Principal Br. at 10-19. There are three reasons why this is so. First, read as a whole, section 707(b)(2)(A) makes clear that bankruptcy's means test is forward looking. *Id.* at 11-15. Second, since bankruptcy's means test is forward looking, one must conclude that payments that a debtor will not make cannot be considered "payments on account of a secured debt." *Id.* at 15-17. Third, disallowing deductions for payments that will never be made best serves the purposes of the means test. *Id.* at 17-19.

In response, the Debtor argues that he should be permitted to deduct monthly mortgage payments on his means test because those payments remained due at the time that he prepared his bankruptcy filing, even though he made clear that he would not make them. *See* Appellee Br. at 4-25. The Debtor's reading of section 707(b)(2)(A)(iii) fails to take into account the entirety of the bankruptcy statute as it applies to the Debtor, and fails to take into account the phrase "following the date of the petition" found in section 707(b)(2)(A)(iii). Further, the Debtor fails to respond to the United States Trustee's argument that the government's reading of section 707(b)(2)(A)(iii) treats payments on secured debts most consistently with other expense deductions under the means test. Finally, because the Debtor's

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[1] *See In re Turner*, 574 F.3d 349, 356 (7th Cir. 2009) (describing the type of payments the Debtor seeks to deduct in this case as "phantom" payments).

assertions that section 707(b)(2)(A)(iii) is not grounded in reality are erroneous, and because reality dictates that the Debtor's non-existent mortgage payment should be disallowed under the means test, reversal is appropriate.

ARGUMENT

I. Notwithstanding the Debtor's Assertions to the Contrary, Section 707(b)(2)(A)(iii) Does Not Provide for the Inclusion of Non-Existent Mortgage Payments Under the Means Test

A. The Debtor's reading of section 707(b)(2)(A)(iii) fails to take into account the entirety of the bankruptcy statute.

In his brief, the Debtor suggests that the phrase "scheduled as contractually due" includes payments that will be contractually due after his bankruptcy filing, regardless of whether they will be made, in order to "give meaning to every word used in the statute."[2] *See* Appellee Br. at 8. However, the United States Trustee's forward-looking construction of section 707(b)(2)(A)(iii) gives the phrase "scheduled as contractually due" meaning. And, unlike the Debtor's construction, does so within the context of the entirety of the Bankruptcy Code.

Under the United States Trustee's construction of section 707(b)(2)(A)(iii), the phrase "scheduled as" requires that a court include only those contractual obligations on secured debts that are properly listed on a bankruptcy schedule because the debtor intends to honor them. *See* Appellant's Principal Br. at 13. The United States Trustee bases this construction on the use of this phrase "scheduled

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[2] The debtor's argument that every word in the statute must be given meaning is ironic because he espouses an interpretation of section 707(b)(2)(A)(iii) that the First Circuit has found renders the words "scheduled as" as mere "surplusage." *See Morse v. Rudler (In re Rudler)*, 576 F.3d 37, 46 (1st Cir. 2009).

as” in section 1111(a) of the Bankruptcy Code. *See* 11 U.S.C. § 1111(a). Because section 1111(a) is the only other provision of the Bankruptcy Code other than section 707(b)(2)(A)(iii) that uses the phrase “scheduled as,” the same meaning imparted to the phrase “scheduled as” in section 1111(a) should be given to the phrase “scheduled as” in section 707(b)(2)(A)(iii). *See Commissioner* v. *Keystone Consol. Industries, Inc.*, 508 U.S. 152, 159 (1993) (“‘identical words used in different parts of the same act are intended to have the same meaning’”).

Section 1111(a) provides that a “proof of claim or interest is deemed filed under section 501 of this title for any claim or interest that appears in the schedules filed under . . . section 521(1) or 1106(a)(2) of this title, except a claim or interest that is **scheduled as** disputed, contingent, or unliquidated.” 11 U.S.C. § 1111(a) (emphasis added). The second part of the provision excepts claims that are “**scheduled as** disputed, contingent, or unliquidated.” *Id.* (emphasis added).

Thus, under the Bankruptcy Code, the term “scheduled as” in section 1111(a) means “appears on the schedule” or “appended to” the schedule. *Cf. In re Harvey*, 407 B.R. 867, 873 (Bankr. W. Va. 2009) (“This Court believes that ‘scheduled as’ is better interpreted to mean ‘appears on a debtor’s bankruptcy schedules.’”).

One of the documents “appended” in this case was the Debtor’s Statement of Intent. *See* Fed. R. Bankr. P. Official Form B8. In it, the Debtor makes clear he will not be making payments on his home because he is surrendering the home. *See* Appellant Rec. No. 1 at 39. Therefore, section 707(b)(2)(A)(iii), which limits expenses to those scheduled as going to be owed, does not allow the Debtor to claim phantom expenses he will not make.

This common sense reading works best in the real world of bankruptcy. In order for the bankruptcy system to function effectively, debtors must honestly and accurately report their financial affairs on their schedules and statements filed with the court, and fulfill their duty to amend those schedules and statements to keep the information in them current. *See In re An-Tze Cheng*, 308 B.R. 448, 458 (B.A.P. 9th Cir. 2004), *aff'd*, 160 Fed. Appx. 644 (9th Cir. 2005); *In re Searles*, 317 B.R. 368, 378 (B.A.P. 9th Cir. 2004), *aff'd*, 212 Fed. Appx. 589 (9th Cir. 2006). The United States Trustee's construction of section 707(b)(2)(A)(iii) is true to this principle. The Debtor's construction is not.

This is so because section 521(a)(2)(B) of the Bankruptcy Code expressly requires that debtors who indicate an intent to surrender collateral on their Statement of Intent, *see* Fed. R. Bankr. P. Official Form B8, actually surrender that collateral shortly after filing their case. *See* 11 U.S.C. § 521(a)(2)(B) ("within 30 days after the first date set for the meeting of creditors under section 341(a), or within such additional time as the court, for cause, within such 30-day period fixes, the debtor **shall** perform his intention with respect to such property, as specified by subparagraph (A) of this paragraph.") (emphasis added).[3] Thus, when debtors, like

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[3] Because section 521(a)(2)(B) uses the word "shall," its requirements are mandatory. *See Plaut v. Spendthrift Fram, Inc.*, 1 F.3d 1487, 1490 (6th Cir. 1993) ("[w]here the word 'shall' appears in a statutory directive, 'Congress could not have chosen stronger words to express its intent that [the specified action] be mandatory. . . .'"), *aff'd.* 514 U.S. 211 (1995); *Lexicon Inc. v. Milberg Weiss Bershad Hynes & Lerach*, 523 U.S. 26, 35 (1998) ("the mandatory 'shall' . . . normally creates an obligation impervious to judicial discretion").

the Debtor in this case, file a Statement of Intent indicating an intent to surrender property, that known reality must be taken into account. *See J.E.M. Ag. Supply, Inc. v. Pioneer Hi-Bred Int'l, Inc.*, 534 U.S. 124, 143-44 (2001) ("'when two statutes are capable of coexistence, it is the duty of the courts, absent a clearly expressed congressional intention to the contrary, to regard each as effective.'").

The United States Trustee's construction of section 707(b)(2)(A)(iii) accomplishes this task because it only includes those contractual obligations on secured debts listed on a debtor's bankruptcy schedules that the debtor **intends to honor**. Conversely, the Debtor's construction overlooks what he is statutorily obligated to do under section 521(a)(2)(B) (*i.e.*, surrender his home), and therefore "violate[s] the basic principle of construction that statutes should be read, if possible, as harmonious texts." *See Leaf Tobacco Exporters Ass'n. v. Block*, 749 F.2d 1106, 1115 (4th Cir. 1984).

Allowing deductions without regard to a debtor's stated intent to surrender associated property would credit a set of facts that is known to be false, giving the debtor the undue benefit of a non-existent expense. *See In re Turner*, 574 F.3d at 356 ("A fixed debt that will disappear . . . is not intended to enrich the debtor at the expense of his unsecured creditors."). Because the bankruptcy court's ruling erred in failing to give effect to the Debtor's statement of intention, and as a consequence the import of section 521(a)(2)(B), it misapplied the language of 707(b)(2)(A)(iii) and its decision should be reversed.

B. The Debtor's reading of section 707(b)(2)(A)(iii) fails to take into account the phrase "following the date of the petition" found in section 707(b)(2)(A)(iii).

As the United States Trustee argued in his opening brief, allowing a deduction for mortgage payments that will never be made, on the theory that the payments are contractually due even if the debtor will never make them, also ignores the phrase "**following** the date of the petition." *See* Appellant's Principal Br. at 14. *Cf. Turner*, 574 F.3d at 349 (rejecting in chapter 13 context any right to claim a "phantom" expense for surrendered property). As we have explained, the word "following," used as a preposition, means "subsequent to" or "after in time." *Webster's Third New Int'l Dictionary*, 833 (1993). By requiring courts to look at payments contractually due "subsequent to" or "after" the date of the petition (*i.e.*, the date a bankruptcy case is filed), the statute's plain meaning contemplates a projection of future expenses rather than a snapshot of current expenses. "A statute 'must be interpreted, if possible, to give each word some operative effect.'" *In re Ennis*, 558 F.3d 343, 346 (4th Cir. 2009) (*quoting Walters v. Metro. Educ. Enters.*, 519 U.S. 202, 209 (1997)). Thus, to give effect to each provision in the statute, section 707(b)(2)(A)(iii) should be read to allow a debtor to deduct only payments that he actually will make "subsequent to" or "after" the date his bankruptcy case is filed.

Although the Debtor repeatedly argues that the means test is a "snapshot" of a debtor's financial condition at the time he files bankruptcy, even he cannot deny that the phrase "following the date of the petition" requires the Court to look forward. Rather than interpreting the phrase to look forward to his anticipated financial condition, however, the Debtor argues that the phrase requires the Court to perform a calculation of his payments on the collateral to be surrendered for 60 months after the petition date. *See* Appellee Br. at 14. No statute says that, and such a construction ignores the plain meaning of the word "following" in section 707(b)(2)(A)(iii). Indeed, the Debtor's construction of the phrase "following the date of the petition" appears to have been rejected by the Seventh Circuit in *Turner*. *See In re Turner*, 574 F.3d at 355 ("Turner infers from this that the amount of the debtor's payments on account of secured debts, such as a debt secured by a mortgage, must be calculated as of the date of the petition. But that is not what the provision says. It merely specifies that the date of the petition is the date on which the payment period begins.").

C. Because the Debtor failed to respond to the United States Trustee's argument that the government's reading of section 707(b)(2)(A)(iii) treats "payments on account of secured debts" most consistently with other expense deductions under the means test, he tacitly concedes the argument.

As the United States Trustee argued in his opening brief, the phrase "payments on account of secured debts" found in section 707(b)(2)(A)(iii) should also be read to call for a forward-looking assessment of what payments the debtor actually will make. *See* Appellant's Principal Br. at 14-15. This is the case because, as noted by the United States Trustee in his principal brief, reading this phrase as forward-looking is most consistent with the treatment of other expenses under the means test. *Id.* Because the Debtor fails to respond to this argument in his brief, he tacitly agrees with this point and therefore concedes the argument. *See* Appellee's Br. at 1-25.

II. Notwithstanding the Debtor's Assertions to the Contrary, Section 707(b)(2)(A)(iii) is Grounded in Reality, and Reality Dictates That the Debtor's Non-Existent Mortgage Payment Be Disallowed Under the Means Test

According to the Debtor, section 707(b)(2) "is generally not grounded in the reality of any debtor's case[,]" and the United States Trustee's position introduces an impermissible element of "subjectivity" into the statute. *See* Appellee Br. at 8-9. The decisions relied upon by the Debtor have made a similar point. But the clear terms of section 707(b)(2) belie the Debtor's interpretation. In devising a mechanism to ascertain a debtor's post-petition financial condition, Congress included a variety of approaches: historical (examining the history of a debtor's "real" earnings), 11 U.S.C. §101(10A) & 707(b)(2)(A)(i); objective "allowances, 11 U.S.C. § 707(b)(2)(A)(ii)(I); and projected actual (*i.e.*, "real") expenses, 11 U.S.C. §707(b)(2)(A)(ii)(II)-(IV). Thus, much of the means test is real, and there is no reason to presume Congress intended that standard expense deductions should be interpreted in a way that defies reality. *Cf. Turner*, 574 F.3d at 349 (rejecting in chapter 13 context any right to claim a "phantom" expense for surrendered property); *In re Ransom*, 577 F.3d 1026, 1030 (9th Cir. 2009) (rejecting, under section 707(b)(2)(A)(ii)(I), any right to claim a "fictitious" vehicle ownership expense). And, while it is true that all predictions must involve guesswork, in this case that guesswork has been eliminated because the Debtor himself has indicated an intent to surrender the property associated with the secured debt in question. *See* 11 U.S.C. § 521(a)(2)(B) (the debtor **shall** perform his intention with respect to such property, as specified by subparagraph (A) of this paragraph.") (emphasis added). Accordingly, "all that is at issue is a fixed debt that **we know will disappear**," *Turner*, 574 F.3d at 356 (emphasis added), and reality therefore dictates that the Debtor's non-existent mortgage payment be disallowed under the means test.

CONCLUSION

For all these reasons, and those asserted in the United States Trustee's principal brief, the judgment of the bankruptcy court below should be reversed.

Respectfully submitted,

RAMONA D. ELLIOTT
General Counsel

P. MATTHEW SUTKO
Associate General Counsel
DAVID I. GOLD
ANNE W. STUKES
Trial Attorneys
Executive Office for
United States Trustees
United States Department of Justice
20 Massachusetts Avenue N.W.
Washington, D.C. 20530

W. CLARKSON McDOW, JR.
United States Trustee

/s/ Joseph A. Guzinski
JOHN ROBERT BYRNES
Assistant United States Trustee
JOSEPH A. GUZINSKI
Trial Attorney
Office for United States Trustee
First Campbell Square
210 First Street, S.W.
Roanoke, Virginia 24011
Telephone: (540) 857-2699

CERTIFICATE OF SERVICE

I hereby certify that on January 22, 2010, I electronically filed the foregoing with the Clerk of the Court and transmitted a true and correct copy through the electronic case filing system, and by first class mail, postage pre-paid, to the following:

William J. Charboneau, Esq.
Magee, Foster, Goldstein & Sayers
P. O. Box 404
Roanoke,, VA 24003
(540) 343-9800
Email: jcharboneau@mfgs.com
Counsel for Debtors and Appellants

/s/ Joseph A. Guzinski
Joseph A. Guzinski
Trial Attorney

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WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*

Loop Corp., et al. v. UST, (In re Health Risk Mgmt.)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*

CTA 8

3. ("CCN") ***CURRENT*** CASE NO.

No.: 03-1786

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*

No.: 02-793

Court: DC D Minn.– Judge Ann D. Montgomery

(Identify judge & cite, if any)

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U.S. TRUSTEES

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Type: Brief for Appellee, UST

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Michael R. Fadlovich, Esq

(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***

BANKRUPTCY

9. ("SU") ! ***SUMMARY*** OF KEY ISSUE(s)

&

√ Any Miscellaneous ***BACKGROUND***

! Whether the district court erred in sustaining the bankruptcy court's decision to convert these four related chapter 11 cases to chapter 7 pursuant to 11 U.S.C. § 1112(b).

√ Background:

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United States Court of Appeals
For The Eighth Circuit

No. 03-1786

In re: Health Risk Management, Inc., BKY 01-43354
HRM Claim Management, Inc, BKY 01-43355
Institute for Healthcare Quality, Inc., BKY 01-43356
Health Benefit Reinsurance, Inc., f/k/a
Health Benefit Reinsurance of Michigan, Inc., BKY 01-43357
Debtors.

Loop Corp, Leon Greenblatt, Nola, LLC.,
Repurchase Corp., Leslie Jabine, Teletech Systems, Inc., Chiplease, Inc.,
and Banco Panamericano,
Appellants,

v.

United States Trustee
& Committee of Unsecured Creditors,
Appellees.

ON APPEAL FROM THE DISTRICT COURT FOR THE
DISTRICT OF MINNESOTA, DISTRICT COURT FILE NO.: 02-793 ADM
HONORABLE ANN D. MONTGOMERY

BRIEF OF APPELLEE UNITED STATES TRUSTEE

HABBO G. FOKKENA
UNITED STATES TRUSTEE

By: Michael R. Fadlovich (#158410)
United States Trustee's Office
1015 U.S. Courthouse
300 South Fourth Street
Minneapolis, MN 55415
(612) 664-5505

Attorneys for Appellee United States Trustee

2003 – BACHMAN LEGAL PRINTING – FAX (612) 337-8053 – PHONE (612) 339-9518 or 1-800-715-3582

SUMMARY OF THE CASE AND DECLINATION OF ORAL ARGUMENT

The issue before this Court is whether the district court erred in sustaining the bankruptcy court's decision to convert these four related chapter 11 cases to chapter 7 pursuant to 11 U.S.C. §1112(b). The decisions of both courts were properly made and should not be reversed on appeal.

The debtors were companies that engaged in health care administration related businesses. The debtors sought bankruptcy protection because they experienced a capital shortfall which was at least in part attributable to the Appellants. Once under the protection of the bankruptcy court, the debtors liquidated their operating assets and proposed a chapter 11 plan which provided for the distribution of $3.25 million in sale proceeds to creditors. The creditors did not accept that proposal and unsuccessful negotiations over the plan's terms continued for months, during which time substantial administrative expenses dissipated the Debtors' assets.

The United States Trustee moved under 11 U.S.C. §1112(b) to convert these cases to chapter 7 so that an independent chapter 7 trustee could liquidate the Debtors' assets for the benefit of creditors because (1) there were ongoing losses to and a diminution of the estate coupled with an absence of any reasonable likelihood of rehabilitation; (2) the Debtor was unable to effectuate a plan; and (3) there was an unreasonable delay which was prejudicial to creditors. The court initially found cause to convert the cases but gave the Debtors a grace period to make progress in the chapter 11 case. Instead of progress, however, conditions worsened. An outside group - the Appellants here - seized control of the Debtors, and the Creditors' Committee independently moved to convert the cases to chapter 7. *At that point, the bankruptcy court exercised its discretion under* §1112(b) and converted the cases, in part, because all parties conceded the debtors had not met the court's previously established requirements for staying in chapter 11. This appeal followed.

The United States Trustee submits that no oral argument is necessary because the uncontested facts overwhelmingly support the bankruptcy court's discretionary decision to convert the cases to chapter 7.

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A. STATEMENT OF JURISDICTION

The bankruptcy court had jurisdiction over the United States Trustee's motion to convert the chapter 11 cases to chapter 7 cases under 28 U.S.C. §157(a) and (b). The district court had jurisdiction to hear the appeal from the bankruptcy court's order converting the cases under 28 U.S.C. §158. The district court entered judgment on February 5, 2003. A timely notice of appeal was filed on March 7, 2003. An order converting a case from chapter 11 to chapter 7 pursuant to 11 U.S.C. § 1112(b) is final for purposes of appellate jurisdiction, and this Court, therefore, has jurisdiction under 28 U.S.C. §158(d).

B. STATEMENT OF THE ISSUE

The issue on appeal is whether the bankruptcy court appropriately exercised discretion when it determined, after three hearings and a review of the record in the case, that cause existed to convert these chapter 11 bankruptcy cases to chapter 7 cases pursuant to 11 U.S.C. §1112(b), when cause included that the Debtors had liquidated their assets and had not been in business for over four months, administrative expenses were diminishing the Debtors' only tangible asset, $3.25 million in cash, the parties could not negotiate a consensual chapter 11 reorganization plan, the Debtors' proposed plan was not confirmable on its face and any attempt to preserve potential net operating loss for future use was speculative at best and futile at worst.

Loop made six separate arguments on appeal to the district court in support of their view that the bankruptcy court erred in converting this case.[1] That court

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[1] The six arguments raised by Loop are as follows:

1. Whether the bankruptcy court applied the proper legal standard under §1112(b)(1) in determining that cause existed to convert the cases to chapter 7,
2. Whether the United States Trustee was held to his proper burden of proof,
3. Whether the United States Trustee introduced sufficient evidence to support the conversion of the cases to chapter 7,
4. Whether the bankruptcy court erred in failing to make adequate findings of fact to support its conversion order,
5. Whether the bankruptcy court failed to give proper weight to

rejected them and found the bankruptcy court acted well within its discretion in converting this case.

A. Decisions

In re Lumber Exch. Bldg. Ltd. P'ship, 968 F.2d 647 (8th Cir. 1992)

Cedar Shore Resort, Inc. v. Mueller, 235 F.3d 375 (8th Cir. 2000)

In re Clarkson v Cooke Sales and Service Co. (In re Clarkson), 767 F.2d 417 (8th Cir. 1985)

In re Fossum, 764 F.2d 520 (8th Cir. 1985).

B. Statutes and Rules

11 U.S.C. § 1112(b)

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certain evidence, and

6. Whether the debtors were deprived of the opportunity to present their revised chapter 11 plan.

C. STATEMENT OF THE CASE

The Appellant challenges the bankruptcy court's order converting this case to chapter 7 which was entered after both the Appellee United States Trustee and the Official Committee of Unsecured Creditors (Creditors' Committee) filed motions seeking conversion and after the bankruptcy court held no less than three hearings on those motions. At the time of conversion, Appellant Loop Corp. ("Loop")[2] was owner of roughly half of the stock of the Debtor parent corporation, and was facing litigation by the Debtor in the chapter 11 proceedings. Shortly before conversion, Loop and related entities seized control of the debtor, which caused the creditors' committee to seek emergency conversion to chapter 7. In the Creditors' Committee's view, the fox had seized the henhouse. On appeal, Loop argues the bankruptcy court erred in converting the cases because it used an improper legal standard, had insufficient evidence to support its conversion decision, used an inappropriate burden of proof, and converted prematurely. The district court rejected each of these contentions in affirming conversion. Loop now argues that the district court made the same errors as the bankruptcy court.

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[2] Since Loop and the rest of the named Appellants are controlled by the same individual and speak with one voice, (see page 5-6), they will be referred to herein in the singular.

D. STATEMENT OF FACTS

These cases were commenced on August 7, 2001, when the Debtors filed voluntary petitions under the debt reorganization provisions of chapter 11 of the Bankruptcy Code, 11 U.S.C. 1101, *et seq. Voluntary Petition*, Doc. #1. The lead debtor, Health Risk Management, Inc. ("HRMI"),[3] was a publicly traded company which wholly owned the three related debtor subsidiaries, HRM Claim Management, Inc., Institute For HealthCare Quality, Inc. and Health Benefit Reinsurance, Inc., as well as other non-debtor corporations. *Joint Disclosure Statement dated December 5, 2001 ("December 5 Disclosure Statement"),* Doc. #214 at 4, 6. The four Debtors operated under the same corporate structure and did not operate their businesses as distinct entities. *See id.* at 4. The bankruptcy court ordered the joint administration of the four bankruptcy estates on August 10, 2001, and further ordered that all pleadings be filed in the HRMI case. Doc. #19.

1. Pre-Bankruptcy Petition Facts

Loop Corp. ("Loop"), Leon Greenblat, Banco Panamericano, Chiplease, Inc., Repurchase Corp., and Teletech Systems are all controlled by Leon Greenblatt and/or Andrew Jahelka. *See Bankruptcy Schedules*, Doc. #79;

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[3] Health Risk Management, Inc., the parent company, will be referred to as the Debtor herein.

Statement of Financial Affairs, Item #21. *See also Debtor's March 13, 2002 Plan of Reorganization* ("March 13 Plan"),[4] Doc. #294 at 5 (definition of Loop Entities). Appellant Leslie Jabine is Mr. Greenblatt's wife. *Motion by Unsecured Creditors' Committee to Convert,* Doc. # 290 at 4. Although the caption of this case indicates that all Appellants are independent entities, they are actually different parts of the same collective entity.

HRMI was founded by Dr. Gary T. McIlroy and his wife, Marlene Travis, in 1977. *See August 16, 2001 Affidavit of Gary T. McIlroy, M.D.,* Doc. #28 at 1. HRMI was the sole shareholder of the other three Debtors, HRM Claim Management, Inc., Institute For HealthCare Quality, Inc. and Health Benefit Reinsurance, Inc. *December 5 Disclosure Statement* at 6. At the time the cases were commenced, the Debtors had two primary businesses, the 4YourCare business, which provided health care management and health claim administration services, and the QualityFirst business, which consisted of an interactive, patient centered system for quality of care management utilizing scientific data bases. *Id.*

The Debtor also had a non-debtor subsidiary known as HRM Health Plans (PA), Inc., which operated two Health Maintenance Organizations which, as of December 31, 2000, had 56,700 members in Philadelphia and another 17,400

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[4] Executed by Leon Greenblatt as Chief Restructuring Officer for the debtors.

members in central Pennsylvania. *December 5 Disclosure Statement* at 1 and Exhibit #1. As of December 31, 2000, the revenues from the Debtor's HMO subsidiaries were $187,637,000.00 and constituted 81% of the Debtor's total revenues. *Id.*

Beginning in 1996, Leon Greenblatt, a Chicago arbitrager, instituted a series of attempts to take over HRMI by acquiring shares in the Debtor. *Affidavit of Gary T. McIlroy, M.D., August 16, 2001*, Doc. # 28 at 1. As Mr. Greenblatt's minority ownership of public shares increased, so did the pressure he sought to exert upon the Debtors' management to take actions to place him in control of the corporations. *Id.* During 1999, Mr. Greenblatt or his associates made over 1,500 calls to the Debtor demanding that the Debtor be sold or turned over to him. *Id.* In 2000, Mr. Greenblatt demanded a seat on the Debtor's Board of Directors and litigated with the Debtor his right under Minnesota Corporate law to demand control over the corporation. *Id.* That litigation resulted in a May, 2000 "standstill" agreement under which Mr. Greenblatt was given one seat on the Debtor's board of directors. *Id.* Mr. Greenblatt appointed his business partner, Andrew Jahelka to sit on the board. *Id.*

During March, 2001, Mr. Greenblatt took actions to prevent the Debtor from obtaining third party financing to fund the companies' operations, and continued to pressure Dr. McIlroy and Ms. Travis to resign their positions with the Debtor. *Id.* at 3. Mr. Greenblatt was successful in obtaining such resignations on March 23, 2001. *Id.* at 3.

In mid May, 2001, Mr. Greenblatt, on behalf of Loop, entered a written agreement with the Debtor to provide the Debtor with $9 million in financing. *Id.* at 4. Subsequently, Loop, through the actions of Mr. Andrew Jahelka, (who was Mr. Greenblatt's designee on the Debtor's Board), withheld a $3 million financing check from the Debtor, refusing to deposit it into the Debtor's Minnesota bank account. *Id.* at 5. *See also December 5 Disclosure Statement* at 7. When Mr. Jahelka took those actions, he was both the president of the payor on the check and the director of the payee Debtor.[5] *See Affidavit of Gary T. McIlroy, M.D.*, August 16, 2001, at 5. During the same time period, Ernst & Young, the Debtors' independent auditors, resigned after informing the Debtors that the medical services payables for the Debtor's HMO subsidiary were materially understated. *December 5 Disclosure Statement* at 7.

In May, 2001, Mr. Greenblatt and Loop, through Mr. Jahelka, advised the Debtor that Loop would not fund a $3.1 million loan commitment it had

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[5] The chapter 7 trustee subsequently sued Loop on this issue. *See* May 1, 2003, complaint in *Timothy D. Moratzka, vs. Loop Corp.*, Adversary Proceeding # 03-4113, filed in this bankruptcy case. That lawsuit remains pending.

contractually committed to provide to the Debtor. *Id.* at 7. On June 7, 2001, the Debtor was informed that it would be delisted from the NASDAQ. *Id.* Further, on August 1, 2001, the Debtor's HMO subsidiaries were placed under an "Order of Rehabilitation" by the Pennsylvania Department of Insurance. *Id.* at 7. On August 7, 2001, the Debtors' lack of adequate cash flow forced them to file for bankruptcy protection under chapter 11 of the Bankruptcy Code. *Id.* at 8, Doc. # 1.

2. Post-Bankruptcy Petition Facts

During the bankruptcy case and pursuant to court order, the Debtors sold substantially all their assets. *December 5 Disclosure Statement* at 1. On November 7, 2001, the bankruptcy court approved the sale of the 4YourCare business for $5,650,000 and the sale of the QualityFirst business for $1,800,000. Doc. # 191, 192. The sales were closed on November 9, 2001, and liens were satisfied, leaving the Debtor with net sale proceeds of approximately $3,250,000 in cash. *December 5 Disclosure Statement* at 9.

At the time it sought bankruptcy protection, the Debtor was engaged in litigation with Loop (Leon Greenblatt) in Cook County, Illinois for Loop's failure to honor its funding commitments. *See Bankruptcy Schedules*, Doc. #79; *Statement of Financial Affairs*, Item #4. At that time, Mr. Greenblatt and his affiliated companies, Loop Corporation, Banco Panamericano, Chiplease, Inc., and Scattered, *et al.* owned forty percent of the debtor's stock. *See Bankruptcy Schedules*, Doc. #79; *Statement of Financial Affairs*, Item #21.

On December 5, 2001, the Debtor filed its Joint Disclosure Statement and Plan and the bankruptcy court set a hearing on adequacy of the disclosure statement for January 23, 2002[6] Docs. # 214, 215 & 220. In order for a chapter 11 case to be successful, a debtor must file and obtain court approval of a disclosure statement and thereafter must submit it along with an accompanying plan to creditors so that the creditors can vote to either accept or reject the plan. 11 U.S.C. §1121 through §1126.

On January 10, 2002, the United States Trustee filed a motion to convert the cases from chapter 11 to chapter 7 under 11 U.S.C. §1112(b). Doc. #238. The United States Trustee argued that cause existed for conversion under §1112(b) because the Debtor had a continuing loss to and diminution of its estate, an inability to effectuate a plan, and its unreasonable delay in confirming a plan was

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[6] The hearing on adequacy of the disclosure statement was continued from January 23, 2001, to February 6, 2001, so that it would be heard simultaneous to the U.S. Trustee's motion to convert. In order for the disclosure statement to contain adequate information, it was necessary for the all issues surrounding the related plan to be addressed. Those plan issues were the focus of the bankruptcy court's analysis at the February 6, March 7 and March 13 hearings. Since they were never resolved, the disclosure statement was never approved.

prejudicial to creditors. *See United States Trustee's Motion to Convert or Dismiss*, Doc. # 239 at 2 (citing, *inter alia*, 11 U.S.C. §1112(b)(1) & (3)).

Loop responded in opposition to the motion to convert on January 30, 2002. *Doc.* #260. The Debtors also objected to the United States Trustee's motion, *Doc.* # 259, as did the Unsecured Creditors' Committee ("Creditors' Committee). *Doc.* #261.

On January 30, 2002, the Creditors' Committee sought authority from the bankruptcy court to sue Loop, Ernst & Young, and certain officers and directors of the Debtor - including Mr. Jahelka. *See Motion by Unsecured Creditors' Committee for Authority to Investigate, File and Prosecute Lawsuits*, Doc. #262 at 3-4 ("Creditors' Committee Motion"). The Creditors' Committee sought to sue Loop based on Loop's breach of its pre petition agreement to "fund the debtors up to $8 million, and failure to provide any funds after payment of the first $3 million." *See Creditors' Committee Motion,* Doc. #262. The Creditors' Committee contended the Loop, in concert with Mr. Jahelka, wrongfully failed to remit $3 million in Mr. Jahelka's possession to the Debtors under Loop's loan commitment. *Id.* The bankruptcy court denied the Creditors' Committee Motion on February 13, 2002. Doc. #279. As a result, the cause of action was left for the

Debtors to pursue.[7]

By February 2002, numerous applications for allowance of fees and expenses had been filed by professionals employed in the case. Those professionals include the Debtors' attorneys, accountant, management consultants, and investment banker, as well as the Creditors' Committee's local and lead counsel. The total fees and expenses sought in all fee applications filed before February 6, 2002, total $1,385,392.25. See Docs. # 71, 100, 103, 111, 160, 180, 206, 207, 209, 213, 224, 225, 236, 266, and 267. All allowed professional fees were payable out of the bankruptcy estate's assets. See 11 U.S.C. §§328, 330.

a. The February 6, 2002, Hearing on Conversion of the Cases to Chapter 7

On February 6, 2002, the bankruptcy court conducted its first hearing on the United States Trustee's motion to convert the cases to chapter 7. *Transcript, February 6, 2002.*

Loop took the position at the hearing that "[t]he United States Trustee has simply stepped before the Court and asked to shift the burden. The burden is on the movant. The movant has produced no evidence." *Transcript,* February 6, 2002, at 28, *l.* 3-16. The United States Trustee responded that the factual basis for

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[7] See footnote # 5.

the motion was established by everything in the record of the case, including

> " (1)the orders approving the sales of the assets; (2) the record of the debtor's plan and disclosure statement which makes the representation that the sales have been consummated and there is no business left; (3) the declaration of Mr. LeBlanc (debtors' then CEO) regarding the existence of $121 million in claims; (4) the schedules; (5) and the claims register."

Transcript, February 6, 2002, p. 29, ll. 18-24. In further opposition to the United States Trustee's motion, Loop argued that "[t]he debtors and Loop Corporation and the committee want to show the court exactly what they can do and how they can do it." *Transcript,* February 6, 2002 at 31, *l.* 7-9.

Counsel for the Debtors reiterated Loop's argument that the U.S. Trustee's conversion motion provided "no factual support in favor of its motion even though it has the burden of proof." *Transcript, February 6, 2002* at 12, *ll.* 15-16. In direct response, and based on unrebutted evidence in the record, the Bankruptcy Court found:

> "Let's start with this. Is there any – it seems to me one of the grounds for conversion or dismissal is a diminution of the estate and the lack of some likelihood of rehabilitation and those both exist here, don't they? The estate is diminishing. Certainly there is no assets coming in and there is expenses accruing and the debtor is not going to be – debtors are not being rehabilitated so grounds have been shown for conversion or dismissal right there, aren't they?

Transcript, February 6, 2002, at *12-13*, *ll.* 20-2.

At the conclusion of the February 6, 2002, hearing, the bankruptcy court continued the motion to convert to March 13, 2002, but before doing so, made the following findings of fact:

> A. There will be "an enormous expense that is . . . going to (be) sustained both to confirm a plan and to consummate this plan." *Transcript*, February 6, 2002 at 33, *ll.* 21-23.
>
> B. A "lot of money has been spent all coming out of the creditors' pockets obviously to pay the debtor's lawyers and the committee's lawyers, of which there are two, to even agree on a plan, and I don't know where that's going . . . ." *Id.* at 24, *ll.* 1-4.
>
> C. "I'm very concerned about the confirmability of it (the plan) or even if we got there." *Id.* at 34, *ll.* 9-10.
>
> D. "I don't know how you can take the creditors of four different legal entities and put them in one class." *Id.* at 23, *ll.* 12-14.
>
> E. "So I'm very concerned if you go through this all this process the plan wouldn't even be confirmable leaving out the other issues that have been raised indirectly by people who are objecting to the disclosure statement so that the confirmation process itself would not be cheap." *Id.* at 34, *ll.* 18-22.
>
> F. "Frankly as I looked at the plan it seemed to me for a case of this size at least unduly complicated and thus expensive. *Id.* at 35, *ll.* 6-8.
>
> G. "I just don't understand the whole concept of a disbursing agent and steering committee at least in a case this size, and why the debtor isn't just paying the money out which is something that could have been done and saved a lot of money. Maybe I'm missing something but I'm not missing the expense that is going to be involved in consummating this plan. Now the benefits maybe I am missing. If the cases were converted substantive consolidation and all those benefits would be available. I guess there are certainly simpler mechanisms for suing people (and) for distributing money. There is a known accountability which I find

ambiguous and unclear under the debtor's plan." *Id.* at 35-36, *ll.* 25-11.

H. "There are costs too in a Chapter 7 case but I'm unconvinced at all that either the costs or delay would be any more substantial in a Chapter 7 case than they would be in a Chapter 11 case." *Id.* at 36, *ll.* 15-17.

I. "I start . . . with . . .that grounds have been shown and cause has been shown here. The estate is diminishing". *Id.* at 35, *ll.* 18-21.

J. "The United States Trustee has shown cause and that cause has been shown. If you are looking for a record I think it is in the debtor's own statements, its own disclosure statement, its own affidavits and statements, so cause has been shown." *Id.* at 27, *ll.* 8-12.

K. "I am willing to give the parties a chance to see if they can come up with something that can convince me." *Id.* at 37, *ll.* 23-25.

L. "So the bottom line is my inclination is to convert the case unless something really substantive, affirmative, that looks likely, has some likely possibility of confirming it that everybody is behind and so by the 13th of March we all come back and we are still all fighting, we are all at each other's throats and we are going to sue each other and dispute who is going to be suing whom over what and having authority then this case is going into Chapter 7, but if in the meantime you can come up with some sort of consensual plan that looks like it is going to create a significant return to creditors over what they would get in a Chapter 7 case, you know, then we'll take a look at it then" *Id.* at 38, *ll.* 14-25.

Despite the fact that the bankruptcy court found that "cause has been shown," *id.* at 27, *ll.* 8-12, it exercised its discretion not to convert at that time in order to provide the parties additional time to negotiate a confirmable plan. For that reason, the bankruptcy court continued the hearing on the United States

Trustee's motion to convert the cases to March 13, 2002. *Id.* at 38 *ll.* 14-25.

b. <u>The March 7, 2002, Hearing on Conversion of the Cases to Chapter 7</u>

On or about March 4, 2002, the Creditors' Committee changed its position in opposition to conversion and filed its own emergency motion to have the Debtors' cases converted to chapter 7. *Committee's Motion for Expedited Hearing and Immediate Conversion*, Doc. # 290. That motion was heard on March 7, 2002.

The Creditors' Committee sought conversion because all members of the Debtor's board of directors had resigned with the exception of Andrew Jahelka, Mr. Jahelka had appointed Leon Greenblatt as the Debtor's chief restructuring officer,[8] Mr. Greenblatt held a major ownership interest in Loop, which the Debtors intended to sue, Loop and Mr. Greenblatt's other companies had made their own claims against the Debtors in excess of $32 million, and Mr. Greenblatt was also a likely target of litigation by the Debtors. *Id.* at 4, ¶¶ 12-16. The Creditors' Committee further sought conversion because "[s]ince the February 6, 2002 hearing, there have been little to no discussions concerning a consensual

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[8] Mr. Greenblatt's takeover of the debtors in possession was verified when, in his new role as the Debtors' Chief Restructuring Officer, he signed a new proposed Reorganization Plan dated March 13, 2002. *Doc.* # 294. *See* p.23, *infra.*

plan among the Debtors, the Committee or Loop." *Id.* at 3, ¶ 11. Finally, the motion also sought to have the $3.25 million in the Debtor's bank accounts frozen so it could be kept from Mr. Greenblat's control and preserved for the estate's creditors. *Doc.* #290 at 5.

At its emergency motion, the Creditors' Committee also argued that "an insider . . . who was a target of litigation or surrounding the plan and as supposed plan participant had brashly taken over the Debtor." *Transcript,* March 7, 2002 at 4, *ll.*19-22. The Creditors' Committee further argued in favor of conversion, stating:

> *"Rather than risk additional expenses, waste additional time trying to clarify what was going on or even Mr. Greenblatt's right to change management at that stage of the Chapter 11, the committee determined that it was best to put a qualified neutral in control of the assets, the claims, the cash, and other assets as quickly as possible."*

Transcript, March 7, 2002 at 5, *ll.* 2-8.e

In response to the Creditors' Committee's motion to convert the cases to chapter 7, Loop attacked the composition of the Creditors' Committee, alleging that the members were not representative of all creditors. *Debtors' Response To Committee's Motion for Immediate Conversion of Cases,* Doc. #292 at 4. That response, although purportedly made by the Debtors, in fact was made at a time when the Debtors were under the control of the Loop's principals. *See Unsworn*

Declaration of Leland LeBlanc in Opposition to Committee's Motion for Immediate Conversion, Doc.#292, ¶¶ 3,5, (wherein Mr. LeBlanc stated that Andrew Jahelka remained the sole director of the Debtor and that Leon Greenblatt was appointed the Debtor's Chief Restructuring Officer).

After hearing oral argument, the bankruptcy court continued the Creditors' Committee's motion to convert to March 13, 2002, to be heard simultaneously with the United States Trustee's continued motion.

c. **The March 13, 2002, Hearing on Conversion of the Cases to Chapter 7**

At the third and final hearing on conversion of the cases to chapter 7, the Creditors' Committee again advised the bankruptcy court that an impasse had been reached in the negotiation of the terms of a consensual reorganization plan. *See Transcript,* March 13, 2002 at 9, *ll.* 1-3; at 12 *ll.* 22-25; at 9, *ll.* 2-3. That fact was also conceded by Loop. *Transcript,* March 13, 2002 at 21, *ll.* 4-7. Further, the Creditors' Committee advised the court that losses to and a diminution of the estate were continuing. "The debtors are currently spending approximately $60,000.00 a month . . . So if you have another two months or three months of this case you are going to have another $120,000 to $180,000 out the door plus whatever attorneys' fees ultimately get approved by the court." *Transcript.* March

13, 2002 at 11. *ll.* 12-18. This was particularly significant because at the time, the debtors had no operations or other source of revenue. Doc. # 190, 191. The Creditors' Committee also noted that the resignations of the Debtor's other directors left Loop's president, Andrew Jahelka, as the Debtor's sole board member and that Loop and Mr. Greenblatt- two of the Debtors' litigation targets - now controlled the Debtors. *Transcript,* March 13, 2002 at 11, *ll.* 21-24; at 12, *ll.* 1-16. These management changes were acknowledged by Loop. *See Transcript,* March 13, 2002 at 26, *ll.* 15-17.

Moments before the March 13 hearing, the Debtor filed a new, lengthy Plan of Reorganization which was signed by Leon Greenblatt as Chief Restructuring Officer for each of the four Debtor entities. *March 13, 2002, Plan of Reorganization*, Doc. # 294. The plan was not consensual, as the court had required at the February 6 hearing. *Transcript,* March 13, 2002 at 8, *ll* 8-25.

At the hearing, the Debtors, now under Loop's control, asked to call a witness in support of the plan it had just filed. *Transcript, March 13, 2002* at 13-14, *ll.* 13-3. Both the United States Trustee and the Creditors' Committee objected to the calling of witnesses and the bankruptcy court sustained those objections, noting that "[t]he plan is what it is . . . [I] don't see any point in calling a witness to explain the plan[,] so there will be no witnesses." *Id.* at 22. The bankruptcy court reasoned that if the Debtors had evidence to offer, they should have submitted affidavits, that the Debtors had never indicated any desire to call any witnesses at trial to explain a new plan, and that Loop never filed any objection to the Creditors' Committee's motion. *Id.*

At the conclusion of the hearing, the bankruptcy court reiterated that it had previously "made certain findings and determinations [at the February 6 hearing] . . . that cause has been shown to convert these cases." *Transcript*, March 13, 2002 at 32, *ll.* 19-21. It then reconfirmed its finding that "[t]he estates are continuing to incur losses and its being diminished and there is no opportunity or chance (sic) for rehabilitation." *Id.* The bankruptcy court also noted that the Creditors' Committee "is the representative body here to make the determination about what is best for unsecured creditors" and relied upon the fact that the Committee "was unable to sign on to the Loop's plan which . . . the debtor has nominally proposed now and [the Committee] has decided no." *Id.* at 33, *ll.* 14-18.

Based upon the information in the record and the undisputed facts established at the three hearings, the bankruptcy court ordered the conversion of all four cases to chapter 7. Doc. # 296. On February 5, 2003, the district court affirmed that decision. Doc. #454; *Loop v. United States Trustee*, 290 B.R. 108 (D. Minn. 2003).

E. STANDARD OF REVIEW

This Court sits as a second court of review on a bankruptcy matter and applies the same standards of review of the district court. *In re Usery*, 123 F.3d 1089, 1093 (8th Cir. 1997), *Cedar Shore Resort, Inc.* , 235 F.3d at 379 (8th Cir. 2000), citing *In re Clark*, 223 F.3d 859, 862 (8th Cir. 2000). "[W]e review the bankruptcy court's factual findings for clear error and its conclusions of law de novo." *In re Vote*, 276 F.3d 1024, 1026 (8th Cir. 2002); *see also Cedar Shore Resort, Inc.,* 235 F.3d at 379 (8th Cir. 2000); *In re O'Brien*, 178 F.3d 962, 966 (8th Cir. 1999); Fed. R. Bankr. P. 8013 (bankruptcy court's factual findings reviewed for clear error). This Court has noted that "[w]hile our review is a searching and independent one, we also realize that we are the second court charged with reviewing the bankruptcy court's factual findings for clear error," and that accordingly, "'[t]o be clearly erroneous, a decision must strike us as more than just maybe or probably wrong; it must . . . strike us as wrong with the force of a five-week old, unrefrigerated dead fish.'" *In re Papio Keno Club, Inc.*, 262 F.3d 725, 729 (8th Cir. 2001) (quoting *Parts and Elec. Motors, Inc. v. Sterling Elec., Inc.*, 866 F.2d 228, 233 (7th Cir. 1988), *cert. denied*, 493 U.S. 847 (1989)). Thus while this Court is "always mindful of our duty to independently review the record, we think this description is a particularly accurate reflection of when we will reverse a bankruptcy court's factual finding that has been upheld by the [lower court] -- we do not treat the [lower court] as a mere way station on the road to this court." *In re Papio Keno Club*, 262 F.3d at 729.

A bankruptcy court's decision to convert or dismiss under § 1112(b) is a matter of discretion, and will be reversed if the court abused its broad discretion. *See In re Cedar Shore Resort, Inc.,* 235 F.3d at 379. "An abuse of discretion occurs if the bankruptcy court fails to apply the proper legal standard or fails to follow proper procedures in making its determination, or if the court bases an award upon findings of fact that are clearly erroneous." *In re Midland Marina, Inc.*, 259 683, 686 (B.A.P. 8th Cir. 2001).

F. SUMMARY OF ARGUMENT

Substantial cause existed under §1112(b) of the Bankruptcy Code to convert these cases to chapter 7 and the bankruptcy court did not abuse its broad discretion in doing so. The unrebutted record before the bankruptcy court established a continuing loss to and diminution of the Debtors' estate and an absence of reasonable likelihood of rehabilitation. *See* 11 U.S.C. §1112(b)(1). The Debtors had no business operations to generate revenue, they had sold virtually all their assets, but they were experiencing a steady stream of unrelenting operational expenses. In addition, there was no reasonable likelihood of rehabilitation because the parties had already been involved in fruitless negotiations for months and could not agree on a confirmable plan of reorganization. 11 U.S.C. 1112(b)(1); *see also* 11 U.S.C. 1126 and 1129 (parties must accept a plan in order for it to be confirmed). The bankruptcy court also did not abuse its discretion in concluding that Loop's last minute "new" plan, which was tossed into the record only moments before the third and final hearing on conversion, was not confirmable and therefore it was in the best interests of creditors to convert the cases to chapter 7.

None of Loop's many arguments opposing conversion have merit. First, the bankruptcy court's conversion decision was unexceptional, like many others this and other courts have upheld. Even if Loop were correct that the bankruptcy court somehow implicitly adopted a *per se* rule, which it most certainly did not, that does not help Loop's case because the specific criteria for conversion under §1112(b) had already been satisfied and the bankruptcy court needed to go no further in finding cause for its order to convert. Loop also is mistaken when it suggests the bankruptcy court erroneously shifted the burden of proof in this case. The United States Trustee bore and met its burden of satisfying §1112(b), something that was easily done in this case because the Debtor's own filings established that the Debtor was hemorrhaging money and the parties' inability to agree on a plan after months of negotiations meant rehabilitation was, to say the least, very unlikely. Loop also unfairly assails the bankruptcy court for not making adequate factual findings, but such findings were made not at one hearing, but at two. Those findings are supported by the record and are more than adequate to sustain conversion. Finally, Loop speculates that the possible ability to draw upon Net Operating Losses of the Debtors ("NOLs") required the court to deny the conversion motion. Capturing those NOLs was predicated on the happening of a number of very unlikely events. Neither the Creditors' Committee, who could have gained from them, the United States Trustee, who administers bankruptcy cases for the public good, nor the court, believed the NOLs to be a good bet, and each independently concluded their possible capture did not justify leaving the Debtors in chapter 11 and under the control of Mr. Greenblatt. Although Loop touts the NOLs here, no one, including Loop, treated them as anything other than a very minor issue before the bankruptcy court, and they paled in light of the other problems in the case.

G. ARGUMENT.

1. The bankruptcy court exercised proper discretion when it found cause under §1112(b) to convert the cases from chapter 7 to chapter 11.

The bankruptcy court converted the cases to chapter 7 because the United States Trustee, as movant, met the requirements of 11 U.S.C. § 1112(b) and established cause, and the district court correctly affirmed that decision.

Section 1112(b) states, in relevant part, that

> (b) the court may convert a case under this chapter to a case under chapter 7 of this title or may dismiss a case under this chapter, whichever is in the best interests of creditors and the estate, for cause, including--
>
> (1) continuing loss to or diminution of the estate and absence of a reasonable likelihood of rehabilitation;
> (2) inability to effectuate a plan;
> (3) unreasonable delay by the debtor that is prejudicial to creditors. . . .

11 U.S.C. § 1112(b).[9]

"A bankruptcy court has broad discretion under 11 U.S.C. §1112(b) to either dismiss a case or convert a case from a Chapter 11 reorganization to a Chapter 7 liquidation." *In re Lumber Exch. Bldg. Ltd. P'ship*, 968 F.2d 647, 648 (8th Cir. 1992). Dismissal or conversion is appropriate if "cause" exists and it is in the "best interests of creditors and the estate." *Id.*; *see also In re Windsor on the River Assocs., Ltd.*, 7 F.3d 127, 133 (8th Cir. 1993).

Section 1112(b) sets forth specifically enumerated examples of "cause" for conversion which include the "continuing loss to or diminution of the estate and absence of a reasonable likelihood of rehabilitation" as well as the inability to

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[9] Under Minnesota Loc. R. Bankr. P. 1017-2(a), "A motion to dismiss or a motion to convert a case shall be deemed a motion either to dismiss or to convert, whichever is in the best interest of creditors and the estate."

effectuate a confirmable plan of reorganization. 11 U.S.C. § 1112(b)(1) & (3). "It should, however, be noted that the statutory list is not exhaustive and that a court may consider other factors and equitable considerations in order to reach an appropriate result in the individual case." *H.R. Rep. No. 595, 95th Cong., 1st Sess.* 405-06 (1977). *See also First Nat'l Bank of Sioux City v. Kerr* (*In re Kerr*), 908 F.2d 400, 404 (8th Cir. 1990).

This Court has sustained bankruptcy courts' discretionary conversion or dismissal of chapter 11 cases under §1112(b) numerous times in the past. *See Lumber Exchange Building Ltd. P'ship*, 968 F.2d 647 (debtor was unable to propose a confirmable plan without improperly classifying creditors); *In re Fossum*, 764 F.2d 520 (8th Cir. 1985) (debtor was unable to effectuate any plan which would be confirmable); *In re Kerr*, 908 F.2d 400 (debtors' proposed plan was unworkable and unfair to creditors, and debtors acted in bad faith and failed to submit a feasible plan); *In re Cedar Shore Resort, Inc.*, 235 F. 3d at 381(finding bad faith and noting cause includes "dismissal based on the lack of any realistic possibility of confirming a plan of reorganization").

This case falls squarely within this Court's §1112(b) jurisprudence. There was more than adequate cause to find that 11 U.S.C. §1112(b) was met because the Debtors had a continuing loss to and diminution of the estate and there was an absence of reasonable likelihood of rehabilitation. 11 U.S.C. §1112(b).

"The first aspect of §1112(b)(1) requires a showing of a 'continuing loss to or diminution of the estate.' . . .This element can be satisfied by demonstrating that the debtor incurred continuing losses or maintained a negative cash flow position after the entry of the order for relief." *Fort Knox Mini Warehouse, Inc.*, 2002 WL 1842452 at 2. The second aspect of §1112(b)(1) requires an absence of reasonable likelihood of rehabilitation. *Id.* at 3. In the present case, the bankruptcy court clearly articulated "cause" as the ongoing losses to the estate and the absence of a reasonable likelihood of rehabilitation when, at the February 6, 2002, hearing it identified the lack of any income from business operations coupled with continued incurrence of professional fees and expenses in negotiating a plan which was of questionable confirmability and to which the parties could not agree. *Transcript, Feb. 6, 2002,* at 24, *ll.* 1-4.

There is little dispute that by February 6, 2002, there was a continuing loss to and diminution of the estate. *Transcript*, February 6, 2002 at 29, *ll.* 18-24. The facts and records in the case, including all verified pleadings filed by the Debtors and other parties, are largely uncontested and are essentially admissions against the Debtors' interests, establishing the continuing losses to the estate. Specifically, by February 6, the total fees and expenses sought in fee applications totaled $1,385,392.25. *See* Doc. Nos. 71, 100, 103, 111, 160, 180, 206, 207, 209, 213, 224, 225, 236, 266, and 267. The money to pay the Creditors' Committee's lawyers and the debtors' lawyers as they attempted to agree on the plan was coming out of the estate. *Transcript,* February 6, 2002, at 34 *ll.* 1-7. Administrative expenses were accruing. *Transcript*, February 6, 2002, at 36, *ll.* 23 -24.

Moreover, not only had expenses been accruing up through February 6, 2002, but the expenses would continue to accrue the longer the Debtors remained in chapter 11. The unrebutted evidence in this case established that the Debtors had sold their assets, were not operating a business, and were reducing the Debtors' cash balance by $60,000 each month. *Transcript*, March 13, 2002 at 11, *ll.* 12-14. The evidence also established that any attempt to confirm and consummate a plan would create enormous additional expense, with no guarantee, or even likelihood, of confirmation. *See Transcript*, February 6, 2002 at 33 *ll.* 21-23; at 34 *ll.* 18-25; at 35 *ll.* 8-24; at 36 *ll.* 1-11; *Transcript*, March 13, 2002, at11 *ll.* 5-14; at 27 *ll.* 5-14. Finally, the Debtors' plan as of February 6, 2002 was "unduly complicated and thus expensive." *Transcript*, February 6, 2002, p. 35, *ll.* 7-8.

Not only were there continuing losses to and diminution of the estate, but the losses and diminution would continue indefinitely, indicating there was no reasonable expectation of rehabilitation. Whether the Debtors' business prospects were sufficient to support a finding of a reasonable likelihood of rehabilitation depends on "whether the causes of the [debtors'] continuing losses can be corrected" and "whether the debtor[s] or some other party in interest is capable of performing the necessary remediation." *See* 7 *Colliers on Bankruptcy* (15th ed. revised) ¶ 112.04[5][a][ii]. As the bankruptcy court found in this case, "rehabilitation" is not synonymous with "reorganization." *Transcript*, February 6, 2002 at 35, *ll.* 7-8. The standard for "reasonable likelihood of rehabilitation" is "not the technical one of whether the debtor can confirm a plan, but, rather, whether the debtor's business prospects justify continuance of the reorganization effort." *Colliers on Bankruptcy* (15th ed. revised) ¶ 112.04[5][a][ii]. In this case, the Debtors had been operating under the protection of chapter 11 since August 7, 2001, but by February 6, 2002, the Debtors' business prospects no longer "justif[ied] continuance of the reorganization effort." *See id.* It was no longer appropriate for the Debtors to "continue in control of their businesses under the umbrella of the reorganization court beyond the point at which reorganization no longer remains a realistic undertaking," where there was no evidence that "liquidation would proceed more expeditiously and less expensively under the control of the debtor[s]." *See In re Wright Air Lines, Inc.*, 51 B.R. 96, 100 (Bankr. N.D. Ohio 1985). In fact, under the Debtors' preferred scenario, remaining in the chapter 11 liquidation mode would have cost at least $125,000 over just a few months. *See Transcript*, March 13, 2002 at 25, *ll.* 9-10.

The Debtors' prospects for rehabilitation were contingent upon the ability to formulate a plan within a reasonable amount of time. *See* 7 *Colliers* at ¶ 112.04[5][a][ii]; *see also In re Smith*, 77 B.R. 496, 501-502 (Bankr. E.D. Pa. 1987) (likelihood of rehabilitation is largely a function of how long debtor has been trying to formulate a plan without success"). In the present case, the bankruptcy court concluded the Creditors' Committee's opposition to the plan appeared to render the plan unconfirmable and that the parties' failure to agree to a plan over a long series of negotiations meant that cause existed to convert. *Transcript*, February 6, 2002 at 12-13, *ll.* 20-22; at 34, *ll.* 18-22.

Notwithstanding all of that, the bankruptcy court, in an abundance of caution, exercised its discretion and gave the parties five weeks (from February 6 to March 13) to negotiate a feasible, consensual and confirmable plan. *Transcript,* February 6, 2002 at *ll.* 14-25. When they failed to do so, the court converted the cases. The conversion properly applied all requirements of §1112(b) and was more than fair to the Debtors and Loop.

Woven throughout Loop's brief is its assertion that the bankruptcy court did not consider the best interests of the creditors and the estate. *See, e.g., Appellant's Brief* at 11, 19. Loop is correct in arguing that the bankruptcy court must analyze the best interests of creditors as part of its conversion analysis under §1112(b), but the record in this case establishes that the bankruptcy court did so.

It is settled law that once a bankruptcy court makes the threshold finding that cause exists, it then looks to the "best interests of the creditors and the estate" to determine whether conversion or dismissal is more appropriate. 11 U.S.C. § 1112(b); *see Lumber Exch. Bldg. Ltd. P'ship,* 968 F.2d at 650; *In re Woodbrook Assoc.*, 19 F.3d at 316. In this case, the record not only shows that the best interests of creditors test was addressed, but that it was the controlling issue driving the bankruptcy court's decision, *to wit*, the reason the bankruptcy court did not convert the case on February 6, 2003 was "the request by the committee to explore [the] plan." *Transcript*, March 13, 2002 at 32 *ll.* 24-25; at 33 *l.* 1. The bankruptcy court first found cause to convert on February 6, 2002. When it subsequently required the Debtors and Loop to propose a consensual, confirmable plan which did not contain unnecessary complexities such as the "steering committee" and "treatment of creditors in all four cases in one class of claims," the bankruptcy court was telling the Debtors, Loop and the Creditors' Committee that they had to show how the best interests of creditors would be served if the cases were allowed to remain in chapter 11. *Transcript*, February 6, 2002, at 35-36, *ll.* 25-11. In fact, Loop specifically told the court that it wanted to make such a showing. *See Transcript*, February 6, 2002 at 31, *l.* 7. When the Debtors and Loop failed to make such a showing, the bankruptcy court predictably, summarily, and properly converted the cases to Chapter 7 because to do so was in the best interests of creditors.

Significantly, the bankruptcy court's conversion decision was supported by the creditors' representative in the bankruptcy case, the Creditors' Committee. Under §1102 the United States Trustee is authorized to create creditors' committees. 11 U.S.C. §1102. Committees have broad powers to represent their constituents. Among other things, they may consult with the debtor about the case; investigate the debtor; participate in the formulation of a plan; and request the appointment of a trustee or an examiner. 11 U.S.C. §1103(c). Here, the Creditors' Committee intensely negotiated a plan with the Debtors over a lengthy period of time. When that proved unsuccessful, the Creditors' Committee exercised another statutory power, they moved under 11 U.S.C. §1103 and §1112(b) to convert this case. Thus, this is not a case where this Court need to speculate whether conversion was in the creditors' best interests. The bankruptcy court concluded it was when the Creditors' Committee affirmatively sought conversion by formal motion.

2. The Burden of Proof Was Not Improperly Shifted to Debtor and Loop

Loop alleges the bankruptcy court was confused "over which party bore the burden of proof," and cites a number of isolated statements made by the United States Trustee as support for the court's "confusion." *Appellant's Brief* at 20-21. By arguing that there was an "automatic" shifting of the burden of proof, Loop improperly attempts to create a legal issue where only a fact issue exists. The record clearly shows that no such "automatic" and improper shifting took place. The record is entirely unrebutted in this case. It establishes the Debtor had sold its assets and ceased business on November 9, 2001, it had unsuccessfully attempted to negotiate the terms of a consensual plan at least from December 5, 2001, through February 6, 2002, it had incurred over a million dollars in professional fees, and all it had to show for months of negotiations was a plan that the bankruptcy court recognized as unconfirmable due to problems with, *inter alia*, the classification of claims. The U.S.Trustee relied upon these facts in urging conversion. Thus, by the February 6 hearing, there was an undeniable ongoing loss to and a diminution of the estate and an absence of a reasonable likelihood of rehabilitation, which the court specifically recognized as the "cause" shown by the

United States Trustee. *Transcript*, February 6, 2002 at 36, *ll.* 19-20; p. 37, *ll.* 8-9.

At that point, the bankruptcy court could have simply converted and its decision would have been fully sustainable based on the record before it. Instead, the bankruptcy court exercised its discretion to give the debtors one last chance to effectuate a plan and remain in chapter 11. It was not burden shifting, rather it was a temporary reprieve. Notwithstanding cause, the court would have let the Debtors stay in bankruptcy if they had agreed to a consensual, confirmable plan and, in the absence of such a showing, the court would convert the case to chapter 7. *Id.* at 38, *ll.* 14-25, 37-38.

Loop asks this Court to punish the bankruptcy court for showing mercy. That would be unfair and would prevent bankruptcy courts from seeking to craft innovative solutions to difficult problems in contentious cases. The only effect of the bankruptcy court's February 6, 2002, order was to allow the Debtors and Loop an opportunity to continue in chapter 11 despite the fact that the United States Trustee's burden had been met. Indeed, Loop acknowledged the nature of the burden on it when it stated that "[t]he debtors and Loop Corporation and the committee want to show the Court exactly what they can do and how they can do it." *Transcript,* February 6, 2002 at 31, *ll.* 7-9. Given that, it is not surprising that five weeks later, on March 13, 2002, Loop acknowledged that it failed to meet that burden when it conceded to the court that there had been no negotiations regarding plan treatment. *Transcript,* March 13, 2002, at 21, *ll.* 4-7. The Creditors' Committee also acknowledged that Loop and the Debtor did not make the required showing. *Transcript,* March 13, 2002 at 9, *ll.* 1-3. Thus, rather than attempting to rebut the United States Trustee's prima facie case below, Loop essentially conceded the key facts establishing cause. *Cf. In re Woodbrook*, 19 F.3d 312, (7th Cir. 1994) (noting under §1112(b) that although the moving party holds the "burden of persuasion," that "does not eviscerate (the non-moving party's) obligation to produce evidence in opposition to a well-supported motion."). Once the United States Trustee met his burden, Loop had to overcome that proof, something that did not happen here. *See, e.g.*, *Loop Corp. v. United States Trustee,* 290 B.R. 108, 113 (D. Minn. 2003) ("Once cause has been shown, the judge may shift the burden of proof to the debtor to demonstrate that Chapter 11 would be better than Chapter 7."); *Matter of Silent Partner, Inc.*, 1992 WL 31255 at *3 (E.D. La. 1992), *aff'd*, 983 F.2d 232 (5th Cir.1993) (once the moving party meets its burden, the burden shifts).

See also, *Minnesota Alpha Foundation,* 122 B.R. 89 (Bankr. D. Minn. 1990), wherein the bankruptcy court specifically addressed liquidating chapter 11 cases and shifted the burden of proof, stating: "Where . . . a debtor is defending a motion under §1112(b) by arguing that it should remain in possession, the debtor must recognize that administration by Chapter 7 trustee is the preferred vehicle for liquidation under the Bankruptcy Code." *Id.* at 94, fn. 10. That court then went on to provide a detailed list of considerations for determining whether to allow a debtor to liquidate under chapter 11. *Id.*

3. The United States Trustee Did Introduce Sufficient Evidence to Meet its Burden of Proof and the Bankruptcy Court could rely on Information in the Record.

Loop takes issue with the bankruptcy court's reliance on the record in the case and claims that the United States Trustee did not present any evidence in support of the motion. *Appellant's Brief* at 5, 21-22. Throughout the course of three hearings, the bankruptcy court had full knowledge of what had and had not transpired in the cases thus far when it considered the arguments of the Debtors, Loop, the United States Trustee, and the Creditors' Committee. As the United States Trustee argued, evidence of cause for conversion lay in the Debtors' "own statements, [their] own disclosure statement, [and their] own affidavits and statements." *Transcript*, February 6, 2002 at 37 *ll.* 9-11.

A motion to convert or dismiss a bankruptcy case under § 1112(b) is a "contested matter" pursuant to Fed. R. Bankr. P. 9014. Within a bankruptcy case, disputes are categorized and litigated as either "adversary proceedings," or "contested matters."[10] An adversary proceeding is commenced by the filing of a complaint and is essentially a separate lawsuit within the context of a bankruptcy case, with all the attributes of a civil action. *See generally* Fed. R. Bankr. P. Part VII. A contested matter, on the other hand, is commenced by the filing of a motion, and is governed by far less stringent criteria than adversary proceedings. *See* Fed. R. Bankr. P. 9014.

Nothing requires that a movant in a contested matter before a bankruptcy court present evidence independent of the court file or independent of the evidence presented by the opposing party in order to meet its burden of proof. *See, e.g., In re SGL Carbon Corp.*, 200 F.3d 154, 158 (3d Cir. 1999) (hearing on 1112(b) motion involved no witness testimony, evidence was entirely documentary or deposition testimony); *Sullivan Central Plaza I Ltd. v. BancBoston Real Estate Capital Corp.*, (*In re Sullivan Central Plaza I, Ltd.*), 935 F.2d 723, 726 (5th Cir. 1991) (parties submitted letter briefs to court in lieu of evidentiary presentation).

As the district court in this case noted, "Appellants (Loop) cite no authority

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[10] Specific enumerated matters must be brought as adversary proceedings as required by Fed. R. Bankr. P. 7001, and by default, any other actual disputes before a bankruptcy court are considered contested matters. *See* Fed. R. Bankr. P. 7001, 9014; Advisory Committee Note to Fed. R. Bankr. P. 9014. Although some bankruptcy rules govern both adversary proceedings and contested matters, *see* Fed. R. Bankr. P. 9014, the two are procedurally distinct.

for the proposition that the [United States Trustee] may not rely on evidence of the debtor's circumstances already in the record to meet its burden of proof." *Loop Corp. v. United States Trustee,* 290 B.R. 108, 114 (D. Minn. 2003). Loop repeats that failure in its brief to this Court.

The court record is often and appropriately used as the record in bankruptcy cases because of the unique and document-intensive nature of bankruptcy. *See, e.g., In re Sunflower Racing, Inc.*, 226 B.R. 665 (D. Kan.1998) ("A bankruptcy judge who has presided over a case since its inception can resolve . . . issues without an additional evidentiary hearing. A full evidentiary hearing on a conversion or dismissal motion simply is unnecessary when an adequate factual record already is before the bankruptcy court.") (citing *In re Tiana Queen Motel, Inc.* 749 F.2d 146 (2d Cir. 1984), *cert. denied*, 471 United States 1138 (1985)); *See also In re Mazzocone*, 183 B.R. at 413; *Coones v. Mutual Life Ins. Co. of N.Y.*, 168 B.R. 247, 258 (D. Wyo. 1994), *aff'd,* 56 F.3d 77 (10th Cir. 1995); *Han v. Linstrom*, 2002 WL 31049846 (dismissal for cause under section 1112(b) does not necessarily require a full evidentiary hearing if all relevant issues have otherwise been addressed in the course of the case) .

Many chapter 11 cases fail and typically by the time a motion to convert or dismiss is filed and heard, the court is intimately familiar with the facts and issues leading up to the motion. *See e.g., Tiana Queen Motel, Inc.,*749 F.2d 146. Although a full evidentiary hearing on a motion is not prohibited by the Bankruptcy Code, a court's decision to not require the movants to introduce evidence already existing in the court file comes nowhere close to being an abuse of discretion. Adopting Loop's arguments would result in a profound waste of judicial resources by requiring the bankruptcy courts to formally receive evidence which simply duplicates the verified pleadings which had previously been filed in the case and which created the law of the case.

4. No *Per Se* Rule Was Established.

Loop asserts that the bankruptcy court adopted an incorrect legal standard in finding cause to convert under §1112(b), *Appellant's Brief* at 10, *ll.* 15-17, in an attempt focus this Court's attention on legal issues, with an easier burden of proof, rather than on the facts on which the bankruptcy court based its conversion order. Specifically, Loop argues that the bankruptcy court improperly "adopted a legal standard that requires conversion unless a debtor in a Chapter 11 case is continuing to operate as [sic] economically viable operating business. Such a legal standard is tantamount to a *per se* rule against liquidating Chapter 11 bankruptcy cases." *Appellant's Brief* at 10. Loop further argues that such a *per se* rule would require conversion to chapter 7 in every liquidating chapter 11 cases because there will always be an ongoing loss to the estate at the point in time where everything has been liquidated so no new money is coming into the estate yet administrative expenses continue to accrue, thereby causing such losses. *Appellant's Brief* at 17-18.

First, even if true, that would be harmless error. See *New Concept Housing v. Poindexter*, 951 F.2d 932, 937 (8th Cir. 1991). The record in this case establishes cause under 11 U.S.C. §1112(b) and that is all that is necessary for this Court to affirm.

Second, Loop's claim of a *per se* rule is simply wrong. Indeed, if the bankruptcy court intended to create and apply such a rule, it would have ordered conversion of the cases at the first hearing on February 6, 2002, and would not have unnecessarily used its time and resources to hold two more hearings on the exact same matter. By giving Loop and the Debtors a window of opportunity from February 6, 2002, to March 13, 2002, the bankruptcy court revealed its willingness to entertain a plan which appeared confirmable and on which parties generally agreed. When the parties returned on March 13 in substantial disagreement about how the case should be handled and who should be in control of the Debtors, the bankruptcy court's decision to convert was easy because there was clearly an absence of any reasonable likelihood of rehabilitation and no ability of the Debtor to effectuate a plan due to, *inter alia*, the Creditors' Committee's challenge of the change in control of the Debtors. Up to that point in time, however, the bankruptcy court's willingness to be persuaded by the facts clearly establishes the absence of a *per se* rule.

Also, contrary to Loop's assertion, neither the bankruptcy court nor the United States Trustee asserted that a party in a chapter 11 case can not propose a liquidating plan. The record is bereft of such an argument. To the contrary, a liquidating plan is clearly contemplated by the Bankruptcy Code. *See* 11 U.S.C. 1123(b)(4) (a chapter 11 plan may provide for the sale of all property of the estate and the distribution of proceeds to creditors). Section 1123(b) is however subject to the requirements of §1123(a), which requires the providing of an adequate means for a plan's implementation. *See* §1123(a)(5). The bankruptcy court simply ruled that *in this case*, the attempt by Loop and the Debtors to propose a liquidating plan had depleted the estate long enough. "(I)n determining cause for dismissal the court may consider other factors as they arise and use its powers to reach appropriate results in individual cases". *See In re Gonic Realty Trust*, 909 F.2d 624, 626 (1st Cir. 1990); *In re Koerner*, 800 F.2d 1358, 1367 (5th Cir. 1986), *see also Laguna Assocs. Ltd. P'ship v. Aetna Cas. & Sur. Co. (In re Laguna Assoc.*

Ltd. P'ship), 30 F.3d 734, 737 (6th Cir. 1994) (§ 1112(b) determination of cause made on case-by-case basis). The bankruptcy court found on February 6, 2002, that the proposed plan was not feasible by its terms and required substantial modification before it could go forward and be confirmed and implemented. *Transcript*, February 6, 2002 at 34, *ll.* 9-10. With plan confirmability as a threshold issue, the bankruptcy court simply did not need to address minor issues such as the plan's distribution mechanisms or NOLs.

The district court also recognized the fallacy of Loop's "*per se* rule" argument when it stated that the court "properly applied the standard used in this Circuit and Loops' attempt to insert their preferred version of the law must be rejected." *Loop v. United States Trustee*, 290 B.R. at 113. The district court went on to state that "[e]ven if the court's application of these legal standards to the facts of the case implied a *per se* rule of cause, the court has broad discretion in determining cause and is not limited to grounds specified in §1112(b), such that the conversion may be supported on multiple bases." *Id.*, at 8; *see also, In re Usery,* 123 F.3d at 1093; *Cedar Shore Resort,* 235 F.3d at 379.

5. There was Not an Absence of Detailed Findings of Fact

Loop argues that the bankruptcy court committed reversible error when it failed to make detailed fact findings regarding cause to convert to Chapter 7 at the hearing on March 13, 2002. *Appellant's Brief*, at 26. However, Loop ignores the bankruptcy court's detailed findings of fact on the record on February 6, 2003, and the incorporation of and reference to those findings by the court at the March 13, 2002, hearing. *See Transcript, March 13, 2002* at 32, *ll.* 19-21.

Loop further asserts that the only evidence before the bankruptcy court when it ordered conversion to chapter 7 consisted of the affidavit of Leland LeBlanc and the Debtors' Liquidation Analysis, *Appellant's Brief* at 28. This is wrong. As is set forth above, numerous verified motions had been filed in the case which were either granted by the court or at least alleged undisputed facts. Such motions include over $1 million in fee applications and the Creditors' Committee's motion to convert which alleged improper takeover of control of the Debtor by Loop's principals.

The affidavit of Mr. LeBlanc on which Loop relies (Doc. #292) also indicated that Mr. LeBlanc and Michael McKim were debtors only remaining employees, Leon Greenblatt was appointed Chief Restructuring Officer on February 28, and the Debtor continued to incur expenses for taxes and personnel of about $40,000 per month, stop loss health insurance premiums of $5,350 per month, and space, computer and communications expenses of $15,000 per month. *Id.* In other words, there were ongoing losses to and a diminution of the estate and an absence of any business operations. Accordingly, specific findings of fact with the level of detail now demanded by Loop were simply not necessary.

"A trial court's factual findings are adequate if they afford a reviewing court "a clear understanding of the basis of the trial court's decision." *Wegner v. Grunewaldt*, 821 F.2d at 1322 (citing *Lynch Corp. v. MII Liquidating Co.*, 717 F.2d 1184, 1187 (8th Cir.1983)); *see also Stanley v. Henderson*, 597 F.2d 651, 654 (8th Cir.1979). The bankruptcy court was not required to give "exhaustive reasons" for its §1112(b) decisions. *See, e.g., In re Gonic Realty Trust*, 909 F.2d at 627, *In re Silent Partner, Inc.*, 1992 WL 31255, (citing *In re Koerner*, 800 F.2d 1358, 1368 (5th Cir. 1986)); *accord*, *Wegner v. Grunewaldt,* 821 F.2d at 1322 ("In documenting his findings, a trial judge is not required to assert the negative of each rejected argument as well as the affirmative of those he finds to be correct. The court only must formulate findings on the ultimate facts necessary to reach a decision, and a reviewing court can conclude that a necessary finding exists because it is implicit in and reinforced by other factual findings of the trial court.") (citing, *Fields Eng'g & Equip., Inc. v. Cargill, Inc.*, 651 F.2d 589, 594 (8th Cir.1981); *see also Allied Van Lines, Inc. v. Small Business Admin.*, 667 F.2d 751, 753 (8th Cir. 1982)).

The bankruptcy court made its findings of fact and conclusions of law as required in a contested matter. *See* Fed. R. Bankr. P. 7052, 9014. Moreover, this Court has held that even if a bankruptcy court does "not enunciate [its] factual findings as such," that this Court will review the "explicit determinations [upon which the court based its decision] only for clear error." *Clarkson v. Cooke Sales and Serv. Co.* (*In re Clarkson*), 767 F.2d 417, 419 (8th Cir. 1985).

6. The bankruptcy cases were not prematurely converted and creditors were not deprived of an opportunity to review a plan which included the administration of NOL's

Loop argues that the cases were prematurely converted and creditors were therefore deprived of an opportunity to review the March 13, 2002, plan which addressed the Debtors' NOLs. *Appellant's Brief* at 30-31. However, the bankruptcy court found cause to convert the cases on February 6, 2003, well before the March 13, 2003, plan was filed. "A chapter 11 case may be converted or dismissed at any time." *See, e.g., In re Woodbrook Assocs.*, 19 F.3d 312, 317 (7th Cir. 1994). It is impossible for the bankruptcy court to have abused its discretion by failing to consider a Plan that was not in existence at the time it ruled.

Furthermore, creditors need not incur the added time and expense of a confirmation hearing on a plan they believe cannot be effectuated. *See Hall v. Vance*, 887 F.2d 1041, 1044 (10th Cir.1989). Loop makes much of the Debtors'

March 13 eve of conversion plan. However, that plan was nothing more than a ploy, trotted out at the last second in a futile effort to delay the inevitable. First, the plan was insufficient because it was clearly non-consensual. *See Transcript*, March 13, 2002, at 8 *ll.* 21-25; at 9 *ll.* 1-3; at 10 *ll.* 24-25; at 12, *ll.* 23-25. Second, the filing of the plan was incomplete, as there was no accompanying disclosure statement. *Transcript*, March 13, 2002 at 15 *ll.* 3-4. 11 U.S.C. §1125. Finally, as the Debtors themselves admit, the plan on its face contained issues precluding immediate confirmation. *Transcript*, March 13, 2002, at 4 *ll.* 22-25; at 5, *ll.* 1-5; at 16 *ll.* 14-21.

The March 13 Plan was based on the novel premise that potential NOLs would justify remaining under the protection of Chapter 11.[11] Loop now contends that the bankruptcy court failed to give sufficient weight to the value of the Debtors' NOLs, "if properly utilized through a confirmed plan." *Appellant's Brief* at 30.

However, as argued in the United States Trustee's Reply to Responses in Opposition of U.S. Trustee's Motion to Convert, *Doc.* #269, unnumbered p. 6, in order to utilize NOLs, the Debtors had to overcome discharge issues. More

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[11] The Debtors' December 5, 2001, plan made no reference whatsoever to Net Operating Losses. Doc. #215.

importantly, virtually every corporate debtor in a case under chapter 11 has prior year tax losses and if the existence of NOLs can be the exclusive basis for denying a motion to convert, there would never be a case where conversion under §1112(b) would be possible. *Id.*

Further, on January 30, 2002, when it responded to the United States Trustee's motion to convert, Loop had no idea if the NOLs had value. As stated by Loop, "[w]hile the parties are not yet clear on the extent to which the NOL can be used, nor the value that could be realized therefrom, it would not be in the best interests of the creditors or the equity holders to lose that potential value until it has been fully and completely explored." *Response of Loop Corp to Motion to Dismiss or Convert*, Doc. # 260 at p. 3, ¶8. Loop apparently continued that "exploration" through March 13, 2002, when, at the last minute before the final hearing on conversion, it threw into the record the March 13, 2002, plan.

By March 13, it was clear that the Creditors' Committee would not support any plan so long as Leon Greenblatt or his companies remained in control of the Debtors. And Mr. Greenblatt was not budging either. The bankruptcy court had clearly articulated the parameters under which it would allow the chapter 11 cases to proceed and those parameters were clearly not met by the unilateral filing of a new plan by the Debtors while under the newly acquired control of Mr. Greenblatt.

Consequently, it was unnecessary for the bankruptcy court to delve into the details of the March 13 Plan since more important threshold issues, such as the consensus of Creditors' Committee had not been met.

Finally, Loop also ignores the fact that in order to reap the benefits of the NOLs under the March 13, 2002 plan, new and complex transactions, and the occurrence of a number of contingent events were required. *Transcript*, March 13, 2002 at 15 *ll.* 14-17. In essence, Loop asked the bankruptcy court for yet another chance to remain in chapter 11 while ignoring the additional expense required to litigate confirmation issues and promising a pot of gold for the estate at the end of the process. *See Transcript*, March 13, 2002 at 17 *ll.* 20-25; at 18 *ll.* 1-4; at 18 *ll.* 21-25; at 19 *ll.* 1-3; at 24 *ll.* 8-13 (creditors must decide whether "they want less money now or they want to take an opportunity to try to get more money later"). Loop is now asking this Court to accept that the bankruptcy court, the district court, the United States Trustee and the Creditors' Committee all wrongly disregarded what Loop alleged to be a $10 to $20 million asset that was available to creditors and simply threw that asset away by converting the bankruptcy cases. *Transcript*, March 13, 2002, p. 16 *ll.* 1-7.

The bankruptcy court properly determined that the potential existence and value of the NOLs was not enough to outweigh the fact that the Debtor was in the midst of questionable management changes which were opposed by the Creditors' Committee, the Debtor was depleting its liquidated assets while trying to negotiate a plan, and there was no substantial reason not to disburse the money to creditors rather than allow the Debtors and Loop to spend time and money trying to force an agreement to an esoteric plan. Loop's NOL argument is nothing more than a pie-in-the-sky, eleventh hour attempt to avoid conversion of the case.

Clearly, the bankruptcy court recognized the NOL issue as too little, too late and it was not clearly erroneous when it gave Loop's NOL argument minimal weight in determining that the cases should be converted to chapter 7.

H. CONCLUSION

For these reasons, the United States Trustee asks this Court to affirm the decision of the district court sustaining the bankruptcy court's decision converting these cases to chapter 7.

Dated: June 26, 2003

HABBO G. FOKKENA
UNITED STATES TRUSTEE
REGION 12

By________________________
Michael R. Fadlovich,
MN ATTY I.D. #158410
Trial Attorney
Department of Justice
Office of the United States Trustee
1015 United States Courthouse
300 South Fourth Street
Minneapolis, MN 55415
(612) 664-5505

Of Counsel
Joseph A. Guzinski
General Counsel

P. Matthew Sutko
Michele M. Mansfield
Attorneys
Office of the General Counsel
Executive Office
for United States Trustees
20 Massachusetts Avenue, N.W.
Suite 8100
Washington, D.C. 20530
(202) 307-1399

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Dated: June 26, 2003

Michael R. Fadlovich
Attorney for the Appellee
Mn Atty I.D. 158410
Trial Attorney
Office of United States Trustee
1015 U.S. Courthouse
Minneapolis, MN 55415
612/664-5505

UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

CERTIFICATION OF DISKETTE

IN RE: Health Risk Management, Inc., *et al*,
debtors, Bankruptcy # 01-43354 *et seq.*,

Loop Corp., *et al*,
v. Appeal #03-1786
Habbo G. Fokkena, U.S. Trustee,
Committee of Unsecured Creditors,
Appellees

I, Michael R. Fadlovich, attorney for the Appellee in the above entitled appeal, do hereby state that the attached diskette contains a PDF copy of the Brief of Appellee and that pursuant to Eighth Circuit Local Rule of Procedure 28A(d), I hereby certify that on June 26, 2003, I scanned the attached diskette for viruses and that the diskette is virus free.

Michael R. Fadlovich

BRIEF BANK — 'SUMMARY SHEET"

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Nicholas Strozza, AUST Region 17, & P. Matthew Sutko, OGC/EOUST
(UST/OGC: 202-307-1399/FAX-2397)

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• Bankruptcy courts have the discretion under section 707(b) of the Bankruptcy Code to dismiss chapter 7 cases for substantial abuse. Did the court below abuse its discretion in dismissing 33 year old Hebbring's chapter 7 case when she could repay 75% of her debts simply by deferring voluntary retirement contributions and savings bond investments for three years?

√ **Background:**

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No. 04-16539

In the United States Court of Appeals
for the Ninth Circuit

In re LISA R. HEBBRING

Lisa R. Hebbring,

Appellant,

v.

William Neary, the United States Trustee,

Appellee.

On Appeal from the United States District Court
District of Nevada

APPELLEE'S OPPOSITION BRIEF

Of Counsel:
Donald F. Walton
Acting General Counsel

P. Matthew Sutko
Mark A. Redmiles
Executive Office for
United States Trustees
Department of Justice
20 Massachusetts Ave., N.W.
Washington, D.C. 20530

Nicholas Strozza, Assistant U.S. Trustee
William B. Cossitt, Trial Attorney
Office of the United States Trustee
Department of Justice
300 Booth Street, Room 2129
Reno NV 89509
Telephone: (775) 784-5335

Attorneys for Appellee
The United States Trustee

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STATEMENT OF THE ISSUE PRESENTED FOR REVIEW

Bankruptcy courts have discretion under section 707(b) of the Bankruptcy Code, 11 U.S.C. § 707(b), to dismiss chapter 7 cases for substantial abuse. It is a substantial abuse to grant chapter 7 relief to debtors who can repay a substantial portion of their debts. In re Price, 353 F.3d 1135 (9th Cir. 2004); In re Kelly, 841 F.2d 908, 914-15 (9th Cir. 1988). Did the court below abuse its discretion in dismissing 33 year old Lisa Hebbring's chapter 7 case when she could repay 75% of her debts simply by deferring voluntary retirement contributions and savings bond investments for three years?

STATEMENT OF THE CASE

On June 5, 2003, Ms. Lisa R. Hebbring sought relief under the debt liquidation provisions of chapter 7 of the Bankruptcy Code. See 11 U.S.C. § 701, et seq. (chapter 7 liquidation provisions) (Appellant's Excerpt of Record Exhibit A, page 1, hereinafter "E.R. _ , p. _.). On September 3, 2003 the United States Trustee[1] filed a motion to dismiss Ms. Hebbring's

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[1] United States Trustees are officials of the Department of Justice appointed by the Attorney General to supervise the administration of bankruptcy cases and trustees. See 28 U.S.C. §§ 581-589; In re Columbia Gas Sys., Inc., 33 F.3d 294, 296 (3d Cir. 1994) (explaining that United States Trustees oversee the bankruptcy process, protect the public interest, and ensure that

case under 11 U.S.C. § 707(b).[2] The United States Trustee contended it would constitute a substantial abuse for Ms. Hebbring to discharge her unsecured debts in chapter 7 when her discretionary savings income enabled her to make substantial payments to those creditors (E.R. B, pp. 32-52.). The United States Trustee contended Ms. Hebbring could repay

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bankruptcy cases are conducted according to law) (citing H.R. Rep. No. 95-595, 109 (1977)). "The United States Trustee is the 'watchdog' of the bankruptcy system * * * charged with preventing fraud and abuse and with 'fill[ing] the vacuum' caused by possible creditor inactivity." In re Castillo, 297 F.3d 940, 950 (9th Cir. 2002); In re Donovan Corp., 215 F.3d 929, 930 (9th Cir. 2000) ("The United States trustee may * * * intervene and appear at any level of the proceedings from the bankruptcy court on, * * * as either a party or an amicus.") (internal quotation marks omitted). Section 707(b) expressly authorizes United States Trustees to seek dismissal of chapter 7 cases for substantial abuse.

[2] Section 707(b) provides:

> (b) After notice and a hearing, the court, on its own motion or on a motion by the United States Trustee, but not at the request or suggestion of any party in interest, may dismiss a case filed by an individual debtor under this chapter whose debts are primarily consumer debts if it finds that the granting of relief would be a substantial abuse of the provisions of this chapter. There shall be a presumption in favor of granting the relief requested by the debtor. In making a determination whether to dismiss a case under this section, the court may not take into consideration whether a debtor has made, or continues to make, charitable contributions (that meet the definition of "charitable contribution" under section 548(d)(3) to any qualified religious or charitable entity or organization (as that term is defined in section 548(d)(4)).

approximately 75% of her unsecured debts in three years through a chapter 13 repayment plan if she deferred her discretionary personal saving for three years. See 11 U.S.C. § 1301, et seq., (provisions governing repayment of debts under chapter 13 of the Bankruptcy Code).

By order entered October 10, 2003 the United States Bankruptcy Court for the District of Nevada dismissed Ms. Hebbring's chapter 7 case under 11 U.S.C. 707(b). The court concluded that Ms. Hebbring should not be saving for her future at the expense of her creditors (E.R. D, p. 81), that she could pay a meaningful sum to her creditors (E.R. D, p. 82), and that it would be unfair for her to put her future security ahead of her current creditors. (E.R. D, pp. 82-83.) Ms. Hebbring timely appealed that order. By order entered July 8, 2004 the United States District Court for the District of Nevada affirmed the bankruptcy court's dismissal. (E.R. H, p. 93, ll. 9-13.) This appeal followed. (E.R. I.)

STATEMENT OF FACTS

On June 5, 2003, Ms. Hebbring filed a petition under the debt liquidation provisions of chapter 7 of the Bankruptcy Code. See 11 U.S.C. § 701, et seq. (chapter 7 liquidation provisions) (Appellant's Excerpt of Record Exhibit A, page 1, hereinafter "E.R. _ , p. _.) Ms. Hebbring was 33 years old. (E.R. C, p.55.)

Ms. Hebbring works as an SBC customer service representative. She listed her gross monthly salary as $4,116.67. (E.R. A, p. 16.)

Ms. Hebbring signed her bankruptcy petition and schedules under penalty of perjury. (E.R. A, pp. 2, 19.) Her schedules revealed she owned a house and a car. Her house was worth $160,000 and was subject to secured mortgage debt of $154,102.54. (E.R. A, p. 5.) Ms. Hebbring proposed to keep her house by reaffirming her secured mortgage debt. (E.R. A, p. 27.) See 11 U.S.C. 524(c) (governing reaffirmation agreements). She also owned a 2001 Volkswagen Beetle automobile, which was subject to $18,839.33 in secured debt (E.R. A, p.10). Ms. Hebbring's schedules reflected that she was making monthly car payments of $425.00, and that she would retain the car by continuing to make those secured debt payments. (E.R. A, p.27.)

In addition to her secured debt, Ms. Hebbring identified two unsecured creditors, Capital One Visa, whom she owed $7,485.00, and Target Visa, whom she owed $3,639.15. This unsecured debt aggregated $11,124.15. (E.R. A, p. 13.) Ms. Hebbring listed no other debts.

On September 3, 2003 the United States Trustee filed a motion to dismiss Ms. Hebbring's case under 11 U.S.C. § 707(b). The United States Trustee contended it would constitute a substantial abuse for Ms. Hebbring to discharge her unsecured debts in chapter 7 when her discretionary savings enabled her to make substantial payments to her unsecured creditors (E.R. B, pp. 32-52.). The United States Trustee contended Ms. Hebbring could repay approximately 75% of her unsecured debts in three years through a chapter 13 repayment plan if she deferred her discretionary personal saving for three years. Sec 11 U.S.C. § 1301, et seq., (provisions governing repayment of debts under chapter 13 of the Bankruptcy Code).

In support of his motion, the United States Trustee relied upon the Declaration of Alice Gowans and the exhibits attached to Ms. Gowans' declaration. Ms. Gowans is a paralegal specialist in the United States Trustee's Reno office. Her declaration revealed that Ms. Hebbring had given the United States Trustee various documents, including payroll statements, tax returns and W-2 statements. Based on the information Ms. Hebbring provided, Ms. Gowans calculated that the debtor was making voluntary monthly payroll deductions of $81.25 for savings bonds and $232.05 for voluntary 401(k) contributions. (E.R. B, pp. 39-44.) If Ms. Hebbring forestalled this voluntary saving for three years, she could repay approximately 75% of her unsecured debt through a chapter 13 repayment plan.

On September 30, 2003 Ms. Hebbring filed an opposition to the United States Trustee's motion to dismiss.[3] (E.R. C, pp. 53-74.) Her opposition did not dispute that Ms. Hebbring was voluntarily setting aside monthly personal savings through her savings bond and 401(k) related withholdings but argued it was not a substantial abuse to save for future personal use instead of repaying her debts. (E.R. C, pp. 53-74). Ms. Hebbring did not submit any declaration or affidavit in support of her opposition. Ms. Hebbring's opposition did not identify any purported material fact that she contended was in dispute. Ms. Hebbring's opposition did not suggest that an evidentiary hearing was necessary to resolve any material disputed fact. Nor did her opposition request such an evidentiary hearing or identify witnesses or other evidence that she would present if such a hearing were conducted.

The bankruptcy court heard the United States Trustee's motion on October 7, 2003. Ms. Hebbring was represented by counsel. Ms.

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[3] Ms. Hebbring disclosed in the opposition that she had recently received a raise from $22.3125 per hour to $23.4250 per hour, increasing her yearly income to $48,842.40.

Hebbring's counsel did not seek to call witnesses or introduce evidence. He did not ask to cross examine Ms. Gowans. Nor did he dispute the validity or the accuracy of the statements Ms. Hebbring made in her petition and schedules under penalty of perjury, or in the other information she subsequently provided to the United States Trustee. The debtor neither took the stand nor asked that the hearing be continued to a later date. (E.R. D, pp. 75-84.)

Instead, Ms. Hebbring sought to convince the court through argument that it was "reasonable" for her to set aside 7% of her income as discretionary savings even though those funds otherwise could be used to repay 75% of her debts to her general unsecured creditors within three years. (E.R. D, p. 80, ll. 9-10, 13-16.)

Based upon the United States Trustee's motion, the Gowans Declaration, the summary exhibit and related documents attached to the Gowans Declaration, the opposition, and the argument of counsel, the bankruptcy court dismissed the debtor's case under section 707(b). The court found the debtor had an ability to repay a substantial portion of her debts and that it was a substantial abuse for this 33-year-old to set aside voluntary savings at the expense of her creditors. (E.R. D, pp. 81-83.) The court found the debtor's relative youth to be a significant factor, noting "[a]nd she's not older. She's not an older person. She's a young person. She's thirty-three years old . . . I have consistently held that putting away money in 401's is inconsistent with what you're trying to do; you're [sic] trying to pay their creditors. And at the same time you're saving, taking away from the creditors . . . I would find that she has disposable income that she's otherwise trying to save through different plans." (E.R. D, p. 81, ll. 10-18; p. 82, ll. 2-4.)

The bankruptcy court also found that because the debtor had a small amount of unsecured debt, the disposable income available for the savings bond investments and voluntary retirement contributions was sufficient for the debtor to make a meaningful repayment of her unsecured debt. The court found it significant that Ms. Hebbring "doesn't owe a lot . . . she owes about eleven thousand dollars . . . You know it wouldn't be meaningful if she owed fifty thousand dollars. But she doesn't owe that much . . . She only owes a small amount of money." (E.R. D, p. 80, ll. 23-24; p. 81, ll. 1-8.)

The court therefore concluded that it would be an abuse of the chapter 7 provisions for the 33-year-old debtor to discharge her unsecured debt and pay nothing to creditors, while making voluntary investments in savings bonds and her retirement account. "...I think it would be an abuse of chapter 7 for her to be able to discharge all these debts and not pay something to these creditors, . . . " (E.R. D, p. 82, ll. 9-11.)

On October 17, 2003 the debtor timely appealed the dismissal order (E.R. F, pp. 85-87.). By order entered July 8, 2004, the United States District Court for the District of Nevada affirmed the bankruptcy court's dismissal order. (E.R. H, pp. 91-95.) The district court, applying an abuse of discretion standard, determined the bankruptcy court did not err in concluding the debtor could make substantial payments to her creditors by foregoing voluntary savings payments for three years. (E.R. H, p. 93, ll. 7-10.) The district court held that the bankruptcy court was not required to hold an evidentiary hearing because there were no material facts in dispute and that the bankruptcy court based its findings and judgment solely on the undisputed information that the debtor had provided. (E.R. H, p. 93, ll. 12-22.) Further, the court determined the United States Trustee met his burden of proof by demonstrating that the debtor had the ability to pay her debts based upon the uncontested record before the bankruptcy court, (E.R. H, pg. 94, ll. 5-9.), concluding "[t]he bankruptcy court's order is supported by the undisputed evidence." (E.R. H, pg. 94, ln. 9-10.) Finally the district court concluded it was not an abuse of discretion for the bankruptcy court to conclude on the figures provided by the debtor that she could fund a chapter 13 plan. (E.R. H, pg. 94, ln. 19-23.)

On July 30, 2004, Ms. Hebbring timely filed a notice of appeal to this Court from the district court's order affirming dismissal. (E.R. I.)

STANDARD OF REVIEW

This Court reviews bankruptcy court orders dismissing chapter 7 cases under 11 U.S.C. § 707(b) for abuse of discretion. In re Price, 353 F.3d 1135, 1138 (9th Cir. 2004). Under that standard, findings of fact are reviewed for clear error and questions of law are reviewed *de novo*. Id. A trial court's exercise of its discretion is not disturbed unless there is "a definite and firm conviction that the court below committed a clear error of judgment." In re Castillo, 297 F.3d 940, 945 (9th Cir. 2002).

SUMMARY OF ARGUMENT

The bankruptcy court did not abuse its discretion in dismissing Ms. Hebbring's chapter 7 case under section 707(b). Bankruptcy courts possess discretion to dismiss chapter 7 cases for substantial abuse when a debtor has an ability to repay a substantial portion of his or her debts. See, e.g., In re

Price, 353 F.3d 1135, 1140 (9th Cir. 2004); In re Kelly, 841 F.2d 908, 914-15 (9th Cir. 1988). The undisputed record in this case established that Ms. Hebbring, a fully-employed 33-year-old, could repay 75% of her debts merely by foregoing voluntary personal savings for three years. The bankruptcy court did not abuse the broad discretion it possesses under Price and Kelly in dismissing this case based on those undisputed facts.

The bankruptcy court acted appropriately in dismissing Ms. Hebbring's case without conducting an evidentiary hearing. Ms. Hebbring never requested such a hearing, and none was required under the bankruptcy rules. Bankruptcy Rule 1017(f)(1) provides that Bankruptcy Rule 9014 governs proceedings to dismiss bankruptcy cases. Fed. R. Bankr. P. 1017(f)(1). Rule 9014(d) requires evidentiary hearings only when there are "disputed material factual issues." Fed. R. Bankr. P. 9014(d). Here there were none. Dismissal was premised on statements Ms. Hebbring made in her petition and schedules under penalty of perjury, and upon documents she provided the United States Trustee, documents whose accuracy she did not contest.

ARGUMENT

A. The Bankruptcy Court Did Not Abuse Its Discretion In Dismissing Ms. Hebbring's Chapter 7 Bankruptcy Case.

Section 707(b) of the Bankruptcy Code gives a court broad discretion to dismiss bankruptcy cases when two factors are present. First there must be a debtor "whose debts are primarily consumer debts."[4] Ms. Hebbring does not dispute her debts are primarily consumer. Second, a court must find that the "granting of relief would be a substantial abuse of the provisions of the chapter." 11 U.S.C. § 707(b).

The primary factor to consider in determining whether the granting of relief constitutes substantial abuse, is the debtor's ability to pay their unsecured debts. A debtor's ability to repay is determined by considering whether, after deducting reasonably necessary expenses from their income, there is sufficient disposable income to make a significant repayment of their unsecured debt . See In re Price, 353 F.3d 1135, 1140 (9th Cir. 2004)

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[4] "Consumer debt", as defined by 11 U.S.C. § 101(8), is "debt incurred by an individual primarily for a personal, family or household purpose." "Debt," in turn is defined as "liability on a claim." 11 U.S.C. § 101(12). "Claim" is defined as "right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured or unsecured;". 11 U.S.C. § 101(5)(A).

(a "debtor's ability to pay his debts standing alone, justif[ies] a section 707(b) dismissal'."); In re Kelly, 841 F.2d 908, 914-15 (9th Cir. 1988) (an ability to repay debts, standing alone, justifies dismissal for substantial abuse.). See also, In re Gomes, 220 B.R. 84 (9th Cir. BAP 1998) (disposable income sufficient to repay 43% of unsecured debt is basis for a finding of substantial abuse). An ability to repay is measured by evaluating how much disposable income a debtor has available to could repay creditors in a three-year chapter 13 plan. 11 U.S.C. § 1325(b)(1)(B). See, e.g., In re Behlke, 358 F.3d 429, 436 (6th Cir. 2004). Disposable income is that which is not reasonably necessary to be expended for the maintenance or support of the debtor or a dependent of the debtor. 11 U.S.C. § 1325(b)(2)(A).

In this case, the bankruptcy court properly exercised its discretion and determined that Ms. Hebbring could repay a substantial portion of her debts merely by dedicating her current savings bond investment and voluntary retirement contribution to the payment of unsecured creditors for three years. (E.R. D, p. 82, ll. 2-16.) The bankruptcy court's ruling clearly came within the ambit of the ability to pay test set forth in Kelly and recently reaffirmed in Price.

Further, as explained in Price, the question of what constitutes substantial abuse falls within the bankruptcy court's discretion. Price, 353 F.3d at 1139. Here, after considering any mitigating factors the debtor had opportunity to present, the bankruptcy court determined Ms. Hebbring's ability to repay constituted substantial abuse. As the district court correctly concluded, Ms. "Hebbring has the ability to fund a Chapter 13 plan and the Bankruptcy Court did not abuse its discretion in dismissing Hebbring's petition." (E.R. H, p. 94, ll. 2-4.)

B. Voluntary Payroll Deduction for Savings Are Not Reasonably Necessary Expenses and Should Therefore be Included in Disposable Income.

Whether a debtor's voluntary contribution to a retirement plan is a reasonably necessary expense and therefore included as disposable income in the ability to pay test is an issue of first impression for this Court. However, the recent Sixth Circuit case, In re Behlke 358 F.3d 429 (6th Cir. 2004), is persuasive. In Behlke, the court examined whether voluntary 401(k) contributions should be included as disposable income or as reasonably necessary expenses in determining a debtor's ability to pay. The court held that while it was unwilling to find *per se* that such contributions are not reasonably necessary expenses for a debtor or their dependents, the court did find that these were not reasonably necessary expenses with respect to the debtors in Behlke. While saving for one's retirement "may represent prudent financial planning," such sums are not necessary or reasonable for the support of the debtor in bankruptcy." Behlke at 435, citing In re Harshbarger, 66 F.3d 775, 777 (6th Cir. 1995).

Other courts have also considered whether voluntary contributions to pension plans, repayment of pension loans, and income derived from pension plans may be included to determine a debtor's ability to pay. Most bankruptcy courts have rejected a deduction for voluntary contributions to 401(k) plans as being unnecessary and unreasonable for a debtor who is seeking bankruptcy relief. See, e.g., In re May, 261 B.R. 770 (Bankr. M.D. Fla. 2001); In re Regan, 269 B.R. 693 (Bankr. W.D. Mo. 2001); In re Fulton, 211 B.R. 247 (Bankr. S.D. Ohio 1997). In fact, a majority of bankruptcy courts have held that as a matter of law, voluntary retirement contributions must be included in disposable income. In re Mendoza, 274 B.R. 522, 524 (Bankr. D. Ariz. 2002); In re Heffernan, 242 B.R. 812, 818 (Bankr. D. Conn. 1999) (debtor's voluntary payment into a pension, savings, or investment-type plan is not an expenditure reasonably necessary for maintenance and support); In re Carlton, 211 B.R. 468 (Bankr.

W.D.N.Y. 1997) (substantial abuse indicated where the debtor was voluntarily making $332.05 per month contributions to a 401(k) plan, which could be discontinued so that the money could be paid to creditors instead).

The bankruptcy court in this case did not reach the issue whether voluntary retirement contribution are *per se* not a reasonably necessary expense in the context of a Section 707(b) motion to dismiss. Rather, it ruled that Ms. Hebbring's youth - she is 33, and her pre-petition retirement savings balance, which is exempt from her creditors claims, established that three years of post-petition voluntary retirement contributions were not reasonably necessary for *this* debtor at this time. Ms. Hebbring relies almost exclusively upon a single contrary case, In re Mills, 246 B.R. 395 (Bankr. S.D. Cal. 2000), to contest this court's exercise of judgment in this case. However, this decision is neither binding nor persuasive authority and is easily distinguished from the facts of this case.

In Mills, the court examined a Section 707(b) dismissal motion filed against a 56-year-old debtor with disposable income of at least $371. The United States Trustee asserted in that case that a 10% monthly voluntary 401(k) contribution of $302 and a monthly repayment of a 401(k) loan of $146 were not reasonably necessary expenses. The Mills court declined to follow the bankruptcy courts that have held that there is a *per se* rule against voluntary 401(k) withholdings. Instead, the Mills court ruled that it should be examined on a case by case basis. In Mills, the bankruptcy court ruled that the retirement contribution was a reasonably necessary expense for the support of a 56-year-old debtor with only $9,000 in retirement savings. Moreover, the court found that the debtor was not accumulating his retirement to the detriment of creditors. Id. at 402. Regarding the 401(k) loan repayment in Mills, however, because the debtor voluntarily borrowed $7,600 from his plan and gave half of that amount away, the loan repayment amount was deemed not reasonably necessary for his support or maintenance and was included as disposable income in the ability to pay analysis.

The Mills decision is the minority view and at least three other bankruptcy courts in the Ninth Circuit have issued decisions in which they declined to follow Mills. These later bankruptcy court decisions followed the majority view and held that voluntary contributions to a retirement plan, while desirable from the debtor's standpoint, is not an expenditure which is reasonably necessary for his maintenance and support. See In re Merrill, 255 B.R. 320 (Bankr. D. Ore. 2000) ("The Debtor is not allowed to acquire financial security for the future at the expense of his unsecured creditors"); See also In re Mendoza, 274 B.R. 522, 524 (Bankr. D. Ariz. 2002) (Contribution to retirement plan must be included as Chapter 13 disposable income. Mandatory retirement contributions are not reasonably necessary for debtor's support); In re Estes, 254 B.R. 261 (Bankr. D. Idaho, 2000) (Voluntary repayment of retirement loan must be included as disposable income under Section 1325(b)(1)(B) and such sums are not reasonably necessary for debtor's support).

This Court need not address this *per se* issue, because even Mills recognizes that courts possess discretion to determine that savings are not reasonable in a particular case. That is what the court below found and that finding was not clearly erroneous.

In addition, there are significant differences between the facts of Mills and those of this case. Ms. Hebbring is 33 years old, a full 23 years further from retirement than was the debtor in Mills. Ms. Hebbring already has close to $7,000 in her exempt retirement account, which is the same approximate balance amount as was held by the debtor in Mills who was much closer to retirement. Ms. Hebbring owns and is current on her home and car loans. She has only two creditors, both of whom can receive a significant distribution if the voluntary savings and retirement contributions are deferred for three years to fund a chapter 13 plan. Ms. Hebbring can repay 75% of her debts in a three-year chapter 13 plan, and 100% in a five-year plan. See 11 U.S.C. § 1322(d) (chapter 13 plans are for three years unless the court determines it is appropriate for payments to be made over five years). Because Ms. Hebbring's estate had no assets to liquidate, this is far better than what the debtor's unsecured creditors would have received if the debtor had been allowed to discharge all her unsecured debt in a chapter 7 case without having to devote any of her future income to at least partially satisfy her obligations to them.

Further, Ms. Hebbring remains free to seek chapter 13 relief notwithstanding the order entered below, and she could satisfy her debts through a chapter 13 repayment plan. See 11 U.S.C. §§ 1321 through 1330 (chapter 13 plans). If Ms. Hebbring does so, she will merely forego retirement payments for a period of three to five years. See 11 U.S.C. § 1322(d) (prescribing time limits for chapter 13 plans). After that, she will emerge from bankruptcy at a young age - mid to late 30s - with between 25 and 30 additional years of employment to continue amassing retirement funds. Although she does not want to pay her creditors, preferring instead to accumulate her retirement, the bankruptcy court engaged in no abuse of discretion by following the weight of authority in exercising jurisdiction under section 707(b) and dismissing the case.

C. The Court's Ruling is Supported by the Record and the Court did not Err in Dismissing this Case Without Conducting an Evidentiary Hearing.

The bankruptcy court had an ample factual basis upon which to make its ruling. First, the bankruptcy court had the debtor's petition, schedules and statement of financial affairs - each signed under penalty of perjury. These established her income and expenditures, including her income deductions for voluntary savings bond investments and retirement contributions. Their veracity was at issue in the case and Ms. Hebbring did not object to the bankruptcy court's consideration of them. Moreover, the bankruptcy court had the Gowans Declaration including the supporting information attached to the Gowans Declaration.

The debtor also cites in her brief to the decision of In re Harris, 279 B.R. 254 (9th Cir. BAP 2002). This bankruptcy appellate panel decision is not binding on this Court, and even if it were, it does not compel a different result. In Harris the United States Trustee relied on the debtor's schedules and the Internal Revenue Service's Financial Collection Standards ("the IRS standards") to dispute a material fact - the reasonableness of certain of the Harris debtors' expenses. The Harris court held that the subjective judgment of the bankruptcy judge regarding reasonableness of the debtors' budgeted expenditure amounts, may not be used and that the court must base unreasonable expense amount findings on some objective criteria. Further, the Harris court questioned the evidentiary value of the IRS standards because it found that a proper foundation had not been laid for the evidentiary admission of those standards.

Unlike Harris, there were no disputed issue of material of fact in Ms. Hebbring's case, and the reasonableness of any specific expense amount was not at issue. Unlike Harris, the United States Trustee did not question whether the amount of any of the debtor's expenses were reasonable so there was no material dispute on that point. Rather, the United States Trustee properly contended that it was not reasonably necessary for this 33-year-old; fully-employed debtor to invest in savings bonds and contribute to her retirement account, when if redirected to a chapter 13 plan, these funds would repay 75% of her $11,000+ in unsecured debt.

To the extent Ms. Hebbring suggests that section 707(b) motions require an evidentiary hearing, she misstates the law. Section 707(b) and

Bankruptcy Rule 1017(e) provide that dismissals must be brought by "motion." 11 U.S.C. § 707(b); Fed. R. Bankr. P. 1017(e). Bankruptcy Rule 1017(f)(1) specifies that dismissal motions be filed as motions under Rule 9014.[5] Fed. R. Bankr. P. 1017(f)(1). Bankruptcy Rule 9013 governs motions. Fed. R. Bankr. P. 9013. It, and Rule 9014, provide that motions trigger contested matters. Rule 9014(d) requires testimony of witnesses in contested matters only to decide disputed matters.[6] It is only for those disputed matters that evidentiary testimony must be taken in the same way that it is taken in adversary proceedings, which are governed by Fed. R. Bankr. P. 7001, et seq.[7]

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[5] Different procedures govern matters brought under 11 U.S.C. 706(a), 1112(a), 1208(a) and (b), and 1307(a) and (b), but this proceeding was brought under section 707(b) to which Rule 1017(f)(1) applies.

[6] Rule 9014(d) was added to the bankruptcy rules in 2002. No circuit court has had cause to interpret Rule 9014(d). The 2002 Advisory Notes of the Bankruptcy Rules Committee explain that subsection (d) "clarif[ies] that if [a] motion cannot be decided without resolving a disputed material issue of fact, an evidentiary hearing must be held at which testimony of witnesses is taken in the same manner as testimony is taken in an adversary proceeding or at a trial in a district court civil case." Reprinted in 2004 Collier Pamphlet Edition, Bankruptcy Rules (Lexis Nexis 2004), p. 684). The note is consistent with the plain language of the rule - both require hearings on in cases where there are disputed material facts.

[7] An adversary proceeding is commenced by the filing of a complaint and is essentially a separate lawsuit within the context of a bankruptcy case, with

Rule 9014(d) is significant for two reasons. First, it requires only that disputed matters be the subject of witness testimony. Second, it provides no mandated procedures for relying upon documents. In order to meet its burden of proof, nothing requires a movant in a contested matter before a bankruptcy court to present evidence independent of the court file or independent of the material presented by the opposing party. See, e.g., In re SGL Carbon Corp., 200 F.3d 154, 158 (3d Cir. 1999) (hearing on 1112(b) contested matter motion involved no witness testimony, evidence was entirely documentary or deposition testimony); Sullivan Central Plaza I Ltd. v. BancBoston Real Estate Capital Corp., (In re Sullivan Central Plaza I, Ltd.), 935 F.2d 723, 726 (5th Cir. 1991) (parties submitted letter briefs to court in lieu of evidentiary presentation).

Here, there were no disputed material facts. To the contrary, all the facts came from the Debtor's sworn petition, schedules and statement, or from documents produced to the U.S. Trustee by the Debtor.

In addition, the debtor never sought an evidentiary hearing. Instead,

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all the attributes of a civil action. See generally Fed. R. Bankr. P. Part VII. A contested matter, on the other hand, is commenced by the filing of a motion, and is governed by far less stringent criteria than adversary proceedings. See Fed. R. Bankr. P. 9014.

she argued that the undisputed facts did not justify dismissal for substantial abuse because it was reasonable for her to save for retirement. (E.R. D, p.80.)

Given the undisputed record, the bankruptcy court did not need to conduct an evidentiary hearing. Nor did it err in issuing oral findings. Under Rule 9014(c), contested matters instituted by motion are governed by some of the rules that apply to adversary proceedings instituted by complaint, including Bankruptcy Rule 7052. See Fed. R. Bankr. P. 9014(c) ("Unless the court directs otherwise, the following rules shall apply . . . 7052 . . . "). Rule 7052, dealing with findings, provides that "Rule 52 F.R.Civ.P. applies." Fed. R. Bankr. P. 7052. In turn, Civil Procedure Rule 52(a) provides that "[i]t will be sufficient if the findings of fact and conclusions of law are stated orally and recorded in open court." Fed. R. Civ. P. 52(a). Here, the bankruptcy court entered appropriate findings in conformity with the Bankruptcy Rules. Nothing in the procedures it employed constituted reversible error.

D. The U.S. Trustee Carried His Burden of Proof.

The debtor suggests incorrectly that the United States Trustee failed to meet its burden of proof. (Appellant's Brief, p. 5.) Here, the United

States Trustee, relying upon documents provided by the debtor and upon statements the debtor made under penalty of perjury established the debtor had the ability to make substantial payments. That satisfied Price and Kelly, and the bankruptcy court did not err in finding substantial abuse and an ability to repay. As the district court noted in affirming the bankruptcy court's dismissal, "[t]he Bankruptcy Court used [Ms.] Hebbring's schedule that showed she had the ability to pay her debts using funds from her current contributions to the 401(k) plan and savings bonds. The U.S. Trustee relied on uncontested evidence provided by Hebbring herself. The bankruptcy court's order is supported by the undisputed evidence." (E.R. H, p. 94, ll. 5-10.) There is no error in any of that.[8]

E. The Debtor Can Fund a Chapter 13 Plan.

Finally, the debtor's argument that she cannot fund a chapter 13 plan is not supported by any admissible evidence before the bankruptcy court. (Appellant's Brief pp. 5-7.) The debtor did not file any amended Schedules

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[8] The debtor notes correctly that section 707(b) contains a presumption in favor of the debtor. 11 U.S.C. 707(b). The United States Trustee overcame that presumption and satisfied Price and Kelly by establishing that the debtor had the ability to repay a substantial portion of her debts See In re Mastromarino, 197 B.R. 171, 177 (Bankr. D. Maine 1996) (noting if U.S. Trustee introduces evidence of ability to pay the presumption vanishes.)

I or J prior to the hearing or testify to any supposed increased expenses. Furthermore, the argument fails on its merits. The $81.25 savings bond deduction is made after taxes. The marginal tax rate on yearly income over $29,050 is 25% such that the pre-tax 401(k) deduction of $232.05 is about $175 after being taxed. Therefore the debtor would have $256 to fund a plan. Over 36 months the Debtor could pay $9,225, less trustee fees of 10%, or $8302, on $11,124.15 of unsecured debt. A 75% payout plan.

As the District Court determined:

> It was not an abuse of discretion for the bankruptcy court to conclude that Hebbring would have approximately $256 per month to fund a plan which over 36 months would represent a 70-75 percent payout plan.

(E.R. H, p. 94, ll. 20-23.)

In addition the debtor pre- and post-petition lives and pays her expenses without the use of the retirement funds. By the debtor's own schedules (E.R. A, pp. 16-19) the funds are not necessary for her day to day living expenses. If she can subsist without those monies today, it is misleading to now contend that those monies should be used to pay everyday expenses and not her creditors.

CONCLUSION

For these reasons, the United States Trustee respectfully asks this Court to affirm the orders entered below.

DATED this 27 day of October, 2004.

Donald F. Walton
Acting General Counsel

Mark A. Redmiles
P. Matthew Sutko
Department of Justice
Office of the General Counsel
Executive Office
for United States Trustees
20 Massachusetts Ave., N.W., Suite 8100
Washington D.C. 20530

Nicholas Strozza
Assistant United States Trustee

Attorneys for Appellee
United States Trustee

STATEMENT OF RELATED CASES

Pursuant to Circuit Rule 28-2.6, Appellee the United States Trustee states he knows of no related cases pending before the Court of Appeals.

Nicholas Strozza
Attorney for Appellee
United States Trustee

CERTIFICATE OF COMPLIANCE
PURSUANT TO Fed. R. App. Pro. 32(a)(7)(C)

I. Nicholas Strozza, attorney for Appellee, certify that the attached brief is not subject to the type-volume limitations of Fed. R. App. P. 32(a)(7)(B) because this brief complies with Fed. R. App. P. 32(a)(1)-(7) and is a principal brief of no more than 30 pages.

Dated: October 27 2004.

Nicholas Strozza
Attorney for Appellee
United States Trustee

BRIEF BANK — "SUMMARY SHEET" *Printed Fri.-6/30/0 (13:09)*

WESTLAW CODES

1. ("TI") *TITLE* OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*
U.S. Trustee v. Newmark Retail Financial Advisors, L.L.C.
(In re joan and david helpern, Inc.)

2. ("CO") *CURRENT* COURT *[E.g., "CTA9"]*
U.S. District Court, Southern District of N.Y. (S.D.N.Y.)

3. ("CCN") *CURRENT* CASE NO.
No.: 00-CV-3601 (JSM) (S.D.N.Y.)

4. ("PCN") *PRIOR* CASE NO. & COURT *[IF ANY]*
No.: 00-B-10961 (SMB) (Bankr. S.D.N.Y.)
Court: U.S. Bankruptcy Court, Southern District of N.Y.
(Identify judge & cite, if any)

5. ("SO") *SOURCE*
U.S. TRUSTEES

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UST Region 2 (212-510-0500):
Carolyn Schwartz, Mary Tom, Wendy Rosenthal, & Greg Zipes)
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") *TOPIC*
BANKRUPTCY

9. ("SU") ! ***SUMMARY*** OF KEY ISSUE(s)

&

/ Any Miscellaneous ***BACKGROUND***

! Whether professionals who act as "financial advisors" to a Chapter 11 debtor may obtain indemnification from the debtor's estate under. 11 U.S.C. §§ 327, 328, 330.

***/* Background:**

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DATE: June 26, 2000

THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

---x
In re :
:
joan and david helpern incorporated, :
: 00-CV-3601 (JSM)
: Bankruptcy Case No. 00-B-10961 (SMB)
Debtor. :
---x
---x
THE UNITED STATES TRUSTEE, :
:
Appellant :
v. :
:
NEWMARK RETAIL FINANCIAL :
ADVISORS LLC and joan and david :
helpern incorporated, :
:
Appellees. :
---x

BRIEF OF APPELLANT, THE UNITED STATES TRUSTEE

CAROLYN S. SCHWARTZ, THE UNITED STATES TRUSTEE
OFFICE OF THE UNITED STATES TRUSTEE
33 WHITEHALL STREET
21ST FLOOR
NEW YORK, NEW YORK 10004

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BRIEF OF APPELLANT, THE UNITED STATES TRUSTEE

I. BASIS OF APPELLATE JURISDICTION

This Court has jurisdiction over this appeal under 28 U.S.C. § 158(a) ("The district courts of the United States shall have jurisdiction to hear appeals from (1) final judgments, orders, decrees . . . of bankruptcy judges"). The memorandum decision (the "Memorandum Decision") dated April 4, 2000 and the order (the "Retention Order") dated April 10, 2000 are final orders of the bankruptcy court. See In re Palm Coast, Matanza Shores Ltd. Partnership, 101 F.3d 253, 256 (2d Cir. 1996) (retention "'[o]rders in bankruptcy cases may be immediately appealed if they finally dispose of discrete disputes within the larger case'") (quoting In re Johns-Manville Corp., 920 F.2d 121, 126 (2d Cir. 1990)).

II. STATEMENT OF THE ISSUES PRESENTED AND STANDARDS OF APPELLATE REVIEW

The issues on appeal are:

(i) Whether the Bankruptcy Court erred in finding that the Debtor should indemnify Newmark Retail Financial Advisors LLC from and against any losses, claims, damages, expenses and liabilities related to, arising out of, or in connection with the Debtor's engagement of Newmark as its business and restructuring advisor except for "any losses, claims, damages or liabilities (or expenses related thereto) that are finally judicially determined by a court of competent jurisdiction to have primarily resulted from the breach of trust, bad faith, self dealing, breach of fiduciary duties (other than ordinary negligence), gross negligence or willful or reckless misconduct of" Newmark; and

(ii) Whether the Bankruptcy Court erred in finding that the Debtor met its burden that the terms of Newmark's employment are reasonable and "in the best interests of the Debtor, its estate and creditors."

The issues raised by this appeal involve questions of law which are subject to de novo review and questions of fact which are subject to a clearly erroneous standard by the District

Court. In re Ionosphere Clubs, Inc., 922 F.2d 984, 988-89 (2d Cir.), cert. denied, 502 U.S. 808 (1991).

III. STATEMENT OF THE CASE

On March 9, 2000, joan and david helpern incorporated (the "Debtor") filed a voluntary petition (the "Petition") under chapter 11 of the Bankruptcy Code. The Petition reveals that the Debtor's assets total \$34.8 million and its liabilities total \$33.1 million, and that the Debtor operates 84 retail boutiques, shops-in-shops located in major department stores, and outlets in the United States and abroad.

On March 10, 2000 (the "March 10th Hearing"), the Debtor presented various "first day" orders to the Bankruptcy Court, including an application for an order authorizing the Debtor to retain Newmark Retail Financial Advisors LLC ("Newmark") as business and restructuring advisor under § 327(a) of the Bankruptcy Code (the "Retention Application"). (D-1, Dkt. 4).[1/]

As set forth in the Retention Application, Newmark is to provide the following services:

a. reviewing, evaluating and advising the Debtor in connection with its business plans and financial projections and assets and liabilities;

b. negotiating with potential lenders for the provision of debtor-in-possession ("DIP") financing;

c. negotiating and structuring arrangements for the disposition, transfer or sale of inventory to third parties;

[1/] "D-____" is used herein to identify a document by number as it is listed in the Designation of the Contents of the Record on Appeal and Statement of Issues (the "Designation Record") filed by the United States Trustee for the Southern District of New York (the "United States Trustee"). "Dkt.____" is used herein to identify a document by number as it is listed on the Bankruptcy Court's docket sheet for this case.

d. making presentations and attending meetings with the Debtor and other parties in interest (and providing testimony if necessary and requested by the Debtor);

e. advising, making recommendations and/or assisting in effectuating store closings and property sales or dispositions (and evaluating the assets and liabilities in connection therewith); and

f. providing services (including consulting and brokerage) for the sale, lease, purchase, modification, termination or restructuring of: (i) real estate interests and (ii) furniture, fixtures and equipment ("FF&E") and other assets (such as customer lists) not provided for above which services may include marketing, organizing the bidding and sale process, reviewing relevant documentation, and negotiating rent reductions, lease modifications and bankruptcy claims.

(D-1, Dkt. 4) (Retention Application, pp. 9-10).

As compensation for these business and restructuring services, the Debtor agreed to pay Newmark a monthly advisory fee of $65,000. (D-1, Dkt. 4) (Retention Application, p. 11). In addition, Newmark has the potential to earn a commission on numerous types of transactions (the "Transactional Fees") including, but not limited to, Newmark's (i) renegotiating the Debtor's existing debt and securing DIP financing,[2/] (ii) securing the disposition of the Debtor's real estate interests, (iii) securing the disposition of the Debtor's FF&E and inventory, and (iv) negotiating the Debtor's leases. (D-1, Dkt. 4) (Retention Application, p. 11-12). In total, Newmark has

---

[2/] On April 12, 2000, the Bankruptcy Court approved the Debtor's application for DIP financing with Paragon Capital LLC wherein Paragon agreed to loan the Debtor $15,000,000. Under the Retention Application, which was slightly modified by the Retention Order, Newmark received a .667% commission on this transaction, for a total of $100,050.

the potential to earn up to $215,000 per month,[3] consisting of the guaranteed minimum plus Transaction Fees. (D-1, Dkt. 4) (Retention Application, p. 13).[4]

At the March 10th Hearing, the United States Trustee[5] orally raised certain objections to the Retention Application, including an objection to a provision in the Retention Application which sought to have the Bankruptcy Court approve the Debtor's agreement to indemnify Newmark from and against any losses, claims, damages, expenses and liabilities related to, arising out of, or in connection with its activities as business and restructuring advisor to the Debtor. Specifically, the United States Trustee objected to the proposed Retention Application which included the following agreement by the Debtor:

> As set forth in more detail in the Letter Agreement, the Debtor has agreed to indemnify [Newmark] (and others associated with [Newmark] in connection with the Debtor's engagement of Newmark) from and against any losses, claims, damages, expenses and liabilities (unless [Newmark] has committed willful misconduct or gross negligence) related to, arising out of, or in connection with its activities as business and restructuring advisor to the Debtor.

---

[3] As set forth in the Retention Application, in the event Newmark earns commissions for securing any of the various transactions described above, up to $40,000 per month will be credited against the $65,000 monthly advisory fee. (D-1, Dkt. 4) (Retention Application, p. 11).

[4] The Retention Order modifies the total maximum amount of monthly compensation under the Retention Application. Initially, under the Retention Application, the total amount of compensation payable to Newmark was the $65,000.00 advisory fee (excluding the credit for Transaction Fees) actually paid, plus $200,000. (D-10, Dkt. 108) (Retention Order, p. 6). This amount was reduced to $150,000, following negotiations with the committee of unsecured creditors (the "Committee").

[5] The United States Trustee is the official of the Executive Branch responsible for "protecting the public interest and ensuring that bankruptcy cases are conducted according to the law." H.R. Rep. No. 95-595, 95th Cong., 2d Sess. 109 (1978), <u>reprinted</u> <u>in</u> U.S.C.C.A.N. 5963, 6070. <u>See</u> <u>also</u> 28 U.S.C. § 586; 11 U.S.C. § 307.

(D-1, Dkt. 4) (Retention Application, p. 14). The Letter Agreement (the "Agreement") from Newmark to the Debtor, annexed to the Retention Application, disclosed the following terms:

> (a) The [Debtor] acknowledges and agrees that [Newmark] has been retained to act solely for the matters contained herein. In such capacity, [Newmark] shall act as an independent contractor,[6/] and any duties arising out of its engagement pursuant to this Agreement shall be owed solely to the [Debtor]. Because [Newmark] will be acting on the [Debtor's] behalf in this capacity, it is customary for us to receive indemnification (see below). . . .
>
> (b) In consideration of [Newmark's] engagement and services hereunder and in connection with the association between [Newmark] and the [Debtor], its affiliates, shareholders, lenders and creditors (the "Engagement"), the [Debtor] agrees to idemnify and hold harmless [Newmark], its affiliates and the shareholders, members, managing members, partners, owners, employees, officers, directors, consultants and agents of [Newmark] and its affiliates ([Newmark], its affiliates and each such other entity or person being an "Indemnified Party") from and against any losses, claims, damages, expenses and liabilities whatsoever, whether joint or several, related to, arising out of or in connection with the Engagement or the Agreement and will reimburse each Indemnified Party for all expenses (including reasonable attorneys fees, expenses and disbursements) as they are incurred, including in connection with the enforcement of the Agreement and investigating, preparing, defending, responding and/or testifying to any subpoena or deposition, being called as a witness or assisting in the defense of any action, claim, suit, investigation or proceeding related to, arising out of or in connection with the Engagement or Agreement, whether or not pending or threatened, whether or not any Indemnified Party is a party, whether or not resulting in any liability and whether or not such action, claim, suit, investigation or proceeding is initiated or brought by the [Debtor]. Notwithstanding the foregoing sentence, the [Debtor] will not be liable under the foregoing indemnification provision for any losses, claims, damages or liabilities (or expenses related thereto) that are <u>finally judicially determined by a court of competent jurisdiction</u>

[6/] At an adjourned hearing on the Retention Application held before the Bankruptcy Court on March 30, 2000, the United States Trustee raised the issue of whether, notwithstanding this "independent contractor" language, Newmark, as a retained professional, was a fiduciary of the Debtor's estate. (D-7) (March 30th Transcript, p. 25, lines 6-8). In response to the inquiry, Newmark conceded it is a fiduciary of the Debtor's estate. (D-7) (March 30th Transcript, p. 25, lines 9-16).

> to have primarily resulted from the bad faith, gross negligence or willful misconduct of [Newmark].

(D-1, Dkt. 4) (Retention Application, Exhibit 1, p. 4) (emphasis added).

At the conclusion of the March 10th Hearing, the Bankruptcy Court adjourned the hearing on the Retention Application to March 15, 2000 (the "March 15th Hearing") in order to provide the United States Trustee, the Debtor's counsel and Newmark an opportunity to discuss the United States Trustee's objections to the Retention Application. However, the parties were unable to resolve their differences. As a result, at the March 15th Hearing, the United States Trustee informed the Bankruptcy Court that she objected to the indemnification provision in the Retention Application and requested an opportunity to brief the issue. The Bankruptcy Court adjourned the hearing on the Retention Application to March 30, 2000 (the "March 30th Hearing").

Subsequently, on March 22, 2000, the United States Trustee filed her objection (the "Objection") to the Retention Application (D-5, Dkt. 44) and Newmark filed its response (the "Response") on March 29, 2000 (D-6, Dkt. 77). The Debtor did not file a response to the Objection, nor did the Committee.

At the March 30th Hearing, after hearing oral arguments and considering the parties' submissions, the Bankruptcy Court issued an oral ruling approving the Retention Application, including the indemnification provision, and overruling the United States Trustee's objections. (D-9, Dkt. 95). Subsequently, on April 4, 2000, the Bankruptcy Court issued the Memorandum Decision regarding the indemnification provision in the Retention Application. (D-9, Dkt. 95).

Thereafter, by order dated April 10, 2000, which was entered on the docket on April 11, 2000, the Bankruptcy Court approved the retention of Newmark, modifying the indemnification provision in the Retention Application to add the phrases "breach of trust," "self dealing" and "breach of fiduciary duties (other than ordinary negligence)" to the list of situations in which Newmark shall not be indemnified. (D-10, Dkt. 108). As will be demonstrated below, these modifications are of little import because under the Retention Order, Newmark will be indemnified for its breach of trust, bad faith, self dealing, breach of fiduciary duties, gross negligence or willful or reckless misconduct unless there is a final judicial determination finding that Newmark is primarily liable for the particular loss, claim, or damage. The United States Trustee timely filed her Notice of Appeal on April 14, 2000.

IV. SUMMARY OF THE ARGUMENT

The Bankruptcy Court erred in approving, under § 327 of the Bankruptcy Code, the retention of Newmark as business and restructuring advisors to the Debtor which included an absolute grant of indemnification. Pursuant to the Retention Order and Memorandum Decision, Chief Bankruptcy Judge Stuart M. Bernstein approved an overly broad indemnification provision which requires the Debtor's bankruptcy estate to reimburse Newmark for Newmark's own negligence and, under certain circumstances, even for Newmark's breach of trust, bad faith, self dealing, breach of fiduciary duties (other than ordinary negligence), gross negligence or willful or reckless misconduct. Except for Newmark's attorneys' fees and expenses, the Retention Order requires the Debtor to reimburse Newmark without any further court review or notice to the parties in interest.

The Bankruptcy Court's preapproval of Newmark's indemnification in this case, without any review for reasonableness, contravenes § 330 of the Bankruptcy Code. The Bankruptcy Court improperly compressed two distinct steps into one: retention of professionals under § 327 of the Bankruptcy Code and approval of payments under § 330 of the Bankruptcy Code. Moreover, the indemnification provision constitutes blatant overreaching by a professional that will be well compensated for its services to the estate while placing further financial pressure upon the Debtor and its creditor body. Finally, the Bankruptcy Court improperly found that the Debtor met its burden to demonstrate that the indemnification provision is a reasonable condition of Newmark's employment and in the best interests of the Debtor's estate.

V. ARGUMENT

A. THE INDEMNIFICATION PROVISION VIOLATES THE BANKRUPTCY CODE'S FRAMEWORK FOR (i) RETENTION AND (ii) COMPENSATION AND REIMBURSEMENT OF PROFESSIONALS

1. The Indemnification Provision Violates § 330 of the Bankruptcy Code

It is well-settled that courts are required to apply the plain meaning rule of statutory construction. "[A]s long as the statutory scheme is coherent and consistent, there is generally no need for a court to inquire beyond the plain meaning of the statute." United States v. Ron Pair Enter., Inc., 489 U.S. 235, 240 (1989).

The Bankruptcy Code sets forth a clear framework for the (i) retention and (ii) compensation and reimbursement of professionals. Pursuant to § 327(a) of the Bankruptcy Code:

> the trustee, with the court's approval, may employ one or more attorneys, accountants, appraisers, auctioneers, or other professional persons, that do not hold or represent an interest adverse to the estate, and that are disinterested persons, to represent or assist the trustee in carrying out the trustee's duties under this title.

11 U.S.C. § 327(a). However, "approval under § 327 [of the Bankruptcy Code] establishes only that [a professional] may be employed by the debtor-in-possession, and not that his employment will therefore or thereafter be compensated from estate funds." In re Engel, 124 F.3d 567, 572 (3d Cir. 1997); see United States Trustee v. Garvey, Schubert & Barer (In re Century Cleaning Serv., Inc.), 195 F.3d 1053, 1060 n.9 (9th Cir. 1999)(§327 of the Bankruptcy Code authorizes the trustee to employ professionals but § 330(a) governs compensation of professionals); In re Johns-Manville Corp., 32 B.R. 728, 731 (S.D.N.Y. 1983)("section 327 approvals are merely preliminary 'go aheads' rather than conclusive determinations [of fees and expenses]"); In re United Co. Fin. Corp., 241 B.R. 521, 524 (Bankr. D. Del. 1999)(obligation to review and approve fee requests was not affected by a prior agreement by the debtor to pay fees); In re C & P Auto Transp., Inc., 94 B.R. 682, 685 (Bankr. E.D. Cal. 1988)("the actual determination of compensation is left to the standards stated in section 330"). Thus, it is clear that retention under § 327 of the Bankruptcy Code does not, by itself, guarantee a professional payment of its anticipated fees and expenses, including indemnification expenses.

Rather, the actual payment of fees and expenses of a professional is governed by § 330 of the Bankruptcy Code. Specifically, § 330(a) provides that:

> (1) After notice to the parties in interest and the United States trustee and a hearing, and subject to sections 326, 328, and 329, the court may award to a trustee, an

> examiner, a professional person employed under section 327 or 1103-
>
> (A) reasonable compensation for actual, necessary services rendered by the trustee, examiner, professional person, or attorney and by any para-professional person employed by any such person; and
>
> (B) reimbursement for actual, necessary expenses.

11 U.S.C. § 330(a)(1)(A) and (B). Thus, under the Bankruptcy Code, "[c]ompensation from the estate depends on the second look taken by the bankruptcy court, as mandated by § 330, for a determination of 'benefit to the estate [for the professional's work].'" Engel, 124 F.3d at 571 (emphasis added). Because this "second look" is so important to the application of § 330, a fortiori, it must take place after the services are rendered.

Furthermore, under § 330 of the Bankruptcy Code, it is insufficient that services are rendered on behalf of the debtor. These services must be "beneficial to the estate." In re Lederman Enter., Inc., 997 F.2d 1321, 1323 (10th Cir. 1993). Accordingly, an application for compensation and reimbursement of expenses must demonstrate that the professional's services were necessary and made a beneficial contribution to the estate or its creditors. Engel, 124 F.3d at 573 (citing In re Arkansas Co., Inc., 798 F.2d 645, 648-49 (3d Cir. 1986)(other citation omitted)); Zolfo, Cooper & Co. v. Sunbeam-Oster Co., Inc., 50 F.3d 253, 261 (3d Cir. 1995)(citation omitted); Huhn v. Wein (In re Huhn), 145 B.R. 872, 875 (W.D. Mich. 1992); In re Copeland, 154 B.R. 693 (Bankr. W.D. Mich. 1993); In re McLean Indus., Inc., 88 B.R. 36, 38 (Bankr. S.D.N.Y. 1988). Therefore, the bankruptcy court has the authority to reduce fees or expenses requested when they are disproportionate to the benefit to the estate. In re Taxman

Clothing Co., 49 F.3d 310, 316 (7th Cir. 1995); see Zolfo, 50 F.3d at 262 (affirming lower courts' denial of improperly documented and inadequately detailed expenses). Moreover, "[s]ervices of a poor quality which are the consequence of wrongful or unethical conduct, may result in denial of any fee or an order for return of any fee paid." In re Whitman, 51 B.R. 502, 506 (Bankr. D. Mass. 1985)(citing Red Carpet Corp. v. Miller, 708 F.2d 1576 (11th Cir. 1983)).

Pursuant to the Retention Order, any expense or fee which Newmark may incur in connection with the broad indemnity granted to it is pre-approved, without any right by the court or parties in interest to object to its "reasonableness."[7/] As such, the indemnity provision is inconsistent with the statutory scheme of (i) retention and (ii) compensation and reimbursement of professionals.

In the Engel case, the Third Circuit held that court authorization to retain a professional under § 327 of the Bankruptcy Code and compensation under § 330 of the Bankruptcy Code cannot be compressed into one step. Engel, 124 F.3d at 572. The Third Circuit found that such a procedure "would render meaningless the structure of the Bankruptcy Code and Rules which contain provisions requiring both approval of employment and after the fact approval of compensation." Id. (emphasis added) (citations omitted); see Davis v. Hibbits (In re Sullivan's Jewelry, Inc.), 226 B.R. 624, 626 (Bankr. 8th Cir. 1998) (professionals may be compensated under §

[7/] The Retention Order requires any attorneys defending Newmark in any action to seek approval of their fees and expenses from the Bankruptcy Court. (D-10, Dkt. 108) (Retention Order, p. 4). Apart from such fees, however, any other component covered by the indemnity (e.g., damages, settlement amounts, etc.) does not require any review by the Bankruptcy Court.

330 of the Bankruptcy Code only after an application is made to the bankruptcy court).

Professionals' requests for compensation are carefully reviewed "because of 'the temptation of a failing debtor to deal too liberally with his property in employing counsel' and because transactions with debtor's attorney provide potential for 'evasion of creditor protection provisions of bankruptcy laws' and 'overreaching by the debtor's attorney.'" Whitman, 51 B.R. at 506 (quoting In re Wood, 210 U.S. 246, 253 (1908) and H.R. Rep. No. 595, 95th Cong. 1st Sess. 329 (1977) U.S.C.C.A.N. 1978, pp. 5787, 6285)(other citation omitted); see In the Matter of Concrete Prod., Inc., 208 B.R. 1000, 1006 (Bankr. S.D. Ga. 1996)("close supervision of administrative expenses is mandated in order to prevent depletion of debtor's estate"). Thus, the two-step process of retaining professionals under § 327 and then compensating such professionals under § 330 "was adopted by Congress to eliminate 'abuses and detrimental practices' attributable to attorney control of bankruptcy cases." Engel, 124 B.R. F.3d at 572-73 (quoting In re Arkansas Co., Inc., 798 F.2d 645, 649 (3d Cir. 1986)); see Huhn v. Wein (In re Huhn), 145 B.R. at 875 ("every dollar expended on legal fees results in a dollar less that is available for distribution to the creditors or for use by the debtor").

Therefore, an automatic payment to professionals of fees or expenses, including an indemnification payment, without a review by the bankruptcy court or the parties in interest for reasonableness and necessity under § 330, subverts the clear intent of the Bankruptcy Code. See In re Commercial Fin. Serv., Inc., 231 B.R. 351, 355 (Bankr. N.D. Okla. 1999)("[n]either section 330 or 331 provides authority for the outright payment of professional fees prior to at least interim scrutiny by the Court"); In the Matter of Schroeder, 120 B.R. 527, 529 (Bankr. D.

Neb. 1990)("post-petition payments to professionals without leave of court circumvents carefully drafted statutes and rules governing the retention and compensation of professionals in connection with bankruptcy cases"); In re C & P Auto Transp., Inc., 94 B.R. at 689 (the Bankruptcy Code requires that fees be awarded by the court after withstanding scrutiny from parties in interest).

To be consistent with the framework of the Bankruptcy Code, "[w]hether indemnification should be offered to a professional should be determined on a case-by-case basis, after the claim has been asserted for which indemnity is sought." In re Mortgage & Realty Trust, 123 B.R. 626, 631 (Bankr. C.D. Cal. 1991) (emphasis added).

2. The Indemnification Provision Violates § 328(c) of the Bankruptcy Code

As noted in the preceding discussion, § 327 of the Bankruptcy Code requires a professional to be a "disinterested person" and not "hold or represent an interest adverse to the estate." 11 U.S.C. § 327(a). Under 11 U.S.C. § 328(c), the bankruptcy court retains the power to deny compensation and reimbursement of expenses to a professional retained under § 327 of the Bankruptcy Code. Section 328(c) provides, in pertinent part, that:

> the court may deny allowance of compensation for services and reimbursement of expenses of a professional person employed under section 327 or 1103 of this title, if, at any time during such professional person's employment under section 327 or 1103 of this title, such professional person is not a disinterested person, or represents or holds an interest adverse to the estate with respect to the matter on which such professional person is employed.

11 U.S.C. § 328(c); see Kravit, Gass & Weber, S.C. v. Michel (In re Crivello), 134 F.3d 831,

839 (7th Cir. 1998)("§ 328(c) remains as a retroactive penalty for those professionals whose retention under §327(a) was improper or who fail to satisfy § 327(a) requirements while working for the estate")(citation omitted); Electro-Wire Prod., Inc. (In re Prince), 40 F.3d 356, 359 (11th Cir. 1994) (§ 328(c) permits a court to deny compensation to professionals found not to be disinterested).

Although not defined in the Bankruptcy Code, an adverse interest exists if a professional has an economic interest "that would tend to lessen the value of the bankruptcy estate or that would create either an actual or potential dispute in which the estate is a rival claimant" or that would create a predisposition against the estate. Prince, 40 F.3d at 361; see also In re BH & P, Inc., 949 F.2d 1300, 1314 (3d Cir. 1991); In re Granite Partners, L.P., 219 B.R. 22, 32-33 (Bankr. S.D.N.Y. 1998); In re Angelika Films 57th, Inc., 227 B.R. 29, 39 (Bankr. S.D.N.Y. 1998) ("what is clear is that undivided loyalty is central to disinterestedness"), aff'd, 246 B.R. 176 (S.D.N.Y. 2000). To the extent that both the "disinterestedness" and "adverse interest" prongs of § 327(a) are duplicative, they form a single test to judge conflicts of interest. In re Martin, 817 F.2d 175, 179 n.4 (1st Cir. 1987); Granite, 219 B.R. at 33. Importantly, the disinterestedness and adverse interest prohibitions under §327(a) cannot be waived, even upon agreement by counsel to the debtor and counsel to the creditors' committee. See In re Tinley Plaza Assoc., 142 B.R. 272, 277-78 (Bankr. N.D. Ill. 1992) ("[s]ection 327(a) is a prohibition without exceptions") (citing In re Diamond Mortgage Corp., 135 B.R. 78, 94 (Bankr. N.D. Ill. 1990); see also Meredith v. Thralls, 144 F.2d 473, 475 (2d Cir.), cert. denied sub nom., Consolidated Realty Corp. v. Meredith, 323 U.S. 758 (1944)(test of disinterestedness cannot be waived because of the integrity or ability of the particular individual under scrutiny) (decided under the former Bankruptcy Act).

By approving the indemnification provision at the outset of the Debtor's chapter 11 case, the Bankruptcy Court abrogated its supervisory role over retained professionals. See Rome v. Braunstein, 19 F.3d 54, 57-58 (1st Cir. 1994) ("the need for self scrutiny and avoidance of conflicts of interest does not end upon appointment"); In re Angelika Films 57th, Inc., 246 B.R. 176, 180 (S.D.N.Y. 2000) ("[c]ompliance with the disinterested requirements . . . is critical at the time of retention, but also throughout the case 'and is so crucial to the proper functioning of the bankruptcy system that a court may raise it and dispose of it whenever its sanctity is questioned.'") (quoting In re Vebeliunas, 231 B.R. 181, 187 (Bankr. S.D.N.Y. 1999), appeal dismissed, 246 B.R. 172 (S.D.N.Y. 2000)); In re Plaza Hotel Corp., 111 B.R. 882, 891 (Bankr. E.D. Cal.) ("the court's continuing supervisory role during the case includes the ability to revisit such issues as conflicts whenever appropriate" and "the court must be prepared to revoke its approval if circumstances so dictate"), aff'd, 123 B.R. 466 (Bankr. 9th Cir. 1990)(table).

The Bankruptcy Court erred in not considering the possible effect of the indemnification upon Newmark's disinterestedness. When Newmark seeks to enforce the indemnification provision and the Debtor disputes Newmark's right to seek an indemnity, such a dispute may affect Newmark's ability to continue representing the Debtor. For example, if Newmark were sued for a certain action it took, it might allege that it acted under direction from the Debtor and the Debtor may dispute that allegation, thus causing a conflict between the parties seeking to blame each other for the resulting problem. If the Bankruptcy Court has no further review over the enforcement of the indemnification provision, these conflicts of interest, which would most likely require the disqualification of Newmark, will never be brought before it. This untenable situation can be avoided by requiring Newmark to request an indemnity payment from the Debtor, upon notice and with the Bankruptcy Court's approval, if an indemnification situation actually arises. If this is required, the Bankruptcy Court, at the time the request is made, can make a determination whether to grant such an indemnity and whether the grant of such an indemnity would create a conflict of interest which would require the disqualification of Newmark. See In re Arochem Corp., 176 F.3d 610, 624 (2d Cir. 1999)(disqualification is mandatory where professional has an actual conflict of interest).

3. The Bankruptcy Court Erred In Relying On Trusts and Corporate Law When the Bankruptcy Code is Clear and Unambiguous

The Bankruptcy Court, relying on the Second Circuit's decision in In re Palm Coast, Matanza Shores Limited Partnership, 101 F.3d 253 (2d Cir. 1996),[8] erred in looking to the law of trusts and New York and Delaware corporate law for justification to permit the indemnification provision. The plain language of the Bankruptcy Code sets forth the framework for retaining and compensating professionals. As discussed in the preceding sections, the Bankruptcy Code does not permit pre-approved payments from a debtor's bankruptcy estate to professionals at the outset of a bankruptcy case. Instead, § 330 of the Bankruptcy Code requires professionals

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[8] In Palm Coast, the Second Circuit, in determining whether or not the Bankruptcy Code permits a Chapter 11 trustee to employ his real estate firm as real estate consultant to the bankruptcy estate, found that because the Bankruptcy Code and legislative history on this issue were not clear, it could look to the law of trusts for guidance. Palm Coast, 101 F.3d at 257 (citing United States v. Sanges, 144 U.S. 310, 311 (1892)).

seeking compensation and reimbursement of expenses from a debtor's estate to make such a request on notice so that parties in interest are afforded an opportunity to object before the bankruptcy court awards fees and expenses. In addition, § 330(a)(2) of the Bankruptcy Code requires the Court to independently review all requests for compensation and reimbursement of expenses whether or not a party in interest objects. See In re Busy Beaver Bldg. Centers, Inc., 19 F.3d 833, 841 (3d Cir. 1994)(the bankruptcy court has the power and the duty to review fee applications notwithstanding the absence of objections from other parties in interest). Therefore, because "'the statutory scheme [of the Bankruptcy Code] is coherent and consistent, there generally is no need for a court to look beyond the plain meaning of the statute.'" In re Am. Steel Prod., Inc., 197 F.3d 1354, 1356 (11th Cir. 1999)(quoting United States v. Ron Pair Enter., Inc., 489 U.S. 235, 240 (1989)).[9]

Even if the Bankruptcy Code were not clear, neither state law nor the law of trusts support the approval of the indemnification provision. The Bankruptcy Court acknowledged that different types of trusts require different standards of care. Specifically, the Bankruptcy Court found that while trustees for inter vivos trusts may be indemnified for their own negligence, trustees for testamentary trusts under New York law may not. (D-9, Dkt. 95) (Memorandum

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[9] At the March 30th Hearing, the Bankruptcy Court noted that § 1125 of the Bankruptcy Code contemplated indemnification provisions. See (D-7) (March 30th Transcript, p. 24, lines 13). However, § 1125(e) of the Bankruptcy Code is limited in scope and applicability to a person who "solicits acceptance or rejection of a plan, in good faith" or "participates in the offer, issuance, sale, or purchase of a security, offered or sold under the plan." See 11 U.S.C. § 1125(e). This provision, by its terms, relates to conduct surrounding a debtor's plan of reorganization and does not apply to the retention of professionals.

Decision, p. 7). The Bankruptcy Court, in distinguishing the fiduciary duties surrounding these two different types of trustees, found, without any explanation, that the scope of fiduciary duties required of a trustee of an inter vivos trust should apply to bankruptcy professionals. The United States Trustee submits that the nature of a testamentary trust is more analogous to a bankruptcy case because creditors of a bankruptcy estate rely on professionals to maximize the value of the assets of the estate as beneficiaries of a testamentary trust rely on an executor to protect the assets of a testamentary trust.

Furthermore, the Bankruptcy Court's reliance on provisions of New York and Delaware corporate law, which provisions are applicable to officers and directors, to determine that bankruptcy professionals may be indemnified for their own negligence is also misplaced. See (D-9, Dkt. 95) (Memorandum Decision, p. 8). Both within and outside of bankruptcy, officers and directors of a corporation may request and receive many terms of employment that are not available to professionals being retained by a bankruptcy estate as fiduciaries. For example, relatives of the debtor's principals and shareholders may serve as officers and directors; in contrast, § 327(a) of the Bankruptcy Code prohibits such "interested" parties from serving as professionals.[10/] In addition, officers and directors may normally be hired and paid with no court review; in contrast, §§ 327 and 330 specifically require that the retention and compensation of professionals take place only after notice, a hearing and court approval. Many other differences

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[10/] The Bankruptcy Code defines "disinterested person" as a person that "is not a creditor, an equity security holder, or an insider." 11 U.S.C. § 101(14)(A). If a debtor is a corporation, the term "insider" includes a "relative of a general partner, director, officer, or person in control of the debtor." 11 U.S.C. § 101(31)(B)(vi).

exist, making it clear that what may be available in the treatment of officers and directors cannot serve as a guide on how professionals in a bankruptcy case may be retained and compensated. Rather, when it comes to professionals, the Bankruptcy Code and existing case law form a sufficient basis to craft appropriate terms of employment without reference to state and common law. Therefore, the Bankruptcy Court's reliance on state corporate law does not support the result reached.

The insistence by financial advisors in bankruptcy cases for indemnification provisions has become more common in recent years.[11/] A bankruptcy court is not free, however, to craft its own solution to a perceived flaw in the Bankruptcy Code which exposes fiduciaries to liability for their own wrongful acts. See In re Fresco Plastics Corp., 996 F.2d 152, 154-55 (7th Cir. 1993) (court may not disregard a specific Bankruptcy Code provision addressing an issue and instead employ its equitable powers to achieve a result not contemplated in the Bankruptcy Code); cf. Amchem Prod., Inc. v. Windsor, 521 U.S. 591, 627 (1997) (innovative class action settlement of mass tort liability was found unjustifiable under Fed. R. Civ. P. 23 where Court noted that Congress can adopt a nationwide solution if it deems such a solution appropriate). It is clear that the indemnification provision in this case is inappropriate, over broad and inconsistent with the Bankruptcy Code, bankruptcy principles and precedent. Therefore, the Bankruptcy Court's decision regarding the indemnification provision must be reversed.

[11/] In the widely reported In re Merry-Go-Round Enter., Inc. case, after the reorganization failed, the chapter 7 trustee sued the financial advisors who eventually settled by paying the estate $185 million. See (D-6, Dkt. 77) (Response, p. 6).

B. THE INDEMNIFICATION PROVISION IS UNREASONABLE AND NOT IN THE BEST INTERESTS OF THE DEBTOR'S ESTATE

In addition to the fact that the indemnification provision violates §§ 330 and 328(c) of the Bankruptcy Code, the Bankruptcy Court abused its discretion in finding that the indemnification provision was a reasonable condition of Newmark's employment. Under 11 U.S.C. § 328(a):

> [t]he trustee, or a committee appointed under section 1102 of this title, with the court's approval, may employ or authorize the employment of a professional person under section 327 or 1103 of this title, as the case may be, on any reasonable terms and conditions of employment, including on a retainer, on an hourly basis, or on a contingent fee basis.

11 U.S.C. § 328(a) (emphasis added). As set forth below, the broad indemnification provision is inconsistent with Newmark's fiduciary duty to the Debtor's estate. Furthermore, as discussed below, the indemnification provision encourages Newmark to settle to keep any dispute regarding the indemnification provision from the scrutiny of a court. In addition, under the terms of the indemnification provision, Newmark has no incentive to negotiate a reasonable settlement.

1. Newmark's Request for Indemnification for its Own Errors and Omissions is Inconsistent with Its Fiduciary Duty

As conceded by Newmark,[12] professionals retained in a bankruptcy case under § 327 of the Bankruptcy Code, including financial advisors, are fiduciaries of a debtor's estate. See In re Gillett Holdings, Inc., 137 B.R. 452, 458 (Bankr. D. Colo. 1991) (investment bankers and financial advisors employed under § 327 of the Bankruptcy Code by a debtor are fiduciaries); In

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[12] See (D-7) (March 30th Transcript, p. 25, lines 9-16).

re Allegheny Int'l, Inc., 100 B.R. 244, 246 (Bankr. W.D. Pa. 1989) (investment bankers and financial advisors are fiduciaries of a debtor's estate); see also Woods v. City Nat. Bank & Trust Co. of Chicago, 312 U.S. 262, 278 (1941)(holding that trustees are fiduciaries). As fiduciaries, professionals "'have obligations of fidelity, undivided loyalty and impartial service in the interest of creditors they represent.'" Allegheny, 100 B.R. at 246 (quoting United Steelworkers of America v. Lampl (In re Mesta Machine Co.), 67 B.R. 151, 156 (Bankr. W.D. Pa. 1986)).

It is well settled that a fiduciary has the obligation to maximize the value of the bankruptcy estate for the benefit of creditors. CFTC v. Weintraub, 471 U.S. 343, 352 (1985). As fiduciaries, professionals subject themselves to exacting court review to safeguard against the "temptation of a failing debtor to deal too liberally with his property in employing" its professionals. In re Wood, 210 U.S. 246, 253 (1908). Transactions with the debtor's professionals provide the potential for "evasion of creditor protection provisions of the bankruptcy laws" and "overreaching" by the debtor's professionals. In re Whitman, 51 B.R. at 506 (citing H.R.Rep. No. 595, 95th Cong. 1st Sess. 329 (1977), reprinted in U.S.C.C.A.N. 5787, 6285 (1978)); In re Consol. Bancshares, Inc., 785 F.2d 1249, 1256 n.6 (5th Cir. 1986) ("The standards for the employment of professionals are strict, for Congress has determined that strict standards are necessary in light of the unique nature of the bankruptcy process.").

Bankruptcy courts have repeatedly held that broad indemnification provisions are inconsistent with the fiduciary duties of professionals. In the case of In re Drexel Burnham Lambert Group, 133 B.R. 13 (Bankr. S.D.N.Y. 1991), the court, in considering a retention application of an investment banker, denied the indemnification provision as a term of the retention for, inter alia, the following reasons:

> [T]he reason for hiring a person is that the person has special expertise that is beneficial to the debtor or the committee. The court expects that such professionals would be especially diligent in making sure they meet the standard of care for exercising their expertise in their work in this case. Indemnification is not consistent with professionalism. [In re Mortgage & Realty Trust, 123 B.R. 626, 630-631 (Bankr. C.D. Cal. 1991)]
>
> Simply stated, indemnification agreements are inappropriate. Moreover, we know that [professionals] carry coverage to protect themselves from malpractice liability. This expense, like professional fees to negotiate a retention, are part of a [professional's] overhead, usually more than adequately covered by a retention fee.

Id. at 27.

Likewise, in Allegheny, the court sua sponte reconsidered an already approved retention order which contained an indemnification provision. Allegheny, 100 B.R. at 246. The Allegheny court held that "holding a fiduciary harmless for its own negligence is shockingly inconsistent with the strict standard of conduct for fiduciaries." Id. at 247. The Allegheny court reasoned that "'[m]any forms of conduct permissible in a workaday world for those acting at arm's length, are forbidden by those bound by fiduciary ties . . . .'" Id. at 246-47 (quoting Meinhard v. Salmon, 249 N.Y. 458, 164 N.E. 545, 546 (1928) (Cardozo, J.)).

The court in In re Mortgage & Realty Trust, 123 B.R. at 632, declined to approve an indemnification provision which allowed the financial advisor to be indemnified by the debtor for losses and claims resulting from a breach of fiduciary duty by the financial advisor. In that case, the debtor moved the court for reconsideration of its previous order denying indemnification for its investment advisor. Id. at 628. Originally, the investment advisor sought approval of an overreaching indemnification provision protecting it against all claims, damages, losses, liabilities, costs and expenses in connection with the investment advisor's engagement except that the debtor would not be liable for the investment advisor's gross negligence or willful misconduct. Id. at 629 n.3. In the motion to reconsider, the investment advisor limited its request for indemnification to include acts other than negligence, gross negligence or willful misconduct. Id. at 629. The court, however, still declined to approve the indemnification provision because the investment advisor sought indemnification for breaches of its fiduciary duty which was broader than allowed under state law and what the Allegheny court authorized. Id. at 632; see also In re Glosser Bros., Inc., 102 B.R. 38, 42 (Bankr. W.D. Pa. 1989) (court declined to approve indemnification provision where financial advisor/investment banker would not be liable for its own "run-of-the-mill" negligence).

Following the Allegheny and Mortgage & Realty Trust decisions, the court in In re Gillett Holdings, 137 B.R. at 452, declined to approve an indemnification provision where an investment banker sought indemnification for its "own errors and omissions, [its] own negligence." Id. at 458. The court found that request "entirely improper" and "unacceptable." Id. The court found that the investment bankers could not "absolve themselves of such a broad range of potential liability or responsibility for their own actions which might constitute negligence or misfeasance." Id.

The Bankruptcy Court below summarily dismissed the reasoning behind these published cases cited above, finding the reactions of the courts to be "visceral." (D-9, Dkt. 95) (Memorandum Decision, p. 9). The Bankruptcy Court was incorrect. These courts' holdings are completely consistent with the Bankruptcy Code and the policy goals of the bankruptcy system which prevents overreaching by professionals and imposes the highest of fiduciary standards upon professionals responsible for bankruptcy estates with limited funds. Newmark's indemnification from its own wrongful acts or omissions is inconsistent with its fiduciary's role.

2. The Bankruptcy Court Erred in Approving an Indemnification Provision that Protects Newmark From Its Own Wrongful Acts

The indemnification provision provides that the Debtor will not be liable for any losses, claims, damages or liabilities (or expenses related thereto) that are finally judicially determined by a court of competent jurisdiction to have primarily resulted from the breach of trust, bad faith, self dealing, breach of fiduciary duties (other than ordinary negligence), gross negligence or willful or reckless misconduct of Newmark. See (D-10, Dkt. 108) (Retention Order, pp. 3-4) (emphasis added). Under these terms and conditions, Newmark may still be indemnified for its own bad faith, breach of fiduciary duty, breach of trust, self-dealing, willful or reckless misconduct or gross negligence if there is never a final judicial determination of liability.

For example, if Newmark is sued for breach of trust, bad faith, self dealing, breach of fiduciary duties (other than ordinary negligence), gross negligence or willful or reckless misconduct, the Debtor would still be liable for the damages caused by Newmark's wrongdoing if the case is settled by Newmark before a final judicial determination of liability is made. This is true whether or not a complaint is actually filed. Moreover, because Newmark is covered by the indemnity, it has incentive to settle to keep the dispute from the scrutiny of a court, but it has no incentive to negotiate a reasonable settlement. Finally, the Debtor is liable for the damages caused by Newmark's breach of trust, bad faith, self dealing, breach of fiduciary duties (other than ordinary negligence), gross negligence or willful or reckless misconduct if there is a final judicial decision that finds that Newmark was only 49%

responsible, and not primarily responsible for the particular loss, claim or damage. This "comparative" standard of liability, which permits Newmark to be "secondarily responsible," cannot be in the best interest of the Debtor or its estate.

3. The Debtor Failed to Submit Any Evidence to Demonstrate that the Indemnification Provision is in the Best Interest of the Estate

The burden of proof to establish that the terms and conditions of employment are reasonable is on the Debtor, the moving party. To meet its burden, the Debtor must provide specific evidence to establish that "the terms and conditions are in the best interest of the estate." In re Gillett Holdings, Inc., 137 B.R. at 455 (quoting In re C & P Auto Transp., Inc., 94 B.R. 682, 686 (Bankr. E.D. Cal. 1988); accord In re Chas. A. Stevens & Co., 109 B.R. 853, 854 (Bankr. N.D. Ill. 1990).

In determining that the terms of the Retention Application, including the indemnification provision, are reasonable and in the best interests of the Debtor's estate, the Bankruptcy Court below improperly relied upon the unsubstantiated opinion of counsel for the Committee[13/] that the indemnification provision in the Retention Application is a customary request, and routinely agreed to, outside of the bankruptcy realm. (D-7) (March 30th Transcript, p. 22 lines 2-6) and (D-9, Dkt 95) (Memorandum Decision, p. 11); see generally Exeter Bancorporation, Inc. v. Kemper Securities Group, Inc., 58 F.3d 1306, 1312 n. 5 (8th Cir.1995)(statements of counsel not evidence). The Debtor did not meet its burden with respect to the Retention Order. The decision of the Bankruptcy Court should be reversed because the Debtor failed to demonstrate why the indemnification provision is a reasonable condition of

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[13/] On March 16, 2000, the United States Trustee appointed the Committee. See 11 U.S.C. §§ 1102 and 1103. As set forth earlier, the Committee did not file pleadings with respect to the Objection.

Newmark's employment and is in the best interests of the Debtor's estate. Alternatively, the Court may remand the issue so that the parties can take discovery on such issues as, inter alia, whether indemnification provisions constitute "industry practice" outside of bankruptcy.[14]

VI. CONCLUSION

For the reasons set forth above, the United States Trustee respectfully requests that the Court reverse the Retention Order and grant such other relief as is just.

Dated: New York, New York
June 5, 2000

CAROLYN S. SCHWARTZ
UNITED STATES TRUSTEE

By: ______________________________
Wendy Rosenthal (WR 4461)
Greg M. Zipes (GMZ 4539)

33 Whitehall Street
21st Floor
New York, New York 10004
Tel. No. (212) 510-0500
Fax. No. (212) 668-2255

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[14] The United States Trustee does not concede, even if indemnification provisions are standard in the industry, that such provisions are appropriate for professionals retained in a bankruptcy case. See In the Matter of Consol. Bancshares, Inc., 785 F.2d at 1256 n.6 ("standards for the employment of professional persons are strict, for Congress has determined that strict standards are necessary in light of the unique nature of the bankruptcy process") (citation omitted); In re Liberty Music & Video, Inc., 54 B.R. 799, 804 (Bankr. S.D.N.Y. 1985) ("many forms of conduct permissible in a workday world for those acting at arm's length, are forbidden to those bound by fiduciary ties") (quoting Meinhard v. Salmon, 249 N.Y. 458, 164 N.E. 545, 546 (1928)).

BRIEF BANK — 'SUMMARY SHEET"

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WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	Gorski v. Eisen (In re Henricks Commerce Park, LLC)
2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	CTA6
3. ("CCN") ***CURRENT*** CASE NO.	No.: No. 06-4030
4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*	No.: Court: Bankr. N.D. Ohio *(Identify judge & cite, if any)*
5. ("SO") ***SOURCE***	**U.S. TRUSTEES**
6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	Filed: December 2006 Type: Proof Brief of Appellee
7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*	Amy L. Good, Trial Attorney, United States Trustee *(UST/OGC: 202-307-1399/FAX-2397)*
8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") ● ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	● 1. Whether the bankruptcy appellate panel of the Sixth Circuit correctly determined Mr. Gorski could not recover attorney fees under 11 U.S.C.§ 503(b)(3)(D) and (4) because those fees constituted work on behalf of a debtor, which falls outside § 503(b)(3)(D) and (4)'s limited authorization of fees only for work performed for equity security holders, creditors, indenture trustees, and committees. 2. Alternatively, if this Court concludes the record below was not sufficiently developed for the appellate panel to reach that conclusion, should this Court remand this case to the bankruptcy court with instructions that it determine..... Sections 2A & 2B can be found under Statement of Issues presented
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No. 06-4030

In the
United States Court of Appeals
for the Sixth Circuit

In re Henricks Commerce Park, LLC
Debtor

Gary T. Gorski,

Appellant
v.
Saul Eisen, United States Trustee,

Appellee

On Appeal from the Bankruptcy Appellate Panel
for the Sixth Circuit

Proof Brief of Appellee

Counsel for Appellee Saul Eisen, United States Trustee

Amy L. Good
Trial Attorney
Office of the U.S. Trustee
United States Department of Justice
H.M. Metzenbaum U.S. Courthouse
201 Superior Avenue, Suite 441
Cleveland, Ohio 44114
(216) 522-7800 ext. 236

Roberta A. DeAngelis
P. Matthew Sutko
Office of the General Counsel
Executive Office for U.S. Trustees
United States Department of Justice
20 Massachusetts Avenue NW
Washington, D.C. 20530
(202) 307-1399

CORPORATE DISCLOSURE

Pursuant to 6th Cir. R. 26.1 Appellee, the United States Trustee, is not required to complete a disclosure of corporate affiliations and financial interests because he is a representative of an agency of the United States government.

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STATEMENT REGARDING ORAL ARGUMENT

The United States Trustee does not believe oral argument will materially aid the Court in determining this appeal but stands ready to participate at argument if this Court deems that appropriate.

No. 06-4030

In the
United States Court of Appeals
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In re Henricks Commerce Park, LLC
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Gary T. Gorski,

Appellant

v.

Saul Eisen, United States Trustee,

Appellee

On Appeal from the Bankruptcy Appellate Panel
for the Sixth Circuit

STATEMENT OF JURISDICTION

The United States Bankruptcy Court for the Northern District of Ohio had subject matter jurisdiction under 28 U.S.C. § 1334 and 157 over Gary Gorski's motion filed under 11 U.S.C. 503(b)(3)(D) and (4) for expenses and attorney fees. The Bankruptcy Appellate Panel of the Sixth Circuit had jurisdiction under 28 U.S.C. § 158(a), (b) and (c) over Mr. Gorski's appeal from the bankruptcy court's order denying his fee request. This Court has appellate jurisdiction under 28 U.S.C. § 158 (d) over Mr. Gorksi's appeal from the appellate panel's order affirming the denial of expenses and fees.

The bankruptcy court entered its memorandum opinion and order denying Mr. Gorski's § 503(b)(3)(D) and (4) motion on June 15, 2005. (Bankruptcy Court Docket record entry 260 Memorandum opinion & order; Joint Appendix ____).[1] This final order ruled Mr. Gorski - who was the sole shareholder and sole managing member of the chapter 11 debtor in this case, Henricks Commerce Park, LLC - could not recover his attorney fees under § 503(b)(3)(D) and (4). Mr. Gorski filed a timely notice of appeal to the appellate panel on July 18, 2005. (R. 266 Notice of appeal; Apx. __).

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[1] From hereinafter entries in the Bankruptcy Court Docket are referred to as R. with the page reference. The Bankruptcy Appellate Panel docket does not contain docket reference numbers and so this brief refers to entries filed with the appellate panel as BAP Doc. ____(date) p. ___ . Citations to the Joint Appendix filed with this Court are cited as "Apx. ___ .

The appellate panel entered a final opinion and judgment affirming the bankruptcy court's order on June 15, 2006. (BAP Doc. 6/15/06 Opinion and judgment; Apx.___). Mr. Gorski timely appealed the appellate panel's order to this Court on July 12, 2006. (BAP Doc. 7/12/06 Notice of appeal; Apx. _____).

STATEMENT OF THE ISSUES PRESENTED FOR REVIEW

Section 503(b)(3)(D) and (4) of the Bankruptcy Code authorize bankruptcy courts to use bankruptcy estate assets to pay the expenses and attorney's fees of **(a)** equity security holders, **(b)** creditors, **(c)** indenture trustees, and **(d)** chapter 11 committees, but only when their services provide a substantial benefit to the bankruptcy case. §503(b)(3)(D) and (4) do not allow the recovery of attorneys fees for work performed on behalf of a debtor; those fees are allowable only if the debtor's counsel is appointed as debtor's counsel by the bankruptcy court under § 327 of the Bankruptcy Code **and** the debtor's counsel's fees are subsequently approved by the bankruptcy court under § 330 of the Code.

The chapter 11 debtor in this case is Henricks Commerce Park, LLC. The appellant here is Mr. Gary Gorski, who is Henricks' sole equity security holder; he also runs Henricks as its managing partner. Before the bankruptcy court, Mr. Gorski sought attorneys fees under § 503(b)(3)(D) and (4) for work Simon & Short, LLC ("Simon") performed in the Henricks bankruptcy case. Prior to Simon performing that work, the bankruptcy court had entered an order denying Henricks' motion to have Simon appointed to act as its § 327 debtor's counsel because the firm failed to meet § 327's disinterestedness requirements. Thereafter, Mr. Gorski nevertheless used Simon to perform what the United States Trustee and the appellate panel concluded was debtor's work and sought reimbursement under § 503(b)(3)(D) and (4) for that debtor's work.

Given this, the two issues presented to this Court are:

1. Whether the bankruptcy appellate panel of the Sixth Circuit correctly determined Mr. Gorski could not recover attorney fees under 11 U.S.C.§ 503(b)(3)(D) and (4) because those fees constituted work on behalf of a debtor, which falls outside § 503(b)(3)(D) and (4)'s limited authorization of fees only for work performed for equity security holders, creditors, indenture trustees, and committees.

2. Alternatively, if this Court concludes the record below was not sufficiently developed for the appellate panel to reach that conclusion, should this Court remand this case to the bankruptcy court with instructions that it determine;

> **A.** Whether, as a matter of fact, Simon's services were performed for the debtor and therefore are not recoverable under 11 U.S.C. § 503(b)(3)(D) and (4); and
>
> **B.** If the bankruptcy court determines that any of Simon & Short's services were in fact performed solely for Mr. Gorski in his status as equity security holder, and therefore could conceivably fall within § 503(b)(3)(D), whether Mr. Gorski made a substantial contribution under § 503(b)(3)(D) and (4) warranting

approval of any of those fees under that section and, if so, what is the reasonable amount of any such attorney's fees?

STANDARD OF APPELLATE REVIEW

This Court "review[s] a bankruptcy appeal differently than a typical appeal from the District Court. The bankruptcy court makes findings of fact and conclusions of law. The [bankruptcy appellate panel or] district court[[2]] then reviews the bankruptcy court's findings of fact for clear error and the bankruptcy court's conclusions of law de novo. [This Court] in turn review[s] the bankruptcy court's findings for clear error and the district court's conclusions of law de novo." [Citations omitted]. Wesbanco Bank Barnesville v. Rafoth (In re Baker & Getty Fin. Servs. Inc.), 106 F. 3d 1255, 1259 (6th Cir. 1997).

In determining whether a bankruptcy appellate panel or district court decision regarding a bankruptcy appeal should be affirmed, reversed, or remanded, this Court must independently review factual findings of the bankruptcy court for clear error and conclusions of law under a de novo standard. In re Airspect Air, Inc., 385 F. 3d 915 (6th Cir. 2004); See also Mayor of Baltimore v. W. Va. (In re Eagle-Pitcher Industries,

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[2] In the Sixth Circuit appeals of bankruptcy court decisions are reviewed by the Bankruptcy Appellate Panel, unless an election is made by a party to have the appeal heard by the district court. See 28 U.S.C. § 158.

Inc.), 285 F.3d 522, 527 (6th Cir. 2002); A bankruptcy court's order denying an application for administrative expenses under 11 U.S.C. § 503(b)(3)(D) is reviewed under an abuse of discretion standard. In re Lister, 846. F. 2d 55, 56-57 (10th Cir. 1988).

STATEMENT OF THE CASE

This appeal involves the question whether § 503(b)(3)(D) and (4) require the Henricks Commerce Park, LLC (the "Debtor") chapter 11 bankruptcy estate to use estate assets to pay the attorney's fees that Simon incurred in representing Mr. Gary T. Gorski, who is the Debtor's sole equity holder and sole managing member. The Debtor filed a petition for relief under chapter 11 of the Bankruptcy Code on August 28, 2002. (Bankr. Doc. entry 1; Apx. ___). On January 26, 2004, the bankruptcy court entered an order denying the Debtor's motion, brought under § 327 of the Code, asking the court to appoint Simon as its bankruptcy counsel. The court denied the motion because Simon's lack of disinterestedness rendered it ineligible under § 327 to act as Henricks' counsel. (R. 82 Order denying application to retain Simon; Apx. _____). Neither the Debtor nor Simon appealed the disqualification order. Sixteen months later, Mr. Gorski filed a motion under 11 U.S.C. 503(b)(3)(D) and (b)(4) asking the bankruptcy court to order the Debtor's bankruptcy estate to pay all fees Simon had incurred since the disqualification order. This motion was based on the ground that services had been provided to Mr. Gorski, not the debtor, and those services met § 503(b)(3)(D)'s requirement that they made a substantial contribution to the Debtor's bankruptcy case. (R. 252 Motion for payment of Simon 's fees; Apx. __). The United States Trustee objected to the motion.[3] (R. 255 Objection of UST to Simon's fees; Apx. ___).

The bankruptcy court denied the motion finding Simon's prior disqualification under § 327 rendered it ineligible to receive fees under § 503(b)(3)(D) and (4). (R. 260 Memorandum and opinion; Apx. ___). Mr. Gorski appealed the bankruptcy court's decision to the appellate panel which affirmed on an alternative ground - holding Simon performed debtor's work, and § 503(b)(3)(D) and (4) do not allow recoveries for such work because they restrict recoveries to work performed for equity

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[3] Congress has authorized the Attorney General to appoint twenty-one United States Trustees, each to serve in a specific geographic region of the United States. See generally 28 U.S.C. § 581 et seq. (establishing United States Trustee Program). United States Trustees are senior Justice Department officials. Id. They "supervise the administration of cases and trustees" in all bankruptcy cases within his or her region through a range of oversight responsibilities. 28 U.S.C. § 586(a)(3). See generally Morganstern v. Revco D.S. Inc. (In re Revco D.S., Inc.), 898 F.2d 498, 500 (6th Cir 1990) (explaining that Unites States Trustees oversee the bankruptcy process, protect the public interest, and ensure that bankruptcy cases are conducted according to law). The United States Trustee may raise and may appear and be heard on any issue in any case or proceeding under Title 11. 11 U.S.C. 307; see also Revco, 898 F.2d at 499-500 (appellate standing of United States Trustee).

security holders, creditors, indenture trustees, and committees. (BAP Doc. 6/15/06 Opinion and judgment; 7/12/06 Notice of appeal; Apx. ___). This appeal followed.

STATEMENT OF FACTS

I. Statutory Framework

a. Debtors Have Ascribed Duties and Obligations Imposed by the Bankruptcy Code.[4]

In a chapter 11 bankruptcy proceeding, a debtor or debtor-in-possession assumes most of the rights and duties of a trustee. 11 U.S.C. § 1107(a).[5] The Bankruptcy Code imposes specific duties and obligations upon debtors. Among other things, a debtor-in-possession has the duty to be accountable for estate assets (11 U.S.C. § 704(a)(2)); review and object to claims (11 U.S.C. § 704(a)(5)); provide requested information to parties in interest (11 U.S.C. § 704(a)(7)); file reports regarding business operations and other requested information where debtor-in-possession has an operating business (11 U.S.C. § 704(a)(8), Fed. R. Bankr. P. 2015); file a plan and disclosure statement (11 U.S.C. § 1106(a)(5) and 1125); file

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[4] The Bankruptcy Code was substantially amended by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 which, in general, became effective on October 17, 2005. Since this case was filed prior to the effective date of the amendments, the amendments do not apply to this case.

[5] A debtor means "debtor-in-possession" in a chapter 11 case unless a trustee is appointed. 11 U.S.C. § 1101(1).

postconfirmation reports (11 U.S.C. § 1106(a)(7)); and operate its business, unless ordered otherwise.

Some of these duties may only be performed by a debtor. These tasks encompass the internal operations of the debtor's business and certain tasks specific to bankruptcy that only a debtor has authority to undertake. Responsibilities exclusive to a debtor include filing monthly operating reports with the United States Trustee and bankruptcy court; securing authority to use cash collateral and selling assets outside of the ordinary course of business (11 U.S.C. § 363 authorizes debtor to use cash collateral or sell assets after notice and a hearing); securing credit or financing (11 U.S.C. § 364 providing for debtor to secure credit or financing); assuming and rejecting leases (11 U.S.C. § 365 provides debtor may assume or reject unexpired lease of executory contract); prosecuting lawsuits against creditors (11 U.S.C. § 545 allows debtor to avoid statutory lien, 547 provides for debtor to avoid preferential transfers, and 548 allows for avoidance of fraudulent transfers).

Other tasks, while falling within the scope of responsibilities of a debtor, may also be undertaken by other interested parties. For example, non-debtor parties are specifically authorized to file a plan of reorganization (11 U.S.C. § 1121) and object to claims (11 U.S.C. § 502). Some courts have determined that parties in interest, other than a debtor, may also prosecute certain causes of action upon court authorization.

b. Bankruptcy Code § 327 Provides the Exclusive Mechanism for Selecting Attorneys to Perform Duties of a Debtor and § 330 Provides the Sole Means to Award Compensation for Such Services.

A debtor in possession, with court approval, may retain counsel to help it carry out its debtor duties. 11 U.S.C. § 327(a) (giving courts discretion to make such appointments). To qualify to represent a debtor, counsel must not represent an interest adverse to the estate and must be disinterested. Id.

In addition to court approval of a debtor's attorney, the Bankruptcy Code also requires an attorney who is authorized to represent a debtor to have its fees approved before they are paid by a debtor. 11 U.S.C. 330(a)(1). Section 330 of the Bankruptcy Code provides that after notice and a hearing, the court may award reasonable compensation and expenses to a professional retained under § 327.

Only those professionals approved by the court under § 327(a) may apply to the court for compensation. Therefore, an attorney seeking payment of fees from a bankruptcy estate must 1) be approved by the Bankruptcy Court, and 2) secure, upon application to the Court, an order approving its fees. The Supreme Court has held that a debtor's attorney is not entitled to be compensated from a bankruptcy estate under 11 U.S.C. § 330 unless retained with bankruptcy court authority. Lamie v. United

States Trustee, 540 U.S. 526, 124 S. Ct. 1023 (2004) (counsel retained by debtor-in-possession in chapter 11 proceeding was not entitled to compensation for services rendered on behalf of debtor after case converted to chapter 7 when counsel was not retained by chapter 7 trustee post-conversion).

c. The Bankruptcy Code Provides Equity Holders and Creditors an Administrative Expense Claim for Fees When a Substantial Contribution to the Estate is Demonstrated.

Bankruptcy Code § 503(b)(3)(D) provides that certain parties, including an equity holder, may ask the court to require the bankruptcy estate to pay expenses it incurred in making a "substantial contribution in [the] case." 11 U.S.C. § 503(b)(3)(D).[6] This statute is restricted to expenses incurred by an equity holder, creditor, indenture trustee, and a committee. It is not available to a debtor and does not allow expenses of an equity holder incurred for services rendered to a debtor. Id.

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[6] 11 U.S.C. § 503(b)(3)(D) provides:

> After notice and a hearing, there shall be allowed, administrative expenses, other than claims allowed under § 502(f) of this title, including –
>
> > (3) the actual, necessary expenses, other than compensation and reimbursement specified in paragraph (4) of this subsection, incurred by –
> >
> > > (D) a creditor, an indenture trustee, an equity holder, or a committee representing creditors or equity security holders other than a committee appointed under § 1102 of this title, making a substantial contribution in a case under chapter 9 or 11 of this title;

If an equity holder demonstrates a substantial contribution has been made in the case, the party may then have its attorney's fees reimbursed to the extent they constitute "reasonable compensation for professional services...based upon the time, the nature, the extent, and the value of such services...." 11 U.S.C. § 503(b)(4).

II. Statement of Facts

Henricks Commerce Park, LLC filed a petition for relief under chapter 11 of the Bankruptcy Code on August 28, 2002. (Bankr. Doc. entry 1; Apx. ___). The Debtor's sole managing member and sole equity holder is Gary T. Gorski. (R. 252 p. 1 Motion for Payment of Simon's fees p. 1; Apx. ___). At the outset of this case, the Debtor secured a bankruptcy court order under 11 U.S.C. § 327 authorizing it to retain Porter Wright Morris & Arthur LLP as its bankruptcy counsel in the Debtor's chapter 11 bankruptcy proceeding. (R. 25 Order authorizing retention of Porter Wright; Apx. __). Thereafter, Porter Wright appeared on behalf of and represented the Debtor in its chapter 11 bankruptcy proceeding.

Sixteen months later, on December 31, 2003, the Debtor filed an emergency application to employ Simon as its substitute legal counsel. (R. 67 Emergency application of debtor to retain Simon; Apx ___). The United States Trustee objected to the Debtor's emergency application to retain Simon because Simon did not meet the requirements for retention under 11 U.S.C. § 327.[7] (R. 69 Objection of UST to Simon retention; Apx. ___). The bankruptcy court entered an order denying Simon's retention after a hearing because it did not meet the standards of § 327(a). The court determined Simon's personal representation of Henricks' sole shareholder - Mr. Gorski - in his individual bankruptcy case gave it a conflict between the Debtor estate and someone with an equity interest in the estate; Simon received a substantial post petition retainer from Mr. Gorski; and, Mr. Gorski, not the Debtor, would continue to pay Simon for the work it performed on the Debtor's behalf in the bankruptcy case. (R. 82 Order denying Simon retention; Apx. ___).

Neither Simon nor the Debtor appealed the order denying Simon's retention. Porter Wright remained the only firm approved under § 327 to provide bankruptcy services to the Debtor. Three days after Simon was disqualified from representing the Debtor, Simon filed a notice of appearance on behalf of Mr. Gorski.

(Bankr. Doc. entry 87; Apx. __).

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[7] 11 U.S.C. § 327(a) provides:

> Except as otherwise provided in this section, the trustee, with the court's approval, may employ one or more attorneys, accountants, appraisers, auctioneers, or other professional persons, that do not hold or represent an interest adverse to the estate, and that are disinterested persons, to represent or assist the trustee in carrying out the trustee's duties under this title.

Simon then commenced rendering services on behalf of Mr. Gorski that were duties of the Debtor. Simon provided some services that were within the exclusive duties of the Debtor and provided other services that were responsibilities of the Debtor but which could be independently provided by non-debtor parties.

Simon undertook tasks that were exclusively the Debtor's responsibilities as follows:

> **1.** Retention of professionals - Simon negotiated, drafted and filed joint motions requesting authority for Debtor to retain professionals including an appraiser, loan broker and special counsel. (Bankr. Doc entries 149, 159, 235; R. 252 Motion for payment of Simon's fees, Ex. 2 p.21, 26-27, 65; Apx. ___). See 11 U.S.C. § 1107 and 327(a) (debtor has authority to retain professionals to carry out debtor's duties).
>
> **2.** Operating reports - Simon reviewed and filed Debtor's monthly operating reports. (Bankr. Doc. entries 152, 153, 156, 175, 185, 189, 206, 218, 245, 247, 258, 259; R. 252 Motion for payment of Simon's fees, Ex. 2 p. 24, 31, 32, 40, 44, 49, 57,67; Apx.___). See 11 U.S.C. § 704(8) (debtor has duty to file periodic reports with Court and U.S. Trustee.); Fed. R. Bankr. P. 2015 (duty to keep records and reports).
>
> **3.** Cash collateral - Simon drafted and filed joint motions for the Debtor's use of cash collateral and negotiated agreements for the Debtor's use of cash collateral. (Bankr. Doc. entries 180, 181; R. 252 Motion for payment of Simon's fees, Ex. 1 p. 13, Ex. 2 p. 7, 8, 9, 10, 31, 36, 39-41, 43; Apx. ___). 11 U.S.C. § 363 (providing debtor may use cash collateral).
>
> **4.** Financing - Simon drafted, filed and negotiated a joint motion for the Debtor to borrow funds for insurance premiums. (Bankr. Doc. entry 117; R. 252 Motion for payment of Simon's fees Ex. 1 p.13, Ex. 2 p. 9, 14; Apx. ____). 11 U.S.C. § 364 (debtor may borrow funds on certain terms).

5. Lease assumption - Simon negotiated, drafted, and filed a joint motion for the Debtor to assume its lease with Main Steel. (Bankr. Doc. entry 222; R. 252 Motion for payment of Simon's fees Ex. 1 p. 13, Ex. 2 p. 26, 62; Apx. ___). 11 U.S.C. § 365 (debtor may assume or reject unexpired leases and executory contracts).

6. Internal business matters and operations - Simon worked with Debtor's sole managing member, facilities manager (Dan Cagle), and accountant (Mike Gaia) and assisted with internal business matters such as insurance, property appraisals, tenants and leases, and real estate taxes. (R. 252 Motion for payment of Simon's fees, Ex. 1 p. 13, Ex. 2 p. 8, 13, 17, 21, 26, 30, 41,50, 61, 64, 65, 67, 68; Apx. ___). 11 U.S.C. § 1108 (unless ordered otherwise, debtor may operate its business).

The motion for payment of Simon's fees categorizes 78.30 hours of time spent on financing, cash collateral, and efforts to seek long term financing; 33 hours of time spent relating to case administration which would include finalizing and filing operating reports and other administrative tasks; and, 10.40 hours of time spent on business operations including lease approval. (R. 252 Motion for payment of Simon's fees, Ex. 1 p. 13; Apx. ___).

Simon litigated and settled disputes of the Debtor. The firm filed complaints for the Debtor that also named Mr. Gorski as a plaintiff. These actions were for the purpose of litigating claims disputed by the Debtor and/or administering estate assets. Simon negotiated and drafted settlements of adversary proceedings as well as disputes with the Debtor's creditors. These actions and settlements involved the following:

1. Danieli Litigation - Simon drafted and filed a complaint commenced by the Debtor and Mr. Gorski to determine the extent and validity and amount of the

Danieli/Sky Bank secured claim, handled discovery, briefed and litigated this action. The docket identifies the Debtor and Mr. Gorski as plaintiffs and lists Simon as counsel for both parties. Simon & Short states its time totaled 161.2 hours for this action. (Bankr. Pro. Doc. No. 04-4097; R. 252 Motion for payment of Simon's fees, Ex. 1 p. 5-6, 13, Ex. 2 p. 19, 21, 25, 26-42; Apx. ___).

2. Tort Litigation - Simon drafted and filed a complaint for the Debtor against its secured creditor (Danieli) and real estate leasing agent (Oxford) for certain tort actions and handled discovery resulting in 124.7 hours of time charged by Simon. The Debtor as well as Mr. Gorski were named as plaintiffs in this action. (Bankr. Pro. Doc. No. 04-4096; R. 252 Motion for payment of Simon's fees, Ex. 1 p. 6-7, Ex. 2 p. 19-25, 27-33, 41-48; Apx. ___).

3. Danieli Settlement - Simon negotiated with the Debtor's secured creditor and for a resolution of all issues with Danieli and reviewed, revised, and filed motion for approval of settlement agreement. Simon requested fees for 71 hours of time related to this settlement. (Bankr. Doc. entry 207; R. 252 Motion for payment of Simon's fees, Ex. 1 p. 7-9, 14, Ex. 2 p. 47-56; Apx. ___). Fed. R. Bankr. P. 9019(a) (debtor in possession may file motion for approval to compromise or settle matter).

4. Oxford Settlement - Simon negotiated and sought approval of a settlement of claims between Oxford and the Debtor totaling 17.3 hours. (Bankr. Doc. entry 207; R. 252 Motion for payment of Simon's fees, Ex. 1 p. 9, 14, Ex. 2 p. 49-58; Apx. ___).

5. Employee personal injury claim - Simon spent 8.10 hours of time drafting and filing an objection of the Debtor and Mr. Gorski to this claim and negotiating an agreement for this matter to be adjudicated in state court. (Bankr. Doc. entry 199, 210; R. 252 Motion for payment of Simon's fees, Ex. 1 p. 9-10, 14; Apx ___).

6. Settlement of mechanics lien of Kleen All of America, Inc. for remediation work rendered to Debtor - Simon drafted a complaint that was not filed against Kleen All challenging the amount and extent of its mechanics lien and negotiated, drafted, and filed a joint motion seeking approval of a settlement of the claim. The time Simon spent on these tasks totaled 19.10 hours. (Bankr.

> Doc. entry 221; R. 252 Motion for payment of Simon's fees, Ex. 1 p. 10-11, 14, Ex. 2 p. 47, 58-61, 63; Apx. ___).
>
> **7.** Debtor's claim against environmental consultant - Simon spent 11.10 hours of time relating to litigation of the Debtor's claim against its environmental consultant for breach of contract and negligence. Services included drafting an exhibit list and discussions with Debtor's special counsel who was approved to represent the Debtor in this matter. (R. 252 Motion for payment of Simon's fees, Ex. 1 p. 11-12, 14, Ex. 2 p. 50-51, 58, 62-66; Apx ___).

Simon also filed for Mr. Gorski a motion to intervene generally in an action that was commenced by the Debtor against its tenant Main Steel:

> Main Steel Litigation -Simon filed a motion to intervene for Mr. Gorski in this adversary action initiated by the Debtor against Main Steel relating to a rent dispute. The firm rendered services relating to a settlement totaling 65.40 hours. (Bankr. Adv. Pro. Doc. No. 02-4247; R. 252 Motion for payment of Simon's fees, Ex. 1 p. 13, Ex. 2 p. 6-7, 11-17; Apx. ___). 11 U.S.C. § 502 (party in interest may object to claims), 704(5) (debtor has duty to examine and object to claims); Fed. R. Bankr. P. 6009 (debtor in possession may defend or initiate any action on behalf of debtor).

Simon rendered some services that were within the scope of the Debtor's duties but which were not exclusive to a debtor. These services included the following:

> Disclosure statement and plan of reorganization - Simon formed a plan strategy, drafted, negotiated, and filed a disclosure statement and plan and various amended versions of a joint disclosure statements and joint plan of reorganization and reviewed and objected to secured creditor's disclosure statement and plan totaling 320 hours of time. (Bankr. Doc. entries 88, 89, 113, 114, 123, 132, 133, 150, 151, R. 252 Motion for payment of Simon's fees, Ex. 1 p. 13, Ex. 2 p. 15-21; Apx. ___). 11 U.S.C. § 1106(5) (debtor in possession has duty to file plan under § 1122); See also 11 U.S.C. § 1125 (plan cannot be solicited without disclosure statement).

During the time Simon rendered these services, Porter Wright remained the Debtor's only approved counsel authorized under § 327 to assist the Debtor with carrying out its general bankruptcy duties. However, Porter Wright was limited in its capacity to act on behalf of the Debtor as Mr. Gorski acted "solely with and through [Simon] in the Bankruptcy Proceedings, both in his capacity as sole representative of the Debtor and as the sole equity security holder of the Debtor...." (R. 252, Motion for payment of Simon's fees, Ex. 3 Gorski Affidavit, p.2; Apx. ___). The Debtor had little contact with Porter Wright once Mr. Gorski retained Simon as his personal counsel. (R. 252, Motion for payment of Simon's fees, Ex. 3 Gorski Affidavit, p.3; Apx. ___). Simon would advise Porter Wright as to efforts being made relating to the Debtor's reorganization and other efforts. On a significant number of occasions, documents drafted by Simon were forwarded to Porter Wright for review, comment and approval. (R. 252, Motion for payment of Simon's fees Ex. 4 Short Affidavit, p. 2-4, Ex. 5 Simon Affidavit, p. 2-4; Apx. ___).

After an order was entered confirming the Debtor's Joint Plan of Reorganization. (Bankr. Doc. entry 249; Apx. ___), Mr. Gorski filed the motion for payment of Simon's fees as an administrative expense of the bankruptcy estate based upon a substantial contribution pursuant to 11 U.S.C. § 503(b)(3)(D) and (b)(4) (R. 252 Motion for payment of Simon's fees; Apx. ___) and a brief in support (R. 253

Brief; Apx. __). Mr. Gorski requested approval of legal fees incurred by Simon in the amount of $298,590 and reimbursement of expenses in the amount of $3,392.62 pursuant to 11 U.S.C. § 503(b)(3)(D) and (b)(4). (R. 252, Motion for payment of Simon's fees, p. 1; Apx.___). The United States Trustee objected to the motion on the ground that the work performed was debtor's work and that no substantial contribution was made in any event. (R. 255 UST Objection to motion for payment of Simon's fees, p. 5; Apx. __).

The bankruptcy court held a hearing on the motion on June 8, 2005 (Bankr. Doc. entry dated 6/8/2005; Apx. ___), and on June 15, 2005 entered a Memorandum Opinion and Order denying Simon's fees. (R. 260 Memorandum opinion and order; Apx. ____). The bankruptcy court held Simon's fees were not entitled to administrative expense treatment because Simon was disqualified by court order from representing the Debtor and the fees it incurred were for representing Mr. Gorski in his capacity as sole managing member and sole equity holder of the Debtor. (R. 260 Memorandum opinion and order, p. 4, 7; Apx ___.) The court noted that Mr. Gorski admitted he used Simon on behalf of the Debtor as well as on behalf of himself. (R. 260 Memorandum opinion and order p. 8; Apx. ___). The bankruptcy court found that despite Simon's disqualification, Mr. Gorski retained Simon to represent him as sole equity holder and also as the Debtor's sole representative. The Court determined that parties negotiating with Simon must have assumed the law firm had the authority to bind the Debtor or else they would not have settled matters with Mr. Gorski. The bankruptcy court therefore found that the work Simon undertook was for the Debtor and that Mr. Gorski's two roles were so intertwined that it was not possible to separate fees that related only to representation of him as sole shareholder. (R. 260 Memorandum opinion and order p. 12-13; Apx. ___). Based upon these finding, the bankruptcy court ruled that the disqualification of Simon precluded an administrative expense claim for attorney fees incurred by Simon in the representation of Mr. Gorski under 11 U.S.C. 503(b)(3)(D) and (4). (R. 260 Memorandum opinion and order, p. 13; Apx. ___).

Mr. Gorski timely asked the court to alter or amend its order (R. 262 Motion to alter or amend; Apx. ___), to which the United States Trustee filed an objection (R. 263 Objection of UST to motion to alter or amend; Apx. ___). The bankruptcy court entered an order denying the motion to alter or amend on July 8, 2005. (R. 264 Order denying motion to alter or amend; Apx. __). The bankruptcy court noted that Mr. Gorski presented no new law or facts; he had the opportunity to introduce evidence; and his conduct amounted to a waiver of an evidentiary hearing. The court reiterated the facts demonstrated that Simon's fees were incurred on behalf of Mr. Gorski as sole representative of the Debtor and sole equity holder and that counsel for a debtor had to be disinterested in accordance with 11 U.S.C. § 327. Simon's performance of services on behalf of Mr. Gorski individually while also performing services for the Debtor did not allow for Simon to bypass the disinterested requirement. (R. 264 Order denying motion to alter or amend, p. 3-4; Apx. __).

Mr. Gorski appealed the order denying his motion to the appellate panel by timely Notice of Appeal on July 18, 2005. (R. 266 Notice of appeal; Apx. ___). The United States Trustee took the position on appeal that the bankruptcy court was correct in its final decision but erred in its legal conclusion that the order disqualifying Simon from representing the Debtor automatically precluded an allowance of attorney fees under 11 U.S.C. 503(b)(3)(D) and (b)(4). On appeal, the United States Trustee requested a remand to the bankruptcy court to address two issues: 1) whether the fees incurred by Simon were incurred for Debtor work or work on behalf of the Debtor that fall outside of § 503(b)(3)(D) and (4); and 2) if legal services performed for Mr. Gorski fall within the parameters of 11 U.S.C. § 503(b)(3)(D), whether Mr. Gorskit made a "substantial contribution" under 11 U.S.C. § 503(b)(3)(D) and (4) warranting administrative expense treatment of legal fees. (BAP entry 11/1/2005 Brief of UST).

On appeal, the appellate panel affirmed the bankruptcy court decision denying Mr. Gorski reimbursement of his counsel fees from the bankruptcy estate and found that a remand was not appropriate. The appellate panel found "no clear error in the bankruptcy court's factual finding that the S & S Firm's work was actually performed on behalf of the Debtor itself." (BAP Doc. 6/15/06 Opinion, p. 10; Apx. ____). The appellate panel noted, after a review of the record, that Simon "was in effect representing the Debtor" (BAP Doc. 6/15/06 Opinion, p.11-12; Apx. ____).

The appellate panel agreed with the United States Trustee that § 503(b)(3)(D) and (b)(4) do not contain any disinterested requirement and that an order disqualifying counsel from representing a debtor under § 327(a) does not automatically preclude treatment of counsel's fees as an administrative expense under 503(b)(3)(D) and (b)(4). However, the appellate panel emphasized that "allowance under § 503(b)(3)(D) and (b)(4) is limited to specified entities: 'a creditor, an indenture trustee, an equity holder, or a committee representing creditors or equity security holders....' Thus, before the issues of substantial contribution and reasonableness may be considered, a movant under [Section] 503(b)(3)(D) and (4) must establish that it is one of the covered entities." (BAP Doc. 6/15/06 Opinion, p. 8; Apx. ____). The appellate panel concluded based on the bankruptcy court record that "[i]t was undisputed that the work performed by [Simon] was work which would routinely be performed by a debtor's counsel." (BAP Doc. 6/15/06 Opinion, p. 9; Apx. ____). The appellate panel further determined that Mr. Short conceded at oral argument that his firm represented the Debtor when he agreed with the bankruptcy court that Debtor's sole managing member and sole equity holder was the same person in terms of approving Simon's actions and Mr. Short conceded at oral argument that he never distinguished between the two. (BAP Doc. 6/15/06, Opinion, p. 10; Apx. ____). The appellate panel found the record supported the bankruptcy court's determination that it was impossible to decipher services rendered by Simon on behalf of Gorski as sole equity holder from those tasks rendered for Mr. Gorski as Debtor's sole managing member. The appellate panel noted that Mr. Gorski never identified any tasks Simon performed for the Debtor's sole managing member that were separate from those services it rendered for Mr. Gorski as sole equity holder and Mr. Gorski did not dispute this finding of the bankruptcy court. The appellate panel stated fees incurred by Simon on behalf of the Debtor's sole managing member were not compensable under § 503(b)(3)(D) because it does not apply to a debtor's attorney fees. Further, the appellate panel found that any services performed on behalf of Mr. Gorski as sole equity holder were so intertwined with the services rendered on behalf of him as the Debtor's sole managing member so as to fall outside of the scope of this provision. (BAP Doc. 6/15/06 Opinion, p. 12; Apx. ____).

The appellate panel further concluded that since the services rendered by Simon were on behalf of Mr. Gorski in his capacity as Debtor's sole managing member, i.e.

the Debtor, as well as Debtor's sole equity holder, fees had to be reviewed in the context of § 327 and 330 as well as § 503(b)(3)(D) and (b)(4). (BAP Doc. 6/15/06 Opinion, p. 11-12; Apx. __).

Given the record, and Mr. Short's concessions, the appellate panel held a remand was not necessary because the record clearly supported the bankruptcy court's factual findings that Simon rendered services on behalf of Mr. Gorski and the Debtor; and, the services rendered were so intertwined that they could not be attributable solely to equity precluding Mr. Gorski's claim under § 503(b)(3)(D) and (b)(4). At the end of its decision, the appellate panel also noted that it would not remand the case for further findings as to what services were rendered on behalf of Debtor and what work was performed on behalf of equity. (BAP Doc. 6/15/06 Opinion, p. 12-13; Apx. ___.)

Mr. Gorski filed a timely notice of appeal of the appellate panel decision affirming the Bankruptcy Court decision on July 12, 2006. (BAP Doc. 7/12/06 Notice of appeal; Apx. __.)

SUMMARY OF ARGUMENT

This Court can affirm the appellate panel's decision affirming the bankruptcy court's denial of Mr. Gorski's administrative expense claim under 11 U.S.C. § 503(b)(3)(D) and (b)(4) for attorney fees incurred by Simon because Mr. Gorski's claim falls outside the scope of recoveries allowed by those sections. Section 503(b)(3)(D) and (4) allow compensation only for fees incurred by one of four types of entities - equity security holders, creditors, indenture trustees and committees. In this case, the bankruptcy court concluded the services Simon provided involved debtor services, which fall outside § 503(b)(3)(D) and (4). On appeal, the bankruptcy appellate panel relied upon the bankruptcy court record and concessions Simon made at oral argument to affirm on the ground that Simon's services were rendered on behalf of the Debtor or were so intertwined with services provided by the Debtor that they fell outside a possible § 503(b)(3)(D) and (4) recovery.

This ruling merits affirmance because the record and concessions below establish that Mr. Gorski used Simon in his capacity as the Debtor's sole managing member & sole equity holder to perform debtor services, including many services that the law allows **only** debtors to perform. As such, the courts below did not err in denying Mr. Gorski's claim for fees under § 503(b)(3)(D) and (b)(4).

In the alternative, if this Court determines the record and concessions below were not adequate to allow the appellate panel to conclude Simon provided solely debtor's services, this Court should remand this case to the bankruptcy court for further proceedings. If this Court remands, the United States Trustee respectfully asks that the remand include instructions that the bankruptcy court first determine whether any of the services were performed on behalf of an equity security holder, creditor, indenture trustee or committee. If they were, the court on remand would then determine whether any services conferred a "substantial benefit" in the case as required by § 503(b)(3)(D) and, if so, what would be the reasonable amount of fees recoverable for such services that contributed a substantial benefit to the case under § 503(b)(4).

ARGUMENT

I. The Record and Concessions Below Support the Appellate Panel's Conclusion that Mr. Gorski's Claim for Attorney Fees Falls Outside the Scope of § 503(b)(3)(d) and (b)(4), given Simon's work in the case, which involved services that were Exclusively Duties of the Debtor or Litigation of Debtor Disputes where the Debtor was the Primary Plaintiff.

The record below and the concessions Simon made at oral argument support the appellate panel determination that Mr. Gorski's claim for attorney fees fall outside the scope of Bankruptcy Code § 503(b)(3)(D) and (b)(4) because services rendered by Simon were duties of a debtor which only the Debtor had authority to undertake, or related to litigation of debtor disputes where the Debtor was the primary plaintiff. Mr. Gorski's motion for payment of Simon's fees, including the attached exhibits and affidavits of Mr. Simon, Mr. Short, and Mr. Gorski detailing the services rendered, his brief in support, as well as the bankruptcy court docket demonstrate that, as a matter of fact, services rendered by Simon were duties of the Debtor or litigation of debtor disputes where the Debtor was the primary party. Compensation for these types of services fall outside § 503(b)(3)(D) and (4) because those sections allow recoveries only by creditors, equity security holders, indenture trustees and committees. Id.

Not only is there no basis to pay Simon's fees under § 503(b)(3)(D) and (4) for performing debtor duties, but the United States Trustee, like the courts below, believes it was highly improper for Mr. Gorski to circumvent the bankruptcy court's prior order, disqualifying Simon from performing debtor's work - an order neither appealed, by rendering services that only debtors could lawfully perform under the facade of representing Mr. Gorski.[8] Put simply, Simon bypassed the bankruptcy court's disqualification order through prospectively performing for Mr. Gorski many of the same debtor tasks that only debtor's counsel could perform.

The record amply establishes that Simon performed tasks that were duties only the Debtor could undertake. The firm provided these debtor services knowing that it

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[8] The United States Trustee reserves the right to seek appropriate sanctions for that conduct in further proceedings before the bankruptcy court.

could not represent the Debtor and that the Debtor could have sought approval of other substitute bankruptcy counsel. (Gary Short response to Court questions at TR p. 216-217, 220-221; Apx. ___).

Simon assisted the Debtor with internal business operations. See 11 U.S.C. § 1108 (unless ordered otherwise, debtor may operate its business). It worked with the Debtor's sole managing member, facilities manager, and accountant and assisted with insurance issues, property appraisals, tenant and lease issues, and real estate taxes. (R. 252 Motion for payment of Simon's fees, Ex. 2 p. 8, 13, 17, 21, 26, 30, 41,50, 61, 64, 65, 67, 68; Apx. ___). Id. Simon filed motions to retain professionals to represent the Debtor. (Bankr. Doc entries 149, 159, 235; R. 252 Motion for payment of Simon's fees, Ex. 2 p.21, 26-27, 65; Apx. ___). See 1107 and 327(a) (debtor has authority to retain professionals to carry out debtor's duties). The firm assisted with the preparation and filing of the Debtor's monthly operating reports. (Bankr. Doc. entries 152, 153, 156, 175, 185, 189, 206, 218, 245, 247, 258, 259; R. 252 Motion for payment of Simon's fees, Ex. 2 p. 24, 31, 32, 40, 44, 49, 57,67; Apx.___). See 11 U.S.C. § 704(8) (debtor has duty to file periodic reports with Court and U.S. Trustee.); Fed. R. Bankr. P. 2015 (duty to keep records and reports). Simon sought and secured the Debtor's use of cash collateral. (Bankr. Doc. entries 180, 181 ; R. 252 Motion for payment of Simon's fees, Ex. 1 p. 13, Ex. 2 p. 7, 8, 9, 10, 31, 36, 39-41, 43; Apx.

___). See 11 U.S.C. § 363 (providing debtor may use cash collateral). It filed a motion for the Debtor to secure financing to pay its insurance. (Bankr. Doc. entry 117; R. 252 Motion for payment of Simon's fees Ex. 1 p. 13, Ex. 2 p. 9, 14; Apx. ____). See 11 U.S.C. § 364 (debtor may borrow funds on certain terms). Simon negotiated, drafted, and filed a motion to assume its lease with Main Steel. (Bankr. Doc. entry 222; R. 252 Motion for payment of Simon's fees Ex. 1 p. 5, 13, Ex. 2 p. 26, 62; Apx. ___). See 11 U.S.C. § 365 (debtor may assume or reject unexpired leases and executory contracts).

Since these tasks were exclusive duties of the Debtor, Simon could only be compensated for these services if the bankruptcy court had entered an order under § 327(a) authorizing the Debtor to retain Simon to assist the Debtor in carrying out its debtor duties. 11 U.S.C. § 327. See 11 U.S.C. § 327 and 330. Lamie v. United States Trustee, 540 U.S. 526, 124 S. Ct. 1023 (2004). The bankruptcy court order denying Simon's employment by the Debtor under § 327(a), prohibited Simon from lawfully providing debtor services to the Debtor.[9] (R. 82 Order denying Simon's retention;

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[9] Mr. Gorski suggests the U.S. Trustee somehow approved of Simon's representation and resulting fees. Mr. Gorski asserts the United States Trustee requested "Gorski, as 'equity', and the Debtor act jointly on matters in the case, if possible, including submission of plan(s) of reorganization" and allegedly stated "if the Debtor and Gorski did not act jointly going forward, the U.S. Trustee may file a motion to have a chapter 11 trustee appointed." (Gorski Brief p. 14-15). First, the U.S. Trustee disputes Appellant's assertions and further states that any

Apx. ___). Since Simon was precluded from representing the debtor, as a matter of law, it cannot be compensated for these debtor services which are the sole responsibility of the Debtor. 11 U.S.C. § 327(a) and 330. See also In re 5900 Associates, Inc., __ 3rd __, 2006 WL 3196441 (6th Cir. 2006) (stating "11 U.S.C. § 330 establishes the exclusive means of allowing a claim for professional fees in a bankruptcy proceeding" and finding counsel retained under 327 whose fees were never allowed by Bankruptcy Court under 330 could not enforce claim after case was dismissed).

Mr. Gorski also seeks payment of Simon's fees resulting from litigating and settling debtor disputes. Simon commenced lawsuits and/or assisted with resolving disputes in which the Debtor was the primary plaintiff. In the lawsuits, Mr. Gorski in his capacity as the Debtor's sole managing member and sole equity holder was also named as a plaintiff. Simon drafted and filed an action of the Debtor against Danieli

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alleged statements are reinterpretations of discussions which related to attempted resolution of pending matters (and thus not admissible evidence) which did not in any way involve "pre-approval" of any legal costs which might be incurred by Appellant. Second, even if Mr. Gorski's assertions were true, the parties could not vitiate the court's § 327 disqualification order. The bankruptcy court ruled Simon could not represent this debtor; the United States Trustee had no power to supercede that order. Third, Mr. Gorski cannot estop the United States government. See Estate of Elinor M. James v. U.S. Department of Agriculture, 404 F. 3d 989 (6th Cir. 2005) (noting federal government cannot be estopped as private parties, rather evidence must show affirmative misconduct by government agent).

challenging the validity and extent of a security interest acquired from Sky Bank. (Bankr. Pro. Doc. No. 04-4097; R. 252 Motion for payment of Simon's fees, Ex. 1 p. 5-6, 13, Ex. 2 p. 19, 21, 25, 26-42; Apx. ___). Simon drafted and filed a tort action for the Debtor against its secured creditor and real estate leasing agent. (Bankr. Pro. Doc. No. 04-4096; R. 252 Motion for payment of Simon & Short's fees, Ex. 1 p. 6-7, Ex. 2 p. 19-25, 27-33, 41-48; Apx. ___). Simon filed a motion to intervene generally for Mr. Gorski in an action involving a rent dispute which was commenced by the Debtor against its tenant Main Steel. (Bankr. Adv. Pro. Doc. No. 02-4247; R. 252 Motion for payment of Simon's fees, Ex. 1 p. 5, 13, Ex. 2 p. 6-7, ____; Apx. ___).

Simon negotiated a global settlement with Danieli resolving all issues and reviewed, revised, and filed a motion for approval of the settlement agreement. (Bankr. Doc. entry 207; R. 252 Motion for payment of Simon's fees, Ex. 1 p. 7-9, 14, Ex. 2 p. 47-56; Apx. ___). The firm negotiated and sought approval of a settlement of claims between the Debtor and Oxford, its real estate leasing agent. (Bankr. Doc. entry 207; R. 252 Motion for payment of Simon's fees, Ex. 1 p. 7-9, 14, Ex. 2 p. 49-58; Apx. ___). Simon filed an objection of the Debtor and Mr. Gorski to a personal injury claim brought by an employee against the Debtor and negotiated an agreement for this claim to be adjudicated in state court. (Bankr. Doc. entry 199, 210; R. 252

Motion for payment of Simon's fees, Ex. 1 p. 9-10, 14; Apx ___.) The firm drafted a complaint against the holder of a mechanics lien filed against the Debtor, and it negotiated, drafted, and filed a joint motion seeking approval of a settlement of the claim. (Bankr. Doc. entry 221; R. 252 Motion for payment of Simon's fees, Ex. 1 p. 10-11, 14, Ex. 2 p. 47, 58-61, 63). Simon provided services relating to litigation of the Debtor's claim against an environmental consultant for breach of contract and negligence. (R. 252 Motion for payment of Simon's fees Ex. 1 p. 11-12, 14, Ex. 2 p. 50-51, 58, 62-66).

These litigation and dispute settlement services provided by Simon (as well as all of the other services provided by Simon) were performed in the name of Mr. Gorski as the Debtor's sole managing member and sole equity holder. However, the underlying actions involved disputes and/or claims of the Debtor in which the Debtor was the primary plaintiff. (R. 252 Motion for payment of Simon's fees Exhibit 1, p. 5-12; Apx. __).

Some of these litigation services provided by Simon related to litigation that was not within the exclusive duties of the Debtor. <u>See</u> 11 U.S.C. § 502 (party in interest may object to claims). However, the Debtor was the primary plaintiff in all of these matters and only the Debtor had authority to prosecute bankruptcy actions and settle all of the debtor disputes. Fed. R. Bankr. P. 6009 (debtor in possession may defend or initiate any action on behalf of debtor); 9019 (trustee or debtor may move to compromise or settle dispute). See also 11 U.S.C. § 704(5) (debtor has duty to examine and object to claims). In each of these matters, Simon was only able to file the complaints and/or settle the disputes because the Debtor was the primary plaintiff and agreed to the settlements. See Fed. R. Bankr. P. 6009 and 9019. Fees resulting from Simon's litigation of actions and settlement of disputes in which the Debtor was the primary plaintiff are not recoverable under § 503(b)(3)(D) and (b)(4). As admitted by Mr. Gorski, Simon handled these Debtor actions on behalf of Mr. Gorski as sole equity holder and also as the Debtor's sole representative. Mr. Gorski as sole representative of the Debtor did not deal with the Debtor's firm. Rather, he acted for the Debtor through Simon. (R. 252 Motion for Payment of Simon's fees, Exhibit 3 Gorski affidavit p. 2-3; Apx. __). As stated by Mr. Short at the bankruptcy court hearing, Simon acted as lead counsel in this case. (Gary Short at TR 14; Apx. ___).

Therefore, Mr. Gorski cannot recover Simon's fees for these litigation and settlement services because § 503(b)(3)(D) and (b)(4) do not cover expenses of a Debtor. § 503(b)(3)(D) and (b)(4) by its own terms is only available to a creditor or equity holder. See In re Lebron, 27 F. 3d 937, 943 (3rd Cir. 1994) (stating "under 503(b)(3)(D) four categories of persons may apply for reimbursement of expenses: (1)

creditors, (2) indenture trustees, (3) equity security holders, and (4) creditor and equity holder committees....”). See also, In re American Plumbing and Mechanical, Inc., 327 B.R. 273, 293-294 (Bankr. W.D. Texas 2005) (debtor’s founders who were also officers and directors and equity holders could not assert claim to extent acted in capacity as officers and directors since outside scope of § 503(b)(3)(D).)

Mr. Gorski argues that the appellate panel erred in considering the type of services rendered and who typically provides such services under § 503(b)(3)(D) and (b)(4). Instead, Mr. Gorski argues the test is whether a substantial contribution was made in the case and the results of services rendered. (Gorski Brief p. 32-34). As a matter of law Mr. Gorski is incorrect. As set forth above, § 503(b)(3)(D) and (b)(4) do not cover the expenses of a Debtor nor do they apply to professional services for a Debtor. Rather, Bankruptcy Code § 327, 330 and 331 are the sole provisions that provide for the retention and payment of a debtor’s counsel for debtor services. See also In re 5900 Associates, Inc., __ 3rd __, 2006 WL 3196441 (6th Cir. 2006).

Mr. Gorski in his capacity as Debtor’s sole equity holder did have authority to file a plan and disclosure statement. 11 U.S.C. § 1121(c). Simon did prepare a plan and disclosure statement, amended versions of such documents, and negotiated with creditors on the terms of the plan and treatment of claims. Approximately one-third of the fees requested by Simon relates to plan and disclosure statement related services. (R. 252 Motion for payment of Simon's fees Ex. 1 p. 12-13; Apx. __).

However, as properly concluded by the bankruptcy court and the appellate panel, Simon rendered services to Mr. Gorski as Debtor's sole role representative and sole equity holder. (R. 260 Memorandum opinion p. 7; BAP Doc 6/15/06 Opinion p. 9; Apx. ___). The motion for payment of Simon's fees was filed by Mr. Gorski in his dual position. The narrative, billing statements, and affidavits, fail to identify any disclosure statement and plan related services that were provided to Mr. Gorski solely in his capacity as the Debtor's sole equity holder. (R. 252 Motion for Payment of Simon's fees p. 1, 5, Ex. 1p. 1, 4-5, Ex. 3 Gorski affidavit; Apx. ___). Mr. Gorski's admission that he refused to work directly with Porter Wright on all matters including the plan and disclosure statement and his decision to work only through Simon in his capacity as Debtor's sole representative further shows he used Simon to represent the Debtor's interests. (R. 252 Motion for payment of Simon's fees Ex. 3 Gorski affidavit p. 2-3; Apx. ___).

Since Mr. Gorski failed to demonstrate any of Simon & Short's fees were for plan and disclosure related services rendered solely to Mr. Gorski in his capacity as equity holder, fees incurred in this category also fall outside the scope of § 503(b)(3)(D). Therefore, the appellate panel was correct in finding that Mr. Gorski's

Motion for Payment of Simon's fees was without merit. (BAP Doc. 6/15/06 Opinion p. 12; Apx. ___).

II. In the alternative, if this Court determines that certain factual matters were not sufficiently developed, then a remand is warranted for a determination as to whether any of the services rendered by Simon & Short were for Mr. Gorski solely in his capacity as Debtor's sole equity holder and within the scope of § 503(b)(3)(D) and (b)(4).

The appellate panel properly held Mr. Gorski could not assert a claim under § 503(b)(3)(D) and (b)(4) because services rendered by Simon for Mr. Gorski were debtor services performed on behalf of Gorski as sole managing member of Debtor and Debtor's sole equity holder. The appellate panel refused to remand for any further factual determinations. (BAP Doc. 6/15/06 p. 12-13; Apx __). It specifically noted that Mr. Gorski had ample opportunity to present testimony and evidence to the Bankruptcy Court and he never requested an evidentiary hearing. He also never separated those services rendered by Simon, if any, that were performed for Debtor from those performed for equity. (BAP Doc. 6/16/06 p. 7, 12; Apx. __).

If this Court disagrees, and orders a remand for further factual findings, the United States Trustee respectfully requests that any such remand should first address whether any of the work performed by Simon was for services that could be performed by a party other than the Debtor and were provided solely to Mr. Gorski in his capacity as the Debtor's equity holder.

Mr. Gorski asks this Court to reverse the appellate panel decision and remand his motion for payment of Simon's fees solely for a determination on whether there was an '"actual and demonstrable benefit to the estate", the extent of that benefit, and the reasonableness of the fees. (Groski Brief p. 49-50). Mr. Gorski's request, however, omits any determination of this preliminary factual issue which is required for any fee allowance under § 503(b)(3)(D).

If on remand, Mr. Gorski shows that some tasks were in fact undertaken by Simon solely on behalf of Mr. Gorski as equity holder, only then would a determination be needed as to whether there was a "substantial contribution" and, if so, what would the reasonable fees be for those services.[10] If this case is remanded, it is important that the bankruptcy court be allowed to consider (a) whether these were impermissible debtor's services; (b) if any tasks were permissible as an equity security

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[10] Equity security holders and others must meet a heavy burden in order to establish they made a substantial contribution in a bankruptcy case. In re Consolidated Bancshares, Inc., 785 F.2d 1249, 1253 (5th Cir. 1986) (court may award fees only when the applicant establishes that the services significantly "foster and enhance, rather than retard or interrupt the progress of reorganization."); Lebron v. Mecham Financial, Inc., 27 F.3d 937, 944 (3rd Cir. 1994) (The mere pursuit of an applicant's own interests in the case is insufficient, if the applicant cannot demonstrate a direct benefit to the estate.); In re Lister, 846 F.2d 55, 58 (10th Cir. 1988) (at a minimum an applicant's "efforts must result in an actual and demonstrable benefit to the bankruptcy estate."). It is the position of the United States Trustee that Mr. Gorski cannot satisfy section 503(b)(3)(D)'s substantial contribution standard.

holder, whether any constituted a substantial contribution; and (c) if any did, what constitutes reasonable fees for that contribution. This is so because Mr. Gorski will not be able to satisfy any of these independent conditions precedent to recover under § 503(b)(3)(D) and (b)(4) upon remand. **First**, Mr. Gorski will not be able to show that the services rendered provided an actual and demonstrable benefit to the estate. **Second**, those services did not make a substantial contribution to the case, as the United States Trustee would establish on remand. **Third**, Simon's services were not necessary because all of the services Simon rendered, including those not exclusive to a debtor, were tasks that would normally be performed by debtor's counsel in assisting debtor with carrying out its obligations and duties. Many of the services rendered by Simon duplicated those provided by the Debtor's counsel. To the extent Simon took the lead in handling the Debtor's reorganization efforts and drafting and filing pleadings, it was because Mr. Gorski as the Debtor's sole representative curtailed Porter Wright from being able to act on the Debtor's by terminating communications with the Debtor's counsel. See In re Ace Finance Company, 69 B.R. 827, 830-831 (Bankr, N.D. Ohio 1987) (party covered by § 503(b)(3)(D) cannot be compensated for services that fall within the scope of duties of a debtor, debtor-in-possession, or other officer of the estate); See also In re Rockwood Computer Corporation, 61 B.R. 961 (Bankr. S.D. Ohio 1986) (finding indenture trustee did not make substantial contribution warranting allowance of legal fees rather services rendered were for primary benefit of indenture trustees and noting services rendered for indenture trustee that are routine tasks of debtor’s counsel are not compensable.); In re Lease-A-Fleet, Inc., 148 B.R. 419, 427 (Bankr. E.D. Pa. 1992) (services that are also rendered by the Debtor are not compensable and a “claimant cannot supplant the debtor’s role unless it shows that the debtor is unable or unwilling to act.” [Citations omitted].) ‘ “Services that duplicate those rendered by the debtor or other court appointed officers, absent proof that they are unwilling or unable to act, are not compensable because they entail an excessive and undue burden to the estate.” ’In re Matter of New Power Company 311 B.R. 118, 125 (Bankr. N.D. Ga. 2004) citing In re Granite Partners, L.P., 213 B.R. 440, 446 (Bankr. S.D.N.Y. 1997).

CONCLUSION

For these reasons, the United States Trustee respectfully asks this Court to affirm the Bankruptcy Appellate Panel decision or, in the alternative, to remand this matter to the Bankruptcy Court for further proceedings consistent with the foregoing.

Respectfully submitted,
SAUL EISEN
United States Trustee
Michigan/Ohio Region 9

Date:__________ By: ______________________________

Amy L. Good (Ohio Bar #0055572)
Trial Attorney
Office of the United States Trustee
United States Department of Justice
H.M. Metzenbaum U.S. Courthouse
201 Superior Avenue E, Suite 441
Cleveland, Ohio 44114
(216) 522-7800 ext. 236
amy.l.good@usdoj.gov

CERTIFICATE OF COMPLIANCE

I hereby certify that the foregoing brief complies with the type-volume limitation provided in Fed. R. App. P. 32(a)(7)(B). The foregoing brief contains 9801 words of Times New Roman (14 point) proportional type. The word processing software used to prepare this brief was WordPerfect 12.

____

Amy L. Good

CERTIFICATE OF SERVICE

I certify that a copy of the foregoing was served by regular U.S. Mail upon Phillip S. Simon, Esq. and Gary W. Short, Esq., Simon & Short, LLC, 2317 Koppers Building, Pittsburgh, PA., 15219; and, James Ehrman, Porter Wright Morris & Arthur, LLP, 925 Euclid Avenue, Suite 1700, Cleveland, Ohio 44115-1483 this ____ day of December, 2006.

____

Amy L. Good

DESIGNATION OF APPENDIX CONTENTS

Appellee, in accordance with Sixth Circuit Rule 28(d) and 30(b), hereby designates the additional items to be included in the Joint Appendix:

Description of Item	**Date**	**Record Entry No.**
Order Authorizing Debtor to Retain Porter Wright	10/23/2002	Bankr. Doc. No. 25
Emergency Application of Debtor to Retain Simon & Short	12/31/2003	Bankr. Doc. No. 67
Objection of UST to Emergency Application to Retain Simon & Short	1/6/2004	Bankr. Doc. No. 69
Gorski’s Brief in Support of Motion for Payment of Simon & Short’s Fees	5/4/2005	Bankr. Doc. No. 253
Objection of UST to Gorski’s Motion to Alter or Amend Judgment	6/30/2005	Bankr. Doc. No. 263

BRIEF BANK — “SUMMARY SHEET”

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WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*
Michael C. Hennen and Crystal L. Hennen (In re Michael C. Hennan and Crystal L. Hennen)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*
D. Minn.

3. ("CCN") ***CURRENT*** CASE NO.
No.: 11-26

4. ("PCN") ***PRIOR*** CASE NO. - & COURT *[IF ANY]*
No.: 10-34079
Court: Bankr. D. Minn.
(Identify judge & cite, if any)

5. ("SO") ***SOURCE***
U.S. TRUSTEES

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*
Filed: February 8, 2011
Type: Brief for the Appellee, United States Dept of Justice

7. **("AU")** ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*
Colin Kreuziger, Noah M. Schottenstein, P. Matthew Sutko, Ramona D. Elliott
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") ● ***SUMMARY*** OF KEY ISSUE(s)

&

√ Any Miscellaneous ***BACKGROUND***

● Did the bankruptcy court abuse its discretion when it converted the Hennens’ chapter 11 bankruptcy case to one under chapter 7, rather than dismiss their bankruptcy case under U.S.C. § 1112(b)(1)?

10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)

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UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MINNESOTA

CASE NO. 11-26

In re MICHAEL C. HENNEN and CRYSTAL L. HENNEN,
Debtors.

MICHAEL C. HENNEN and CRYSTAL L. HENNEN,
Appellants,

v.

UNITED STATES DEPARTMENT OF JUSTICE,
Appellee.

ON APPEAL FROM THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF MINNESOTA
BANKRUPTCY CASE NO. 10-34079

BRIEF FOR THE APPELLEE, UNITED STATES DEPARTMENT OF JUSTICE

RAMONA D. ELLIOTT
General Counsel
P. MATTHEW SUTKO
Associate General Counsel
NOAH M. SCHOTTENSTEIN
Trial Attorney

United States Department of Justice
Executive Office for United States Trustees
20 Massachusetts Avenue, N.W., Suite 8100
Washington, D.C. 20530
Telephone: (202) 305-2796
Facsimile: (202) 305-2397

HABBO G. FOKKENA
United States Trustee for Region 12
ROBERT B. RASCHKE
Assistant United States Trustee
COLIN KREUZIGER
Trial Attorney

United States Department of Justice
Office of the United States Trustee
300 South Fourth Street, Suite 1015
Minneapolis, MN 55415
Telephone: (612) 334-1350
Facsimile: (612) 335-4032

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STATEMENT OF APPELLATE JURISDICTION

The United States Bankruptcy Court for the District of Minnesota had jurisdiction over Michael and Crystal Hennen's chapter 11 bankruptcy case under 28 U.S.C. §§ 157 and 1334. The bankruptcy court converted the Hennens' chapter 11 case to one under chapter 7 on November 16, 2010. The Hennens timely filed a notice of appeal from that order under 28 U.S.C. § 158(c)(2) and Fed. R. Bankr. P. 8002(a) on November 30, 2010.

This Court has jurisdiction over this appeal under 28 U.S.C. § 158(a). The bankruptcy court's order converting the Hennens' case is a final, appealable order. *See Hedquist v. Fokkena (In re Hedquist)*, 450 F.3d 801, 802 (8th Cir. 2006).

STATEMENT OF THE ISSUE

Section 1112(b)(1) of the Bankruptcy Code requires a bankruptcy court to convert a chapter 11 case to one under chapter 7 or dismiss the case, whichever is in the best interests of creditors and the bankruptcy estate, if the movant establishes cause and no unusual circumstances exist that establish that conversion or dismissal is not in the best interests of creditors and the estate.

Here, did the bankruptcy court abuse its discretion when it converted the Hennens' chapter 11 bankruptcy case to one under chapter 7, rather than dismiss their bankruptcy case?

STANDARD OF REVIEW

This Court reviews a bankruptcy court's decision to convert a chapter 11 case for abuse of discretion. *See Loop Corp. v. U.S. Trustee*, 379 F.3d 511, 515 (8th Cir. 2004) (noting the bankruptcy court's "broad discretion" in deciding whether to dismiss or convert a chapter 11 case). A bankruptcy court abuses its discretion only if it "fails to apply the proper legal standard or fails to follow proper procedures in making its determination, or if the court bases an award upon findings of fact that are clearly erroneous." *City of Sioux City, Iowa v. Midland Marina, Inc. (In re Midland Marina, Inc.)*, 259 B.R. 683, 686 (B.A.P. 8th Cir. 2001) (citation omitted). Findings of fact "will not be reversed as clearly erroneous unless the reviewing court is left with a definite and firm conviction that a mistake has been committed." *Id.*

STATEMENT OF THE CASE

The United States Trustee moved to convert the Hennens' chapter 11 bankruptcy case for cause under 11 U.S.C. § 1112(b)(4), based on the Hennens' misconduct during the case, failure to prosecute their chapter 11 case, and the presence of significant non-exempt assets available for liquidation.[1] The Hennens agreed that cause existed, but

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[1] Congress has authorized the United States Attorney General to appoint 21 United States Trustees, each to serve in a specific geographic region of the United States. *See generally* 28 U.S.C. § 581 et seq. (establishing the United States Trustee Program). The United States Trustees are senior officials of the Department of Justice. *Id.* The United States Trustees "supervise the administration of cases and trustees" in all bankruptcy cases within their region through the exercise of a range of oversight responsibilities. 28 U.S.C. § 586(a)(3); *see generally Morgenstern v. Revco D.S. Inc. (In re Revco D.S., Inc.)*, 898 F.2d 498, 500 (6th Cir. 1990) (explaining that United

argued that dismissal, rather than conversion, was in the best interests of their creditors and the estate. After hearing from the Hennens' major secured creditor, New Market Bank, and Mr. Hennen, the bankruptcy court agreed with the United States Trustee and converted the Hennens' chapter 11 case to one under chapter 7. This appeal followed.

STATUTORY FRAMEWORK

When a debtor commences a bankruptcy case, a separate legal entity known as the "estate" is created. 11 U.S.C. § 541(a). The estate contains all of the debtor's property, subject to exceptions not applicable here. *Id.*

When a debtor files a case to reorganize under chapter 11 of the Bankruptcy Code, the debtor becomes a "debtor-in-possession" of that estate. 11 U.S.C. § 1101. The debtor-in-possession maintains control over the estate's property, but also obtains the rights, powers, and fiduciary duties of a trustee. 11 U.S.C. §§ 1106-1108.

Section 1112(b)(1) of the Bankruptcy Code provides that a debtor's chapter 11 bankruptcy case shall be dismissed or converted to one under chapter 7, "whichever is in the best interests of creditors and the estate," upon a showing of "cause."[2] 11 U.S.C. § 1112(b)(1). Section 1112(b)(4) provides examples of cause, which "includes — . . .

States Trustees oversee the bankruptcy process, protect the public interest, and ensure that bankruptcy cases are conducted according to law). United States Trustees may raise, appear, and be heard on any issue in any case or proceeding under Title 11. 11 U.S.C. § 307; *see Revco*, 898 F.2d at 499-500 (upholding broad appellate standing of United States Trustees).

[2] Section 1112(b) was amended on December 20, 2010. Those amendments are not relevant to this case.

failure timely to provide information . . . reasonably requested by the United States Trustee," 11 U.S.C. § 1112(b)(4)(H); and "failure to maintain appropriate insurance that poses a risk to the estate or to the public." 11 U.S.C. § 1112(b)(4)(C). And under section 102(3), "including" is "not limiting," so section 1112(b)(4)'s list is illustrative, not exhaustive. 11 U.S.C. § 102(3).

STATEMENT OF THE FACTS

1. Background

Michael and Crystal Hennen owned property in Jordan, Minnesota, which New Market Bank — the Hennens' secured lender — had scheduled for foreclosure. DE #31 at 1.[3] On the eve of the foreclosure sale, June 2, 2010, the Hennens filed a voluntary petition for chapter 11 bankruptcy relief. *Id.*; DE #1. Two weeks later, on June 16, 2010, they filed their bankruptcy schedules and a statement of financial affairs. DE #4. The Hennens' bankruptcy schedules disclosed real estate valued at $4,237,100, which was encumbered by secured claims totaling $977,000. DE #4 at 2-3. They also disclosed nearly $1.8 million in personal property, *id.* at 4-6, but only $133,123.56 in general unsecured liabilities. *Id.* at 11-13.

The United States Trustee convened the meeting of the Hennens' creditors pursuant to 11 U.S.C. § 341 on July 16, 2010. DE #25 at 3. At that meeting, the Hennens

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[3] All references to the bankruptcy court record are designated as "DE" with the respective docket entry number. Page numbers refer to pagination contained within the electronic .pdf version of the relevant document.

represented that they intended to hire professionals to sell the Jordan property. DE #31 at 1. They also revealed that their original bankruptcy schedules failed to include sufficient detail about a $1.2 million account receivable, the value of an inheritance recently received, and did not accurately reflect their 2008 federal and state tax liabilities. DE #4 at 5, 9-10; DE #25 at 3 n.2. In addition, their original statement of financial affairs failed to disclose the Hennens' activity as officers, directors, or partners in certain business entities, such as the interest in their farming business, Hennen Udder Farms, or their excavation business, Hennen Dirt Works. DE #4 at 28; DE #25 at 3 n.2.

After the Hennens testified at the meeting of their creditors, the United States Trustee requested that they correct the omissions or misstatements in their bankruptcy schedules and statement of financial affairs, and provide supporting documentation for other information provided in the schedules. DE #25 at 3. Despite assurances from the Hennens and their counsel, they failed to correct the omissions or provide any supporting documentation to the United States Trustee. *Id.* The Hennens also failed to retain professionals or make any other attempt to sell the Jordan property. *See* DE #31 at 1.

In addition, the Hennens had further problems satisfying their responsibilities as chapter 11 debtors and in prosecuting their bankruptcy case. First, the Hennens failed to provide proof of current insurance for their assets. DE #25 at 3-4; *see* 11 U.S.C. § 363(e) (allowing estate property to be used upon the provision of "adequate protection" for the creditor's interest in that property). Second, the Hennens failed to file any disclosure statement or plan of reorganization.[4] DE #25 at 4. Third, the Hennens failed to explain certain transactions, such as a $9,225.83 cash withdrawal that occurred on July 20, 2010, six weeks after the case was filed, which was just one day after they deposited $42,012.01 in inheritance proceeds into their bank account. DE #31 at 2-3. Fourth, the Hennens' monthly operating report for the month of July failed to include a profit and loss statement that indicated their net cash flow during that month. DE #21. Finally, the Hennens' monthly operating reports indicated that the bankruptcy estate had been operating at a net loss of $5,310. DE #17 at 6; DE #22 at 6; DE #30 at 6; DE #31 at 2.

2. The United States Trustee's Motion to Convert Under Section 1112(b)(1)

The United States Trustee filed a motion to convert the Hennens' case under 11 U.S.C. § 1112(b)(1) and (4) on October 14, 2010. DE #25. The United States Trustee sought conversion of the case, rather than dismissal, because, "[b]ased on the Debtors' schedules, there appear to be significant non-exempt assets which a chapter 7 trustee could liquidate." *Id.* at 5; DE #4 at 2-6 (demonstrating nearly $5 million in equity in the Hennens' real and personal property). The United States Trustee argued that the circumstances of the case suggested the Hennens were attempting to avoid their creditors by "park[ing] this case under the protection of the automatic stay [for over four months] without providing required information to determine whether this case really belongs in

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[4] The Bankruptcy Code bestows upon the debtor the exclusive right, with certain exceptions not relevant to this case, to file a plan within the first 120 days of the case. 11 U.S.C. § 1121(b).

bankruptcy or whether the Debtors are avoiding their creditors." DE #25 at 5. New Market Bank — the Hennens' major secured creditor, which holds an $850,000 secured claim representing 87% of all secured debt and 76% of all debt in the case — supported converting the Hennens' chapter 11 bankruptcy case to one under chapter 7, instead of dismissing the case. DE #31 at 2.

On November 11, 2010, the Hennens responded to the motion. DE #33. They admitted that cause existed to dismiss or convert the case. *Id.* at 3. They argued, however, that dismissal served the best interests of creditors and the estate because conversion to chapter 7 would require "significant additional administrative expenses and a liquidation of the farm property in a down market (rather than continued farming operations) may not maximize value for the estate." *Id.* at 5. The Hennens contended they had not engaged in ongoing fraud or dishonesty that would prejudice creditors. *Id.* Finally, they argued that sufficient assets existed to pay all of their debts and that creditors could pursue state law remedies in the event of dismissal. *Id.* They presented no evidence to support their arguments.

3. The Bankruptcy Court's Conversion Order

On November 16, 2010, the bankruptcy court held a hearing on the United States Trustee's motion to convert the Hennens' case. At the hearing, New Market Bank stated its desire to have the Hennens' chapter 11 case converted to one under chapter 7 due to the Hennens' failure to disclose their financial information. *Tr.* at 8:20-25. In the event that the court decided to dismiss the case rather than convert it, New Market Bank requested dismissal with prejudice to prevent further delay. *Id.* at 9:4-10.[5]

Mr. Hennen testified regarding the farming operations of Hennen Udder Farms. *Id.* at 11:18-25, 12:1-25. He stated that they had earned $15,000 to $20,000 from farming in 2009, but that they no longer had a bank account for Hennen Udder Farms. *Id.* at 13:6-25, 14:1-3. Instead, they reinvested that money into their excavation business, Hennen Dirt Works. *Id.* at 14:1-16. He also spoke about the prospects for their farming operations, explaining that "there's issues of marketing, transporting and everything . . . A lot of crops right now have everything full so I can't sell." *Id.* at 16:7-11. And he affirmed that the majority of their income came from the excavation business, rather than farming. *Id.* at 23:8-18.

At the conclusion of the testimony, the bankruptcy court stated that it would convert the case to chapter 7. *Id.* at 24:23-24. The bankruptcy court concluded, "it's in the best interest of creditors to convert it. Here I actually think it is." *Id.* at 25:14-17. The bankruptcy court observed that "this debtor has been here for over -- for a goodly number of months . . . he's been parked here . . . keeping a creditor at bay when there was a foreclosure impending while the case was filed. I don't like that kind of conduct." *Id.* at 25:18-24. "There's been no activity in this case and I think just for that reason alone

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[5] An individual may be barred from being a debtor under the Bankruptcy Code for 180 days for the debtor's willful failure to abide by orders of the court or properly prosecute the case, or when the debtor requested and obtained dismissal subsequent to a creditor's request for relief from the automatic stay. 11 U.S.C. § 109(g).

when you come in to [sic] bankruptcy you can’t get out of it all that easily, especially if you have not been honest necessarily or careful with the court.” *Id.* at 25:24-25, 26:1-4. It concluded:

> I don’t know whether it’s a lack of care or dishonesty, but . . . I think this is a case where a Chapter 7 trustee might find lots of very interesting things going on . . . and I think it’s a good place for the creditors to be taken care of under the circumstances.

Id. at 26:4-11. The bankruptcy court entered an order converting the case on November 16, 2010. DE #35.

SUMMARY OF ARGUMENT

The bankruptcy court did not abuse its discretion in converting the Hennens’ chapter 11 bankruptcy case because its finding that conversion was in the best interests of creditors and the estate is supported by the record. First, the United States Trustee and New Market Bank, which holds 87% of the secured debt and 76% of all debt in the Hennens’ case, supported conversion. Furthermore, no other creditor opposed conversion or supported dismissal.

Second, the bankruptcy court concluded, based upon the uncontested allegations of the United States Trustee and New Market Bank, that the Hennens engaged in misconduct during the bankruptcy proceeding and attempted to use the proceedings merely to stall foreclosure, rather than honestly reorganize their farming business. Significantly, the

Hennens offered no evidence, either by way of their verified response or evidence at the hearing, that the allegations were not true.[6]

Third, the bankruptcy court did not clearly err in finding that the Hennens' creditors could benefit from having a chapter 7 trustee maintain oversight of the Hennens' assets. That is because the Hennens engaged in questionable asset transfers immediately before and after commencing their bankruptcy case. Again, the Hennens offered no evidence to the contrary. Thus, those findings are sufficient to support the bankruptcy court's order converting the case.

At trial, the Hennens produced no evidence whatsoever that dismissal would be in the best interest of creditors and the estate, nor can they show that the bankruptcy court failed to adequately consider the interests of the estate when deciding to convert. None of the evidence adduced at the November 16, 2010, hearing contradicts the information provided in the Hennens' schedules, which indicates that the Hennens possessed nearly $5 million of non-exempt assets available for immediate liquidation and distribution to creditors. In fact, the Hennens possessed sufficient assets to pay all creditors in full in a chapter 7 liquidation.

Additionally, the bankruptcy court found that the Hennens' misconduct and misrepresentations warranted conversion to chapter 7 in order to protect the assets of the

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[6] Local Bankruptcy Rule 9013-2(b) requires "[a]ny entity opposing a motion" to file an affidavit, "if facts are at issue." Local Bankruptcy Rule 9001-1(1) defines an "affidavit" to include "a verified motion and a statement endorsed with an unsworn declaration."

estate and the creditors. Therefore, the record fully supports the bankruptcy court's conclusion that conversion to chapter 7 was in the best interests of both the creditors and the estate.

ARGUMENT

I. The bankruptcy court did not abuse its discretion in converting the Hennens' chapter 11 bankruptcy case to one under chapter 7 because their major secured creditor supported conversion, the Hennens engaged in misconduct, and the estate could recover improperly transferred assets in a chapter 7 proceeding.

The Bankruptcy Code provides that, upon finding cause, "the court shall convert a case under this chapter to a case under chapter 7 or dismiss a case under this chapter, *whichever is in the best interests of creditors and the estate*." 11 U.S.C. § 1112(b)(1) (emphasis supplied). Once cause is established, the bankruptcy court enjoys "broad discretion as to whether the case should be converted or dismissed." *Lumber Exch. Bldg. Ltd. P'Ship v. Mut. Life Ins. Co. of New York (In re Lumber Exch. Bldg. Ltd. P'Ship)*, 968 F.2d 647, 648 (8th Cir. 1992). Although the moving party ultimately carries the burden of proof, a party opposing conversion must produce adequate rebuttal evidence in support of its position. *Loop Corp.*, 379 F.3d at 518. A bankruptcy court is not required to accept mere speculation, including self-serving testimony or affidavits, as fact. *Id.*

Determining whether conversion or dismissal serves the best interests of creditors and the estate requires the bankruptcy court to "ascertain the impact on the creditors and on the estate of each of the options." *Rollex Corp. v. Associated Materials, Inc. (In re Superior Siding & Window, Inc.)*, 14 F.3d 240, 243 (4th Cir. 1994). First, when evaluating the best interests of creditors, a court should compare "the creditors' interests in bankruptcy with those they would have under state law." *Id.* Furthermore, the bankruptcy court should "consider the interests of *all* creditors." *Id.* (emphasis in original); *see Shulkin Hutton, Inc. v. Treiger (In re Owens)*, 552 F.3d 958, 961 (9th Cir. 2009) (finding dismissal, rather than conversion, appropriate where the debtor was profitable and had the ability to repay creditors outside of bankruptcy). The principle of equality among similar creditors is "central to the Bankruptcy Code" and "is one of the factors to be considered in determining the 'best interest of the creditors' under section 1112(b)." *Rollex Corp.*, 14 F.3d at 243.

Second, "[t]he element of the best interest of the estate focuses upon whether the economic value of the estate is greater inside or outside of bankruptcy." *In re Staff Inv. Co.*, 146 B.R. 256, 261 (Bankr. E.D. Cal. 1992); *see In re OptInRealBig.com, LLC*, 345 B.R. 277, 290 (Bankr. D. Colo. 2006) (finding that dismissal, rather than conversion, was in the best interest of the estate because the chapter 11 debtor was profitable and would be more valuable as a going concern outside of bankruptcy than it would be to liquidate the company under chapter 7). "When a court determines that a debtor's economic value is likely to be greater by dismissing the case rather than converting it, the court maximizes the opportunity of individual creditors to recover their claims." *OptInRealBig.com*, 345 B.R. at 290.

When evaluating this factor, it is important to recognize that the interests of the debtor and the estate are not the same. Significantly, the best interests of the debtor is not a factor under section 1112(b). *Staff Inv. Co.*, 146 B.R. at 261. "Persons in control of the debtor commonly have other interests that are inconsistent with vigorous maximization of the value of the economic enterprise." *Id.*

Also, when considering whether to dismiss or convert a case, a bankruptcy court may consider the debtor's misconduct and mismanagement in the bankruptcy case. *Reagan v. Wetzel (In re Reagan)*, 403 B.R. 614, 622 (B.A.P. 8th Cir. 2009). In *Reagan*, the panel affirmed a bankruptcy court order converting a case, over the opposition of the debtor, based on the debtor's mismanagement of the estate, including the failure to file operating reports and misuse of estate funds. *Id.* Conversion was necessary because it was preferable for the assets of the estate to be overseen by a trustee rather than the debtor. *Id.* Furthermore, conversion had been particularly appropriate because the debtor "had filed her chapter 11 petition voluntarily, her estate had benefitted from the automatic stay and staved off creditors for four years, and . . . she should not be able to walk away from the bankruptcy now that she felt it did not suit her purposes." *Id.*

This factor is particularly important when there are actions available only in a chapter 7 case that could inure to the benefit of the creditors. "As the trustee's powers to recover property are generally greater than [what] would be available outside of bankruptcy, this factor tends to favor conversion where there is not continuing revenue-generating activity." *Staff Inv. Co.*, 146 B.R. at 261; *see In re Citi-Toledo Partners*, 170 B.R. 602, 609 (Bankr. N.D. Ohio 1994) ("[T]he fact that creditors will likely enjoy greater rights in bankruptcy court than they would enjoy in state court militates in favor of conversion.”).

Here, the bankruptcy court’s determination that conversion was in the best interests of the creditors and the estate is well-supported by the record. First, New Market Bank — the secured creditor with an $850,000 secured claim representing 87% of all secured debt and 76% of all debt in the Hennens’ case — supported conversion, and no other creditors supported dismissal. DE #31 at 2. This supports conversion over dismissal because (a) all of the creditor’s preferences would be satisfied, *Rollex Corp.*, 14 F.3d at 243; and (b) the creditor with the most substantial interest in the case supports conversion. *Staff Inv. Co.*, 146 B.R. at 261.

Second, the record shows that the Hennens engaged in misconduct during their chapter 11 case. Specifically, the Hennens failed to provide information reasonably requested by the United States Trustee. DE #25 at 3. They failed to correct significant errors contained in documents filed with the bankruptcy court. *Id.*; *see* DE #4 at 20, 29 (requiring debtor to attest to accuracy of those documents under penalty of perjury). They did not present proof that they maintained adequate insurance on their properties, as required by statute. DE #25 at 3-4; *see* §§ 363(e), 1112(b)(4)(C). And they used the case as a mechanism to stall New Market Bank’s foreclosure proceedings. *Tr.* at 25:18-25, 26:1-2. In particular, the bankruptcy court looked askance at the Hennens’ “parking” of the case in chapter 11 to keep New Market Bank “at bay” when foreclosure was imminent. *Id.* These facts show that the interests of the estate support conversion over dismissal because it would allow a chapter 7 trustee to preserve the property of the estate, and effectively and expeditiously liquidate property of the estate for the benefit of creditors. *Reagan*, 403 B.R. at 622.

Third, the Hennens' assets could be liquidated quickly to satisfy all claims in the case. *See* DE #25 at 5; DE #31 at 2. The Hennens' schedules indicate that their non-exempt, unencumbered assets total $4,727,600, and their unsecured claims total $133,123.56. DE #4 at 2-6, 11-13; DE #8. Outside of bankruptcy, the Hennens' creditors would rush to judgment to seize these assets. Converting, rather than dismissing, the case supports "the policy of equality of distribution" for all creditors because the chapter 7 trustee could execute a swift, orderly liquidation of the assets and satisfy all of the claims against the estate. *Rollex*, 14 F.3d at 243.

Fourth, the Hennens' monthly operating reports demonstrate net losses of at least $5,310 during the pendency of the case. DE #31 at 2; DE #17 at 6; DE #22 at 6; DE #30 at 6. That the estate was operating at a loss while under the protection of the automatic stay supports conversion over dismissal because it allows the property of the estate to be quickly and effectively distributed to creditors before the operating losses further diminish the assets available to satisfy the outstanding debts. *Staff Inv. Co.*, 146 B.R. at 261.

Fifth, the Hennens engaged in questionable transfers and uses of estate property. For example, in one of their monthly operating reports, the Hennens disclosed a $3,500 post-petition transfer as an "other cash receipt" and $17,292.30 in bank withdrawals for no apparent purpose. *See* DE #31 at 2-3. The Hennens offered no explanation or rebuttal to such facts.

Therefore, the bankruptcy court properly recognized the potential for significant recoveries of such questionable transfers in a chapter 7 case. *Tr.* at 26:7-11. The opportunity for the chapter 7 trustee to recover those assets supports conversion over dismissal because "the economic value of the estate is greater inside" the bankruptcy case, thereby providing a benefit to both the estate and its creditors. *Staff Inv. Co.*, 146 B.R. at 261. This is particularly true when the estate is not generating other revenue, like the estate here. *Id.*

Sixth, conversion is the most equitable outcome. The Hennens used the automatic stay to stave off their major secured creditor, rather than to make a good faith effort to reorganize their financial affairs and repay their creditors. *Tr.* at 25:18-25, 26:1-6. Conversion is an appropriate outcome where a debtor voluntarily files for bankruptcy, obtains a significant benefit at the creditors' expense, and seeks to walk away when the bankruptcy no longer suits the debtor's purpose. *Reagan*, 403 B.R. at 622. Here, dismissal would be in the interest of the Hennens, not the estate and the creditors, because it would validate the Hennens' dilatory tactics.

On appeal, the Hennens maintain that "liquidation would require expensive administrative costs" and that creditors could simply pursue their claims in state court. Appellant's Br. at 9-10. But the Hennens presented no evidence of this below, nor is there anything in the record to indicate that the administrative costs of a chapter 7 liquidation would be more expensive and time consuming — for both the Hennens and their creditors — than the multiplicity of state court proceedings that would follow after dismissal.

In short, the Hennens did not "produce adequate rebuttal evidence in support of their position." *Loop*, 379 F.3d at 518. They provided no evidence that the estate would be larger if the case were dismissed, rather than converted. They provided no evidence that an independent fiduciary, such as the chapter 7 trustee, was not necessary to investigate their assets and impartially liquidate the estate. Therefore, they cannot show that the bankruptcy court abused its discretion when it found that conversion was in the best interests of the creditors and the estate.

II. The bankruptcy court was not required to make specific factual findings on whether conversion was in the best interests of the estate separate from whether conversion was in the best interests of creditors.

The Hennens also contend that reversal is necessary because the bankruptcy court only considered the best interests of the creditors and failed to make a specific finding that conversion was in the best interests of the estate. Appellant's Br. at 10. That argument is without merit because the bankruptcy court is not required to make specific and distinct findings solely on the best interests of the estate when deciding whether conversion or dismissal is appropriate.

For over thirty years, the law of the Eighth Circuit has been settled. When it is clear from the record that the trial court considered the appropriate factors when reaching a decision, the failure to use "magic words" does not constitute reversible error. *United States v. Evans,* 697 F.2d 240, 249 (8th Cir. 1983).

This principle applies equally to bankruptcy courts. A bankruptcy court need not set forth extensive findings of fact to support its decision to convert a bankruptcy case. *Loop Corp.*, 379 F.3d at 519. In *Loop,* the Eighth Circuit affirmed a conversion order where the bankruptcy court merely "listed the reasons it considered Chapter 7 to be preferable to Chapter 11." *Id.* In fact, the *Loop* court further observed that a bankruptcy court's factual findings may be sufficient even when it consists of a single sentence. *Id.* (citing *In re Fossum*, 764 F.2d 520, 521-22 (8th Cir. 1985)). Consistent with this principle, the Eighth Circuit has repeatedly affirmed section 1112(b) orders when the bankruptcy court has articulated a cognizable reason based in the record. *See, e.g., Cedar Shore Resort, Inc. v. Mueller (In re Cedar Shore Resort, Inc.)*, 235 F.3d 375, 381-82 (8th Cir. 2000) (affirming dismissal based on equitable grounds); *Lumber Exch.*, 968 F.2d at 648 (affirming dismissal based solely on the finding that the case was "substantially a single liability case").

Here, the record shows that the bankruptcy court considered both the interest of the creditors and the estate. The bankruptcy court believed chapter 7 was "a good place for the creditors to be taken care of under the circumstances." *Tr.* at 26. This shows that the court considered the best interests of the creditors. *See Rollex Corp.,* 14 F.3d at 243 (emphasizing the importance of the creditor's preferences).

The court also observed that "this is a case where a Chapter 7 trustee might find lots of very interesting things going on." *Tr.* at 26. This shows that the court considered the best interests of the estate. *See Staff Inv. Co.*, 146 B.R. at 261 (explaining that the ability for a chapter 7 trustee to recover assets supports conversion over dismissal). Therefore, the bankruptcy court did not abuse its discretion when it entered the conversion order.

Additionally, this Court may affirm on any basis supported by the record. *Schoelch v. Mitchell*, 625 F.3d 1041, 1046 (8th Cir. 2010). As explained above, the record shows that conversion was in the interests of both the creditors and the estate. *See supra* Part I. Thus, the bankruptcy court's order may be affirmed on this basis as well.

CONCLUSION

For these reasons, the United States Trustee respectfully asks this Court to affirm the order entered by the bankruptcy court.

Dated: February 4, 2011

HABBO G. FOKKENA
UNITED STATES TRUSTEE
REGION 12

BY: /e/ Robert B. Raschke
Robert B. Raschke
Assistant United States Trustee
MN Atty. No. 161081
/e/ Colin Kreuziger
Colin Kreuziger
Trial Attorney
MN Atty. No. 0386834

Office of U.S. Trustee
1015 U.S. Courthouse
300 South Fourth Street
Minneapolis, MN 55415
TEL: (612) 334-1350
FAX: (612) 335-4032

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MINNESOTA

CASE NO. 11-26

In re MICHAEL C. HENNEN and CRYSTAL L. HENNEN,
Debtors.

MICHAEL C. HENNEN and CRYSTAL L. HENNEN,
Appellants,

v.

UNITED STATES DEPARTMENT OF JUSTICE,
Appellee.

ON APPEAL FROM THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF MINNESOTA
BANKRUPTCY CASE NO. 10-34079

UNSWORN CERTIFICATE OF SERVICE

I, Audrey Williams, declare under penalty of perjury that on February 4, 2011, I served copies of the Brief of Appellee United States Trustee and Certificate of Compliance with Local Rule 7.1, electronically by Notice of Electronic Filing, and upon all parties who have requested service in these cases by filing the same via ECF with the

United States District Court, District of Minnesota, and/or upon the following by first class mail postage pre-paid:

Michael A Weber
Weber Law Group PA
900 IDS Center
80 South 8th Street
Minneapolis, MN 55402

Dated: February 4, 2011 BY: /e/ Audrey Williams
Audrey Williams
Office of the United States Trustee

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MINNESOTA

CASE NO. 11-26

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v.

UNITED STATES DEPARTMENT OF JUSTICE,
Appellee.

ON APPEAL FROM THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF MINNESOTA
BANKRUPTCY CASE NO. 10-34079

CERTIFICATION OF COMPLIANCE WITH LOCAL RULE 7.1

I, Colin Kreuziger, certify that the Brief of Appellee Office of United States Trustee complies with Local Rules 7.1(d) and 7.1(f) of the District Court for the District of Minnesota and Local Rule 8010-3 of the Bankruptcy Court for the District of Minnesota.

I further certify that this brief was prepared using Corel WordPerfect X5, and that this processing program has been applied specifically to include all text, including headings, footnotes, and quotations, but excluding the cover sheet, table of contents, table of authorities, signature line, and certificates of counsel, in preparing the following word count.

I further certify that this brief contains 5,003 words.

I further certify that the type size used in this brief is font size 13.

Dated: February 4, 2011

BY: /e/ Colin Kreuziger
Colin Kreuziger
Trial Attorney
Office of U.S. Trustee
1015 U.S. Courthouse
300 South Fourth Street
Minneapolis, MN 55415
TELE: (612) 334-1350
FAX: (612) 335-4032
MN Atty. No. 0386834

BRIEF BANK — 'SUMMARY SHEET" *Printed Tue-7/17/07 13:45*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE
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Hersh v. US

2. ("CO") ***CURRENT*** COURT
[E.g., "CTA9"]
CTA 5th

3. ("CCN") ***CURRENT*** CASE NO.
No.: 07-10226, 07-10265

4. ("PCN") ***PRIOR*** CASE NO. & COURT
[IF ANY]
No.: 05-2330
Court: US District Court for the Northern District of Texas
(Identify judge & cite, if any)

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U.S. TRUSTEES

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Mark Stern and Mark R. Freeman
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") ● ***SUMMARY*** OF KEY ISSUE(s)
&
√ Any Miscellaneous ***BACKGROUND***

● Whether 11 U.S.C. § 526(a)(4), which provides that attorneys and other bankruptcy professionals should not advise clients to take on additional debt in contemplation of filing a bankruptcy petition, violates the First Amendment.

√ **Background:**

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Nos. 07-10226, 07-10265

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

SUSAN B. HERSH,

Plaintiff-Cross-Appellant,

v.

UNITED STATES OF AMERICA,

Defendant-Appellant.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF TEXAS

BRIEF FOR APPELLANT UNITED STATES OF AMERICA

PETER D. KEISLER
Assistant Attorney General

RICHARD B. ROPER, III
United States Attorney

MARK B. STERN
(202) 514-5089
MARK R. FREEMAN
(202) 514-5714
Attorneys, Appellate Staff
Civil Division, Room 7531
Department of Justice
950 Pennsylvania Ave., N.W.
Washington, D.C. 20530-0001

STATEMENT REGARDING ORAL ARGUMENT

Because the district court has held a statute of the United States unconstitutional, the government respectfully urges that oral argument is appropriate.

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STATEMENT REGARDING ORAL ARGUMENT

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UNITED STATES OF AMERICA,

Defendant-Appellant.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF TEXAS

BRIEF FOR APPELLANT UNITED STATES OF AMERICA

STATEMENT OF JURISDICTION

Plaintiff invoked the jurisdiction of the district court under 28 U.S.C. § 1331. CR181 (RE3, at ¶ 1).[1] The district court entered final judgment on December 15, 2006. CR282 (RE5). The United States filed a notice of appeal on February 12, 2007, within the time provided by Fed. R. App. P. 4(a)(1)(B). CR285 (RE6). Plaintiff filed a timely notice of cross-appeal on February 23, 2007. CR288 (RE7). This Court has jurisdiction pursuant to 28 U.S.C. § 1291.

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[1] “CR” denotes a citation to the Clerk’s Record. “RE” denotes a citation to the United States’s record excerpts.

STATEMENT OF THE ISSUE

Whether 11 U.S.C. § 526(a)(4), which provides that attorneys and other bankruptcy professionals should not advise clients to take on additional debt in contemplation of filing a bankruptcy petition, violates the First Amendment.

STATEMENT OF THE CASE

As part of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23 (2005), Congress provided that attorneys and other professionals should not advise clients to take on additional debt in contemplation of filing a bankruptcy petition. See 11 U.S.C. § 526(a)(4). Plaintiff, an attorney who represents debtors in bankruptcy, filed this facial challenge to section 526(a)(4) and to 11 U.S.C. § 527, which requires attorneys to make certain disclosures to clients. The district court dismissed plaintiff's challenge to section 527, but held that section 526(a)(4) is unconstitutionally overbroad and potentially limits an attorney's ability to provide a client with her best advice. The United States appealed from the order invalidating section 526(a)(4), and plaintiff cross-appealed.[2]

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[2] Relying in part on the decision of the district court in this case, district courts in three other circuits have held that section 526(a)(4) violates the First Amendment. See Zelotes v. Martini, 352 B.R. 17 (D. Conn. 2006), appeal docketed, No. 07-1853 (2d Cir.); Milavetz, Gallop & Milavetz P.A. v. United States, 355 B.R. 758 (D. Minn. 2006), appeal docketed, No. 07-
(continued...)

STATEMENT OF FACTS

A. Statutory Background

1. In the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, Congress enacted “a comprehensive package of reform measures” designed “to improve bankruptcy law and practice by restoring personal responsibility and integrity in the bankruptcy system and ensure that the system is fair for both debtors and creditors.” H.R. Rep. No. 109-31, pt. 1, at 2 (2005), reprinted in 2005 U.S.C.C.A.N. 88, 89 (“House Report”). Described by Congress as “the most comprehensive set of [bankruptcy] reforms in more than 25 years,” id. at 3, the Act both modifies the substantive standards for bankruptcy relief and adopts a variety of new measures intended to curb abusive practices that Congress concluded had come to pervade the bankruptcy system.

As part of this reform package, Congress established certain minimum standards of professional conduct for attorneys and other bankruptcy professionals — collectively termed “debt relief agencies” — who provide for-profit services to consumer debtors.

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[2] (...continued)
2405 (8th Cir.); Olsen v. Gonzales, 350 B.R. 906 (D. Or. 2006) (final judgment not yet entered). Several additional challenges to the statute are pending in other district courts. See, e.g., Conn. Bar Ass'n v. United States, No. 06-729 (D. Conn.); In re Reyes, No. 07-20689 (S.D. Fla.).

See 11 U.S.C. § 101(12A) (definition of "debt relief agency").[3] Misleading and abusive practices by such professionals, Congress determined, had become a substantial cause of unnecessary bankruptcy petitions and, in some circumstances, jeopardized debtors' ability to obtain a discharge of their debts. For example, Congress heard evidence that a civil enforcement initiative undertaken by the United States Trustee Program had "consistently identified * * * misconduct by attorneys and other professionals" as among the sources of abuse in the bankruptcy system. House Report, at 5 (citation omitted). Congress therefore responded in the 2005 Act by "strengthening professionalism standards for attorneys and others who assist consumer debtors with their bankruptcy cases." Id. at 17.

2. The new standards enacted by Congress are principally set forth in 11 U.S.C. §§ 707 and 526-528.[4] Section 707, as amended by the 2005 Act, now requires bankruptcy attorneys to make their own reasonable investigation into the circumstances giving rise to the debtor's petition, including a specific

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[3] The term "debt relief agency" includes "any person" who, for a fee, "provides any bankruptcy assistance to an assisted person." 11 U.S.C. § 101(12A). "Bankruptcy assistance," in turn, is defined to include "providing legal representation." Id. § 101(4A). An "assisted person" is "any person whose debts consist primarily of consumer debts and the value of whose nonexempt property is less than $164,250." Id. § 101(3); cf. id. § 104(a) (adjustment of dollar figures).

[4] For the Court's convenience, these provisions are reproduced in full in an addendum to this brief.

inquiry into the veracity of the debtor’s debt and asset schedules. See 11 U.S.C. § 707(b)(4)(C)-(D). The legislation further requires that the attorney certify that she has determined that the petition does not constitute an “abuse” under section 707(b). See ibid.

Sections 527 and 528 set forth several interrelated disclosure requirements. Section 527 requires debt relief agencies to provide specific notices to clients, including a description of the different types of relief available in the bankruptcy system. Section 528(a) similarly requires debt relief agencies to provide clients with written contracts that clearly explain the services that will be provided and the fees that will apply, while section 528(b) requires debt relief agencies to make related disclosures in their advertisements to the public.

Section 526 lays down four basic rules of professional conduct. Section 526(a)(1) requires debt relief agencies to perform all promised services. Section 526(a)(2) prohibits debt relief agencies from advising an assisted person to make statements that are untrue or misleading in seeking bankruptcy relief. Section 526(a)(3) precludes debt relief agencies from misrepresenting the services they will provide, the benefits that will accrue, or the risks that may be entailed in filing for bankruptcy.

Section 526(a)(4), the provision at issue in this appeal, states:

> A debt relief agency shall not * * * advise an assisted person or prospective assisted person to incur more debt in contemplation of such person filing a case under this title or to pay an attorney or bankruptcy petition preparer fee or charge for services performed as part of preparing for or representing a debtor in a case under this title.

11 U.S.C. § 526(a)(4).

The primary remedy for violations of these sections is a civil action by the debtor, or by the relevant state attorney general, to recover actual damages to the debtor. See 11 U.S.C. § 526(c)(2) & (c)(3). A bankruptcy court may impose an "appropriate civil monetary penalty" if it finds intentional violations of these provisions or a clear and consistent practice of violations. Id. § 526(c)(5).

B. Facts and Prior Proceedings

1. Plaintiff Susan B. Hersh is an attorney who represents consumer debtors in bankruptcy. CR198-CR199. Shortly after the 2005 Act became effective, Hersh filed this suit against the United States, seeking declaratory and injunctive relief to prohibit federal officials from enforcing the Act's professional conduct provisions against licensed attorneys.[5] See CR7-CR11

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[5] Although the complaint also named the State of Texas as a defendant, Hersh's claims against Texas were dismissed for failure to effect service of process. CR282 (final judgment).

(complaint). Hersh amended her complaint to allege that attorneys are not “debt relief agencies” within the meaning of the Bankruptcy Code. CR24 (First Am. Compl., ¶ 10). She further claimed that, to the extent attorneys are considered debt relief agencies, the professional conduct restrictions in section 526(a)(4) and the disclosure requirements of section 527 violate the First Amendment.[6] Finally, Hersh contended that both provisions unconstitutionally invade her clients’ Fifth Amendment right to counsel in a civil matter. CR24.

2. In July 2006, the district court dismissed Hersh’s challenge to section 527, as well as her effort to assert Fifth Amendment claims on behalf of her prospective clients, but refused to dismiss Hersh’s First Amendment challenge to section 526(a)(4). See CR165-CR179 (RE2); Hersh v. United States, 347 B.R. 19 (N.D. Tex. 2006).

As a threshold matter, the district court found that the “plain meaning” of the Bankruptcy Code forecloses Hersh’s

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[6] Hersh’s initial complaint purported to challenge sections 527 and 528. See CR9-CR10 (Compl. ¶¶ 6, 10, 14). Subsequent filings made clear that she was in fact challenging sections 526(a)(4) and 527, and both parties litigated the case as though the latter two provisions were principally at issue. See, e.g., CR125; CR40 n.1. The district court likewise focused on those provisions in ruling on the government’s motion to dismiss. See CR166 n.1. Hersh later amended her complaint formally to challenge sections 526(a)(4) and 527. See CR182-CR183 (RE3, at ¶¶ 6, 12-18).

assertion that the term “debt relief agency” does not encompass attorneys. See 347 B.R. at 22-23.

The district court also rejected Hersh’s constitutional challenge to the disclosure requirements of section 527, reasoning that the government “has a legitimate interest in attempting to ensure that a client is informed of certain basic information before he or she commences a case in bankruptcy.” Id. at 27. The court further held that Hersh lacks standing to challenge the debt relief agency provisions as an infringement on her prospective clients’ Fifth Amendment right to counsel. Id. at 28.

The district court declined, however, to dismiss Hersh’s challenge to section 526(a)(4), which the court regarded as facially invalid under the First Amendment. The court did not dispute that Congress designed section 526(a)(4) to “end the manipulation of the [bankruptcy] system by certain filers who took on additional debt prior to bankruptcy.” 347 B.R. at 24. Nevertheless, in the court’s view, section 526(a)(4) “prevents lawyers from giving their clients their best advice,” because in some cases “taking on more debt could be the most financially prudent option for someone considering bankruptcy.” Ibid. The court reasoned that, for example, a person contemplating bankruptcy might want to “refinanc[e] [her debts] at a lower rate to reduce payments and forestall or even prevent entering bankruptcy." Ibid. Alternatively, a person might want to "tak[e] on secured debt such as [a] loan on an automobile that would survive bankruptcy and also enable the debtor to continue to get to work and make payments." Ibid.

3. In December 2006, the district court granted plaintiff's motion for summary judgment and issued a permanent injunction barring the United States from enforcing section 526(a)(4). CR282-CR283 (RE5). These appeals followed.

SUMMARY OF ARGUMENT

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 contains a range of measures designed to curb abuses of the bankruptcy system, both by debtors and by the professionals who represent them. A principal concern of the legislation was to address the recurring problem of debtors' incurring new debt in contemplation of filing a bankruptcy petition in order to take advantage of the Bankruptcy Code's discharge provisions or otherwise manipulate its protections. In addition to other measures, the 2005 Act restricts the ability of debtors to discharge such debt and expands the authority of bankruptcy courts to dismiss petitions for abuse of the bankruptcy system, including in cases in which debtors abuse the Code by taking on additional debt in contemplation of filing a petition.

Congress also addressed the responsibilities of attorneys and other professionals for ensuring that bankruptcy filings do not abuse the Code. The legislation thus seeks to enhance standards of professional conduct in the bankruptcy bar by imposing a duty on bankruptcy attorneys to certify that the petitions filed by their clients do not constitute an abuse of the Code, and by authorizing bankruptcy courts to impose sanctions for violations of that duty.

Section 526(a)(4), at issue in this suit, complements this duty by requiring an attorney not to advise a client to “to incur more debt in contemplation of” filing a petition for bankruptcy relief. 11 U.S.C. § 526(a)(4). As the district court did not dispute, this provision, like other provisions in the 2005 Act, is designed to “end the manipulation of the [bankruptcy] system by certain filers who took on additional debt prior to bankruptcy.” 347 B.R. at 24.

The district court did not suggest that debtors can properly take on additional debt to manipulate the bankruptcy system, or that attorneys are constitutionally entitled to encourage them to do so. Nevertheless, the district court concluded that section 526(a)(4) is fatally overbroad because it believed that the provision encompasses even advice to engage in conduct consistent with the Bankruptcy Code and the client’s legitimate interests.

That reading extends section 526(a)(4) far beyond Congress’s purpose. A statute should be construed to avoid, rather than to invite, constitutional difficulties. In precluding attorneys from urging their clients to take on additional debt “in contemplation of” a bankruptcy filing, Congress was concerned only with debt purposefully accumulated in order to manipulate the bankruptcy system. Neither the language of the statute nor relevant legislative history warrants the district court’s assumption that section 526(a)(4) would restrict a lawyer from offering candid advice on the legality of a debtor’s proposed course of conduct, nor that it would prohibit an attorney from urging a client to take actions consistent with the Bankruptcy Code and the client’s best interests.

Indeed, the principal remedies provided by Congress for violations of section 526(a)(4) — suits for “actual damages” suffered by the debtor — presuppose that the client has, in fact, been injured by the attorney’s advice. As these remedies reflect, section 526(a)(4) is directed to the very kind of abusive accumulation of additional debt that can trigger penalties against the debtor under the Code, including dismissal of the petition or denial of a discharge. The statute has no apparent application to good-faith advice to engage in conduct consistent with the Code and the client’s interests, and the district court erred in reading the statute to encompass such circumstances.

The district court’s analysis also departs from basic principles of overbreadth analysis. Even outside the context of regulations governing attorneys and other closely regulated professions, a facial challenge may succeed only when the asserted overbreadth is both real and substantial in relation to the statute's legitimate goals. The district court did not question that the statute would be constitutional in many of its applications even under the court's own broad reading. The court articulated no basis for striking down the statute on its face, and indeed, enjoined enforcement even of the aspects of section 526(a)(4) that plaintiff has not challenged.

STANDARD OF REVIEW

A facial challenge to the constitutionality of a statute presents a question of law subject to de novo review. United States v. Bredimus, 352 F.3d 200, 203 (5th Cir. 2003).

ARGUMENT

CONGRESS CONSTITUTIONALLY REGULATED THE CONDUCT OF BANKRUPTCY PROFESSIONALS BY PRECLUDING THEM FROM ENCOURAGING CLIENTS TO ABUSE THE BANKRUPTCY SYSTEM BY TAKING ON ADDITIONAL DEBT IN CONTEMPLATION OF FILING A PETITION.

Congress adopted section 526(a)(4) in the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 as one of several measures designed to "end the manipulation of the [bankruptcy] system by certain filers who took on additional debt prior to bankruptcy." 347 B.R. at 24. Among other reforms, the 2005 Act both expanded the authority of the bankruptcy courts to dismiss petitions for abuse and required bankruptcy attorneys affirmatively to certify that no basis exists for deeming their clients’ petitions abusive. Section 526(a)(4) complements these reforms by precluding bankruptcy professionals from encouraging their clients to abuse the bankruptcy system by incurring new debt in anticipation of filing a petition. Because the First Amendment does not disable Congress from regulating the professional conduct of bankruptcy attorneys in this manner, the district court’s judgment with respect to section 526(a)(4) should be reversed.

A. The 2005 Act Addresses Abuses Of The Code By Debtors Who Incur New Debt In Anticipation Of Bankruptcy And By Attorneys Who Encourage Clients To Engage In Such Conduct.

1. Abuses Of The System By Debtors Incurring Additional Debt In Contemplation Of Bankruptcy.

A principal purpose of the 2005 legislation was to curb a variety of abusive practices by consumer debtors and their representatives that Congress concluded had come to pervade the bankruptcy system. Among the primary abuses that Congress sought to address is the problem of debtors attempting to exploit the Code’s discharge provisions, or otherwise manipulate the bankruptcy system, by purposefully accumulating additional debt in contemplation of filing a petition for bankruptcy.

Congress had long been aware that this practice poses a fundamental threat to the Code’s twin goals of affording debtors a fresh start while providing an orderly and equitable system of resolving creditors’ claims. For example, when Congress enacted 11 U.S.C. § 523(a)(2)(C), which creates a presumption that certain eve-of-bankruptcy debts are not dischargeable, the accompanying Senate Report emphasized that “[e]xcessive debts incurred within a short period prior to the filing of the petition present a special problem: that of ‘loading up’ in contemplation of bankruptcy.” S. Rep. No. 98-65, at 9 (1983). The report explained that “[a] debtor planning [to] file a petition with the bankruptcy court has a strong economic incentive to incur dischargeable debts for either consumable goods or exempt property,” noting that “[i]n many instances, the debtor will go on a credit buying spree in contemplation of bankruptcy at a time when the debtor is, in fact, insolvent.” Ibid. As the report concluded, “[n]ot only does this result in direct losses for the creditors that are the victims of the spree, but it also creates a higher absolute level of debt so that all creditors receive less in liquidation. During this period of insolvency preceding the filing of the petition, creditors would not extend credit if they knew the true facts.” Ibid. Indeed, as early as 1973, Congress was informed that “the most serious abuse of consumer bankruptcy is the number of instances in which individuals have purchased a sizable quantity of goods and services on credit on the eve of bankruptcy in contemplation of obtaining a discharge.” Report of the

Commission of the Bankruptcy Laws of the United States, H.R. Doc. No. 93-137, Part I, at 11 (July 1973).

In adopting the 2005 Act, Congress expressed concern that these earlier measures had not adequately restricted the ability of debtors to "knowingly load up with credit card purchases or recklessly obtain cash advances and then file for bankruptcy relief." House Report at 15. Accordingly, Congress took a series of new steps in the 2005 Act to combat the problem of debts incurred in contemplation of bankruptcy. Thus, the Act reduced the threshold amounts at which certain types of eve-of-bankruptcy debts, such as cash advances, become presumptively fraudulent and therefore nondischargeable.[7] See Pub. L. No. 109-8, § 310, 119 Stat. at 84 (amending 11 U.S.C. § 523(a)(2)(C)).

More fundamentally, Congress greatly expanded the authority of the bankruptcy courts to dismiss petitions for abuse of the bankruptcy system, including in cases in which debtors abuse the Code by purposefully incurring additional debt in contemplation of filing a petition. Even before the 2005 legislation, a bankruptcy court was authorized to dismiss a petition for

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[7] One of the factors that bankruptcy courts consider in determining whether a debt is fraudulent and nondischargeable, moreover, is "[w]hether or not an attorney has been consulted concerning the filing of bankruptcy before the charges were made." In re Eashai, 87 F.3d 1082, 1087 (9th Cir. 1996); see also In re Mercer, 246 F.3d 391, 408 (5th Cir. 2001) (en banc) ("whether, prior to card-use, an attorney was consulted about bankruptcy").

"substantial abuse" under former 11 U.S.C. § 707(b)(1). Moreover, it was established that, under the "substantial abuse" standard, a debtor's purposeful accumulation of debt in contemplation of bankruptcy could justify dismissal of the petition. See, e.g., In re Price, 353 F.3d 1135, 1139-40 (9th Cir. 2004) (describing factors relevant to a finding of substantial abuse, including "[w]hether the debtor has engaged in eve-of-bankruptcy purchases"); In re Charles, 334 B.R. 207, 222 (Bankr. S.D. Tex. 2005) ("It is settled law that a debtor's good faith should be questioned if the debtor makes purchases in contemplation of a bankruptcy case."); In re Rathbun, 309 B.R. 901, 904 (Bankr. N.D. Tex 2004); In re Aiello, 284 B.R. 756, 761 (Bankr. E.D.N.Y. 2002).[8]

In the 2005 Act, Congress reduced the threshold finding required under 11 U.S.C. § 707(b) for a bankruptcy court to dismiss a debtor's petition as abusive, from "substantial abuse" to merely "abuse," see House Report at 48, and it repealed the statutory presumption in favor of granting the relief sought by the debtor, see id. at 49; Pub. L. No. 109-8, § 102, 119 Stat. at 27. Congress further made clear that, in determining whether a

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[8] As the Supreme Court recently explained in the context of chapter 13 debtors, bad faith pre-petition conduct by the debtor justifies dismissal of the petition because such a debtor "is not a member of the class of 'honest but unfortunate debtor[s]' that the bankruptcy laws were enacted to protect." Marrama v. Citizens Bank, 127 S. Ct. 1105, 1111 (2007) (quoting Grogan v. Garner, 498 U.S. 279, 287 (1991)).

petition should be dismissed for abuse, a bankruptcy court may properly consider “whether the debtor filed the petition in bad faith” and whether “the totality of the circumstances * * * of the debtor’s financial situation demonstrates abuse.” 11 U.S.C. § 707(b)(3). At the same time, Congress authorized any party in interest — including, for example, unsecured creditors aggrieved by a debtor’s eleventh-hour accumulation of new debt — to file a motion for such relief. See id. § 707(b)(1). Under prior law, only the United States Trustee, or the court on its own motion, could seek to dismiss a petition as abusive.

2. Abuses Of The System By Lawyers And Other Bankruptcy Professionals.

Congress also responded in the 2005 Act to evidence that attorneys and other bankruptcy professionals often played a critical role in abuse of the bankruptcy system. Citing data collected by the U.S. Trustee Program, the House Report noted that the study “consistently identified” among the sources of abuse “misconduct by attorneys and other professionals” and “problems associated with bankruptcy petition preparers.” House Report at 5 (quoting Darling & Redmiles, Protecting the Integrity of the System: the Civil Enforcement Initiative, Am. Bankr. Inst. J. 12 (Sept. 2002)).

The need to address misconduct by bankruptcy professionals was made particularly urgent by the “principal consumer bankruptcy reform” in the 2005 legislation, which was the adoption of a “means testing” mechanism intended to restrict debtors who have the ability to repay at least some of their debts from obtaining a complete discharge under chapter 7. See House Report at 48; see also id. at 3 (describing means testing as the “heart” of the 2005 Act’s reform provisions). Under the new means-testing provision, a debtor’s petition for complete relief under chapter 7 is presumed to be abusive if the debtor’s income exceeds his unsecured debts by a certain ratio. See 11 U.S.C. § 707(b)(2)(A). The effect of the means test is to ensure that debtors who have the ability to repay a portion of their debts are channeled into chapter 13, which provides an opportunity for a structured repayment plan.

As Congress recognized, however, the means test exacerbates the incentive for debtors to manipulate the system by “loading up” on debt in contemplation of filing a petition, because a higher debt ratio can allow an otherwise borderline debtor to avoid the burdens of a chapter 13 repayment plan and obtain a complete and immediate discharge under chapter 7. Concern was expressed at the congressional hearings that attorneys would respond to the means test by counseling their clients to take on additional debt before filing for bankruptcy. As one bankruptcy judge testified, “[t]he more debt that is incurred prior to filing, the more likely the debtor will qualify for chapter 7.” Thus, “[p]erverse as it may seem, I can envision debtor’s counsel advising their clients to buy the most expensive car that someone will sell them, and sign on to the biggest payment they can afford (at least until the bankruptcy is filed) as a way of increasing their deductions under [the means test].” Bankruptcy Reform Act of 1998: Part I, Hearing on H.R. 3150 before House Judiciary Comm., 105th Cong. 25 (1998) (testimony of Judge Randall Newsome).

Congress addressed these problems in the 2005 Act by “strengthening professionalism standards for attorneys and others who assist consumer debtors with their bankruptcy cases” in return for a fee. House Report at 17. Under the amended provisions of the Code, an attorney who represents a consumer debtor in filing a bankruptcy petition must make her own reasonable investigation into the circumstances giving rise to the debtor’s petition, including a specific inquiry into the veracity of the debtor’s debt and asset schedules. See 11 U.S.C. § 707(b)(4)(C)-(D). By signing the petition, the attorney personally certifies that she believes the petition is warranted by the facts, that she has no reason to believe the debtor’s schedules are incorrect, and that she has determined that the petition does not constitute an “abuse” under section 707(b). See ibid. Congress thus effectively required bankruptcy attorneys to warrant that their clients’ pre-petition conduct and financial circumstances — including any assumption of debt in contemplation of bankruptcy — do not provide grounds for dismissal of the petition as abuse of the bankruptcy system.

Two provisions of section 526(a) complement these requirements by precluding attorneys and other “debt relief agencies,” see 11 U.S.C. § 101(12A) (definition), from advising consumer debtors to abuse the bankruptcy system. Section 526(a)(2) prohibits attorneys from encouraging clients to make false statements in a bankruptcy proceeding. Section 526(a)(4), at issue here, precludes attorneys from encouraging their clients to abuse the bankruptcy system by taking on additional debt in contemplation of filing a bankruptcy petition.

B. Section 526(a)(4) Constitutionally Restricts Attorneys From Encouraging Clients To Take On Additional Debt In Contemplation of Bankruptcy.

1. The First Amendment Does Not Preclude Restrictions On Attorney Advice To Engage In Improper Conduct.

The district court did not suggest that the First Amendment bars Congress from restricting attorneys from encouraging their clients to abuse the bankruptcy system. Indeed, it is established that attorneys, like other professionals, are subject to various restrictions in urging their clients to undertake action. See, e.g., ABA Model Rules of Prof. Conduct R. 1.2(d) (“A lawyer shall not counsel a client to engage, or assist a client, in conduct that the lawyer knows is criminal or fraudulent, but a lawyer may discuss the legal consequences of any proposed course of conduct with a client and may counsel or assist a client to make a good-faith effort to determine the validity, scope, meaning, or application of the law”); accord Tex. Discip. R. Prof. Conduct 1.02(c); La. R. Prof. Conduct 1.2(d); Miss. R. Prof. Conduct 1.2(d).

Regulations of professional ethics of this kind do not violate the First Amendment. See Gentile v. State Bar of Nevada, 501 U.S. 1030, 1071-76 (1991) (discussing the standards governing regulation of attorney speech). Indeed, Rule 1.2(d) has been applied to precisely the type of conduct that Congress addressed by section 526(a)(4). See Attorney Grievance Comm'n of Maryland v. Culver, 381 Md. 241, 275-76 (2004) (attorney violated Rule 1.2(d) by advising a client to obtain credit card loans with the intent that the debt be discharged in bankruptcy).

2. Section 526(a)(4) Should Not Be Construed More Broadly Than Necessary To Achieve Congress’s Purpose.

The district court expressed concern, however, that section 526(a)(4) “prevents lawyers from giving their clients their best advice,” because in some cases “taking on more debt could be the most financially prudent option for someone considering bankruptcy.” 347 B.R. at 24. The court reasoned that a person contemplating bankruptcy might want to “refinanc[e] [her debts] at a lower rate to reduce payments and forestall or even prevent entering bankruptcy.” Ibid. Alternatively, a person might want to “tak[e] on secured debt such as [a] loan on an automobile that would survive bankruptcy and also enable the debtor to continue to get to work and make payments.” Ibid. Without analysis, the court thus assumed that the statute would apply to advice by an attorney that is consistent both with the client’s interests and with the policies of the Bankruptcy Code.

Reading the statute in this manner expands its scope far beyond Congress’s purpose to “end the manipulation of the [bankruptcy] system by certain filers who took on additional debt prior to bankruptcy.” 347 B.R. at 24. By providing that a debt relief agency shall not advise a client “to incur more debt in contemplation of such person filing a case under this title,” § 526(a)(4) (emphasis added), Congress addressed only advice to a debtor to accumulate additional debt for the purpose abusing the bankruptcy system, such as by “loading up” on new debt in order to obtain a more advantageous discharge. Like section 526(a)(2), which precludes attorneys from advising clients to make false statements, section 526(a)(4) thus encompasses advice to engage in improper or abusive conduct.

That interpretation follows from Congress’s unmistakable purposes in the 2005 Act. As already discussed, section 526(a)(4) represents only one of many measures in the 2005 Act aimed at preventing abuses of the bankruptcy system by debtors and their professional representatives. Among other significant amendments, Congress enhanced the authority of bankruptcy courts to dismiss petitions as abusive, see 11 U.S.C. § 707(b)(1), expanded the definition of "abuse" to take account of a debtor's bad faith in seeking bankruptcy relief, see id. § 707(b)(3), and specifically required bankruptcy attorneys to investigate the facts underlying a debtor's petition and to certify that no basis exists for dismissing the petition as abusive, see 11 U.S.C. § 707(b)(4)(C)-(D). Against the background of such amendments, it is apparent that Congress intended the phrase "to incur more debt in contemplation of" bankruptcy in section 526(a)(4) as a reference to the recognized problem of debtors purposefully accumulating new debt in an effort to abuse the protections of the Bankruptcy Code. Cf. Report of the Commission of the Bankruptcy Laws of the United States, H.R. Doc. No. 93-137, Part I, at 11 (July 1973) (observing that "the most serious abuse of consumer bankruptcy is the number of instances in which individuals have purchased a sizable quantity of goods and services on credit on the eve of bankruptcy in contemplation of obtaining a discharge" (emphasis added)).

That understanding, moreover, is consistent with Congress's repeated references, in the legislative histories cited above, to debts incurred to manipulate the bankruptcy system as debts incurred "in contemplation of" bankruptcy. See S. Rep. No. 98-65, at 9 ("In many instances, the debtor will go on a credit buying spree in contemplation of bankruptcy at a time when the debtor is, in fact, insolvent" (emphasis added)); see also Consumer Bankruptcy Reform Act of 1998, S. Rep. No. 105-253, at 83 (1998) (minority views) ("Clearly, debtors should not incur debts with the intention not to repay them, e.g., if they know that they are going to file for bankruptcy," but "debts incurred within 90 days prior to filing may not have been incurred in contemplation of bankruptcy, and thus the isolation of these debts for special treatment is somewhat arbitrary."); cf. 18 U.S.C. § 152(7) (prohibiting the fraudulent transfer or concealment of property "in contemplation of a case under title 11"); In re Charles, 334 B.R. at 222 ("It is settled law that a debtor's good faith should be questioned if the debtor makes purchases in contemplation of a bankruptcy case.").

Section 526(a)(4) therefore has no application to the hypothetical conduct that troubled the district court. An attorney would be free to advise a client to refinance her debts at a lower rate to prevent bankruptcy, 347 B.R. at 24,[9] or to

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[9] Indeed, as an initial matter, the district court failed to explain why merely refinancing an existing debt — that is, exchanging one loan for another with the same principal balance but a different interest rate or repayment period — would constitute incurring "more debt" within the meaning of section 526(a)(4). In any event, as explained above, advising a debtor to refinance a debt in order to avoid bankruptcy would not trigger section 526(a)(4), because it would not involve encouraging the debtor to incur unnecessary debt for the purpose of abusing the bankruptcy system.

"tak[e] on secured debt such as [a] loan on an automobile that would survive bankruptcy and also enable the debtor to continue to get to work and make payments," ibid., assuming that the client made all necessary disclosures to the lender. In neither case would the attorney be advising the debtor to incur unnecessary debt for the purpose of abusing the bankruptcy system. Cf. Culver, 381 Md. at 275-76 (attorney violated Rule 1.2(d) by advising a client to obtain credit card loans with the intent that the debt be discharged in bankruptcy).

In other contexts, the phrase "in contemplation of bankruptcy" may reflect the broad scope assumed here by the district court. E.g., Conrad, Rubin & Lesser v. Pender, 289 U.S. 472, 478 (1933) (interpreting bankruptcy provision regarding attorney compensation). Yet the same phrase also has an accepted narrower meaning. See Black's Law Dictionary 336 (8th ed. 2004) (defining "contemplation of bankruptcy" as "the thought of declaring bankruptcy because of the inability to continue current financial operations, often coupled with action designed to thwart the distribution of assets in a bankruptcy proceeding"); see also In re Mercer, 246 F.3d 391, 421 n.43 (5th Cir. 2001) (en banc) (describing "loading up" as the practice of "incurring card debt in contemplation of bankruptcy"); id. at 421 (referring to "a dishonest but patient debtor who intends to incur card-debt in contemplation of discharge”).[10] As the text and purposes of the 2005 Act make clear, it is this narrower sense in which Congress used the phrase in section 526(a)(4).

In any event, the district court erred in adopting the broadest possible reading of the statute without regard to whether it was required by the statutory language and congressional intent. It is fundamental that when “an otherwise acceptable construction of a statute would raise serious constitutional problems,” a federal court must “construe the statute to avoid such problems unless such a construction would be plainly contrary to legislative intent.” Planned Parenthood v. Sanchez, 403 F.3d 324, 341 (5th Cir. 2005) (quoting Edward J. DeBartolo Corp. v. Fla. Gulf Coast Bldg. & Constr. Trades Council, 485 U.S. 568, 575 (1988)) (internal quotation marks omitted). The district court departed from this principle in failing to adopt — or even address — readings of section 526(a)(4) that would avoid the constitutional difficulties that it postulated.

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[10] See also Webster’s Third New International Dictionary 491 (1993) (defining “contemplation” to mean, inter alia, “the act of intending or considering a future event”); Random House Dictionary Unabridged 438 (2d ed. 1987) (“contemplate” means, inter alia, “to have as a purpose; intend”).

3. Section 526(a)(4) Does Not Preclude A Candid Discussion Of Legal Options.

The district court also erred in assuming that section 526(a)(4) would preclude a bankruptcy attorney from providing a candid discussion of a client’s legal options. Rules governing legal practice commonly distinguish between a circumstance in which an attorney “counsels” (or, in this case, “advises”) a course of conduct, and a case in which an attorney simply discusses various options.

Thus, although the ABA Model Rules of Professional Conduct provide that “[a] lawyer shall not counsel a client to engage, or assist a client, in conduct that the lawyer knows is criminal or fraudulent,” the same rule also provides that “a lawyer may discuss the legal consequences of any proposed course of conduct with a client and may counsel or assist a client to make a good-faith effort to determine the validity, scope, meaning, or application of the law.” ABA Model Rule 1.2(d). The commentary to Model Rule 1.2 underscores the point: “There is a critical distinction between presenting an analysis of legal aspects of questionable conduct and recommending the means by which a crime or fraud might be committed with impunity.” ABA Model Rule 1.2, cmt 9. In section 526(a)(4), Congress intended the phrase “advise * * * to incur more debt” in the same sense of affirmative encouragement. Cf. Webster’s Third New International

Dictionary 32 (1993) (defining “advise” to mean, inter alia, “counsel” or “recommend”).

Contrary to the district court’s understanding, therefore, section 526(a)(4) does not “prevent[] lawyers from giving their clients their best advice.” 347 B.R. at 24. Like the model rules, section 526(a)(4) reaches only the conduct of an attorney in affirmatively urging (“advis[ing]”) a client to pursue a particular course of conduct, without impairing the attorney’s ability to offer a candid assessment of the client’s legal options. Cf. ABA Model Rule 1.2, cmt 9 (explaining that the prohibition against advising clients to engage in fraud “does not preclude the lawyer from giving an honest opinion about the actual consequences that appear likely to result from a client's conduct”).

The restriction of section 526(a)(4) thus parallels that of section 526(a)(2), which provides that a debt relief agency shall not “counsel or advise any assisted person or prospective assisted person to make a statement in a document filed in a case or proceeding under this title, that is untrue and misleading.” Congress’s concern in both provisions was not to proscribe ordinary legal advice, but to prevent attorneys and other bankruptcy professionals from becoming the affirmative engines of bankruptcy abuse, thereby both undermining the policies of the Code and jeopardizing their clients’ petitions for relief.

4. The Remedies For Violations of Section 526(a)(4) Are Consistent With Its Purpose Of Restricting Encouragement To Engage In Abusive Conduct That Jeopardizes a Client's Interests.

The remedial provisions of the statute underscore the error of the district court's interpretation. Congress's intent in section 526(a)(4) was to protect consumer debtors from active encouragement by their representatives to engage in conduct that abuses the bankruptcy system and may result in the dismissal of their petition or other sanctions. Consistent with that intent, the principal remedy for a violation of section 526(a)(4) is a suit against the attorney to recover the debtor's "actual damages," as well as restitution of any fees paid by the debtor. See id. § 526(c)(2); see also id. § 526(c)(3)(B) (authorizing suits by state attorney general to recover "actual damages" on debtor's behalf). The power of the bankruptcy court to impose an "appropriate civil penalty" is limited to cases of intentional violations and patterns of misconduct. See id. § 526(c)(5). Congress's emphasis in these provisions on the debtor's "actual damages" presupposes that the debtor has been injured by the attorney's conduct: advice that is in the debtor's best interests and fully consistent with the Bankruptcy Code does not trigger any remedial provision.

Quite apart from section 526(a)(4), moreover, an attorney faces sanctions under the Bankruptcy Code for actively encouraging a debtor to accumulate additional debt in order to facilitate a bankruptcy filing, because the 2005 Act requires attorneys to certify that the petitions filed by their clients are not abusive. As discussed above, the Act imposed a new duty on every bankruptcy attorney make a reasonable investigation into the factual basis for the debtor’s petition (including a reasonable inquiry into the veracity of the debtor’s debt and asset schedules) and to certify that, in the attorney’s judgment, the petition will not be subject to dismissal for abuse. See 11 U.S.C. § 707(b)(4)(C)-(D); see also id. § 707(b)(4)(A)-(B) (authorizing civil monetary penalties against attorneys who make false certifications). At the same time, Congress lowered the standard for dismissing a petition as abusive, and it made clear that a bankruptcy court, in determining whether to grant such a motion, should consider whether the debtor has acted in bad faith. Id. §§ 707(b)(1), 707(b)(3); cf. In re Charles, 334 B.R. 207, 222 (Bankr. S.D. Tex 2005) (“It is settled law that a debtor's good faith should be questioned if the debtor makes purchases in contemplation of a bankruptcy case.”). Under these circumstances, it is highly unlikely that a bankruptcy attorney could encourage a client to incur unnecessary debts in order to buttress an anticipated bankruptcy filing without herself violating her obligations under the Code. Section 526(a)(4) addresses the increased risk of dismissal resulting from such unethical attorney advice and provides the debtor with remedies against attorneys who encourage abusive conduct.

C. The District Court Failed To Apply Basic Principles of Overbreadth Analysis.

Even outside the context of ethical rules governing attorneys and other closely regulated professions, a statute may not be invalidated on its face solely because of posited concerns raised by some of its potential applications. Instead, “[t]he Court has made clear that facial challenges of this sort can succeed only if there is a significant imbalance between the protected speech the statute should not punish and the unprotected speech it legitimately reaches: ‘[O]verbreadth of a statute must not only be real, but substantial as well, judged in relation to the statute's plainly legitimate sweep.’” Shackelford v. Shirley, 948 F.2d 935, 940 (5th Cir. 1991) (quoting Broadrick v. Oklahoma, 413 U.S. 601, 615 (1973)).

The district court recognized that, even under its own reading of the statute, section 526(a)(4) would be constitutional in many of its applications. The court did not explain why it nevertheless believed facial invalidation was appropriate, even assuming that it was compelled to read the statute to cover instances in which an attorney’s advice to encourage additional debt is fully consistent with the Bankruptcy Code and the client’s interests.

The district court's error is highlighted by its invalidation of section 526(a)(4) in its entirety, without addressing that part of the statute that precludes an attorney from advising a client to incur additional debt in order to pay the attorney's own fees. See 11 U.S.C. § 526(a)(4) ("A debt relief agency shall not * * * advise an assisted person or prospective assisted person to incur more debt * * * to pay an attorney or bankruptcy petition preparer fee or charge for services performed as part of preparing for representing a debtor in a case under this title."). Plaintiff makes no allegation that she plans to encourage clients to take on additional debt in order to pay her fees, see, e.g., CR182-CR184 (RE3) (complaint); CR198-CR202 (plaintiff's affidavit in support of summary judgment), and a challenge to that part of the statute was therefore not properly before the district court.

More fundamentally, the district court's willingness to strike down section 526(a)(4) on its face, without addressing this part of the statute, underscores the court's failure to recognize the nature of the issues presented by this facial challenge and to adopt a reading of the statute that avoids constitutional questions to the extent possible. Nothing in the record indicates that the attorneys-fee portion of section 526(a)(4) is fatally overbroad, and the district court identified no reason why that provision should be enjoined (or why Hersh even has standing to challenge it). Nor, as with its analysis of the remainder of the provision, did the court explain why any posited defects could not be addressed by reading the provision to avoid any asserted constitutional difficulties.

CONCLUSION

For the foregoing reasons, the judgment of the district court with respect to the constitutionality of 11 U.S.C. § 526(a)(4) should be reversed.

Respectfully submitted,

PETER D. KEISLER
Assistant Attorney General

RICHARD B. ROPER, III
United States Attorney

MARK B. STERN
(202) 514-5089
MARK R. FREEMAN
(202) 514-5714
Attorneys, Appellate Staff
Civil Division, Room 7531
Department of Justice
950 Pennsylvania Ave., N.W.
Washington, D.C. 20530-0001

JULY 2007

CERTIFICATE OF SERVICE

I hereby certify that on this 13th day of July, 2007, I caused copies of the foregoing brief to be filed with the Court by Federal Express overnight delivery, and caused copies to be served by Federal Express overnight delivery upon the following counsel:

Howard Marc Spector
Law Office of Howard Marc Spector
Banner Place
12770 Coit Rd Suite 1100
Dallas, TX 75251
214-365-5377
hms7@cornell.edu

Mark R. Freeman

CERTIFICATE OF COMPLIANCE WITH RULE 32(a)(7)(C) OF THE FEDERAL RULES OF APPELLATE PROCEDURE

Pursuant to Rule 32(a)(7)(C) of the Federal Rules of Appellate Procedure, I hereby certify that:

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3. ("CCN") ***CURRENT*** CASE NO. No.: 07-10226

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8. ("TO") ***TOPIC*** **BANKRUPTCY**

9. ("SU") ● ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***

●Whether 11 U.S.C. § 526(a)(4), which provides that attorneys and other bankruptcy professionals should not advise clients to take on additional debt in contemplation of filing a bankruptcy petition, violates the First Amendment.

√ **Background:**

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Nos. 07-10226, 07-10265

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

SUSAN B. HERSH,

Plaintiff-Cross-Appellant,

v.

UNITED STATES OF AMERICA,

Defendant-Appellant-
Cross-Appellee.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF TEXAS

COMBINED RESPONSE AND REPLY BRIEF FOR APPELLANT UNITED STATES OF AMERICA

PETER D. KEISLER
Assistant Attorney General

RICHARD B. ROPER, III
United States Attorney

MARK B. STERN
(202) 514-5089
MARK R. FREEMAN
(202) 514-5714
Attorneys, Appellate Staff
Civil Division, Room 7531
Department of Justice
950 Pennsylvania Ave., N.W.
Washington, D.C. 20530-0001

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FOR APPELLANT UNITED STATES OF AMERICA

INTRODUCTION AND SUMMARY

In the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, Congress enacted a series of provisions designed to "strengthen[] professionalism standards for attorneys and others who assist consumer debtors with their bankruptcy cases." H.R. Rep. No. 109-31, pt. 1, at 17. Among them are the measures challenged here, which preclude attorneys from advising their clients to take on additional debt in contemplation of bankruptcy, see 11 U.S.C. § 526(a)(4), and require attorneys to provide debtors with basic factual information about the bankruptcy process, see id. § 527(b).

Notwithstanding Congress's belief that it was adopting these provisions to establish stronger "professionalism standards for attorneys," plaintiff devotes much of her brief to arguing that attorneys are exempt from all of the professional conduct regulations established by the 2005 Act. Her interpretation founders on the plain language of the statute, which makes the professional conduct regulations in the 2005 Act applicable to "any person" who provides paid "legal representation" to consumer debtors. See 11 U.S.C. § 101(4A); id. § 101(12A).

Plaintiff's constitutional claims fare no better. Section 526(a)(4) prohibits an attorney from advising a debtor "to incur more debt in contemplation of such person filing a case under this title." As plaintiff does not dispute, Congress enacted this provision in recognition of the fact that debtors frequently "load up" with new debt on the eve of bankruptcy in an effort to game the bankruptcy system. Plaintiff does not suggest that attorney advice to take on new debt for such a purpose is protected by the First Amendment. Instead, she insists that the statute should be also be construed to apply "in all the varied circumstances where there is a bona fide, good faith, lawful and ethical reason for incurring the debt and where doing so would be in the client's best interest." Br. 20.

That interpretation is neither required by the statutory text nor consistent with Congress's purposes in the 2005 Act. As our opening brief establishes (at 22-24), Congress and the federal courts have frequently described pre-petition debts amassed for improper purposes as debts incurred "in contemplation of" bankruptcy. This Court's en banc decision in In re Mercer, which involved allegedly fraudulent credit-card purchases made prior to bankruptcy, employed the same phrase in the same sense. See 246 F.3d 391, 421 n.43 (5th Cir. 2001) (en banc) (describing "loading up" as the practice of "incurring card debt in contemplation of bankruptcy" (emphasis added)); see also Black's Law Dictionary 336 (8th ed. 2004) (explaining that the phrase "contemplation of bankruptcy" typically connotes "action designed to thwart the distribution of assets in a bankruptcy proceeding"). Plaintiff makes no reference to these authorities, nor does she attempt to explain why this Court should adopt the broadest possible reading of the statute in order to sustain her facial challenge.

On her cross-appeal, plaintiff presses her constitutional challenge to 11 U.S.C. § 527(b), which requires bankruptcy attorneys to provide debtors with a notice that explains basic factual information about the bankruptcy process. Congress enacted section 527(b) in response to evidence that many debtors lacked even the most rudimentary information regarding the bankruptcy system. As the district court concluded, "[t]he government clearly has a legitimate interest in attempting to ensure that a client is informed of certain basic information before he or she commences a case in bankruptcy," and the Supreme Court has repeatedly upheld similar disclosure requirements in other contexts.

The district court properly rejected plaintiff's assertion that section 527(b) requires plaintiff to make false and misleading statements. As the district court explained, plaintiff's contention, at bottom, is that the notice requires elaboration and context. If plaintiff believes this to be the case, nothing in section 527(b) prevents her from providing that elaboration. Indeed, the statute itself provides that the disclosures may be provided in any "substantially similar" form, and are mandatory only "to the extent applicable" in the circumstances.

ARGUMENT

I. CONGRESS ENACTED THE "DEBT RELIEF AGENCY" PROVISIONS OF THE 2005 ACT TO REGULATE ATTORNEYS AS WELL AS OTHER BANKRUPTCY PROFESSIONALS.

1. In enacting the 2005 bankruptcy amendments, Congress was concerned not merely with abuses by debtors, but also with abuses committed by — and at the encouragement of — debtors' professional representatives in the bankruptcy system. See generally Gov. Br. 23-28. Accordingly, as part of "a comprehensive package of reform measures," Congress enacted the "debt relief agency" provisions of the 2005 Act to "strengthen[] professionalism standards for attorneys and others who assist consumer debtors with their bankruptcy cases." H.R. Rep. No. 109-31, pt. 1, at 2, 17 (2005), reprinted in 2005 U.S.C.C.A.N. 88, 89, 103 ("House Report").

Plaintiff nevertheless devotes much of her brief to arguing that attorneys are exempt from all of the professional conduct regulations established by the 2005 Act. As the district court recognized, that contention founders on the plain language of the statute. See 347 B.R. at 22-23. Congress defined the term "debt relief agency" to include "any person" who, for a fee, "provides any bankruptcy assistance to an assisted person." 11 U.S.C. § 101(12A). "Bankruptcy assistance," in turn, includes "providing information, advice, counsel, document preparation, or filing * * * with respect to a case or proceeding under this title," including in particular "appearing in a case or proceeding on behalf of another" or "providing legal representation." Id. § 101(4A) (emphasis added). By its plain terms, therefore, the statute encompasses "any person" who "counsel[s]" or provides "legal representation" to consumer debtors in exchange for a fee — a category that unmistakably includes bankruptcy attorneys.

Congress chose this definition for a reason. As our opening brief explains (at 17-20), Congress enacted the 2005 legislation partly in response to evidence that identified misconduct by attorneys as a source of abusive and unnecessary bankruptcy filings. For example, the House Report accompanying the 2005 Act cited a study that "consistently identified," among the sources of bankruptcy abuse, "misconduct by attorneys and other professionals." House Report at 5 (quoting Darling & Redmiles, Protecting the Integrity of the System: the Civil Enforcement Initiative, 21 Am. Bankr. Inst. J. 12 (Sept. 2002)). Similarly, in adopting the advertising disclosure requirements in section 528, Congress heard evidence of "increasingly aggressive lawyer advertising" that offered to make consumers' debts "disappear," but failed to explain that such relief would require a petition for bankruptcy. See 108th Cong. 55 (2003). Congress responded to these concerns by enacting the debt relief agency provisions to "strengthen[] professionalism standards for attorneys and others who assist consumer debtors with their bankruptcy cases" in return for a fee. House Report at 17 (emphasis added).

2. Plaintiff makes no attempt to reconcile her arguments with this declaration of congressional intent, and her efforts to derive a contrary purpose from the text of the statute fail at every turn.

Plaintiff stresses, for example, that the definition of "debt relief agency" does not expressly mention attorneys. Br. 11-12. The definition does, however, use the term "bankruptcy assistance," which in turn explicitly includes "legal representation." 11 U.S.C. § 101(4A). Plaintiff does not explain why Congress would define "bankruptcy assistance" to include "legal representation" if it meant to exclude lawyers from the statute's scope. Congress was not required to state, in addition, that a statute regulating persons who provide "legal representation" encompasses the very persons who provide such representation. See Heintz v. Jenkins, 514 U.S. 291, 294-95, 298 (1995) (lawyers who engage in debt collection are "debt collectors" under the Fair Debt Collection Practices Act, even though the statute does not specifically refer to lawyers or the practice of law); Goldfarb v. Virginia State Bar, 421 U.S. 773, 787-88 (1975) (noting the "heavy presumption against implicit exemptions," and accordingly refusing to construe the Sherman Act to exempt lawyers).

Equally mistaken is plaintiff's reliance on 11 U.S.C. § 527(b), which requires debt relief agencies to inform debtors that "you can represent yourself, you can hire an attorney to represent you, or you can get help in some localities from a bankruptcy petition preparer who is not an attorney." Ibid. Plaintiff urges that it would be "illogical and absurd" to require attorneys to inform clients of their right to hire an attorney. Br. 12. By the plain terms of the statute, however, the disclosures are mandatory only "to the extent applicable." 11 U.S.C. § 527(b). Moreover, plaintiff's logic would also exclude bankruptcy petition preparers from the definition of "debt relief agency" — even though bankruptcy petition preparers are expressly referenced in that definition. See 11 U.S.C. § 101(12A).

Nor is there any merit to plaintiff's argument that attorneys cannot be "debt relief agencies" because consumer bankruptcy attorneys are sometimes retained to advise creditors. Br. 12-13. The debt relief agency provisions apply only when an attorney advises an "assisted person." See 11 U.S.C. § 101(12A) (debt relief agency is "any person who provides bankruptcy assistance to an assisted person"). An "assisted person," in turn, is "any person whose debts consist primarily of consumer debts and the value of whose nonexempt property is less than $164,250." Id. § 101(4A). The Code thus contemplates that "debt relief agencies" are persons who advise debtors, not creditors.[1] See House Report at 17 (describing the debt relief agency provisions as "professionalism standards for attorneys and others who assist consumer debtors with their bankruptcy cases" (emphasis added)). And even if creditors were "assisted persons" under the Code, it is unclear exactly what "absurd results" (Br. 13) plaintiff believes would ensue — neither of the two provisions whose validity plaintiff challenges, for example, would remotely apply in such a circumstance. See 11 U.S.C. § 526(a)(4) (governing advice given to an assisted person "in contemplation of such person filing a case under this title"); id. § 527(b) (requiring certain disclosures to assisted persons "to the extent applicable").

3. Plaintiff suggests that interpreting the 2005 Act to encompass bankruptcy lawyers would impermissibly intrude on "the states' traditional role of regulating attorneys." Br. 14. This assertion is baseless. It cannot seriously be disputed that Congress may provide rules for the conduct of attorneys practicing in the federal courts, including in the federal bankruptcy courts. See, e.g., 28 U.S.C. § 1927; Fed. R. Civ. P.

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[1] Congress could not simply use the word "debtor" in the definition of "assisted person" because, for purposes of the Bankruptcy Code, a "debtor" is a person with respect to whom a bankruptcy case has already been commenced. See 11 U.S.C. § 101(13). The debt relief agency provisions, by contrast, govern the interactions between attorneys and their bankruptcy clients both pre- and post-petition.

11; Fed. R. Bankr. P. 9011; cf. Chambers v. NASCO, Inc., 501 U.S. 32 (1991). Indeed, federal law commonly supplies rules of professional conduct for attorneys in regulatory areas that, like bankruptcy, reflect uniquely federal concerns. See, e.g., 15 U.S.C. § 7245 (Securities and Exchange Commission); 31 C.F.R. Part 10 (Internal Revenue Service); 37 C.F.R. Part 10 (Patent and Trademark Office).[2]

Plaintiff's reliance on the preemption savings clause in section 526(d) is misplaced for similar reasons. See Br. 13. Section 526(d) provides that nothing in the 2005 Act shall "be deemed to limit or curtail the authority * * * of a State * * * to determine and enforce qualifications for the practice of law under the laws of that State." 11 U.S.C. § 526(d)(2)(A). The challenged provisions create substantive standards of conduct for debt relief agencies in the federal bankruptcy system; they do not purport to regulate state bar admission or other "qualifications for the practice of law." In fact, section 526(d) expressly distinguishes between restrictions on conduct

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[2] Plaintiff cites Leis v. Flynt, 439 U.S. 438 (1979), for the proposition that the regulation of attorneys is exclusively entrusted to the states. See Br. 14 n.9. The Court in Leis, however, merely rejected a claim that the Fourteenth Amendment prohibits state courts from denying pro hac vice admission to attorneys from other states. See 439 U.S. at 441-45. Nothing in Leis casts doubt on the authority of the federal government to regulate attorneys practicing before federal tribunals. See In re Desilets, 291 F.3d 925, 929 (6th Cir. 2002) ("Leis does not hold that state rules govern practice in federal courts.").

and qualifications for legal practice, preempting state rules of conduct “to the extent” they are inconsistent with the federal debt relief agency requirements, see 11 U.S.C. § 526(d)(1), while leaving undisturbed state bar admission requirements, see id. § 526(d)(2)(A). The preemption savings clause merely ensures that nothing in the 2005 Act will limit the ability of the states to decide who may become members of their respective bars.

4. Finally, plaintiff wrongly suggests that, notwithstanding the plain text of the statute, this Court may exclude attorneys from the scope of the 2005 Act under the rubric of constitutional avoidance. Br. 11, 14. As an initial matter, plaintiff’s interpretation would “avoid” far more than her constitutional claims: her reading would exempt bankruptcy attorneys not merely from the two provisions whose validity she challenges, but also from the many other professional conduct regulations in the 2005 Act whose constitutionality is undisputed. See, e.g., 11 U.S.C. § 526(a)(1) (requirement to perform all promised services); id. § 527 (requirement to provide written notice of debtors’ rights and obligations in bankruptcy); id. § 528(a)(1)-(2) (requirement to prepare a written contract with clear notice of applicable fees).

More fundamentally, the avoidance canon permits — indeed, requires — a court to adopt any reasonable construction of a statute that avoids a serious constitutional question, but it does not permit a court to disregard an unambiguous expression of congressional intent. Congress enacted the debt relief agency provisions to establish "professionalism standards for attorneys and others who assist consumer debtors with their bankruptcy cases," House Report at 17 (emphasis added), and plaintiff cannot properly invoke the doctrine of avoidance to frustrate that intent.

II. SECTION 526(a)(4) CONSTITUTIONALLY PROHIBITS BANKRUPTCY ATTORNEYS FROM ENCOURAGING THEIR CLIENTS TO ABUSE THE BANKRUPTCY SYSTEM.

A. Section 526(a)(4) Should Not Be Construed More Broadly Than Necessary To Achieve Congress's Purposes.

As discussed at length in our opening brief, Congress has long been aware that debtors frequently abuse the protections of the bankruptcy code by "loading up" with new debt on the eve of bankruptcy. See House Report at 15 (expressing concern that earlier legislative measures had not adequately restricted the ability of debtors to "knowingly load up with credit card purchases or recklessly obtain cash advances and then file for bankruptcy relief"); S. Rep. No. 98-65, at 9 (1983) (noting special problem posed by "'loading up' in contemplation of bankruptcy"); Report of the Commission of the Bankruptcy Laws of the United States, H.R. Doc. No. 93-137, pt. I, at 11 (July 1973) (concluding that "the most serious abuse of consumer bankruptcy is the number of instances in which individuals have purchased a sizable quantity of goods and services on credit on the eve of bankruptcy in contemplation of obtaining a discharge”).

In hearings preceding the 2005 Act, moreover, Congress heard evidence that “misconduct by attorneys and other professionals” had been “consistently identified” by the U.S. Trustee Program as a source of abusive bankruptcy filings. See House Report at 5 (citation omitted). Other witnesses, including bankruptcy judges, informed Congress that these problems were likely to be exacerbated by the new “means testing” provisions in the 2005 legislation, which create an incentive for unethical attorneys to encourage their clients to run up additional debt on the eve of bankruptcy in order to obtain a full discharge of their debts under chapter 7. See generally Gov. Br. 17-20. It was against this background that Congress enacted 11 U.S.C. § 526(a)(4).

None of this is controverted. Plaintiff does not deny Congress’s purpose in adopting these reforms, nor does she dispute that Congress targeted a genuine problem. Nor, indeed, does plaintiff deny that Congress can properly restrict attorneys from encouraging their clients to engage in such abusive practices. Her contention, instead, is that section 526(a)(4) must be read expansively to apply “in all the varied circumstances where there is a bona fide, good faith, lawful and ethical reason for incurring the debt and where doing so would be in the client’s best interest.” Br. 20.

That approach turns the canon of constitutional avoidance on its head. Plaintiff is not entitled to insist upon the broadest possible interpretation of section 526(a)(4) in order to secure its invalidation. When "an otherwise acceptable construction of a statute would raise serious constitutional problems," a federal court must "construe the statute to avoid such problems unless such a construction would be plainly contrary to legislative intent." Planned Parenthood v. Sanchez, 403 F.3d 324, 341 (5th Cir. 2005) (quoting Edward J. DeBartolo Corp. v. Florida Gulf Coast Bldg. & Constr. Trades Council, 485 U.S. 568, 575 (1988)). Although plaintiff acknowledges this principle elsewhere in her brief, see Br. 11 & n.5, she makes no mention of the avoidance canon in pressing her challenge to section 526(a)(4). If plaintiff believes that avoidance principles may be jettisoned merely because she asserts an overbreadth claim, she is mistaken: Even when First Amendment interests are potentially affected, a court will "presume any narrowing construction or practice to which the law is 'fairly susceptible,'" and will not strike down a statute on the basis of facial overbreadth "when a limiting construction has been or could be placed on the challenged statute." Baby Dolls Topless Saloons, Inc. v. City of Dallas, 295 F.3d 471, 483 (5th Cir. 2002) (quoting City of Lakewood v. Plain Dealer Publishing Co., 486 U.S. 750, 770 n.11 (1988), and Broadrick v. Oklahoma, 413 U.S. 601, 612 (1973)).

B. Plaintiff's Sweeping Interpretation Of Section 526(a)(4) Is Neither Required By The Text Of The Statute Nor Consistent With Congress's Purposes.

Plaintiff's interpretation of section 526(a)(4) is plainly not compelled by the terms of the statute. As we explained in our opening brief (and as plaintiff does not dispute), Congress and the federal courts have both commonly described pre-petition debts amassed for improper purposes as debts incurred "in contemplation of" bankruptcy. See Gov. Br. 22-24. This Court's en banc decision in In re Mercer, which involved allegedly fraudulent credit-card purchases made prior to bankruptcy, employed the same phrase in the same sense. See 246 F.3d 391, 421 n.43 (5th Cir. 2001) (en banc) (describing "loading up" as the practice of "incurring card debt in contemplation of bankruptcy" (emphasis added)); see also id. at 421 (referring to "a dishonest but patient debtor who intends to incur card-debt in contemplation of discharge").

This use of the phrase "in contemplation of," moreover, reflects settled connotations in the bankruptcy context. See Black's Law Dictionary 336 (8th ed. 2004) (explaining that the phrase "contemplation of bankruptcy" typically connotes "action designed to thwart the distribution of assets in a bankruptcy proceeding"). See also, e.g., United States v. Fox, 95 U.S. 670, 672 (1877) ("To legislate for the prevention of frauds * * * when committed in contemplation of bankruptcy, would seem to be within the competency of Congress."); In re Charles, 334 B.R. 207, 222 (Bankr. S.D. Tex. 2005) ("It is settled law that a debtor's good faith should be questioned if the debtor makes purchases in contemplation of a bankruptcy case."); cf. 18 U.S.C. § 152(7) (prohibiting fraudulent transfer or concealment of assets "in contemplation of a case under title 11").

Plaintiff's construction of section 526(a)(4), by contrast, would require the Court to disregard the context in which Congress placed the provision. Section 526(a)(4) is one of four subsections of section 526(a). The other three subsections indisputably provide rules of professional conduct designed to protect debtors from abusive practices by bankruptcy attorneys and other debt relief agencies. See 11 U.S.C. § 526(a)(1) (debt relief agencies must perform all promised services); id. § 526(a)(2) (prohibiting debt relief agencies from advising debtors to make false or misleading statements to obtain bankruptcy relief); id. § 526(a)(3) (prohibiting debt relief agencies from misrepresenting to debtors the services to be provided or the costs or benefits of filing for bankruptcy relief). Against this background, it is apparent that Congress did not enact, as the fourth item in this list, the sweeping prohibition on "good faith, lawful and ethical" advice that plaintiff claims.

Likewise, plaintiff makes no attempt to reconcile her interpretation with the remedial provisions of the statute. As our opening brief explains (at 29-31), the principal remedy for a violation of section 526(a)(4) is a suit against the attorney to recover the debtor's "actual damages." See 11 U.S.C. § 526(c)(2); see also id. § 526(c)(3)(B). Congress's emphasis on compensating the debtor's "actual damages" from violations of section 526 underscores the error of plaintiff's interpretation: Congress was concerned with abusive practices that risk dismissal of the debtor's petition, denial of a discharge, and other "actual damages" to the debtor, not ordinary legal advice that is consistent with the Bankruptcy Code and the client's best interests.

Plaintiff is thus quite wrong to insist that the statute prohibits "a wide range of legally permissible, ethical, advisable conduct." Br. 28. Echoing the district court, for example, plaintiff contends that section 526(a)(4) would prevent her from advising a client to borrow money to buy a dependable automobile in order to continue working during bankruptcy, or to obtain student loans in order to complete her education and better her financial condition. Br. 28-29. But as we made clear in our opening brief, section 526(a)(4) has no application to such advice, nor to any other advice similarly consistent with the policies of the Bankruptcy Code and with the client's best interests, provided all necessary disclosures are made to the lenders.[3] See Gov. Br. 24-25. Section 526(a)(4) simply prevents attorneys and other professionals from becoming the affirmative engines of bankruptcy abuse.

C. Section 526(a)(4) Provides A Bankruptcy-Specific Rule Of Professional Conduct That Constitutionally Precludes Attorneys From Encouraging Debtors To Abuse The Bankruptcy Code.

Understood in this manner, there is little doubt that section 526(a)(4) satisfies the First Amendment. As we have noted, even plaintiff does not contend that she has a First Amendment right to encourage her clients to file abusive bankruptcy petitions, or to load up on new debt prior to bankruptcy with the intent that the debt be discharged. As the Supreme Court made clear in Gentile v. State Bar of Nevada, 501 U.S. 1030 (1991), attorneys are not merely agents of their clients but also officers of the courts, and for that reason may be "subject to ethical restrictions on speech to which an ordinary citizen would not be." Id. at 1071. The Court in Gentile quoted with approval Justice Stewart's dispositive concurrence in In re Sawyer, 360 U.S. 622 (1959), in which he rejected the notion "that a lawyer can invoke the constitutional right of free speech to immunize himself from even-handed

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[3] Plaintiff is thus incorrect to assert that these examples would be prohibited even under the government's interpretation of the statute. Br. 28.

discipline for proven unethical conduct," because "[a] lawyer belongs to a profession with inherited standards of propriety and honor, which experience has shown necessary in a calling dedicated to the accomplishment of justice. * * * Obedience to ethical precepts may require abstention from what in other circumstances might be constitutionally protected speech." Id. at 646-47 (Stewart, J., concurring in judgment); see Gentile, 501 U.S. at 1071. See also Ohralik v. Ohio State Bar Ass'n, 436 U.S. 447, 460 (1978) (sustaining a restriction on attorney solicitation because the government "bears a special responsibility for maintaining standards among members of the licensed professions"); Goldfarb, 421 U.S. at 792 (the government's interest "in regulating lawyers is especially great since lawyers are essential to the primary governmental function of administering justice, and have historically been 'officers of the courts'").

Plaintiff insists that section 526(a)(4) does not regulate professional conduct and should not be analyzed under the principles discussed in Gentile. Br. 15-19. That contention is difficult to fathom. Section 526(a)(4) provides a bankruptcy-specific rule of conduct akin to Model Rule of Professional Conduct 1.2(d), which states that an attorney may not "counsel a client to engage, or assist a client, in conduct that the lawyer knows is criminal or fraudulent." As we observed in our opening brief, that rule has been applied to precisely the conduct that section 526(a)(4) addresses. See Attorney Grievance Comm'n of Maryland v. Culver, 381 Md. 241, 275-76 (2004) (attorney violated Rule 1.2(d) by advising a client to obtain credit card loans with the intent that the debt be discharged in bankruptcy). Moreover, Congress itself described the "debt relief agency" provisions of the 2005 Act as "professionalism standards for attorneys." See House Report at 17 (debt relief agency provisions "strengthen[] professionalism standards for attorneys and others who assist consumer debtors with their bankruptcy cases").

Plaintiff nevertheless offers a series of reasons why, in her view, the Gentile standard is inapplicable. None has merit. First, plaintiff contends that section 526(a)(4) cannot be construed as an ethical standard because "there exists no independent basis which prohibits the attorney conduct contained in 11 U.S.C. § 526(a)(4)." Br. 17. That contention, however, merely reflects plaintiff's position that section 526(a)(4) should be read to prohibit all attorney advice to incur debt, even for a "bona fide, good faith, lawful and ethical reason." Br. 20. As plaintiff does not dispute, a substantial body of law does prohibit debtors from amassing debt on the eve of bankruptcy without the intent and ability to repay, or for the purpose of abusing the Bankruptcy Code's protections. See 11 U.S.C. § 523(a)(2); id. § 707(b); 18 U.S.C. § 157; see also, e.g., Uniform Fraudulent Transfer Act §§ 4-5 (1984).[4] Indeed, plaintiff herself acknowledges that, because "incurring debt with no intent to repay is already fraudulent * * * and has potential criminal ramifications under many state laws, an attorney could not, lawfully or consistent with state ethical requirements, advise a client to incur it." Br. 18 n.14.

Plaintiff argues that interpreting section 526(a)(4) in this manner would render the statute "completely unnecessary" in light of underlying state ethical rules. Br. 18 n.14. But Congress undoubtedly has the power to provide uniform rules of professional conduct for attorneys in bankruptcy cases, even where state law already supplies the underlying norm. Cf. 28

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[4] Plaintiff suggests that the power of a bankruptcy court under 11 U.S.C. § 707(b) to dismiss a debtor's petition for abuse of the Bankruptcy Code is irrelevant to the First Amendment analysis because, in plaintiff's view, that section provides a "substantive rule of law" rather than a penalty for particular conduct. Br. 17. That contention is baseless. Plaintiff does not dispute that a debtor's deliberate accumulation of debt on the eve of bankruptcy for the purpose of manipulating the Code would constitute an "abuse" under section 707(b), and she admits that a determination of abuse "can result in denial of a debtor's discharge" or "dismissal of the proceeding." Br. 17. Section 707(b) thus imposes a very real penalty on debtors for abusive pre-petition conduct. Moreover, as our opening brief explains (at 29-31), the 2005 Act imposes an affirmative duty on bankruptcy attorneys themselves to certify, on pain of civil penalties, that their clients' petitions do not constitute an abuse of the Code. See 11 U.S.C. § 707(b)(4). And while plaintiff is correct that section 707 applies only in chapter 7 cases, it is well established that bad-faith pre-petition conduct by a debtor justifies dismissal under other chapters of the Code as well. See Marrama v. Citizens Bank, 127 S. Ct. 1105, 1110-12 (2007); see generally 11 U.S.C. § 1307(c) (chapter 13); id. § 1208(c) (chapter 12); id. § 1112(b) (chapter 11).

U.S.C. § 1927; Fed. R. Civ. P. 11. Moreover, section 526 supplies a federal cause of action for aggrieved debtors to recover their "actual damages" from unethical attorney advice. See 11 U.S.C. § 526(c). The Constitution does not bar Congress from regulating practice in federal courts, regardless of the potential availability of post-hoc malpractice remedies in state court.

Nor is there any merit to plaintiff's contention that, although an attorney's advertising, solicitation, and other public conduct may be subject to regulation, the government lacks the authority to regulate a lawyer's advice to "actual, living, breathing clients." Br. 18-19. To the contrary, it is when an attorney serves as the trusted agent for an "actual, living, breathing" client who seeks relief from a court that the government's interest in preventing unethical attorney conduct reaches its zenith. See Gentile, 501 U.S. at 1071; Ohralik, 436 U.S. at 460.

Plaintiff's attack on section 526(a)(4) as a "content-based restriction" on speech, Br. 25, likewise fails to come to grips with the distinctions between regulation of professional conduct and general restrictions on public speech. Rules governing attorneys and other professionals are typically content-based. Model Rule 1.2(d), which precludes attorneys from advising clients to engage in fraud, is no less a content-based restriction on attorney speech. At bottom, plaintiff’s claim is not that Congress may not regulate the content of professional speech, but that it should not regulate the particular speech at issue — a contention that merely reflects her view that section 526(a)(4) should be read as broadly as possible to invite constitutional concerns.

The error of plaintiff’s analysis is reflected in her reliance on Thomas v. Collins, 323 U.S. 516 (1945). See Br. 29. The Supreme Court in that case upheld the right of a union organizer to give a speech in a public forum urging workers to join his labor union, finding no “clear and present danger” to the public interest. Id. at 530. As Gentile later made clear, such analysis is wholly inapposite to regulations governing the professional conduct of attorneys as officers of the courts. See Gentile, 501 U.S. at 1071.

Plaintiff’s reliance on Legal Services Corp. v. Velazquez, 531 U.S. 533 (2001) is similarly wide of the mark. See Br. 20-23. The statute at issue in Velazquez conditioned the receipt of federal funds on an attorney’s agreement not to challenge the validity of state or federal welfare laws. 531 U.S. at 538. The provision did not seek to regulate attorney ethics or avoid client abuses. Instead, the statute prevented attorneys from making “all the reasonable and well-grounded arguments necessary for proper resolution of the case,” thereby inhibiting the unfettered advocacy upon which courts depend for the exercise of judicial power. Id. at 545. Section 526(a)(4) does nothing of the sort. Indeed, it does the opposite: section 526(a)(4) prevents attorneys from subverting the bankruptcy process and jeopardizing their clients' interests by encouraging debtors to abuse the protections of the Code.

D. The District Court Further Erred In Striking Down Section 526(a)(4) On Its Face.

Finally, as we explained in our opening brief (at 31-33), the district court additionally erred in striking down section 526(a)(4) on its face, without pausing to consider whether the statute's allegedly unconstitutional applications were not only "real, but substantial as well, judged in relation to the statute's plainly legitimate sweep." Shackelford v. Shirley, 948 F.2d 935, 940 (5th Cir. 1991) (quoting Broadrick v. Oklahoma, 413 U.S. 601, 615 (1973)). The court's error in this respect was highlighted by its invalidation of section 526(a)(4) in its entirety, without addressing the portion of the statute that precludes an attorney from advising a client to incur additional debt to pay the attorney's own fees. See 11 U.S.C. § 526(a)(4) (prohibiting advice "to incur more debt * * * to pay an attorney or bankruptcy petition preparer fee or charge for services performed as part of preparing for or representing a debtor in a case under this title").

In her brief, plaintiff admonishes the government for addressing this portion of the statute on appeal "for the first time in this case." Br. 30-33. This characterization entirely misperceives the issue. At no point in the district court did plaintiff challenge the attorney-fee provision of section 526(a)(4), or even specifically allege that she intends to violate it.[5] The constitutionality of that provision therefore was not before the district court, and the court could not properly declare the entire statute invalid on its face.

In any event, plaintiff's belated attack on the validity of the attorney-fee provisions of section 526(a)(4) is without merit. Congress undoubtedly possesses the authority to prevent bankruptcy attorneys from abusing their positions as officers of the court and "trusted agents of their clients," Ohralik v. Ohio State Bar Ass'n, 436 U.S. 447, 460 (1978), by seeking preferential treatment for themselves in the bankruptcy process. An attorney who encourages a debtor to incur new (and almost certainly unsecured) debt in order to pay the attorney's own fees is effectively urging the debtor to exploit the bankruptcy system

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[5] Plaintiff now claims that she did raise the issue in district court, see Br. 30 n.35, citing a line in her affidavit that paraphrases the provisions of section 526(a)(4) and an equally generic allegation that she "intend[s] to engage in protected speech or conduct that violates the statute at issue." CR200. Such generalized references were not sufficient to place the constitutionality of the second half of section 526(a)(4) in issue. Plaintiff's district court briefs did not discuss the provision, and the court consequently did not address it.

to shift the cost of the lawyer's services onto unsuspecting creditors. Nothing in the First Amendment prevents Congress from forbidding such deceptive practices by members of the bankruptcy bar. See Gentile, 501 U.S. at 1071.[6]

III. SECTION 527(b) CONSTITUTIONALLY REQUIRES BANKRUPTCY ATTORNEYS TO PROVIDE DEBTORS WITH BASIC FACTUAL INFORMATION ABOUT THE BANKRUPTCY PROCESS.

In her cross-appeal, plaintiff renews her contention that the disclosure requirements in 11 U.S.C. § 527(b) constitute compelled speech in violation of the First Amendment.

A. Congress Enacted Section 527(b) To Ensure That Consumer Debtors Will Receive Basic Information About Their Rights And Obligations In The Bankruptcy System.

In hearings preceding the 2005 Act, Congress heard evidence that many consumer debtors lack even the most rudimentary information about their rights and obligations in the bankruptcy process. For example, one debtor who had filed for bankruptcy

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[6] Plaintiff objects that "[l]aws inhibiting advice to hire a lawyer have long been held to violate the First Amendment." Br. 32. But section 526(a)(4) does not prohibit advice to hire a bankruptcy attorney. Rather, it prohibits attorneys from encouraging debtors to incur new debt — debt that will be discharged in bankruptcy — in order to pay the attorney's own fees, at the expense of other creditors. Plaintiff's further suggestion that Congress may not in any respect limit a debtor's ability to retain counsel in a bankruptcy proceeding is plainly mistaken. See Hadd v. LSG-Sky Chefs, 272 F.3d 298, 301 (5th Cir. 2001) (no right to counsel in a civil case, regardless of legal sophistication or ability to pay); United States v. Kras, 409 U.S. 434, 446 (1973) ("There is no constitutional right to obtain a discharge of one's debts in bankruptcy."); cf. Lamie v. U.S. Trustee, 540 U.S. 526 (2004) (discussing restrictions on compensation for debtors' attorneys under the Bankruptcy Code).

urged Congress to "require attorneys or the bankruptcy court to tell debtors about their options, both within bankruptcy and outside of bankruptcy," explaining that his own attorney had never mentioned chapter 13 and had not discussed the possibility of credit counseling. Bankruptcy Reform Act of 1998: Part I, Hearing on H.R. 3150 Before House Judiciary Comm., 105th Cong. 93, 94 (1998) (testimony of Nicholl J. Russell).

Similarly, a professor at Iowa State University described to Congress a survey she had conducted of debtors' experiences in the bankruptcy system. See Consumer Bankruptcy Reform Act: Seeking Fair and Practical Solutions to the Bankruptcy Crisis, Hearing on S. 1301 Before Senate Judiciary Comm., 105th Cong. 28 (1998) (testimony of Dr. Tahira K. Hira). She testified that most of the surveyed debtors had learned what little they knew about the bankruptcy system from friends and family, and from attorney advertisements. Id. at 28-29. In hindsight, many complained that they had not received adequate information from their lawyers. Ibid. Suggestions from the debtors for improving the system included that someone should "explain laws and terms in plain English"; that "[t]here should be strict guidelines for lawyers [requiring them] to inform clients fairly and not for their own wallets"; and that "[t]he lawyers should be made to explain details instead of taking the money and moving you through the system like cattle." Id. at 32.

Congress reacted to these concerns by enacting 11 U.S.C. § 527(b), which requires attorneys and other debt relief agencies to provide their clients with a "clear and conspicuous" statement of basic factual information about the bankruptcy process. The statute describes the content of the required notice in detail, see 11 U.S.C. § 527(b), and requires that the attorney provide the prescribed information to the debtor, "to the extent applicable" under the circumstances, within three days of the start of the representation, see ibid.

Among other information, the notice required by section 527(b) explains:

- that in the bankruptcy system, a debtor may represent herself, hire a lawyer, or in some cases, hire a bankruptcy petition preparer;
- that attorneys and bankruptcy petition preparers are obligated to provide written contracts explaining the services they will provide and how much they will cost;
- that there are different types of debt relief available under the bankruptcy system, and that the debtor will have to choose which type to seek;
- that filing for bankruptcy involves submitting documents to a court, and that a filing fee will apply; and
- that bankruptcy may involve litigation.

See generally 11 U.S.C. § 527(b).

B. The District Court Correctly Rejected Plaintiff's Claim That Section 527(b) Violates the First Amendment.

The district court rejected plaintiff's claim that the disclosure requirements in section 527(b) violate the First

Amendment. See 347 B.R. at 25-27. That conclusion is not subject to substantial challenge. The Supreme Court has repeatedly made clear that the statutes requiring attorneys and other professionals to disclose basic factual information to their clients will be upheld if they are reasonably related to a legitimate government interest and are not unduly burdensome. See Zauderer v. Office of Disciplinary Counsel of Supreme Court of Ohio, 471 U.S. 626, 650-52 (1985); Planned Parenthood v. Casey, 505 U.S. 833, 881-884 (1992).

The Supreme Court in Zauderer upheld an Ohio rule of professional conduct that required attorneys to disclose, in advertisements for contingency-fee arrangements, the manner in which court costs and fees would be charged to the client. See 471 U.S. at 633. Like plaintiff here, see Br. 40, the attorney in Zauderer urged the Court to strike down the disclosure requirement by analogy to compelled speech cases such as West Virginia State Board of Education v. Barnette, 319 U.S. 624 (1943) (recitation of the pledge of allegiance), and Wooley v. Maynard, 430 U.S. 705 (1977) ("live free or die" motto). But the Court rejected that analogy, explaining that the First Amendment interests implicated by a regulation requiring attorneys to provide "purely factual and uncontroversial information" to potential clients are simply "not of the same order." Id. at 651. The Ohio disclosure requirement "easily passe[d] muster" under the First Amendment because it was "reasonably related" to the state's legitimate interest in "preventing the deception of consumers." Id. at 650-51.[7]

Similarly, in Planned Parenthood v. Casey, physicians challenged a state law requiring them to provide patients with basic factual information regarding the risks of abortions and the alternative options available to the patient. Like plaintiff here, the physicians argued that the requirement to disclose specific information in the manner mandated by the state violated their First Amendment rights against compelled speech. And as in Zauderer, the Court rejected that argument, finding "no constitutional infirmity in the requirement that the physician provide the information mandated by the State." 505 U.S. at 884. The Court explained that the physicians' First Amendment rights were implicated only "as part of the practice of medicine," which

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[7] Like the advertising regulations in Zauderer, section 527(b) involves a regulation of commercial speech. Indeed, one purpose of the disclosures required by the statute — which must be made within three days of the attorney's first "offer[] to provide any bankruptcy assistance" to the debtor, see 11 U.S.C. § 527(a)(2); id. § 527(b) — is to enable the debtor to make an informed decision regarding whether to hire an attorney. Thus, the required statement indicates that debtors have the right to represent themselves, and warns debtors to "[a]sk to see [a] contract before you hire someone." § 527(b).

In any event, even outside of the commercial speech context, statutes requiring licensed professionals to disclose factual information to their clients will be upheld if they are reasonably related to a legitimate state interest. See Casey, 505 U.S. at 884.

in turn was "subject to reasonable licensing and regulation by the State." Ibid.

Although the district court specifically relied on Casey in rejecting her challenge to section 527(b), plaintiff makes no attempt to distinguish these authorities in her brief. Nor does she dispute the court's conclusion that "[t]he government clearly has a legitimate interest in attempting to ensure that a client is informed of certain basic information before he or she commences a case in bankruptcy." 347 B.R. at 27. As the district court observed, "among consumer creditors, attorneys, and their debtor clients, the consumer debtor is often at an informational disadvantage." Ibid. Consequently, a "factual, viewpoint-neutral statement provides a sufficiently benign and narrow means of ensuring that clients are aware of certain general information regarding bankruptcy." Ibid.

Plaintiff disputes none of this. Instead, she offers ten respects in which, in her view, the disclosures in section 527(b) are "false" or "potentially misleading." Br. 34-35.[8]

Not one of plaintiff's examples, however, actually involves a factual or legal error. In a few instances, plaintiff's understanding of the statute is simply inaccurate. For example, four of plaintiff's alleged inaccuracies (examples three, six,

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[8] Plaintiff lists 11 examples, but examples six and eight are identical.

eight, and nine) involve variants of the claim that section 527(b) "fails to state that attorneys are the only ones authorized by law to provide" certain legal advice. In fact, the disclosure in section 527(b) specifically states that "only attorneys, not bankruptcy petition preparers, can give you legal advice." 11 U.S.C. § 527(b).

Plaintiff's remaining examples of "false and misleading" statements are, as the district court recognized, merely instances in which plaintiff would prefer to add further context or elaboration to the basic information provided by the statute. And as the court observed, nothing in section 527(b) prevents her from doing so. See 347 B.R. at 27 ("[I]n an area of law as intricate as bankruptcy, a generalized statement may often require further explanation by a client's attorney. Nothing in section 527 prevents this.").[9] Indeed, section 527(b) authorizes the required disclosures to be given in any "substantially similar" form, and the statements need only be provided "to the extent applicable." As the district court concluded, this freedom "leaves the bankruptcy attorney with sufficient control * * * to avoid any undue burden." Ibid.

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[9] To take plaintiff's first example of a purportedly "false" statement, for example, section 527(b) requires plaintiff to warn her clients that a petition for bankruptcy will require a filing fee in bankruptcy court. See 11 U.S.C. § 527(b). Nothing prevents plaintiff from further advising her clients that, in some instances, these fees can be deferred under Fed. R. Bankr. P. 1006(b). See Br. 34.

Equally baseless is plaintiff's contention that section 527(b) unconstitutionally compels her to make irrelevant disclosures to creditors and other clients who are not consumer debtors. Br. 37-38. As discussed in Part I above, the premise of this argument — that the statutory term "assisted person" includes creditors as well as debtors — is incorrect. See supra at 8-9. But even if it were otherwise, the disclosures in section 527(b) are mandatory only "to the extent applicable" under the circumstances. See 11 U.S.C. § 527(b). The statute thus does not oblige plaintiff to make irrelevant disclosures to her creditor clients.

Finally, plaintiff briefly suggests that the statute violates her right to due process, hypothesizing that she may be unable to determine immediately whether a particular consumer debtor qualifies as an "assisted person" under the statute and thus is entitled to receive the disclosures in section 527(b). Br. 36. Such speculation is plainly not a proper basis for invalidating a federal statute on its face. And in any event, nothing in section 527(b) bars plaintiff from simply providing the required statement to such a client with the caveat that the disclosure may not be legally mandatory. Cf. Zauderer, 471 U.S. at 651 ("[A]ppellant's constitutionally protected interest in not providing any particular factual information * * * is minimal.").

CONCLUSION

For the foregoing reasons, the district court's judgment with respect to 11 U.S.C. § 526(a)(4) should be reversed, and its judgment with respect to 11 U.S.C. § 527(b) should be affirmed.

Respectfully submitted,

PETER D. KEISLER
Assistant Attorney General

RICHARD B. ROPER, III
United States Attorney

MARK B. STERN
(202) 514-5089
MARK R. FREEMAN
(202) 514-5714
Attorneys, Appellate Staff
Civil Division, Room 7531
Department of Justice
950 Pennsylvania Ave., N.W.
Washington, D.C. 20530-0001

OCTOBER 2007

CERTIFICATE OF SERVICE

I hereby certify that on this 15th day of October, 2007, I caused copies of the foregoing brief to be filed with the Court by Federal Express overnight delivery, and caused copies to be served by Federal Express overnight delivery upon the following counsel:

Howard Marc Spector
Law Office of Howard Marc Spector
Banner Place
12770 Coit Rd Suite 1100
Dallas, TX 75251
214-365-5377
hms7@cornell.edu

____
Mark R. Freeman

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Pursuant to Rule 32(a)(7)(C) of the Federal Rules of Appellate Procedure, I hereby certify that:

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Mark R. Freeman

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! Whether, under Sec. 324(a), the bankruptcy court validly removed appellant "for cause" as a Ch 7 Bankruptcy Panel Trustee in *In re Unclaimed Freight, Inc.* and acted within its discretion in allowing her removal under 324(b), from all other bankruptcy cases to which she was assigned as a Panel Trustee. Whether the Bankruptcy Court abused its discretion when it held Hill in civil contempt for failure to comply with the court's orders to turn over all case files, financial records and estate funds. Whether the Bankruptcy Court abused its discretion when it denied Hill all compensation in cases in which she previously had served as trustee. Whether the Bankruptcy Court abused its discretion when it suspended Hill from practice before it as an attorney on the grounds that she lied to the court, altered its orders, and failed to comply with its orders.

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IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

DIANNE HILL,
Appellant,
v.
US TRUSTEE; EUGENE HASTINGS, Trustee;
FRAN STRANGE, Assistant Trustee;
MOREHOUSE GENERAL HOSPITAL,
Appellees.

DIANNE HILL,
Appellant,
v.
EUGENE HASTINGS, Trustee;
FRAN STRANGE, Assistant Trustee;
MOREHOUSE GENERAL HOSPITAL,
Appellees.

DIANNE HILL,
Appellant,
v.
EUGENE HASTINGS.
Appellee.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF LOUISIANA

BRIEF FOR APPELLEES, US TRUSTEE; FRAN STRANGE, Assistant Trustee

STUART E. SCHIFFER
Acting Assistant Attorney General

WILLIAM FLANAGAN
United States Attorney

WILLIAM KANTER
(202) 514-4575
ROBERT D. KAMENSHINE
(202) 514-2494
Attorneys, Appellate Staff
Civil Division, Rm. 9102
Department of Justice
601 D Street, N.W.
Washington, D.C. 20530-0001

STATEMENT ON ORAL ARGUMENT

Appellees, United States Trustee and Fran Strange, Assistant United States Trustee, believe that the principal briefs suffice to enable this Court to render an appropriate decision. Nevertheless, given the significance to the United States Trustee of the issues in the case, we do not oppose the holding of oral argument, and would be pleased to participate should this Court decide that such argument is desirable.

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IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 00-30655

DIANNE HILL,
Appellant,
v.

US TRUSTEE; EUGENE HASTINGS, Trustee;
FRAN STRANGE, Assistant Trustee;
MOREHOUSE GENERAL HOSPITAL,
Appellees.

DIANNE HILL,
Appellant,
v.

EUGENE HASTINGS, Trustee;
FRAN STRANGE, Assistant Trustee;
MOREHOUSE GENERAL HOSPITAL,
Appellees.

DIANNE HILL,
Appellant,
v.

EUGENE HASTINGS,
Appellee.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF LOUISIANA

BRIEF FOR APPELLEES, US TRUSTEE;
FRAN STRANGE, Assistant Trustee

JURISDICTIONAL STATEMENT

A. The district court had subject matter jurisdiction of this case by virtue of 28 U.S.C. 1334.

B. This Court has jurisdiction pursuant to 28 U.S.C. 1291.

C. On May 18, 2000, appellant Dianne Hill, filed a timely notice of appeal from the judgments entered, March 23, 2000 and April 20, 2000. <u>See</u> Fed. R. App. P. 4(a)(1).

D. This appeal is from final orders that dispose of all the parties' claims.

STATEMENT OF THE ISSUES PRESENTED FOR REVIEW

1. Whether, under 11 U.S.C. 324(a), the bankruptcy court validly removed appellant, Dianne Hill, "for cause" as a Chapter 7 Bankruptcy Panel Trustee in In re Unclaimed Freight, Inc., and acted within its discretion in allowing her removal, under 11 U.S.C. 324(b), from all other bankruptcy cases to which she was assigned as a Panel Trustee.

2. Whether the bankruptcy court abused its discretion when it held Hill in civil contempt for failure to comply with the court's orders to turn over all case files, financial records and estate funds.

3. Whether the bankruptcy court abused its discretion when it denied Hill all compensation in cases in which she previously had served as trustee.

4. Whether the bankruptcy court abused its discretion when it suspended Hill from practice before it as an attorney on the grounds that she had lied to the court, altered its orders, and failed to comply with its orders.

5. Whether the bankruptcy judge abused his discretion when he declined to recuse himself in Hill's contempt hearing.

STATEMENT OF THE CASE

A. Nature of the Case.

In this case, a former bankruptcy trustee, Dianne Hill, appeals from two judgments of the federal district court, affirming orders in which the bankruptcy court first, removed her as trustee in all cases in which she was presently serving in that capacity based on her having altered an order of the court and her "continuing * * * inability to properly comply with the requirements of the United States Trustee"[1] (CR 902, SRE, Tab 100 at 93), second, held her in civil contempt for failure to comply with the court's orders to relinquish her estate files and funds to the successor trustee, third, based largely on her "egregious conduct" (CR 62, SRE, Tab 145 at 17), denied her all compensation in cases from which she was removed as trustee, and fourth, suspended her from practice before it as an attorney on the grounds that she had lied to the court, and altered and disobeyed its orders.

B. Course of Proceedings and Disposition Below.

On May 24, 1999, in <u>In re Unclaimed Freight</u>, the bankruptcy court issued an order granting the motion of the United States

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[1] The United States Trustee -- not to be confused with the private individual, such as Hill, who is appointed as bankruptcy trustee for a particular case -- is an Executive Branch official who is responsible for "protecting the public interest and ensuring that bankruptcy cases are conducted according to the law." H.R. Rep. No. 95-595, at 109 (1978), <u>reprinted in</u> 1978 U.S.C.C.A.N. 5963, 6070.

Trustee (UST) to remove Hill as trustee from all open bankruptcy cases to which she was then assigned and requiring her to turn over all case files, case funds, and financial records to the successor trustee and provide him with status reports. CR 958, SRE, Tab 92 at 1. On September 8, 1999, in In re Spohn, the bankruptcy court suspended Hill from practicing as an attorney before that court and denied her compensation in that case. SRE, Tab 136. On October 29, 1999, pursuant to a hearing held on August 4, 1999, the bankruptcy court found Hill in civil contempt for failure to comply with its turnover order and its subsequently issued order to comply. CR 63, SRE, Tab 145 at 18. The court further ordered that Hill pay a successor trustee $1,500, and that she not receive compensation in any of the cases from which she had been removed as trustee.[2] Id.

On March 23, 2000, the district court affirmed the removal of Hill as a trustee, the denial of compensation in Spohn, and her suspension from practicing before the bankruptcy court. CR Vol 3, 410, RE, Tab D at 1. On April 20, 2000, the district court affirmed the finding of civil contempt, the payment of $1,500 to the successor trustee, and the denial of compensation

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[2] On August 3, 1999, Hill had filed with the district court a Rule to Show Cause requesting compensation for prior trustee case assignments. CR Vol. 1, Docket Sheet, RE, Tab A at 4. On April 4, 2000, the district court determined that this request was moot in that the court would address Hill's compensation in its review of the pertinent order of the bankruptcy court. CR Vol. 1, Docket Sheet, RE, Tab A at 8.

in all other cases from which Hill had been removed as trustee. CR Vol. 3, RE, Tab F at 1.

STATEMENT OF FACTS

I. Statutory Scheme[3]

United States Trustees are officials of the Department of Justice appointed by the Attorney General to appoint trustees in bankruptcy cases and supervise the administration of bankruptcy cases. 28 U.S.C. 581-589. They generally have standing to "raise and * * * appear and be heard on any issue in any case or proceeding under this title * * * ." 11 U.S.C. 307. See generally United States Trustee v. Columbia Gas Sys., Inc. (In re Columbia Gas Sys., Inc.), 33 F.3d 294, 296 (3d Cir. 1994) (United States Trustees oversee the bankruptcy process, protect the public interest, and ensure that bankruptcy cases are conducted according to law).

The United States Trustee, by region, is given the mandate to establish, maintain, and supervise a panel of private trustees that are eligible to serve as trustees in chapter 7 cases. 28 U.S.C. 586(a)(1). To be a chapter 7 trustee, a candidate must make application to the United States Trustee after the position is publicly advertised. If the candidate meets the qualifications as set forth in 28 C.F.R. 58.3 and is selected by

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[3] The pertinent statutes and regulations are set forth in the addendum to this brief.

the United States Trustee in that region, the trustee must be prepared to accomplish the duties of the chapter 7 trustee as set forth in 11 U.S.C. 704. The duties include in part: collecting and liquidating assets, investigating the financial affairs of the debtor, being accountable for the assets, disbursing the funds after reviewing the claims, filing a final report and a final accounting, and closing the case as soon as is expeditious. The United States Trustee is responsible for supervising and evaluating the performance and integrity of appointed bankruptcy trustees.

The trustees may be removed administratively, under 28 C.F.R. 58.6, or by order of the bankruptcy court, under 11 U.S.C. 324. In regard to judicial removal, the Bankruptcy Code, 11 U.S.C. 324(a), provides that the bankruptcy court "after notice and a hearing, may remove a trustee * * * for cause." The Code, 11 U.S.C. 324(b), further provides that [w]henever the court removes a trustee * * * under subsection (a) * * *, such trustee * * * shall thereby be removed in all other cases * * * in which such trustee * * * is then serving unless the court orders otherwise."

II. Facts[4]

Hill served as a member of a panel of chapter 7 trustees established by the UST for cases filed in the Monroe Division of the United States Bankruptcy Court for the Western District of Louisiana. CR 46, SRE, Tab 145 at 1. In late 1998, in connection with the Unclaimed Freight case, Hill's "role as a Trustee reached a critical point," when she filed her final report and account (TFR). Id. The UST filed a Comment and Objection to the Report that noted several defects, most significantly that "the purported copy of an Order of [the bankruptcy court] * * * served by Ms. Hill and included in her report appeared to have been altered, in that certain material had been 'obliterated,' and the copy served by Ms. Hill on interested parties would suggest that the order she presented had been granted, whereas, in fact, it was denied."[5] CR 47, SRE, Tab 145 at 2. The bankruptcy court sustained the objection of the UST, partially sustained the objection of an objecting bank[6]

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[4] This summary is based on the findings of fact by the bankruptcy court in its October 29, 1999 opinion on contempt. CR 46-63, SRE, Tab 145 at 1-18.

[5] The UST's objections also noted that Hill failed "to object to or take some corrective action concerning a claim that was misfiled in the Unclaimed Freight claims file and pertained to an unrelated debtor." CR 47, SRE, Tab 145 at 2.

[6] Hibernia National Bank had also filed an objection, alleging that Hill "had improperly administered collateral on which it had a secured claim." CR 47, RE, Tab 145 at 2. All proceeds of the bank's fully secured collateral should have been

(whose fully secured collateral proceeds would have been disbursed to Hill and invalid claimants), and disallowed the TFR. CR 47, SRE, Tab 145 at 2.

Hill's testimony on the alteration of the court's order was "conflicting" - - "once stating that she had personally altered the order," and then stating "that the alteration was actually performed by an employee in her office, who could not be identified." Id. Hill "attach[ed] no apparent significance to the fact that the Court had denied the order," "insist[ing] that she contacted the office of the Clerk of the Bankruptcy Court and was advised that the order was 'filed' and 'valid,' and, thus, the change [from the Court's handwritten 'denied'] was justifiable." CR 47-48, SRE Tab 145 at 2-3.

Subsequently, the court held a hearing for Hill "to show cause why she should not be held in contempt and sanctions should not be imposed in connection with the alteration of the Court's order." CR 48, SRE, Tab 145 at 3. In an order, which Hill did not appeal, she was suspended from practice in the bankruptcy court for 30 days. Id. Shortly thereafter, the UST requested an order removing Hill as a trustee, and requiring her to file accountings and turn over all case records. Id.

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distributed to Hibernia rather than the erroneous distribution that Hill had proposed.

On May 20, 1999, the bankruptcy court entered an order ("removal order") removing Hill from all 287 cases in which she served as Chapter 7 trustee, requiring her to file a status report in each case, and requiring her to turn over "all case files, financial records, and estate funds" (collectively "case files") to the successor trustee in each case. CR 48-49, SRE, Tab 145 at 3-4. Following removal, the UST unsuccessfully attempted to arrange an amicable transfer of records. CR 49, SRE, Tab 145 at 4. The UST then filed, on June 18, 1999, a motion to compel Hill to turn over the case files. That same day, the bankruptcy court entered an order ("order to compel") "directing Ms. Hill to turn over all estate property on each of [her] cases," and "expressly authoriz[ing] the United States Marshal to enter the offices of Ms. Hill and to remove the items described in the Removal Order, should Ms. Hill fail to appear or in any manner oppose the enforcement of the Court's Orders." Id.

Once again the UST tried to arrange an amicable transfer. "Partial Delivery was accomplished on [June 23, 1999]." Id. On July 14, 1999, the UST moved to hold Hill in contempt for failing to comply with the removal order and the order to compel. Id. The bankruptcy court scheduled a hearing on the motion for August 4, 1999 at 11:00 a.m. Id. Hill was also directed to be present in her office at 9:00 a.m. on that date to "(hopefully) finally complete the transfer of estate property and records 'in the manner in which they were kept in the usual course of business, to the successor trustees, their agents, or the agents of the [UST].'" CR 49-50, SRE, Tab 145 at 4-5.

The hearing was held as scheduled. The UST called two witnesses - Philip Reiland, a Bankruptcy Analyst for the UST (CR 50, SRE, Tab 145 at 5), and Eugene Hastings, the successor trustee in many of Hill's cases. CR 51, SRE, Tab 145 at 6. Hill was present and represented by counsel, but did not testify or offer any evidence. CR 55, SRE, Tab 145 at 10.

Reiland testified that when Hill was a trustee, "on all the occasions when the [UST's] audit team [had] visited Ms. Hill's office, her files had contained 'Form 1's'[[7]], activity notes, trustee time sheets, telephone notes, accounts receivables logs, copies of pleadings and correspondence." CR 50, SRE, Tab 145 at 5. But "when the documents were turned over to the successor trustee [(Hastings)] these documents were in large part not present as required by the Removal Order and the Order to Compel," such that "the files were not in the condition in which they were maintained in the 'ordinary' course of business." Id.

The disparity was shown "by the comparison of the file in the Bruce case * * *, one of four retrieved by the United States Marshal on June 23, 1999," with "over 282 case files" also turned

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[7] A "Form 1" is a listing of a debtor's assets submitted every 180 days to the United States Trustee by panel trustees in each case.

over to Hastings on that day. CR 50-51, SRE, Tab 145 at 5-6. Hastings testified that these files were "incomplete," "[m]any contain[ing] only ['incomplete'] copies of court pleadings." CR 51, SRE, Tab 145 at 6. Further, Hill "ha[d] filed no status report in any of the cases." Id.

In the period between the partial removal of June 23, 1999 and the August 4, 1999 contempt hearing, Hill filed "requests for compensation in the cases in which she had previously served as trustee." Id. In five of these cases, the requests referenced pleadings that Hastings testified he had not received from Hill. Id. He further testified that "just that morning, at her office, Ms. Hill told him, her attorney, Mr. Reiland and an Assistant United States Trustee that the records in question had been destroyed." Id.

On September 1, 1999, after the contempt hearing, but before the bankruptcy court's October 29, 1999 judgment, there was a hearing in the Spohn[8] case, one of the cases from which Hill had been removed as trustee and Hastings substituted. Id. There, Hastings and Morehouse General Hospital, a secured creditor, sought to have funds in Hasting's possession paid to the hospital in recognition of its claim. CR 51-52, SRE, Tab 145

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[8] As a result of this hearing, the bankruptcy court entered an order suspending Hill from practice in the bankruptcy courts of the Western District of Louisiana, and denying her request for compensation in Spohn. CR 52-53, SRE, Tab 145 at 7-8.

at 6-7. Hill objected on the ground that "no provisions had been made to pay her compensation and expenses as the prior trustee." CR 52, SRE, Tab 145 at 7. In her testimony, she "acknowledg[ed] * * * that the records formerly contained in her files had been destroyed," but "stated she could not remember just when and how the destruction occurred." Id. She went on, however, to state "that some records could be reconstructed from her word processing equipment, telephone logs, postage meter, and by other means." Id. Based upon this "stunning" development, the bankruptcy court ordered a United States Marshal to accompany Hill, Hastings, and Assistant UST Frances Hewitt Strange to Hill's office "to collect any items covered by the Turnover Order or Order to Compel." Id. "Numerous documents were downloaded from Ms. Hill's computer word-processing program or were retrieved from various locations in the office." Id. "[N]ot only were numerous records recovered, but funds [('total[ing] $864.00 and consist[ing] of eleven checks, dated from June 25, 1999, to August 21, 1999')] pertaining to the Spohn estate were located which had not been turned over to the Successor Trustee." Id. "All of these checks post-date[d] *both* the Removal Order and the Order to Compel." Id. "Four checks actually post-date[d] the contempt hearing." Id. "Another [was] dated August 4, 1999, the date of the contempt hearing, and presumably received by [Hill] afterwards." Id.

Based on the evidence developed at the August 4 and September 1 hearings, the Bankruptcy Court entered an order, on October 29, 1999, holding Hill in contempt and filed reasons supporting the decision. CR 64, SRE, Tab 146. The order sanctioned Hill by (1) denying her compensation in all cases in which she previously served as trustee, and (2) ordering her to pay the successor trustee, Hastings, $1500. Id. On November 2, the bankruptcy court supplemented its reasons, noting that a $1050 check dated May 28, 1999 belonging to the Healthy Lifestyles estate was subsequently discovered among the documents seized from Hill on September 1, and ordering the Clerk to turn the original check over to Hastings. CR 75-76, 231-232, SRE, Tab 148 at 1-2.

III. Opinions of the Bankruptcy Court

A. May 24, 1999 (Unclaimed Freight) -- Removal Of Hill As Panel Trustee From Unclaimed Freight And All Other Cases[9]

Initially, the court adopted the findings it had made at previous hearings, including that holding Hill in contempt for violating a bankruptcy court order. CR 900, SRE, Tab 100 at 91. The court also "adopt[ed] as findings of fact and conclusions of law the supporting memorandum filed on behalf of the [UST's] Office." CR 900, SRE, Tab 100 at 91. See Memorandum. CR 431-

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[9] This summarizes the oral findings of fact and conclusions of law of the bankruptcy court on May 19, 1999.

454, Tab 58, 1-24. The court explained that 11 U.S.C. 324 does * * * require cause but, as is usually the case with the Code, cause is a standard that is not defined, and we adopt the case standard * * * within the memorandum of the United States Trustee in support of the removal here."[10] CR 902, SRE, Tab 100 at 93.

The court concluded that Hill demonstrated "a continuing pattern of the inability to properly comply with the requirements of the United States Trustee." CR 902, SRE, Tab 100 at 93. Specifically, the court found that Hill: (1) failed to deposit checks and keep records thereof, (2) failed to visit the Clerk's Office in Alexandria, Louisiana to examine the claims files (and relied solely on the Claims Register instead), (3) made no effort to comply with the guidelines of the United States Trustee Manuals or the checklists that were provided here, (4) failed to investigate the financial affairs of the debtor, (5) relied solely on statements made by the debtor concerning collateral and failed to conduct a proper UCC-1 search until it was too late to do so, (6) failed to close the estate as expeditiously as compatible with the best interests of the parties in interest, and (7) failed to prepare a final report and final account with

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[10] The UST's memorandum stated that "Cause exists * * * when removal of the trustee is in the best interests of the estate. Actual malfeasance is not required. Further, a trustee may be removed if the best interests of the estate are harmed by the trustee's continued service, ' * * * without reflection upon his honesty or integrity.'" CR 441, SRE, Tab 58 at 11 (footnote omitted).

the Court and the United States Trustee. CR 900-905, SRE, Tab 100 at 91-96.

The court stated that "[i]n short, the activities of this trustee * * * justify removal for cause, even if the shocking situation with regard to the alteration of the Court's Order had not occurred." CR 905, SRE, Tab 100 at 96. The court further stated that it "believes that the activities of the trustee * * * indicate that she cannot continue to serve as a trustee in the Division and in the District and that the best interest of creditors and the estate and the public interest justify her removal not only from this case, but as set forth in Section 324 of the Code, (b), that she be removed from all other cases under this Title in which she serves." Id. The court recognized that it had "the authorization to order otherwise in connection with the removal from all other cases," but "d[id] not find cause or any reason to order otherwise." Id.

B. September 8, 1999 (Spohn) - - Denial Of Fees And Suspension Of Hill From Practicing Before Bankruptcy Court[11]

The court held that Hill was not entitled to compensation in that her "objection" "d[id] not comply with the Local Rules and the requirement that a copy be served on the [UST] and that [the application] contain an accurate, detailed explanation of the nature of the services and the tasks that were performed." RE, Tab – - at 97. Further, the court noted, "[w]e have the problem that it is a reconstructed time record and subject to, therefore, the lack of possible credibility." RE, Tab – - at 97. Additionally, the court stated, "we have the situation that the services * * * essentially were of no benefit to this estate with regard to this particular asset * * *." Id.

The court then highlighted "the absolutely, truly amazing situation that developed here today in Ms. Hill's testimony," where having previously testified at the August 4 contempt hearing "that the records had been destroyed, today we had Ms. Hill's testimony that there items that were shown on her objection had been reconstructed by a review of items that were

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[11] This summarizes the oral findings of fact and conclusions of law of the bankruptcy court on September 1, 1999. RE, Tab -- at 92. On September 8, 1999, the court issued its order of suspension (RE, Tab 136 at 1) and its Reasons For Order Concerning Suspension From Practice. RE, Tab 135 at 1. In this opinion, the court relied on its "reasons orally assigned at the [September 1, 1999] hearing * * *." Id. at 2.

available in her office, including the records that might include a demand letter, one of something like 180 she sent to patients of Dr. Spohn's, the possible reconstruction of phone logs, copy expenses and so forth." RE, Tab – - at 97-98. The court then alluded to "over $800 that appeared to pertain to this case and to the administration of this case by the successor Trustee that Mr. Hastings has never seen before today and that for reasons known only to her, Ms. Hill was apparently concealing from the successor Trustee and the Court." Id. The court cited "records in this case, correspondence from the account debtors, correspondence from other attorneys and other documents in other cases in which Mr. Hastings is the successor Trustee that have been concealed from [him]." Id. at 98-99.

The court concluded that Hill "ha[d] engaged in a deliberate pattern [of concealing] assets of this estate and particularly, the sums exceeding $800 * * *." RE, Tab – - at 100. Further, the court stated, it believed that Hill "ha[d] deliberately concealed and withheld documents pertaining to the administration of this case and other cases." Id. Reserving decision on "[w]hether or not * * * those documents were * * * within the confines and the description of this Court's Order for the turnover or motion to compel," the court stated that "what we have here, regardless of the contents of those Orders or Ms. Hill's interpretation, is a false application, a situation in which she has repeatedly lied or omitted information that would have been helpful to this Court and the ongoing administration of this and other cases by * * * the successor Trustee." Id.

The Court described the "situation" as one "in which the Court finds that the counsel - - Ms. Hill is not just a Trustee, a predecessor Trustee. She is a lawyer. She has lied to this Court. She has altered its Orders, She has failed to comply with its Orders." Id. The court further indicated that "the next action that the Court will [take] with regard to Ms. Hill is a referral to the United States Attorney in the hope that she will be prosecuted for bankruptcy crimes and the Court intends to make a referral [of] this matter pursuant to [18 U.S.C. 151][[12]] * * *." RE, Tab – - at 101. In conclusion, the court stated that "[i]t just seems to me that beginning with what happened in the Unclaimed Freight case as incompetence of the highest order, we now have more than just incompetence. We have the deliberate willful breach of a fiduciary duty." RE, Tab – - at 103.

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[12] 18 U.S.C. 151-157 deals with bankruptcy crimes.

C. October 29, 1999 - - Holding Hill In Civil Contempt And Imposing Sanctions[13]

Distinguishing between criminal and civil contempt, the court stated that "[a] bankruptcy court has the authority to conduct civil contempt proceedings." CR 53, SRE, Tab 145 at 8. The court then stated that the Fifth Circuit "has delineated the test for civil contempt," by requiring a showing that "(1) a court order was in effect; (2) the order required certain conduct; and (3) the respondent failed to comply with the order." CR 54, SRE, Tab 145 at 9. Further, the court noted, "the burden of proof is clear and convincing, as opposed to preponderance of [the] evidence." Id. Once this test has been met, the court explained, "the respondent bears the burden of showing mitigating circumstances * * *." Id.

After quoting from its "Order Of Removal" and "Order To Compel," the court stated that "[t]here can be little doubt that the test has been met here." CR 54-55, SRE, Tab 145 at 9-10. Both orders, the court stated, "simply required Ms Hill to (1) turnover (a) records and (b) funds and (2) to file status reports

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[13] At the August 4, 1999 hearing, the bankruptcy judge declined a motion to recuse himself. CR 160, SRE, Tab 147 at 64. The judge stated that "if the Court feels any feelings toward Ms. Hill's capacity in this case, or her demeanor, it is because of her own actions that she has created in consistently being late and not properly filing her pleadings * * *. It arose from within the case. I do not believe that constitutes cause for a recusal." CR 161, SRE, Tab 147 at 65.

in each of the cases from which Ms. Hill was removed as trustee." CR 55, SRE, Tab 145 at 10. Here, "Ms. Hill failed to comply with both prongs * * *." Id.

Turning to Hill's defense, the court stated that her "only explanation, other than that the records were destroyed, is a statement she made on September 1, at the hearing in the Spohn case," where "she observed * * * that the turnover of the file contents in their entirety was not required by the order, apparently a reference to the original turnover order." Id. The court responded that "[w]hile it is true that the removal order specified 'case files, financial records, and estate funds in each case listed' and the Order to Compel referred to 'files, financial documents, funds and other assets and the Records * * *,' Ms. Hill's attempt to quibble over the differing language of the orders falls on deaf ears." Id.

Alluding to "the history of Ms. Hill's understanding of this Court's orders," the court stated that "one might think she would simply comply, rather than again applying her own gloss or interpretation to the same." Id. The court noted that "[r]egardless of the difference in the descriptions of the items, both orders clearly required Ms. Hill to file a status report in each case, which she has not done." CR 55, SRE, Tab 145 at 10. The court pointed out that "Ms. Hill did not testify at the contempt hearing, offered no evidence of any mitigating circumstances, and filed no brief." Id. Noting that Hill's counsel had argued that she lacked intent to violate the court's orders, the court stated that "intent is not an element in civil contempt matters," and that "the basic rule is that all orders and judgments of courts must be complied with promptly." CR 55-56, SRE, Tab 145 at 10-11.

The court then addressed the destruction of records, acknowledging that "[t]he[ir] destruction * * * could possibly be a mitigating circumstance, had they been destroyed by a fire or flood." CR 56, SRE, Tab 145 at 11. But here, the court explained, Hill had testified in the September 1, 1999 hearing in Spohn "that the records were destroyed," but "has offered no explanation, other than her statement on September 1, 1999 that she could not remember the details of the destruction." Id. The court "d[id] not find sufficient evidence of a mitigating circumstance," and noted that "Ms. Hill is hard-pressed to explain her non-compliance with the portions of the orders that required her to file status reports." Id.

Finally, citing Hill's testimony in Spohn "that she was able to reconstruct certain documents and time and expense records," the court stated that "it was incumbent upon Ms. Hill to make every effort to do so without delay." CR 56, SRE, Tab 145 at 11. The court found to be "without any justification whatsoever," Hill's "continued intransigence in the face of repeated efforts by the Court and the [UST] to seek compliance." Id. Thus, the court stated, "the only conclusion that can be adduced is that Ms. Hill willfully and deliberately flouted the Court's directives."[14] Id.

The Court then turned to the matter of a remedy, in particular as related to compensation of the trustee. Id. The court noted that in addition to seeking compensation in the bankruptcy court, Hill also had sought compensation in the district court in over 287 cases. CR 58, SRE, Tab 145 at 13. The bankruptcy court expressed its hope that "the District Court will decide that the compensation issues should first be resolved in this forum." CR 58 n.9, SRE, Tab 145 at 13 n.9.

Addressing compensation in the asset cases, under 11 U.S.C. 326, the court rejected Hill's claim that since she was precluded from taking the cases to completion, in which case compensation

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[14] On November 2, 1999, the bankruptcy court supplemented its reasons for finding Hill in contempt to reflect the subsequent discovery, within the materials removed from her office on September 1, 1999, of an additional check ($1050) payable to her as trustee, relating to one of her cases, Healthy Lifestyles. CR 75, SRE, Tab 148 at 1. The court stated that "Ms. Hill deliberately concealed property of more than one of the estates she had been appointed to administer as trustee prior to her removal" and noted that "[i]n the Healthy Lifestyles case the funds are dated May 27, 1999, after entry of the Removal Order, but prior to the Order to Compel." CR 232, SRE, Tab 148 at 2. The court further stated that "[d]espite these orders, Ms. Hill failed to turn over these funds to the successor trustee," and that "[n]othing could more clearly demonstrate her total disregard for the Orders of the Court." Id. Finally, the court stated, "[s]he has shown no mitigating circumstance preventing her from complying with the orders." Id.

would be a percentage of moneys she had disbursed, her compensation was to be based on $100.00 per hour expended. CR 58, SRE, Tab 145 at 13. The court reasoned that "[t]he compensation of a Chapter 7 trustee is 'capped' at the percentages set forth in 11 U.S.C. §326," and "is based on monies actually disbursed or turned over in the case by the trustee to parties in interest, and is unconditional." Id. Further, the court stated, "[a]ny award, within the maximum rate, is subject to the discretion of the court, to be determined based on the reasonable value of the services." CR 58-59, SRE, Tab 145 at 13-14.

"Thus," the court concluded, "there is no support under 11 U.S.C. § 326 for Ms. Hill's applications for compensation, absent their being correlated to disbursements to creditors." CR 59, SRE, Tab 145 at 14. And, the court added, "[u]nfortunately, the same statutory scheme bars an award [for] Mr. Hastings * * *." Id. The court then explained that, by contrast, "the same result is not required as to six Consensual Sale matters for which Ms. Hill received the compensation, but [which] Mr. Hastings was required to complete the sale." CR 59, SRE, Tab 145 at 14. "[A]s to those matters," the court stated, "Ms. Hill should not be permitted to profit to the detriment of the successor trustee," and noted that "[t]he sales at issue" amounted to $1500. CR 59-60, SRE, Tab 145 at 14-15. The court further held that Hill's applications for compensation were "incompatible with the lack of records." CR 60, SRE, Tab 145 at 15. The court explained that "[t]he fact that compensation is fixed by statute does not * * * obviate the need for time records or for a proper application." Id.

The court first pointed out that Hill's ability "to itemize her time and expense records in 287 cases" was "scarcely compatible with her professed inability to produce the records," and then, alluding to Spohn, noted that "[i]t strains credulity to suggest that Ms. Hill can account for sending 198 demand letters at a cost of $65.34 while simultaneously claiming her records were mysteriously destroyed." CR 61, SRE, Tab 145 at 16. Further, the court stated, Hill's "applications are defective on their face" for failure to comply with Local Bankruptcy Rule (LBR) 2016-1, "which incorporates a requisite showing of the factors relative to the quality of representation * * *." Id. Additionally, noting that "[a]ll applications exceeding $500.00 must be noticed for a hearing which counsel must attend," and that "[a]ll pleadings including applications for professional compensation, must be served in accordance with LBR 9013-3 and accompanied by a Certificate of Service," the court stated that "Ms. Hill's applications were not noticed for hearings and were not served on any party in interest." CR 62, SRE, Tab 145 at 17.

Finally, the court, stated that the "most compelling reason for the denial of all compensation, relates to this former trustee's conduct." Id. Stating that Hill's "egregious conduct warrants the denial of all compensation" (id.), the court explained that Hill "has repeatedly failed to comply with orders of the court."[15] CR 63, SRE, Tab 145 at 18. The court stated that "[p]ermitting her to continue the farce of seeking compensation while all the while disregarding the orders of the court would only burden the United States Trustee, the Successor Trustees, and this Court with an inordinate number of unnecessary hearings." Id. Therefore, the court denied Hill compensation "in all cases in which she previously served as Trustee," ordered her to pay Hastings $1,500 (compensation she had already had received), and, "in the event the District Court should grant relief under Ms. Hill's ***Rule to Show Cause***," "report[ed] and recommend[ed] that the District Court deny all compensation to Hill in all the cases from which she was removed as Trustee." Id.

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[15] The court quoted at length from Continental Ill. Nat'l Bank & Trust Co. v. Charles N. Wooten, Ltd. (In re Evangeline Refining Co.), 890 F.2d 1312, 1323 (5th Cir. 1989). CR 62, SRE, Tab 145 at 17.

IV. Opinions of the District Court

A. March 23, 2000 - - Removal Of Hill As Chapter 7 Panel Trustee (Unclaimed Freight); Denial Of Compensation In Spohn As Predecessor Trustee; Suspension From Practicing Before Bankruptcy Court (Spohn)

The district court affirmed the bankruptcy court's order in Unclaimed Freight (May 24, 1999), and its orders in Spohn (September 8, 1999). CR Vol. 3 at 406, RE, Tab C at 1. The court explained that the findings of fact of the bankruptcy court were to be "scrutinized under the clearly erroneous standard of review," and that its "conclusions of law are subject to *de novo* review." CR Vol. 3 at 407, RE, Tab C at 2. The court stated that it "ha[d] reviewed [each] appeal in accordance with the appropriate standards and finds no error in the bankruptcy court's decision." CR Vol. 3 at 408-409, RE, Tab C at 3-4.

Addressing Hill's removal in connection with Unclaimed Freight, the court summarized the bankruptcy court's findings as to "Hill['s] contempt of court for altering a bankruptcy court Order," and as to Hill having "engaged in a 'continuing pattern of the inability to properly comply with the requirements of the United States Trustee.'" CR Vol. 3 at 407, RE, Tab C at 2.

Turning to Spohn, the court noted the bankruptcy court's finding "that Hill had engaged in a deliberate pattern of concealing assets of the estate from the successor trustee and that she intentionally withheld documents pertaining to the administration of the case." CR Vol. 3 at 409, RE, Tab C at 4.

B. April 20, 2000 - - Contempt; Denial Of Compensation In All Cases (__Contempt Decision__, October 29, 1999)

The district court affirmed the bankruptcy court's decision of October 29, 1999, holding Hill in civil contempt and imposing sanctions against her. CR Vol. 3 at 429, RE, Tab E at 1. The court explained that the findings of fact of the bankruptcy court were to be "scrutinized under the clearly erroneous standard of review," and that its "conclusions of law are subject to *de novo* review." CR Vol. 3 at 440, RE, Tab E at 2. The district court concluded that it "ha[d] reviewed this appeal in accordance with the appropriate standards and f[ound] no error in the bankruptcy's court's decision."[16] CR Vol. 3 at 443, RE, Tab E at 5.

After the court summarized the events leading to the finding of contempt and the imposition of sanctions, the court explained that the bankruptcy judge "concluded that the U.S. Trustee proved by clear and convincing evidence that Hill willfully and

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[16] The court further noted that on November 2, 1999, the bankruptcy court had supplemented its reasons, noting that a May 28, 1999 check for $1,050.00 which belonged to an estate in one of Hill's cases "was discovered among the documents seized from Hill's office on September 1, 1999," and had "ordered the original check [turned] over to the Successor Trustee." The district court also affirmed this order. CR Vol. 3 at 444 n.2, RE, Tab E at 6 n.2.

deliberately failed to comply with the bankruptcy court's Orders" (CR Vol. 3 at 442, RE, Tab E at 4), and "further concluded that Hill failed to prove the existence of any mitigating circumstances that might have prevented her from complying * * *." CR Vol. 3 at 443, RE, Tab E at 5. The court then summarized the bankruptcy court's reasoning supporting the denial of fees to Hill including the bankruptcy court's having found that "Hill's egregious conduct * * *, including her repeated failure to comply with the bankruptcy court's Orders, warranted the denial of all compensation." Id.

SUMMARY OF ARGUMENT

1. The bankruptcy court acted reasonably in removing Hill as trustee in Unclaimed Freight and in not preventing her removal from all her other cases. The "cause" for which a bankruptcy judge may remove a trustee, under 11 U.S.C. 324(a), includes the trustee's incompetence or unwillingness to perform his or her duties. See 3 Collier On Bankruptcy ¶ 324.02, at 324-3 (Lawrence P. King, ed., 15th ed. 2000). Thus, contrary to Hill's apparent claim, the Code does not require the bankruptcy court to wait until demonstrated incompetence or unwillingness results in a significant loss to one or more of the trustee's estates.

The Code does not define "cause," but the term, rooted in the common law, is commonly used in federal statutes and regulations relating to the removal of an officer or employee.

The "for cause" standard, in contrast to service "at will," requires a ground for removal that is reasonably related to a substantial failure by the officer or employee to fulfill the requirements of his or her position. When, as in the Bankruptcy Code, Congress uses a common law term with a settled meaning, the term must be given that meaning unless Congress otherwise indicates. "Cause" is such a term, and nothing in the Bankruptcy Code suggests that it should be given other than its usual meaning, requiring a case-by-case evaluation of the circumstances alleged to warrant removal. Once the bankruptcy court removes a trustee "for cause," the Code, 11 U.S.C. 324(b), provides that the trustee "<u>shall</u> thereby be removed in <u>all other cases</u> under this title in which such trustee * * * is then serving <u>unless</u> the court orders otherwise" (emphasis supplied). Thus, only an exercise of the court's discretion can prevent this broader removal.

Here, Hill does not contest the bankruptcy court's findings of fact that overwhelmingly demonstrate her incompetence or unwillingness to perform her duties. Thus her removal "for cause" as trustee in <u>Unclaimed Freight</u> was valid. This same evidence made unthinkable her continued service in this capacity in <u>any</u> case. Hill offered the bankruptcy court no reason to reach a contrary result. And it properly did not.

2. The bankruptcy court also validly held Hill in civil contempt for failure to comply with its orders. Hill did not testify at the contempt hearing, offered no other evidence to dispute the UST's case, and did not file a brief. She now acknowledges that "[t]he crux of the contempt order is that the files turned over were incomplete" (Aplnts. Br. 14). Then by discussing what documents should or should not be in a trustee's file, she attempts to divert attention from the fact that the bankruptcy court dealt with her failure to relinquish numerous documents _already in her files_ as trustee. She also claims that the court's orders were insufficiently comprehensive, but never explains why. A reading of those orders, which refer to "all case files" and "all * * * files" demonstrates that they indeed required her to turn over the entirety of the files. Finally, contrary to Hill's claim, the court made totally clear the fact that her belated turnover of files was incomplete.

Hill's attack on the constitutionality of the contempt finding is equally unavailing. The bankruptcy court afforded Hill, who while an attorney herself was represented by counsel, a full hearing consistent with due process. Hill claims, however, that there was an improper "reopening"of the contempt hearing during the September 1, 1999 hearing in _Spohn_. There was no such reopening. Rather, in her efforts to collect a fee, Hill there testified that the missing records contained in the case files had been destroyed, but that certain records could be reconstructed from her word processing equipment, telephone logs, postage meter, and other means.

Based upon this "stunning" development (CR 52, SRE, Tab 145 at 7) and the two outstanding orders to produce the files, the bankruptcy court had more than sufficient reason, including possible further destruction of files, to order a United States Marshal to accompany Hill, Hastings, and Assistant U.S. Trustee Strange to Hill's office to collect any documents covered under the removal order. And that search of Hill's office retrieved numerous records, and eleven checks belonging to the Spohn estate. Hill never requested a reopening of the contempt hearing to explain her failure previously to turn over these items, nor did she submit any written explanation to the court. The bankruptcy court appropriately considered these further developments, (including a twelfth such check later discovered in the court's exhibits) when it held Hill in contempt.

3. The bankruptcy court also properly exercised its discretion to deny compensation to Hill in all of her cases. Her "egregious conduct" (CR 62, SRE, Tab 145 at 17), violating her trustee's duty as an officer of the court who is held to high fiduciary standards more than sufficed as the basis for such denial. Continental Ill. Nat'l Bank & Trust Co. v. Charles N. Wooten, Ltd. (In re Evangeline Refining Co.), 890 F.2d 1312, 1323, 1325 (5th Cir. 1989). Moreover, even without such misconduct, Hill failed to submit the documentation necessary to support her claim for fees. Under Bankruptcy Rule 2106, "an application must be sufficiently detailed and accurate that, in conjunction with any proceeding in connection therewith and the record in the case, a court can make an independent evaluation as to what level of fees are actual, necessary and reasonable." Evangeline, 890 F.2d at 1326. Further, this Court has recognized that while contemporaneous records are not required per se, reconstructed records are highly problematic where they become "a mere guess by the applicant" (id. at 1326-27), and that while a total denial of fees is "rare" (id at 1327), it may be warranted. This is such a case.

Here, the bankruptcy court properly held that Hill's applications were "defective on their face" (CR 61, SRE, Tab 145 at 16) under Local Bankruptcy Rule 2016-1. Hill is wrong to suggest that the rule is inapplicable. See Evangeline, 890 F.2d at 1326 (applying Rule 2016 to a trustee). Further, the bankruptcy court also correctly invoked Hill's failure to comply with the formal requirements in local rule 9013-2C(5), since this was not the "ordinary" case in which the court might well overlook such matters. Finally, the court properly found that Hill's applications were incompatible with the lack of records. The court had every reason to doubt Hill's ability "to itemize her time and expense records in 287 cases" (CR 61, SRE, Tab 145 at 16), yet simultaneously not produce the records.

4. The bankruptcy court also reasonably determined that Hill be suspended from practice before it. This Court has recognized that "a bankruptcy court does have the power to conduct a disciplinary hearing and discipline the attorneys who practice before it," and that the purpose is not punishment, "'but * * * to determine the fitness of an official of the court to continue in that capacity and to protect the courts and the public from the official ministration of persons unfit to practice.'" Cunningham v. Ayers (In re Johnson), 921 F.2d 585, 586-87 (5th Cir. 1991).

Here, the bankruptcy court found that "[Hill] has lied to this Court. She has altered its Orders. She has failed to comply with its Orders." SRE, Tab - - at 100. Under these circumstances, Hill's suspension was entirely warranted.

5. Finally, the bankruptcy judge correctly declined to recuse himself at Hill's contempt hearing. Opinions formed by the judge from "facts introduced or events occurring in the course of the current proceedings, or of prior proceedings" may be invoked as a basis for seeking recusal only if "they display a deep-seated favoritism or antagonism that would make fair judgment impossible." Liteky v. United States, 510 U.S. 540, 555 (1994).

Here, in the testimony Hill cites, the bankruptcy judge simply recounted her derelictions, for example, that "she has burdened the Court and the Clerk with processing innumerable [claims] for * * * Compensation where it is the policy of the [UST] that Applications for Compensation in asset cases must be supported by time records, that for reasons that are yet unknown to me, and perhaps you know them, Mr. Charles [(Hill's then attorney)], she has not turned over." CR 160, SRE, Tab 147 at 64. As for Hill's claim that the judge had "personal knowledge" (Aplnts. Br. 25) that required recusal, he had only the knowledge that derived from the very course of his official and proper involvement with Hill and the successor trustee in the matters related to her contempt.

STANDARD OF REVIEW

This Court reviews decisions relating to (1) a finding of civil contempt, (2) the award of compensation to a bankruptcy trustee, (3) the suspension of an attorney, and (4) the issue of recusal, under an abuse of discretion standard. United States v. Brumfield, 188 F.3d 303, 307 (5th Cir. 1999) (civil contempt); Continental Ill. Nat'l Bank & Trust Co. v. Charles N. Wooten, Ltd. (In re Evangeline Refining Co.), 890 F.2d 1312, 1322 (5th Cir. 1989) (compensation of trustee); Cunningham v. Ayers (In re Johnson), 921 F.2d 585, 587 (5th Cir. 1991) (suspension of attorney); United States v. Wilson, 77 F.3d 105, 110 (5th Cir.

1996) (recusal). Further, since, in the case of a trustee removed in one case, under 11 U.S.C. 324(a), the bankruptcy court may, under 11 U.S.C. 324(b), prevent the trustee's automatic removal from all other assigned cases, the court's decision on this issue must be reviewed for abuse of discretion.

"A bankruptcy court's findings of fact are subject to the clearly erroneous standard of review and will be reversed only if, considering all the evidence, we are left with the definite and firm conviction that a mistake has been made. Strict application of this standard is particularly appropriate when the district court has affirmed the bankruptcy court's findings. We are particularly mindful of 'the opportunity of the bankruptcy court to judge the credibility of the witnesses.' Conclusions of law, of course, are reviewed de novo" (footnotes omitted). In re Young, 995 F.2d 547, 548 (5th Cir. 1993). See also Placid Refining Co. v. Terrebonne Fuel and Lube (In re Terrebonne Fuel and Lube, Inc.), 108 F.3d 609, 612 (5th Cir. 1997). Matter of World Hospitality, Ltd., 983 F.2d 650, 651 (5th Cir. 1993).

ARGUMENT

I.

THE BANKRUPTCY JUDGE HAD "CAUSE," UNDER 11 U.S.C. 324(a), TO REMOVE HILL AS TRUSTEE IN UNCLAIMED FREIGHT, AND ACTED WITHIN ITS DISCRETION IN ALLOWING HER REMOVAL, UNDER 11 U.S.C. 324(b), FROM ALL OTHER BANKRUPTCY CASES TO WHICH SHE WAS ASSIGNED AS A PANEL TRUSTEE

A. "Cause" Includes A Trustee's Incompetence Or Unwillingness To Perform Her Duties

1. "Cause" Is A Commonly Used Federal Standard

The Bankruptcy Code provides that a trustee may be removed for "cause," but does not define it. The term, however, was not written "on a clean slate." It is commonly used in federal statutes governing removal of an officer[17] or dismissal of an

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[17] See 14 U.S.C. 738(a) ("President may, for cause, remove the name of any officer from a list of selectees" (emphasis supplied)); 12 U.S.C. 1422b(a)(2) (Federal Home Loan Bank Board may "suspend or remove for cause a director, officer, employee, or agent of any Federal Home Loan Bank or joint office" (emphasis supplied)); 39 U.S.C. 3601(a) (Commissioners of Postal Rate Commission "may be removed by the President only for cause" (emphasis supplied)); 18 U.S.C. 3602(a) ("court may, for cause, remove a probation officer appointed to serve with compensation, and may, in its discretion, remove a probation officer appointed to serve without compensation" (emphasis supplied)); 43 U.S.C. 1629e(b)(2)(B) (Native Corporation that has established Settlement Trust may "remove the trustees of the trust for cause" (emphasis supplied)); 16 U.S.C. 4009(f)(5) ("[t]he Secretary shall remove any member of a council if the council concerned first recommends, by not less than two-thirds of its members, removal for cause" (emphasis supplied)); 16 U.S.C. 1852(b)(6) ("The Secretary may remove for cause any member of a Council required to be appointed by the Secretary" (emphasis supplied)).

employee,[18] and is rooted in the common law. See Arnett v. Kennedy, 416 U.S. 134, 159-60 (1974).

2. The Usual Meaning Of "Cause"

Persons who may be removed "at will," are contrasted with persons who may be removed only for "cause." An "at will" officer or employee is subject to removal for any reason or no reason. But in the case of an officer or employee who may be 40 removed only for "cause," there must be a ground for removal that is reasonably related to a substantial failure to fulfill the requirements of his or her position.[19] Although, the "for cause"

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[18] 5 U.S.C. 7513(a) (authorizing removal or suspension without pay "for such cause as will promote the efficiency of the service").

[19] See, e.g., Fox v. Cody, 141 Misc. 552, 553, 252 N.Y.S. 395, 397 (S. Ct. N.Y. 1930) ("in the absence of a provision in the charter or by-laws * * * that a director may be removed without cause, he may not be arbitrarily removed"); Youngblood v. City of Galveston, 920 F. Supp. 103, 106 (S.D. Tex. 1996) ("Youngblood was an at-will employee and could be terminated without cause"); Martin v. Corrections Cabinet, 822 S.W.2d 858, 860 (S. Ct. Ky. 1991) ("cause relating to, and affecting, the administration of the office, must be restricted to something of a substantial nature directly affecting the rights and interests of the public"); Morrison v. Department of Highways, 85 So. 2d 51, 53, 229 La. 116, 120 (1955) ("'no "cause" is shown for the termination of the employment * * * where there is no proof of substantial shortcoming which renders continuance of the employee in employment in some way detrimental to the discipline or efficiency of the Civil Service'"); State ex rel. Ryan v. Board of Aldermen, 43 Mont. 188, 196, 122 P. 569, 571 (1912) ("'" Cause for removal" means some substantial shortcoming which renders continuance in office or employment in some way detrimental to the discipline and efficiency of the service, and something which the law and a sound public opinion will recognize as a good cause for his no longer occupying the place"'" (quoting Dillon,

standard thus affords the officer or employee a significant protection against arbitrary removal, it does not thwart the removal of one who is unwilling or unable to perform his or her duties.[20]

3. The Meaning Of "Cause" In The Bankruptcy Code

"Where Congress uses terms that have accumulated settled meaning under * * * the common law, a court must infer, unless the statute otherwise dictates, that Congress means to incorporate the established meaning of these terms." Nationwide Mut. Ins. Co. v. Darden, 503 U.S. 318, 322 (1992). See also

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Municipal Corporations § 477 (5th ed. 1911)).

[20] Three federal regulations provide that "cause" "include[s] but [is] not limited to: extensive and unauthorized absences; misconduct; inability to perform assignments; and failure to accept supervision." 45 C.F.R. 2553.52(a), 2552.53(a), 2551.53(a). The rules governing the Attorney General's removal of a "Special Counsel" specify the grounds as "dereliction of duty, incapacity, conflict of interest, or * * * other good cause, including violation of Departmental policies" (emphasis supplied). 28 C.F.R. 600.7(d). Regulations governing termination of an officer or employee of a federal saving association state that "[t]ermination for cause shall include termination because of the officer or employee's personal dishonesty, incompetence, willful misconduct, breach of fiduciary duty involving personal profit, intentional failure to perform stated duties, willful violation of any law, rule, or regulation (other than traffic violations or similar offenses) or final cease-and-desist order, or material breach of any provision of the contract." 12 C.F.R. 563.39. Finally, a regulation relating to "School Boards For Department of Defense Domestic Dependent Elementary And Secondary Schools" provides that "[s]chool board members may be removed * * * for dereliction of duty, malfeasance, or other grounds for cause shown" (emphasis supplied). 32 C.F.R. 69.5(d)(6).

Bragdon v. Abbott, 524 U.S. 624, 645 (1998) ("[w]hen administrative and judicial interpretations have settled the meaning of an existing statutory provision, repetition of the same language in a new statute indicates, as a general matter, the intent to incorporate its administrative and judicial interpretations as well"). As just shown, "cause" is precisely such a term. Further, nothing in the Bankruptcy Code suggests that it "otherwise dictates" (Nationwide, 503 U.S. at 322) that Section 324's "for cause" standard be given a new meaning.

Thus, in In re Lundborg, 110 B.R. 106 (Bankr. D. Conn. 1990), the court stated that "[c]ause, which is not defined by the Code, must be determined by courts on an ad hoc basis." Id. at 108. See also In re University Ave. Properties, 55 B.R. 986, 991 (Bankr. E.D. Wis. 1986) ("'cause' * * * can only be defined on a case-by-case basis depending on the facts of the particular case"). Nothing in the decisions cited by Hill, pertaining to removal for either alleged "conflict of interest" or "misconduct" "involving losses to the estate" (Aplnts. Br. 8-9), supports her claim that "[c]ases involving removal of trustees fall into two categories," i.e., that these are the sole grounds for removal.[21]

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[21] Thus, in In re Baker, 38 B.R. 705 (D. MD 1983) (Aplnts. Br. 9), the court noted that "[m]ost of the case law concerning removal of a trustee involves intentional misconduct or negligence" and that "[i]n several cases * * * a trustee was seemingly removed on the basis of" "the best interests of the

If this were so, the bankruptcy court could not act even when presented, as here, with overwhelming evidence of a trustee's incompetence or unwillingness to perform his or her duties, until such time as a significant loss resulted to an estate.

To the contrary, as with other offices as to which the removal "for cause" standard applies, "[c]auses for removal [of a trustee] include situations in which the trustee is found to be incompetent or unwilling to perform [his or her] duties * * *." 3 Collier On Bankruptcy ¶ 324.02, at 324-3 (Lawrence P. King, ed., 15th ed 2000). This was the case in In re Schoen Enters., Inc., 76 B.R. 203 (Bankr. M.D. Fla. 1987). There, the court held, in circumstances closely resembling Hill's, that it was appropriate to remove a corporate Chapter 7 trustee that "ha[d]

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estate." Id. at 707-08. The court upheld the decision of the bankruptcy judge not to remove the trustee since there was insufficient evidence of negligence or misconduct, and since there was "substantial foundation" for the bankruptcy judge's conclusion that removal was not in the best interests of the estate. Id. at 708-09. And in In re Peckinpaugh, 50 B.R. 865 (Bankr. N.D. Ohio 1985), the court stated that "[s]ome courts professed to rule on the basis of the 'best interest of the estate' or * * * 'avoiding even the appearance of impropriety,' but "most of the courts faced with alleged potential conflict of interest or potential wrongdoing hold that 'potential conflicts of interest do not warrant the removal of a trustee' in the absence of fraud and actual injury." Id. at 867 (citing, In re Freeport Italian Bakery, Inc., 340 F.2d 50, 54 (2d Cir. 1965)). Finally, Ford Motor Credit Co. v. Weaver, 680 F.2d 451 (6th Cir. 1982) (Aplnts. Br. 9) has nothing to do with removal or disqualification of a trustee. Rather, the decision concerns only the standard to be applied in determining personal or official liability. 680 F.2d at 461-62.

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failed to perform the functions required of it by the Bankruptcy Code."[22] Id. at 206.

The court explained that the trustee "has neglected to 'investigate the financial affairs of the debtor' in failing to pursue possible avoidable preferences." The court then noted that "[this neglect is coupled with the further failure to 'furnish such information concerning the estate and the estate's

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[22] The Bankruptcy Code, 11 U.S.C. 704, establishes the "[d]uties of the [t]rustee," requiring that the trustee:

> (1) collect and reduce to money the property of the estate for which such trustee serves, and close such estate as expeditiously as is compatible with the best interests of parties in interest;
>
> (2) be accountable for all property received;
>
> (3) ensure that the debtor shall perform his intention as specified in section 521(2)(B) of this title;
>
> (4) investigate the financial affairs of the debtor;
>
> (5) if a purpose would be served, examine proofs of claims and object to the allowance of any claim that is improper;
>
> (6) if advisable, oppose the discharge of the debtor;
>
> (7) unless the court orders otherwise, furnish such information concerning the estate and the estate's administration as is requested by a party in interest.

administration as is requested by a party in interest,'" and "intentional[] violation of] the order of this Court * * *." 76 B.R. at 205. Similarly, in Matter of Island Amusement, Inc., 74 B.R. 18, 19 (Bankr. D.P.R. 1987) and In re Mira-Pak, Inc., 72 B.R. 430, 431 (Bankr. S.D. Tex. 1987), the courts held that an unreasonable delay in the performance of a trustee's duties was sufficient "cause" for removal. And in In re Cee Jay Discount Stores, Inc., 171 B.R. 173, 175 (Bankr. E.D.N.Y. 1994), the court stated that "[v]arious remedies are available when a trustee is found to have acted negligently," and that "[a]n extreme solution is removal of the trustee upon a showing of cause."

B. The Facts Overwhelmingly Show Hill's Incompetence Or Unwillingness To Perform Her Duties

Hill does not contest the factual determinations of the bankruptcy court that demonstrate her incompetence or unwillingness to perform the duties of a trustee. Nor could she. As explained by the district court, at the time the bankruptcy judge held a hearing on the motion of the UST for Hill's removal, he had already held Hill "in contempt of [the] court for altering a bankruptcy court order" (CR Vol. 3 at 407, RE, Tab C at 2), a matter that the bankruptcy judge deemed to be a "shocking situation." CR Vol. 3 at 408, RE, Tab C at 3. The court then quoted the bankruptcy judge's finding that "Hill engaged in a 'continuing pattern of the inability to properly comply with the requirements of the [UST].'"[23] CR Vol. 3 at 407, RE, Tab C at 2.

C. Once Having Removed Hill As Trustee In Unclaimed Freight, The Bankruptcy Court Did Not Abuse Its Discretion, Under 11 U.S.C. 324(b), In Allowing Her Removal As Trustee In All Her Cases To Take Effect

The Bankruptcy Code, 11 U.S.C. 324(b), provides that "[w]henever the court removes a trustee * * * under subsection(a) * * * such trustee * * * shall thereby be removed in all other cases under this title in which such trustee * * * is then serving unless the court orders otherwise" (emphasis supplied). Thus, the statute makes clear that once the bankruptcy court removed Hill for "cause" in Unclaimed Freight, the court would have had to exercise its discretion and make an exception in Hill's favor if she were to continue as trustee in her remaining cases.

Hill states that "[t]he court removed [her] as trustee from all other cases * * * citing her refusal to undergo continual training." Aplnts. Br. 9. Thus, she misdirects this Court by suggesting that it was her failure to participate in training that led to this result. Rather, the overwhelming and unrefuted evidence of incompetence or unwillingness to perform her duties as a trustee made unthinkable her continued service in this capacity in any case. After referencing "the shocking situation

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[23] The requirements are based on the Bankruptcy Code, 11 U.S.C. 101 et seq., the Federal Rules Of Bankruptcy Procedure, 1001-9036, and the published Handbook For Chapter VII Trustees.

with regard to the alteration of the Court's Order" (CR 905, SRE, Tab 100 at 96), the court stated that it "believe[d] that the activities of [Hill] in this case indicate that she cannot continue to serve as a trustee in the Division and in the District and that the best interest of creditors and the estate and the public interest justify her removal" (id.) from all of her cases. Hill offered the bankruptcy court no reason to reach a contrary result. The court, referring to its discretion as to whether to remove Hill from the remaining cases, simply noted her "refusal * * * to undergo continual training" (emphasis supplied). Id.

II.

THE BANKRUPTCY COURT VALIDLY HELD HILL IN CIVIL CONTEMPT FOR FAILURE TO COMPLY WITH THE COURT'S ORDERS

A bankruptcy court may conduct civil contempt proceedings. 11 U.S.C. 105(a); Placid Refining Co. v. Terrebonne Fuel and Lube (In re Terrebonne Fuel and Lube, Inc.), 108 F.3d 609, 612-13 (5th Cir. 1997). A party seeking an order of civil contempt must show, by clear and convincing evidence,[24] that (1) a court order was in effect, (2) the order required certain conduct by the respondent, and (3) the respondent failed to comply. Piggly Wiggly Clarksville v. Mrs. Baird's Bakeries, Inc., 177 F.3d 380,

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[24] Evidence is clear and convincing if it is so clear, direct and weighty and convincing as to enable the finder of fact to come to a clear conviction, without hesitancy. Travelhost, Inc. v. Blandford, 68 F.3d 958, 961 (5th Cir. 1995).

382 (5th Cir. 1999). If these requirements are met, the party alleged to be in contempt must show sufficient mitigating circumstances to avoid a finding. Whitfield v. Pennington, 832 F.2d 909, 913 (5th Cir. 1987), cert. denied, 487 U.S. 1205 (1988).

Here, as shown below, the bankruptcy court correctly applied these standards to determine that Hill was in contempt. Moreover, the court's determination met constitutional standards.

A. The Bankruptcy Court Correctly Found That Hill Had Failed To Comply With Its Orders

Hill did not testify at the contempt hearing, offered no other evidence to dispute the UST's case, and did not file a brief.[25] Hill properly recognizes that "[t]he crux of the contempt order is that the files turned over were incomplete." Aplnts. Br. 14. Yet by stating that "[t]here was no testimony as to what makes a file complete" (id.), and that "there is no requirement that certain records be kept, or that certain records be turned over with case files" (id. at 16), she attempts to distract attention from the fact that the controversy was over the numerous documents already in her files as trustee that she didn't turn over. She also maintains that while the bankruptcy judge "considered the order for turnover of case files to cover

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[25] Thus, she never raised before the bankruptcy court her claims as to the scope of the Court's orders or any other aspect of the court's proceedings.

every document in the file," "this was not the order of the court." Aplnts. Br. 13. But Hill neither sets forth nor discusses the bankruptcy court's actual orders. A reading of those orders demonstrates that they indeed required her to turn over the entirety of the files.

On May 20, 1999, in connection with Hill's removal as trustee from all cases in which she was acting as trustee, the court directed her to (1) "turn over <u>all case files</u>, financial records, and estate funds in each case * * * to the successor trustee in each case" (emphasis supplied) and (2) "turn over to the United States Trustee a status report for each case * * *." CR 183-184, 937-938, SRE, Tab 70 at 1-2.

Then, on June 18, 1999, after Hill had failed to turn over any of the specified materials, the court issued an order ("order to compel") requiring that she "shall immediately comply with the Order for Removal" and authorizing the United States Marshal, if necessary, to enter Hill's offices and remove the case files. The order further provided that "on Wednesday, June 23, 1999, at 10 a.m.," Hill "shall turn over <u>all</u> of the Estate Property (including but not limited to: <u>files</u>, financial documents, funds and other assets) and the Records * * * on each of her formerly assigned cases without a final decree to the successor trustee or to the [UST] where there is no successor trustee" (emphasis supplied).[26] CR 958, SRE, Tab 92 at 1.

Finally, Hill is wrong and misleading when she states that the judge "never articulated in his ruling what was defective about the files that were turned over to the successor trustee." Aplnts. Br. 12-13 The opinion of the bankruptcy court describes in detail the deficiencies with Hill's compliance. See CR 50-52, 55, SRE, Tab 145 at 5-7, 10; CR 75-76, 231-232, SRE, Tab 148 at 1-2.

B. The Bankruptcy Court Met Constitutional Standards

On August 3, 1999, the bankruptcy court afforded Hill, who while an attorney herself was represented by counsel, a full hearing on contempt consistent with the requirements of due process. Hill's claims of constitutional violations (Aplnts. Br. 18-19) relate almost entirely to the September 1, 1999 hearing in Spohn and are insubstantial.[27] What Hill terms a "reopening" of

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[26] The order further required "that the Estate Property and Records be turned over in the manner they were used and maintained in the ordinary course of business * * *." CR 958, SRE, Tab 92 at 1.

[27] Hill also claims a violation of due process in that "[s]ixteen days after the [contempt] hearing and ruling, the judge himself submitted additional evidence, indicating that he considered it in his ruling." Aplnts. Br. 18. The "additional evidence" was a check that was among the records found in Hill's office on September 1. Assistant UST Strange, while making copies of exhibits for a criminal referral, discovered the check in the Clerk of Court's exhibit file stuck between two pieces of paper. She turned the check and referencing documents over to

the contempt proceeding at the Spohn hearing was something quite different. The bankruptcy court never reopened the contempt hearing. Rather, during the course of Spohn, involving a joint motion to pay secured creditor and an objection filed by Hill as former trustee, Hill testified that the missing records contained in the case files had been destroyed, but that certain records could be reconstructed from her word processing equipment, telephone logs, postage meter, and other means.

Based upon this "stunning" development (CR 52, SRE, Tab 145 at 7), the bankruptcy court ordered a United States Marshal to accompany Hill, Hastings, and Assistant U.S. Trustee Strange to Hill's office that afternoon to collect any documents covered under the removal order. The Marshal returned with numerous records, and eleven checks belonging to the Spohn estate. All of the checks postdated both the removal order and the order to compel, and four checks even postdated the August 4 contempt hearing. Subsequent to these events, Hill never requested that the contempt hearing be reopened to afford her the opportunity to explain her failure previously to turn over the materials found in her office, nor did she submit any written justification to

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the clerk who gave them to the bankruptcy judge., who ultimately sent it to the successor trustee and put a copy into the exhibit file. See CR 75-76, 231-232, SRE, Tab 148 at 1.

the court. The bankruptcy court appropriately considered these further developments when, on October 29, 1999, it held Hill in contempt.

The bankruptcy court's response to the unanticipated disclosure by Hill was not only understandable, but entirely consistent with constitutional requirements. Hill's claim that "[i]t was premature to seize any documents before a ruling on contempt" (Aplnts. Br. 20) is unsupported. There is no requirement of a prior "judgment specifying what additional documents were necessary to comply with the turnover order." Id. Certainly, Hill's admission in open court provided the bankruptcy judge with more than probable cause to order the seizure of materials from Hill's office.

Further, Hill's claim that her "arrest" (being taken into the custody of the United States Marshall from the time of the court's recess at 12:42 p.m. until it reconvened at 3:00 p.m. See CR 56, 58-61, SRE, Tab - - at 56, 58-61.) in connection with the search and seizure was invalid because "[a]rrest is allowed only to secure compliance to a court order" (Aplnts. Br. 20) and that her "arrest and detention * * * was unlawful as it is a criminal sanction, beyond the authority of Bankruptcy Courts" (id. at 23), ignores the two outstanding orders requiring the turnover of her files as trustee. Given these orders and Hill's testimony regarding destruction of records, her "arrest" was a reasonable measure to bring about her cooperation and ensure that there would be no further destruction prior to the Marshal's seizure of the additional items at her office. See United States v. Rizzo, 539 F.2d 458, 465 (5th Cir. 1976) ("Dr. Rizzo was ordered incarcerated until he produced the cards. This coercive imprisonment, contempt of which he could purge himself should he produce the cards, is civil").

III.

THE BANKRUPTCY COURT REASONABLY DECIDED TO DENY HILL COMPENSATION IN ALL CASES IN WHICH SHE PREVIOUSLY HAD SERVED AS TRUSTEE[28]

The denial of compensation to Hill in all of her cases is sustainable independent of "reimbursing the injured party for losses and expenses incurred for noncompliance" (Aplnts. Br. 21) as a remedy for civil contempt.[29] Cf. Cunningham v. Ayers (In re

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[28] Beyond challenging the bankruptcy court's October 29, 1999 denial of all fees, Hill objects to the district court's ruling, on April 4, 2000, holding to be moot her August 3, 1999 "Rule to Show Cause * * * demanding compensation for prior trustee case assignments" Aplnts. Br. 11. Hill neglects to explain that the district court went on to state that "[t]he Court will address the issue of whether or not Hill is entitled to compensation when it rules on her appeal in cv99-2113" (CR Vol. 1 at 437, RE Docket Sheet at 8), i.e., the appeal from the bankruptcy court's order denying all fees. Of course, on April 20, 2000, the district court affirmed that order. CR Vol. 3 at 445, RE, Tab F at 1.

[29] The bankruptcy court recognized that "civil contempt is intended to compensate the aggrieved party for its losses

Johnson), 921 F.2d 585, 586 (5th Cir. 1991). Thus, Hill's complaint that the bankruptcy court's denial of compensation "does not attempt to determine actual costs incurred by the successor trustee as a result of violations of the turnover order" (Aplnts. Br. 21) is besides the point.

A. Fees Were Properly Denied Based on Hill's "Egregious Conduct"

This Court has emphasized that "[w]hen persons perform duties in he administration of the bankruptcy estate, they act as 'officers of the court' and not private persons," and that, "[a]s such, trustees and attorneys for trustees are held to high fiduciary standards of conduct." Continental Ill. Nat'l Bank & Trust Co. v. Charles N. Wooten, Ltd. (In re Evangeline Refining Co.), 890 F.2d 1312, 1323 (5th Cir. 1989). Serious misconduct by a trustee may warrant the denial of all compensation. Thus, in Evangeline, this Court held that all fees should be denied a trustee who makes intentional misrepresentations on a fee application. Id. at 1325. In Peerless Mfg. Co. v. United Merchants & Mfrs., Inc., 523 F.2d 110, 112 (7th Cir. 1975), the

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resulting from noncompliance with the Court's orders." The court referred to the information provided by the UST that "the Successor Trustees have suffered damages in that the cases formerly handled by Ms. Hill have required both curative work and action to move the cases toward completion," and "[that] [m]any of these efforts will go uncompensated." CR 57, SRE, Tab 145 at 12. For this reason, the court ordered Hill to pay to Hastings the $1,500 in compensation that she had received in connection with six consensual sale matters. CR 63, SRE, Tab 145 at 18.

court in upholding the award of fees to a validly appointed trustee who had been replaced, emphasized that "[this is not a situation in which there was a finding of negligence, abuse of trust, or unfaithfulness."

Here, the bankruptcy court, has ample ground to deny all fees. Quoting at length from Evangeline, the court concluded that "the final, and most compelling reason for the denial of all compensation" was Hill's "egregious conduct." CR 62, SRE, Tab 145 at 17. Noting that "Hill has repeatedly failed to comply with orders of the court," the court stated that "[p]ermitting [Hill] to continue the farce of seeking compensation while all the while disregarding the orders of the court would only burden the United States Trustee, the Successor Trustees, and this Court with an inordinate number of unnecessary hearings." CR 63, SRE, Tab 145 at 18.

B. Fees Were Properly Denied To Hill For Lack Of Necessary Documentation

In Evangeline, this Court also addressed the technical requisites for obtaining an award of fees. This Court first stated that "[s]ince bankruptcy judges have discretion in determining attorney and trustee's fees, we will reverse a determination of fees only upon abuse of discretion." 890 F.2d at 1325. See also Anderson v. Anderson (In re Anderson), 936 F.2d 199, 204 (5th Cir. 1991) (upholding award of fees, but noting that "we would likely have affirmed a total disallowance of fees had the bankruptcy court so held"); Arens v. Boughton (In re Prudhomme), 43 F.3d 1000, 1003 (5th Cir. 1995) (emphasizing bankruptcy court's "broad discretion in awarding and denying fees paid in connection with bankruptcy proceedings").

This Court explained in Evangeline that "[t]he applicant bears the burden of proof in a fee application case," and that "[t]he reviewing court should not venture guesses nor undertake extensive investigation to justify a fee for an attorney or trustee who has not done so himself." 890 F.2d at 1325. Turning to Bankruptcy Rule 2016, requiring a "detailed statement," this Court stated that while less than an "'ideal level of completeness' may suffice," "an application must be sufficiently detailed and accurate that, in conjunction with any proceeding in connection therewith and the record in the case, a court can make an independent evaluation as to what level of fees are actual, necessary and reasonable." 890 F.2d at 1326. See James B. Hirsch, Bankruptcy Fee Applications: Compensable Service Or Cost Of Doing Business, 58 Fordham L. Rev. 1327, 1351 (1990) (("little dispute that lack of specificity in a fee application may jeopardize a fee award").

With respect to whether the records must be contemporaneous, this Court stated that "[w]hile a lack of contemporaneous record keeping does not per se result in a denial of fees, where reconstructed records become a mere guess by the applicant, it is difficult, if not impossible, for a reviewing court to make an independent evaluation as to what fees are actual, necessary and reasonable based upon a record sufficiently detailed and accurate to support that evaluation." 890 F.2d at 1327. Recognizing that "[t]he harsh sanction of total denial of compensation is a rare one," this Court stressed that "a court should only award fees to the level that has been proven to be actual, necessary and reasonable" and that "[a]ny lesser requirement would make the applicant's burden of proof a mere shell." 890 F.2d at 1327.

Here, the bankruptcy court properly determined that Hill's applications for compensation were "incompatible with the lack of records." Contrary to Hill's claim the court did not hold that her "time sheets are fraudulent because they were not kept contemporaneously." Aplnts. Br. 17. Rather the court was skeptical of Hill's ability "to itemize her time and expense records in 287 cases" because it was "scarcely compatible with her professed inability to produce the records" (CR 61, SRE, Tab 145 at 16), and observed that "[i]t strains credulity to suggest that Ms. Hill can account for sending 198 demand letters at a cost of $65.34 while simultaneously claiming her records were mysteriously destroyed." Id.

Further, the bankruptcy court properly held that Hill's applications were "defective on their face" for failure to comply with Local Bankruptcy Rule 2016-1. Id. Hill is wrong in suggesting that this rule is inapplicable to a trustee. Aplnts. Br. 17. See Evangeline, 890 F.2d at 1326.[30] Also, the court was correct in invoking Hill's failure to meet the formal requirements of local Rule 9013-3C(5). Hill correctly notes that such failure does not "ordinarily result in loss of right" (emphasis supplied). Aplnts. Br. 17. But this is not an "ordinary" case. The bankruptcy court was warranted in considering this failure as part of the totality of circumstances supporting a denial of fees.

IV.

THE BANKRUPTCY COURT REASONABLY DETERMINED TO SUSPEND HILL FROM PRACTICE BEFORE IT ON THE GROUNDS THAT SHE HAD LIED TO THE COURT, ALTERED ITS ORDERS, AND FAILED TO COMPLY WITH ITS ORDERS

In Cunningham v. Ayers (In re Johnson), 921 F.2d 585 (5th Cir. 1991), this Court reviewed a contempt judgment of a bankruptcy court in which, as in this case, the court removed the trustee from all pending cases and suspended her from the practice of law before the bankruptcy court. This Court, although finding the bankruptcy court's judgment to be invalid for conflict of interest, held that "a bankruptcy court does have

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[30] The local rule implements the requirements of 11 U.S.C. 330, which applies to trustees, such as Hill, whose compensation is governed by 11 U.S.C. 326(b).

the power to conduct a disciplinary hearing and discipline the attorneys who practice before it * * *." Id. at 587. Noting that "[a]lthough [the bankruptcy judge] referred to the hearing as a contempt proceedings, he also indicated that he considered the proceedings to be disciplinary," this Court explained that "[c]ourts have used [Bankruptcy Code 105(a)][[31]] as a basis for holding that bankruptcy courts have both statutory and inherent authority to deny attorneys and others the privilege of practicing before that bar." Id. at 586.

This Court further explained that "'[d]isbarment proceedings are not for the purpose of punishment, but rather seek to determine the fitness of an official of the court to continue in that capacity and to protect the courts and the public from the official ministration of persons unfit to practice.'" Id. at 586 (quoting, In re Derryberry, 72 B.R. 874, 881 (Bankr. N.D. Ohio 1987)). See Dragoo v. Akard (In re Dragoo), 186 F.3d 614 (5th Cir. 1999) (sustaining a four-year suspension); D.H. Overmyer Co. v. Robson, 750 F.2d 31, 33 (6th Cir. 1984) (attorney admitted pro hac vice suspended for failing to comply with court rule regarding disclosure of conflicts).

Here, the suspension of Hill, occurring prior to the bankruptcy court's decision on contempt, was not "punitive"

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[31] This section provides that "[t]he court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title."

(Aplnts. Br. 21) and had nothing to do with "assur[ing] compliance with the turnover order" (id. at 24). Rather, the concern was "'the fitness of an official of the court.'" Cunningham, 921 F.2d at 586. In the September 1, 1999 hearing (Spohn), the court concluded that "what we have here * * * is a false application, a situation in which [Hill] has repeatedly lied or omitted information that would have been helpful to this Court and the ongoing administration of this and other cases by * * *." SRE, Tab - - at 100. The court further stated that

"[i]t is a situation in which the Court finds that the counsel - - Ms. Hill is not just a Trustee, a predecessor Trustee. She is a lawyer. She has lied to this Court. She has altered its Orders. She has failed to comply with its Orders." SRE, Tab - - at 100. Under these circumstances, Hill's suspension was entirely warranted.

V.

THE BANKRUPTCY JUDGE PROPERLY DECLINED TO RECUSE HIMSELF AT THE CONTEMPT HEARING

A. The Standard For Recusal

In Liteky v. United States, 510 U.S. 540 (1994), the Court described the circumstances, under 28 U.S.C. 455, in which "opinions formed by the judge on the basis of facts introduced or events occurring in the course of the current proceedings, or of prior proceedings" may "constitute a basis for a bias or partiality motion." Id. at 555. The Court held that such opinions may not be invoked "unless they display a deep-seated favoritism or antagonism that would make fair judgment impossible." Id. "Thus," the Court explained, "judicial remarks during the course of a trial that are critical or disapproving of, or even hostile to, counsel, the parties, or their cases, ordinarily do not support a bias or partiality challenge." Id.

The Court noted that such in-trial remarks "may [support a bias or partiality challenge] if they reveal an opinion that derives from an extrajudicial source; and they will do so if they reveal such a high degree of favoritism or antagonism as to make fair judgment impossible." Id. Finally, the Court emphasized that "[n]ot establishing bias or partiality * * * are expressions of impatience, dissatisfaction, annoyance, and even anger, that are within the bounds of what imperfect men and women, even after having been confirmed as federal judges, sometimes display." Id. See also Hollywood Fantasy Corp. v. Gabor, 151 F.3d 203, 215-16 (5th Cir. 1998); Conkling v. Turner, 138 F.3d 577, 593 (5th Cir. 1998).

B. The Standard Is Not Met

Hill claims that in the contempt hearing, "the judge vented his hostility [against her] for asserting her legal rights in filing 'voluminous' documents in this proceeding, and verbalized a preconceived bias against her." Aplnts. Br. 25. The transcript reads differently. There is no "deep-seated favoritism or antagonism that would make fair judgment impossible" (Liteky, 510 U.S. at 555), but simply a recounting of Hill's derelictions.

Addressing Hill's attorney, Mr. Charles, the judge, first noted that Hill has been "30 minutes late on an objection that she filed in the Unclaimed case" (CR 159, SRE, Tab 147 at 63), which objection she "did not serve." CR 160, SRE, Tab 147 at 64. The judge then stated that "she has burdened the Court and the Clerk with processing innumerable requests for * * * compensation where it is the policy of the [UST] that Applications for Compensation in asset cases must be supported by time records, that for reasons that are yet unknown to me, and perhaps you know them, Mr. Charles, she has not turned over." CR 160, SRE, Tab 147 at 64.

Hill's claim that "[t]he judge's personal knowledge of facts in controversy ma[d]e him unsuitable to serve in this case" (Aplnts. Br. 25) is equally baseless. Specifically, Hill cites the judge's "personal knowledge of disputed facts with regard to the destruction of files," his "putting on the record his contact with the successor trustee regarding the status of cases,"[32] and

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[32] The judge explained that "[t]he Court and the Panel Trustee have an obligation to administer the cases and keep the Court's business working. At the time of Ms. Hill's removal, there were consensual sales and abandonments that were pending. I attempted and instructed my Chambers and the Office of the

his turning over of "certain pleadings and files" to the successor trustee. Aplnts. Br. 25. Yet, the judge evinced only the knowledge that derived from the very course of his official and proper involvement with Hill and Hastings in the bankruptcy matters as to which her contempt occurred.[33]

* * * * *

In sum, the bankruptcy court's responses to Hill's "egregious" misconduct and her unwillingness or incapacity to perform the duties of a bankruptcy trustee were reasonable and valid in all respects and must be upheld.

CONCLUSION

For the foregoing reasons, the judgments of the district court should be affirmed .

Respectfully submitted,
STUART E. SCHIFFER
Acting Assistant Attorney General

WILLIAM FLANAGEN
United States Attorney

Clerk to attempt to assist Mr. Hastings in his capacity as successor Trustee and, accordingly, will file as Court Exhibit 1 my letter to Mr. Hastings of July 2nd and the attached list and including a letter to Ms. Hill of April 22nd, 1999 so that the record will be complete as to the nature of the Court's contact with Mr. Hastings." CR 171-172, SRE, Tab 147 at 75-76.

[33] Hill's reference to "the manner in which [the judge] extensively interrogated witnesses at every hearing," and her statement that the judge's "comments and actions as a whole reflect that he ha[d] abandoned his position as a neutral magistrate" (Aplnts. Br. 25) are unsupported and too general to warrant discussion.

WILLIAM KANTER
(202) 514-4575
ROBERT D. KAMENSHINE
(202) 514-2494
Attorneys, Appellate Staff
Civil Division, Room 9012
601 "D" Street, N.W.
Washington, D.C. 20530-0001

APRIL 2001

CERTIFICATE OF SERVICE

I hereby certify that on this 9th day of April, 2001, I filed the foregoing brief with this Court by causing copies to be mailed, postage prepaid, and served the foregoing brief upon counsel by causing copies to be mailed, postage prepaid to:

Daryl Blue, Esq.
900 Saint John Street
Monroe, LA 71201

E. Eugene Hastings, Esq.
409 Bres Avenue
Monroe, LA 71201

ROBERT D. KAMENSHINE
Attorney

CERTIFICATE OF COMPLIANCE

I hereby certify, as required by FRAP 32(a)(7)(C), that on the basis of a word count produced by computer, the foregoing brief contains 14,551 words.

ROBERT D. KAMENSHINE
Attorney

BRIEF BANK — 'SUMMARY SHEET" *Printed Thu-5/3/07 10:7*

WESTLAW CODES

1. ("TI") *TITLE* OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*
Hill v. Comacho and UST

2. ("CO") *CURRENT* COURT *[E.g., "CTA9"]*
United States District Court for the District of Oregon

3. ("CCN") *CURRENT* CASE NO.
No.:

4. ("PCN") *PRIOR* CASE NO. & COURT *[IF ANY]*
No.: 05-47061-tmb7
Court: United States Bankruptcy Court for the District of Oregon
(Identify judge & cite, if any)

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U.S. TRUSTEES

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Type: Brief of Appellee, the United States Trustee

7. ("AU") *PRINCIPAL AUTHORS & OFFICE* *[E.g.,"UST/OGC"]*
Sean Martin, Pamela Griffith
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") *TOPIC*
BANKRUPTCY

9. ("SU") ● *SUMMARY* OF KEY ISSUE(s)

&

√ Any Miscellaneous *BACKGROUND*

●
Did the bankruptcy court correctly hold that funds in a chapter 7 debtor's attorney's trust account became property of the chapter 7 bankruptcy estate and the attorney had to turn them over to the trustee upon the commencement of the case?
Does the Bankruptcy Code preempt Oregon law that would permit a debtor's attorney to be paid from property of the estate through an otherwise-valid attorney's lien, when the attorney has not met the Code's own payment provisions?
Is an Oregon attorney's lien valid against funds not yet earned by an to the attorney, when such a lien secures only amounts due for "services rendered client"?

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IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF OREGON

In re:	)	
	)	
JOHN EDWARD HILL,	)	
	)	
	)	
Debtor	)	Civ. App. No. ____________
____________________________________	)	
	)	
JOHN EDWARD HILL, SHAWN P. RYAN,	)	
	)	
Appellants,	)	
	)	
v.	)	
	)	
RODOLFO A. CAMACHO, ILENE LASHINSKY, UNITED STATES TRUSTEE, REGION 18	)	Bk. Case No. 05-47061-tmb7
	)	
Appellees.	)	
____________________________________	)	

Brief of Appellee, the United States Trustee

Roberta A. DeAngelis
Sean E. Martin
Department of Justice
20 Massachusetts Ave., N.W.
Washington, D.C. 20530
phone: (202) 307-1399

Pamela J. Griffith
Office of the United States Trustee
Department of Justice
620 SW Main, Suite 213
Portland , OR 97205
phone: (503) 326-4000
Counsel for Ilene Lashinsky,
United States Trustee

STATEMENT OF JURISDICTION

The bankruptcy court had jurisdiction under 28 U.S.C. 157(a) and (b) to hear the underlying case, a voluntary petition under chapter 7 of the Bankruptcy Code, 11 U.S.C. 701, et seq.[1] The bankruptcy court had jurisdiction under 28 U.S.C. 157(a) and (b) over the trustee's motion to compel turnover of funds held by Shawn P. Ryan, attorney for John Edward Hill, who filed a voluntary bankruptcy petition. The bankruptcy court granted the trustee's motion in a memorandum opinion entered Nov. 30, 2006. Excerpt of Record ("ER") 42-52. The bankruptcy court ordered turnover of the retained funds, by final order entered December 5, 2006. ER 54. Ryan and Hill filed a timely notice of appeal of this final order on December 13, 2006. ER 55-56. The same day, Ryan and Hill also timely filed an objection to Bankruptcy Appellate Panel referral and a motion to stay turnover pending appeal. ER 4-5. On January 31, 2007, the bankruptcy court granted Ryan's motion to stay. ER 6. This court has jurisdiction over this appeal under 28 U.S.C. 158(a)(1).

STATEMENT OF THE ISSUES

1. The bankruptcy court granted the trustee's motion to compel turnover of estate funds held by a debtor's attorney. These funds were the unearned remainder of an advance fee retainer the debtor gave his attorney before the debtor filed a bankruptcy petition. Did the bankruptcy

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[1] The bankruptcy petition in the instant case was filed prior to October 17, 2005, the general effective date of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA). BAPCPA made numerous significant changes to the Bankruptcy Code, 11 U.S.C. 101 *et seq*. This brief cites to the pre-BAPCPA version of the Bankruptcy Code that governed the instant case.

court correctly hold that these unearned funds became property of the estate by the debtor's filing the bankruptcy petition?

2. Does the Bankruptcy Code preempt Oregon law that would permit a debtor's attorney to be paid from property of the estate through an otherwise-valid attorney's lien, when the attorney has not met the Code's own payment provisions?

3. Is an Oregon attorney's lien valid against funds not yet earned by an attorney, when such a lien secures only amounts due for "services rendered to the client"?

STATEMENT OF THE CASE

I. Nature of the Case

This appeal challenges a bankruptcy court's order that a debtor's attorney turn over unearned funds to the trustee administering the debtor's bankruptcy case. John Edward Hill filed a voluntary chapter 7 bankruptcy petition on October 13, 2005. ER 1. For bankruptcy representation, Hill had paid his attorney Shawn P. Ryan a $5,000 retainer which Ryan placed into an attorney trust account. ER 42-43. When Hill filed his petition, Ryan stated there was no unpaid compensation due from Hill. ER 7. Ryan had earned and withdrawn $2,115 from the $5,000 for his pre-petition services and paid Hill's $209 filing fee from the retainer. Id. Hill listed the unearned $2,676 remaining in the retainer as his personal property. ER 10. Contending that these funds were property of the bankruptcy estate, the chapter 7 trustee in Hill's case filed a motion to compel Ryan to turn over these funds. ER 12. After briefing by the parties and two hearings, the bankruptcy court granted the trustee's motion in a published opinion. In re Hill, 355 B.R. 260 (Bankr. D. Or. 2006); ER 42-52. The court held that because there was no underlying debt to Ryan when Hill filed his petition, the retainer became property of the estate. ER 45. The court also concluded that even if Ryan held a state-law lien in the retainer, that lien could not be used to pay Ryan from property of the estate for services provided after Hill filed his petition, under the Supreme Court's holding in Lamie v. United States Trustee, 540 U.S. 526 (2004). ER 51-52. The court held that interpreting state lien law to allow payments specifically prohibited by the Bankruptcy Code violates the Supremacy Clause. Id. The court ordered turnover of the funds to the trustee. See ER 4. This appeal followed.

II. Statement of Facts

A. Statutory Background

An individual who seeks to discharge his past debts may file a petition under chapter 7 of the Bankruptcy Code. See 11 U.S.C. 701, et seq.[2] By filing such a petition, the individual "commences" a bankruptcy case and becomes a "debtor." See 11 U.S.C. 301(a), 101(13). When a case is commenced, practically all of the debtor's property at that time becomes property of the bankruptcy estate. 11 U.S.C. 541(a).

Under the Bankruptcy Code, all third parties must turn over all property of the estate to the chapter 7 trustee. 11 U.S.C. 542(a). Under federal law, the chapter 7 trustee becomes the estate's sole representative. 11 U.S.C. 323(a). The chapter 7 trustee's duties include taking possession of all estate property and liquidating it for distribution among the creditors who have filed claims against the estate. See 11 U.S.C. 704(1). If the trustee needs legal assistance in performing these duties, the trustee may file a motion under section 327 requesting authorization to retain counsel. 11 U.S.C. 327; Lamie, 540 U.S. at 531-32. Barring debtor misconduct or

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[2] This brief cites to the prior version of the Bankruptcy Code that governed cases filed through October 16, 2005. See *supra* n.1.

other special situations, the bankruptcy court will eventually issue an order discharging most of the debtor's pre-petition financial obligations. See 11 U.S.C. 727.

The Bankruptcy Code also regulates the retention, compensation and payment of attorneys in chapter 7 cases. The Code does not authorize a bankruptcy court to award fees to an attorney for a chapter 7 debtor unless the trustee retains the attorney pursuant to 11 U.S.C. 327(a) to represent or assist the trustee in carrying out the trustee's duties. See Lamie, 540 U.S. at 538-39 ("we hold that § 330(a)(1) does not authorize compensation awards to debtors' attorneys from estate funds unless they are employed as authorized by § 327. If the attorney is to be paid in a chapter 7 case, he must be employed by the trustee and approved by the court.").

To receive compensation from a bankruptcy estate, attorneys in chapter 7 cases must meet two tests. First, they must be employed under section 327(a). Lamie, 540 U.S. at 529 (affirming the lower court's ruling that attorneys may not be compensated from the estate "unless the attorney has been appointed under § 327 of the Code"). Second, attorneys must receive a fee award under section 330. Id. Section 330(a) fee awards are not self-executing. Section 503(b)(2) of the Code authorizes a bankruptcy court to pay compensation awarded under section 330(a)(1) as an administrative expense. 11 U.S.C. 503(b)(2). This is significant because administrative expense awards receive first payment priority under section 507(a)(1) of the Code. See 11 U.S.C. 507(a)(1).

United States Trustees are officials of the Department of Justice appointed by the Attorney General to supervise the administration of bankruptcy cases and trustees. See 28 U.S.C. 581-589 (specifying the powers and duties of United States Trustees).[3] Congress

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[3] See In re Castillo, 297 F.3d 940, 950 (9th Cir. 2002) ("The United States Trustee is the 'watchdog' of the bankruptcy system . . . charged with preventing fraud and abuse and with

instructed United States Trustees to "monitor" attorney employment applications filed under section 327 of the Code and, "whenever the United States Trustee deems it to be appropriate, fil[e] with the court comments with respect to the approval of such applications." 28 U.S.C. 586(a)(3)(H).

B. Factual Background and Proceedings Below

John Edward Hill filed a voluntary chapter 7 bankruptcy petition on October 13, 2005. ER 1. Hill had paid his attorney Shawn P. Ryan a $5,000 retainer which Ryan placed into an attorney trust account. ER 42-43. When Hill filed his petition, Ryan had actually earned and withdrawn $2,115 of the $5,000. ER 7. Ryan also paid Hill's $209 filing fee from the retainer. Id. Ryan listed as zero the unpaid compensation due and payable to him from Hill. Id. Hill listed the remaining $2,676 as his personal property on Schedule B filed with his bankruptcy petition. ER 10. As the date Hill filed his bankruptcy petition, the $2,676 remaining in the trust account held by Ryan was unearned by Ryan. See ER 7, 43.

The written fee agreement between Hill and Ryan, which Hill signed the same day he filed his bankruptcy petition, did not purport to transfer title to the retainer funds to Ryan. ER 36-37. Nor did the agreement state in any way that any retainer funds would be earned by Ryan upon receipt. See id. On the contrary, the agreement's heading states that the agreement was for "hourly" representation and that "client agrees to pay for such services on an hourly basis." ER 36. The agreement did not purport to give Ryan any rights different from or greater than he was

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'fill[ing] the vacuum' caused by possible creditor inactivity."); see also In re Donovan Corp., 215 F.3d 929, 930 (9th Cir. 2000) (United States Trustee may intervene and appear at any level of the proceedings, from the bankruptcy court on, as a party or an amicus).

entitled to receive as counsel in a bankruptcy case. Id. The agreement offers no notice that Ryan would have any potential attorney's lien or any potential rights therein. Id.

On November 3, 2005, Rodolfo A. Camacho was appointed trustee to administer and liquidate Hill's bankruptcy estate. See ER 1. The trustee never sought authorization, under 11 U.S.C. 327 or otherwise, to appoint Ryan as chapter 7 counsel. See ER 1-6. The bankruptcy court never entered an order appointing Ryan to act as chapter 7 counsel. See id.

After Hill filed his petition, Ryan did not turn over to the trustee the unearned retainer funds in his trust account. Contending that these funds were property of the bankruptcy estate, the trustee filed a motion on May 4, 2006 to compel Ryan to turn over these funds. ER 12.

C. The Bankruptcy Court's Decision

The bankruptcy court issued a published opinion, In re Hill, 355 B.R. 260 (Bankr. D. Or. 2006), following briefing by the parties as well as hearings held on June 21 and September 26, 2006. ER 42-52. The bankruptcy court concluded that under Oregon state law, funds in the retainer held by Ryan remained Hill's property until earned by Ryan. ER 45. The bankruptcy court ordered that the $2,676 be turned over to the trustee for distribution to creditors. ER 52.

To support its holding, the bankruptcy court cited the Oregon Supreme Court's holding that retainer funds are client property unless there is a clear written agreement between the lawyer and client that advance fees constitute an earned-on-receipt retainer. Id. at 44 (citing Conduct of Biggs, 318 Or. 281, 864 P.2d 1310 (1994)). The bankruptcy court noted that it was undisputed that there was no written agreement between Ryan and Hill that the fees were an earned-on-receipt retainer. ER 45. Therefore, at the time of filing, Hill owed no fees to Ryan and had an absolute right to a refund of the funds remaining in the retainer. Id. Accordingly, by operation of law, the funds became property of the estate under 11 U.S.C. 541(a)(1). Id. The court rejected Ryan's argument, which relied on a since-reversed Kansas bankruptcy court decision,[4] that the trustee had only a reversionary interest in the funds in the retainer when Hill filed his bankruptcy petition. Id.

The bankruptcy court also rejected Ryan's alternative argument that even if the unearned funds were property of the estate, Ryan held a state-law security interest pursuant to an Oregon attorney's lien, Or. Rev. St. 87.430, which allowed him to be paid from estate funds for services provided after Hill filed his petition. ER 51-52. The bankruptcy court acknowledged that an Oregon bankruptcy court and the Ninth Circuit Bankruptcy Appellate Panel had held prior to Lamie that if a chapter 7 debtor's attorney could not be paid from estate property under section 330, a valid attorney's lien on a pre-petition retainer could justify paying the attorney from estate property for post-petition services. ER 46-47; See Century Cleaning Servs., Inc., 202 B.R. 149, 153 (Bankr. D. Or. 1996), *aff'd*, 215 B.R. 18 (9th Cir. BAP 1997).[5] The bankruptcy court stated that Lamie overruled these holdings. ER 47. Regardless of whether Ryan held a security interest in the funds remaining in the retainer, it held, the funds could not be used to compensate Ryan for his post-petition services, because Ryan was not authorized to act as attorney for the trustee under section 327. Id. at 52. The court concluded that interpreting state lien law to allow payments specifically prohibited by the Bankruptcy Code violates the Supremacy Clause. Id. at 51-52. Ryan and Hill appealed. ER 55-56.

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[4] See Redmond v. Lentz & Clark (In re Wagers), 340 B.R. 391 (Bankr. D. Kan. 2006), *rev'd by* 355 B.R. 268 (10th Cir. BAP 2006).

[5] On appeal of the Century Cleaning BAP decision, the Ninth Circuit reversed the BAP without deciding the attorney's lien issue. See In re Century Cleaning Servs., Inc., 195 F.3d 1053, 1061 (9th Cir. 1999).

STANDARD OF REVIEW

The interpretation of the Bankruptcy Code and state law are questions of law reviewed *de novo*. See In re Eliapo, 468 F.3d 592, 596 (9th Cir. 2006); In re Estate of Covington, 450 F.3d 917, 925 n.8 (9th Cir. 2006).

SUMMARY OF ARGUMENT

1. The bankruptcy court correctly held that retainer funds that were a debtor's property as of filing a bankruptcy petition became property of the bankruptcy estate. It is undisputed that Hill owed Ryan no fees when Hill filed his petition. Under Oregon law, unearned funds in such a retainer remain a client's property. Therefore the funds became property of the estate and were subject to turnover to the trustee. This court should affirm the bankruptcy court.

2. Assuming *arguendo* that Ryan had an otherwise-valid Oregon attorney's lien in funds that were property of the estate, the bankruptcy court correctly concluded that it would violate the Supremacy Clause to authorize payment through this lien. First, sections 327, 330, 503 and 507 of the Bankruptcy Code establish a comprehensive scheme that controls the retention of attorneys and governs their compensation from bankruptcy estate funds. These sections preempt the operation of contrary state law because Ryan had not been retained in the chapter 7 case under section 327, which meant he could not receive a fee award under section 330 and could not receive payment from the bankruptcy estate under sections 503 and 507. Second, the Bankruptcy Code independently preempts Ryan's compensation under state law because this would conflict with sections 542(a), 323(a), and 704(1), which present a comprehensive federal scheme for administering debtors' estates. Ryan's state-law theory interferes with this scheme because it is premised upon Ryan's using estate funds that he had failed to turn over in violation

of section 542(a), and upon the erroneous notion that Ryan could perform chapter 7 work without a section 327 retention by the trustee even though that would negate the trustee's power under sections 323 and 704. Finally, under Ninth Circuit law, allowing Ryan to assert a state lien for payment from estate property violates the Bankruptcy Code's goal of equitable distribution of debtor assets. This court should affirm the bankruptcy court.

3. Ryan did not have a valid lien pursuant to the Oregon attorney's lien statute, Or. Rev. St. 87.430. When Hill filed his petition, Ryan was due nothing for the services he had rendered. The lien statute does not apply against unearned funds, under its plain language and under the general rule of law that attorney liens only secure fees and charges which are due.

4. Ryan misconstrues section 329, erroneously characterizing it as a provision authorizing payments from estate property. In fact, section 329 is a disclosure provision that allows a court to recoup for the benefit of the bankruptcy estate any pre-petition fees deemed unreasonable. As the Ninth Circuit had recognized, section 329 aims to prevent overreaching by debtor's attorneys. Ryan also makes a meritless "bundle of sticks" argument, with his only authority a reversed Kansas bankruptcy court case. Finally, strong policy rationales buttress the bankruptcy court's decision.

ARGUMENT

This court should affirm the bankruptcy court's order that Ryan turn over to the trustee the $2,676 in funds unearned when Hill filed his bankruptcy petition. The unearned funds became property of the estate when Hill filed his bankruptcy petition. Assuming *arguendo* that Ryan had an otherwise-valid attorney's lien on this estate property, paying Ryan from estate property pursuant to this lien is preempted by the Bankruptcy Code. The Code comprehensively addresses attorney retention and payment, trustee control over estate property, and establishes a unique scheme for equitable distribution to creditors. But Ryan did not have a valid Oregon attorney's lien on the funds, because such liens only apply to funds already due. Finally, Ryan's arguments misconstrue the operation of section 329, his "bundle of sticks" argument lacks merit, and strong policy reasons support the bankruptcy court's decision.

I. The unearned fees were Hill's property and became property of the estate when Hill filed his bankruptcy petition.

As the bankruptcy court correctly held and as Ryan himself concedes, the unearned funds in the retainer became property of Hill's estate when Hill filed his bankruptcy petition.[6] In bankruptcy, the threshold questions of the existence and scope of the debtor's interest in a given asset are determined under state law. See In re Raintree Healthcare Corp., 431 F.3d 685, 688 (9th Cir. 2005). At the time Hill filed his petition, the extent of interest in the retainer held by Ryan depends on the terms of the fee agreement, under applicable Oregon law. Applicable Oregon law that establishes that Hill had full ownership of the unearned funds. The Oregon Supreme Court has held that "[w]ithout a clear written agreement between a lawyer and a client that fees paid in advance constitute a non-refundable retainer earned on receipt, such funds must be considered client property . . ." Matter of Biggs, 318 Or. 281, 293 (1994).[7] As the

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[6] See Ryan's Opening Brief ("ROB") 1 ("The issue for appeal is whether an attorney's security *retainer that is property of the estate*, but subject to an attorney lien . . . can be used to pay the attorney's post-petition fees and costs.) (emphasis added).

[7] The Oregon Supreme Court recently cited this holding in Biggs and stated that if an advance retainer is not earned on receipt, "the retainer payment is the *client's* money until the lawyer performs legal services that the client has agreed to pay for." Conduct of Balocca, 342 Or. 279, 287-88, 151 P.3d 154, 159 (2007).

bankruptcy court noted, it was undisputed that there was no agreement between Hill and Ryan that the advance fees were earned on receipt. Therefore the funds remained Ryan's and became estate property by operation of Section 541(a), which includes "all legal or equitable interests of the debtor in property as of the commencement of the case." See In re Feiler, 218 F.3d 948, 955 (9th Cir. 2000) ("Property [of the estate] is broadly defined by the Bankruptcy Code."); In re Hines, 147 F.3d 1185, 1189 (9th Cir. 1998) (noting a "host" of cases holding that the right to unearned attorney fees as of the petition filing date "becomes property of the estate as a matter of bankruptcy law").

Other courts have reviewed similar retainers under applicable state law and have reached the same conclusion that unearned funds remain client property and become property of the estate upon the filing of a bankruptcy petition. See Barron v. Countryman, 432 F.3d 590, 597(5th Cir. 2005) (concluding that Texas law is settled that funds remaining in a pre-petition retainer become property of the estate when the petition is filed); In re Equip. Servs., Inc., 290 F.3d 746-47 (4th Cir. 2002) (concluding, based on Virginia disciplinary rules, that remaining funds in a pre-petition retainer became property of estate), *aff'd sub nom*. Lamie v. United States Trustee, 540 U.S. 526 (2004); Indian Motocycle Assoc. III Ltd. P'ship v. Massachusetts Hous. Fin. Agency, 66 F.3d 1246, 1255 (1st Cir. 1995) (noting that under ethical rules applicable in most jurisdictions, a retainer to secure payment of anticipated legal expenses remains client property until services are actually performed); In re Mahendra, 131 F.3d 750, 756 (8th Cir. 1997) (same).

The $2,676 in unearned advance fees that Ryan continues to hold is property of Hill's bankruptcy estate. The bankruptcy court did not err in this conclusion.

II. Ryan’s attempt to rely upon Oregon lien law would violate the Supremacy Clause of the United States Constitution and is preempted by the Bankruptcy Code.

Assuming *arguendo* that Ryan has an otherwise valid Oregon attorney’s lien under Or. Rev. St. § 87.430 on the unearned retainer funds, the Bankruptcy Code preempts any right Ryan might have to assert that lien to ensure that he receive payment from property of the estate for his post-petition services. The Supremacy Clause of the United States Constitution establishes that federal law preempts inconsistent state law.[8] The Bankruptcy Clause of the Constitution, U. S. Const. art. I, § 8, cl. 4, expressly grants Congress the power to establish “uniform” laws on the subject of bankruptcies throughout the United States. Congress has exercised that power by enacting the Bankruptcy Code, 11 U.S.C. 101, et seq.

Congress has broad authority to preempt state laws, and its intent to do so is properly inferred where “state law stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.” California Fed. Sav. and Loan Ass’n v. Guerra, 479 U.S. 272, 281 (1987) (internal quotation omitted). Alternatively, a federal statute may create a scheme of federal regulation so pervasive as to make reasonable the inference that Congress left no room for the states to supplement it. Barnett Bank of Marion County, N.A. v. Nelson, 517 U.S. 25, 31 (1996). The Ninth Circuit has observed that federal bankruptcy law is pervasive and involves a federal interest so dominant as to preclude enforcement of state laws on the same subject. Sherwood Partners, Inc. v. Lycos, Inc., 394 F.3d 1198, 1201 (9th Cir. 2005) (noting that

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[8] The Supremacy Clause of the United States Constitution mandates that “the Laws of the United States . . . shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.” U. S. Const. art. VI, § 2. Thus, under the Supremacy Clause, federal legislation can preempt state or local laws. See M'Culloch v. Maryland, 17 U. S. (4 Wheat.) 316, 327 (1819).

the Bankruptcy Code occupies a full title of the United States Code and provides a comprehensive system of rights, obligations and procedures and a complex administrative machinery that includes a special system of federal courts and United States Trustees.).

There are three separate and independent reasons why the Bankruptcy Code preempts paying Ryan from estate property through an otherwise-valid Oregon attorney's lien under Or. Rev. St. § 87.430. First, reliance upon the lien statute to pay Ryan for his post-petition services would run squarely counter to the Bankruptcy Code's comprehensive scheme for retaining, awarding, and paying fees to attorneys from estate funds for post-petition work done in chapter 7 cases. Second, paying Ryan through the lien would be inconsistent with the Bankruptcy Code's provisions governing the administration of estate assets in chapter 7 cases which establish that the trustee is the representative of the estate and which require all third parties to turn over all estate property to the trustee. Third, enforcing the lien would place Ryan ahead of other post-petition creditors seeking compensation from estate property, and would run counter to the Ninth Circuit's recognition that equitable distribution of assets among creditors is a key goal of the Bankruptcy Code.

A. The Bankruptcy Code's comprehensive federal scheme for retaining, awarding and paying fees to attorneys from estate funds for work done in chapter 7 cases preempts inconsistent Oregon lien law.

Ignoring the dictates of the Bankruptcy Code, Ryan impliedly asserts that where an attorney has a valid attorney's lien under Or. Rev. St. § 87.430, that attorney need not file a fee application with the bankruptcy court to be compensated from estate funds for his post-petition legal services to a chapter 7 debtor. As the bankruptcy court correctly held, this legal construction would violate the Supremacy Clause. See ER 51-52 ("Interpreting state lien law to allow payments that are specifically prohibited by the Bankruptcy Code violates the Supremacy

Clause.”).[9] The Bankruptcy Code provides no general right to recover attorney’s fees incurred during a bankruptcy case. Instead, attorneys must rely on a statutory source of authority to order to have their fees paid by the estate.

Significantly, the Supreme Court has long held that the federal statutory scheme governing the compensation of bankruptcy professionals in bankruptcy cases is a pervasive scheme of regulation that preempts inconsistent state laws. Brown v. Gerdes, 321 U.S. 178, 183 (1944) (Chandler Act amendments to the Bankruptcy Act of 1898 created “comprehensive supervision over compensation and allowances” under federal law and “provided centralized control” over attorney fees). This is because bankruptcy jurisdiction over professional fees in bankruptcy cases is “paramount and exclusive” and federal provisions governing professional compensation “cause any conflicting [state] procedure to give way.” Brown, 321 U.S. at 183 (holding that under the Bankruptcy Act, bankruptcy courts, not state courts, fix compensation for attorneys representing the estate, even in state litigation) (citations omitted).

The Bankruptcy Code of 1978, like the former Bankruptcy Act construed by the Supreme Court in Brown, comprehensively governs the retention, fee award and compensation of lawyers from estate funds. Indeed, one of the most fundamental aspects of the Bankruptcy Code is this governance and control of administrative and professional expenses under 11 U.S.C. 327, 330, 503 and 507.[10]

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[9] A federal district court recently held in similar fashion that the Supremacy Clause would preempt payment to a debtor’s attorney under state lien law, where the attorney was not appointed under section 327. See In re CK Liquidation Corp., 343 B.R. 376 (D. Mass. 2006).

[10] The federal bankruptcy scheme controlling professional compensation is so comprehensive that section 329 of the Code requires bankruptcy courts to review even those fees that attorneys charge before they file bankruptcy petitions, and which are not paid from estate funds. 11 U.S.C. 329. Under section 329(b), the court may order the return of those non-estate

The relevant professional compensation provisions of the Bankruptcy Code – 11 U.S.C. §§ 327 330, 503, and 507 – collectively reveal a comprehensive scheme covering attorney retention and compensation. See In re Reimers, 972 F.2d 1127, 1128 (9th Cir. 1992) ("The bankruptcy code contains specific provisions governing compensation of professionals."); In re Occidental Financial Group, Inc., 40 F.3d 1059, 1063 (9th Cir. 1994) (rejecting debtor's attorney argument for *quantum meruit* award of fees from estate funds and citing In re Shirley, 134 B.R. 940, 944-45 (9th Cir. BAP 1992) that allowing attorney to recover under state law theories "would void bankruptcy code and rules requiring court approval of employment").

Allowing state law to operate in conflict with this system would present an obstacle to the accomplishment and execution of congressional purposes. See California Fed. Sav., 479 U.S. at 281. Alternatively, these Bankruptcy Code provisions present a federal scheme of federal regulation so pervasive as to make reasonable the inference that Congress left no room for the States to supplement it. See Barnett Bank, 517 U.S at 31.

Through the Bankruptcy Code, Congress has established a comprehensive set of rules, which dictate: (i) how attorneys may be retained at estate expense – through the granting of a section 327 employment motion; (ii) how they are compensated by the estate – through a section 330 fee award; (iii) how they receive payment from the estate – through the payment of their section 330(a) award under section 503(b)(2); and (iv) what priority their payment receives – first administrative priority under sections 507(a)(1). Section 327(a) allows trustees to retain attorneys in chapter 7 cases by court order. 11 U.S.C. 327(a). See also Fed. R. Bankr. P.

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funds if the attorney's charges were unreasonable. See In re Jastrem, 253 F.3d 438 (9th Cir. 2001) (reducing attorney fees under section 329(b) for pre-petition services provided to an individual). Ryan wrongly asserts that his post-petition services are analyzed and payable under Section 329. See ROB 6, 10; *infra* section IV.A.

2014(a) (governing application for and order for employment of professionals pursuant to section 327). In turn, section 330(a) allows the court to award fees to an attorney but only if the attorney has been "employed under section 327."[11] 11 U.S.C. 330(a). Section 503(b)(2) allows an attorney to receive payment from the estate for his professional services but only if "compensation . . . [has been] awarded [to the attorney] under section 330(a)." 11 U.S.C. 503(b)(2). Finally, section 507(a)(1) grants first payment priority to an attorney fee award under section 503(b)(2), as an "administrative expense" of the estate. 11 U.S.C. 507(a)(1).

That Congress made these provisions interdependent indicates that they constitute a comprehensive and self-contained scheme. For example, an attorney's right to payment under section 503(b)(2) is expressly conditioned upon a section 330(a) fee award and the right to receive such a section 330(a) award is conditioned upon the attorney having been retained under section 327. Compensation for services rendered without the court's approval or prior to the retention date established by the court is not payable from the estate under Section 330. See Lamie, 540 U.S. 526, 538-39 ("we hold that 330(a)(1) does not authorize compensation awards to debtors' attorneys from estate funds, unless they are employed as authorized by 327"); see also Barron v. Countryman, 432 F.3d 590, 595 (5th Cir. 2005) ("The Code requires approval of all attorneys fees sought to be paid *from the estate of the debtor*."); In re F/S Airlease II, Inc. 844 F.2d 99, 109 (3d Cir. 1988) ("If [the debtor's attorney] were able to be compensated under section 503(b)(1)(A), it would render section 327(a) nugatory and contravene Congress' intent in providing for prior approval."); In re Williams, 357 B.R. 434 (6th Cir. BAP 2007) (stating it

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[11] Section 330(a) also allows awards to attorneys who represent chapter 11 creditors' committees under section 1103(a), but that provision does not apply in the instant case.

would be “impermissible” for chapter 7 debtor’s attorney to seek payment of fees from estate funds unless his employment was authorized under section 327).

Federal appellate law supports the conclusion that to the extent that Oregon lien law would otherwise apply, once Hill filed his bankruptcy petition, the Bankruptcy Code governed solely. For example, the Eighth Circuit categorically repudiated the idea that a state law lien could authorize payment from estate property for post-petition legal services provided by a chapter 7 debtor’s attorney outside sections 327 and 330. In re Mahendra,131 F.3d 750, 756 (8th Cir. 1997). Similarly, the Ninth Circuit’s Bankruptcy Appellate Panel held after its earlier decision in Century Cleaning that an attorney’s lien secures “only the amount of fees and costs specifically allowed by the bankruptcy court” rather than the entire retainer, because otherwise “would render the employment and compensation requirements of the Code and Rules meaningless.” In re Monument Auto Detail, Inc., 226 B.R. 219 (9th Cir. BAP 1998). See also In re On-Line Servs. Ltd., 324 B.R. 342, 347-48 (8th Cir. BAP 2005) (citing Lamie for the conclusion that an attorney is prevented from using a state law lien arising from a pre-petition security retainer for work in a chapter 7 case when the trustee had not retained the attorney under section 327).

In light of Congress’ thorough regulation of all aspects of professional compensation in bankruptcy cases, Ryan’s attempt to apply Oregon’s attorney’s lien statute to circumvent the Bankruptcy Code is improper. Ryan’s construction of state law would allow recovery from the Hill bankruptcy estate when sections 327, 330, 503 and 507 would not. Such a conclusion stands “as an obstacle to the accomplishment and execution of the full purposes and objectives . . . Congress” mandated in enacting the Bankruptcy Code and is preempted by the Bankruptcy Code. California Fed. Sav., 479 U.S. at 281. Indeed, applying the Oregon lien statute would squarely conflict with federal law. Alternatively, the Code presents such a pervasive scheme of federal regulation of attorney compensation in bankruptcy cases that it is reasonable to infer that Congress left no room for states to supplement the scheme. See Barnett Bank, 517 U.S. at 31. The bankruptcy court properly concluded that Ryan could not be paid from estate funds through an Oregon attorney's lien.

B. The Bankruptcy Code's comprehensive federal scheme for administering debtors also preempts Ryan's claim because the Code governs the administration of estate assets in chapter 7 cases and requires all third parties to turn over all estate property to the trustee.

Similarly, to permit Ryan to hoard and dispose of property of the estate based on the Oregon attorney's lien statute is inconsistent with the Bankruptcy Code's provisions governing the administration of assets in chapter 7 cases. Because the unearned funds became property of the bankruptcy estate under section 541(a), Ryan had a duty under section 542(a) to turn over the funds to the trustee. Under sections 323(a) and 704(1), only the trustee could administer estate funds, including the retainer. Those sections also gave the trustee the sole right to decide whether the estate would hire lawyers in the chapter 7 case, and who those lawyers should be.

Ryan has failed to turn over the funds and continues to hold this estate property in direct contravention of the Bankruptcy Code. The Code requires that estate property be turned over to the trustee. It is clear that the unearned funds in the retainer became property of the estate under section 541(a) once Hill filed his bankruptcy petition. See In re FitzSimmons, 725 F.2d 1208, 1210 (9th Cir. 1984) (noting that the bankruptcy estate comprises the property that will be available to satisfy the costs of bankruptcy administration and pay off the claims of the creditors). Therefore, section 542(a) of the Code commands that Ryan "deliver to the trustee" such funds. See In re Gerwer, 898 F.2d 730, 734 (9th Cir. 1990) ("The Trustee's power under Section 542 to obtain turnover does encroach upon the expectations of a lienholder.").

The Bankruptcy Code also provides that only the chapter 7 trustee, not the debtor's attorney, had the power to control and administer the funds at issue. Once a chapter 7 case commences, the trustee "is the representative of the estate." 11 U.S.C. 323(a). It is the role of solely the trustee to collect and administer estate property. 11 U.S.C. 704(1). As the Ninth Circuit has noted, a chapter 7 trustee can liquidate a debtor's right to legal services "by rejecting the contract with the attorney and demanding a refund of the unearned fees." <u>In re Hines,</u> 147 F.3d 1185, 1189 (9th Cir. 1998).

Significantly, the Supreme Court in <u>Lamie</u> relied upon this concept of the trustee's power to buttress its holding that a debtor's attorney shall not be paid from estate funds for chapter 7 work unless the trustee hires the attorney under section 327. <u>Lamie</u>, 540 U.S. at 537. <u>Lamie</u> explained that "[s]ection 327's limitation on debtors' incurring debts for professional services without the chapter 7 trustee's approval is not absurd. In the context of a chapter 7 liquidation it advances the trustee's responsibility for preserving the estate." <u>Id</u>.

In Hill's bankruptcy case, once the trustee was appointed, only the trustee could make decisions regarding estate property. Under federal law, Ryan was required to deliver the funds to the trustee. And only the trustee could decide whether the estate needed legal services and who should be nominated under section 327. But the trustee did not seek to use Ryan to perform services on behalf of the estate. Instead, he sought and obtained permission under section 327 to use another attorney. Ryan was not acting as chapter 7 counsel to the extent he performed post-petition services for Hill.

For these reasons, sections 542(a), 323(a), and 704(1) preempt Ryan's ability under state law to retain estate property.[12] The Oregon attorney's lien statute would effectively grant Ryan trustee-like powers and would present a square conflict with the Bankruptcy Code. Applying the Oregon statute in this bankruptcy context would grant Ryan "powers that are within the heartland of bankruptcy administration," requiring its preemption. Sherwood Partners, Inc. v. Lycos, Inc., 394 F.3d 1198, 1201 (9th Cir. 2005). Even if Ryan had a valid lien in a non-bankruptcy context, here he sought to employ that lien in derogation of these Code provisions, and in derogation of Lamie and thus was preempted by federal law. This court should affirm the turnover order. See In re Mahendra, 131 F.3d 750, 755(8th Cir. 1997) (holding that attorney cannot use a pre-petition retainer secured by a state-law lien to pay for his post-petition services because the debtor "lost the right to authorize" the attorney's legal services "which could potentially further encumber this asset of the bankruptcy estate.").

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[12] Within the context of bankruptcy case administration, Ryan's argument for payment from estate funds under the Oregon attorney's lien statute also runs afoul of preemption doctrine for its conflict with the automatic stay provisions of the Bankruptcy Code. See 11 U.S.C. 362(a). Because it is apparent that Congress included these provisions as part of a pervasive and comprehensive scheme governing administration of bankruptcy cases, state law must give way to the extent it conflicts with this federal scheme.

Specifically, the estate created by section 541 is protected from the piecemeal reach of creditors by section 362, which imposes an automatic stay on all actions and proceedings that affect a debtor's property. See 11 U.S.C. 362(a). Once Hill filed his petition, Ryan was prohibited under section 362(a)(3) from "any act . . . to exercise control over property of the estate," *i.e*, the funds in the retainer. Ryan was also barred under section 362(a)(4) from taking "any act to create, perfect, or enforce any lien against property of the estate." Finally, Ryan was prohibited by section 362(a)(5) from "any act to create, perfect, or enforce against property of the debtor any lien to the extent that such lien secures a claim that arose before the commencement of the case under this title." Ryan's argument that under state law he was entitled to assert a lien for payment from estate property must fail. Under Ryan's attorney's lien theory of recovery, his efforts to control or otherwise interfere with estate property violate the automatic stay. The Oregon statute is therefore preempted by federal law.

C. Allowing Ryan to assert a state lien for payment from estate property violates the Bankruptcy Code's goal of equitable distribution of debtor assets.

Finally, allowing Ryan payment from estate funds pursuant to the Oregon attorney's lien statute runs impermissibly counter to a central goal of the Bankruptcy Code – the equitable distribution of debtor assets. The Ninth Circuit has observed that chapter 7 of the Bankruptcy Code embodies the twin goals of a fresh start for an individual debtor and the equitable distribution of debtor assets among competing creditors. Sherwood Partners, Inc. v. Lycos, Inc., 394 F.3d 1198, 1203 (9th Cir. 2005). Therefore, state statutes that implicate either goal will be preempted. Id. As Sherwood Partners observed, the Bankruptcy Code seeks to accomplish equitable distribution "through a distinctive form of collective proceeding . . . that makes bankruptcy different from a collection of actions by individual creditors." Id. The filing of a bankruptcy petition brings the bankruptcy estate into being and triggers the automatic stay, "which prevents creditors from enforcing their claims, thus preserving the debtor's assets for ultimate distribution by the bankruptcy trustee." Id. at 1204. For these reasons, in addition to the assignee preference statute preempted in Sherwood Partners, the Ninth Circuit has repeatedly held that the Bankruptcy Code preempts state laws and private agreements that conflict with the Code. See, e.g., In re Miles, 430 F.3d 1083 (9th Cir. 2005); MSR Exploration, Ltd. v. Meridian Oil, Inc., 74 F.3d 910 (9th Cir. 1996); Gonzales v. Parks, 830 F.2d 1033 (9th Cir. 1987); Matter of 268 Ltd., 789 F.2d 674 (9th Cir. 1986).

Ryan's use of the attorney's lien statute would undermine the Code's distinctive collective method of asset distribution, including the automatic stay and the trustee's exclusive role in preserving assets for equitable distribution. If each debtor's attorney with a state-law attorney's lien on a pre-petition security retainer could simply ignore the Code and freely perform services after a case is filed, the Code's scheme would be effectively rewritten. The bankruptcy court was correct to resist Ryan's invitation to do so.

III. The Oregon attorney's lien statute is invalid against funds unearned by an attorney.

Setting aside the issue of preemption of an otherwise-valid lien, Ryan lacked a valid lien from the beginning. Ryan did not have a valid security interest for services not yet rendered. Or. Rev. St. 87.430 grants an attorney a lien on client money in his or her possession "for services rendered to the client." Or. Rev. St. 87.430. When Hill filed his petition, Ryan was due nothing for the services he rendered. Ryan's alleged lien did not exist, because Hill had paid for all services Ryan had rendered to date

Although fundamental black-letter law requires the existence of an actual debt or obligation before any lien is created, Ryan alleges a lien where Hill owed no obligation. A lien is an "incident of" a debt or obligation secured, and therefore "cannot exist in the absence of the debt or obligation the payment of which it secures." 53 C.J.S. *Liens* § 4 (updated Feb. 2007). More specifically, the standard rule is that a lien such as Ryan's applies only to secure attorney fees and charges which are due for services rendered. See 7A C.J.S. *Attorney & Client* § 445 (updated Feb. 2007); see also In re Monument Auto Detail, Inc., 226 B.R. 219 (9th Cir. BAP 1998) (holding that an attorney's lien secures "only the amount of fees and costs specifically allowed by the bankruptcy court" rather than the entire retainer); Tri City Equipment Co. v. Modern Real Estate Investments, Ltd., 460 N.W. 2d 464, 466 (Iowa 1990) ("Under the general rule and the Iowa cases, a retaining lien is available only to secure the attorney's fees and charges which are due for services already rendered.").

There are no Oregon state court cases that allow an attorney's lien to become effective for future services, and it indeed demands a tortured reading of the plain language of Or. Rev. St. 87.430 to conclude that an attorney's lien attaches for services not yet performed or otherwise unearned. The statute clearly provides that the lien applies only for services "rendered." Those services that an attorney might render in the future are simply not included. If the Oregon legislature had intended that a lien apply "for services rendered and for future services to be rendered" then presumably it would have said so. But allowing an attorney to retain client property to secure future services threatens interference with a client's undisputed power to terminate counsel at will with or without cause, subject to possible liability for breach of contract. See In re Lachmund's Estate, 170 P.2d 748, 752, 179 Or. 420, 429 (1946). Although Ryan makes much of the earlier bankruptcy court interpretation of Or. Rev. St. 87.430 in Century Cleaning, that interpretation – which is not binding on this court – was based on a single statement from a general liens treatise. See In re Century Cleaning Servs., Inc., 202 B.R. 149, 153 (Bankr. D. Or. 1996).

Finally, Ryan himself appeared to share the common-sense understanding that he would lack any rights over client property until he performed services requiring payment. Ryan told the bankruptcy court that "the clear written agreement [] provides for me to be able to charge against those monies for services that the client, the debtor, asks me to do. And to the extend [sic] that I do that, then I have a claim to that money." ER 62. In other words, Ryan recognized that he would only gain a legal claim over retainer funds once he had provided services that Hill asked him to perform. Ryan could not claim lien rights over money he had not yet earned and which remained his client's property. Ryan had no lien.

IV. Ryan's section 329 argument misconstrues the statute, his "bundle of sticks" argument lacks merit, and strong policy rationales support the bankruptcy court's ruling.

A. Ryan's section 329 argument misconstrues the statute.

Ryan mischaracterizes the operation of the Bankruptcy Code's section 329 as a provision authorizing payments to chapter 7 debtor attorneys from estate property. See ROB 9-11. In doing so, he relies on a Kansas bankruptcy court decision, In re Wagers, 340 B.R. 391 (Bankr. D. Kan. 2006), that was reversed several months before he filed his brief. See In re Wagers, 355 B.R. 268 (10th Cir. BAP 2006). Section 329 does not operate to authorize payment from estate funds or to authorize compensation for post-petition services. See In re Smith, 317 F.3d 918, 924 (9th Cir. 2002) ("Section 330(a) of the Bankruptcy Code governs the compensation of officers and professionals working on a bankruptcy case.").

Instead, section 329 is a disclosure provision that requires attorneys for debtors to state what compensation they have received during the year before petitioning for bankruptcy and that allows the bankruptcy court to recoup for the benefit of the estate any pre-petition fees deemed unreasonable. See 11 U.S.C. 329. In light of the comprehensive Bankruptcy Code scheme for retaining and compensating attorneys in bankruptcy cases, it is unsurprising that even fees paid to chapter 7 attorneys from non-estate funds – by a debtor pre-petition – are subject to scrutiny under section 329(a). As the Ninth Circuit has recognized, the legislative history of Code provisions including section 329 suggests such provisions were "intended to prevent overreaching or the collusive use of fee arrangements." Matter of 268 Ltd., 789 F.2d 674, 677 (9th Cir. 1986).

Ironically, in light of this legislative purpose, Ryan attempts to overreach by using section 329 as a safe harbor from the applicable requirements of the Code. As Lamie recognized, it is only section 330 in the Code that authorizes payment to a chapter 7 debtor attorney's from estate funds.

B. Ryan's "bundle of sticks" argument lacks merit.

Ryan's brief also relies on the reversed In re Wagers Kansas bankruptcy court case to support the misleading and inaccurate notion that he had an all-consuming "stick in the bundle" of property rights in the retainer. See ROB 11; In re Wagers, 355 B.R. 268 (10th Cir. BAP 2006), *rev'g* 340 B.R.391 (Bankr. D. Kan. 2006). Similarly, Ryan's assertion that the trustee had only a contingent reversionary interest in the unearned funds is without support beyond the reversed In re Wagers decision. As correctly concluded by the bankruptcy court under Oregon law, unearned funds in an attorney retainer remain client property, and become estate property under federal law when a client files a bankruptcy petition.

C. Strong policy rationale supports the bankruptcy court's ruling.

Although a chapter 7 debtor's attorney must be employed by the trustee to be paid from estate property, this has not presented undue hardships in bankruptcy cases. As the Supreme Court explained in Lamie, "[s]eeming order has attended the [government's] rule's application for five years in the Fifth Circuit and for four years in the Eleventh Circuit." Lamie, 540 U.S. at 537. Similarly, in the three years since Lamie issued, the United States Trustee Program is not aware of chaos emanating from the Supreme Court's construction of federal law. Post-petition attorney's fees can be paid out of a chapter 7 debtor's post-petition earnings, which are not property of the estate. Additionally, to the extent that the services of the debtor's attorney would benefit the bankruptcy estate, the attorney could seek to be employed by the chapter 7 trustee pursuant to section 327, as explicitly provided for in section 330.

Moreover, Chapter 7 debtors routinely pay their attorney a flat fee prior to filing bankruptcy to compensate the attorney for preparing and filing their petitions. See Lamie, 526 U.S. at 537 (recognizing the propriety of popular flat fee-type pre-petition retainers). Ryan had the opportunity to structure his fee arrangement with Hill this way, but instead chose an hourly arrangement for pre- and post-petition services. If Hill had the incorrect understanding that all funds in all pre-petition retainers immediately become attorney property, that may be attributable to Ryan's misunderstanding of federal law but is hardly "unfair." See ROB 12.

By contrast, adopting Ryan's approach would encourage attorneys for chapter 7 debtors to obtain substantial pre-petition retainers to serve as collateral for liens without which they would not be allowed by federal law to recover fees from the estate for post-petition services. The net result of such a scheme would be to reduce the amount available to pay creditors of the estate and valid administrative expenses, a result clearly contrary to the fundamental principles of the Bankruptcy Code. After all, as the Supreme Court noted in Lamie, section 327's requirement of trustee approval "advances the trustee's responsibility for preserving the estate" in the context of a Chapter 7 liquidation. Lamie, 526 U.S. at 537. A chapter 7 debtor does not administer or control the estate on behalf of creditors; a trustee does. Moreover, every dollar taken from the chapter 7 estate reduces the funds available for creditors. It is reasonable to prohibit the siphoning of finite assets in chapter 7 cases by preventing debtors from using estate funds to pay the bills of their personal attorneys for post-petition services that do not benefit the estate.

CONCLUSION

For these reasons, the United States Trustee respectfully asks that this court affirm the bankruptcy court's decision ordering turnover of Ryan's unearned retainer to the trustee.

Respectfully submitted,

ILENE J. LASHINSKY
UNITED STATES TRUSTEE

/s/ M. Vivienne Popperl
M. Vivienne Popperl, OSB #85305
Attorney for the United States Trustee

Roberta A. DeAngelis
Sean E. Martin
Department of Justice
20 Massachusetts Ave., N.W.
Washington, D.C. 20530
/ / /
phone: (202) 307-1399
fax: (202) 307-2397

Pamela J. Griffith
Office of the United States Trustee
Department of Justice
620 SW Main, Suite 213
Portland , OR 97205
phone: (503) 326-4000

BRIEF BANK — “SUMMARY SHEET”

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WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	In re Cindy Ann Hilmes (William T. Neary, United States Trustee v. Cindy Ann Hilmes)
2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	N. D. Tex.
3. ("CCN") ***CURRENT*** CASE NO.	No.: 09-cv-00732-Y
4. ("PCN") ***PRIOR*** CASE NO. - & COURT *[IF ANY]*	No.: 09-42301-rfn7 Court: Bankr. N. D. Tex. *(Identify judge & cite, if any)*
5. ("SO") ***SOURCE***	**U.S. TRUSTEES**
6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	Filed: December 31, 2009 Type: Brief of Appellant William T. Neary, United States Trustee
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8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	• Whether the bankruptcy court erred by utilizing a “substantial abuse” standard rather than the a mere “abuse” standard under 11 U.S.C. § 707(b)(3)(B) and whether the bankruptcy court erred by requiring the United States Trustee to prove that the debtor had a current ability to repay her unsecured creditors through a chapter 13 plan.
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IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHER DISTRICT OF TEXAS

In re §
§
CINDY ANN HILMES §

WILLIAM T. NEARY §
UNITED STATES TRUSTEE § CASE NO. 09-cv-00732-Y
§
Appellant §
§
v. §
§
CINDY ANN HILMES §
§
Appellee §

ON APPEAL FROM THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF TEXAS

<u>BRIEF OF APPELLANT WILLIAM T. NEARY, UNITED STATES TRUSTEE</u>

RAMONA D. ELLIOTT
General Counsel

P. MATTHEW SUTKO
Associate General Counsel
DAVID I. GOLD
Trial Attorney
Executive Office for United States Trustees
Department of Justice
20 Massachusetts Avenue, N.W.
Washington, D.C. 20530
Ph: (202) 307-1399
Fax: (202) 307-2397

WILLIAM T. NEARY
United States Trustee for Region 6

ERIN MARIE SCHMIDT
Trial Attorney
State Bar of Texas No. 24033042
ELIZABETH ANN ZIEGLER
Trial Attorney
Licensed in New York
Department of Justice
1100 Commerce Street, Rm. 976
Dallas, TX 75242
(214) 767-8967
(214) 767-8971 (fax)

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JURISDICTIONAL STATEMENT

The bankruptcy court had jurisdiction under 28 U.S.C. §§ 157(a) and (b), and 1334(a) to issue its final order denying the United States Trustee's motion to dismiss the Debtor's chapter 7 bankruptcy case under 11 U.S.C. §§ 707(b)(1) and (b)(3)(B). The bankruptcy court issued its final order denying the United States Trustee's motion on October 15, 2009. *See U.S. Trustee v. Cortez (In re Cortez),* 457 F.3d 448, 453-54 (5th Cir. 2006) (an order denying a motion to dismiss a bankruptcy case is a final order under 28 U.S.C. § 158(d)). The United States Trustee filed a notice of appeal on October 23, 2009, which is timely under 28 U.S.C. §§ 158(a) and (c)(2). This Court has appellate jurisdiction under 28 U.S.C. § 158(a)(1), a statutory provision under which district courts have jurisdiction to hear appeals from final judgments, orders, and decrees of bankruptcy judges.

STANDARD OF REVIEW

On appeal "conclusions of law are reviewed *de novo*, findings of fact are reviewed for clear error, and mixed questions of law and fact are reviewed *de novo*." *Century Indem. Co. v. Nat'l Gypsum Co. Settlement Trust (In re Nat'l Gypsum Co.)*, 208 F. 3d 498, 504 (5th Cir. 2000).

In determining whether providing chapter 7 relief to a debtor would constitute abuse under 11 U.S.C. § 707(b)(3), bankruptcy courts apply a "totality of the circumstances" test to the debtor's financial situation. *See* 11 U.S.C. § 707(b)(3)(B). The "totality of the circumstances" test is a "fact-intensive determination" which is reviewed on appeal for abuse of discretion. *Cf. Hebbring v. U.S. Trustee*, 463 F.3d 902, 905 (9th Cir. 2006) (pre-2005 Act case).

In this case, the bankruptcy court's interpretations of 11 U.S.C. §§ 707(b)(1) and 707(b)(3)(A) raise both issues of law, subject to *de novo* review, and issues concerning whether the bankruptcy court abused its discretion in failing to grant the relief requested by the United

States Trustee.

STATEMENT OF THE ISSUES PRESENTED

(1) Whether the Bankruptcy Court erred as a matter of law by utilizing the standard of "substantial abuse" rather than the correct standard of mere "abuse" in failing to dismiss the Debtor's case pursuant to 11 U.S.C. § 707(b)(3)(B)?

(2) Whether the Bankruptcy Court erred as a matter of law by requiring the United States Trustee to prove that the Debtor had a current ability to repay her unsecured creditors through a chapter 13 plan in order to dismiss the Debtor's case for abuse under section 707(b)(3)(B)?

(3) Whether the Bankruptcy Court abused its discretion in failing to grant the relief requested by the United States Trustee, and by failing to consider the United States Trustee's alternative "bad faith" argument under 11 U.S.C. § 707(b)(3)(A)?

STATEMENT OF THE CASE

On April 20, 2009, the Debtor sought chapter 7 bankruptcy relief in the United States Bankruptcy Court for the Northern District of Texas. *See* 11 U.S.C. § 701 et seq. On July 20, 2009, the United States Trustee[1] filed a motion to dismiss the Debtor's case for abuse under 11 U.S.C. §§ 707(b)(1) and (b)(3)(B). On August 31, 2009, the Debtor filed a response to the motion to dismiss. On October 15, 2009, the bankruptcy court entered an order denying the United States Trustee's motion to dismiss. This appeal followed.

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[1] United States Trustees "serve as bankruptcy watch-dogs to prevent fraud, dishonesty, and overreaching in the bankruptcy arena." H.R. Rep. No. 95-595, at 88 (1977), *as reprinted in* 1978 U.S.C.C.A.N. 5963, 5966, 6071. The United States Trustee Program therefore acts in the public interest to promote and preserve the efficiency and integrity of the bankruptcy system. Congress has provided that "[t]he United States trustee may raise and may appear and be heard on any issue in any case or proceeding ." 11 U.S.C. § 307. *See Thompson v. Greenwood*, 507 F.3d 416, 420 n.3 (6th Cir. 2007) (stating "[t]he United States Trustee is an interested party by statute").

STATUTORY FRAMEWORK

I. Relief Available to Individual Debtors

The Bankruptcy Code establishes two primary forms of bankruptcy relief for individual debtors – chapter 7 and chapter 13. Under chapter 7, "an individual debtor receives an immediate unconditional discharge of personal liability for certain debts in exchange for relinquishing his or her nonexempt assets to a bankruptcy trustee for liquidation and distribution to creditors." H.R. Rep. 109-31(I), at 10 (2005), *as reprinted in* 2005 U.S.C.C.A.N. 88, 97; *see* 11 U.S.C. §§ 701-727. Under chapter 13, "a debtor commits to repay some portion of his or her financial obligations" over a specified period "in exchange for retaining nonexempt assets and receiving a broader discharge of debt than is available under chapter 7." H.R. Rep. 109-31(I), at 10; *see* 11 U.S.C. §§ 1321-1330.

The difference between chapter 7 and 13 is dramatic. In chapter 7 cases, creditors may look solely to debtors' pre-bankruptcy, non-exempt assets for payment. *See* 11 U.S.C. § 541 (limiting property of the estate to debtors' pre-petition assets). Debtors' post-bankruptcy income is not subject to creditor claims. *Id.* Subject to narrow exceptions, debtors receive a complete discharge of all their pre-petition debts in a chapter 7 case. *See* 11 U.S.C. § 727(b).

Chapter 13 is different because debtors must use post-petition income to fund a chapter 13 payment plan. *See* 11 U.S.C. § 1306(a)(2) (property of the bankruptcy estate also includes post-petition income); 11 U.S.C. § 1325(b) (projected disposable income applied to make payments to unsecured creditors). In chapter 13, debtors typically receive a discharge only after they have completed their chapter 13 repayment plans. *See* 11 U.S.C. §§ 1328(a) and (c); *see also* 11 U.S.C. § 1328(b) (listing exceptions to this rule).

II. Former Section 707(b): Dismissal of Chapter 7 Cases for Substantial Abuse

Since 1984, Congress has enacted a series of tests that have allowed courts to dismiss chapter 7 cases to prevent unjust discharge of pre-petition debts. In 1984, Congress amended chapter 7 to permit dismissal of a chapter 7 bankruptcy petition under § 707(b) if a court found "substantial abuse." Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, § 312, 98 Stat. 333, 335. Congress enacted this amendment to respond "to concerns that some debtors who could easily pay their creditors might resort to chapter 7 to avoid their obligations." H.R. Rep. 109-31(I), at 12 (2005), *reprinted in* 2005 U.S.C.C.A.N. 88, 98 (internal quotation omitted). Two years later, Congress again amended this provision to authorize the United States Trustee to seek dismissal of chapter 7 petitions for "substantial abuse." Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1986, Pub. L. No. 99-554, § 219, 100 Stat. 3088, 3101.

After twenty-years' experience, Congress found that these amendments were insufficient to control abuse of chapter 7. Congress identified, among other problems, the "inherent[] vague[ness]" of the "substantial abuse" standard, which led to disagreement in the courts about whether a debtor's ability to repay a significant portion of his or her debts out of future income constitutes substantial abuse, meriting dismissal. H.R. Rep. 109-31(I), at 12. Another problem was that the Bankruptcy Code established "a presumption in favor of granting the relief requested by the debtor," which influenced courts' decisions whether to find substantial abuse. 11 U.S.C. § 707(b) (2000 suppl. 4); *See* H.R. Rep. 109-31(I), at 12.

Responding to these perceived shortcomings of the Bankruptcy Code, Congress held hearings over five years to identify what reforms it could adopt "to ensure that debtors repay creditors the maximum they can afford." H.R. Rep. 109-31(I), at 2, 12. The Bankruptcy Abuse

Prevention and Consumer Protection Act of 2005 (the "2005 Act"), Pub. L. No. 109-8, 119 Stat. 23, implemented the reforms Congress identified.

III. Changes Under the 2005 Act

On October 17, 2005, most provisions of the 2005 Act took effect, thereby implementing significant changes to the Bankruptcy Code. In enacting the 2005 Act, Congress:

> concluded that the complete overhaul of § 707(b) was necessary, with clear, non discretionary requirements imposed on the bankruptcy court to reject the notion that debtors were entitled to a discharge as a matter of right without regard to their ability to pay and to assure that in practice those with the ability to pay would not be entitled to chapter 7 relief.

146 Cong. Rec. S11700 (December 7, 2000), *reprinted in* http://www.gpoaccess.gov/crecord/retrieve.html; *see also* 151 Cong. Rec. S1856 (Mar. 1, 2005). Congress enacted the section 707(b) amendments to curb bankruptcy abuse by, *inter alia*, dismissing chapter 7 cases filed by debtors seeking to have their debts discharged despite having the ability to repay their creditors. *See* 151 Cong. Rec. S1856 (Mar. 1, 2005) (statement of Sen. Charles Grassley).[2] To effectuate this goal, Congress took four important steps.

First, Congress repealed the statutory presumption in favor of granting relief to the debtor. *Compare* 11 U.S.C. § 707(b) (1986) *with* 11 U.S.C. § 707(b) (2005).

Second, Congress lowered the standard for dismissal under all subsections of new section 707(b) from "substantial abuse" to mere "abuse." *See* 11 U.S.C. § 707(b)(1) (cases are now dismissed for "abuse"); 11 U.S.C. § 707(b)(2) (subjecting cases to dismissal for abuse); 11 U.S.C. § 707(b)(3) (same).

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[2] In his statement, Senator Grassley explained the purpose behind the section 707(b) amendments as follows: "[i]t is this simple: if repayment is possible, then [a debtor] will be channeled into chapter 13 of the Bankruptcy Code which requires people to repay a portion of their debt. . . ." *Id.*

Third, Congress authorized dismissal when a mathematical formula, known as the "means test," yields monthly disposable income that exceeds a statutory threshold. *See* 11 U.S.C. § 707(b)(2).

Fourth, Congress enacted new § 707(b)(3). This section allows courts to dismiss cases based upon either a debtor's bad faith, *see* 11 U.S.C. § 707(b)(3)(A), or the totality of a debtor's financial circumstances, *see* 11 U.S.C. § 707(b)(3)(B). Thus, even if a presumption of abuse does not arise or is rebutted under section 707(b)(2), a chapter 7 petition should still be dismissed for abuse under section 707(b)(3) when "bad faith" is demonstrated or "the totality of the circumstances . . . of the debtor's financial situation demonstrates abuse." 11 U.S.C. § 707(b)(3)(A) and (B); *In re Ross-Tousey*, 549 F.3d 1148, 1161-62 (7th Cir. 2008).

Sections 707(b)(3)(A) and (B) of the 2005 Act represent a significant departure from old section 707(b) because they clarify that cases can be dismissed either solely for misconduct, under subsection 707(b)(3)(A), or solely based upon the totality of the circumstances of a debtor's financial situation, under section 707(b)(3)(B).

FACTUAL BACKGROUND

I. Events Leading Up to the Debtor's Bankruptcy Filing

Approximately one year prior to filing for bankruptcy, the Debtor received a $12,170 income tax refund for 2007. *See* Transcript of Hearing, October 7, 2009 (hereinafter "Tr.")[3] Tr.31:5-15 [UST Exhibit 5, UST Exhibit 10]. In the same month, the Debtor had gastric bypass

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[3] *See* Appellant's Designation of Record (hereinafter "Appellant R."). The United States Trustee designated the Transcript of Hearing and Ruling. However, the Clerk's office separated the Transcripts in a separate volume that is not Bates-stamped as part of the Appellant's Record. Therefore, all references to the Transcript of Hearing and Ruling will use the page number of the Transcript.

surgery. *See* Tr. 64:2-9 [UST Exhibit 23]. The Debtor's out of pocket expense for this surgery was $2,500. *See* Tr. 123:1-12. After shrinking from a size 16 to a size 0, the Debtor spent over $450 to alter her knee length mink coat. *See* Tr. 17:10-23, 104:22-105:11.

In May 2008, the Debtor borrowed $35,000 from her 401k account.[4] *See* Tr. 56:4-9 [UST Exhibit 15]. The Debtor used the loan to pay for general household expenses and her daughter's private school tuition *See* Tr. 40:24-41:11. A week after taking out the loan, the Debtor put a down payment on a summer vacation to Destin, Florida. *See* Tr. 65:10-19 [UST Exhibit 22]. That same month, the Debtor also charged $950 to a credit card for her daughter's summer camp expense. *See* Tr. 65:2-6 [UST Exhibit 22].

In August 2008, the Debtor and her daughter drove to Destin, Florida for a week long vacation, stopping in New Orleans on the return trip. *See* Tr. 42:17-22. The Debtor charged a substantial portion of this trip on her credit cards, including the condominium rental, hotel charges, and activities. *See* Tr. 43:15-20, 66:15-68:16 [UST Exhibit 23].

In September 2008, the Debtor leased a new BMW 328i as a birthday gift for her sixteen year old daughter, creating an additional monthly household expense of $484.79. *See* Appellant R. No. 39, Tr. 69:24-70:8 [Schedule J, UST Exhibit 23]. According to the Debtor, she "didn't even think buying her a car would be an issue." *See* Tr. 111:2-3.

In the same month, the Debtor changed her gym membership from one costing approximately $108 per month to one costing $200 per month. *See* Tr. 71:31-72:15, 121:12-122:8.

At approximately the same time, the Debtor's sister informed her that she was returning

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[4] The repayment term of the loan is five years, and the last scheduled payment on the loan is June 4, 2013. *See* [UST Exhibit 15].

to school and would be unable to assist with the mortgage payments on a rental property located in Rhode Island . *See* Tr. 28:9-21, 120:18-22. The Debtor and her sister had purchased the rental property for $310,000 in 2005. *See* Appellant R. No. 21, Tr. 117:4-5, 14:2-9 [Schedule A]. Although the Debtor is solely liable for the mortgage on the property, she and her sister split the cost of expenses incurred outside of the rental income. *See* Tr. 14:10-14, 78:11-14, 117:6-13. The Debtor never made a profit on this rental property, and calculated losses on the property totaling $11,104 in 2007, and $23,040 in 2008. *See* Tr. 120:2-5, 130:22-131:3. However, the Debtor received an income tax refund in the amount of $12,170 for 2007, and $9,930 for 2008, in part due to the losses she sustained from the rental property. *See* Tr. 120:10-12 [UST Exhibit 5]. The October 2008 mortgage payment was the final payment the Debtor made on the rental property.[5] *See* Tr. 14:12-14, 120:23-121:5.

The Debtor continued to use her credit cards, even after learning her sister would no longer make rental payments and after admitting her financial problems associated with the rental property. *See* Tr. 72:16-74:24 [UST Exhibit 23]. In October 2008, the Debtor took out a cash advance from a credit card in the amount of $11,800, and used the money for routine household expenses and for other credit card payments. *See* Tr. 44:17-45:20 [UST Exhibit 22].

Between November 8th and November 16th, 2008, the Debtor spent over $700 in clothing purchases for her daughter at designer boutiques such as Juicy Couture, True Religion and Ed Hardy. *See* Tr. 72:22-73:12 [UST Exhibit 23].

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[5] During the course of the Debtor's bankruptcy, JP Morgan Chase moved to lift the bankruptcy stay as to the Rhode Island property in order to foreclose on its lien. *See* Appellant R. No. 71[Docket Sheet, UST Exhibit 1, Motion for Relief From Stay]. The Debtor and JP Morgan Chase agreed to lift the stay and to allow the lender to foreclose. *See* Appellant R. No. 114 [Agreed Order Lifting Stay]. Thus, the Debtor is no longer liable for making payments on the Rhode Island property. *See* Appellant R. No. 114 [Agreed Order Lifting Stay].

The Debtor and her daughter also traveled to Phoenix, Arizona for Thanksgiving to visit a sick friend. *See* Tr. 43:6-7, 127:14-20.

On December 15, 2008, the Debtor learned she would not be receiving a bonus. *See* Tr. 34:21-23. The Debtor contends that she based her financial decisions for the previous year on the assumption that she would be receiving the additional, discretionary bonus money. *See* Tr. 35:1-8. Thus, after failing to receive her anticipated bonus, the Debtor acknowledged she had financial problems. *See* Tr. 146:15-18.

However, rather than reducing her expenses, the Debtor continued to increase her expenditures as follows:

- From December 17, 2008 through January 13, 2009, the Debtor used her credit card to purchase $1,644.95 in consumer goods from vendors such as overstock.com, the Buckle, and Diesel. *See* Tr. 75:4-18.
- From December 17, 2008 through December 31, 2008, the Debtor took out $3,000 in cash advances on her credit cards. *See* Tr. 47:8-18.
- In December 2008, the Debtor traveled with her daughter to Rhode Island. *See* Tr. 43:2-5 [UST Exhibit 11].
- From January 1, 2009 through April 16, 2009, the Debtor incurred $7,471.35 in purchases and cash advances on her credit cards for consumer goods and services. *See* Tr. 75:18-77:8 [UST Exhibit 23].

II. The Debtor's Bankruptcy Filing

On April 20, 2009, the Debtor filed a voluntary petition for relief under the liquidation provisions of chapter 7 of the Bankruptcy Code in the United States Bankruptcy Court for the Northern District of Texas. *See* Appellant R. No. 4, 10 [Docket Sheet, Petition]. The Debtor is a

51 year old manager for Sabre Holdings (Travelocity). *See* Appellant R. No. 38, Tr. 7:15-8:2 [Schedule I]. She has a Bachelors Degree in Architecture, a Bachelors Degree in Psychology, and an Associates Degree in Interior Design. *See* Tr. 8:9-11. She is not married and has one dependent, a sixteen year old daughter. *See* Appellant R. No. 38 [See Schedule I].

The Debtor's yearly salary totals $123,000, which is more than double the $54,908 median income for a household of two in Texas. *See* Appellant R. No. 63, Tr. 96:1-2 [UST Exhibit 3, Means Test]. The Debtor's gross monthly income totals $9,886.00. *See* Appellant R. No. 38, Tr. 24:12-17 [Schedule I]. In addition to her base salary, the Debtor is eligible for a bonus of up to 25% of her salary. *See* Tr. 34:24-35:8. The Debtor has worked at Sabre Holdings since 1997, although she left the company from 2000-2004 for another employment opportunity. *See* Tr. 8:2-8. She has been consistently employed over the past five years. *See* Tr. 7:20-24.

The Debtor's voluntary contributions to her retirement accounts and the repayment of a 401k loan total $1,652.49 per month. *See* Appellant R. No. 38 [Schedule I]. With respect to the former, the Debtor contributes $988.65, or 10% of her gross monthly income, to her retirement accounts, and receives matching contributions from her employer to that account totaling 6% of her contributions. *See* Appellant R. No. 38, Tr. 24:18-23, 25:4-8 [Schedule I]. With respect to the latter, the Debtor repays herself $663.84 per month for a 401k loan, for which payments are due through June 4, 2013. *See* Appellant R. No. 38, Tr. 24:24-25:3 [Schedule I; UST Exhibit 15]. The Debtor did not reduce her retirement contributions before or after bankruptcy. *See* Tr. 24:18-25:3, 33:5-6. As of the date of filing, the Debtor had $158,669.48 in her retirement accounts, but wants at least one million dollars in that account for retirement. *See* Appellant R. No. 23-24, Tr. 103:2-12 [Schedule B].

The Debtor lives with her sixteen year old daughter in a 3,800 square foot home, located in Flower Mound, Texas, valued at $500,000. *See* Appellant R. No. 21, Tr. 10:15-16, 13:7-11 [Schedule A]. She custom built this home in 2006. *See* Tr. 11:24-12:12. The home contains four bedrooms, three bathrooms, a pool, three car garage, outdoor patio and grill and a media room. *See* Tr. 10:15-24 [UST Exhibit 27].

The Debtor's total monthly mortgage expense totals $3,888.76, which consists of a first mortgage payment of $3,155, and a second mortgage payment of $733.76. *See* Appellant R. No. 39 [Schedule J]. The utility costs associated with the home total $400 per month. *See* Appellant R. No. 39 [Schedule J]. By comparison, the IRS Local Standard for Housing and Utilities for the Debtor's household size in the county in which the Debtor lives was $1,769 as of October 6, 2009.[6] *See* Tr. 84:5-11 [See UST Exhibit 26]. Thus, the Debtor's total housing expense is more than double the IRS Standard.

Prior to moving to her custom built home, the Debtor owned a home that sold in April 2006 for $257,245.01. *See* Appellant R. No. 45, Tr. 30:1-6 [Statement of Financial Affairs]. The monthly mortgage payment for the Debtor's prior home was $2,400, or approximately 40% less than the Debtor's current mortgage payment. *See* Appellant R. No. 39, Tr. 30:13-18 [Schedule I]. When the Debtor's former home was sold, the Debtor used the $41,359.23 in net proceeds to: (a) pay off the loan on her 2003 BMW X5; and (b) use as a down payment on her new home. *See* Appellant R. No. 45, Tr. 30:7-12 [Statement of Financial Affairs].

At the time she filed for bankruptcy, the Debtor stated her intention to retain her custom built Flower Mound home and reaffirm the debt associated with that home. *See* Appellant R. No. 52 [Statement of Intent]. However, she has never reaffirmed the debt on this property. *See*

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[6] This amount covers both housing and attendant costs such as gas and electricity. *See* [UST Exhibit 26].

Appellant R. No. 4-9 [See Docket Sheet]. Instead, she listed the home for sale with a realtor for $524,000. *See* Tr. 9:18-10:8, Tr. 13:12-18 [UST Exhibit 27].

The Debtor currently leases two vehicles, a 2008 BMW 528i and a 2008 BMW 328i, at a cost of $1,124.04 per month. *See* Appellant R. No. 39 [See Schedule B]. The Debtor spends $639.25 per month on the 528i and $484.79 per month on the 328i. *See* Appellant R. No. 39, Tr. 27:17-20, 28:2-8 [Schedule J]. The IRS Local Standard transportation ownership/lease expense for one vehicle is $489, and $978 for two vehicles. *See* Appellant R. No. 64-65 [UST Exhibit 3, Means Test]. Thus, the Debtor's total monthly vehicle ownership expenses exceed this amount by $146.04. *See* Appellant R. No. 39 [Schedule J]. The Debtor drives the new 528i while her sixteen year old daughter drives the new 328i. *See* Tr. 20:18-21:15. As previously discussed, the 328i was a birthday present for her daughter's sixteenth birthday. *See* Tr. 21:19-24. The Debtor pays for most of the other costs associated with the vehicles, including the insurance premiums for both vehicles and repairs to her daughter's vehicle after car accidents. *See* Tr. 21:25-22:5 . The only vehicle expense her daughter covers is gas. *See* Tr. 22:2-3.

In total, the Debtor's total scheduled monthly expenses (*i.e.,* $8,395.76) exceed her monthly net income (*i.e.,* $6,299.93) by $2,095.83 per month. *See* Appellant R. No. 39 [Schedule J]. However, the Debtor failed to schedule several routine monthly expenses, including those for her housekeeper and for manicure and haircut expenses for her and her daughter. *See* Tr. 27:3-16, 28:22-29:14.

The Debtor's bankruptcy schedules reflect total assets of $1,033,190.81. *See* Appellant R. No. 19 [Summary of Schedules]. Those assets include the Debtor's custom built Flower Mound home and her Rhode Island rental property. *See* Appellant R. No. 21 [Schedule A]. Those assets also include the following personal property: (a) household goods which the Debtor valued on her schedules at $3,960; (b) retirement accounts which the Debtor valued on her schedules at $158,669.48; (c) clothing and personal effects which the Debtor valued on her schedules at $950; (d) furs which the Debtor valued on her schedules at $350; (e) pictures and art objects which the Debtor valued on her schedules at $200; and (f) jewelry which the Debtor valued on her schedules at $880. *See* Appellant R. No. 22-26 [Schedule B]. By comparison, the insured value of the Debtor's art, fur, and jewelry totals $2,390, $6,000, and $8,120 respectively. *See* Appellant R. No. 122 [Motion to Dismiss at ¶15, UST Exhibit 20]. Thus, the discrepancy between the Debtor's valuations of certain personal property listed on the Debtor's bankruptcy schedules and what the Debtor actually insured that property for was over $15,000. *See* Appellant R. No. 122 [Motion to Dismiss at ¶15].

The Debtor's bankruptcy schedules reflect total liabilities of $905,802. *See* Appellant R. No. 19 [Summary of Schedules]. The Debtor admits her liabilities are primarily consumer debt. *See* Appellant R. No. 10, 122, 139 [Petition, UST Motion at ¶ 14; Debtor's Response at ¶ 14]. The Debtor's schedules reflect $833,260.46 in secured debt, and $72,541.68 in unsecured debt. *See* Appellant R. No. 19, 30-31, 33-35 [Schedules D and F]. The Debtor's unsecured debt consists primarily of credit card charges for entertainment, shopping and various consumer goods and services. *See* Tr. 24:9-11. These charges include purchases for designer clothing for her daughter at luxury boutiques such as Ed Hardy and Juicy Couture. *See* Tr. 72:22-73:13, 89:20-90:5.

III. The Debtor's Post-Bankruptcy Filing Activities

Since filing for bankruptcy, the Debtor continues to use at least four credit cards.[7] *See*

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[7] These cards had zero balances at the time of the Debtor's bankruptcy filing and therefore were not included as part of the Debtor's bankruptcy filing. *See* Tr. 125:18-126:4.

Tr. 22:10-23:23, 126:5-19. For example, from April 20, 2009, the date she filed her bankruptcy petition, until May 4, 2009, the date she paid her Discover Card bill, the Debtor charged $786 and paid that amount off in full. *See* Tr. 52:3-12 [UST Exhibit 13].

Further, following the filing of her bankruptcy petition, the Debtor withdrew $15,000 from her JP Morgan Chase 401(k) retirement accounts to pay her daughter's 2009-2010 tuition. *See* Tr. 20:1-9, 56:20-57:2. This withdrawal left the Debtor with approximately $143,669 in retirement savings. *See* Tr. 52:3-12.

Finally, in May 2009, the month after filing for bankruptcy, the Debtor transferred $500 from her personal bank account into her daughter's bank account. *See* Tr. 55:12-56:3 [UST Exhibit 14].

IV. The Motion to Dismiss and the Bankruptcy Court's Ruling

On July 20, 2009, the United States Trustee timely filed his motion to dismiss the Debtor's case as an abuse under 11 U.S.C. §§ 707(b)(1), (b)(3)(A), and (b)(3)(B). *See* Appellant R. No. 119 [United States Trustee Mot. To Dismiss at 1]. The Debtor opposed the relief requested by the United States Trustee. *See* Appellant R. No. 136 [Debtor's Response to United States Trustee Mot. To Dismiss]. The United States Trustee subsequently replied to the Debtor's Response, providing additional information regarding the totality of the circumstances of the Debtor's financial situation. *See* Appellant R. No. 155 [UST Reply].

On October 7, 2009, the bankruptcy court held a hearing on the motion to dismiss. *See* Appellant R. No. 7 [Docket Sheet]. In its ruling, the bankruptcy court utilized the old standard of "substantial abuse" set forth under the old section 707(b) as opposed to the new standard of "abuse" set forth under the 2005 Act. *See* Transcript of Ruling at 11:18-25 (hereinafter "Tr. Ruling"). Further, the bankruptcy court found that because the Debtor might not be required to make payments to her unsecured creditors under a hypothetical chapter 13 plan, the Debtor did not have an ability to repay her creditors. *See* Tr. Ruling 3:7-24. Finally, the bankruptcy court completely failed to opine on the reasonableness of the Debtor's retirement contributions. *See* Tr. Ruling.

More specifically, the bankruptcy court found that:

- The Debtor's housing and car expenses were not excessive because the Debtor purchased theses items "at a time when she had the ability to do so, and these were well within her means." *See* Tr. Ruling at 4:23-25.
- The Debtor was "living off cash flow" instead of off a budget, her expenses were not excessive. *See* Tr. Ruling at 7:24-8:8.
- Because it was the Debtor's habit to incur high amounts of consumer debt, she was "emotionally unfit to stop it, and she became complicit in her daughter's spending habits." *See* Tr. Ruling 11:12-17.
- The Debtor's spending habits were not "the type of mentality Congress was trying to address when it instructed courts to dismiss cases for substantial abuse." *See* Tr. Ruling 11:17-21.

Ultimately, the bankruptcy court entered an order denying the United States Trustee's motion to dismiss, and the United States Trustee now appeals that decision. *See* Appellant R. No. 1-2, 3 [Order Denying Motion; Notice of Appeal].

SUMMARY OF THE ARGUMENT

The bankruptcy court's order dismissing the Debtors' chapter 7 petition should be reversed and remanded on any of four alternative bases:

First, the bankruptcy court committed an error of law by applying the incorrect standard for dismissal under new bankruptcy section 707(b)(3)(B). By utilizing the pre-2005 Act standard of "substantial abuse" rather than the correct post-2005 Act standard of "abuse" the bankruptcy court committed an error of law. This case should be remanded so the court can evaluate the case under the proper legal standard.

Second, the bankruptcy court committed an error of law by requiring the United States Trustee to prove that the Debtor had a current ability to repay her unsecured creditors under a chapter 13 plan in order to dismiss the Debtor's case for abuse under section 707(b)(3)(B). Dismissal under section 707(b)(3)(B)'s totality of the financial circumstances test is not dependent on a debtor's ability to propose a viable payment plan under chapter 13. Instead, the default remedy for abuse under section 707(b)(3)(B) is dismissal.

Third, by failing to opine as to the reasonableness of the Debtor's $1,652.49 in monthly retirement related expenses, and $3,888.76 in monthly mortgage related expenses, the bankruptcy court abused its discretion in denying the United States Trustee's motion to dismiss. In section 707(b)(3)(B), Congress underscored its concern that chapter 7 be reserved only for debtors who truly cannot repay their creditors by mandating that courts utilize a totality of the financial circumstances test in determining abuse. By ignoring the Debtor's discretionary choice to devote approximately 26% of her net monthly income towards retirement related endeavors (*i.e.,* $1,652.49/$6,299.93), and approximately 61% of her net monthly income towards the Flower Mound home she is actively seeking to sell and has not reaffirmed (*i.e.*, $3,888.76/$6,299.93), the bankruptcy court abused its discretion in applying section 707(b)(3)(B)'s totality of the financial circumstances test.

Fourth, the bankruptcy court abused its discretion by failing to consider the United States Trustee's "bad faith" argument under new bankruptcy section 707(b)(3)(A). In addition to lowering the standard for abuse under section 707(b), the 2005 Act also created a new basis for dismissal under section 707(b)(3)(A) – "bad faith." The United States Trustee presented several examples of the Debtor's "bad faith" at trial, but the bankruptcy court's findings are silent on this subject. Accordingly, the bankruptcy court abused its discretion for this reason as well.

ARGUMENT

I. Because the Bankruptcy Court Committed an Error of Law by Utilizing the Pre-2005 Act Standard of "Substantial Abuse" Rather than the Correct Post-2005 Act Standard of "Abuse" this Court Should Reverse and Remand

Congress enacted the 2005 Act to respond to an upward trend in consumer bankruptcy filings and concern that bankruptcy relief was "too readily available" and "sometimes used as a first resort, rather than a last resort." *See Morse v. Rudler (In re Rudler)*, 576 F.3d. 37, 40 (1st Cir. 2009) (*citing* H.R. Rep. No. 109-31(I), at 4 (2005), *reprinted in* 2005 U.S.C.C.A.N. 88, 90). Correspondingly, the 2005 Act relaxed the standard for dismissal of a case under section 707(b). *In re Rudler*, 576 F.3d at 40; *In re King,* No. 08-41975, 2009 WL 62252 at *4 (Bankr. E. D. Tex. Jan. 6, 2009). Before the 2005 Act, a showing of "substantial abuse" was required for dismissal under section 707(b), and a presumption existed in favor of discharging the debtor. *See In re King,* 2009 WL 62252 at *4. Following the enactment of the 2005 Act, the word "substantial" was removed, and section 707(b) now allows for a case to be dismissed if granting a discharge will be a mere "abuse" of the code. *See In re Rudler*, 576 F.3d at 40; *In re Meurer,* No. 09-41446, 2009 WL 4263368 at *2 (Bankr. N.D. Tex. Nov. 18, 2009); 11 U.S.C. §§ 707(b)(1) and 707(b)(3)(B) (each referencing "abuse" as a threshold). In its ruling, the bankruptcy court stated that although the Debtor was "emotionally unfit" to stop her spending habits, "it just doesn't strike the Court that that is the type of mentality that Congress was trying to address when it instructed courts to dismiss cases for **substantial abuse**." *See* Tr. Ruling 11:14-25 (emphasis added). Thus, the bankruptcy court applied the wrong legal standard to its abuse analysis in this case.

Further, because the bankruptcy court's error affected the United States Trustee's substantive right to obtain the dismissal of this case using the proper legal standard (*i.e.,* mere "abuse" not "substantial abuse"), its decision should be reversed. *See* 28 U.S.C. § 2111. As previously discussed, the United States Trustee established at trial: (a) that the Debtor's spending habits were unreasonable; (b) that the Debtor had an ability to repay her creditors; (c) that portions of the Debtor's schedules were inaccurate; and (d) that the Debtor's post-bankruptcy filing spending habits were unreasonable in light of her attempts to discharge all of her unsecured debts. *See* United States Trustee's Br., *supra* at 6-14. Prior to the enactment of the 2005 Act, most circuit decisions interpreting old section 707(b) opined that a debtor's ability to repay a meaningful portion of her debt, **standing alone**, justifies dismissal under the heightened "substantial abuse" test prescribed by the old statute. *See, e.g., Stewart v. U.S. Trustee (In re Stewart)*, 175 F.3d 796, 809 (10th Cir. 1999); *Kornfield v. Schwartz (In re Kornfield)*, 164 F.3d 778, 784 (2d Cir. 1999); *First U.S.A. v. Lamanna (In re Lamanna*), 153 F.3d 1, 4-5 (1st Cir. 1998); *Zolg v. Kelly (In re Kelly)*, 841 F.2d 908, 914-15 (9th Cir. 1998); *Stuart v. Koch (In re Koch*), 109 F.3d 1285, 1288 (8th Cir. 1997); *In re Krohn*, 886 F.2d 123, 126 (6th Cir. 1989). No less is true under new section 707(b)(3)(B), in which Congress **lowered the bar** for dismissing cases. Accordingly, because the United States Trustee provided significant reasons to dismiss the Debtor's case beyond even what the old standard for abuse required, the bankruptcy court's error of law in this case was material, and reversal and remand for consideration of abuse under section 707(b)(3)(B)'s proper legal standard is appropriate.

II. Because an Ability to Repay in Chapter 13 is Not Determinative of Abuse in Chapter 7, the Bankruptcy Court Committed an Error of Law by Requiring the United States Trustee to Prove that the Debtor had a Current Ability to Repay Her Unsecured Creditors Under a Chapter 13 Plan in Order to Dismiss the Debtor's Case for Abuse Under Section 707(b)(3)(B)

In ruling, the bankruptcy court determined that it could not dismiss the Debtor's case for abuse because the Debtor had no disposable income available to creditors under a hypothetical chapter 13 means test. Tr .Ruling 3:14-24. This was an error of law. Nothing in the text of section 707(b)(3)(B) makes dismissal under the "totality of the financial circumstances" test dependent on a debtor's ability to propose a viable payment plan under chapter 13. The opposite is true. Under the statute, the default remedy for abuse under section 707(b)(3)(B)'s plain language is dismissal. *See* 11 U.S.C. § 707(b)(1) (referencing dismissal of case absent debtor's consent). Accordingly, because the bankruptcy court failed to recognize this important aspect of section 707(b)(1), its decision should be reversed and remanded for this reason as well.

Before the enactment of the 2005 Act, dismissal for abuse was not conditioned on eligibility for a chapter 13. *In re Krohn*, 886 F.2d 123, 127 (6th Cir. 1989) ("[I]nability to qualify under Chapter 13 should not be dispositive of whether there may be a § 707(b) dismissal, since there are other factors to be considered in deciding if a debtor is needy"). Following the enactment of the 2005 Act, this result has not changed. *See In re Baeza,* 398 B.R. 692, 697 (Bankr. E.D. Cal. 2008) ("[t]he question before the court is not whether the Debtor[] **would be required** to pay anything to [his] unsecured creditors in a chapter 13, but rather, whether [he has] the **ability to pay** something substantial to [his] unsecured creditors.") (emphasis in original). To the contrary, the default remedy for abuse under sections 707(b)(3)(A) and (B) is dismissal, not conversion. *See* 11 U.S.C. § 707(b)(1).

Were abuse under section 707(b)(3)(B) determined solely by evaluating whether a debtor could fund a hypothetical chapter 13 plan, the totality analysis required under section 707(b)(3)(B) would, in many cases, be superfluous to the means test analysis required by section 707(b)(2): each would determine abuse based solely on a debtor's income and expenses. *Cf.* Fed. R. Bankr. P. Official Form 22A (the chapter 7 means test form), and Fed. R. Bankr. P. Official Form 22C (the chapter 13 means test form).

Under new section 707(b)(3)(B), a court deciding whether to dismiss a chapter 7 case must consider whether "the totality of the circumstances (including whether the debtor seeks to reject a personal services contract and the financial need for such rejection as sought by the debtor) of the debtor's financial situation demonstrates abuse." 11 U.S.C. § 707(b)(3)(B). The dictionary defines "totality" to mean "the state of being total; **entirety**" *Random House Dictionary.* (2009) (emphasis added). Such a meaning should therefore be imparted to the term "totality" used in section 707(b)(2)(3)(B). *See Bailey v. United States*, 516 U.S. 137, 144-45 (1995) (turning to dictionary definition of a term to define its statutory meaning).

In this regard, section 707(b)(3)(B)'s totality of the financial circumstances test directs courts to look not only at income and expenses, but also to other factors, including assets, liabilities, and post-petition economic circumstances impacting a debtor's ability to repay. *See* John A.E. Pottow, *The Totality of the Circumstances of the Debtor's Financial Situation in a Post-Means Test World*, 71 Mo. L. Rev. 1053, 1066 (2006); *see also U.S. Trustee v. Cortez (In re Cortez),* 457 F.3d 448, 456 (5th Cir. 2006).

This comports with the chapter 13 process in general. In this Circuit, increases in income and reductions in expenses are to be considered as part of the chapter 13 plan confirmation process. *See Nowlin v. Peake (In re Nowlin)*, 576 F.3d 258, 267 (5th Cir. 2009) (adopting a forward-looking, holistic approach to 11 U.S.C. § 1325(b)). Further, even after a chapter 13 plan is confirmed a debtor, a debtor's standing chapter 13 trustee, or a debtor's unsecured creditors may still seek modification of prescribed plan payments based on increases in income or reductions in expenses. *See* 11 U.S.C. § 1329(a)(1). Finally, under chapter 13 a bankruptcy court may deny confirmation of a chapter 13 plan or dismiss a chapter 13 case before a confirmed plan is completed when it finds that the plan has not been proposed in good faith or plan payments are not being made. *See* 11 U.S.C. §§ 1307(c) and 1325(a)(3). Thus, sections 1307(c), 1325(a), 1325(b), and 1329(a) all support the conclusion that a total reliance on a debtor's hypothetical ability to fund a chapter 13 plan, as the bankruptcy court engaged in below, is nothing less than speculative.

Because the United States Trustee provided significant reasons to dismiss the Debtor's case beyond merely the Debtor's hypothetical ability to fund a chapter 13 plan, *see* United States Trustee's Br., *supra* at 6-14, reversal and remand for consideration of abuse under the **totality** of the Debtor's financial circumstances is appropriate so the court below can apply the correct legal standard.

III. By Ignoring the Debtor's Choice to Devote Approximately 26% of Her Net Monthly Income Towards Retirement Related Endeavors, and Approximately 61% of Her +Net Monthly Income Towards the Flower Mound Home She is Actively Seeking to Sell and Has Not Reaffirmed, the Bankruptcy Court Abused its Discretion in Applying Section 707(b)(3)(B)'s Totality of the Financial Circumstances Test

Courts have long held that the totality of a debtor's financial circumstances is abusive if a debtor may reduce expenses without being deprived of basic necessities. *See, e.g., In re Camp,* 416 B.R. 304, 313 (Bankr. N.D. Tex. 2009) (noting that debtors "were enjoying a relatively affluent lifestyle" and that with the surrender of their prior home, "there must be some room in their budget to pay their existing secured creditors"); *In re Wadsworth,* 383 B.R. 330, 334

(Bankr. N.D. Ohio 2007) ("[D]ebtors may be expected to do some belt tightening, including, where necessary, foregoing the reaffirmation of those secured debts which are not reasonably necessary for the maintenance and support of the debtor and his family"). This belt-tightening notion, which pre-dates the 2005 Act, assumes a debtor may not be able to immediately repay unsecured creditors until that debtor has reduced unnecessary expenses. *See In re Krohn,* 886 F.2d at 128. Otherwise, permitting consumer debtors with unreasonable expenses to receive a chapter 7 discharge rewards "outrageous abusers of consumer credit, while denying to those with more moderate consumer debt the benefits of Chapter 7." *Krohn*, 886 F.2d at 127.

The intent behind the enactment of the 2005 Act bolsters this conclusion. The 2005 amendments were designed to "respond to many of the factors contributing to the increase in consumer bankruptcy filings, such as lack of personal financial accountability, the proliferation of serial filings, and the absence of effective oversight to eliminate abuse in the system." *Perlin v. Hitachi Capital Am. Corp. (In re Perlin),* 497 F.3d 364, 371 (3d Cir. 2007) (quoting H.R. Rep. No. 109-31(I), at 2). By mandating a "financial circumstances" test under the amended statute, Congress underscored its concern that chapter 7 be reserved for debtors who truly could not repay their creditors. *See United States v. Am. Trucking Ass'ns*, 310 U.S. 534, 543 (1940) (stating that the words of a statute are the best indication of its purpose). This is borne out by the legislative history to the 2005 Act which expressed that "debtors repay creditors the maximum they can afford." H.R. Rep. 109-31(I), at 2.

In this case, the Debtor and her daughter live an extravagant lifestyle. *See* United States Trustee's Br., *supra* at 6-14. Given this lifestyle, the United States Trustee challenged those expenses which were unnecessary. *See* Appellant R. No. 119 [UST Motion to Dismiss]. The challenged expenses included the Debtor's secured debt payments on her Flower Mound home and two vehicles, her retirement related contributions, designer clothing, vacations, housekeeping services, manicures, and gym trainers. While the Bankruptcy Court found many of these expenses "are simply not very defensible," *see* Tr. Ruling 9:7-9, it did not determine whether a reduction of the Debtor's unnecessary expenses would have freed up available income for her creditors. *See* Tr. Ruling 9:7-9. In particular, it failed to take into account the Debtor's choice to devote roughly 26% of her net income to retirement related endeavors, and approximately 61% of her net monthly income towards the Flower Mound home she is actively seeking to sell and has not reaffirmed. *See* Tr. Ruling. Accordingly, in light of the express purpose behind the 2005 Act (*i.e.*, ensuring that debtors repay creditors the maximum they can afford), the bankruptcy court abused its discretion in finding that the Debtor's case did not constitute an abuse of chapter 7.

A. Retirement-Related Expenses

Under pre-2005 Act law, courts in this district excluded voluntary retirement-related expenses from a debtor's budget and included those contributions in disposable income. *See, e.g., In re Rathbun*, 309 B.R. 901, 905 (Bankr. N.D. Tex. 2004); *In re Watkins*, 216 B.R. 394, 396 (Bankr. N.D. Tex. 1997). Following the enactment of the 2005 Act, retirement-related expenses are still considered a factor under the totality of the circumstances test. *See, e.g., In re Tucker*, 389 B.R. 535, 539-541 (Bankr. N.D. Ohio 2008) (holding that voluntary retirement contributions must be evaluated in the context of a totality of the circumstances analysis, including the age of the debtor, the amount of the contribution, and overall budget)*; In re Lenton*, 358 B.R. 651, 663-666 (Bankr. E.D. Penn. 2006) (holding that repayment of 401k loans can be considered under a totality of the circumstances analysis).[8]

While the bankruptcy court below failed to make any specific findings regarding the Debtor's retirement-related expenses, *see* Tr. Ruling, the record before the bankruptcy court demonstrated that the Debtor, who had $158,669 in retirement savings at the time her bankruptcy case was filed, continues to contribute $1,652.49 per month towards retirement-related expenses ($988.65 in retirement contributions and $663.84 in retirement loan repayments). *See* United States Trustee's Br., *supra* at 6-14. This amount constitutes approximately 26% of the Debtor's net monthly income. *Id.* At the same time, the Debtor, who is in good health and currently earns more than double the median income for a household size of two in Texas, can anticipate working for at least another fifteen years. *Id.* Further, the Debtor's last payment on her 401K loan is due on June 4, 2013. *Id.* Accordingly, in light of the substantial circuit law opining that a debtor's ability to repay a meaningful portion of her debt, standing alone, justified dismissal under the heightened "substantial abuse" test prescribed by the pre-2005 Act section 707(b), *see,*

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[8] Those courts holding the opposite do so under the theory that because a court may not consider a debtor's retirement related contributions as disposable income under section 1325(b)(2) of the Bankruptcy Code, the same must be true under section 707(b)(3)(B)'s totality of the circumstances analysis. *See, e.g., In re Phillips,* 417 B.R. 30, 40-41 (Bankr. S.D. Ohio 2009) (cannot include voluntary retirement contributions and loan repayments in disposable income because of statutory changes wrought by 11 U.S.C. § 541(b)(7)); *In re Mravik,* 399 B.R. 202, 211 (Bankr. E.D. Wis. 2008) (cannot include retirement contributions in disposable income because specifically excluded by Congress under 11 U.S.C. § 541(b)(7)). This theory is misplaced because it does not conform to the language of the statute. The prohibition against considering retirement-related income under section 1325(b)(2)'s disposable income analysis finds its genesis in sections 541(b)(7) and 1322(f) of the Bankruptcy Code. *See* 11 U.S.C. §§ 541(b)(7) and 1322(f). However, sections 541(b)(7) and 1322(f), by their very language, only impact section 1325(b)(2)'s disposable income analysis, and there is no mention of section 707(b) – the statute at issue in this case – anywhere in those provisions. *Id.* Accordingly, the cases holding that retirement-related contributions cannot be considered in the context of a section 707(b) should not be relied upon.

e.g., Stewart, 175 F.3d at 809; *Kornfield*, 164 F.3d at 784; *Lamanna*, 153 F.3d at 4-5; *Kelly*, 841 F.2d at 914-15; *Koch*, 109 F.3d at 1288; *Krohn*, 886 F.2d at 126, and the Bankruptcy Code's diminished requirement for a finding of abuse under the post-2005 Act section 707(b), the bankruptcy court abused its discretion in failing to consider this substantial outlay as part of its section 707(b)(3)(B) analysis.[9]

B. Mortgage-Related Expenses

While secured debt payments – like the $3,888.76 in mortgage payments at issue in this case – are allowed, under certain conditions, in determining whether an evidentiary presumption of abuse arises under section 707(b)(2)'s means test, courts may still consider those payments in analyzing whether abuse is present under section 707(b)(3)(B). *See In re Gonzalez,* 388 B.R. 292, 302 n.5 (Bankr. S.D. Tex. 2008); *In re Kaminski,* 387 B.R. 190, 196 (Bankr. N.D. Ohio 2008).[10] Indeed, several courts, including Texas courts, have found that excessive secured debt

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[9] Indeed, it would be extremely odd for the Fifth Circuit to mandate the consideration of such outlays as part of a section 1325(b)(2) projected disposable income analysis, *see Nowlin*, 576 F.3d at 267 (requiring consideration of income that would become available to debtor due to anticipated termination of 401K loan repayments), and not do the same as part of a section 707(b)(3)(B) analysis.

[10] Some courts have held that it is improper to consider the reasonableness of a debtor's mortgage payment as part of a section 707(b)(3)(B) analysis. *See In re Johnson*, 399 B.R. 72, 76-77 (Bankr. S.D. Cal. 2008) (concluding that to look at the reasonableness of a mortgage payment would contravene Congress' intent in legislating § 707(b)(2)); *In re Jensen*¸ 407 B.R. 378, 385-86 (Bankr. C.D. Cal. 2009) (concluding that court could not reach a result that is inconsistent with the implicit policies of the means test under section 707(b)(3)(B)); *In re Dumas*, No. 08-61190, 2009 WL 3856664, *4 (Bankr. E.D. Tex. November 17, 2009) (Congressional failure to include a limit on the allowable housing expense on a means test under § 707(b)(2)(A)(iii) prevented the court from determining whether the overall expense was reasonable). However, an analysis of the totality of a debtor's financial circumstances under section 707(b)(3)(B) requires consideration of a debtor's "**actual income and expenses**," notwithstanding what may or may not be allowed under section 707(b)(2)'s means test. *See Ross-Tousey v. Neary (In re Ross-Tousey),* 549 F.3d 1148, 1161-62 (7th Cir. 2008) (emphasis added). Furthermore, the Fifth Circuit has instructed that courts should be able to look to a debtor's future ability to repay his debts due to postpetition changes in circumstances.

expenses weighed in favor of dismissal under section 707(b)(3)(B). *See, e.g., In re Castellaw*, 401 B.R. 223, 228 (Bankr. N.D. Tex. 2009) (concluding, *inter alia*, that $5,100 per month mortgage payment for $1.2 million dollar, 3,600 square foot home was excessive); *In re Meurer*, No. 09-41446, 2009 WL 4263368, *4 (Bankr. N.D. Tex. November 18, 2009) (concluding, *inter alia*, that $4,072.72 per month mortgage payment for a $500,000 home was excessive); *In re King,* No. 08-41975, 2009 WL 62252, *4 (Bankr. E. D. Tex. January 9, 2009) (concluding, *inter alia*, that $3,008 per month in housing related expenses for $385,000, 3,407 square foot home was excessive); *In re Talley*, 389 B.R. 741, 745 (Bankr. W.D. Wash. 2008) (ordering dismissal under section 707(b)(3)(B) after finding that the debtor's mortgage payment was three times the local IRS standard); *In re Oot,* 368 B.R. 662, 669 (Bankr. N.D. Ohio 2007) (concluding that debtor's $4,000 per month mortgage payment is a luxury item and excessive under section 707(b)(3)(B)).

The bankruptcy court's findings regarding the reasonableness of the Debtor's mortgage payments are far from clear. While it stated that her "house is an expensive house and it's a large house for a household of two people," it also stated that "the fact that debtors have nice houses . . . is not the be-all and end-all of excessiveness." *See* Tr. Ruling 4:3-12. At the same time, the record shows that the Debtor's mortgage payments, exclusive of the associated costs for insurance and utility payments, are more than double the corresponding IRS local housing standard for the Debtor's locality; that the $3,888.76 in mortgage payments at issue in this case constitute roughly 61% of the Debtor's net monthly income; and that the Debtor has put her Flower Mound home on the market, and did not seek to reaffirm the debt on that home. *See*

See Cortez, 457 F.3d at 456. Accordingly, *Johnson*, *Jensen*, *Dumas* and the cases that follow them should not be relied upon.

Appellant R. No. 39-40 [UST Exhibit 26, UST Exhibit 27]. These facts demonstrate that the Debtor's budgeted mortgage-related expenses are excessive, and lend credence to the United States Trustee's position that there is a substantial likelihood that a future reduction in the Debtor's housing costs is likely. Accordingly, by failing to consider the true scope of these substantial expenditures as part of its section 707(b)(3)(B) analysis, the bankruptcy court abused its discretion for this reason as well.

IV. The Bankruptcy Court Abused its Discretion By Failing to Consider the United States Trustee's Alternative "Bad Faith" Argument Under New Bankruptcy Section 707(b)(3)(A).

As an alternative to his arguments under section 707(b)(3)(B)'s totality of the financial circumstances test, the United States Trustee also presented the bankruptcy court with facts and argument demonstrating that the Debtor's case should be dismissed under section 707(b)(3)(A)'s "bad faith" test. *See* Appellant R. No. 119 [United States Trustee Mot. To Dismiss at 1]; United States Trustee's Br., *supra* at 6-14. Because the bankruptcy court failed to even consider the United States Trustee's "bad faith" argument in reaching its decision, *see* Tr. Ruling, it abused its discretion for this reason as well.

CONCLUSION

For these reasons, the United States Trustee respectfully asks this Court to reverse the order entered by the bankruptcy court below and remand for further proceedings.

RAMONA D. ELLIOTT General Counsel	WILLIAM T. NEARY United States Trustee for Region 6
	/s/ Erin Marie Schmidt
P. MATTHEW SUTKO Associate General Counsel DAVID I. GOLD Trial Attorney Executive Office for United States Trustees Department of Justice 20 Massachusetts Avenue, N.W. Washington, D.C. 20530 Ph: (202) 307-1399 Fax: (202) 307-2397	ERIN MARIE SCHMIDT Trial Attorney State Bar of Texas No. 24033042 ELIZABETH ANN ZIEGLER Trial Attorney Licensed in New York State Department of Justice 1100 Commerce Street, Rm. 976 Dallas, TX 75242 (214) 767-8967 (214) 767-8971 (fax)

CERTIFICATE OF SERVICE

I certify that I forwarded a true and correct copy of the foregoing BRIEF OF APPELLANT WILLIAM T. NEARY, UNITED STATES TRUSTEE by prepaid first class mail to the persons listed below on December 31, 2009

/s/ Erin Marie Schmidt
Erin Marie Schmidt

Appellee:
Cindy Ann Hilmes
PO Box 271822
Flower Mound, TX 75027

Appellees' Counsel:
Behrooz P. Vida &
Carla Reed Vida
The Vida Law Firm, PLLC
3000 Central Drive
Bedford, TX 76021

BRIEF BANK — "SUMMARY SHEET" *Printed Fri-2/26/10 9:54*

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2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	N.D. Tex.
3. ("CCN") ***CURRENT*** CASE NO.	No.: 09-cv-00732-Y
4. ("PCN") ***PRIOR*** CASE NO. - & COURT *[IF ANY]*	No.: 09-42301-rfn7 Court: Bankr. N.D. Tex. *(Identify judge & cite, if any)*
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IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF TEXAS

In re	§	
	§	
CINDY ANN HILMES	§	

WILLIAM T. NEARY	§	
UNITED STATES TRUSTEE	§	CASE NO. 09-cv-00732-Y
	§	
Appellant	§	
	§	
v.	§	
	§	
CINDY ANN HILMES	§	
	§	
Appellee	§	

ON APPEAL FROM THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF TEXAS

REPLY BRIEF OF APPELLANT WILLIAM T. NEARY, UNITED STATES TRUSTEE

RAMONA D. ELLIOTT
General Counsel

P. MATTHEW SUTKO
Associate General Counsel
DAVID I. GOLD
Trial Attorney
Executive Office for United States Trustees
Department of Justice
20 Massachusetts Avenue, N.W.
Washington, D.C. 20530
Ph: (202) 307-1399
Fax: (202) 307-2397

WILLIAM T. NEARY
United States Trustee for Region 6

ERIN MARIE SCHMIDT
Trial Attorney
State Bar of Texas No. 24033042
ELIZABETH ANN ZIEGLER
Trial Attorney
Licensed in New York
Department of Justice
1100 Commerce Street, Rm. 976
Dallas, TX 75242
(214) 767-8967
(214) 767-8971 (fax)

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INTRODUCTION

In his opening brief, the United States Trustee established that the bankruptcy court committed an error of law when it did not dismiss Ms. Hilmes's chapter 7 bankruptcy case for abuse. In response, Ms. Hilmes attempts to defend the bankruptcy court's analysis by arguing that the totality of the circumstances test for dismissal under the Bankruptcy Abuse Prevention and Consumer Protection Act ("2005 Act") is essentially the same as before. This is incorrect – the 2005 Act fundamentally changed the approach that bankruptcy courts must take when determining if a chapter 7 case should be dismissed. In addition, Ms. Hilmes fundamentally misunderstands the Code when she argues that mortgage and retirement expenses are exempt from review under the totality of the financial situation analysis because they are not considered under the section 707(b)(2) means test. The other arguments Ms. Hilmes raises are equally unpersuasive.

As the United States Trustee has established, and Ms. Hilmes fails to rebut, Ms. Hilmes's pattern of lavish spending demonstrates she has the financial means to pay her creditors. Ms. Hilmes does not seriously dispute that she can change her lifestyle to set aside money to re-pay her creditors. To the contrary, she implicitly admits in her brief to this Court that she can pay something back. *See* Appellee Br. at 38.

It is undisputed that Ms. Hilmes receives a salary of over $120,000 per year to support herself and her daughter, Brittany. Record at 38, (Schedule I). By her own admission, Ms. Hilmes leases two late model BMW cars – a 528i for herself and a 328i for Brittany, whom she "has in the past overindulged." Appellee Br. at 14, Record at 25, (Schedule B). In 2006, Ms. Hilmes purchased a house with four bedrooms, three baths, and a media room that is worth approximately $500,000; she wanted that much space for two people to "accommodate Brittany and her friends." *Id.* at 18; UST Ex. 27. Despite being in debt, Ms. Hilmes joined a health club in 2008 that offered personal training because she "was not familiar with the ins and outs of exercising . . . ." Appellee Br. at 22.

Ms. Hilmes admits to these expenses and offers no plausible reason why they cannot be significantly reduced so that Ms. Hilmes can pay back her creditors. In other cases, it might be difficult to gauge whether the debtor's "financial situation" warrants dismissal. Not so here. The bankruptcy court erred when it failed to assess Ms. Hilmes's ability to pay her debts. The decision below should be reversed.

ARGUMENT

I. The Bankruptcy Court's Explicit Statement and Reasoning Demonstrates That it Applied the Superseded "Substantial Abuse" Standard, an Error of Law Warranting Reversal.

Contrary to Ms. Hilmes's argument, the bankruptcy court erred by applying a substantial abuse standard when determining whether Ms. Hilmes was entitled to a discharge. Appellee Br. at 30. The court explicitly mentioned "substantial abuse" – the incorrect standard – when assessing Ms. Hilmes's "habit to incur a lot of consumer debt." Opinion Tr. at 11. Specifically the court stated "it just doesn't strike the Court that that is the type of mentality that Congress was trying to address when it instructed courts to dismiss cases for substantial abuse . . . ." *Id.*

Ms. Hilmes argues that the bankruptcy judge simply misspoke when he invoked the "substantial abuse" standard during his ruling from the bench. Appellee Br. at 30. Even if she is correct, the decision must still be reversed because the court's analysis did not comport with any of the requirements of the 2005 Act. The reasoning of the decision, however, demonstrates that the bankruptcy court erroneously applied the superseded substantial abuse standard, warranting reversal.

Before the 2005 Act, courts in the Fifth Circuit determined substantial abuse under a totality of the circumstances review. *U.S. Trustee v. Cortez (In re Cortez)*, 457 F.3d 448, 456 n.7 (5th Cir. 2006). In deciding whether to dismiss a case, courts emphasized ability to repay creditors but also included other factors such as good faith, fair dealing with creditors leading up to bankruptcy, and precipitating events leading up to the bankruptcy. *Id.* (citing *In re Hill*, 328 B.R. 490, 494-96 (Bankr. S.D. Tex. 2005)).

As Ms. Hilmes admits, before 2005 the courts engaged in value judgments to decide if, on balance, it would be equitable to grant the debtor a discharge. Appellee Br. at 10. The court in this case performed a classic pre-2005 substantial abuse totality of the circumstances analysis, weighing a variety of factors together. The court acknowledged that Ms. Hilmes's expenses were excessive: "[i]t is safe to say that many of the items that have been pointed out by Ms. Ziegler today are simply not very defensible items." Opinion Tr. at 9. It considered whether it was prudent for Ms. Hilmes to lease two BMWs, take three vacations in the six months before bankruptcy, and to live in a four-bedroom house. *Id.* It compared Ms. Hilmes's situation to those of other debtors and posited that Ms. Hilmes's spending was the product of societal pressure to over-spend. *Id.* at 8. It concluded that Ms. Hilmes's situation was a close-call, but on balance decided that she had been living on "the edge," incurring "a lot of consumer debt." *Id.* at

10. She had nevertheless paid her credit cards along the way, and therefore was not "carelessly and frivolously incurring more consumer debt," making her eligible for a fresh start through a chapter 7 discharge. *Id.* at 11-12. This consideration of a variety of factors ranging from Ms. Hilmes's spending patterns to her intent in accumulating debt reflects the *ad hoc* discretionary approach to determining eligibility for discharge that the 2005 Act was designed to curtail.

Even under the pre-2005 Act "substantial abuse" standard, the court erred in granting Ms. Hilmes a discharge. Under the previous version of section 707(b), lower courts in the Fifth Circuit followed the Sixth Circuit test to evaluate whether "substantial" abuse existed by considering simultaneously both the debtor's conduct and the debtor's ability partially to repay his debts outside bankruptcy or through a chapter 13 repayment plan. *In re Krohn*, 886 F.2d 123, 126 (6th Cir. 1989)("substantial abuse can be predicated upon either lack of honesty or want of need."); *In re Cortez,* 457 F.3d at 456 n. 7 (noting that lower courts in the Fifth Circuit have adopted the totality of circumstances approach). This was a wide-ranging analysis with ability to pay a central consideration. *See Krohn*, 886 F.2d at 126-27. Furthermore, a debtor cannot get a discharge simply because she would not be able to make a substantial repayment to creditors. *Behlke v. Eisen (In re Behlke)*, 358 F.3d 429, 437 (6th Cir. 2004). Ms. Hilmes has not demonstrated any financial need and can pay something back to her creditors. Under any standard, she is not entitled to a discharge.

A. The bankruptcy court failed to conduct the analysis required under 11 U.S.C. 707(b)(3), an error of law requiring reversal and remand.

The court below erred as a matter of law in performing that pre-2005 Act classic substantial abuse totality of the circumstances analysis. It was error because the 2005 Act "produced a sea change." *Egebjerg v. Anderson (In re Egebjerg)*, 574 F.3d 1045, 1048 (9th Cir. 2009). The statutory presumption favoring chapter 7 relief is gone and the emphasis is on repaying creditors as much as possible. *Id.* (citing H.R.Rep. No. 109-31, pt. 1 at 2 (2005), reprinted in 2005 U.S.C.C.A.N. 88, 89.). Even if the bankruptcy court tried to apply the 2005 Act, it did so incorrectly for the reasons outlined below.

The court failed to analyze independently bad faith and ability to repay. Section 707(b)(3) now requires that a bankruptcy court conduct two separate analyses before granting discharge. *Yuan v. McVay (In re Yuan)*, No. 1:09-cv-00833-SS, slip op. at 6 (W.D. Tex. Feb. 4, 2010). First, the court must determine if the debtor filed a petition in bad faith. 11 U.S.C. § 707(b)(3)(A). Second, the court must determine if the totality of the debtor's financial circumstances indicates that she can re-pay her creditors. 11 U.S.C. § 707(b)(3)(B). The second analysis requires consideration of a debtor's "actual income and expenses." *Ross-Tousey v. Neary (In re Ross-Tousey),* 549 F.3d 1148, 1161-62 (7th Cir. 2008). Sections 707(b)(3)(A) and (B) of the 2005 Act represent a significant departure from old section 707(b) because they clarify that cases can be dismissed either solely for misconduct, under subsection 707(b)(3)(A), or solely based upon the totality of the circumstances of a debtor's financial situation, under section 707(b)(3)(B).

In deciding whether a debtor has the ability to repay creditors under section 707(b)(3)(B), a court must look only at the totality of a debtor's financial circumstances, including whether a debtor may reduce expenses without being deprived of basic necessities. *In re Camp,* 416 B.R. 304, 312 (Bankr. N.D. Tex. 2009). Under section 707(b)(3)(B), courts must consider the debtor's assets, liabilities, expenses, and expected future income, and whether any of the debtor's obligations are secured by unnecessary luxury goods: in short, financial factors that are relevant to the determination of the debtor's ability to pay creditors. *In re Wolf,* 390 B.R. 825, 833 (Bankr. D.S.C. 2008) ("[t]he plain meaning of "financial situation" must necessarily include the debtor's ability to pay creditors"); *see In re Yuan*, slip op. at 5.

In an opinion issued on February 4, 2010, Judge Sparks of the Western District of Texas recognized that the 2005 Act represents a "significant departure" from the old statute and requires rigorous analysis of the debtor's ability to repay. *In re Yuan*, slip op. at 5 (copy attached). Judge Sparks affirmed dismissal of the debtors' chapter 7 case because Mr. Yuan wished to pay the mortgage on his parents' house in Colorado and rent an apartment in a luxury high-rise in downtown Austin rather than repay his substantial credit card debt. *Id.* at 8 ("Here the debtors would be able to repay their creditors, even if Ms. Eichhorst's [Mr. Yuan's wife] continued unemployment, were they not spending so much in rent."). Judge Sparks dismissed the case even though the debtors were honest and even though they faced financial difficulties. *Id.* at 9. He dismissed the case because the 2005 Act does not allow debtors to maintain a high-style standard of living when they can no longer afford it. *Id.*

In contrast, the bankruptcy court in this case would discharge debts Ms. Hilmes is able to substantially repay because "the Court sense[d] that she [Ms. Hilmes] was just emotionally unfit to stop it [consumer spending], and she became complicit in her daughter's spending habits, something she can no longer do." Opinion Tr. at 11-12. This was an error of law: the standard is whether the debtor's "financial circumstances" allow her to repay creditors; the debtor's intent when accumulating debt is irrelevant under 11 U.S.C. § 707(b)(3)(B). *In re Yuan*, slip op. at 7 (citing *In re Zaporski*, 366 B.R. 758, 770 (Bankr. E.D. Mich. 2007)).

The bankruptcy court compounded this error by failing to analyze Ms. Hilmes's "financial situation." 11 U.S.C. § 707(b)(3)(B). It did not consider her assets, her future earning potential, or changes she could make to her lifestyle to reduce her costs. The bankruptcy court did not consider Ms. Hilmes's actual financial situation but accepted at face value her assertion that a hypothetical chapter 13 plan would not result in a dividend for creditors as evidence that she could not repay her debts. Appellee Br. at 32.

This was an error of law because ability to fund a chapter 13 plan is not the governing standard for dismissing a chapter 7 petition. The Bankruptcy Code does not mention chapter 13 in section 707. Instead, section 707(b)(3) states that the court "must" conduct an independent review of a debtor's ability to repay creditors based on the totality of the financial circumstances, which includes consideration of all sources of income. This includes consideration of a debtor's future ability to repay creditors due to post-petition changes in circumstances. *See Cortez*, 457 F.3d at 456. Also relevant are future housing expenses and retirement loan repayment terms. The bankruptcy court did not address any of these factors. Instead, it excused Ms. Hilmes's pattern of lavish spending because "we have, as a society, basically done what the debtor has done here, and that is to say that in many instances, we've taken what are purely discretionary items and redefined those as necessary items in our lives, and gone out and lived as if they are in fact necessary." Opinion Tr. at 9. That is not the standard Congress established. This failure to consider whether Ms. Hilmes could pay back her creditors constitutes reversible error.

B. Ms. Hilmes is not entitled to a discharge because she can make payments to her creditors.

The bankruptcy court did not analyze whether Ms. Hilmes could reduce her expenses to help repay her creditors. *In re Wadsworth,* 383 B.R. 330, 334 (Bankr. N.D. Ohio 2007) ("[D]ebtors may be expected to do some belt tightening . . . ."). Ms. Hilmes does not indicate how she has reduced her expenses, except to note that she has given up her gym membership and that she shares clothes with her daughter. Appellee Br. at 22. Instead, the court improperly excused her from trying because "it was her habit to incur a lot of consumer debt. That was just the way she was." Opinion Tr. at 11. Common sense, however, dictates that allowing a debtor to keep two BMW cars, a four bedroom house, and to condone continued extravagant spending deprives creditors of funds that could be used to repay debts.

Ms. Hilmes makes approximately $120,000 per year to support a family of two. Tr. 96:1-2. By her own calculation, she spends $137.04 more per month on her two BMWs than the IRS allowance for two cars. Appellee Br. at 38. She has arranged for cosmetic breast surgery for her daughter for March 16, 2010 for which for which she has already put down $5,000. *Id.* at 23. Even after filing her bankruptcy petition, she has continued to shop at major department stores, a habit she could break. Tr. 14:13-15:25. Partial payment is enough to prevent discharge. *In re Behlke*, 358 F.3d at 437 (affirming dismissal for substantial abuse because debtors could repay 14-23% of their debts, depending on the length of the chapter 13 plan). Because Ms. Hilmes can repay her creditors at least partially, the bankruptcy court committed reversible error by determining that Ms. Hilmes was entitled to a discharge.

II. The Bankruptcy Court Also Abused its Discretion By Failing to Consider the United States Trustee's Alternative "Bad Faith" Argument Under Section 707(b)(3)(A).

The United States Trustee's motion sought dismissal under two independent grounds. The first ground was based upon the debtor's financial circumstances under section 707(b)(3)(B) Independent of that, the Trustee sought dismissal due to Ms. Hilmes's bad faith under section 707(b)(3)(A). *See* Appellant's Br. at 14, 27, Appellant R. No. 119 [United States Trustee Mot. To Dismiss at 1]. Ms. Hilmes maintains the bankruptcy court found the case was not an abusive filing based on bad faith. Appellee Br. at 13, 27, 33. This is incorrect.

The bankruptcy court limited its bad faith analysis to determining that Ms. Hilmes's testimony was credible without making an explicit finding as to whether the case was filed in bad faith. Tr. Ruling at 6:15-18. The bankruptcy court erred in not conducting an independent analysis of bad faith under section 707(b)(3)(A) that considered Ms. Hilmes's conduct both before and after the bankruptcy filing. *See In re Hageney*, ___ B.R.___, 2009 WL 5217674, *4, (Bankr. E.D. Wash. 2009), *In re Honkomp*, 416 B.R. 647, 649 (Bankr. N.D. Iowa 2009), *In re Booker*, 399 B.R. 662, 667 (Bankr. W.D. Mo. 2009). Ms. Hilmes admits that she took three vacations in the nine months before she filed for bankruptcy protection. Appellee Br. at 23-24. The United States Trustee established that she continued to make clothing purchases at major department stores even after she filed her chapter 7 petition. UST 14; Tr. 14:13-15:25. Failure to consider bad faith as an independent grounds for dismissal constitutes grounds for reversal.

See Krohn, 886 F.2d at 127 (affirming dismissal because of "a consistent pattern of living on credit or beyond the debtor's means" before and after filing a chapter 7 petition).

III. Ms. Hilmes's Justifications for the Bankruptcy Court's Decision to Grant Her a Discharge Ignore the Requirements of the 2005 Act.

A. The fact Ms. Hilmes passed the means test is irrelevant.

Ms. Hilmes's attempts to shield her full financial situation from scrutiny under section 707(b)(3)(B) are unavailing. Ms. Hilmes argues that because she passed the means test, the bankruptcy court did not abuse its discretion in granting a discharge. Appellee Br. at 33. That is incorrect.

The 2005 Act creates a two-step financial analysis for determining if a chapter 7 petition should be dismissed. The first is a mechanical calculation under § 707(b)(2), known as the "means test." The second is a subjective analysis under § 707(b)(3)(B). *In re Yuan*, slip op. at 6. Indeed, the Seventh Circuit squarely held in *Ross-Tousey* that passing the means test did not preclude dismissal under section 707(b)(3). *Ross-Tousey*, 549 F.3d at 1161-62.

The plain language of the 2005 Act demonstrates that the subsections of section 707(b) perform two distinct functions in determining whether a debtor is eligible for a discharge. The "means test," namely the calculations mandated by section 707(b)(2)(A)(i)-(iv), reflects congressional intent that there be an "easily applied formula" to create a presumption of abuse. *In re Henebury,* 361 B.R. 595, 603 (Bankr. S.D. Fla. 2007); *see* Appellee Br. at 33 ("mathematical formula"). "Passing the means test" merely means that the court will not "presume abuse exists;" it is not a finding of fact that the debtor is entitled to relief under chapter 7. 11 U.S.C. § 707(b)(2)(A)(i); *In re Yuan,* slip op. at 5-6 (means test does not create a "safe harbor"); *In re Booker*, 399 B.R. 662, 666 (Bankr. W.D. Mo. 2009) (stating that the results of the "means test" are "not dispositive").

The means test is an objective evaluation of a debtor's financial circumstances. Section 707(b)(3)(B) follows with a more subjective, flexible consideration of whether discharge is appropriate considering the financial circumstances. *In re McGillis*, 370 B.R. 720, 747 (Bankr. W.D. Mich. 2007). An expense that is allowed under the means tests may also provide the basis for dismissal under section 707(b)(3)(B).

For instance, the Seventh Circuit held that car payments that are allowed under section 707(b)(2) must also be reviewed under (b)(3)(B). *Ross-Tousey*, 549 F.3d at 1161 ("[p]ermitting a debtor to take the deduction . . . does not insulate his case from dismissal"). Even if there is no presumption of abuse, a bankruptcy court can still dismiss the case "either for bad faith, or based on the totality of circumstances, which can take into consideration a debtor's actual income and expenses." *Id.* at 1161-62. Passing the means test has no relevance to analysis of the debtor's finances under section 707(b)(3)(B). *In re Yuan*, slip op. at 6.

The majority of courts have rejected the Ms. Hilmes's theory that passing the means test limits any further consideration of her financial situation. *In re Crink*, 402 B.R. 159, 168-69 (Banrk. M.D.N.C. 2009) (citing 13 cases). First, the statute mandates that the court "shall" consider a debtor's financial condition and circumstances if the presumption of abuse does not arise as a result of the means test calculation. 11 U.S.C. § 707(b)(3); *Reed v. Anderson (In re Reed)*,__B.R.__, No. 07-04357, 2009 WL 5227840, at *13 (C.D. Cal. Nov. 24, 2009). If Congress had intended that the means test foreclose further consideration of a debtor's ability to pay, it would not have required further analysis of petitions which passed that test. Instead, "a court must consider a debtor's actual debt-paying ability in ruling on a motion to dismiss based on abuse where the presumption does not arise or is rebutted." *In re Mestemaker*, 359 B.R. 849, 854-55 (Bankr. N.D. Ohio 2007). If Congress had intended to eliminate consideration of ability to pay, "it would have done so expressly or by explicit references to § 707(b)(2)(A)." *In re Lenton*, 358 B.R. 651, 663 (Bankr. E.D. Pa. 2006).

B. Ms Hilmes improperly wants to shield her mortgage payment and retirement funds from consideration of the totality of her financial circumstances analysis.

Ms. Hilmes claims her retirement related expenses are immune from review as a chapter 13 means test excludes retirement contributions from disposable income, but this is not persuasive. Appellee Br. at 39. No statutory language supports the theory that income that is excluded from calculation of a chapter 13 plan, or the chapter 7 means test, is automatically immune from the section 707(b)(3)(B) totality of the financial circumstances analysis. In addition, it is established law that retirement contributions maybe be included in disposable income. *In re Taylor*, 212 F.3d 395, 397 (8th Cir. 2000); *In re Rathbun*, 309 B.R. 901, 905 (Bankr. N.D. Tex. 2004); *In re Watkins*, 216 B.R. 394, 396 (Bankr. N.D. Tex. 1997). As the purpose of the 2005 Act was to make it harder for debtors to obtain chapter 7 discharges, this line of cases is still valid. *In re Yuan*, slip op. at 5.

Ms. Hilmes argues that because Congress failed to impose limits on the amount of secured debt payment in a chapter 13 or chapter 7 means test through section 707(b)(2), all payments for secured debt on housing expenses are inherently reasonable and a party in interest is precluded from determining whether a housing expense is excessive in the context of a totality of the circumstances analysis. Appellee Br. at 36-37. Mortgage payments, like retirement payments, are considered a part of the totality of the debtor's financial circumstances and are thus subject to court scrutiny. *In re Yuan*, slip op. at 7. The reasonableness of these payments is a consideration in analyzing whether abuse is present under section 707(b)(3)(B). *See In re Gonzalez,* 388 B.R. 292, 302 n.5 (Bankr. S.D. Tex. 2008); *In re Kaminski,* 387 B.R. 190, 196 (Bankr. N.D. Ohio 2008). Texas courts have held that excessive secured debt expenses weighed in favor of dismissal under section 707(b)(3)(B). *See, e.g., In re Castellaw,* 401 B.R. 223, 228 (Bankr. N.D. Tex. 2009)(concluding, *inter alia*, that $5,100 per month mortgage payment for a $1.2 million home was excessive); *In re Meurer*, No. 09-41446, 2009 WL 4263368, *4 (Bankr. N.D. Tex. November 18, 2009) (concluding, *inter alia*, that $4,072.72 per month mortgage payment for a $500,000 home was excessive); *In re King,* No. 08-41975, 2009 WL 62252, *4 (Bankr. E. D. Tex. 2009) (concluding, *inter alia*, that $3,008 per month in housing related expenses for $385,000, 3,407 square foot home was excessive).

C. Notwithstanding the Debtor's new allegations to the contrary, the Debtor's bankruptcy filing is a consumer case

For the first time on appeal, Ms. Hilmes contends this is a "business debt" case. Appellee Br. at 34. This argument lacks merit. First, Ms. Hilmes signed her bankruptcy petition under oath, representing that she had accumulated primarily consumer debt. Record at 10, (Petition). She is estopped from arguing the contrary now.

Second, Ms. Hilmes admits her “debts are primarily consumer debts.” Appellee Br. at 34. Debt is considered to be consumer debt when more than half of the total amount and the majority of creditors are categorized as consumer. *In re Booth*, 858 F.2d 1051, 1055 (5th Cir. 1988). Only two of her seventeen creditors are business related, which constitutes approximately 30% of her total debt, while over 70% of her debt is for her residence and personal credit cards. Record at 30-31, 33-35, (Schedules D and F). The Debtor made one bad investment in commercial property in Rhode Island, but her bankruptcy filing resulted from a lavish lifestyle that her income could not support.

D. The failure of creditors to join in the United States Trustee’s motion to dismiss is immaterial to an analysis of abuse under bankruptcy Section 707(b)(3).

Ms. Hilmes argues that no other party in interest filed a motion to dismiss and therefore her case is not abusive. Appellee Br. at 35. No other party in interest has participated because it is the statutory duty of the United States Trustee to police the bankruptcy system to, among other things, prevent abusive filings. 11 U.S.C. § 707(b)(1); 11 U.S.C. § 307 (granting United States Trustee standing to raise any issue). Before the enactment of the 2005 Act, parties in interest could not allege substantial abuse. 11 U.S.C. § 707(b) (2004). Now they can. 11 U.S.C. § 707(b)(2005). This does not mean that the United States Trustee no longer has the primary responsibility to monitor chapter 7 cases for abuse to protect the integrity of the system. 11 U.S.C. § 707(b) (2010). Absence of Ms. Hilmes’s creditors is immaterial.

CONCLUSION

For these reasons, the United States Trustee respectfully asks this Court to reverse the order entered by below and remand for further proceedings.

February 18, 2010

RAMONA D. ELLIOTT
General Counsel

P. MATTHEW SUTKO
Associate General Counsel
DAVID I. GOLD
Trial Attorney
Executive Office for United States Trustees
Department of Justice
20 Massachusetts Avenue, N.W.
Washington, D.C. 20530
Ph: (202) 307-1399
Fax: (202) 307-2397

WILLIAM T. NEARY
United States Trustee for Region 6

/s/ Erin Marie Schmidt
ERIN MARIE SCHMIDT
Trial Attorney
State Bar of Texas No. 24033042
ELIZABETH ANN ZIEGLER
Trial Attorney
Licensed in New York State
Department of Justice
1100 Commerce Street, Rm. 976
Dallas, TX 75242
(214) 767-8967
(214) 767-8971 (fax)

CERTIFICATE OF SERVICE

I certify that I forwarded a true and correct copy of the foregoing BRIEF OF APPELLANT WILLIAM T. NEARY, UNITED STATES TRUSTEE by prepaid first class mail to the persons listed below on February 18, 2010.

/s/ Erin Marie Schmidt
Erin Marie Schmidt

Appellee:
Cindy Ann Hilmes
PO Box 271822
Flower Mound, TX 75027

Appellees' Counsel:
Behrooz P. Vida &
Carla Reed Vida
The Vida Law Firm, PLLC
3000 Central Drive
Bedford, TX 76021

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2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]* B.A.P. 9th Cir.

3. ("CCN") ***CURRENT*** CASE NO. No.: 10-1468

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(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC*** **BANKRUPTCY**

9. ("SU") ● ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***

● Whether the amount offset from a sale price because of a credit bid constitutes "moneys disbursed" by a chapter 7 trustee to a secured creditor under 11 U.S.C. § 326(a)?

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UNITED STATES BANKRUPTCY APPELLATE PANEL
OF THE NINTH CIRCUIT

BAP No. HI-10-1468
Bankr. No. 07-00504 (Chapter 7)

In re HOKULANI SQUARE, INC.,
Debtor.

UNITED STATES TRUSTEE,
Appellant,

v.

BRADLEY R. TAMM, CHAPTER 7 TRUSTEE,
Appellee.

BRIEF FOR THE APPELLANT, UNITED STATES TRUSTEE

RAMONA D. ELLIOTT
General Counsel
P. MATTHEW SUTKO
Associate General Counsel
NOAH M. SCHOTTENSTEIN (VSB #79031)
Trial Attorney

United States Department of Justice
Executive Office for United States Trustees
20 Massachusetts Avenue, NW, Suite 8100
Washington, D.C. 20530
Telephone: (202) 305-2796
Facsimile: (202) 305-2397
E-Mail: noah.m.schottenstein@usdoj.gov

TIFFANY CARROLL
Acting United States Trustee for Region 15
CURTIS B. CHING (HSB #3931)
Assistant United States Trustee

United States Department of Justice
Office of the United States Trustee
1132 Bishop Street, Suite 602
Honolulu, HI 96813-2830
Telephone: (808) 522-8150
Facsimile: (808) 522-8156
E-mail: curtis.b.ching@usdoj.gov

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STATEMENT OF APPELLATE JURISDICTION

This Court has jurisdiction over this appeal under 28 U.S.C. §§ 158(a) and (c). The United States Bankruptcy Court for the District of Hawaii had jurisdiction over Hokulani Square, Inc.'s chapter 7 bankruptcy case under 28 U.S.C. §§ 157 and 1334. The bankruptcy court's final order approving the chapter 7 trustee's final fee application under 11 U.S.C. § 330 was entered on November 12, 2010. The United States Trustee timely filed a notice of appeal under 28 U.S.C. § 158(c)(2) and Fed. R. Bankr. P. 8002(a) on November 26, 2010.

STATEMENT OF THE ISSUE

When a secured creditor purchases its collateral from the estate, it may "credit bid" and offset the liability under the sale agreement against its secured claim under 11 U.S.C. § 363(k).

The question presented is whether the amount offset from a sale price because of a credit bid constitutes "moneys disbursed" by a chapter 7 trustee to a secured creditor under 11 U.S.C. § 326(a)?

STANDARD OF REVIEW

The bankruptcy court's conclusions of law are reviewed de novo and its factual findings are reviewed for clear error. Price v. U.S. Trustee (In re Price), 353 F.3d 1135, 1138 (9th Cir. 2004). Questions of statutory interpretation are reviewed de novo. Sacora v. Thomas, 628 F.3d 1059, 1065 (9th Cir. 2010).

STATEMENT OF THE CASE

In the case below, the chapter 7 trustee sold fully secured condominiums to a group of secured creditors, who used a credit bid to offset the entire purchase price against their secured claims. No money changed hands. The chapter 7 trustee then included the value of the credit bid when determining the amount of "moneys disbursed" under section 326(a).

The bankruptcy court agreed. Although the chapter 7 trustee had not disbursed cash to the secured creditors, the court thought the trustee might have been able to structure the transaction as a cash sale — and if the trustee had done so, he could have disbursed money to the secured creditors. The court also believed that the Ninth Circuit already considered credit bids to be "moneys disbursed." This appeal followed.

I. Statutory Framework

Section 326(a) of title 11 establishes the maximum amount of compensation that a bankruptcy court may award to a chapter 7 or 11 trustee under 11 U.S.C. § 330. Under section 326(a), a trustee's section 330 fee award may not exceed a percentage of "moneys disbursed or turned over in the case by the trustee to parties in interest, excluding the debtor, but including holders of secured claims." 11 U.S.C. § 326(a).

Section 363(k) of title 11 allows a secured creditor to "credit bid" the amount of the secured claim at a sale of the secured property, and if the secured creditor obtains the property, it may offset the value of the secured claim against the purchase price. 11 U.S.C. § 363(k). The purpose of this statute is to allow a secured creditor to obtain possession of its collateral if the price bid at an auction would not satisfy the amount of the creditor's secured claim. 3 Collier on Bankruptcy § 363.06[10] (16th ed. 2010).

II. Statement of the Facts

Hokulani Square, Inc., filed a petition for relief under chapter 11 of the Bankruptcy Code on May 10, 2007. ER, Tab A, at 3. Hokulani's principal asset was a 19-unit condominium building, which was fully encumbered by mortgages on the property. ER, Tab B, at 11.

After two years of continuing losses and management disputes, two secured creditors holding the mortgages on the building — Investors Funding Corporation and Walter and Sylvia Chang (collectively, the "secured creditors") — moved to convert the case to chapter 7 or for the appointment of a chapter 11 trustee. ER, Tab C, at 53. The bankruptcy court ordered the appointment of a chapter 11 trustee. ER, Tab D, at 89. The United States Trustee then appointed Bradley R. Tamm to serve as the chapter 11 trustee. ER, Tab E, at 91.

Eleven days later, Mr. Tamm moved to convert the chapter 11 case to one under chapter 7 based on the absence of a reasonable likelihood of rehabilitation. ER, Tab F, at 93-94. The bankruptcy court entered the conversion order the same day. ER, Tab G, at 95. Mr. Tamm was then appointed to serve as the chapter 7 trustee. Id.

Subsequently, Mr. Tamm moved to transfer the remaining condominium units in the building to the secured creditors in response to a joint $1.5 million credit bid of their outstanding secured claims. ER, Tab H, at 104. The proposed transaction also provided the opportunity for others to overbid the credit bid and purchase the condominiums at a cash price of $1.65 million. Id. at 105-06. Mr. Tamm acknowledged that the transaction "will not result in any distributions to unsecured creditors." ER, Tab I, at 123-24.

The bankruptcy court approved the motion. ER, Tab J, at 128. No overbids occurred, and Mr. Tamm transferred the condominiums to the secured creditors. ER, Tab K, at 141.

Mr. Tamm then finished administering the estate and filed his final report. ER, Tab L, at 142. It showed $2.72 million in disbursements. Id. That amount included a $1.5 million "liquidation" from the credit-bid transaction, which is listed as the $1.5 million sale price simultaneously offset against the $1.5 million in mortgage liability. Id. at 153. The entry for the credit-bid transaction, however, did not record any moneys disbursed under column 6, "Disbursements ($)." Id.

Based on the $2.72 million figure, Mr. Tamm stated his maximum compensation pursuant to section 326(a) was $109,293. Id. at 143. He then requested that amount for his fees. Id. at 161.

III. Statement of the Proceedings Below

The United States Trustee objected to Mr. Tamm's calculation. ER, Tab M, at 165. The United States Trustee argued that the amount of the credit bid could not be considered "moneys disbursed" for the purpose of calculating Mr. Tamm's maximum fee under section 326(a) because no money was ever paid to the secured creditors in satisfaction of their secured claims. Id. at 171-72.

Without monetizing the $1.5 million credit bid, the United States Trustee stated that Mr. Tamm's maximum compensation would be $69,267. Id. at 168.

Mr. Tamm replied, arguing that the equities of the case justified including the credit bid in his section 326(a) calculation because he was able to secure a 28.2% return for the general unsecured creditors.[1] ER, Tab N, at 195. In addition, he argued that two Ninth Circuit cases, which were decided approximately 30-years ago under the Bankruptcy Act of 1898, implied that credit bids should be considered "moneys disbursed." Id. at 196.

The bankruptcy court agreed with Mr. Tamm and held that "credit bids should be treated as moneys disbursed" in the section 326(a) calculation. ER, Tab O, at 219. The court provided two reasons.

First, the bankruptcy court believed that if credit bids were not treated as "moneys disbursed," it might elevate form over substance. Id. at 219-220. The court speculated that if credit bids were not included in the section 326(a) calculation, "then Trustees would simply insist that potential credit bidders hand them a check for the amount of the credit bid, and the Trustee would then endorse

---

[1] After paying other administrative expenses, Mr. Tamm stated the general unsecured creditors would receive $15,018 on $53,316 in allowed unsecured claims. This amount excludes the Changs' unsecured remainder of their mortgage on the condominium building, which was allowed as a $436,209 unsecured claim. The Changs waived any recovery on that claim when they settled the estate's litigation against them concerning various business torts. ER, Tab L, at 162-63.

the check and hand it right back to the creditor." Id. The court did, however, reject Mr. Tamm's argument that the equities of the case should be considered. Id. at 223. As the court stated, "it's either moneys disbursed or it's not moneys disbursed, and the underlying circumstances of the case I don't think are relevant." Id.

Second, the bankruptcy court agreed with Mr. Tamm that the Ninth Circuit case law allowed credit bids to be included in the section 326(a) calculation. Although the court recognized the existence of directly on-point authority from the Third and Fifth Circuits to the contrary, it stated that the Ninth Circuit "would probably stick with" the existing case law. Id. at 233. The court did not explain how it reached that conclusion.

SUMMARY OF THE ARGUMENT

Section 326(a) limits the maximum amount of compensation that a trustee may receive to a percentage of all "moneys disbursed" by the trustee. Here, when Mr. Tamm calculated the amount of money he disbursed, he included the credit bid, i.e., the amount of the liability under the transaction agreement that the secured creditors offset against their secured claims. The United States Trustee objected because Mr. Tamm did not disburse any money to the creditors. The only thing that changed hands in the transaction was the title to the condominiums.

The bankruptcy court overruled this objection. The court held that a broad interpretation of section 326(a) was necessary to prevent raising form over function. The court also reasoned that the Ninth Circuit already allowed credit bids to be treated as disbursements to creditors.

This Court should reverse the bankruptcy court's decision on both grounds. First, the bankruptcy court failed to apply the plain language of section 326(a). The phrase "moneys disbursed" means that money — currency, not property or future interests — must change hands, as the Third and Fifth Circuits have held. Here, no money changed hands. Transferring the condominiums and offsetting the mortgage liability was not disbursing money. Because this statutory language is not absurd, the court was required to enforce the statute as written. It did not.

Second, the bankruptcy court erred when it predicted that the Ninth Circuit would split with the Third and Fifth Circuits, and require bankruptcy courts to consider credit bids "moneys disbursed" under section 326(a). The case law the court relied upon for this prediction — two 30-year-old decisions rendered under the Bankruptcy Act of 1898 — are not controlling. They did not concern credit bids and did not attempt to define the meaning of the phrase "moneys disbursed." Consequently, the construction of section 326(a) remains open within this circuit.

And given the Ninth Circuit's practices in cases like this, there is no reason to presume it would create a circuit split.

Therefore, this Court should reverse the bankruptcy court's decision and hold that credit bids are not "moneys disbursed" under section 326(a).

ARGUMENT

I. A credit-bid transaction does not constitute "moneys disbursed" by a trustee under 11 U.S.C. § 326(a).

The Bankruptcy Code does not define the phrase "moneys disbursed" or the terms individually. Thus, the plain and ordinary meaning of the language applies. Ransom v. FIA Card Serv., N.A., 131 S. Ct. 716, 724 (2011). When inquiring into the meaning of a statute, courts "must give its terms their ordinary and plain meaning, and may follow the common practice of consulting dictionaries to determine how the terms were defined at the time the statute was adopted." Stanford v. MemberWorks, Inc., 625 F.3d 550, 559 (9th Cir. 2010) (quotation omitted). "[T]he structure and purpose of a statute may also provide guidance in determining the plain meaning of its provisions." Bailey v. Hill, 599 F.3d 976, 980 (9th Cir. 2010).

A. The plain and ordinary meaning of the phrase “moneys disbursed” is limited to payments made in currency.

Money means “[c]urrent coin . . . in portable form as a medium of exchange and measure of value.” Oxford English Dictionary 992 (2d ed. 1989). Accord U.C.C. § 1-201(24) (“Money means a medium of exchange currently authorized or adopted by a domestic or foreign government.”); Merriam-Webster’s Collegiate Dictionary 801 (11th ed. 2005) (“something generally accepted as a medium of exchange, a measure of value, or a means of payment”); Black’s Law Dictionary 1096 (9th ed. 2009) (“[t]he medium of exchange authorized or adopted by a government”).

Disbursement means “to pay out or expend money.” Oxford English Dictionary 726 (2d ed. 1989) (explaining that the word derives from the Old French term for a purse or pocket). Accord Merriam-Webster’s Collegiate Dictionary 355 (11th ed. 2005) (to “pay out,” “expend . . . from a fund,” or “make a payment in settlement of a bill”); Black’s Law Dictionary 530 (9th ed. 2009) (“The act of paying out money, commonly from a fund or in settlement of a debt or account payable.”).

Although the Ninth Circuit has not squarely addressed the meaning of the phrase “moneys disbursed” in section 326(a), it has held that money should be given its dictionary meaning. Worley v. United States, 340 F.2d 500, 502 (9th Cir.

1965) ("[M]oney . . . means money; the kind one could bite, feel or pinch. If one should define it 'as money or the right to receive money,' the door would be open beyond any reasonable width that Congress could have had in mind."). The Ninth Circuit has also held that disbursement should be given its dictionary meaning in a bankruptcy context. St. Angelo v. Victoria Farms, Inc., 38 F.3d 1525, 1534 (9th Cir. 1994) (defining "disbursement" under 28 U.S.C. § 1930(a)(6), which governs the amount of quarterly fees paid in chapter 11 cases).

The Third and Fifth Circuits, however, have rendered decisions on the meaning of "moneys disbursed" in section 326(a). They agree that it is limited to payments made in currency. Staiano v. Cain (In re Lan Assoc. XI), 192 F.3d 109, 118 (3d Cir. 1999) (holding that a credit bid was not "moneys disbursed" under section 326(a) because the statutory language is limited to "something generally accepted as a medium of exchange"); U.S. Trustee v. Pritchard (In re England), 153 F.3d 232, 235 (5th Cir. 1998) (holding that a credit bid was not "moneys disbursed" under section 326(a) because money's "common everyday meaning . . . does not include property"). Cf. Vienna Park Prop. v. United Postal Sav. Ass'n (In re Vienna Park Prop.), 976 F.2d 106, 116 (2d Cir. 1992) (adopting the "general definition" of money as "a medium of exchange" and holding that "[a] contractual right to obtain money at some future time is not the same thing as money itself").

Therefore, the plain and ordinary meaning of "moneys disbursed" in section 326(a) is limited to payments made in (1) legal currency or (2) an asset that may be used like cash, such as certificates of deposit, checks, and credit card balances.

B. The statutory context supports interpreting the phrase "moneys disbursed" according to its plain and ordinary meaning.

Giving the phrase "moneys disbursed" its plain and ordinary meaning in section 326(a) is bolstered by (1) the statutory framework and (2) the statutory language in the Bankruptcy Act, in other sections of the Bankruptcy Code, and elsewhere in the United States Code.

First, section 326(a) is congruent with the larger statutory scheme regulating how chapter 7 trustees are compensated. The trustee's fundamental duty is to "collect and reduce to money the property of the estate." 11 U.S.C. § 704(a)(1). This means the trustee is required to liquidate the property of the estate to pay the creditors' claims. Thus, it makes sense that Congress would create an incentive for trustees to maximize the amount of money available to creditors by linking that duty with the maximum potential compensation under section 326(a) — but then only allow "reasonable compensation" under section 330 to prevent trustees from taking advantage of section 326(a). See Lan, 192 F.3d at 120-21 (analyzing the interplay between sections 326(a), 330, and 704(a)(1)); England, 153 F.3d at 236-37 (observing the same).

Second, if Congress wanted to expand the ambit of section 326(a) beyond money payments, it could have employed a broader term. Such was the case under section 76(g) of the Bankruptcy Act, predecessor to the modern section 326(a). That statute compensated "reorganization" trustees based upon "all moneys disbursed or turned over . . . and where under the plan of reorganization any part of the consideration to be paid to unsecured creditors is other than money, upon the amount of the fair value of such consideration." 11 U.S.C. § 76(g) (repealed 1978). In enacting section 326(a), however, "Congress intended to distinguish between the concepts of property and money . . . Congress's decision not to include such language in section 326(a) is indicative of its intent to limit trustee compensation to 'moneys' in the strict sense of the word." Lan, 192 F.3d at 118.

The language employed in various sections of the Bankruptcy Code also supports a plain-language interpretation of section 326(a). For example, the Bankruptcy Code elsewhere distinguishes money from other types of valuable property. In section 547(a)(2), Congress defined the phrase "new value" as "money or money's worth in goods, services, or new credit, or release by a transferee of property previously transferred to such transferee in a transaction." 11 U.S.C. § 547(a)(2). This shows that Congress understands how to delineate money as a medium of exchange, i.e., cash and its functional equivalents, separately from money as a measure of value in property. See 11 U.S.C. §§ 345 (referring to investing or depositing the money of the estate), 704(a)(1) (reducing the property of the estate to money), 748 (governing how the trustee must reduce securities to money).

The Bankruptcy Code also distinguishes money disbursements from other types of property conveyances. Congress referred to "disbursements" of money from the estate as the basis for calculating quarterly fees in chapter 11 cases. See 28 U.S.C. § 1930(a)(6). But when referring to dispositions of property in general, Congress has utilized terms such as transfer or distribute. See § 547 ("transferring" property of the estate); 11 U.S.C. § 726 ("distributing" the property of the estate).

Finally, applying the plain and ordinary meaning of "moneys disbursed" in section 326(a) is consistent with the meaning of the terms in other titles of the United States Code. See 31 U.S.C. § 5340 (defining "money" as "cash or cash equivalent proceeds" for the purposes of money laundering); 26 U.S.C. § 430 (defining "disbursements" as all payments from a pension plan for benefits and administrative expenses under ERISA).

Congress chose to limit a trustee's maximum compensation in section 326(a) to "moneys disbursed." That choice should be respected, particularly when the statutory context, the history of the statute, and the language found in other statutes all indicate that Congress deliberately used the phrase "moneys disbursed," rather than employ a broader phrase such as "the value of property distributed." See Bailey, 599 F.3d at 980. The plain and ordinary meaning of "moneys disbursed" in section 326(a) thus ensures that the phrase "carries meaning, as each word in a statute should." Ransom, 131 S. Ct. at 724.

C. A credit-bid transaction does not result in "moneys disbursed" because no money changes hands.

The credit-bid transaction between Mr. Tamm and the secured creditors did not involve any money being passed from the estate to the secured creditors. Under section 363(k), the secured creditors in this case "offset [their] claim against the purchase price of such property." 11 U.S.C. § 363(k). Mr. Tamm simply recognized the offset in satisfaction of the mortgages, and transferred the condominiums to the secured creditors. ER, Tab L, at 153.

As no moneys were disbursed to the secured creditors, the transaction did not fall within the plain language of section 326(a). Nonetheless, the bankruptcy court considered the offset against the purchase price to be "moneys disbursed" under section 326(a). ER, Tab O, at 232-33. The court analogized using a credit bid to a simple credit transaction, like "handing a check to somebody." Id. This analogy was mistaken.

Here, Mr. Tamm did not hand the secured creditors cash, a check, or another instrument that allowed them to withdraw a specific amount of money from a bank. He gave them condominiums.

This means there was no money disbursed from the estate. Unlike a personal check or credit card, a credit bid against a secured claim cannot be offered to purchase groceries, or drawn on to receive money from a bank. Because this credit is not money, it cannot be "moneys disbursed" under the plain language of section 326(a). Lan, 192 F.3d at 118; England, 153 F.3d at 237.

To the contrary, a credit bid simply allows a secured creditor to offset liability from the sale agreement against its secured claim. See § 363(k). Just as using a coupon to obtain a discounted price at a store does not result in money being disbursed to a shopper, using a credit bid to reduce the purchase price of property at a section 363 sale does not result in money being given to a secured creditor. In fact, the Bankruptcy Code supports using offsets to avoid the needless transaction costs arising from "making A pay B when B owes A." Citizens Bank of Md. v. Strumpf, 516 U.S. 16, 18 (1995); see 11 U.S.C. §§ 362(b)(27) (exempting master-netting agreements from the automatic stay), 542(b) (allowing a creditor to retain property of the estate when a debt may be offset), 553 (recognizing setoff rights established by non-bankruptcy law).

Thus, because the estate does not disburse any money by recognizing a credit bid, such transactions cannot result in "moneys disbursed" under the plain language of section 326(a). See St. Angelo, 38 F.3d at 1534 (defining disbursement as expenditures or payments from the estate); 3 Collier on Bankruptcy § 362.02[1][f][i] (16th ed. 2010) ("When the secured creditor bids on the property pursuant to section 363(k) and sets off its claim against the purchase price, courts generally hold that such credit-bid sales should be excluded from the scope of 'moneys disbursed.'").

II. Applying the plain and ordinary meaning of the phrase "moneys disbursed" does not produce absurd results.

"It is well established that when the statute's language is plain, the sole function of the courts — at least where the disposition required by the text is not absurd — is to enforce it according to its terms." Lamie v. U.S. Trustee, 540 U.S. 526, 534 (2004) (quotation omitted). The rule that courts may not "soften the import of Congress's chosen words even if . . . the words lead to a harsh outcome is longstanding." Id. at 538. The "avoidance of unhappy consequences is not an adequate basis for interpreting a text." Nixon v. Mo. Mun. League, 541 U.S. 125, 141 (2004) (Scalia, J., concurring).

The canon against absurdities should be invoked only "where it is quite impossible that Congress could have intended the result . . . and where the alleged absurdity is so clear as to be obvious to most anyone." Pub. Citizen v. Dep't of Justice, 491 U.S. 440, 470-71 (1989) (Kennedy, J., concurring). The statute must be more than arbitrary or irrational — it must "render another section within the statute or within the act inoperative or contradictory." Amalgamated Transit Union Local 1309, AFL-CIO v. Laidlaw Transit Serv., Inc., 448 F.3d 1092, 1098 (9th Cir. 2006). See also United States v. Cook, 594 F.3d 883, 891 (D.C. Cir. 2010) ("A statutory outcome is absurd if it defies rationality by rendering a statute nonsensical or superfluous or if it creates an outcome so contrary to perceived social values that Congress could not have intended it.").

This standard is extraordinarily high. Sturges v. Crowninshield, 17 U.S. (4 Wheat.) 122, 202-03 (1819) (stating that absurdity must be "so monstrous, that all mankind would, without hesitation, unite in rejecting" it); Am. Bankers Ins. Group v. United States, 408 F.3d 1328, 1334 (11th Cir. 2005) (citations omitted) (stating that absurdity must be "so gross as to shock the general moral or common sense . . . plainly at variance with the policy of the legislation as a whole"). There must be nothing in the statutory language, context, or legislative history that suggests Congress intended the absurd result. United States v. Rollness, 561 F.3d 996, 998 (9th Cir. 2009) (per curiam). Compare Taylor v. Dir., Office of Workers Comp. Programs, 201 F.3d 1234, 1241 (9th Cir. 2000) (holding that a workers' compensation statute that allowed a spouse to recover twice for the same injury to her husband — once before his death and once afterwards — was not absurd) with United States v. Mack, 164 F.3d 467, 472 (9th Cir. 1999) (holding that a statute simultaneously authorizing law enforcement officers to confiscate prohibited weapons and punishing them for possessing the confiscated weapons was absurd).

Here, the bankruptcy court rejected the plain language of section 326(a) because if "credit bids weren't treated as moneys disbursed, then Trustees would simply insist that potential credit bidders hand them a check . . . and the Trustee would then endorse the check and hand it right back to the Creditor." ER, Tab O, at 219-20. Thus, "rather than force people to go through that little ritual," the court held that it was appropriate to "make the substance consistent with the form." Id.

That does not render section 326(a) absurd, and does not justify departing from the plain language of section 326(a). What the statutory text requires — that trustees actually pay money to creditors to include the value of the asset administered in the trustee's maximum-fee calculation — is the result of Congress's decision to bring trustee compensation in-line with the monetary benefits provided to creditors. See supra Part I.B.; 3 Collier on Bankruptcy § 362.LH[4] (16th ed. 2010) (reviewing the legislative history and summarizing the changes effected by the Bankruptcy Reform Act of 1978). For example, Congress also removed the ability to include non-monetary consideration from the trustee's maximum-fee calculation in chapter 11 cases and reduced the minimum compensation by 87% in chapter 7 cases, but then increased the percentage of "moneys disbursed" that establish a trustee's maximum fee in both chapter 7 and chapter 11 cases. Id.

The statutory text, context, and legislative history all indicate that Congress made a deliberate policy choice to narrow a trustee's fee base to only "moneys disbursed" under section 326(a) as an incentive for trustees to get the best price for property of the estate. To be sure, this requirement causes Mr. Tamm to lose approximately $40,000 in fees based on the form of the credit-bid transaction. But he would still be paid almost $70,000 — at an effective rate of $182 per hour — as compensation for his services to the estate. This is what Congress intended, and it is not an absurd result. Rollness, 561 F.3d at 998.

Therefore, there is no cause to re-write section 326(a) merely because one might perceive that it would "make the substance consistent with the form." ER, Tab O, at 219. Even when Congress's chosen words "lead to a harsh outcome," bankruptcy courts must enforce the law according to its terms. Lamie, 540 U.S. at 534 (denying all compensation to an estate professional based on the professional's failure to re-apply for employment after the bankruptcy case was converted from chapter 11 to chapter 7). The bankruptcy court below did not.

III. Ninth Circuit law does not dictate that the value of a credit bid constitutes "moneys disbursed" under 11 U.S.C. § 326(a).

The bankruptcy court also reasoned that Ninth Circuit law treats credit bids as "moneys disbursed," based on York Int'l Building, Inc. v. Chaney (In re York), 527 F.2d 1061 (9th Cir. 1976) and Southwestern Media, Inc. v. Rau, 708 F.2d 419 (9th Cir. 1983). ER, Tab O, at 220, 233. This too was wrong.

A. York and Southwestern Media are not binding precedent on whether credit bids are considered "moneys disbursed."

Under Ninth Circuit law, "where a panel confronts an issue germane to the eventual resolution of the case, and resolves it after reasoned consideration in a published opinion, that ruling becomes the law of the circuit." United States v. Luong, 627 F.3d 1306, 1310 (9th Cir. 2010). The issue decided must have been "fairly presented" and "refined through the adversary process." United States v. Johnson, 256 F.3d 895, 916 (9th Cir. 2001) (en banc) (opinion of Kozinski, J.) (plurality); see also Sanchez v. Mukasey, 521 F.3d 1106, 1111 (9th Cir. 2008) (Wallace, J., concurring) (observing that the issue before the previous panel was not binding because it was not "refined by the fires of adversary presentation.") (quoting United States v. Crawley, 837 F.2d 291, 293 (7th Cir. 1988)).

But "where it is clear that a statement is made casually and without analysis, where the statement is uttered in passing without due consideration of the alternatives, or where it is merely a prelude to another legal issue that commands the panel's full attention," it is not law of the circuit. Gonzalez v. Arizona, 624 F.3d 1162, 1190-91 (9th Cir. 2010) (citing Johnson). And a "casual, off-hand remark or a broad statement of principle" is not considered a pronouncement of circuit law. Johnson, 256 F.3d at 916.

For example, a one-sentence observation about legal doctrine — stated in an appeal that does not turn on the mentioned doctrine — is not binding circuit law. Gonzalez, 624 F.3d at 1190-91 (citing Johnson) (holding that a statement about the law-of-the-circuit doctrine mentioned in a case that did not involve the doctrine was not a reasoned, binding decision on the issue discussed). Nor can an analogy become the basis for binding precedent. Thacker v. FCC (In re Magnacom Wireless, LLC), 503 F.3d 984, 993-94 (9th Cir. 2007) (explaining that an analogy equating the FCC's ability to cancel licenses under 11 U.S.C. § 525 with foreclosure on collateral did not decide whether cancelling a license was a lien-enforcement action under the automatic stay).

Under this test, neither York nor Southwestern Media are controlling here. York, which dates from 1976, is a Bankruptcy Act case that concerned the amount of reasonable compensation awarded to a trustee. In York, the trustee had sold a building subject to existing loans. In a footnote, the panel stated that "[f]or the purpose of calculating the trustee's fee under this section, we treat the assumption of the existing mortgages as a disbursement." York, 527 F.2d 1061, 1704 n.12.

As the panel recognized, it made an assumption — not a decision. It was a lone sentence uttered as a prelude to the issue of the reasonableness of the trustee's services, made without supporting analysis or reasoned consideration. See Gonzalez, 624 F.3d at 1190-91. It was not litigated by the parties or "refined through the adversary process." Johnson, 256 F.3d at 916.

Southwestern Media, which dates from 1983, is also a Bankruptcy Act case. In Southwestern Media, the trustee sold fully secured property to a third party and then distributed the cash proceeds from the sale to satisfy a secured creditor's lien on the property. Southwestern Media, 708 F.2d at 421-22. The issue before the Southwestern Media panel was whether "moneys disbursed" was impliedly limited to the "net equity value" realized by the estate. Id. at 423. In coming to its decision, the panel observed that three century-old district court cases from New York, Massachusetts, and Pennsylvania, as well as York, allowed sales of encumbered property to lien creditors, rather than third parties, to be counted toward the trustee's maximum fees. Id. at 423.

Again, this single sentence was just a passing observation uttered without supporting analysis, not a reasoned decision on whether credit bids should be included in a section 326(a) calculation. See Gonzalez, 624 F.3d at 1190-91. It was raised as an analogy to show that the equity value of property held in the estate is irrelevant to the amount of money disbursed by the trustee. Its persuasive value is properly limited to the case in which it was made. See Thacker, 503 F.3d at 993-94.

Thus, there was no reason for the bankruptcy court to believe that either York or Southwestern Media should determine the issue of whether a credit bid constitutes "moneys disbursed" under section 326(a). Neither involved credit-bid purchases by secured creditors. Neither held what the phrase "moneys disbursed" means. Neither analyzed the statutory context and the consequential differences between the Bankruptcy Act and the Bankruptcy Code. Neither decided, after engaging in reasoned consideration, whether properties transferred to secured creditors in satisfaction of a lien constituted "moneys disbursed."

Accordingly, York and Southwestern Media are not binding Ninth Circuit law in this appeal. Gonzalez, 624 F.3d 1191. This Court is free to decide the issue before it on the merits.

B. There is no "strong reason" for the Ninth Circuit to extend York or Southwestern Media to include credit bids.

When confronting an issue that other circuits have already decided, "absent a strong reason to do so," the Ninth Circuit "will not create an inter-circuit conflict." Torre v. Brickey, 278 F.3d 917, 919 (9th Cir. 2002). This is particularly important when a decision would result in the inconsistent application of a uniform federal law. Silvers v. Sony Pictures Entm't, 402 F.3d 881, 890 (9th Cir. 2005). Where Congress's intent for national uniformity is clear, "the creation of a circuit split would be particularly troublesome" because "[i]nconsistent rules among the circuits would lead to different" results in different areas of the country, even if the same conduct is occurring nationwide. Id.

"The Bankruptcy Clause, which grants Congress the power to make bankruptcy laws, U.S. Const. art. I, § 8, cl. 4, stresses that such rules must be 'uniform.'" Sherwood Partners, Inc. v. Lycos, Inc., 394 F.3d 1198, 1201 (9th Cir. 2005). And here, both the Third and Fifth Circuits have held that credit bids do not constitute "moneys disbursed" under section 326(a). Lan, 192 F.3d at 118 (Third Circuit); England, 153 F.3d at 235 (Fifth Circuit). The Government does not believe that 30-year-old case law of questionable relevancy presents a "strong reason" for the Ninth Circuit to invite the inconsistent application of the

Bankruptcy Code across the country by creating an "inter-circuit conflict" with the Third and Fifth Circuits. Torre, 278 F.3d at 919.

CONCLUSION

For these reasons, the United States Trustee respectfully asks this Court to reverse the order entered below.

Respectfully Submitted,

TIFFANY CARROL
Acting United States Trustee for Region 15

Dated: March 3, 2011

By: /s/ Noah M. Schottenstein
Trial Attorney
VSB #79031

United States Department of Justice
Executive Office for United States Trustees
20 Massachusetts Avenue, NW, Suite 8100
Washington, D.C. 20530
Telephone: (202) 305-2796
Facsimile: (202) 305-2397
E-Mail: noah.m.schottenstein@usdoj.gov

CERTIFICATION OF RELATED CASES

BAP No. HI-10-1468, Hokulani Square, Inc. (debtor)

Pursuant to 9th Cir. BAP R. 8010(a)-1(c), I certify that the following are the known related cases and appeals:

> Chang v. Crouch (In re Hokulani Square, Inc.), Case Nos. 09-00589, 09-00601 (D. Hawaii filed 12/11/2009) (consolidated appeals from the settlement agreement resolving the adversary proceedings in the lead bankruptcy case, which are administratively suspended pending settlement negotiations as of March 3, 2011).

By: /s/ Noah M. Schottenstein
Trial Attorney
Dated: March 3, 2011

CERTIFICATE OF SERVICE

I certify that a single hard copy of this brief and a single hard copy of the excerpts of the record were served via Federal Express, for overnight delivery, to each of the following:

Ronald K. Kotoshirodo, Attorney
76 N. King Street, Suite 209
Honolulu, HI 96817

Lissa D. Shults, Attorney
Shults & Tamm, ALC
1164 Bishop St, Suite 1611
Honolulu, HI 96813-0000

Bradley R. Tamm, Attorney
Shults & Tamm, ALC
1164 Bishop St, Suite 1611
Honolulu, HI 96813-0000

I certify that I filed the brief by sending five hard copies of the brief and five hard copies of the excerpts of the record via Federal Express, for overnight delivery, to:

Clerk of the United States Bankruptcy Appellate Panel of the Ninth Circuit
Richard H. Chambers Court of Appeals Building
125 South Grand Avenue
Pasadena, CA 91105

By: /s/ Noah M. Schottenstein
Trial Attorney
Dated: March 3, 2011

ADDENDUM - 11 U.S.C. §§ 326, 363

EFFECTIVE DATE OF 1994 AMENDMENT

Amendment by Pub. L. 103–394 effective Oct. 22, 1994, and not applicable with respect to cases commenced under this title before Oct. 22, 1994, see section 702 of Pub. L. 103–394, set out as a note under section 101 of this title.

EFFECTIVE DATE OF 1986 AMENDMENT

Effective date and applicability of amendment by section 207 of Pub. L. 99–554 dependent upon the judicial district involved, see section 302(d), (e) of Pub. L. 99–554, set out as a note under section 581 of Title 28, Judiciary and Judicial Procedure.

Amendment by section 257 of Pub. L. 99–554 effective 30 days after Oct. 27, 1986, but not applicable to cases commenced under this title before that date, see section 302(a), (c)(1) of Pub. L. 99–554.

EFFECTIVE DATE OF 1984 AMENDMENT

Amendment by Pub. L. 98–353 effective with respect to cases filed 90 days after July 10, 1984, see section 552(a) of Pub. L. 98–353, set out as a note under section 101 of this title.

§ 323. Role and capacity of trustee

(a) The trustee in a case under this title is the representative of the estate.

(b) The trustee in a case under this title has capacity to sue and be sued.

(Pub. L. 95–598, Nov. 6, 1978, 92 Stat. 2562.)

HISTORICAL AND REVISION NOTES

SENATE REPORT NO. 95–989

Subsection (a) of this section makes the trustee the representative of the estate. Subsection (b) grants the trustee the capacity to sue and to be sued. If the debtor remains in possession in a chapter 11 case, section 1107 gives the debtor in possession these rights of the trustee: the debtor in possession becomes the representative of the estate, and may sue and be sued. The same applies in a chapter 13 case.

§ 324. Removal of trustee or examiner

(a) The court, after notice and a hearing, may remove a trustee, other than the United States trustee, or an examiner, for cause.

(b) Whenever the court removes a trustee or examiner under subsection (a) in a case under this title, such trustee or examiner shall thereby be removed in all other cases under this title in which such trustee or examiner is then serving unless the court orders otherwise.

(Pub. L. 95–598, Nov. 6, 1978, 92 Stat. 2562; Pub. L. 99–554, title II, § 208, Oct. 27, 1986, 100 Stat. 3098.)

HISTORICAL AND REVISION NOTES

SENATE REPORT NO. 95–989

This section permits the court, after notice and a hearing, to remove a trustee for cause.

AMENDMENTS

1986—Pub. L. 99–554 amended section generally, designating existing provisions as subsec. (a), substituting ‘‘a trustee, other than the United States trustee, or an examiner’’ for ‘‘a trustee or an examiner’’, and adding subsec. (b).

EFFECTIVE DATE OF 1986 AMENDMENT

Effective date and applicability of amendment by Pub. L. 99–554 dependent upon the judicial district involved, see section 302(d), (e) of Pub. L. 99–554, set out as a note under section 581 of Title 28, Judiciary and Judicial Procedure.

§ 325. Effect of vacancy

A vacancy in the office of trustee during a case does not abate any pending action or proceeding, and the successor trustee shall be substituted as a party in such action or proceeding.

(Pub. L. 95–598, Nov. 6, 1978, 92 Stat. 2562.)

HISTORICAL AND REVISION NOTES

SENATE REPORT NO. 95–989

Section 325, derived from Bankruptcy Act section 46 [section 74 of former title 11] and Bankruptcy Rule 221(b), specifies that a vacancy in the office of trustee during a case does not abate any pending action or proceeding. The successor trustee, when selected and qualified, is substituted as a party in any pending action or proceeding.

§ 326. Limitation on compensation of trustee

(a) In a case under chapter 7 or 11, the court may allow reasonable compensation under section 330 of this title of the trustee for the trustee’s services, payable after the trustee renders such services, not to exceed 25 percent on the first $5,000 or less, 10 percent on any amount in excess of $5,000 but not in excess of $50,000, 5 percent on any amount in excess of $50,000 but not in excess of $1,000,000, and reasonable compensation not to exceed 3 percent of such moneys in excess of $1,000,000, upon all moneys disbursed or turned over in the case by the trustee to parties in interest, excluding the debtor, but including holders of secured claims.

(b) In a case under chapter 12 or 13 of this title, the court may not allow compensation for services or reimbursement of expenses of the United States trustee or of a standing trustee appointed under section 586(b) of title 28, but may allow reasonable compensation under section 330 of this title of a trustee appointed under section 1202(a) or 1302(a) of this title for the trustee’s services, payable after the trustee renders such services, not to exceed five percent upon all payments under the plan.

(c) If more than one person serves as trustee in the case, the aggregate compensation of such persons for such service may not exceed the maximum compensation prescribed for a single trustee by subsection (a) or (b) of this section, as the case may be.

(d) The court may deny allowance of compensation for services or reimbursement of expenses of the trustee if the trustee failed to make diligent inquiry into facts that would permit denial of allowance under section 328(c) of this title or, with knowledge of such facts, employed a professional person under section 327 of this title.

(Pub. L. 95–598, Nov. 6, 1978, 92 Stat. 2562; Pub. L. 98–353, title III, § 430(a), (b), July 10, 1984, 98 Stat. 369; Pub. L. 99–554, title II, § 209, Oct. 27, 1986, 100 Stat. 3098; Pub. L. 103–394, title I, § 107, Oct. 22, 1994, 108 Stat. 4111.)

HISTORICAL AND REVISION NOTES

LEGISLATIVE STATEMENTS

Section 326(a) of the House amendment modifies a provision as contained in H.R. 8200 as passed by the House. The percentage limitation on the fees of a trustee contained in the House bill is retained, but no additional percentage is specified for cases in which a trustee operates the business of the debtor. Section 326(b) of the Senate amendment is deleted as an unnecessary restatement of the limitation contained in section 326(a) as modified. The provision contained in section 326(a) of the Senate amendment authorizing a trustee to receive a maximum fee of $150 regardless of the availability of assets in the estate is deleted. It will not be necessary in view of the increase in section 326(a) and the doubling of the minimum fee as provided in section 330(b).

Section 326(b) of the House amendment derives from section 326(c) of H.R. 8200 as passed by the House. It is a conforming amendment to indicate a change with respect to the selection of a trustee in a chapter 13 case under section 1302(a) of title 11.

SENATE REPORT NO. 95–989

This section is derived in part from section 48c of the Bankruptcy Act [section 76(c) of former title 11]. It must be emphasized that this section does not authorize compensation of trustees. This section simply fixes the maximum compensation of a trustee. Proposed 11 U.S.C. 330 authorizes and fixes the standard of compensation. Under section 48c of current law, the maximum limits have tended to become minimums in many cases. This section is not intended to be so interpreted. The limits in this section, together with the limitations found in section 330, are to be applied as outer limits, and not as grants or entitlements to the maximum fees specified.

The maximum fee schedule is derived from section 48c(1) of the present act [section 76(c)(1) of former title 11], but with a change relating to the bases on which the percentage maxima are computed. The maximum fee schedule is based on decreasing percentages of increasing amounts. The amounts are the amounts of money distributed by the trustee to parties in interest, excluding the debtor, but including secured creditors. These amounts were last amended in 1952. Since then, the cost of living has approximately doubled. Thus, the bases were doubled.

It should be noted that the bases on which the maximum fee is computed includes moneys turned over to secured creditors, to cover the situation where the trustee liquidates property subject to a lien and distributes the proceeds. It does not cover cases in which the trustee simply turns over the property to the secured creditor, nor where the trustee abandons the property and the secured creditor is permitted to foreclose. The provision is also subject to the rights of the secured creditor generally under proposed section 506, especially 506(c). The $150 discretionary fee provision of current law is retained.

Subsection (b) of this section entitles an operating trustee to a reasonable fee, without any limitation based on the maximum provided for a liquidating trustee as in current law, Bankruptcy Act §48c(2) [section 76(c)(2) of former title 11].

Subsection (c) [enacted as (b)] permits a maximum fee of five percent on all payments to creditors under a chapter 13 plan to the trustee appointed in the case.

Subsection (d) [enacted as (c)] provides a limitation not found in current law. Even if more than one trustee serves in the case, the maximum fee payable to all trustees does not change. For example, if an interim trustee is appointed and an elected trustee replaces him, the combined total of the fees payable to the interim trustee and the permanent trustee may not exceed the amount specified in this section. Under current law, very often a receiver receives a full fee and a subsequent trustee also receives a full fee. The resultant ‘‘double-dipping’’, especially in cases in which the receiver and the trustee are the same individual, is detrimental to the interests of creditors, by needlessly increasing the cost of administering bankruptcy estates.

Subsection (e) [enacted as (d)] permits the court to deny compensation to a trustee if the trustee has been derelict in his duty by employing counsel, who is not disinterested.

AMENDMENTS

1994—Subsec. (a). Pub. L. 103–394 substituted ‘‘25 percent on the first $5,000 or less, 10 percent on any amount in excess of $5,000 but not in excess of $50,000, 5 percent on any amount in excess of $50,000 but not in excess of $1,000,000, and reasonable compensation not to exceed 3 percent of such moneys in excess of $1,000,000’’ for ‘‘fifteen percent on the first $1,000 or less, six percent on any amount in excess of $1,000 but not in excess of $3,000, and three percent on any amount in excess of $3,000’’.

1986—Subsec. (b). Pub. L. 99–554 amended subsec. (b) generally, substituting ‘‘under chapter 12 or 13 of this title’’ for ‘‘under chapter 13 of this title’’, ‘‘expenses of the United States trustee or of a standing trustee appointed under section 586(b) of title 28’’ for ‘‘expenses of a standing trustee appointed under section 1302(d) of this title’’, and ‘‘under section 1202(a) or 1302(a) of this title’’ for ‘‘under section 1302(a) of this title’’.

1984—Subsec. (a). Pub. L. 98–353, §430(a), substituted ‘‘and three percent on any amount in excess of $3000’’ for ‘‘three percent on any amount in excess of $3,000 but not in excess of $20,000, two percent on any amount in excess of $20,000 but not in excess of $50,000, and one percent on any amount in excess of $50,000’’.

Subsec. (d). Pub. L. 98–353, §430(b), amended subsec. (d) generally. Prior to amendment, subsec. (d) read as follows: ‘‘The court may deny allowance of compensation for services and reimbursement of expenses of the trustee if the trustee—

‘‘(1) failed to make diligent inquiry into facts that would permit denial of allowance under section 328(c) of this title; or

‘‘(2) with knowledge of such facts, employed a professional person under section 327 of this title.’’

EFFECTIVE DATE OF 1994 AMENDMENT

Amendment by Pub. L. 103–394 effective Oct. 22, 1994, and not applicable with respect to cases commenced under this title before Oct. 22, 1994, see section 702 of Pub. L. 103–394, set out as a note under section 101 of this title.

EFFECTIVE DATE OF 1986 AMENDMENT

Effective date and applicability of amendment by Pub. L. 99–554 dependent upon the judicial district involved, see section 302(d), (e) of Pub. L. 99–554, set out as a note under section 581 of Title 28, Judiciary and Judicial Procedure.

EFFECTIVE DATE OF 1984 AMENDMENT

Amendment by Pub. L. 98–353 effective with respect to cases filed 90 days after July 10, 1984, see section 552(a) of Pub. L. 98–353, set out as a note under section 101 of this title.

REFERENCES IN SUBSECTION (b) TEMPORARILY DEEMED TO INCLUDE ADDITIONAL REFERENCES

Until the amendments made by subtitle A (§§201 to 231) of title II of Pub. L. 99–554 become effective in a district and apply to a case, for purposes of such case any reference in subsec. (b) of this section—

(1) to chapter 13 of this title is deemed to be a reference to chapter 12 or 13 of this title,

(2) to section 1302(d) of this title is deemed to be a reference to section 1302(d) of this title or section 586(b) of Title 28, Judiciary and Judicial Procedure, and

(3) to section 1302(a) of this title is deemed to be a reference to section 1202(a) or 1302(a) of this title,

see section 302(c)(3)(A), (d), (e) of Pub. L. 99–554, set out as an Effective Date note under section 581 of Title 28.

§ 327. Employment of professional persons

(a) Except as otherwise provided in this section, the trustee, with the court’s approval, may employ one or more attorneys, accountants, ap-

Notwithstanding directory language adding par. (14) at end of subsec. (b), par. (14) was added after par. (13) to reflect the probable intent of Congress.

1986—Subsec. (b). Pub. L. 99–509 inserted sentence at end.

Subsec. (b)(6). Pub. L. 99–554, § 283(d)(1), substituted '', financial institutions'' for ''financial institution,'' in two places.

Subsec. (b)(9). Pub. L. 99–554, § 283(d)(2), (3), struck out ''or'' at end of first par. (9) and redesignated as par. (10) the second par. (9) relating to leases of nonresidential property, which was added by section 363(b) of Pub. L. 98–353.

Subsec. (b)(10). Pub. L. 99–554, § 283(d)(3), (4), redesignated as par. (10) the second par. (9) relating to leases of nonresidential property, added by section 363(b) of Pub. L. 99–353, and substituted ''property; or'' for ''property.''. Former par. (10) redesignated (11).

Subsec. (b)(11). Pub. L. 99–554, § 283(d)(3), redesignated former par. (10) as (11).

Subsec. (b)(12), (13). Pub. L. 99–509 added pars. (12) and (13).

Subsec. (c)(2)(C). Pub. L. 99–554, § 257(j), inserted reference to chapter 12 of this title.

1984—Subsec. (a)(1). Pub. L. 98–353, § 441(a)(1), inserted ''action or'' after ''other''.

Subsec. (a)(3). Pub. L. 98–353, § 441(a)(2), inserted ''or to exercise control over property of the estate''.

Subsec. (b)(3). Pub. L. 98–353, § 441(b)(1), inserted ''or to the extent that such act is accomplished within the period provided under section 547(e)(2)(A) of this title''.

Subsec. (b)(6). Pub. L. 98–353, § 441(b)(2), inserted ''or due from'' after ''held by'' and ''financial institution,'' after ''stockbroker'' in two places, and substituted ''secure, or settle commodity contracts'' for ''or secure commodity contracts''.

Subsec. (b)(7) to (9). Pub. L. 98–353, § 441(b)(3), (4), in par. (8) as redesignated by Pub. L. 98–353, § 392, substituted ''the'' for ''said'' and struck out ''or'' the last place it appeared which probably meant ''or'' after ''units;'' that was struck out by Pub. L. 98–353, § 363(b)(1); and, in par. (9), relating to notices of deficiencies, as redesignated by Pub. L. 98–353, § 392, substituted a semicolon for the period.

Pub. L. 98–353, § 392, added par. (7) and redesignated former pars. (7) and (8) as (8) and (9), respectively.

Pub. L. 98–353, § 363(b), struck out ''or'' at end of par. (7), substituted ''; or'' for the period at end of par. (8), and added par. (9) relating to leases of nonresidential property.

Subsec. (b)(10). Pub. L. 98–353, § 441(b)(5), added par. (10).

Subsec. (c)(2)(B). Pub. L. 98–353, § 441(c), substituted ''or'' for ''and''.

Subsec. (d)(2). Pub. L. 98–353, § 441(d), inserted ''under subsection (a) of this section'' after ''property''.

Subsec. (e). Pub. L. 98–353, § 441(e), inserted ''the conclusion of'' after ''pending'' and substituted ''The court shall order such stay continued in effect pending the conclusion of the final hearing under subsection (d) of this section if there is a reasonable likelihood that the party opposing relief from such stay will prevail at the conclusion of such final hearing. If the hearing under this subsection is a preliminary hearing, then such final hearing shall be commenced not later than thirty days after the conclusion of such preliminary hearing.'' for ''If the hearing under this subsection is a preliminary hearing—

''(1) the court shall order such stay so continued if there is a reasonable likelihood that the party opposing relief from such stay will prevail at the final hearing under subsection (d) of this section; and

''(2) such final hearing shall be commenced within thirty days after such preliminary hearing.''

Subsec. (f). Pub. L. 98–353, § 441(f), substituted ''Upon request of a party in interest, the court, with or'' for ''The court,''.

Subsec. (h). Pub. L. 98–353, § 304, added subsec. (h).

1982—Subsec. (a). Pub. L. 97–222, § 3(a), inserted '', or an application filed under section 5(a)(3) of the Securities Investor Protection Act of 1970 (15 U.S.C. 78eee(a)(3)),'' after ''this title'' in provisions preceding par. (1).

Subsec. (b). Pub. L. 97–222, § 3(b), inserted '', or of an application under section 5(a)(3) of the Securities Investor Protection Act of 1970 (15 U.S.C. 78eee(a)(3)),'' after ''this title'' in provisions preceding par. (1).

Subsec. (b)(6). Pub. L. 97–222, § 3(c), substituted provisions that the filing of a bankruptcy petition would not operate as a stay, under subsec. (a) of this section, of the setoff by a commodity broker, forward contract merchant, stockbroker, or securities clearing agency of any mutual debt and claim under or in connection with commodity, forward, or securities contracts that constitutes the setoff of a claim against the debtor for a margin or settlement payment arising out of commodity, forward, or securities contracts against cash, securities, or other property held by any of the above agents to margin, guarantee, or secure commodity, forward, or securities contracts, for provisions that such filing would not operate as a stay under subsection (a)(7) of this section, of the setoff of any mutual debt and claim that are commodity futures contracts, forward commodity contracts, leverage transactions, options, warrants, rights to purchase or sell commodity futures contracts or securities, or options to purchase or sell commodities or securities.

EFFECTIVE DATE OF 2006 AMENDMENT

Amendment by Pub. L. 109–390 not applicable to any cases commenced under this title or to appointments made under any Federal or State law, before Dec. 12, 2006, see section 7 of Pub. L. 109–390, set out as a note under section 101 of this title.

EFFECTIVE DATE OF 2005 AMENDMENT

Amendment by Pub. L. 109–8 effective 180 days after Apr. 20, 2005, and not applicable with respect to cases commenced under this title before such effective date, except as otherwise provided, see section 1501 of Pub. L. 109–8, set out as a note under section 101 of this title.

EFFECTIVE DATE OF 1994 AMENDMENT

Amendment by Pub. L. 103–394 effective Oct. 22, 1994, and not applicable with respect to cases commenced under this title before Oct. 22, 1994, see section 702 of Pub. L. 103–394, set out as a note under section 101 of this title.

EFFECTIVE DATE OF 1990 AMENDMENT

Section 3007(a)(3) of Pub. L. 101–508 provided that: ''The amendments made by this subsection [amending this section and section 541 of this title] shall be effective upon date of enactment of this Act [Nov. 5, 1990].''

Section 3008 of Pub. L. 101–508, provided that the amendments made by subtitle A (§§ 3001–3008) of title III of Pub. L. 101–508, amending this section, sections 541 and 1328 of this title, and sections 1078, 1078–1, 1078–7, 1085, 1088, and 1091 of Title 20, Education, and provisions set out as a note under section 1078–1 of Title 20, were to cease to be effective Oct. 1, 1996, prior to repeal by Pub. L. 102–325, title XV, § 1558, July 23, 1992, 106 Stat. 841.

EFFECTIVE DATE OF 1986 AMENDMENTS

Amendment by section 257 of Pub. L. 99–554 effective 30 days after Oct. 27, 1986, but not applicable to cases commenced under this title before that date, see section 302(a), (c)(1) of Pub. L. 99–554, set out as a note under section 581 of Title 28, Judiciary and Judicial Procedure.

Amendment by section 283 of Pub. L. 99–554 effective 30 days after Oct. 27, 1986, see section 302(a) of Pub. L. 99–554.

Section 5001(b) of Pub. L. 99–509 provided that: ''The amendments made by subsection (a) of this section [amending this section] shall apply only to petitions filed under section 362 of title 11, United States Code, which are made after August 1, 1986.''

Effective Date of 1984 Amendment

Amendment by Pub. L. 98–353 effective with respect to cases filed 90 days after July 10, 1984, see section 552(a) of Pub. L. 98–353, set out as a note under section 101 of this title.

Report to Congressional Committees

Section 5001(a) of Pub. L. 99–509 directed Secretary of Transportation and Secretary of Commerce, before July 1, 1989, to submit reports to Congress on the effects of amendments to 11 U.S.C. 362 by this subsection.

§363. Use, sale, or lease of property

(a) In this section, ''cash collateral'' means cash, negotiable instruments, documents of title, securities, deposit accounts, or other cash equivalents whenever acquired in which the estate and an entity other than the estate have an interest and includes the proceeds, products, offspring, rents, or profits of property and the fees, charges, accounts or other payments for the use or occupancy of rooms and other public facilities in hotels, motels, or other lodging properties subject to a security interest as provided in section 552(b) of this title, whether existing before or after the commencement of a case under this title.

(b)(1) The trustee, after notice and a hearing, may use, sell, or lease, other than in the ordinary course of business, property of the estate, except that if the debtor in connection with offering a product or a service discloses to an individual a policy prohibiting the transfer of personally identifiable information about individuals to persons that are not affiliated with the debtor and if such policy is in effect on the date of the commencement of the case, then the trustee may not sell or lease personally identifiable information to any person unless—

(A) such sale or such lease is consistent with such policy; or

(B) after appointment of a consumer privacy ombudsman in accordance with section 332, and after notice and a hearing, the court approves such sale or such lease—

(i) giving due consideration to the facts, circumstances, and conditions of such sale or such lease; and

(ii) finding that no showing was made that such sale or such lease would violate applicable nonbankruptcy law.

(2) If notification is required under subsection (a) of section 7A of the Clayton Act in the case of a transaction under this subsection, then—

(A) notwithstanding subsection (a) of such section, the notification required by such subsection to be given by the debtor shall be given by the trustee; and

(B) notwithstanding subsection (b) of such section, the required waiting period shall end on the 15th day after the date of the receipt, by the Federal Trade Commission and the Assistant Attorney General in charge of the Antitrust Division of the Department of Justice, of the notification required under such subsection (a), unless such waiting period is extended—

(i) pursuant to subsection (e)(2) of such section, in the same manner as such subsection (e)(2) applies to a cash tender offer;

(ii) pursuant to subsection (g)(2) of such section; or

(iii) by the court after notice and a hearing.

(c)(1) If the business of the debtor is authorized to be operated under section 721, 1108, 1203, 1204, or 1304 of this title and unless the court orders otherwise, the trustee may enter into transactions, including the sale or lease of property of the estate, in the ordinary course of business, without notice or a hearing, and may use property of the estate in the ordinary course of business without notice or a hearing.

(2) The trustee may not use, sell, or lease cash collateral under paragraph (1) of this subsection unless—

(A) each entity that has an interest in such cash collateral consents; or

(B) the court, after notice and a hearing, authorizes such use, sale, or lease in accordance with the provisions of this section.

(3) Any hearing under paragraph (2)(B) of this subsection may be a preliminary hearing or may be consolidated with a hearing under subsection (e) of this section, but shall be scheduled in accordance with the needs of the debtor. If the hearing under paragraph (2)(B) of this subsection is a preliminary hearing, the court may authorize such use, sale, or lease only if there is a reasonable likelihood that the trustee will prevail at the final hearing under subsection (e) of this section. The court shall act promptly on any request for authorization under paragraph (2)(B) of this subsection.

(4) Except as provided in paragraph (2) of this subsection, the trustee shall segregate and account for any cash collateral in the trustee's possession, custody, or control.

(d) The trustee may use, sell, or lease property under subsection (b) or (c) of this section only—

(1) in accordance with applicable nonbankruptcy law that governs the transfer of property by a corporation or trust that is not a moneyed, business, or commercial corporation or trust; and

(2) to the extent not inconsistent with any relief granted under subsection (c), (d), (e), or (f) of section 362.

(e) Notwithstanding any other provision of this section, at any time, on request of an entity that has an interest in property used, sold, or leased, or proposed to be used, sold, or leased, by the trustee, the court, with or without a hearing, shall prohibit or condition such use, sale, or lease as is necessary to provide adequate protection of such interest. This subsection also applies to property that is subject to any unexpired lease of personal property (to the exclusion of such property being subject to an order to grant relief from the stay under section 362).

(f) The trustee may sell property under subsection (b) or (c) of this section free and clear of any interest in such property of an entity other than the estate, only if—

(1) applicable nonbankruptcy law permits sale of such property free and clear of such interest;

(2) such entity consents;

(3) such interest is a lien and the price at which such property is to be sold is greater than the aggregate value of all liens on such property;

(4) such interest is in bona fide dispute; or

(5) such entity could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest.

(g) Notwithstanding subsection (f) of this section, the trustee may sell property under subsection (b) or (c) of this section free and clear of any vested or contingent right in the nature of dower or curtesy.

(h) Notwithstanding subsection (f) of this section, the trustee may sell both the estate's interest, under subsection (b) or (c) of this section, and the interest of any co-owner in property in which the debtor had, at the time of the commencement of the case, an undivided interest as a tenant in common, joint tenant, or tenant by the entirety, only if—

(1) partition in kind of such property among the estate and such co-owners is impracticable;

(2) sale of the estate's undivided interest in such property would realize significantly less for the estate than sale of such property free of the interests of such co-owners;

(3) the benefit to the estate of a sale of such property free of the interests of co-owners outweighs the detriment, if any, to such co-owners; and

(4) such property is not used in the production, transmission, or distribution, for sale, of electric energy or of natural or synthetic gas for heat, light, or power.

(i) Before the consummation of a sale of property to which subsection (g) or (h) of this section applies, or of property of the estate that was community property of the debtor and the debtor's spouse immediately before the commencement of the case, the debtor's spouse, or a co-owner of such property, as the case may be, may purchase such property at the price at which such sale is to be consummated.

(j) After a sale of property to which subsection (g) or (h) of this section applies, the trustee shall distribute to the debtor's spouse or the co-owners of such property, as the case may be, and to the estate, the proceeds of such sale, less the costs and expenses, not including any compensation of the trustee, of such sale, according to the interests of such spouse or co-owners, and of the estate.

(k) At a sale under subsection (b) of this section of property that is subject to a lien that secures an allowed claim, unless the court for cause orders otherwise the holder of such claim may bid at such sale, and, if the holder of such claim purchases such property, such holder may offset such claim against the purchase price of such property.

(*l*) Subject to the provisions of section 365, the trustee may use, sell, or lease property under subsection (b) or (c) of this section, or a plan under chapter 11, 12, or 13 of this title may provide for the use, sale, or lease of property, notwithstanding any provision in a contract, a lease, or applicable law that is conditioned on the insolvency or financial condition of the debtor, on the commencement of a case under this title concerning the debtor, or on the appointment of or the taking possession by a trustee in a case under this title or a custodian, and that effects, or gives an option to effect, a forfeiture, modification, or termination of the debtor's interest in such property.

(m) The reversal or modification on appeal of an authorization under subsection (b) or (c) of this section of a sale or lease of property does not affect the validity of a sale or lease under such authorization to an entity that purchased or leased such property in good faith, whether or not such entity knew of the pendency of the appeal, unless such authorization and such sale or lease were stayed pending appeal.

(n) The trustee may avoid a sale under this section if the sale price was controlled by an agreement among potential bidders at such sale, or may recover from a party to such agreement any amount by which the value of the property sold exceeds the price at which such sale was consummated, and may recover any costs, attorneys' fees, or expenses incurred in avoiding such sale or recovering such amount. In addition to any recovery under the preceding sentence, the court may grant judgment for punitive damages in favor of the estate and against any such party that entered into such an agreement in willful disregard of this subsection.

(*o*) Notwithstanding subsection (f), if a person purchases any interest in a consumer credit transaction that is subject to the Truth in Lending Act or any interest in a consumer credit contract (as defined in section 433.1 of title 16 of the Code of Federal Regulations (January 1, 2004), as amended from time to time), and if such interest is purchased through a sale under this section, then such person shall remain subject to all claims and defenses that are related to such consumer credit transaction or such consumer credit contract, to the same extent as such person would be subject to such claims and defenses of the consumer had such interest been purchased at a sale not under this section.

(p) In any hearing under this section—

(1) the trustee has the burden of proof on the issue of adequate protection; and

(2) the entity asserting an interest in property has the burden of proof on the issue of the validity, priority, or extent of such interest.

(Pub. L. 95–598, Nov. 6, 1978, 92 Stat. 2572; Pub. L. 98–353, title III, § 442, July 10, 1984, 98 Stat. 371; Pub. L. 99–554, title II, § 257(k), Oct. 27, 1986, 100 Stat. 3115; Pub. L. 103–394, title I, § 109, title II, §§ 214(b), 219(c), title V, § 501(d)(8), Oct. 22, 1994, 108 Stat. 4113, 4126, 4129, 4144; Pub. L. 109–8, title II, §§ 204, 231(a), title XII, § 1221(a), Apr. 20, 2005, 119 Stat. 49, 72, 195.)

Historical and Revision Notes

legislative statements

Section 363(a) of the House amendment defines ''cash collateral'' as defined in the Senate amendment. The broader definition of ''soft collateral'' contained in H.R. 8200 as passed by the House is deleted to remove limitations that were placed on the use, lease, or sale of inventory, accounts, contract rights, general intangibles, and chattel paper by the trustee or debtor in possession.

Section 363(c)(2) of the House amendment is derived from the Senate amendment. Similarly, sections 363(c)(3) and (4) are derived from comparable provisions in the Senate amendment in lieu of the contrary procedure contained in section 363(c) as passed by the House.

The policy of the House amendment will generally require the court to schedule a preliminary hearing in accordance with the needs of the debtor to authorize the trustee or debtor in possession to use, sell, or lease cash collateral. The trustee or debtor in possession may use, sell, or lease cash collateral in the ordinary course of business only ''after notice and a hearing.''

Section 363(f) of the House amendment adopts an identical provision contained in the House bill, as opposed to an alternative provision contained in the Senate amendment.

Section 363(h) of the House amendment adopts a new paragraph (4) representing a compromise between the House bill and Senate amendment. The provision adds a limitation indicating that a trustee or debtor in possession sell jointly owned property only if the property is not used in the production, transmission, or distribution for sale, of electric energy or of natural or synthetic gas for heat, light, or power. This limitation is intended to protect public utilities from being deprived of power sources because of the bankruptcy of a joint owner.

Section 363(k) of the House amendment is derived from the third sentence of section 363(e) of the Senate amendment. The provision indicates that a secured creditor may bid in the full amount of the creditor's allowed claim, including the secured portion and any unsecured portion thereof in the event the creditor is undersecured, with respect to property that is subject to a lien that secures the allowed claim of the sale of the property.

SENATE REPORT NO. 95–989

This section defines the right and powers of the trustee with respect to the use, sale or lease of property and the rights of other parties that have interests in the property involved. It applies in both liquidation and reorganization cases.

Subsection (a) defines ''cash collateral'' as cash, negotiable instruments, documents of title, securities, deposit accounts, or other cash equivalents in which the estate and an entity other than the estate have an interest, such as a lien or a co-ownership interest. The definition is not restricted to property of the estate that is cash collateral on the date of the filing of the petition. Thus, if ''non-cash'' collateral is disposed of and the proceeds come within the definition of ''cash collateral'' as set forth in this subsection, the proceeds would be cash collateral as long as they remain subject to the original lien on the ''non-cash'' collateral under section 552(b). To illustrate, rents received from real property before or after the commencement of the case would be cash collateral to the extent that they are subject to a lien.

Subsection (b) permits the trustees to use, sell, or lease, other than in the ordinary course of business, property of the estate upon notice and opportunity for objections and hearing thereon.

Subsection (c) governs use, sale, or lease in the ordinary course of business. If the business of the debtor is authorized to be operated under § 721, 1108, or 1304 of the bankruptcy code, then the trustee may use, sell, or lease property in the ordinary course of business or enter into ordinary course transactions without need for notice and hearing. This power is subject to several limitations. First, the court may restrict the trustee's powers in the order authorizing operation of the business. Second, with respect to cash collateral, the trustee may not use, sell, or lease cash collateral except upon court authorization after notice and a hearing, or with the consent of each entity that has an interest in such cash collateral. The same preliminary hearing procedure in the automatic stay section applies to a hearing under this subsection. In addition, the trustee is required to segregate and account for any cash collateral in the trustee's possession, custody, or control.

Under subsections (d) and (e), the use, sale, or lease of property is further limited by the concept of adequate protection. Sale, use, or lease of property in which an entity other than the estate has an interest may be effected only to the extent not inconsistent with any relief from the stay granted to that interest's holder. Moreover, the court may prohibit or condition the use, sale, or lease as is necessary to provide adequate protection of that interest. Again, the trustee has the burden of proof on the issue of adequate protection. Subsection (e) also provides that where a sale of the property is proposed, an entity that has an interest in such property may bid at the sale thereof and set off against the purchase price up to the amount of such entity's claim. No prior valuation under section 506(a) would limit this bidding right, since the bid at the sale would be determinative of value.

Subsection (f) permits sale of property free and clear of any interest in the property of an entity other than the estate. The trustee may sell free and clear if applicable nonbankruptcy law permits it, if the other entity consents, if the interest is a lien and the sale price of the property is greater than the amount secured by the lien, if the interest is in bona fide dispute, or if the other entity could be compelled to accept a money satisfaction of the interest in a legal or equitable proceeding. Sale under this subsection is subject to the adequate protection requirement. Most often, adequate protection in connection with a sale free and clear of other interests will be to have those interests attach to the proceeds of the sale.

At a sale free and clear of other interests, any holder of any interest in the property being sold will be permitted to bid. If that holder is the high bidder, he will be permitted to offset the value of his interest against the purchase price of the property. Thus, in the most common situation, a holder of a lien on property being sold may bid at the sale and, if successful, may offset the amount owed to him that is secured by the lien on the property (but may not offset other amounts owed to him) against the purchase price, and be liable to the trustee for the balance of the sale price, if any.

Subsection (g) permits the trustee to sell free and clear of any vested or contingent right in the nature of dower or curtesy.

Subsection (h) permits sale of a co-owner's interest in property in which the debtor had an undivided ownership interest such as a joint tenancy, a tenancy in common, or a tenancy by the entirety. Such a sale is permissible only if partition is impracticable, if sale of the estate's interest would realize significantly less for the estate that sale of the property free of the interests of the co-owners, and if the benefit to the estate of such a sale outweighs any detriment to the co-owners. This subsection does not apply to a co-owner's interest in a public utility when a disruption of the utilities services could result.

Subsection (i) provides protections for co-owners and spouses with dower, curtesy, or community property rights. It gives a right of first refusal to the co-owner or spouse at the price at which the sale is to be consummated.

Subsection (j) requires the trustee to distribute to the spouse or co-owner the appropriate portion of the proceeds of the sale, less certain administrative expenses.

Subsection (k) [enacted as (*l*)] permits the trustee to use, sell, or lease property notwithstanding certain bankruptcy or ipso facto clauses that terminate the debtor's interest in the property or that work a forfeiture or modification of that interest. This subsection is not as broad as the anti-ipso facto provision in proposed 11 U.S.C. 541(c)(1).

Subsection (*l*) [enacted as (m)] protects good faith purchasers of property sold under this section from a reversal on appeal of the sale authorization, unless the authorization for the sale and the sale itself were stayed pending appeal. The purchaser's knowledge of the appeal is irrelevant to the issue of good faith.

Subsection (m) [enacted as (n)] is directed at collusive bidding on property sold under this section. It permits the trustee to void a sale if the price of the sale was controlled by an agreement among potential bidders. The trustees may also recover the excess of the value of the property over the purchase price, and may recover any costs, attorney's fees, or expenses incurred in voiding the sale or recovering the difference. In addition, the court is authorized to grant judgment in favor of the estate and against the collusive bidder if the agreement controlling the sale price was entered into in willful disregard of this subsection. The subsection does not specify the precise measure of damages, but simply provides for punitive damages, to be fixed in light of the circumstances.

References in Text

Section 7A of the Clayton Act, referred to in subsec. (b)(2), is classified to section 18a of Title 15, Commerce and Trade.

The Truth in Lending Act, referred to in subsec. (*o*), is title I of Pub. L. 90–321, May 29, 1968, 82 Stat. 146, as amended, which is classified generally to subchapter I (§ 1601 et seq.) of chapter 41 of Title 15, Commerce and Trade. For complete classification of this Act to the Code, see Short Title note set out under section 1601 of Title 15 and Tables.

Amendments

2005—Subsec. (b)(1). Pub. L. 109–8, § 231(a), substituted '', except that if the debtor in connection with offering a product or a service discloses to an individual a policy prohibiting the transfer of personally identifiable information about individuals to persons that are not affiliated with the debtor and if such policy is in effect on the date of the commencement of the case, then the trustee may not sell or lease personally identifiable information to any person unless—'' and subpars. (A) and (B) for period at end.

Subsec. (d). Pub. L. 109–8, § 1221(a), substituted ''only—'' and pars. (1) and (2) for ''only to the extent not inconsistent with any relief granted under section 362(c), 362(d), 362(e), or 362(f) of this title.''

Subsecs. (*o*), (p). Pub. L. 109–8, § 204, added subsec. (*o*) and redesignated former subsec. (*o*) as (p).

1994—Subsec. (a). Pub. L. 103–394, § 214(b), inserted ''and the fees, charges, accounts or other payments for the use or occupancy of rooms and other public facilities in hotels, motels, or other lodging properties'' after ''property''.

Subsec. (b)(2). Pub. L. 103–394, §§ 109, 501(d)(8)(A), struck out ''(15 U.S.C. 18a)'' after ''Clayton Act'' and amended subpars. (A) and (B) generally. Prior to amendment, subpars. (A) and (B) read as follows:

''(A) notwithstanding subsection (a) of such section, such notification shall be given by the trustee; and

''(B) notwithstanding subsection (b) of such section, the required waiting period shall end on the tenth day after the date of the receipt of such notification, unless the court, after notice and hearing, orders otherwise.''

Subsec. (c)(1). Pub. L. 103–394, § 501(d)(8)(B), substituted ''1203, 1204, or 1304'' for ''1304, 1203, or 1204''.

Subsec. (e). Pub. L. 103–394, § 219(c), inserted at end ''This subsection also applies to property that is subject to any unexpired lease of personal property (to the exclusion of such property being subject to an order to grant relief from the stay under section 362).''

1986—Subsec. (c)(1). Pub. L. 99–554, § 257(k)(1), inserted reference to sections 1203 and 1204 of this title.

Subsec. (*l*). Pub. L. 99–554, § 257(k)(2), inserted reference to chapter 12.

1984—Subsec. (a). Pub. L. 98–353, § 442(a), inserted ''whenever acquired'' after ''equivalents'' and ''and includes the proceeds, products, offspring, rents, or profits of property subject to a security interest as provided in section 552(b) of this title, whether existing before or after the commencement of a case under this title'' after ''interest''.

Subsec. (b). Pub. L. 98–353, § 442(b), designated existing provisions as par. (1) and added par. (2).

Subsec. (e). Pub. L. 98–353, § 442(c), inserted '', with or without a hearing,'' after ''court'' and struck out ''In any hearing under this section, the trustee has the burden of proof on the issue of adequate protection''.

Subsec. (f)(3). Pub. L. 98–353, § 442(d), substituted ''all liens on such property'' for ''such interest''.

Subsec. (h). Pub. L. 98–353, § 442(e), substituted ''at the time of'' for ''immediately before''.

Subsec. (j). Pub. L. 98–353, § 442(f), substituted ''compensation'' for ''compenation''.

Subsec. (k). Pub. L. 98–353, § 442(g), substituted ''unless the court for cause orders otherwise the holder of such claim may bid at such sale, and, if the holder'' for ''if the holder''.

Subsec. (*l*). Pub. L. 98–353, § 442(h), substituted ''Subject to the provisions of section 365, the trustee'' for ''The trustee'', ''condition'' for ''conditions'', ''or the taking'' for ''a taking'', and ''interest'' for ''interests''.

Subsec. (n). Pub. L. 98–353, § 442(i), substituted ''avoid'' for ''void'', ''avoiding'' for ''voiding'', and ''In addition to any recovery under the preceding sentence, the court may grant judgment for punitive damages in favor of the estate and against any such party that entered into such an agreement in willful disregard of this subsection'' for ''The court may grant judgment in favor of the estate and against any such party that entered into such agreement in willful disregard of this subsection for punitive damages in addition to any recovery under the preceding sentence''.

Subsec. (*o*). Pub. L. 98–353, § 442(j), added subsec. (*o*).

Effective Date of 2005 Amendment

Pub. L. 109–8, title XII, § 1221(d), Apr. 20, 2005, 119 Stat. 196, provided that: ''The amendments made by this section [amending this section and sections 541 and 1129 of this title and enacting provisions set out as a note under this section] shall apply to a case pending under title 11, United States Code, on the date of enactment of this Act [Apr. 20, 2005], or filed under that title on or after that date of enactment, except that the court shall not confirm a plan under chapter 11 of title 11, United States Code, without considering whether this section would substantially affect the rights of a party in interest who first acquired rights with respect to the debtor after the date of the filing of the petition. The parties who may appear and be heard in a proceeding under this section include the attorney general of the State in which the debtor is incorporated, was formed, or does business.''

Amendment by sections 204 and 231(a) of Pub. L. 109–8 effective 180 days after Apr. 20, 2005, and not applicable with respect to cases commenced under this title before such effective date, except as otherwise provided, see section 1501 of Pub. L. 109–8, set out as a note under section 101 of this title.

Effective Date of 1994 Amendment

Amendment by Pub. L. 103–394 effective Oct. 22, 1994, and not applicable with respect to cases commenced under this title before Oct. 22, 1994, see section 702 of Pub. L. 103–394, set out as a note under section 101 of this title.

Effective Date of 1986 Amendment

Amendment by Pub. L. 99–554 effective 30 days after Oct. 27, 1986, but not applicable to cases commenced under this title before that date, see section 302(a), (c)(1) of Pub. L. 99–554, set out as a note under section 581 of Title 28, Judiciary and Judicial Procedure.

Effective Date of 1984 Amendment

Amendment by Pub. L. 98–353 effective with respect to cases filed 90 days after July 10, 1984, see section 552(a) of Pub. L. 98–353, set out as a note under section 101 of this title.

Construction of Section 1221 of Pub. L. 109–8

Pub. L. 109–8, title XII, § 1221(e), Apr. 20, 2005, 119 Stat. 196, provided that: ''Nothing in this section [see Effective Date of 2005 Amendment note above] shall be construed to require the court in which a case under chapter 11 of title 11, United States Code, is pending to remand or refer any proceeding, issue, or controversy to

BRIEF BANK — 'SUMMARY SHEET" *Printed Wed-4/6/05 9:24*

WESTLAW CODES

1. **("TI")** *TITLE* OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	Hollis, Jr. v. United States Trustee
2. **("CO")** *CURRENT* COURT *[E.g., "CTA9"]*	CTA4
3. **("CCN")** *CURRENT* CASE NO.	No.: 04-2543
4. **("PCN")** *PRIOR* CASE NO. & COURT *[IF ANY]*	No.: Court: D MD *(Identify judge & cite, if any)*
5. **("SO")** *SOURCE*	U.S. TRUSTEES
6. **("DA")** *DATE* OF FILING *& TYPE* OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	Filed: March 17, 2005 Type: Appellee's Informal Brief and Supporting Memo
7. **("AU")** *PRINCIPAL AUTHORS & OFFICE [E.g.,"UST/OGC"]*	Michele M. Mansfield, Esq., EOUST *(UST/OGC: 202-307-1399/FAX-2397)*
8. **("TO")** *TOPIC*	BANKRUPTCY
9. **("SU")** • *SUMMARY* OF KEY ISSUE(s) & √ Any Miscellaneous *BACKGROUND*	1) Whether the district court properly dismissed an appeal from the bankruptcy court for lack of jurisdiction when appellant filed notice of appeal from the bankruptcy court's order 27 days after the entry of judgment appealed from and where 28 USC 158(c)(2) makes the timely filing of a NOA as jurisdictional requirement. 2) Whether the bankruptcy court abuse it discretion by denying the appellant's untimely filed post-trial motions seeking to alter or amend under Fed.R.Bankr.P. 9023.
10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)	I:\seggert\My Files\BriefBank-Web\Hollis\Hollis01.wpd
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IN THE UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

04-2543

MELDON S. HOLLIS, JR.,
Appellant,

v.

UNITED STATES TRUSTEE,
Appellee.

ON APPEAL FROM THE DISTRICT COURT
FOR THE DISTRICT OF MARYLAND

APPELLEE'S INFORMAL BRIEF AND SUPPORTING MEMORANDUM

W. Clarkson McDow, Jr.
United States Trustee for Region 4

Donald F. Walton
Acting General Counsel

Michele M. Mansfield
Department of Justice
Executive Office for United States Trustees
20 Massachusetts Ave., N.W., Suite 8000
Washington, D.C., 20530
(202) 307-1385
Fax: (202) 307-2397

John L. Daugherty
Department of Justice
Office of the United States Trustee
6305 Ivy Lane, Suite 600
Greenbelt, MD 20770
(301) 344-6216

IN THE UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

04-2543

MELDON S. HOLLIS, JR.,
Appellant,

v.

UNITED STATES TRUSTEE,
Appellee.

ON APPEAL FROM THE DISTRICT COURT
FOR THE DISTRICT OF MARYLAND

INFORMAL BRIEF

Re: *Hollis v. United States Trustee*, Case No. 04-2543

In compliance with Local Rule 34(b) and this court's Order entered December 22, 2004, the United States Trustee submits this informal brief and supporting memorandum.

Statement of Jurisdiction

On appeal is the district court's order (1) dismissing the appeal, for lack of subject matter jurisdiction resulting from an untimely notice of appeal, of the bankruptcy court's March 12, 2004, judgment under 11 U.S.C. 110; and (2) affirming the bankruptcy court's denial of appellant's two post-trial motions, for which notice of appeal was timely filed. This Court lacks jurisdiction, as did the district court, over the merits of the appeal of the underlying March 12 bankruptcy court judgment. This Court has jurisdiction pursuant to 28 U.S.C. 158(d) to review the district court's dismissal of the appeal of the underlying judgment and the district court's affirmance of the bankruptcy court orders denying the two post-trial motions.

This Court stated in its December 22, 2004, order that it would consider only issues raised in appellant's informal brief. Mr. Hollis raised three issues in his brief to this Court. First, whether “irregularities” in the bankruptcy and district court proceedings denied him due process and equal protection of the law; second, whether he is entitled to “an impartial review of factual and legal disputes” in the bankruptcy court proceedings; and third, whether the district court had jurisdiction to hear his untimely notice of appeal.

The “irregularities” in the bankruptcy court cited by Mr. Hollis as violations of his constitutional rights are at best issues that could be raised on a review of the merits of the underlying order on remand if this Court reverses the district court’s dismissal of the appeal. None of his allegations, even if true, however, can confer appellate jurisdiction upon the district court absent such jurisdiction granted by Congress. Likewise, the alleged “irregularities” cannot create a right to “an impartial [appellate] review of factual and legal disputes” in the bankruptcy court as argued by Mr. Hollis when jurisdiction to hear those issues is lacking. Under the Constitution, the district court has no authority not granted to it by Congress. The district court’s appellate review is limited by statutes granting such, like 28 U.S.C. 158. The sole issue before this Court with respect to the underlying judgment of the bankruptcy court, therefore, is whether, under 28 U.S.C. 158, the district court possessed appellate jurisdiction over this case. If this Court finds it did not, Mr. Hollis’ appeal should be dismissed. If this Court finds it did, this matter should be remanded for an adjudication of the merits of Mr. Hollis’ claims.

Issues on Appeal

1. As a matter of law, did the district court properly dismiss an appeal from the bankruptcy court for lack of jurisdiction when Mr. Hollis filed his notice of appeal from the bankruptcy court’s order twenty-seven days after the entry of the judgment appealed from and where 28 U.S.C. 158(c)(2) makes the timely filing of a notice of appeal as jurisdictional requirement?

2. Did the bankruptcy court abuse its discretion by denying the appellant’s untimely filed post-trial motions seeking to alter or amend judgment under Fed. R. Bankr. P. 9023?

Standard of Review

A determination of subject matter jurisdiction by the district court is reviewed de novo. *See, e.g., New Horizon of NY LLC v. Jacobs*, 231 F.3d 143, 150 (4th Cir. 2000) (citation omitted). The denial of motions under Fed. R. Bankr. P. 9023 are reviewed for abuse of discretion.[1/] *Stamathis v. Flying J, Inc.*, 389 F.3d 429, 436 (4th Cir. 2004) (court has discretion whether to grant motion under Fed. R. Civ. P. 59) (citations omitted); *see also* Fed. R. Bankr. P. 9023 (making Fed. R. Civ. P. 59 applicable to bankruptcy cases).

Supporting Facts and Background

There are no factual disputes relevant to the matter before this Court. Mr. Meldon Hollis is a bankruptcy petition preparer and disbarred attorney who helped debtor Romeo E. Sackar prepare a chapter 7 bankruptcy petition and related documents. In assisting the debtor, Mr. Hollis violated a number of provisions of 11 U.S.C. 110, which governs the conduct of petition preparers, and the United States Trustee initiated an adversary proceeding against Mr. Hollis in response to those statutory violations. (Complaint, Bankr. Ct. Case No. 03-01127, Dkt #1). The bankruptcy court entered a judgment against Mr. Hollis on the merits of the United States Trustee's complaint on March 12, 2004. (Order Entering Judgment, Bankr. Ct. Case No. 03-01127, Dkt #73). That merits ruling is not before this court because the district court dismissed the appeal of the judgment for lack of jurisdiction arising from Mr. Hollis' failure to timely appeal the March 12

[1/] Mr. Hollis erroneously suggests the standard of review as "clearly erroneous," under Fed. R. Bankr. P. 8013, which states that findings of fact of the bankruptcy court should not be set aside unless "clearly erroneous." The district court's jurisdictional statement was based upon uncontested facts and Mr. Hollis fails to identify any finding of fact by the bankruptcy court or district court that is disputed. This appeal presents the legal question of whether an untimely notice of appeal from a bankruptcy court confers appellate jurisdiction to the district court under 11 U.S.C. 158, which this Court reviews de novo, and requires a review the denial of post-trial motions, which is a matter committed to the discretion of a bankruptcy court.

order. (Order, Dist. Ct. Case No. 04-1581, Dkt #14). Mr. Hollis also appealed the denial by the bankruptcy court of two post-trial motions. (Notice of Appeal, Bankr. Ct. Case No. 03-01127, Dkt #83). The notice of appeal was timely as to these two orders. *See* 28 U.S.C. 158(c), Fed. R. Bankr. P. 8002. The district court asserted jurisdiction over the appeal of the two orders and affirmed the bankruptcy court. Order, Dist. Ct. Case No. 04-1581, Dkt #14. This Court has jurisdiction to rule on the merits of this appeal with respect to the orders denying the post-trial motions, but not on the merits of the underlying March 12 judgment.

Mr. Hollis filed the first of his post-trial motions in the bankruptcy court seventeen days after entry of the March 12 judgment, on March 29, 2004, in the form of a motion to extend the time to alter or amend the judgment under Fed. R. Bankr. P. 9023. (Motion, Bankr. Ct. Case No. 03-01127, Dkt #77). The bankruptcy court denied this motion on March 31, 2004. (Order, Bankr. Ct. Case No. 03-01127, Dkt #78). Despite the court's refusal to grant additional time, on April 6, 2004, twenty-four days after the entry of the underlying judgment, Mr. Hollis filed his second post-trial motion, an untimely motion to alter or amend judgment under Fed. R. Bankr. P. 9023. (Motion, Bankr. Ct. Case No. 03-01127, Dkt #80). The bankruptcy court denied this motion on April 8, 2004. (Order, Bankr. Ct. Case No. 03-01127, Dkt #81).

Mr. Hollis filed his notice of appeal to the district court on April 9, 2004, twenty-seven days after the entry of the bankruptcy court's March 12 merits ruling. (Notice of Appeal, Bankr. Ct. Case No. 03-01127, Dkt #83). The United States Trustee moved to dismiss the appeal for lack of jurisdiction. (Motion, Dist. Ct. Case No. 04-1581, Dkt #9). The district court entered a memorandum opinion and order on November 17, 2004, dismissing the appeal of the March 12 judgment and affirming the bankruptcy court's denial of the two post-trial motions. (Order, Dist.

Ct. Case No. 04-1581, Dkt #14, 15). Mr. Hollis filed a notice of appeal from the district court on December 14, 2004. (Notice of Appeal, Dist. Ct. Case No. 04-1581, Dkt #16).

MEMORANDUM IN SUPPORT OF APPELLEE'S INFORMAL BRIEF

1. The district court lacked subject matter jurisdiction to consider the merits of the bankruptcy court's March 12 judgment because Mr. Hollis' appeal from that was untimely under Fed. R. Bankr. P. 8002, and 28 U.S.C. 158(c)(2) grants appellate jurisdiction only where the notice of appeal is filed in compliance with the time limits set forth in Rule 8002.

"Federal courts are not courts of general jurisdiction; they have only the power that is authorized by article III of the Constitution and the statutes enacted by Congress thereto." *Brickwood Contractors, Inc. v. Datanet Eng'g, Inc.*, 369 F.3d 385, 389 (4th Cir. 2004) (*quoting Bender v. Williamsport Area Sch. Dist.*, 475 U.S. 534, 541 (1986). A district court's appellate jurisdiction to review final judgments, orders and decrees of bankruptcy judges is established by 28 U.S.C. 158(a) and 158(c)(2). *Accord Hamilton v. Lake Elmo Bank* (*In re Delta Eng'g Int'l, Inc.*), 270 F.3d 584, 585 (8th Cir. 2001) (bankruptcy appellate panel jurisdiction conferred by 28 U.S.C. 158 (b) and (c)). A district court's appellate jurisdiction, therefore, cannot be expanded beyond what is authorized by section 158. Subsection 158(c)(2) sets forth a time frame for appealing bankruptcy decisions to the district courts, requiring that such appeals "shall be taken in the same manner as appeals in civil proceedings generally are taken to the courts of appeals from the district courts," and "*in the time provided by Rule 8002 of the Bankruptcy Rules*." 28 U.S.C. 158(c)(2) (emphasis added). In turn, Fed. R. Bankr. P. 8002(a) requires a notice of appeal be filed within ten days of the bankruptcy court's order unless an appellant had filed one of the motions identified in Fed. R. Bankr. P. 8002(b) within that ten day period.

Bankruptcy Rule 8002(b) provides that where any party files a "timely motion" (1) to amend under Fed. R. Bankr. P. 7052; (2) to alter or amend judgment or for a new trial under Fed.

R. Bankr. P. 9023; or (3) for relief under Fed. R. 9024 filed within ten days after the entry of judgment, "the time for appeal for all parties runs from the entry of the order disposing of the last such motion outstanding." Fed. R. Bankr. P. 8002(b). Hollis filed a notice of appeal of the March 12 judgment almost a month after the entry of the judgment. The time to file a notice of appeal, however, expired ten days after the entry of the March 12 judgment, because neither Hollis, nor any other party, took any actions to toll or extend the time to file a notice of appeal.

As explained, the time to file a notice of appeal may be tolled by the *timely* filing of certain post-trial motions. Fed. R. Bankr. P. 8002(b). The time to file a notice of appeal may also be extended beyond the ten day limit by the timely filing of a motion to extend the time to file a notice of appeal. Fed. R. Bankr. P. 8002(c). Mr. Hollis never filed a motion to extend the time to file a notice of appeal, and the only motion filed by Mr. Hollis that could have tolled the time to file a notice of appeal was his motion to alter or amend judgment filed on April 6, 2004. To toll the time to file a notice of appeal, Mr. Hollis must have filed his motion within ten days after the entry of the March 12 judgment. He filed his motion, however, twenty-five days after the entry of March 12 judgment. Under Rule 8002(b), motions must be filed within ten days of the entry of the order appealed to toll the time for appealing. Fed. R. Bankr. P. 8002(b); *see also, e.g., Whitemere Dev. Corp., Inc. v. Township of Cherry Hill*, 786 F.2d 185, 187 (3d Cir. 1986). This motion was untimely filed by fifteen days, and untimely motions do not toll the time to file a notice of appeal under Fed. R. Bankr. P. 8002. *See, e.g., Constellation Dev. Corp. v. Dowden (In re B.J. McAdams, Inc.),* 999 F.2d 1221, 1225 (8th Cir. 1993) (citation omitted). Therefore, Mr. Hollis' motion did to alter or amend did not toll his time to appeal the March 12 order and did not confer jurisdiction upon the district court to hear his appeal.[2/]

Although this Court has not issued a precedential decision[3/] determining whether a timely notice of appeal from a bankruptcy court order is a condition precedent to the district court's exercise of appellate jurisdiction, the United States courts of appeals for the First, Third, Fifth, Sixth, Eighth, Ninth, and Eleventh circuits have concluded it is. *See, e.g., Suhar v. Burns* (*In re Burns*), 322 F.3d 421, 425 (6th Cir. 2003); *In re Bond*, 254 F.3d 669, 673 (7th Cir. 2001); *Hamilton v. Lake Elmo Bank* (*In re Delta Eng'g Int'l, Inc.*), 270 F.3d 584, 586 (8th Cir. 2001); *Williams v. EMC Mortgage Corp. (In re Williams)*, 216 F.3d 1295, 1298 (11th Cir. 2000); *Stangel v. United States* (*In re Stangel*), 219 F.3d 498, 500 (5th Cir. 2000); *Don Vicente Macias, Inc. v. Texas Gulf Trawling Co., Inc.* (*In re Don Vicente Macias, Inc.*), 168 F.3d 209, 211 (5th Cir. 1999); *Shareholders v. Sound Radio, Inc.,* 109 F.3d 873, 879 (3d Cir. 1997); *Veltman v. Whetzal*, 93 F.3d 517, 520-21 (8th Cir. 1996); *In re Maurice*, 69 F.3d 830, 832 (7th Cir. 1995); *Solomon v. Smith* (*In re Moody*), 41 F.3d 1024, 1026 (5th Cir. 1995); *Anderson v. Mouradick* (*In re Mouradick*), 13 F.3d 326, 327 (9th Cir. 1994); *Fellows v. Colonial Sav. and Loan Ass'n* (*In re Fellows*), 19 F.3d 245, 247 (5th Cir. 1994); *Deyhimy v. Rupp* (*In re Herwitt*), 970 F.2d 709, 710 (10th Cir. 1992); *In re Schultz Mfg. Fabricating Co.*, 956 F.2d 686 (7th Cir. 1992); *Colon v. Hart* (*In re Colon*), 941 F.2d 242, 245 (3d Cir. 1991); *River Prod. Co., Inc. v. Webb* (*In re Topco, Inc.*), 894 F.2d 727, 733 & n.7 (5th Cir. 1991); *Slimick v. Silva* (*In re Slimick*), 928 F.2d 304, 306 (9th Cir. 1990); *Greene v.*

[2/] Mr. Hollis' other post-trial motion, the motion for an extension of time to file a motion to alter or amend, which was untimely filed on March 29, 2004, is not a type of motion that tolls the time to file a notice of appeal under Fed. R. Bankr. P. 8002(b), even if it was timely.

[3/] In *dicta*, however, in a case examining jurisdiction under 28 U.S.C. 1334, this Court stated that an order was final "because it was not appealed from on or before 10 days [after entry of the order] pursuant to 28 U.S.C. § 158(a) and § 158(c) and Rule 8002 of the Bankruptcy Rules." *New Horizons of NY LLC v. Jacobs*, 231 F.3d 143, 152 (4th Cir. 2000) (emphasis added).

United States (*In re Souza*), 795 F.2d 855, 856-57 (9th Cir. 1986); *Stelpflug v. Fed. Land Bank of St. Paul*, 790 F.2d 47, 49 (7th Cir. 1986); *Whitemere Dev. Corp., Inc. v. Township of Cherry Hill*, 786 F.2d 185, 187 (3d Cir. 1986); *In re Abdallah*, 778 F.2d 75, 77 (1st Cir. 1985); *In re Universal Minerals, Inc.* 755 F.2d 309, 310 (3d Cir. 1985).

It is worth noting that 28 U.S.C. 158(c)(2), not Fed. R. Bankr. P. 8002, creates the jurisdictional requirement of a timely appeal.[4/] In granting appellate jurisdiction over bankruptcy court decisions to the district court in section 158(c)(2), Congress specifically incorporated the requirement of compliance with Fed. R. Bankr. P. 8002. 28 U.S.C. 158(c)(2) ("An appeal . . . shall be taken . . . in the time provided by [Bankruptcy] Rule 8002."). As the Supreme Court recently noted in *Kontrick v. Ryan* (a case examining the nature of Fed. R. Bankr. P. 4004), procedural rules may not create or withdraw jurisdiction. 124 S. Ct. 906, 914 (2004). Unlike the statute at issue in *Kontrick*, however, section 158(c)(2) is one of the "[c]ertain statutory provisions" which "contain built-in time constraints." *Kontrick v. Ryan*, 124 S. Ct. 906, 914 (2004) (noting 28 U.S.C. 157(c) limits the jurisdiction of federal district courts to review bankruptcy court findings and conclusions in non-core proceedings to matters to which party has "timely and specifically objected").

Congress' express incorporation of Rule 8002's ten day filing deadline into section 158(c)(2) conditions the exercise of appellate jurisdiction upon the timely filing of a notice of appeal. *See, e.,g.*, *In re Bond*, 254 F.3d 669, 673 (7th Cir. 2001) (to perfect an appeal of a final judgment filed under section 158 and confer appellate jurisdiction, notice of appeal must be filed

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[4/] A number of courts have inarticulately stated that Rule 8002 is "jurisdictional," which incorrectly implies the Rule itself creates jurisdiction.

within ten days of bankruptcy court's decision); *River Prod. Co., Inc. v. Webb* (*In re Topco, Inc.*), 894 F.2d 727, 734 (5th Cir. 1991) (appeals under section 158(a) must comply with time requirements of section 158(c)) (citing Fed. R. Bankr. P. 8002).

Mr. Hollis argues that the United States Trustee's motion to dismiss for lack of jurisdiction was "untimely," and that the district court therefore violated Mr. Hollis' equal protection rights by "permitting late and unjustified filings [by the United States Trustee] while denying late filings from [Hollis]." Appellant's Brief at 9, 10. Subject matter jurisdiction, however, can be raised at any time, "even initially at the highest appellate interest." *Grupo Dataflux v. Atlas Global Group, L.P.*, 124 S. Ct. 1920, 1927 (2004) (quoting *Kontrick v. Ryan*, 124 S. Ct. 906, 915 (2004)). Moreover, an objection to a federal court's subject matter jurisdiction cannot be forfeited. *Id.; see also Kontrick v. Ryan*, 124 S. Ct. 906, 916 (2004). Nor can subject-matter jurisdiction be conferred by agreement of the parties or a defect in jurisdiction waived. *See, e.g., Brickwood Contractors, Inc. v. Datanet Eng'g, Inc.*, 369 F.3d 385, 389 (4th Cir. 2004) (citing *United States v. Cotton*, 535 U.S. 625, 630 (2002)).

Mr. Hollis also argues that the bankruptcy court should have extended the time to file a notice of appeal based on "excusable neglect" under Fed. R. Bankr. P. 8002(c). The "excusable neglect," presumably, is the fact that Mr. Hollis was out of town when notice of the court's March 12 judgment was delivered to him. This argument fails for two reasons. First, Mr. Hollis cites no authority to support, nor is there any support, for the failure of an appellant to be home to receive properly sent notice, even if, as Mr. Hollis contends, the bankruptcy court "had notice" that he was going to be out of town. In fact, the Bankruptcy Rules specifically state that "[l]ack of notice does not affect the time to appeal or authorize the court to relieve a party for failure to appeal within the time allowed, except as provided by Rule 8002." Fed. R. Bankr. P. 9022(a). The failure to receive notice of entry of a judgment is not excusable neglect because a party has an affirmative duty to monitor the dockets. More importantly, even if Mr. Hollis could demonstrate excusable neglect, Rule 8002(c) only allows for the extension of time for filing a notice of appeal by a request made by "written motion filed before the time for filing the notice of appeal has expired," and Mr. Hollis never requested an extension of time to file a notice of appeal – neither prior to nor after the expiration of the time allowed for such a request. Fed. R. Bankr. P. 8002(c).

Mr. Hollis offers no legal support for his argument that the district court and this Court may make the "equitable decision" to hear his appeal in violation of the jurisdictional bar imposed by 28 U.S.C. 158(c)(2). Under that section, the district court lacked jurisdiction to review the merits of the judgment against him. Given that, this Court also does not have jurisdiction to review the merits of the underlying judgment at this time. Where a district court lacks subject matter jurisdiction, a circuit court of appeals also lacks jurisdiction. *See, e.g., Don Vincente Macias, Inc. v. Texas Gulf Trawling Co., Inc. (In re Don Vincente Macias, Inc.),* 168 F.3d 209, 211 (5th Cir. 1999)*; Weston v. Mann* (*In re Weston*), 18 F.3d 860, 862 (10th Cir. 1994); *Colon v. Hart* (*In re Colon*), 941 F.2d 242, 244 (3d Cir. 1991).

2. The bankruptcy court did not abuse its discretion by denying the untimely motion to extend the time to file a motion to alter or amend or by denying the untimely motion to alter or amend.

Hollis' notice of appeal was timely as to the March 31 order denying his motion to extend time to file a motion to alter or amend judgment and the April 8 order denying his motion to alter or amend judgment. Therefore, the timing of the notice of appeal presents no jurisdictional bar to review by the district court or this Court. The denial of these motions by the bankruptcy court was proper because both motions were untimely filed, and the district court properly affirmed these orders. A motion to alter or amend a judgment in a bankruptcy case is governed by Fed. R. Bankr. P. 9023, which makes Fed. R. Civ. P. 59 applicable to cases under the Bankruptcy Code. Civil Procedure Rule 59(e) provides that "[a]ny motion to alter or amend a judgment shall be filed no later than 10 days after the entry of the judgment." Fed. R. Civ. P. 59(e). In this case, the time to file a motion to alter or amend the judgment expired on March 22, 2004. After the expiration of this time, on March 29, 2004, Hollis filed his motion for an extension of time. The bankruptcy court correctly denied this motion because Fed. R. Bankr. P. 9006, governing the computation, enlargement, and reduction of time periods in bankruptcy cases, expressly prohibits the court from enlarging the time to file a motion to alter or amend judgment. Fed. R. Bankr. P. 9006(b)(2); *see also Alston v. MCI Communications Corp.*, 84 F.3d 705, 706 (4th Cir. 1996).

Mr. Hollis acknowledges the fact that Rule 9006 prohibited the bankruptcy court from granting his extension of time to file a motion to alter or amend, but claims that "this fact was not known [to Hollis] at the time of filing the motion to alter or amend judgment." Appellant's Brief at 13. He also acknowledges that Rule 9006 is part of the reason he is not able to "contest[] the Bankruptcy Court's judgement [sic] in the most appropriate manner." *Id.* Even if the bankruptcy court had disregarded Rule 9006 and granted the extension of time to file a motion to alter or amend, this would have no impact on the court's lack of jurisdiction to review the underlying March 12 judgment because the time to file a notice of appeal expired before Mr. Hollis filed his motion, and, moreover, this motion is not a motion that has the potential to toll the filing of a notice of appeal under 28 U.S.C. 158 and Fed. R. Bankr. P. 8002.

Despite the fact that the bankruptcy court denied his motion for an extension of time, Hollis proceeded to file an untimely motion to alter or amend judgment. The bankruptcy court correctly denied this motion because, in addition to the motion being untimely, there were no legal grounds for altering or amending the judgment. The three narrow grounds for amending an earlier judgment are (1) to accommodate an intervening change in controlling law; (2) to account for new evidence not available at trial; or (3) to correct a clear error of law or prevent manifest injustice. *See Hutchinson v. Staton*, 994 F.2d 1076, 1081 (4th Cir. 1993). Mr. Hollis neither asserted nor proved any of these grounds.

Conclusion

For these reasons, the United States Trustee respectfully asks this Court to dismiss Mr. Hollis' appeal from the March 12 order for lack of subject matter jurisdiction; affirm the district court's order dismissing Mr. Hollis' appeal from the March 12 order; and affirm the district court's order affirming denial of Mr. Hollis' post-trial motions by the bankruptcy court.

Respectfully Submitted,

____

W. Clarkson W. McDow, Jr.
United States Trustee

Michele M. Mansfield
Department of Justice
Executive Office for United States Trustees
20 Massachusetts Ave., N.W., Suite 8000
Washington, D.C. 20530

CERTIFICATE OF SERVICE

I certify that on March 17, 2005, I mailed a complete copy of this Informal Brief and all attachments to all parties, addressed as shown below.

Michele M. Mansfield

Meldon S. Hollis, Jr.
307 Yoakum Parkway
Unit 1406
Alexandria, VA 22304

BRIEF BANK — "SUMMARY SHEET"

Printed Mon.-5/3/4 (14:36)

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	Houlihan Lokey Howard v. Unsecured Creditor's Liquidating Trust, et al. (In re Commercial Financial Services, Inc.)
2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	CA10
3. ("CCN") ***CURRENT*** CASE NO.	No.:
4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*	No.: Court: BAP ND Okla. *(Identify judge & cite, if any)*
5. ("SO") ***SOURCE***	**U.S. TRUSTEES**
6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	Filed: April 2004 Type: Brief for UST
7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*	R. Craig Green, Esq., Civil DOJ P. Matthew Sutko, Esq., OGC/DOJ *(UST/OGC: 202-307-1399/FAX-2397)*
8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") ! ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	! Whether the bankruptcy court abused its discretion in awarding $904,000.00 to debtor's attorneys as "reasonable compensation" under 11 U.S.C. §330(a). √ **Background:**
10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)	D:\MyFiles\BriefBank-Web\Houlihan\HoulihanSum.wpd
11. DO YOU RECOMMEND POSTING IN UST BRIEFBANK?	| X | YES | | NO ***NAME:*** Steven Eggert ***DATE:*** Mon.-5/3/4 (13:56)

IN THE UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

IN RE: COMMERCIAL FINANCIAL SERVICES, INC.
Debtor.

HOULIHAN LOKEY HOWARD & ZUKIN CAPITAL
Appellant,
v.

UNSECURED CREDITOR'S LIQUIDATING TRUST; ABS
LIQUIDATING TRUSTEE; COMMERCIAL FINANCIAL SERVICES, INC.;
CFS LIQUIDATING TRUSTEE; CF/SPC NGU, INC.;
UNITED STATES TRUSTEE,
Appellees.

ON APPEAL FROM THE UNITED STATES BANKRUPTCY
APPELLATE PANEL OF THE TENTH CIRCUIT

BRIEF FOR UNITED STATES TRUSTEE

PETER D. KEISLER
Assistant Attorney General

WILLIAM KANTER
(202) 514-4575
R. CRAIG GREEN
(202) 514-2498
Attorneys, Appellate Staff
Civil Division, Room 9104
Department of Justice
601 D Street, N.W.
Washington, D.C. 20530

OF COUNSEL:

DONALD F. WALTON
Acting General Counsel
P. MATTHEW SUTKO
Attorney
Office of the General
Counsel, Executive Office
for U.S. Trustees
20 Massachusetts Ave., N.W.
Washington, D.C. 20530

ORAL ARGUMENT NOT REQUESTED

Appeal from the Bankruptcy Appellate Panel of the Tenth Circuit (Clark, Nugent, Thurman, JJ.); and from the United States Bankruptcy Court of the Northern District of Oklahoma (Rasure, J.)

TABLE OF CONTENTS

TABLE OF AUTHORITIES

STATEMENT OF RELATED CASES

The U.S. Trustee is not aware of any prior or related appeals.

IN THE UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

IN RE: COMMERCIAL FINANCIAL SERVICES, INC.

Debtor.

HOULIHAN LOKEY HOWARD & ZUKIN CAPITAL

Appellant,

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UNSECURED CREDITOR'S LIQUIDATING TRUST; ABS
LIQUIDATING TRUSTEE; COMMERCIAL FINANCIAL SERVICES, INC.;
CFS LIQUIDATING TRUSTEE; CF/SPC NGU, INC.;
UNITED STATES TRUSTEE,

Appellees.

ON APPEAL FROM THE UNITED STATES BANKRUPTCY
APPELLATE PANEL OF THE TENTH CIRCUIT

BRIEF FOR UNITED STATES TRUSTEE

STATEMENT OF JURISDICTION

The United States Bankruptcy Court for the Northern District of Oklahoma had jurisdiction over the Chapter 11 proceeding in this case pursuant to 11 U.S.C. § 157(b)(1). On January 10, 2003, the bankruptcy court approved a final fee award of $904,000 to Houlihan Lokey Howard & Zukin Financial Services, Inc. ("Houlihan"). On January 20, 2003, Houlihan appealed the amount of that award to the Bankruptcy Appellate Panel ("BAP"). The BAP had jurisdiction under 28 U.S.C. § 158(b) and (c). On August 27, 2003, the BAP affirmed the bankruptcy court's decision. On

September 25, 2003, Houlihan appealed the BAP's decision to this Court, which has jurisdiction under 28 U.S.C. § 158(d).

STATEMENT OF THE ISSUE

Whether the bankruptcy court abused its discretion in awarding $904,000 to Houlihan as "reasonable compensation" under 11 U.S.C. § 330(a).

STATEMENT OF THE CASE

Commercial Financial Services, Inc., and its subsidiary, CF/SPC NGU, Inc., filed voluntary petitions for reorganization under chapter 11. See generally 11 U.S.C. § 1101, et seq. The United States Trustee appointed a committee to represent creditors holding asset-based securities ("ABS Committee"). 11 U.S.C. § 1102(a)(1). The bankruptcy court authorized the ABS Committee to retain Houlihan as a financial advisor. 11 U.S.C. § 1103(a). Houlihan applied for fees, and the bankruptcy court awarded part of the requested amount. 11 U.S.C. § 330. Houlihan appealed the award, and the BAP affirmed.

STATEMENT OF FACTS

A. Statutory Background

This case concerns bankruptcy courts' authority under Section 330 of the Bankruptcy Code to award reasonable compensation to professionals employed by creditors committees. In chapter 11 bankruptcy cases, the U.S. Trustee appoints an unsecured creditors committee and additional creditors committees as appropriate. 11 U.S.C. § 1102. Under 11 U.S.C. § 1103(a), creditors committees may, if the bankruptcy court approves, employ attorneys and other professionals to serve or represent the committee.[1]

Payment of bankruptcy professionals is governed by 11 U.S.C. § 328 and 11 U.S.C. § 330. Under Section 328, bankruptcy courts may – but are not obliged to – approve specific, reasonable terms of employment prior to a professional's service.[2] When a bankruptcy court does not specifically preapprove a professional's terms of employment, the court must determine compensation under Section 330 after notice and a hearing.[3]

Section 330 is the provision relevant here. It allows bankruptcy courts to award reasonable compensation only for

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[1] 11 U.S.C. § 1103(a) ("[W]ith the court's approval, such committee may select and authorize the employment by such committee of one or more attorneys, accountants, or other agents, to represent or perform services for such committee."); cf. 11 U.S.C. § 327(a), 1107(a) (similar for trustees and debtors in possession).

[2] 11 U.S.C. § 328 ("[A] committee appointed under section 1102 of this title, with the court's approval, may employ * * * a professional * * * [under 11 U.S.C. § 1103] on any reasonable terms and conditions of employment, including on a retainer, on an hourly basis, or on a contingent fee basis.").

[3] 11 U.S.C. § 330 ("After notice * * * and a hearing, and subject to [11 U.S.C. § 328], * * * the court may award to * * * a professional person * * * (1) reasonable compensation for actual, necessary services rendered * * * based on the nature, the extent, and the value of such services, the time spent on such services, and the cost of comparable services other than in a case under this title; and (2) reimbursement for actual, necessary expenses.").

"actual, necessary services rendered" and "actual, necessary expenses." 11 U.S.C. § 330(a)(1). "The court may * * * award compensation that is less than the amount of compensation that is requested." 11 U.S.C. § 330(a)(2). In determining the appropriate amount of "reasonable compensation," Section 330 instructs bankruptcy courts to "consider the nature, the extent, and the value of [the professional's] services, taking into account all relevant factors." 11 U.S.C. § 330(a)(3). Illustrative factors "includ[e] — (A) the time spent on such services; (B) the rates charged for such services; (C) whether the services were necessary * * * ; (D) whether the services were performed within a reasonable amount of time * * * ; and (E) whether the compensation is reasonable based on the customary compensation charged by comparably skilled practitioners in cases other than cases under this title." Ibid. By its terms, Section 330's list of factors is not exhaustive; courts are also required to consider other "relevant factors" in determining fees where appropriate. 11 U.S.C. § 102(3) ("including" in Title 11 is not a term of limitation).

B. Procedural Background

1. In December 1998, Commercial Financial Services, Inc., and its subsidiary CF/SPC NGU, Inc., ("the Debtors") filed voluntary petitions for chapter 11 reorganization. The U.S. Trustee appointed an Unsecured Creditors Committee and appointed

the ABS Committee to represent creditors with asset-based securities.

On January 7, 1999, the bankruptcy court issued a standing order outlining procedures and guidelines for professional fee applications. The bankruptcy court found "good cause * * * for establishing an orderly and uniform procedure for professionals seeking compensation * * * from the estate," and the order intended to "inform professionals in advance as to the categories of fees and expenses the Court generally will or will not allow to be paid * * * so that professionals may make informed decisions." App. 39.

The January 1999 order prospectively required all professionals to file interim reports and prescribed that "**[t]he rate charged for * * * service shall correspond to the expertise necessary to perform the task, rather than the ordinary rate charged by the person performing it.**" App. 40 (emphasis original). The order also declared that the United States Trustee Guidelines would be applicable. See 28 U.S.C. § 586(a)(3)(A) (requiring the United States Trustee to adopt fee guidelines); 28 C.F.R. Pt. 58 App. A. Finally, under the heading "Criteria for Evaluating Fee Applications," the order stated:

> Hourly Rates. The primary criterion used to evaluate the reasonableness of the hourly rate charged will be the amount reasonably charged by a person possessing the skill, experience and expertise **required to perform the given task.** * * * **[T]he rate charged for the**

> **service shall correspond to the expertise necessary to perform the task, rather than the ordinary rate charged by the person performing it.** * * *
>
> Locality. Professionals * * * may charge hourly rates consistent with those charged by a practitioner in the professional's geographic area possessing education, experience, expertise, and skills commensurate with the professional * * * seeking compensation.

Id. at 42 (emphasis original).

2. On February 3, 1999, the ABS Committee applied for approval under 11 U.S.C. § 1103 to employ Houlihan "as financial advisors." App. 44. The application asserted Houlihan's expertise in the field of "financial advisory services" and sought Houlihan's employment to perform "services of a financial advisor." Id. 50-51.

As required by Bankruptcy Rule 2014(a), the ABS Committee attached an affidavit from Houlihan's Managing Director, Michael A. Kramer, indicating that "[s]ubject to the Court's approval, Houlihan Lokey will charge the Debtors for its reasonable advisory services a financial advisory fee of $200,000 per month. In addition, Houlihan Lokey will reserve the right to seek, * * * subject to the approval of this Court, a [success or transaction] fee in excess of the monthly advisory fee at the conclusion of these cases." App. 65. The affidavit further represented that "[w]hen and if engaged herein, Houlihan Lokey intends to apply to the Court for allowance of compensation * * * in accordance with applicable provisions of the Bankruptcy Code." Id. at 66.

The U.S. Trustee and the Unsecured Creditors Committee objected to the ABS Committee's application, id. at 70-76, and the bankruptcy court held a hearing on March 9, 1999, id. at 265-323. During the hearing, Kramer testified that he understood that, "[s]ubject to approval of the Court, we [Houlihan] would receive a monthly payment in the amount of $200,000 per month * * * , obviously subject not only to our retention or employment in the matter, but also to final review by the Bankruptcy Court as to the relative fairness or whatever the exact standard is." Id. at 289. The bankruptcy court did not explicitly approve or mention any fee arrangement. Instead, the bankruptcy court clarified that, per the January 1999 order, Houlihan should record its time so that subsequent fee applications could be scrutinized by the court. Id. at 320.

On October 1, 1999, the bankruptcy court issued an order retroactively authorizing Houlihan's employment as a "financial advisor" from January 4, 1999, until June 30, 1999. App. 336-337. That order did not approve any fee arrangement concerning Houlihan's services, nor did the order mention a monthly rate or "success fee." Ibid.

3. On March 22, 2000, the ABS Committee applied for approval "to reemploy Houlihan as Financial Advisor." App. 339; accord id. at 338, 340, 341. The ABS Committee's March 2000

application acknowledged that Houlihan's ultimate fee award would be subject to court approval under Section 330:

> Subject to the [January 1999] Order Establishing Fee Application Procedure and Fee Guidelines for Professionals, and subject to the approval of this Court, Houlihan Lokey will charge: (i) a monthly fee of $75,000 plus expenses, * * * and (ii) a deferred transaction fee payable upon the successful conclusion of this case. Houlihan Lokey understands and agrees that the allowance and payment of the monthly fees, expenses and the deferred transaction fee are subject to the ultimate approval of this Court.

Id. at 340.

On April 4, 2000, the bankruptcy court held a hearing on the ABS Committee's application to reemploy Houlihan. App. 384-404. In describing its previous application to retain Houlihan under 11 U.S.C. § 1103(a), the ABS Committee explained that Houlihan's prior employment had been judicially approved "with the understanding, * * * notwithstanding the [$200,000 per month] terms of the engagement, that Houlihan, Lokey would have to keep time records * * * and that their ultimate compensation and reimbursement of expenses would be dependent upon the content of that application, the amount of time and the reasonableness of the expenses that were spent." Id. at 387. The ABS Committee acknowledged that Houlihan's proposed reemployment would also require Houlihan to keep time like other professionals in the case and to have its fee applications scrutinized by the court. Id. at 391. The ABS Committee did not request preapproval of any fee arrangement. Rather, the ABS Committee indicated its understanding that Houlihan would "not be paid absent the entry of an order by this Court approving the fees and expenses as reasonable." Ibid. The ABS Committee could not at that time describe particular hourly rates for Houlihan's employees, id. at 393, yet it represented to the court that, when Houlihan's service was complete, "the amount of time that is spent times an hourly rate that's charged by comparable professionals" would show "that the $75,000 fee that they're going to be asked to be paid is fair and reasonable." Id. at 394. "[T]heir fees are going to be comparable to what the other professionals are [sic] that have been employed by the Unsecured Creditor's Committee." Ibid. "We would hope that * * * [all parties] would support whatever sort of fee that Houlihan, Lokey might request at that time. All bets are off however, Your Honor. No guarantees have been made, no assurance has been made." Id. at 401.

At the hearing's conclusion, the bankruptcy court orally approved the ABS Committee's application to reemploy Houlihan. App. 403. The bankruptcy court declared that Houlihan "shall keep contemporaneous time records and documentation of expenses for which fees and reimbursement may be sought and shall comply with the [January 1999] order establishing fee application procedure[s] and fee guidelines for professionals * * * . The Court will expect that evidence as to the reasonableness of hourly rates will be presented in connection with the presentation of a fee application." Ibid.; see also id. at 404 (clarifying that Houlihan, not the court, must keep such records). On April 18, 2000, the bankruptcy court issued a written order adopting its oral ruling and approving Houlihan's reemployment as a "financial advisor." Id. at 350-351.

4. On October 18, 2001, Houlihan applied to the bankruptcy court for $1,920,967.74 in fees, covering both periods of employment.[4] For service from January 4, 1999, through June 30, 1999, Houlihan sought fees of $200,000 per month, totaling $1,174,193.55. App. 463. For service from March 22, 2000, through July 31, 2001, Houlihan sought $746,774.74 in fees based on "adjusted" monthly rates of $75,000, $50,000, and $25,000 per month. Ibid.; see also id. at 542 (detailing Houlihan's proposal). In its fee application, Houlihan argued that its proposed fees "are consistent with Houlihan Lokey's normal and customary billing practices for a case of this size and complexity and based on the services being provided during each specific retention period." Id. at 471. Houlihan also claimed that it "does not bill clients on an hourly basis for financial restructuring services." Ibid. Thus, Houlihan argued that its requested fees were "based on usual and customary rates and

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[4] Houlihan also requested $72,896.13 in expenses. That figure was later reduced to $41,026.56, and the amount of expenses is not now in dispute. Id. at 856 ("[T]he sole unresolved issue pertains to the fees sought by Houlihan Lokey."); id. at 986.

expenses charged in connection with professional services rendered for other clients on both bankruptcy and non-bankruptcy-related matters and were negotiated and agreed to at the times of each separate retention based upon the role and services to be provided during each retention period." Id. at 478.

The U.S. Trustee and Unsecured Creditors Liquidating Trust ("UCLT")[5] objected that Houlihan's fee application did not comply with the bankruptcy court's January 1999 order, and that Houlihan had not proved that its fees were reasonable under Section 330. See App. 853-854, 848-850, 869-873, 874-882, 971-979. On November 14, 2001, Houlihan supplemented and amended its fee application. Houlihan acknowledged that its application did not comply with the January 1999 order but claimed that it should be exempt from "administrative burdens" that such compliance would require. Id. at 603. Houlihan attached exhibits listing compensation paid in other bankruptcy cases to Houlihan, id. at 609, and its "competitors," id. at 611-612.

On March 26, 2002, the bankruptcy court held a hearing on Houlihan's fee request. Houlihan's Managing Director, David Hilty, was asked to compare Houlihan's activities in this case with those of financial advisory professionals retained by the

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[5] The UCLT was created upon the Debtors' liquidation, which was confirmed on September 14, 2001. App. 848. The Trust has responsibility for appearing in this case with the same status and authority as the former Unsecured Creditors Committee.

Debtors and by the Unsecured Creditor's Committee. Hilty detailed the activities of those other professionals and noted, in several respects, that Houlihan provided similar services in advising the ABS Committee. See App. 1012 ("I think in some measure the services we provided really incorporated all the services that were provided by those different professionals.").[6]

In an oral decision, the bankruptcy court ruled that "the terms and conditions of [Houlihan's] employment were not unconditionally preapproved under Section 328(a)," and that therefore "all fees and expenses * * * are subject to review under Section 330." App. 1112-1113. The bankruptcy court also held that Houlihan's fee application did not comply with, and was not exempt from, the January 1999 standing order. Thus, the court denied the fee application without prejudice and instructed that "Houlihan Lokey must * * * demonstrate by competent evidence appropriate hourly rates, as required by the guidelines." Id. at

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[6] See ibid. (noting that evaluation of the Asset-Based Trust was done both by Houlihan and by other professionals); id. at 1013 (same with respect to assessing the sale of noncore assets); id. at 1016 (same with respect to settlement negotiations and evaluating various distributions of assets); see also id. at 1367-1370 (summarizing Hilty's testimony). But cf. id. at 1013 (noting that a financial consultant retained by the Debtors was also "involved in really managing and running the company day-to-day, which is something we don't do"); id. at 1057-1058 (stating that a financial advisor retained by the Unsecured Creditors Committee provided some "different services," but was "doing a lot of * * * similar activities" to those performed by Houlihan); id. at 1098 (asserting that servicing agreement sales was "[t]he one area where I believe we were the only professional providing that").

1114. On April 12, 2002, the bankruptcy court issued a written order incorporating the terms of its oral ruling. Id. at 987.

5. On May 24, 2002, Houlihan filed a "Third Supplement" to its fee application.[7] Per the court's January 1999 order, Houlihan subdivided its employees' time entries by task category. App. 1131-1231. Also, Houlihan attached a list of thirteen cases in which other bankruptcy courts had required Houlihan to maintain time records and had allowed Houlihan to receive some level of compensation. Id. at 1233. Houlihan described its "effective hourly rates" in those cases as ranging from $262 per hour to $3271 per hour. Ibid. Those "effective hourly rates" were calculated by dividing the total amount of Houlihan's compensation – including any "success or transaction fees" – by the total number of hours.

The U.S. Trustee and UCLT objected to Houlihan's fee request, App. 1238-1242, 1244-1248, noting that Houlihan's proposed "effective hourly rate" in this case was $750.79, whereas the maximum awarded to comparable financial advisors in this case as "reasonable compensation" ranged from $350 to $410 per hour. Id. at 1239.1 & n.4; id. at 1245, 1248. On June 18, 2002, the bankruptcy court conducted a hearing and took testimony from Richard Chesley, then-general counsel for Houlihan's

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[7] Houlihan's "Second Supplement and Amendment" was filed on January 2, 2002; that document reduced Houlihan's request for expenses but did not affect its request for fees. App. 855-857.

financial restructuring group,[8] and Carmen R. Eggleston, a managing director for one of the Unsecured Creditors Committee's financial advisors. See id. at 1286-1422.

6. On January 10, 2003, the bankruptcy court awarded Houlihan $904,000 in fees. The bankruptcy court applied Section 330's standards for reasonable compensation and noted that Houlihan had the burden to prove that its proposed compensation was reasonable. Bankr. Op. 4, 10. "After considering the nature, extent, and the value of the services rendered by Houlihan Lokey" — including the five factors listed in Section 330(a)(3) — the bankruptcy court held that "the amount of compensation requested in this case has not been justified and is excessive." Id. at 11. The bankruptcy court accordingly exercised its discretion to grant fees "less than the amount of compensation that is requested." Ibid. (quoting 11 U.S.C. § 330(a)(2)).

The bankruptcy court discussed the "financial advisory services" that Houlihan provided to the ABS Committee, and the court noted that the Debtors and the Unsecured Creditors Committee also employed entities providing "financial advisory services." Bankr. Op. 5-6. The bankruptcy court held that, "[a]lthough the services rendered by Houlihan Lokey * * * were

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[8] Chesley is now an attorney for Jones Day who represents Houlihan in this appeal.

not identical to the services rendered by other financial advisors in this case, the services were substantially comparable to other services rendered." Id. at 6. The bankruptcy court rejected Houlihan's efforts to distinguish itself as the only "investment banking firm" in this case because, according to testimony adduced at the June 2002 hearing, many "financial advisory services" rendered by Houlihan "were not uniquely in the nature of 'investment banking services.'" Id. at 6 n.6.

The bankruptcy court noted that every financial advisor in this case other than Houlihan had proffered "competent evidence of customary compensation charged by comparably skilled professionals." Bankr. Op. 6. The bankruptcy court likewise concluded that, "[i]n this instance, the amount of compensation awarded to Houlihan Lokey should be based on the time expended at an appropriate hourly rate." Id. at 11. Fees in this case for individuals with experience similar to two of Houlihan's four employees ranged from $350 to $410 per hour. Id. at 7-8. Fees for professionals with experience similar to other two Houlihan employees ranged from $120 to $375 per hour. Ibid. The bankruptcy court thus determined that reasonable rates for the Houlihan employees at issue were $400, $390, $300, and $275 per hour, thereby awarding fees at "the high end of rates allowed to other financial consulting professionals in this case." Id. at 11 n.17.

The bankruptcy court also found that its $904,000 award was reasonable by reference to thirteen bankruptcy engagements where other bankruptcy courts had determined fee awards for Houlihan. Houlihan's effective compensation rate in those engagements ranged from $262 to $3271 per hour. Bankr. Op. 9. The bankruptcy court noted that many of the thirteen engagements included a "transaction or success fee" as part of Houlihan's compensation. Id. at 11. The bankruptcy court found inclusion of such "success fees" inappropriate for comparison to this case (ibid.) because, as Houlihan's counsel had conceded, "[this] engagement failed; there's no question about that." App. 1412. Excluding success fees, Houlihan's compensation in the thirteen cases ranged from $160 to $2417 per hour, with an average of $409. Bankr. Op. 9. Under the bankruptcy court's $904,000 fee award, Houlihan's effective compensation rate in this case was $353.31 per hour for 2558.6 hours of work. Id. at 10-11.

Finally, the bankruptcy court rejected Houlihan's claim that its $1,920,967.74 fee request (an average of $750.79 per hour) was reasonable because its competitors charge monthly fees. The bankruptcy court noted that none of Houlihan's evidence demonstrated "customary compensation * * * in cases other than cases under this title," 11 U.S.C. § 330(a)(3)(E), because all of the proffered cases concerning Houlihan's competitors arose in the context of bankruptcy proceedings. App. 1279. Furthermore, the bankruptcy court held that Houlihan "failed to establish that the services rendered in [its competitors'] matters were comparable to the services [Houlihan] rendered in this case." Ibid.

7. On January 21, 2003, Houlihan appealed. On September 3, 2003, the BAP affirmed. The BAP found no dispute that Section 330 governs this case, because the bankruptcy court did not preapprove Houlihan's fee agreements under Section 328. BAP Op. 18, 24. The BAP noted that appellate review of fee determinations under Section 330 requires "considerable deference," because "[t]he bankruptcy judge is on the front line, in the best position to gauge the ongoing interplay of factors and to make the delicate judgment calls which such a decision entails." Id. at 20 (internal quotation marks omitted). The BAP recognized that, although Section 330(a)(3) "includes a nonexclusive list of factors that a court may (or may not) consider," "the factors to be taken into account in determining reasonableness are within the discretion of the bankruptcy court, which is best positioned to determine what is 'relevant' in any given case." Id. at 21.

The BAP endorsed the bankruptcy court's analysis in this case, which "expressly considered, as it [was] compelled to do under 330(a)(3), the nature, extent and value of Houlihan's services." BAP Op. 22. The BAP held that the bankruptcy court's application of legal principle, and its decision to approve only $904,000 of Houlihan's fee request, did not constitute an abuse of discretion. Ibid. The BAP explained that the bankruptcy court, "acting well within its discretion," calculated an hourly rate for each Houlihan professional. Id. at 23. Those hourly rates were "appropriately influenced" by the hourly rates of other professionals with education, experience, and skill levels similar to those of Houlihan's professionals in this case. Ibid. The bankruptcy court's hourly rates were "set at the highest or higher end of approved hourly rates in the case," and the BAP held that such rates, like the rates of comparable professionals, adequately compensated Houlihan for its beneficial service to the estate. Ibid. Although Houlihan claimed that the bankruptcy court's award was too low to ensure quality professional services, the BAP noted the absence of "any evidence to support" that factual allegation. Id. at 26.

The BAP also rejected Houlihan's argument that a judicial award of $1,920,967.74 in fees was compelled by its contract with the ABS Committee for monthly charges. Under Section 330, the BAP held that the bankruptcy court "was not bound by the ABS Committee's retention agreements," because bankruptcy courts have an "independent duty" to evaluate whether proposed fees constitute "reasonable compensation." BAP Op. 24. The BAP found that "Houlihan's demand [to] be compensated on a monthly basis does not govern the bankruptcy court." Id. at 25. To contract for a fixed fee "is by no means a guarantee that the fees will be awarded in that fashion." Ibid. (internal quotation marks omitted). Similarly, the BAP found that Houlihan's assertion that monthly fees are a common practice in the marketplace "may be a relevant factor in determining * * * reasonableness, but it does not preclude the bankruptcy court from independently * * * taking into account factors that it determines, in its discretion, to be relevant." Ibid.

The BAP denied that the bankruptcy court's award of $904,000 was "unfair" to Houlihan. Based on an "exhaustive review of the record," the BAP concluded that, inter alia, the bankruptcy court's January 1999 Order, the court's questions and comments at the March 1999 hearing, the April 2000 bench ruling, and the April 2000 written order "all put Houlihan on sufficient notice that although its approved engagement by the ABS Committee was based on a monthly fee, the court would evaluate the reasonableness of that fee when a fee application was filed," and also informed Houlihan "that a reasonableness inquiry would take into account the time Houlihan spent on the Debtors' cases as reflected in required time records." BAP Op. 27. The BAP found repeated indications in the record demonstrating that the ABS Committee, Houlihan's managers, the parties' attorneys, and the bankruptcy court understood that Houlihan's proposed fee would be judicially reviewed under Section 330 to determine whether the hours spent, and the effective rate of payment for those hours, was reasonable. Id. at 27-29.

SUMMARY OF ARGUMENT

In prescribing "reasonable compensation" under Section 330, the bankruptcy court did not abuse its discretion by awarding Houlihan $904,000 in fees. Bankruptcy courts have broad authority under Section 330 to prescribe reasonable levels of professional compensation. Here, the bankruptcy court's award to Houlihan matched the compensation granted to financial professionals who did similar work in this case. That award reasonably compensated Houlihan and did not overcharge the Debtors' estate.

The bankruptcy court did not err in calculating Houlihan's compensation using an "effective hourly rate." The number of hours spent on a task is often vital to determining a reasonable level of compensation. Although Houlihan claims that it often contracts with clients for fixed monthly fees, the bankruptcy court's appointment orders under Section 1103(a) in this case did not approve such contractual terms of employment under Section 328. On the contrary, the bankruptcy court's standing order and subsequent rulings made clear that Houlihan's fee applications would be reviewed for reasonableness under Section 330(a) after services were complete. Thus, as in many bankruptcy cases, the court was required to evaluate whether the amount of Houlihan's proposed fees were objectively reasonable given the totality of case-specific circumstances. In conducting that reasonableness evaluation, the bankruptcy court relied on Houlihan's hours as a "relevant factor" in determining Houlihan's fee and in comparing Houlihan's fees to those of other professionals. The bankruptcy court awarded reasonable compensation that, in its view, adequately compensated Houlihan for its services without overcharging the estate. That decision was both reasonable and permissible.

Despite Houlihan's claim that its services were not comparable to those of other professionals in this case, the bankruptcy court's ruling is amply supported by the record and is not clearly erroneous. Houlihan also argues that the bankruptcy court's award impermissibly deviated from the "market rate" for Houlihan's services. Section 330, however, allows bankruptcy courts to determine and award only "reasonable compensation," not "average market rates." Section 330(a)(3) requires courts to consider all "relevant factors" in awarding fees, including the "value" of the professional services to the estate. Moreover, as an evidentiary matter, Houlihan's proof of "market rates" is flawed because it describes only judicial fee awards in bankruptcy cases with potentially different facts. The bankruptcy court in this case determined Houlihan's fee based on a detailed comparison of Houlihan's activities and compensation to those of comparably skilled and experienced practitioners. That ruling was not an abuse of discretion.

STANDARD OF REVIEW

In an appeal from BAP decisions, this Court independently reviews the bankruptcy court's judgment. In re Lampe, 331 F.3d 750, 753 (10th Cir. 2003). A bankruptcy court's ultimate award of fees is reviewed for abuse of discretion. In re Anderson, 936 F.2d 199, 203 (10th Cir. 1991). In scrutinizing the factual and discretionary determinations "involved in calculating * * * fee awards," the Court gives "considerable deference to the bankruptcy court. Historically, bankruptcy courts have been accorded wide discretion * * * in regard to the terms and conditions of the engagement of professionals." In re Miniscribe Corp., 309 F.3d 1234, 1244 (10th Cir. 2002) (internal quotation marks omitted). "The bankruptcy judge is on the front line, in the best position to gauge the ongoing interplay of factors and to make the delicate judgment calls which such a decision entails." Ibid.

ARGUMENT

I. Bankruptcy Courts Have Substantial Discretion In Calculating Reasonable Professional Fees Under Section 330

The Bankruptcy Code requires bankruptcy courts to serve as gatekeepers that supervise professional employment and thereby protect estate assets and the bankruptcy system's integrity.

Under 11 U.S.C. § 1103, a creditors committee may only hire bankruptcy professionals "with the court's approval." Professionals thus employed may be paid only if, and insofar as, such payment is legally "reasonable" after consideration of all "relevant factors," including the "value" of professional services to the estate. 11 U.S.C. §§ 328, 330.

The Bankruptcy Code provides two mechanisms for compensating professionals. Section 328, which is not relevant to this appeal,[9] allows bankruptcy courts to preapprove specific, reasonable terms of employment, which may include employment "on a retainer," such as a monthly fee, "on an hourly basis, or on a contingent fee basis." 11 U.S.C. § 328. When, as here, the bankruptcy court does not preapprove specific terms of employment, Section 330 allows bankruptcy courts to determine and award only "reasonable compensation for actual, necessary services" after professional employment is complete. 11 U.S.C. § 330. To protect the estate from overbilling, Section 330 provides that "[i]n determining the amount of reasonable compensation to be awarded, the court shall consider the nature, the extent, and the <u>value</u> of such services, taking into account <u>all relevant factors</u>." <u>Ibid.</u> (emphasis added).

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[9] Appellant's brief does not cite, much less rely on, Section 328 as a basis for its fee request. <u>See</u> Appellant's Br. 26 (conceding the bankruptcy court's determination that this case is "governed by Section 330," not Section 328); <u>cf.</u> BAP Op. 18. ("It is uncontested that this case is governed by § 330.").

Section 330 provides an illustrative list of relevant factors, "including – (A) the time spent on such services; (B) the rates charged for such services; (C) whether the services were * * * beneficial at the time at which the services were rendered toward the completion of a case under this title; (D) whether the services were performed within a reasonable amount of time * * * ; and (E) whether the compensation is reasonable based on the customary compensation charged by comparably skilled practitioners in cases other than cases under this title." 11 U.S.C. § 330(a)(3). The word "including" clarifies that bankruptcy courts' analysis of reasonable fees may, indeed must, consider factors other than those enumerated where they are "relevant." See 11 U.S.C. § 102 ("In this title * * * 'includes' and 'including' are not limiting.").

As the BAP held (Op. 21), bankruptcy courts not only determine the weight of particular factors under Section 330; decisions about the factors to "be taken into account in determining reasonableness are [also] within the discretion of the bankruptcy court, which is best positioned to determine what is 'relevant' in any given case." Ibid. Through its approach to determining "reasonable fees," Section 330 balances the need for reasonable professional compensation against the risk that estate assets could be abused by private agreements that, although consensual between the parties, are not reasonable given the totality of circumstances, including the services' value to the estate.[10] Section 330's requirements regarding reasonable compensation are particularly important in the context of creditors committees because any professional fees are paid by the bankruptcy estate, not the committee members. 11 U.S.C. § 503(b)(3); cf. In re Thermadyne Holdings Corp., 283 283 B.R. 749 (8th Cir. BAP 2002).

II. The Bankruptcy Court Did Not Abuse Its Discretion In Determining Houlihan's Effective Hourly Rate

Under the Bankruptcy Code, applicants for professional fees have long borne the evidentiary burden of proving that their requested fees are reasonable. See, e.g., Zolfo, Cooper & Co. v. Sunbeam-Oster Co., 50 F.3d 253, 261 (3d Cir. 1995); In re Kenneth Leventhal & Co., 19 F.3d 1174, 1177 (7th Cir. 1994). In this case, the bankruptcy court found that Houlihan carried that

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[10] Houlihan misunderstands Section 330 in its claim (Br. 7, 10, 25, 33-36) that the bankruptcy court "approved" Houlihan's fee agreement in October 1999 and April 2000, when the bankruptcy court authorized Houlihan's retention under 11 U.S.C. § 1103. In a case governed by Section 330, scrutiny and "approval" of fees necessarily occurs after "actual, necessary services" have been "rendered." 11 U.S.C. § 330(a)(1)(A). The bankruptcy court thus considered the reasonableness of Houlihan's proposed fees under Section 330 for the first time when Houlihan filed its fee application in October 2001. See BAP Op. 26-28; Bankr. Op. 4; App. 1110-1113.

Furthermore, as the BAP noted, many factors – including the bankruptcy court's January 1999 standing order, the bankruptcy court's retention orders and statements on the record, and representations to the court by the ABS Committee and Houlihan employees – indicated that, in this case, Houlihan's fees would be evaluated and determined under Section 330 after its services were complete. BAP. Op. 27-28.

burden only with respect to $904,000 of its requested fees. The bankruptcy court evaluated the time and expertise required to perform Houlihan's financial advisory services, and the court prescribed a rate of compensation that both represented the fair value of Houlihan's services and was reasonable compared to other professionals who performed substantially similar work. The bankruptcy court's approach was not an abuse of discretion, and its underlying factual findings were not clearly erroneous.

A. The Bankruptcy Court's Determination That Houlihan's Services In This Case Were Substantially Comparable To Services Of Other Financial Professionals Was Not Clear Error

Throughout its employment in this case, Houlihan was authorized to act as a "financial advisor" to the ABS Committee.[11] Similarly, the bankruptcy court authorized employment of other financial advisors and financial professionals by the Unsecured Creditors Committee and the Debtors. The Unsecured Creditors Committee hired Policiano & Manzo, L.L.C., and InteCap, Inc. (formerly Technology & Dispute Resolution Consulting, Inc.) as "financial advisors," and Asset Backed Solutions, L.L.C., as a "Securitization Consulting Expert." App. 442, 587, 684, 712, 732. The Debtors retained

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[11] App. 44, 50-51 (Feb. 1999 Application for Employment); id. at 336-337 (June 1999 Order); id. at 338-341 (Mar. 2000 Application for Employment); id. at 350-351 (Apr. 2000 Order).

Development Specialists, Inc. ("DSI"), as a "financial consultant." Id. at 615.

The bankruptcy court held, in the face of conflicting evidence, that "[a]lthough the services rendered by Houlihan Lokey * * * were not identical to the services rendered by other financial advisors in this case, the services were substantially comparable to other services rendered." Bankr. Op. 6. That conclusion was not clearly erroneous. On the contrary, the bankruptcy court heard testimony and considered numerous documents regarding professionals' activities in this case, including evidence in applications for professional employment[12] and requests for fees.[13]

Most importantly, the bankruptcy court heard testimony directly comparing Houlihan's services in this case to those of other financial advisors and professionals. During the March 2002 hearing, Houlihan's Managing Director, David Hilty,

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[12] E.g., App. 44-67 (Houlihan Application for Employment); id. at 338-346 (Houlihan Application for Employment); id. at 712-730, 736-743, 747-758, 763-772, 781-792, 804-814 (InteCap/TDRC Applications for Employment); id. at 797-802 (Asset Backed Solutions Application for Employment),

[13] E.g., App. 440-462 (Policiano Compensation Request); id. at 463-514 (Houlihan Compensation Request); id. at 587-600 (Asset Backed Solutions Compensation Request); id. at 601-614 (Houlihan Supplemental Compensation Request); id. at 615-683 (DSI Compensation Request); id. at 684-710, 819-847 (InteCap Compensation Request); id. at 855-858 (Houlihan Supplemental Compensation Request); id. at 1117-1233 (Houlihan Supplemental Compensation Request).

testified that "in some measure really the services we provided really incorporated all the services that were provided by those different professionals. For example, * * * [Policiano Manzo] was monitoring the debtor's financial performance and evaluating its financial performance. That was an activity we did." App. 1012. Hilty also explained that "other professionals retained by the [Unsecured Creditors Committee] were then looking at the Asset-Based Trust, * * * looking at the value of the securities * * * [and] at potential claims * * * from those trusts. That was something we did at the beginning of the case as well as all through the case." Ibid. Despite Hilty's testimony that "DSI was involved in * * * running the company day-to-day which is something we don't do," Hilty also stated that DSI "looked at selling various noncore assets of the estate * * * [which] was really the same process we were looking at as part of the debtor's overall sale process for the servicing trust." Id. at 1013. Hilty acknowledged that DSI was "looking at trying to bring the – Asset-Backed Committee and the Unsecured Committee together * * * in trying to reach a settlement. We were attempting to do the same thing, but representing our client, the Asset-Based Holders." Id. at 1016.

Hilty explained that professionals representing various economic constituencies in this case worked with one another in "going through the different scenarios and the different analyses, * * * negotiating the different pieces of the settlement proposal, and actually structuring the proposal," especially concerning "how [assets] would be distributed between the trusts and things of that nature." Ibid. Houlihan's efforts concerning servicing agreements required "really the same process" performed by DSI in selling noncore assets (id. at 1013), but Hilty also suggested that marketing servicing agreements was "[t]he one area where I believe we were the only professional providing that," id. at 1098 (emphasis added); cf. id. at 1059-1060, 1081-1082. Hilty conceded that no evidence showed how much of Houlihan's time was spent on that allegedly "unique" service. Id. at 1060.

During the June 2002 hearing, Richard Chesley, then-general counsel for Houlihan's financial restructuring group,[14] testified that, although he did not think other professionals in this case typically compete with Houlihan, he had no significant knowledge "as to what [such professionals] did in this case" aside from the contents of relevant fee applications. App. 1359. When the bankruptcy court observed that Chesley's attempts to distinguish the work performed by Houlihan were "directly inconsistent" with Hilty's account of similarities between Houlihan's services and those of other professionals, id. at 1367-1370, Chesley admitted

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[14] Chesley now works as an attorney for Jones Day and is representing Houlihan in this appeal.

that other financial professionals provided "bits and pieces of services that Houlihan provided all of," and that "if we were to look at the total compensation of all four of those professionals, that might be one away to evaluate [reasonable fees]." Id. at 1371. The bankruptcy court ultimately used such a comparison between Houlihan's and other professionals' work to calculate Houlihan's $904,000 fee award. Bankr. Op. 6-11.

Carmen R. Eggleston, a managing director for InteCap, testified on behalf of the Unsecured Creditors Committee that there was no substantial difference between Houlihan's services in this case and those provided by Policiano, Asset-Backed Solutions, and DSI. App. 1381. Even as to the servicing agreements, Eggleston testified that Houlihan's time sheets revealed that no substantial or overwhelming amount of time was spent on such activities. Id. at 1382. Eggleston explained that "[i]t was all in the role of a financial advisor. * * * The types of analysis that were performed by the various professionals were very similar. Houlihan Lokey had a greater number of constituents * * * but the underlying analyses were substantially the same." Id. at 1381-1382.

Houlihan argues (Br. 43) that the bankruptcy court's comparison of Houlihan to other financial professionals erroneously compared "apples to oranges." But Houlihan overlooks the specific and substantial evidence that supports the bankruptcy court's conclusion. Compare supra pages 27-30, with Appellant's Br. 45 ("[T]here was no evidence presented that the four firms * * * provided substantially comparable services."). Although Houlihan claims that its services in this case were "unique" and "not comparable" to those of other professionals, e.g., Appellant's Br. 2, 4, 21-22, 25, 37, 39, such assertions are inadequate given the bankruptcy court's contrary factual determination.

It is untrue that the bankruptcy court "ignored" the services provided by Houlihan Lokey. E.g., Appellant's Br. 22, 37, 49. The bankruptcy court described Houlihan's activities in detail, Bankr. Op. 5, and held that they were similar in kind to other financial professionals' services, which the bankruptcy court held were of comparable value to the progress of this case. The bankruptcy court rejected Houlihan's claim that it merited different treatment as the "only investment banking firm in this case." Bankr. Op. 6 n.6; cf. Appellant's Br. 50. As Eggleston's testimony showed, Houlihan's services in this case "were not uniquely in the nature of 'investment banking services,'" but rather were "financial advisory services" that were substantially similar to other financial professionals' services. Bankr. Op. 6 n.6; see App. 1379-1383. Indeed, throughout this case, Houlihan has been viewed as providing to the ABS Committee "financial advisory services," rather than any unique form of "investment banking services." See App. 44, 50-51, 336-341, 350-351, 386-387, 468, 473, 476, 601, 602, 1119, 1128; Bankr. Op. 5-6. Houlihan's self-characterization (Br. 50) as the "lone investment banking/financial advisory firm during the totality of these cases" lacks support in light of the bankruptcy court's contrary finding. The bankruptcy court properly determined Houlihan's fees based on its specific activities in this case, not based on general characterizations of its business elsewhere.

All of the financial professionals in this case, including Houlihan, were undeniably "highly competent and qualified" (Appellant's Br. 46-47), and Houlihan admits that DSI in particular "was heavily involved in a number of critical * * * matters" (ibid.), as were other financial professionals. Nonetheless, Houlihan seeks to distinguish its work from that of other professionals by stressing minor details, such the length of other professionals' retention (id. at 48-49), and by overbroad characterizations of professionals' work in other cases (id. at 47). Such arguments cannot unseat the bankruptcy court's specific and supported factual determination that Houlihan's services in this case "were not identical to the services rendered by other financial advisors in this case, [but] were substantially comparable to other services rendered." Bankr. Op. 6.

B. The Bankruptcy Court's Comparison Of Houlihan Employees To Individuals With Similar Experience And Credentials Was Not Clear Error

The bankruptcy court compared the experience and credentials of the four Houlihan employees in this case to financial professionals employed by other entities in this case. The two relatively senior Houlihan employees were college graduates with between eight and ten years of experience. Bankr. Op. 7 & n.10. The bankruptcy court found those employees comparable to four high-level individuals who worked for other financial firms. The non-Houlihan individuals had twenty-five years of experience, twenty-three years of experience, seventeen years of experience, and eight years of experience, and they received "reasonable compensation" under Section 330 at hourly rates of $405, $360, $410, and $350. Id. at 8. One of Houlihan's more junior employees held a masters degree in business with six years of experience, while the other was a college graduate with three years of experience. Ibid. The bankruptcy court held that financial professionals with comparable experience and skills received "reasonable compensation" in this case at rates between $120 and $375 per hour. Ibid.

Houlihan does not directly dispute the above findings. Instead, Houlihan claims that the bankruptcy court's analysis "was factually irrelevant and legally unsound" because it "ignored the * * * determination of the actual services that the individuals and their firms provide." Appellant's Br. 49. On the contrary, the bankruptcy court's analysis of Houlihan's individual employees is based on its determination that Houlihan performed services comparable to those of other financial professionals in this case. Notably, although Houlihan's "Third Supplement" included time sheets for its four employees, App. 1131-1231, Houlihan introduced no specific testimony or evidence to distinguish its individual employees' activities from the services of equally credentialed individuals who advised the Debtors and the Unsecured Creditors Committee. Most importantly, Houlihan has not shown any clear error in the bankruptcy court's judgment that Houlihan and non-Houlihan employees were comparably skilled and credentialed, or in the bankruptcy court's holding that they performed substantively comparable services on behalf of different economic constituencies in this case.

C. The Bankruptcy Court's Use Of Hourly Rates To Compare Houlihan and Non-Houlihan Employees Was Not An Abuse of Discretion

1. Houlihan offers two reasons that the bankruptcy court's use of hourly data was erroneous as a "matter of law." Appellant's Br. 24, 33. First, Houlihan suggests that the bankruptcy court erred in holding that reasonable fees under Section 330 must be calculated using hourly rates. Appellant's Br. 27. As the BAP explained, the bankruptcy court held no such thing. "An hourly analysis was not mandated by the bankruptcy

court." BAP Op. 24 (emphasis added). Rather, "acting well within its discretion," the bankruptcy court chose to calculate Houlihan's effective hourly rates as an important factor in "evaluat[ing] whether the requested monthly fee-based compensation was reasonable" and in "determin[ing] a lesser, reasonable compensation as permitted under § 330(a)(2)." Id. at 23-24.

The bankruptcy court's decision to calculate an "effective hourly rate" by dividing Houlihan's total requested fees by its total hours of work was not an abuse of discretion. This Court routinely relies on hourly rates as a measure of appropriate professional fees. See, e.g., In re Miniscribe Corp., 309 F.3d 1234, 1243-1244 (10th Cir. 2002). Under Section 330, bankruptcy courts are required to consider the "extent" of a professional's service, including the "time spent on such services." 11 U.S.C. § 330(a)(3). Similarly, courts must determine the "value" of such services, ibid., which is often determined by reference to a reasonable hourly rate. Indeed, to ignore a professional's hours in fee determinations would seriously weaken judicial oversight and would risk imposing unreasonable fee awards upon the estate. As Hilty testified, Houlihan would have charged the same monthly fee if it "had worked twice as many hours." App. 1028. Less scrupulous professionals might have sought the same monthly fee if they had worked half as many hours, or no hours at all. In cases governed by Section 330, bankruptcy courts have an "independent duty" (BAP Op. 24) to scrutinize proposed professional compensation, and hourly data can be critical to executing that responsibility. Proper analysis of "reasonable compensation" and "value" under Section 330 may often require the comparison of a professional's total fee to its total hours of work, and the bankruptcy court did not abuse its discretion by making that comparison here.

The bankruptcy court also determined effective hourly rates in order to compare Houlihan's compensation to that of other professionals, who were paid on an hourly basis. Houlihan's argument seems to imply that bankruptcy courts cannot compare two professionals' compensation unless they happen to bill in similar formats. That mistaken claim is unsupported by the statutory text. As the BAP held, a "demand [to] be compensated on a monthly basis does not govern the bankruptcy court," and to contract for a fixed fee "is by no means a guarantee that the fees will be awarded in that fashion." BAP Op. 24 (internal quotation marks omitted). Bankruptcy courts have ample discretion to demand hourly information, and to calculate effective hourly rates, where doing so is useful to compare different professionals' compensation and thereby determine reasonable fees.

Houlihan is correct that Section 330 allows bankruptcy courts to employ "flexible approaches to professional compensation." Appellant's Br. 24. That flexibility works against Houlihan here, however, because it confirms that bankruptcy courts have broad discretion and must exercise their own judgment in determining fees under Section 330. In a proper case, a bankruptcy court might choose not to use hourly rates, cf. id. at 27 (collecting bankruptcy court decisions), and Section 330 would be satisfied if the resultant compensation were reasonable. Yet Houlihan offers no statutory or appellate authority to support its stronger claim (Br. 37) that the bankruptcy court was forbidden from acting as it did in this case, i.e., using hourly rates as a significant and relevant factor to determine Houlihan's reasonable professional fees under Section 330. Given bankruptcy courts' significant flexibility to supervise bankruptcy professionals and their fees, the bankruptcy court's use of hourly data in this case was not an abuse of discretion.

2. Houlihan also claims that the bankruptcy court erred as matter of law because its $904,000 award did not represent the "market rate" that Houlihan and its competitors receive in other bankruptcy engagements. As a preliminary matter, Houlihan misreads Section 330 by assigning undue importance to "market rates." Section 330 prescribes that courts may award only

"reasonable compensation" and that courts "shall consider the nature, the extent, and the value of such services, taking into account all relevant factors." 11 U.S.C. § 330(a)(1)(A), (3)(A) (emphasis added). All of those requirements remain applicable even where a totality of "relevant factors" yields compensation different from alleged "market prices." Thus, Houlihan misapplies Section 330(a)(3) by giving supremacy to subsection (E), even though it is, by its statutory terms, only one of a non-exhaustive set of factors warranting judicial consideration in determining reasonable compensation in a particular case.

a. Houlihan is correct that one relevant factor under Section 330 is "the customary compensation charged by comparably skilled practitioners in cases other than cases under this title." 11 U.S.C. § 330(a)(3)(E). But there is no indication in Section 330 or its legislative history that that enumerated factor should trump other factors, from Section 330's non-exhaustive list or otherwise, that the bankruptcy court deems "relevant." Nor is Houlihan correct to imply that professionals are entitled to their contractual fees even if those fees are deemed unreasonable and do not represent fair value in a particular case. Insofar as Congress enacted Section 330 to sustain quality professional services, it is important that Congress chose "reasonable compensation" – not "market rate" – as striking the appropriate balance, with proper attention to the services' "value" to the estate. In this case, for example, Houlihan "did not produce any evidence" that the bankruptcy court's $904,000 fee award was too low to procure high-quality professional representation. BAP Op. 26. On the contrary, Houlihan "has * * * [failed] to refute the bankruptcy court's finding" that similarly skilled financial advisors were available in this case to serve at that rate. Ibid.

In any event, Section 330(a)(3)(E) does not support Houlihan's argument here because Houlihan has proffered no evidence of "customary compensation charged by comparably skilled practitioners in cases other than cases under this title." 11 U.S.C. § 330(a)(3)(E) (emphasis added). At most, Houlihan has introduced proof of its competitors' charges in other bankruptcy cases. See App. 609 (listing bankruptcy engagements involving other entities). As the BAP explained, Houlihan "introduced no evidence" of comparably skilled practitioners' "nonbankruptcy professional compensation, [whether] hourly rate or otherwise." BAP Op. 26. Because Houlihan admits that none of its evidence concerns other entities' performance outside the bankruptcy context, Appellant's Br. 42 n.5, the bankruptcy court was correct that Section 330(a)(3)(E) by its terms has no relevance to this case, Bankr. Op. 11.

Even insofar as "market rates" are relevant under Section 330, judicial fee awards in other bankruptcy cases do not necessarily reveal true "market" rates. And Section 330 does not require a bankruptcy court to award fees that seem unduly high or low just because other courts have made similar fee awards in potentially dissimilar factual circumstances. Each bankruptcy court under Section 330 has an independent duty to consider "all relevant factors," 11 U.S.C. § 330(a), including not only awards to professionals in comparable cases (if such there be), but also awards to comparable professionals in the case at hand and the services' "value" to the estate. That is the approach the bankruptcy court followed here.

The bankruptcy court found Section 330(a)(3)(E) irrelevant on the facts of this case because Houlihan "failed to establish that the services rendered" by its competitors in other bankruptcy cases "were comparable to the services [Houlihan] rendered in this case." Bankr. Op. 11; see App. 609. Although Houlihan refers (Br. 24-25) to allegedly "undisputed evidence" of its competitors' "similar restructuring engagements" (emphasis added), that characterization lacks support given the bankruptcy court's factual finding, which is not clearly erroneous. Houlihan's list of its competitors' engagements (App. 609) does not demonstrate whether any of those cases was factually similar to this case, involved comparable professional services, or required a similar dedication of personnel or hours. Id. at 1084-1085 (no reliable evidence of competitors' services); id. at 1316, 1347, 1392 (no reliable evidence of competitors' hours). Without those details, mere evidence that other entities have used a monthly fee structure does not prove that the fee amounts in those cases should determine Houlihan's reasonable fee here, nor does it indicate the value of Houlihan's services to the estate.[15]

Houlihan claims that its list of competitors' bankruptcy engagements (App. 609) should nonetheless be credited under Section 330(a)(3)(A) because "non-bankruptcy evidence on effective hourly rates does not exist." Appellant's Br. 42 n.5, That response is incomplete. Regardless of competitors' hourly rates, Houlihan has not offered, and cannot explain the lack of, evidence even of competitors' non-hourly compensation in comparable non-bankruptcy cases. Moreover, Houlihan does not explain whether bankruptcy courts have required its competitors to keep comprehensive time records, as Houlihan has done in at least thirteen cases. See App. 1233. In the bankruptcy court,

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[15] Another factor that differentiates the proffered engagements involving Houlihan's competitors is that some, if not all, of those fee awards involved terms of employment that were specifically preapproved by the bankruptcy court, often with explicit reference to Section 328. See, e.g., App. 4570-4571, 4645-4646, 4740, 4902. As discussed supra, this case involves the approval of fees under Section 330 after professional services are complete, and that requires a significantly different analysis of final fee applications.

it was Houlihan's burden to demonstrate its requested fees' reasonableness, and the BAP was correct that "Houlihan failed to * * * [produce] evidence of 'comparable compensation' of nonbankruptcy investment bankers." BAP Op. 26. Whatever explanation might be proffered, Houlihan "cannot fault the bankruptcy court for failing to consider what it did not have before it." Ibid. Houlihan's efforts to reverse the bankruptcy court's evaluation of the record, which rests on analysis of all available evidence and is not clearly erroneous, must fail.

b. Houlihan is also mistaken that the bankruptcy court was legally required to grant its $1.9 million fee request simply to match Houlihan's compensation in other bankruptcy cases. As with the argument concerning competitors' data, Houlihan has not established that any of its own prior bankruptcy engagements was substantively similar to this case. Nor has Houlihan offered evidence concerning Houlihan's charges in non-bankruptcy cases where fees are not judicially prescribed, as would be necessary to demonstrate true "market prices." If anything, Houlihan's fee awards in prior bankruptcy cases primarily demonstrate the broad range of fees that a bankruptcy court may permissibly award in any given case.

Based on testimony from Eggleston (App. 1387, 1390-1391), the bankruptcy court here determined that Houlihan's fee should not be compared to compensation in cases that include "success fees" because the reorganization here resulted in liquidation, not "success." Bankr. Op. 9, 11. That judgment was not an abuse of discretion. Houlihan claims that the bankruptcy court was required to include its success fees because "it is this 'package' of compensation that ordinarily defines Houlihan Lokey's compensation." Appellant's Br. 41 n.4. That argument misses the point. The bankruptcy court held that cases that include a "success fee" were not valid bases for comparison here, because this case involved no "success" that would merit that form of compensation. The bankruptcy court thus determined that appropriate "reasonable compensation" might differ substantially depending on whether the reorganization results in success or liquidation. That judgment regarding the proper frame of comparison lies within the bankruptcy court's discretion to evaluate fees under Section 330.

Excluding success fees from Houlihan's thirteen other bankruptcy cases yields effective hourly rates from $160 to $2417. Bankr. Op. 9. That data confirms the breadth of bankruptcy court discretion to award different levels of "reasonable compensation." It also confirms that the award in this case – whose effective hourly rate was $353.31 – falls well within the range of reasonable fees awarded to Houlihan in other cases.[16]

Houlihan seems to assume that any fee award that is less than its "average" is, by that fact alone, potentially unreasonable as a matter of law. That is incorrect. Under Section 330, bankruptcy professionals are entitled to an award of "reasonable compensation," based on a totality of "relevant factors," regardless of whether the resultant figure is greater or lesser than an aggregate "average" amount of past fee awards. The bankruptcy court correctly stated in its January 1999 order that "the rate charged for [professional] services shall correspond to the expertise necessary to perform the task, rather than the ordinary rate charged by the person performing it." App. 42. In awarding Houlihan a $904,000 fee, the bankruptcy court properly evaluated the skill and expertise of Houlihan's employees and awarded a reasonable level of compensation relative to that of comparable professionals in the case. The bankruptcy court's observation that the $904,000 fee was "consistent with," though not identical to, "the average hourly rate paid to Houlihan Lokey in bankruptcy engagements in which no transaction fee was paid" only corroborates the reasonableness of that fee.

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[16] Indeed, the bankruptcy court's award is reasonable even under Houlihan's analysis of reasonable fees – ranging from $262 to $3271 per hour – which improperly inflates past awards by including "success fees." Appellant's Br. 41.

Bankr. Op. 11. The fact that the bankruptcy court's award differs from Houlihan's average effective hourly rate in other cases in no way renders that award an abuse of discretion.

D. The Bankruptcy Court's Award Of $904,000 Does Not Violate Any Provision Of The Bankruptcy Code

Houlihan claims that the bankruptcy court's decision not to grant its full $1.9 million fee request "violates all notions of fundamental fairness and equity that underlie the Bankruptcy Code." Appellant's Br. 33. Houlihan did not raise that argument before the bankruptcy court. Cf. March v. IRS, 335 F.3d 1186, 1189 (10th Cir. 2003) (finding an argument waived because it was not presented to the bankruptcy court). Moreover, Houlihan cites no statutory or judicial authority for reversing an otherwise proper award under Section 330, based solely on a litigant's contested claim of "unfairness." Such unstructured "second-guessing" seems contrary to the typically deferential appellate review applied in this context. In re Miniscribe Corp., 309 F.3d at 1244.

In any event, the BAP considered Houlihan's argument and correctly found it "wholly unsupported." BAP Op. 26. Houlihan claims that the Bankruptcy Code required that its $1.9 million fee request be granted because: (i) Houlihan requested that amount, (ii) the bankruptcy court approved such fees when it initially authorized Houlihan's employment, and (iii) the parties expected payments of that amount.

First, with respect to Houlihan's request, bankruptcy professionals compensated under Section 330 are entitled only to fees that the bankruptcy court deems "reasonable," after considering all "relevant factors" such as the services' value. The amount that a professional requests is not, without more, relevant to that inquiry. Also irrelevant is whether the parties contracted for the proposed fee. BAP Op. 24 (collecting cases). The Bankruptcy Code does not allow parties, merely by contracting for professional services, to override bankruptcy courts' federal statutory responsibility for appointing professionals under 11 U.S.C. § 1103, and, under Section 330, determining the "value" of professional services and the amount of compensation that would be "reasonable." Without court approval, a creditors committee cannot even employ a bankruptcy professional, and contractual terms that are not approved under Section 328 cannot bind a bankruptcy court to award an unreasonable and unfair fee. The Code cannot countenance any suggestion that private parties can "agree" to contractual terms, and thereby bind the court to award fees that it deems unfair or unreasonable. Especially because bankruptcy professionals under Section 330 are paid from assets of the estate, 11 U.S.C. § 503(b)(3), bankruptcy courts have a critical "independent duty" (BAP Op. 24) to ensure that such fees are reasonable based on a totality of circumstances.

Second, Houlihan is incorrect that the bankruptcy court's decision to authorize Houlihan's employment "approved" the amount of Houlihan's fees. In a case such as this one, which is governed by Section 330, scrutiny and "approval" of fees necessarily occurs after the "actual, necessary services" have been "rendered." 11 U.S.C. § 330(a)(1)(A); see supra note 10. That requirement remains effective even though many professionals, like Houlihan, seek approval for their employment, under 11 U.S.C. § 1103, long before fees are ever considered. Neither of the bankruptcy court's orders authorizing Houlihan's employment in this case provided any indication that the monthly fee was "approved." See App. 336-337, 350-352. Indeed, the April 2000 order explicitly provided that Houlihan "must keep contemporaneous records of the time spent on this engagement" and that Houlihan's "entitlement to the allowance of fees" would be subsequently evaluated pursuant to the court's January 1999 order. Id. at 351. This case exemplifies the ordinary distinction, under Section, 330 between initial decisions to authorize employment and subsequent decisions to determine fees. That distinction is neither unfair nor inequitable under the Code.

Third, the BAP correctly noted numerous indications in the record that the parties (and the court) expected Houlihan's fees to be evaluated after the fact for reasonableness, and that is exactly what happened. The bankruptcy court's January 1999 order, which predated Houlihan's employment, stated that "Hourly Rates" would be a primary basis for evaluating fees and that "the rate charged * * * shall correspond to the expertise necessary * * * , rather than the ordinary rate charged by the person performing it." App. 42. The bankruptcy court clarified at the March 1999 hearing that Houlihan would have to record its time because such hourly data would be important to the judicial evaluation of Houlihan's final fee requests. Id. at 320. In its April 2000 order, the bankruptcy court reiterated the need for Houlihan to provide hourly data. Id. at 403-404, 350-351.

In supporting the ABS Committee's application to retain Houlihan, Kramer represented to the court that Houlihan's contracted monthly fee was "obviously subject not only to [Houlihan's] retention or employment in the matter, but also to final review by the Bankruptcy Court as to the relative fairness or [reasonableness]" under Section 330. App. 289. Counsel for the ABS Committee also repeatedly indicated that Houlihan's contractual fee would be reviewed for reasonableness using time records. E.g., id. at 387, 390-391, 394, 401. That view corresponded with the apparent consensus of the Unsecured Creditors Committee, the Debtors, and the U.S. Trustee that Houlihan's monthly fees would be substantively evaluated by the bankruptcy court after service was complete. E.g., App. 289, 318, 398-399, 401, 971-979. Houlihan overlooks all of this evidence and argues, without support, that there was never "any contemplation" that Houlihan's effective hourly rates might be used in determining its final fee award under Section 330. Appellant's Br. 34. Houlihan also fails to rebut the BAP's detailed analysis rejecting claims of unfairness after an "exhaustive review of the record." BAP Op. 26-29.

In sum, the bankruptcy court properly exercised its substantial authority under Section 330 by awarding Houlihan fees of $904,000 based on individual rates of $400, $390, $300, and $275 per hour. Houlihan's fee award compared favorably to the fees awarded to similarly credentialed financial professionals who made "substantially comparable" contributions to this case. Bankr. Op. 6. As the BAP correctly held, the bankruptcy court's judgment was not an abuse of discretion.

CONCLUSION

For the foregoing reasons, this Court should affirm the BAP's judgment.

Respectfully submitted,

PETER D. KEISLER
Assistant Attorney General

WILLIAM KANTER
(202) 514-4575
R. CRAIG GREEN
(202) 514-2498
Attorneys, Appellate Staff
Civil Division, Room 9104
Department of Justice
601 D Street, N.W.
Washington, D.C. 20530

OF COUNSEL:

DONALD F. WALTON
Acting General Counsel
P. MATTHEW SUTKO
Attorney
Office of the General
Counsel, Executive Office
for U.S. Trustees
20 Massachusetts Ave., N.W.
Washington, D.C. 20530

APRIL 2004

CERTIFICATE OF COMPLIANCE

I certify that pursuant to Fed. R. App. P. 32(a)(7)(C), the attached Brief for Appellee is monospaced (in Courier New, 12 point font), has 10.5 or fewer characters per inch and contains 10661 words (excluding cover, tables, and certificates), according to the count of Corel WordPerfect 9.

R. CRAIG GREEN
Attorney

CERTIFICATE OF SERVICE

I hereby certify that on this 9th day of April, 2004, I filed and served the foregoing Brief For United States Trustee by causing the original and seven copies to be sent to this Court by Federal Express overnight, and by causing two copies to be served upon the following counsel by first-class mail:

David A. Cheek
McKinney & Stringer
101 N. Robinson, Suite 1300
Oklahoma City, OK 73102-5504

Christina E. Murray
Jones Day
272 N. Harwood St.
Dallas, TX 75201

Richard A. Chesley
Jones Day
77 Wacker Dr., Suite 3500
Chicago, IL 60601

Sidney K. Swanson
Gable & Gotwals
1100 ONEOK Plaza
100 West 5th St.
Tulsa, OK 74103-4217

Dennis S. Meir
Melinda A. Marbes
1100 Peachtree St. N.E., Suite 2800
Atlanta, GA 30309-4530

Jay Switzer
Jenner & Block
One IBM Plaza
Chicago, IL 60611

Neal Tomlins
Ronald E. Goins
Tomlins & Goins, P.C.
2100 S. Utica Ave., Suite 300
Tulsa, OK 74114

Larry M. Wolfson
Shaw, Gussis, Domanskis, Fishman,
Gantz & Wolfson
1144 W. Fulton Ave., Suite 200
Chicago, IL 60607

R. CRAIG GREEN
Attorney

STATEMENT REGARDING ORAL ARGUMENT

The U.S. Trustee does not request oral argument in this case, but the U.S. Trustee wishes to participate if the Court deems argument helpful to resolving this matter.

BRIEF BANK — “SUMMARY SHEET”

Printed Fri-3/12/10 15:45

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	In re Martin W. Howser (Martin W. Howser v. United States Trustee)
2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	E.D Wash.
3. ("CCN") ***CURRENT*** CASE NO.	No.: 2:09-cv-00228-FVS
4. ("PCN") ***PRIOR*** CASE NO. - & COURT *[IF ANY]*	No.: 09-02439-PCW II Court: Bankr. E.D. Wash. *(Identify judge & cite, if any)*
5. ("SO") ***SOURCE***	**U.S. TRUSTEES**
6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	Filed: November 10, 2009 Type: Reply Memorandum in Support of Appellee United States Trustee’s Motion to Dismiss Appeal.
7. **("AU") PRINCIPAL AUTHORS & OFFICE** [E.g.,"UST/OGC"]	Gary W. Dyer, Robert D. Miller *(UST/OGC: 202-307-1399/FAX-2397)*
8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") ● ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	● Whether an appeal of an order refusing to approve the appointment of counsel in a chapter 11 case is moot because the underlying chapter 11 case had been converted to chapter 7 and subsequently dismissed.
10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)	
11. DO YOU RECOMMEND POSTING IN UST BRIEFBANK?	☒ YES ☐ NO ***NAME:*** Linda Figueroa ***DATE:***

GARY W. DYER, CSBA# 106701
Acting Assistant United States Trustee
United States Department of Justice
Office of United States Trustee
United States Courthouse
920 West Riverside, Room 593
Spokane, WA. 99201
Telephone (509) 353-2999
Fax (509) 353-3124

Hon. FRED VAN SICKLE

UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF WASHINGTON

In re

MARTIN W. HOWSER,

Appellant,

v.

UNITED STATES TRUSTEE,

Appellee.

Case No. 2:09-cv-00228-FVS

[BK Case No. 09-02439-PCW11]

REPLY
MEMORANDUM IN SUPPORT OF APPELLEE UNITED STATES TRUSTEE'S MOTION TO DISMISS APPEAL

The Acting United States Trustee, by and through his attorney, Gary W. Dyer, replies to the opposition and response to the motion to dismiss this appeal.

Mr. Howser appealed the order of the bankruptcy court refusing to approve the employment of a specific law firm to represent Mr. Howser in his chapter 11 bankruptcy case because the proposed firm had actual conflicts of interest and therefore, did not qualify for employment under 11 U.S.C. § 327(a). The United States Trustee argued that this appeal must be dismissed because it was taken from an interlocutory order without leave of this Court and because Mr. Howser no longer has any interest in getting court approval of the firm's employment. Not only is Mr. Howser no longer proceeding under chapter 11, but he has now dismissed his bankruptcy case altogether. Therefore, as explained in the United States Trustee's motion, Mr. Howser no longer has a legally-cognizable interest in the outcome of this appeal and the appeal is moot.

Mr. Howser agrees in his response that the order he appeals from "was an interlocutory one, and that standing alone, it is moot." Response Memorandum at 4 (emphasis omitted). However, Mr. Howser asserts that the jurisdictional defects in his appeal have been cured by subsequent events in his bankruptcy case. Specifically, he argues that the fact that he recently appealed the decision of the bankruptcy court not to award fees to his attorneys[1] and purportedly filed a motion to consolidate the two appeals[2] means that this appeal is no longer moot or an appeal from an interlocutory order.

Mr. Howser does not explain why his second appeal would revive his

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[1] As Mr. Howser admits, the bankruptcy court has not yet entered an order on this issue. Therefore, Mr. Howser's appeal of the fees decision is premature. In addition, Mr. Howser is the wrong party to appeal the bankruptcy court's decision regarding fees because Mr. Howser's **attorneys,** rather than Mr. Howser are the ones with the interest in being paid.

[2] As of November 9, 2009, the United States Trustee has not been served with a motion to consolidate, nor does the docket in this appeal reflect that such a motion has been filed.

interest in obtaining court approval to hire attorneys to represent him in a now-defunct chapter 11 case. It does not. The appeal is still moot.

Mr. Howser relies upon the case of *Nicholson v. Schafe*, 558 F.3d 1266 (11th Cir. 2009), but that case does not address the mootness issue and is inapposite as to the lack of finality of Mr. Howser's appeal. The *Nicholson* case involved an appeal of an order that granted attorney's fees in an undetermined amount subject to proof of reasonable fees. The circuit court questioned whether that portion of the appeal was premature, given that the lower court had yet to quantify the award of attorney's fees. While the appeal was pending, the district court determined the amount of attorney's fees awarded and the appellant appealed that order. The circuit court found that the consolidation of the two appeals mooted its question about its jurisdiction to review an award of unquantified fees, presumably because the fees were no longer unquantified. Nicholson, 558 F.3d at 1270.

That is not the situation in this case. The two appeals in this case are taken from orders involving different issues. This appeal is from the order disqualifying Mr. Howser's law firm from employment because of conflicts of interest. It concerns whether Mr. Howser is entitled to employ specific attorneys to represent him in his terminated chapter 11 bankruptcy case. Mr. Howser's second appeal, by contrast, is from the bankruptcy court's decision to deny the disqualified law firm's fees for their representation of Mr. Howser during his chapter 11 proceeding. Unlike the first order appealed from in *Nicholson*, the bankruptcy court's order denying approval for employment left nothing unresolved for the court to decide later. Also unlike *Nicholson*, the second order appealed from in this case denying fees did not complete the employment order or affect it in any way.[3] Therefore, the second appeal can not "cure" the interlocutory nature of the first appeal.

Because this appeal remains moot and impermissibly seeks review of an interlocutory order without leave of this Court, the United States Trustee requests that the appeal be dismissed.

Dated: November 10, 2009

Respectfully submitted,

ROBERT D. MILLER JR.
Acting United States Trustee

/s/Gary W. Dyer
GARY W. DYER
Acting Assistant U.S. Trustee

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[3] While prior court approval of employment is a prerequisite to the award of fees, the bankruptcy court does not revisit the propriety of the employment order in the context of the fee application.

CERTIFICATE OF SERVICE RE :
REPLY MEMORANDUM IN SUPPORT OF
UNITED STATES TRUSTEE'S MOTION TO DISMISS APPEAL

I declare the under penalty of perjury that a true and correct copy of the United States Trustee's Reply Memorandum in Support of United States trustee's Motion to Dismiss Appeal was mailed to the following on November 10, 2009:

JOHN F BURY
MURPHY BANTZ & BURY
818 W RIVERSIDE, 631 LINCOLN BLDG
SPOKANE, WA 99201-0989

Dated: November 10, 2009

__/s/Gary W. Dyer_
GARY W. DYER

BRIEF BANK — "SUMMARY SHEET" *Printed Mon-5/23/11 11:21*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	In re: James Randell Hughes (Hughes v. UST)
2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	Dist. Tex.
3. ("CCN") ***CURRENT*** CASE NO.	No.: 3:07-cv-00240
4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*	No.: 05-82316-SGJ-7 Court: Bankr. Tex. *(Identify judge & cite, if any)*
5. ("SO") ***SOURCE***	**U.S. TRUSTEES**
6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	Filed: March 31, 2008 Type: Brief of the United States Trustee
7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*	William S. Parkinson, William Neary, P. Matthew Sutko *(UST/OGC: 202-307-1399/FAX-2397)*
8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	• Whether the bankruptcy court's findings that Mr. Hughes' discharge should be denied for failure to keep adequate records of his financial transactions was clearly erroneous? √ **Background:**
10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)	
11. DO YOU RECOMMEND POSTING IN UST BRIEFBANK?	| x | YES | | NO ***NAME:*** Linda Figueroa ***DATE:***

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

IN RE	§	
	§	
JAMES RANDELL HUGHES	§	**CASE NO. 05-82316-SGJ-7**
	§	
	§	
DEBTOR	§	
	§	
	§	
JAMES RANDELL HUGHES **APPELLANT**	§	
	§	
	§	
V.	§	**CIVIL ACTION NO. 3:07-CV-0240-L**
	§	
UNITED STATES TRUSTEE **APPELLEE**	§	
	§	

BRIEF OF THE UNITED STATES TRUSTEE

WILLIAM T. NEARY
UNITED STATES TRUSTEE
WILLIAM S. PARKINSON
TRIAL ATTORNEY
UNITED STATES TRUSTEE
United States Department of Justice
Office of the United States Trustee
1100 Commerce St.
Room 976
Dallas, Texas 75242
(214) 767-8967

CERTIFICATE OF INTERESTED PERSONS

The parties interested in the outcome of this appeal are:

James Randell Hughes
17608 Cedar Creek Canyon
Dallas, Texas 75252

United States Trustee
1100 Commerce St.
Room 976
Dallas, Texas 75242

as well as all general unsecured creditors whose debts will not be discharged as the result of the Bankruptcy Court's decision.

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STATEMENT OF ISSUES TO BE PRESENTED

1) Whether the Bankruptcy Court's findings that Mr. Hughes's discharge should be denied for failure to keep adequate records of his financial transactions was clearly erroneous?

STANDARD OF REVIEW

The issues raised in this appeal are principally questions of fact. The Bankruptcy Court's findings of fact may only be set aside if clearly erroneous. Fed. R. Bank. P. 8013. To any extent there are issues of law, this Court reviews them *de novo*. *Matter of Pengo Industries, Inc.*, 962 F.2d 543 (5th Cir. 1992), *Matter of Luce*, 960 F.2d 1277 (5th Cir. 1992).

STATEMENT OF THE CASE

Mr. Hughes filed his voluntary Chapter 7 petition under 11 U.S.C. §301 and §701 *et seq*. on October 5, 2005 (Rec. Page 81). The United States Trustee timely filed a complaint seeking to deny the Debtor's discharge (Rec. Page 55). Trial was held, and on August 21, 2006, the Bankruptcy Court entered its Memorandum Opinion indicating that Mr. Hughes's discharge should be denied because he failed to keep or preserve adequate records from which his financial condition or business transactions could be ascertained (Rec. Page 711). The Court then entered judgment denying the discharge (Rec. Page 755). The Debtor moved for, but was denied a new trial (Rec. Pages 757 and 761). Mr. Hughes now appeals the denial of his discharge.

STATEMENT OF FACTS

Mr. Hughes filed his voluntary Chapter 7 (liquidation) bankruptcy petition on October 5, 2005 (Rec. Page 81). With this petition, he sought to discharge all debts he owed prior to filing. One requirement for receiving this discharge is that Mr. Hughes have kept adequate books and records from which his financial transactions could be ascertained.

For many years prior to filing the case, Mr. Hughes, along with his partner, Gordon Todd, were general contractors of “high-end” homes (Rec. Pages 713, 917 *et seq*.). They operated through a series of entities which usually bore the name of the two partners in some fashion (Rec. Pages 918 *et seq*., 714). Various setbacks to each succeeding entity resulted in the accumulation of millions in unpaid debts on which both Todd and Hughes were personally liable (Rec. Pages 921, 714-715). The partners had a “falling-out”, (Rec. Pages 936, 938, 719), and Mr. Hughes eventually began working for a company his wife owns, H. Hughes Properties, Inc. (Rec. Pages 936, 940, 720). This company is also a general contractor of “high-end” homes.

For approximately 15 years prior to filing bankruptcy Mr. Hughes operated on a “cash basis” and had no bank accounts (Rec. Pages 928-929). Any checks he received during this time were negotiated into cash, which was then spent in any way he saw fit. He did this to avoid persistent garnishments by creditors. This cash practice continued while he was an employee of his wife’s company.

Mr. Hughes’s bi-weekly pay checks from H. Hughes Properties were based on $6,910.00/month gross salary,[1] (Rec. Pages 95, 871-872, 848), and he received $5,000.00 each month after withholdings (Rec. Pages 95, 848, 960, 722-723). He cashed these checks at local banks (Rec. Pages 881, 762). After receiving $5,000.00 in cash, he placed $2,000.00 in a drawer at home which he and his wife used to pay some of their family’s expenses, including pool maintenance, housekeepers, and their children’s tuition at Jesuit and Hockaday Academy (Rec. Pages 962-963, 722-723). Mr. Hughes did not keep or maintain any records of how either this $2,000.00 or the remaining $3,000.00 was spent (Rec. Pages 810-811, 882-884, 961-963, 722-723).

After Mr. Hughes filed bankruptcy, the United States Trustee began inquiring about his affairs

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[1] Judge Jernigan believed there were many reasons to question the veracity of this amount. There were manifest discrepancies between a) what was shown on the Debtor’s bankruptcy Schedules for income in the period prior to filing, b) his W-2 forms, his tax returns, and (depending on whether or not he decided to cash his check in any given period) c) the amount the Debtor actually received. *See*, *e.g.*, Rec. Pages 853-857, 724-727. The most consistent amount identified at trial, and the amount the Bankruptcy Court used for its analysis were the $6,900.00 and $5,000.00 figures.

(Rec. Pages 799 *et seq.*). It was learned that Mr. and Mrs. Hughes[2] reported $307,618.00 of wage and salary income on their 2004 federal income tax return (Rec. Page 385). Mr. Hughes's original 2004 W-2 reported that H. Hughes Properties had paid him $210,000.00 (Rec. Page 400). An amended W-2 reported him receiving only $100,000.00 (Rec. Pages 398-399). When asked about the manifest discrepancy, Mr. Hughes deferred to his accountant and disavowed any knowledge about the reasons for the change (Rec. Pages 181, 849-850, 856, 726-727). When asked for documents to explain this, he had none. Mr. Hughes testified that H. Hughes Properties provides him with a company car and pays the related expenses (Rec. Page 901). But when asked why his W-2 does not reflect the income that must be recognized for that vehicle, he again deferred to his accountant to explain (Rec. Pages 901-902).

Mr. Hughes also disavowed knowledge about many other specific items, including the 2004 sale of stock in a company his wife previously owned and another company she previously worked for. When asked for documents to explain these, he had none (Rec. Pages 857-858, 860-861). Shortly after being asked about his family's $13,445.00 of monthly expenses shown on Schedule J,[3] (Rec. Page 96), he amended Schedule J to show monthly expenses of $19,060.00 (Rec. Page 120). When asked about the difference he simply explained he did not focus on them the first time he prepared the Schedule (Rec. Pages 803, 806-807, 974-975). When asked for documents to verify the amounts on Schedule J, he only had a few checks signed by his wife on her account (Rec. Pages 825-828), a few grocery receipts, and a check for his children's tuition (Rec. Pages 801-802, 829, 723). He testified he has no knowledge of how the money in the drawer is spent other than the fact that his wife uses it to pay various bills. *See, e.g.*, Rec. Pages 901-902. He could not explain whether certain expenses he listed on Schedule J (Rec. Page

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[2] Mrs. Hughes did not file for bankruptcy. However, her income and share of the family's expenses can be considered for purposes on Mr. Hughes case and, therefore, must be disclosed.

[3] Schedule J requires debtors to report and itemize their monthly personal living expenses. It must be completed by all debtors, and must include information about a spouse's expenses, even if the spouse did not file bankruptcy.

120) for his daughter's vehicle and insurance were paid from money he put in the drawer (Rec. Page 902). There was also no explanation or documentation explaining why he originally reported $45,000.00 of year-to-date income on his Statement of Financial Affairs ("SOFA") (Rec. Page 99), why he amended that to $83,000.00, (Rec. Page 121), why both amounts conflicted with various pay stubs, (Rec. Pages 418-425), and why these amounts also conflicted with what he should have made in those periods if he was paid $6,900.00/month as his Schedule I[4] reported[5] (Rec. Pages 871-879).

Because of Mr. Hughes's failure to keep any records of his cash dealings, and the many mistakes he made in completing his bankruptcy schedules,[6] the United States Trustee filed a complaint asking the Bankruptcy Court to deny Mr. Hughes's discharge. At trial, Mr. Hughes admitted that no records of his cash dealings were ever kept (Rec. Pages 882-883). His only explanation was that it had been his practice to deal in cash to avoid creditors' collection efforts.

Judge Jernigan denied Mr. Hughes's discharge. Her Opinion notes that the record-keeping requirement of Bankruptcy Code §727(a)(3) is intended to insure there is a trail from which parties can follow a debtor's financial history, and that this trail must give credibility to a debtor's oral explanations (Rec. Page 739). She applied the principle that once a *prima facie* case for no records was made, the burden fell to Mr. Hughes to justify his not having records (Rec. Page 736). The Opinion recognized that a debtor's records need not be perfect or impeccably kept (Rec. Page 736), and that the quality and

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[4] Schedule I requires debtors to report their monthly income. Like Schedule J it must be completed by all debtors and must include their spouse's income, regardless of whether the spouse filed bankruptcy.

[5] Multiplying $6,900.00/month times 9 months means Mr. Hughes should have been reported approximately $62,100.00 in year-to-date gross income on his SOFA, which conflicts with both the original and amended SOFA.

[6] Believing that the Debtor had failed to satisfactorily account for the loss of assets, and that the number of mistakes made in completing his Schedules and Debtor's evasiveness in explaining them was tantamount to a false or account, *see The Cadle Company v. Mitchell* (*In re Mitchell*),102 Fed. Appx. 860 (5th Cir. 2004), *United States Trustee v. Moschella*, (*In re Moschella*), Adv. No. 04-4055 (Unpublished Memorandum Opinion, (Bankr. N.D. Tex. 2004) the United States Trustee's Complaint also sought to deny the discharge under §727(a)(4)(A) and (a)(5). However, the Bankruptcy Court found the Debtor's explanations for these mistakes sufficiently exculpatory so as to deny relief on those causes.

quantity of records can be commensurate to a debtor's sophistication, motivation, and other circumstances (Rec. Page 738).

Implementing these principles in Mr. Hughes's case, Judge Jernigan found that the United States Trustee had unequivocally established a *prima facie* case that Mr. Hughes had no records (Rec. Page 741). When she turned to Mr. Hughes, the only justification he gave was that it had been his practice for some time, and that it was instigated in an effort to avoid creditors (Rec. Pages 741-742). She rejected this as an appropriate justification (Rec. Pages 742-743), noting that his income and expenses was a material matter worthy of being investigated. The targets of such an investigation included:

> a) the $110,000.00 discrepancy in income reported on Mr. Hughes's 2004 original and amended 2004 W-2 forms;
>
> b) the $38,000.00 discrepancy between the original and amended year-to-date income Mr. Hughes disclosed in his bankruptcy schedules;
>
> c) the discrepancy between what Mr. Hughes reported on Schedule I as his monthly income and the amounts shown for year-to-date income on both the original and amended Statement of Financial Affairs; and
>
> d) the questionable reliability of the information the Hughes gave their accountant for his preparation of their tax returns.

(Rec. Pages 744-745). She expressed particular interest in having these matters investigated because she was unwilling to rely on Mr. Hughes's oral explanations about his income and expenses. She noted that even if Mr. Hughes's W-2 forms were 100% accurate, this still did not adequately document his disbursements of $5,000.00 each month, especially when his only justification for not keeping records or having a bank account was to avoid creditors (Rec. Pages 743-744). Because Mr. Hughes is a sophisticated and educated businessman (Rec. Page 744), Judge Jernigan believed he should be kept to a higher record keeping standard (Rec. Page 744). She then held that his failure to keep records rendered him ineligible for a discharge.

ARGUMENT

I

THE BANKRUPTCY COURT DID NOT ABUSE ITS DISCRETION BY DENYING THE DEBTOR'S DISCHARGE FOR FAILURE TO KEEP ADEQUATE RECORDS

The sole issue in this appeal is whether or not the Bankruptcy Court abused its discretion or was clearly erroneous in denying Mr. Hughes's discharge for unjustifiably failing to keep any books or records of his cash dealings. Under 11 U.S.C. §727(a):

> The court shall grant the debtor a discharge, unless....
>
> (3) the debtor has....failed to keep....any recorded information, including books, documents, records, and papers, from which the debtor's financial condition or business transactions might be ascertained, unless such act or failure to act was justified under all of the circumstances of the case;

This obligation to keep adequate records exists to insure that parties-in-interest get a true picture of a debtor's financial affairs. *In re Womble*, 289 B.R. 836 (Bankr. N.D. Tex. 2003); *Clean Cut Tree Service, Inc. v. Costello* (*In re Costello*), 299 B.R. 882 (Bankr. N.D. Ill. 2003). *See also, Phillips v. Nipper* (*In re Nipper*), 186 B.R. 284 (Bankr. M.D. Fla. 1995); *Nof v. Gannon* (*In re Gannon*), 173 B.R. 313 (Bankr. S.D. N.Y. 1994). The initial test under §727(a)(3) is primarily objective. All that must be shown is that a debtor failed to keep and maintain adequate books and records. Once a *prima facie* case is established that inadequate records were kept, it is incumbent on debtor to justify that failure. *Krohn v. Cromer* (*In re Cromer*), 214 B.R. 86 (Bankr. E.D. N.Y. 1997), *Chemical Bank, et. al. v. Hecht* (*In re Hecht*), 237 B.R. 7 (Bankr. D. Conn. 1999). Culpability for inadequate records is not dependent on an intent to conceal financial information. *State Bank of India, et al. v. Sethi* (*In re Sethi*), 250 B.R. 831 (Bankr. E.D. N.Y. 2000). All that is required is that there be no justification for not having adequate records.

What constitutes adequate records under §727(a)(3) and whether there is justification for not having them is somewhat more subjective. It is, therefore, left to the trial court's discretion, and can only be overturned upon a showing of clear error and/or an abuse of discretion. *In re Dennis,* 330 F.3d 696 (5th Cir. 2003). Section 727(a)(3) does not require perfect financial records that would pass muster under generally accepted accounting principles. However, there must be some records, and they must be kept in an intelligent fashion which allows for a reasonable reconstruction of the debtor's financial condition. *In re Womble*, *supra*. The adequacy of the debtor's records is examined case by case, *see United States v. Trogdon* (*In re Trogdon*), 111 B.R. 655 (Bankr. N.D. Ohio 1990), and includes consideration of a debtor's occupation, financial structure, education, experience, sophistication, nature of the business, and any other circumstances that serve the interests of justice. *In re Trogdon*, *supra*, *Chicago Title Ins. Co. Inc. v. Mart* (*In re Mart*), 87 B.R. 206, 210 (Bankr. S.D. Fla. 1988). Sophisticated business debtors are held to a higher standard of accountability in record keeping. *Meridian Bank v. Alten* (*In re Alten*), 958 F.2d 1226 (2nd Cir. 1992).

There is no dispute that Mr. Hughes did not keep records of his day-to-day expenditures of either the $3,000.00 he allotted himself each month or the $2,000.00 going into and out of the drawer each month in the years before filing (Rec. Pages 810-811, 961-963, 722-723). This undisputed fact established the *prima facie* case that adequate records were not kept, and shifted the burden to Mr. Hughes for him to justify the failure to keep records.

Mr. Hughes attempts to justify his failure by casting himself as an average consumer who otherwise would not be asked to document his personal transactions. In other words, he would have had the Bankruptcy Court believe that his having no records at all of his personal expenses was totally excusable. However, the Bankruptcy Code's requirement for keeping records is not limited to only business debtors. Indeed, §727(a)(3) employs the disjunctive "or" between "financial condition" and "business transactions", clearly indicating that *all* debtors must have adequate records, not just business debtors. The lack of any records at all is *per se* disqualifying absent an appropriate justification.

Mr. Hughes would also like this Court to apply a relaxed standard of record keeping because the transactions in question were average consumer expenses. But Judge Jernigan found that Mr. Hughes is _not_ an average consumer. He has a bachelors degree from the University of Oklahoma, with a major in finance (Rec. Pages 846, 713). He is a sophisticated businessman accustomed to complicated transactions in millions of dollars (Rec. Page 744), and confessed that his election to deal in cash was intended to evade creditors' efforts. He testified and reported on Schedule I that he received $5,000.00 in cash each month, or approximately $60,000.00 per year. Under his system, Mr. Hughes should have received $45,000.00 in cash during the period between January 1st and September 30, 2005. This is in excess of 72% of his personal year-to-date income, and almost 20% of what the family's salaried income was in 2004. But because he kept no records, neither the Trustee nor parties-in-interest have any way to trace, confirm, refute, and/or challenge the Debtor's statements that this $5,000.00 each month was simply spent on daily expenses. Without records, Mr. Hughes essentially asks parties-in-interest to rely on his statement that: "Here's what happened to the money, and if you don't believe it, just ask me." These are not the circumstances of an average consumer debtor, and this is precisely the scenario §727(a)(3) intends to prevent. *Christy et al. v. Kowalski* (*In re Kowalski*), 316 B.R. 596 (Bankr. E.D. N.Y. 2004).

Moreover, the Court pointed out that a need to investigate Mr. Hughes's income clearly existed (Rec. Pages 724-728). Mr. Hughes's original SOFA reported year-to-date income of $45,000.00, whereas his amended SOFA reported $83,000.00. Assuming Mr. Hughes really earns $6,900.00 per month, he would have been paid $64,100.00 in the calendar year he filed bankruptcy. But this was not what he reported in response to Question No. 1 on either his original or amended SOFA (Rec. Pages 99 and 121). When extrapolated, it also differs with what he reported on the original and amended SOFA's for income in 2004.

Mr. Hughes also made a 30% change in what he reported on his original Schedule J to be his family's monthly expenses - going from $13,445.00/month to $19,060.00/month. He provided no excuse for the increase other than he apparently got them wrong the first time he completed the Schedule. More importantly, he had no records to back-up his changes or confirm his explanations. When this discrepancy is combined with those on the his original and amended 2004 W-2 statements, there were more than adequate facts from which Judge Jernigan could find a compelling reason to investigate his income and expenses. This, however, cannot be done to any degree of certainty without records.

Given the amounts involved, his sophistication, the discrepancies in his Schedules and tax returns, and his motivation for dealing in cash, the Bankruptcy Court was clearly within its discretion to find that Mr. Hughes's lack of records was unjustified under the circumstances.

II

CASE LAW SUPPORTS THE NECESSITY FOR ADEQUATE RECORDS OF PERSONAL INCOME AND EXPENSES

Other courts concur with the necessity for a debtor to maintaining records of personal spending. Just as in this case, the Debtors in *Meridian Bank v. Alten, supra*, kept few records of what were almost exclusively cash transactions that began in an effort to thwart creditors. Acknowledging that having sufficient records was prerequisite to receiving a discharge, the *Alten* Court found that a fear of liens and other collection efforts was not sufficient justification for failing to keep records of cash transactions. *Alten* at 1234. *See also, Superior National Bank et al. v. Schroff* (*In re Schroff*), 156 B.R. 250 (Bankr. W.D. Mo. 1993)(discharge denied when debtor had not had a bank account for over three years, was paid by wholly-owned corporations in cash, received unspecified gambling winnings and loans from his roommate, and operated both his business and personal affairs without records of the cash dealings); *Peninsula Bank v. French* (*In re French*), 338 B.R. 668 (C.D. Fla. 2006)(debtor disposed of all personal records when he moved); *Structured Asset Services, L.L.C. v. Self* (*In re Self*), 325 B.R. 224 (Bankr. N.D. Ill. 2005)(producing a few bank statements and cancelled checks did not constitute adequate records even for a debtor with only a high school education); *Matter of Silverman*, 10 B.R. 727 (Bankr. S.D. N.Y.

1981)(discharge denied when bankrupt[7] could produce virtually no records of his personal spending); *Soloman v. Barman* (*In re Barman*), 244 B.R. 896 (Bankr. E.D. Mich. 2000)(discharge denied when Debtor, a professional gambler, kept no records of his winnings, losses, or spending); *Matter of Horton*, 621 F.2d 968 (9th Cir. 1980)(bankruptcy court properly denied a discharge where bankrupt[8] dealt in cash because of his dislike of banks and kept no records of how he spent his salary).

III

THE CASES MR. HUGHES CITES ARE BOTH FACTUALLY DISTINGUISHABLE AND NOT CONTROLLING

Mr. Hughes cites a number of cases decided under the Bankruptcy Act of 1898 in an attempt to create the perception that record keeping has never been required for personal spending. He mistakenly cites *In re McCrea*, 161 F. 246 (2nd Cir. 1908), where the Court does not state that records of personal transactions are never required - only that a lack of records was not indicative of fraudulent intent. He also cites *In re Weisman*, 1 F.Supp. 723 (S.D. N.Y. 1932); *In re Rios*, 27 F.Supp. 744 (S.D. N.Y. 1939); *In re Goldman*, 37 F.Supp. 761 (E.D. N.Y. 1941); *In re Perkins*, 40 F.Supp. 114 (D. N.J. 1941); *In re Margolin*, 64 F.Supp. 213 (E.D. N.Y. 1946); and *In re Collins*, 45 F.Supp. 990 (E.D. N.Y. 1942), which are all factually distinguishable because, unlike the present case, the bankrupts in those cases had not owned or operated their own businesses for many years (in *Margolin* the bankrupt had a personal business for only two weeks)(in *Collins* the Court only stated in *dicta* that records of personal expenses were unnecessary - the Court sustained the denial of discharge for lack of business related records). Mr. Hughes also cites *Goff v. Russell Co.* (*Matter of Goff*), 495 F.2d 199 (5th Cir. 1974), wherein the Court upheld the denial of discharge for failure to keep records of a business, and only alluded in a footnote to

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[7] The Debtor in this case filed for Title 11 relief under the Bankruptcy Act of 1898, wherein petitioners were referred to as “bankrupts” rather than “debtors”. The provision in the Act requiring debtors to keep adequate records was closely comparable to §727(a)(3).

[8] *Id.*

the proposition that "....normal people ....[with] uncomplex [sic] financial affairs....do not require books or substantial records." *Goff* at 202, note 12.

Mr. Hughes also cites cases under the Bankruptcy Code which are distinguishable from the present. The Court found in *In re Shoup*, 214 B.R. 166 (Bankr. N.D. Ohio 1997), that unlike this case, the Debtor's having bank statements and not the actual checks were sufficient records. He also cites *Martin Marietta Materials Southwest, Inc. et al v. Lee* (*In re Lee*), 309 B.R. 468 (Bankr.W.D. Tex. 2004), where, unlike here, the debtor had some bank statements, checks, and other documents from which the liquidation of investments could be traced. The *Lee* Court found credible the debtor's explanation that was spent on day laborers hired to repair storm damage, and it was not an uncommon practice for such transactions to go undocumented.

All of Mr. Hughes cases are either factually distinguishable from the present or not controlling. More importantly, to any extent these cases are factually analogous to the present, they do nothing to show how Judge Jernigans's findings in this case were clearly erroneous. Because her findings are not clearly erroneous, they should not be altered.

CONCLUSION

The Bankruptcy Court neither abused her discretion nor made clearly erroneous findings in concluding that Mr. Hughes unjustifiably failed to keep adequate records from which his financial circumstances could be ascertained. Because they are not clearly erroneous, she was within her discretion to deny his discharge under §727(a)(3). The Bankruptcy Court's decision should be affirmed in all respects.

DATED: May 23, 2011

Respectfully submitted,
WILLIAM T. NEARY
UNITED STATES TRUSTEE

/S/ William S. Parkinson

William S. Parkinson
Ohio Bar Registration 0021679
Office of the United States Trustee
1100 Commerce Street
Room 976
Dallas, Texas 75242
(214) 767-8967

CERTIFICATE OF SERVICE

I do hereby certify that on May 23, 2011, a true copy of the foregoing document was forwarded by first class United States mail to the following persons:

Mark Agee, Esq.
5401 North Central Expressway
Suite 220
Dallas, Texas 75205

/S/ William S. Parkinson

William S. Parkinson

BRIEF BANK — "SUMMARY SHEET"

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1. ("TI") ***TITLE*** **OF CASE** ***[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]***	In re James Randell Hughes (Hughes v. Neary, UST)
2. ("CO") *CURRENT* COURT *[E.g., "CTA9"]*	5th Cir.
3. ("CCN") *CURRENT* CASE NO.	No.: 08-10384
4. ("PCN") *PRIOR* CASE NO. & COURT *[IF ANY]*	No.: 3:07-cv-240 Court: N.D. Tex. *(Identify judge & cite, if any)*
5. ("SO") *SOURCE*	U.S. TRUSTEES
6. ("DA") *DATE* OF FILING *& TYPE* OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	Filed: August 1, 2008 Type: Brief of the United States Trustee
7. ("AU") *PRINCIPAL AUTHORS &* OFFICE *[E.g.,"UST/OGC"]*	William S. Parkinson, Michael E. Ridgway, Erin Schmidt, P. Matthew Sutko, William T. Neary *(UST/OGC: 202-307-1399/FAX-2397)*
8. ("TO") *TOPIC*	BANKRUPTCY
9. ("SU") ● *SUMMARY* OF KEY ISSUE(s) & √ Any Miscellaneous *BACKGROUND*	● Did the district court abuse its discretion in affirming the bankruptcy court's decision to deny the Debtor/Appellant's discharge under 11 U.S.C. §727(a)(3) for failing to keep adequate books and records from which his financial affairs might be ascertained?
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IN THE UNITED STATES CIRCUIT COURT OF APPEALS
FIFTH CIRCUIT

CASE No. 08-10384

RE: JAMES RANDELL HUGHES, DEBTOR

JAMES RANDELL HUGHES
APPELLANT
V.
WILLIAM T. NEARY, UNITED STATES TRUSTEE
THE CADLE COMPANY
APPELLEES

RE: JAMES RANDELL HUGHES
DEBTOR

JAMES RANDELL HUGHES
APPELLANT
V.
THE CADLE COMPANY
APPELLEE

BRIEF OF THE UNITED STATES TRUSTEE

WILLIAM T. NEARY
UNITED STATES TRUSTEE
WILLIAM S. PARKINSON
TRIAL ATTORNEY
Department of Justice

Office of the United States Trustee
1100 Commerce St. Room 976
Dallas, Texas 75242
(214) 767-8967

CERTIFICATE OF INTERESTED PERSONS

Case No. 08-10384

Re: James Randell Hughes, Debtor

James Randell Hughes, Appellant v. William T. Neary, United States Trustee & The Cadle Company, Appellees

The undersigned counsel of record certifies that the following listed persons and entities as described in the fourth sentence of Rule 28.2.1 have an interest in the outcome of this case. These representations are made in order that the judges of the court may evaluate possible disqualification or recusal.

James Randell Hughes, Debtor
17608 Cedar Creek Canyon
Dallas, Texas 75252

The Cadle Company, Creditor
Andrew Emerson, Esq.
Counsel for the Cadle Company
8111 LBJ Freeway, Suite 480
Dallas, Texas 75251

Mark Ian Agee, Esq.
Counsel for Appellant
5401 North Central Expressway Suite 200
Dallas, Texas 75205

Mark Howe, Esq.
Co-counsel for Appellant
2027 Young St.
Dallas, Texas 75201

William T. Neary
United States Trustee
1100 Commerce St. Room 976
Dallas, Texas 75242

Bruce K. Thomas, Esq.
Co-counsel for the Cadle Company
1825 Market St. Suite 200
Dallas, Texas 75207

James Cunningham, Trustee
6412 Sondra Dr.
Dallas, Texas 75214

and all creditors whose debts will not be discharged

.

Attorney of record for the United States Trustee

STATEMENT REGARDING ORAL ARGUMENT

The decisions of both the bankruptcy court and the district court are well reasoned and amply supported by the evidentiary record. The United States Trustee believes the issues before the Court can be resolved without oral argument.

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I. The Bankruptcy Court did not Abuse its Discretion by Denying the Debtor's Discharge for Failure to Keep Adequate Records

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STATEMENT OF ISSUES TO BE PRESENTED

1) Did the district court abuse its discretion in affirming the bankruptcy court's decision to deny the Debtor/Appellant's discharge under 11 U.S.C. §727(a)(3) for failing to keep adequate books and records from which his financial affairs might be ascertained?

STANDARD OF REVIEW

Appellant attempts to characterize this appeal as involving issues of law. However, findings regarding a debtor's financial record keeping are issues of fact. *Goff v. Russell Co.* (*In re Goff*), 495 F.2d 199, 202 (5th Cir. 1974). Findings of fact are within the trial court's discretion and should not be set aside unless clearly erroneous. Fed. R. Bank. P. 8013. To any extent there are issues of law, this Court reviews them *de novo*. *Robertson v. Dennis (In re Dennis)*, 330 F. 3d 696, 701 (5th Cir. 2003), *In re Pengo Industries, Inc.*, 962 F.2d 543, 545 (5th Cir. 1992); *In re Luce*, 960 F.2d 1277, 1280 (5th Cir. 1992). Mixed questions of law and fact are also reviewed *de novo*. *Bass v. Denney (Matter of Bass)*, 171 F.3d 1016, 1021 (5th Cir. 1999).

STATEMENT OF THE CASE

James Hughes ("Debtor") filed his voluntary chapter 7 petition under 11 U.S.C.

§301 and §701 *et seq*. on October 5, 2005. (Rec. at 81).[1] The United States Trustee timely filed a complaint under 11 U.S.C. §727 seeking to deny the Debtor a discharge. (Rec. at 55). Trial was held on August 21, 2006, and on November 6, 2006, the bankruptcy court issued a memorandum opinion[2] denying the Debtor a discharge under 11 U.S.C. §727 for failing to keep or preserve adequate records from which his financial condition could be ascertained. (Rec. at 711). The court then entered judgment denying the discharge. (Rec. at 755). The Debtor moved for, but was denied a new trial. (Rec. at 757, 761). He timely filed a notice of appeal to the district court. (Rec. at 1).

The bankruptcy court subsequently denied the Debtor's discharge in a separate action brought by the Cadle Company, co-appellee. (Cadle Rec. 40). The Debtor also timely filed a notice of appeal in that case.[3] (Cadle Rec. at 1). The Debtor moved the district court for and was granted consolidation of those appeals. (Cadle Dis. Ct. at 95). On March 27, 2008, the district court affirmed the bankruptcy court's denial of

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[1] In this consolidated appeal, there are four independently paginated records - one each from the United States Trustee's and the Cadle Company's objections to discharge, and one each for the appeals in District Court. In this brief, unless otherwise noted, all record citations will be to the record of the United States Trustee's adversary proceeding against the Debtor.

[2] *United States Trustee v. Hughes,* 353 B.R. 486 (Bankr. N.D. Tex. 2006).

[3] *Cadle v. Hughes,* 354 B.R. 801 (Bankr. N.D. Tex. 2006).

a discharge in both proceedings.[4] (UST Dis. Ct. Rec. at 104). The Debtor now appeals to this Court. (Dis. Ct. Rec. at 116).

STATEMENT OF FACTS

The Debtor filed his voluntary chapter 7 (liquidation) bankruptcy petition on October 5, 2005. (Rec. at 81). With his petition, he sought to discharge all debts he owed prior to filing. As a prerequisite to receiving a discharge, the Bankruptcy Code requires a debtor to have kept adequate books and records from which his financial transactions can be ascertained. 11 U.S.C. §727(a)(3). Failing to have kept such records serves as a basis to deny the discharge. 11 U.S.C. §727(a)(3).

The Debtor holds an undergraduate degree in finance and business from the University of Oklahoma. (Rec. at 846). He played professional football from 1977 to 1981. (Rec. at 918). During the 1970s and 1980s he was one of two business partners in a multi-million dollar contracting firm that built "high-end" homes in the Dallas area. (Rec. at 713, 918 *et seq*.). He and his partner operated through a series of entities. (Rec. at 714, 918 *et seq*.). Various setbacks to each succeeding entity left the Debtor personally liable on millions in unpaid debts. (Rec. at 714-715, 921). The partners had a "falling-out," (Rec. at 719, 936, 938), and in 2002 the Debtor began working for his wife's firm, also a general contractor of "high-end" homes. (Rec. at 717).

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[4] *United States Trustee v. Hughes*, 386 B.R. 624 (N.D. Tex. 2008).

According to his Schedules, the Debtor owed $41,808,513 in unsecured obligations to eleven creditors. *See* Schedule F. (Rec. at 692). The vast majority of this debt was incurred and/or connected to his housing/real estate development businesses. *Id.* (Although the Official Forms asks for the dates debts were insurred, the Debtor did not schedule those dates).

For approximately fifteen years prior to filing bankruptcy, the Debtor operated on a "cash basis" to avoid garnishments by creditors . (Rec. at 929-930). In recent years, his wife's company paid him $6,910 /month gross salary[5] (Rec. at 95, 848, 871-872), and he received $5,000/month net after withholdings. (Rec. at 95, 722, 848, 960). His $5,000 net salary was paid by check, which the Debtor negotiated into cash at local banks. (Rec. at 722, 881). He then took the cash and placed $2,000 of it in a drawer at home which he and his wife used to pay family expenses, including pool maintenance, housekeepers, and tuition at their children's expensive private schools (Hockaday Academy and Jesuit Preparatory Academy). (Rec. at 722-723, 962-963). With the exception of several checks from his wife's bank account (which was

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[5] Based on discrepancies between a) what was shown on the Debtor's bankruptcy Schedules for income in the period prior to filing, b) his W-2 forms, his tax returns, and (depending on whether or not he decided to cash his check in any given period) c) the amount the Debtor actually received, the bankruptcy court found the Debtor's testimony and evidence suspect. *See, e.g.,* Rec. at 853-857, 724-727. The most consistent amount identified at trial, and the amount the bankruptcy court used for its analysis were the $6,900 and $5,000 figures.

separate property pursuant to a partition agreement) and several grocery receipts, the Debtor kept no records reflecting how either this $2,000 or the remaining $3,000 was spent each month. (Rec. at 722-723, 810-811, 882-884, 961-963).

The Debtor's bankruptcy disclosures revealed that he and his wife[6] reported $307,618 of wage and salary income on their joint 2004 federal income tax return. (Rec. at 385). The Debtor's original 2004 IRS Form W-2 ("W-2") reported a salary of $210,000 from his wife's company. (Rec. at 400). An amended W-2, however, reported only $100,000. (Rec. at 398-399). At trial, the Debtor disavowed any knowledge regarding this discrepancy in figures, and deferred to his accountant. (Rec. at 181, 726-727, 856). Despite several requests, he could produce no documents explaining the change. The Debtor also could not explain or document why his W-2 did not recognize income which should have been imputed to him based on his use of his wife's company car and the other "perks" (e.g., cell phone and credit card) his wife's company provided him. In response to inquiries about these perks, Debtor again deferred to his accountant. (Rec. at 901-902).

Also, the Debtor's bankruptcy Schedules and Statement of Financial Affairs, Fed. R. Bankr. P. Official Forms 6 and 7, were replete with other inconsistencies he was either unwilling or unable to explain or document. These included:

a) the 2004 sale of stock in a company his wife previously owned and

---

[6] Mrs. Hughes did not file bankruptcy.

another company she previously worked for (Rec. at 860-861);

b) the amendment of his original Schedule of Expenses[7] increasing his monthly expenses from $13,445 (Rec. at 96) to $19,060 (Rec. at 120);[8]

c) the specifics of how the money in the drawer is spent, *see, e.g.,* Rec. at 901-902, including whether the expense listed on the Schedule of Expenses (Rec. at 120) for his daughter's vehicle and insurance were paid from money in the drawer (Rec. at 902); and

d) the discrepancies between:

> 1) the $45,000 year-to-date income as was originally reported on his Statement of Financial Affairs (Rec. at 99);
>
> 2) the $83,000 reported on an amended Statement of Financial Affairs, (Rec. at 121);
>
> 3) the amounts shown on various pay stubs, (Rec. at 418-425); and
>
> 4) the amount he should have been paid if the $6,900/month of income reported on Schedule I[9] was accurate (Rec. at 871-

---

[7] The Schedule of Expenses, Schedule J, requires debtors to report and itemize their monthly personal living expenses. It must be completed by all debtors, and must include information about a spouse's expenses, even if the spouse did not file bankruptcy.

[8] His only explanation was that he failed to focus on scheduling correct amounts for those expenses when he first completed the form. (Rec. at 803, 806-807). The only documents he produced were a few checks signed by his wife on her account (Rec. at 825-828), a few grocery receipts and cashier's checks for his children's tuition. (Rec. at 723, 801-802, 829).

[9] Schedule I requires a debtor to report his monthly income.

879).[10]

The Debtor's failure to keep records of his cash transactions and his many mistakes in completing his bankruptcy schedules led the United States Trustee[11] to file a complaint under 11 U.S.C. §727(a)(3) seeking an order from the bankruptcy court denying his discharge.[12] (Rec. at 55). At trial, the Debtor admitted to keeping no

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[10] Hughes should have reported approximately $62,100 in year-to-date gross income on his Statement of Financial Affairs ($6,900/month x 9 months = $62,100). This amount conflicts with both the original and amended Statement of Financial Affairs.

[11] The Attorney General appoints United States Trustees to supervise the administration of bankruptcy cases and trustees. 28 U.S.C. 581-589a. United States Trustees "serve as bankruptcy watch-dogs to prevent fraud, dishonesty, and overreaching in the bankruptcy arena." H.R. Rep. No. 95-595, at 88 (1977). The United States Trustee Program thus acts in the public interest to promote the efficiency, and to protect and preserve the integrity, of the bankruptcy system. To this end Congress has provided that "[t]he United States Trustee may raise and may appear and be heard on any issue in any case or proceeding." 11 U.S.C. 307. *See In re Donovan Corp.*, 215 F.3d 929, 930 (9th Cir. 2000).

[12] The complaint also alleged under §727(a)(4)(A) and (a)(5) that Mr. Hughes a) failed to satisfactorily account for the loss of assets, and b) that the numerous errors made in completing the Schedules and Statement of Financial Affairs and his evasiveness in explaining them was tantamount to a false oath or account. *See The Cadle Company v. Mitchell* (*In re Mitchell*),102 Fed. Appx. 860 (5th Cir. 2004), *United States Trustee v. Moschella*, (*In re Moschella*), Adv. No. 04-4055 (Bankr. N.D. Tex. 2004)(unpublished memorandum opinion). However, the bankruptcy court found the Debtor's explanations for these mistakes sufficiently exculpatory so as to deny relief on those counts. The United States Trustee did not appeal the bankruptcy court's order regarding these counts.

records of his cash dealings (Rec. at 882-883), and explained only that it had been his practice to deal in cash to avoid creditors. (Rec. at 928).[13]

The bankruptcy court denied the Debtor's discharge, noting that the record-keeping requirement of Bankruptcy Code §727(a)(3) is intended to ensure a credible trail for parties to follow in an attempt to verify a debtor's oral explanations concerning his financial history. (Rec. at 739). The bankruptcy court found that the United States Trustee made a *prima facie* showing that there were no records (Rec. at 741), and that Debtor thereafter failed to carry his burden to justify the lack of records. (Rec. at 742). The bankruptcy court recognized that the quality and quantity of records required is commensurate with a debtor's sophistication, motivation, and other circumstances (Rec. at 738), and that a debtor's records need not be perfect or impeccably kept. (Rec. at 736). Because of his experience and education, the bankruptcy court held the Debtor to a higher standard for record keeping, (Rec. at 744), and rejected his efforts to avoid creditors as appropriate justification for failing to keep records. (Rec. at 741-743). The bankruptcy court identified Debtor's income and expenses as matters of material interest requiring investigation because of:

> a) the $110,000 discrepancy between the Debtor's original and amended 2004 W-2 forms reported on he and his wife's joint 2004 tax return;

---

[13] The Debtor was subject to garnishments, such as the one involving a bank account which held the last $500,000 of Debtor's "Cowboy money," which had been set aside for his retirement. *U.S. Trustee v. Hughes*, 353 B.R. at 494.

b) the $38,000 discrepancy between the original and amended year-to-date income the Debtor disclosed in his bankruptcy schedules;

c) the discrepancy between what the Debtor reported on the Schedule of Income as his monthly income and the amounts shown for year-to-date income on both the original and amended Statement of Financial Affairs; and

d) the questionable reliability of the financial information the Debtor gave his accountant for preparation of the joint tax returns.

(Rec. at 744-745). The bankruptcy court refused to accept the Debtor's oral explanations, noting that even assuming the W-2 forms were 100% accurate, his disbursements of $5,000 each month were still not adequately explained or documented. (Rec. at 745). Accordingly, the bankruptcy court rejected his explanations as exculpatory and held that his failure to keep records rendered him ineligible to receive a discharge. (Rec. at 743-745).

In his appeal to the district court, the Debtor challenged two aspects of the bankruptcy court's decision. First, he challenged whether there was an adequate showing on the second element of §727(a)(3) - that the lack of records prevented an understanding of his financial condition. (Dis. Ct. Rec. at 53). On this issue, the district court ruled the bankruptcy court did not abuse its discretion in finding that the Debtor's inability to:

a) account for the $2,000 put into the drawer each month;

b) account for the $400-$500 he personally spent each month; and

c) verify his earnings during the relevant year, including his personal use of his spouse's company car, cell phone, and credit card adequately demonstrated how the lack of records prevented an understanding of the Debtor's financial history. (Dis. Ct. Rec. at 108).

Second, Hughes challenged the standard for record keeping which the bankruptcy court applied to him. (Dis. Ct. Rec. at 48). He asserted that 1) the bankruptcy court required "precise" records, and 2) case law precedent does not require an individual to keep records for personal expenses. (Dis. Ct. Rec. at 49). The district court rejected this challenge as misstating the bankruptcy court's use of the term "precise". (Dis. Ct. Rec. at 109). The district court noted that the term "precise" was aimed at the employer's records as they pertained to Debtor's income (Dis. Ct. Rec. at 109), rather than what records the bankruptcy court expected from the Debtor for his cash spending. (Dis. Ct. Rec. at 110). The district court also agreed that the Debtor's education, sophistication, and business acumen distinguished his case from those in which unsophisticated debtors were not required to have personal records. (Dis. Ct. Rec. at 111). Although the district court agreed that the trial court could find the Debtor's explanations credible, it held that the bankruptcy court's rejection of those explanations did not constitute clear error. The district court also found that "[§727(a)(3)] impose(d) a duty on (him) to justify, not merely explain, his failure to maintain adequate records." *United States Trustee v. Hughes*, 386 B.R. at 630.

ARGUMENT

I

THE BANKRUPTCY COURT DID NOT ABUSE ITS DISCRETION BY DENYING THE DEBTOR'S DISCHARGE FOR FAILURE TO KEEP ADEQUATE RECORDS

A.

Preliminary Statement

In a chapter 7 liquidation case, a debtor who satisfies the conditions set forth in §727(a) of the Bankruptcy Code may receive an order discharging his debts. 11 U.S.C. §727(a). A discharge granted under this section frees the debtor from all debts that arose before the bankruptcy case commenced other than those excepted from discharge under Section 523 of the Code. 11 U.S.C. §727(b).

B.

The Legal Standard for Record Keeping

The sole issue in this appeal is whether the bankruptcy court abused its discretion or was clearly erroneous in denying Debtor's discharge for unjustifiably failing to keep any books or records of his cash dealings. Under 11 U.S.C. §727(a)(3):

> The court shall grant the debtor a discharge, unless . . .
>
> the debtor has . . . failed to keep . . . any recorded information, including books, documents, records, and papers, from which the debtor's financial condition or business transactions might be ascertained, unless such act or failure to act was justified under all of the circumstances of the case[.]

11 U.S.C. §727(a)(3). This obligation to keep adequate records ensures that parties-

in-interest get a true picture of a debtor's financial affairs. *Robertson v. Dennis*, *supra*; *Pher Partners v. Womble* (*In re Womble)*, 289 B.R. 836 (Bankr. N.D. Tex. 2003), *aff'd,* 108 Fed.Appx. 993 (5th Cir. 2004); *Clean Cut Tree Serv., Inc. v. Costello* (*In re Costello*), 299 B.R. 882 (Bankr. N.D. Ill. 2003); *See also, Phillips v. Nipper* (*In re Nipper*), 186 B.R. 284 (Bankr. M.D. Fla. 1995)(debtor's discharge denied because he failed to maintain adequate records of corporation for which he was officer and sole shareholder); *Nof v. Gannon* (*In re Gannon*), 173 B.R. 313 (Bankr. S.D. N.Y. 1994)(debtor's discharge denied based on his failure to account for diamonds and inadequate record keeping).

The initial test under §727(a)(3) is primarily objective. It requires a *prima facia* showing that a debtor failed to keep and maintain adequate books and records, and that this lack of records prevented an understanding of the debtor's financial affairs. *Goff v. Russell Co. (In re Goff)*, 495 F.2d 199 (5th Cir. 1974). The bankruptcy court has "wide discretion" in its inquiry when deciding whether a debtor maintained adequate books and records. *Dennis*, 330 F.3d at 701. Such findings can only be overturned if there was clear error or an abuse of discretion. *Id.* An intent to conceal financial information is not a prerequisite to finding that records were inadequate, *State Bank of India v. Sethi* (*In re Sethi*), 250 B.R. 831, 837 (Bankr. E.D. N.Y. 2000), nor is a lack of records justified by an honest belief that records do not need to be kept. *Miller v. Pulos* (*In re Pulos*), 168 B.R. 682 (Bankr. D. Minn.1994). All that

§727(a)(3) requires is that there be a just reason for having inadequate records.

Once a *prima facie* case is made, the burden shifts to the debtor to justify the inadequacy of records. *Robertson v. Dennis*, 330 F.3d at 703; *Krohn v. Cromer* (*In re Cromer*), 214 B.R. 86 (Bankr. E.D. N.Y. 1997); *Chemical Bank, et. al. v. Hecht* (*In re Hecht*), 237 B.R. 7 (Bankr. D. Conn. 1999). Justification is also a discretionary factual finding made case-by-case and cannot be set aside absent clear error or abuse of discretion. *Meridian Bank v. Alten* (*In re Alten*), 958 F.2d 1226 (2nd Cir. 1992)("[t]he bankruptcy court's determination that all the factual circumstances of the case amounted to justification for inadequate record keeping by the Altens is an ultimate fact").

Section 727(a)(3) does not require perfect financial records that would pass muster under generally accepted accounting principles. However, there must be adequate records, and they must be kept in an intelligent fashion which allows for a reasonable reconstruction of the debtor's financial condition. *Womble*, 289 B.R. at 856. A court's measure for adequacy may include a debtor's occupation, financial structure, education, experience, sophistication, nature of business, motivation for not keeping records, and any other circumstances that serve justice. *United States v. Trogdon (In re Trogdon)*, 111 B.R. 655, 658 (Bankr. N.D. Ohio 1990); *Chicago Title Ins. Co. Inc. v. Mart* (*In re Mart*), 87 B.R. 206, 210 (Bankr. S.D. Fla. 1988). Sophisticated debtors can be held to a higher standard of accountability in record keeping. *Alten*, 958 F.2d at 1231.

C.

The Records the Debtor Produced Do Not Support a Finding that the Bankruptcy Court Abused its Discretion in Ruling the Debtor Failed to Rebut the United States Trustee's *Prima Facia* Case

There is no dispute that the Debtor kept virtually no records of how he spent $5,000 of cash each month. (Rec. at 722-723, 810-811, 882-884, 961-963). The bankruptcy court found that to be the case, *U.S. Trustee v. Hughes,* 353 B.R. at 501, and the district court determined that this finding was not clearly erroneous. *U.S. Trustee v. Hughes*, 386 B.R. at 629. In this appeal, Debtor challenges the findings made by those courts.

To justify his failure to keep or maintain records, the Debtor argues that the bankruptcy court abused its discretion by finding that the retirement plan, insurance policies, partition agreement, copies of judgments, property tax records, corporate records, checks from his wife's account, judgment abstracts, and other papers he produced did not adequately portray his financial condition. (Appellant's Brief at 33). These documents, though, simply do not provide any "paper trail" to the cash which went into and then from the Debtor's drawer at home.

These documents and the others the Debtor produced were irrelevant to his cash distributions, i.e., where hundred of thousands of dollar went, and why it was not available to help pay his $41.8 million debt. (Appellant's Brief at 32). Most of those documents were either forms or contracts prepared by other persons and were not records he generated. While the documents all detailed matters to which the Debtor was a party, they neither memorialized his $5,000 cash transactions each month nor verified his testimony concerning those distributions. Only his pay stubs and tax returns had any relevance to this inquiry, and they did not disclose where the money went. Moreover, the bankruptcy court found these documents to be highly suspect and without effect in explaining the many discrepancies. *United States Trustee v. Hughes*, 353 B.R. at 503. While the Debtor produced: a) one Discover bill (Rec. at 158), b) two cashier's checks for private school tuition (Hockaday Academy and Jesuit Preparatory School) (Rec. at 829), and c) several grocery receipts — those few documents neither clarified nor verified the substantive inconsistencies, nor explained where the vast bulk of the Debtor's income went. Given his motivation for not having records, his argument that the trial court abused its discretion by refusing to find that these materials adequately documented his affairs, is without merit.

Thus, the bankruptcy court did not abuse its discretion in this regard because the evidence adduced at trial supports both the bankruptcy court's and district court's conclusions that the lack of underlying records perpetuated the uncertainty concerning his financial condition. The record reflects too many unanswered questions. Did the Debtor secrete unspent cash? (Rec. at 909-910). It is impossible to ascertain that given the absence of financial records.

Nor are there records to explain why the original information and subsequent amendments to his Schedules I and J regarding his income and expenses are so radically different. (Rec. at 26-27, 48, 801, 803-805, 871-879). Why could the Debtor not reconcile the discrepancies between the income shown on his Statement of Financial Affairs, his amended Statement of Financial Affairs, his tax returns, and his Schedule I? (Rec. at 20-25, 807-809, 842, 871-879). The record also reflects Debtor's inability to explain the discrepancies in his reported income in 2004. (Rec. at 25, 41, 842, 853-857). Nor were there any records to explain whether all of Debtor's reportable income was disclosed or whether there existed any residual tax claims against the estate for unreported income. (Rec. at 25, 842, 899-902), (Dis. Ct. Rec. at 108, Rec. at 24-25). And the Debtor admitted in his testimony that he listed income of $5,000 per month, or approximately $60,000 per year, on his bankruptcy schedules. Based on this figure, he should have received $45,000 in that portion of the calendar year immediately preceding his filing.[14] But because he kept no records, neither the bankruptcy court, nor any party-in-interest could trace, confirm, refute or challenge Debtor's putative receipts or his alleged use of 72% of his personal year-to-date income (almost 20% of the family's salaried income in 2004) for daily expenses. Without records, Hughes essentially asked his creditors to accept his self-serving explanation - Here's what happened to the money, and if you don't believe it, just ask

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[14] January 1, 2005 - October 5, 2005.

me. This situation is precisely the scenario §727(a)(3) was designed to prevent, and the bankruptcy court did not abuse its discretion by denying a discharge on this record. *See Christy v. Kowalski (In re Kowalski)*, 316 B.R. 596, 602 (Bankr. N.D. N.Y. 2004).

The bankruptcy court also did not abuse its discretion in finding that the Debtor's oral explanations were inadequate to justify his utter lack of financial records. (Rec. at 724-728). His original Statement of Financial Affairs reported year-to-date income of $45,000, whereas his amended Statement of Financial Affairs reported $83,000. If the Debtor really earned $6,900 per month as he testified, simple arithmetic dictates that he would have been paid $64,100 in the calendar year before filing bankruptcy. Yet what he reported in response to Question No. 1 on both his original and his amended Statement of Financial Affairs (Rec. at 99, 121) was entirely different. When extrapolated, the figure to which the Debtor testified as his earnings also differed from what he reported on the original and amended Statement of Financial Affairs for income in 2004. This inconsistency was magnified when he increased by 30% the expenses originally reported on Schedule J.[15] The Debtor provided no excuse for the increase in his expenses other than his failure to focus on them when completing the Schedule J. More importantly, he offered no records to validate his explanations.

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[15] His putative expenses increased from $13,445/month to $19,060/month.

Other than a few cashier's checks and some grocery receipts, the Debtor was unable to produce any documents showing how he spent his money. There were no bank statements, canceled checks, ledgers, diaries or receipts for the cash coming out of the drawer for household expenses. He was unable to produce any documentation regarding the manner in which he disposed of approximately $400 to $500 in spending money each month. *United States Trustee v. Hughes*, 353 B.R. at 494. "Failure to justify why he did not track the receipt and expenditure of literally thousands of dollars each month is not justified. His oral testimony of how the funds were spent is not sufficient." *Id*. at 503.

Section 727(a)(3) exists to ensure creditors receive documents so they can ascertain a debtor's financial situation for themselves. The Bankruptcy Code does not require creditors to accept a debtor's word at every turn. *See Krohn v. Cromer, (In re Cromer)*, 214 B.R. 86, 98 (Bankr. E.D. N.Y. 1997); *Structured Asset Serv., L.L.C. v. Self (In re Self),* 325 B.R. 224, 240 (Bankr. N.D. Ill. 2005). When, as here, the Debtor has no supporting documentation, when discrepancies were not explained and when manifest uncertainty remained, it is not an abuse of discretion to deny a discharge.

D.

The Bankruptcy Court Did Not Abuse Its Discretion In Concluding This Debtor Could Reasonably be Expected to Maintain More

Financial Records Than He Did

The Debtor alternatively contends the lower courts erred by applying to him a record-keeping standard more appropriate for business debtors than individual debtors. (Appellant's Brief at 20). In effect, he asks this Court to absolve him from any responsibility for having any records of his personal expenses. The Bankruptcy Code's requirement for record-keeping is not limited to business debtors. Indeed, §727(a)(3) employs the disjunctive "or" between "financial condition" and "business transactions". It requires all debtors to keep and preserve adequate records, not just business debtors. The lack of any records at all per se disqualifies a debtor from receiving a discharge absent an appropriate justification. For this reason alone, the Debtor's argument fails.

Assuming *arguendo* there is an exception that excuses a consumer debtor from record keeping, the Debtor urges this Court to apply this relaxed standard to him because the transactions in question were consumer expenses. (Appellant's Brief at 22). However, even a consumer debtor must have records of personal spending if they expect to receive a discharge. For example, the debtors in *Meridian Bank v. Alten (In re Alten)*, 958 F.2d 1226 (2nd Cir. 1992), like this Debtor, kept few records and used almost exclusively cash transactions. *Alten* at 1228. Acknowledging that having sufficient records was a prerequisite to receiving a discharge, the *Alten* Court found that even a fear of liens and other collection efforts was not sufficient justification for failing to document cash transactions. *Alten* at 1234. *See also, Superior Nat'l Bank v. Schroff* (*In re Schroff*), 156 B.R. 250 (Bankr. W.D. Mo. 1993)(discharge denied when debtor had not had a bank account for over three years, was paid by wholly-owned corporations in cash, received unspecified gambling winnings and loans from his roommate, and operated both his business and personal affairs without records of the cash dealings); *Structured Asset Serv., L.L.C. v. Self* (*In re Self*), 352 B.R. 224 (Bankr. N.D. Ill. 2005)(producing a few bank statements and cancelled checks did not constitute adequate records even for a debtor with only a high school education); *In re Silverman*, 10 B.R. 727 (Bankr. S.D. N.Y. 1981)(discharge denied when the bankrupt[16] could produce virtually no records of his personal spending); *Solomon v. Barman* (*In re Barman*), 244 B.R. 896 (Bankr. E.D. Mich. 2000)(discharge denied when debtor, a professional gambler, kept no records of his winnings, losses, or spending); *Stewart Enterprises, Inc. v. Horton (In re Horton)*, 621 F.2d 968 (9th Cir. 1980)(bankruptcy court properly denied a discharge where the bankrupt dealt in cash because of his dislike of banks and kept no records of how he spent his salary).

In this case, there also was ample evidence that this Debtor was not just a consumer debtor. The bankruptcy court noted that Hughes has an undergraduate

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[16] Debtors filing for bankruptcy prior to 1978 filed under the Bankruptcy Act of 1898, and were referred to as "bankrupts" rather than "debtors" as they are currently referred to under the Bankruptcy Code. The provision in the Bankruptcy Act requiring bankrupts to keep adequate records closely resembled §727(a)(3).

degree in finance and business from the University of Oklahoma (Rec. at 846, 713). He had previously been involved in the construction and sale of "high end" homes ("$200,000 to $300,000 range, some of them on speculation and some custom homes in the Richardson/North Dallas area"). *United States Trustee v. Hughes*, 353 B.R. at 490. He is a sophisticated businessman accustomed to complicated transactions in millions of dollars (Rec. at 744). He amassed $41.8 million in debts arising out of his ventures. (Rec. at 692). He had been personally involved in sophisticated legal proceedings (Rec. at 904). He fashioned means to evade creditors, and maintained that evasion for many years (Rec. at 929-930). The evidentiary record amply supports these specific findings, and Hughes is unable to identify any factual error in that regard. Thus, the bankruptcy court did not abuse its discretion in ruling that this Debtor's virtual absence of financial records for years prior to his bankruptcy filing justified a denial of a discharge.

II

DEBTOR'S AUTHORITIES ARE DISTINGUISHABLE FROM THE PRESENT CASE

The Debtor relies heavily on *Goff v. Russell Co. (In re Goff),* 495 F.2d 199 (5th Cir. 1974), as authority that consumer debtors need not maintain financial records. However, as already explained, §727 requires all debtors to maintain records. *Goff* does not hold otherwise. Instead, in *Goff* this Court upheld the denial of discharge for failure to keep records of a business, and merely alluded in a footnote that ". . . normal people . . . [with] uncomplex [sic] financial affairs...do not require books or substantial records." *Goff* at 202, n. 12. Here, the district court noted this Debtor-businessman's sophistication, experience, and record- keeping abilities were at least as high as the debtor in *Goff*

> "(b)ecause normal people in these classifications do not have lawn and pool maintenance expenses, housekeeping expenses, and children in private school, Hughes's financial affairs are not comparable to a small farmer, traveling salesman, or student. He is a sophisticated business man with a degree in finance who kept no records of his expenditures and provided unreliable documentation of his income."

United States Trustee v. Hughes, 386 B.R. at 629. (Dis. Ct. Rec. At 110-111). Since Mr. Hughes cannot point to a factual error in the lower Courts' findings that he was not a "....normal [person]....[with] uncomplex [sic] financial affairs....", the lower courts's findings that this Debtor was not an unsophisticated wage earner is not clearly erroneous. *Id*.

The Debtor relies on *Chemoil Inc. v. Pfeifle* (*In re Pfeifle*), 154 Fed. Appx. 432 (5th Cir. 2005), for the proposition that a debtor's oral explanation of cash expenditures may be adequate without supporting records. However, the facts in *Pfeifle* are diametric to this case. There, the bankruptcy court exercised its discretion to find that the debtor was unable to maintain adequate records. *Pfeifle* at 435. This contrasts with this case, where the bankruptcy court held that Mr. Hughes could maintain records, but simply did not. *United States Trustee v. Hughes*, 353 B.R. at

502. In addition, this Debtor produced even fewer documents than the debtor in *Pfeifle*. Moreover, in *Pfeifle*, there was no suggestion that the records were in any way suspect, or that the lack of cash accounting was motivated by an effort to avoid creditors. Finally, the fact that the court in *Pfeifle* exercised its discretion to grant a discharge in the absence of such circumstances does not mean it was an abuse of discretion for this bankruptcy court to deny the discharge. That is the essence of an abuse of discretion standard of review. Trial courts retain broad latitude to evaluate the facts of specific cases and make findings based upon them. Where, as here, there is substantial support for the findings, they should be affirmed in all respects.

The Debtor also cites a number of ancient cases decided under the Bankruptcy Act of 1898[17] in an attempt to create the perception that record keeping has never been required for personal spending. (Appellant's Brief at 24). The Debtor's reliance upon *In re McCrea*, 161 F. 246 (2nd Cir. 1908) is misplaced because that court did not state that records of personal transactions are never required - only that a lack of records was not indicative of fraudulent intent. *McCrea* at 217. He also cites *In re Weisman*, 1 F.Supp. 723 (S.D. N.Y. 1932); *In re Rios*, 27 F.Supp. 744 (S.D. N.Y. 1939); *In re Goldman*, 37 F.Supp. 761 (E.D. N.Y. 1941); *In re Perkins*, 40 F.Supp. 114 (D. N.J. 1941); *In re Margolin*, 64 F.Supp. 213 (E.D. N.Y. 1946); and *In re Collins*, 45

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[17] The Bankruptcy Act of 1898 was replaced in its entirety in 1978 by the Bankruptcy Code.

F.Supp. 990 (E.D. N.Y. 1942). All of these cases are factually distinguishable. Unlike the present case, the bankrupts in those cases had not owned or operated businesses over many years (in *Margolin* the bankrupt had a personal business for only two weeks)(in *Collins* the court only stated in *dicta* that records of personal expenses were unnecessary - the court sustained the denial of discharge for lack of business - related records). In contrast, this Debtor was involved in the construction and home building business from the late 1970s through the early 1990s. He was a sophisticated businessman who dealt with multi-million dollar transactions on a regular basis during that time and incurred $41.8 million in losses — money he owes to third party creditors. (Rec. at 692).

The Debtor also relies on cases decided under the Bankruptcy Code as supporting approval for a lack of personal records. These are also factually distinguishable. He cites *In re Shoup*, 214 B.R. 166 (Bankr. N.D. Ohio 1997) for the proposition that the production of bank statements in lieu of the actual checks was sufficient. *Shoup* at 176. In this case, however, the Debtor did not have a checking account. (Rec. at 871). The Debtor also relies upon *Martin Marietta Materials Southwest, Inc. v. Lee* (*In re Lee*), 309 B.R. 468 (Bankr.W.D. Tex. 2004). In that case (unlike here), the debtor had *some* bank statements, checks, and other documents from which the liquidation of investments could be traced. *Lee* at 479. In *Lee*, the court found credible the debtor's explanation that cash was spent on day laborers hired to repair storm damage, and that it was not an uncommon practice for such transactions to go undocumented. *Lee* at 479-80. The Debtor also relies upon *PNC Bank v. Buzzelli* (*In re Buzzelli*), 246 B.R. 75 (Bankr. W.D. Pa. 2000), and the quotation therein from Collier on Bankruptcy, that his failure to keep records should be vindicating because "few" other consumers do so. *Buzzelli* at 98, *citing* 6 Collier on Bankruptcy ¶ 727.03[3][g] at 727-36 (Bender 1999). This commentary and the Debtor's reliance thereon appears premised on the theory that most consumer debtors do not maintain extensive books and records beyond bills, receipts, and cancelled checks. *Buzzelli* at 98. However, both the debtor in *Buzzelli* (an ophthalmologist with a solo practice) and Hughes are sophisticated businessmen compared with average consumer debtors. *See Buzelli* at 86. Furthermore, the trial court has broad discretion to view a debtor's sophistication, motivation, and all the circumstances of a case to determine whether a lack of records is justified. The Debtor's cases are either factually distinguishable from the present or are not controlling.

CONCLUSION

For these reasons, the United States Trustee respectfully asks this Court to affirm the orders entered below.

DATED: May 23, 2011 Respectfully submitted,

WILLIAM T. NEARY
UNITED STATES TRUSTEE

William S. Parkinson
Ohio Bar Registration 0021679
Office of the United States Trustee
Department of Justice
1100 Commerce Street Room 976
Dallas, Texas 75242
(214) 767-8967

CERTIFICATE OF COMPLIANCE

In accordance with Fed. R. App. P. 32(a)(7)(C), I hereby certify that this Brief is monospaced in 14-point Times New Roman fint and was produced on Corel WordPerfect 12.0. Exclusive of portions exempted by Fed. R. App. P. 32(a)(7)(B)(iii), this brief contains 6,329 words according to Corel WordPerfect 12.0.

William S. Parkinson

CERTIFICATE OF SERVICE

I do hereby certify that on May 23, 2011, a true copy of the foregoing document was forwarded by first class United States mail to the following persons:

Mark Agee, Esq.
5401 North Central Expressway
Suite 220
Dallas, Texas 75205

Bruce Thomas, Esq.
1825 Market Center Blvd., Ste. 200
Dallas, Texas 75207

William S. Parkinson

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WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE
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In re Paul Hupp (Paul Hupp v. Educational Credit Management)

2. ("CO") ***CURRENT*** COURT
[E.g., "CTA9"]
9rd Cir.

3. ("CCN") ***CURRENT*** CASE NO.
No.: 08-56403

4. ("PCN") ***PRIOR*** CASE NO. & COURT
[IF ANY]
No.: 3-08-cv-00414-H-RBB
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Christopher C. Fonzone
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s)
&
√ Any Miscellaneous ***BACKGROUND***

• 1). Whether the bankruptcy code's student loan non-dischargeability provision, 11 U.S.C. § 523(a)(8), and the statutory provision authorizing the Secretary of Education to recoup collection costs from defaulting borrowers, 20 U.S.C. § 1091a, violate due process, equal protection, and a number of other constitutional protections.
2). Whether the bankruptcy court erred in granting extensions of time to and engaging in ex parte communication with the United States and denying plaintiff's motion for class certification.

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IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

PAUL HUPP,

Plaintiff-Appellant,

v.

EDUCATIONAL CREDIT MANAGEMENT CORPORATION,

Defendant-Appellee

and

THE UNITED STATES OF AMERICA,

Intervenor-Appellee.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF CALIFORNIA

BRIEF FOR INTERVENOR-APPELLEE

TONY WEST
Assistant Attorney General

WILLIAM KANTER
(202) 514-4575
CHRISTOPHER C. FONZONE
(202) 514-1838
Attorneys, Appellate Staff
Civil Division, Room 7242
U.S. Department of Justice
950 Pennsylvania Avenue, N.W.
Washington, DC 20530-0001

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ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF CALIFORNIA

BRIEF FOR INTERVENOR-APPELLEE

STATEMENT OF JURISDICTION

Appellant brought this action seeking to discharge his educational loans. See 11 U.S.C. § 523(a)(8). The bankruptcy court had jurisdiction over Appellant's action pursuant to 28 U.S.C. § 1334(b) and 28 U.S.C. § 157(b)(2)(I). The district court had jurisdiction to hear the appeal from the bankruptcy court under 28 U.S.C. § 158(a).

On August 15, 2008, the district court entered a final judgment against Appellant. No post-judgment motion was filed. Appellant filed a timely Notice of Appeal on August 18, 2008. This court has jurisdiction under 28 U.S.C. § 1291.

STATEMENT OF THE ISSUES

1. Whether the Bankruptcy Code's student loan non-dischargeability provision, 11 U.S.C. § 523(a)(8), and the statutory provision authorizing the Secretary of Education to recoup collection costs from defaulting borrowers, 20 U.S.C. § 1091a, violate Due Process, Equal Protection, and a number of other constitutional protections.

2. Whether the bankruptcy court erred in granting extensions of time to and engaging in ex parte communication with the United States and denying Plaintiff's motion for class certification.

STATEMENT OF THE CASE

I. Nature of the Case

Paul Hupp ("Plaintiff" or "Appellant") filed suit against the Educational Credit Management Corporation ("ECMC") in the United States Bankruptcy Court for the Southern District of California seeking to discharge educational loans pursuant to 11 U.S.C. § 523(a)(8). Plaintiff also argued that the non-dischargeability provisions of 11 U.S.C. § 523(a)(8) and the collection costs authorized by 20 U.S.C. § 1091a violate various constitutional provisions. The United States intervened to defend the constitutionality of the challenged statutory provisions.

After a trial, the bankruptcy court determined that Plaintiff was not entitled to discharge his educational loans. On appeal, the District Court for the Southern District of California affirmed the bankruptcy court's decision declaring Plaintiff's student debt non-dischargeable. In addition, the district court upheld the constitutionality of 11 U.S.C. § 523(a)(8) and 20 U.S.C. § 1091a. Hupp appealed, and is litigating this case in a pro se capacity.

II. Statutory and Regulatory Background

A. 11 U.S.C. § 523(a)(8)

While "[o]ne of the primary purposes of the Bankruptcy Act" is to grant debtors "a new opportunity in life" through the discharge of preexisting debts, Local Loan Co. v. Hunt, 292 U.S. 234, 244 (1934), the right to discharge has never been absolute, see Grogan v. Garner, 498 U.S. 279, 287 (1991). Indeed, the Bankruptcy Code, like the Bankruptcy Act before it, has long contained non-dischargeability provisions that reflect Congress's decision "to exclude from the general policy of discharge certain categories of debts." Id.

Educational loans are one such category of debt. Pursuant to 11 U.S.C. § 523(a)(8), "an individual debtor" may not discharge an educational loan in bankruptcy "unless excepting such debt from discharge under this paragraph would impose an undue hardship on the debtor and the debtor's dependents."[1] When originally enacted, § 523(a)(8) provided that student loan debts were non-dischargeable for five years. See Education Amendments of 1976, Pub. L. No. 94-482, § 127(a), 90 Stat. 2081. Congress subsequently extended the period of non-dischargeability to seven years in 1990, see Pub. L. No. 101-647, 104 Stat. 4865, 4964-65 (1990), and in 1998 Congress provided for an indefinite period of non-dischargeability, see Pub. L. No. 105-244, 112 Stat 1581, 1837 (1998).

Congress enacted 11 U.S.C. § 523(a)(8) in response to a "rising incidence" of consumer bankruptcies among former students, many of whom were declaring bankruptcy immediately upon graduation. See Report of the Commission on the Bankruptcy Laws of the United States, House Doc. No. 93-137, Pt. I, 93d Cong., 1st Sess. (1973) at 140 n. 14. This provision was thus designed "to prevent abuses in and protect the solvency of" federal educational loan programs. In re Merchant, 958 F.2d 738, 742 (6th Cir. 1992); see also In re Pena, 155 F.3d 1108, 1111 (9th Cir. 1998); In re Pelkowski, 990 F.2d 737, 743 (3d. Cir. 1993); In re Brunner, 46 B.R. 752, 753-54

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[1] Under the prevailing law of this court, a debtor must satisfy a three-part test to demonstrate undue hardship: (1) the debtor must establish "'that she cannot maintain, based on current income and expenses, a minimal standard of living . . . if forced to repay the loans;'" (2) the debtor must show that "'this state of affairs is likely to persist for a significant portion of the repayment period of the student loans;'" and (3) the debtor must demonstrate that he "'has made good faith efforts to repay the loans.'" In re Pena, 155 F.3d 1108, 1111 (9th Cir. 1998) (quoting In re Brunner, 831 F.2d 395, 396 (2d Cir. 1987)).

(Bankr.D.C.N.Y.1985). Indeed, "Congress, by excepting educational loans from discharge, has determined that the continued solvency of educational funding and financial aid programs override the need to provide debtors with a fresh start in their financial affairs." Merchant, 958 F.2d at 742; see also Grogan, 498 U.S. at 287 (noting that non-dischargeability provisions reflect Congress's judgment that, for certain categories of debt, "the creditors' interest in recovering full payment" outweighs "the debtors' interest in a complete fresh start").

B. 20 U.S.C. § 1091a

The other statutory provision at issue in this case, 20 U.S.C. § 1091a, states that "a borrower who has defaulted" on a federal educational loan, "shall be required to pay . . . reasonable collection costs." See 20 U.S.C. § 1091a(b)(1). This provision ensures that "the borrowers themselves, [and] not the taxpayers, should bear the reasonable costs of collecting student loans in default." Black v. Educational Credit Management Corp., 459 F.3d 796, 800 (7th Cir. 2006); see also H.R. Rep. No. 99-383, at 41 (1985) (noting that 20 U.S.C. § 1091a(b)(1) was enacted in order to "reduce collection costs").

The Secretary's regulations implementing 20 U.S.C. § 1091a(b)(1) confirm the statute's focus on properly allocating collection costs. The regulations state that the holder of a student loan "shall charge a borrower an amount equal" to the "reasonable costs" of "collecting a loan on which the agency has paid a default or bankruptcy claim." 34 C.F.R. § 682.410(b)(2). "These costs may include, but are not limited to, all attorney's fees, collection agency charges, and court costs." Id.; see also 34 C.F.R. § 30.60 (providing a list of "costs associated with the collection of a particular debt" that the Secretary of Education may charge a debtor).

III. Statement of Facts and Proceedings Below

A. Background and Procedural History

1. Plaintiff attended San Diego State University from 1986 to 1990, earning a bachelor's degree in education. See Complaint ¶¶ 6-7, at A31.[2] To finance his education, Plaintiff obtained three federally-subsidized student loans totaling $7,300. See District Court Opinion ("Op.") at A2.[3] Plaintiff later consolidated these three loans into a single loan. Op. at A2.

From approximately May 1987 until 1998, Plaintiff successfully requested forbearance or deferment of his educational debts. Op. at A2. Plaintiff's forbearance or deferments ended on January 1, 1998, when Plaintiff determined he could not pay the consolidated loan. Id. Plaintiff's loan then went into default. Op. at A2.

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[2] For the Court's convenience, we have included excerpts of Plaintiff's Complaint as an addendum to this brief. The Complaint is docket #1 in Plaintiff's bankruptcy court adversary proceeding, Hupp v. ECMC, No. 06-00198 (Bankr. S.D. Cal.).

[3] For the Court's convenience, we have included a copy of the district court's opinion as an addendum to this brief.

2. On February 8, 2006, Plaintiff commenced this adversary proceeding against ECMC[4] in the United States Bankruptcy Court for the Southern District of California in order to determine the dischargeability of his student loan debt. Op. at A4. In his complaint, Plaintiff asserted that he owed approximately $60,000 on his defaulted student loans. Op. at A4.

Plaintiff subsequently filed a motion for summary judgment. Op. at A4. Plaintiff argued that his student debts constituted an "undue hardship" and that he was thus entitled to discharge under 11 U.S.C. § 523(a)(8). Plaintiff also argued that the non-dischargeability provisions of 11 U.S.C. § 523(a)(8) and the collection costs authorized by 20 U.S.C. § 1091a violated various constitutional protections. The United States intervened to defend the constitutionality of the challenged statutory provisions. See 28 U.S.C. § 2403(a).

The bankruptcy court denied Plaintiff's motion for summary judgment without opinion, and entered an order specifying that Plaintiff's trial would be "limited to the issue of undue hardship under 11 U.S.C. § 523(a)(8)." Op. at A5. After a trial, the court ruled that Plaintiff's loans do not constitute an undue hardship, and that Plaintiff was therefore not entitled to a discharge of his

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[4] Plaintiff initially filed suit against United Student Aid Funds ("USAF"), Inc. See Op. at A4. ECMC filed the Answer to Plaintiff's Complaint, however, since USAF was in the process of transferring all of its student loans to ECMC, and ECMC was the real party in interest in the case. See Op. at A4.

educational debts. Op. at A5. Plaintiff timely appealed the bankruptcy court's decision to the district court. See 28 U.S.C. § 158(a).

3. Before the district court, Plaintiff reasserted that he was entitled to discharge his educational loans as an "undue hardship" under 11 U.S.C. § 523(a)(8), and he again raised numerous challenges to the constitutionality of both 11 U.S.C. § 523(a)(8) and 20 U.S.C. § 1091a. Additionally, Plaintiff also challenged a number of the bankruptcy court's "discovery rulings, procedural decisions, and scheduling orders." See Op. at A15.

As it did in the bankruptcy court, the United States filed a brief as an intervenor defending the constitutionality of both 11 U.S.C. § 523(a)(8) and 20 U.S.C. § 1091a. In its briefing, the United States also argued that Plaintiff's procedural claims implicating the United States were meritless.

B. The District Court's Decision

The district court rejected all of Plaintiff's claims and "affirm[ed] in its entirety the decision of the bankruptcy court." Op. at A17. In so doing, the court concluded that the Plaintiff had "failed to establish that being forced to repay his student loans would constitute an undue hardship under" 11 U.S.C. § 523(a)(8). Op. at A7. The district court thus affirmed the bankruptcy court's decision to deny the plaintiff a discharge of his educational debts.

The district court also rejected Plaintiff's various constitutional arguments, starting with the claim that § 523(a)(8) violates the Fifth Amendment's Due Process and Equal Protection guarantees. Noting that there is "'no constitutional right to obtain a discharge of one's debts,'" Op. at A10 (quoting United States v. Kras, 409 U.S. 434, 446 (1973)), the court held that § 523(a)(8) neither infringes a fundamental right nor discriminates against a suspect class, Op. at A10-A11. The court thus evaluated the constitutionality of the provision using rational basis review, and concluded that § 523(a)(8) was rationally related to Congress's legitimate interests in "prevent[ing] abuses in" and "protect[ing] the solvency" of federal student loan programs. Op. at A12.

The court rejected Plaintiff's three other challenges to the constitutionality of § 523(a)(8). First, the court determined that the 1990 and 1998 amendments to § 523(a)(8) were not impermissibly retroactive legislation, since the amendments altered "no rights that had vested in Plaintiff." Op. at A13. Moreover, the court noted that, even if the amendments were retroactive, "the Constitution only forbids the retroactive application of penal legislation and civil legislation that is so punitive as to be quasi-penal," and "§ 523(a)(8) does not qualify as such a law." Op. at A13. Second, the court concluded that § 523(a)(8) was not void for vagueness, since "ordinary civil" statutes are "only susceptible to challenge on vagueness grounds" if they are "substantially incomprehensible." Op. at A13 (internal quotations omitted). Third, the court found "no support" for the Plaintiff's argument that "the Constitution . . . renders a loan contract unenforceable" if there is no mutuality of contract, and similarly rejected Plaintiff's arguments that his student loan contract was unconstitutionally unconscionable, and that "the government interfered with Plaintiff's ability to repay his loan." Op. at A12, A14.

The district court also determined that 20 U.S.C. § 1091a does not violate the Excessive Fines Clause of the Eighth Amendment, since § 1091a does not serve "punitive purposes" and the Excessive Fines Clause only limits "the government's ability 'to extract payments . . . as punishment.'" Op. at A14 (quoting Austin v. United States, 509 U.S. 602, 609-10 (1993)) (emphasis in original).

Finally, the district court affirmed all of the bankruptcy court's "discovery rulings, procedural decisions, and scheduling orders," including those that implicated the United States. Op. at A15-A17. In particular, the court concluded that the bankruptcy court did not abuse its discretion in granting the United States extensions of time or denying Plaintiff's motion for class certification. See Op. at A15-A16. The court also rejected Plaintiff's claim that an "administrative" discussion between the United States and a member of the bankruptcy court's staff comprised an improper ex parte communication, finding that

Plaintiff did not "allege, much less prove, that any improper communication occurred" between the United States and the trial court "regarding the merits of a pending case." Op. at A17.

SUMMARY OF THE ARGUMENT

I. The United States intervenes to defend the constitutionality of the Bankruptcy Code's student loan non-dischargeability provision, 11 U.S.C. § 523(a)(8), and the statutory provision authorizing the Secretary of Education to recoup collection costs from defaulting borrowers, 20 U.S.C. § 1091a, against the constitutional challenges advanced in Plaintiff's brief. As we demonstrate below, each of Plaintiff's numerous challenges is meritless. Both provisions are fully constitutional, and the district court was correct to uphold them.

A. Plaintiff's primary claim is that 11 U.S.C. § 523(a)(8) and 20 U.S.C. § 1091a violate the Fifth Amendment's Equal Protection and Due Process guarantees. This argument fails, however, because both 11 U.S.C. § 523(a)(8) and 20 U.S.C. § 1091a constitute economic legislation that neither infringes on a protected right nor discriminates against a protected class. And since these provisions are both related to the legitimate governmental goals of preventing abuses in and protecting the solvency of federal student loan programs, they easily satisfy rational basis review.

B. Plaintiff also incorrectly claims that 11 U.S.C. §

523(a)(8)'s "undue hardship" standard violates constitutional prohibitions on vague and overbroad legislation. As this Court has noted, there is a settled judicial interpretation of the "undue hardship" standard, see In re Pena, 155 F.3d 1108, 1111 (9th Cir. 1998), and § 523(a)(8) can thus hardly be termed "substantially incomprehensible" and void for vagueness. Likewise, § 523(a)(8) infringes none of Plaintiff's fundamental rights, and is therefore not substantially overbroad.

C. Plaintiff's numerous challenges to the constitutionality of 20 U.S.C. § 1091a and its implementing regulations are also mistaken. These provisions authorize lenders to charge debtors for the "reasonable costs incurred" in collecting a loan. See 34 C.F.R. § 682.410(b)(2). As such, the provisions serve a remedial, not a punitive, purpose, and Plaintiff's Ex Post Facto Clause and Eighth Amendment Excessive Fines Clause challenges must therefore fail. Additionally, 20 U.S.C. § 1091a and its associated regulations do not violate Plaintiff's procedural due process rights, as they provide a debtor with notice and a hearing before allowing a creditor to offset tax refunds or garnish wages.

D. Finally, Plaintiff erroneously claims that the provisions at issue here violate a number of common law contract doctrines – mutuality of contract, unconscionability, and unclean hands - and that these contractual violations render the provisions unconstitutional. Not only are the contractual doctrines on which

Plaintiff relies without constitutional significance, but Plaintiff's contractual arguments also fail on their own terms.

II. In addition to his substantive constitutional claims, Plaintiff challenges numerous procedural decisions made by the bankruptcy court, three of which implicate the United States. These claims are meritless. The bankruptcy court did not abuse its discretion in granting the United States extensions of time or denying Plaintiff's motion for class certification, and the court engaged in no improper ex parte communications with the United States. The district court correctly rejected Plaintiff's procedural claims.

STANDARD OF REVIEW

A district court's ruling on the constitutionality of an act of Congress is subject to de novo review by this Court. United States v. Serang, 156 F.3d 910, 913 (9th Cir. 1998).

ARGUMENT

I. BOTH 11 U.S.C. § 523(a)(8) AND 20 U.S.C. § 1091a ARE CONSTITUTIONAL.

A. 11 U.S.C. § 523(a)(8) and 20 U.S.C. § 1091a Do Not Violate the Fifth Amendment's Due Process or Equal Protection Guarantees.

Plaintiff's primary constitutional argument is that 11 U.S.C. § 523(a)(8) and 20 U.S.C. § 1091a violate the Fifth Amendment's Due Process and Equal Protection guarantees. This argument is mistaken: neither of these provisions infringe a fundamental right or discriminate against a protected class, and both provisions easily satisfy rational basis review.

1. Rational Basis Review Applies As Neither 11 U.S.C. § 523(a)(8) Nor 20 U.S.C. § 1091a Infringes a Fundamental Right or Discriminates Against a Suspect Class.

Plaintiff argues that this Court should apply strict scrutiny in reviewing his Fifth Amendment challenge to 11 U.S.C. § 523(a)(8) and 20 U.S.C. § 1091a. But strict scrutiny is appropriate only if a challenged statute infringes a fundamental right or discriminates against a suspect class. See Kadrmas v. Dickinson Pub. Sch., 487 U.S. 450, 457-58 (1988). The provisions at issue in this case do neither.

a. Neither 11 U.S.C. § 523(a)(8) nor 20 U.S.C. § 1091a infringes on Plaintiff's fundamental constitutional rights. As discussed above, 11 U.S.C. § 523(a)(8) excepts student loan debts from discharge in bankruptcy unless doing so would cause undue hardship to the debtor and his dependents. Thus, for certain debtors, Section 523(a)(8) limits a statutorily granted right, not a fundamental constitutional right. Indeed, as the Supreme Court has held, "[t]here is no constitutional right to obtain a discharge of one's debts." United States v. Kras, 409 U.S. 434, 446 (1973).

Likewise, 20 U.S.C. § 1091a provides that "a borrower who has defaulted" on a federal educational loan, "shall be required to pay . . . reasonable collection costs." Fees of this sort – which require an individual to reimburse the government for monies spent due to the individual’s actions – are entirely commonplace, and clearly do not infringe on any fundamental constitutional rights. See Washington v. Glucksberg, 521 U.S. 702, 721 (1997) (stating that a fundamental constitutional right must not only be “deeply rooted in this Nation's history and tradition,” but also “implicit in the concept of ordered liberty,” so that “neither liberty nor justice would exist if [it] were sacrificed”).

While plaintiff contends that these provisions violate his fundamental right to the "basic necessities of life", see Appellant’s Brief at 12, it is important to recall that the Supreme Court has recognized that legislation affecting “the most basic economic needs of impoverished human beings” often involves “‘practical’” trade-offs between competing societal interests. Dandridge v. Williams, 397 U.S. 471, 485 (1970) (quoting Metropolis Theatre Co. v. City of Chicago, 228 U.S. 61, 69-70 (1913)). Federal courts thus have “no power to impose . . . their views of what constitutes wise economic or social policy” when reviewing such legislation. Id. at 486; see also San Antonio Independent School Dist. v. Rodriguez, 411 U.S. 1, 29-39 (1973).

Moreover, even if such a putative right to “basic necessities” did exist, it would not be infringed by the provisions at issue here. As the district court recognized, the very purpose of § 523(a)(8)’s “undue hardship” exception is to guarantee a discharge for those who truly cannot obtain the “basic necessities of life” if their student loan debt is not discharged. See Comm'n on the Bankruptcy Laws of the United States, Report, H.R. Doc. No. 93-137, pt. II, at 140-41 n.17 (1973) (stating that discharge should be allowed if a debtor cannot maintain a "minimal standard of living" for himself and his dependents); Collier on Bankruptcy § 523.14 (Alan J. Resnick & Henry J. Sommer eds., 15th ed. 2006). In other words, the Bankruptcy Code's student loan non-dischargeability provision honors the very "right" Plaintiff claims it violates.

Plaintiff's reliance on Shapiro v. Thompson, 394 U.S. 618 (1969) is also misplaced. In Shapiro, the Supreme Court applied strict scrutiny to a durational residency requirement, not because the regulation affected the "basic necessities of life," but because it infringed the right to interstate travel. Id. at 637; see also Saenz v. Roe, 526 U.S. 489, 499 (1999); Dandridge, 397 U.S. at 484 n. 16. That right is plainly not implicated here.

b. Nor do 11 U.S.C. § 523(a)(8) or 20 U.S.C. § 1091a discriminate against a suspect class. Plaintiff argues that these provisions should be subjected to strict scrutiny because they discriminate based on "wealth." See Appellant's Br. at 12-13. But the Supreme Court has long held that the indigent are not a suspect class, see Kadrmas, 487 U.S. at 458; Harris v. McRae, 448 U.S. 297, 322-23 (1980); Rodriguez v. Cook, 169 F.3d 1176, 1179 (9th Cir. 1999), and, regardless, as the district court noted and we discuss above, the "undue hardship" exception actually benefits impoverished individuals. See Op. at A10-A11.

Plaintiff’s argument that 11 U.S.C. § 523(a)(8) and 20 U.S.C. § 1091a discriminate based on race also fails. Plaintiff notes that neither provision references race in any way, but he claims that the provisions should be subjected to strict scrutiny regardless, since they “can be traced to a racially discriminatory purpose.” See Appellant’s Brief at 13 (citing Washington v. Davis, 426 U.S. 229 (1976)). But Plaintiff produces no evidence that Congress was motivated by a discriminatory purpose in passing either 11 U.S.C. § 523(a)(8) or 20 U.S.C. § 1091a other than reports demonstrating that loan default rates vary based on race. See id. at 13-18.

As the district court correctly held, Plaintiff’s statistical evidence “fall[s] far short” of triggering strict scrutiny. See Op. at A11. The Supreme Court has long held that “naked statistical” evidence is insufficient, except in extremely rare instances, to demonstrate discriminatory purpose. See Jefferson v. Hackney, 406 U.S. 535, 548 (1972); see also Arlington Heights v. Metropolitan Housing Dev. Corp., 429 U.S. 252, 266 (1977). Indeed, evidence of statistical disparity must be so “stark” to trigger strict scrutiny, Arlington Heights, 429 U.S. at 266, that the data must be “tantamount for all practical purposes to a mathematical demonstration” that the relevant government officials acted with a discriminatory purpose. See Gomillion v. Lightfoot, 364 U.S. 339, 340-41 (1960) (finding that a state legislature violated equal protection when it altered city boundaries "from a square to an uncouth twenty-eight-sided figure" in order to exclude 395 of 400 black voters without excluding a single white voter); see also Yick Wo v. Hopkins, 118 U.S. 356 (1886) (holding a laundry permitting scheme unconstitutional when all but one of the white applicants received permits, but none of the over 200 Chinese applicants did). The statistical data presented by Plaintiff here simply does not demonstrate the same "stark" pattern of discriminatory impact as the data presented by the plaintiffs in Gomillion or Yick Wo.

2. 11 U.S.C. § 523(a)(8) and 20 U.S.C. § 1091a Are Rationally Related to a Legitimate Government Purpose.

Since the Bankruptcy Code's student loan non-dischargeability provisions neither infringe upon a fundamental right nor discriminate against a protected class, the provisions must satisfy rational basis review to be constitutional. See, e.g., Heller v. Doe, 509 U.S. 312, 319-320 (1993). Under rational basis review, legislation "is presumed to be valid" and will be sustained if it "is rationally related to a legitimate state interest." City of Cleburne v. Cleburne Living Ctr., 473 U.S. 432, 440 (1985). Further, the heavy burden of negating every conceivable rational basis for the challenged statute falls upon the plaintiff. FCC v. Beach Communications, Inc., 508 U.S. 307, 314-15 (1993).

Here, Plaintiff is unable to meet that burden. In passing 11

U.S.C. § 523(a)(8), Congress responded to a "rising incidence" of consumer bankruptcies among former students by limiting the discharge of student debts. See Report of the Commission on the Bankruptcy Laws of the United States, House Doc. No. 93-137, Pt. I, 93d Cong., 1st Sess. (1973) at 140 n. 14. Congress thus sought to limit the dischargeability of student debts in order to "forestall students . . . from abusing the bankruptcy system," In re Pena, 155 F.3d 1108, 1111 (9th Cir. 1998) (internal quotations omitted), and to "protect the solvency" of the federal student loan program, In re Merchant, 958 F.2d 738, 742 (6th Cir. 1992). Section 523(a)(8) - and its subsequent amendments - therefore represent a rational Congressional decision to prioritize the government's legitimate interests in providing low-cost loans to frequently underprivileged students over the interest of some individuals in obtaining a discharge of their student debts through bankruptcy. See, e.g., Grogan v. Garner, 498 U.S. 279, 287 (1991).

Likewise, in passing 20 U.S.C. § 1091a(b)(1), Congress made the rational judgment that the defaulting "borrowers themselves . . . should bear the reasonable costs of collecting student loans in default." Black v. Educational Credit Management Corp., 459 F.3d 796, 800 (7th Cir. 2006). This provision therefore not only reduces the overall cost of the student loan program to the government, see H.R. Rep. No. 99-383, at 40-41 (1985), but it also ensures that the costs of default are not borne by non-defaulting student debtors (in the form of higher rates) or taxpayers in general, see Black, 459 F.3d at 800. These are both legitimate goals, and § 1091a(b)(1) easily survives rational basis review.

Plaintiff challenges the rationality of 11 U.S.C. § 523(a)(8) and 20 U.S.C. § 1091a on two fronts. Both of Plaintiff's arguments misunderstand the nature of rational basis review, however. Plaintiff first contends that § 523(a)(8) and § 1091a were not supported by "valid and reliable" evidence, and that Congress instead passed the legislation based on "wild speculation and anecdotal evidence" and without sufficient debate. See Appellant's Brief at 19, 21-22. But, as the Supreme Court has recognized, a legislative choice is not subject to courtroom fact-finding and the choice may be based on rational speculation unsupported by evidence or empirical data. See, e.g., Vance v. Bradley, 440 U.S. 93, 111 (1979); Williamson v. Lee Optical of Oklahoma, 348 U.S. 483, 487 (1955) (stating that it is the role of the "legislature, not the courts, to balance the advantages and disadvantages" of economic legislation). Indeed, both the nature and extent of Congress's deliberations and the congressional record are irrelevant to rational basis review, see Beach Communications, 508 U.S. at 315, as the government is not even required to show that Congress actually considered the rationale for a statute that the government is advancing before the court, see Heller, 509 U.S. at 320; Nordlinger v. Hahn, 505 U.S. 1, 15 (1992). Instead, Plaintiff must counter all possible rationales for the statute "whether or not the basis has a foundation in the record." Heller, 509 U.S. at 320-21. As demonstrated above, this is a burden Plaintiff cannot carry.

Second, Plaintiff claims that the Bankruptcy Code's student loan non-dischargeability provisions are overbroad and more "draconian" than necessary to protect the solvency of the student loan program and deal with the problem of abusive student loan discharges. See Appellant's Brief at 19-22. This argument ignores, however, the fact that legislation "is not required to resort to close distinctions or to maintain a precise, scientific uniformity with reference" to its goals in order to survive rational basis review. Allied Stores of Ohio, Inc. v. Bowers, 358 U.S. 522, 527 (1959). As the Supreme Court has made clear, legislation "does not offend the Constitution simply because . . . [it] 'is not made with mathematical nicety,'" Dandridge, 397 U.S. at 485 (quoting Lindsley v. Natural Carbonic Gas Co., 220 U.S. 61, 78 (1911)).

Moreover, this is true even if Plaintiff is correct that 11 U.S.C. § 523(a)(8) and 20 U.S.C. § 1091a did not on their own "lead to a significant increase in the availability of private student loans." Appellant's Brief at 20. The cost of student loans is undoubtedly affected by many factors – both within and outside the control of Congress – and rational basis review simply does not "require[]" legislation to eradicate "all evils of the same genus" to be constitutional. See Ry. Express Agency, Inc. v. New York, 336 U.S. 106, 110 (1949).

B. 11 U.S.C. § 523(a)(8) Is Neither Void for Vagueness Nor Overbroad.

Pursuant to 11 U.S.C. § 523(a)(8), a debtor may only discharge an educational loan in bankruptcy if "excepting such debt from discharge . . . would impose an undue hardship on the debtor and the debtor's dependents." Plaintiff argues that this provision is unconstitutionally vague and overbroad because "[t]here is absolutely no way to determine" what the "'undue hardship' term encompasses." See Appellant's Brief at 23. Plaintiff's arguments are mistaken.

First, as the district court correctly recognized, 11 U.S.C. § 523(a)(8) is not void for vagueness. As this Court has noted, civil statutes as reviewed for "'vagueness with somewhat greater tolerance than [statutes] involving criminal penalties,' because the consequences of imprecision are less severe." Craft v. National Park Service, 34 F.3d 918, 922 (9th Cir. 1994) (quoting United States v. 594,464 Pounds of Salmon, 871 F.2d 824, 829 (9th Cir. 1989)). Thus, vagueness review of civil statutes is "fairly lenient," Doe v. Staples, 706 F.2d 985, 988 (6th Cir. 1983), particularly where, as here, the challenged statute does not "threaten[] to inhibit the exercise of constitutionally protected rights," Hoffman Estates v. Flipside, Hoffman Estates, 455 U.S. 489, 499 (1982). Indeed, a court will only invalidate an ordinary civil statute on vagueness grounds if it is “substantially incomprehensible,” Staples, 706 F.2d at 988; Exxon Corp. v. Busbee, 644 F.2d 1030 (5th Cir. 1981), or "so vague and indefinite as really to be no rule or standard at all,” A.B. Small Co. v. American Sugar Refining Co., 267 U.S. 233, 239 (1925).

Given these standards, § 523(a)(8) is plainly not void for vagueness. This Court and other circuit courts, as well as the “bankruptcy and district courts” in nearly every federal circuit, all use the three-part Brunner test for determining when a debtor is entitled to an “undue hardship” discharge of his student loans. See supra note 2; see also In re Pena, 155 F.3d 1108, 1111 (9th Cir. 1998) (detailing all of the federal courts that employ the Brunner test); but see In re Long, 322 F.3d 549, 554 (8th Cir. 2003) (employing a totality of the debtor’s economic circumstances test rather than the Brunner test). While the Brunner test does leave some room for judges to make discretionary determinations regarding a debtor’s financial means, § 523(a)(8)’s “undue hardship” term can hardly be termed “incomprehensible” or “no standard at all” in light of such a settled judicial interpretation.

Second, 11 U.S.C. § 523(a)(8) is not overbroad. See Plaintiff’s Brief at 23. As this Court has recognized, the “overbreadth doctrine requires that the enactment reach ‘a substantial amount of constitutionally protected conduct. If it does not, then the overbreadth challenge must fail.'" Craft, 34 F.3d at 921 (quoting United States v. Austin, 902 F.2d 743, 744 (9th Cir.)); see also Hoffman Estates, 455 U.S. at 494. As discussed earlier, "[t]here is no constitutional right to obtain a discharge of one's debts," Kras, 409 U.S. at 446, and Plaintiff does not successfully argue that § 523(a)(8) infringes on any of his other fundamental rights, see supra at I.A.1. Plaintiff's overbreadth challenge must therefore fail.

C. Plaintiff's Remaining Challenges to the Constitutionality of 20 U.S.C. § 1091a Fail.

In his briefing, Plaintiff advances numerous challenges to the constitutionality of 20 U.S.C. § 1091a and its implementing regulations. As we demonstrate below, each of Plaintiff's claims fails.

1. Plaintiff first argues that 20 U.S.C. § 1091a and its supporting regulations were put into place "after he took out his student loans in 1986, 1987, and 1988," and that the provisions therefore violate the Ex Post Facto Clause. See Appellant's Brief at 24. This claim is baseless: even if we assume that the challenged provisions do post-date Plaintiff's student loans – which is by no means certain[5] – these provisions do not violate the

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[5] According to Plaintiff's complaint, he took out educational loans on April 26, 1986, April 7, 1987, and November 7, 1988; and consolidated these loans on December 27, 1991. See Complaint ¶¶ 9-12, at A31. Thus, all of Plaintiff's loans post-date the original statutory provision stating that "borrower[s] who ha[ve] defaulted"
(continued...)

Ex Post Facto Clause. See Landgraf v. USI Film Products, 511 U.S. 244, 267-68 (1994) (noting that retroactive legislation "often serve[s] entirely benign and legitimate purposes," such as "simply [giving] comprehensive effect to a new law Congress considers salutary").

Indeed, 20 U.S.C. § 1091a and its supporting regulations do not even implicate the Ex Post Facto Clause. As the Supreme Court has stated, the Ex Post Facto Clause only prohibits the retroactive application of penal, and not civil, legislation, unless the regulatory scheme is "so punitive either in purpose or effect as to negate" the intention to deem it civil. Smith v. Doe, 538 U.S. 84, 92 (2003) (internal quotations omitted); see also Hudson v. United States, 522 U.S. 93, 100 (1997) (requiring "the clearest proof" to transform "a civil remedy into a criminal penalty"); Kansas v. Hendricks, 521 U.S. 346, 361 (1997) (deferring to the legislature's intent as to whether legislation is civil). And 20 U.S.C. § 1091a and its supporting laws are clearly remedial, not punitive, in both "purpose and effect." Indeed, the provisions are designed to appropriately allocate the costs of default, Black, 459 F.3d at

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[5] (...continued)
on student loans "shall be required to pay . . . reasonable collection costs." See Pub. L. No. 99-272, 100 Stat. 356, at Title XVI, § 16033 (April 7, 1986). Thus, it is unclear precisely what aspects of the regulatory scheme established by 20 U.S.C. § 1091a and its implementing regulations Plaintiff contests. Indeed, at the time Plaintiff took out his loans, he should have been on notice that a defaulting borrower would be required to pay reasonable collection costs.

800, and reduce the cost of the student loan program to the government, see H.R. Rep. No. 99-383, at 41 (1985), rather than impose any sort of criminal penalty or punishment. Moreover, in effect, 20 U.S.C. § 1091a and its implementing regulations only allow the government to recoup "reasonable collection costs" from defaulting borrowers. See 20 U.S.C. § 1091a(b)(1); see also Black, 459 F.3d at 800-01 (upholding the Secretary's regulations used to calculate "reasonable collection costs"). This is hardly punitive, and the Ex Post Facto Clause thus does not apply.

2. Plaintiff also incorrectly claims that the collection costs authorized under 20 U.S.C. § 1091a are excessive under the Eighth Amendment. See Appellant's Brief at 25-29. The Excessive Fines Clause limits the ability of the government "to extract payments, whether in cash or in kind, 'as punishment for some offense.'" Austin v. United States, 509 U.S. 602, 609-10 (1993) (quoting Browning-Ferris Indus. of Vt., Inc. v. Kelco Disposal, Inc., 492 U.S. 257, 265 (1989)) (emphasis in original). Accordingly, a plaintiff must establish that a fine constitutes "punishment" to successfully bring an Eighth Amendment claim. See Op. at A14.

This Plaintiff is unable to do. The actual purposes served by a fine determine whether the fine is remedial or punitive. See United States v. Halper, 490 U.S. 435, 447 n. 7 (1989) (noting that whether a fine constitutes punishment is not "determined from the defendant's perspective"). And, as discussed above in the context of Plaintiff's Ex Post Facto Clause challenge, the purposes of § 1091a are remedial. See supra at 25-26. Indeed, the collection costs authorized by § 1091a bear none of the hallmarks of punishment, as they are not "imposed at the culmination of a criminal proceeding" or in any way linked to criminal wrongdoing. See United States v. Bajakajian, 524 U.S. 321, 328 (1998).

Moreover, even if this Court does find that the collection costs imposed by § 1091a constitute punishment, Plaintiff is still unable to demonstrate that the costs violate the Excessive Fines Clause. The Supreme Court has stated that a fine must be "grossly disproportionate" to the offense to be excessive, id. at 326, and the collection costs authorized by § 1091a do not rise to that level. While there are no "rigid set of factors" that define when a fine is grossly disproportional, United States v. Mackby, 339 F.3d 1013, 1016 (9th Cir. 2003), the provisions at issue here link the collection costs charged to a defaulting debtor to the "reasonable costs incurred . . . in collecting a loan," see 34 C.F.R. § 682.410(b)(2). Such an effort to recoup the collection costs expended by the Department of Education, Black, 459 F.3d at 800, is not disproportionate, let alone grossly so.

3. Plaintiff's argument that 20 U.S.C. § 1091a and its implementing regulations violate the "Liberty of Contract" protected by the Fifth Amendment's Due Process Clause also fails.

See Appellant's Brief at 25. "Acts adjusting the burdens and benefits of economic life come to the Court with a presumption of constitutionality, and . . . the burden is on one complaining of a due process violation to establish that the legislature has acted in an arbitrary and irrational way." Usery v. Turner Elkhorn Mining, Co., 428 U.S. 1, 15 (1976) (finding that an Act which required coal mines to compensate disabled mine-workers who terminated their employment prior to the enactment of the act did not violate due process). As discussed earlier, Plaintiff is unable to make such a showing, because § 1091a is a reasonable regulation designed to more appropriately allocate the costs of default while reducing the overall cost of the student loan program to the government. See supra I.A.2.

4. Finally, Plaintiff claims that 20 U.S.C. § 1091a and its supporting regulations must be "struck down," since they allowed for Plaintiff's wages and tax refunds to be garnished without a "court order or due process." See Appellant's Brief at 25 (citing Sniadich v. Family Finance Corp., 395 U.S. 337 (1969)). Whatever the precise nature of Plaintiff's factual allegations concerning his wages and tax refunds, this claim is based on a faulty premise. As the Supreme Court made clear in Mathews v. Eldridge, 424 U.S. 319 (1976), the procedural protections required by due process vary based on context, and a pre-deprivation "court order" is certainly not required in all instances. Id. at 332-35 (noting that

Sniadich, while requiring "some type of pretermination hearing," "said nothing" about whether a judicial proceeding was required). Here, the regulations allowing a creditor to garnish wages or offset tax refunds clearly provide for notice and a pre-termination hearing. See 34 C.F.R. § 682.410(b)(6)(ii) (stating procedures necessary to offset tax refunds); id. § 682.410(b)(9) (same for garnishing wages). These provisions thus plainly satisfy Mathews's balancing approach.

D. Plaintiff's Contractual Arguments Have No Basis in the Constitution and Also Fail On Their Own Terms.

Plaintiff argues that the Bankruptcy Code's student loan non-dischargeability provisions violate a number of common law contract doctrines – mutuality of contract, unconscionability, and unclean hands - and that these contractual violations render the provisions unconstitutional.[6] As the district court recognized, Plaintiff's claims are without merit. Not only are the contractual doctrines on which Plaintiff relies without constitutional significance, but Plaintiff's contractual arguments also fail on their own terms.

1. Plaintiff first argues that the non-dischargeability of his student loans violates a constitutionally-imposed requirement of "mutuality of contract." See Appellant's Brief at 22.

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[6] While 28 U.S.C. § 2403(a) allows the United States to intervene to defend the constitutionality of a federal statute, the United States addresses the substance of Plaintiff's contractual claims because Plaintiff presents these arguments in a constitutional guise.

Plaintiff’s claim appears to be based on the fact that his creditor faces “no time limit” in enforcing his loan contract, while Plaintiff faces a strict statute of limitations as to when he can “sue government actors.” See id.

Even leaving to the side whether Plaintiff has accurately characterized the remedies available to creditors and debtors under the federal student loan program, Plaintiff’s claim is baseless. Plaintiff’s argument has no basis in the Constitution, and regardless, "the law does not require that the parties [to a contract] have similar remedies in case of breach . . . ." See Restatement (Second) of Contracts, § 363 (1979). As such, Plaintiff’s claim is without foundation in either the Constitution or contract law.[7]

2. Plaintiff next argues that the penalties imposed by the terms of his student loan contract are unconscionable, and that 20 U.S.C. § 1091a is therefore unconstitutional. See Appellant's Brief at 24. But Plaintiff again neglects to tether his argument to any provision in the Constitution, or point to any case in which a court has struck down a federal statute based upon the

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[7] Plaintiff incorrectly claims that this Court upheld the doctrine of “mutuality of contract” in Espinosa v. United Student Aid Funds, Inc., 553 F.3d 1193 (9th Cir. 2008). While Espinosa does involve questions concerning the dischargeability of student loans, it speaks not at all of “mutuality of contract.” Instead, Espinosa’s primary focus is on whether a “student loan debt[] can be discharged by way of a Chapter 13 plan if the creditor does not object, after receiving notice of the proposed plan.” Id. at 1205.

contractual doctrine of unconscionability. Moreover, as discussed earlier, 20 U.S.C. § 1091a does not violate the constitutional provision that does target disproportionately harsh penalties, the Eighth Amendment's prohibition on excessive fines. See supra at 26-27. Thus, given that collection costs and penalties are commonly imposed on debtors who are in default, Congress's decision to impose collection costs cannot be viewed as unconscionable, let alone unconstitutionally so.[8]

3. Plaintiff also argues that the government should be enjoined from preventing discharge of his student loan because it interfered with his ability to repay his loan. See Appellant's Brief at 25 (arguing that the government has "unclean hands"). Whatever the legal or constitutional basis for this claim, Plaintiff produces no evidence demonstrating that the United States in any way frustrated his ability to repay his loan. Instead, Plaintiff's claim appears to be that the California Commission on Teacher Credentialing, a state body, has made it more difficult to repay his loan by denying him a teaching credential. See Appellant's Brief at 2-3; Op. at A14. Even if Plaintiff's argument had any basis in law or fact, the United States is not responsible for the actions of a state. Indeed, it is unclear how the actions

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[8] The provisions of the Fair Debt Collection Practices Act, 15 U.S.C. §§ 1692-1692p, and the California Rosenthal Fair Debt Collection Practices Act, Cal. Civil Code §§ 1788-1788.33 are immaterial. See Appellant's Brief at 24 n.19 & n.20.

of a state – even if Plaintiff's claims were true - can render an act of Congress unconstitutional.

II. PLAINTIFF'S PROCEDURAL CLAIMS IMPLICATING THE UNITED STATES ARE MERITLESS.

Plaintiff alleges that the bankruptcy court committed numerous procedural errors, and that these errors violated Plaintiff's "basic procedural due process rights." See Plaintiff's Brief at 7-12. Three of Plaintiff's procedural claims implicate the United States, and each of the claims is meritless.

1. Plaintiff first alleges that the bankruptcy court erred in granting extensions of time to the United States. See id. at 10-11. As the district court already recognized, this claim is baseless. See Op. at A15. Extensions of time granted by the court under Fed. R. Civ. P. 6(b) are reviewed for abuse of discretion, Kyle v. Campbell Soup Co., 28 F.3d 928, 930 (9th Cir. 1994), and, although Plaintiff argues that the extensions given to the United States caused him unnecessary expense, he does not explain how the bankruptcy court abused its discretion in granting the extensions or how the extension affected the outcome of the proceeding.

2. Plaintiff next alleges that the bankruptcy court engaged in improper ex parte contacts with the United States when the court's courtroom deputy contacted the government's trial counsel to schedule a hearing regarding Plaintiff's motion for summary judgment. See Appellant's Brief at 10. But, ex parte communication with a party is prohibited only when it concerns the

merits of a pending lawsuit. Drobny v. CIR, 113 F.3d 670, 680 (7th Cir. 1997); In re School Asbestos Litig., 977 F.2d 764, 789 (3d Cir. 1992) ("[Ex parte communications] are tolerated of necessity, however, where related to non-merits issues, for administrative matters, and in emergency circumstances."). As such, "a phone call from a member of a judge's staff regarding an administrative matter does not constitute an impermissible ex parte communication." See Op. at A16-A17. Indeed, as the district court noted, "Plaintiff does not allege, must less prove, that any improper communication occurred regarding the merits" of his case. Id. at A17.

3. Finally, Plaintiff alleges that the bankruptcy court erred in denying his motion to certify a class so that the Secretary of Education would be enjoined from enforcing 11 U.S.C. § 523(a)(8) and 20 U.S.C. § 1091a against "virtually all other student loan debtors." See Appellant's Brief at 10-11. But, as the district court noted, "a court's 'decision to certify a class is subject to very limited review and will be reversed only upon a strong showing that the . . . decision was a clear abuse of discretion.'" Op. at A16 (quoting Duke v. Wal-Mart, Inc., 509 F.3d 1168, 1175 (9th Cir. 2007)). Plaintiff has made no such showing here.

In particular, Plaintiff offers no argument as to how he would "fairly and adequately protect the interests" of the putative class. Id. (quoting Fed. R. Civ. P. 23(a)(4)). Indeed, pro se litigants are prohibited from representing a class of plaintiffs.

See Fymbo v. State Farm Fire & Cas. Co., 213 F.3d 1320, 1321 (10th Cir. 2000); Phillips v. Tobin, 548 F.2d 408, 413 (2d Cir. 1976); Oxendine v. Williams, 509 F.2d 1405, 1407 (4th Cir. 1975); United States ex rel. Schwartz v. TRW Inc., 118 F. Supp. 2d 991 (C.D. Cal. 2000); see also Thompson v. Poindexter, 798 F.2d 471 (6th Cir.1986) (applying this rule to pro se prisoners). Plaintiff "may bring his own claims to federal court without counsel, but not the claims of others." Fymbo, 213 F.3d at 1321.

CONCLUSION

For the foregoing reasons, the Court should dismiss Plaintiff's challenges to the constitutionality of 11 U.S.C. § 523(a)(8) and 20 U.S.C. § 1091a, as well as Plaintiff's procedural claims implicating the United States.

Respectfully submitted,

TONY WEST
Assistant Attorney General

WILLIAM KANTER
(202) 514-4575

/s/ Christopher C. Fonzone
CHRISTOPHER C. FONZONE
(202) 514-1838
Attorneys, Appellate Staff
Civil Division, Room 7214
U.S. Department of Justice
950 Pennsylvania Avenue, N.W.
Washington, DC 20530-0001

APRIL 2009

STATEMENT OF RELATED CASES

Counsel for Intervenor-Appellee is aware of the following related cases pending in this Court:

1. Hupp v. Educational Credit Management Corporation, No. 09-55286 (9th Cir.). In this case, which involves the same parties and many of the same issues as the dispute currently before the Court, Plaintiff Hupp appeals from the district court's dismissal of his case on res judicata grounds.

2. Hupp v. Kurpinsky, No. 07-55977 (9th Cir.). Here, Plaintiff Hupp challenges the State Bar of California's refusal to license him as an attorney. The district court dismissed the case on subject matter jurisdictional grounds, and Plaintiff appealed.

/s/ Christopher C. Fonzone
Christopher C. Fonzone
Attorney for Intervenor

CERTIFICATE OF COMPLIANCE

Pursuant to Rule 32(a)(7)(C) of the Federal Rules of Appellate Procedure, I hereby certify that:

1. This brief complies with the type-volume limitation of Rule 32(a)(7)(B) because this brief uses a monospaced typeface and, according to the count of Corel Wordperfect 12, contains 7,788 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii).

2. Ths brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and type style requirements of Fed. R. App. P. 32(a)(6) because this brief has been prepared in monospaced typeface using Corel Wordperfect 12 with Courier New font of no more than 10.5 characters per inch (12 point font).

/s/ Christopher C. Fonzone
Christopher C. Fonzone
Attorney for Intervenor

APRIL 2009

CERTIFICATE OF SERVICE

I hereby certify that on this 30th day of April, 2009, I caused a copy of the foregoing brief to be electronically filed with the Clerk of the Court for the United States Court of Appeals for the Ninth Circuit by using the appellate CM/ECF system.

Participants in the case who are registered CM/ECF users will be served by the appellate CM/ECF system.

I further certify that some of the participants in the case are not registered CM/ECF users. Copies of the foregoing brief were thus sent to the following to the following non-CM/ECF participants by email and Federal Express:

Paul Hupp
965 Hidden Oaks Dr.
Beaumont, CA 92223

/s/ Christopher C. Fonzone
Christopher C. Fonzone
Attorney for Intervenor

APRIL 2009

BRIEF BANK — 'SUMMARY SHEET" *Printed Wed-11/8/06 15:2*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE
[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]
Fokkena, UST v Fredrikson & Byron, P.A., et al.

2. ("CO") ***CURRENT*** COURT
[E.g., "CTA9"]
DC Minn.

3. ("CCN") ***CURRENT*** CASE NO.
No.: 06-2607

4. ("PCN") ***PRIOR*** CASE NO. & COURT
[IF ANY]
No.: 97-45174
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(Identify judge & cite, if any)

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Robert Schneider, Esq., Attorney Advisor, OUST, Newaek, NJ
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") ● ***SUMMARY*** OF KEY ISSUE(s)
&
√ Any Miscellaneous ***BACKGROUND***

● Under Bankruptcy Code § 726(b), at the conclusion of a chapter 7 case that was converted from chapter 11, payment of allowed administrative expense claims incurred while in chapter 11 “shall be made pro rata” when there is not enough money to pay them in full. Did the Bankruptcy Court err in allowing three of the debtor’s professionals to retain *more* than their pro rata share of their allowed chapter 11 administrative expense claims – thus ensuring that everyone else with allowed chapter 11 administrative expense claims would receive *less* than their pro rata share.

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IN THE UNITED STATES DISTRICT COURT
DISTRICT OF MINNESOTA
06-2607

HABBO G. FOKKENA
UNITED STATES TRUSTEE

Appellant,

v.

FREDRIKSON & BYRON P.A.;
KALINA, WILLS, GISVOLD & CLARK, P.L.L.P.; AND
MERICAL ASSOCIATES, INC.;

Appellees.

ON APPEAL FROM THE UNITED STATES BANKRUPTCY COURT FOR THE
DISTRICT OF MINNESOTA, BANKRUPTCY COURT FILE NO.: 97-45174
HONORABLE ROBERT J. KRESSEL

BRIEF OF APPELLANT

Of Counsel:

Roberta A. DeAngelis
Acting General Counsel

Robert J. Schneider
Walter W. Theus, Jr.
Sherri L Wattenbarger
United States Department of Justice
Executive Office for United States Trustees
20 Massachusetts Avenue, NW
Washington, D.C. 20530
(202) 307-1399

Habbo G. Fokkena
United States Trustee

Robert B. Raschke
Michael E. Ridgway
Sarah J. Wencil
Office of United States Trustee
300 South Fourth Street, Suite 1015
Minneapolis, MN 55415
(612) 664-5500

ATTORNEYS FOR APPELLANT

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FEDERAL RULES

LOCAL RULES

STATEMENT OF ISSUE PRESENTED

Under Bankruptcy Code § 726(b), at the conclusion of a chapter 7 case that was converted from chapter 11, payment of allowed administrative expense claims incurred while in chapter 11 "shall be made pro rata" when there is not enough money to pay them in full. Did the Bankruptcy Court err in allowing three of the debtor's professionals to retain *more* than their pro rata share of their allowed chapter 11 administrative expense claims – thus ensuring that everyone else with allowed chapter 11 administrative expense claims would receive *less* than their pro rata share?

STATEMENT OF APPLICABLE STANDARD OF APPELLATE REVIEW

The bankruptcy court's legal findings are reviewed *de novo*, as are its conclusions involving mixed questions of law and fact. *Debold v. Case*, 452 F.3d 756, 761 (8th Cir. 2006). The bankruptcy court's findings regarding statutory interpretation are also subject to *de novo* review. *Huisinga v. Carter (In re Juhl Enters., Inc.)*, 921 F.2d 800, 802 (8th Cir. 1990). The bankruptcy court's factual findings are reviewed for clear error. Fed. R. Bankr. P. 8013. Matters left to the bankruptcy court's discretion are reviewed for abuse of that discretion. *In re Farmland Indus., Inc.*, 397 F.3d 647, 651 (8th Cir. 2005). "The bankruptcy court abuses its discretion when it fails to apply the proper legal standard or bases its order on findings that are clearly erroneous." *Id*.

STATEMENT OF THE CASE AND OF THE FACTS

I. STATUTORY FRAMEWORK

This appeal deals with the interpretation of 11 U.S.C. § 726 (“§ 726(b)”),[1] which governs the distribution of estate property in a chapter 7 liquidation case. Specifically, this appeal involves the statutorily-mandated equality of distribution among administrative expense claims allowed under 11 U.S.C. § 503(b) (“§ 503(b)”), which include professional fees awarded under 11 U.S.C. § 330 (“§ 330(a)”).

A. Priority and Distribution of Bankruptcy Estate Property

Congress established a priority-based system for the distribution of estate assets in a liquidation case under chapter 7 of the Bankruptcy Code, 11 U.S.C. § 701 *et seq*. Section 726(a) ranks six categories of claims and interests to which estate property is to be distributed at the conclusion of a chapter 7 case, with first priority afforded “claims of the kind specified in, and in the order specified in,” 11 U.S.C. § 507(a) (“§ 507(a)”). Section 507(a), in turn, prioritizes nine types of elite claims that Congress accorded top priority for distribution. First priority under § 507(a) is shared by “administrative

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[1] As this case was filed prior to October 17, 2005, the changes to the Bankruptcy Code made by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (“BAPCPA”), S. 256, Pub. L. No. 109-8, 119 Stat. 23, do not apply. In any event, the BAPCPA did not alter any of the statutory provisions relevant to this appeal.

expenses allowed under [§ 503(b)], and any fees and charges assessed against the estate under chapter 123 of title 28." *See* 11 U.S.C. § 507(a)(1).[2]

A party seeking administrative expense treatment must file a timely request for payment. *See* 11 U.S.C. § 503(a). Not every payment made by a trustee or chapter 11 debtor in possession gives rise to a § 503(b) administrative expense claim, however; only those "allowed" by the bankruptcy court "[a]fter notice and a hearing" are subject to § 503(b). For example, statutory fees paid under chapter 123 of title 28 are not subject to court approval after a noticed hearing, and are not § 503(b) "administrative expense claims." Similarly, payments made in the ordinary course of business pursuant to 11 U.S.C. § 363(c)(1) are not subject to court approval after a noticed hearing, and thus are not § 503(b) "administrative expense claims."

At the end of a chapter 7 case, the trustee makes payments on all outstanding claims in the order established by §§ 507(a) and 726(a) until all estate assets are distributed. If the estate lacks sufficient funds to pay in full all claims in the last category to receive any payment, § 726(b) mandates that the last group of claims "shall be paid pro rata." *See* 11 U.S.C. § 726(b). Once all property of the estate is fully distributed in this manner, claims in any subordinate categories receive nothing.

When a chapter 7 case has been converted from chapter 11 of the Bankruptcy Code, § 726(b) subordinates all allowed § 503(b) administrative expense claims incurred

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[2] In some cases certain unpaid secured claims are given "superpriority" under 11 U.S.C. § 507(b).

during chapter 11 to those allowed § 503(b) administrative expense claims incurred after conversion to chapter 7. As allowed § 503(b) administrative expense claims are paid before all other classes of claims, this subordination becomes relevant only in "administratively insolvent" cases in which the estate contains insufficient funds at the end of the case to cover both chapter 7 and chapter 11 allowed § 503(b) administrative expense claims. This appeal deals with such a case.

B. Professional Employment and Compensation

The importance of professionals to the bankruptcy system is underscored by the high priority, "administrative expense" status granted to professional fees awarded under § 330. *See* 11 U.S.C. § 503(b)(2). On the other hand, the number of provisions regulating the employment and compensation of estate professionals recognizes the unique potential for abuse by these professionals (by, for example, attempting to get paid from estate funds to the detriment of other claimants). Thus, bankruptcy courts rigorously supervise the employment and compensation of estate professionals.

For example, under 11 U.S.C. § 327(a) ("§ 327(a)") an estate professional must not "hold or represent an interest adverse to the estate" and must be a "disinterested person" as defined by 11 U.S.C. § 101(14). In addition, the bankruptcy court reviews proposed terms of employment for reasonableness under 11 U.S.C. § 328(a). Once a professional has rendered services, the court applies criteria prescribed by § 330(a) to determine the amount to award as "reasonable compensation for actual, necessary services rendered" and as "reimbursement for actual, necessary expenses." The compensation and reimbursement so awarded is accorded administrative expense status by § 503(b)(2).

Unlike other § 503(b) administrative expense claimants, professionals may seek court approval to receive interim disbursements under 11 U.S.C. § 331 ("§ 331"). Such interim payments do not become final until the end of the case, however, and the court may order the return to the estate of interim compensation that exceeds the final compensation awarded to the professional. *See* 11 U.S.C. § 330(a)(5).

The Federal Rules of Bankruptcy Procedure also impose strict demands on professionals employed in bankruptcy cases, which, if they are not complied with, may result in denial or disgorgement of compensation. *See* Fed. R. Bankr. P. 2014 (requirements for employment application); Fed. R. Bankr. P. 2016 (requirements for compensation application).

II. FACTUAL BACKGROUND

Hyman Freightways, Inc. (the "Debtor") filed a petition for relief under chapter 11 of the Bankruptcy Code on July 23, 1997. (Voluntary Petition, App. at 130-42). At the time it filed, the Debtor was a trucking company employing over 300 people. (Motion to Dismiss or Convert, App. at 210-11). The day after it filed, the Debtor sought authority to pay certain necessary expenses, including $1,980,000 for pre-petition employee wages and expenses and $600,000 for pre-petition amounts due to cartage companies. (Motion to Pay Certain Necessary Exp., App. at 143-49). No party objected to this motion, which was granted after a noticed hearing. (Order Authorizing Payment of Necessary Exp., App. at 154-55). The Debtor subsequently made the authorized payments on pre-petition amounts due to its employees and cartage companies. (Fredrikson Mem. In Opp. to Motion for Disgorgement, App. at 443).

On July 31, 1997, the Debtor requested court permission to employ Merical Associates, Inc. ("Merical") as financial advisor. (Appl. to Employ Bankr. Consultant, App. at 156-62). The Debtor sought permission to pay Merical weekly, although Merical would apply for court approval of its fees every 60 days. *Id.* The Debtor also requested court approval of a $30,000 retainer paid to Merical. *Id.* The application did not seek permission to transfer title of the retainer to Merical, but instead sought permission to apply the retainer against Merical's fees. *Id.* A supporting Unsworn Declaration of Burton W. Merical proposed that the retainer be applied to Merical's weekly billings. (Unsworn Decl. of Burton W. Merical, App. at 159-61).

The bankruptcy court authorized the Debtor to employ Merical under § 327(a) by order entered August 1, 1997. (Order Approving Empl. of Consultant, App. at 163-64). The court ordered, however, that the Debtor pay no fees to Merical "except as provided in 11 U.S.C. §§ 330 and 331." *Id.* The court further ordered that the time for filing a § 331 interim fee application would be shortened from 120 days to 60 days. *Id.* The court did not approve either the weekly payment to Merical, the $30,000 retainer, or the request to allow Merical to draw upon the retainer without court order.

Within the next few weeks, the Debtor filed applications to employ Fredrikson & Byron, P.A. ("Frederickson") as its chapter 11 counsel and Kalina, Wills, Gisvold &

Clark ("Kalina") as special counsel for litigation, regulatory, and union matters. (Appl. to Employ Attorneys, App. a 165-72; Amended Appl. to Employ Special Counsel, App. at 197-204). The Debtor sought approval of a $75,000 retainer to Fredrikson and a $20,000 retainer to Kalina. *Id.* at 166 and 198. The applications did not seek permission to transfer title of the retainers to the law firms, but instead sought permission to apply them against fees. *Id.* The Debtor agreed that Fredrikson could hold $25,000 of its retainer to apply against its final fee award, but would seek court approval of this agreement in its first fee application. *Id.* at 166.

In support of the Fredrikson application, the Debtor filed an Unsworn Declaration of James L. Baillee, which disclosed that Fredrikson actually held a retainer of $58,993.50, plus an additional $20,000 retainer to pay experts if necessary. (Unsworn Decl. of James L. Baillee, App. at 168). In support of the Kalina application, the Debtor filed an Unsworn Declaration of Andrew Clark, which disclosed that Kalina was owed $17,837 for pre-petition services. (Unsworn Decl. of Andrew Clark, App. at 201).

The bankruptcy court authorized the Debtor to employ Fredrikson as bankruptcy counsel under § 327(a) by order entered August 6, 1997, (Order Approving Empl. of Attorneys, App. at 205-06), and Kalina as special counsel under § 327(e) by order entered August 14, 1997, (Order Approving Empl. of Attorneys, App. at 207-08). Neither order approved the firms' retainers or authorized them to draw upon the retainers without court order.

The Debtor operated its business in chapter 11 for only a few months. On November 12, 1997, the bankruptcy court granted a motion filed by the United States Trustee[3] and converted the case to a chapter 7 liquidation case. (Order Converting Case, App. at 236-38). The United States Trustee appointed Thomas F. Miller to serve as chapter 7 trustee ("Trustee"). (Appointment of Trustee, App. at 239). The Debtor operated as a chapter 11 debtor in possession for fewer than 120 days and never filed the disclosure statement and plan contemplated by 11 U.S.C. §§ 1121 through 1129.[4]

Before the case was converted, Merical filed its first fee application seeking $43,700 in compensation and $1,010.71 in expenses. (Appl. for Fees and Exp., App. at 240-44). By order entered October 10, 1997, the bankruptcy court awarded Merical compensation of $43,700 and reimbursement of $987.51 in expenses, for a total award of $44,687.51. (Order Allowing Fees and Exp., App. at 245-46). The court authorized Merical to apply its remaining $22,617[5] retainer to its allowed fees and authorized the

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[3] The United States Trustee is an official of the United States Department of Justice, charged by statute with the duty to supervise the administration of bankruptcy cases. *See* 28 U.S.C. § 586(a). Congress expressly granted standing to the United States Trustee under 11 U.S.C. § 307 to raise and be heard on the issues raised in this appeal. *See Morgenstern v. Revco D.S., Inc. (In re Revco D.S., Inc.),* 898 F.2d 498, 499-500 (6th Cir. 1990) (appellate standing of United States Trustee).

[4] During its short chapter 11 case, the Debtor made certain payments in the ordinary course of business as authorized by 11 U.S.C. §§ 363(c), 1107 and 1108. Unlike § 503(b) administrative expense claims, however, ordinary course payments do not require court approval at a noticed hearing.

[5] Apparently, Merical already had applied part of its $30,000 retainer to fees for pre-petition services provided to the Debtor.

Debtor to pay the balance. *Id.* Thereafter, Merical applied the retainer and the Debtor paid the balance of Merical's interim award. (Appl. for Fee and Exp., App. at 247-57). Later, Merical filed a second fee application seeking approval of additional fees of $37,100 and reimbursement of $1,774.75 in expenses for the period from September 8, 1997, through the conversion date. *Id.* In the application, Merical acknowledged that it did not know "whether there [would] be sufficient funds to pay all administrative expenses," and it requested that these fees and expenses be addressed in the Trustee's final report and accounting.[6] *Id.* Thus, Merical has already received $44,687.51, or over 53% of its total allowed chapter 11 § 503(b) administrative expense claim of $83,562.26.

After the case converted to chapter 7, Kalina filed a fee application requesting approval of compensation of $48,291 and reimbursement of $851.15 in expenses. (Appl. by Special Counsel for Fees and Exp., App. at 258-62). In requesting approval of its fees, Kalina represented that it "believe[d] that sufficient sums ha[d] been and continue[d] to be generated by the liquidation to pay chapter 7 and chapter 11 administrative expenses." *Id.* Kalina acknowledged that it was "not requesting payment of its claim in full, but simply wishe[d] to apply the retainer to the debt." *Id.* By order entered March 19, 1998, the court approved the compensation and expenses sought by Kalina for a total award of $49,142.15, and authorized Kalina to apply its $20,000 retainer to the allowed fees.

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[6] *See* Local Rule 3002-2 (requiring holders of administrative expense claims incurred after commencement of a chapter 11 case but before conversion to chapter 7 to file a request for payment and serve the request upon the chapter 7 trustee).

(Order Allowing Fees and Appl. of Retainer, App. at 263-64). Kalina subsequently applied the retainer, and accordingly has already received almost 41% of its allowed chapter 11 § 503(b) administrative expense claim.

Fredrikson filed an application on April 29, 1998, requesting approval of the following fees: (i) unpaid fees of $5,488.50 and expenses of $26.69 related to pre-petition services; (ii) compensation of $282,729.60 and expenses of $25,607.67 for services rendered during chapter 11; and (iii) compensation of $6,269.50 and expenses of $1,785.47 for services rendered during chapter 7. (Appl. for Allowance of Fees and Exp. App. at 265-73). Fredrikson admitted that it did not know "whether there [would] be sufficient funds to pay all administrative expenses," that it was only seeking authority to apply its retainers, and that it was requesting that the court either approve its fees or defer approval until the Trustee's final report and accounting. *Id.* at 266. By order entered May 21, 1998, the court approved Fredrikson's request for compensation and expenses totaling $8,054.97 as a chapter 7 administrative expense claim. (Order Allowing Fees and Appl. of Retainer, App. at 274-76). The court also authorized Fredrikson to apply its retainers, but deferred determination of Fredrikson's chapter 11 fee award until a later date. *Id*. Fredrikson applied $74,796.86 of its retainer to its chapter 11 fees and expenses. (Fredrikson Mem. In Opp. to Motion for Disgorgement, App. at 442). Thus, Fredrikson has already received 24% of its total allowed chapter 11 § 503(b) administrative expense claim of $308,337.27.

In anticipation of preparing a final report and account, on January 12 and February 27, 2006, the Trustee filed motions seeking to disgorge chapter 11 compensation paid to Merical, Kalina, and Fredrikson. (Motion for Disgorgement, App. at 277-92 and 293-302). The United States Trustee joined the Trustee's motions. (Joinder of U.S. Trustee, App. at 303-07 and 308-66). The Trustee represented that, while the estate had sufficient funds to pay all chapter 7 § 503(b) administrative expense claims, there would only be $357,785 left to pay chapter 11 § 503(b) administrative expense claims totaling approximately $3,516,000.[7] (Motion for Disgorgement, App. at 277-79 and 293-96). *Id.* None of the $37 million in claims subordinate in priority to administrative claims will receive payment, as the estate is administratively insolvent. *Id.*

The Trustee's motion estimated that the distribution to chapter 11 administrative expense claimants would be 10%. *Id.* By that measure, if Merical, Kalina, and Fredrikson were ordered to disgorge the entire $139,484.37 sought by the Trustee, chapter 11 § 503(b) administrative expense claimants (including Merical, Kalina, and

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[7] Although it was not part of the record before the bankruptcy court, the Trustee's Interim Report and Proposed Distribution listing 750 chapter 11 administrative expense claims was filed on June 28, 2006. (Trustee's Interim Report and Proposed Distribution, App. at 496-714). In addition to the unpaid portions of Merical, Kalina, and Fredrikson's chapter 11 § 503(b) claims, these claims include amounts owed to approximately 500 of the Debtor's employees who were not paid in full for work performed during chapter 11, as well as claims of professionals employed under 11 U.S.C. § 1103 by the Official Committee of Unsecured Creditors ("Committee") appointed by the United States Trustee under 11 U.S.C. § 1102. (Notice of Appointment of Creditors' Committee, App. at 173-74; Orders Authorizing Employment of Committee Professionals, App. at 193-96). Unlike Merical, Kalina, and Fredrikson, the Committee's professionals received no retainers or payments for services rendered during the chapter 11 case.

Fredrikson) would each receive a pro rata distribution of approximately 14%.[8] If the as-yet unpaid portions of Merical, Kalina, and Fredrikson's allowed chapter 11 § 503(b) administrative expense claims share with the other unpaid chapter 11 administrative expense claimants, these Debtor professionals will ultimately receive even more of their claims than the 53%, 41%, and 24% respectively, they have received to date.[9]

In support of the Trustee's motion the Trustee and United States Trustee argued that, because Merical, Kalina, and Fredrikson had received substantially more than a pro rata share of their chapter 11 § 503(b) administrative expense claims, disgorgement of these funds was mandatory to ensure compliance with § 726(b). (Mem. in Support of Motion for Disgorgement of Professional Payments, App. at 280-81, 297-98, 303-04, 308-09). The Trustee and United States Trustee further argued that a failure require to the return of the funds would create a "superpriority" status for estate professionals separate from other chapter 11 § 503(b) administrative expense claimants, a status not grounded in

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[8] According to the Trustee Interim Report and Proposed Distribution filed on June 28, 2006, chapter 11 administrative expense claims will actually receive 17.3% with no disgorgement; if the funds are disgorged, the distribution will increase to 21.3%. (Trustee's Interim Report and Proposed Distribution, App. at 496-714).

[9] Based on the disbursement proposed in the Trustee Interim Report and Proposed Distribution filed on June 28, 2006, unless disgorgement is ordered Merical, Kalina, and Fredrikson will ultimately receive distributions during the case totaling 62%, 51%, and 37% of their total allowed chapter 11 § 503(b) administrative expense claims. (Trustee's Interim Report and Proposed Distribution, App. at 496-714).

any language of the Bankruptcy Code. *Id.* Merical, Kalina, and Fredrikson opposed returning their disproportionate share to the Trustee.

A hearing was held on March 22, 2006, after which the bankruptcy court denied the motions. (Order Denying Motions to Refund Fees, App. at 715-22). In a reported decision,[10] the bankruptcy court held that neither § 726(b) nor any other Bankruptcy Code provision authorizes the Trustee to recover administrative expenses previously paid to Merical, Kalina, and Fredrikson. *Id.* The bankruptcy court further held that the requested disgorgement was "patently inequitable," due in part to the millions of dollars in ordinary course payments made while the Debtor was in chapter 11. *Id*. at 720. The bankruptcy court highlighted this alleged inequity by noting that the Trustee had not sought to recover moneys paid during the chapter 11 case to the United States Trustee (for quarterly fees pursuant to 28 U.S.C. § 1930(a)(6)) and parties paid in the ordinary course of business (pursuant to 11 U.S.C. § 363(c)). *Id*. at 721. Finally, the bankruptcy court decreed that a 3% increase in the distribution to allowed chapter 11 § 503(b) administrative expense claimants would be insignificant given the time expended by the parties during the case and the length of time that case has been pending. *Id*. at 722.

The United States Trustee appealed the bankruptcy court's ruling to this Court. (Notice of Appeal, App. at 723-24 and U.S. Trustee Election, App. at 726).

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[10] *In re Hyman Freightways, Inc.*, 342 B.R. 575 (Bankr. D. Minn. 2006).

SUMMARY OF THE ARGUMENT

By allowing Merical, Kalina, and Fredrikson to retain interim compensation on their allowed chapter 11 § 503(b) administrative expense claims, the bankruptcy court has allowed them to receive distributions on their claims to date of 53%, 41%, and 24%, respectively. In so doing, the bankruptcy court essentially ruled that all other allowed chapter 11 § 503(b) administrative expense claimants should receive distribution of the 10% referenced in the Trustee's motion. This decision was erroneous as a matter of law, as it violated both the letter and intent of § 726(b).

The bankruptcy court's decision was also erroneous in that it creates a priority for the Debtor's professionals that is not supported by the Bankruptcy Code. In addition, the bankruptcy court was apparently swayed by equitable and policy considerations that should be left to Congress, not applied on a case-by-case basis by bankruptcy courts. Finally, the bankruptcy court's decision was based on erroneous interpretations of statutory provisions other than § 726(b).

ARGUMENT

I. THE BANKRUPTCY COURT'S DECISION IS CONTRARY TO THE PLAIN LANGUAGE OF § 726(b) AND CONGRESSIONAL INTENT

An analysis of the plain language of § 726(b) reveals that, in cases converted from chapter 11 to chapter 7, Congress mandated pro rata distribution among allowed chapter 11 § 503(b) administrative expense claims that remain unpaid at the end of the chapter 7 case. As the bankruptcy court's decision failed to effect pro rata distribution among all outstanding allowed chapter 11 § 503(b) administrative expense claims, it was erroneous as a matter of law and must be reversed.

A. Pro Rata Distribution is Mandatory in Light of the Statutory Language and Equal Distribution Objective of § 726(b)

1. The Bankruptcy Court's Decision is Contrary to the Plain Meaning of the Statutory Language

As this appeal involves the interpretation of § 726(b), this Court's analysis must begin with the language of the statute itself. *See, e.g., United States v. Ron Pair Enters., Inc.*, 489 U.S. 235, 241 (1989). Section 726(b) provides that payments to claimants of similar priority "*shall* be made pro rata." 11 U.S.C. § 726(b) (emphasis added). Congress's use of the term "shall" in a statute "normally creates an obligation impervious to judicial discretion." *Lexecon, Inc. v. Milberg Weiss Bershad Hynes & Lerach*, 523 U.S. 26, 35 (1998). Thus, the bankruptcy court is afforded no discretion by § 726(b): All persons with allowed chapter 11 § 503(b) administrative expense claims must receive the same percentage distribution on their claims. Any other interpretation of § 726(b) is invalid in light of the plain meaning of the statutory language.

In the only circuit court decision to have addressed the issue in this appeal, the Sixth Circuit found that "11 U.S.C. § 726(b) plainly mandates *pro rata* distribution of assets among creditors in the same statutory class." *Specker Motor Sales Co. v. Eisen*, 393 F.3d 659, 662 (6th Cir. 2004). The Sixth Circuit further found that "[t]he use of the word 'shall' with the pro rata requirement in § 726(b) indicates that such distribution is not discretionary." *Id*. The Sixth Circuit therefore ordered debtor's counsel to disgorge previously awarded interim compensation so that all chapter 11 § 503(b) administrative expense claimants could receive the pro rata distribution mandated by § 726(b). *Id*. at 663-64.

As the bankruptcy court's decision ensures that chapter 11 administrative expense claimants will not share pro rata as mandated by § 726(b), it was erroneous as a matter of law and must be reversed.

2. The Bankruptcy Court's Decision is Contrary to the Intent of Congress

The Eighth Circcit has analyzed § 726(b) in another context, and has determined that the statutory language is unambiguous. *Huisinga v. Carter (In re Juhl Enters., Inc.),* 921 F.2d at 803. When a statute is unambiguous, "'the sole function of the courts is to enforce it according to its terms.'" *United States v. Ron Pair Enters., Inc.*, 489 U.S. at 241 (quoting *Caminetti v. United States*, 242 U.S. 470, 485 (1917)). The only exceptions to the literal application of unambiguous statutory language are the "rare cases [in which] the literal application of a statute will produce a result demonstrably at odds with the intentions of its drafters," in which case Congress's intent controls. *Griffin v. Oceanic Contractors, Inc.*, 485 U.S. 564, 571 (1982). Absent a clear indication that Congress intended differently, however, § 726(b) cannot be read to allow some chapter 11 § 503(b) administrative expense claimants to receive a higher percentage of their claims than other similarly situated claimants.

The Supreme Court has stated that "[e]quality of distribution among creditors is a central policy of the Bankruptcy Code [according to which] creditors of equal priority should receive pro rata shares of the debtor's property." *Begier v. Internal Revenue Service*, 496 U.S. 53, 58 (1990) (citing § 726(b)). In light of "the equal distribution objective underlying the Bankruptcy Code," any question regarding the meaning of a Code provision "is best resolved in accord with the Bankruptcy Code's equal distribution aim." *Howard Delivery Service, Inc. v. Zurich American Insurance Co.*, ___ U.S. ___, 126 S.Ct. 2105, 2116 (2006). The Eighth Circuit has reiterated that statutory provisions are not to be interpreted in such a way as to "undermine the carefully crafted equality-of-distribution scheme fundamental to the operation of the Bankruptcy Code." *Hartford Underwriters Ins. Co. v. Magna Bank, N.A. (In re Hen House Interstate, Inc.),* 177 F.3d 719, 723 (8th Cir. 1999) (en banc), *aff'd sub nom, Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A.*, 530 U.S. 1 (2000).

Section 726(b) must therefore be interpreted so as to give effect to Congress's "equal distribution" intent. Indeed, in considering the issue before this Court, the Sixth Circuit found that "[e]quality of distribution would be vitiated if one equally situated administrative claimant – [debtor's counsel] – received more than his pro rata share." *Specker Motor Sales Co. v. Eisen*, 393 F.3d at 664.

Merical, Kalina, and Fredrikson, along with over 750 other claimants, have outstanding chapter 11 administrative expense claims that have been allowed under § 503(b). According to the Trustee's motion, each of these claimants is entitled under

§ 726(b) to a distribution totaling approximately 14% of their claims. The bankruptcy court's decision, however, ensures that Merical, Kalina, and Fredrikson will receive at least 53%, 41%, and 24% of their claims, respectively, while all other chapter 11 § 503(b) administrative expense claimants will receive, according to the Trustee's motion, 10% of their claims. Indeed, if Merical, Kalina, and Fredrikson share in this distribution as well, their total recovery will be 62%, 51%, and 37%, respectively – percentages that dwarf the recovery of their similarly-prioritized fellow chapter 11 § 503(b) administrative expense claimants. The interpretation of § 726(b) urged by the United States Trustee would ensure that all similarly-situated claimants receive a pro rata distribution; this interpretation is not "demonstrably at odds with," but rather gives effect to, the intent of Congress. While the bankruptcy court's decision purports to be based on a literal interpretation of § 726(b), the decision is in fact demonstrably at odds with Congress's "equal distribution" intent. The bankruptcy court's decision is therefore based on an invalid interpretation of § 726(b) and must be reversed.

B. Disgorgement is Mandatory When Necessary to Effectuate the Equal Distribution Scheme Embodied in § 726(b)

The majority of courts have held that disgorgement of interim compensation at the end of a chapter 7 case is mandatory when necessary to effectuate the priority distribution scheme created by Congress. *See, e.g., Specker Motor Sales Co. v. Eisen*, 393 F.3d at 664 ("[W]e find that interim compensation must be disgorged when necessary to achieve pro rata distribution."); *In re Lockwood Corp.*, 2006 WL 2038660 at *1 (Bankr. D. Neb. Apr.

26, 2006) ("The case law is clear that pro rata distribution among administrative claimants is mandated by § 726(b)[.]"); *In re Chewning & Frey Security, Inc.*, 328 B.R. 899, 923 (Bankr. N.D. Ga. 2005) ("[T]he language of § 726 is mandatory, thereby preventing the Court from exercising discretion or contemplating the equities of the circumstances."); *In re Saathoff*, 2005 WL 1139893 at *2 (Bankr. W.D. Mo. Apr. 12, 2005) ("[F]ailure to order disgorgement would ignore the mandatory distributive provisions of the Bankruptcy Code," leaving the bankruptcy court with "no discretion to consider the equitable arguments offered by counsel[.]"); *In re Kingston Turf Farms, Inc*., 176 B.R. 308, 310 (Bankr. D.R.I. 1995) ("[D]isgorgement is required as a matter of law, just to adhere to the mandatory payment scheme of the Code, i.e. to ensure that all creditors of the same class share [pro rata] in the available pool of funds.").

The bankruptcy court's decision was based, in part, on its observation that § 726(b) does not expressly provide for the recovery of non-pro rata distributions. The absence of such an express provision should not, however, lead to a result that violates the core equal distribution principle embodied in § 726(b). If no mechanism exists to recover non-pro rata payments, then § 726(b) is reduced from a Congressional mandate to a mere aspiration. The bankruptcy court used Congress's silence as a lever to pry apart the tightly crafted distribution scheme embodied in § 726(b), but "[t]here is a basic difference between filling a gap left by Congress' silence and rewriting rules that Congress has affirmatively and specifically enacted." *Mobil Oil Corp. v. Higginbotham*, 436 U.S. 618, 625 (1978).

Congress's use of the word "shall" indicates that § 726(b) is no mere guideline; if at the end of the case the court finds that a non-pro rata distribution was made during the case, then it must be unmade. Any other interpretation of § 726(b) would read the word "shall" right out of the statute. Such legislation from the bench is not appropriate.

The Eighth Circuit has held that § 726 must be read so as to give effect to the clear meaning of the statute. In *Stuart v. Carter (In re Larsen)*, 59 F.3d 783, 787 (8th Cir. 1995), the Eighth Circuit interpreted § 726(a)(1) as affording § 507(a) priority only to administrative expenses incurred in a pending case, but not to administrative expenses incurred in a prior case by the same debtor. *Id*. While the plain language of § 726 does not expressly contain such a qualification, the Eighth Circuit interpreted the statute in that manner so as to give effect to the plain statutory language and "the overarching objective of creditor equality" embodied in § 726. *Id.* Similarly, in the instant appeal the Eighth Circuit could be expected to interpret § 726(b) so as to require disgorgement to the extent necessary to give effect to the statute's letter and intent.

Even if authority to disgorge is not found within § 726(b), the bankruptcy court is certainly empowered by 11 U.S.C. § 105(a) ("§ 105(a)") to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of [the Bankruptcy Code]." Whether under § 726(b) or § 105(a), courts have found the power to order disgorgement where necessary to effect the equal distribution intent of § 726(b). *See, e.g.*, *Matz v. Hoseman*, 197 B.R. 635, 640 (N.D. Ill. 1996) ("Regardless of whether this authority stems from 11 U.S.C. § 105 . . . or is simply an inherent power of the court in its effort to effectuate the distribution scheme outlined by § 726(b) . . . it is without cavil that the bankruptcy court has the power to disgorge interim professional fees."); *Shaia v. Durrette, Irvin, Lemons & Bradshaw, P.C. (In re Metropolitan Elec. Supply Corp.),* 185 B.R. 505, 512 (Bankr. E.D. Va. 1995) ("[W]hile § 726(b) does not specifically permit the Court to require disgorgement, the authority for that action is found in 11 U.S.C. § 105."); *Guinee v. Toombs (In re Kearing),* 170 B.R. 1, 7 (Bankr. D.D.C. 1994) ("Although section 726(b) does not specifically authorize the recapture of administrative payments made pursuant to orders allowing the payment of interim compensation, such authority can be found in section 105.").

Without recourse to disgorgement, § 726(b) would be rendered toothless, despite Congress's clear intent to mandate pro rata distribution among similar claimants. As the bankruptcy court's interpretation of § 726(b) precludes the recovery of non-pro rata distributions, it is erroneous as a matter of law and must be reversed.

C. The Bankruptcy Court's Interpretation of § 726(b) Changes the Priorities Established by Congress

The bankruptcy court's decision was based, in part, on its impression that the United States Trustee's interpretation of § 726(b) unfairly singled out the Debtor's professionals for disparate treatment. This impression was mistaken, as the United States Trustee seeks only to ensure equal distribution among all those with allowed chapter 11 § 503(b) claims. The Trustee's motion only addressed professionals because only professionals received partial payment on their chapter 11 § 503(b) administrative expense claims. In fact, the Trustee's motion was not unfairly aimed at professionals as a group, as the professionals employed by the Official Committee of Unsecured Creditors would benefit from the Trustee's motion.

Indeed the bankruptcy court's decision treats the Debtor's professionals differently than similarly prioritized claimants, as it has allowed Merical, Kalina, and Fredrikson to receive to date 53%, 41%, and 24%, respectively – amounts that dwarf the expected distribution to all other allowed chapter 11 § 503(b) claims. Such a decision is not only wrong as matter of law; it is patently inequitable.

The bankruptcy court's decision essentially creates a superpriority for the debtor's professionals. *See Specker Motor Sales Co. v. Eisen*, 393 F.3d at 664 ("failure to order disgorgement gives interim compensation superpriority"); *Shaia v. Durrette, Irvin, Lemons & Bradshaw, P.C. (In re Metropolitan Elec. Supply Corp.)*, 185 B.R. at 512 ("To the extent [debtor's professionals] retain amounts in excess of that intended by § 726(b), they are granting themselves a superpriority over other administrative claimants."). No statutory justification exists for allowing the Debtor's professionals to receive far more of their claims than similarly-situated claimants. That their interim compensation was paid pursuant to § 331 is no reason to allow them to keep their excessive distribution, as interim compensation is always subject to final approval at the conclusion of a case. *See* 11 U.S.C. § 330(a)(5); *see, e.g., In re Regan*, 135 B.R. 216, 218 (Bankr. E.D.N.Y. 1992) ("Interim allowances under the Bankruptcy Code remains [sic] a *payment on account of an ultimate final allowance*, in order that the administration of a debtor's estate may be carried on. Final allowances under Section 330 . . . are ordinarily to be determined at the conclusion of the case, since only then is a thorough analysis of the various factors enumerated in Section 330 possible.") (emphasis added).

Unlike Merical, Kalina, and Fredrikson, most chapter 11 § 503(b) administrative expense claimants in this case could not receive advances on their claims in the form of § 331 interim compensation. Most administrative expense claimants have had to wait since 1997 to receive any distribution on their chapter 11 § 503(b) administrative expense claims, and now the bankruptcy court has effectively told them that they will receive only the 10% distribution referred to in the Trustee's motion. On the other hand, the Debtor's professionals, who received interim payments while the other claimants were forced to wait, seek to retain several times that amount on their identically prioritized claims.[11]

The Supreme Court has stated that "preferential treatment of a class of creditors is in order *only when clearly authorized by Congress*." *Howard Delivery Service, Inc. v. Zurich American Insurance Co.*, ___ U.S. ___, 126 S.Ct. at 2109 (emphasis added). As a result, statutory provisions establishing priority among claimants "must be tightly construed." *Id*. at 2116. In addition, the Eighth Circuit has stated that "as a matter of policy, statutory priorities should be strictly construed in the bankruptcy context[.]"

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[11] Although some of the holders of allowed chapter 11 § 503(b) administrative expense claims may have received payment on pre-petition unsecured claims, that is irrelevant. Section 726(b) only requires pro-rata distribution among the last class of claims to receive payment, which in this case is chapter 11 administrative expense claims allowed under § 503(b). No other claims enter into the calculus.

Northwest Financial Express, Inc. v. JWD, Inc. (In re Northwest Financial Express, Inc.), 950 F.2d 561, 563 (8th Cir. 1991). As the bankruptcy court created a new distribution scheme in which the Debtor's professionals are preferred, its decision violated the priority distribution scheme created by Congress, and constitutes an error of law that must be reversed.

D. Policy Considerations Cannot be Used to Circumvent the Plain Meaning of the Statutory Language

In drafting the Bankruptcy Code, Congress balanced policy considerations related to the deference to be accorded certain claims and expenses with policy considerations regarding the fair and equitable distribution of bankruptcy estates. The result, embodied in § 726(b), was a system for liquidating chapter 7 cases that ranks expenses and claims by class and systematically distributes estate funds to each class in order of priority, but provides for pro rata payment within a class that cannot be paid in full.

While policy or equitable arguments might be advanced in favor of a non-literal application of § 726(b), courts must presume that Congress took all relevant equitable and policy considerations into account when drafting § 726(b). As the Eighth Circuit has held, "[p]olicy considerations and equitable concerns . . . are impermissible bases for statutory interpretation when, as here, the language of the statute is clear and unambiguous." *Hartford Underwriters Ins. Co. v. Magna Bank, N.A. (In re Hen House Interstate, Inc.),* 177 F.3d 719, 723 (8th Cir. 1999) (en banc), *aff'd sub nom, Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A.*, 530 U.S. 1 (2000). In addition, while some may think § 726(b) produces an inequitable result, the courts are not "licensed to attempt to soften the clear import of Congress' chosen words whenever [they] believe those words lead to a harsh result." *United States v. Locke*, 471 U.S. 84, 95 (1985). Thus, "[i]f Congress enacted into law something different from what it intended, then it should amend the statute to conform it to its intent." *Lamie v. United States Trustee*, 540 U.S. 526, 541 (2004).

Indeed, Congress recently overhauled the Bankruptcy Code as part of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, and it presumably was aware of the Sixth Circuit's *Specker* decision and similar cases mandating disgorgement to ensure pro rata distribution. That Congress made no changes to § 726(b) indicates that Congress saw no need to soften the mandatory language of § 726(b) or to otherwise clarify that disgorgement is not available to assist in carrying out the required pro rata distribution.

The bankruptcy court's decision was also based, in part, on the court's apparent conclusion that a 10% distribution is just as good as a 14% distribution to the chapter 11 administrative expense claimants in this case. The unpaid administrative expense claimants include truck drivers and other employees to whom several thousand dollars could make a world of difference. The bankruptcy court was apparently upset by the age of the case, but these administrative expense claimants have been more affected than anyone by waiting since 1997 for payment. The bankruptcy court cited no case to support its determination that the difference between 10% and 14% is immaterial as a matter of law. Furthermore, as a matter of policy it hardly seems appropriate to favor the interests of professionals, who undertook employment in this case fully aware of the risks of nonpayment, over those of truck drivers who stayed on the job with a reasonable expectation that their wages would be paid.

To the extent that the bankruptcy court was swayed by policy and equitable considerations, its decision was an error of law that should be reversed.

II. THE BANKRUPTCY COURT'S ANALYSIS OF OTHER STATUTORY PROVISIONS IS ERRONEOUS

The bankruptcy court's decision was based not only on its misinterpretation of § 726(b), but also on its misinterpretation of several other statutory provisions. For example, the bankruptcy court did not seem to appreciate what constitutes an "allowed § 503(b) claim" for § 726(b) purposes. The bankruptcy court suggested that Merical, Kalina, and Fredrikson "do not hold administrative expenses" for the claims on which they received interim compensation, despite the fact that they have yet to receive final payment on their compensation awards (which were awarded under § 330, and are thus currently outstanding § 503(b)(2) claims). Similarly, the bankruptcy court suggested that payments made in the ordinary course and quarterly fees paid to the United States Trustee were "chapter 11 administrative expenses," despite the fact that such payments are not "allowed" administrative expense claims under § 503(b), and thus have nothing to do with a § 726(b) analysis. In light of the bankruptcy court's mistakes regarding the applicability of other statutory provisions, its decision was erroneous as a matter of law, and must be reversed.

A. Section 541 Cannot be Read in Such a Way as to Render § 726(b) a Nullity

The bankruptcy court viewed the Trustee's motion as an attempt to bring property into the estate in contravention of 11 U.S.C. § 541 ("§ 541"). *In re Hyman Freightways, Inc*., 342 B.R. at 579. In actuality, the Trustee's motion was an attempt to ensure that estate property is distributed in the way Congress mandated in § 726(b). There can be no question that, when the interim compensation requests were granted, the retainers used to pay them were property of the estate.[12] *See, e.g., In re Brick Hearth Pizza, Inc*., 302 B.R. 877, 883 (Bankr. D. Minn. 2003); *In re Fitzsimmons Trucking, Inc*., 124 B.R. 556, 560 (Bankr. D. Minn. 1991). "In any event . . . the characterization of an interim fee payment as a 'retainer' does not magically protect it from disgorgement." *Matz v. Hoseman*, 197 B.R. at 641 n.8.

Section 726(b) governs the distribution of property of the estate. If, during the administration of the estate, property of the estate was distributed in a way that violates § 726(b), that property must be subject to recovery by the Trustee. The bankruptcy court's juxtaposition of §§ 541 and 726(b) would emasculate § 726(b); the only way the

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[12] Merical was employed as a financial advisor, not an attorney. Thus, to the extent it received a retainer, Minnesota state law applicable to attorney retainers presumably do not apply to Merical.

bankruptcy court's analysis is correct is if § 726(b) is read to mean "payments of estate property shall be made pro rata, unless they have already been made some other way." Fundamental tenets of statutory construction require that a statutory provision must not be interpreted so as to render another statutory provision a nullity. *Cf. United Sav. Ass'n of Texas v. Timbers of Inwood Forest Assocs., Ltd.*, 484 U.S. 365, 375 (1988) (rejecting interpretation of one Bankruptcy Code provision when it would render another provision "a practical nullity and a theoretical absurdity"). The bankruptcy court cited no case supporting its interpretation of § 541. For the foregoing reasons, the court's reliance on that statute was an error of law.

B. Section 549 is Not Relevant to a § 726(b) Analysis

The bankruptcy court also stated that, as 11 U.S.C. § 549 ("§ 549") does not allow the Trustee to recover the payments made to Merical, Kalina, and Fredrikson, "the negative implication . . . is that postpetition payments authorized by the court or the Code are not recoverable by the trustee." *In re Hyman Freightways, Inc.*, 342 B.R. at 579. This assertion is false as a matter of statutory interpretation, as § 549 by its terms addresses only certain *unauthorized* post-petition transfers that a trustee "may" avoid. It does not prohibit the trustee from recovering post-petition transfers that *were* authorized, but that are subsequently found to have been unlawful or inequitable. In addition, unlike § 549, which is a general statute pursuant to which a trustee "may" act, § 726(b) specifically mandates what a trustee "shall" do. As a result, § 549 cannot preclude the Trustee from carrying out the § 726(b) mandate. *Cf. Guidry v. Sheet Metal Workers Nat'l*

Pension Fund, 493 U.S. 365, 375 (1990) ("It is an elementary tenet of statutory construction that where there is no clear intention otherwise, a specific statute will not be controlled or nullified by a general one.") (internal quotations omitted). In any event, there is no suggestion in the Bankruptcy Code, legislative history, or case law that § 549 is relevant to a § 726(b) analysis. *See, e.g.*, *Matz v. Hoseman*, 197 B.R. at 640 (§ 549 not applicable where subject matter of dispute is court-authorized professional compensation, not avoidable transfer); *Shaia v. Durrette, Irvin, Lemons & Bradshaw, P.C. (In re Metropolitan Elec. Supply Corp.)*, 185 B.R. at 511 (same). The bankruptcy court cited no case supporting its interpretation of § 549. For the foregoing reasons, the court's reliance on that statute was an error of law.

C. Section 363(c) Ordinary Course Payments are Not "Allowed § 503(b) Claims"

The bankruptcy court also suggested that ordinary course transactions under 11 U.S.C. § 363(c) ("§ 363(c)") result in "chapter 11 administrative expenses" of a kind that share pro rata with allowed § 503(b) claims under § 726(b). *In re Hyman Freightways, Inc*., 342 B.R. at 579. This fundamentally misstates the nature of the allowed chapter 11 § 503(b) claims to which § 726(b) applies.

Pursuant to § 726(b), "[p]ayment on *claims* of a kind specified in [§ 507(a)(1)] shall be made pro rata." 11 U.S.C. § 726(b) (emphasis added). Section 507(a)(1), in turn, specifies only the following claims: "administrative expenses *allowed under* [§ 503(b)], and any fees and charges assessed against the estate under chapter 123 of title 28." 11

U.S.C. § 507(a)(1) (emphasis added). Section 503(b) lists several administrative expenses, all of which are "allowed" only "[a]fter notice and a hearing." After conversion of a case from chapter 11 to chapter 7, § 726(b) subordinates "a *claim allowed* under [§ 503(b)]" for chapter 11 administrative expenses to "a *claim allowed* under [§ 503(b)]" for chapter 7 administrative expenses. 11 U.S.C. § 726(b) (emphasis added).

Thus, at the end of a chapter 7 case, when the trustee is required to distribute money derived from the liquidation of estate assets, § 726(b) *mandates* distribution *pro rata* among all outstanding *claims* that have been *allowed* administrative expense status *after a noticed hearing*. Anything that is not a "claim" at the end of the case, or was not "allowed" under § 503(b), does not enter into the § 726(b) calculus for determining pro rata distribution.

Unlike § 503(b) administrative expense claims, § 363(c) ordinary course payments (i) are made under § 363(c) and 11 U.S.C. § 1108, not § 503(b); (ii) are made without court approval, and without notice and a hearing; and (iii) are fully satisfied upon payment, so they do not result in a "right to payment." The recipients of ordinary course payments therefore never have "claims" as defined in 11 U.S.C. § 101(5). Thus, while ordinary course payments are authorized by the Bankruptcy Code, they are not "allowed § 503(b) claims." If, upon conversion to chapter 7, an obligation that arose in the ordinary course of business has not yet been paid, then pursuant to 11 U.S.C. § 348 the unpaid amount – and *only* the unpaid amount – becomes a general unsecured claim (unless it is the kind of claim specified in § 503(b), in which case it remains a chapter 11 administrative expense claim).

As they are not "allowed § 503(b) claims," ordinary course payments made under § 363(c) have no place in a § 726(b) pro rata distribution analysis. *See, e.g., In re Lochmiller Indus. Inc*., 178 B.R. 241, 249 (Bankr. S.D. Cal. 1995) ("disgorgement may not be had of claimants paid in the ordinary course"); *Guinee v. Toombs (In re Kearing),* 170 B.R. at 7 (same). As a result, the bankruptcy court erred to the extent its decision was based on the Trustee's decision not to seek disgorgement from "suppliers and other vendors, providers of services, [and] employees." *In re Hyman Freightways, Inc*., 342 B.R. at 580.

D. Quarterly Fees Payable to the United States Trustee Pursuant to 28 U.S.C. § 1930(a)(6) are Not Allowed § 503(b) Claims

Similarly, the bankruptcy court expressly stated that disgorgement by the Debtor's professionals would be inequitable given that the Trustee had not sought disgorgement from "the United States Trustee." *In re Hyman Freightways, Inc*., 342 B.R. at 580. The Eighth Circuit, however, has rejected the argument that everything paid during the chapter 11 portion of a case constitutes a "chapter 11 administrative expense claim" under § 503(b) subject to the priority distribution scheme of § 726(b): "The bankruptcy court's attempt to lump the [United States] Trustee's payments with [debtor's counsel's] Chapter 11 legal expenses on the basis of their common origin in a Chapter 11 proceeding finds no support in the statutes." *See Huisinga v. Carter (In re Juhl Enterprises, Inc.)*, 921 F.2d 800, 803 (8th Cir. 1990).

As they arise under chapter 23 of title 28, quarterly fees payable to the United States Trustee under 28 U.S.C. § 1930(a)(6) share first priority under § 507(a) with – but are distinct from – § 503(b) administrative expense claims. *Id.* As quarterly fees are not § 503(b) claims, the Eighth Circuit held that in a converted case they share pro rata with chapter 7 § 503(b) claims, not with chapter 11 § 503(b) claims. *Id.* Thus, in the instant case, any unpaid quarterly fees will be paid in full along with chapter 7 administrative claims. As a result, disgorgement of previously paid quarterly fees is not relevant, and the bankruptcy court erred to the extent it based its decision on the Trustee's failure to seek to recover previously paid quarterly fees.

E. Sections 329 and 330 are Not the Sole Bases For Disgorgement

The bankruptcy court suggested that 11 U.S.C. § 329 and § 330 are the only vehicles pursuant to which disgorgement may be ordered from the Debtor's professionals. *In re Hyman Freightways, Inc.*, 342 B.R. at 579-80. Those provisions afford the bankruptcy court discretion to order disgorgement where the professional has been paid an amount that exceeds the value of its services. Such discretionary disgorgement is distinguishable from the disgorgement sought by the Trustee's motion, which is mandated by Congress's intent to ensure a fair division of estate assets.

Under the bankruptcy court's interpretation, disgorgement may only be had when the professional receives interim compensation that "exceeded the reasonable value of the total services." *Id*. at 580. Bankruptcy courts, however, do not limit disgorgement to cases under §§ 329 and 330. *See, e.g.*, *In re Wilson-Seafresh, Inc*., 263 B.R. 624, 631 (Bankr. N.D. Fla. 2001) (directing disgorgement to fund payment to claimant with a 11 U.S.C. § 507(b) superpriority); *Tate v. NationsBanc Mortgage Corp. (In re Tate)*, 253 B.R. 653, 669 (Bankr. W.D.N.C. 2000) (directing disgorgement of unreasonable 11 U.S.C. § 506(b) secured creditor attorney's fee).

As the bankruptcy court clearly had the power under § 105(a) to order disgorgement where necessary to carry out the provisions of the Bankruptcy Code that do not expressly refer to disgorgement, its decision was erroneous as a matter of law and must be reversed.

F. Payment of Interim Compensation Under § 331 Does Not Mean Merical, Kalina, and Fredrikson Have no "Claims" for § 726(b) Purposes

The bankruptcy court also stated that, to the extent Merical, Kalina, and Fredrikson received payment on their interim compensation awards, they "do not hold administrative expenses." *In re Hyman Freightways, Inc*., 342 B.R. at 579. All professional compensation is awarded under § 330, however; § 331 only permits interim payment of § 330 awards. As the Eighth Circuit has noted, "Section 503(b)(2) provides that compensation awarded under § 330(a) 'shall be allowed administrative expenses.'" *In re Farmland Indus., Inc*., 397 F.3d at 651.

Even if the awards to Merical, Kalina, and Fredrikson were not expressly styled "interim" awards, it would not matter. The only way professionals can receive payment of their allowed chapter 11 § 503(b) claims before the end of the case is through § 331 – otherwise, they would have to wait until the end of the case like everyone else. As they received payment before the end of the case, the payments had to have been made pursuant to § 331 whether they were styled as such or not. *See, e.g., Stumpf v. Creel & Atwood, P.C. (In re Lockwood Corp.)*, 216 B.R. 628, 637 (Bankr. D. Neb. 1997); *Shaia v. Durrette, Irvin, Lemons & Bradshaw, P.C. (In re Metropolitan Elec. Supply Corp.)*, 185 B.R. at 510.

As interim compensation is always subject to disgorgement until the end of the case, Merical, Kalina, and Fredrikson have outstanding § 330 claims, and thus have outstanding § 503(b)(2) claims until they receive their final payment. *See United States Trustee v. Johnston*, 189 B.R. 676, 677-78 (N.D. Miss. 1995) (rejecting argument that interim compensation award is paid in full, and thus no longer a "claim," as interim award "is not final and is therefore reviewable at any time before the case is ultimately closed"). As insufficient funds exist to pay Merical, Kalina, and Fredrikson's § 330 awards in full, the entire amount of their awards must be added into the § 726(b) pro rata calculation.

This treatment of professionals differs from the treatment of claimants who received payments from the Debtor in the ordinary course of its business but got stuck with an unpaid bill upon conversion to chapter 7. Ordinary course payments are not "allowed" under § 503(b), while professional compensation awards are allowed under § 503(b). Any changes to this statutory construct must be made by Congress, not by courts on a case-by-case basis.

CONCLUSION

For all of the foregoing reasons, the United States Trustee respectfully requests that the Bankruptcy Court's decision be reversed.

Respectfully submitted,

HABBO G. FOKKENA
United States Trustee

Robert B. Raschke
Assistant United States Trustee
Office of United States Trustee
300 South Fourth Street, Suite 1015
Minneapolis, Mn 55415
(612) 664-5500

Of Counsel:

ROBERTA A. DEANGELIS
Acting General Counsel

Robert J. Schneider
Walter W. Theus, Jr.
Sherri L Wattenbarger
United States Department of Justice
Executive Office for United States Trustees
20 Massachusetts Avenue, NW
Washington, D.C. 20530
(202) 307-1399

By: /s/ Sarah J. Wencil
Sarah J. Wencil
Trial Attorney

Dated: August 28, 2006

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In re M.R. Moses, MD and M.E. Moses

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- 1. Whether the bankruptcy court abused its discretion in vacating the order authorizing Lon B. Isaacson Associates to be employed as the Debtors' general bankruptcy counsel.

2. Whether the bankruptcy court abused its discretion in ordering disgorgement of the retainer paid by Debtors to Lon B. Isaacson Associates.

3. Whether the bankruptcy court abused its discretion in denying the final fee application of Lon B. Isaacson Associates following the court's order vacating the firm's order of employment.

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UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

In re MAX ROBERT MOSES MD AND MARLENE ELLEN MOSES, Debtor(s)	District Court Case Number CV 02-9802 SVW (Consolidated with District Court Case Number CV 03-00801 SVW) Bankruptcy Court Case Number LA 01-16606 EC
LON B. ISAACSON ASSOCIATES, Appellant v. UNITED STATES TRUSTEE, Appellee	DATE: SEPTEMBER 29, 2003 TIME: 1:30 P.M. LOCATION: DEPARTMENT 6

Appeal From The United States Bankruptcy Court
For The Central District of California

Honorable Ellen Carroll
Bankruptcy Judge, Presiding

APPELLEE MAUREEN A. TIGHE, UNITED STATES TRUSTEE OPENING BRIEF

MAUREEN A. TIGHE
United States Trustee
Jill Sturtevant
Assistant U.S. Trustee
Alvin P. Mar, SBN 151482
Trial Attorney
OFFICE OF THE U.S. TRUSTEE
725 S. Figueroa Street
Suite 2600
Los Angeles, California 90017
(213) 894-4219
FAX: (213) 894-2603

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BRIEF FORMAT CERTIFICATION PURSUANT TO RULE 32(a)(7) OF THE FEDERAL RULES OF APPELLATE PROCEDURE

Pursuant to FRAP Rule 32(a)(7)(C) made applicable by Local Rule 5.1 of the United States District Court for the Central District of California, I certify that Appellee’s Opening Brief is proportionately spaced, using Courier New, 14 point type and that the word count as calculated by the word processing program used to prepare this brief is 6,726, not counting this certification.

OFFICE OF THE UNITED STATES TRUSTEE

By:________________________________
Alvin Mar, Attorney for the
United States Trustee

I.
STATEMENT OF ISSUES ON APPEAL

1. Whether the bankruptcy court abused its discretion in vacating the order authorizing Lon B. Isaacson Associates to be employed as the Debtors' general bankruptcy counsel.

2. Whether the bankruptcy court abused its discretion in ordering disgorgement of the retainer paid by Debtors to Lon B. Isaacson Associates.

3. Whether the bankruptcy court abused its discretion in denying the final fee application of Lon B. Isaacson Associates following the court's order vacating the firm's order of employment.

II.

STANDARD OF REVIEW

A federal district court has jurisdiction to review decisions of a bankruptcy court pursuant to 28 U.S.C. §158(a). Orders on employment and disqualification of professionals are reviewed for abuse of discretion. In re CIC Investment Corporation, 175 B.R. 52, 53 (9th Cir.BAP 1994). A bankruptcy court's disallowance of attorney's fees is reviewed for abuse of discretion. In re Mednet, 251 B.R. 103, 106 (9th Cir. BAP 2000). A court abuses its discretion when the record contains no evidence to support its decision. MGIC Indemnity Corp. v. Moore, 952 F.2d 1120, 1122 (9th Cir. 1991).

____Findings are reviewed under the clearly erroneous standard. Fed.R.Bankr.P. 8013.

III.

STATEMENT OF THE CASE AND RELEVANT FACTS

Appellant appeals the bankruptcy court's decision that revoked its order appointing Appellant as counsel for the Debtors, denied allowance of all fees, and ordered disgorgement of Appellant's $25,000 retainer. The court's order was based on Appellant's series of conflicting disclosures regarding the terms of employment, particularly whether the $25,000 retainer had been kept intact or used to pay for pre-petition debt owed by Debtors to counsel. Frustrated by counsel's lack of candor and finding that counsel had not adequately disclosed the disposition of the retainer and lacking evidence to the contrary, the court disqualified counsel, vacated the order employing them and denied them all fees.

Max Robert Moses, MD and Marlene Ellen Moses, (“Moses” or “Debtors”), husband and wife, filed their voluntary Chapter 11 petition on March 9, 2001. E.R.,[1] 2. An employment application seeking court approval for the employment of Lon B. Isaacson Associates to represent the Debtors in their bankruptcy proceeding was filed on March 22, 2001. E.R., 4. The employment application did not make reference to or include a copy of any written retainer agreement entered into by Appellant and the Debtors.

The supporting declaration of Appellant in that employment application disclosed that within one year of the Debtors’ Chapter 11 filing, the firm has been paid a total of $25,000 of which $8,336.08 was applied as a Chapter 11 retainer and $16,663.92 had been applied for pre-filing legal services and costs. E.R.,

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[1] ”E.R.” refers to the ‘Appellant’s Appendix of Exhibits in Support of Appeal from Bankruptcy Court’s Order Denying Appellant’s Application for Fees and Costs in a Chapter 11 Proceeding Assigned Case Number LA 01-16606 EC; District Court Case Number CV 02-9802 SVW Consolidated with: CV 03-00801 SVW’ and is followed by a reference to an Exhibit and then, as appropriate, by page number therein.

4, page 10, ¶4.

On April 26, 2001, the bankruptcy court entered its order authorizing the employment of Lon B. Isaacson Associates as counsel for the Debtors and Debtors-in-Possession. E.R., 6.

The Debtors' Chapter 11 petition was ultimately dismissed by an order entered on July 3, 2002 because the only plan of reorganization the Debtors were willing to propose was unconfirmable. E.R., 25.

On June 26, 2002, prior to the entry of the order dismissing the Debtors' Chapter 11 case, Appellant filed its request for final fees pursuant to 11 U.S.C. §330, requesting allowance and authorization for payment of fees and costs incurred pre-petition as well as post-petition.[2] E.R., 26. In Appellant's initial

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[2] Appellant's initial fee application requested $61,634.50. E.R., 26, page 16. Subsequently, Appellant filed a fee application identifying the firm's post-petition fees and costs as $44,326.98. E.R., 30, page 5, lines 12 to 16. In a supplemental pleading, Appellant requested that the bankruptcy court confine its ruling to post-petition fees. E.R., 33, page 9, line 21. Such request was consistent with the firm's order of employment entered by the Court that compensation would be fixed by the Court for post-filing fees and costs. E.R., 6, page 2.

fee application, Appellant indicated that the Debtors had paid to date, $25,000 for pre- and post-petition Chapter 11 work. E.R. 26, page 13, lines 17 and 18. The declaration filed in support of Appellant's fee application reflected that the Debtors had written to Appellant requesting a refund of a portion of the $25,000 true retainer. E.R. 26, page 19, ¶3.

Appellant subsequently amended its final fee application requesting allowance and authorization for payment of additional post-petition fees and costs. E.R., 30, pages 5 and 6. See also E.R., 33, page 23, ¶11. The United States Trustee filed objections to Appellant's fee application. E.R., 27. See also E.R., 31. The Debtors also filed their objections to Appellant's fee application. E.R., 28. Included in Debtors' objection, was their request to the bankruptcy court that it disregard their retainer agreement with the Appellant; this being the first reference that a retainer agreement had been entered into between the Debtors and the Appellant. E.R., 28, page 8, lines 20 and 21. Also included in the Debtors' objection was a copy of a June 4, 2002 letter addressed by Appellant to the Debtors stating that the firm would not refund any portion of the true retainer previously paid to the firm based on the Debtors’ agreement in that retainer agreement that the $25,000 true retainer was non-refundable and was earned upon receipt by the firm. E.R., 28, Exhibit A.

In addition, Appellant’s response to the objections filed by the United States Trustee suggested that the court simply reduce from the $25,000 retainer received by the firm, its fees incurred pre-petition in calculating the amount to award to the firm for post-petition services. E.R., 29, page 3, ¶5. The response also indicated that Appellant reserved its rights to calculate the pre-petition costs to be reduced from the $25,000 retainer. E.R., 29, page 3, ¶5.

Based on the above, the United States Trustee added in its supplemental objection to Appellant’s request for fees and expenses that Appellant’s revelations suggested that the firm had not drawn down on its pre-petition retainer for fees and costs incurred prior to the filing of the Debtors’ Chapter 11 petition, thereby raising the issue of Appellant’s lack of disinterestedness.[3]. E.R. 31. <u>See also</u> E.R. 36, Exhibit C, page 4, ¶3.

The hearing on Appellant's final fee application was continued a number of times for various reasons. Appellant's response filed on September 4, 2002 further stated that Appellant had maintained intact the $25,000 retainer and that the firm would "gladly deduct from the $25,000 retainer the sums earned pre-petition". E.R., 33, page 22, ¶8. <u>See also</u> E.R., 33, page 9, lines 21 to 23. Ultimately, the United States Trustee filed her motion to disqualify counsel and for disgorgement of the retainer paid to Appellant. E.R., 36.

In Appellant's opposition to the United States Trustee's motion to disqualify the firm, the firm acknowledged that it had initially treated the $25,000 retainer paid by the Debtors as a true retainer, earned

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[3] Appellant's various declarations submitted in support of its fee application revealed for the first time that at the time the bankruptcy petition was filed, Appellant had not drawn down on its retainer for pre-petition fees incurred. As a result, on the date the petition was filed, Appellant was a creditor of the debtor and therefore not disinterested and not eligible to be employed as general counsel. E.R., 29, page 3, ¶5. See also E.R., 33, page 22, ¶8.

upon receipt and non-refundable. E.R., 37. Thereafter, Appellant argued that on or about the date of the Debtors’ Chapter 11 filing in March 2001, the firm waived the provisions of the initial retainer agreement requiring that the $25,000 retainer be treated as a true retainer and applied the fees incurred pre-petition against the retainer leaving a balance of $8,336.08 as the Chapter 11 pre-petition retainer. Neither the above history regarding Appellant’s treatment of the $25,000 initial retainer nor a copy of the firm’s retainer agreement which also was attached in Appellant’s opposition to the United States Trustee’s motion to disqualify the firm had been previously revealed to the bankruptcy court. The firm also argued that it had consistently waived the true retainer provision of its contract with the Debtors. E.R., 37, page 9, line 16. In reply to Appellant’s opposition, the United States Trustee directed the bankruptcy court’s attention to Appellant’s June 4, 2002 letter to the Debtors addressing their insistence upon a refund. In that letter, Appellant sternly reminded the Debtors that they had agreed that the

$25,000 retainer was a true retainer, earned upon receipt by the firm and non-refundable. This position clearly was inapposite to the firm's contention that a novation had occurred over a year earlier. E.R., 38, page 3, lines 4 to 23. A subsequent surreply was filed by Appellant which tried in vain to explain away the June 4, 2002 letter. E.R., 39. At the final hearing on the U.S. Trustee's motion to disqualify the firm, the bankruptcy court pointed to the inconsistent pleadings and positions taken by Appellant in addressing the United States Trustee's motion. E.R., 40. Moreover, Appellant, in responding to how the firm treated the proceeds of the $25,000 retainer, represented at one point that the entire $25,000 had initially been deposited into the firm's general account and that the firm had no accounting to reflect drawdowns. Yet, later on, Appellant represented to the bankruptcy court that $8,336.00 was put into trust when the Chapter 11 was filed. E.R., 40, pages 38, 39, and 53. The bankruptcy court further noted the failure of Appellant to submit bank statements which would have objectively demonstrated exactly how the firm treated the $25,000.00 retainer on the date of the Debtors' bankruptcy filing. E.R.,40, page 6, lines 20 to 25.

The bankruptcy court ultimately granted the United States Trustee's motion to disqualify counsel and vacated Appellant's order of employment. The Court also ordered disgorgement of Appellant's entire retainer of $25,000 because Appellant failed to demonstrate adequately that it was not a creditor on the date of filing and therefore not disinterested as required by 11 U.S.C. §327. Furthermore, the bankruptcy court cited to Appellant's lack of adequate disclosure of the terms of its employment in its employment application. E.R., 42. See also E.R., 40, pages 55 and 56.

After vacating the order granting Appellant's employment, the bankruptcy court then denied Appellant's application for final fees and reimbursement of expenses. E.R., 41. See also E.R., 40, page 56 and 57. Because the court had vacated the order authorizing Appellant's employment, Appellant was no longer eligible to be paid fees pursuant to 11 U.S.C. § 330.

Two orders were prepared in accordance with the bankruptcy court’s rulings. One order denied the application for final fees and expenses, entered on November 1, 2002, and a second order finding that Appellant was disqualified from representing the Debtors, vacated the order granting Appellant’s employment and ordered disgorgement of the $25,000 retainer. This order was entered on November 4, 2002.

Appellant filed a motion to reconsider the order vacating employment on November 8, 2002. E.R., 43. The court denied the reconsideration motion by order entered on February 21, 2003. E.R., 55.

IV. ARGUMENT

A. THE BANKRUPTCY COURT DID NOT ABUSE ITS DISCRETION IN DENYING FEES BECAUSE OF THE LACK OF ADEQUATE DISCLOSURE AND OMISSION OF APPELLANT’S RETENTION AGREEMENT WITH DEBTORS.

Federal Rules of Bankruptcy Procedure 2014 requires, in pertinent part, disclosure of a professional’s proposed arrangement for compensation. Coy or incomplete disclosures which require the bankruptcy court to ferret out pertinent information from other sources are not sufficient. Full and complete disclosure includes disclosure of all the details of fee arrangements with the debtor so the court can assess conflicts that may give rise to disqualification. In re Independent Engineering Co., Inc., 232 B.R. 529 (1st Cir.BAP 1999) aff'd 197 F.3d 13 (1st Cir. 1999). Courts have long recognized that failure to disclose the terms of one's employment, including the nature of the fee arrangement with the debtor, is a sufficient basis for disqualification or disgorgement. Id. at 532. See also, In re Park-Helena Corp., 63 F.3d 877 (9th Cir. 1995), In re Downs, 103 F.3d 472 (6th Cir. 1996).

In this case, many of the terms of Appellant's retention agreement with the Debtors were not included or revealed to the bankruptcy court in Appellant's employment application. E.R., 38, pages 4 to 6. Appellant erroneously claims the retainer agreement terms did not need to be included. E.R., 39, pages 2 to 4 and 7 to 12. The omissions included the following provisions:

1) assignment of the Debtors' case to attorneys not

affiliated with the firm[4],

2) lien rights and receiving a general power of attorney,[5] and

3) post-petition retainers.[6]

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[4] Retainer language states:

You agree to allow our firm the right to assign your case or matter (or any portion thereof) to any attorney licensed to practice law in California, including but not limited to temporary attorneys and independent contractor attorneys not affiliated with our firm. Our case load and (sic) is such that Mr. Isaacson or any regularly assigned affiliated attorney may be unavailable to try or work on your case, in which event you grant us sole authority to select any attorney we deem appropriate to your representational or legal service needs. E.R., 37, Exhibit "1" thereto.

[5] Retainer language states:

Client agrees that our firm shall have a lien for services rendered and costs advanced on any sums recovered whether by way of settlement or judgment on the account of the aforesaid matters of client. Client grants firm and Lon B. Isaacson a General Power of Attorney and instructs the firm to use that power to execute any check, payment instrument or document as the firm determines appropriate, whether to protect its interest or the client's, or both. E.R., 37, Exhibit "1" thereto.

[6] Retainer language states:

. . . As we work on your matter, and both the hours we expend and the hours we project will be consumed, become known or anticipated, you grant us the authority to fix, charge and collect another retainer (and yet further other retainers as appropriate) from you. . . . E.R., 37, Exhibit "1" thereto.

The existence of these undisclosed provisions and others demonstrate Appellant's lack of candor with the court. See also E.R., 40, pages 41 to 43.

Appellant urged the bankruptcy court to accept its explanation that it had clearly disclosed in its initial employment application that the firm would retain sole discretion to assign attorneys employed by and supervised by the firm to make appearances on behalf of the firm and that the provision regarding assignment of the Debtors' case to other attorneys set forth in the retainer agreement clearly reflected that intent. E.R., 39, pages 2 and 3. However, a plain reading of the retainer agreement does not clarify or suggest the explanation provided. E.R., 37, Exhibit "1" thereto. See also E.R., 40, pages 10 and 11. Appellant then argued that the other disclosure deficiencies resulted in "no harm, no foul" to the administration of the estate as these provisions were never effectuated. E.R., 39, pages 3 and 4. Unfortunately for Appellant, "no harm, no foul" is not the standard used by the courts.

More importantly, Appellant's initial disclosure did not disclose the fact that it had not been paid for its prepetition work because it had not drawn down on its prepetition retainer.

Appellant described in its employment application that Debtors had provided a $25,000 retainer of which $16,663.92 had been applied for pre-filing legal services and costs with $8,336.08 retainer remaining. E.R., 4, page 10, ¶4. As set forth in Appellant’s subsequent pleadings, this assertion was apparently not true. E.R., 33, page 22, ¶8. See also E.R., 33, page 9, lines 21 to 23. Nonetheless, because of the assertion that Appellant had been paid its prepetition claim, Debtors’ request to employ Appellant was granted by entered order dated April 26, 2001.

Prior to the entry of the order dismissing the Debtors’ case on July 3, 2002, Appellant filed an application requesting court approval of fees and reimbursement of expenses. In response to an objection raised by the Office of the United States Trustee to Appellant’s fee application, Appellant revealed for the first time that it had maintained intact the full amount of the $25,000 retainer and in turn would deduct the sums earned pre-petition to the extent the bankruptcy court was inclined to limit its review of Appellant's fee application to post-petition fees and expenses. E.R., 33, page 22, ¶8. See also E.R., 33, page 9, lines 21 to 23.

Based on Appellant's new representation that it had not drawn down on its pre-petition retainer for services rendered prior to the filing of the Debtors' bankruptcy petition, the United States Trustee filed her motion to disqualify Appellant as Debtors' bankruptcy counsel.

Subsequent papers filed by Appellant indicated that Appellant had initially entered into an agreement with the Debtors characterizing the $25,000 retainer as "earned upon receipt" and "non-refundable," what Appellant deemed a "true retainer." E.R., 37, page 15, ¶2. Appellant later argued in the bankruptcy court that through a novation occurring at or about the date of Debtors' chapter 11 filing, the earlier agreement had been changed and that Appellant had re-characterized the retainer as a general retainer and had reduced the amount of the retainer received by

$16,663.92 for pre-petition fees incurred and earmarked the remainder of $8,336.08 to be applied for post-petition bankruptcy services. E.R., 37, pages 15 and 16, ¶3 and 5. See also E.R., 40, pages 17 and 18. Nowhere in Appellant's employment application did Appellant disclose the history of Appellant's financial arrangement with the Debtors. Only after inquiry by the bankruptcy court did Appellant attempt to explain the history -explanations which are self-contradictory. E.R., 40.

As the bankruptcy court correctly pointed out ". . what needs to happen is that counsel disclose every element of the employment arrangement, and the Court can determine what's important and what is not important." E.R. 40, p. 4. Truthful disclosure is required because it is ultimately the court that must determine the propriety of employment of a professional. In re Park-Helena Corp. at 880 ("To facilitate the court's policing responsibilities, the Bankruptcy Code and Federal Rules of Bankruptcy Procedure impose several disclosure requirements on attorneys who seek to represent a debtor and who seek to recover fees.") <u>See also</u> 11 U.S.C. §327.

At no time has Appellant fully disclosed the required information. In response to the United States Trustee's motion to disqualify Appellant as Debtors' bankruptcy counsel, Appellant indicated that $8,336.08 of the initial $25,000 retainer received from the Debtor was held in trust for post-petition services. E.R., 40, page 53, lines 23 to 25. Contrarily, at other times Appellant argued that the entire retainer had been deposited into Appellant's general account[7] and that no monies were ever segregated in the firm's trust account. E.R., 37, page 6, lines 11 to 15. At yet other times, Appellant seemingly retreated back to characterizing the retainer as a "true retainer" which was earned upon receipt. E.R., 28, Exhibit A thereto, on page 2 of Exhibit A. This inconsistency alone puts in question whether Appellant has ever fully disclosed the required elements to be deemed "disinterested."

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[7] If there was a novation in Appellant's retention agreement with the Debtors, Appellant's failure to segregate those funds in a trust account as advances for fees and costs appears to run afoul of Rule 4-100 of the State Bar of California Rules of Professional Conduct.

Negligent or inadvertent omissions do not vitiate the failure to disclose. In re Park-Helena Corp. at 881. Similarly, a disclosure violation may result in sanctions "regardless of actual harm to the estate." Id. Such failure may result in a denial of all requested fees. Id. at 882.

The bankruptcy court was justified in discounting Appellant's explanations based on the plain meaning of the terms set forth in Appellant's retainer agreement. Clearly the bankruptcy court's holding that it is not counsel's decision to determine what is or is not significant but that proposed counsel fully disclose all terms of its proposed employment so that a court is able to make an informed decision, comports with the standards applied by courts in the Ninth Circuit and elsewhere. See In re Park-Helena Corp., 63 F.3d 877 (9th Cir. 1995). See also In re Independent Engineering Co., Inc., 232 B.R. 529 (1st Cir.BAP 1999) aff'd 197 F.3d 13 (1st Cir. 1999).

____The bankruptcy court did not abuse its discretion by denying Appellant's entire request for fees based on Appellant's failure to fully comply with the disclosure requirements of Rule 2014. In re Park-Helena Corp. at 882. (Ninth Circuit affirms bankruptcy court's order denying an entire fee request even though failure to disclose ultimate source of pre-petition retainer may not have created an actual conflict of interest). In re Kisseberth, 273 F.3d 714 (6th Cir. 2001) (Sixth Circuit affirms bankruptcy court order disgorging substantially all fees received based on counsel's failure to strictly adhere to the disclosure requirements of 11 U.S.C. §329 and F.R.B.P. 2016(b)). In re Downs, 103 F.3d 472 (6th Cir. 1996)(Sixth Circuit finds bankruptcy court erred in refusing to compel counsel to disgorge retainer *in toto* based on intentional failure to disclose financial arrangements under 11 U.S.C. §329 and F.R.B.P. 2016 and remands case with instructions to order a disgorgement of all fees paid to bankruptcy counsel).

B. THE BANKRUPTCY COURT DID NOT ABUSE ITS DISCRETION IN DENYING APPELLANT'S FEE REQUEST ON EQUITABLE GROUNDS.

Appellant also requests that this Court reverse the bankruptcy court's order denying its fee application on equitable grounds. In support of its contention, Appellant cites to the holding by the Ninth Circuit Bankruptcy Appellate Panel in In re CIC Inv. Corp., 192 B.R. 549 (9th Cir.BAP 1996). CIC Investment Corporation is distinguishable, however, because in that case, the court found that counsel had fully disclosed all potential conflicts and dealings with the debtor. In CIC Investment Corporation, the appellate court held that where a professional's employment was approved by the bankruptcy court after full disclosure of all potential conflicts, subsequent denial of compensation for the professional's failure to be disinterested is within the court's discretion. Id. at 553.

In contrast, Appellant did not fully disclose the terms of employment in its employment application. It is only after inquiry did Appellant eventually provide additional information. Appellant's deficient contradictory disclosures in its employment application regarding its dealing with the Debtors ultimately resulted in the bankruptcy court's disqualification of Appellant and the court's order vacating the prior order allowing employment. E.R., 40, pages 55 and 56. See also E.R., 60, pages 18 to 20.

C. THE BANKRUPTCY COURT DID NOT ABUSE ITS DISCRETION TO RECONSIDER ITS PRIOR ORDER AUTHORIZING APPELLANT'S EMPLOYMENT.

In In re Elias, 188 F.3d 1160 (9th Cir. 1999)("Elias II"), the Ninth Circuit addressed the issue of whether a bankruptcy court abused its discretion when it declined to reopen the case to set aside an employment order and whether the bankruptcy court acted improperly in declining to adjudicate professional fees. In the Bankruptcy Appellate Panel, the bankruptcy court's orders declining to reopen the case to set aside the employment order and to decline to adjudicate professional fees were affirmed on the basis that such additional relief may have been beyond the limited jurisdiction of the bankruptcy court or alternatively, that the bankruptcy court did not abuse its discretion to review pending state court issues arising from disputed attorneys' fees. In re Elias, 215 B.R. 600 (9th Cir. BAP 1997)("Elias I").

Appellant's application and extension of the holding in Elias I to the case at hand is misplaced. In Elias I, the BAP held that resolving post-dismissal disputes regarding bankruptcy attorney's fees was "new relief," which was beyond the bankruptcy court's jurisdiction. However, the facts in Elias are clearly distinguishable from this case. In Elias, debtor's counsel sued the debtor in state court for his fees incurred during the debtor's bankruptcy proceeding. The state court referred the parties back to the bankruptcy court to adjudicate the fee dispute. It was only then in the bankruptcy court that motions to rescind debtor's counsel's order of employment were filed. By contrast, in this case, no other forum was ever used. The bankruptcy court solely reviewed Appellant's fees and expenses; the same court that reviewed and authorized its employment, the same court which ultimately reviewed its own order and proceedings regarding its rulings.

Moreover, in affirming the bankruptcy court's order in Elias II, the Ninth Circuit observed that the bankruptcy court generally has discretion regarding whether it should reopen proceedings to reconsider its prior orders as occurred in the instant case. Elias II at 1161. See also Post v. Ewing, 119 B.R. 566 (S.D.Ohio 1989). In fact, Appellant's reliance on

Elias I is misplaced and inapposite herein. Given the holding in Elias II, the bankruptcy court did not exceed its jurisdiction in considering the United States Trustee's motion to vacate the order authorizing Appellant's employment in this case.

D. APPELLANT WAS NOT A DISINTERESTED PERSON.

Sections 327 and 328(c) of the Bankruptcy Code govern the determination of the propriety of professional fees arising during the course of a bankruptcy case. In particular, section 328(c) of the Bankruptcy Code provides, in pertinent part, that a court may deny allowance of compensation and reimbursement of expenses of a professional person employed under section 327, if at any time during such professional person's employment section 327, such professional person is not a disinterested person or represents or holds an interest adverse to the interest of the estate with respect to the matter on which such professional person is employed.

The term "disinterested person" is defined in the Bankruptcy Code, in pertinent part, as a person who is not a creditor. See 11 U.S.C. §101(14)(A). The term creditor is further defined in the Bankruptcy Code, in pertinent part, as an entity that has a claim against the debtor that arose at the time of or before the order for relief concerning the debtor. See 11 U.S.C. §101(10)(A). The commencement of a voluntary case under the Bankruptcy Code constitutes an order for relief under the Code. See 11 U.S.C. §301.

Appellant stated in its employment application that it was disinterested as that term is defined in 11 U.S.C. §101(14). E.R., 4, page 9, ¶3.

As a result of the subsequent disclosure that the prepetition retainer had not been drawn down, the United States Trustee made a motion to disqualify counsel and order disgorgement of all fees. E.R., 36. The motion was based upon Appellant's lack of disinterestedness at the time of the commencement of Debtors' bankruptcy case as Appellant was clearly a pre-petition creditor. The United States Trustee also requested disgorgement of Appellant's retainer if the bankruptcy court granted the United States Trustee's motion to disqualify.

Owing to Appellant's failure to adequately address the issues raised in the United States Trustee’s motion to disqualify the firm and because of Appellant’s inconsistent positions taken in its pleadings and oral argument, the bankruptcy court found that Appellant was not disinterested. E.R., 40, pages 55 and 56. See also E.R., 60, page 20. The bankruptcy court also found that Appellant’s request in its fee application that it reserve the right to augment its request for undetermined expenses reflected on Appellant as a pre-petition creditor notwithstanding Appellant’s later withdrawal of such request when confronted with its own folly. E.R., 40, page 25 to 28 and pages 42 and 43. In the end, the bankruptcy court determined that the amount of retainer still on hand was $25,000 because Appellant failed to adequately account for the pre-petition disposition of the retainer proceeds, thus rendering Appellant a pre-petition creditor. E.R., 40, page 56, lines 17 to 24.

Appellant would have this Court conclude, *arguendo*, that to the extent Appellant was a pre-petition creditor, Appellant did not lack disinterestedness because its fees and expenses were incurred solely for services rendered in contemplation of and in connection with the bankruptcy case. App.Brief[8] at page 21. Courts have not universally embraced the notion that professionals holding pre-petition claims incurred in direct relation to the filing of the bankruptcy petition may represent the debtor. See In re Eastern Charter Tours, Inc., 167 B.R. 995 (Bankr.M.D.Ga. 1994). See also United States Trustee v. Price Waterhouse, 19 F.3d 138 (3rd Cir. 1994)(". . bankruptcy courts cannot use equitable principles to disregard unambiguous statutory language." citing In re Middleton Arms, 934 F.2d 723, 725 (6th Cir. 1991)(internal quotations and citations omitted)).

Whether or not all courts agree upon this principle, Appellant's own papers submitted in connection with this bankruptcy case indicate that not all the unpaid pre-petition work was bankruptcy related. Appellant's Rule 2016(b) statement states that the $25,000 retainer received by the firm included 'pre-petition non-bankruptcy fees and costs.' E.R., 2.

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[8] "App.Brief" refers to "Appellant's Opening Brief", followed by page number.

See also E.R., 37, page 19, ¶15. Moreover, nowhere in Appellant's retainer agreement is reference made that the Debtors' employment of the firm was solely limited to the filing of a bankruptcy petition. E.R., 37, Exhibit "1" thereto. This fact is underscored by Appellant's narrative in its fee application, which states that the Debtors initially consulted with Appellant in January 2001 desiring to protect their retirement account from seizure by the Internal Revenue Service. E.R., 26, page 5, lines 3 to 17. It was not until two months later, when the Debtors learned that the Internal Revenue Service sought to take immediate legal action, that Debtors filed their voluntary Chapter 11 petition. E.R., 26, page 5, lines 18 to 23. See also E.R., 2. Consequently, Appellant cannot claim that its services were solely in contemplation of a bankruptcy filing.

Therefore, the bankruptcy court did not abuse its discretion in determining that Appellant was not disinterested, and its orders should be affirmed.

E. THE BANKRUPTCY COURT DID NOT ABUSE ITS DISCRETION IN DENYING APPELLANT'S APPLICATION FOR COMPENSATION FOLLOWING ITS ORDER VACATING APPELLANT'S ORDER OF EMPLOYMENT.

When the debtor is a debtor in possession, as in this case, Section 330 will allow compensation to an attorney for the debtor only if his employment is authorized pursuant to 11 U.S.C. §327. Court approval of the employment of counsel for a debtor in possession is the *sine qua non* to counsel getting paid. In re Shirley, 134 B.R. 940, 943 (9th Cir.BAP 1992), In re Weibel, Inc., 176 B.R. 209 (9th Cir.BAP 1994). See also In re Monument Auto Detail, Inc., 226 B.R. 219 (9th Cir.BAP 1998).

The language of §§327 and 330 of the Bankruptcy Code, when read together, provide a clear statutory scheme by which professionals are compensated. To ignore these interrelated provisions subverts the intent of the Bankruptcy Code.

In this case, the bankruptcy court vacated Appellant's previously entered order authorizing its employment, finding that Appellant failed to disclose fully how it treated its retainer, and consequently Appellant was a creditor of the debtor at the time the petition was filed, rendering it not disinterested as required by 11 U.S.C. § 101(14). E.R., 40, page 56.

Because Appellant was not eligible to be employed pursuant to 11 U.S.C. § 327, it was not eligible to be paid pursuant to 11 U.S.C. § 330(a) of the Bankruptcy Code. As a result, the bankruptcy court did not abuse its discretion in denying Appellant's request for final fees and reimbursement of its expenses.

F. APPELLANT'S POSSESSION OF AN ATTORNEYS' LIEN DOES NOT OBVIATE ITS OBLIGATION TO SATISFY THE EMPLOYMENT REQUIREMENTS OF THE BANKRUPTCY CODE.

An attorney's lien can attach to property only when an attorney has some rights. A California attorney's lien can provide no rights other than that provided in the Bankruptcy Code. Sections 327, 328, 330, 503(b)(2), and 507(a)(1) provide a comprehensive federal scheme that sets forth attorneys' rights to payment of fees from estate property. This scheme preempts any other rights that might be created by state statutes.

Appellant argues that its attorney's lien, created by operation of California law, protected its interest in the $25,000 retainer for services rendered, even if it is not eligible for compensation under 11 U.S.C. § 330(a). For this proposition, Appellant relies on <u>In</u>

re Century Cleaning Services, Inc., 215 B.R. 18 (9th Cir. BAP 1997), *reversed* In re Century Cleaning Services, Inc., 195 F.3rd 1053 (9th Cir. 1999). The issue in Century Cleaning was whether debtor's counsel in a case converted to Chapter 7 from Chapter 11 could be compensated for work he performed in the Chapter 7. The bankruptcy court and the Bankruptcy Appellate Panel both determined that a change in the Bankruptcy Code rendered Chapter 7 debtor's attorneys ineligible for compensation pursuant to 11 U.S.C. § 330(a). Instead, those courts decided that the attorney had a possessory attorney's lien on his pre-petition retainer and could take his fees from that fund of money. However, the Ninth Circuit reversed the BAP and determined that a Chapter 7 debtor's attorney could be paid for work he performed if that work benefitted the estate. The Ninth Circuit specifically declined to consider whether an attorney would be entitled to fees under Oregon's attorney's lien statute and vacated that award without prejudice. 195 F.3rd at 1061.

As the Ninth Circuit held, the reasoning of the lower courts was flawed. Appellant's interpretation of the effects of an attorney’s lien would render the employment and compensation requirements of the Bankruptcy Code and Federal Rules of Bankruptcy Procedure meaningless. An attorney’s lien simply secures the amount of the underlying debt as determined by the bankruptcy court. In re Monument Auto Detail, Inc. at 225. (An attorney’s lien secures only the amount of the fees and costs specifically allowed by the bankruptcy court, not the amount of the entire retainer. Id.)

In addition, on facts very similar to this case, the court in Monument Auto, which was decided after the Bankruptcy Appellate Panel opinion, but before the Ninth Circuit opinion in Century Cleaning, further held that an attorney’s lien does not obviate an attorney’s obligation to satisfy the employment and compensation requirements of the Bankruptcy Code and Rules previously addressed above. In the instant case, the bankruptcy court vacated the order approving Appellant’s employment due to Appellant’s lack of disinterestedness and accordingly, disallowed all post-petition fees and reimbursement of expenses.

G. THE BANKRUPTCY COURT DID NOT EXCEED ITS JURISDICTION TO CONSIDER THE MOTION SEEKING APPELLANT'S DISQUALIFICATION.

The broad grant of jurisdiction under 28 U.S.C. §1334 enables bankruptcy courts, which are created as adjuncts of the district court for the purpose of exercising jurisdiction, to dispose of controversies that arise in bankruptcy cases or under the bankruptcy code. In re Aheong, 276 B.R. 233, 245 (9th Cir.BAP 2002) citing Senate Report No. 95-989. The "arising under" jurisdiction under 28 U.S.C. §1334 does not depend on the present existence of an open case or a non-dismissed case. It depends solely on the existence of "civil proceedings arising under title 11." Id. Such civil proceedings also includes any disputes related to administrative matters in a bankruptcy case. Id. In the instant case, Appellant sought bankruptcy court approval of its fees and expenses. Awards of professional fees are core proceedings concerning administration of an estate. In re Meronk, Jr., 249 B.R. 208 (9th Cir.BAP 2000). Equally, issues relating to the employment of professionals are core proceedings concerning the administration of an estate. In re

Vettori, 217 B.R. 242 (Bankr.N.D.Ill. 1998).

Clearly the bankruptcy court's review of the dispute raised by the United States Trustee concerning Appellant's continued eligibility for employment falls squarely within the jurisdiction conferred under 28 U.S.C. §1334 to the court.

H. BANKRUPTCY COURT DID NOT ABUSE ITS DISCRETION IN ORDERING DISGORGEMENT OF APPELLANT'S RETAINER.

A bankruptcy court has discretion to hear ancillary matters after dismissal of a case. In re Elias at 188 F.3d 1162. The Ninth Circuit has held that bankruptcy courts may dispose of ancillary matters such as an application for an award of attorney's fees for services rendered in connection with the underlying case post-dismissal. In re Taylor, 884 F.2d 478 (9th Cir. 1989). In the instant case, the bankruptcy court exercised its ancillary jurisdiction in considering Appellant's final application for fees and reimbursement of expenses.

Appellant would have this Court find that the bankruptcy court lacked jurisdiction to order disgorgement of its retainer based upon 11 U.S.C.

§349(b)(3) and that as a result of the dismissal of the case, that retainer was vested in Appellant. However, Appellant submitted to the jurisdiction of the bankruptcy court when it filed its employment application and when it requested an order directing payment of any approved compensation in excess of the retainer received. Assuming the bankruptcy court did not have jurisdiction over 'non-estate' funds following dismissal of the case, it is unclear from Appellant's position how the bankruptcy court could then order payment from the Debtors of compensation beyond the amount of the retainer received as requested by Appellant in its fee application. E.R., 26, page 16. Moreover, to the extent the bankruptcy court denied Appellant's request for compensation as it did in this case, or otherwise allowed compensation less than the retainer received, Appellant's position would effectively render such an order meaningless since Appellant claims a vested interest in that retainer.

Moreover, the bankruptcy court did not abuse its discretion in ordering disgorgement of Appellant's entire retainer. Appellant's failure to adequately demonstrate that the retainer had been drawn down prior to the commencement of Debtors' bankruptcy case for pre-petition services as discussed above clearly contributed to the bankruptcy court's finding that the entire $25,000 remained property of the Debtor's bankruptcy estate on the date of filing. E.R., 40, page 56, lines 17 to 24.

The non-refundability provision advocated at different times by Appellant in the lower court with respect to the proceeds of the retainer have been found to be unenforceable in bankruptcy. See In re C & P Auto Transport, Inc., 94 B.R. 682 (Bankr.E.D.Cal. 1988).

Circuit courts have recognized repeatedly that disgorgement is appropriate when bankruptcy counsel are hired improperly or engage in misconduct. See generally In re Pillowtex, Inc., 304 F.3d 246 (3rd Cir. 2002)(remanding a fee dispute for a review of the merits and imposition of an appropriate remedy, including possible disgorgement); United States Trustee v. First Jersy Securities, Inc., (*In re First Jersey Securities, Inc.*), 180 F.3d 504, 514, and n.9 (3rd Cir.

1999)(holding that where a debtor's counsel had received a preferential transfer, the bankruptcy court could take "further action" on remand and noting such action could include "not only disgorgement of the preference, but also [] the possible denial or reduction of compensation"(citation and internal quotation omitted)); Citicorp Venture Capital Ltd. v Committee of Unsecured Creditors, 160 F.3d 982, 986, 991-92 (3rd Cir. 1998)(allowing the pursuit of remedies against a fiduciary of a debtor, including disgorgement, upon remand in a chapter 11 case with a confirmed plan); United States Trustee v. Federated Department Stores, Inc., (*In re Federated Department Stores, Inc.*), 44 F.3d 1310, 1316 (6th Cir. 1995)(bankruptcy court could order disgorgement on remand); United States v. Richman (*In re Richman*), 124 F.3d 1201 (10th Cir. 1997)(ordering that on remand funds could be disgorged to a chapter 13 debtor who had a confirmed chapter 13 plan).

V. CONCLUSION

This Court should affirm the bankruptcy court's order vacating Appellant's order of employment due to

Appellant’s failure to adequately comply with the disclosure requirements of Federal Rule of Bankruptcy Procedure 2014 or alternatively, on Appellant’s lack of disinterestedness or both. This Court should further affirm the bankruptcy court’s order disgorging Appellant’s retainer based on the lack of Appellant’s eligibility for compensation under the Bankruptcy Code arising from the bankruptcy court’s disqualification of the firm.

Dated: OFFICE OF THE U.S. TRUSTEE

By:___________________________
Alvin Mar
Attorney for the U.S. Trustee

PROOF OF SERVICE BY MAIL

STATE OF CALIFORNIA
COUNTY OF LOS ANGELES

I am employed in the County of Los Angeles, state of California, in the Office of the Unites States Trustee under the supervision of a member of the bar of this Court at whose direction the service hereinafter described was made; I am over the age of 18 and not a party to the within action; and my business address is: 725 South Figueroa Street, Suite 2600, Los Angeles, California 90017.

On __________________ , I served the foregoing document described as: **APPELLEE'S OPENING BRIEF** on the interested parties at their last known address in the action by placing a true and correct copy thereof in a sealed envelope with sufficient postage thereon full prepaid, in the United States Mail at Los Angeles, California, addressed as follows and as addressed on the attached service list:

APPELLANT:
Lon B. Isaacson Associates
c/o Lon B. Isaacson, Esq.
3435 Wilshire Boulevard, Ste 2910
Los Angeles, CA 90010-2015

ATTORNEY FOR APPELLANT:
Lon B. Isaacson Associates
c/o Lon B. Isaacson, Esq.
Larry D. Johnson, Esq.
3435 Wilshire Boulevard, Ste 2910
Los Angeles, CA 90010-2015

By Federal Express and by
U.S. Mail

CO-APPELLEES:
Max Robert Moses, M.D.
Marlene Ellen Moses
26806 Fond Du Lac Road
Rancho Palos Verdes, CA 90275

COUNSEL FOR CO-APPELLEES, MAX ROBERT MOSES, M.D. AND MARLENE ELLEN MOSES:
Moses S. Hall, Esq.
Law Offices of Moses S. Hall
2555 E. Chapman Avenue, Ste 150
Fullerton, CA 92831

OTHER INTERESTED PARTY:
Irene Scott Carroll, Esq.
Special Assistant United States Attorney
Room 3018, Federal Building
300 N. Los Angeles Street
Los Angeles, CA 90012

I declare under penalty of perjury that the foregoing is true and correct.

Dated: ______________________

Helen Cruz

BRIEF BANK — 'SUMMARY SHEET" *Printed Mon-3/13/06 14:30*

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Jackson v UST (In re Jackson)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*
DC SC

3. ("CCN") ***CURRENT*** CASE NO.
No.: 05-44941

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*
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Court:
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U.S. TRUSTEES

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Filed: February 2006
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7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*
John T. Stack, Trial Attorney, Columbia SC
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") ● ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***

● 1. Did the Bankruptcy Court err in denying without prejudice Appellant's motion seeking an order declaring invalid certain provisions of the United States Code on constitutional and other grounds, when Appellant failed to follow applicable Federal Rules of Bankruptcy Procedure requiring that such a challenge be made by an adversary proceeding. 2. In light of Appellant's failure to follow procedural requirements, should issues of ripeness and justiciability be reserved for decision until such time as Appellant brings an appropriate proceeding using appropriate process.

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UNITED STATES DISTRICT COURT
DISTRICT OF SOUTH CAROLINA
AIKEN DIVISION

In re:	)	
	)	Chapter 13
Shannon Denise Jackson,	)	Bankr. Case No. 05-44941-B
	)	
Debtor.	)	
	)	
Shannon Denise Jackson,	)	
	)	
Appellant,	)	
	)	CA No. 1:06-CV-00089-MBS
v.	)	
	)	
W. Clarkson McDow, Jr., United	)	
States Trustee for Region Four,	)	
and Joy S. Goodwin,	)	
	)	
Appellees.	)	

BRIEF OF APPELLEE UNITED STATES TRUSTEE

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STATEMENT OF BASIS FOR APPELLATE JURISDICTION

This Court has jurisdiction over this appeal pursuant to 28 U.S.C. § 158(a).

STATEMENT OF ISSUES PRESENTED

1. Did the Bankruptcy Court err in denying without prejudice Appellant's motion seeking an order declaring invalid certain provisions of the United States Code on constitutional and other grounds, when Appellant failed to follow applicable Federal Rules of Bankruptcy Procedure requiring that such a challenge be made by an adversary proceeding?

2. In light of Appellant's failure to follow procedural requirements, should issues of ripeness and justiciability be reserved for decision until such time as Appellant brings an appropriate proceeding using appropriate process?

STATEMENT OF STANDARD OF REVIEW

The standards of review on appeal are clearly erroneous as to findings of fact and *de novo* as to conclusions of law. *In re Merry-G-Round Enter., Inc.,* 400 F.3d 219 (4th Cir. 2005). This appeal raises only issues of law.

STATEMENT OF THE CASE

I. The Statutory and Legislative Background

On April 20, 2005, the President signed into law the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA"). The bulk of its provisions became effective on October 17, 2005. This legislation constitutes the most extensive overhaul of the United States

Bankruptcy Code, 11 U.S.C. §§ 101 *et seq.* ("Bankruptcy Code") since its enactment in 1978. As indicated by its title, the BAPCPA has two primary goals: the prevention of bankruptcy abuse and the protection of consumers involved in the bankruptcy process. The consumer protection provisions consist, *inter alia*, of enhanced disclosure requirements and other safeguards pertaining to reaffirmations of dischargeable debt by bankruptcy debtors, penalties for abusive practices by creditors, requirements for credit counseling and debtor education, and the provisions pertaining to debt relief agencies. It is these last provisions that the appellant Shannon Denise Jackson ("Appellant") seeks to challenge in her bankruptcy case.

The Bankruptcy Code defines "debt relief agencies" to include persons that provide "legal representation" in bankruptcy proceedings. *See* 11 U.S.C. §§ 101(12A), 101(4A). The requirements imposed on debt relief agencies are for the benefit of persons "whose debts consist primarily of consumer debts and the value of whose nonexempt property is less than $150,000," 11 U.S.C. § 101(3), *i.e.*, persons of moderate and less than moderate means. These requirements are set forth in three new sections of the Bankruptcy Code: §§ 526, 527 and 528. Section 526 prohibits debt relief agencies from: (i) misrepresenting to assisted persons the services to be provided to them or the risks attendant upon becoming a debtor; (ii) advising an assisted person to make untrue or misleading statements in bankruptcy filings; and (iii) advising an assisted person to incur more debt in contemplation of filing bankruptcy or for the purpose of paying an attorney or bankruptcy petition preparer for bankruptcy services. It also provides that any waiver of rights under §§ 526, 527 and 528 is unenforceable.

Section 527 requires debt relief agencies to provide assisted persons with certain information, notices and disclosures, including: (i) notice of the right to proceed *pro se*, hire an attorney or hire a bankruptcy petition preparer; (ii) information on how to complete the bankruptcy schedules, value assets and determine what property is exempt; and (iii) notice of the obligation of debtors to provide truthful and accurate information and the potential consequences of failing to do so.

Section 528 requires debt relief agencies to provide assisted persons a written contract explaining clearly and conspicuously the nature of services they will render, the amount of the fees or charges for such services, and the terms of payment. In addition, § 528 requires debt relief agencies to disclose in their advertising that they are debt relief agencies, that the assistance they provide may involve bankruptcy relief, and that they are in the business of helping people file for relief under the Bankruptcy Code.

II. Procedural History

On October 21, 2005, appellant Shannon Denise Jackson (“Appellant”) filed a voluntary petition under chapter 13 of the Bankruptcy Code. Because Appellant filed her case after October 17, 2005, the provisions of BAPCPA, including the debt relief agency provisions, were applicable to her case.

On November 8, 2005, Appellant filed her Motion of Debtor for Declaration that the Debt Relief Provisions of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 are Invalid as Applied to Duly Admitted Members of the Bar Practicing Before the United States Bankruptcy Court for the District of South Carolina (“Motion”). In the Motion, Appellant asked the Bankruptcy Court to declare that the debt relief provisions are invalid as applied to bankruptcy attorneys in South Carolina. The Motion stated that it sought declaratory relief pursuant to 28 U.S.C. §§ 2201 and 2202. Motion, paragraph 6. It further stated that 11 U.S.C.

§ 526(c)(5) excused Appellant from the obligation to seek the declaratory relief by means of an adversary proceeding under Fed. R. Bankr. P. 7001.

On November 21, 2005, the Bankruptcy Court *sua sponte* entered the Order. The Bankruptcy Court found that the declaratory relief sought in the Motion could be properly sought only by way of an adversary proceeding filed pursuant to Fed. R. Bankr. P. 7001. The Bankruptcy Court further found that 11 U.S.C. § 526(c)(2) did not apply, because no violation of the debt relief provision of BAPCPA had occurred. Finally, the Bankruptcy Court stated that the matter was not ripe as no actual or justiciable controversy had arisen in Appellant's case.

On December 1, 2005, Appellant filed with the Bankruptcy Court a timely notice of appeal from the Order.

ARGUMENT

I. The Bankruptcy Court properly denied the Motion, as it sought relief that under applicable rules must be sought by an adversary proceeding.

Cases and related proceedings in United States Bankruptcy Courts are governed by the Federal Rules of Bankruptcy Procedure ("Rules"). The Rules distinguish between "contested matters" and "adversary proceedings." Under Rule 9014(a), a contested matter not otherwise governed by the Rules is initiated by the filing of a motion. Fed. R. Bankr. P. 9014(a). Rule 7001 describes a series of proceedings denominated as "adversary proceedings" that are governed by Part VII of the Rules. Part VII of the Rules makes applicable to adversary proceedings, with some modifications, virtually all of the Federal Rules of Civil Procedure that apply to civil cases in the United States District Courts.

The important Rules for this case are Rules 7003 and 7004, which dictate how adversary proceedings are commenced and how defendants in adversary proceedings are to be served. Rule 7003 directly applies Fed. R. Civ. P. 3 to adversary proceedings; an adversary proceeding is commenced by filing a complaint with the court. Fed. R. Bankr. P. 7003; Fed. R. Civ. P. 3. Rule 7004 incorporates, with some modifications not germane to the issues in this case, the requirements of Fed. R. Civ. P. 4 that the complaint filed pursuant to Rule 7003 be served upon the defendants with a summons issued by the clerk of the court. Fed. R. Bankr. P. 7004; Fed. R. Civ. P. 4. If, therefore, the relief sought by Appellant in the Motion was properly the subject of an adversary proceeding, Appellant should have filed a complaint with the clerk of the Bankruptcy Court, had the clerk issue a summons, and served the summons and complaint in compliance with the requirements of the Rules.

Rule 7001 provides in relevant part:

> An adversary proceeding is governed by the rules of this Part VII. The following are adversary proceedings:
>
> (7) a proceeding to obtain an injunction or other equitable relief . . .; [or]
>
> (9) a proceeding to obtain a declaratory judgment relating to any of the foregoing . . . .

Fed. R. Bankr. P. 7001(7) and (9).

That the relief sought in the Motion falls within the scope of Rule 7001 is not seriously subject to question. The Motion seeks declaratory relief that would effectively enjoin the enforcement of the debt relief agency provisions of BAPCPA against attorneys in South Carolina. Because the relief sought is both declaratory and equitable, it may be sought only through the filing of a complaint and the service of the complaint and a summons on all necessary parties defendant to the action.

In her brief, Appellant does not contend that Rule 7001 is inapplicable. Instead, she argues that, because the requirement that an adversary proceeding be commenced by complaint is not jurisdictional, this requirement is waivable. While the U.S. Trustee does not necessarily disagree with this as a general principle of law, the principle does not apply here. A “waiver” is an “intentional relinquishment or abandonment of a known right or privilege.” *Johnson v. Zerbst*, 304 U.S. 458, 464 (1938). Neither the U.S. Trustee nor, to the best of his knowledge, any other party waived either expressly or impliedly the requirement that an adversary proceeding be brought in this case.

The cases cited by Appellant all stand for the proposition that the adversary complaint requirement may be voluntarily waived. In *In re Pence*, 905 F.2d 1107 (7th Cir. 1990), the Seventh Circuit Court of Appeals noted that the debtor had expressly waived any objection to the fact that a complaint had not been filed. *Id.* at 1109. In *In re Kmart Corp.*, 290 B.R. 601 (Bankr. N.D. Ill. 2002), the bankruptcy court noted that no party had raised the issue of whether the injunctive and declaratory relief sought should have been sought by way of a complaint instead of a motion. Finding that no party had been prejudiced by the failure to bring an adversary proceeding, and that the potential defendants had waived the requirement because of their failure to object, the court proceeded to decide the matter. *Id.* at 604. Finally, In *In re Davis*, 40 B.R. 934 (Bankr. D.S.D. 1984), the court noted that the party upon whom a motion seeking injunctive and declaratory relief had been served had not objected to the defective procedure, and therefore decided not to object to the defective procedure on its own motion. *Id.* at 936. *Davis* certainly does not stand for the proposition that a court cannot insist that parties bringing matters before it comply with applicable rules. The Bankruptcy Court in the case at bar quickly determined that the Motion was procedurally defective and took the initiative to dismiss it without prejudice. This action was well within the power of the court.

Appellant also argues that, because she seeks to vindicate rights that she characterizes and "vital" and "substantive," she should not be required to file an adversary proceeding. She bases this argument on the decision of the United States Supreme Court in *Tennessee Student Assistance Corp. v. Hood*, 541 U.S. 440 (2004). The court in *Hood* was faced with special circumstances that are not present here.

In *Hood*, a debtor filed an adversary proceeding against Tennessee Student Assistance Corporation ("TSAC"), which was a governmental corporation created by the State of Tennessee to administer student loan programs. In her complaint, the debtor sought a determination under 11 U.S.C. § 523(a)(8) that excepting certain student loan obligations from her bankruptcy discharge would impose an undue hardship on her. TSAC filed a motion to dismiss for lack of jurisdiction, asserting Eleventh Amendment sovereign immunity. The Supreme Court held that, because the determination of whether a debt was dischargeable in bankruptcy is an *in rem* proceeding, the action against TSAC seeking such a determination was not a suit against a State for purposes of the Eleventh Amendment. *Id.* at 451.

The Supreme Court in *Hood* also dealt with the requirement of the Bankruptcy Rules that a proceeding to determine the dischargeability of a debt be brought by adversary proceeding. It was asserted that the service of a summons on TSAC would have sovereign immunity implications because the bankruptcy court would thereby acquire personal jurisdiction over the

State. In response, the Supreme Court held that, because the debtor had the *in rem* right under the Bankruptcy Code to an undue hardship determination, the Bankruptcy Rules could not appropriately deny her that right by requiring that she serve a summons on the State. *Id.* at 454 (citing 28 U.S.C. § 2075 for the proposition that a bankruptcy rule may not abridge a substantive right). This case therefore bears no similarities to *Hood*. While Appellant asserts that it would be inconvenient for her to file an adversary proceeding, requiring her to follow the rules would not abridge any substantive rights she might have under the Bankruptcy Code or otherwise.

The Fourth Circuit Court of Appeals insists on strict compliance with the adversary proceeding requirement. In *In re Banks*, 299 F.3d 296 (4th Cir. 2002), the Fourth Circuit held that a chapter 13 debtor could not rely on a provision in his confirmed plan to affect his obligations to continue to pay interest on a student loan. Rule 7001(6) requires that a proceeding to determine the dischargeability of a debt be brought by way of an adversary proceeding. The debtor asserted that because the creditor received notice of the plan provision under Rule 2002, the creditor was bound by the confirmed plan. The Fourth Circuit strenuously disagreed:

> We agree a bankruptcy court confirmation order generally is afforded a preclusive effect. But we cannot defer to such an order if it would result in a denial of due process in violation of the Fifth Amendment to the United States Constitution. *Piedmont Trust Bank v. Linkous (In re Linkous),* 990 F.2d 160, 162 (4th Cir.1993). Where the Bankruptcy Code and Bankruptcy Rules specify the notice required prior to entry of an order, due process generally entitles a party to receive the notice specified before an order binding the party will be afforded preclusive effect. *See id.* (quoting *Mullane v. Central Hanover Bank and Trust,* 339 U.S. 306, 314, 70 S.Ct. 652, 94 L.Ed. 865 (1950)); *Cen-Pen Corp. v. Hanson (In re Hanson),* 58 F.3d 89, 93 (4th Cir.1995).
>
> In *In re Linkous*, the creditor received "notice" pursuant to Rule 2002, but was not served with a summons and motion as required under Rule 7004. *Id.* at 163. We held the notice was insufficient and refused to accord finality to the bankruptcy court's confirmation order. Specifically, we ruled due process entitled the creditor to receive notice of a hearing as provided by the Bankruptcy Rules. *Id*. In *In re*

> *Hanson*, we held where an adversary proceeding "is required to resolve the disputed rights of the parties, the potential defendant has the right to expect that the proper procedures will be followed." 58 F.3d at 93. In *In re Deutchman*, we confirmed that a Debtor's failure to give specific notice of his intent to discharge nondischargeable debts violates the creditor's due process rights and, as a result, the confirmation order discharging the debt will not be given preclusive effect. 192 F.3d at 461.

Id. at 302.

It is therefore clear that the Fourth Circuit Court of Appeals does not treat compliance with the requirements of the Bankruptcy Rules as a matter to be taken cavalierly. This is precisely what Appellant has done in this case. She is seeking radical and far-reaching relief without observing the procedural requirements of the forum in which she has chosen to proceed. The Bankruptcy Court properly insisted that she comply with the Bankruptcy Rules and denied her Motion without prejudice.

II. Section 526(c)(5) of the Bankruptcy Code does not provide Appellant with a right that can be asserted by motion.

In the Motion, Appellant alleged that the matter did not have to be filed as an adversary proceeding because 11 U.S.C. § 526(c)(5) specifically allowed it to be brought by motion. Section 526(c)(5) provides:

> (5) Notwithstanding any other provision of Federal law and in addition to any other remedy provided under Federal or State law, if the court, on its own motion or on the motion of the United States trustee or the debtor, finds that a person intentionally violated this section, or engaged in a clear and consistent pattern or practice of violating this section, the court may –
>
> (A) enjoin the violation of such section; or
>
> (B) impose an appropriate civil penalty against such person.

11 U.S.C. § 526(c)(5). This statute therefore permits debtors and others to bring before the Bankruptcy Court by motion the issue of whether a debt relief agency has committed certain

violations of the debt relief agency provisions of the Bankruptcy Code. The statute does not, however, give Appellant the right to challenge by motion the constitutionality and enforceability of the statutory scheme of which it itself is an integral part. The only motion a debtor is authorized to file under § 526(c)(5) is a motion alleging that a debt relief agency has failed to comply with the law. The Motion did not make any such allegations. The Bankruptcy Court therefore properly found that § 526(c)(5) did not excuse Appellant from the requirement that she file a proper adversary proceeding.

III. Issues of ripeness and justiciability should be reserved until Appellant brings her arguments before a proper court using appropriate pleadings and process.

In the Order, the Bankruptcy Court *sua sponte* found that because no actual or justiciable controversy had arisen in this case, the matter was not ripe. While much of Appellant's brief is addressed to this issue, this Court need not reach it. If Appellant is correct and a case or controversy exists, the Court nevertheless must affirm the Bankruptcy Court's denial of the Motion because of Appellant's failure to seek relief through an adversary proceeding. If, on the other hand, the Bankruptcy Court was correct in concluding that there was no case or controversy, Appellant will still have the right after affirmance of the denial of the Motion to file an appropriate proceeding in an appropriate forum against appropriate adverse parties. Whether that proceeding presents an actual case or controversy will be determined based upon the allegations of the complaint and the responses filed by the adverse parties.

CONCLUSION

Based on the foregoing, the U.S. Trustee requests that this Court enter an order affirming the Bankruptcy Court's denial of the Motion because of Appellant's failure to file an adversary proceeding in compliance with Part VII of the Bankruptcy Rules and granting such further relief as is appropriate under the circumstances.

W. CLARKSON MCDOW, JR.
United States Trustee
Region Four

By: s/ John Timothy Stack
Trial Attorney
Dist. Ct. I. D. No. 4272

s/ Walter W. Theus, Jr.
Trial Attorney
Dist. Ct. I. D. No. 4056
Executive Office for U.S. Trustees

Department of Justice
1835 Assembly Street, Ste. 953
Columbia, SC 29201
(803) 765-5218 (Stack)
(803) 705-5159 (Theus)
John.T.Stack@usdoj.gov
Walter.W.Theus@usdoj.gov

Date: 2/9/06

CERTIFICATE OF SERVICE

I, John T. Stack, do hereby certify that on February 9, 2006, I served the below-named documents upon the parties also listed below by First Class United States Mail, postage prepaid, with return address clearly shown, as designated below.

BRIEF OF APPELLEE UNITED STATES TRUSTEE
CERTIFICATE OF SERVICE

V. Lee Ringler, Esquire
753 Broad Street, Ste. 1500
Augusta, GA 30901

Joy S. Goodwin, Esquire
P. O. Box 2066
Columbia, 29202

s/ John T. Stack
John T. Stack
Trial Attorney
Office of the United States Trustee
Department of Justice
Dist. Ct. I. D. No. 4272
1835 Assembly Street, Ste. 953
Columbia, SC 29201
(803) 765-5218
john.t.stack@usdoj.gov

Date: 2/9/06

BRIEF BANK — 'SUMMARY SHEET" *Printed Tue-5/24/05 8:21*

WESTLAW CODES

1. **("TI")** *TITLE* OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*
Brady, LLP v. Maxfield (UST) (In re Jennings)

2. **("CO")** *CURRENT* COURT *[E.g., "CTA9"]*
MD Fla

3. **("CCN")** *CURRENT* CASE NO.
No.: 6:05-cv-248-Orl-19DAB

4. **("PCN")** *PRIOR* CASE NO. & COURT *[IF ANY]*
No.:
Court: US Bankr Court for the Middle District of Florida
(Identify judge & cite, if any)

5. **("SO")** *SOURCE*
U.S. TRUSTEES

6. **("DA")** *DATE* OF FILING *& TYPE* OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*
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7. **("AU")** *PRINCIPAL AUTHORS & OFFICE [E.g.,"UST/OGC"]*
William L. Courshon, Trial Attny OUST, Seattle, WA
(UST/OGC: 202-307-1399/FAX-2397)

8. **("TO")** *TOPIC*
BANKRUPTCY

9. **("SU")** • *SUMMARY* OF KEY ISSUE(s) & √ Any Miscellaneous *BACKGROUND*
•Whether the Bankruptcy Court erred in concluding that Quarles & Brady, LLP failed to comply with the disclosure requirements of 11 U.S.C. § 327 and Fed. R. Bankr. P. 2014, where Quarles & Brady failed to disclose in its application for employment as counsel for eleven related chapter 11 debtors all of its connections with such debtors, to enable the Court to make an informed decision as to whether to approve such employment, and failed to supplement its application for employment at any time to disclose any connections of which Quarles & Brady became aware after the filing of its initial application. See Brief for other issues.

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IN THE UNITED STATES DISTRICT COURT
MIDDLE DISTRICT OF FLORIDA
ORLANDO DIVISION

In re

BRUCE LEE JENNINGS, et al.,

Debtors.

QUARLES & BRADY, LLP,

Appellant,

vs.

BRANDON JAMES MAXFIELD and
UNITED STATES TRUSTEE,

Appellees.

Case No. 6:05-cv-248-Orl-19DAB

On Appeal from Bankruptcy Case
Nos. 03-04926-3F1 and
03-04928-3F1 through 03-04937-3F1
(All Cases Administratively
Consolidated Under Case No.
03-04926-3F1)

BRIEF FOR APPELLEE, UNITED STATES TRUSTEE

FELICIA S. TURNER
United States Trustee, Region 21

Elena L. Escamilla, Trial Attorney
Florida Bar No.: 898414
United States Department of Justice
Office of the United States Trustee
135 W. Central Blvd., Suite 620
Orlando, FL 32801
Telephone No.: (407) 648-6465
Facsimile No.: (407) 648-6323
E-mail: Elena.L.Escamilla@usdoj.gov

William L. Courshon, Trial Attorney
Florida Bar No.: 270490
United States Department of Justice
Office of the United States Trustee
700 Stewart Street, Suite 5103
Seattle, WA 98101-1271
Telephone No.: (206) 553-2000
Facsimile No.: (206) 553-2566
E-mail: Bill.L.Courshon@usdoj.gov

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STATEMENT OF THE ISSUES PRESENTED ON APPEAL

1. Whether the Bankruptcy Court erred in concluding that Quarles & Brady, LLP ("Quarles & Brady"), failed to comply with the disclosure requirements of 11 U.S.C. § 327 and Fed. R. Bankr. P. 2014, where Quarles & Brady failed to disclose in its application for employment as counsel for eleven related chapter 11 debtors all of its connections with such debtors, to enable the Court to make an informed decision as to whether to approve such employment, and failed to supplement its application for employment at any time to disclose any connections of which Quarles & Brady became aware after the filing of its initial application.

2. Whether the Bankruptcy Court erred in concluding that Quarles & Brady was not a disinterested person under 11 U.S.C. § 327(a), where the Court found that Quarles & Brady simultaneously represented multiple debtors, among which actual or potential conflicts of interest existed.

3. Whether the Bankruptcy Court abused its discretion in disqualifying Quarles & Brady as counsel for the debtors, denying all of its compensation in the chapter 11 cases, and requiring disgorgement of any prepetition retainer, based on Quarles & Brady's initial and continuing violation of the disclosure rules, lack of disinterestedness, and injury resulting to the bankruptcy estates from its inability to evaluate independently the various claims, transfers, and interests in the related cases.

4. Whether the Bankruptcy Court abused its discretion in denying Quarles & Brady's motions for reconsideration.

STANDARD OF APPELLATE REVIEW

In an appeal from an order or judgment of a bankruptcy court, an appellate court reviews the bankruptcy court's findings of fact for clear error, and reviews conclusions of law de novo. *Electro-Wire Products, Inc. v. Sirote & Permutt, P.C. (In re Prince)*, 40 F.3d 356, 359 (11th Cir. 1994); *Intru, Inc. v. Regency Realty Associates (In re Regency Realty Associates)*, 205 B.R. 317, 318 (M.D. Fla. 1997). The court reviews an award or refusal to award attorney's fees in a bankruptcy case for abuse of discretion. *In re Celotex Corp.*, 227 F.3d 1336, 1338 (11th Cir. 2000). The court also reviews the disposition of a motion for reconsideration for abuse of discretion. *Florida Association of Rehabilitation Facilities, Inc. v. State of Florida Department of Health and Rehabilitative Services*, 225 F.3d 1208, 1216 (11th Cir. 2000). A bankruptcy judge's discretion in awarding compensation for services performed during bankruptcy proceedings deserves great deference. *In re Prince*, 40 F.3d at 359. "An abuse of discretion occurs if the judge fails to apply the proper legal standard or to follow proper procedures in making the determination, or bases an award upon findings of fact that are clearly erroneous." *Stroock & Stroock & Lavan v. Hillsborough Holdings Corp. (In re Hillsborough Holdings Corp.)*, 127 F.3d 1398, 1401 (11th Cir. 1997) (quoting *In re Red Carpet Corp. of Panama City Beach*, 902 F.2d 883, 890 (11th Cir. 1990).

STATEMENT OF THE CASE AND OF THE FACTS[1]

Quarles & Brady appeals from an order entered by the United States Bankruptcy Court for the Middle District of Florida ("Bankruptcy Court") on November 16, 2004, disqualifying Quarles & Brady as counsel for the eleven related debtors in the above-captioned chapter 11 bankruptcy cases, denying all fees requested by Quarles & Brady in the chapter 11 cases, and requiring disgorgement of any prepetition retainer received by Quarles & Brady ("Disqualification Order"). In addition, Quarles & Brady appeals from an order entered by the Bankruptcy Court on December 16, 2004, denying Quarles & Brady's motions to alter, amend,

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[1] In this brief, citations to "R." shall refer to documents from the record in Bankruptcy Court Case No. 03-04926-3F1, followed by the Bankruptcy Court docket number. Citations to "Ex." shall refer to trial exhibits utilized by Appellee, Brandon James Maxfield, at the evidentiary hearings before the Bankruptcy Court on April 29, 2004, and May 28, 2004, followed by the exhibit number. Citations to "Appellant's Brief" shall refer to the Appellant Quarles & Brady, LLP's Revised Opening Brief on Appeal, filed April 22, 2005, followed by the page number(s).

or vacate the Disqualification Order, for a new trial, and to stay enforcement of the Disqualification Order ("Motions for Reconsideration").

I. Statutory Framework and Relevant Bankruptcy Rules Governing Employment and Compensation of Professional Persons in Bankruptcy Cases

This appeal addresses the issues of whether Quarles & Brady (1) properly complied with its statutory obligations under the Bankruptcy Code (Title 11, U.S.C.) to disclose fully its connections with the debtors, creditors, and any other parties in interest in its application for employment as counsel for the debtors, and (2) met the statutory requirements for employment as counsel for the debtors in the chapter 11 cases.

Title 11 U.S.C. § 327(a) governs the procedure for obtaining bankruptcy court approval of the employment of attorneys and other professionals by trustees and debtors in possession[2] in bankruptcy cases, limiting such employment to persons "that do not hold or represent an interest adverse to the estate, and that are disinterested persons."[3] A professional person's failure to comply with these requirements at any time during such professional person's employment under § 327 may result in a denial of compensation. *See* 11 U.S.C. § 328(c). Rule 2014(a), Fed. R.

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[2] A debtor in a chapter 11 bankruptcy case is a "debtor in possession," except when a trustee is appointed in the case. *See* 11 U.S.C. § 1101(1). A debtor in possession has most of the rights, powers, and duties of a trustee serving in a chapter 11 case. *See* 11 U.S.C. § 1107(a).

[3] The Bankruptcy Code defines a "disinterested person," in pertinent part, as a "person that– (A) is not a creditor, an equity security holder, or an insider; ... and (E) does not have an interest materially adverse to the interest of the estate or of any class of creditors or equity holders, by reason of any direct or indirect relationship to, connection with, or interest in, the debtor or any investment banker specified in subparagraph (B) or (C) of this paragraph, or for any other reason." 11 U.S.C. § 101(14)(A), (E).

Bankr. P., requires that an application for employment under § 327 shall include a statement, to the best of the applicant's knowledge, of "all of the person's connections with the debtor, creditors, any other party in interest, their respective attorneys and accountants, the United States trustee, or any person employed in the office of the United States trustee." Rule 2014(a) further provides that "[t]he application shall be accompanied by a verified statement of the person to be employed setting forth the person's connections" with any such other persons.[4]

Title 11 U.S.C. § 330(a) authorizes a bankruptcy court to award to a professional person employed under § 327 reasonable compensation for actual, necessary services rendered by the professional person and reimbursement for actual, necessary expenses, after notice and a hearing. Under 11 U.S.C. § 331, professional persons may apply for interim compensation and reimbursement for expenses not more than once every 120 days, or more often if the court permits, after notice and a hearing. Rule 2016(a), Fed. R. Bankr. P., provides that an entity seeking interim or final compensation for services or reimbursement of expenses shall file an application setting forth a detailed statement of the services rendered, time expended, and expenses incurred, and the amounts requested.

Title 11 U.S.C. § 329(a) and Rule 2016(b), Fed. R. Bankr. P., require debtors' attorneys to file with the court a statement of compensation paid or agreed to be paid within one year prior to the date of filing of the bankruptcy petition and the source of such compensation. A

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[4] Although Rule 2014(a) does not expressly require supplemental or continuing disclosure, § 327(a) implies a continuing duty of disclosure and requires professionals to reveal connections that arise after their retention. *See In re Keller Financial Services of Florida, Inc.*, 248 B.R. 859, 898 (Bankr. M.D. Fla. 2000); *In re Granite Partners, L.P.*, 219 B.R. 22, 35 (Bankr. S.D. N.Y. 1998).

supplemental statement is required to be filed within 15 days after any payment or agreement not previously disclosed. Fed. R. Bankr. P. 2016(b). Title 11 U.S.C. § 329(b) authorizes the court to deny or require disgorgement of any such compensation to the extent excessive, if the compensation exceeds the reasonable value of the services rendered.

II. Factual Background

Appellee, Brandon James Maxfield ("Maxfield"), the largest creditor in the chapter 11 cases, is an individual who was injured when a handgun designed by Bruce Lee Jennings ("Jennings"), manufactured by Bryco Arms, Inc. ("Bryco"), and distributed by B.L. Jennings, Inc. ("BLJ"), accidentally discharged and injured Maxfield. R.889, at 1-2. On May 23, 2001, Maxfield commenced an action against Jennings, Bryco, and BLJ in California Superior Court to recover damages for his personal injuries. R.889, at 2. Maxfield also sought to recover from the assets of Janice Kay Jennings ("Janice Jennings"), RKB Investments ("RKB"), the Kimberly K. Jennings California Trust, the Kimberly K. Jennings Nevada Trust, the Bradley A. Jennings California Trust, the Bradley A. Jennings Nevada Trust, the Rhonda D. Jennings California Trust, and the Rhonda D. Jennings Nevada Trust (collectively, the "Trust Debtors") any judgment liability obtained against Jennings, Bryco, and BLJ under joint venture/enterprise, partnership, constructive trust, alter ego, and other legal theories (collectively, the "Alter Ego

Claims").[5] R.889, at 2. Maxfield served his complaint on Jennings in October 2001. R.889, at 2.

In January and February 2002, attorneys from Quarles & Brady, including one of Quarles & Brady's partners, Ned R. Nashban ("Nashban"), performed estate planning services for Jennings, including providing legal advice regarding "Florida residency, domicile, and exempt assets" and "home purchase, estate planning, possible bankruptcy options, and real estate mortgages." R.889, at 2-3; Ex. 11. On or about February 15, 2002, Jennings purchased a home in Daytona Beach, Florida, for $925,000 in cash. Ex. 28-29. On March 5, 2002, Jennings purchased a $500,000 annuity issued by Allianz Insurance Company. R.889, at 3; Ex.31.

On May 13, 2003, the California Superior Court entered judgment for damages in favor of Maxfield against Jennings, Bryco, and BLJ in the amount of $24,774,146.53. R.605, at 1; Ex.26.

On May 14, 2003, one day after the entry of the Maxfield judgments against Jennings, Bryco, and BLJ, but before any ruling on Maxfield's Alter Ego Claims, Quarles & Brady filed eleven voluntary chapter 11 bankruptcy petitions in the Bankruptcy Court on behalf of Jennings, Bryco, BLJ, Janice Jennings, RKB, and the six Trust Debtors (collectively, the "Debtors"). R.889, at 4.

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[5] Jennings is the sole owner of BLJ. Janice Jennings is Jennings' former wife and the sole owner of Bryco. The beneficiaries of the Trust Debtors are the children of Jennings and/or Janice Jennings, who established all of the Trust Debtors and serve as the trustees for the Trust Debtors. RKB is a partnership formed by three of the Trust Debtors. R.889, at 2. Bryco was a firearm manufacturer, which sold the majority of its guns to BLJ. R.583, at 90.

On May 16, 2003, Quarles & Brady filed a complaint for declaratory relief in the Bankruptcy Court on behalf of RKB and the Trust Debtors seeking a determination that RKB and the Trust Debtors have no liability to Jennings, Bryco, or BLJ for any Alter Ego Claims asserted by Maxfield, as well as by other claimants with similar personal injury claims against Jennings, Bryco, and/or BLJ (Adversary Proceeding No. 03-203).[6] Ex.16.

On May 19, 2003, Quarles & Brady filed the Debtor's [sic] Application for Employment of Attorneys ("Application"), signed by Jennings on behalf of all of the Debtors, pursuant to 11 U.S.C. § 327(a). R.20; Ex.18. The Application included an Affidavit of Proposed Attorney for Debtor-in-Possession [sic], signed by Nashban, pursuant to Rule 2014(a) ("Affidavit"). R.20; Ex.18.

Paragraphs 6 and 8 of the Application provided as follows:

> 6. To the best of the Debtors' knowledge, [Quarles & Brady] has no connection with any creditors of the Debtors or any other party in interest, nor their respective attorneys.
>
> . . .
>
> 8. Quarles & Brady LLP represents no creditors of the estate nor any interest adverse to the Debtors as Debtors-in-possession or to the estate in the matters upon which it is to be engaged to perform legal services for the Debtors-in-possession, and its employment would be in the best interest of the estate.

R.20; Ex.18.

Paragraphs 3 and 4 of the Affidavit provided as follows:

> 3. Benjamin R. Norris, a partner at Quarles & Brady LLP, and I will be the principal attorneys responsible for the representation of the Debtors. Neither

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[6] On August 29, 2003, Quarles & Brady filed a similar complaint for declaratory relief in the Bankruptcy Court on behalf of Janice Jennings (Adversary Proceeding No. 03-345). Ex.17.

> of us nor Quarles & Brady LLP hold or represent any interest adverse to the Estates and we are disinterested persons as required by 11 U.S.C. 327(a).
>
> 4. That such law firm has no connection with the Debtors herein, its [sic] creditors or any other party in interest or their respective attorneys or accountants. And that it represents no interest adverse to that of the Debtors in the above-captioned matter, except that it was owed legal fees for legal work done for one of the Debtors, Bruce Lee Jennings, pre-petition, which bill has been paid to the law firm prior to the commencement of this action.

R.20; Ex.18.

On May 28, 2003, the Bankruptcy Court entered, *ex parte*, an order approving the employment of Quarles & Brady as attorneys for the Debtors pursuant to 11 U.S.C. § 327(a) ("Employment Order"). R.889, at 5. On that date, the Bankruptcy Court also entered an order authorizing joint administration of the Debtors' chapter 11 cases (for procedural purposes only) pursuant to Rule 1015(b), Fed. R. Bankr. P. R.24.

On June 20, 2003, Quarles & Brady filed bankruptcy schedules on behalf of Jennings. R.35; Ex.3. Jennings' schedules listed as assets two accounts receivable due to Jennings from BLJ for (1) back payroll in the amount of $875,000, and (2) loans in the amount of $2,000,000.[7] R.35: Ex.3 (Schedule B). Jennings' schedules listed exemption claims under Florida law in, *inter alia*, Jennings' residence in Daytona Beach, Florida, which he purchased in February 2002, and the annuity, which he purchased in March 2002. R.35; Ex.3 (Schedule C). Jennings' schedules listed only one general unsecured creditor, Maxfield. R.35; Ex.3 (Schedule F).

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[7] On July 25, 2003, Quarles & Brady amended Jennings' schedules, revising the amount of the account receivable due to Jennings for loans from Jennings to BLJ to $1,404,000. R.137; Ex.3 (Amended Schedule B).

On June 23, 2003, Quarles & Brady filed schedules on behalf of BLJ. R.43; Ex.1. BLJ's schedules listed a secured claim held by Jennings for a personal loan from Jennings to BLJ in the amount of $1,404,000. R.43; Ex.1 (Schedule D). BLJ's schedules indicated that BLJ's total assets were $1,278,952.34, of which $1,117,336.50 represented inventory on hand. R.43; Ex.1 (Schedule B). BLJ's schedules also listed a claim held by Jennings for unpaid wages in the amount of $875,000. R.43; Ex.1 (Schedule E). BLJ's schedules listed a total of 58 general unsecured creditors, including Maxfield and 45 holders of contingent, unliquidated, and disputed litigation claims in an unknown amount. R.43; Ex.1 (Schedule F).

On June 23 and 24, 2003, Quarles & Brady filed schedules on behalf of Bryco and RKB, respectively. R.46; R.49; Ex.2. Bryco's schedules listed a general unsecured claim against RKB for "rental" in the amount of $81,000. R.46 (Schedule F). RKB's schedules listed an account receivable for "rental deposits" from "Knowleton Communities Property" in the amount of $300,000. R.49; Ex.2 (Schedule B). Bryco's schedules listed 108 general unsecured claims, R.46 (Schedule F), and RKB's schedules listed only 11 unsecured litigation claims, including Maxfield's, in an unknown amount. R.49; Ex.2 (Schedule F).

On February 11, 2004, Quarles & Brady filed its first application for interim compensation and reimbursement of expenses for the period from May 15, 2003, through August 31, 2003 ("Interim Fee Application").[8] R.410.

III. The Disqualification Motion

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[8] Inexplicably, Quarles and Brady delayed filing its Interim Fee Application until nearly six months after the period for which compensation was requested.

On February 25, 2004, shortly after Quarles & Brady filed its Interim Fee Application, Maxfield filed a Motion to Disqualify Debtors' Counsel and for Disgorgement of Retainer ("Disqualification Motion").[9] R.423. On April 26, 2004, Quarles & Brady filed its response to the Disqualification Motion. R.526. On May 6, 2004, Maxfield filed a response to the Interim Fee Application. R.544.

The Bankruptcy Court conducted an extensive evidentiary hearing on the Disqualification Motion on April 29, 2004 and May 28, 2004, at which the Court heard testimony from both Nashban and Jennings. R.663; R.583, at 88-127. At the May 28, 2004 hearing, the Bankruptcy Court also heard testimony from Nashban on the Interim Fee Application. R.583, at 127-162. Counsel for Quarles & Brady, Maxfield, and the United States Trustee[10] participated at both hearings.

Significantly, at the May 28, 2004 hearing, the Bankruptcy Court admitted into evidence Quarles & Brady's engagement letter for representation of the Debtors in the proposed chapter

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[9] Prior to filing the Disqualification Motion, counsel for Maxfield sent to Nashban two letters dated June 26, 2003, and October 20, 2003, advising him of the existence of certain undisclosed conflicts of interest on the part of Quarles & Brady in connection with its joint representation of the Debtors, putting him on notice of Maxfield's intent to bring these matters to the Bankruptcy Court's attention, and affording him the opportunity to mitigate the firm's potential losses. R. 912 (Exhibits A and B); Ex.5.

[10] The United States Trustee is an official of the United States Department of Justice, charged by statute with the duty to oversee and supervise the administration of bankruptcy cases and trustees. *See* 28 U.S.C. § 586(a). Congress expressly granted standing to the United States Trustee under 11 U.S.C. § 307 to raise and be heard on any issue under Title 11, except that the United States Trustee may not file a plan of reorganization under Chapter 11. *See United States Trustee v. McCormick, Barstow, Sheppard, Wayte & Carruth (In re Donovan Corp.)*, 215 F.3d 929, 930 (9th Cir. 2000). The United States Trustee's oversight duties include monitoring employment applications filed under 11 U.S.C. § 327 and monitoring and reviewing applications for compensation and reimbursement filed under 11 U.S.C. § 330. 28 U.S.C. § 586(a)(3)(A), (H).

11 cases, dated May 8, 2003, and signed by Nashban on behalf of Quarles & Brady, and by Jennings and Janice Jennings on behalf of the various Debtors ("Engagement Letter"), which Quarles & Brady had not disclosed previously to the Bankruptcy Court or the United States Trustee. R.583, at 115; Ex.47. The Engagement Letter made specific reference to Maxfield's lawsuit against the Debtors and other lawsuits in which Alter Ego Claims were asserted, and provided, *inter alia*, as follows:

> Since we may be filing multiple Chapter 11 cases and potentially consolidating the cases, either administratively or substantively, by executing this engagement letter, **you also waive any potential conflicts among the parties that may arise**. In addition, we shall be allowed to share attorney/client privilege information among all of the individuals and entities that we will be representing in the Chapter 11 proceedings without breaching any rules of confidentiality. **However, if the Court does determine that there is a conflict that cannot be waived, we understand that and agree that it is your intention that we represent the various [Trust Debtors] and the real estate partnership [RKB] and the remaining parties will seek other counsel, subject to Court approval.**

Ex.47, at 4 (emphasis added).

At the conclusion of the hearing on the Disqualification Motion, the Bankruptcy Court took the matter under advisement and instructed the parties, including the United States Trustee, to submit post-hearing briefs on the Disqualification Motion in lieu of oral argument. R.583, at 126-127. At the conclusion of the hearing on the Interim Fee Application, the Bankruptcy Court also requested the filing of any post-hearing submissions on the Interim Fee Application in lieu of oral argument. R.583, at 160-162.

Subsequently, the United States Trustee filed a post-hearing memorandum in support of the Disqualification Motion on June 28, 2004. R.603. Quarles & Brady filed supplemental briefs in support of the Interim Fee Application and in opposition to the Disqualification Motion on June 28 and 29, 2004, respectively. R.602; R.604. On June 29, 2004, Maxfield filed post-hearing memoranda in support of the Disqualification Motion and in opposition to the Interim Fee Application. R.605; R.607.

IV. Trial Testimony on the Disqualification Motion

At the evidentiary hearing on the Disqualification Motion, Nashban testified that he had reviewed the schedules for Jennings and BLJ, indicating Jennings' wage claim and secured claim against BLJ, but that he did not amend the Application or Affidavit to disclose this information. R.663, at 17-19, 33-34, 37. Nashban acknowledged that Jennings claimed a security interest in the assets of BLJ, including its inventory and accounts receivable, and that Jennings' claim exceeded the value of those assets, but that to date he had taken no action to protect Jennings' interest in such collateral. R.663, at 20-21, 24, 30-31. In addition, Nashban testified that he was aware of additional prepetition transfers from BLJ to Jennings in the year before the filing of the bankruptcy cases in the amount of $650,000, but he did not amend the Application or Affidavit to disclose this information either. R.663, at 37-39; Ex.15. When asked if he could have disclosed these connections and sought a determination from the Bankruptcy Court at that time as to whether he could continue to represent both debtors, Nashban responded that, "[i]f I thought there was some conflict of interest, I would have sought a determination." R.663, at 18. Nashban admitted that his simultaneous representation of Jennings as a secured creditor and BLJ as a borrower was a potential conflict of interest but not an actual conflict. R.663, at 33, 39.

Prior to October 2002, RKB owned Bryco's business premises in Costa Mesa, California, and had entered into a five-year lease with Bryco, commencing on January 1, 2001. R.889, at 3; Ex.37. In October 2002, RKB sold the property to Knowleton Communities, Inc. ("Knowleton"), and Knowleton entered into a new one-year lease with Bryco, commencing October 17, 2002. R.889, at 3; Ex. 38. Jennings testified that RKB posted a security deposit of $337,507.20, which Knowleton required under its lease to Bryco. R.583, at 95; Ex.39. Jennings further testified that, at that time, RKB and Knowleton entered into an agreement for an assignment of rents, which provided that as monthly rent payments were made by Bryco to Knowleton, Knowleton would in turn return the money to RKB. R.583, at 99; Ex.45. Jennings also testified that Bryco currently owed Knowlton $150,000 (and thus by extension, RKB) in unpaid postpetition rent. R.583, at 101-102; R.889, at 3. Nashban testified on this subject that Quarles & Brady was currently conducting an investigation into the issue of whether RKB had posted a security deposit on behalf of Bryco, but that he had made no written disclosure to the Bankruptcy Court regarding such matter. R.663, at 62.

When questioned regarding $500,000 in loans payable by RKB to Jennings, which RKB apparently removed from its financial statements and tax returns in 2002 even though no actual money changed hands, Nashban testified that "this is the first I'm learning of the $500,000, as of this moment."[11] R.663, at 44; Ex.19-21.

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[11] However, the record reflects that Benjamin R. Norris, a Quarles & Brady partner and the other principal attorney responsible for the representation of the Debtors in the chapter 11 cases, was present and appeared on behalf of the Debtors at the deposition of the Debtors' accountant, Gary Genske, on February 4, 2004, at which these matters were discussed. Ex.19.

At the April 29, 2004 hearing, the Bankruptcy Court accepted the stipulation of the parties that Quarles & Brady had taken no actions on behalf of any of the Debtors to recover any prepetition asset transfers among the Debtors. R.663, at 57.

With respect to the Engagement Letter, Nashban testified that all of the Debtors are jointly and severally liable for payment of Quarles & Brady's fees for services incurred on behalf of the Debtors. R.583, at 114-115.

V. The Bankruptcy Court's Ruling on the Disqualification Motion

On November 16, 2004, the Bankruptcy Court entered an order granting the Disqualification Motion and denying the Interim Fee Application, except that the Court approved reimbursement of all expenses requested by Quarles & Brady (totaling $14,917.90), and entered detailed Findings of Fact and Conclusions of Law. R.889; R890.

The Bankruptcy Court concluded that Quarles & Brady's Rule 2014 disclosure was "woefully insufficient" because it failed to make the following disclosures:

(1) That Jennings was a secured creditor of BLJ and also claimed over $875,000 in back wages from BLJ (of which Quarles & Brady was aware on June 20 and 23, 2004, when it filed bankruptcy schedules for Jennings and BLJ);

(2) The existence of the Alter Ego Claims against Janice Jennings, RKB, and the Trust Debtors, even though the consolidation of that litigation was the primary reason for filing the chapter 11 cases, and the Engagement Letter addressed specifically the possible conflict of interest in representing both sides of that litigation;

(3) The existence of possible claims between RKB and Bryco arising from the RKB/Bryco lease and/or the Knowleton/Bryco lease, the assignment of lease revenue rights thereunder to RKB, and the circumstances surrounding the payment of the $337,507.20 security deposit by RKB on Bryco's behalf (of which

Quarles & Brady was aware no later than October 1, 2003, when Jennings testified regarding these matters at his Rule 2004 examination); and

(4) That Quarles & Brady had performed estate planning work for Jennings during 2002.

R.889, at 8. The Bankruptcy Court found that despite Quarles & Brady's awareness of these matters, it failed to disclose any of these matters in the Affidavit, amend the Affidavit, or seek a ruling from the Court concerning the continued propriety of representing the Debtors under the circumstances. R.889, at 8-9.

The Bankruptcy Court further concluded that Quarles & Brady was not a disinterested person as required under 11 U.S.C. § 327(a) as a result of:

(1) Quarles & Brady's simultaneous representation of Jennings and BLJ, where BLJ's schedules indicated that Jennings held a secured claim of $1,404,000 against BLJ;

(2) Quarles & Brady's simultaneous representation of Jennings and RKB, where the firm had a fiduciary duty to investigate a $500,000 loan from Jennings to RKB, which RKB apparently removed from its financial statements and tax returns, even though no money changed hands and RKB had the funds to pay the obligation; and

(3) Quarles & Brady's simultaneous representation of RKB and Bryco, in light of the questions surrounding RKB's payment of the security deposit to Knowleton on Bryco's behalf and the fact that RKB is at minimum a creditor of Bryco and perhaps could assert an administrative claim in Bryco's case.

R.889, at 10-12.

The Bankruptcy Court ordered the disqualification of Quarles & Brady as counsel for the Debtors, denied all of its compensation in the chapter 11 cases, and required disgorgement of any prepetition retainer, based on Quarles & Brady's initial and continuing violation of the disclosure rules, lack of disinterestedness, and injury resulting to the bankruptcy estates from its inability to evaluate independently the various claims, transfers, and interests in the related cases. R.889, at 12-14.

VI. The Motions for Reconsideration

On November 26, 2004, Quarles & Brady filed its Motions for Reconsideration and memorandum in support thereof. R.895-898. On November 30, 2004, the Bankruptcy Court entered an order directing any party opposing the Motions for Reconsideration to file a response in opposition to the relief requested within ten days. R.901. Maxfield and the United States Trustee filed responses in opposition to the Motions for Reconsideration on December 8 and 10, 2004, respectively. R.912; R.914. On December 16, 2004, the Bankruptcy Court entered an order denying the Motions for Reconsideration. R.921. On December 27, 2004, Quarles & Brady filed a notice of appeal from the Bankruptcy Court's orders granting the Disqualification Motion and denying the Motions for Reconsideration. R.945.

SUMMARY OF ARGUMENT

The Bankruptcy Court properly concluded that Quarles & Brady failed to comply with the requirements of 11 U.S.C. § 327 and Rule 2014(a), Fed. R. Bankr. P., by failing to disclose all of its connections with the Debtors in the Application and Affidavit or to amend the Application or Affidavit at any time to disclose any such connections of which Quarles & Brady became aware after the entry of the Employment Order. The Bankruptcy Code and Rules mandate such disclosure to enable the bankruptcy courts to make informed decisions whether professional persons meet the statutory requirements for employment under § 327(a). Neither the Bankruptcy Court, the creditors, nor the United States Trustee had any obligation to search through voluminous documents in the file or to conduct a fact-finding investigation to seek out conflicts of interest that Quarles & Brady did not disclose in the Application or Affidavit. That duty fell solely on Quarles & Brady. By failing to comply with its statutory duties of disclosure, Quarles & Brady deprived the Bankruptcy Court of its ability to make a proper and timely determination of Quarles & Brady's eligibility for employment as counsel for the Debtors.

The Bankruptcy Court properly concluded that Quarles & Brady was not a "disinterested person" as required for employment as counsel for the Debtors under § 327(a) by reason of undisclosed potential or actual conflicts of interest among the various Debtors, which rendered Quarles & Brady unable to represent the respective bankruptcy estates impartially, and resulted in irreparable injury to the estates. As a result of Quarles & Brady's divided loyalties, it was unable to evaluate independently the various claims, transfers, and interests in the Debtors' chapter 11 cases or otherwise to ensure that the Debtors complied with their fiduciary obligations to their respective bankruptcy estates and creditors, to the prejudice of the creditors.

Based on the record in the chapter 11 bankruptcy cases, the Bankruptcy Court did not abuse its discretion in disqualifying Quarles & Brady as counsel for Debtors, denying all of its compensation in the chapter 11 cases, and requiring disgorgement of any prepetition retainer, where it properly concluded that: (1) Quarles & Brady had failed to comply with the disclosure requirements of § 327 and Rule 2014(a); (2) Quarles & Brady was not a disinterested person as required under § 327(a); and (3) Quarles & Brady's inability to evaluate independently the various claims, transfers, and interests in the chapter 11 cases resulted in injury to the Debtors. The courts of appeal have recognized that bankruptcy courts have the discretion to disqualify counsel for the bankruptcy estate or deny all compensation for a failure to comply with the statutory disclosure requirements, even if such failure is negligent or inadvertent. In addition, the courts of appeal have acknowledged the bankruptcy courts' discretion to disqualify counsel or deny its compensation for lack of disinterestedness, based on potential, as well as actual, conflicts of interest. In arguing erroneously that the Bankruptcy Court lacked discretion to disqualify Quarles & Brady or deny its compensation based solely on potential conflicts, Quarles & Brady has misconstrued the provisions of 11 U.S.C. §§ 327(a), 327(c), and 328(c), and ignored established precedents from the circuits holding to the contrary.

Finally, the Bankruptcy Court did not abuse its discretion in denying the Motions for Reconsideration, where Quarles & Brady failed to show a manifest error of law or fact, to present any newly discovered evidence, or to make any showing required under Rule 60(b), Fed. R. Civ. P.

ARGUMENT

I. The Bankruptcy Court Did Not Err in Concluding that Quarles & Brady Failed to Comply with the Disclosure Requirements of 11 U.S.C. § 327 and Rule 2014(a), Fed. R. Bankr. P.

The Bankruptcy Court properly recognized that the Bankruptcy Code and Rules impose a mandatory obligation on an attorney seeking employment by a chapter 11 bankruptcy estate to make a complete disclosure of his or her relationship to the debtor and of any potential conflicts involved in the representation. R.889, at 7-8. Proper disclosure is necessary to enable a court to make an informed decision as to whether the professional person meets the statutory requirements for employment under 11 U.S.C. § 327(a), i.e., that such person does not "hold or represent an adverse interest to the estate" and is a "disinterested person." *See* 11 U.S.C. § 327(a); *Neben & Starrett, Inc. v. Chartwell Financial Corp. (In re Park-Helena Corp.)*, 63 F.3d 877, 881 (9th Cir. 1995), *cert. denied*, 516 U.S. 1049, 116 S.Ct. 712, 133 L.Ed.2d 667 (1996); *In re Granite Partners, L.P.*, 219 B.R. 22, 35 (Bankr. S.D. N.Y. 1998).

To enable bankruptcy courts to determine properly whether attorneys or other professional persons comply with these requirements, Rule 2014(a), Fed. R. Bankr. P., sets forth the following requirements for applications for employment under § 327:

> An order approving the employment of attorneys, accountants, appraisers, auctioneers, agents, or other professional persons pursuant to § 327, § 1103, or § 1114 of the Code shall be made only on application of the trustee or committee. The application shall be filed and, unless the case is a chapter 9 municipality case, a copy of the application shall be transmitted by the applicant to the United States trustee. **The application shall state** the specific facts showing the necessity for the employment, the name of the person to be employed, the reasons for the selection, the professional services to be rendered, any proposed arrangement for compensation, and, **to the best of the applicant's knowledge, all of the person's connections with the debtor, creditors, any other party in interest, their respective attorneys and accountants, the United States trustee, or any person employed in the office of the United States trustee. The application shall be accompanied by a verified statement of the person to be employed setting forth the person's connections with the debtor, creditors, any other party in interest, their respective attorneys and accountants, the United States trustee, or any person employed in the office of the United States trustee.** [Emphasis added.]

Rule 2014(a) requires all attorneys and other professional persons employed under § 327 to disclose all known connections with the debtor, creditors, and other parties in interest both in the application for employment and in an accompanying verified statement. *Kravit, Gass & Weber, S.C. v. Michel (In re Crivello)*, 134 F.3d 831, 836 (7th Cir. 1998).

Because a professional person's failure to comply with the requirements of § 327(a) at any time during such person's employment may result in a denial of compensation, *see* 11 U.S.C. § 328(c), the courts have held that the duty to disclose is a continuing duty that survives the initial filing of the application for employment and requires professionals to reveal connections that arise after their retention. *See In re Keller Financial Services of Florida, Inc.*, 248 B.R. 859, 898 (Bankr. M.D. Fla. 2000); *In re Bennett Funding Group, Inc.*, 226 B.R. 331, 334 (Bankr. N.D. N.Y. 1998); *In re Granite Partners, L.P.*, 219 B.R. 22, 35 (Bankr. S.D. N.Y. 1998). "[T]he need for professional self-scrutiny and avoidance of conflicts of interest does not end upon appointment." *Rome v. Braunstein*, 19 F.3d 54, 57-58 (1st Cir. 1994).

Under Rule 2014(a), "[t]he scope of disclosure is much broader than the question of disqualification ... The applicant and the professional must disclose all connections and not merely those that rise to the level of conflicts." *Keller Financial Services*, 248 B.R. at 897 (quoting *In re Granite Partners, Inc.*, L.P., 219 B.R. 22, 35 (Bankr. S.D. N.Y. 1998)); *accord, In re Gulf Coast Orthopedic Center*, 265 B.R. 318, 323 (Bankr. M.D. Fla. 2001). "The professional must disclose all facts that bear on his disinterestedness, and cannot usurp the court's function by unilaterally choosing which connections impact on his disinterestedness and which do not." *Keller Financial Services*, 248 B.R. at 897.

The courts of appeals have recognized the importance of these disclosure requirements and the power of the bankruptcy courts to sanction attorneys for failing to comply with these requirements. *See, e.g., Kravit, Gass & Weber, S.C. v. Michel (In re Crivello)*, 134 F.3d 831, 836 (7th Cir. 1998); *Neben & Starrett, Inc. v. Chartwell Financial Corp. (In re Park-Helena Corp.)*, 63 F.3d 877, 881-882 (9th Cir. 1995), *cert. denied*, 516 U.S. 1049, 116 S.Ct. 712, 133 L.Ed. 2d 667 (1996); *Rome v. Braunstein*, 19 F.3d 54, 59-60 (1st Cir. 1994). In *Park-Helena*, in which the debtor's attorney failed to disclose the source of a prepetition retainer, the Ninth Circuit acknowledged that the disclosure requirements of Rule 2014 are applied "strictly." *Id.* at 881. "All facts that may be pertinent to a court's determination of whether an attorney is disinterested or holds an adverse interest to the estate must be disclosed." *Id.* at 882. "The duty of professionals is to disclose all connections with the debtor, debtor-in-possession, insiders, creditors, and parties in interest ... They cannot pick and choose which connections are irrelevant or trivial ... No matter how old the connection, no matter how trivial it appears, the professional seeking employment must disclose it." *Id.* The Ninth Circuit further stated that "[t]he disclosure rules are applied literally, even if the results are sometimes harsh." *Id.* at 881. Negligent or inadvertent omissions "do not vitiate the failure to disclose." *Id.* The failure to comply with the disclosure rules is a sanctionable violation, even if proper disclosure would have shown that the attorney had not actually violated any Bankruptcy Code provision or Bankruptcy Rule. *Id.* at 880. Applying these strict standards, the *Park-Helena* court held that the attorney's failure to describe the circumstances of the payment of the retainer violated the disclosure requirements of Rule 2014, and that the bankruptcy court did not abuse its discretion in denying all the attorney's requested fees as a sanction for the attorney's failure to disclose.[12] *Id.* at 882; *see also*

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[12] In *Park-Helena*, the Ninth Circuit also held that the debtor's attorney failed to comply with the disclosure requirements of Rule 2016(b), Fed. R. Bankr. P. 63 F.3d at 881. The *Park-Helena* court concluded that the undisclosed payment of the attorney's retainer by the debtor's president who was also a creditor was a connection within the meaning of Rule 2014(a) and that the attorney's failure to disclose that payment constituted a violation of both Rule 2014(a) and Rule

Crivello, 134 F.3d at 836 ("failure to disclose is sufficient grounds to revoke an employment order and deny compensation"); *Rome v. Braunstein*, 19 F.3d at 59-60 (counsel's failure to make full and spontaneous disclosure of financial transactions between debtor and insiders provided sufficient ground for denial of compensation).

In the instant cases, the Bankruptcy Court correctly followed applicable law in concluding that Quarles & Brady failed to comply with the disclosure requirements of § 327 and Rule 2014(a) by failing to disclose its connections with the Debtors in the Application and Affidavit, and by failing to amend the Affidavit to disclose any additional connections of which Quarles & Brady subsequently became aware.

The Application disclosed that "[t]o the best of the Debtors' knowledge," Quarles & Brady had **"no connection with any creditors of the Debtor or any other parties in interest**" and that Quarles & Brady represented **"no creditors of the estate nor any interest adverse to the Debtors as Debtors-in-possession or to the estate** in matters upon which it is to be engaged to perform legal services for the Debtors-in-possession." R.20; Ex.18 (emphasis added).

Nashban's sworn Affidavit disclosed that he, Benjamin R. Norris, and Quarles & Brady did not "**hold or represent any interest adverse to the estate"** and were "**disinterested persons as required by § 327(a)**." The Affidavit further disclosed that Quarles & Brady had

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2016(b). 63 F.3d at 880-882. In so holding, the Court noted that the fiduciary duties of disclosure under Rule 2014(a) and Rule 2016(b) are similar and overlapping ("The disclosure requirements of Rule 2014 are applied as strictly as the requirements of Rule 2016 and section 329 ..."). *Id.* at 881. Other courts of appeal have similarly required or upheld sanctions for attorneys' failure to comply with the disclosure requirements of Rule 2016(b). *See In re Kisseberth*, 273 F.3d 714, 721 (6th Cir. 2001); *In re Independent Engineering Co.*, 197 F.3d 13, 17 (1st Cir. 1999); *In re Downs*, 103 F.3d 472, 479-480 (6th Cir. 1996); *In re Prudhomme*, 43 F.3d 1000, 1003-1004 (5th Cir. 1995).

“**no connection with the Debtors herein, its** [sic] **creditors or any other party in interest**” and that “**it represents no interest adverse to that of the Debtors**” except that it was owed fees “**for legal work**” done for Jennings prepetition, which bill was paid to Quarles & Brady prior to the commencement of the chapter 11 cases. R.20; Ex.18 (emphasis added).

The Application and Affidavit disclosed no connections between Quarles & Brady and the Debtors other than unspecified prepetition legal services performed for Jennings. The Bankruptcy Court correctly found that Quarles & Brady had failed to disclose in the Application and Affidavit, or to amend subsequently the Affidavit to disclose: (1) that Jennings was a secured creditor of BLJ and also claimed back wages from BLJ; (2) the existence of the Alter Ego Claims and the potential conflict in representing both sides of the litigation; (3) the existence of possible claims between RKB and Bryco arising from RKB’s payment of the $337,507.20 security deposit on behalf of Bryco and from the assignment of rents under the Knowleton/Bryco lease to RKB; and (4) that Quarles & Brady had performed estate planning work for Jennings during 2002. R.889, at 8.

While Quarles & Brady is quick to point out that neither the United States Trustee nor any other party in interest objected to the Application, and that the Court approved the Application on May 28, 2003, Appellant’s Brief, at 14, Quarles & Brady failed to disclose any of these connections in the Application and Affidavit. Nonetheless, Quarles & Brady insists that it had in fact disclosed all of these matters at various times during the proceedings, both before and after the Bankruptcy Court’s entry of the Employment Order on May 28, 2003, citing to innumerable references to such matters in the Debtors’ schedules and pleadings filed in the

Bankruptcy Court, as well as testimony or argument at various hearings and the Debtors' meeting of creditors held (on June 24, 2003) pursuant to 11 U.S.C. § 341(a) ("§ 341 Meeting"), during a period of over one year.[13] Appellant's Brief, at 8-22, 42-52.

In addressing attorneys' duties of disclosure under § 327(a) and Rule 2014(a), the courts have held that a bankruptcy court has no duty to search the file to ferret out information of actual or potential adverse interests or other evidence of noncompliance with § 327. *See, e.g., In re Love*, 163 B.R. 164, 169 (Bankr. D. Mont. 1993). "It is not ... the obligation of the bankruptcy court to search the record for possible conflicts of interest. That obligation belongs to the party who seeks employment by the estate ..." *In re BH & P, Inc.*, 949 F.2d 1300, 1317 (3rd Cir. 1991). The court has "no duty to rummage through files or conduct independent fact-finding investigations in order to determine whether prospective attorneys are involved in actual or potential conflicts of interest." *In re Tinley Plaza Associates, L.P.*, 142 B.R. 272, 278-279 (Bankr. N.D. Ill. 1992).

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[13] Significantly, on August 29, 2003, Nashban filed on behalf of BLJ an application under § 327 to employ Jennings as manager of BLJ, in order to obtain Bankruptcy Court authorization to pay him a postpetition salary of $25,000 per month (which he had accrued prepetition). Appellant's Brief, at 19, 46. The application and Rule 2014(a) statement signed by Jennings disclosed that Jennings was a creditor of BLJ. R.180. On October 16, 2003, the Court denied the application after Maxfield and the United States Trustee objected that Jennings was not disinterested and that the proposed salary was excessive. R.190; R.957, at 56-66, 70. Incredibly, Quarles & Brady cites to Jennings' employment application as an example of its disclosure of these facts to the Bankruptcy Court. That Nashban made these disclosures in Jennings' employment application, but failed to do so in Quarles & Brady's own Application, is inexcusable under the circumstances. In addition, Quarles & Brady states that it disclosed in its Rule 2016(b) statements filed in each of the Debtors' chapter 11 cases the fact that Jennings and BLJ paid Quarles & Brady's retainer on behalf of all of the Debtors. The source of payment of the retainer was a connection that Quarles & Brady was also required under Rule 2014(a) to fully disclose in the Affidavit, but did not. *See Park-Helena*, 63 F.3d at 881.

In *In re Marine Outlet, Inc.*, 135 B.R. 154, 156 (Bankr. M.D. Fla. 1991), where the court held that special counsel for the chapter 11 estate had failed to disclose properly its representation of the debtor's principal, who also claimed to be a creditor of the debtor, the court stated as follows:

> There is no duty placed on the United States Trustee or on creditors to search the record for the existence, vel non, of a conflict of interest of a professional sought to be employed. On the contrary, there is a definite affirmative duty placed on a professional to disclose his and her connection with parties whose interest is or may be antagonistic or opposite to the interest of the general estate ...

Consistent with applicable law, the Bankruptcy Court properly recognized that the burden of bringing any actual or potential conflicts to the attention of the Court was Quarles & Brady's, and not Maxfield's, the United States Trustee's, or any other party's. R.889, at 9-10.

Notwithstanding Quarles & Brady's claim that the parties and the Bankruptcy Court were all aware of the Alter Ego Claims, the Bankruptcy Court and the United States Trustee did not become aware of Quarles & Brady's Engagement Letter until the May 28, 2004 hearing on the Disqualification Motion, over a year after Nashban signed the Engagement Letter. Only then did the Court and the United States Trustee first learn that the Debtors had expressly agreed to waive any potential conflicts on the part of Quarles & Brady and that Quarles & Brady would represent only the Trust Debtors and RKB if the Bankruptcy Court determined that Quarles & Brady had a non-waivable conflict arising from Quarles & Brady's representation of both sides of that litigation. Ex.47. The Bankruptcy Court, however, could not timely make this determination absent any proper disclosure of these conflicts by Quarles & Brady. In any event, a law firm that is not disinterested may not represent a debtor even if that debtor has consented to such representation and waived the conflict. *See In re Granite Partners, L.P.*, 219 B.R. 22, 34 (Bankr. S.D. N.Y. 1998); *In re American Printers & Lithographers, Inc.*, 148 B.R. 862, 867 (Bankr. N.D. Ill. 1992); *In re Amdura Corp.*, 121 B.R. 862, 866 (Bankr. D. Colo. 1990).

Quarles & Brady's contention that it fully disclosed its prepetition legal work for Jennings is disingenuous, in that Quarles & Brady failed to disclose the nature or the timing of the services performed. Appellant's Brief, at 54-55. These prepetition legal services, i.e., estate planning services, have in fact become the subject of contested litigation in Jennings' chapter 11 case, arising from Maxfield's objection to Jennings' claim of an exemption in the $500,000 annuity purchased by Jennings (acting on Quarles & Brady's advice). Ex.9-10.

Quarles & Brady's argument that it sufficiently disclosed its connections with the Debtors is further betrayed by Nashban's own testimony that "[if I thought there was some conflict, I would have sought a determination." R.663, at 18. Quarles & Brady did not have the right to pick and choose which connections were worthy of disclosure. *See Park-Helena*, 63 F.3d at 881. Nashban was aware of Jennings' status as a secured creditor and wage claimant of BLJ, which he admitted was at least a potential conflict, from the time that Quarles & Brady filed Jennings' and BLJ's bankruptcy schedules on June 20 and 23, 2003, at the latest, although Quarles & Brady indicates in its brief that it was aware of this relationship even prior to filing the Application. Appellant's Brief, at 42. Nashban became aware of the potential conflict between RKB and Bryco on or before June 23, 2003, when Quarles & Brady listed RKB as a creditor on Bryco's Schedules. Appellant's Brief, at 52. He was aware of the Alter Ego Claims, the Engagement Letter, and Quarles & Brady's prepetition engagement to perform estate planning services for Jennings at the outset of the chapter 11 cases; yet Quarles & Brady disclosed none of these connections in the Affidavit, nor did it at any time amend the Affidavit to disclose such matters. By failing to comply with its fiduciary duty to disclose all its connections with the Debtors, as required by § 327 and Rule 2014(a), Quarles & Brady deprived the Bankruptcy Court of its ability to make a proper and timely determination of Quarles & Brady's eligibility for employment as counsel for the Debtors in the chapter 11 cases.

II. The Bankruptcy Court Did Not Err in Concluding that Quarles & Brady Was Not a Disinterested Person under 11 U.S.C. § 327(a).

Based on the record in this case, the Bankruptcy Court correctly concluded that Quarles & Brady was not a disinterested person under 11 U.S.C. § 327(a).

Title 11 U.S.C. § 327(a) provides as follows:

> Except as otherwise provided in this section, the trustee,[14] with the court's approval, may employ one or more attorneys, accountants, appraisers, auctioneers, or other professional persons, **that do not hold or represent an interest adverse to the estate, and that are disinterested persons**, to represent or assist the trustee in carrying out the trustee's duties under this title. [Emphasis added.]

The purpose of § 327(a) is to ensure impartiality in bankruptcy representation. *Electro-Wire Products, Inc. v. Sirote & Permutt, P.C. (In re Prince)*, 40 F.3d 356, 360 (11th Cir. 1994). The requirements for employment of a professional person to represent the bankruptcy estate under § 327(a) are two-fold: (1) the professional person must "not hold or represent an interest adverse to the estate"; and (2) the person must be a "disinterested person." 11 U.S.C. § 327(a).

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[14] As used in § 327(a), "trustee" also includes a debtor in possession in a chapter 11 bankruptcy case. *See* 11 U.S.C. § 1107(a).

While the Bankruptcy Code does not define "hold or represent an interest adverse to the estate," the Eleventh Circuit Court of Appeals has defined this phrase as follows:

> ... possessing, or serving as an attorney for a person possessing, either an "economic interest that would tend to lessen the value of the bankruptcy estate or that would create **either an actual or potential dispute** in which the estate is a rival claimant ... or ... a predisposition under the circumstances that render such a bias against the estate." [Emphasis added.]

Id. at 361; *accord, Kravit, Gass & Weber, S.C. v. Michel (In re Crivello)*, 134 F.3d 831, 835 (7th Cir. 1998). Title 11 U.S.C. § 101(14) defines the term "disinterested person," as used in § 327(a), in pertinent part, as a "person that ... is not a creditor, an equity security holder, or an insider" and who "**does not have an interest materially adverse to the interest of the estate** or of any class of creditors or equity holders, by reason of any direct or indirect relationship to, connection with, or interest in, the debtor ... or for any other reason." 11 U.S.C. § 101(14)(A), (E) (emphasis added); *Prince*, 40 F.3d at 360-361; *Crivello*, 134 F.3d at 835. Together, these statutory requirements of disinterestedness and no interest adverse to the estate "serve the important policy of ensuring that all professionals appointed pursuant to § 327(a) tender undivided loyalty and provide untainted advice and assistance in furtherance of their fiduciary responsibilities." *Id.* at 836 (quoting *Rome v. Braunstein*, 19 F.3d 54, 58 (1st Cir. 1994)).

In *In re Prince*, the Eleventh Circuit reversed an award of attorneys' fees to the debtor's counsel after counsel had withdrawn from the case, and denied all fees, holding that the debtor's counsel could not qualify as a disinterested person, and thus could not receive any compensation pursuant to 11 U.S.C. § 328(c). 40 F.3d at 361. There, the debtor's counsel initially failed to disclose its prepetition performance of estate planning services for the debtor and his wife, its representation of a corporation operated and controlled by the debtor, and its receipt of a potential preferential transfer from the debtor. *Id.* at 358. Within five months before the commencement of the debtor's chapter 11 bankruptcy case, the debtor's counsel performed estate planning services which resulted in a transfer of property worth approximately $600,000 from the debtor to his wife for no valuable consideration, which counsel also had failed to disclose. *Id.* Subsequently, counsel amended its application for employment, stating that it inadvertently failed to disclose its performance of prepetition estate planning services for the debtor, but failed to disclose fully the timing of such services and any impact of such services on the bankruptcy proceedings. *Id.* at 359. Later, counsel filed a second amendment stating that it inadvertently failed to disclose its prepetition representation of the debtor's wife in other matters unrelated to the bankruptcy proceedings. *Id.*

The *Prince* court concluded that the debtor's counsel could not qualify as a disinterested person under the facts of that case, and that whether counsel "inadvertently or intentionally neglected to inform the court of its conflicts is of no import." *Id.* at 361. The Eleventh Circuit stated that by representing the debtor in his bankruptcy case, it deprived the debtor of "a conflict-free, impartial independent evaluation of the potential claims of and against his estate," particularly in light of its inability to evaluate independently the $600,000 property transaction between the debtor and his wife and its possible effect on the debtor's estate. *Id.* at 360. The Eleventh Circuit noted that the actual prejudice to the debtor in *Prince*, as in the instant cases, was not counsel's failure to pursue claims, but its inability to independently evaluate claims for its client. *Id.* The court found, as in these cases, the debtor's counsel "was in the unfortunate position of having too many masters." *Id.* at 361.

Quarles & Brady mistakenly attempts to distinguish *Prince*; it contends that *Prince* involved only actual conflicts of interest, while conceding that its own conflicts in these cases are at least potential conflicts. Appellant's Brief, at 37-39, 55-56. In defining disinterestedness, however, the Eleventh Circuit recognized that it could arise from either an actual or potential conflict. *Id.* at 360-361. By mischaracterizing *Prince* as holding that only actual conflicts are actionable, Quarles & Brady wrongly suggests that the Eleventh Circuit is at odds with other circuits, which have permitted disqualification and denial of compensation based on potential conflicts, but it is not. *See In re Marvel Entertainment Group, Inc.*, 140 F.3d 463, 476 (3rd Cir. 1998) (holding that bankruptcy court has discretion to disqualify any attorney who has potential conflict of interest); *Interwest Business Equipment, Inc. v. United States Trustee (In re Interwest Business Equipment, Inc.)*, 23 F.3d 311, 316 (10th Cir. 1994) (holding that § 327(c) "does not preempt the more basic requirements of [§327(a)]").

Here, Quarles & Brady, like the debtor's counsel in *Prince*, failed to disclose that it performed prepetition estate planning services for the debtor.[15] As a result of prepetition estate planning services by Quarles & Brady, hastened by Maxfield's lawsuit against the Debtors,

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[15] In *Prince*, however, unlike these cases, the debtor's counsel subsequently attempted to mitigate any harm to the estate by amending its application to disclose its prepetition estate planning services for the debtor and voluntarily withdrawing from the case. 40 F.3d at 359. Here, Quarles & Brady at no time amended the Application or Affidavit to disclose this connection or any other connection with the Debtors, nor did it ever offer to withdraw from representing any of the Debtors.

Jennings purchased a $925,000 homestead in Florida and a $500,000 annuity. After the commencement of the bankruptcy cases, on July 7, 2003, Maxfield filed an objection to Jennings' claim of an exemption in the annuity (but not in the homestead) on the grounds that Jennings converted non-exempt property to exempt property with the intent to hinder, delay, or defraud creditors.[16] Ex. 9. This matter has been the subject of contested litigation between Maxfield and the Jennings estate, which is still pending, and in which Quarles & Brady attorneys are potential witnesses. Quarles & Brady, however, failed to disclose in the Affidavit the nature and timing of its prepetition estate planning services, despite the relevance of those legal services to pending litigation in the bankruptcy proceedings. Whether Jennings ultimately prevails in the exemption litigation is irrelevant because Quarles & Brady's prepetition representation of Jennings in this matter would in any event taint its ability to represent independently and disinterestedly the Jennings estate, and the interest of its creditors (who would directly benefit

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[16] Maxfield alleged that the annuity exemption claim violated § 222.30(2), Fla. Stat., which provides that "[a]ny conversion by a debtor of an asset that results in the proceeds of the asset becoming exempt by law from the claims of a creditor of the debtor is a fraudulent asset conversion as to the creditor ... if the debtor made the conversion with the intent to hinder, delay, or defraud the creditor." Ex.9. Quarles & Brady asserts that "Florida law is clear that an individual debtor's pre-bankruptcy planning and maximization of available exemptions is permissible," citing *Havoco of America, Ltd. v. Hill*, 790 So.2d 1018 (Fla. 2001), for the proposition that a debtor may transfer non-exempt assets and take advantage of the unlimited homestead exemption even if such transfers were undertaken to hinder, delay, or defraud creditors. Appellant's Brief, at 55. *Havoco* is inapposite here and in no way condones Jennings' or Quarles & Brady's conduct in connection with Jennings' purchase of, or claim of an exemption in, the $500,000 annuity. In *Havoco*, the Florida Supreme Court, deciding an issue certified by the Eleventh Circuit Court of Appeals, held that because Florida's unlimited homestead exemption originates from the Florida Constitution, *see* Fla. Const., Art. X, § 4, it preempts any act of the Florida legislature and thus is not subject to forfeiture pursuant to any state statute, including § 222.30(2). *Id.* at 1029. Maxfield, however, objected only to Jennings' claim of an exemption in an annuity under § 222.21(2), Fla. Stat., which is subject to forfeiture under § 222.30(2). R.35; Ex.3 (Exhibit C); Ex. 9.

in the amount of $500,000 if the Bankruptcy Court sustains Maxfield's objection), in this litigation.[17]

Where a single law firm sought to represent multiple interrelated debtors in related chapter 11 cases, as in the instant cases, the Tenth Circuit affirmed the bankruptcy court's denial of the debtors' application for employment of the law firm as counsel for the debtors, holding that the firm failed to meet the minimum requirements of § 327(a). *Interwest Business Equipment, Inc. v. United States Trustee (Interwest Business Equipment, Inc.*), 23 F.3d 311, 318 (10th Cir. 1994). In *Interwest*, the law firm was seeking court approval to represent two related corporations, the sole shareholder of both corporations, and a fourth related entity, which received income from one of the corporations pursuant to a management contract and also made lease payments for that corporation. *Id.* at 313. Unlike here, however, the law firm in *Interwest* disclosed substantial intercompany debt among the debtors in its Rule 2014(a) affidavits, but the affidavits did not disclose any further information regarding the validity or amount of the intercompany debt or other information sufficient to address any of the conflicts involved in representing the separate estates. *Id.* at 314. The Tenth Circuit concluded that the bankruptcy court did not abuse its discretion in finding: (1) that the firm's simultaneous representation of each debtor in possession and one of the other estates as creditor constituted representation of an interest adverse to the estate, and that the firm was thus not disinterested; and (2) that the

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[17] Quarles & Brady filed an initial response on behalf of Jennings in opposition to Maxfield's objection to Jennings' exemption of the annuity. Ex.10. Subsequently, Jennings employed separate counsel to represent him in the exemption litigation, but such substitution of counsel did not remove Quarles & Brady's potential conflict or excuse its failure to disclose this connection.

existence of a prepetition debt from one estate to the other created a disqualifying conflict of interest. Id. at 314, 318. In so holding, the court recognized the importance of the fiduciary duty of the debtor in possession, as trustee of the estate, and of counsel's obligation to serve the trustee independently. *Id.* at 317; *see also In re BH & P, Inc.*, 949 F.2d 1300, 1317-1318 (3d Cir. 1991) (affirming disqualification of counsel for multiple related bankruptcy estates of corporation and its two principals, where estates had claims against one another and counsel failed to disclose potential conflicts); *In re Coal River Resources, Inc.,* 321 B.R. 184, 189 (W.D. Va. 2005) (affirming bankruptcy court's finding that single attorney could not represent interests of four related corporate debtors with intercompany debts, and in particular fiduciary obligation of each debtor to its own creditors); *In re Wheatfield Business Park LLC*, 286 B.R. 412, 418 (Bankr. C.D. Cal. 2002) ("Where a bankruptcy debtor is a creditor of a related debtor, it is presumptively improper for the same attorney ... to be general counsel for the related debtors"); *In re Lee*, 94 B.R. 172, 180 (Bankr. C.D. Cal. 1988) (counsel for two related debtors could not represent both estates, where debt existed between estates and counsel failed to disclose potential conflicts).

Here, in concluding that Quarles & Brady lacked disinterestedness, the Bankruptcy Court closely scrutinized actual or potential conflicts existing among the Debtors.

First, as a result of Jennings' $1,404,000 secured claim against BLJ, Quarles & Brady, as attorneys for both estates, had a fiduciary obligation to represent directly conflicting interests. Quarles & Brady was duty-bound to represent zealously both the interest of Jennings as secured creditor and that of BLJ as the borrower. Jennings' loan documents indicated that he asserted a prepetition security interest in all or substantially all of BLJ's assets, including accounts receivable and all firearms and other inventory. Ex.14. Even if Jennings' security interest extended to after-acquired property of BLJ, by operation of 11 U.S.C. § 552(a),[18] Jennings' security interest was cut off as of the date of the filing of BLJ's petition and thus did not extend to any inventory, accounts receivable, or other new assets acquired by BLJ after the filing of its petition. Based on BLJ's schedules, because BLJ's prepetition assets were listed with a value less than the amount of Jennings' secured claim, Jennings was an undersecured creditor. R.43; Ex.1 (Schedules B and D). Pursuant to 11 U.S.C. § 363(c) and (e), BLJ could not use this collateral without providing adequate protection to Jennings to protect his bankruptcy estate against any diminution in the value of the collateral.[19] As counsel for Jennings' bankruptcy estate, Quarles & Brady was obligated to take the necessary actions to protect the estate's interest in BLJ's inventory and other assets.

On the other hand, as counsel for BLJ's bankruptcy estate, Quarles & Brady recognized that BLJ needed to sell its firearm inventory to generate cash to stay in business. During the first

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[18] Title 11 U.S.C. § 552(a) provides that "[e]xcept as provided in subsection (b) of this section, property acquired by the estate or the debtor after the commencement of the case is not subject to any lien resulting from any security agreement entered into by the debtor before the commencement of the case."

[19] Title 11 U.S.C. § 363(c) provides that the trustee may not use, sell, or lease cash collateral unless each entity that has an interest in such cash collateral consents or the court approves such use, sale, or lease of cash collateral, after notice and a hearing. Section 363(e) further provides that on request of an entity that has an interest in property used, sold, or leased by the trustee, the court shall prohibit or condition such use, sale or lease as is necessary to provide adequate protection of such interest. Title 11 U.S.C. § 361 provides examples of adequate protection required to be provided under § 363, in order to protect against a decrease in the value of an entity's interest in property, including periodic cash payments or an additional or replacement lien.

month and a half after filing, BLJ consumed $266,019.50 in prepetition inventory. R.889, at 11; Ex.4. By November 2003, BLJ had sold all of its prepetition inventory subject to Jennings' prepetition lien, which BLJ valued at $1,117,336.50 in its schedules; and BLJ's estate had consumed all proceeds of such inventory. R.889, at 11; Ex.4. At no time did Quarles & Brady, in its dual role as counsel for Jennings' bankruptcy estate, seek any adequate protection from BLJ for Jennings' estate for the use of Jennings' collateral, which resulted in the dissipation of all or substantially all of Jennings' collateral, and thus direct injury to Jennings' bankruptcy estate. R.663, at 23-34. Because the creditor constituency of the Jennings estate is entirely different from that of BLJ, Jennings' creditor constituency suffered a material loss. R.889, at 11.

Quarles & Brady asserts mistakenly that during its representation of the Debtors, "all of the assets remained available for creditors, so no dollars left the universe of the BLJ or [Jennings] estates." Appellant's Brief, at 33-34. In fact, the Jennings estate suffered actual injury as a result of Quarles & Brady's divided loyalties in representing both the Jennings and BLJ estates. BLJ has ceased operations, and it has depleted all of its inventory and other assets. By operation of §552(a), Jennings' security interest did not extend to any assets which BLJ acquired postpetition, and thus Quarles & Brady's inaction resulted in extinguishing Jennings' lien. Quarles & Brady's suggestion that it can avoid injury to the Jennings estate by providing for the reinstatement of Jennings' lien through a plan of reorganization is completely without merit because there is nothing left to reinstate. Thus, the Bankruptcy Court correctly concluded that Quarles & Brady's simultaneous representation of Jennings and BLJ rendered it not disinterested. R.889, at 10-12.

Second, in the year preceding the bankruptcy, RKB apparently removed a $500,000 debt to Jennings from its financial statements and tax returns, even though no money changed hands and RKB had the funds to the pay this obligation. R.889, at 12. As counsel for the Jennings bankruptcy estate, Quarles & Brady had a fiduciary duty to investigate the existence of the prepetition loan relationship and "cancellation of indebtedness." Conversely, as counsel for RKB's bankruptcy estate, Quarles & Brady had a duty to its client to defend this transfer. Because of its divided loyalties, Quarles & Brady placed itself in the untenable position of representing two clients with diametrically-opposed interests. Quarles & Brady's only response on this issue is that it did not improperly fail to disclose this matter since Nashban testified at the hearing on the Disqualification Motion on April 29, 2004, that he had no prior knowledge of this issue.[20] This is irrelevant, however, because the Bankruptcy Court did not find a lack of disclosure of this connection, but nonetheless correctly found that once this matter became known, Quarles & Brady had a duty to investigate the facts for the benefit of one estate to the detriment of the other. R.889, at 8, 12. Because Quarles & Brady would then be compelled to represent an interest of one estate materially adverse to the other, the Bankruptcy Court thus correctly concluded that Quarles & Brady's simultaneous representation of Jennings and RKB rendered it not disinterested. R.889, at 12.

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[20] Notwithstanding Nashban's profession of ignorance, Quarles & Brady knew or should have known of this matter because its partner and co-counsel for the Debtors, Benjamin R. Norris, appeared on behalf of the Debtors at the deposition of the Debtors' accountant, Gary Genske, on February 4, 2004, at which Mr. Genske testified on this issue. Ex.19.

Third, in light of questions surrounding RKB's payment of the $337,520.77 security deposit to Knowleton on behalf of Bryco and the fact that RKB was at least a creditor of Bryco and could assert an administrative claim in Bryco's case, the Bankruptcy Court correctly concluded that Quarles & Brady's simultaneous representation of RKB and Bryco rendered it not disinterested. R.889, at 12.

Nonetheless, despite its duty to represent vigorously the separate bankruptcy estates, each of which had different creditor constituencies, Quarles & Brady argues that hiring multiple sets of attorneys for the Debtors to permit them to assert claims against each other "made no sense and only would serve to deplete the estates." Appellant's Brief, at 35. That was not Quarles & Brady's decision to make, however; it was the Bankruptcy Court's. By failing to bring any potential conflict of interest to the Bankruptcy Court's attention so it could properly and timely decide these issues, Quarles & Brady usurped this decision-making process from the Bankruptcy Court.

III. The Bankruptcy Court Properly Exercised its Discretion in Disqualifying Quarles & Brady as Counsel for the Debtors, Denying All of its Compensation in the Chapter 11 Cases, and Requiring Disgorgement of Any Prepetition Retainer, Based on Quarles & Brady's Failure to Disclose and Lack of Disinterestedness.

A. The Failure to Disclose by Itself Was Sufficient Grounds for Disqualification and Denial of Compensation.

The Bankruptcy Court correctly exercised its discretion in disqualifying Quarles & Brady as counsel for the Debtors, denying all of its compensation in the chapter 11 cases, and requiring disgorgement of any prepetition retainer, based on both Quarles & Brady's failure to disclose its connections with the Debtors and its lack of disinterestedness.

Failure to disclose is sufficient grounds to revoke an employment order and deny compensation. *Kravit, Gass & Weber, S.C. v. Michel (In re Crivello)*, 134 F.3d 831, 836 (7th Cir. 1998). The failure to disclose the professional person's relationships is sufficient in and of itself to require denial and disgorgement of all compensation separate and apart from any question that there is any actual conflict of interest. *In re Gulf Coast Orthopedic Center*, 265 B.R. 318, 323 (Bankr. M.D. Fla. 2001).

The courts of appeal have held that "[e]ven a negligent or inadvertent failure to disclose fully relevant information may result in a denial of all requested fees." *In re Kisseberth*, 273 F.3d 714, 721 (6th Cir. 2001); *Neben & Starrett, Inc. v. Chartwell Financial Corp. (In re Park-Helena Corp.)*, 63 F.3d at 877, 882 (9th Cir. 1995), *cert. denied,* 516 U.S. 1049, 116 S.Ct. 712, 133 L.Ed.2d 667 (1996); *see also In re BH & P, Inc.*, 949 F.2d 1300, 1318 (3rd Cir. 1991) ("[n]egligence does not excuse the failure to disclose a possible conflict of interest"). In so ruling, the circuits courts have recognized that bankruptcy courts have broad and inherent authority to deny any and all compensation where an attorney fails to comply with the disclosure requirements for employment and compensation of attorneys. *Kisseberth*, 273 F.3d at 721; *Law Offices of Nicholas A. Franke v. Tiffany (In re Lewis)*, 113 F.3d 1040, 1045 (9th Cir. 1997).

In *Kisseberth*, the Sixth Circuit affirmed the bankruptcy court's disgorgement and denial of fees for the failure of the debtor's attorney to disclose all payments received from the debtors as required under Rule 2016(b). 273 F.3d at 716. In that case, the debtor's attorney was an experienced bankruptcy practitioner who claimed that his failure to disclose resulted from negligence or inadvertence. *Id.* at 716, 718. Nonetheless, the Sixth Circuit affirmed the bankruptcy court's disgorgement of all but $2,288 in fees received and denied all other compensation requested by the attorney. 273 F.3d at 716; *see also In re Downs*, 103 F.3d 472, 479-480 (6th Cir. 1996) (bankruptcy court abused its discretion in not requiring disgorgement of all fees as result of attorney's willful failure to disclose retainer as required under Rule 2016(b)).

Similarly, in *Park-Helena*, the Ninth Circuit held that the bankruptcy court's denial of all the debtor's attorney's fees based upon his failure to disclose the source of a retainer as required under both Rule 2014(a) and Rule 2016(b) was within the bankruptcy court's discretion. 63 F.3d at 881; *see also In re Lewis*, 113 F.3d at 1045-1046 (Ninth Circuit affirmed order requiring attorney for chapter 11 debtor to disgorge all retainers received, where debtor's counsel misrepresented the timing of retainers received and failed to properly supplement his initial disclosure of compensation under Rule 2016(b)); *BH & P, Inc.*, 949 F.2d at 1318 (Third Circuit affirmed disqualification of counsel for trustee in multiple related bankruptcy cases, where counsel failed to disclose potential conflicts of interest, notwithstanding its claim of negligence); *In re Jore Corporation*, 298 B.R. 703, 726, 732 (Bankr. D. Mont. 2003) (court disqualified debtor's attorneys, disallowed all fees and costs incurred, and required disgorgement of all fees and costs previously received, based on attorneys' failure to disclose existence of limited conflicts waiver in its Rule 2014(a) statement, although attorneys claimed that failure to disclose was negligent or inadvertent).[21]

The First and Fifth Circuits have also upheld the complete denial of compensation for violations of the Bankruptcy Code's disclosure requirements. *See In re Independent Engineering Co.*, 197 F.3d 13, 17 (1st Cir. 1999) (court affirmed disgorgement of all fees for attorney's failure to disclose postpetition draws and payments from debtor under Rule 2016(b)); *In re Prudhomme*, 43 F.3d 1000, 1003-1004 (5th Cir. 1995) (court affirmed disgorgement of all fees due to attorney's failure to disclose retainer under Rule 2016(b)).

Although Quarles & Brady claims that it "engaged in no active efforts to conceal any material facts," Appellant's Brief, at 38, in light of Nashban's more than 30 years of legal experience, Quarles & Brady's failure to comply with the Bankruptcy Code's disclosure rules was inexcusable. The Bankruptcy Court thus properly observed that it had the discretion to disqualify Quarles & Brady as counsel for the Debtors or to deny its compensation based on its

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[21] Quarles & Brady's failure to disclose the contents of the Engagement Letter, in which Quarles & Brady acknowledged "potential conflicts of interest," and confirmed the Debtors' agreement that the firm would represent only RKB and the Trust Debtors if the Bankruptcy Court were to find an actual non-waivable conflict, is similar to the non-disclosure in *Jore*. There, the bankruptcy court disqualified the debtor's counsel and disallowed and required disgorgement of all of its compensation and expenses for failing to disclose the terms of a limited conflicts waiver from the debtor's primary secured creditor, wherein the debtor's counsel agreed that it would not represent the debtor in "litigation directly adverse" to the creditor, despite counsel's assertion that the non-disclosure was negligent or inadvertent. *In re Jore Corporation*, 298 B.R. 703, 709, 726, 732 (Bankr. D. Mont. 2003). In both *Jore* and the instant cases, the bankruptcy courts were unable to make a timely determination regarding whether a non-waivable conflict existed because the attorneys failed to disclose properly the terms of the conflicts waivers and the attorneys' connections. Unlike *Jore*, where the court denied all fees and expenses, the Bankruptcy Court here exercised its discretion to allow Quarles & Brady's request for reimbursement of expenses. R.890; *cf. Prince*, 40 F.3d at 359, 361-362 (Eleventh Circuit denied all fees and expenses although counsel subsequently amended its employment application to disclose connections with debtor and his wife).

inadequate disclosure alone, but that the Court need not make that determination because the Court also found that the Quarles & Brady was not disinterested. R.889, at 10.

B. Lack of Disinterestedness Is Grounds for Disqualification and Denial of Compensation Based on Either Potential or Actual Conflicts of Interest.

Title 11 U.S.C. § 328(c) provides as follows:

> Except as provided in section 327(c), 327(e), or 1107(b) of this title, **the court may deny allowance of compensation** for services and reimbursement of expenses of a professional person employed under section 327 or 1103 of this title **if, at any time during such professional persons' employment under section 327** or 1003 of this title, **such professional person is not a disinterested person**, or represents or holds an interest adverse to the interest of the estate with respect to the matter on which the professional person is employed. [Emphasis added.]

In *Prince*, the Eleventh Circuit held that the bankruptcy court abused its discretion in awarding compensation to the debtor's counsel, where, as in the instant cases, counsel was not disinterested and had failed to disclose its connections with the debtor and other parties in interest. 40 F.3d at 361. Similarly, in these cases, like *Prince*, the Debtors' counsel had "too many masters." *Id.*

The Eleventh Circuit properly noted that § 328(c) is permissive; it permits a court to deny compensation to professionals found not to be disinterested persons but does not require a denial of fees in those instances. *Id.* at 359. The *Prince* court further noted that denial of fees is proper when actual injury to the debtor's estate occurs. *Id.* at 360. In this regard, the court stated:

> ... "[I]n exercising the discretion granted by statute we think the [bankruptcy] court should lean strongly toward denial of fees, and if the past benefit to the wrongdoer fiduciary can be quantified, to require disgorgement of compensation previously paid that fiduciary even before the conflict arose."

Id. at 360 (quoting *Gray v. English*, 30 F.3d 1319, 1324 (10th Cir. 1994). The Bankruptcy Court properly followed this legal standard in denying all Quarles & Brady's compensation, where actual injury to the Debtors' estates occured as a result of its simultaneous representation of the Debtors in these cases. As noted above, however, the Bankruptcy Court also had the discretion to deny Quarles & Brady's compensation and require disgorgement of its retainer due to its failure to comply with the disclosure requirements of § 327 and Rule 2014(a), even if negligent or inadvertent. *See Park-Helena*, 63 F.3d at 882; *Jore*, 298 B.R. at 729; see also *Kisseberth*, 273 F.3d at 721 (affirming denial of compensation for failure to disclose payments under Rule 2016(b)).

Quarles & Brady's primary argument in this appeal is that the Bankruptcy Court mistakenly relied on *Prince* and failed to comply with 11 U.S.C. § 327(c) by disqualifying Quarles & Brady and denying its compensation based upon potential conflicts, which Quarles & Brady concedes it had. Appellant's Brief, at 37-39, 55-56. This contention misconstrues the Eleventh Circuit's holding in *Prince* and the meaning of §§ 327(a), 327(c), and 328(c), and ignores the important interrelationship among these provisions.

Title 11 U.S.C. § 327(c) provides as follows:

> In a case under chapter 7, 12 or 11 of this title, a person is not disqualified for employment under this section **solely because of such person's employment by or representation of a creditor**, unless there is objection by another creditor or the United States trustee, in which case the court shall disapprove such employment if there is an actual conflict of interest. [Emphasis added.]

Section 327(c) provides that a professional person's representation of a creditor, by itself, does not automatically disqualify such person from employment on behalf of the bankruptcy estate, unless the court determines that such person has an actual conflict of interest. Section 327(c) was not applicable to *Prince*, because the debtor's counsel in that case had already withdrawn from its representation of the debtor prior to the court's determination of counsel's application for compensation, and in any event, the decision does not indicate that the law firm had at any time represented a creditor of the debtor, prepetition or postpetition. In *Prince*, the Eleventh Circuit properly denied the counsel's fees under § 328(c) because it was not a disinterested person during the bankruptcy case, not because it had an actual conflict of interest. 40 F.3d at 361. As defined by the *Prince* court, disinterestedness may arise from either an actual or a potential conflict. *Id.* at 360-361. In the instant cases, the Bankruptcy Court properly applied the same disinterestedness standard in concluding that Quarles & Brady was not a disinterested person based on potential or actual conflicts of interest. R.889, at 6.

Consistent with *Prince*, the Tenth Circuit, in *Interwest Business Equipment, Inc. v. United States Trustee (In re Interwest Business Equipment, Inc.*), 23 F.3d 311, 315-316 (10th Cir. 1994), affirmed the bankruptcy court's denial of an application for employment of a single law firm as counsel for multiple related debtors with substantial intercompany claims, under § 327(a). There, the appellants erroneously argued, like Quarles & Brady here, that counsel's employment could be denied only under § 327(c), as opposed to § 327(a), where the debtors were creditors of one another. In rejecting this argument, the Tenth Circuit stated:

> The Appellants' conclusion reads § 327(c) too broadly. The requirements of subsection (a) are threshold requirements that must be met even if subsection (c) is implicated. Subsection (c) addresses the situation where dual representation of a creditor and debtor is the *only* reason advanced for disqualification *and* the professional is otherwise qualified ...

> Thus, § 327(c) does not end all inquiry simply because intercompany debts placed each estate, at some point, in a debtor/creditor relationship with another. In these cases, the dual representation of a creditor was not the only reason for concern, the bankruptcy judge was also concerned about the simultaneous representation of three debtors in possession. Thus, the bankruptcy court was additionally concerned with conflict between debtors in possession: with conflict between three separate estates, each of which must be represented by an independent fiduciary ...
>
> Since subsection (c) of § 327 does not preempt the more basic requirements of subsection (a), the bankruptcy and district courts properly focused on their responsibility to approve the fiduciary's choice of professionals only when that professional's judgment and advocacy would be unclouded by divided loyalty.

Id. at 316.

Fully consistent with the Tenth Circuit's holding in *Interwest,* the Third Circuit has held that notwithstanding the language of § 327(c), which, together with § 327(a), imposes a *per se* disqualification of any attorney or other professional person who has an actual conflict of interest because of such person's employment by or representation of a creditor, a bankruptcy court may within its discretion–pursuant to § 327(a) and consistent with § 327(c)–disqualify an attorney who has a potential conflict of interest. *In re Pillowtex, Inc.*, 304 F.3d 246, 251 (3rd Cir. 2002); *In re Marvel Entertainment Group, Inc.*, 140 F.3d 463, 476 (3rd Cir. 1998); *In re BH & P, Inc.*, 949 F.2d 1300, 1315-1317 (3rd Cir. 1991). "Denomination of a conflict as 'potential' or 'actual' and the decision concerning whether to disqualify a professional in situations not yet rising to the level of an actual conflict are matters committed to the bankruptcy court's sound exercise of discretion." *Id.* at 1316-1317; *see also In re Martin*, 817 F.2d 175, 182 (1st Cir. 1989) ("The naked existence of a potential for conflict of interest does not render the appointment of counsel nugatory, but makes it voidable as the facts may warrant").

To support its position that § 327(c) requires an actual conflict, Quarles & Brady points to a number of lower court decisions that permit the simultaneous representation of multiple related debtors by one law firm.[22] Appellant's Brief, at 29-32. That there is no *per se* rule

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[22] The decisions cited by Quarles & Brady are distinguishable because, unlike in this case, the attorneys in those cases fully disclosed their connections with the debtors, or the courts otherwise found no actual injury to the estate from simultaneous representation. *See In re Professional Development Corp.*, 140 B.R. 467, 473 (W.D. Tenn. 1992) (law firm could represent both corporation and its sole shareholder, where shareholder was not creditor of corporation); *In re Vanderbilt Associates, Ltd.*, 117 B.R. 678, 681 (D. Utah 1990) (law firm could represent two limited partnerships with common general partner, where several contingencies would have to occur before conflict would exist); *In re Palumbo Family Ltd. Partnership*, 182 B.R. 447, 467 (Bankr. E.D. Va. 1995) (law firm that initially represented both limited partnership and its general partner was entitled to compensation following its withdrawal from representation of partnership, where court found that partner's interests were not adverse to those of partnership); *In re Howell*, 148 B.R. 269, 272 (Bankr. S.D. Tex. 1992) (law firm that represented individual debtors and their wholly-owned "mom and pop" corporation was entitled to compensation following its withdrawal from representation of corporation due to potential conflict, where failure to disclose was not at issue); *In re Mulberry Phosphates, Inc.*, 142 B.R. 997, 998-999 (Bankr. M.D. Fla. 1992) (law firm could represent parent company and subsidiaries, where court found potential conflicts among debtors were insufficient to warrant disqualification or denial of compensation, and creditors' committee and United States Trustee did not object to firm's continued representation of debtors); *In re Office Products of America, Inc.*, 136 B.R. 983, 988 (Bankr. W.D. Tex. 1992) (law firm that represented corporate debtor and its principals was entitled to compensation for services in chapter 11 proceedings after case was reconverted to chapter 7, where court found no conflict of interest and failure to disclose was not at issue); *In re Huddleston*, 120 B.R. 399, 402-403 (Bankr. E.D. Tex. 1990) (law firm could represent both "mom and pop" corporation and its sole shareholder, where court found no actual conflict of interest); *In re Waterfall Village of Atlanta, Ltd.*, 103 B.R. 340, 345-347 (Bankr. N.D. Ga. 1989) (court denied motion to disqualify debtor's counsel, which represented parent corporation of debtor's management company in unrelated matters, where counsel was disinterested person, but court reserved right to deny compensation due to lack of proper disclosure); *In re Global Marine, Inc.*, 108 B.R. 998, 1004-1005 (Bankr. S.D. Tex. 1987) (law firm could represent parent corporation and subsidiaries in related chapter 11 cases and receive compensation, where potential conflict existed due to intercompany debt, but such representation did not result in any injury to estates, and no party objected to adequacy of disclosure by counsel); *In re Hurst Lincoln Mercury, Inc.*, 80 B.R. 894, 897 (Bankr. S.D. Ohio 1987) (law firm that initially represented both corporate debtor and its sole shareholder could receive compensation despite existence of claims between debtor and

prohibiting such representation is not in dispute. Section 327(a) prohibits such multiple representation, however, where, as here, the single firm cannot provide impartial advice to the related debtors. Courts have generally declined to formulate bright-line rules concerning the criteria for disqualification and have determined the propriety of employment for multiple related debtors on a case-by-case basis, taking all circumstances into account. *BH & P, Inc.*, 949 F.2d at 1315. Factors that a court must consider include, but are not limited to, the nature of disclosure of the conflict made at the time of appointment, whether the interests of the related estates are parallel or conflicting, and the nature of the inter-debtor claims made. *Id.* at 1316. Thus, in a number of multiple-debtor cases, as here, after considering all of these factors, the courts have held that the inability of the professional to fulfill its role as an independent fiduciary on behalf of the estates warranted disqualification. *See, e.g., Interwest*, 23 F.3d at 316 (separate counsel required when intercompany debts placed each estate in creditor-debtor relationship with another); *BH & P, Inc.*, 949 F.2d at 1317-1318 (court properly exercised discretion in disqualifying counsel for multiple related bankruptcy estates for corporation and its two principals, where estates had claims against one another and counsel had negligently failed to disclose potential conflicts); *In re Coal River Resources, Inc.*, 321 B.R. 184, 189 (W.D. Va.

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shareholder, after firm had voluntarily withdrawn as counsel for shareholder); *In re H & S Transportation Co.*, 53 B.R. 128, 133-134 (Bankr. M.D. Tenn. 1985) (court awarded compensation to counsel for former trustee for four related corporate debtors with intercompany claims, where counsel's representation of trustee was limited to matters in which interests of estate were parallel, and counsel assisted trustee in bringing conflict to court's attention at end of counsel's representation of estates); *In re O.P.M. Leasing Services, Inc.*, 16 B.R. 932, 940-941 (Bankr. S.D. N.Y. 1982) (court denied motion to disqualify counsel for chapter 11 trustee for corporate debtor and wholly-owned subsidiary, where counsel did not represent adverse interests and made full disclosure of potential conflicts to court).

2005) (counsel was disqualified from representing two of four related debtors at outset of case, where some debtors had intercompany debt against another); *In re C & C Demo, Inc.*, 273 B.R. 502, 508 (Bankr. E.D. Tex. 2001) (counsel for corporate chapter 11 debtor was disqualified from representing corporation based on counsel's failure to disclose simultaneous representation of debtor's shareholders in their individual chapter 13 cases); *In re Lee*, 94 B.R. 172, 180 (Bankr. C.D. Cal. 1988) (counsel for two related debtors could not represent both estates where debt existed between estates and counsel failed to disclose potential conflicts).

Quarles & Brady's contention that the Bankruptcy Court could not disqualify Quarles & Brady in the absence of an actual conflict of interest is an improper attempt to deny bankruptcy courts the discretion that the Bankruptcy Code and the courts of appeal give them to disqualify counsel from employment in potential conflict cases. The Bankruptcy Court properly exercised its discretion to disqualify Quarles & Brady based on both its lack of disinterestedness and its failure to properly disclose its connections with the Debtors in the Application and Affidavit or to amend the Affidavit to disclose connections of which it became aware after the Bankruptcy Court approved its employment. R.889, at 13.

C. By Failing to Disclose it Connections with the Debtors, Quarles & Brady Risked Disqualification and Denial of All of its Compensation at Any Time During the Bankruptcy Proceedings.

Quarles & Brady further contends that the Bankruptcy Court's ruling is "unfair" because it came after Quarles & Brady incurred substantial fees in performing services which arguably benefited the estate.[23] Appellant's Brief, at 62-64. This problem, however, was one of Quarles & Brady's own making. Had Quarles & Brady properly disclosed its connections and potential or actual conflicts in the Application and Affidavit or in an amendment to the Affidavit, or otherwise requested the Bankruptcy Court to rule on the propriety of its continued employment by the Debtors in the initial stages of the bankruptcy proceedings, as Quarles & Brady was required to do under § 327 and Rule 2014(a), the Bankruptcy Court could have ruled on this issue prior to the incurrence of substantial fees, thus mitigating any loss to Quarles & Brady. *See Rome v. Braunstein*, 19 F.3d 54, 59 (1st Cir. 1994) ("[A]s soon as counsel acquires even constructive knowledge reasonably suggesting an actual or **potential** conflict, ... a bankruptcy court ruling should be obtained" (emphasis added)).

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[23] Here, Quarles & Brady asserts, in part, that a motion to disqualify counsel or deny fees for a failure to comply with § 327(a) can be estopped due to delay by the movant or the court. Appellant's Brief at 62-64. All of the authorities that Quarles & Brady cites in support of this contention, however, are inapposite and/or distinguishable. *See In re Valley-Vulcan Mold Co.*, 237 B.R. 322, 337-338 (B.A.P. 6th Cir. 1999) (motion to disqualify attorney for non-debtor defendant in fraudulent transfer action; § 327 inapplicable); *Graham v. Lennington*, 74 B.R. 963, 966 (S.D. Ind. 1987) (issue of conflict of interest of trustee's counsel was raised for first time on appeal of order setting aside transfers of real property; no objection to counsel's employment had been filed in bankruptcy court); *Halperin v. Kissinger*, 542 F.Supp. 829, 832 (D. D.C. 1982) (motion to disqualify counsel in non-bankruptcy litigation; § 327 inapplicable); *In re A & T Paramus Co.*, 253 B.R. 606, 614-617 (Bankr. D. N.J. 1999) (motion to disqualify attorney for debtor's fuel vendor under non-bankruptcy law; § 327 inapplicable); *In re Kliegl Bros. Universal Elec. Stage Lighting Co.*, 189 B.R. 874, 875, 877 (Bankr. E.D. N.Y. 1995) (conflict and disclosure issues were raised for first time in objection to debtor's counsel's final fee application, heard more than five years after employment of counsel; no motion to disqualify counsel had been filed); *In re Hurst Lincoln Mercury, Inc.*, 80 B.R. 894, 895-896 (Bankr. S.D. Ohio 1987) (creditor was estopped from objecting to debtor's counsel's fee application after creditor had voluntarily withdrawn prior motion to disqualify counsel brought on same grounds, following counsel's withdrawal from representation of debtor's sole shareholder).

As early as June and October 2003, Maxfield's counsel gave fair warning to Quarles & Brady of Maxfield's possible intent to move for disqualification of Quarles & Brady if it failed to mitigate any further harm to the Debtors' estates by making full disclosure or voluntarily withdrawing from representation of one or more of the Debtors. R.912 (Exhibits A and B). Quarles & Brady continued to incur fees, however, in connection with its representation of all the Debtors and made no effort whatsoever to bring these issues to the Bankruptcy Court's attention or otherwise to minimize any possible loss of compensation. It was not the obligation of the Bankruptcy Court to search the record for possible conflicts of interest; that obligation "belongs to the party who seeks employment by the estate." *BH & P, Inc.*, 949 F.2d at 1317. In failing to fulfill that obligation, Quarles & Brady took a calculated risk in deciding to proceed forward at that point. The Bankruptcy Court correctly observed that "attorneys who fail to disclose their representation of competing interests bear all of the responsibility and associated risks for making an inadequate Rule 2014 disclosure." R.889, at 9. "Though [Rule 2014] allows the fox to guard the proverbial hen house, counsel who fail to disclose timely and completely their connections proceed at their own risk because failure to disclose is sufficient grounds to revoke an employment order and deny compensation." *Kravit, Gass & Weber, S.C. v. Michel (In re Crivello)*, 134 F.3d 831, 836 (7th Cir. 1998); *see also Rome v. Braunstein*, 19 F.3d at 59 ("Absent the spontaneous, timely and complete disclosure required by § 327(a) and Fed. R. Bankr. P. 2014(a), court-appointed counsel proceed at their own risk").

While a bankruptcy court has the discretion to determine what fees, if any, it should allow, it also has the discretion to deny all fees for a disclosure violation without inquiring as to the appropriate amount of the fee. *Lewis*, 113 F.3d at 1046. Disclosure violations are sanctionable, "regardless of any actual harm to the estate." *Park-Helena*, 63 F.3d at 881. Nonetheless, here, the Court properly exercised its discretion to deny all fees, where it found actual injury to the estate. *See Prince*, 40 F.3d at 360; *cf. Woods v. City Nat'l Bank & Trust Co. of Chicago*, 312 U.S. 262, 268, 61 S.Ct. 493, 497, 85 L.Ed. 820 (1941) (Supreme Court reversed award of compensation to counsel for bondholders' committee, which also represented indenture trustee and other parties with interests in conflict with those of committee, holding that compensation should be denied where "claimant was serving more than one master or was subject to conflicting interests"). The record below reflects actual injury to the Jennings bankruptcy estate as a direct result of Quarles & Brady's failure to request adequate protection for Jennings' security interest in the assets of BLJ. BLJ has depleted those assets, both Bryco and BLJ have since shut their doors and ceased operating, and reorganization of the Debtors is no longer possible. In addition, despite Quarles & Brady's contention that its services resulted in a "substantial benefit" to all of the estates, Appellant's Brief, at 59-60, the record is replete with other instances where Quarles & Brady's conduct demonstrated its inability to fulfill its fiduciary duties to represent the respective bankruptcy estates independently and impartially.[24]

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[24] For example, with respect to the sale of Bryco's assets, Quarles & Brady originally filed a motion for an auction sale in California, which it withdrew after Maxfield objected to the proposed auctioneer. R.257-258; R.266; R.409. Subsequently, Quarles & Brady proposed a private sale of the assets to an insider, Paul Jimenez, Bryco's former factory foreman, for $150,000, even though Bryco scheduled the assets with a value of $237,500. R.400; R.46 (Schedule B). Maxfield again objected, requesting, *inter alia*, that the Bankruptcy Court require an auction of the property to the highest bidder in order to maximize the value of the assets for the benefit of creditors, but Quarles & Brady continued to resist any effort to expose the property to competitive bidding. R.414; R.448; R.578; R.584. Initially, the Bankruptcy Court approved the sale for $150,000, but gave

Under the circumstances of these cases, the Bankruptcy Court did not abuse its discretion in disqualifying Quarles & Brady as counsel for the Debtors, denying all of its compensation, and requiring disgorgement of its retainer, based on Quarles & Brady's failure to disclose its connections with the Debtors and its lack of disinterestedness.

IV. The Bankruptcy Court Properly Exercised its Discretion in Denying Quarles & Brady's Motions for Reconsideration.

The Bankruptcy Court properly exercised it discretion in denying Quarles & Brady's Motions for Reconsideration. Quarles & Brady filed the Motions for Reconsideration pursuant to Rules 9023, 9024, and 7062, Fed. R. Bankr. P., which incorporate by reference the provisions

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creditors an additional 20 days to object to the sale, noting that Quarles & Brady had failed to give adequate notice to creditors of the continued hearing. (Although the Bankruptcy Court previously entered an agreed order on April 22, 2004, continuing the sale hearing to June 17, 2004, establishing certain bidding procedures, and requiring Quarles & Brady to serve a copy of the order on all creditors, Quarles & Brady did not serve notice of the continued hearing until June 10, 2004.) R.591. Subsequently, after other creditors objected to the sale, the Bankruptcy Court set an auction for August 12, 2004, which resulted in Mr. Jimenez's increasing his offer to $510,000 (despite Quarles & Brady's continued insistence that Bryco's assets were not worth more than $150,000). R.632; R.634; R.644; R.687. Thus, the Bryco estate's ability to maximize the value of Bryco's assets for the benefit of creditors resulted primarily through the efforts of Maxfield and other creditors to expose the assets to competitive bidding, despite Quarles & Brady's calculated effort to sell the assets to an insider for the lowest possible price. Regarding the settlement of Cessna's secured claim against BLJ, Quarles & Brady initially stipulated to a priority administrative claim in favor of Cessna against BLJ's estate in the amount of $138,584. R.392, at 3. Cessna withdrew its demand for an administrative claim only after Maxfield objected on the grounds that the Cessna aircraft provided no benefit to BLJ's estate. R.395; R.419; R.503. Although Cessna's sale of the aircraft ultimately resulted in a small surplus to the BLJ estate after full satisfaction of Cessna's secured claim, R.656, at 2, this outcome raises additional questions regarding Quarles & Brady's judgment in stipulating to relief from the automatic stay in favor of Cessna on the joint representation that Cessna was undersecured. R.297; R.392. In addition, as set forth above, Quarles & Brady's actions in resisting Maxfield's objection to Jennings' exemption claim in the $500,000 annuity (which Jennings purchased prepetition in reliance on Quarles & Brady's "estate planning" advice), and in unsuccessfully seeking approval of an excessive postpetition salary for Jennings from BLJ in the amount of $25,000 per month, did not benefit the creditors of Jennings or BLJ, although they were intended to benefit Jennings personally. *Supra*, at 25 n.13, 32-33.

of Rules 59, 60, and 62, Fed. R. Civ. P., respectively. The Motions for Reconsideration included: (1) a motion for a new trial on the Disqualification Motion and Interim Fee Application pursuant under Rule 59(a); (2) a motion to alter, amend, or vacate the Bankruptcy Court's Disqualification Order under Rules 59(e) and 60(b); and (3) a motion for a stay of enforcement of the Disqualification Order pending resolution of the Motions for Reconsideration under Rule 62(b). R.895-897.

The grounds for both motions for a new trial under Rule 59(a) and motions to alter or amend a judgment under Rule 59(e) are the same. Both motions require a showing of: (1) manifest error of fact; (2) manifest error of law; or (3) newly discovered evidence. *See In re Investors Florida Aggressive Growth Fund, Ltd.*, 168 B.R. 760, 768 (Bankr. N.D. Fla. 1994) (motion for reconsideration denied); *In re Tiffany Square Associates, Ltd.*, 104 B.R. 438, 442 (Bankr. M.D. Fla. 1989) (motion for rehearing denied); *see also In re Kellogg*, 197 F.3d 1116, 1120 (11th Cir. 1999) (party "may not use a Rule 59(e) motion to raise arguments available but not advanced at the [prior] hearing").

Courts may grant a motion for relief from a judgment under Rule 60(b) for the following reasons: (1) mistake, inadvertence, surprise, or excusable neglect; (2) newly discovered evidence; (3) fraud; (4) the judgment is void; (5) the judgment has been satisfied, released, or discharged; or (6) any other reason justifying relief from the operation of the judgment. Fed. R. Civ. P. 60(b).

Pursuant to Rule 62(b), a court may stay the execution of a judgment pending the disposition of a motion for a new trial or to alter or amend a judgment made pursuant to Rule 59, or a motion for relief from a judgment or order made pursuant to Rule 60, "[i]n its discretion and on such conditions for the security of the adverse party as are proper." Fed. R. Civ. P. 62(b).

Quarles & Brady's Motions for Reconsideration merely reiterated the same arguments set forth in their responses in opposition to the Disqualification Motion, citing no new legal authority or newly discovered evidence. R.898.

The Bankruptcy Court promptly afforded any interested parties an opportunity to respond to the Motions for Reconsideration. R.901. The Bankruptcy Court considered Quarles & Brady's Motions for Reconsideration and supporting memorandum, as well as the responses submitted by Maxfield and the United States Trustee. R.921. The Bankruptcy Court did not abuse its discretion in denying the Motions for Reconsideration under Rules 9023 and 9024, where Quarles & Brady failed to show a manifest error of law or fact, to cite to any new legal authority or newly discovered evidence, or to make any showing required under Rule 60(b). In addition, because the Bankruptcy Court promptly denied those motions, it properly denied as moot Quarles & Brady's motion for a stay pending resolution of the Motions for Reconsideration under Rule 62(b). R.921.

CONCLUSION

For the foregoing reasons, this Court should affirm the Bankruptcy Court's orders granting the Disqualification Motion and denying the Motions for Reconsideration.

DATED: May 12, 2005.

Respectfully submitted,

FELICIA S. TURNER
United States Trustee, Region 21

/s/ Elena L. Escamilla
Elena L. Escamilla, Trial Attorney
Florida Bar No.: 898414
United States Department of Justice
Office of United States Trustee
135 W. Central Blvd., Suite 620
Orlando, FL 32801
Telephone No.: (407) 648-6465
Facsimile No.: (407) 648-6323
E-mail: Elena.L.Escamilla@usdoj.gov

William L. Courshon, Trial Attorney
Florida Bar No.: 270490
United States Department of Justice
Office of the United States Trustee
700 Stewart Street, Suite 5103
Seattle, WA 98101-1271
Telephone No.: (206) 553-2000
Facsimile No.: (206) 553-2566
E-mail: Bill.L.Courshon@usdoj.gov

CERTIFICATE OF SERVICE

I hereby certify that on May 12, 2005, I electronically filed the foregoing Brief for Appellee, United States Trustee with the Clerk of the Court by using the CM/ECF system, which will send a notice of electronic filing to the following: Ned R. Nashban, Esq., at nrn@quarles.com; and Richard R. Thames, Esq., at RRThames@Stutsman-Thames.com.

I further certify that on May 12, 2005, a copy of the foregoing was served by mail on Ned R. Nashban, Esq., Quarles & Brady, LLP, One Lincoln Place, 1900 Glades Road, Suite 355, Boca Raton, FL 33431; Benjamin R. Norris, Esq., Quarles & Brady Streich Lang LLP, Two North Central Avenue, Phoenix, AZ 85004-2391; and Richard R. Thames, Esq., Stutsman & Thames, P.A., 121 Forsyth Street, Suite 600, Jacksonville, FL 32202.

DATED: May 12, 2005.

/s/ Elena L. Escamilla
Elena L. Escamilla, Trial Attorney
Florida Bar No.: 898414
United States Department of Justice
Office of United States Trustee
135 W. Central Blvd., Suite 620
Orlando, FL 32801
Telephone No.: (407) 648-6465
Facsimile No.: (407) 648-6323
E-mail: Elena.L.Escamilla@usdoj.gov

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Quarles & Brady, LLP V.Maxfield and UST
(In re: Jennings)

2. ("CO") ***CURRENT*** COURT
[E.g., "CTA9"]

CTA11

3. ("CCN") ***CURRENT*** CASE NO.

No.: 05-15212

4. ("PCN") ***PRIOR*** CASE NO.
& COURT
[IF ANY]

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Elena L. Escamilla, Trial Attorney, UST
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***

BANKRUPTCY

9. ("SU")
- ***SUMMARY*** OF KEY ISSUE(s)

&

√ Any Miscellaneous ***BACKGROUND***

1. Whether the Bankruptcy Court abused its discretion in sanctioning the law firm of Quarles & Brady, LLP for violating mandatory bankruptcy disclosure requirements by not telling the Court and the parties to the bankruptcy case about Quarles's intricate web of relationships with eleven debtors at the time those debtors sought bankruptcy court permission to retain Quarles as their chapter 11 bankruptcy counsel. 2. Alternatively, whether the Bankruptcy Court and the District Court erred in concluding that Quarles was not a disinterested person under section 327(a), based on either actual or potential conflicts of interest in representing multiple debtors. See document for issues 3 and 4

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APPEAL NO. 05-15212-BB

UNITED STATES COURT OF APPEALS
FOR THE ELEVENTH CIRCUIT

In re BRUCE LEE JENNINGS, et al.,

Debtors.

QUARLES & BRADY, LLP,
Appellant,

v.

BRANDON JAMES MAXFIELD and UNITED STATES TRUSTEE,
Appellees.

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE MIDDLE DISTRICT OF FLORIDA (Case No. 6:05-cv-248-PCF-DAB)

BRIEF FOR APPELLEE, UNITED STATES TRUSTEE

FELICIA S. TURNER
United States Trustee for Region 21

Elena L. Escamilla, Trial Attorney
Florida Bar No.: 898414
United States Department of Justice
Office of the United States Trustee
135 W. Central Blvd., Suite 620
Orlando, Florida 32801
Telephone No.: (407) 648-6465
Facsimile No.: (407) 648-6323

William L. Courshon, Trial Attorney
Florida Bar No.: 270490
United States Department of Justice
Office of the United States Trustee
700 Stewart Street, Suite 5103
Seattle, Washington 98101-1271
Telephone No.: (206) 553-2000
Facsimile No.: (206) 553-2566

CERTIFICATE OF INTERESTED PERSONS AND CORPORATE DISCLOSURE STATEMENT

Appellant, United States Trustee, pursuant to Rule 26.1, Fed. R. App. P., and Eleventh Circuit Rule 26.1-1, respectfully submits that, in addition to the persons listed on the Corporate Disclosure Statement contained in the appellant, Quarles & Brady, LLP's Opening Brief, filed November 7, 2005, the following persons have an interest in the outcome of the above-referenced appeal:

1. Courshon, William L., attorney for Felicia S. Turner, United States Trustee for Region 21.
2. Crews, Gregory K., chapter 7 trustee for Bruce Lee Jennings.
3. Dawson, John J., attorney for Quarles & Brady, LLP.
4. Escamilla, Elena L., attorney for Felicia S. Turner, United States Trustee for Region 21.
5. Lawrence, Gregory A., attorney for Gregory K. Crews, chapter 7 trustee for Bruce Lee Jennings.
6. Maxfield, Brandon James, appellee.
7. Nashban, Ned R., attorney for Quarles & Brady, LLP.
8. Norris, Benjamin R., attorney for Quarles & Brady, LLP.

9. Thomas & Lawrence, P.A., attorneys for Gregory K. Crews, chapter 7 trustee for Bruce Lee Jennings.

10. Turner, Felicia S., United States Trustee for Region 21, appellee.

DATED: January __, 2006.

____
Elena L. Escamilla, Trial Attorney
Florida Bar No.: 898414
United States Department of Justice
Office of United States Trustee
135 W. Central Blvd., Suite 620
Orlando, FL 32801
Telephone No.: (407) 648-6465
Facsimile No.: (407) 648-6323

William L. Courshon, Trial Attorney
Florida Bar No.: 270490
United States Department of Justice
Office of the United States Trustee
700 Stewart Street, Suite 5103
Seattle, WA 98101-1271
Telephone No.: (206) 553-2000
Facsimile No.: (206) 553-2566

Attorneys for Appellee,
United States Trustee

STATEMENT REGARDING ORAL ARGUMENT

Appellee, United States Trustee, stands ready to provide oral argument should this Court determine that it is appropriate in this case.

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OTHER AUTHORITIES:

STATEMENT OF JURISDICTION

This Court has jurisdiction under section 158(d) of title 28, United States Code, to review the District Court's order entered September 7, 2005, affirming the Bankruptcy Court's rulings below. The District Court had jurisdiction over the appeal of the Bankruptcy Court's rulings pursuant to section 158(a)(1).

The Bankruptcy Court's order granting the motion to disqualify appellant, Quarles & Brady, LLP ("Quarles"), and for disgorgement of its retainer, entered November 16, 2004, and order denying Quarles's post-trial motions, entered December 16, 2005, were final, appealable orders of that Court under section 158(a)(1). The District's Court's order entered September 7, 2005, was a final, appealable order under section 158(d). Quarles timely filed its notice of appeal from that order on September 13, 2005.

STATEMENT OF THE ISSUES ON APPEAL

1. Whether the Bankruptcy Court abused its discretion in sanctioning the law firm of Quarles & Brady, LLP for violating mandatory bankruptcy disclosure requirements by not telling the Court and the parties to the bankruptcy case about Quarles's intricate web of relationships with eleven debtors at the time those debtors sought bankruptcy court permission to retain Quarles as their chapter 11 bankruptcy counsel.

2. Alternatively, whether the Bankruptcy Court and the District Court erred in concluding that Quarles was not a disinterested person under section 327(a), based on either actual or potential conflicts of interest in representing multiple debtors.

3. Whether the Bankruptcy Court abused its discretion in disqualifying Quarles as counsel for the debtors, denying all of its compensation in the chapter 11 cases, and requiring disgorgement of any prepetition retainer, based on Quarles's initial and continuing violation of the disclosure rules, lack of disinterestedness, and injury resulting to the bankruptcy estates from its inability to evaluate independently the various claims, transfers, and interests in the related cases.

4. Whether the Bankruptcy Court abused its discretion in denying Quarles's post-trial motions.

STATEMENT OF THE CASE[1]

This is an appeal from a final order of the United States District Court for the Middle District of Florida ("District Court"), affirming a final order entered by the United States Bankruptcy Court for the Middle District of Florida ("Bankruptcy Court"), disqualifying Quarles as counsel for the debtors in eleven related chapter 11 bankruptcy cases, denying all fees requested by Quarles in the chapter 11 cases, and requiring disgorgement of any prepetition retainer received by Quarles ("Disqualification Order"). The District Court also affirmed the Bankruptcy Court's order denying Quarles's post-trial motions to alter, amend, or vacate the Disqualification Order, for a new trial, and to stay enforcement of the Disqualification Order ("Post-trial Motions").

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[1] In this brief, citations to "DR" shall refer to documents from the record in the District Court, followed by the District Court docket number. Citations to "BR" shall refer to documents from the record in Bankruptcy Court Case No. 03-04926-3F1, followed by the Bankruptcy Court docket number. Citations to "Ex." shall refer to trial exhibits utilized by appellee, Brandon James Maxfield, at the evidentiary hearings before the Bankruptcy Court on April 29, 2004, and May 28, 2004, followed by the exhibit number. Citations to "SRE" shall refer to the United States Trustee's Supplemental Record Excerpts, followed by the tab number. Citations to "Appellant's Brief" shall refer to Quarles's Opening Brief, filed November 7, 2005, followed by the page number(s).

STATEMENT OF THE FACTS

I. Statutory Framework and Relevant Bankruptcy Rules Mandating Full Disclosure by Professional Persons Employed in Bankruptcy Cases

Section 327(a) of title 11, United States Code, governs the procedure for obtaining a bankruptcy court's approval of the employment of attorneys and other professionals by trustees and debtors in possession[2] in bankruptcy cases, limiting such employment to persons "that do not hold or represent an interest adverse to the estate, and that are disinterested persons."[3] A professional person's failure to comply with these requirements at any time during such professional person's employment under section 327 may result in denial of compensation. *See* 11 U.S.C. § 328(c). Rule 2014(a), Fed. R. App. P., requires that an application for employment under section 327 include a statement, to the best of the applicant's knowledge, of "all of the person's connections with the debtor, creditors, any other party in interest, their

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[2] A debtor in a chapter 11 bankruptcy case is a "debtor in possession," except when a trustee is appointed in the case. *See* 11 U.S.C. § 1101(1). A debtor in possession has most of the rights, powers, and duties of a trustee serving in a chapter 11 case. *See* 11 U.S.C. § 1107(a).

[3] The Bankruptcy Code defines a "disinterested person," in pertinent part, as a "person that– (A) is not a creditor, an equity security holder, or an insider; ... and (E) does not have an interest materially adverse to the interest of the estate or of any class of creditors or equity holders, by reason of any direct or indirect relationship to, connection with, or interest in, the debtor or any investment banker specified in subparagraph (B) or (C) of this paragraph, or for any other reason." 11 U.S.C. § 101(14)(A), (E).

respective attorneys and accountants, the United States trustee, or any person employed in the office of the United States trustee." Rule 2014(a) further provides that "[t]he application shall be accompanied by a verified statement of the person to be employed setting forth the person's connections" with any such other persons.

II. Facts Specific to this Appeal

A. Quarles's Undisclosed Prepetition Connections with the Debtors

In January and February 2002, attorneys from Quarles, a law firm, including one of the firm's partners, Ned R. Nashban ("Nashban"), performed estate planning services for Bruce Lee Jennings ("Jennings"), including providing legal advice regarding "Florida residency, domicile, and exempt assets" and "home purchase, estate planning, possible bankruptcy options, and real estate mortgages." BR 889, at 2-3; Ex. 11. At that time, Jennings and entities related to him were defendants in a tort action in California state court. BR 889, at 1-2. These entities included B.L. Jennings, Inc., a gun distributor ("Distributor") owned by Jennings; Bryco Arms, Inc., a gun manufacturer ("Manufacturer") owned by Jennings' ex-wife, Janice Kay Jennings ("Janice Jennings"), also a defendant in the California lawsuit; six trusts established by Jennings and/or Janice Jennings for the benefit of their children (collectively, the "Trusts"); and RKB Investments, a partnership ("Partnership") formed by three of the Trusts, then the Manufacturer's landlord. BR 889, at 1-3; BR 583, at 90.

On or about February 15, 2002, Quarles' client, Jennings, purchased a home in Daytona Beach, Florida, for $925,000 in cash. Ex. 28-29. On March 5, 2002, Jennings purchased a $500,000 annuity issued by Allianz Insurance Company. BR 889, at 3; Ex. 31.

In October 2002, the Partnership sold the Manufacturer's business premises to Knowleton Communities, Inc. ("Knowleton"), which entered into a new lease with the Manufacturer commencing October 17, 2002, replacing the prior lease between the Partnership and the Manufacturer. The Partnership paid a $337,000 security deposit on the Knowleton lease on behalf of the Manufacturer; Knowleton, in turn, agreed to return the money to the Partnership as the Manufacturer made its monthly rent payments to Knowleton. BR 889, at 3; Ex. 39, 45. As a result of these transactions, the Manufacturer owed Knowleton, and by extension, the Partnership, $150,000 in unpaid rent. BR 583, at 101-102; BR 889, at 3.

On May 8, 2003, Quarles entered into an engagement letter to represent Jennings, Janice Jennings, the Manufacturer, the Distributor, the Partnership, and the Trusts in proposed chapter 11 bankruptcy cases ("Engagement Letter"). Nashban signed the Engagement Letter on behalf of Quarles. BR 583, at 115; Ex. 47. The Engagement Letter provided, *inter alia*, as follows:

> Since we may be filing multiple Chapter 11 cases and potentially consolidating the cases, either administratively or substantively, by executing this engagement letter, **you also waive any potential conflicts among the parties that may arise**. In addition, we shall be allowed to share attorney/client privilege information among all of the individuals and entities that we will be representing in the Chapter 11 proceedings without breaching any rules of confidentiality. **However, if the Court does determine that there is a conflict that cannot be waived, we understand that and agree that it is your intention that we represent the various Trusts and the [Partnership] and the remaining parties will seek other counsel, subject to Court approval.**

BR 889, at 4; Ex. 47, at 4 (emphasis added).

On May 14, 2003, one day after the California court entered a judgment against Jennings, the Manufacturer, and the Distributor in excess of $20,000,000, Quarles filed eleven voluntary chapter 11 bankruptcy petitions in the Bankruptcy Court on behalf of Jennings, Janice Jennings, the Manufacturer, the Distributor, the Partnership, and the Trusts (collectively, the “Debtors”). BR 889, at 4.

After Quarles filed the Debtors’ bankruptcy petitions, at no time did it ever disclose to the Bankruptcy Court any of these prepetition connections with the Debtors, including: (1) its prepetition estate/exemption planning work for Jennings, (2) the Engagement Letter, in which it acknowledged potential conflicts of interest in representing each of the Debtors in chapter 11 proceedings, and (3) the Partnership's possible claims against the Manufacturer. BR 889, at 8.

B. Quarles's Failure to Disclose its Connections in its Employment Application

On May 19, 2003, Quarles filed in the Debtors' chapter 11 cases the Debtor's [sic] Application for Employment of Attorneys ("Application"), signed by Jennings on behalf of all the Debtors, pursuant to section 327(a). BR 20; Ex.18. The Application included an Affidavit of Proposed Attorney for Debtor-in-Possession [sic], signed by Nashban, pursuant to Rule 2014(a) ("Affidavit"). BR 20; Ex.18.

Paragraphs 6 and 8 of the Application provided as follows:

> 6. To the best of the Debtors' knowledge, [Quarles] has no connection with any creditors of the Debtors or any other party in interest, nor their respective attorneys.
>
> . . .
>
> 8. Quarles & Brady LLP represents no creditors of the estate nor any interest adverse to the Debtors as Debtors-in-possession or to the estate in the matters upon which it is to be engaged to perform legal services for the Debtors-in-possession, and its employment would be in the best interest of the estate.

BR 20; Ex.18.

Paragraphs 3 and 4 of the Affidavit provided as follows:

> 3. Benjamin R. Norris, a partner at Quarles & Brady LLP, and I will be the principal attorneys responsible for the representation of the Debtors. Neither of us nor Quarles & Brady LLP hold or represent any interest adverse to the Estates and we are disinterested persons as required by 11 U.S.C. 327(a).

> 4. That such law firm has no connection with the Debtors herein, its [sic] creditors or any other party in interest or their respective attorneys or accountants. And that it represents no interest adverse to that of the Debtors in the above-captioned matter, except that it was owed legal fees for legal work done for one of the Debtors, Bruce Lee Jennings, pre-petition, which bill has been paid to the law firm prior to the commencement of this action.

BR 20; Ex.18.

Although the Affidavit included a brief reference to unspecified prepetition legal work for Jennings, Quarles failed to disclose in the Application and Affidavit: (1) the nature, extent, and timing of its prepetition estate planning services for Jennings, (2) the existence and material terms of the Engagement Letter, and (3) any connections or conflicts arising from various claims among the Debtors. BR 889, at 8; BR 20; Ex. 18. In the absence of such disclosure, on May 28, 2003, the Bankruptcy Court entered, *ex parte*, an order approving the employment of Quarles as counsel for the Debtors pursuant to section 327(a) ("Employment Order"). BR 889, at 5; BR 26.

C. The Disqualification Motion

On February 25, 2004, shortly after Quarles filed its first application for interim compensation and reimbursement of expenses for the period from May 15, 2003, through August 31, 2003 ("Interim Fee Application"),[4] BR 410, appellee, Brandon

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[4] Pursuant to the Interim Fee Application, Quarles requested interim fees of $322,471.75 and reimbursement for costs of $14,917.90. Inexplicably, Quarles delayed filing the Interim Fee Application until nearly six months after the period for

James Maxfield ("Maxfield") filed a Motion to Disqualify Debtors' Counsel and for Disgorgement of Retainer ("Disqualification Motion"). BR 423. On April 26, 2004, Quarles filed its response to the Disqualification Motion. BR 526. On May 6, 2004, Maxfield filed a response to the Interim Fee Application. BR 544.

The Bankruptcy Court conducted an extensive evidentiary hearing on the Disqualification Motion on April 29, 2004 and May 28, 2004, at which the Court heard testimony from both Nashban and Jennings. BR 663; BR 583, at 88-127. At the May 28, 2004 hearing, the Bankruptcy Court also heard testimony from Nashban on the Interim Fee Application. BR 583, at 127-162. Counsel for Quarles, Maxfield, and the United States Trustee[5] participated at both hearings.

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which it requested compensation. BR 410.

[5] The United States Trustee is an official of the United States Department of Justice, charged by statute with the duty to oversee and supervise the administration of bankruptcy cases and trustees. *See* 28 U.S.C. § 586(a). Congress expressly granted standing to the United States Trustee to raise and be heard on any issue under title 11, except that the United States Trustee may not file a plan of reorganization under chapter 11. *See* 11 U.S.C. § 307; *United States Trustee v. McCormick, Barstow, Sheppard, Wayte & Carruth (In re Donovan Corp.)*, 215 F.3d 929, 930 (9th Cir. 2000). The United States Trustee's oversight duties include monitoring employment applications filed under section 327 and monitoring and reviewing applications for compensation and reimbursement filed under section 330. 28 U.S.C. § 586(a)(3)(A), (H).

Significantly, at the May 28, 2004 hearing, the Bankruptcy Court admitted into evidence the Engagement Letter, which Quarles had failed to disclose previously to the Bankruptcy Court or the United States Trustee. BR 583, at 115; Ex. 47.

At the conclusion of the hearings on the Disqualification Motion and the Interim Fee Application, the Bankruptcy Court took the matter under advisement and instructed the parties, including the United States Trustee, to submit post-hearing briefs in lieu of oral argument. BR 583, at 126-127, 160-162. Subsequently, the parties filed post-hearing memoranda on the Disqualification Motion and the Interim Fee Application. BR 602-605, 607.

D. Quarles's Trial Testimony

At the evidentiary hearing on the Disqualification Motion, Nashban testified on behalf of Quarles that he had reviewed the schedules for Jennings and the Distributor, indicating Jennings's wage claim and secured claim against the Distributor, but that he did not amend the Application or Affidavit to disclose this information. BR 663, at 17-19, 33-34, 37. Nashban acknowledged that Jennings claimed a security interest in the assets of the Distributor, including its inventory and accounts receivable, and that Jennings's claim exceeded the value of those assets, but admitted that he had taken no action to protect Jennings's interest in such collateral. BR 663, at 20-21, 24, 30-31. Nashban testified that he was aware of additional prepetition transfers from the Distributor to Jennings in the year before the filing of the bankruptcy cases in the amount of $650,000, but he did not amend the Application or Affidavit to disclose this information either. BR 663, at 37-39; Ex. 15. When asked if he could have disclosed these connections and sought a determination from the Bankruptcy Court at that time as to whether he could continue to represent both debtors, Nashban responded that, "[i]f I thought there was some conflict of interest, I would have sought a determination." BR 663, at 18. Nashban admitted that his simultaneous representation of Jennings as a secured creditor and the Distributor as a borrower was a potential conflict of interest but not an actual conflict. BR 663, at 33, 39. Nashban also admitted that he had made no written disclosure to the Bankruptcy Court regarding the financial transactions involving the Manufacturer's leases with the Partnership and Knowleton, which resulted in possible claims between the Partnership and the Manufacturer. BR 663, at 62.

E. The Bankruptcy Court's Ruling on the Disqualification Motion

On November 16, 2004, the Bankruptcy Court entered an order granting the Disqualification Motion and denying the Interim Fee Application, except that the Court approved reimbursement of all expenses requested by Quarles, and entered detailed Findings of Fact and Conclusions of Law. BR 889, 890.

The Bankruptcy Court concluded that Quarles's Rule 2014 disclosure was "woefully insufficient" because it failed to disclose: (1) that Quarles sought to represent simultaneously two debtors, Jennings and the Distributor, without disclosing that Jennings was a secured creditor of the Distributor and also claimed over $875,000 in back wages from the Distributor; (2) the existence of certain claims that three of Quarles's clients, Jennings, the Manufacturer, and the Distributor, held against eight other Quarles clients, Janice Jennings, the Partnership, and the Trusts, under joint venture/enterprise, partnership, constructive trust, alter ego, and other legal theories arising from the California lawsuit and similar litigation (collectively, the "Alter Ego Claims"); (3) the existence of possible claims between Quarles's Partnership client and Manufacturer client arising from the financial transactions involving the Manufacturer's leases with the Partnership and Knowleton; and (4) that Quarles had performed estate planning work for Jennings during 2002 that enabled Jennings to transfer significant assets beyond the reach of his creditors. BR 889, at 8. The Bankruptcy Court found that despite Quarles's awareness of these matters, it failed to disclose any of these matters in the Application and Affidavit, to amend the Affidavit to disclose such matters, or to seek a ruling from the Court concerning the continued propriety of representing the Debtors under the circumstances. BR 889, at 8-9.

Alternatively, the Bankruptcy Court concluded that Quarles was not a disinterested person as required under section 327(a) as a result of its simultaneous representation of: (1) Jennings and the Distributor, where Jennings held a secured claim of $1,404,000 against the Distributor; (2) Jennings and the Partnership, where the firm had a fiduciary duty to investigate a $500,000 loan from Jennings to the Partnership and subsequent "cancellation of indebtedness"; and (3) the Partnership and the Manufacturer, where the Partnership had possible claims against the Manufacturer arising from the Partnership's transactions with Knowleton. BR 889, at 10-12.

The Bankruptcy Court ordered the disqualification of Quarles as counsel for the Debtors, denied all of its compensation in the chapter 11 cases, and required disgorgement of any prepetition retainer, based on Quarles's initial and continuing violation of the disclosure rules, lack of disinterestedness, and injury resulting to the bankruptcy estates from its inability to evaluate independently the various claims, transfers, and interests in the related cases. BR 889, at 12-14.

F. Post-Trial Motions

On November 26, 2004, Quarles filed the Post-trial Motions and memorandum in support thereof. BR 895-898. Maxfield and the United States Trustee filed responses in opposition to the Post-trial Motions. BR 912, 914. On December 16, 2004, the Bankruptcy Court entered an order denying the Post-trial Motions. BR 921. On December 27, 2004, Quarles & Brady filed a notice of appeal from the Bankruptcy Court's orders granting the Disqualification Motion and denying the Post-trial Motions. BR 945.

G. The District Court's Ruling on Appeal

On September 7, 2005, the District Court entered an order affirming the Bankruptcy Court's Disqualification Order and order denying the Post-trial Motions. DR 48. The District Court held that the Bankruptcy Court: (1) correctly concluded that Quarles failed to disclose adequately its prepetition exemption work on behalf of Jennings and failed to disclose its various connections; (2) did not err in disqualifying Quarles based on its initial and continued violation of the Bankruptcy Code's disclosure rules coupled with its lack of disinterestedness; (3) did not abuse its discretion in denying compensation to Quarles and requiring disgorgement of any prepetition retainer; and (4) did not abuse its discretion in denying the Pre-trial Motions. DR 48, at 14, 23, 29, 30. Quarles appealed.

STANDARD OF REVIEW

This Court reviews findings of fact for clear error and reviews conclusions of law *de novo*. *Electro-Wire Products, Inc. v. Sirote & Permutt, P.C. (In re Prince)*, 40 F.3d 356, 359 (11th Cir. 1994). This Court reviews an award or refusal to award attorney's fees in a bankruptcy case for abuse of discretion. *In re Celotex Corp.*, 227 F.3d 1336, 1338 (11th Cir. 2000). This Court also reviews the disposition of a motion to alter or amend judgment for abuse of discretion. *American Home Assurance Co. v. Glenn Estess & Associates, Inc.*, 763 F.2d 1237, 1238-1239 (11th Cir. 1985). A bankruptcy judge's discretion in awarding compensation for services performed during bankruptcy proceedings deserves great deference. *In re Prince,* 40 F.3d at 359. "An abuse of discretion occurs if the judge fails to apply the proper legal standard or to follow proper procedures in making the determination, or bases an award upon findings of fact that are clearly erroneous." *Stroock & Stroock & Lavan v. Hillsborough Holdings Corp. (In re Hillsborough Holdings Corp.),* 127 F.3d 1398, 1401 (11th Cir. 1997) (quoting *In re Red Carpet Corp. of Panama City Beach*, 902 F.2d 883, 890 (11th Cir. 1990)).

SUMMARY OF ARGUMENT

Both the Bankruptcy Court and the District Court properly concluded that Quarles failed to comply with the requirements of section 327(a) of the Bankruptcy Code and Rule 2014(a) by failing to disclose all its connections with the Debtors in the Application and Affidavit or to amend the Application or Affidavit at any time to disclose any such connections of which Quarles became aware after the entry of the Employment Order. In fact, Quarles never disclosed most of these connections at any time and made only passing references to two of these connections in a few documents, where this information was literally buried in hundreds of pages of bankruptcy schedules and over 1,000 docket entries. The Bankruptcy Court, the creditors, and the United States Trustee did not have any obligation to search through the record to seek out conflicts of interest that Quarles failed to disclose properly. That duty fell solely on Quarles. By failing to comply with its statutory duties of disclosure, Quarles deprived the Bankruptcy Court of its ability to make a proper and timely determination of Quarles's eligibility for employment as counsel for the Debtors.

Alternatively, the Bankruptcy Court and the District Court correctly concluded that Quarles was not a disinterested person under section 327(a), based on conflicts of interest that Quarles concedes are at least potential conflicts. Quarles's contention that the Bankruptcy Court could not disqualify or deny compensation to Quarles based on potential conflicts is incorrect and inconsistent with the plain language of the Bankruptcy Code and established precedents from this Court and other circuits.

Based on the record below, the Bankruptcy Court did not abuse its discretion in disqualifying Quarles as counsel for Debtors, denying all of its compensation in the chapter 11 cases, and requiring disgorgement of any prepetition retainer, where it properly concluded that: (1) Quarles had failed to comply with the disclosure requirements of section 327 and Rule 2014(a); (2) Quarles was not a disinterested person as required under section 327(a); and (3) Quarles's inability to evaluate independently the various claims, transfers, and interests in the chapter 11 cases resulted in injury to the Debtors. The courts of appeal recognize that bankruptcy courts have the discretion to disqualify counsel for the bankruptcy estate or deny all compensation for a failure to comply with the statutory disclosure requirements, even if such failure is negligent or inadvertent. In addition, the courts of appeal acknowledge the bankruptcy courts' discretion to disqualify counsel or deny its compensation for lack of disinterestedness, based on potential, as well as actual, conflicts of interest.

Finally, the Bankruptcy Court did not abuse its discretion in denying the Post-trial Motions, where Quarles failed to show a manifest error of law or fact, to present any newly discovered evidence, or to make any showing required under the applicable rules.

ARGUMENT

I. The Bankruptcy Court and District Court Did Not Err in Concluding that Quarles Failed to Comply with the Disclosure Requirements of Section 327 and Rule 2014(a).

Quarles contends that it disclosed all its connections to the Bankruptcy Court in the Debtors' chapter 11 cases, but this argument does not reflect accurately the facts in these cases and ignores the Bankruptcy Code's disclosure requirements and circuit court precedent mandating strict compliance with such requirements.

Both the Bankruptcy Court and the District Court properly recognized that the Bankruptcy Code and Rules impose a mandatory obligation on an attorney seeking employment by a chapter 11 bankruptcy estate to make a complete disclosure of his or her relationship to the debtor and of any potential conflicts involved in the representation. BR 889, at 7-8; DR 48, at 10-11. Proper disclosure is necessary to enable a bankruptcy court to make an informed decision as to whether the professional person meets the statutory requirements for employment under section 327(a), i.e., that such person does not "hold or represent an adverse interest to the estate" and is a "disinterested person." *See* 11 U.S.C. § 327(a); *Neben & Starrett, Inc. v. Chartwell Financial Corp. (In re Park-Helena Corp.),* 63 F.3d 877, 881 (9th Cir. 1995), *cert. denied*, 516 U.S. 1049, 116 S.Ct. 712 (1996); *In re Granite Partners, L.P.,* 219 B.R. 22, 35 (Bankr. S.D. N.Y. 1998).

To enable bankruptcy courts to determine properly whether attorneys or other professional persons comply with these requirements, Rule 2014(a), Fed. R. Bank. P., sets forth the following requirements for applications for employment under section 327:

> ... **The application shall state** the specific facts showing the necessity for the employment, the name of the person to be employed, the reasons

> for the selection, the professional services to be rendered, any proposed arrangement for compensation, and, **to the best of the applicant's knowledge, all of the person's connections with the debtor, creditors, any other party in interest, their respective attorneys and accountants, the United States trustee, or any person employed in the office of the United States trustee. The application shall be accompanied by a verified statement of the person to be employed setting forth the person's connections with the debtor, creditors, any other party in interest, their respective attorneys and accountants, the United States trustee, or any person employed in the office of the United States trustee.** [Emphasis added.]

Rule 2014(a) requires all attorneys and other professional persons employed under section 327 to disclose all known connections with the debtor, creditors, and other parties in interest both in the application for employment and in an accompanying verified statement. *Kravit, Gass & Weber, S.C. v. Michel (In re Crivello),* 134 F.3d 831, 836 (7th Cir. 1998). As the Second Circuit has ruled, however, the duty to disclose "arises not solely by reason of the bankruptcy rules, but also is founded upon 'the fiduciary obligation owed by counsel for the debtor to the bankruptcy court.'" *Futuronics Corp. v. Arutt, Nachamie & Benjamin (In re Futuronics Corp.),* 655 F.2d 463, 470 (2nd Cir. 1981), *cert. denied*, 455 U.S. 941, 102 S.Ct. 1435 (1982) (quoting *In re Arlan's Department Stores, Inc.*, 615 F.2d 925, 937 (2nd Cir. 1979)).

Because a professional person's failure to comply with the requirements of section 327(a) at any time during such person's employment may result in a denial of compensation, *see* 11 U.S.C. § 328(c), the courts have held that the duty to disclose is a continuing duty that survives the initial filing of the application for employment and requires professionals to reveal connections that arise after their retention. *See In re Keller Financial Services of Florida, Inc.*, 248 B.R. 859, 898 (Bankr. M.D. Fla. 2000); *accord, I.G. Petroleum, L.L.C. v. Fenasci (In re West Delta Oil Co.)*, ___ F.3d ___, 2005 WL 3220291, at 6 (5th Cir. 2005). "[T]he need for professional self-scrutiny and avoidance of conflicts of interest does not end upon appointment." *Rome v. Braunstein*, 19 F.3d 54, 57-58 (1st Cir. 1994).

Under Rule 2014(a), "[t]he scope of disclosure is much broader than the question of disqualification ... The applicant and the professional must disclose all connections and not merely those that rise to the level of conflicts." *Keller Financial Services*, 248 B.R. at 897 (quoting *In re Granite Partners, Inc.*, L.P., 219 B.R. 22, 35 (Bankr. S.D. N.Y. 1998)); *accord, In re Gulf Coast Orthopedic Center*, 265 B.R. 318, 323 (Bankr. M.D. Fla. 2001). "The professional must disclose all facts that bear on his disinterestedness, and cannot usurp the court's function by unilaterally choosing which connections impact on his disinterestedness and which do not." *Keller Financial Services*, 248 B.R. at 897.

Although Quarles fails to cite to any relevant circuit court authority, the courts of appeals have recognized the importance of the Bankruptcy Code's disclosure requirements and the power of the bankruptcy courts to sanction attorneys for failing to comply with these requirements. *See, e.g., I.G. Petroleum, L.L.C. v. Fenasci (In re West Delta Oil Co.)*, ___ F.3d ___, 2005 WL 3220291, at 6 (5th Cir. 2005)*; Kravit, Gass & Weber, S.C. v. Michel (In re Crivello)*, 134 F.3d 831, 836 (7th Cir. 1998); *Neben & Starrett, Inc. v. Chartwell Financial Corp. (In re Park-Helena Corp.)*, 63 F.3d 877, 881-882 (9th Cir. 1995), *cert. denied*, 516 U.S. 1049, 116 S.Ct. 712 (1996); *Rome v. Braunstein*, 19 F.3d 54, 59-60 (1st Cir. 1994).

In *Park-Helena*, in which the debtor's attorney failed to disclose the source of a prepetition retainer, the Ninth Circuit acknowledged that the disclosure requirements of Rule 2014 are applied "strictly." *Id.* at 881. "All facts that may be pertinent to a court's determination of whether an attorney is disinterested or holds an adverse interest to the estate must be disclosed." *Id.* at 882. "The duty of professionals is to disclose all connections with the debtor, debtor-in-possession, insiders, creditors, and parties in interest ... They cannot pick and choose which connections are irrelevant or trivial ... No matter how old the connection, no matter how trivial it appears, the professional seeking employment must disclose it." *Id.* The Ninth Circuit further stated that "[t]he disclosure rules are applied literally, even if the results are sometimes harsh." *Id.* at 881. Negligent or inadvertent omissions "do not vitiate the failure to disclose." *Id.* The failure to comply with the disclosure rules is a sanctionable violation, even if proper disclosure would have shown that the attorney had not actually violated any Bankruptcy Code provision or Bankruptcy Rule. *Id.* at 880. Applying these strict standards, the *Park-Helena* court held that the attorney's failure to describe the circumstances of the payment of the retainer violated the disclosure requirements of Rule 2014, and that the bankruptcy court did not abuse its discretion in denying all the attorney's requested fees as a sanction for the attorney's failure to disclose. *Id.* at 882; *see also West Delta Oil Co.*, 2005 WL 3220291, at 6 (quoting *Crivello*, 134 F.3d at 836) ("failure to disclose is sufficient grounds to revoke an employment order and deny compensation"); *Rome v. Braunstein*, 19 F.3d at 59-60 (counsel's failure to make full and spontaneous disclosure of financial transactions between debtor and insiders provided sufficient ground for denial of compensation).

Here, both the Bankruptcy Court and the District Court correctly followed applicable law in concluding that Quarles failed to comply with the disclosure requirements of section 327 and Rule 2014(a) by failing to disclose its connections with the Debtors in the Application and Affidavit, and by failing to amend the Affidavit to disclose any additional connections of which Quarles subsequently became aware.

The Application and Affidavit disclosed no connections between Quarles and the Debtors other than unspecified prepetition legal services performed for Jennings.[6] The Bankruptcy Court correctly found that Quarles had failed to disclose in the Application and Affidavit, or to amend subsequently the Affidavit to disclose: (1) that Jennings was a secured creditor of the Distributor and also claimed back wages from the Distributor; (2) the existence of the Alter Ego Claims and the potential conflict in representing both sides of the litigation; (3) the existence of possible claims between the Partnership and the Manufacturer arising from the financial transactions involving the Manufacturer's leases with the Partnership and Knowleton; and (4) that Quarles had performed estate planning work for Jennings during 2002. R.889, at 8.

The record in the bankruptcy cases reflects that at no time during the chapter 11 proceedings did Quarles ever disclose the: (1) claims between the Partnership and the Manufacturer; (2) nature, extent, and timing of Quarles's prepetition estate planning work for Jennings; or (3) existence and material terms of the Engagement Letter, which specifically addressed conflicts arising in connection with litigation of

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[6] Quarles argues that it disclosed its prepetition work for Jennings despite its failure to disclose any facts in the Affidavit regarding the nature, extent, or timing of such services. Appellant's Brief, at 10, 31. The District Court, however, properly concluded that this disclosure was inadequate as a result of Quarles's failure to disclose any specific facts concerning its prepetition representation of Jennings. DR 48, at 12-14.

the Alter Ego Claims. BR 889, at 8-9. The Bankruptcy Court and the United States Trustee did not become aware of the Engagement Letter until the May 28, 2004 hearing on the Disqualification Motion, over a year after Nashban signed the Engagement Letter. Only then did the Court and the United States Trustee first learn that the Debtors had expressly agreed to waive any potential conflicts on the part of Quarles and that Quarles intended to represent only the Trusts and the Partnership if the Bankruptcy Court determined that Quarles & Brady had a non-waivable conflict arising from Quarles & Brady's representation of both sides of that litigation.[7] Ex.47. The Bankruptcy Court, however, could not timely make this determination absent any proper disclosure of these conflicts by Quarles.

Although Quarles subsequently listed Jennings's claims against the Distributor on the Debtors' bankruptcy schedules, where this information was literally buried in hundreds of pages of schedules,[8] Quarles nonetheless failed to comply with its

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[7] A law firm that is not disinterested may not represent a debtor even if that debtor has consented to such representation and waived the conflict. *See In re Granite Partners, L.P.*, 219 B.R. 22, 34 (Bankr. S.D. N.Y. 1998); *In re American Printers & Lithographers, Inc.*, 148 B.R. 862, 867 (Bankr. N.D. Ill. 1992); *In re Amdura Corp.*, 121 B.R. 862, 866 (Bankr. D. Colo. 1990); *see also In re Congoleum Corp.*, 426 F.3d 675, 692 (3rd Cir. 2005) ("waivers under § 327(a) are ordinarily not effective"); *In re Jore Corporation*, 298 B.R. 703, 726, 732 (Bankr. D. Mont. 2003) (court sanctioned debtor's attorneys based on attorneys' failure to disclose existence and terms of written conflicts waiver in Rule 2014(a) statement).

[8] On June 20, 2003, Quarles filed 23 pages of bankruptcy schedules on behalf of Jennings, which listed accounts receivable due to Jennings from the

affirmative duty under the Bankruptcy Code to amend its employment documents to disclose properly these connections. Likewise, while Quarles may have filed a few pleadings that included some brief references to the Alter Ego Claims,[9] buried among the over 1,000 docket entries filed in the chapter 11 proceedings, Quarles never amended its employment documents to disclose the potential conflicts arising from those claims. BR 889, at 8. Quarles cites no legal authority from any circuit to support its contention that such "disclosure" satisfied the requirements of § 327(a) and Rule 2014(a).[10]

"It is not ... the obligation of the bankruptcy court to search the record for possible conflicts of interest. That obligation belongs to the party who seeks

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Distributor for back payroll in the amount of $875,000 and loans in the amount of $2,000,000, buried on page four of that document. BR 35; Ex. 3. On June 23, 2003, Quarles filed 26 pages of schedules on behalf of the Distributor, which listed a secured claim held by Jennings for a personal loan from Jennings to the Distributor in the amount of $1,404,000, buried on page seven of that document, and a claim held by Jennings for unpaid wages in the amount of $875,000, buried on page eight. BR 43; Ex. 1. On July 25, 2003, Quarles amended Jennings' schedules, revising the amount of the account receivable due to Jennings for loans from Jennings to the Distributor to $1,404,000. BR 137; Ex. 3.

[9] *See* BR 8, at 5-6; BR 10, at 5; BR 22, at 2,3,7; and Docket No. 1 in Adv. Proc. No. 03-203, at 3-4.

[10] Quarles also argues that its isolated statements at one of countless hearings held in these cases constituted "disclosure" of these matters. Appellant's Brief, at 28. Quarles made such statements, however, in the context of completely different legal issues before the Bankruptcy Court at that time and not for the purpose of disclosing its connections or conflicts.

employment by the estate ..." *In re BH & P, Inc.*, 949 F.2d 1300, 1317 (3rd Cir. 1991). "Bankruptcy courts have neither the resources nor the time ... to root out the existence of undisclosed conflicts of interest." *Crivello*, 134 F.3d at 839; *see also In re Marine Outlet, Inc.*, 135 B.R. 154, 156 (Bankr. M.D. Fla. 1991) ("there is no duty placed on the United States Trustee or on creditors to search the record for the existence, vel non, of a conflict of interest of a professional sought to be employed").

Consistent with applicable law, the Bankruptcy Court and District Court properly recognized that the burden of bringing any connections or actual or potential conflicts to the attention of the Court was Quarles's, and not the creditors', the United States Trustee's, or any other party's. BR 889, at 9-10; DR 48, at 10-11.

Quarles's contention that it sufficiently disclosed its connections with the Debtors is further betrayed by Nashban's own testimony that "[i]f I thought there was some conflict of interest, I would have sought a determination." BR 663, at 18. Quarles did not have the right to pick and choose which connections were worthy of disclosure. *See Park-Helena*, 63 F.3d at 881. By failing to comply with its fiduciary duty to disclose properly all its connections with the Debtors, as required by section 327 and Rule 2014(a), Quarles deprived the Bankruptcy Court of its ability to make a proper and timely determination of Quarles's eligibility for employment as counsel for the Debtors.

II. Alternatively, the Bankruptcy Court and the District Court Did Not Err in Concluding that Quarles Was Not a Disinterested Person under Section 327(a), Based on Either Actual or Potential Conflicts of Interest.

A. The Bankruptcy Court Properly Applied the Bankruptcy Code and *In re Prince* in Basing its Decision to Disqualify and Deny Compensation to Quarles on Actual or Potential Conflicts.

The Bankruptcy Court and the District Court correctly concluded that Quarles was not a disinterested person under section 327(a), based on Quarles's simultaneous representation of the Debtors, where actual or potential conflicts of interest existed among the Debtors. BR 889, at 10-12; DR 48, at 22-23. Although Quarles concedes that all of these conflicts are at least potential conflicts, it argues that the Bankruptcy Court erred because it could only disqualify counsel or deny compensation based on actual, not potential, conflicts. Appellant's Brief, at 34-35, 41-42. In particular, Quarles argues that the Bankruptcy Court erred in basing its decision to disqualify and deny compensation to Quarles on this Court's holding in *In re Prince* because *Prince* mandates disqualification only if an actual conflict exists. Appellant's Brief, at 44-46. As the District Court correctly observed, however, this contention misconstrues this Court's holding in *Prince* and the meaning of sections 327(a), 327(c), and 328(c). DR 48, at 19.

In examining the courts' rulings below, it is first necessary to look to the plain meaning of the statutes themselves. *See Lamie v. United States Trustee,* 540 U.S. 526, 534, 124 S.Ct. 1023, 1030 (2004) ("when the statute's language is plain, the sole function of the courts ... is to enforce it according to its terms"). Section 327(a) provides as follows:

> Except as otherwise provided in this section, the trustee,[11] with the court's approval, may employ one or more attorneys, accountants, appraisers, auctioneers, or other professional persons, **that do not hold or represent an interest adverse to the estate, and that are disinterested persons**, to represent or assist the trustee in carrying out the trustee's duties under this title. [Emphasis added.]

The purpose of section 327(a) is to ensure impartiality in bankruptcy representation. *Electro-Wire Products, Inc. v. Sirote & Permutt, P.C. (In re Prince)*, 40 F.3d 356, 360 (11th Cir. 1994). The requirements for employment of a professional person to represent the bankruptcy estate under section 327(a) are two-fold: (1) the professional person must "not hold or represent an interest adverse to the estate"; and (2) the person must be a "disinterested person." 11 U.S.C. § 327(a). While the Bankruptcy Code does not define "hold or represent an interest adverse to the estate," this Court has defined this phrase as follows:

> ... possessing, or serving as an attorney for a person possessing, either an "economic interest that would tend to lessen the value of the bankruptcy estate or that would create **either an actual or potential dispute** in which the estate is a rival claimant ... or ... a predisposition under the circumstances that render such a bias against the estate."

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[11] As used in section 327(a), "trustee" also includes a debtor in possession in a chapter 11 bankruptcy case. *See* 11 U.S.C. § 1107(a).

Id. at 361 (emphasis added); *accord, I.G. Petroleum, L.L.C. v. Fenasci (In re West Delta Oil Co.),* ___ F.3d ___, 2005 WL 3220291, at 7 (5th Cir. 2005); *Kravit, Gass & Weber, S.C. v. Michel (In re Crivello),* 134 F.3d 831, 835 (7th Cir. 1998). Section 101(14) defines the term "disinterested person," as used in section 327(a), in pertinent part, as a "person that ... is not a creditor, an equity security holder, or an insider" and who "**does not have an interest materially adverse to the interest of the estate** or of any class of creditors or equity holders, by reason of any direct or indirect relationship to, connection with, or interest in, the debtor ... or for any other reason." 11 U.S.C. § 101(14)(A), (E) (emphasis added); *Prince*, 40 F.3d at 360-361; *West Delta Oil Co.*, 2005 WL 3220291, at 7; *Crivello*, 134 F.3d at 835. Together, these statutory requirements of disinterestedness and no interest adverse to the estate "serve the important policy of ensuring that all professionals appointed pursuant to § 327(a) tender undivided loyalty and provide untainted advice and assistance in furtherance of their fiduciary responsibilities." *Id.* at 836 (quoting *Rome v. Braunstein*, 19 F.3d 54, 58 (1st Cir. 1994)).

Section 327(c) provides a limited exception to the requirements of section 327(a), where the professional seeking employment has previously represented a creditor of the bankruptcy estate, and states as follows:

> In a case under chapter 7, 12 or 11 of this title, a person is not disqualified for employment under this section **solely because of such**

> **person's employment by or representation of a creditor**, unless there is objection by another creditor or the United States trustee, in which case the court shall disapprove such employment if there is an actual conflict of interest. [Emphasis added.]

Section 328(c) gives bankruptcy courts the discretion to deny compensation of a professional person if such professional is not a disinterested person and provides as follows:

> Except as provided in section 327(c), 327(e), or 1107(b) of this title, **the court may deny allowance of compensation** for services and reimbursement of expenses of a professional person employed under section 327 or 1103 of this title **if, at any time during such professional persons' employment under section 327** or 1003 of this title, **such professional person is not a disinterested person**, or represents or holds an interest adverse to the interest of the estate with respect to the matter on which the professional person is employed. [Emphasis added.]

Quarles's arguments notwithstanding, Appellant's Brief, at 44-46, the Bankruptcy Court's sanction in these cases faithfully applied this Court's ruling in *Electro-Wire Products, Inc. v. Sirote & Permutt, P.C. (In re Prince),* 40 F.3d 356 (11th Cir. 1994). Indeed, Quarles's misconduct, although broader in scope, shares some similarities with the misconduct this Court sanctioned in *Prince,* where the debtor's counsel also failed to disclose fully prepetition estate planning services. *Prince*, 40 F.3d at 359-361.

In *Prince,* this Court reversed an award of attorneys' fees to the debtor's counsel after counsel had withdrawn from the case, and denied all fees, holding that the debtor's counsel could not qualify as a disinterested person, and thus could not receive any compensation under the Bankruptcy Code. 40 F.3d at 361. Like Quarles, the debtor's counsel in *Prince* initially failed to disclose a series of prepetition services for affiliated entities. *Id.* at 358 (counsel performed prepetition estate planning services for the debtor and his wife, represented a corporation operated and controlled by the debtor, and possibly obtained a preferential transfer from the debtor). Counsel failed to disclose any of this at the time it was retained to act as the debtor's counsel. *Id.* Subsequently, counsel amended its application for employment, stating that it inadvertently failed to disclose its performance of prepetition estate planning services for the debtor, but failed to disclose fully the timing of such services and any impact of such services on the bankruptcy proceedings. *Id.* at 359. Later, counsel filed a second amendment stating that it inadvertently failed to disclose its prepetition representation of the debtor's wife in other matters unrelated to the bankruptcy proceedings. *Id.*

In *Prince*, this Court denied compensation to the debtor's counsel under section 328(c) because it was not a disinterested person during the bankruptcy case. 40 F.3d at 361. In defining disinterestedness under section 327(a), this Court properly recognized that the term could encompass either actual or potential conflicts. *Id.* at 360-361.

In sanctioning Quarles for its misconduct, the Bankruptcy Court properly applied the same disinterestedness standard in concluding that Quarles was not a disinterested person based on potential or actual conflicts of interest. BR 889, at 6. By mischaracterizing *Prince* as holding that only actual conflicts are actionable, Quarles incorrectly suggests, Appellant's Brief, at 44-46, this Court's jurisprudence departs from that of all other circuits, which have consistently permitted disqualification and denial of compensation based on potential conflicts, but it does not. *See In re Marvel Entertainment Group, Inc.*, 140 F.3d 463, 476 (3rd Cir. 1998) (holding that bankruptcy court has discretion to disqualify any attorney who has potential conflict of interest); *Interwest Business Equipment, Inc. v. United States Trustee (In re Interwest Business Equipment, Inc.)*, 23 F.3d 311, 316 (10th Cir. 1994) (holding that § 327(c) "does not preempt the more basic requirements of [§ 327(a)]"); *In re B H & P, Inc.*, 949 F.2d 1300, 1317-1318 (3rd Cir. 1991) (court disqualified counsel for multiple related bankruptcy estates where counsel failed to disclose potential conflicts arising from claims among estates).

Here, Quarles, like the debtor's counsel in *Prince*, failed to disclose that it performed prepetition estate planning services for the debtor.[12] As a result of

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[12] In *Prince*, however, unlike these cases, the debtor's counsel subsequently attempted to mitigate any harm to the estate by amending its application to disclose its prepetition estate planning services for the debtor and voluntarily withdrawing

prepetition estate planning services by Quarles, its client, Jennings, purchased a $925,000 homestead in Florida and a $500,000 annuity. After the commencement of the bankruptcy cases, on July 7, 2003, Maxfield filed an objection to Jennings's claim of an exemption in the annuity on the grounds that Jennings converted non-exempt property to exempt property with the intent to hinder, delay, or defraud creditors.[13] Ex. 9. Quarles now asserts that some courts have permitted exemption planning as part of the services rendered by a debtor's counsel to its client, Appellant's Brief, at 32, but fails to apprise this Court that the Bankruptcy Court recently entered an order *in these cases* sustaining Maxfield's objection to Jennings' exemption claim in the annuity, disallowing such exemption, and concluding that Jennings' purchase of the annuity in reliance on Quarles's legal advice was a fraudulent asset conversion. In vitiating Quarles' transaction for Jennings, the bankruptcy court freed up

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from the case. 40 F.3d at 359. Here, Quarles at no time amended the Application or Affidavit to disclose this connection or any other connection with the Debtors, nor did it ever offer to withdraw from representing any of the Debtors.

[13] Maxfield alleged that the annuity exemption claim violated section 222.30(2) of the Florida Statutes, which provides that "[a]ny conversion by a debtor of an asset that results in the proceeds of the asset becoming exempt by law from the claims of a creditor of the debtor is a fraudulent asset conversion as to the creditor ... if the debtor made the conversion with the intent to hinder, delay, or defraud the creditor." Ex.9. Quarles cites to two Florida bankruptcy court decisions permitting prepetition exemption planning involving the purchase of annuities, Appellant's Brief, at 32, but both cases were decided prior to the enactment of section 222.30 effective October 1, 1993. *See In re Swecker*, 157 B.R. 694, 696 (Bankr. M.D. Fla. 1993) (decided July 13, 1993); *In re Levine*, 40 B.R. 76, 82 (Bankr. S.D. Fla. 1984).

approximately $400,000 to help pay Jennings's creditors.[14] In any event, even if the Bankruptcy Court ultimately had allowed the exemption, Quarles performance of prepetition estate planning services for Jennings tainted its ability to represent independently and disinterestedly the Jennings estate and the interest of its creditors.

B. The Bankruptcy Court and District Court Correctly Concluded that Quarles Was Not a Disinterested Person Based on its Actual or Potential Conflicts of Interest in Representing Multiple Debtors.

The Bankruptcy Court and the District Court correctly concluded that Quarles was not a disinterested person under section 327(a), as a result of: (1) Jennings's secured claim against the Distributor; (2) Jennings's $500,000 loan to the Partnership and subsequent "cancellation of indebtedness"; and (3) the Partnership's possible claims against the Manufacturer arising from the financial transactions involving the

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[14] In order to assist the Court by clarifying the record and correcting any material misstatements or omissions, the United States Trustee provides herewith copies of additional items from the Bankruptcy Court record, which impact the issues in this appeal but were filed after certification of the Bankruptcy Court record to the District Court in the prior appeal before the District Court, in the United States Trustee's Supplemental Record Excerpts. The United States Trustee also files herewith the United States Trustee's motion requesting leave to supplement the record on appeal or, in the alternative, requesting that the Court take judicial notice of such matters. True copies of the Bankruptcy Court's order sustaining Maxfield's objection to Jennings's exemption claim in the annuity and findings and conclusions thereon, entered September 22, 2005, are included in the United States Trustees' Supplemental Record Excerpts as SRE 1301 and SRE 1300, respectively. Jennings appealed that order to the District Court on September 30, 2005 (Case No. 6:05-cv-01728-ACC-KRS). SRE 1304.

Manufacturer's leases with the Partnership and Knowleton. BR 889, at 10-12; DR 48, at 22-23.

Although Quarles suggests otherwise, the courts of appeal and other courts have found in similar circumstances that bankruptcy courts' concern for potential and actual conflicts, or counsel's lack of disinterestedness, authorized those courts to prohibit firms like Quarles from representing multiple debtors. *See* 11 U.S.C. 327(a) (giving courts discretion to retain firms only when they are disinterested and hold no adverse interest). For example, where a law firm sought to represent multiple interrelated debtors in related chapter 11 cases, as in the instant cases, the Tenth Circuit affirmed the bankruptcy court's denial of the firm's application for employment as counsel for the debtors, holding that the firm failed to meet the minimum requirements of section 327(a). *Interwest Business Equipment, Inc. v. United States Trustee (Interwest Business Equipment, Inc.*), 23 F.3d 311, 318 (10th Cir. 1994). In *Interwest*, the law firm was seeking court approval to represent two related corporations, the sole shareholder of both corporations, and a fourth related entity, which received income from one of the corporations pursuant to a management contract and also made lease payments for that corporation. *Id.* at 313. Unlike here, however, the law firm in *Interwest* disclosed substantial intercompany debt among the debtors in its Rule 2014(a) affidavits, but the affidavits did not disclose any further information regarding the validity or amount of the intercompany debt or other information sufficient to address any of the conflicts involved in representing the separate estates. *Id.* at 314. The Tenth Circuit concluded that the bankruptcy court did not abuse its discretion in finding: (1) that the firm's simultaneous representation of each debtor and one of the other estates as creditor constituted representation of an interest adverse to the estate, and that the firm was thus not disinterested; and (2) that the existence of a prepetition debt from one estate to the other created a disqualifying conflict of interest. *Id.* at 314, 318. In so holding, the court recognized the importance of the fiduciary duty of the debtor in possession, as trustee of the estate, and of counsel's obligation to serve the trustee independently. *Id.* at 317; *see also In re BH & P, Inc.*, 949 F.2d 1300, 1317-1318 (3d Cir. 1991) (affirming disqualification of counsel for multiple related bankruptcy estates of corporation and its two principals, where estates had claims against one another and counsel failed to disclose potential conflicts); *In re Coal River Resources, Inc.*, 321 B.R. 184, 189 (W.D. Va. 2005) (affirming bankruptcy court's finding that single attorney could not represent interests of four related corporate debtors with intercompany debts, and in particular fiduciary obligation of each debtor to its own creditors); *In re Wheatfield Business Park LLC*, 286 B.R. 412, 418 (Bankr. C.D. Cal. 2002) ("[w]here a bankruptcy debtor is a creditor of a related debtor, it is presumptively improper for the same attorney ... to be general counsel for the related debtors"); *In re Lee*, 94 B.R. 172, 180 (Bankr. C.D. Cal. 1988) (counsel for two related debtors could not represent both estates, where debt existed between estates and counsel failed to disclose potential conflicts).[15]

Here, the Bankruptcy Court correctly concluded that Quarles lacked disinterestedness based on three conflicts of interest, which Quarles admits are at least potential conflicts:

(1) <u>Jennings's secured claim against the Distributor</u>: The Bankruptcy Court correctly found that an "actual dispute" arose because of Jennings's secured claim against the Distributor. BR 889, at 11-12; DR 48, at 22. As counsel for both estates, Quarles had a fiduciary obligation to represent directly conflicting interests, i.e., Jennings's interest as secured creditor and the Distributor's interest as borrower.

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[15] The District Court correctly distinguished *In re Global Marine, Inc.*, 108 B.R. 998 (Bankr. S.D. Tex. 1987), in which the court exercised its discretion and approved counsel's representation of multiple debtors where the court found no actual conflict of interest based on the evidence of record, as well as other lower court cases upon which Quarles relies, which turn on findings based on the record in each particular case. DR 48, at 20. Quarles's reliance on *In re Winn-Dixie Stores, Inc., et al.*, Case No. 05-03817-3F1 (Bankr. M.D. Fla.), is similarly misplaced. Appellant's Brief, at 40-41. Unlike the Debtors here, the debtors in *Winn-Dixie* are a publicly-held parent corporation and 23 subsidiaries. Quarles cites selectively to only two docket items in massive reorganization proceedings with more than 4,000 docket entries filed. It is beyond the scope of this appeal to determine the correctness of the Bankruptcy Court's rulings in *Winn-Dixie*, *vis-à-vis* its rulings in the instant cases, when the record in *Winn-Dixie* is not properly before this Court. In any event, regardless of the ultimate outcome in *Winn-Dixie*, the Bankruptcy Court here did not abuse its discretion based on the record below.

Jennings's schedules indicated that he asserted a $1,404,000 secured claim against the Distributor's assets, valued at $1,278,952, including inventory worth $1,117,336. BR 889, at 5. Quarles could not effectively protect Jennings's collateral without inhibiting the Distributor's ability to operate; nor could Quarles advocate the Distributor's continued operations without impacting Jennings's security interest in the Distributor's prepetition assets. BR 889, at 10-12; DR 48, at 23. By November 2003, the Distributor had sold all of its prepetition inventory and had consumed all proceeds of such inventory, which resulted in direct injury to Jennings' bankruptcy estate.[16] BR 889, at 11, 13.

(2) Jennings's $500,000 loan to the Partnership and subsequent "cancellation of indebtedness": In the year preceding the bankruptcy, the Partnership apparently removed a $500,000 debt to Jennings from its financial statements and tax returns, even though no money changed hands and the Partnership had the funds to the pay this obligation. BR 889, at 12. Quarles could not investigate and pursue the recovery

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[16] Quarles asserts mistakenly that during its representation of the Debtors, "all of the assets remained available for creditors, so no dollars left the universe of [the Distributor's] and [Jennings's] estates." Appellant's Brief, at 42. In fact, the Jennings estate suffered actual injury as a consequence of Quarles's divided loyalties in representing both Jennings's and the Distributor's estates. The Distributor has ceased operations and depleted all of its inventory and other assets, thus effectively terminating Jennings's lien. Quarles's suggestion that it could avoid injury to the Jennings estate by providing for the reinstatement of Jennings's lien through a plan of reorganization is completely without merit because there is nothing left to reinstate.

of funds for the Jennings estate while opposing these efforts on behalf of the Partnership's estate. The Bankruptcy Court thus correctly concluded that because of Quarles's divided loyalties, it could not comply with its fiduciary duty to represent each estate independently and impartially.[17] BR 889, at 12; DR 48, at 23.

(3) The Partnership's possible claims against the Manufacturer: In light of the Partnership's possible claims against the Manufacturer arising from the financial transactions involving the Manufacturer's leases with the Partnership and Knowleton, the Bankruptcy Court correctly concluded that Quarles's simultaneous representation of the Partnership and the Manufacturer rendered it not disinterested, where it could not independently investigate the claims of one client against the other. BR 889, at 12; DR 48, at 23.

Nonetheless, despite its duty to represent vigorously the separate bankruptcy estates, Quarles argues that hiring multiple sets of attorneys for the Debtors to permit them to assert claims against each other "made no sense and only would serve to deplete the estates." Appellant's Brief, at 44. That was not Quarles's decision to

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[17] Quarles responds on this issue that it did not improperly fail to disclose this matter since Nashban testified at the hearing on the Disqualification Motion on April 29, 2004, that he had no prior knowledge of this issue. Appellant's Brief, at 21-22, 42; BR 663, at 44. This is irrelevant, however, because the Bankruptcy Court did not find a lack of disclosure of this connection, but nonetheless correctly found that once this matter became known, Quarles had a duty to investigate the facts for the benefit of one estate to the detriment of the other. BR 889, at 8, 12.

make, however; it was the Bankruptcy Court's. By failing to bring any potential conflicts of interest to the Bankruptcy Court's attention so it could properly and timely decide these issues, Quarles usurped this decision-making process from the Bankruptcy Court.

III. The Bankruptcy Court Properly Exercised its Discretion in Disqualifying Quarles as Counsel for the Debtors, Denying All of its Compensation in the Chapter 11 Cases, and Requiring Disgorgement of Any Prepetition Retainer, Based on Quarles's Failure to Disclose and Lack of Disinterestedness.

A. The Failure to Disclose by Itself Was Sufficient Grounds for Disqualification and Denial of Compensation.

The Bankruptcy Court correctly exercised its discretion in disqualifying Quarles as counsel for the Debtors, denying all of its compensation in the chapter 11 cases, and requiring disgorgement of any prepetition retainer, based on both Quarles's failure to disclose its connections with the Debtors and its lack of disinterestedness.

Failure to disclose is sufficient grounds to revoke an employment order and deny compensation. *I.G. Petroleum, L.L.C. v. Fenasci (In re West Delta Oil Co.)*, ___ F.3d ___, 2005 WL 3220291, at 6 (5th Cir. 2005); *In re Kisseberth*, 273 F.3d 714, 721 (6th Cir. 2001); *Kravit, Gass & Weber, S.C. v. Michel (In re Crivello)*, 134 F.3d 831, 836 (7th Cir. 1998); *Mapother & Mapother, P.S.C. v. Cooper (In re Downs)*, 103 F.3d 472, 477 (6th Cir. 1996); *accord, In re Gulf Coast Orthopedic Center*, 265 B.R. 318, 323 (Bankr. M.D. Fla. 2001) ("failure to disclose the [professional's] relationships is sufficient in and of itself to require denial and disgorgement of all compensation separate and apart from any question that there was any actual conflict of interest").

The circuits courts recognize that bankruptcy courts have broad and inherent authority to deny any and all compensation where an attorney fails to comply with the disclosure requirements for employment and compensation of attorneys. *See In re Kisseberth*, 273 F.3d 714, 721 (6th Cir. 2001); *Law Offices of Nicholas A. Franke v. Tiffany (In re Lewis)*, 113 F.3d 1040, 1045 (9th Cir. 1997). The Sixth and Ninth Circuits have held that "[e]ven a negligent or inadvertent failure to disclose fully relevant information may result in a denial of all requested fees." *Kisseberth*, 273 F.3d at 721 (Sixth Circuit affirmed disgorgement and denial of fees for attorney's failure to disclose all payments received from debtors under Rule 2016(b), where attorney claimed such failure was negligent or inadvertent);[18] *Neben & Starrett, Inc. v. Chartwell Financial Corp. (In re Park-Helena Corp.),* 63 F.3d at 877, 882 (9th Cir. 1995), *cert. denied,* 516 U.S. 1049, 116 S.Ct. 712 (1996) (Ninth Circuit upheld denial of all attorney's fees for failure to disclose the source of retainer under both Rule 2014(a) and Rule 2016(b)); *see also In re BH & P, Inc.*, 949 F.2d 1300, 1318 (3rd Cir. 1991) ("[n]egligence does not excuse the failure to disclose a possible conflict of interest"); *In re Jore Corporation*, 298 B.R. 703, 726, 732 (Bankr. D. Mont. 2003) (court disqualified debtor's attorneys and denied and required disgorgement of all fees

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[18] Section 329(a) and Rule 2016(b) require debtors' attorneys to file with the court a statement of compensation paid or agreed to be paid within one year prior to the date of filing of the bankruptcy petition and the source of such compensation. *See* 11 U.S.C. § 329(a); Fed. R. Bankr. P. 2016(b). The fiduciary duties of disclosure under Rule 2014(a) and Rule 2016(b) are similar. *See Park-Helena*, 63 F.3d at 881 ("[t]he disclosure requirements of Rule 2014 are applied as strictly as the requirements of Rule 2016 and section 329").

and costs for attorneys' failure to disclose limited conflicts waiver, although attorneys claimed that such failure was negligent or inadvertent).

The First and Fifth Circuits have also upheld the complete denial of compensation for violations of the Bankruptcy Code's disclosure requirements. *See In re Independent Engineering Co.*, 197 F.3d 13, 17 (1st Cir. 1999) (court affirmed disgorgement of all fees for attorney's failure to disclose postpetition draws and payments from debtor under Rule 2016(b)); *In re Prudhomme*, 43 F.3d 1000, 1003-1004 (5th Cir. 1995) (court affirmed disgorgement of all fees due to attorney's failure to disclose retainer under Rule 2016(b)).

Although Quarles claims that it "engaged in no active efforts to conceal any material facts," Appellant's Brief, at 45, this representation is not consistent with the facts in these cases. Quarles's complete failure to comply with the Bankruptcy Codes's disclosure rules was inexcusable under the circumstances. *See Prince*, 40 F.3d at 361 ("[w]hether [counsel] inadvertently or intentionally neglected to inform the court of its conflicts is of no import"). The Bankruptcy Court thus properly observed that it had the discretion to disqualify Quarles as counsel for the Debtors or to deny its compensation based on its inadequate disclosure alone, but that the Court need not make that determination because the Court also found that Quarles was not disinterested. BR 889, at 10.

Significantly, the Bankruptcy Court had discretion to order disgorgement even if Quarles's omissions are viewed as inadvertent rather than intentional. *See Kisseberth*, 273 F.3d at 721 (firm required to disgorge for negligent failures to disclose potential conflicts at employment application stage). Either way, the Bankruptcy Court's disgorgement order here is fully sustainable based solely on Quarles's failure to disclose, even assuming Quarles did not lack disinterestedness or hold an adverse interest under section 327(a).

B. Lack of Disinterestedness Is Grounds for Disqualification and Denial of Compensation Based on Either Potential or Actual Conflicts of Interest.

This Court, in *Prince*, held that the bankruptcy court abused its discretion in awarding compensation to the debtor's counsel, where, as in the instant cases, counsel was not disinterested and had failed to disclose its connections with the debtor and other parties in interest. 40 F.3d at 361. This Court properly noted that section 328(c) is permissive; it permits a court to deny compensation to professionals found not to be disinterested persons but does not require a denial of fees in those instances. *Id.* at 359. This Court further noted that denial of fees is proper when actual injury to the debtor's estate occurs. *Id.* at 360. In this regard, this Court stated:

> ... "[I]n exercising the discretion granted by statute we think the [bankruptcy] court should lean strongly toward denial of fees, and if the past benefit to the wrongdoer fiduciary can be quantified, to require

> disgorgement of compensation previously paid that fiduciary even before the conflict arose."

Id. at 360 (quoting *Gray v. English*, 30 F.3d 1319, 1324 (10th Cir. 1994)). The Bankruptcy Court properly followed this legal standard in denying all Quarles's compensation, where actual injury to the Debtors' estates occured as a result of its simultaneous representation of the Debtors in these cases. Here, like in *Prince*, the Debtors' counsel had "too many masters." *Prince*, 40 F.3d at 361. As noted above, however, the Bankruptcy Court also had the discretion to deny Quarles's compensation and require disgorgement of its retainer due to its failure to comply with the disclosure requirements of section 327 and Rule 2014(a), even if negligent or inadvertent. *See Park-Helena*, 63 F.3d at 882; *Jore*, 298 B.R. at 729; *see also Kisseberth*, 273 F.3d at 721 (affirming denial of compensation for failure to disclose payments under Rule 2016(b)).

As set forth above, Quarles misreads *Prince*, where this Court denied compensation to the debtor's counsel based on a lack of disinterestedness, not the existence of an actual conflict. *Supra*, at 28-29, 33. Fully consistent with this Court's holding in *Prince*, the Third Circuit has held that notwithstanding the language of section 327(c), which, together with section 327(a), imposes a *per se* disqualification of any attorney or other professional person who has an actual conflict of interest because of such person's employment by or representation of a creditor, a bankruptcy court may within its discretion, pursuant to section 327(a) and consistent with section 327(c), disqualify an attorney who has a potential conflict of interest. *See In re Pillowtex, Inc.*, 304 F.3d 246, 251 (3rd Cir. 2002); *In re Marvel Entertainment Group, Inc.*, 140 F.3d 463, 476 (3rd Cir. 1998); *In re BH & P, Inc.*, 949 F.2d 1300, 1315-1317 (3rd Cir. 1991). "Denomination of a conflict as 'potential' or 'actual' and the decision concerning whether to disqualify a professional in situations not yet rising to the level of an actual conflict are matters committed to the bankruptcy court's sound exercise of discretion." *Id.* at 1316-1317; *see also In re Martin*, 817 F.2d 175, 182 (1st Cir. 1989) ("[t]he naked existence of a potential for conflict of interest does not render the appointment of counsel nugatory, but makes it voidable as the facts may warrant").

To support its position that disqualification or denial of compensation requires an actual conflict, Quarles cites to lower court cases where the courts exercised their discretion to permit a single law firm to represent multiple related debtors. Appellant's Brief, at 35-39. That there is no *per se* rule prohibiting such representation is not in dispute. Sections 327(a) and 328(c) vest bankruptcy courts with the discretion to disqualify or deny compensation to counsel where, as here, the court determines in the exercise of its discretion that a law firm potentially cannot provide impartial advice to the related debtors. Courts have generally declined to formulate bright-line rules concerning the criteria for disqualification and have determined the propriety of employment for multiple related debtors on a case-by-case basis, taking all circumstances into account. *BH & P, Inc.*, 949 F.2d at 1315. Factors that a court must consider include, but are not limited to, the nature of disclosure of the conflict made at the time of appointment, whether the interests of the related estates are parallel or conflicting, and the nature of the inter-debtor claims made. *Id.* at 1316.

Thus, in a number of multiple-debtor cases, as here, after considering all of these factors, the courts have held that the inability of the professional to fulfill its role as an independent fiduciary on behalf of the estates warranted disqualification. *See, e.g., Interwest*, 23 F.3d at 316 (separate counsel required when intercompany debts placed each estate in creditor-debtor relationship with another); *BH & P, Inc.*, 949 F.2d at 1317-1318 (court properly exercised discretion in disqualifying counsel for multiple related bankruptcy estates for corporation and its two principals, where estates had claims against one another and counsel had negligently failed to disclose potential conflicts); *In re Coal River Resources, Inc.*, 321 B.R. 184, 189 (W.D. Va. 2005) (court disqualified counsel from representing two of four related debtors at outset of case, where some debtors had intercompany debt against another); *In re C & C Demo, Inc.*, 273 B.R. 502, 508 (Bankr. E.D. Tex. 2001) (court disqualified counsel for corporate chapter 11 debtor from representing corporation based on counsel's failure to disclose simultaneous representation of debtor's shareholders in their individual chapter 13 cases); *In re Lee,* 94 B.R. 172, 180 (Bankr. C.D. Cal. 1988) (counsel for two related debtors could not represent both estates where debt existed between estates and counsel failed to disclose potential conflicts).

Quarles's contention that the Bankruptcy Court could not disqualify Quarles in the absence of an actual conflict of interest is an improper attempt to deny bankruptcy courts the discretion that the Bankruptcy Code and the courts of appeal give them to disqualify counsel from employment in potential conflict cases. The Bankruptcy Court properly exercised its discretion to disqualify Quarles based on both its lack of disinterestedness and its failure to properly disclose its connections with the Debtors. BR 889, at 13; DR 48, at 23.

C. By Failing to Disclose its Connections with the Debtors, Quarles Risked Disqualification and Denial of All of its Compensation at Any Time During the Bankruptcy Proceedings.

Quarles suggests that the Bankruptcy Court's ruling is unfair because it came after Quarles incurred substantial fees in performing services which arguably benefited the estate. Appellant's Brief, at 34 n.13.[19] This problem, however, was one

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[19] Here, Quarles asserts, in part, that a motion to disqualify counsel or deny fees for a failure to comply with section 327(a) can be estopped due to delay by the movant or the court. The cases that Quarles cites in support of this contention, however, are inapposite and/or distinguishable. *See, e.g., Halperin v. Kissinger,* 542 F.Supp. 829, 832 (D. D.C. 1982) (motion to disqualify counsel in non-bankruptcy

of Quarles's own making. Had Quarles properly disclosed its connections and potential or actual conflicts in the Application and Affidavit or in an amendment to the Affidavit, or otherwise requested the Bankruptcy Court to rule on the propriety of its continued employment by the Debtors in the initial stages of the bankruptcy proceedings, as Quarles was required to do under section 327 and Rule 2014(a), the Bankruptcy Court could have ruled on this issue prior to the incurrence of substantial fees, thus mitigating any loss to Quarles. *See Rome v. Braunstein,* 19 F.3d 54, 59 (1st Cir. 1994) ("as soon as counsel acquires even constructive knowledge reasonably suggesting an actual or **potential** conflict, ... a bankruptcy court ruling should be obtained" (emphasis added)).

As early as June and October 2003, Maxfield's counsel gave fair warning to Quarles of Maxfield's possible intent to move for disqualification of Quarles if it failed to mitigate any further harm to the Debtors' estates by making full disclosure or voluntarily withdrawing from representation of one or more of the Debtors. BR 912 (Exhibits A and B). Quarles continued to incur fees, however, in connection with its representation of all the Debtors and made no effort whatsoever to bring these

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litigation; section 327 inapplicable); *In re Kliegl Bros. Universal Elec. Stage Lighting Co.*, 189 B.R. 874, 875, 877 (Bankr. E.D. N.Y. 1995) (conflict and disclosure issues were raised for first time more than five years after employment of counsel in objection to final fee application; no motion to disqualify counsel had been filed).

issues to the Bankruptcy Court's attention or otherwise to minimize any possible loss of compensation. It was not the obligation of the Bankruptcy Court to search the record for possible conflicts of interest; that obligation "belongs to the party who seeks employment by the estate." *BH & P, Inc.*, 949 F.2d at 1317. In failing to fulfill that obligation, Quarles took a calculated risk in deciding to proceed forward at that point. The Bankruptcy Court correctly observed that "attorneys who fail to disclose their representation of competing interests bear all of the responsibility and associated risks for making an inadequate Rule 2014 disclosure." BR 889, at 9. "Though [Rule 2014] allows the fox to guard the proverbial hen house, counsel who fail to disclose timely and completely their connections proceed at their own risk because failure to disclose is sufficient grounds to revoke an employment order and deny compensation." *West Delta Oil Co.*, 2005 WL 3220291, at 6 (quoting *Crivello*, 134 F.3d 831, 836); *see also Rome v. Braunstein*, 19 F.3d at 59 ("[a]bsent the spontaneous, timely and complete disclosure required by § 327(a) and Fed. R. Bankr. P. 2014(a), court-appointed counsel proceed at their own risk").

While a bankruptcy court has the discretion to determine what fees, if any, it should allow, it also has the discretion to deny all fees for a disclosure violation without inquiring as to the appropriate amount of the fee. *Lewis*, 113 F.3d at 1046. Disclosure violations are sanctionable, "regardless of any actual harm to the estate."

Park-Helena, 63 F.3d at 881. Nonetheless, here, the Court properly exercised its discretion to deny all fees, where it found actual injury to the estate. *See Prince*, 40 F.3d at 360; *cf. Woods v. City Nat'l Bank & Trust Co. of Chicago*, 312 U.S. 262, 268, 61 S.Ct. 493, 497, 85 L.Ed. 820 (1941) (Supreme Court reversed award of compensation to counsel for bondholders' committee, which also represented indenture trustee and other parties with interests in conflict with those of committee, holding that compensation should be denied where "claimant was serving more than one master or was subject to conflicting interests"). The record below reflects actual injury to the Jennings bankruptcy estate as a direct result of Quarles & Brady's failure to protect Jennings's security interest in the assets of the Distributor. The Distributor has depleted those assets, both the Manufacturer and Distributor have since shut their doors and ceased operating, and reorganization of the Debtors is no longer possible.[20]

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[20] Quarles's brief neglected to apprise this Court that the Bankruptcy Court converted Jennings's chapter 11 case to a chapter 7 liquidation case on June 7, 2005, SRE 1268, or that the Bankruptcy Court entered an order on March 24, 2005, authorizing Maxfield to pursue malpractice claims against Quarles on behalf of Jennings's bankruptcy estate. SRE 1145. That litigation is currently pending in the District Court under Case No. 3:05-cv-00518-HLA-HTS. Despite Quarles's representation that it "achieved successful results" for the Debtors, Appellant's Brief, at 19-21, the Bankruptcy Court made no findings to support this contention. Although the Bankruptcy Court properly exercised its discretion to sanction Quarles without inquiring as to the appropriate amount of the fee, *see Lewis*, 113 F.3d at 1046, if this Court determines that findings regarding the value or benefit of Quarles's services are necessary or appropriate, this Court may remand this matter to the Bankruptcy Court with instructions to enter findings on this issue.

In these cases, the Bankruptcy Court did not abuse its discretion in disqualifying Quarles as counsel for the Debtors, denying all of its compensation, and requiring disgorgement of its retainer, based on Quarles's failure to disclose its connections with the Debtors and its lack of disinterestedness.

IV. The Bankruptcy Court Properly Exercised its Discretion in Denying Quarles's Post-trial Motions.

The Bankruptcy Court properly exercised its discretion in denying Quarles's Post-trial Motions. Quarles filed the Post-trial Motions pursuant to Rules 9023, 9024, and 7062, Fed. R. Bankr. P., which incorporate by reference the provisions of Rules 59, 60, and 62, Fed. R. Civ. P., respectively. BR 895-897.

The grounds for both motions for a new trial under Rule 59(a) and motions to alter or amend a judgment under Rule 59(e) are the same. Both motions require a showing of: (1) manifest error of fact; (2) manifest error of law; or (3) newly discovered evidence. *See In re Investors Florida Aggressive Growth Fund, Ltd.*, 168 B.R. 760, 768 (Bankr. N.D. Fla. 1994) (motion for reconsideration denied); *In re Tiffany Square Associates, Ltd.*, 104 B.R. 438, 442 (Bankr. M.D. Fla. 1989) (motion for rehearing denied); *see also In re Kellogg*, 197 F.3d 1116, 1120 (11th Cir. 1999) (party "may not use a Rule 59(e) motion to raise arguments available but not advanced at the [prior] hearing").

Courts may grant a motion for relief from a judgment under Rule 60(b) for the following reasons: (1) mistake, inadvertence, surprise, or excusable neglect; (2) newly discovered evidence; (3) fraud; (4) the judgment is void; (5) the judgment has been satisfied, released, or discharged; or (6) any other reason justifying relief from the operation of the judgment. Fed. R. Civ. P. 60(b).

Pursuant to Rule 62(b), a court may stay the execution of a judgment pending the disposition of a motion for a new trial or to alter or amend a judgment made pursuant to Rule 59, or a motion for relief from a judgment or order made pursuant to Rule 60, "[i]n its discretion and on such conditions for the security of the adverse party as are proper." Fed. R. Civ. P. 62(b).

Quarles's Post-trial Motions merely reiterated the same arguments set forth in their responses in opposition to the Disqualification Motion, citing no new legal authority or newly discovered evidence. BR 898.

The Bankruptcy Court promptly afforded any interested parties an opportunity to respond to the Post-trial Motions. BR 901. The Bankruptcy Court considered Quarles's Post-trial Motions and supporting memorandum, as well as the responses submitted by Maxfield and the United States Trustee. BR 921. The Bankruptcy Court did not abuse its discretion in denying the Post-trial Motions under Rules 9023 and 9024, where Quarles failed to show a manifest error of law or fact, to cite to any new legal authority or newly discovered evidence, or to make any showing required under Rule 60(b). DR 48, at 29-30. In addition, because the Bankruptcy Court promptly denied those motions, it properly denied as moot Quarles's motion for a stay pending resolution of the Post-trial Motions under Rule 62(b). BR 921.

CONCLUSION

For these reasons, the United States Trustee respectfully asks this Court to affirm the orders entered below.

DATED: January __, 2006.

Respectfully submitted,

FELICIA S. TURNER
United States Trustee, Region 21

____
Elena L. Escamilla, Trial Attorney
Florida Bar No.: 898414
United States Department of Justice
Office of United States Trustee
135 W. Central Blvd., Suite 620
Orlando, FL 32801
Telephone No.: (407) 648-6465
Facsimile No.: (407) 648-6323

William L. Courshon, Trial Attorney
Florida Bar No.: 270490
United States Department of Justice
Office of the United States Trustee
700 Stewart Street, Suite 5103
Seattle, WA 98101-1271
Telephone No.: (206) 553-2000
Facsimile No.: (206) 553-2566

Attorneys for Appellee,
United States Trustee

CERTIFICATE OF COMPLIANCE WITH RULE 32(a)

I HEREBY CERTIFY as follows:

1. This brief complies with the type-volume limitation of Rule 32(a)(7)(B), Fed. R. App. P., because this brief contains 13,375 words, excluding the parts of the brief exempted by Rule 32(a)(7)(B)(iii).

2. This brief complies with the typeface requirements of Rule 32(a)(5) and the type style requirements of Rule 32(a)(6) because this brief has been prepared in a proportionately spaced typeface using WordPerfect 9 in14-point Times New Roman font.

DATED this ____ day of January, 2006.

____

Elena L. Escamilla, Trial Attorney
Florida Bar No.: 898414
United States Department of Justice
Office of United States Trustee
135 W. Central Blvd., Suite 620
Orlando, FL 32801
Telephone No.: (407) 648-6465
Facsimile No.: (407) 648-6323

Attorney for Appellee,
United States Trustee

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on January __, 2006, copies of the foregoing Brief for Appellee, United States Trustee, were served by mail on Ned R. Nashban, Esq., Quarles & Brady, LLP, One Lincoln Place, 1900 Glades Road, Suite 355, Boca Raton, FL 33431; Benjamin R. Norris, Esq., Quarles & Brady Streich Lang LLP, Two North Central Avenue, Phoenix, AZ 85004-2391; and Richard R. Thames, Esq., Stutsman & Thames, P.A., 121 Forsyth Street, Suite 600, Jacksonville, FL 32202.

I FURTHER CERTIFY that on January __, 2006, an original and six (6) copies of the foregoing Brief for Appellee, United States Trustee, were hand-delivered to the Office of the Clerk, United States Court of Appeals for the Eleventh Circuit, 56 Forsyth Street, N.W., Atlanta, GA 30303-2289.

DATED: January __, 2006.___________________________________

____

Elena L. Escamilla, Trial Attorney
Florida Bar No.: 898414
United States Department of Justice
Office of United States Trustee
135 W. Central Blvd., Suite 620
Orlando, FL 32801
Telephone No.: (407) 648-6465
Facsimile No.: (407) 648-6323

Attorney for Appellee,
United States Trustee

BRIEF BANK — "SUMMARY SHEET" *Printed Thu-3/17/11 15:55*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*
Jim Slemons Hawaii, Inc., Anthony P. Loccrichio v. Office of the United States Trustee, Continental Investment Company, LTD

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*
B.A.P. 9th Cir.

3. ("CCN") ***CURRENT*** CASE NO.
No.: 10-1284

4. ("PCN") ***PRIOR*** CASE NO. - & COURT *[IF ANY]*
No.: 09-01802
Court: Bankr. Hi.
(Identify judge & cite, if any)

5. ("SO") ***SOURCE***
U.S. TRUSTEES

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*
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Terri H. Didion, Catherine B. Sevcenko, P. Matthew Sutko, Ramona D. Elliott, Curtis Ching, Tiffany L. Carroll
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***
• 1) Whether the BAP has jurisdiction given the appellant's untimely notice of appeal. 2) Whether the bankruptcy court abused its discretion in awarding debtor's counsel no fees under 11 U.S.C. § 330 where counsel failed to prove that his services were reasonable and necessary, and the bankruptcy court found counsel's services harmed the estate and the debtor.

10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)

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YES NO ***DATE:***

TIFFANY L. CARROLL, Acting United States Trustee
CURTIS CHING, Assistant United States Trustee (HSB 3931)
TERRI H. DIDION, Trial Attorney (CSB 133491)
United States Department of Justice
Office of the United States Trustee
1132 Bishop Street, Suite 602
Honolulu, Hawaii 96813
Telephone: (808) 522-8150

RAMONA D. ELLIOT, General Counsel
P. MATTHEW SUTKO, Associate General Counsel
CATHERINE B. SEVCENKO, Trial Attorney
United States Department of Justice
Executive Office for United States Trustee
20 Massachusetts Ave., N.W.
Washington, DC 20530

Attorneys for Appellee, United States Trustee for Region 15

UNITED STATES BANKRUPTCY APPELLATE PANEL
OF THE NINTH CIRCUIT

In re)
)
JIM SLEMONS HAWAII, INC.,)
Debtor.)
_______________________________)
JIM SLEMONS HAWAII INC.,)
ANTHONY P. LOCRICCHIO)
)
Appellants,)
)
v.)
)
OFFICE OF THE UNITED STATES)
TRUSTEE, CONTINENTAL)
INVESTMENT COMPANY, LTD,)

BAP NO. HI-10-1284

(Bankruptcy Case No. 09-01802)
Chapter 11
Bankruptcy Judge: Robert J. Faris

APPELLEE BRIEF OF UNITED
STATES TRUSTEE

)
Appellees.)
_________________________________)

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I.

STATEMENT OF BASIS OF APPELLATE JURISDICTION[1]

This Court has jurisdiction to hear appeals "from final judgments, orders, and decrees." 28 U.S.C. §§ 158(a)(1);158(b)(1). The bankruptcy court's order granting the United States Trustee's motion to dismiss Jim Slemons Hawaii Inc.'s ("JSH") chapter 11 bankruptcy case under 11 U.S.C. §1112(b) was a final order. *Zolg v. Kelly (In re Kelly)*, 841 F.2d 908, 911 (9th Cir.1988). The order was entered on July 13, 2010 and timely appealed on July 27, 2010. 28 U.S.C. §158(c)(2); Fed. R. App. P. 8002(a).

The United States Trustee respectfully maintains its position that this court does not have jurisdiction under 28 U.S.C. §158(c)(2) over the appeal of the bankruptcy court's order denying attorney fees to Mr. Anthony Loccrichio, counsel in the bankruptcy case, because the appeal was not timely. *See* United States Trustee Motion to Dismiss filed on August 26, 2010. [Doc. 009155961]. The bankruptcy court entered an order denying Mr. Loccrichio's application for professional compensation on June 29, 2010. This was a final order. *In re*

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[1] The United States Trustee incorporates her arguments concerning lack of jurisdiction made in her motion to dismiss, filed with this Court on August 26, 2010. [009155961]. In the event that this Court continues to disagree with the United States Trustee's jurisdictional analysis, this brief explains the grounds upon which this Court should affirm the bankruptcy court.

Yermakov, 718 F.2d 1465, 1469 (9th Cir. 1983) (holding the bankruptcy court's determination regarding an attorney's application for compensation to be a final order). It was entered on June 29, 2010, giving Mr. Locricchio 14 days to file a notice of appeal. 28 U.S.C. §158(c)(2); Fed. R. App. P. 8002(a). This requirement is jurisdictional. *Bowles v. Russell*, 551 U.S. 205, 206, 213 (2007) (stating that if Congress establishes a time-limit for noticing an appeal, it is jurisdictional); *Anderson v. Mouradick (In re Mouradick)*, 13 F.3d 326, 327 (9th Cir. 1994). The 14-day appeal clock expired on July 13, 2010. Mr. Locricchio's July 27 notice of appeal was therefore untimely to perfect an appeal from the June 29 order denying his application for professional compensation.

This Court denied the United States Trustee's motion to dismiss on the grounds that an interim fee order is not final and thus can always be reviewed. Doc. 9160870 (filed Oct. 25, 2010) (relying on *Leitchy v. Neary (In re Strand)*, 375 F.3d 854, 858 (9th Cir. 2004)). *Leitchy* is, however, distinguishable. The *Leitchy* court approved an initial fee application, giving the attorney $22,012.50 but only authorizing payment of $16,510. *Id.* at 857. The attorney then filed a second, final fee request. The Ninth Circuit held it was proper for the bankruptcy court to adjust its first award when determining the final compensation amount. *Id.* at 858.

Here, there was no interim fee award. The bankruptcy court considered, and denied, a single fee application at the end of the case. *See In re Mouradick*, 13 F.3d at 327 (stating that appeal window for appeal of administrative matters is “rigid” because of the need for efficiency in bankruptcy proceedings) (citation omitted).

II.

STATEMENT OF ISSUES PRESENTED

1. Whether the bankruptcy court abused its discretion when it dismissed Debtor’s chapter 11 bankruptcy case under 11 U.S.C. §1112(b).

2. Whether the bankruptcy court abused its discretion in awarding Debtor’s counsel no fees under 11 U.S.C. §330 where counsel failed to prove that his services were reasonable and necessary, and the bankruptcy court found counsel’s services harmed the estate and the Debtor.

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III.

STATEMENT OF THE CASE

There are two separate issues before this Court. The first issue arises from the United States Trustee's motion to dismiss Debtor's chapter 11 case which was filed on April 26, 2010. The second issue concerns the fee application of Debtor's counsel, Anthony P. Locricchio, for $39,647.40 and expenses of $205. The bankruptcy court granted the motion to dismiss because the estate had been substantially diminished as a result of Mr. Locricchio's failure to assume a non-residential real property lease under 11 U.S.C. §365(d)(4), removing the possibility of a successful reorganization. In its decision, the bankruptcy court also denied Mr. Locricchio's request for fees and expenses because of his incompetence in not assuming the lease, which led to the estate losing its most valuable asset.

IV.

FACTS

A. Motion to Dismiss

Jim Slemons Hawaii, Inc. ("JSH") filed a voluntary petition for relief under chapter 11 of the Bankruptcy Code on August 10, 2009 to prevent it from being evicted from a commercial property located at 98-085 Kamehameha Highway, Aiea, Hawaii.[2] (A.E.R., A, p.4.) JSH had not paid rent to the owner of the property, Continental Investment Company, Ltd., since March 2009. (A.E.R., A, p.4; II L, p. 143; pp.225-226.)

At the time of the bankruptcy, JSH still had nine years remaining on the lease with monthly rent of $58,000 plus real property taxes of approximately $4,000. (A.E.R., A, p.4.) JSH subleased the property to five entities, collecting an aggregate monthly rent of $59,250.00. (A.E.R., A, pp.4-5.) Two of those companies stopped paying rent, creating a cash-flow problem for JSH, and generating a series of legal claims and counter-claims. (A.E.R., K, pp. 125-127.)

At the time of filing, however, the City of Honolulu appeared to be in the process of exercising its right of eminent domain to take over part of the Aiea property for a new fixed rail system. *Id.* at 10. Mr. Slemons testified at a November meeting of creditors that the condemnation claim arising out of the rapid transit project would affect approximately 200 feet of the front portion of JSH's leasehold but that no condemnation proceeding had yet been commenced by the City of Honolulu. (A.E.R., A, p.5.) Nevertheless, JSH assumed that part of its

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[2] "E.R." refers to Appellant's Appendix for Opening Brief' and is followed by a reference to a numbered exhibit and then, as appropriate, by page number(s) therein. "A.E.R." refers to "Appellee's Appendix of Exhibits' and is likewise followed by a reference to a lettered exhibit and then, as appropriate, by page number(s) therein.

leasehold had increased earning potential as a rail parking area, which alone could potentially generate income of $50,000 per month. (A.E.R., K, p.130.) JSH had already explored with various parking companies sub-leasing the land it would control for the remaining nine years on the lease. *Id.*

On October 2, 2009, Mr. Loccrichio filed JSH's first monthly operating report ("MOR") for the period August 10-31, 2009 with the bankruptcy court. (A.E.R., A, p. 5; II O, pp. 237-252.) It indicated that JSH's plan of reorganization was premised on being able to 1) receive compensation from the City of Honolulu for the "fair market value of portion of leased land" and 2) "sublease of non-condemed [sic] land." as parking for rail commuters. (A.E.R., A, pp. 5-6; II O p. 250.)

Continental, the owner of the property leased by JSH, filed a motion on December 23, 2009 requesting that the bankruptcy court verify that JSH's lease had terminated because JSH had not timely assumed the lease, or asked for an extension, during the 120 days following the filing of its petition, as required by 11 U.S.C. § 365(d)(4). Continental asked the Court to order JSH to to surrender the premises and grant related relief. (A.E.R., II L, pp. 140-226). The bankruptcy court granted Continental's motion on the grounds that JSH's opportunity to assume or reject the lease under 11 U.S.C. §365(d)(4) expired on December 9, 2009, and JSH had neither filed a motion to assume the lease or requested an extension of time to do so. (E.R., 8, pp. 41-47.) The subsequent judgment was entered on March 3, 2010. JSH did not file an appeal. (A.E.R., B, pp. 39-41.)

Instead of appealing the judgment terminating the lease, Mr. Loccrichio filed a Motion to Recuse the bankruptcy judge from hearing any further matters pertaining to the case. (A.E.R., C, pp. 43-69.) The recusal motion hearing was held on April 26, 2010, and the denial order was entered on May 5, 2010. (A.E.R., D, pp. 71-85.)

On April 26, 2010, the United States Trustee filed a Motion to Dismiss the bankruptcy case under 11 U.S.C. §1112(b) because JSH had lost its primary asset – its leasehold on the Aiea property – and thus would not be able to propose a plan of reorganization based on income from commuter parking or possible condemnation compensation. (A.E.R., A, pp. 9-12.) In addition, JSH had not complied with the reporting and administrative requirements for a chapter 11 debtor-in-possession. (A.E.R., A, p. 6; 9; 16). Continental supported the United States Trustee's motion to dismiss. (A.E.R., E, pp. 87-95.) JSH responded that it "took no position" and "does not intend to oppose Trustee's form of the Motion to Dismiss." (A.E.R., F, pp. 97,100.) Instead, the response made arguments related to preserving JSH's appeal rights. (A.E.R., F, pp. 100-101.)

After a hearing, the bankruptcy court granted the United States Trustee's motion to dismiss, finding that because the Aiea lease had been "deemed rejected, the estate had been substantially diminished and there is no longer any prospect for a successful reorganization." (A.E.R., G, p. 104.) The order of dismissal was entered on July 13, 2010. (A.E.R., J, pp.118-119.) JSH filed a notice of appeal of the dismissal order on July 27, 2010.

B. Attorney Fees

JSH's counsel in this matter, Mr. Anthony Loccrichio, filed an application for employment on September 28, 2009 under 11 U.S.C. § 327. The United States Trustee objected to Mr. Loccrichio's appointment on numerous grounds. (A.E.R., II M, pp. 228-232.) First, Mr. Loccrichio did not file a compensation disclosure form with his application, which the staff of the United States Trustee later had to give to him. (A.E.R., K, pp. 122; 124-125; 133-134; II M, pp. 229-230; and II N, pp. 234-235.) Second, at the time of his application, Mr. Loccrichio had not filed a statement of financial affairs for JSH. (A.E.R., K, p. 134; II M, p. 231.) The United States Trustee also alleged that Mr. Loccrichio had 1) not opened a DIP account; 2) not applied for a Federal Tax identification number; and 3) not acquired a General Excise Tax license. (A.E.R., II M, p. 231.) Mr. Loccrichio did not deny any of these allegation in his response. (A.E.R., II P, p.254-278.)

The bankruptcy court, however, authorized employment on January 12, 2010. (A.E.R., II Q, p. 281-282.) Nevertheless at the hearing, the judge cautioned Mr. Loccrichio that representing a debtor-in-possession is "a specialized area of law practice . . . that's hard to do right." (A.E.R., K, p. 123.) The court advised him to "think about associating with somebody who does have more of the relevant experience." *Id.*

As explained above, Mr. Loccrichio did not file a motion to assume the lease on the Aiea property by the December 9, 2009, deadline. In addition, Mr. Mr. Loccrichio also failed to appear at a continued 341 meeting on October 22, 2009. (A.E.R., A, p. 5; 15.) He did not file any monthly reports on behalf of JSH after January 2010. (A.E.R., A, p. 5; 16.)

Mr. Loccrichio did, however, file an application for interim fees on February 4, 2010, asking for $ 39,647.40 for his services up to that point. (E.R., 1, pp. 1-8.) His breakdown included 34 hours described as "Meeting with Jim Slemons" and an additional 9.25 hours for "approximately 3 phone calls a week for 21 weeks each one lasting approximately 15 minutes, some more some less." *Id.* at 3-4. He also requested $24,978.20 for 73.9 hours of "[W]ork on documents on behalf of Jim Slemons." *Id.* at 3.

The United States Trustee objected to the fee request because it did not provide adequate information for the United States Trustee to assess Mr. Loccrichio's fee request under 11 U.S.C. § 330. (E.R. 2, pp. 9-11.)

The bankruptcy court denied the fee application "in its entirety." (A.E.R., G, pp. 107-108.) Because Mr. Loccrichio was responsible for filing a timely motion to assume the Aiea lease, the bankruptcy court found that he "missed the deadline and thus failed to fulfill a basic responsibility." (A.E.R., G, p. 107.) The court then found that this failure caused JSH to lose its most valuable assets, so that "it would be an understatement to say that counsel's services were not beneficial to the estate; in fact, counsel's services harmed the estate and the debtor." (A.E.R., G, p. 108.) The court concluded that the "reasonable amount of compensation for counsel's services in this case is zero." *Id.*

The bankruptcy court also found that Mr. Loccrichio's fee application did not comply with Fed. R. Bankr. P. 2016, providing an independent ground for denying fees.[3] *Id.*

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[3] On June 9, 2010, Mr. Loccrichio filed a notice with the bankruptcy court that JSH had terminated his services, effective June 4, 2010. (A.E.R., H, pp. 112-113.)

The order denying fees was entered on June 29, 2010. (A.E.R., I, pp. 115-116.)

Mr. Loccrichio filed a notice of appeal of the denial of fees on July 27, 2010 – 28 days after the bankruptcy court's order had been entered.

V.

STANDARD OF REVIEW: DISMISSAL OF CHAPTER 11 CASE

This Court reviews a bankruptcy court's decision to convert or dismiss a chapter 11 case under 11 U.S.C. §1112(b) for abuse of discretion. *Marsch v. Marsch (In re Marsch),* 36 F.3rd 825,828 (9th Cir. 1994). A bankruptcy court's conclusions of law are reviewed *de novo* and its findings of fact are reviewed for clear error. *Price v. United States Trustee (In re Price),* 353 F.3d 1135, 1138 (9th Cir. 2004).

VI.

THE BANKRUPTCY COURT'S FINDING OF CAUSE TO DISMISS WAS NOT AN ABUSE OF DISCRETION

Section 1112(b)(1) provides that a bankruptcy court "shall" convert or dismiss a case, whichever is in the best interests of creditors and the estate, if "cause" is established. Although Section 1112(b)(4) provides a list of findings that may constitute cause, that list is nonexclusive. See 11 U.S.C. §1112(b)(4) ("[f]or the purposes of this subsection, the term 'cause' ***includes***...") (emphasis added). As a result, Congress granted the bankruptcy courts great discretion to convert or dismiss a chapter 11 case for "cause" under Section 1112(b). *In re Consol. Pioneer Mortgage Entities*, 264 F.3d 803,806 (9th Cir. 2001); *In re Marsch*, 36 F.3d at 828. This Court should only reverse a bankruptcy court's dismissal for cause if it is "based on an erroneous conclusion of law or when the record contains no evidence on which [the bankruptcy court] rationally could have based that decision." *Consol. Pioneer Mortgage Entities*, 264 F.3d at 806-807 (citations omitted).

A. Cause to dismiss Debtor's chapter 11 bankruptcy case existed under 11 U.S.C. §1112(b)(4)(A) where evidence before the bankruptcy court supports a finding of a continuing loss to or diminution of Debtor's estate

Under Section 1112(b)(4)(A), "substantial or continuing loss to or diminution of the estate and the absence of a reasonable likelihood of rehabilitation" constitutes cause to dismiss a chapter 11 case. The bankruptcy court did not clearly err when it found that "because the leases were deemed rejected, the estate has been substantially diminished, and there is no longer any prospect of a successful reorganization." (A.E.R., G, p. 104.) As set forth previously, it is undisputed that the Aiea, Hawaii lease was rejected by operation of law under 11 U.S.C. §364(d)(4). This was the primary asset of Debtor's estate. (A.E.R., A, p. 3; G, p. 103.) The bankruptcy court issued a final order confirming the rejection, and no appeal was taken by Debtor. (A.E.R., B, pp. 39-41; II R, pp. 284-290.) Without the lease, JSH could not generate potential rental income or pursue its alleged condemnation claim against the City of Honolulu.

In response to the United States Trustee's motion to dismiss, JSH filed a pleading which took no position and did not otherwise dispute the merits of the motion. JSH specifically stated in its pleading that it "does not intend to oppose Trustee's form of the Motion to Dismiss, it should be clear that the Motion to Dismiss will be approved." (A.E.R., F, p. 100.) Debtor's only interest was preserving its appeal rights concerning the bankruptcy court's order denying Debtor's motion to recuse Bankruptcy Judge Robert J. Faris entered on May 5, 2010. (A.E.R., F, p. 98.) Because JSH did not raise any objection before the bankruptcy court, it has waived the issue on appeal. *AlohaCare v. State of Hawaii*, 572 F.3d 740, 744 (9th Cir. 2009) citing *In re America West Airlines, Inc.*, 217 F.3d 1161, 1165 (9th Cir. 2000) (Absent exceptional circumstances, we generally will not consider arguments raised for the first time on appeal, although we have discretion to do so). This discretion may be exercised to "(1) prevent a miscarriage of justice; (2) when a change in the law raises a new issue while an appeal is pending; and (3) when the issue is purely one of law." *In re AlohaCare*, 572 F.3d at 744-745. (citations omitted). Since JSH did not oppose or otherwise refute any of the factual allegations raised in the United States Trustee's motion to dismiss, it cannot now raise them before this Court; they have been waived. *In re AlohaCare,* 572 F.3d at 744-745.

Furthermore, Debtor's opening brief does not address the bankruptcy court's finding of cause and whether or not there was an abuse of discretion. Debtor seems to be focused on actions taken by Continental and subsequent rulings by the bankruptcy court after the case was dismissed. No argument has been made concerning this appeal to support reversal of the bankruptcy court's decision to dismiss the Debtor's chapter 11 case. The debtor cannot do so in its reply brief, as the issue is waived. *In re AlohaCare*, 572 F.3d at 744-745.

The United States Trustee has met her burden that Debtor's case should be dismissed. Under Sections 1112(b)(1) and (2), if the movant establishes cause, then the burden shifts to the debtor to prove the existence of "unusual circumstances" such that dismissal would be detrimental to the creditors and the estates. *In re Prods. Int'l Co.*, 395 B.R. 101,109 (Bankr. D. Ariz. 2008) (relying on 7 Collier on Bankruptcy, ¶1112.04[3], p. 1112-26, 1112-27 (15th ed. rev.))

In this case, Debtor is not eligible to attempt to make a Section 1112(b)(1) and (2) showing of unusual circumstances. These Code provisions require that a debtor show that " the grounds for granting such relief [denial of dismissal due to unusual circumstances] include an act or omission of the debtor **other than under paragraph (4)(A).** 11 U.S.C. §1112(b)(2)(B) (emphasis added). The plain language of Section 1112(b) precludes overriding the establishment of cause to dismiss if that cause is diminution of the estate and unlikelihood of rehabilitation–the precise grounds for dismissing this case. Here, the bankruptcy court based its decision to dismiss on Section 1112(b)(4)(A). Therefore, Section 1112(b)(2)(B) prevents Debtor from raising an unusual circumstance defense to block dismissal.

Even if Debtor were eligible to make such an argument, it would fail. Debtor's brief does not address this provision of the statute that explains what a debtor must do to prevent dismissal even after a party in interest has established cause or lack of unusual circumstances. Debtor did not demonstrate that there was a reasonable likelihood that a plan would be confirmed within the time frames established by Sections 1121(e) and 1129(e) of the Code, or if these sections do not apply, a plan would be confirmed within a reasonable period of time. 11 U.S.C. §1112(b)(2)(A).

Second, Debtor did not show that its acts or omissions that caused the grounds for dismissal are justifiable. 11 U.S.C. §1112(b)(2)(B)(i).

Third, Debtor did not prove that it could cure the grounds that would justify dismissal. 11 U.S.C. §1112(b)(2)(B)(ii). Debtor has shown none of the foregoing, and did not oppose the request of the United States Trustee to dismiss the chapter 11 case.

As the bankruptcy court's findings of fact were based on the record, and Debtor did not oppose the relief requested, the bankruptcy court's decision to dismiss the Debtor's case was not an abuse of discretion and should be affirmed.

VII.

STANDARD OF REVIEW: DENIAL OF FEE APPLICATION

The question whether the bankruptcy court had jurisdiction to award no fees to counsel is a question of law that is reviewed *de novo;* any actual findings are reviewed for clear error. *In re Ferrell*, 539 F.3d 1186, 1189 (9th Cir. 2008). This Court reviews the bankruptcy court's determination of the proper amount of attorney's fees for an abuse of discretion. *In re Mednet*, 251 B.R. 103, 106 (9th Cir. B.A.P. 2000). A court abuses its discretion when the record contains no evidence to support its decision. *MGIC Indemnity Corp. v. Moore*, 952 F.2d 1120, 1122 (9th Cir. 1991). Findings are reviewed under the clearly erroneous standard. Fed. R. Bankr. P. 8013.

VIII.

THE BANKRUPTCY COURT DID NOT ABUSE ITS DISCRETION IN DENYING ALL FEES TO COUNSEL BECAUSE IT COULD NOT FIND THAT THERE WAS ANY VALUE TO THE SERVICES WHICH PROVIDED A BENEFIT TO THE ESTATE

The bankruptcy court did not abuse its discretion under 11 U.S.C. §330 when it did not award any fees to counsel in connection with the services he provided to the Debtor during the chapter 11 proceeding. Counsel bears the burden of proof to demonstrate entitlement to the requested fee, including providing documentation of time worked. *Hensley v. Eckerhart*, 461 U.S. 424, 437 (1983). Therefore, a bankruptcy court is required to examine the nature, extent, and value of the services provided. 11 U.S.C. §330(a)(1)(A) and 11 U.S.C. §330(a)(3). Further, a bankruptcy court is prohibited from compensating an attorney for any services that were not reasonably likely to benefit the estate or were unnecessary for the administration of the case. 11 U.S.C. §330(a)(4)(A)(ii). In reviewing compensation requests, the bankruptcy court reviews what services the professional provided, and decides, in retrospect, after considering all of the salient factors, whether the fees requested are reasonable. *In re Garcia*, 335 B.R. 717, 723-725 (9th Cir. B.A.P. 2005) (the bankruptcy court did not clearly err in finding that counsel's services were not beneficial to the estate).

In this case, the bankruptcy court did not commit clear error in finding that the value of counsel's services did not provided a benefit at the time at which the service was rendered towards the completion of the case. 11 U.S.C. §330(a)(3)(C).

There is no dispute that counsel failed to timely assume the Aiea, Hawaii lease or, at the very least, file a motion to extend the time for doing so. The lease and related sub-leases provided Debtor with its only potential source of monthly revenue. (A.E.R., A, pp. 4-5.) Debtor's leasehold interest also was a potential basis for a claim against the City of Honolulu in connection with its anticipated exercise of eminent domain. (A.E.R., A, p. 3; 5 and K, pp. 130-131.) With the lease rejected under 11 U.S.C. §365(d)(4), JSH lost its income stream and condemnation claim. These facts led the bankruptcy court to conclude, without clear error, that "it would be an understatement to say that counsel's services were not beneficial to the estate; in fact, counsel's services harmed the estate and the debtor." (A.E.R., G, pp. 107-108.) The bankruptcy court did not abuse its discretion in deciding that the "reasonable amount of compensation for counsel's services in this case is zero." (A.E.R., G, p. 108.)

Second, the bankruptcy court found that counsel's billing records were inadequate to allow the bankruptcy court to make the findings necessary to compensate him from the bankruptcy estate pursuant to Fed. R. Bankr. P. 2016 and LBR 2016-1. The United State Trustee objected on these same grounds and requested that counsel amend his application to comport with the requirements of the Bankruptcy Code and Rules. Despite the fact that nearly three months lapsed between the time of the United States Trustee's objection and the hearing on the fee application, counsel failed to amend or request additional time to submit an amended fee application. Instead, counsel did nothing.

Mr. Loccrichio's opening brief describes the events at the May 24, 2010 hearing as an "ambush" and seeks permission from this Court to amend his fee application. Br. at 17. This characterization is simply not supported by the record because (1) the Tentative Decision on Motions Set for May 24, 2010 ("Tentative Decision") made it clear that the bankruptcy court's inclination to deny the fee application as moot due to granting the United States Trustee's motion to dismiss was subject to further oral argument (E.R., 9, pp. 48-49); (2) prior to the May 24, 2010 hearing, Continental filed and served on Mr. Loccrichio a response to the Tentative Decision which requested that the pending fee application be adjudicated (E.R., 10, pp. 53, 55, and 56.); (3) at the May 24, 2010 hearing, Mr. Loccichio made oral argument to the bankruptcy court as to why his fee application should not be adjudicated (A.E.R., II S, pp. 302-303.); (4) the bankruptcy court at the

May 24, 2010 hearing allowed Mr. Locricchio the opportunity to file a supplemental statement regarding the adjudication of his fee application (A.E.R., II S, p. 303.) and (5) Mr. Loccrichio filed on May 25, 2010 an opposition to the bankruptcy court's Tentative Decision (A.E.R., II T, pp. 307-316.). In addition, the bankruptcy court found that counsel's failure to comply with Fed. R. Bankr. P. 2016 and LBR 2016-1 was an independent ground to deny the application. The bankruptcy court did not abuse its discretion in denying counsel's fees for that reason.

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IX.

CONCLUSION

For the foregoing reasons, the United States Trustee respectfully requests that the appeal of the June 29, 2010 order denying application for professional compensation be AFFIRMED; and that the appeal of the July 13, 2010 order dismissing case also be AFFIRMED.

Dated: Honolulu, Hawaii January 31, 2011

Respectfully submitted,

By: /s/ TERRI H. DIDION
TIFFANY L. CARROLL
Acting United States Trustee
TERRI H. DIDION
Trial Attorney for United States Trustee

RAMONA D. ELLIOT
General Counsel
P. MATTHEW SUTKO
Associate General Counsel
CATHERINE B. SEVCENKO
Trial Attorney
Executive Office for United States Trustees
Department of Justice

CERTIFICATION OF COMPLIANCE

I certify that, pursuant to BAP Rule 8010(a)-1, Federal Rule of Appellate Procedure 32(a)(7)(C) and Ninth Circuit Rule 32-1, the attached Appellee's Responsive Brief is proportionately spaced, has a typeface of 14 points or more, and contains 4764 words (as calculated by the word processor).

Dated: Honolulu, Hawaii January 31, 2011

Respectfully submitted,

/s/ TERRI H. DIDION
TERRI H. DIDION
Trial Attorney for United States Trustee

CERTIFICATION OF RELATED CASES

The undersigned certifies that, pursuant to BAP Rule 8010(a)-1(c), that the following are known related cases and appeals:

1. Jim Slemons Hawaii, Inc. v. Continental Investment Company, Ltd.
   BAP No. HI 10-1403
   Status : Pending

2. Jim Slemons Hawaii, Inc. v. Continental Investment Company, Ltd.
   BAP No. HI 10-1404
   Status : Pending

3. Jim Slemons Hawaii, Inc. v. Continental Investment Company, Ltd.
   BAP No. HI 10-1405
   Status : Pending

4. Jim Slemons Hawaii, Inc. v. Continental Investment Company, Ltd.
   BAP No. HI 10-1469
   Status : Pending

5. Jim Slemons Hawaii, Inc. v. Continental Investment Company, Ltd.
   BAP No. HI 10-1470
   Status : Pending

Dated: Honolulu, Hawaii January 31, 2011

Respectfully submitted,

/s/ TERRI H. DIDION
TERRI H. DIDION
Trial Attorney for United States Trustee

CERTIFICATE OF SERVICE

I hereby certify that on January 31, 2011, I electronically filed the foregoing **Appellee Brief of United States Trustee** with the Clerk of the Court for the Bankruptcy Appellate Panel for the Ninth Circuit by using the CM/ECF system.

I certify that parties of record to this appeal who are either registered CM/ECF users, or who have registered for electronic notice, or who have consented in writing to electronic service will be served through the CM/ECF system. I further certify that **Excerpts of Record of Appellee, Volume I and II, United States Trustee** were served by First-Class Mail, postage pre-paid. Electronic service and service by mail have been made on the following parties:

Attorney for Appellee Continental Investment Co.
Jerry K. Guben, Esq.
JKG@OPGLAW.com
O'Connor, Playdon & Guben
Makai Tower, 24th Floor
733 Bishop Street
Honolulu, Hawaii 96813

Special Attorney for Jim Slemons Hawaii, Inc.
Attorney for Appellant Anthony P. Locricchio
Anthony P. Locricchio, Esq.
Tony96734@yahoo.com
903 Maunawili Circle
Kailua, Hawaii 96734

/s/ TERRI H. DIDION
TERRI H. DIDION
Trial Attorney for United States Trustee

BRIEF BANK — “SUMMARY SHEET” *Printed Wed-5/20/09 16:13*

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In re Richard and Linda Johnson (Marshall v. Richard and Linda Johnson)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*
7th Cir.

3. ("CCN") ***CURRENT*** CASE NO.
No.: 09-cv-1212

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*
No.: 08-B-12062

Court: Bankr. N.D. Ill.
(Identify judge & cite, if any)

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David Gold, P. Matthew Sutko, Ramona Elliott
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s)

&

√ Any Miscellaneous ***BACKGROUND***

• Whether the bankruptcy court correctly defined the word “projected” in section 1325(b)(1) in reaching its conclusion that the debtors’ plan committed all of their “projected disposable income” to making payments under their plan.

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IN THE UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

In re Richard and Linda Johnson,

Debtors.

MARILYN O. MARSHALL,

Trustee-Appellant,

v.

RICHARD AND LINDA JOHNSON,

Debtor-Appellees.

ON DIRECT APPEAL FROM THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE SUPPORTING AFFIRMANCE

RAMONA D. ELLIOTT
General Counsel

P. MATTHEW SUTKO
Associate General Counsel
DAVID I. GOLD
Trial Attorney
Executive Office for United States Trustees
Department of Justice
20 Massachusetts Avenue, N.W.
Washington, D.C. 20530
Ph: (202) 307-1399
Fax: (202) 307-2397

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The United States submits this brief under Fed. R. App. P. 29 as *amicus curiae* in support of affirmance of the bankruptcy court's order below.

INTEREST OF THE UNITED STATES

This appeal involves a dispute over the interpretation of "projected disposable income" under 11 U.S.C. § 1325(b). This term determines when debtors meet their statutory obligation to dedicate their "projected disposable income" to paying creditors through their chapter 13 plans. By interpreting section 1325(b), this Court will determine the amount above-median-income chapter 13 debtors must pay their creditors in their chapter 13 plans. The United States has a direct interest in the proper construction of section 1325(b) because United States Trustees, who are Justice Department officials appointed by the Attorney General, supervise the administration of chapter 13 cases and trustees, monitor chapter 13 plans, and file comments with the court regarding such plans in connection with plan confirmation hearings under section 1324 of the Bankruptcy Code. *See* 28 U.S.C. § 586(a)(3)(C). *See also* H.R. Rep. No. 95-595, at 88 (1977), *as reprinted in* 1978 U.S.C.C.A.N. 5963, 6049 (United States Trustees "serve as bankruptcy watch-dogs to prevent fraud, dishonesty, and overreaching in the bankruptcy arena.").

Given this interest, the United States submits this brief to share its views on the application of section 1325(b). *See* 28 U.S.C. § 517 (authorizing the Department of Justice "to attend to the interests of the United States in a suit pending in a court of the United States"). *See also* 11 U.S.C. § 307 ("The United States trustee may raise and may appear and be heard on any issue in any case or proceeding.").

STATUTORY BACKGROUND

On April 20, 2005, Congress enacted the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005. *See* Pub. L. No. 109-8, 119 Stat. 23 (2005). The 2005 Act significantly altered how debtors obtain relief under chapters 7 and 13 of the Bankruptcy Code.

In a chapter 13 case, a debtor's unsecured creditors or trustee may insist the debtor devote all of his "projected disposable income" to pay creditors. *See* 11 U.S.C. § 1325(b)(1). Although "projected disposable income" is not defined, "disposable income" is defined as a net number: historical income less prescribed expenses. *See* 11 U.S.C. § 1325(b)(2).

Under the 2005 Act, above-median-income debtors, like the Johnsons, determine "disposable income" by first calculating gross historical income.[1] Next, they deduct permitted expenses, which include "amounts reasonably necessary to be expended" for maintenance or support or necessary business expenses. 11 U.S.C. § 1325(b)(2) and (3). Above-median-income chapter 13 debtors determine "amounts reasonably necessary to be expended . . . in accordance with" sections 707(b)(2)(A)(ii), (iii), and (iv) of the Bankruptcy Code. 11 U.S.C. § 1325(b)(3) (incorporating those provisions). Deducting all allowed expenses from a debtor's

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[1] The term "current monthly income," which is used to calculate gross historical income, *see* 11 U.S.C. § 1325(b)(2), is a defined term. *See* 11 U.S.C. § 101(10A)(defining "current monthly income" as the debtor's average monthly income for the six-month period preceding the month of the filing of the debtor's petition). "Current monthly income" has been broadly construed. *See Blausey v. U.S. Trustee*, 552 F.3d 1124 (9th Cir. 2009).

gross historical income yields a net number – “disposable income.” Under current bankruptcy rules, debtors must file Official Form 22C setting forth their gross historical income and expenses in calculating “disposable income.”

Because a debtor must also file the traditional Schedules I and J setting forth their actual income and expenses, it often becomes apparent that there is a significant difference between an above-median debtor's uncommitted income under Schedules I and J and his historical “disposable income” under Form 22C. In some cases, like the Johnsons’, the use of Form 22C captures a temporary increase in a debtor’s “disposable income” that does not continue into the plan period, while in other cases the use of Form 22C results in a lower amount of “disposable income.” In these and other cases, it may become clear that the historical circumstances that produced a particular “disposable income” figure will change prospectively.

The merits of this appeal present the question whether the bankruptcy court correctly defined the word “projected” in section 1325(b)(1) in reaching its conclusion that the Johnsons’ plan committed all of their “projected disposable income” to making payments under their plan.

SUMMARY OF ARGUMENT

The 2005 Act amendments to section 1325 have created important interpretive questions about the proper way to understand “projected disposable income.” As the case law reflects, there are different ways that courts have interpreted and applied that statutory language in light of the amendments. The interpretation offered here by the trustee should be rejected, because it fails to take into account all of the language in the statute and yields inequitable results.

The trustee interprets the term “projected disposable income” to require use of a debtor’s historical “disposable income” figure throughout the chapter 13 plan period, regardless of the debtor’s actual income and expenses during that period. In this case, the Johnsons’ historical “disposable income” was artificially high because their gross historical income included $3,906.75 in monthly workers compensation payments received during the six-month period preceding the filing of their bankruptcy petition, but which ceased before their petition was filed. *See* Trustee’s Designation of Record No. 2 (Original Chapter 13 Statement of Current Monthly Income filed 5/12/08). The trustee’s interpretation does not account for the usual meaning of “projected” income or for the statutory phrases “to be received” and “will be applied to make payments” in section 1325(b)(1)(B). Mechanically extending into the future a gross historical income calculation, which may bear no relationship to actual income that the debtor will receive in the future, would either attribute to the debtor future income that does not exist (as in the case of the Johnsons), or, when the debtor has a financial change for the better after filing the petition, permit the debtor to avoid using income that does exist to repay creditors.

Like the bankruptcy court below, the Eighth and Tenth circuits, as well as most intermediate appellate courts, have rejected the construction of “projected disposable income” that the trustee advances here. And, while the Ninth Circuit’s decision in *Kagenveama* adopts the interpretation urged by the trustee, it should not be followed because it fails to take into account statutory language, and has led to inequitable results.

As the bankruptcy court below concluded, the proper meaning of the statutory phrase "projected disposable income" requires that the historical "disposable income" figure found on Form 22C be subject to adjustment to account for any increases or decreases in a debtor's income that are likely in a particular case. Such adjustments may be necessary in individual cases to ensure that the income attributed to a debtor in his chapter 13 plan is actually income that is "projected" and "to be received" and that "will be applied to make payments" to unsecured creditors. While a simple multiplication of the historical "disposable income" number by the relevant number of months is a presumptive starting point, the proper interpretation allows adjustments to be made in appropriate cases. This interpretation is also consistent with this Court's ruling in *Ross-Tousey*, and with the overall goals of chapter 13.

ARGUMENT

I. The Debtor's Historical "Disposable Income" Is The Starting Point In Determining "Projected Disposable Income" Under Section 1325, But Courts May Take Into Account Changes In The Debtor's Financial Condition If Necessary To Reflect The Debtor's Ability To Fund A Repayment Plan.

The 2005 Act amendments to section 1325 created a significant change in the law. Before these amendments were enacted, section 1325(b)(1) provided that if the trustee or the holder of an allowed unsecured claim objected to the confirmation of a chapter 13 plan, the court was not permitted to approve the plan unless it provided that "all of the debtor's projected disposable income to be received in the three-year period beginning on the date that the first payment is due under the plan will be applied to make payments under the plan." 11 U.S.C. § 1325(b)(1)(B) (pre 2005 Act). The term "disposable income" was defined as income received by the debtor that was "not reasonably necessary to be expended" for "maintenance or support of the debtor or a dependent" or for necessary business expenses if the debtor was engaged in a business. 11 U.S.C. § 1325(b)(2)(A) (pre 2005 Act). Under the former statute, a debtor's "projected disposable income" was calculated simply by subtracting the debtor's expenses on Schedule J from the debtor's income on Schedule I, two forms that a chapter 13 debtor was (and still is) required to file.

In contrast, under the 2005 Act section 1325(b)(1) now provides that:

> If the trustee or the holder of an allowed unsecured claim objects to the confirmation of the plan, then the court may not approve the plan unless, as of the effective date of the plan –
>
> * * *
>
> (B) the plan provides that all of the debtor's projected disposable income to be received in the applicable commitment period beginning on the date that the first payment is due under the plan will be applied to make payments to unsecured creditors under the plan.

11 U.S.C. § 1325(b)(1). Further, "disposable income" is now defined expressly to mean "current monthly income received by the debtor . . . less amounts reasonably necessary to be expended" for maintenance or support or necessary business expenses.[2] 11 U.S.C. § 1325(b)(2).

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[2] As previously noted, "current monthly income" means the debtor's average monthly income for the six-month period preceding the month of the filing of the debtor's petition. *See* 11 U.S.C. § 101(10A).

A. The Courts Have Offered Two Different Interpretations Of Section 1325.

1. The minority position taken in a number of bankruptcy court decisions, and the position advocated by the trustee here, is that section 1325 requires "projected disposable income" to be computed by taking the historical "disposable income" figure, as defined in section 1325(b)(2), and simply multiplying it by the number of months in the debtor's chapter 13 plan.[3] *See* Trustee's Brief, at 7-14. The Ninth Circuit is the only court of appeals to have adopted this interpretation. *See Maney v. Kagenveama (In re Kagenveama)*, 541 F.3d 868 (9th Cir. 2008).

The underlying rationale for this position is that "disposable income" was defined for the first time in the 2005 amendments to the Bankruptcy Code, and is used nowhere other than in the phrase "projected disposable income" in section 1325(b)(1)(B). Thus, the argument goes, "projected disposable income," while still undefined in the Bankruptcy Code, must mean nothing more than historical "disposable income" that is projected out through the plan period (*i.e.,* the sum of a debtor's historical "disposable income" calculation multiplied by the number of months in her plan). *See Kagenveama*, 541 F.3d at 874 ("To get from the statutorily defined 'disposable income' to 'projected disposable income,' 'one simply takes the calculation . . . and does the math.'") (*quoting In re Alexander*, 344 B.R. 742, 749 (Bankr. E.D. N.C. 2006)); *Mancl v. Chatterton (In re Mancl)*, 381 B.R. 537, 540-41 (W.D. Wis. 2008).

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[3] This position has been labeled as the "conclusive approach" by the bankruptcy court below. *See In re Johnson*, 400 B.R. 639, 646 (Bankr. N.D. Ill. 2009).

2. Most courts read “projected disposable income” as allowing courts to reflect reality by using credible evidence of changes in income and expenses that are likely over the life of a debtor’s chapter 13 plan. *See, e.g., Hamilton v. Lanning (In re Lanning)*, 545 F.3d 1269, 1278-82 (10th Cir. 2008), *pet. for cert. filed* No. 08-998 (Feb. 3, 2009); *Coop v. Frederickson (In re Frederickson)*, 545 F.3d 652, 659-60 (8th Cir. 2008), *pet. for cert. denied* No. 08-950 (Mar. 23, 2009); *Hildebrand v. Thomas (In re Thomas)*, 395 B.R. 914, 923 (B.A.P. 6th Cir. 2008); *Hildebrand v. Petro (In re Petro)*, 395 B.R. 369, 377-78 (B.A.P. 6th Cir. 2008); *Pak v. eCast Settlement Corp. (In re Pak)*, 378 B.R. 257, 262 (B.A.P. 9th Cir. 2007), *abrogated by Kagenveama*, 541 F.3d at 868; *Kibbe v. Sumski (In re Kibbe)*, 361 B.R. 302, 314-15 (B.A.P. 1st Cir. 2007) (*per curium*); *In re Johnson*, 400 B.R. at 649-51.

And, while the bankruptcy court below further divided this camp into what it labeled the “presumptive” and “harmonizing” approaches, *see Johnson*, 400 B.R. at 648-49, that is a distinction without a difference. Under the “presumptive” approach, a debtor’s historical “disposable income” figure found on Form 22C is the starting point for calculating “projected disposable income,” and that figure is applied absent a party introducing evidence that changes in that figure are likely to occur over the life of a debtor’s chapter 13 plan. *See, e.g., Lanning*, 545 F.3d at1278-82; *Frederickson*, 545 F.3d at 659-60. Under the “harmonizing” approach advocated by the bankruptcy court below, a debtor’s historical “disposable income” figure found on Form 22C is not entitled to any presumptive weight, but a debtor is required to “supplement” his Form 22C with a “statement of any changes in the ‘current monthly income’ as reported in the form, and any changes in the expenses allowed, anticipated to take place during the applicable commitment period.” *Johnson*, 400 B.R. at 651. Thus, under *both* approaches, the courts allow for the consideration of credible evidence of changed circumstances to the extent such circumstances exist, and the end result is the same.

If anything, the *sole* difference between the “presumptive” approach and the “harmonizing” approach is the fact that the “presumptive” approach affords the historical “disposable income” figure found on Form 22C some presumptive weight unless a party introduces evidence of changes to income or expenses. However, even this difference is not the great divide the bankruptcy court makes it out to be. This is so because notwithstanding that nothing in section 1325(b) expressly creates a presumption of correctness in Form 22C’s historical “disposable income” figure, *see Johnson*, 400 B.R. at 648, the burden of proof on an objection under section 1325(b) remains a shifting one. *See Education Assistance Corp. V. Zellner (In re Zellner)*, 827 F.2d 1222, 1226 (8th Cir. 1987) (party objecting under section 1325(b) has “*initial burden* of producing satisfactory evidence to support the contention that the debtor is not applying all of his disposable income”) (emphasis added); *Itule v. Heath (In re Heath)*, 182 B.R. 557, 560-61 (B.A.P. 9th Cir. 1995) (*citing Zellner* for same); *In re McNichols*, 349 B.R. 160, 168 (Bankr. N.D. Ill. 2000) (describing burden shifting objection process under section 1325(b)); *In re Barnes*, 378 B.R. 774, 777 (Bankr. D.S.C. 2007) (same); *In re Ehret*, 238 B.R. 85, 87 (Bankr. D. N.J. 1999) (same); *In re Fries*, 68 B.R. 676, 685 (Bankr. E.D. Pa. 1986) (same).

While an objecting trustee or unsecured creditor is initially required to produce satisfactory evidence that a debtor is not devoting his "projected disposable income" to his chapter 13 plan, once that burden is met, the burden shifts to the debtor to demonstrate, by a preponderance of the evidence, compliance with section 1325(b). *See McNichols*, 349 B.R. at 168; *Barnes*, 378 B.R. at 777; *Ehret*, 238 B.R. at 87; *Fries*, 68 B.R. at 685. The "presumptive" approach merely articulates this long established practice by first considering a debtor's Form 22C, and then, where appropriate, shifting the burden to allow for the consideration of credible evidence of changed circumstances.[4]

B. Both The Trustee's Approach To Section 1325(b) And The Ninth Circuit's Decision In *Kagenveama* Are Flawed.

The trustee in this case argues "projected" does not allow proof that a debtor's income or expenses have or will change. She contends that section 1325 requires only a "mechanical application" of Form 22C for determining what must be paid to unsecured creditors. Trustee Brief, at 7. She recognizes that the Code fails to define "projected disposable income," Trustee Brief, at 9, but argues that it is no more than a multiple of historical "disposable income." Trustee Brief, at 7-8.

The Ninth Circuit adopted this approach in *Kagenveama*, 541 F.3d at 868, but this mechanical approach to section 1325 is flawed. To begin with, the Ninth Circuit's construction fails to consider the term "projected" in its proper context.

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[4] This Court has previously observed, in the context of post-confirmation plan modification, that "no particularly burdensome proof is required . . . to show 'changed circumstances.'" *In re Witkowski*, 16 F.3d 739, 743 (7th Cir. 1994) (*quoting In re Moseley*, 74 B.R. 791, 799 n.13 (Bankr. C.D. Cal. 1987)).

See Hibbs v. Winn, 542 U.S. 88, 101 (2004) (statutory words must be construed in context). The use of the term "projected" in the economic and financial context of this statute suggests a forecast or estimate of an expected future financial reality. *See The Random House Dict. of the English Lang.* 1546 (2d ed. 1987) (defining to "project" as, *inter alia*, "to set forth or calculate (some future thing); *They projected the building costs for the next five years.*"); *Webster's Third New Int'l Dict.* 1813 (1993) (defining "projected" as, *inter alia*, "planned for future execution: contrived, proposed," as "[projected] outlays for new plant and equipment"). While the calculation of "projected" financial data may well *begin* with historical data, it does not necessarily (or even usually) *end* there, nor does it entail a rigid and inviolable assumption, made by the trustee, that "projected" income will be identical with past income even when the available facts demonstrate otherwise. The trustee's and the Ninth Circuit's test ignores this context of the statutory language.

Even more important, while both the trustee, Trustee Brief, at 7-14, and the Ninth Circuit, *Kagenveama*, 541 F.3d at 873, assert that they are merely applying the plain meaning of section 1325(b)(1)(B), their interpretation fails to take into account other language in the same statutory provision.

First, although section 1325(b)(1)(B) explicitly refers to the income "to be *received* by the debtor" (emphasis added), the Ninth Circuit's test fails to address cases in which the historical income required to be used may have no relationship to the actual income "to be received," something that has led to unjust results within the Ninth Circuit post-*Kagenveama*. For example, in *Featherstone*, the district court affirmed a bankruptcy court's order denying confirmation of the debtors' plan where the debtors sought to exclude income received from a one-time sale of livestock from their "projected disposable income" calculation. *See In re Featherstone*, No. 08-00016, 2008 WL 5217936 (D. Mont. Dec. 11, 2008). Similarly, in *Stansell*, the bankruptcy court required non-recurring income received from the debtor's deceased spouse to be included in the debtor's calculation of "current monthly income" notwithstanding that the deceased spouse's income would not be available during the term of the debtor's plan. *See In re Stansell*, 395 B.R. 457 (Bankr. D. Idaho 2008).

Under the Ninth Circuit's test, the projection (*i.e.*, multiplication) of a debtor's artificially high pre-petition income over the plan period results in fictitious "deemed" income that will never be "received by the debtor" within the meaning of section 1325(b)(1)(B). Neither the trustee in this case, nor the Ninth Circuit in *Kagenveama*, make any effort to address this language in the same statutory provision despite their purported reliance on "plain meaning" and the fact that section 1325(a)(6) of the Bankruptcy Code requires that a court only confirm a repayment plan if "the debtor will be able to make all payments under the plan. . . ." *Cf. Kagenveama*, 541 F.3d at 878 (Bea, J., concurring in part and dissenting in part) (because the statute speaks of income "to be received," "even if a debtor's projected disposable income is zero at the time he seeks plan confirmation, he must commit to pay such disposable income as he receives it – should he receive it – during the applicable commitment period").

Second, the Ninth Circuit's test fails to take into account another statutory phrase in section 1325(b)(1)(B) as well: "will be applied to make payments." For reasons similar to those we discussed in connection with the "to be received" requirement, fictitious income cannot "be applied to make payments." Both the trustee here and the Ninth Circuit base their understanding of "projected disposable income" strictly on the historical "current monthly income" figure, minus expenses. In cases like *Stansell* and *Featherstone*, projecting forward this deemed or hypothetical income does not permit it to be applied to make payments, for the simple reason that it *does not exist*. Under the Ninth Circuit's test, either the debtor is charged with income that does not exist and cannot be "applied to make payments" under the plan, or the plan must be rejected, in which case the debtor is denied recourse under chapter 13. Neither the trustee here nor the Ninth Circuit even attempts to explain the phrase "be applied to make payments" in the same statutory provision.[5] It is no answer to say that the chapter 13 plan may be amended under section 1329 to take into account changed financial circumstances. *See Kagenveama*, 541 F.3d at 875, 77. In cases like *Stansell* and *Featherstone*, the Ninth Circuit's test would likely preclude confirmation of any chapter 13 plan in the first place. *See* 11 U.S.C. 1325(a)(6) (court shall confirm a plan only if "the debtor

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[5] The trustee fails to address this specific language at all. For its part, the Ninth Circuit mentions the phrase in passing when it holds that there is no applicable commitment period when there is no "projected disposable income" to pay out during it. *See Kagenveama*, 541 F.3d at 876 ("When read together, only 'projected disposable income' has to be paid out over the 'applicable commitment period.' When there is no 'projected disposable income,' there is no 'applicable commitment period.'").

will be able to make all payments under the plan and to comply with the plan").

Any interpretation of section 1325(b)(1)(B) must take into account *all* of the language in the provision. If the interpretation cannot account for two phrases in the statute, which create serious interpretive issues in specific fact situations, the interpretation must be incorrect. It is well established that courts "must, if possible, construe a statute to give every word some operative effect." *Cooper Indus., Inc. v. Aviall Servs., Inc.*, 543 U.S. 157, 167 (2004) (citing *United States v. Nordic Village, Inc.*, 503 U.S. 30, 35-36 (1992)). The trustee's and Ninth Circuit's interpretation would require the Court to ignore this statutory maxim.

C. To Give Content To All Parts Of The Statute, Section 1325 Must Be Read To Require That The Historical Figure Be Used As A Starting Point, Subject To Adjustment Based On Changes In The Debtor's Financial Condition.

The correct interpretation of section 1325 uses historical "disposable income" as the starting point for determining "projected disposable income," but also takes into account changes in a debtor's income or expenses that affect the debtor's ability to fund a plan.

1. In our view, the assessment of "projected disposable income" in the current version of the statute must, as a general matter, be based on the newly defined "disposable income" in section 1325(b)(2), which in turn is based on an historical calculation of "current monthly income," computed as the average income received during the six month period before the bankruptcy petition is filed. But there are circumstances in which a debtor's financial condition is projected to

change from that pre-petition period and, in such circumstances, it will not be appropriate to use the historical calculation. *See, e.g., Lanning*, 545 F.3d at 1269; *Frederickson*, 545 F.3d at 652.

Our interpretation not only is faithful to the new definition of "disposable income" in section 1325(b)(2) as an historical number but also treats "projected disposable income" as a future-oriented concept, as required by the language of section 1325(b)(1). *See Pak*, 378 B.R. at 264-65; *Kibbe*, 361 B.R. at 307-08. This interpretation requires the use of the historical income figure called for in the definition of "disposable income" as a *starting point*, and it calls for a *presumption* that the historical figure should be carried forward throughout the term of the plan, absent evidence to the contrary. But in order to take into account the future-orientation of the remaining language of the statute, and to ensure that "projected disposable income" is, in fact, a projection, it allows that presumption to be rebutted whenever the debtor is likely to experience (or actually has experienced) either an increase or decrease in net income after the filing of the chapter 13 plan.[6]

The reason for having a starting presumption that the historical "disposable income" figure should be applied mathematically to derive the "projected disposable income" is that, while "projected disposable income" is certainly not the *same* as "disposable income," it is appropriate in construing the former phrase to give effect

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[6] As previously noted, this presumptive affect conforms with the burden shifting standard of proof required under section 1325(b). *See* United States Brief *supra* at 9-10 (*citing Zellner*, 827 F.2d at 1226; *Heath*, 182 B.R. at 560-61; *McNichols*, 349 B.R. at 168; *Barnes*, 378 B.R. at 777; *Ehret*, 238 B.R. at 87; *Fries*, 68 B.R. at 685).

to the definition of the latter. Section 1325(b)(2) provides a definition "[f]or purposes of this subsection." 11 U.S.C. § 1325(b)(2). The only time that "disposable income" is used in "this subsection," section 1325(b), other than in the definition itself, is in the term "projected disposable income." Thus, we accept that a court should begin by applying the historical "disposable income" figure as a starting point, and by presumptively carrying that figure forward over the plan period.[7]

At the same time, however, this initial presumption that the historical "disposable income" will be used must necessarily be rebuttable. "[P]arties contending that a debtor's Form B22C disposable income figure does not accurately project the debtor's future ability to fund a plan must present documentation similar to that required by section 707(b)(2)(B)(ii) in support of their claim." *In re Lanning*, 380 B.R. 17, 25 (B.A.P. 10th Cir. 2007). *See Pak*, 378 B.R. at 267 ("It makes no sense to interpret 'projected disposable income,' governing debtors' future payments under their chapter 13 plans, as cast in stone by their pre-bankruptcy history, without any opportunity for the trustee, creditors or the debtor to offer rebutting evidence as to changed income circumstances before the effective date of the plan.").

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[7] Congress may well have expected that the historical figure, computed generally with standard rather than actual expenses, would result in a higher "disposable-income" total for "above-median" debtors and a greater amount designated for repayment to creditors under the debtor's chapter 13 plan. But the fact that this is often not the case does not authorize a court to ignore Form 22C altogether in determining "projected disposable income" and base it instead on Schedules I and J in the ordinary case. Such decisions cannot find support in the statutory language. *See, e.g., In re Demonica*, 345 B.R. 895, 900 (Bankr. N.D. Ill. 2006); *In re Riggs*, 359 B.R. 649, 652-53 (Bankr. E.D. Ky. 2007).

Thus, contrary to the trustee's argument here, Trustee Brief, at 7, application of the historical "disposable income" figure to the plan period is not the end of the matter in all cases. There are situations in which a debtor has had, or is likely to have, changes in income after the period in which the historical "disposable income" is computed, and in order to give full effect to the statutory text those changes must be taken into account in "project[ing]" the debtor's future "disposable income." *See, e.g., Stansell*, 395 B.R. at 457; *Featherstone*, 2008 WL 5217936 at *1.

There are two types of cases that section 1325 must be able to address. First, a debtor may have either an increase in income at about the time he files his chapter 13 petition or a predictable increase later. For example, a debtor may be unemployed during the six-month period in which "current monthly income" is calculated but may accept a high-paying job at about the time he files his petition. *See Pak*, 358 B.R. 257 (debtor was unemployed for three years but found a job paying over $100,000 two months before filing his petition). Such a debtor would have an artificially low historical "disposable income" but might well be able to fund a chapter 13 plan that would repay most or all of his unsecured debt.

Second, conversely, a debtor may suffer a loss of income – for example, by losing a job – at about the time he files his chapter 13 petition, as in *Lanning*. *See Lanning*, 545 F.3d at 1269. Such a debtor would have a relatively high "current monthly income," based on an average of the six months preceding the month in which the petition was filed. Yet if that historical income were simply extended forward for purposes of the chapter 13 plan, it would not reflect the actual income available to the debtor during that future period. *See, e.g., Lanning*, 380 B.R. at 25 ("Where it is shown that Form B22C disposable income fails accurately to predict a debtor's actual ability to fund a plan, that figure may be subject to modification."). To put it in statutory terms, the future "disposable income" thus computed would not be the debtor's "projected" disposable income (because it would demonstrably *not* be based on a reliable estimate of future income), nor would it be the "disposable income" actually "received" by the debtor during the applicable commitment period. *See* 11 U.S.C. § 1325(b)(1)(B). Moreover, because the income amount determined by the Ninth Circuit's test is merely deemed or hypothetical and not actually received, the income could not be "applied to make payments to unsecured creditors." *Id.* In such a case, therefore, the court must take into account the loss of income in order to apply section 1325(b) faithfully.

2. Our interpretation is also consistent with this Court's ruling in *Ross-Tousey*. *See Ross-Tousey v. Neary*, 549 F.3d 1148 (7th Cir. 2008). In *Ross-Tousey*, this Court interpreted the means test as it applies to chapter 7 debtors under the Bankruptcy Code.[8] *Id.* (interpreting means test in connection with motion to dismiss for abuse under section 707(b)(1) of the Bankruptcy Code). *Ross-Tousey* ruled that chapter 7 cases are initially evaluated for dismissal under section 707(b)(2), which only evaluates a debtor's historical income and statutorily

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[8] Just as the means test applies to chapter 13 debtors by utilizing the defined term "current monthly income" and incorporating section 707(b)(2) of the Bankruptcy Code, *see* 11 U.S.C. § 1325(b)(2) and (3), the means test also applies to chapter 7 debtors. *See* 11 U.S.C. § 707(b)(2).

prescribed expense amounts. *Id.* at 1157-61. However, *Ross-Tousey* went on to find that: (a) merely passing section 707(b)(2)'s means test does not guarantee chapter 7 relief; (b) section 707(b)(3)(B) requires the dismissal of cases that pass the means test when the totality of a debtor's financial situation establishes abuse; and (c) abuse is evaluated based on a debtor's "actual income and expenses." *Id.* at 1161-62.

Ross-Tousey's construction of section 707(b)(3)(B) supports the United States' reading of section 1325(b)(1)(B) in this case. Just as section 707(b)(3)(B) mandates the dismissal of a chapter 7 debtor's case based upon an evaluation of a debtor's actual income and expenses, and regardless of a contrary result under section 707(b)(2)'s means test, *see Ross-Tousey*, 549 F.3d at 1161-62; so too does section 1325(b)(1)(B) require that a chapter 13 debtor make plan payments based upon their actual income and expenses (as projected over the life of their plan), and regardless of section 1325(b)(3)'s incorporation of section 707(b)(2)'s means test. Indeed, the trustee's contrary reading would transform section 707(b)(2)'s means test – which is merely a stage-one "screening mechanism" in chapter 7, H.R. Rep. 109-31 at 1 (I) (2005), *reprinted* in 2005 U.S.C.C.A.N. 88, 89 – into the final arbiter of chapter 13 plan payments.

3. Admittedly, the language of section 1325 is not a model of clarity. However, our interpretation gives effect to all of the statutory language far more faithfully than the test advocated by the trustee and adopted by the Ninth Circuit in *Kagenveama*. Almost as important, it better furthers the overall goal of chapter

13.

Chapter 13 focuses on having debtors devote future income to paying their creditors. Indeed, the 2005 Act placed additional emphasis on this goal of paying future income to creditors when it added language to section 707(b) permitting a court, with the debtor's consent, to convert an abusive chapter 7 case to chapter 13, as an alternative to dismissal. *See* 11 U.S.C. § 707(b)(1). While the Ninth Circuit's test does require future income to be used to pay creditors, that future income is measured exclusively by reference to historical income, and in some cases, like this one, it bears little relation to the actual income available to the debtor. In contrast, our interpretation permits a court to consider the actual income that can "be applied to make payments" under the plan in those cases in which a different amount of actual income is available to a debtor because of changed circumstances. The use of actual income in such cases is an important measure of fairness, both to creditors in cases where the debtor's actual future income is greater than his historical income, and to debtors in cases like this one, *Stansell*, *Featherstone*, and *Lanning*, where a temporary pre-petition payment to the debtor is not reflective of the debtor's continuing income or ability to fund a chapter 13 plan.

4. In short, the Court should consider *all* of the language of section 1325(b)(1)(B) – "to be received," and "will be applied to make payments," as well as the phrase "projected disposable income." For the reasons we have given, the language of that section, read as a whole, does not support the Ninth Circuit's test, a test that is never subject to adjustment in light of changes in income or expenses

after the filing of the petition.

CONCLUSION

For these reasons, the United States respectfully asks the Court to affirm the lower court's order.

May 11, 2009

Respectfully submitted,

/s/ David I. Gold
RAMONA D. ELLIOTT
General Counsel
P. MATTHEW SUTKO
Associate General Counsel
DAVID I. GOLD
Trial Attorney
Executive Office for United
States Trustees
Department of Justice
20 Massachusetts Avenue, N.W.
Washington, D.C. 20530
Ph: (202) 307-1399
Fax: (202) 307-2397

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I, David I. Gold, do hereby certify that 2 hard and 1 digital copies of the foregoing Brief of the United States as Amicus Curiae have been served this day on the below named individual(s) via Federal Express Overnight Priority Mail at the address listed below:

Marilyn O. Marshall, Trustee
O. Anthony Olivadoti, Esq.
224 S. Michigan Ave.
Suite 800
Chicago, IL 60604

Peter F Geraci, Esq.
Nathan E. Curtis, Esq.
55 E. Monroe, Suite 3400
Chicago, Illinois 60603

I further certify that 15 hard and 1 digital copies of the foregoing Brief of the United States as Amicus Curiae have been dispatched for filing with the Clerk of this Court via Federal Express Overnight Priority Mail at the address listed below:

Clerk's Office
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219 S. Dearborn Street
Chicago, IL 60604

DATED, this 11th day of May, 2009.

/s/ David I. Gold
David I. Gold
Attorney for the United States
as Amicus Curiae

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May 11, 2009

/s/ David I. Gold
DAVID I. GOLD
Attorney for the United States
as Amicus Curiae

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BAP 6th Cir.

3. ("CCN") ***CURRENT*** CASE NO.
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FOR THE SIXTH CIRCUIT

In re:

Cinseree Johnson	)	Case No.: 09-21476
	)	
	)	Chapter 7
	)	
Debtor.	)	
	)	
	)	
Cinseree Johnson	)	
	)	
Appellant,	)	BAP Case No. 10-8011
	)	
	)	
Daniel McDermott, **United States Trustee**	)	
	)	
Appellee.	)	
	)	

United States Trustee's Motion to Dismiss Case

Counsel for Appellee Daniel McDermott
United States Trustee

Amy L. Good
Trial Attorney for U.S. Trustee
Office of the U.S. Trustee
U.S. Department of Justice
H.M. Metzenbaum U.S. Courthouse
201 Superior Avenue, East
Cleveland, Ohio 44114
(216) 522-7800

INTRODUCTION

Under 28 U.S.C. § 158, this Court has jurisdiction to consider an appeal from a bankruptcy court only if the appeal is taken "in the time provided by Rule 8002 of the Bankruptcy Rules." 28 U.S.C. § 158(c)(2). Under Rule 8002(a), a notice of appeal must be filed within 14 days of the date of entry of the order appealed. Under subsection (b) of Rule 8002, however, if a party makes a timely motion to alter or amend under Rule 9023, the time to appeal runs from the date of the order disposing of the tolling motion. *See* Fed. R. Bankr. P. 8002(b). A "motion to reconsider" filed within 14 days of the judgment is commonly construed as a motion under Fed. Bankr. P. 9023, which applies Fed. R. Civ. P. 59 to bankruptcy cases. *See In re Hogan,* 03-5338, 79 Fed. Appx. 846, 848, 2003 WL 22474621, 2 (6th Cir. Oct. 29, 2003) (concluding that"the bankruptcy court properly viewed [appellant's] motion [for reconsideration] as a motion to alter or amend judgment pursuant to Fed. R. Civ. P. 59" and Fed. R. Bankr. 9023).

In this case, the order dismissing Ms. Johnson's case was entered on January 5, 2010. *See* Bankr. Dkt. 23. Thus, under Bankruptcy Rule 8002(a) and (b), Ms. Johnson needed to file a notice of appeal or motion to alter or amend no later than January 19, 2010. She did so. On January 15, 2010, she filed a motion to reconsider, which the bankruptcy court appropriately construed as a motion to alter or amend under Bankruptcy Rule 9023. *See* Bankr. Dkt. 25; *see also* Bankr. Dkt. 32 (construing motion for reconsideration as a Rule 9023 motion). The bankruptcy court's order denying Ms. Johnson's motion for reconsideration was entered on January 26, 2010. *See* Bankr. Dkt. 32. Entry of the order denying the motion for reconsideration started the 14-day appeal clock running. *See* Fed. R. Bankr. P. 8002(b). Thus, to perfect her appeal from the order dismissing her case, Ms. Johnson needed to file a notice of appeal no later than February 9, 2010. She did not. [1]

Instead, Ms. Johnson filed a "renewed motion for reconsideration" on February 5, 2010. Bankr. Dkt. 39. The "renewed" motion raised the same grounds of alleged racial and religious discrimination as Ms. Johnson's original motion for reconsideration. *Compare* Bankr. Dkt. 39 *with* Bankr. Dkt. 25. The bankruptcy court denied the renewed motion for reconsideration in an order entered February 8, 2010, on the grounds that the Federal Rules of Bankruptcy Procedure do not recognize such a motion and because it was meritless. *See* Bankr. Dkt. 40. Nine days later, on February 17, 2010, Ms. Johnson filed a notice of appeal "from the final judgment entered in this action on January 5, 2010." Bankr. Dkt. 43. For the reasons set forth below, Ms. Johnson's February 17 notice of appeal was untimely to perfect an appeal from the January 5 final order.

ANALYSIS

Because Bankruptcy Rule 8002 "was tailored carefully after a corresponding rule, Rule 4(a)(4) of the Federal Rule of Appellate Procedure," courts in the Sixth Circuit are guided by cases construing Rule 4(a)(4) when faced with issues under Rule 8002. *In re Bell & Beckwith,* No. 86-4015, 831 F.2d 293 (Table), 1987 WL 44937, *1 (6th Cir. Oct. 5, 1987). In this circuit, there is no question under Fed. R. App. P. 4(a)(4) that a second or "renewed" motion for reconsideration does not toll the time to appeal. *See, e.g., Costello v. Lungaro*, Nos. 92-3757, 92-3939, 977 F.2d 580 (Table), 1992 WL 245929, 1 (6th Cir. Sept. 29, 1992) ("A second, or

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[1] Ms. Johnson also failed to file a statement of issues on appeal and designation of record in accordance with Fed. R. Bankr. P. 8002. These documents were due within 14 days after Ms. Johnson filed her Notice of Appeal, which was March 5, 2010.

successive motion to reconsider a prior ruling . . . does not, however, toll the time for filing a notice of appeal."). Moreover, the Third Circuit has squarely held under Bankruptcy Rule 8002 that a second or successive motion for reconsideration does not toll the time to appeal when, as here, the second motion raises no new grounds. *See In re Taylor,* 343 Fed. Appx. 753, 756, 2009 WL 2768985, 2 (3d Cir. 2009) ("if a district court denies a motion for reconsideration, and if the party who lost that motion files and loses a second motion for reconsideration, the [appeal] clock does not re-start if 'the factual and legal issues surrounding the [first] motion and the [second] motion are roughly similar....' ") (citing *Turner v. Evers*, 726 F.2d 112, 114 (3d Cir. 1984)).

In this case, Ms. Johnson's notice of appeal was untimely to appeal the final judgment. Although she did file an initial, timely Rule 9023 motion on January 15 (Bankr. Dkt. 25), her 14-day appeal clock began to run on January 26, 2010, the date of entry of the order denying reconsideration, (Bankr. Dkt. 32). Under the law recited above, her "renewed" motion for reconsideration — which raised no new grounds — did not toll the time to appeal. *See* Bankr. Dkt. 39. Thus, the time period for appealing the final judgment (Bankr. Dkt. 23) expired on February 9, 2010. *See* Fed. R. Bankr. P. 8002(b). Ms. Johnson's February 17, 2010 notice of appeal (Bankr. Dkt. 43) was therefore untimely to perfect an appeal from the January 5, 2010 final order. The time to appeal as set forth in 28 U.S.C. § 158(c)(2) requires adherence to the time periods in Bankruptcy Rule 8002. When a time period for perfecting a timely notice of appeal is set forth in a statute, it is jurisdictional. *See Bowles v. Russell,* 551 U.S. 205, 213 (2007). Accordingly, because Ms. Johnson's notice of appeal was untimely, this Court lacks jurisdiction over the appeal.

CONCLUSION

For all of the foregoing reasons, this Court should dismiss this case for lack of jurisdiction.

Dated: March 15, 2010

Respectfully submitted,

Amy L. Good (0055572)
Trial Attorney
Department of Justice
Office of the U.S. Trustee
H.M. Metzenbaum U.S. Courthouse
Suite 441
201 Superior Avenue
Cleveland, Ohio 44114
(216) 522-7800 ext. 236
amy.l.good@usdoj.gov

Attorney for U.S. Trustee Daniel M. McDermott

Certificate of Service

A copy of the foregoing was served by regular U.S. Mail this 15th day of March, 2010 upon the following:

Cinseree Johnson
P.O. Box 20024
Cleveland, Ohio 44120

Amy L. Good

BRIEF BANK — "SUMMARY SHEET" *Printed Wed-3/9/11 11:45*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	Herbert W. Johnson v. Daniel M. McDermott, United States Trustee (In re Herbert W. Johnson)
2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	B.A.P. 6th Cir.
3. ("CCN") ***CURRENT*** CASE NO.	No.: 10-8058
4. ("PCN") ***PRIOR*** CASE NO. - & COURT *[IF ANY]*	No.: 09-21715 Court: Bankr. E.D. Ky. *(Identify judge & cite, if any)*
5. ("SO") ***SOURCE***	**U.S. TRUSTEES**
6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	Filed: February 17, 2011 Type: Brief of Appellee
7. **("AU")** ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*	Catherine B. Sevcenko, P. Matthew Sutko, Ramona D. Elliott, John J. Daugherty *(UST/OGC: 202-307-1399/FAX-2397)*
8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") ● ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	● Did the bankruptcy court abuse its discretion in denying appellant a bankruptcy discharge because he without justification "failed to keep records, account for assets and because he made a false oath?" 11 U.S.C. § 727(a)(3); 11 U.S.C.§727(a)((5); 11 U.S.C. § 727(a)(4)(A).
10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)	
11. DO YOU RECOMMEND POSTING IN UST BRIEFBANK?| x | | | ***NAME:***	Linda Figueroa YES NO ***DATE:***

No. 10-8058

In the Bankruptcy Appellate Panel of the Sixth Circuit

In re Herbert W. Johnson,
Debtor.

Herbert W. Johnson,
Appellant,

v.

Daniel M. McDermott, United States Trustee,
Appellee.

On Appeal from the United States Bankruptcy
Court for the Eastern District of Kentucky,
Judge Tracey N. Wise, Presiding

Brief of Appellee

John L. Daugherty
Assistant U.S. Trustee
United States Department of Justice
Office of the United States Trustee
100 E. Vine St., Suite 500
Lexington, KY 40507
(859) 233-2822 x 113

Ramona D. Elliott
General Counsel
P. Matthew Sutko
Associate General Counsel
Catherine Bentley Sevcenko
Trial Attorney
United States Department of Justice
Executive Office for United States
Trustees
20 Massachusetts Ave. NW, Suite 8000
Washington, DC 20530
(202) 307-1399

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STATEMENT REGARDING ORAL ARGUMENT

Appellee believes that oral argument will not materially aid the Court in deciding this case.

STATEMENT OF JURISDICTION

The Bankruptcy Court had jurisdiction under 28 U.S.C. §§ 157(a) and (b) to hear the underlying case, a voluntary petition under chapter 7 of the Bankruptcy Code, 11 U.S.C. § 701, *et seq*. In a judgment entered on August 6, 2010, the Bankruptcy Court denied Mr. Johnson a discharge, which is a final order. 28 U.S.C. § 158(d)(1). On August 16, 2010, Mr. Johnson filed a timely appeal with this Court. This Court has jurisdiction over this appeal under 28 U.S.C. § 158(c)(1).

STATEMENT OF ISSUES PRESENTED

(1) Did the Bankruptcy Court abuse its discretion in denying Appellant a bankruptcy discharge because he without justification "failed to keep or preserve any recorded information, including books, documents, records, and papers, from which [his] financial condition or business transactions might be ascertained?" 11 U.S.C. § 727(a)(3).

(2) Did the Bankruptcy Court abuse its discretion in denying Appellant a bankruptcy discharge because he failed to explain satisfactorily any loss of assets or deficiency of assets to meet the debtor's liabilities? 11 U.S.C. §727(a)(5).

(3) Did the Bankruptcy Court abuse its discretion in denying Appellant a bankruptcy discharge because he knowingly and fraudulently made a false oath or account in the case? 11 U.S.C. § 727(a)(4)(A).

STANDARD OF APPELLATE REVIEW

On appeal from a bankruptcy court, this Court applies the clearly erroneous standard of review to findings of fact, and reviews questions of law *de novo*. *Stamper v. United States (In re Gardner*), 360 F.3d 551, 557 (6th Cir. 2004). Contrary to Appellant's assertion in his brief, Br. at vii, the issues raised in the appeal solely involve the Bankruptcy Court's findings of fact. A finding of fact is clearly erroneous only when "the reviewing court on the entire evidence is left with the definite and firm conviction that a mistake has been committed." *Riverview Trenton*

Ry v. DSC, Ltd. (In re DSC, Ltd.), 486 F.3d 940, 944 (6th Cir. 2007) (citations omitted).

STATEMENT OF THE FACTS

Mr. Johnson's Business Entities

The Debtor in this case, Herbert Johnson, began advising people on investment strategies after graduating high school. Tr.[1] at 78. He would review their portfolios and financial statements, do additional research, and then "give them an opinion based upon that third party information." Tr. at 79. To prepare himself for this work, Mr. Johnson took financial courses from the American College, an on-line university, although he did not receive a degree. Tr. at 71; 2004 Exam[2] at 34-35. In addition, he attended various seminars on weekends. Tr. at 72. Mr.

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[1] "Tr." refers to the Transcript of the July 29, 2010 trial of the Adversary Proceeding, Dkt. 50; "UST [number]" refers to the Exhibits introduced by the United States Trustee at trial, Dkt. 27; "JS" refers to the Joint Stipulations filed by the parties, Dkt. 31. The reference to "Dkt." refers to the docket of Adversary Proceeding No. 10-2010, the matter below.

[2] The reference to "2004 Exam" refers to the transcript of Mr. Johnson's examination on January 27, 2010 directed by an order of the Bankruptcy Court pursuant to Fed. R. Bankr. P. 2004, and designated part of the record on appeal in Appellee's Designation of Record, Dkt. 47.

Johnson admitted he is not a registered investment adviser. Tr. at 73. Nor is he licensed by the Securities and Exchange Commission or state regulators in Ohio or Kentucky. Tr. at 72.

Mr. Johnson first worked on his own and then went into business as Thompson, Spratley, and Johnson, Inc. in Cincinnati, Ohio. Tr. at 23. After the corporation disbanded, Mr. Johnson formed Jabez Advisory Group in 2000, also in Cincinnati, which grew to 140 clients. Tr. at 23-24. At Jabez he "made recommendations on the existing portfolios they [the clients] had." Tr. at 24.

Although Mr. Johnson was not a registered investment adviser, two different versions of the Thompson, Spratley, Inc. letterhead identified Mr. Johnson as "Herb Johnson, RIA." Tr. at 26-27; UST 10-13. Mr. Johnson stated at trial that he was "sure" that RIA "could" mean Registered Investment Advisor. Tr. at 25. He, however, did not know how the term RIA was placed after his name, testifying that it was a "misprint" or "typo." Tr. at 27. The Bankruptcy Court, however, did not find Mr. Johnson's testimony on the "typo" credible. Tr. at 227.

From 2005 to 2008, Mr. Johnson engaged in extensive stock trading on his own account. In the four calendar years preceding Mr. Johnson's 2009 bankruptcy filing, he sold $76,445,941 in stock. *See* UST 29-32.

Mr. Johnson's "Private Annuity" with Martha J. Martin

In the mid-1980s, Mr. Johnson met Martha J. Martin and they became friends. 2004 Exam at 42. At that time Ms. Martin was a widow in her mid-sixties. See Tr. at 179-80. Mr. Johnson described her as a "very generous and nice woman." *Id.* According to Mr. Johnson, Ms. Martin "offered to help him" by giving him "a lump sum of money." *Id.* Mr. Johnson described the arrangement as a "Private Annuity." *Id.* at 43. On or about November 21, 1994, Mr. Johnson and Ms. Martin executed this "Private Annuity," UST 8, in which Mr. Johnson promised to pay Ms. Martin, or her daughter Nancy Frakes upon Ms. Martin's death, the amount of $2,200 monthly for 20 years beginning December 1, 1994. JS 1.

In exchange, Mr. Johnson received a check for $280,000 from Ms. Martin, which was deposited in Mr. Johnson's personal investment account. Although the record is not entirely clear, it appears Mr.

Johnson used his money to invest in real estate. UST 35; 2004 Exam at 45-50.

Mr. Johnson paid Ms. Martin $2,200 per month until she passed away in 2003. At that point, he began paying her daughter – Nancy Frakes – approximately $1,500 per month, based on his calculation of what tax-exempt bonds would have paid for the nine years he paid Ms. Martin the $2,200. 2004 Exam at 52-53. Mr. Johnson admitted that his agreement with Ms. Martin did not provide for adjusting the pay-out after her death. *Id.* at 53. Eventually Mr. Johnson stopped paying Ms. Frakes entirely. Tr. at 113, 146. He testified to the United States Trustee that "It [the annuity] was [$]280,000; I paid back [$]415,[000]. That's why I don't see why I'm [sic] keep getting grilled. I don't see what Mrs. Frakes['s] complaint is. I don't see what Mr. Dickman's [attorney for Ms. Frakes] complaint is or yours." 2004 Exam at 55.

Mr. Johnson's Residence

Mr. Johnson purchased his current residence at 8166 North Dilcrest Circle, Florence, Kentucky in 2004. JS 2. He transferred this property to Mary L. Cahill by Deed dated October 20, 2006, UST 4; JS 3. Mr.

Johnson married Ms. Cahill on March 30, 2007, JS 5, and they continue to live there. JS 4. Mr. Johnson also purchased land in the Dilcrest subdivision; he sold Lots 136 and 136A on November 7, 2008. UST 5.

At the meeting of Creditors held on September 3, 2009, Mr. Johnson engaged in the following testimony with the examining trustee, Mr. Kendrick:

Q. All right, sir. Do you own just the one parcel of real estate?

A. My wife and I own it, yeah.

Q. And you have one mortgage on the property?

A. There's two.

Q. All right. The petition says no real estate.

A. Well, it's in my wife's name.

MR. MASSEY [Mr. Johnson's lawyer]: It's not in his name at all.

Q. Okay. When did you transfer it to her or has it always been in her name?

A. It's always – it's always been in her name.

UST 3 at 6 (emphasis added). Mr. Johnson repeated this testimony later in the examination. *Id.* at 28.

When called upon to give testimony about the ownership of his residence at the 2004 Exam, Mr. Johnson gave different testimony:

Q. The address you gave me earlier, the Dillcrest [sic], do you own that house?

A. My wife and I do, yes.

Q. You both own it?

A. Actually, it's in her name.

Q. Okay. When did she buy the house?

A. I want to say 2007.

Q. Who did she buy it from?

A. Me.

2004 Exam at 4 (emphasis added).

<u>Activities of Park Holding Company</u>

Mr. Johnson formed Park Holding Company, LLC ("Park Holding") in 2000. JS 6. Park Holding owned and leased out multi-family properties. JS 7. Mr. Johnson was the sole member from 2006 until January 1, 2008. JS 6. On or about January 1, 2008, Mr. Johnson transferred a 50% interest in Park Holding to Gerald Barron in exchange for $100,000. JS 8. Mr. Barron testified that the agreement he signed stated he was paying Mr. Johnson a $100,000 purchase price. Tr. at 9-10; UST 17. But the copy of the agreement that Mr. Johnson provided the United States Trustee showed a $10,000 purchase price. Tr. at 52, 56; UST 18.

Mr. Johnson testified that he sent the agreement to Mr. Barron with two separate front pages but did not explain the reason to Mr. Barron. Tr. at 54-55; UST 16. Mr. Barron testified that did not recall ever seeing a second front page with the $10,000 amount or discussing the two amounts with Mr. Johnson. Tr. at 9-10. Mr. Johnson also sent the agreement with the $10,000 purchase price to his accountant, and he did not inform her of the existence of the version of the agreement stating a $100,000 purchase price. Tr. 55-56.

On or about May 28, 2008, Mr. Johnson received a check in the amount of $70,000 from Christoforo Kimoto to invest as Mr. Johnson saw fit. UST 24; JS 9-10. The two did not have a written agreement. Tr. at 160. Mr. Johnson initially deposited this check into his personal checking account, then deposited $62,500 of these funds into an E*Trade account. Tr. at 60-61; UST 25-26; JS 11.

At some point after receiving the $70,000, Mr. Johnson suffered losses in his investments. In an email dated October 3, 2008, he offered Mr. Kimoto part ownership of Park Holding in lieu of returning the $70,000. UST 27. Mr. Kimoto accepted, and they executed an agreement dated January 1, 2008 [sic] transferring a 50% interest in Park Holding to Mr. Kimoto. UST 28.

As with Mr. Barron, Mr. Johnson ultimately admitted that two versions of the agreement existed, but Mr. Johnson only provided the United States Trustee with a version setting forth a purchase price of $10,000. Tr. at 65. Neither Mr. Barron nor Mr. Kimoto knew the other owned 50% of Park Holding. Tr. at 11-12 (Barron); UST 34 at 26 (Kimoto); UST 36 (Johnson). Mr. Johnson continued to collect the rents for Park Holding on behalf of the two owners. JS 12; Tr. at 12 (Barron), 68 (Johnson). They learned of each other's existence from the United States Trustee. Tr. at 11.

Mr. Johnson's Bankruptcy Petition

Mr. Johnson filed for relief under chapter 7 of the United States Bankruptcy Code on July 9, 2009 in the United States Bankruptcy Court for the Eastern District of Kentucky. JS 14. On that same date, Mr. Johnson filed Schedules and Statement of Financial Affairs that he signed under penalty of perjury. JS 15. At the first meeting of creditors held on September 3, 2009, Mr. Johnson testified under oath that his Schedules and Statement of Financial Affairs were true and correct. UST 3 at 5-6.

In response to Question number 10(a) of the Statement of Financial Affairs, which asks Mr. Johnson to list all property transferred other than in the ordinary course of business within the two years prior to filing for bankruptcy relief, Mr. Johnson answered "None." UST 2. By answering "none" to question 10(a), Mr. Johnson did not disclose the sale of the Dilcrest lots or the transfer of his interest in Park Holdings to Mr. Barron and Mr. Kimoto. At trial, Mr. Johnson stated that he did not list the transfers because he believed they were in the ordinary course of business. Tr. at 121, 173-75. The Bankruptcy Court, however, concluded that "the debtor was not in business of transferring membership interests in LLC[s]." Tr. at 228.

Mr. Johnson's Representations and Disclosures to the United States Trustee After Filing His Bankruptcy Petition

On November 24, 2010, the United States Trustee obtained an Order directing Mr. Johnson to appear at a Rule 2004 Examination. UST 6. The Order directed Mr. Johnson to produce:

(a) All statements and canceled checks from all bank and investment accounts used by the Debtor and any entity controlled by the Debtors from January 1, 2004 to September 30, 2009;

(b) All books and records concerning real estate held by the Debtor or Park Holding Co., LLC from January 1, 2004 to September 30, 2009;

(c) All books and records concerning investments of the Debtor or Jabez Advisory Group, LLC from January 1, 2004 to September 30, 2009; and

(d) All HUD-1 or other real estate closing statements from the sale of any real estate held by the Debtor or Park Holding Co., LLC from January 1, 2004 to September 30, 2009.

Id.

In response to this court order, Mr. Johnson did not produce any books and records of Park Holding or Jabez Advisory Group. He only produced tax returns for 2005 through 2008 and personal bank statements for one account for April to November 2008 and for July 2009. UST 7. Other than monthly statements for August 2009 and December 2008, and year end summaries and tax statements for 2005 through 2008, Mr. Johnson produced no records of his investment accounts. UST 7; Tr. at 4-7.

Mr. Johnson testified that his accountant turned over her entire file, which had cost him $250 in copying fees, “which if you are bankrupt is – is a lot of money.” Tr. at 127. He testified that he could not provide any more documentation because the banks “were wanting more money than what I had.” *Id.*

Mr. Johnson was also asked to provide a complete accounting of all receipts, disbursements, and other dispositions for the Martin “Private Annuity.” In response, Mr. Johnson stated that “other than the letters sent to the annuitant [UST 10-14], there are no other documents, receipts, etc. regarding this transaction.” UST 33 at 8.

Bankruptcy Court Decision

On February 12, 2010, the United States Trustee filed a Complaint seeking to deny Mr. Johnson a discharge in bankruptcy. Dkt. 1. Trial was held on July 29, 2010. At the end of the proceedings, the Court ruled in favor of the United States Trustee on three Counts of his Complaint to deny Mr. Johnson a discharge. First, the Court found that Mr. Johnson had failed to keep or preserve records from which his financial condition or business transactions might be ascertained under section 727(a)(3). Second, the Court found that Mr. Johnson had failed to explain satisfactorily any loss or deficiency of assets to meet his liabilities under section 727(a)(5). Finally, the Court found that Mr. Johnson had made false oaths under section 727(a)(4)(A). Judgment, Dkt. 41.

In its ruling, the Court stated that it "didn't find the debtor's testimony to be particularly credible, and the evidence shows that his testimony is inconsistent, and even in some instances can be said to make it up as he goes along." Tr. at 226. The Bankruptcy Court concluded that there "are inconsistencies . . . each time the debtor is under oath." *Id.*

For example, the Court identified Mr. Johnson's statements about the "Private Annuity" that he had executed with Ms. Martin as an example of his inconsistent testimony. Tr. at 226. In March of 2009, after Ms. Martin had passed, Mr. Johnson informed counsel for her daughter, Ms. Frakes, that the survivorship clause in the "Private Annuity" was not enforceable and so he was not obligated to make payments until 2014, as stated in the agreement. Tr. at 114. At the Meeting of Creditors, Mr. Johnson referred to the "Private Annuity" as a loan. UST 3 at 12. Finally, in response to Interrogatories propounded by the United States Trustee, Mr. Johnson stated that he terminated the annuity payments to Ms. Frakes not because the agreement was unenforceable, but because the agreed payments "had been accelerated and paid in full." UST 33 at 5. He also appeared to take the same position at trial. Tr. at 145-47.

On August 6, 2010, the Bankruptcy Court entered judgment denying Mr. Johnson's discharge. Dkt. 41. Mr. Johnson then timely appealed to this Court.

SUMMARY OF THE ARGUMENT

The facts of this case are largely undisputed and the Code provision at issue – 11 U.S.C. § 727 – has been frequently interpreted by bankruptcy judges. Both the facts and well-established law indicate that the Bankruptcy Court did not abuse its discretion in denying Mr. Johnson a discharge on three independent bases. It was not clear error to find that Mr. Johnson 1) failed to produce adequate documentation to support his assertions concerning his financial affairs; 2) failed to adequately explain his loss of assets; and 3) made false oaths on his schedules and at the meeting of creditors.

The bankruptcy court did not clearly err in finding that Mr. Johnson did not provide adequate documentation. Mr. Johnson produced only his personal tax returns, two monthly bank statements, and year-end summaries for 2005-2008. He produced no investment records. He produced no information about his real estate transactions. Mr.

Johnson responded to inquiries about his record-keeping by either stating that his tax accountant would produce the documents or that he could not afford the cost of obtaining the information. The Bankruptcy Court did not clearly err in finding that Mr. Johnson was a sophisticated investor who had not fulfilled his obligation to keep detailed records of his transactions.

Second, the bankruptcy court did not clearly err in finding that Mr. Johnson did not adequately account for the loss of his assets. Between 2004 and 2008, Mr. Johnson engaged in $76 million dollars worth of stock trades. He bought and sold real estate. Yet he could not testify consistently about where the money went. The Bankruptcy Court did not clearly err by denying Mr. Johnson a discharge because "in some instances" Mr. Johnson seemed to be "mak[ing] it up as he goes along." Tr. at 226.

Third, the Bankruptcy Code did not clearly err when it found that Mr. Johnson had made false oaths, providing a third, independent ground to deny him a discharge. Mr. Johnson testified at the meeting of creditors that his wife had always owned their marital residence, although he had in fact transferred the property into her name several months before they were married. Mr. Johnson also represented to the trustee that he had made $10,000 when he sold half of his interest in Park Holdings when in fact the buyer had paid $100,000. These misrepresentations were material because, if left uncorrected, they would have left the trustee with an inaccurate picture of Mr. Johnson's financial affairs.

Finally, Mr. Johnson's brief, which cites only one case, simply asserts that Mr. Johnson is honest or "splits hairs" to try to justify his financial transactions. Tr. at 226. Even if Mr. Johnson's arguments were to garner sympathy from this Court, he has provided no legal basis upon which this Court could hold that the Bankruptcy Court abused its discretion in denying his discharge. The decision below should be affirmed.

ARGUMENT

The Bankruptcy Court ruled in favor of the United States Trustee on three Counts of his Complaint. Mr. Johnson could be denied a discharge on any one of the Counts; therefore, this Court must affirm the judgment if it affirms the Bankruptcy Court's ruling on any one Count. As set forth below, the Bankruptcy Court's decision is supported by the record, its findings of fact are not clearly erroneous, and it correctly applied the law.

I. Mr. Johnson failed to produce adequate documentation under section 727(a)(3).

A bankruptcy court shall not grant a discharge if

> the debtor has concealed, destroyed, mutilated, falsified, or failed to keep or preserve any recorded information, including books, documents, records, and papers, from which the debtor's financial condition or business transactions might be ascertained, unless such act or failure to act was justified under all of the circumstances of the case.

11 U.S.C. § 727(a)(3). Under this subsection, the debtor's records must provide "enough information to ascertain the debtor's financial condition and track his financial dealings with substantial completeness and accuracy for a reasonable period past to present." *In re Juzwiak*, 89 F.3d 424, 427 (7th Cir. 1996). Proof of an intent to defraud is not required. *E.g.*, *Peterson v. Scott (In re Scott)*, 172 F.3d 959, 969 (7th Cir. 1999); *Bergeron v. Ross (In re Ross)*, 367 B.R. 577, 581 (Bankr. W.D. Ky. 2007).

The adequacy of a debtor's records is determined on a case-by-case basis. *Turoczy Bonding Co. v. Strbac (In re Strbac)*, 235 B.R. 880, 882 (6th Cir. BAP 1999). Considerations include a debtor's "occupation, financial structure, education, experience, sophistication and other circumstances that should be considered in the interest of justice." *Id.* The United States Trustee and the Bankruptcy Court "should not be required to speculate as to the financial history or condition of the debtor, nor should they be compelled to reconstruct the debtor's affairs." *Juzwiak*, 89 F.3d at 428 (citation omitted).

The Bankruptcy Court did not clearly err when it ruled that Mr. Johnson was engaged in activities that required substantial record-keeping. Mr. Johnson held himself out as an investment advisor, and obtained many clients while acting as if he were an investment advisor. Tr. at 23-24, 26-27. He engaged in significant stock trading on his own account, selling over $70 million in stock between 2005 and 2008. Tr. at 42-43; UST 29-31. Finally, he owned and managed a business (Park Holding) that owned multi-family housing. JS 6-7, 12; Tr. at 12 (Barron), 68 (Johnson).

A sophisticated debtor engaged in business is held to a higher level of accountability in record keeping, and the more complex the debtor's financial situation, the more numerous and detailed the debtor's financial records should be. *Ross*, 367 B.R. at 581 (*quoting McCord v. Sethi (In re Sethi)*, 250 B.R. 831, 839 (Bankr. E.D.N.Y. 2000)).

The record demonstrates Mr. Johnson's numerous failures to provide documentation to explain his financial affairs. To name four: first, he failed to provide documentation – other than year end statements of earnings and losses – of over $76 million in stock trading from 2005 to 2008. UST 7; Tr. at 4-7.

Second, Mr. Johnson testified at trial that he normally kept three years of records for his clients, Tr. at 128, but he failed to produce any such records for the three years immediately preceding the February 2010 Complaint filed by the United States Trustee. UST 7.

Third, Mr. Johnson failed to produce any accounting of his use of the $280,000 received from Ms. Martin for the "Private Annuity." He failed to keep any records of his pay-out of the annuity to her during her lifetime or to her daughter after her death. UST 32 at 8; Tr. at 32, 33-34, 40-41, 62-63.

Fourth, Mr. Johnson provided no records related to the Park Holding apartments. Tr. 44. He was unable to document the holding company's finances when he owned it, when he co-owned it with Mr. Barron, and when he managed it on behalf of Mr. Barron and Mr. Kimoto. JS 12.

The Bankruptcy Court did not commit clear error in finding that Mr. Johnson's justifications for failing to provide this documentation were not persuasive. This is so for at least three reasons.

First, Mr. Johnson testified that his accountant had provided his tax return files for which she possessed copies. Tr. 44-46. Copies of tax returns alone, even when prepared by an accountant, do not constitute adequate record keeping for the purposes of section 727(a)(3). *PNC Bank v. Buzzelli (In re Buzzelli)*, 246 B.R. 75, 104 (Bankr. W.D. Pa. 2000). This is true in this case. The records Mr. Johnson produced contained a few bank statements and no monthly account statements of Mr. Johnson's extensive stock trading. He did not produce any document that had been independently verified, the minimum necessary to satisfy the Code's requirements. *See id.*

Second, Mr. Johnson maintained at trial that his own testimony sufficiently explained his financial affairs. His testimony is not an adequate substitute for written records, especially in light of his inconsistent testimony under oath. *Micro Connections v. Shah (In re Shah)*, 388 B.R. 23, 32 (Bankr. E.D.N.Y 2008). *See* Tr. at 226 (Court finding of inconsistent testimony); *supra* at 15 (inconsistent testimony regarding private annuity); *infra* at 28-34 (false oaths and inconsistent testimony concerning transfers).

Third, the Bankruptcy Court did not clearly err in rejecting Mr. Johnson's testimony that he could not produce his records because he could not afford to obtain bank records. Tr. at 227-28; Tr. at 127, 2004 Exam at 7. The copying fees pale in comparison to the $280,000 he obtained from Ms. Martin, the $100,000 he obtained from Mr. Barron in 2008, and the $70,000 he obtained from Mr. Kimoto. It also does not explain his failure to produce recent records and records other than bank statements, such as the records of Park Holding. Tr. at 227-228.

Mr. Johnson argues that he should not be faulted because the documentation he produced "simply did not meet the satisfaction of the Trustee and Judge Wise." Br. at 6. He claims that he produced the documents he could afford and thus was "compliant." *Id.* However, the court order that directed Mr. Johnson to produce a list of specific documents, UST 6, established the standard of compliance for Mr. Johnson to meet. It is undisputed that he did not comply with the Bankruptcy Court's order to provide documents for the 2004 exam. UST 7; Tr. 4-7. The bankruptcy court did not abuse its discretion in denying Mr. Johnson a discharge under section 727(a)(3). Its decision should be affirmed.

II. Mr. Johnson failed to explain satisfactorily his deficiency of assets under section 727(a)(5).

A bankruptcy court also cannot grant a discharge if a debtor "has failed to explain satisfactorily, before determination of denial of discharge under this paragraph, any loss of assets or deficiency of assets to meet the debtor's liabilities." 11 U.S.C. § 727(a)(5). This subsection is broad enough to include any unexplained disappearance or shortage of assets. *Solomon v. Barman (In re Barman)*, 244 B.R. 896, 900 (Bankr. E.D. Mich. 2000) (*citing Chalik v. Moorefield (In re Chalik)*, 748 F.2d 616 (11th Cir. 1984)).

Furthermore, fraudulent intent is not required; this section imposes "strict liability" if the debtor cannot provide a satisfactory accounting of funds. *Baker v. Reed (In re Reed*), 310 B.R. 363, 368 (Bankr. N.D. Ohio 2004). In that context, satisfactory "may mean reasonable, or it may mean that the court, after having heard the excuse, the explanation, has that mental attitude which finds contentment in saying that he believes the explanation . . . ." *Slocum v. Wheeler (In re Wheeler)*, 38 B.R. 842, 846 (Bankr. E.D. Tenn. 1984) (citation omitted).

The Bankruptcy Court, after hearing Mr. Johnson's testimony and other evidence, found that his financial transactions "cannot be traced with any certainty," Tr. at 225, and that Mr. Johnson's own testimony was "not particularly credible," "inconsisten[t]," and "vague." Tr. at 226, 229. "Vague and indefinite explanations" are unacceptable without supporting documentation. *Schilling v. O'Bryan (In re O'Bryan)*, 246 B.R. 271, 280 (Bankr. W.D. Ky. 1999) (citation omitted).

The Bankruptcy Court did not abuse its discretion in finding that Mr. Johnson failed to explain his extensive financial dealings, either through credible testimony or written documentation.

On the date Mr. Johnson filed for bankruptcy relief (July 9, 2009), his liabilities exceeded his assets by $466,212.21. JS 18. However, in the four years preceding his bankruptcy filing, Mr. Johnson sold $76,445,941 in stocks on his own account. UST 29-32. He also received $100,000 from Mr. Barron in January of 2008, and $70,000 from Mr. Kimoto in May of 2008. JS 8-9. He could not document the disposition of these funds, much less show how he ended up with a deficit of nearly half a million dollars. Tr. at 43-44; 62-63.

In his brief, Mr. Johnson explains that he sold his membership in Park Holdings because he needed cash. Br. at 9. But the issue under section 727(a)(5) is what happened to the money, not the reason why the debtor sold the asset in the first place. Mr. Johnson blames his reversal of fortune on the "faltering economy." *Id.* The Bankruptcy Court did not clearly err in finding Mr. Johnson's explanations, such as he "is not the only American who lost equity in stocks in the past few years," *Id.*, to be unsatisfactory.

III. Mr. Johnson knowingly and fraudulently made false oaths under section 727(a)(4)(A).

Finally, a bankruptcy court shall not grant a debtor a discharge if a debtor "knowingly and fraudulently, in or in connection with the case made a false oath or account." 11 U.S.C. § 727(a)(4)(A). The Bankruptcy Code imposes a duty on the debtor to disclose all assets. 11 U.S.C. § 521(a); *Browning v. Levy*, 283 F.3d 761, 775 (6th Cir. 2002); *Browning Manufacturing v. Coastal Plains, Inc.* (*In re Coastal Plains, Inc.)*, 179 F.3d 197, 208 (5th Cir. 1999) ("the importance of this disclosure duty cannot be overemphasized"); *Lewis v. Summers (In re Summers*), 320 B.R. 630, 642 (Bankr. E.D. Mich. 2005) (stating that debtors have a "'paramount duty' and 'strict obligation' to truthfully, accurately, and completely answer questions in their schedules and statement of financial affairs") (citations omitted).

Under Sixth Circuit law, the failure to meet this disclosure duty will result in denial of a discharge under section 727(a)(4)(A) if five conditions are met. *Keeney v. Smith, (In re Keeney)*, 227 F.3d 679, 685 (6th Cir. 2000). First, the debtor made the statements under oath; second, the statements were false; third, the debtor knew the statements were false; fourth, the debtor made the statements with fraudulent intent; and fifth, the statements related materially to the bankruptcy case. *Id.* The purpose of this section is "to make certain that those who seek the shelter of the bankruptcy code do not play fast and loose with their assets or with the reality of their affairs." *Hamo v. Wilson (In re Hamo)*, 233 B.R. 718, 725 (6th Cir. BAP 1999) (citation omitted).

Mr. Johnson made two sets of statements under oath that are at issue here: his Statement of Financial Affairs and his testimony at the Meeting of Creditors. JS 15 (Statement of Financial Affairs); UST 3 at 3 (Meeting of Creditors).

Question 10 of the Statement of Financial Affairs required Mr. Johnson to "[l]ist all other property, other than property transferred in the ordinary course of business or financial affairs of the debtor, transferred . . . within two years immediately preceding the commencement of this case [July 9, 2007 to July 9, 2009]." UST 2 at 4. In response, Mr. Johnson filled in the "None" box. *Id.* At the meeting of creditors on September 3, 2009, Mr. Johnson testified under oath that his Schedules and Statement of Financial Affairs were true and correct. UST 3 at 5-6.

In contrast, however, the record shows, and Mr. Johnson does not dispute, that he made three significant transfers during this time period:

1. Mr. Johnson transferred of 50% of Park Holding to Mr. Barron in January 2008 for $100,000, UST 15;

2. Mr. Johnson transferred his remaining 50% share of Park Holding to Christoforo Kimoto, at an unknown date around October 2008.[3] UST 27, 28; and

3. Mr. Johnson sold a parcel of undeveloped real estate for $30,500 in November 2008. UST 5.

Nor did the Bankruptcy Court clearly err in concluding that Mr. Johnson "knowingly" made false oaths. The Bankruptcy Court found

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[3] The Sale Agreement with Mr. Kimoto is dated January 1, 2008 – the same date as the Sale Agreement with Mr. Barron. Although the record does not clarify this discrepancy, Mr. Kimoto did not invest money with Mr. Johnson until May 2008, UST 24, making it impossible for the two men to have contracted a sale of property to make up for investment losses that occurred at least five months *in the future*.

"taints of dishonesty" in the fact that Mr. Johnson signed the Agreements of Sale in which he sold 50% interests to Mr. Barron for $100,000 and to Mr. Kimoto for $70,000, without informing either man of the involvement of the other. Tr. at 230. Because Mr. Johnson admitted at trial that the two men "were secret from one another," as the Court described it, there was no clear error in finding that Mr. Johnson had the requisite knowledge to support a violation of section 727(a)(4)(A). Tr. at 229 (denying discharge for "false oaths, for the omissions in the debtor's schedules, for the omissions at the first meeting of creditors.").

Furthermore, Mr. Johnson's misrepresentations were material because they bore "a relationship to the bankrupt's business transactions or estate, or concerns the discovery of assets, business dealings, or the existence and disposition of his property." *Keeney*, 227 F.3d. at 686 (citation omitted).

Insofar as a debtor rarely admits to fraudulent intent, it is inferred from circumstantial evidence of from his course of conduct. *Hamo*, 233 B.R. at 724. Intent is also established when a debtor exhibits a "reckless disregard as to whether a representation is true." *Keeney*, 227 F.3d at 686.

The record in the underlying case is replete with "badges of . . . dishonesty and unfairness that taint this proceeding." Tr. at 227-228 (ruling of Bankruptcy Court). First, Mr. Johnson represented that he was a Registered Investment Agent in his letters to Ms. Martin. Tr. at 26-27; UST 10-13. Second, he prepared two different versions of the Agreements to sell interests in Park Holding to Mr. Barron and Mr. Kimoto and did not inform them of this fact. Tr. at 9-10, 52, 54-56; UST 17, 18, 28. Finally, he did not tell Mr. Barron that Mr. Kimoto owned the remaining 50% of Park Holding, and vice versa. Tr. at 11-12 (Barron); UST 34 at 26 (Kimoto); UST 36 (Johnson).

Fraudulent intent is also supported by the fact that Ms. Frakes was taking action to enforce her right under the "Private Annuity"at the time the false oaths were made. JS 13. The undisclosed transfers of Mr. Johnson's interest in Park Holding were potentially recoverable by the chapter 7 trustee as a preference[4] or as a fraudulent conveyance[5] in the case of the transfer of his residence, giving him further incentive to conceal them.

The Bankruptcy Court did not clearly err when it found unpersuasive Mr. Johnson's excuse that he did not list the transfers because he believed they were in the ordinary course of business. Tr. 121, 173-175; Br. at 6-7. Mr. Johnson has not explained how a transfer of personal business or real estate interests would be in the ordinary course of business for an investment adviser. *Cf. Devers v. Bank of Sheridan (In re Devers),* 759 F.2d 751, 754 (9th Cir. 1985) (finding fraudulent intent under 727(a)(2)(B) because the debtors claimed that selling off all their breeding stock was "culling" in the "ordinary course of business"). The Bankruptcy Court did not clearly err when it found that Mr. Johnson

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[4] Subject to numerous limitations and defenses, a trustee may recover payments to creditors on account of antecedent debts made within 90 days of filing (or one year if the creditor is an insider) while the debtor is insolvent. 11 U.S.C. § 547(b).

[5] While 11 U.S.C. § 548 only permits recovery of fraudulent conveyances within one year of filing, a Kentucky trustee may recover fraudulent conveyances made within five years pursuant to Ky. Rev. Stat. §§ 378.010, 413.120. *See* 11 U.S.C. § 544(b) (trustee has rights and powers of creditor under state law).

"was not in business of transferring membership interests in LLC[s]," and could not "fake" this fact. Tr. 228.

Mr. Johnson argues in his brief that he did not make a false statement when he said that his residence had always been in his wife's name because he had transferred it to her more than two years before filing for bankruptcy. Br. at 7. However, Mr. Johnson had a "paramount duty" to be completely honest. *Summers*, 320 B.R. at 642. Mr. Johnson stated under oath that his wife had always owned the house. UST 3 at 6. This was untrue.

Mr. Johnson's defense is that he did not have to reveal the transfer on his schedules because it had happened more than two years earlier. Br. at 8. But the Trustee had asked a factual question about whether his wife had always owned the house. Mr. Johnson was under oath and obligated to tell the truth that he had owned it and transferred it to her. He failed to do so. He cannot now plausibly attempt to explain away the misrepresentation because "in the context of what the debtor was asked, he was correct in his answer." Br. at 9.

The Bankruptcy Court did not clearly err in finding that Mr. Johnson's "no harm no foul" attitude towards his lack of transparency in his business dealings, and in his interactions with the trustee and with the Court, could not be reconciled with the rules of the bankruptcy system. Tr. at 228.

CONCLUSION

For these reasons, the United States Trustee respectfully requests that the judgment of the Bankruptcy Court be affirmed.

Dated: February 17, 2011

Respectfully submitted,

Daniel M. McDermott
United States Trustee
By Counsel

/s/ John L. Daugherty
John L. Daugherty
Assistant U.S. Trustee
United States Department of Justice
Office of the United States Trustee
100 E. Vine St., Suite 500
Lexington, KY 40507
(859) 233-2822 x 113

Ramona D. Elliott
General Counsel
P. Matthew Sutko
Associate General Counsel
Catherine Bentley Sevcenko
Trial Attorney
United States Department of Justice
Executive Office for U.S. Trustees
20 Massachusetts Ave. NW
Suite 8000
Washington, DC 20530
(202) 307-1399

CERTIFICATE OF COMPLIANCE
Fed. R. App. P. 32(a)(7)(C)

I certify that this brief complies with the typeface and word count provisions of Fed. R. App. P. 32(a). It was prepared in 14-point Century Schoolbook using WordPerfect X5, and the Word Count of all words in this document is 7,568.

/s/ John L. Daugherty
John L. Daugherty

CERTIFICATE OF SERVICE

I certify that on February 17, 2011, a copy of the foregoing brief was served upon counsel for Appellant via ECF electronic noticing.

/s/ John L. Daugherty
John L. Daugherty

APPENDIX

Dkt. #	Description	
27	UST 2	Statement of Financial Affairs
	UST 3	Transcript of Meeting of Creditors
	UST 4	Deed transferring residence from Defendant to Mary L. Cahill
	UST 5	Deed transferring building lot from Defendant and spouse to Nelsons
	UST 6	Order for Rule 2004 Examination of Defendant
	UST 7	Summary of documents received from Defendant's Attorney or his Accountant
	UST 8	"Private Annuity" between Martha J. Martin and Defendant
	UST 10	Letter from Defendant to Martha Martin
	UST 11	Letter from Defendant to Martha Martin
	UST 12	Letter from Defendant to Martha Martin
	UST 13	Letter from Defendant to Martha Martin
	UST 14	Letter from Defendant to Martha Martin

Dkt. #	Description	
27	UST 15	Check on account of Gerald Barron payable to the order of Herb Johnson for $100,000
	UST 16	Letter from Defendant to Jerry Barron
	UST 17	Sale and Assignment of Interest: Limited Liability Company between Herbert W. Johnson, Jerry Barron, and Park Holding Company, LLC; consideration $100,000
	UST 18	Sale and Assignment of Interest: Limited Liability Company between Herbert W. Johnson, Jerry Barron, and Park Holding Company, LLC; consideration $10,000
	UST 19	Certified Copy of Resolution, Park Holding Company, LLC
	UST 20	HUD-1 for 2335 Park Avenue
	UST 21	Note
	UST 22	HUD-1 for 2347 Park Avenue
	UST 23	Note
	UST 24	Kimoto check
	UST 25	Bank statement for account held by Defendant and spouse at First Security Trust Bank
	UST 26	Bank statement for account held by Defendant and spouse at First Security Trust Bank

Dkt. #	Description	
27	UST 27	email
	UST 28	Sale and Assignment of Interest: Limited Liability Company between Herbert W. Johnson, Christoforo Kimoto, and Park Holding Company, LLC; consideration $10,000
	UST 29	Form 1040, Schedule D of Defendant's 2005 tax return
	UST 30	Form 1040, Schedule D of Defendant's 2006 tax return
	UST 31	Form 1040, Schedule D of Defendant's joint 2007 tax return
	UST 32	Form 1040, Schedule D of Defendant's joint 2008 tax return
	UST 33	Defendant's Response to Request for Admissions, Interrogatories, and Request for the Production of Documents
	UST 34	Excerpts from deposition of Christoforo Kimoto
	UST 35	Excerpt from deposition of Herbert Johnson
	UST 36	Excerpt from deposition of Herbert Johnson
31		Joint Stipulations 1-15, 18

Dkt. #	Description
47	Appellee Designation of Record: Transcript of Mr. Johnson's examination on January 27, 2010 pursuant to Fed. R. Bankr. P. 2004, pages 4, 7, 34-35, 42, 45-50, 52-53, and 55
50	Transcript of Trial, pages 4-7, 9-12, 23-27, 29-38, 40-46, 52, 54-57, 59-63, 65, 68, 71-73, 78-79, 114, 121, 127-128, 145-147, 173-175, 177, and 225-229

BRIEF BANK — 'SUMMARY SHEET" *Printed Tue-5/8/07 14:1*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE
[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]

In Re: Jordan (Jordan v. Greenwood and Clippard, UST)
In Re: Thompson (Thompson v. Greenwood and Clippard, UST)

2. ("CO") ***CURRENT*** COURT
[E.g., "CTA9"]

CTA 6

3. ("CCN") ***CURRENT*** CASE NO.

No.: 06-6519 06-6430

4. ("PCN") ***PRIOR*** CASE NO. & COURT
[IF ANY]

No.:
Court: United States District Court for the Western District of Tennessee
(Identify judge & cite, if any)

5. ("SO") ***SOURCE***

U.S. TRUSTEES

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF
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P. Matthew Sutko, Sean M. Haynes
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***

BANKRUPTCY

9. ("SU") ● ***SUMMARY*** OF KEY ISSUE(s)
&
√ Any Miscellaneous ***BACKGROUND***

● When a bankruptcy case is filled in a court lacking venue, may that court deny a timely motion to dismiss or transfer and instead retain the case?

√ **Background:**

10. PATH TO FILE LOCATION:
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Nos. 06-6430 & 06-6519

IN THE UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

In re: REUBEN WALTER THOMPSON and PATRICIA J. THOMPSON,
Debtors.

REUBEN WALTER THOMPSON and PATRICIA J. THOMPSON,
Appellants,

v.

MADALYN S. GREENWOOD and RICHARD F. CLIPPARD,
Appellees.

In re: LEONARD W. JORDAN,
Debtor.

LEONARD W. JORDAN,
Appellant,

v.

MADALYN S. GREENWOOD and RICHARD F. CLIPPARD,
Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF TENNESSEE

PROOF BRIEF FOR APPELLEES

Of Counsel

ROBERTA A. DEANGELIS
Acting General Counsel

P. MATTHEW SUTKO
Office of the General Counsel
Executive Office for U.S. Trustees
Department of Justice
20 Mass. Ave., NW Suite 8100
Washington, DC 20530

SEAN M. HAYNES
Office of the U.S. Trustee
Department of Justice
200 Jefferson Ave., Room 400
Memphis, TN 38103

PETER D. KEISLER
Assistant Attorney General

DAVID F. KUSTOFF
United States Attorney

WILLIAM KANTER
(202) 514-4575
JONATHAN H. LEVY
(202) 353-0169
Attorneys, Appellate Staff
Civil Division, Room 7231
Department of Justice
950 Pennsylvania Ave., N.W.
Washington, DC 20530-0001

STATEMENT REGARDING ORAL ARGUMENT

This Court is fully capable of deciding the straightforward legal question presented in this appeal without oral argument.[1] However, should the Court decide to hear such argument, the United States will participate and requests time equal to that given to the appellants.

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[1] Appellants suggest that there is a split of authority on the issue presented "among the judges of the Western District of Tennessee." Aplt. Br. 1; accord id. at 3 (referring to question that has "sharply divided this district"). This suggestion is only accurate as to bankruptcy judges. There is no split of authority with respect to district court judges.

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IN THE UNITED STATES COURT OF APPEALS
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ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF TENNESSEE

PROOF BRIEF FOR APPELLEES

STATEMENT OF JURISDICTION

The bankruptcy court had jurisdiction under 28 U.S.C. § 157(a) & (b) to hear the underlying Jordan case, a voluntary petition under Chapter 7 of the Bankruptcy Code, 11 U.S.C. §§ 701, et seq. See also 28 U.S.C. §§ 151 & 1334(a). On August 5, 2004, the bankruptcy judge entered an order denying the United States

Trustee’s motion to transfer or dismiss for lack of venue. (R. 16 in No. 04-28437, JA ___-___). The United States trustee filed a timely notice of appeal to the district court on August 16, 2004. (R. 24-26 in No. 04-28437, JA ___-___).[2] Subsequently, on August 24, 2004, the United States Trustee filed an objection to the Chapter 7 Trustee’s Report of No Assets. (R. 49 in No. 04-28437). That objection was overruled by order dated September 23, 2004, (R. 62 in No. 04-28437, JA ___-___), and the United States Trustee filed a timely notice of appeal to the district court from that order on October 1, 2004. (R. 69 in No. 04-28437, JA ___-___).

Similarly, the bankruptcy court had jurisdiction under 28 U.S.C. § 157(a) & (b) to hear the underlying Thompson case, a voluntary petition under Chapter 13 of the Bankruptcy Code, 11 U.S.C. §§ 1301, et seq. See also 28 U.S.C. §§ 151 & 1334(a). On August 25, 2004, the bankruptcy judge granted the United States Trustee’s motion to dismiss or transfer by ordering the case transferred to the Northern District of Mississippi. (R. 29 in No. 04-29553, JA ___-___). The debtors filed a timely notice of appeal to the district court on August 26, 2004. (R. 30 in No. 04-29553, JA ___-___). The bankruptcy court denied a subsequent motion to stay pending appeal, (R. 57 in No. 04-29553), but the district court granted a stay, (R. 5 in No. 04-2765).

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[2] An appeal may be taken from a bankruptcy judge’s decision to the district court. See 28 U.S.C. § 158.

The district court consolidated the three appeals noted above as well as a fourth appeal in a different case, which is no longer relevant. (See R. 7 in No. 04-2979; R.8 in No. 04-2765; R. 4 in No. 04-2766). On October 31, 2006, the district court issued a single opinion deciding the shared question of law common to both the Thompson and Jordan cases. This decision affirmed the transfer in Thompson and reversed and remanded the order retaining the case in Jordan. (R. 12 in No. 04-2979, R. 17 in No. 04-2765, and R. 16 in No. 04-2766, JA ___-___). Jordan filed a timely notice of appeal to this Court on November 29, 2006. (R. 17 in No. 04-2766, JA ___-___). The Thompson debtors filed a timely notice of appeal to this Court on November 7, 2006. (R. 19 in No. 04-2765, JA ___-___). This Court has consolidated these two appeals, which it has jurisdiction to hear under 28 U.S.C. § 158(d).

STATEMENT OF THE ISSUE

When a bankruptcy case is filed in a court lacking venue, may that court deny a timely motion to dismiss or transfer and, instead, retain the case?

STATEMENT OF THE CASE

A. Statement of the Facts and Proceedings Below

1. Bankruptcy Court Proceedings in Jordan. Debtor Leonard Jordan, who lives and works in Southaven, Mississippi, initiated his bankruptcy case by filing a voluntary petition under Chapter 7 on June 2, 2004 in the United States District Court for the Western District of Tennessee. (R. 1 in No. 04-28437, JA ___-___). On June 15, 2004, the United States Trustee filed a motion to dismiss or transfer on the basis that venue was lacking because the debtor did not reside in the district (R. 9 in NO. 04-28437), which the bankruptcy judge denied by order dated August 5, 2004, (R. 16 in No. 04-28437, JA ___-___). The bankruptcy judge acknowledged that "retention by the court of a bankruptcy case, after it has been determined that case venue is improper, is not specifically authorized by statute." Id. at 2, JA ___. However, he concluded that "there is no express statutory provision under title 28 for the court to dismiss or retain an improperly venued case upon a timely motion being filed to contest venue," id. at 26, JA ___, and therefore the sole question was whether it was "logical to allow an interest of justice or for the convenience of the parties standard" to retain the case. Id. at 27, JA ___.

Five days later, the bankruptcy judge substituted a "supplemental memorandum" explaining the basis for the denial of the motion to transfer or dismiss, (R. 18 in No. 04-28437, JA ___-

___), which is published as In re Jordan, 313 B.R. 242 (Bankr. W.D. Tenn. 2004). In that opinion, the bankruptcy court made clear that the basis for its decision was its "inherent or implicit authority," rather than any statutory authority. Id. at 18, JA ___. The Court also explained that it would not apply 28 U.S.C. § 1406 – the general statute regarding proceedings when a case is filed in a court lacking venue – because venue considerations in bankruptcy cases differ from those in other cases. Id. at 2, 11-12, JA ___, ___-___.

The United States trustee filed a timely notice of appeal from the denial of its motion on August 16, 2004. (R. 24-26 in No. 04-28437, JA ___-___). Subsequently, on August 24, 2004, the United States Trustee filed an objection to the Chapter 7 Trustee's Report of no Assets. (R. 49 in No. 04-28437). That objection was overruled by order dated September 23, 2004, (R. 62 in No. 04-28437, JA ___-___), and the United States Trustee filed a timely notice of appeal from that order on October 1, 2004, (R. 69 in No. 04-28437, JA ___-___).

2. Bankruptcy Court Proceedings in Thompson. The Thompson debtors – a husband and wife who reside in Olive Branch, Mississippi – filed a voluntary petition under Chapter 13 on June 21, 2004 in the United States District Court for the Western District of Tennessee. (R. 1 in No. 04-29553, JA ___-___). On July 20, 2004, the United States Trustee filed a motion to dismiss

or transfer based on lack of venue because of the debtors' residence. (R. 11 in No. 04-29553). Relying on a previous opinion holding that bankruptcy courts lack discretion to retain cases filed in the wrong venue, the bankruptcy judge granted that motion on August 25, 2004, ordering the case transferred to the Northern District of Mississippi. (R. 29 in No. 04-29553, JA ___-___). The debtors filed a timely notice of appeal on August 26, 2004. (R. 30 in No. 04-29553, JA ___-___). The bankruptcy court denied a subsequent motion to stay pending appeal, (R. 57 in No. 04-29553), but the district court granted a stay, (R. 5 in No. 04-2765).

3. District Court Proceedings. The cases were consolidated before the district court. See District Court Opinion, R. 17 in No. 04-2765, R. 16 in No. 04-2766, at 3 ("Dist. Ct. Op."), JA ___. The district court held that when a court lacks venue over a bankruptcy case, it must grant a timely motion to dismiss or transfer and has no discretion to retain the case. It therefore reversed the bankruptcy court in Jordan and affirmed in Thompson. Id. at 21, JA ___.

The district court began its analysis by noting that 28 U.S.C. § 1408 establishes venue for bankruptcy cases and that its provisions necessarily "provide[] legal constraints on bankruptcy filing, not mere suggestions." Id. at 12, JA ___. Thus the debtors here correctly "concede[d] that the venue in which they filed was improper, or at least 'technically improper.'" Id. at

13, JA ___. The district court then noted that in 1984, Congress had repealed a statutory provision, 28 U.S.C. § 1477, that expressly allowed bankruptcy courts to retain cases even when they lacked venue. Such a repeal must be viewed as purposeful, and the fact that Congress reenacted (with minor changes) other bankruptcy venue provisions, but not § 1477 must be given meaning. Id. at 13-16, JA ___-___. Moreover, there is an applicable statute that requires dismissal or transfer of cases filed in a court lacking venue. That statute, 28 U.S.C. § 1406(a), applies "on its face" to bankruptcy cases because it, like the bankruptcy-specific statutory provisions, applies to a "case" filed in a "district court." Id. at 17, JA ___. Accordingly, the district court held that § 1406 controlled the question before it and that the cases could not be maintained before the courts in Tennessee. Id. at 21, JA ___.

These consolidated appeals followed.

B. Relevant Statutory Provisions

Venue in bankruptcy cases is governed by 28 U.S.C. § 1408, which primarily provides for venue in the judicial district where an individual debtor lives:

> Except as provided in section 1410 of this title, a case under title 11 may be commenced in the district court for the district–
>
> (1) in which the domicile, residence, principal place of business in the United States, or principal assets in the United States, of the person or entity that is the subject of such case have been located for the one hundred and eighty days immediately preceding such commencement, or for a longer

> portion of such one-hundred-and-eighty-day period that the domicile, residence, or principal place of business, in the United States, or principal assets in the United States, of such person were located in any other district; or
>
> (2) in which there is pending a case under title 11 concerning such person's affiliate, general partner, or partnership.

A case filed in the wrong venue is governed by 28 U.S.C. § 1406, the relevant portion of which here is subsection (a):

> The district court of a district in which is filed a case laying venue in the wrong division or district shall dismiss, or if it be in the interest of justice, transfer such case to any district or division in which it could have been brought.

While this provision refers specifically to a "district court" (and not a bankruptcy court), a separate statutory provision explains that a "bankruptcy court" is "a unit of the district court." 28 U.S.C. § 151. Finally, appellants contend that a provision addressing the transfer of bankruptcy cases is relevant here. That provision states that:

> A district court may transfer a case or proceeding under title 11 to a district court for another district, in the interest of justice or for the convenience of the parties.

28 U.S.C. § 1412.

SUMMARY OF ARGUMENT

Congress expressly forbade a court from retaining a case over which it lacks venue. In 28 U.S.C. § 1406(a), it clearly provided that such a court "<u>shall</u> dismiss, or if it be in the interest of justice, transfer such case . . . ." (Emphasis added). Congress also enacted certain venue rules that are specific to bankruptcy cases, but none of those rules addresses a court's ability to retain a case over which it lacks venue. Because general statutes apply to bankruptcy cases unless there is a direct and irreconcilable conflict with a bankruptcy-specific statute, § 1406(a) applies to bankruptcy cases and precludes a court from retaining a case over which it lacks jurisdiction, at least when, as here, a timely motion to dismiss or transfer is filed.

Appellants' arguments to the contrary are not supported. The statutory provision establishing venue in bankruptcy cases, 28 U.S.C. § 1408 (which appellants here ignored by filing in a court that they concede lacks venue), would be rendered meaningless under their proposed scheme. And they concede that the statutory provision on which they most rely, 28 U.S.C. § 1412, is "silent" with respect to whether a court lacking venue can retain the case.

Their primary appeal is to the bankruptcy court's alleged equitable power and the supposed inconvenience to the parties of requiring residents of Memphis suburbs that are located within the State of Mississippi to litigate their bankruptcy claims in a court located in Mississippi that is further from their homes than Memphis. But appellants grossly exaggerate the degree of inconvenience involved in litigating in their state of residence, and, at any rate, no court's equitable authority allows it to act contrary to the requirements of statutes enacted by Congress.

For these reasons, all three Article III courts to have ruled on this question have concluded that a court without venue over a bankruptcy case lacks authority to retain it when a proper motion to dismiss or transfer is filed. In addition to the decision below, these rulings are Swinney v. Turner, 309 B.R. 638 (M.D. Ga. 2004), and In re Peachtree Lane, 188 B.R. 815 (N.D. Ill. 1995). The only Bankruptcy Appellate Panel to rule on this question reached the same result, In re Sorrells, 218 B.R. 580 (10th Cir. BAP 1998), as have the majority of bankruptcy courts to address the question, see id. at 586 (collecting cases).

ARGUMENT

I. REVIEW IS DE NOVO.

The district court's decision was solely on questions of statutory interpretation and is therefore subject to de novo review. See First of Mich. Corp. v. Bramlet, 141 F.3d 260, 262 (6th Cir. 1998). Appellants agree. See Aplt. Br. 14 ("This appeal involves only a question of law so the standard of review is de novo.").

II. TITLE 28 SECTION 1406(a) REQUIRES DISMISSAL OR TRANSFER OF A CASE FILED IN A COURT LACKING VENUE.

A. Appellants' brief opens with the assertion that the law governing the question presented in this case is "murky." Aplt. Br. 15. To the contrary, it is quite clear and rather simple.

This case is squarely governed by 28 U.S.C. § 1406(a), which leaves no possibility that the bankruptcy courts could retain the petitions at issue here:

> The district court of a district in which is filed a case laying venue in the wrong division or district shall dismiss, or if it be in the interest of justice, transfer such case to any district or division in which it could have been brought.

This statute applies to the bankruptcy petitions at issue here because the bankruptcy judges in each judicial district constitute a "unit of the district court," 28 U.S.C. § 151, to whom bankruptcy cases may be referred, id. § 157. See Dist. Ct. Op. 4, JA ___. (noting that Congress "granted original and exclusive jurisdiction of all bankruptcy cases to the federal district courts, and then authorized the delegation of such authority to the bankruptcy courts as adjuncts to the district courts"); id. at 5 n.4, JA ___. Appellants agree. See Aplt. Br. 16, 18.

The petitions at issue here also meet the second criterion in § 1406(a) because, as even appellants themselves concede, the petitions lay venue in the wrong division or district. See, e.g., Aplt. Br. 9 ("In each case, the debtors conceded that venue in the Bankruptcy Court for the Western District of Tennessee was not technically proper"); accord id. at 2, 9, 12-13, 15, 38. Accordingly, under 28 U.S.C. § 1406(a), the courts' only options were to "dismiss, or if it be in the interest of justice, transfer" these cases. Indeed, appellants agree that where § 1406(a) applies, it "requires" dismissal or transfer. Aplt. Br. 40. On this basis alone, the district court's decision should be affirmed.

> The applicable statutes simply do not authorize a bankruptcy court to retain a case when venue is improper, even if retaining the case may be more convenient for the parties or in the interest of justice. Since the plain language of the applicable statutory authority makes this clear, it is unnecessary and inappropriate to look beyond the plain language of those provisions in an attempt to speculate at some contrary intent of Congress.

Swinney, 309 B.R. at 641.

B. Where statutory meaning is clear, a court need not "resort to the canons of construction that we use to resolve doubtful cases. Beach v. Ocwen Fed. Bank, 523 U.S. 410, 417 (1998). Here, the meaning of § 1406(a) is clear and its applicability plain. No further analysis is necessary. Nonetheless, the clear language is fully supported by the usual tools of statutory construction as well.

1. "[T]he meaning of statutory language, plain or not, depends on context." Holloway v. United States, 526 U.S. 1, 7 (1999) (internal quotation marks omitted). The context here demonstrates that § 1406(a) applies. The context includes, most importantly, 28 U.S.C. § 1408 – the statutory provision that appellants concede establishes venue in bankruptcy cases, including the cases at issue here. Section 1408 divides all bankruptcy cases into two categories: (1) cases filed in a court with venue and (2) cases filed in a court without venue. This distinction matters

precisely because a case filed in a court with venue can be retained, dismissed, or transferred, see 28 U.S.C. § 1404, while a case filed in a court lacking venue can only be dismissed or transferred (if an appropriate motion is filed), id. §§ 1406(a) & 1412. That makes sense.

Appellants' interpretation of the statute does not make sense because they assert that there is no difference between a case filed in a court with venue and a case filed in a court without venue: under either circumstance, the court can retain, dismiss, or transfer the case. Appellants' interpretation would thus render § 1408, and, indeed, the entire concept of venue in bankruptcy cases, irrelevant. See In re Sorrells, 218 B.R. at 588 (A court lacking venue must not be allowed to retain a bankruptcy case, "otherwise, there would be no reason to define proper venue" and "sections 1408 through 1410, which define venue [would] be totally circumvented."); Dist. Ct. Op. 12, JA ___ ("If venue is to have any meaning at all in a bankruptcy context, the Court must consider the terms of § 1408 as providing legal constraints on bankruptcy filing, not mere suggestions."). Because appellants' reading of the statute renders § 1408 irrelevant, it violates well-settled principles of statutory construction. See, e.g., Mountain States Tel. & Tel. Co. v. Pueblo of Santa Ana, 472 U.S. 237, 249 (1985) ("'[A] statute should be interpreted so as not to render one part inoperative.'") (quoting Colauitti v. Franklin, 439 U.S. 379, 392

(1979)); TRW Inc. v. Andrews, 534 U.S. 19, 31 (2001) (statute ought to be construed so that no clause, sentence, or word is superfluous, void, or insignificant) (quoting Duncan v. Walker, 533 U.S. 167, 174 (2001)). The district court properly rejected such an approach. See Dist. Ct. Op. 16, JA ___ (noting that the purpose of § 1408 is "to distinguish properly venued cases from those improperly venued" and that it therefore does not make sense "to treat these two categories of cases as if they were one").

2. If the statute were ambiguous, courts would look to the relevant legislative history for guidance. Here too, that history indicates that Congress did not intend to allow courts to retain bankruptcy cases where venue was lacking. As appellants agree, the relevant legislative history involves former 28 U.S.C. § 1477, which was repealed in 1984. That provision had done what appellants seek here; it stated that:

> The bankruptcy court of a district in which is filed a case or proceeding laying venue in the wrong division or district may, in the interest of justice and for the convenience of the parties, retain such case or proceedings, or may transfer . . . such case or proceeding to any other district or division.

Appellants concede that this provision was "repealed" in 1984 and "not replace[d]," Aplt. Br. 19, but nonetheless suggest that "Congress did not intend" by this repeal "a departure from prior law," Aplt. Br. 30. Of course, following the general rule that Congress means what it says and says what it means, when Congress repeals and does not replace a provision, the logical inference to be drawn is that it no longer wants the repealed provision to operate. See, e.g., Lamie v. United States Trustee, 540 U.S. 526 (2004) (giving effect to Congressional decision to delete a phrase from a statute, even where the deletion left a grammatically incorrect phrase that was not parallel to other statutory provisions); Carter v. United States, 530 U.S. 255, 270-71 & n.9 (2000) (rejecting contention, based on legislative history, that deletion of the word "feloniously" from statute was a mere "stylistic change" not intended to alter the meaning of the statute). The fact that Congress repealed the provision expressly allowing courts without venue to retain bankruptcy cases thus indicates that Congress no longer wanted them to be able to do so. This logical interpretation reinforces the plain meaning of § 1406(a).

Appellants would draw the opposite conclusion, "[d]espite this repeal." Aplt. Br. 20. They suggest that legislative history indicates that "Congress intended no major change in the law," Aplt. Br. 20, and repealed § 1477 only because it was repetitive. Aplt. Br. 37. There are three serious flaws with this reasoning. First, even when the legislative history indicates that Congress did not intend to make significant changes when it repeals statutory language, the touchstone of legislative interpretation is the statutory language that remains, not the legislative history.

See Carter, 530 U.S. at 270-71 & n.9 (giving effect to the deletion of a word from the statute despite legislative history "that Congress intended only to make 'changes in phraseology.'") (quoting H.R. Rep. No. 80-304, at A135 (1947)). Second, appellants misstate the legislative history, which indicates that Congress did intend some changes. See S. Rep. No. 98-55, at 19-20 (1983) (saying that the statute repealing § 1477 "makes very few changes in current venue provisions"). This history is entirely consistent with giving substantive meaning to Congress's decision to delete § 1477, since that deletion was simply one of the "very few" changes that Congress intended. Third, appellants themselves admit that § 1477 was not redundant of other federal law because in 1984 (as now) there was no other federal law authorizing the retention of improperly venued bankruptcy cases. See Aplt. Br. 37-38 ("Section 1477 was the only statutory provision that specifically provided for retention of improperly venued cases. In this sense, section 1477 was not duplicative of other statutory venue provisions at all."). Appellants suggest that this creates "confusion," Aplt. Br. 38, but the confusion is of appellants' own making. Applying § 1406(a) on its own terms dispels all supposed "confusion," and results in a coherent and reasonable statutory scheme that complies with the statutory language.

3. Interpretation of ambiguous statutes can also be aided by looking to appropriate regulations. Congress has provided that

“[t]he Supreme Court shall have the power to prescribe by general rules, the forms of process, writs, pleadings, and motions, and the practice and procedure in cases under title 11.” 28 U.S.C. § 2075. Pursuant to this statutory provision, the Supreme Court has prescribed bankruptcy rules, and if there were any statutory ambiguity, it could be resolved by reference to the applicable rule of bankruptcy procedure. Rule 1014(a)(2) of the Federal Rules of Bankruptcy Procedure states:

> **Cases filed in improper district**
> If a petition is filed in an improper district, on timely motion of a party in interest and after hearing on notice to the petitioners, the United States trustee, and other entities as directed by the court, the case may be dismissed or transferred to any other district if the court determines that transfer is in the interest of justice or for the convenience of the parties.

This rule tracks 28 U.S.C. § 1406(a) in providing two alternatives when a bankruptcy case is filed in an improper district: dismissal and transfer. Neither this rule nor any other rule provides for the court to retain a case filed in an improper district.

If there were any ambiguity in the rule, it is dispelled by the Advisory Committee Note to the rule, which explains that the rule implements congressional repeal of § 1477, and reflects the fact that § 1406(a) applies to bankruptcy cases:

> Formerly, 28 U.S.C. § 1477 authorized a court either to transfer or retain a case which had been commenced in a district where venue was improper. However, 28 U.S.C. § 1412, which supersedes 28 U.S.C. § 1477, authorizes only

> the transfer of a case. The rule is amended to delete the reference to retention of a case commenced in the improper district. Dismissal of a case commenced in the improper district as authorized by 28 U.S.C. § 1406 has been added to the rule.

This discussion is important in two respects. First, it recognizes the legislative history point above. The rule treats the repeal of § 1477 as having meaning, namely, removing the authority to retain an improperly venued case. Second, the advisory committee explicitly states that with respect to dismissal of a case where venue is lacking – a subject not addressed by § 1412 – § 1406(a) applies. See Dist. Ct. Op. 18, JA ___ ("Clearly the Committee viewed § 1406 as governing wrongly venued bankruptcy cases."). It naturally follows that, with respect to retaining a case where venue is lacking – also a subject not addressed by § 1412 – § 1406(a) similarly applies.

Appellants' discussion of Rule 1014 is unconvincing. First, without any analysis or explanation whatsoever, appellants assert that Rule 1014(a)(2) "provides the court with the authority to retain the case despite improper venue, if retention were in the interest of justice or for the convenience of the parties in furtherance of the judicial goal of the bankruptcy court." Aplt. Br. 25 (emphasis added). Saying that does not make it so. And certainly there is no actual language in Rule 1014 that could be interpreted in this way. Indeed, the rule, on its face, does not mention the concept of a court retaining a case under any circumstances; it refers only to transfer and dismissal. Moreover, the concepts of "interest of justice" and "convenience of the parties" in Rule 1014 relate solely to a possible transfer and have no relation whatsoever to the concept of retaining a case. In short, Rule 1014 does not by any conceivable stretch of its actual language stand for the proposition attributed to it by appellants.

Second, appellants assert that because the rule provides that a court "may" dismiss or transfer a case, it necessarily follows that it may, also, retain the case. Aplt. Br. 25. There is no warrant for such an inference. The word "may" is not always permissive. Indeed, in a very similar context – a specific venue statute – the Supreme Court reached just the opposite conclusion. In Radzanower v. Touche Ross & Co., 426 U.S. 148, 152 (1976), the Supreme Court addressed a statute providing "that suits against a national banking association 'may be had' in the federal district court for the district where such association is established." Although this statute, like Rule 1014, uses the permissive word "may," to establish venue, the Supreme Court concluded "that this grant of venue is mandatory and exclusive." Id.; Mercantile Nat'l Bank at Dallas v. Langdeau, 371 U.S. 555, 560 (1963). Accordingly, the use of the word "may," by itself, obviously does not mean that additional alternatives are available.[3]

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[3] Further examples of the use of "may" in a non-permissive sense abound. For example, Fed. R. App. P. 25(d)(3) says that "[p]roof of service may appear on or be affixed to the papers

Third, appellants suggest that the Advisory Committee Notes should be disregarded because they do not measure up to appellants' views regarding the goal of "equitable, just, and speedy" resolution of bankruptcy cases. Aplt. Br. 33. But vague principles do not trump regulations or negate the usefulness of the Advisory Committee Notes. Indeed, both the Supreme Court and this Court have relied on those notes in interpreting the rules. See In re Bli Farms, 465 F.3d 654, 657 (6th Cir. 2006) (relying on Advisory Committee Note to narrow scope of facially broad Bankruptcy Rule); see also Kontrick v. Ryan, 540 U.S. 443, 456 n.10 (2004); Pioneer Inv. Servs. Co. V. Brunswick Assocs. Ltd., 507 U.S. 380, 389 n.4 (1993).

III. APPELLANTS PROVIDE NO BASIS TO REFUSE TO APPLY § 1406(a).

Appellants offer a host of reasons to ignore 28 U.S.C. § 1406(a) here, none of which has merit.

A. The bulk of appellants' brief suggests that this Court should look to policy or equitable concerns, instead of the

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filed." The alternatives presented in this rule are exclusive, i.e. the rule requires that the proof of service either appear on or be affixed to the papers filed. Rule 27(d)(1)(A) of the Federal Rules of Appellate Procedure states that "[a] motion, response, or reply may be reproduced by any process that yields a clear black image on light paper." Although the language is permissive, the import of the rule is that no other mode of reproduction is allowed. Rule 35(a) of this Court states that "[a] suggestion for a hearing or rehearing en banc may be made as provided in FRAP 35 or by any member of the en banc Court." No additional alternatives exist; this list is exclusive, despite the fact that it follows the word "may."

statutes enacted by Congress, in ruling on the venue question here. This Court should not follow such suggestions. For example, appellants argue that:

> In order to effectively construe and apply the Bankruptcy Code in achieving the judicial goals enumerated, the totality of the particular facts and circumstances of each individual case must be factored in to determine the venue or forum that best accommodates the parties in interest, while keeping the interests of justice in mind.

Aplt. Br. 28-29. But, of course, appellants do not get to make up their own rules regarding what factors should be relevant to determining venue; <u>Congress</u> does. Here, Congress has explained in 28 U.S.C. § 1408 what factors are relevant to venue in bankruptcy cases, namely the "domicile, residence, principal place of business in the United States, or principal assets in the United States" of the debtor. And, in § 1406(a), Congress explained the consequences of the absence of venue as defined by Congress. Congress did not vest courts with discretion to consider factors not listed in § 1408 in determining venue (including the factors suggested by appellants here), nor did it vest courts with discretion to respond to the absence of venue in ways not described in § 1406(a).[4]

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[4] To be sure, Congress also stated that the "interests of justice" and "the convenience of the parties" could justify the <u>transfer</u> of a bankruptcy case, 28 U.S.C. § 1412, but appellants are not suggesting that a transfer was appropriate here. Quite the contrary, they are suggesting that the courts below should have retained – and not transferred – the cases. Thus, § 1412 is inapplicable here. Indeed, appellants themselves agree that "[s]ection 1412 . . . is silent as to whether an improperly venued

Similarly, appellants boldly assert (without citation) that "the Bankruptcy Court, a court of equity, has the inherent and implicit authority to retain, dismiss or transfer the case, in the interest of justice or for the convenience of the parties." Aplt. Br. 12. Similarly without citation, they assert that "bankruptcy courts are courts of equity where the interest of justice or the convenience of the parties may dictate that cases be administered in a court of improper venue." The Supreme Court disagrees, noting that "it is well established that [c]ourts of equity can no more disregard statutory and constitutional requirements and provisions than can courts of law." Reno v. Bossier Parish Sch. Bd., 520 U.S. 471, 485 (1997) (internal quotation marks omitted); INS v. Pangilinan, 486 U.S. 875, 883 (1988); Regional Airport Auth. of Louisville v. LFG, LLC, 460 F.3d 697, 711 (6th Cir. 2006).

More specifically, there is no basis for distinguishing district courts and bankruptcy courts in this regard. Both are created by statute. 28 U.S.C. §§ 132 & 151. Both can act as "courts of equity." See United States v. Oakland Cannabis Buyers

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case may be retained." Aplt. Br. 41; accord Swinney v. Turner, 309 B.R. 638, 640-41 (M.D. Ga. 2004) (Section 1412 "provided for the transfer of a case to another district for the convenience of the parties or in the interest of justice. However, no current statutory provision authorizes a court to retain a case in an improper venue for the convenience of the parties or in the interest of justice.") (citation omitted); In re Sorrells, 218 B.R. 580, 586 (10th Cir. BAP 1998) ("Section 1412 states that a court 'may' transfer a case, but it does not say anything about retaining a case of improper venue.").

Co-op., 532 U.S. 483, 496 (2001) (district court can act as court of equity). And, indeed, bankruptcy courts are merely "unit[s]" of the district courts. 28 U.S.C. § 151; accord Aplt Br. 18 (describing "bankruptcy courts as adjuncts of the United States district courts"). No one – not even appellants – would suggest that district courts are free to disregard the requirements of § 1406(a). See Aplt. Br. 40 (noting that § 1406 "requires" that an improperly venued case be dismissed or transferred). It necessarily follows that the fact that bankruptcy courts (just like the district courts of which they are units) can be described as courts of equity does not allow them to disregard the requirements of § 1406 (or any other statute).[5]

B. Given that this case must be governed by statute rather than general policy concepts, the only remaining question is whether appellants have provided any statutory reason for this Court to decline to apply § 1406(a). They have not.

1. Appellants appear to suggest that § 1406(a) should not apply because the word "case" has a different meaning with respect to civil cases than with respect to bankruptcy cases. Aplt. Br.

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[5] Ancillary to their argument that bankruptcy courts have equitable power to ignore the venue statutes, appellants repeat the mantra that "bankruptcy is different" when it comes to venue. See, e.g., Aplt. Br. 21, 25-26. But bankruptcy is only different because (and to the extent that) Congress has deemed it so. Appellants concede that no bankruptcy-specific statute addresses the retention of improperly venued cases, and therefore, with respect to the retention of such cases, bankruptcy is not different.

15-17. This argument is puzzling, at best. Appellants concede that venue with respect to the cases at issue here is governed by 28 U.S.C. § 1408, see e.g., Aplt. Br. 12, 24, which refers to commencing "a case . . . in the district court." It necessarily follows that each of the petitions at issue here was "a case . . . in the district court." This exact same concept – indeed, the exact same words, "a case" filed in the "district court" – is used just two sections earlier in § 1406(a). Appellants provide no coherent explanation for why each of the proceedings at issue in this case constituted "a case" filed in a "district court" under § 1408 but not under § 1406(a), and there is none. See Dist. Ct. Op. 17, JA ___ (noting that § 1406 uses the same language as the bankruptcy-specific provisions in §§ 1408 and 1412).

2. Appellants suggest that § 1406(a) should not be applied because §§ 1408 & 1412, which specifically relate to bankruptcy cases, should apply instead. See Aplt. Br. 18-20. But the existence of a bankruptcy-specific statute on a topic does not negate the application of all non-bankruptcy-specific statutes on that same or similar topics. To the contrary, as the Supreme Court recognized in Connecticut Nat'l Bank v. Germain, 503 U.S. 249, 253 (1992), two overlapping statutes must both be given effect "so long as there is no 'positive repugnancy'" between them (quoting Wood v. United States, 41 U.S. (16 Pet.) 342, 363 (1842)). There, a statute addressed review by the Court of Appeals of interlocutory

district court decisions generally, and a separate provision addressed review by the Court of Appeals of district court decisions in bankruptcy cases. The Supreme Court rejected the argument that the statute governing appeals in bankruptcy cases, which was "silent" with respect to interlocutory decisions, limited by implication the statute regarding interlocutory appeals from district courts, whether or not in bankruptcy cases. 503 U.S. at 254. Accord Things Remembered, Inc. v. Petrarca, 516 U.S. 124, 129 (1995) (where general statute regarding removal and bankruptcy-specific statute regarding removal can "comfortably coexist," effect must be given to both). Germain is directly applicable here. Section 1406(a) is a general venue statute that addresses whether a court without venue can retain a case, and § 1412 is a bankruptcy-specific venue statute that appellants concede is "silent" on that question. Germain mandates that § 1406(a) applies in this situation.

In other words, because § 1406(a) applies on its face, and clearly prohibits a court from refusing to transfer or dismiss a bankruptcy case where venue is lacking and a timely objection to venue is made, appellants could only prevail by finding a bankruptcy-specific statute that also applies and that has precisely the opposite effect, i.e, that gives the court authority to retain an improperly venued case. But the only statute they cite is silent on this question.[6]

Appellants place much emphasis on 28 U.S.C. §§ 1408 and 1412 as statutes supposedly in tension with § 1406(a). See Aplt. Br. 24 ("The consideration of 28 U.S.C. §§ 1408 and 1412 in the instant case should be sufficient to determine the final result for the venue in these cases."). But, in fact, both of these statutes are completely consistent with § 1406(a).

Section 1408 is particularly unhelpful to appellants. That provision defines where venue lies in bankruptcy cases. It does not directly state whether a case can be maintained in a court lacking venue. For that reason alone, it is consistent with § 1406(a), which states that a case cannot be maintained in a court lacking venue. But beyond that, the entire tenor of § 1408 is

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[6] Appellants cite to various forms of legislative history surrounding the repeal of 28 U.S.C. § 1477 in 1984, and suggest that this history indicates that, in general, a permissive view of bankruptcy venue ought to prevail. See Aplt. Br. 19-20. But this puts the cart before the horse. Legislative history is only resorted to when the governing statutes are unclear. See, e.g., United States v. Gonzales, 520 U.S. 1, 6 (1997) ("Given the straightforward statutory command, there is no reason to resort to legislative history."). As noted above, § 1406(a) is clear, and requires dismissal or transfer of an improperly venued case. For reasons discussed above, the legislative history actually supports the district court's ruling, but even if it supported appellants, that fact alone would not be sufficient to overcome the clear statutory language that was actually enacted by Congress and thus constitutes the applicable law. See, e.g., Lexecon Inc. v. Milberg Weis Bershad Hynes & Lerach, 523 U.S. 26, 37 (1998) ("The language is straightforward, and with a straightforward application ready to hand, statutory interpretation has no business getting metaphysical.").

consistent with § 1406(a) and not with appellants' view of venue. Section 1408 says that a case may not be "commenced" in a court lacking venue. The cases at issue here were "commenced" in a court lacking venue – a point that appellants do not contest. See, e.g. Aplt. Br. 15. Appellants suggest that, although they violated the requirements of § 1408, no corrective action should be taken. As noted above, this would render § 1408 a nullity, which this Court should not do. Instead, it is far more logical to conclude that Congress intended § 1408 to have real meaning, and that meaning is provided by § 1406(a), which spells out the consequences that follow from a violation of § 1408 (and other venue provisions).

Similarly, with respect to retaining a case where venue is lacking, there is no "positive repugnancy" between § 1412 and § 1406(a). Section 1412 is aptly entitled "change of venue," and addresses the situations in which "[a] district court may transfer a case or proceeding under title 11 to a district court for another district." 28 U.S.C. § 1412. This provision is obviously silent as to the question at issue here (and directly addressed in § 1406(a)): whether a court may retain a case where venue is lacking and a timely objection is made. Indeed, appellants admit that it is "silent" on this question. Aplt. Br. 41; accord Swinney v. Turner, 309 B.R. 638, 640-41 (M.D. Ga. 2004) (Section 1412 "provided for the transfer of a case to another district for the convenience of the parties or in the interest of justice. However, no current statutory provision authorizes a court to retain a case in an improper venue for the convenience of the parties or in the interest of justice.") (citation omitted); In re Sorrells, 218 B.R. 580, 586 (10th Cir. BAP 1998) (noting that § 1412 "does not say anything about retaining a case of improper venue," which "alone leads us to believe that section 1412 does not authorize a court of improper venue to retain a bankruptcy case"). In other words § 1412 says that a court may transfer a case (under certain circumstances) and is silent as to what other options are available. Section 1406(a) also notes that a court may transfer a case, but, unlike § 1412, does speak to the remaining options available. It says that there is only one such option, when venue is lacking, and that is dismissal. Accordingly, nothing in § 1412 calls into question the requirement of § 1406(a) that a district court lacking venue must either transfer or dismiss.[7]

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[7] Appellants suggest that there may be a conflict between § 1406(a) and § 1412 with respect to the courts' power to transfer cases in certain circumstances. If, as appellants suggest on pages 31-33 of their brief, § 1412 allows a court lacking venue to transfer a case to another court lacking venue, then there could be a conflict. Accord Aplt. Br. 19-20. As a matter of statutory construction, appellants' contention is highly questionable. See Dist. Ct. Op. 20, JA ___ (holding that "28 U.S.C. § 1412 governs the transfer of bankruptcy cases filed in the proper venue"). But there is no need to debate this point because it is not necessary to resolve it in order to decide the case at hand. The asserted conflict between §§ 1406(a) and 1412 involves whether a case may be transferred from one court lacking venue to another. That is not the question before this Court. Instead, this Court must determine whether a court lacking venue can retain a case. On that question, appellants concede that there is no conflict because they admit that § 1412 is "silent." Aplt. Br. 41 ("Section 1412 . . . is

C. Finally, appellants suggest that the requirements of § 1406(a) can be disregarded here because its application "creates absurd results." Aplt. Br. 13. The apparent absurdity is that they are not allowed to proceed "in a convenient, albeit technically improper venue." Aplt. Br. 29. While appellants do not specify why mere inconvenience is absurd, they focus on the distance between their homes and Aberdeen, Mississippi, home of the bankruptcy court for the Northern District of Mississippi (where all the parties agree that venue is proper). See Aplt. Br. 26-27 (noting that appellants "live and work in closer proximity to the United States Bankruptcy Court for the Western District of Tennessee, Western Division [based in Memphis], than to the United States Bankruptcy Court for the Northern District of Mississippi [based in Aberdeen]"). More specifically, they complain that Memphis is about 15-25 miles from their homes wile Aberdeen is about 120-135 miles away, up to two hours further. Id. at 10-11, 22-24, 27.

Although it is correct that statutes must be interpreted to avoid absurd results, the standard of absurdity is a high one. Sturges v. Crowninshield, 17 U.S. (4 Wheat.) 122, 202-03 (1819) (absurdity must be "so monstrous, that all mankind would, without hesitation, unite in rejecting" it); Robbins v. Chronister, 435

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silent as to whether an improperly venued case may be retained . . . .").

F.3d 1238, 1241 (10th Cir. 2006) (requiring an absurdity "so gross as to shock the general moral or common sense") (internal quotations and citation omitted); Sigmon Coal Co. v. Apfel, 226 F.3d 291, 308 (4th Cir. 2000) (same), aff'd 534 U.S. 438 (2002). An extra two hours of driving time does not qualify. Indeed, appellants do not allege that it is absurd that their appeal be heard in this Court, which is located over 500 miles from their residences.

More importantly, appellants omit a number of key facts that demonstrate little or no inconvenience to them from being required to file in their state of residence. For example, although Aberdeen is indeed the seat of the bankruptcy court in the Northern District of Mississippi, that fact has almost no relevance to appellants. If appellants had properly filed their bankruptcy cases in the Northern District of Mississippi (and if this court upholds the district court's decision), bankruptcy court proceedings would not be held in Aberdeen, but rather in Oxford, Mississippi, which is only about 60 miles from appellants' residences.[8]

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[8] This practice is reflected in the February 1986 Standing Order of the United States Bankruptcy Court for the Northern District of Mississippi, which is attached as Addendum 1 to this Brief and notes that bankruptcy cases originating from DeSoto County (where debtors reside) are scheduled and conducted at Oxford.

Accordingly, the relevant courthouse is only about 60 miles away, half as far as appellants suggest. But even more importantly, appellants need never travel even those 60 miles. Instead, they can prosecute their cases through their counsel, without ever traveling to the court itself (much as they presumably intend to litigate before this much more distant Court). Indeed, many Chapter 7 and 13 debtors do just that. The only proceeding that debtors are required to attend in person is the meeting of creditors. See 11 U.S.C. § 341(d). But that meeting cannot be attended by the bankruptcy judge, see id. § 341(c), and need not occur in court or even near the courthouse. To the contrary, the United States Trustee has designated a number of different locations for such meetings, one of which is the DeSoto Civic Center in Southaven, Mississippi. See http://149.101.1.32/ust/r05/jackson/meetroom.htm. The Jordan Debtor actually resides in the very same town, Supplemental Opinion, R. 18 in No. 04-28437, JA ___ , and the Thompson Debtors live in Olive Branch, Mississippi, Aplt. Br. 10, which is just twelve miles away. In other words, with respect to the only bankruptcy event at which their personal attendance is necessary, the location of the meeting will actually be more convenient for appellants if their cases are handled in the Northern District of Mississippi than if they were to remain in a Tennessee-based court. In sum, there is no inconvenience to appellants, much less sufficient inconvenience to render Congress's decision in this regard "absurd."

At any rate, Congress was fully justified in enacting a statute that establishes bankruptcy venue based on the debtor's residence rather than his or her convenience. Despite appellants' assertion that "state lines are not necessarily drawn in the best interest of the citizens," Aplt. Br. 28, state lines do have important legal significance. They are the basis for the boundaries of the judicial districts, see 28 U.S.C. §§ 81-131, and those districts, in turn, are the boundaries that Congress deemed relevant to venue in bankruptcy cases, see id. § 1408. More importantly, the law governing bankruptcy "requires bankruptcy courts to consult state law in determining the validity of most claims." Travelers Cas. & Sur. Co. v. Pacific Gas & Elec., 127 S. Ct. 1199 (March 20, 2007); accord Vanston Bondholders Protective Comm. v. Green, 329 U.S. 156, 161 (1946) ("What claims of creditors are valid and subsisting obligations against the bankrupt at the time a petition in bankruptcy is filed is a question which, in the absence of overruling federal law, is to be determined by reference to state law."). Important issues, such as the exemptions available to a debtor, can turn on the law of the state in which the debtor resides. See 11 U.S.C. § 522(b)(3)(A) (exemptions based on "State or local law . . . at the place in which the debtor's domicile has been located."); In re Spears, 744 F.2d 1225 (6th Cir.

1984) (applying § 522(b)). Because the law of the debtor’s state of residence must frequently be applied in bankruptcy proceedings, it was entirely reasonable for Congress to require that bankruptcy cases be brought within that state, before judges more likely to be familiar with that law, even if (unlike in this particular instance) it meant that the debtors would have to drive a few extra miles to the meeting of creditors. See Rudd Constr. Equip. Co. v. Clark Equip. Co., 735 F.2d 974, 978 (6th Cir. 1984) (“The district judge will normally have a knowledge of that state’s law and will have the resources for ascertaining it.”); Selko v. Home Ins. Co., 139 F.3d 146, 151 (3d Cir. 1998) (noting that federal judges sitting in a state are “familiar with that state’s law”). There is nothing remotely “absurd” about Congress’s judgment in this regard.

CONCLUSION

For the foregoing reasons, the decision of the district court should be affirmed.

Respectfully submitted,

Of Counsel

ROBERTA A. DEANGELIS
Acting General Counsel

P. MATTHEW SUTKO
Office of the General Counsel
Executive Office for U.S. Trustees
Department of Justice
20 Mass. Ave., NW Suite 8100
Washington, DC 20530

SEAN M. HAYNES
Office of the U.S. Trustee
Department of Justice
200 Jefferson Ave., Room 400
Memphis, TN 38103

MARCH 2007

PETER D. KEISLER
Assistant Attorney General

DAVID F. KUSTOFF
United States Attorney

WILLIAM KANTER
(202) 514-4575
JONATHAN H. LEVY
(202) 353-0169
Attorneys, Appellate Staff
Civil Division, Room 7231
Department of Justice
950 Pennsylvania Ave., N.W.
Washington, DC 20530-0001

CERTIFICATE OF COMPLIANCE

Pursuant to Sixth Circuit Rule 32(a) and Rule 32(a)(7)(C) of the Federal Rules of Appellate Procedure, I hereby certify that the foregoing brief complies with the type and volume limitations set forth in Rule 32 of the Federal Rules of Appellate Procedure. I further certify that the computerized word count for the foregoing brief (excluding exempt material) is 8,091.

____
JONATHAN H. LEVY
Attorney for the Appellees

CERTIFICATE OF SERVICE

I hereby certify that on March 30, 2007, I dispatched one (1) signed original of the foregoing Proof Brief for the Appellees to the Clerk of this Court by Federal Express Overnight. On the same date, and by the same manner of delivery, I served two (2) copies of the brief on the following counsel:

Holly W. Schumpert
Law Offices of Holly W. Schumpert
100 N. Main Building
Suite 948
Memphis, TN 38103

____
JONATHAN H. LEVY
Attorney for the Appellees

ADDENDA

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF MISSISSIPPI

PRO TEMPORE ORDER AS TO SITES FOR BANKRUPTCY MEETINGS AND HEARINGS

WHEREAS, pursuant to consideration of the budgetary implications of the Gramm-Rudman-Hollings Act for the operation of the federal court system in the Northern District of Mississippi, bankruptcy hearings or meetings shall be discontinued for the present time at Clarksdale, Mississippi; and

WHEREAS, the discontinuation of such hearings and meetings is predicated on lawful directives for the effectuation of stringent budgetary economies in the operation of the Judicial Branch of Government throughout the United States; and

WHEREAS, the assessment of ways and means to achieve budgetary economies in this district indicate that cost effectiveness will best be achieved by discontinuing all operations at Clarksdale, Mississippi, which are not required by the United States Constitution or by federal statute to be conducted at such site; and

WHEREAS, the conducting of bankruptcy hearings and meetings at Clarksdale, Mississippi, is not required by the United States Constitution or by federal statute;

NOW, THEREFORE, IT IS HEREBY ORDERED that, pending the further order of this court, any and all bankruptcy hearings or meetings for which hearing or meeting dates have not already been scheduled to be held at Clarksdale, Mississippi, shall henceforth be scheduled for and conducted at Greenville, Mississippi, or Oxford, Mississippi, depending upon the county with which any such filing may be associated; and

IT IS FURTHER ORDERED that the configuration of counties which shall control the determination of places of such hearings and meeting as to such Delta Division cases shall be as follows:

Cases originating from Bolivar County shall be scheduled and conducted at Greenville, Mississippi. Cases originating from Coahoma, DeSoto, Panola, Quitman, Tallahatchie, Tate and Tunica Counties shall be scheduled and conducted at Oxford, Mississippi.

~~A.M.~~
Entered 2-13-86 at 4:20 P.M.
United States Bankruptcy Court
Northern District of Mississippi
Joseph E. Wroten, Clerk
By P. Bartell D.C.

IT IS FURTHER ORDERED that, subject to appropriate exceptions on account of potential conflicts of interest, illness, or other inability to act, etc., and irrespective of present statutory division lines in the Northern District of Mississippi, the several members of the presently constituted Chapter 7 Panel of Trustees in this district shall be routinely appointed as interim trustees and, unless creditors shall lawfully elect other trustees in particular Chapter 7 cases, as permanent trustees in such cases based on the following configuration of counties geographically located in the Northern District of Mississippi, to-wit:

Hon. Jacob C. Pongetti: Choctaw, Alcorn, Attala, Chickasaw, Clay, Itawamba, Lee, Lowndes, Monroe, Oktibbeha, Prentiss, Tishomingo and Winston Counties;

Hon. Alex B. Gates: Coahoma, DeSoto, Panola, Quitman, Tallahatchie, Tate, Tunica, Grenada and Montgomery Counties;

Hon. Stephen P. Livingston, Sr.: Benton, Calhoun, Lafayette, Marshall, Pontotoc, Tippah, Union, Webster and Yalobusha Counties; and

Hon. Jeffrey A. Levingston: Bolivar, Carroll, Humphreys, Leflore, Sunflower and Washington Counties.

ORDERED AND ADJUDGED this the 11th day of February, 1986.

David W. Houston, III

DAVID W. HOUSTON, III
UNITED STATES BANKRUPTCY JUDGE

Approved this the 12th day of February, 1986.

L. T. Senter, Jr.

L. T. SENTER, JR.
CHIEF UNITED STATES DISTRICT JUDGE
NORTHERN DISTRICT OF MISSISSIPPI

Designation of Appendix Contents

Pursuant to Sixth Circuit Rules 28(d) and 30(b) & (f), the appellees hereby designate the following parts of the record to be included in the Joint Appendix:

Document Description	Date	Case No.	Record No.
Bankruptcy Court Docket (Jordan)	------	04-28437	--
Bankruptcy Court Docket (Thompson)	------	04-29553	--
District Court Docket (Thompson)	------	04-2765	--
District Court Docket (Jordan)	------	04-2766	--
Chapter 7 Voluntary Petition (Jordan)	6/2/04	04-28437	1
Chapter 13 Voluntary Petition (Thompson)	6/21/04	04-29553	1
District Court Order Reversing in Jordan and affirming in Thompson	10/31/06	04-2765 04-2766	17 16
District Court Judgment (Thompson)	10/31/06	04-2765	18
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BRIEF BANK — 'SUMMARY SHEET" *Printed Tue-4/5/05 15:21*

WESTLAW CODES

1. **("TI")** *TITLE* OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]* — Jordan v. Liebmann, In re Doyon

2. **("CO")** *CURRENT* COURT *[E.g., "CTA9"]* — CTA 4

3. **("CCN")** *CURRENT* CASE NO. — No.: 04-2323

4. **("PCN")** *PRIOR* CASE NO. & COURT *[IF ANY]* — No.:

Court: D MD

(Identify judge & cite, if any)

5. **("SO")** *SOURCE* — U.S. TRUSTEES

6. **("DA")** *DATE* OF FILING *& TYPE* OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]* — Filed: March 25, 2005

Type: Opening Brief of United States Trustee

7. **("AU")** *PRINCIPAL AUTHORS & OFFICE [E.g.,"UST/OGC"]* — Paul W. Bridenhagen, Esq. EOUST

P. Matthew Sutko, Esq. EOUST

(UST/OGC: 202-307-1399/FAX-2397)

8. **("TO")** *TOPIC* — BANKRUPTCY

9. **("SU")** ● *SUMMARY* OF KEY ISSUE(s) & √ Any Miscellaneous *BACKGROUND*

● Whether the bankruptcy court abused its discretion under 11 U.S.C. 330 by limiting the compensation awarded to Jordan for Services performed during the Chapter 13 phase of the case.

√ Background:

10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...) — F:\seggert\My Files\BriefBank-Web\Jordan\Jordan01.wpd

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APPEAL NO. 04-2323

IN THE

UNITED STATES COURT OF APPEALS

FOR THE FOURTH CIRCUIT

In Re: Daniel Doyon,

Debtor

MARC L. JORDAN,	Plaintiff-Appellant,
v.	
GEORGE W. LIEBMANN,	Trustee-Appellee,
HEIDI RICHARDSON,	Creditor-Appellee,
UNITED STATES TRUSTEE,	U.S. Trustee-Appellee,
OREGON COLLEGE SAVINGS PLAN,	Defendant
JOEL P. GOLDBERGER,	Trustee.

ON APPEAL FROM THE DISTRICT COURT FOR THE
DISTRICT COURT FOR THE DISTRICT OF MARYLAND

BRIEF OF UNITED STATES TRUSTEE, APPELLEE

Clarkson McDow
United States Trustee

Donald F. Walton
Acting General Counsel

Paul W. Bridenhagen
Trial Attorney
U.S. Department of Justice
Executive Office for U.S. Trustees
20 Massachuset, N.W.
Washington, D.C. 20530

Tel. (202) 307-1337
FAX (202) 307-2397

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STATEMENT OF JURISDICTION

The bankruptcy court had jurisdiction under 28 U.S.C. § 157. On December 22, 2003, the bankruptcy court entered a final order limiting the attorney's fees payable to Appellant Marc L. Jordan ("Jordan"). Jordan timely filed a notice of appeal on December 24, 2003, over which the district court had jurisdiction under 28 U.S.C. § 158(a). The district court entered a final order affirming the bankruptcy court on September 30, 2004. On October 15, 2004, Jordan timely filed a notice of appeal to this Court, which has jurisdiction under 28 U.S.C. § 158(d).

STATEMENT OF THE ISSUE PRESENTED FOR REVIEW

Whether the bankruptcy court abused its discretion under 11 U.S.C. § 330 by limiting the compensation awarded to Jordan for services performed during the chapter 13 phase of the case.

STANDARD OF REVIEW

A bankruptcy court's findings of fact are reviewed for clear error, and its conclusions of law are reviewed *de novo*. *In re Merry-Go-Round Enter., Inc.*, --- F.3d ----, 2005 WL 418692 (4th Cir. 2005). An award of attorneys fees is reviewed only for abuse of discretion. *In re Wingert*, 89 F.2d 305 (4th Cir. 1937).

STATEMENT OF THE CASE

A. Nature of the Case and Procedural Background.

This appeal concerns the bankruptcy court's discretion to allow compensation for a chapter 13 debtor's counsel under 11 U.S.C. § 330(a)(4)(A). Jordan filed an application for attorney's fees ("Fee Application"), wherein he sought a total of $6,142.50 for services provided to Daniel Richard Doyon ("Debtor") during the chapter 13 case phase of his case. (A. at 100-126). Both the Debtor's ex-wife, Heidi A. Richardson ("Richardson"), who is the primary creditor in the case, and the United States Trustee[1/] filed objections to the Fee Application. (A. 100 - 125). Following a hearing, the bankruptcy court issued an order limiting Jordan's compensation to $1,000, which amount the Debtor had already paid. (Appendix ("A.") at 35-38). On appeal, the district court affirmed, (A. at 25-33), and this appeal ensued. (A. at 23, Pleading (Pl.) 185).

B. **Statement of the Facts**

Debtor and Richardson obtained a divorce decree in New York on October 11, 2000. (Supplemental Appendix ("S.A.") at 465 - 462). That decree incorporated a separation agreement that required that the Debtor pay her certain

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[1/] United States Trustees are officials of the Department of Justice appointed by the Attorney General to supervise the administration of bankruptcy cases and trustees. See 28 U.S.C. §§ 581-589. See also In re Columbia Gas Sys., Inc., 33 F.3d 294, 296 (3d Cir. 1994) (United States Trustees oversee the bankruptcy process, protect the public interest, and ensure that bankruptcy cases are conducted according to law) (citing H.R. Rep. No. 95-595, 109 (1977)).

sums. (S.A. at 443 - 457). Debtor failed to those payments and Richardson filed a complaint in Circuit Court for Howard County, Maryland seeking to enforce the terms of the agreement. (S.A. at 460 - 465). Jordan represented the Debtor in the Maryland divorce proceeding, which was resolved by the entry on July 24, 2002, of a Settlement Decree and Consent Judgment (S.A. at 463 - 474), under which the Debtor was required to pay Richardson approximately $120,000. (S.A. at 441).

Following unsuccessful efforts by Richardson to collect any of the amounts owed her under the Settlement Decree and Consent Judgment, and shortly after Richardson garnished several of the Debtor's bank accounts (S.A. at 463), Jordan filed a voluntary petition for relief on behalf of the Debtor under chapter 7 of the Bankruptcy on October 16, 2002. (A., Pl. 1). Jordan also filed a Disclosure of Compensation of Attorney for Debtor, as required by 11 U.S.C. § 329(a) and Fed. R. Bankr. P. 2016(b). The disclosure stated that the agreed fee in the chapter 7 case was $1,500, which had been paid pre-petition. (S.A. at 22). George W. Liebmann was appointed as the chapter 7 trustee ("trustee").

On February 11, 2003, Jordan filed a one-page motion to convert the debtor's chapter 7 case to one under chapter 13. (A. at 84). Along with that motion, Jordan filed a new Rule 2016(b) statement, which disclosed that Jordan had agreed to accept $1,950 as a flat fee to represent the Debtor in his chapter 13 case and that he had already been paid $1,000 in advance. (A. 83). The bankruptcy court granted the Debtor's motion and entered an order converting the case to chapter 13 on February 21, 2004. The bankruptcy court entered an order converting the case to chapter 13 on February 21, 2004. (A. 35 - 38). Thereafter, the appointment of George Liebmann as chapter 7 trustee was terminated and Joel Goldberger was appointed to serve as chapter 13 trustee. (A. at 1).

On April 30, 2003, less than three months after disclosing his agreement to handle the Debtor's case for $1,950, Jordan filed an Application of Debtor's Attorney for Allowance of Compensation ("Fee Application") seeking a total of $6,142.50 for the work he provided the Debtor in the Debtor's chapter 13 case. Both Richardson and the United States Trustee objected to the Fee Application. (A. 100 - 125). On June 25, 2003, Jordan filed a supplemental Rule 2016(b) statement, disclosing a fee agreement with the Debtor for the chapter 13 case for $6,142.50. (A. at 14). On June 27, 2003, Jordan filed a motion to withdraw his appearance. (S.A. at 248). As of July 2, 2003, when the bankruptcy court granted the motion to withdraw, no plan had been confirmed and the Debtor had not made any plan payments as required under 11 U.S.C. § 1326. *See generally*, (A. 5 - 24). The case was reconverted to chapter 7 on Richardson's motion on September 29, 2003, and George W. Liebmann was reappointed to serve as the chapter 7 trustee. (A. at 20, Pl. 152).

Jordan's tenure as counsel to the Debtor was marked by repeated conflict with Richardson (his ex-wife), the chapter 7 trustee and the United States Trustee. *See generally,* (A. at 5 - 24) (reflecting 178 docket entries from the time the case was filed until the hearing on Jordan's Fee Application). These actions included objecting to the trustee's proposed sale of estate property (A. at 8, Pl. 33); filing a motion to remove the trustee (S.A. at 28 - 35); moving to quash a subpoena issued by the trustee for the Debtor's deposition (S.A. at 66), and; opposing the trustee's motion to extend the deadline for filing objections to discharge and to determine the dischargeability of certain debts (S.A. at 7, Pl. 18). The bankruptcy court ruled against the Debtor on all of those issues.

On February 11, 2003, the same date on which he filed a one-page motion to convert, Jordan also filed motions requesting leave to pursue an interlocutory appeal and for a stay of the bankruptcy court's decision allowing the sale of the personal property. (A. at 19, Pl. 185; S.A. at 91). The Debtor contended that this property included certain books and records that he needed to pursue his chapter 13 case. Following a telephonic hearing on February 25, 2003, the district court denied these motions. (S.A. at 106). The district court held that both motions were moot because, as a result the sale of the estate property, the buyer, Jennifer Thomas (a friend of Richardson), was a good faith purchaser as of January 3, 2003. *Id.* As a consequence of this sale, the district court held that the chapter 7 estate no longer owned the disputed property when Jordan filed.

Subsequent to conversion, Jordan filed two motions concerning the estate property previously sold by the chapter 7 trustee. The first was a March 5, 2003, motion that requested that the chapter 7 trustee show cause why he should not be held in contempt for failing to turn over that property to the chapter 13 trustee, Joel Goldberger. (S.A. at 108). On April 30, 2003, Jordan filed a motion seeking to compel the chapter 7 trustee, Richardson, and Thomas (buyer of the estate property) to turn over the books and records. (S.A. at 203). Both of these motions were denied, as the court had previously found, the property had been prior to conversion and was no longer in the possession of the chapter 7 trustee. (S.A. at 235 and 245).

In addition to being involved with substantial litigation, Jordan also failed to comply with repeated requests from the United States Trustee's Office and from counsel for Richardson for the Debtor's updated address, information the Debtor was required to provide under Fed. R. Bankr. P. 4002(5). (S.A. at 180 - 197). Jordan also failed to file corrected bankruptcy schedules I and E. *Id.* Despite Jordan's repeated assurances, he did not correct these deficiencies during his tenure as Debtor's counsel.

On December 4, 2003, a hearing was held on the Fee Application. At that hearing, although argument was presented, the Debtor presented no evidence in support of his application, either testimonial or documentary. (A. 63 - 99). By order entered December 19, 2003, the bankruptcy court held that Jordan's compensation should be limited to the $1,000 he had already been paid. (A. at 35 - 39). The bankruptcy court observed that in the Bankruptcy Court for the District of Maryland, chapter 13 attorneys customarily received between $1,000 and $1,500. Id. at 2 - 3. It further reasoned that Jordan was bound by his fee agreement with the Debtor to no more than $1,950. The bankruptcy court concluded, however, that because Jordan withdrew prior to the confirmation hearing on the Debtor's plan, the fee claimed in his Rule 2016(b) disclosure should be reduced to $1,000. (A. at 37). On appeal, the district court affirmed, generally following the reasoning of the bankruptcy court. (A. at 25 - 33).

ARGUMENT

THE RECORD BELOW SUPPORTS THE LIMITATION OF JORDAN'S FEES, NOTWITHSTANDING ERROR BY THE LOWER COURTS

A. The Lower Courts Erred By Applying Incorrect Criteria In Reviewing Jordan's Fees

Section 330 of the Bankruptcy Code governs compensation to attorneys in bankruptcy cases. 11 U.S.C. § 330. It allows bankruptcy courts to award reasonable compensation in such cases only for "actual, necessary services rendered" and "actual, necessary expenses." 11 U.S.C. § 330(a)(1). Section 330(a)(3) sets forth a non-exhaustive list of criteria that a court must consider in determining whether to award such fees.[2/]

[2/] The criteria set forth in section 330(a)(3) include the following:

> (A) the time spent of such services;
>
> (B) the rates charged for such services;
>
> (C) whether the services were necessary to the administration of, or beneficial at the time at which the services were rendered toward completion of, a case under this title;
>
> (D) whether the services were performed within a reasonable time commensurate with the complexity, importance, and nature of the problem, issue or task addressed; and
>
> (E) whether the compensation is reasonable based on the customary compensation charged by comparably skilled practitioners in cases other than cases under this title.

Under section 330(a)(4)(A),[3/] the compensation of a debtor's attorney in chapter 7 or 11 requires a showing of a benefit to the estate. *See In re Reed*, 890 F.2d 104, 106 (8th Cir.1989) (this rule is based in part upon the unfairness of allowing a debtor to deplete estate assets by pursuing the interests of the debtor to the detriment of creditors.). Section 330(a)(4)(B)[4/], however, provides a different set of criteria for determining whether fees may be awarded to debtors' counsel in chapter 13 cases. This section allows a bankruptcy court to award compensation to a chapter 13 debtor's counsel "for representing the interests of the debtor in connection with the bankruptcy case" based on considerations of benefit and

---

[3/] Section 330(a)(4)(A) provides as follows:

> (A) Except a provided in subparagraph (B), the Court shall not allow compensation for–
>
> (i) unnecessary duplication of services; or
>
> (ii) services that were not–
>
> > (I) reasonable likely to benefit the estate;
> >
> > (II) necessary to the administration of the case.

[4/] Section 330(a)(4)(B) of the Bankruptcy Code provides as follows:

> In a chapter 12 or chapter 13 case in which the debtor is an individual, the court may allow reasonable compensation to the debtor's attorneys, for representing the interests of the debtor in connection with the bankruptcy case based on a consideration of the benefit and necessity of such services to the debtor and the other factors set forth in this section.

necessity of such services to the debtor, and other factors set forth in that section. *See Lamie v. United States Trustee*, 124 S.Ct. 1023, 1031 (2004) (noting in dicta that debtor's counsel may be paid by the estate under § 330(a)(4)(B)).

The bankruptcy court reviewed the criteria set forth in both sections 330(a)(4)(A) and 330(a)(4)(B). In performing that analysis, however, it focused only on the criteria contained in 330(a)(4)(A), which required consideration of the benefit to the debtor's estate and the necessity of those services for the administration of the case. The bankruptcy court reduced Jordan's fees, in part, because it determined that generally his services did not benefit and were not necessary to the administration of the debtor's estate. (A. 36 - 38). The district court did not identify which statutory criteria it applied, but affirmed the bankruptcy court's holding concerning the benefit of Jordan's services to the estate. (A. at 32).

To the extent that the lower courts' rulings considered the benefit to the estate of Jordan's services, their decisions were in error. Section 330(a)(4)(A) provides that the courts should consider whether the services benefitted the debtor's estate or were necessary to the administration of the estate. However, the first clause of that section contains a proviso that prohibits courts from denying fees to chapter 13 attorneys on those grounds. 11 U.S.C. § 330(a)(4)(A) ("Except as provided in subparagraph (B), the court shall not allow compensation for -- "

Thus, it was error for the lower courts to reduce fees based upon the fact that Jordan's services did not benefit the debtor's estate.

B. The Bankruptcy Court's Conclusion That Jordan Was Bound To The Maximum Amount Of Fees Agreed To Under The Fee Agreement Was Error

The bankruptcy court also reduced Jordan's chapter 13 fee request because it determined that he had made no showing that he was entitled to the $6,142.50 in fees sought. In performing its analysis, the bankruptcy court also relied, in-part, on the fact that Jordan had agreed to a maximum fee of $1,950 for the chapter 13 case. The bankruptcy court held that Jordan was bound by the agreement and that he had made no showing justifying a departure from the agreement. (A. 37 - 38).

Before the lower courts, in its objection to the fee application and in the joint Appellee's Brief in the District Court (A. 56), the United States Trustee and Co-Appellees argued that Jordan's fee should be limited to that provided by the fee agreement. Upon further reflection, the United States Trustee believes that the propriety of fees must be determined by applying the criteria Congress specified in section 330(a)(4)(B). Even when a debtor agrees to pay an attorney a specific fee, that agreement is not binding on the court, which instead must determine fees by applying criteria set forth in section 330(a)(4)(B). Certainly, the amount counsel anticipated his services might be worth may have evidentiary weight in determining what fee is appropriate. But, as here, a simple agreement, without supporting testimony why that fee is appropriate, would seem to have little evidentiary weight in determining what fee is appropriate under section 330(a)(4)(B).

The Bankruptcy Code does not allow parties, merely by contracting for professional services, to override bankruptcy courts' federal statutory responsibility for determining the "value" of professional services and the amount of compensation that would be "reasonable" pursuant to section 330. Because bankruptcy professionals under section 330 are paid from assets of the estate, 11 U.S.C. § 503(b)(3), bankruptcy courts have a critical "independent duty" to ensure that such fees are reasonable based on a totality of circumstances. *In re Busy Beaver Building Centers*, 19 F.3d 833, 840 (3d. Cir. 1994) (Bankruptcy court has power and duty to review fee applications, notwithstanding absence of objection by United States Trustee, creditors, or other interested party). Consequently, to the extent that the private parties' pre-petition fee agreements may have been deemed controlling, a defense of this appeal on that ground would be inconsistent with section 330(a)(4)(B).[5/]

Although the bankruptcy court incorrectly considered the benefit of Jordan's services to the estate and $1,950 fee agreement with the Debtor, those errors were harmless. As discussed below, the other factors the courts identified, and the

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[5/] It should be noted that the district court's decision is less problematic as it recognized that fee agreements would not always be determinative. (A. at 30 - 34).

record before the court support the bankruptcy court's exercise of its discretion in awarding $1,000 in fees in this case.

C. The Record Below Justifies Affirming the Decision of the District Court

The limitation by the lower courts of the compensation sought by Jordan to $1,000 should be affirmed as a reasonable exercise of the bankruptcy court's discretion. In this regard, two factors are critical. The first is that under the Bankruptcy Code, applicants for professional fees have long borne the evidentiary burden of proving that their requested fees are reasonable. *See, e.g., Zolfo, Cooper & Co. v. Sunbeam-Oster Co.*, 50 F.3d 253, 261 (3d Cir. 1995); *In re Kenneth Leventhal & Co.*, 19 F.3d 1174, 1177 (7th Cir. 1994). The second is the broad discretion afforded bankruptcy courts in determining fees. In scrutinizing the factual and discretionary determinations "involved in calculating . . . fee awards," appellate courts give "considerable deference to the bankruptcy court. Historically, bankruptcy courts have been accorded wide discretion . . . in regard to the terms and conditions of the engagement of professionals." *In re Miniscribe Corp.*, 309 F.3d 1234, 1244 (10th Cir. 2002). "The bankruptcy judge is on the front line, in the best position to gauge the ongoing interplay of factors and to make the delicate judgment calls which such a decision entails." Id.

With respect to Jordan's burden of proof, it is significant that at the hearing on his fee application he presented no testimony, nor any documentary evidence whatsoever. (A. at 63 - 99). Consequently, Jordan's Fee Application constitutes his entire proffer on his entitlement to fees and that proffer is woefully insufficient. Throughout the Fee Application, Jordan offers no concrete details supporting his claim for compensation. (A. at 142 -152). Instead, he only avers that his application satisfies various statutory and case law criteria. For example, he stated that he "believes" that his services were necessary and beneficial. (A. at 145 (Fee Application at 4, ¶ 10(iii)). He did not, however, present any evidence or refer to any information in the record to support this claim. Similarly, in Jordan's discussion of the degree of skill required to provide legal services, he states only that this case required "services of capable counsel." (A. 147 (Fee Application at 6, ¶ 12(iii)). Again, however, Jordan did not offer any evidence concerning how capable his services were. A review of his discussion of other criteria in his application and his failure to present any evidence either in his Fee Application or at the hearing confirms that Jordan failed to carry his evidentiary burden of establishing that a reasonable fee under section 330(a)(4)(B) was $6,142.50.[6/]

[6/] Concerning the inadequacies of Jordan's Fee Application, the United States Trustee agrees with that portion of co-appellee's brief (at 20 - 25) that addresses the relevant enumerated factors that this Court set forth in *Barber v. Kimbrell's, Inc.* 577 F.2d 216 (4th Cir. 1978), relating to the reasonableness of attorneys' fees.

Given Jordan's failure to meet his burden of proof, the bankruptcy court could have denied the fee request as not adequately proven. Instead, the court exercised its power under section 330(a)(4)(B) to determine what an appropriate fee might be. *See* 11 U.S.C. 330(a)(4)(B) (with respect to debtor's counsel in a chapter 13 case "the court may allow reasonable compensation . . . "). Based on its review, the bankruptcy court awarded Jordan $1,000. Under the facts of this case, that award was adequate and was not an abuse of discretion.

In determining what compensation would be appropriate, the bankruptcy court held that counsel in chapter 13 cases, in the District of Maryland, typically receive $1,000 to $1,500 in fees for representing chapter 13 debtors. (A. at 36 - 37). The bankruptcy court further noted that Jordan had resigned as counsel before a plan confirmation hearing was held. *Id.* Given that Jordan performed fewer services than counsel typically do, it was an appropriate exercise of discretion for the bankruptcy court to reduce Jordan's fees in this case to something less than that typically awarded to chapter 13 counsel who represent their clients through the entire chapter 13 process. *Cf. In re Kindhart*, 167 F.3d 1158, 1160 (7th Cir. 1999) ($1,000 chapter 13 attorney's fee that obviates the need for individualized fee review in chapter 13, where district-wide fee level is fair and reasonable).

Although the bankruptcy court and the district court incorrectly focused on the benefit to the estate of Jordan's services, the district court did consider the benefit to the Debtor of Jordan's services. (A. at 32). A review of the record supports the district court's conclusion that generally the services provided by Jordan to the Debtor did not satisfy the criteria of "representing the interests of the debtor in connection with the bankruptcy case." 11 U.S.C. § 330(a)(4)(B). Although the Bankruptcy Code does not define the term "in connection with the bankruptcy case," the United States Trustee contends it is best understood as allowing services that moves the debtor's case forward. Debtors file chapter 13 cases so they can liquidate their debts through a chapter 13 repayment plan. 11 U.S.C. §§ 1301, et. seq. As a leading legal treatise on bankruptcy has observed, actions that are not necessary for completion of the plan should be seen as falling outside the ambit of compensable services under section 330(a)(4)(B). Collier on Bankruptcy, (15th Ed.) ¶ 330.04[1][b] ("services that benefit the debtor in connection with the case are services that facilitate the successful completion of the plan.").

Such non-compensable services include time for preparing his Fee Application (1.2 hours). (A. at 151). *In re Copeland,* 154 B.R. 693 (Bankr. W.D. Mich. 1993) (chapter 13 debtor's counsel not entitled to compensation for preparing attorneys fees, because work benefits counsel, not debtor). Jordan also requests compensation for time (7.8 hours) which, based on the facts set forth in Co-Appellees' Brief (at 28 - 30), did not benefit the Debtor in confirming or performing his plan. Further, Jordan sought compensation for time (at least 7.9 hours)[7] related to preparing and filing a one-page motion to convert the Debtor's case from chapter 7 to chapter 13, and related form documents. (A. at 151). By any standard, this amount of time is excessive.

Jordan also seeks compensation for time (5.2 hours) preparing for and attending a first meeting of creditors pursuant to section 341 of the Bankruptcy Code. Although the parties dispute why that meeting required four hours to complete, Jordan did not satisfy his burden of proving that his conduct and that of the Debtor in any way promoted the confirmation or completion of the Debtor's plan.

In sum, for the reasons set forth above and for the additional reasons set forth in the Argument portion of the Co-Appellees' Brief, section B.2, (at 31 - 34) B.3 (at 32 - 36) and B.5 (at 36 - 37), the lower courts did not abuse their discretion in limiting Jordan's fees.

CONCLUSION

For the reasons set forth above, the United States Trustee respectfully requests that this Court affirm the decision of the district court limiting Jordan's fees to $1,000.

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[7] *See* This time is set forth in 6 entries (February 6, 7, 11, 24, 24 and 25), referring to motion to convert which total more than 8.7 hours. It should be noted that because both February 24, 2003, entries "lump" time for services, the exact amount of time related to the motion to convert cannot be ascertained. (A. 150).

Respectfully Submitted,

Clarkson McDow
United States Trustee

Donald F. Walton
Acting General Counsel

____
Paul W. Bridenhagen
Trial Attorney
U.S. Department of Justice
Executive Office for U.S. Trustees
20 Massachussets, N.W.
Washington, D.C. 20530
Tel. (202) 307-1337
FAX (202 307-2397

CERTIFICATE OF COMPLIANCE

The Brief of United States Trustee, Appellee has been prepared using:

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Exclusive of Table of Contents; Table of Authorities; Statement on Oral Argument; and, Certificate of Service, the Brief of United States Trustee, Appellee contains 4,099 words.

I understand that a material misrepresentation can result in the Court's striking the brief and imposing sanctions. If the Court so directs, I will provide an electronic version of this Brief and/or a copy of the word or line printout.

______________________ ___________
Paul Wm. Bridenhagen Date

STATEMENT ON ORAL ARGUMENT

The United States Trustee requests oral argument in this matter.

Paul Wm. Bridenhagen Date

CERTIFICATE OF SERVICE

I hereby certify that service of this Brief was accomplished this 25th day of March, 2005, by placing two copies in the United States mail, first class postage, prepaid to the parties listed below:

Marc Jordan
Jordan & Tell, LLP
7370 Grace Drive, Suite 101
Columbia, Maryland 21044
(443) 535-0040

Orbie R. Shively
George W. Libmann, PA
8 West Hamilton Street
Baltimore, Maryland 21210
(410) 752-5887

Michael J. Avenatti
Prescott A. Baier
100 Wilshire Boulevard
21st Floor
Santa Monica, California 90407
(310) 572-1200

______________________ ___________

Paul Wm. Bridenhagen Date

BRIEF BANK — "SUMMARY SHEET"

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WESTLAW CODES

1. ("TI") TITLE OF CASE [E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]
Perkins Coie, LLP v. Office of the United States Trustee (In re Jore Corporation)

2. ("CO") CURRENT COURT [E.g., "CTA9"]
United States District Court for the District of Montana, Missoula Division

3. ("CCN") CURRENT CASE NO.
No.: CV 03-144-DWM

4. ("PCN") PRIOR CASE NO. & COURT [IF ANY]
No.: 01-31609-7
Court: United States Bankruptcy Court for the District of Montana
(Identify judge & cite, if any)

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Daniel P. McKay and William L. Courshon, UST/DOJ
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") TOPIC
BANKRUPTCY

9. ("SU") • SUMMARY OF KEY ISSUE(s) & √ Any Miscellaneous BACKGROUND

• Did the bankruptcy court err in concluding that an attorney who failed to comply with the disclosure requirements of 11 U.S.C. §327 and Fed. R. Bankr. P. 2014, where it disclosed that it represented a bank, the debtor's primary pre-petition secured creditor and post-petition lender, in unrelated matters, but it did not disclosed the limited nature of the waivers under which it agreed not to represent the debtor in litigation directly adverse to the Creditor?

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DATE: Fri.-11/21/3 (12:26)

DANIEL P. McKAY
Office of the United States Trustee
United States Department of Justice
301 Central Avenue, Suite 204
P.O. Box 3509
Great Falls, MT 59403
Telephone: (406) 761-8777
Facsimile: (406) 761-8895

WILLIAM L. COURSHON
Office of the United States Trustee
United States Department of Justice
1200 Sixth Avenue, Suite 600
Seattle, WA 98101
Telephone: (206) 553-2000
Facsimile: (206) 553-2566

Attorneys for the United States Trustee

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MONTANA
MISSOULA DIVISION

In re	)	Cause No. CV 03-144-DWM
	)	
JORE CORPORATION,	)	Bankruptcy No. 01-31609-7
	)	
Debtor.	)	
	)	
	)	
PERKINS COIE LLP,	)	
	)	
Appellant,	)	
	)	
vs.	)	BRIEF FOR APPELLEE,
	)	UNITED STATES TRUSTEE
OFFICE OF THE UNITED STATES	)	
TRUSTEE,	)	
	)	
Appellee.	)	

ON APPEAL FROM THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF MONTANA

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STATEMENT OF THE ISSUES PRESENTED ON APPEAL

> 1. Whether the bankruptcy court erred in concluding that Perkins Coie LLP failed to comply with the disclosure requirements of 11 U.S.C. § 327 and Fed. R. Bankr. P. 2014, where Perkins disclosed that it represented Wells Fargo Bank, the debtor's primary pre-petition secured creditor and post-petition lender, in unrelated matters, and that it received oral conflicts waivers from Wells Fargo and the debtor and was in the process of obtaining written waivers, but Perkins did not disclose the limited nature of the waivers, under which it agreed not to represent the debtor in litigation directly adverse to Wells Fargo.
>
> 2. Whether the bankruptcy court abused its discretion in disqualifying Perkins as counsel for the debtor, vacating the court's order of employment, and requiring disgorgement of Perkins' fees and costs, where Perkins had failed to disclose an unwaived, actual, and material conflict with the debtor's largest creditor, while repeatedly representing that it had disclosed all issues and potential conflicts of interest.

STATEMENT OF APPLICABLE STANDARD OF REVIEW

The bankruptcy court's findings of fact are reviewed for clear error and its conclusions of law are reviewed de novo. The court's decision about the proper amount of legal fees to be awarded is reviewed for an abuse of discretion. *In re Lewis*, 113 F.3d 1040, 1043 (9th Cir. 1997); *Neben & Starrett, Inc. v. Chartwell Financial Corp. (In re Park-Helena Corp.)*, 63 F.3d 877, 880 (9th Cir. 1995), *cert. denied*, 516 U.S. 1049 (1996). Under the abuse of discretion standard, the appellate court "must have a definite and firm conviction that the court below committed a clear error of judgment in the conclusion it reached, before reversal is proper." *In re Crowe*, 243 B.R. 43, 47 (B.A.P. 9th Cir.), *aff'd*, 246 F.3d 673 (9th Cir. 2000).

STATEMENT OF THE CASE[1]

This is an appeal from an order entered by the United States Bankruptcy Court for the District of Montana ("Bankruptcy Court") on July 28, 2003, disqualifying Perkins Coie LLP ("Perkins") as counsel for the Debtor, Jore Corporation ("Debtor"), vacating the Bankruptcy Court's order approving Perkins' employment, and requiring disgorgement of Perkins' fees and costs.

On May 22, 2001, the Debtor filed a voluntary bankruptcy petition under chapter 11 of the Bankruptcy Code (Title 11 U.S.C.). The chapter 11 case was filed as a result of the Debtor's inability to restructure its financing with its primary secured lender, Wells Fargo Bank ("Wells Fargo"). After the filing of the petition, Wells Fargo agreed to provide critical postpetition debtor-in-possession ("DIP") financing to the Debtor to fund its reorganization efforts.

Both before and after the filing of the bankruptcy case, Perkins represented Wells Fargo in a number of unrelated legal matters. In connection with its application for employment, Perkins disclosed to the Bankruptcy Court that it currently represented Wells Fargo in unrelated matters, that it had received oral conflicts waivers from both Wells Fargo and the Debtor, and that it was in the process of obtaining written waivers from both parties. However, Perkins failed to disclose to the Bankruptcy Court, the United States Trustee ("UST"),[2] and other parties in interest the limited nature of the written conflict waivers, under which Perkins had agreed not to represent the Debtor "in

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[1] References to documents contained in the Appellant's Excerpts of Record shall be cited herein as "ER" followed by the exhibit ("Ex.") and page number. References to documents contained in the Appellee's Supplemental Excerpts of Record shall be cited herein as "SER" followed by the page number.

[2] The UST is an official of the United States Department of Justice, charged by statute with the duty to oversee and supervise the administration of bankruptcy cases. *See* 28 U.S.C. § 586(a). The UST is expressly given standing under 11 U.S.C. § 307 to raise and be heard on any issue under Title 11, except that the UST may not file a plan of reorganization under Chapter 11. *See United States Trustee v. McCormick, Barstow, Sheppard, Wayte & Carruth (In re Donovan Corp.)*, 215 F.3d 929, 930 (9th Cir. 2000).

litigation directly adverse to Wells Fargo," as well as "in any matter involving the assertion against Wells [Fargo] of a claim of fraud, misrepresentation, or dishonest conduct." ER, Ex. 1. Perkins also failed to disclose the existence of a limited conflicts waiver from another secured creditor and current Perkins client, General Electric Capital Corporation ("GECC"), which contained similar language precluding Perkins from asserting fraud claims against GECC on behalf of the Debtor. ER, Ex. 9.

Approximately a year after the bankruptcy case was filed, a dispute between Wells Fargo and the Debtor resulted in the Debtor's decision to bring litigation to assert claims against Wells Fargo arising from its alleged failure to comply with the "carve-out" provisions of the DIP financing order and for surcharge of Wells Fargo's collateral under 11 U.S.C. § 506(c). After Perkins advised Wells Fargo of its intent to assert such claims against Wells Fargo on behalf of the Debtor, counsel for Wells Fargo objected because Perkins had agreed not to represent the Debtor in litigation directly adverse to Wells Fargo pursuant to the terms of the written conflicts waiver between Wells Fargo and Perkins. ER, Ex. A, at 19-22, Ex. 2-7. Ultimately, Perkins was compelled to bring the limited conflicts waiver to the Bankruptcy Court's attention, and the Debtor retained other counsel to represent it in such litigation against Wells Fargo. ER, Ex. A, at 22-23; SER 6-7.

On September 5, 2002, the Bankruptcy Court entered an order converting the chapter 11 case to chapter 7, and a chapter 7 trustee was appointed. ER, Ex. A, at 24.

On March 5, 2003, the UST filed a motion to disqualify Perkins as counsel for the debtor, vacate the Bankruptcy Court's order employing Perkins, and require disgorgement of Perkins' fees and costs ("Motion"), as a result of Perkins' failure to disclose the terms of the limited conflicts waiver from Wells Fargo, as well as Perkins' failure to disclose the existence of the limited conflicts waiver requested from GECC. ER, Ex. A, at 25.

On May 8 and 9, 2003, the Bankruptcy Court conducted a two-day bench trial on the UST's Motion. On July 28, 2003, the Court entered an order and judgment granting the Motion. The court concluded, *inter alia*, that the terms of the limited conflicts waiver from Wells Fargo and the unwaived, actual conflict between Perkins and Wells Fargo were material and that Perkins' failure to disclose these matters was sanctionable, even if such failure were only negligent or inadvertent, as Perkins contended. As a sanction for Perkins' failure to disclose, the Bankruptcy Court disqualified Perkins as counsel for the debtor, vacated its order of employment, and ordered the disgorgement of all fees and all but $59,234 of the costs received by Perkins. ER, Ex. A.

STATEMENT OF THE FACTS

I. Perkins' Employment and Related Disclosures

After it became apparent that the Debtor would not be able to restructure its financing with Wells Fargo outside of bankruptcy, at Wells Fargo's urging, the Debtor hired a turnaround professional, Clyde Hamstreet, to oversee the bankruptcy and restructuring and to find a buyer for the Debtor's assets. In turn, Mr. Hamstreet recommended that Perkins be retained as bankruptcy counsel for the Debtor. ER, Ex. A, at 3-4. Both before and after the filing of the bankruptcy case, Perkins had represented Wells Fargo in a number of unrelated matters, amounting to gross revenues to Perkins of $640,000 in 2000, $656,000 in 2001, and $278,000 in the first six months of 2002. The attorney-client relationship between Wells Fargo and Perkins dated back at least 20 years prior to the filing of the bankruptcy case. ER, Ex. 8, at 2-3.

On May 22, 2001, the date of filing of the bankruptcy case, the Debtor filed an *ex parte* application to employ Perkins as attorneys for the debtor, together with an Affidavit of Bruce G. MacIntyre, dated May 20, 2001. ER, Ex. 18. Exhibit 18 stated that Perkins had "undertaken an investigation of any connections that may exist between Perkins Coie and the Debtor, the creditors of the Debtor or any other party in interest ..." and that "to the best of [Mr. MacIntyre's] knowledge, [Mr. MacIntyre] and Perkins Coie have no such connections and are 'disinterested persons' as defined in 11 U.S.C. § 101(14), except as stated in this Affidavit."[3] ER, Ex. 18, at 2. Exhibit 18 disclosed that Perkins currently represented Wells Fargo in matters unrelated to the Debtor, and it also included a list of the Debtor's creditors who were current or former clients of Perkins, including Wells Fargo and GECC. ER, Ex. 18, at 3. Exhibit 18 indicated that "Perkins Coie continues to review its connections with shareholders, creditors, potential creditors, and parties in interest in this Chapter 11 case" and that Perkins "will notify the Court if any actual conflicts of interest or other significant connections are discovered in this process." It further provided as follows:

> I know of no reason that would impair Perkins Coie's ability to represent the Debtor zealously and effectively in this case. The Debtor has agreed that in the event Perkins Coie has an actual unwaived conflict of interest with any party adverse to the Debtor herein, Perkins Coie will not represent either the Debtor or the adverse party for such matters. If an actual conflict of interest arises herein, Debtor will (i) request Perkins to obtain the necessary and appropriate waivers; (ii) apply to employ special counsel to the Debtor if required by the nature of such matters; or (iii) use Jore's local counsel, Harold V. Dye or Jore's in-house counsel, David Bjornson, to represent Debtor in those matters.

ER, Ex. 18, at 4.

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[3] Exhibit 18 and subsequent disclosures were filed pursuant to Fed. R. Bankr. P. 2014(a), which requires applications for employment of professional persons under 11 U.S.C. § 327 to be accompanied by a verified statement setting forth all of the professional person's connections with the debtor, creditors, or other parties in interest.

On May 23, 2001, the Bankruptcy Court entered an order approving Perkins' employment on an interim basis and setting a final hearing on Perkins' employment application for June 7, 2001. On June 6, 2001, Perkins filed a Supplemental Declaration of Bruce G. MacIntyre, dated June 4, 2001. ER, Ex. 19. Exhibit 19 disclosed that due to the role of Wells Fargo as primary prepetition and postpetition DIP lender, Perkins "has received oral waivers from both Wells Fargo and Jore and is in the process of obtaining written waivers from both parties." ER, Ex. 19, at 2. Exhibit 19 also included a list of additional creditors and parties in interest who were current or former clients of Perkins. Exhibit 19 provided that "[t]his Declaration discloses all issues and potential conflicts of interest that have been identified at the present time ... Perkins Coie will notify the Court if any actual conflicts of interest or other significant connections are discovered ..." ER, Ex. 19, at 5. Exhibit 19 further provided as follows:

> I do not believe that anything in the matters disclosed above, or in the May 20 MacIntyre Affidavit should disqualify Perkins Coie from vigorous and unfettered representation of the interests of Jore in connection with this case. The Debtor has agreed that in the event Perkins Coie has an actual unwaived direct conflict of interest with any party adverse to the Debtor herein or if an actual direct conflict of interest arises herein, Perkins Coie will obtain waivers as may be required by the applicable rules of professional conduct or that the matter will be handled by either Jore's in-house counsel or its local counsel, Harold V. Dye.

ER, Ex. 19, at 5.

On June 28, 2001, the Bankruptcy Court entered a final order approving the employment of Perkins as attorneys for the debtor. ER, Ex. A, at 11. On August 15, 2001, Perkins filed a second Supplemental Declaration of Bruce G. MacIntyre, dated August 14, 2001, disclosing a connection with Northwest Capital Appreciation, Inc. ("NCA"), a potential purchaser of the debtor's business assets, whose affiliates were current clients of Perkins in unrelated matters. ER, Ex. 20. Exhibit 20 provided that "Perkins Coie has verbally received the informed consent of both the Debtor and NCA to continue the simultaneous representation of both entities, and is in the process of securing written confirmation of this informed consent." ER, Ex. 20, at 2. Exhibit 20 also indicated that "[t]his Declaration discloses all additional issues and potential conflicts of interest that have been identified at the present time ... Perkins Coie will notify the Court if any actual conflicts of interest or other significant connections are discovered ..." ER, Ex. 20, at 2-3.

II. Conflicts Waivers

On June 4, 2001, Perkins partner, Alan D. Smith, sent a letter to Scott L. Manookin, vice president of Wells Fargo, regarding "Simultaneous Representation of Wells Fargo Bank and Jore Corporation," which set forth the terms of the conflicts waiver between Perkins and Wells Fargo. ER, Ex. 1. In Exhibit 1, Mr. Smith stated that Perkins "has received the informed consent of Wells Fargo ... to undertake the representation of Jore Corporation ... on a matter in which the interests of Jore and Wells [Fargo] are adverse, while continuing our representation of Wells [Fargo] on unrelated matters." Mr. Smith further admitted that "[c]ertain aspects of the Chapter 11 bankruptcy proceedings are adverse to Wells [Fargo], including without limitation the fact that Wells [Fargo] is Jore's principal lender." As set forth in Exhibit 1, Mr. Smith affirmatively agreed that Perkins "**will not represent Jore in litigation directly adverse to Wells [Fargo]**, or in any matter involving the assertion against Wells [Fargo] of a claim of fraud, misrepresentation, or dishonest conduct ..." [Emphasis added.] Mr. Smith further acknowledged that "the Firm's representation of Jore on a matter adverse to Wells [Fargo], and simultaneous representation of Wells [Fargo] on unrelated matters **creates a conflict of interest**." [Emphasis added.] Mr. Manookin signed Exhibit 1 on behalf of Wells Fargo, consenting to Perkins' simultaneous representation of the Debtor and Wells Fargo. ER, Ex. 1.

On June 4, 2001, Mr. Smith sent to GECC a similar conflicts waiver letter, which contained a limitation precluding Perkins from asserting fraud claims against GECC on behalf of the Debtor, but unlike the Wells Fargo conflicts waiver, did not contain a "no litigation" exception. ER, Ex. 9. On that same date, Mr. Smith also sent to the Debtor a letter requesting the Debtor to waive any conflicts between Perkins and both Wells Fargo and GECC. ER, Ex. 10. Exhibit 10 pointed out the differences in the limitations contained in the conflicts waivers from Wells Fargo and GECC. The Debtor's president and CEO, Gerald McConnell, signed Exhibit 10, consenting to the conflicts on behalf of the Debtor. ER, Ex. 10.

Although Perkins disclosed that it had received oral waivers from both Wells Fargo and the Debtor and was in the process of obtaining written waivers from both parties, Perkins failed to disclose the limitations contained in the written conflicts waiver, including the "no litigation" clause, for more than one year after it became aware of such limitations. ER, Ex. A, at 10, 20, 22. Perkins also failed to disclose the existence of the GECC conflicts waiver. ER, Ex. A, at 20. Although Perkins currently or formerly represented a substantial number of the Debtor's secured and unsecured creditors, Perkins did not obtain a conflicts waiver from any other creditor or party in interest in this case, except for a conflicts waiver letter dated August 7, 2001, regarding NCA. ER, Ex. 12.

III. DIP Financing and the Actual Conflict Between Perkins and Wells Fargo

At the outset of the chapter 11 case, the Debtor and Wells Fargo entered into a stipulation providing for interim postpetition DIP financing pursuant to 11 U.S.C. § 364, as well as for interim use of Wells Fargo's cash collateral pursuant to 11 U.S.C. § 363(c). In addition, the stipulation provided for senior liens and "super-priority" administrative expense claims in favor of Wells Fargo with an exception for a "professional fee carve-out" ("carve-out") for professionals of the Debtor, any trustee, or official creditors' committee not to exceed a total of $585,000. The stipulation also provided for the Debtor's waiver of any surcharge claims against Wells Fargo under 11 U.S.C. § 506(c), and for the Debtor's waiver of any defenses, claims, or counterclaims against Wells Fargo with respect to the validity of Wells Fargo's prepetition secured claim against the Debtor. ER, Ex. A, at 13. The Court entered an interim DIP financing order approving this stipulation on May 23, 2001, and a final DIP financing order on June 29, 2001. In addition to the terms contained in the interim DIP financing order, the final DIP financing order also provided that the unsecured creditors' committee would have the right to examine any claims the estate may have against Wells Fargo, notwithstanding the Debtor's waiver of such claims, and required the Debtor to propose a plan to which Wells Fargo would not object. ER, Ex. A, at 14.

Throughout the Debtor's chapter 11 proceedings, the availability of DIP financing from Wells Fargo was critical to the Debtor's survival and ability to reorganize, and it was a central issue in the case. ER, Ex. A, at 12. In December 2001, after purchase offers from NCA and another potential buyer, Pentair, had fallen through, an actual conflict arose when Wells Fargo strongly opposed the Debtor's motion to extend the DIP financing order and alternative emergency motion for use of Wells Fargo's cash collateral. Despite Perkins' agreement in Exhibit 1 that it would not represent the Debtor in litigation directly adverse to Wells Fargo, Mr. MacIntyre appeared at the contested hearing on December 19, 2001, on behalf of the Debtor. Wells Fargo did not raise the issue of the "no litigation" exception at the time. The Bankruptcy Court granted the Debtor's emergency motion to use cash collateral, overruling Wells Fargo's objection. Wells Fargo appealed and filed a motion to modify the automatic stay pursuant to 11 U.S.C. § 362(d) to foreclose on its secured claims, but the motion was settled. ER, Ex. A, at 15-16.

In April 2002, the Bankruptcy Court approved a sale of the Debtor's assets for approximately $32.9 million, which was insufficient to pay secured claims in full or to pay any administrative claims for professional fees. ER, Ex. A, at 18. At that time, a further actual conflict arose between Perkins and Wells Fargo regarding whether the $585,000 carve-out under the DIP financing order for professional fees (including those of Perkins and Mr. Hamstreet) applied to fees previously paid (but not approved by the Bankruptcy Court), and whether the Debtor's waiver of § 506(c) surcharge claims remained binding. ER, Ex. A, at 19-22, Ex. 2-7. On May 2, 2002, Mr. Smith sent to counsel for Wells Fargo a letter advising that Perkins intended to bring litigation asserting these claims against Wells Fargo. Mr. Smith requested that Wells Fargo either confirm that this litigation was covered under the June 4, 2001 conflicts waiver or consent to a further waiver. ER, Ex. 2. By letter dated May 9, 2001, and subsequent letters, counsel for Wells Fargo objected, responding that Perkins had agreed not to sue Wells Fargo on behalf of the Debtor pursuant to the June 4, 2001 conflicts waiver, and indicating Wells Fargo's refusal to consent to a further waiver. ER, Ex. 3, 5, 7.

On June 14, 2002, Perkins filed with the Bankruptcy Court a status report disclosing for the first time that Perkins had a dispute with Wells Fargo regarding the meaning of the "no litigation" exception. ER, Ex. A, at 22; SER 6-7. As a result of Wells Fargo's refusal to consent to a further conflicts waiver, the Debtor filed an application to authorize the Debtor's local counsel, Harold V. Dye, to represent the Debtor in the proposed litigation against Wells Fargo on the condition that Perkins and Mr. Hamstreet's firm be authorized to indemnify Mr. Dye's firm for fees and costs up to $50,000. SER 11-14. The UST objected. ER, Ex. A, at 22-23; SER 15-20.

IV. Perkins' Trial Testimony Regarding Conflicts Waivers and Disclosures

Alan D. Smith, when asked why Perkins did not disclose the "no litigation exception" in the Wells Fargo conflicts waiver letter, testified that he did not remember thinking about whether it should be disclosed and that it did not appear to him to be an important issue at the time. He further stated that he thought the "no litigation" exception was not significant because the debtor had waived any claims against Wells Fargo as part of the DIP financing order. ER, Ex. D, at 21-22, 27-28.

Mr. Smith testified that such waivers of claims in DIP financing order are "universal," despite the fact that they were generally prohibited in the Western District of Washington, where Mr. Smith's primary law practice is located, at the time of the filing of this case, and were still prohibited at the time of his testimony. ER, Ex. D, at 13-14, Ex. 15, ¶ A.7. In any event, Mr. Smith conceded that the waiver of claims applied only to prepetition claims and not to postpetition claims, including any litigation arising in connection with the DIP financing order and § 506(c) claims. ER, Ex. D, at 102-103.

Mr. Smith acknowledged that Perkins decided it was appropriate to disclose the existence (but not the limitations) of the Wells Fargo waiver. ER, Ex. D, at 103-105. Mr. Smith stated that he was not positive it was necessary to disclose the existence of a waiver with a particular client because of Perkins' "fall-back position" of seeking a further waiver or utilizing back-up counsel in the event of an unwaived conflict. ER, Ex. D, at 104-105. However, confirming his earlier deposition testimony, Mr. Smith conceded that the Court or any other person reading Perkins' disclosures would have no way of knowing that the Wells Fargo conflicts waiver was anything less than a full and total waiver without asking Perkins. ER, Ex. D, at 80-83.

Mr. Smith admitted that he did not negotiate the language of the conflicts waiver with Wells Fargo and had no knowledge of such negotiations. ER, Ex. D, at 78-79. Mr. Smith testified that a dispute arose between Perkins and Wells Fargo in April 2002 regarding the scope or meaning of the litigation exclusion in the June 4, 2001 conflicts waiver letter. Despite the unequivocal language in the waiver letter, he asserted that there is a "gray area" with respect to the meaning of "litigation" that was to be excluded from the waiver, in the context of a bankruptcy case. ER, Ex. D, at 31-32. However, on cross-examination, Mr. Smith himself conceded that the cash collateral motion contested by Wells Fargo was "litigation directly adverse to Wells Fargo." ER, Ex. D. at 93. Mr. Smith also admitted that although Wells Fargo did not raise the issue of the limited waiver at the time, it had no obligation or duty, ethical or otherwise, to challenge whether or not Perkins could bring an action under the waiver. ER, Ex. D, at 93-94, 95-96, 98-99.

Bruce G. MacIntyre, the Perkins partner who prepared and filed the three disclosures in connection with Perkins' employment application, admitted that he did not disclose the terms of the limited conflicts waiver from Wells Fargo (prior to the June 14, 2002 status report), even though he had previously disclosed that Perkins had received an oral waiver from Wells Fargo and was in the process of obtaining a written waiver. ER, Ex. E, at 54-55, 59. He testified that he believed that the limitations contained in the Wells Fargo conflicts waiver letter were not significant and did not need to be disclosed because it was just "standard" language, the Debtor had already waived any claims against Wells Fargo in connection with the interim DIP financing order, and Perkins had already reviewed Wells Fargo's security interest and concluded that it was perfected. ER, Ex. E, at 28-29.

Mr. MacIntyre testified that he did not disclose the existence of the GECC waiver because he did not believe GECC was any longer a significant player after it became apparent by June 2001 that GECC was not going to be a DIP lender or take-out lender. ER, Ex. E, at 29-31. Mr. MacIntyre later stated that he had no recollection as to why Perkins did not disclose the GECC waiver. ER, Ex. E, at 42.

V. Expert Testimony at Trial

Peter R. Jarvis testified as an expert witness on behalf of the UST in the area of attorney professional responsibility in general. The parties stipulated on the record to Mr. Jarvis' expertise.[4] ER, Ex. F, at 7. Mr. Jarvis testified that although written conflicts waivers are not required under Montana RPC 1.7,[5] conflicts waiver letters such as those used in this case are a regular part of the practice in large law firms such as Perkins. ER, Ex. F, at 20, 25-26. Mr. Jarvis explained that a conflicts waiver letter is a stipulated exception to the duty of undivided loyalty that lawyers have toward their clients, and it is important that the letter clearly define the scope of the lawyer's representation of the client with respect to a specific matter or matters and delineate what is or is not included within that exception. ER, Ex. F, at 28. Mr. Jarvis opined that the limitations contained in the Wells Fargo and GECC conflicts waiver letters were material terms of those conflicts waivers,

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[4] Mr. Jarvis is the President-Elect of the Association of Professional Responsibility Lawyers, and he has devoted a significant portion of his law practice for the past 20 years to legal ethics issues, primarily in the Pacific Northwest. Mr. Jarvis has lectured extensively on professional responsibility issues and has published numerous law review articles and other writings on conflicts of interest, conflicts waivers, honesty and candor issues, and other ethics issues. ER, Ex. F, at 5-7; SER 25-27, 31-49.

[5] Montana RPC 1.7 provides in pertinent part as follows:

> (a) A lawyer shall not represent a client if the representation of that client will be directly adverse to another client, unless:
>
> (1) the lawyer reasonably believes the representation will not adversely affect the relationship with the other client; and
>
> (2) each client consents after consultation.
>
> (b) A lawyer shall not represent a client if the representation of that client may be materially limited by the lawyer's responsibility to another client or to a third person, or by the lawyer's own interests, unless:
>
> (1) the lawyer reasonably believes the representation will not be adversely affected; and
>
> (2) the client consents after consultation ...

and that Perkins' statements made in Exhibits 18, 19, and 20 fell short of Perkins' professional responsibilities of honesty and candor under the applicable rules of professional conduct, including Montana RPC 4.1 and 8.4(c). ER, Ex. F, at 18-27, 36-42, 53-54.

In response to Mr. Smith's opinion that the meaning of the "no litigation" exception in the Wells Fargo waiver letter was unclear, Mr. Jarvis testified that conflicts waiver letters are generally construed against the lawyer, and not against the client to whom the lawyer owes a fiduciary duty. Mr. Jarvis further stated that the extent to which the language of the exception was unclear made it more important for Perkins to disclose the exception at the outset so that the Bankruptcy Court could timely address and resolve these issues. ER, Ex. F, at 43-45. Mr. Jarvis further indicated that the client is not required to act in a reasonable or rational manner in consenting or withholding consent to a conflicts waiver, and that the client is free to withhold consent to a waiver and still enjoy the attorney's duty of absolute loyalty. ER, Ex. F, at 43.

Perkins' professional responsibility expert, David Boerner, admitted that he had no expertise in bankruptcy. ER, Ex. J, at 45-46. Mr. Boerner opined that the "no litigation" exception in the Wells Fargo waiver was not material, that Perkins had no ethical obligation to disclose that limitation to the Bankruptcy Court or other interested parties, and that Perkins' disclosures to the Court were adequate. ER, Ex. J, at 36-38. Mr. Boerner based his opinion on the opinions of Perkins' bankruptcy experts, Jerome Shulkin and Harold V. Dye, but he did not examine any of the bankruptcy case law cited by the UST or Perkins. ER, Ex. J, at 32, 34-35, 56-57. Mr. Boerner agreed with Mr. Jarvis' opinion that Wells Fargo had the right to decide whether or not to invoke the "no litigation" exception to the conflicts waiver, and that Wells Fargo did not have to be reasonable or have reasons whether to waive or not. ER, Ex. J, at 65. On cross-examination, Mr.

Boerner agreed that vague or unambiguous terms in conflicts waivers are construed against the lawyer. ER, Ex. J, at 62.

Joel E. Guthals, an experienced Montana bankruptcy attorney employed by the Chapter 7 trustee, testified on behalf of the UST as an expert regarding the standards for employment of professional persons in Montana bankruptcy cases. Mr. Guthals testified that if he were requesting court approval to be employed as counsel for a debtor in possession in a case in which he had received a conditional or limited conflicts waiver from another client, he would be obligated to disclose to the court the terms of the conditional waiver in detail. ER, Ex. G, at 16. Mr. Guthals further testified that if the other client were the DIP lender in the case and that client had agreed to a limited waiver with a litigation exclusion, he would have a difficult time determining that he was disinterested, even if he had an agreement that another attorney would represent the debtor with respect to any matter in which an unwaived conflict may arise. Mr. Guthals testified that if he were in that situation, he would fully disclose the conflicts waiver so that the Court could determine his eligibility for employment, knowing that his employment may not be approved under such circumstances, and he acknowledged his continuing duty to disclose any subsequent developments concerning the conflicts waiver. ER, Ex. G, at 18-21.

Jerome Shulkin, counsel for the unsecured creditors' committee, and Harold V. Dye, local counsel for the Debtor, testified on behalf of Perkins as experts on the standard of disclosure required under Fed. R. Bankr. P. 2014 in Montana bankruptcy cases.[6] Mr. Shulkin testified that the Wells Fargo limited conflicts waiver was not a significant deterrent to Perkins' ability to act as counsel for

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[6] Perkins erroneously states that three expert witnesses on bankruptcy testified at trial that Perkins' disclosures to the Bankruptcy Court were consistent with the practice of disclosures in the District of Montana under Fed. R. Bankr. P. 2014. Appellant's Brief, at 13.

the debtor. ER, Ex. I, at 8. Mr. Shulkin also testified that Perkins' disclosures relative to Wells Fargo and other creditors were consistent with bankruptcy practice in Montana. ER, Ex. I, at 20-21. Mr. Dye stated his opinion that Perkins' disclosures satisfied the applicable standard and that the UST was advocating a more stringent standard. ER, Ex. H, at 10-11, 17.

The Bankruptcy Court ruled that the issue before the Court was whether Perkins failed to comply with its duty of disclosure under Rule 2014(a), and not whether Perkins' disclosures complied with its obligations under the rules of professional responsibility, which was primarily a matter between Perkins and Wells Fargo. Thus, it was not necessary for the Bankruptcy Court to decide between the opinions of Mr. Jarvis and Mr. Boerner regarding whether Perkins violated its duty under those rules. ER, Ex. A, at 32.

In addition, the Bankruptcy Court properly ruled that the Court decides the legal requirements for disclosure under Rule 2014, not the parties' expert witnesses. Accordingly, the Bankruptcy Court acted fully within its discretion as the trier of fact to give little probative weight to the expert testimony of Messrs. Shulkin and Dye regarding the Court's requirements for disclosure under Rule 2014 because that was a matter for the Court to decide. Because Mr. Boerner relied on Messrs. Shulkin's and Dye's opinions in forming his own opinion, the Bankruptcy Court similarly ruled that his opinion carried the same lack of probative weight. ER, Ex. A, at 44. The Court also appropriately found that Mr. Guthals' expert testimony came much closer to describing the applicable legal standard requiring continuing, complete disclosure of a professional person's connections with creditors and parties in interest under Rule 2014(a). ER, Ex. A, at 44 n.29.

ARGUMENT

I. The Bankruptcy Court Did Not Err in Concluding that Perkins Failed to Comply with the Disclosure Requirements of 11 U.S.C. § 327 and Fed. R. Bankr. P. 2014.

The Bankruptcy Court correctly recognized that the Bankruptcy Code imposes a high standard of disclosure on attorneys who seek to be employed in bankruptcy cases and that those disclosure requirements are strictly construed by the courts in the Ninth Circuit and the District of Montana. Title 11 U.S.C. § 327(a) governs the procedure for obtaining court approval of the employment of attorneys and other professionals by trustees and debtors in possession in bankruptcy cases, limiting such employment to persons "that do not hold or represent an interest adverse to the estate, and that are disinterested persons."[7] A professional person's failure to comply with these requirements at any time during such professional person's employment under § 327 may result in a denial of compensation. *See* 11 U.S.C. § 328(c). Fed. R. Bankr. P. 2014(a) requires that an application for employment under § 327 shall include a statement, to the best of the applicant's knowledge, of "**all of the person's connections** with the debtor, creditors, any other party in interest, their respective attorneys and accountants, the United States trustee, or any person employed in the office of the United States trustee." [Emphasis added.] Rule 2014(a) further provides that "[t]he application shall be accompanied by a verified statement of the person to be employed setting forth the person's connections" with any such other persons. Although Rule 2014(a) does not expressly require supplemental or continuing disclosure, § 327(a) implies a continuing duty of disclosure and requires professionals to reveal connections that arise after their retention. *See In re Bennett Funding*

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[7] A "disinterested person" is defined in the Bankruptcy Code, *inter alia*, as a "person that ... does not have an interest materially adverse to the interest of the estate or of any class of creditors or equity holders, by reason of any direct or indirect relationship to, connection with, or interest in, the debtor or any investment banker specified in subparagraph (B) or (C) of this paragraph, or for any other reason." 11 U.S.C. § 101(14)(E).

Group, Inc., 226 B.R. 331, 334 (Bankr. N.D. N.Y. 1998); *In re Granite Partners, L.P.*, 219 B.R. 22, 35 (Bankr. S.D. N.Y. 1998); *In re Olsen Industries, Inc.*, 222 B.R. 49, 59 (Bankr. D. Del. 1997).

The Ninth Circuit has closely examined the obligation of attorneys to disclose all of their connections with the debtor, creditors, and parties in interest. *See Neben & Starrett, Inc. v. Chartwell Financial Corp. (In re Park-Helena Corp.)*, 63 F.3d 877, 881-882 (9th Cir. 1995), *cert. denied*, 516 U.S. 1049 (1996). In *Park-Helena*, where the debtor's attorney failed to disclose the source of a prepetition retainer, the Ninth Circuit explained that Rule 2014(a) assists the court in ensuring that the attorney has no conflicts of interest and is disinterested, as required by 11 U.S.C. § 327(a). *Id.* at 881. The disclosure requirements of Rule 2014 are applied "strictly."[8] *Id.* "All facts that may be pertinent to a court's determination of whether an attorney is disinterested or holds an adverse interest to the estate must be disclosed." *Id.* at 882, *quoting In re Hathaway Ranch Partnership*, 116 B.R. 208, 219 (Bankr. C.D. Cal. 1990). "The duty of professionals is to disclose all connections with the debtor, debtor-in-possession, insiders, creditors, and parties in interest ... They cannot pick and choose which connections are irrelevant or trivial ... No matter how old the connection, no matter how trivial it appears, the professional seeking employment must disclose it." 63 F.3d at 882, *quoting In re EWC, Inc.,* 138 B.R. 276, 280-281 (Bankr. W.D. Okla. 1992). The

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[8] Perkins erroneously asserts that the Ninth Circuit's decision in *Park-Helena* addresses only financial disclosures under Fed. R. Bankr. P. 2016, not conflict disclosures under Rule 2014. Appellant's Brief, at 20. Title 11 U.S.C. § 329(a) and Rule 2016(b) require debtors' attorneys to file with the court a statement of compensation paid or agreed to be paid within one year prior to the date of filing of the bankruptcy petition and the source of such compensation. A supplemental statement is required to be filed within 15 days after any payment or agreement not previously disclosed. Fed. R. Bankr. P. 2016(b). The *Park-Helena* court concluded that the undisclosed payment of the debtor's attorney's retainer by the debtor's president who was also a creditor was a connection within the meaning of Rule 2014(a) and that the attorney's failure to disclose that payment constituted a violation of both Rule 2014(a) and Rule 2016(b). 63 F.3d at 880-882. In so holding, the Court noted that the fiduciary duties of disclosure under Rule 2014(a) and Rule 2016(b) are similar and overlapping ("The disclosure requirements of Rule 2014 are applied as strictly as the requirements of Rule 2016 and section 329 ..."). *Id.* at 881. Perkins' contention that Rule 2016 imposes a higher standard on attorneys than Rule 2014 is incorrect and contrary to Ninth Circuit precedent. Appellant's Brief, at 20 n.5.

Ninth Circuit further stated that "[t]he disclosure rules are applied literally, even if the results are sometimes harsh." 63 F.3d at 881. Negligent or inadvertent omissions "do not vitiate the failure to disclose." *Id., quoting In re Maui 14K, Ltd.*, 133 B.R. 657, 660 (Bankr. D. Haw. 1991). The failure to comply with the disclosure rules is a sanctionable violation, even if proper disclosure would have shown that the attorney had not actually violated any Bankruptcy Code provision or Bankruptcy Rule. 63 F.3d at 880. Applying these strict standards, the *Park-Helena* court held that the debtor's attorney's failure to describe the circumstances of the payment of the retainer violated the disclosure requirements of Rule 2014.[9] *Id.* at 882.

As evidenced by the Bankruptcy Court's ruling below and prior decisions, that court has consistently followed the Ninth Circuit in strictly interpreting the disclosure requirements of Fed. R. Bankr. P. 2014(a). *See In re Love*, 163 B.R. 164, 168 (Bankr. D. Mont. 1993); *In re Fjeldheim*, 1993 WL 590145, 12 Mont. B.R. 267, 274-275 (Bankr. D. Mont. 1993). In *Love*, the court denied the debtor's counsel's second fee application in its entirety based upon the counsel's failure to comply with Rule 2014(a) to timely disclose her law firm's prior representation of the debtor's partner in a partnership to which estate funds were transferred. In *Love*, like the instant case, this connection was not disclosed to the court until over one year after the debtor's counsel filed her application for employment. Quoting from its earlier decision in *Fjeldheim*, the court in *Love*

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[9] Prior to the enactment of Bankruptcy Code, the requirement that attorneys disclose all of their connections in bankruptcy cases was recognized by the Ninth Circuit under the Bankruptcy Act. *See In re Haldeman Pipe & Supply Co.*, 417 F.2d 1302, 1304 (9th Cir. 1969) ("General Order 44 [the precursor to Rule 2014] does not give the attorney the right to withhold information because it is not apparent to him that there is a conflict."). In *Haldeman*, however, the court reversed and remanded the case because the bankruptcy referee had failed to appraise the facts in the case and determine, as a discretionary matter, what if any fees should be allowed. *Id.* at 1305. Unlike that case, in the instant case, the Bankruptcy Court carefully considered the evidence and properly exercised his discretion to require disgorgement of all of the fees incurred by Perkins, based upon Perkins' failure to timely disclose material facts to the Court.

reiterated that "Rule 2014 requires the professional to disclose all facts that *may* be pertinent ... Further, a negligent failure to disclose all facts required by [Rule] 2014(a) does not relieve the professional of the consequences of failing to make a complete disclosure." *Love*, 163 B.R. at 168-169, *quoting Fjeldheim*, 12 Mont. B.R. at 276 [emphasis in original]. The court in *Love* further recognized that the burden of disclosure is on the applicant, and not on the court or other parties in interest: "the Court has no duty to rummage through files or conduct independent fact-finding investigations in order to determine whether prospective attorneys are involved in actual or potential conflicts of interest. It is the duty of the attorney to so inform the Court." *Love*, 163 B.R. at 170, *quoting Fjeldheim*, 12 Mont. B.R. at 278. Similarly, in *Fjeldheim*, where the court disqualified the debtor's attorney for failing to fully disclose a $45,000 retainer and the source of the retainer, it held that:

> It was not this Court's nor anyone else's duty other than [the debtor's attorney] to make full disclosure. Nor was it full disclosure for [the debtor's attorney] to disclose what it thought sufficient and then to correct any deficiencies to which the U.S. Trustee objected.

Id. at 277. The court further noted that the attorney's duty of full disclosure was a "continuing duty" to disclose connections when they arose, even if they arose after the court approved the attorney's employment.[10] *Id.*

Thus, applicable case law from both the Ninth Circuit and the District of Montana confirms that 11 U.S.C. § 327(a) and Fed. R. Bankr. P. 2014(a) impose a fiduciary duty on attorneys to disclose **all** facts that may be pertinent to the court's determination of whether an attorney is

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[10] Other courts within the Ninth Circuit have also strictly enforced attorneys' fiduciary duty of disclosure in bankruptcy cases. *See, e.g., In re Maui 14K, Ltd.*, 133 B.R. 657, 660 (Bankr. D. Haw. 1991); *In re Hathaway Ranch Partnership*, 116 B.R. 208, 219-220 (Bankr. C.D. Cal. 1990); *In re B.E.S. Concrete Products, Inc.*, 93 B.R. 228, 236-237 (Bankr. E.D. Cal. 1988); *In re Coastal Equities, Inc.*, 39 B.R. 304, 308 (Bankr. S.D. Cal. 1984).

disinterested or represents an interest adverse to the estate.[11] This fiduciary duty is important to the bankruptcy system and is intended to facilitate the court's policing responsibilities. The disclosure rules impose upon attorneys as officers of the court an independent responsibility to disclose all pertinent facts so that the court may properly decide whether the attorney is entitled to be employed or compensated. Thus, an attorney's failure to comply with his or her fiduciary duty is sanctionable. *See Park-Helena*, 63 F.3d at 880, 882. Ultimately, the court must decide which facts are relevant or important, not the attorney.

In the instant case, the record reflects that the material terms of the limited conflicts waiver from Wells Fargo were not timely disclosed to the Bankruptcy Court and only came to the surface over a year later after an actual conflict of interest had arisen between Perkins and Wells Fargo. Messrs. Smith and MacIntyre both testified that they did not disclose the terms of the waiver because they did not think it was important. Although Perkins argues that its failure to disclose these facts was not willful, Perkins violated its fiduciary duty to disclose all pertinent facts, as strictly construed

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[11] Although not cited by the Bankruptcy Court below, other bankruptcy courts have held that agreements similar to the "no litigation" exception contained in the June 4, 2001 Wells Fargo conflicts waiver letter have a direct impact upon whether an attorney is disinterested or represents an interest adverse to the estate. For example, in *In re American Printers & Lithographers, Inc.*, 148 B.R. 862, 864 (Bankr. N.D. Ill. 1992), the court denied approval of the chapter 11 debtor's application to employ counsel, finding that an actual conflict of interest was created by the counsel's continuing representation of the debtor's major secured lender in unrelated matters, where **counsel conceded in open court that it would not represent the debtor in a lawsuit against the creditor**, notwithstanding the fact that both the debtor and the creditor consented to the law firm's representation of the debtor. In *In re Amdura Corp.*, 121 B.R. 862, 867, 869 (Bankr. D. Colo. 1990), the court similarly held that the two co-counsel for related Chapter 11 debtors, who represented the debtors' major secured lender in unrelated matters, were not disinterested, represented interests adverse to the debtors, and could not be employed by any of the debtors, where **both co-counsel advised the court that they could not investigate or prosecute any claims against the creditor**. In *American Printers* and *Amdura,* the courts disapproved counsel's employment, even after full disclosure of such agreements. *See also In re Granite Partners, L.P.*, 219 B.R. 22, 40 (Bankr. S.D. N.Y. 1998) (counsel for the chapter 11 trustee represented adverse interests resulting in denial of compensation, **where counsel failed to disclose that it had agreed at the outset of the case to investigate but not sue the debtor's audit firm because that firm was also the law firm's auditor**); *In re Envirodyne Industries, Inc.*, 150 B.R. 1008, 1014 n.7 (Bankr. N.D. Ill. 1993) (counsel for related Chapter 11 debtors, which represented a substantial creditor of one debtor, was not disinterested and represented an adverse interest, and order employing counsel was vacated, **where counsel had stated in a memorandum that it would not investigate or sue such creditor**).

by the Ninth Circuit. Perkins did not have the right to pick and choose which connections were worthy of disclosure. *See Park-Helena*, 63 F.3d at 881. Having affirmatively and unequivocally disclosed to the Bankruptcy Court in three different declarations that it had disclosed all issues and potential conflicts and would notify the Court if any actual conflicts of interest or other significant connections are discovered, and having disclosed that a conflicts waiver had been received from Wells Fargo, Perkins was obligated to disclose the "no litigation" exception to the waiver. By the time that Mr. MacIntyre filed Exhibit 20 in August 2001, Perkins had known of the terms of the limited Wells Fargo waiver for almost two months. Wells Fargo was the Debtor's largest creditor and primary source of DIP financing, without which the Debtor could not stay in business. By failing to timely disclose the limitations of the waiver, Perkins deprived the Bankruptcy Court, the UST, and other parties in interest of the ability to fully and timely determine whether Perkins had a conflict of interest in connection with its simultaneous representation of Wells Fargo in unrelated matters. Even if the Bankruptcy Court were to determine that Perkins did not have a conflict of interest, Perkins' failure to disclose material facts is a sanctionable violation, as of the time that the failure occurred, and not when the true facts were ultimately revealed. *Id.* at 880.

Perkins argues that its failure to disclose the "no litigation" exception in the Wells Fargo waiver should be excused because (1) the "no litigation" exception did not apply to matters in the bankruptcy case and thus was not important or material, (2) the Debtor had waived all claims against Wells Fargo under the terms of the DIP Financing Order, and (3) the "fall-back" position included in Perkins' disclosures eliminated the need to disclose the terms of the conflicts waiver. The Bankruptcy Court correctly concluded that none of these arguments excuses or mitigates Perkins' failure to disclose. ER, Ex. A, at 35, 37.

The record reflects that Perkins and Wells Fargo did not agree on what constituted "litigation" within the meaning of the limited conflicts waiver, which made it all the more important for Perkins to disclose the exception to the waiver. ER, Ex. A, at 35 n.25. Had Perkins disclosed the terms of the waiver at the outset of the case, the Bankruptcy Court could then have timely settled any ambiguity and determined whether Perkins had an unwaived conflict of interest with Wells Fargo. Thus, contrary to Perkins' inaccurate characterization of the "no litigation" exception as "*de minimis*" or an "undisclosed nuance," that limitation in the Wells Fargo conflicts waiver was a material term which Perkins was obligated to disclose.

The Debtor's waiver of claims against Wells Fargo did not excuse Perkins' failure to disclose because a disclosure violation may result in sanctions regardless of any actual harm to the estate. *See Park-Helena*, 63 F.3d at 881. In any event, that waiver of claims against Wells Fargo did not cover postpetition claims, including any litigation that may arise from disputes relating to the DIP financing order itself or § 506(c) claims, all of which were foreseeable and did in fact occur.

Finally, Perkins' "fall-back position" to request further waivers or retain Mr. Dye or other counsel in the event of an unwaived conflict did not obviate the need to disclose the Wells Fargo waiver.[12] Mr. Smith conceded that in the absence of any disclosure of the "no litigation" exception,

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[12] In *In re Amdura Corp.*, 121 B.R. 862, 867 (Bankr. D. Colo. 1990), the court rejected the debtors' counsel's argument that a conflict with the debtors' major secured creditor could be avoided by utilizing separate counsel or by turning the matter over to the creditors' committee or an examiner. While a "carve-out" of certain issues from a retained law firm's responsibilities may be appropriate in some cases to avoid a conflict of interest, the *Amdura* court stated that this is not appropriate where the resolution of the other client's claims will be the "lynch-pin" of the case, as was true of Wells Fargo's claims in the instant case.

Further, Perkins implies that the "special counsel" provisions of 11 U.S.C. § 327(e) were intended as a means to circumvent the disinterestedness requirement of § 327(a) when a conflict arises during the course of a bankruptcy case. Appellant's Brief, at 14. On the contrary, Congress enacted § 327(e) primarily as a means to permit the bankruptcy estate to retain for a specified special purpose an attorney who represented the debtor prior to bankruptcy, so that such attorney may continue his or her representation after the bankruptcy case has commenced, notwithstanding the attorney's lack of disinterestedness on account of a debt for prepetition legal fees or other reason. *See* H.R. Rep. No. 595, 95th Cong., 1st Sess. 328 (1977); S. Rep. No. 989, 95th Cong., 2nd Sess. 38-39 (1978).

the Bankruptcy Court and parties in interest would have no way of knowing whether there were any unwaived conflicts with respect to Wells Fargo. Without full disclosure of all of the facts, including the "no litigation" exception, the Court, the UST, and other parties in interest could not adequately and timely determine the appropriateness of the proposed "fall-back" procedure to address any unwaived conflict of interest.

II. The Bankruptcy Court Properly Exercised its Discretion in Disqualifying Perkins as Counsel for the Debtor, Vacating the Court's Order of Employment, and Requiring Disgorgement of Perkins' Fees and Costs.

The bankruptcy court is vested with the discretion to disqualify professional persons employed by the court, deny all fees, and order disgorgement of fees, where a debtor's attorney has failed to disclose material facts. *In re Love*, 163 B.R. 164, 170 (Bankr. D. Mont. 1993). In *Park-Helena*, 63 F.3d at 881, where the bankruptcy court denied all of the debtor's attorney's fees based upon his failure to disclose the source of a retainer as required under Rule 2014(a) and Rule 2016(b), the Ninth Circuit held that the court's denial of **all fees** was within its discretion. Although the bankruptcy court in *Park-Helena* found the disclosure violation to be willful, the Ninth Circuit held that "[e]ven a negligent or inadvertent failure to disclose fully relevant information may result in a denial of all requested fees." *Id.* at 882.

The Ninth Circuit further delineated the bankruptcy court's power to sanction attorneys for violations of the Bankruptcy Code's disclosure requirements in *In re Lewis*, 113 F.3d 1040, 1045-1046 (9th Cir. 1997). In *Lewis*, the Ninth Circuit affirmed an order requiring the attorney for a chapter 11 debtor to disgorge all retainers received, where the debtor's counsel had misrepresented the timing of retainers received and failed to properly supplement his initial disclosure of compensation. In so ruling, the Ninth Circuit held that the bankruptcy court has broad and inherent authority to deny any and all compensation when an attorney fails to meet the requirements of 11 U.S.C. §§ 327, 329, 330, and 331, **regardless of the excessiveness or reasonableness of such compensation**. Under the circumstances, the court held that **an inquiry into the appropriate amount of the fee was not required**. *Id.* at 1046.

Similarly, in *Fjeldheim*, where the chapter 11 debtor's attorney failed to fully disclose a $45,000 retainer and the source of the retainer, the Montana bankruptcy court disqualified counsel, vacated his employment *ab initio*, ordered the disgorgement of all retainers, and denied all compensation. *See In re Fjeldheim*, 1993 WL 590145, 12 Mont. B.R. 267, 279 (Bankr. D. Mont. 1993). In *Love*, where the debtor's attorney failed to disclose her representation of the debtor's partner when she filed her application for employment, the same court acknowledged that it has the discretion to disqualify the applicant, deny all fees, and order disgorgement.[13] *See Love*, 163 B.R. at 170.

In this case, the Bankruptcy Court found that Mr. MacIntyre made a false statement in Exhibit 20, filed over two months after the June 4, 2001 conflicts waiver from Wells Fargo, that he had disclosed "all additional issues and potential conflicts of interest that have been identified at the present time," when in fact he had failed to disclose the terms of the limited conflicts waivers from Wells Fargo and GECC. ER, Ex. A, at 40. Although Perkins argued at trial that its failure to disclose was not willful, the Bankruptcy Court properly exercised its discretion in sanctioning Perkins for such failure, relying on Ninth Circuit precedent recognizing that a negligent or

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[13] However, in *Love*, the court in its discretion considered the fact that counsel voluntarily amended her Rule 2014(a) statement more than one year later to fully disclose her connection with the debtor's partner and performed extensive services in the case that resulted in a confirmed plan and substantial benefit to the estate. Accordingly, the court declined to order disgorgement of interim compensation previously awarded to counsel in the amount of $25,226, but denied all fees and costs requested by counsel pursuant to her second fee application in the amount of $91,211 (78% of the total). 163 B.R. at 171.

inadvertent as well as a willful failure to disclose fully relevant information may result in a denial of all fees. *Park-Helena*, 63 F.3d at 882. In this case, as distinguished from *Love*, at no time did Perkins voluntarily amend its Rule 2014(a) statements to disclose the terms of the Wells Fargo and GECC limited conflicts waivers. The Bankruptcy Court correctly noted that Perkins' belated disclosure of the "no litigation" exception to the Wells Fargo conflicts waiver in the June 14, 2002 status report did not excuse Perkins' failure to timely disclose. ER, Ex. A, at 41.

Perkins cites a number of decisions from other jurisdictions in which the courts exercised their discretion to impose lesser sanctions for various disclosure violations. However, the Bankruptcy Court below correctly observed that such decisions "are not binding on this Court like *Park-Helena*." ER, Ex. A, at 34. In fact, the Ninth Circuit's holdings in *Park-Helena* and *Lewis* are fully consistent with courts of appeals decisions from the First, Fifth, and Sixth Circuits upholding the complete denial of fees for violations of the Bankruptcy Code's disclosure requirements. *See In re Independent Engineering Co.*, 197 F.3d 13, 17 (1st Cir. 1999) (court affirmed disgorgement of all fees for attorney's failure to disclose postpetition draws and payments from debtor); *In re Downs*, 103 F.3d 472, 479-480 (6th Cir. 1996) (bankruptcy court abused its discretion in not requiring full disgorgement of all fees as result of attorney's willful failure to disclose retainer); *In re Prudhomme*, 43 F.3d 1000, 1003-1004 (5th Cir. 1995) (court affirmed disgorgement of all fees due to attorney's failure to disclose retainer); *see also In re Kisseberth*, 273 F.3d 714, 721 (6th Cir. 2001) (court affirmed disgorgement and denial of fees for attorney's failure to disclose all payments received from debtors). In *Kisseberth*, like this case, the debtor's attorney was an experienced bankruptcy practitioner who claimed that his failure to disclose resulted from negligence or inadvertence. Nonetheless, the Sixth Circuit affirmed the bankruptcy court's disgorgement of all but $2,288 in fees received and denied all other compensation requested by the attorney. In so ruling, the Sixth Circuit, like the Bankruptcy Court below, held that disgorgement may be proper even if the failure to disclose resulted from negligence or inadvertence. The court further recognized that "bankruptcy courts have broad and inherent authority to deny any and all compensation where an attorney fails to satisfy the requirements of the Code and Rules." 273 F.3d at 721.

Contrary to Perkins' contention, the risk of an actual conflict arising between Perkins and Wells Fargo was substantial and likely and in fact did occur. As the Bankruptcy Court noted, Wells Fargo was the Debtor's largest creditor and primary source of DIP financing. At the same time, Perkins' attorney-client relationship with Wells Fargo was long-standing and not insubstantial. Mr. Smith conceded in Exhibit 1 that a conflict of interest existed between Perkins and Wells Fargo. In December 2001, Perkins represented the Debtor on a contested cash collateral motion against Wells Fargo, and Wells Fargo subsequently appealed the ruling on that motion. Months later, Perkins threatened to bring litigation against Wells Fargo. However, unbeknownst to the Bankruptcy Court, Perkins had a limited conflicts waiver agreement with Wells Fargo, which on its face excepted these conflicts from the waiver. Perkins and Wells Fargo subsequently disputed the meaning of the "no litigation" exception.[14] For these reasons, the terms of the conflicts waiver were fully and absolutely

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[14] Perkins mistakenly contends that the Bankruptcy Court clearly erred in admitting into evidence correspondence between Perkins and counsel for Wells Fargo because such documents were inadmissible hearsay. Appellant's Brief, at 12, 18. At the outset of the trial, on the stipulation of the parties, the Court admitted these and other documents into evidence. ER, Ex. P, at 24; Ex. 3, 5, 7. At no time during the trial did Perkins affirmatively object to the admission of any of these documents as required under Fed. R. Evid. 103. In any event, the letters do not constitute hearsay as they were not offered in evidence to prove the truth of the contents of the letters, but rather as evidence of an actual conflict between Perkins and Wells Fargo and the existence of a dispute between Perkins and Wells Fargo regarding the meaning of the "no litigation" exception to the conflicts waiver. Fed. R. Evid. 801(c); *see Orsini v. O/S Seabrooke O.N.*, 247 F.3d 953, 960 n.4 (9th Cir. 2001); *In re Papp International, Inc.*, 189 B.R. 939, 947 (Bankr. D. Neb. 1995). Scott Clark, the author of the letters in question, represented Wells Fargo at the time of Wells Fargo's consent to the June 4, 2001 conflicts waiver letter, and in fact he was copied on that letter by Mr. Smith. ER, Ex. 1.

relevant to the issue whether Perkins had a conflict with Wells Fargo from the outset of the case, and were by no means "*de minimis*."

As further grounds for disqualification, the Bankruptcy Court noted that 11 U.S.C. § 327(c) imposes a *per se* disqualification of any attorney or other professional person who has an actual conflict of interest because of such person's employment by or representation of a creditor. ER, Ex. A, at 43; *see In re Pillowtex, Inc.*, 304 F.3d 246, 251 (3rd Cir. 2002); *In re Marvel Entertainment Group, Inc.*, 140 F.3d 463, 476 (3rd Cir. 1998) (court may also within its discretion disqualify an attorney who has a potential conflict of interest). The Bankruptcy Court correctly concluded that Perkins had an unwaived actual conflict of interest with Wells Fargo based on Mr. Smith's own statement in Exhibit 1 and his admission at trial that the contested cash collateral motion constituted "litigation directly adverse to Wells Fargo."[15] ER, Ex. D, at 93.

Finally, Perkins' attorneys and other witnesses appearing on Perkins' behalf testified that Perkins' "zealous" representation of the debtor was not affected by its relationship with Wells Fargo. Even if this were true, disclosure violations are sanctionable "without regard to any actual harm to the estate." *Park-Helena*, 63 F.3d at 881. Perkins also presented testimony regarding the "success" of its efforts in the case, primarily in permitting the debtor to continue as a going concern and preserving some employees' jobs. While the court has the discretion to determine what fees, if any, should be allowed, the Ninth Circuit held in *Lewis* that the court had the discretion to deny all fees for a disclosure violation without inquiring as to the appropriate amount of the fee. *Lewis*, 113 F.3d at 1046. In this case, Mr. MacIntyre testified that there was little likelihood from the outset of the

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[15] Although Wells Fargo did not raise the issue of the "no litigation" exception at the time, Messrs. Jarvis and Boerner both agreed that Wells Fargo was not required to act in a reasonable manner in consenting or withholding consent to a conflicts waiver, and that vague or ambiguous terms in a conflicts waiver are construed against the attorney. ER, Ex. A, at 26, 27.

case that the unsecured creditors would receive anything. ER, Ex. E, at 64-65, 74. Only the Debtor, Wells Fargo, and other secured creditors stood to benefit from the Chapter 11 case. After the sale of the Debtor's assets was concluded, there were no unencumbered funds in the estate available to pay Perkins' fees. Thus, in this case, as distinguished from *Love*, Perkins' services did not result in a substantial benefit to the estate--a plan was not and could not be confirmed, secured creditors sustained substantial losses, unsecured creditors have received nothing, and the estate is administratively insolvent.[16] Under the circumstances of this case, the Bankruptcy Court did not abuse its discretion in entering its July 28, 2003 order and judgment disqualifying Perkins as counsel for the debtor, vacating the Bankruptcy Court's order approving Perkins' employment, and requiring disgorgement of Perkins' fees and costs.

CONCLUSION

For the foregoing reasons, the Bankruptcy Court's July 28, 2003 order and judgment should be affirmed.

DATED this _____ day of November, 2003.

Respectfully submitted,

DIANE E. TEBELIUS
United States Trustee for Region 18

____
DANIEL P. McKAY
WILLIAM L. COURSHON
Attorneys for the United States Trustee

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[16] Furthermore, Perkins took some actions in this case which were contrary to the interest of creditors, e.g., opposing secured creditors' right to credit bid in connection with the proposed sale of assets to Pentair. ER, Ex. E, at 62-63.

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on the _____ day of November, 2003, true and correct copies of the foregoing Brief for Appellee, United States Trustee, were served by first class mail, postage prepaid, upon the following:

Fred Simpson
Jack Jenks
PHILLIPS & BOHYER, P.C.
283 West Front, Suite 301
P.O. Box 8569
Missoula, MT 59807-8569

Theodore J. Collins
Bruce G. MacIntyre
Alan D. Smith
PERKINS COIE LLP
1201 Third Avenue, Suite 4800
Seattle, WA 98101-3099

Gerald K. Smith
Susan M. Freeman
LEWIS & ROCA, LLP
40 North Central Avenue, Suite 1900
Phoenix, AZ 85004

WILLIAM L. COURSHON
Attorney for the United States Trustee

BRIEF BANK — "SUMMARY SHEET"

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WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*
IN RE P.J. KEATING CO., ET AL.

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*
Bankr. D. Mass. (Western Div.)

3. ("CCN") ***CURRENT*** CASE NO.
No.: 93-41350, et al.

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*
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Paul W. Bridenhagen (UST/OGC)
Peter J. Stocks (UST/Region 1, Worchester, MA)
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") ! ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***
! Quarterly Fees: Does 28 U.S.C. § 1930(a)(6), as amended in 1996, require all Chapter 11 post-confirmation Debtors to pay Quarterly Fees based upon all disbursements made by those Debtors until the Chapter 11 case is dismissed or converted.

√ **Background:**

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UNITED STATES BANKRUPTCY COURT
DISTRICT OF MASSACHUSETTS
(WESTERN DIVISION)

In re **P.J. KEATING COMPANY,** **KEATING SPORTS GROUP, INC.** **ROOFBLOK LIMITED AND** **KEATING MATERIALS CORP.** **Debtors**	**Chapter 11** **Case Nos. 93-41350-JFQ** **through 93-42353-JFQ** **Joint Administration**

UNITED STATES TRUSTEE’S MEMORANDUM OF LAW

The United States Trustee submits this Memorandum of Law, pursuant to 11 U.S.C. §§105, 307, 28 U.S.C. §1930(a)(6), F.R.B.P. 9013 and Local Rule 26, in support of his Response To Debtors’ Motion For Final Decree. The Court has jurisdiction over this case under 28 U.S.C. §157(b).

STATEMENT OF ISSUE

Does 28 U.S.C. §1930(a)(6), as amended in 1996, require all chapter 11 post-confirmation debtors to pay quarterly fees based upon all disbursements made by those debtors until the Chapter 11 case is dismissed or converted.

STATEMENT OF FACTS

In May, 1993, P.J. Keating Company (“Keating Co.” or ”Debtor”), Keating Sports Group, Inc. (“Sports”), Roofblok Limited (“Roofblok”) and Keating Materials Corporation (“Materials”) filed voluntary petitions for relief under Chapter

11. On June 17, 1994, the bankruptcy court (the “Court”) confirmed the Keating Co. Third Party Plan of Reorganization(“the Plan”). Pursuant to the Plan, Materials merged into Keating Co., Roofblok continued to operate as a distinct legal entity and Sports is apparently a defunct, but not dissolved, corporate shell. In addition, a consummation agent (“Agent”) was appointed to distribute certain assets of the debtors. Keating Co. also has or will pay over $101,000.in pre-confirmation claims. Agent’s Final Accounting, Exhibit 5. Various other assets were vested into the so-called reorganized Debtor and Roofblok.

On October 30, 1996, the Debtor filed a Motion For Final Decree (the “Motion”), pursuant 11 U.S.C. §350, seeking an Order waiving Keating Co.’s, requirement to pay any quarterly disbursement fees to the United States Trustee Program (“the “Program”). Keating Motion at, p.5, para. 7. The Motion did not address the liability of Sports, Materials or Roofblok cases for quarterly fees owed to the Program.

On November 7, 1996, the United States Trustee filed his Response To Debtor’s Motion(the “Response”). The Response sought an Order from the Court requiring the payment of approximately $24,000. in unpaid quarterly disbursement fees by all four debtors, pursuant to 28 U.S.C. §1930(a)(6). The Debtor later filed a “Statement Of P.J. Keating Company Concerning Payment Of Quarterly Fees To United States Trustee”(the “Statement”). In the Statement, Keating now concedes that subsection (a)(6), requires the payment of post-confirmation quarterly fees. It also acknowledges that if the United States Trustee’s position is sustained, Keating Co. is liable for $25,000. in quarterly fees to the Program. The Statement fails to address whether any additional quarterly fees are due from Roofblock, Sports or Materials. As the cases have been jointly administered (but not substantively consolidated), any order regarding Keating should also extend to the other three chapter 11 cases.

A hearing was held on November 27, 1996 addressing the Motion, Response and Statement, at which time the Court granted the United States Trustee’s request for an opportunity to submit a memorandum of law addressing the quarterly fee issue. On December 11, 1996, the Court extended the deadline for filing the memorandum to December 20, 1996.

ARGUMENT

PURSUANT TO 28 U.S.C. § 1930(a)(6), QUARTERLY FEES ARE CALCULATED BASED ON ALL DISBURSEMENTS MADE DURING THE PENDENCY OF THE CASE

A. As Originally Enacted, The Plain Language Of 28 U.S.C. § 1930(a)(6) Required Quarterly Fees To Paid During the Pre-Confirmation Period Based On All Disbursements Made During The Pendency Of The Bankruptcy Case

On October 27, 1996, the President signed into law the Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1986, Pub. L. No. 99-554, 100 Stat. 3088 (1986)("1986 Act"). The 1986 Act expanded the pilot United

States Trustee Program from 18 judicial district to a permanent nationwide program. Section 117 of the 1986 Act amended 28 U.S.C. § 1930(a) by, among other things, creating a new quarterly fee for chapter 11 cases. Pursuant to the 1986 Act, a new subsection (6) was added to section 1930(a) following subsections (a)(1) - (5). As originally enacted, section 1930(a)(6) provided as follows:

> (6) In addition to the filing fee paid to the clerk, a quarterly fee shall be paid to the United States trustee, for deposit in the Treasury, in each case under chapter 11 of title 11 for each quarter (including any fraction thereof) until the case is converted or dismissed, whichever occurs first. The fee shall be $150 for each quarter in which **disbursements** total less than $15,000; $300 for each quarter in which **disbursements** total $15,000 or more but less than $150,000; $750 for each quarter in which **disbursements** total $150,000 or more but less than $300,000; $2,250 for each quarter in which **disbursements** total $300,000 or more but less that $3,000,000; $3,000 for each quarter in which **disbursements** total $3,000,000 or more. The fee shall be payable on the last day of the calendar month following the calendar quarter for which the fee is owed.

(emphasis added).

Section 1930(a)(6) ("the quarterly fee statute") is straight forward. It requires payment of a statutory fee quarterly based on a sliding scale, which is tied to the amount of disbursements made in a case. As originally enacted, the quarterly fee applied in all pending cases until a plan of reorganization was confirmed, or the case was converted or dismissed.

As the Supreme Court has noted, the best evidence of

Congressional intent is the plain language of the statute. CSX Transportation v. Easterwood, Inc., 507 U.S. 658, 633 (1993). Section 1930(a)(6) uses only two words to describe on what basis the quarterly fee is calculated: a "case" pending in chapter 11, and "disbursements." The parameters of a pending chapter 11 case is defined in the Bankruptcy Code as commencing with the filing of a petition, 11 U.S.C. §§ 301 - 303. If the case remains under chapter 11 and obtains confirmation of a plan, it proceeds until the estate has fully administered and the bankruptcy court enters a final decree. 11 U.S.C. § 350; F.R.B.P. 3022. Unlike the word "case," the word "disbursement" is not defined in the Bankruptcy Code, nor under any provisions of title 28.

Where a statute's language is not conclusive, the courts next look to its legislative history to determine congressional intent. Immigration and Naturalization Service v. Cardoza-Fonseca, 480 U.S. 421, 432 n.12 (1987). The United States Trustee, however, is aware of no applicable legislative history concerning the 1986 Act that addresses the definition of the word disbursement.[1] The legislative history of the 1986 Act does

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[1] The United States Trustee is aware of no Legislative History expressly addressing the meaning of the term disbursement. In response to this Court's request for legislative history concerning quarterly fees and the activities of the United States Trustee Program in connection with the passage of section 1930(a)(6), attached hereto as Exhibit A is a Statement made by Thomas J. Stanton, former Director, Executive Office for United States Trustees, to the House Committee on the Judiciary prior to the passage of the 1986 Act.

disclose that the enactment of the Quarterly Fee Statute was an effort by a Congress, confronted with budget deficits and the need to maintain tax revenues, to apportion fairly the cost of the United States Trustee Program on users. See H.R. No. 764, 99th Cong., 2d Sess. 22 (1986), reprinted in 1986 U.S. Code and Admin. News 5227 (1986). "The United States Trustee Program should not have to be self-funding. It provides a great service to our country's bankruptcy system. However, in this time of budget deficit concerns, self-funding becomes a necessity." Id. at 26. Thus, Congress expressly intended that the beneficiaries of the bankruptcy system, i.e., the debtors, pay the incumbent costs associated with its benefits.

Because neither the statute, nor its legislative history defines the word disbursement, its meaning must be derived from the plain language of the statute and accepted cannons of statutory construction. The most applicable cannon of statutory construction in this circumstance is the axiom that where a word is not otherwise defined in the relevant statute, the courts should construe it in accord with its ordinary and natural meaning. Smith v. United States, 507 U.S. 223, 228 (1993); Perrin v. United States, 444 U.S. 37, 42 (1979). Applying this cannon of statutory construction, those courts which have addressed the issue of what constitutes a disbursement under section 1930(a)(6) have construed that term very broadly to mean any payment, whether made directly or by a third party.

In St. Angelo v. Victoria Farms, 38 F.3d 1525, 1534 (9th Cir. 1994), for example, the Ninth Circuit reversed the district court's holding that a payment to a secured creditor from the proceeds of the sale of the secured property did not constitute a disbursement. The Court of Appeals noted that the definition of "disburse" in Webster's Third New International Dictionary, was "to expend . . . pay out." Id. It further observed that the statute drew no distinction between payments to secured and unsecured creditors and that the sparse legislative history on the issue suggested Congress intended an expansive definition. Id. at n. 10 and accompanying text. From this, the Court of Appeals concluded the the term disbursements included all payments made by the debtor's estate.

A number of courts have followed the Victoria Farms reasoning in according an expansive definition to the term "disbursements." See, e.g., In re Flatbush Associates, 198 B.R. 75 (Bankr.S.D.N.Y. 1996)(payment of rent to cooperative apartment is a disbursement); In re Meyer, 187 B.R. 650 (Bankr.W.D.Mo. 1995)(that distribution made to secured creditor by an escrow agent does not allow debtor to avoid payment of quarterly fees); In re Hays Builders, Inc., 144 B.R. 778, 780 (Bankr.W.D.Tenn. 1992)("All disbursements, whether direct or through a third party, [are] included in the calculation of fees due the trustee under 1930(a)(6)."); In re Wernerstruck, Inc., 130 B.R. 86, 89 (Bankr. D.S.D. 1991)(holding any payments by the debtor are disbursements under section 1930(a)(6); In re Ozark Beverage, Inc., 105 B.R. 510, 511-12 (Bankr.E.D. Mo 1989) (rejecting debtor's argument that "disbursements" mean only payments made to pre-petition creditors and holding that disbursements means all expenses in a given quarter).

In the pre-confirmation period, some courts have analyzed disbursements in the context of payments made by or in connection with the bankruptcy estate, while others have not. Compare St. Angelo v. Victoria Farms, In re Flatbush Associates, supra, (referencing the bankruptcy estate) with In re Ozark Beverage, Inc. and In re Wernerstruck, Inc., supra, (making no mention of the bankruptcy estate). To the extent that courts have referenced the bankruptcy estate, this reference is understandable since upon filing of a bankruptcy case, an estate is created which consists of all the debtor's legal and equitable interests in property. 11 U.S.C. § 541(a). None of these cases, can fairly be read as restricting the ordinary meaning of the term disbursements, which includes all payments. Indeed, each of the above-cited cases have held that the term disbursements is to be construed broadly in accordance with the ordinary meaning of the word.

As discussed above, however, the legislative history of the 1986 Act does indicate that Congress intended the users of the bankruptcy system to pay its incumbent costs. H.R. No. 764, 99th Cong., 2d Sess. at 26. The bankruptcy estate is not a user of a chapter 11 bankruptcy reorganization, it is merely the repository of the debtor's property between the filing of the case and confirmation of the plan. It is the debtor that seeks reorganization that is the user of the system and the entity that Congress intended would pay quarterly fees on all disbursements made during the case.

B. Nothing In The Recent Legislation Extending Quarterly Fee Obligations Into The Post-Confirmation Period Limits The Term "Disbursements" Or Otherwise Supports the Debtor's Attempt To Minimize Its Quarterly Fee Obligations

(1) The January 27, 1996 Amendment To Section 1930(a)(6) Imposed On the Post-Confirmation Debtor The Same Quarterly Fee Requirements As Congress Imposed On The Pre-Confirmation Debtor In The 1986 Act

On January 27, 1996, section 1930(a)(6) was amended pursuant to section 211 of the Balanced Budget Downpayment Act, I, Pub. L. No. 104-99, 110 Stat. 26, 37-38 (1996) ("Public Law 104-99"), by striking out the words "a plan is confirmed".[2] The portion of section 1930(a)(6) which was amended (hereinafter "January 1996

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[2] Section 211 provides that "Public Law 104-91 is amended by inserting after the words 'the protection of the Federal judiciary' in section 101(a), the following: 'to the extent and in the manner and', and by inserting at the end of the paragraph containing those words, but before the semicolon, the following: ": Provided That, with the exception of section 114, the General Provisions for the Department of Justice included in [House Conference Report 104-378] are hereby enacted into law." See Attachment B (Public Law 104-99, section 211) and Attachment C (Public Law 104-91). Section 111 of the General Provisions in House Report 104-378 states as follows: "Section 1930(a)(6) of title 28, United States Code, is amended by striking the words 'a plan is confirmed or'."

Amendment" or "amended section 1930(a)(6)") provides as follows, with the language stricken by Public Law 104-99 redlined in the text:

> In addition to the filing fees paid to the clerk, a quarterly fee shall be paid to the United States trustee in each case under chapter 11 of title 11 for each quarter (including any fraction thereof) until [~~a plan is confirmed or~~] the case is converted or dismissed, whichever occurs first . . ..

As is evident from the above quoted text, the only change in the statute was the deletion of the words "a plan is confirmed or" from the text of section 1930(a)(6). The intended effect of this amendment was to extend a debtor's obligation to pay quarterly fees into the post-confirmation period. McLean Square Associates, C.P., 201 B.R. 436, 439 (Bankr.E.D.Va. 1996).

As with the 1986 Act, the United States Trustee is not aware of any legislative history the addresses the meaning of the word "disbursement."[3] The legislative history of the 1996 amendment does, however, clearly articulate the reason for this amendment. As explained in the initial House Report from the Committee on Appropriations, which was reported from the House of Representatives on July 19, 1996, Congress expressly considered

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[3] Although the United States Trustee requested an extension of the quarterly fee into the post-confirmation period, it submitted nothing to Congress addressing the meaning of the term disbursement. Attached hereto as Exhibit D is the relevant portion of the United States Trustee's budget request for fiscal year 1997, which contains its request for an extension of the quarterly fee into the post-confirmation period.

the need to increase quarterly fee revenues by extending the fee into the post-confirmation period:

> <u>Decline in Bankruptcy filings.</u>--The recommendation [to increase the U.S. Trustee's fees] assumes an overall decline in bankruptcy filings in 1996, as assumed in the budget, but reduces the amount of funding to correspond to this decline, which was not reflected in the budget request. The Committee understands that due to this decline, Chapter 11 filing fees which partially finance this program are anticipated to drop significantly. However, <u>because cases with assets to administer often take two to three years, the pending caseload still in progress will require ongoing attention</u>. The Committee recommendation includes an extension of the quarterly fee payments under Chapter 11 to include the period after a reorganization plan has been confirmed by the Bankruptcy Court until the case has been dismissed (i.e., the post-confirmation period). Presently, quarterly fees are collected only until the plan of reorganization in the case is confirmed by the court.

H.R. Rep. No. 104-196, 104th Cong., 1st Sess. at 16-17 (1995)(emphasis added).[4]

Although the legislative history of amended section 1930(a)(6) does not address the meaning of the word disbursement, it does very clearly reflect that Congress intended to extend post-confirmation the same quarterly fee payment made pre-confirmation under the 1986 Act. Both House Report 104-196, quoted above, and the Joint Explanatory Statement of House Conference Report 104-378 provide that the quarterly fee

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[4] A copy of the relevant portions of 104-196 are attached hereto as Exhibit E for the court's convenience. For a concise synopsis of the Legislative History of Public Law 104-99, <u>see generally</u> 142 Cong. Rec. H3842-02, H3943-44 (April 25, 1996), a copy of which is attached hereto as Exhibit F.

assessment will simply continue post-confirmation, without discussing any change in the calculation of the fee:

> In addition, under section 111, the conferees agree to include an extension of post-confirmation quarterly fee payments made under Chapter 11 as proposed in both the House and Senate bills and expect that these fees will apply to all pending Chapter 11 cases with confirmed reorganization plans.

H.R. Conf. Rep. 104-378, 104th Cong., 1st Sess. (December 4, 1995); 141 Cong. Rec. H13894 (December 4, 1995) (emphasis added). The only logical inference to be drawn from Congress' failure to discuss a different basis for calculating the quarterly fee post-confirmation is that Congress intended the that the fee be calculated on all disbursements post-confirmation, just as it is calculated on all disbursements pre-confirmation. A copy of the relevant portions of H.R. Conf. Rep. 104-378 is attached hereto as Exhibit G.

The legislative history further identifies the debtor as the party that Congress intended would pay the fees connected with those disbursements. Conference Report 104-378 provides as follows:

> The conference agreement includes section 111 as proposed in the House and Senate bills, **which extends the quarterly fee payments for debtors under Chapter 11** of the Bankruptcy Code to include the period from when a reorganization plan is confirmed by the Bankruptcy Court until the case is converted or dismissed. The conferees intend that this fee will apply to both pending and new cases.

H.R. Conf. Rep. 104-378, 104th Cong., 1st Sess. (December 4, 1995); 141 Cong. Rec. H13899 (December 4, 1995) (emphasis added). Thus, although there is no available legislative history discussing the meaning of the term disbursement, the amended statute, together with its legislative history unequivocally demonstrate that Congress intended the debtor would pay precisely the same quarterly fee post-confirmation as it did pre-confirmation in order to ensure adequate funding of the bankruptcy system.

(2) Quarterly Fee Legislation Enacted On September 30, 1996 Demonstrates Congress' Intent To Increase Revenues And To Have Amended Section 1930(a)(6) Construed Broadly

On September 30, 1996, additional legislation was enacted to augment quarterly fee revenues. That legislation was contained in Section 109 ("Section 109") of the General Provisions for the Department of Justice contained in Title I of the Omnibus Appropriations Act for Fiscal Year 1997, Public Law 104-208, 110 Stat. 3009, and affected quarterly fees in two ways.[5]
First, Section 109(a) amended the schedule of quarterly fee payments set forth in section 1930(a)(6).[6] The schedule was amended by increasing the number of levels of fees from five to

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[5] The relevant portions of this legislation is attached hereto as Exhibit H.

[6] Attached hereto as Exhibit I, is the Statement of Joseph Patchan, Director, Executive Office for United States Trustees before the Subcommittee On Commercial and Administrative Law, Committee on the Judiciary, U.S. House of Represenattives Concerning the United Sattes Trustee Program, Presented on July 24, 1996.

ten and by increasing significantly the maximum amount of fees applicable to large cases. For, example, in a case with quarterly disbursements of $3,000,000, the corresponding fee was increased from $5,000 to $8,000.[7]

The second provision related to quarterly fees was set forth in Section 109(d), and provided as follows:

> "Section 101(a) of Public Law 104-91, as amended by section 211 of Public Law 104-99 is further amended by inserting ": Provided further, That, <u>notwithstanding any other provision of law</u>, the fees under 28 U.S.C. 1930(a)(6) <u>shall accrue and be payable from and after January 27, 1996, in all cases (including without limitation, any cases pending as of that date), regardless of</u>

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[7] The text of Section 109(a) provided as follows:

> SEC. 109. (a) Section 1930(a) of title 28, United States Code, is amended *in paragraph (3), by inserting "$" before "800", and* in paragraph (6), by striking everything after "total less than $15,000;" and inserting in lieu thereof: "$500 for each quarter in which disbursements total $15,000 or more but less that $75,000; $750 for each quarter in which disbursements total $75,000 or more but less than $150,000; $1,250 for each quarter in which disbursements total $150,000 or more but less than $225,000; $1,500 for each quarter in which disbursements total $225,000 or more but less that $300,000; $3,750 for each quarter in which disbursements total $300,000 or more but less than $1,000,000; $5,000 for each quarter in which disbursements total $1,000,000 or more but less than $2,000,000; $7,500 for each quarter in which disbursements total $2,000,000 or more but less than $3,000,000; $8,000 for each quarter in which disbursements total $3,000,000 or more but less than $5,000,000; $10,000 for each quarter in which disbursements total $5,000,000 or more. The fee shall be payable on the last day of the calendar month following the calendar quarter for which the fee is owed.

> confirmation status of their plans" after "enacted into law".,

This amendment to Public Law 104-91 was enacted in response to a number of bankruptcy court cases which held that post-confirmation quarterly fees could not be collected from debtors with plans confirmed prior to the effective date of the January 27, 1996 amendment to section 1930(a)(6). See, e.g., In re Precision Autocraft, Inc., 197 B.R. 901 (Bankr. W.D. Wash. 1996). By enacting this clarifying legislation, Congress expressly stated its intent that amended section 1930(a)(6) be applied all pending chapter 11 cases, including those with plans confirmed prior to the effective date of the January 27, 1996 amendment.[8]

Once again, nothing in this legislation, nor in its legislative history addresses the meaning of the word disbursement or in any way evidences any intent by Congress that post-confirmation debtors should pay quarterly fees on anything but the same basis as pre-confirmation debtors.

(3) Keating Co.'s Construction Of The Term Disbursement Would Require Two Separate Definitions Of That Term And Is Contrary To The Plain Language Of The Statute

There is no dispute that Keating Co.'s chapter 11 case was

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[8] The applicable conference report for this legislation expressly provides that the Amendment serves to "clarify that fees collected under post-confirmation status are to be assessed in all pending chapter 11 cases." H.R. Conf. Rep. No. 3620, 104th Cong. Sess., 142 Cong. Rec. H11644, H11850 (daily ed. September 28, 1996). A copy of the relevant portions of this conference report is attached hereto as Exhibit J.

pending in the relevant time period and that disbursements have occurred. Indeed, Keating Co. concedes that it has disbursed in excess of $5 million and that if the United States Trustee's construction of the term "disbursements" is correct, it owes quarterly fees of $25,000. Keating Statement at 5, ¶ 8. Keating Co. argues, however, that its post-confirmation disbursements must be calculated in a manner different from its pre-confirmation disbursements: "quarterly fees payable after confirmation of a plan of reorganization are based on disbursements made by the bankruptcy estate pursuant to the confirmed plan, and not on all disbursements made by the reorganized debtor in the operation of its business postconfirmation." Keating Statement at 3, ¶ 5. Keating Co.'s argument is without merit for several reasons.

First, nothing in either the plain language or legislative history of the 1986 Act suggests that Congress intended to limit the term disbursements to payments by the "bankruptcy estate." Instead, Congress was concerned only in establishing a viable, self-funded United States Trustee Program paid for by the entities which sought protection of and were benefitted by the bankruptcy system, <u>i.e.</u>, debtors. <u>See</u> <u>United States Trustee v. Prines</u>, 867 F.2d 478, 484-85 (8th Cir. 1989)(quarterly fee established to impose costs of system on the users); H.R. Conf. Rep. 104-378, 104th Cong., 1st Sess. (December 4, 1995); 141 Cong. Rec. H13899 (December 4, 1995) (amendment to section

1930(a)(6) extends the quarterly fee payments "for debtors under Chapter 11" into post-confirmation period).

Keating Co. cites St. Angelo v. Victoria Farms, Inc. for the proposition that disbursements must be limited to payments made by the bankruptcy estate. As discussed above, that case and the others that have addressed the issue have not referenced the legal concepts of the bankruptcy estate or debtor-in-possession in order to limit the meaning of the term disbursement. To the contrary, those courts have used them as part of an analytical framework to apply the term "disbursements" broadly and to reject technical arguments raised by debtors to avoid paying all fees owed. See, e.g., St. Angelo v. Victoria Farms, Inc., 38 F.3d at 1534.

Indeed, Keating Co.'s contention is reminiscent of another technical argument that was rejected in In re Ozark Beverage Co., 105 B.R. 510 (Bankr. E.D. Mo. 1989). There, the debtor asserted that the word "disbursements" meant only payments made to pre-petition creditors. The bankruptcy court rejected the debtor's argument, stating as follows:

> neither the statute nor its legislative history gives even a hint that this was Congress' intended definition. Further, the Debtor has given the Court no indication as to the source of this new interpretation. In essence, the Debtor has simply proposed a novel definition of the term which would engender a less harsh result in this case. If Congress had intended such a meaning, surely it would have stated so more clearly.

Id. at 512 (emphasis added). Like the debtor in Ozark Beverage, Inc., Keating Co. has simply proposed a novel construction of the term disbursement in order to limit the amount it owes in quarterly fees. This argument is unsupported by the either the plain language of the statute or its legislative history, however, and should be rejected.

A second error in Keating Co.'s argument is that it relies on the flawed analysis in SeaEscape Cruises for the proposition that postconfirmation disbursements are necessarily limited to are payments made by under the plan of reorganization. In SeaEscape Cruises, the bankruptcy court first noted that "[u]pon a plan's confirmation and/or pursuant to the plans terms, the bankruptcy estate's assets revest in the name of the reorganized debtor and are no longer part of the bankruptcy estate." 20 B.R. at 323 (citing 11 U.S.C. § 1141(b)). Notwithstanding this conclusion, the SeaEscape court summarily concluded that payments under the plan were payments from the estate without citation to any authority.

The SeaEscape analysis is logically and legally inconsistent. If confirmation of a plan revests the assets of the estate in the debtor, 11 U.S.C. § 1141(b), payments by a reorganized debtor under a plan, as a matter of law, cannot constitute payments from the bankruptcy estate.[9] Moreover, if

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[9] See McKinney v. Waterman Steamship Corporation, 925 F.2d 1, 4 (1st Cir. 1991)(confirmation revests estate property in the debtor and discharges its debts); see also In re Robbins, 167 B.R. 724 (Bankr. D. Mass. 1994) (the bankruptcy estate revests in

post-confirmation disbursements are limited to payments by a bankruptcy estate that no longer exists, then no quarterly fees beyond a minimum amount would ever be owed pursuant to amended section 1930(a)(6). Congress' intent to increase funding for the United States Trustee Program would then be a nullity. Such a construction would achieve an absurd result and, therefore, must be rejected. Griffin v. Oceanic Contractor, Inc., 458 U.S. 564, 575 (1982)(statutory constructions leading to absurd result are to be avoided); Pritzker v. Yari, 42 F.3d 53, 67 (1st Cir. 1994)(same).

Further, the SeaEscape decision, in effect, holds that post-confirmation disbursement are limited to payments under the plan of reorganization. If Congress had wanted to limit post-confirmation "disbursements" in this manner, however, it could have done so. See 28 U.S.C. § 586(e)(1)(B)(ii)(I) (limiting standing trustee compensation to "ten percent of the payments made under the plan"). The SeaEscape decision improperly fails to recognize these differences in statutory language. Russello v. United States, 464 U.S. 16, 23 (1983); 2A N. Singer, Sutherland on Statutory Construction, § 46.07 (5th ed. 1992 and Supp. 1996). At best, the SeaEscape Cruises decision should be viewed as a result-oriented decision, rather than one based on the law. It provides little guidance for this court to follow.

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the debtor at confirmation and no longer exists).

The third flaw in Keating Co.'s argument is that it necessarily requires differing definitions of the term disbursements for the pre-confirmation and post-confirmation periods. As set forth above, the courts that have addressed the issue of what constitutes a disbursement in the pre-confirmation period have consistently applied a broad construction of that term to the effect that quarterly fees are calculated based on all payments made. Indeed, as the First Circuit has recognized, a presumption exists in the law that Congress was aware of prior judicial and administrative interpretations of statutory terms. United States v. Ramirez, et al., 82 F.3d 1131 (1st Cir. 1996)(citing Lorillard v. Pons, 434 U.S. 575, 580 (1978); Sierra Club v. Secretary of the Army, 820 F.2d 513, 522 (1st. Cir. 1987)). Consequently, Congress must be presumed to be aware of the broad construction afforded the term "disbursements" under section 1930(a)(6).

As discussed above, there is no evidence that Congress considered adopting a narrower definition of the term "disbursement" in the post-confirmation period. Indeed, as discussed above the history of the January 27, 1996 amendment to section 1930(a)(6) indicates that Congress intended simply to extend post-confirmation the same quarterly fee paid pre-confirmation. Consequently, Keating Co.'s arguments to the contrary should be rejected.

(4) Keating Co.'s Policy Arguments Should Be

Rejected

Keating Co. states that its interpretation of the statute "comports with the purpose underlying Section 1930(a)(6) -- that debtors availing themselves of Chapter 11 fund the services necessitated by their Chapter 11 cases." Keating Statement at 5, ¶ 9. This approach is unavailing for several reasons.

First, contrary to Keating Co.'s contention, nothing in either the statute or its legislative history suggests that Congress intended to link the amount of effort expended by the United States Trustee in a given case with the amount of quarterly fees it pays. To the contrary, the relative ease of basing the quarterly fee on all disbursements indicates that Congress intended an straight forward system that designed to avoid dragging the courts through a laborious process of deciding how much the United States Trustee should receive in each case.[10] Had Congress wished to created such a linkage, presumably it could have structured post confirmation fees along the lines of professional fees, which are limited according to various criteria. 11 U.S.C. § 328 (Limitations on compensation of professional persons). Instead, Congress established the amount of the quarterly fee obligation relative only to the debtor's

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[10] Cf. In re Savage, 67 B.R. 700, 705-08 (D.R.I. 1986) (Congress established a percentage fee structure for compensating standing trustees that avoids the vicissitudes of individual cases to ensure that adequate funding exists to administer all cases).

disbursements.

Second, Keating Co.'s argument disregards the fact that Congress has structured the fee in an equitable fashion and with full knowledge of the impact that it would have on chapter 11 debtors. Modest fees are assessed on a graduated scale according to the amount of disbursements made by a debtor. Congress has also imposed a ceiling so that no debtor would pay more than a fixed maximum in any quarter. Moreover, the overriding premise for the quarterly fee inextricably ties the benefits of chapter 11 protection the debtor receives from the law and its concurrent responsibilities. Consequently, Keating Co.'s attempt to limit quarterly fees on this basis is unjustified.

Third, contrary to Keating Co.'s contention, the United States Trustee did undertake post-confirmation activities in the above-captioned case. The Office of the United States Trustee reviewed various fee applications, participated in a number of discussions regarding post-confirmation disbursements, responded to inquiries by various creditors of the debtors, and sought closure of the cases.

Fourth, to the extent that Keating Co. may argue that post-confirmation disbursements should not be considered disbursements on fairness grounds, this contention is plainly without merit. It was the protections of chapter 11 that enabled Keating Co. to remain a viable ongoing entity. That Congress has determined to assess a fee during the post-confirmation period, during which a debtor still enjoys the benefits of chapter 11 protection can hardly be considered unfair. For example, during the post-confirmation period, a debtor might seek modification of its plan pursuant to 11 U.S.C. § 1127, or seek resolution of any number of disputes arising under the plan in the bankruptcy court rather than in an alternate forum. If a debtor wishes to minimize its post confirmation quarterly fees, it should move expeditiously to substantially consumate its plan and seek a final decree, which would close the case and prevent the assessment of additional fees.

Finally, under the approach urged by Keating Co., the fairness and uniformity of the quarterly fee system would be jeopardized. Calculating quarterly fees according to all disbursements by the debtor during the pendancy of the case results in one uniform standard being applied to all. If Keating Co.’s approach were adopted and quarterly fees were determined based on disbursements by the estate, those debtors whose plans do not revest property of the estate in the debtor may be forced to pay larger quarterly fees that debtors whose plans do permit or require bankruptcy estate property to revest.[11] Such a result

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[11] To the extent that Keating Co. may rely on equitable considerations, such considerations do not allow a court to set aside the applicable bankruptcy law. Prisbrey v. Noble, 505 F.2d 170 (10th Cir. 1974). While bankruptcy courts are courts of equity, a fundamental principle of equity is that "equity follows the law." Wedges v. Dixon County, 150 U.S. 182, 192 (1893). As noted above, Congress has struck what it considers to be an equitable balance. Barring a constitutional infirmity, Congress'

would undermine the uniform, straightforward nature of the quarterly fee system, has no basis in the law and should be rejected.

CONCLUSION

The U.S. Trustee submits that subsection 1930(a)(6) requires all four above-captioned debtors to pay quarterly disbursement fees based upon all post-confirmation disbursements made by each debtor or so-called reorganized debtor. This conclusion is supported by the plain meaning of the statutory language of 28 U.S.C. §1930(a)(6), when read in conjunction with the legislative history of the subsection evidencing Congress’s intent. The U.S. Trustee therefore respectfully urges the Court to deny the debtors’ request for the entry of final decrees until all quarterly disbursement fees owed by these debtors are paid.

Respectfully submitted,

J. Christopher Marshall
United States Trustee, Region 1

By:_____________________________

Peter J. Stocks, Esq.
Attorney-Advisor
U.S. Trustee's Office
44 Front Street, Room 440
Worcester, MA 01608
(508) 793-0555

OF COUNSEL

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decision must be respected. TVA v. Hill, 437 U.S. 153 (1978).

Martha L. Davis, Esq.
Paul Bridenhagen, Esq.
Executive Office for
United States Trustees
901 E Street, NW
Suite 780
Washington, DC 20530

DATE: Dec. 20, 1996

CERTIFICATE OF SERVICE

I, Richard T. King, certify that I have served the attached Memorandum of Law in support of the U.S. Trustee’s Response To Debtors’ Motion For Final Decree, by first class mail, postage prepaid, upon:

A. Davis Whitesell, Esq.
COHN & KELAKOS
265 Franklin Street
Boston, MA 02110
For P.J. Keating Co.

Charles A. Dale, Esq.
HANIFY & KING
One Federal St., 13th floor
Boston, MA 02110
For Paul J. Keating

Janet E. Bostwick, Esq.
GOLDSTEIN & MANELLO
265 Franklin Street
Boston, MA 02110
For Alvarez & Marsal, Inc.

Richard T. King

DATE: Dec. 20, 1996

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In re: Kagenveama (Maney v. Kagenveama)

2. ("CO") ***CURRENT*** COURT
[E.g., "CTA9"]

CTA 9

3. ("CCN") ***CURRENT*** CASE NO.

No.: 06-17083

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P. Matthew Sutko, William Kanter, Edward Himmelfarb

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8. ("TO") ***TOPIC***

BANKRUPTCY

9. ("SU") ● ***SUMMARY*** OF KEY ISSUE(s)

&

√ Any Miscellaneous ***BACKGROUND***

● Whether the bankruptcy court erred in holding that the debtor's projected disposable income under section 1325(b)(1) of the Bankruptcy Code is computed by simply multiplying the debtor's disposable income, as defined in section 1325(b)(2), by the number of months in the chapter 13 plan, with no other adjustments.

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IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

In re LAURA F. KAGENVEAMA,

Debtor.

EDWARD J. MANEY, CHAPTER 13 TRUSTEE,

Trustee-Appellant,

v.

LAURA F. KAGENVEAMA,

Debtor-Appellee.

ON APPEAL FROM THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF ARIZONA

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE SUPPORTING REVERSAL

OF COUNSEL:

ROBERTA A. DEANGELIS
Acting General Counsel

P. MATTHEW SUTKO
Associate General Counsel
Executive Office for United States Trustees
Department of Justice
20 Massachusetts Avenue, N.W.
Washington, D.C. 20530

PETER D. KEISLER
Assistant Attorney General

WILLIAM KANTER
(202) 514-4575
EDWARD HIMMELFARB
(202) 514-3547
Attorneys, Appellate Staff
Civil Division, Room 7646
Department of Justice
950 Pennsylvania Avenue, N.W.
Washington, D.C. 20530

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BRIEF FOR THE UNITED STATES AS AMICUS CURIAE SUPPORTING REVERSAL

Pursuant to Rule 29 of the Federal Rules of Appellate Procedure, the United States submits this brief as amicus curiae supporting reversal of the bankruptcy court's order.

INTEREST OF THE UNITED STATES

The Attorney General appoints United States Trustees to supervise the administration of bankruptcy cases and trustees in regions comprising the vast majority of the federal judicial districts. 28 U.S.C. 581-589a. United States Trustees "serve as bankruptcy watch-dogs to prevent fraud, dishonesty, and overreaching in the bankruptcy arena." H.R. Rep. No. 95-595, at 88 (1977). The United States Trustee Program thus acts in the public interest to promote the efficiency, and to protect and preserve the integrity, of the bankruptcy system. To this end, Congress has provided that "[t]he United States trustee may raise and may appear and be heard on any issue in any case or proceeding." 11 U.S.C. 307. See In re Donovan Corp., 215 F.3d 929, 930 (9th Cir. 2000).

This case involves a dispute over confirmation of a plan under chapter 13 of the Bankruptcy Code. The United States Trustee is authorized, among other things, to "supervise the administration of cases and trustees" in chapter 13 cases, monitor chapter 13 plans, and file comments with the court regarding such chapter 13 plans in connection with a plan confirmation hearing under section of the Code. 28 U.S.C. 586(a)(3)(C).

In 2006, more than a quarter million persons filed bankruptcy petitions under chapter 13. In chapter 13 cases, with so-called above-median debtors,[1] the question of statutory interpretation presented in this case has occurred frequently and is

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[1] An above-median debtor is the name often used in referring to a debtor whose current monthly income under 11 U.S.C. 101(10A), multiplied by 12, is above the annual median income in the state of a family of comparable size. See 11 U.S.C. 1325(b)(3).

continuing to occur. In fact, there are already approximately 50 bankruptcy court decisions that have faced this statutory issue.

In this brief, the United States respectfully offers this Court its views on the correct interpretation of section 1325(b). See 28 U.S.C. 517 (authorizing Department of Justice "to attend to the interests of the United States in a suit pending in a court of the United States").

STATEMENT OF THE ISSUE

Whether the bankruptcy court erred in holding that the debtor's projected disposable income under section 1325(b)(1) of the Bankruptcy Code is computed by simply multiplying the debtor's disposable income, as defined in section 1325(b)(2), by the number of months in the chapter 13 plan, with no other adjustments.

STATEMENT

A. Statutory Background.

In 2005, Congress passed and the President signed into law the Bankruptcy Abuse Prevention and Consumer Protection Act, Pub. L. No. 109-8, 119 Stat. 23 (2005) (BAPCPA).

One of the innovations of the BAPCPA was means-testing. In section 707 of the Bankruptcy Code, which addresses dismissal of abusive chapter 7 petitions, Congress established special rules for debtors whose current monthly income, reduced by certain permitted expenses, exceeded a threshold for abuse under a specified formula.

11 U.S.C. 707(b)(2). This amendment changed the way these expenses were computed; some were no longer the debtor's actual and reasonable expenses but instead were standard expenses under the National Standards and Local Standards issued by the Internal Revenue Service for the debtor's area of residence. 11 U.S.C. 707(b)(2)(A)(ii).

Congress also applied means-testing to chapter 13 cases, like this one, in which the debtor seeks not to liquidate his debts, as in chapter 7, but rather to establish a plan for repaying all or part of those debts. Before the BAPCPA amendments were enacted, section 1325, governing confirmation of a chapter 13 plan, required such a plan to provide that all of the debtor's "projected disposable income" during the plan period would be used to repay debts. Disposable income was calculated from the debtor's actual income and expenses set forth on Schedules I and J, which the debtor was required to file. But the BAPCPA amended section 1325 to change the definition of "disposable income." The new section 1325(b)(2) defines "disposable income" to mean "current monthly income received by the debtor * * * less amounts reasonably necessary to be expended" for maintenance or support or necessary business expenses. 11 U.S.C. 1325(b)(2).[2] This definition incorporates two changes: first, it defines "disposable income" based on an average of past monthly income and expense figures;

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[2] "Current monthly income" means the "average monthly income from all sources" that the debtor received during the six-month period ending the last calendar month before the debtor filed his bankruptcy petition. 11 U.S.C. 101(10A).

and second, for debtors with higher income levels, it requires the use of the same standard expenses mandated for certain debtors under section 707(b)(2). Specifically, section 1325(b)(3) now directs that reasonable expenses be determined "in accordance with subparagraphs (A) and (B) of section 707(b)(2)" for those chapter 13 debtors whose current monthly income, multiplied by 12, is greater than the median family income for a family of the corresponding size. 11 U.S.C. 1325(b)(3). Chapter 13 debtors in this class are typically referred to as "above-median" debtors. An above-median debtor is not one whose income places him in the top half of all debtors; it is one whose income places him in the top half of families of his size in his area.

Under current bankruptcy rules, such a debtor must file a Form 22C,[3] which sets forth the debtor's income and expenses in accordance with standard numbers issued by the IRS. Because a debtor must also file the traditional Schedules I and J setting forth actual income and expenses, it often becomes apparent that there is a significant difference between the above-median debtor's disposable income under Schedules I and J and his disposable income under Form 22C. In some cases, the use of standard expenses for above-median debtors under Form 22C actually results in a lower amount of disposable income, and in a few cases, like the present case, the use of Form 22C actually converts an otherwise positive disposable income into a negative

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[3] The form was known as "B22C" at the time the debtor filed in this case. We will use the current form name "22C" throughout.

one. Likewise, in some cases, it is clear that the historical circumstances that produced a particular income figure will change prospectively.

For the convenience of the Court, we have attached in an addendum to this brief the pre-BAPCPA text of section 1325, the current text of section 1325, and a redlined version showing the changes to section 1325 made by the BAPCPA.

B. Facts.

The debtor, Laura Kagenveama, filed a chapter 13 petition on November 28, 2005. Accompanying her petition were two different sets of forms disclosing her income and expenses and computing those figures in different ways. The first set of forms, the traditional Schedules I and J,[4] showed a total combined monthly income of $4,096.26 and total monthly expenses of $2,572.37, for a monthly net income of $1,523.89. ER 1-2. The second form, Form 22C,[5] as amended, which is a new Form

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[4] A chapter 13 petition must be accompanied by a variety of schedules to illustrate the debtor's financial situation. Schedule I (Current Income of Individual Debtor(s)) requires the debtor to compute net monthly take home pay, along with additional sources of income. Schedule J (Current Expenditures of Individual Debtor(s)) requires the debtor to set forth estimates of the average monthly expenses of the debtor and his family. At the bottom of Schedule J, the total monthly expenses are deducted from the total income figure from Schedule I.

[5] Form 22C is a new form developed after the enactment of BAPCPA. Titled "Statement of Current Monthly Income and Calculation of Commitment Period and Disposable Income," this form provides for the computation of the debtor's income and expenses pursuant to the definitions and rules found in BAPCPA. As we will explain, those definitions and rules are different from those that are found in Schedules I and J.

developed for use after the enactment of the BAPCPA, showed the debtor's statutorily defined "current monthly income" to be $6,168.21 ($74,018.52 annually), which after computing deductions allowable under BAPCPA, showed monthly disposable income of negative $4.04. ER 19.

In light of this negative disposable income, the debtor filed a chapter 13 plan that called for her to make no payments to unsecured creditors. The chapter 13 trustee objected, arguing that the debtor's Schedules I and J indicated actual disposable income that could be used to pay unsecured creditors. The debtor countered that her disposable income was negative, and that if that negative income was projected through the plan period, she would satisfy the requirement of section 1325(b)(1)(B) that "all of the debtor's projected disposable income to be received in the applicable commitment period beginning on the date that the first payment is due under the plan will be applied to make payments to unsecured creditors under the plan." That is, "all" of her projected disposable income was less than nothing, so by paying nothing, she was complying with the Code, and her plan should be confirmed.

2. The bankruptcy court agreed with the debtor. Citing "the plain words of the statute," the bankruptcy court noted that Congress, in BAPCPA, had focused the definition of "disposable income" on "current monthly income." ER 23. The bankruptcy court pointed out that the definition, in section 1325(b)(2), applies in "this subsection," and that the term appears nowhere else but in section 1325(b)(1)(B),

which refers to "projected disposable income." Id. Thus, "[u]nless the definition applies to 'projected disposable income,' it has no meaning." Id.

The bankruptcy court rejected the chapter 13 trustee's argument that a simple historical number could not be "projected," observing that one would just "apply the current monthly income amount over the applicable commitment period." ER 23. It is true, the bankruptcy court admitted, that this computation might bear little relation to actual income available to the debtor during the plan period, and that Schedules I and J might provide a better measure. Nevertheless, that is what Congress called for, as "ironic and unfortunate" as that may be. ER 24.

3. The chapter 13 trustee asked the bankruptcy court to certify its order for direct interlocutory appeal to the court of appeals under 28 U.S.C. 158(d)(2). The debtor did not object, and the bankruptcy court ordered that the matter be certified. ER 36-37. The Ninth Circuit granted permission to appeal on October 30, 2006.

SUMMARY OF ARGUMENT

The BAPCPA amendments to section 1325 have created important interpretive questions about the proper way to understand "projected disposable income." As the case law reflects, there are three different ways to interpret and apply that statutory language in light of the amendments. The interpretation adopted by the bankruptcy court (and supported by the debtor) should be rejected, because it fails to take into account all the language in the statute.

The bankruptcy court interpreted the term "projected disposable income" to require use of the historical "disposable income" figure throughout the chapter 13 plan period, regardless of the debtor's actual income and expenses during that period. In this case, the debtor's historical "disposable income" was negative, and under the bankruptcy court's interpretation, the debtor's negative disposable income was "projected" over the entire plan period, with the result that her chapter 13 plan called for repayment of no debt whatsoever. If this were what the statute actually required, that would be one thing. But the bankruptcy court's interpretation does not account for the usual meaning of "projected" income or for the statutory phrases "to be received" and "will be applied to make payments" in section 1325(b)(1)(B). Blindly extending into the future an historical monthly income calculation, which the court itself admitted may bear no relationship to actual income that the debtor will receive in the future, makes it impossible for the plan to apply available future income to make payments to unsecured creditors in accordance with the statute. That approach relies exclusively on a definition of current monthly income that is inherently retrospective. Blindly using the inherently retrospective number to make the inherently prospective projection required by the statute makes no sense and fails to give meaning to every word in the statute.

Albeit in a less problematic way, the chapter 13 trustee's interpretation also fails to give weight to all the language of the statute. The chapter 13 trustee correctly explains that the bankruptcy court's interpretation of "projected disposable income" does not take into account important statutory language. However, the chapter 13 trustee's own interpretation – which asks courts to focus on income and expenses in Schedules I and J, as they used to do before the language was amended – fails to give adequate meaning to the new definition of "disposable income," the one term in section 1325(b) that now is actually defined.

In contrast with both of these interpretations, the best interpretation of section 1325(b) is one that gives meaning to "disposable income" by requiring its use in determining the "disposable income" that is to be projected as an initial matter, subject to adjustment to account for any significant increases or decreases in the debtor's income that are likely in particular cases. Such adjustments may be necessary in individual cases to ensure that the income attributed to a debtor in his chapter 13 plan is actually income that is "projected" and "to be received" and that "will be applied to make payments" to unsecured creditors. While a simple multiplication of the initial disposable income number by the relevant number of months is a presumptive starting point, this approach allows adjustments to be made.

Though our interpretation is not wholly free of minor textual difficulties, those difficulties are considerably less problematic than those raised by the bankruptcy court's interpretation. Our interpretation is also consistent with the overall goals of chapter 13.

ARGUMENT

THE BANKRUPTCY COURT ERRED IN HOLDING THAT AN ABOVE-MEDIAN DEBTOR'S "PROJECTED DISPOSABLE INCOME" UNDER SECTION 1325(b) OF THE BANKRUPTCY CODE MUST BE DETERMINED EXCLUSIVELY BY APPLYING HISTORICAL "DISPOSABLE INCOME" OVER THE PLAN PERIOD.

A. The Bankruptcy Court's Interpretation Fails To Give Content To Three Statutory Phrases.

In this case, the debtor, Laura Kagenveama, is an above-median debtor, whose income and expenses, under 11 U.S.C. 1325(b)(3), are computed in accordance with national and local standards. Although her Schedules I and J produced a disposable income of $1,523.89 a month, her Form 22C showed disposable income of -$4.04. ER 24. In holding that this negative disposable income had to be "projected" over the entire chapter 13 plan period, with no other adjustments, the bankruptcy court applied a mechanical interpretation of "projected disposable income" that fails to give meaning to all parts of the statutory language.

1. The BAPCPA amendments in 2005 to section 1325 created a significant change in the law. Before these amendments were enacted, section 1325(b)(1) provided that if the trustee or the holder of an allowed unsecured claim objected to the confirmation of a chapter 13 plan, the court was not permitted to approve the plan unless it provided that "all of the debtor's projected disposable income to be received in the three-year period beginning on the date that the first payment is due under the

plan will be applied to make payments under the plan." 11 U.S.C. 1325(b)(1) (2000 ed.). The term "disposable income" was defined as income received by the debtor that was "not reasonably necessary to be expended" for "maintenance or support of the debtor or a dependent" or for necessary business expenses if the debtor was engaged in a business. 11 U.S.C. 1325(b)(2) (2000 ed.). As the bankruptcy court in this case recognized, a debtor's projected disposable income under that former law was calculated simply by "subtracting the debtor's expenses set out on Schedule J from the debtor's income set out on Schedule I," two forms that a chapter 13 debtor was required to file. ER 21.

In contrast, under the BAPCPA amendments, section 1325(b)(1) now provides that:

> (b)(1) If the trustee or the holder of an allowed unsecured claim objects to the confirmation of the plan, then the court may not approve the plan unless, as of the effective date of the plan – * * * (B) the plan provides that all of the debtor's projected disposable income to be received in the applicable commitment period beginning on the date that the first payment is due under the plan will be applied to make payments to unsecured creditors under the plan.

11 U.S.C. 1325(b)(1). And now, "disposable income" is defined expressly to mean "current monthly income received by the debtor * * * less amounts reasonably necessary to be expended" for maintenance or support or necessary business expenses. 11 U.S.C. 1325(b)(2). "Current monthly income" is defined as the "average monthly

income from all sources" that the debtor received during the six-month period ending the last calendar month before the debtor filed the chapter 13 petition. 11 U.S.C. 101(10A). An above-median debtor calculates these figures on Form 22C.

The bankruptcy court held that "projected disposable income" in the current version of the statute must refer to the newly defined term "disposable income" in section 1325(b)(2), which in turn is based on a retrospective calculation of current monthly income based on the average of recent months. Although it realized that "historical current monthly income may or may not have any relationship to the actual income to be received by the debtors during the course of their Chapter 13 plan," ER 24, the court held that the statutory language required it to "project" this historical income by applying it across the term of the chapter 13 plan. Because, in the present case, the debtor's historical monthly income was less than zero, the projected disposable income would be negative, no matter how long the term of the chapter 13 plan.[6]

2. The bankruptcy court's interpretation of "projected disposable income" is not correct. Most significantly, it adopts a contextually invalid interpretation of the term "projected" and wholly fails to account for two other important phrases in section 1325(b)(1)(B).

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[6] The United States takes no position on the parties' dispute over the "applicable commitment period."

First, the bankruptcy court erred in concluding that to "project[]" disposable income means to "apply the current monthly income amount over the applicable commitment period." ER 23. Statutory words must be construed in context. Hibbs v. Winn, 542 U.S. 88, 101 (2004). In the economic and financial context – which is plainly the relevant context for purposes of this statute – the calculation of "projected" financial data may well begin with historical data, but it does not necessarily (or even usually) end there, and it certainly does not entail a rigid and inviolable assumption that projected income will necessarily be identical to past income even when the available facts demonstrate otherwise. To the contrary, in context the term "projected" must be understood to refer to a forecast or estimate of an expected future financial reality. See The Random House Dict. of the English Lang. 1546 (2d ed. 1987) (defining to "project" as, inter alia, "to set forth or calculate (some future thing); *They projected the building costs for the next five years.*"); Webster's Third New Int'l Dict. 1813 (1993) (defining "projected" as, inter alia, "planned for future execution: contrived, proposed," as "[projected] outlays for new plant and equipment"). The bankruptcy court erred in failing to adopt a contextually accurate interpretation of the term "projected."

Second, as the court itself conceded, the historical income required to be used may have no relationship to the actual income "to be received" by the debtor. ER 24. This concession is highly significant. Section 1325(b)(1)(B) states that the court may not approve a plan unless it provides that all the debtor's projected disposable income "to be received" during the plan period is applied to make payments to unsecured creditors. To the extent historical income bears no relationship with actual income "to be received" by the debtor, the court's interpretation is inconsistent with the statutory language.

Third, the bankruptcy court's interpretation also ignores the statutory phrase "will be applied to make payments." If projected disposable income is based on an historical figure, minus expenses, there will be some cases in which income in the plan is only deemed, or hypothetical, and not actually received. A fairly typical case would be one in which a debtor lost a job at about the time he filed a chapter 13 petition. In such a case, the debtor's current monthly income, an average of the past six months' income, would reflect the income from that job, and the debtor's disposable income (the current monthly income less expenses) would not reflect the loss of that job. Projecting that figure forward would require the debtor to apply deemed or hypothetical income that was not actually "received" in the future "to make payments" under the plan.

These are more than mere policy objections to the bankruptcy court's interpretation; they are critical textual flaws. It is well established that courts "must, if possible, construe a statute to give every word some operative effect." Cooper Indus., Inc. v. Aviall Servs., Inc., 543 U.S. 157, 167 (2004) (citing United States v. Nordic

Village, Inc., 503 U.S. 30, 35-36 (1992)). The bankruptcy court's interpretation fails to heed this statutory maxim.

B. The Chapter 13 Trustee's Interpretation Is Problematic, Because It Requires The Court In Every Case To Consider Income On Schedules I And J.

While the chapter 13 trustee correctly points out some of the flaws in the bankruptcy court's reading of the statute, his own interpretation fails to give sufficient meaning to the statute's new definition of "disposable income."

The chapter 13 trustee correctly argues that the word "projected" in "projected disposable income" confers a future orientation to the analysis. Trustee Br. 31 ("The plain meaning of 'projected' is 'to calculate, estimate, or predict (something in the future), based on present data or trends.'); see id. at 39-42. The fact that Congress used the phrase "projected disposable income" suggests that the meaning is different in some way from the defined phrase "disposable income." Trustee Br. 32. In addition, the chapter 13 trustee accurately points out that the bankruptcy court's interpretation fails to give meaning to "to be received," a phrase that indicates future receipt of actual income. Trustee Br. 33-34. Finally, the chapter 13 trustee offers that the phrase "as of the effective date of the plan" in section 1325(b)(1) speaks of the forthcoming plan confirmation date, another future event. Trustee Br. 34-35.

We are in general agreement with the chapter 13 trustee that the words he cites are indicia of future orientation. But the chapter 13 trustee goes on to make a broader interpretive point that is in some tension with the statutory language.

Summarizing his interpretation, the chapter 13 trustee argues that, in ruling on whether to confirm a plan to which a chapter 13 trustee has objected, the court "may look not only to the static number calculated using Form B22C, but <u>must</u> also 'take into account the debtor's actual current income as reported on Schedule I, projected to include the actual income the debtor expects to receive over the life of the plan.'" Trustee Br. 35-36 (emphasis added) (quoting <u>In re Edmondson</u>, ___ B.R. ___, 2007 WL 656457 at *5 (Bankr. D.N.M. Mar. 5, 2007)). Schedule I (income) and Schedule J (expenses) are the forms that were used in determining projected disposable income under section 1325 before the BAPCPA amendments. (They are still required of chapter 13 debtors and are used in formulating plans for debtors who are not above-median.)

In our view, there is no statutory basis for <u>requiring</u> the court to take into account the debtor's Schedules I and J in every case. That was the practice before Congress passed the BAPCPA amendments, but the chapter 13 trustee overstates matters in claiming that "[t]he BAPCPA amendments have not changed this practice." Trustee Br. 44. In fact, those amendments appear to have significantly modified the relevant statutory approach.

In particular, section 1325(b)(2) now defines "disposable income" as an historical figure based on an average of income over the six months preceding the filing of the petition. The financial data necessary to determine "disposable income" for above-median debtors are disclosed on Form 22C, not on Schedules I and J, as under pre-BAPCPA practice. Under the statutory definition, then, one cannot compute "projected disposable income" by ignoring Form 22C altogether and relying solely on Schedules I and J, as if Congress's rewriting of section 1325 were meant to accomplish nothing.

We explained in Part A. why the bankruptcy court erred in relying exclusively upon the historical income provided in Form 22C. But the chapter 13 trustee arguably errs in the other direction by giving too little effect to Congress's definition of "disposable income." As we will now explain, the new statutory language is best read as adopting a different approach, which starts but does not finish with Form 22C and the statutory definition of "disposable income."

C. Section 1325 Should Be Interpreted To Require That The Historical Disposable Income Figure Be Presumptively Applied Over The Plan Period, But Adjusted For Significant Changes In Income.

This Court should adopt an interpretation of section 1325(b) that not only gives meaning to the new definition of "disposable income" in section 1325(b)(2) as an historical number but also treats "projected" disposable income as a future-oriented concept, as required by the language of section 1325(b)(1). More specifically, the Court should interpret section 1325(b) to require the use of the historical income figure called for in the definition of "disposable income" as a starting point, and a presumption that the historical figure should be carried forward throughout the term of the plan, absent evidence to the contrary. But in order to take into account the future-orientation of the remaining language of the statute, and ensure that projected disposable income is, in fact, a projection, the Court should allow that presumption to be rebutted whenever the debtor is likely to experience (or actually has experienced) either a significant increase or a significant decrease in income after the filing of the chapter 13 plan.

1. A starting presumption that the historical figure should be used is appropriate in light of the BAPCPA amendments. While we agree that "projected disposable income" is not the same as "disposable income," Trustee Br. 16, 29, 30, it is appropriate in construing the former phrase to give some effect to the definition of the latter. Section 1325(b)(2) provides a definition "[f]or purposes of this subsection." 11 U.S.C. 1325(b)(2). The only time that "disposable income" is used in "this subsection," section 1325(b), other than in the definition itself, is in the term "projected disposable income." As the bankruptcy court observed, "Unless the definition applies to 'projected disposal [sic] income,' it has no meaning." ER 23. To give it meaning, a court should begin by applying the historical "disposable income" figure as a starting point. Moreover, the court can likewise presumptively carry that figure forward over the plan period.

It may seem odd to apply an historical "current monthly income" figure over a future plan period, but Congress may well have expected that the historical figure, computed generally with standard rather than actual expenses, would result in a higher disposable-income total for "above-median" debtors and a greater amount designated for repayment to creditors under the debtor's chapter 13 plan. The fact that this is often not the case does not authorize a court to ignore the statutory definition altogether.

2. This initial presumption that the historical current monthly income will be used is necessarily rebuttable. Thus, contrary to the bankruptcy court's conclusion here, application of the historical income figure to the plan period is not the end of the matter in all cases. There are situations in which a debtor has or is likely to have significant changes in income after the period in which the historical "current monthly income" is computed, and in order to give full effect to the statutory text those changes must be taken into account in "project[ing]" the debtor's future disposable income.

A good illustration of this point is the debtor who suffers a significant loss of income at about the time he files his chapter 13 petition. Such a debtor may have a relatively high "current monthly income," based on an average of the six months preceding the month in which he filed his petition. Yet if that historical income were simply extended forward for purposes of the chapter 13 plan, it would not reflect the actual income available to the debtor during that future period. To put this in statutory terms, the future disposable income thus computed would not be the debtor's "projected" disposable income (because it would demonstrably not be based on a reliable estimate of future income) nor would it be the disposable income "received" by the debtor during the applicable commitment period. 11 U.S.C. 1325(b)(1)(B). Moreover, because the income amount determined by the bankruptcy court's approach is merely deemed or hypothetical and not actually received, the income could not be "applied to make payments to unsecured creditors." Id. In such a case, therefore, the court would have to take into account this significant loss of income in order to apply section 1325(b) faithfully.[7]

3. Although our interpretation may not fit the statutory language perfectly in every respect, it gives effect to the statutory language more fully and faithfully than does the bankruptcy court's interpretation. Almost as important, it best furthers the overall goal of chapter 13.

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[7] We recognize that some of these concerns with the statutory text do not arise in the same manner when the debtor finds himself with a significant increase in income at about the time he files his petition. See, e.g., In re Pak, 357 B.R. 549 (Bankr. N.D. Cal. 2006) (debtor was unemployed during most of six-month period before month in which he filed petition, but at time he filed he was earning over $100,000). With an increase in income, the lower historical figure would actually be received by the debtor and could be applied to pay unsecured creditors. But it would still not be an accurate "project[ion]" of the debtor's disposable income to be "received" during the plan period, and thus the bankruptcy court's interpretation is irreconcilable with the statutory text in these circumstances also. And in any event, section 1325(b) should be interpreted in one uniform way for all above-median debtors, so the rebuttable presumption approach should be applied across the board.

Unlike chapter 7, which allows a debtor to discharge his obligations, chapter 13 focuses on having debtors devote future income to paying their creditors. Indeed, BAPCPA placed additional emphasis on this goal when it added language to section 707(b) permitting a court, with the debtor's consent, to convert an abusive chapter 7 case to chapter 13, as an alternative to dismissal. 11 U.S.C. 707(b)(1). While the bankruptcy court's interpretation does require a deemed amount of purported future income to be used to pay creditors, that deemed amount is measured exclusively by reference to historical income, which in some cases bears no relation to actual income available to the debtor. In contrast, our interpretation permits a court to consider the actual income that can "be applied to make payments" under the plan in cases in which a different amount of actual income is available to a debtor because of changed circumstances. This is an important measure of fairness, both to the debtor in cases in which the debtor's prospective income is below his historical income, and to creditors in cases in which the debtor will earn significant additional income that is not reflected in the historical calculation. Moreover, it avoids the absurd results entailed in requiring debtors to make payments to creditors on the basis of deemed "future" income assumptions that are known to be grossly inaccurate. See Rowland v. California Men's Colony, 506 U.S. 194, 200 (1993) (referring to "the common mandate of statutory construction to avoid absurd results").

4. For the reasons outlined above, this Court should reverse the bankruptcy

court's order and remand the case for further proceedings. It would be inadvisable for this Court itself to attempt to apply the rule we propose to the facts of this case. Even if applying the rule we articulate here might not bring about a different result, the bankruptcy court has the greatest familiarity with the facts, and there may well be a need for the parties to develop the facts further in light of this Court's decision.

CONCLUSION

For the foregoing reasons, the order of the bankruptcy court should be reversed and the case remanded for further proceedings.

Respectfully submitted,

PETER D. KEISLER
Assistant Attorney General

WILLIAM KANTER
(202) 514-4575
EDWARD HIMMELFARB
(202) 514-3547
Attorneys, Appellate Staff
Civil Division, Room 7646
Department of Justice
950 Pennsylvania Avenue, N.W.
Washington, D.C. 20530

OF COUNSEL:

ROBERTA A. DEANGELIS
Acting General Counsel

P. MATTHEW SUTKO
Associate General Counsel
Executive Office for United States Trustees
Department of Justice
20 Massachusetts Avenue, N.W.
Washington, D.C. 20530

MAY 2007

CERTIFICATE OF COMPLIANCE

I certify that this brief is proportionately spaced, using Times Roman font, 14 point type. Based on a word count under Corel Word Perfect 12, this brief contains 5,606 words, excluding the table of contents, table of authorities, addenda, and certificates of counsel.

Edward Himmelfarb
Attorney for the United States
as Amicus Curiae

CERTIFICATE OF SERVICE

I hereby certify that on May 16, 2007, I served the foregoing Brief for the United States as Amicus Curiae in Support of Reversal on the following by causing two copies of the brief to be sent by Express Mail, for overnight delivery, to:

Ronald L. Hoffbauer, Esq.
P.O. Box 10434
Phoenix, AZ 85064-0434

Andrew Nemeth, Esq.
3030 N. 3rd Street
1100
Phoenix, AZ 85012

I also certify that I filed the brief by causing an original and fifteen copies to be sent to the Clerk, United States Court of Appeals for the Ninth Circuit, by Federal Express, for overnight delivery.

Edward Himmelfarb
Attorney for the United States
as Amicus Curiae

ADDENDUM – STATUTES

BRIEF BANK — "SUMMARY SHEET" *Printed Thu-10/1/09 14:14*

WESTLAW CODES

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In re Kentucky Processing Company (United States v. Kentucky Processing Company)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*
E.D. Ky.

3. ("CCN") ***CURRENT*** CASE NO.
No.: 5:09-cv-277-JMH

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Paul Bridenhagen, John Daughty, P. Matthew Sutko, Richard F. Clippard
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***
• Whether the bankruptcy court erred by holding debtor did not owe quarterly fees assessed under 28 U.S.C. § 1930(a)(6) for quarters in which there were no disbursements, notwithstanding that the applicable language of the statute states that a fee shall be paid for each quarter "in which disbursements total less than $15,000".

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IN THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF KENTUCKY

In re

KENTUCKY PROCESSING COMPANY, **Bankr. No. 98-52437**

Debtor.

UNITED STATES TRUSTEE,

Appellant,

v. **Case No. 5:09-CV-227-JMH**

KENTUCKY PROCESSING COMPANY,

Appellee.

BRIEF OF APPELLANT, THE UNITED STATES TRUSTEE

ON APPEAL FROM THE UNITED STATES BANKRUPTCY COURT FOR THE EASTERN DISTRICT OF KENTUCKY

RAMONA D. ELLIOTT
GENERAL COUNSEL
P. Matthew Sutko
Paul Wm. Bridenhagen
United States Department of Justice
Executive Office for United States Trustees
20 Massachusetts Ave., N.W., Ste 8100
Washington, D.C. 20530
(202) 307-1399

RICHARD F. CLIPPARD
UNITED STATES TRUSTEE
John L. Daugherty
Assistant United States Trustee
United States Department of Justice
Office of the U.S. Trustee
100 E. Vine St., Suite 500
Lexington, KY 40513
(859) 233-2822

September 29, 2009

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STATEMENT OF APPELLATE JURISDICTION

The bankruptcy court had jurisdiction over this proceeding under 28 U.S.C. §§ 1334(a) and 157(b). The order below concerning quarterly fees was entered on the docket on June 30, 2009, and the United States Trustee timely filed his appeal pursuant to 28 U.S.C. § 158(c)(2) and Fed. R. Bankr. P. 8002(a) on July 9, 2009. The bankruptcy court's order is final and appealable. See In re Dannys' Markets, Inc., 266 F.3d 523 (6th Cir. 1998) (treating quarterly fee order as a final order); Vergos v. Greggs' Enters., Inc., 159 F.3d 989 (6th Cir. 1998) (same). This Court has jurisdiction over this appeal of a final order of the bankruptcy court under 28 U.S.C. §§ 1334(a) and 158(a).

STATEMENT OF THE ISSUE

Whether the bankruptcy court erred in holding that Kentucky Processing Company did not owe quarterly fees assessed under 28 U.S.C. § 1930(a)(6) for quarters in which there were no disbursements, notwithstanding that the applicable language of the statute states that a fee shall be paid for each quarter "in which disbursements total less than $15,000"?

STANDARD OF REVIEW

The issue in this appeal is one of statutory interpretation, which this Court reviews de novo as a question of law. Vergos v. Greggs' Enters., Inc., 159 F.3d at 990.

STATEMENT OF THE CASE

Statutory Background

This appeal concerns statutory fees that are paid to the Department of Justice in chapter 11 cases on a quarterly basis ("quarterly fees"). Under federal law, the Department of Justice, acting through its United States Trustees, supervises cases filed under chapter 11 of the

Bankruptcy Code. See generally 28 U.S.C. § 586(a) (describing the various duties of the United States Trustee). The United States Code includes a quarterly fee statute, 28 U.S.C. § 1930(a)(6), that raises revenue to support the United States Trustees' chapter 11 supervisory activities. The quarterly fee statute was first enacted in 1986 as part of the Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1986, Pub. L. No. 99-554, 100 Stat. 3088 (1986) (the "1986 Act").[1]

Quarterly fee payments to the United States Trustees are deposited in the United States Trustee System Fund, an account managed by the United States Department of the Treasury. The Fund is the source of monies then appropriated by Congress to fund the United States Trustee's operations. See 28 U.S.C. § 589a (establishing the United States Trustee System Fund). Quarterly fees are thus part of the United States Trustees' self-funding mechanism and constitute a significant portion of the monies deposited into the Fund. See In re Prines, 867 F.2d 478, 480 (8th Cir. 1989).

Section 1930(a)(6) contains three sentences, the first two of which are relevant to this appeal.[2] The first sentence requires the payment of a quarterly fee in each case for each quarter or fraction thereof until it is converted, dismissed or closed. Vergos v. Greggs' Enters., Inc., 159 F.3d at 993. The second sentence sets forth a sliding scale to be used in determining the fee to

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[1] The United States Trustee Program was created as a pilot program as part of the Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (1978). The 1986 Act made the Program permanent and, with the exceptions of Alabama and North Carolina, extended it nationwide.

[2] The amendments to section 1930(a)(6) made since the filing of the Kentucky Processing Company case on September 25, 1998, increased the quarterly fee amounts, but have not changed the operative statutory terms at issue in this appeal.

be paid each quarter and is comprised of twelve clauses. The first clause sets the lowest level of the fee as follows: "The fee shall be $325 for each quarter in which disbursements total less than $15,000." 28 U.S.C. § 1930(a)(6). The next ten clauses establish progressively higher levels of fees based on increasing amounts of disbursements, with each level bounded by both an upper and lower dollar amount. The twelfth and final clause provides that the quarterly fee shall be "$30,000 for each quarter in which disbursements total more than $30,000,000." Id.[3]

Statement of Facts

On September 25, 1998, Kentucky Processing Company, the debtor and appellee ("Kentucky Processing"), filed a voluntary petition for relief under the provisions of chapter 11 of the United States Bankruptcy Code. Bankruptcy Docket ("Bankr. Dkt.") # 1. On May 31, 2001, the United States Bankruptcy Court for the Eastern District of Kentucky entered an order confirming Kentucky Processing's chapter 11 plan. Bankr. Dkt. # 249. Kentucky Processing made no disbursements after December 31, 2001. Memorandum Opinion at 5 (hereinafter "Memorandum Opinion"). Bankr. Dkt. # 337.

The bankruptcy case remained open pending the resolution of an adversary proceeding concerning whether DLX, Inc. and a Kentucky Processing affiliate, Fox Trot Properties, Inc. ("Fox Trot"), owned a parcel of real estate referred to in the opinion below as the "Refuse Pile Tract." Memorandum Opinion at 3, Bankr. Dkt. # 337. Counsel for the parties to that adversary proceeding, DLX, Inc. and Fox Trot, expressed concern that the bankruptcy court would not have jurisdiction over the adversary proceeding if the bankruptcy case were closed. Id.

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[3] The full text of section 1930(a)(6) is included in the Addendum at Exhibit A.

DLX, Inc. prevailed in the adversary proceeding. Memorandum Opinion at 4, Bankr. Dkt. # 337. After that litigation was over, Kentucky Processing filed a motion to close its bankruptcy case on September 23, 2008. Bankr. Dkt. # 301. In that motion, Kentucky Processing acknowledged that it owed the United States Trustee outstanding quarterly fees in the amount claimed by the United States Trustee, $4,550. Memorandum Opinion at 5, Bankr. Dkt. # 337. Kentucky Processing also requested that the bankruptcy court close the case prior to December 31, 2008, to avoid the further accrual of quarterly fees. Id. at 2-3. Additionally, Kentucky Processing requested that the bankruptcy court enforce a purported oral agreement between it and the parties to the Refuse Pile Tract adversary proceeding, that the unsuccessful party in that litigation would pay all accrued quarterly fees. Id. at 1-2. The United States Trustee did not oppose that motion.

On November 17, 2008, the bankruptcy court, acting sua sponte, entered an order setting a hearing on the motion to close case that directed the parties "to advise the court, within ten (10) days from the date of this order, whether in their view quarterly fees are actually owed for the several quarters this chapter 11 case was kept open to accommodate the litigation in Adv. No. 01-5199 between two non-debtor parties." Bankr. Dkt. # 305. No party disputed the United States' right to collect quarterly fees in the amount acknowledged by Kentucky Processing to be owing, $4,550. Indeed, on November 20, 2008, Kentucky Processing simply filed a Report attaching the last bill received for $4,500 in quarterly fees. Bankr. Dkt. # 306.

When no party objected to the fees that Kentucky Processing acknowledged as owed, the bankruptcy court on November 21, 2008, took the unusual step of filing a pleading it entitled "Comment." In its Comment, the bankruptcy court posited that there had been no disbursements made since October 2001 and that "[t]he real issue in this case is whether U.S. Trustee fees are owed for quarters in which no distributions are made." Id. The bankruptcy court concluded its Comment by stating that "[a] **holistic** reading of the provisions of 1930(a) appears to require that disbursements be made in a quarter before quarterly fees are due." Id. (emphasis added). The United States Trustee, with the leave of the bankruptcy court, filed a memorandum on December 11, 2008, sharing the United States' position that the text of section 1930(a)(6) requires that the minimum $325 quarterly fee is due when quarterly disbursements equal zero, until a chapter 11 case is converted, dismissed, or closed by order of the bankruptcy court.[4] Bankr. Dkt. # 313.

On June 30, 2009, the court below rejected Kentucky Processing's acknowledgment that it owed $4,500 in fees in a memorandum opinion and an order. The bankruptcy court ruled Kentucky Processing did not owe quarterly fees to the United States Trustee because there were no disbursements made by Kentucky Processing in the months for which it sought either to pay the quarterly fees or to have them paid by its affiliate Fox Trot.[5] Bankr. Dkt. ## 337, 338. The United States Trustee timely filed this appeal to the United States District Court for the Eastern District of Kentucky. Bankr. Dkt. ## 340, 341.

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[4] Although $325 is a modest number, the aggregate amount is significant because it applies in a large number of chapter 11 cases.

[5] Although not mentioned by name in its motion to close the case, under the alleged agreement it would appear that Kentucky Processing's affiliate Fox Trot would be responsible, as the non-prevailing party, for payment of the fees.

SUMMARY OF ARGUMENT

The issue in this appeal is whether quarterly fees accrue for those quarters in which a chapter 11 debtor does not make disbursements. Section 1930(a)(6) provides: "The fee shall be $325 for each quarter in which disbursements total less than $15,000." 28 U.S.C. § 1930(a)(6). The bankruptcy court erred in failing to properly construe this statutory language, concluding that a disbursement of zero cannot be totaled and therefore is not less than $15,000. Memorandum Opinion at 7, Bankr. Dkt. # 337. The bankruptcy court failed to enforce the plain language of section 1930(a)(6), which requires a minimum fee for all quarters in which disbursements are less than $15,000, including those in which there are no disbursements. The bankruptcy court's analysis was predicated on the incorrect belief that zero is not a number. Although any resort to legislative history is precluded by the plain language of the statute, the legislative history concerning the quarterly fee statute does not support the bankruptcy court's ruling

ARGUMENT

The Bankruptcy Court Erred in Refusing to Allow Fees for Those Quarters in Which Disbursements Were Zero

In construing a statute, courts first look to the plain statutory language as the best evidence of congressional intent. CSX Transp. v. Easterwood, 507 U.S. 658, 663 (1993). The language in section 1930(a)(6) establishing the lowest level of the quarterly fee is contained in the first clause of the second sentence and provides as follows: "The fee shall be $325 for each quarter in which disbursements total less than $15,000." 28 U.S.C. § 1930(a)(6). Had Congress wished to limit the payment of the fee to only those quarters in which there were disbursements, it could have included a lower boundary for the minimum fee, as it did for each of the next ten levels of fees. 28 U.S.C. § 1930(a)(6). The absence of a lower boundary for the lowest level of the fee demonstrates Congress imposed the minimum fee for all quarters in which a debtor's disbursements are less than $15,000, including quarters in which total disbursements are zero.

This reading is supported by a ruling of the United States Court of Appeals for the District of Columbia Circuit, which recently construed the phrase "less than" just this way. Gorman v. National Transp. Safety Bd., 558 F.3d 580 (D.C. Cir. 2009). In that case, the court considered an appeal concerning whether a particular federal aviation regulation applied to aircraft with a passenger seating capacity of "less than 20 seats." Id. at 588 (quoting 14 C.F.R. § 119.23(a)). The pilot in that case argued the regulations did not apply, because the plane in question had no passenger seats. In rejecting this argument, the court of appeals held that "'[z]ero is, in fact, a number' and '[i]f you have zero seats, you do have less than 20 seats.'" Id. at 585 (quoting the administrative law judge). The court also held that this reading was reinforced by the caption of the regulation, which made it applicable to cargo airplanes. Id. The regulation was captioned as follows: "Operators engaged in passenger-carrying operations, cargo operations, or both with airplanes when common carriage is not involved." Id. (citing 14 C.F.R. § 119.23).

Similar to the circumstances in Gorman, reading the quarterly fee statute as requiring payment of the minimum fee for quarters in which the debtor makes zero disbursements is supported by additional language in the statute. See FTC v. Mandel Brothers, Inc., 359 U.S. 385, 389 (1959) (holding that statutes should be interpreted so as to "fit, if possible, all parts into an harmonious whole"). The first sentence of section 1930(a)(6) is written in mandatory language that provides, in relevant part: "a quarterly fee **shall be paid** to the United States' trustee . . . **in each case** under chapter 11 of title 11 **for each quarter (including any fraction thereof)** until the case is converted or dismissed [or closed], whichever occurs first." 28 U.S.C. § 1930(a)(6) (emphasis added).

As this case demonstrates, there are cases in which debtors make no quarterly disbursements. Only a construction of section 1930(a)(6) requiring payment of the minimum fee for quarters in which there are no disbursement gives effect to the mandate in this first sentence of section 1930(a)(6) that a fee will be paid in each case and for every quarter, including partial quarters, for as long as the case remains open. See Bowsher v. Merck & Co., Inc., 460 U.S. 824, 833 (1983) (restating and reaffirming "the settled principle of statutory construction that we must give effect, if possible, to every word of the statute").

The bankruptcy court's misreading of section 1930(a)(6) appears to relate to its misunderstanding of the concept of zero. The bankruptcy court asserted that "[o]ne cannot prove zero is less than $15,000" by subtraction, addition or division. Memorandum Opinion at 7, Bankr. Dkt. # 337. The bankruptcy also court stated that zero is a "nothing, nil." Id. The bankruptcy court further observed that Congress could not have intended zero disbursements to be totaled, as such would be an exercise in futility, and concluded that zero disbursements cannot total less than $15,000. Id. Although its analysis is somewhat unclear, it appears that the bankruptcy court did not believe zero to be a number. This conclusion is, however, incorrect. Gorman v. National Transp. Safety Bd., 558 F.3d at 585 (rejecting this conclusion); Memorial Hosp. of Laramie County v. Healthcare Realty Trust Inc., 509 F.3d 1225, 1231 (10th Cir. 2007) (zero is a number) (citing Robert Kaplan, The Nothing That Is: A Natural History of Zero at 90-115 (1999); Morris Kline, Mathematics for the Nonmathematician at 60 (1985) (explaining that zero is a member of our number system and is different from nil).[6] Because zero is a number, it can be used mathematically and one can add daily or monthly disbursements to reach a quarterly total, even if that total is zero. Therefore, the bankruptcy court's analysis was incorrect and the plain meaning of the statute compels the conclusion that Kentucky Processing does owe the minimum fee for those quarters in which no disbursements were made.

Because the quarterly fee statute is so plain in its wording, it is perhaps unsurprising that in the twenty-three years that have elapsed since the statute was first enacted, the issue of whether fees must be paid for quarters in which no disbursements are made has been infrequently litigated. Other than the court below, the United States Trustee is aware of only three bankruptcy courts that have expressly ruled on the issue.

In one case, the bankruptcy court agreed with the United States Trustee's reading that quarterly fees were payable for quarters in which no disbursements were made. In re Boulders on the River, Inc., 205 B.R. 948, 951 (Bankr. D. Or.), rev'd on other grounds, 218 B.R. 528 (D. Or. 1997). This result is supported by a number of other courts that, although not expressly confronted with the issue, have also expressed the view that the statute requires payment of a minimum quarterly fee even when there are no disbursements. See, e.g., In re Aquatic

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[6] Morris Kline was the author or editor of more than a dozen books, including Mathematics in Western Culture (1953), Mathematics: The Loss of Certainty (Oxford University Press, 1980), and Mathematics and the Search for Knowledge (Oxford University Press, 1985). Two analogies used by the late Professor Kline (formerly Professor Emeritus of Mathematics at New York University) help clarify the distinction between the concepts of zero and nil (nothing) as follows: "A student's grade in a course he never took is no grade or nothing. He may, however, have the grade of zero in a course he has taken." A second example used by Professor Kline is closer to the current issue raised by the court below: "If a person has no account in a bank, his balance is nothing. If he has a bank account, he may very well have a balance of zero." Mathematics for the Nonmathematician at 60. Zero is, therefore, a real number that can be used in addition and can describe the quarterly total of disbursements made by a debtor.

Development Group, Inc., 352 F.3d 671, 674 n.2 (2d Cir. 2003) (observing that minimum fee is payable in quarters in which there were no disbursements); In re Celebrity Home Entm't, 210 F.3d 995, 998 (9th Cir. 2000) (observing that a narrow definition of "disbursements" as limited to payments by a bankruptcy estate would mean that "most reorganized debtors would have to pay only the minimum quarterly fee which is due when there are zero disbursements"); In re Adams, 299 B.R. 540, 546 (B.A.P. 8th Cir. 2003) (section 1930(a)(6) "requires a debtor in possession to pay a quarterly fee . . . based on disbursements during the quarter, but with [the statutory minimum payment] per quarter"); In re Maruko Inc., 206 B.R. 225, 230 (Bankr. S.D. Cal. 1997) ("The court finds that there are no disbursements . . . . Accordingly, [the debtor] owes the minimum amount"), rev'd on other grounds, 219 B.R. 567 (S.D. Cal. 1998); In re Sedro-Woolley Lumber Co., 209 B.R. 987, 989 (Bankr. W.D. Wash. 1997) ("In those cases where there have been no disbursements, the fee would be the minimum due under the schedule.").

In the other two decisions directly addressing this issue, the bankruptcy courts' initial conclusion that no fees were payable for quarters in which the debtor made zero disbursements were questioned on appeal, remanded and were effectively reversed. United States Trustee v. Torres-Ruiz, 123 B.R. 696 (D.P.R. 1990), remanded, No. 86-01799 (Bankr. D.P.R., February 3, 1993) (dismissed on order to show cause for failure to pay quarterly fees);[7] In re Smith & Son, 88 B.R. 375 (Bankr. D. Utah 1988), decision on appeal, No. 88C-0651G (D. Utah, March 24,

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[7] Although the bankruptcy court's dismissal order is unavailable, the docket, which is included in the Addendum at Exhibit B, reflects that after remand the bankruptcy court dismissed the case on its order to show cause why the case should not be dismissed for failure to pay quarterly fees.

1989), remanded, 1990 LEXIS 2777, *8, No. 86B-05435 (Bankr. D. Utah, October 5, 1990) (decision on remand holding quarterly fees owed).

To the extent that the bankruptcy court relied on legislative history, the United States Trustee notes that the document cited by the bankruptcy court, a report prepared by an outside contractor for the Department of Justice (Abt Associates), is not legislative history. Moreover, when interpreting a statute, a court may "resort to a review of congressional intent or legislative history only when the language of the statute is not clear." In re Comshare Inc. Sec. Litig., 183 F.3d 542, 549 (6th Cir. 1999) (emphasis added). See also Lockhart v. Napolitano, 573 F.3d 251, 262 (6th Cir. 2009) (court may examine legislative history if statute is not clear). As set forth above, the United States Trustee has demonstrated that the statute is not ambiguous and a resort to its legislative history is not appropriate.

Finally, even if an examination of legislative history were appropriate, it would not support the bankruptcy court's conclusion. The preliminary House Report concerning the House's version of the bill that preceded the 1986 Act, H.R. Rep. No. 99-764 (1986), reprinted in U.S.C.C.A.N. 5227 (1986), contains the isolated statement that only debtors who have made disbursements would pay the quarterly fee. However, after both the House and Senate bills passed their respective chambers, Congress deleted this statement from the final Conference Committee Report, H.R. Rep. No. 99-958 (1986), that reconciled both bills into the 1986 Act. United States Trustee v. Torres-Ruiz, 123 B.R. at 697 (citing Smith & Son, No. 88C-0651G (D. Utah, March 24, 1989)). Consequently, the stronger evidence of Congressional intent does not support the bankruptcy court's decision. Moore v. District of Columbia, 907 F.2d 165, 175 (D.C. Cir. 1990) (the disposition of the respective House and Senate bills in conference furnishes the strongest evidence of what both chambers intended). See also United States Trustee v. Torres-Ruiz, 123 B.R. at 697 (remanding for consideration of Conference Committee Report).

CONCLUSION

For these reasons, the United States Trustee respectfully asks this Court to reverse the order entered below.

Respectfully submitted,

RAMONA D. ELLIOTT
GENERAL COUNSEL
P. Matthew Sutko
Paul Wm. Bridenhagen
United States Department of Justice
Executive Office for United States Trustees
20 Massachusetts Ave., N.W., Ste. 8100
Washington, D.C. 20530
(202) 307-1399

RICHARD F. CLIPPARD
UNITED STATES TRUSTEE
United States Department of Justice
Office of the United States Trustee

By Counsel

/s/ John L. Daugherty
John L. Daugherty
Assistant United States Trustee
100 E. Vine St., Ste. 500
Lexington, KY 40513
(859) 233-2822

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W. Thomas Bunch, Sr.
Bunch & Brock
271 W. Short Street, Suite 805
PO Box 2086
Lexington, KY 40588-2086

/s/ John L. Daugherty
John L. Daugherty

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WESTLAW CODES

1. (“TI”) TITLE OF CASE [E.g., “SMITH v. U.S. TRUSTEE (IN RE SMITH)”]
Neary v. KeraVision, Inc., et al. & KeraVision, Inc.

2. (“CO”) CURRENT COURT [E.g., “CTA9"]
The United States Court of Appeals for the Ninth Circuit

3. (“CCN”) CURRENT CASE NO.
No.: 03-16067

4. (“PCN”) PRIOR CASE NO. & COURT [IF ANY]
No.: C 01-02559 CRB
Court: United States District Court for the Northern District of California
District Judge Breyer

5. (“SO”) SOURCE
U.S. TRUSTEES

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Filed: July 2003
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8. (“TO”) TOPIC
BANKRUPTCY

9. (“SU”) ! SUMMARY OF KEY ISSUE(s) & √ Any Miscellaneous BACKGROUND
! Whether a law firm may be appointed under section 327(a) when one of the firm’s partners is not “disinterested” because he served as the debtor’s corporate secretary prior to the bankruptcy filing.

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No. 03-16067

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

UNITED STATES TRUSTEE, William T. Neary,
Appellant,

v.

KERAVISION, INC., et al.,
Appellees,

and,

KERAVISION, INC.,
Debtor.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF CALIFORNIA

BRIEF FOR APPELLANT

Of Counsel:

JOSEPH A. GUZINSKI
General Counsel

P. MATTHEW SUTKO
Executive Office for
United States Trustees
U.S. Department of Justice
20 Massachusetts Ave., N.W.
Washington, D.C. 20530

MARK L. POPE
Office of the U.S. Trustee
Oakland, CA 94612

PETER D. KEISLER
Assistant Attorney General

KEVIN V. RYAN
United States Attorney

ROBERT M. LOEB
(202) 514-4332
ERIC D. MILLER
(202) 514-2754
Attorneys, Appellate Staff
Civil Division, Room 9131
U.S. Department of Justice
601 “D” Street, N.W.
Washington, D.C. 20530-0001

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UNITED STATES TRUSTEE, William T. Neary,
Appellant,

v.

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and,

KERAVISION, INC.,
Debtor.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF CALIFORNIA

BRIEF FOR APPELLANT

STATEMENT OF JURISDICTION

1. The bankruptcy court had jurisdiction under 28 U.S.C. §§ 157(b) and 1334. After that court entered a final order, appellant filed a timely notice of appeal to the district court. The district court had jurisdiction under 28 U.S.C. § 158(a).

2. The order in this case grants a final application for attorney's fees. See Excerpts of Record ("E.R.") 1-2. Unlike an order authorizing retention of counsel, which a bankruptcy court might later modify or revoke and which therefore is not final, see In re S.S. Retail Stores Corp.,

162 F.3d 1230 (9th Cir. 1998) ("S.S. Retail I"), this order is appealable because it conclusively resolves the issue of counsel's right to payment, and it represents the bankruptcy court's final determination of the propriety of counsel's appointment. This Court therefore has jurisdiction under 28 U.S.C. §§ 158(d) and 1291.

Although this Court held in In re S.S. Retail Stores Corp., 216 F.3d 882, 884 (9th Cir. 2000) ("S.S. Retail II"),[1] that it sometimes has the discretion to dismiss an appeal of a fee award when it would be "inequitable" to require the law firm "to disgorge the fees and expenses it ha[s] been paid," this is not such a case. Here, the contested fee has been placed in an interest-bearing account segregated from the law firm's operating account, and the Court therefore could reverse the bankruptcy court's order without requiring it to impose a remedy of disgorgement.

In any event, S.S. Retail II at most establishes a discretionary doctrine that permits, but does not compel, the dismissal of an appeal in the interests of equity. There is no basis in law or equity for dismissal of this appeal. Under S.S. Retail I, the United States Trustee could not have taken an earlier appeal. Thus, if review were unavailable now, it would mean that a bankruptcy court's appointment of a professional, which the United States Trustee contends was in violation of a federal statute, is entirely immune from appellate review. Such a result is not contemplated by the Bankruptcy Code, nor is it supported by equitable concerns here.

3. The district court's judgment was entered on April 7, 2003, see E.R. 3, and the notice of appeal was filed on June 3, 2003, see E.R. 4, 8. This appeal is therefore timely. See Fed. R.

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[1] But see In re Zenith Elecs. Corp., 329 F.3d 338, 347 (3d Cir. 2003) (declining to apply S.S. Retail, "in light of our 'virtually unflagging obligation' to exercise our jurisdiction") (quoting Colorado River Water Conservation Dist. v. United States, 424 U.S. 800, 817 (1976)).

App. P. 4(a)(1)(B).

STATEMENT OF THE ISSUE PRESENTED FOR REVIEW

Section 327(a) of the Bankruptcy Code permits the bankruptcy court to appoint a "disinterested" attorney to assist a debtor-in-possession. The question presented is whether a law firm may be appointed under section 327(a) when one of the firm's partners is not "disinterested" because he served as the debtor's corporate secretary prior to the bankruptcy filing.

STATEMENT OF THE CASE

Appellee Keravision, Inc., petitioned for relief under Chapter 11 of the Bankruptcy Code. Acting as a debtor-in-possession, Keravision asked the bankruptcy court to appoint Latham & Watkins LLP as counsel for the estate under 11 U.S.C. § 327(a). The United States Trustee objected, noting that section 327(a) requires attorneys to be "disinterested," and arguing that the firm was not disinterested because one of its partners had served as Keravision's corporate secretary until three weeks before the bankruptcy filing. The bankruptcy court nevertheless appointed the firm, and the district court affirmed. Subsequently, the bankruptcy court granted Latham's final application for approximately $178,000 in fees. The district court again affirmed, and the United States Trustee now appeals to this Court.

STATEMENT OF FACTS

A. Statutory and Regulatory Background

1. The Bankruptcy Code permits the debtor in Chapter 11 cases to act as a "debtor-in-possession" -- that is, instead of appointing a trustee, the bankruptcy court may allow the debtor to retain control of its business and property. See 11 U.S.C. § 1107(a) (A debtor-in-possession

"shall have all the rights . . . and powers, and shall perform all the functions and duties . . . of a trustee"). Like a trustee, a debtor-in-possession is a fiduciary "owing a duty of care and loyalty to the estate's creditors." In re McConville, 110 F.3d 47, 49 (9th Cir. 1997).

With the bankruptcy court's approval, a debtor-in-possession may employ the services of "professional persons," provided that those persons are "disinterested":

> Except as otherwise provided in this section, the trustee, with the court's approval, may employ one or more attorneys, accountants, appraisers, auctioneers, or other professional persons, that do not hold or represent an interest adverse to the estate, and that are disinterested persons, to represent or assist the trustee in carrying out the trustee's duties under this title.

Id. § 327(a). The Code defines a "disinterested" person as one who

> (A) is not a creditor, an equity security holder, or an insider;
> . . . .
> (D) is not and was not, within two years before the date of the filing of the petition, a director, officer, or employee of the debtor . . .; and
> (E) does not have an interest materially adverse to the interest of the estate or of any class of creditors or equity security holders, by reason of any direct or indirect relationship to, connection with, or interest in, the debtor.

Id. § 101(14).

2. The United States Trustee is an official of the Executive Branch of the federal government and is responsible for "protecting the public interest and ensuring that bankruptcy cases are conducted according to the law." H.R. Rep. No. 95-595, at 109 (1978), reprinted in 1978 U.S.C.C.A.N. 5963, 6070. United States Trustees "serve as bankruptcy watch-dogs to prevent fraud, dishonesty, and overreaching in the bankruptcy arena." Id. at 88, 1978 U.S.C.C.A.N. at 6049. Congress therefore provided that "[t]he United States trustee may raise and may appear and be heard on nay issue in any case or proceeding" under the Bankruptcy Code. 11 U.S.C. § 307. Congress also directed United States Trustees to "revie[w] . . .

applications filed for compensation under section 330 of title 11," and to file with the court any "objections to such application." 28 U.S.C. § 586(a)(3)(A)(i)-(ii); see also In re Donovan Corp., 215 F.3d 929, 930 (9th Cir. 2000).

B. Facts and Prior Proceedings

In March 2001, Keravision, Inc., petitioned for relief under Chapter 11 of the Bankruptcy Code. See In re Keravision, Inc., 273 B.R. 614, 615 (N.D. Cal. 2002) (reprinted in addendum). The bankruptcy court permitted Keravision to act as a debtor-in-possession, and soon thereafter, the company applied to the bankruptcy court for an order appointing Latham & Watkins LLP to act as counsel for the estate under section 327(a). See ibid. In connection with the application, Latham disclosed (1) that two of its partners owned stock in the debtor; (2) that one of those partners, Michael Hall, had served as the debtor's corporate secretary until about three weeks before the bankruptcy filing; and (3) that the firm had served as the debtor's outside counsel for several years. See ibid. Against this backdrop, the United States Trustee objected to Latham's appointment, arguing that the firm was not "disinterested." See ibid.

The bankruptcy court nevertheless approved the application. See ibid. As a condition of its approval, it required the two partners to sell their stock in the debtor, and it directed that Hall not be involved in the representation. See ibid. The court stayed its order to permit the United States Trustee to pursue an interlocutory appeal to the district court. See ibid.

The district court affirmed the order appointing Latham & Watkins. See id. at 619-20. The court agreed that under the statutory definition, Hall was not a "disinterested" person. See id. at 616. But the court rejected the argument that Hall's disqualification could be imputed to Latham. It explained that "[t]he statute provides that a person who is an officer is disqualified;

it does not provide further that the law firm in which the officer is a partner is also not disinterested." Ibid.

The district court then considered "whether Latham is disqualified because of its own involvement with the debtor." Id. at 619. The court stated that it was "inclined to remand this matter to the bankruptcy court for further proceedings" to determine whether Latham was disqualified because it, and not just Hall, had served as Keravision's corporate secretary. Id. at 620. Because the United States Trustee had not pressed that argument, however, the court simply affirmed the order appointing the firm. See ibid.

The case was eventually converted from Chapter 11 to Chapter 7 under 11 U.S.C. § 1112(b), and Latham filed a final fee application, seeking fees and expenses of approximately $178,000. See E.R. 1-2. The United States Trustee again objected. The bankruptcy court overruled the objection and approved Latham's compensation. See ibid. In response to the United States Trustee's motion for a stay, the court allowed Latham to remove its retainer from Keravision's trust account, but it ordered that the funds be kept in a separate, interest-bearing account segregated from Latham's operating account.[2]

The United States Trustee again appealed to the district court. That court affirmed, relying on the reasons stated in its prior opinion. See E.R. 3.

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[2] The bankruptcy court's order was entered on March 6, 2003, after the case was appealed to the district court. Although it is not part of the record as defined by Fed. R. App. P. 6(b)(2)(B)(iii), this Court may take judicial notice of it. See Fed. R. Evid. 201; Papai v. Harbor Tug & Barge Co., 67 F.3d 203, 207 n.5 (9th Cir. 1995) ("Judicial notice is properly taken of orders and decisions made by other courts or administrative agencies"), rev'd on other grounds, 520 U.S. 548 (1997). The order is reprinted in an addendum to this brief.

SUMMARY OF ARGUMENT

The Bankruptcy Code provides that "professional persons" such as attorneys may be retained by a debtor-in-possession only if they are "disinterested." 11 U.S.C. § 327(a). Under the Code, a person is not disinterested if he or she served as "a director, officer, or employee of the debtor" within two years prior to the filing of the petition. Id. § 101(14)(D). A law firm is a "person" under the Code and is subject to the disinterestedness requirement. See id. § 101(41). But a firm, which is simply an association of individuals, cannot be disinterested unless the individuals it comprises are themselves disinterested. The bankruptcy court therefore erred when it appointed Latham & Watkins in this case even though one of its partners was not "disinterested" because he had previously served as the debtor's corporate secretary.

The bankruptcy court's appointment of Latham is fundamentally inconsistent with the purposes underlying the disinterested-person requirement. When attorneys are appointed to assist the debtor-in-possession, their true client is the bankruptcy estate, not the debtor. The requirement of disinterestedness is important because it ensures that if the attorneys discover that the estate has a claim against a former officer of the debtor, they will not hesitate to pursue it. But if the officer in question is one of their law partners, they will face a conflict of interest, and they may be reluctant to act. For this reason, principles of professional responsibility generally provide that when an attorney is disqualified from a representation because of a personal interest, the disqualification is imputed to his or her firm. Section 327(a) should be interpreted consistently with these principles.

The bankruptcy court apparently believed that its appointment of Latham was permissible because the firm did not have an actual conflict of interest in this case. In so holding, it failed to appreciate that sections 327(a) and 101(14)(D) establish a prophylactic rule of disqualification intended to prevent even the potential for conflict. The court erred in substituting its own assessment of conflict for Congress's categorical judgment.

STANDARD OF REVIEW

Because this Court "is in as good a position as the district court to review the findings of the bankruptcy court, [it] independently review[s] the bankruptcy court's decision." In re Emery, 317 F.3d 1064, 1069 (9th Cir. 2003). The only issues in this appeal are questions of law, and the bankruptcy court's legal conclusions are reviewed de novo. See ibid.

ARGUMENT

THE BANKRUPTCY COURT'S APPOINTMENT OF LATHAM & WATKINS AS COUNSEL TO KERAVISION WAS INCONSISTENT WITH THE DISINTERESTEDNESS REQUIREMENT OF 11 U.S.C. § 327(a).

Under the Bankruptcy Code, "professional persons" such as attorneys may be appointed to assist a debtor-in-possession only if they are "disinterested." 11 U.S.C. § 327(a). The Code's definition of "person" extends to law firms, see id. § 101(41), and the Code draws no distinction between the disinterestedness requirement that it imposes on a law-firm "person" and that which it imposes upon natural persons, see id. § 327(a). As a logical matter, an association of individuals, such as a law firm, cannot be disinterested when the individuals it comprises are not themselves "disinterested." Because one of Latham's partners was not "disinterested," the firm should not have been appointed in this case. The bankruptcy court's award of fees was therefore unauthorized by 11 U.S.C. § 330(a).

The bankruptcy court's contrary holding is not only inconsistent with the plain language of the statute, it also undermines the statutory purpose and contravenes established principles of professional responsibility. The court erred because it failed to appreciate that Congress rejected a regime in which courts evaluate interest on a case-by-case basis, instead creating a bright-line prophylactic rule aimed at eliminating even the potential for a conflict of interest.

A. The Purpose of the Disinterestedness Requirement in Section 327(a) is to Avoid Even a Potential Conflict of Interest That Might Prejudice the Bankruptcy Estate.

1. The history of section 327(a) demonstrates that the purpose of the disinterestedness requirement is to ensure that counsel hired by the debtor-in-possession protects the interests of the estate. The requirement of a "disinterested" participant in corporate bankruptcy proceedings has its origins in the Chandler Act of 1938. See Chandler Act, ch. 575, §§ 156-58, 52 Stat. 840, 888 (1938). In enacting that statute, Congress explained that reforms to the bankruptcy law were necessary because the prior rules governing corporate reorganizations had been manipulated by insiders of debtor corporations. A House Report quoted at length from the testimony of William O. Douglas, then Commissioner of the Securities and Exchange Commission, who outlined the abuses that unchecked insider control had permitted under the prior system:

> The record [shows] that plans of reorganization were frequently dictated by a single interest -- by a closely-knit inside group . . . . These conclusions indicate that something must be done to provide impartial, capable control over reorganizations.

H.R. Rep. No. 75-1409, at 37 (1937). Commissioner Douglas explained that insider manipulation had been made possible by the fact that "[a] debtor [corporation] may remain in possession of the property; or one of its officials may be appointed trustee for the debtor," which he thought permitted insiders to evade any meaningful scrutiny from, or responsibility to, interests other than their own. Ibid.

To solve the problem of unchecked insider control over the reorganization process, the

Chandler Act required judges to appoint "one or more trustees" in any reorganization involving a corporate debtor owing $250,000 or more. Chandler Act § 156. These trustees, as well as any attorneys appointed to represent them, were required to be "disinterested." Id. §§ 156, 157. No person could be considered "disinterested" if he had been, within two years prior to the date on which the bankruptcy petition was filed, a "director, officer, or employee of the debtor." Id. § 158. The House Report noted that the importance of these "disinterested" trustees was "difficult to overemphasize," H.R. Rep. No. 75-1409, at 43, observing that "[t]he central problem in reorganization is to see to it that . . . power is not exploited by reorganizers but appropriated for the benefit of investors," and that the "shift in power, inherent in the device of an independent trustee, is basic and fundamental if the reorganization system is to be reconstituted in the interest of investors," id. at 44.

2. The bankruptcy law has been amended several times since the Chandler Act. Under the new system, the appointment of a trustee is not mandatory in corporate reorganizations -- that is, a debtor corporation may be permitted to serve as "debtor-in-possession."

In cases where there is not an independent trustee, it is all the more important that the "professional persons" through whom the debtor participates in the bankruptcy proceeding be "disinterested." That is why section 327(a) requires the debtor-in-possession to obtain the court's approval before retaining any attorney or other "professional perso[n]" to represent or assist it in carrying out its duties, and prohibits the court from approving the employment of any professional person who is not "disinterested." Only with such a safeguard in place can a debtor corporation be trusted to retain possession of its assets during a reorganization -- to be, in effect, both debtor and trustee. See 11 U.S.C. § 1107(a) (with specified exceptions, "a debtor in possession shall have all the rights . . . and powers, and shall perform all the functions and duties . . . of a trustee").

The debtor-in-possession bears a fiduciary duty to the debtor's creditors. See Wolf v. Weinstein, 372 U.S. 633, 649 (1963) ("[S]o long as the Debtor remains in possession, it is clear that the corporation bears essentially the same fiduciary obligation to the creditors as does the trustee for the Debtor out of possession"); In re McConville, 110 F.3d 47, 49 (9th Cir. 1997). The appointed attorney has a similar duty. See In re Park-Helena Corp., 63 F.3d 877, 880 (9th Cir. 1995) ("[A]ttorneys who represent the debtor [must] do so in the best interests of the bankruptcy estate"); In re Interwest Bus. Equip., Inc., 23 F.3d 311, 317 (10th Cir. 1994) (describing the professional's duty "to independently serve the trustee"). After all, the true client of counsel to the debtor-in-possession is not the debtor itself, but the bankruptcy estate. See In re Perez, 30 F.3d 1209, 1219 (9th Cir. 1994). Congress has determined that only counsel completely free of "interest" can be relied upon to fulfill these fiduciary obligations. See Rome v. Braunstein, 19 F.3d 54, 58 (1st Cir. 1994) (explaining that the disinterestedness requirements "serve the important policy of ensuring that all professionals . . . tender undivided loyalty and provide untainted advice and assistance in furtherance of their fiduciary responsibilities").

Experience has borne out Congress' concern that if attorneys for a debtor-in-possession are insufficiently detached from the corporation's insiders, insiders will often seize the opportunity to abuse the bankruptcy process for their own ends. Attorneys for debtors-in-possession fail to satisfy their obligation to check the self-serving actions of insiders when, for example, they acquiesce in reorganization plans that improperly benefit the corporation's insiders to the detriment of the corporation's creditors, see, e.g., In re Kendavis

Indus. Int'l, Inc., 91 B.R. 742 (Bankr. N.D. Tex. 1988); or assist insiders in sabotaging the creditors' efforts to get a true picture of the corporation's financial condition, see, e.g., In re Bonneville Pac. Corp., 147 B.R. 803 (Bankr. D. Utah 1992), aff'd in part and rev'd in part, Hansen, Jones & Leta, P.C. v. Segal, 220 B.R. 434 (D. Utah 1998); or decline to investigate the insiders' decision to sell off the corporation's assets, see, e.g., In re Wilde Horse Enterps., 136 B.R. 830 (Bankr. C.D. Cal. 1991).

3. In section 327(a), Congress sought to prevent not just actual conflicts of interest but also situations that posed potential conflicts. The statute separately provides that appointed professionals may not "represent an interest adverse to the estate." 11 U.S.C. § 327(a). The "disinterestedness" requirement is a distinct and independent statutory criterion that must be satisfied whether or not the professional actually has an adverse interest. It sets up a bright-line prophylactic rule to eliminate the need for case-by-case inquiry into the existence of a conflict. See Interwest Bus. Equip., 23 F.3d at 316 n.9 ("§ 327(a) is prophylactic 'to insure that the undivided loyalty and exclusive allegiance required of a fiduciary to an estate in bankruptcy is not compromised'") (quoting In re Prudent Holding Corp., 153 B.R. 629, 631 (Bankr. E.D.N.Y. 1993)); In re Federated Dep't Stores, Inc., 44 F.3d 1310, 1319 (6th Cir. 1995) ("Congress sought to disqualify professionals with the appearance of a conflict of interest as well as those who have an actual conflict of interest"). Under section 327(a), even if the professional would not have an actual conflict of interest -- indeed, even if the appointment might provide "practical benefits" -- a bankruptcy court is barred from appointing a professional who is not "disinterested." United States Trustee v. Price Waterhouse, 19 F.3d 138, 142 (3d Cir. 1994).

B. Permitting A Law Firm That Is Not Composed Of "Disinterested Persons" To Qualify As A "Disinterested Person" Would Undermine The Purpose Of The

"Disinterested Person" Requirement.

1. The bankruptcy court's holding -- that a firm may be appointed to represent the estate even when one of its partners is not "disinterested" -- is contrary to the purposes for which the "disinterested person" requirement was created. The Supreme Court has stressed "[o]ver and over" that "[i]n expounding a statute, [courts] must not be guided by a single sentence or member of a sentence, but look to the provisions of the whole law, and to its object and policy." Regions Hosp. v. Shalala, 522 U.S. 448, 460 n.5 (1998); see also Davis v. Michigan Dep't of Treasury, 489 U.S. 803, 809 (1989) ("It is a fundamental canon of statutory construction that the words of a statute must be read in their context and with a view to their place in the overall statutory scheme"). The bankruptcy court's conclusion that a law firm may be considered disinterested despite the interest of its former-officer partner seriously undermines the "object and policy" underlying the disinterested-person requirement.

As a practical matter, a firm that is partly composed of "interested persons" cannot be relied upon to act in the thoroughly detached fashion in which a truly "disinterested" person would act. For example, if a disinterested individual serving as counsel to the debtor-in-possession were to uncover evidence indicating that the officers of the debtor corporation were liable for wrongdoing committed before the bankruptcy filing, he or she would not hesitate to initiate a lawsuit against the officers to recover money and property which rightfully belongs to the bankruptcy estate. See, e.g., Trone v. Smith, 621 F.2d 994, 996 (9th Cir. 1980) (trustee initiated legal action against officers of the debtor corporation); In re Sally Shops, Inc., 50 B.R. 264, 265 (Bankr. E.D. Pa. 1985) (same). As the Tenth Circuit has put it, "[t]he jaundiced eye and scowling mien of counsel for the debtor should fall upon all who have done business with the debtor recently enough to be potential targets for the recovery of assets of the estate." Interwest Bus. Equip., 23 F.3d at 316, quoting In re McKinney Ranch Assoc., 62 B.R. 249, 255 (Bankr. C.D. Cal. 1986).

But if counsel for the debtor-in-possession is a law firm with a partner or partners who are, or recently were, officers of the debtor, the firm's loyalty to the bankruptcy estate could be impaired. The detachment and vigilance of the "interested" attorney's partners would be undermined by a natural reluctance to initiate a legal action that might subject their own former-officer partner to liability. As one court has explained, "[i]t defies reason and belief to suggest that [a] firm can exercise the independence of judgment necessary to the performance of its duties" when those duties "may well include taking a position adverse to the interests" of one of its partners. In re Michigan Interstate Ry. Co., Inc., 32 B.R. 327, 330 (Bankr. E.D. Mich. 1983); see also In re Essential Therapeutics, Inc., ___ B.R. ___, 2003 WL 21398001, *6 (Bankr. D. Del. 2003) ("[I]t is entirely possible that officers of the Debtor may be subject to suit or, at a minimum, to questions regarding their role in the Debtors' demise. It would be impossible for [a firm with a former-officer partner] to adequately represent the Debtors' interests in that event") (footnote omitted).

Specifically, the "interested" attorney's partners would be less motivated to seek out evidence of wrongdoing by the debtor corporation's officers than "disinterested" counsel would be. They also would be inclined to exercise less vigilant scrutiny over the debtor corporation's business plans than would "disinterested" counsel, because they would think it possible that their former-officer partner had a hand in creating the plans, or could in any case be held legally responsible for them by virtue of his former position. And this sort of lax oversight might be exactly what the debtor's insiders intended -- a financially ailing debtor might appoint as one of its officers a partner of a large law firm for the express purpose of having a friendly firm representing the estate in a Chapter 11 proceeding.

2. We do not suggest that Latham & Watkins or its attorneys have been involved in such manipulation, or that they have in any way behaved unethically in this case. But as we have explained, Congress expressly declined to leave determinations as to whether recent service as an officer of the debtor corporation gives rise to disqualifying "interest" to case-by-case inquiry. Instead, it created a per se rule of disqualification. See 11 U.S.C. §§ 101(14)(D), 327(a). Because Congress has clearly expressed its preference for a categorical rule, courts are bound to respect its judgment.

In departing from the bright-line rule of section 327(a), the bankruptcy court produced an internally inconsistent holding. The court believed that a firm may be disinterested even when some of its partners are not disinterested. But at the same time, it ordered two Latham partners, including Michael Hall, to sell stock that they held in the debtor. See 273 B.R. at 615. The Code provides that a person is not disinterested if he owns stock in the debtor. See 11 U.S.C. § 101(14)(A). But under the bankruptcy court's approach, it should have been permissible for some of Latham's partners to own stock, because their lack of disinterestedness would not be imputed to the firm as long as they did not participate in the representation.

Perhaps the bankruptcy court could conclude that stock ownership created an actual conflict, giving the firm an "interest adverse to the estate." 11 U.S.C. § 327(a). The district court made this idea explicit, suggesting that "depending on the circumstances," a court might decline to appoint a firm if it concluded that the firm was an insider, or that it had an interest adverse to the estate. 273 B.R. at 618. But this approach even more obviously eliminates the per se rule of the statute and replaces it with case-specific investigation of actual conflicts. But cf. In re Essential Therapeutics, 2003 WL 21398001, *6 (observing that a case-by-case inquiry would entail the "herculean task" of "interrogat[ing] all the members (and even associates) of the firm . . . to ascertain whether the actions of the attorney who served as an officer of the debtor would impair their ability to act on behalf of the debtor and the estate in an impartial manner"). As we have shown, that interpretation improperly undermines Congress's decision to adopt a prophylactic rule.

C. The Bankruptcy Court's Interpretation of Section 327(a) Is Contrary to Basic Principles of Professional Responsibility.

1. General principles of professional responsibility also show that the disqualifying interest of an attorney should be imputed to his or her firm. The bankruptcy court therefore erred when it appointed Latham & Watkins, because it failed to construe section 327(a) so as to make it consistent, rather than inconsistent, with well-settled background legal principles. See Astoria Fed. Sav. & Loan Ass'n v. Solimino, 501 U.S. 104, 108 (1991) ("[W]here a common-law principle is well established . . . the courts may take it as given that Congress has legislated with an expectation that the principle will apply except 'when a statutory purpose to the contrary is evident'") (quoting Isbrandtsen Co. v. Johnson, 343 U.S. 779, 783 (1952)).

Under the ABA Model Rules of Professional Conduct, a lawyer may not represent a client when "there is a significant risk that the representation . . . will be materially limited by . . . a personal interest of the lawyer." Model Rule 1.7(a)(2). The California rule is similar.

California Rule of Professional Conduct 3-310(B)(2) restricts the representation of a client when the attorney "previously had a legal, business, financial, professional, or personal relationship with a party or witness in the same matter [and] the previous relationship would substantially affect" the representation. See also Rule 3-310(B)(4) (restricting representation when the attorney "has or had a legal, business, financial, or professional interest in the subject matter of the representation").

Congress's judgment, expressed in 11 U.S.C. § 327(a), is that prior service as an officer of the debtor automatically disqualifies an attorney from appointment as counsel to the estate. In other words, Congress has made a categorical determination that such service creates a "significant risk" that the representation "will be materially limited," and that the service may "substantially affect" the representation.

To be sure, the rules of professional responsibility sometimes permit conflicts to be waived by the client. See Model Rule 1.7(b)(4) (permitting representation if "each affected client gives informed consent, confirmed in writing"); Cal. Rule Prof. Conduct 3-310(B) (permitting representation if the attorney "provid[es] written disclosure to the client"). But in the bankruptcy context, the client is the entire estate, rather than an individual or identified group of individuals, so it is not possible to provide disclosure or to obtain the client's consent.

And crucially, when an attorney is disqualified by reason of a conflict of interest, the disqualification is imputed to all of the attorneys at the same firm. See Model Rule 1.10(a) ("While lawyers are associated in a firm, none of them shall knowingly represent a client when any one of them practicing alone would be prohibited from doing so by Rules 1.7 or 1.9"); Henriksen v. Great American Sav. & Loan, 14 Cal. Rptr. 2d 184, 187 (Cal. Ct. App. 1992) ("As a general rule in California, where an attorney is disqualified from representation, the entire law firm is vicariously disqualified as well"). This rule is based on "the premise that a firm of lawyers is essentially one lawyer for purposes of the rules governing loyalty to the client." Model Rule 1.10, cmt. 2. Section 327(a) should be interpreted consistently with this background principle of professional ethics.

2. The bankruptcy court held that Latham & Watkins did not need to be disqualified as long as Michael Hall, the interested partner, did not participate in the representation. See 273 B.R. at 615. The court apparently believed that screening Hall from the representation would eliminate any conflict of interest. But as we have explained, section 327(a) is concerned with more than simply actual conflicts of interest. The bankruptcy court does not have discretion to disregard the statute's per se rule of disqualification, even if it believes that no actual conflict is present. See Price Waterhouse, 19 F.3d at 142.

In any event, under general principles of professional responsibility, "screening" is not an appropriate response to a potential conflict of interest. Screening primarily serves the function of ensuring that confidential information held by the screened-off attorney is not shared with other attorneys in the firm representing clients with adverse interests. In the bankruptcy context, screening may block the flow of confidential information and may prevent "interested" attorneys from directly taking part in the representation, but it cannot remove the hesitation that the interested attorney's partners will feel when they discover that cause exists for recommending lawsuits against the debtor's insiders -- including against their own law partner, in his capacity as a former officer of the debtor corporation. Nor can it erase the other partners' natural tendency to take a favorable view of business plans which they know or suspect that their law partner was involved in developing.

For these reasons, screening generally is not considered an adequate solution to conflicts arising from an interested attorney's membership in a law firm, and the ABA Model Rules limit screening to conflicts caused by successive government and private employment, where a more lenient rule is "necessary to prevent the disqualification rule from imposing too severe a deterrent against entering public service." Model Rule 1.11, cmt. 4; accord Henriksen, 14 Cal. Rptr. 2d at 187-88 (applying California Rules of Professional Conduct). In all other situations, an attorney's disqualifying interest disqualifies the entire firm, whether or not the attorney is screened. See Model Rule 1.10. Even if Hall took no part in the representation, Latham still should have been disqualified in this case.

CONCLUSION

The judgment of the district court should be reversed, and the case should be remanded with instructions to reverse the order granting the final application for attorney's fees.

Respectfully submitted,

Of Counsel:

JOSEPH A. GUZINSKI
General Counsel

P. MATTHEW SUTKO
Executive Office for
United States Trustees
U.S. Department of Justice
20 Massachusetts Ave., N.W.
Washington, D.C. 20530

MARK L. POPE

PETER D. KEISLER
Assistant Attorney General

KEVIN V. RYAN
United States Attorney

ROBERT M. LOEB
(202) 514-4332
ERIC D. MILLER
(202) 514-2754
Attorneys, Appellate Staff
Civil Division, Room 9131
U.S. Department of Justice

Office of the U.S. Trustee________ 601 “D” Street, N.W.
Oakland, CA 94612___________________ Washington, D.C. 20530-0001

JULY 2003

CERTIFICATE OF SERVICE

I certify that on July 30, 2003, I filed and served the foregoing brief by causing sixteen copies to be sent by Federal Express to the Clerk of the Court, and by causing two copies to be sent by Federal Express to the following counsel:

Mr. Peter M. Gilhuly
Latham & Watkins LLP
633 W. Fifth Street, Ste. 4000
Los Angeles, CA 90071
(213) 485-1234

____
Eric D. Miller

CERTIFICATE OF RELATED CASES

Counsel is aware of no pending related cases.

____
Eric D. Miller

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3. ("CCN") CURRENT CASE NO.

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√ Any Miscellaneous BACKGROUND

- Whether a law firm may be appointed under section 327(a) when one of the firm's partners is not "disinterested" because he served as the debtor's corporate secretary prior to the bankruptcy filing.

√ **Background:**

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No. 03-16067

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

UNITED STATES TRUSTEE, William T. Neary,
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v.

KERAVISION, INC., et al.,
Appellees,

and,

KERAVISION, INC.,
Debtor.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF CALIFORNIA

REPLY BRIEF FOR APPELLANT

Of Counsel:

JOSEPH A. GUZINSKI
General Counsel

P. MATTHEW SUTKO
Executive Office for
United States Trustees
U.S. Department of Justice
20 Massachusetts Ave., N.W.
Washington, D.C. 20530

MARK L. POPE
Office of the U.S. Trustee
Oakland, CA 94612

PETER D. KEISLER
Assistant Attorney General

KEVIN V. RYAN
United States Attorney

ROBERT M. LOEB
(202) 514-4332
ERIC D. MILLER
(202) 514-2754
Attorneys, Appellate Staff
Civil Division, Room 9131
U.S. Department of Justice
601 "D" Street, N.W.
Washington, D.C. 20530-0001

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ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF CALIFORNIA

REPLY BRIEF FOR APPELLANT

INTRODUCTION

The Bankruptcy Code provides that a debtor-in-possession may retain "professional persons" such as attorneys only if the professionals are "disinterested." 11 U.S.C. § 327(a). Under the Code, a person is not disinterested if he or she served as "a director, officer, or employee of the debtor" within two years prior to the filing of the petition. Id. § 101(14)(D). In our opening brief, we showed that the bankruptcy court erred in appointing Latham & Watkins as counsel to the estate because one of the firm's partners had previously served as the debtor's corporate secretary.

Keravision does not dispute that one of the Latham & Watkins partners was an "officer" of the debtor and hence was not "disinterested." But it argues that his disqualification should not disqualify the firm. Under Keravision's theory, the disinterestedness of a law firm with "interested" partners should be evaluated by an ad hoc, standardless inquiry into whether the firm has an interest that would prejudice the representation. This theory is at odds with the statutory text, which sets out a specific definition of "disinterested." It also undermines the statutory purpose, which is to protect the integrity of the bankruptcy system by establishing a broad prophylactic rule that eliminates even the possibility of a conflict of interest. And it makes the statute inconsistent with background principles of professional responsibility, under which the disqualification of an attorney normally is imputed to his or her firm. It therefore should be rejected.

Keravision urges that Latham & Watkins be paid a fee even if its representation in this case was unlawful. This argument overlooks that a firm that is not "disinterested" has no statutory entitlement to payment. Permitting firms to be paid for work performed in violation of the statute would encourage firms to evade the safeguards established by Congress.

ARGUMENT

I. THE BANKRUPTCY COURT'S APPOINTMENT OF LATHAM & WATKINS AS COUNSEL TO KERAVISION WAS INCONSISTENT WITH THE DISINTERESTEDNESS REQUIREMENT OF 11 U.S.C. § 327(a).

Title 11 U.S.C. § 327(a) provides that "professional persons" providing services to a bankruptcy trustee -- or to the debtor-in-possession, acting as trustee -- must be "disinterested." Under § 101(41), law firms are considered "persons" and therefore are subject to the disinterestedness requirement. In our opening brief, we explained that the disinterestedness of a firm depends on whether the individuals who make up the firm satisfy the definition of "disinterested" set out in § 101(14). Keravision, in response, advocates an ad hoc inquiry into whether the firm's representation of the estate would be prejudiced. See Appellee's Brief ("Br.") at 41. Keravision's argument should be rejected. Examining whether a firm's members are "disinterested" is supported by the statutory structure, better serves the statutory purpose, makes the statute conform to basic background principles of professional responsibility, and is the approach taken by most courts.

A. The Structure of the "Disinterested Person" Definition in 11 U.S.C. § 101(14) Suggests that the Disinterestedness of a Law Firm Should Be Evaluated by Examining the Individual Attorneys in the Firm.

The structure of the "disinterested person" definition in § 101(14) suggests that a law firm is disinterested if and only if the individuals it comprises are themselves disinterested. Law firms are subject to the disinterestedness requirement because § 327(a) requires professional "persons" to be disinterested, while § 101(41) defines "person" to include a law firm. But several of the components of the "disinterested person" definition can only apply to natural persons. In law, as in ordinary usage, the terms "director, officer, or employee," § 101(14)(D), refer to natural persons, not to corporations or partnerships. Likewise, only an individual can be an "insider," at least insofar as that term is defined to include a "relative of a general partner, director, officer, or person in control of the debtor." §§ 101(14)(A), 101(31)(B)(vi). That provision is further evidence that "director" and "officer" refer to natural persons, for a partnership or corporation surely could not have a "relative." If these components of the "disinterested person" definition are to have any effect when the "person" in question is a law firm, it can only be by looking at the attorneys who make up the firm.

Keravision argues that a law firm can sometimes be an "officer." Br. at 16. Its only authority for this proposition is In re Capitol Metals Co., 228 B.R. 724 (B.A.P. 9th Cir. 1998). In that case, Peterson, the debtor's CFO, was one of two principals of ABC Capital Markets Group; the other was Peterson's wife. See id. at 725. After filing a Chapter 11 petition, the debtor sought to employ ABC as a financial advisor and investment banker. See ibid. Such an appointment would be clearly prohibited if Peterson's disqualifying interest were imputed to his firm. But the Bankruptcy Appellate Panel was constrained to reject a rule of imputed disqualification by In re S.S. Retail Stores Corp., 211 B.R. 699 (B.A.P. 9th Cir. 1997), the same case relied on by the bankruptcy court here. Accordingly, the Capitol Metals court held that ABC was disqualified because the company had also served as the debtor's CFO. See 228 B.R. at 727. In other words, the court was compelled -- by the very rule advocated by Keravision in this case -- to adopt a strained construction of the term "officer" in order to disqualify an obviously interested firm. The court did not discuss the definition of the term "officer" at any length, and so far as we are aware, Capitol Metals is the only case to suggest that a corporation can be an "officer."

Even Keravision does not argue that a corporation or partnership can be an "employee" or a "director" for purposes of § 101(14). So if those components of the statute are to have any effect when the professional person is a law firm, it can only be by looking at the individual professionals within the firm.

Keravision emphasizes the contrast between Rule 5002(a) of the Federal Rules of Bankruptcy Procedure, which expressly provides that another type of disqualification must be imputed to a disqualified individual's law firm, and § 327(a) of the Bankruptcy Code, which does not explicitly mention imputation.

See Br. at 15-16. From this it infers that § 327(a) must not require a firm's disqualification based on its partner's "interest." This reasoning is flawed. To be sure, "[w]here Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion." Bates v. United States, 522 U.S. 23, 29-30 (1997). But Rule 5002 does not appear in the "same Act" or even in any other Act. It was not enacted by Congress, but rather was drafted by the advisory committee and adopted by the Supreme Court. Sound inferences as to Congress's intent may not be drawn by comparing the language that Congress placed in a statute with the language that an advisory committee placed in a rule. Indeed, such an inference is precluded by the Rules Enabling Act, which bars any use of the Federal Rules of Bankruptcy Procedure to "abridge, enlarge, or modify any substantive right." 28 U.S.C. § 2075.

B. Imputed Disqualification Best Promotes the Prophylactic Purposes of Section 327(a).

In addition to being the most natural interpretation of the statutory text, disqualifying a firm when its members are not "disinterested" promotes the purpose of 11 U.S.C. § 327(a). As we explained in our opening brief (pp. 15-16), that purpose is to avoid even the appearance of a conflict of interest that would prejudice the estate. A truly disinterested professional might determine that it is in the best interest of the estate to pursue legal action against the debtor's former directors. See In re Interwest Bus. Equip., Inc., 23 F.3d 311, 316 (10th Cir. 1994); In re Essential Therapeutics, Inc., 295 B.R. 203, 211 (Bankr. D. Del. 2003). If a law firm representing the estate includes some of those former directors, it cannot realistically be expected to act in a disinterested fashion.

At a minimum, a firm with "interested" members would give the appearance of not being disinterested -- an appearance Congress sought to avoid by adopting a very broad conflict rule in § 327(a). See In re Federated Dep't Stores, Inc., 44 F.3d 1310, 1319 (6th Cir. 1995) ("Congress sought to disqualify professionals with the appearance of a conflict of interest as well as those who have an actual conflict of interest"). If Congress's concern had been simply actual conflicts of interest, then most of the specific prohibitions in § 101(14) would be superfluous; the statute would only need to include § 101(14)(E), which requires that professionals "not have an interest materially adverse to the interest of the estate." Congress enacted the categorical prohibitions in § 101(14) in order to make absolutely certain that counsel would "tender undivided loyalty and provide untainted advice and assistance" to the trustee. Rome v. Braunstein, 19 F.3d 54, 58 (1st Cir. 1994). As a fiduciary, counsel owes the estate "[n]ot honesty alone, but the punctilio of an honor the most sensitive.” Meinhard v. Salmon, 164 N.E. 545, 546 (N.Y. 1928).

Keravision argues that a rule of imputed disqualification will “penaliz[e] a party,” Br. at 26, or “den[y] debtors their preferred choice of counsel,” Br. at 50. This reflects a fundamental confusion about whom counsel for the estate represents. As this Court has explained, counsel in Chapter 11 cases “must keep firmly in mind that [their] client is the estate and not the debtor individually.” In re Perez, 30 F.3d 1209, 1219 (9th Cir. 1994). Section 327(a) permits the retention of professional persons not to represent the debtor’s interests, but to “assist the trustee,” or the debtor-in-possession acting as a trustee, “in carrying out the trustee’s duties” to the estate. After all, the debtor-in-possession has a “fiduciary obligation to creditors and shareholders.” CFTC v. Weintraub, 471 U.S. 343, 355. The “willingness of courts to leave debtors in possession is premised upon an assurance” that debtors “can be depended upon to carry out the fiduciary responsibilities of a trustee” rather than to promote their own interests. Ibid (quotation marks omitted). To provide such assurance, Congress has directed that the professionals who assist debtors must be approved by the court and must meet statutory standards of disinterestedness. See 11 U.S.C. § 327. The debtor’s own interests or preferences about its counsel should not override the safeguards that

Congress established in order to protect the estate.

Nor does it matter that a law firm may have a "long-term relationshi[p]" with the debtor. Br. at 49. Congress has unequivocally specified that professionals may not represent the estate unless they are "disinterested" -- a requirement that often disqualifies professionals who have long-term relationships with debtors. Any "practical benefits" that might be provided by employing a non-"disinterested" professional are simply not relevant, given the mandatory language of § 327(a). United States Trustee v. Price Waterhouse, 19 F.3d 138, 142 (3d Cir. 1994). In any event, Keravision acknowledges that many large firms have bankruptcy practices, and the estate in this case could have received competent representation from one of them. See Br. at 50 n.14, 51.

Keravision argues that the bankruptcy court should perform an ad hoc assessment in each case of whether a law firm with an "interested" member is likely to lack "the requisite independent judgment and impartial attitude." Br. at 41, quoting In re O'Connor, 52 B.R. 892, 899 (Bankr. W.D. Okla. 1985). Keravision does not explain what standard a bankruptcy court would apply in conducting such an evaluation. To the extent that Keravision would have the bankruptcy court look for actual conflicts of interest, its approach is inconsistent with the statute. As we have shown, § 327(a) is intended to prevent not just actual conflicts, but also the appearance of conflict. Cf. 11 U.S.C. § 327(a) (court may appoint professionals "that do not hold or represent an interest adverse to the estate, and that are disinterested persons") (emphasis added).

In any case, whatever the precise standard envisioned by Keravision, its approach would entail serious practical problems. First, the bankruptcy court often will be unable to determine whether the presence in a law firm of an "interested" attorney will affect the firm's handling of the representation. For example, Keravision proposes a regime in which the bankruptcy court must monitor the firm to ensure that it is "engag[ing] in adequate investigation." Br. at 35. But the bankruptcy court is unlikely to have enough information to monitor the firm's investigation in a meaningful fashion. If the firm discovers, but then suppresses, evidence suggesting that the interested partner might be liable to the estate, the bankruptcy court will never learn of it.

Second, the ongoing monitoring envisioned by Keravision would create the possibility that a firm might have to be disqualified in the middle of a case once a conflict of interest becomes apparent. See Br. at 35 n.12. Requiring the substitution of counsel in the middle of a case would impose additional costs on the estate, prejudicing the interests of creditors. That is why appointment decisions under § 327(a) are to be made at the beginning of the case. See In re Martin, 817 F.2d 175, 183 (1st Cir. 1987) (disqualification "must be judged prospectively"); In re RKC Dev. Corp., 205 B.R. 869, 872 (Bankr. S.D. Ohio 1997) (It is "the responsibility of the Court to determine qualification at the commencement of the case and not . . . address the issues after the fact"). The scheme contemplated by Keravision would contravene this sound practice. It therefore should be rejected.

C. Basic Principles of Professional Responsibility Suggest that Section 327(a) Should Be Interpreted to Establish a Rule of Imputed Disqualification.

In our opening brief, we showed that under general rules of professional responsibility, a conflict of interest that disqualifies one attorney will be imputed to other attorneys in the same firm. Keravision apparently misunderstands the significance of this fact, because it devotes a section of its brief to demonstrating that its representation in this case did not violate the California Rules of Professional Conduct. See Br. at 51-55. That may well be true; as we have explained, the "disinterest" standard that § 327(a) imposes in bankruptcy cases is much stricter than the conflict-of-interest rules governing lawyers generally. Principles of professional responsibility are relevant in this case not because they prohibit the representation of their own force, but because they offer a guide to the interpretation of § 327(a). In accordance with those principles, the statutory disqualification of attorneys who are not "disinterested" should be imputed to their law firms.

The Supreme Court has held that statutes should be "read with a presumption favoring the retention of long-established and familiar principles." Isbrandtsen Co. v. Johnson, 343 U.S. 779, 783 (1952). Courts "may fairly presume that Congress is aware of the common-law background against which it legislates," Chappell v. Robbins, 73 F.3d 918, 924 (9th Cir. 1996), and that "where a common-law principle is well established," Congress "has legislated with an expectation that the principle will apply," Astoria Fed. Sav. & Loan Ass'n v. Solimino, 501 U.S. 104, 108 (1991). For this reason, the provisions of the Bankruptcy Code governing disqualification of counsel should be read so that they are consistent, rather than inconsistent, with general principles of professional responsibility.

The "traditional presumption" of the law governing professional responsibility is that an interest that disqualifies one attorney also disqualifies any affiliated attorneys. Developments in the Law -- Conflicts of Interest in the Legal Profession, 94 Harv. L. Rev. 1244, 1361 (1981). The ABA's Model Code of Professional Responsibility stated unequivocally: "If a lawyer is required to decline employment or to withdraw from employment under a Disciplinary Rule, no partner or associate, or any other lawyer affiliated with him or his firm may accept or continue such employment." ABA Model Code of Professional Responsibility, Disciplinary Rule 5-105(D) (1974). And the Model Rules of Professional Conduct, which have been adopted by a substantial majority of the States, are similar. See Geoffrey C. Hazard, Jr. & W. William Hodes, The Law of Lawyering § 1.15 (3d ed. 2001 & 2003 Supp.). Under Model Rule 1.10(a), when lawyers are affiliated in a firm, "none of them shall knowingly represent a client when any one of them practicing alone would be prohibited from doing so" by the rules governing conflicts. ABA Model Rules of Professional Conduct, Rule 1.10(a) (2003); accord Henriksen v. Great American Sav. & Loan, 14 Cal. Rptr. 2d 184, 187 (Cal. Ct. App. 1992) (reaching same result under California Rules of Professional Responsibility); see also Restatement (Third) of the Law Governing Lawyers § 123 (2000) ("[T]he restrictions upon a lawyer imposed by [the provisions governing conflicts] also restrict other affiliated lawyers who . . . are associated with that lawyer in rendering legal services to others through a law partnership"). As the Restatement explains, this rule reflects the reality that "lawyers in a law firm . . . ordinarily share each other's interests," which means that if one lawyer has an interest that gives him or her "an incentive to violate an obligation" to a client, "an affiliated lawyer will often have similar incentive." Id., comment b.

Keravision cites three cases that, it says, reject a per se rule of imputed disqualification. See Br. at 39. Its reading of the cases is incorrect. The California decision, Adams v. Aerojet-General Corp., 104 Cal. Rptr. 2d 116, 122 (Cal. Ct. App. 2001), stated flatly: "It is now firmly established that where the attorney is disqualified from representation due to an ethical conflict, the disqualification extends to his entire firm." The court merely declined to apply this rule in reverse by disqualifying an attorney in a case where his former firm would have been conflicted. See ibid. Of the two bankruptcy court decisions that Keravision cites, one actually applied the principle of imputed disqualification and disqualified a law firm because one of its associates had an interest adverse to the estate. See In re Cropper Co., 35 B.R. 625, 632 (Bankr. M.D. Ga. 1983) ("Even though Mr. Griffin is an associate of Sell & Melton rather than a partner, his disqualification results in the disqualification of all members of that law firm"). In the other case, the court did not disqualify the firm, but it reached this decision after finding that the individual attorney had done nothing disqualifying. See In re Lawrence, 217 B.R. 658, 664-665 (Bankr. S.D. Fla. 1998). Although the court directed that the attorney in question be screened from the representation, it did so only "out of an abundance of caution." Id. at 662.

Thus, the established rule is that the disqualification of an attorney is imputed to his or her law firm. Section 327(a) should be interpreted in accordance with this principle.

D. A Rule of Imputed Disqualification Is Consistent with the Approach Taken by Most Courts.

Keravision errs in suggesting that most courts have rejected a rule of imputed disqualification. Br. at 21-32. No court of appeals has addressed the question, and although some bankruptcy courts and district courts have adopted the view urged by Keravision, most courts have held that the "interest" of an attorney is imputed to his or her law firm. See Essential Therapeutics, 295 B.R. at 208-09 (citing cases); see also In re Vebeliunas, 231 B.R. 181, 196 (Bankr. S.D.N.Y. 1999) ("The general rule is that when one member of a firm is disqualified, all members of that firm must be similarly disqualified"); In re Tinley Plaza Assocs., L.P., 142 B.R. 272, 277 (Bankr. N.D. Ill. 1992) ("If an attorney who is a member of a law firm is disqualified . . . then all the members of the attorney's law firm are also disqualified"); In re Wells Benrus Corp., 48 B.R. 196, 199 (Bankr. D. Conn. 1985) ("The disqualification of any attorney pursuant to Code § 327(a) causes every attorney in that attorney's firm to be disqualified as well").

II. "EQUITABLE CONSIDERATIONS" DO NOT PERMIT LATHAM & WATKINS TO RECEIVE PAYMENT FOR SERVICES THAT IT PROVIDED IN VIOLATION OF SECTION 327(a).

Keravision argues that "equitable considerations" permit Latham & Watkins to be paid fees as counsel to the bankruptcy estate even if its service was contrary to law. Br. at 55. That is incorrect. Because the firm was not "disinterested," its appointment violated the explicit requirements of § 327(a). The firm therefore has no statutory right to payment, and this Court should reverse the order awarding fees.

A. At the outset, we note that Keravision is incorrect when it suggests that this case involves "disgorgement" of Latham's fee. Br. at 55, 57. To be sure, if Latham had already been paid, disgorgement would be appropriate here. Disgorgement is a standard remedy when an attorney has collected fees in a Chapter 11 case despite being ineligible under § 327(a) to provide professional services. See, e.g., In re Occidental Fin. Group, Inc., 40 F.3d 1059, 1062-63 (9th Cir. 1994); cf. In re First Jersey Sec., Inc., 180 F.3d 504, 514 n.9 (3d Cir. 1999). More generally, this Court has explained that disgorgement of unlawfully collected funds in a bankruptcy case is appropriate whenever a party had timely notice that its ability to collect those funds was under challenge. See In re Cascade Roads, Inc., 34 F.3d 756, 761 (9th Cir. 1994) (because "[t]he trustee is a party to this appeal and has been aware at all times that the United States would seek appellate review," it would not be "inequitable" to order disgorgement of a judgment against which the United States claimed an offset); In re International Envtl. Dynamics, Inc., 718 F.2d 322, 326 (9th Cir. 1983) (since counsel for creditors "has known since [the fees were disbursed] that [the trustee] contests the bankruptcy court's order that he be paid," it would not be "inequitable" to order disgorgement of the fees). Here, of course, Latham & Watkins has known since the beginning of the case that the United States Trustee challenged the propriety of its appointment. Equity therefore would not bar disgorgement.

This case, however, does not involve disgorgement. The contested fees have not yet been paid to Latham & Watkins. Instead, the bankruptcy court ordered that they be placed in an interest-bearing account segregated from the firm's operating account. See Stipulation and Order Granting in Part and Denying in Part U.S. Trustee's Mot. to Continue Stay, No. 01-41564 (Bankr. N.D. Cal. March 6, 2003), reprinted in Appellant's Brief, Addendum at 7. As we explained in the jurisdictional statement of our opening brief, that fact makes this case significantly different from In re S.S. Retail Stores Corp., 216 F.3d 882, 884 (9th Cir. 2000), in which this Court dismissed an appeal of a fee award because it would have been "inequitable" to order disgorgement. Keravision has conceded this point by endorsing our jurisdictional statement. See Br. at 3.

B. Because the appointment of Latham & Watkins was unlawful, the firm has no statutory entitlement to a fee award. Under the Code, a bankruptcy court may award fees to "a professional person employed under section 327." 11 U.S.C. §

330(a)(1). Latham is not such a “person,” because it failed to satisfy the standards of § 327(a). As the Sixth Circuit has held, “a valid appointment under § 327(a) is a condition precedent to the decision to grant or deny compensation under § 330(a)” so that a bankruptcy court may not authorize the payment of fees to a professional who is not disinterested. In re Federated Dep’t Stores, Inc., 44 F.3d 1310, 1320 (6th Cir. 1995). Although other courts have held that a bankruptcy court has some discretion to decide whether to award fees, they have stressed that fees generally should not be permitted if a professional does not satisfy the requirements of § 327(a). See Gray v. English, 30 F.3d 1319, 1324 (10th Cir. 1994) (“In exercising the discretion granted by the statute we think the court should lean strongly toward denial of fees”); accord In re Prince, 40 F.3d 356, 360 (11th Cir. 1994); see also In re Wiredyne, Inc., 3 F.3d 1125, 1127 (7th Cir. 1993) (noting that “courts have generally denied fees as a matter of course under sections 327 and 328 in the event of a conflict”).

Whatever the precise scope of discretion permitted to bankruptcy courts, it would be an abuse of discretion to award fees in this case, because the appointment of Latham & Watkins plainly violated the disinterested-person requirement of § 327(a). As the Supreme Court has explained, “a court sitting in equity cannot ‘ignore the judgment of Congress, deliberately expressed in legislation.'" United States v. Oakland Cannabis Buyers' Coop., 532 U.S. 483, 497 (2001), quoting Virginian R. Co. v. Railway Employees, 300 U.S. 515, 551 (1937); see also In re Futoran, 76 F.3d 265, 267 (9th Cir. 1996) ("The bankruptcy court's equitable powers may only be exercised 'in furtherance of the goals of the Bankruptcy Code'") (quoting In re Bownic Insulation Contractors, Inc., 134 B.R. 261, 267 (Bankr. S.D. Ohio 1991)). Allowing a law firm to escape a strict disqualification provision set forth in the Code can hardly be thought to be "in furtherance of" the Bankruptcy Code's goals.

Permitting law firms to earn fees regardless of the unlawfulness of their representations would undermine the efficiency and fairness of the bankruptcy system. Confident that they would be able to accrue all of their fees before a court of appeals could rule on a challenge to their eligibility, attorneys would feel free to engage in representations that appellate courts would, given the opportunity, declare unlawful. Cf. In re BBQ Resources, Inc., 237 B.R. 639, 642 (Bankr. E.D. Ky. 1999) (denial of fees "is meant to dissuade counsel from becoming involved in the representation of debtors where there are substantial questions apparent at the outset concerning conflicts of interest"). Professionals who anticipated challenges to their eligibility would have an incentive to proceed with undue haste -- by winning the race against the challenger's appeals, they could be rewarded with an entitlement to their fees notwithstanding the unlawfulness of their employment. The United States Trustee could seek to stay bankruptcy cases pending review of its challenges to appointments, but that approach would burden the other parties by impeding the speedy resolution of cases.

Contrary to Keravision's suggestion, there is nothing "fundamentally unjust," Br. at 57, about denying fees for an appointment that violated § 327. To be sure, the bankruptcy court and the district court approved Latham's representation. But the firm was aware that the United States Trustee objected to its appointment, and it knew that the appointment order might be challenged at the conclusion of the case in an appeal to this Court. The firm nonetheless chose to take the risk of proceeding with the representation, just as a firm that takes a case on a contingent-fee basis accepts the risk that it might not be able to collect a fee. If reliance on a bankruptcy court order does not preclude disgorgement of funds erroneously collected, then a fortiori it should not preclude a decision not to award money. Cf. Cascade Roads, 34 F.3d at 761; International Envtl. Dynamics, 718 F.2d at 326; In re Spirtos, 992 F.2d 1004, 1007 (9th Cir. 1993).

Moreover, Latham & Watkins is not the only party with an interest in being paid by the estate. This is a Chapter 7 case, which means that liquidation of Keravision's assets will not produce sufficient funds to satisfy all creditor claims. The creditors' already-diminished recoveries will be further reduced if Latham & Watkins is paid a fee. That result would not prevent an injustice; it would create one.

Finally, it is not relevant that in this particular case the unlawfulness of Latham's appointment may not have resulted in any "harm or prejudice to the estate." Br. at 57. The Supreme Court has held that when a fiduciary's ability to provide "loyal and disinterested service" is impaired by that professional's interests, "[i]t is no answer to say that fraud or unfairness were not shown to have resulted." Woods v. City Nat'l Bank & Trust Co., 312 U.S. 262, 268 (1941). The remedy of denying compensation is designed to eradicate "not only actual evil results" but also the "tendency to evil in other cases." Ibid, quoting Weil v. Neary, 278 U.S. 160, 173 (1929).

C. Even if the bankruptcy court was not compelled to deny compensation, it at least had discretion to do so. A court abuses its discretion when it makes an error of law, see Southwest Voter Registration Educ. Project v. Shelley, 344 F.3d 914, 918 (9th Cir. 2003) (en banc), and here, the bankruptcy court's fee award rested on the erroneous conclusion that Latham's appointment was permissible under § 327(a). Therefore, if this court concludes that Latham's appointment was improper because the firm was not "disinterested," it should at least reverse the district court with instructions to remand the case to the bankruptcy court to permit that court to reconsider whether to award fees, and if so, in what amount.

CONCLUSION

The judgment of the district court should be reversed, and the case should be remanded with instructions to reverse the order granting the final application for attorney’s fees.

Respectfully submitted,

PETER D. KEISLER
Assistant Attorney General

KEVIN V. RYAN
United States Attorney

ROBERT M. LOEB
(202) 514-4332
ERIC D. MILLER
(202) 514-2754
Attorneys, Appellate Staff
Civil Division, Room 9131
U.S. Department of Justice
601 “D” Street, N.W.
Washington, D.C. 20530-0001

Of Counsel:

JOSEPH A. GUZINSKI
General Counsel

P. MATTHEW SUTKO
Executive Office for
United States Trustees
U.S. Department of Justice
20 Massachusetts Ave., N.W.
Washington, D.C. 20530

MARK L. POPE
Office of the U.S. Trustee
Oakland, CA 94612

NOVEMBER 2003

CERTIFICATE OF SERVICE

I certify that on November 6, 2003, I filed and served the foregoing brief by causing sixteen copies to be sent by Federal Express to the Clerk of the Court, and by causing two copies to be sent by Federal Express to the following counsel:

Mr. Peter M. Gilhuly
Latham & Watkins LLP
633 W. Fifth Street, Ste. 4000
Los Angeles, CA 90071
(213) 485-1234

____
Eric D. Miller

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In re Ralph Kimbro and Patricia Ann Kimbro (Henry Hildebrand, III v. Ralph Kimbro, Jr., et al.)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*
6th Cir.

3. ("CCN") ***CURRENT*** CASE NO.
No.: 08-5871

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Court: BAP 6th Cir.
(Identify judge & cite, if any)

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David A. Levine, P. Matthew Sutko, Ramona D. Elliott
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s)
• Whether the Bankruptcy Appellate Panel erred in ruling debtor may claim a vehicle ownership deduction under section 707(b)(2)(A)(ii)(I) of the bankruptcy code when they have no associated vehicle ownership expenses.

&

√ Any Miscellaneous ***BACKGROUND***

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IN THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

In re RALPH KIMBRO and PATRICIA ANN KIMBRO,
Debtors.

HENRY HILDEBRAND, III,
Chapter 13 Trustee - Appellant,

v.

RALPH KIMBRO and PATRICIA ANN KIMBRO,
Debtors - Appellees.

ON APPEAL FROM
THE UNITED STATES BANKRUPTCY
APPELLATE PANEL OF THE SIXTH CIRCUIT

BRIEF OF THE UNITED STATES AS *AMICUS CURIAE* SUPPORTING REVERSAL

RAMONA D. ELLIOTT
General Counsel
P. MATTHEW SUTKO
Associate General Counsel
DAVID A. LEVINE
Executive Office for United States Trustees
Department of Justice
20 Massachusetts Ave., N.W.
Washington, D.C. 20530
Telephone: (202) 307-1399
Facsimile: (202) 307-2397
E-mail: p.matthew.sutko@usdoj.gov
COUNSEL FOR THE UNITED STATES

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The United States submits this brief under Fed. R. App. P. 29 as amicus curiae supporting reversal.

INTEREST OF THE UNITED STATES

This appeal calls upon this Court to interpret a statutory provision affecting chapter 13 bankruptcy cases, 11 U.S.C. 1325(b)(3). Section 1325(b)(3) makes two chapter 7 provisions – 11 U.S.C. 707(b)(2)(A) and (B) – applicable to chapter 13 cases.

The United States has a direct interest in the proper construction of these provisions because United States Trustees, who are Justice Department officials appointed by the Attorney General, supervise the administration of chapter 7 and chapter 13 bankruptcy cases in all federal judicial districts within this circuit. 28 U.S.C. 581-589a. See also H.R. Rep. No. 95-595, at 88 (1977) (United States Trustees "serve as bankruptcy watch-dogs to prevent fraud, dishonesty, and overreaching in the bankruptcy arena."); In re Revco D.S., Inc., 898 F.2d 498, 500 (6th Cir. 1990) (citing legislative history).

This appeal affects the United States' interests for two distinct reasons:

First, by applying section 1325(b)(3), this Court will determine how much above-median-income chapter 13 debtors must repay their creditors in their chapter 13 repayment plans. The United States has an interest in that question because United States Trustees “supervise the administration of [chapter 13] cases and trustees,” monitor chapter 13 plans, and file comments with the court regarding such chapter 13 plans in connection with plan confirmation hearings under section 1324 of the Code. 28 U.S.C. 586(a)(3)(C).

Second, because section 1325(b)(3) incorporates two parts of the chapter 7 means test, sections 707(b)(2)(A) and (B), this appeal will also determine what expenses above-median-income chapter 7 debtors can claim on the means test. The means test determines whether an above-median-income debtor’s chapter 7 case should be dismissed as abusive. See 11 U.S.C. 707(b)(1) and (2).

United States Trustees play a unique role in chapter 7 means test cases because section 704(b) requires them to review all such cases and, whenever a case is deemed presumptively abusive under the statute, either (a) seek its dismissal, or (b) file a statement declining to seek dismissal. See 11 U.S.C. 704(b). See also Schultz v. United States, 529 F.3d 343, 348 (6th Cir. 2008) (describing the United States Trustee’s duties to enforce the chapter 7 means test under the 2005 Act).

In fiscal year 2007, United States Trustees filed 3,370 motions to dismiss under section 707(b)(2) and 1,441 statements declining to seek dismissal when a presumption of abuse existed in a case.

Given these interests, the United States submits this brief to share its views on the application of sections 1325(b)(3) and 707(b)(2)(A). See 28 U.S.C. 517. See also 11 U.S.C. 307.

STATEMENT OF THE ISSUE

The Bankruptcy Code allows debtors to claim a vehicle ownership expense, in a set amount, when it is "applicable." 11 U.S.C. 707(b)(2)(A)(ii)(I). The expense amount is a standardized dollar value debtors may claim to account for vehicle loan or lease payments. The debtors in this case claimed such a set amount for two vehicles, even though they have no loan or lease payments for one of the vehicles.

The question presented is: Did the bankruptcy appellate panel err in ruling the Kimbros could claim that expense amount on the vehicle for which they had no vehicle ownership expenses?

STATUTORY BACKGROUND

This appeal involves the interpretation of provisions added to the Bankruptcy Code by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005.[1] The 2005 Act significantly altered how debtors obtain chapter 13 bankruptcy relief.

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[1] Pub. L. No. 109-8, 119 Stat. 23 (2005). The 2005 Act applies to the Kimbros' case, because the act's general effective date is for cases filed on or after October 17, 2005.

In a chapter 13 case, a debtor's unsecured creditors or trustee may insist the debtor devote all of his "projected disposable income" to repay unsecured creditors over a period of up to five years. See 11 U.S.C. 1325(b)(1). Disposable income is a net number: income less allowed expenses.

Under the 2005 Act, above-median-income debtors, like the Kimbros, determine disposable income by first calculating their gross income.[2] Next, the debtors deduct permitted expenses. See 11 U.S.C. 1325(b)(2)

Above-median-income chapter 13 debtors determine their permitted expenses by employing the formula found in 11 U.S.C. 707(b)(2)(A) and (B). 11 U.S.C. 1325(b)(3) (incorporating those provisions). Section 707(b)(2)(A)(ii)(I) permits debtors to deduct **(a)** certain prescribed "actual" expenses, and **(b)** other "applicable" expense amounts. Applicable expense amounts are not the debtor's actual expenses. Instead, they are the static amounts listed in the Internal Revenue Service's Local and National Standards.[3] Id. Last, a debtor may deduct additional

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[2] The Bankruptcy Code defines income as "current monthly income received by the debtor." 11 U.S.C. 1325(b)(2). It defines "current monthly income" in 11 U.S.C. 101(10A).

[3] Because the Kimbros filed their case on June 7, 2007, the Collection Financial Standards in effect prior to October 1, 2007, are applicable. See 11

expenses identified in other subsections of section 707(b)(2)(A). That yields a net number – disposable income, which establishes the minimum an above-median-income debtor must pay to unsecured creditors under a chapter 13 plan. 11 U.S.C. 1325(b)(1)(B).

This appeal poses a question about one part of this expense-side calculation of disposable income related to vehicle ownership expenses under the IRS Local Standards. Transportation expenses incorporate two components: (1) monthly expenses for costs associated with operating vehicles and (2) monthly expenses for costs associated with purchasing or leasing vehicles. All debtors receive monthly transportation expenses based on either public transportation costs or the costs associated with operating one or two cars. Operating expenses include amounts for vehicle maintenance, fuel, state and local registration, required inspection, parking fees, tolls, and driver's license fees.

The ownership expense allowance under the IRS Standards is one amount for each vehicle that is based on the average cost of financing a vehicle as determined

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U.S.C. 707(b)(2)(A)(ii)(I) (IRS standards will be those "as in effect on the date of the order for relief").

annually by the Federal Reserve Board. Id. Independent of operating expenses, when applicable, debtors can claim a standardized amount to reflect a loan or lease payment. Id. Like the operating expense, the ownership expense, which covers vehicle lease or purchase payments, is limited to no more than two vehicles. Id.

Specifically at issue in this appeal is whether a standardized vehicle ownership amount deduction is "applicable" under section 707(b)(2)(A)(ii)(I) when the debtor has no associated vehicle ownership expense. The Kimbros have no loan or lease payments on their second vehicle, so this appeal requires this Court to determine whether they may nonetheless claim the standardized IRS Local Standard expense amount for that vehicle and thereby subtract $332 from their plan payment for each month of their 60-month repayment plan.

STATEMENT OF FACTS

On June 7, 2007, Mr. and Mrs. Kimbro filed a voluntary petition under chapter 13 of the Bankruptcy Code, 11 U.S.C. 1301, *et seq*. (R. 1, Voluntary Petition). Their means test form calculated monthly disposable income of $183.60.[4]

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[4] The chapter 13 means test form, Fed. R. Bankr. P. Official Form 22C, facilitates the computation of a chapter 13 debtor's income and expenses under the 2005 Act.

(R. 3, Ch. 13 Statement of Current Monthly & Disposable Income, p. 5).

In making this calculation, the Kimbros claimed $343 under the Local Standards for monthly vehicle operating expenses for two vehicles. (Id., p. 3). In addition, the Kimbros also claimed monthly vehicle ownership expenses for two vehicles. (Id.). The Kimbros deducted an ownership expense of $358.82 for their first vehicle, calculated by subtracting their average monthly car payment of $112.18 from the IRS Local Standard of $471. (Id.). The Kimbros also claimed on their means test form a standardized $332 monthly vehicle ownership expense amount for a second vehicle under the IRS Local Standard, although they own this vehicle free and clear of any loan or lease payments. (Id.).

The Kimbros' chapter 13 repayment plan proposed to pay $183.60 monthly to unsecured creditors over 60 months, which represented approximately 39% of their $27,009.46 in scheduled debts to unsecured creditors. (R. 2, Ch. 13 Plan, p. 3).

The chapter 13 trustee objected to confirmation of the Kimbros' plan. (R. 19, Motion for Hearing On Confirmation and Request for Dismissal, p. 1). He argued

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The means test form was approved by the Judicial Conference of the United States and the Federal Rules of Bankruptcy Procedure require all chapter 13 debtors to file the form. See Fed. R. Bankr. P. 1007(b)(6).

that the Kimbros could not reduce creditor payments by claiming a standardized vehicle ownership expense amount for one of their two vehicles because they had no associated ownership expenses for that vehicle. (R. 25, Brief in Support of Trustee's Objection to Confirmation, p. 3).

The trustee alleged that striking that inapplicable expense amount yielded monthly disposable income sufficient to repay their unsecured creditors in full. (Id.). The Kimbros countered that they were entitled to claim the expense amount regardless of whether their second car was paid in full.

The United States Bankruptcy Court for the Middle District of Tennessee overruled the trustee's objection and confirmed the Kimbros' plan. (R. 29, Order Confirming Ch. 13 Plan, p.1; R. 34, Order Denying Trustee's Objection, p. 1). The trustee timely filed a notice of appeal to the Bankruptcy Appellate Panel for the Sixth Circuit. (R. 32, Notice of Appeal).

On June 12, 2008, a divided panel of the Bankruptcy Appellate Panel for the Sixth Circuit issued an order and opinion affirming the bankruptcy court's decision. In re Kimbro, 389 B.R. 518 (B.A.P. 6th Cir. 2008). In so doing, the majority of the appellate panel held that debtors may deduct the standardized vehicle ownership expense amount even when they have no associated vehicle ownership expenses. Id. at 524. On July 7, 2008, the trustee filed a notice of appeal to this Court.

SUMMARY OF ARGUMENT

Mr. and Mrs. Kimbro, who are chapter 13 debtors, seek to shield almost $16,000 from their creditors by claiming a standardized vehicle ownership expense amount under 11 U.S.C. 707(b)(2)(A)(ii)(I) when they have no corresponding vehicle ownership expenses.[5] The appellate panel allowed the Kimbros to claim this expense amount. See In re Kimbro, 389 B.R. at 532 (Fulton, J., dissenting) (calling the majority ruling "a superb effort to weave a seemingly robust cloth from somewhat thin threads.".

That ruling conflicts with the weight of bankruptcy appellate panel and district court rulings, and it is wrong for five reasons.

1. First, the Kimbros cannot claim a standardized vehicle ownership expense amount on their second vehicle because section 707(b)(2)(A)(ii)(I) allows a debtor to claim it only when it is "applicable" to the debtor's case. The standardized vehicle ownership amount deduction is not applicable to the Kimbros' second vehicle because they have no associated vehicle ownership expense.

Reading the word "applicable" in section 707(b)(2)(A)(ii)(I) as limiting expense amounts to debtors who have associated expenses is the best construction

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[5] Section 1325(b)(3) incorporates section 707(b)(2)(A)(ii)(I) into the Kimbros' chapter 13 bankruptcy case.

of this section because it (1) uses the ordinary dictionary meaning of "applicable," and does so in a way that gives meaning to each word in the section; (2) fulfills Congress' stated reasons for enacting the section; and (3) most equitably implements bankruptcy policy - both for debtors and for creditors.

2. Giving "applicable" its ordinary definition in section 707(b)(2)(A)(ii)(I) yields a statute that allows debtors who have monthly expenses to claim the expense amount set out in the IRS Standards. At the same time, it prevents debtors who lack monthly expenses from claiming phantom expense amounts. This construction also gives meaning to every word in the section, something the appellate panel's construction does not.

3. The 2005 Act's legislative history supports this interpretation of section 707(b)(2)(A)(ii)(I). The Act's House Report reveals Congress enacted the new law to ensure debtors would repay their debts when they were able, and to eliminate loopholes and incentives for debtor abuse in discharging debts when a portion could be repaid. Allowing the Kimbros to claim a fictional expense amount diverges from the purpose of the 2005 Act.

4. Reading "applicable" in section 707(b)(2)(A)(ii)(I) to require a loan or lease payment also fosters sound public policy. Barring above-median-income debtors like the Kimbros from claiming inapplicable ownership expense amounts is fair because it simply prevents them from claiming a monthly expense for an expense they do not have. This interpretation does not hurt lower-income debtors, because they are not subject to section 707(b)(2)(A)(ii)(I) in the first place. See 11 U.S.C. 1325(b)(3). It is also fair to creditors because they will receive payments on their debts when debtors have the financial ability to repay.

5. Finally, the bankruptcy system has two safety valves to ensure that higher-income debtors without loan or lease payments will not suffer by being denied phantom vehicle expenses. First, when they have older vehicles, they receive an additional $200 monthly expense allowance for up to two vehicles to fund the operation of these older vehicles. Second, these chapter 13 debtors can modify their court confirmed repayment plan under section 1329(a) if they require a new car during the course of repaying their creditors.

ARGUMENT

THE APPELLATE PANEL ERRED IN RULING DEBTORS MAY CLAIM A VEHICLE OWNERSHIP DEDUCTION UNDER SECTION 707(b)(2)(A)(ii)(I) OF THE BANKRUPTCY CODE WHEN THEY HAVE NO ASSOCIATED VEHICLE OWNERSHIP EXPENSES.

The United States asks this Court to reverse the appellate panel's ruling that section 707(b)(2)(A)(ii)(I) allows the Kimbros to reduce their disposable income available to repay creditors by claiming an inapplicable standardized vehicle ownership expense amount. This case presents an issue of statutory construction that this Court reviews *de novo*. Rembert v. AT&T Universal Card Servs., 141 F.3d 277, 280 (6th Cir. 1998).

I. A vehicle ownership expense amount is "applicable" under section 707(b)(2)(A)(ii)(I) only when a debtor is making a corresponding loan or lease payments on the vehicle.

A. Vehicle ownership expense amounts are not "applicable" to a debtor who makes no loan or lease payment on a vehicle.

The Bankruptcy Code permits above-median-income individuals to claim a vehicle ownership expense amount when that expense is "applicable." 11 U.S.C. 707(b)(2)(A)(ii)(I). Section 707(b)(2)(A)(ii)(I) provides that a "debtor's monthly expenses shall be the debtor's applicable monthly expense amounts specified under the . . . Local Standards . . . issued by the Internal Revenue Service. . . ." 11 U.S.C.

707(b)(2)(A)(ii)(I) (emphasis added).

"Applicable" is not defined in the Bankruptcy Code, so the word should be given its ordinary meaning. Smith v. United States, 508 U.S. 223, 228 (1993) ("When a word is not defined by statute, we normally construe it in accord with its ordinary and natural meaning."); Limited, Inc. v. Comm'r, 286 F.3d 324, 333 (6th Cir. 2002) (same). Courts frequently turn to dictionaries to ascertain a word's ordinary meaning. See e.g., Clark Equip. Co. v. United States, 912 F.2d 113, 117 (6th Cir. 1990) (applying a dictionary definition to determine the common meaning of a statutory term).

The dictionary defines "applicable" to mean "capable of being applied: having relevance . . . fit, suitable, or right to be applied: APPROPRIATE" Webster's Third New International Dictionary at 105 (1981) (emphasis in original).

The appellate panel's ruling is inconsistent with the ordinary, common sense definition of "applicable" because it allows debtors like the Kimbros to deduct a monthly vehicle loan/lease expense amount when they have no associated monthly loan or lease expenses on their vehicles. See In re Ross-Tousey, 368 B.R. 762, 767 (E.D. Wis. 2007) (section 707(b)(2)(A)(ii)(I) does not make such "fixed allowances guaranteed to every car owner").

The point here is simple – a debtor has no section 707(b)(2)(A)(ii)(I) vehicle ownership expense amounts that are "capable of being applied" to him if he does not make any loan or lease payments. Ransom v. MBNA America Bank, N.A. (In re Ransom), 380 B.R. 799, 807-08 (B.A.P. 9th Cir. 2007). Like the dissent below, the weight of district courts and bankruptcy appellate panels rejected the appellate panel's contrary interpretation. In re Kimbro, 389 B.R. 532-33 (Fulton, J., dissenting); Babin v. Powell (In re Powell), 392 B.R. 407 (B.A.P. 8th Cir. 2008); Babin v. Wilson (In re Wilson), 383 B.R. 729 (B.A.P. 8th Cir. 2008); Grossman v. Sawdy (In re Sawdy), 384 B.R. 199 (E.D. Wis. 2008); Wieland v. Thomas (In re Thomas), 382 B.R. 793 (D. Kan. 2008); Meade v. McVay (In re Meade), 384 B.R. 132 (W.D. Tex. 2008); United States Trustee v. Deadmond (In re Deadmond), 2008 WL 191165 (D. Mont. Jan. 22, 2008); Fokkena v. Hartwick (In re Hartwick), 373 B.R. 645 (D. Minn. 2007); In re Ross-Tousey, 368 B.R. 762 (E.D. Wis. 2007); In re Ransom, 380 B.R. at 807-08. But see In re Armstrong, 2008 WL 4426144 (E.D. Wash. Sep. 24, 2008) (permitting debtor to deduct the vehicle ownership expense even in the absence of loan or lease payments); In re Pearson, 390 B.R. 706 (B.A.P. 10th Cir. July 28, 2008) (same).

B. The appellate panel's interpretation of section 707(b)(2)(A)(ii)(I) suffers from four flaws the dissent's interpretation avoids: (a) conflating "applicable" with "actual," (b) rendering "applicable" superfluous, (c) misinterpreting the significance of the term "payments for debts" under section 707(b)(2)(A)(ii)(I), and (d) defining "applicable" inconsistently with its intended use in the immediately following subsection, 11 U.S.C. 707(b)(2)(A)(ii)(II).

The divided court below concluded section 707(b)(2)(A)(ii)(I) entitles debtors to claim vehicle ownership expenses even when they have no associated loan or lease payment. It did not read "applicable" as an eligibility requirement. Instead, it concluded that "applicable" simply directs debtors to pick out and use the dollar amounts set forth in tables published by the IRS, so all debtors can claim the expense amount for every vehicle they own. In re Kimbro, 389 B.R. at 524.

This interpretation suffers from at least four flaws:

First, it confuses the distinction between the words "actual" and "applicable" in section 707(b)(2)(A)(ii)(I). The panel ruled that conditioning an expense amount deduction upon the existence of an expense would require "applicable" to mean "actual" in section 707(b)(2)(A)(ii)(I). In re Kimbro, 389 B.R. at 523-24. The panel also noted that the term "applicable" is an adjective that modifies the "amounts specified" in the IRS Local Standards, and does not modify the "debtor's monthly expenses" which appears at the beginning of section 707(b)(2)(A)(ii)(I).

Id. at 524 quoting In re Chamberlain, 369 B.R. 519, 524 (Bankr. D. Ariz. 2007). This lead the panel majority to rule "applicable" cannot mean debtors must have an associated expense because that would give identical meaning to two different words Congress used in the same statute.

This conclusion fails to recognize the words "applicable" and "actual" have different meanings in section 707(b)(2)(A)(ii)(I) because "expense amounts" – the words following "applicable" in the statute – do **not** refer to "actual" costs. In re Hartwick, 373 B.R. at 650 (recognizing that a debtor's "actual" expense does not control the amount of the vehicle ownership deduction" under section 707(b)(2)(A)(ii)(I)).

To the contrary, vehicle expense amounts are static numbers drawn from the IRS Local and National Standards; they are not the debtor's actual vehicle ownership expenses. These fixed amounts are used regardless of the debtor's "actual" expenses. Id. They are the opposite of "actual" expenses.

Because "applicable" and "actual" have different meanings, the panel's concern about overlapping definitions was simply incorrect, and led to an incorrect reading of the statute. See In re Ross-Tousey, 368 B.R. at 765 (the United States' reading "gives meaning to the distinction between 'applicable' and 'actual' without taking a further step to conclude that 'applicable' means 'nonexistent' or 'fictional.'"); In re Thomas, 2008 WL 597586 at *4 (same); In re Meade, 382 B.R. at 798 (same).

The dissent understood this, as it explained that "Congress intended and used the phrases 'applicable monthly expense amounts' . . . and 'actual expenses' . . . simply in recognition of the differing ways in which the IRS uses the National Standards and Local Standards versus the Other Necessary Expense categories." In re Kimbro, 389 B.R. at 533 (Fulton, J., dissenting).

The panel's reading would be wrong, however, even if "applicable" and "actual" meant the same thing in section 707(b)(2)(A)(ii)(I). As the Supreme Court has recognized, there is nothing wrong with two different words within a single section being synonyms. Wachovia Bank v. Schmidt, 546 U.S. 303, 314 (2006) ("Congress may well have comprehended the words 'located' and 'established,' as used in [28 U.S.C.] § 1348, not as contrasting, but as synonymous or alternative terms"). Therefore, even should this Court conclude that "applicable" is synonymous with "actual" in section 707(b)(2)(A)(ii)(I), the Kimbros would remain ineligible for a vehicle ownership expense amount for their second vehicle because they have no "actual" ownership expenses associated with that vehicle.

Second, as the dissent below recognized, the panel's reading of "applicable" renders it superfluous. See In re Kimbro, 389 B.R. at 532-33 (Fulton, J., dissenting). Under the majority's reading, section 707(b)(2)(A)(ii)(I) would have the same meaning without the word "applicable" in it. Id. at 533.

The majority suggests the word instructs debtors to perform the "very simple task" of going to the IRS Standards referenced in section 707(b)(2)(A)(ii)(I) and "looking up" the standard dollar figure it establishes for a debtor's locality and for the number of vehicles the debtor has. Id. at 523.

But debtors would do the same thing if the word were not in the statute because the statute would then read "[t]he debtor's monthly expenses shall be the debtor's ~~applicable~~ monthly expense amounts" under the IRS standards. 11 U.S.C. 707(b)(2)(A)(ii)(I) (emphasis added). Striking out the word "applicable" would still lead the debtor to the same line under the Local Standards that the majority below suggests the word "applicable" exists to accomplish. In re Ross-Tousey, 368 B.R. at 765 (E.D. Wis. 2007) ("Had Congress intended to indiscriminately allow all expense amounts specified in the National and Local Standards, it would have written 707(b)(2)(A)(ii)(I) [without using the word 'applicable.']"); In re Ransom, 380 B.R. at 808 (concluding that the Debtors' construction would "read[]

'applicable' right out of the Bankruptcy Code"); In re Deadmond, 2008 WL 191165 at *4 ("The word ['applicable] must mean something, and if some monthly expenses are applicable, then other monthly expenses are not applicable.").

Because the panel's reading renders "applicable" superfluous, the word must have a different meaning than the one the court ascribed. See generally Cooper Indus., Inc. v. Aviall Servs., Inc., 543 U.S. 157, 167 (2004)(courts "must, if possible, construe a statue to give every word some operative effect"); United States v. Page, 131 F.3d 1173, 1180 (6th Cir. 1997) ("It is well settled law that statutory constructions that render portions of a statute superfluous are to be avoided."), cert. denied, 525 U.S. 828 (1998). As we explain above, the word "applicable" does have a different meaning. Under its dictionary meaning, the word exists to allow debtors to claim a standard vehicle expense amount that is inapplicable because they have a loan or lease expense.

Third, the panel's interpretation of "applicable" was premised, in part, on the proviso within section 707(b)(2)(A)(ii)(I) providing that "the monthly expenses of the debtor shall not include payments for debts." The majority below concluded that "[t]his provision alone establishes beyond doubt that Congress intended to allow an ownership expense even when a debtor has no debt payment on a vehicle" because otherwise, "there would be no reason for this limitation." In re Kimbro, 389 B.R. at 523.

This reading misinterprets the term "payments for debts." Debtors for whom the ownership expense is applicable receive a fixed standard allowance that is the dollar amount under the applicable standard. This is not a "payment for a debt." Cf. 11 U.S.C. 707(b)(2)(A)(iii) (which allows an expense deduction for a debtor's actual average monthly secured debt payments to creditors).

The "payment for debts" language exists instead to ensure debtors do not double-deduct their actual payments for debts under section 707(b)(2)(A)(ii)(I) and then claim overlapping expenses for certain categories in the IRS's Other Necessary Expenses, such as secured debt payments and repayment of delinquent tax debts, as those are already allowed elsewhere under the means test. See IRS Internal Revenue Manual, Financial Analysis Handbook, Pt. 5, ch. 15, § 5.15.1.10, available at http://www.irs.gov/irm/part5/ch15s01.html#d0e195695 (listing categories of Other Necessary Expenses). See also 707(b)(2)(A)(iii) (permitting deduction for secured debts under the means test) and 707(b)(2)(A)(iv) (permitting deduction for tax debts under the means test). And it also ensures debtors do not deduct their student loan payments under the means test, even though the IRS categorizes them as an “Other Necessary Expense.” See In re Knight, 370 B.R. 429, 436-37 (Bankr. N.D. Ga. 2007) (concluding that the plain language of section 707(b)(2)(A)(ii) “precludes deduction” of student loan payments as an expense under the means test.

Fourth, and significantly, the United States’ reading permits an interpretation of “applicable” in section 707(b)(2)(A)(ii)(I) that is consistent with the meaning of the same word in the immediately following subsection. This is consistent with “the ‘normal rule of statutory construction’ that ‘identical words used in different parts of the same act are intended to have the same meaning.” Gustafson v. Alloyd Co., Inc., 513 U.S. 561, 570 (1995) (quoting Dep’t of Revenue v. ACF Indus., Inc., 510 U.S. 332, 342 (1994).

Specifically, we interpret “applicable” in section 707(b)(2)(A)(ii)(I) to mean capable of being applied or appropriate. Webster’s Third New International Dictionary at 105 (1981).

The immediately following subsection, 707(b)(2)(A)(ii)(II), uses the word “applicable” in precisely the same way - i.e., debtors get expenses when they actually incur them. It provides, in relevant part, that “the debtor’s monthly expenses may include, *if applicable*, the continuation of *actual* expenses paid by the debtor . . . for care and support of an elderly, chronically ill, or disable household member or member of the debtor's immediately family. . . ." 11 U.S.C. 707(b)(2)(A)(ii)(II) (emphasis added).

Subsections (I) and (II) use "applicable" for different purposes, *i.e.*, subsection (I) allows expense amounts under the IRS Standards and (II) allows actual expenses. But clearly in the latter, Congress intended to allow debtors expenses only if they apply to that particular debtor. Under accepted rules of statutory construction, the same meaning of "applicable" in 707(b)(2)(A)(ii)(II) should be given to the word in 707(b)(2)(A)(ii)(I).

II. Reading section 707(b)(2)(A)(ii)(I) to limit vehicle ownership expense amounts to debtors with loan or lease payments fulfills two goals Congress expressed in enacting the 2005 Act: ensuring that above-median-income debtors repay their debts when they can, and eliminating abuse.

A. Congress passed the 2005 Act to maximize debtor repayment to creditors and to eliminate opportunities for bankruptcy abuse.

1. In interpreting "applicable" in section 707(b)(2)(A)(ii)(I), this Court may look to its legislative history to determine the statute's objectives and illuminate its text. United States v. Markwood, 48 F.3d 969, 975 n. 7 (6th Cir. 1995) (finding that "when a term is undefined or its meaning unclear from the context of the statute, it is our duty to examine the legislative history in order to render an interpretation that gives effect to Congress's intent.").

2. The "heart" of the 2005 Act is the means test, which seeks to "ensure that debtors repay creditors the maximum they can afford." H.R. Rep. No. 109-31 (I), at 1 (2005), reprinted in 2005 U.S.C.C.A.N. 88, 89.[6] See also Schultz v. United States 529 F.3d 343, 347 (6th Cir. 2008) ("The centerpiece of the [2005 Act] is the imposition of a 'means test' for chapter 7 filers."). Cf. In re Thomas, 382 B.R. at 798 ("If a debtor were permitted a car ownership allowance when he actually incurs no such expense, application of the means test would not accurately reflect the debtor's ability to repay creditors, and the purpose of the statue would be frustrated.").

Congress felt this aspect of bankruptcy reform legislation was so important that it included this language in the very first paragraph of the legislative history. H.R. Rep. No. 109-31 (I), at 1 (2005), reprinted in 2005 U.S.C.C.A.N. 88, 89. Congress saw fit to reiterate this point when it addressed this specific provision in the legislative history. Id. at 97 - 100. Given how important this was to Congress, the statute should be interpreted in accordance the overarching goal that underpins the 2005 Act.

And this underscores another flaw in the panel's reasoning – that the purpose

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[6] There is no Senate Report or Conference Report to the 2005 Act.

of the statute was to adopt a mechanical test. See In re Kimbro 389 B.R. at 527 (noting that "the purpose of the means test" was "to adopt a uniform, bright-line test that eliminates judicial discretion").

That is not what the legislative history indicates Congress was doing. To the contrary, Congress enacted the statute to require debtors to make repayments when they were able. H.R. Rep. No. 109-31 (I), at 1 (2005), reprinted in 2005 U.S.C.C.A.N. 88, 89.

The panel thus confused the purpose of the statute - to increase creditor recoveries - with the fact that Congress employed a number of methods, including non-mechanical methods, to achieve that goal.[7]

And, significantly, Congress also used non-mechanical methods in section 707 to determine other aspects of a debtor's expenses. For example, in calculating disposable income under section 707(b)(2), multiple provisions permit debtors to claim non-standard "reasonable and necessary" expenses for a host of categories, including health insurance, disability insurance, health savings accounts, amounts to care for elderly, chronically ill or disabled household and family members, home

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[7] Many Reform Act provisions are non-mechanical. See, e.g., 11 U.S.C. 1112(b) (authorizing conversion or dismissal of a chapter 11 case).

energy costs in excess of amounts allowed under the IRS Local Housing Standards, expenses to maintain the family's safety from domestic violence, and amounts for children under 18 to attend a private or public elementary or secondary school. *See* 11 U.S.C. 707(b)(2)(A)(ii)(I) - (IV). In addition, debtors who, prior to filing for bankruptcy, fall behind on their mortgage or car payments and intend to keep the property, may claim expenses necessary to retain the property under a chapter 13 repayment plan. 11 U.S.C. 707(b)(2)(A)(iii)(II). None of these are mechanical.

3. In any event, the United States' interpretation is no more or less mechanical than the panel's. Both employ the same arithmetical calculation. The United States simply would allow debtors without a loan or lease payment $0 for vehicle ownership expenses under the Local Standards, while the panel would allow the full amount. Neither approach is more mechanical than the other.

4. Finally, the 2005 Act also seeks to eliminate "loopholes and incentives" in the system "that allow and – sometimes – even encourage opportunistic personal filings and abuse." H.R. Rep. No. 109-31 (I), at 5, 2005 U.S.C.C.A.N. at 92.

Thus, ensuring that above-median-income debtors claim vehicle ownership expense amounts only when they have associated ownership expenses fulfills

Congress' intent that such debtors repay their debts when they are able. See In re Ross-Tousey, 368 B.R. at 766 ("The statute is only concerned about protecting the debtor's ability to continue owning a car, and if the debtor already owns the car, the debtor is adequately protected."); In re Hartwick, 373 B.R. at 652 (same); In re Ransom, 380 B.R. at 807 ("[W]hat is important is the payments that debtors actually make, not how many cars they own, because the payments that debtors make are what actually affect their ability to make payments to their creditors."); Babin v. Wilson, 383 B.R. at 733 (for above-median-income chapter 13 debtors, the "purpose" of the 2005 Act was to "require" such debtors "to make more funds available to their unsecured creditors").

B. The Appellate Panel's interpretation of section 707(b)(2)(A)(ii)(I) would yield inequitable results not contemplated by Congress.

The panel's interpretation of section 707(b)(2)(A)(ii)(I) yields unfair results not contemplated by Congress.[8] Under the appellate panel's reading of section 707(b)(2)(A)(ii)(I), a higher-income debtor with an inoperable car "rusting away in

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[8] By allowing the Kimbros to deduct monthly ownership expense amounts for nonexistent costs in calculating disposable income, the bankruptcy court's interpretation of section 707(b)(2)(A)(ii)(I) would reduce payments to creditors by approximately $16,000 over 60 months.

his backyard" could claim the ownership expense amount simply because the car is an "automobile" and he "owns" it. In re Ross-Tousey, 368 B.R. at 768. This statutory reading has been rejected by lower appellate courts because it "defies common sense." In re Deadmond, 2008 WL 191165 at *4. See also In re Ross-Tousey, 368 B.R. at 766 (when a debtor "has no monthly ownership expenses, it makes no sense to deduct an ownership expense to shield it from creditors.").

III. Barring above-median-income debtors from claiming phantom vehicle ownership expenses implements sound bankruptcy policy.

A. Reading section 707(b)(2)(A)(ii)(I) to limit vehicle ownership expenses to debtors with a loan or lease payment is fair to debtors and creditors.

Reading section 707(b)(2)(A)(ii)(I) to limit vehicle ownership expense amounts to debtors with a loan or lease payment is fair. This is so because it establishes a threshold – the existence of vehicle loan or lease payments – for claiming a standardized ownership expense amount, one that is consistent for all chapter 13 debtors.

Significantly, section 1325(b)(2) independently requires below-median-income debtors to incur an expense to claim a deduction. See 11 U.S.C. 1325(b)(2) (allowing such debtors only "reasonably necessary" expenses).

Reading "applicable" as requiring above-median-income debtors to have an associated expenses means the above-median-income debtors will not be able to claim phantom expenses that less wealthy debtors cannot.

Nor does our interpretation otherwise adversely affect below-median income debtors – those most likely to file bankruptcy petitions – because such debtors are not subject to section 707(b)(2)(A)(ii)(I) in the first place. See 11 U.S.C. 1325(b)(3). These below-median-income debtors represent approximately 73% of the men and women who seek chapter 13 protection.[9]

Similarly, in chapter 7 bankruptcies, section 707(b)(2)(A)(ii)(I) only applies to the 10% of debtors with above-median incomes.[10] See Schultz v. United States,

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[9] There were 307,521 non-business chapter 13 cases filed in fiscal year 2007. See U.S. Courts, Bankruptcy Statistics, 2007 Fiscal Year by Chapter, available at http://www.uscourts.gov/bnkrpctystats/sept2007/f2table.xls. Of these cases, the United States estimates that 83,030 cases may have been filed by above-median-income debtors. The United States' estimate is based on a 2006 survey conducted by RAND across a sample of nine judicial districts that estimated that 27% of chapter 13 cases were filed by above-median-income debtors. See The Bankruptcy Abuse and Consumer Protection Act of 2005: Evaluation of the Effects of Using IRS Expense Standards to Calculate a Debtor's Monthly Disposable Income, RAND Institute for Civil Justice at x, 23, available at www.usdoj.gov/ust/eo/public_affairs/reports_studies/index.htm.

[10] During fiscal year 2007, according to data collected by the U.S. Trustee Program, 451,012 non-business chapter 7 cases were filed nationwide, excluding the judicial districts in Alabama and North Carolina, whose data were not collected. Of these cases, only 10% had above-median incomes and were thereby subject to the means test and the requirements of section 707(b)(2)(A)(ii)(I).

529 F.3d 343, 347 (6th Cir. 2008) (noting that under 11 U.S.C. 707(b)(7), the presumption of abuse cannot arise with respect to below-median-income debtors).

Our interpretation is also fair to creditors. Congress enacted the 2005 Act because under prior law "some bankruptcy debtors are able to repay a significant portion of their debts" but were not required to do so. H.R. Rep. No. 109-31 (I), at 5 (2005), reprinted in 2005 U.S.C.C.A.N. 88, 92. Our interpretation of section 707(b)(2)(A)(ii)(I) ensures that above-median-income debtors will not avoid repaying their debts by claiming expense amounts when those debtors have no associated expense.

B. Other Bankruptcy Code provisions adequately protect above-median-income debtors who own vehicles, but lack vehicle ownership expenses.

Under our reading of section 707(b)(2)(A)(ii)(I), at least two safety valves are available to prevent hardships against above-median-income debtors who own vehicles but have no vehicle ownership expenses.

First, every debtor who owns a vehicle, whether or not it is subject to a loan or lease payment, receives an unrelated vehicle operating expense under the IRS Local Standards. Operating expenses include vehicle insurance, maintenance, fuel, state and local registration, required inspection, parking fees, tolls, and driver's license fees. The majority opinion below incorrectly characterized many of these "operating expenses" as "ownership expenses" and failed to acknowledge that all debtors who incur operating expenses receive the operating expense allowance under the IRS Local Standards. In re Kimbro, 389 B.R. at 531. Indeed, the Kimbros claimed $332 in monthly vehicle operating expenses for their two vehicles, in addition to claiming ownership expenses for their vehicles.

And, debtors who own unencumbered vehicles that are six or more years old or have 75,000 or more miles, also receive an additional $200 in monthly vehicle expense deduction per vehicle under the IRS framework. See IRS Internal Revenue Manual, Pt. 5, ch. 8, § 5.8.5.5.2 ("Treatment of Non-Business Transportation Expenses"), available at http://www.irs.gov/irm/part5/ch08s05.htm. See also In re Ransom, 380 B.R. at 808 (recognizing $200 additional allowance); In re Hartwick, 373 B.R. at 652 (same); Babin v. Wilson, 383 B.R. at 734 (same).

Second, if any debtor needs a new vehicle during the course of his chapter 13 plan, the debtor can move to modify his plan to reduce payments to creditors to account for the new expense. See 11 U.S.C. 1329(a); Babin v. Wilson, 383 B.R. 729, 734 (B.A.P. 8th Cir. 2008) ("[I]n the event a debtor needs a new car during the course of a case, the debtor can move to modify the plan based on changed circumstances."). For debtors who require a new vehicle, plan modification is appropriate because financing the vehicle usually indicates a substantial change in a debtor's ability to pay that was not already taken into account at the time of plan confirmation. Cf. In re Storrey, 392 B.R. 266, 272 (B.A.P. 6th Cir. 2008) (plan modification possible if a debtor's circumstances change following plan confirmation).

CONCLUSION

For these reasons, the United States respectfully asks this Court to reverse the order of the United States Bankruptcy Appellate Panel for the Sixth Circuit and remand with instructions that the panel remand this case to the bankruptcy court with instructions that it deny confirmation of the Kimbros' plan.

Respectfully submitted,

/s/ P. Matthew Sutko, Esq.

RAMONA D. ELLIOTT
General Counsel

P. MATTHEW SUTKO
Associate General Counsel

DAVID A. LEVINE
Executive Office for United States Trustees
Department of Justice
20 Massachusetts Avenue, N.W.
Washington, D.C. 20530
Telephone: (202) 307-1399
Facsimile: (202) 307-2397
E-mail: p.matthew.sutko@usdoj.gov
COUNSEL FOR THE UNITED STATES

CERTIFICATE OF COMPLIANCE WITH FED. R. APP. P. 32(a)

I hereby certify that the foregoing brief complies with the typeface requirements in Fed. R. App. P. 32(a)(5), the page and type-volume limitation in Fed. R. App. 32(a)(7). I also certify that the foregoing brief is proportionately spaced, using Times Roman font, 14 point type. Based on a word count under Corel Word Perfect 12, this brief contains 6,667 words excluding the table of contents, table of authorities, addenda, and certificates of counsel.

/s/ P. Matthew Sutko, Esq.
P. Matthew Sutko
Attorney for the United States
as Amicus Curiae

CERTIFICATE OF SERVICE

I hereby certify that on October 7, 2008, I served the foregoing Brief for the United States as *Amicus Curiae* in Support of Reversal on the following by sending two copies of the brief by Federal Express, to:

Henry E. Hildebrand, III, Esq.
Chapter 13 Bankruptcy Trustee's Office
P.O. Box 190664
Nashville, TN 37219-0664
Appellant / Chapter 13 Trustee

Mary Elizabeth Ausbrooks, Esq.
Clark & Washington, P.C.
237 French Landing Dr.
Nashville, TN 37228
Counsel for Debtors, Ralph and Patricia Ann Kimbro

/s/ P. Matthew Sutko, Esq.
P. Matthew Sutko
Attorney for the United States
as Amicus Curiae

BRIEF BANK — "SUMMARY SHEET"

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WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*
In re: Robert D. Klages (UST v. Robert D. Klages)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*
8th Cir. B.A.P.

3. ("CCN") ***CURRENT*** CASE NO.
No.: 07-cv-6051

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*
No.: 06-30189-wle
Court: Bankr. S. Iowa
(Identify judge & cite, if any)

5. ("SO") ***SOURCE***
U.S. TRUSTEES

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*
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P. Matthew Sutko, David I. Gold, Robert Gainer, Habbo Fokkena
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s)

&

√ Any Miscellaneous ***BACKGROUND***

- Whether the bankruptcy court committed clear error in revoking the debtor's discharge under 11 U.S.C. § 727(d)(2).

√ **Background:**

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BEFORE THE UNITED STATES BANKRUPTCY APPELLATE PANEL FOR THE EIGHTH CIRCUIT

07-6051

In re Robert D. Klages

Habbo Fokkena, United States Trustee for Region 12,

Appellee

v.

Robert D. Klages,

Appellant

Appeal from the United States Bankruptcy Court for the Southern District of Iowa
(06-30189-wle)

BRIEF OF APPELLEE

HABBO FOKKENA,
UNITED STATES TRUSTEE FOR
REGION 12

By: /S/ Robert Gainer
ROBERT C. GAINER
Trial Attorney
Office of the United States Trustee
United States Department of Justice
210 Walnut Street, Suite 793
Des Moines, IA 50309-2108
(515)284-4982

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I. TABLE OF AUTHORITIES

STATEMENT CONCERNING ORAL ARGUMENT

The United States Trustee does not seek oral argument. However, should the Debtor request it, and should the Court determine that oral argument is necessary, the United States Trustee requests equal time to that provided to the Debtor.

JURISDICTIONAL STATEMENT

The United States Trustee invoked the bankruptcy court's jurisdiction in this proceeding under 28 U.S.C. §§ 157 and 1334, and 11 U.S.C. § 727(d). (R. 4) On August 2, 2007, the bankruptcy court entered a final order revoking the Debtor's discharge. (R. 2; R. 3) On August 10, 2007, the Debtor timely filed a notice of appeal under 28 U.S.C. § 158(c)(2) and Fed. R. Bankr. P. 8002(a). (R. 1) This Court has jurisdiction over this appeal under 28 U.S.C. §§ 158(a) and 158(b).

STATEMENT OF THE ISSUES

The issue before this Court is whether the bankruptcy court committed clear error in revoking the Debtor's discharge under 11 U.S.C. § 727(d)(2).

STATEMENT OF THE CASE

On October 10, 2005, the Debtor, through counsel, filed a voluntary petition for relief under the liquidation provisions of chapter 7 of the Bankruptcy Code. (R. 6) Shortly thereafter, Mr. Thomas L. Flynn ("Trustee") was appointed as the Debtor's chapter 7 trustee. (R. 6) On November 15, 2005, the Trustee conducted the Debtor's meeting of creditors under Section 341 of the Bankruptcy Code. (R. 6; R. 13) The Debtor was orally admonished at that meeting not to spend any tax refunds he might receive. (R. 5, at 9:19-10:9, 10:19-10:22, 28:1-28:10.) Further, the Debtor was provided with a written warning instructing him not to spend any tax refunds absent Trustee approval, and requesting that he provide the Trustee with copies of his 2005 Federal and State tax returns (the "2005 Tax Returns"). (R. 5, at 9:9-10:17; R. 14) On January 18, 2006, the bankruptcy court entered an order discharging the Debtor of all of his dischargeable debts. (R. 6) On February 6, 2006, the Debtor filed his 2005 Tax Returns. (R. 8)

The 2005 Tax Returns requested a refund, which the Debtor promptly received and spent. (R. 5, at 30:13-30:17; R. 8) On June 21, 2006, following the Debtor's failure to appear at an examination pursuant to Fed. R. Bankr. P. 2004, and the Trustee's receipt of copies of the 2005 Tax Returns, the Trustee made demand upon the Debtor for the estate's portion of his 2005 tax refunds. (R. 5, at 12:4-15:16) When the refunds were not forthcoming, and the Debtor failed to appear at a second examination, the United States Trustee filed a complaint (the "Complaint") seeking the revocation of the Debtor's discharge under Sections 727(d)(2) and (3) of the Bankruptcy Code. (R. 4; R. 5, at 15:19-17:1; R. 6) On July 26, 2007, the bankruptcy court conducted a trial on the Complaint and took the matter under advisement. (R. 3, at 1) Shortly thereafter, on August 2, 2007, the bankruptcy court entered an order and written opinion revoking the Debtor's discharge under Section 727(d)(2) of the Bankruptcy Code.[1] (R. 2; R. 3) It is from that order that the Debtor now appeals.[2] (R. 1)

STATEMENT OF THE FACTS

A. Statutory Background

Under chapter 7, "an individual debtor receives an immediate unconditional discharge of personal liability for certain debts in exchange for relinquishing his or her nonexempt assets to a bankruptcy trustee for liquidation and distribution to creditors." H.R. Rep. 109-31(I), at 10; *see* 11 U.S.C. §§ 701–727. A debtor's bankruptcy estate generally includes all legal or equitable

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[1] The bankruptcy court also denied the United States Trustee's request for relief with respect to the Section 727(d)(3) portion of the Complaint. (R. 3)

[2] The Debtor has failed to comply with L.R. B.A.P. 8th Cir. 8001B(b)(3) and Fed. R. Bankr. P. 8009(b). *See* L.R. B.A.P. 8th Cir. 8001A(c).

interests of a debtor in non-exempt property as of the commencement of a case, and a debtor has a duty to surrender such property to his bankruptcy trustee.[3] *See* 11 U.S.C. §§ 521, 541 and 542. To the extent a debtor acquires property of the estate after the entry of his discharge, but knowingly and fraudulently fails to surrender such property to his bankruptcy trustee, his discharge must be revoked. *See* 11 U.S.C. § 727(d)(2).

B. The Proceedings Below

On October 10, 2005, the Debtor, through counsel, filed a voluntary petition for relief under the liquidation provisions of chapter 7 of the Bankruptcy Code. (R. 6) The Debtor filed his petition together with his bankruptcy Schedules A-J and Statement of Financial Affairs. (R. 6) The Debtor listed no real property on his Schedule A. (R. 12) He valued his cash, household goods, and apparel at $3,100.00 on his Schedule B. (R. 12) He fully exempted each of these items on his Schedule C. (R. 12) The Debtor listed no secured or priority creditors on his Schedules D and E. (R. 12) On his Schedule F, the Debtor listed $8,308.12 in general unsecured creditors. (R. 12) Finally, the Debtor's Statement of Financial Affairs listed no payments to creditors within the 90 days prior to the filing of his petition, and no payments to insiders, executions, garnishments, attachments, or transfers within the 1 year period prior to the filing of his petition. (R. 12)

On November 15, 2005, the Debtor's Trustee conducted the Debtor's meeting of creditors under Section 341 of the Bankruptcy Code. (R. 6; R. 13) At that meeting, the Debtor

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[3] Such property may eventually leave the estate if is abandoned by the Trustee. *See* 11 U.S.C. §§ 544(b) and (c). However, that did not occur in this case. (R. 6).

was examined under oath. (R. 13) Among other things, the Trustee inquired regarding the Debtor's receipt of tax refunds. (R. 13, at 5:10-5:17) The Debtor was orally admonished not to spend any tax refunds he might receive. (R. 5, at 9:19-10:9, 10:19-10:22, 28:1-28:10) Moreover, the Debtor was provided with a one-page handout (the "Handout") warning him not to spend any tax refunds absent Trustee approval, and requesting that he provide the Trustee with copies of his Tax Returns once filed. (R. 5, at 9:9-10:17; R. 14) The Handout set out the following language in bold typeface: "**<u>Warning</u>: Do <u>not</u> spend <u>any</u> of your tax refunds until you have received approval from my office, even if you have received notice from the Bankruptcy Court that a bankruptcy discharge has been entered. The bankruptcy discharge does not close your bankruptcy case or eliminate your need to turn over non-exempt assets.**" (R. 14) (bold and underlining in original) The Debtor took the Handout home with him. (R. 5, at 53:2-53:14) He claims he did not read it. (R. 5, at 53:2-53:14)

On January 18, 2006, the bankruptcy court entered an order (the "Discharge Order") discharging the Debtor of all of his dischargeable debts.[4] (R. 6) The Discharge Order was silent with respect to the subject of turnover and advised the Debtor that "[b]ecause the law is complicated, you may want to consult an attorney to determine the exact effect of the discharge in this case." *See* Official Bankruptcy Form B-18. However, rather than contacting his attorney regarding this subject, as the Discharge Order advised, the Debtor testified he assumed his bankruptcy case was a "done deal" and that he had no further obligations in this case. (R. 5, at 28:1-29:16)

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[4] The Discharge Order was served on the Debtor, at his address of record, on January 21, 2006. (R. 6)

On February 6, 2006, the Debtor filed his 2005 Tax returns. (R. 8) The 2005 Tax Returns requested refunds in the aggregate amount of $3,510.00. (R. 8) Shortly thereafter, the Debtor received his refunds and, unbeknownst to the Trustee, used the money to pay off debts and bills. (R. 5, at 30:13-30:17)

On June 5, 2006, having failed to receive copies of the 2005 Tax Returns as requested in the Handout, the Trustee filed a motion for examination of the Debtor pursuant to Fed. R. Bankr. P. 2004. (R. 6; R. 7) On June 6, 2006, the bankruptcy court entered an order granting the Trustee's 2004 examination request. (R. 6) Although the Debtor failed to appear at the scheduled 2004 examination, the Debtor did, shortly thereafter, tender copies of the 2005 Tax Returns to the Trustee. (R. 5, at 12:4-12:24) Based on those returns, the Trustee was able to calculate that $1,556.11 of the $3,510.00 in taxes previously refunded to the Debtor (the "Tax Refunds") constituted property of the Debtor's bankruptcy estate. (R. 5, at 15:3-15:9, 16:23-17:1)

On June 21, 2006, the Trustee made demand upon the Debtor for the Tax Refunds. (R. 5, at 12:4-15:16) When the money was not forthcoming, the Trustee sought to examine the Debtor once again. (R. 6; R. 10) That same day, the bankruptcy court entered an order granting the Trustee's second examination request. (R. 6) However, when the Debtor failed to appear at his second scheduled examination, and failed to tender the Tax Refunds to the Trustee, the United States Trustee, on September 26, 2006, initiated the instant proceeding seeking to revoke the Debtor's discharge under Sections 727(d)(2) and (3) of the Bankruptcy Code. (R. 4; R. 5, at 15:19-17:1; R. 6) On July 26, 2007, the bankruptcy court conducted a trial on the matter, at which the Debtor was represented by counsel, and at which both the Debtor and the Trustee testified. (R. 5) The bankruptcy court took the matter under advisement, and on August 2, 2007, entered an order and written opinion revoking the Debtor's discharge under Section 727(d)(2) of the Bankruptcy Code. (R. 2; R. 3)

In its written opinion, the bankruptcy court expressly found that "[the] Trustee . . . orally cautioned [the Debtor] not to spend any 2005 tax refunds without talking to his office, even if the discharge were granted." (R. 3, at 7) Further, the bankruptcy court found that "[the Trustee] gave [the Debtor] a written warning, which provided in bold type the warning that he should not spend any of his tax refunds 'even if you have received notice from the Bankruptcy Court that a bankruptcy discharge has been entered.'" (R. 3, at 7) Finally, the bankruptcy court found that "in light of the warnings, [the Debtor's] testimony that he believed he could spend the refunds [was] not credible." (R. 3, at 7)

STANDARD OF REVIEW

A bankruptcy court's findings of fact are reviewed for clear error and its legal conclusions are reviewed de novo. *See Four B. Corp. v. Food Barn Stores, Inc. (In re Food Barn Stores, Inc.)*, 107 F.3d 558, 561 (8th Cir. 1997). Findings of fact shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the bankruptcy court to judge the credibility of witnesses. *See Richardson v. Sugg*, 448 F.3d 1046, 1052 (8th Cir. 2006); Fed. R. Bankr. P. 8013.

ARGUMENT

Section 727(d)(2) of the Bankruptcy Code provides for the revocation of a debtor's discharge if the debtor acquires property of the estate and knowingly and fraudulently fails to deliver such property to his trustee. *See* 11 U.S.C. § 727(d)(2). Here, the bankruptcy court, after a full evidentiary hearing on the matter, determined that the Debtor acquired property of the estate in the form of the Tax Refunds, and knowingly and fraudulently failed to surrender them to his Trustee. The bankruptcy court made such a determination after considering all of the facts and circumstances in this case, including: (a) repeated warnings provided to the Debtor not to spend his tax refunds, and (b) the Debtor's argument that once his discharge was entered he assumed his bankruptcy case was a "done deal" and had no further obligations in this case. Ultimately, the bankruptcy court found that "in light of the warnings, [the Debtor's] testimony that he believed he could spend the refunds [was] not credible." (R. 3, at 7) Such a determination should be given great weight by this Court, and should only be set aside if clearly erroneous. *See Richardson v. Sugg*, 448 F.3d at 1052; Fed. R. Bankr. P. 8013.

As demonstrated below, nothing in the record before this Court indicates that the bankruptcy court committed clear error in concluding that the Debtor's discharge should be revoked. Accordingly, this Court should affirm the bankruptcy court's order revoking the Debtor's discharge.

First, the bankruptcy court properly concluded that the Tax Refunds constituted property of the Debtor's bankruptcy estate. Under Section 541(a) of the Bankruptcy Code, the commencement of a voluntary case under Section 301 of the Bankruptcy Code creates an estate. *See* 11 U.S.C. § 541(a). A bankruptcy estate is generally comprised of all of a debtor's legal and equitable interests in property as of the commencement of a case. *Id.* This includes contingent interests in future payments such as a debtor's anticipated tax refund. *See In re Benn*, 491 F.3d 811, 813 (8th Cir. 2007); *Barowsky v. Serelson (In re Barowsky)*, 946 F.2d 1516, 1517-18 (10th Cir. 1991); *Turshen v.* Chapman, 823 F.2d 836, 838 (4th Cir. 1987); Doan *v. Hudgins (In re*

Doan), 672 F.2d 831 (11th Cir. 1982); *see also Kokoszka v. Belford*, 417 U.S. 642, 645-48 (1974)(Bankruptcy Act case). Here, the Debtor commenced this case on October 10, 2005. Accordingly, any tax refunds associated with the period January 1, 2005 through October 10, 2005 constituted property of the Debtor's bankruptcy estate.

Second, the bankruptcy court properly concluded that the Debtor had a duty to report and surrender the Tax Refunds to his Trustee. *See In re Kasden*, 209 B.R. 239, 243-44 (B.A.P. 8th Cir. 1997); *Turshen v.* Chapman, 823 F.2d at 838-39*; In re Markey*, – B.R. – , 2007 WL 3170187, at *6 (Bankr. D. Minn. October 29, 2007); 11 U.S.C. §§ 521(a)(4) and 542(a).

Lastly, the bankruptcy court did not commit clear error in determining that the Debtor knowingly and fraudulently failed to surrender the Tax Refunds to his Trustee. While there is no question that the Debtor spent the Tax Refunds for his own personal use (R. 5, at 30:13-30:17), and therefore failed to surrender them to his Trustee (R. 5, at 16:23-17:1), the Debtor professes to have done so under the alleged belief that once his discharge was entered he had no further obligations in this case. (R. 5, at 28:1-29:3) The bankruptcy court considered this explanation and rejected it.

Specifically, the bankruptcy court found that in light of the repeated oral and written warnings provided to the Debtor not to spend such refunds, the Debtor's statement indicating an entitlement to them based on the entry of his discharge was not credible. (R. 3, at 7) In doing so, the bankruptcy court noted that "[the] Trustee . . . orally cautioned [the Debtor] not to spend any 2005 tax refunds without talking to his office, even if discharge were granted." (R. 3, at 7) Further, the bankruptcy court noted that "[the Trustee] gave [the Debtor] a written warning, which provided in bold type the warning that he should not spend any of his tax refunds ‘even if you have received notice from the Bankruptcy Court that a bankruptcy discharge has been entered.’” (R. 3, at 7) Moreover, the Discharge Order upon which the Debtor professes to have relied is silent with respect to the subject of turnover – a matter of no small import when one considers that the Discharge Order advised the Debtor to consult with counsel to determine the effects of his discharge and the Debtor ignored that advice.[5] *See* Official Bankruptcy Form B-18; (R. 5, at 28:1-29:16) Accordingly, since the bankruptcy court's account of the evidence in this case is plausible in light of the record viewed in its entirety, it’s ruling must be upheld on appeal. *See Anderson v. Bessemer City*, 470 U.S. 564, 573-4 (1985); *Rogers v.* Kelly, 866 F.2d 997, 1000 (8th Cir. 1989); *Forbes v. Forbes (In re Forbes)*, 215 B.R. 183, 187 (B.A.P. 8th Cir. 1997); *see also* HSBC *Bank USA v. F & M Bank Northern Va.*, 246 F.3d 335, 338 (4th Cir. 2001); *W.H. Scott Const. Co., Inc. v. City of Jackson, Miss.*, 199 F.3d 206, 219 (5th Cir. 1999); *Metzler v. IBP, Inc.*, 127 F.3d 959, 965 (10th Cir. 1997).

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[5] As previously noted, the Debtor was represented by bankruptcy counsel at the time.

CONCLUSION

For these reasons, the United States Trustee respectfully asks the Court to affirm the order entered below.

Respectfully submitted this 20th day of November, 2007.

HABBO FOKKENA,
UNITED STATES TRUSTEE
Regions 9 and 12

By: /S/ Robert Gainer
Robert C. Gainer
Trial Attorney
210 Walnut Street, Suite 793
Des Moines, IA 50309-2108
(515)284-4982

CERTIFICATE OF SERVICE

I certify that a copy of the foregoing document to which this certificate is attached, was sent to the parties or attorneys of record, shown below on November 20, 2007.

Parties receiving hand or mailed service:

Robert D. Klages
56619 200th Avenue
Lacona, IA 50139

By:/s/Shelly W. Fellner
Shelly W. Fellner
Legal Clerk
Office of the United States Trustee

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WESTLAW CODES

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[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]
Stuart v. Koch

2. ("CO") CURRENT COURT
[E.g., "CTA9"]
CA8

3. ("CCN") CURRENT CASE NO.
No.: 96-1541

4. ("PCN") PRIOR CASE NO. & COURT
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Court: USDC D SD
(Identify judge & cite, if any)

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Paul W. Bridenhagen, Esq., OGC/DOJ
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") TOPIC
BANKRUPTCY

9. ("SU") • SUMMARY OF KEY ISSUE(s)
&
√ Any Miscellaneous BACKGROUND

• Whether the bankruptcy and the district courts erred in holding that disability payments to one of the debtors could be considered in determining whether to dismiss a case for substantial abuse pursuant to §707(b).

√ **Background:**

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DATE: Tue.-5/4/4 (15:03)

UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

NO. 96-1541

BARBARA G. STUART, UNITED STATES TRUSTEE,

Appellant,

v.

EUGENE WAYNE KOCH and DEBRA MARIE NELSON-KOCH

Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF SOUTH DAKOTA
SOUTHERN DIVISION

District Court No. 94-4265

BRIEF OF THE UNITED STATES TRUSTEE, APPELLANT
(oral argument requested)

BARBARA G. STUART
United States Trustee

BRUCE J. GERING
Assistant United States Trustee

MARTHA L. DAVIS
General Counsel

PAUL W. BRIDENHAGEN
Attorney
Executive Office for
United States Trustees
901 E Street, N.W., Suite 780
Washington, D.C. 20530

SUMMARY AND REQUEST FOR ORAL ARGUMENT

This appeal arose from a decision of the bankruptcy court in the District of South Dakota denying the United States Trustee's Motion to Dismiss for Substantial Abuse pursuant to 11 U.S.C. § 707(b). The bankruptcy court denied the United States Trustee's motion, holding that certain disability payments received by debtor Eugene Wayne Koch could not be considered in applying the "ability to pay" test set forth in In re Fonder, 974 F.2d 981 (8th Cir. 1989).

Oral argument is requested because the issue of law raised in this appeal appears far more technical than it really is and the resolution of this issue would be facilitated by oral argument.

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ADDENDUM

TABLE OF AUTHORITIES

CASES

STATUTES

STATEMENT OF SUBJECT MATTER AND APPELLATE JURISDICTION

This appeal arose from a decision of the bankruptcy court in the District of South Dakota denying the United States Trustee's Motion to Dismiss for Substantial Abuse pursuant to 11 U.S.C. § 707(b). The bankruptcy court issued a final order on October 25, 1994, denying the United States Trustee's motion to dismiss and holding that certain disability payments received by debtor Eugene Wayne Koch could not be considered in applying the "ability to pay" test set forth in In re Fonder, 974 F.2d 981 (8th Cir. 1989). Joint Appendix ("JA"), Tab 6; JA, Tab 7 at 29-30. A notice of appeal was timely filed on November 4, 1994. JA, Tab 8. The district court therefore properly had jurisdiction over this matter pursuant to 28 U.S.C. § 158(a).

The district court, per Judge Lawrence L. Piersol, issued a memorandum opinion and order on September 28, 199, In re Koch, 187 B.R. 664 (D.S.D. 1995), affirming the decision of the bankruptcy court. JA, Tab 2. The United States Trustee timely filed a motion for Rehearing on October 10, 1995. JA, Tab 1, at 3, Docket # 13. The district court entered its Order Denying Motion for Rehearing on December 15, 1995. JA, Tab 1, at 3, Docket # 17. The United States Trustee timely filed a notice of appeal on February 12, 1996. JA, Tab 4. This Court, therefore, properly has jurisdiction pursuant to 28 U.S.C. §§ 158(d) and 1291.

STATEMENT OF THE ISSUE PRESENTED

Whether the bankruptcy court and the district court erred in holding that disability payments to one of the debtors in the amount of $1,343.33 per month could not be considered in determining whether to dismiss a case for substantial abuse pursuant to 11 U.S.C. § 707(b).

The most apposite cases in this matter are as follows:

In re Fonder, 974 F.2d 996 (8th Cir. 1992);
In re Harris, 960 F.2d 74 (8th Cir. 1992);
In re Walton, 866 F.2d 981 (8th Cir. 1989);
In re Jackson, 173 B.R. 168 (Bankr.E.D.Mo. 1994) . .

STATEMENT OF THE CASE

The relevant facts in this case are not in dispute. Eugene Koch and Debra Nelson-Koch (hereinafter the "debtors") filed a petition for relief under chapter 7 of title 11 of the United States Code on May 13, 1994. JA, Tab 9. At the time they filed their petition, the debtors listed in their schedules unsecured debt totaling $29,885.15. JA, Tab 9 (Schedule F - Creditors Holding Unsecured Nonpriority Claims). The debtors subsequently amended their schedules to add two unsecured creditors with claims totalling $290.40, for a total unsecured debt of $30,175.55. JA, Tab 11 (Amendment to Amended Schedule F). The debtors reported monthly take-home pay of $1,940.81 and monthly expenses of $1,841.00. JA, Tab 9 (Schedule I - Current Income of Individual Debtors; Schedule J - Current Expenditures of Individual Debtors). The debtors did not include in their monthly take-home pay calculation certain workers' compensation payments totalling $1,343.33 per month received by Mr. Koch and claimed exempt by the debtors. JA, Tab 9 (Schedule C - Property Claimed as Exempt).

The United States Trustee filed a motion to dismiss for substantial abuse pursuant to 11 U.S.C. § 707(b) on August 8, 1994. JA Tab 5, at 2, Docket # 19. In that motion the United States Trustee asserted that the debtors' bankruptcy should be dismissed pursuant to section 707(b) because, when Mr. Koch's workers' compensation benefits were considered along with other available income, the debtors had the ability to pay all of their creditors. The debtors, relying on S.D.C.L. § 62-4-42, claimed those workers' compensation payments were exempt.[1]

At the October 18, 1994 hearing on that motion, the parties stipulated as to the admissibility of exhibits that set forth the debtors' monthly take-home pay, including Mr. Koch's workers' compensation benefits, and their monthly expenses. Although the debtors did not amend their schedules, Mr. Koch also testified that he had incurred an additional $40,000 to $50,000 in medical expenses that were not covered by workers' compensation. The debtors did not offer any evidence to corroborate Mr. Koch's testimony in this regard. JA, Tab 7, Transcript of 10/18/94 Hearing ("Tr.") at 7-13.

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[1] S.D.C.L. § 62-4-42 provides as follows:

> No claim for compensation under this title is assignable, and all compensation and claims therefor are exempt from all claims of creditors except for those for child support and spousal support.

The exhibits admitted at the hearing demonstrated that the debtors had the ability to pay their creditors $50,693.04 over a three-year period. JA, Tab 7, Tr. Ex. 1. This amount represents 167.99% of the unsecured debt reflected on their bankruptcy schedules, or between 63.23% and 72.24% of the unsecured debt reflected on their bankruptcy schedules <u>and</u> the additional "$40,000 to $50,000" about which Mr. Koch testified. <u>Id.</u> Alternatively, the debtors could pay $84,448 over a five-year period, JA, Tab 7, at 13, which would be the equivalent of $279.98% of the unsecured debt listed on their schedules, or between 105.38% and 120.39% of the unsecured debt reflected on their schedules and the additional "40,000 to "$50,000" of unsecured debt about which Mr. Koch testified. At the October 18, 1994 hearing, their counsel conceded unequivocally that the debtors had the ability to pay their debts: "we admit [the debtors] could pay creditors if they chose to do so . . . .." JA, Tab 7, TR. at 27.

The bankruptcy court denied the United States Trustee's motion to dismiss, holding that the workers' compensation payments were exempt and could not be considered part of debtor's disposable income in a chapter 13 case. On appeal, the district court affirmed. The district court acknowledged the existence of substantial case law recognizing that a bankruptcy court may consider property which is exempt under chapter 7 in assessing whether a case should be dismissed for substantial abuse pursuant to section 707(b). JA, Tab 2 (187 B.R. 664, 667-68). Notwithstanding that case law and the express statement by the

Eighth Circuit in In re Walton, 866 F.2d 981, 982, 984, fn.7. (8th Cir. 1989) that exempt income should be considered in assessing a debtor's "ability to pay", the district court held that workers' compensation payments could not be considered in a section 707(b) analysis. JA, Tab 2 (187 B.R. at 668). In affirming the bankruptcy court, the district court relied on In re Berger, 61 F.3d 624 (8th Cir. 1995).

APPLICABLE STANDARD OF APPELLATE REVIEW

The applicable standard of review on appeal is de novo with respect this issue, which is a question of law. Miller v. Farmers Home Administration, 16 F.3d 240 (8th Cir. 1994).

SUMMARY OF THE ARGUMENT

The Eighth Circuit has recognized that the debtors no longer have unfettered access to chapter 7 bankruptcy relief. With the enactment of 11 U.S.C. § 707(b), Congress has authorized courts to dismiss cases which the bankruptcy courts determine would constitute a substantial abuse of the bankruptcy system. In re Walton, 866 F.2d 981, 982 (8th Cir. 1989). The Eighth Circuit, has determined that where debtors have the ability to pay their creditors, which is assessed by reference to their ability to fund a hypothetical plan of reorganization under chapter 13 of the Bankruptcy Code, dismissal of their chapter 7 case under section 707(b) is appropriate.

In this case, it is uncontested that debtors can pay their creditors if they so choose. They prefer instead to pay nothing, arguing they cannot be compelled to commit certain workers compensation funds, which they claim are exempt, to fund a chapter 13 plan. In affirming the bankruptcy court in its refusal to dismiss the debtors' bankruptcy case under section 707(b), the district court relied on In re Berger, 61 F.3d 624 (8th Cir. 1995) for the proposition that exempt money is not includable in the disposable income which a chapter 13 debtor must commit to his or her chapter 13 plan. Because the debtors cannot be compelled to commit these workers compensation benefits to a chapter 13 plan, the district court reasoned that those funds could not be considered in any assessment under section 707(b) of the debtor's ability to pay their creditors. The district court's decision is flawed, however, because the central inquiry in a substantial abuse analysis in the Eighth Circuit is not whether a debtor can be compelled to pay their creditors, but rather whether they have the ability to pay them. Because the debtors in this case have the uncontested ability to pay their creditors, the bankruptcy court erred in refusing to consider the workers' compensation benefits as in assessing whether the debtors' case should be dismissed for substantial abuse under section 707(b).

ARGUMENT

THE DISTRICT COURT ERRED BY REFUSING TO CONSIDER MR. KOCH'S WORKERS' COMPENSATION BENEFITS AS PART OF ITS SUBSTANTIAL ABUSE ANALYSIS

The Eighth Circuit has recognized that "[w]ith the enactment of the Bankruptcy Amendments and Federal Judgeship Act of 1984[, Pub. L. 98-353, 98 Stat. 353] ("1984 Act"), debtors no longer have unfettered access to voluntary Chapter 7 relief." In re Walton, 866 F.2d 981, 982 (8th Cir. 1989). Pursuant to the 1984 Act, Congress substantially amended section 707 of the Bankruptcy Code by adding section 707(b), which provides as follows:

> (b) After notice and a hearing, the court, on its own motion or on a motion by the United States trustee, but not at the request or suggestion of any party in interest, may dismiss a case filed by an individual debtor under this chapter whose debts are primarily consumer debts if it finds that the granting of relief would be a substantial abuse of the provisions of this chapter. There shall be a presumption in favor of granting the relief requested by the debtor.

11 U.S.C. § 707(b) (emphasis added).

The Eighth Circuit has determined, in light of its legislative history, that section 707(b) was "aimed primarily at stemming the use of Chapter 7 relief by unneedy debtors." Walton, 866 F.2d at 983 (citing S. Rep No. 65, 98th Cong., 1st Sess. 3 (1983)). (emphasis added). Consequently, the Eighth Circuit has expressed the belief that section 707(b) "upholds creditors' interests in obtaining repayment where such repayment would not be a burden on the debtors." Id. at 983 (quoting S. Rep. No. 65 at 53). Although the term "substantial abuse" is not defined in section 707(b) or elsewhere in the Bankruptcy Code, the Eighth Circuit has determined that Congress expressly declined to adopt a rigid, mechanical approach, but opted rather for an undefined, flexible "substantial abuse" standard. Walton, 866 F.2d at 983.

Although recognizing that section 707(b) had no defined standard, the Eighth Circuit noted that "almost all the courts that have interpreted the 'substantial abuse' language of section 707(b) have concluded that this language encompasses consideration of the debtor's ability to pay his debts out of future income." Id. at 984. The Eighth Circuit therefore adopted the reasoning of the Ninth Circuit in In re Kelly, 841 F.2d 908 (9th Cir. 1988), which held that:

> [T]he debtor's ability to pay his debts when due as determined by his ability to fund a chapter 13 plan is the primary factor to be considered in determining whether granting relief would be substantial abuse. . . That is not to say that inability to pay will shield a debtor from section 707(b) dismissal where bad faith is otherwise shown. But "a finding that a debtor is able to pay his debts, standing alone, supports a conclusion of substantial abuse.

Walton, 866 F.2d at 984-85 (emphasis added). The Walton decision was subsequently reaffirmed in both Fonder v. United States, 974 F.2d 996, 999 (8th Cir. 1992) and United States v. Harris, 960 F.2d 74, 76 (8th Cir. 1992). Although the Eighth Circuit has concluded that a debtor's ability to fund a chapter 13 plan is a "primary factor", it has expressly declined to hold that to be dismissed under section 707(b), a debtor must be eligible for chapter 13 relief. Fonder v. U.S., 974 F.2d 996, 999 (8th Cir. 1992).

In this case, the debtors openly admit that they have the ability to pay their creditors. Their counsel stated unequivocally at the hearing on the United States Trustee's motion that "we admit [the debtors] **could pay their creditors if they chose to do so** . . ." Tr. at 27. (emphasis added). This admission is not surprising in light of the substantial funds available to the debtors. As set forth above, the uncontroverted evidence establishes that they have the ability to pay their creditors $50,693 over three years. This amount is equivalent to $167.99% of the unsecured debt reflected on their bankruptcy schedules or between 63.23% and 72.24% of their scheduled debt and the "$40,000 to $50,000 of additional debt claimed by Mr. Koch at the hearing. Alternatively, they could pay $84,448 over a five-year period, which sum is equivalent to 279.39% of their scheduled debt, or between 105.38% and 120.39% of the scheduled unsecured debt and the "$40,000 to $50,000 of additional debt about which Mr. Koch testified.

Under any of these scenarios, the debtors have the uncontested ability to repay either a substantial portion or all of their debt. See Walton, 866 F.2d at 985 (debtor's ability to pay two-thirds of debt in three years or 100% of debt in five years is sufficient to rebut the statutory presumption in section 707(b) in favor of granting the relief requested by debtor and justifies dismissal for substantial abuse).

Rather than taking advantage of the statutory protections available under chapter 13 that would enable them to pay their debts, debtors prefer to pay their creditors nothing, arguing that they cannot be forced to use an asset which is exempt from liquidation in a chapter 7 proceeding to fund a chapter 13 plan. In upholding the debtors' decision to ignore their creditors' interests -- and rights -- the district court disregarded both the letter and the spirit of controlling Eighth Circuit case law, which clearly provides that cases filed by "unneedy debtors" for whom repayment "would not be a burden" should be dismissed. Walton, 866 F.2d at 983.

The district court's decision acknowledged the existence of the substantial case law, including the Walton decision, expressly recognizing that a bankruptcy court may consider property which is exempt under chapter 7 in assessing whether a case should be dismissed for substantial abuse pursuant to section 707(b). 187 B.R. at 667-68 (citing, In re Minor, 177 B.R. 576, 579 (Bankr. E.D.Tenn. 1995); In re Jackson, 173 B.R. 168, 171 (Bankr.E.D.Mo. 1994); In re Morse, 164 B.R. 651 (Bankr. E.D. Wash. 1994); In re Schnabel, 153 B.R. 809 (Bankr. N.D.Ill. 1993). See also, In re Rogers, 168 B.R. 806 (Bankr. M.D. Ga. 1993)).

In assessing a debtor's ability to fund a hypothetical chapter 13 plan, these courts have examined the ability of the debtor to repay debts out of future disposable income. Rogers, 168 B.R. at 809. The analysis of this issue has generally focused on the definition in 11 U.S.C. § 1325(b)(2) of "disposable income" as "income which is received by the debtor and which is not reasonably necessary to be expended -- (A) for the maintenance or support of the debtor or a dependant of the debtor . . ." See Rogers, 168

B.R. at 809. Because the plain language of section 1325(b)(2) does not exclude exempt income from disposable income, the majority of courts that have addressed this issue have declined to read such a limitation into that section. See, e.g., Rogers, 168 B.R. at 809 (citing Schnabel, 155 B.R. at 815).

The district court relied on Berger, which it incorrectly believed had held that exempt proceeds of a life insurance policy "may not be included in calculating the amount of income available to pay the claims of unsecured creditors under 11 U.S.C. § 1225(b)." 187 B.R. at 667.[2] Because it determined that section 1225(b) is so closely analogous to section 1325(b), the district court held that Berger controlled in the debtors' hypothetical chapter 13 case as well. Id. Specifically, the district court held that, notwithstanding the substantial case law to the contrary, exempt income may not be considered part of disposable income under section 1325(b). From this, the district court reasoned that Mr. Koch's workers' compensation benefits, which are exempt from liquidation in a chapter 7 proceeding, are excluded

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[2] As discussed in the text, the issue of whether exempt income may be considered part of disposable income under 11 U.S.C. § 1325(b) is irrelevant in an ability to pay analysis. The true issue is whether the debtors have the ability to pay their creditors such that dismissal for substantial abuse is appropriate. Nonetheless, contrary to the district court's statement, the Eighth Circuit in Berger did not hold exempt property or income was not part of a chapter 12 debtor's disposable income under 11 U.S.C. § 1225(b). That issue was decided by the bankruptcy court, was not challenged on appeal and was therefore not a holding of the Court of Appeals. See In re Berger, 61 F.3d 624, 626 (8th Cir. 1995)("The bankruptcy court determined that the proceeds were exempt . . .and that ruling is not challenged on appeal.").

from disposable income under section 1325(b) and may not be considered in a section 707(b) analysis. 187 B.R. at 667-68. The district court's reasoning in this regard is flawed for several reasons.

First, the Eighth Circuit in Berger did not confront or consider an application of the substantial abuse standard. Indeed, as the district court noted, the Berger decision did not cite any of the considerable case authority discussing exempt income in the context of a substantial abuse analysis. 187 B.R. at 668. Consequently, that case offers no guidance concerning the implementation of § 707(b) and should not be read as contrary authority to the express statement in Walton that exempt income may be considered in assessing a debtor's ability to pay his creditors.[3]

Second, the district court's reliance on Berger in holding that a debtor cannot be compelled to fund a chapter 13 plan with exempt income ignores the central question concerning substantial abuse under Walton. That question is not whether the debtors can be compelled to pay their debt -- no chapter 7 debtor can be compelled to do so. See Walton, 866 F.2d at 984, fn.6 (citing In

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[3] In In re Walton, the Eighth Circuit expressly addressed the holding in In re Brady, 86 B.R. 616 (W.D.Mo. 1987). In Brady, the district court overruled the dismissal of the debtor's bankruptcy for substantial abuse, holding that exempt income may not be considered in a substantial abuse analysis. This is the only case of which appellant is aware to so hold and the only case relied upon by the debtors for this proposition. In Walton, however, the Eighth Circuit expressly stated that the bankruptcy court's decision in Brady, 95 B.R. 1004 (Bankr. W.D.Mo. 1987), which included exempt social security benefits in its substantial abuse analysis, represented "the correct view of the law".

re Edwards, 50 B.R. 933, 939 (Bankr. S.D.N.Y. 1985)) ("Although Code § 707(b) may have the effect of relegating a debtor to a Chapter 13 if he wants any bankruptcy relief, **any decision to utilize Chapter 13 remains that of the debtor.**" (emphasis added)). The question is instead whether the debtors have the **ability** to do so. Indeed, as this Court stated in In re Fonder,

> While the Walton\Harris test for substantial abuse focuses on whether the debtor can fund a Chapter 13 plan, the essential inquiry remains whether the debtor's ability to repay creditors with future income is sufficient to make the Chapter 7 liquidating bankruptcy a substantial abuse of the [Bankruptcy] Code.

974 F.2d 996, 999 (8th Cir. 1992). (emphasis added). See also In re Morse, 164 B.R. 651, 656 (Bankr. E.D. Wash. 1994) ("While the court does not dispute that debtors are entitled to any exemption which they may validly claim, **the ability to claim an exemption is an independent issue from whether debtors have the ability to repay their debts**." (emphasis added)); In re Anatal, 85 B.R. 838 (Bankr. W.D. Mo. 1988) (injecting considerations of exempt property or money into the section 707(b) analysis is inappropriate, where central inquiry is simply whether debtor has the ability to pay creditors).

The district court erred by focusing on whether the debtors might claim an exemption in a chapter 13 case, as opposed to addressing the central question under the substantial abuse standard set forth in Walton of the debtors' ability to pay their creditors. The district court decision that Mr. Koch's $1,343.33

per month in workers' compensation benefits may not be considered in assessing whether the debtor had ability to pay creditors is contrary to the Eighth Circuit's broad interpretation of section 707(b) and its determination that "unneedy debtors" should not be permitted chapter 7 relief. The district court's analysis is therefore contrary to the law of the Eighth Circuit and should be rejected.

CONCLUSION

For the reasons set forth, the United States Trustee respectfully urges this Court to reverse the decision of the district court.

BARBARA G. STUART
United States Trustee

BRUCE J. GERING
Assistant U.S. Trustee
Shriver Square - Suite 502
230 South Phillips Avenue
Sioux Falls, S.D. 57102
Tele: 605/330-4450

MARTHA L. DAVIS
General Counsel

PAUL W. BRIDENHAGEN
Attorney
Executive Office for
  U.S. Trustees
901 E. Street, N.W., Suite 780
Washington, D.C. 20530
Tele: 202/307-1399

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Kontrick v. Ryan

2. ("CO") ***CURRENT*** COURT
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The Supreme Court of the United States

3. ("CCN") ***CURRENT*** CASE NO.

No.: 02-819

4. ("PCN") ***PRIOR*** CASE NO. & COURT
[IF ANY]

~~No.: 00-CV-5736~~

Court: US Court of Appeals for the Seventh Circuit
Hon. Harry D. Leinenweber *(Identify judge & cite, if any)*

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8. ("TO") ***TOPIC***

BANKRUPTCY

9. ("SU") ! ***SUMMARY*** OF KEY ISSUE(s)

&

√ Any Miscellaneous ***BACKGROUND***

! Whether the requirement in Fed. R. Bankr. P. 4004(a) that a complaint objecting to a bankruptcy discharge "shall be filed no later than 60 days" after the meeting of creditors may be forfeited by the debtor.

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No. 02-819

In the Supreme Court of the United States

ANDREW J. KONTRICK, PETITIONER

v.

ROBERT A. RYAN

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE SUPPORTING RESPONDENT

THEODORE B. OLSON
Solicitor General
Counsel of Record

ROBERT D. MCCALLUM, JR.
Assistant Attorney General

PAUL D. CLEMENT
Deputy Solicitor General

KENT L. JONES
Assistant to the Solicitor General

WILLIAM KANTER
MICHAEL E. ROBINSON
Attorneys

Department of Justice
Washington, D.C. 20530-0001
(202) 514–2217

JOSEPH A. GUZINSKI
General Counsel

P. MATHEW SUTKO

MICHELE M. MANSFIELD
Attorneys
Office of the United States Trustee
Washington, D.C.

QUESTION PRESENTED

Whether the requirement in Fed. R. Bankr. P. 4004(a) that a complaint objecting to a bankruptcy discharge "shall be filed no later than 60 days" after the meeting of creditors may be forfeited by the debtor.

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BRIEF FOR THE UNITED STATES AS AMICUS CURIAE SUPPORTING RESPONDENT

INTEREST OF THE UNITED STATES

Pursuant to Section 727 of the Bankruptcy Code, the trustee of the debtor's estate, the United States trustee, or any creditor may object to the granting of a discharge of a debtor. 11 U.S.C. 727(c)(1). Rule 4004(a) of the Federal Rules of Bankruptcy Procedure specifies that "a complaint objecting to the debtor's discharge under § 727(a) of the Code shall be filed no later than 60 days after the first date set for the meeting of creditors * * * ." This case presents the question whether the requirement that the objection to discharge be filed within the 60-day period specified in Rule 4004(a) may be forfeited by the debtor. Because the United States is a creditor in many bankruptcies and, through the United States Trustee Program, supervises the administration of bankruptcy cases, the United States has a strong interest in the proper interpretation and application of this Rule.[1]

BANKRUPTCY RULES INVOLVED

1. Rules 4004(a) and (b) of the Federal Rules of Bankruptcy Procedure provide:

> (a) **Time for Filing Complaint Objecting to Discharge; Notice of Time Fixed.** In a chapter 7 liquidation case a complaint objecting to the debtor's discharge under § 727(a) of the Code shall be filed no later than 60 days after the first date set for the meeting of creditors under § 341(a). In a chapter 11 reorganization case, the complaint shall be filed no later than the first date set for the hearing on confirmation. At least 25 days' notice of the time so fixed shall be given to the United States trustee and all creditors as provided in Rule 2002(f) and (k) and to the trustee and the trustee's attorney.
>
> (b) **Extension of Time.** On motion of any party in interest, after hearing on notice, the court may for cause extend the time to file a complaint objecting to discharge. The motion shall be filed before the time has expired.

2. Rule 9006(b)(1) and (3) of the Federal Rules of Bankruptcy Procedure provide:

(b) **Enlargement.**

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[1] See also 11 U.S.C. 307 (the United States Trustee may appear and be heard on any issue in any bankruptcy case). The United States Trustee Program is created by 28 U.S.C. 581-589. In the administration of that program, the United States Trustee files hundreds of complaints each year that object to the entry of a discharge or seek revocation of a discharge.

> (1) *In General.* Except as provided in paragraphs (2) and (3) of this subdivision, when an act is required or allowed to be done at or within a specified period by these rules * * * , the court for cause shown may at any time in its discretion (1) with or without motion or notice order the period enlarged if the request therefor is made before the expiration of the period originally prescribed or as extended by a previous order or (2) on motion made after the expiration of the specified period permit the act to be done where the failure to act was the result of excusable neglect.
>
> * * * * *
>
> (3) *Enlargement limited.* The court may enlarge the time for taking action under Rules 1006(b)(2), 1017(e), 3002(c), 4003(b), 4004(a), 4007(c), 8002, and 9033, only to the extent and under the conditions stated in those rules.

STATEMENT

1. In a Chapter 7 liquidation case, a debtor who satisfies the several conditions set forth in Section 727(a) of the Bankruptcy Code is to receive an order discharging his debts. 11 U.S.C. 727(a).[2] A discharge

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[2] Under Section 727(a) of the Bankruptcy Code, a court may not grant a discharge if the debtor (i) is not an individual, (ii) has concealed, transferred or destroyed property of the estate in the year preceding bankruptcy or during the bankruptcy case, (iii) has destroyed books and records, (iv) has knowingly given a false oath or account, (v) has presented or used a false claim, (vi) has attempted to obtain money by acting or forbearing to act, (vii) has withheld documents relating to the debtor's property or financial affairs, (viii) has failed to explain a loss or deficiency of assets, (ix) has refused to obey court orders, (x) has refused to testify in the

granted under this Section frees the debtor from all debts that arose before the bankruptcy case commenced other than those excepted from discharge under Section 523 of the Code. 11 U.S.C. 727(b).[3]

The trustee, the United States trustee, or any creditor may object to the granting of a discharge under Section 727. 11 U.S.C. 727(c)(1). Such an "objection[] to discharge" is a "core proceeding" within the jurisdiction of the bankruptcy court. 28 U.S.C. 157(b)(2)(J). Nothing in the Bankruptcy Code, however, specifies a time or deadline for filing such an objection. Instead, the time frame for filing a complaint objecting to a discharge is set forth in Rule 4004(a) of the Federal Rules of Bankruptcy Procedure. That Rule states in relevant part that "a complaint objecting to the debtor's discharge under § 727(a) of the Code shall be filed no later than 60 days after the first date set for the meeting of creditors * * * ." Rule 4004(b) then goes on to provide that "[t]he court may for cause extend the time to file a complaint objecting to discharge" if the motion is "filed before the time has expired." And, Rule 9006(b)(3), which addresses motions for enlargement of

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case, (xi) has received a chapter 11 discharge within six years of the filing of the current bankruptcy case, (xii) has received a chapter 12 or 13 discharge within six years in a case in which the debtor did not pay at least 70 percent of the allowed unsecured claims or, in certain circumstances, all of those claims, unless the court approves a written waiver of discharge after the order for relief in the case has been entered. 11 U.S.C. 727(a)(1)-(10).

[3] Many specific types of debts are excepted from discharge by Section 523. See, *e.g.*, 11 U.S.C. 523(a)(1) (certain debts "for a tax or a customs duty"); 11 U.S.C. 523(a)(2)(A)) (certain debts for money obtained by "false pretenses * * * or actual fraud"); 11 U.S.C. 523(a)(6) (debts for "willful and malicious injury by the debtor").

time generally, further provides that "the court may enlarge the time for taking action under Rule[ ] 4004(a) * * * only to the extent and under the conditions stated in [that] rule." Fed. R. Bankr. P. 9006(b)(3).[4]

2. On April 4, 1997, petitioner filed a voluntary petition for bankruptcy under Chapter 7. Pet. App. 1. Respondent, who is one of petitioner's creditors, sought and obtained three separate extensions of the 60-day deadline for filing an objection to discharge under Rule 4004(a). The final extension was until January 13, 1998. Pet. App. 3-4, 26.

On January 13, 1998, respondent filed an adversary complaint that objected to petitioner's discharge. In that complaint, respondent alleged that petitioner had transferred property within one year of filing bankruptcy with intent to defraud and should therefore be denied a discharge under 11 U.S.C. 727(a)(2)-(5) of the Bankruptcy Code. See Pet. App. 4, 26; note 2, *supra*. On May 6, 1998, without an additional court-approved extension, respondent filed an amended complaint that asserted an additional objection to discharge. The new objection was based on respondent's allegation that

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[4] An analogous provision provides for objections to the discharge of a particular debt pursuant to 11 U.S.C. 523(c). See note 3, *supra*. Rule 4007(c) specifies that "[a] complaint to determine the dischargeability of a debt under § 523(c) shall be filed no later than 60 days after the first date set for the meeting of creditors under § 341(a) * * * . On motion of a party in interest, after hearing on notice, the court may for cause extend the time fixed under this subdivision. The motion shall be filed before the time has expired." Because the language in Rules 4007(c) and 4004(a) and (b) are virtually identical, courts have found it appropriate to consider decisions construing Rule 4007(c) in determining whether the time limit set forth in Rule 4004(a) may be forfeited. See Pet. App. 8 n.3.

petitioner had fraudulently transferred money to his wife by removing his name from a family checking account and then continuing to deposit his salary into the account. According to the amended complaint, such transfers were fraudulent and therefore provided an additional basis for denying the discharge under Section 727(a)(2)(A). See Pet. App. 4, 27.

Petitioner filed an answer in which he denied liability on the asserted fraudulent transfers. He did not, however, object to the amended complaint on the ground that it was filed beyond the time permitted by Rule 4004. Pet. App. 4.

3. The bankruptcy court granted respondent's motion for summary judgment. The court concluded that the fraudulent transfers described in the amended complaint were appropriate grounds for denying petitioner a discharge under Section 727(a)(2). Pet. App. 4-5.

Petitioner then moved for reconsideration. In that motion, he argued for the first time that the allegations of the amended objection to discharge were untimely and that the court was therefore deprived of "jurisdiction" to deny his discharge on those grounds. The bankruptcy court held that the time limit set forth in Rule 4004(a) is not "jurisdictional" and that, by not raising a timely objection to the grounds stated in the amended complaint, petitioner had forfeited his objection under that Rule. Pet. App. 5, 29.

4. The district court upheld the bankruptcy court ruling. Pet. App. 25-38. The court agreed with the holding of *In re Santos*, 112 B.R. 1001, 1008 (B.A.P. 9th Cir. 1990), that "the timeliness of a dischargeability complaint presents an affirmative defense that must be raised in an answer or responsive pleading [and that] [i]f the defense is not raised in the answer or responsive

pleading, it is generally waived." Pet. App. 31-32.[5] Adopting the reasoning of the Second Circuit in *In re Benedict*, 90 F.3d 50, 54 (1996), and of the Fourth Circuit in *Farouki* v. *Emirates Bank International, Ltd.*, 14 F.3d 244, 248 (1994), the court noted that the filing requirement set forth in Rule 4004(a) is not different from "a statutory provision that imposes a filing deadline" and that "statutory filing deadlines are generally subject to the defenses of waiver, estoppel, and equitable tolling." Pet. App. 31. The court therefore concluded that, "[b]y not raising the timeliness of the family account claim in his responsive pleading, [petitioner] waived the objection." *Id.* at 33.

5. The court of appeals affirmed. Pet. App. 1-23. The court emphasized that the statutes that grant jurisdiction to the bankruptcy courts "over bankruptcy matters do not indicate that timeliness of objections to discharge is a jurisdictional predicate." *Id.* at 12 (citing 28 U.S.C. 157(b)(2)(J)). The court agreed with the holding of the Second and Fourth Circuits that the timely filing requirement of Rule 4004(a) is not "jurisdictional" and, like other limitations provisions,

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[5] The issue in this case is more accurately described as one of forfeiture rather than waiver. "Waiver is different from forfeiture. Whereas forfeiture is the failure to make the timely assertion of a right, waiver is the 'intentional relinquishment or abandonment of a known right.'" *United States* v. *Olano*, 507 U.S. 725, 733 (1993) (quoting *Johnson* v. *Zerbst*, 304 U.S. 458, 464 (1938)). Although in other contexts that distinction has material consequences, that is not the case for Rule 4004. And, since the lower court opinions use these terms interchangeably, this brief will not retain the distinction. See *Freytag* v. *Commissioner*, 501 U.S. 868, 895 n.2 (1991) (Scalia, J., concurring) ("I shall not try to retain the distinction between waiver and forfeiture throughout this opinion, since many of the sources I shall be using disregard it.").

may therefore be waived. Pet. App. 14 (citing *In re Benedict*, 90 F.3d at 53-54; *Farouki* v. *Emirates Bank International, Ltd.*, 14 F.3d at 248).

The court of appeals noted that petitioner did not challenge the timeliness of respondent's objection to discharge under Rule 4004(a) prior to his motion for rehearing in the bankruptcy court. Pet. App. 18. The court of appeals concluded that petitioner waived the affirmative defense that the objection to discharge was untimely by not raising that defense until *after* the court ruled on the merits of the objection. *Ibid.*

SUMMARY OF ARGUMENT

1. The court of appeals correctly determined that the time limit set forth in Rule 4004(a) is subject to forfeiture. The core jurisdiction of the bankruptcy courts expressly encompasses all "objections to discharge." 28 U.S.C. 157(b)(2)(J). In that statute, Congress did not impose, as a jurisdictional predicate, a requirement that objections to discharge be filed in a timely manner under the bankruptcy rules. To the contrary, while this statute requires that *some* matters be timely asserted as a prerequisite of core jurisdiction, the statute contains no such requirement for objections to discharge. Nothing in this jurisdictional statute thus indicates that bankruptcy courts have jurisdiction only over objections to discharge that are timely filed under the bankruptcy rules or that a debtor otherwise cannot forfeit an argument about the timeliness of an objection to discharge by failing to raise the argument.

Moreover, the bankruptcy rules themselves specify that they are not to be construed either to extend or limit the jurisdiction of the bankruptcy courts. Fed. Bank. R. Proc. 9030. The filing deadline for objections to discharge in Rule 4004(a) is thus expressly not "jurisdictional." Instead, like other filing deadlines, it operates "like a statute of limitations" and is therefore "subject to [the defenses of] waiver, estoppel and equitable tolling." *Zipes* v. *Trans World Airlines, Inc.*, 455 U.S. 385, 393 (1982).

2. That does not, of course, mean that the doctrine of forfeiture—or equitable defenses such as tolling or estoppel—would always be applicable under Rule 4004(a) and that a failure to raise an argument about the timeliness of an objection to discharge would always result in forfeiture of that argument. In this case, however, petitioner no longer argues that a factual basis for a finding of forfeiture does not exist. Instead, petitioner incorrectly urges only that the timely filing requirement of Rule 4004(a) is "jurisdictional" and therefore may never be forfeited.

3. Petitioner errs in claiming that the decision of the court of appeals conflicts with this Court's decision in *Taylor* v. *Freeland & Kronz*, 503 U.S. 638 (1992). In *Taylor*, the Court held that the time limits for filing objections to a debtor's list of exempt property in Rule 4003 apply even for exemptions that are not claimed in "good faith." *Id.* at 644-645. That decision does not suggest that the deadline in Rule 4003 is jurisdictional and does not support a contention that a debtor cannot forfeit the defense that an objection to discharge is untimely under Rule 4004(a).

ARGUMENT

THE TIME LIMITS IMPOSED IN RULE 4004(a) FOR FILING AN OBJECTION TO DISCHARGE MAY BE FORFEITED BY THE DEBTOR

This Court has made clear that, unless strict compliance with a filing deadline is a prerequisite to the jurisdiction of the court, "[s]tatutory filing deadlines are generally subject to the defenses of waiver, estoppel, and equitable tolling." *United States* v. *Locke*, 471 U.S. 84, 94 n.10 (1985). See *Zipes* v. *Trans World Airlines, Inc.*, 455 U.S. 385, 393 (1982). In this case, the court of appeals correctly held that the time limits imposed by Rule 4004(a) of the Federal Rules of Bankruptcy Procedure are not "a jurisdictional prerequisite to suit in federal court, but [are instead] a requirement that, like a statute of limitations, is subject to waiver, estoppel and equitable tolling" (*Zipes* v. *Trans World Airlines, Inc.*, 455 U.S. at 393).

A. The Federal Rules Of Bankruptcy Procedure Do Not Have Jurisdictional Effect

1. The jurisdiction of the lower federal courts is created by statute, not by rules of practice. As this Court has emphasized, "[i]t is axiomatic" that the rules of practice and procedure established by this Court for the lower federal courts can neither create nor destroy the jurisdiction that Congress has created. *Owen Equipment & Erection Co.* v. *Kroger*, 437 U.S. 365, 370 (1978); see *Snyder* v. *Harris*, 394 U.S. 332, 337 (1969); *Sibbach* v. *Wilson & Co.*, 312 U.S. 1, 9-10 (1941). Instead, the procedural rules adopted by this Court "merely prescribe the method by which the jurisdiction granted the courts by Congress is to be exercised."

Wright, Miller & Marcus, *Federal Practice & Procedure* § 3141, at 485 (1997).

As pertinent to this case, Congress has specified that an "objection[] to discharge" is a "core proceeding" within the jurisdiction of the bankruptcy court. 28 U.S.C. 157(b)(2)(J). Moreover, Rule 9030 specifies that the bankruptcy rules of practice "shall not be construed to extend or limit the jurisdiction of the courts or the venue of any matters therein." Fed. R. Bankr. P. 9030.[6] Accordingly, nothing in Rule 4004—including the time limit for the filing of objections to discharge set forth in that rule–-"limit[s] the jurisdiction of the courts" over such objections. Fed. R. Bankr. P. 9030.

In order for a time limit for filing a claim to constitute a true "jurisdictional prerequisite to suit in federal court" (*Zipes* v. *Trans World Airlines, Inc.*, 455 U.S. at 393), it would need to be established by Congress, not in a rule of practice or procedure adopted by this Court.[7] In this case, however, the statute that creates

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[6] Rule 82 of the Federal Rules of Civil Procedure similarly states that the rules of civil procedure "shall not be construed to extend or limit the jurisdiction of the United States district courts or the venue of actions therein." Fed. R. Civ. P. 82.

[7] In rejecting the assertion that a time requirement in a rule of practice is "jurisdictional and cannot be waived," the Court stated in *Schact* v. *United States*, 398 U.S. 58, 64 (1970), that "it must be remembered that this rule was not enacted by Congress but was promulgated by this Court under authority of Congress to prescribe rules * * * . The procedural rules adopted by the Court for the orderly transaction of its business are not jurisdictional and can be relaxed by the Court in the exercise of its discretion when the ends of justice so require." Justice Harlan similarly emphasized in his concurring opinion in *Schact* that "this Court on occasion waives the time limitations imposed by its own

jurisdiction over "objection[s] to discharge" in bankruptcy cases contains no time limit for filing such claims. 28 U.S.C. 157(b)(2)(J). While this jurisdictional statute requires that some motions or proceedings in bankruptcy cases must be brought in a "timely" manner, the statute contains no such requirement for objections to discharge.[8] Because, as it applies to

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Rules and yet treats time requirements imposed by statute as jurisdictional." *Id.* at 68.

To be sure, a rule may, by its express terms or structure, require absolute compliance with a time limit and thus preclude reliance on equitable doctrines or waiver. For example, the time period for filing a notice of appeal may be strictly enforced even when it is fixed by rule, rather than statute. See, *e.g.*, Fed. R. App. P. 4(b)(1)(A) (10-day limit for appeal by a criminal defendant). While courts sometimes refer to such provisions as "jurisdictional" in an effort to describe the strict nature of the timeliness requirements, they are not true limits on jurisdiction. See *Steel Co.* v. *Citizens for a Better Env't*, 523 U.S. 83, 90 (1998) ("Jurisdiction, it has been observed, 'is a word of many, too many, meanings.' "); *Zipes* v. *Trans World Airlines, Inc.*, 455 U.S. at 395 (the deadline for filing EEOC complaints is subject to equitable estoppel even though "our cases contain scattered references to the timely-filing requirement as jurisdictional").

[8] As the court of appeals emphasized (Pet. App. 12):

> Matters of timeliness are, notably, present in other provisions. For instance, section 157(b)(3) states that "[t]he bankruptcy judge shall determine, on the judge's own motion or on timely motion of a party, whether a proceedings is a core proceeding." 28 U.S.C. § 157(b)(3). Further, for a party to obtain de novo review in the district court of a bankruptcy court's findings of fact and conclusions of law in a non-core proceeding, that party must "timely and specifically object[]." 28 U.S.C. § 157(c)(1). These references to timeliness in sections other than the grants of jurisdiction support the view that timeliness is not a prerequisite to the bankruptcy court's exercise of jurisdiction in a core proceeding such as [petitioner's] objection to discharge.

objections to discharge, this statute "does not limit jurisdiction to those cases in which there has been a timely filing," compliance with the time limitations of Rule 4004 is not a "jurisdictional prerequisite." *Zipes* v. *Trans World Airlines, Inc.*, 455 U.S. at 393.

The time limit for filing objections to discharge is set forth in a procedural rule adopted by this Court that has no jurisdictional effect and does not preclude application of principles of waiver or forfeiture. The bankruptcy rules, including Rule 4004(a), are designed to assist the bankruptcy courts in the management of cases and to promote the "'expeditious and economical administration' of cases under the Code." Fed. R. Bankr. P. 1001 advisory committee's note. These rules are to "be construed to secure the just, speedy, and inexpensive determination of every case and proceeding;" they are not to be construed to extend or limit the court's jurisdiction. Fed. R. Bankr. P. 1001, 9030.

The relevant jurisdictional provision in this case has no time limit for objections to discharge. It thus stands in stark contrast to jurisdictional provisions, such as the Federal Tort Claims Act, which commands that failure to comply with a filing requirement means that "an action shall not be instituted" and that "a tort claim against the United States shall be forever barred * * *." 28 U.S.C. 2675(a), 2401(b). Similarly, 28 U.S.C. 2107 specifies that, "[e]xcept as otherwise provided in this section, no appeal shall bring any judgment, order or decree in an action, suit or proceeding of a civil nature before a court of appeals for review unless notice of appeal is filed, within thirty days after the entry of such judgment, order or decree." The Court has therefore noted that "the filing of a notice of appeal is an event of jurisdictional significance—it confers jurisdiction on the court of appeals and divests the district court of its control over those aspects of the case involved in the appeal." *Griggs* v. *Provident Consumer Discount Co.*, 459 U.S. 56, 58 (1982).

Unlike a timely notice of appeal, which is a prerequisite for the jurisdiction of the court of appeals, the filing of a timely objection to discharge neither confers nor deprives the bankruptcy courts of jurisdiction over a creditor's discharge. That jurisdiction is established by statute (28 U.S.C. 157(b)(2)(J)), and the bankruptcy rules merely "govern procedure in [such] cases." Fed. R. Bank. P. 1001.

2. This Court's recent decision in *Young* v. *United States*, 535 U.S. 43 (2002), supports the conclusion that the time deadline in Rule 4004(a) is not jurisdictional. In *Young*, the Court addressed the three-year lookback period in Section 507(a)(8)(A)(i) of the Bankruptcy Code, which allows the government to collect taxes "for which a return was due within three years before the filing of an individual debtor's petition." *Id.* at 44. The Court held in *Young* that the period established in this limitations provision is subject to equitable tolling. *Id.* at 47. The Court stated that this statute "prescribes a period within which certain rights (namely, priority and nondischargeability in bankruptcy) may be enforced" and rejected the argument that the statutory lookback period was a "substantive component" of the Code. *Id.* at 47, 48. Instead, the Court found it to be a limitation provision that "serves the 'same basic policies [furthered by] all limitations provisions: repose, elimination of stale claims, and certainty about a plaintiff's opportunity for recovery and a defendant's potential liabilities." *Id.* at 47. The Court emphasized that, while the purpose of the period is to "encourage[ ] the IRS to protect its rights" before the three-year period has elapsed (*id.* at 47-48), "nothing in the Bankruptcy Code precludes

equitable tolling of the lookback period." *Id.* at 47. Instead, the Court concluded that such limitations periods in bankruptcy cases are presumptively subject to equitable tolling because bankruptcy courts "are courts of equity and apply the principles and rules of equity jurisprudence." *Id.* at 50 (citations and internal quotation omitted).

Those same principles apply here. See *In re Phillips*, 288 B.R. 585, 592-593 (Bankr. M.D. Ga. 2002) (applying *Young* to Rule 4007). The deadline in Rule 4004(a) serves the same purposes furthered by all limitations periods—finality, repose, and certainty about liability. As *Young* makes clear, these basic purposes are not jeopardized by recognizing the applicability of equitable defenses in particular cases.

B. The Time Limit For Filing Objections to Discharge In Rule 4004(a) Of The Bankruptcy Rules Of Practice And Procedure May Be Forfeited By The Debtor

1. Because the timely filing requirements of the bankruptcy rules do not constitute "a jurisdictional prerequisite to suit in federal court," they are to be treated "like a statute of limitations" and are therefore presumptively "subject to waiver, estoppel and equitable tolling." *Zipes* v. *Trans World Airlines, Inc.*, 455 U.S. at 393. The fact that the time limit in Rule 4004(a) is presumptively "subject to" the doctrine of waiver—and to defenses such as equitable tolling or estoppel—does not, of course, mean that these defenses would always be available under Rule 4004(a) or that a failure to point out that an objection to discharge is untimely will always prove fatal. In the present case, however, petitioner does not claim that appropriate factual grounds for a finding of waiver are not present. See Pet. App. 18, 31, 33. Instead, petitioner incorrectly

urges only that the timely filing requirement of Rule 4004(a) is "jurisdictional" and therefore may never be waived. That contention is incorrect for the reasons already described.

Moreover, much of petitioner's argument is actually directed to an issue that is not presented in this case. Petitioner insistently maintains that, taken together, the structure of Rule 4004(a) (which establishes the time for objecting to discharge) and of Rule 9006(b)(3) (which provides that the time for such objections may be enlarged only when timely application for an extension is made pursuant to Rule 4004(a)) require the conclusion that "a court has no authority to *extend the deadlines* based on equitable exceptions imported from outside the rules." Pet. Br. 13 (emphasis added); see also *id.* at 28 (arguing courts have no equitable authority "to extend the time for objecting to discharge"). This case, however, does not involve the issue of equitable tolling, for it does not involve a timely objection to an untimely application to "extend the deadlines" for filing an objection to discharge under Rule 4004(a). Instead, it involves the distinct issue of whether petitioner *waived his right to object* to an objection to discharge that was admittedly untimely. The question whether, under these Rules, equitable tolling doctrines would permit a court to "extend" the deadline is thus not presented here. And, because that question is not presented here, the Court need not address whether the time restrictions in these Rules are in such "emphatic form" that they negate the "presumption" that equitable tolling is available to remedy "unfairness in individual cases" by extending the filing deadline. *United States* v. *Brockamp*, 519 U.S. 347, 350, 353 (1997).

2. The filing deadline in Rule 4004(a) is designed to further the prompt administration of bankruptcy estates and to allow the debtor to enjoy finality and certainty in relief from financial distress. Those purposes do not preclude application of the doctrine of waiver in this case. As petitioner acknowledges, the doctrine of waiver is designed to "promote finality" and efficiency in the adjudicative process (Pet. Br. 21). "[T]he debtor, if he or she asserts his or her rights in a timely manner, will not suffer any impairment of his or her interest in certainty, finality and prompt administration." *In re Santos*, 112 B.R. 1001, 1008 (B.A.P. 9th Cir. 1990).

Indeed, this case presents a core example of a waiver of rights in litigation, for petitioner failed to challenge the timeliness of respondent's objection to discharge until *after* the court had ruled on the merits of that objection. See page 6, *supra*. Recognizing that the bankruptcy rules are to be interpreted and applied to achieve "the just, speedy, and inexpensive determination of every case and proceeding" (Fed. R. Bank. P. 1001), the court of appeals properly concluded that the doctrine of waiver applies in this case.

C. The Decision Below Is Not Inconsistent With *Taylor* v. *Freeland & Kronz*

Petitioner mistakenly argues (Pet. Br. 19-21) that the decision in this case is inconsistent with the decision of this Court in *Taylor* v. *Freeland & Kronz*, 503 U.S. 638 (1992).[9] In *Taylor*, the Court held that the time limits

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[9] Petitioner also erroneously relies (Pet. Br. 21) on *Carlisle* v. *United States*, 517 U.S. 416 (1996), which concerned the proper application of Rule 29(c) of the Federal Rules of Criminal Procedure. The Court held in *Carlisle* that Rule 29(c) is "plain and unambiguous" and does not permit untimely motions for acquittal,

in Rule 4003 for filing objections to a debtor's list of exempt property apply even for exemptions that are not claimed in "good faith." *Id.* at 644-645. Under the Bankruptcy Code, a debtor may claim certain property as exempt from his bankruptcy estate. 11 U.S.C. 522(b). To do so, "[t]he debtor shall file a list of property the debtor claims as exempt. * * * Unless a party in interest objects, the property claimed as exempt on such list is exempt." 11 U.S.C. 522(*l*). Bankruptcy Rule 4003(b) specifies that the trustee or any "creditor may file an objection to the list of property claimed as exempt within 30 days after the meeting of creditors." Fed. R. Bankr. P. 4003(b).

The debtor in *Taylor* had listed as exempt property the proceeds from her pending employment discrimination suit. Even though only a portion of these proceeds would have been allowable as an exemption, the trustee decided not to object to the claimed exemption because he thought the debtor's claim "might be a 'nullity.'" 503 U.S. at 641. In a settlement of the discrimination suit that followed a verdict in favor of the debtor, the debtor received $110,000. The trustee thereafter filed a complaint to obtain a turnover of the funds to the estate. *Ibid.*

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even when the failure to make a timely filing is assertedly the result of "excusable neglect." 517 U.S. at 421. Indeed, the Rules involved in that case specified that "excusable neglect" is not a valid basis for a failure to comply with the time limits in Rule 29(c). *Id.* at 421. Moreover, in *Carlisle*, the government timely argued that the defendant's motion for acquittal "should be denied as untimely" (*id.* at 418), and the Court therefore had no occasion to address or consider whether the government could waive its right to challenge an untimely filing under Rule 29(c). The decision in *Carlisle* thus has no application to the present case.

The Court framed the issue in *Taylor* as "whether the trustee may contest the validity of an exemption after the 30-day period if the debtor had no colorable basis for claiming the exemption." 503 U.S. at 639. The Court held that the trustee "could have made a valid objection under § 522(*l*) and Rule 4003 if he had acted promptly * * * [but] that his failure to do so prevents him from challenging the validity of the exemption now." 503 U.S. at 642. The Court noted that Rule 4003(b) expressly gives the trustee and creditors 30 days from the initial creditors' meeting to object and that, "[b]y negative implication, the Rule indicates that creditors may not object after 30 days 'unless, within such period, further time is granted by the court.' " 503 U.S. at 643. The Court concluded that there was no statutory basis for limiting this 30-day requirement to exemptions that the debtor claimed in good faith under Section 522(*l*). 503 U.S. at 644-645.

The decision in *Taylor* does not describe the filing deadline contained in Rule 4003(b) as jurisdictional. Nor, as the court of appeals noted in this case, did the Court hold that the debtor had an unlimited time in which to object to an untimely objection by the trustee. Pet. App. 15 n.4. Indeed, the question whether the 30-day limitation period in Rule 4003(b) was subject to waiver or equitable tolling was simply not raised or presented in the petition in that case.[10] The Court in

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[10] As Justice Stevens noted in his dissenting opinion in *Taylor*, the Court did not address in that case whether "the doctrine of equitable tolling applies to the 30-day limitations period in Federal Rule of Bankruptcy Procedure 4003(b)." 503 U.S. at 646. Justice Stevens suggested that, if the Court had reached that question, it would have found "ample authority" for such a holding. *Ibid.* The Court, however, expressly declined to consider arguments in *Taylor* that were not raised below and that were not contained in

Taylor thus neither addressed nor unsettled the established rule that filing deadlines in procedural rules—like statutes of limitation generally—are presumptively "subject to waiver, estoppel and equitable tolling." *Zipes* v. *Trans World Airlines, Inc.*, 455 U.S. at 393.

CONCLUSION

The judgment of the court of appeals should be affirmed.

Respectfully submitted.

THEODORE B. OLSON
Solicitor General

ROBERT D. MCCALLUM, JR.
Assistant Attorney General

PAUL D. CLEMENT
Deputy Solicitor General

KENT L. JONES
Assistant to the Solicitor General

WILLIAM KANTER
MICHAEL E. ROBINSON
Attorneys

JOSEPH A. GUZINSKI
General Counsel

P. MATHEW SUTKO

MICHELE M. MANSFIELD
Attorneys
Office of the United States Trustee

JULY 2003

"the questions set forth in the petition" for writ of certiorari in that case. 503 U.S. at 645 (quoting Sup. Ct. R. 14.1(a)).

BRIEF BANK — "SUMMARY SHEET"

Printed Fri.-1/8/99 (11:57)

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*

IN RE KORNFIELD
(ROBERT & KAREN KORNFIELD v. CAROLYN SCHWARZ)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*

CTA2 (U.S. Court of Appeals, 2d Cir.)

3. ("CCN") ***CURRENT*** CASE NO.

No.: 97-5080

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*

No.: N/A

Court: W.D. N.Y.

(Identify judge & cite, if any)

5. ("SO") ***SOURCE***

U.S. TRUSTEES

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*

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7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g., "UST/OGC"]*

Jeanne M. Crouse (UST/OGC)

(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***

BANKRUPTCY

9. ("SU") ! ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***

! Whether dismissal for "substantial abuse" under § 707(b) is warranted where Debtors sought to discharge debts despite ability to repay; their financial troubles were caused by their own pecuniary improvidence; Debtors filed schedules that evidenced their intent to continue living lavishly, rather than paying creditors; and they lived extravagantly while in bankruptcy.

√ **Background:**

10. PATH TO FILE LOCATION: (e.g., S:\GENERAL COUNSEL\BRFBANK\etc...)

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IN THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

No. 97-5080

In re Robert N. Kornfield and Karen E. Kornfield,

Debtors.

Robert N. Kornfield and Karen E. Kornfield,

Appellants,
v.

Carolyn S. Schwartz, United States Trustee,

Appellee.

On Appeal from the United States District Court
for the Western District of New York

BRIEF FOR APPELLEE UNITED STATES TRUSTEE

STATEMENT OF THE ISSUE PRESENTED FOR REVIEW

Did the bankruptcy court err in dismissing the Kornfields' bankruptcy petition pursuant to section 707(b) of the Bankruptcy Code?

STATEMENT OF THE CASE

A. Nature of the Case.

The Kornfields challenge the dismissal of their chapter 7 bankruptcy case. The bankruptcy court dismissed their case pursuant to section 707(b) of the Bankruptcy Code after concluding it would be a substantial abuse of chapter 7 of the Bankruptcy Code to erase the Kornfields' debts given their unwillingness to alter their lavish lifestyle and their ability to make substantial payments to their creditors.[1] On appeal, the district court affirmed the bankruptcy court's decision in all respects. This appeal followed.

B. Factual Background and Proceedings Below.

Robert N. Kornfield is a gastroenterologist who now works for a professional corporation in which he is President, sole shareholder and the sole physician-employee. A120-21, 198, 283, 300, 302.[2] Dr. Kornfield lives with his wife, Karen E. Kornfield, in Pittsford, New York (A276), a town of 27,500 persons located within the Rochester, New York, Standard Metropolitan Statistical Area ("SMSA"). Rochester has a low cost of living. The area's median home cost is $88,100. Of the 135 SMSAs in the United States, only 33 have a lower median home price. See Median Home Prices Across the USA, Money, Nov. 14, 1997, available in Allnewsplus file (1997 WL 7019974) (Rochester SMSA's $88,100 median home price is 70% of the $126,500 national aver-

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[1] Pertinent statutory provisions (11 U.S.C. §§ 102,707) and rules (Fed. R. Bankr. P. 1017) are reproduced in the Addendum to this Brief.

[2] The citation form "A__" refers to the page on which this information is found in the Appendix submitted by appellants.

age).

In 1996, Dr. Kornfield earned $318,127 from his medical practice. A206. In 1995, he earned $404,050.[3] A206, 295. He earned $472,445 in 1994. A295. Mrs. Kornfield lists her occupation as housewife. A293, 307.

The Kornfields' financial difficulties began when they built a $2.1 million dollar home in Pittsford in 1991. A142. Their problems increased in 1995 when Dr. Kornfield (who was then self-employed) did not timely pay his federal income taxes; as a result of his failure to pay taxes, the Kornfields had to refinance their property in the amount of $225,000 to pay their tax obligations.[4] A142-43. The loan to repay the taxes was made in February 1995; in October 1995 the Kornfields defaulted on this mortgage. A142-43, 170. Litigation that followed the foreclosure on their house precipitated the Kornfields' filing for bankruptcy relief. A143-44, 219-20, 228.

On July 30, 1996, the Kornfields filed a petition seeking protection under the debt liquidation provisions of chapter 7 of

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[3] Dr. Kornfield did not set up his professional corporation until 1995. A206. His earnings in 1995 represented $92,396 in wages from his corporation and $311,654 in profit from his previously unincorporated business. Id.

[4] In the application that they submitted to obtain the February 1995 loan, the Kornfields described the "upgraded improv." to their house as "Custom Brick[,] Gold Faucets[,] Marble Foyers[,] Solid Cherry Library[,] 6 fireplaces[,] Copper roof & gutters[,] Pella Windows[,] Hand painted tiles." A190.

the Bankruptcy Code. A276-305. In a chapter 7 case, a debtor’s non-exempt assets can be used to pay existing creditors but the debtor’s future income is shielded from the repayment of those debts. 11 U.S.C. § 541(defining property of the estate). The Kornfields’ schedules listed assets of $433,666 and liabilities of $646,673. A282-284, 305. A debtor’s schedules are intended to provide the court and all parties to the case with an accurate snapshot of the debtor’s finances. Because of their critical importance to the effective administration of the bankruptcy system, these documents are signed under penalty of perjury. 11 U.S.C. § 521(1); see also Fed. R. Bankr. P. 1008. The Kornfields amended certain of their schedules on September 5, 1996 and February 19, 1997; these amendments did not significantly change their initial petition. A220 n.1, 306-07; Bankruptcy Court Docket (“B. Dkt.”) 50.

The Kornfields’ general unsecured debt arose from consumer loans, including credit card purchases. A220 n.1, 289-90. They owed money on a First Fidelity Bank VISA card, a First Union Bank VISA card, a First USA credit card, a USAA credit card, and a Citibank credit card. Id. Their schedule of unsecured claims lists additional debts arising from consumer purchases of goods or services. Id. Their largest unsecured debts were the unsecured portions of the loans owed to the creditors who had held first and second mortgages on their $2 million home, First

Federal Savings & Loan ("First Federal") and First Union Home Equity Bank ("First Union"). Id. See 11 U.S.C. § 506(governing treatment of undersecured creditors). In their schedules, the Kornfields did not list the debts owed to First Federal and First Union as disputed, although in later papers they challenged the First Federal debt. A220, 289.

The Kornfields' bankruptcy schedules evidenced an intent to live lavishly post-petition. A294. In them, the Kornfields claimed they needed $13,115 monthly for living expenses, including $3,000 each month to rent a house, $400 for clothing, $4,470 for private school tuition, and $1,200 a month for food and entertaining. Id. Their schedules reveal they owned or leased three vehicles, a 1996 Range Rover, a 1994 Plymouth Grand Voyager, and a 1989 Voyager. A283-84. The Kornfields stated in their petition that they intended to keep and maintain all three.[5] A285-86, 304. The Kornfields' petition revealed their intention to reaffirm the indebtedness securing their cars, and their list of expenditures included debt service for them, including monthly gasoline and oil costs of $175 and an additional $200 budgeted each month for automobile repairs. A294.

Of the $433,666 in assets that the Kornfields identified on their schedules (A281-85), $398,216 of those assets were claimed

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[5] One Voyager apparently was repossessed in the course of the bankruptcy case. A221 n.3.

as exempt from liquidation to repay their debts (A285). The largest exempt asset was $390,216, which represented a profit-sharing plan that Dr. Kornfield's professional corporation established for his benefit. A285. See also A85 (general description of plan).[6]

The remaining assets the Kornfields listed on their schedules had minimal value. Despite the fact that their previous home cost $2.1 million, the Kornfields represented in their schedules that all their household goods and furnishings were worth only $4,000. A282. They then exempted the value of these furnishings pursuant to New York law. A285. Although at the time they filed their bankruptcy petition they rented a house for $3,000 a month (A294), they stated in their petition that there were no existing security deposits that had been given to their landlord (A282).

Because the Kornfields had minimal assets other than Dr. Kornfield's pension, which was protected from his creditors, the Kornfields' general unsecured creditors, who are owed $584,694 (A289-90), would have received nothing in a chapter 7 liquidation because the Kornfields' secured and priority unsecured debts of $61,979 (A286-87) exceed their scheduled estimates of $35,450 in

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[6] Dr. Kornfield is the only corporate employee eligible to participate in this plan. A122.

nonexempt assets[7] (A281-85). A chapter 7 discharge would, however, free the Kornfields from all these debts. 11 U.S.C. §§541, 726, 727(b).

After the Kornfields filed their chapter 7 petition, Peter Scribner was appointed as chapter 7 trustee for their case. A64. See 11 U.S.C. § 704 (describing duties of case trustee). The first meeting of creditors was scheduled for and held on September 5, 1996. Id. Before and after the meeting of creditors, Mr. Scribner asked the Kornfields' attorney for additional information about various matters raised in their schedules, including information about Dr. Kornfield's pension plan. A67-68, 71. In a September 19 letter, Mr. Scribner told debtor's counsel that he had "grave problems with [the pension plan's] exemptability" and also advised that the United States Trustee was considering a motion to dismiss their case because of substantial abuse. A71. Mr. Scribner also stated that the decision to move to dismiss the case depended on whether the pension funds were exempt because, if they were not exempt assets, liquidation of those funds in chapter 7 obviously would result in a large distribution to creditors. Id. Thus, Mr. Scribner advised, if the exemption issue could not be resolved by the deadline for filing a substantial abuse motion, an extension of that deadline would be re-

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[7] The $35,450 figure is calculated by deducting the Kornfields' $398,216 in exempt assets (A285) from their $433,666 in total assets (A284).

quested.[8] Id.

Fed. R. Bankr. P. 1017(e) requires the United States Trustee to file a motion to dismiss a case for substantial abuse no later than sixty days after the first date set for the meeting of creditors.[9] However, before those 60 days elapse, the bankruptcy court can extend the time for filing a section 707(b) motion if cause is shown. Fed. R. Bankr. P. 1017(e)(1). In this case, the United States Trustee had to file her motion under 707(b) on or before November 4, 1996. A71.

On October 23, 1996, the United States Trustee moved ex parte to extend the time for filing any motion to dismiss for substantial abuse. A64-72. The United States Trustee requested

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[8] On September 5, 1996, Mr. Scribner filed an objection to the Kornfields' claimed exemption of the pension funds. A84. Mr. Scribner filed this pleading to preserve any objection and candidly admitted that "[t]he trustee must review this exemption much more closely before consenting to the validity of such a large pension by a self employed person." Id. In order to pursue and obtain a ruling on the objection, Mr. Scribner would have needed to schedule a hearing on this matter. No hearing was ever scheduled.

[9] United States Trustees are officials of the Department of Justice appointed by the Attorney General to supervise the administration of bankruptcy cases and trustees. See 28 U.S.C. §§ 581-589 (establishing the United States Trustee Program and the powers of United States Trustees); United States Trustee v. Columbia Gas Systems, Inc. (In re Columbia Gas Systems, Inc.), 33 F.3d 294, 296 (3d Cir. 1994)(United States Trustees oversee the bankruptcy process, protect the public interest, and ensure that bankruptcy cases are conducted according to law)(citing H.R. Rep. No. 595, 95th Cong., 2d Sess. 109 (1977); United States Trustee v. Revco D.S., Inc. (In re Revco), 898 F.2d 498, 499 (6th Cir. 1990) ("[t]he United States trustee, an officer of the Executive Branch, represents . . . [the] public interest").

additional time so that Mr. Scribner could complete his research and determine whether the $400,000 in pension funds were in fact exempted from distribution to creditors in this case. A64-66. The United States Trustee attached to her motion correspondence from Mr. Scribner to her office and to the Kornfields' counsel. A67-72.

On October 28, 1996, before the 60-day deadline expired, the court granted the United States Trustee an extension of time to file a motion to dismiss for substantial abuse. A63. Two months later, on December 27, the Kornfields moved for reconsideration of the order extending time.[10/] A73-85.

After the United States Trustee filed her opposition (A86-87), a hearing was held on January 8, 1997, on the motion to reconsider (resettle) the order extending time (A88-108). The Kornfields argued that extending the deadline for the substantial abuse motion ex parte denied them their rights to be heard on the issue. They also contended that cause did not exist to extend the deadline. The court concluded that because additional time was needed to investigate the validity of the Kornfields' exemption, cause existed to extend the deadline for the substantial

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[10/] The Kornfields filed this motion through the law firm of Lacy, Katzen, Ryen & Mittleman, LLP. A73. They previously had been represented in this case by Albert H. Pinsky, Esq. A276-78. It is not clear from the record when Lacy, Katzen began representing the Kornfields because Mr. Pinsky never formally withdrew from the case and Lacy, Katzen never formally entered its appearance. <u>See</u> <u>also</u> A86.

abuse motion.[11] A106-07. The motion to resettle was denied.[12] A109-110.

So that the case would not be delayed further, on the same day that she filed her opposition to the Kornfields' motion to reconsider, the United States Trustee moved to dismiss the Kornfields' bankruptcy case pursuant to section 707(b) of the Bankruptcy Code. A111-114, 276-307. The debtors opposed the motion. A198-226. Mr. Scribner and creditor First Union filed papers supporting the motion to dismiss (A163-197); and a hearing was held February 12, 1997 (A115-162). At the end of the hearing, the bankruptcy court gave all parties time to submit any additional evidence or analysis they wanted considered. A161. The court specifically directed the Kornfields' counsel to submit evidence concerning the debtors' monthly income.[13] Id. Mr.

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[11] The court did note that it had interpreted the United States Trustee's papers as saying that the debtors were not cooperating with the case trustee and that the debtors agreed that a deadline was necessary to reach the merits of a 707(b) motion. A99-100. Upon receipt of the Kornfields' December 27 motion, the court regretted that it had not contacted the debtors' counsel prior to extending the deadline and concluded that future extension motions could not be filed ex parte. A100, 102, 107. Nevertheless, the court concluded that cause existed to extend the filing deadline. A106-07.

[12] The Kornfields appealed from this interlocutory order. A308. Their appeal was denied. A309-10.

[13] At the hearing, one of Dr. Kornfield's three attorneys asserted that the debtors' net income in 1996 was only $120,000. A157. The court specifically instructed Dr. Kornfield's lead counsel to submit evidence on this point. A161.

Scribner filed a supplemental pleading (A227-28) and the United States Trustee filed a letter-memorandum (A229-74); however, the Kornfields submitted nothing, choosing instead “to rely upon the papers, pleadings, and arguments heretofore made and submitted. . . [Counsel has] sent this letter only to let the court know that the Debtors have not overlooked the matter.” A275.

In a lengthy opinion entered on June 23, 1997, the court found that to grant the Kornfields a discharge would constitute substantial abuse under section 707(b). A28-62; In re Carlton, 211 B.R. 468 (Bankr. W.D.N.Y. 1997).[14] Accordingly, the court dismissed the Kornfields’ case. The Kornfields filed a notice of appeal to the district court on July 1, 1997. A311-12.

On November 10, 1997, the United States District Court for the Western District of New York, issued an order and memorandum decision affirming the bankruptcy court’s dismissal of the Kornfields’ case. A10-27; Kornfield v. Schwartz, 214 B.R. 705 (W.D.N.Y. 1997). On December 5, 1997, the Kornfields filed a notice of appeal to this Court. A8-9.

STATEMENT OF THE STANDARD OR SCOPE OF REVIEW

This Court’s review of the decision of the district court in its “‘capacity as [an] appellate court in bankruptcy cases is

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[14] The Carltons, whose case also was dismissed in the same opinion, did not appeal from dismissal of their case.

plenary. Therefore, we review the district court's determinations of law de novo and its determinations of fact for clear error only.'" United States Trustee v. Bloom (In re Palm Coast, Matanza Shores Ltd. Partnership), 101 F.3d 253, 256 (2d Cir. 1996) (citation omitted). Findings of fact should be reviewed under a deferential standard and reversed only if this Court's review "convinces us that the bankruptcy court clearly erred." Brody v. Brody (In re Brody), 3 F.3d 35, 38 (2d Cir. 1993). The bankruptcy court's decision may be affirmed on any basis supported by the record. Lawson v. Ford Motor Co. (In re Roblin Indus., Inc.), 78 F.3d 30, 38 (2d Cir. 1996).

SUMMARY OF ARGUMENT

Section 707(b) of the Bankruptcy Code authorizes dismissal of a chapter 7 case if it would constitute substantial abuse to give the debtor chapter 7 relief. Although the Kornfields allege the bankruptcy court erred in dismissing their case, their case is a textbook example of substantial abuse. The Kornfields sought to discharge their lawful debts even though they have the ability to repay them; their financial difficulties were caused by their own pecuniary improvidence; they filed schedules that evidenced their intent to continue living lavishly rather than pay their creditors; and they lived extravagantly while in bankruptcy.

The Kornfields also categorically refused to consider seeking bankruptcy relief under other chapters of the Bankruptcy Code, which could have given them the opportunity to resolve their debts in an orderly fashion while assuring that their creditors would receive a fair return on their debts. Instead, the Kornfields insist to this day that they have the right to subsidize their personal lifestyle at their creditors' expense by liquidating their debts in a chapter 7 proceeding in which — unlike a chapter 11 or chapter 13 case — their substantial future income is ignored. This is an unfair result that the law does not mandate. As the district court noted, "[a] fresh start is not the same thing as a 'free ride,' which is what [the bankruptcy court] was concerned with preventing here, to the detriment of appellants' creditors." A26-27; 214 B.R. at 713.

ARGUMENT

1. The Bankruptcy Court Acted Appropriately in Dismissing the Kornfields' Petition for Substantial Abuse.

Section 707(b) of the Bankruptcy Code, 11 U.S.C. 707(b), authorizes a bankruptcy court, upon its own motion or upon that of the United States Trustee, to dismiss a debtor's chapter 7 petition if two conditions are met. First, the debtor must be an individual with primarily consumer debts. This prong is not at issue in this case. The Kornfields do not contest that they have primarily consumer debts. A277 (Kornfields executed certification in schedules "BY INDIVIDUAL CHAPTER 7 DEBTOR WITH PRIMARILY

CONSUMER DEBTS"). See also A198-205, 219-26 (no assertion in pleadings that Kornfields' debts are not consumer debts).

Second, the court must find that the "granting of relief would be a substantial abuse of the provisions of this chapter." Section 707(b) establishes a presumption in favor of granting the relief sought by the debtor.

The Bankruptcy Code does not define "substantial abuse" and the apposite legislative history is unhelpful. See generally In re Ontiveros, 198 B.R. 284, 288 (C.D. Ill. 1996) (describing the absence of meaningful legislative history). It is clear, however, that section 707(b) was enacted to stem bankruptcy filings by non-needy debtors. Green v. Staples (In re Green), 934 F.2d 568, 570 (4th Cir. 1991); In re Krohn, 886 F.2d 123, 126 (6th Cir. 1989).

This Court has not had occasion to interpret this term.[15] Other circuits have created three overlapping tests to help determine whether a case constitutes substantial abuse. The Eighth and Ninth Circuits hold that the "primary factor" evidencing substantial abuse is a debtor who has an "ability to pay his

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[15] Below, the bankruptcy court reviewed extant case law and decided it would apply a "blended approach," enumerating 15 non-exclusive factors culled from reported decisions to be considered when deciding substantial abuse motions. A49-52; 211 B.R. at 477-78. The court ultimately concluded that "to allow the Kornfields a Chapter 7 discharge would be a substantial abuse of Chapter 7, no matter what legal standard the Court utilizes." A61; 211 B.R. at 483.

debts out of his income." United States Trustee v. Harris, 960 F.2d 74, 76 (8th Cir. 1992); Zolg v. Kelly (In re Kelly), 841 F.2d 908, 914-15 (9th Cir. 1988). These courts will dismiss a case based solely upon a debtor's ability to use future income to repay a substantial portion of its debt. Id. They espouse this test because it preserves "'the bankruptcy courts' ability to dismiss cases filed by debtors who are not dishonest, but who also are not needy.'" Harris, 960 F.2d at 76 (quoting In re Walton, 866 F.2d 981, 983 (8th Cir. 1989)).

The Fourth Circuit prefers a test that it characterizes as a "totality of the circumstances" analysis. Green, 934 F.2d at 572. This court places greater emphasis on determining whether a debtor has acted appropriately in seeking bankruptcy protection. The Fourth Circuit will consider, among other things, (1) whether the bankruptcy is a product of sudden illness, calamity, disability, or unemployment; (2) whether the debtor has made consumer purchases far in excess of its ability to repay; (3) whether the debtor's proposed family budget is excessive or unreasonable; (4) whether the debtor's schedules and statement of current income and expenses are reasonable and accurate; and (5) whether the petition has been filed in good faith.[16/] Id.

[16/] The Fourth Circuit does not require that all five criteria be analyzed or satisfied in every case. Instead, courts must reach decisions on a "case-by-case basis." Green, 934 F.2d at 572. Accord Kestell v. Kestell (In re Kestell), 99 F.3d 146, 149-50 (4th Cir. 1996) (dismissing pursuant to section 707(b) for

In addition, the Fourth Circuit agrees with the Eighth and Ninth Circuits that a court may consider a debtor’s ability to repay. Id. (court may consider “the relation of the debtor’s future income to his future necessary expenses”). See In re Smurthwaite, 149 B.R. 409, 410 (Bankr. N.D.W. Va. 1992) (Green “gave considerable weight to the debtor’s ability to repay as a factor which it should consider”).

The Sixth Circuit allows courts to consider a debtor’s conduct and its ability to repay. In re Krohn, 886 F.2d 123, 126-27 (6th Cir. 1989) (court may consider a number of factors, including: the ability to repay; whether unforeseen or catastrophic events caused the bankruptcy; whether the debtor has a “stable source of future income”; whether the debtor’s schedules evidence good faith; and whether expenses can be reduced significantly).[17]

It not necessary for this Court to adopt one of these tests to determine this appeal because the bankruptcy court correctly held that the Kornfields’ case constitutes substantial abuse “no matter what legal standard the Court utilizes.” A61; 211 B.R. at

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lack of good faith because the debtor “sought to avoid paying what he owe[d] to [one specific creditor,] his former wife[,]” without analyzing the other four Green factors).

[17] The Eighth and Ninth Circuits do not prohibit courts from considering Green and Krohn-type factors. Instead, they hold the absence of such factors cannot save the chapter 7 petition of a debtor who can repay a substantial portion of his or her debts. Walton, 866 F.2d at 982,983; Kelly, 841 F.2d at 914-15.

483. Collectively, the Kornfields' unwillingness to adjust their conduct (including their extravagant lifestyle) and their ability to repay a substantial part of their debts justified dismissal. A57-60; 211 B.R. at 479-80.

The bankruptcy court properly dismissed the Kornfields' petition based upon the evidence before it. "Dr. Kornfield has and will continue to enjoy stable employment." A59. The Kornfields suffered no sudden illness, calamity, disability, or unemployment which forced them into bankruptcy. A59; 211 B.R. at 482. See Green, 934 F.2d at 572 (citing this as a factor justifying dismissal); Krohn, 886 F.2d at 126 (same).

The court found that the Kornfields' proposed budget, which was "excessive and possibly even extravagant", buttressed the dismissal of their case. A57, 211 B.R. at 481. See Green, 934 F.2d at 572 (citing this as a factor justifying dismissal). Rather than demonstrating an intent to rectify their financial problems, the court found that the evidence established that the Kornfields

> appear unwilling to make any effort to reduce their possibly actual, but in large part voluntary and excessive, living expenses to enable them to repay something to their creditors. In fact, the Kornfields, . . . , have in essence argued to the court that no one should involuntarily be required to live below their current means to repay creditors, notwithstanding prior financial mistakes, and the Bankruptcy System is there to ensure that that cannot happen, because it allows a debtor to simply file a Chapter 7 case, obtain a discharge from all of his debts, even though he has an Ability to Pay, continue to live an extravagant life-

> style, and retain substantial exempt funds.

A60; 211 B.R. at 482-83.

The Kornfields' budget also evidenced an intent to live lavishly post-petition. A294. Their fashionable lifestyle included a monthly rental payment of $3,000, $120 a month for telephone bills (which included four telephone lines), $1,200 a month for food and entertaining,[18] $400 a month for clothing,[19] recreation of $100 a month, life insurance payments of $250, monthly automobile expenses of $1,455, and monthly tuition payments of $4,470. A294. These extravagant expenditures while in bankruptcy called their good faith into question. See Green, 934 F.2d at 572 (citing bad faith as a basis for dismissal).

The bankruptcy court also dismissed the Kornfields' case because they have the ability to repay substantial sums to their creditors if they reduce their expenses to reasonable levels. A57-58. The court found the Kornfields have gross monthly take-home pay of $25,939.16. A58. After withholding income tax at a rate of 50.8%, the Kornfields have net monthly income of

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[18] See Krohn, 886 F.2d at 124 (citing "large food bills"). See also Kelly, 841 F.2d 908, 915 n.9 ("going out to dinner, entertaining people" are not "items [that] qualify as reasonably necessary . . . for the maintenance or support of the debtor or a dependent of the debtor" (citations omitted)).

[19] See Krohn, 886 F.2d at 124 (citing "large clothing allowance").

$12,762.[20] A58.

The court then concluded the Kornfields could reasonably reduce their monthly expenses in at least five ways. A57-58. The court found that monthly food costs could be reduced by at least $350, the telephone expenses could be reduced by $50, clothing costs could be reduced by $200, charitable donations of $200 could be reduced, and the private school tuition costs of $4,470 per month (or $53,640 per year) could be eliminated.[21] Id. The court thus concluded that the Kornfields could easily reduce their monthly expenses by $5,270 by making only the five reductions listed.[22] A58. The court then used the figure of $4,117 in reduced expenses per month to conclude that these five reductions alone would make available to creditors $148,212 over

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[20] The court applied a withholding percentage of 50.8% because that was the rate used by the Kornfields in their schedules. A307. However, this tax rate was contradicted by the debtors' records, which evidenced a withholding rate of 29 to 31%. A164, 167. The Kornfields' tax records for 1994 and 1995 evidenced a tax rate of 40% of gross income. A164.

The 50.8 percentage results in $13,177 in withholding. The court mistakenly states in its opinion that the Kornfields have $13,177 in monthly income, but later uses the correct monthly income number of $12,762 in its calculations ($25,939.16 - $13,177 = $12,762). A58.

[21] The court noted that the Kornfields' public school district was "nationally acclaimed." A57; 211 B.R. at 481.

[22] In reaching the calculation of $5,270, the court included in its calculations but did not itemize the $200 in extra clothing expenses. A58.

a 36-month term and $247,020 over a 60-month term.[23] A58.

In addition, the record plainly shows that there are other “extras” in the Kornfields’ budget.[24] For instance, $3,000 a month for rent is “at the extreme high end of rents in this area” and could have easily been reduced to $1,000 to $1,500. A165. Second, the court used the 50.8% tax withholding rate that the Kornfields employed in their schedules to calculate net monthly income. A307. However, their own payroll and tax documents demonstrate that withholding of 40% is more accurate. A163-64, 167-68. Using a 40% withholding rate would result in net monthly income of $15,906.35, which represents an increase in the income figure that the court used of $3,144.35.[25] A58. Analysis of only these two items yields an additional $4,144.35 ($1,000 plus $3,144.35) in net monthly income. Other “extras” that are susceptible to question are the $1,100 monthly repayments that Dr. Kornfield made to himself for a loan from his pension funds (A148-49) and a $250 payment that the Kornfields make each month on life insurance that they did not claim as an asset on their

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[23] If the total amount of hypothetical reductions had been used ($5,270), that would have resulted in $189,270 available to creditors in a 36-month term and $316,200 in a 60-month term.

[24] Harris, 960 F.2d at 77 (affirming district court’s consideration of additional income evidenced by the record).

[25] Net monthly income of $15,906 is calculated as follows: 1996 net income of $318,127 (A206) divided by 12 = $26,510.58. 40% (A164,167-68) of $26,510.58 = $10,604.23. $26,510.58 minus $10,604.23 = $15,906.35.

schedules (A282, 294).[26]

Thus, the record plainly shows that the “Kornfields clearly have an Ability to Repay” substantial sums to their creditors. A60. By making reasonable cutbacks in their lifestyle, the Kornfields would be able to pay their creditors either $247,020 over five years (according to the court’s calculations (A58)) or $316,200 over five years (using a monthly calculation of $5,270 additional income per month) without “depriving any of them of adequate food, clothing, shelter or other necessities; . . .” A58. Adding the $4,144 gained from the reductions in mortgage expense and tax withholding brings the total available for repayment over five years from $316,200 to $564,840.

The Kornfields are the masters of their financial future. They can repay a substantial portion of their debts. A57-58. They can seek relief under the debt reorganization provisions of chapter 11 of the Code if they need breathing room to reorganize their debts; they may also be eligible for chapter 13 relief.[27] A59. Indeed, in her motion, the United States Trustee stated

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[26] These calculations also assume the Kornfields neither extend the life of their debt service nor negotiate any forgiveness of debt. A58.

[27] The case trustee noted that, because the Kornfields dispute the amounts owed to at least one bank, the Kornfields may qualify for relief under chapter 13. A228. Moreover, as the court correctly observed, the Kornfields in a chapter 11 case could voluntarily reserve some of their income to fund a repayment plan. A56-57; 211 B.R. at 480-81.

that, as an alternative to dismissal, "the Debtors should be permitted to convert to a Chapter 11 or Chapter 13 [case] if they so desire." A114. The Kornfields rejected this proposal out-of-hand, contending instead that they were entitled to a chapter 7 discharge that would leave their creditors with nothing while allowing them to keep all of their future income to fund their lavish lifestyle. A220. Finally, the bankruptcy court did not bar them from filing another chapter 7 petition (A60-61), and they could do so if their financial circumstances worsen. The Kornfields should not be denied all relief in bankruptcy, but the bankruptcy court properly found that it would be inappropriate to allow them relief under the liquidation provisions of chapter 7.

The bankruptcy court also noted that their "unwillingness to consider a Chapter 11 case where they might negotiate a consensual plan with their creditors, . . . raises concerns as to their honesty and good faith in their approach to the Bankruptcy System and their creditors; . . ." A59. Other evidence in the record buttresses this conclusion. The debtors were less than candid about their monthly income. In their schedules, the debtors state that their monthly gross income is $23,000. A293, 307. However, the very evidence that they submitted in opposition to the United States Trustee's motion shows that Dr. Kornfield's 1996 income was $318,127, which comes to $26,510 per month. A206 (Kornfields' accountant's letter).

Their own evidence notwithstanding, Dr. Kornfield’s General Counsel (one of three attorneys who represented the Kornfields at the February 12 hearing) insisted at that hearing that the debtors’ net income in 1996 after tax withholdings was $120,000. A157. The court explicitly asked the Kornfields’ lead counsel to submit evidence to support the $120,000 figure. A161. Despite the court’s request, the debtors did not submit this evidence, choosing instead to “rely upon the papers, pleadings, and arguments heretofore made and submitted.”[28] A275. Finally, the debtors never amended their schedules to reflect the numbers submitted by their accountant. The debtors plainly were less than forthright with the court and their creditors about their true income.[29]

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[28] See Industrial Ins. Servs., Inc. v. Zick (In re Zick), 931 F.2d 1124, 1128-29 (6th Cir. 1991) (finding dismissal under 707(a) appropriate where debtor failed to respond to court’s request for additional information).

[29] In their opening brief, the Kornfields contend that the court erred in failing to harmonize national policies governing “pensions, education, and mortgage lending.” Appellants’ Br. at 13-30. These arguments are without merit. The Kornfields’ argument concerning pensions misstates the record — the Kornfields contend that the bankruptcy court’s decision forces them to invade their $400,000 in exempt pension funds. App. Br. at 15-19. The bankruptcy court did not order them to distribute these funds; it simply noted the existence of these monies as one of the totality of the circumstances of the case. A59. This approach comports with applicable case law. See, e.g., Stuart v. Koch (In re Koch), 109 F.3d 1285, 1288-89 (8th Cir. 1997) (in deciding 707(b) motion, bankruptcy court should consider exempt income in calculations of hypothetical chapter 13 plan). So does the bankruptcy court’s approach to the extravagant $53,640 annual tuition expenses for private schools. In re Gyurci, 95 B.R. 639,

This case should have been, and properly was, dismissed. "At no point in the [Kornfields'] history, either before or after filing for chapter 7 relief, ha[ve] the debtor[s] shown a sincere resolve to repay [their] obligations and/or to reduce [their] monthly expenses." Krohn, 886 F.2d at 127. The Kornfields will profit as much as their creditors from some "good, old-fashioned belt tightening." Id. at 128.

2. The Bankruptcy Court Did Not Commit Any Procedural Errors in Dismissing the Kornfields' Case.

In their opening brief, the Kornfields "raise a gaggle of

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643 (Bankr. D. Minn. 1989).

In addition, the Kornfields, who cursorily mentioned this argument in a five-sentence footnote below (A220 n.2), now contend the bankruptcy court applied 707(b) in a manner that conflicts with Congressional intent as evidenced by the Financial Institution Reform, Recovery, and Enforcement Act ("FIRREA"). Appellants' Br. at 12, 23-30. FIRREA principally involves the power of the FDIC to liquidate banks. See, e.g., 12 U.S.C. §§ 1811-1825. Whatever limitations FIRREA might impose on the FDIC's powers, no provision of the Bankruptcy Code permits, much less requires, a court to consider vague national policies — regarding pensions, mortgages or anything else — in deciding a substantial abuse motion under section 707(b). Cf. Patterson v. Shumate, 504 U.S. 753, 112 S. Ct. 2242, 2246-48 (1992) (holding that when Bankruptcy Code provision explicitly referenced "applicable nonbankruptcy law", courts had to consider federal ERISA law). As the district court observed, the Kornfields' argument alleging improper "protection" of mortgage lenders "is in effect an argument that those who deliberately live beyond their means should be relieved of their obligation to repay lenders because it was foolhardy to lend them money in the first place." A24; 214 B.R. at 712. In any event, there is no implied right of action under FIRREA even as to the FDIC for debt relief for individuals such as the Kornfields. See generally Hindes v. Federal Deposit Ins. Corp., — F.3d —, 1998 WL 65978 *21 (3d Cir. 1998).

procedural matters that they claim require reversal. Appellants' claims are without merit." A15; 214 B.R. at 708. The bankruptcy court did not commit any procedural errors in finding that the Kornfields' case constituted substantial abuse of the bankruptcy system.

First, the Kornfields argue that the bankruptcy court committed reversible error in granting the United States Trustee's motion to extend time for filing her substantial abuse motion ex parte. Appellants' Br. at 37-41. Fed. Rule Bankr. P. 1017, which governs motions to dismiss for substantial abuse, requires that the United States Trustee's motion to dismiss shall be filed no later than 60 days following the first meeting of creditors, unless "before [the deadline for such motions] has expired, the court for cause extends the time for filing the motion." Fed. R. Bankr. P. 1017(e)(1).

The plain language of Rule 1017(e)(1) does not require notice and a hearing before the court extends the time to file a substantial abuse motion. See also Fed. R. Bankr. P. 9006(b) (contemplating ex parte motions to enlarge time); 9013 (contemplating certain motions can be filed ex parte). In contrast, Fed. R. Bankr. P. 4004, upon which the Kornfields rely in their brief (Appellants' Br. at 38-40), does require a "hearing on notice" before a court can extend the time for filing complaints objecting to discharge. Fed. R. Bankr. P. 4004(b). The language of Rule 4004(b) is not pertinent here. The requirements of the pertinent rule — Rule 1017(e)(1) — were met when the court found that cause existed to extend the filing deadline and reached this decision before the 60-day deadline had expired.

Finally, as the district court cogently noted, “the single biggest flaw” in this argument is the fact that the Kornfields did “have an opportunity to raise all these matters” concerning the impropriety of the ex parte motion when the court heard the debtors’ motion to resettle on January 8. A16; 214 B.R. at 708. At that hearing, the bankruptcy court found that the interests of judicial economy constituted sufficient cause to support the extension of time. A106-07. That decision should be affirmed.

The Kornfields also contend that the bankruptcy court’s decision should be reversed because the court improperly permitted the case trustee, Mr. Scribner, and a creditor to submit papers and participate at the hearing on the substantial abuse motion. Appellants’ Br. at 44-50. The Kornfields’ argument does not comport with the applicable bankruptcy rules.

Rule 1017(e) explicitly states that an individual debtor’s bankruptcy case can be dismissed “only . . . after a hearing on notice to the debtor, the trustee, the United States trustee, and such other parties in interest as the court directs.” All parties in interest received notice of the United States Trustee’s motion to dismiss the Kornfield case. A111 (“CREDITORS ARE

INVITED, BUT NOT REQUIRED, TO APPEAR AND BE HEARD”). As the district court observed, “there is nothing in the Code that proscribes a creditor’s participation in proceedings relating to a substantial abuse motion brought by the U.S. Trustee. Bankruptcy Rule 1017(e) . . . suggests precisely the opposite.” A26; 214 B.R. at 713. Accord Zolg v. Kelly (In re Kelly), 841 F.2d 908, 917 (9th Cir. 1988) (dictum) (after “the issue of section 707(b) dismissal is raised, the debtor and, if appropriate, other parties as well are free to present evidence on the relevant issues”). See also H.R. Conf. Rep. No. 99-958, 132 Cong. Rec. H8986, H8998 (daily ed. Oct. 2, 1986), reprinted in 1986 U.S.C.C.A.N. 5246, 5248 (“The conferees anticipate that panel trustees will frequently appear in court regarding the motions filed by the U.S. Trustee under Section 707(b)”).

Finally, the Kornfields’ contention that they were denied a proper hearing is likewise meritless. A case may be dismissed under section 707(b) only “[a]fter notice and a hearing.” 11 U.S.C. § 707(b). Section 102(1) of the Code explains that “notice and a hearing” means whatever notice and hearing “as in appropriate in the particular circumstances.” Such circumstances do not require a full-blown evidentiary hearing. Zick, 931 F.2d at 1128-29. See also DiNova v. Harris (In re DiNova), 212 B.R. 437, 442 (Bankr. 2d Cir. 1997) (notice and hearing means notice and opportunity for hearing that is appropriate in the circumstances).[30]

In this case, as in Zick, the Kornfields were given a full and fair "opportunity to present pleadings or an affidavit in opposition and to respond to the court through his counsel." Id. at 1129. Indeed, the court adopted the legal analysis that the Kornfields advocated (A138 ("The basic element in a substantial abuse case is an ability to pay"); A221-22 (court must consider "all the surrounding circumstances")) and relied upon the debtors' sworn statements and other documents they had submitted in reaching its conclusion. The court accepted the Kornfields' budget, which they signed under penalty of perjury, and their calculations, including their tax withholding rate, despite the fact that the tax rate was contradicted by other evidence they submitted. A56-60, 163-64, 167-68, 198-218, 276-307.

Moreover, not once during the February 12 hearing did the Kornfields make a proffer as to any additional evidence that they wished to submit; nor did they request an evidentiary hearing. A115-162. They never filed a motion for reconsideration seeking

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[30] The Kornfields mistakenly assert that DiNova mandates reversal here. Appellants' Br. at 37, 39. DiNova involved a situation in which the court dismissed the entire bankruptcy case pursuant to an ex parte motion and contrary to the requirement in 707(a) that a case can be dismissed only after notice and a hearing. 212 B.R. at 446. In this case, the court extended the United States Trustee's deadline for filing a substantial abuse motion based on the United States Trustee's ex parte motion to extend time. As previously discussed, Rule 1017(e)(1) does not require notice and a hearing before the court extends this deadline. DiNova is inapposite to the instant case.

an evidentiary hearing after the court issued its decision. Finally, although the court specifically requested that they adduce evidence in support of their assertions of reduced income at the February 12 hearing, they chose not to submit any further evidence on this issue. A157, 161, 275.

Their complaints as to notice are also specious. The United States Trustee clearly referenced and appended the Kornfields' schedules to her motion to dismiss. A112-113, 276-307. After the case trustee and a creditor filed pleadings to support the United States Trustee's motion (A163-97), the Kornfields in responsive papers took pains to rebut carefully the expense issues detailed in those pleadings (A198-218). The Kornfields should not be heard now to say that the notice and hearing afforded them were inadequate.

CONCLUSION

The bankruptcy court properly refused to permit the Kornfields to obtain a chapter 7 discharge at the expense of their lawful creditors. For the foregoing reasons, the United States Trustee respectfully asks this Court to affirm the decisions of the bankruptcy and district courts dismissing the Kornfields' bankruptcy case.

Dated: March 6, 1998

Respectfully submitted,

CAROLYN S. SCHWARTZ
United States Trustee, Region 2
80 Broad Street, Third Floor
New York, New York 10004

(212) 668-2200

MARTHA L. DAVIS
General Counsel

JEANNE M. CROUSE
Attorney
U.S. Department of Justice
Executive Office for
United States Trustees
Office of the General Counsel
901 E St., N.W., Suite 780
Washington, D.C. 20530
(202) 307-1399

OF COUNSEL:
TRUDY A. NOWAK
Assistant U.S. Trustee
100 State Street
Room 6090
Rochester, NY 14614
(716) 263-5812

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on the 6th day of March, 1998, I filed the Brief of Appellee United States Trustee by sending the original and 10 copies of the foregoing Brief by Federal Express, next-day delivery, to the Clerk of the Court, United States Court of Appeals for the Second Circuit, and I served two true and correct copies of the foregoing Brief by Federal Express, next-day delivery, on:

David D. MacKnight, Esq.
Lacy, Katzen, Ryen & Mittleman, LLP
The Granite Building
130 East Main Street
Rochester, New York 14604-1686
Counsel for Appellants.

Jeanne M. Crouse

BRIEF BANK — 'SUMMARY SHEET" *Printed Fri-12/1/06 10:26*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*
Giddens v. Kreutzer (In re: Kreutzer)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*
CTA10

3. ("CCN") ***CURRENT*** CASE NO.
No.: 06-5127

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*
No.:
Court: DC Okla.
(Identify judge & cite, if any)

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Tara Leith Grove, Appellate Staff, Civil Division
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***

• (1) Whether Giddens lacks standing to appeal, because the bankruptcy court's order did not cause him a direct pecuniary injury. See Aplt. App. at 342-45, 440-43. (2) Whether, in the alternative, the bankruptcy court properly exercised its discretion in reopening this bankruptcy case to allow a newly-appointed Chapter 7 trustee to determine how to administer an asset of the estate. See Aplt. App. at 73-83, 443-48.

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No. 06-5127

IN THE UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

In re: REBECCA KREUTZER; MICHAEL KREUTZER,
Debtors,

JIMMY GIDDENS, M.D.,
Appellant,

v.

REBECCA KREUTZER; MICHAEL KREUTZER;
FELICIA S. TURNER, as U.S. TRUSTEE,
Appellees,

BANKRUPTCY TRUSTEE, KATHERINE M. VANCE; STEVEN W. SOULE,
Trustees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF OKLAHOMA
[The Honorable Claire V. Egan]

BRIEF FOR THE APPELLEE UNITED STATES TRUSTEE

PETER D. KEISLER
Assistant Attorney General

DAVID E. O'MEILIA
United States Attorney

WILLIAM KANTER
(202) 514-4575
TARA LEIGH GROVE
(202) 514-1201
Attorneys, Appellate Staff
Civil Division
U.S. Department of Justice
950 Penn. Ave, N.W., Room 7230
Washington, D.C. 20530-0001

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STATEMENT OF PRIOR OR RELATED APPEALS

Counsel for the government are not aware of any prior or related appeals.

IN THE UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

No. 06-5127

In re: REBECCA KREUTZER; MICHAEL KREUTZER,
Debtors,

JIMMY GIDDENS, M.D.,
Appellant,

v.

REBECCA KREUTZER; MICHAEL KREUTZER;
FELICIA S. TURNER, as U.S. TRUSTEE,[1]
Appellees,

BANKRUPTCY TRUSTEE, KATHERINE M. VANCE; STEVEN W. SOULE,
Trustees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF OKLAHOMA
[The Honorable Claire V. Egan]

BRIEF FOR THE APPELLEE UNITED STATES TRUSTEE

STATEMENT OF JURISDICTION

The bankruptcy court had jurisdiction under 28 U.S.C. §§ 157(a) and (b) to hear the underlying case, a voluntary petition under Chapter 7 of the Bankruptcy Code, 11 U.S.C. §§ 701, et seq. See also 28 U.S.C. §§ 151, 1334(a). On November 21, 2005, the bankruptcy court granted the debtors' motion to

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[1] Counsel hereby notifies the Court that Mary E. May, the prior United States Trustee, passed away. Pursuant to Federal Rule of Appellate Procedure 43(c)(2), Felicia S. Turner is automatically substituted as the United States Trustee.

reopen the bankruptcy case. Aplt. App. at 270-79; Addendum to Opening Brief ("Addendum"), Tab A, at 1-10.

On November 29, 2005, Dr. Jimmy Giddens ("Giddens") filed a timely notice of appeal from that order to the district court. See Aplt. App. at 280-81; Fed. R. Bankr. P. 8002(a). The district court had jurisdiction to hear the appeal under 28 U.S.C. § 158(a). On June 12, 2006, the district court dismissed the appeal, holding that Giddens lacked standing to challenge the bankruptcy court's order. See Aplt. App. at 438-48; Addendum, Tab C, at 1-11. Giddens subsequently filed a timely notice of appeal to this Court on June 27, 2006. Aplt. App. at 450-52. This Court has jurisdiction to hear the appeal under 28 U.S.C. § 158(d).

STATEMENT OF THE ISSUES PRESENTED FOR REVIEW

(1) Whether Giddens lacks standing to appeal, because the bankruptcy court's order did not cause him a direct pecuniary injury. See Aplt. App. at 342-45, 440-43.

(2) Whether, in the alternative, the bankruptcy court properly exercised its discretion in reopening this bankruptcy case to allow a newly-appointed Chapter 7 trustee to determine how to administer an asset of the estate. See Aplt. App. at 73-83, 443-48.

STATEMENT OF THE CASE

The Bankruptcy Code requires debtors to disclose all assets, including any contingent or potential claims against third parties. See 11 U.S.C. §§ 521(a)(1), 541(a). In April 2003, debtors Michael and Rebecca Kreutzer ("debtors") jointly filed for bankruptcy protection under Chapter 7 of the Bankruptcy Code. The debtors, however, failed to disclose a potential malpractice claim against Dr. Jimmy Giddens.

The debtors later moved to reopen their bankruptcy case to disclose the malpractice claim. The bankruptcy court, over Giddens' objection, granted the motion to reopen, and directed the United States Trustee to appoint a Chapter 7 trustee to complete the administration of the bankruptcy estate. The bankruptcy court's order left the newly-appointed trustee with the discretion to decide whether to pursue the malpractice claim against Giddens.

Giddens sought to appeal, and the district court dismissed the appeal for lack of jurisdiction. Applying the strict test for appellate standing in bankruptcy, the court held that Giddens lacked standing to appeal this bankruptcy court order, because it did not cause him any direct pecuniary injury. The district court further stated that, even if Giddens had standing, it would affirm the bankruptcy court's decision on the merits. This appeal followed.

STATEMENT OF FACTS

I. Statutory and Regulatory Background

A. Bankruptcy Protection for Individual Debtors

An individual who seeks to discharge his past debts may file a petition under Chapter 7 of the Bankruptcy Code. See 11 U.S.C. §§ 701, et seq. The debtor's assets are then transferred to a new legal entity: the "bankruptcy estate." See id. § 541(a). A trustee is appointed to help with the administration and liquidation of the estate. See id. §§ 701, 702, 704.

The Chapter 7 trustee liquidates the debtor's assets and distributes the proceeds to creditors who have filed claims against the estate. See 11 U.S.C. §§ 507, 704(a)(1), 726. At the end of this process, the bankruptcy court discharges most of the debtor's prior financial obligations, and closes the case. See id. §§ 350(a), 727.[2]

The Bankruptcy Code authorizes the bankruptcy court to reopen a case under certain circumstances. "A case may be reopened . . . to administer assets, to accord relief to the debtor, or for other cause." 11 U.S.C. § 350(b).

B. Contingent and Unliquidated Claims Against Third Parties

The Bankruptcy Code requires debtors to disclose all assets, including any potential claims against third parties. See 11 U.S.C. §§ 521(a)(1), 541(a); Official Bankruptcy Form 6, Schedule B (Personal Property) (the debtor must list "contingent and unliquidated claims of every nature"). The Chapter 7 trustee must then decide how to administer any such claim. The trustee may bring suit against the third party on behalf of the estate. See 11 U.S.C. §§ 541(a)(1), 704(a)(1); see also id. § 726(a) (proceeds must first be used to pay creditors). Alternatively,

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[2] The bankruptcy court may also, within one year after granting a discharge, revoke the discharge if it was "obtained through the fraud of the debtor[.]" See 11 U.S.C. §§ 727(d)(1),(e).

the trustee may abandon the claim if he concludes that it would be too costly to litigate or would provide little monetary value to the estate. See id. § 554(a) ("After notice and a hearing, the trustee may abandon any property of the estate that is burdensome to the estate or that is of inconsequential value and benefit to the estate."). If the trustee abandons the claim, the debtor may pursue it. See id. § 726(a)(6).

Significantly, if the debtor fails to disclose a pre-petition claim, the claim continues to be property of the estate, because it has neither been administered nor abandoned by the trustee. See 11 U.S.C. § 554(d) ("Unless the court orders otherwise, property of the estate that is not abandoned under this section and that is not administered in the case remains property of the estate.").

II. Factual Background and Proceedings Below

A. The Bankruptcy and State Court Proceedings

In April 2003, Michael and Rebecca Kreutzer jointly filed a voluntary petition for bankruptcy under Chapter 7. See Aplt. App. at 9-31. The debtors indicated on their bankruptcy petition that they did not have any "contingent [or] unliquidated claims" against any third party. See Aplt. App. at 14. A few months later, the bankruptcy court issued a general order of discharge and closed the case. See Aplt. App. at 51 (order of discharge on 08/11/03); Aplt. App. at 54 (order closing case on 08/29/03).

In fact, the debtors had a pre-petition medical malpractice claim against Dr. Jimmy Giddens. The debtors believed that, in

September 2001, Giddens negligently performed gall bladder surgery on Rebecca Kreutzer. See Aplt. App. at 150-53. The debtors, however, did not notify the creditors or the Chapter 7 trustee about this potential asset of the estate. See Aplt. App. at 14, 56.

In June 2003, during the pendency of the bankruptcy case, the debtors brought the malpractice action against Giddens in Oklahoma state court. See Aplt. App. at 150-53. The debtors later dismissed the suit without prejudice and refiled it in February 2004. See Aplt. App. at 56, 90-92. In September 2005, Giddens sought to dismiss the state court action, asserting that the debtors lacked standing to pursue the claim, because it was an asset of their bankruptcy estate. See Aplt. App. at 112-14. Giddens also argued that the debtors should be judicially estopped from prosecuting a claim that they had failed to disclose in bankruptcy. See Aplt. App. at 114-18.

The debtors moved to reopen their bankruptcy case in order to disclose the pre-petition malpractice claim. See Aplt. App. at 56-60. Giddens objected to the motion to reopen. See Aplt. App. at 63-85.

B. The Bankruptcy Court's Decision

The bankruptcy court granted the debtors' motion to reopen. See Aplt. App. at 270-79; Addendum, Tab A, at 1-10. The court observed that, under the law of this Circuit, a bankruptcy court has a "'duty . . . to reopen an estate whenever prima facie proof is made that [it] has not been fully administered.'" Aplt. App.

at 272 (quoting In re Mullendore, 741 F.2d 306, 308 (10th Cir. 1984)); Addendum, Tab A, at 3. And, here, "all parties agree[d]" that the malpractice claim was still an asset of the estate, "because it was not administered or abandoned by the Chapter 7 trustee." Ibid. Accordingly, the bankruptcy court found that it had a "duty to reopen the bankruptcy case in order to permit a trustee to determine whether the asset should be administered for the benefit of the creditors." Aplt. App. at 273; Addendum, Tab A, at 4.

The bankruptcy court rejected Giddens' claim that judicial estoppel should apply here. See Aplt. App. at 273-79; Addendum, Tab A, at 4-10. The court found that it would be inequitable to prevent "the trustee, who is blameless, from administering the Malpractice Claim for the benefit of the estate," simply because the debtors failed to disclose it. See Aplt. App. at 278-79; Addendum, Tab A, at 9-10; see also Aplt. App. at 277 (noting that the creditors' "only hope for any repayment derives from the potential proceeds of the Malpractice Claim"); Addendum, Tab A, at 8.

Accordingly, the bankruptcy court granted the debtors' motion to reopen and ordered them to "amend their schedules to disclose the Malpractice Claim[.]" Aplt. App. at 279; Addendum, Tab A, at 10. The court directed the United States Trustee "to appoint a Chapter 7 trustee to complete the administration of the estate." Ibid.[3]

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[3] United States Trustees are Justice Department officials (continued...)

Giddens sought to appeal to the district court. See Aplt. App. at 280-81. The United States Trustee participated as appellee in district court, urging that Giddens lacked standing to prosecute the appeal, see Aplt. App. at 342-45, and that, in any event, the bankruptcy court's decision was correct on the merits, see Aplt. App. at 346-59.

C. The District Court's Decision

The district court held that Giddens lacked standing to appeal the bankruptcy court's order.[4] See Aplt. App. at 440-43; Addendum, Tab C, at 3-6. The court recognized that the test for standing in bankruptcy cases is "more stringent" than the requirements for standing under Article III. See Aplt. App. at 441-42; Addendum, Tab C, at 4-5. "To have standing to appeal [in bankruptcy], the litigant must have a direct and adverse pecuniary interest in the particular order he is challenging." Aplt. App. at 441; Addendum, Tab C, at 4. The court found that Giddens failed to demonstrate any such direct pecuniary injury. See Aplt. App. at 441-43; Addendum, Tab C, at 4-6. Giddens claimed only that "he may be exposed to potential liability if the bankruptcy is reopened[.]" See Aplt. App. at 442-43;

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[3](...continued) appointed by the Attorney General to supervise the administration of bankruptcy cases. See 28 U.S.C. §§ 581-89; In re Columbia Gas Systems, Inc., 33 F.3d 294, 296 (3d Cir. 1994) (noting that United States Trustees oversee the bankruptcy process and ensure that bankruptcy cases are conducted according to law) (citing H.R. Rep. No. 99-764, at 24 (1986)).

[4] The district court reviewed the report and recommendation of a magistrate judge. See Aplt. App. at 373-82; Addendum, Tab B, at 1-10.

Addendum, Tab C, at 5-6. The court determined that Giddens' assertions of "potential" future harm did not satisfy the stringent requirements for standing in bankruptcy appeals. See ibid.

The district court further found that Giddens' objections to the bankruptcy court's decision were without merit. The court rejected Giddens' assertion that the debtors lacked standing to file the motion to reopen. See Aplt. App. at 443-44; Addendum, Tab C, at 6-7. The court likewise rejected Giddens' judicial estoppel claim. See Aplt. App. at 444-48; Addendum, Tab C, at 7-11. The district court agreed with the bankruptcy court that the trustee should not be estopped from pursuing the malpractice action on behalf of the creditors of the estate. See Aplt. App. at 445-48; Addendum, Tab C, at 8-11.

Giddens subsequently filed this appeal.[5]

SUMMARY OF ARGUMENT

I. The district court properly held that Dr. Jimmy Giddens lacks standing to appeal this bankruptcy court order. To appeal a bankruptcy court's decision, a litigant must demonstrate that his "rights or interests are directly and adversely affected pecuniarily" by the challenged order. See In re American Ready Mix, Inc., 14 F.3d 1497, 1500 (10th Cir. 1994) (internal

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[5] Following the bankruptcy court's decision, the United States Trustee appointed a Chapter 7 trustee. The trustee filed an appearance in the state court action, and asked the bankruptcy court to notify creditors that the debtors' estate has a potentially valuable asset. Counsel for the government understand that the state court action is largely on hold pending resolution of this appeal.

quotation marks omitted). Giddens cannot satisfy this stringent test for appellate standing.

The bankruptcy court here granted the debtors' motion to reopen their bankruptcy case, so that they could disclose an asset of the estate: a potential malpractice claim against Giddens. The court also directed the United States Trustee to appoint a Chapter 7 trustee to determine how to administer this asset. Giddens' interest in this order was, at best, remote and speculative: *If* the Chapter 7 trustee chose to pursue the malpractice claim, and *if* he prevailed, Giddens *might* ultimately have to pay money damages. Such an indirect and conjectural claim of injury does not satisfy the stringent requirements for appellate standing in bankruptcy. Accordingly, the Court should dismiss this appeal for lack of jurisdiction.

II. The Court should, in the alternative, uphold the bankruptcy court's decision on the merits. The bankruptcy court properly exercised its discretion in reopening this case and in authorizing a Chapter 7 trustee to administer an additional asset of the estate (the malpractice claim against Giddens). As this Court has emphasized, a bankruptcy court has a "duty . . . to reopen an estate whenever prima facie proof is made that it has not been fully administered." *In re Mullendore*, 741 F.2d 306, 308 (10th Cir. 1984).

Giddens fails to demonstrate that the bankruptcy court abused its discretion in granting the debtors' motion to reopen. First, contrary to Giddens' assertion, the debtors clearly had standing to file the motion. The debtors had an obligation to disclose their pre-petition malpractice claim, and could face criminal prosecution if they deliberately concealed it.

Furthermore, the bankruptcy court properly rejected Giddens' judicial estoppel argument. Giddens repeatedly asserts that the debtors should be judicially estopped from pursuing the malpractice action, because they took inconsistent positions with respect to that claim in bankruptcy court and Oklahoma state court. But Giddens' argument is misplaced. The bankruptcy court did not permit the debtors to pursue that claim. Instead, it authorized a newly-appointed Chapter 7 trustee to administer the claim on behalf of the creditors of the estate. The trustee has never taken any inconsistent position with respect to the malpractice claim. Accordingly, judicial estoppel simply does not apply to the trustee.

THE STANDARD OF REVIEW

This Court reviews the decision of the bankruptcy court according to the same standards as the district court. See In re Hodes, 402 F.3d 1005, 1008 (10th Cir. 2005). The Court reviews the bankruptcy court's factual findings for clear error and its legal determinations de novo. Ibid.; see also Rascon v. US West Communications, Inc., 143 F.3d 1324, 1329 (10th Cir. 1998) ("the application of judicial estoppel presents a legal question"). The Court reviews the bankruptcy court's decision to reopen the case for abuse of discretion. See In re Woods, 173 F.3d 770, 778 (10th Cir. 1999).

ARGUMENT

I. Giddens Lacks Standing To Appeal The Bankruptcy Court's Order.

It is axiomatic that, in order to appeal a case to federal court, a litigant must demonstrate standing. As the district court recognized, the test for standing in bankruptcy cases is even "more stringent" than that required by Article III. See Aplt. App. at 441-42; Addendum, Tab C, at 4-5; In re Alpex Computer Corp., 71 F.3d 353, 357 n.6 (10th Cir. 1995). Under Article III, a party may establish standing by demonstrating that he has suffered an injury-in-fact that is fairly traceable to the defendant's allegedly improper conduct. See Utah Association of Counties v. Bush, 455 F.3d 1094, 1099-1100 (10th Cir. 2006). By contrast, in bankruptcy, an appellant must show that he is a "person aggrieved." In re American Ready Mix, Inc., 14 F.3d 1497, 1500 (10th Cir. 1994). To qualify as a "person aggrieved," a litigant must demonstrate that his "rights or interests are directly and adversely affected pecuniarily" by the challenged order. Ibid. (internal quotation marks omitted) (emphasis added); see also Alpex, 71 F.3d at 357 n.6 ("[t]he standing requirement is more stringent in bankruptcy appeals than the case or controversy standing requirement of Article III, which need not be financial and need only be fairly traceable to the alleged illegal action") (internal quotation marks omitted).[6]

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[6] Notably, this test for appellate standing applies only to private parties, and not to the United States Trustee. See 11 U.S.C. § 307 (authorizing the United States Trustee to "appear and be heard on any issue in any case or proceeding under this title"); In re Donovan Corp., 215 F.3d 929, 930 (9th Cir. 2000) (recognizing that 11 U.S.C. § 307 confers broad standing on the

(continued...)

Giddens cannot satisfy this stringent test for appellate standing in bankruptcy. See also In re Thompson, 965 F.2d 1136, 1142 n.9 (1st Cir. 1992) ("[g]enerally speaking, a nonparty lacks appellate standing in bankruptcy proceedings"). The bankruptcy court order at issue here did not cause him any direct pecuniary injury.

The court here reopened the bankruptcy case, ordered the debtors to disclose an additional asset (their potential malpractice claim against Giddens), and authorized a newly-appointed Chapter 7 trustee to determine what to do with the asset. See Aplt. App. at 279; Addendum, Tab A, at 10. Giddens' interest in this bankruptcy court order was, at most, indirect and speculative. Giddens suggests that, if the Chapter 7 trustee chose to pursue the malpractice action against him, and if the trustee prevailed, Giddens might suffer a future financial injury. But any such future harm would not be the direct result of the order challenged here. Instead, any such harm would depend on the separate and independent judgments of the Chapter 7 trustee and the Oklahoma state courts. See Travelers Insurance Co. v. H.K. Porter Co., Inc., 45 F.3d 737, 741 (3d Cir. 1995) (the appellant lacked standing because its interest was "too remote and contingent to satisfy the standing requirement[s] of bankruptcy appeals").

For these reasons, courts of appeals have repeatedly denied standing to litigants like Giddens, who seek to challenge a

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[6] (...continued)
United States Trustee).

bankruptcy court order simply because it may expose them to future litigation. Such "potential defendants" do not have a sufficiently direct stake in the bankruptcy case to qualify as "persons aggrieved." See Travelers, 45 F.3d at 743 ("a potential defendant in [a separate] adversary proceeding" lacks standing in bankruptcy); In re El San Juan Hotel, 809 F.2d 151, 155-56 (1st Cir. 1987) (same); In re Fondiller, 707 F.2d 441, 443 (9th Cir. 1983) (same); see also Alpex, 71 F.3d at 354, 358 (the appellant's "status as a defendant in a [separate] civil suit" did not render it a "party in interest" with standing to move to reopen a Chapter 11 bankruptcy case).

The First Circuit's decision in In re El San Juan Hotel, 809 F.2d 151 (1st Cir. 1987), is particularly instructive. The bankruptcy court in San Juan Hotel issued an order, authorizing the United States to bring suit against a former bankruptcy trustee for breach of fiduciary duty. See id. at 153. The former trustee sought to appeal the order authorizing suit against him. See ibid. The First Circuit held that he lacked standing, because the bankruptcy court's order had "'no direct and immediate impact on [his] pecuniary interests,'" but only exposed him to future litigation. See id. at 155-56 (appellant's "'only demonstrable interest in the order [was] as a potential party defendant in an adversary proceeding'") (quoting Fondiller, 707 F.2d at 443). The court recognized that the "former trustee [did] have an interest in defending himself against liability, but the order in question [did] not prevent [him]" from doing that, because he could assert any claims or defenses in the separate suit. See id. at 155.

Likewise, the bankruptcy court's decision here does not prevent Giddens from defending against the malpractice claim. Contrary to Giddens' suggestion (see Open. Br. 18), he may assert any claim or defense, including judicial estoppel, in the state court suit. Indeed, Giddens previously recognized as much, for he first raised his judicial estoppel defense with the Oklahoma state court. See Aplt. App. at 114-18. For the reasons identified below, we believe that any such judicial estoppel claim lacks merit as applied to the Chapter 7 trustee,[7] but nothing in the bankruptcy court's decision precludes Giddens from asserting it against the debtor. See, e.g., Ryan Operations G.P. v. Santiam-Midwest Lumber Co., 81 F.3d 355, 361 (3d Cir. 1996) (the defendants "were not barred from seeking judicial estoppel" against the debtor in their separate civil suit "by the fact that they were not parties to [the debtor's] bankruptcy proceeding").[8]

Giddens fails to show that the bankruptcy court's decision directly injured him at all, much less that it caused him direct

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[7] It is also not clear that a state court would have the authority to prohibit a bankruptcy trustee from pursuing an action that had been approved by the bankruptcy court.

[8] Giddens does not attempt to distinguish (see Open. Br. 14-20) the bulk of this appellate court precedent. Instead, Giddens seeks to rely (Open. Br. 15-16) on two bankruptcy court decisions, which allowed certain tort defendants to file objections in bankruptcy court. See In re Pryor, 341 B.R. 571 (Bkrtcy. N.D. Miss. 2006); In re Tarrer, 273 B.R. 724 (Bkrtcy. N.D. Ga. 2001). But neither court purported to apply the "person aggrieved" test. See Pryor, 341 B.R. at 576; Tarrer, 273 B.R. at 730-31. Accordingly, those decisions do not demonstrate that Giddens has standing here.

pecuniary harm. Accordingly, this Court should dismiss Giddens' appeal for lack of jurisdiction. Alternatively, for the reasons set forth below, this Court should affirm the bankruptcy court's decision on the merits.

II. The Bankruptcy Court Properly Exercised Its Discretion In Reopening This Bankruptcy Case To Allow A Chapter 7 Trustee To Complete The Administration Of The Estate.

A. The bankruptcy court properly exercised its discretion in granting the debtors' motion to reopen and in directing the appointment of a Chapter 7 trustee. The Bankruptcy Code provides that "[a] case may be reopened . . . to administer assets, to accord relief to the debtor, or for other cause." 11 U.S.C. § 350(b). Here, the debtors notified the court about a previously undisclosed asset: the potential malpractice claim against Giddens. The bankruptcy court properly granted the motion to reopen, so that a newly-appointed Chapter 7 trustee could "administer [this] asset[]" of the estate. _See_ 11 U.S.C. § 350(b); _see also In re Woods_, 173 F.3d 770, 777 n.3 (10th Cir. 1999) (noting that a case may be reopened "when there [were] assets unknown to the trustee at the time the case was closed"). Indeed, any other decision would likely have been an _abuse_ of discretion. As this Court has stated, the bankruptcy court has a "duty . . . to reopen an estate whenever prima facie proof is made that it has not been fully administered." _In re Mullendore_, 741 F.2d 306, 308 (10th Cir. 1984).

B. Giddens fails to demonstrate that the bankruptcy court abused its discretion in reopening this bankruptcy case. First, contrary to Giddens' assertion (_see_ Open. Br. 20-23), the debtors clearly had standing to file the motion to reopen. Debtors have an ongoing duty to disclose pre-petition assets, see 11 U.S.C. §§ 521(a)(1), 541(a); Ajaka v. Brooksamerica Mortgage Corp., 453 F.3d 1339, 1344 (11th Cir. 2006) ("[t]he duty to disclose is a continuing one") (internal quotation marks omitted), and, indeed, may be criminally prosecuted if they conceal assets of the estate, see 18 U.S.C. § 152(1) ("[a] person who [] knowingly and fraudulently conceals . . . any property belonging to the estate of a debtor . . . shall be fined under this title, imprisoned not more than 5 years, or both").

Accordingly, the debtors here had not only the authority, but an obligation, to seek to reopen the bankruptcy proceeding to notify the court about a previously undisclosed asset. See also United States v. Messner, 107 F.3d 1448, 1452 (10th Cir. 1997) (the prosecutor explained that, to avoid criminal liability, a debtor may "petition[] the bankruptcy court to reopen the [bankruptcy] case to determine whether the assets should be administered for the benefit of creditors or abandoned").

Giddens is likewise incorrect in asserting that the doctrine of judicial estoppel applies here. "Judicial estoppel bars a party from adopting inconsistent positions in the same or related litigation." Rascon v. US West Communications, Inc., 143 F.3d 1324, 1330 (10th Cir. 1998) (internal quotation marks omitted); see Johnson v. Lindon City Corp., 405 F.3d 1065, 1068-69 (10th Cir. 2005).

Giddens' judicial estoppel claim rests on a fundamental misconception about the bankruptcy court's decision. Giddens insists (Open. Br. 23-41) that the debtors should be judicially estopped from pursuing the malpractice action against him, because they took "inconsistent positions" with respect to that claim in their bankruptcy case and in the separate state court suit. In the bankruptcy case, the debtors failed to acknowledge that the claim existed, while, in the state court action, they vigorously prosecuted the claim.

But the bankruptcy court's order does not permit the debtors to pursue the state court suit against Giddens. On the contrary, the bankruptcy court authorized a newly-appointed Chapter 7 trustee to administer the claim on behalf of the bankruptcy estate. Judicial estoppel plainly does not apply to the trustee. The trustee has never taken any position with respect to the malpractice claim, and thus plainly would not be taking an inconsistent position if he pursued the state court suit. See Parker v. Wendy's International, Inc., 365 F.3d 1268, 1272 (11th Cir. 2004) (the trustee "never took an inconsistent position under oath with regard to [the debtor's] claim" and thus "cannot [] be judicially estopped from pursuing it"); see also Kaiser v. Bowlen, 455 F.3d 1197, 1203 (10th Cir. 2006) (the defendant's judicial estoppel claim "fails for the simple reason that [the plaintiff] did not take a [contrary] position in a prior legal proceeding").

Nor is the trustee "tainted or burdened" by the debtors' failure to disclose their malpractice claim. See Parker, 365 F.3d at 1273 ("The trustee made no false or inconsistent statement under oath in a prior proceeding and is not tainted or burdened by the debtor’s misconduct.”). When a trustee brings suit on behalf of a bankruptcy estate, the trustee is subject only to defenses that could have been raised against the debtor prior to the filing of the bankruptcy petition. See Bank of Marin v. England, 385 U.S. 99, 101 (1966) (“the trustee is subject to all claims and defenses which might have been asserted against the bankrupt but for the filing of the petition”); Integrated Solutions, Inc. v. Service Support Specialties, Inc., 124 F.3d 487, 495 (3d Cir. 1997) (“the trustee only succeeds to the same rights the debtor possessed in the property prepetition”) (emphasis added).[9] But “any post-petition conduct by [the debtor], including failure to disclose an asset,” may not be charged to the trustee. See Parker, 365 F.3d at 1272 n.3 (emphasis in original).

Moreover, applying judicial estoppel here would be at odds with the equitable considerations underlying that doctrine. As the bankruptcy court recognized, it would be inequitable to prevent “the trustee, who is blameless, from administering the Malpractice Claim for the benefit of the estate.” See Aplt. App. at 278-79; Addendum, Tab A, at 9-10. Such a ruling would harm a completely innocent group: the creditors, whose “only hope for any repayment derives from the potential proceeds of the Malpractice Claim.” See Aplt. App. at 277; Addendum, Tab A, at 8. As the Seventh Circuit has observed, “[j]udicial estoppel is

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[9] That would encompass, for example, a statute of limitations defense. See, e.g., In re McGavin, 189 F.3d 1215, 1220-21 (10th Cir. 1999).

an equitable doctrine, and it is not equitable to employ it to injure creditors who are themselves victims of the debtor's deceit." Cannon-Stokes v. Potter, 453 F.3d 446, 448 (7th Cir. 2006); see Biesek v. Soo Line Railroad Co., 440 F.3d 410, 413 (7th Cir. 2006) ("[The debtor's] nondisclosure in bankruptcy harmed his creditors by hiding assets from them. Using this same nondisclosure to wipe out his [potential] claim would complete the job by denying creditors even the right to seek some share of the recovery."). For these reasons, the Seventh and Eleventh Circuits have properly concluded that a debtor's prior nondisclosure does not preclude a trustee from pursuing a claim on behalf of a bankruptcy estate. See Cannon-Stokes, 453 F.3d at 448 (the debtor's misconduct "does not prevent the creditors themselves from realizing on the claim"); Parker, 365 F.3d at 1269 ("because the party pursuing this case . . . is not [the debtor], but is instead the bankruptcy trustee - who did not make any inconsistent statements to the courts - we hold that judicial estoppel does not apply").[10]

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[10] Although the Fifth Circuit has reached a different conclusion, see In re Coastal Plains, Inc., 179 F.3d 197, 201-02, 209-13 (5th Cir. 1999) (applying judicial estoppel to both a debtor and a trustee), it has never explained how the trustee may be charged with the debtor's misconduct, see id. at 209-13 (explaining why the debtor should be judicially estopped from pursuing a previously undisclosed claim, but failing to explain why the same analysis applies to the trustee); see also In re Superior Crewboats, Inc., 374 F.3d 330, 334-36 (5th Cir. 2004) (holding that the debtor was judicially estopped from bringing a previously undisclosed tort claim, and stating, without further explanation, that this "judicial estoppel determination . . . . renders moot the trustee's claim to substitute as plaintiff"). Because the Fifth Circuit has not articulated any rationale for applying judicial estoppel against the trustee, its approach

(continued...)

The bankruptcy court here authorized the Chapter 7 trustee to pursue the malpractice action on behalf of the creditors of the estate. Accordingly, Giddens' argument that the debtors should be judicially estopped is simply misplaced. This Court need not at this point address whether, or to what extent, judicial estoppel should apply to the debtors. See Parker, 365 F.3d at 1273 n.4 (observing that, "in the unlikely scenario where the trustee would recover more than an amount that would satisfy all creditors and the costs and fees incurred, then, perhaps judicial estoppel could be invoked by the defendant [at that time] to limit any recovery to only that amount and prevent an undeserved windfall from devolving on the non-disclosing debtor").

CONCLUSION

For the foregoing reasons, the judgment of the district court should be affirmed.

Respectfully submitted,

PETER D. KEISLER
Assistant Attorney General

DAVID E. O'MEILIA
United States Attorney

WILLIAM KANTER
(202) 514-4575
TARA LEIGH GROVE
(202) 514-1201
Attorneys, Appellate Staff
Civil Division
U.S. Department of Justice

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[10] (...continued)
should not be followed here.

950 Penn. Ave, N.W., Room 7230
Washington, D.C. 20530-0001

OCTOBER 2006

STATEMENT REGARDING ORAL ARGUMENT

The government believes that this appeal may be resolved on the briefs, but would be pleased to present oral argument if this Court concludes that argument would assist in clarifying and resolving the issues presented.

CERTIFICATE OF COMPLIANCE

Pursuant to Fed. R. App. P. 32(a)(7)(C), I hereby certify that this brief is double spaced (except for headings and footnotes), using Courier New font, 12 point type (which is no more than 10.5 characters per inch, in accordance with Fed. R. App. P. 32(a)(5)(B)). Based on a word count of Corel Wordperfect 12, this brief contains 5274 words (not including the cover page, the Table of Contents, the Table of Authorities, the Statement of Prior and Related Appeals, the Certificate of Service, and this Certificate of Compliance).

TARA LEIGH GROVE
Attorney

October 10, 2006

CERTIFICATE OF SERVICE

I hereby certify that on this 10th day of October, 2006, I filed and served the foregoing Brief for the Appellee United States Trustee by causing copies to be sent to the Clerk by Federal Express and electronic mail, and by Federal Express and electronic mail to:

Ben D. Catterlin
6216 S Lewis Ave, Suite 200
Tulsa, OK 74136
(918) 749-4044
gmiller@tulsacoxmail.com

Matthew B. Free
Amy Ellen Kempfert
Dan Wesley Ernst
Best & Sharp
100 W. Fifth St., Suite 808
Tulsa, OK 74103-4225
(918) 582-1234
mfree@bestsharp.com

Steven W. Soule
Hall, Estill, Hardwick, Gable, Golden & Nelson
320 S. Boston Avenue, Suite 400
Tulsa, OK 74103-3708
(918) 594-0529
Ssoule@HallEstill.com

and by United States mail and electronic mail to:

Christopher M. Hunt
Chris M. Hunt, PLLC
P.O. Box 450939
Grove, OK 74345-0939
(918) 786-6002
chris@flynnlaw.net

TARA LEIGH GROVE
Attorney

CERTIFICATE OF DIGITAL SUBMISSION

Pursuant to this Court’s Emergency General Order filed October 20, 2004 and amended most recently on January 1, 2006, I hereby certify that:

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TARA LEIGH GROVE
Attorney

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WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*

In re: Frank J. Kristan v. John C. Turner

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*

BAP 1st Cir.

3. ("CCN") ***CURRENT*** CASE NO.

No.: 08-003

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*

No.: 04-20328-JBH

Court: Bankr. Me.

(Identify judge & cite, if any)

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U.S. TRUSTEES

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Richard King, Phoebe Morse, P. Matthew Sutko

(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***

BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s)

&

√ Any Miscellaneous ***BACKGROUND***

• Whether the bankruptcy court abused its discretion or erred as a matter of law by denying the debtor's motion to overturn a final order entered more than three years prior where the debtor did not file an appeal of the original order.

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UNITED STATES BANKRUPTCY APPELLATE PANEL
FOR THE FIRST CIRCUIT

BAP NO. EP 08-003

FRANK J. KRISTAN,
Debtor,

FRANK J. KRISTAN,
Appellant,

v.

JOHN C. TURNER, Chapter 7 Trustee,
and PHOEBE MORSE, United States Trustee,
Appellees.

ON APPEAL FROM THE UNITED STATES BANKRUPTCY COURT FOR THE DISTRICT OF MAINE

CASE NO. 04-20328-JBH

BRIEF OF APPELLEE, UNITED STATES TRUSTEE

Roberta DeAngelis
Acting General Counsel
P. Matthew Sutko
Associate General Counsel
Department of Justice
Executive Office for United States Trustee
20 Massachusetts Avenue, NW
Washington, DC 20530

Phoebe Morse
United States Trustee
Richard King, Esq.
Assistant United States Trustee
Office of the United States Trustee
446 Main Street, 14th Floor
Worcester, MA 01608
Tel: (508) 793-0555, ext. 112

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STATEMENT OF ISSUES PRESENTED

The issues to be decided in this appeal are whether the bankruptcy court abused its discretion or erred as a matter of law by denying the debtor's motion to overturn a final order entered more than three years ago where the debtor did not file an appeal of the original order.

STATEMENT OF APPELLATE JURISDICTION

The United States Bankruptcy Court for the District of Maine ("the bankruptcy court" or "court") had jurisdiction under 28 U.S.C. §§ 157(b) and 1334(a) over the bankruptcy case Frank J. Kristan ("Mr. Kristan") initiated on March 8, 2004, by filing a voluntary chapter 7 petition. This appeal is taken from a final order of that bankruptcy court entered on January 10, 2008, denying Mr. Kristan's Motion to Revoke Denial of Discharge (the "Discharge Order"). Mr. Kristan filed a timely notice of appeal from that order on January 18, 2008.[1] This Panel has jurisdiction over this appeal under 28 U.S.C. §158(a) and 158(b)(1).

STANDARD OF REVIEW

Reviewing courts apply a clearly erroneous standard to a bankruptcy court's findings of

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[1] Mr. Kristan's notice of appeal states that he is appealing from "the final judgment order, entered in this case on January 9, 2008." Only the Minutes of a hearing held on January 9, 2008, were entered that day. The Discharge Order was entered on January 10, 2008. Fed. R. Bankr. P. 8002(a) provides that a notice of appeal filed after the announcement of an order but before entry of such order "shall be treated as filed after such entry and on the date thereof."

fact and a *de novo* standard to conclusions of law. See TI Fed. Credit Union v. DelBonis, 72 F.3d 921, 928 (1st Cir. 1995); Western Auto Supply Co. v. Savage Arms, Inc. (In re Savage Indus., Inc.), 43 F.3d 714, 719-20 n. 8 (1st Cir. 1994). Mixed questions of law and fact are reviewed "along a degree-of-deference continuum, ranging from plenary review for law-dominated questions to clear-error review for fact-dominated questions." Johnson v. Watts Regulator Co., 63 F.3d 1129, 1132 (1st Cir. 1995). The decision denying the Debtor's Motion to Revoke Denial of Discharge should be reviewed for abuse of discretion. See Aguiar v. Interbay Funding, LLC (In re Aguiar), 311 B.R. 129, 131 (B.A.P. 1st Cir. 2004)

STATEMENT OF THE CASE

Mr. Kristan is a *pro se* debtor who transferred virtually all of his assets into an Australian trust (the "Trust") before filing his bankruptcy petition. On March 8, 2004, Mr. Kristan filed a voluntary petition under Chapter 7 of the Bankruptcy Code. On February 9, 2005, in response to an adversary proceeding filed by Mr. Kristan's primary creditor, the bankruptcy court denied Mr. Kristan's discharge (the "Discharge Denial Order") under 11 U.S.C. § 727(a)(2)(A), finding that his transfer to the Trust was made with actual intent to hinder, delay, or defraud his creditors. Mr. Kristan did not appeal the Discharge Denial Order.

Almost three years later, Mr. Kristan filed a "Motion to Revoke Denial of Discharge" (the "Discharge Motion"), asking the bankruptcy court to overturn the Discharge Denial Order. (Appellant's Appendix-Motion to Revoke Denial of Discharge.) Both the United States Trustee and the Chapter 7 trustee opposed the Discharge Motion. (Appellant's Appendix-Trustee's

Objection to Motion to Revoke; U.S. Trustee’s Objection to Motion to Revoke.) On January 10, 2008, the bankruptcy court denied the Discharge Motion (the “Discharge Order”). (Appellant’s Appendix-Order Denying Motion to Revoke Denial of Discharge.) In this appeal, the sixth of eight appeals filed by Mr. Kristan in this case, Mr. Kristan asserts that the bankruptcy court erred in denying the Discharge Motion.[2]

STATEMENT OF FACTS

I. Statutory Framework - Overview of 11 U.S.C. §727(e)(2)

Absent unusual circumstances, individuals who file for protection under the Bankruptcy Code are entitled to a discharge of their debts. 11 U.S.C. § 727(a). If, however, a debtor misleads the court or his creditors, or engages in certain other acts, his discharge may be denied. 11 U.S.C. § 727(a) provides a list of factors constituting cause for denial of a debtor’s discharge. See *e.g.* 11 U.S.C. §§ 727(a)(3) (concealing, destroying or falsifying records); 727(a)(5) (failing

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[2] The appeals are:

B.A.P. Case No. 05-030	(appeal from an order denying Mr. Kristan’s motion to convert case to chapter 11, dismissed for failure to file a designation of the record);
B.A.P. Case No. 05-049	(appeal from order denying reconsideration of order denying Mr. Kristan’s objection to claim filed by Patriot Growth Fund, L.P., affirmed by the Panel in an unpublished opinion, that opinion being later affirmed by judgment of the First Circuit Court of Appeals, Case No. 06-9004);
B.A.P. Case No. 06-063	(appeal from order approving a compromise with Patriot Growth Fund, L.P., later withdrawn);
B.A.P. Case No. 07-032	(appeal from order denying Mr. Kristan’s motion to hold a post-petition creditor in violation of the automatic stay, affirmed by the Panel in an unpublished opinion holding that the automatic stay terminated in 2005);
B.A.P. Case No. 08-002	(appeal from January 10, 2008 order granting the chapter 7 trustee’s motion for sanctions (“Sanction Order”) under Rule 9011, dismissed by the Panel as interlocutory);
B.A.P. Case No. 08-009	(the instant appeal);
B.A.P. Case No. 08-009	(second appeal from the Sanctions Order, pending);
B.A.P. Case No. 08-010	(appeal from order granting application for compensation, pending).

to satisfactorily explain the loss of assets to meet liabilities); 727(a)(6) (refusing to obey any lawful order of the court). Mr. Kristan's discharge was denied for transferring property with intent to hinder, delay or defraud his creditors. A.P. 04-2063, Docket No. 18; 11 U.S.C. § 727(a)(2).

If a debtor has already received a discharge but the discharge was obtained through fraud or like means, the United States Trustee, the case trustee or a creditor may petition the court to revoke such discharge. 11 U.S.C. § 727(d). Section 727(e) sets time limits for actions to revoke discharge. An action to revoke discharge must be filed within one year after the discharge was granted or, in certain enumerated circumstances, the action may be filed at any time before the case is closed. 11 U.S.C. § 727(e)(1), (e)(2). By their express terms, §§ 727(d)(2) and 727(e) apply only in cases where a discharge was previously granted to the debtor.

II. Factual and Procedural Background

Mr. Kristan filed a voluntary *pro se* chapter 7 petition on March 8, 2004. Prior to filing, Mr. Kristan transferred virtually all of his assets into an Australian trust (the "Trust"). (Appellant's Appendix-Motion to Revoke Denial of Discharge.) On February 2, 2005, the bankruptcy court avoided Mr. Kristan's transfer to the Trust. *Id.* On February 9, 2005, the bankruptcy court entered an order denying Mr. Kristan a discharge under 11 U.S.C. § 727(a)(2)(A) (the "Discharge Denial Order"). *Id.* Mr. Kristan did not appeal either order.

The automatic stay expired upon entry of the Discharge Denial Order. Kristan v. Nesbit, B.A.P. Case No. 07-032, unpublished opinion of September 6, 2007 at 6 (Appellee's Addendum at Exhibit 1). Nevertheless, Mr. Kristan continued to act as if the automatic stay was in effect. *Id.* Mr. Kristan also objected to all efforts by the Chapter 7 trustee to compromise claims and all requests for trustee compensation. See Docket Nos. 116, 128, 135, 168, 228; 114, 134, 140, 149, 174, 186, 206, 211, 366. It is Mr. Kristan's position that the automatic stay will remain in effect until his bankruptcy case is closed.

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On November 30, 2007, nearly three years later after the entry of the Discharge Denial Order, Mr. Kristan filed a Motion to Revoke Denial of Discharge (referred to herein as the "Discharge Motion"), requesting that the bankruptcy court revoke the 2005 Discharge Denial Order. Mr. Kristan cited 11 U.S.C. § 727(e)(2) as the basis on which the bankruptcy court could grant him relief. *Id*. Mr. Kristan also used the Discharge Motion to allege that the Chapter 7 trustee engaged in wrongdoing while administering the bankruptcy estate. *Id.* Both the United States Trustee and the Chapter 7 trustee opposed the Discharge Motion. (Appellant's Appendix-Trustee's Objection to Motion to Revoke; U.S. Trustee's Objection to Motion to Revoke.) On December 12, 2007, the Chapter 7 trustee filed a motion for sanctions, requesting an award of attorneys' fees and an order requiring Mr. Kristan to obtain the permission of the bankruptcy court before filing any further pleadings.

On January 9, 2008, the bankruptcy court held a hearing on the Discharge Motion. On January 10, 2008, the bankruptcy court entered its order denying the Discharge Motion (the "Discharge Order"). (Appellant's Appendix-Order Denying Motion to Revoke Denial of

Discharge.) On the same day, the bankruptcy court entered a separate order granting the trustee's motion for sanctions.[3] On January 18, 2008, Mr. Kristan filed a timely appeal of the Discharge Order.

SUMMARY OF ARGUMENT

The 2005 Discharge Denial Order was a final order that Mr. Kristan did not appeal. If the Discharge Motion is a motion from relief from judgment under Fed. R. Civ. P. 60(b)(3) and Fed. R. Bankr. P. 9024, it must fail because it was filed more than one year after the Discharge Denial Order was entered. Moreover, as a substantive matter, 11 U.S.C. § 727(e) applies only to debtors who have received a discharge and is thus inapplicable to Mr. Kristan.

ARGUMENT

I. The 2005 Discharge Denial Order is a Final Order that Mr. Kristan Did Not Appeal

A decision is final if "it ends the litigation on the merits and leaves nothing for the court to do but execute the judgment." Fleet Data Processing Corp. v. Branch (In re Bank of New England Corp.), 218 B.R. 643, 646 (B.A.P. 1st Cir. 1998). Although a flexible approach to the concept of finality should be applied in bankruptcy appeals, an order denying discharge is without question a final appealable order. In re Aoki, 323 B.R. 803, 811 (B.A.P. 1st Cir. 2005). Thus, the 2005 Discharge Denial Order was a final appealable order.[4]

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[3] The bankruptcy court's order granting the trustee's motion for sanctions is the subject of three B.A.P. appeals, Case Nos. 08-002, 08-009 and 08-010.

[4] Within ten days of its entry, Mr. Kristan could have asked the bankruptcy court to modify the Discharge Denial Order by filing a motion to alter or amend the judgment under Fed. R. Civ. P. 59(e) (made applicable by Fed. R. Bankr. P. 9023). He did not do so.

A notice of appeal in a bankruptcy case must be taken within ten days of the date of entry of judgment or order appealed from. Fed. R. Bankr. P. 8002(a). A bankruptcy judge may extend the time for filing a notice of appeal. Fed. R. Bankr. P. 8002(c). However, any motion for extension of time to file an appeal must be filed within thirty days of the time for filing a notice of appeal as prescribed by Rule 8002(a). *Id*. Mr. Kristan did not file an appeal of the Discharge Denial Order within ten days of its entry, nor did he file a motion to extend time for filing a notice of appeal. The Discharge Motion is essentially a late attempt by Mr. Kristan to circumvent the time limits for appealing the Order Denying Discharge. Because the Discharge Denial Order was not appealed, the Discharge Denial Order cannot now be overturned.

II. If the Discharge Motion is a Motion From Relief From Judgment Under Fed. R. Civ. P. 60(b)(3), It Must Fail Because It Was Filed More Than One Year After the Discharge Denial Order Was Entered

Because the Discharge Motion was filed almost three years after the Discharge Denial Order entered, the Discharge Motion is properly treated as a motion for relief from judgment pursuant to Fed. R. Civ. P. 60, made applicable here by Fed. R. Bankr. P. 9024[5]. See In re Joseph S. Chicco, 23 B.R. 292, 293 (B.A.P. 1st Cir. 1982) (construing a motion filed in a bankruptcy court to revoke a previous order entered by that bankruptcy court under Rule 60). Fed. R. Civ. P. 60(b) provides for relief from a final judgment or order for reasons of (1)

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[5] The time limits for taking action under Fed. R. Bankr. P. 9024 may not be enlarged. Fed. R. Bankr. P. 9006 (c)(2).

mistake, inadvertence or excusable neglect, (2) newly discovered evidence, (3) fraud, (4) and (5) because the judgment is void or satisfied, or (6) "for any other reason that justifies relief." Fed. R. Civ. P. 60(b). The Discharge Motion does not allege mistake, newly discovered evidence, or that the Discharge Denial Order is void or otherwise satisfied.

Because the Panel construes *pro se* arguments liberally, it could view the Discharge Motion as a Rule 60(b)(3) motion seeking relief from judgment for fraud.[6] See Kasparian v. Conley (In re Conley), 369 B.R. 67 (B.A.P. 1st Cir. 2007). If the Panel takes this view however, the Discharge Motion fails because Rule 60(b)(3) motions cannot be brought more than one year "after the judgment, order or proceeding was entered or taken" and the Discharge Denial Order was entered in February, 2005.[7] Fed. R. Civ. P. 60(c)(1). If the Panel interprets the Discharge Motion as a Rule 60(b)(6) motion "for any other reason that justifies relief," that view must also fail because motions brought under Rule 60(b)(6) must be brought within a "reasonable time." *Id.* Three years after the entry of an order is not a "reasonable time." See In re Martin, 287 B.R. 423, 431-32 (Bankr. E.D. Ark. 2003). Even if the Discharge Motion was timely filed, Rule 60(b)(6) is "intended to provide relief only where exceptional circumstances prevent the moving party from seeking redress through the usual channels" and no exceptional circumstances are

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[6] Mr. Kristan asserts that the trustee's actions constituted fraud and are therefore cause to revoke denial of the discharge. However, all of the trustee's actions in this case were approved by the court, and are now final orders. Mr. Kristan was denied a discharge not because of any action by the trustee, but as a result of Mr. Kristan's own wrongful actions in attempting to transfer property beyond the reach of his creditors, which actions had to be addressed by the trustee on behalf of the estate.

[7] The "fraud on the court" standard is "distinct from the more general fraud standard of Rule 60(b)(3), and may be brought at any time. However, while there is no strict time limitation for filing a motion alleging fraud on the court, such a motion must be brought within a reasonable time." See In re Martin, 268 B.R. 168, 171 (Bankr. E.D. Ark. 2001).

present here. See In re Crystalin LLC, 293 B.R. 455, 466 (B.A.P. 8th Cir. 2003). (*internal quotations and citation omitted*); In re Cole, 382 B.R. 20, 26 (Bankr. E.D.N.Y. 2008).

III. As a Substantive Matter, 11 U.S.C. § 727(e) Applies Only to Debtors Who Have Received a Discharge and is Thus Inapplicable to Mr. Kristan

Mr. Kristan uses 11 U.S.C. § 727(e) as both the jurisdictional and the substantive basis for the Discharge Motion. 11 U.S.C. § 727(e) does not apply to Mr. Kristan because § 727 (e) applies only the debtors who have previously obtained a discharge and Mr. Kristan did not obtain a discharge in the underlying bankruptcy case.

The import of § 727(e) is that if a debtor has already received a discharge, “the Trustee, a creditor, or the United States Trustee may request a revocation” of that discharge upon a showing that the discharge was obtained through fraud or like means.[8] 11 U.S.C. § 727(e). Mr. Kristan misinterprets § 727(e)(2)’s provision that a revocation of discharge may be sought by any date before “the date the case is closed” using it, without basis, to attack the Discharge Denial Order entered years earlier. The bankruptcy court committed no error of law in finding that Mr. Kristan is not entitled to relief under 11 U.S.C. § 727(e).

CONCLUSION

Mr. Kristan has failed to meet his burden on appeal. Accordingly, the Discharge Denial

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[8] Mr. Kristan ignores the clear language of § 727(e) that only the “trustee, a creditor, or the United States Trustee may request a revocation of discharge” by claiming that he purchased his creditors’ claims, and thus he now stands in the shoes of the creditors to revoke the Discharge Denial Order under section 727(e)(2).

Order should be affirmed.

Respectfully submitted,

PHOEBE MORSE,
United States Trustee

By: Phoebe Morse
United States Trustee
Richard King
Assistant United States Trustee
United States Department of Justice
Office of the United States Trustee
446 Main Street, 14th Floor
Worcester, MA 01608
Tel: (508) 793-0555, ext. 112
Fax:(508) 793-0558
Email: Richard.T.King@usdoj.gov

Dated: April 14, 2008

CERTIFICATE OF SERVICE

The undersigned hereby certifies that on this 11th day of April, 2008, a copy of the Appellee's Brief of the United States Trustee was served via first class mail, postage pre-paid, upon the following:

Richard C. Donovan, Clerk
Bankruptcy Appellate Panel, First Circuit
John Joseph Moakley U.S. Courthouse
1 Courthouse Way, Suite 2-500
Boston, MA 02210

Frank J. Kristan
PO Box 214
Kennebunkport, ME 04046

John C. Turner, Esq.
JC Turner & Associates, Inc.
PO Box 1897
Auburn, ME 04211

Jonathan R. Doolittle, Esq.

Verrill Dana, LLP
One Portland Square
PO Box 586
Portland, ME 04112

Richard King, Esq.
Assistant United States Trustee
Office of the United States Trustee
446 Main Street, 14th Floor
Worcester, MA 01608

10

UNITED STATES BANKRUPTCY APPELLATE PANEL
FOR THE FIRST CIRCUIT

BAP NO. EP 08-003

FRANK J. KRISTAN,
Debtor,

FRANK J. KRISTAN,
Appellant,

v.

JOHN C. TURNER, Chapter 7 Trustee,
and PHOEBE MORSE, United States Trustee,
Appellees.

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ON APPEAL FROM THE UNITED STATES BANKRUPTCY COURT FOR THE DISTRICT OF MAINE

CASE NO. 04-20328-JBH

ADDENDUM TO BRIEF OF APPELLEE, UNITED STATES TRUSTEE

Roberta DeAngelis
Acting General Counsel
P. Matthew Sutko
Associate General Counsel
Department of Justice
Executive Office for United States Trustee
20 Massachusetts Avenue, NW
Washington, DC 20530

Phoebe Morse
United States Trustee
Richard King, Esq.
Assistant United States Trustee
Office of the United States Trustee
446 Main Street, 14th Floor
Worcester, MA 01608
Tel: (508) 793-0555, ext. 112

ADDENDUM
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BRIEF BANK — "SUMMARY SHEET"

Printed Fri.-1/8/99 (12:06)

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*

IN RE KROY, INC.

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*

Bank. D. Ariz.

3. ("CCN") ***CURRENT*** CASE NO.

No.: 90-05034-PHX-RGM (on remand from dist. ct. appeal)

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*

No.: 97-0898-PHX-SMM

Court: Dist. Ct. (Ariz.)

(Identify judge & cite, if any)

5. ("SO") ***SOURCE***

U.S. TRUSTEES

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*

Filed: OCT. 1, 1998

Type: UST'S OPPOSITION TO MOTION TO COMPEL INTERROGATORY ANSWERS AND FOR SANCTIONS (WITH SUPPORTING DECLARATION)

7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*

Paul W. Bridenhagen (UST/OGC)

Christopher J. Pattock (UST/Region 14-Phoenix)

(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***

BANKRUPTCY

9. ("SU") ! ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***

! **Discovery:** Opposition to motion to compel. We argued debtors failed to allege prima facie case of "selective enforcement."

√ **Background:**

10. PATH TO FILE LOCATION: (e.g., S:\GENERAL COUNSEL\BRFBANK\etc...)

S:\GENERAL COUNSEL\BrfBank\To-West-Net\GROUP03 West-Net\Kroy1.wpd

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NAME: Paul Bridenhagen

DATE: Fri.-10/2/98 (12:31)

Christopher J. Pattock
Office of the United States Trustee
2929 North Central Avenue, Ste. 700
P.O. Box 36170
Phoenix, Arizona 85067-6170
(602) 640-2100

Paul Bridenhagen
Office of the General Counsel
Executive Office for U.S. Trustees
Department of Justice
Washington D.C. 20530
(202) 307-1399
Attorneys for U.S. Trustee

UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF ARIZONA

In re KROY (EUROPE) LIMITED, a company chartered under the laws of the United Kingdom, Debtor.	)	Case No. 90-05034-PHX-RGM (Jointly Administered) (Chapter 11)
In re KROY, Inc., a Minnesota corporation, Debtor.	)	

UNITED STATES TRUSTEE'S OPPOSITION TO DEBTORS' MOTION FOR AN ORDER COMPELLING THE UNITED STATES TRUSTEE TO ANSWER INTERROGATORIES, AND FOR SANCTIONS

The United States Trustee, through undersigned counsel, opposes the Motion Of Kroy, Inc. And Kroy (Europe) Ltd. ("Debtors") For An Order Compelling The United States Trustee To Answer Interrogatories, And For Sanctions ("Motion to Compel"). As set forth in their motion, Debtors sought discovery from the United States Trustee by propounding six interrogatories. The United States Trustee's objections to those interrogatories were, for the reasons set forth below, appropriate, and Debtors are not entitled to the discovery sought. Moreover, the United States Trustee has provided information to the Debtors on an informal basis that will enable them to obtain any additional information they seek, if they so choose. Consequently, Debtors' motion to compel and for sanctions should be denied.

I. The United States Trustee Has Attempted In Good Faith To Avoid An Unnecessary Discovery Dispute

In the course of attempting to resolve this discovery dispute, the United States Trustee, through undersigned counsel, Paul W. Bridenhagen, attempted in good faith to avoid a discovery dispute with counsel for Debtors (Richard A. Baumgart). Motion to Compel, Exhibit C; United States Trustee's Opposition Exhibit A, Declaration of Paul W. Bridenhagen, ¶¶ 5-9 . Debtors's Interrogatory #1 requested the "number of cases in the District of Arizona in which the Office of the United States Trustee has pursued post-confirmation fees pursuant to 28 U.S.C. § 19309a)(6)." Debtors's Interrogatory #2 requested the name and case number of each case identified in response to Interrogatory #1. The United States Trustee objected to these requests, inter alia, on vagueness grounds, because she was unable to determine the precise meaning of the term "pursued." Specifically, the United States Trustee was unsure whether the term "pursued" included a written request for payment of a debtor's post-confirmation obligation, whether it was limited only to a filing of a motion or an objection in bankruptcy court seeking payment of fees, or whether it was limited only to the pursuit of an appeal of an adverse decision of a bankruptcy court in response to a motion or an objection filed by the United States Trustee. In response to that objection, Debtors refined the meaning of the term "pursued " to mean "taken **any** formal action to collect fees." Motion to Compel, at 6. (emphasis added).

Thus defined, counsel for the United States Trustee informed Debtors' counsel that, under the supervision of the Executive Office for United States Trustees ("EOUST"), written notices and requests for payment concerning post-confirmation quarterly fee obligations were sent to all debtors in cases in the District of Arizona listed in EOUST's database as having plans that were confirmed before January 17, 1996 pending from and after that date (hereinafter these cases will be referred to as the "relevant cases"). Counsel for the United States Trustee informed Debtors' counsel, therefore, that the United States Trustee had pursued quarterly fees in all of the relevant cases. See, Exhibit A, Declaration of Paul W. Bridenhagen, ¶ 6 .

Without waiving the United States Trustee's objections to the discovery sought, in an effort to avoid a formal discovery dispute, counsel for the United States Trustee offered to have electronic search commands formulated and run by the contractor retained by EOUST to service its electronic case database system concerning quarterly fees in order to generate lists of the relevant cases and a summary of all post-confirmation fees collected therein. See, Exhibit A, Declaration of Paul W. Bridenhagen, ¶ 7 & 8. Although undersigned counsel initially understood that the formulation and execution of the necessary search commands could be performed by about September 10, 1998, the reports were not able to be completed until the afternoon of September 18, 1998. See, Exhibit A, Declaration of Paul W. Bridenhagen, ¶ 8. Shortly thereafter, these reports were sent by overnight courier to counsel for Debtors, with a request that he contact counsel for the United States Trustee to discuss whether the information provided was sufficient for Debtors' needs in this litigation. Exhibit A, Declaration of Paul W. Bridenhagen, attached letter and reports. To date, counsel for the Debtors has not contacted counsel for the United States Trustee to discuss the adequacy of the information provided. See, Exhibit A, Declaration of Paul W. Bridenhagen, ¶ 9.

II. Debtors Have Failed To Demonstrate That They Are Entitled To Discovery, Which Is Sought Solely In Connection With Debtors' Facially Invalid "Selective Enforcement" Defense

Contrary to the representation by Debtors in their motion (Motion to Compel, at 5), the United States Trustee did not suggest that the issues on remand were in any way limited. The United States Trustee's relevancy objection was set forth as follows: "The information sought by this interrogatory is neither relevant nor reasonably calculated to lead to the discovery of relevant evidence that relates to any of the six issues identified by the district court, **or to any other valid defense**, in this matter. See Motion to Compel, Exhibit B, at 2 (emphasis added). In their Motion, Debtors argue only that all of the interrogatories "directly relate to whether the United States Trustee has selectively enforced its interpretation of § 1930(a)(6), and bear upon the United States Trustee's belief as to what [she] can collect." Motion to Compel, at 5. In their brief on remand, Debtors' selective enforcement argument is articulated as follows: "The local United States Trustee's offices handles cases concerning this issue inconsistently . . . those entities who actively seek to close their cases, such as New Kroy, face the United States Trustee's demand for the payment of quarterly fees. Reorganized debtors whose cases are administratively closed by the Clerk's Office, however, do not face similar demands for payment." Brief Of Kroy, Inc., And Kroy (Europe) Ltd., On Remand Relating To Liability For Payment Of Quarterly Fees Allegedly owed To The United States Trustee ("Debtor's Brief On Remand"), at 13.

Debtors' selective enforcement argument appears to be based solely on a footnote in this Court's order granting its request for final decree. Motion to Compel, at 2 n.1, citing In re Kroy (Europe) Limited, In re Kroy, Inc., no. B-90-05034-PHX-RGM, B-90-05035-PHX-RGM, unreported, 1997 WL 178857, n.1 (Bankr. D. Ariz., March 5, 1997). As set forth in the United States Trustee's Brief on Remand, at 18, n.6, however, the United States Trustee sought reconsideration of that decision, in part, based on the content of that footnote. In denying the reconsideration sought, the Court noted that the footnote contained nothing more "than an observation regarding the apparent inconsistency" in the United States Trustee's policies, and that observation had no bearing on the facts and conclusions regarding the approval of the entry of the final decree in the case. 1997 WL 178857, *2 (emphasis added).

As the Supreme Court and the Ninth Circuit have both recognized, the government retains broad discretion in the enforcement of its laws. Wayte v. United States, 470 U.S. 598, 607

(1985) (government retains broad prosecutorial discretion); United States v. Bourgeois, 964 F.2d 935 , 937 (9th Cir. 1992) (same). Although broad, that discretion is not unfettered, and may not be "deliberately based upon an unjustifiable standard such as race, religion, or other arbitrary classification." Wayte v. United States, 470 U.S. at 608, quoting Oyler v. Boles, 368 U.S. 448, 456 (1962). In United States v. Ness, 652 F.2d 890, 891 (9th Cir. 1981), cert. denied, 454 U.S. 1126 (1981), the Ninth Circuit directly addressed a party's right to conduct discovery in the context of a claim of selective prosecution. In that case, the Ninth Circuit stated that a party seeking discovery in support of such a claim has the "burden of establishing that others similarly situated have not been prosecuted and that the allegedly discriminatory prosecution was based on an impermissible motive." Id..

In this matter, Debtors have failed to satisfy either prong of this test and are not entitled to the discovery sought. First, the Debtors cite only footnote No. 1 in this Court's final decree, which this Court has described as merely an observation of an apparent inconsistency. Furthermore, although under-staffing has forced the United States Trustee to prioritize her collection efforts, the evidence before the Court demonstrates that the United States Trustee has both on her own and through the EOUST pursued quarterly fees in all of the relevant cases by, inter alia, sending demands for payment. See, Exhibit A, Declaration of Paul W. Bridenhagen, ¶¶ ; See, Exhibit B, Declaration of Michele R. Hankins, at 1. Second, the Debtors have failed to articulate any impermissible motive (related to such considerations as race, religion, free speech, or retaliation) that would support a claim of selective enforcement. See also Graham v. Commissioner of Internal Revenue Service, 822 F.2d 844, 85 3 (9th Cir. 1987) (taxpayer failed to demonstrate "type of hostility to a target of law enforcement that would support a claim of selective enforcement"), citing U.S. v. Ness, supra. Thus, under the law of this Circuit, Debtors are not entitled to the discovery sought. United States v. Ness, 652 F.2d at 891 (fact that discovery might be helpful does not relieve party of burden of making initial showing).

Finally, even if the United States Trustee did seek quarterly fees more actively from debtors who filed motions to close their cases, such a policy would have been a reasonable exercise of her discretion: debtors who actively litigate their cases demonstrate in an immediately verifiable way that they are still in existence and are more likely to have the funds necessary to pay the fees sought. See, Exhibit B, Declaration of Michele R. Hankins, at 1-3 (describing the United States Trustee's practices and policies concerning the collection of post-confirmation quarterly fees). See also United States v. Bourgeois, 964 F.2d 935, 938 (9th Cir. 1992) ("selective enforcement prosecution claims are evaluated 'according to ordinary due process standards'") quoting United States Wyate, 470 U.S. at 608-09.

III. The Discover Sought Is Burdensome, Particularly In Light Of The Current Understaffing Of The United States Trustee's Office And The Information Already Provided To Debtors

The United States Trustee has, by providing the lists attached to Exhibit A to this opposition, enabled Debtors to obtain any further information they may deem necessary to their defense in this matter. Because responses to Interrogatories ## 3-5 by the United States Trustee could only have be made after a manual search of all United States Trustee and court files of all the cases identified in response to interrogatories ## 1 and 2, such a search would be unduly burdensome in the context of this case. See, Exhibit A, Declaration of Paul W. Bridenhagen, attached letter and reports. See also, Exhibit B, Declaration of Michele R. Hankins, at 2-3. Therefore, the United States Trustee's objection in this regard was appropriate.

Conclusion

For the above-stated reasons, the United States Trustee requests that the Court deny Debtors' request for an order compelling discovery and for sanctions.

Respectfully submitted,

Brenda M. Whinery
UNITED STATES TRUSTEE

Michele R. Hankins
ASSISTANT U.S. TRUSTEE

____
Christopher J. Pattock
ATTORNEY ADVISOR

Martha L. Davis
GENERAL COUNSEL

____
Paul Bridenhagen
ATTORNEY
Department of Justice
Executive Office for
United States Trustees
Suite 780
901 E. Street, N.W.
Washington D.C. 20530
(202) 307-1399

October 1, 1998

CERTIFICATE OF SERVICE

An original and one copy of the foregoing United States Trustee's opposition to debtors' motion to compel discovery and for sanctions were served by U.S. Mail (first class, postage pre-paid) this 1st day of October, 1998, upon:

Richard A. Baumgart, Esq.
Dettlebach, Sicherman & Baumgart
1801 East Ninth Street, Suite 1100
Cleveland, OH 44114-3169
FAX: (216) 696-3338

Madeleine C. Wanslee, Esq.
Guest Rosenfeld, P.C.
201 North Central Avenue
Phoenix, Az 85073-3300
FAX: (602) 340-1538

Christopher J. Pattock

Christopher J. Pattock
Office of the United States Trustee
2929 North Central Avenue, Ste. 700
P.O. Box 36170
Phoenix, Arizona 85067-6170
(602) 640-2100

Paul Bridenhagen
Office of the General Counsel
Executive Office for U.S. Trustees
Department of Justice
Washington D.C. 20530
(202) 307-1399
Attorneys for U.S. Trustee

UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF ARIZONA

In re KROY (EUROPE) LIMITED, a company chartered under the laws of the United Kingdom,	)	
	)	Case No. 90-05034-PHX-RGM
	)	(Jointly Administered)
Debtor.	)	
	)	(Chapter 11)
In re KROY, Inc., a Minnesota corporation,	)	
	)	
Debtor.	)	
______________________________________	)	

DECLARATION

I, Paul W. Bridenhagen, hereby declare as follows:

1. I have been employed with the Executive Office for United States Trustees ("EOUST") since April 1993 as an attorney in the Office of the General Counsel

2. I make this declaration based on my own knowledge and information made known to me in the course of my responsibilities as an attorney in the Office of the General Counsel.

3. I have been assigned to assist the Office of the United States Trustee in Arizona in the above-captioned case and was the primary attorney responsible for handling the United States Trustee’s response to the interrogatories propounded by the Debtors this matter.

4. In the course of my responsibilities in this matter, after consultation with the Office of the United States Trustee in Arizona and personnel at the Executive Office for United States Trustees, I prepared, signed and served the United States Trustee's objections to the interrogatories propounded by the Debtors.

5. In a good faith effort to avoid a discovery dispute, I discussed with counsel for Debtors, Stuart Baumgart, the Debtors' theory concerning selective enforcement and expressed the view that I believed it was without legal merit. On at least three separate occasions, August 28, 1998, September 4, 1998 and September 8, 1998, I had conversations Mr. Baumgart. During the course of those conversations I reiterated the objections of the United States Trustee to the Debtors' interrogatory requests, but sought to understand his discovery needs. During the September 4, 1998 conversation, I expressly stated to Mr. Baumgart that in responding to the Debtors' discovery requests, the United States Trustee had not taken the position that the parties were limited in the issues that could be raised on remand.

6. Following my initial discussions with Mr. Baumgart, I consulted with the personnel at the Database Management Systems, EOUST, and was informed that its contractors had sent written notices concerning quarterly fees in all cases listed in EOUST's database that had plans confirmed prior to January 27, 1996. Those notices informed the parties of the January 1996 amendment to 28 U.S.C. § 1930(a)(6) that extended the obligation of chapter 11 debtors to pay quarterly fees into the post-confirmation period and demanded payment of all fees due. During my September 4, 1998, conversation with Mr. Baumgart, I informed him that these written requests for payment were made in all the relevant cases and stated, therefore, that the United States Trustee had pursued quarterly fees in all cases with plans confirmed prior to January 27, 1996, including those pending in Arizona.

7. In early September, I inquired whether the contractor that manages the database used in the collection of quarterly fees was capable of generating a list of all cases in the District of Arizona with plans that were confirmed before January 17, 1996 that were pending from and after that date (hereinafter these cases will be referred to as the "relevant cases.") . I further inquired whether the contractor could generate a summary of all post-confirmation fees collected in the relevant cases. I was initially told that the database was not configured to generate such reports.

8. On, or shortly before, September 8, 1998, I was informed by that, although EOUST's database was not then capable of generating the lists discussed in ¶ 7, the contractor could formulate search commands that would generate such lists, but that the process would take approximately two days. On September 8, 1998, I spoke with Mr. Baumgart and offered to provide him with lists containing the case names and numbers of all the relevant cases and a list of all post-confirmation fees collected in those cases to date. I indicated that I was uncertain as to how long the contractor would take to generate the list, but had been told it would take about two days. He stated that he would proceed to prepare and file his motion to compel and that he would review whatever information I ultimately provided him and then discuss his discovery needs further.

9. Although I repeatedly attempted to expedite the processing of the lists that I had offered to provide to Mr. Baumgart, I did not receive them until the afternoon of September 18, 1998. I immediately called Mr. Baumgart to discuss the matter, but he was not in his office. I left a message for him to call me. I called again the following Monday and was informed he was out of the office. He called me the next day September 22, 1998, and we discussed the contents of the lists, which I sent to him by overnight mail that day. In a letter dated September 22, 1998,

that accompanied the lists, I requested that he call me to discuss me whether the information provided would be sufficient for Debtors' needs in this matter. To date he has not contacted me in this regard.

10. True and accurate copies of the reports provided to Debtors' counsel, along with the transmittal letter, are attached hereto.

I hereby declare on penalty of perjury that the foregoing is true and correct.

____
Paul Bridenhagen
ATTORNEY
Department of Justice
Executive Office for
United States Trustees
Suite 780
901 E. Street, N.W.
Washington D.C. 20530
(202) 307-1399

October 1, 1998

CERTIFICATE OF SERVICE

An original and one copy of the foregoing Declaration in support of the United States Trustee's opposition to debtors' motion to compel discovery and for sanctions were served by U.S. Mail (first class, postage pre-paid) this 1st day of October, 1998, upon:

Richard A. Baumgart, Esq.
Dettlebach, Sicherman & Baumgart
1801 East Ninth Street, Suite 1100
Cleveland, OH 44114-3169
FAX: (216) 696-3338

Madeleine C. Wanslee, Esq.
Guest Rosenfeld, P.C.
201 North Central Avenue
Phoenix, Az 85073-3300
FAX: (602) 340-1538

____
Christopher J. Pattock

BRIEF BANK — "SUMMARY SHEET"

Printed Fri.-1/8/99 (12:23)

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE
[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]

FIRST USA, et. al. v. RICHARD LAMANNA (IN RE LAMANNA)

2. ("CO") ***CURRENT*** COURT
[E.g., "CTA9"]

CTA1

3. ("CCN") ***CURRENT*** CASE NO.

No.: 98-9003

4. ("PCN") ***PRIOR*** CASE NO. & COURT
[IF ANY]

No.: N/A

Court: BAP-CTA1, affirming *In re Lamanna*, 210 B.R. 17 (Bankr. D.R.I. 1997)
(Identify judge & cite, if any)

5. ("SO") ***SOURCE***

U.S. TRUSTEES

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF
[E.g., "Opening Brief," "Reply," "Amicus," etc.]

Filed: MAY 20, 1998

Type: UST AMICUS CURIAE BRIEF

7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g., "UST/OGC"]*

Paul W. Bridenhagen (UST/OGC)
Eric Kempton Bradford (UST/REGION 1-BOSTON)
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***

BANKRUPTCY

9. ("SU") ! ***SUMMARY*** OF KEY ISSUE(s)

&

√ Any Miscellaneous ***BACKGROUND***

! In a motion to dismiss for "substantial abuse" under 11 USC 707(b), a debtor's ability-to-repay is the primary, though not necessarily exclusive factor, and "bad faith" need not be shown to warrant dismissal under 707(b).

√ **Background:** Here, debtor lived with his parents and could repay all his debts with future disposable income in 3 years. In a case of first impression within the First Circuit, the appeals court affirmed dismissal under 707(b) in *In re Lamanna*, 153 3d 1 (1st Cir. Aug. 25, 1998).

10. PATH TO FILE LOCATION:
(e.g., S:\GENERAL COUNSEL\BRFBANK\etc...)

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| | NO

NAME: Anthony J. Ciccone
DATE: Fri.-11/13/98 (10:14)

No. 98-9003

UNITED STATES COURT OF APPEALS
FOR THE FIRST CIRCUIT

FIRST USA, ET AL.

Appellees

v.

RICHARD LAMANNA

Appellant

ON APPEAL FROM A JUDGMENT OF THE UNITED STATES BANKRUPTCY APPELLATE PANEL OF THE FIRST CIRCUIT

AMICUS CURIAE BRIEF OF J. CHRISTOPHER MARSHALL, UNITED STATES TRUSTEE

Eric Kempton Bradford, Esq.
Office of the United States Trustee
Thomas P. O'Neill, Jr. Federal Building
10 Causeway Street, Room 1184
Boston, Massachusetts 02222
Tel. (617) 565-6360
May 20, 1998

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CERTIFICATE OF SERVICE

ADDENDUM

STATEMENT OF JURISDICTION

This appeal arises from a final order entered by the Bankruptcy Appellate Panel for the First Circuit ("BAP") dated January 23, 1998, which affirmed the May 7, 1997 order ("Order") of the Rhode Island United States Bankruptcy Court dismissing the chapter 7 bankruptcy case of Richard Lamanna ("Debtor") for substantial abuse under 11 U.S.C. § 707(b). In re Lamanna, 210 B.R. 17 (Bankr. D.R.I. 1997). This Court has jurisdiction over this appeal under 28 U.S.C. § 158(d).

STATEMENT OF ISSUE PRESENTED

Did the bankruptcy court, as affirmed by the BAP, commit clear error in dismissing Debtor's chapter 7 case for substantial abuse under 11 U.S.C. § 707(b), where he demonstrated no meaningful economic or other hardships that prevented him from repaying all of his debts?

STANDARD OF APPELLATE REVIEW

In general, appellate courts "'... independently review the bankruptcy court's decision, applying the 'clearly erroneous' standard to findings of fact and de novo review to conclusions of law.' ... [Where the issue] poses a mixed question of law and fact, [the Court applies] the clearly erroneous standard, unless the bankruptcy court's analysis was 'infected by legal error ...'" In re Winthrop Old Farm Nurseries, Inc., 50 F.3d 72, 73 (1st Cir. 1995) (citations omitted). See Fed. R. Bankr. P. 8013.[1/]

[1/] A finding of fact is clearly erroneous "... when although there is evidence to support it, the reviewing court on the evidence is left with the definite and firm conviction that a mistake has been committed ..." United States v. United States Gypsum Co., 333 U.S. 364, 395, 68 S.Ct. 525, 542, 92 L.Ed 756, 766 (1948). "... When the finding of fact is premised on an improper legal standard, or a proper one is improperly applied, that finding loses the insulation of the clearly erroneous rule ..." Wilson v. Huffman (In re Missionary Baptist Foundation of America, Inc., 712 F.2d 206, 209 (5th Cir. 1983).

The facts in this appeal, however, are not disputed. The Court reviews de novo both the meaning of the statutory terms used in section 707(b) and the lower courts' ultimate conclusion that granting the debtor a discharge would be a "substantial abuse" of chapter 7. Fonder v. United States, 974 F.2d 996, 999 (8th Cir. 1992); In re Green, 934 F.2d 568, 570 (4th Cir. 1991).

STATEMENT OF THE CASE

A. Nature of the Case.

This case arises out of a chapter 7 petition filed by Debtor on February 18, 1997. Appendix ("App.) at 1; 3. After reviewing the schedules accompanying Debtor's petition, the bankruptcy court, sua sponte, issued an order to show cause why it should not dismiss Debtor's case under 11 U.S.C. 707(b). Following the show cause hearing, the bankruptcy court found that Debtor could easily pay all of his debts, and it dismissed his case for substantial abuse. Debtor appealed, and the Bankruptcy Appellate Panel for the First Circuit affirmed the Order. Debtor subsequently appealed to this Court.

B. Course of Proceedings Below

1. Proceedings In Bankruptcy Court

Shortly after Debtor filed his chapter 7 petition, the bankruptcy court, in conducting its standard section 707(b) review of all Rhode Island chapter 7 consumer petitions, prepared a worksheet based on Debtor's schedules "I" and "J." App. at 30. In his schedule "I," Debtor stated that he was employed by the Town of Johnston, Rhode Island and that his monthly take home pay totaled $1,330.96, net of Federal, State and local taxes and "Retpup."[2] App. at 17. In his schedule

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[2] On information and belief, "Retpup" represents monthly deductions for a defined benefit or a defined contribution retirement plan. The record does not indicate either that Debtor claimed an interest in any vested retirement benefits and/or that his interest would be exempt under applicable law.

"J," Debtor stated that his monthly expenses totaled $580, consisting of rent ($300), food ($100), transportation ($60), clothing ($100) and recreation ($20), leaving him disposable, monthly income of $770.96. App. at 17 - 18. In his statement of financial affairs, Debtor also stated that he earned gross income of $23,171 in 1995. App. at 20.

Based on the foregoing, sworn information filed by Debtor, the bankruptcy court concluded that Debtor could repay 100% of his pre-petition debts in equal monthly payments of $491.10 under a three year chapter 13 plan, or $294.66 under a five year plan. App. at 30. The court's worksheet indicated that Debtor could repay his pre-petition debts without difficulty, because, after making monthly chapter 13 plan payments, he would still have excess, disposable income of $279.86 per month under a three year plan and $476.30 per month under a five year plan. App. at 30.

The bankruptcy court issued an order dated February 24, 1997, requiring Debtor to show cause why his chapter 7 case should not be dismissed under section 707(b) for substantial abuse, stating that "... the majority of debts listed on Schedule F appear to be consumer debts ..." and attaching a copy of its worksheet showing that he could easily repay his debts. App. at 29 - 30. Debtor filed a one page "Responde [*sic*] of Debtor to Trustee's Motion to Dismiss" dated March 28, 1997, stating that his monthly expenses of $580, "... while accurately reflect[ing] Debtor's circumstances at the time of filing [were] artificially low because at the time of filing Debtor was living with his parents ..." App. at 31. Debtor further stated that "... [i]t is obviously preposterous to believe that a 28 year old man can pay for housing, food, transportation, health insurance, clothing and other normal expenses for less than $7,000.00 a year. To sustain the Trustee's objection in this case would be to determine that Debtor is required to live below the poverty level in order to avoid substantial abuse ..." App. at 31.

The bankruptcy court conducted the section 707(b) show cause hearing on April 10, 1997. App. at 2; 36. Debtor, through his counsel, affirmed that his scheduled income and expenses were "entirely accurate" and conceded that he currently had sufficient after tax income to repay his entire pre-petition indebtedness. App. at 38 - 39. The court inquired whether Debtor anticipated a present change in his circumstances that might diminish his ability to make payments under a chapter 13 plan, such as emancipating himself from his parents. App. at 39 - 40.[3] Debtor's counsel did not indicate that any such change was anticipated, arguing instead that "... [w]e're here because if the numbers are applied sort of by an adding machine it shows excess income, but we say -- when we say that it true, it simply is a matter of law. It does not show substantial abuse ..." (sic). App. at 39 - 40. He declined the court's invitation to adduce circumstances demonstrating that he could not repay all his debts from disposable income. Thus, the record below demonstrates that, other than his arguments concerning his income level and his "artificially low" expenses, Debtor offered no countervailing considerations (e.g., job loss or sudden illness) to demonstrate that, notwithstanding his admitted ability to repay all his debts, his case should not be dismissed for substantial abuse. App. At 31. Debtor did not dispute that he owed primarily consumer debts. App. at 31.

The bankruptcy court issued the Order on May 7, 1997, finding on the admitted facts that Debtor owed primarily consumer debts, which, given his admitted monthly income and expenses, he could entirely repay. App. at 44 - 47. Applying a "totality of the circumstances test," the court dismissed Debtor's chapter 7 case for substantial abuse under section 707(b), stating as follows:

> [Debtor] has sufficient disposable income to liquidate all of his debts with relative ease and, in fact, he would

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[3] "... [I]f you're telling me that the debtor intends to move out and have expenses like everybody else does — and I don't want to hold him hostage in his parents' house ..." App. at 39 - 40.

> still have $279.86 left over after his monthly payment to the Chapter 13 trustee, even under a [three year] 100% plan. These cases are fact specific and in this instance the payment of these debts would not deprive the Debtor of adequate food, shelter, clothing, or other necessities. Because the numbers here are on a smaller scale than most does not alter or relieve the Debtor of his Section 707(b) responsibility, and having failed to show cause why the case should not be dismissed under Section 707(b), it is so ORDERED.

App. at 46; 210 B.R. at 218. The court stayed the implementation of its Order pending Debtor's appeal. App. at 47 - 48; 210 B.R. at 218.

2. Proceedings Before the BAP

Debtor filed a timely notice of appeal to the First Circuit BAP. On appeal, Debtor did not contest the bankruptcy court's findings of fact concerning his ability to repay all of his debts, instead arguing that only "real" substantial abuse, such as where a debtor had unreasonable expenses, merited dismissal of his case under section 707(b). Addendum ("Add.") at 3. He further argued that "...[t]o sustain the Decision below in this case, the Bankruptcy Appellate Panel would need to determine that any level of income and expenses, which yield an excess, automatically require dismissal of the Chapter 7 case, even where the 'excess' is created by a highly artificial situation in which a very low income Debtor lives and is supported by his parents and accordingly, at the moment of filing, lacks normal expenses ..." Add. at 3. The BAP was unpersuaded:

> As to the last argument, the Appellant's expenses are what they are, and are not expected to change. That is not artificial; that is actual. To base a finding that there was substantial abuse on the Appellant's potential to increase his spending would be artificial. As to the remaining arguments, they substantially overstate the case.

App. at 57. Finding no error, the BAP affirmed the bankruptcy court's Order on January 23, 1998. App. at 57. Debtor timely perfected this appeal of the BAP's order on January 30, 1998.

C. Unexplained "Eve Of Bankruptcy Expenditures"

Although not expressly relied upon by either the bankruptcy court or the BAP, the record on appeal demonstrates that Debtor signed and dated his petition, along with his schedules and statement of financial affairs, under pains and penalties of perjury on November 22, 1996. App. at 1; 3; 4; 19; 26; 27. During the *four week* period immediately prior to signing the documents, Debtor charged $9,994.45, or 63%, of his total $15,911.72 in admittedly pre-petition, consumer debts on credit cards and personal credit lines.[4] App. at 13 - 14; 44; Appellant's Brief at 3. Other than a 1995 $1,900 college loan, the record below does not suggest what Debtor's eve of bankruptcy expenditures were. In his schedule "B," however, Debtor claimed that his only assets comprised personalty - cash and clothing - worth $2,006, all which he claimed as exempt in his schedule "C." App. at 7 - 8; 10.

SUMMARY OF ARGUMENTS

The bankruptcy court found, based on Debtor's sworn schedules, that he could easily repay 100% of his debts. Debtor did not contest these findings. Moreover, although give ample notice and an opportunity to respond to the bankruptcy court's show cause order, Debtor presented no evidence of any countervailing considerations that militated against dismissal, such as the occurrence of a sudden illness or financial or other hardships. Considering the totality of the circumstances in the

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[4] The $9,994.45 figure included the following debts incurred in October, 1996: a $7,729.88 "personal loan" from Household Finance; a $821.18 credit card debt payable to Norwest Financial; a $763.76 personal loan payable to Hospital Trust; and a $679.63 credit card debt payable to "HRS". Separately, Debtor had incurred a $4,017.27 credit card debt to First USA in October, 1995, within thirteen months of signing the petition. The remaining $1,900 debt represented a September, 1995 "college debt" payable to Mount Ida College. App. at 13 - 14.

record before it, the bankruptcy court correctly found that granting relief to Debtor under chapter 7 would be a substantial abuse, and the BAP agreed. Accordingly, the Court should affirm the Order, as did the BAP.

The record below provides an additional ground for sustaining the dismissal of the Debtor's case. Although not focused on by the courts below, the record demonstrates that Debtor incurred 63% of his total indebtedness ($9,994.45) within the four weeks preceding the signing of his petition. Applying the totality of the circumstances test, the bankruptcy court could have found substantial abuse based on Debtor's unexplained, eve of bankruptcy spending spree.

I. THE BAP CORRECTLY AFFIRMED THE BANKRUPTCY COURT'S DISMISSAL OF DEBTOR'S CASE FOR SUBSTANTIAL ABUSE BASED ON HIS ADMITTED ABILITY TO REPAY ALL OF HIS DEBTS

With the enactment of Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. 98-353, 98 Stat. 353 ("1984 Act"), "... debtors no longer have unfettered access to voluntary Chapter 7 relief ..." In re Walton, 866 F.2d 981, 982 (8th Cir. 1989). Pursuant to the 1984 Act, Congress substantially amended section 707 of the Bankruptcy Code by adding section 707(b), which currently provides as follows:

> (b) After notice and a hearing, the court, on its own motion or on a motion by the United States trustee, but not at the request or suggestion of any party in interest, may dismiss a case filed by an individual debtor under this chapter whose debts are primarily consumer debts if it finds that the granting of relief would be a *substantial abuse* of the provisions of this chapter. There shall be a presumption in favor of granting the relief requested by the debtor.

11 U.S.C. § 707(b) (emphasis added). Section 707(b) therefore authorizes the bankruptcy court, sua

sponte , or on the motion of the United States Trustee, to dismiss the chapter 7 case of an individual debtor who owes primarily consumer debts for substantial abuse.[5] Although the term “substantial abuse” is not defined in the 1984 Act, neither the courts nor the commentators dispute that the initiative for section 707(b)[6] arose from Congress’ concern that consumer borrowers had been filing chapter 7 liquidation cases in record numbers following the enactment of the Bankruptcy Code in 1978 and discharging progressively higher amounts of consumer debts, which, researchers claimed, a significant minority had the capacity to repay. In re Green, 934 F.2d at 570 (“...Section 707(b) introduced an additional restraint upon a debtor’s ability to gain Chapter 7 relief, by allowing a bankruptcy court to deal equitably with the situation in which an unscrupulous debtor seeks the courts assistance in a scheme to take unfair advantage of his creditors...”); In re Walton, 866 F.2d at 983 (section 707(b) was "... aimed primarily at stemming the use of Chapter 7 relief by unneedy

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[5] Although Debtor has not contested that his are primarily consumer debts, by way of background, section 101(8) of the Bankruptcy Code defines consumer debt as “... debt incurred by an individual primarily for personal, family, or household purpose ...” In re Mastromarino, 197 B.R. 171, 174 (Bankr. D. Me. 1996). “... [P]rimarily suggests an overall ratio of consumer debts of over fifty percent. Furthermore, the consumer debts should be evaluated not only by amount, but by their relative number ...” Matter of Booth, 858 F.2d 1051, 1055 (5th Cir. 1988).

[6] Among the 1984 Act’s nineteen amendments to the Bankruptcy Code, the Consumer Credit Amendments added 11 U.S.C. § 109(g), authorizing the bankruptcy court to bar a debtor from filing successive petitions for 180 days - In re Tomlin, 105 F.3d 933, 938 (4th Cir. 1997) - and requiring all individual chapter 7 debtors to file schedules “I” and “J,” detailing their current, monthly income and expenses - Fonder v. U.S., 974 F.2d at 999 (“... [w]hen Congress enacted § 707(b) in 1984, it also added the requirement that debtors file an Income/Expense Schedule ‘to facilitate addressing the question of abuse in Chapter 7 cases ...”) (citations omitted). It also added 11 U.S.C. § 1325(b), which “... provides that if the trustee or the holder of an unsecured claim objects to confirmation of the plan, the plan may not be confirmed unless the debtor proposes to pay into the plan all of the debtor’s ‘disposable income’ for a period of three years or until all allowed unsecured claims are paid in full, whichever is earlier ... ‘Disposable income’ is defined as income not reasonably necessary for the maintenance or support of the debtor or a dependant of the debtor ...” 8 Lawrence P. King, Collier on Bankruptcy, ¶ 1325.08[1] (15th Ed. 1997) (Revised).

debtors ..."), citing S. Rep No. 65, 98th Cong., 1st Sess. 3 (1983) (emphasis added). See also Wells, Kurtz and Calhoun The Implementation of Bankruptcy Code Section 707(b): The Law and the Reality, 39 Clev. St. L. Rev. 15 (1991) at 30.

Although the tests employed by the various Courts of Appeal differ slightly, they generally agree that dismissal under section 707(b) is warranted either if a debtor does not “need” a chapter 7 discharge, because he can repay his consumer debts with ease out of his future earnings, or if he has been“dishonest” with his creditors, for example, by making “eve of bankruptcy” purchases or misrepresenting facts in his schedules and statement of financial affairs. See In re Krohn, 886 F.2d 123, 126 (6th Cir. 1989); see also In re Green, 934 F.2d at 572; accord In re Walton, 866 F.2d at 985 (8th Cir. 1989); In re Kelly, 841 F.2d 908, 914 - 915 (9th Cir. 1988).[7]

A. "Substantial Abuse" Is Determined On The Totality Of Circumstances, But Ability To Repay Debts May Be Enough To Support Dismissal, Unless There Are Sufficient Countervailing Considerations.

This Court has not yet decided a case involving "substantial abuse" under section 707(b). Most circuits that have addressed the issue have applied a totality of the circumstances type test. In our view, the proper approach is a "totality of the circumstances" analysis, a version of which the

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[7] ... In determining whether to apply § 707(b) to an individual debtor, then, a court should ascertain from the totality of the circumstances whether he is merely seeking an advantage over his creditors, or is “honest,” in the sense that his relationship with his creditors has been marked by essentially honorable and undeceptive [sic] dealings, and whether he is “needy” in the sense that his financial predicament warrants the discharge of his debts in exchange for liquidation of his assets ... *Substantial abuse can be predicated upon either lack of honesty or want of need ...*

In re Krohn, 886 F.2d at 126 (citations omitted) (emphasis added).

bankruptcy court adopted in dismissing Debtor’s petition. App. at 35. Under this approach, a debtor's ability to repay his debts may alone be a basis for dismissal, unless there are sufficient countervailing considerations.

Prior to enactment of section 707(b) in 1984, chapter 7 debtors were subject only to dismissal for cause under 11 U.S.C. § 707(a), to denial of discharge for various types of wrongdoing under 11 U.S.C. § 727(a) and to exceptions of specific debts from discharge under 11 U.S.C. § 523(a). They otherwise "... enjoyed an unfettered right to a 'fresh start' under Chapter 7, in exchange for liquidating their nonexempt assets for the benefit of their creditors ..." In re Krohn, 886 F.2d at 126. In permitting dismissal of a chapter 7 case for “substantial abuse,” section 707(b) was intended to "... deny Chapter 7 relief to the dishonest or non-needy debtor ..." Id.,citing In re Walton, 866 F.2d at 983. The goal was to "... promote fairness to creditors, and thereby increase the flow of consumer credit ..." In re Koch, 109 F.3d 1285, 1288 (8th Cir. 1997).

Congress did not define "substantial abuse" in section 707(b), choosing instead to leave the standard "flexible" in order to enable courts to respond to a wide range of factual situations. In re Krohn, 866 F.2d at 983; see In re Kelly, 841 F.2d at 914. The Fourth Circuit has enumerated several factors to be considered in the "substantial abuse" inquiry. These include whether the debtor has the ability to repay, as well as (1) whether the petition was filed "... because of sudden illness, calamity, disability, or unemployment ...;" (2) whether the debtor "... incurred cash advances and made consumer purchases far in excess of his ability to pay ...;" (3) whether the debtor's "... proposed family budget is excessive or unreasonable ...;" (4) whether the debtor's schedules and statement of current income and expenses "... reasonably and accurately reflect [his] true financial condition ...;" and (5) whether the petition "... was filed in good faith ..." In re Green, 934 F.2d at 572.[8]

The Sixth Circuit has also offered a nonexclusive list of similar factors: "... the debtor's good faith and candor in filing schedules and other documents, whether he has engaged in 'eve of bankruptcy purchases,' and whether he was forced into Chapter 7 by unforeseen or catastrophic events ..." In re Krohn, 886 F.2d at 126. These factors are comparable to factors (1), (2), (4), and (5) under In re Green.

All four courts of appeals to address the "substantial abuse" standard agree that the "primary" or "principal" factor is the debtor's ability to repay his debts. In re Green, 934 F.2d at 572; In re Krohn, 886 F.2d at 126; In re Walton, 866 F.2d at 984; In re Kelly, 841 F.2d at 914. "... The primary factor that may indicate a substantial abuse is the ability of the debtor to repay the debts out of future disposable income ..." 6 Lawrence P. King, Collier on Bankruptcy ¶ 707.04[4], at 707-20 (15th Ed.1997) (Revised).

The Fourth Circuit held in Green that an ability to repay debts was not alone sufficient in that case to support dismissal under section 707(b). It further noted that debtor's "... relative solvency may raise an inference ..." that he is trying to take unfair advantage of creditors, but that "... solvency alone is not a sufficient basis ..." for a finding of substantial abuse. In re Green, 934 F.2d at 572 . The remaining three circuits have concluded that an ability to repay debts, standing alone, may suffice, even though other factors may also be relevant. See United States Trustee v. Harris, 960 F.2d 74, 77 (8th Cir. 1992) (ability to fund chapter 13 plan sufficient, although court may "... 'take the

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[8] A court need not analyze all these factors in every case, since substantial abuse is a case-specific and fact-based determination. See, e.g., In re Kestell, 99 F.3d 146, 150 (4th Cir. 1996) (focusing on lack of good faith of debtor who "... sought to avoid paying what he owes to his former wife while making good on his other financial obligations ...").

petitioner's good faith and unique hardships into consideration ...'") (quoting In re Walton, 866 F.2d at 983); In re Krohn, 886 F.2d at 126 (ability to repay sufficient, at least when debtor has ability to repay "with relative ease"); In re Kelly, 841 F.2d at 915 (ability to repay sufficient for dismissal under section 707(b), but inability to repay will not preclude dismissal if bad faith is otherwise shown).

These differences are less significant than they may at first appear. The varying formulations of the circuits can be reconciled with what we consider to be the thrust of section 707(b): Under a "totality of the circumstances" approach, the debtor's ability to repay his debts may be enough, standing alone, to warrant dismissal for substantial abuse under section 707(b), unless there are countervailing considerations - such as sudden illness, calamity, disability, or unemployment - which might indicate that mandating repayment of debts would impose an unwarranted hardship on the debtor. This analysis is consistent with the language and purpose of section 707(b), as well as the holdings of other circuits.[9]

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[9] With one possible exception, First Circuit bankruptcy courts, including the courts below, have adopted the totality of the circumstances test, stressing that a debtor’s ability to repay debts is the primary factor. See In re Snow, 185 B.R. 397, 402 - 403 (Bankr. D.Mass. 1995) (“... [a]lthough there is predictability in a per se rule [such as that articulated in In re Kelly, 841 F.2d at 915], it is obtained at the expense of fairness and perhaps even of basic principles of due process ...” (citation omitted); In re Mastromarino, 197 B.R. at 176 - 177 [Maine]; In re Haffner, 198 B.R. 646, 648 (Bankr. D. R.I. 1996); In re Blair, 214 B.R. 257, 258 - 259 (Bankr. D.Me. 1997); In re Lapatin, 215 B.R. 643 (Bankr. D.R.I. 1997); In re Meleleu, 215 B.R. 645 (Bankr. D.R.I. 1997); c/f In re Keniston, 85 B.R. at 222 (Bankr. D.N.H. 1988) (obviating an analysis of the constitutionality of section 707(b) under the Equal Protection Clause by narrowly interpreting it to provide a redundant check on “bad faith” filings under 11 U.S.C. § 105(a)).

B. The Record Supports The Dismissal of Debtor's Case For Substantial Abuse, Because He Can Repay His Debts Under A Chapter 13 Plan With Ease, And He Has Demonstrated No Financial Or Other Hardships Entitling Him To Chapter 7 Relief.

As below, Debtor concedes here that his debts are primarily consumer debts and that he is eligible for chapter 13 relief. Appellant's Brief at 3. The sole issue before the Court, therefore, is whether the totality of the circumstances, established by the record below, supported the bankruptcy court's dismissal of Debtor's case as an abuse of chapter 7. In re Wilson, 125 B.R. 742, 745 (W.D.Mich. 1990).

In this case, the bankruptcy court properly weighed all of the evidence before it. Based on the admitted facts, the bankruptcy court found that Debtor's monthly take home pay totaled $1,330.96 and that his monthly expenses were $580, leaving him disposable, monthly income of $770.96. App. at 17 - 18. From this, the bankruptcy court concluded that Debtor could repay 100% of his pre-petition debts in equal monthly payments of $491.10 under a three year chapter 13 plan, or $294.66 under a five year plan. App. at 30. The court further determined this repayment would be relatively easy, because after making monthly chapter 13 plan payments, he would still have excess, disposable income of $279.86 under a three year plan and $476.30 under a five year plan. App. at 30.

Despite the bankruptcy court's granting him ample opportunities (App. at 39 - 40; 45), Debtor did not articulate any specific, countervailing circumstances demonstrating that his bankruptcy would not be a substantial abuse. For example, Debtor did not proffer any evidence - in either his written response to the show cause order or his April 10, 1997 oral argument - that any tragedy, illness and/or unemployment or other unanticipated circumstances had precipitated his bankruptcy filing.[10] Moreover, he did not argue that he presently intended to move out of his parents' home, which might have reduced his future net disposable income. App. at 37 - 42; cf. In re Andrus, 94 B.R. 76 (Bankr. W.D. Pa. 1988); In re Matias, 203 B.R. 490 (Bankr. S.D. Fla. 1996) (finding that parents' subsidizing a debtor's living expenses did not require court to adjust its calculation of disposable income for purposes of determining whether the debtor could repay his debts with ease and, therefore, whether he was needy).

In sum, the record below shows that while living at his parents' home and making in excess of $23,000 per year, Debtor voluntarily incurred consumer debts that he apparently chose not to repay and, in exempting all of his assets, proposed to pay his creditors nothing. In re Peluso, 72 B.R. 732, 738 (Bankr. N.D.N.Y. 1987); In re Grant, 51 B.R. 385, 394 (Bankr. N.D.Ohio 1985). Debtor is, therefore, the precise type of "unneedy" debtor that section 707(b) was meant to screen out of the bankruptcy system. In re Green, 934 F.2d at 572 (noting that "... the real concern behind Section 707(b)[is the] abuse of the bankruptcy process by a debtor seeking to take unfair advantage of his creditors ..." See also, In re Mastromarino, 197 B.R. at 178 - 180. Under the totality of circumstances in the record, the bankruptcy court correctly dismissed Debtor's case pursuant to section 707(b).

Debtor argues that the bankruptcy court mechanically applied a rigid "ability to pay" or "future income" test that was expressly rejected by Congress in the 1984 Act. Appellant's Brief, at 7. He attempts to support his argument by citing various congressional statements offered incident

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[10] See In re Shepard, 147 B.R. 422 (Bankr. N.D.Ohio 1992); In re Beles, 135 B.R. 286 (Bankr. S.D. Ohio 1991); In re Hampton, 147 B.R. 130 (Bankr. E.D.Ky. 1992); In re Martens, 171 B.R. 43 (Bankr. N.D.Ohio 1994).

to the passage of section 707(b). The stray comments to which he refers were not authoritative expressions of congressional intention, however, because they were not part of a written report. In re Kelly, 841 F.2d at 914 - 915; accord, In re Walton, 866 F.2d at 983 - 984. Moreover, insofar as "...[t]here were no committee reports on the 1984 Act ... the [1983 Senate report discussing the draft predecessor to section 707(b)] S. 445 is the best available evidence of Congress' intent in enacting section 707(b) ..." In re Kelly, 841 F.2d at 914, n.7. Cf. In re Green, 934 F.2d at 571, n. 4; In re Keniston, 85 B.R. at 214 - 215.[11/] That report clearly indicated that where a debtor could repay some of his consumer debts with ease out of his future earnings, such as here, his receiving a chapter 7 discharge would be a substantial abuse of the bankruptcy system.[12/] Congress adopted the phrase

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[11/] Indeed, the only authoritative "... source for finding the Legislature's intent lies in the Committee Reports on the bill, which 'represen[t] the considered and collective understanding of those Congressmen involved in drafting and studying proposed legislation.' We have eschewed reliance on the passing comments of one Member and casual statements from the floor debates ..." Garcia v. United States, 469 U.S. 70, 76 (1984)(quoting Zuber v. Allen, 396 U.S. 168, 186 (1969)) (brackets in original) (internal citations deleted); see also Holder v. Hall, 512 U.S. 874, 933 (1994) (Thomas, J., concurring) ("... [W]hen resort to legislative history is necessary, it is only Committee Reports, not other sources of legislative history, that should be considered ..."); Thornberg v. Gingles, 478 U.S. 30, 44 n.7 (1986) ("... We have repeatedly recognized that the authoritative source for legislative intent lies in the Committee Reports on the bill ..."); In re St. Hilaire, 102 B.R. 1,3 (Bankr. D. Mass. 1989) (applying Garcia).

[12/]

> This provision represents a balancing of two interests. It preserves that fundamental concept embodied in our bankruptcy laws that debtors who cannot meet debts as they come due should be able to relinquish non-exempt property in exchange for a fresh start. At the same time, however, it upholds creditors' interests in obtaining repayment where such repayment would not be a burden. Crushing debt burdens and severe financial problems place enormous strains on borrowers and their families. Family life, personal emotional health, or work productivity often suffers. By enabling individuals who cannot meet their debts to start a new life, unburdened with debts they cannot pay, the bankruptcy laws allow troubled borrowers to become productive members of their communities. Nothing in this bill denies such borrowers with unaffordable debt burdens bankruptcy relief under Chapter 7. *However, if a debtor can meet his debts without difficulty as they come due, use of Chapter 7 would represent a substantial abuse.*

"substantial abuse" from S 455 and incorporated it into section 707(b). In re Balaja, 190 B.R. 335, 340 - 341 (Bankr. N.D.Ill. 1996). Thus, to the extent that the Court considers the legislative history of section 707(b), it should reject Debtor's arguments that future, disposable income cannot be considered in determining substantial abuse.

Debtor next argues that the bankruptcy court erred in dismissing his case for substantial abuse insofar as it made no express finding of "bad faith." Such a finding is not a prerequisite to section 707(b) dismissal. In re Green, 934 F.2d at 568. Moreover, the Consumer Credit Amendments incorporated into the 1984 Act reflected congressional intention that bankruptcy courts, in a departure from prior law, regulate access to chapter 7 discharge by individuals who could easily pay their debts. New section 521, for example, required individual chapter 7 debtors to file schedules "I" and "J," delineating their monthly income and expenses. Pub.L. 98-353, §305(2). Prior to the 1984 Act, a bankruptcy court lacked a direct means to evaluate an individual debtor's income and expenses. 4 Lawrence P. King, Collier on Bankruptcy, ¶ 521.06[4] (15th Ed. 1997) (Revised); see In re Snow, 185 B.R. at 401 ("... No utility beyond assisting an income based determination under § 707(b) comes to mind ..."). See also Fonder v. U.S., 974 F.2d at 999 ("... [w]hen Congress enacted § 707(b) in 1984, it also added the requirement that debtors file Income/Expense Schedule 'to facilitate the question of abuse in chapter 7 cases ...'"), quoting 3 Norton Bankruptcy Law and Practice § 69.01, n. 12 (1991).

The 1984 Act also mandated that bankruptcy clerks inform debtors with primarily consumer debts that they could file a chapter 13 case in order to repay some or all of their debts (Pub.L. No. 98-353, § 302), that debtors sign statements acknowledging their option of filing for chapter 13

S.Rep. No. 65, 95th Cong., 1st Sess. 43 (1983) (emphasis added).

(Pub.L. No. 98-353, § 322) and that debtors' attorneys affirm that they had advised their clients that they might file chapter 13 (Pub.L. No. 98-353, § 322(2)). In re Grant, 51 B.R. at 392 - 393.[13] Debtor and his attorney signed their respective statements, so they presumptively knew that Debtor could have chosen to repay his consumer debts in chapter 13. App. at 4. He elected not to do so.

Contrary to Debtor's argument, section 707(b) was not redundant of other provisions authorizing the bankruptcy court to dismiss his case for bad faith. In re Snow, 185 B.R. at 400. ("... While the intent of Congress is lost in the darkness of conference committee deliberations, it is fair to assume that Congress intended to accomplish something when it enacted the provision. The section is more than a needless duplication of other provisions of the Code that have always required petitioners to file in good faith ...").[14] The courts below applied section 707(b) to the facts here in a manner consistent with Congress's desire to screen out consumer debtors who did not need chapter 7 relief. Accordingly, the Court should affirm the Order, as affirmed by the BAP.

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[13] This interpretation is also consistent with congressional intention to preserve the "fresh start" of a chapter 7 discharge for those who truly need it, while providing the incentive of a broader discharge available in chapter 13 to those who repay at least a portion of their debts. In enacting chapter 13 and broadening its eligibility requirements beyond the "wage earner" restriction of former Chapter XIII, as interpreted by Perry v. Commerce Loan Company, 383 U.S. 392, 15 L.Ed.2d 827, 86 S.Ct. 852 (1966), to include anyone who realized "regular income," Congress sought to encourage repayment of debts commensurate with the debtor's ability. "... The premises of the bill with respect to consumer bankruptcy are that use of the bankruptcy law should be a last resort; that if it is used, debtors's should attempt repayment under chapter 13 ..." 8 Lawrence P. King, Collier on Bankruptcy, ¶ 1300.02 (15th Ed. 1997) (Revised) (citing H.R. Rep. No. 595, 95th Cong. 1st Sess. 117 (1977); 11 U.S.C. §§ 109(e); 101(30). Congress gave debtors the incentive to complete performance under their chapter 13 plan by granting them a broader discharge than they would have received in chapter 7. In re Rimgale, 669 F.2d 426, 428 (7th Cir. 1982) (analyzing section 1328).

[14] Prior to the advent of section 707(b), the specific exceptions and objections listed in 11 U.S.C. §§ 523 and 727(c), (d) and (e) and 707(a) prescribed a bankruptcy court's ability to regulate a chapter 7 debtor's access to discharge. See In re Green, 934 F.2d at 570 - 571.

II. THE COURT SHOULD ALSO AFFIRM THE LOWER COURTS' ORDERS, BECAUSE DEBTOR EVIDENCED BAD FAITH IN MAKING SUBSTANTIAL CONSUMER CREDIT PURCHASES ON THE EVE OF BANKRUPTCY

A. The Record Indicates That Debtor Charged The Majority of His Consumer Debts Within Four Weeks Of Signing His Bankruptcy Petition.

Although not focused on below, the record indicates that Debtor incurred the vast bulk of his pre-petition debt within four weeks of signing his bankruptcy petition, charging $9,994.45, or 63%, of his total indebtedness. App. at 13 - 14; 44. Given the brief time between when he incurred the debts and signed the petition, the bankruptcy court could easily have inferred that Debtor went on a "eve of bankruptcy spending spree." Such a spending spree is another factor that, in the totality of the circumstances of this case, would allow this Court to affirm the lower courts' decisions. In re Parque Forestal, Inc., 949 F.2d 504, 510 (1st Cir. 1991) (a reviewing court may affirm a bankruptcy court order upon any grounds presented by the record, even if they were neither argued to nor relied upon by the bankruptcy court); Fish Market Nominee Corp. v. Pelofsky, et al., 72 F.3d 4 (1st Cir. 1995); Petit v. Fessenden, 80 F.3d 29, 32 (1st Cir. 1996).

As the Sixth Circuit in In re Krohn noted, section 707(b) "... serves notice upon those tempted by unprincipled accumulation of consumer debt that they will be held to at least a rudimentary standard of fair play and honorable dealing ..." In re Krohn, 886 F.2d at 126. Nothing in the record offered by Debtor suggests that he made his consumer purchases over a period of years and that the compounded effects of recent charges and old debt service overwhelmed his ability to pay his bills as they came due. See In re Balaja, 190 B.R. at 342 ("... There has been no showing that the debtors deliberately constructed this situation in order to obtain an unfair advantage over their creditors in bankruptcy. To the contrary, it appears that the debtors gradually, over a long period of time, found credit card interest increasing their debt to unmanageable levels ..."). Where, as here, a debtor makes substantial consumer charges within a brief period before filing, a bankruptcy court, drawing reasonable inferences from the facts, cannot find that his "... relationship with his creditors has been marked by essentially honorable and undeceptive dealings ..." (sic). In re Krohn, 886 F.2d at 126; In re Webb, 75 B.R. 264, 265 (M.D.Tenn. 1986); see In re Braithwaite, 192 B.R. 882, 884 (Bankr. N.D.Ohio 1996).

Debtor asserts that the bankruptcy court unfairly infringed upon his right to a fresh start. However, insofar as a bankruptcy discharge is a creation of congressional policy, rather than a constitutional right, Congress may limit its availability under certain circumstances, where, as here, a debtor seeks to secure "... a 'headstart' on conspicuous consumption and its concomitant status at the expense of [his] deserving creditors ..." In re Grant, 51 B.R. at 397; In re Krohn, 886 F.2d at 127, citing United States v. Kras, 409 U.S. 434, 446 - 447, 93 S.Ct. 631, 638 - 639, 34 L.Ed.2d 626 (1973). Although not considered below, the record below fully supports the lower courts' dismissal of Debtor's case for substantial abuse on the additional circumstance that he incurred the vast bulk of his debt shortly before he signed his bankruptcy petition.

CONCLUSION

The Court should affirm the lower courts' decisions dismissing Debtor's chapter 7 case for substantial abuse under section 707(b), because, as the record demonstrates, he could have easily repaid all of his debts out of his future earnings and, although afforded the opportunity, he did not demonstrate any countervailing considerations militating against dismissal. Further, the record evidences that Debtor went on a spending spree on the eve of bankruptcy, a factor, when considered in the totality of the circumstances, suggesting that Debtor's bankruptcy is a substantial abuse.

PRAYER

WHEREFORE, the United States Trustee prays that the Court affirm the courts' decisions below.

Respectfully submitted,

J. CHRISTOPHER MARSHALL
United States Trustee

By: ______________________________
Eric Kempton Bradford (bma 04873)
United States Department of Justice
Thomas P. O'Neill Jr. Federal Bldg.
10 Causeway Street, Room 1184
Boston, MA 02222
(617) 565-6360

Paul W. Bridenhagen, Esq.
Executive Office for United States Trustees
Office of the General Counsel
901 E Street, N.W. (Suite 78)
Washington, D.C. 20530
(202) 307-1337

Dated: July 20, 1998.

CERTIFICATE OF SERVICE

The undersigned certifies that on July 20, 1998, two copies each of the foregoing brief were served by United States Mail, First Class postage prepaid, upon the each individuals listed below.

Eric Kempton Bradford

Peter G. Berman, Esq.
Raskin & Berman
116 East Manning Street
Providence, RI 02903
(Counsel for Appellant, Richard Lamanna)

Louis Geremia, Esq.
Geremia & Demarco, Ltd.
189 Canal Street
Providence, RI 02903

Marcia McGair Ippolito, Esq.
Chief Legal Officer
Rhode Island Department of Taxation
One Capital Hill
Providence, RI 02908

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2. ("CO") *CURRENT* COURT *[E.g., "CTA9"]*	The Supreme Court for the United States
3. ("CCN") *CURRENT* CASE NO.	No.: 02-693
4. ("PCN") *PRIOR* CASE NO. & COURT *[IF ANY]*	No.: 1:00-cv-00143 Court: US District Court for the Western District of Virginia Judge Jones
5. ("SO") *SOURCE*	**U.S. TRUSTEES**
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8. ("TO") *TOPIC*	**BANKRUPTCY**
9. ("SU") ! *SUMMARY* OF KEY ISSUE(s) &	! Section 330 does not authorize the use of estate funds to compensate a Chapter 7 debtor's attorney. The court of appeals correctly concluded that Section 330(a)(l) is plain on its face in not authorizing compensation to the debtor's attorney in a chapter 7 case. The statutory context, history, and purposes are consistent with the view that Congress intentionally omitted the phrase "or the debtor's attorney'' from the statute. Finally, because the statute as written creates a sensible statutory scheme, there is no warrant for petitioner's claim that the Court should rewrite the Code.
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No. 02-693

In the Supreme Court of the United States

JOHN M. LAMIE, PETITIONER

v.

UNITED STATES TRUSTEE

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

BRIEF FOR THE RESPONDENT

THEODORE B. OLSON
Solicitor General
Counsel of Record

PETER D. KEISLER
Assistant Attorney General

THOMAS G. HUNGAR
Deputy Solicitor General

LISA S. BLATT
Assistant to the Solicitor General

Department of Justice
Washington, D.C. 20530-0001
(202) 514-2217

JOSEPH A. GUZINSKI
General Counsel

P. MATTHEW SUTKO
Attorney
Executive Office for United States Trustees
Washington, D.C 20530

QUESTION PRESENTED

Whether Section 330(a)(1) of the Bankruptcy Code, 11 U.S.C. 330(a)(1), authorizes a court to use the funds of a bankruptcy estate to compensate an attorney of a chapter 7 debtor.

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In the Supreme Court of the United States

No. 02-693

JOHN M. LAMIE, PETITIONER

v.

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ON WRIT OF CERTIORARI
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FOR THE FOURTH CIRCUIT

BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-14a) is reported at 290 F.3d 739. The opinion of the district court (Pet. App. 15a-27a) is reported at 260 B.R. 273. The opinion of the bankruptcy court (Pet. App. 28a-44a) is reported at 253 B.R. 724.

JURISDICTION

The judgment of the court of appeals was entered on May 31, 2002. A petition for rehearing was denied on August 5, 2002 (Pet. App. 45a). A petition for a writ of certiorari was filed on November 4, 2002, and was granted on March 10, 2003. The jurisdiction of this Court rests under 28 U.S.C. 1254(1).

STATUTORY PROVISIONS INVOLVED

The relevant statutory provisions are reproduced in an Appendix to this brief. App., *infra*, 1a-5a.

STATEMENT

1. United States Trustees supervise the administration of bankruptcy cases and trustees within specified geographic regions. 28 U.S.C. 581-589. "The United States Trustee Program acts in the public interest to promote the efficiency and to protect and preserve the integrity of the bankruptcy system." http://www.usdoj.gov/ust/mission.htm. See H.R. Rep. No. 595, 95th Cong., 2d Sess. 88 (1977) (United States Trustees "serve as bankruptcy watch-dogs to prevent fraud, dishonesty, and overreaching in the bankruptcy arena."). Congress provided in the Code that "[t]he United States trustee may raise and may appear and be heard on any issue in any case or proceeding under this Title." 11 U.S.C. 307. Congress also has specifically directed United States Trustees to "review[] * * * applications filed for compensation and reimbursement under section 330 of title 11[] and * * * [to] fil[e] with the court" any "objections to such application." 28 U.S.C. 586(a)(3)(A)(i) and (ii).

2. On December 24, 1998, Equipment Services, Inc., filed a voluntary petition for relief under the debt reorganization provisions of chapter 11 of the Bankruptcy Code, 11 U.S.C. 1101 *et seq.* At the time of the filing, the company had retained petitioner, an attorney, to represent it in the bankruptcy proceedings and had given petitioner a $6000 retainer, of which $1000 was used to pay the fees and costs of filing the petition. Petitioner deposited the remaining $5000 in an escrow account, to be drawn upon as petitioner earned fees. On January 26, 1999, the Bankruptcy Court approved

petitioner's employment as the attorney for the debtor-in-possession in the chapter 11 proceeding. Pet. App. 2a, 28a; see 11 U.S.C. 327(a), 1107.

On March 17, 1999, on the motion of the United States Trustee, the proceeding was converted into a case under the liquidation provisions of chapter 7. 11 U.S.C. 1112(b). Petitioner filed an application with the Bankruptcy Court seeking $2325 in attorneys fees, $1325 of which was earned during the chapter 11 proceeding and $1000 of which was earned during the chapter 7 proceeding. The United States Trustee objected to the application to the extent that it requested $1000 in compensation for services rendered after the case was converted to a chapter 7 proceeding. Pet. App. 4a, 15a-17a, 29a.

The Bankruptcy Court held that the Code did not authorize a chapter 7 debtor's attorney to be paid funds from the bankruptcy estate. Pet. App. 30a-38a. The court explained that, before the Code was amended in 1994, 11 U.S.C. 330 (1988) had authorized an award to any debtor's attorney, but Congress in a 1994 amendment to Section 330 deleted the statutory language authorizing such an award. Pet. App. 34a. The court further observed that Congress in 1994 added a separate provision to Section 330 that "provide[s] express authority for payment of counsel to a Chapter 12 or 13 debtor from the estate." Pet. App. 33a (citing 11 U.S.C. 330(a)(4)(B)). The court accordingly concluded that there was no authority to award fees to a chapter 7 debtor's attorney. The Bankruptcy Court nonetheless awarded petitioner fees for services rendered while the case proceeded under chapter 7 because the court concluded that the pre-petition retainer was not, under state law, property of the bankruptcy estate. *Id.* at 38a-43a.[1]

The district court affirmed. Pet. App. 15a-26a. The court concluded that Section 330(a)(1) was "plain" in not authorizing fees to a chapter 7 debtor's attorney. *Id.* at 22a, 24a. The district court nonetheless agreed with the bankruptcy court's conclusion that, under state law, the retainer was not property of the estate and accordingly that petitioner was entitled to draw from the retainer fees earned during the chapter 7 proceeding. *Id.* at 25a-26a.

3. A divided panel of the court of appeals affirmed the district court's construction of Section 330, but the panel unanimously reversed the district court's conclusion that the retainer was not property of the bankruptcy estate. Pet. App. 1a-14a. The court of appeals held that Section 330(a) does not authorize a chapter 7 debtor's attorney to be compensated from the estate. *Id.* at 5a-9a. The court of appeals reasoned that "§ 330(a), as revised in 1994, omits the phrase 'or the debtor's attorney' from the list of persons to whom a court may award 'reasonable compensation' from the bankruptcy estate for services rendered in a Chapter 7 proceeding." *Id.* at 6a. The court concluded that it "should follow the plain language of the 1994 version of § 330(a), particularly because application of that plain language supports a reasonable interpretation of the Bankruptcy Code." *Id.* at 8a.

Judge Michael dissented from the court's holding that Section 330 did not authorize the award of fees to a

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[1] On July 10, 2000, the Bankruptcy Court had separately approved petitioner's application for $1325 in fees earned for services rendered while he represented the company in its capacity as a debtor-in-possession under chapter 11. Pet. App. 29a n.18.

chapter 7 debtor's attorney. Pet. App. 13a-14a. In his view, the deletion of the phrase "or to the debtor's attorney" from the statute was a "drafting error" subject to correction by the court. *Id.* at 13a.

SUMMARY OF ARGUMENT

A. The 1994 amendments to Section 330 removed "the debtor's attorney" from the list of eligible individuals entitled to receive compensation. The current version of Section 330 thus contains no statutory authority to use estate funds to compensate a chapter 7 debtor's attorney. The judgment of the court of appeals therefore must be affirmed unless petitioner meets the heavy burden of showing that the omission of the phrase "or the debtor's attorney" from the statute is unquestionably a scrivener's error that produces absurd results.

B. Petitioner fails to demonstrate beyond question that Congress's omission was an accident, much less one that, if not corrected, would produce results that Congress could not have rationally intended. The statutory context indicates that Congress purposefully omitted the phrase "or the debtor's attorney" from Section 330. The omission is the most direct and obvious means to eliminate the authority to pay debtors' attorneys out of estate funds held for the benefit of creditors. Moreover, while the 1994 amendments to 11 U.S.C. 330(a) (1988) omitted the phrase "or the debtor's attorney," the amendments enacted a new provision authorizing only attorneys for individual chapter 12 or 13 debtors to be paid fees from the estate. 11 U.S.C. 330(a)(4)(B). Congress's simultaneous denial of similar authorization for attorneys for chapter 7 debtors reflects deliberate action on the part of Congress.

C. The legislative history also is consistent with the conclusion that Congress intentionally omitted the phrase "or the debtor's attorney" from Section 330(a)(1). The phrase was deleted in the same amendment that added the authorization in Section 330(a)(4)(B) for estate fees to be paid solely to attorneys for chapter 12 or 13 debtors. Furthermore, the members of Congress had over five months before final enactment in which to read and consider the text of the Senate bill that had deleted the phrase "or the debtor's attorney" from Section 330(a). In that intervening period, the deletion of the phrase was brought to the attention of Congress by an organization of debtors' attorneys who expressed no objection to the deletion, and Congress thereafter left the provision unchanged.

D. Enforcing the statute as written serves legitimate and substantial policy objectives. Unlike proceedings under chapters 11, 12, and 13, in which the debtor is responsible for developing repayment plans for the benefit of creditors, a proceeding under chapter 7 involves liquidation of the estate by a trustee. 11 U.S.C. 704. Chapter 7 is a zero-sum game in which any funds diverted from the estate to pay attorneys reduce the amount of funds available to pay creditors. Congress therefore quite rationally could have determined to preserve chapter 7 estate funds for the benefit of creditors.

At the same time, denial of estate funds to pay a chapter 7 debtor's attorney is entirely consistent with the orderly administration and liquidation of chapter 7 estates. Such denial does not affect the 96% of all chapter 7 cases in which there are no funds available in the estate to pay counsel (or creditors, for that matter). Moreover, where funds *are* available, the Code gives the trustee the power to seek court approval to hire counsel, including the debtor's counsel, where appropriate and in the best interest of the estate. 11 U.S.C. 327(a) and (e). Chapter 7 debtors play very little role in the administration of the estate and are therefore given no similar statutory authority to retain counsel to assist the administration of the estate. Finally, regardless of the size of the estate, a chapter 7 debtor who retains counsel for the debtor's personal benefit may compensate counsel by giving counsel a pre-petition flat fee, by using his post-petition income, or both. For those reasons, the United States Trustees, who are charged with supervising the administration of bankruptcy cases, 28 U.S.C. 586(a)(3), view enforcing Section 330(a)(1) as written as furthering the proper administration of chapter 7 estates.

ARGUMENT

SECTION 330 DOES NOT AUTHORIZE THE USE OF ESTATE FUNDS TO COMPENSATE A CHAPTER 7 DEBTOR'S ATTORNEY

The court of appeals correctly concluded that Section 330(a)(1) is plain on its face in not authorizing compensation to the debtor's attorney in a chapter 7 case. The statutory context, history, and purposes are consistent with the view that Congress intentionally omitted the phrase "or the debtor's attorney" from the statute. Finally, because the statute as written creates a sensible statutory scheme, there is no warrant for petitioner's claim that the Court should rewrite the Code.

A. The Plain Text Of Section 330(a)(1) Does Not Authorize Estate Funds To Be Paid To A Chapter 7 Debtor's Attorney

1. The assets of a chapter 7 estate must be distributed pursuant to the priority provisions of the Code. 11 U.S.C. 503, 507, 726. The Code gives priority to administrative expenses, 11 U.S.C. 507(a)(1), and permits "compensation and reimbursement awarded under section 330(a)" to be treated as an administrative expense, 11 U.S.C. 503(b)(2). *In re Milwaukee Engraving Co.*, 219 F.3d 635, 636-637 (7th Cir. 2000); *F/S Airlease II, Inc.* v. *Simon*, 844 F.2d 99, 108-109 (3d Cir.), cert. denied, 488 U.S. 852 (1988). Petitioner in this case sought such priority treatment in applying for compensation out of the funds of the chapter 7 estate under Section 330(a) for services performed during the chapter 7 proceeding. Pet. App. 2a.

The 1994 amendments to Section 330(a), however, compel the conclusion that the Code does not authorize estate funds to be awarded to a chapter 7 debtor's attorney. As originally enacted in the Bankruptcy Reform Act of 1978, Section 330(a), entitled "Compensation of officers," provided that:

> After notice to any parties in interest and to the United States trustee and a hearing, and subject to sections 326, 328, and 329 of this title, the court may award to a trustee, to an examiner, to a professional person employed under section 327 or 1103 of this title, *or to the debtor's attorney*—
>
> (1) reasonable compensation for actual, necessary services rendered by such trustee, examiner, professional person, or attorney, as the case may be, and by any paraprofessional persons

> employed by such trustee, professional person, or attorney, as the case may be, based on the time, the nature, the extent, and the value of such services, and the cost of comparable services, other than in a case under this title; and
>
> (2) reimbursement for actual, necessary expenses.

Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, § 330, 92 Stat. 2564 (11 U.S.C. 330(a) (1988)) (emphasis added). In the Bankruptcy Reform Act of 1994, Congress substantially revised Section 330(a) to provide in relevant part:

> (a)(1) After notice to the parties in interest and the United States Trustee and a hearing, and subject to sections 326, 328, and 329, the court may award to a trustee, an examiner, a professional person employed under section 327 or 1103—
>
> (A) reasonable compensation for actual, necessary services rendered by the trustee, examiner, professional person, or attorney and by any paraprofessional person employed by any such person; and
>
> (B) reimbursement for actual, necessary expenses.
>
> * * * * *
>
> (4) * * * (B) In a chapter 12 or chapter 13 case in which the debtor is an individual, the court may allow reasonable compensation to the debtor's attorney for representing the interests of the debtor in connection with the bankruptcy case

> based on a consideration of the benefit and necessity of such services to the debtor and the other factors set forth in this section.

Bankruptcy Reform Act of 1994, Pub. L. No. 103-394, § 224, 108 Stat. 4130 (11 U.S.C. 330(a)(1) and (4)(B)).

Thus, the prior version of Section 330(a) authorized compensation to "a trustee, to an examiner, to a professional person employed under section 327 or 1103 of this title, or to the debtor's attorney." By contrast, the statute as revised permits an award of compensation to only "a trustee," "an examiner," and "a professional person employed under section 327 or 1103." 11 U.S.C. 330(a)(1). Section 330(a)(1) thus unambiguously "excludes attorneys from its catalog of professional officers of a bankruptcy estate who may be compensated for their work." *In re Pro-Snax Distribs., Inc.*, 157 F.3d 414, 425 (5th Cir. 1998). Section 330(a)(1) is accordingly "clear textually on its face" in not providing statutory authority to compensate any debtor's attorney from funds of the estate. *In re Am. Steel Prod., Inc.*, 197 F.3d 1354, 1356 (11th Cir. 1999); *In re Century Cleaning Servs., Inc.*, 195 F.3d 1053, 1061 (9th Cir. 1999) (Thomas, J., dissenting) ("The plain language of § 330(a) is not ambiguous: it precludes an award of attorney's fees to Chapter 7 debtors' attorneys from the bankruptcy estate.").

2. Given the complete absence of any statutory authority to compensate a chapter 7 debtor's attorney, petitioner argues that Section 330(a)(1) should be judicially revised to include the phrase "or the debtor's attorney." In petitioner's view (Pet. Br. 16, 28), the absence of that phrase reflects a "scrivener's error" caused by a "slip of the pen" of a drafter who deleted the phrase during the 1994 amendments to Section

330(a). See *In re Century Cleaning Servs., Inc.*, 195 F.3d at 1060 (Reinhardt, J.). What petitioner requests, however, "is not a construction of a statute, but, in effect, an enlargement of it by the court, so that what was omitted, presumably by inadvertence, may be included within its scope." *Iselin* v. *United States*, 270 U.S. 245, 251 (1926). This Court, however, does not have "*carte blanche* to redraft statutes in an effort to achieve that which Congress is perceived to have failed to do." *United States* v. *Locke*, 471 U.S. 84, 95 (1985). "There is a basic difference between filling a gap left by Congress' silence and rewriting rules that Congress has affirmatively and specifically enacted." *Ibid.* (quoting *Mobil Oil Corp.* v. *Higginbotham*, 436 U.S. 618, 625 (1978)). That conclusion is compelled out of "deference to the supremacy of the Legislature, as well as recognition that Congressman typically vote on the language of a bill." *Ibid.*

Accordingly, when "the statute's language is plain, 'the sole function of the courts—at least where the disposition required by the text is not absurd—'is to enforce it according to its terms.'" *Hartford Underwriters Ins.* v. *Union Planters Bank, N.A.*, 530 U.S. 1, 6 (2000) (quoting *United States* v. *Ron Pair Enters., Inc.*, 489 U.S. 235, 241 (1989)). In other words, when the "result the text produces is not necessarily absurd, [it] cannot be dismissed as an obvious drafting error." *Chan* v. *Korean Air Lines, Ltd.*, 490 U.S. 122, 134 (1989); see *Union Bank* v. *Wolas*, 502 U.S. 151, 163 (1991) (Scalia, J., concurring) (A scrivener's error is one that "produc[es] an absurd result.").

This Court found a scrivener's error subject to judicial correction in *United States National Bank* v. *Independent Insurance Agents of America, Inc.*, 508 U.S. 439 (1993). In that decision, the Court disregarded quotation marks appearing in the Act of Sept. 7, 1916, ch. 461, 39 Stat. 753, and held that "the placement of the quotation marks in the 1916 Act was a simple scrivener's error, a mistake made by someone unfamiliar with the law's object and design." 508 U.S. at 462. The Court invoked the settled rule permitting courts to "disregard the punctuation, or repunctuate, if need be, to render the true meaning of the statute." *Ibid.* (quoting *Hammock* v. *Loan & Trust Co.*, 105 U.S. 77, 84-85 (1881)). The Court also found that, based on "*overwhelming evidence* from the structure, language, and subject matter of the 1916 Act," "[t]he true meaning of the 1916 Act is *clear beyond question.*" *Ibid.* (emphasis added).

Petitioner here requests a significant extension of that decision. Petitioner seeks not to repunctuate the statute, or, indeed, to interpret any particular statutory text. Rather, he seeks to insert an entire phrase that is conspicuously missing from the Code in order to create a substantive authorization for chapter 7 debtors' attorneys to be given priority over creditors in the distribution of estate assets. Accordingly, even if there were some basis for petitioner's claim of a drafting error in removing the phrase "or the debtor's attorney" —which there is not—the relief petitioner seeks would be impermissible. As this Court stated in *Iselin*, 270 U.S. at 251, "[t]o supply omissions transcends the judicial function." See also *United States* v. *Granderson*, 511 U.S. 39, 68 (1994) (Kennedy, J., concurring) ("It is beyond our province to rescue Congress from its drafting errors, and to provide for what we might think * * * is the preferred result."). In her concurring opinion in *Director, Office of Workers' Compensation Programs* v. *Newport News Shipbuilding & Dry Dock Co.*, 514 U.S. 122, 142 (1995), Justice Ginsburg similarly observed that "[c]orrecting a scrivener's error is within this Court's competence, see, *e.g.*, [*United States Nat'l Bank, supra*], but only Congress can correct larger oversights of the kind presented by the OWCP Director's petition," *i.e.*, Congress's failure to confer standing on the Director when it amended the statute at issue.

There is particular reason for the Court to hesitate here before embarking on the judicial creation of a substantive right for all debtors' attorneys to seek compensation from the bankruptcy estate. Congress has shown considerable willingness to amend the Bankruptcy Code in order to correct perceived flaws or achieve policy goals, and in fact has done so many times since 1994 without choosing to insert language authorizing the use of chapter 7 estates to pay debtors' lawyers.[2]

Indeed, far from acting to authorize such payments, Congress has specifically declined to pass three bills that would have added the phrase "or the debtor's attorney" to Section 330(a)(1). H.R. 120, 105th Cong., 1st Sess. § 7 (Jan. 7, 1997); H.R. 764, 105th Cong., 1st Sess. § 7 (Nov. 13, 1997); S. 1559, 104th Cong., 2d Sess. § 4 (Aug. 2, 1996). Similarly, the current bankruptcy reform bill passed by the House would amend Section 330(a)(1) without reinserting the phrase "or the debtor's attorney." H.R. 975, 108th Cong., 1st Sess.

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[2] Pub. L. No. 107-204, § 803(1)-(3), 116 Stat. 801 (2002); Pub. L. No. 106-554, § 1(a)(5) [Tit. I § 112(c)], 114 Stat. 2763A-393 to 2763A-396 (2000); Pub. L. No. 106-420, § 4, 114 Stat. 1868 (2000); Pub. L. No. 106-181, § 744(a) and (b), 114 Stat. 175-176 (2000); Pub. L. No. 105-277, § 603, 112 Stat. 2681-886 (1998); Pub. L. No. 105-244, § 971(a), 112 Stat. 1837 (1998); Pub. L. No. 105-183, §§ 2-4, 112 Stat. 517-518 (1998); Pub. L. No. 104-193, § 374(a)(1)-(4), 110 Stat. 2255 (1996); Pub. L. No. 104-134, § 101, 110 Stat. 1321-74 (1996); Pub. L. No. 104-88, § 302, 109 Stat. 943 (1995).

§§ 332(b), 333 (Mar. 19, 2003); 149 Cong. Rec. D258, D262 (daily ed. Mar. 19, 2003). In short, "[t]he current version of § 330(a) has been in force now for eight years and Congress has not elected to recognize that it made a scrivener's error when it amended the statute in 1994." Pet. App. 9a. While such subsequent legislative history may be a suspect interpretive tool in other contexts, it is a significant obstacle to petitioner's ability to carry the burden of showing that the text of Section 330(a) can only be explained as a scrivener's error. Accordingly, at least in the absence of "overwhelming evidence" demonstrating "beyond question" (*United States Nat'l Bank*, 508 U.S. at 462) that Congress could not have intended to remove the phrase "or the debtor's attorney" from Section 330(a), the statutory text must be enforced as written.

B. The Statutory Context Is Consistent With Congress's Intentional Deletion Of The Phrase "Or The Debtor's Attorney"

1. The starting point in discerning congressional intent is, of course, the text of the statute. *Hughes Aircraft Co.* v. *Jacobson*, 525 U.S. 432, 438 (1999); *Schreiber* v. *Burlington N., Inc.*, 472 U.S. 1, 5 (1985). "[I]n interpreting a statute a court should always turn first to one, cardinal canon before all others. * * * [C]ourts must presume that a legislature says in a statute what it means and means in a statute what it says there." *Connecticut Nat'l Bank* v. *Germain*, 503 U.S. 249, 253-254 (1992). That presumption should apply in this case. The most efficient and direct way to eliminate compensation for debtors' attorneys was the precise course that Congress chose here, *i.e.*, the deletion of "the debtor's attorney" from the list of eligible officers entitled to receive compensation under Section

330(a)(1). "[B]y deleting 'to the debtor's attorney' from the statute, Congress has clearly indicated that the debtor's attorney may not be compensated from the estate." *In re Pro-Snax Distribs., Inc.*, 157 F.3d at 425.

Petitioner contends (Pet. Br. 4, 17, 20, 25) that the omission of the phrase "or the debtor's attorney" reflects a scrivener's error because, while Section 330(a)(1) excludes the debtor's attorney from the list of eligible officers entitled to receive compensation, Section 330(a)(1)(A) permits an award of "reasonable compensation for * * * services rendered by the trustee, examiner, professional person, or *attorney*." The most logical explanation for the "attorney" reference, however, is that Congress failed to make corresponding changes to the parts of Section 330(a)(1)(A) that were affected by Congress's deliberate removal of the phrase "or the debtor's attorney" from Section 330(a)(1). Cf. *Chickasaw Nation* v. *United States*, 534 U.S. 84, 94 (2001) ("The canon requiring a court to give effect to each word '*if possible*' is sometimes offset by the canon that permits a court to reject words 'as surplusage' if 'inadvertently inserted or if repugnant to the rest of the statute.'") (quoting Karl Llewellyn, *The Common Law Tradition* 525 (1960)). Making that corresponding change might have resulted in a cleaner text, but the fact remains that omitting the critical, operative reference to "the debtor's attorney" was the most direct and efficient way to implement the change.

More importantly, the reference to "attorney" in Section 330(a)(1)(A) does not render the statute unenforceable as written. As discussed, Section 330(a)(1) permits the court to award fees to "a professional person employed under section 327 or 1103." 11 U.S.C. 330(a)(1). The Code expressly contemplates that the phrase "a professional person" encompasses an attorney employed by the trustee under Section 327 or by chapter 11 creditor committees under Section 1103. 11 U.S.C. 327, 328(c), 1103. Accordingly, as the court of appeals explained, the phrase "a professional person employed under section 327 or 1103 could be the antecedent to 'attorney' as used in § 330(a)(1)(A), because the Trustee is authorized to hire an attorney as a professional person." Pet. App. 8a (citation omitted). Although "the reference in § 330(a)(1)(A) to 'attorney' may be superfluous," *id.* at 9a, it is not "necessarily absurd," *Chan* v. *Korean Air Lines, Ltd.*, 490 U.S. at 134, and therefore does not justify judicial reinsertion of language that Congress unambiguously omitted.[3]

For similar reasons, petitioner errs in relying (Pet. Br. 4, 14, 20) on the fact that Section 330(a)(1) contains a grammatical error: there is a missing "or" between the phrases "an examiner" and "a professional person." The omission of a conjunction, however, "is an oversight that is as consistent with the *deliberate* deletion of the words 'debtor's attorney' as it is with the inadvertent deletion of those words from that section." Pet. App. 9a. The absence of a conjunction also does not affect the substance or application of the text because "[the] omission does not change the meaning of the words around it." *In re Pro-Snax Distribs., Inc.*, 157 F.3d at

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[3] Petitioner mistakenly suggests (Pet. Br. 18-19) that the reference to "attorney" in Section 330(a)(1)(A) "literal[ly]" authorizes an award of fees to a chapter 7 debtor's attorney. As petitioner elsewhere concedes (Pet. Br. 4), Section 330(a)(1)(A) merely lists "parties that provide compensable services" (including paraprofessional persons), while Section 330(a)(1) "identifies persons who may be paid compensation." Thus, only persons who are included in the latter provision may be awarded compensation from the estate; chapter 7 debtors' attorneys are notably absent from that provision.

425 n.14. "Indeed, all that the omission would signify to a reader unfamiliar with the pre-1994 statute is the typographical deletion of 'or' before the phrase 'a professional person.'" *Ibid.* Such a missing conjunction is not uncommon. The United States Code is replete with such instances.[4]

2. The structure of Section 330(a) is also consistent with Congress's intentional exclusion of the previously existing authority to compensate a chapter 7 debtor's attorney. At the same time that Congress enacted Section 330(a)(1) to limit fee awards to trustees, examiners, and professional persons employed under Sections 327 and 1103, Congress added Section 330(a)(4)(B) to authorize compensation to a limited class of debtor's attorneys. Section 330(a)(4)(B) provides that "*[i]n a chapter 12 or 13 case* in which the debtor is an individual, the court *may allow* reasonable compensation to *the debtor's attorney* for representing the interests of the debtor in connection with the bankruptcy case based on a consideration of the benefit and necessity of such services to the debtor and the other factors set

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[4] *E.g.*, 7 U.S.C. 136(hh)(3)(B); 8 U.S.C. 1101(a)(27); 8 U.S.C. 1324a(b)(1)(B); 12 U.S.C. 1715z-14(b); 12 U.S.C. 3303(a); 15 U.S.C. 78c(a)(34)(G); 15 U.S.C. 5201(b); 16 U.S.C. 3166(b)(2); 16 U.S.C. 3372(a); 16 U.S.C. 3911(a)(1)(A); 16 U.S.C. 4723(a)(1)(F); 18 U.S.C. 1030(a); 20 U.S.C. 1091(a); 22 U.S.C. 1972; 22 U.S.C. 2198; 22 U.S.C. 4802(c); 25 U.S.C. 1613a(b)(3)(A); 25 U.S.C. 3001(15); 26 U.S.C. 6038B(a); 42 U.S.C. 405(j)(4)(B); 42 U.S.C. 415(i)(1); 42 U.S.C. 1395bb(a); 42 U.S.C. 1395ww(d)(5)(F)(vii)(II); 42 U.S.C. 1396a(a)(10)(A); 42 U.S.C. 1436a(i)(2); 42 U.S.C. 3026(a); 42 U.S.C. 5633(a)(3)(E); 42 U.S.C. 7651f(a); 42 U.S.C. 10138(b)(5); 42 U.S.C. 13992; 42 U.S.C. 14072(a)(3); 47 U.S.C. 396(i)(1).

forth in [Section 330(a)]." 11 U.S.C. 330(a)(4)(B) (emphasis added).[5]

If Congress had intended to permit compensation for chapter 7 debtors' attorneys, it naturally would have included them in Section 330(a)(4)(B), which "allow[s]" a court to award fees to a debtor's attorney, but only in cases under chapters 12 and 13. "Thus, although Chapter 12 and Chapter 13 debtors' attorneys were also affected by the amendment to § 330(a), Congress specifically added a mechanism providing for their compensation." *In re Century Cleaning Servs., Inc.*, 195 F.3d at 1062 (Thomas, J., dissenting). "The inclusion of Chapter 12 and Chapter 13 debtors' attorneys in a new section of the statute, coupled with the omission of 'debtor's attorney' from the general section, lends support to the conclusion that the choice was deliberate under the statutory construction principle of *expressio unius est exclusio alterius*." *Ibid.*

Petitioner is also wrong in arguing (Pet. Br. 23) that Section 330(a) necessarily contemplates compensation to all debtors' attorneys because Section 330(a)(4)(B) permits the compensation of attorneys for chapter 12 and 13 debtors under a standard that is an "exception" to the general standards set forth in Section 330(a)(4)(A). The authority to compensate those attorneys does not depend on an interpretation of the statute that would authorize compensation of all debtors' attorneys. Section 330(a)(4)(B) *itself* authorizes estate funds to be awarded to attorneys for chapter 12

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[5] Chapter 13 allows individuals with regular income to satisfy their debts through a repayment plan. 11 U.S.C. 1301 *et seq.* Chapter 12 similarly allows family farmers with regular annual income to satisfy their debts through a repayment plan. 11 U.S.C. 1201 *et seq.*

and 13 debtors by providing that the court "may allow" reasonable compensation to those attorneys based on a consideration of the benefit to the chapter 12 or 13 debtor and "the other factors set forth in this section." Section 330(a)(4)(B) also by its own terms makes applicable to requests for compensation by chapter 12 and 13 debtors' attorneys the factors that the court considers in awarding fees to those seeking compensation under 11 U.S.C. 330(a)(1), *i.e.*, trustees, examiners, and professional persons employed under Sections 327 and 1103.

Among those factors is the prohibition in Section 330(a)(4)(A) that bars compensation if the services were not "reasonably likely to benefit the debtor's estate" or "necessary to the administration of the case." 11 U.S.C. 330(a)(4)(A)(ii). Thus, the "[e]xcept as provided in subparagraph (B)" clause at the beginning of Section 330(a)(4)(A) authorizes the court to award fees to a chapter 12 or 13 debtor's attorney under "subparagraph (B)," even where the services do not benefit the estate, as long as the services benefit the *debtor*. That reading is consistent with the provision's history, which shows that Section 330(a)(4) was derived from a previous version of S. 540, 103d Cong., 1st Sess. (1993), which, before it was limited to chapter 12 and 13 debtors, would have provided that, "[i]n a case in which the debtor is an individual, the court shall allow reasonable compensation for services by the debtor's attorney representing the interests of the debtor without regard to the benefit of such services to the estate." 140 Cong. Rec. S4416 (daily ed. Apr. 19, 1994); see p. 24, *infra*. Accordingly, construing Section 330(a) in accordance with its text yields no interpretive difficulties and is consistent with the legislative evolution of the 1994 amendments.

Petitioner similarly errs in arguing (Pet. Br. 24) that, because Section 330(a)(4)(B) applies when the attorney represents the chapter 12 or 13 *debtor*, there must be some other authorization in Section 330(a)(1) to compensate such an attorney when he "represent[s] the interests of *the debtor's estate*." *Trustees*, not chapter 7 debtors or debtors' attorneys, represent the estate. 11 U.S.C. 323(a). Section 330(a)(4)(B) moreover permits a chapter 12 or 13 debtor's attorney to be compensated for representing *the debtor* when his services benefit the debtor as well as the estate. 11 U.S.C. 330(a)(4)(B). Such a benefit typically occurs in chapter 12 and 13 under which the debtor proposes a repayment plan and remains in possession of all property of the estate. 11 U.S.C. 1203, 1207(b), 1221, 1303, 1304, 1306(b), 1321. No similar circumstances are present under chapter 7. See pp. 35-36, *infra*.

3. Petitioner's reading of Section 330(a)(1) should also be rejected because it would circumvent a specific provision in the Code that addresses the circumstances under which the debtor's attorney may be compensated for services that benefit the estate. As discussed, Section 330(a)(1) permits a court to award compensation to individuals, including attorneys, retained by the trustee as professional persons under Section 327. 11 U.S.C. 327, 328(c), 330(a)(1). In particular, Section 327(e) permits "[t]he trustee, with the court's approval, [to] employ, for a specified special purpose, other than to represent the trustee in conducting the case, an attorney that has represented the debtor, if in the best interest of the estate, and if such an attorney does not represent or hold any interest adverse to the debtor or to the estate with respect to the matter on which such attorney is to be employed." 11 U.S.C. 327(e). Section 327(e) thus explicitly entrusts the trustee, a fiduciary

who represents the estate on behalf of creditors (11 U.S.C. 323(a); *Mosser* v. *Darrow*, 341 U.S. 267, 271 (1951)), with the responsibility of determining when to hire a former debtor's counsel, and the Code permits such retention only if a court concludes that counsel does not have a conflict of interest and his services serve a special purpose and further the best interests of the estate.[6]

Under petitioner's reading of the statute, however, a chapter 7 debtor's counsel would be able to bypass altogether the provisions of Section 327(e) while still obtaining compensation from the estate. Petitioner freely admits (Pet. Br. 32) that Section 327 is unsatisfactory from his perspective, because retention under Section 327 is "sufficiently uncertain—including because the choice would be left to the trustee and because the debtor's counsel may be deemed to have a preclusive conflict of interest." This Court should reject an interpretation that would usurp the trustee's authority under Section 327(e) to determine whether counsel's services are necessary, and that would permit counsel with a conflict to seek compensation under Section 330(a).[7]

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[6] In the United States Trustees' experience, trustees usually retain special counsel to litigate claims made against and on behalf of the estate. See also David Tatge et al., *Chapter 7 Bankruptcy Trustee's Manual* § 4.28 (1993).

[7] As discussed, the Code expressly permits chapter 12 and 13 debtors' counsel to seek fees from the estate. Moreover, because chapter 12 and 13 debtors remain in possession of the estate, see p. 20, *supra*, and chapter 12 and 13 trustees do not collect and reduce to money the property of the estate, 11 U.S.C. 1202(b)(1) and 1302(b)(1), counsel's services for the chapter 12 and 13 debtor with respect to claims made against and on behalf of the estate would not usurp the trustee's role under Section 327(e).

4. Petitioner also relies (Pet. Br. 24-25) on Section 330(a)(5)'s direction to courts to reduce a final award of professional fees by any interim compensation awarded under 11 U.S.C. 331, which provides for interim compensation to, *inter alia,* "a debtor's attorney." Petitioner's argument lacks merit. Section 331 provides that various persons, including "a debtor's attorney," "may apply to the court * * * for such compensation for services * * * or reimbursement for expenses * * * *as is provided under section 330 of this title.*" 11 U.S.C. 331 (emphasis added). The authority to award interim compensation under Section 331 is thus expressly tied to the authority of the court to award final compensation under Section 330. Read together, Sections 330(a)(5) and 331 provide that debtors' attorneys who are authorized under Section 330 to seek compensation, *i.e.*, attorneys for debtors in chapter 12 and 13, may seek an interim award of fees to be credited in the final award of compensation. That straightforward result provides no support for petitioner's counter-textual interpretation of the statute.

C. The Legislative History Is Consistent With An Intentional Deletion Of The Phrase "Or The Debtor's Attorney"

Petitioner places heavy reliance (Pet. Br. 18, 25-30) on the legislative history of the 1994 amendments to Section 330 in attempting to show that Congress inadvertently deleted the phrase "or the debtor's attorney" from the statute. The history, however, is consistent with an intentional deletion of the phrase, and thus does not demonstrate "beyond question" (*United States Nat'l Bank*, 508 U.S. at 462) that the deletion was inadvertent.

1. The revised version of Section 330 originated as Section 309 of a Senate bill, S. 540, 103d Cong., 1st Sess., which was introduced in the Senate on March 10, 1993, and referred to the Committee on the Judiciary. 139 Cong. Rec. S2610, S2621-2622 (daily ed. Mar. 10, 1993). Section 309 originally did not diminish the existing right of any debtor's attorney to seek fees but, *inter alia,* deleted the phrase "of this title" from the original 1978 Act and added new language requiring consideration of the views of the United States Trustees:

> **Section 309. Professional Fees.**
>
> Section 330(a) of title 11, United States Code, is amended to read as follows:
>
> "(a)(1) After notice to the parties in interest and the United States trustee and a hearing, and subject to sections 326, 328, and 329, the court may award to a trustee, an examiner, a professional person employed under section 327 or 1103, or the debtor's attorney, after considering comments and objections submitted by the United States Trustee in conformance with guidelines adopted by the Executive Office for United States Trustees pursuant to section 586(a)(3)(A) of title 28—
>
> (A) reasonable compensation for actual, necessary services rendered by the trustee, examiner, professional person, or attorney and by any paraprofessional person employed by any such person; and
>
> (B) reimbursement for actual, necessary expenses.

139 Cong. Rec. at S2621-S2622. That version of the bill also set forth new criteria for awarding compensation in a new provision, Section 330(a)(2), and added another provision, Section 330(a)(3), which provided that "[t]he court shall not allow compensation for duplication of services or for services that are not either reasonably likely to benefit the debtor's estate or necessary in the administration of the case." *Id.* at S2622.

On October 28, 1993, the Judiciary Committee reported S. 540 to the Senate with a new provision, Section 330(a)(3)(B), which would have provided that, "[i]n a case in which the debtor is an individual, the court shall allow reasonable compensation for services *by the debtor's attorney* representing the interests of the debtor without regard to the benefit of such services to the estate." S. 540, 103d Cong., 1st Sess. (1993) (emphasis added); 139 Cong. Rec. S14,625 (daily ed. Oct. 28, 1993).

On April 19, 1994, S. 540 was brought before the Senate for debate. 140 Cong. Rec. at S4405, S4415-4416. On April 20, 1994, the day before the phrase "or the debtor's attorney" was deleted from the bill, Senator Heflin explained that Section 309 of S. 540 was being revised in order to encourage debtors to file for bankruptcy protection under chapter 13:

> During the course of our hearings, it became very apparent that chapter 13 is often the best overall process for debtors, creditors, and the national economy. Numerous bankruptcy judges have indicated that most individuals want to pay their debts in a manner similar to the program offered under chapter 13 of this code. Unfortunately, the use of this chapter is not widespread throughout the country, and many people are simply not informed that this

> option is available when they seek the Bankruptcy Code's protection. This title contains many provisions that take into account these concerns.

140 Cong. Rec. S4507 (daily ed. Apr. 20, 1994); accord *id.* at S4505, S4506.

The following day, Senator Heflin, on behalf of Senator Metzenbaum, introduced Amendment No. 1645, which revised Section 330 with language identical to that ultimately adopted by Congress later that year. 140 Cong. Rec. S4741-S4742 (daily ed. Apr. 21, 1994); *id.* at S4646. The Senate unanimously passed the bill the same day. *Id.* at S4666, D418.

Amendment No. 1645 is consistent with deliberate action by Congress in important respects. The amendment both deleted the phrase "or the debtor's attorney" from the committee's version of Section 330(a)(1) and simultaneously authorized in Section 330(a)(4)(B) compensation solely to attorneys for chapter 12 and 13 debtors. 140 Cong. Rec. at S4741-S4742. Not only is petitioner factually wrong in asserting (Pet. Br. 25) that the 1994 amendments to Section 330 contained no "substantive" change, but rather, "the fact that Congress carefully reexamined and entirely rewrote the * * * provision * * * supports the conclusion that the text * * * as enacted reflects the deliberate choice of Congress." *Union Bank* v. *Wolas*, 502 U.S. at 160.

Other features of the amendment also signal a deliberate intent to preclude chapter 7 debtors' attorneys from seeking compensation out of estate funds. In addition to deleting the authority to compensate all debtors' attorneys from Section 330(a)(1), the amendment accomplished a similar result by deleting the language in the committee's version of the bill that would have authorized compensation for *any* individual debtor's attorney, including an individual chapter 7 debtor's attorney, when the services were necessary and beneficial to the debtor. In light of the concerns expressed by Senator Heflin, Amendment No. 1645 replaced the committee's language with a new provision, Section 330(a)(4)(B), which authorized compensation solely to attorneys for individual debtors in chapters 12 and 13. That elimination of authority to compensate attorneys for individual chapter 7 debtors was undoubtedly intentional, and it supports the conclusion that Congress acted with similar intent in deleting the authority to compensate such debtors' attorneys in Section 330(a)(1).

Likewise, the deletion of the phrase "or the debtors' attorney" from Section 330(a) comports with the view of the amendment's sponsor, Senator Metzenbaum, that "chapter 13 is often the best overall process for debtors, creditors, and the national economy," 140 Cong. Rec. at S4507, presumably because chapter 13 enlarges the sources of repayment to creditors by drawing upon post-petition income to fund a repayment plan, 11 U.S.C. 1321-1328. By making available estate funds to compensate only chapter 12 and 13 debtors' attorneys, the 1994 amendments provided an incentive for debtors' attorneys to educate their clients about the potential advantages to the debtor of a chapter 13 bankruptcy petition, rather than a chapter 7 liquidation. Given the concern that "[u]nfortunately, the use of this chapter [13] is not widespread throughout the country, and many people are simply not informed that this option is available when they seek the Bankruptcy Code's protection," 140 Cong. Rec. at S4507, Congress rationally could have sought to remedy this perceived problem and to encourage the use of chapter 13 by precluding debtors' attorneys from seeking compensation from chapter 7 estates.

2. The events following the Senate's passage of Amendment No. 1645 further suggest that the members of Congress were aware of the text of the legislation that they enacted. As an initial matter, the members of Congress had *over five additional months* to read and consider Amendment No. 1645 before final passage of the legislation as H.R. 5116 by the House on October 5, 1994 (140 Cong. Rec. at H10,917), and by the Senate on October 6, 1994 (*id.* at S14,461).[8] During that intervening period, moreover, the deletion of the phrase "or the debtor's attorney" was specifically brought to Congress's attention.

On August 17, 1994, three months after the Senate passed Amendment No. 1645, the House Subcommittee on Economic and Commercial Law held hearings on bankruptcy reform. Among the written materials submitted to the committee for the hearing was a statement by National Association of Consumer Bankruptcy Attorneys (NACBA). The NACBA is "the only national association of attorneys organized for the specific purpose of protecting the rights of consumer bank-

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[8] Although the House held hearings on bankruptcy reform in August 1994, no bankruptcy reform bill was apparently formally introduced in the House until September 28, 1994, when H.R. 5116 was introduced and referred to the Committee on the Judiciary without any amendment to Section 330. 140 Cong. Rec. D1153, D1155 (daily ed. Sept. 28, 1994); *id.* at H10,006. The House Committee on the Judiciary reported H.R. 5116 to the House on October 4, also without amendment to Section 330. 140 Cong. Rec. at H10,726. The same day H.R. 5116 was amended to include, among other things, a revised Section 330 with language conforming to S. 540 as passed by the Senate. *Id.* at H10,752, H10,758-10,759.

ruptcy debtors," NACBA Pet. Am. Br. 2, a class that comprises approximately 98% of all chapter 7 debtors <http://www.uscourts.gov/Press_Releases/cy02. pdf (table F-2)>. In analyzing S. 540, the NACBA informed the members of the Committee that the provision regarding professional fees

> appears to have some minor drafting errors, including the apparently inadvertent *removal of debtors' attorneys* from the list of professionals whose compensation awards are covered by section 330(a).
>
> *NACBA does not oppose this provision, since it contains language ensuring that chapter 12 and 13 individual debtors' attorneys may be awarded compensation* for their work in protecting the debtor's interests in a bankruptcy case.

Bankruptcy Reform: Hearing on H.R. 5116 Before the Subcomm. on the Economy and Commercial Law of the House Comm. on the Judiciary, 103d Cong., 2d Sess. 551 (1994) (emphasis added). "Despite having the specific impact of the Senate bill on Chapter 7 debtors' attorneys called to its attention, the House of Representatives passed House Bill 5116, which included the text of § 330 as passed by the Senate." *In re Century Cleaning Servs., Inc.*, 195 F.3d at 1063 (Thomas, J., dissenting).

The NACBA's testimony is the *only* direct evidence relating to petitioner's assertion of a scrivener's error, and it is in clear tension with petitioner's theory. It shows that Congress was affirmatively notified of both the deletion of the phrase "or the debtor's attorney" and the lack of any objection to the deletion, and Congress passed the statute as written. That sequence of events makes it highly unlikely that the deletion was a mere accident, and the NACBA's outright acquiescence in the provision certainly renders it difficult to conclude that a rational Congress could not have deleted the phrase "or the debtor's attorney" from the statute. Petitioner's retort is that, even were members of Congress "aware of this snippet, they likely agreed with its conclusion that the omission was inadvertent." Pet. Br. 29. Acceptance of that contention, however, would turn the doctrine of scrivener's error on its head, since it would permit statutory amendment by judicial fiat even where Congress *consciously* enacts the words of a statute.

3. Petitioner argues (Pet. Br. 14, 18, 25-28) that Congress deleted the phrase "or the debtor's attorney" only as a "last minute" addition to the Bankruptcy Reform Act of 1994, and did so inadvertently when the statute's drafter removed the phrases appearing immediately before and after the phrase "or the debtor's attorney." As demonstrated above, the Senate had engaged in over a year of deliberations leading up to its passage of S. 540 as revised by Amendment No. 1645, *i.e.* from March 10, 1993 until April 21, 1994. Congress also had an additional five months to review the text of the Senate bill before passage of the final legislation in October 1994 and, in the intervening period, the House was explicitly notified of the omission of the phrase "or the debtor's attorney." See pp. 27-28, *supra*. Thus, the deletion of the phrase "or the debtor's attorney" was the product of a lengthy deliberative process. And in any event, there is no principle of law that deprives a "last minute" statutory change to a bill of its statutory force and effect, or that makes such a change less likely to reflect a deliberate choice by the members of Congress.

Contrary to petitioner's theory, moreover, Amendment No. 1645 made *no* change to the words that appeared immediately before the phrase "or the debtor's attorney." Rather, the phrase "of this title," which had appeared immediately before the phrase "or to the debtor's attorney" in Section 330 of the Bankruptcy Reform Act of 1978, was deleted by the original version of S. 540 that was introduced in the Senate on March 10, 1993, a full year before Amendment No. 1645 removed the phrase "or the debtor's attorney." See p. 23, *supra*. Nor is it significant that Amendment No. 1645 *did* delete the phrase that immediately followed the phrase "or the debtor's attorney" from the committee version of the bill. That phrase related to an entirely different subject matter—comments, objections, and guidelines by the United States Trustees regarding fee applications—and that phrase was separated from the phrase "or the debtor's attorney" by a comma. It is exceedingly unlikely that the statute's drafters, whose specific intent was to make "improvements and modifications from the initial sections adopted by the committee" (140 Cong. Rec. at S4507), failed to notice that they were deleting the phrase "or the debtor's attorney" from the statute, either at the time of the deletion or during the five months leading up to the final passage of the legislation.

4. Petitioner also relies (Pet. Br. 28-29) on the House Report to H.R. 5116 and post-enactment statements by Senator Metzenbaum remarking that the United States Trustees would develop guidelines for "fee applications" under the 1994 amendments to 28 U.S.C. 586(a)(3)(A). H.R. Rep. No. 835, 103d Cong., 2d Sess. 51 (1994); 140 Cong. Rec. S14,597 (daily ed. Oct. 7, 1994) (Sen. Metzenbaum). As an initial matter, the cited House Report related to a bill that contained no

changes to Section 330 of the Code, see note 8, *supra*, and therefore has little bearing on Congress's intent in passing Section 330 as amended. Moreover, nothing in Senator Metzenbaum's statement suggests that chapter 7 debtors' attorneys may receive compensation from the estate. As discussed, Section 330 permits the award of fees to examiners, trustees, and professional persons, as well as chapter 12 and 13 debtors' attorneys, all of whom must submit "fee applications" subject to the United States Trustees' Guidelines. See 28 C.F.R. Pt. 58, App. A.

Senator Metzenbaum's statements also refute the notion that Congress intended the 1994 amendments to "*increase* the compensation paid to counsel," as suggested by petitioner (Pet. Br. 3). In fact, Senator Metzenbaum commented that, "throughout the process of crafting a viable bankruptcy reform proposal, I have reiterated that there is one problem in particular that we must fix—professional fees in bankruptcy." 140 Cong. Rec. at S14,597. The Senator explained that earlier hearings had "revealed a number of examples of how lawyers suck the financial life out of companies by charging exorbitant and often unnecessary fees." *Ibid.* "In light of these abuses," Senator Metzenbaum stated that he was "particularly pleased that [his] proposal relating to professional fees is included in the act." *Ibid.* In short, neither those statements, nor any other piece of legislative history, shows that Congress unquestionably intended to authorize a chapter 7 debtor's attorney to be awarded fees from the bankruptcy estate.

5. Petitioner also argues (Pet. Br. 14-16, 36-42) that Congress would not have eliminated the rights of any debtor's attorney to seek fees without an affirmative statement by members of Congress in the legislative

history. The 1994 amendments to Section 330, however, did not make the seismic shift asserted by petitioner, see pp. 33-35, *infra*, and the NACBA, the group who presumably would have been affected by the omission of the phrase "or the debtor's attorney," did not oppose the amendments because of the specific grant of authority to chapter 12 and 13 debtors' attorneys to seek fees. In those circumstances, Congress's silence is hardly surprising. *Harrison* v. *PPG Indus., Inc.*, 446 U.S. 578, 592 (1980) ("[A]lthough the number of actions comprehended by a literal interpretation of [the statute] is no doubt substantial, the number would not appear so large as ineluctably to have provoked comment in Congress.").

Moreover, "it would be a strange canon of statutory construction that would require Congress to state in committee reports or elsewhere in its deliberations that which is obvious on the face of a statute. In ascertaining the meaning of a statute, a court cannot, in the manner of Sherlock Holmes, pursue the theory of the dog that did not bark." *Harrison*, 446 U.S. at 592; accord *Morales* v. *Trans World Airlines, Inc.*, 504 U.S. 374, 385, n.2 (1992) ("Suffice it to say that legislative history need not confirm the details of changes in the law effected by statutory language before we will interpret that language according to its natural meaning.").

Petitioner similarly argues that the Court should "not read the Bankruptcy Code to erode past bankruptcy practice absent a clear indication that Congress intended such a departure." Pet. Br. 36 (citing *Cohen* v. *de la Cruz*, 523 U.S. 213, 221 (1998) (quoting *Pennsylvania Dep't of Pub. Welfare* v. *Davenport*, 495 U.S. 552, 563 (1990)). That canon is inapposite here. The Court has invoked that principle to interpret terms in the Bankruptcy Code of 1978 that were unclear on their face or to resolve issues not explicitly addressed by the text. *Cohen*, 523 U.S. at 221; *Dewsnup* v. *Timm*, 502 U.S. 410, 419-420 (1992); *Pennsylvania Dep't of Pub. Welfare*, 495 U.S. at 563; *United States* v. *Ron Pair Enters.*, 489 U.S. 235, 245-246 (1989). That principle has never been invoked to reinsert a phrase that Congress specifically struck in an amendment to the Code. Because the omission of "the debtor's attorney" in Section 330(a)(1) is plain on its face in removing the statutory basis for awarding counsel fees to chapter 7 debtors' attorneys, the revised statute is controlling. See *Raleigh* v. *Illinois Dep't of Revenue*, 530 U.S. 15, 22 (2000) ("[T]he Code generally incorporates pre-Code practice *in the absence of explicit revision.*") (emphasis added); *Hartford Underwriters Ins. Co.* v. *Union Planters Bank, N.A.*, 530 U.S. 1, 10 (2000) ("[P]re-Code practice informs our understanding of the language of the Code, [but] cannot overcome that language. It is a tool of construction, not an extratextual supplement.") (citation and internal quotation marks omitted); *BFP* v. *Resolution Trust Corp.*, 511 U.S. 531, 546 (1994) ("[W]here the meaning of the Bankruptcy Code's text is itself clear, its operation is unimpeded by contrary * * * prior practice.") (citation and internal quotation marks omitted).

D. Enforcing Section 330(a)(1) As Written Furthers Reasonable Policy Objectives

1. Congress's preclusion of fee awards to chapter 7 debtors' attorneys advances legitimate policy goals without adversely affecting the administration of bankruptcy cases, and petitioner's apocryphal allegations to the contrary are without merit. The amendment did not, as petitioner repeatedly suggests (Pet. Br. 5, 14, 15, 19, 30, 36) result in a "profound" or "radical" "sea

change" in bankruptcy practice by preventing an award of fees to all debtor's counsel. Such a change presumably would have garnered an objection by the NACBA during the consideration of the 1994 amendments, but no such objection was forthcoming. As discussed, Section 330(a)(4)(B) expressly authorizes a court to award fees to attorneys for chapter 12 and 13 debtors. 11 U.S.C. 330(a)(4)(B) (see pp. 17-18, *supra*). The Code also permits a former debtor's attorney to be awarded fees when he is employed by the trustee, including in a chapter 7 case. 11 U.S.C. 327(e), 330(a)(1) (see p. 20, *supra*).

In addition, Section 330(a)(1) authorizes compensation to attorneys employed by debtors-in-possession under the reorganization provisions of chapter 11. The Code gives chapter 11 debtors-in-possession "all" statutory powers, rights, and duties of a trustee, except the right to be paid as a trustee. 11 U.S.C. 1107(a); see also 11 U.S.C. 1106. The chapter 11 debtor-in-possession's rights thus include the trustee's right to retain counsel under Section 327 "to represent or assist the trustee in carrying out the trustee's duties." 11 U.S.C. 327(a). Indeed, the Code is explicit in providing that an attorney who was retained by a chapter 11 debtor-in-possession before the filing of a petition "is not disqualified from employment under section 327." 11 U.S.C. 1107(b). Counsel who are retained by chapter 11 debtors-in-possession thus have express statutory authority to seek fees from the estate as "a professional person employed under section 327." 11 U.S.C. 330(a)(1).[9]

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[9] Petitioner argues (Pet. Br. 21-22) that an award of fees to counsel for a chapter 11 debtor-in-possession conflicts with an interpretation of the statute that gives "full effect" to the deletion

2. Substantial policy reasons support Congress's choice to exclude attorneys fees in chapter 7 cases, and chapter 11 cases where a trustee has been appointed, while permitting estate funds to be used to pay attorneys for debtors-in-possession under chapter 11 and individual debtors in chapters 12 and 13. Debtors-in-possession in chapter 11, like debtors in chapters 12 and 13, pursue along with creditors the common goal of crafting and adopting a repayment plan to pay creditors from an estate that includes post-petition assets and income. Because only the chapter 11 debtor-in-possession is authorized to propose a plan initially, 11 U.S.C. 1121(a), (b) and (c), its counsel's assistance in developing a plan benefits the creditors who are paid from post-petition income and assets. 11 U.S.C. 1122-1129. The same is true for chapters 12 and 13, under which debtors remain in possession of all property of the estate and have the responsibility to propose post-petition repayment plans. 11 U.S.C. 1203, 1207(b), 1221, 1303, 1304, 1306(b), 1321. Because those chapters include post-petition assets in the pool of potential recovery, Congress rationally could have determined to authorize estate funds to be paid to attorneys for debtors in proceedings under those chapters as compensation for their services in assisting the debtor to develop a repayment plan for the benefit of creditors.

A case under the liquidation provisions of chapter 7 is fundamentally different from cases under chapters 11,

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of the phrase "the debtor's attorney." Petitioner is mistaken. The Code unambiguously includes attorneys within the category of "professional persons" who may be retained by the trustee, 11 U.S.C. 327(a), or the chapter 11 debtor-in-possession with the same rights and powers of the trustee, 11 U.S.C. 1107, and the Code unambiguously authorizes compensation to such "professional person[s]" in Section 330(a)(1).

12, and 13. A chapter 7 debtor does not administer or control the estate on behalf of creditors. That function is instead performed by the trustee, who is appointed in all chapter 7 cases, 11 U.S.C. 701, and who represents the estate on behalf of creditors, pp. 20-21, *supra*. Moreover, the chapter 7 debtor does not propose a repayment plan. Rather, he "surrender[s] * * * all property of the estate" to the trustee, 11 U.S.C. 521(4), who liquidates the debtor's nonexempt assets for the benefit of the estate's creditors, 11 U.S.C. 704(1), 726.

Significantly, as discussed, the Code gives a trustee who needs legal assistance in administering or liquidating a chapter 7 estate authority to seek court approval to retain counsel. Section 327(a) thus permits "the trustee, with the court's approval, [to] employ one or more attorneys * * * that do not hold or represent an interest adverse to the estate, and that are disinterested persons, to represent or assist the trustee in carrying out the trustee's duties under this title." 11 U.S.C. 327(a). And Section 327(e) permits the trustee to retain the former debtor's counsel for a special purpose when in the best interest of the estate.

Additionally, every dollar taken from the chapter 7 estate reduces the amount of funds available for creditors. Because the size of a chapter 7 estate is cast in stone as of the date of the filing of the petition, 11 U.S.C. 727(b), chapter 7 is a zero-sum game. Any diversion of funds from a chapter 7 estate to pay for a debtor's personal attorney reduces the amount of estate funds available to pay creditors. In those circumstances, it was reasonable for Congress to prohibit the siphoning of finite assets in chapter 7 cases by preventing chapter 7 debtors from using estate funds to pay the bills of their personal attorneys.

At the same time, the lack of authorization to use *estate* funds to pay counsel for a chapter 7 debtor does not prevent the debtor from hiring an attorney, as suggested by petitioner (Pet. Br. 2). Quite to the contrary, subject to certain limited exceptions, all assets and income acquired by a chapter 7 individual debtor after the petition is filed belong to the debtor. 11 U.S.C. 541(a)(5) and (6), 726, 727(b). An individual debtor typically will have post-petition funds, particularly his or her salary, that the debtor may use to pay counsel for any post-petition legal services. Similarly, when a corporate chapter 7 debtor is being liquidated, the Code does not restrict the corporation's former shareholders or officers from using their personal funds to pay for legal services in order to further their personal interests.[10]

3. Petitioner argues (Pet. Br. 30-36) that, without access to estate funds, bankruptcy lawyers will be discouraged from representing debtors in performing

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[10] Similar policy reasons support the absence of authority to use estate funds to compensate the debtor's counsel in the unusual case where a chapter 11 trustee is appointed "for cause, including fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor by current management" or because the appointment is in "the interest of creditors." 11 U.S.C. 1104(a)(1) and (2). In those circumstances, the debtor loses its powers over the estate, including the sole right under Section 1121(b) to propose an initial reorganization plan and the rights and powers of a trustee under Sections 327(a), 1106, and 1107 to retain professional persons. It is thus entirely appropriate that the debtor should not be in a position to siphon funds from the estate to pay the debtor's attorney—yet that is the result that would be permissible under petitioner's interpretation. As discussed in the text, moreover, the Code does not restrict the use of post-petition earnings by individual debtors, 11 U.S.C. 541(a)(6), and the Code permits the trustee to retain the debtor's counsel under Section 327(e).

their statutorily imposed duties in the over one million chapter 7 cases filed each year. For several reasons, however, it is the experience and considered view of the United States Trustees, whom Congress has charged with supervising the administration of bankruptcy cases (28 U.S.C. 586(a)(3)), that enforcing Section 330(a)(1) as written has no appreciable detrimental impact upon the administration of chapter 7 bankruptcy cases.[11]

First, the right to seek chapter 7 debtors' counsel fees from the bankruptcy estate has no practical effect in the overwhelming majority of chapter 7 cases. The data that the United States Trustees maintain on chapter 7 cases in the regions they supervise reveal that 96% of chapter 7 cases closed during 2002, *i.e.*, 1,001,697 of the 1,041,065 chapter 7 cases, had no assets in the estate to pay anything to counsel (or creditors for that matter). Thus, it is only in the remaining 4% of chapter 7 cases—less than 40,000 cases annually—that the amendment limits the ability of the chapter 7 debtor's counsel to seek fees from the estate. In those instances, however, Congress has made the rational choice of preserving those funds for creditors and of requiring the chapter 7 debtor to use non-estate, post-

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[11] Chapter 7 filing data maintained by the United States Trustees support the conclusion that enforcing Section 330(a)(1) as written does not unduly discourage chapter 7 filings. In the years 1999 and 2000, chapter 7 filings declined nationally. Those filings declined at a lower rate, however, in the Fifth and Eleventh Circuits, which have enforced the statute as written. *In re Pro-Snax Distribs., Inc.*, 157 F.3d 414 (5th Cir. 1998); *In re Am. Steel Prods., Inc.*, 197 F.3d 1354 (11th Cir. 1999). Similarly, in 2001, while chapter 7 filings increased nationally, such filings in the Fifth and Eleventh Circuits increased at a higher rate than the national average.

petition funds to pay for counsel if needed, or to comply with the provisions of Section 327(e) that permit retention of the debtor's counsel by the trustee. See pp. 20, 36-37, *supra.*

Second, the vast majority of chapter 7 debtors who have retained counsel, both before and after Congress amended Section 330, have paid their attorney a flat fee *prior* to filing bankruptcy to compensate the attorney for the typical services provided by counsel. Teresa A. Sullivan et al., *As We Forgive Our Debtors* 23 (1999) ("Because most attorneys insist on being paid in advance, the debtor must find some money for fees and filing before bankruptcy is possible. Some people are literally saving up for their bankruptcies."); Amy L. Good & Dean P. Wyman, *Representing Consumer Debtors: Fiduciary Duties of Counsel,* Prac. Law., Mar. 1999, at 33 ("Chapter 7 attorneys are generally paid a one-time fee immediately before the filing of the bankruptcy petition."); Stanley B. Bernstein et al. *Collier Compensation, Employment and Appointment of Trustees and Professionals in Bankruptcy* ¶ 3.02[1], at 3-2 (2001) ("In the majority of [chapter 7] cases, the debtor's counsel will accept an individual or a joint consumer chapter 7 case only after being paid a retainer that covers the 'standard fee' [which Bernstein estimates as between $750 and $850 in 2001] and the cost of filing the petition.").

Those fees routinely compensate counsel for his work in a chapter 7 case, most of which is completed *before* the petition is filed and the debtor's non-exempt assets become part of the estate under 11 U.S.C. 541. "Proceedings under Chapter 7 differ from cases under other Chapters of the Code in that the bulk of the legal and fact-finding work is done *before* the petition is filed." Rosemary E. Williams, *Bankruptcy Practice*

Handbook § 5:1, at 5-4 (2d ed. 2002); accord *In re Century Cleaning Servs., Inc.*, 195 F.3d at 1064 (Thomas, J., dissenting) ("In many Chapter 7 cases, there is little for the debtor's attorney to do after the petition is filed.").

The Code imposes very limited duties on a chapter 7 debtor. The debtor must complete a bankruptcy petition, a schedule of assets and liabilities, a statement of Financial Affairs, and a disclosure of debts secured by real property. 11 U.S.C. 521(1) and (2); Bankr. R. 4002; 11 U.S.C. App. Official Forms 1, 6, 7. Those duties generally may be performed before the debtor files for bankruptcy. The debtor also must cooperate with the trustee, surrender all property of the estate to the trustee, and appear at any discharge hearing. 11 U.S.C. 521(3)-(5); Bankr. R. 4002(2) and (3). Additionally, the debtor must attend an initial meeting of creditors where he may be asked questions to make sure that he accurately reported assets and liabilities on the bankruptcy filings. 11 U.S.C. 341. Thus, where counsel is retained in chapter 7, the attorney typically analyzes the debtor's financial condition, advises the debtor whether to file bankruptcy, prepares schedules for filing, and appears at the initial meeting of creditors. *Representing Consumer Debtors*, *supra*, at 40.

Petitioner asserts (Pet. Br. 1) that "[t]he debtor" has a duty to "maximize the value of the estate." The decision cited by petitioner, *Louisiana World Exposition* v. *Federal Insurance Co.*, 858 F.2d 233, 246 (5th Cir. 1988)), however, involves a chapter 11 debtor-in-possession, which has the duty of a trustee to manage the estate on behalf of creditors, 11 U.S.C. 1106, 1107(a), 1108. That duty has no application to debtors in chapter 7, who have neither the right nor obligation to control or manage the estate. 11 U.S.C. 323(a), 521(4).

For similar reasons, petitioner errs in attempting to show (Pet. Br. 6-7, 30-31) that the services he performed—such as his work in reviewing proofs of claims, in connection with the adversary complaint, and in investigating flood damage to the estate property—are illustrative of essential services by chapter 7 debtors' attorneys. The chapter 7 *trustee*, not the debtor, reviews proofs of claims, 11 U.S.C. 704(5), reduces to money the property of the estate, 11 U.S.C. 704(1), and acts to preserve the estate's assets, 11 U.S.C. 704(1) and (2). There was thus no need for petitioner to perform those services, which should have been performed by the trustee or counsel retained by the trustee (and subject to the trustee's direction, not the debtor's) under the specific provisions of Section 327.[12]

Based on the limited and generally pre-petition nature of the duties of a chapter 7 debtor, it is the United States Trustees' experience that chapter 7 debtors' counsel routinely receive flat fees before the bankruptcy petition is filed, even in those circuits that allow chapter 7 debtors' counsel to seek fees in "asset" cases (i.e., those relatively few cases in which the chapter 7 estate actually contains some assets for distribution). Indeed, only the most imprudent attorney would fail to secure payment before commencing work for a client who is entering chapter 7. Regardless of the

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[12] Some of petitioner's services were potentially adverse to the estate's interests. Petitioner observes (Pet. Br. 6), for example, that post-conversion he explained to the debtor, a defunct corporation, how it could attempt to reconvert the case to chapter 11. Petitioner's time records also suggest that he drafted a notice of appeal from the order converting the case to chapter 7. Pet. Br. App. 13a. Petitioner was therefore performing services that apparently were designed to benefit the debtor's equity holders, not the estate that petitioner no longer represented.

outcome of this case, the United States Trustees fully expect debtors' counsel in chapter 7 cases to continue to charge a flat fee in advance for their services, rather than work for free and then face the uncertain prospect of seeking judicial approval for an award of fees from the assets (if any) of the liquidating estate.

Because chapter 7 counsel are already routinely fully paid for their services up front, petitioner also errs (Pet. Br. 35) in predicting that enforcement of the statute as written will encourage enhanced flat fees that would unduly reduce the size of the estate. In any event, the Code already ensures that any pre-petition fee arrangement must be reasonable. Section 329 requires any attorney representing a debtor, whether or not the attorney "applies for compensation," to disclose all fee arrangements made within one year of the petition and to return any payment that "exceeds the reasonable value" of counsel services. 11 U.S.C. 329(a) and (b). The Code similarly prohibits preferential payments to counsel. 11 U.S.C. 547(b); *In re Pillowtex, Inc.*, 304 F.3d 246, 250 (3d Cir. 2002); *In re First Jersey Secs., Inc.*, 180 F.3d 504, 508-514 (3d Cir. 1999).[13]

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[13] Petitioner notes (Pet. Br. 36 n.7) that some States consider funds that are paid to an attorney for services that have not yet been performed to be potentially refundable to the client. In that instance, such funds may be part of the estate when the petition is filed. 11 U.S.C. 541. Any chapter 7 debtor's attorney who practices in those jurisdictions may nonetheless be compensated out of the debtor's post-petition salary or other income for any post-petition services. As discussed, moreover, most services of the chapter 7 debtor's attorney are typically performed pre-petition, *i.e.*, before the creation of the estate, and an attorney can accordingly be paid reasonable compensation for his pre-petition services.

4. Petitioner also speculates (Pet. Br. 33) that an attorney who represents a chapter 11 debtor-in-possession may find himself ethically compelled to "work[] for free" if the case converts to chapter 7. Conversions, however, form only a very small fraction of chapter 7 cases. Records maintained by the United States Trustees indicate that conversions reflect less than 0.26% of chapter 7 cases. Furthermore, counsel may seek in advance to limit the scope of the representation to his services for the chapter 11 debtor-in-possession as approved by the court under Section 327(a). Cf. Model Rules of Professional Conduct Rule 1.2(c) (2002) ("A lawyer may limit the scope of the representation if the limitation is reasonable under the circumstances and the client gives informed consent."). In any event, there is no reason to think that the chapter 7 debtor's attorney will be saddled with post-petition work in the typical case, see pp. 39-40, *supra*, and Section 327(e) permits retention of the debtor's counsel as needed.

* * * * *

In sum, the statute as enacted by Congress produces reasonable results that are fully consistent with the proper administration of bankruptcy proceedings. Indeed, the United States Trustees have observed no detrimental effects from the 1994 amendments to Section 330(a) on the administration of bankruptcy cases throughout the country, including in the circuits that have enforced the statute as passed by Congress. In light of the United States Trustees' experience and Congress's refusal over the last eight years to amend Section 330 as urged by petitioner, there is no justification for accepting petitioner's extraordinary request to rewrite the Bankruptcy Code.

CONCLUSION

The judgment of the court of appeals should be affirmed.

Respectfully submitted.

THEODORE B. OLSON
Solicitor General

PETER D. KEISLER
Assistant Attorney General

THOMAS G. HUNGAR
Deputy Solicitor General

LISA S. BLATT
Assistant to the Solicitor General

JOSEPH A. GUZINSKI
General Counsel

P. MATTHEW SUTKO
Attorney
Executive Office for United States Trustees

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APPENDIX

1. Section 327 of Title 11, U.S. Code, provides:

§ 327. Employment of professional persons

(a) Except as otherwise provided in this section, the trustee, with the court's approval, may employ one or more attorneys, accountants, appraisers, auctioneers, or other professional persons, that do not hold or represent an interest adverse to the estate, and that are disinterested persons, to represent or assist the trustee in carrying out the trustee's duties under this title.

(b) If the trustee is authorized to operate the business of the debtor under section 721, 1202, or 1108 of this title, and if the debtor has regularly employed attorneys, accountants, or other professional persons on salary, the trustee may retain or replace such professional persons if necessary in the operation of such business.

(c) In a case under chapter 7, 12, or 11 of this title, a person is not disqualified for employment under this section solely because of such person's employment by or representation of a creditor, unless there is objection by another creditor or the United States trustee, in which case the court shall disapprove such employment if there is an actual conflict of interest.

(d) The court may authorize the trustee to act as attorney or accountant for the estate if such authorization is in the best interest of the estate.

(e) The trustee, with the court's approval, may employ, for a specified special purpose, other than to represent the trustee in conducting the case, an attorney that has represented the debtor, if in the best interest of the estate, and if such attorney does not represent or hold any interest adverse to the debtor or to the estate with respect to the matter on which such attorney is to be employed.

(f) The trustee may not employ a person that has served as an examiner in the case.

2. Section 330 of Title 11, U.S. Code, provides:

§ 330. Compensation of officers

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

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

(B) reimbursement for actual, necessary expenses.

(2) The court may, on its own motion or on the motion of the United States Trustee, the United States Trustee for the District or Region, the trustee for the estate, or any other party in interest, award compensation that is less than the amount of compensation that is requested.

(3)(A)[1] In determining the amount of reasonable compensation to be awarded, the court shall consider the nature, the extent, and the value of such services, taking into account all relevant factors, including—

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[1] So in original.

(A) the time spent on such services;

(B) the rates charged for such services;

(C) whether the services were necessary to the administration of, or beneficial at the time at which the service was rendered toward the completion of, a case under this title;

(D) whether the services were performed within a reasonable amount of time commensurate with the complexity, importance, and nature of the problem, issue, or task addressed; and

(E) whether the compensation is reasonable based on the customary compensation charged by comparably skilled practitioners in cases other than cases under this title.

(4)(A) Except as provided in subparagraph (B), the court shall not allow compensation for—

(i) unnecessary duplication of services; or

(ii) services that were not—

(I) reasonably likely to benefit the debtor's estate; or

(II) necessary to the administration of the case.

(B) In a chapter 12 or chapter 13 case in which the debtor is an individual, the court may allow reasonable compensation to the debtor's attorney for representing the interests of the debtor in connection with the bankruptcy case based on a consideration of the benefit and necessity of such services to the debtor and the other factors set forth in this section.

(5) The court shall reduce the amount of compensation awarded under this section by the amount of any

interim compensation awarded under section 331, and, if the amount of such interim compensation exceeds the amount of compensation awarded under this section, may order the return of the excess to the estate.

(6) Any compensation awarded for the preparation of a fee application shall be based on the level and skill reasonably required to prepare the application.

(b)(1) There shall be paid from the filing fee in a case under chapter 7 of this title $45 to the trustee serving in such case, after such trustee's services are rendered.

(2) The Judicial Conference of the United States—

(A) shall prescribe additional fees of the same kind as prescribed under section 1914(b) of title 28; and

(B) may prescribe notice of appearance fees and fees charged against distributions in cases under this title;

to pay $15 to trustees serving in cases after such trustees' services are rendered. Beginning 1 year after the date of the enactment of the Bankruptcy Reform Act of 1994, such $15 shall be paid in addition to the amount paid under paragraph (1).

(c) Unless the court orders otherwise, in a case under chapter 12 or 13 of this title the compensation paid to the trustee serving in the case shall not be less than $5 per month from any distribution under the plan during the administration of the plan.

(d) In a case in which the United States trustee serves as trustee, the compensation of the trustee under this section shall be paid to the clerk of the bankruptcy court and deposited by the clerk into the

United States Trustee System Fund established by section 589a of title 28.

3. Section 331 of Title 11, U.S. Code provides:

§ 331. Interim compensation

A trustee, an examiner, a debtor's attorney, or any professional person employed under section 327 or 1103 of this title may apply to the court not more than once every 120 days after an order for relief in a case under this title, or more often if the court permits, for such compensation for services rendered before the date of such an application or reimbursement for expenses incurred before such date as is provided under section 330 of this title. After notice and a hearing, the court may allow and disburse to such applicant such compensation or reimbursement.

No. 02-693

IN THE

Supreme Court of the United States

John M. Lamie,
Petitioner,
v.
United States Trustee.

On Writ of Certiorari
to the United States Court of Appeals
for the Fourth Circuit

BRIEF FOR THE PETITIONER

John M. Lamie
BROWNING, LAMIE &
GIFFORD, P.C.
P.O. Box 519
Abingdon, VA 24212

Additional counsel listed on inside cover

Thomas C. Goldstein
(Counsel of Record)
Amy Howe
GOLDSTEIN & HOWE, P.C.
4607 Asbury Pl., NW
Washington, DC 20016
(202) 237-7543

May 30, 2003

Additional counsel:

G. Eric Brunstad, Jr.
P.O. Box 208215
127 Wall St.
New Haven, CT 06520

John A. E. Pottow
Assistant Professor of Law
University of Michigan Law School
625 South State St.
Ann Arbor, MI 48109

Craig Goldblatt
Andrew Currie
WILMER, CUTLER & PICKERING
2445 M St., NW
Washington, DC 20037

QUESTION PRESENTED

Does 11 U.S.C. 330(a)(1) authorize a court to award fees to a debtor’s attorney?

PARTIES TO THE PROCEEDINGS BELOW

In the court of appeals, this matter was captioned *United States Trustee* v. *Equipment Services (In re Equipment Services)*. Equipment Services is a debtor represented by John M. Lamie. Because the issue in this Court is Lamie's right to attorney's fees, and because the United States Trustee objected to the fee award in the proceedings below, they are respectively denominated the petitioner and the respondent in this Court. Equipment Services was identified as a nominal party by the Petition for Certiorari.

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OPINIONS BELOW AND JURISDICTION

The opinion of the Fourth Circuit (Pet. App. 1a-14a) is published at 290 F.3d 739. The opinions of the district court (Pet. App. 15a-27a) and bankruptcy court (*id.* 28a-44a) are unpublished. The court of appeals issued its opinion on May 31, 2002, and denied rehearing *en banc* on August 5, 2002. This Court granted certiorari on March 10, 2003. This Court has jurisdiction pursuant to 28 U.S.C. 1254(1).

RELEVANT STATUTORY PROVISIONS

The relevant statutory provisions are reproduced *infra* at 1a-5a.

STATEMENT

For more than a century, Congress has authorized bankruptcy courts to use funds of the bankruptcy estate to pay the fees of a debtor's attorney for services that benefit the estate. A divided panel of the Fourth Circuit in this case nonetheless inferred that Congress implicitly reversed course entirely, forbidding such compensation, when it revised and recodified Section 330(a) of the Bankruptcy Code in 1994. The court of appeals rejected the contrary rule endorsed by the leading treatise and adopted by "the majority of courts" (*In re Hasset, Ltd.*, 283 B.R. 376, 381 (Bankr. E.D.N.Y. 2002)), acknowledging that three circuits had reached the opposite conclusion.

1. The Bankruptcy Code imposes an array of duties on a debtor in bankruptcy. For example, the debtor must "file a list of creditors," together with "a schedule of assets and liabilities." 11 U.S.C. 521(1); Bankr. R. 1007(a)(1), (b)(1). The debtor must also take steps to "maximize the value of the estate." *La. World Exposition* v. *Federal Ins. Co.*, 858 F.2d 233, 246 (CA5 1988) (citing *CFTC* v. *Weintraub*, 471 U.S. 343, 352 (1985)). "In addition," whether the debtor is "in

possession" of the estate or instead a trustee has been appointed to represent the estate, the debtor "shall"

> (1) attend and submit to an examination at the times ordered by the court; (2) attend the hearing on a complaint objecting to discharge and testify, if called as a witness; (3) inform the trustee immediately in writing as to the location of real property in which the debtor has an interest and the name and address of every person holding money or property subject to the debtor's withdrawal or order * * *; (4) cooperate with the trustee in the preparation of an inventory, the examination of proofs of claim, and the administration of the estate, and (5) file a statement of any change of the debtor's address.

Bankr. R. 4002 ("Duties of Debtor"). See also 11 U.S.C. 521(3), (4) (providing that debtor must "cooperate with the trustee as necessary to enable the trustee to perform the trustee's duties," including by "surrender[ing] to the trustee all property of the estate and any recorded information, including books, documents, records, and papers, relating to property of the estate"). The debtor must also appear at the meeting of creditors to be examined by the trustee and to be advised of the consequences of the proceedings. *Id.* § 341; Bankr. R. 2004. These duties remain ongoing during the course of the proceedings.

Although the debtor thus bears substantial responsibilities, a number of which can generally be competently fulfilled only with legal advice, the debtor lacks funds to pay counsel. The debtor's assets are deemed to be the property of the estate (11 U.S.C. 541), which must be "surrender[ed] for distribution * * * at the time of bankruptcy" (*Local Loan Co.* v. *Hunt*, 292 U.S. 234, 244 (1934) (emphasis omitted)). Any expenditure by the debtor of those funds without permission of the bankruptcy court is forbidden. 11 U.S.C. 549.

To solve this dilemma, Congress has long permitted the debtor's legal fees to be paid from the debtor's estate *to the extent that* they benefit the estate or are necessary to the administration of the case. The Code authorizes the debtor to retain counsel. 11 U.S.C. 329(a). The Code addresses the payment of fees to attorneys and other professionals in the provision at issue in this case, Section 330(a). 11 U.S.C. 330(a). Congress enacted this provision to *increase* the compensation paid to counsel under predecessor provisions of the bankruptcy laws. See 3 Collier on Bankruptcy ¶ 330.LH, at 330-72 (15th ed. 2002).

Subsection 330(a)(1) authorizes the court to award compensation. Subsection (a)(2) gives the Office of the United States Trustee, a division of the Department of Justice, the right to comment on and object to any fee application. Subsection (a)(3) sets forth extensive criteria for the bankruptcy court to evaluate such an objection, including "the nature, the extent, and the value of such services, taking into account all relevant factors." Subsection (a)(4) affirmatively forbids compensation for "unnecessary duplication of services," as well as for "services that were not (I) reasonably likely to benefit the debtor's estate; or (II) necessary to the administration of the case." Fees approved under Section 330 are deemed an "administrative expense" payable from the estate on a priority basis. *Id.* §§ 503(b)(2), 507(a)(1).

Section 503 of the Code contains a separate, more general provision authorizing the use of estate funds to pay for services that benefit the estate. A party such as an attorney may submit "a request for payment of an administrative expense." 11 U.S.C. 503(a). The bankruptcy court, in turn, is directed to allow as legitimate administrative expenses "the actual, necessary costs and expenses of preserving the estate." *Id.* § 503(b)(1)(A).

Sections 330 and 503 are relevant only if the attorney is to be compensated from the property of the estate. They are inapposite to the extent the debtor seeks to pay counsel from non-estate funds, as when, prior to the commencement of the bankruptcy proceedings, the debtor secures counsel and pays the attorney a particular form of retainer. 11 U.S.C. 329(a). If properly framed, and if permitted under the legal ethics rules of the state in question, the retainer is the property of the *attorney* rather than the property of the *estate*. The bankruptcy court has substantially less control over such a retainer, which is reviewed not under the searching standards of Section 330(a)(3) and (4), *supra*, but instead simply for whether it "exceeds the reasonable value of [the attorney's] services" (*id.* § 329(b)).

2. Congress substantially revised and recodified the fee provisions of Section 330(a) in 1994. The question presented by this case is whether Congress in the 1994 Act implicitly intended to prohibit bankruptcy courts from compensating attorneys even for services beneficial to the estate. The question arises because the statute, as revised, contains an obvious scrivener's error. Section 330(a) contains two conjoined lists that contain irreconcilable references to the debtor's attorney:

> [T]he court may award to a trustee, an examiner, [*sic*] a professional person employed under section 327 or 1103--(A) reasonable compensation for actual, necessary services rendered by *the* trustee, examiner, professional person, or *attorney*.

11 U.S.C. 330(a)(1)(A) (emphasis added). For ease of reference, we will call the former list (which does not refer to the debtor's attorney and contains a grammatical error by omitting the conjunction "or") the "payees list," because it identifies persons who may be paid compensation. We will call the latter list (which does refer to the attorney) the "providers list," because it identifies the parties that provide compensable services.

Prior to the adoption of the current version of Section 330(a) in 1994, both lists referred to the debtor's attorney. The question presented by this case is whether the omission of the phrase "debtor's attorney" from the payees list in 1994 overcomes the other provisions of the Bankruptcy Code that authorize compensating the debtor's attorney and thus prohibits the payment of fees to the debtor's counsel from the estate, thereby effecting a sea change in bankruptcy law. A divided panel of the Fourth Circuit answered that question in the affirmative. The majority denied that Section 330(a) was at all ambiguous and therefore refused to consider whether the court's holding could be rationalized with other statutory provisions, the purpose of the Code, the legislative history, or past Code practice. The court of appeals thereby parted ways with a majority of courts, which hold that Congress in 1994 did not intend to abrogate the longstanding authority to compensate counsel for services that benefit the bankruptcy estate.

3. Equipment Services, Inc., a mine services company, hired petitioner John M. Lamie, an attorney, to represent the company in its bankruptcy proceedings. Prior to the commencement of the proceedings, the company paid Lamie a $6,000 retainer. Petitioner spent an initial $1,000 to cover the cost of preparing a petition for Chapter 11 reorganization and to pay the $830 filing fee. Petitioner held the remaining $5,000 of the retainer in a client escrow account.

Petitioner filed the petition for relief in December 1998. The bankruptcy court then appointed him counsel for the debtor. Petitioner represented Equipment Services in its Chapter 11 proceeding, earning $1,325 in fees for 10.5 hours of work and incurring $3.85 in expenses. Among other things, petitioner filed an adversary complaint against a creditor relating to equipment held by the debtor in a mine.

When the debtor was unable to secure insurance on the equipment in its custody, the U.S. Trustee successfully moved to have the case converted from a Chapter 11 reorganization to a Chapter 7 liquidation. As in all Chapter 7 cases, the bankruptcy court named a trustee to oversee the liquidation. See 11 U.S.C. 701(a). Over the course of the next several months, petitioner worked a further 8.1 hours on the case (totaling $1,000 in fees), often under order of the court or at the request of the trustee. The U.S. Trustee does not dispute in this Court that petitioner's services were non-duplicative, necessary to the administration of the case, and beneficial to the bankruptcy estate.[1]

For example, on the date the bankruptcy court converted the case to a Chapter 7 proceeding, March 17, 1999, petitioner wrote to the debtor to explain that the conversion had occurred and to discuss steps the debtor potentially could take to reconvert the case to Chapter 11. The bankruptcy court's conversion order also required "the debtor(s) (or Trustee)" to file a report detailing any debts incurred, or property acquired, by the debtor since the bankruptcy filing. App. 15a; 11 U.S.C. 521(1). In this case like many others, the debtor's counsel (here, petitioner) took responsibility for filing the report (App. 17a-18a) because the newly appointed trustee was not familiar with the debtor's assets and liabilities.

Next, in April 1999, petitioner prepared and filed an amendment to the bankruptcy schedules to reflect a claim filed by an additional creditor. App. 19a-21a. He also distributed a required notice of the "Section 341" creditors meeting. App. 22a; see 11 U.S.C. 341. Petitioner appeared with the debtor at the creditors' meeting. See 11 U.S.C. 341(d) (providing that debtor must be available for examination). Soon thereafter, at the request of the trustee, petitioner held a telephone call regarding the status of the equipment held in the mine. See *id.* § 521(3) (debtor is required to cooperate with trustee).

In December 1999, petitioner appeared at a hearing on the adversary complaint that he had previously filed on behalf of the debtor. Petitioner then wrote to advise the debtor that it

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[1] Any properly preserved argument by the U.S. Trustee that petitioner's services were not sufficiently beneficial to qualify for payment under the Code would be left for remand.

was essential to coordinate with the trustee regarding proceedings on the complaint. Petitioner also advised the debtor regarding issues relating to a lien that had the potential to reduce the equipment's value to the estate.

In January 2000, petitioner provided the trustee with the adversary complaint, together with an order substituting the trustee as the plaintiff. App. 25a; see 11 U.S.C. 521(4) (duty to provide materials to trustee). At the trustee's request, petitioner coordinated with the creditor's counsel the exchange of witnesses and exhibits regarding a hearing on the complaint. App. 26a.

In March 2000, once again at the trustee's request, petitioner investigated allegations that the equipment in the mine had been damaged by flooding. App. 27a-28a. Based on that investigation, the trustee requested that petitioner attend a meeting between the trustee, the debtor, and an asset-recovery firm regarding the equipment.

4. Since at least the Bankruptcy Act of 1898, Congress has authorized bankruptcy courts to compensate debtors' attorneys from the assets of the estate in both reorganizations and liquidations. In June 2000, petitioner submitted to the bankruptcy court a request to approve the modest $2,325 in fees he had earned, and $3.85 in expenses he had incurred, throughout the case. Respondent U.S. Trustee, however, opposed that portion of the fee request ($1,000) relating to petitioner's work during the Chapter 7 stage. The U.S. Trustee contended that Section 330(a), as revised and recodified in 1994, forbids the bankruptcy court from awarding such fees because, although the providers list refers to the debtor's attorney, the payees list omits the reference to the debtor's attorney that was included in the pre-1994 version of the statute. See *supra* at 4 (quoting the statute).

The U.S. Trustee did not, however, oppose petitioner's application for the $1,325 in fees for services he provided before the case was converted to Chapter 7. Section 330(a) applies generally to fee requests, including in *both* Chapter 7 and Chapter 11 cases. Nonetheless, the U.S. Trustee took the view, favorable to petitioner, that several Code provisions in combination authorized petitioner to receive fees during the Chapter 11 proceedings not as a *debtor's* attorney but instead as a *trustee's* attorney. A Chapter 11 debtor in possession has the rights of a trustee (*id.* § 1107(a)), including the right under Section 327 of the Code to hire an attorney (*id.* § 327(a)). Section 330(a)'s payees list, in turn, authorizes the bankruptcy court to award fees to "a professional person employed under section 327."

The U.S. Trustee also disputed petitioner's alternative argument that, without regard to Section 330(a), he was entitled to be paid all his fees, including the $1,000 for work during the Chapter 7 proceedings, from the $6,000 pre-petition retainer. The U.S. Trustee acknowledged below that certain types of retainers – so-called "general" or "classic" retainers – become the property of the *attorney* upon payment and thus are not part of the bankruptcy *estate.* The attorney's receipt of such a retainer is accordingly subject to review by the bankruptcy court under Section 329(b) only to determine if it "exceeds the reasonable value of [the attorney's] services" rather than under the more searching standards of Section 330(a)(3) and (4). But the U.S. Trustee argued that the particular retainer paid by Equipment Services to petitioner in this case did not so qualify, but rather remained the property of the estate because it authorized petitioner to draw upon it only as he performed legal services and furthermore obligated petitioner to return to the debtor any balance remaining at the conclusion of the proceedings.

5. The bankruptcy court agreed with the U.S. Trustee's contention that Section 330(a)(1) does not authorize petitioner to receive payment for the fees he earned during the Chapter 7 proceedings. See Pet. App. 32a-38a. The court acknowledged that its interpretation renders Section 330(a)(1) "arguably internally inconsistent with" the statute's providers list, which authorizes payment for services rendered by "the * * * attorney." *Id.* 35a. Further, the court acknowledged

that "the absence of legislative history and a brief review of the syntax of the statute might indicate that" the absence of "attorneys" from the payees list "was inadvertent." *Id.* 36a. But the court found it dispositive that "the current version of 330(a)(1) is the result of a deletion by Congress [of the phrase 'or a debtor's attorney' from the payees list] that resulted in a statute which is clearly at odds with its pre-amendment version." *Id.* 35a.

The bankruptcy court agreed with petitioner, however, that Section 330(a) simply did not govern his fee application because the retainer he had been paid by Equipment Services was his property, not "property of the estate." The court rejected the U.S. Trustee's proposed distinction among types of retainers (Pet. App. 42a), reasoning that "the client cannot retain the benefit of the services being rendered and yet to be rendered by the attorney and at the same time demand a refund of the current unearned balance of the retainer" (*id.* 38a). On the bankruptcy court's view, "[o]nly to the extent that a balance remains in the retainer after all services have been rendered and fees have been allowed under § 329 does the reversionary interest of the debtor in that balance become property of the bankruptcy estate." *Id.*

The bankruptcy court recognized "the unsatisfactory potential consequences of a decision which places a premium upon a debtor's attorney obtaining a retainer large enough to cover in advance any and all legal services which might reasonably be contemplated during the entire case." Pet. App. 43a. The refusal to award fees altogether, however, would create

> a very powerful disincentive * * * to attorneys to accept Chapter 7 cases in the first place, or to provide anything beyond the most perfunctory required post-petition services to the client in those Chapter 7 cases that were accepted. Particularly in the context of a Chapter 7 corporate debtor without interested, willing, and financially able owners or

> affiliates, the likelihood of payment for post-petition services by the debtor's attorney precluded from relying on his retainer for payment would appear to be doubtful at best.

Id. 42a. The bankruptcy court concluded that the retainer Equipment Services had paid to petitioner was reasonable in light of the services he provided (see 11 U.S.C. 329(b)) and accordingly approved the award of all of petitioner's requested fees from it. Pet. App. 43a-44a.

6. The district court affirmed in all respects. Pet. App. 15a-27a. The district court agreed with the bankruptcy court that Section 330(a) does not authorize the award of attorney's fees to a debtor's attorney in light of "the mysterious disappearance from the Bankruptcy Code" of the reference to the debtor's counsel in the payees list. *Id.* 19a. The court acknowledged that "[n]o principled reason appears in any legislative history for the removal of the crucial words, nor is there a record of any debate of the deletion." *Id.* 22a. Further, "[t]here are doubtless strong policy reasons for *not* omitting a chapter 7 debtor's attorney from eligibility for fees paid from the debtor's estate, particularly since § 330 limits compensation to those services 'reasonably likely to benefit the debtor's estate.'" *Id.* 24a (quoting 11 U.S.C. 330(a)(4)(A)(ii)(I)). But the court did not deem it "nonsensical" for Congress to have withdrawn the bankruptcy courts' authority to award fees to debtors' attorneys from the property of the estate. *Id.*

The district court nonetheless agreed with the bankruptcy court that Section 330(a) was irrelevant to this case, and that petitioner was entitled to be paid from the pre-petition retainer he received from Equipment Services, because the retainer was petitioner's property, not property of the estate. The district court reasoned that, although "a chapter 7 debtor's attorney may not be entitled under the Bankruptcy Code to compensation from the estate, the debtor is not prohibited from being represented and until such representation is ended, the debtor–and hence, the debtor's bankruptcy estate–is not entitled to a refund." Pet. App. 26a.

7. On the U.S. Trustee's appeal, a divided panel of the Fourth Circuit affirmed the district court's holding that Section 330(a)(1) forbids compensating debtors' attorneys from estate property, but it reversed the holding that the particular retainer paid by Equipment Services in this case was petitioner's property and thus immune from review under Section 330(a). The court of appeals therefore disallowed payment of the $1,000 petitioner earned during the Chapter 7 proceedings. The court acknowledged that its decision conflicted with rulings of the Second, Third, and Ninth Circuits. Pet. App. 2a, 6a-7a.

a. The Fourth Circuit majority held that "the plain language of the 1994 version of § 330(a)" is "unambiguous and is reasonable in application." Pet. App. 8a-9a. The court did not rest its decision on any literal prohibition against paying the debtor's attorney. Rather, it inferred that Congress so intended in recodifying the statute: "The 1994 version clearly omits the prior authorization to compensate the debtor's attorney from a Chapter 7 estate." *Id.* Deeming the deletion "plain," the court refused to consider contrary indications of congressional intent: "When a statute is unambiguous, canons of construction prevent us from considering outside sources, such as legislative history, to attempt to discern what Congress may or may not have intended to do." *Id.* 9a.

The Fourth Circuit separately reversed the lower courts' determination that the retainer received by petitioner was not part of the bankruptcy estate. The court of appeals agreed with petitioner and the U.S. Trustee that retainer agreements can be shaped to become property of the attorney, rather than property of the estate, and thus to avoid the provisions of Section 330(a):

> Retainer agreements can take various forms. For example, a retainer can be paid simply to ensure an

> attorney's availability to represent the client, whether or not services are ever performed. Or a retainer can be a prepayment for all future services to be performed, amounting to a flat fee. Under either one of these arrangements, the attorney acquires title to the retainer fee at the time he receives it, regardless of whether he thereafter performs legal services for the client. On the other hand, if the relationship is a trust arrangement in which the attorney holds the retainer for the client as security for the payment of future fees, then the retainer so held, less any fees charged against it, constitutes the property of the client.

Pet. App. 11a (citing *Indian Motorcycle Assocs.* v. *Mass. Housing Finance*, 66 F.3d 1246, 1254 (CA1 1995)). But under the particular retainer agreement in this case, the Fourth Circuit concluded that, as a matter of Virginia law, "until [petitioner] earned fees, the account remained the property of Equipment Services so that in the end, if any of the $6,000 remained, [petitioner] would be required to return the balance to Equipment Services." *Id.* The retainer was accordingly "property of the estate" and could only be used to pay fees consistent with Section 330(a). *Id.*

b. In dissent, Judge Michael agreed with the panel majority that the retainer was part of the bankruptcy estate but disagreed with its interpretation of Section 330(a)(1). See Pet. App. 13a-14a. He would have adopted the conclusion of the Second, Third, and Ninth Circuits that when Congress revised and recodified "§ 330(a) in 1994, it inadvertently deleted debtors' attorneys from the existing statutory list of those who could be paid from the bankruptcy estate for services rendered in bankruptcy proceedings." *Id.* 13a. Because the bankruptcy court had only considered the reasonableness of the retainer under Section 329(b), and thus had not applied the more stringent guidelines for awarding fees set out in Section 330(a)(3) and (4), Judge Michael would have "vacate[d] the award of attorney's fees to [petitioner] for his post-Chapter 7 services and * * * remand[ed] for the bankruptcy court to evaluate [petitioner's] fee application under the proper standard." *Id.* 14a.

8. This Court subsequently granted certiorari to decide the following question: "Does 11 U.S.C. § 330(a)(1) authorize a court to award fees to a debtor's attorney?" Pet. i. Petitioner did not challenge the court of appeals' state-law determination that the particular retainer in this case was property of the estate, rather than of petitioner. *Id.* 8 n.2. The U.S. Trustee did not cross-petition (see S. Ct. R. 12.5) from so much of the judgment below as authorized petitioner to be paid for his services at the Chapter 11 stage of the proceedings.

SUMMARY OF THE ARGUMENT

The Fourth Circuit reasoned that the "plain language" of the Bankruptcy Code prohibits compensating debtors' attorneys from the funds of the bankruptcy estate because Section 330(a), as revised and recodified in 1994, omits the reference to the debtor's attorney that previously appeared in the statute's payees list. The negative inference drawn by the court of appeals exclusively from that one omission is unsound. It fails to account for the fact that Section 330(a) contains an obvious scrivener's error that renders the statute ambiguous: the payees and providers lists are inextricably intertwined, yet one refers to the debtor's attorney while the other does not. Both cannot be enforced as written. Nor is the failure of the payees list to mention the debtor's attorney dispositive of the power to compensate counsel, for that power can be located in other provisions of the Code as well. For those reasons and others, this Court can properly construe Section 330(a) only by looking beyond the isolated text of the payees list to factors such as the text of the statute as a whole, the animating purposes of federal bankruptcy law, and past practice under the Code.

The text and structure of Section 330(a), as well as other provisions of the Bankruptcy Code, demonstrate that the court of appeals erred. Each party named in the providers list refers back to a parallel reference in the payees list. For example, "a trustee" may receive compensation for services by "the trustee." The better view is accordingly that, in retaining the authority in the providers list to pay compensation for the services of "the * * * attorney," Congress in 1994 necessarily assumed that an attorney would receive that compensation. Equally important, the court of appeals' decision cannot be reconciled with two other provisions that Congress added to Section 330(a) in the 1994 Act: subsection (a)(4) sets forth standards for paying the debtor's counsel; and subsection (a)(5) incorporates the power to pay the debtor's counsel interim compensation.

The legislative record furthermore demonstrates that the omission upon which the court of appeals seized was inadvertent, not a purposeful deletion from Section 330(a). The statute was the result of a last-minute amendment to the 1994 Act that, among other things, removed the phrases that appeared both immediately before and immediately after "or the debtor's attorney" in the payees list. Every indication – including from the Act's legislative history and the statement of the amendment's sponsor – is that the drafter made the mistake of striking all the text from the beginning of the first phrase to the end of the second. The inadvertent nature of the omission is confirmed by the fact that the amendment deleted even the conjunction "or," leaving the payees list grammatically incorrect.

The absence of any indication in the legislative record that Congress intended to eliminate the power to compensate debtors' counsel takes on still greater significance in light of the profound conflict that result would have with fundamental policies embodied by the Bankruptcy Code. Congress recognized in enacting Section 330(a) that counsel will not serve if they cannot be paid, a result that the bankruptcy system cannot countenance. Debtors have numerous important responsibilities that often can be fulfilled only with the assistance of an attorney. Even if the power to pay counsel were eliminated only in the more than one million cases a year in which a trustee has been appointed to administer the assets of the estate – a result the text cannot sustain – the negative consequences for bankruptcy administration would be so profound that it is almost inconceivable that Congress could have intended to incur them.

Finally, this case is controlled by the canon of construction that legislation will not be construed to depart dramatically from longstanding bankruptcy practice absent some affirmative indication of congressional intent. The history of the payment of the fees of debtor's counsel in bankruptcy is one written in three parts: practice under the Bankruptcy Act of 1867; procedures under the Act of 1898; and procedures under the current Bankruptcy Code. The history is also one of three relevant themes: the gradual expansion of the role of debtor's counsel in bankruptcy proceedings; the recognition of the fairness and need for counsel to be paid from the estate in order to ensure the orderly administration of the estate and that essential services are performed; and the eventual abandonment of the concept that services performed in a bankruptcy case are less deserving of payment than other legal services offered in the marketplace generally. In reviewing this history, one observation is particularly striking. In exercising its rulemaking authority under the Act of 1867, this Court adopted a "General Order" abrogating the prior practice of allowing the fees of debtor's counsel to be paid out of the debtor's estate. Subsequently, in enacting the Act of 1898 (and, later, the provisions of the current Bankruptcy Code), Congress explicitly, consistently, and repeatedly repudiated the Court's prohibition. Given this express and sustained determination by Congress, the conclusion that it in 1994 implicitly removed authorization for the payment of the fees of debtor's counsel from Section 330 is tantamount to ascribing to Congress a view that it had never previously embraced and, indeed, purposefully rejected at the close of the nineteenth century.

The judgment should accordingly be reversed.

ARGUMENT

I. Section 330(a) Contains a Scrivener's Error that Requires the Court To Consider the Text, Purpose, and History of the Statute and the Code as a Whole To Determine Its Meaning.

The Fourth Circuit held that the Bankruptcy Code does not permit the bankruptcy court to compensate petitioner for the services he provided in the Chapter 7 proceedings in this case, notwithstanding that those services benefited the bankruptcy estate. The panel majority refused to consider anything beyond the isolated text of Section 330(a)'s payees list – such as the text of the Code as a whole, the legislative history, the policies embodied by federal bankruptcy law, and prior practice. It maintained that the "plain language" of Section 330(a) compelled its construction. Pet. App. 8a. But that characterization by the majority of the statute considerably overstates the ruling's textual support. No provision of the Bankruptcy Code provides, as the court of appeals held, that the bankruptcy court is prohibited from compensating a debtor's attorney from the debtor's estate. The court of appeals instead rested its decision on the fact that "[t]he 1994 version clearly omits the prior authorization to compensate the debtor's attorney." *Id.* The decision below thus relies not on a statutory *proscription* against compensating counsel but on a negative *inference* that the absence of the phrase "a debtor's attorney" from the payees list of the 1994 Act is purposeful and controlling over other provisions of the Bankruptcy Code.

This Court should conclude that, for at least four reasons, the inference drawn by the court of appeals cannot alone bear the weight of its dramatic holding that Congress in 1994 eliminated the bankruptcy court's power to award fees to the debtor's attorney from the property of the estate. Instead, the proper construction of Section 330(a) requires the Court to consider other sources that inform the statute's meaning.

First, the Fourth Circuit's contention that the text of Section 330(a) is "plain" is wrong. The statute is facially ambiguous, not clear, and contains an obvious scrivener's error. It sets forth two lists that are ineluctably tied together:

> The court may award to a trustee, an examiner, [*sic*] a professional person employed under section 327 or 1103--(A) reasonable compensation for actual, necessary services rendered by *the* trustee, examiner, professional person, or *attorney* * * *.

11 U.S.C. 330(a)(1) (emphases added). The two lists are facially irreconcilable. Either Congress inadvertently omitted the "debtor's attorney" from the "payees" list, on which the court of appeals relied, or it inadvertently retained the reference to the attorney in the latter, "payees" list.[2] The 1994 Act also omitted the necessary conjunction "or" from the payees list, further evidencing the carelessness of the scrivener. There is no apparent reason, other than a drafting error, that Congress would have rewritten the statute to produce a grammatically incorrect provision.

Although petitioner believes that the drafting error was the omission of "or the debtor's attorney" from the payees list rather than the retention of the reference to the attorney in the providers list (see Part II-A, *infra*), the inescapable point for present purposes is that the statute contains a mistake of some kind. The court of appeals thus erred in drawing an inference exclusively from the text of the payees list in disregard of the

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[2] The lower courts themselves essentially acknowledged that the two lists are inconsistent. See Pet. App. 9a (court of appeals' recognition that, on its reading, "the reference in [the providers list] to 'attorney' may be superfluous"); *id.* 35a (bankruptcy court's acknowledgment that payees list is "arguably internally inconsistent with" providers list).

"cardinal rule that a statute is to be read as a whole" (*Wash. State Dep't of Soc. & Health Servs.* v. *Guardianship Estate of Keffeler*, 123 S. Ct. 1017, 1025 (2003)) and without regard to other indicia of congressional intent. Construction of the Bankruptcy Code, in particular, is a uniquely "holistic endeavor." *United Sav. Ass'n* v. *Timbers of Inwood Forest Assocs., Ltd.*, 484 U.S. 365, 371 (1988).

Second, the Fourth Circuit reasoned from the false premise that Congress in 1994 amended Section 330(a) by specifically deleting the reference to the debtor's counsel from the payees list. See Pet. App. 8a-9a. In reality, Congress substituted a new, and substantially different, version of Section 330(a). See Bankruptcy Reform Act of 1994, Pub. L. No. 103-394, § 224(b), 108 Stat. 4106, 4130 (substituting new provision in place of former Section 330(a) that substantially revised subsection (a)(1) and added entirely new subsections (a)(2)-(6)). And as more fully described in Part III, *infra*, the phrase "debtor's attorney" was itself omitted from the substitute bill only in a last-minute overhaul of the whole provision. The change was thus in no sense the targeted and purposeful deletion from the predecessor Bankruptcy Code imagined by the court of appeals.

Third, the Bankruptcy Code contains authority to compensate counsel other than in the payees list of Section 330(a). The providers list on its face authorizes the fee award in this case, directing the bankruptcy court to award "reasonable compensation for actual, necessary services rendered by *the* * * * *attorney*." 11 U.S.C. 330(a)(1)(A) (emphasis added). Section 330(a) must be read to "give meaning to each element" of the statute (*Lorillard Tobacco Co.* v. *Reilly*, 533 U.S. 525, 542 (2001)), and thus to each element of the providers list. Section 503 similarly provides for the payment of administrative expenses to the extent they represent "the actual, necessary costs and expenses of preserving the estate." Our point is not that Section 503 permits compensation in circumstances *clearly precluded* by Section 330; it logically does not. Rather, because the literal terms of the Code authorize the bankruptcy court to award fees in these circumstances, the negative inference drawn from the single statutory omission cited by the Fourth Circuit is not strong enough to justify its sweeping holding.

Fourth, it is simply implausible to believe that, if Congress actually did intend to make the radical departure from past practice of eliminating the power to compensate debtors' counsel, it would have done so in the oblique and ham-fisted manner of the 1994 revision to the statute. As just described, the 1994 Act eliminated only one of the two references to the attorney in Section 330(a). In addition, as we show in the next section, every other relevant source of statutory construction contradicts, and ultimately defeats, the inference drawn by the Fourth Circuit. Petitioner's position is thus supported by the text of the Code, the history of the 1994 Act, past practice, and the purposes of federal bankruptcy law. The leading treatise on bankruptcy law thus urges courts to recognize that the omission from the payees list is simply a drafting error:

> [S]ection 330(a)(1) of the Code deletes the reference to "the debtor's attorney" as a party who may be allowed compensation. Clearly this result was unintended * * *. [It] would represent a fundamental change in the law. * * * Because the change is inconsistent with current case law and the legislative history of section 330 does not support such a drastic change, courts should construe the deletion as unintended.

3 Collier ¶ 330.LH[5].

This Court has not hesitated to reject an inference, like that drawn by the court of appeals in this case, which is supported by an omission from a statute but is contradicted by other evidence in the text as well as the history of the provision's enactment and common sense. "An inference drawn from congressional silence certainly cannot be credited when it is contrary to all other textual and contextual evidence of congressional intent." *Burns* v. *United States*, 501 U.S. 129, 136 (1991). Such a negative inference is "a valuable servant, but a dangerous master" and has no place where, as in this case, it "leads to inconsistency or injustice." *Ford* v. *United States*, 273 U.S. 593, 612 (1927) (citation omitted); see also *Chevron U.S.A.* v. *Echazabal*, 536 U.S. 73, 84 (2002) ("*Expressio unius* just fails to work" in such situations.).

II. The Decision Below Conflicts with the Text and Structure of Section 330(a) and Other Provisions of the Bankruptcy Code.

A. The better reading of the text of Section 330(a) is that Congress did not intend to eliminate the authority to compensate debtors' attorneys.

1. Interpreting Section 330(a) involves a forced choice between giving full effect to the payees list (which does not refer to the debtor's attorney) or instead to the providers list (which does). The text does not conclusively resolve the inconsistency, but what guidance it does provide undermines the Fourth Circuit's decision. The payees and providers lists function in parallel: "a trustee" may receive compensation for services by "the trustee"; "an examiner" for services by "the * * * examiner"; and "a professional person employed under section 327" for services by "the * * * professional person." 11 U.S.C. 330(a)(1). Read consistently, by retaining the reference in the providers list to "*the* * * * attorney," Congress assumed that an "attorney" would receive payment for the attorney's services. Cf. *United States* v. *Morton*, 467 U.S. 822, 828 (1984) (a statutory term "must be read in light of the immediately following phrase").

In addition, the providers list is grammatically correct; the payees list, which omits not just "a debtor's attorney" but also the introductory conjunction "*or*," is not. We are not suggesting that statutes deserve respect only in proportion to how well they are written. Rather, as between two closely related but flatly irreconcilable provisions contained in direct succession, Congress more likely made an inadvertent mistake in the provision that contains the grammatical error.

2. The alternative reading of Section 330(a) pressed by the U.S. Trustee faces the equally substantial obstacle that it is logically inconsistent. The decision below reasons that Congress purposefully omitted the phrase "debtor's attorney" from Section 330(a), retaining only the authority to compensate distinct actors in the bankruptcy process: "a trustee, an examiner, [*sic*] a professional person employed under section 327 or 1103." The Fourth Circuit's premise was thus that Congress drafted the 1994 Act intending to *distinguish* the "debtor's attorney" from, *inter alios*, "a professional person employed under section 327."

But the U.S. Trustee elsewhere *rejects* that very premise, arguing that the debtor's attorney in some instances should be deemed "a professional person employed under section 327." In an effort to minimize the negative consequences of its construction of Section 330(a), respondent maintains that bankruptcy courts retain the authority to compensate debtors' counsel in Chapter 11 cases in which no trustee has been appointed.[3] Section 330(a) by its terms applies to attorney's fees in all forms of bankruptcy, including in cases under both Chapter 7 and Chapter 11, and furthermore without regard to whether a trustee has been appointed to administer the assets of the estate. The U.S. Trustee nonetheless asserts – without any support in the legislative record – that Congress in 1994 intended to eliminate the authority to pay the debtor's attorney *only* in Chapter 7 proceedings and those Chapter 11 proceedings in which no trustee has been appointed. It reasons that, in Chapter 11 cases in which there is no trustee,

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[3] As noted *supra* at 13, the U.S. Trustee has not challenged in this Court that portion of the judgment in this case that authorizes petitioner to be paid from the bankruptcy estate for the services he provided during the Chapter 11 proceedings. Our point is that the U.S. Trustee's concession that petitioner is entitled to those fees rests on an internally contradictory reading of Section 330(a).

the debtor in possession has a trustee's power to retain an attorney (11 U.S.C. 327(a), 1107(a)), who may in turn be compensated under Section 330(a) not as an "attorney" but as a "professional person employed under section 327."

The U.S. Trustee cannot have it both ways. If Congress in 1994 intentionally eliminated the authority to compensate "a debtor's attorney" but not "a professional person employed under section 327" from Section 330(a), without making any special provision for certain Chapter 11 proceedings, then that deletion must be given full effect. Yet neither *any court* nor the U.S. Trustee endorses the view that Congress intended to eliminate entirely the power to compensate counsel in all cases. But that is the inevitable consequence of the Fourth Circuit's reading of the statute.

The "debtor's attorney" furthermore cannot be equated with a "professional person employed under section 327" because the Code consistently distinguishes those two terms. See 11 U.S.C. 330(a) (providers list), 331 (interim compensation authority). Statutes will not be read so as to render their terms "altogether redundant." *Gustafson* v. *Alloyd Co.*, 513 U.S. 561, 574 (1995).

B. The Fourth Circuit's holding that Congress intended in the 1994 Act to prohibit bankruptcy courts from compensating counsel with funds of the debtor's estate cannot be reconciled with two provisions that Congress added to Section 330(a) at that time.

The most significant change made by Congress in revising and recodifying Section 330(a) in 1994 was its addition of detailed criteria under which the bankruptcy court is to determine whether, and to what extent, fees should be paid. The 1994 Act specifically added two new subsections relating to attorney compensation. The fact that the enactment on which the Fourth Circuit rested its decision *expressly contemplates* paying debtors' attorneys refutes its conclusion that Congress simultaneously intended to *eliminate* that very authority.

1. Section 330(a)(4), added in 1994, contains a categorical prohibition on awarding fees in certain circumstances, but provides an exception for attorneys in a subset of bankruptcies:

> (A) *Except as provided in subparagraph (B)*, the court shall not allow compensation for--
>
> (i) unnecessary duplication of services; or
>
> (ii) services that were not--
>
> (I) reasonably likely to benefit the debtor's estate; or
>
> (II) necessary to the administration of the case.
>
> (B) In a chapter 12 or chapter 13 case in which the debtor is an individual, the court may allow reasonable compensation *to the debtor's attorney* for representing the interests *of the debtor* in connection with the bankruptcy case based on a consideration of the benefit and necessity of such services to the debtor and the other factors set forth in this section.

11 U.S.C. 330(a)(4) (emphases added).

The 1994 Act, in Section 330(a)(4), thus explicitly contemplates that bankruptcy courts will award compensation to a "debtor's attorney" under subsection (a)(1). Congress adopted general standards governing the award of compensation (subsection (a)(4)(A)) that incorporate a specific exception that more permissively allows the award of fees to the debtor's attorney in a subset of cases otherwise subject to the general rule (subsection (a)(4)(B)). Neither the general rule nor the exception makes sense if, as the Fourth Circuit held, Congress intended in 1994 to render debtors' attorneys ineligible to receive compensation in the first instance. Put another way, the U.S. Trustee cannot offer a reading of the statute under which the special standards for compensating counsel in Chapter 12 and Chapter 13 cases actually operate, as the text requires, as an exception to the general standards of subsection (a)(4)(A).

The status of subsection (a)(4)(B) as an exception – as opposed to an affirmative grant of authority to compensate counsel only under Chapters 12 and 13 – is confirmed by the fact that it refers only to compensating the debtor's counsel for "representing the interests of *the debtor*" (emphasis added) but directs the bankruptcy court in awarding compensation to consider "the other factors set forth in this section," which include the "benefit [to] *the debtor's estate*" (emphasis added). The authority to pay compensation to the debtor's attorney for representing the interests of *the debtor's estate* must therefore arise from some other Code provision. Indeed, in virtually every context – including all instances under Chapter 7 and Chapter 11, and with respect to the payment of parties other than the debtor's counsel (such as the trustee) even under Chapters 12 and 13 – the *sine qua non* of compensation is benefit to the estate. See 11 U.S.C. 330(a)(3). It is difficult to imagine that Congress intended to compensate counsel in Chapter 12 and Chapter 13 cases for services that benefit the debtor but to forbid their compensation for the services they provide that benefit the estate.

2. Subsection 330(a)(5), also added by the 1994 Act, furthermore incorporates the authority to compensate debtors' counsel on an interim basis that is set forth in Section 331. It directs bankruptcy courts to "reduce the amount of compensation awarded under [Section 330(a)(1)] by the amount of any interim compensation awarded under section 331." 11 U.S.C. 330(a)(5). Section 331, in turn, employs the traditional list and provides that compensation may be paid to "[a] trustee, an examiner, *a debtor's attorney*, or any professional person employed under section 327." 11 U.S.C. 331 (emphasis added). Subsection (a)(5) thus contemplates the availability of interim compensation for all the parties named in Section 331; no exception was made for that paid to debtors' attorneys. Congress in 1994 could not have intended, as the Fourth Circuit concluded, to forbid that very compensation.

Relatedly, the Fourth Circuit's decision impermissibly reads out of the Code the explicit authority conferred by Section 331 to award debtors' attorneys interim compensation. "Obviously, if a debtor's attorney is eligible to apply for interim payments, she must be eligible for payments in the first place." *In re Taylor*, 250 B.R. 869, 871 (E.D. Va. 2000).

III. The Circumstances Surrounding the 1994 Recodification of Section 330(a) Refute the Claim that Congress Intended To Eliminate the Authority To Compensate Counsel.

The preceding analysis doubtless raises the question of the source of the scrivener's error that omitted the debtor's attorney from the payees list but retained it in all related sections. "No principled reason appears in any legislative history for the removal of the crucial words, nor is there a record of any debate of the deletion." Pet. App. 22a. The answer lies in examining what actually changed in the 1994 amendments and how specific sentences were moved at the last minute. Both the providers and payees lists of Section 330(a)(1) as currently enacted are derived from similar provisions of the prior Code. Although the 1994 Act included a variety of wording differences beyond the omission of "a debtor's attorney," none was substantive.[4] Nothing suggests

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[4] The differences between the provisions, with deletions struck out and additions italicized, are as follows:

> (a)*(1)* After notice to ~~any~~ *the* parties in interest and ~~to~~ the United States Trustee and a hearing, and subject to sections 326, 328, and 329~~ of this title~~, the court may award to a trustee, ~~to~~ an examiner, [*sic*] ~~to~~ a professional person employed under section 327 or 1103~~ of this title, or to the debtor's attorney--~~
>
>> ~~(1)~~*(A)* reasonable compensation for actual, necessary services rendered by ~~such~~ *the* trustee, examiner, professional person, or attorney~~, as the case may be,~~

that Congress in 1994 intended to do anything other than carry forward with minor wording changes the predecessor provisions governing the persons to whom compensation may be paid. To the contrary, as noted, the redrafted version of Section 330(a)(1) retains the debtor's attorney in the providers list.

The reference in the payees list to the debtor's attorney appears simply to have been inadvertently omitted when Section 330(a) was overhauled through a "last minute addition * * * to the 1994 Act." 3 Collier ¶ 330.LH[5], at 330-75. As originally introduced, the bill that became the 1994 Act would have revised Section 330(a), by making each of the non-substantive wording changes to subsection (a)(1) just noted, one of which is relevant here: the bill would have deleted the phrase "of this title" that appeared immediately *before* "or to the debtor's attorney" in the payees list. The bill also would have inserted, immediately *after* the reference to the debtor's attorney, an additional provision directing the U.S. Trustee to review fee applications. It provided:

> (a)(1) After notice to the parties in interest and the United States trustee and a hearing, * * * the court may award to a trustee, an examiner, a professional person employed under section 327 or 1103, *or the debtor['']s attorney*, after considering comments and objections submitted by the United States Trustee in conformance with guidelines adopted by the Executive Office for United States Trustees pursuant to section 586(a)(3)(A) of title 28
>
> (A) reasonable compensation for actual, necessary services rendered by the trustee, examiner, professional person, or attorney and by any

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and by any paraprofessional person~~s~~ employed by ~~such trustee, professional person, or attorney, as the case may be~~ *any such person* * * *.

> paraprofessional person employed by any such person * * *[.]

S. 540, 103d Cong. (1993), *reprinted in* S. Rep. No. 168, 103d Cong., 1st Sess. (1993) (emphasis added).

On April 21, 1994, the day the Senate passed the Act, it considered fifteen separate amendments prior to final passage. "The Bankruptcy Reform Act of 1994 comprehensively covers a wide range of bankruptcy provisions. Due to the breadth of the amendments, technical errors are to be expected." 3 Collier ¶ 330.LH[5], at 330-76.[5] The amendment at issue here, No. 1645, substantially reorganized the provisions of the proposed replacement version of Section 330(a). With respect to subsection (a)(1), it carried forward the proposed deletion of the phrase "of this title" that appeared before "or the debtor's attorney." The amendment also deleted and moved to a new subsection (a)(2), the newly proposed provision relating to the U.S. Trustee's authority to review fee applications that had appeared immediately after the reference to the debtor's attorney. 140 Cong. Rec. S4741-01 (daily ed. Apr. 21, 1994). But the amendment also omitted the phrase "or the debtor[']s attorney" that appeared between

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[5] Indeed, the 1994 amendments introduced an array of errors into the Code: Sections 330(a)(3)(A) and 546(g) appear twice; the Code skips from Section 101(2) to Section 101(4), with the former Section 101(3) moved to Section 101(21B); Section 101(56A) was inserted between Sections 101(53C) and 101(53D); Sections 365(c)(4) and (d)(5) through (d)(9) were not deleted as expired, yet subsection (p) was; Section 522(f)(2) was redesignated as Section 522(f)(1)(B), but the cross-reference in Section 522(g)(2) was left unchanged; new Section 523(a)(15) was placed at the end of Section 523 rather than at the end of Section 523(a); Section 362(b)(14) was renumbered as 362(b)(17), but the cross-reference in Section 553(b)(1) was not corrected; Section 553(b)(1) refers to Section 546(h), which does not exist because there are two Section 546(g)'s; and Section 726(b) refers to a nonexistent Section 1009.

the two purposeful deletions; the drafter struck from the beginning of one to the end of the other, apparently without recognizing the phrase in between. In other words, the omission seems to have been, quite literally, a "slip of the pen."

The legislative history furthermore contradicts the suggestion that Amendment No. 1645 purposefully deleted the authority to pay fees to debtors' counsel. The 1994 version of Section 330(a) sought "to codify many of the factors previously considered by courts in awarding compensation and reimbursing expenses." 3 Collier ¶ 330.LH[5], at 330-73. "The purpose of these amendments was to foster greater uniformity in the application, processing and approval of fees. To accomplish this goal, the amendments expand[ed] the factors that courts should consider in approving fee applications, recognize[d] a bankruptcy court's authority to review fee applications sua sponte and require[d] the executive office of the United States trustee to establish national guidelines for the allowance of fees and expenses." Norton Bankruptcy Law and Practice § 26:5, at 206 (2d ed. 1997 Supp.). "Coincidentally, the language providing for objections, which [the] amendment removed from § 330(a)(1) in the reorganization, was contained in a clause that happened to fall immediately after the term 'debtor's attorney,' although the two subject matters were *entirely unrelated*." *In re Century Cleaning Servs.*, 195 F.3d 1053, 1059 (CA9 1999) (emphasis added).

Indeed, directly contrary to the Fourth Circuit's decision, the legislative history contemplates that fees *will be paid* to debtors' attorneys. The definitive report on the 1994 Act states that Section 330(a), as revised,

> requires the United States Trustee to invoke procedural guidelines regarding fees in bankruptcy cases and file comments with fee applications. These changes should help foster greater uniformity

> in the application for and processing and approval of fee applications.

H.R. Rep. No. 835, 103d Cong., 2d Sess. 51 (1994); 140 Cong. Rec. H10,769 (daily ed. Oct. 4, 1994). The sponsor of the amendment in question, Senator Metzenbaum, similarly explained that it

> sets forth in clear and concise terms those factors that must be considered when deciding the appropriateness of a fee request. * * * In addition, the U.S. trustees will be required to adopt uniform procedural guidelines for the review of fee applications and where appropriate, object to a fee request.

140 Cong. Rec. S14,597-02 (daily ed. Oct. 7, 1994).

There is no substantial support in the legislative record for the contrary holding of the court of appeals. As noted, nothing in the legislative history suggests the deletion of the phrase "a debtor's attorney" was purposeful. One piece of written testimony provided to a Subcommittee of the House Judiciary Committee during consideration of the 1994 Act noted, in passing, "the apparently inadvertent removal of debtors' attorneys from the list of professionals whose compensation awards are covered by section 330(a)." *Bankruptcy Reform: Hearing on H.R. 5116 Before the Subcomm. on Econ. & Commercial Law of the Comm. on the Judiciary*, 103d Cong. 551 (1994). In the unlikely event members of Congress were aware of this snippet, they likely agreed with its conclusion that the omission was inadvertent and would not alter the statute's meaning.

Subsequent to the Act's adoption, two "technical corrections" bills were introduced in the House that included, among their provisions, an amendment reinserting the debtor's attorney to the payees list. H.R. 120, 105th Cong. § 7 (1997); H.R. 764, 105th Cong. § 4 (1997). "Failed legislative proposals are a particularly dangerous ground on which to rest an interpretation of a prior statute." *Solid Waste*

Agency v. United States Army Corps of Engineers, 531 U.S. 159, 169-70 (2001). That rule is particularly apt here. Given the circuit conflict, the failure to pass corrective legislation does not indicate support for one reading of Section 330(a) over the other. The technical corrections bills may not have passed for a host of reasons, including objections to any of the several other amendments to the Bankruptcy Code they proposed.

The circumstances surrounding the omission of the phrase "a debtor's attorney," as confirmed by the legislative history, thus support the conclusion that Congress did not intend the radical change of prohibiting bankruptcy courts from compensating debtors' counsel but rather made an inadvertent error in the course of a last-minute statutory reorganization.

IV. The Fourth Circuit's Decision Conflicts with Basic Bankruptcy Policies and Produces an Absurd Result.

The inference drawn by the Fourth Circuit that Congress intended to eliminate the power to compensate counsel out of the assets of the bankruptcy estate is implausible for the further reason that it would entail an inexplicable, wholesale departure from not only the purpose of Section 330(a) as revised in 1994 but also the guiding principle of the "prompt and effectual administration" of federal bankruptcy law as a whole (*Katchen* v. *Landy*, 382 U.S. 323, 328 (1966)). The Code embodies Congress's recognition that the sound administration of the bankruptcy process requires imposing on debtors a variety of requirements, many of which can be fulfilled only by counsel. The 1994 Act does not eliminate any of these obligations of debtors. See, *e.g.*, 11 U.S.C. 341, 343, 521; Bankr. R. 1007(a), 2004, 4002.

This case is a perfect illustration. The owners of Equipment Services, a small mine services company, had no capacity to prepare either the Chapter 11 filing or the adversary complaint that petitioner filed on behalf of the debtor. Nor would the debtor have been aware of either the significance of the conversion of the case to a Chapter 7 proceeding or its obligation to cooperate with the appointed trustee. Upon conversion, only counsel would have had the knowledge and experience either to arrange the "Section 341" creditors meeting or to coordinate the proceedings on the adversary complaint.

Commentators agree that the policies embodied by the Code require compensating debtors' attorneys in order to ensure the operation of the bankruptcy process:

> There are several postpetition services commonly performed by the debtor's attorney in chapter 7 proceedings that are necessary to the administration of the estate. If debtors' attorneys' compensation is not permitted, this may have the effect of denial of counsel, or at the very least, lead to debtors representing themselves. This possibility may lead to increased errors and time spent to correct those errors, thereby further extending the time necessary to adjudicate all parts of the case.

Joseph G. Minias, *Text and Context: Discerning the Basis for Debtor's Attorneys' Fees Under Chapter 7 and 11 of the Bankruptcy Code*, 18 Bankr. Dev. J. 201, 219-20 (2001). We have collected other representative cases illustrating the valuable services provided by debtors' counsel, including in Chapter 7 proceedings and Chapter 11 proceedings in which a trustee has been appointed, in the Appendix, *infra*, at 29a-32a.

Counsel generally will not, of course, agree to serve a client in bankruptcy without compensation. Congress's point in enacting and subsequently revising Section 330(a) – a purpose which the Fourth Circuit's decision serves to defeat – was to ensure that attorneys are willing and able to represent parties to the bankruptcy process. "[I]t has become clear over the years that it is most difficult to attract competent attorneys to perform the often complex legal services required in bankruptcy if they must constantly be preoccupied with the manner in which they are to be paid * * *." W. Homer

Drake, Jr., Bankruptcy Practice for the General Practitioner § 10.14 (3d ed. 2002). The decision below thus runs contrary to the "principal goal" of ensuring "open access" to bankruptcy relief. Report of the Commission on the Bankruptcy Laws of the United States, H.R. Doc. No. 137, Part II, 93d Cong., 1st Sess. (1973); H.R. Rep. No. 595, 95th Cong., 1st Sess. 220 (1977); see also, *e.g.*, *In re UNR Indus., Inc.*, 986 F.2d 207, 210 (CA7 1993) (Section 330 is designed to ensure "that attorneys [would] be reasonably compensated and that future attorneys [would] not be deterred from taking bankruptcy cases due to a failure to pay adequate compensation. * * * [T]he important thing is to provide compensation in bankruptcy equivalent to that outside it."); *In re Pontiac Hotel Assocs.*, 92 B.R. 715, 716 (E.D. Mich. 1988) ("Bankruptcy judges may award compensation to a debtor's attorney pursuant to 11 U.S.C. § 330. This statute was designed to ensure that bankruptcy counsel would command fees comparable to non-bankruptcy counsel, and thus that competent professionals would be attracted to the bankruptcy field." (citing H.R. Rep. No. 595, *supra*, at 329-30)).

It is no answer that, as respondent suggests, the trustee can secure the assistance of counsel, including the counsel who previously represented the debtor (see 11 U.S.C. 327, 328(b)), who can be compensated as the trustee's lawyer under Section 330(a). That prospect is sufficiently uncertain – including because the choice would be left to the trustee and because the debtor's counsel may be deemed to have a preclusive conflict of interest (see 11 U.S.C. 327(a)) – that counsel will refuse to come into the case in the first instance. The Code also imposes distinct duties on *the debtor*, which needs its own counsel throughout the proceedings. But even if that were not so, respondent's proposal would be self-defeating at best, as it would provide no substantive benefit to the bankruptcy process but instead would give rise to an inefficient and ultimately purposeless process in which the parties regularly file form motions to name the debtor's lawyer as the counsel to the trustee.

The Fourth Circuit's view of Congress's intent is furthermore implausible even if, as the U.S. Trustee proposes, Section 330(a) is read to eliminate the power to compensate counsel not in every bankruptcy proceeding but instead in Chapter 7 cases and Chapter 11 cases in which a trustee has been appointed. If attorneys know that they cannot be compensated for work done under Chapter 7, then they will be loath to take on a Chapter 11 case for fear that a trustee will be appointed or (as in this case) the proceeding will be converted to Chapter 7. The construction of Section 330(a)(1) adopted below creates in the attorney's mind the fear that he or she will be left "working for free," in part because "state law ethical obligations may require an attorney to continue to perform as counsel, regardless of the potential prohibition of payment." Bruce H. White & William L. Medford, *Compensation for Debtor's Counsel After a Chapter 11 Trustee Is Appointed: When Should Debtor's Counsel Stop Working*, 1999 ABI J. LEXIS 79, at *7-*8 (June 1999). Fearing that the canons of ethics would prevent them from abandoning their client once a trustee entered the case, attorneys will stay away from the outset. Cf. Model Rules of Professional Conduct Rule 1.16(b) (permitting attorneys to withdraw from representing a client only "if withdrawal can be accomplished without material adverse effect on the interests of the client" or if other unusual circumstances exist).

But in any event, there are more than one million Chapter 7 filings every year, more than twice the number for all other forms of bankruptcy combined. *2001 Year-End Totals for Filings Reach New High*, The Bankruptcy Strategist, Apr. 2002, at 1. Even those judges who read the text of the payees list to eliminate only the right to compensation in that subset of cases recognize the grave consequences of the rule they grudgingly apply. The bankruptcy judge in this case thus wrote that, in his experience, the failure to pay counsel will give rise to "a *very powerful* disincentive * * * to attorneys to accept Chapter 7 cases in the first place, or to provide anything beyond the most perfunctory required post-petition services." Pet. App. 42a (emphasis added). Judge Thomas of the Ninth Circuit similarly recognized that the policies underlying Section 330 point in "favor of allowing attorneys to receive reimbursement under § 330. There are several post-petition services commonly performed by the debtor's attorney in Chapter 7 proceedings that are necessary to the administration of the estate." *Century Cleaning Servs.*, 195 F.3d at 1060 (dissenting opinion). "Categorical exclusion of fees can only result in denial of access to justice, with debtors unrepresented or under-represented. The increase in *pro se* cases, and in cases which become *pro se* after the petition is filed, does not aid the administration of our bankruptcy system." *Id.* at 1064.[6]

There also is no reason to believe that Congress decided to forbid compensating counsel under Section 330(a) in order to preserve the assets of the estate. Congress addressed the question of asset preservation in subsections (a)(3) and (a)(4), which set forth detailed criteria for awarding fees, and which forbid compensation (except in cases under Chapters 12 and 13) for "unnecessary duplication of services" and services that are not "(I) reasonably likely to benefit the debtor's estate; or (II) necessary to the administration of the case." "There are doubtless strong policy reasons for *not* omitting a chapter 7 debtor's attorney from eligibility for fees paid from the debtor's estate, particularly since § 330 limits compensation to those services 'reasonably likely to benefit

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[6] There is also no reason Congress in 1994 would have chosen to eliminate the right to compensation from the assets of the estate in Chapter 7 cases and Chapter 11 "debtor out of possession" cases as the Fourth Circuit supposed, but simultaneously preserved (and even enhanced) the right to compensation in all other forms of bankruptcy. The distinction cannot be that the assets are being liquidated, for there is no liquidation under Chapter 11. Nor can the distinction be the presence of a trustee, for a trustee is appointed in Chapter 12 and 13 cases as well. See 11 U.S.C. 1202, 1302.

the debtor's estate.'" Pet. App. 24a (quoting 11 U.S.C. 330(a)(4)(A)(ii)(I)) (emphasis added). "The bankruptcy court may reduce or even disallow the requested amount of compensation when no real benefit is conferred upon the debtor's estate by the services for which the applicant seeks compensation." 3 Collier ¶ 330.03[3], at 330-25 (collecting cases). We have collected representative cases illustrating the scrutiny that bankruptcy courts apply to fee applications submitted by debtors' counsel, including in Chapter 7 proceedings and Chapter 11 proceedings in which a trustee has been appointed, in the Appendix, *infra*, at 33a-35a. The Fourth Circuit nonetheless attributed to Congress an illogical, penny-wise and pound-foolish determination to eliminate entirely – as a purportedly asset-preserving measure – compensation that is essential to debtors' receipt of legal services that are "necessary" and "benefi[cial]" to the value of the estate.

Indeed, the Fourth Circuit's decision is likely to have the absurd consequence in many cases of *reducing* the assets of the estate, as well as the bankruptcy court's control over fee awards. Congress could not have intended either result, given that the principal innovation of the 1994 Act was the adoption of more stringent standards for the court to apply in reviewing fee applications. The court of appeals held, and the U.S. Trustee agreed, that debtors and their counsel may enter into pre-petition "general" retainer agreements that, because they are the debtor's property rather than property of the estate, will be reviewed only for their "reasonableness" under Section 329(b) rather than under the more stringent standards of Section 330(a). See Pet. App. 11a. There can be no dispute regarding "the unsatisfactory potential consequences of a decision which places a premium upon a debtor's attorney obtaining a retainer large enough to cover in advance any and all legal services which might reasonably be contemplated during the entire case." *Id.* 43a. Indeed, the attorney will logically insist that the retainer be enhanced to account for the risk that services required in the proceeding will be more extensive than anticipated, thereby reducing the funds that are ultimately available to creditors as a part of the estate.[7]

V. Congress Would Not Have So Profoundly Changed Prior Bankruptcy Practice Without Any Acknowledgement in the Statutory History.

The Fourth Circuit's decision implausibly attributes to Congress the intent to abandon silently over a century of established bankruptcy law authorizing the payment of the fees of debtor's counsel from the assets of the bankruptcy estate. "When Congress amends the bankruptcy laws, it does not write on 'on a clean slate.'" *Dewsnup* v. *Timm*, 502 U.S. 410, 419 (1992). As this Court has repeatedly made plain, "[w]e * * * 'will not read the Bankruptcy Code to erode past bankruptcy practice absent a clear indication that Congress intended such a departure.'" *Cohen* v. *de la Cruz*, 523 U.S. 213, 221 (1998) (quoting *Pennsylvania Dep't of Pub. Welfare* v. *Davenport*, 495 U.S. 552, 563 (1990)); see also *Davenport*, 495 U.S. at 565 (Blackmun, J., joined by O'Connor, J., dissenting) ("This Court carefully has set forth a method for statutory analysis of the Bankruptcy Code. * * * * To determine the drafters' intent, the Court presumes that Congress intended to keep continuity between pre-Code judicial practice and the enactment of the Bankruptcy Code in 1978." (citations omitted)). Applying this approach in a series of cases, the Court has indicated time and again that, in construing the provisions of the Code, it will not presume that Congress intended to overturn an established bankruptcy rule

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[7] Although some jurisdictions prohibit such retainers (see, *e.g.*, *In re Craig*, 265 B.R. 624, 629 (Bankr. M.D. Fla. 2001) (discussing Florida law)), others do not, and it is unlikely that Congress intended to make the availability of compensation in federal bankruptcy proceedings turn on the nuances of individual states' attorney ethics rules.

sub silentio, but will instead require any intent to change the law to be "unmistakably clear." *Cohen*, 523 U.S. at 222.

Since the adoption of the Constitution, Congress has enacted five distinct bankruptcy acts. The first, the Act of 1800, and the second, the Act of 1841, contained no express provision for the compensation of debtor's counsel out of the property of the debtor's bankruptcy estate. See Bankruptcy Act of 1800, ch. 19, 2 Stat. 19 (repealed 1803); Bankruptcy Act of 1841, ch. 9, 5 Stat. 440 (repealed 1843); 3A Collier ¶ 64.01, at 2046-47 (14th ed. 1988).[8]

Enacted in the wake of the Civil War, the Nation's third bankruptcy statute – the Act of 1867 – was distinctly different. See Bankruptcy Act of 1867, ch. 176, 14 Stat. 517

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[8] This is not surprising. Both statutes were enacted during a period in which imprisonment for debt was common and insolvent debtors were viewed, more often than not, as criminal offenders. See Charles Warren, Bankruptcy in United States History 52 (1935) (discussing the gradual abolishment of the practice of imprisonment for debt in the United States during the first half of the nineteenth century); James Kent et al., *Bankrupt and Insolvent Laws, Report of the Incalculable Chancellor and Judges of the Supreme Court of the State of New York* (Jan. 22, 1819), *reprinted in* 16 Niles' Wkly. Reg. 85 (1819) (extolling the virtues of the common practice of imprisonment for debt). Moreover, both bankruptcy acts were principally debt collection devices concerned with the seizure and liquidation of the debtor's property, and each contemplated little role for the debtor (or, by extension, his counsel) beyond the debtor's surrendering of his property and submission to interrogation. See Act of 1800, § 18, 2 Stat. at 26 (providing that imprisoned debtor would be subject to examination); *id.* § 20, 2 Stat. at 27 (authorizing officials administering the Act to "break open" the debtor's houses and chests and take possession of all of the debtor's property); Act of 1841, § 3, 5 Stat. at 442 (transferring the debtor's property to the bankruptcy assignee); *id.* § 4, 5 Stat. at 443-44 (providing that the debtor would be subject to examination "at all times," and would be guilty of perjury for any false statement).

(repealed 1878). First, it was crafted after the general demise of the practice of imprisonment for debt and likewise reflected emerging popular perceptions of insolvent debtors as typically "honest but unfortunate" rather than criminal. See *Edwards* v. *Kearzey*, 96 U.S. 595, 602 (1877) (remarking that "[i]mprisonment for debt is a relic of ancient barbarism" and that "[e]very right-minded man must rejoice when such a blot is removed from the statute-book"). Second, the Act expanded both the debtor's benefits in bankruptcy (primarily by providing an enhanced right of discharge) and likewise the debtor's role in the administration of the case. See *Louisville Joint Stock Land Bank* v. *Radford*, 295 U.S. 555, 588 (1935) ("[t]he discharge of the debtor has come to be an object of no less concern than the distribution of his property"); *Stellwagen* v. *Clum*, 245 U.S. 605, 617 (1918) (observing the importance of granting the "unfortunate" debtor a discharge); Charles Jordan Tabb, *The Historical Evolution of the Bankruptcy Discharge*, 65 Am. Bankr. L.J. 325, 353-62 (1991) (discussing innovations under the Act of 1867, including expanded right of discharge).

Because the Act contemplated that the debtor would surrender all of his property at the commencement of the case to an "assignee" (essentially, a trustee), the Act logically and expressly contemplated that the debtor's expenses incurred in complying with the Act would likewise be borne by the estate, although it did not expressly address the compensation of the *debtor's* counsel. See Act of 1867, §§ 26, 28, 14 Stat. at 529-31. Exercising its rulemaking authority under the Act (see Act of 1867, § 10; see also *J.B. Orcutt Co.* v. *Green*, 204 U.S. 96, 103 (1907)), and reacting to amendments by Congress restricting the payment of most administrative expenses (Act of June 22, 1874, ch. 390, § 18, 18 Stat. 178, 184), this Court weighed in on the practice of paying the fees of debtor's counsel by abrogating it. The Court's General Order 30 provided that "no allowance shall be made against the estate of the bankrupt for fees of attorneys, solicitors, or counsel, *except when necessarily employed by the assignee*, when the same may be allowed as disbursements." See *In re Gies*, 10 F. Cas. 339, 339 (E.D. Mich. 1875) (emphasis added). Because the debtor's counsel was employed by the *debtor* rather than the assignee, General Order 30 was thought to prevent the payment of the fees of debtor's counsel. See *id.*; *In re Handell*, 11 F. Cas. 420 (W.D. Tex. 1876) (same).

Against this backdrop, Congress revisited the issue of the payment of the fees of debtor's counsel, and rejected the approach of General Order 30, when it enacted the Bankruptcy Act of 1898, ch. 541, 30 Stat. 544. In no fewer than three separate provisions of the 1898 Act, Congress expressly authorized the payment of the fees of the debtor's attorney.[9]

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[9] Congress so provided in Section 64(b)(3). After further amendment (including one that transferred the provisions of Section 64(b)(3) to Section 64(a)(1)), the section, as it existed immediately prior to the enactment of the Bankruptcy Code in 1978, expressly authorized the payment of "one reasonable attorney's fee, for the professional services actually rendered, irrespective of the number of attorneys employed, to the bankrupt in voluntary and involuntary cases * * * in such amount as the court may allow." Bankruptcy Act of 1926, Pub. L. No. 69-301, § 15, 44 Stat. 662, 667.

In addition, in 1934 Congress enacted Section 77B dealing specially with corporate reorganizations. Act of June 7, 1934, ch. 424, 48 Stat. 911, *codified at* 11 U.S.C. 207. In creating this special procedure, Congress also specifically authorized the court in reorganization proceedings to "allow a reasonable compensation for the services rendered * * * in connection with this proceeding * * * by * * * parties in interests * * * and the attorneys * * * of any of the foregoing *and of the debtor*." Bankruptcy Act of 1898, ch. 54, § 77B(c)(9), 30 Stat. 544, *codified at* 11 U.S.C. 207(c)(9) (emphasis added). In 1938, Congress replaced Section 77B with the corporate reorganization provisions of Chapter X, and specifically replaced Section 77B(c)(9) with Section 241 of Chapter X. In relevant part, Section 241(4) provided that "[t]he judge may allow * * * reasonable compensation for services rendered * * * in

As this Court subsequently explained, the touchstone for the allowance of compensation of the fees of debtor's counsel under the 1898 Act was whether those fees were "rendered in aid of the administration of the estate and the carrying out of the provisions of the act." *Conrad, Rubin & Lesser* v. *Pender*, 289 U.S. 472, 476 (1933); see also *Randolph & Randolph* v. *Scruggs*, 190 U.S. 533, 539 (1903); 3A Collier ¶ 62.31, at 1596-1600 (14th ed. 1988) (collecting cases). To the extent that they were rendered in aid of administration, fees were properly compensable and the reported decisions clearly establish the link between the payment of these fees and the useful and necessary functions of counsel for the debtor in the administration of the debtor's bankruptcy case. See *In re Kross*, 96 F. 816, 819 (S.D.N.Y. 1899); 3A Collier ¶ 62.31[3], at 1604-10 (14th ed. 1988); *id.* ¶ 62.31[4], at 1610-12 (analyzing fees compensable under Section 64); 6A Collier ¶ 13.04, at 571-76 (14th ed. 1988) (analyzing fees compensable under Section 241).

As summarized by one court, although the 1898 Act authorized compensating the debtor's counsel, it required strict frugality:

> The amount of compensation should be based, in ordinary cases, upon the nature of the case, the extent and character of the work actually performed, and the amount involved in the controversy. In bankruptcy cases, while these elements should properly be considered in fixing the compensation of the attorney, the policy of the act should be steadily

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a proceeding under this chapter * * * (4) by the attorney for the debtor." See also former Chapter X Rule 10-215(c)(1) (providing a similar authorization).

Finally, in addition to Sections 64 and 241, Congress also added the provisions of Chapter XII governing real property arrangements and, in doing so, added Section 491. Act of 1898, § 491, 11 U.S.C. 891. Section 491(4) is identical in all material respects to Section 241.

> kept in view, that is, that it should be administered with *severe economy* * * * so as to reduce to the lowest minimum the costs of administration.

In re Lang, 127 F. 755, 757 (W.D. Tex. 1904) (emphasis added); see also 3A Collier ¶ 62.05[1], at 1427 (14th ed. 1988).

When Congress enacted the 1978 Bankruptcy Code after ten years of study, it continued in Section 330(a) the practice of providing for the payment of the fees of debtor's counsel out of the assets of the estate. Significantly, in enacting Section 330, the debate in Congress focused not on the practice of compensating the debtors' counsel *vel non*, but rather on the standard by which professional fees would be allowed. That debate was resolved in favor of *enhancing* compensation. As described in the definitive joint statement of the floor managers of the 1978 Act:

> Section 330(a) contains the standard of compensation adopted in H.R. 8200 as passed by the House rather than the contrary standard contained in the Senate amendment. Attorneys' fees in bankruptcy cases can be quite large and should be closely examined by the court. However, bankruptcy legal services are entitled to command the same competency of counsel as other cases. In that light, the policy of this section is to compensate attorneys and other professionals serving in a case under title 11 at the same rate as the attorney or other professional would be compensated for performing comparable services other than in a case under title 11 * * *. Notions of economy of the estate in fixing fees are outdated and have no place in [the] bankruptcy code.

124 Cong. Rec. H11,089 (daily ed. Sept. 28, 1978) (statement of Rep. Edwards), *reprinted in* 1978 U.S.C.C.A.N. 6436, 6442; 124 Cong. Rec. S17,406 (daily ed. Oct. 6, 1978) (statement of Sen. DeConcini), *reprinted in* 1978

U.S.C.C.A.N. 6505, 6511. Section 330 thus reflected an intentional liberalization of the award of attorney's fees in bankruptcy cases in favor of attracting skilled representation. See 3 Collier on Bankruptcy ¶ 330.LH[4] (15th ed. rev. 2001).

In sum, other than a brief deviation by this Court under its rulemaking authority that was corrected by Congress in a subsequent legislative revision, there has *never* been a question for over a century that compensation for debtors' counsel comes from the estate. Legislative revision has focused on ways to watch-dog that compensation and perceived problems of quality of representation, but never on the long-established question of compensation *simpliciter*. In the 1994 Act, either Congress swept aside this century of long-settled practice without a hint of deliberation, or the scrivener erred in a statutory amendment that contains both a grammatical error and an internal inconsistency on its face. This Court's precedents holding that Congress will not be held to have dramatically departed from prior bankruptcy practice without discussion compel the latter conclusion.

CONCLUSION

For the foregoing reasons, the judgment of the United States Court of Appeals for the Fourth Circuit should be reversed.

Respectfully submitted,

John M. Lamie
BROWNING, LAMIE &
GIFFORD, P.C.
P.O. Box 519
Abington, VA 24212

G. Eric Brunstad, Jr.
P.O. Box 208215
127 Wall St.
New Haven, CT 06520

Craig Goldblatt

WILMER,CUTLER&
PICKERING
2445 M St., NW
Washington, DC 20037

May 30, 2003

Thomas C. Goldstein
(Counsel of Record)
Amy Howe
GOLDSTEIN & HOWE, P.C.
4607 Asbury Pl., NW
Washington, DC 20016
(202) 237-7543

John A. E. Pottow
Assistant Professor of Law
University of Michigan Law
School
625 South State St.
Ann Arbor, MI 48109

RELEVANT STATUTORY PROVISIONS

11 U.S.C. 327(a) provides in relevant part:

Except as otherwise provided in this section, the trustee, with the court's approval, may employ one or more attorneys * * * or other professional persons * * * to represent or assist the trustee in carrying out the trustee's duties under this title.

11 U.S.C. 328(a) provides in relevant part:

The trustee * * *, with the court's approval, may employ * * * a professional person under section 327 or 1103 of this title * * * on any reasonable terms or conditions of employment, including on a retainer, on an hourly basis, or on a contingent fee basis.

11 U.S.C. 329 provides:

(a) Any attorney representing a debtor in a case under this title, or in connection with such a case, whether or not such attorney applies for compensation under this title, shall file with the court a statement of the compensation paid or agreed to be paid, if such payment or agreement was made after one year before the date of the filing of the petition, for services to be rendered in contemplation of or in connection with the case by such attorney, and the source of such compensation.

(b) If such compensation exceeds the reasonable value of any such services, the court may cancel such agreement, or order the return of any such payment, to the extent excessive, to –

(1) the estate, if the property transferred –

(A) would have been property of the estate; or

(B) was to be paid by or on behalf of the debtor under a plan under chapter 11, 12, or 13 of this title; or

(2) the entity that made such payment.

11 U.S.C. 330(a) provides:

(1) After notice to the parties in interest and the United States Trustee and a hearing, and subject to sections 326, 328, and 329, the court may award to a trustee, an examiner, [*sic*] a professional person employed under section 327 or 1103--

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

(B) reimbursement for actual, necessary expenses.

(2) The court may, on its own motion or on the motion of the United States Trustee, the United States Trustee for the District or Region, the trustee for the estate, or any other party in interest, award compensation that is less than the amount of compensation that is requested.

(3)(A) In determining the amount of reasonable compensation to be awarded, the court shall consider the nature, the extent, and the value of such services, taking into account all relevant factors, including--

(A) [*sic*] the time spent on such services;

(B) the rates charged for such services;

(C) whether the services were necessary to the administration of, or beneficial at the time at which the service was rendered toward the completion of, a case under this title;

(D) whether the services were performed within a reasonable amount of time commensurate with the complexity, importance, and nature of the problem, issue, or task addressed; and

(E) whether the compensation is reasonable based on the customary compensation charged by comparably skilled practitioners in cases other than cases under this title.

(4)(A) Except as provided in subparagraph (B), the court shall not allow compensation for--

(i) unnecessary duplication of services; or

(ii) services that were not--

(I) reasonably likely to benefit the debtor's estate; or

(II) necessary to the administration of the case.

(B) In a chapter 12 or chapter 13 case in which the debtor is an individual, the court may allow reasonable compensation to the debtor's attorney for representing the interests of the debtor in connection with the bankruptcy case based on a consideration of the benefit and necessity of such services to the debtor and the other factors set forth in this section.

(5) The court shall reduce the amount of compensation awarded under this section by the amount of any interim compensation awarded under section 331, and, if the amount of such interim compensation exceeds the amount of compensation awarded under this section, may order the return of the excess to the estate.

(6) Any compensation awarded for the preparation of a fee application shall be based on the level and skill reasonably required to prepare the application.

11 U.S.C. 331 provides:

A trustee, an examiner, a debtor's attorney, or any professional person employed under section 327 or 1103 of this title may apply to the court not more than once every 120 days after an order of relief in a case under this title, or more often if the court permits, for such compensation for services rendered before the date of such an application or reimbursement for expenses incurred before such date as is provided under section 330 of this title. After notice and a hearing, the court may allow and disburse to such applicant such compensation or reimbursement.

11 U.S.C. 501(a) provides in relevant part:

A creditor * * * may file a proof of claim.

11 U.S.C. 502 provides in relevant part:

(a) A claim or interest, proof of which is filed under section 501 of this title, is deemed allowed, unless a party in interest * * * objects.

(b) * * * [I]f such objection to a claim is made, the court, after notice and a hearing, shall determine the amount of such claim * * * and shall allow such claim in such amount, except to the extent that –

* * *

(4) if such claim is for services of an * * * attorney of the debtor, such claim exceeds the reasonable value of such services;

* * * .

11 U.S.C. 503 provides in relevant part:

(a) An entity may timely file a request for payment of an administrative expense, or may tardily file such request if permitted by the court for cause.

(b) After notice and a hearing, there shall be allowed administrative expenses, other than claims allowed under section 502(f) of this title, including –

(1)(a) the actual, necessary costs and expenses of preserving the estate, including wages, salaries, or commissions for services rendered after the commencement of the case; * * *

(2) compensation and reimbursement awarded under section 330(a) of this title;

* * * .

11 U.S.C. 507(a) provides in relevant part:

The following expenses and claims have priority in the following order:

(1) First, administrative expenses allowed under section 503(b) of this title * * *.

11 U.S.C. 726(a) provides in relevant part:

Except as provided in section 510 of this title, property of the estate shall be distributed –

(1) first, in payment of claims of the kind specified in, and in the order specified in, section 507 of this title * * *.

11 U.S.C. 1107(a) provides:

Subject to any limitations on a trustee serving in a case under this chapter, and to such limitations or conditions as the court prescribes, a debtor in possession shall have all the rights, other than the right to compensation under section 330 of this title, and powers, and shall perform all the functions and duties, except the duties in sections 1106(a)(2), (3), and (4) of this title, of a trustee serving in a case under this chapter.

IN THE UNITED STATES BANKRUPTCY COURT

FOR THE WESTERN DISTRICT OF VIRGINIA

ABINGDON DIVISION

IN RE: EQUIPMENT SERVICES, INC.

CHAPTER 7

NO.: 98-04851-WSA-7

NOTICE

TO ALL CREDITORS AND PARTIES OF INTEREST:

PLEASE TAKE NOTICE that on July 6, 2000 at 10:00 a.m. I will appear before the Judge of this court in the United States District Courtroom at Abingdon and move for approval of my Fee Application filed in this case requesting fees in the amount of $2,325.00 and costs in the amount of $3.85.

____

John M. Lamie
Browning, Lamie & Sharp, P.C.
P.O. Box 519
Abingdon, VA 24210
Counsel for Equipment Services, Inc.

CERTIFICATE

I, John M. Lamie, do hereby certify that I have mailed a true and correct copy of the foregoing Notice to the debtor, all creditors and parties in interest listed on the bankruptcy matrix, Robert Wick, Trustee, PO Drawer 8, Bristol, Virginia 24203 and the United States Trustee, 280 Franklin Road, S.W., Roanoke, VA 24011, on this the 2 day of June, 2000.

____

John M. Lamie

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE WESTERN DISTRICT OF VIRGINIA
ABINGDON DIVISION

IN RE: EQUIPMENT SERVICES, INC.
CHAPTER 7

NO.: 98-04851-WSA-7

APPLICATION FOR FEES

Comes now John M. Lamie, counsel for the debtor in the above proceeding, and applies for fees as follows:

1. John M. Lamie has represented Equipment Services, Inc. in this bankruptcy case from December 24, 1998 until the date of this Fee Application. This case commenced as a Chapter 11 and converted to Chapter 7 on March 17, 1999.

2. During that time he has provided legal services to the debtor as follows: drafting bankruptcy petition and schedules, conferring with the debtor on financial matters, appearing at Court proceedings and representing the debtor in the bankruptcy proceedings.

3. He has expended through May 31, 2000 $0.00 in costs and provided 18.60 hours of legal services. An itemized statement of the costs and expenses is attached hereto.

4. Additional costs are $3.85 for mailing the Fee Application and Notice.

5. The hourly rate for John M. Lamie in his representation of the debtor was $125.00 per hour and the debtors have paid $6,000.00 as a retainer in this proceeding. (*From the retainer the filing fee of $830.00, an Adversary Proceeding filing fee of $150.00 and an Amendment fee of $20.00 was paid*).

6. The fees expended in this proceeding were reasonable and necessary expenses for representing the debtor and were incurred in the best interest of the estate.

WHEREFORE, John M. Lamie prays that the Court approve his Fee Application in this proceeding for $2,325.00 and costs in the amount of $3.85.

Respectfully submitted,

____

John M. Lamie
Counsel for the Debtor

EQUIPMENT SERVICES
Case No. 98-04851
Our File No. 98-0409A

DATE	SERVICES RENDERED	TIME SPENT
12/24/98	Cover letter to the Court w/Chapter 11 voluntary petition, List of 20 Largest Unsecured Creditors, etc.	1.0
12/31/98	Review U.S. Trustee package	0.2
12/31/98	Draft letter to client re: forms	0.2
12/31/98	Instruct assistant on preparation of schedules	0.1
1/4/99	Review Debtor-In-Possession Order	0.1
1/4/99	Letters to client re: US Trustee forms, telephone conferences w/US Trustee for 1/15/99 @ 11:00a.m., and Application for Order Approving Employment of Attorney	0.3
1/5/99	Call from Mr. Dowdy about High Hops collection effort of this debt.	0.2
1/11/99	Cover letter to the Court w/Motion for Extension of Time in Which to File Schedules	0.2
1/13/99	Review correspondence from the IRS	0.1
1/13/99	Letter to client re: reminder of hearing set for 1/29/99 @ 10 a.m.	0.1
1/15/99	Cover letter to the Court w/Application for Order Approving Employment of Attorney and Declaration	0.2
1/15/99	Letter to the US Trustee's office w/copy of Application for Order Approving Employment of Attorney and Declaration and proposed Order	0.2

1/15/99	Letter to F. Bradley Pyott, Esq. re: L.B.J. Coal Co., Inc. Complaint	0.2
1/20/99	Cover letter to the Court w/Amended Declaration	0.2
1/22/99	Letter to the US Trustee's Office re: mailed originals of the Debtor-in-Possession Report by the Debtor	0.2
1/26/99	Review final draft of schedules	0.3
1/27/99	Review correspondence from B. Copeland re: Motion to Compel	0.1
1/27/99	Letter to client re: Motion to Compel filed by B. Copeland	0.1
1/27/99	Cover letter to the Court w/remaining schedules	0.2
1/28/99	Review correspondence from B. Copeland re: request for copy of schedules and Motion for Relief on behalf of Carlis McGlothlin	0.1
1/29/99	Appear at 341 meeting	0.5
2/1/99	Review correspondence from B. Copeland re:Notice of Appearance and Request for All Notices, Plans and Disclosure Statements	0.1
2/1/99	Letter to H.P. Hess w/ Application for Order Approving Employment of CPA	0.2
2/3/99	Letter to client w/Corporate Resolution and Application to Approve the Employment of CPA	0.2
2/17/99	Review Notice of Hearing from B. Copeland for 3/16/99 @ 11:00 a.m. re: Hiope Mining, Inc. v. Equipment Services, Inc.	0.1
2/18/99	Call to clients re: Equipment move	0.3
2/18/99	Draft Complaint	0.5
2/19/99	Phone dep. of witness on AP	0.3

2/22/99	Call from Copeland re: equipment	0.2
2/22/99	Call to Dowdy	0.2
2/23/99	Proof AP draft	0.3
2/23/99	Cover letter to the Court w/AP, filing fee	0.2
2/24/99	Review correspondence from B. Copeland re: Emergency Motion to Appoint Trustee or to Designate Responsible Individual or to Appoint Examiner and/or Convert to Ch. 7 and Motion to Shorten Time	0.1
2/25/99	Review correspondence from B. Copeland re: Amended Motion for Relief	0.1
2/25/99	Review Service of Process of Summons and Complaint	0.1
2/26/99	Review motion from Hiope and call Mr. Dowdy about hearing.	0.3
3/1/99	Call Mr. Dowdy about hearing on Motion for a Trustee	0.3
3/3/99	Review fax correspondence from the US Trustee re: Motion for a Trustee/insurance	
3/6/99	Call Lee Dowdy about insurance on equipment	0.3
3/8/99	Review correspondences from B. Copeland re: Counter Claim and Answers	0.1
3/8/99	Letter by fax to the US Trustee re: letter of 3/3/99	0.2
3/10/99	Call client and U.S. Trustee re: insurance on equipment	0.1
3/13/99	Telephone conference re: litigation over mine site	0.5
3/16/99	Appear at hearing on the AP & motions of L.B.J., et al.	1.0
3/17/99	Letter to client re: 3/16/99 AP and hearing	0.2

3/22/99	Review Order Converting Case	0.1
3/23/99	Review file, notice of appeal, write client and Trustee	0.4
3/31/99	Cover letter to the Court w/ Final Report of the Debtor-In-Possession	0.2
3/31/99	Prepare Notice of Amendment for client to sign	0.2
4/6/99	Letter to the Court w/Notice of Amendment to Equipment Services, Inc. bankruptcy	0.1
4/13/99	Letter to client re: Ch. 7 341 meeting set for 4/21/99 @ 3 p.m.	0.1
4/19/99	Review Proof of Claim from Charlie Jessee on behalf of Lee and Loretta Dowdy	0.1
4/21/99	Appear at 341 meeting	0.5
4/27/99	Telephone conference with Chris Ruhe and Bob Copeland Re: equipment at the mine	0.2
5/24/00 [sic]	Review Proof of Claim from Charlie Jessee on behalf of American Bit Company	0.1
10/22/99	Letter to client re: status of AP and reminder of status hearing on 12/6/99 @ 9 a.m.	0.1
12/6/99	Review fax correspondence from B. Copeland re: Temporary Restraining Order	0.1
12/8/99	Review correspondence from B. Copeland re: Emergency Motion to Relieve Stay, If Applicable, to Secure Property of Movant	0.1
12/10/99	Review Temporary Restraining Order	0.1
12/10/99	Review correspondence from the Court re: filing fees	0.1
12/14/99	Hearing	0.5

12/15/99	Cover letter to Judge Stone w/Order on AP	0.2
12/20/99	Letter to client re: status of case	0.2
1/21/00	Letter to Bob Wick w/copy of complaint, Bob Copeland's Answers and order substituting as plaintiff	0.2
1/24/00	Review correspondence from Bob Wick re: Exchange of names of witnesses and photocopies of exhibits	0.1
2/16/00	Appear at Trial	0.5
3/8/00	Call to/from client re: allegations mine is flooded	0.2
3/8/00	Letter to Bob Wick re: allegations mine is flooded with equipment in it.	0.2
3/20/00	Review Notice of Filing Appeal	0.1
3/23/00	Letter to Bob Wick re: Notice 3/20/00	0.2
3/23/00	Letter to client re: Court's ruling and status of case	0.2
3/24/00	Review Amended Notice of Appeal to The US District Court	0.1
3/27/00	Review Designation of Issues on Appeal and Designation of Record on Appeal	0.1
5/17/00	Review Brief of the Appellant	0.1
5/25/00	Draft and review Fee Application	0.5
5/31/00	Prepare Fee Application, cover letter and Notice of Hearing	2.0
	Total Hours Expended	18.60

UNITED STATES BANKRUPTCY COURT
FOR THE WESTERN DISTRICT OF VIRGINIA
ABINGDON DIVISION

In re: **EQUIPMENT SERVICES, INC.** Debtor(s)	Case No. 98-04851-HPA-7 Chapter 7

ORDER CONVERTING CASE

It is hereby ORDERED that this case be, and the same hereby is, converted from a case under Chapter 11 to a case under Chapter 7 of Title 11 of the United States Code; and it is further

ORDERED

that the debtor(s) (or Trustee) in the superseded case shall file with the Court a final report and account within thirty (30) days from the date of the entry of this Order. Said report shall include a schedule of unpaid debts incurred after commencement of the superseded case. Said report shall also include the name, address and zip code in MATRIX form of all such additional creditors.

It is further ORDERED that if an Order confirming a plan was entered in the superseded case, the debtor(s) (or Trustee) shall file with the Court (A) a schedule of property not listed in the final report and account, which property was acquired after the filing of original petition but before the entry of this Conversion Order; (B) a schedule of unpaid debts not listed in the final report and account, additionally in matrix form, incurred after confirmation but before entry of this Conversion Order; and (C) a schedule of executory contracts entered into or assumed after the filing of the original petition but before entry of this Conversion Order.

Service of a copy of this Order shall be by mail to the debtor(s), attorney for the debtor(s), Trustee, if any, U.S. Trustee, and all creditors and parties in interest.

DATED: March 17, 1999 H. Clyde Pearson, Judge
U.C./S.C

Browning,
Lamie and Sharp, P.C.
Attorneys at Law

Larry G. Browning
John M. Lamie
Gerald F. Sharp
Please reply to the Abingdon Office

John M. Heuser
John J. Gifford
Eric Reese, Paralegal

March 31, 1999

John W. L. Craig, II, Clerk
United States Bankruptcy Court
P.O. Box 2390
Roanoke, VA 24010

RE: Equipment Services, Inc.
Chapter 7 Case No. 98-04851-HPA-7

Dear Mr. Craig:

Please find enclosed, for filing, the Final Report of the Debtor-in-Possession in the above referenced case.

Thank you for your kind assistance.

Sincerely yours,

John M. Lamie

pma
Enclosure
xc: US Trustee (w/enc)

P.O. Box 850
Grundy, VA 24614
540-935-5240
Fax 540-935-7232

P.O. Box 459
Lebanon, VA 24266
540-889-1182
Fax 540-889-2215

P.O. Box 519
Abingdon, VA 24212
540-628-6165
Fax 540-628-4847

P.O.Box 827
Wytheville, VA 24382
540-228-2119
Fax 540-228-2032

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE WESTERN DISTRICT OF VIRGINIA
ABINGDON DIVISION

IN RE: EQUIPMENT SERVICES, INC.	) CHAPTER 7
	) CASE NO.
Debtor.	) 98-04851

FINAL REPORT BY CHAPTER 11 DEBTOR-IN-POSSESSION

The debtor, Equipment Services, Inc., by counsel, files as its Final Report of the Debtor-in-Possession upon conversion of the case, the following:

1. Debtor incurred no additional unpaid debts after the commencement of the case.
2. Debtor acquired no new property after the commencement of the case.
3. Debtor entered into no new contracts after the commencement of this case.
4. Debtor has no funds to report in its Chapter 11 account.

Dated: March 31, 1999
EQUIPMENT
SERVICES, INC.

BY:______________________
John M. Lamie

Browning,
Lamie and Sharp, P.C.
Attorneys at Law

Larry G. Browning
John M. Lamie
Gerald F. Sharp
Please reply to the Abingdon Office

John M. Heuser
John J. Gifford
Eric Reese, Paralegal

April 6, 1999

John W.L. Craig, II, Clerk
United States Bankruptcy Court
P.O. Box 2390
Roanoke, VA 24010

RE: Equipment Services, Inc.
98-04851-HPA-7

Dear Mr. Craig:

Enclosed please find a notice of amendment for the above named debtor which I would appreciate your filing along with a check for $20.00 for the filing of same.

This is to certify that I have mailed a true copy of the notice of amendment, proof of claim, and original 341 notice, to all parties in interest.

Thank you for your kind assistance.

Sincerely yours,

John M. Lamie

pma
Enclosure

P.O. Box 850
Grundy, VA 24614
540-935-5240
Fax 540-935-7232

P.O. Box 459
Lebanon, VA 24266
540-889-1182
Fax 540-889-2215

P.O. Box 519
Abingdon, VA 24212
540-628-6165
Fax 540-628-4847

P.O.Box 827
Wytheville, VA 24382
540-228-2119
Fax 540-228-2032

United States Bankruptcy Court
for the Western District of Virginia

IN RE: EQUIPMENT SERVICES, INC.) Chapter 7
) Case No. 98-
Debtor.) 04851-HPA-7

NOTICE OF AMENDMENT TO DEBTOR'S SCHEDULES OF CREDITORS AND/OR MATRIX

Debtor, pursuant to Bankruptcy Rule 1009, hereby gives NOTICE of the names of creditors added to debtor's schedules of creditors and/or mailing matrix as follows:

NAME AND ADDRESS OF CREDITOR	DATE OF DEBTAND SECURITY IF ANY	WHETHER DISPUTED	AMOUNT
Lee and Loretta Dowdy PO Box 1805 Richlands, VA 24641	unsecured business loan	UD	$100,000.00

Dated: 4/5/99

LORETTA DOWDY, PRESIDENT

The above-named debtor(s) certifies under penalty of perjury that the foregoing is true and correct pursuant to 28 U.S.C. Section 1746.

NOTICE IS FURTHER GIVEN that the above-named creditor(s) are hereby given 10 days from the date such notice of amendment to schedules are/or mailing matrix is mailed by debtor to file objections to the granting of the discharge or to determine the non-dischargeability of such debt pursuant to 11 U.S.C. Section 727 and Section 523 and Bankruptcy Rule 7001, *et seq*., and Bankruptcy Rules 2004(a) and 4007(d); and to file a proof of claim herein, if it be so advised, or until the last date fixed by the Notice of the Section 341(a) meeting of creditors, whichever period is longer; and that if a discharge has heretofore been granted, the same shall be deemed set aside for the purposes herein stated and will be deemed reinstated without further notice or order at the expiration of 30 days from this date unless timely objections are filed.

CERTIFICATION

I hereby certify that I have contacted the Bankruptcy Court Clerk's office and the above-styled case has not been closed or I have enclosed herewith a Motion to Re-open and the appropriate filing fees. I further certify that a true copy of the Notice was duly mailed on 4-6-99, to the Court, debtor, trustee, U.S. Trustee, and, if the Section 341(a) creditors' meeting notice has been issued, to the above-named creditors, which notice of amendment to said creditors shall include a copy of the Section 341(a) creditors' meeting notice, proof of claim form, and order of discharge, as applicable.

Signed:_____________
JOHN M. LAMIE

Form B9D (Chapter 7 Corporation/Partnership Asset Case)(9/97)

Case Number 98-04851-HPA-7

UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT VIRGINIA

Notice of Chapter 7 Bankruptcy Case, Meeting of Creditors, & Deadlines

A bankruptcy case concerning the debtor corporation listed below was originally filed under chapter 11 on December 24, 1998 and was converted to a case under chapter 7 on March 16, 1999.

You may be a creditor of the debtor. **This notice lists important deadlines**. You may want to consult an attorney to protect your rights. All documents filed in the case may be inspected at the bankruptcy clerk's office at the address listed below.

NOTE: The staff of the bankruptcy clerk's office cannot give legal advice.

See Reverse Side For Important Explanations

Debtor (name(s) and address):

EQUIPMENT SERVICES, INC.
PO BOX 1805
RICHLANDS, VA 24641

Case Number: 98-04851-HPA-7	Taxpayer ID Nos.: 54-18775533
Attorney for Debtor (name and address): JOHN M. LAMIE, ESQ BROWNING, LAMIE & SHARP, P.C. P.O. BOX 519 ABINGDON, VA 24212-	Bankruptcy Trustee (name and address): ROBERT E. WICK, TR. P.O. DRAWER 8 BRISTOL, VA 24203 Telephone number: (540) 466-4488

0519 Telephone number: (540) 628-6165	466-4488
Meeting of Creditors:	
Date: April 21, 1999 Time: 3:00 P.M. Location: U.S. Bankruptcy Court, U.S. Courthouse, Abingdon, VA 24210	
Deadline to File a Proof of Claim: Proof of Claim must be *received* by the bankruptcy clerk's office by the following deadline: For all creditors (except a governmental unit): July 20, 1999 For a governmental unit: July 20, 1999	
Creditors May Not Take Certain Actions: The filing of the bankruptcy case automatically stays certain collection and other actions against the debtor and the debtor's property. If you attempt to collect a debt or take other action in violation of the Bankruptcy Code, you may be penalized.	
Address of the Bankruptcy Clerk's Office: 210 CHURCH AVE. SW P.O. BOX 2390 ROANOKE, VA 24010 Telephone number: 540-857-2391	**For the Court:** Clerk of the Bankruptcy Court: John W. L. Craig, II
Hours Open: Monday-Friday, 8:00 a.m.-4:30 p.m.	Date: March 17, 1999

Browning,
Lamie and Sharp, P.C.
Attorneys at Law

Larry G. Browning
John M. Lamie
Gerald F. Sharp
Please reply to the Abingdon Office

John M. Heuser
John J. Gifford
Eric Reese, Paralegal

December 17, 1999

John W. L. Craig, II, Clerk
United States Bankruptcy Court
P.O. Box 2390
Roanoke, VA 24010

RE: Equipment Services, Inc.
Chapter 11 Case No. 98-04851-HPA-11

Dear Mr. Craig:

Enclosed please find a certificate of mailing in the above mentioned case which certifies that a true copy of the Order entered on December 16, 1999 was mailed to all parties in interest.

Thank you for your kind assistance in this regard.

Sincerely yours,

John M. Lamie

JML:rg
Enclosure

P.O. Box 850
Grundy, VA 24614
540-935-5240
Fax 540-935-7232

P.O. Box 459
Lebanon, VA 24266
540-889-1182
Fax 540-889-2215

P.O. Box 519
Abingdon, VA 24212
540-628-6165
Fax 540-628-4847

P.O.Box 827
Wytheville, VA 24382
540-228-2119
Fax 540-228-2032

Browning,
Lamie and Sharp, P.C.
Attorneys at Law

Larry G. Browning
John M. Lamie
John M. Heuser

John M. Heuser
John J. Gifford
Scott S. Farthing
Eric Reese, Paralegal

Please respond to the Abingdon Office

January 21, 2000

Robert E. Wick, Trustee
PO Drawer 8
Bristol, VA 24203

RE: Equipment Services, Inc.
Chapter 7 Case No. 98-04851-WSA-7
Equipment Services, Inc. V. LBJ Coal Company, Inc. And Hiope Mining, Inc.
A/P No. 7-99-00035

Dear Bob:

Please find enclosed a copy of the complaint in the above referenced adversary proceeding. Also enclosed is a copy of Bob Copeland's answers and a copy of the order substituting you as plaintiff.

Please let me know if you have any questions for me in this regard.

Sincerely yours,

John M. Lamie

pma
Enclosures

P.O. Box 850
Grundy, VA 24614
540-935-5240
Fax 540-935-7232

P.O. Box 459
Lebanon, VA 24266
540-889-1182
Fax 540-889-2215

P.O. Box 519
Abingdon, VA 24212
540-628-6165
Fax 540-628-4847

P.O.Box 827
Wytheville, VA 24382
540-228-2119
Fax 540-228-2032

ROBERT E. WICK
LAW OFFICES
THE CUMBERLAND-600 CUMBERLAND
BRISTOL, VIRGINIA 24203

MAILING ADDRESS:	TELEPHONE:
POST OFFICE	540-466-4488
DRAWER 8	

January 24, 2000

John M. Lamie, Esquire
P O Box 519
Abingdon, VA 24212

In Re: Equipment Services, Inc.
Chapter 7, 237-98-04851-WSA

Dear John:

Judge Stone ordered the exchange of names of witnesses by January 31, 2000. I would appreciate your providing this information to Bob Copeland, with photocopies to me, at your very early convenience.

Likewise, I would appreciate your forwarding photocopies of all the exhibits to Bob Copeland, with photocopies to me, as this must be tendered to Mr. Copeland by February 4, 2000, pursuant to the enclosed order.

Very truly,

R.E. Wick

REW/cfs

Browning,
Lamie and Sharp, P.C.
Attorneys at Law

Johm M. Lamie	John J. Gifford
Gerald F. Sharp	Scott S. Farthing
John M. Heuser	Eric Reese, Paralegal
Please respond to the Abingdon Office	

March 8, 2000

Robert E. Wick, Trustee
PO Drawer 8
Bristol, VA 24203

RE: Equipment Services, Inc.
Chapter 7 Case No. 98-04851-WSA-7

Dear Bob:

I have talked with Dennis Dowdy concerning the allegation that the mine is flooded with the equipment in it. Mr. Dowdy has heard several “rumors” concerning this. One story is that the mine is flooded but that the equipment had been moved to higher ground in the mine and is safe; second, the mine and equipment are flooded; and third, the equipment was removed from the mine by a back entrance and sold.

I would suggest that Larry Akers be contacted and asked to investigate this situation.

Please let me know how you wish to proceed.

Sincerely yours,

John M. Lamie

PS- Dennis did confirm that men moved the equipment to a higher part of the mine before he shut down.
John

pma
xc: Ms. Loretta Dowdy

P.O. Box 850
Grundy, VA 24614
540-935-5240
Fax 540-935-7232

P.O. Box 459
Lebanon, VA 24266
540-889-1182
Fax 540-889-2215

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540-228-2119
Fax 540-228-2032

Examples Of Valuable Services Provided By Debtors' Counsel

United States Trustee v. Garvey, 195 F.3d 1053, 1060 (CA9 1999): Court remands for determination of appropriate compensation for post-petition services rendered by attorney in Chapter 7 cases. Court explains that "[t]here are several post-petition services commonly performed by the debtor's attorney in Chapter 7 proceedings that are necessary to the administration of the estate. * * * In this case, for example, [the debtor's attorney] filed the conversion petition, prepared schedules, amended reports, a statement of affairs, and a Rule 2015 report, communicated with creditors, and participated in 2004 examinations. Interpreting the ambiguous provision in § 330(a)(1) so as to eliminate the possibility of post-petition compensation for Chapter 7 debtor's attorneys would significantly alter the ability of Chapter 7 debtors to secure counsel in order to perform these services - a fundamental change in bankruptcy law."

In re Tundra Corp., 243 B.R. 575, 581 (Bankr. D. Mass. 2000): In Chapter 11 non-DIP case converted to Chapter 7, court approves fees for debtor's counsel for work on business operations; case administration; fee/employment applications; financing; meeting of creditors; seeking relief from stay proceedings.

In re Crown Oil, Inc., 257 B.R. 531, 543-44 (Bankr. D. Mo. 2000): Court allows fees "for the purpose of alleviating hardship and for allowing reasonable fees likely to benefit the estate at the time the services and expenses were provided." Court notes that attorneys "negotiated a recovery for the estate shortly after the beginning of the case consisting of a ten percent interest in the oil wells from ResourceFund, which Watts described as the single largest asset in the estate. Both Watts and Deschenes provided services in compiling and assembling the Debtor's Schedules and Statements. Deschenes represented the Debtor in the § 341 meetings of creditors in the Chapter 11 case, and after conversion in the

Chapter 7 case. Watts provided the Chapter 7 Trustee with services, records, and information regarding possible preference actions against shareholders."

In re Office Prods. of Am., 136 B.R. 964, 974 (Bankr. W.D. Tex. 1992): Attorney's fees for debtor's counsel in Chapter 7 case upheld for services related to assisting trustee with operation of unusually complex business: "The trustee knew from the beginning that he needed to operate the debtor's stores at least for a short period of time to realize the value of the assets. These operations demanded the assistance of the debtor, including working with the debtor's pre-petition lender, because only the debtor was sufficiently familiar with both legal and operational problems associated with running office products warehouse-style retail outlets located in eastern states over 1500 miles from the situs of the trustee. With inventory to account for, sales tax to take care of, and employee benefits to attend to (including making arrangements for withholding not only for federal income taxes but also state income taxes), there were many special duties imposed on this debtor not normally required of the usual debtor in chapter 7. Any actual, necessary legal services rendered to the debtor relative to its performing these important duties are compensable." Ordinarily, however, chapter 7 debtor's attorney may be compensated only for "assisting the debtor in performing his legal duties" under Bankruptcy Code Section 521 and Bankruptcy Rule 4002.

In re Wash. Mfg. Co., 21 Bankr. Ct. Dec. 1345 (Bankr. M.D. Tenn. 1991): Court concludes that Chapter 11 debtor's counsel is entitled to reasonable compensation for time and expenses in preparing, presenting and defending fee application. *See also Smith v. Edwards & Hale, Ltd.*, 305 F.3d 1078, 1088 (CA9 2002), cert. denied, 71 U.S.L.W. 3721 (2003) ("The preparation of fee applications was necessary for the administration of the case and provided a direct benefit to the estate because those services aided the trustee in determining the allocation of administrative fees.").

In re TS Indus., Inc., 125 B.R. 638 (Bankr. D. Utah 1991): Chapter 11 debtor’s counsel fee application. Court upholds fee requests for general estate administration, work on specific claims against the estate, and services rendered in preparing various business agreements.

In re Colorado-Ute Elec. Ass’n, 132 B.R. 174, 180 (Bankr. D. Colo. 1991): Chapter 11 debtor’s counsel entitled to fees for work in rate cases before the public utilities commission, for representation in a jurisdictional dispute regarding the commission, as well as for representation relating to “general case administration, cash collateral, employee benefits, utilities deposits, the employment of professionals, Craig 3 lease issues, other lease issues, motions for relief from stay, Public Utilities Commission intervention, and the Office of Consumer Counsel intervention.” Court also allows fees for time spent preparing fee application.

In re Stoecker, 114 B.R. 965, 971 (Bankr. N.D. Ill. 1990): Court awards compensation to Chapter 11 debtor’s counsel “for services provided in connection with making court appearances and reviewing, drafting, editing and revising pleadings,” for “time expended reviewing and assembling voluminous documents,” and for time spent resolving discovery issues with trustee’s counsel and creditors’ counsel, since the debtor was “the sole equity holder in the corporate cases and was asserting his Fifth Amendment privilege.”

In re Holden, 101 B.R. 573 (Bankr. N.D. Iowa 1989): “An attorney for the debtor is entitled to compensation for analyzing the debtor's financial condition; rendering advice and assistance to the debtor in determining whether to file a petition in bankruptcy; the actual preparation and filing of the petition, schedules of assets and liabilities, and the statement of affairs; and representing the debtor at the Section 341 meeting of creditors.’” (citations omitted).

In re Wash. Mfg. Co., 101 B.R. 944, 954 (Bankr. M.D. Tenn. 1989): Court upholds fee award to Chapter 11 debtor’s counsel based on time spent “on research, pleadings and memoranda concerning the appointment of a trustee,” as well as for time spent on efforts “to protect the estate's assets in their communications with creditors, both secured and unsecured; in their representation of the debtors in labor negotiations and in a temporary restraining order action filed by the U.S. Department of Labor; and in their representation of the debtors in defense of a manager trainee who was criminally charged and arrested in Kentucky for the debtors' failure to pay pre-petition wages.”

In re Brady, 20 B.R. 936, 955-56 (Bankr. N.D. Ohio 1982): Attorney for debtor in Chapter 7 proceeding entitled to recover legal fees for filing of initial bankruptcy petition. The Court concludes that “the attorney for the debtor is entitled to be paid a legal fee for the initial filing of the petition in bankruptcy out of the assets in this estate.”

Examples Of Judges Scrutinizing Fee Applications

In re Top Grade Sausage, Inc., 227 F.3d 123, 132 (3d Cir. 2000): Chapter 11 debtor's counsel fee application denied. Court finds that "[a]fter a search of the record, we are unable to ascertain any particular action by the debtor's attorney that could not have been done by the Trustee and his staff."

In re Rheam of Indiana, 133 B.R. 325, 334-35 (E.D. Pa. 1991): Fee award to debtor's attorney in Chapter 7 proceeding reduced upon bankruptcy court's determination that legal questions in the case were "extremely simple," and therefore the hourly rate should be reduced to hourly rate for junior associate from hourly rate for senior partner. Fees also denied for appeals that bankruptcy court determined were not "necessary" to represent debtor's estate.

In re Hasset, 283 B.R. 376, 381 (Bankr. E.D.N.Y. 2003): Court denies in part fee application in Chapter 11 case converted to Chapter 7 case when compensation sought for "services that went beyond the typical statutory duties required of a debtor post-conversion."

In re Berg, 268 B.R. 250, 262 (Bankr. D. Mo. 2002): Court disallows fees when counsel should have realized that reorganization was infeasible and thus services did not benefit the estate, but awards some fees when attorneys' "services in compiling and assembling the Debtor's Schedules and Statements may have ultimately aided the Chapter 7 Trustee."

In re Crown Oil, Inc., 257 B.R. 531 (Bankr. D. Mo. 2000): Court disallows fees when counsel should have realized that reorganization was infeasible and had filed false certificate of service with the court.

In re Poseidon Pools of Am., 180 B.R. 718, 732, 736, 739-40 (Bankr. E.D.N.Y. 1995): Court lowers fee amount for Chapter 7 debtor's counsel, concluding that attorney's accounting of time was "woefully deficient in providing that level of information necessary for a meaningful evaluation."

Court also disallows fee award for unnecessary document retrieval. Finally, some services rejected as duplicative.

In re Waxman, 148 B.R. 178 (Bankr. E.D.N.Y. 1992): Chapter 7 proceeding. Court concludes that attorney for Chapter 7 debtor is not entitled to compensation out of bankruptcy estate for services rendered to defend debtor against creditor's objections to discharge and dischargeability of debt.

In re Ginji Corp., 117 B.R. 983, 992 (Bankr. D. Nev. 1990): Using very careful review of application for compensation by Chapter 11 debtor's counsel (debtor out of possession case), court reduces award for "general" and "tangential" research, explaining that in case in which trustee has been appointed, "the correct approach is not to disallow fees but to scrupulously inquire into such services so as to ascertain whether or not they were for the benefit of the estate or for some other interest." Court denies fees for services duplicative of trustee's or other attorneys' efforts.

In re Grabill, 110 B.R. 356 (Bankr. N.D. Ill. 1990): Chapter 7 proceeding converted to Chapter 11 (trustee appointed). Court concludes that debtor's counsel is not entitled to compensation from estate for time spent contesting expansion of trustee's power, to extent that such services were for benefit of prepetition management rather than estate. Court carefully reviews fee application and reduces two categories, while fees are awarded in full in three categories.

In re Holden, 101 B.R. 573, 576 (Bankr. N.D. Iowa 1989): Chapter 7 debtor's counsel fees denied for defending an objection to exemptions or discharge. Court notes that "courts have been fairly restrictive in their interpretation of what benefits the estate."

In re Moss, 90 B.R. 189 (Bankr. D.S.C. 1988): Chapter 7 debtor's counsel fees for time spent contesting Chapter 7 trustee's liquidation of one of debtor's assets benefited debtor, not estate, and thus, are not compensable from estate.

In re Rhoten, 44 B.R. 741 (Bankr. M.D. Tenn. 1984): Chapter 7 debtor’s counsel fees compensation from debtors' estate not allowed for work of protecting debtors' discharge or exemptions.

BRIEF BANK — “SUMMARY SHEET” *Printed Fri.-9/12/3 (8:10)*

WESTLAW CODES

1. (“TI”) ***TITLE*** OF CASE *[E.g., “SMITH v. U.S. TRUSTEE (IN RE SMITH)”]*
John M. Lamie v. United States Trustee

2. (“CO”) ***CURRENT*** COURT *[E.g., “CTA9"]*
The Supreme Court for the United States

3. (“CCN”) ***CURRENT*** CASE NO.
No.: 02-693

4. (“PCN”) ***PRIOR*** CASE NO. & COURT *[IF ANY]*
No.: 1:00-cv-00143
Court: US District Court for the Western District of Virginia
Judge Jones

5. (“SO”) ***SOURCE***
U.S. TRUSTEES

6. (“DA”) ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., “Opening Brief,” “Reply,” “Amicus,” etc.]*
Filed: Sept. 2003
Type: Reply Brief for the Petitioner

7. (“AU”) ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,“UST/OGC”]*
Thomas C. Goldstein & Amy Howe
(UST/OGC: 202-307-1399/FAX-2397)

8. (“TO”) ***TOPIC***
BANKRUPTCY

9. (“SU”) ! ***SUMMARY*** OF KEY ISSUE(s) &
Please see numbers 56 (Brief for the Respondent) and 57 (Brief for the Petitioner)

√ Any Miscellaneous ***BACKGROUND***
√ **Background:**

10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)
D:\MyFiles\BriefBank-Web\Lamie\LamieIIISum.wpd

11. DO YOU RECOMMEND POSTING IN UST BRIEFBANK?
☒ YES ☐ NO
NAME: Steven Eggert
DATE: Thu.-9/11/3 (15:43)

No. 02-693

IN THE

Supreme Court of the United States

John M. Lamie,
Petitioner,
v.
United States Trustee.

On Writ of Certiorari
to the United States Court of Appeals
for the Fourth Circuit

REPLY BRIEF FOR THE PETITIONER

John M. Lamie
BROWNING, LAMIE &
GIFFORD, P.C.
P.O. Box 519
Abingdon, VA 24212

Additional counsel listed on inside cover

Thomas C. Goldstein
(Counsel of Record)
Amy Howe
GOLDSTEIN & HOWE, P.C.
4607 Asbury Pl., NW
Washington, DC 20016
(202) 237-7543

September 10, 2003

Additional counsel:

G. Eric Brunstad, Jr.
P.O. Box 208215
127 Wall St.
New Haven, CT 06520

John A. E. Pottow
Assistant Professor of Law
University of Michigan Law School
625 South State St.
Ann Arbor, MI 48109

Craig Goldblatt
Andrew Currie
WILMER, CUTLER & PICKERING
2445 M St., NW
Washington, DC 20037

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases

Statutes

Other Authorities

Rules

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REPLY BRIEF FOR THE PETITIONER

Petitioner's opening brief demonstrated that 11 U.S.C. 330(a)(1) contains an obvious drafting error with respect to the power of courts to compensate debtors' attorneys. Section 330(a)(1) functions as a series of inextricably intertwined parallel references: "the court may award to a trustee * * * reasonable compensation for actual, necessary services rendered by the trustee"; it may award compensation to "an examiner" for services of the "examiner"; and it may award compensation to "a professional person employed under section 327 or 1103" for services of the "professional person." Section 330(a)(1) also expressly empowers the court to pay reasonable compensation for the services of the debtor's "attorney," but it does not specifically name the attorney as an authorized recipient of the compensation. Congress thus either inadvertently included the attorney in the "providers list" or it inadvertently omitted the attorney from the statute's "payees list."

This case calls on this Court to resolve the ambiguity in Section 330(a)(1) with its standard tools of statutory construction, augmented by the special canons applicable in bankruptcy. This manifestly is *not*, as respondent urges, a case in which one construction or the other can be sustained only on a heightened showing that the statute's literal terms should be ignored as a "scrivener's error." Neither the construction pressed by respondent, nor the contrary view of most courts, permits "[e]nforcing the statute as written." Contra Resp. Br. 6. This Court could adopt respondent's construction only by reading out of Section 330(a)(1) the authority expressly conferred by Congress for bankruptcy courts to pay compensation for the services of the "attorney." Indeed, respondent and the majority below admit that their interpretation renders that central provision "superfluous." *Id.* 16 (quoting Pet. App. 9a). Both parties thus agree that the statute contains a drafting error; the disagreement is what that error is. So neither petitioner nor respondent bears a burden of showing that "Congress unquestionably intended to" adopt its view or "could not have rationally intended" the contrary, for neither position calls for an interpretation that conflicts with the result genuinely compelled by the literal language. Contra Resp. Br. 5, 31.

Respondent's litany of decisions reiterating the uncontroversial proposition that this Court "does not have '*carte blanche*' to redraft statutes" (Resp. Br. 11 (quoting *United States* v. *Locke*, 471 U.S. 84, 95 (1985))) thus does not advance its position. These cases each involve clear, grammatically correct, and internally consistent statutory language. See, *e.g.*, *Iselin* v. *United States*, 270 U.S. 245, 250 (1926) (noting statute was "evidently drawn with care"); *United States* v. *Ron Pair Enters., Inc.*, 489 U.S. 235, 240-41 (1989) (citing "coherent and consistent" statutory scheme and "precision" of language and grammar). In contrast, where coherence and consistency are lacking, and where the text of one provision in isolation is ambiguous, this Court looks to the structure of the statute as a whole as well as to other evidence of legislative intent. See, *e.g.*, *Chickasaw Nation* v. *United States*, 534 U.S. 84, 90 (2001) (concluding, in light of an internal inconsistency in a statute, that Congress must have made a drafting mistake, and resolving that mistake); *Hartford Underwriters Ins.* v. *Union Planters Bank, N.A.*, 530 U.S. 1, 6-8 (2000) (looking to "contextual features" of the Bankruptcy Code as well as "pre-Code practice and policy considerations"); *United States* v. *Granderson*, 511 U.S. 39, 44-53 (1994) (considering internal consistency within statute, stated legislative purpose, legislative history, and policy concerns).[1]

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[1] Even in a traditional "scrivener's error" case – *i.e.*, a case in which the Court must choose between a literal reading of the text and a departure from it, rather than (as in this case) between two alternate means of resolving an inconsistency in the text – this Court will not impose a special, dramatically heightened standard to justify the departure, but rather will "look to the provisions of the whole law, and to its object and policy," to determine Congress's intent. *United States Nat'l Bank* v. *Independent Insurance Agents of America, Inc.*, 508 U.S. 439, 545-55 (1993) (citation omitted). Although in *National Bank* the Court noted that "overwhelming evidence" supported its view, it did not suggest that such evidence was required. *Id.* at 462. Contra. Resp. Br. 12.

As petitioner now shows, his reading is supported by each relevant tool of statutory construction. Further, there is no merit to respondent's contention that the omission of the word "attorney" from the payees list in the 1994 amendment to Section 330(a) was purposeful because it furthers supposed policy goals.

I. The Inherent Ambiguity In Section 330(a), As Amended In 1994, Is Properly Resolved By Concluding That Congress Did Not Intend To Revoke The Century-Old Authority Of Courts To Compensate Counsel For Services Necessary And Beneficial To The Estate.

The interpretative question before the Court is straightforward: who has the better reading of Section 330(a)(1)? The answer is plain; indeed, it is not seriously disputed. Stripped of its contention that petitioner must show that the Fourth Circuit's reading is "absurd," respondent does not genuinely contend that its is the superior interpretation.

1. As petitioner's opening brief detailed, Congress carefully considered and expressly addressed the authority of bankruptcy courts to compensate counsel in the Bankruptcy Act of 1898 and the Bankruptcy Code of 1978. Acting specifically to overturn cases reading this Court's General Order 30 to forbid compensation (see Pet. Br. 39 & n.9), Congress in the 1898 Act authorized compensation from estate funds in all forms of bankruptcy for services "rendered in aid of the administration of the estate and the carrying out of the provisions of the Act" (*Conrad, Rubin & Lesser* v. *Pender*, 289 U.S. 472, 476 (1933)). When federal bankruptcy law was thoroughly revised in 1978, there was no serious suggestion in Congress that this power should be repealed; to the contrary, Section 330(a) was adopted to authorize compensation more broadly. Pet. Br. 41-42.

Under the 1898 Act, courts awarded limited fees based on a principle of "severe economy * * * so as to reduce to the lowest minimum the costs of administration." *In re Lang*, 127 F. 755, 757 (W.D. Tex. 1904) (internal citation omitted). In enacting Section 330 in 1978, by contrast, Congress determined that, although fees "should be closely examined by the court," "[n]otions of economy of the estate in fixing fees are outdated and have no place in [the] bankruptcy code." 124 Cong. Rec. H11,089 (daily ed. Sept. 28, 1978) (definitive joint statement of floor managers, per Rep. Edwards), *reprinted in* 1978 U.S. Code Cong. & Admin. News 6436, 6442.

Respondent does not contest this history. See Br. 32-33. And although respondent contends that *petitioner* cannot show a pellucid intention by Congress to retain the right to compensate counsel (see *infra* at 5-10), respondent does not argue that there is a clear statement in the text or legislative record of an intent to deviate from past practice. Those concessions are essentially dispositive of the question presented, for respondent's position would clearly work "a fundamental change in the law" that would be "inconsistent with current case law." 3 Collier on Bankruptcy ¶ 330.LH[5] (15th ed. 2002). Indeed, the essence of respondent's textual argument is that the 1994 Act represented a substantial change from prior practice that Congress could not have overlooked. However, this Court "will not read the Bankruptcy Code to erode past bankruptcy practice absent a clear indication that Congress intended such a departure." *Pa. Dep't of Pub. Welfare* v. *Davenport*, 495 U.S. 552, 563 (1990). If not in text, there must be "at least some discussion in the legislative history." *Dewsnup* v. *Timm*, 502 U.S. 410, 419 (1992). Congress adopted the 1994 Act against the backdrop of that settled canon.

Respondent only reinforces the point. It contends that the plain statement canon would apply only if the terms of Section 330(a)(1) "were unclear on their face or to resolve issues not explicitly addressed by the text." Br. 32-33. Respondent reiterates that its sole contention is that "Section 330(a)(1) is plain on its face in removing the statutory basis for awarding counsel fees to chapter 7 debtors' attorneys." *Id.* 33. But as petitioner has shown – and respondent concedes in admitting that its reading renders "superfluous" the courts' statutory authority to pay compensation for the services of the "attorney" (*id.* 16) – the text is ambiguous, not plain. Because there is no clear statement by Congress in the text or the legislative history of an intent to depart from nearly a century of settled bankruptcy practice in the 1994 amendment (see *infra* at 5-10), Section 330(a)(1) is properly understood to maintain the authority to compensate the debtor's counsel from the assets of the estate.

2. Respondent fails to undermine petitioner's showing that his construction is more faithful to the statutory text. Respondent, like the majority below, principally reasons not from the text of Section 330(a)(1) as currently enacted, but from the contrast between that text and the 1978 version's explicit reference to the debtor's counsel in the payees list. Respondent contends that "[t]he omission is the most direct and obvious means" of limiting the compensation paid for the services provided by debtors' counsel. Resp. Br. 5.

That simply is not so. The "direct" and "obvious" approach would have been to amend not just one isolated reference to the attorney's right to compensation, but all of the provisions relating to that authority (including Section 330(a)'s providers list, 11 U.S.C. 331, and 28 U.S.C. 586(a)(3)(A)), without simultaneously enacting other provisions that necessarily presume the availability of fees for attorneys (11 U.S.C. 330(a)(4)(B)) and that govern the award of those fees (*id.* § 330(a)(4)(A)). Further, as between the payees list and the providers list, if Congress actually intended to eliminate or limit the availability of compensation, it would have amended the latter. But it did not, instead leaving unaltered the court's explicit authority in the providers list to pay "reasonable compensation for actual, necessary services rendered by *the* * * * *attorney*." 11 U.S.C. 330(a)(1) (emphasis added). Congress in 1994 merely omitted a provision that addresses the ministerial act of turning the compensation over to the attorney.

Although Section 330(a) is inartfully phrased on any reading, at least petitioner's interpretation gives meaning to each of its terms. Respondent's contention that petitioner would read additional terms into the statute is incorrect. As just noted, Congress retained in the providers list the power to award compensation for the attorney's services. The 1994 omission of the attorney in the provision addressing the act of transmitting otherwise-authorized compensation is a relatively minor error that would ordinarily be overlooked as unremarkable. In any event, as petitioner's opening brief explained, compensation is separately authorized by Section 503 of the Bankruptcy Code, which broadly authorizes "payment of administrative expenses to the extent they represent 'the actual, necessary costs and expenses of preserving the estate.'" Pet. Br. 18 (quoting 11 U.S.C. 503). Respondent's brief ignores this font of authority.

3. Petitioner's reading similarly best makes sense of both the statutory structure and its object. Respondent's position is supported, at best, by the omission from the payees list "in isolation," whereas petitioner's reading prevails because it is most consistent with the "statute[] as a whole" (*United States* v. *Morton*, 467 U.S. 822, 828 (1984)), particularly given that construction of the Bankruptcy Code is a uniquely "holistic endeavor" (*United Sav. Ass'n* v. *Timbers of Inwood Forest Assocs.*, 484 U.S. 365, 371 (1988)). The 1994 amendment to Section 330(a) added provisions that contemplate the continued availability of attorney's fees under Section 330(a)(1). Congress enacted procedures for the court to reduce fee awards on the basis of objections by third parties (Section 330(a)(2)), specific standards for evaluating fee applications (330(a)(3)), threshold requirements for receiving fees (330(a)(4)), and offsetting rules to account for "interim compensation" already awarded (330(a)(5)).[2] Petitioner reads these provisions, as Congress intended them, to govern fee awards to the debtor's attorney under Section 330(a)(1). Congress sought to ensure judicial

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[2] Respondent correctly notes that, on its reading, a "debtor's attorney" in Chapters 12 and 13 is *literally* eligible for interim compensation as required by Sections 330(a)(5) and 331. Br. 22. But because Chapter 12 and 13 reorganizations generally involve "relatively standardized services" (*In re Kimber*, No. 00-14333, 2001 Bankr. LEXIS 1506, at *7 (Bankr. D. Colo. Sept. 7, 2001)) paid for with "flat fees" (*In re Pineloch Enters.*, 192 B.R. 675, 678 (Bankr. E.D.N.C. 1996)), there is no *practical* reason Congress would have enacted a provision that contemplates the use of interim compensation for just those cases. See, *e.g.*, *In re Campbell*, 259 B.R. 615, 620 n.3 (Bankr. N.D. Ohio 2001) ("the flat fee of $750 is an amount that many Chapter 13 counsel charge a debtor for handling a routine Chapter 13 case").

scrutiny of fee awards (see, *e.g.*, 140 Cong. Rec. S14,597 (daily ed. Oct. 7, 1994) (Sen. Metzenbaum)) – scrutiny that would be impossible if those fees were eliminated.

Petitioner's position is specifically supported by Congress's 1994 enactment of Sections 330(a)(4)(A) and (B). The former permits the award of fees only for services "necessary to the administration of the case" or "likely to benefit the *estate*" (emphasis added). The latter provides that fees may be awarded to an individual debtor's counsel in cases under Chapters 12 or 13 for "representing the interests of the *debtor*" (emphasis added). Petitioner contends that subsection (a)(4)(A) announces a general rule limiting the availability of fees for, *inter alios*, debtors' attorneys, and that subsection (a)(4)(B) creates a special exception to that general rule which expands the availability of fees under Chapters 12 and 13. By contrast, respondent contends that subsection (a)(4)(A) does not apply to fee awards to the "debtor's attorney" for services benefiting the estate (which it says are not permitted), and that subsection (a)(4)(B) permits limited fees in Chapter 12 and 13 cases. The disagreement matters because if petitioner is correct that the 1994 Act codifies a general rule providing for the availability of attorney's fees in subsection (a)(4)(A), Congress could not have intended to eliminate those very fees in the same statute. Petitioner's reading is superior for several reasons.

First, the text plainly states that subsection (a)(4)(B) is an exception that expands the availability of fees that could otherwise be awarded in Chapter 12 and 13 cases. The limitations on fees in Section 330(a)(4)(A) constitute a general rule applicable to all fees "*[e]xcept* as provided in subparagraph (B)" (emphasis added). Only petitioner's reading treats the provisions of subsection (a)(4)(B) as such an "exception" to the general rule of subsection (a)(4)(A).

Second, Congress could not logically have intended, as respondent supposes, that counsel for Chapter 12 and 13 debtors would be eligible for compensation for services that benefit the "debtor" but *not* for services that benefit only the debtor's "estate." Respondent does not dispute that the *sine qua non* of the availability of fees in bankruptcy has always been benefit to the estate. See Pet. Br. 24. But under respondent's novel reading, a Chapter 12 or 13 debtor's counsel is inexplicably ineligible for attorney's fees for services that benefit only the estate – for example, those that provide creditors with information regarding the availability of assets to satisfy their claims.

Third, on respondent's view, attorney's fees in Chapter 12 and 13 cases would implausibly not be subject to Section 330(a)(1). Section 330(a)(1) incorporates Section 329, which permits the court to terminate or modify fee agreements. Section 330(a)(1) grants the U.S. Trustee and other parties the right to object to fee applications. And Section 330(a)(1), unlike Section 330(a)(4)(B), confers the right to reimbursement for expenses. Congress could not have intended that each of these provisions would apply to *every* type of fee application in bankruptcy *except* attorney's fee applications filed by individual Chapter 12 and 13 debtors.

Finally, there is no merit to respondent's *expressio unius* argument (Br. 18) that Congress's failure to list Chapter 7 debtors' counsel in subsection (a)(4)(B) implies an intent to eliminate the availability of attorney's fees in such cases. That Congress authorized additional compensation in some Chapter 12 and 13 cases for services that benefit the "debtor" does not suggest a corresponding intention to abandon – and is in fact logically unrelated to – the general authority to pay compensation for services benefiting the "estate."

4. Respondent could, at least conceivably, rescue its reading of the 1994 amendment if it could establish that Congress gave genuine consideration to deleting the courts' longstanding authority to pay counsel. By showing that the omission of the attorney from the payees list was purposeful, respondent arguably could explain Congress's failure to delete the parallel reference in the providers list as an inadvertent oversight in pursuit of this deliberate goal. (Yet it would remain doubtful that Congress would have intended to eliminate the availability of attorney's fees when the 1994 amendment's obvious overriding object was enhancing judicial scrutiny of fees rather than forbidding those fees outright.) The legislative

record, however, makes clear that Congress omitted the "attorney" from the payees list accidentally.

As discussed in the leading bankruptcy treatise, the omission occurred as a result of a final change to a "last minute addition * * * to the 1994 Act." 3 Collier ¶ 330.LH[5], at 330-75. The revision to Section 330(a) occurred on the final day the 1994 Act was considered, along with numerous amendments, by the Senate (April 21, 1994). Five months later, the bill was introduced in the House and passed the next day (October 5, 1994). In only one day (October 6, 1994), it was returned to, and passed by, the Senate. Respondent's emphatic claims that Section 330(a) was pending for "*over five additional months*" before enactment (Br. 27 (emphasis in original)) and was the subject of "over a year of deliberations" (*id.* 29) are thus misleading. The "five months" was a period in which the bill was not pending in either chamber. The "year" refers to the seven-month stretch before the relevant amendment was made to Section 330(a) and the five-month period in which neither the House nor the Senate had the bill before it.

It is also obvious how the inadvertent omission occurred. The reference to the debtor's attorney in the payees list was dropped when the succeeding clause was deleted and then reinserted in another place. The drafter simply struck out too much text, a conclusion reinforced by the fact that the deletion extended to the necessary conjunction "or." See Pet. Br. 25-30. As respondent itself points out, that subsequent clause and the amendment as a whole involved the review of fee applications by the U.S. Trustee, which is "an entirely different subject matter" from the courts' authority to award fees. Br. 30; see also 3 Collier ¶ 330.LH[5], at 330-73; Norton Bankruptcy Law and Practice § 26:5, at 206 (2d ed. 1997 Supp.). Although respondent asserts that "[i]t is exceedingly unlikely that the statute's drafters * * * failed to notice" the omission (Br. 30), the last-minute nature of the change makes it not unlikely at all, as *even respondent* implicitly acknowledges in arguing that Congress inadvertently overlooked its "fail[ure] to make corresponding changes" in the providers list (*id.* 15). Indeed, petitioner's opening brief demonstrated, and respondent does not contest, that the 1994 amendments introduced numerous other obviously inadvertent errors into the Code. Pet. Br. 27 n.5.

The sequence of the amendment's transformation from a last-minute cut-and-paste job to federal law indicates that this is no more than an instance in which a reorganization caused a statutory reference to be "lost in the shuffle" (*United States* v. *Wilson*, 503 U.S. 329, 336 (1992)), a fact that this Court can and will recognize without some specially persuasive showing that Congress made a scrivener's error (*id.*). Here, as in *Wilson*, "Congress entirely rewrote [the statute] when it changed it to its present form": "It rearranged its clauses, rephrased its central idea * * *, and more than doubled its length." *Id.* Indeed, there is even more reason to recognize that the omission was inadvertent here than there was in *Wilson*, because here the Court can determine "what happened to the [missing] reference" (*id.*): the drafter inadvertently omitted the "attorney" in an entirely unrelated, "last-minute change" (3 Collier ¶ 330.LH[5], at 330-75) to the adjoining clause in the statute. Cf. *Fulman* v. *United States*, 434 U.S. 528, 539 (1978) ("we will not read legislation to abandon previously prevailing law when, as here, a recodification of law is incomplete or departs substantially and without explanation from prior law").[3]

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[3] Respondent's repeated emphasis that the omission was noted without objection in the House does not support its view that Congress acted purposefully. The cited reference is buried in a single sentence of written testimony for a House hearing that appears in a 718-page hearing record. *Bankruptcy Reform: Hrg. on H.R. 5116 Before the Subcomm. On the Economy and Comm. Law of the House Comm. On the Judiciary*, 103d Cong., 2d Sess. 551 (1994). Respondent's contention that the point was made by the National Association of Consumer Bankruptcy Attorneys (NACBA), which respondent contends is the nation's most expert organization on these questions (Br. 27-28, 32), is genuinely strange. Respondent has either forgotten or decided to ignore that NACBA filed a brief *in this very case* explaining that the Fourth Circuit's refusal to recognize that the omission of "the debtor's attorney" was an inadvertent error that if not recognized as such would have a "pernicious real world effect" on the orderly

II. Respondent's Contradictory Policy Arguments Do Not Call For A Different Result.

Although respondent advances policy arguments that it contends support its position, the fact that those arguments are mutually inconsistent and unsupported by the legislative record demonstrates that respondent's position is at best a *post hoc* rationalization and not an accurate reflection of Congress's intent. That conclusion is reinforced by the undisputed fact that Congress expressly considered and rejected these very policy arguments in enacting Section 330(a) in 1978. On the one hand, respondent hypothesizes that Congress "rationally could have determined" (Br. 6) to eliminate the availability of fees for debtors' attorneys under Section 330(a)(1) in order to prevent attorneys from "siphoning off" estate assets in Chapter 7 cases or as leverage to discourage debtors from pursuing relief under Chapter 7 rather than Chapters 12 and 13. On the other hand, respondent takes the opposite position that such a policy choice would be essentially meaningless because attorneys will still be paid under the Code from the assets of the estate, including in Chapter 7, because (*inter alia*) they may be hired by the trustee.

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administration of bankruptcy proceedings. See NACBA Cert. *Amicus* Br. 6. (NACBA's position was stated sufficiently clearly at the cert. stage that it was unnecessary to file a duplicative merits *amicus* brief.) Although respondent contends that NACBA did not oppose the 1994 amendments because it believed the change was not problematic, NACBA's statement makes clear (as does its brief in this case) that the organization believed Congress or the courts would ignore the omission as "inadvertent." *Hrg. on H.R. 5116*, *supra*, at 551.

Respondent's invocation of "subsequent" legislative history is flawed for the reasons set out in petitioner's opening brief, which respondent ignores. The bills that would have corrected the omission of "attorney" contained numerous other provisions that could have caused them not to pass. And given that most courts have deemed the omission unintentional, it is not surprising that Congress found it unnecessary to intervene. See Pet. Br. 30.

If Congress had concluded that any of these were genuinely "[s]ubstantial policy reasons" for the 1994 amendment (Resp. Br. 35), it would have pursued them coherently, and those reasons would have been acknowledged *somewhere* in the legislative history, whether by a legislator, by respondent in its own comments on the Act, or by at least a witness. But the entire history of the Act contains not a single instance in which anyone made those arguments, or even expressed more general concern regarding the longstanding availability of Chapter 7 attorney's fees. That silence is deafening here, for respondent is asking this Court to read the last-minute omission of one reference to the "attorney" in Section 330(a)(1) as embodying a significant change in bankruptcy policy that Congress consistently rejected for nearly a century. See *supra* at 3-4.

Further, respondent's claim that it is presenting an "experience[d] and considered view" on these policy matters (Br. 38) – like its quotation of its own public relations materials stating that it "acts in the public interest" (Br. 1 (quoting http://www.usdoj.gov/ust/mission.htm)) – rings hollow. Neither prior to nor in the course of the 1994 revision to Section 330(a)(1) did respondent suggest the change in the availability of fees that it now reads into the statute.

Rather, respondent's position is openly directed at arrogating to itself authority that trustees were *not* granted by Congress. The 1994 amendments to Section 330(a) conferred on the U.S. Trustee the right to review and comment on fee applications, including those submitted by debtors' attorneys. See 11 U.S.C. 330(a)(1), (2). But respondent would convert the amendment into the much broader authority – which the U.S. Trustee has never possessed – to control which attorneys are retained in the first instance. It thus contends that attorneys in Chapter 7 cases may be paid from estate funds *only if hired by the trustee*. See Resp. Br. 6-7. All the available evidence refutes the suggestion that Congress intended such a sweeping expansion of trustees' powers.[4]

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[4] Respondent's assertion that it is not the *courts* but "the United States Trustees[] who are charged with supervising the

As petitioner now shows, in the 1994 amendments, Congress was not pursuing the policies suggested by respondent.

1. Respondent opines that the 1994 omission of "debtor's attorney" may have been intended to preserve the assets of the estate because "under petitioner's interpretation" debtors supposedly would "siphon funds from the estate to pay the debtor's attorney" (Br. 37 n.10) and "divert[]" those funds from creditors (*id.* 6). The legislative history on which respondent relies, however, undermines its claim. Although the sponsor of the 1994 amendment (Senator Metzenbaum) expressed concern over excessive attorney's fees being awarded in large corporate reorganizations (140 Cong. Rec. at S14,597), those cases are overwhelmingly Chapter 11 "debtor in possession" proceedings, which is the lone category of cases that respondent contends was *unaffected* by the 1994 amendment. Indeed, the prototypical example cited by Senator Metzenbaum was the Chapter 11 reorganization of Colt Manufacturing. See *id.* (citing Laurence Zuckerman, *Judgment Day for a Legal Powerhouse*, N.Y. Times, Sept. 25, 1994, at C2). Further, respondent quotes Senator Metzenbaum's statement that he was "particularly pleased that [his] proposal relating to professional fees [was] included in the act" (Br. 31), but omits that the proposal was (as the *next sentence* of the Senator's statement explains) not the elimination of fees in any cases but the enactment "in clear and concise terms [of] those factors that must be considered when

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administration of bankruptcy cases" (Resp. Br. 7) is contradicted by the very statute respondent cites. The "supervis[ory]" authority of the U.S. Trustees that respondent invokes with respect to attorney's fees does not include acting on fee requests (that is the court's responsibility (see 11 U.S.C. 330(a)) but instead is limited to "reviewing * * * applications filed for compensation and reimbursement under section 330" and "filing with the court" any "comments [or] objections to such application[s]" (28 U.S.C. 586(a)(3)(A)). This responsibility applies "in cases *under chapter 7*, 11, 12 or 13." *Id.* (emphasis added). But respondent reads Section 330(a) to forbid Chapter 7 debtors from submitting attorney's fee applications.

deciding the appropriateness of the fee request" (140 Cong. Rec. at S14,597).

As an entirely separate matter, respondent's argument rests on an important misstatement of basic bankruptcy law. The 1978 Act specifically rejected the view that attorney's fees waste estate assets. See *supra* at 3-4. Congress in the 1994 Act then adopted Senator Metzenbaum's proposal to codify the rule that courts may approve fees for services "likely to benefit the debtor's estate" or "necessary to the administration of the case." 11 U.S.C. 330(a)(4)(A). See generally 3 Collier ¶ 330.03[3], at 330-25. Respondent inexplicably ignores not only this central provision but also the many cases demonstrating that courts rigorously scrutinize fee applications. See Pet. Br. App. 33a-35a. If a fee application involves an actual "diver[sion]" of funds that should be paid to creditors, it will be denied.

Further, on respondent's reading, Chapter 7 attorney's fees will *still* be paid from the assets of the estate, albeit in a way Congress could not have intended. Respondent contends that attorneys will be retained by the trustee and/or will receive a pre-petition retainer from the debtor. Br. 36-37. The funds to pay an attorney hired by the trustee are paid from the estate under Section 330(a)(1). Similarly, the funds for a pre-petition retainer would otherwise form part of the estate. 11 U.S.C. 541(a)(1). By encouraging the use of such retainers, respondent's position perversely reduces the court's authority to scrutinize payments to attorneys. See Pet. Br. 35-36 (explaining that pre-petition retainers are subject to less rigorous review under Section 329(b) than are fees under Section 330(a)). This case – in which the bankruptcy and district courts agreed that the retainer petitioner was paid by his client was "reasonable" without scrutinizing the services petitioner provided – is a perfect example.

In any event, respondent's reading of the 1994 amendment to Section 330(a) would not reduce the availability of fees only under Chapter 7. It would more broadly eliminate the authority to pay debtors' counsel for services necessary and beneficial to the estate in most bankruptcies: those under Chapters 7, 12, and 13, as well as under Chapter 11 if the debtor is "out of possession." Respondent repeatedly mischaracterizes the issue as implicating Chapter 7 alone, acknowledging only at the end of its brief that it reads the 1994 amendment as eliminating the power to pay such fees not merely "in chapter 7 cases" but also in "chapter 11 cases where a trustee has been appointed." Br. 35. Even this statement omits that courts would have no authority to pay fees either (i) to counsel for individual Chapter 12 and 13 debtors for services that benefit the estate but not the debtor or (ii) in any cases involving Chapter 12 business debtors. See 11 U.S.C. 330(a)(4)(B).

2. Nor does respondent have a persuasive explanation for why Congress in 1994 would have intended to eliminate the availability of attorney's fees in many Chapter 7 cases while simultaneously expanding the availability of fees under Chapters 12 and 13. Throughout the history of federal bankruptcy law, the authority to award fees has applied uniformly to all forms of bankruptcy, and there is no substantial reason Congress would have intended for the first time to, *sub silentio*, draw the distinction hypothesized by respondent.

Respondent contends that in cases under Chapters 12 and 13, as well as when a Chapter 11 debtor is "in possession," the debtors "pursue along with creditors the common goal of crafting a repayment plan to pay creditors from an estate that includes post-petition assets and income." Br. 35. By contrast, under Chapter 7, the estate is administered by a trustee and involves liquidation rather than repayment. *Id.* 36. But respondent has done no more than identify commonalities and distinctions among some kinds of bankruptcy. Innumerable other lines could be drawn. For example, Chapter 7 and 11 cases involve larger estates while Chapters 12 and 13 are subject to defined income limits. Chapters 7, 11, and 12 involve businesses and therefore more complex reorganizations, while cases under Chapter 13 only involve individuals. But none of these comparisons, including those made by respondent, relates to whether Congress intended fees to be paid from the estate.

Respondent's argument that "Chapter 7 is a zero-sum game in which any funds diverted from the estate to pay attorneys reduce the amount of funds available to pay creditors" (Br. 6) misapprehends how Chapter 7 operates. Neither the claims against the estate nor the assets of the estate are finally established at the point a bankruptcy petition is filed. Rather, the debtor and the trustee often work to reduce the claims against the estate and maximize the value of the assets. Debtor's counsel assists the trustee in pursuing adversary proceedings that will generate funds for the estate, including avoiding "preferences" to increase the size of the estate for creditors (see, *e.g.*, 11 U.S.C. 547-550), cooperates with the trustee examining proofs of claim filed against the estate (see Bankr. R. 4002(4)), and takes steps to ensure that the bankruptcy process operates smoothly (such as providing information to the affected parties) to ensure that the estate's funds are properly distributed to creditors (see 11 U.S.C. 521).

3. Respondent alternatively emphasizes that one goal of the 1994 amendments to Section 330(a) was to encourage individual debtors eligible for treatment under Chapters 12 and 13 to reorganize under those provisions. Br. 26-27. That fact is no help to respondent because that objective was pursued through the enactment of Section 330(a)(4)(B), not any change to Section 330(a)(1). See *supra* at 6-9. Respondent imagines that Congress might have omitted the prior authorization to pay debtors' counsel from subsection (a)(1) as the "stick" to accompany the "carrot" of newly enacted subsection (a)(4)(B), hypothesizing that "Congress rationally could have sought to * * * encourage the use of chapter 13 by precluding debtors' attorneys from seeking compensation from chapter 7 estates." Br. 26-27. Respondent offers only one piece of support for this unusual theory, in which Congress begrudges compensation for services that are "necessary" or "beneficial" to the estate. It is Senator Heflin's statement that his amendment to Section 330(a) would encourage Chapter 13 filings. Br. 24-25 (quoting 140 Cong. Rec. S4507 (daily ed. Apr. 20, 1994)). But respondent concedes that this statement was made "before the phrase 'or the debtor's attorney' was deleted from the bill" (*id.* 24), as it refers instead to the provision that became subsection (a)(4)(B).

Further, only petitioner's construction is consistent with Congress's goal of encouraging resort to Chapters 12 and 13.

Under any reading, Section 330(a)(4)(B) provides that *individual* Chapter 12 and 13 debtors may compensate their counsel for services that benefit the *debtor*. But respondent's reading prohibits attorney's fees in Chapters 12 and 13 in important circumstances, and it is therefore less likely to encourage use of Chapters 12 and 13. Only petitioner's reading permits *business* Chapter 12 filers to pay fees and furthermore permits debtors to compensate their counsel for services that benefit only the debtor's *estate*.

Respondent would also read the statute as a blunderbuss that is inconsistent with the statute's supposed purpose of encouraging individual debtors to pursue relief under Chapters 12 and 13. Chapters 12 and 13 are limited to, respectively, "family farmers with regular annual income" (11 U.S.C. 109(f)) and "individuals with regular income" but certain maximum debts (*id.* § 109(e)). Of *particular* importance, the great majority of the approximately 40,000 Chapter 7 filings that respondent contends involve ongoing attorney's fees under Section 330(a)(1) are likely to be more complicated business liquidations *ineligible* for treatment under Chapters 12 and 13. It is no coincidence that the 40,000 figure is roughly comparable to the annual average of approximately 34,500 Chapter 7 bankruptcy filings by businesses. See http://www.uscourts.gov/judicialfactsfigures/table5.2.htm. This case perfectly illustrates the misfit between the elimination of the availability of fees under Section 330(a)(1) and the goal of encouraging resort to Chapters 12 or 13. Because petitioner's client is a company, neither Chapter 12 nor Chapter 13 was ever an option.

At bottom, respondent ignores the many respects in which its interpretation does not fit with the statutory goals it imagines Congress might have been pursuing. Just a few examples demonstrate the point. If Congress had actually concluded that fees are merited in Chapter 12 and 13 cases (Br. 35), why would it have eliminated them for services that benefit the estate (as opposed to the debtor) in such cases or for all services in Chapter 12 business cases? If Congress had actually intended to draw a distinction based on whether creditors would be paid from post-petition assets (*id.* 35), why would it have eliminated fees in Chapter 11 cases in which the debtor is out of possession? And if Congress had actually concluded that it was sufficient that individual debtors under Chapter 7 and debtors generally under Chapter 11 could pay their attorneys from pre- or post-petition assets (*id.* 37 & n.10), why would it have not applied the same approach in all forms of bankruptcy?

4. Petitioner's opening brief collected not "apocryphal allegations" (contra Resp. Br. 33) but an array of authorities – including the leading bankruptcy treatise and the judges in this very case – recognizing that respondent's construction will have genuine adverse consequences for bankruptcy administration. See Pet. Br. 31-34. Respondent's reading produces a "very powerful disincentive * * * to attorneys to accept Chapter 7 cases in the first place, or to provide anything beyond the most perfunctory required post-petition services." Pet. App. 42a.

The limited data collected by respondent does not undermine that showing. Respondent acknowledges that its position would prohibit the payment of fees from the estate in the approximately 40,000 Chapter 7 cases each year in which the estate has assets (Br. 38), which is a significant number. Moreover, these are precisely the cases – those in which the bankruptcy will actually be *litigated* rather than a simple liquidation – in which the presence of counsel is most important to bankruptcy administration.

Although respondent characterizes the duties of a debtor as "very limited" (Br. 40), it cites an array of responsibilities, many of which can be performed only with the assistance of counsel. Respondent acknowledges the obligations to attend a creditors meeting and to be prepared to answer questions regarding the assets and liabilities of the estate (11 U.S.C. 341); file a list of creditors and schedule of assets and liabilities (*id.* § 521(1)); file a statement regarding secured assets (*id.* § 521(2)); cooperate in the execution of the trustee's duties (*id.* § 521(3)); surrender relevant books and records (*id.* § 521(4)); appear at any discharge hearings (*id.* § 521(5)); cooperate in examining proofs of claim and identify real property (Bankr. R. 4002); and identify exempt property (*id.* R. 4003). Petitioner's opening brief also collected an array of case law, which respondent ignores, demonstrating the many services performed by debtor's counsel, including in Chapter 7 cases, as in *United States Trustee* v. *Garvey*, 195 F.3d 1053, 1060 (CA9 1999), in which the debtor's attorney "filed the conversion petition, prepared schedules, amended reports, a statement of affairs, and a Rule 2015 report, communicated with creditors, and participated in 2004 examinations." The court accordingly recognized that "[i]nterpreting the ambiguous provision in § 330(a)(1) so as to eliminate the possibility of post-petition compensation for Chapter 7 debtor's attorneys would significantly alter the ability of Chapter 7 debtors to secure counsel in order to perform these services – a fundamental change in bankruptcy law." See generally Pet. Br. App. 29a-32a. The notion that an individual could undertake these tasks without a lawyer, much less that an officer of a corporation could do so in a complex bankruptcy proceeding, is not even a serious argument. Importantly, these are duties of the *debtor* that cannot be performed by an attorney retained by the trustee to represent the *estate*.

This very case is a perfect illustration. Respondent cannot, and does not, contest that the debtor in this case – a small mine-services company – would have been completely incapable of undertaking the responsibilities performed by petitioner, as required by the Code. See Pet. Br. 5-7, 30. Respondent does argue that *some* of these tasks "should have been performed by the trustee or counsel retained by the trustee." Br. 41. Many others, however, indisputably were the responsibility of the debtor's counsel. Further, respondent's view would produce a substantially less efficient bankruptcy system. Petitioner, as the attorney with the relationship with the debtor and the knowledge of the case, was best positioned to promptly resolve issues relating to the status of the estate. That is no doubt why both the judge and the trustee turned to him. Nor does anything in the Code preclude the debtor's counsel from undertaking such tasks, as even respondent implicitly acknowledges in arguing (Br. 37) that debtor's counsel can be paid for post-petition services through a pre-petition retainer or post-bankruptcy assets. And requiring the trustee regularly to secure judicial approval to hire the debtor's counsel would be a profound waste of resources.

Thus, although respondent quotes Judge Thomas's statement that "[i]n many Chapter 7 cases, there is little for the debtor's attorney to do after the petition is filed" (Br. 40 (quoting *In re Century Cleaning Servs.*, 195 F.3d 1053, 1064 (CA9 1999) (dissenting opinion))), it omits his *conclusion* that the distinction between classes of debtors drawn by respondent "makes no sense" (*id.* (quoting *In re Ames Dep't Stores*, 76 F.3d 66, 782 (CA2 1996))) and that, while "in the typical 'no asset' Chapter 7 case, there is little activity after the filing of the petition other than attendance at the section 341 hearing,"

> in *many cases*, the debtor's attorney is called upon to represent the debtor in post-petition adversary proceedings, Rule 2004 examinations, and in reaffirmation hearings. In more complex Chapter 7 bankruptcies, post-petition demands on the debtor's counsel *increase dramatically*. Categorical exclusion of fees can only result in denial of access to justice, with debtors unrepresented or under-represented. The increase in pro se cases, and in cases which become pro se after the petition is filed, does not aid the administration of our bankruptcy system.

Id. (emphases added).

* * * *

This case calls on the Court to interpret an inherently ambiguous statute. Of the two possible readings, petitioner's best comports with the text of the specific provision and the statute as a whole. It also best makes sense of the course of last-minute events that led to the introduction of the ambiguity. And, particularly important in the context of bankruptcy law, it comports with longstanding bankruptcy practice, from which Congress gave no indication of an intent to depart. The judgment of the court of appeals should accordingly be reversed.

CONCLUSION

For the foregoing reasons, as well as those set forth in petitioner's opening brief, the judgment of the United States Court of Appeals for the Fourth Circuit should be reversed.

Respectfully submitted,

John M. Lamie
BROWNING, LAMIE &
GIFFORD, P.C.
P.O. Box 519
Abington, VA 24212

G. Eric Brunstad, Jr.
P.O. Box 208215
127 Wall St.
New Haven, CT 06520

Craig Goldblatt
Andrew Currie
WILMER,CUTLER&
PICKERING
2445 M St., NW
Washington, DC 20037

Thomas C. Goldstein
(Counsel of Record)
Amy Howe
GOLDSTEIN & HOWE, P.C.
4607 Asbury Pl., NW
Washington, DC 20016
(202) 237-7543

John A. E. Pottow
Assistant Professor of Law
University of Michigan Law
School
625 South State St.
Ann Arbor, MI 48109

September 10, 2003

BRIEF BANK — "SUMMARY SHEET" Printed Tue.-1/4/0 (11:05)

WESTLAW CODES

1. ("TI") TITLE OF CASE [E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]	PATRICIA A. STAINANO, U.S. TRUSTEE V. JAMES J. CAIN (IN RE LAN ASSOCIATES XI, L.L.P.)
2. ("CO") CURRENT COURT [E.g., "CTA9"]	CTA3
3. ("CCN") CURRENT CASE NO.	No.: 98-5434
4. ("PCN") PRIOR CASE NO. & COURT [IF ANY]	Civil No. 98-2286-JEI (D.N.J., Irenas, D.J.) Bankr. Case No. 92-13413-JHW (Bankr. D.N.J., Wizmur, B.J.) (Identify judge & cite, if any)
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8. ("TO") TOPIC	**BANKRUPTCY**
9. ("SU") • SUMMARY OF KEY ISSUE(s) & */* Any Miscellaneous BACKGROUND	• For purposes of the cap on trustee compensation in 11 U.S.C. 326(a) — which "allow[s] reasonable compensation under § 330...not to exceed [varying per-cents] upon all moneys disbursed or turned over...by the trustee to parties" — the term "moneys disbursed" does not include disbursement of estate property. / **Background:** Dist. Court agreed with UST & reversed Bankruptcy Court order that based a trustee's compensation on the full purchase price of estate property sold back to a secured creditor. See UST v. Cain (In re Lan Associates), 237 B.R. 49 (D.N.J. 1998) (the term "moneys disbursed" in section 326 does . not include "credit bids" under section 363(k), which lets a secured party "offset [its] claim against the purchase price of [certain] property").
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No. 98-5434

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

In re: LAN ASSOCIATES XI, L.P., Debtor.

PATRICIA A. STAIANO,
UNITED STATES TRUSTEE,
Appellee,

v.

JAMES J. CAIN, TRUSTEE FOR
LAN ASSOCIATES XI, L.P.,
(D.C. Civil No. 98-2286)
Appellant.

ON APPEAL FROM THE UNITED STATES
DISTRICT COURT FOR THE DISTRICT OF NEW JERSEY

BRIEF FOR THE APPELLEE, UNITED STATES TRUSTEE

OFFICE OF THE UNITED STATES TRUSTEE
DISTRICT OF NEW JERSEY
One Newark Center, Suite 2100
Newark, New Jersey 07102
(973) 645-3014

PATRICIA A. STAIANO, UNITED STATES TRUSTEE
REGION 3

DONALD F. WALTON, ASSISTANT U.S. TRUSTEE
DISTRICT OF NEW JERSEY

ROBERT J. SCHNEIDER, SENIOR ATTORNEY

February 19, 1999

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STATEMENT OF JURISDICTION

The Bankruptcy Court had jurisdiction over this Chapter 7 proceeding pursuant to 28 U.S.C. § 157(a). The District Court had appellate jurisdiction over the Bankruptcy Court's final order pursuant to 28 U.S.C. § 158(a)(1). This appeal was timely filed on September 4, 1998. This Court has jurisdiction over the District Court's final order dated August 7, 1998, pursuant to 28 U.S.C. §§ 158(d) and 1291.

STATEMENT OF ISSUES PRESENTED

1. Whether the District Court erred as a matter of law in strictly interpreting 11 U.S.C. § 326(a)[1/] to exclude the credit bid portion of a 11 U.S.C. § 363(k) sale from the calculation of maximum trustee compensation.

2. Whether the District Court erred as a matter of law in holding that the 11 U.S.C. § 326(a) maximum is not a factor in determining reasonable trustee compensation under 11 U.S.C. § 330(a).

3. Whether the District Court erred in holding that the Bankruptcy Court's reasonableness determination cannot be influenced by the timing of the U.S.

[1/] As the underlying bankruptcy case was filed in 1992, unless otherwise noted all citations to title 11, United States Code, refer to that statute as it existed prior to the Bankruptcy Reform Act of 1994.

Trustee's objection nor the hardship disgorgement would cause the Trustee.

STATEMENT OF THE CASE

This appeal is from an order of the Honorable Joseph E. Irenas, U.S. District Judge for the District of New Jersey ("District Court") reversing an order of the Honorable Judith H. Wizmur, U.S. Bankruptcy Judge ("Bankruptcy Court") that had awarded final compensation to James J. Cain ("Trustee"). The United States Trustee ("U.S. Trustee") had objected to Trustee's Final Report on the grounds that the Trustee had received interim compensation in excess of the maximum established by 11 U.S.C. § 326(a). That provision limits trustee compensation to a percentage of "moneys disbursed or turned over by the trustee to parties in interest," which the U.S. Trustee interprets as requiring the actual disbursement of cash.

In this case, however, the Trustee based his compensation on cash disbursements plus the value of a $7.78 million credit bid made pursuant to 11 U.S.C. § 363(k) by the secured creditor in purchasing the estate's main asset. Rather than selling the asset, disbursing any cash received to unsecured creditors, and then basing his compensation on a percentage of cash disbursements, the Trustee first calculated the compensation he would request, then carved out a small portion to set aside for unsecured creditors. Thus, the sale benefitted the Trustee in an amount almost four times the benefit received by unsecured creditors. By basing his compensation on noncash disbursements, the Trustee has violated his fiduciary duty and administered the estate so as to primarily benefit himself, with only a residual benefit to unsecured creditors.

The principal issue in this case is whether the Trustee properly included the credit bid in calculating the 11 U.S.C. § 326(a) maximum. The Bankruptcy Court loosely interpreted the statute and allowed the credit bid to be included; the District Court literally interpreted it and allowed only cash disbursements to be included.

Other issues raised by this case include: (i) whether the 11 U.S.C. § 326(a) maximum is a factor in the 11 U.S.C. § 330 determination of reasonable trustee compensation; (ii) whether the fact that the U.S. Trustee objected to neither the asset sale nor the interim compensation request may influence the reasonableness determination; (iii) whether the hardship caused by the Trustee's possible disgorgement of excess interim compensation may be included in the reasonableness determination; and (iv) whether the Trustee's interim compensation was, in fact, reasonable. The Bankruptcy Court's answer to each of these issues was "Yes." The District Court's answer to the first three was "No," so it remanded the case for a reasonableness determination devoid of extraneous factors.

Although the District Court did not address the reasonableness of the Trustee's compensation, if its decision is affirmed the Bankruptcy Court on remand will only be able to base maximum compensation on cash disbursements. Thus, regardless of what amount is deemed reasonable compensation in light of the benefit the Trustee's services conferred to the estate, the Trustee will have to disgorge over $142,000.

STATEMENT OF FACTS

On July 6, 1992, LAN Associates XI, L.P. ("Debtor") filed a voluntary petition under Chapter 11 of title 11, United States Code ("Bankruptcy Code" or "Code"). *JA3*. On August 24, 1992, the Bankruptcy Court, entered an order directing the U.S. Trustee to appoint a trustee pursuant to Code Section 1104(a), and the Trustee was subsequently appointed. *JA9*. On May 21, 1993, the Bankruptcy Court entered an order converting this case to one under Chapter 7 of the Code and allowing the Debtor to be operated pursuant to Code Section 721. *JA17*. The U.S. Trustee subsequently appointed the Trustee to serve as Chapter 7 trustee. *Id.*

This estate's principal asset was a parcel of real property ("Property") originally valued at $9,000,000 by the Debtor. *JA76, JA176*. The Property was encumbered by the mortgage of First Fidelity Bank, N.A. ("Bank"), which filed a proof of claim for $12,865,434.55. *JA204*. The Property was later appraised at a fair market value of $9,727,000 and a liquidation value of $7,781,200. *JA77*.

By interlocutory order dated April 8, 1993, the Trustee was awarded interim compensation of $28,665.51 based upon disbursements of $949,183.54, all made as Chapter 11 trustee. *JA73, JA46.* As he rendered 163.5 hours of services, the Trustee received compensation at the rate of $175.26 per hour. *JA43*.

In January 1994, the Trustee filed a motion to approve the Property's sale. *JA76-81*. In support the he certified that the Bank proposed a transaction in which no cash would change hands, but the Bank would bid a portion of its claim pursuant to Code Section 363(k) in an amount equal to the liquidation value ("Credit Bid"), waive its deficiency claim of approximately $5 million, and allow the Trustee to retain $372,387 in cash collateral already in the Trustee's account. *JA77-79*. The Trustee also stated that notice of the sale would allow other bidders to submit higher and better offers. *JA77.* The sale price as noticed comprised a $7,781,200 credit bid. *JA88*.

The Trustee further certified that he "ha[d] an ability" to pursue the Debtor's general partner, Antonio Reale, "for any deficiency of property of the estate to pay all claims of the estate." *JA77.* The Trustee asserted that if the Property were abandoned "waiting for a foreclosure to be completed in order for the deficiency to be determined would significantly delay the commencement of" any action against Mr. Reale. *JA78*.

The Trustee anticipated a $70,000 "commission" on cash disbursed while operating the Property and a $233,616 "commission" on the sale. *Id*. The Trustee further certified that to pay administrative claims and a "meaningful distribution" estimated at 25% to unsecured creditors he "agreed to contribute $83,346.00 of the commission that [he] would have been authorized to receive if the property sold for at least $7,781,200.00." *JA80*. Finally, he asserted that, although he believed the distribution to unsecured creditors would be meaningful, even without such distribution the sale should be approved to facilitate any action against Mr. Reale. *Id*.

The Bankruptcy Court authorized the sale by a February 14, 1994 order that made no mention of the amount of compensation to be awarded based on the sale. *JA92-94*. The Trustee thereafter "sold" the Property to a subsidiary of the Bank. *JA96*. The Trustee's Deed dated March 30, 1994, indicated that the consideration paid for the Property was not the $7,781,200 credit bid certified to the Bankruptcy Court and noticed to creditors, but a $7,408,813 credit bid plus $372,387 in cash. *JA98-101*.[2]

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[2] The discrepancy does not affect this appeal. If the Credit Bid (whatever the amount) cannot be included in the Section 326(a) calculation, the $372,387 in cash disbursed may still be included. Similarly, if this Court concludes that the Bankruptcy Court's reasonableness analysis was satisfactory, the issue will be moot.

In October 1994, the Trustee submitted an application for interim compensation of $204,522.76 and reimbursement of $999.40 in expenses. *JA106*. The requested compensation amounted to an hourly rate of $403.09 based on 578.50 hours of services, some as Chapter 11 trustee and some as Chapter 7 trustee. *JA129*.

In calculating the disbursements upon which he based his compensation request, the Trustee added the Credit Bid to "operating revenues" of $2,763,942.42, making total disbursements of $10,545,142.42. *JA109*. From this amount he calculated an "allowable commission" of $316,534.27, or $547.16 per hour. *JA110, 129*. The Trustee then subtracted the $28,665.51 interim compensation previously received plus a "voluntary reduction" of $83,346 from which a "meaningful distribution" of $62,500 to unsecured creditors was anticipated. *JA110-11*.

On December 2, 1994, the Bankruptcy Court entered an interlocutory order authorizing the interim compensation as requested. *JA159*. Although estate

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If, however, this Court holds that the Credit Bid may be included but still remands for a further reasonableness determination, the Bankruptcy Court must determine whether the Trustee based his compensation calculation solely on "sale proceeds" of $7,781,200 (which includes the $372,387 cash), or whether he based it on the constructive disbursement of $7,781,200 plus the actual disbursement of $372,387. If the Bankruptcy Court finds that the Trustee counted the $372,387 twice, the Trustee could have to disgorge over $11,000 on this basis alone.

administration was not complete, on December 6, 1994, the Trustee paid himself the entire award of $204,522.76. *JA196*.

In March 1995 the Trustee filed a motion to permit him to disburse $62,500 to unsecured creditors. *JA160-64*. The Bankruptcy Court subsequently entered an order authorizing the distribution, and the Trustee disbursed the funds. *JA169, JA195*. The U.S. Trustee calculated the disbursement as only 19% of the $328,538.03 total allowed unsecured claims, not 25% as previously represented by the Trustee. *JA229*.

On October 6, 1995, the Trustee's proposed abandonment of his cause of action against Mr. Reale was noticed to all creditors. *JA32*. Despite the Trustee's use of his potential action against Mr. Reale as a reason to approve the sale of the Property, the Trustee did not reference it as an asset in his Final Report. *JA176*.

On November 13, 1995, the Trustee forwarded his Final Report to the U.S. Trustee pursuant to Code Section 704(9). *JA171*. As of that date the Trustee held $19,086.88, from which he proposed a 73% *pro rata* disbursement to the remaining administrative claimants. *JA224*. The Trustee requested no additional compensation and certified that the interim compensation previously approved and paid did not exceed the Code Section 326(a) maximum. *JA207*.

The U.S. Trustee determined that as Chapter 11 trustee the Trustee disbursed cash totaling $1,333,503.14. *JA235*. Thus, the U.S. Trustee calculated the Trustee's Section 326(a) maximum compensation as Chapter 11 trustee to be $40,185.94. *Id*. The U.S. Trustee further calculated gross estate proceeds of $1,679,097.80 as Chapter 7 trustee. *JA235*. The Section 326(a) maximum compensation on the disbursement of this amount is $50,552.93. *Id*. As a result, the U.S. Trustee calculated that the Trustee's maximum allowable compensation is only $90,738.87. *JA235-36*.

The U.S. Trustee objected to the Final Report on the grounds that the plain meaning of Code Section 326(a) requires maximum trustee compensation to be based only on cash disbursements. *JA226-40*. As the Credit Bid was not "moneys" for purposes of Section 326(a), the U.S. Trustee argued that the Trustee must disgorge the $142,449.40 excess interim compensation based on the Credit Bid, plus interest, and distribute these funds to unsecured creditors. *Id.*

The Trustee responded that the U.S. Trustee received notice of both the sale of the Property and the subsequent interim compensation application and should be precluded from objecting to the Trustee's compensation at the final hearing. *See Bankruptcy Court Decision*, in Addendum A to this Brief, at 10. The Trustee also asserted that the Credit Bid was a "constructive disbursement" of moneys for purposes of Section 326(a). *Id.* at 11.

On March 16, 1998, the Bankruptcy Court rendered a written decision in which it agreed with the U.S. Trustee that, as the interim compensation orders were not final orders, the objection was not precluded by the doctrines of *res judicata*, collateral estoppel, law of the case, laches, equitable estoppel, or trustee immunity. *Bankruptcy Court Decision* at 22-28. The Court disagreed with the U.S. Trustee, however, regarding whether the Credit Bid could be included in the Section 326(a) calculation. *Id*. at 17-21. Noting that cases decided under the Bankruptcy Act of 1898 ("Bankruptcy Act" or "Act") had acknowledged the possibility of including "constructive disbursements" as "moneys disbursed or turned over," the Bankruptcy Court determined that Section 326(a) was ambiguous, and could not be strictly applied as written. *Id*. at 12-17. As a result, the Court held that the Trustee had properly included the Credit Bid in calculating his compensation request. *Id*. at 17.

The Bankruptcy Court then addressed whether the Trustee's compensation was reasonable. *Bankruptcy Court Decision* at 28. The Court rejected the U.S. Trustee's assertion that trustee compensation is subject to a Code Section 330(a) reasonableness determination to which the Section 326(a) cap must be strictly imposed. *Id*. at 31. Instead, the Court held that Congress intended trustee compensation to be different from compensation payable to other professionals. *Id*.

The Court found that Section 326(a) serves as an incentive compensation system that allows trustees to receive a percentage of assets brought into the estate. *Id*. Noting that in its experience trustees generally receive the maximum, and further stating that the Trustee had received less than the maximum by virtue of his "voluntary reduction," the Court held that the Trustee's compensation was reasonable. *Id*. at 32-34.

The Bankruptcy Court directed some funds disgorged, however. *Id*. at 35. As the Trustee had always asserted enough of a carve out from his "commission" to fund a 25% distribution to unsecured creditors, the Court directed him to disgorge $19,634.51. *Id*. at 37. This amount, when added to the distribution already made, would bring to 25% the total distribution to unsecured creditors. *Id*.

The U.S. Trustee filed a timely notice of appeal, and the Trustee did not cross-appeal either the preclusion issue or the disgorgement issue. *JA35*. The District Court did not entertain oral argument and, after reviewing the briefs of the parties and the National Association of Bankruptcy Trustees ("NABT") as *amicus curiae*, entered an order dated August 7, 1998 reversing the Bankruptcy Court's decision and remanding this case for a new determination of the Trustee's compensation award. *See District Court Decision*, in Addendum A to this Brief, at 2. The District Court's decision was based on the plain meaning of Section 326(a), which allows compensation only on moneys actually disbursed. *Id*. at 12-15. The District Court "predict[ed] that the Third Circuit would not endorse the constructive disbursement theory, at least not in the context of a credit bid sale." *Id*. at 17. Citing the support for the U.S. Trustee's position in case law and in the legislative history, the District Court concluded that it was legal error for the Bankruptcy Court to allow the Trustee to include the Credit Bid in calculating his maximum compensation. *Id.* at 23.

The District Court also held that "it is legal error to import § 326(a)'s maximum compensation levels into the reasonableness analysis," and that to the extent the Bankruptcy Court did so it must limit its decision on remand to the Section 330(a) criteria. *Id.* at 25. The District Court further held that to the extent the Bankruptcy Court considered factors such as the timing of the U.S. Trustee's objection and the hardship caused by disgorgement it abused its discretion and on remand would be required to limit its analysis to the Section 330(a) criteria. *Id.* at 26.

The Trustee filed a timely notice of appeal of the District Court's order. *JA1*.

STATEMENT OF RELATED CASES AND PROCEEDINGS

There are no cases or proceedings related to this matter on appeal.

STATEMENT OF STANDARD OF APPELLATE REVIEW

In reviewing the District Court's decision for error this Court reviews the Bankruptcy Court's findings using the standards applicable to the District Court. *See Universal Minerals, Inc. v. C.A. Hughes & Co.*, 669 F.2d 98, 102 (3d Cir. 1981). Questions of law are reviewed *de novo*. *First Jersey Nat'l Bank v. Brown (In re Brown)*, 951 F.2d 564, 567 (3d Cir. 1991). Findings of fact are set aside only if clearly erroneous. *Stendardo v. Federal Nat'l Mortgage Ass'n (In re Stendardo)*, 991 F.2d 1089, 1094 (3d Cir. 1993). In addition, "[f]ee awards are reviewed for an abuse of discretion, which can occur 'if the judge fails to apply the proper legal standard or to follow proper procedures in making the determination, or bases an award upon findings of fact that are clearly erroneous.'" *Zolfo, Cooper & Co. v. Sunbeam-Oster Co.,* 50 F.3d 253, 257 (3d Cir. 1995) (quoting *Electro-Wire Prods., Inc. v. Sirote & Permutt, P.C. (In re Prince)*, 40 F.3d 356, 359 (11th Cir. 1994)).

The standard of review regarding Issues Nos. 1 and 2 is plenary, as these are purely questions of law. As Issue No. 3 is a question of both law and fact, the standard of review is plenary as to whether the Bankruptcy Court properly considered the timing of the U.S. Trustee's objection and the potential hardship of disgorgement on the Trustee, and abuse of discretion as to the Bankruptcy Court's determination of the reasonableness of the Trustee's compensation.

SUMMARY OF ARGUMENT

Congress based maximum trustee compensation on cash disbursements. See 11 U.S.C. § 326(a). Nonetheless, the Trustee received $142,449.40 in excess interim compensation calculated upon a "sale" of this estate's principal asset in which the secured creditor merely bid $7.78 million of its claim while allowing the Trustee to retain funds already in his account. Indeed, the Trustee reversed the usual process, basing the sale's terms on the amount of compensation he expected rather than simply selling the asset first and applying for compensation later. Despite the Trustee's fiduciary duty to administer estate assets for the benefit of creditors, he was the intended primary beneficiary of the sale from its inception.

Rather than basing his compensation on the tangible benefit his services obtained for the estate, the Trustee based the creditors's return on the $316,534.27 "allowable commission" to which he believes he is "entitled" as a result of the "sale." Although the Trustee "carved out" a return of $62,500 to unsecured creditors, constituting 19% of their allowed claims, this return pales in comparison to the Trustee's receipt of 85% of the $372,387 cash proceeds of the "sale." Once recovered into the estate pursuant to Section 506(c) these funds should have been paid mostly to unsecured creditors with a small percentage to the Trustee – not the other way around.

The District Court properly applied Code Section 326(a) literally, and its decision should be affirmed. The District Court's decision is consistent with the vast majority of cases interpreting Section 326(a) (including the only circuit court to do so), basic tenets of statutory construction applied by this Circuit, the legislative history, and Third Circuit cases decided under the Bankruptcy Act. The contrary position espoused by the Trustee and the NABT would require a sea change in the way this Circuit interprets statutes, and would open the door to erratic, case-by-case determinations of the meaning of "moneys disbursed or turned over." Indeed, it is not even clear that the Trustee's position was uniformly applied under the Act – and Congress did not include in Section 326(a) the Act-era language that might have supported compensation on constructive disbursements. If the Third Circuit adopts a loose interpretation of Section 326(a), the provision would be rendered meaningless and Congress' expressed intent to limit trustee compensation would be lost.

In addition, to the extent the Bankruptcy Court considered the Section 326(a) maximum as a factor in the 11 U.S.C. § 330(a) determination of reasonable trustee compensation, it was clearly in error. Section 330 establishes the basis for determining compensation to all estate professionals, including trustees. Section 326(a) merely sets an outside limit, and does not make trustee compensation an incentive-based "commission" as asserted by the Bankruptcy Court and the NABT. Therefore, the District Court's decision on this issue should be affirmed.

Also, as the interim compensation awards were subject to change at any time during the case and the U.S. Trustee's objection was not subject to any form of preclusion, the Bankruptcy Court was in error to the extent it based its decision on the fact that the U.S. Trustee did not object before the final hearing stage. Similarly, the fact that disgorgement of the excess compensation would cause a hardship to the Trustee is not a factor to be considered in the Section 330 reasonableness determination. To the extent the Bankruptcy Court was influenced by such equitable considerations to circumvent clear statutory language, it was in error. Thus, the District Court decision on this issue must be affirmed, and the matter must be remanded for a reasonableness determination in which Section 330(a) is properly applied.

In addition, the Trustee's interim compensation was unreasonable in light of the services rendered. The Trustee is attempting to use the $62,500 "bone" thrown to unsecured creditors to justify his receipt of over $230,000. If the excess interim compensation is disgorged and paid to unsecured creditors, however, these creditors will see their return grow from 19% of their claim (and only 25% of the Trustee's "cut") to over 60% of their claim. If the District Court's decision is affirmed the Trustee will still have received over $90,000, not an insubstantial sum for serving as the Property's landlord for little more than eighteen months and then "selling" it to the Bank. The Trustee will have been amply, but not excessively, rewarded for recovering funds for the benefit of creditors – which is what Congress intended.

ARGUMENT

I. THE DISTRICT COURT PROPERLY EXCLUDED CREDIT BIDS FROM THE MAXIMUM TRUSTEE COMPENSATION CALCULATION

The maximum compensation allowable to a Chapter 7 trustee is governed by Code Section 326(a), entitled "Limitation on compensation of trustee," which provides that "the court may allow reasonable compensation under [Code Section 330] . . . for the trustee's services . . . not to exceed [a percentage based] upon all *moneys disbursed or turned over* in the case by the trustee to parties in interest, excluding the debtor, but including holders of secured claims" (emphasis added). The U.S. Trustee submits that the phrase "moneys disbursed or turned over" refers solely to "*cash* disbursed or turned over," not the value of a credit bid.

The Trustee, however, argues that the Credit Bid should be treated as if it were the receipt and disbursement of $7.78 million in cash. Thus, the Trustee seeks to retain the entire $233,188.27 interim compensation received, including $142,449.40 attributable to the Credit Bid, even though the unsecured creditors to whom he owes his primary fiduciary duty received only $62,500 from his services. *Cf. In re Pearson Indus., Inc.*, 178 B.R. 753, 761 (Bankr. C.D. Ill. 1995) ("A Chapter 7 trustee in bankruptcy represents the interest of the unsecured creditors and not the secured creditors."); *Fox v. Anderson (In re Thu Viet Dinh)*, 80 B.R. 819, 822 (Bankr. S.D. Miss. 1987) ("it is a fundamental concept in bankruptcy that a trustee's primary duty is to the unsecured creditors rather than to the secured creditors").

The Trustee's position directly contradicts Section 326(a) and the vast majority of relevant Code cases, the legislative history, Third Circuit Act cases, and basic tenets of statutory interpretation applied by the Supreme Court and the Third Circuit. As a result, the District Court's holding that the Credit Bid cannot be included in the Trustee's maximum compensation calculation must be affirmed.

A. The District Court's Strict Interpretation of Section 326(a) is Consistent With the Majority of Cases Decided Under the Code

The majority of reported Code decisions have applied Section 326(a) literally. The Fifth Circuit recently became the first circuit to address the meaning of "moneys disbursed or turned over" under the Code in a reported decision. In *Pritchard v. U.S. Trustee (In re England)*, 153 F.3d 232 (5th Cir. 1998), the trustee transferred property to creditors in satisfaction of their claims. *Id*. at 234. The trustee requested compensation on cash disbursements plus the value of property transferred to creditors, arguing that a strict interpretation of Section 326(a) contradicts Congressional intent. *Id*. at 234-36. The Fifth Circuit rejected the trustee's policy arguments and the handful of Code cases that have allowed trustee compensation on something other than actual cash disbursed. *Id*. at 237. As "[t]he plain language of § 326(a) indicates that the statute caps a trustee's compensation based upon only the moneys disbursed," and as the statutory language is consistent with the Code Section 704(1) duty to reduce estate property to "money," the Fifth Circuit reversed a district court decision that had allowed compensation on the value of property transferred. *Id*. at 235-37 (citing, *inter alia*, *In re Brigantine Beach Hotel Corp.*, 197 F.2d 296, 299 (3d Cir.), *cert. denied*, 344 U.S. 832 (1952)).

Although *Pritchard* was not a credit bid case, the U.S. Trustee respectfully submits that the Third Circuit should adopt the Fifth Circuit's sound reasoning rather than blaze the trail urged by the Trustee. Congress has decreed that cash disbursements alone form the basis for calculating maximum trustee compensation.

The plain meaning of Section 326(a) must prevail – trustee compensation cannot be based on the value of property transferred in satisfaction of creditor claims.

Many courts have interpreted “moneys disbursed or turned over” as meaning cash disbursed by the trustee. *See, e.g.*, *Havis v. Rhea (In re Rhea)*, 143 B.R. 690, 691 (S.D. Tex. 1992) (no “authority for departing from the unambiguous language of the statute”); *Kandel v. Alexander Leasing Corp.*, 107 B.R. 548, 551 (N.D. Ohio 1988) (compensation based only on "monies [that] actually passed through [the trustee's] hands"); *In re Landing, Inc.*, 142 B.R. 169, 172 (Bankr. N.D. Ohio 1992) (noting “the general trend towards strict construction of statutory language,” trustee compensation allowed only on cash disbursed, not value of liens assumed); *In re Music Merchandisers, Inc.*, 131 B.R. 377, 380 (Bankr. M.D. Tenn. 1991) ("That the trustee did not disburse or turn over cash money has compelled courts on various facts to resist inclusion of 'constructive disbursements' in the compensation base for purposes of § 326."); *In re Palm Beach Resort Properties, Inc.*, 73 B.R. 323, 324 (Bankr. S.D. Fla. 1987) (where $2.4 million “did not pass through the trustee’s account . . . . [t]here was no actual or constructive disbursement”); *In re New England Fish Co.*, 34 B.R. 899, 901-02 (Bankr. W.D. Wash. 1983) ("the trustee's compensation must be based on actual monies disbursed . . . and not on assets or settlements which can be construed as a constructive disbursement").

More recently, two courts in the District of New York applied Section 326(a) literally to credit bid situations. In *United States Trustee v. Messer (In re Pink Cadillac Assocs.)*, 1997 WL 164282 (S.D.N.Y. April 7, 1997), the trustee sold an asset encumbered by a lien of over $2.7 million to the mortgagee for a $1.5 million credit bid. *Id*. at *1. While no cash was disbursed, the trustee requested $20,000, which he argued was a 71% “voluntary reduction” from the maximum “commission” to which he was “entitled” — if the $1.5 million credit bid was included in the calculation. *Id*. at *2. Although the bankruptcy court agreed with the trustee, the district court reversed on the grounds that the U.S. Trustee’s emphasis on "moneys" was consistent with Congress' position regarding the trustee's principal duty to "reduce to money" property of the estate. *Id*. at *3. The district court noted that many Code cases have interpreted "moneys" literally. *Id*. The district court rejected the trustee's argument that a strict application raises form over function, since the trustee never actually handled cash, and it was not "clear how he would have done so." *Id*. at *4. As the credit bid covered the entire purchase price, the transaction did not generate "moneys.” *Id*.

In *In re Colonial Southbury L.P.*, Case No. 94-22057 (Bankr. S.D.N.Y. June 3, 1997), the court in an unpublished decision followed *Pink Cadillac*, adding that even if compensation could be based on the credit bid the compensation requested was unreasonable in light of the services rendered. *JA244-55*. In *Colonial Southbury*, a secured creditor with a $16.5 million lien purchased estate assets using a $3 million credit bid. *JA246-48*. The secured creditor agreed to contribute 3% of the sale price for distribution to creditors, and the trustee sought a “commission” on all disbursements made while operating the debtor, including the value of the credit bid. *Id*. The *Colonial Southbury* court agreed that the line of cases supporting the U.S. Trustee's position was "compelling, particularly in light of the legislative history of Section 326(a)," and that allowing the requested compensation "would equate to judicial legislation." *JA251*. The court also rejected the Act cases cited by the trustee as the legislative history evinces Congress’ determination that "moneys" is not the equivalent of "property." *JA252*. As the U.S. Trustee noted, the secured creditor could have bid its entire claim instead of only $3 million – in which case the trustee would have sought compensation on $16.5 million, which could not be what Congress intended. *Id*. Thus, the court only allowed compensation on cash disbursements. *JA255*.

The *Pink Cadillac* and *Colonial Southbury* cases, in addition to *Pritchard*, indicate that the District Court’s decision was consistent with the most recent determinations regarding non-cash disbursements under Section 326(a). The

Trustee "sold" property with a $7.78 million liquidation value for a $7.78 million credit bid plus $372,387 in cash. As in *Pink Cadillac* and *Colonial Southbury*, the mortgage far exceeded the Property's value. It was highly unlikely that the Trustee could have structured a pure cash transaction, since the Bank could win any "bidding war" without paying a cent merely by bidding its entire claim. In addition, the *Pink Cadillac* trustee argued that he had taken a "voluntary" reduction of 71%, but the district court was not taken in by this ruse as the trustee was actually entitled to 0% of the amount requested. Similarly, in the instant case the District Court rejected the Trustee's argument that to carve out a distribution to administrative claimants and unsecured creditors he had taken a "voluntary reduction" of 26% of his "commission." Although no cash changed hands in *Pink Cadillac*, it is obvious from that court's analysis that if cash had changed hands the trustee would only have been allowed to include the cash, and not the credit bid, in his Section 326(a) calculation.

The few Code cases that have loosely applied Section 326(a) are easily distinguishable. For example, in *In re Greenley Energy Holdings of Pa., Inc.*, 102 B.R. 400 (E.D. Pa. 1989), a Chapter 11 trustee's compensation was based on the present value of $28 million in guaranteed contracts he had entered into. The trustee engineered what the court termed a "small miracle" by taking a non-operating debtor facing a $30 million environmental reclamation project and developing a business plan that paid creditors in full. *Id*. at 401. As the trustee had created new property that would result in future cash payments to creditors, the court determined that it would be unjust to deny compensation on the present value of these disbursements. *Id*. at 404-05. The trustee did not even request the maximum, instead seeking compensation at the rate of only $226 per hour. *Id*. at 403 n.3.

Two Texas bankruptcy courts have also liberally interpreted Section 326(a). In *In re Guyana Dev. Corp.*, 201 B.R. 462 (Bankr. S.D. Tex. 1996), a Chapter 11 trustee ran a multinational firm, disbursed almost $80 million in cash, and confirmed a plan that paid 88% to unsecured creditors. *Id*. at 472. Given the complexity of the case and the considerable benefit for unsecured creditors, the court held that a lodestar analysis would not result in reasonable compensation and included the value of encumbered property sold in the Section 326(a) calculation. In *In re Stanley*, 120 B.R. 409, 413-15 (Bankr. E.D. Tex. 1990), the court allowed lien assumptions to be included in the Section 326(a) calculation, but stated that it would have denied compensation had the sale been of fully encumbered property or property with nominal equity.

These cases contained facts absent from the instant case. The Trustee did not produce the results of the *Greenley* and *Guyana* trustees, and the *Stanley* court would have denied the Trustee's requested compensation as there was no equity in the Property. In addition, after the Fifth Circuit's *Pritchard* decision the *Guyana* and *Stanley* courts would now have to apply Section 326(a) strictly. Thus, these decisions are of little precedential value in Texas, much less anywhere else.

In sum, the overwhelming weight of Code authority supports the District Court's strict interpretation of Section 326(a). Although virtually no Code cases support his position, the Trustee nonetheless requests that this Court render the first Circuit Court Code decision to accept the constructive disbursement theory. As such a decision would represent a radical departure from the majority of decided cases, the District Court's decision should be affirmed.

B. The District Court's Strict Interpretation of Section 326(a) is Consistent With Basic Tenets of Statutory Construction

"It is axiomatic that statutory interpretation begins with the language of the statute itself." *Government of Virgin Islands v. Knight*, 989 F.2d 619, 633 (3d Cir. 1993). A statutory language analysis must precede any resort to prior law or legislative history as "[t]here is, of course, no more persuasive evidence of the purpose of a statute than the words by which the legislature undertook to give expression to its wishes." *United States v. Amer. Trucking Ass'ns, Inc.*, 310 U.S.

534, 543 (1930). The statutory language is the best indicia of Congress' intent as "much less thought is spent on the future implications of committee reports and explanations on the floor than in choosing the words of a statute." *Paskel v. Heckler*, 768 F.2d 540, 543-44 (3d Cir. 1985).

If a statute is unambiguous courts need not resort to legislative history and pre-statute case law to divine Congressional intent. *See, e.g.*, *United States v. Ron Pair Enters., Inc.*, 489 U.S. 235, 241-42 (1989); *Velis v. Kardanis*, 949 F.2d 78, 81 (3d Cir. 1991). Once statutory language is found to be unambiguous, courts "must give effect to Congress' intent as Congress expressed it with that writing." *United States Trustee v. Columbia Gas Sys., Inc. (In re Columbia Gas Sys., Inc.)*, 33 F.3d 294, 300 (3d Cir. 1994). A finding of no ambiguity ends the search for alternative readings as "courts must presume that a legislature says in a statute what it means and means in a statute what it says there." *Connecticut Nat'l Bank v. Germain*, 503 U.S. 249, 253-54 (1992).

In determining the ambiguity of statutory language, courts apply the "fundamental canon of statutory construction . . . that, unless otherwise defined, words will be interpreted as taking their ordinary, contemporary, common meaning." *See, e.g.*, *Perrin v. United States*, 444 U.S. 37, 42 (1979). Congress used the common words "moneys" and "disbursed" in Section 326(a); as these words were not defined in the Code, they must be given their everyday meaning. “Moneys” is commonly defined as “sums of money” or “funds.” *See Webster’s Third New Int’l Dictionary* at 1458 (1981). “Money” is “something generally accepted as a medium of exchange,” such as currency, coin, negotiable paper, and any other asset readily convertible to cash. *Id*. “Disburse” means “to expend esp[ecially] from a public fund: pay out.” *Id*. at 644. The relevant definition of “turn over” is “to hand over: DELIVER, TRANSFER.” *Id*. at 2469.

Even if “moneys” is viewed as a term of art, the legal and commercial usage is virtually the same as the lay usage. For example, in legal usage “money” means “coins and paper currency used as circulating medium of exchange, and does not embrace notes, bonds, evidences of debt, or other personal or real estate.” *Black’s Law Dictionary* 1005 (6th ed. 1990). In addition, in the Uniform Commercial Code “money” is defined as “a medium of exchange authorized or adopted by a domestic or foreign government as a part of its currency.” N.J. Stat. Ann. tit. 12A § 1-201(24) (1996).

Thus, if Congress is taken at its word Section 326(a) bases maximum trustee compensation solely upon cash delivered to parties in interest by the trustee. Credit bids do not fall within the aegis of Section 326(a) unless its plain meaning is ignored and other words are read into the statute.

Even if “moneys” is ambiguous, legislative history and Act cases should not be consulted. The Third Circuit has directed courts to clarify perceived ambiguities regarding a word or phrase in the Code by considering how the word or phrase is used elsewhere in the Code. *Velis*, 949 F.2d at 81. “Money” as used elsewhere in the Code always refers to cash. For example, Section 345 addresses the investment of money of the estate. Congress’ intent in using the word “money” in this section is obvious — one cannot “deposit or invest” the encumbered portion of real estate or the value of claims extinguished. In addition, one of the fundamental trustee duties under Section 704(1) is to “collect and *reduce to money* the property of the estate” (emphasis added). Again, Congress’ intent that assets be turned into cash for ultimate distribution to creditors is evident. Thus, Congress’ use of “money” elsewhere in the Code evinces the word’s intended meaning without the need to resort to Act cases.

Another canon of statutory interpretation, *expressio unius est exclusio alterius* (“the expression of one thing excludes another”), indicates that Congress intended to limit maximum trustee compensation to a percentage of cash disbursed. That Congress did not include any word other than “moneys” is evidence that all non-“moneys” were intentionally excluded from the Section 326(a) calculus.

When drafting the Code, Congress separately listed items where separate consideration of each is appropriate. One example is Section 523(a)(2), regarding exceptions to discharge, which separately lists “money, property, services, or . . . credit.” Since it considers “money” to be distinct from “property” and “credit,” Congress would have included words other than “moneys” in Section 326(a) if it had intended to base trustee compensation on something other than cash disbursements. Despite its assumed knowledge of the hoary Act precedent for including non-“moneys” in calculating trustee compensation, Congress did not add such phrases as “value of assets administered,” “amount of claims paid or otherwise extinguished,” or even “moneys disbursed or turned over, whether in the form of cash or constructively.” *See, e.g.*, *In re Barnett*, 133 B.R. 487, 489 (Bankr. N.D. Iowa 1991) (Congress "could, but did not, choose the words 'property' or 'value' . . . . I cannot escape the feeling that were I to rule in the trustee's favor, I would be legislating a result different from that provided for by Congress."); *New England Fish Co.*, 34 B.R. at 901 ("Had it so desired, Congress could readily have included properties turned over, assumed claims, and the value of compromised claims as well as monies as the basis on which commissions were to be computed. However, it did not do so."). Absent the mention of anything other than “moneys,” this Court must conclude that Section 326(a) does not include theoretical, “constructive," non-cash disbursements.

In the instant case, the Trustee conducted a "sale" whereby he transferred a $7.78 million asset for the following consideration: (i) a credit bid of $7.78 million of the Bank's $12.8 million claim; (ii) a waiver of the remainder of the claim; and (iii) $372,387 in cash collateral already in the Trustee's account. The only portion of that consideration that falls within the definition of "moneys" is the $372,387 in cash. The Credit Bid was not "disbursed," nor was the Bank's waiver of its deficiency claim. Despite the Trustee's assertion, the sale was not a cash transaction. As the Trustee only received $372,387 in cash, that is all he could have disbursed. Section 326(a) permits no other interpretation – credit bids and other consideration that is "like" money or "in lieu of" money cannot be included in the calculation.

In light of its application of the "plain meaning" doctrine as required by the Supreme Court and Third Circuit, the District Court's strict interpretation of Section 326(a) was correct. The Bankruptcy Court erroneously used legislative history and Act cases to circumvent the plain meaning of "moneys disbursed or turned over." As that phrase must be interpreted as "*cash* disbursed or turned over," other sources may not be consulted simply to avoid imposing a hardship on the Trustee. Since the statutory language evinces Congressional intent to limit trustee compensation to a percentage of cash disbursements, the District Court's decision must be affirmed.

C. The Legislative History Supports a Literal Reading of "Moneys Disbursed or Turned Over"

Courts may only disregard a statute's plain meaning if a literal application "will produce a result demonstrably at odds with the intentions of its drafters." *Ron Pair Enters.,* 489 U.S. at 242. Such a situation is rare, and requires a result "so bizarre that Congress 'could not have intended' it." *Demarest v. Manspeaker*, 498 U.S. 184, 191 (1991) (quoting *Griffin v. Oceanic Contractors, Inc.*, 458 U.S. 564, 575 (1982)). Indeed, "extraordinarily clear evidence of a contrary legislative intent . . . is required to override clear statutory language." *Malloy v. Eichler*, 860 F.2d 1179, 1183 (3d Cir. 1988). Thus, to reverse the District Court this Court must find "not whether a result inconsistent with the literal language of the statute is consistent with the legislative history, but rather whether it is *compelled* by that history." *Smith v. Fidelity Consumer Discount Co.*, 898 F.2d 907, 912 (3d Cir. 1989) (emphasis added). Absent convincing evidence of contrary Congressional intent, the statute must be applied as written.

The sparse legislative history of Section 326(a) indicates that a strict application is consistent with Congress' concerns at the time the Code was enacted. The

House Committee on the Judiciary's Report stated that Section 326(a) is to be applied to "the *amounts of money distributed by the trustee*," and further stated that:

> [T]he base on which the maximum fee is computed includes *moneys turned over* to secured creditors, to cover the situation where the trustee *liquidates* property subject to a lien and *distributes the proceeds.* It does not cover cases in which the trustee simply *turns over the property to the secured creditor*, nor where the trustee abandons the property and the secured creditor is permitted to foreclose.

H.R. Rep. No. 95-595 at 327 (1977) (emphasis added). The House Report further noted the legislators' displeasure that the Act's compensation provisions had become a floor rather than a ceiling. *Id*. In addition, Congress' overhaul of the nation's bankruptcy system was based in part on the concern that bankruptcy estates were being administered to benefit trustees and their professionals rather than creditors. *Id*. at 93-94, 327. The House Report contains no suggestion that Congress intended to blow the cap off trustee compensation by including non-cash items in the Section 326(a) calculation. Indeed, trustees are to "liquidate[ ] property . . . and distribute[ ] the proceeds," which is not what transpires in a credit bid transaction. *Id*. at 327.

Contrary to the Trustee's assertion, the House Report does not provide the evidence of contrary intent needed to circumvent clear statutory language. There is no suggestion that Congress intended an expansive interpretation of "moneys," or that it intended to codify the "constructive disbursement" theory. Indeed, courts have held that the House Report demonstrates the rejection of Act cases that allowed compensation on non-cash "constructive disbursements." *See, e.g.*, *In re Indoor-Outdoor Dining, Inc.*, 77 B.R. 952, 954 (Bankr. S.D. Fla. 1987) ("The statutory history [of Section 326(a)] suggests a deliberate rejection of some decisions under the former statutes which would equate the debtor's property with 'moneys' administered by the trustee."); *New England Fish Co.*, 34 B.R. at 901.

Likewise, the Trustee incorrectly implies that the House Report's express exclusion of situations in which the trustee "simply turns over" or "abandons" property means that Congress intended to include every other conceivable situation under the rubric "moneys disbursed or turned over." The Report's drafters could have had a number of improper scenarios in mind, but they included only two as examples. Indeed, it would appear from the legislative history that Congress had grown weary of trustees receiving compensation for non-cash transactions generally. Regardless, "it is, of course, 'not the law that a statute can have no effects which are not explicitly mentioned in its legislative history' . . . be they good or ill." *Fidelity Consumer Discount Co.*, 898 F.2d at 912 (quoting *Pittson Coal Group v.*

Sebben, 488 U.S. 105, 115 (1988)). As the Supreme Court has stated, "[i]n such a substantial overhaul of the system [as the Code], it is not appropriate or realistic to expect Congress to have explained with particularity each step it took. Rather, as long as the statutory scheme is coherent and consistent, there generally is no need for a court to inquire beyond the plain language of the statute." *Ron Pair Enters.*, 489 U.S. at 242. Whether the House Report listed every exception from Section 326(a) is not dispositive – Congress could not be expected to explain in detail the intended interpretation of every provision.

If this Court adopts the Trustee's argument, then anything can be considered "moneys" provided property is not "simply" turned over or abandoned without consideration. Such a result would contradict Congress' express intent to circumscribe the trustee compensation base. Indeed, if "moneys" may be read as the Trustee argues, then credit bids will only be the first of many "constructive disbursements" allowable, and the language used by Congress will be rendered meaningless.

Perhaps the most telling aspect of Section 326(a)'s legislative history is what Congress chose *not* to carry over from the Act. Section 48 of the Act, which was codified at 11 U.S.C. § 76, provided that trustee compensation in bankruptcy proceedings superseded by reorganization proceedings "shall be computed upon all moneys disbursed or turned over . . . and where under the plan of reorganization any part of the consideration to be paid to unsecured creditors is other than money, *upon the amount of the fair value of such consideration*." 11 U.S.C. § 76(g) (1976) (quoted in *District Court Opinion* at 15) (emphasis added). Similar language applied to payments under an arrangement. *Id*. § 76(f). Although the Act did not expressly address the inclusion of credit bids or other "constructive disbursements" in calculating trustee compensation, the statutory language could arguably support such a result. The language also reveals, however, that under the Act Congress expressly differentiated between "moneys" and the "fair value of consideration other than money." Although both were used in calculating trustee compensation, they were deemed distinct enough to be separately listed. As a matter of statutory interpretation, this Court must assume Congress did not use redundant language and identified a difference between "moneys" and "fair value of consideration other than money."

Section 40 of the Act, which was codified at 11 U.S.C. § 68, contained similar language regarding referee compensation, and provided that the Director of the Administrative Office of the U.S. Courts (with the approval of the Judicial Conference of the United States) "may make, and from time to time amend, rules and regulations prescribing methods for determining *net proceeds* realized in asset cases [and] *fair values of considerations other than money . . . .*" *Id.* § 68 (emphasis added). The following rule was subsequently established:

> "[N]et proceeds realized in asset cases" shall mean, in the case of sale or liquidation, the *amount of money* coming into the estate . . . as assets of such estate *which shall include the entire sale price of encumbered property when sold free and clear of all liens* or, if not sold or liquidated, *the fair cash market value of all property coming into the estate as assets of such estate* . . . provided, however, that where property is sold or transferred *subject to* a valid [lien], the amount of such [lien] not affected by such sale *shall not* be included in determining the amount of net proceeds realized.

Reports of the Proceedings of the Judicial Conference of the United States 22 (1966) (quoted in *In re Riverside Inv. Partnership*, 674 F.2d 634, 636 (7th Cir. 1982)) (emphasis added).

The Act's compensation provisions were subsumed within Section 326(a) when the Code was enacted, but Congress left out any mention of "fair value of consideration other than money," as well as what effect the "sale free and clear" versus "sale subject to" dichotomy had on compensation. As the legislative history does not explain the omission of such language, the words used in the Code remain the only evidence of Congressional intent. Thus, the only logical reading of Congress' decision to exclude Act-era language from the Code is that trustee compensation is no longer based on both "moneys disbursed or turned over" *and* the "fair value of consideration other than money" conferred to creditors. *See* 2B Norman J. Singer*, Sutherland on Statutes and Statutory Construction* § 51.02 at 122 (5th ed. 1992) ("[I]f words used in a prior statute to express a certain meaning are omitted, it will be presumed that a change of meaning was intended."). Rather, trustee compensation under the Code is based *solely* on the disbursement of "moneys," which has always meant cash handled by the trustee. If Congress had intended trustee compensation to be based on anything other than cash disbursements it would have retained the Act language regarding the fair value of non-monetary consideration. It did not, and has not inserted such language in Section 326(a) despite several amendments in the last twenty years.

It is disingenuous to assume that in completely overhauling the nation's bankruptcy law Congress chose not to correct a perceived ambiguity. Obviously, Congress perceived no ambiguity in the phrase "moneys disbursed or turned over"; otherwise, it would have incorporated words other than "moneys" in Section 326(a). The District Court's interpretation of "moneys disbursed or turned over," therefore, is not contrary to Congress' intent, nor is it so fanciful that Congress could not have intended it. Indeed, the House Report indicates that Congress expects trustees to be paid for disbursing cash to general creditors, not engineering noncash "sales" of overencumbered property to secured creditors. As the District

Court's holding is consistent with the legislative history, it should be affirmed.

D. Pre-Code Third Circuit Cases Do Not Support the "Constructive Disbursement" Theory

Although the Third Circuit has never squarely addressed the validity of the constructive disbursement theory, several Act decisions indicate an unwillingness to compensate trustees for noncash transactions. For example, in *In re Vulcan Foundry & Machine Co.*, 180 F. 671, 673-74 (3d Cir. 1910), the second mortgagees bought encumbered property by credit bid. The Third Circuit held that as the asset's "virtual owners," the second mortgagees could not be charged with commissions "upon the whole amount of their bid, as if it had all been paid in cash." *Id*. at 675.

Similarly, in *American Surety Co. v. Freed,* 224 F. 333, 337 (3d Cir. 1915), the Third Circuit held that a trustee could only receive compensation on cash disbursed when he had sold an asset's equity to bondholders who essentially already owned the rest of the asset. *Id*. at 336. Although the Third Circuit cited cases that had addressed the issue of constructive disbursements, it expressly distinguished those cases factually and did not state, even in *dicta*, that it acknowledged the viability of constructive disbursements. The Trustee's and NABT's assertions notwithstanding, the Third Circuit only stated that "courts have held . . .

" and provided the reasoning behind constructive disbursement cases without editorializing. When it came to actually resolving the matter before it, however, the Third Circuit only allowed compensation on cash disbursed, not the value of liens extinguished. *Id*.

In addition, in *In re Prindible*, 115 F.2d 21 (3d Cir. 1940), the trustee's final account reflected an entry for "Amount of Distribution of Real Estate" of $29,200. *Id*. at 23. The encumbered real estate "was sold in bankruptcy to the mortgagees thereof for the discharge of the mortgage debt, the mortgagees contributing, under agreement with the trustee, $1,800 toward the general administration expenses. No part of the consideration, except for the $1,800, ever came into the trustee's hands." *Id*. The trustee received cash totalling $3,556.50 during the case, which was consumed by administrative expenses. *Id*. The Third Circuit found that "[t]he fees and commissions appear to bear no relation to the extent of services or to the quantum of the estate actually administered," stating:

> Trustees in bankruptcy . . . are public officers and officers of the court, and compensation is owing to them only on clear warrant of law. Before trustees in bankruptcy are entitled to compensation upon moneys disbursed or turned over by them to lienholders, it is necessary that the trustees show some act of administration with respect to encumbered property, such as preserving an equity of the bankrupt in the property. *And, even then, compensation has been held to be due only upon*

> *the value of the equity of redemption*.

Id. at 24 (emphasis added).

The Third Circuit directed the referee to recover from “those who participated in the division of the bankrupt’s estate in excess of reasonable fees, commissions and expenses or surcharge the trustee for the improvident payments.” *Id*. After these amounts were recovered, “the fund representing the value of the encumbered property *actually sold by the trustee and for which he received payment of the consideration*” was to be set aside for distribution to lienholders and, if any residue was left, to the general estate. *Id*. at 24-25 (emphasis added). Thus, in *Prindible* the Third Circuit found that trustees may only take compensation on the cash received from a sale of encumbered property and not the value of mortgages extinguished.

Similarly, in another Act case where a trustee sought compensation for returning property to the debtor, the Third Circuit stated that "it is clear that the word 'moneys' in the clause '. . . upon all moneys disbursed or turned over by him to any persons, including lienholders, . . . ' is not the equivalent of property." *In re Brigantine Beach Hotel Corp.*, 197 F.2d 296, 299 (3d Cir.), *cert. denied*, 344 U.S. 832 (1952).

In light of these decisions, the U.S. Trustee respectfully submits that the

District Court properly interpreted the Third Circuit's past holdings as not indicating the acceptance of the "constructive disbursement" theory. This Court's past decisions do not support the Trustee's request that the Third Circuit become the first Circuit under the Code to allow compensation to be based on whatever noncash transactions a trustee may attempt to fit into the phrase "moneys disbursed or turned over."

E. The Arguments Raised by the Trustee and the NABT do not Support Reversal of the District Court's Decision

1. The Literal Interpretation of Section 326(a) Does not Improperly Elevate Form Over Function

The main thrust of the Trustee's brief is that the District Court's decision was based on a "hypertechnical" reading of Section 326(a). This Court should read the word "literal" in place of "hypertechnical" – there is not a wide spectrum of possible interpretations of "moneys disbursed or turned over." The statute is either read literally or it is not. It cannot be read "extra"-literally or "kind of" literally. The majority of cases apply Section 326(a) literally, and the minority simply disregard the statutory language and render a decision on some other basis.

The U.S. Trustee respectfully submits that, in light of the Supreme Court and Third Circuit jurisprudence regarding statutory interpretation, there is no authority for a non-literal reading of Section 326(a). Indeed, the Trustee places form over substance as the Property was "sold" in form only. The Trustee refers to the "economic reality" of the transaction as a cash sale whereby the Trustee received and disbursed cash to the Bank. Of course, this is merely a hypothetical economic *theory*; in economic *reality* this was not a $7.78 million cash transaction. The Trustee transferred property for $372,387 cash and a $12.8 million bundle consisting of a credit bid and a deficiency waiver. This was a purely paper-shuffling transaction where no cash ever changed hands, the Trustee already possessed the $372,387 cash collateral, and the Bank for all intents and purposes owned the Property. Nevertheless, the Trustee believes he is entitled to over $200,000 for engineering the sale.

The "economic" reality of the transaction, therefore, is far different from that portrayed by the Trustee. The Bank was motivated to obtain the Property, and possessed a $12.8 million claim, the entirety of which could be bid. The logical extension of the Trustee's argument is that this could easily have been a $12.8 million sale, with the Trustee "entitled" to a "commission" on the entire $12.8 million. Of course, the sale price could also have been $9 million, or $5 million, or $500,000, or $100. At a foreclosure sale, another bidder would have had to produce $12,865,435 in cash before the Bank would have had to reach into its proverbial pocket. In economic reality, if the Property had been abandoned, the

Bank would have obtained the Property as the lone bidder at a foreclosure sale for a nominal price. *See Carteret Sav. & Loan Ass'n, F.A. v. Davis*, 105 N.J. 344, 351, 521 A.2d 831 (1987) (study showed that in only 3% of foreclosure sales did secured creditor pay over nominal amount, and in only 3% did outside bidder purchase for an amount equaling mortgages, interest, costs, and sheriff's fees). It is only in the theoretical realm that the same transaction could be a nominal transaction worth $0 to the Trustee or a $12.8 million transaction potentially providing compensation of over $360,000, depending on whether it is called a "sale free and clear."

Had the Trustee structured the sale so that the Bank paid $7.78 million cash and he handed it right back, the question would arise: Why? The only reason to set up such a sale would be to generate compensation for the Trustee – a violation of the Trustee's fiduciary duty that could result in the reduction or denial of compensation. Indeed, such a transaction has been deemed "farcical." *In re Music Merchandisers, Inc.*, 131 B.R. at 379-80 (denying compensation on moneys "deemed" disbursed); *cf. In re H.E. Graf, Inc.*, 125 B.R. 604, 606 (Bankr. E.D. Cal. 1991) (denying "preposterous" request for compensation on sale proceeds paid to secured creditor that had purchased its overencumbered collateral). An award of maximum compensation for such a "sale" would not pass a proper

Section 330 reasonableness determination.

Despite the Trustee's suggestion that no court in America would "deny" the Trustee's "commission" if this were a cash transaction, trustees often receive less than the maximum. *See, e.g.*, *In re Kusler*, 224 B.R. 180, 192 (Bankr. N.D. Okla. 1998) (denying maximum where trustee sold fully encumbered asset and received minimal funds for unsecured creditors); *In re Lehal Realty Assocs*., 112 B.R. 590, 593 (Bankr. S.D.N.Y. 1990) (maximum not awarded where "the Trustee would have been required to perform the same services if the property had sold for $710,000 rather than over $7 million"). Indeed, courts have criticized trustees who administer overencumbered assets to increase their compensation. *See, e.g.*, *Carey v. Pauline (In re Pauline)*, 119 B.R. 727, 728 (9th Cir. B.A.P. 1990) ("the Trustee has apparently engaged in a course of conduct designed to enhance the size of his bank account rather than the size of the funds available for the Debtor's unsecured creditors"); *In re Preston Lumber Corp.*, 199 B.R. 415, 416 (Bankr. N.D. Cal. 1996) ("The trustee's powers under the Bankruptcy Code are not supposed to be money-making assets which the trustee can make available to the highest bidder."); *In re Crawford Hardware, Inc.*, 82 B.R. 885, 889 (Bankr. S.D. Ohio 1987) ("[W]hen [turnovers of money to secured creditors] leave minimal assets for unsecured creditors, that fact limits the percentage this Court will allow as compensation in connection with those turnovers.”).

Although the Trustee urges that there is no policy reason why the instant transaction should be treated differently than a cash payment from a third party, the fact remains that Congress must be presumed to have considered all relevant policies in choosing the final statutory language. As these deliberations produced no mention of non-moneys in Section 326(a), this Court should respect Congress’ intent, and should not interject its own beliefs. *Cf. Orr v. Yuhas*, 104 F.3d 612, 615 (3d Cir. 1997) (“It is not for us to take sides in this policy debate.”).

In “substance,” the Trustee did not conduct a $7.78 million cash sale, and could never have sold the Property to anyone at any price – other than the Bank. Once the “form” of a “sale free and clear” is wiped away, the economic reality is clear: the Trustee returned the Property to the entity that would have obtained it regardless of whether it was “sold” or abandoned. In exchange for conducting the Bank’s foreclosure sale, the Trustee was allowed to keep $372,387 already in his account. This is not the kind of transaction on which Congress intended to base maximum trustee compensation. As the sale only brought $372,387 into the estate, that was all the Trustee could disburse. Applying the only allowable reading of Section 326(a), the credit bid was not “actually” disbursed, cannot be considered “constructively” disbursed, and should not be included in calculating maximum trustee compensation.

2. Cases Decided Under the Act do not Universally Support a Liberal Interpretation of Section 326(a)

The Trustee and the NABT rely heavily on Act cases to support their position. As addressed above, however, changes in the wording between the Act and Code render these cases of little use in interpreting Section 326(a). Even if Act cases have some value, they support the "plain meaning" theory adopted by the District Court at least as often as the liberal position espoused by the Trustee and the NABT.

For example, in *Realty Assocs. Sec. Corp. v. O'Connor*, 295 U.S. 295, 297-98 (1935), a referee sought compensation on the face value of bonds payable in ten years. The Supreme Court held that it was unreasonable to treat the bonds as the equivalent of cash. *Id*. Indeed, the Court stated that "[c]ommon sense revolts at the suggestion that creditors have been paid," and that "[e]xtravagent costs of administration in the winding up of estates in bankruptcy have been denounced as crying evils." *Id*. at 299. Similarly, in *Callaghan v. Reconstruction Fin. Corp*., 297 U.S. 464, 466 (1936), the Supreme Court affirmed a Second Circuit decision that had allowed compensation solely on cash disbursements. The Court noted that the Act's compensation sections were strictly construed "even when the compensation allowed was . . . materially less than that which otherwise might have been considered reasonable." *Id*. at 468.

Circuit courts under the Act also applied a strict reading of the compensation statutes. *See, e.g.*, *Gugel v. New Orleans Nat'l Bank*, 239 F. 676, 679 (5th Cir. 1917) (allowing only the equivalent costs of state court foreclosure on sale of overencumbered property); *In re New York Commercial Co.*, 231 F. 445, 447 (2d Cir. 1916) (basing commissions on profits from sale, not value of property sold); *In re Meadows*, 211 F. 948, 950 (2d Cir.), *cert. denied*, 234 U.S. 763 (1914) (where trustee sold asset for small surplus, "creditors might be justified in thinking that the sale by the trustee was not for their interest, but was had for the purpose of enabling these officers to collect commissions on the entire value of the property, although the creditors had no interest except in the small equity"). *Cf. In re Harralson*, 179 F. 490, 492 (8th Cir. 1910) (denying trustee's request that mortgagee pay cash rather than credit bid, since trustee could not base commission on non-cash sale).

In addition, district court cases under the Act strictly interpreted the statutory language. *See, e.g.*, *In re Lehrenkrauss*, 16 F. Supp. 792, 793 (E.D.N.Y. 1936) (mortgages could not be reduced to a dollar value for purposes of calculating trustee compensation); *In re Morris Bros.*, 8 F.2d 629, 630 (D. Or. 1925) ("[T]he statute is plain and unambiguous . . . . it is the moneys disbursed or turned over, and not the property, that forms the basis for such allowance."); *In re Old Oregon Mfg. Co.*, 236 F. 804, 805 (W.D. Wash. 1916) ("The estate administered by the trustee was the interest which the bankrupt had in the property at the time of adjudication. This interest was the value of the property over and above the mortgage indebtedness.").

The Act circuit court decisions cited by the Trustee and the NABT are not on point. *Southwestern Media, Inc. v. Rau*, 708 F.2d 419, 422 (9th Cir. 1983), for example, is not a constructive disbursement or credit bid case at all – creditors were paid in full, in cash. The *Rau* court's holding that cash paid to secured creditors may be included in trustee compensation is a mere truism, and any statement it made about the possible existence of non-cash constructive disbursements were mere *dicta*. In addition, the decision in *Varney v. Harlow (In re Columbia Cotton Oil & Provision Corp.)*, 210 F. 824, 827 (4th Cir. 1913), was based purely on equity, not statutory application. The same goes for the District Court decisions cited by the Trustee and the NABT, none of which engages in any real statutory analysis. *See, e.g.*, *In re Lowell Textile Co.*, 288 F. 989, 990 (D. Mass. 1923) (trustee can base commission on money paid to secured creditors); *In re Toole*, 294 F. 975, 976-78 (S.D.N.Y. 1920) (broadly interpreting Act Section 48 to include stock distributed to creditors); *In re Morse Iron Works & Dry Dock Co.*, 154 F. 214, 214 (E.D.N.Y. 1906) (allowing constructive disbursement so as not "to deprive the trustee of his meager compensation for his services"); *In re Sanford Furniture Mfg. Co.*, 126 F. 888, 888-89 (E.D.N.C. 1903) (allowing referee commission on entire sale price of encumbered property, whether "subject to" or "free and clear").

Congress is assumed to take all equitable considerations into account during its deliberations; once Congress has spoken, courts must apply the statute as drafted, not legislate from the bench. If changes are to be made to the base for calculating the maximum trustee compensation calculation they must be made by Congress. The court-to-court, indeed case-by-case, interpretation of Section 326(a) suggested by the Trustee would nullify the Constitutional grant to Congress of the power "to establish . . . uniform laws on the subject of bankruptcies throughout the United States." U.S. Constitution art. I § 8. As a result, the Act cases cited by the Trustee should not be used as the basis for the judicial legislation urged by the Trustee.

3. U.S. Marshals Service Commissions are not Analogous to Maximum Chapter 7 Trustee Compensation

Without explanation, the Trustee analogizes commissions payable to the U.S.

Marshals Service under 28 U.S.C. § 1921(c) to compensation payable to private Chapter 7 trustees pursuant to Code Section 330 as limited by Section 326(a). The relevant portion of Section 1921(c) reads as follows:

> (c)(1) The United States Marshals Service shall collect a commission of 3 percent of the first $1,000 *collected* and 1½ percent on the excess of any sum over $1,000, for *seizing or levying* on property . . ., *disposing of such property by sale, setoff, or otherwise*, and *receiving* and paying over money, except that the amount of commission shall be within the range set by the Attorney General. . . . This subsection applies to any judicially ordered sale or execution sale. . . .

28 U.S.C. § 1921(c) (emphasis added).

Subsection (c) of Section 1921 was enacted by the Anti-Drug Abuse Act of 1988, Pub. L. 100-690,102 Stat. 4181 (1988), prior to which "[t]he U.S. Marshals Service costs for serving process far exceeded the fees charged private litigants, thus requiring the Service to use public funds to subsidize private litigation." 56 Fed. Reg. 2436 (1991). Although the Trustee implies that commissions constitute remuneration for individual U.S. Marshals, Section 1921 commissions are paid to the U.S. Marshals Service, a bureau of the U.S. Department of Justice, which deposits these funds into the U.S. Treasury. *See* 28 U.S.C. § 566.

Unlike trustee compensation, U.S. Marshals Service commissions are predicated upon assets recovered, not moneys disbursed. *See State Mut. Life*

Assurance Co. of Am. v. North Hotel Assocs., 1991 WL 114600, at *3-5 (E.D. Pa. 1991). The U.S. Marshals Service must (i) seize or levy on property, (ii) dispose of property, and (iii) receive and pay out money – if any one step is missed, no commission may ensue. *See, e.g.*, *Federal Land Bank of St. Paul v. Hassler*, 595 F.2d 356, 358 (6th Cir. 1979); *Hill v. Whitlock Oil Servs., Inc.*, 450 F.2d 170, 173 (10th Cir. 1971). The cases cited by the Trustee generally pre-date the 1988 amendment to 28 U.S.C. § 1921, when courts held that once these three requirements were met they had no discretion to determine a "reasonable" commission but instead had to impose the mandatory Section 1921 commission. *See, e.g.*, *Odyssey Stevedoring Corp. v. Celtic Venture*, 817 F.2d 709, 711 (11th Cir. 1987); *Bank of Am. v. M/V Executive*, 797 F.2d 772, 775 (9th Cir. 1986); *Transamerica ICS, Inc. v. M/V Hellenic Sun*, 778 F.2d 194, 195 (4th Cir. 1985).

In 1991 the Attorney General established a maximum commission of $50,000, regardless of the value of property seized, the price at which it is sold, and the amount of money disbursed. *See* 28 C.F.R. § 0.114(d). This regulation was passed to eliminate the excessive commissions that were the norm prior to the 1988 amendment to 28 U.S.C. § 1921. *See* 56 Fed. Reg. 2436 (1991). If the Trustee continues to pursue this analogy, a Section 1921(c) analysis would entitle him to only $50,000, requiring a disgorgement of over $180,000 – presumably not what he had in mind.

Likewise, the Trustee's suggestion that every case for the past 50 years supports his interpretation of "moneys" is misleading. Prior to the 1988 amendments most circuit courts addressing the issue held that, where the U.S. Marshals Service conducted a judicial sale such as a foreclosure sale, no commission could be paid as no property was "seized" or "levied." *See, e.g.*, *Hassler*, 595 F.2d at 358; *James T. Barnes & Co. v. United States*, 593 F.2d 352, 353 (8th Cir. 1979); *Travelers Ins. Co. v. Lawrence*, 509 F.2d 83, 90 (9th Cir. 1974). As a foreclosure sale is the closest non-bankruptcy comparison to the transaction in the instant case, the pre-1988 cases would have denied all compensation – again, presumably not the analogy the Trustee intended.

Indeed, prior to 1962 the U.S. Marshals Service was entitled to no commission at all, instead receiving the same small fee paid to local sheriffs for seizing and selling an asset. In 1962, Congress amended Section 1921, adding the commission to increase the amount payable to the U.S. Marshals Service, as the minuscule amounts received by local sheriffs no longer adequately reimbursed the federal government as they had in 1853, when the first U.S. Marshals Service fee statute was enacted.

Given the public policy behind Section 1921, courts have understandably read it expansively. *Cf. United States v. Petty Motor Co.*, 767 F.2d 712, 715-16 (10th Cir. 1985) (requiring actual cash payments "frustrates the intent of Congress that private parties pay the cost of the services rendered to them by the government"). It is in the common weal for the U.S. Marshals Service to obtain as much compensation as is allowable, since the appropriations made by Congress from the public fisc are offset by such compensation. *See* 28 U.S.C. § 1921(e). Indeed, any reading of Section 1921 that restricts receipts would be contrary to Congressional intent.

Code Section 326(a), on the other hand, is not as inclusive. Its very title evinces Congress' intent: "*Limitation* on compensation of trustee." As a limiting statute, it must be strictly construed lest the intent of Congress be lost. *See, e.g.*, *Taylor v. Freeland & Kronz*, 938 F.2d 420, 424 (3d Cir. 1991) ("Where [Congressional] intent is to provide leeway, a permissive construction is the right one; where it is to be strict, a permissive construction is wrong.").

Further, trustee compensation is capped by a percentage of moneys disbursed, not the value of assets "collected," "seized," "levied," and "disposed of" as well as moneys "received." In addition, whereas the U.S. Marshals Service is entitled to a "commission," trustees may request compensation – they are not "entitled" to a statutory percentage "commission." The U.S. Marshals Service may also receive commissions on dispositions of assets *by setoff or otherwise*, a phrase that could easily include credit bids. No such provision exists in Section 326(a). Thus, any case that advocates an expansive reading of 28 U.S.C. § 1921 is not instructive as to the interpretation of Section 326(a).

The tenets of statutory construction analyzed above explain why "money" in 28 U.S.C. § 1921(c) and "moneys" in Section 326(a) are construed differently. To determine the meaning of Section 326(a) this Court must look to the way "money" is used elsewhere in *title 11*; it is improper to search from one inapposite statute to another hoping to find a contrary use of the word. *Cf.* 2B *Sutherland on Statutes and Statutory Construction*, *supra*, § 51.03 at 138 ("[t]he adventitious occurrence of like or similar phrases in laws enacted for wholly different ends" does not justify interpreting the phrases similarly). The word "money" in Section 1921(c), if ambiguous, is made so by the company it keeps – most of the words surrounding it apply to asset recovery and disposal, not "disbursement" of cash. The austere "moneys disbursed or turned over" in Section 326(a) is straightforward by comparison.

For the foregoing reasons, the Trustee's attempted analogy to U.S. Marshals Service commissions is inapposite and actually undercuts the Trustee's position. Thus, it does not provide cause to overturn the District Court's decision.

4. Other Code Provisions do not Support an "Elastic" Interpretation of Section 326(a)

The NABT argues that Code Sections 330 and 363(j) support an "elastic" interpretation of Section 326(a). This is clearly incorrect. Section 331 merely enables professionals to request compensation periodically rather than wait until the end of the case. Section 330 remains the source of all compensation, and Section 326(a) still limits the amount of compensation allowable to trustees. Although some courts have allowed interim compensation when no disbursements have been made, they base the award on the fact that the trustee has the funds in hand and is expected to make disbursements. Section 331 is not a source for unearned compensation; if interim compensation awarded prior to disbursements turns out to be excessive, it is subject to disgorgement. In any event, Section 331 supports neither a strict nor a liberal interpretation of Section 326(a), which merely caps trustee compensation.

Similarly, Section 363(j) has nothing to do with limiting trustee compensation from estate funds. This section provides that a non-debtor co-owner's interest must also be sold if the trustee wants to sell an estate asset – but the co-owner's interest is not an asset of the estate. Trustees are unable to base compensation on the turnover of non-estate assets to their rightful owners, who are not "parties in interest” for purposes of Section 326(a). Under Section 363(j), the trustee’s job in relation to co-owners is simply to return their assets to them. A trustee may then charge the costs of the sale to the co-owner’s portion, but he cannot take a hearty chunk for himself from these non-estate funds. Section 363(j) imposes no limits on Section 326(a); it merely ensures that the trustee, as fiduciary to an estate, does not stray afield and attach non-estate assets in order to increase his compensation.

Neither Section 331 nor Section 363(j) has even a tangential relation to the issues raised in the instant appeal. Thus, they provide no support for the reversal of the District Court’s decision.

II. THE DISTRICT COURT PROPERLY HELD THAT TRUSTEE COMPENSATION IS SUBJECT TO A CODE SECTION 330(a) REASONABLENESS DETERMINATION

Like all professional compensation, trustee compensation is determined pursuant to Code Section 330(a), which in the version applicable to this case provides in part:

> subject to section[] 326 . . . the court may award to a trustee . . .(1) reasonable compensation for actual, necessary services rendered by such trustee . . . based on the nature, the extent, and the value of such services, the time spent on such services, and the cost of comparable services [in nonbankruptcy cases].

Like all fee applicants, trustees bear the burden of proving that requested compensation is reasonable. *See, e.g.*, *Continental Ill. Nat'l Bank & Trust Co. of Chicago v. Charles N. Wooten, Ltd. (Matter of Evangeline Ref. Co.)*, 890 F.2d 1312, 1326 (5th Cir. 1989).

Congress intended the Section 326(a) maximum to be just that – a cap on the "reasonable compensation under section 330" that the court "may allow," not an entitlement to a percentage "commission." *See* H.R. Rep. No. 95-595 at 327; *see, e.g.*, *In re Draina*, 191 B.R. 646, 648 (Bankr. D. Md. 1995); *In re C & A Enters., Inc.*, 132 B.R. 303, 310 (Bankr. W.D. Pa. 1991); *In re Volador Equity/Income Fund '86-'87*, 131 B.R. 739, 740 (Bankr. W.D. Okla. 1991). Congress' displeasure with the practice of automatically awarding the maximum was undoubtedly the reason behind the replacement of the Act term "commission" with the Code term "compensation."

Again, the House Report answers any lingering questions about the intent behind Section 326(a), "emphasiz[ing] that this section does not authorize compensation of trustees. *This section merely fixes the maximum compensation of a trustee*. Proposed 11 U.S.C. 330 *authorizes and fixes the standard of compensation*." H.R. Rep. No. 95-595 at 327 (emphasis added).

In the instant case, the Bankruptcy Court determined that Congress intended Section 326(a) to establish an incentive scheme distinguishable from compensation available to other professionals. *Bankruptcy Court Decision* at 30-31. The Court expressly stated that "[t]he compensation scheme for trustees incorporates *both* percentage-based compensation *and* a reasonable analysis." *Id*. at 31 (emphasis added). The NABT advances the same argument in its *amicus* brief.

The District Court's decision, however, is supported by the statutory language, the legislative history, and the majority of cases. The "trustee compensation scheme" established by Congress does *not* "incorporate percentage based compensation." Reasonable trustee compensation is determined under Section 330 – the percentage-based Section 326(a) cap is irrelevant to the reasonableness of a trustee's compensation. If reasonable compensation is less than the cap the trustee receives the reasonable amount; if it exceeds the cap, the trustee may only receive the cap.

The District Court was unable to determine the extent to which the Bankruptcy Court was influenced by the Section 326(a) calculation in making its reasonableness determination. *District Court Decision* at 25. As a result, the District Court properly directed that "on remand the bankruptcy court will be required to perform the reasonableness analysis based solely on the criteria set forth in § 330." *Id*.

It is unclear why the Trustee selected this as an issue to be decided on appeal. The Trustee's brief apparently acknowledges that reasonable trustee compensation is calculated pursuant to Section 330, and that Section 326(a) merely sets an upper limit and is not a factor in the reasonableness determination. The District Court merely restated the law with which the Trustee now appears to concur, and directed that on remand the Bankruptcy Court may not include the cap as a factor in the reasonableness determination. To the extent the Bankruptcy Court did not do so, as the Trustee asserts, it will not do so again. If the Bankruptcy Court's reasonableness determination was tainted by a "percentage commission" theory, it will not be in the future.

The NABT, on the other hand, asserts that the Section 326(a) cap cannot be determined without considering the Section 330 reasonable compensation, and vice versa. The only support the NABT provides is the *Guyana* case, which would presumably have to be decided differently in light of the Fifth Circuit's strict interpretation of Section 326(a) as espoused in its *Pritchard* decision, as was addressed previously in this brief.

As the Trustee does not seek a finding that the Section 326(a) cap should be factored into the Section 330 reasonableness determination, he does not seek reversal of the District Court's decision on this point. The District Court did not even make a finding that the Bankruptcy Court improperly analyzed the Trustee's request, so there is no "erroneous" finding to reverse. As a result, the District Court's decision should be affirmed in its entirety.

III. THE DISTRICT COURT PROPERLY DIRECTED THAT THE BANKRUPTCY COURT SHOULD NOT INCLUDE EXTRANEOUS FACTORS IN ITS REASONABLENESS DETERMINATION

The District Court determined that the Bankruptcy Court may have been influenced by irrelevant factors in determining the reasonableness of the Trustee's interim compensation. For example, although the Bankruptcy Court rejected every argument for preclusion raised by the Trustee, it inexplicably went on to state that its reasonableness determination was based in part upon the fact that the U.S. Trustee objected at the Final Report stage after not objecting to either the sale of the Property or the Trustee's interim compensation request. *Bankruptcy Court Decision* at 22-28.

If the Bankruptcy Court's reasonableness determination was indeed clouded by the timing of the U.S. Trustee's objection, it was clearly in error. The order approving the sale made no mention of the amount of trustee compensation to be awarded, so there were no grounds on which to appeal it even if the U.S. Trustee did not approve of the sale. In any event, the sale turned an asset with no value to the estate into $372,387 in cash; that Trustee had expressed the belief that he was entitled to much of that recovery was no reason to object to the sale.

Once the $372,387 in cash was received pursuant to Code Section 506(c), it became an estate asset that had to be disbursed according to the Code, not agreements between the parties. *See, e.g.*, *Ford Motor Credit Co. v. Reynolds & Reynolds Co. (In re JKJ Chevrolet, Inc.)*, 26 F.3d 481, 484 (4th Cir. 1994). In addition, Section 506(c) cannot be used to recover all administrative expenses incurred during the life of the case; it is only used to recover the direct costs attendant to selling the property. *See, e.g.*, *United Jersey Bank v. Miller (In re C.S. Assocs.)*, 29 F.3d 903, 906 (3d Cir. 1994). As a result, regardless of the Trustee's intentions there was no reason to assume that almost two-thirds of the Section 506(c) recovery would be in the Trustee's hands, and not unsecured creditors' hands, at the end of the case. The only valid assumption at the time of the sale was that the Bank allowed the estate to retain $372,387 because it considered that amount to be the benefit it incurred from the sale.

Nevertheless, the Trustee has continued to beat the "You never objected to the sale" drum throughout these proceedings. The U.S. Trustee's non-objection is only relevant to the Trustee's final compensation if the compensation provision was a "make or break" term of the sale, in which case the Trustee might argue that he would have withdrawn the sale and abandoned the property had the U.S. Trustee opposed the sale. If the compensation was a deal-breaker, however, the Trustee must admit that he structured the deal in order to get $204,522.76 for himself, not $62,500 for unsecured – and thus admit that he abdicated his fiduciary duty. If the Trustee administered the estate to benefit himself, his compensation is subject to being reduced or denied in full. *Cf. In re Derryberry*, 72 B.R. 874, 879 (Bankr. N.D. Ohio 1987) (directing disgorgement, removal, and disbarment where "it was obvious [the trustee's] primary concern was for his check").

Indeed, one of the primary reasons given by the Trustee for the Property sale was the possible action to be brought against the Debtor's principal. The Trustee actually certified that this action was so important that the sale should be approved even if the unsecured creditors would receive nothing.[3/] Of course, once the Trustee received his compensation he abandoned his action against Mr. Reale – but at the time the sale was proposed there was every reason for creditors and the U.S. Trustee to believe that the Trustee might be able obtain a significant recovery from Mr. Reale. Had additional funds been recovered for ultimate disbursement to creditors, the Trustee's interim compensation might have been brought in line with

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[3/] This assertion should be compared to the Trustee's brief at page 19, footnote 5, where the Trustee feigns shock that any court might allow a credit bid sale when unsecured creditors are to receive no distribution.

reality before the end of the case.

If the Court gives the Trustee the benefit of the doubt and assumes that he did not structure the transaction primarily for his own benefit, then the U.S. Trustee's non-objection to the sale is a non-issue. The sale simply brought $372,387 into the estate, and the Trustee had no rights to it other than the right to submit an application pursuant to Code Section 330(a), which he subsequently did.

As for the Trustee's 1994 interim compensation request, the Bankruptcy Court correctly noted that interim compensation is always subject to review and revision at a later stage if necessary. *See Bankruptcy Court Decision* at 22-23 and cases cited therein. Thus, the non-objection to the Trustee's interim compensation is also a non-issue, as the Trustee's interim award was not yet final and the U.S. Trustee was perfectly within her rights to object at the final hearing stage. Certainly unreasonable compensation cannot become reasonable simply because the U.S. Trustee did not object prior to the final hearing.

In any event, the Trustee never appealed the Bankruptcy Court's laches and estoppel determination, and he cannot attempt to resurrect these issues now. As the Bankruptcy Court acknowledged in rejecting the Trustee's preclusion arguments, the U.S. Trustee is simply not subject to laches and equitable estoppel as are other, non-governmental litigants. *See, e.g.*, *Heckler v. Community Health*

Servs. of Crawford Co., 467 U.S. 51, 60 (1984) ("it is well settled that the Government may not be estopped on the same terms as any other litigant"); *United States v. Summerlin*, 310 U.S. 414, 416 (1940) ("It is well established that the United States is not . . .subject to the defense of laches in enforcing its rights."); *Dole v. Local 427, Int'l Union of Elec., Radio & Mach. Workers, AFL-CIO*, 894 F.2d 607, 612 (3d Cir. 1990) ("The principle that the United States are not . . . barred by any laches of their officers, however gross . . . is established past all controversy or doubt.").

Congress created the U.S. Trustee to monitor cases and trustees and, by ensuring compliance with the Code, uphold the integrity of the bankruptcy system. *Cf.* 28 U.S.C. § 586. As creditors all too often do not take an active role in cases due in part to the assumption that recovery is unlikely, part of the U.S. Trustee's role is to speak for creditors who otherwise would have no voice. As a result, the U.S. Trustee is often only objector – but the lack of other objectors should not be used to justify the award of unreasonable compensation.

In order to perform her trustee supervision duties the U.S. Trustee receives all trustee final reports and compensation applications. In light of the huge quantities of documents received every year by the U.S. Trustee, it should come as no surprise that every interim application cannot be objected to. It should be even less surprising that the U.S. Trustee did not object to a sale that would turn a valueless asset into $372,387 in cash. The Trustee, however, effectively requests that this Court establish a rule that compensation awards, even those made pursuant to interlocutory orders, are carved in stone as soon as they are granted and may not be adjusted at the end of the case even if they were at variance with the applicable law. In addition, the Trustee effectively asks this Court to hold that the approval of a sale constitutes approval of every underlying assumption that led the parties to set the sale terms as they did – even when those assumptions are at variance with the law.

The Bankruptcy Court also based its decision in part on the irrelevant fact that the Trustee had already paid himself in full two years before the Objection was filed, thus rendering disgorgement a "hardship." This finding has no relation to the reasonableness of the requested compensation, and it ignores the fact that the Trustee unilaterally decided to pay himself in full almost one year before he filed his Final Report. The Trustee could have waited until the end of the case, included his previously-awarded compensation as an administrative expense, and proposed to pay himself along with other administrative claimants after estate administration was complete. If not reversed the Bankruptcy Court's decision would have transferred the hardship of losing over $142,000 from the Trustee to the creditors of this estate merely because the Trustee had already paid it to himself. To the extent any “equities” impact on this case, it is the interests of the estate’s intended beneficiaries, not those of the Trustee, that should prevail. To the extent that the Bankruptcy Court's decision was based on the "hardship" that the Trustee would endure if improperly paid interim compensation had to be disgorged, the decision was an abuse of the Bankruptcy Court's discretion that was properly reversed by the District Court.

The U.S. Trustee respectfully submits that the determination of reasonable compensation in December 1994 and the determination of reasonable final compensation in December 1996 (when the Objection was heard) were independent of one another. Compensation that may have looked reasonable in 1994 should be adjusted at the end of a case if it becomes clear that the interim award exceeded the statutory limits.

The Trustee’s arguments are equitable in nature. The Third Circuit has held, however, that equitable considerations cannot be used to circumvent the plain language of a statute. *See, e.g.*, *Columbia Gas Sys.,* 33 F.3d at 302; *United States Trustee v. Price Waterhouse*, 19 F.3d 138, 141 (3d Cir. 1994). As Sections 326(a) and 330 are not ambiguous, no equitable considerations may be invoked. *Cf. Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 206 (1988) (“[W]hatever equitable powers remain in the bankruptcy courts must and can only be exercised within the confines of the Bankruptcy Code.”). Any changes to the way trustee compensation is determined must be made by Congress, not the Third Circuit.

Once the "failure to object" and "hardship" arguments are stripped away, the Bankruptcy Court’s decision rests solely on the reasonableness of compensation at approximately $400 per hour, in light of the services rendered and benefits conferred by the Trustee. The reasonableness of the Trustee’s compensation must be determined by his actions, not the actions or inactions of other parties. To properly determine reasonable compensation on remand the Bankruptcy Court will have to apply the criteria contained in Section 330; no extraneous factors may called upon to avoid scrutiny of the Trustee’s compensation.

Indeed, even in the absence of a U.S. Trustee objection the Bankruptcy Court had the obligation to review the Trustee’s compensation request and deny it if it exceeded the maximum allowable. *Cf. In re Busy Beaver Bldg. Ctrs., Inc.*, 19 F.3d 833, 844 (3d Cir. 1994) (bankruptcy courts must review compensation applications to “protect the estate, lest overreaching attorneys or other professionals drain it of wealth which by right should inure to the benefit of unsecured creditors”). The Bankruptcy Court obviously did not conduct the market analysis contemplated by *Busy Beaver* – if it had it would have discovered that, while maximum compensation might be awarded in most cases, such compensation is not generally paid at a rate in excess of $400 per hour. On remand, the Bankruptcy Court will have to undergo the proper market analysis. Of course, without the Credit Bid factored into the Section 326(a) base the Trustee's maximum compensation would amount to an eminently reasonable $122.29 per hour based on the 742 hours expended during the case.

In addition, the U.S. Trustee respectfully submits that the District Court's remand should be affirmed even if the Credit Bid may be factored into the Section 326(a) cap, as the interim compensation awarded to the Trustee was nevertheless unreasonable in light of the nature of the services rendered and the concomitant benefit to the estate.

CONCLUSION

In light of the foregoing, the U.S. Trustee respectfully requests that the decision of the District Court be affirmed in its entirety.

Respectfully submitted,

PATRICIA A. STAIANO
UNITED STATES TRUSTEE
REGION 3

DONALD F. WALTON
ASSISTANT UNITED STATES TRUSTEE
DISTRICT OF NEW JERSEY
One Newark Center, Suite 2100
Newark, New Jersey 07102
(973) 645-3014

By: ______________________________
Robert J. Schneider
Senior Attorney

Dated: February 18, 1999

CERTIFICATION OF COMPLIANCE WITH FEDERAL RULE OF APPELLATE PROCEDURE 28(b)

I HEREBY CERTIFY that, at the direction of the Office of the Clerk of the United States Court of Appeals for the Third Circuit, the Brief for the Appellee, United States Trustee ("Appellee's Brief") is being filed as both the Appellee's principal brief pursuant to Federal Rule of Appellate Procedure ("F.R.A.P.") 28(b) as well as the Appellee's response to the *amicus* brief filed by the National Association of Bankruptcy Trustees.

I FURTHER CERTIFY that, at the direction of the Office of the Clerk of the United States Court of Appeals for the Third Circuit, the Appellee's Brief has been prepared in Times New Roman 14 point font, the size of which has pushed the Appellee's Brief over the page limit established by F.R.A.P. 32(a)(7)(A).

I FURTHER CERTIFY that the Appellee's Brief complies with the alternate limits of F.R.A.P. 32(a)(7)(B) in that it contains 1265 lines of text as computed by the WordPerfect 8.0 word processing software used by the Office of the United States Trustee for the District of New Jersey.

____
Robert J. Schneider
Senior Attorney

Dated: February 18, 1999

CERTIFICATION OF SERVICE

I HEREBY CERTIFY that on February 19, 1999, ten copies of the Brief for the Appellee, United States Trustee, including the original, were hand delivered to the Office of the Clerk, United States Court of Appeals for the Third Circuit, 21400 United States Courthouse, 601 Market Street, Philadelphia, Pennsylvania 19106.

I FURTHER CERTIFY that on February 19, 1999, two copies of the Brief for the Appellee, United States Trustee, were served upon each of the foregoing counsel by Federal Express, addressed as follows:

Ronald L. Glick, Esq.
Arthur H. Jones, Esq.
Archer & Greiner
One Centennial Square
Haddonfield, New Jersey 08033
Counsel for Appellant James J. Cain

Joseph I. Wittman, Esq.
435 S. Kansas Avenue, 2nd Floor
Topeka, Kansas 66603
Counsel for National Association of
Bankruptcy Trustees, *Amicus Curiae*

By: ______________________
Robert J. Schneider
Senior Attorney

BRIEF BANK — "SUMMARY SHEET"

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WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	**IN RE LAN ASSOCIATES XI, L.P. (UST v. JAMES CAIN)**
2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	D.N.J.
3. ("CCN") ***CURRENT*** CASE NO.	No.: Civil No. 98-2286-JEI (District Judge Irenas)
4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*	No.: Bankr. Case No. 92-13413-JHW (Bankruptcy Judge Wizmur) Court: Bankr. D.N.J. *(Identify judge & cite, if any)*
5. ("SO") ***SOURCE***	**U.S. TRUSTEES**
6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	Filed: May 19, 1998 Type: UST OPENING BRIEF
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8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") ! ***SUMMARY*** OF KEY ISSUE(s)	! For purposes of the cap on trustee compensation in 11 U.S.C. 326(a) — which "allow[s] reasonable compensation under § 330...not to exceed [varying per-cents] upon all moneys disbursed or turned over...by the trustee to parties" — the phrase "moneys disbursed" does not include the disbursement of estate property.
& √ Any Miscellaneous ***BACKGROUND***	√ **Background:** The Dist. Court agreed with the UST & reversed a bankruptcy court order that based a trustee's compensation on the full purchase price of estate property sold back to a secured creditor. See *UST v. Cain (In re Lan Associates)*, __ B.R. __, 1998 WL 467100 (D.N.J. Aug. 12, 1998).
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UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF NEW JERSEY

--x

In re:

LAN ASSOCIATES XI, L.P.,

Debtor.

--x

UNITED STATES TRUSTEE,

Appellant,

v.

JAMES J. CAIN,

Appellee.

--x

Chapter 7

Bankr. Case No. 92-13413 (JHW)

Civil No. 98-2286 (JEI)

Hon. Joseph E. Irenas

Proceedings Regarding the Appeal
of an Order Entered by
Hon. Judith H. Wizmur, U.S.B.J.

BRIEF BY THE UNITED STATES TRUSTEE, APPELLANT, IN SUPPORT OF APPEAL OF ORDER REGARDING OBJECTION TO THE FINAL REPORT OF JAMES J. CAIN, APPELLEE

PATRICIA A. STAIANO
UNITED STATES TRUSTEE
REGION 3

STEVEN E. MACKEY
ASSISTANT UNITED STATES TRUSTEE
DISTRICT OF NEW JERSEY
One Newark Center, Suite 2100
Newark, New Jersey 07102
(973) 645-3014

By: Robert J. Schneider
Senior Attorney
RS 0595

May 19, 1998

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STATEMENT OF BASIS FOR APPELLATE JURISDICTION

Patricia A. Staiano, the United States Trustee for Region 3 (the "United States Trustee") appeals from a final order of the United States Bankruptcy Court for the District of New Jersey. The bankruptcy court has jurisdiction over this Chapter 7 proceeding pursuant to 28 U.S.C. § 157(a). On November 13, 1996, the United States Trustee transmitted for filing the Trustee's Final Report and Final Application for Trustee Compensation (the "Final Report") of Chapter 7 trustee James J. Cain (the "Trustee") together with the United States Trustee's Objection thereto. The Final Report and its attendant Objection constituted a core proceeding under 28 U.S.C. § 157(b)(2)(A) as it was a matter concerning the administration of the estate. On March 16, 1998, the Bankruptcy Court issued a written decision that overruled the Objection. The Court's decision was subsequently memorialized in an order dated April 6, 1998, which was a final order. The United States Trustee timely noticed this appeal on March 25, 1998.[1] Accordingly, the jurisdiction of this Court is properly invoked pursuant to 28 U.S.C. § 158(a)(1).

STATEMENT OF ISSUES PRESENTED

The instant appeal presents three issues:

1. Whether the court below erred as a matter of law in deviating from the plain meaning of 11 U.S.C. § 326(a), pursuant to which maximum allowable trustee compensation is determined, and allowing the Trustee to base his compensation calculation upon the credit bid portion of a 11 U.S.C. § 363(k) sale.

2. Whether the court below erred as a matter of law in holding that trustee compensation is not limited to a reasonableness determination as required by 11 U.S.C. § 330(a).

3. Whether the court below erred in finding that the compensation received by the

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[1] Federal Rule of Bankruptcy Procedure 8002(a) states that "[a] notice of appeal filed after the announcement of a decision or order but before entry of the judgment, order, or decree shall be treated as filed after such entry and on the day thereof." Thus, the United States Trustee's appeal, filed after announcement of the decision but before an order was entered, was timely filed.

Trustee was reasonable in light of the Trustee's efforts.

STATEMENT OF APPLICABLE STANDARD OF APPELLATE REVIEW

On appeal to this Court, questions of law are reviewed *de novo*. *General Motors Acceptance Corp. v. Jones*, 999 F.2d 63, 66 (3d Cir. 1993); *First Jersey Nat'l Bank v. Brown (In re Brown)*, 951 F.2d 564, 567 (3d Cir. 1991). A bankruptcy court's findings of fact should be set aside on appeal if they are clearly erroneous. *Stendardo v. Federal Nat'l Mortgage Ass'n (In re Stendardo)*, 991 F.2d 1089, 1094 (3d Cir. 1993); *see also* Fed. R. Bankr. P. 8013.

Compensation orders present matters committed to the bankruptcy court's discretion. Abuse of discretion by a bankruptcy court may be found where "(1) the decision was based on an erroneous conclusion of law; (2) where the record contains no evidence on which the judge could have based his decision; or (3) where the supposed facts found are clearly erroneous as found." *Integrated Resources, Inc. v. Ameritrust Co. Nat'l Ass'n (In re Integrated Resources, Inc.)*, 157 B.R. 66, 72 (S.D.N.Y. 1993) (citation omitted).

STATEMENT OF THE CASE

Congress based maximum trustee compensation on cash actually disbursed by a trustee. *See* 11 U.S.C. § 326(a). Nonetheless, in the instant case the Appellee received compensation of $204,522.76, at a rate of over $400 per hour, based not only upon actual cash disbursements but also upon a credit bid of approximately $7.78 million made pursuant to 11 U.S.C. § 363(k) by the secured creditor in purchasing the principal asset of this estate. Although the Appellee obtained a return of $62,500, or 19%, to unsecured creditors, this return pales in comparison to the benefit received by the Appellee as a result of the sale.

As a fiduciary for the estate the Appellee was expected to administer estate assets to benefit the creditors of the estate, not himself. The Appellee, however, included his anticipated “commission” in determining the terms of the sale, making him the primary beneficiary of the sale from the time the sale was proposed. The Appellee’s actions resulted in the overpayment of $142,449.40 in excess of the 11 U.S.C. § 326(a) maximum. As these funds should have been paid to the unsecured creditors, the Appellee must be directed to disgorge the overpayment.

The bankruptcy court in this case committed reversible error when it found that 11 U.S.C. § 326(a) was ambiguous enough to allow trustee compensation on the credit bid portion of the sale. The bankruptcy court also erred in its analysis of the proper standard to apply to trustee compensation requests by treating the 11 U.S.C. § 326(a) maximum as a factor to be considered in making a “reasonableness” determination pursuant to 11 U.S.C. § 330(a), and not merely as a cap to be applied after the reasonable fee has been determined. Moreover, the bankruptcy court erred in finding that the compensation received by the Appellee was reasonable in light of the Appellee’s services in this case.

STATEMENT OF FACTS

On July 6, 1992, a voluntary petition was filed under Chapter 11 of title 11, United States Code (the “Bankruptcy Code” or "Code") by LAN Associates XI, L.P. (the “Debtor”). *See* Voluntary Chapter 11 petition of LAN Associates XI, L.P., Docket No. 1. On August 24, 1992, the Honorable Judith H. Wizmur, United States Bankruptcy Judge, (the “Bankruptcy Court”) entered an Order directing the United States Trustee to appoint a trustee pursuant to 11 U.S.C. § 1104(a), and on August 31, 1992, the Trustee was appointed to serve as Chapter 11 trustee. Thereafter, pursuant to the Trustee's motion, on May 21, 1993, the Bankruptcy Court entered an Order converting this case to one under Chapter 7 of the Bankruptcy Code and allowing the trustee to operate the Debtor pursuant to 11 U.S.C. § 721. *See* Docket No. 157. On or about June 2, 1993, the United States Trustee appointed the Trustee to serve as the Chapter 7 trustee.

The principal asset in this estate was a parcel of real property known as the Marlton Executive Park, Route 73 and Executive Drive, Evesham Township, New Jersey. *Id*. This asset consisted of two office buildings and was originally valued at $9,000,000 on the Debtor's schedule of real property. *See* Debtor's Schedule A, Docket No. 15. This property was encumbered by a mortgage held by First Fidelity Bank, N.A. (the "Bank") originally scheduled by the Debtor as being essentially equivalent to the value of the property, but the Bank subsequently filed a proof of claim in the amount of $12,865,434.55. *See* Certification of Trustee James J. Cain in Support of Motion to Sell Real Property, Docket No. 264. The Trustee's appraiser appraised the property at a fair market value of $9,727,000 and a liquidation value of $7,781,200. *Id*.

The Trustee was awarded compensation in the amount of $28,665.51 by Order dated April 8, 1993. *See* Docket No. 141. This compensation was based upon 163.5 hours of services rendered as Chapter 11 trustee, for a rate of $175.26 per hour. *See* Trustee's Application for Interim Allowance, Docket No. 121. The bulk of these services had involved the Trustee's acting as the landlord of the Marlton Executive Park for approximately nine months during the Chapter 11 portion of the case.

In January 1994 the Trustee filed a Certification in support of his motion to approve the sale of the Marlton Executive Park. *See* Docket No. 264. In this Certification the Trustee stated that the Bank had proposed a sale whereby it would "credit bid" $7,781,200 of its claim, an amount equal to the liquidation price. *Id*. In addition, the Bank agreed to waive its deficiency claim of approximately $5 million and also agreed to allow the Trustee to retain the $372,387 in cash collateral that the Trustee had on hand. *Id*. The Trustee also stated that notice of the sale motion would provide an opportunity for other bidders to submit higher and better offers. *Id*.

The Trustee further certified that he “ha[d] the ability” to pursue the Debtor’s general partner, Antonio Reale, “for any deficiency of property of the estate to pay all claims of the estate.” *Id*. To this end the Trustee asserted that, if he were to abandon the property, “waiting for a foreclosure to be completed in order for the deficiency to be determined would significantly delay the commencement of my cause of action” against Mr. Reale. *Id*.

The Trustee also estimated that he expected to make a claim for $70,000 as a “commission” on the rent received during his operation of the Marlton Executive Park and $233,616 as a “commission” on the sale. *Id*. The Trustee further certified that, in order to pay the remaining administrative claims and to provide a “meaningful distribution” estimated at 25% to unsecured creditors, he had “agreed to contribute $83,346.00 of the commission that I would have been authorized to receive if the property sold for at least $7,781,200.00.” *Id*. Finally, the Trustee asserted that, although he believed the 25% distribution to unsecured creditors would be meaningful, he also believed that the Bankruptcy Court should authorize the sale even without such distribution in order to facilitate any action against Mr. Reale. *Id*.

The Bankruptcy Court authorized the proposed sale pursuant to an Order dated February 14, 1994 (the “Sale Order”). *See* Docket No. 277. The Sale Order made no mention of compensation to be awarded to the Trustee as a result of the sale. *Id*. The Trustee thereafter "sold" the Marlton Executive Park on April 18, 1994, to the Bank’s subsidiary, Marlton/Fidoreo LS, Inc. *See* Report of Private Sale, attached as Exhibit B to Trustee’s Legal Brief in Response to Objection of United States Trustee to Trustee’s Final Report, Docket No. 351.

In October 1994, the Trustee submitted an application for interim compensation (the “Interim Application”) in the amount of $204,522.76 and reimbursement of $999.40 in expenses. *See* Docket No. 293. The compensation requested was for 578.50 hours, some of which was performed during his approximately nine months as Chapter 11 trustee and some of which was performed during the approximately nine months the Trustee operated it as Chapter 7 trustee. The requested compensation amounted to an hourly rate of $403.09. *Id*.

In calculating his compensation request, the Trustee included the $7.78 million credit bid portion of the sale with the cash he actually disbursed during the case, making a total base of $10,545,142.42. *Id*. From this amount the trustee calculated an “allowable commission” of $316,534.27. *Id*. From this amount the Trustee subtracted the $28,665.51 interim compensation previously received as well as a “voluntary reduction” of $83,346 from which a “meaningful distribution” of $62,500 to unsecured creditors was anticipated. *Id*.

In the Interim Application the Trustee referred to "operating revenues" of $2,763,942.42 from September 1992 through August 1994. *Id*. Based on this information, during the Chapter 11 portion of this case the Trustee received cash totaling $1,333,503.14. As a result, pursuant to 11 U.S.C. § 326(a) the maximum compensation to which the Trustee is allowed as Chapter 11 trustee is $40,185.94, of which $28,665.51 was paid pursuant to his first interim application.

Following a hearing on December 1, 1994, Trustee’s counsel submitted a letter to the Bankruptcy Court in which it was reiterated that the Trustee had taken a “voluntary reduction” from his “commission” so that a 25% distribution could be paid to all creditors. *See* letter dated December 2, 1994, from Joseph A. McCormick, Jr. Esq. to the Honorable Judith H. Wizmur, attached as Exhibit D to Docket No. 351. In support of the Trustee’s requested compensation, Trustee’s counsel stated that the Trustee was entitled to compensation in excess of that generally charged by attorneys because of the potential liability attendant to administering an asset worth over $7 million. *Id*. Finally, Trustee’s counsel urged the Bankruptcy Court to consider the results of the case and the fact that the Trustee had taken a “voluntary reduction.” *Id*.

Apparently satisfied with this information, without further hearing the Bankruptcy Court entered an order authorizing the compensation as requested. *See* Docket No. 305. This Order provided that the interim allowance was "to be paid from funds allocated by the secured creditor pursuant to the provisions of 11 USC 506c." *Id*. On December 6, 1994, the Trustee paid himself interim compensation of $204,522.76.

In March 1995 the Trustee filed a motion requesting permission to make an “interim” disbursement of $62,500 to unsecured creditors. *See* Docket Nos. 313-15. Following a hearing on April 17, 1995, the Bankruptcy Court entered an order an April 24, 1995 authorizing the “interim” distribution. *See* Docket No. 318. The Trustee thereafter made these disbursements, which amounted to 19% of the $328,538.03 total allowed unsecured claims rather than the 25% that had been represented in support of the Sale Motion and Interim Application.

On October 6, 1995, the Trustee’s proposed abandonment of his cause of action against Mr. Reale was noticed to all creditors. *See* Docket No. 331. This notice asserted that, as Mr. Reale’s liabilities apparently far outweighed his assets, it would not have been cost effective to pursue the cause of action. *Id*.

On November 20, 1995, the Office of the United States Trustee received the Trustee's Final Report. *See* Docket No. 346. In addition, an Estate Cash Receipt and Disbursement Record, which the Trustee is required to maintain pursuant to Federal Rule of Bankruptcy

Procedure 2015(a), was submitted with the Final Report. *Id*. As of the Final Report filing date, the Trustee had funds on hand totaling $19,086.88, with which he proposed to make a 73% *pro rata* distribution on the remaining amounts requested by the Clerk of the Bankruptcy Court, the Trustee's accountant, and counsel to the Trustee. *Id*.

The Trustee's Final Report reflects "Gross Estate Proceeds" of $1,679,097.80 during the Chapter 7 portion of this case. *Id*. The maximum allowable compensation on this amount pursuant to 11 U.S.C. § 326(a) is $50,552.93. Combined with the $40,185.94 maximum allowable as Chapter 11 trustee, the maximum compensation to which the Trustee is entitled for case disbursements during this case is, $90,738.87, of which he has already received $28,665.51.

As the United States Trustee determined that the Trustee is only entitled to compensation on actual cash disbursements and not on the credit portion of the sale, the United States Trustee objected to the Final Report on the grounds that Trustee’s total $233,188.27 compensation exceeded the 11 U.S.C. § 326(a) cap by $142,449.40. *See* Docket Nos. 347-48, 352, 357.

The Trustee responded that the United States Trustee had been noticed regarding the sale of overencumbered property as well as the interim compensation request, and as a result should be precluded from objecting to the Trustee’s compensation at the final hearing stage. *See* Docket Nos. 351, 356. The Trustee also asserted that the inclusion of the credit bid in his compensation calculation was a “constructive disbursement,” which had been recognized as includable in trustee compensation calculations in cases decided under the Bankruptcy Act of 1898. *Id*.

At a hearing held on December 12, 1996, the Bankruptcy Court heard the arguments of counsel and reserved her decision. *See* Transcript of December 12, 1996 hearing, Docket No. 355. On March 16, 1998 a written decision was rendered. *See* Docket No. 364. In its decision, the Bankruptcy Court agreed with the United States Trustee that the objection was not precluded by the doctrines of *res judicata*, collateral estoppel, law of the case, laches, equitable estoppel, or trustee immunity. *Id*. at 22-28. The Bankruptcy Court disagreed with the United States Trustee, however, regarding the substantive issue of whether or not the credit bid could be included in the 11 U.S.C. § 326(a) calculation. *Id*. at 17-21. Noting that pre-Code cases had acknowledged the possibility of "constructive disbursements" includable as "moneys disbursed or turned over," the Bankruptcy Court determined that 11 U.S.C. § 326(a) was ambiguous, and could not be strictly applied as written. *Id*. at 17. As a result, the Court held that the Trustee had properly included the $7.78 million credit bid in calculating his compensation request. *Id*. at 17-21.

The Bankruptcy Court then turned to whether or not the amount of compensation received by the Trustee was proper. The Court rejected the United States Trustee's assertion that trustee compensation is subject to a reasonableness determination under 11 U.S.C. § 330(a) to which the 11 U.S.C. § 326(a) amount should be strictly imposed as a cap. *Id*. at 31. Instead, the Court held that Congress intended trustee compensation to be different from compensation payable to other professionals. *Id*. The Court found that 11 U.S.C. § 326(a) serves as an incentive compensation system that allows trustees to be paid a percentage of assets brought into the estate. *Id*. Noting that in its experience trustees generally receive the maximum, and further stating that the Trustee had, after all, received less than the maximum by virtue of his "voluntary reduction," the Court held that the compensation received by the Trustee was not excessive. *Id*. 32-34.

The Bankruptcy Court did direct the Trustee to disgorge some funds, however. As the Trustee had always asserted that he would be setting aside from his "commission" enough funds to make a 25% distribution to unsecured creditors, the Court directed him to disgorge $19,634.51. *Id*. This amount, when added to the 19% distribution already received by unsecured creditors, would bring to 25% the total distribution that the Trustee had represented would be paid to unsecured creditors.

The United States Trustee filed a notice of appeal on March 25, 1998. Upon the Bankruptcy Court's entry of an order embodying its decision on April 6, 1998, the United States Trustee's notice of appeal was deemed timely filed by operation of Federal Rule of Bankruptcy Procedure 8002(a). *See* Order Regarding Objection to the Final Report by the United States Trustee, Docket No. 367.

ARGUMENT

I. THE BANKRUPTCY COURT ERRED AS A MATTER OF LAW BY DEVIATING FROM THE PLAIN MEANING OF 11 U.S.C. § 326(a) AND ALLOWING THE TRUSTEE TO INCLUDE THE CREDIT BID PORTION OF A 11 U.S.C. § 363(k) SALE IN CALCULATING HIS MAXIMUM COMPENSATION

A. Pursuant to the Plain Meaning of 11 U.S.C. § 326(a), Only Cash Disbursements are to be Included in Calculating Maximum Trustee Compensation

The maximum compensation allowable to a trustee is governed by 11 U.S.C. § 326. This provision, entitled "Limitation on compensation of trustee," provides that "the court may allow reasonable compensation under [11 U.S.C. § 330] . . . for the trustee's services . . . not to exceed [a percentage based] upon all moneys disbursed or turned over in the case by the trustee to parties in interest, excluding the debtor, but including holders of secured claims." In the instant appeal, the determination of the meaning of "moneys disbursed or turned over" is of paramount importance. The United States Trustee respectfully submits that the Bankruptcy Court's holding that the Trustee could include the credit bid in calculating his maximum compensation must be reversed as it was clearly erroneous as a matter law.

According to Supreme Court precedent, courts faced with questions of statutory interpretation must look to the words used by the legislature in drafting the statute and ascribe to these words their normal, everyday meaning. *See, e.g.*, *Perrin v. United States*, 444 U.S. 37, 42, 100 S.Ct. 311, 314, 62 L.Ed.2d 199 (1979). When the language of a statute is clear and unambiguous it is unnecessary to resort to legislative history and pre-statute case law to divine Congressional intent. *See, e.g., United States v. Ron Pair Enters., Inc.*, 489 U.S. 235, 241-42, 109 S.Ct. 1026, 103 L.Ed.2d 290 (1989). Indeed, "[t]here is, of course, no more persuasive evidence of the purpose of a statute than the words by which the legislature undertook to give expression to its wishes." *United States v. Amer. Trucking Ass'ns, Inc.*, 310 U.S. 534, 543, 60 S.Ct. 1059, 1063, 84 L.Ed. 1345 (1930).

The Third Circuit has likewise stated that "[i]t is axiomatic that statutory interpretation properly begins with the language of the statute itself, including all of its parts. There is no need to resort to legislative history unless the statutory language is ambiguous." *Velis v. Kardanis,* 949 F.2d 78, 81 (3d Cir. 1991); *see, e.g., United States Trustee v. Columbia Gas Systems, Inc. (In re Columbia Gas Systems, Inc.),* 33 F.3d 294, 300 (3d Cir. 1994) ("When a statute is clear and unambiguous, the courts must give effect to Congress' intent as Congress explained it with that writing."). Thus, a statute's ambiguity cannot arise from the legislative history or prior case law, as these sources are not even consulted until *after* a determination of ambiguity is made.

On page 12 of the decision below, the Bankruptcy Court made the following statement regarding the plain meaning of 11 U.S.C. § 326(a):

> At first blush, the plain meaning of the phrase "moneys disbursed or turned over in the case by the trustee" appears to preclude the opportunity of a Chapter 7 trustee to include a credit bid as the basis for the calculation of his/her commission. The satisfaction of the secured claim of the purchaser/lienholder does not appear to constitute "moneys," and the trustee does not literally disburse or turn over the amount of the lien to parties in interest. However, there has been substantial debate in the cases, dating back to the early days of [sic] Bankruptcy Act of 1898, as to whether, on the basis of a constructive disbursement theory, a Chapter 7 trustee may calculate a commission based on the total value of property sold to a secured creditor.

Although the Bankruptcy Court "readily acknowledge[d] that the definitional analysis of 'moneys' does not support" its decision, nevertheless the Court held that the statute was ambiguous "in light of the substantial case law that has highlighted the ambiguity of the phrase." As it was based upon factors other than the language used by Congress the Bankruptcy Court's finding of "ambiguity" is contrary to basic tenets of statutory construction and must be reversed.

In enacting 11 U.S.C. § 326(a), Congress used simple words such as “moneys” and “disbursed.” The word “moneys” is defined as “sums of money” or “funds.” *See* 2 *Webster’s Third New International Dictionary* at 1458 (1981). “Money” is something generally accepted as a medium of exchange, such as “currency, coin, negotiable paper,” and any other asset readily convertible to cash. *Id*.; *see also* IX *Oxford English Dictionary* at 992-95 (2nd ed. 1989) (in modern parlance, “money” is “applied indifferently to coin and to such promissory documents representing coin (especially government and bank notes) as are currently accepted as a medium of exchange”). “Disburse” means “to pay out or expend (money),” and a “disbursement” is defined as “that which has been disbursed; money paid out.” *See* IV *Oxford English Dictionary* at 726.

Even if the word “moneys” is viewed as a term of art, the relevant definitional sources clearly show that the common legal and commercial usage is virtually the same as the lay usage described above. For example, in legal usage the term “money” means “coins and paper currency used as circulating medium of exchange, and does not embrace notes, bonds, evidences of debt, or other personal or real estate.” *Black’s Law Dictionary* at 1005 (6th ed. 1990). In addition, in the Uniform Commercial Code the term “money” is defined as “a medium of exchange authorized or adopted by a domestic or foreign government[.]” N.J. Stat.Ann. tit. 12A § 1-201 (1997).

As the words used by Congress to constitute the phrase “moneys disbursed or turned over” are clear and unambiguous, the phrase itself is also clear and unambiguous. Even if it is deemed ambiguous, however, the Bankruptcy Court's analysis was erroneous. The Third Circuit has directed that courts should clarify perceived ambiguities regarding a word or phrase in the Bankruptcy Code by considering how the word or phrase is used elsewhere in the Code. *Velis v. Kardanis*, 949 F.2d at 81. The word “money” as used elsewhere in the Bankruptcy Code always refers to cash or cash equivalents. For example, 11 U.S.C. § 345 addresses the investment of “money of the estate.” Congress’ intent in using the word “money” in this Code section is obvious — one cannot “deposit or invest” the encumbered portion of a parcel of real estate, nor can one “deposit or invest” the value of creditor claims extinguished. In addition, one of the fundamental trustee duties under the Bankruptcy Code is to “collect and *reduce to money* the property of the estate.” 11 U.S.C. § 704(1) (emphasis added). Again, Congress’ intent that assets be turned into cash for ultimate distribution to creditors is evident. Thus, an examination of Congress’ use of “money” elsewhere in the Bankruptcy Code eliminates any lingering doubts about the intended meaning of the word without the need to resort to pre-Code cases.

In light of the “plain meaning” doctrine as applied by the Supreme Court and Third Circuit, the Bankruptcy Court’s ruling on the ambiguity of 11 U.S.C. § 326(a) is reversible error. Once the Bankruptcy Court determined "at first blush" that the word “moneys” was unambiguous, its inquiry into the meaning of “moneys disbursed or turned over” should have ended — there is no "second blush." As “moneys” means “sums of money,” “disburse” means “pay out money,” and “money” means “cash or other instruments generally accepted as a medium of exchange and easily convertible to cash,” under Supreme Court and Third Circuit precedent the Bankruptcy Court had little choice but to find that the phrase “moneys disbursed or turned over” means “cash or cash equivalents disbursed or turned over.” Thus, the Court’s strained finding of “ambiguity” based not on the language of the statute but on pre-Code case law was erroneous, and must be reversed.

B. The Legislative History of 11 U.S.C. § 326 Does Not Support the Bankruptcy Court's Decision

Pursuant to Supreme Court precedent, the only time courts are to disregard a statute's plain meaning is when a strict application "will produce a result demonstrably at odds with the intentions of its drafters." *United States v. Ron Pair Enters., Inc.*, 489 U.S. at 242. When the legislative history of 11 U.S.C. § 326 is examined, however, it becomes evident that the strict application espoused by the United States Trustee is entirely consistent with Congress' concerns at the time the Bankruptcy Code was enacted. The House Report stated that 11 U.S.C. § 326(a) is to be applied to “the *amounts of money distributed by the trustee*” and not to cases in which a trustee takes compensation for simply turning over property to a secured creditor. H.R. Rep No. 595, 95th Cong., 1st Sess. 327 (1977) (emphasis added).

Courts have held that the House Report language demonstrates that the drafters of the

Code specifically rejected those cases under the Bankruptcy Act of 1898 which allowed compensation to trustees based on "constructive disbursements" of something other than cash. *See, e.g.*, *In re Indoor-Outdoor Dining, Inc.*, 77 B.R. 952, 954 (Bankr. S.D. Fla. 1987) ("The statutory history [of Section 326(a)] suggests a deliberate rejection of some decisions under the former statutes which would equate the debtor's property with 'moneys' administered by the trustee."); *In re New England Fish Co.*, 34 B.R. 899, 901 (Bankr. W.D. Wash. 1983). It is disingenuous to believe that, in completely overhauling the bankruptcy laws of this country, Congress chose not to correct a perceived ambiguity. Obviously, Congress perceived no ambiguity in the phrase “moneys disbursed or turned over.”

Congress had the opportunity to add phrases such as the following to 11 U.S.C. § 326(a): “value of assets administered”; “amount of claims paid or otherwise extinguished”; or, as the Trustee proposed and the court below accepted, "the extent of potential liability undertaken by the trustee." Despite its assumed knowledge of the hoary precedent for including non-“moneys” in calculating trustee compensation, Congress chose not to base trustee compensation on anything other than “moneys disbursed or turned over.” *See, e.g.*, *In re Barnett*, 133 B.R. 487, 489 (Bankr. N.D. Iowa 1991) (Congress "could, but did not, choose the words 'property' or 'value' . . . . I cannot escape the feeling that were I to rule in the trustee's favor, I would be legislating a result different from that provided for by Congress."); *In re New England Fish Co.*, 34 B.R. at 901 ("Had it so desired, Congress could readily have included properties turned over, assumed claims, and the value of compromised claims as well as monies as the basis on which commissions were to be computed. However, it did not do so.").

In the decision below, the Bankruptcy Court stated that Congress' failure to change the phrase "moneys disbursed or turned over" provides no evidence as to its position regarding whether "moneys" may include a constructive disbursement. Another tenet of statutory interpretation supports the United States Trustee's argument regarding this issue, however: *expressio unius est exclusio alterius* — in essence, "The expression of one thing excludes another." Although Congress was presumably aware of the disagreement in pre-Code cases as to whether "moneys" may include anything other than actual cash disbursed, it nevertheless based maximum trustee compensation upon moneys disbursed or turned over, and nothing else. As a result, it must be assumed that everything that is not "moneys" was intentionally excluded from the calculation.

In light of the foregoing, the United States Trustee respectfully submits that the legislative history makes it clear that Congress expected trustees to be paid for disbursing cash to creditors, not engineering "sales" of overencumbered property to the secured creditor. As a result, the legislative history does not support the Bankruptcy Court's decision in the instant case.

C. Case Law Decided Under the Bankruptcy Code Does Not Support the Bankruptcy Court's Decision

The overwhelming majority of cases interpreting the phrase "moneys disbursed or turned over" under the Bankruptcy Code have held that "the trustee's compensation must be based on actual monies disbursed . . . and not on assets or settlements which can be construed as a constructive disbursement." *In re New England Fish Co.*, 34 B.R. at 901-02; *see, e.g., Havis v. Rhea (In re Rhea)*, 143 B.R. 690, 691 (S.D. Tex. 1992); *Kandel v. Alexander Leasing Corp.*, 107 B.R. 548, 551 (N.D. Ohio 1988) (trustee compensation can only be based on "monies [that] actually passed through [the trustee's] hands"); *In re Landing, Inc.*, 142 B.R. 169, 172 (Bankr. N.D. Ohio 1992) (trustee compensation may be based only on cash actually disbursed, and not value of liens assumed by buyers); *In re Music Merchandisers, Inc.*, 131 B.R. 377, 380 (Bankr. M.D. Tenn. 1991) ("[t]hat the trustee did not disburse or turn over cash money has compelled courts on various facts to resist inclusion of 'constructive disbursements' in the compensation base for purposes of § 326"); *In re North Am. Oil & Gas, Inc.*, 130 B.R. 473, 480-81 (Bankr. W.D. Tex. 1990) ("[u]nliquidated assets simply 'turned over' to the liquidating agent are not includable" in determining trustee compensation).

The few courts under the Bankruptcy Code that have strayed from a strict application of 11 U.S.C. § 326(a) are easily distinguishable. In *In re Greenley Energy Holdings of Pa., Inc.*, 102 B.R. 400 (E.D. Pa. 1989), the trustee was allowed compensation based on the present value of $28,000,000 in guaranteed contracts entered into by the trustee. In that case, however, the trustee was a Chapter 11 trustee who had engineered what the court termed a "small miracle" by taking a non-operating debtor confronted with a $30 million environmental reclamation project and developing a business plan that paid all secured and unsecured creditors in full. *Id*. at 401. As the trustee had created new property and had not merely turned property over to a party in interest, the court determined that it would be unjust to deny the trustee compensation based on the guaranteed contract funds to be received by the creditors. *Id*. at 404-05. Indeed, the trustee did not even request the maximum, and he sought compensation at the rate of only $226 per hour. *Id*. at 403 n.3; *cf*. *In re Stanley*, 120 B.R. 409 (Bankr. E.D. Tex. 1990) (although court held that lien assumptions could be included in calculating the trustee's maximum compensation, it stated that it would have denied compensation if the sale had been of fully encumbered property or property with nominal equity).

Similarly, in *In re Guyana Dev. Corp.*, 201 B.R. 462 (Bankr. S.D. Tex. 1996), the case relied upon most heavily in the Bankruptcy Court's decision, involved a Chapter 11 trustee who ran a multinational firm and confirmed a liquidating plan that paid 88% to unsecured creditors. Total cash disbursements in the case were $79,938,954.41. *Id*. At 472. Given the complexity of the case and the magnificent benefit for unsecured creditors, it is no surprise that the *Guyana* court held that a lodestar analysis would not result in reasonable compensation.

Other courts recently faced with the same issue as the court below have properly applied the plain meaning of 11 U.S.C. § 326(a) in holding that maximum trustee compensation is calculated upon actual cash disbursements, and not on the "credit bid" portion of a 11 U.S.C. § 363(k) sale. For example, in *United States Trustee v. Messer (In re Pink Cadillac Assocs.)*, 96 Civ. 4571 (S.D.N.Y. April 7, 1997), the Honorable Louis L. Stanton of the Southern District of New York vacated a bankruptcy court order which had allowed the trustee to include the amount of a credit bid in calculating his compensation request. In *Pink Cadillac*, the trustee sold an asset encumbered by a lien of over $2.7 million to the mortgagee for a credit bid of $1.5 million. *Id*. slip op. at 2-3. The trustee then requested $20,000 in compensation, despite the fact that he had made no actual cash disbursements during the case. *Id*. The basis for the compensation requested was an agreement between the trustee and the mortgagee, and the trustee argued that $20,000 was well below the 11 U.S.C. § 326(a) maximum if the $1.5 million credit bid was included in the calculation. *Id*. Based upon the "constructive disbursement" of the $1.5 million credit bid, the 11 U.S.C. § 326(a) maximum would have been $68,250. Thus, the trustee in *Pink Cadillac* was purportedly taking a "voluntary reduction" of 71% of the "commission" to which he thought he was "entitled" upon the credit bid portion of the sale. Indeed, the bankruptcy judge in *Pink Cadillac* based his decision in part upon the assumption that the trustee was "entitled" to a

$68,000 “commission.” *Id*., slip op. at 4.

The District Court in *Pink Cadillac* found that the emphasis on "moneys" rather than value or property was consistent with Congress' position regarding the trustee's principal duty to "reduce to money" property of the estate. *Id*., slip at 5-6. In addition, the *Pink Cadillac* court noted that many cases decided under the Bankruptcy Code have interpreted "moneys" literally. *Id*., slip op. at 6. The court rejected the trustee's argument that a strict application raises form over function, as the money did not actually pass through the trustee's hands and it was not "clear how he would have done so." *Id*., slip op. at 9. As the credit bid covered the entire purchase price of the property, the transaction did not give rise to "moneys" that could be used to calculate maximum trustee compensation. *Id*.

The United States Trustee respectfully submits that the *Pink Cadillac* analysis of the "plain meaning" and legislative intent behind 11 U.S.C. § 326(a) is far more sound and grounded in precedent than the Bankruptcy Court's analysis in the instant case. The Trustee "sold" property with a liquidation value of $7.78 million for a credit bid of $7.78 million plus $372,387 in cash. As in *Pink Cadillac*, the total amount of the mortgage far exceeded the value of the property, making it questionable how the Trustee could have structured a pure cash transaction with a secured creditor that could win any "bidding war" without having to pay a cent merely by bidding the entire amount of its claim pursuant to 11 U.S.C. § 363(k). In addition, the trustee in *Pink Cadillac* argued that he had taken a "voluntary" reduction of 71%, but the District Court was not taken in by this ruse as the trustee was actually entitled to 0% of the amount requested. In the instant case the Trustee argued, and the Bankruptcy Court accepted, that in order to carve out a distribution to administrative claimants and unsecured creditors the Trustee had generously taken a “voluntary reduction” of a mere 26% of his "commission." Although no cash changed hands in *Pink Cadillac*, it is obvious from the District Court's analysis that if cash had changed hands the trustee would only have been allowed to include the cash, and not the credit bid, in his 11 U.S.C. § 326(a) calculation.

In another recent case, a bankruptcy judge in the Southern District of New York followed the *Pink Cadillac* reasoning in holding that a trustee was not entitled to base his compensation upon the credit bid portion of a 11 U.S.C. § 363(k) sale, and that even if compensation could be based on the credit bid the compensation requested was unreasonable in light of the services rendered. *See In re Colonial Southbury L.P.*, Case No. 94-22057 (Bankr. S.D.N.Y. June 3, 1997). In *Colonial Southbury L.P.*, the trustee obtained a court order authorizing the sale of assets subject to a lien of $16.5 million to the secured creditor for $3 million. *Id*., slip op. at 3-4. Pursuant to a stipulation order previously entered by the court, the secured creditor agreed to contribute an amount equal to 3% of the sale price for distribution to creditors, and the trustee would be “entitled to receive a commission of all disbursements made while operating” the debtor. *Id*., slip op. at 4.

The trustee subsequently requested “commissions” of $91,138.96 on the credit bid sale. *Id*., slip op at 5. The United States Trustee objected on the grounds that the trustee had not actually disbursed the $3 million credit bid, that the trustee could not use 11 U.S.C. § 506(c) to circumvent the plain meaning of 11 U.S.C. § 326(a), and that the requested compensation was not reasonable. *Id*. The trustee argued that the credit bid was a disbursement as contemplated in 11 U.S.C. § 326(a) and that the requested compensation had been authorized by previous orders of the court. *Id*.

The *Colonial Southbury* court agreed that the line of cases supporting the United States Trustee's position was "compelling, particularly in light of the legislative history of Section 326(a)." *Id.*, slip op. at 8. The court stated that allowing the requested compensation "would equate to judicial legislation." *Id*. In addition, the court rejected the trustee's dependence on pre-Code cases as the legislative history makes it clear that Congress has determined that "moneys" is not the equivalent of "property." *Id.*, slip op. at 9 n.7. As the United States Trustee had pointed out, the secured creditor could have bid its entire $16 million claim instead of the $3 million credit bid — in which case the trustee would have sought compensation on $16 million, which could not be what Congress intended. *Id*. Thus, the court only allowed the trustee to receive compensation on actual cash disbursements. *Id.*, slip op. at 12.

In light of the foregoing, the United States Trustee respectfully requests that the reasoning of the *Pink Cadillac* and *Colonial Southbury* decisions be adopted as they are grounded in the proper application of the "plain meaning" doctrine to facts similar to those in the instant case. As the Bankruptcy Court's decision runs counter to the vast majority of cases interpreting 11 U.S.C. § 326(a), it should be reversed.

D. Pre-Code Third Circuit Cases Do Not Support the Bankruptcy Court's Decision

In order to support its decision, the Bankruptcy Court resorted to cases decided under the Bankruptcy Act of 1898. *See, e.g., Southwestern Media, Inc. v. Rau*, 708 F.2d 419 (9th Cir. 1983); *In re Sanford Furniture Mfg. Co.*, 126 F. 888, 889 (E.D.N.C. 1903). Nevertheless, pre-Code decisions of the Third Circuit, even those cited by the Bankruptcy Court, do not support its decision. For example, the Third Circuit in *American Surety Co. v. Freed,* 224 F. 333, 337 (3d

Cir. 1915), expressly stated that it was not faced with a constructive disbursement situation. The Third Circuit held that the trustee could only receive compensation on the cash received, as he had essentially sold the equity in the asset to the bondholders who, for all intents and purposes, already owned the rest of the property. *Id*. at 336. Although the Third Circuit cited cases that had addressed the issue of constructive disbursements, it did not state, even in *dicta*, that it acknowledged the viability of constructive disbursements in the calculation of maximum trustee compensation. Thus, the statement of the Bankruptcy Court in the instant case that the Third Circuit in *American Surety* "confirmed" the constructive disbursement analysis of earlier cases was incorrect.

Although the Third Circuit has apparently never squarely addressed the question of whether or not credit bids may be included in calculating trustee compensation, one pre-Code case in particular is illustrative. In *In re Prindible*, 115 F.2d 21 (1940), the Third Circuit was faced with a situation in which the trustee's final account reflected an entry for "Amount of Distribution of Real Estate" in the amount of $29,200. *Id*. at 23. The encumbered real estate in question "was sold in bankruptcy to the mortgagees thereof for the discharge of the mortgage debt, the mortgagees contributing, under agreement with the trustee, $1,800 toward the general administration expenses. No part of the consideration, except for the $1,800, ever came into the trustee's hands." *Id*. The total funds received by the trustee during the case was $3,556.50, all of which was consumed by administrative expenses. *Id*.

Finding that "[t]he fees and commissions appear to bear no relation to the extent of services or to the quantum of the estate actually administered," the Third Circuit reversed the District Court's order, which had dismissed the appeal of the referee's order approving the trustee's final account. *Id*. at 22, 25. The Third Circuit held as follows:

> Trustees in bankruptcy . . . are public officers and officers of the court, and compensation is owing to them only on clear warrant of law. Before trustees in bankruptcy are entitled to compensation upon moneys disbursed or turned over by them to lienholders, it is necessary that the trustees show some act of administration with respect to encumbered property, such as preserving an equity of the bankrupt in the property. *And, even then, compensation has been held to be due only upon the value of the equity of redemption.*

Id. at 24 (emphasis added).

The Third Circuit directed the referee to recover from "those who participated in the division of the bankrupt's estate in excess of reasonable fees, commissions and expenses or surcharge the trustee for the improvident payments." *Id.* After these amounts were recovered, "the fund representing the value of the encumbered property *actually sold by the trustee and for which he received payment of the consideration*" was to be set aside for distribution to lienholders and, if any residue was left, to the general estate. *Id.* at 24-25 (emphasis added).

Thus, in *In re Prindible* the Third Circuit found that trustees may only take compensation on the equity portion of a sale of encumbered property — i.e., the actual cash received and not the value of mortgages extinguished. Similarly, in another pre-Code case, the Third Circuit, faced with a trustee seeking compensation for returning the debtor's property to it, stated that "it is clear that the word 'moneys' in the clause '. . . upon all moneys disbursed or turned over by him to any persons, including lienholders, . . . ' is not the equivalent of property." *In re Brigantine Beach Hotel Corp.*, 197 F.2d 296, 299 (3d Cir.), *cert. denied*, 344 U.S. 832 (1952). It is reasonable to assume that, faced with the facts in the instant case, the Third Circuit would hold that the Trustee's compensation may be based on the cash disbursed by the Trustee, but not the credit bid.

In light of the foregoing, even the pre-Code cases upon which the Bankruptcy Court below relied are inapposite. The Third Circuit's pre-Code cases do not support a "constructive disbursement" argument. The pre-Code Third Circuit cases state that "moneys" does not mean the value of property administered, and that trustees may only receive compensation for the cash portions of transactions rather than the forgiveness of debts.

As the Bankruptcy Court's decision has no valid basis in statutory interpretation, legislative history, and case law under the Bankruptcy Code, and pre-Code Third Circuit cases, it is erroneous as a matter of law and should be reversed.

II. THE BANKRUPTCY COURT ERRED AS A MATTER OF LAW IN HOLDING THAT TRUSTEE COMPENSATION IS NOT LIMITED TO A REASONABLENESS DETERMINATION AS REQUIRED BY 11 U.S.C. § 330(a)

Like all other professional compensation, trustee compensation is determined pursuant to 11 U.S.C. § 330(a), which in the pre-1994 Amendment version applicable to this case provides in pertinent part as follows:

> subject to section[] 326 . . . the court may award to a trustee . . . (1) reasonable compensation for actual, necessary services rendered by such trustee . . . based on the nature, the extent, and the value of such services, the time spent on such services, and the cost of comparable services [in nonbankruptcy cases].

As is the case with any other fee applicant, a trustee bears the burden of proving that his requested compensation is reasonable. *See, e.g., Continental Ill. Nat'l Bank & Trust Co. of Chicago v. Charles N. Wooten, Ltd. (Matter of Evangeline Ref. Co.)*, 890 F.2d 1312, 1326 (5th Cir. 1989). By the clear language of the statute the reasonableness of trustee compensation is based not solely upon a lodestar calculation dependent upon reasonable hours and a reasonable hourly rate; the trustee must prove that his services are reasonable in light of the benefit conferred to the estate.

The legislative history shows that Congress intended the 11 U.S.C. § 326(a) maximum to be just that — a cap on the "reasonable compensation under section 330" that the court "may allow," not an entitlement to a percentage "commission." *See* H.R. Rep. No. 595, 95th Cong., 1st Sess. 327 (1977); *see, e.g.*, *In re Draina*, 191 B.R. 646, 648 (Bankr. D. Md. 1995); *In re C & A Enters., Inc.*, 132 B.R. 303, 310 (Bankr. W.D. Pa. 1991); *In re Volador Equity/Income Fund '86-'87*, 131 B.R. 739, 740 (Bankr. W.D. Okla. 1991) (citing 2 Lawrence P. King, *Collier on Bankruptcy*, ¶ 326.01[1] at 326-6 (15th ed. 1991). Congress' displeasure with the pre-Code practice of automatically awarding the maximum was undoubtedly the reason behind the Bankruptcy Code's jettisoning of the misleading term "commission" in favor of "compensation."

Indeed, the legislative history could not be more clear — trustee compensation is subject to the same reasonableness determination as that of any other professional. Again, the House Report answers any lingering questions about the intent behind 11 U.S.C. § 326(a):

> It must be emphasized that this section does not authorize compensation of trustees. *This section merely fixes the maximum compensation of a trustee*. Proposed 11 U.S.C. 330 *authorizes and fixes the standard of compensation*. Under section 48c of current law, the maximum limits have tended to become minimums in many cases. *This section is not intended to be so interpreted*. The limits in this section, together with the limitations found in section 330, *are to be applied as outer limits, and not as grants or entitlements to the maximum fees specified*.

Id. at 327 (emphasis added).

The Bankruptcy Court below determined that in enacting 11 U.S.C. § 326(a) Congress intended to set up an incentive scheme distinguishable from compensation available to other professionals. In light of the foregoing discussion, the United States Trustee disagrees with the *Guyana* decision upon which the Bankruptcy Court's decision primarily relies. The Bankruptcy Court improperly incorporated the 11 U.S.C. § 326(a) maximum as a factor in the "reasonableness" decision, rather than determining reasonableness first and only then applying the 11 U.S.C. § 326(a) cap.

The Bankruptcy Court stated that trustees generally receive the maximum compensation, as if that was what Congress had intended. Even if most trustees receive the maximum in most cases there would be no reason to assume that it is reasonable for *this* trustee in *this* case to receive the maximum without the proper 11 U.S.C. § 330 analysis. While the legislative history acknowledged the pre-Code practice of awarding trustees the maximum in virtually every case, it did so with disdain, not approval, stating that such practice "diverged from the original intent of [the] draftsmen [of the Bankruptcy Act of 1898's trustee compensation provisions.]" H.R. Rep. No. 95-595 at 93. Congress could not have intended to codify this practice in the new Code.

Congress did indeed hope to provide incentive for trustees to find and liquidate assets and distribute the proceeds to creditors. It did *not* do this, however, by enacting 11 U.S.C. § 326(a). The incentive was introduced by eliminating the Bankruptcy Act provision that allowed trustees in minimal asset cases to obtain a discretionary award of $150. *Id*. at 103-04, 109. Congress determined that this $150, which had become automatic with most courts, took away any incentive to pursue questionable assets. *Id*. Eliminating the discretionary fee was expected to "cause the system to operate more for the benefit of creditors than for the benefit of administration." *Id*. at 109. Thus the purpose of the "incentive" was to prod trustees to obtain greater returns for creditors, not to increase trustee compensation.

The only nod to increasing trustee compensation was the significant increase in the percentages to be applied in calculating the 11 U.S.C. § 326(a) maximum. While this was genuinely intended to increase trustee compensation and ensure that qualified people were willing to serve as trustees, the fact remains that Congress merely *increased the percentages* applied to the compensation base. The method of determining "reasonable" trustee compensation did not become a "commission" calculation.

Trustee compensation does have one salient feature that distinguishes it from all other professional compensation under the Bankruptcy Code — it is subject to a limit that is beyond the court's discretionary "reasonableness" determination. Every other professional but the trustee may obtain astronomical fees merely for working hard and providing beneficial services. The trustee, on the other hand, can put in more hours and provide more benefit than anyone else, but at the end of the case his compensation is still subject to a ceiling comprised of a percentage of disbursements made during the case. Thus, 11 U.S.C. § 326(a) is not to be used to enhance, or even to determine, trustee compensation. As its very title indicates, it imposes a "limitation on compensation to trustees."

In light of the foregoing, the United States Trustee respectfully submits that the Bankruptcy Court's interpretation of the Congressional intent behind 11 U.S.C. § 326(a) is erroneous. Not only does it contradict the clear meaning of the words used in the statute, the Bankruptcy Court's analysis also flies in the face of Congress' own expression of its intent. The United States Trustee respectfully submits that the Bankruptcy Court's holding regarding the standard applicable to trustee compensation requests must be reversed, and that the Trustee's compensation must be subject to a "reasonableness" determination pursuant to 11 U.S.C. § 330(a) subject to the cap imposed by 11 U.S.C. § 326(a).

III. THE BANKRUPTCY COURT ABUSED ITS DISCRETION IN FINDING THAT THE COMPENSATION REQUESTED BY THE TRUSTEE IN THIS CASE WAS REASONABLE IN LIGHT OF THE SERVICES RENDERED BY THE TRUSTEE

Even if the credit bid may be included in the 11 U.S.C. § 326(a) compensation base, the total award of $233,188.27 for the services rendered as Chapter 11 and Chapter 7 trustee in the instant case was not reasonable as required by 11 U.S.C. § 330(a). The Bankruptcy Court introduced irrelevant factors into the reasonableness determination, and otherwise inflated the actual value to the estate of the Trustee’s services. As a result, the Bankruptcy Court’s decision was an abuse of discretion and should be reversed.

One of the irrelevant factors considered by the Bankruptcy Court was the fact that the United States Trustee objected at the Final Report stage, but did not object to the 11 U.S.C. § 363(k) sale or the interim compensation request. Although the Bankruptcy Court flatly rejected every argument for preclusion raised by the Trustee, the Court inexplicably went on to state that its determination of the reasonableness of the Trustee's compensation was based in part upon the fact that the United States Trustee had not previously objected. This portion of the Bankruptcy Court's decision was clearly in error, as the reasonableness of the compensation received by the Trustee is based on the Trustee's actions alone, and is completely independent of the actions or inactions of any other party. The “failure to object” arguments raised by the Trustee were only relevant to a determination as to whether or not the United States Trustee’s objection could be considered. Once the Bankruptcy Court had properly rejected the "red herring" preclusion arguments thrown up by the Trustee, the Court's analysis should have been restricted to whether or not the Trustee's services and the concomitant benefit to the estate warranted the compensation received.

Similarly, the Bankruptcy Court based its decision in part on the irrelevant fact that the

Trustee had already paid himself in full two years before the Objection was filed, thus rendering disgorgement a "hardship." This finding has no relation to the reasonableness of the requested compensation, and it ignores that fact that the Trustee made the decision to pay himself in full almost one year before he filed his Final Report. The Trustee clearly could have waited until the end of the case, included his previously awarded compensation as an administrative expense to be paid, and only paid himself after the administration of the case was complete. The Bankruptcy Court's decision means that the creditors of this estate should bear the hardship of not receiving an additional $140,000 merely because the Trustee had already paid it to himself. The United States Trustee respectfully submits that the determination of reasonable compensation in December 1994 and the determination of reasonable final compensation in December 1996 (when the Objection was heard) were independent of one another. To the extent that the Bankruptcy Court's decision was based on the "hardship" that the Trustee would endure if improperly paid interim compensation had to be disgorged, the decision was an abuse of the Court's discretion that must be reversed.

Once the "failure to object" and "hardship" arguments are stripped away, the decision below rests solely on the reasonableness of compensation totaling $233,188.27, or approximately $400 per hour based on 578.50 hours worked, in light of the services rendered and benefits conferred by the Trustee in this case. The United States Trustee respectfully submits that compensation received by the Trustee was unreasonable.

The Trustee’s services in this case, while presumably competent, were far from the Herculean feats achieved by the *Greenley* and *Guyana* trustees discussed above. The Trustee managed two office buildings for nine months in Chapter 11 and another nine months in Chapter 7. When he sold the asset, it was to a secured creditor with a claim almost $5 million in excess of the purchase price. Although the Trustee asserted that by noticing the "sale" he was allowing other bidders to come up with higher and better offers, in reality it was highly unlikely that the secured creditor would be outbid. The highest appraised value for the property was $9 million, and the secured creditor's mortgage exceeded that amount by $3 million. Any third-party bidder would have had to pay over $12 million before it could have outbid the secured creditor. As a result, the Trustee did not *constructively* disburse $7.78 million, as there was never really a chance of him *actually* disbursing $7.78 million. Indeed, even if the Trustee had structured the transaction so that the secured creditor handed him $7.78 million cash and he handed it right back, such a transaction would in no way warrant compensation at $400 per hour.

The Trustee did obtain a benefit for unsecured creditors — the $372,387 cash he received from the sale. His services in this case resulted in a total of $2,763,942.42 in cash receipts. For these services, the United States Trustee asserts that the Trustee is entitled to $90,738.87, not an insignificant sum in light of the fact that unsecured creditors received a mere $62,500 from the Trustee's services.

It is clear, however, that the transaction was not structured to benefit unsecured creditors, but to benefit the Trustee. They received a percentage of *his* dividend — which is exactly the opposite of Congress' intent and the fiduciary duty of a Chapter 7 trustee. The Trustee received over 50% of the cash brought in by the sale. His commission was not 3% of the amount disbursed to creditors, but three times as much as the supposed beneficiaries of his services as fiduciary during the case. Indeed, the Trustee could easily have structured the same transaction with the unsecured creditors receiving the lion's share and himself receiving a percentage "carve-out" from the unsecured creditors' recovery. In light of the fact that the Trustee structured the transaction to benefit himself above the creditors to whom he owes a fiduciary duty, the United States Trustee respectfully submits that the compensation received by the Trustee in this case is unreasonable.

Even if a higher amount than that calculated by the United States Trustee is reasonable, however, compensation of $400 per hour is out of touch with reality. In this case, the Trustee had an attorney, an accountant, and a real estate broker. One must assume that some of the services rendered in running and selling the Marlton Executive Park between September 1992 and February 1994 were performed by these other professionals. The Bankruptcy Court certainly made no findings to the contrary, either in support of the interim compensation request or at the December 1996 hearing.

The Third Circuit has held that bankruptcy courts have an affirmative duty to review all compensation requests for reasonableness under 11 U.S.C. § 330. *See In re Busy Beaver Bldg. Centers, Inc.*, 19 F.3d 833 (3d Cir. 1994). To the extent that the Bankruptcy Court's decision of reasonableness was based on the Court's experience with compensation received by other trustees in similar cases, then the decision must be reversed as the Court did not conduct the kind of market rate analysis anticipated by the Third Circuit's *Busy Beaver* decision. *Id*. at 852-56. There has been no determination of the "hourly rates," if any, charged by other trustees in the Camden vicinage in cases of similar size and complexity. As a result, there is absolutely no basis upon which to determine whether or not the compensation awarded to the Trustee was reasonable.

Although the Bankruptcy Court did direct a small disgorgement to enable unsecured creditors to receive the 25% recovery that the Trustee had proposed, the Trustee has still been allowed to retain compensation far in excess of the reasonable value of his services. As the Bankruptcy Court's decision was not based upon a proper 11 U.S.C. § 330 determination, it was an abuse of discretion and should be reversed.

CONCLUSION

In light of the foregoing, the United States Trustee respectfully requests that the decision of the Bankruptcy Court be reversed.

Respectfully submitted,

PATRICIA A. STAIANO
UNITED STATES TRUSTEE
REGION 3

STEVEN E. MACKEY
ASSISTANT UNITED STATES TRUSTEE
DISTRICT OF NEW JERSEY

By: __________________________
Robert J. Schneider
Senior Attorney

Dated: May 19, 1998

PATRICIA A. STAIANO
UNITED STATES TRUSTEE
REGION OF NEW JERSEY, DELAWARE, & PENNSYLVANIA
ONE NEWARK CENTER, SUITE 2100
NEWARK, NEW JERSEY 07102
(973) 645-3014
By: Robert J. Schneider, Esq.
RS 0595

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF NEW JERSEY

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In re:	Chapter 7
LAN ASSOCIATES XI, L.P.,	Bankr. Case No. 92-13413 (JHW)
Debtor.	

---x

UNITED STATES TRUSTEE,	Civil No. 92-2286 (JEI)
Appellant,	Hon. Joseph Irenas
v.	Proceedings Regarding the Appeal of an Order Entered by Hon. Judith H. Wizmur, U.S.B.J.
JAMES J. CAIN,	
Appellee.	

---x

CERTIFICATE OF SERVICE

IT IS HEREBY CERTIFIED that on this 19th day of May, 1998, the Brief by the United States Trustee, Appellant, in Support of Appeal of Order Regarding Objection to the Final Report of James J. Cain, Appellee, and supporting papers were caused to be served by Federal Express, addressed as follows:

JOSEPH A. MCCORMICK, JR., ESQ.
Weinberg, McCormick, Chatzinoff & Paul
109 Haddon Avenue
Haddonfield, New Jersey 08033
Counsel for Appellee James J. Cain

By: ______________________
Jennifer A.F. Sullivan
Paralegal Specialist

BRIEF BANK — "SUMMARY SHEET"

Printed Fri.-1/8/99 (12:36)

WESTLAW CODES	
1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	**IN RE LAN ASSOCIATES XI, L.P. (UST v. JAMES CAIN)**
2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	D.N.J.
3. ("CCN") ***CURRENT*** CASE NO.	No.: Civil No. 98-2286-JEI (District Judge Irenas)
4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*	No.: Bankr. Case No. 92-13413-JHW (Bankruptcy Judge Wizmur) Court: Bankr. D.N.J. *(Identify judge & cite, if any)*
5. ("SO") ***SOURCE***	**U.S. TRUSTEES**
6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	Filed: June 12, 1998 Type: UST REPLY BRIEF
7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*	John L. Daugherty (UST/OGC) Robert J. Schneider (UST/REGION 3-Newark) *(UST/OGC: 202-307-1399/FAX-2397)*
8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") ! ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	! For purposes of the cap on trustee compensation in 11 U.S.C. 326(a) — which "allow[s] reasonable compensation under § 330 ... not to exceed [varying percents] upon all moneys disbursed or turned over ... by the trustee to parties" — the phrase "moneys disbursed" does not include the disbursement of estate property. √ **Background:** The District Court agreed with the UST and reversed a bankruptcy court order that based a trustee's compensation on the full purchase price of estate property sold back to a secured creditor. See *UST v. Cain (In re Lan Associates)*, __ B.R. __, 1998 WL 467100 (D.N.J. Aug. 12, 1998).
10. PATH TO FILE LOCATION: (e.g., S:\GENERAL COUNSEL\BRFBANK\etc...)	S:\GENERAL COUNSEL\BrfBank\To-West-Net\GROUP03 West-Net\LAN2-RPL.wpd
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UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF NEW JERSEY

---x
In re:

LAN ASSOCIATES XI, L.P.,

Debtor.
---x
UNITED STATES TRUSTEE,

Appellant,

v.

JAMES J. CAIN,

Appellee.
---x

Chapter 7

Bankr. Case No. 92-13413 (JHW)

Civil No. 98-2286 (JEI)

Hon. Joseph E. Irenas

Proceedings Regarding the Appeal
of an Order Entered by
Hon. Judith H. Wizmur, U.S.B.J.

BRIEF BY THE UNITED STATES TRUSTEE, APPELLANT, IN *REPLY* TO THE BRIEFS FILED BY JAMES J. CAIN, APPELLEE AND THE NATIONAL ASSOCIATION OF BANKRUPTCY TRUSTEES, *AMICUS CURIAE*

PATRICIA A. STAIANO
UNITED STATES TRUSTEE
REGION 3

STEVEN E. MACKEY
ASSISTANT UNITED STATES TRUSTEE
DISTRICT OF NEW JERSEY
One Newark Center, Suite 2100
Newark, New Jersey 07102
(973) 645-3014

By: Robert J. Schneider
Senior Attorney
RS 0595

June 12, 1998

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I. The Bankruptcy Court's Finding That Credit Bids May be Included in Calculating the 11 U.S.C. § 326(a) Cap on Trustee Compensation is a Finding of Law Subject to *de novo* Review, Not a Finding of Fact Subject to an "Abuse of Discretion" Review

As the briefs previously filed by the Trustee (the "Trustee's Brief") and United States Trustee (the "UST's Brief")[1] agree, the Bankruptcy Court's findings of law are reviewed *de novo* by the District Court, and are not subject to the deferential "abuse of discretion" standard applied to findings of fact. The United States Trustee ("UST") presented the Bankruptcy Court with a threshold legal question: may the phrase "moneys disbursed or turned over" include the credit bid portion of a 11 U.S.C. § 363(k) sale? The answer to this question is a finding of law, based upon statutory interpretation, legislative history, and case law. As a result, on appeal this Court must make its own *de novo* determination as to whether the phrase "moneys disbursed or turned over" applies only to cash and cash equivalents, as the UST argues, or if it may be read expansively to include credit bids, as argued by the Trustee and National Association of Bankruptcy Trustees ("NABT") as *amicus curiae*.

The Trustee's Brief and the NABT's *amicus* brief (collectively, the "Responding Briefs") assert that this issue is left to the Bankruptcy Court's discretion. The UST respectfully submits that, while the 11 U.S.C. § 330(a) determination of reasonable compensation in an amount between $0 and the cap is discretionary, the method for calculating the cap itself is not. *See* 2 Lawrence P. King, *Collier on Bankruptcy* ¶ 330.03[1] at 330-13 (15th ed. 1998) ("The requirement of reasonableness in section 330 in no way affects the limitation imposed by section

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[1] The UST's Brief is included herein by reference in its entirety. "Trustee" refers throughout this Reply Brief to the Appellee, James J. Cain.

326.”). Indeed, courts have no discretion to award an amount in excess of the 11 U.S.C. § 326(a) cap. *See, e.g.*, *Matter of Rauch*, 110 B.R. 467, 475 (Bankr. E.D. Cal. 1990) (“[T]here is no question as to the interpretation of § 326(a) in that it provides a cap on the discretionary authority to approve trustee’s fees based upon funds brought in and expended from the estate.”); *see also Collier on Bankruptcy*, ¶ 326.02[2][c] at 326-8.

If the Bankruptcy Court’s determination of the cap was fact-driven and not governed by the applicable statutory and case law establishing clear boundaries regarding maximum trustee compensation, then the wrong standard was applied and the decision should be reversed. The UST respectfully submits, however, that this was actually finding of law, not a finding of fact. Even though it stated that its inclusion of the credit bid in the 11 U.S.C. § 326(a) cap was based on the circumstances of the case, the Bankruptcy Court’s holding was based on an analysis of the applicable statutes, legislative history, and case law. At page 22 of its decision, the Bankruptcy Court “conclude[s] that the statute on its face does not preclude the inclusion of the extent of the lien as a basis for calculation of the trustee’s commission in this case” — a finding clearly grounded in statutory analysis, not the facts of the case.

The only true finding of fact made by the Bankruptcy Court was the reasonableness of the Trustee’s compensation. Other than the reasonableness issue, the appeal raises no real factual disputes between the UST and the Trustee. This is so despite the attempt in the Trustee’s Brief’s Statement of Facts to make it seem as though the Trustee’s every action was in compliance with UST guidelines. The sections of the UST memoranda cited in the Trustee’s Brief at pages 7-8 deal solely with the propriety of selling encumbered property. They are silent as to the ability of a trustee to seek compensation on credit bids, which is the issue underlying this appeal. As a result, whether or not he complied with them is irrelevant to a determination of whether compensation may be based on a credit bid.

The UST respectfully submits that the interpretation of 11 U.S.C. § 326(a) cannot be fact sensitive if there is to be any consistency regarding what may or may not be included when calculating maximum trustee compensation. If the Court accepts the Trustee's argument regard the fact-based determination of the statutory maximum, Congress' intended cap on trustee compensation would be rendered a nullity as it would be subsumed within the 11 U.S.C. § 330(a) "reasonableness" determination. The determination of whether or not the credit bid in the instant case may be included in the 11 U.S.C. § 326(a) cap, must turn on the meaning of "moneys disbursed or turned over," not the vagaries of the case. As a result, it is a legal issue that this Court must determine *de novo*

If this Court agrees with the UST that the 11 U.S.C. § 326(a) cap may only be based on disbursements of cash or cash equivalents, then the Trustee will be entitled to no more than $90,738.87, even if a "reasonable" award would be higher. This Court need not review the Bankruptcy Court's use of discretion unless it makes a *de novo* finding that credit bids may be included in calculating the 11 U.S.C. § 326(a) cap.

II. The Trustee Has Provided No Statutory Analysis to Assist This Court in its *de novo* Determination of the Meaning of "Moneys Disbursed or Turned Over"

At pages 11 through 15 the UST's Brief provides considerable analysis of the "plain meaning" doctrine as applied to the phrase "moneys disbursed or turned over" in 11 U.S.C. § 326(a). To summarize, statutes must be interpreted by looking first at the words used by Congress and ascribing to them their common meaning. If the words comprising the statute are unambiguous, then the statutory analysis ends there and the statute must be applied as written. If a court finds a particular word to be ambiguous, the meaning of the word as used elsewhere in the statute is dispositive. Legislative history and prior case law are only consulted after the statute is found to be ambiguous, and thus cannot be the source of such ambiguity.

In the instant case, the Responding Briefs provide no statutory analysis to refute that provided by the UST. Instead, they take the same leap in logic made by the Bankruptcy Court, bypassing the required first step of statutory language analysis and beginning with the assumption that the phrase "moneys disbursed or turned over" is ambiguous because pre-Code cases and legislative history make it so. The UST's Brief, on the other hand, attempts to assist this Court's *de novo* determination by logically proceeding through the steps involved in statutory analysis.

The UST respectfully requests that this Court adopt the uncontroverted statutory analysis in the UST's Brief. As the word "moneys" is used in common parlance and elsewhere in the Code to refer only to cash and cash equivalents, nothing else may be included in calculating the 11 U.S.C. § 326(a) cap. Subjective considerations such as "reasonableness" and "fairness" cannot be used to override the plain meaning of the statute. *See, e.g., U.S. Trustee v. Columbia Gas Sys. Inc. (In re Columbia Gas Sys. Inc.)*, 33 F.3d 294, 302 (3d Cir. 1994); *U.S. Trustee v. Price Waterhouse*, 19 F.3d 138, 141 (3d Cir. 1994).

The UST respectfully submits that the application of basic tenets of statutory construction must inevitably result in the reversal of the Bankruptcy Court's erroneous legal finding regarding the inclusion of credit bids in calculating maximum allowable trustee compensation.

III. The Sources Cited in the Responding Briefs do Not Support the Finding That "Moneys Disbursed or Turned Over" May Include the Amount of Credit Bids

In support of the Trustee's position the Trustee's Brief at page 13 quotes at length a passage from *Collier on Bankruptcy* (which itself cites a case decided under the Bankruptcy Act of 1898, although citations are omitted from the Trustee's Brief). On the very next page, however, that noted treatise makes the following statement in direct contradiction of the Trustee's position: "Compensation may be based on actual monies distributed to parties in interest, *not constructive disbursements*." 2 Lawrence P. King, *Collier on Bankruptcy* ¶ 326.02[2][f][ii] at 326-10 (emphasis added). This portion of the treatise contains citations to cases decided under the Code — one of which, *New England Fish Co.,* 34 B.R. 899, 901 (Bankr. W.D. Wash. 1983) (cited in both the UST's and Trustee's Briefs), expressly held that Congress rejected the theory of constructive disbursements when it passed 11 U.S.C. § 326(a). It would appear that the quote on which the Trustee relies is a vestige of past editions of *Collier on Bankruptcy* from earlier this century, and that the present editors adhere to the UST's position. In any event, the conflicting sections render this source useless to the Trustee.

In addition, the Trustee's reliance upon the Third Circuit's decision in *American Surety Co. v. Freed*, 224 F. 333, 337 (3d Cir. 1915), is misplaced. Both the Bankruptcy Court and the Trustee are incorrect when they state that the Third Circuit "cited with approval" cases that allowed constructive disbursements. Instead, the Third Circuit merely acknowledged the existence of the cases cited to it by the trustee and referee, and went directly on to state that "[t]he case under review does not require us to approve or follow that law." *American Surety*, 224 F. at 336-37. At no point in its entire opinion did the Third Circuit even suggest that it accepted the possibility that trustees might include constructive disbursements in calculating their maximum compensation. Indeed, the District Court in *American Surety* had relied on the constructive disbursement cases upon which the Trustee pins his hopes, and its decision was flatly reversed by the Third Circuit. *See id.*; *In re Breakwater Co.*, 220 F. 26 (E.D. Pa. 1915). As a result, *American Surety* provides no support for the Trustee's position.

The Trustee's Brief is also inaccurate when it states at page 15 that the UST's Brief suggested that the trustee in *In re Greenley Energy Holdings of Pa., Inc.*, 102 B.R. 400 (E.D. Pa. 1989), was "qualif[ied]" to receive compensation upon a constructive disbursement. The UST's Brief at page 17-18 merely discussed the facts of *Greenley* in order to show that they are distinguishable from the instant case. The UST's Brief did not opine as to whether the *Greenley* court had made the correct decision. In any event, the "constructive disbursement" in *Greenley* was of actual cash that would be generated over time by the $28,000,000 in guaranteed contracts entered into by the trustee. *Id*. at 18. Since the disbursements would be made over a number of years, the court allowed the trustee to be paid now rather than years from now, after the creditors had received their cash.

The *Greenley* case provides no support for the argument that credit bids may be included in calculating maximum trustee compensation, as it was a case in which *actual cash* ("moneys") would ultimately be received by creditors. The NABT's *amicus* brief at 4 is patently incorrect when it states that the UST "acknowledges" that the courts in *Greenley* and *In re Stanley*, 120 B.R. 409 (Bankr. E.D. Tex. 1990) "embraced the concept of including 'credit bids' in determining the compensation to trustees." These courts neither embraced nor rejected the concept of including credit bids in the 11 U.S.C. § 326(a) cap, as neither case involved a credit bid situation.

Accordingly, the UST's Brief at 17 merely states that these cases are among the scant few "that have strayed from a strict application of 11 U.S.C. § 326(a)" — but even these cases did not stray into the realm of credit bids.

Similarly, the Trustee's reliance on *In re Leedy Mortgage Co., Inc.*, 126 B.R. 907 (Bankr. E.D. Pa. 1991) is completely misplaced. The Trustee's Brief is misleading when it states that the UST approved of constructive disbursements in that case, since the *Leedy* case involved the payment of actual cash to creditors.[2] The "constructive" aspect of the disbursements was the fact that the cash was paid by the trustee's accountant rather than the trustee himself. *Id.* This case provides no support for the argument that credit bids may be included in calculating the 11 U.S.C. § 326(a) cap, as the judge expressly noted that cash was paid to the secured creditors. *Id.* at 916.

In addition, the Trustee's Brief is misleading when it implies at page 17 that the court in *New England Fish Co., Inc.*, 34 B.R. 889 (Bankr. W.D. Wash. 1983), "acknowledged" the existence of authority in support of constructive disbursements. In fact, *New England Fish Co., Inc.* is actually one of the strongest cases in support of a strict reading of 11 U.S.C. § 326(a). The Trustee's Brief did not include the entire quote, which reads: "*Under the Bankruptcy Act*, there is authority for the trustee's position." *Id.* at 900 (emphasis added). The court then went on to hold that Congress intentionally did not codify the "constructive disbursement" cases of which it was undoubtedly aware, and thus rejected the "constructive disbursement" theory. *Id.* at

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[2] The Trustee's Brief is also misleading in that it identifies the UST attorney referred to in *Leedy* as the "Assistant United States Trustee." Although he was so designated by the *Leedy* judge, this is a common misnomer often applied to UST attorneys. The attorney in *Leedy* has never held the high-level position of Assistant United States Trustee, a fact that the UST pointed out to the Trustee in the case below but which the Trustee has decided to shield from this Court.

901-02. The court applied a strict application of the plain meaning of 11 U.S.C. § 326(a), and disallowed compensation upon several "constructive disbursements" including credit bids. *Id*.

Both of the Responding Briefs cite *Southwestern Media, Inc. v. Rau*, 708 F.2d 419 (9th Cir. 1983), suggesting that the *New England Fish Co., Inc.* court improperly ignored the earlier ruling of its Circuit court. This argument neglects the fact that the *Southwestern Media* case was filed prior to the effective date of the Bankruptcy Code. *Id.* at 421 n.1. As a result, it was a Bankruptcy Act case, and the *New England Fish Co., Inc.* court found that the "constructive disbursement" theory under the Act did not survive the enactment of 11 U.S.C. § 326(a). Thus, the failure to cite *Southwestern Media* is understandable. In any event, *Southwestern Media* does not support the Trustee's position as in that case creditors were paid 100% in cash. *Id.* at 421-22. It was not a credit bid case, or even a constructive disbursement case — all discussion of constructive disbursement cases is mere *dicta.* The issue was whether the trustee could base his compensation on all of the $2,500,000 cash generated by his sale of an encumbered asset to a third party, or if he could only base it on an amount equal to the equity in the asset. *Id*. at 423.

The Trustee's reliance on recent cases to support his position is also misguided. The court in *United States Trustee v. Messer (In re Pink Cadillac Assocs.)*, 96 CV 4571 (S.D.N.Y. April 7, 1997) did not base its finding regarding the compensability of credit bids upon the specific facts of the case, as the Trustee's Brief suggests at 18, but on the strict application of 11 U.S.C. § 326(a). Indeed, the court expressly stated that "[t]he bankruptcy court's determination that the $20,000 award did not exceed the maximum amount allowable under the Bankruptcy Code *is a conclusion of law subject to de novo review in this court.*" *Id.*, slip op. at 4 (emphasis added).

Similarly, in *In re Colonial Southbury L.P.*, Case No. 94-22057 (Bankr. S.D.N.Y. June 3, 1997), the court did not make the statement attributed to it by the Trustee's Brief at 18. *Id*., slip op. at 9. The quoted material comes instead from a case cited by the *Colonial Southbury* court. In addition, the Trustee's Brief feebly attempts at 18 to distinguish *Colonial Southbury*, in which the trustee received $50,404.85 on actual cash disbursements of $943,097.06 but wanted an additional $91,138.96 based on a credit bid of $3,000,000, from the instant case, in which the Trustee received $90,738.87 on actual cash disbursements of over $2 million but wants to keep an additional $142, 449.40 based on a credit bid of $7.78 million. Contrary to the Trustee's assertion, it is the similarities between the cases, not the differences, that are obvious — the only real difference is the size of the numbers. In virtually every aspect the *Colonial Southbury* case mirrors the instant case, and the *Colonial Southbury* court found in favor of the UST.

Both of the Responding Briefs cite and attach as an exhibit a recent case, *In re Borrego Springs Dev. Corp.*, Case No. 94-10475-B7 (Bankr. S.D. Cal. Feb. 18, 1998), to support the Trustee's position. In the *Borrego Springs* case, the trustee requested compensation of $296,742.22 in addition to $100,000 previously received, and he was awarded $155,450 in addition to the $100,000 previously paid. *Id*., slip op. at 1, 3. The court gave no explanation as to why it reduced the trustee's award by over $141,000, a figure eerily reminiscent of the overpayment the UST seeks to have the Trustee disgorge in the instant case. Indeed, the *Borrego Springs* court did not specify either the amount of cash included in the transaction or the amount paid to unsecured creditors. For all this Court knows, unsecured creditors received a 100% distribution, and the mysteriously reduced compensation was allowed only upon actual cash disbursements. In any event, the issue before the *Borrego Springs* court was only the 11 U.S.C. § 330 reasonableness determination, not the calculation of the 11 U.S.C. § 326(a) cap.

Finally, the Trustee Brief misreads the Third Circuit's decision in *In re Marine Maintenance Corp.*, 181 F.2d 119, 121 (3d Cir. 1950). The Third Circuit was faced not only with the surcharge of a trustee, but also the trustee's appeal of his compensation award. *Id*. at 121. The Third Circuit addressed the compensation award first — and decided against the trustee, who thought he was entitled to greater compensation than had been awarded. *Id*. Indeed, he appealed the referees determination, the issue being "the correctness of the referee's calculation of the sum available for fees and disbursements." *Id*.

Whether intentional or not, the Trustee's Brief at 21 misleadingly implies that the Third Circuit found in favor of the trustee in *Marine Maintenance*. The entire quote, which the Trustee did not provide to this Court, reads as follows:

> The Trustee is an experienced lawyer. Generally speaking, he performed an excellent job of work in this tedious, exacting matter. He was instrumental in the good over-all results obtained. *However*, we cannot say that the sum awarded to him is so unreasonable as to warrant interference by this Court.

Id. (emphasis added).

The trustee's compensation was not disturbed, so the trustee lost this issue on appeal (although he did prevail with regard to surcharges due to "bad accounting practice"). *Id*. Since he had appealed his award, he undoubtedly thought he deserved more. The Third Circuit disagreed, despite the fact that the trustee had performed well. As a result, this case provides absolutely no support for the Trustee in the instant case.

In sum, when the sources cited in the Responding Briefs are read with a critical eye, it becomes clear that they have cited no authority under the Bankruptcy Code for allowing a trustee to base his compensation on the non-cash portion of a transaction. The UST respectfully requests that this Court reverse the Bankruptcy Court's erroneous legal finding that credit bids may be included as "constructive disbursements" in calculating the 11 U.S.C. § 326(a) cap.

IV. The Compensation Received by the Trustee Exceeds the Bounds of Reasonableness

The Responding Briefs are misleading in that they imply that the UST's concerns regarding reasonableness are based solely on the hourly rate represented by the compensation allowed to the trustee to date. In actuality, the UST Brief points out that the Trustee's services in this case were workmanlike, not spectacular. The Trustee will be paid handsomely, but not excessively, if the UST prevails on this appeal.

As the UST Brief points out, the compensation received by the Trustee is outrageous when compared to the benefit to the estate of his services. In this case unsecured creditors received $62,500. As his reward for making this distribution and serving as a landlord for 18 months, the Trustee actually argues that he is entitled to $233,188.27 — over three times the amount paid to unsecured creditors that are the intended beneficiaries of his services. Indeed, over one half of the cash brought in by the credit bid sale went directly into the Trustee's pocket. It is the extreme inequity of the Trustee's compensation in light of his services and the comparatively small payment to creditors, not just the hourly rate, that leads to the UST's assertion that the award was unreasonable.

In light of the foregoing, the UST respectfully requests that this Court reverse the factual finding that the Trustee's compensation was reasonable as it was an abuse of the Bankruptcy Court's discretion in light of the record before it regarding the Trustee's services.

CONCLUSION

For all of the reasons stated in this Reply and the UST's Brief, the UST respectfully requests that this Court reverse the Bankruptcy Court's decision.

Respectfully submitted,

PATRICIA A. STAIANO
UNITED STATES TRUSTEE
REGION 3

STEVEN E. MACKEY
ASSISTANT UNITED STATES TRUSTEE
DISTRICT OF NEW JERSEY

By: ________________________
Robert J. Schneider
Senior Attorney

Dated: June 12, 1998

PATRICIA A. STAIANO
UNITED STATES TRUSTEE
REGION OF NEW JERSEY, DELAWARE, & PENNSYLVANIA
ONE NEWARK CENTER, SUITE 2100
NEWARK, NEW JERSEY 07102
(973) 645-3014
By: Robert J. Schneider, Esq.
RS 0595

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF NEW JERSEY

--x

In re:	Chapter 7
LAN ASSOCIATES XI, L.P.,	Bankr. Case No. 92-13413 (JHW)
Debtor.	
UNITED STATES TRUSTEE,	Civil No. 92-2286 (JEI)
Appellant, v.	Hon. Joseph Irenas
	Proceedings Regarding the Appeal of an Order Entered by Hon. Judith H. Wizmur, U.S.B.J.
JAMES J. CAIN,	
Appellee.	

--x

CERTIFICATE OF SERVICE

IT IS HEREBY CERTIFIED that on this 12th day of June, 1998, the Brief by the United States Trustee, Appellant, in Reply to the Briefs Filed by James J. Cain, Appellee and the National Association of Bankruptcy Trustees, *Amicus Curiae*, and supporting papers were caused to be served by Federal Express, addressed as follows:

JOSEPH A. MCCORMICK, JR., ESQ.
Weinberg, McCormick, Chatzinoff & Paul
109 Haddon Avenue
Haddonfield, New Jersey 08033
Counsel for Appellee James J. Cain

By: ______________________
Jennifer A.F. Sullivan
Paralegal Specialist

BRIEF BANK — “SUMMARY SHEET”

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WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*

In re: Stephanie Kay Lanning (Lanning et al. v. Hamilton)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*

10th Cir.

3. ("CCN") ***CURRENT*** CASE NO.

No.: 08-3009

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*

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Court: BAP 10th Cir.

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Melissa R. Burgess, Sean E. Martin, P. Matthew Sutko

(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***

BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***

• Whether the Bankruptcy Appellate Panel correctly held that the starting point in computing a debtor’s “projected disposable income” is the debtor’s“ disposable income,” as defined in section 1325(b)(2), multiplied by the number of months in the chapter 13 plan, but that the amount is subject to adjustment if it fails to predict a debtor’s actual ability to fund a plan.

√ **Background:**

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No. 08-3009

IN THE UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

In re STEPHANIE KAY LANNING,

Debtor.

JAN HAMILTON, CHAPTER 13 TRUSTEE,

Trustee-Appellant,

v.

STEPHANIE KAY LANNING,

Debtor-Appellee.

ON APPEAL FROM THE BANKRUPTCY APPELLATE PANEL
FOR THE TENTH CIRCUIT
BANKRUPTCY JUDGES BOHANON, McNIFF, THURMAN

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE SUPPORTING AFFIRMANCE

OF COUNSEL:

ROBERTA A. DEANGELIS
Acting General Counsel

P. MATTHEW SUTKO
Associate General Counsel
Executive Office for United States Trustees
Department of Justice
20 Massachusetts Avenue, N.W.
Washington, D.C. 20530

JEFFREY S. BUCHOLTZ
Acting Assistant Attorney General

WILLIAM KANTER
(202) 514-4575
EDWARD HIMMELFARB
(202) 514-3547
Attorneys, Appellate Staff
Civil Division, Room 7646
Department of Justice
950 Pennsylvania Avenue, N.W.
Washington, D.C. 20530

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STATEMENT OF RELATED CASES

There are no prior or related appeals. However, as explained in this brief, the same or similar issue is being and has been litigated in other cases.

IN THE UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

No. 08-3009

In re STEPHANIE KAY LANNING,

Debtor.

JAN HAMILTON, CHAPTER 13 TRUSTEE,

Trustee-Appellant,

v.

STEPHANIE KAY LANNING,

Debtor-Appellee.

ON APPEAL FROM THE BANKRUPTCY APPELLATE PANEL
FOR THE TENTH CIRCUIT

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE SUPPORTING AFFIRMANCE

Pursuant to Rule 29 of the Federal Rules of Appellate Procedure, the United States submits this brief as amicus curiae supporting affirmance of the Bankruptcy Appellate Panel's order.

STATEMENT OF THE ISSUE

Whether the Bankruptcy Appellate Panel correctly held that the starting point in computing a debtor's "projected disposable income" is the debtor's "disposable income," as defined in section 1325(b)(2), multiplied by the number of months in the chapter 13 plan, but that the amount is subject to adjustment if it fails to predict a debtor's actual ability to fund a plan.

INTEREST OF THE UNITED STATES

The Attorney General appoints United States Trustees to supervise the administration of bankruptcy cases and trustees in regions comprising the vast majority of the federal judicial districts. 28 U.S.C. 581-589a. United States Trustees "serve as bankruptcy watch-dogs to prevent fraud, dishonesty, and overreaching in the bankruptcy arena." H.R. Rep. No. 595, 95th Cong., 1st Sess. 88, reprinted in 1978 U.S.C.C.A.N. 5963, 6049. The United States Trustee Program thus acts in the public interest to promote the efficiency, and to protect and preserve the integrity, of the bankruptcy system. To this end, Congress has provided that "[t]he United States trustee may raise and may appear and be heard on any issue in any case or proceeding." 11 U.S.C. 307. See In re Donovan Corp., 215 F.3d 929, 930 (9th Cir. 2000).

This case involves a dispute over confirmation of a plan under chapter 13 of the Bankruptcy Code. The United States Trustee is authorized, among other things, to "supervise the administration of cases and trustees" in chapter 13 cases, monitor chapter 13 plans, and file comments with the court regarding such chapter 13 plans in connection with a plan confirmation hearing under section of the Code. 28 U.S.C. 586(a)(3)(C).

In 2007, more than 310,000 persons filed bankruptcy petitions under chapter 13.[1] In chapter 13 cases, with so-called above-median debtors,[2] the question of statutory interpretation presented in this case has occurred frequently and is continuing to occur. In fact, there are already scores of bankruptcy court decisions that have faced this statutory issue.

As of the date on which this brief is filed, no court of appeals has yet issued a decision addressing the issue. This is only the second case in which the issue has been presented to a court of appeals. We filed an amicus brief in the first such case, Kagenveama v. Maney (In re Kagenveama), No. 06-17083 (9th Cir.), and presented oral argument in August 2007. The matter is awaiting decision.

Given the decision of the debtor in this case not to file a brief in this Court, our amicus brief will be the only one to defend the decisions below. In this brief, the

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[1] See http://www.uscourts.gov/bnkrpctystats/sept2007/f2table.xls (Excel spreadsheet).

[2] An above-median debtor is the name often used in referring to a debtor whose current monthly income under 11 U.S.C. 101(10A), multiplied by 12, is above the annual median income in the state of a family of comparable size. See 11 U.S.C. 1325(b)(3).

United States respectfully offers this Court its views on the correct interpretation of section 1325(b). See 28 U.S.C. 517 (authorizing Department of Justice "to attend to the interests of the United States in a suit pending in a court of the United States").

STATEMENT OF FACTS

A. Statutory Background.

In 2005, Congress passed and the President signed into law the Bankruptcy Abuse Prevention and Consumer Protection Act, Pub. L. No. 109-8, 119 Stat. 23 (2005) (BAPCPA).

One of the innovations of the BAPCPA was means-testing. In section 707 of the Bankruptcy Code, which addresses dismissal of abusive chapter 7 petitions, Congress established special rules for debtors whose current monthly income, reduced by certain permitted expenses, exceeded a threshold for abuse under a specified formula. 11 U.S.C. 707(b)(2). This amendment changed the way these expenses were computed; some were no longer the debtor's actual and reasonable expenses but instead were standard expenses under the National Standards and Local Standards issued by the Internal Revenue Service for the debtor's area of residence. 11 U.S.C. 707(b)(2)(A)(ii).

Congress also applied means-testing to chapter 13 cases, in which the debtor seeks not to liquidate his debts, as in chapter 7, but rather to establish a plan for repaying all or part of those debts. Before the BAPCPA amendments were enacted, section 1325, governing confirmation of a chapter 13 plan, required such a plan to provide that all of the debtor's "projected disposable income" during the plan period would be used to repay debts. Disposable income was calculated from the debtor's actual income and expenses set forth on Schedules I and J, which the debtor was required to file.

But the BAPCPA amended section 1325 to change the definition of "disposable income." The new section 1325(b)(2) defines "disposable income" to mean "current monthly income received by the debtor * * * less amounts reasonably necessary to be expended" for maintenance or support or necessary business expenses. 11 U.S.C. 1325(b)(2).[3] This definition incorporates two changes: first, it defines "disposable income" based on an average of past monthly income and expense figures; and second, for debtors with higher income levels, it requires the use of the same standard expenses mandated for certain debtors under section 707(b)(2). Specifically, section 1325(b)(3) now directs that reasonable expenses be determined "in accordance with subparagraphs (A) and (B) of section 707(b)(2)" for those chapter 13 debtors whose current monthly income, multiplied by 12, is greater than the median family income for a family of the corresponding size. 11 U.S.C. 1325(b)(3). Chapter 13 debtors in

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[3] "Current monthly income" means the "average monthly income from all sources" that the debtor received during the six-month period ending the last calendar month before the debtor filed his bankruptcy petition. 11 U.S.C. 101(10A).

this class are typically referred to as "above-median" debtors. To be clear, an above-median debtor is not one whose income places him in the top half of all debtors; it is one whose income places him in the top half of families of his size in his state of residence.

Under current bankruptcy rules, such a debtor must file a Form 22C,[4] which sets forth the debtor's income and expenses in accordance with standard numbers issued by the IRS. Because a debtor must also file the traditional Schedules I and J setting forth actual income and expenses, it often becomes apparent that there is a significant difference between the above-median debtor's disposable income under Schedules I and J and his disposable income under Form 22C. In some cases, the use of Form 22C actually results in a lower amount of disposable income, but in other cases, like the present case, the use of Form 22C captures a temporary increase in the debtor's disposable income that does not continue into the plan period. In this and other cases, it may become clear that the historical circumstances that produced a particular income figure will change prospectively.

For the convenience of the Court, we have attached in an addendum to this brief the pre-BAPCPA text of section 1325, the current text of section 1325, and a redlined version showing the changes to section 1325 made by the BAPCPA.

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[4] The form was previously known as "B22C." We will use the current form name "22C" throughout.

B. Facts.

1. The debtor, a single woman with no children, filed for bankruptcy under chapter 13 on October 26, 2006. Her annual income was $43,147 in 2004 and $56,516 in 2005, both of these figures being above the state median family income for a family of one. During the six-month period before filing under chapter 13, the debtor took a buyout from her employer. As a result of this buyout, her monthly gross income was $11,990.03 in April 2006 and $15,356.42 in May 2006. Because these two months were within the six-month window for computing "current monthly income," as defined in 11 U.S.C. 101(10A), her "current monthly income" was considerably higher than it otherwise would have been – $64,124 annually, or $5,343 a month. App. 114.

The "reality" of the buyout was that the debtor no longer had the job or the income she had had before filing her chapter 13 petition. App. 114. Her Schedule I (income) showed net income of $1,922 a month ($23,064 annually), which is below the state median. Her Schedule J (expenses) showed monthly expenses of $1,772.97, resulting in excess monthly income of about $149. The debtor's chapter 13 plan, accordingly, proposed to pay $144 a month for 36 months. App. 114-15.

Using the calculation on Form 22C, however, the debtor had monthly disposable income of $1,114 with which to repay unsecured creditors. According to the Chapter 13 Trustee, a payment of $756 a month for 60 months would repay the creditors in full. While recognizing that the debtor could afford to repay only what was proposed in her plan and did not have the ability to fund a plan at $1,114, the Chapter 13 Trustee argued that 11 U.S.C. 1325 required a strict mathematical computation based on the historical current monthly income figures, which included the buyout. App. 115-16.

2. The bankruptcy court adopted an interpretation of "projected disposable income" that allowed the debtor to fund a chapter 13 plan based on actual income available to her, and not based on the historical current monthly income. The court gave four reasons for its interpretation: First, language in section 1325(b)(1)(B) refers to projected disposable income "to be received" during the applicable commitment period, which suggests that projected disposable income is not based entirely on historical income. Second, the word "projected" suggests a look at the future. Third, the calculation is supposed to be made "as of the effective date of the plan," which indicates something other than historical income. Fourth, it would be "absurd" to ignore the effect that a significant drop in income has occurred since the months preceding the filing of the petition. Debtors who suffered such a significant drop in income would be unable to confirm a chapter 13 plan. Thus, the bankruptcy court stated that it would presume the historical income and expense figures on Form 22C to constitute the projected disposable income "unless the debtor can show that there has been a substantial change in circumstances such that the numbers contained in

Form B22C are not commensurate with a fair projection of the debtor's budget in the future." App. 126 (quoting In re Jass, 340 B.R. 411, 418-19 (Bankr. D. Utah 2006)).

The bankruptcy court also held that the expenses to be deducted were those in the National and Local IRS Standards, even for cases in which the debtor could show a substantial change in circumstances. App. 127-28. Finally, the court held that the plan had to be for the full 60 months, not 36 months as proposed by the debtor, given that the debtor's plan was not going to be able to pay the creditors back completely. App. 128-31. The court agreed to confirm the debtor's plan, so long as it continued for 60 months, instead of 36. App. 131.

3. This Circuit's Bankruptcy Appellate Panel (BAP) affirmed. Relying heavily on decisions of the BAPs of two other circuits, In re Pak, 378 B.R. 257 (B.A.P. 9th Cir. 2007); In re Kibbe, 361 B.R. 302 (B.A.P. 1st Cir. 2007), the BAP held that if "it is shown that Form B22C disposable income fails accurately to predict a debtor's actual ability to fund a plan, that figure may be subject to modification." App. 185. The BAP drew an analogy with section 707(b)(2)(B)(i). Under section 707(b)(2)(A), certain chapter 7 debtors are subject to a presumption that a discharge would be an abuse. Section 707(b)(2)(B)(i) gives those debtors the ability to rebut the presumption by showing "special circumstances" justifying their "additional expenses or adjustments of current monthly income for which there is no reasonable alternative." App. 185. The BAP looked to section 707(b)(2)(B) for guidance in the

chapter 13 context presented here. It concluded that parties seeking to show the historical disposable income figure does not accurately project the debtor's ability to fund a plan must show documentation similar to that required by section 707(b)(2)(B)(ii). App. 186. The BAP "emphasize[d] that deviation from the Form B22C determination of disposable income will be the exception rather than the rule." App. 186.

SUMMARY OF ARGUMENT

The BAPCPA amendments to section 1325 have created important interpretive questions about the proper way to understand "projected disposable income." As the case law reflects, there are different ways that courts have interpreted and applied that statutory language in light of the amendments. The interpretation offered here by the Chapter 13 Trustee should be rejected, because it fails to take into account all the language in the statute.

The Chapter 13 Trustee interprets the term "projected disposable income" to require use of the historical "disposable income" figure throughout the chapter 13 plan period, regardless of the debtor's actual income and expenses during that period. In this case, the debtor's historical "disposable income" was inflated by a one-time buyout by her employer, and under the Chapter 13 Trustee's interpretation, the debtor's high disposable income figure would be "projected" over the entire plan period, with the result that she would be unable to fund her chapter 13 plan based on her actual income, having lost her job as part of the buyout. If this were what the statute actually required, that would be one thing. But the Chapter 13 Trustee's interpretation does not account for the usual meaning of "projected" income or for the statutory phrases "to be received" and "will be applied to make payments" in section 1325(b)(1)(B). Mechanically extending into the future an historical monthly income calculation, which may bear no relationship to actual income that the debtor will receive in the future, would either attribute to the debtor future income that does not exist, as in this case, or (when the debtor has a financial change for the better) permit the debtor to avoid using income that does exist to repay creditors.

In contrast, the courts below correctly gave meaning to "disposable income" by requiring this historical income figure to be projected as an initial matter, subject to adjustment to account for any significant increases or decreases in the debtor's income that are likely in particular cases. Such adjustments may be necessary in individual cases to ensure that the income attributed to a debtor in his chapter 13 plan is actually income that is "projected" and "to be received" and that "will be applied to make payments" to unsecured creditors. While a simple multiplication of the initial disposable income number by the relevant number of months is a presumptive starting point, this correct approach allows adjustments to be made in appropriate cases. This interpretation is also consistent with the overall goals of chapter 13.

ARGUMENT

THE DEBTOR'S HISTORICAL "DISPOSABLE INCOME" IS THE STARTING POINT IN DETERMINING "PROJECTED DISPOSABLE INCOME" UNDER SECTION 1325, BUT COURTS MAY TAKE INTO ACCOUNT SIGNIFICANT CHANGES IN THE DEBTOR'S FINANCIAL CONDITION IF NECESSARY TO REFLECT THE DEBTOR'S ABILITY TO FUND A PLAN.

Congress's amendments to section 1325 three years ago have caused serious interpretive problems. The bankruptcy courts have taken three different approaches to analyzing what "projected disposable income" means in confirming a chapter 13 plan. We will discuss each of the three approaches and explain why the Chapter 13 Trustee's approach here is mistaken and why the bankruptcy court's and BAP's interpretation is most consistent with the statutory language and the policies of the Bankruptcy Code.

A. The Bankruptcy Courts Have Offered Three Different Interpretations Of Section 1325.

1. The BAPCPA amendments in 2005 to section 1325 created a significant change in the law. Before these amendments were enacted, section 1325(b)(1) provided that if the trustee or the holder of an allowed unsecured claim objected to the confirmation of a chapter 13 plan, the court was not permitted to approve the plan unless it provided that "all of the debtor's projected disposable income to be received in the three-year period beginning on the date that the first payment is due under the

plan will be applied to make payments under the plan." 11 U.S.C. 1325(b)(1)(B) (2000 ed.). The term "disposable income" was defined as income received by the debtor that was "not reasonably necessary to be expended" for "maintenance or support of the debtor or a dependent" or for necessary business expenses if the debtor was engaged in a business. 11 U.S.C. 1325(b)(2)(A) (2000 ed.). Under that former law, a debtor's projected disposable income was calculated simply by subtracting the debtor's expenses on Schedule J from the debtor's income on Schedule I, two forms that a chapter 13 debtor was required to file.

In contrast, under the BAPCPA amendments, section 1325(b)(1) now provides that:

> (b)(1) If the trustee or the holder of an allowed unsecured claim objects to the confirmation of the plan, then the court may not approve the plan unless, as of the effective date of the plan – * * * (B) the plan provides that all of the debtor's projected disposable income to be received in the applicable commitment period beginning on the date that the first payment is due under the plan will be applied to make payments to unsecured creditors under the plan.

11 U.S.C. 1325(b)(1). And now, "disposable income" is defined expressly to mean "current monthly income received by the debtor * * * less amounts reasonably necessary to be expended" for maintenance or support or necessary business expenses. 11 U.S.C. 1325(b)(2). "Current monthly income" is defined as the "average monthly income from all sources" that the debtor received during the six-month period ending

the last calendar month before the debtor filed the chapter 13 petition. 11 U.S.C. 101(10A). It is, in other words, an historical figure representing the monthly average of the period shortly before the petition was filed. An above-median debtor – one whose current monthly income, multiplied by 12, is above the annual median income in the state of a family of comparable size – calculates these figures on Form 22C.

2. The minority position taken in a number of bankruptcy court decisions is that section 1325 requires "projected disposable income" to be computed by taking the historical "disposable income" figure, as defined in section 1325(b)(2), and simply multiplying it by the number of months in the debtor's chapter 13 plan. The Chapter 13 Trustee cites some of these decisions at pages 12 to 13 of his brief.

Their underlying rationale is that "disposable income" was defined for the first time in the 2005 amendments and is used nowhere else than in the phrase "projected disposable income" in section 1325(b)(1)(B). Thus, the argument goes, "projected disposable income," while still undefined in the Code, must mean nothing more than "disposable income" that is projected out through the plan period – in other words, that is multiplied by the number of months in the plan.

Some courts have found this strict mathematical approach to be difficult to rationalize in cases in which the debtor's income or expenses changed significantly from the pre-petition period on which the historical disposable income figure is based. A handful of those courts have determined projected disposable income based on the income and expense figures used in Schedules I and J. See, e.g., In re Demonica, 345 B.R. 895, 900 (Bankr. N.D. Ill. 2006); In re Riggs, 359 B.R. 649, 652-53 (Bankr. E.D. Ky. 2007).

But most courts dissatisfied with the strict mathematical approach, like the bankruptcy court and the BAP here, have not insisted on the use of Schedules I and J in every case. Rather, they have accepted that "projected disposable income" in section 1325 presumptively requires use of the historical disposable income figure but have allowed significant changes in the debtor's income or expenses to be considered when the strict historical figure paints an incorrect picture of the debtor's ability to fund a chapter 13 plan. See, e.g., In re Pak, 378 B.R. 257 (B.A.P. 9th Cir. 2007); In re Kibbe, 361 B.R. 302 (B.A.P. 1st Cir. 2007); In re Jass, 340 B.R. 411, 418-19 (Bankr. D. Utah 2006).

B. The Chapter 13 Trustee's Mechanical Approach To Section 1325(b) Is Flawed.

The Chapter 13 Trustee argues in favor of the strict mathematical approach. He contends that section 1325 and Form 22C create "a mathematical formula" for determining what must be paid to the unsecured creditors, and that a court "is not free to stray from this rigid, mechanical test and consider other factors in making this determination." Br. 8; see Br. 14 (projection of disposable income is effected by "merely multiplying the net 'disposable income' figure as calculated on Form 22C by the applicable commitment period"). He recognizes that the Code fails to define "projected disposable income," Br. 11, but argues that it is simply "part and parcel of the same concept" as "disposable income." Br. 12.

That mechanical approach to section 1325 is flawed. First, it is founded upon a contextually incorrect interpretation of the term "projected." See Hibbs v. Winn, 542 U.S. 88, 101 (2004) (statutory words must be construed in context). The use of the term "projected" in the economic and financial context of this statute suggests a forecast or estimate of an expected future financial reality. See The Random House Dict. of the English Lang. 1546 (2d ed. 1987) (defining to "project" as, inter alia, "to set forth or calculate (some future thing); *They projected the building costs for the next five years.*"); Webster's Third New Int'l Dict. 1813 (1993) (defining "projected" as, inter alia, "planned for future execution: contrived, proposed," as "[projected] outlays for new plant and equipment"). While the calculation of "projected" financial data may well begin with historical data, it does not necessarily (or even usually) end there, nor does it entail a rigid and inviolable assumption, made by the Chapter 13 Trustee, that projected income will be identical with past income even when the available facts demonstrate otherwise. The Chapter 13 Trustee's mechanical test ignores this context of the statutory language.

Second, the Chapter 13 Trustee's approach wholly fails to account for two other important phrases in section 1325(b)(1)(B). For one thing, the statute refers to the income "to be received by the debtor," but the mechanical test fails to address cases in which the historical income required to be used may have no relationship to the actual income "to be received." The Chapter 13 Trustee dismisses these cases as merely "harsh results." Br. 17. But when one is trying to understand statutory language and the results of an interpretation are unduly harsh, the proper course is to make absolutely certain that one's interpretation takes all the relevant language into account.[5] In this case, by ignoring the textual phrase "to be received" in section 1325(b)(1)(B), when historical income bears no relationship with actual income "to be received" by the debtor, the Chapter 13 Trustee's interpretation fails to adhere to the statutory language.

The mechanical test ignores another statutory phrase, as well: "will be applied to make payments." If projected disposable income is based strictly on an historical figure, minus expenses, there will be some cases in which income in the plan is only deemed, or hypothetical, and not actually received. In such cases, the deemed or hypothetical income cannot be applied to make payments for the simple reason that it does not exist. The present case is actually a fairly typical example, in which the debtor lost her job at about the time she filed a chapter 13 petition. Here, the debtor's

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[5] It is unnecessary to decide whether the results of the mechanical test are "absurd" or merely "harsh." Br. 17-19. That test not only is not compelled by the statutory language but, as we show here, also fails to take into account other language in the same section.

current monthly income, an average of the past six months' income, reflects the income from that job, and the debtor's disposable income (the current monthly income less expenses) would not reflect the loss of that job. Projecting that figure forward would require the debtor to apply deemed or hypothetical income that was not actually "received" in the future "to make payments" under the plan. Or else it would deprive the debtor of recourse to chapter 13 simply because she had lost a job at about the time she filed.

These problems with the Chapter 13 Trustee's interpretation are more than mere policy issues; they are critical textual flaws. It is well established that courts "must, if possible, construe a statute to give every word some operative effect." Cooper Indus., Inc. v. Aviall Servs., Inc., 543 U.S. 157, 167 (2004) (citing United States v. Nordic Village, Inc., 503 U.S. 30, 35-36 (1992)). The Chapter 13 Trustee's interpretation would require the Court to ignore this statutory maxim.[6]

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[6] The Chapter 13 Trustee suggests that section 1129(a)(15)(B) requires courts to treat "projected disposable income" the same as "disposable income," Br. 15 – that is, as "nothing more than 'disposable income' annualized." In re Pak, 378 B.R. at 264 n.7. But the phrase "not less than the projected disposable income of the debtor (as defined in section 1325(b)(2))" in section 1129(a)(15)(B) suggests nothing of the sort. The "as defined in" parenthetical obviously refers to "disposable income," which is defined in section 1325(b)(2), and not to "projected disposable income," which is not. Thus, section 1129(a)(15)(B) provides no further help in understanding section 1325(b)(1)(B). See In re Pak, 378 B.R. at 264 n.7 ("none of the provisions of the Bankruptcy Code incorporating the term 'projected disposable income' provides definitive guidance as to its interpretation").

C. The Bankruptcy Appellate Panel's Interpretation Appropriately Gives Content To All Parts Of The Statute.

The correct interpretation of section 1325 is the one offered by both the bankruptcy court and the BAP.

1. As both courts recognized, "projected disposable income" in the current version of the statute will, as a general matter, be based on the newly defined "disposable income" in section 1325(b)(2), which in turn will be based on an historical calculation of current monthly income, computed as the average of the six month before the petition was filed. But both courts also understood that there are circumstances in which the debtor's financial condition changes significantly from that pre-petition period and that, in such circumstances, it will not be appropriate to use the historical calculation. As the BAP expressed the point: "Where it is shown that Form B22C disposable income fails accurately to predict a debtor's actual ability to fund a plan, that figure may be subject to modification," App. 185, albeit in "exception[al]" cases. App. 186.

The courts' interpretation not only is faithful to the new definition of "disposable income" in section 1325(b)(2) as an historical number but also treats "projected" disposable income as a future-oriented concept, as required by the language of section 1325(b)(1). See In re Pak, 378 B.R. at 264-65; In re Kibbe, 361 B.R. at 307-08. The interpretation requires the use of the historical income figure called for in the definition of "disposable income" as a starting point, and it calls for a presumption that the historical figure should be carried forward throughout the term of the plan, absent evidence to the contrary. But in order to take into account the future-orientation of the remaining language of the statute, and to ensure that projected disposable income is, in fact, a projection, it allows that presumption to be rebutted whenever the debtor is likely to experience (or actually has experienced) either a significant increase or a significant decrease in income after the filing of the chapter 13 plan.

The reason for having a starting presumption that the historical disposable income figure should be applied mathematically to derive the projected disposable income is that, while "projected disposable income" is not the same as "disposable income," it is appropriate in construing the former phrase to give effect to the definition of the latter. Section 1325(b)(2) provides a definition "[f]or purposes of this subsection." 11 U.S.C. 1325(b)(2). The only time that "disposable income" is used in "this subsection," section 1325(b), other than in the definition itself, is in the term "projected disposable income." Thus, we accept that a court should begin by applying the historical "disposable income" figure as a starting point and by presumptively carrying that figure forward over the plan period.[7]

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[7] Congress may well have expected that the historical figure, computed generally with standard rather than actual expenses, would result in a higher disposable-income total for "above-median" debtors and a greater amount designated for repay-
(continued...)

At the same time, however, this initial presumption that the historical current monthly income will be used must necessarily be rebuttable. As the BAP explained, "parties contending that a debtor's Form B22C disposable income figure does not accurately project the debtor's future ability to fund a plan must present documentation similar to that required by section 707(b)(2)(B)(ii) in support of their claim." App. 186. See also In re Pak, 378 B.R. at 267 ("It makes no sense to interpret 'projected disposable income,' governing debtors' future payments under their chapter 13 plans, as cast in stone by their pre-bankruptcy history, without any opportunity for the trustee, creditors or the debtor to offer rebutting evidence as to changed income circumstances before the effective date of the plan.").

Thus, contrary to the Chapter 13 Trustee's argument here, Br. 14, application of the historical income figure to the plan period is not the end of the matter in all cases. To the contrary, there are situations in which a debtor has or is likely to have significant changes in income after the period in which the historical "current monthly income" is computed, and in order to give full effect to the statutory text those

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[7](...continued)
ment to creditors under the debtor's chapter 13 plan. But the fact that this is often not the case does not authorize a court to ignore the statutory definition altogether. Thus, the decisions that ignore Form 22C in determining projected disposable income and base it instead on Schedules I and J in the ordinary case cannot find support in the statutory language. See, e.g., In re Demonica, 345 B.R. 895, 900 (Bankr. N.D. Ill. 2006); In re Riggs, 359 B.R. 649, 652-53 (Bankr. E.D. Ky. 2007).

changes must be taken into account in "project[ing]" the debtor's future disposable income.

There are two types of exceptional case that section 1325 must be able to address. First, a debtor may be unemployed during the six-month period in which "current monthly income" is calculated but may accept a high-paying job at about the time he files his chapter 13 petition. See In re Pak, supra (debtor was unemployed for three years but found a job paying over $100,000 two months before filing his petition). Such a debtor would have an artificially low "disposable income" but might well be able to fund a chapter 13 plan that would repay most or all of his unsecured debt.

Second, conversely, a debtor may suffer a significant loss of income – for example, by losing a job – at about the time he files his chapter 13 petition, as in this case. Such a debtor would have a relatively high "current monthly income," based on an average of the six months preceding the month in which the petition was filed. Yet if that historical income were simply extended forward for purposes of the chapter 13 plan, it would not reflect the actual income available to the debtor during that future period. That would be precisely the situation in this case if the mechanical test were used. To put it in statutory terms, the future disposable income thus computed would not be the debtor's "projected" disposable income (because it would demonstrably not be based on a reliable estimate of future income) nor would it be the disposable income "received" by the debtor during the applicable commitment period. 11 U.S.C. 1325(b)(1)(B). Moreover, because the income amount determined by the Chapter 13 Trustee's approach is merely deemed or hypothetical and not actually received, the income could not be "applied to make payments to unsecured creditors." Id. In a case like this, therefore, the court must take into account the significant loss of income in order to apply section 1325(b) faithfully.[8]

2. The Chapter 13 Trustee argues that allowing any adjustment of the historical disposable income figure is at odds with the plain meaning of section 1325 and with congressional intent. Br. 19-21. That argument is unpersuasive.

We have already explained why the adjustment of the historical figure in some cases is actually compelled by the statutory language and why the statutory text does not support the Chapter 13 Trustee's notion of a "standardized formula" that is unrelated to any actual income to be received. Adjustment of the historical figure is sometimes necessary to ensure that the income is "to be received" and "applied to

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[8] We recognize that some of these concerns with the statutory text do not arise in the same manner in our first example, when the debtor finds himself with a significant increase in income at about the time he files his petition. With an increase in income, the lower historical figure would actually be received by the debtor and could be applied to pay unsecured creditors. But it would still not be an accurate "project[ion]" of the debtor's disposable income to be "received" during the plan period, and thus the bankruptcy court's interpretation is irreconcilable with the statutory text in these circumstances also. And in any event, section 1325(b) should be interpreted in one uniform way for all above-median debtors, so the rebuttable presumption approach should be applied across the board.

make payments." In the Chapter 13 Trustee's mechanical view of section 1325(b)(1)(B), those two critical phrases in the statute become surplusage.

Thus, the Chapter 13 Trustee's position that the statute prohibits any adjustment of the historical disposable income figures turns not on the language itself but rather on the pre-enactment history of the BAPCPA. The claim is that when Congress was considering the changes to section 1325, certain chapter 13 trustees warned Congress that its definition of "disposable income" might be unrelated to the debtor's actual income available to fund a chapter 13 plan; yet, "despite these warnings, no changes were made." Br. 21. From this pre-enactment history, the Chapter 13 Trustee seems to draw the conclusion that Congress must have specifically intended to enact the entire parade of horribles that a purely mechanical test creates. That conclusion is unwarranted. See Lamie v. U.S. Trustee, 540 U.S. 526, 539 (2004) ("the history creates more confusion than clarity about the congressional intent"). For all anyone knows, Congress may have believed the chapter 13 trustees were mistaken and that section 1325 actually would allow bankruptcy courts to do precisely what the chapter 13 trustees thought it would not. Or Congress might simply not have gotten the message. Or perhaps the congressmen who did get the message realized the language was unclear but were reluctant to upset the compromises represented in the bill. "There are," after all, "many reasons for saying no." Reed Dickerson, The Interpretation and Application of Statutes 160 (1975). As Justice Holmes put it, "It is a delicate business to base speculations about the purposes or construction of a statute upon the vicissitudes of its passage." Pine Hill Coal Co. v. United States, 259 U.S. 191, 196 (1922).

All this Court has to work with is the language that Congress actually enacted. For the reasons we have given, that language does not support a purely mechanical test that is never subject to adjustment in light of significant changes in income or expenses after the filing of the petition.

3. We would be the first to admit that the language of section 1325 is not a model of clarity. But while our interpretation is necessarily based on certain inferences from context, it gives effect to all the statutory language far more faithfully than the Chapter 13 Trustee's interpretation. Almost as important, it better furthers the overall goal of chapter 13.

Chapter 13 focuses on having debtors devote future income to paying their creditors. Indeed, BAPCPA placed additional emphasis on this goal of paying future income to creditors when it added language to section 707(b) permitting a court, with the debtor's consent, to convert an abusive chapter 7 case to chapter 13, as an alternative to dismissal. 11 U.S.C. 707(b)(1). While the Chapter 13 Trustee's interpretation does require future income to be used to pay creditors, that future income is measured exclusively by reference to historical income, and in some cases, like this one, it is merely "deemed" income that bears no relation to the actual income available to the debtor. In contrast, our interpretation permits a court to consider the actual income that can "be applied to make payments" under the plan in those cases in which a different amount of actual income is available to a debtor because of changed circumstances. The use of actual income in such cases is an important measure of fairness, both to the debtor in cases like this one, in which the debtor's actual future income is below her historical income, and to creditors in cases like In re Pak, in which the debtor will earn significant additional income that is not reflected in the historical calculation.

CONCLUSION

For the foregoing reasons, the order of the Bankruptcy Appellate Panel should be affirmed.

STATEMENT REGARDING ORAL ARGUMENT

The United States requests oral argument. Although the United States is technically an amicus in this appeal, it is the only party to defend the rationale of the decisions below, given that the debtor, as appellee, is not filing a brief. The statutory issue presented here is of great significance. It has produced many conflicting decisions in the bankruptcy courts, and, as of the date on which this brief is filed, no court of appeals has rendered a decision on the issue. Even if another circuit issues a decision in the next few months, the conflict will continue in bankruptcy courts within this Circuit. This Court should hear argument to resolve the matter for itself.

Respectfully submitted,

JEFFREY S. BUCHOLTZ
Acting Assistant Attorney General

WILLIAM KANTER
(202) 514-4575
EDWARD HIMMELFARB
(202) 514-3547
Attorneys, Appellate Staff
Civil Division, Room 7646
Department of Justice
950 Pennsylvania Avenue, N.W.
Washington, D.C. 20530

OF COUNSEL:

ROBERTA A. DEANGELIS
Acting General Counsel

P. MATTHEW SUTKO
Associate General Counsel
Executive Office for United States Trustees
Department of Justice
20 Massachusetts Avenue, N.W.
Washington, D.C. 20530

MARCH 2008

CERTIFICATE OF COMPLIANCE

I certify that this brief is proportionately spaced, using Times Roman font, 14 point type. Based on a word count under Corel Word Perfect 12, this brief contains 6,552 words, excluding the table of contents, table of authorities, addenda, and certificates of counsel.

/s
Edward Himmelfarb
Attorney for the United States
as Amicus Curiae

CERTIFICATE OF DIGITAL SUBMISSION

Pursuant to the Court's General Order filed August 10, 2007, I hereby certify (1) that no privacy redactions were required to be made on this brief, (2) that the brief and addendum submitted in Digital Form electronically is an exact copy of the written brief and addendum filed with the Clerk, and (3) that the digital submission has been scanned for viruses using Trend Micro OfficeScan, version 6.5, last updated March 30, 2008, and according to that program is free from viruses.

/s
EDWARD HIMMELFARB
Attorney for the United States
as Amicus Curiae

CERTIFICATE OF SERVICE

I hereby certify that on March 31, 2008, I served the foregoing Brief for the United States as Amicus Curiae in Support of Affirmance on the following by causing two copies of the brief to be sent by Express Mail, for overnight delivery, to:

Teresa L. Rhodd, Esq.
Staff Attorney
Chapter 13 Trustee
P.O. Box 3527
Topeka, KS 66601-0000

Michael F. Brunton, Esq.
700 S.W. Jackson
Suite 206
Topeka, KS 66603-0000

I also certify that I filed the brief by causing an original and seven copies to be sent to the Clerk, United States Court of Appeals for the Tenth Circuit, by Federal Express, for overnight delivery.

_____/s__________________________
Edward Himmelfarb
Attorney for the United States
as Amicus Curiae

ADDENDUM – STATUTES

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Jan Hamilton, Chapter 13 Trustee v. Stephanie Kay Lanning

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United States Supreme Court

3. ("CCN") ***CURRENT*** CASE NO.
No.: 08-998

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• In calculating projected disposable income under 11 U.S.C. 1325, which incorporates 11 U.S.C. 707(b)(2), may a debtor take into account known changes in income and expenses that will occur during the duration of the chapter 13 plan?

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In the Supreme Court of the United States

JAN HAMILTON, CHAPTER 13 TRUSTEE, PETITIONER

v.

STEPHANIE KAY LANNING

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE SUPPORTING RESPONDENT

RAMONA D. ELLIOTT
General Counsel

P. MATTHEW SUTKO
Associate General Counsel

DAVID I. GOLD
CATHERINE B. SEVCENKO
Attorneys
Executive Office for United States Trustees
Washington, D.C. 20530

ELENA KAGAN
Solicitor General
Counsel of Record

TONY WEST
Assistant Attorney General

MALCOLM L. STEWART
Deputy Solicitor General

SARAH E. HARRINGTON
Assistant to the Solicitor General

WILLIAM KANTER
EDWARD HIMMELFARB
Attorneys

Department of Justice
Washington, D.C. 20530-0001
(202) 514-2217

QUESTION PRESENTED

Under Section 1325(b)(1)(B) of Title 11 of the United States Code, when a trustee or unsecured creditor objects to the confirmation of a debtor's Chapter 13 plan, the bankruptcy court can confirm that plan if "all of the debtor's projected disposable income to be received" during the plan period "will be applied to make payments to unsecured creditors under the plan." The debtor's "disposable income" is calculated by examining her monthly expenses when the Chapter 13 petition was filed and her average monthly income during the six-month period before the petition was filed. The question presented is as follows:

Whether, in calculating the debtor's "projected disposable income" during the plan period, the bankruptcy court may consider evidence suggesting that the debtor's income or expenses during that period are likely to be different from her income or expenses during the pre-filing period.

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In the Supreme Court of the United States

No. 08-998

JAN HAMILTON, CHAPTER 13 TRUSTEE, PETITIONER

v.

STEPHANIE KAY LANNING

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
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BRIEF FOR THE UNITED STATES AS AMICUS CURIAE SUPPORTING RESPONDENT

INTEREST OF THE UNITED STATES

The United States has a direct interest in the proper construction of Section 1325(b)(1)(B) of the Bankruptcy Code because United States Trustees—who are Department of Justice officials appointed by the Attorney General—supervise the administration of Chapter 13 cases and trustees, monitor Chapter 13 plans, and file comments with bankruptcy courts regarding such plans in connection with confirmation hearings pursuant to 11 U.S.C. 1324. See 28 U.S.C. 586(a)(3)(C); H.R. Rep. No. 595, 95th Cong., 1st Sess. 88 (1977). Congress has provided that "[t]he United States trustee may raise and may appear and be heard on any issue in any case or proceeding." 11 U.S.C. 307. At the Court's invitation, the United States filed a brief as amicus curiae at the petition stage of this case.

STATEMENT

1. a. Chapter 13 of the Bankruptcy Code provides for the adjustment of debts of an individual with regular income. 11 U.S.C. 1301 *et seq*. A debtor who files for bankruptcy under Chapter 13 retains possession of her assets, and she typically receives a discharge of her debts only after she pays her creditors under a plan confirmed by the bankruptcy court. 11 U.S.C. 1306(b), 1321 *et seq*.

If the trustee or an unsecured creditor objects to confirmation of a Chapter 13 debtor's plan, the court cannot confirm that plan

> unless, as of the effective date of the plan—
>
> (A) the value of the property to be distributed under the plan on account of such claim is not less than the amount of such claim; or
>
> (B) the plan provides that all of the debtor's projected disposable income to be received in the applicable commitment period beginning on the date that the first payment is due under the plan will be applied to make payments to unsecured creditors under the plan.

11 U.S.C. 1325(b)(1)(A)-(B). Thus, the bankruptcy court may confirm a contested Chapter 13 plan only if the debtor commits either to pay her unsecured creditors in full or to apply all of her "projected disposable income" during the plan period to paying those creditors.

b. This case concerns the proper method for calculating a debtor's "projected disposable income" during the plan period. Neither Section 1325 nor any other provision of the Bankruptcy Code defines the term "projected disposable income." Section 1325 does, however, define the term "disposable income." That definition was recently amended as part of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA or Act), Pub. L. No. 109-8, 119 Stat. 23. Because petitioner's arguments depend in large measure on that amendment, it is important to understand the statutory scheme both before and after BAPCPA's enactment.

i. Before BAPCPA became effective in October 2005, Section 1325 defined "disposable income" as "income which is received by the debtor and which is not reasonably necessary to be expended" for the debtor's "maintenance or support," "charitable contributions," or "business * * * expenditures." 11 U.S.C. 1325(b)(2)(A)-(B) (2000). Then as now, a debtor listed her monthly income on Schedule I and her monthly expenditures on Schedule J. See Fed. R. Bankr. P. Official Form 6, Scheds. I-J (2000). Thus, to calculate a debtor's *current disposable income*, a bankruptcy court generally began with the monthly income listed on Schedule I and deducted any monthly expenditures listed on Schedule J that the court determined were reasonably necessary to support the debtor, to contribute to charity, or to operate the debtor's business.

Then, to calculate the debtor's *projected disposable income*, the court typically multiplied the debtor's current disposable income by the number of months in her plan. See, *e.g.*, *In re Killough*, 900 F.2d 61, 64 (5th Cir. 1990). In projecting disposable income, however, courts considered any changes to the debtor's income or expenses that appeared likely to occur during the plan period. See, *e.g.*, *In re Petro*, 395 B.R. 369, 377 (B.A.P.

6th Cir. 2008) ("Prior to BAPCPA the schedules were a starting point and courts gave meaning to the words 'projected' and 'to be received' by taking into account a debtor['s] anticipated future income."); *In re Simms*, No. 06-1206, 2008 WL 217174, at *9 (Bankr. N.D. W. Va. Jan. 23, 2008) ("Of course, under pre-BAPCPA law, bankruptcy courts sometimes deviated from the debtor's income and expenses listed on Schedules I & J based on known increases or decreases in either income or expenses.").

ii. In BAPCPA, Congress amended the definition of "disposable income." Section 1325 now defines that term as "current monthly income received by the debtor * * * less amounts reasonably necessary to be expended" for certain items. 11 U.S.C. 1325(b)(2). "[C]urrent monthly income" is defined, in turn, as the debtor's "average monthly income from all sources" during the six months preceding the filing. 11 U.S.C. 101(10A)(A)(i). Although a debtor is still required to file Schedules I and J, now she must also file Official Form 22C, on which she calculates her current monthly income as defined in Section 101(10A)(A)(i). See Fed. R. Bankr. P. Official Form 22C (2009); Pet. Supp. App. 1-8.[1] Thus, to calculate a debtor's monthly income under BAPCPA, a court no longer focuses on a single month's income at the time of filing; rather, it considers a historical average of the debtor's income during the six-month period before commencement of the case.

In addition to changing the method of calculating all debtors' monthly income, BAPCPA also changed the

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[1] Form B22C was an interim form that subsequently became Official Form 22C. Pet. App. 39. Respondent completed Form B22C, *ibid.*, but the Forms are virtually identical and they are referred to interchangeably herein.

method of calculating some debtors' monthly expenses. If a debtor's current monthly income is below the median income of a comparably-sized household in her State, the debtor may claim the same types of general expenses—*i.e.*, "maintenance or support" obligations, "charitable contributions," and "business * * * expenditures"—as she could before BAPCPA. 11 U.S.C. 1325(b)(2)(A)(i)-(ii) and (b)(2)(B). But if a debtor's current monthly income is above-median, she may claim only particular kinds of expenses in amounts specified under Section 707(b)(2) of the Bankruptcy Code. 11 U.S.C. 1325(b)(3)(A) (incorporating 11 U.S.C. 707(b)(2)).

Thus, BAPCPA amended the formulae for computing "disposable income" under Section 1325(b)(2) in two respects: it altered the manner in which a debtor's current income is determined, and it established a new method of calculating an above-median debtor's expenses. The Act did not, however, address the method a court should employ to calculate "projected disposable income" under Section 1325(b)(1)(B). See Pet. App. 50-51 ("BAPCPA linked 'disposable income' to Form B22C current monthly income, which is a historically based figure, but it left 'projected disposable income,' which had an established pre-BAPCPA treatment, alone."). Accordingly, the specific question presented in this case is whether, in projecting disposable income, courts should consider anticipated changes to the debtor's financial circumstances, just as they did before BAPCPA.

2. Respondent is a single woman with no children who resides in Kansas. On October 16, 2006, she filed a Chapter 13 petition to address $36,793.36 in unsecured debt. During the six-month period that preceded her filing, respondent received a one-time buyout from her

former employer that increased her monthly gross income to $11,990.03 in April 2006 and $15,356.42 in May 2006. When respondent averaged her monthly income for April through September 2006 on Form 22C, her current monthly income amounted to $5,343.70. Because that figure placed her above the median income for a family of one in Kansas, she calculated her expenses in accordance with Section 707(b)(2) of the Bankruptcy Code. Respondent's monthly expenses totaled $4,228.71, leaving her with monthly disposable income of $1,114.98 on her Form 22C. Pet. App. 4-5.

As a result of the buyout payments respondent received, however, the "current monthly income" stated on her Form 22C was substantially greater than the monthly income that she could reasonably expect to earn during the plan period. On her Schedule I, she listed a monthly net income from new employment of $1,922, which placed her considerably below the state median income level. On her Schedule J, she listed actual monthly expenses of $1,772.97, leaving her with monthly disposable income of $149.03. Based on that figure, respondent proposed a repayment plan of $144 per month for 36 months, or a total of $5,184. Pet. App. 4, 57.

Petitioner, the bankruptcy trustee, objected to confirmation of the plan. He argued that, because respondent's monthly disposable income on her Form 22C was $1,114.98, the plan did not satisfy Section 1325(b)(1)(B)'s requirement that "all of the debtor's projected disposable income to be received" in the plan period must "be applied to make payments to unsecured creditors." Petitioner contended that respondent's "projected disposable income" during the plan period was simply her monthly "disposable income" ($1,114.98) derived from the pre-plan figures, multiplied by the number of months in her plan (36), for a total "projected disposable income" of $40,139.28. Petitioner therefore proposed that the plan provide for monthly payments of $756, which would have repaid respondent's unsecured creditors in full over the life of the plan. Petitioner acknowledged, however, that respondent did not have the means to fund such a plan. Pet. App. 5-7.

3. a. Over petitioner's objection, the bankruptcy court confirmed the plan essentially as proposed by respondent. Pet. App. 54-82.[2] The court reasoned that "Congress' reference in § 1325(b)(1)(B) to *projected* disposable income *to be received* in the applicable commitment period would be superfluous if the historical average was the start and end of the equation." *Id.* at 69. The court further explained that Section 1325(b)(1)(B) requires a "determination whether the debtor is committing all of his or her projected disposable income 'as of the effective date of the plan,'" not as of the date of the petition. *Id.* at 70 (emphasis omitted). The court also concluded that petitioner's approach would "lead[] to absurd results that are at odds with both congressional purpose and common sense" because it would prevent debtors whose "incomes drop[] significantly from their pre-petition monthly average * * * from ever being able to file a feasible and confirmable Chapter 13 repayment plan." *Id.* at 70-71. The bankruptcy court therefore "agree[d] with the majority of courts, which have found that the term 'projected' is a forward-looking concept" that allows consideration of "any reasonably antic-

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[2] The bankruptcy court ordered that respondent's plan run for 60 months rather than the 36 months that respondent had proposed. Pet. App. 76-80. Respondent did not challenge that aspect of the bankruptcy court's decision, see *id.* at 11-12 & n.4, and it is not at issue in this Court.

ipated changes in [disposable] income during the life of the proposed Chapter 13 plan." *Id.* at 69.

b. The bankruptcy appellate panel affirmed. Pet. App. 33-53. After describing an existing split in authority on the question, *id.* at 44-50, the panel reasoned that, although "BAPCPA linked 'disposable income' to Form B22C current monthly income, which is a historically based figure, * * * it left 'projected disposable income,' which had an established pre-BAPCPA treatment, alone." *Id.* at 50-51. Before BAPCPA's enactment, the panel explained, if bankruptcy courts "had reason to believe that [a debtor's] schedules did not accurately predict a debtor's actual ability to pay, other evidence was also considered." *Id.* at 51. The panel therefore concluded that, although BAPCPA had modified the formulae for calculating a debtor's current disposable income, it had not "eliminate[d] the bankruptcy courts' discretion" to consider anticipated changes to a debtor's financial condition "where significant circumstances support doing so." *Ibid.*

c. The court of appeals affirmed. Pet. App. 1-32. After likewise surveying the split in authority on the question, *id.* at 16-23, the court concluded that petitioner's "mechanical approach"—multiplying a debtor's current monthly "disposable income" by the number of months in her plan—is not consistent with the statutory text. *Id.* at 24-25. The court relied in particular on Section 1325(b)(1)(B)'s directive that, "as of the effective date of the plan," all of the debtor's projected disposable income "to be received" during the plan period "will be applied to make payments to unsecured creditors." *Id.* at 25 (emphasis omitted). The court construed those three statutory phrases to "suggest[] consideration of the debtor's actual financial circumstances as of the effective date of the plan." *Ibid.* The court of appeals further concluded that the language of Form 22C and BAPCPA's legislative history confirmed Congress's intent that courts utilize a "forward-looking approach." *Id.* at 28-29. The court finally noted that the mechanical approach would foreclose bankruptcy relief for debtors like respondent whose post-filing income decreases, while allowing debtors whose post-filing income increases to avoid paying creditors all that they are able. *Id.* at 31.

SUMMARY OF ARGUMENT

In crafting Chapter 13 of the Bankruptcy Code, Congress intended to create an orderly system that permits honest debtors to be released from crushing debt by repaying their creditors as much as they can afford over the life of the bankruptcy. That intent is apparent in Section 1325(b)(1)(B), which, upon objection by the trustee or a creditor, conditions the confirmation of a Chapter 13 plan on the bankruptcy court's determination that the debtor will either repay her unsecured creditors in full or devote all of her "projected disposable income" to such repayment for the duration of the plan. Although Congress defined the term "disposable income" in Section 1325, it did not define the word "projected" or the entire phrase "projected disposable income." The ordinary meaning of the word "projected," however, indicates that Congress intended bankruptcy courts to consider the debtor's actual financial circumstances and any changes to those circumstances that the court knows are likely to occur in the future, rather than relying only on financial data that may no longer reflect a debtor's income and expenses.

This approach is also faithful to the remainder of Section 1325, which requires courts to project the disposable income that "will be received" by the debtor and "will be applied to make payments to unsecured creditors." 11 U.S.C. 1325(b)(1)(B). Under petitioner's mechanical view of the term "projected"—according to which a court must simply multiply a debtor's "disposable income" by the number of months in her plan—debtors such as respondent must commit to paying money they will never receive and never apply to repay creditors. That is not a natural reading of the term "projected disposable income," and it is inconsistent as well with the rest of Chapter 13, which evinces Congress's intent that the implementation of a Chapter 13 plan be grounded in a debtor's actual financial circumstances rather than tied to historical data that no longer reflect the debtor's real-life situation.

Before Congress amended the Bankruptcy Code in 2005, bankruptcy courts used the disposable income derived from the information reported on a debtor's Schedules I and J as the starting point for determining the debtor's projected disposable income. If that figure accurately reflected the debtor's financial situation at the time of confirmation and was likely to reflect the debtor's financial situation over the life of the plan, a court would merely multiply the disposable income by the number of months in the plan. But when the debtor's financial situation had changed between the time of filing and the time of confirmation, or when it was likely to change during the life of the plan, bankruptcy courts would take such changes into account in projecting the debtor's disposable income. Nothing in BAPCPA suggests that Congress intended to alter that approach. Courts therefore should continue to "project[]" a debtor's disposable income using the same method they did before BAPCPA.

Petitioner acknowledges that his reading of the statute produces unfair results for some debtors who will be shut out of the bankruptcy system, and that it produces unfair results for some creditors who will receive little or no repayment from debtors who can afford to satisfy their obligations. Under the approach employed by the court of appeals, by contrast, neither debtors nor creditors fall prey to unfair and illogical results. Petitioner suggests that a debtor may avoid the harsh effects of the mechanical approach by strategically delaying the filing of a petition, dismissing a petition and then refiling at a later date, ignoring the requirement that a debtor file a Schedule I, or attempting to file under Chapter 7 instead of under Chapter 13. This Court should not construe the term "projected disposable income" in a way that encourages gamesmanship, requires a debtor to risk his ability to enjoy the protections of bankruptcy, or otherwise undermines the intent of Congress.

ARGUMENT

IN PROJECTING A CHAPTER 13 DEBTOR'S DISPOSABLE INCOME UNDER SECTION 1325(b)(1)(B), COURTS SHOULD CONSIDER EVIDENCE INDICATING THAT THE DEBTOR'S FINANCIAL CIRCUMSTANCES HAVE CHANGED OR ARE LIKELY TO CHANGE DURING THE PLAN PERIOD

As this Court has long recognized, the twin goals at the core of the federal bankruptcy system are giving the honest but unfortunate debtor a fresh start and ensuring the maximum possible equitable distribution to creditors. See, *e.g.*, *Stellwagen* v. *Clum*, 245 U.S. 605, 617 (1918); *Williams* v. *United States Fid. & Guar. Co.*, 236 U.S. 549 (1915). Petitioner's reading of Section

1325(b)(1)(B) would frustrate both of those objectives. Some honest debtors in need of relief under Chapter 13 will be shut out of the system. And some creditors will be foreclosed from obtaining satisfaction of debts from debtors who can afford to repay them. The text of Section 1325(b)(1)(B), along with the structure, history, and purposes of that provision, indicates that a bankruptcy court's calculation of a debtor's "projected disposable income" should take into account evidence indicating that the debtor's income or expenses during the plan period are likely to be different from her pre-petition income or her expenses at the time of filing.

A. The Text Of Section 1325 Makes Clear That A Court Should Rely On A Debtor's Actual Financial Circumstances Rather Than Only On Historical Income Figures

1. Under Chapter 13 of the Bankruptcy Code, a debtor is required to submit a plan for repaying her unsecured creditors that is consistent with the requirements of 11 U.S.C. 1322. When either a creditor or the Chapter 13 trustee objects to such a plan, the bankruptcy court may confirm it only if the debtor either will repay all of her unsecured creditors in full or will devote all of her "projected disposable income" toward repayment of her creditors over the life of the plan. 11 U.S.C. 1325(b)(1)(B). Although Section 1325 defines the term "disposable income," it does not define the term "projected disposable income" or specify a method for calculating how a debtor's current "disposable income" should be "projected" into the future. The Court must therefore look to the common and ordinary meaning of the term "projected." See *Rousey* v. *Jacoway*, 544 U.S. 320, 330 (2005). That adjective is derived from the verb "project," which ordinarily means "[t]o calculate, esti-

mate, or predict (something in the future), based on present data or trends." *In re Jass*, 340 B.R. 411, 415 (Bankr. D. Utah 2006) (quoting *American Heritage College Dictionary* 1115 (4th ed. 2002)); see *Merriam-Webster Collegiate Dictionary* 993 (11th ed. 2005) (defining the verb "project" as "to plan, figure, or estimate for the future," and the noun "projection" as "an estimate of future possibilities based on a current trend"); *The New Oxford American Dictionary* 1355 (2d ed. 2005) (defining the verb "project" as "[to] estimate or forecast (something) on the basis of present trends").

Consistent with that usual understanding of the term "projected," bankruptcy courts should determine a debtor's "projected disposable income" by forecasting whether current trends are reasonably likely to continue—*i.e.*, whether a debtor can reasonably expect to receive the same income and incur the same expenses during the plan period as prior to the filing of her bankruptcy petition. See *In re Nowlin*, 576 F.3d 258, 263 (5th Cir. 2009) ("[W]e interpret the phrase 'projected disposable income' to embrace a forward-looking view grounded in the present via the statutory definition of 'disposable income' premised on historical data."); 8 *Collier on Bankruptcy* ¶ 1325.08[5][a] at 1325-61 (Alan N. Resnick & Henry J. Sommer eds., 15th ed. rev. 2006) (*Collier*) ("To the extent that courts give any meaning to the word 'projected,' and courts are supposed to give meaning to every word in a statute, they may have to disregard the debtor's prior income if circumstances have changed."). Petitioner and his amicus contend (Pet. Br. 41; NACBA Am. Br. 17-18) that the bankruptcy court must calculate "projected disposable income" by simply multiplying the debtor's historically-based "disposable income" by the number of months in the plan.

But "[t]he word 'multiplied' is quite different from the word 'projected,'" *In re Kibbe*, 361 B.R. 302, 312 n.9 (B.A.P. 1st Cir. 2007), and other provisions of the Bankruptcy Code expressly require the mechanical calculation that petitioner advocates here. See, *e.g.*, 11 U.S.C. 1325(b)(3) (providing that debtor's current monthly income be "multiplied by 12" to determine whether debtor has above-median income).[3] Congress's decision to require projection rather than multiplication in Section 1325(b)(1)(B) indicates that it did not intend future disposable income to be mechanically derived from current disposable income.

Contrary to petitioner's assertion (Pet. Br. 41), the court of appeals' forward-looking approach does not leave Section 1325's definition of "disposable income" with "no apparent purpose." That definition continues to serve the same two important purposes that the prior definition of that term served before BAPCPA was enacted. First, it directs the bankruptcy court's calculation of disposable income, now by further specifying the types of revenue that the debtor must treat as income, and the types of expenses that an above-median debtor may claim as reasonable and necessary. See Pet. App. 27. Although the process by which a debtor's future income is "projected" may involve predictive judgments

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[3] See also 11 U.S.C. 1325(b)(4)(A)(ii) (providing that debtor's current monthly income be "multiplied by 12" to determine whether debtor has above-median income); 11 U.S.C. 704(b)(2) (same); see also 11 U.S.C 707(b)(2)(A)(i) (providing that debtor's current monthly income be "multiplied by 60" to determine in part whether presumption of abuse applies); 11 U.S.C. 1322(d)(1)-(2) (providing that debtor's current monthly income be "multiplied by 12" to determine length of plan); 11 U.S.C. 1326(b)(3)(B)(ii) (providing that certain payments be "multiplied by 5 percent" to determine trustee compensation).

rather than simple multiplication, those predictive judgments must focus on the types of revenue and expenses that are included in Section 1325's definition of "disposable income." By contrast, if the term "disposable income" were undefined, bankruptcy courts would need to determine which types of revenue and expenses should be considered. The statutory definition thus constrains the bankruptcy courts' discretion in calculating "projected disposable income," even though it does not reduce that calculation to a mathematical formula.

Second, as a practical matter, Section 1325's definition of "disposable income" will often control what a debtor must contribute to a Chapter 13 plan in order to receive confirmation. In many cases, a court may reasonably expect that a debtor's monthly income will be the same during the plan period as it was during the six months before she filed her petition, and that her expenses will be the same during the plan period as at the time of filing. In those cases, projecting the debtor's disposable income will require nothing more than multiplying her current disposable income by the number of months in her plan. But when the evidence indicates that the debtor's current income or expenses are likely to change during the plan period—or that they have already changed during the interval between the filing of the petition and the time of plan confirmation—"a debtor's 'disposable income' calculation on Form 22C is a starting point for determining the debtor's 'projected disposable income,' " and "the final calculation can take into consideration changes that have occurred in the debtor's financial circumstances." *In re Frederickson*, 545 F.3d 652, 659 (8th Cir. 2008), cert. denied, 129 S. Ct. 1630 (2009).

2. Petitioner contends (Pet. Br. 40) that the Court should "adopt a reading [of Section 1325] that does not treat statutory terms as mere surplusage." Petitioner's own construction of the term "projected disposable income," however, would render much of Section 1325(b)(1)(B) meaningless. Section 1325(b)(1)(B) requires the bankruptcy court to ensure, upon objection by the trustee or a creditor, that all of a debtor's "projected disposable income *to be received* in the applicable commitment period * * * *will be applied* to make payments to unsecured creditors." 11 U.S.C. 1325(b)(1)(B) (emphases added). By referring to "projected disposable income" that will "be received" and "be applied to make payments" during the plan period, Section 1325(b)(1)(B) "links 'projected disposable income' with the debtor's income actually received during the plan, and indicates a forward-looking orientation of the phrase." *In re Nowlin*, 576 F.3d at 263. Under petitioner's mechanical interpretation of the term "projected," however, the bankruptcy court is precluded from considering either the amount of income a debtor is actually likely to receive over the duration of her plan or the amount of such income she will be able to apply in that period to make payments to her creditors.

Application of petitioner's interpretation to the facts of this case illustrates its inconsistency with the overall thrust of Section 1325(b)(1)(B). Under petitioner's mechanical view, respondent's "projected disposable income" is $1,114.98 per month, even though petitioner concedes that respondent's actual disposable income during the plan period will be only $149.03 per month. See Pet. App. 4-6. Petitioner would make confirmation of the plan contingent on respondent's commitment to pay $756 per month, even though nearly $607 of that amount will never "be received" and thus will never "be applied to make payments" during the plan period. In short, petitioner's proposed plan would require respondent to commit to repay creditors with income that she will never receive. That is not a natural reading of the statutory text.

Under Section 1325(b)(1)(B), a plan must also commit that, "as of the effective date of the plan," all of the debtor's projected disposable income will be applied to repayment of unsecured creditors. Because a Chapter 13 plan is not binding on the debtor and other parties until it is confirmed, 11 U.S.C. 1327(a), "the effective date of the plan" is the date on which the plan is confirmed by the bankruptcy court. The requirement that bankruptcy courts determine a debtor's projected disposable income at the time of confirmation, which often occurs months after the time of filing, further indicates that Congress intended to allow for "consideration of evidence at the time of the plan's confirmation that may alter the historical calculation of disposable income on Form 22C." *In re Nowlin*, 576 F.3d at 263; see Pet. App. 25. By contrast, petitioner's mechanical approach would preclude the bankruptcy court from considering not only changes in the debtor's financial circumstances that are demonstrably likely to occur during the plan period, but even changes that have already occurred between the pre-filing period and the date the confirmation decision is made.

Section 1325 also provides that, as a condition of confirmation, a court must determine that "the debtor will be able to make all payments under the plan and to comply with the plan." 11 U.S.C. 1325(a)(6); see pp. 26-28, *infra*. To make that determination, the court necessarily must assess the debtor's likely future financial circumstances. There is no reason that Congress would require such a forward-looking inquiry in one subsection of Section 1325 and prohibit it in another.

3. Petitioner and his amicus observe (Pet. Br. 45-56; NACBA Am. Br. 19-20) that Section 1325(b)(3) (through the incorporation of Section 707(b)(2)(A)) expressly allows courts to adjust an above-median debtor's expenses upon a showing of special circumstances. They argue that Congress's failure expressly to authorize similar adjustments on the income side of the ledger reflects an intent to limit the courts' discretion in this regard, and that the court of appeals' decision disserves that congressional intent. That argument is misconceived.

Under Sections 1325(b)(3) and 707(b)(2)(A), a court's adjustment of an above-median-income debtor's expenses due to special circumstances takes place in the calculation of the debtor's "disposable income." The absence of any similar "special circumstances" exception to the statutory definition of "current monthly income," see 11 U.S.C. 101(10A)(A)(i), means that the court must use historical income data to calculate a debtor's "disposable income" under Section 1325(b)(2). The question in this case, however, is how a court should "project[]" a debtor's disposable income over the life of her bankruptcy plan so as to ensure that all of the income "to be received" in that time "will be applied to make payments to unsecured creditors under the plan." 11 U.S.C. 1325(b)(1)(B). Sections 1325(b)(3) and 707(b)(2)(A) have no bearing on the proper resolution of that issue.

B. Other Provisions In Chapter 13 Of The Bankruptcy Code Confirm That Section 1325 Mandates A Forward-Looking Approach That Reflects A Debtor's Actual Financial Circumstances

The proper interpretation of particular statutory provisions turns not only on "the language itself [and] the specific context in which that language is used," but also on "the broader context of the statute as a whole." *Robinson* v. *Shell Oil Co.*, 519 U.S. 337, 341 (1997). The broader statutory context confirms that Congress intended a Chapter 13 debtor's plan to reflect the reality of her circumstances, even when those circumstances change over time. To that end, Congress included two provisions expressly permitting the modification of a debtor's initial plan.

The first, 11 U.S.C. 1323, allows a debtor to modify her plan "at any time before confirmation." A debtor may modify her proposed plan for many reasons, including to cure an objection that the trustee or a creditor has raised, to cure a post-petition arrearage in mortgage payments, or to accommodate "a change in circumstances making it impossible for the debtor to carry out the terms of the original, or prior, plan." 8 *Collier* ¶ 1323.02, at 1323-2 to 1323-3. To be sure, a debtor's pre-confirmation modification of her plan does not exempt her from complying with the requirements of Section 1325. But the flexibility built into the development of a confirmable Chapter 13 plan is evidence of Congress's intent that such plans reflect a debtor's actual ability to repay her creditors.

The second provision, 11 U.S.C. 1329, permits the debtor, trustee, or any unsecured creditor to seek modification of a Chapter 13 plan "[a]t any time after confirmation of the plan." This provision, too, reflects Congress's recognition that a debtor's financial circumstances may change in ways that will alter her ability to repay her creditors. Congress's decision to allow a debtor, creditor, or trustee to seek post-confirmation modification reflects Congress's understanding that changes in circumstances can either hamper a debtor's ability to comply with her plan or enhance her ability to satisfy her unsecured debts. Although Section 1329 does not govern the standards a bankruptcy court must employ in deciding whether to confirm a plan under Section 1325(b)(1)(B), it is further evidence that Congress expected the Chapter 13 system to operate in a realistic manner that takes account of a debtor's actual financial circumstances. If the bankruptcy court may modify a Chapter 13 plan *after* confirmation to take account of changes in a debtor's income or expenses, it would make little sense to preclude the court, in determining whether that plan should be confirmed, from taking account of changes in the debtor's financial circumstances that have occurred between the pre-filing period and the time of plan confirmation.[4]

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[4] Under Section 1327 of the Bankruptcy Code, "[t]he provisions of a confirmed plan bind the debtor and each creditor." 11 U.S.C. 1327(a). Some courts of appeals have held that, under Section 1327, the confirmation of a plan has a *res judicata* effect such that parties may not seek post-confirmation alteration of a plan to take into account circumstances known or reasonably foreseeable at the time of confirmation. See *In re Dorsey*, 505 F.3d 395, 398-399 (5th Cir. 2007); *In re Murphy*, 474 F.3d 143, 149-150 (4th Cir. 2007); but see *Barbosa* v. *Solomon*, 235 F.3d 31, 38-41 (1st Cir. 2000); *In re Witkowski*, 16 F.3d 739, 743-746 (7th Cir. 1994). Under that view of Section 1327, adoption of petitioner's rule would mean that parties affected by a Chapter 13 bankruptcy are *never* permitted to take into account changes in a debtor's financial circumstances that occur prior to confirmation but are not reflected in the six-

C. BAPCPA's History And Purposes Confirm That Section 1325 Mandates A Forward-Looking Approach To The Calculation Of "Projected Disposable Income"

1. The legislative history that accompanied BAPCPA is not extensive, but the House Judiciary Report explains that BAPCPA "[was] intended to ensure that debtors repay creditors the maximum they can afford." H.R. Rep. No. 31, 109th Cong., 1st Sess. Pt. 1, at 2 (2005) (*2005 House Report*). Although in this case petitioner's mechanical approach would have required respondent to commit to make payments well in excess of the funds that would actually be available to her, in other cases that same approach would allow debtors to pay less than they could afford. See *In re Kagenveama*, 541 F.3d 868, 871 (9th Cir. 2008) (affirming confirmation of plan pursuant to which debtor would pay less than her actual future disposable income); see also *In re Turner*, 574 F.3d 349, 355-356 (7th Cir. 2009) (reversing plan that would allow debtor to deduct amount for expense he would not actually incur during plan). When a debtor's pre-filing disposable income understates the resources that are likely to be available to her during the plan period (*e.g.*, because of a temporary decrease in income during the pre-filing period or an increase in expenses at the time of filing), mechanically extrapolating that net income figure into the future would deprive creditors of payments that the debtor would be able to make during the plan period. That result is inconsistent with Congress's intent "that debtors pay the greatest amount within their capabilities. Nothing more; nothing less." *In re Kibbe*, 361 B.R. at 314.

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month look-back period utilized in the calculation of a debtor's "disposable income."

2. Before BAPCPA's enactment, bankruptcy courts "usually" multiplied a debtor's disposable income by the number of months in the plan to determine his projected disposable income, *e.g.*, *Anderson* v. *Satterlee*, 21 F.3d 355, 357 (9th Cir. 1994), but they departed from that mathematical calculation when necessary to take into account anticipated changes to a debtor's financial circumstances, see, *e.g.*, *In re Petro*, 395 B.R. 369, 377 (B.A.P. 6th Cir. 2008) ("Prior to BAPCPA the schedules were a starting point and courts gave meaning to the words 'projected' and 'to be received' by taking into account a debtor['s] anticipated future income.").[5] Indeed, Schedules I and J, which courts used as the starting point for determining a debtor's disposable income, required (and continue to require) debtors to note when "any increase or decrease" in income or expense is "reasonably anticipated within the year following the filing" of the relevant schedule. Fed. R. Bankr. P. Official Form 6, Scheds. I-J (2000).

Congress is presumed to be familiar with the backdrop against which it acts. See, *e.g.*, *Goodyear Atomic Corp.* v. *Miller*, 486 U.S. 174, 184-185 (1988); *Cannon* v.

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[5] See also, *e.g.*, *In re Simms*, No. 06-1206, 2008 WL 217174, at *9 (Bankr. N.D. W. Va. Jan. 23, 2008) ("Of course, under pre-BAPCPA law, bankruptcy courts sometimes deviated from the debtor's income and expenses listed on Schedules I & J based on known increases or decreases in either income or expenses."); *In re Richardson*, 283 B.R. 783, 799 (Bankr. D. Kan. 2002) ("Before a plan is confirmed, the debtor, the trustee, and the court must look to see what the plan offers in payments from projected disposable income that will predictably flow to the debtor. If income is foreseeable at confirmation, it is included within projected disposable income."); Thomas J. Izzo, *Projecting the Past: How the Bankruptcy Abuse Prevention and Consumer Protection Act Has Befuddled § 1325(b) and "Projected Disposable Income,"* 25 Emory Bankr. Devs. J. 521, 552 (2009).

University of Chicago, 441 U.S. 677, 696-697 (1979). For that reason, this Court "will not read the Bankruptcy Code to erode past bankruptcy practice absent a clear indication that Congress intended such a departure." *Cohen* v. *de la Cruz*, 523 U.S. 213, 221 (1998) (quoting *Pennsylvania Dep't of Pub. Welfare* v. *Davenport*, 495 U.S. 552, 563 (1990)). Although BAPCPA modified the formulae used to calculate a debtor's "disposable income," it did not address the manner in which the debtor's income is "projected" into the future. See pp. 4-6, *supra*. Accordingly, bankruptcy courts should employ the same approach they employed prior to 2005 by starting with the disposable income figure from Form 22C and multiplying that by the number of months in a debtor's plan—*unless* there is reason to believe that the debtor's financial circumstances have changed or will change, in which case the court should project the debtor's likely disposable income over the life of the plan. If Congress had intended to preclude bankruptcy courts from continuing to consider debtors' likely future financial circumstances when determining projected disposable income, "one would expect Congress to have made unmistakably clear its intent." *Cohen*, 523 U.S. at 222.

3. Petitioner contends that adopting his interpretation of the term "projected disposable income" will further Congress's efforts to reduce bankruptcy courts' discretion in determining debtors' ability to repay their creditors. Petitioner bases his argument on statements from one member of Congress related to a bankruptcy reform bill that was introduced, but never enacted, five years before Congress passed BAPCPA. See Pet. Br. 28-29 (relying on statements of Senator Grassley, 146 Cong. Rec. S11,700 and S11,703 (daily ed. Dec. 7, 2000)).

Although the statement of one Senator about a bill that was never enacted is of dubious value in interpreting a federal statute, it is apparent from the 2005 amendments that Congress did intend to curtail the discretion of bankruptcy judges in certain respects. Prior to BAPCPA, individual judges had greater latitude to determine which sources of revenue to count as income and which expenses to consider reasonably necessary. In exercising that discretion, different judges sometimes employed different criteria, so that two debtors with identical financial circumstances might be required to pay different amounts to their creditors. For example, courts differed as to whether to treat property that is exempt under Section 522(c) of the Bankruptcy Code as income under the former version of Section 1325, see *In re Hunton*, 253 B.R. 580, 581-582 (Bankr. N.D. Ga. 2000) (collecting cases), and about whether to allow school tuition to be deducted as a reasonable expense, *In re Burgos*, 248 B.R. 446, 450 (Bankr. M.D. Fla. 2000) (collecting cases).

When Congress amended the Code in 2005, it curtailed that type of discretion by delineating the types of revenue that should be counted as "income" and the types of expenses that may be counted as reasonably necessary for above-median debtors. But Congress did not require courts to rely on a debtor's historical financial data when that information does not accurately reflect the debtor's likely resources during the period covered by her bankruptcy plan.[6] Rather, Congress left

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[6] *E.g.*, *In re Turner*, 574 F.3d at 355 ("Since the object of a Chapter 13 bankruptcy is to balance the need of the debtor to cover his living expenses against the interest of the unsecured creditors in recovering as much of what the debtor owes them as possible, we cannot see the merit in throwing out undisputed information, bearing on how much the debt-

unchanged the term "projected disposable income," which had previously been understood to allow consideration of a debtor's likely financial circumstances during the plan period. Congress also left intact other features of the statutory scheme (*e.g.*, Section 1325(b)(1)(B)'s reference to income "to be received" during the plan period) that direct the bankruptcy court to consider the debtor's actual ability to pay. See pp. 16-18, *supra*. Congress's decision to preclude bankruptcy courts from exercising one form of discretion does not mean Congress wanted to preclude bankruptcy courts from exercising other forms of discretion, provided in separate, unamended statutory language.

For essentially the same reason, petitioner's argument is not advanced by his assertion (Br. 34) that Chapter 13 trustees "warned" Congress that "strict use of the Form 22C formula would lead to anomalous results in some cases, namely that above median income debtors might pay less than they would prior to BAPCPA." Here too, the change in the law to which petitioner refers has nothing to do with the manner in which disposable income is "projected." Rather, petitioner again refers to BAPCPA's establishment of new and more determinate formulae for calculating *current* disposable income (*i.e.*, disposable income during the six-month pre-filing period). Some Chapter 13 trustees appear to have expressed concern prior to BAPCPA's enactment that the new formulae would often produce lower disposable-income figures for above-median debtors (and thus require such debtors to pay less to their creditors) than the prior, more discretionary regime.

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or can afford to pay, that comes to light between the submission and approval of a plan of reorganization.").

See *In re Alexander*, 344 B.R. 742, 746-747 (Bankr. E.D.N.C. 2006). Petitioner argues that Congress was aware of such concerns and nonetheless precluded judges from exercising discretion in calculating current disposable income. But once again, petitioner cites no evidence suggesting that Congress intended to preclude (or that Chapter 13 trustees generally understood BAPCPA to preclude) bankruptcy courts from considering likely changes in a debtor's financial circumstances in calculating *projected* disposable income.

D. Petitioner's Mechanical Approach To Determining A Debtor's Projected Disposable Income Would Undermine The Purposes Of The Chapter 13 Bankruptcy System

Petitioner's mechanical approach to projecting a debtor's disposable income would preclude some honest debtors from filing at all and would permit other debtors with relatively abundant resources to avoid repaying their creditors what they can afford. That is not what Congress intended in creating the Chapter 13 system or in amending it in 2005.

1. Under petitioner's approach, respondent would be required to commit to make payments of $756 per month, leaving her with $1166 per month for living expenses. Pet. App. 6, 44 & n.11. That amount is $408 less than the standard deductions for housing, utilities, food, clothing, and household and personal care supplies—without even considering transportation, taxes, health care, and telecommunication expenses. Pet. App. 44 n.11. Because that approach would require respondent to commit to making payments that she cannot possibly afford, petitioner's plan is not confirmable. See 11 U.S.C. 1325(a)(6) (requiring as a condition of confir-

mation that "the debtor will be able to make all payments under the plan and to comply with the plan").

Petitioner acknowledges (Br. 48) that his reading of Section 1325(b)(1)(B) "may effectively deny [respondent] Chapter 13 bankruptcy relief" because she cannot propose a confirmable plan. That consequence will not be unusual among Chapter 13 debtors, many of whom are in respondent's situation. In fact, petitioner's interpretation of Section 1325(b)(1)(B) often will deny bankruptcy protection to those who need it most: debtors whose financial situation has significantly deteriorated over the six months prior to filing. Pet. App. 71-72.

Many people seek bankruptcy protection after losing a source of income or incurring an unusual and onerous expense. Such events cause financial distress precisely because they are unexpected. Section 1325(b)(1)(B) does not require bankruptcy courts to treat such events either as if they did not happen (as in the case of a recently lost job) or as if they can be expected to recur in the future (as in the case of an exceptional expense of limited duration). Instead, Section 1325(b)(1)(B) requires judges to approve a repayment plan that reflects a debtor's actual circumstances. As bankruptcy courts have recognized, "[b]ecause people are frequently forced to file for bankruptcy relief as a result of sudden life-altering events," there are "numerous debtors who would be foreclosed from seeking bankruptcy protection" if their current net incomes were mechanically projected into the future, without any consideration of their actual financial circumstances. *In re Jass*, 340 B.R. at 417; see Thomas J. Izzo, *Projecting the Past: How the Bankruptcy Abuse Prevention and Consumer Protection Act Has Befuddled § 1325(b) and "Projected Disposable Income*," 25 Emory Bankr. Devs. J. 521, 546

(2009); cf. *In re Grady*, 343 B.R. 747, 752 (Bankr. N.D. Ga. 2006) ("Certainly the proponents of BAPCPA did not intend to close the bankruptcy court doors to debtors who voluntarily, and in good faith, seek to repay creditors with the funds they actually have on hand each month."). That is not what Congress intended when it enacted BAPCPA.

In other Chapter 13 cases, adoption of petitioner's mechanical approach would work unfairness to creditors. On petitioner's reading of Section 1325(b)(1)(B), a debtor who had been unemployed for six months could file a Chapter 13 petition on the eve of obtaining a new job, commit to repaying little or nothing to unsecured creditors, and still obtain an eventual discharge of his pre-petition debts. See, *e.g.*, *In re Arsenault*, 370 B.R. 845, 847 (Bankr. M.D. Fla. 2007) (debtor filed his Chapter 13 petition in October and did not include his yearly bonuses in the calculation of his current monthly income). Similarly, a debtor could claim a significant expense that he will not incur during the plan period. See, *e.g.*, *In re Turner*, 574 F.3d at 355-356. That result is squarely at odds with one of BAPCPA's core purposes: to deter abuse of the bankruptcy system by debtors with an actual ability to repay some or all of their debts.

Petitioner observes (Br. 50) that "the results of the mechanical approach are neither consistently harsh nor weighted for or against debtors," noting that in some cases reliance on historical figures will produce "a more 'debtor-friendly' result." But it is equally true that, under the court of appeals' approach, consideration of likely changes in financial circumstances will require debtors to make higher payments in some cases and allow them to make lower payments in others. That the mechanical approach does not systematically advantage or disadvantage debtors therefore provides no basis for preferring it to the court of appeals' analysis, which also does not systematically advantage or disadvantage debtors. Unlike petitioner's mechanical approach, however, the court of appeals' interpretation of the term "projected disposable income" furthers Congress' intent that every Chapter 13 debtor be required as a condition of plan confirmation to make payments at (*i.e.*, neither above nor below) the maximum level she can afford.

2. Petitioner observes (Pet. Br. 51) that "[t]he debtor * * * always has control over the date of the filing of the petition," and he suggests various means by which a debtor may evade the result that the mechanical approach would otherwise produce. See also NACBA Am. Br. 9. Petitioner further suggests (Pet. Br. 53) that a debtor in respondent's position may simply dismiss her case and re-file a new petition in order to avoid an unfavorable six-month look-back period. But the potential for debtors to manipulate the bankruptcy system through strategic filing is a further disadvantage of petitioner's approach, not a reason to adopt it. See *2005 House Report* 5 (explaining that one of Congress's goals in enacting BAPCPA was to prevent the continued use of "loopholes and incentives that allow and—sometimes —even encourage opportunistic personal filings and abuse"). The various stratagems that petitioner suggests also run counter to the longstanding requirement that Chapter 13 plans be proposed "in good faith." 11 U.S.C. 1325(a)(7).[7]

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[7] Petitioner further suggests (Br. 53-54) that respondent could have filed a Chapter 7 liquidation rather than a Chapter 13 repayment plan. In enacting BAPCPA, however, Congress sought to increase the amount of money unsecured creditors will receive from the bankruptcy

In any event, petitioner is incorrect in suggesting that debtors whose actual income is less than the "current monthly income" calculated with reference to the pre-petition six-month period generally will be able to manipulate the system so that their "projected disposable income" reflects their current or anticipated reality. Experience has shown that the principal motivation for many Chapter 13 filers is protection from mortgage foreclosure. See, *e.g.*, *In re Monson*, No. 09-20487, 2009 WL 4663864, at *2 (Bankr. D. Wyo. Dec. 7, 2009); *In re Snipes*, 314 B.R. 898, 902 (Bankr. S.D. Ga. 2004); *In re Boomgarden*, 780 F.2d 657, 658-659 (7th Cir. 1985); Pamela Smith Holleman & Lesley M. Varghese, *Bankruptcy and Mechanics' Lien in Foreclosure: An Overview*, 91 Mass. L. Rev. 116, 117 (2008).[8] A debtor facing the threat of foreclosure usually files a bankruptcy petition not only to cure the arrearages on her mortgage, but also to take advantage of the protection offered by the automatic stay provision in 11 U.S.C. 362. Such a debtor cannot wait several weeks or months before filing a petition without risking the loss of her home. Petitioner's further suggestion that a debtor could simply dismiss and re-file her petition in order to change the court's calculation of her "current monthly income" similarly ignores the circumstances confronted by debtors who are facing foreclosure. When a debtor behaves as petitioner suggests, she may forfeit protection of the

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system by shifting more debtors from Chapter 7 into Chapter 13. *2005 House Report* 2; *id.* at 12 .

[8] See also John Eggum, *et al*, *Saving Homes in Bankruptcy: Housing Affordability and Loan Modification*, 2008 Utah L. Rev. 1123, 1126; Michelle J. White, *Personal Bankruptcy Under the 1978 Bankruptcy Code: An Economic Analysis*, 63 Ind. L.J. 1, 48 (1987).

automatic stay, again risking the loss of her home. See 11 U.S.C. 362(c)(3)(A).[9]

Finally, both petitioner and his amicus suggest (Pet. Br. 21-22, 51-52; NACBA Am. Br. 10, 20, 26) that a Chapter 13 debtor can evade the result mandated by the mechanical approach by deliberately failing to file a Schedule I statement of income and subsequently asking the court to set a different six-month look-back period for calculating the debtor's "current monthly income." See 11 U.S.C. 101(10A)(A)(ii) (providing that current monthly income may be calculated with reference to a six-month period ending on "the date on which current income is determined by the court * * * if the debtor does not file the schedule of current income required by 521(a)(1)(B)(ii)"). But the filing of a Schedule I is mandatory unless excused by the court, see 11 U.S.C. 521(a)(1)(B)(ii); *In re Shelor*, No. 08-80738C-13D, 2008 WL 4344894, at *2 (Bankr. M.D.N.C. Sept. 23, 2008), and a debtor's breach of that requirement may lead to dismissal of his petition, see 11 U.S.C. 521(i)(1); *In re Dunford*, 408 B.R. 489, 493 (Bankr. N.D. Ill. 2009); Fed. R. Bankr. P. 1007(c). The approach that petitioner and his amicus propose therefore would encourage debtors to disregard the requirements of the Bankruptcy Code, and to place their eligibility for bankruptcy relief at risk, simply to ensure that their repayment plans reflect their

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[9] In addition, Section 109(g) prohibits the filing of any type of bankruptcy by a debtor who has had a case pending within the preceding 180 days if the case was dismissed "for willful failure of the debtor to abide by orders of the court, or to appear before the court in proper prosecution of the case," or if the debtor had the prior case voluntarily dismissed "following the filing of a request for relief from the automatic stay."

actual ability to pay. Congress cannot reasonably be thought to have intended that result.

CONCLUSION

The judgment of the court of appeals should be affirmed.

Respectfully submitted.

ELENA KAGAN
Solicitor General

TONY WEST
Assistant Attorney General

MALCOLM L. STEWART
Deputy Solicitor General

SARAH E. HARRINGTON
Assistant to the Solicitor General

WILLIAM KANTER
EDWARD HIMMELFARB
Attorneys

RAMONA D. ELLIOTT
General Counsel

P. MATTHEW SUTKO
Associate General Counsel

DAVID I. GOLD
CATHERINE B. SEVCENKO
Attorneys
Executive Office for United States Trustees

FEBRUARY 2010

BRIEF BANK — “SUMMARY SHEET”

Printed Wed-11/3/10 14:57

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	Betsey Warren Lebbos v. Sara L. Kistler, Acting United States Trustee, Region 17 (In re Betsey Warren Lebbos)
2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	E. D. Ca.
3. ("CCN") ***CURRENT*** CASE NO.	No.: 2:09-cv-1252-LKK
4. ("PCN") ***PRIOR*** CASE NO. - & COURT *[IF ANY]*	No.: 06-22225-D-7 Court: Bankr. E. D. Ca. *(Identify judge & cite, if any)*
5. ("SO") ***SOURCE***	**U.S. TRUSTEES**
6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	Filed: November 6, 2009 Type: Appellee’s Opening Brief
7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*	Antonia G. Darling, Sara L. Kistler *(UST/OGC: 202-307-1399/FAX-2397)*
8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	• 1) Whether the bankruptcy court abused its discretion by denying Ms. Lebbos’ discharge, pursuant to 11 U.S.C. § 727(a)(6)(A), based on Ms. Lebbos’ failure to obey two (2) lawful orders of the court; 2) Whether the bankruptcy court abused its discretion by denying Ms. Lebbos’ discharge, pursuant to 11 U.S.C. § 727(a)(4)(D), because Ms. Lebbos knowingly and fraudulently withheld records and documents from an officer of the estate in her bankruptcy case; and 3) Whether the bankruptcy court denied Ms. Lebbos a fair trial.
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UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF CALIFORNIA
(SACRAMENTO DIVISION)

In re:)	**US Dist Court # 2:09-cv-1252-LKK**
)	
BETSEY WARREN LEBBOS,)	
Debtor.)	
___________________________________)	
)	
BETSEY WARREN LEBBOS,)	
Appellant.)	Bankruptcy Case No. 06-22225-D-7
v.)	Adversary No. 08-2072-D-7
)	
SARA L. KISTLER, ACTING UNITED)	
STATES TRUSTEE, REGION 17)	
Appellee)	
___________________________________)	

Appeal from the United States Bankruptcy Court
for the Eastern District of California

Honorable Robert Bardwil
Bankruptcy Judge, Presiding

APPELLEE'S OPENING BRIEF

Sara L. Kistler, Appellee
Acting United States Trustee, Region 17

Antonia G. Darling, State Bar No. 76190
Assistant United States Trustee
Office of the United States Trustee
United States Department of Justice
501 I Street, Ste 7-500
Sacramento, CA 95814
(916) 930-2100/Fax (916) 930-2099

November 6, 2009

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STATEMENT OF BASIS OF APPELLATE JURISDICTION

This is an appeal from a judgment, dated April 27, 2009 and entered by the United States Bankruptcy Court for the Eastern District of California in an adversary proceeding within the chapter 7 bankruptcy case of Betsey Warren Lebbos ("Ms. Lebbos"). The judgment denied entry of a discharge for Ms. Lebbos, pursuant to Bankruptcy Code Section 727(a)(6)(A), for willfully failing to obey two orders of the bankruptcy court, and pursuant to Section 727(a)(4)(D) for knowingly and fraudulently failing to provide properly requested documents to the trustee. [A-1, B-2].[1] The bankruptcy court had jurisdiction under 28 U.S.C. §§ 157(a) and (b), and 1334(a) to enter the judgement denying Ms. Lebbos' discharge.

Ms. Lebbos filed a Notice of Appeal on May 1, 2009, which is timely under 28 U.S.C. § 158(a) and (c)(2). This Court has jurisdiction under 28 U.S.C. § 158(a)(1) to hear appeals from "final judgements, orders and decrees of bankruptcy judges" entered in bankruptcy cases. The judgment denying Ms. Lebbos' discharge is a "final judgment" for the purposes of this appeal.

STATEMENT OF ISSUES

The Acting United States Trustee for Region 17, Sara L. Kistler ("United States Trustee"), submits that the following three issues are presently before the Court for consideration:

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[1] Documents in the record transmitted to the district court by the parties are identified by the designation used by Appellant in her Designation of Record on Appeal, consisting of a letter or letters followed by a number, or by the designation "UST- number" for records designated by the Appellee.

1. Whether the bankruptcy court abused its discretion by denying Ms. Lebbos' discharge, pursuant to 11 U.S.C. § 727(a)(6)(A), based on Ms. Lebbos' failure to obey two (2) lawful orders of the court;

2. Whether the bankruptcy court abused its discretion by denying Ms. Lebbos' discharge, pursuant to 11 U.S.C. § 727(a)(4)(D), because Ms. Lebbos knowingly and fraudulently withheld records and documents from an officer of the estate in her bankruptcy case; and

3. Whether the bankruptcy court denied Ms. Lebbos a fair trial.

APPLICABLE STANDARD OF REVIEW

On appeal from a decision of the bankruptcy court, the appellate court applies a clearly erroneous standard to the bankruptcy court's findings of fact and conducts a *de novo* review of conclusions of law. See Fed. R. Bankr. P. 8013; Resyn Corp. v. United States, 851 F.2d 660, 664 (3d Cir. 1988); In re Jersey City Medical Center, 817 F.2d 1055, 1059 (3d Cir. 1987); In re Winthrop Nurseries, Inc., 50 F.3d 72, 73 (1st Cir. 1995).

STATEMENT OF THE CASE

Factual Basis for Denial of Discharge

Ms. Lebbos moved to Redding, California on or about May 14, 2006, in connection with the sale of her business "Lawyer Defend Yourself" to a Redding businessman. Part of the sale agreement was that Ms. Lebbos would assist in running the business for the following two years, and she would be paid approximately $6,000 per month from the business proceeds. On June 26, 2006, Ms. Lebbos filed a chapter 7 bankruptcy case in the Eastern District of California, and the case was assigned Number 06-22225–D-7. (B-2)

Attorney Darryl Alvey ("Attorney Alvey") was Ms. Lebbos' attorney of record in her bankruptcy case. Prior to commencing the case, Ms. Lebbos reviewed her bankruptcy documents and signed a statement of correctness regarding the accuracy of the information that she had provided. She then signed the petition, schedules and statement of financial affairs in front of Attorney Alvey. (B-2,3)

Linda Schuette ("Trustee Schuette") was appointed as the chapter 7 trustee in the case. The first meeting of creditors for the bankruptcy case was scheduled for July 19, 2006, in Redding, California ("Creditors' Meeting"). In connection with her responsibilities in administering Ms. Lebbos' case, Trustee Schuette faxed a letter to Attorney Alvey on July 5, 2006 ("July 5th Letter"), which requested the production of specific documents by July 12, 2006, in advance of the Creditors' Meeting. The documents requested by Trustee Schuette were:

1) Tax returns for 2000-2005 for ''Lawyer Defend Yourself";
2) Ms. Lebbos' personal tax returns for 2003-2005;
3) Tax returns for 1996 through 2005 for all trust entities for which Ms. Lebbos was a beneficiary, trustee or administrator;[2]
4) Purchase documents for the sale of the business "'Lawyer Defend Yourself";
5) Cancelled checks for all accounts on which Ms. Lebbos had signing authority;
6) Copies of all trust documents for trusts Ms. Lebbos had signed on from

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[2] Among the information requested by Trustee Schuette was documentation to verify Ms. Lebbos' interest in a condominium located in Long Beach, California. Trustee Schuette had been provided with information suggesting that Ms. Lebbos transferred her interest in the condominium to a trust prior to filing her bankruptcy case. During the pendency of her case, Ms. Lebbos alleged that she was never "really" the owner of the condominium, but she has never provided the documents to support this claim.

1996; and

7) Copies of all documents regarding any real property transactions Ms. Lebbos participated in from 1996.

In the event that Ms. Lebbos did not have any of the requested documents, the July 5th Letter requested an explanation of why they were not in her possession, together with and the names of contact people who would have them. (B-3)

Ms. Lebbos failed to provide any of the requested documents, or her tax return and payment advices, to Trustee Schuette a week before the Creditors' Meeting, as required by 11 U.S.C. § 521. Ms. Lebbos appeared at the Creditors' Meeting on July 19, 2006, with Attorney Alvey, but she did not bring any of the documents previously requested by Trustee Schuette. According to Ms. Lebbos, certain of the requested documents were located in either San Jose or Long Beach, California, and she would have to travel to retrieve them. The Creditors' Meeting was continued on the record to October 18, 2006, in Redding, California, in order to allow Ms. Lebbos to travel to San Jose or Long Beach to recover the documents. (B-3) Ms. Lebbos did not appear at the continued Creditors' Meeting on October 18, 2006. In fact, the Creditors' Meeting was continued at least nine times in order to afford Ms. Lebbos an adequate opportunity to comply with the statutory requirements imposed on her as a chapter 7 debtor. She never appeared again after the first Creditors' Meeting. (DD-204-209, 213)

On August 4, 2006, Ms. Lebbos sent Trustee Schuette two of the documents requested in the July 5th Letter, but nothing more.[3] On or about August 14, 2006, Ms. Lebbos moved from Redding to Saratoga, California. On December 1, 2006, Ms. Lebbos moved to San Jose, California. Each time she moved, Ms. Lebbos

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[3] The documents provided by Ms. Lebbos on August 4, 2006 were a copy of the Aida Madeleine Lebbos Trust No. 2 and the sale contract for "Lawyer Defend Yourself." (B-4)

traveled by car. (B-4).

Based on Ms. Lebbos' failure to voluntarily satisfy the statutory requirements imposed on her, Trustee Schuette filed a motion to compel Ms. Lebbos to produce the documents requested in the July 5th Letter and to appear at the continued Creditors' Meeting. A hearing on the motion to compel was conducted on January 3, 2007. The court permitted Ms. Lebbos to appear and participate in the hearing by telephone. (B-4)

Following the hearing, the bankruptcy court entered an order, dated January 19, 2007 ("January 19th Order"), which directed Ms. Lebbos to appear at the continued Creditors' Meeting on February 21, 2007 in Redding, California. The January 19th Order also required her to produce at the Creditors' Meeting all documents requested by Trustee Schuette in the July 5th Letter, that were in her possession, custody or control. The bankruptcy court clerk served a copy of the January 19th Order on Ms. Lebbos at the address provided by her to the court. (DD-236) Ms. Lebbos did not appeal this order.

Ms. Lebbos did not appear at the continued Creditors' Meeting on February 21, 2007. (B-4) She alleged that she was not able to appear because she was serving a sentence of house arrest in San Jose, California, which resulted from Ms. Lebbos having practiced law without a license.[4] Therefore, according to Ms. Lebbos, she was not able to travel to Redding for the Creditors' Meeting. In response to Ms. Lebbos' allegations regarding her house arrest sentence, Trustee Schuette directed her attorney, Michael Dacquisto ("Daquisto"), to contact Ms. Lebbos' probation officer. Contrary to Ms. Lebbos' assertions, her probation

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[4] As stated in footnote four of her brief in this appeal, Ms. Lebbos was sentenced to electronic monitoring in San Jose for nine months because her publication of the two volume set of books, *Lawyer Defend Yourself*, constituted the practice of law without a license.

officer advised Dacquisto that Ms. Lebbos could, in fact, leave the jurisdiction to attend to court matters. (DD-212)

On March 14, 2007, Trustee Schuette filed a motion, pursuant to Rule 2005 of the Federal Rules of Bankruptcy Procedure ("Fed. R. Bankr. P."), seeking to have Ms. Lebbos taken into custody by the United States Marshall and brought for examination in Redding, California. The bankruptcy court held a hearing on this motion on April 25, 2007. Ms. Lebbos participated in the hearing by telephone. (B-4)

Throughout the pendency of her bankruptcy case, Ms. Lebbos has alleged that she suffers from heart and lung disabilities which restrict her ability to travel. However, she has not consented to the United States Trustee and Trustee Schuette verifying her medical condition by refusing to allow access to her medical providers for examination. (FF-304) Nonetheless, as a result of Ms. Lebbos' alleged infirmities, the bankruptcy court decided not to enter an order under Fed. R. Bankr. P. 2005, during the hearing on April 25, 2007. Rather, to accommodate Ms. Lebbos, the court ordered Trustee Schuette and her counsel travel to San Jose, California, where Ms. Lebbos was residing at the time. The court allowed Trustee Schuette to conduct an examination of Ms. Lebbos at the United States Trustee's office in the San Jose courthouse, pursuant to Fed. R. Bankr. P. 2004 ("Rule 2004 Examination"). (B-4) The parties discussed the possibility of scheduling the Rule 2004 Examination in late May 2007. During this discussion, Ms. Lebbos never informed the court or the parties that she would not be able to appear on May 31, 2007, nor did she mention any plans to move before May 31, 2007. (DD-214) Following the hearing, the bankruptcy court entered an order on May 10, 2007, which directed Ms. Lebbos to appear for the Rule 2004 Examination at 280 South First Street, Room 130, San Jose, California, on May 31, 2007 ("May 10th

Order"). The May 10th Order further required Ms. Lebbos to produce all remaining documents requested by the Trustee in the July 5th Letter. The bankruptcy court clerk served a copy of the May 10th Order on Ms. Lebbos at the address provided by her to the court. Ms. Lebbos did not appeal this order. (B-4)

On May 26, 2007, Ms. Lebbos moved once again. This time, she relocated to southern California, and, again, she traveled by car. She also sent a letter to Trustee Schuette, by regular mail, stating that she would no longer be in San Jose, California, and would not be available for the Rule 2004 Examination on May 31, 2007. On May 31, 2007, Ms. Lebbos moved again, this time to Long Beach, California. Ms. Lebbos failed to appear for the Rule 2004 Examination on May 31, 2007, and she failed to provide the documents requested by Trustee Schuette, as directed by the May 10th Order. (B-5)

On November 14, 2007, the Bankruptcy Appellate Panel for the Ninth Circuit ("Bankruptcy Appellate Panel") entered a decision resolving Ms. Lebbos' appeals from three orders entered in her bankruptcy case. This decision affirmed the bankruptcy court's denial of Ms. Lebbos' requests for (1) the transfer of venue of her bankruptcy case, (2) the disqualification of Bankruptcy Judge Robert Bardwil ("Judge Bardwil"), and (3) the dismissal of Ms. Lebbos' bankruptcy case.[5] (UST-2, pg 3)

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[5] The Bankruptcy Appellate Panel decision, dated November 14, 2007, was entered in the appeals found at Bankruptcy Appellate Panel Numbers: EC-07-1163; EC-07-1174; and EC-07-1203. (UST-2)

Procedural Facts

Based on her conclusion that Ms. Lebbos had repeatedly failed to comply with the minimum requirements imposed on her as a chapter 7 debtor, the United States Trustee commenced an adversary proceeding against Ms. Lebbos on February 7, 2008. The United States Trustee's complaint in the adversary proceeding sought a denial of Ms. Lebbos' discharge, pursuant to 11 U.S.C. §§ 727(a)(4)(D) and (a)(6)(A), based on her failure to comply with two bankruptcy court orders and her refusal to turn over the documents requested in the July 5th Letter. The United States Trustee timely served the summons and complaint on Ms. Lebbos on February 8, 2008. Pursuant to Fed. R. Bankr. P. 7012(a), Ms. Lebbos was required to answer the complaint within thirty (30) days of the summons issue date, or by March 8, 2008. (C-9, C-10)

On February 25, 2008, Ms. Lebbos filed a motion requesting a stay of the adversary proceeding, pending the resolution of appeals that she had filed in the main bankruptcy case. The bankruptcy court denied Ms. Lebbos' request for a stay by memorandum decision, entered on February 28, 2008. (UST-3, pg 21, docket # 7, 10)

On March 10, 2008, Ms. Lebbos filed a motion seeking to dismiss the adversary proceeding. The motion to dismiss also requested sanctions against the United States Trustee based on the alleged filing of a frivolous lawsuit and intentional discrimination against the disabled. The United States Trustee objected to the motion, and the bankruptcy court denied the relief requested in the motion in an order entered on April 23, 2008. (UST-3, pg 23, docket #27)

On June 4, 2008, the United States Trustee filed a request for entry of default in the adversary proceeding based on Ms. Lebbos' failure to file an answer to the complaint. In response to the United States Trustee's request, the court clerk entered a default on June 5, 2008. (UST-3, pg 22, docket # 20, 23)

The following day, June 6, 2008, Ms. Lebbos filed an answer to the complaint and an affidavit seeking disqualification of Judge Bardwil. (UST-3, pg 23, docket #27) On June 16, 2008, Ms. Lebbos filed a motion requesting that the court set aside her default. In an effort to extend to Ms. Lebbos every opportunity to defend herself, the United States Trustee did not oppose the motion to set aside the default. Consequently, the bankruptcy court entered an order on August 15, 2008, which set aside Ms. Lebbos' default in the adversary proceeding. (UST-3, pg 24, docket # 48)

In the interim, the bankruptcy court entered an order on June 18, 2008, denying Ms. Lebbos' request for the disqualification of Judge Bardwil. (UST-3, pg 23, docket #30, 31) Ms. Lebbos appealed this decision to the Bankruptcy Appellate Panel.[6] On August 12, 2008, the Bankruptcy Appellate Panel entered an order which denied Ms. Lebbos' request for leave to appeal, finding that the bankruptcy court order was interlocutory. The Bankruptcy Appellate Panel dismissed the appeal. (Appendix I)

On August 14, 2008, the bankruptcy court entered a scheduling order in the adversary proceeding and set a pretrial conference for February 19, 2009. The order required that both parties file and serve a pre-trial statement on the other side, no later than 7 days before the pre-trial conference. (UST-3, pg 24, docket # 47) The United States Trustee filed a pre-trial statement and served it on Ms. Lebbos on February 12, 2009. (AA-188)

On February 19, 2009, the United States Trustee's counsel appeared at the pre-trial conference. Ms. Lebbos did not appear. However, attorney John Read

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[6] This appeal was assigned Bankruptcy Appellate Panel Number EC-08-1167.(Appendix I)

made a "special appearance" on her behalf. That same day, the bankruptcy court entered a "Notice and Order for Trial," which scheduled the trial in the adversary proceeding for April 23, 2009. The Notice and Order for Trial also directed Ms. Lebbos to file and serve on the United States Trustee, no later than March 6, 2009, a list of all exhibits for trial (each identified and numbered) and a list of all witnesses to be called at trial. The Notice and Order for Trial further stated "[a]ny individual that is not named on the list of witnesses, will not be allowed to testify at trial, and any document that is not indicated on the list of exhibits, will not be allowed into evidence at trial." (UST-1, pg 1,2)

On February 23, 2009, four days after the pre-trial conference, Ms. Lebbos filed a document entitled "Pre-Trial Statement." This statement did not set forth a list of witnesses or trial exhibits. Ms. Lebbos did not file any other document which contained a list of witnesses or exhibits to support her defense at the trial. (BB-193)

On March 20, 2009, Ms. Lebbos filed a motion to (1) change the venue of the adversary proceeding, (2) disqualify Judge Bardwil, and (3) continue the trial in the adversary proceeding. She set the motion for hearing on April 22, 2009, the day before the trial date. (W-167) The United States Trustee opposed the motion, asserting that Ms. Lebbos had failed to provide any evidence to support a continuance or change of venue, and that the request for disqualification had been previously asserted and denied. (X-177, Y-184) The bankruptcy court held a hearing to address the motion on April 22, 2009, and Ms. Lebbos participated in the hearing by telephone. (FF-296) After consideration of the motion, reply and argument, the bankruptcy court denied Ms. Lebbos' motion orally, and very clearly informed Ms. Lebbos that the trial would proceed the next day. (Z-187)

On April 23, 2009, Ms. Lebbos did not appear, in person, by telephone or through counsel at the trial. Counsel for the United States Trustee introduced witnesses and presented evidence in support of the relief requested in the complaint. The court asked some additional questions of the witnesses and admitted the exhibits into evidence, as there were no objections. (GG-308) At the conclusion of the trial, the court found for the United States Trustee, and directed that a Findings of a Fact and Conclusion be prepared and submitted. (A-1) On April 27, 2009, the bankruptcy court entered a Judgment in favor of the United States Trustee on its causes of action pursuant to 11 U.S.C. §§ 727(a)(4)(D) and (a)(6)(A). (B-2) Ms. Lebbos' appeal from that judgment is the matter now pending before this Court.

SUMMARY OF ARGUMENT

The bankruptcy court did not abuse its discretion in entering a judgment in favor of the United States Trustee on her causes of action under 11 U.S.C. §§ 727(a)(4)(D) and (a)(6)(A). Despite having been given every opportunity to participate in her trial, Ms. Lebbos failed to comply with the Notice and Order for Trial and she failed to appear for the trial. By her own actions, she prevented the bankruptcy court from considering any evidence she may have had in defense of the United States Trustee's complaint.

With regard to the cause of action under 11 U.S.C. § 727(a)(6)(A), the court did not abuse its discretion in finding that the United States Trustee satisfied the burden of demonstrating that Ms. Lebbos knowingly refused to obey the January 19th Order and the May 10th Order. The bankruptcy court also did not abuse its discretion in finding no merit in Ms. Lebbos' explanation of her failure to comply with the orders. With regard to the cause of action under 11 U.S.C. § 727(a)(4)(D), the bankruptcy court did not abuse its discretion in deciding that Ms. Lebbos knowingly and fraudulently withheld from Trustee Schuette the documents requested in the July 5th Letter. As a result, the decision to deny Ms. Lebbos' discharge, pursuant to 11 U.S.C. §§ 727(a)(6)(A) and (a)(4)(D), was not an abuse of discretion.

Ms. Lebbos has argued that she did not receive a fair trial because the bankruptcy judge refused to disqualify himself from presiding over the case, he refused to transfer the venue of the case and he declined to dismiss the case. These arguments are without merit because they were previously raised and decided in a November 14, 2007 decision of the Bankruptcy Appellate Panel for the Ninth Circuit. Nor would these arguments have any merit even if this Court were to review them. Ms. Lebbos' further arguments that she did not receive a fair trial also lack merit. For these reasons, the bankruptcy court judgment should be affirmed.

ARGUMENT

I. THE BANKRUPTCY COURT DID NOT ABUSE ITS DISCRETION BY DENYING MS. LEBBOS' DISCHARGE PURSUANT TO 11 U.S.C. § 727(a)(6)(A)

Pursuant to 11 U.S.C. § 727(a)(6)(A), a chapter 7 debtor may be denied a discharge if she has "refused," in her bankruptcy case, "to obey any lawful order of the court, other than an order to respond to a material question or to testify."

> The term used in § 727(a)(6)(A) is "refused" not "failed." Accordingly, the Court must find that the [debtor's] lack of compliance with the relevant court order was willful and intentional. The party objecting to discharge satisfies this burden by demonstrating the debtor received the order in question and failed to comply with its terms. Such a showing then imposes upon the debtor an obligation to explain his non-compliance.

<u>Smith v. Jordan (In re Jordan)</u>, 521 F.3d 430, 433 (4th Cir. 2008) (citations omitted).

The plaintiff seeking the denial of a discharge for a debtor's refusal to obey a lawful court order must show, by a preponderance of the evidence, that the court issued an order directed at the debtor, that the order was lawful, that the order was not one requiring a response to a material question or to testify, and that the debtor refused to obey the order. In re Green, 335 B.R. 181, 183 (Bankr. D. Utah 2005); see Magar v. United States Trustee (In re Magar), No. 7:07CV00111, 2007 WL 2220517, *2 (D. W. Va. July 31, 2007) (stating that "[t]he United States Trustee may meet [her] burden by demonstrating that the debtor received the order in question and failed to comply with its terms").

A. The Bankruptcy Court Did Not Abuse its Discretion in Concluding that the United States Trustee Satisfied her Burden of Demonstrating Ms. Lebbos' Refusal to Comply with Two Orders

The bankruptcy court entered two (2) orders, which Ms. Lebbos willfully refused to obey. Both the January 19th Order and the May 10th Order directed Ms. Lebbos to appear for her continued Creditors' Meeting and produce the documents requested in the July 5th Letter from Trustee Schuette. Both of the orders were issued following noticed hearings, in which Ms. Lebbos participated. She had every opportunity to contest the orders, both before and after they were issued. Both orders were served on Ms. Lebbos by the bankruptcy court clerk's office at the address provided by her to the court. The orders were also docketed on the official case docket. Ms. Lebbos did not appeal, or otherwise challenge, either of the orders. Consequently, they are lawful orders of the court, which she was bound to obey.

Additionally, both the January 19th Order and the May 10th Order are specifically directed to Ms. Lebbos, the debtor in the underlying case. Both orders required Ms. Lebbos to produce documentation and appear at a specific location, on a specific date and time, for an examination by Trustee Schuette. However, neither order directs Ms. Lebbos to answer any specific questions, nor does it impinge on Ms. Lebbos' ability to claim her privileges under the Fifth Amendment of the United States Constitution nor any other right or privilege. The January 19th Order and the May 10th Order merely require that Ms. Lebbos appear for examination and produce certain documentation.

Significantly, the January 19th Order and the May 10th Order imposed no further requirements on Ms. Lebbos than those which are already expressly set forth in the Bankruptcy Code. Section 343 of the Bankruptcy Code states that "the debtor shall appear and submit to examination under oath at the meeting of creditors under section 341(a) of this title. . . ." Pursuant to 11 U.S.C. § 521(a)(3), a chapter 7 debtor shall "cooperate with the trustee as necessary to enable the trustee to perform the trustee's duties under this title." Section 521(a)(4) requires each debtor to "surrender to the trustee all property of the estate and any recorded information, including books, documents, records, and papers, relating to property of the estate . . . ." Additionally, 11 U.S.C. § 521(e)(2)(A) requires a debtor to provide to the chapter 7 trustee, not later than seven days before the first date set for the meeting of creditors, a copy of her tax return for the most recent year ending before the year in which she filed her petition.

The documents requested by the July 5th Letter relate directly to Ms. Lebbos' interest in property of her bankruptcy estate. Therefore, as set forth above, the January 19th Order and the May 10th Order directed Ms. Lebbos to do nothing that is not already required of her by the express language of the Bankruptcy Code.

In defiance of the January 19th Order and the May 10th Order, Ms. Lebbos refused to produce all but two of the documents requested by Trustee Schuette, and she failed to appear for the continued Creditors' Meetings. Both the bankruptcy court and Trustee Schuette made every effort in this case to accommodate Ms. Lebbos. The Creditors' Meeting was continued at least nine (9) times in order to afford Ms. Lebbos adequate time and opportunity to recover the requested documents and appear for her examination. Some of the Creditors' Meetings were scheduled with several months between them to provide Ms. Lebbos with enough time to collect the requested documentation. Despite the fact that Ms. Lebbos voluntarily chose to file her case in the Eastern District of California, the court repeatedly permitted Ms. Lebbos to appear by telephone to participate in court matters because she claimed that her compromised health prohibited her from traveling. In a further effort to prevent Ms. Lebbos from having to travel, the May 10th Order directed Trustee Schuette and her counsel to travel to San Jose, California to conduct the Rule 2004 Examination. Five days before the scheduled date for the Rule 2004 Examination, however, Ms. Lebbos moved, without notice, from San Jose to southern California. Despite the repeated attempts by the court and Trustee Schuette to facilitate the administration of her case, Ms. Lebbos simply refused to satisfy, and even actively evaded, the basic requirements imposed on her as a chapter 7 debtor. Consequently, the bankruptcy court properly concluded that the United States Trustee satisfied the burden of demonstrating that Ms. Lebbos willfully and intentionally failed to comply with the January 19th Order and the May 10th Order.

B. The Bankruptcy Court Did Not Abuse its Discretion in Concluding that Ms. Lebbos Did Not Satisfy her Burden of Explaining her Failure to Comply with the January 19th Order and the May 10th Order

Ms. Lebbos failed to appear at her trial. Consequently, she introduced no evidence, produced no witnesses, and made no objections. Further, even if she had appeared, she would not have been allowed to introduce any evidence or present witness testimony, as she had not complied with the bankruptcy court's Notice and Order for Trial. While she has made many assertions, the simple fact is that the record is completely devoid of any evidence to support her claims.

Even if Ms. Lebbos had participated in her trial and been allowed to present evidence, her defense is without merit because she has not adequately explained her failure to comply with the bankruptcy court's orders. First, she claimed that her house arrest prohibited her from appearing at the Creditors' Meeting scheduled by the January 19th Order. However, Ms. Lebbos' probation officer confirmed that the terms of her sentence permitted her to leave the jurisdiction for court matters. Second, Ms. Lebbos contends that her production of two (2) of the documents requested by Trustee Schuette satisfied her obligations under the January 19th Order and the May 10th Order. However, the orders directed the production of all remaining documents, and Ms. Lebbos' selective compliance with those directives is not adequate. Finally, Ms. Lebbos has repeatedly argued that she suffers from medical conditions which prohibited her from traveling to recover the documents requested by Trustee Schuette and to appear at her Creditors' Meeting. The bankruptcy court correctly found this to be an inadequate defense.

Ms. Lebbos has moved four (4) times since she commenced her bankruptcy case. Each time she moved, she traveled by car. Significantly, because Ms. Lebbos was living in San Jose, California when the bankruptcy court entered the May 10th Order, the order required Trustee Schuette to travel to San Jose to conduct the Rule 2004 Examination. The May 10th Order scheduled the Rule 2004 Examination for May 31, 2009. Despite the accommodations made by the court and Trustee Schuette, Ms. Lebbos moved away from San Jose to southern

California just five days before the Rule 2004 Examination was to take place, perhaps in an effort to avoid it. Moreover, although she argued that she was unable to travel for the Rule 2004 Examination, she traveled on May 31, 2009, the scheduled date for the examination, when she moved again to Long Beach, California.

Additionally, Ms. Lebbos has argued that she has not been able to retrieve some of the documents requested in the July 5th Letter because they are located in San Jose and Long Beach California, and it would be too difficult for her to travel to obtain the documents. However, since the commencement of this case, Ms. Lebbos has lived for extended periods in both San Jose and Long Beach.

Quite evidently, Ms. Lebbos' inability to travel is selective. The history of this case reveals that she is certainly able to travel when she feels that doing so will serve her interests. While she claims to suffer from certain medical conditions, her actions suggest otherwise, and she refuses to waive her doctor-patient privilege and allow access to her medical providers for examination. Ms. Lebbos' conclusory and self-serving allegations are not an adequate defense to a claim under 11 U.S.C. § 727(a)(6)(A). Coleman v. Simpson (In re Coleman), No. L-04-786, 2005 WL 3877408 (D. Md. March 23, 2005) (denying debtor's discharge under 11 U.S.C. § 727(a)(6)(A) based on debtor's failure to appear at creditors' meeting when her explanation of why she did not appear was based on conclusory, unsupported allegations of misconduct by appellee).

The production of documents relating to estate assets and the appearance at a Creditors' Meeting are among the most basic and fundamental requirements imposed on chapter 7 bankruptcy debtors. The January 19th Order and the May 10th Order required no more of Ms. Lebbos than that which is expressly required by the Bankruptcy Code. Ms. Lebbos has not provided a reasonable explanation for her refusal to comply with these lawful orders. Consequently, the bankruptcy court correctly concluded that Ms. Lebbos had not satisfied her burden under 11 U.S.C. § 727(a)(6)(A) and properly denied her discharge on this basis. See In re Onubah, 375 B.R. 549, 557 (B.A.P. 9th Cir. 2007) ("The integrity of [the bankruptcy] process requires, among other things, that a debtor fully disclose all assets and liabilities when the petition is filed, provide the trustee with financial records, surrender all property of the estate to the trustee, cooperate with the trustee's administration of the estate, comply with the Bankruptcy Code's exemption scheme, and obey the bankruptcy court's lawful orders.").

II. THE BANKRUPTCY COURT DID NOT ABUSE ITS DISCRETION BY DENYING MS. LEBBOS' DISCHARGE PURSUANT TO 11 U.S.C. § 727(a)(4)(D)

Section 727(a)(4)(D) of the Bankruptcy Code provides for the denial of a debtor's discharge when the debtor "knowingly and fraudulently, in or in connection with the case[,] withheld from an officer of the estate entitled to possession under this title, any recorded information, including books, documents, records, and papers, relating to the debtor's property or financial affairs." "The focus of § 727(a)(4)(D) is on the debtor's duty to maintain and turn over recorded information which bears upon the debtor's financial condition and business affairs." Mitan v. Taunt (In re Mitan), No. 06-15114, 2007 WL 1424225 (E.D. Mich. May 10, 2007) (affirming bankruptcy decision to deny discharge under § 727(a)(4)(D) because debtor "refused to turn over documents, alleged that they were confiscated after the Meeting of Creditors, and then demanded formal discovery proceedings rather than comply with his obligations").

In Soliman v. Smith (In re Soliman), No. 2:07-cv-469-GEB, 2008 WL

802484, *2 (E.D. Cal. March 24, 2008), the chapter 7 trustee requested copies of all agreements relating to real property owned by the debtor that was rented or leased. Although the debtor leased certain property, he failed to provide the requested lease agreement. Id. As a result, the bankruptcy court denied the debtor's discharge under 11 U.S.C. § 727(a)(4)(D). Id. On appeal, the debtor argued that the bankruptcy court's findings were clearly erroneous because there was insufficient evidence that the debtor knowingly and fraudulently withheld the lease agreement, the debtor's withholding of the lease agreement was not material, and that the trustee never specifically asked for the lease agreement. Id. The District Court for the Eastern District of California affirmed the bankruptcy court's decision because, on appeal, the debtor did not show that the bankruptcy court's findings were not "plausible in light of the record viewed in its entirety." Id. (quoting Bradley v. Ingalls (In re Bradley), 501 F.3d 421, 434 (5th Cir. 2007) ("when the bankruptcy court's weighing of the evidence is plausible in light of the record taken as a whole, a finding of clear error is precluded, even if we would have weighed the evidence differently.").

A. The Bankruptcy Court Did Not Abuse its Discretion in Concluding that the United States Trustee Satisfied Her Burden Under 11 U.S.C. § 727(a)(4)(D)

As the bankruptcy court concluded, Ms. Lebbos was given more than a reasonable opportunity to obtain the documents requested by Trustee Schuette in the July 5th Letter, and she simply refused to do so. As is demonstrated by Ms. Lebbos' numerous appeals, evasive conduct and refusal to cooperate, the failure to produce the requested documents was a deliberate, knowing and fraudulent attempt to evade her statutory obligations.[7]

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[7] Attached is a list of many, but not all, of Ms' Lebbos' appeals. (Appendix I)

Pursuant to 11 U.S.C. §§ 521(a)(3), (a)(4) and (e)(2)(A), Ms. Lebbos was required to cooperate with Trustee Schuette by turning over the requested documents. The obligations imposed by these provisions are basic requirements which apply equally in every chapter 7 case. All of the documents requested in the July 5th Letter are expressly required by the Bankruptcy Code. For this reason, no justification exists for a failure to provide them when they are properly requested and more than adequate time is given to obtain them. Nonetheless, Ms. Lebbos simply failed to turn over all but two (2) of the documents requested in the July 5th Letter.

Ms. Lebbos' conduct in connection with the document production request more closely resembles that of an individual trying to evade applicable bankruptcy requirements than a debtor who is honestly seeking bankruptcy relief and a fresh start. She claimed that many of the documents requested by Trustee Schuette were located in San Jose and Long Beach, California and she could not recover them because traveling to these locations would be too difficult. Since the commencement of the case, however, Ms. Lebbos has actually lived in San Jose and Long Beach for extended periods of time without obtaining the requested documents and forwarding them to Trustee Schuette. The apparent access Ms. Lebbos had to the requested documents reveals that her refusal to turn them over was a knowing and fraudulent attempt to keep them from Trustee Schuette.

B. The Bankruptcy Court Did Not Abuse its Discretion in Concluding that Ms. Lebbos' Defense to the Cause of Action Under 11 U.S.C. § 727(a)(4)(D) Lacked Merit

Ms. Lebbos was aware of the trial in this case and the requirements imposed upon her in connection with the trial. Nonetheless, she failed to comply with the Notice and Order for Trial and she did not appear and participate in the trial. In Ms. Lebbos' absence, the United States Trustee presented evidence and witness testimony. The bankruptcy court weighed the evidence and correctly concluded that a denial of discharge was appropriate under 11 U.S.C. § 727(a)(4)(D).

In addition to the fact that Ms. Lebbos deliberately and knowing failed to participate in her trial, the decision to deny her discharge was correct because Ms. Lebbos' defense lacks merit. Throughout the pendency of her case, Ms. Lebbos has never challenged the request for documents by Trustee Schuette on the basis that those documents do not exist, that they are privileged, or that they are otherwise not appropriate for turnover. Rather, Ms. Lebbos only argues that the task of obtaining them for turnover is too onerous, given her medical condition.

As set forth in detail above, the medical conditions which allegedly preclude Ms. Lebbos from traveling appear only to affect her when the obligation to travel is imposed by the court or Trustee Schuette. Considering this fact with Ms. Lebbos' unsubstantiated assertions of improprieties against the court, the United States Trustee and Trustee Schuette, as well as Ms. Lebbos' numerous and duplicative appeals of decisions in her case, it appears that Ms. Lebbos' refusal to turnover the requested documents is driven by her desire to delay the administration of her case, rather than by her health conditions.

For these reasons, the bankruptcy court properly concluded that Ms. Lebbos' defense to the cause of action under 11 U.S.C. § 727(a)(4)(D) lacked merit and denied Ms. Lebbos' discharge on that basis. Because this conclusion is plausible in light of the record viewed in its entirety, this Court should affirm the bankruptcy court's decision. In re Soliman, 2008 WL 802484, at *2.

III. THE BANKRUPTCY COURT DID NOT DENY MS. LEBBOS A FAIR TRIAL

Ms. Lebbos argues that she was denied a fair trial for three reasons. Each of these arguments is without merit.

A. The Bankruptcy Court did not Abuse its Discretion by Denying Ms. Lebbos' Motions for Disqualification of Judge Bardwil, Transfer of Venue and Dismissal of her Case

Ms. Lebbos argues that her bankruptcy case should have been dismissed because she never reviewed and signed her bankruptcy petition before it was filed. She further argues that Judge Bardwil should have been disqualified from presiding over her case. Finally, she contends that the venue of her case should be transferred, as she is no longer living within the jurisdiction of the Eastern District of California.

Ms. Lebbos raised all of these arguments before the court in her bankruptcy case, and the bankruptcy court denied her requests for relief on each of these matters. Ms. Lebbos appealed these decisions to the Bankruptcy Appellate Panel. Pursuant to this appeal, the Bankruptcy Appellate Panel for the Ninth Circuit entered a decision on November 14, 2007.[8] This decision by the Bankruptcy Appellate Panel analyzed each of the arguments asserted by Ms. Lebbos and affirmed the bankruptcy court's denial of each of her requests. Consequently, Ms. Lebbos' arguments in this regard have already been conclusively decided on appeal, and under the principles of res judicata, there is no reason to revisit them.

B. Ms. Lebbos Misunderstands Judicial Notice of her Bankruptcy

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[8] As set forth above, the Bankruptcy Appellate Panel decision, dated November 14, 2007, was entered in the following Bankruptcy Appellate Panel appeals: EC-07-1163; EC-07-1174; and EC-07-1203. A copy of the decision is contained in the Appellee's Excerpts of Record, UST -2.

Docket to be Judicial Notice of Arguments and Disputed Facts Set Forth in the Documents Contained in the Record

Ms. Lebbos asserts that the bankruptcy court took judicial notice of the record in the entire case, including both adversary proceedings. She further asserts that, because the Judge Bardwil failed to consider the contents of every document she filed as true, he treated her unfairly. These assertions have no legal or factual support.

Judicial notice of the filing of a document does not equate to a finding that everything contained in the document is true or persuasive. There is a difference between taking judicial notice of the existence of certain documents, and the finding that the contents are true. In re Earl, 140 B.R. 728, 731 n.2 (Bankr. N.D. Ind. 1992). The documents contained in the bankruptcy docket are public documents and, therefore, the court may take judicial notice of them. See U.S. v. Southern California Edison Co., 300 F. Supp.2d 964, 974 (E.D. Cal. 2004). While a court may take judicial notice of a public document, it may not take judicial notice of the veracity of the arguments and disputed facts contained therein. Id. (citing U.S. ex rel Robinson Rancheria Citizens Council v. Borneo, Inc., 971 F.2d 244, 248 (9th Cir. 1992)). Likewise, the court may not take judicial notice of one party's opinion of how a matter of public record should be interpreted. Id. However, the statements contained within documents filed by a party may be treated as party admissions under Federal Rule of Evidence 801(d)(2). In re Moore, 269 B.R. 864 (Bankr. D. Idaho 2001).

Based on this authority, Ms. Lebbos' argument regarding judicial notice appears to be a confusion of the difference between judicial notice of the bankruptcy docket and judicial notice of arguments and disputed facts contained in those documents. While taking judicial notice of the docket, the weight of the disputed facts and arguments in those documents was left to the bankruptcy court's discretion. The bankruptcy court's decisions in that regard are not clearly erroneous.

C. Ms. Lebbos Incorrectly Asserts that there is No Party Plaintiff in this Case

Ms. Lebbos asserts that there is no real plaintiff in the complaint. Ms. Lebbos' belief appears to result from the bankruptcy court clerk's naming of the party plaintiff on the summons as the "United States Trustee." However, the complaint clearly names the plaintiff in this case as "Sara L. Kistler, Acting United States Trustee." See 28 U.S.C. § 581(a)(17) (creating district); 11 U.S.C. § 727(c)(1) (stating that United States Trustee may object to discharge). This argument is entirely without merit. Additionally, Ms. Lebbos failed to raise this argument before the bankruptcy court. Consequently, it should be disregarded.

CONCLUSION

For the reasons set forth above, the United States Trustee respectfully requests that the Court affirm the judgment entered by the bankruptcy court on July 27, 2009.

SARA L. KISTLER
ACTING UNITED STATES TRUSTEE

By: **/s/ Antonia G. Darling**
ANTONIA G. DARLING, Cal Bar # 76190
Assistant United States Trustee

United States Department of Justice
Office of the United States Trustee
United States Department of Justice
501 I Street, Ste 7-500
Sacramento, CA 95814
(916) 930-2100/Fax (916) 930-2099

APPENDIX I

PARTIAL LIST OF APPEALS IN:

Bk # 06-22225 In re Betsey Warren Lebbos
Adv # 06-2314 Alonzo v Lebbos [Not all appeals listed]
Adv # 07-2006 Schuette, Ch 7 Trustee v Lebbos [Not all appeals listed]
Adv # 08-2072 UST v Lebbos

Case #	Order appealed	Ruling	Appealed to 9th
9TH CIR BAP APPEALS			
07-1068	Denial M/Terminate Ch. 7 Trustee, Trustee's counsel & disciplinary relief	BK affirned	Yes- 08-15031
07-1119	(Duplicate appeal of 07-1068)	BK affirned	Yes- 08-15031
07-1129	Denial M/Dismiss Adv. Proc. and M/Change Venue of Adv Proc	Dismissed - interloc	No
07-1163	Denial M/Change Venue Bk case	BK affirned	Yes- 08-15025
07-1168	Denial M/Change Venue of Adv.Proc.	Dismissed - interloc	No
07-1172	Denial M/Disqualify Bankr. Judge	Dismissed - interloc	No
07-1173	Denial M/Disqualify Bankr. Judge	Dismissed - interloc	No
07-1174	Denial M/Disqualify Bankr. Judge	BK affirned	Yes- 08-15025
07-1203	Denial M/Dismiss case	BK affirned	Yes- 08-15025
07-1382	Denial M/Disqualify Bankr. Judge	BK affirned	Yes- 08-15043
07-1383	Denial M/Disqualify Bankr. Judge	BK affirned	Yes- 08-15041
*07-1396	Denial M/Disqual Bankr. Judge	Dismissed - interloc	No
*07-1397	Denial M/Disqual Bankr. Judge	Dismissed - interloc	No
07-1427	Denial M/Dismiss Adv.Proc.	BK affirned	Yes- 08-15347
*07-1428	Denial M/Transfer Adv.Proc. and Denial M/Dismiss Adv.Proc.	BK affirned	Yes- 08-15348
*07-1429	Denial M/Transfer Adv.Proc. and Denial M/Dismiss Adv.Proc.	BK affirned	Yes- 08-15349
07-1461	Denial M/Summary Judgment in Adv.Proc.	BK affirned	Yes- 08-15350
08-1031	Denial M/Terminate Ch. 7 Trustee	BK affirned	Yes- 08-60041
08-1032	Denial M/Dismiss Bankruptcy Case	BK affirned	Yes- 08-60042
08-1167	Denial of affidavit to disqualify Judge	Dismissed - interloc	
08-1168	M/Award of Costs in Ad.Proc.	Trans to Dist Ct -2:08-cv-0912	
08-1169	M/for Order Directing Clerk to Register Judgment	Trans to Dist Ct -2:08-cv-0912	

Case #	Order appealed	Ruling	Appealed to 9th
DISTRICT COURT APPEALS			
Eastern District of California -			
2:08-cv-0440	Denial of Mtn Strike ans / enter default	Dismissed - interloc	Yes- 08-16577 & 08-72784
*08-cv-0502	Denial Mtn Strike ans/ enter default	Dismissed - interloc	Yes- 08-16580 & 08-72784
*08-cv-0503	Denial Mtn Strike ans / enter default	Dismissed - interloc	Yes- 08-16578 & 08-72784
2:08-cv-0680	Approval of Mtn to sell lawsuit	BK affirned	Yes 09-56562?
2:08-cv-0763	Denial M/Disqual Judge	BK affirmed	Yes- 08-17140
2:08-cv-0912	Default J in Schuette adv	BK Affirmed	Yes- 08-73708 & 09-15271
2:08-cv-1726	Registration of default	BK Affirmed	NO
2:08-cv-1896	Award Attys fees & costs	BK Affirmed	Yes- 09-15668
2:08-mc-0046	Request for IFP app	Granted	NO
2:09-cv-1252	Denial of Discharge	CURRENT APPEAL	
Central District of California			
09-cv-1072	Denial of stay of order to record Judgement	BK affirmed	Yes- 09-56562

9th Circuit APPEALS

Case #	Order appealed	Ruling
08-15025	Trans venue, disqual Judge, dismiss case	Dismissed - interloc
08-15031	Denial of ER Stay Pending Appeal	Dismissed - interloc
08-15041	Denial of ER Stay Pending Appeal	Dismissed - interloc
08-15043	Denial of ER Stay Pending Appeal	Dismissed - interloc
08-15347	Denial of Leave to Appeal <u>and</u> Dismissal of Appeal	Dismissed - interloc
*08-15348	Denial of Leave to Appeal <u>and</u> Dismissal of Appeal	Dismissed - interloc
*08-15349	Denial of Leave to Appeal <u>and</u> Dismissal of Appeal	Dismissed - interloc
08-15350	Denial of Leave to Appeal <u>and</u> Dismissal of Appeal	Dismissed - interloc
08-16577	Denial of Leave to Appeal <u>and</u> Dismissal of Appeal	Interloc - vol dism appeal
08-16578	Denial of Leave to Appeal <u>and</u> Dismissal of Appeal	Interloc - vol dism appeal

08-16580	Denial of Leave to Appeal and Dismissal of Appeal	Interloc - vol dism appeal
08-17140	Affirming Bk. Ct. Denial of M/Disqualify Judge	Dismissed - interloc
08-60041	Judgment affirming Bk. Ct. Decision	Dismissed - interloc
08-60042	Judgment affirming Bk. Ct. Decision	Dismissed - interloc
08-72784	Pet writ of mandamus	Dismissed - interloc
08-73708	Pet writ of mandamus	Denied- insuff proof
08-80145	9th Cir Sue Sponte/ Pre filing Order	Pre filing Order issued
09-15271	Entry of default in Schuette Adv	Open
09-15668	Order to pay Attys fees &costs (Schuette adv)	Open
09-56562	Denial of Stay of writ	Open

* Duplicate appeals filed in the name of Gold or Carter

BRIEF BANK — "SUMMARY SHEET" *Printed Wed.-12/17/3 (10:01)*

WESTLAW CODES

1. ["TI"] ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*
In re Lincoln Hospital Medical Center, Inc. and Weinstein, Eisen, et al.

2. ["CO"] ***CURRENT*** COURT *[E.g., "CTA9"]*
US Court of Appeals for the Ninth Circuit (CTA9)

3. ["CCN"] ***CURRENT*** CASE NO.
No.: 03-72828

4. ["PCN"] ***PRIOR*** CASE NO. & COURT *[IF ANY]*
No.:
Court: The US Bankruptcy Court for the Central District of CA
(Identify judge & cite, if any)

5. ["SO"] ***SOURCE***
U.S. TRUSTEES

6. ["DA"] ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*
Filed: December 8, 2003
Type: US Trustee's Response to Petition for a Writ of Mandamus

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P. Matthew Sutko and Paul W. Bridenhagen, Esqs. UST/OGC
(UST/OGC: 202-307-1399/FAX-2397)

8. ["TO"] ***TOPIC***
BANKRUPTCY

9. ["SU"] ! ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***
! US Trustee files this response to a petition for a writ of mandamus that seeks to compel the bankruptcy court to authorize a ch. 11 debtor in possession to employ a specific law firm as "disinterested" counsel under 11 USC section 327(a).

√ **Background:**

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No. 03-72828

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IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

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In re LINCOLN HOSPITAL MEDICAL
CENTER, INC., AND WEINSTEIN, EISEN,
WEISS & ROTHSCHILD LLP.,

Petitioners.

____

ON PETITION FOR A WRIT OF MANDAMUS
TO THE UNITED STATES BANKRUPTCY
COURT FOR THE CENTRAL
DISTRICT OF CALIFORNIA

____

UNITED STATES TRUSTEE'S RESPONSE TO PETITION FOR A WRIT OF MANDAMUS

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PETER D. KEISLER
Assistant Attorney General

WILLIAM KANTER
(202) 514-4575
R. CRAIG GREEN
(202) 514-2498
Attorneys, Appellate Staff
Civil Division, Room 9104
Department of Justice
601 D Street, N.W.
Washington, D.C. 20530

OF COUNSEL:

JOSEPH A. GUZINSKI
General Counsel
P. MATTHEW SUTKO
PAUL W. BRIDENHAGEN
Office of the General
Counsel, Executive Office
for U.S. Trustees
20 Massachusetts Ave., N.W.
Washington, D.C. 20530

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STATEMENT OF THE CASE

Pursuant to this Court's order of October 21, 2003, the United States Trustee files this response to a petition for a writ of mandamus that seeks to compel the bankruptcy court to authorize a chapter 11 debtor in possession, Lincoln Hospital, to employ Weinstein, Eisen, Weiss & Rothschild LLP as "disinterested" bankruptcy counsel under 11 U.S.C. 327(a).

Also pending is a direct appeal requesting similar relief, In re Lincoln Hospital, No. 03-56260. On November 3, 2003, the Court ordered appellants in that case to show cause why the appeal should not be dismissed for lack of jurisdiction. On November 24, 2003, the United States Trustee filed a response arguing that In re SS Retail Stores Corp., 162 F.3d 1230 (9th Cir. 1998), requires dismissal of that appeal. On November 26, 2003, appellants filed a reply and petition for en banc hearing. Under Federal Rule of Appellate Procedure 35(e), the United States Trustee will not respond to that petition unless directed by the Court to do so.

STATEMENT OF FACTS

A. Under 11 U.S.C. 327(a), a debtor-in-possession, "with the court's approval, may employ one or more attorneys * * * that do not hold or represent an interest adverse to the estate, and that are disinterested persons" (emphasis added).

The Bankruptcy Code defines “disinterested person” as someone who “does not have an interest materially adverse to the interest of the estate * * * by reason of any _direct or indirect_ relationship to, connection with, or interest in, the debtor * * * _or for any other reason_.” 11 U.S.C. 101(14)(E) (emphasis added).

This mandamus proceeding challenges a bankruptcy court’s decision denying the application of a chapter 11 debtor in possession, Lincoln Hospital, to employ Weinstein, Eisen, Weiss & Rothschild LLP (WEWR) as counsel. On November 18, 2002, Lincoln Hospital filed for chapter 11 bankruptcy under 11 U.S.C. 1101, _et seq._, and applied for authorization to employ WEWR under 11 U.S.C. 327(a).[1] The bankruptcy court denied that application, and held that WEWR could not represent Lincoln Hospital because it possessed a conflict of interest.

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[1] Under 11 U.S.C. 1107, a debtor in possession has all relevant rights of a trustee under 11 U.S.C. 1106, including the right under 11 U.S.C. 327(a) to request bankruptcy court authorization to employ counsel. Like a trustee, the fiduciary duties of a debtor in possession differ from those of a normal corporation because they run first to the estate’s creditors. _See_ _CFTC v. Weintraub_, 471 U.S. 343, 355 (1985) (“[I]f a debtor remains in possession * * * the debtor’s directors bear * * * [a] fiduciary obligation to [the] creditors and shareholders.”); _In re McConville_, 110 F.3d 47, 49 (9th Cir. 1997) (describing debtors in possession as fiduciaries “owing a duty of care and loyalty to the estate’s creditors”).

The bankruptcy court relied on the fact that WEWR’s principal partner, David Weinstein, was scheduled to testify in an ongoing adversary proceeding against Lincoln’s chief financial officer and treasurer, Bryan Weiss, and against Lincoln’s president, John Carvelli. Carvelli, in addition to managing Lincoln Hospital, indirectly owned one-third of its stock. The adversary proceeding was brought against Weiss and Carvelli by the Official Committee of Unsecured Creditors in a separate chapter 11 case, wherein California Psychiatric Management Services (CPMS) was the debtor in possession.[2]

In the adversary proceeding, the CPMS Creditors Committee alleged that Weiss and Carvelli misappropriated $1.5 million from CPMS when they served on CPMS’s management committee. Under 11 U.S.C. 541(a)(1), the claims against Weiss and Carvelli were property of the CPMS bankruptcy estate, and CPMS, as the debtor in possession, held both the claims and the original right to sue on them. A stipulation between CPMS and the CPMS Creditors Committee, which the bankruptcy court approved, authorized the CPMS Creditors Committee to sue Weiss

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[2] See 11 U.S.C. 1102, 1103 (providing for the creation and powers of creditors committees). According to petitioners, on April 4, 2003, after all the here-relevant events occurred, CPMS’s case converted to chapter 7 liquidation. Mand. Pet. 5.

and Carvelli on CPMS's behalf.[3] That stipulation granted the CPMS Creditors Committee authority to prosecute such litigation "for the benefit of the Estate." Stip. ¶ 1 (emphasis added). It also required the CPMS Creditors Committee to "consult with and consider the opinions of [the debtor, CPMS]." Id. at ¶ 2.

The stipulation between CPMS and the CPMS Creditors Committee further prescribed that CPMS, as the owner of the estate's claims, must "cooperate with the Committee, to the extent necessary and appropriate in the prosecution" of claims like those against Weiss and Carvelli. Ibid. Under the stipulation, CPMS retained title to any damages that might be recovered from Weiss and Carvelli.

Independent of the stipulation, because WEWR was judicially appointed as CPMS's counsel under 11 U.S.C. 327(a), WEWR had a legal duty to assist in the prosecution of CPMS's claims against Weiss and Carvelli. CPMS's fiduciary duties as a debtor in possession ran to its creditors, and those duties

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[3] The Third Circuit has held that creditors committees may obtain judicial permission to litigate legal claims held by debtors in possession, like CPMS's claim against Weiss and Carvelli. Official Committee of Unsecured Creditors of Cybergenics Corp. ex rel. Cybergenics Corp. v. Chinery, 330 F.3d 548 (3d Cir. 2003) (en banc). The correctness of that ruling is not presented by this mandamus proceeding.

required CPMS to aid in pursuing claims like those brought against adverse parties such as Weiss and Carvelli.

At a hearing concerning the application to employ WEWR — an application filed by Weiss and Carvelli as Lincoln Hospital's management — the CPMS Creditors Committee objected. The CPMS Creditors Committee argued that WEWR should not be allowed to work for Lincoln Hospital when one of WEWR's clients stood in adverse litigation against Lincoln Hospital's management and major shareholder. The CPMS Creditors Committee told the bankruptcy court that "[w]e don't understand how [WEWR] can on the one hand represent Lincoln Hospital, whose principals are responsible for stealing money from CPMS, while at the same time agreeing to cooperate with us in the prosecution of claims against these self-same individuals." 11/20/03 Bankr. Hr'g 20. "[WEWR] will be serving two masters here — with opposing interests." 11/21/03 Bankr. Hr'g 9. The United States Trustee agreed that WEWR could not be employed under 11 U.S.C. 327(a).[4]

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[4] United States Trustees are officials of the Department of Justice appointed by the Attorney General to supervise the administration of bankruptcy cases and trustees. See 28 U.S.C. 581-589; In re Columbia Gas Sys., Inc., 33 F.3d 294, 296 (3d Cir. 1994) (United States Trustees oversee the bankruptcy process, protect the public interest, and ensure that bankruptcy cases are conducted according to law) (citing H.R. Rep. No. 95-595, 109 (1977)). "The United States Trustee is the 'watchdog' of the bankruptcy system * * * charged with

Upon hearing both sides' arguments, the bankruptcy court exercised its discretion under 11 U.S.C. 327(a) to disapprove WEWR's employment. The bankruptcy court concluded that WEWR's relationship to the lawsuit against Weiss and Carvelli "is putting [WEWR] in an obvious conflict * * * , and so I'm not going to approve. It's pretty rare that I do this, but in this situation * * * I think I'm doing you a favor. You don't believe it at the moment, but it is — I think it is putting you in a serious conflict position. And without any question about your integrity, * * * it's putting you in * * * that position of conflict." 11/21/03 Bankr. Hr'g 24-25. On December 12, 2002, the bankruptcy court issued a written order memorializing the denial of Lincoln Hospital's application to employ WEWR.

On December 2, 2002, debtor in possession Lincoln Hospital filed an application under 11 U.S.C. 327(a) seeking authorization to retain as counsel Levene, Neale, Bender,

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preventing fraud and abuse and with 'fill[ing] the vacuum' caused by possible creditor inactivity." In re Castillo, 297 F.3d 940, 950 (9th Cir. 2002). Section 307 of the Bankruptcy Code authorizes the United States Trustee to appear and be heard on the propriety of retaining WEWR in this case. See 11 U.S.C. 307; In re Donovan Corp., 215 F.3d 929 (9th Cir. 2000) ("The United States trustee may * * * intervene and appear at any level of the proceedings from the bankruptcy court on, * * * as either a party or an amicus.") (internal quotation marks omitted).

Rankin & Brill, LLP. On December 27, 2002, the bankruptcy court approved Levene’s employment. Levene has served since that date as Lincoln Hospital’s counsel, and Lincoln Hospital has not expressed any dissatisfaction with that representation.

B. On June 18, 2003, the Bankruptcy Appellate Panel for the Ninth Circuit unanimously affirmed the bankruptcy court’s decision, though it disagreed with the bankruptcy court’s “choice of nomenclature.” BAP Op. 10. The BAP held that “[a]ppellants are technically correct that the facts here present no actual conflict,” because WEWR never represented Weiss or Carvelli individually “and owed no duty of loyalty to them.” Id. at 8. Nevertheless, “as the bankruptcy court recognized,” the BAP noted that “a law firm’s relationship with a corporation is necessarily conducted through its officers.” Ibid. In this case, the BAP found that “WEWR’s representation of Lincoln would be controlled by Carvelli and Weiss, the very individuals against whom [WEWR’s principal partner] might have to testify” — and the very individuals in whose prosecution CPMS agreed to cooperate, with resultant “possibilit[ies] of sharing legal theories and other sensitive information.” Ibid.

The BAP noted that "[t]he decision whether to approve an employment application is fundamentally discretionary, and is based on the facts of each case." BAP Op. 9. The BAP held that the bankruptcy court did not abuse its discretion here because, according to statutory text, "being disinterested requires more than the absence of an actual or a potential conflict." Ibid. It requires the absence of any materially adverse interest, due to "direct or indirect relationship to * * * the debtor," or "for any other reason." Ibid. (quoting 11 U.S.C. 101(14)(E)). Noting bankruptcy courts' authority "to further the integrity (and perceived integrity) of the bankruptcy process," the BAP concluded that the bankruptcy court "did not exceed the broad scope of 101(14)(E)" in disqualifying WEWR as counsel.

C. On July 18, 2003, WEWR filed a notice of appeal from the BAP's ruling. See In re Lincoln Hospital, No. 03-56260. On August 5, 2003, Lincoln Hospital and WEWR filed this petition for mandamus.

SUMMARY OF ARGUMENT

The bankruptcy judge and the BAP panel properly held that WEWR's links to CPMS disqualified it from representing Lincoln Hospital. Petitioners' request for mandamus addresses only the fact that WEWR's principal partner was to testify against

Weiss and Carvelli. But that is only a small part of the justification for denying WEWR’s employment under 11 U.S.C. 327(a). Most importantly, WEWR was legal counsel to CPMS. CPMS held a contractual and fiduciary responsibility to help pursue — and win — its claim against Weiss and Carvelli. And WEWR, as CPMS’s court-approved counsel under 11 U.S.C. 327(a), was bound to assist its client in doing just that. Indeed, CPMS had pledged to “cooperate” with the CPMS Creditors Committee in prosecuting actions like that against Weiss and Carvelli. The Bankruptcy Code does not allow WEWR to pursue claims against individuals in one bankruptcy case, yet take orders from those same individuals in another case. The undeniably intimate links between WEWR, CPMS, and two high-ranking Lincoln Hospital executives create a serious actual conflict, potential for conflict, and appearance of conflict, each of which bankruptcy courts have broad authority to prevent.

Also critical is the fact that Carvelli is a one-third beneficial owner of Lincoln Hospital. This means that WEWR lacked the “disinterestedness” required by the Bankruptcy Code under 11 U.S.C. 327(a) and 101(14)(E). As the BAP properly noted, “being disinterested requires more than the absence of an actual or potential conflict.” BAP Op. 9. Because

Carvelli beneficially owns 33% of Lincoln Hospital, WEWR's paid professional allegiance to CPMS, including the latter's duty to pursue claims against Carvelli, constitutes an interest adverse to an "equity security holder[]" of Lincoln Hospital, in violation of 11 U.S.C. 101(14)(E).

Even if the bankruptcy court's judgment were mistaken, the decision to disqualify WEWR is not the sort of extraordinarily clear legal error that warrants a writ of mandamus. The Supreme Court has repeatedly held that "the remedy of mandamus is a drastic one * * * . Only exceptional circumstances, amounting to a judicial usurpation of power, will justify the invocation of this extraordinary remedy." Allied Chem. Corp. v. Daiflon, Inc., 449 U.S. 33, 34-35 (1980) (per curiam) (internal quotation marks omitted). Nothing in this case approaches that standard. Circumstances required a quick decision by the bankruptcy court regarding WEWR's employment. The bankruptcy court's decision was based on facts (most importantly WEWR's commitment to CPMS) that reasonably support a finding of inadequate disinterestedness, actual adversity, potential adversity, and apparent adversity with respect to Lincoln Hospital's equitable owner (Carvelli), and Lincoln Hospital itself through its individual officers. The BAP, composed of three bankruptcy judges, properly reviewed the initial bankruptcy court’s conclusion and unanimously affirmed the discretionary judgment that WEWR should not be counsel in the Lincoln Hospital case.

Petitioners are correct that, under this Circuit’s cases, direct appellate review is not available to correct a legal error in disqualifying or approving bankruptcy counsel. See In re SS Retail Stores Corp., 162 F.3d 1230 (9th Cir. 1998). Any quarrel regarding this Court’s finality jurisprudence, however, would require en banc consideration in the context of petitioners’ direct appeal. To apply mandamus jurisdiction in this case would constitute an inappropriate end run around this Court’s prior decisions, and would present an improper mechanism for resolving any unfairness that might arise under this Court’s cases. Certainly, the absence of appellate jurisdiction due solely to application of this Court’s finality jurisprudence is not enough to justify a writ of mandamus, especially when the decision to be reviewed is highly discretionary and substantively reasonable. “[T]he party seeking mandamus has the burden of showing that its right to issuance of the writ is clear and indisputable.” Gulfstream Aerospace Corp. v. Mayacamas Corp., 485 U.S. 271, 289 (1988) (internal quotation marks omitted). WEWR and

Lincoln Hospital never acknowledge the existence of that significant burden, and they do not succeed in carrying it.

ARGUMENT

I. The Bankruptcy Court Properly Exercised Its Discretion In Declining To Authorize WEWR's Employment

1. Under 11 U.S.C. 327(a), bankruptcy courts may approve attorneys' employment only if two conditions are satisfied: the attorneys do not "hold or represent an interest adverse to the estate," and are "disinterested persons." Although the term "interest adverse to the estate" is not explicitly defined by the Bankruptcy Code, "disinterested person" is a person who, inter alia, "does not have an interest materially adverse to the interest of the estate or of any class of * * * equity security holders, by reason of any direct or indirect relationship to, connection with, or interest in, the debtor." 11 U.S.C. 101(14)(E).

This Circuit has not had occasion to analyze 11 U.S.C. 327(a) in detail, but other circuits have, and there is consensus that bankruptcy courts exercise substantial discretion and judgment in deciding whether to approve a professional's employment.[5] The Seventh Circuit has explained

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[5] See, e.g., In re Interwest Bus. Equip., Inc., 23 F.3d 311, 315 (10th Cir. 1994) (applying an abuse of discretion standard on direct appeal); In re Harold & Williams Dev. Co., 977 F.2d 906, 909-10 & n.2 (4th Cir. 1992) (same); In re BH &

that "[t]ogether, the statutory requirements of disinterestedness and no adverse interest to the estate serve the important policy of ensuring that all professionals appointed * * * tender undivided loyalty and provide untainted advice and assistance." In re Crivello, 134 F.3d 813, 836 (7th Cir. 1998). The Tenth Circuit also has noted that high standards of undivided loyalty are indispensable given counsel's duty "to survey the landscape in search of property of the estate, defenses to claims, preferential transfers, fraudulent conveyances and other causes of action that may yield a recovery to the estate." In re Interwest Bus. Equip., Inc., 23 F.3d 311, 316 (10th Cir. 1994) (internal quotation marks omitted); see also, e.g., In re AroChem Corp., 173 F.3d 610, 621 (2d Cir. 1999) (noting that, under 11 U.S.C. 327(a), "the attorney must not represent an adverse interest relating to the services which are to be performed").

As the Tenth Circuit also noted, "[t]he jaundiced eye and scowling mien that counsel for the debtor is required to cast upon everyone * * * will likely not fall upon the party with whom he has a potential conflict." Ibid. (internal quotation marks omitted) (emphasis added); see also In re Prince, 40

P, 949 F.2d 1300, 1312-13 (3d Cir. 1991) (same); In re Martin, 817 F.2d 175, 181-83 (1st Cir. 1987) (same).

F.3d 356, 361 (11th Cir. 1994) (disqualifying attorneys whose clients possess "either an economic interest that would tend to lessen the value of the bankruptcy estate or that would create either an actual or potential dispute in which the estate is a rival claimant * * * or * * * a predisposition under the circumstances that render such a bias against the estate") (internal quotation marks omitted) (emphasis added).

That view coheres with 11 U.S.C. 327(a)'s textual provision that debtors "may" employ attorneys, but only "with the court's approval." Chapter 11 debtors in possession differ substantially from non-debtor corporations because a bankrupt's fiduciary duties run to its creditors' benefit, not the debtor's. See CFTC v. Weintraub, 471 U.S. 343, 355 (1985); In re McConville, 110 F.3d 47, 49 (9th Cir. 1997). For that reason, bankruptcy courts, not debtors, exercise ultimate discretion and gatekeeping authority over who "may" be employed as bankruptcy counsel under 11 U.S.C. 327(a).

2. Here, Lincoln Hospital and WEWR focus exclusively on the fact that WEWR's principal partner was scheduled to testify against Weiss and Carvelli. As troubling as that fact may be, more important is WEWR's professional duty to represent CPMS and to assist the CPMS Creditors Committee in recovering damages against Weiss and Carvelli. Although WEWR

and Lincoln Hospital claim that WEWR’s partner was never called as a witness against Weiss and Carvelli and that the CPMS Committee “misrepresented its intentions to the bankruptcy court and the United States Trustee,” those claims are not accompanied by record citations. See Mand. Pet. 22. And even if true, such arguments do not support any inference that the bankruptcy court’s decision was improper given the information available to the court at the time the bankruptcy court entered its order denying employment.

In contrast, all facts necessary to support the bankruptcy court’s judgment are undisputed. During the relevant period, WEWR was CPMS’s general bankruptcy counsel under 11 U.S.C. 327(a) with a fiduciary duty to pursue legal claims for CPMS’s creditors (Weintraub, 471 U.S. at 355; Mand. Pet. 5), CPMS agreed to cooperate with the CPMS Creditor Committee in litigating against Weiss and Carvelli (Mand. Pet. 6), such litigation was undertaken for the financial benefit of the CPMS estate (ibid.), and Carvelli was a one-third indirect shareholder of Lincoln Hospital (id. 7 n.5). Although petitioners note that WEWR would not, even if approved, have formally represented Weiss and Carvelli (id. at 16, 24), that does not support petitioners’ broader claim that “WEWR and its clients have no interest in the outcome” of the litigation against Weiss and Carvelli, nor their claim that such litigation "has nothing to do with Debtor whatsoever" (id. at 21).

On the contrary, at the time of the bankruptcy proceeding, CPMS had an economic stake in, and a contractual and fiduciary duty to pursue, significant monetary litigation against Weiss and Carvelli. Indeed, the adversary proceeding pursued by the CPMS Creditors Committee, brought on CPMS's behalf and with CPMS's cooperation, was undertaken for the sole benefit of the CPMS estate. It blinks reality for petitioners to suggest that a $1.5 million lawsuit against two of Lincoln Hospital's high-ranking executives "has nothing to do" with that company's financial interests. Mand. Pet. 21. The conflict at issue was only magnified by the fact that, in this case, "WEWR's representation [of Lincoln] would be controlled by Carvelli and Weiss" personally. BAP Op. 8.

As the bankruptcy court understood, and the BAP unanimously affirmed, those circumstances would have saddled Lincoln Hospital's creditors with counsel that, in making day-to-day decisions about Lincoln's bankruptcy case, would have simultaneously "serv[ed] two masters * * * with opposing interests." 11/21/03 Bankr. Hr'g 9 (statement of CPMS Creditors Committee). Such facts created an actual conflict between the interest of WEWR’s ongoing client, CPMS, in maximizing recovery against Weiss and Carvelli, and the interests of WEWR’s proposed client, Lincoln Hospital, whose management was being sued.

3. The potential for conflict also was present. See, e.g., In re Interwest Business Equip., Inc., 23 F.3d at 316. The possible testimony of WEWR’s partner only illustrates the kind of litigative support that CPMS, in “cooperating” with the CPMS Creditors Committee, may well have desired, and that Weiss and Carvelli, through their management of Lincoln Hospital, might well have opposed. WEWR could not be authorized to provide professional services in light of such probable cross-purposes.

Petitioners’ insistence that WEWR might not have any information adverse to the CPMS Creditors Committee misses the point. Mand. Pet. 22. The necessary confidence between attorney and client is sufficiently damaged when there is potential for adverse interests on either side. See In re Prince, 40 F.3d at 361; In re Interwest Bus. Equip., Inc., 23 F.2d at 315. It might be that WEWR, in the course of representing Lincoln Hospital, would need to learn sensitive information about Weiss and Carvelli. Or it might be that WEWR already had information regarding the CPMS Creditors

Committee that Lincoln Hospital and its managers would like to know. It is irrelevant how WEWR might address those sorts of potential conflicts. Whether WEWR would share information with the adverse party, would keep existing confidences, or would avoid obtaining useful (but delicate) information in the first place, it is highly realistic to believe that the relationship between WEWR and Lincoln Hospital could be put at risk. To avoid such realistic potential for conflict, 11 U.S.C. 327(a) allows bankruptcy courts to deny authorization of employment.

4. Finally, there was, at a minimum, an appearance of conflict here. The courts of appeals have divided on whether the mere appearance of conflict (as opposed to more serious potential and actual conflicts) is enough to support a professional's disqualification. Compare In re Vouzianas, 259 F.3d 103 (2d Cir. 2001) (yes) with In re Marvel Entertainment Group, Inc., 140 F.3d 463, 476 (3d Cir. 1998) (no). Here, this Court need not decide that question because the abundant appearance of conflict only corroborates the existence of potential and actual conflicts, and negates the propriety of mandamus jurisdiction, see infra Part II (requiring petitioners to demonstrate a "clear and indisputable" entitlement to relief). The CPMS Creditors Committee objected

to WEWR’s employment by Lincoln Hospital on the ground that WEWR’s proposed association with Weiss’s and Carvelli’s employer might affect WEWR’s willingness or ability to counsel CPMS to cooperate in suing those two high-level managers.

Similarly, if WEWR’s employment had been approved, Lincoln Hospital’s creditors might have feared that Weiss and Carvelli could be in a position to use WEWR’s employment for personal benefit rather than the benefit of Lincoln’s creditors. Regardless of whether such events would actually have occurred, Lincoln Hospital’s creditors had a right to <u>prophylactic assurance</u> that the attorneys charged with representing their interests would do so fairly and impartially. Bankruptcy courts have no obligation, under such circumstances, to ignore damage to a bankruptcy proceeding’s apparent integrity.

5. Independent of conflicting interests, the BAP was also correct that the bankruptcy court’s decision is justified on grounds of “disinterestedness.” Although conflicts of interest may tend to indicate a lack of disinterestedness, <u>see</u> Mand. Pet. 28 (collecting cases), no court has ever held that the two standards are coterminous. On the contrary, Congress in enacting 11 U.S.C. 101(14)(E) made clear its intent to expand the available bases for disqualification beyond simply

interests adverse to the estate. See TRW, Inc. v. Andrews, 534 U.S. 19, 31 (2001) ("It is a cardinal principle of statutory construction that a statute ought, upon the whole, to be so construed that * * * no clause, sentence, or word shall be superfluous, void, or insignificant."). Specifically, subsection (14)(E) provides that counsel is not "disinterested" when it, like WEWR, holds an interest adverse to a major "equity security holder," like Carvelli — who indirectly owns one-third of Lincoln Hospital. See 11 U.S.C. 101(14)(E) (providing that, to be disinterested, counsel may not be adverse to equity security holders). Here, WEWR is adverse to Lincoln Hospital's principal security holder. That constitutes a text-book lack of disinterestedness under 11 U.S.C. 101(14)(E); consequently, WEWR was properly denied employment under 11 U.S.C. 327(a).

Conflicts with high-level management personnel raise similar concerns, in that WEWR would again be in a situation where the interests of its clients would point in contradictory directions. See generally In re Marvel Entertainment Group, Inc., 140 F.3d at 476 ("A plain reading of this section suggests that one is a 'disinterested person' only if he has no interest that is materially adverse either for one of the specific reasons delineated in the statute or 'for any other reason.'") (emphasis added).

In response, Lincoln Hospital and WEWR rely only on general assertions that debtors in possession should have the privilege of selecting their own counsel. Mand. Pet. 12, 16. As the BAP correctly noted, however, it is wholly impermissible for a debtor to choose any counsel, unless that counsel is disinterested and holds no interest adverse to the estate. See 11 U.S.C. 327(a). Moreover, when a debtor enters bankruptcy, the Code interposes 11 U.S.C. 327(a) in order to erect procedural and substantive protections, each of which specifically limits ordinary flexibility to select one's own preferred counsel. The important interest that petitioners overlook is the Bankruptcy Code's goal of obtaining impartial counsel who can be trusted to deal responsibly with the estate's assets and with the myriad fiduciary tasks that arise in the course of doing so. See, e.g., In re Crivello, 134 F.3d at 836; In re Interwest Bus. Equip., Inc., 23 F.3d at 316; see also CTFC v. Weintraub, 471 U.S. 343, 355 (1985) (noting that debtors in possession have fiduciary obligations to creditors and shareholders).

WEWR's appointment was not necessarily in the best interests of Lincoln Hospital's creditors, and those creditors have not appeared in support of this mandamus petition. Lincoln Hospital was managed for the benefit of its creditors by two men, Weiss and Carvelli, whose own significant legal problems demanded considerable time and attention. In that circumstance, Lincoln Hospital’s creditors particularly needed the debtor to be represented by indisputably disinterested counsel. At best, WEWR’s duty to help litigate claims against Lincoln Hospital’s management in an unrelated case would have caused tension between those managers and the attorneys litigating against them. At worst, Lincoln Hospital’s creditors might have feared that Weiss and Carvelli could use Lincoln Hospital’s retention of WEWR to improve their individual chances of avoiding a $1.5 million personal judgment. In either instance, there was no legitimate basis for burdening Lincoln Hospital’s creditors with WEWR’s professional baggage, particularly when competent and conflict-free counsel was readily available, and quickly approved. The bankruptcy court’s refusal to authorize WEWR’s employment was arguably commendable, based both on actual and potential risks to the estate and the proceedings’ integrity. That decision certainly did not constitute clear error in the context of the bankruptcy court’s substantial gatekeeping authority and discretion to authorize professional employment under 11 U.S.C. 327(a).

II. Even If The Bankruptcy Court Erred, Mandamus Is Not Appropriate

Lincoln Hospital and WEWR seriously misconstrue the circumstances under which mandamus is available. Although petitioners correctly cite the five standards articulated by this Court’s decision In re Canter, 299 F.3d 1150 (9th Cir. 2002), petitioners overlook the long-established principle that “[m]andamus is a drastic remedy that should be invoked only in extraordinary circumstances.” Calderon v. United States Dist. Court, 107 F.3d 756 (9th Cir. 1997) (quoting Armster v. United States Dist. Court, 792 F.2d 1423, 1431 (9th Cir. 1986)). Mandamus is “an extraordinary remedy that may be obtained only in order to confine an inferior court to a lawful exercise of its prescribed jurisdiction or to compel it to exercise its authority when it is its duty to do so.” Cordoza v. Pacific States Steel Corp., 320 F.3d 989, 998 (9th Cir. 2003) (internal quotation marks omitted). “A judicial readiness to issue the writ of mandamus in anything less than an extraordinary situation would run the real risk of defeating the very policies sought to be furthered” by Congress’s decision to authorize appellate review at the end of a trial or not at all. Kerr v. United States Dist. Court, 426 U.S. 394, 403 (1976); see also Bankers Life & Cas. Co v. Holland, 346 U.S. 379, 383-84 (1953) (same). “In short, our cases have answered the question as to the availability of mandamus in situations such as this with the refrain: ‘What never? Well hardly ever!’” Allied Chem. Corp. v. Daiflon, Inc., 449 U.S. 33, 36. “We have held that the party seeking mandamus has the burden of showing that its right to issuance of the writ is clear and indisputable.” Gulfstream Aerospace Corp. v. Mayacamas Corp., 485 U.S. 271, 289 (1988). Such reluctance to apply the extraordinary writ is at its zenith in cases like this one, where the decision under review is highly discretionary. Indeed, Allied Chemical Corp., 449 U.S. at 36, held that almost always, “[w]here a matter is committed to discretion, it cannot be said that a litigant’s right to a particular result is ‘clear and indisputable.’”

Under Canter, the five applicable factors to be applied in determining whether an extraordinary case warrants mandamus relief are whether: (i) there exist other adequate means of relief, (ii) the petitioner will be damaged or prejudiced in an uncorrectable way, (iii) the district court’s order is clearly erroneous, (iv) the error often repeats, and (v) the error raises new and important problems. Canter, 299 F.3d at 1153.

With respect to the first of those factors, the availability of other modes of relief, it is quite true that this Circuit’s case law denies the possibility of review on appeal. The controlling precedent is In re SS Retail Stores Corp., 162 F.3d 1230 (9th Cir. 1998). In SS Retail, this Court held that where a bankruptcy court authorizes appointment of counsel under 11 U.S.C. 327(a), that order is interlocutory and is not an appealable “final order,” even under bankruptcy’s flexible standards of finality. Id. at 1232. There is no principled distinction for finality purposes between judicial orders authorizing appointment of counsel and those that refuse such authorization.

Lincoln Hospital and WEWR correctly note that this Court’s decision in SS Retail conflicts with rulings issued by other circuits, which have held that orders regarding professional employment are appealable final orders. See, e.g., In re Pillowtex, Inc., 304 F.3d 246, 250 (3d Cir. 2002); In re Arochem Corp., 176 F.3d 610, 619-20 (2d Cir. 1999). In SS Retail, the United States Trustee argued that decisions by a bankruptcy court to authorize or deny employment often evade any form of appellate review if they are not reviewed immediately. See In re SS Retail Stores Corp. 216 F.3d 882, 885 (9th Cir. 2000) (denying appellate review after final judgment). This Court, however, adopted a different approach. Under SS Retail, if a bankruptcy court errs in such bankruptcy employment decisions, it is possible that counsel who are disinterested might be denied work unfairly or — far more importantly — that counsel who are not disinterested might be allowed to continue in place, with corresponding damage to the actual and perceived impartiality of the bankruptcy proceeding as a whole.

The oddity of petitioners' position is that they interpret SS Retail's denial of appellate review as a bare invitation to seek mandamus review. That end run is inapt. Interlocutory decisions regarding bankruptcy counsel are not in any sense "extraordinary." Indeed, petitioners' interpretation of mandamus could cause the full gamut of employment challenges — i.e., those alleging erroneous authorizations and those claiming wrongful denials of professional employment — to be filed as mandamus petitions. Petitioners cite no court of appeals that has chosen such a path. To create such a broad new category of mandamus review would lie in serious tension with the writ's traditionally narrow limits. Moreover, because mandamus is an inherently equitable remedy, Independence Min. Co., Inc. v. Babbitt, 105 F.3d 502, 505 (9th Cir. 1997), expanding its prevalence as a means of obtaining review would risk providing less certain access to appellate courts.

One category of disparity that this Court should especially avoid, even if mandamus is granted in this case, is applying unduly lenient review of bankruptcy court orders that deny professional employment and unduly restrictive review to orders granting such authorization. As cases like this one and SS Retail illustrate, creditors and the United States Trustee sometimes object that professional employment is improper under 11 U.S.C. 327(a) and 11 U.S.C. 101(14)(E). After this Court's decision in SS Retail, however, whenever bankruptcy courts deny those objections, it has seemed evident that such denials are not immediately reviewable by direct review or by mandamus. If, however, the Court in this case decides that mandamus is an appropriate means of obtaining relief, it may be important to clarify that mandamus is available in both circumstances.

The equitable factors at stake, if anything, weigh more in favor of appellate review for erroneous approvals of employment like SS Retail, rather than erroneous denials, like this one. In most denials, the debtor quickly proposes a substitute, and, as here, that substitute is competent and indisputably disinterested. Thus, in case of error, the only party with mentionable harm from a denial is often the professional herself. In the case of an erroneous grant, in contrast, a not-disinterested professional, or one with an material adverse interest, might continue representation and thereby heap upon the estate significant risks of loss and irrevocable abuse. The United States Trustee does not believe that mandamus is a proper vehicle for reviewing employment orders in either circumstance. If this Court disagrees, however, the Bankruptcy Code's basic fairness commends strongly in favor of a rule that would expressly allow at least as much opportunity for appellate review by opponents of a bankruptcy court's retention order as exists for those who argue in favor of such orders.

The second Canter factor, prejudice, also does not weigh strongly in favor of mandamus, because the primary harm cognizable under the Bankruptcy Code is damage to the estate or the parties. No such prejudice pertains here, as is evident from Lincoln Hospital's quickly retaining substitute counsel, which is undeniably disinterested and serving ably. To the contrary, this Court's exercise of discretionary mandamus review must take into account the fact that replacing present counsel at this late date could be fundamentally unfair to creditors because Levene's knowledgeable, engaged, and indisputably proper service would be displaced by WEWR, which has been out of this case for twelve months.

The prejudice primarily relied upon by Lincoln Hospital and WEWR is the right to appoint one’s own counsel. As discussed infra, that “right” does not exist in bankruptcy except within the established boundaries 11 U.S.C. 327(a), applied as an exercise of the bankruptcy court’s discretion. Contrary to petitioners’ characterization, the bankruptcy court’s order in this case did not assume, and the BAP did not affirm, a “free form veto over a debtor’s selection of counsel,” based on what the bankruptcy court simply “felt.” Mand. Pet. 20, 23. On the contrary, both courts looked to WEWR’s troubling relationship with Weiss, Carvelli, Lincoln Hospital, and CPMS, and to CPMS’s adverse interests regarding two high-ranking officers and one large equity holder in Lincoln Hospital. Such factors are well within the range of considerations that courts should use in applying 11 U.S.C. 327(a) and 11 U.S.C. 101(14)(E). Although petitioners suggest that Lincoln Hospital “has already been prejudiced by being deprived of experienced counsel of its choosing, who was immersed in the facts, circumstances and crises of the case,” Mand. Pet. 14, there is no suggestion that any prejudice of that sort — if it existed at all — would be alleviated by reinserting WEWR into a bankruptcy case that is now handled by a law firm that indisputably satisfies 11 U.S.C. 327(a).

The third Canter factor, clear error, has been addressed supra in Part I. The arguments of WEWR and Lincoln Hospital on this point have three basic flaws. First, petitioners entirely fail to address the interrelationship between WEWR and CPMS, and focus only on the potential duties of WEWR partner’s as a witness. E.g., Mand. App. 14-16. Second, they misconstrue the term “disinterested” under 11 U.S.C. 101(14)(E) as meaning “actual conflict.” Compare Mand. App. 18 (“[W]hat logically must follow is that is one does not bear a conflict of interest * * * then one * * * is ‘disinterested’ under 327(a), upon a showing that the remaining factors set forth in 101(14 [other than 101(14)(E)] are met.”), with supra at I.5. Third, they assume that Lincoln Hospital lacks any interest in the private litigation of Weiss and Carvelli, even though Lincoln Hospital is personally managed by Weiss and Carvelli. And petitioners assume that WEWR lacks any interest in that same litigation, even though WEWR’s client CPMS owns the claim, must help prosecute it, and would receive any damages recovered. See Mand. Pet. 16, 21. Because the bankruptcy court did not err, much less commit plain error (a standard much more lenient than even abuse of discretion), mandamus relief is inappropriate.

The fourth factor, whether the error is "oft-repeated" does not weigh strongly in favor of mandamus relief, both because (as petitioners concede, Mand. Pet. 22) there is no record of repetition in this case, and because treating employment orders as interlocutory and unreviewable on appeal is the direct result of a Ninth Circuit case prescribing that result. Again, it is hard to square why eminently ordinary bankruptcy employment cases such as this one should be deemed insufficiently final to warrant appellate review, but should qualify for the "extraordinary" relief of mandamus jurisdiction.

Under the fifth Canter factor, legal novelty, the issue of whether disqualification under 11 U.S.C. 327(a) requires an actual conflict of interest is not especially novel (or difficult). Indeed, the most novel aspect of this petition is the jurisdictional argument.

In conclusion, although some of the Canter factors could be read to support mandamus jurisdiction, none of them does so with appreciable weight. Moreover, the Supreme Court has repeatedly explained that "the party seeking mandamus has the burden of showing that its right to issuance of the writ is clear and indisputable." Gulfstream Aerospace Corp. v. Mayacamas Corp., 485 U.S. 271, 289 (1988). Petitioners have not carried that burden; thus, under the extremely high standards for a writ of mandamus, the absence of any "clear and indisputable" error by the bankruptcy court is dispositive.

As has been discussed supra, the bankruptcy court identified serious problems arising from the fact that WEWR was actively representing another client, CPMS, in litigation against a Lincoln Hospital equity holder and high-ranking officers of Lincoln Hospital. Under such circumstances, WEWR was not "disinterested," and had actual, potential, and apparent conflicts of interest. Accordingly, the bankruptcy court did not err, much less did it commit the sort of "judicial usurpation of power" for which mandamus is typically reserved.

CONCLUSION

For the foregoing reasons, appellant's petition for mandamus should be denied.

Respectfully submitted,

PETER D. KEISLER
Assistant Attorney General

OF COUNSEL:

JOSEPH A. GUZINSKI
General Counsel
P. MATTHEW SUTKO
PAUL W. BRIDENHAGEN
Office of the General
Counsel, Executive Office
for U.S. Trustees
20 Massachusetts Ave., N.W.
Washington, D.C. 20530

WILLIAM KANTER
(202) 514-4575
R. CRAIG GREEN
(202) 514-2498
Attorneys, Appellate Staff
Civil Division, Room 9104
Department of Justice
601 D Street, N.W.
Washington, D.C. 20530

DECEMBER 2003

CERTIFICATE OF SERVICE

I hereby certify that on this December 8, 2003, I caused and original and three copies of the foregoing response to be sent to the Court, and one copy to be sent to the following counsel, all via Federal Express:

Martin J. Brill, Esq.
Suite 1120
Levene, Neale & Bender
1801 Avenue of the Stars
Los Angeles, CA 90067

David R. Weinstein
Weinstein, Eisen, Weiss & Rothschild
1925 Century Park East
Los Angeles, CA 90067

Peter J. Gurfein
Akin, Gump, Strauss, Huer & Feld
2029 Century Park East
Los Angeles, CA 90067

Carolyn A. Dye
Law Offices of Carolyn A. Dye
1925 Century Park East, Suite 1150
Los Angeles, CA 90067

U.S. Bankruptcy Court
Central District California
Edward R. Roybal Federal Building
and Courthouse
255 East Temple Street
Los Angeles, CA 90012

Bankruptcy Appellate Panel for
the Ninth Circuit
Richard H. Chambers
United States Court of Appeals Building
125 South Grand Ave.
Pasadena, CA 91105

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R. CRAIG GREEN
<u>Attorney</u>

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WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*
In re: David B. Lorenz (Lorenz v Miller, UST)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*
D. Or.

3. ("CCN") ***CURRENT*** CASE NO.
No.:

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*
No.: 07-30593-elp7
Court: Bankr. Or.
(Identify judge & cite, if any)

5. ("SO") ***SOURCE***
U.S. TRUSTEES

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*
Filed: March, 21, 2008
Type: Brief of Appellee, the United States Trustee

7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*
Pam Griffith, Paul Bridenhagen, P. Matthew Sutko
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***
• Did the bankruptcy court abuse its discretion when it order that EAJA fees should be denied because the United States Trustee's actions in Mr. Lorenz's case were substantially justified?
√ **Background:**

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IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF OREGON

In re	)	
	)	
DAVID B. LORENZ,	)	
	)	
Debtor.	)	Civ. App. No. ____________
________________________________	)	
	)	
DAVID B. LORENZ,	)	
	)	
Appellant,	)	
	)	
v.	)	
	)	
ROBERT D. MILLER JR.,	)	
Acting United States Trustee,	)	Bk. Case No. 07-30593-elp7
	)	
Appellee.	)	
________________________________	)	

Brief of Appellee, the United States Trustee

Roberta A. DeAngelis
Matthew P. Sutko
Department of Justice
20 Massachusetts Ave., N.W.
Washington, D.C. 20530
phone: (202) 307-1399

Pamela J. Griffith, OSB #81249
Office of the United States Trustee
Department of Justice
620 SW Main, Suite 213
Portland , OR 97205
phone: (503) 326-4000

Counsel for Robert D. Miller Jr.,
Acting United States Trustee, Region 18

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STATEMENT OF JURISDICTION

The bankruptcy court had jurisdiction under 28 U.S.C. §§ 157(a) and (b) over 1) the underlying case, a voluntary bankruptcy filed by David B. Lorenz under chapter 7 of the Bankruptcy Code[1] and 2) the motion by Mr. Lorenz for an award of attorney's fees against the United States Trustee pursuant to 28 U.S.C. § 2412 [the Equal Access to Justice Act ("EAJA")]. The bankruptcy court denied the motion for EAJA fees by order entered on November 30, 2007. Excerpt of Record ("ER") 311-13. On December 10, 2007, Mr. Lorenz filed a timely notice of appeal of this final order, ER 314, and an election to have the appeal heard by this court, ER 319. This court has jurisdiction over this appeal pursuant to 28 U.S.C. § 158(a)(1).

STATEMENT OF THE ISSUE

Did the bankruptcy court abuse its discretion when it ordered that EAJA fees should be denied because the United States Trustee's actions in Mr. Lorenz's case were substantially justified?

STATEMENT OF THE CASE

I. Nature of the Case

This appeal challenges a bankruptcy court's order that denied an EAJA award to Mr. Lorenz. The United States Trustee filed a motion to dismiss Mr. Lorenz's bankruptcy case for abuse pursuant to 11 U.S.C. § 707(b)(3). The bankruptcy court denied the motion after an evidentiary hearing. Mr. Lorenz then filed a timely motion for an award of attorney's fees

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[1] The Bankruptcy Code is codified in 11 U.S.C. § 101 et seq.

under EAJA. The bankruptcy court sua sponte denied the motion for EAJA fees, finding that the United States Trustee's motion was substantially justified. This appeal followed.

II. Statement of Facts

A. Statutory Background

An individual who seeks to discharge his past debts may file a petition under chapter 7 of the Bankruptcy Code. See 11 U.S.C.§ 701, et seq. By filing such a petition, the individual "commences" a bankruptcy case and becomes a "debtor." See 11 U.S.C. §§ 301(a), 101(13). Congress enacted sweeping changes to the Bankruptcy Code in the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (the "BAPCPA"). Most of the provisions of the BAPCPA were effective for cases filed on and after October 17, 2005.

Congress enacted new section 707(b)(3) in the BAPCPA. Prior to that amendment, section 707(b) authorized courts to dismiss cases when granting debtors chapter 7 relief would constitute a "substantial abuse." 11 U.S.C. § 707(b) (superceded). In evaluating whether substantial abuse existed under old section 707(b), courts considered both the debtor's conduct and the debtor's ability to repay debts outside bankruptcy or through a chapter 13 repayment plan. See, e.g., In re Kelly, 841 F.2d 908, 914-15 (9th Cir. 1988); In re Stewart, 175 F.3d 796 (10th Cir. 1999); In re Lamanna, 153 F.3d 1 (1st Cir. 1998); In re Krohn, 886 F.2d 123 (6th Cir. 1989). Most courts, including the Ninth Circuit, recognized that a debtor's ability to repay a portion of his debts was the predominant factor. Id.

Congress substantially rewrote section 707(b) in the BAPCPA. Among other things,

> 1. Congress lowered the standard for dismissal under all subsections of new section 707(b) from "substantial abuse" to mere "abuse."
>
> 2. Congress eliminated a statutory presumption in favor of granting the relief requested by the debtor.
>
> 3. Congress enacted new section 707(b)(2) which creates a presumption of abuse against certain debtors when a mathematical formula, known as the "Means Test," yields monthly disposable income that exceeds a statutory trigger.[2]
>
> 4. Congress enacted new section 707(b)(3) which allows courts to dismiss cases based upon either a debtor's bad faith conduct, 11 U.S.C. § 707(b)(3)(A), or the totality of the debtor's financial circumstances, 11 U.S.C. § 707(b)(3)(B).

Compare 11 U.S.C. § 707(b)(superceded) to 11 U.S.C. §§ 707(b)(1), (2) and (3).

Section 707(b)(3)(A) allows dismissal for "bad faith" misconduct. Alternatively, section 707(b)(3)(B) of the BAPCPA codifies that aspect of pre-2005 case law that mandated dismissal of chapter 7 cases when debtors had the ability to repay a portion of their debt. See, e.g., Hebbring v. United States Trustee, 463 F.3d 902 (9th Cir. 2006) (affirming dismissal under old section 707(b) because the debtor had $615 available each month to pay creditors).

Sections 707(b)(3)(A) and (B) of the BAPCPA clarify that cases can be dismissed either solely for misconduct or solely based upon a debtor's ability to repay his or her debts. See, e.g., In re Henebury, 361 B.R. 595, 607 (Bankr. S.D. Fla. 2007). Thus, under section 707(b)(3)(B), debtors' cases should be dismissed whenever the evidence establishes that they can make a

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[2] Individual Chapter 7 debtors with primarily consumer debts are required to file Official Form B22A, titled "Statement of Current Monthly Income and Means Test Calculation" (the "Means Test Form"). 11 U.S.C. § 521 and 11 U.S.C. § 707(b)(2)(C). The Means Test Form provides financial information for use in evaluating whether or not the presumption of abuse arises.

meaningful effort to pay their debt - either (a) outside bankruptcy, or (b) through a chapter 11 or chapter 13 repayment plan. See 11 U.S.C. § 707(b)(1) (allowing a court to dismiss a case for abuse, or allowing the court and the debtor to agree that the case should be converted to chapter 11 or chapter 13 instead). See also H.R. Rep. 109-31 at 5 & n.18 (2005), reprinted in 2005 U.S.C.C.A.N. 88, 92 (Congress enacted section 707(b) to issue a "clear mandate requiring these debtors to repay their debts.").

In commenting upon an identical version of section 707(b)(3)(B) proposed by a prior Congress but not enacted into law, Senator Grassley, the sponsor, explained that section 707(b)(3) allows dismissal based upon the ability to repay factors described in "such" pre-reform cases as In re Lamanna. 146 Cong. Rec. S11683, 11700 (Dec. 7, 2000) (Statement of Sen. Grassley). Under In re Lamanna and similar "such" cases, courts could consider a number of financial factors, including factors that evaluated a debtor's ability to repay debts both outside bankruptcy and through chapter 13:

> Among the factors to be considered in deciding whether a debtor is needy is his ability to repay his debts out of future earnings. That factor alone may be sufficient to warrant dismissal. For example, a court would not be justified in concluding that a debtor is needy and worthy of discharge, where his disposable income permits liquidation of his consumer debts with relative ease. Other factors relevant to need include whether the debtor enjoys a stable source of future income, whether he is eligible for adjustments of his debts through Chapter 13 of the Bankruptcy Code, whether there are state remedies with the potential to ease his financial predicament, the degree of relief obtainable through private negotiations, and **whether his expenses can be reduced significantly without depriving him of adequate food, clothing, shelter and other necessities.**

Lamanna, 153 F.3d 1, 4 (1st Cir. 1998)(emphasis supplied).

Ability to repay is not restricted to a narrow mechanical test. Moreover, pre-BAPCA cases from the Ninth Circuit and Oregon noted that there is no threshold repayment percentage for a finding of abuse under an "ability to pay" standard. In re Gomes, 220 BR 84 (9th Cir. BAP 1998); see also In re Meler, 295 B.R. 625, 633 (D. Ariz. 2003)(summarizing cases and noting that the percentage of debt repayment is not necessarily determinative). In the Oregon case of In re Davenport, ER 105-115, the bankruptcy court held that it was the debtor's ability to make a substantial effort to pay, rather than the ability to pay a particular percentage of claims, that precluded relief under Chapter 7. In that case, the debtor had disposable income of $532 per month. ER 112.

Congress, in the BAPCPA, gave United States Trustees[3] a central role in curbing abuse by Chapter 7 debtors. The United States Trustee reviews individual Chapter 7 cases to determine whether or not the "Means Test" presumption of abuse arises and files statements with the court regarding the same. 11 U.S.C. § 707(b)(2) and 11 U.S.C. § 704(b)(1). If the presumption of abuse arises, the United States Trustee is charged with filing either a motion to dismiss or a statement as to why the United States Trustee believes that a motion to dismiss is not appropriate. 11 U.S.C. § 704(b)(2). Congress granted only the United States Trustee and the court standing to file motions to dismiss in certain situations. 11 U.S.C. § 707(b)(6).

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[3] United States Trustees are senior officials of the Department of Justice who "supervise the administration of cases and trustees" in all bankruptcy cases within their geographic regions through the exercise of a range of oversight responsibilities. 28 U.S.C. § 586(a)(3). See generally In re Castillo, 297 F.3d 940, 950 (9th Cir. 2002)(explaining that the United States Trustee is the "watchdog" of the bankruptcy system).

B. Factual Background and Proceedings Below

David B. Lorenz filed a voluntary chapter 7 bankruptcy petition on February 26, 2007. ER 1. Mr. Lorenz was married at the time that he filed for bankruptcy but his wife did not file with him. See, e.g., ER 59. Throughout the pendency of his case, Mr. and Mrs. Lorenz lived together in a home that Mr. Lorenz purchased in February 2006 for $800,000. ER 98. The home is approximately 3,685 square feet and includes approximately 14 acres of real property, including a barn.[4] ER 98, 259. Mr. Lorenz has custody of his two minor children from a previous marriage for ten days a month. ER 97. Other than the time that the children spend with them, Mr. and Mrs. Lorenz live alone. Id.

On the day he filed bankruptcy, Mr. Lorenz also filed schedules and statements that he had signed under penalty of perjury. These documents reflected that Mr. Lorenz had secured debts in the amount of $1,025,816; priority debts in the amount of $3,200; and unsecured non-priority debts in the amount of $234,861. ER 18. Mr. Lorenz operated a trucking business which he closed in 2006 because it was not profitable. ER 97. Many of the debts on Mr. Lorenz's Schedule F (Creditors Holding Unsecured Nonpriority Claims) arose from personal guarantees or debts associated with the trucking business. ER 97.

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[4] At the time of the evidentiary hearing in October 2007, Mr. Lorenz had one horse and Mrs. Lorenz had 9 horses. ER 98.

Mr. Lorenz's Schedule D (Creditors Holding Secured Claims) included the following secured debts:

> $845,662 secured by a single family residence[5];
> $41,187 secured by a 2005[sic][6] Chevrolet Silverado 3500 Pickup;
> $29,000 secured by a 2005[sic] Chevy Silvarado [sic] 3500 4wd PU;
> $29,000 secured by a Chevy 3500 Flatbed Pick up;
> $31,817 secured by a horse trailer with live in compartment;
> $18,438 secured by a 2004 John Deere Tractor;
> $6,775 secured by a 2005 Harley Davidson 880 Sportster;
> $6,627 secured by a 2005 Harley Davidson 880 Sportster; and
> $4,500 secured by a Quad Runner

ER 26-29.

Mr. Lorenz filed a Means Test Form on Official Form B22A on which he reported average monthly income for himself and his wife during the six month period covered by the means test analysis (August 2006 through January 2007). Mr. Lorenz reported "Current Monthly Income" of $13,401 per month ($4,425 for him and $8,976[7] for his wife). ER 74. This resulted in annualized income of $160,812 - well above $63,946, the median income for a household of four in Oregon at the time Mr. Lorenz's case was filed. Id.

While the Means Test Form examines historical income, Schedule I (Current Income of Individual Debtor(s)) reflects current and anticipated income. Mr. Lorenz reported on his

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[5] This is the total of a debt to Americas Servicing Co. in the amount of $640,000, a debt to Hsbc/Ms in the amount of $160,862, a debt to CJ Construction Inc. in the amount of $37,000, and a debt to Multnomah County Property Tax in the amount of $7,000.

[6] Mr. Lorenz later clarified that the two Chevrolet Silverado 3500s were 2006 models rather than 2005 models. See ER 97-98.

[7] The Means Test Form reflected that Mrs. Lorenz had net income of $8,986 per month from the operation of her business (monthly gross receipts of $30,220 less expenses of $21,244). ER 73.

Schedule I that he was currently an unemployed truck driver but that he anticipated looking for work. ER 59. He estimated an income of $30,000 per year once he was employed. Id. Mr. Lorenz disclosed that his wife was a general contractor. Under the category of "Other monthly income," Mr. Lorenz disclosed receipt of $8,000 per month from his wife described as follows: "Houshold [sic] contribution by spouse as necessary." ER 59.

Mr. Lorenz deducted certain expenses on his Means Test Form[8]. After deducting these expenses, the Means Test Form showed monthly income of -(negative) $4,897.73. ER 78. The deductions for secured debt payments alone totaled $8,542.40. These expenses were:

> $3,600 to Americas Servicing Co. secured by the residence
> $1,398.80 to Hsbc/MS secured by the residence
> $616.67 to CJ Construction Inc. secured by the residence
> $130 to Multnomah Co. Property tax secured by the residence
> $686.45 to GMAC secured by the 2005[sic] Chevrolet Silverado 3500 pickup
> $483.33 to GMAC secured by the 2005[sic] Chevy Silvarado[sic] 3500 4wd pickup
> $483.33 to GMAC secured by the Chevy 3500 Flatbed Pick up
> $324.66 to Gemb/Financing secured by the horse trailer with live in compartment
> $307.30 to Deere Credit Services secured by the 2004 John Deere tractor
> $213.50 to Amer Gen Fin secured by a Freightliner Truck
> $112.91 to Esb/Harley secured by a 2005 Harley Davidson 880 Sportster
> $110.45 to Esb/Harley secured by a 2005 Harley Davidson 880 Sportster
> $75 to United Finance Co. secured by the Quad Runner

ER 77.

Schedule J (Current Expenditures of Individual Debtor(s)) requires debtors to estimate the average or projected monthly expenses of the debtor and the debtor's family at the time the case is filed. See ER 60. Mr. Lorenz reported monthly expenses of $12,301.00 on his Schedule J.

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[8] The Means Test allows certain uniform national and local deductions specified in the IRS Financial Collections Standards and other deductions for certain additional actual expenses, including expenses related to secured debt.

Id. He had a number of high expenses in addition to the large monthly expenses arising from secured debt, discussed above. For example, Mr. Lorenz listed internet expenses of $115 per month, cell phone expenses of $150 per month, and direct TV expenses of $89/month. ER 61. His net monthly income on Schedule J was -(negative) $4,301. ER 60.

Individual debtors are required to file a statement of intention disclosing what they intend to do with property secured by liens. 11 U.S.C. § 521(a)(2)(A). Mr. Lorenz's statement of intention disclosed that he intended to surrender the Freightliner Truck and the two Harley Davidson motorcycles, but did not express any intent with respect to the remainder of the property secured by liens. ER 15. At the time of the trial on the United States Trustee's motion to dismiss, Mr. Lorenz had determined to keep most of the remaining property including his home; the two 2006 Chevy Silverados; the quad; and the John Deere tractor. ER 98.

Mr. Lorenz testified under oath at a meeting of creditors on March 29, 2007. Mr. Lorenz there testified that he had obtained employment since the filing of his case and would be making about $40,000 per year working for a joint venture in which his wife was involved. ER 97.

The United States Trustee filed her[9] motion to dismiss pursuant to 11 U.S.C. § 707(b)(3)(A)[10] and 11 U.S.C. § 707(b)(3)(B) on May 8, 2007. The United States Trustee asserted that Mr. Lorenz was not the type of debtor that Congress meant to protect with

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[9] At the time the motion to dismiss was filed, Ilene J. Lashinsky was the United States Trustee for Region 18.

[10] Although the United States Trustee's arguments in his case focused on ability to repay under 11 U.S.C. § 707(b)(3)(B), the case also presented elements of bad faith under 11 U.S.C. § 707(b)(3)(A) such as a lavish lifestyle that continued even after it because apparent that the Lorenzes could not afford it. See, e.g., In re Oot, 368 B.R. 662 (Bankr. N.D. Ohio 2007).

the bankruptcy laws and that he and his wife could pay creditors a substantial amount if they curtailed their lavish lifestyle. ER 80-82.

By the time of trial in October 2007, both Mr. and Mrs. Lorenz had changed jobs. Mr. Lorenz was making $4,000 per month. Instead of operating her own business where she contributed $8,000 per month to household expenses as needed, Mrs. Lorenz was making wages of $5,416. ER 98, 209. Together, Mr. and Mrs. Lorenz made $9,416 per month ($112,992 per year) at the time of trial and believed that their jobs were stable. Id.

Prior to trial, Mr. Lorenz agreed that Exhibits 5 and 6 accurately reflected current expenses for him and his wife under the column titled "Updated Budget." ER 98. Mr. and Mrs. Lorenz reported expenses of $11,090 compared to income after taxes of $7,530, resulting in a monthly deficit of $3,560. ER 209.

C. The Bankruptcy Court's Decision

The bankruptcy court held an evidentiary hearing on the United States Trustee's motion to dismiss on October 29, 2007. The United States Trustee argued that Mr. Lorenz was not the needy type of debtor for whom Congress intended bankruptcy relief and that he could pay a significant amount to his creditors if he curtailed his lifestyle. ER 238. The court admitted into evidence United States Trustee exhibits 1 through 7. Exhibits 5 and 6 showed household income and expenses for Mr. and Mrs. Lorenz on the date the case was filed (in the "As Filed" column) and at the time of the hearing (in the "Updated Budget" column). The latter column was then compared to pertinent IRS Financial Collection Standards (the "IRS Standards"). ER 209, 220. These exhibits reflected that if Mr. and Mrs. Lorenz's living expenses were reduced to IRS

Standards, they would have an excess of $2,656 per month (Exhibit 5) or $2,523 per month (Exhibit 6)[11] from which payments to creditors could be made.[12]

The United States Trustee included both Mr. and Mrs. Lorenz's income and expenses in Exhibits 5 and 6 because they shared a common household and devoted the majority of their income to pay common household items. ER 249. The United States Trustee also introduced Exhibit 7, an analysis of Mr. Lorenz's income and expenses alone compared to pertinent IRS standards. This exhibit reflected that if Mr. Lorenz's expenses were reduced to IRS standards, he would have an excess of $596 per month that could be used to pay creditors. ER 233.

Some of the deductions that the United States Trustee included in Exhibits 5, 6, and 7 were overstated in a manner that favored Mr. Lorenz. For example, the United States Trustee included deductions for a household size of four even though Mr. Lorenz only had custody of his two children ten days a month. See ER 98, 206, 220, 233, 247. Similarly, because Mr. Lorenz had not yet filed his 2006 tax returns, and his tax status for 2007 was uncertain, the amount of income tax withholdings for Mr. Lorenz was shown as an amount that might be appropriate if Mr. Lorenz had no loss carry forwards. The testimony reflected that the actual amount of the taxes owed by Mr. Lorenz could be zero for a significant period of time regardless of his

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[11] Exhibit 6 was produced because counsel for Mr. Lorenz previously advised United States Trustee counsel of his position that the IRS Standards scheduled to go in effect on January 1, 2008 should be used rather than the Standards that were in effect when the case was filed. Both Exhibit 5 and Exhibit 6 were introduced to show that it didn't make a significant difference which Standards were used.

[12] Contrary to Mr. Lorenz's contention in his Appellant's Opening Brief, the United States Trustee did not assert that all of this amount had to be paid to Mr. Lorenz's creditors or that all of Mrs. Lorenz's disposable income had to be used to pay Mr. Lorenz's creditors. Rather, the United States Trustee consistently maintained that Mr. Lorenz could pay his creditors a significant amount if he lived more modestly. See, e.g., ER 100, 238, 284.

ongoing earnings. See ER 276-278.

The bankruptcy court denied the United States Trustee's motion to dismiss. The court acknowledged that Mr. Lorenz's expenses were "ridiculous ," ER 295, but found that even if his expenses were curtailed to what the court believed to be a reasonable amount, Mr. Lorenz could not make payments to his creditors. Two major factors leading to the court's conclusion were 1) the court's determination to look at Mr. Lorenz's income and expenses separately from those of his wife and 2) the court's conclusion that Mr. Lorenz was entitled to deduct expenses associated with a median priced home in the local area rather than expenses consistent with the IRS Standards for housing in the local area. Use of the median price housing numbers was an approach developed by the judge herself; it had not been argued by Mr. Lorenz's attorney.

The court's order denying dismissal of the debtor's case was entered on November 1, 2007. Thereafter, on November 28, 2007, Mr. Lorenz filed an application for attorney's fees under EAJA. Two days later, on November 30, 2007, the bankruptcy court issued an order denying Mr. Lorenz's motion for EAJA fees without setting a hearing, requiring a briefing, or considering evidence beyond what already was on record in the case.[13]

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[13] The record does not contain the additional information that might have been elicited in such a briefing or hearing. While this information might have assisted the bankruptcy court and this court in rendering a decision, the bankruptcy court had ample evidence from which to conclude that the government's position was substantially justified. If this court does not affirm, the case should be remanded. Matters that could be considered on remand include additional evidence demonstrating the reasonableness of the United States Trustee's position; whether or not the EAJA even applies in the context of 11 U.S.C. § 707(b), an issue that the bankruptcy court did not decide, ER 312, see also 11 U.S.C. § 707(b)(5); and, if EAJA fees were deemed applicable and warranted, the appropriate amount of the fees, particularly in light of the numerous unsuccessful theories advanced by Mr. Lorenz.

STANDARD OF REVIEW

An order denying attorney's fees under EAJA is reviewed on appeal for abuse of discretion. United States v. Marolf, 277 F.3d 1156, 1161 (9th Cir. 2002).

SUMMARY OF ARGUMENT

This court should affirm the bankruptcy court's order denying Mr. Lorenz's attorney fees under EAJA. The bankruptcy court correctly held that the United States Trustee's motion to dismiss Mr. Lorenz's chapter 7 case was substantially justified. The facts of Mr. Lorenz's case demonstrate that he was not the type of needy debtor for whom Congress intended Chapter 7 bankruptcy relief. The United States Trustee's position that Mr. Lorenz had an ability to repay creditors if he lived more modestly was more than substantially justified.[14] Other courts have upheld similar arguments by the United States Trustee.

ARGUMENT

I. Mr. Lorenz Fails to Demonstrate an Abuse of Discretion

Mr. Lorenz must demonstrate that the bankruptcy judge abused her discretion when denying his request for an EAJA award. This is a difficult standard to meet. Mr. Lorenz correctly points out in his opening brief that the standard requires an erroneous conclusion of law or **no** evidence in the record on which the judge could have based her decision. In re Petition of Hill, 775 F.2d 1037, 1040 (9th Cir. 1985) quoting Premium Service Corp. V. Sperry & Hutchinson Co., 511 F.2d 225, 229 (9th Cir. 1975)(emphasis supplied). Mr. Lorenz fails to

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[14] The United States Trustee believes that the position was not only justified but correct. However, the United States Trustee exercised her discretion not to appeal the bankruptcy court's order denying the motion to dismiss Mr. Lorenz's case.

satisfy either of these standards. First, he does not argue that the bankruptcy court made an erroneous conclusion of law.[15] Second, the record contained ample evidence on which the court based its decision.

The bankruptcy court did not deem it necessary to consider any response to Mr. Lorenz's EAJA motion to reach the conclusion that the United States Trustee's position was substantially justified. The court identified some of the evidence on which its judgment was based in the order denying the motion:

> This debtor had an $800,000 house, at least four vehicles on which he owed substantial amounts, and a wife who contributes a substantial amount to the household but who did not join in the bankruptcy petition. Although the court ultimately decided that, even given reasonable expenses, this debtor could not afford to make a meaningful payment to creditors, the UST was justified in challenging this debtor's use of the bankruptcy system, given the lifestyle he leads.

ER 313.

II. The United States Trustee's Position was Substantially Justified

A. A "Substantially Justified" Position Under the EAJA is a Reasonable Position

The EAJA provides that "a court shall award to a prevailing party other than the United States" reasonable attorney fees and expenses "incurred by that party in any civil action ... brought by or against the United States in any court having jurisdiction of that action, unless the court finds that the position of the United States was substantially justified or that special circumstances make an award unjust." 28 U.S.C. § 2412(d)(1)(A).

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[15] The bankruptcy court assumed, without deciding, that the legal standard was as represented by Mr. Lorenz. ER 312.

The Supreme Court of the United States has held that in the context of the EAJA, the term "substantially justified" does not mean "justified to a high degree." Rather it means:

> [J]ustified in substance or in the main–that is, justified to a degree that could satisfy a reasonable person. That is no different from the 'reasonable basis both in law and fact' formulation adopted by the Ninth Circuit and the vast majority of other Courts of Appeals that have addressed this issue.

Pierce v. Underwood, 487 U.S. 552, 565, 108 S.Ct. 2541 (1988).

B. Substantial Justification Does Not Require a "Win"

Mr. Lorenz appears to believe that because the United States Trustee's motion to dismiss was denied, the United States Trustee's position was not substantially justified. His opening brief states: "The UST took a position that was unsupported in law and fact in attempting to dismiss Mr. Lorenz's chapter 7 bankruptcy case. Their position was not substantially justified. They lost."

The mere fact that the United States Trustee failed to prevail on her motion to dismiss does not mean that her position was not substantially justified. The Ninth Circuit has repeatedly held that the fact the government "lost does not raise a presumption that its position was not substantially justified..." See, e.g., In re Petition of Hill, 775 F.2d 1037, 1042 (9th Cir. 1985). "To be substantially justified the government's position need not be 'correct'...." See Kiareldeen v. Ashcroft, 273 F.3d 542, 554 (3d Cir. 2001) (citing Pierce v. Underwood, 487 U.S. 552, 565, 566 n.2 (1988)). Nor does the government even "need [to] show that it had a substantial likelihood of prevailing." In re Petititon of Hill, 775 F.2d at 1042 (9th Cir. 1985).

C. The Unclear State of the Law and Complex Facts Weigh in the Government's Favor

The Ninth Circuit noted in Gutierrez v. Barnhart, 274 F.3d 1255, 1261-62 (9th Cir. 2001) that it has repeatedly held that the government's litigation position was substantially justified when the rules under which it operated were ambiguous and the government pursued a reasonable interpretation on which the Ninth Circuit had not previously ruled. Although there is no per se rule that EAJA fees cannot be awarded in a case of first impression, this factor is "an appropriate component of the inquiry into substantial justification." Kali v. Bowen, 854 F.2d 329, 332 n. 2 (9th Cir. 1988). See also TKB Int'l, Inc. v. United States, 995 F.2d 1460, 1468 (9th Cir 1993)(affirming denial of attorney's fees under 26 U.S.C. § 7430 where the "government's arguments both at trial and on appeal are based on supportable interpretations of federal tax statutes and case law").

This case involved sections of the BAPCPA which had only become effective on October 17, 2005. There were few local or appellate decisions under the new 11 U.S.C. § 707(b)(3). Moreover, the primary underlying issue in the case, the amount of expenses that are reasonable, is one as to which the trial court is given substantial discretion. The Ninth Circuit, in a case applying pre-BAPCPA law to the "substantial" abuse standard, described this discretion as follows with respect to allowable expenses:

> Requiring a fact-specific analysis to determine whether an expense is reasonably necessary is sound policy because it comports with the Code's approach to identifying substantial abuse of the Chapter 7 relief provisions. We have consistently held that § 707(b) does not include a "bright line test" for substantial abuse, but rather "commit[s] the question of what constitutes substantial abuse to the discretion of bankruptcy judges within the context of

> the Code." *Price*, 353 F.3d at 1140; *see also Kelly*, 841 F.2d at 916. 'Congress chose neither to define 'substantial abuse' in the 1984 Act nor to leave specific guidance in legislative history. Congress thus left a flexible standard enabling courts to address each petition on its own merit." *In re Lamanna*, 153 F.3d 1,3 (1st Cir 1998)(footnote omitted). That Congress granted courts the discretion to identify substantial abuse necessarily suggests it intended courts to have the discretion to answer the subsidiary question of whether particular expenses are reasonably necessary.

Hebbring v. U.S. Trustee, 463 F.3d 902, 907 (9th Cir. 2006).

In his opening brief, Mr. Lorenz attempts to characterize the case law as clear[16] and asserts that the UST was attempting to "push the envelope." Mr. Lorenz did not find the case law so clear at the time of trial. In fact, he then had a quite different perspective. He described aspects of the 11 U.S.C. § 707(b)(3) totality of circumstances test other than the ability to repay as follows: "Given the variety of facts in the tests imposed by other decisions it is clear that a trier of fact can look to any circumstances." ER 122. Mr. Lorenz also accurately described the 11 U.S.C. § 707(b)(3) ability to pay standard: "There is no bright line abuse test." ER 118. In discussing allowable expenses, the crux of this case, Mr. Lorenz stated in his trial brief: "Under a § 707(b)(3) motion to dismiss under totality of the circumstances the fact finder is given some leeway in deciding whether an expense is reasonable. **It is clear from the case law that the standard is arbitrary and dependent upon the individual fact finder making the assessment.**" ER 119 (emphasis supplied). Mr. Lorenz obviously recognized at the time of trial, if he does not now, that the

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[16] Mr. Lorenz does not describe what aspect of the case law is clear or cite to any cases that might elucidate his point.

ruling of a particular judge on what constitutes a reasonable expense is a matter of considerable uncertainty.

This case also presented factual complexities. The bankruptcy court noted that the case had "various layers of complication to it." ER 286. An analysis of the debtor's ability to repay was rendered more difficult by the fact that the debtor and his wife did not file a bankruptcy case together. This led to uncertainty as to what extent to include Mrs. Lorenz's income and deduct or include her expenses in an ability to repay analysis. Other factual complexities included substantial and ongoing changes in Mr. and Mrs. Lorenz's employment; changes in claimed expenses;[17] and uncertainty regarding Mr. Lorenz's ongoing tax liabilities (or lack thereof). See, e.g. ER 276-278.

D. The United States Trustee's Position on Consideration of Mrs. Lorenz's Income was Substantially Justified

Mr. Lorenz argues in his opening brief that the United States Trustee unjustifiably took the position that Mrs. Lorenz should contribute all of her income to pay off Mr. Lorenz's debts. Mr. Lorenz misstates the United States Trustee's position. See footnote 12, supra. The consideration of Mrs. Lorenz's income in the ability to repay analysis was supported by both the case law and the facts of the case. Moreover, the United States

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[17] For example, Exhibit 4, sent by Mr. Lorenz in late August 2007, represents that Mr. Lorenz's withholding tax obligation was $640 per month. ER 207. Mr. Lorenz agreed in the Joint Statement of Agreed Facts that this was his withholding tax obligation. ER 98, 209, 220. However, shortly before trial, Mr. Lorenz provided information that his monthly tax withholdings were $814. This figure, which was incorporated into Exhibit 7, caused an almost $200 per month decrease in Mr. Lorenz's disposable income.

Trustee's position was substantially justified even without the inclusion of Mrs. Lorenz's income, an analysis that the United States Trustee also presented.

1. It was Appropriate for the United States Trustee to Consider Mrs. Lorenz's Income in the Ability to Pay Analysis

It is appropriate for courts to consider the income of a non-filing spouse in an ability to repay analysis. In In re Haney, 2006 WL 3020961 (Bankr. W.D. Ky. 2006), for example, the court noted that the debtor and her husband operated as a single financial unit and concluded: "Spouses may not incur debts which overwhelmingly benefit both spouses and then have the spouse with the smallest income file for bankruptcy to discharge the debts." The court dismissed the debtor's case for bad faith under 11 U.S.C. § 707(b)(3). See also In re Adams, 2007 WL 3091583 (Bankr D. Md. 2007)(Court found that when debtor's husband's income was taken into account, debtor would be able to repay her debts if she had a reasonable budget); cf. In re Travis, 353 BR 520, 530 (Bankr. E.D. Mich. 2006)(non-filing spouse's income and expenses are relevant under a § 707(b) motion; non-filing spouse's income should be considered if it is substantial enough to raise the debtor's standard of living and generate total household income in excess of the reasonable costs of food, clothing, shelter, and other necessities).

Oregon precedent under the "substantial abuse" standard also discussed the necessity of considering a non-filing spouse's income in an ability to repay analysis. In re Falke, 284 B.R. 133 (Bankr D. Or. 2002). The bankruptcy court in Falke noted that most courts, at a minimum, required consideration of the non-debtor spouse's income. Under the facts of

Falke, where the spouses earned substantially the same income, the court held that the parties should share equally in the household expenses.

In this case, although much of Mr. Lorenz's general unsecured debt arose from the failure of his businesses, most of his total debt relates to consumer items titled and financed in his name alone, although both he and Mrs. Lorenz benefitted from its use.[18] Unlike cases in which spouses kept their income and expenses separate or the non-filing spouse did not contribute to joint household expenses, in this case, the Lorenzes pooled their income and expenses. Mr. Lorenz's own sworn document reflected that Mrs. Lorenz "contributed" $8,000 per month to the household as necessary. ER 59. The Joint Statement of Facts reflect joint expenses as did Exhibit 4, Mr. Lorenz's earlier communication regarding income and expenses. ER 98, 207.

2. The United States Trustee Introduced Evidence of Mr. Lorenz's Separate Income and Expenses

Although it was difficult divide the Lorenz's income and expenses given their method of handling finances, the United States Trustee attempted to do so in Exhibit 7. ER 233. This exhibit, which was admitted into evidence, also reflected a significant excess of income over expenses when Mr. Lorenz's separate situation was compared to IRS Standards. Although the court ultimately did not agree with the United States Trustee's

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[18] For example, of all of the $1,025,816 of secured debt referenced in Mr. Lorenz's Schedule D, including the house loans, the three Silverado loans, the two Harley loans, and the John Deere loan, Mrs. Lorenz appears to be obligated only on the debt to United Finance ($4,500) for the Quad Runner. See ER 29, 58.

numbers, the United States Trustee was substantially justified in asserting that Mr. Lorenz alone could make an effort to repay creditors.

E. The United States Trustee's Use of the IRS Financial Collection Standards was Reasonable

The United States Trustee argued that Mr. Lorenz could pay a significant amount to his unsecured creditors if he reduced his expenses to a reasonable amount. The largest expenses in Mr. Lorenz's budget related to his home. At the time of trial, Mr. Lorenz's mortgages, property taxes, and homeowner's insurance expenses alone totaled $5,756 per month. ER 233.

Historically, excessive housing expenses formed the basis for dismissal of cases for substantial abuse under § 707(b). See, e.g., In re Cox, 315 B.R. 850 (8th Cir. BAP 2004)(housing expense of $3,400 per month was not reasonable); In re Cook, 110 B.R. 544 (Bankr. N.D. Ok 1990)(housing expenses of $2,006 per month were excessive).

Excessive housing expenses continue to be an important factor in an ability to repay analysis under the BAPCPA.

> The U.S. Trustee also correctly notes that the 2005 bankruptcy amendments lowered the threshold in § 707(b) from "substantial abuse" to mere "abuse." Thus, courts have continued to look at the reasonableness of housing expenses when determining whether a case should be dismissed under the new provisions of 11 U.S.C. § 707(b)(3). *See In re O'Brien*, 2007 WL 1847390 (Bankr. N.D. Ohio June 25, 2007)(granting U.S.Trustee's motion to dismiss under § 707(b)(3) where debtors had a mortgage expense of $2,400 per month); *In re Zayas*, 2007 WL 987240 (Bankr. N.D. Ohio Apr. 2, 2007)(where debtors' mortgage payment of approximately $3,000.00 per month was twice the Local Standard, the court concluded that debtors could significantly reduce their expenses to fund a Chapter 13 plan by moving to a

> more affordable home. In particular, the court noted that the debtors do not have the right to live in a house of their choosing at the expense of their unsecured creditors).

In re Nissen, 2007 WL 2915648, 3 (Bankr. D. Neb. 2007).

The United States Trustee's use of the IRS Standards in a post-BAPCPA case[19] was reasonable given the extensive use of those standards in the BAPCPA and the decisional law from other jurisdictions that reference the Standards.

1. Congress and Courts Reference the Standards

Congress made extensive use of the Standards in the BAPCPA Means Test. 11 U.S.C. § 707(b)(2). In that context, at least one court has limited a debtor's housing expense to that established by the IRS Standards rather than allowing the amount of the debtor's actual rent. In In re Shinkle, ___ B.R. ____, 2008 WL 435183 (Bankr. E.D. Ky. 2008), the debtors argued that they should be able to deduct $658 in addition to the IRS housing allowance to accommodate the $1,500 that they actually paid for rent. The court held that the debtors had not demonstrated special circumstances pursuant to

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[19] The Ninth Circuit Bankruptcy Appellate Panel questioned the evidentiary value of the Standards in the case of In re Harris, 279 B.R. 254 (9th Cir. BAP 2002). In that case, the bankruptcy judge rejected the use of the standards as a basis for determining whether the debtors' expenses were reasonable. The judge nevertheless found that the case should be dismissed as a substantial abuse. The BAP reversed, finding that there was no evidence presented to support the court's finding. The In re Harris case is inapplicable to the case at bar. First, in this case, unlike In re Harris, the bankruptcy court allowed the United States Trustee's evidence incorporating the IRS Standards, overruling a directed verdict motion by Mr. Lorenz. ER 251-52. Second, the Standards' likely evidentiary weight increased markedly after Congress incorporated the Standards extensively in the BAPCPA.

11 U.S.C. § 707(b)(2)(B)[20] and that the case would dismissed unless the debtors voluntarily converted their case to one under another chapter.

Courts also consider the IRS Standards for housing when determining whether or not cases should be dismissed under 11 U.S.C. § 707(b)(3). For example, the bankruptcy court in the case of In re Edighoffer, 375 B.R. 789 (Bankr. N.D. Ohio 2007), decided that the debtor's case should be dismissed if the debtor did not convert to Chapter 13. The debtor intended to surrender her house and buy another one. She included a mortgage expense of $1,113 per month. The court recited that the applicable IRS standard for a family two was $531 and concluded that the debtor has or should have a mortgage expense significantly less than she claimed. The court found that the debtor "can allocate a reasonable amount toward housing expenses and still have disposable income to pay her unsecured creditors." 376 B.R. at 796. Similarly, the court in In re Gonzalez, 378 BR 168 (Bankr. N.D. Ohio 2007), questioned the accuracy and wisdom of the debtors allocating almost $2,200 toward their housing expenses compared to the applicable IRS Standard of $1,292. The court referenced the Means Test standards as a "pole for guidance" that "can be helpful when determining the reasonableness of a debtor's expenses under § 707(b)(3)." 378 B.R. at 175.

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[20] When the presumption of abuse arises under the Means Test, debtors must demonstrate special circumstances in order to rebut the presumption and obtain Chapter 7 relief.

2. Congress Intended that Debtors Have Adequate Housing, Not an Entitlement to a Median Priced Home

The bankruptcy court rejected the United States Trustee's argument that there were other, less expensive alternatives available to the debtors than a median priced home. See ER 293. Although the United States Trustee did not appeal, the United States Trustee believes that this determination was in error. As discussed supra, Congress meant to allow debtors who file Chapter 7 cases **adequate** expenses for reasonable costs of living. This is a different standard than allowing the level of expenses associated with the median priced home in a population comprised solely of only homeowners.

CONCLUSION

For these reasons, the United States Trustee respectfully asks that this court affirm the bankruptcy court's decision denying EAJA attorney fees to Mr. Lorenz.

Respectfully submitted,

ROBERT D. MILLER JR.
ACTING UNITED STATES TRUSTEE

/s/ Pamela J. Griffith
Pamela J. Griffith, OSB #81249
Assistant United States Trustee

Roberta A. DeAngelis
Sean E. Martin
Department of Justice
20 Massachusetts Ave., N.W.
Washington, D.C. 20530
phone: (202) 307-1399
fax: (202) 307-2397

Pamela J. Griffith
Office of the United States Trustee
Department of Justice
620 SW Main, Suite 213
Portland , OR 97205
phone: (503) 326-4004
fax: (503) 326-7658

APPENDIX

LEXSTAT 11 USCS § 101(13)

UNITED STATES CODE SERVICE

*** CURRENT THROUGH P.L. 110-190, APPROVED 2/28/2008 ***

TITLE 11. BANKRUPTCY
CHAPTER 1. GENERAL PROVISIONS

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11 USCS § 101

§ 101. Definitions

In this title the following definitions shall apply:

(1) The term "accountant" means accountant authorized under applicable law to practice public accounting, and includes professional accounting association, corporation, or partnership, if so authorized.

(2) The term "affiliate" means--

(A) entity that directly or indirectly owns, controls, or holds with power to vote, 20 percent or more of the outstanding voting securities of the debtor, other than an entity that holds such securities--

(i) in a fiduciary or agency capacity without sole discretionary power to vote such securities; or

(ii) solely to secure a debt, if such entity has not in fact exercised such power to vote;

(B) corporation 20 percent or more of whose outstanding voting securities are directly or indirectly owned, controlled, or held with power to vote, by the debtor, or by an entity that directly or indirectly owns, controls, or holds with power to vote, 20 percent or more of the outstanding voting securities of the debtor, other than an entity that holds such securities--

(i) in a fiduciary or agency capacity without sole discretionary power to vote such securities; or

(ii) solely to secure a debt, if such entity has not in fact exercised such power to vote;

(C) person whose business is operated under a lease or operating agreement by a debtor, or person substantially all of whose property is operated under an operating agreement with the debtor; or

(D) entity that operates the business or substantially all of the property of the debtor under a lease or operating agreement.

(3) The term "assisted person" means any person whose debts consist primarily of consumer debts and the value of whose nonexempt property is less than $ 164,250.

(4) The term "attorney" means attorney, professional law association, corporation, or partnership, authorized under applicable law to practice law.

(4A) The term "bankruptcy assistance" means any goods or services sold or otherwise provided to an assisted person with the express or implied purpose of providing information, advice, counsel, document preparation, or filing, or attendance at a creditors' meeting or appearing in a case or proceeding on behalf of another or providing legal representation with respect to a case or proceeding under this title.

(5) The term "claim" means--

(A) right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured; or

(B) right to an equitable remedy for breach of performance if such breach gives rise to a right to payment, whether or not such right to an equitable remedy is reduced to judgment, fixed, contingent, matured, unmatured, disputed, undisputed, secured, or unsecured.

(6) The term "commodity broker" means futures commission merchant, foreign futures commission merchant, clearing organization, leverage transaction merchant, or commodity options dealer, as defined in section 761 of this *title [11 USCS § 761*], with respect to which there is a customer, as defined in section 761 of this *title [11 USCS § 761*].

(7) The term "community claim" means claim that arose before the commencement of the case concerning the debtor for which property of the kind specified in section 541(a)(2) of this *title [11 USCS § 541(a)(2)*] is liable, whether or not there is any such property at the time of the commencement of the case.

(7A) The term "commercial fishing operation" means--

(A) the catching or harvesting of fish, shrimp, lobsters, urchins, seaweed, shellfish, or other aquatic species or products of such species; or

(B) for purposes of section 109 [*11 USCS § 109*] and chapter 12 [*11 USCS §§ 1201* et seq.], aquaculture activities consisting of raising for market any species or product described in subparagraph (A).

(7B) The term "commercial fishing vessel" means a vessel used by a family fisherman to carry out a commercial fishing operation.

(8) The term "consumer debt" means debt incurred by an individual primarily for a personal, family, or household purpose.

(9) The term "corporation"--

(A) includes--

(i) association having a power or privilege that a private corporation, but not an individual or a partnership, possesses;

(ii) partnership association organized under a law that makes only the capital subscribed responsible for the debts of such association;

(iii) joint-stock company;

(iv) unincorporated company or association; or

(v) business trust; but

(B) does not include limited partnership.

(10) The term "creditor" means--

(A) entity that has a claim against the debtor that arose at the time of or before the order for relief concerning the debtor;

(B) entity that has a claim against the estate of a kind specified in section 348(d), 502(f), 502(g), 502(h) or 502(i) of this *title [11 USCS § 348(d), 502(f), 502(g), 502(h)* or *502(i)*]; or

(C) entity that has a community claim.

(10A) The term "current monthly income"--

(A) means the average monthly income from all sources that the debtor receives (or in a joint case the debtor and the debtor's spouse receive) without regard to whether such income is taxable income, derived during the 6-month period ending on--

(i) the last day of the calendar month immediately preceding the date of the commencement of the case if the debtor files the schedule of current income required by section 521(a)(1)(B)(ii) [*11 USCS § 521(a)(1)(B)(ii)*]; or

(ii) the date on which current income is determined by the court for purposes of this title if the debtor does not file the schedule of current income required by section 521(a)(1)(B)(ii) [*11 USCS § 521(a)(1)(B)(ii)*]; and

(B) includes any amount paid by any entity other than the debtor (or in a joint case the debtor and the debtor's spouse), on a regular basis for the household expenses of the debtor or the debtor's dependents (and in a joint case the debtor's spouse if not otherwise a dependent), but excludes benefits received under the Social Security Act [*42 USCS §§ 301* et seq.], payments to victims of war crimes or crimes against humanity on account of their status as victims of such crimes, and payments to victims of international terrorism (as defined in section 2331 of title 18 [*18 USCS § 2331*]) or domestic terrorism (as defined in section 2331 of title 18 [*18 USCS § 2331*]) on account of their status as victims of such terrorism.

(11) The term "custodian" means--

(A) receiver or trustee of any of the property of the debtor, appointed in a case or proceeding not under this title;

(B) assignee under a general assignment for the benefit of the debtor's creditors; or

(C) trustee, receiver, or agent under applicable law, or under a contract, that is appointed or authorized to take charge of property of the debtor for the purpose of enforcing a lien against such property, or for the purpose of general administration of such property for the benefit of the debtor's creditors.

(12) The term "debt" means liability on a claim.

(12A) The term "debt relief agency" means any person who provides any bankruptcy assistance to an assisted person in return for the payment of money or other valuable consideration, or who is a bankruptcy petition preparer under section 110 [*11 USCS § 110*], but does not include--

(A) any person who is an officer, director, employee, or agent of a person who provides such assistance or of the bankruptcy petition preparer;

(B) a nonprofit organization that is exempt from taxation under *section 501(c)(3) of the Internal Revenue Code of 1986* [*26 USCS § 501(c)(3)*];

(C) a creditor of such assisted person, to the extent that the creditor is assisting such assisted person to restructure any debt owed by such assisted person to the creditor;

(D) a depository institution (as defined in section 3 of the Federal Deposit Insurance Act [*12 USCS § 1813*]) or any Federal credit union or State credit union (as those terms are defined in section 101 of the Federal Credit Union Act [*12 USCS § 1752*]), or any affiliate or subsidiary of such depository institution or credit union; or

(E) an author, publisher, distributor, or seller of works subject to copyright protection under title 17 [*17 USCS §§ 101* et seq.], when acting in such capacity.

(13) The term "debtor" means person or municipality concerning which a case under this title has been commenced.

(13A) The term "debtor's principal residence"--

(A) means a residential structure, including incidental property, without regard to whether that structure is attached to real property; and

(B) includes an individual condominium or cooperative unit, a mobile or manufactured home, or trailer.

(14) The term "disinterested person" means a person that--

(A) is not a creditor, an equity security holder, or an insider;

(B) is not and was not, within 2 years before the date of the filing of the petition, a director, officer, or employee of the debtor; and

(C) does not have an interest materially adverse to the interest of the estate or of any class of creditors or equity security holders, by reason of any direct or indirect relationship to, connection with, or interest in, the debtor, or for any other reason.

(14A) The term "domestic support obligation" means a debt that accrues before, on, or after the date of the order for relief in a case under this title, including interest that accrues on that debt as provided under applicable nonbankruptcy law notwithstanding any other provision of this title, that is--

(A) owed to or recoverable by--

(i) a spouse, former spouse, or child of the debtor or such child's parent, legal guardian, or responsible relative; or

(ii) a governmental unit;

(B) in the nature of alimony, maintenance, or support (including assistance provided by a governmental unit) of such spouse, former spouse, or child of the debtor or such child's parent, without regard to whether such debt is expressly so designated;

(C) established or subject to establishment before, on, or after the date of the order for relief in a case under this title, by reason of applicable provisions of--

(i) a separation agreement, divorce decree, or property settlement agreement;

(ii) an order of a court of record; or

(iii) a determination made in accordance with applicable nonbankruptcy law by a governmental unit; and

(D) not assigned to a nongovernmental entity, unless that obligation is assigned voluntarily by the spouse, former spouse, child of the debtor, or such child's parent, legal guardian, or responsible relative for the purpose of collecting the debt.

(15) The term "entity" includes person, estate, trust, governmental unit, and United States trustee.

(16) The term "equity security" means--

(A) share in a corporation, whether or not transferable or denominated "stock", or similar security;

(B) interest of a limited partner in a limited partnership; or

(C) warrant or right, other than a right to convert, to purchase, sell, or subscribe to a share, security, or interest of a kind specified in subparagraph (A) or (B) of this paragraph.

(17) The term "equity security holder" means holder of an equity security of the debtor.

(18) The term "family farmer" means--

(A) individual or individual and spouse engaged in a farming operation whose aggregate debts do not exceed $ 3,544,525 and not less than 50 percent of whose aggregate noncontingent, liquidated debts (excluding a debt for the principal residence of such individual or such individual and spouse unless such debt arises out of a farming operation), on the date the case is filed, arise out of a farming operation owned or operated by such individual or such individual and spouse, and such individual or such individual and spouse receive from such farming operation more than 50 percent of such individual's or such individual and spouse's gross income for--

(i) the taxable year preceding; or

(ii) each of the 2d and 3d taxable years preceding;

the taxable year in which the case concerning such individual or such individual and spouse was filed; or

(B) corporation or partnership in which more than 50 percent of the outstanding stock or equity is held by one family, or by one family and the relatives of the members of such family, and such family or such relatives conduct the farming operation, and

(i) more than 80 percent of the value of its assets consists of assets related to the farming operation;

(ii) its aggregate debts do not exceed $ 3,544,525 and not less than 50 percent of its aggregate noncontingent, liquidated debts (excluding a debt for one dwelling which is owned by such corporation or partnership and which a shareholder or partner maintains as a principal residence, unless such debt arises out of a farming operation), on the date the case is filed, arise out of the farming operation owned or operated by such corporation or such partnership; and

(iii) if such corporation issues stock, such stock is not publicly traded.

(19) The term "family farmer with regular annual income" means family farmer whose annual income is sufficiently stable and regular to enable such family farmer to make payments under a plan under chapter 12 of this *title [11 USCS §§ 1201* et seq.].

(19A) The term "family fisherman" means--

(A) an individual or individual and spouse engaged in a commercial fishing operation--

(i) whose aggregate debts do not exceed $ 1,642,500 and not less than 80 percent of whose aggregate noncontingent, liquidated debts (excluding a debt for the principal residence of such individual or such individual and spouse, unless such debt arises out of a commercial fishing operation), on the date the case is filed, arise out of a commercial fishing operation owned or operated by such individual or such individual and spouse; and

(ii) who receive from such commercial fishing operation more than 50 percent of such individual's or such individual's and spouse's gross income for the taxable year preceding the taxable year in which the case concerning such individual or such individual and spouse was filed; or

(B) a corporation or partnership--

(i) in which more than 50 percent of the outstanding stock or equity is held by--

(I) 1 family that conducts the commercial fishing operation; or

(II) 1 family and the relatives of the members of such family, and such family or such relatives conduct the commercial fishing operation; and

(ii)

(I) more than 80 percent of the value of its assets consists of assets related to the commercial fishing operation;

(II) its aggregate debts do not exceed $ 1,642,500 and not less than 80 percent of its aggregate noncontingent, liquidated debts (excluding a debt for 1 dwelling which is owned by such corporation or partnership and which a shareholder or partner maintains as a principal residence, unless such debt arises out of a commercial fishing operation), on the date the case is filed, arise out of a commercial fishing operation owned or operated by such corporation or such partnership; and

(III) if such corporation issues stock, such stock is not publicly traded.

(19B) The term "family fisherman with regular annual income" means a family fisherman whose annual income is sufficiently stable and regular to enable such family fisherman to make payments under a plan under chapter 12 of this *title [11 USCS §§ 1201* et seq.].

(20) The term "farmer" means (except when such term appears in the term "family farmer") person that received more than 80 percent of such person's gross income during the taxable year of such person immediately preceding the taxable year of such person during which the case under this title concerning such person was commenced from a farming operation owned or operated by such person.

(21) The term "farming operation" includes farming, tillage of the soil, dairy farming, ranching, production or raising of crops, poultry, or livestock, and production of poultry or livestock products in an unmanufactured state.

(21A) The term "farmout agreement" means a written agreement in which--

(A) the owner of a right to drill, produce, or operate liquid or gaseous hydrocarbons on property agrees or has agreed to transfer or assign all or a part of such right to another entity; and

(B) such other entity (either directly or through its agents or its assigns), as consideration, agrees to perform drilling, reworking, recompleting, testing, or similar or related operations, to develop or produce liquid or gaseous hydrocarbons on the property.

(21B) The term "Federal depository institutions regulatory agency" means--

(A) with respect to an insured depository institution (as defined in section 3(c)(2) of the Federal Deposit Insurance Act [*12 USCS § 1813(c)(2)*]) for which no conservator or receiver has been appointed, the appropriate Federal banking agency (as defined in section 3(q) of such Act [*12 USCS § 1813(q)*]);

(B) with respect to an insured credit union (including an insured credit union for which the National Credit Union Administration has been appointed conservator or liquidating agent), the National Credit Union Administration;

(C) with respect to any insured depository institution for which the Resolution Trust Corporation has been appointed conservator or receiver, the Resolution Trust Corporation; and

(D) with respect to any insured depository institution for which the Federal Deposit Insurance Corporation has been appointed conservator or receiver, the Federal Deposit Insurance Corporation.

(22) The term "financial institution" means--

(A) a Federal reserve bank, or an entity that is a commercial or savings bank, industrial savings bank, savings and loan association, trust company, federally-insured credit union, or receiver, liquidating agent, or conservator for such entity and, when any such Federal reserve bank, receiver, liquidating agent, conservator or entity is acting as agent or custodian for a customer (whether or not a "customer", as defined in section 741 [*11 USCS § 741*]) in connection with a securities contract (as defined in section 741 [*11 USCS § 741*]) such customer; or

(B) in connection with a securities contract (as defined in section 741 [*11 USCS § 741*]) an investment company registered under the Investment Company Act of 1940.

(22A) The term "financial participant" means--

(A) an entity that, at the time it enters into a securities contract, commodity contract, swap agreement, repurchase agreement, or forward contract, or at the time of the date of the filing of the petition, has one or more agreements or transactions described in paragraph (1), (2), (3), (4), (5), or (6) of section 561(a) [*11 USCS § 561(a)*] with the debtor or any other entity (other than an affiliate) of a total gross dollar value of not less than $ 1,000,000,000 in notional or actual principal amount outstanding (aggregated across counterparties) at such time or on any day during the 15-month period preceding the date of the filing of the petition, or has gross mark-to-market positions of not less than $ 100,000,000 (aggregated across counterparties) in one or more such agreements or transactions with the debtor or any other entity (other than an affiliate) at such time or on any day during the 15-month period preceding the date of the filing of the petition; or

(B) a clearing organization (as defined in section 402 of the Federal Deposit Insurance Corporation Improvement Act of 1991 [*12 USCS § 4402*]).

(23) The term "foreign proceeding" means a collective judicial or administrative proceeding in a foreign country, including an interim proceeding, under a law relating to insolvency or adjustment of debt in which proceeding the assets and affairs of the debtor are subject to control or supervision by a foreign court, for the purpose of reorganization or liquidation.

(24) The term "foreign representative" means a person or body, including a person or body appointed on an interim basis, authorized in a foreign proceeding to administer the reorganization or the liquidation of the debtor's assets or affairs or to act as a representative of such foreign proceeding.

(25) The term "forward contract" means--

(A) a contract (other than a commodity contract, as defined in section 761 [*11 USCS § 761*]) for the purchase, sale, or transfer of a commodity, as defined in section 761(8) of this *title [11 USCS § 761(8)*], or any similar good, article, service, right, or interest which is presently or in the future becomes the subject of dealing in the forward contract trade, or product or byproduct thereof, with a maturity date more than two days after the date the contract is entered into, including, but not limited to, a repurchase or reverse repurchase transaction (whether or not such repurchase or reverse repurchase transaction is a "repurchase agreement", as defined in this section)[,] consignment, lease, swap, hedge transaction, deposit, loan, option, allocated transaction, unallocated transaction, or any other similar agreement;

(B) any combination of agreements or transactions referred to in subparagraphs (A) and (C);

(C) any option to enter into an agreement or transaction referred to in subparagraph (A) or (B);

(D) a master agreement that provides for an agreement or transaction referred to in subparagraph (A), (B), or (C), together with all supplements to any such master agreement, without regard to whether such master agreement provides for an agreement or transaction that is not a forward contract under this paragraph, except that such master agreement shall be considered to be a forward contract under this paragraph only with respect to each agreement or transaction under such master agreement that is referred to in subparagraph (A), (B), or (C); or

(E) any security agreement or arrangement, or other credit enhancement related to any agreement or transaction referred to in subparagraph (A), (B), (C), or (D), including any guarantee or reimbursement obligation by or to a forward contract merchant or financial participant in connection with any agreement or transaction referred to in any such subparagraph, but not to exceed the damages in connection with any such agreement or transaction, measured in accordance with section 562 [*11 USCS § 562*].

(26) The term "forward contract merchant" means a Federal reserve bank, or an entity the business of which consists in whole or in part of entering into forward contracts as or with merchants in a commodity (as defined in section 761 [*11 USCS § 761*]) or any similar good, article, service, right, or interest which is presently or in the future becomes the subject of dealing in the forward contract trade.

(27) The term "governmental unit" means United States; State; Commonwealth; District; Territory; municipality; foreign state; department, agency, or instrumentality of the United States (but not a United States trustee while serving as a trustee in a case under this title), a State, a Commonwealth, a District, a Territory, a municipality, or a foreign state; or other foreign or domestic government.

(27A) The term "health care business"--

(A) means any public or private entity (without regard to whether that entity is organized for profit or not for profit) that is primarily engaged in offering to the general public facilities and services for--

(i) the diagnosis or treatment of injury, deformity, or disease; and

(ii) surgical, drug treatment, psychiatric, or obstetric care; and

(B) includes--

(i) any--

(I) general or specialized hospital;

(II) ancillary ambulatory, emergency, or surgical treatment facility;

(III) hospice;

(IV) home health agency; and

(V) other health care institution that is similar to an entity referred to in subclause (I), (II), (III), or (IV); and

(ii) any long-term care facility, including any--

(I) skilled nursing facility;

(II) intermediate care facility;

(III) assisted living facility;

(IV) home for the aged;

(V) domiciliary care facility; and

(VI) health care institution that is related to a facility referred to in subclause (I), (II), (III), (IV), or (V), if that institution is primarily engaged in offering room, board, laundry, or personal assistance with activities of daily living and incidentals to activities of daily living.

(27B) The term "incidental property" means, with respect to a debtor's principal residence--

(A) property commonly conveyed with a principal residence in the area where the real property is located;

(B) all easements, rights, appurtenances, fixtures, rents, royalties, mineral rights, oil or gas rights or profits, water rights, escrow funds, or insurance proceeds; and

(C) all replacements or additions.

(28) The term "indenture" means mortgage, deed of trust, or indenture, under which there is outstanding a security, other than a voting-trust certificate, constituting a claim against the debtor, a claim secured by a lien on any of the debtor's property, or an equity security of the debtor.

(29) The term "indenture trustee" means trustee under an indenture.

(30) The term "individual with regular income" means individual whose income is sufficiently stable and regular to enable such individual to make payments under a plan under chapter 13 of this *title [11 USCS §§ 1301* et seq.], other than a stockbroker or a commodity broker.

(31) The term "insider" includes--

(A) if the debtor is an individual--

(i) relative of the debtor or of a general partner of the debtor;

(ii) partnership in which the debtor is a general partner;

(iii) general partner of the debtor; or

(iv) corporation of which the debtor is a director, officer, or person in control;

(B) if the debtor is a corporation--

(i) director of the debtor;

(ii) officer of the debtor;

(iii) person in control of the debtor;

(iv) partnership in which the debtor is a general partner;

(v) general partner of the debtor; or

(vi) relative of a general partner, director, officer, or person in control of the debtor;

(C) if the debtor is a partnership--

(i) general partner in the debtor;

(ii) relative of a general partner in, general partner of, or person in control of the debtor;

(iii) partnership in which the debtor is a general partner;

(iv) general partner of the debtor; or

(v) person in control of the debtor;

(D) if the debtor is a municipality, elected official of the debtor or relative of an elected official of the debtor;

(E) affiliate, or insider of an affiliate as if such affiliate were the debtor; and

(F) managing agent of the debtor.

(32) The term "insolvent" means--

(A) with reference to an entity other than a partnership and a municipality, financial condition such that the sum of such entity's debts is greater than all of such entity's property, at a fair valuation, exclusive of--

(i) property transferred, concealed, or removed with intent to hinder, delay, or defraud such entity's creditors; and

(ii) property that may be exempted from property of the estate under section 522 of this *title [11 USCS § 522*];

(B) with reference to a partnership, financial condition such that the sum of such partnership's debts is greater than the aggregate of, at a fair valuation--

(i) all of such partnership's property, exclusive of property of the kind specified in subparagraph (A)(i) of this paragraph; and

(ii) the sum of the excess of the value of each general partner's nonpartnership property, exclusive of property of the kind specified in subparagraph (A) of this paragraph, over such partner's nonpartnership debts; and

(C) with reference to a municipality, financial condition such that the municipality is--

(i) generally not paying its debts as they become due unless such debts are the subject of a bona fide dispute; or

(ii) unable to pay its debts as they become due.

(33) The term "institution-affiliated party"--

(A) with respect to an insured depository institution (as defined in section 3(c)(2) of the Federal Deposit Insurance Act [*12 USCS § 1813(c)(2)*]), has the meaning given it in section 3(u) of the Federal Deposit Insurance Act [*12 USCS §*

1813(u)]; and

(B) with respect to an insured credit union, has the meaning given it in section 206(r) of the Federal Credit Union Act [*12 USCS § 1786(r)*].

(34) The term "insured credit union" has the meaning given it in section 101(7) of the Federal Credit Union Act [*12 USCS § 1752(7)*].

(35) The term "insured depository institution"--

(A) has the meaning given it in section 3(c)(2) of the Federal Deposit Insurance Act [*12 USCS § 1813(c)(2)*]; and

(B) includes an insured credit union (except in the case of paragraphs (23) and (35) of this subsection).

(35A) The term "intellectual property" means--

(A) trade secret;

(B) invention, process, design, or plant protected under title 35 [*35 USCS §§ 1* et seq.];

(C) patent application;

(D) plant variety;

(E) work of authorship protected under title 17 [*17 USCS §§ 101* et seq.]; or

(F) mask work protected under chapter 9 of title 17 [*17 USCS §§ 901* et seq.];

to the extent protected by applicable nonbankruptcy law.

(36) The term "judicial lien" means lien obtained by judgment, levy, sequestration, or other legal or equitable process or proceeding.

(37) The term "lien" means charge against or interest in property to secure payment of a debt or performance of an obligation.

(38) The term "margin payment" means, for purposes of the forward contract provisions of this title, payment or deposit of cash, a security or other property, that is commonly known in the forward contract trade as original margin, initial margin, maintenance margin, or variation margin, including mark-to-market payments, or variation payments.

(38A) "master netting agreement"--

(A) means an agreement providing for the exercise of rights, including rights of netting, setoff, liquidation, termination, acceleration, or close out, under or in connection with one or more contracts that are described in any one or more of paragraphs (1) through (5) of section 561(a) [*11 USCS § 561(a)*], or any security agreement or arrangement or other credit enhancement related to one or more of the foregoing, including any guarantee or reimbursement obligation related to 1 or more of the foregoing; and

(B) if the agreement contains provisions relating to agreements or transactions that are not contracts described in paragraphs (1) through (5) of section 561(a) [*11 USCS § 561(a)*], shall be deemed to be a master netting agreement only with respect to those agreements or transactions that are described in any one or more of paragraphs (1) through (5) of section 561(a) [*11 USCS § 561(a)*].

(38B) The term "master netting agreement participant" means an entity that, at any time before the date of the filing of the petition, is a party to an outstanding master netting agreement with the debtor.

(39) The term "mask work" has the meaning given it in section 901(a)(2) of title 17 [*17 USCS § 901(a)(2)*].

(39A) The term "median family income" means for any year--

(A) the median family income both calculated and reported by the Bureau of the Census in the then most recent year; and

(B) if not so calculated and reported in the then current year, adjusted annually after such most recent year until the next year in which median family income is both calculated and reported by the Bureau of the Census, to reflect the percentage change in the Consumer Price Index for All Urban Consumers during the period of years occurring after such most recent year and before such current year.

(40) The term "municipality" means political subdivision or public agency or instrumentality of a State.

(40A) The term "patient" means any individual who obtains or receives services from a health care business.

(40B) The term "patient records" means any written document relating to a patient or a record recorded in a magnetic, optical, or other form of electronic medium.

(41) The term "person" includes individual, partnership, and corporation, but does not include governmental unit, except that a governmental unit that--

(A) acquires an asset from a person--

(i) as a result of the operation of a loan guarantee agreement; or

(ii) as receiver or liquidating agent of a person;

(B) is a guarantor of a pension benefit payable by or on behalf of the debtor or an affiliate of the debtor; or

(C) is the legal or beneficial owner of an asset of--

(i) an employee pension benefit plan that is a governmental plan, as defined in *section 414(d) of the Internal Revenue Code of 1986* [*26 USCS § 414(d)*]; or

(ii) an eligible deferred compensation plan, as defined in *section 457(b) of the Internal Revenue Code of 1986* [*26 USCS § 457(b)*];

shall be considered, for purposes of section 1102 of this *title [11 USCS § 1102*], to be a person with respect to such asset or such benefit.

(41A) The term "personally identifiable information" means--

(A) if provided by an individual to the debtor in connection with obtaining a product or a service from the debtor primarily for personal, family, or household purposes--

(i) the first name (or initial) and last name of such individual, whether given at birth or time of adoption, or resulting from a lawful change of name;

(ii) the geographical address of a physical place of residence of such individual;

(iii) an electronic address (including an e-mail address) of such individual;

(iv) a telephone number dedicated to contacting such individual at such physical place of residence;

(v) a social security account number issued to such individual; or

(vi) the account number of a credit card issued to such individual; or

(B) if identified in connection with 1 or more of the items of information specified in subparagraph (A)--

(i) a birth date, the number of a certificate of birth or adoption, or a place of birth; or

(ii) any other information concerning an identified individual that, if disclosed, will result in contacting or identifying such individual physically or electronically.

(42) The term "petition" means petition filed under section 301, 302, 303, or 304 of this *title [11 USCS § 301*, *302*, *303*], as the case may be, commencing a case under this title.

(42A) The term "production payment" means a term overriding royalty satisfiable in cash or in kind--

(A) contingent on the production of a liquid or gaseous hydrocarbon from particular real property; and

(B) from a specified volume, or a specified value, from the liquid or gaseous hydrocarbon produced from such property, and determined without regard to production costs.

(43) The term "purchaser" means transferee of a voluntary transfer, and includes immediate or immediate transferee of such a transferee.

(44) The term "railroad" means common carrier by railroad engaged in the transportation of individuals or property or owner of trackage facilities leased by such a common carrier.

(45) The term "relative" means individual related by affinity or consanguinity within the third degree as determined by the common law, or individual in a step or adoptive relationship within such third degree.

(46) The term "repo participant" means an entity that, at any time before the filing of the petition, has an outstanding repurchase agreement with the debtor.

(47) The term "repurchase agreement" (which definition also applies to a reverse repurchase agreement)--

(A) means--

(i) an agreement, including related terms, which provides for the transfer of one or more certificates of deposit, mortgage related securities (as defined in section 3 of the Securities Exchange Act of 1934 [*15 USCS § 78c*]), mortgage loans, interests in mortgage related securities or mortgage loans, eligible bankers' acceptances, qualified foreign government securities (defined as a security that is a direct obligation of, or that is fully guaranteed by, the central government of a member of the Organization for Economic Cooperation and Development), or securities that are direct obligations of, or that are fully guaranteed by, the United States or any agency of the United States against the transfer of funds by the transferee of such certificates of deposit, eligible bankers' acceptances, securities, mortgage loans, or interests, with a simultaneous agreement by such transferee to transfer to the transferor thereof certificates of deposit, eligible bankers' acceptance, securities, mortgage loans, or interests of the kind described in this clause, at a date certain not later than 1 year after such transfer or on demand, against the transfer of funds;

(ii) any combination of agreements or transactions referred to in clauses (i) and (iii);

(iii) an option to enter into an agreement or transaction referred to in clause (i) or (ii);

(iv) a master agreement that provides for an agreement or transaction referred to in clause (i), (ii), or (iii), together with all supplements to any such master agreement, without regard to whether such master agreement provides for an agreement or transaction that is not a repurchase agreement under this paragraph, except that such master agreement shall be considered to be a repurchase agreement under this paragraph only with respect to each agreement or transaction under the master agreement that is referred to in clause (i), (ii), or (iii); or

(v) any security agreement or arrangement or other credit enhancement related to any agreement or transaction referred to in clause (i), (ii), (iii), or (iv), including any guarantee or reimbursement obligation by or to a repo participant or financial participant in connection with any agreement or transaction referred to in any such clause, but not to exceed the damages in connection with any such agreement or transaction, measured in accordance with section 562 of this *title [11 USCS § 562*]; and

(B) does not include a repurchase obligation under a participation in a commercial mortgage loan.

(48) The term "securities clearing agency" means person that is registered as a clearing agency under section 17A of the Securities Exchange Act of 1934 [*15 USCS § 78q-1*], or exempt from such registration under such section pursuant to an order of the Securities and Exchange Commission, or whose business is confined to the performance of functions of a clearing agency with respect to exempted securities, as defined in section 3(a)(12) of such Act [*15 USCS § 78c(a)(12)*] for the purposes of such section 17A [*15 USCS § 78q-1*].

(48A) The term "securities self regulatory organization" means either a securities association registered with the Securities and Exchange Commission under section 15A of the Securities Exchange Act of 1934 [*15 USCS § 78o-3*] or a national securities exchange registered with the Securities and Exchange Commission under section 6 of the Securities Exchange Act of 1934 [*15 USCS § 78f*].

(49) The term "security"--

(A) includes--

(i) note;

(ii) stock;

(iii) treasury stock;

(iv) bond;

(v) debenture;

(vi) collateral trust certificate;

(vii) pre-organization certificate or subscription;

(viii) transferable share;

(ix) voting-trust certificate;

(x) certificate of deposit;

(xi) certificate of deposit for security;

(xii) investment contract or certificate of interest or participation in a profit-sharing agreement or in an oil, gas, or mineral royalty or lease, if such contract or interest is required to be the subject of a registration statement filed with the Securities and Exchange Commission under the provisions of the Securities Act of 1933 [*15 USCS §§ 77a* et seq.], or is exempt under section 3(b) of such Act [*15 USCS § 77c(b)*] from the requirement to file such a statement;

(xiii) interest of a limited partner in a limited partnership;

(xiv) other claim or interest commonly known as "security"; and

(xv) certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase or sell, a security; but

(B) does not include--

(i) currency, check, draft, bill of exchange, or bank letter of credit;

(ii) leverage transaction, as defined in section 761 of this *title [11 USCS § 761*];

(iii) commodity futures contract or forward contract;

(iv) option, warrant, or right to subscribe to or purchase or sell a commodity futures contract;

(v) option to purchase or sell a commodity;

(vi) contract or certificate of a kind specified in subparagraph (A)(xii) of this paragraph that is not required to be the subject of a registration statement filed with the Securities and Exchange Commission and is not exempt under section 3(b) of the Securities Act of 1933 [*15 USCS § 77c(b)*] from the requirement to file such a statement; or

(vii) debt or evidence of indebtedness for goods sold and delivered or services rendered.

(50) The term "security agreement" means agreement that creates or provides for a security interest.

(51) The term "security interest" means lien created by an agreement.

(51A) The term "settlement payment" means, for purposes of the forward contract provisions of this title, a preliminary settlement payment, a partial settlement payment, an interim settlement payment, a settlement payment on account, a final settlement payment, a net settlement payment, or any other similar payment commonly used in the forward contract trade.

(51B) The term "single asset real estate" means real property constituting a single property or project, other than residential real property with fewer than 4 residential units, which generates substantially all of the gross income of a debtor who is not a family farmer and on which no substantial business is being conducted by a debtor other than the business of operating the real property and activities incidental.

(51C) The term "small business case" means a case filed under chapter 11 of this title in which the debtor is a small business debtor.

(51D) The term "small business debtor"--

(A) subject to subparagraph (B), means a person engaged in commercial or business activities (including any affiliate of such person that is also a debtor under this title and excluding a person whose primary activity is the business of owning or operating real property or activities incidental thereto) that has aggregate noncontingent liquidated secured and unsecured debts as of the date of the petition or the date of the order for relief in an amount not more than $ 2,190,000 (excluding debts owed to 1 or more affiliates or insiders) for a case in which the United States trustee has not appointed under section 1102(a)(1) [*11 USCS § 1102(a)(1)*] a committee of unsecured creditors or where the court has determined that the committee of unsecured creditors is not sufficiently active and representative to provide effective oversight of the debtor; and

(B) does not include any member of a group of affiliated debtors that has aggregate noncontingent liquidated secured and unsecured debts in an amount greater than $ 2,190,000 (excluding debt owed to 1 or more affiliates or insiders).

(52) The term "State" includes the District of Columbia and Puerto Rico, except for the purpose of defining who may be a debtor under chapter 9 of this *title [11 USCS §§ 901* et seq.].

(53) The term "statutory lien" means lien arising solely by force of a statute on specified circumstances or conditions, or lien of distress for rent, whether or not statutory, but does not include security interest or judicial lien, whether or not such interest or lien is provided by or is dependent on a statute and whether or not such interest or lien is made fully effective by statute.

(53A) The term "stockbroker" means person--

(A) with respect to which there is a customer, as defined in section 741 of this *title [11 USCS § 741*]; and

(B) that is engaged in the business of effecting transactions in securities--

(i) for the account of others; or

(ii) with members of the general public, from or for such person's own account.

(53B) The term "swap agreement"--

(A) means--

(i) any agreement, including the terms and conditions incorporated by reference in such agreement, which is--

(I) an interest rate swap, option, future, or forward agreement, including a rate floor, rate cap, rate collar, cross-currency rate swap, and basis swap;

(II) a spot, same day-tomorrow, tomorrow-next, forward, or other foreign exchange, precious metals, or other commodity agreement;

(III) a currency swap, option, future, or forward agreement;

(IV) an equity index or equity swap, option, future, or forward agreement;

(V) a debt index or debt swap, option, future, or forward agreement;

(VI) a total return, credit spread or credit swap, option, future, or forward agreement;

(VII) a commodity index or a commodity swap, option, future, or forward agreement;

(VIII) a weather swap, option, future, or forward agreement;

(IX) an emissions swap, option, future, or forward agreement; or

(X) an inflation swap, option, future, or forward agreement;

(ii) any agreement or transaction that is similar to any other agreement or transaction referred to in this paragraph and that--

(I) is of a type that has been, is presently, or in the future becomes, the subject of recurrent dealings in the swap or other derivatives markets (including terms and conditions incorporated by reference therein); and

(II) is a forward, swap, future, option, or spot transaction on one or more rates, currencies, commodities, equity securities, or other equity instruments, debt securities or other debt instruments, quantitative measures associated with an occurrence, extent of an occurrence, or contingency associated with a financial, commercial, or economic consequence, or economic or financial indices or measures of economic or financial risk or value;

(iii) any combination of agreements or transactions referred to in this subparagraph;

(iv) any option to enter into an agreement or transaction referred to in this subparagraph;

(v) a master agreement that provides for an agreement or transaction referred to in clause (i), (ii), (iii), or (iv), together with all supplements to any such master agreement, and without regard to whether the master agreement contains an agreement or transaction that is not a swap agreement under this paragraph, except that the master agreement shall be considered to be a swap agreement under this paragraph only with respect to each agreement or transaction under the master agreement that is referred to in clause (i), (ii), (iii), or (iv); or

(vi) any security agreement or arrangement or other credit enhancement related to any agreements or transactions referred to in clause (i) through (v), including any guarantee or reimbursement obligation by or to a swap participant or financial participant in connection with any agreement or transaction referred to in any such clause, but not to exceed the damages in connection with any such agreement or transaction, measured in accordance with section 562 [*11 USCS § 562*]; and

(B) is applicable for purposes of this title only, and shall not be construed or applied so as to challenge or affect the characterization, definition, or treatment of any swap agreement under any other statute, regulation, or rule, including the Gramm-Leach-Bliley Act, the Legal Certainty for Bank Products Act of 2000 [*7 USCS §§ 27* et seq.], the securities laws (as such term is defined in section 3(a)(47) of the Securities Exchange Act of 1934 [*15 USCS § 78c(a)(47)*]) and the Commodity Exchange Act [*7 USCS §§ 1* et seq.].

(53C) The term "swap participant" means an entity that, at any time before the filing of the petition, has an outstanding swap agreement with the debtor.

[(53C.1)] (56A) The term "term overriding royalty" means an interest in liquid or gaseous hydrocarbons in place or to be produced from particular real property that entitles the owner thereof to a share of production, or the value thereof, for a term limited by time, quantity, or value realized.

(53D) The term "timeshare plan" means and shall include that interest purchased in any arrangement, plan, scheme, or similar device, but not including exchange programs, whether by membership, agreement, tenancy in common, sale, lease, deed, rental agreement, license, right to use agreement, or by any other means, whereby a purchaser, in exchange for consideration, receives a right to use accommodations, facilities, or recreational sites, whether improved or unimproved, for a specific period of time less than a full year during any given year, but not necessarily for consecutive years, and which extends for a period of more than three years. A "timeshare interest" is that interest purchased in a timeshare plan which grants the purchaser the right to use and occupy accommodations, facilities, or recreational sites, whether improved or unimproved, pursuant to a timeshare plan.

(54) The term "transfer" means--

(A) the creation of a lien;

(B) the retention of title as a security interest;

(C) the foreclosure of a debtor's equity of redemption; or

(D) each mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with--

(i) property; or

(ii) an interest in property.

(54A) The term "uninsured State member bank" means a State member bank (as defined in section 3 of the Federal Deposit Insurance Act [*12 USCS § 1813*]) the deposits of which are not insured by the Federal Deposit Insurance

Corporation.

(55) "United States", when used in a geographical sense, includes all locations where the judicial jurisdiction of the United States extends, including territories and possessions of the United States.

HISTORY:

(Nov. 6, 1978, P.L. 95-598, Title I, § 101, 92 Stat. 2549; July 27, 1982, P.L. 97-222, § 1, 96 Stat. 235; July 10, 1984, P.L. 98-353, Title III, Subtitle F, § 391, Subtitle G, § 401, Subtitle H, § 421, 98 Stat. 364, 366, 367; Oct. 27, 1986, P.L. 99-554, Title II, Subtitles A-C, §§ 201, 251, 283(a), 100 Stat. 3097, 3104, 3116; Oct. 18, 1988, P.L. 100-506, § 1(a) 102 Stat 2538; Nov. 3, 1988, P.L. 100-597, § 1, 102 Stat. 3028; June 25, 1990, P.L. 101-311, Title I, § 101, Title II, § 201, 104 Stat. 267, 268; Nov. 29, 1990, P.L. 101-647, Title XXV, Subtitle B, § 2522(e), 104 Stat. 4867; Oct. 24, 1992, P.L. 102-486, Title XXX, Subtitle B, § 3017(a), 106 Stat. 3130; Oct. 22, 1994, P.L. 103-394, Title I, § 106, Title II, §§ 208(a), 215, 217(a), 218(a), Title III, § 304(a), Title V, § 501(a), (b)(1), (d)(1), 108 Stat. 4111, 4124, 4126, 4127, 4128, 4132, 4141-4143; Dec. 21, 2000, P.L. 106-554, § 1(a)(5), 114 Stat. 2763; April 20, 2005, P.L. 109-8, Title I, § 102(b), (k), Title II, Subtitle B, § 211, Subtitle C, §§ 226(a), 231(b), Title III, § 306(c), Title IV, Subtitle A, §§ 401(a), 414, Subtitle B, § 432(a), Title VIII, § 802(b), Title IX, § 907(a)(1), (b), (c), Title X, §§ 1004, 1005, 1007(a), Title XI, § 1101(a), (b), Title XII, § 1201, 119 Stat. 32, 35, 50, 66, 73, 80, 104, 107, 110, 145, 170, 175, 186, 187, 189, 192; Dec. 12, 2006, P.L. 109-390, § 5(a)(1), 120 Stat. 2965; Feb. 14, 2007, *72 Fed. Reg. 7082.)*

HISTORY; ANCILLARY LAWS AND DIRECTIVES

Prior law and revision:

Legislative Statements

Section 101(2) defines "affiliate." The House amendment contains a provision that is a compromise between the definition in the House-passed version of H.R. 8200 and the Senate amendment in the nature of a substitute to H.R. 8200. Subparagraphs (A) and (B) are derived from the Senate amendment and subparagraph (D) is taken from the House bill, while subparagraph (C) represents a compromise, taking the House position with respect to a person whose business is operated under a lease or an operating agreement by the debtor and with respect to a person substantially all of whose property is operated under an operating agreement by the debtor and with respect to a person substantially all of whose property is operated under an operating agreement by the debtor and the Senate position on leased property. Thus, the definition of "affiliate" excludes persons substantially all of whose property is operated under a lease agreement by a debtor, such as a small company which owns equipment all of which is leased to a larger nonrelated company.

Section 101(4)(B) represents a modification of the House-passed bill to include the definition of "claim" a right to an equitable remedy for breach of performance if such breach gives rise to a right to payment. This is intended to cause the liquidation or estimation of contingent rights of payment for which there may be an alternative equitable remedy with the result that the equitable remedy will be susceptible to being discharged in bankruptcy. For example, in some States, a judgment for specific performance may be satisfied by an alternative right to payment, in the event performance is refused; in that event, the creditor entitled to specific performance would have a "claim" for purposes of a proceeding under title 11.

On the other hand, rights to an equitable remedy for a breach of performance with respect to which such breach does not give rise to a right to payment are not "claims" and would therefore not be susceptible to discharge in bankruptcy.

In a case under chapter 9 to title 11, "claim" does not include a right to payment under an industrial development bond issued by a municipality as a matter of convenience for a third party.

Municipalities are authorized, under *section 103(c) of the Internal Revenue Code of 1954,* as amended [title 26], to issue tax-exempt industrial development revenue bonds to provide for the financing of certain projects for privately owned companies. The bonds are sold on the basis of the credit of the company on whose behalf they are issued, and the principal, interest, and premium, if any, are payable solely from payments made by the company to the trustee under the bond indenture and do not constitute claims on the tax revenues or other funds of the issuing municipalities. The

LEXSTAT 11 USC 301

UNITED STATES CODE SERVICE

*** CURRENT THROUGH P.L. 110-190, APPROVED 2/28/2008 ***

TITLE 11. BANKRUPTCY
CHAPTER 3. CASE ADMINISTRATION
SUBCHAPTER I. COMMENCEMENT OF A CASE

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11 USCS § 301

§ 301. Voluntary cases

(a) A voluntary case under a chapter of this title is commenced by the filing with the bankruptcy court of a petition under such chapter by an entity that may be a debtor under such chapter.

(b) The commencement of a voluntary case under a chapter of this title constitutes an order for relief under such chapter.

HISTORY:

(Nov. 6, 1978, P.L. 95-598, Title I, § 101, 92 Stat. 2558; April 20, 2005, P.L. 109-8, Title V, § 501(b), 119 Stat. 118.)

HISTORY; ANCILLARY LAWS AND DIRECTIVES

Prior law and revision:

Legislative Statements

Sections 301, 302, 303, and 304, are all modified in the House amendment to adopt an idea contained in sections 301 and 303 of the Senate amendment requiring a petition commencing a case to be filed with the bankruptcy court. The exception contained in section 301 of the Senate bill relating to cases filed under chapter 9 is deleted. Chapter 9 cases will be handled by a bankruptcy court as are other title II cases.

Senate Report No. 95-989

Section 301 specifies the manner in which a voluntary bankruptcy case is commenced. The debtor files a petition under this section under the particular operative chapter of the bankruptcy code under which he wishes to proceed. The filing of the petition constitutes an order for relief in the case under that chapter. The section contains no change from current law, except for the use of the phrase "order for relief" instead of "adjudication." The term adjudication is replaced by a less pejorative phrase in light of the clear power of Congress to permit voluntary bankruptcy without the necessity for an adjudication, as under the 1898 act [former title 11], which was adopted when voluntary bankruptcy was a concept not thoroughly tested.

Effective date of section:

This section became effective on October 1, 1979, pursuant to § 402(a) of Act Nov. 6, 1978, P.L. 95-598, which appears as *11 USCS prec § 101* note.

Amendments:

2005. Act April 20, 2005 (effective 180 days after enactment and inapplicable to cases commenced before the effective date, as provided by § 1501 of such Act, which appears as *11 USCS § 101* note), inserted designated the existing provisions as subsec. (a), and, in such subsection as so designated, deleted "The commencement of a voluntary case under a chapter of this title constitutes an order for relief under such chapter." following "such chapter."; and added subsec. (b).

LEXSTAT 11 USCS § 521

UNITED STATES CODE SERVICE

*** CURRENT THROUGH P.L. 110-190, APPROVED 2/28/2008 ***

TITLE 11. BANKRUPTCY
CHAPTER 5. CREDITORS, THE DEBTOR, AND THE ESTATE
SUBCHAPTER II. DEBTOR'S DUTIES AND BENEFITS

Go to the United States Code Service Archive Directory

11 USCS § 521

§ 521. Debtor's duties

(a) The debtor shall--
  (1) file--
    (A) a list of creditors; and
    (B) unless the court orders otherwise--
      (i) a schedule of assets and liabilities;
      (ii) a schedule of current income and current expenditures;
      (iii) a statement of the debtor's financial affairs and, if section 342(b) [*11 USCS § 342(b)*] applies, a certificate--
        (I) of an attorney whose name is indicated on the petition as the attorney for the debtor, or a bankruptcy petition preparer signing the petition under section 110(b)(1) [*11 USCS § 110(b)(1)*], indicating that such attorney or the bankruptcy petition preparer delivered to the debtor the notice required by section 342(b) [*11 USCS § 342(b)*]; or
        (II) if no attorney is so indicated, and no bankruptcy petition preparer signed the petition, of the debtor that such notice was received and read by the debtor;
      (iv) copies of all payment advices or other evidence of payment received within 60 days before the date of the filing of the petition, by the debtor from any employer of the debtor;
      (v) a statement of the amount of monthly net income, itemized to show how the amount is calculated; and
      (vi) a statement disclosing any reasonably anticipated increase in income or expenditures over the 12-month period following the date of the filing of the petition;
  (2) if an individual debtor's schedule of assets and liabilities includes debts which are secured by property of the estate--
    (A) within thirty days after the date of the filing of a petition under chapter 7 of this *title [11 USCS §§ 701* et seq.] or on or before the date of the meeting of creditors, whichever is earlier, or within such additional time as the court, for cause, within such period fixes, the debtor shall file with the clerk a statement of his intention with respect to the retention or surrender of such property and, if applicable, specifying that such property is claimed as exempt, that the debtor intends to redeem such property, or that the debtor intends to reaffirm debts secured by such property;
    (B) within 30 days after the first date set for the meeting of creditors under section 341(a) [*11 USCS § 341(a)*], or within such additional time as the court, for cause, within such 30-day period fixes, the debtor shall perform his intention with respect to such property, as specified by subparagraph (A) of this paragraph; and
    (C) nothing in subparagraphs (A) and (B) of this paragraph shall alter the debtor's or the trustee's rights with regard to such property under this *title [11 USCS §§ 101* et seq.], except as provided in section 362(h) [*11 USCS § 362(h)*];
  (3) if a trustee is serving in the case or an auditor serving under section 586(f) of title 28 [*28 USCS § 586(f)*],

cooperate with the trustee as necessary to enable the trustee to perform the trustee's duties under this *title [11 USCS §§ 101* et seq.];

(4) if a trustee is serving in the case or an auditor serving under section 586(f) of title 28 [*28 USCS § 586(f)*], surrender to the trustee all property of the estate and any recorded information, including books, documents, records, and papers, relating to property of the estate, whether or not immunity is granted under section 344 of this *title [11 USCS § 344*];

(5) appear at the hearing required under section 524(d) of this *title [11 USCS § 524(d)*];

(6) in a case under chapter 7 of this *title [11 USCS §§ 701* et seq.] in which the debtor is an individual, not retain possession of personal property as to which a creditor has an allowed claim for the purchase price secured in whole or in part by an interest in such personal property unless the debtor, not later than 45 days after the first meeting of creditors under section 341(a) [*11 USCS § 341(a)*], either--

(A) enters into an agreement with the creditor pursuant to section 524(c) [*11 USCS § 524(c)*] with respect to the claim secured by such property; or

(B) redeems such property from the security interest pursuant to section 722 [*11 USCS § 722*].

If the debtor fails to so act within the 45-day period referred to in paragraph (6), the stay under section 362(a) [*11 USCS § 362(a)*] is terminated with respect to the personal property of the estate or of the debtor which is affected, such property shall no longer be property of the estate, and the creditor may take whatever action as to such property as is permitted by applicable nonbankruptcy law, unless the court determines on the motion of the trustee filed before the expiration of such 45-day period, and after notice and a hearing, that such property is of consequential value or benefit to the estate, orders appropriate adequate protection of the creditor's interest, and orders the debtor to deliver any collateral in the debtor's possession to the trustee; and

(7) unless a trustee is serving in the case, continue to perform the obligations required of the administrator (as defined in section 3 of the Employee Retirement Income Security Act of 1974 [*29 USCS § 1002*]) of an employee benefit plan if at the time of the commencement of the case the debtor (or any entity designated by the debtor) served as such administrator.

(b) In addition to the requirements under subsection (a), a debtor who is an individual shall file with the court--

(1) a certificate from the approved nonprofit budget and credit counseling agency that provided the debtor services under section 109(h) [*11 USCS § 109(h)*] describing the services provided to the debtor; and

(2) a copy of the debt repayment plan, if any, developed under section 109(h) [*11 USCS § 109(h)*] through the approved nonprofit budget and credit counseling agency referred to in paragraph (1).

(c) In addition to meeting the requirements under subsection (a), a debtor shall file with the court a record of any interest that a debtor has in an education individual retirement account (as defined in *section 530(b)(1) of the Internal Revenue Code of 1986* [*26 USCS § 530(b)(1)*]) or under a qualified State tuition program (as defined in section 529(b)(1) of such Code [*26 USCS § 529(b)(1)*]).

(d) If the debtor fails timely to take the action specified in subsection (a)(6) of this section, or in paragraphs (1) and (2) of section 362(h) [*11 USCS § 362(h)*], with respect to property which a lessor or bailor owns and has leased, rented, or bailed to the debtor or as to which a creditor holds a security interest not otherwise voidable under section 522(f), 544, 545, 547, 548, or 549 [*11 USCS § 522(f)*, *544*, *545*, *547*, *548*, or *549*], nothing in this title shall prevent or limit the operation of a provision in the underlying lease or agreement that has the effect of placing the debtor in default under such lease or agreement by reason of the occurrence, pendency, or existence of a proceeding under this title or the insolvency of the debtor. Nothing in this subsection shall be deemed to justify limiting such a provision in any other circumstance.

(e) (1) If the debtor in a case under chapter 7 or 13 [*11 USCS §§ 701* et seq. or *1301* et seq.] is an individual and if a creditor files with the court at any time a request to receive a copy of the petition, schedules, and statement of financial affairs filed by the debtor, then the court shall make such petition, such schedules, and such statement available to such creditor.

(2) (A) The debtor shall provide--

(i) not later than 7 days before the date first set for the first meeting of creditors, to the trustee a copy of the Federal income tax return required under applicable law (or at the election of the debtor, a transcript of such return) for the most recent tax year ending immediately before the commencement of the case and for which a Federal income tax return was filed; and

(ii) at the same time the debtor complies with clause (i), a copy of such return (or if elected under clause (i), such transcript) to any creditor that timely requests such copy.

(B) If the debtor fails to comply with clause (i) or (ii) of subparagraph (A), the court shall dismiss the case unless the debtor demonstrates that the failure to so comply is due to circumstances beyond the control of the debtor.

(C) If a creditor requests a copy of such tax return or such transcript and if the debtor fails to provide a copy of such tax return or such transcript to such creditor at the time the debtor provides such tax return or such transcript to the trustee, then the court shall dismiss the case unless the debtor demonstrates that the failure to provide a copy of such tax return or such transcript is due to circumstances beyond the control of the debtor.

(3) If a creditor in a case under chapter 13 [*11 USCS §§ 1301* et seq.] files with the court at any time a request to receive a copy of the plan filed by the debtor, then the court shall make available to such creditor a copy of the plan--

(A) at a reasonable cost; and

(B) not later than 5 days after such request is filed.

(f) At the request of the court, the United States trustee, or any party in interest in a case under chapter 7, 11, or 13 [*11 USCS §§ 701* et seq., *1101* et seq., or *1301* et seq.] , a debtor who is an individual shall file with the court--

(1) at the same time filed with the taxing authority, a copy of each Federal income tax return required under applicable law (or at the election of the debtor, a transcript of such tax return) with respect to each tax year of the debtor ending while the case is pending under such chapter;

(2) at the same time filed with the taxing authority, each Federal income tax return required under applicable law (or at the election of the debtor, a transcript of such tax return) that had not been filed with such authority as of the date of the commencement of the case and that was subsequently filed for any tax year of the debtor ending in the 3-year period ending on the date of the commencement of the case;

(3) a copy of each amendment to any Federal income tax return or transcript filed with the court under paragraph (1) or (2); and

(4) in a case under chapter 13 [*11 USCS §§ 1301* et seq.]--

(A) on the date that is either 90 days after the end of such tax year or 1 year after the date of the commencement of the case, whichever is later, if a plan is not confirmed before such later date; and

(B) annually after the plan is confirmed and until the case is closed, not later than the date that is 45 days before the anniversary of the confirmation of the plan;

a statement, under penalty of perjury, of the income and expenditures of the debtor during the tax year of the debtor most recently concluded before such statement is filed under this paragraph, and of the monthly income of the debtor, that shows how income, expenditures, and monthly income are calculated.

(g) (1) A statement referred to in subsection (f)(4) shall disclose--

(A) the amount and sources of the income of the debtor;

(B) the identity of any person responsible with the debtor for the support of any dependent of the debtor; and

(C) the identity of any person who contributed, and the amount contributed, to the household in which the debtor resides.

(2) The tax returns, amendments, and statement of income and expenditures described in subsections (e)(2)(A) and (f) shall be available to the United States trustee (or the bankruptcy administrator, if any), the trustee, and any party in interest for inspection and copying, subject to the requirements of section 315(c) of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 [note to this section].

(h) If requested by the United States trustee or by the trustee, the debtor shall provide--

(1) a document that establishes the identity of the debtor, including a driver's license, passport, or other document that

contains a photograph of the debtor; or
(2) such other personal identifying information relating to the debtor that establishes the identity of the debtor.

(i) (1) Subject to paragraphs (2) and (4) and notwithstanding section 707(a) [*11 USCS § 707(a)*], if an individual debtor in a voluntary case under chapter 7 or 13 [*11 USCS §§ 701* et seq. or *1301* et seq.] fails to file all of the information required under subsection (a)(1) within 45 days after the date of the filing of the petition, the case shall be automatically dismissed effective on the 46th day after the date of the filing of the petition.

(2) Subject to paragraph (4) and with respect to a case described in paragraph (1), any party in interest may request the court to enter an order dismissing the case. If requested, the court shall enter an order of dismissal not later than 5 days after such request.

(3) Subject to paragraph (4) and upon request of the debtor made within 45 days after the date of the filing of the petition described in paragraph (1), the court may allow the debtor an additional period of not to exceed 45 days to file the information required under subsection (a)(1) if the court finds justification for extending the period for the filing.

(4) Notwithstanding any other provision of this subsection, on the motion of the trustee filed before the expiration of the applicable period of time specified in paragraph (1), (2), or (3), and after notice and a hearing, the court may decline to dismiss the case if the court finds that the debtor attempted in good faith to file all the information required by subsection (a)(1)(B)(iv) and that the best interests of creditors would be served by administration of the case.

(j) (1) Notwithstanding any other provision of this title, if the debtor fails to file a tax return that becomes due after the commencement of the case or to properly obtain an extension of the due date for filing such return, the taxing authority may request that the court enter an order converting or dismissing the case.

(2) If the debtor does not file the required return or obtain the extension referred to in paragraph (1) within 90 days after a request is filed by the taxing authority under that paragraph, the court shall convert or dismiss the case, whichever is in the best interests of creditors and the estate.

HISTORY:

(Nov. 6, 1978, P.L. 95-598, Title I, § 101, 92 Stat. 2586; July 10, 1984, P.L. 98-353, Title III, Subtitle A, § 305, Subtitle H, § 452, 98 Stat. 352, 375; Oct. 27, 1986, P.L. 99-554, Title II, Subtitle C, § 283(h), 100 Stat. 3117.)

(As amended April 20, 2005, P.L. 109-8, Title I, § 106(d), Title II, Subtitle C, § 225(b), Title III, §§ 304(1), 305(2), 315(b), 316, Title IV, Subtitle B, § 446(a), Title VI, § 603(c), Title VII, § 720, 119 Stat. 38, 66, 78, 80, 89, 92, 118, 123, 133.)

HISTORY; ANCILLARY LAWS AND DIRECTIVES

Prior law and revision:

Legislative Statements

Section 521 of the House amendment modifies a comparable provision contained in the House bill and Senate amendment. The Rules of Bankruptcy Procedure should provide where the list of creditors is to be filed. In addition, the debtor is required to attend the hearing on discharge under section 524(d).

Senate Report No. 95-989

This section lists three [now four] duties of the debtor in a bankruptcy case. The Rules of Bankruptcy Procedure will specify the means of carrying out these duties. The first duty is to file with the court a list of creditors and, unless the court orders otherwise, a schedule of assets and liabilities and a statement of his financial affairs. Second, the debtor is required to cooperate with the trustee as necessary to enable the trustee to perform the trustee's duties [now para. (3) of this section]. Finally, the debtor must surrender to the trustee all property of the estate, and any recorded information, including books, documents, records, and papers, relating to property of the estate [now para. (4) of this section]. This phrase "recorded information, including books, documents, records, and papers," has been used here and throughout the bill as a more general term, and includes such other forms of recorded information as data in computer storage or in

LEXSTAT 11 USC 701

UNITED STATES CODE SERVICE

*** CURRENT THROUGH P.L. 110-190, APPROVED 2/28/2008 ***

TITLE 11. BANKRUPTCY
CHAPTER 7. LIQUIDATION
SUBCHAPTER I. OFFICERS AND ADMINISTRATION

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11 USCS § 701

§ 701. Interim trustee

(a) (1) Promptly after the order for relief under this chapter, the United States trustee shall appoint one disinterested person that is a member of the panel of private trustees established under section 586(a)(1) of title 28 [*28 USCS § 586(a)(1)*] or that is serving as trustee in the case immediately before the order for relief under this chapter to serve as interim trustee in the case.

(2) If none of the members of such panel is willing to serve as interim trustee in the case, then the United States trustee may serve as interim trustee in the case.

(b) The service of an interim trustee under this section terminates when a trustee elected or designated under section 702 of this *title [11 USCS § 702*] to serve as trustee in the case qualifies under section 322 of this *title [11 USCS § 322*].

(c) An interim trustee serving under this section is a trustee in a case under this *title [11 USCS §§ 101* et seq.].

HISTORY:

(Nov. 6, 1978, P.L. 95-598, Title I, § 101, 92 Stat. 2604; Oct. 27, 1986, P.L. 99-554, Title II, Subtitle A, § 215, 100 Stat. 3100.)

HISTORY; ANCILLARY LAWS AND DIRECTIVES

Prior law and revision:

Legislative Statements

The House amendment deletes section 701(d) of the Senate amendment. It is anticipated that the Rules of Bankruptcy Procedure will require the appointment of an interim trustee at the earliest practical moment in commodity broker bankruptcies, but no later than noon of the day after the date of the filing of the petition, due to the volatility of such cases.

Senate Report No. 95-989

This section requires the court to appoint an interim trustee. The appointment must be made from the panel of private trustees established and maintained by the Director of the Administrative Office under proposed *28 U.S.C. 604(e)* [*28 USCS § 604(f)*].

Subsection (a) requires the appointment of an interim trustee to be made promptly after the order for relief, unless a

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TITLE 11. BANKRUPTCY
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11 USCS § 704

§ 704. Duties of trustee

(a) The trustee shall--

(1) collect and reduce to money the property of the estate for which such trustee serves, and close such estate as expeditiously as is compatible with the best interests of parties in interest;

(2) be accountable for all property received;

(3) ensure that the debtor shall perform his intention as specified in section 521(2)(B) of this *title [11 USCS § 521(2)(B)*];

(4) investigate the financial affairs of the debtor;

(5) if a purpose would be served, examine proofs of claims and object to the allowance of any claim that is improper;

(6) if advisable, oppose the discharge of the debtor;

(7) unless the court orders otherwise, furnish such information concerning the estate and the estate's administration as is requested by a party in interest;

(8) if the business of the debtor is authorized to be operated, file with the court, with the United States trustee, and with any governmental unit charged with responsibility for collection or determination of any tax arising out of such operation, periodic reports and summaries of the operation of such business, including a statement of receipts and disbursements, and such other information as the United States trustee or the court requires;

(9) make a final report and file a final account of the administration of the estate with the court and with the United States trustee;

(10) if with respect to the debtor there is a claim for a domestic support obligation, provide the applicable notice specified in subsection (c);

(11) if, at the time of the commencement of the case, the debtor (or any entity designated by the debtor) served as the administrator (as defined in section 3 of the Employee Retirement Income Security Act of 1974 [*29 USCS § 1002*]) of an employee benefit plan, continue to perform the obligations required of the administrator; and

(12) use all reasonable and best efforts to transfer patients from a health care business that is in the process of being closed to an appropriate health care business that--

(A) is in the vicinity of the health care business that is closing;

(B) provides the patient with services that are substantially similar to those provided by the health care business that is in the process of being closed; and

(C) maintains a reasonable quality of care.

(b) (1) With respect to a debtor who is an individual in a case under this chapter--

(A) the United States trustee (or the bankruptcy administrator, if any) shall review all materials filed by the debtor and, not later than 10 days after the date of the first meeting of creditors, file with the court a statement as to whether the debtor's case would be presumed to be an abuse under section 707(b) [*11 USCS § 707(b)*]; and

(B) not later than 5 days after receiving a statement under subparagraph (A), the court shall provide a copy of the statement to all creditors.

(2) The United States trustee (or bankruptcy administrator, if any) shall, not later than 30 days after the date of filing a statement under paragraph (1), either file a motion to dismiss or convert under section 707(b) [*11 USCS § 707(b)*] or file a statement setting forth the reasons the United States trustee (or the bankruptcy administrator, if any) does not consider such a motion to be appropriate, if the United States trustee (or the bankruptcy administrator, if any) determines that the debtor's case should be presumed to be an abuse under section 707(b) [*11 USCS § 707(b)*] and the product of the debtor's current monthly income, multiplied by 12 is not less than--

(A) in the case of a debtor in a household of 1 person, the median family income of the applicable State for 1 earner; or

(B) in the case of a debtor in a household of 2 or more individuals, the highest median family income of the applicable State for a family of the same number or fewer individuals.

(c) (1) In a case described in subsection (a)(10) to which subsection (a)(10) applies, the trustee shall--

(A) (i) provide written notice to the holder of the claim described in subsection (a)(10) of such claim and of the right of such holder to use the services of the State child support enforcement agency established under sections 464 and 466 of the Social Security Act [*42 USCS §§ 664* and *666*] for the State in which such holder resides, for assistance in collecting child support during and after the case under this title;

(ii) include in the notice provided under clause (iii) the address and telephone number of such State child support enforcement agency; and

(iii) include in the notice provided under clause (i) an explanation of the rights of such holder to payment of such claim under this chapter [*11 USCS §§ 701* et seq.];

(B) (i) provide written notice to such State child support enforcement agency of such claim; and

(ii) include in the notice provided under clause (i) the name, address, and telephone number of such holder; and

(C) at such time as the debtor is granted a discharge under section 727 [*11 USCS § 727*], provide written notice to such holder and to such State child support enforcement agency of--

(i) the granting of the discharge;

(ii) the last recent known address of the debtor;

(iii) the last recent known name and address of the debtor's employer; and

(iv) the name of each creditor that holds a claim that--

(I) is not discharged under paragraph (2), (4), or (14A) of section 523(a) [*11 USCS § 523(a)*]; or

(II) was reaffirmed by the debtor under section 524(c) [*11 USCS § 524(c)*].

(2) (A) The holder of a claim described in subsection (a)(10) or the State child support enforcement agency of the State in which such holder resides may request from a creditor described in paragraph (1)(C)(iv) the last known address of the debtor.

(B) Notwithstanding any other provision of law, a creditor that makes a disclosure of a last known address of a debtor in connection with a request made under subparagraph (A) shall not be liable by reason of making such disclosure.

HISTORY:

(Nov. 6, 1978, P.L. 95-598, Title I, § 101, 92 Stat. 2605; July 10, 1984, P.L. 98-353, Title III, Subtitle A, § 311(a), Subtitle H, § 474, 98 Stat. 355, 381; Oct. 27, 1986, P.L. 99-554, Title II, Subtitle A, § 217, 100 Stat. 3100; April 20, 2005, P.L. 109-8, Title I, § 102(c), Title II, Subtitle B, § 219(a), Title IV, Subtitle B, § 446(b), Title XI, § 1105(a), 119 Stat. 32, 55, 118, 192.)

HISTORY; ANCILLARY LAWS AND DIRECTIVES

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UNITED STATES CODE SERVICE

*** CURRENT THROUGH P.L. 110-190, APPROVED 2/28/2008 ***

TITLE 11. BANKRUPTCY
CHAPTER 7. LIQUIDATION
SUBCHAPTER I. OFFICERS AND ADMINISTRATION

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11 USCS § 707

§ 707. Dismissal of a case or conversion to a case under chapter 11 or 13

(a) The court may dismiss a case under this chapter [*11 USCS §§ 701* et seq.] only after notice and a hearing and only for cause, including--

(1) unreasonable delay by the debtor that is prejudicial to creditors;

(2) nonpayment of any fees [or] and charges required under chapter 123 of title 28; and

(3) failure of the debtor in a voluntary case to file, within fifteen days or such additional time as the court may allow after the filing of the petition commencing such case, the information required by paragraph (1) of section 521 [*11 USCS § 521*], but only on a motion by the United States trustee.

(b) (1) After notice and a hearing, the court, on its own motion or on a motion by the United States trustee, trustee (or bankruptcy administrator, if any), or any party in interest, may dismiss a case filed by an individual debtor under this chapter whose debts are primarily consumer debts, or, with the debtor's consent, convert such a case to a case under chapter 11 or 13 of this *title [11 USCS §§ 1101* et seq. or *1301* et seq.], if it finds that the granting of relief would be an abuse of the provisions of this chapter [*11 USCS §§ 701* et seq.]. In making a determination whether to dismiss a case under this section, the court may not take into consideration whether a debtor has made, or continues to make, charitable contributions (that meet the definition of "charitable contribution" under section 548(d)(3) [*11 USCS § 548(d)(3)*]) to any qualified religious or charitable entity or organization (as that term is defined in section 548(d)(4) [*11 USCS § 548(d)(4)*]).

(2) (A) (i) In considering under paragraph (1) whether the granting of relief would be an abuse of the provisions of this chapter [*11 USCS §§ 701* et seq.], the court shall presume abuse exists if the debtor's current monthly income reduced by the amounts determined under clauses (ii), (iii), and (iv), and multiplied by 60 is not less than the lesser of--

(I) 25 percent of the debtor's nonpriority unsecured claims in the case, or $ 6,575, whichever is greater; or

(II) $ 10,950.

(ii) (I) The debtor's monthly expenses shall be the debtor's applicable monthly expense amounts specified under the National Standards and Local Standards, and the debtor's actual monthly expenses for the categories specified as Other Necessary Expenses issued by the Internal Revenue Service for the area in which the debtor resides, as in effect on the date of the order for relief, for the debtor, the dependents of the debtor, and the spouse of the debtor in a joint case, if the spouse is not otherwise a dependent. Such expenses shall include reasonably necessary health insurance, disability insurance, and health savings account expenses for the debtor, the spouse of the debtor, or the dependents of the debtor. Notwithstanding any other provision of this clause, the monthly expenses of the debtor shall not include any payments for debts. In addition, the debtor's monthly expenses shall include the debtor's reasonably necessary expenses incurred to maintain the safety of the debtor and the family of the debtor from family violence as identified under section 309 [320] of the Family Violence Prevention and Services Act [*42 USCS § 10421*], or other applicable Federal law. The expenses included in the debtor's monthly expenses described in the preceding sentence shall be kept confidential by the court. In addition, if it is demonstrated that it is reasonable and necessary, the debtor's monthly expenses may also include an additional allowance for food and clothing of up to 5 percent of the food and clothing categories as specified by the National Standards issued by the Internal Revenue Service.

(II) In addition, the debtor's monthly expenses may include, if applicable, the continuation of actual expenses paid by the debtor that are reasonable and necessary for care and support of an elderly, chronically ill, or disabled household member or member of the debtor's immediate family (including parents, grandparents, siblings, children, and grandchildren of the debtor, the dependents of the debtor, and the spouse of the debtor in a joint case who is not a dependent) and who is unable to pay for such reasonable and necessary expenses.

(III) In addition, for a debtor eligible for chapter 13 [*11 USCS §§ 1301* et seq.], the debtor's monthly expenses may include the actual administrative expenses of administering a chapter 13 [*11 USCS §§ 1301* et seq.] plan for the district in which the debtor resides, up to an amount of 10 percent of the projected plan payments, as determined under schedules issued by the Executive Office for United States Trustees.

(IV) In addition, the debtor's monthly expenses may include the actual expenses for each dependent child less than 18 years of age, not to exceed $ 1,650 per year per child, to attend a private or public elementary or secondary school if the debtor provides documentation of such expenses and a detailed explanation of why such expenses are reasonable and necessary, and why such expenses are not already accounted for in the National Standards, Local Standards, or Other Necessary Expenses referred to in subclause (I).

(V) In addition, the debtor's monthly expenses may include an allowance for housing and utilities, in excess of the allowance specified by the Local Standards for housing and utilities issued by the Internal Revenue Service, based on the actual expenses for home energy costs if the debtor provides documentation of such actual expenses and demonstrates that such actual expenses are reasonable and necessary.

(iii) The debtor's average monthly payments on account of secured debts shall be calculated as the sum of--

(I) the total of all amounts scheduled as contractually due to secured creditors in each month of the 60 months following the date of the petition; and

(II) any additional payments to secured creditors necessary for the debtor, in filing a plan under chapter 13 of this *title [11 USCS §§ 1301* et seq.], to maintain possession of the debtor's primary residence, motor vehicle, or other property necessary for the support of the debtor and the debtor's dependents, that serves as collateral for secured debts;

divided by 60.

(iv) The debtor's expenses for payment of all priority claims (including priority child support and alimony claims) shall be calculated as the total amount of debts entitled to priority, divided by 60.

(B) (i) In any proceeding brought under this subsection, the presumption of abuse may only be rebutted by demonstrating special circumstances, such as a serious medical condition or a call or order to active duty in the Armed Forces, to the extent such special circumstances that justify additional expenses or adjustments of current monthly income for which there is no reasonable alternative.

(ii) In order to establish special circumstances, the debtor shall be required to itemize each additional expense or adjustment of income and to provide--

(I) documentation for such expense or adjustment to income; and

(II) a detailed explanation of the special circumstances that make such expenses or adjustment to income necessary and reasonable.

(iii) The debtor shall attest under oath to the accuracy of any information provided to demonstrate that additional expenses or adjustments to income are required.

(iv) The presumption of abuse may only be rebutted if the additional expenses or adjustments to income referred to in clause (i) cause the product of the debtor's current monthly income reduced by the amounts determined under clauses (ii), (iii), and (iv) of subparagraph (A) when multiplied by 60 to be less than the lesser of--

(I) 25 percent of the debtor's nonpriority unsecured claims, or $ 6,000, whichever is greater; or

(II) $ 10,000.

(C) As part of the schedule of current income and expenditures required under section 521 [*11 USCS § 521*], the debtor shall include a statement of the debtor's current monthly income, and the calculations that determine whether a presumption arises under subparagraph (A)(i), that show how each such amount is calculated.

(D) Subparagraphs (A) through (C) shall not apply, and the court may not dismiss or convert a case based on any form of means testing, if the debtor is a disabled veteran (as defined in section 3741(1) of title 38 [*38 USCS § 3741(1)*]), and the indebtedness occurred primarily during a period during which he or she was--

(i) on active duty (as defined in section 101(d)(1) of title 10 [*10 USCS § 101(d)(1)*]); or

(ii) performing a homeland defense activity (as defined in section 901(1) of title 32 [*32 USCS § 901(1)*]).

(3) In considering under paragraph (1) whether the granting of relief would be an abuse of the provisions of this chapter [*11 USCS §§ 701* et seq.] in a case in which the presumption in subparagraph (A)(i) of such paragraph does not arise or is rebutted, the court shall consider--

(A) whether the debtor filed the petition in bad faith; or

(B) the totality of the circumstances (including whether the debtor seeks to reject a personal services contract and the financial need for such rejection as sought by the debtor) of the debtor's financial situation demonstrates abuse.

(4) (A) The court, on its own initiative or on the motion of a party in interest, in accordance with the procedures described in *rule 9011 of the Federal Rules of Bankruptcy Procedure*, may order the attorney for the debtor to reimburse the trustee for all reasonable costs in prosecuting a motion filed under section 707(b) [*11 USCS § 707(b)*], including reasonable attorneys' fees, if--

(i) a trustee files a motion for dismissal or conversion under this subsection; and

(ii) the court--

(I) grants such motion; and

(II) finds that the action of the attorney for the debtor in filing a case under this chapter [*11 USCS §§ 701* et seq.] violated *rule 9011 of the Federal Rules of Bankruptcy Procedure.*

(B) If the court finds that the attorney for the debtor violated *rule 9011 of the Federal Rules of Bankruptcy Procedure*, the court, on its own initiative or on the motion of a party in interest, in accordance with such procedures, may order--

(i) the assessment of an appropriate civil penalty against the attorney for the debtor; and

(ii) the payment of such civil penalty to the trustee, the United States trustee (or the bankruptcy administrator, if any).

(C) The signature of an attorney on a petition, pleading, or written motion shall constitute a certification that the attorney has--

(i) performed a reasonable investigation into the circumstances that gave rise to the petition, pleading, or written motion; and

(ii) determined that the petition, pleading, or written motion--

(I) is well grounded in fact; and

(II) is warranted by existing law or a good faith argument for the extension, modification, or reversal of existing law and does not constitute an abuse under paragraph (1).

(D) The signature of an attorney on the petition shall constitute a certification that the attorney has no knowledge after an inquiry that the information in the schedules filed with such petition is incorrect.

(5) (A) Except as provided in subparagraph (B) and subject to paragraph (6), the court, on its own initiative or on the motion of a party in interest, in accordance with the procedures described in *rule 9011 of the Federal Rules of Bankruptcy Procedure*, may award a debtor all reasonable costs (including reasonable attorneys' fees) in contesting a motion filed by a party in interest (other than a trustee or United States trustee (or bankruptcy administrator, if any)) under this subsection if--

(i) the court does not grant the motion; and

(ii) the court finds that--

(I) the position of the party that filed the motion violated *rule 9011 of the Federal Rules of Bankruptcy Procedure*; or

(II) the attorney (if any) who filed the motion did not comply with the requirements of clauses (i) and (ii) of paragraph (4)(C), and the motion was made solely for the purpose of coercing a debtor into waiving a right guaranteed to the debtor under this title.

(B) A small business that has a claim of an aggregate amount less than $ 1,100 shall not be subject to subparagraph (A)(ii)(I).

(C) For purposes of this paragraph--

(i) the term "small business" means an unincorporated business, partnership, corporation, association, or organization that--

(I) has fewer than 25 full-time employees as determined on the date on which the motion is filed; and

(II) is engaged in commercial or business activity; and

(ii) the number of employees of a wholly owned subsidiary of a corporation includes the employees of--

(I) a parent corporation; and

(II) any other subsidiary corporation of the parent corporation.

(6) Only the judge or United States trustee (or bankruptcy administrator, if any) may file a motion under section 707(b) [*11 USCS § 707(b)*], if the current monthly income of the debtor, or in a joint case, the debtor and the debtor's spouse, as of the date of the order for relief, when multiplied by 12, is equal to or less than--

(A) in the case of a debtor in a household of 1 person, the median family income of the applicable State for 1 earner;

(B) in the case of a debtor in a household of 2, 3, or 4 individuals, the highest median family income of the applicable State for a family of the same number or fewer individuals; or

(C) in the case of a debtor in a household exceeding 4 individuals, the highest median family income of the applicable State for a family of 4 or fewer individuals, plus $ 575 per month for each individual in excess of 4.

(7) (A) No judge, United States trustee (or bankruptcy administrator, if any), trustee, or other party in interest may file a motion under paragraph (2) if the current monthly income of the debtor, including a veteran (as that term is defined in section 101 of title 38 [*38 USCS § 101*]), and the debtor's spouse combined, as of the date of the order for relief when multiplied by 12, is equal to or less than--

(i) in the case of a debtor in a household of 1 person, the median family income of the applicable State for 1 earner;

(ii) in the case of a debtor in a household of 2, 3, or 4 individuals, the highest median family income of the applicable State for a family of the same number or fewer individuals; or

(iii) in the case of a debtor in a household exceeding 4 individuals, the highest median family income of the applicable State for a family of 4 or fewer individuals, plus $ 575 per month for each individual in excess of 4.

(B) In a case that is not a joint case, current monthly income of the debtor's spouse shall not be considered for purposes of subparagraph (A) if--

(i) (I) the debtor and the debtor's spouse are separated under applicable nonbankruptcy law; or

(II) the debtor and the debtor's spouse are living separate and apart, other than for the purpose of evading subparagraph (A); and

(ii) the debtor files a statement under penalty of perjury--

(I) specifying that the debtor meets the requirement of subclause (I) or (II) of clause (i); and

(II) disclosing the aggregate, or best estimate of the aggregate, amount of any cash or money payments received from the debtor's spouse attributed to the debtor's current monthly income.

(c) (1) In this subsection--

(A) the term "crime of violence" has the meaning given such term in section 16 of title 18 [*18 USCS § 16*]; and

(B) the term "drug trafficking crime" has the meaning given such term in section 924(c)(2) of title 18 [*18 USCS § 924(c)(2)*].

(2) Except as provided in paragraph (3), after notice and a hearing, the court, on a motion by the victim of a crime of violence or a drug trafficking crime, may when it is in the best interest of the victim dismiss a voluntary case filed under this chapter [*11 USCS §§ 701* et seq.] by a debtor who is an individual if such individual was convicted of such crime.

(3) The court may not dismiss a case under paragraph (2) if the debtor establishes by a preponderance of the evidence that the filing of a case under this chapter [*11 USCS §§ 701* et seq.] is necessary to satisfy a claim for a domestic support obligation.

HISTORY:

(Nov. 6, 1978, P.L. 95-598, Title I, § 101, 92 Stat. 2606; July 10, 1984, P.L. 98-353, Title III, Subtitle A, § 312, Subtitle H, § 475, 98 Stat. 355, 381; Oct. 27, 1986, P.L. 99-554, Title II, Subtitle A, § 219, 100 Stat. 3100; June 19, 1998, P.L. 105-183, § 4(b), 112 Stat. 518; April 20, 2005, P.L. 109-8, Title I, § 102(a), (f), 119 Stat. 27, 33; Feb. 14, 2007, *72 Fed. Reg. 7082.)*

HISTORY; ANCILLARY LAWS AND DIRECTIVES

Prior law and revision:

Legislative Statements

Section 707 of the House amendment indicates that the court may dismiss a case only after notice and a hearing.

Senate Report No. 95-989

This section authorizes the court to dismiss a liquidation case only for cause, such as unreasonable delay by the debtor that is prejudicial to creditors or nonpayment of any fees and charges required under chapter 123 [§ 1911 et seq.] of title 28. These causes are not exhaustive, but merely illustrative. The section does not contemplate, however, that the ability of the debtor to repay his debts in whole or in part constitutes adequate cause for dismissal. To permit dismissal on that ground would be to enact a non-uniform mandatory chapter 13, in lieu of the remedy of bankruptcy.

Explanatory notes:

The section number "320" has been inserted in brackets in subsec. (b)(2)(A)(ii)(I) to indicate the reference probably intended by Congress.

Effective date of section:

This section became effective on October 1, 1979, pursuant to § 402(a) of Act Nov. 6, 1978, P.L. 95-598, which appears as *11 USCS prec § 101* note.

Amendments:

1984. Act July 10, 1984 designated the existing provisions as subsec. (a), and, in paras. (1) and (2), purported to substitute "or" for "and", but the amendment was executed to subsec. (a), paras. (1) and (2) as so designated, as the probable intent of Congress; and added subsec. (b).

1986. Act Oct. 27, 1986 (effective and applicable as provided by § 302 of such Act, which appears as *28 USCS § 581* note), in subsec. (a), in para. (1), deleted "or" following "creditors;", in para. (2), substituted "; and" for the concluding period, and added para. (3); and in subsec. (b), substituted "motion or on a motion by the United States trustee, but" for "motion and".

1998. Act June 16, 1998 (applicable as provided by § 5 of such Act, which appears as *11 USCS § 544* note), in subsec. (b), added the sentence beginning "In making a determination whether to dismiss . . .".

2005. Act April 20, 2005 (effective 180 days after enactment and inapplicable to cases commenced before the effective

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UNITED STATES CODE SERVICE

*** ARCHIVE MATERIAL ***

*** CURRENT THROUGH 108TH CONGRESS, SECOND SESSION ***

TITLE 11. BANKRUPTCY
CHAPTER 7. LIQUIDATION
SUBCHAPTER I. OFFICERS AND ADMINISTRATION

11 USCS § 707 (2004)

§ 707. Dismissal

(a) The court may dismiss a case under this chapter *[11 USCS §§ 701* et seq.] only after notice and a hearing and only for cause, including--

(1) unreasonable delay by the debtor that is prejudicial to creditors;

(2) nonpayment of any fees [or] and charges required under chapter 123 of title 28; and

(3) failure of the debtor in a voluntary case to file, within fifteen days or such additional time as the court may allow after the filing of the petition commencing such case, the information required by paragraph (1) of section 521 *[11 USCS § 521],* but only on a motion by the United States trustee.

(b) After notice and a hearing, the court, on its own motion or on a motion by the United States trustee, but not at the request or suggestion of any party in interest, may dismiss a case filed by an individual debtor under this chapter whose debts are primarily consumer debts if it finds that the granting of relief would be a substantial abuse of the provisions of this chapter *[11 USCS §§ 701* et seq.]. There shall be a presumption in favor of granting the relief requested by the debtor. In making a determination whether to dismiss a case under this section, the court may not take into consideration whether a debtor has made, or continues to make, charitable contributions (that meet the definition of "charitable contribution" under section 548(d)(3) *[11 USCS § 548*(d)(3)]) to any qualified religious or charitable entity or organization (as that term is defined in section 548(d)(4) *[11 USCS § 548*(d)(4)]).

HISTORY:

(Nov. 6, 1978, P.L. 95-598, Title I, § 101, 92 Stat. 2606; July 10, 1984, P.L. 98-353, Title III, Subtitle A, § 312, Subtitle H, § 475, 98 Stat. 355, 381; Oct. 27, 1986, P.L. 99-554, Title II, Subtitle A, § 219, 100 Stat. 3100.)

(As amended June 19, 1998, P.L. 105-183, § 4(b), 112 Stat. 518.)

HISTORY; ANCILLARY LAWS AND DIRECTIVES

Prior law and revision:

Legislative Statements

Section 707 of the House amendment indicates that the court may dismiss a case only after notice and a hearing.

Senate Report No. 95-989

This section authorizes the court to dismiss a liquidation case only for cause, such as unreasonable delay by the

LEXSTAT 26 USC 7430

UNITED STATES CODE SERVICE

*** CURRENT THROUGH P.L. 110-197, APPROVED 3/14/2008 ***

TITLE 26. INTERNAL REVENUE CODE
SUBTITLE F. PROCEDURE AND ADMINISTRATION
CHAPTER 76. JUDICIAL PROCEEDINGS
SUBCHAPTER B. PROCEEDINGS BY TAXPAYERS AND THIRD PARTIES

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26 USCS § 7430

§ 7430. Awarding of costs and certain fees.

(a) In general. In any administrative or court proceeding which is brought by or against the United States in connection with the determination, collection, or refund of any tax, interest, or penalty under this title, the prevailing party may be awarded a judgment or a settlement for--

(1) reasonable administrative costs incurred in connection with such administrative proceeding within the Internal Revenue Service, and

(2) reasonable litigation costs incurred in connection with such court proceeding.

(b) Limitations.

(1) Requirement that administrative remedies be exhausted. A judgment for reasonable litigation costs shall not be awarded under subsection (a) in any court proceeding unless the court determines that the prevailing party has exhausted the administrative remedies available to such party within the Internal Revenue Service. Any failure to agree to an extension of the time for the assessment of any tax shall not be taken into account for purposes of determining whether the prevailing party meets the requirements of the preceding sentence.

(2) Only costs allocable to the United States. An award under subsection (a) shall be made only for reasonable litigation and administrative costs which are allocable to the United States and not to any other party.

(3) Costs denied where party prevailing protracts proceedings. No award for reasonable litigation and administrative costs may be made under subsection (a) with respect to any portion of the administrative or court proceeding during which the prevailing party has unreasonably protracted such proceeding.

(4) Period for applying to IRS for administrative costs. An award may be made under subsection (a) by the Internal Revenue Service for reasonable administrative costs only if the prevailing party files an application with the Internal Revenue Service for such costs before the 91st day after the date on which the final decision of the Internal Revenue Service as to the determination of the tax, interest, or penalty is mailed to such party.

(c) Definitions. For purposes of this section--

(1) Reasonable litigation costs. The term "reasonable litigation costs" includes--

(A) reasonable court costs, and

(B) based upon prevailing market rates for the kind or quality of services furnished--

(i) the reasonable expenses of expert witnesses in connection with a court proceeding, except that no expert witness shall be compensated at a rate in excess of the highest rate of compensation for expert witnesses paid by the

United States,

(ii) the reasonable cost of any study, analysis, engineering report, test, or project which is found by the court to be necessary for the preparation of the party's case, and

(iii) **[Caution: See § 3.39 of *Rev. Proc. 2007-66* (*26 USCS § 1* note) for provision that, for fees incurred in calendar year 2008, the attorney fee award limitation under this clause is $ 170 per hour.]** reasonable fees paid or incurred for the services of attorneys in connection with the court proceeding, except that such fees shall not be in excess of $ 125 per hour unless the court determines that a special factor, such as the limited availability of qualified attorneys for such proceeding, the difficulty of the issues presented in the case, or the local availability of tax expertise, justifies a higher rate.

In the case of any calendar year beginning after 1996, the dollar amount referred to in clause (iii) shall be increased by an amount equal to such dollar amount multiplied by the cost-of-living adjustment determined under section 1(f)(3) [*26 USCS § 1(f)(3)*] for such calendar year, by substituting "calendar year 1995" for "calendar year 1992" in subparagraph (B) thereof. If any dollar amount after being increased under the preceding sentence is not a multiple of $ 10, such dollar amount shall be rounded to the nearest multiple of $ 10.

(2) Reasonable administrative costs. The term "reasonable administrative costs" means--

(A) any administrative fees or similar charges imposed by the Internal Revenue Service, and

(B) expenses, costs, and fees described in paragraph (1)(B), except that any determination made by the court under clause (ii) or (iii) thereof shall be made by the Internal Revenue Service in cases where the determination under paragraph (4)(C) of the awarding of reasonable administrative costs is made by the Internal Revenue Service.

Such term shall only include costs incurred on or after whichever of the following is the earliest: (i) the date of the receipt by the taxpayer of the notice of the decision of the Internal Revenue Service Office of Appeals; (ii) the date of the notice of deficiency; or (iii) the date on which the first letter of proposed deficiency which allows the taxpayer an opportunity for administrative review in the Internal Revenue Service Office of Appeals is sent.

(3) Attorneys' fees.

(A) In general. For purposes of paragraphs (1) and (2), fees for the services of an individual (whether or not an attorney) who is authorized to practice before the Tax Court or before the Internal Revenue Service shall be treated as fees for the services of an attorney.

(B) Pro bono services. The court may award reasonable attorneys' fees under subsection (a) in excess of the attorneys' fees paid or incurred if such fees are less than the reasonable attorneys' fees because an individual is representing the prevailing party for no fee or for a fee which (taking into account all the facts and circumstances) is no more than a nominal fee. This subparagraph shall apply only if such award is paid to such individual or such individual's employer.

(4) Prevailing party.

(A) In general. The term "prevailing party" means any party in any proceeding to which subsection (a) applies (other than the United States or any creditor of the taxpayer involved)--

(i) which--

(I) has substantially prevailed with respect to the amount in controversy, or

(II) has substantially prevailed with respect to the most significant issue or set of issues presented, and

(ii) which meets the requirements of the 1st sentence of *section 2412(d)(1)(B) of title 28, United States Code* (as in effect on October 22, 1986) except to the extent differing procedures are established by rule of court and meets the requirements of section 2412(d)(2)(B) of such title 28 (as so in effect).

(B) Exception if United States establishes that its position was substantially justified.

(i) General rule. A party shall not be treated as the prevailing party in a proceeding to which subsection (a) applies if the United States establishes that the position of the United States in the proceeding was substantially justified.

(ii) Presumption of no justification if Internal Revenue Service did not follow certain published guidance. For purposes of clause (i), the position of the United States shall be presumed not to be substantially justified if the Internal Revenue Service did not follow its applicable published guidance in the administrative proceeding. Such presumption may be rebutted.

(iii) Effect of losing on substantially similar issues. In determining for purposes of clause (i) whether the position of the United States was substantially justified, the court shall take into account whether the United States has lost in courts of appeal for other circuits on substantially similar issues.

(iv) Applicable published guidance. For purposes of clause (ii), the term "applicable published guidance" means--

(I) regulations, revenue rulings, revenue procedures, information releases, notices, and announcements, and

(II) any of the following which are issued to the taxpayer: private letter rulings, technical advice memoranda, and determination letters.

(C) Determination as to prevailing party. Any determination under this paragraph as to whether a party is a prevailing party shall be made by agreement of the parties or--

(i) in the case where the final determination with respect to the tax, interest, or penalty is made at the administrative level, by the Internal Revenue Service, or

(ii) in the case where such final determination is made by a court, the court.

(D) Special rules for applying net worth requirement. In applying the requirements of *section 2412(d)(2)(B) of title 28, United States Code*, for purposes of subparagraph (A)(ii) of this paragraph--

(i) the net worth limitation in clause (i) of such section shall apply to--

(I) an estate but shall be determined as of the date of the decedent's death, and

(II) a trust but shall be determined as of the last day of the taxable year involved in the proceeding, and

(ii) individuals filing a joint return shall be treated as separate individuals for purposes of clause (i) of such section.

(E) Special rules where judgment less than taxpayer's offer.

(i) In general. A party to a court proceeding meeting the requirements of subparagraph (A)(ii) shall be treated as the prevailing party if the liability of the taxpayer pursuant to the judgment in the proceeding (determined without regard to interest) is equal to or less than the liability of the taxpayer which would have been so determined if the United States had accepted a qualified offer of the party under subsection (g).

(ii) Exceptions. This subparagraph shall not apply to--

(I) any judgment issued pursuant to a settlement; or

(II) any proceeding in which the amount of tax liability is not in issue, including any declaratory judgment proceeding, any proceeding to enforce or quash any summons issued pursuant to this title, and any action to restrain disclosure under section 6110(f) [*26 USCS § 6110(f)*].

(iii) Special rules. If this subparagraph applies to any court proceeding--

(I) the determination under clause (i) shall be made by reference to the last qualified offer made with respect to the tax liability at issue in the proceeding; and

(II) reasonable administrative and litigation costs shall only include costs incurred on and after the date of such offer.

(iv) Coordination. This subparagraph shall not apply to a party which is a prevailing party under any other provision of this paragraph.

(5) Administrative proceedings. The term "administrative proceeding" means any procedure or other action before the Internal Revenue Service.

(6) Court proceedings. The term "court proceeding" means any civil action brought in a court of the United States (including the Tax Court and the United States Claims Court [United States Court of Federal Claims]).

(7) Position of United States. The term "position of the United States" means--

(A) the position taken by the United States in a judicial proceeding to which subsection (a) applies, and

(B) the position taken in an administrative proceeding to which subsection (a) applies as of the earlier of--

(i) the date of the receipt by the taxpayer of the notice of the decision of the Internal Revenue Service Office of Appeals, or

(ii) the date of the notice of deficiency.

(d) Special rules for payment of costs.

(1) Reasonable administrative costs. An award for reasonable administrative costs shall be payable out of funds appropriated under *section 1304 of title 31, United States Code*.

(2) Reasonable litigation costs. An award for reasonable litigation costs shall be payable in the case of the Tax Court in the same manner as such an award by a district court.

(e) Multiple actions. For purposes of this section, in the case of --
(1) multiple actions which could have been joined or consolidated, or
(2) a case or cases involving a return or returns of the same taxpayer (including joint returns of married individuals) which could have been joined in a single court proceeding in the same court,

such actions or cases shall be treated as 1 court proceeding regardless of whether such joinder or consolidation actually occurs, unless the court in which such action is brought determines, in its discretion, that it would be inappropriate to treat such actions or cases as joined or consolidated.

(f) Right of appeal.
(1) Court proceedings. An order granting or denying (in whole or in part) an award for reasonable litigation or administrative costs under subsection (a) in a court proceeding, may be incorporated as a part of the decision or judgment in the court proceeding and shall be subject to appeal in the same manner as the decision or judgment.
(2) Administrative proceedings. A decision granting or denying (in whole or in part) an award for reasonable administrative costs under subsection (a) by the Internal Revenue Service shall be subject to the filing of a petition for review with the Tax Court under rules similar to the rules under section 7463 [*26 USCS § 7463*] (without regard to the amount in dispute). If the Secretary sends by certified or registered mail a notice of such decision to the petitioner, no proceeding in the Tax Court may be initiated under this paragraph unless such petition is filed before the 91st day after the date of such mailing.
(3) Appeal of Tax Court decision. An order of the Tax Court disposing of a petition under paragraph (2) shall be reviewable in the same manner as a decision of the Tax Court, but only with respect to the matters determined in such order.

(g) Qualified offer. For purposes of subsection (c)(4)--
(1) In general. The term "qualified offer" means a written offer which--
(A) is made by the taxpayer to the United States during the qualified offer period;
(B) specifies the offered amount of the taxpayer's liability (determined without regard to interest);
(C) is designated at the time it is made as a qualified offer for purposes of this section; and
(D) remains open during the period beginning on the date it is made and ending on the earliest of the date the offer is rejected, the date the trial begins, or the 90th day after the date the offer is made.
(2) Qualified offer period. For purposes of this subsection, the term "qualified offer period" means the period--
(A) beginning on the date on which the first letter of proposed deficiency which allows the taxpayer an opportunity for administrative review in the Internal Revenue Service Office of Appeals is sent, and
(B) ending on the date which is 30 days before the date the case is first set for trial.

HISTORY:
(Added Sept. 3, 1982, P.L. 97-248, Title II, § 292(a), 96 Stat. 572; July 18, 1984, P.L. 98-369, Div A, Title VII, § 714(c), 98 Stat. 961; Oct. 22, 1986, P.L. 99-514, Title XV, § 1551(a)-(g), 100 Stat. 2752, 2753; Nov. 10, 1988, P.L. 100-647, Title I, § 1015(i), Title VI, § 6239(a), 102 Stat. 3571, 3743; July 30, 1996, P.L. 104-168, Title VII, §§ 701(a)-(c)(2), 702(a), 703(a), 704(a), 110 Stat. 1463, 1464; Aug. 5, 1997, P.L. 105-34, Title XII, § 1285(a)-(c), Title XIV, § 1453(a), 111 Stat. 1038, 1055; July 22, 1998, P.L. 105-206, Title III, § 3101(a)-(e), Title VI, §§ 6012(h), 6014(e), 112 Stat. 727, 728, 819, 820; Dec. 21, 2000, P.L. 106-554, § 1(a)(7) (Title III, § 319(25)), 114 Stat. 2763, 2763A-647.)

HISTORY; ANCILLARY LAWS AND DIRECTIVES

Explanatory notes:

LEXSTAT 28 USC 157

UNITED STATES CODE SERVICE

*** CURRENT THROUGH P.L. 110-197, APPROVED 3/14/2008 ***

TITLE 28. JUDICIARY AND JUDICIAL PROCEDURE
PART I. ORGANIZATION OF COURTS
CHAPTER 6. BANKRUPTCY JUDGES

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28 USCS § 157

§ 157. Procedures

(a) Each district court may provide that any or all cases under title 11 and any or all proceedings arising under title 11 or arising in or related to a case under title 11 shall be referred to the bankruptcy judges for the district.

(b)

(1) Bankruptcy judges may hear and determine all cases under title 11 and all core proceedings arising under title 11, or arising in a case under title 11, referred under subsection (a) of this section, and may enter appropriate orders and judgments, subject to review under section 158 of this *title [28 USCS § 158*].

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

(A) matters concerning the administration of the estate;

(B) allowance or disallowance of claims against the estate or exemptions from property of the estate, and estimation of claims or interests for the purposes of confirming a plan under chapter 11, 12, or 13 of title 11 [*11 USCS §§ 1101* et seq., *1201* et seq. or *1301* et seq.] but not the liquidation or estimation of contingent or unliquidated personal injury tort or wrongful death claims against the estate for purposes of distribution in a case under title 11;

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

(D) orders in respect to obtaining credit;

(E) orders to turn over property of the estate;

(F) proceedings to determine, avoid, or recover preferences;

(G) motions to terminate, annul, or modify the automatic stay;

(H) proceedings to determine, avoid, or recover fraudulent conveyances;

(I) determinations as to the dischargeability of particular debts;

(J) objections to discharges;

(K) determinations of the validity, extent, or priority of liens;

(L) confirmations of plans;

(M) orders approving the use or lease of property, including the use of cash collateral;

(N) orders approving the sale of property other than property resulting from claims brought by the estate against persons who have not filed claims against the estate;

(O) other proceedings affecting the liquidation of the assets of the estate or the adjustment of the debtor-creditor or the equity security holder relationship, except personal injury tort or wrongful death claims; and

(P) recognition of foreign proceedings and other matters under chapter 15 of title 11 [*11 USCS §§ 1501* et seq.].

(3) The bankruptcy judge shall determine, on the judge's own motion or on timely motion of a party, whether a

proceeding is a core proceeding under this subsection or is a proceeding that is otherwise related to a case under title 11. A determination that a proceeding is not a core proceeding shall not be made solely on the basis that its resolution may be affected by State law.

(4) Non-core proceedings under *section 157(b)(2)(B) of title 28, United States Code*, shall not be subject to the mandatory abstention provisions of section 1334(c)(2) [*28 USCS § 1334(c)(2)*].

(5) The district court shall order that personal injury tort and wrongful death claims shall be tried in the district court in which the bankruptcy case is pending, or in the district court in the district in which the claim arose, as determined by the district court in which the bankruptcy case is pending.

(c)

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

(2) Notwithstanding the provisions of paragraph (1) of this subsection, the district court, with the consent of all the parties to the proceeding, may refer a proceeding related to a case under title 11 to a bankruptcy judge to hear and determine and to enter appropriate orders and judgments, subject to review under section 158 of this *title [28 USCS § 158*].

(d) The district court may withdraw, in whole or in part, any case or proceeding referred under this section, on its own motion or on timely motion of any party, for cause shown. The district court shall, on timely motion of a party, so withdraw a proceeding if the court determines that resolution of the proceeding requires consideration of both title 11 and other laws of the United States regulating organizations or activities affecting interstate commerce.

(e) If the right to a jury trial applies in a proceeding that may be heard under this section by a bankruptcy judge, the bankruptcy judge may conduct the jury trial if specially designated to exercise such jurisdiction by the district court and with the express consent of all the parties.

HISTORY:

(July 10, 1984, P.L. 98-353, Title I, § 104(a), 98 Stat. 340; Oct. 27, 1986, P.L. 99-554, Title I, Subtitle C, §§ 143, 144(b), 100 Stat. 3096; Oct. 22, 1994, P.L. 103-394, Title I, § 112, 108 Stat. 4117.)

(As amended April 20, 2005, P.L. 109-8, Title VIII, § 802(c)(1), 119 Stat. 145.)

HISTORY; ANCILLARY LAWS AND DIRECTIVES

Effective date of section:

This section took effect on July 10, 1984, pursuant to § 122(a) of Act July 10, 1984, P.L. 98-353, which appears as *28 USCS § 151* note.

Amendments:

1986. Act Oct. 27, 1986 (effective 30 days after enactment on 10/27/86, and applicable as provided by § 302 of such Act, which appears as *28 USCS § 581* note), in subsec. (b)(2), in subpara. (B), substituted "interests" for "interest", inserted ", 12,", and in subpara. (G), inserted a comma following "annul".

LEXSTAT 28 USC 158

UNITED STATES CODE SERVICE

*** CURRENT THROUGH P.L. 110-190, APPROVED 2/28/2008 ***

TITLE 28. JUDICIARY AND JUDICIAL PROCEDURE
PART I. ORGANIZATION OF COURTS
CHAPTER 6. BANKRUPTCY JUDGES

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28 USCS § 158

§ 158. Appeals

(a) The district courts of the United States shall have jurisdiction to hear appeals[--]
(1) from final judgments, orders, and decrees;
(2) from interlocutory orders and decrees issued under section 1121(d) of title 11 increasing or reducing the time periods referred to in section 1121 of such title; and
(3) with leave of the court, from other interlocutory orders and decrees;

of bankruptcy judges entered in cases and proceedings referred to the bankruptcy judges under section 157 of this *title [28 USCS § 157*]. An appeal under this subsection shall be taken only to the district court for the judicial district in which the bankruptcy judge is serving.

(b) (1) The judicial council of a circuit shall establish a bankruptcy appellate panel service composed of bankruptcy judges of the districts in the circuit who are appointed by the judicial council in accordance with paragraph (3), to hear and determine, with the consent of all the parties, appeals under subsection (a) unless the judicial council finds that--
(A) there are insufficient judicial resources available in the circuit; or
(B) establishment of such service would result in undue delay or increased cost to parties in cases under title 11.
Not later than 90 days after making the finding, the judicial council shall submit to the Judicial Conference of the United States a report containing the factual basis of such finding.
(2) (A) A judicial council may reconsider, at any time, the finding described in paragraph (1).
(B) On the request of a majority of the district judges in a circuit for which a bankruptcy appellate panel service is established under paragraph (1), made after the expiration of the 1-year period beginning on the date such service is established, the judicial council of the circuit shall determine whether a circumstance specified in subparagraph (A) or (B) of such paragraph exists.
(C) On its own motion, after the expiration of the 3-year period beginning on the date a bankruptcy appellate panel service is established under paragraph (1), the judicial council of the circuit may determine whether a circumstance specified in subparagraph (A) or (B) of such paragraph exists.
(D) If the judicial council finds that either of such circumstances exists, the judicial council may provide for the completion of the appeals then pending before such service and the orderly termination of such service.
(3) Bankruptcy judges appointed under paragraph (1) shall be appointed and may be reappointed under such paragraph.
(4) If authorized by the Judicial Conference of the United States, the judicial councils of 2 or more circuits may

establish a joint bankruptcy appellate panel comprised of bankruptcy judges from the districts within the circuits for which such panel is established, to hear and determine, upon the consent of all the parties, appeals under subsection (a) of this section.

(5) An appeal to be heard under this subsection shall be heard by a panel of 3 members of the bankruptcy appellate panel service, except that a member of such service may not hear an appeal originating in the district for which such member is appointed or designated under section 152 of this *title [28 USCS § 152]*.

(6) Appeals may not be heard under this subsection by a panel of the bankruptcy appellate panel service unless the district judges for the district in which the appeals occur, by majority vote, have authorized such service to hear and determine appeals originating in such district.

(c) (1) Subject to subsections (b) and (d)(2), each appeal under subsection (a) shall be heard by a 3-judge panel of the bankruptcy appellate panel service established under subsection (b)(1) unless--

(A) the appellant elects at the time of filing the appeal; or

(B) any other party elects, not later than 30 days after service of notice of the appeal, to have such appeal heard by the district court.

(2) An appeal under subsections (a) and (b) of this section shall be taken in the same manner as appeals in civil proceedings generally are taken to the courts of appeals from the district courts and in the time provided by Rule 8002 of the Bankruptcy Rules [*USCS Court Rules, Bankruptcy Rules, Rule 8002*].

(d) (1) The courts of appeals shall have jurisdiction of appeals from all final decisions, judgments, orders, and decrees entered under subsections (a) and (b) of this section.

(2) (A) The appropriate court of appeals shall have jurisdiction of appeals described in the first sentence of subsection (a) if the bankruptcy court, the district court, or the bankruptcy appellate panel involved, acting on its own motion or on the request of a party to the judgment, order, or decree described in such first sentence, or all the appellants and appellees (if any) acting jointly, certify that--

(i) the judgment, order, or decree involves a question of law as to which there is no controlling decision of the court of appeals for the circuit or of the Supreme Court of the United States, or involves a matter of public importance;

(ii) the judgment, order, or decree involves a question of law requiring resolution of conflicting decisions; or

(iii) an immediate appeal from the judgment, order, or decree may materially advance the progress of the case or proceeding in which the appeal is taken;

and if the court of appeals authorizes the direct appeal of the judgment, order, or decree.

(B) If the bankruptcy court, the district court, or the bankruptcy appellate panel--

(i) on its own motion or on the request of a party, determines that a circumstance specified in clause (i), (ii), or (iii) of subparagraph (A) exists; or

(ii) receives a request made by a majority of the appellants and a majority of appellees (if any) to make the certification described in subparagraph (A);

then the bankruptcy court, the district court, or the bankruptcy appellate panel shall make the certification described in subparagraph (A).

(C) The parties may supplement the certification with a short statement of the basis for the certification.

(D) An appeal under this paragraph does not stay any proceeding of the bankruptcy court, the district court, or the bankruptcy appellate panel from which the appeal is taken, unless the respective bankruptcy court, district court, or bankruptcy appellate panel, or the court of appeals in which the appeal in pending, issues a stay of such proceeding pending the appeal.

(E) Any request under subparagraph (B) for certification shall be made not later than 60 days after the entry of the judgment, order, or decree.

HISTORY:

(July 10, 1984, P.L. 98-353, Title I, § 104(a), 98 Stat. 341; Dec. 1, 1990, P.L. 101-650, Title III, § 305, 104 Stat. 5105; Oct. 22, 1994, P.L. 103-394, Title I, §§ 102, 104(c), (d), 108 Stat. 4108-4110.)

(As amended April 20, 2005, P.L. 109-8, Title XII, § 1233(a), 119 Stat. 202.)

LEXSTAT 28 USC 586

UNITED STATES CODE SERVICE

*** CURRENT THROUGH P.L. 110-197, APPROVED 3/14/2008 ***

TITLE 28. JUDICIARY AND JUDICIAL PROCEDURE
PART II. DEPARTMENT OF JUSTICE
CHAPTER 39. UNITED STATES TRUSTEES

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28 USCS § 586

§ 586. Duties; supervision by Attorney General

(a) Each United States trustee, within the region for which such United States trustee is appointed, shall--

(1) establish, maintain, and supervise a panel of private trustees that are eligible and available to serve as trustees in cases under chapter 7 of title 11 [*11 USCS §§ 701* et seq.];

(2) serve as and perform the duties of a trustee in a case under title 11 when required under title 11 to serve as trustee in such a case;

(3) supervise the administration of cases and trustees in cases under chapter 7, 11, 12, 13, or 15 of title 11 [*11 USCS §§ 701* et seq., *1101* et seq., *1201* et seq., *1301* et seq., or *1501* et seq.] by, whenever the United States trustee considers it to be appropriate--

(A)

(i) reviewing, in accordance with procedural guidelines adopted by the Executive Office of the United States Trustee (which guidelines shall be applied uniformly by the United States trustee except when circumstances warrant different treatment), applications filed for compensation and reimbursement under section 330 of title 11; and

(ii) filing with the court comments with respect to such application and, if the United States Trustee considers it to be appropriate, objections to such application.[;]

(B) monitoring plans and disclosure statements filed in cases under chapter 11 of title 11 [*11 USCS §§ 1101* et seq.] and filing with the court, in connection with hearings under sections 1125 and 1128 of such title, comments with respect to such plans and disclosure statements;

(C) monitoring plans filed under chapters 12 and 13 of title 11 [*11 USCS §§ 1201* et seq., *1301* et seq.] and filing with the court, in connection with hearings under sections 1224, 1229, 1324, and 1329 of such *title [11 USCS §§ 1224*, *1229*, *1324*, and *1329*], comments with respect to such plans;

(D) taking such action as the United States trustee deems to be appropriate to ensure that all reports, schedules, and fees required to be filed under title 11 and this title by the debtor are properly and timely filed;

(E) monitoring creditors' committees appointed under title 11;

(F) notifying the appropriate United States attorney of matters which relate to the occurrence of any action which may constitute a crime under the laws of the United States and, on the request of the United States attorney, assisting the United States attorney in carrying out prosecutions based on such action;

(G) monitoring the progress of cases under title 11 and taking such actions as the United States trustee deems to be appropriate to prevent undue delay in such progress;

(H) in small business cases (as defined in section 101 of title 11 [*11 USCS § 101*]), performing the additional duties specified in title 11 pertaining to such cases; and

(I) monitoring applications filed under section 327 of title 11 [*11 USCS § 327*] and, whenever the United States trustee deems it to be appropriate, filing with the court comments with respect to the approval of such applications;

(4) deposit or invest under section 345 of title 11 money received as trustee in cases under title 11;

(5) perform the duties prescribed for the United States trustee under title 11 and this title, and such duties consistent with title 11 and this title as the Attorney General may prescribe;

(6) make such reports as the Attorney General directs, including the results of audits performed under section 603(a) of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 [note to this section];

(7) in each of such small business cases--

(A) conduct an initial debtor interview as soon as practicable after the date of the order for relief but before the first meeting scheduled under section 341(a) of title 11 [*11 USCS § 341(a)*], at which time the United States trustee shall--

(i) begin to investigate the debtor's viability;

(ii) inquire about the debtor's business plan;

(iii) explain the debtor's obligations to file monthly operating reports and other required reports;

(iv) attempt to develop an agreed scheduling order; and

(v) inform the debtor of other obligations;

(B) if determined to be appropriate and advisable, visit the appropriate business premises of the debtor, ascertain the state of the debtor's books and records, and verify that the debtor has filed its tax returns; and

(C) review and monitor diligently the debtor's activities, to identify as promptly as possible whether the debtor will be unable to confirm a plan; and

(8) in any case in which the United States trustee finds material grounds for any relief under section 1112 of title 11, the United States trustee shall apply promptly after making that finding to the court for relief.

(b) If the number of cases under chapter 12 or 13 of title 11 [*11 USCS §§ 1201* et seq. or *1301* et seq.] commenced in a particular region so warrants, the United States trustee for such region may, subject to the approval of the Attorney General, appoint one or more individuals to serve as standing trustee, or designate one or more assistant United States trustees to serve in cases under such chapter. The United States trustee for such region shall supervise any such individual appointed as standing trustee in the performance of the duties of standing trustee.

(c) Each United States trustee shall be under the general supervision of the Attorney General, who shall provide general coordination and assistance to the United States trustees.

(d) (1) The Attorney General shall prescribe by rule qualifications for membership on the panels established by United States trustees under paragraph (a)(1) of this section, and qualifications for appointment under subsection (b) of this section to serve as standing trustee in cases under chapter 12 or 13 of title 11 [*11 USCS §§ 1201* et seq. or *1301* et seq.]. The Attorney General may not require that an individual be an attorney in order to qualify for appointment under subsection (b) of this section to serve as standing trustee in cases under chapter 12 or 13 of title 11 [*11 USCS §§ 1201* et seq. or *1301* et seq.].

(2) A trustee whose appointment under subsection (a)(1) or under subsection (b) is terminated or who ceases to be assigned to cases filed under title 11, United States Code, may obtain judicial review of the final agency decision by commencing an action in the district court of the United States for the district for which the panel to which the trustee is appointed under subsection (a)(1), or in the district court of the United States for the district in which the trustee is appointed under subsection (b) resides, after first exhausting all available administrative remedies, which if the trustee so elects, shall also include an administrative hearing on the record. Unless the trustee elects to have an administrative hearing on the record, the trustee shall be deemed to have exhausted all administrative remedies for purposes of this paragraph if the agency fails to make a final agency decision within 90 days after the trustee requests administrative remedies. The Attorney General shall prescribe procedures to implement this paragraph. The decision of the agency shall be affirmed by the district court unless it is unreasonable and without cause based on the administrative record before the agency.

(e)

(1) The Attorney General, after consultation with a United States trustee that has appointed an individual under subsection (b) of this section to serve as standing trustee in cases under chapter 12 or 13 of title 11 [*11 USCS §§ 1201* et seq. or *1301* et seq.], shall fix--

(A) a maximum annual compensation for such individual consisting of--

(i) an amount not to exceed the highest annual rate of basic pay in effect for level V of the Executive Schedule; and

(ii) the cash value of employment benefits comparable to the employment benefits provided by the United States to individuals who are employed by the United States at the same rate of basic pay to perform similar services during the same period of time; and

(B) a percentage fee not to exceed--

(i) in the case of a debtor who is not a family farmer, ten percent; or

(ii) in the case of a debtor who is a family farmer, the sum of--

(I) not to exceed ten percent of the payments made under the plan of such debtor, with respect to payments in an aggregate amount not to exceed $ 450,000; and

(II) three percent of payments made under the plan of such debtor, with respect to payments made after the aggregate amount of payments made under the plan exceeds $ 450,000;

based on such maximum annual compensation and the actual, necessary expenses incurred by such individual as standing trustee.

(2) Such individual shall collect such percentage fee from all payments received by such individual under plans in the cases under chapter 12 or 13 of title 11 [*11 USCS §§ 1201* et seq. or *1301* et seq.] for which such individual serves as standing trustee. Such individual shall pay to the United States trustee, and the United States trustee shall deposit in the United States Trustee System Fund--

(A) any amount by which the actual compensation of such individual exceeds 5 per centum upon all payments received under plans in cases under chapter 12 or 13 of title 11 [*11 USCS §§ 1201* et seq. or *1301* et seq.] for which such individual serves as standing trustee; and

(B) any amount by which the percentage for all such cases exceeds--

(i) such individual's actual compensation for such cases, as adjusted under subparagraph (A) of paragraph (1); plus

(ii) the actual, necessary expenses incurred by such individual as standing trustee in such cases. Subject to the approval of the Attorney General, any or all of the interest earned from the deposit of payments under plans by such individual may be utilized to pay actual, necessary expenses without regard to the percentage limitation contained in subparagraph (d)(1)(B) of this section.

(3) After first exhausting all available administrative remedies, an individual appointed under subsection (b) may obtain judicial review of final agency action to deny a claim of actual, necessary expenses under this subsection by commencing an action in the district court of the United States for the district where the individual resides. The decision of the agency shall be affirmed by the district court unless it is unreasonable and without cause based upon the administrative record before the agency.

(4) The Attorney General shall prescribe procedures to implement this subsection.

(f) (1) The United States trustee for each district is authorized to contract with auditors to perform audits in cases designated by the United States trustee, in accordance with the procedures established under section 603(a) of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 [note to this section].

(2) (A) The report of each audit referred to in paragraph (1) shall be filed with the court and transmitted to the United States trustee. Each report shall clearly and conspicuously specify any material misstatement of income or expenditures or of assets identified by the person performing the audit. In any case in which a material misstatement of income or expenditures or of assets has been reported, the clerk of the district court (or the clerk of the bankruptcy court if one is certified under section 156(b) of this title *[11 USCS § 156*(b)]) shall give notice of the misstatement to the creditors in the case.

(B) If a material misstatement of income or expenditures or of assets is reported, the United States trustee shall--

(i) report the material misstatement, if appropriate, to the United States Attorney pursuant to section 3057 of title 18 [*18 USCS § 3057*]; and

(ii) advisable, take appropriate action, including but not limited to commencing an adversary proceeding to revoke the debtor's discharge pursuant to section 727(d) of title 11 [*11 USCS § 727(d)*].

HISTORY:

(Nov. 6, 1978, P.L. 95-598, Title II, § 224(a), 92 Stat. 2663; Oct. 27, 1986, P.L. 99-554, Title I, Subtitle B, § 113, 100 Stat. 3091; Nov. 5, 1990, P.L. 101-509, Title V, § 529 [Title I, § 110(a) 104 Stat. 1452; Oct. 22, 1994, P.L. 103-394, Title II, § 224(a), Title V, § 502, 108 Stat. 4130, 4147.)

(As amended April 20, 2005, P.L. 109-8, Title IV, Subtitle B, § 439, Title VI, § 603(b), Title VIII, § 802(c)(3), Title XII, § 1231, 119 Stat. 113, 122, 146, 201.)

HISTORY; ANCILLARY LAWS AND DIRECTIVES

References in text:

Level V of the Executive Schedule, referred to in subsec. (e)(1)(A)(i), is set out in *5 USCS § 5316*.

Explanatory notes:

The bracketed semicolon has been inserted in subsec. (a)(3)(A)(ii) to indicate the punctuation probably intended by Congress.

Effective date of section:

This section took effect on October 1, 1979, pursuant to § 402(c) of Act Nov. 6, 1978, P.L. 95-598, which appears as *11 USCS prec § 101* note.

Amendments:

1986. Act Oct. 27, 1986 (effective 30 days after enactment on 10/27/86, and applicable as provided by § 302 of such Act, which appears as *28 USCS § 581* note), in subsec. (a), in the introductory matter, substituted "the region for which such United States trustee is appointed" for "his district", in para. (3), substituted "by, whenever the United States trustee considers it to be appropriate--" for the semicolon, and added subparas. (A)-(H), and in para. (5), inserted "and this title, and such duties consistent with title 11 and this title as the Attorney General may prescribe".

Such Act further substituted subsecs. (b), (d) and (e) for ones which read:

"(b) If the number of cases under chapter 13 of title 11 commenced in a particular judicial district so warrant, the United States trustee for such district may, subject to the approval of the Attorney General, appoint one or more individuals to serve as standing trustee, or designate one or more assistant United States trustee, in cases under such chapter. The United States trustee for such district shall supervise any such individual appointed as standing trustee in the performance of the duties of standing trustee.";

"(d) The Attorney General shall prescribe by rule qualifications for membership on the panels established by United States trustees under subsection (a)(1) of this section, and qualifications for appointment under subsection (b) of this section to serve as standing trustee in cases under chapter 13 of title 11. The Attorney General may not require that an individual be an attorney in order to qualify for appointment under subsection (b) of this section to serve as standing trustee in cases under chapter 13 of title 11.";

"(e)

(1) The Attorney General, after consultation with a United States trustee that has appointed an individual under

LEXSTAT 28 USC 2412

UNITED STATES CODE SERVICE

*** CURRENT THROUGH P.L. 110-190, APPROVED 2/28/2008 ***

TITLE 28. JUDICIARY AND JUDICIAL PROCEDURE
PART VI. PARTICULAR PROCEEDINGS
CHAPTER 161. UNITED STATES AS PARTY GENERALLY

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28 USCS § 2412

§ 2412. Costs and fees

(a)

(1) Except as otherwise specifically provided by statute, a judgment for costs, as enumerated in section 1920 of this *title [28 USCS § 1920*], but not including the fees and expenses of attorneys, may be awarded to the prevailing party in any civil action brought by or against the United States or any agency or any official of the United States acting in his or her official capacity in any court having jurisdiction of such action. A judgment for costs when taxed against the United States shall, in an amount established by statute, court rule, or order, be limited to reimbursing in whole or in part the prevailing party for the costs incurred by such party in the litigation.

(2) A judgment for costs, when awarded in favor of the United States in an action brought by the United States, may include an amount equal to the filing fee prescribed under section 1914(a) of this *title [28 USCS § 1914(a)*]. The preceding sentence shall not be construed as requiring the United States to pay any filing fee.

(b) Unless expressly prohibited by statute, a court may award reasonable fees and expenses of attorneys, in addition to the costs which may be awarded pursuant to subsection (a), to the prevailing party in any civil action brought by or against the United States or any agency or any official of the United States acting in his or her official capacity in any court having jurisdiction of such action. The United States shall be liable for such fees and expenses to the same extent that any other party would be liable under the common law or under the terms of any statute which specifically provides for such an award.

(c) (1) Any judgment against the United States or any agency and any official of the United States acting in his or her official capacity for costs pursuant to subsection (a) shall be paid as provided in sections 2414 and 2517 of this *title [28 USCS §§ 2414*] and shall be in addition to any relief provided in the judgment.

(2) Any judgment against the United States or any agency and any official of the United States acting in his or her official capacity for fees and expenses of attorneys pursuant to subsection (b) shall be paid as provided in sections 2414 and 2517 of this *title [28 USCS §§ 2414* and *2517*], except that if the basis for the award is a finding that the United States acted in bad faith, then the award shall be paid by any agency found to have acted in bad faith and shall be in addition to any relief provided in the judgment.

(d)

(1) (A) Except as otherwise specifically provided by statute, a court shall award to a prevailing party other than the United States fees and other expenses, in addition to any costs awarded pursuant to subsection (a), incurred by that party

in any civil action (other than cases sounding in tort), including proceedings for judicial review of agency action, brought by or against the United States in any court having jurisdiction of that action, unless the court finds that the position of the United States was substantially justified or that special circumstances make an award unjust.

(B) A party seeking an award of fees and other expenses shall, within thirty days of final judgment in the action, submit to the court an application for fees and other expenses which shows that the party is a prevailing party and is eligible to receive an award under this subsection, and the amount sought, including an itemized statement from any attorney or expert witness representing or appearing in behalf of the party stating the actual time expended and the rate at which fees and other expenses were computed. The party shall also allege that the position of the United States was not substantially justified. Whether or not the position of the United States was substantially justified shall be determined on the basis of the record (including the record with respect to the action or failure to act by the agency upon which the civil action is based) which is made in the civil action for which fees and other expenses are sought.

(C) The court, in its discretion, may reduce the amount to be awarded pursuant to this subsection, or deny an award, to the extent that the prevailing party during the course of the proceedings engaged in conduct which unduly and unreasonably protracted the final resolution of the matter in controversy.

(D) If, in a civil action brought by the United States or a proceeding for judicial review of an adversary adjudication described in section 504(a)(4) of title 5, the demand by the United States is substantially in excess of the judgment finally obtained by the United States and is unreasonable when compared with such judgment, under the facts and circumstances of the case, the court shall award to the party the fees and other expenses related to defending against the excessive demand, unless the party has committed a willful violation of law or otherwise acted in bad faith, or special circumstances make an award unjust. Fees and expenses awarded under this subparagraph shall be paid only as a consequence of appropriations provided in advance.

(2) For the purposes of this subsection--

(A) "fees and other expenses" includes the reasonable expenses of expert witnesses, the reasonable cost of any study, analysis, engineering report, test, or project which is found by the court to be necessary for the preparation of the party's case, and reasonable attorney fees (The amount of fees awarded under this subsection shall be based upon prevailing market rates for the kind and quality of the services furnished, except that (i) no expert witness shall be compensated at a rate in excess of the highest rate of compensation for expert witnesses paid by the United States; and (ii) attorney fees shall not be awarded in excess of $ 125 per hour unless the court determines that an increase in the cost of living or a special factor, such as the limited availability of qualified attorneys for the proceedings involved, justifies a higher fee.);

(B) "party" means (i) an individual whose net worth did not exceed $ 2,000,000 at the time the civil action was filed, or (ii) any owner of an unincorporated business, or any partnership, corporation, association, unit of local government, or organization, the net worth of which did not exceed $ 7,000,000 at the time the civil action was filed, and which had not more than 500 employees at the time the civil action was filed; except that an organization described in *section 501(c)(3) of the Internal Revenue Code of 1954* [1986] (*26 U.S.C. 501(c)(3)*) exempt from taxation under section 501(a) of such Code, or a cooperative association as defined in section 15(a) of the Agricultural Marketing Act (*12 U.S.C. 1141j(a)*), may be a party regardless of the net worth of such organization or cooperative association or for purposes of subsection (d)(1)(D), a small entity as defined in section 601 of title 5;

(C) "United States" includes any agency and any official of the United States acting in his or her official capacity;

(D) "position of the United States" means, in addition to the position taken by the United States in the civil action, the action or failure to act by the agency upon which the civil action is based; except that fees and expenses may not be awarded to a party for any portion of the litigation in which the party has unreasonably protracted the proceedings;

(E) "civil action brought by or against the United States" includes an appeal by a party, other than the United States, from a decision of a contracting officer rendered pursuant to a disputes clause in a contract with the Government or pursuant to the Contract Disputes Act of 1978;

(F) "court" includes the United States Claims Court [United States Court of Federal Claims] and the United States Court of Appeals for Veterans Claims;

(G) "final judgment" means a judgment that is final and not appealable, and includes an order of settlement;

(H) "prevailing party", in the case of eminent domain proceedings, means a party who obtains a final judgment (other than by settlement), exclusive of interest, the amount of which is at least as close to the highest valuation of the property involved that is attested to at trial on behalf of the property owner as it is to the highest valuation of the property involved that is attested to at trial on behalf of the Government; and

(I) "demand" means the express demand of the United States which led to the adversary adjudication, but shall not include a recitation of the maximum statutory penalty (i) in the complaint, or (ii) elsewhere when accompanied by an express demand for a lesser amount.

(3) In awarding fees and other expenses under this subsection to a prevailing party in any action for judicial review of an adversary adjudication, as defined in subsection (b)(1)(C) of *section 504 of title 5, United States Code*, or an adversary adjudication subject to the Contract Disputes Act of 1978, the court shall include in that award fees and other expenses to the same extent authorized in subsection (a) of such section, unless the court finds that during such adversary adjudication the position of the United States was substantially justified, or that special circumstances make an award unjust.

(4) Fees and other expenses awarded under this subsection to a party shall be paid by any agency over which the party prevails from any funds made available to the agency by appropriation or otherwise.

(e) The provisions of this section shall not apply to any costs, fees, and other expenses in connection with any proceeding to which *section 7430 of the Internal Revenue Code of 1954* [1986] [*26 USCS § 7430*] applies (determined without regard to subsections (b) and (f) of such section [*26 USCS § 7430(b)*, (f)]). Nothing in the preceding sentence shall prevent the awarding under subsection (a) of *section 2412 of title 28, United States Code*, of costs enumerated in section 1920 of such title (as in effect on October 1, 1981).

(f) If the United States appeals an award of costs or fees and other expenses made against the United States under this section and the award is affirmed in whole or in part, interest shall be paid on the amount of the award as affirmed. Such interest shall be computed at the rate determined under section 1961(a) of this *title [28 USCS § 1961(a)*[, and shall run from the date of the award through the day before the date of the mandate of affirmance.

HISTORY:

(June 25, 1948, ch 646, § 1, 62 Stat. 973; July 18, 1966, P.L. 89-507, § 1, 80 Stat. 308; Oct. 21, 1980, P.L. 96-481, Title II, § 204(a), (c), 94 Stat. 2327, 2329; Sept. 3, 1982, P.L. 97-248, Title II, Subtitle G, § 292(c), 96 Stat. 574; Aug. 5, 1985, P.L. 99-80, §§ 2, 6, 99 Stat. 184, 186; Oct. 29, 1992, P.L. 102-572, Title III, § 301(a), Title V, §§ 502(b), 506(a), 106 Stat. 4511, 4512, 4513; Dec. 21, 1995, P.L. 104-66, Title I, Subtitle I, § 1091(b), 109 Stat. 722; March 29, 1996, P.L. 104-121, Title II, Subtitle C, § 232, 110 Stat. 863; Nov. 11, 1998, P.L. 105-368, Title V, Subtitle B, § 512(b)(1)(B), 112 Stat. 3342.)

HISTORY; ANCILLARY LAWS AND DIRECTIVES

Prior law and revision:

Based on *title 28, U.S.C., 1940 ed., §§ 258, 931(a)* (March 3, 1911, ch 231, § 152, 36 Stat. 1138; Aug. 2, 1946, ch 753, § 410(a), 60 Stat. 843).

Section consolidates the last sentence of *section 931(a) of title 28, U.S.C.*, 1940 ed., with section 258 of said title 28. For other provisions of said section 931(a), see Distribution Table.

Subsection (a) is new. It follows the well-known common-law rule that a sovereign is not liable for costs unless specific provision for such liability is made by law. This is a corollary to the rule that a sovereign cannot be sued without its consent.

Many enactments of Congress relating to fees and costs contain specific exceptions as to the liability of the United States. (See, for example, *section 548 of title 28, U.S.C.*, 1940 ed.) A uniform rule, embodied in this section, will make such specific exceptions unnecessary.

Subsection (b) incorporates *section 258 of title 28, U.S.C.*, 1940 ed.

Subsection (c) incorporates the costs provisions of *section 931(a) of title 28, U.S.C.*, 1940 ed.

CERTIFICATE OF SERVICE

I hereby certify that on March 21, 2008, I served a copy of the foregoing BRIEF OF APPELLEE by mailing a copy of this document, by United States first class mail, postage prepaid, addressed to the following:

None

I further certify that based on the Bankruptcy Court's Electronic Case Filing records, the following person(s) will be served electronically when the foregoing document is filed with the Court:

* MARK B COMSTOCK	mcomstock@garrettlaw.com
* BRET A. KNEWTSON	bknewtson@yahoo.com, knewtsonecf@gmail.com
* Robert K Morrow Inc	or12@ecfcbis.com
* JOHN D SCHLOTTER	bkmail@mrdefault.com, bkmail@mrdefault.com
* JOHN W WEIL	bmail@hooplaw.com, csayles@hooplaw.com

ROBERT D. MILLER JR.
Acting United States Trustee

/s/ Pamela J. Griffith
Pamela J. Griffith, OSB #81249
Assistant United States Trustee

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1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*
In re: Jonathan Loy (Jonathan Loy v. Jeremiah Anthony O'Sullivan, et al.)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*
E. D. Va.

3. ("CCN") ***CURRENT*** CASE NO.
No.: 10-cv-00054-RAJ-TEM

4. ("PCN") ***PRIOR*** CASE NO. - & COURT *[IF ANY]*
No.: 09-51379-FJS
Court: Bankr. E.D. Va.
(Identify judge & cite, if any)

5. ("SO") ***SOURCE***
U.S. TRUSTEES

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*
Filed: June 1, 2010
Type: Brief of Appellee W. Clarkson, Jr., United States Trustee

7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*
Kenneth N. Whitehurst, III, Catherine B. Sevcenko, P. Matthew Sutko, Ramona D. Elliott, Debera F. Conlon, W. Clarkson McDow, Jr.
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") ● ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***
● Whether the bankruptcy court properly denied debtor's motion to dismiss on the merits because the case was commenced properly under 11 U.S.C. §301 by a foreign representative in a recognized foreign main proceeding, pursuant to 11 U.S.C. §1511(a)(2).

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IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF VIRGINIA
NEWPORT NEWS DIVISION

IN RE:	)	
	)	
Jonathan Loy,	)	
	)	
DEBTOR	)	**Civil No. 4:10-cv-00054-RAJ-TEM**
______________________________	)	
	)	
Jonathan Loy,	)	
	)	
APPELLANT	)	**On Appeal From**
v.	)	**Bankruptcy Case 09-51379-FJS**
	)	
Jeremiah Anthony O'Sullivan, et al.	)	
	)	
APPELLEES	)	

ON APPEAL FROM THE UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF VIRGINIA

BRIEF OF APPELLEE W. CLARKSON MCDOW, JR., UNITED STATES TRUSTEE

RAMONA D. ELLIOTT
General Counsel

P. MATTHEW SUTKO
Associate General Counsel

CATHERINE B. SEVCENKO
Trial Attorney
Executive Office for United States Trustees
Department of Justice
20 Massachusetts Avenue, N.W.
Washington, D.C. 20530
Ph: (202) 307-1399
Fax: (202) 307-2397

W. CLARKSON MCDOW, JR.
United States Trustee for Region 4

DEBERA F. CONLON
Assistant United States Trustee

KENNETH N. WHITEHURST, III
Trial Attorney
Virginia State Bar No. 48919
Office of the U.S. Trustee
Norfolk Federal Building, Room 625
200 Granby Street
Norfolk, Virginia 23510
(757) 441-6012
(757) 441-3266 (fax)
kenneth.n.whitehurst@usdoj.gov

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STATEMENT OF BASIS FOR APPELLATE JURISDICTION

This matter comes before the Court on appeal from the United States Bankruptcy Court for the Eastern District of Virginia, Newport News Division, of a final order denying the Motion to Dismiss "'Voluntary' Chapter 7 Bankruptcy Under 11 U.S.C. § 301 & §303 and for Punitive Damages & Sanctions," filed October 9, 2009 as docket entry #58 by Jonathan A. Loy ("Mr. Loy") in Case No. 09-51379-FJS. The United States District Court for the Eastern District of Virginia, Newport News Division has jurisdiction over this appeal pursuant to 28 U.S.C. §158(a).

ISSUES PRESENTED

Did the bankruptcy court properly deny Mr. Loy's motion to dismiss a chapter 7 bankruptcy petition filed by the representative of Mr. Loy's foreign bankruptcy estate?

STANDARD OF REVIEW

In an appeal taken from a bankruptcy court order, a district court reviews a bankruptcy court's conclusions of law *de novo* and its findings of fact for clear error. *See In re Merry-Go-Round Enters., Inc.,* 400 F.3d 219, 224 (4th Cir. 2005).

STATEMENT OF THE CASE

As an initial matter, this case has two procedural infirmities. First Mr. Loy has presented an argument to this Court on the construction of chapter 15, title 11, U.S. Code (the "Bankruptcy Code") that he made twice in the bankruptcy court below. Second, seven of the nine arguments he makes are forfeited because he did not make them in the motion that is on appeal. Although neither res judicata or forfeiture alone justifies the dismissal of Mr. Loy's appeal, collectively they do. Because Mr. Loy's chapter 15 argument is res judicata and his other arguments are foreclosed, there is nothing for this Court to review.

On the merits, this is a case about the application of chapter 15 of the United States

Bankruptcy Code that "provides effective mechanisms for dealing with cases of cross-border insolvency . . . ." 11 U.S.C. § 1501. The voluntary bankruptcy case at issue here was commenced under chapter 7 of the Bankruptcy Code by Jeremiah Anthony O'Sullivan ("English Trustee"), the official receiver and trustee of the property of Jonathan Loy in an English insolvency proceeding. *In re Loy*, 380 B.R. 154, 158 (Bankr. E.D.Va. 2007) (St. John, J). The English Trustee acted in his capacity as foreign representative of a foreign main proceeding that had been recognized by the United States Bankruptcy Court for the Eastern District of Virginia in a separate case. *Id.* at 163 (recognizing Mr. Loy's English bankruptcy as a foreign main proceeding).

Since the commencement of the chapter 7 case, Mr. Loy has filed a series of motions seeking dismissal of the case on a variety of theories. Currently before this court on appeal is the bankruptcy court's order denying Mr. Loy's Motion to Dismiss "'Voluntary' Chapter 7 Bankruptcy Under 11 U.S.C. §301 & §303 and for Punitive Damages & Sanctions," filed October 9, 2009. [Dkt. #58]. As set forth below in greater detail, Mr. Loy's motion was properly denied on the merits.

STATEMENT OF FACTS

In this case, Mr. Loy has filed five motions to dismiss the chapter 7 bankruptcy filed by the English Trustee. The bankruptcy court has denied four of those motions; the fifth is still pending below. Mr. Loy appeals the denial of his fourth motion to dismiss, which he filed on October 9, 2009 [Dkt #58] and which the bankruptcy court denied on February 10, 2010 [Dkt. #155]. This is the only order that he has appealed.

Prior to October 2007, Mr. Loy was declared a bankrupt under the laws of England. *Loy,* 380 B.R. at 158. The English Trustee serves, under English bankruptcy law, as the trustee for Mr.

Loy's English bankruptcy estate. *Id.* On October 28, 2007, the English Trustee petitioned the United States District Court for the Eastern District of Virginia for an order recognizing Mr. Loy's English bankruptcy as a foreign main proceeding under 11 U.S.C. §1517(a)(1). *Id.* Mr. Loy opposed the relief requested by the English Trustee. An evidentiary hearing was conducted. Mr. Loy was provided both notice and opportunity to participate, which he did. *Loy*, 380 B.R. at 154. On December 18, 2007, the bankruptcy court granted the relief requested by the English Trustee, and entered an order recognizing Mr. Loy's English bankruptcy as a foreign main proceeding. (Appellant's Des., Item 1, pp. 4-6).[1]

On August 26, 2007, the English Trustee filed, pursuant to 11 U.S.C. §301, a voluntary petition under chapter 7 of the Bankruptcy Code in his capacity as foreign representative of a recognized foreign main proceeding. (Appellant's Des., Item 1). *See* 11 U.S.C. §1511(a)(2) (permitting foreign representative to commence a case under 11 U.S.C. §301 upon recognition of a foreign proceeding as a foreign main proceeding). The case was docketed as No. 09-51379.

On September 4, 2009, Mr. Loy moved to dismiss the case. [Dkt. #19]. On November 18, 2009, the bankruptcy court denied that motion. [Dkt. #90]. On September 17, 2009, Mr. Loy filed a second motion to dismiss, claiming the filing was barred by various statutes of limitation. [Dkt. #30]. Mr. Loy later withdrew this motion, as reflected in the bankruptcy court's order entered January 15, 2010. [Dkt. #122]. On October 1, 2009, Mr. Loy again moved to dismiss the case, citing his failure to obtain pre-petition credit counseling as required by 11 U.S.C. §109(h). [Dkt. #53]. That motion was also denied on November 18, 2009. [Dkt. #91]. Mr. Loy did not appeal any of those decisions.

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[1] Appellant's Des. refers to Mr. Loy's designation filed on April 14, 2010 [Dkt. #184]. Citations to the record refer to the bankruptcy court's docket unless otherwise noted.

On October 9, 2009, Mr. Loy filed a fourth motion seeking dismissal of his chapter 7 bankruptcy. [Dkt. #58]. The bankruptcy court denied it on February 10, 2010. [Dkt. #152]. The denial of this motion forms the only basis of Mr. Loy's current appeal. *See* Notice of Appeal [Dkt# 163].

On October 29, 2009, Mr. Loy filed a fifth motion seeking dismissal of his case. [Dkt. #75]. It is in the context of this fifth motion that Mr. Loy raises, for the first time, most of the arguments he makes to this Court. The October 29th motion remains pending in the bankruptcy court, and has not yet been reduced to a final, appealable order.

SUMMARY OF THE ARGUMENT

1. The arguments raised in Mr. Loy's current appeal from the February 10 order denying his fourth motion to dismiss are not properly before this Court. In that motion he made one argument based on the construction of section 1511 of the Bankruptcy Code. The bankruptcy court had already rejected that argument on November 18, 2009. Therefore the other arguments he raises to this Court are forfeited. In addition, some are not ripe for consideration, as the bankruptcy court has not yet ruled on them.[2] The following chart illustrates the issues raised by Mr. Loy in his appeal brief and the procedural reasons they are inappropriate for consideration by this Court in this appeal.

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[2] Mr. Loy has also raised his due process concerns in a separate action pending before this Court. *See Jonathan Loy and Susan J. Loy v. United States of America*, Case No. 4:10cv00017-RAJ-TEM (Filed February 17, 2010). On May 26, 2010, the United States moved for dismissal of that Complaint, or, in the alternative, for summary judgment in favor of the United States.

Issue Raised by Mr. Loy	**Argued in Motions Denied Nov. 18, 2009?**	**Argued in Motion On Appeal?**	**Argued in Oct. 29 Motion Pending Below?**	**Reason This Court Cannot Review**
Under §1511, can a foreign involuntary case be brought as a voluntary case in US Bankruptcy Courts?	Yes	Yes	No	Res Judicata
Foreign Representative must use §303	Yes	Yes	Yes	Res Judicata
UNCITRAL insolvency regulations	No	No	No	Not raised below
Violation of Rule 9011	Yes	No	Yes	Not raised below
Breach of the Fifth Amendment	No	No	Yes	Not raised below
Violation of Public Policy	No	No	Yes	Not raised below
Violation of §109(h)	Yes	No	Yes	Not raised below; Estopped by Dkt. #91
Violation of §521	No	No	Yes	Not raised below
Equity	No	No	No	Not raised below

2. Even if Mr. Loy's arguments are appropriately raised in this appeal, they are without merit. Section 1511 expressly permits the English Trustee to file a voluntary chapter 7 bankruptcy case under 11 U.S.C. §301 on Mr. Loy's behalf. The plain meaning of section 1511 does not require the English Trustee to have filed an involuntary case under 11 U.S.C. §303. The procedural anomalies that Mr. Loy stresses in his brief are insufficient to override the plain meaning of 11 U.S.C. §1511.

Mr. Loy's second core argument, that he has been denied due process, is unsupported by the facts in the record. Mr. Loy was given sufficient due process in the separate chapter 15 bankruptcy proceeding that preceded this case. After full litigation, the bankruptcy court recognized Mr. Loy's English bankruptcy as a foreign main proceeding. The English Trustee obtained the right to file a petition under 11 U.S.C. §301 upon recognition of Mr. Loy's English bankruptcy as a foreign main proceeding. No further notice was due.

Mr. Loy's secondary arguments are also without merit. Accordingly, the bankruptcy court properly denied Mr. Loy's motion to dismiss. This Court should either dismiss this case because the issues presented are either res judicata or forfeited. If this Court reaches the merits, the bankruptcy court's order should be affirmed.

ARGUMENT

I. This Appeal Is Not Properly Before this Court Because Mr. Loy Has Had a Full and Fair Opportunity to Litigate Them in a Prior Motion and Did Not Appeal the Order Denying that Motion.

The only issue that is before this Court is whether the bankruptcy court properly denied Mr. Loy's fourth motion to dismiss, filed on October 9, 2010. [Dkt. #58 (motion); Dkt. #152, #155 (original and corrected dismissal orders)]. The history of the case up until October 9 demonstrates that this appeal is improperly before this Court.

Mr. Loy filed his first dismissal motion on September 4, 2009. [Dkt. #19]. The bankruptcy court denied it on November 18, 2009. [Dkt. #90]. His second was filed on September 17, 2009, and later withdrawn in open court. [Dkt. #30, #118]. His third was filed on October 1, 2009 and also denied on November 18, 2009. [Dkt. #53, #91]. After filing the motion to dismiss currently on appeal, he submitted a fifth on October 29. [Dkt. #75]. It remains pending in the bankruptcy court.

Mr. Loy's brief to this Court is a compendium of the arguments he made in the five motions that he filed and argued below. He asks this Court to consider anew arguments the bankruptcy court ruled upon in prior orders that Mr. Loy did not appeal. In addition, he asks this Court to consider arguments that he did not raise in the October 9 motion, which is currently before this Court, some of which are still awaiting a decision in the bankruptcy court. Therefore, his appeal violates at least three basic rules of appellate procedure prohibiting reviewing courts from considering issues that were not properly appealed, that were not argued below, and which have not received final adjudication in a lower court. The procedural infirmities provide this Court with ample grounds to dismiss.

A. This Court should dismiss this case because Mr. Loy raised his argument that the English trustee could not file this case as a voluntary bankruptcy in an earlier motion to dismiss that the bankruptcy court denied on November 18, 2009 and that Mr. Loy did not appeal.

Although Mr. Loy has raised the argument that the English Trustee cannot file this case as a voluntary bankruptcy in three motions in the bankruptcy court, his opportunity to argue that point was triggered on September 4 when he filed his first motion to dismiss. [Dkt. #19]. The bankruptcy court denied that motion on November 18, 2009 and Mr. Loy never appealed it. His later attempt to make the same argument, specifically his October 9 motion now on appeal, was res judicata below.[3] Therefore, he may not raise it now.

When Mr. Loy filed his first motion to dismiss his chapter 7 case on September 4, 2009 he opened a stand-alone contested matter. Fed. R. Bankr. P. 9014; *In re Kempner*, 152 B.R. 37 (D.

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[3] Under modern terminology, res judicata incorporates two concepts: claim preclusion and issue preclusion (collateral estoppel). "*Claim preclusion* prevents a party from suing on a claim which has been previously litigated to a final judgment by that party or such party's privies and precludes the assertion by such parties of any legal theory, cause of action, or defense which could have been asserted in that action. *Issue preclusion* prevents relitigation of issues actually litigated and necessary for the outcome of the prior suit, even if the current action involves different claims." 18 Moore's Federal Practice § 131.10 (italics in original). As both concepts are implicated in this case, so that the general term "res judicata" is used.

Del. 1993). Contested matters are governed by the Federal Rules of Bankruptcy Procedure. In a contested matter, relief is requested by motion, and reasonable notice and opportunity for hearing must be afforded to the party against whom relief is sought. Fed. R. Bankr. P. 9014(a). In a contested matter, the judge may make findings of fact and conclusions of law. Fed. R. Bankr. P. 7052(a)(3) (incorporated under Fed. R. Bankr. P. 9014(c). A judgment is entered in a contested matter, from which an appeal lies. Fed. R. Bankr. P. 7054 (incorporated under Fed. R. Bankr. P. 9014(c). An appeal must be filed within 14 days. 28 U.S.C. § 158(c)(2); Fed. R. Bankr. P. 8002. Adjudication of the contested matter gave Mr. Loy his opportunity to litigate the question of whether the English Trustee could file a voluntary chapter 7 case. *See Hicks, Muse & Co. v. Brandt (In re Healthco Int'l., Inc.)*, 136 F.3d 45, 53 n.9 (1st Cir. 1998) ("[R]es judicata normally bars subsequent litigation of claim which could have been litigated in earlier contested matter or adversary proceeding.").

It is hornbook law that a litigant is bound by a court's final decision.[4] The doctrine of res judicata forecloses "the relitigation of issues of fact or law that are identical to issues which have been actually determined and necessarily decided in prior litigation in which the party against whom [preclusion] is asserted had a full and fair opportunity to litigate." *Sedlack v. Braswell Serv. Gp.*, 134 F.3d 219, 224 (4th Cir. 1998) (quotation omitted). Res judicata applies in bankruptcy proceedings. *First Union Commercial Corp. v. Nelson, Mullins, Riley &*

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[4] Finality in the bankruptcy context "has traditionally been applied 'in a more pragmatic and less technical way . . . than in other situations.'" *A.H. Robins Co., Inc. v. Piccinin*, 788 F.2d 994, 1009 (4th Cir. 1986) (quotation omitted). Rather, in bankruptcy an order is final if it "finally dispose[s] of a discrete dispute within a larger case." *In re Computer Learning Centers, Inc.*, 407 F.3d 656, 660 (4th Cir. 2005) (quoting *In re Saco Local Dev. Corp.*, 711 F.2d 441, 444 (1st Cir.1983) (Breyer, J.)). The bankruptcy court's order rejected Mr. Loy's assertion that the English Trustee had to proceed in an involuntary case under section 303 of the Bankruptcy Code. That determination ended a discrete dispute within the larger case.

Scarborough (In re Varat Enters.), 81 F.3d 1310, 1315 (4th Cir. 1996). It exists to prevent a debtor from re-litigating an issue once it has been "actually and necessarily determined by a court having jurisdiction in the case." *Turshen v. Chapman*, 823 F.2d, 839 (4th Cir. 1987) (affirming bankruptcy court's refusal to hear a debtor's claim for breach of fiduciary duty against the trustee after the bankruptcy court determined that the trustee's conduct did not warrant removal).

Mr. Loy argued in his initial motion to dismiss, filed September 4, 2009, that the English Trustee was committing "blatant fraud . . . by converting an English involuntary bankruptcy in the United Kingdom into an [sic] voluntary bankruptcy in the United States." Sept. 4 Motion at 4, ¶ 14) [Dkt #19] (Appellant's Des., Item 7). He also stated that "[t]he statute [title 11] clearly states that involuntary cases, as in the case of Jonathan Loy, are to be commenced under 11 U.S.C. § 303." *Id.* at 5, ¶ 17 [Dkt #19]. As relief, Mr. Loy requested that the chapter 7 case be dismissed and that he be granted costs, damages, and punitive damages.

The chapter 7 Trustee and the English Trustee both filed briefs in opposition to Mr. Loy's motion to dismiss. [Dkt #67, #68]. The bankruptcy court held a hearing and denied the motion at a hearing on October 27, 2009. [Dkt. #71]. Mr. Loy noted his objections on November 5, 2009. Mr. Loy had a full and fair opportunity to litigate his claims.

The bankruptcy court entered the order on November 17, 2009, [Dkt. #90], which started Mr. Loy's window of time to appeal. *Faragalla v. Access Receivable Mgmt. (In re Faragalla)*, 422 F.3d 1208 (10th Cir. 2005). Mr. Loy never appealed that order. It is too late for him to do so now. Fed. R. Bankr. P. 8002(a); *Veltman v. Whetzal*, 93 F.3d 517 (8th Cir. 1996) (holding a reviewing court does not have subject matter jurisdiction over an untimely appeal).

In his current appeal, Mr. Loy requests that this Court consider whether a "foreign trustee" can place an individual in voluntary bankruptcy in the United States if that same individual was "forced into involuntary bankruptcy in a foreign proceeding." *Compare* Appellant Br. at 1, ¶ 2; 9-11, ¶¶ 21-23 *with* Sept. 4 Motion at 4, ¶14 (arguing that a "Foreign Representative" cannot convert an English involuntary bankruptcy into a voluntary bankruptcy in the United States). He also argues again that an individual cannot be placed in bankruptcy against his will under the provisions of §301 of the Bankruptcy Code. *Compare* Appellant Br. at 14-15, ¶¶ 34-35 *with* Sept. 4 Motion at 4, ¶¶ 17-18.

This Court should dismiss this appeal because the issue was res judicata in the single order of November 18 from which Mr. Loy appeals and because Mr. Loy failed to appeal the bankruptcy court's earlier order on the same issue. [Dkt. #90].

B. At a minimum, seven of the nine arguments Mr. Loy makes in his brief are forfeited because he did not raise them below.[5]

In his October 9 motion, the only one before this Court, Mr. Loy made a single argument that the English receiver cannot place him in a voluntary chapter 7 case. In his brief to this Court, he makes nine separate arguments, only two of which pertain to his motion below or the decision of the bankruptcy court on the record. *See* Hr'g Trans. at 1-6 (Feb. 10, 2010) (Appellee's Des., Item 20, pp. 1-6). Specifically, Mr. Loy raises the following arguments for the first time on appeal:

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[5] The transcript of the January 26, 2010 hearing at which Mr. Loy's October 9 motion was argued has not been designated. The United States Trustee will file a motion to have the transcript designated for the purpose full disclosure to the Court. To the extent, however, that Mr. Loy may have argued points at the hearing that he asks this Court to consider, they would not be properly before this Court because they bankruptcy court did not address them on February 10, 2010 when ruling on the October 9 motion. Hr'g Trans. at 1-6 (Feb. 10, 2010) (Appellee's Des., Item 20, pp. 1-6). Arguments not considered by a court are generally not reviewed on appeal. *Exxon Shipping Co. v. Baker*, 128 S. Ct. 2605, 2618 (2008).

1. Filing of a voluntary petition based on an involuntary foreign case violates UNCITRAL insolvency regulations;

2. The English Trustee violated Fed. R. Bankr. P. 9011 when he filed a voluntary petition on behalf of Mr. Loy;

3. The voluntary petition breaches the Fifth Amendment;

4. The voluntary petition violates public policy;

5. The voluntary petition violates 11 U.S.C. §109(h);

6. The voluntary petition violates 11 U.S.C. §521; and

7. The forced voluntary petition violates principles of equity.

It is axiomatic that a reviewing court may not consider new arguments raised for the first time on appeal, absent extraordinary circumstances. *Singleton v. Wulff*, 428 U.S. 106, 120, 96 S.Ct. 2868, 2877 (1976); *United States v. One 1971 Mercedes Benz 2-Door Coupe*, 542 F.2d 912, 915 (4th Cir. 1976). Mr. Loy's three-page motion on appeal does not mention UNCITRAL, Fed. R. Bankr. P. 9011, the Fifth Amendment, public policy, sections 109(h) and 521 of title 11, or make any equitable arguments. Thus, these arguments are waived. *First Va. Banks, Inc. v. BP Exploration & Oil Inc.,* 206 F.3d 404, 407 n.1 (4th Cir. 2000) (declining to consider issues raised for first time on appeal); *Dean v. McDow,* 299 B.R. 133, 138 (E.D. Va. 2003) (failure to raise non-jurisdictional issue before the bankruptcy court operates as a waiver of the right to have the issue heard on appeal); *Edwards v. City of Goldsboro,* 178 F.3d 231, 241 n.6 (4th Cir. 1999) (noting that issues not briefed or argued are deemed abandoned).

Mr. Loy's October 9 motion alludes to "credit counseling" and "prescribed procedures," but that is insufficient to preserve his §109 and §521 arguments on appeal. *Beaudett v. City of Hampton*, 775 F.2d 1274, 1278 (4th Cir. 1985) ("fleeting references" insufficient to preserve questions on appeal) (discussing limits of leniency given to *pro se* litigants).

Many of Mr. Loy’s arguments on appeal do appear in his October 29 motion [Dkt. #75] The bankruptcy court has addressed some issues raised in that motion but others remain pending below.[6] Mr. Loy’s Notice of Appeal does not refer to his October 29 Motion [Dkt. #75]. Nor could it, as there has been not final judgment on that motion entered below.[7] Fed. R. Bankr. P. 7054 (made applicable by Fed. R. Bankr. P. 9014(c)).

Mr. Loy may not now augment his single-issue motion below with new theories and further-developed arguments. This Court is not an appropriate forum for the debtor to refine his arguments. *See Tele-Communications, Inc. v. C.I.R.*, 104 F.3d 1229, 1233 (10th Cir. 1997) (stating that the appellate court “should not be considered a ‘second shot’ forum . . . where secondary, back-up theories may be mounted for the first time”). Instead, litigants must “‘give it everything they’ve got’ at the trial level” before their arguments may be raised on appeal. *Id.* (citation omitted). Mr. Loy cannot use one thinly-argued narrow motion as a platform to bring multiple issues to the attention of this Court.

Starting on September 4, 2009, Mr. Loy filed a motion to dismiss, made his best legal case, and had the benefit of a hearing. He cannot simply re-start the process below by filing another motion to dismiss based on the same facts and the same, or slightly refined, legal theories

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[6] The United States Trustee's response to the Debtor's October 29 motion is contained in the record of this appeal. (Appellee's Des., Item 15).

[7] At the February 10, 2010 hearing in which the Court denied Mr. Loy’s motion that is the subject of this appeal, the Court set Mr. Loy’s October 29 motion for further hearing and directed the Chapter 7 Trustee to file a status report. (Feb. 10, 2010 Transcript) (Appellee’s Des., Item 20, p. 24) (“I’m going to be in Newport News on Friday the 19th, and I will expect a status report at 10:30 as to where we stand. I will not make a final disposition on docket item Number 75 unless – until I have sufficient information to determine whether there is a bankruptcy purpose to be served by continued administration of this case.”).

and then appeal that later order to get around jurisdictional deadlines. Mr. Loy's first motion to dismiss was denied on the same arguments raised in his brief on appeal. He failed to appeal the denial of his first motion to dismiss. He cannot re-litigate it in this appeal.

II. The Bankruptcy Court Properly Denied Mr. Loy's Motion to Dismiss on the Merits Because the Case Was Commenced Properly under 11 U.S.C. §301 by a Foreign Representative in a Recognized Foreign Main Proceeding, Pursuant to 11 U.S.C. §1511(a)(2).

As demonstrated above, this appeal should be dismissed because Mr. Loy either did not raise the issues below, or they are still pending, and he was collaterally estopped from arguing that the English Trustee had to file an involuntary case in the October 9 motion that he appealed. Should the Court find otherwise, the United States Trustee explains below why Mr. Loy is also incorrect on the merits.

A. The English Trustee's filing of the voluntary Chapter 7 bankruptcy petition is expressly permitted by 11 U.S.C. §1511(a)(2).

The only argument that Mr. Loy made in the motion that he has appealed to this Court is that the English Trustee improperly commenced Mr. Loy's chapter 7 bankruptcy by filing a voluntary petition. Mr. Loy is incorrect as a matter of law.

As the bankruptcy court found below, the English Trustee filed the petition in his capacity as a foreign representative of a foreign main proceeding recognized by the United States Bankruptcy Court for the Eastern District of Virginia. *See* Hr'g Trans. (Feb. 10, 2010) (Appellee's Des., Item 20, pp.3-4); *Loy*, 380 B.R. at 163 (recognizing Mr. Loy's English bankruptcy as a foreign main proceeding). The English Trustee filed the petition on behalf of Mr. Loy, pursuant to 11 U.S.C. §1511(a)(2), which states: "(a) Upon recognition, a foreign representative may commence – (1) an involuntary case under section 303; or (2) a voluntary case under section 301 or 302, if the foreign proceeding is a foreign main proceeding." Here, Mr. Loy's foreign proceeding has been recognized as a foreign main proceeding. Accordingly, the plain language of section 1511 permits the English Trustee's filing of this voluntary case, pursuant to section 301.

B. The English Trustee was not required to file an involuntary petition upon recognition of the debtor's English bankruptcy as a foreign main proceeding.

Section 1511 expressly permits the foreign representative of a recognized foreign main proceeding to commence a voluntary case under 11 U.S.C. §301.[8] Nevertheless, Mr. Loy argues that the bankruptcy court should have dismissed the filing because the English Trustee chose to file a voluntary case under section 301 instead of an involuntary case under section 303. Mr. Loy argues that the English Trustee should have proceeded with a section 303 involuntary case because Mr. Loy's participation in the case is "involuntary" in the literal sense, and because he contends his English bankruptcy was involuntary.

Mr. Loy's argument ignores the plain meaning of 11 U.S.C. §1511, and seeks to read additional unwritten requirements into the statute. Nothing in the United States Bankruptcy Code supports this argument. Mr. Loy provides no authority to support it, other than a reference to the UNCITRAL Model Cross-Border Insolvency Law, from which Chapter 15 of the United States Bankruptcy Code was partially derived, and the law of the United Kingdom. Appellant's Br. at 11. Neither the UNCITRAL model law, nor the law of the United Kingdom govern this matter. Section 1511(a) of the United States Bankruptcy Code does, and it is clear. "The plain meaning of legislation should be conclusive, except in the 'rare cases [in which] the literal application of a

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[8] The Debtor concedes this point. Appellant's Br. at 9 ("11 U.S.C. §1511 gives a foreign representative in a 'main proceeding' the option to file under 11 U.S.C. §301 Voluntary cases or §303 Involuntary cases.").

statute will produce a result demonstrably at odds with the intentions of its drafters.'" *United States v. Ron Pair Enters.,* 489 U.S. 235, 242 (1989) (quotation omitted). *Ron Pair* requires this Court to apply the 'plain meaning' rule to 11 U.S.C. §1511, unless Mr. Loy can demonstrate that the result is contrary to the result Congress intended. *See In re Sunterra Corp. (RCI Tech. Corp. v. Sunterra Corp.),* 361 F.3d 257, 269 (4th Cir. 2004) (stating "a federal court must 'determine the meaning of the statute passed by Congress, not whether wisdom or logic suggests that Congress could have done better") (quoting *Sigmon Coal Co. v. Apfel*, 226 F.3d 291, 308 (4th Cir. 2000), *aff'd sub nom.*, *Barnhart v. Sigmon Coal Co.*, 534 U.S. 438, 122 S.Ct. 941, 151 L.Ed.2d 908 (2002)). Mr. Loy's reliance on foreign and international model laws is insufficient to demonstrate that the plain meaning of section 1511 is other than what Congress intended. The bankruptcy court correctly applied the plain meaning of section 1511 in denying Mr. Loy's motion. The order of the bankruptcy court should be affirmed.

C. Mr. Loy's examples of difficulties he contends arise in this voluntary case are insufficient to override the plain meaning of 11 U.S.C. §1511.

Mr. Loy cites a variety of issues that arose in the bankruptcy court below to support his argument that section 1511 should not be read to permit the filing of a voluntary case when the debtor himself is not a volunteer. Appellant's Br. at 12-16. Among his examples, Mr. Loy claims: (1) the filing of the petition violates Fed. R. Bankr. P. 9011(a) because Mr. Loy did not sign it; (2) Mr. Loy did not obtain pre-petition credit counseling in compliance with 11 U.S.C. §109(h); and (3) Mr. Loy has intentionally failed to comply with the document production and filing requirements set forth in 11 U.S.C. §521. As discussed below, each of these examples, even if appropriately raised on appeal, is insufficient to support dismissal of Mr. Loy's bankruptcy case.

1. The English Trustee's filing of a bankruptcy petition pursuant to his authority under 11 U.S.C. §1511(a)(2) did not violate Fed R. Bankr. P. 9011.

Federal Rule of Bankruptcy Procedure 9011 mandates that documents filed with the bankruptcy court "be signed by at least one attorney of record in the attorney's individual name," or an unrepresented party. Fed. R. Bankr. P. 9011(a). The rule further states: "An unsigned paper shall be stricken unless omission of the signature is corrected promptly after being called to the attention of the attorney or party." *Id.* Mr. Loy argues that he did not sign the petition filed by the English Trustee, and, therefore, it should be stricken pursuant to Rule 9011(a). Appellant's Br. at 12). Mr. Loy did not file the petition. The English Trustee did. The petition bears the signature of the English Trustee, as foreign representative, and his counsel. Appellant's Des., Item 1. Mr. Loy's signature was not required by Rule 9011(a) because Mr. Loy did not file the document with the bankruptcy court.

2. The bankruptcy court did not err in denying Mr. Loy's motion to dismiss for failure to comply with the credit counseling of 11 U.S.C. §109(h) because Mr. Loy complied with the requirements established by the court.

At the time of filing the petition, the English Trustee filed a motion seeking waiver of the credit counseling requirement contained in 11 U.S.C. §109(h). [Dkt #2]. An order granting the waiver was entered October 29, 2009. [Dkt. #76]. Pursuant to the order, Mr. Loy was required to obtain the appropriate credit counseling on or before September 23, 2009.[9] On September 23, 2009, Mr. Loy did obtain credit counseling, and filed a certificate of credit counseling with the Court. [Dkt. #33].

Mr. Loy now maintains that his failure to obtain credit counseling prior to the filing of the

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[9] The October 29 order memorialized an order from the bench at a September 8, 2010 hearing.

petition warrants dismissal. If there is any doubt about the procedural infirmities that riddled Mr. Loy's appeal, there can be none here. On November 18, 2010, the bankruptcy court itself issued an order declaring Mr. Loy collaterally estopped from making his credit counseling argument. [Dkt. #91, at ¶ 5]. Mr. Loy did not appeal that order. It is doubly barred in the context of this appeal.

Even if Mr. Loy's §109(h) argument is appropriately raised in this appeal, Mr. Loy's argument is contrary to the facts and his own actions in the bankruptcy court. In fact, Mr. Loy obtained the required credit counseling. Accordingly, the issue is moot. [Dkt. #33].

As a matter of law, Mr. Loy is also incorrect. The term "debtor" as used in chapter 15 has a completely separate meaning than it does in the rest of the Bankruptcy Code. As a result, the restrictions on who may be a debtor under section 109, which mandates credit counseling as a prerequisite to filing, is inapplicable in chapter 15 cases. *See In re Tri-Continental Exch.*, 349 B.R. 627 (Bankr. E.D. Cal. 2006) (holding an insurance company could seek to have its insolvency proceeding recognized under chapter 15).

The structure of chapter 15 strongly supports the *Tri-Continental* analysis. Section 1501(c) contains a short list of entities to which chapter 15 does not apply. These are: entities ineligible for bankruptcy relief under 109(b), with the exception of insurance companies; individuals who reside in the United States and who have debts within the 109(e) limits; and stockbrokers, commodity broker, or an entity subject to the Securities Protector Investment Act. These restrictions parallel those entities that are ineligible from filing bankruptcy cases under section 109. However, section 1501(c) must have a purpose and, in fact, it does. It distinguishes the eligibility requirements for debtors under chapter 15, as opposed to those under the rest of the Bankruptcy Code. One difference is that the requirement of section 109(h) for credit counseling is omitted. To ignore that difference would make section 1501 surplusage.

3. Mr. Loy's refusal to comply with the filing and disclosure requirements of 11 U.S.C. §521 does not support his argument for reversal of the bankruptcy court's order.

Pursuant to 11 U.S.C. §521, a debtor in a voluntary case is required to file a variety of documents with the Court to further the administration of his bankruptcy case. Mr. Loy, however, is not a chapter 7 debtor in the traditional sense. The Debtor in this case is not Mr. Loy. It is the English Representative of this proceeding, who is authorized to dispose of Mr. Loy's assets in the United States within the framework of his bankruptcy proceeding in the United Kingdom. As such Mr. Loy's failure to comply with the requirements of 11 U.S.C. §521 is immaterial and cannot trigger automatic dismissal pursuant to 11 U.S.C. §521(i).

If this Court were to disagree about Mr. Loy's status in this case, the issue of compliance with section 521, if required, is not ripe for review. The English Trustee moved for relief from the requirements of section 521 on August 31, 2009. [Dkt. #14]. In his motion, the English Trustee requested a suspension of the section 521 filing deadline, and a status conference before the Court to determine how the filings would be handled going forward. Although a hearing was held on the motion, no order appears in the record. There is no final decision for this Court to review.

4. Mr. Loy's due process rights were not violated by the filing of the voluntary petition.

Mr. Loy argues that commencement of this Chapter 7 bankruptcy pursuant to section 301 violates his due process rights under the Fifth Amendment. Appellant's Br. at 12. Even if Mr. Loy's Fifth Amendment argument is properly raised, it is without merit. As the bankruptcy court noted at the February 10, 2010 hearing: "My recollection is that Mr. Loy waived the constitutional challenge, but nevertheless, the Court finds that on the state of this record, Mr. Loy has been afforded an unenviable amount of notice and an opportunity for hearing" Appellee's Des., Item 20, p. 8.

Mr. Loy initially opposed the English Trustee's October 28, 2007 petition for recognition of a foreign proceeding as a foreign main proceeding under Chapter 15 of the Bankruptcy Code. *In re Jonathan A. Loy*, Case. No. 07-51040 (Bankr. E.D. Va. filed Oct. 27, 2007). Mr. Loy appeared at numerous hearings and was afforded a full opportunity to oppose the petition for recognition of his English bankruptcy as a foreign main proceeding. *Loy,* 380 B.R. at 161.

Nevertheless, Mr. Loy now argues that the commencement of this chapter 7 case pursuant to 11 U.S.C. §1511(a)(2) violates his constitutional rights by depriving him and his spouse of "the liberty to use their property without due process of law" and violates the public policy of the United States. (Appellant's Brief at 12-13). The statute is clear, however: "*Upon recognition*, a foreign representative may commence . . . a voluntary case under section 301 or 302, if the foreign proceeding is a foreign main proceeding." 11 U.S.C. §1511(a)(2) (emphasis added). The bankruptcy court went through a pain-staking process to determine if Mr. Loy's English bankruptcy was a foreign main proceeding. That afforded Mr. Loy due process. Everything that Mr. Loy complains of is a direct result of the decision, adverse to him, in the chapter 15 recognition litigation.[10] *Loy*, 380 B.R. at 163. The "harm" he alleges results from operation of the Bankruptcy Code not insufficient due process. *See* 11 U.S.C. §1520(a) (applying 11 U.S.C. §§361, 362, 363, 549, and 552 to Mr. Loy's property in the United States).

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[10] In its order recognizing the English bankruptcy as a foreign main proceeding, the bankruptcy court expressly prohibited Mr. Loy from "transferring, encumbering, or otherwise disposing of any of his non *de minimis* assets." In addition, recognition permitted the foreign representative to operate Mr. Loy's business and to avoid any transfer of Mr. Loy's property made after the commencement of the Chapter 15 case. 11 U.S.C. § 1520. Mr. Loy has alleged no deprivation of liberty or property that was not already accomplished by the recognition of the English bankruptcy.

Due process has been afforded to Mr. Loy in the form of the Chapter 15 recognition proceedings. The application of the law and the commencement of this case are not in violation of Mr. Loy's due process rights, and accordingly are not "manifestly contrary to the public policy of the United States" such that this Court should refuse to act pursuant to 11 U.S.C. §1506. The bankruptcy court's order should be affirmed.

CONCLUSION

For these reasons the United States Trustee respectfully asks this Court to dismiss this case or, in the alternative affirm the order of the bankruptcy court denying Mr. Loy's motion to dismiss.

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Respectfully submitted,

/s/ Kenneth N. Whitehurst, III

RAMONA D. ELLIOTT
General Counsel

P. MATTHEW SUTKO
Associate General Counsel

CATHERINE B. SEVCENKO
Trial Attorney
Executive Office for United States Trustees
Department of Justice
20 Massachusetts Avenue, N.W.
Washington, D.C. 20530
Ph: (202) 307-1399
Fax: (202) 307-2397

W. CLARKSON MCDOW, JR.
United States Trustee for Region 4

DEBERA F. CONLON
Assistant United States Trustee

KENNETH N. WHITEHURST, III
Trial Attorney
Virginia State Bar No. 48919
Office of the U.S. Trustee
Norfolk Federal Building, Room 625
200 Granby Street
Norfolk, Virginia 23510
(757) 441-6012
(757) 441-3266 (fax)
kenneth.n.whitehurst@usdoj.gov

CERTIFICATE OF SERVICE

On June 1, 2010, I mailed a copy of the foregoing Brief and all attachments thereto, by regular mail and electronic mail, to:

Jonathan A. Loy
105 LaSalle Avenue
Hampton, Virginia 23661
jonathan@englishoakhouse.com

Douglas M. Foley, Esq.
McGuire Woods LLP
9000 World Trade Center
101 W. Main St.
Norfolk, Virginia 23510
dfoley@mcguirewoods.com

/s/ Kenneth N. Whitehurst, III
KENNETH N. WHITEHURST, III
Trial Attorney
Virginia State Bar No. 48919
Office of the U.S. Trustee
Norfolk Federal Building, Room 625
200 Granby Street
Norfolk, Virginia 23510
(757) 441-6012
(757) 441-3266 (fax)
kenneth.n.whitehurst@usdoj.gov

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1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	In re LENDER SERVICE BUREAU: WEINTRAUB GENSHLEA & SPROUL v. CHICAGO TITLE COMPANY & UST
2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	CTA9 (U.S. Court of Appeals for the Ninth Circuit)
3. ("CCN") ***CURRENT*** CASE NO.	No.: 99-17683
4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*	No.: Court: E.D.CA. (U.S. District Court for the Eastern District of Calif.) *(Identify judge & cite, if any)*
5. ("SO") ***SOURCE***	**U.S. TRUSTEES**
6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	Filed: April 19, 2000 Type: Brief for Appellee, U.S. Trustee
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8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") ! ***SUMMARY*** OF KEY ISSUE(s) & ***/*** Any Miscellaneous ***BACKGROUND***	! Bankruptcy Court properly reduced attorney fees under 11 U.S.C. § 330 based on finding that services rendered by law firm in taking weak case to trial were neither necessary nor reasonable for estate. **/ Background:**
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IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT
No. 99-17683

In re LENDER SERVICE BUREAU,
a California corporation, Debtor.

WEINTRAUB GENSHLEA & SPROUL,
Law Corporation, Special Counsel for Robert C. Greeley,
Chapter 7 Trustee for the estate of Lender Service Bureau,
Appellant,
v.

CHICAGO TITLE COMPANY, et. al, and
THE UNITED STATES TRUSTEE,
Appellees,

On appeal from the United States District Court for the
Eastern District of California.

BRIEF OF APPELLEE UNITED STATES TRUSTEE

Of Counsel:
MARTHA L. DAVIS
General Counsel
P. MATTHEW SUTKO
Attorney
U.S. DEPARTMENT OF JUSTICE
Office of the General Counsel
Executive Office for U.S. Trustees
901 E. Street, N.W., Ste. 780
Washington, D.C. 20530
April 19, 2000

MAUREEN A. TIGHE
United States Trustee
ANTONIA G. DARLING
Assistant United States Trustee
DONNA S. TAMANAHA
Attorney
U.S. DEPARTMENT OF JUSTICE
Office of the United States Trustee
501 "I" Street, Ste. 7-500
Sacramento, Ca 95814
Phone: (916) 930-2100

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I.
BASIS FOR APPELLATE JURISDICTION

The bankruptcy court had subject matter jurisdiction to determine a fee award pursuant to 28 U.S.C. § 1334 and 28 U.S.C. § 157. The review of fees is a matter concerning the administration of the estate and is therefore a "core proceeding" under 28 U.S.C. § 157(b)(2)(A). The bankruptcy court's January 12, 1999, order, entered on January 13, 1999, fully and finally determined the fee award to the appellant Weintraub Genshlea and Sproul ("the Law Firm"), Tab 46, and was therefore a final order. The district court had jurisdiction to hear the appeal from the bankruptcy court's final order under 28 U.S.C. § 158(a). The district court's order of October 22, 1999, Tab 136, EOR 1336-1351, affirming the bankruptcy court, was also final. Pursuant to 28 U.S.C. § 158(d), this Court has jurisdiction over this appeal from the district court's order affirming the bankruptcy court.

II.
ISSUES ON APPEAL AND APPLICABLE STANDARD OF REVIEW

The Law Firm has raised issues on appeal related to its fee award in the bankruptcy court. The Law Firm has contended: (a) the bankruptcy court applied the wrong statute in reviewing its fees; and (b) the bankruptcy court abused its discretion when it made substantial fee reductions.

Absent abuse of discretion or an erroneous application of law, the bankruptcy court's award of fees should not be disturbed. Pitrat v. Reimers (In re Reimers), 972 F.2d 1127, 1129 (9th Cir. 1992); Unsecured Creditors' Comm. v. Puget Sound Plywood (In re Puget Sound Plywood), 924 F.2d 955, 957 (9th Cir. 1991). Since this Court is in "as good a position" as the district court to review the bankruptcy court's decisions, the bankruptcy court's order is reviewed independently. Neben & Starrett v. Chartwell Financial Corporation (In re Park-Helena Corp.), 63 F.3d 877, 879 (9th Cir. 1995), quoting Sousa v. Miguel (In re United States Trustee), 32 F.3d 1370, 1372 (9th Cir. 1994). The bankruptcy court's findings of fact are reviewed for clear error, while its conclusions of law are reviewed de novo. Ibid., citing 32 F.3d at 1372. A bankruptcy court's decision about the amount of a fee award is subject to the abuse of discretion standard. Ibid., citing In re Film Ventures Int'l, 75 B.R. 250, 253 (Bankr. 9th Cir. 1987).

III.
STATEMENT OF THE CASE

A. PROCEDURAL BACKGROUND

Nature of the Case. This case concerns the authority of the bankruptcy court to reduce the amount of attorneys' fees based upon its finding that services rendered by the Law Firm in taking a weak case to trial were neither necessary nor reasonable.

Course of Proceedings and Disposition. The bankruptcy court's January 12, 1999, order awarding final fees to the Law Firm was appealed to the district court and affirmed on appeal on October 22, 1999. The Law Firm has filed an appeal to this Court.

B. STATEMENT OF FACTS

Background: Employment of the Law Firm. In December of 1997, Robert C. Greeley ("Greeley"), the bankruptcy trustee of Lender Service Bureau ("LSB"), sought the assistance of counsel, the Law Firm, to pursue claims against John Ward ("Ward Litigation"). The underlying theories in the Ward Litigation were: (a) Ward breached his fiduciary duty as an officer, shareholder, and director of LSB and (b) Ward, as an alter ego of LSB's sister company Lender Service Bureau of America ("LSBOA") was liable for LSBOA's debt to LSB. Tab 22, EOR 0250-0251. Ward was one of several defendants in an adversary proceeding which had been commenced by Greeley about eight months before Greeley sought the assistance of Law Firm. Tab 1, EOR 0001-0008.

On January 7, 1998, the bankruptcy court approved Greeley's application to employ the Law Firm. Tab 9 ("the Employment Order"). The Employment Order, standard for the district, provided in pertinent part:

> IT IS ORDERED that Robert C. Greeley, Trustee, is hereby authorized to retain the firm of Weintraub Genshlea & Sproul Law Corporation...as special counsel, subject to the following terms and conditions pursuant to 11 U.S.C. § 328(a):
>
> 1. No compensation is permitted except upon court order following application pursuant to 11 U.S.C. § 330(a).
>
> 2. Compensation will be at the 'lodestar rate' applicable at the time that services are rendered in accordance with the Ninth Circuit decision in In re Manoa Fin. Co., 853 F.2d 687 (9th Cir. 1988). No hourly rate referred to in the application papers is approved unless unambiguously so stated in this order or in a subsequent order of this court.

Tab 9, EOR 0052:22 - 0053:3.

First Interim Fee Application. The Ward Litigation proceeded. About a month before trial, the Law Firm applied for a first interim award of fees. The Court awarded $85,000, a portion of the $100,221.50 sought. Exhibit 29, EOR 454-455. The court noted that it was "unable to make the various determinations that are necessary under 11 U.S.C. § 330 for final awards of compensation." Tab 29, EOR 454:19-25.

Trial of the Ward Litigation. In July 1998 the Ward Litigation went to trial. On August 4, 1998, the court rendered findings of fact and conclusions of law on the record, ruling in favor of Ward on all causes of action. Tab 22, EOR 0249-0285.

The court found that Ward had not breached his fiduciary duty to LSB. For the period of time when Ward was a shareholder and director of LSB, i.e., from the formation of LSB until November 30, 1995, the court found no evidence that Ward functioned as a "defacto officer" of LSB. Tab 22, EOR 0272-0273. Nor was there a basis to impose liability under the exceptions to director liability in California Code Section 204. Tab 22, EOR 0273-0276.

For the time period when Ward became an officer of LSB following the untimely death of Amos Blacksea, the court found that Ward had not abdicated his duties. Tab 22, EOR 0277. In fact, the court observed that as trustee Greeley "undertook a similar approach" to the business as Ward did:

> continuing the status quo, including the relationship with LSBOA, while attempting to procure a sale for the company. And Mr. Greeley took over a company with much better books and records than those of the company Mr. Ward had assumed. Mr. Ward's conduct does meet the standard of business judgment.

Tab 22, EOR 0278:3-9.

The court observed that Ward was a "thoroughly credible witness," Tab 22, EOR 0261:3-4. "[P]ersuaded that John Ward acted honorably, with integrity, and discharged his duties to both LSB and LSBAO [sic] with appropriate care," the court noted for the record that Ward's successful defense was not based on a "technicality based on the plaintiff's failure to prove elements of its case." Tab 22, EOR 0283:10-16.

Second Interim Fee Application. On September 8, 1998, just over a month after the conclusion of trial in the Ward Litigation, the Law Firm filed a second interim application for fees and costs seeking an additional $153,583.55, bringing the total incurred to $264,802.78. Tabs 24-30. The Appellees, Priority Posting & Publishing and Chicago Title Company, former members of the Official Creditors Committee ("OCC Members") and the United States Trustee opposed the fees, urging a reduction in fees or holding the Law Firm to a contingency fee arrangement. Tabs 31, 32, and 33.

The OCC Members and the United States Trustee asked the bankruptcy court to consider the following bases to reduce fees: (a) whether or not the Law Firm properly evaluated the Ward Litigation; Tab 31 at EOR 0527, 0530-0531; (b) representations made to the OCC Members and to the United States Trustee about a fee budget and how retention on an hourly basis would be less costly than on a contingency fee basis. Tab 33, EOR 0561-0561; 0566–567; and (c) failure to keep the OCC members informed about a change in their view of the fee budget or the merits of the Ward Litigation. Tab 32, EOR 0536-0537. The Law Firm responded that the fees were reasonable since the expected recovery was $1.5 million with "a substantial prospect of success." Tab 34, EOR 0570.

Memorandum Decision on Second Interim Application. On December 1, 1998, the bankruptcy court issued its memorandum decision on the Law Firm's second interim application for compensation, ("Memorandum Decision"). Tab 42, EOR 0626-0637, incorporating the Ward Litigation findings of fact and conclusions of law. Tab 42, EOR 0630. Of the total requested amount of $264,802.78, the court allowed $106,000. Tab 42, EOR 0635.

From the court's vantage point, "the case against Ward was extremely weak." Tab 42, EOR 0630:7-8. With respect to the first [breach of fiduciary duty as "outside" director] and third [alter ego of LSBOA] claims, "[t]he relevant facts and applicable law provide no support for either [claim]." Tab 42, EOR 0630:10-15. While Ward had "some vulnerability" in the second claim [breach of fiduciary duty as officer], the claim was "not strong." Tab 42, EOR 0631. The court reiterated in detail her assessment of Ward's credibility as a witness in the eight-day trial:

> ...at trial, Ward's explanation of the business decisions he made following Amos Blacksea's death was highly credible and consistent with the company's best interests. His testimony was supported by every other witness with contemporaneous knowledge of the events. Moreover, the decisions made by Ward, such as positioning the company for sale, hiring competent accounting staff, and continuing the relationship with LSBOA, are identical to the decisions made by the Trustee when he was appointed in this case.

Tab 42, EOR 0631:2-9.

The court criticized the Law Firm for taking a weak case to trial:

> By the close of discovery, an objective analysis of the evidence by WGS should have resulted in the conclusion that two of the claims were not worth taking to trial and that the remaining claim was not strong. Taking the case to trial, after only minimal settlement discussions, was not a proper decision, and given the result obtained, cannot provide the basis for a fee award by the simple application of the lodestar approach. Under any analysis, a substantial reduction in fees is warranted, and the question is the amount of that reduction.

Tab 42, EOR 0631:10-18.

The court considered but denied the requests of the opposition to alter the fee arrangement. Opining that there were sufficient circumstances which would satisfy altering the Law Firm's fee arrangement consistent with Section 328 of the Bankruptcy Code, the bankruptcy court declined to impose such an "overly harsh result." Tab 42, EOR 0631-0633.

The bankruptcy court then reviewed the Law Firm's services under Section 330(a) of the Bankruptcy Code. Tab 42, 0633:9-15. Based upon the court's review of the Law Firm's time records and fee applications, the court found that the Law Firm "failed to properly assess the merits of the Ward Litigation throughout its various stages." Tab 42, 0633:9-15.

The court observed:

> If this lawsuit had been close or even stood a fair chance of success, the court would be reluctant to reduce fees based on hindsight. However, in light of the marginal nature of the case against Ward, as shown at trial, the Trustee and his counsel failed to adequately appraise the facts ascertained during discovery, consider the risks of the litigation, or to explore settlement possibilities. WGS had an obligation to advise the Trustee, on behalf of the estate and creditors, of the significant risks and costs faced at trial. Although counsel for former OCC members periodically discussed this litigation with the Trustee and his counsel, he was never advised of any changes to the original predictions for a certain recovery, underestimates on litigation budgets, or the potential liability to Ward for his attorneys' fees. WGS failed in its duty to the creditors in this case, who have been forced to fund this litigation with none of the controls that a client would normally exercise.

Tab 42, EOR 0634:12-27.

In reducing the entire fee request to $106,000, the court construed this amount as compensation for most of the time spent on discovery, research, strategy and settlement discussions. Tab 42, EOR 0635:3-5. The court further stated unequivocally that it could not find the trial expenses were "necessary or beneficial." Tab 42, 0635:5-6.

Pursuant to the Memorandum Decision, the court allowed interim compensation in the amount of $21,000 for the period covered by the second interim application, further providing:

> ...unless Weintraub Genshlea & Sproul seeks additional compensation beyond that awarded on an interim basis, the court will treat the compensation awarded on an interim basis, i.e., $106,000, as a final

> award pursuant to 11 U.S.C. section 330(a) without the necessity of further application.

Tab 43, EOR 0638.

Final Application. On December 1, 1998, the same date the Memorandum Decision was filed, the Law Firm filed a final fee application seeking more fees. At this point all fees and costs incurred by the Law Firm totaled $277,193.75. Tab 37, EOR 581; Tab 36 - 41. The OCC members and the United States Trustee filed opposition. Tabs 44 and 45. On January 13, 1999, based upon the stipulation of the parties, the court awarded final fees in the amount of $106,000. Tab 46.

IV.

ARGUMENT

SUMMARY OF ARGUMENT

The Law Firm's contention on appeal that it had a court-approved "contract" which insulated its fees from scrutiny under Section 330 of the Bankruptcy Code is based upon the Law Firm's confused interpretation of the facts and the law applicable to fee awards under the Bankruptcy Code. The bankruptcy court properly applied Section 330 of the Bankruptcy Code in evaluating the services rendered by the Law Firm.

A. THE BANKRUPTCY COURT PROPERLY EVALUATED THE NATURE, EXTENT AND VALUE OF LAW FIRM'S SERVICES.

1. Compensation to professionals in a bankruptcy case is governed by 11 U.S.C. § 330.

Compensation to bankruptcy professionals is governed by 11 U.S.C. § 330, which provides in pertinent part that:

> (a) (1) ...subject to sections 326, 328, and 329, the court may award to...a professional person employed under section 327 or 1103 —
>
> > (A) reasonable compensation for actual, necessary services rendered by...the attorney ....
> >
> > (3)(A) In determining the amount of reasonable compensation to be awarded the court shall consider the nature, the extent, and the value of such services, taking into account all relevant factors, including —
> > ....
> > (C) whether the services were necessary to the administration of, or beneficial at the time at which the service was rendered toward the completion of, a case under this title; ....

Guided by the plain reading of the applicable statute, the bankruptcy court reviewed the evidence presented at trial in the Ward Litigation and found that the matter should not have been taken to trial. The court methodically and clearly laid out in substantial detail its view of the evidence presented as it pertained to each cause of action. This approach was entirely consistent with what is contemplated under Section 330(a)(3)(A) (C) of the Bankruptcy Code.

B. THE LAW FIRM'S CONTENTION THAT THE ORDER APPROVING ITS EMPLOYMENT WAS A PRE-APPROVED "CONTRACT" WHICH INSULATED ITS SERVICES FROM REVIEW UNDER SECTION 330 IS WHOLLY WITHOUT MERIT.

The Law Firm's primary contention on appeal is that the bankruptcy court erroneously applied Section 330 of the Bankruptcy Code when it should have applied Section 328.[1/] The Law Firm argues for the existence of a pre-arranged contract based solely upon references to the "lodestar rate" and to Section 328 contained in their Employment Order. Tab 9. Reading the Employment Order in its entirety, taking into consideration the straightforward analysis contained in the Memorandum Decision, and following the applicable law, this argument fails.

In this case, no issues under Section 328 are implicated. Contrary to the Law Firm's assertion, see Appellant's Opening Brief, p. 9, there has never been a pre-approved contract. The Employment Order simply does not provide what the Law Firm suggests it does. Finally, the Law Firm had no reason to expect treatment under any other statute but Section 330.

[1/] The Law Firm has not consistently argued whether Section 330 is applicable or not. In its brief to the district court, it argued that "the court should have applied a lodestar analysis." Tab 134, EOR 1281, 1285. When questioned by the district court about why Section 330 does not apply, counsel seemed to suggest that under Section 328, the court must evaluate fees under the lodestar and reasonableness standards (standards which apply under section 330). See Tab 135, EOR 1329. Now, in its brief to this Court, it argues again that the error in law made by bankruptcy court was to apply Section 330 instead of Section 328. Appellant's Opening Brief, p. 9.

The Law Firm has made inconsistent arguments to this Court. On one hand, it contends its fees are not reviewable under Section 330. Appellant's Brief, p 9, 10-11. On the other hand, the Law Firm argues that the fees should be reviewed under a "lodestar" analysis. Appellant's Brief, p. 12. An argument that a "lodestar" analysis applies to a review of its fees necessarily admits that Section 330 applies. However, it is necessary to address any vestige of Law Firm's argument on appeal that the bankruptcy court erred in reviewing its fees under Section 330, when it had obtained approval of its employment on a "lodestar" basis.

1. The principle that a bankruptcy court may not alter pre-approved terms and conditions of employment, absent a finding that the terms and conditions were improvident in light of unanticipated developments does not apply to these facts in this case.

The statute and the case law on Section 328 is clear. Once a bankruptcy court has approved terms and conditions of employment, they may be altered only

> if such terms and conditions prove to be improvident in light of developments not capable of being anticipated at the time of the fixing of such terms and conditions.

11 U.S.C. § 328(a).

When, for example, the court approves employment of counsel on a contingency fee basis, it may not grant fees on an "hourly" basis without making findings about unanticipated developments. See Pitrat v. Reimers (In re Reimers), 972 F.2d

1127 (9th Cir. 1992). Although the court has substantial discretion to alter the fee arrangement when justified, the court abuses its discretion if it fails to make specific findings of those improvident circumstances. In re Confections by Sandra, 83 B.R. 729, 733 (Bankr. 9th Cir. 1987). The term "unanticipated developments" is "subject to broad interpretation." Id. at 733.

2. The Law Firm did not have a pre-approved contract.

The Employment Order was no different from most employment orders entered in this judicial district. In this district,

> [t]he usual request for authority to employ an attorney . . . which is routinely approved, does not seek to impose any particular terms and conditions and leaves the question of compensation until later. Although the papers may recite the attorney's usual billing rate, the actual determination of compensation is left to the standards stated in section 330.

C&P Auto Transport, 94 B.R 682, 685 (Bankr. E.D. Cal. 1988). Moreover, to invoke the protection embodied in Section 328 against modification of a prior-approved arrangement, the language in the employment order must "expressly and unambiguously state specific terms and conditions." Id. at 685, FN 4.

The Law Firm contends the Employment Order constitutes a pre-approved fee arrangement -- a "contract" -- which immunizes its fees from court scrutiny under Section 330 of the Bankruptcy Code. See Appellant's Brief, p. 9.

The Court's order specifically provided that "[n]o compensation is permitted except upon court order following application pursuant to 11 U.S.C. § 330(a)." Tab 9, EOR 0052:26-27. The meaning of this is clear -- the court was making no guarantees. This counsel, like all counsel, was being told -- from the inception of its representation -- that it would have to come before the court and justify its request for fees based upon the criteria set forth in Section 330 of the Bankruptcy Code.

The court's order also specified that "[c]ompensation will be at the 'lodestar rate' applicable at the time that services are rendered in accordance with the Ninth Circuit decision in In re Manoa Fin. Co., 853 F.2d 687 (9th Cir. 1988)." Id. Counsel appears to misapprehend the significance of this section. It merely provides the rate at which any approved compensation will be paid. It does not specify that counsel has a contract to be paid for any work it chose to submit to the court, even work – like that at issue here – which the court specifically concluded was unnecessary and improvidently provided.

The notion that language providing for compensation at the "lodestar rate" transforms a routine employment order -- with no other particular terms and conditions specified -- into a "contract" under which counsel avoids review for reasonableness simply defies logic. Moreover, the assertion is contradicted by specific language in the preceding paragraph of the order:

The Law Firm's argument that its Employment Order constitutes a "contract" or pre-approved fee arrangement which is reviewable under Section 328 alone – and hence not reviewable under Section 330 – was not directly raised before the bankruptcy court. See Tabs 24- 30, 34, 35, 36-40. Having failed to argue this point to the bankruptcy court, this issue is now waived on appeal. See Leibowitz v. County of Orange (In re Leibowitz) 230 B.R. 392, 399(Bankr. 9th Cir. 1999).

3. The Law Firms' adherence to the contention that Section 328 prevents scrutiny under Section 330 is undermined by its own statements acknowledging the contrary.

A complete and objective analysis of the Employment Order should place to rest any question whether the Law Firm's fees were subject to review under Section 330. In addition, the Law Firm cannot seriously assert a subjective belief that its fees were not reviewable under Section 330. Throughout the proceedings, in pleadings filed with the court and in a statement to the court, counsel acknowledged that its fees were subject to scrutiny under Section 330.

For example, counsel declared under penalty or perjury that "Special counsel understands and acknowledges that all compensation is subject to Sections 328, 329, 330 and 331 of the Bankruptcy Code." Tab 5, EOR 0031:9-10.

When the Law Firm first sought employment, counsel affirmatively agreed with the court's admonishment that all fees would be scrutinized "at the end of the day." Tab 32, EOR 0552:11-23.

Finally, fee applications were filed by the Law Firm -- not pursuant Section 328 -- but "pursuant to Section 330." Tab 12, EOR 0068:18-24, EOR 0069:4-7 [First Interim Fee Application]; Tab 25, EOR 0291:18-25, EOR 0292:9-12 [Second Interim Fee Application]; Tab 37, EOR 0580:18-25, EOR 0581:15-17 [Final Fee Application].

C. WHEN THE BANKRUPTCY COURT REDUCED FEES TO AN AMOUNT WHICH COMPENSATED THE LAW FIRM FOR SERVICES UP TO TRIAL, THE COURT PROPERLY EXERCISED ITS DISCRETION.

In making the fee award, the bankruptcy court applied Section 330. The court's analysis in making the fee award was consistent with principles articulated in Ninth Circuit and relevant Seventh Circuit case law on Section 330. As the trier of fact, the court must determine the reasonableness of fees and expenses. In re Kenneth Leventhal & Company, 19 F.3d 1174, 1178 (7th Cir. 1994). Based upon its opinion that the case was too weak to take to trial and that counsel failed to adequately advise the trustee, the court allowed compensation for pre-trial services only. In essence, only those services rendered up to trial satisfied the reasonable and necessary standards of Section 330. In making this determination, the court did not abuse its discretion.

1. A bankruptcy court's determination of the amount of fees must be reviewed under the abuse of discretion standard.

The bankruptcy court's fee awards are upheld unless the court abused its discretion or erroneously applied the law. Unsecured Creditors Committee v. Puget Sound Plywood, 924 F.2d 955, 957 (9th Cir. 1991). Findings of fact are binding unless clearly erroneous. Ibid.

2. The bankruptcy court's reduction of fees under the facts of this case was consistent with the plain reading of 11 U.S.C. § 330.

In the court's Memorandum Decision, Tab 42, EOR 0633, the bankruptcy court followed the plain meaning in Section 330(a)(3)(A)(C) [sic], which provides in pertinent part that:

> in determining the amount of reasonable compensation to be awarded, the court shall consider the nature, the extent, and the value of such services, taking into account all relevant factors, including...whether the services were necessary to the administration of, or beneficial at the time at which the service was rendered...

11 U.S.C. § 330(a)(3)(A)(C)[sic]. The reduction in fees was consistent with the statutory directions given to the bankruptcy court.

3. A fee award based upon a finding that services were not reasonable is consistent with Ninth Circuit law.

The bankruptcy court's analysis of the fees was consistent with Ninth Circuit case law, in particular Unsecured Creditors Committee v. Puget Sound Plywood (In re Puget Sound Plywood), 924 F.2d 955 (9th Cir. 1991)(Bankruptcy court did not abuse discretion by reducing fees of counsel who failed to consider maximum possible recovery). Accord Digesti & Peck v. Kitchen Factors (In re Kitchen Factors), 143 B.R. 560 (Bankr. 9th Cir. 1992)(Counsel for trustee had fiduciary relationship to the estate and was required to consider cost-effectiveness of pursuit of litigation; fees submitted for $12,000 in pursuit of $12,000 debt were reduced); In re Taxman Clothing Company, 49 F.3d 310 (7th Cir. 1995)(Counsel for the bankruptcy estate is under a duty to consider the merits of a case at all stages of the case; like the trustee, counsel must exercise care, diligence, and skill not only in the prosecution of the estate's claims, but in deciding "which claims to prosecute, and how far." Id. at 315.) By objectively analyzing the merits of the Ward Litigation and evaluating counsel's decision to proceed to trial with a weak case, the bankruptcy court did not err.

4. Ninth Circuit authority does not require the bankruptcy court to engage in a mechanical calculation of fees based on multiplying actual hours times the hourly rate.

Nor did the bankruptcy court err when it declined to award fees based strictly upon multiplying actual hours expended times hourly rate. The Ninth

Circuit has held that the multiplication of hours times hourly rate is merely the beginning point of a fee calculation. Puget Sound Plywood, 924 F.2d at 958. Moreover, calculation of the "lodestar," is the "primary" but not the "exclusive" method for calculating fees, especially in the bankruptcy context. 924 F.2d at 960. Finally, the applicant must show the services were "necessary and reasonable," Id. at 958, and counsel does not have "free reign to run up a tab without considering the maximum probable recovery." Ibid.

In this case, the bankruptcy court held that services rendered up to trial were reasonable and necessary. In doing so, disallowance of fees for services rendered thereafter, i.e. services deemed to be unreasonable, unlikely to benefit the estate and therefore unnecessary, was consistent with the law in this circuit.

5. The bankruptcy court properly exercised discretion and applied the correct law.

In reaching the amount of the fee award, the bankruptcy court: (a) recalled the evidence in the Ward Litigation which was presented in an eight day trial, Tab 42, EOR 0628, 0630-0631, incorporating Tab22, EOR0248-0285; (b) considered the applicable law and the interests at stake, Tab 42, EOR 0628-0629,0631-0634; and (c) made detailed findings of fact and conclusions of law, Tabs 42 and 22. The court supplied reasons at every step in its analysis. The bankruptcy court properly discharged its duties.

D. THE BANKRUPTCY COURT'S FINDING THAT THE LAW FIRM FAILED TO OBJECTIVELY EVALUATE THE MERITS OF THE WARD LITIGATION WAS NOT CLEARLY ERRONEOUS.

1. The Law Firm must demonstrate that the bankruptcy court's findings of fact, upon which the court reduced its fees, were clearly erroneous.

As the trier of fact, the bankruptcy court's findings of fact and conclusions of law should be accorded considerable deference. See Fed. R. Bankr. P. 8013. When there are two permissible views of the facts, the view chosen by the fact finder cannot be clearly erroneous. Anderson v. City of Bessemer City, N.C., 470 U.S. 564, 574, 105 S.Ct. 1504, 84 L.Ed.2d (1985).

The Law Firm has supplied voluminous records from the Ward Litigation to demonstrate that there was evidence to support the claims against Ward. Yet, not all of the evidence has been provided. Furthermore, despite assertions about the "compelling" evidence, the Law Firm has not demonstrated in any persuasive way that the bankruptcy court's findings were clearly erroneous. On the other hand, substantial evidence in the record supports the bankruptcy court's finding that the case against Ward was not strong.

2. There was evidence to support the bankruptcy court's finding that Ward did not breach his fiduciary duty as an "outside" director.

With respect to the first cause of action, that as an "outside director," Ward breached his fiduciary duty by undercapitalizing the corporation, the bankruptcy found that LSB was adequately capitalized. Tab 22, EOR 253. The bankruptcy court found evidence "lacking" to support other grounds for imposing liability as an "outside director." Tab 22, EOR 0273-0276. Furthermore, the court rejected the contention that Mr. Ward was in control of the corporation during this period. Id. at EOR 0273. The testimony was almost uncontroverted: When Amos Blacksea was alive, he was in control. Id. at EOR 253-255. In fact, the Law Firm's own papers acknowledge this fact. Appellant's Opening Brief, Appendix A, p. 9 ("Blacksea really ran LSBOA, just as he ran LSB.") Like the contradiction in the Law Firm's assertions that Ward was both over- controlling yet asleep at the wheel (see Tab 22, EOR 0275), the overwhelming truth about Amos Blacksea's dominance of -- indeed sole control over -- all of LSB's and LSBOA's operations had remarkably escaped the Law Firm's evaluation of the facts.

3. There was evidence to support the bankruptcy court's finding that Ward did not breach his fiduciary duty as "inside" director.

The next cause of action in the Ward Litigation was that Ward breached his duty as "inside" director. In late 1995, following the death of Amos Blacksea, Ward became an officer of LSB. The bankruptcy court found that there was no abdication of duties by Ward. Tab 22, EOR 0277. Although the court recognized, with the benefit of hindsight that Ward could have done things differently, Tab 22, EOR 0277, Ward's approach to handling the company's operations was similar to the chapter 11 trustee's. As the court's detailed recounting of the history of LSB demonstrates, see Tab 22, EOR 0251-0273, by the end of the Ward Litigation, the court understood the history and background of LSB. The court was fully informed when she found that Ward's conduct satisfied the business judgment standard. Tab 22, EOR 0277-0278.

4. There was evidence to support the bankruptcy court's finding that Ward was not an alter ego of LSBOA.

With respect to the third cause of action, the bankruptcy court noted that the alter ego doctrine is an equitable remedy which allows a court to hold shareholders liable for corporate obligations when one is the alter ego of another. Tab 22, EOR 0278. The court discussed the evidence and concluded "John Ward obtained no personal advantage from Lender Service Bureau of America," Tab 22, EOR 0281, further finding:

> The self-dealing that is typically present in cases which find an alter ego relationship is totally absent in this case. There's no inequitable conduct to be remedied in this case. To the extent LSB was harmed by its relationship with LSBOA, it knew exactly what it was doing and it's not at all clear that it was harmed.

Tab 22, EOR 0282.

E. THE LAW FIRM'S CONTENTIONS THAT THE BANKRUPTCY COURT ABUSED ITS DISCRETION ARE NOT SUPPORTED BY THE RECORD.

The Law Firm's various contentions of abuse of discretion by the bankruptcy court have little support in the record and are based upon a misunderstanding or distortion of the record.

1. <u>The Law Firm's complaint that the bankruptcy court abused its discretion when it "faulted" the Law Firm for making representations about "certain recovery" of $1.5 million in the Ward Litigation is inaccurate</u>.

The Law Firm contends that the bankruptcy court abused its discretion by "fault[ing]" WG&S for alleged representations that there was a "certain recovery." Appellant's Brief, p. 3. According to the Law Firm, the "*only* representations [emphasis in original]," in the record consisted of a letter from the trustee's general counsel, Mark Serlin ("Serlin") who "has no affiliation with WG&S." Appellant's Brief, p. 3.

The Law Firm's attempt to disassociate itself from claims exaggerating the likelihood of success of the Ward Litigation is unconvincing. Contrary to the assertion above, the court did not attribute the term "certain recovery" to the Law Firm. In fact, the court declined to impute to the Law Firm representations of "certain recovery" made by Greeley and Serlin "because the record is not entirely clear what representations were made by WGS, as opposed to Serlin, when WGS was hired..." Tab 42, EOR 0632-0633. Yet, the court found that "the evidence demonstrates that, in the months that followed WGS never backed away from Serlin's rosy picture of the litigation." Tab 42, EOR 0633. The court's criticism of the Law Firm was for Law Firm's failure to fulfill its

> obligation to advise the Trustee, on behalf of the estate and creditors, of the significant risks and costs faced at trial. Although counsel for former OCC members periodically discussed this litigation with the Trustee and his counsel, he was never advised of any changes to the original predictions for a certain recovery, underestimates on litigation budgets, or the potential liability to Ward for his attorneys' fees. WGS failed in its duty to the creditors in this case, who have been forced to fund this litigation with none of the controls that a client would normally exercise.

Tab 42, EOR 0634.

It is not entirely accurate to state that the Law Firm has no affiliation with Serlin, to whom representations of "certain recovery" have been attributed. In the Ward Litigation, the Law Firm was expressly employed as co-counsel with Serlin. Indeed, although the Law Firm has referred to itself as "special counsel," its application sought employment as co-counsel with Serlin. Tab 6, EOR 0030:23-26; Tab 7, EOR 0045-0046; Tab 8, EOR 0048.

The above stated representations were not the only representations which were made about the rosy prospects in the Ward Litigation. Representations of certain recovery were made by Greeley to the United States Trustee. Tab 33, EOR 0566-0567. What else can be inferred by a virtual guarantee that a fee arrangement on an hourly basis would be more economical than on a contingency basis? The suggestion that the Law Firm was unaware of such representations is also not supported by the record. The Law Firm, in fact, received a letter from the Assistant United States Trustee confirming the making of such representations. Tab 33, EOR 0566-00569.

The Law Firm's lead counsel himself offered an optimistic prediction of recovery to the bankruptcy at the outset of employment. At the hearing on the employment application in January 1998, counsel stated to the court: "There's a million and a half dollars at stake, and we fully anticipate winning the case..." Tab 32, EOR 0552:16-18.

2. <u>The Law Firm's assertion that the bankruptcy court abused its discretion by "speculating about confidential legal advice to the trustee" has no basis in the record</u>.

The Law Firm unfairly accuses the bankruptcy court of abuse of discretion because it "improperly speculated about the content of confidential attorney-client communications and settlement discussions." Appellant's Opening Brief, p. 15. This baseless accusation refers to one sentence in the Memorandum Decision criticizing the Law Firm for taking the case to trial with "minimal settlement discussions." Tab 42 at EOR 0631.

First, the accusation takes the court's statement out of context. The court was not "speculating" about advice but was concerned about the Law Firm's judgment. The court, in fact, relied upon the Law Firm's own time sheets as evidence of time spent on settlement discussions. As noted in the same Memorandum Decision from which the above quote was taken:

> ...WGS' time sheets reveal a disturbing lack of concern with a broader perspective. During the periods covered by the two interim fee applications, WGS incurred approximately $10,000 in strategy meetings (including the analysis of legal theories), $5,000 on legal research on theories of liability, and only $2,500 in settlement discussion. By contrast, $87,000 was spent on discovery and another $108,000 on trial and trial preparation (which does not include the time spent seeking a jury trial in district court.)

Tab 42, EOR 0634:3-11.

In the Ninth Circuit, counsel for the estate must consider the interests of the estate, including "[t]o what extent may the estate benefit if the services are rendered and what is the likelihood of the disputed issues being resolved successfully?" Unsecured Creditors' Committee v. Puget Sound Plywood, 924 F.2d at 959. The bankruptcy court properly considered whether or not the Law Firm exercised good judgment in evaluating the settlement prospects of the Ward Litigation. The bankruptcy court was properly concerned about proportionality and billing judgment exercised by a fiduciary. In awarding fees in this case, the bankruptcy court did not abuse its discretion by considering the strength of the case and counsel's evaluation of the case, including the proportion of time spent by counsel in settlement of the case.

V.

CONCLUSION

The bankruptcy court did not abuse its discretion when it reduced the fee award of the Law Firm based upon findings that the services rendered by Law Firm in taking a weak case to trial were not necessary to the administration of the case nor were they beneficial at the time the services were rendered. The district court applied the appropriate standard of review when it affirmed the order of the bankruptcy court. Each court properly exercised its discretion. Accordingly, this Court should uphold the bankruptcy court's fee award.

DATED: April 19, 2000

Respectfully submitted,

MAUREEN A. TIGHE
United States Trustee for Region 17

ANTONIA G. DARLING
Assistant United States Trustee

By: __________________________
DONNA S. TAMANAHA
Attorney, United States
Department of Justice

VI.
STATEMENT OF RELATED CASE

The United States Trustee is unaware of any related case pending in this Court.

DATED: April 19, 2000

Respectfully submitted,

MAUREEN A. TIGHE
United States Trustee for Region 17

ANTONIA G. DARLING
Assistant United States Trustee

By: ___________________________
DONNA S. TAMANAHA
Attorney, United States
Department of Justice

VII.
CERTIFICATION PURSUANT TO CIRCUIT RULE 32(a)(7)(C) AND CIRCUIT RULE 32-1 FOR CASE NUMBER 99-17683

Pursuant to Fed. R. App. P. 32 (a)(7)(C) and Ninth Circuit Rule 32-1, the attached answering brief is proportionately spaced, has a typeface of 14 points or more type, and contains no more than 7,300 words.

DATED: April 19, 2000

Respectfully submitted,

MAUREEN A. TIGHE
United States Trustee for Region 17

ANTONIA G. DARLING
Assistant United States Trustee

By: ____________________________
DONNA S. TAMANAHA
Attorney, United States
Department of Justice

BRIEF BANK — "SUMMARY SHEET" *Printed Mon-5/23/11 14:11*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE
[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]

In re LTV Steel Company, Inc. (Glenn J. Moran v. LTV Steel Company, Inc. & Official Committee of Administrative Claimants)

2. ("CO") ***CURRENT*** COURT
[E.g., "CTA9"]

6th Cir

3. ("CCN") ***CURRENT*** CASE NO.

No.: 06-cv-4580 - consolidated with 07-3530, 07-3534, 07-3537

4. ("PCN") ***PRIOR*** CASE NO. & COURT
[IF ANY]

No.: 1:05-cv-2285

Court: N.D. Ohio

(Identify judge & cite, if any)

5. ("SO") ***SOURCE***

U.S. TRUSTEES

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF
[E.g., "Opening Brief," "Reply," "Amicus," etc.]

Filed: May 5, 2009

Type: Opposition to Petition for Rehearing and to a Suggestion for Rehearing EnBanc

-

7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*

Amy Good, William Kantor, Kelsi Brown Corkran, Catherine B. Sevcenko, P. Matthew Sutko, Daniel M. McDermott

(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***

BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s)

&

√ Any Miscellaneous ***BACKGROUND***

• Should the sixth circuit reconsider whether a potential claimant to an estate is a "person aggrieved" under 6th circuit bankruptcy appellate standing?

-

10. PATH TO FILE LOCATION:
(e.g., S:\OGC\BRFBANK\etc...)

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| x | YES | | NO

NAME: Linda Figueroa

DATE:

06-4580; 07-3530/3534/3537

IN THE UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

In re LTV STEEL COMPANY, INC.,
Debtor.

***

GLENN J. MORAN,
Appellant,

v.

LTV STEEL COMPANY, INC. & OFFICIAL COMMITTEE OF ADMINISTRATIVE CLAIMANTS,
Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF OHIO

OPPOSITION TO PETITION FOR REHEARING AND TO A SUGGESTION FOR REHEARING EN BANC

Daniel M. McDermott
United States Trustee, Region 9
Amy L. Good (0055572)
Trial Attorney

Office of the U.S. Trustee

Department of Justice
H.M. Metzenbaum U.S. Courthouse
201 Superior Avenue, Suite 441

Tony West
Assistant Attorney General
William Kanter
Kelsi Brown Corkran
Attorneys, Appellate Staff
Civil Division

Department of Justice

950 Pennsylvania Ave, N.W.
Washington, D.C. 20530

Ramona D. Elliott
General Counsel
P. Matthew Sutko
Associate General Counsel
Catherine B. Sevcenko
Trial Attorney
Department of Justice
Executive Office for the

Cleveland, Ohio 44114

(216) 522-7800 ext. 236

United States
Trustee
20 Massachusetts
Ave., N.W.
Washington, D.C.
20530

(202) 307-1399

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INTRODUCTION AND SUMMARY

Pursuant to this Court's Order of May 1, 2009, Appellee the United States Trustee respectfully submits this memorandum in opposition to Appellant Glenn J. Moran's petition for rehearing and suggestion for rehearing en banc.

In 2000, LTV Steel Company, Inc., filed for Chapter 11 bankruptcy protection. The United States Trustee exercised its power to appoint a committee to represent the interests of the company's unsecured creditors, *see* 11 U.S.C. § 1102(a)(1), and the bankruptcy court ultimately issued a Standing Order granting the committee authority to bring a lawsuit against certain officers and directors of LTV, including Moran. When Moran attempted to appeal the Standing Order in district court, the district court found that Moran lacked standing to challenge the Order because he is not a "person aggrieved" by the Order under this Court's bankruptcy appellate-standing doctrine. This Court affirmed on appeal, and Moran now seeks rehearing en banc.

Moran's petition should be denied. Rehearing en banc is appropriate only when the panel's opinion "directly conflicts with Supreme Court or Sixth Circuit precedent" or involves "a precedent-setting error of exceptional public importance." 6th Cir. R. 35(c); *see also* Fed. R. App. P. 35. Neither of these criteria is present in this case. Although Moran contends that the panel majority's opinion creates an intra-circuit conflict with *Hyundai Translead, Inc. v. Jackson Truck & Trailer Repair, Inc. (In re Trailer Source, Inc.)*, 555 F.3d 231 (6th Cir. 2009), the majority holding in that case plainly has no application to Moran's appeal. Indeed, not even the dissenting judge in this case suggests that the panel majority's reasoning conflicts with any circuit or Supreme Court precedent. Moran also fails to offer any basis for concluding that the panel majority's decision implicates issues of exceptional public importance. Under these circumstances, rehearing en banc is unwarranted.

STATEMENT

Under 11 U.S.C. § 1102(a)(1), when a company initiates chapter 11 bankruptcy proceedings, the United States Trustee[1] has authority to appoint a committee of the company's unsecured creditors to "investigate the acts, conduct, assets, liabilities, and financial condition of the debtor, the operation of the debtor's business . . . and any other matter relevant to the case," 11 U.S.C. § 1103(c)(2). This committee "may raise and may appear and be heard on any issue" in the case. 11 U.S.C. § 1109(b).

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[1] The United States Trustees "serve as bankruptcy watch-dogs to prevent fraud, dishonesty, and overreaching in the bankruptcy arena." H.R. Rep. No. 95-595, at 88 (1977). The United States Trustee Program thus acts in the public interest to promote the efficiency, and to protect and preserve the integrity, of the bankruptcy system. To this end, Congress has given the United States Trustees authority to "supervise the administration of cases and trustees" in all bankruptcy cases through a range of oversight responsibilities, 28 U.S.C. § 586(a)(3), and provided that the United States Trustees "may raise and may appear and be heard on any issue in any [bankruptcy] case or proceeding," 11 U.S.C. § 307. *See generally Morganstern* v. *Revco D.S. Inc. (In re Revco D.S., Inc.)*, 898 F.2d 498, 500 (6th Cir. 1990).

Appellant Glenn Moran is the former Chief Executive Officer of LTV Steel Company, which filed for chapter 11 protection in December 2000. Exercising its power under 11 U.S.C. § 1102(a)(1), the United States Trustee appointed a committee of unsecured creditors, which, among other things, investigated the conduct of LTV's officers and directors to determine whether there were any causes of action that should be pursued against them. The committee ultimately concluded that colorable claims existed against certain officers and directors for breach of fiduciary duty, negligence, and corporate waste, and accordingly filed a motion in bankruptcy court seeking leave to commence and prosecute a lawsuit against those directors and officers, including Moran, on behalf of the LTV bankruptcy estate. The bankruptcy court issued a Standing Order granting the motion and, two weeks later, the committee initiated a lawsuit against the directors and officers in district court.

Moran attempted to challenge the Standing Order in district court, but the district court dismissed the appeal, holding, among other things, that Moran lacked standing under this Court's bankruptcy appellate standing doctrine because he is not a "person aggrieved" by the Order.[2] *See Moran* v. *Official Comm. of Admin.*

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[2] Five other putative defendants also attempted to block the lawsuit, but instead of challenging the Standing Order, they filed motions seeking dissolution of the committee. The bankruptcy court denied their motions, and the district court affirmed. This Court consolidated their appeals with Moran's appeal, and the panel majority concluded that those appellants lacked standing for the same reasons as Moran. Only

Claimants, No. 1:05-cv-2285, 2006 WL 3253128 at *5 (N.D. Ohio Nov. 8, 2006). A divided panel of this Court affirmed. Writing for the majority, Judge Gilman explained that under well-established Sixth Circuit precedent, "parties may not appeal a bankruptcy order unless they have a direct financial stake in the order such that it 'diminishes [their] property, increase [their] burdens, or impairs [their] rights.'" Maj. Op. at 5 (*quoting Fid. Bank, Nat'l Ass'n* v. *M.M. Group, Inc.*, 77 F.3d 880, 882 (6th Cir. 1996)); *see also Harker v. Troutman (In re Troutman Enter., Inc.)*, 286 F.3d 359, 364 (6th Cir. 2002) (explaining that standing in bankruptcy court proceedings is "more limited than Article III standing or the prudential requirements associated therewith"). Although the burden of defending a lawsuit maybe "onerous or unpleasant," Judge Gilman observed, it is not the kind of "direct and immediate harm that makes a party 'aggrieved' so as to confer standing in a bankruptcy appeal.'" Maj. Op. at 6 (*citing Fid. Bank*, 77 F.3d at 883 for the proposition that being "subject[ed] to the possibility of future litigation" by a bankruptcy order is "insufficient to confer standing").

Moran, however, filed a rehearing petition. The United States Trustee is a party to *Bricker v.Official Committee of Administrative Claimants* (07-3530) and *Babcock v. Official Committee of Administrative Claimants* (07-3537). We are filing this brief at this Court's invitation.

In the alternative, Moran argued that he is a "person aggrieved" by the Order because, pursuant to a bylaws indemnity provision, his expenses in defending against the lawsuit will be paid by the estate, and as such, he has an administrative claim against the estate and "an interest . . . in seeing that the estate's assets are distributed appropriately and without waste." Maj. Op. at 8. The panel majority rejected this argument as well. Observing that "simply holding a claim of any type against the estate does not automatically confer appellate standing," *id.*, Judge Gilman explained that it would be "perverse logic" to permit Moran to appeal based on his indemnification while defendants without indemnification — "who would clearly be burdened to a greater extent than Moran because they would have to pay all defense costs and any awards against them from their own pockets" — could not appeal, *id.* at 9.

Judge Kennedy filed a separate opinion, concurring in part with and dissenting in part from the majority opinion. Judge Kennedy emphasized that she agreed with the majority that "an order that makes a party a defendant in a lawsuit cannot be appealed by that defendant," and that "not all creditors necessarily have appellate standing to challenge an order of the bankruptcy court." Dis. Op. at 12. She disagreed, however, with the majority's conclusion that Moran could not establish standing based on LTV's obligation to indemnify him for attorneys' fees and certain judgments against him. *Id.* at 13. Judge Kennedy reasoned that because Moran's ability to recover attorneys' fees from the estate could in theory be compromised by the use of estate funds to bring the lawsuit against him, he should have standing to challenge the bankruptcy court's authorization of that lawsuit.

ARGUMENT

Neither of the criteria for obtaining rehearing en banc — a conflict with another decision of this Circuit or the Supreme Court, or an issue of "exceptional public importance" — is present here. Accordingly, Moran's petition should be denied.

1. The panel majority's holding is not inconsistent with the precedent of this Court or the Supreme Court. Specifically, the majority applied the well-established rule that a bankruptcy court authorization of a lawsuit does not make the putative defendant a "person aggrieved" who would have standing to challenge the bankruptcy court order. Maj. Op. at 5-6. Judge Kennedy expressly agreed that the majority applied the correct standard, Dis. Op. at 12 ("To be clear, I agree with the majority that an order that makes a party a defendant in a lawsuit cannot be appealed by that defendant . . . ."), and noted that she had "no qualms with the majority's discussion of a bare defendant's lack of appellate standing," *id.* Her partial dissent grew out of the majority's application of the standard rule to Moran without, in her view, giving adequate consideration to Moran's dual status as a defendant and a potential

administrative claimant,[3] *id.* at 13-15. At no point did Judge Kennedy suggest that she believed that the panel majority's reasoning strayed from Circuit or Supreme Court precedent. She simply disagreed with the panel majority's application of law to the facts of this case. This Court's rules expressly state that the application of law to facts is not appropriate for en banc review. 6th Cir. R. 35.

Although Moran asserts that the panel's analysis of the "person aggrieved" standard conflicts with the "pronouncements" on the issue by the panel in *Hyundai Translead, Inc.* v. *Jackson Truck & Trailer Repair Inc. (In re Trailer Source, Inc.)*, 555 F.3d 231 (6th Cir. 2009), *see* Reh'g Pet. at 12, this argument is misplaced. *Hyundai* addresses the extent to which a bankruptcy court has the power to grant derivative standing to a creditors committee to bring a claim on behalf of the estate. In considering the scope of derivative standing, the *Hyundai* panel touched briefly on bankruptcy appellate standing. *Hyundai*, 555 F.3d at 235-36. The majority held that if one party has standing to appeal from the bankruptcy court to the district court, then the losing party in the district court may appeal to the appellate court, regardless of whether it would have had standing to appeal the initial bankruptcy decision. *Id.* at 236-37. In a dissenting opinion, Judge Rogers argued that the basic bankruptcy

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[3] The Response of the Official Committee of Administrative Claimants correctly explains why Mr. Moran's assertion that he has an administrative claim against the LTV estate is not persuasive. *See* Claimants' Resp. at 7-9.

appellate standing rule — that a party must be “aggrieved” by the decision to appeal — applied whether the appeal was from the bankruptcy court to district court or district court to circuit court. *Id.* at 247. In other words, with respect to bankruptcy appellate standing doctrine, the *Hyundai* panel ruled on only one question: whether the same standing analysis applies to the first and second levels of appeals. *Id.* at 236. Both the majority and the dissent in the present case agree that where, as here, the appellant was the losing party in both the bankruptcy court and district court, the *Hyundai* holding is entirely irrelevant. *See* Maj. Op. at 7; Dis. Op. at 12.

Although Moran attempts to create the appearance of a circuit split by suggesting that the panel in this case “adopted Judge Rogers’ dissenting opinion in *Hyundai*,” Reh’g Pet. at 2, this is plainly a mischaracterization of the Court’s decision. Judge Rogers’s (partially) dissenting opinion in *Hyundai* begins by explaining his disagreement with the majority’s decision not to apply the Court’s bankruptcy appellate standing doctrine, and then goes on to analyze whether the appellants would have standing if that doctrine were applied. The *Hyundai* majority never considered, much less refuted, Judge Rogers’ analysis on that point because they believed it was irrelevant under the circumstances of their case. *Hyundai*, 555 F.3d 231, 237, n.4. In the present case, where bankruptcy appellate standing doctrine indisputably governs the issue of standing, both the panel majority and Judge Kennedy found Judge Rogers’ standing analysis in *Hyundai*, albeit hypothetical, useful in thinking about Moran's standing to bring this appeal. *See* Maj. Op. at 7; Dis. Op. at 12. Moran cannot plausibly contend that a discussion of Judge Rogers' opinion in this context results in any "conflicting guidance to district courts," Reh'g Pet. at 1, much less a circuit split.

2. Moran also fails in his attempt to characterize this case as involving an issue of exceptional public importance. Moran's primary argument on this point is that en banc review is necessary "[b]ecause of the exceptional importance of providing guidance to the lower court judges of this Circuit who are now faced with unclear instruction" as to whether the directors and officers of bankrupt companies having standing to appeal bankruptcy court orders authorizing lawsuits against them. Reh'g Pet. at 3. But, as explained above, there is nothing unclear about how this decision and *Hyundai* affect future cases. *Hyundai* holds that if one party has standing to appeal from the bankruptcy court to the district court, then the losing party in the district court may appeal to the appellate court, regardless of whether it would have had standing to appeal the initial bankruptcy decision. 555 F.3d at 236-37. The present case holds that when a bankruptcy court authorizes an administrative claimant committee to commence a lawsuit against the officers and directors of a now-bankrupt company, those officers and directors cannot rely on either their putative defendant status or their indemnification rights to establish standing under this Court's

bankruptcy appellate standing doctrine. Moran has not and cannot identify any inconsistency in these holdings.

CONCLUSION

For the reasons outlined above, the United States Trustee respectfully requests that this Court deny Moran's petition for rehearing and suggestion for rehearing en banc.

Respectfully submitted,

Daniel M. McDermott
United States Trustee, Region 9

Date: _______

/s/ Amy L. Good
Amy L. Good (0055572)
Trial Attorney
Office of the U.S. Trustee
Department of Justice
H.M. Metzenbaum U.S. Courthouse
201 Superior Avenue, Suite 441
Cleveland, OH 44114
(216) 522-7800, ext. 236

William Kantor
Kelsi Brown Corkran
Attorneys, Civil Division
P. Matthew Sutko
Associate General Counsel
Catherine B. Sevcenko
Trial Attorney
Department of Justice
Executive Office for United States Trustee
20 Massachusetts Avenue, N.W.
Washington, D.C. 20530
(202) 307-1399

CERTIFICATE OF SERVICE

A copy of the foregoing Motion of the United States Trustee was served by regular U.S. Mail, postage prepaid the ____ day of May, 2009 upon the following:

Michael A. VanNiel, Esq.
Matthew R. Goldman, Esq.
Baker & Hostetler
3200 National City Center
1900 East Ninth Street
Cleveland, Ohio 44114

Attorneys for the Administrative Claimants Committee

Pierre H. Bergeron
Squire, Sanders & Dempsey L.L.P.
221 East Fourth Street
Suite 2900
Cincinnati, Ohio 45202

Thomas S. Kilbane
J. Philip Calabrese
Amy Cadle Hocevar
Squire, Sanders & Dempsey L.L.P.
4900 Key Tower
127 Public Square
Cleveland, Ohio 44114

Attorneys for Glenn J. Moran

/s/Amy L. Good
Amy L. Good

BRIEF BANK — “SUMMARY SHEET”

Printed Wed-1/13/10 16:39

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	Edward C. Lucas v. Daniel M. McDermott United State Trustee
2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	S D. Ohio
3. ("CCN") ***CURRENT*** CASE NO.	No.: 1:09-cv-00060-SJD-MRM
4. ("PCN") ***PRIOR*** CASE NO. - & COURT *[IF ANY]*	No.: 1:09-bk-11421 Court: Bankr. S.D. Ohio *(Identify judge & cite, if any)*
5. ("SO") ***SOURCE***	**U.S. TRUSTEES**
6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	Filed: January 11, 2010 Type: Brief of Appellee, The United States Trustee
7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*	Monica V. Kindt, Wendy Cox, P. Matthew Sutko, Ramona D. Elliott, Daniel M. McDermott *(UST/OGC: 202-307-1399/FAX-2397)*
8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	• Whether in the absence of any allegation that the bankruptcy court erred in ordering a bankruptcy petition preparer to pay $3000 in statutory damages and fines for violating 11 U.S.C. §110, this Court may remove or reduce the sanctions based on the bankruptcy petition preparer’s alleged inability to pay?
10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)	
11. DO YOU RECOMMEND POSTING IN UST BRIEFBANK?	☒ YES ☐ NO ***NAME:*** Linda Figueroa ***DATE:***

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF OHIO
WESTERN DIVISION

EDWARD C. LUCAS,

Appellant,
v.

DANIEL M. McDERMOTT,
UNITED STATES TRUSTEE
FOR REGION 9,

Appellee.

Case no. 01:09-mc-00060

Chief Judge Dlott

Magistrate Judge Merz

BRIEF OF APPELLEE, THE UNITED STATES TRUSTEE

RAMONA D. ELLIOTT
General Counsel
P. MATTHEW SUTKO
Associate General Counsel
WENDY COX
Trial Attorney
United States Department of Justice
Executive Office for U.S. Trustees
Office of the General Counsel
20 Massachusetts Ave., N.W., Suite 8100
Washington, D.C. 20530
(202) 307-1399

DANIEL M. McDERMOTT
United States Trustee
MONICA V. KINDT 0073085
Assistant United States Trustee
United States Department of Justice
Office of the United States Trustee
36 E. Seventh Street, Suite 2030
Cincinnati, Ohio 45202
(513) 684-6988 x 226

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STATEMENT OF APPELLATE JURISDICTION

The bankruptcy court had jurisdiction under 28 U.S.C. §§ 1334(a) and §157(a) and (b) to enter its final order awarding sanctions against the Appellant, Edward C. Lucas, in a case arising under title 11. That order, which is the subject of this appeal, was entered on the docket on August 7, 2009. Mr. Lucas timely filed motions for reconsideration on August 14, 2009 and August 19, 2009, which were both denied on September 14, 2009. Mr. Lucas filed a timely notice of appeal on September 21, 2009, pursuant to 28 U.S.C. §158(c)(2) and Fed. R. Bankr. P. 8002. This Court has jurisdiction over this appeal under 28 U.S.C. §158(a)(1).

STATEMENT OF THE ISSUE

Whether in the absence of any allegation that the bankruptcy court erred in ordering a bankruptcy petition preparer to pay $3000 in statutory damages and fines for violating 11 U.S.C. §110, this Court may remove or reduce the sanctions based on the bankruptcy petition preparer's alleged inability to pay?

STANDARD OF REVIEW

A bankruptcy court's decision to issue sanctions is within its sound discretion, and therefore is reviewed for an abuse of discretion. *Peppers v. Barry*, 873 F.2d 967, 968 (6th Cir. 1989). "Abuse of discretion is defined as a definite and firm conviction that the trial court committed a clear error of judgment." *Bowling v. Pfizer*, 102 F. 3d 777, 780 (6th Cir. 1996), *cert. denied*, 522 U.S. 906 (1997).

STATEMENT OF THE CASE

I. Statutory Background and Overview

A bankruptcy petition preparer is "a person, other than an attorney for the debtor or an employee of such attorney under the direct supervision of such attorney, who prepares for compensation a document for filing" in a bankruptcy case. 11 U.S.C. §110(a)(1). A "document for filing" is defined as a "petition or any other document prepared for filing by a debtor in a United States bankruptcy court or a United States district court in connection with a case under this title." 11 U.S.C. §110(a)(2).

Subsections (b) through (g) of section 110 set forth standards of conduct to which bankruptcy petition preparers must adhere. 11 U.S.C. §110(b) - (g). For example, a bankruptcy petition preparer must sign each document prepared for filing in a bankruptcy case and include the preparer's name, address, and, if preparer is an individual, his or her Social Security number. 11 U.S.C. §110(b) - (c). A bankruptcy petition preparer may not execute any document on behalf of the debtor, use the word "legal" in any advertisements or advertise under any category that includes the word "legal" or collect or receive any payment from the debtor for the court fees required for filing the petition. 11 U.S.C. §110(e) - (g). Section 110 also prohibits a bankruptcy petition preparer from offering legal advice. 11 U.S.C. §110(e).

A bankruptcy petition preparer who does not comply with section 110 may be required to pay to the debtor actual damages, statutory damages, and attorneys' fees. 11 U.S.C. §110(i)(1). The bankruptcy petition preparer also may forfeit his fees and he may be fined up to $500 for each failure to comply.[1] 11 U.S.C. §110(h)(3)(B); 11 U.S.C. §110(l)(1).

Section 110 of title 11 was enacted in 1994 to "create standards and penalties pertaining to bankruptcy petition preparers." 140 Cong. Rec. H 10,770 (October 4, 1994). The legislative history of section 110 explains that it was enacted in response to the proliferation of bankruptcy petition preparers who were not employed or supervised by attorneys, many of whom attempted to provide legal advice and legal services to debtors without the necessary legal training and ethics regulation. *Id.* Such services, Congress noted, might take unfair advantage of people who were ignorant about their rights both in and out of bankruptcy. *Id.* Section 110 was strengthened in the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, which added several subsections relevant to this appeal, including subsection (e) prohibiting bankruptcy petition preparers from giving legal advice and subsection (l) authorizing bankruptcy courts to fine bankruptcy petition preparers up to $500 for each violation of the statute. *See* Pub. L. No. 109-8, § 210, 119 Stat. 23, 60-62 (2005).

II. Statement of Facts

The debtors, Brady and Angela Kendall, filed a voluntary petition under chapter 7 of the United States Bankruptcy Code on March 17, 2009. Voluntary Petition [District Court Docket ("Dkt") #6, Attachment ("Att.") #1].[2] The Debtors utilized the services of a bankruptcy petition preparer, Edward Lucas, of E.L. Investments. *Id.* at 49, Form B19. Mr. Lucas is the appellant in this appeal.

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[1] The fines are paid to the United States Trustee and deposited in the United States Trustee Fund. 11 U.S.C. §110(l)(4)(A).

[2] The record on appeal is comprised of the attachments to the Notice of Appeal from the Bankruptcy Court [Dkt #1] and the attachments to the United States Trustee's Motion to Supplement the Record on Appeal [Dkt #6], which this Court granted on December 18, 2009.

Mr. Lucas is not an attorney, although he advertises his services on websites under the heading of “legal services.”[3] Mr. Lucas’s business is to prepare bankruptcy filings for debtors. Hr’g Tr. at 55 [Dkt #6, Att. #7]. He uses a computer software program to complete the petitions and associated paperwork. Id. at 63.

Mr. Lucas met with the Debtors, advised them about the bankruptcy filing, and prepared the Debtors’ bankruptcy forms. *Id.* at 45. He charged the Debtors $300 for his services. Voluntary Petition at pg. 48, Form 280 [Dkt #6, Att. #1]. Mr. Lucas had the Debtors complete a questionnaire to provide information that he needed for their petition and financial schedules. Hr’g Tr. at 45, 50-51 [Dkt #6, Att. #7]. He also advised the Debtors that it would be unlikely that they could keep their home if they filed chapter 13 bankruptcy. *Id.* at 52-53. He also filled in the information on the Debtors’ schedule of exemptions. *Id.* at 46-47.

On May 20, 2009, the United States Trustee filed a motion in the Debtors’ bankruptcy case seeking sanctions against Mr. Lucas because he engaged in activities prohibited by 11 U.S.C. §110. United States Trustee’s Sanctions Mot. [Dkt #6, Att. #2]. The United States Trustee alleged that Mr. Lucas had violated section 110(e) by providing legal advice to the Debtors, and had violated section 110(f) by advertising his services under a category that included the word “legal.” *Id.* at 3-4. The sanctions motion asked the bankruptcy court to order Mr. Lucas to return the preparation fee of

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[3] A copy of one of Mr. Lucas’s advertisements on “Craigslist” is attached as Exhibit #1 to the United States Trustee’s Motion for Sanctions [Dkt #6, Att. #2].

$300 to the Debtors, pay $2,000 in damages to the Debtors, and fine Mr. Lucas $1500 for violations of section 110.[4] *Id*. at 4-5.

Mr. Lucas opposed the sanctions motion, asserting, among other things, that he does not give legal advice. Resp. of E. Lucas at 1 [Dkt #6, Att. #3]. The bankruptcy court held a hearing on August 3, 2009. Hr'g Tr. [Dkt #6, Att. #7] Mr. Lucas was represented by counsel at the hearing. *Id.* at 4-10. At the hearing, the parties stipulated and agreed Mr. Lucas had violated 11 U.S.C. §110(e) and 11 U.S.C. §110(f). *Id.* at 23-25; *See also* Appellant's brief at 3 [Dkt # 4] (affirmatively stating that he ratifies without reservation the stipulations entered into in Paragraphs A through F of the Bankruptcy Court Order). Thereafter, the bankruptcy court took testimony concerning the appropriate amount of the monetary sanctions. Hr'g Tr. at 33-79 [Dkt #6, Att. #7]. Mr. Lucas did not dispute the disgorgement of the preparation fee nor the modified $1000 fine payable to the United States Trustee. *Id.* at 41. In fact, counsel for Mr. Lucas stated that Mr. Lucas could afford a $1000 fine. *Id.* Mr. Lucas offered no testimony or other evidence concerning his financial status. *See generally* Hr'g Tr. [Dkt #6, Att. #7].

On August 7, 2009, the bankruptcy court entered an order finding Mr. Lucas had violated sections 110(e) and (f). Sanctions Order [Dkt #1, Att. # 2]. The order adopted the parties' six stipulations:

A. Mr. Lucas's stipulation that he and E.L. Investments advertise under the category "legal" on several websites, in violation of §110(f).

B. Mr. Lucas's stipulation that he advised clients on Schedule C exemptions.

C. Mr. Lucas's stipulation that he and E.L. Investments would cease advertising under a category termed "legal" immediately.[5]

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[4] The $1500 in fines requested under §110(l)(1) was reduced to $1000 at the hearing when the United States Trustee decided to seek fines for only two violations of the statute instead of three. Hr'g Tr. at 39 [Dkt#6, Att. #7].

D. Mr. Lucas's stipulation that he would not advise clients on exemptions.

E. Mr. Lucas's stipulation that he would no longer contact the Chapter 7 Panel Trustees for the Southern District of Ohio.

F. Mr. Lucas's stipulation that his company, E.L. Investments, would return the $300 preparation fees to the Debtors.

Id. at 2-3.

After the bankruptcy court found that Mr. Lucas had violated section 110, it determined sanctions were appropriate. *Id.* at 4. The bankruptcy court ordered the three types of statutory monetary relief requested by the United States Trustee: 1) it directed Mr. Lucas to return his fee to the Debtors pursuant to 11 U.S.C. §110(h)(3)(B), 2) it directed Mr. Lucas to pay statutory damages to the Debtors of $2000 pursuant to 11 U.S.C. §110(i)(1)(B)(i), and 3) it imposed statutory fines totaling $1000[6] pursuant to 11 U.S.C. §110(l)(1) to be paid to the United States Trustee Fund. *Id.* at 5. In addition, and in accordance with the parties' agreed stipulations, the bankruptcy court ordered Mr. Lucas to stop advertising in violation of 11 U.S.C. §110(f) and to stop engaging in conduct prohibited under 11 U.S.C. §110(e). *Id.* The bankruptcy court also stated it would refer the matter to appropriate authorities to determine whether Mr. Lucas had engaged in the unauthorized practice of law.[7] *Id.*

On August 14, and again on August 19, 2009, Mr. Lucas timely filed motions for reconsideration of the order imposing sanctions against him. *See* Mot. For Reconsideration [Dkt #6, Att. #5]; Mot. to Reconsider [Dkt #6, Att. #6]. On September

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[5] Mr. Lucas also agreed to take steps immediately to modify the advertisement on the "Craigslist" website and the Better Business Bureau website. *Id.*

[6] As stated above, the United States Trustee ultimately sought fines for only two violations of the statute, instead of three and accordingly the bankruptcy court imposed $1000 in fines instead of $1500.

[7] Although Appellant's brief mentions an investigation by the Kentucky Bar Association, the bankruptcy court referral was made to the Cincinnati Bar Association, who is still investigating. The Kentucky Bar Association letter attached to Appellant's brief and referenced therein involved a separate referral.

14, 2009, the bankruptcy court denied the motions for reconsideration. Order Denying Mot. for Reconsideration [Dkt #1, Att. # 3]. Mr. Lucas filed his notice of appeal to the Sixth Circuit Bankruptcy Appellate Panel on September 17, 2009. Notice of Appeal [Dkt # 1]. On October 13, 2009, the United States Trustee elected to remove the appeal to this Court. *See* BAP – Notice of Election to District Court [Dkt. #1, Att. 6].

On December 1, 2009, Mr. Lucas filed his opening brief in this appeal. In it, he concedes he violated section 110 and that it was appropriate for the bankruptcy court to have sanctioned him under that statute. Appellant's brief at 2 [Dkt # 4]. His appeal seeks only to remove or suspend the statutory damages and statutory fines imposed on him. *Id*. at 2.

SUMMARY OF ARGUMENT

Mr. Lucas asks this Court to vacate or remit the statutory damages and fines imposed by the bankruptcy court pursuant to section 110(i)(1) and section 110(l)(1). This Court should not do so because the bankruptcy court acted well within its discretion in imposing them. Those sanctions were allowed under the statute. They were appropriate given Mr. Lucas's multiple violations of section 110. There is no question that Mr. Lucas violated the statute; he stipulated to the acts in court and concedes that point repeatedly in his brief. Given that, the bankruptcy court was required by statute to award damages in the amount of $2000 and it was well within its discretion to impose a $1000 statutory fine. It should not be reversed for doing so.

The essence of Mr. Lucas's appeal seems to be that, despite the lawfulness of the sanctions order, this Court should mitigate the order's allegedly severe financial impact on Mr. Lucas by reducing, removing, or suspending the statutory damages and fines because he has seen the error of his ways. The statute, however, makes no provision for reduction, removal, or suspension of statutory penalties based on ability to pay, or conditioned on good behavior. Nor is it the role of an appellate court to exercise such discretion.

Mr. Lucas's alleged limited financial means do not constitute a valid reason for vacating or remitting the statutory penalties imposed by the bankruptcy court.

Finally, Mr. Lucas has waived this issue on appeal because he never raised any argument in the bankruptcy court concerning his ability to pay. Therefore, it is too late for him to raise it now. Even if he did not forfeit the issue, there is no evidence in the record to support Mr. Lucas's alleged inability to pay. To the contrary, his counsel represented to the bankruptcy court that they could "afford a $1000 fine." Hr'g Tr. at 41 [Dkt #6, Att. #7].

ARGUMENT

I. The Bankruptcy Court Did Not Abuse Its Discretion When It Imposed Statutory Penalties on Mr. Lucas for Violating 11 U.S.C. §110.

A. Mr. Lucas Violated the Statute and Stipulated to the Violations.

The bankruptcy court properly sanctioned Mr. Lucas for violating two subsections of 11 U.S.C. §110, subsections (e) and (f). Section 110 sets forth certain standards of conduct that every "bankruptcy petition preparer[]," as that term is defined in 11 U.S.C. §110(a)(1), must satisfy.[8] *See* 11 U.S.C. §110(b)-(g). There is no doubt that Mr. Lucas is a bankruptcy petition preparer. He signed the Debtors' petition and schedules as their bankruptcy petition preparer. Voluntary Petition at 3, 36, 47-49 [Dkt #6, Att. #1]. Mr.

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[8] "'[B]ankruptcy petition preparer' means a person, other than an attorney for the debtor or an employee of such attorney under the direct supervision of such attorney, who prepares for compensation a document for filing; and []'document for filing' means a petition or any other document prepared for filing by a debtor in a United States bankruptcy court . . . ." 11 U.S.C. § 110(a)(1),(2).

Lucas states in his response to the sanctions motion that he "prepared the forms for the Petitioners to file their bankruptcy." Resp. to Sanctions Mot. at 1 [Dkt #6, Att. #3]. The bankruptcy court sanctioned him in his capacity as bankruptcy petition preparer. Sanctions Order [Dkt #1, Att. # 2]. He does not contest that status on appeal.[9]

The bankruptcy court did not err in finding that Mr. Lucas violated section 110(e). Subsection 110(e)(2) prohibits a bankruptcy petition preparer from offering any legal advice to a debtor. It provides:

> (2)(A) A bankruptcy petition preparer may not offer a potential bankruptcy debtor any legal advice, including any legal advice described in subparagraph (B).
>
> (B) The legal advice referred to in subparagraph (A) includes advising the debtor—
> (i) whether –
> (I) to file a petition under this title; or
> (II) commencing a case under chapter 7, 11, 12, or 13 is appropriate;
> (ii) whether the debtor's debts will be discharged in a case under this title;
> (iii) whether the debtor will be able to retain the debtor's home, car, or other property after commencing a case under this title;
> (iv) concerning—
> (I) the tax consequences of a case brought under this title; or
> (II) the dischargeability of tax claims;
> (v) whether the debtor may or should promise to repay debts to a creditor or enter into a reaffirmation agreement with a creditor to reaffirm a debt;
> (vi) concerning how to characterize the nature of the debtor's interests in property or the debtor's debts; or
> (vii) concerning bankruptcy procedures and rights.

11 U.S.C. §110(e)(2)

The statutory list is not exhaustive. *See* 11 U.S.C. §102(3) ("includes" is not limiting). *See also Grissett v. Derrick Hills (In re Grissett)*, No. 07-4210, 2008 WL 4553083 at *3 (Bankr. E.D. Mich. Oct. 8, 2008). By using the word "includes," the 2005

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[9] Mr. Lucas refers to himself in his opening brief as a "non-attorney petition preparer." Appellant's Brief at 3 n.1 [Dkt #4].

amendment to §110(e)(2) explicitly prohibited actions by bankruptcy petition preparers that had previously been prohibited by state law as the unauthorized practice of law. *In re Bernales*, 345 B.R. 206, 214-15 (Bankr. C.D. Cal. 2006). Section 110(e)(2) should be understood as a general prohibition against the practice of law by bankruptcy petition preparers. *Id.* at 215.

Section 110 prohibits virtually all conduct falling into the category of guidance or advice, effectively restricting bankruptcy petition preparers to providing typing services only. *In re Guttierez*, 248 B.R. 287, 297-98 (Bankr. W.D. Tex. 2000). A bankruptcy petition preparer cannot, for example, explain to the debtor how to fill out the bankruptcy forms or schedules, or answer questions about exemptions. *Id.* at 298. A bankruptcy petition preparer cannot opine on the likelihood of a debtor being able to keep his home in a bankruptcy. 11 U.S.C. § 110(e)(2)(B)(iii). And a bankruptcy petition preparer cannot solicit information from a debtor and then translate that information into completed bankruptcy forms. *Frankfort Digital, Svcs. v. Neary* (*In re Reynoso),* 315 B.R. 544, 552 (9th Cir. B.A.P. 2004), *aff'd*, 477 F.3d 111 (9th Cir. 2007).

Mr. Lucas did much more than provide typing services to the Debtors. Mr. Lucas stipulated, and testified, that he advised clients on what exemptions to claim on Fed. R. Bankr. P. Official Form 6, Schedule C.[10] Sanctions Order at 2, Stip. B [Dkt #1, Att. #2]; Hr'g Tr. at 23-25 [Dkt #6, Att. #7]. In addition, one of the Debtors testified that Mr. Lucas advised him that the Debtors might not be able to keep their house in a chapter 13

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[10] Schedule C is an attachment to a debtor's bankruptcy petition. We have included a copy of the current Schedule C as an addendum to this brief. In Schedule C, a debtor chooses how to apply various available legal exemptions to his property to prevent that property from being liquidated as part of the bankruptcy estate. For each asset for which a debtor claims an exemption, he must describe the asset, choose the legal basis for the exemption to which he believes he is entitled, state the value of the exemption being claimed, and provide the value of asset without the exemption.

bankruptcy. Hr'g Tr. at 52-53 [Dkt #6, Att. #7]. The Debtor further testified that he filled out a questionnaire provided by Mr. Lucas to disclose his assets and liabilities. *Id.* at 45. Mr. Lucas testified that he uses a questionnaire to gather the information he needs from his clients to complete the bankruptcy forms in all the cases he handles. *Id.* at 55. Based on this conduct, and Appellant's stipulation, the bankruptcy court found Mr. Lucas provided legal advice to debtors in violation of section 110(e). *See In re Farness*, 244 B.R. 464 (Bankr. D. Idaho 2000) (Providing assistance to debtors by identifying exemptions constitutes the unauthorized practice of law.); 11 U.S.C. §110(e)(2) (providing advice regarding whether the debtor will be able to retain the debtor's home after commencing a case under title 11 constitutes prohibited legal advice); *In re Bernales*, 345 B.R. at 216 (use of questionnaire to gather information from which to complete bankruptcy petition and associated paperwork constitutes unauthorized practice of law). Because there was substantial evidence supporting that finding, the bankruptcy court did not engage in clear error in making it.

Nor did the bankruptcy court err in finding Mr. Lucas violated 11 U.S.C. §110(f) by advertising his services under a category containing the word "legal." Sanctions Order at 2 [Dkt #1, Att. #2]. Mr. Lucas stipulated that his conduct violated section 110(f), which provides that "[a] bankruptcy petition preparer shall not use the word 'legal' or any similar term in any advertisements, or advertise under any category that includes the word 'legal' or any similar term." 11 U.S.C. § 110(f); Sanctions Order at 2, Stip. A [Dkt #1, Att. #2]. Based on that stipulation, the bankruptcy court properly found that Mr. Lucas violated section 110(f).

B. The Bankruptcy Court Was Required by Statute to Order Mr. Lucas to Pay $2000 in Statutory Damages and Properly Exercised Its Discretion in Ordering Him to Pay $1000 in Statutory Fines.

Mr. Lucas is subject to statutory penalties for his failure to comply with Section 110. The statute authorizes three types of monetary penalties. First, the bankruptcy court may order the turnover of fees paid by the debtor. 11 U.S.C. §110(h)(3)(B). Second, the bankruptcy court must award actual and statutory damages to the debtor. *See* 11 U.S.C. § 110(i)(1) ("If a bankruptcy petition preparer violates this section . . . the court shall order the bankruptcy petition preparer to pay to the debtor" actual and statutory damages and reasonable attorneys fees). Third, the bankruptcy court may fine the debtor up to $500 for each violation. 11 U.S.C. §110(l)(1) In this case, the bankruptcy court did all three by ordering Mr. Lucas 1) to return the $300 the Debtors paid him, which Mr. Lucas had already agreed to do; 2) to pay the Debtors $2000 in statutory damages; and 3) to pay $1000 in fines to the United States Trustees Fund. Sanctions Order at 5, Stips. C, D, E [Dkt #1, Att. #2].

In his opening brief, Mr. Lucas does not allege that the bankruptcy court erred in imposing sanctions against him under section 110. Indeed, he concedes that he violated section 110 and that sanctions are warranted. Appellant's Brief at 1-2 [Dkt #4] ("Appellant has had a substantial change of heart in the defense of sanctions imposed upon him by the bankruptcy Court….His narrow appeal is the extent and amount of monetary penalties imposed upon him."). Instead, Mr. Lucas argues that the bankruptcy court had discretion not to award statutory damages or impose statutory fines and that he should not be made to pay the monetary penalties because he is on a fixed income and because he will voluntarily comply with his obligations under the statute.[11] *Id.* at 7. As explained below, those arguments are unavailing.

1. The Bankruptcy Court Was Required to Award $2000 in Statutory Damages.

Section 110(i) of title 11 provides for a mandatory damages award to the debtor. *In re Jarvis*, 351 B.R. 894, 898 (Bankr. E.D. Tenn. 2006). Subsection 110(i)(1) provides in relevant part:

> If a bankruptcy petition preparer violates this section . . . the court *shall* order the bankruptcy petition preparer to pay to the debtor— (A) the debtor's actual damages; (B) the greater of— (i) $2000; or (ii) twice the amount paid by the debtor to the bankruptcy petition preparer for the preparer's services; and (C) reasonable attorneys' fees and costs in moving for damages under this subsection."

(emphasis added). "'Shall' means 'shall'" and is not subject to statutory interpretation. *In re Sexton*, 397 B.R. 375, 377 (Bankr. M.D. Tenn. 2008).

The amount of the mandatory damages award is equal to the sum of: 1) the debtor's actual damages, and 2) the greater of $2000 or twice the bankruptcy petition preparer's fee, and 3) any attorney's fees and costs incurred by the debtor in moving for sanctions. 11 U.S.C. §110(i)(1). In this case, there was no evidence presented of actual damages suffered by the Debtors. The Debtors paid Mr. Lucas $300 for his services. Voluntary Petition at pg. 48, Form 280 [Dkt #6, Att. #1]. The greater of $2000 or twice Mr. Lucas's fee is $2000, so the amount of statutory damages is $2000. The Debtors did not incur any attorney's fees with regard to the motion for sanctions because it was filed by the United States Trustee. Hr'g Tr. at 73-74 [Dkt #6, Att. #7]. The sum of the three

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[11] Because Mr. Lucas is bound by his trial court stipulations, including his agreement to return the $300 preparation fees to the debtor, and does not contest them on appeal, the propriety of the bankruptcy court's disgorgement order is not at issue in this appeal and will not be addressed in this brief other than to note that the bankruptcy court had discretion to order the disgorgement under 11 U.S.C. § 110 (h)(3)(B).

damages components under section 110(i)(1) is $2000. Therefore, the bankruptcy court was required to award damages to the Debtors under 11 U.S.C. §110(i) in the amount of $2000.

Mr. Lucas contends that the bankruptcy court had discretion to limit the award of statutory damages to the amount of the Debtors' actual damages, which Mr. Lucas alleges are nonexistent.[12] Appellant's Brief at 7 [Dkt #4]. That argument ignores the fact that the statute is written in the conjunctive, rather than the disjunctive. In other words, the statute is cumulative as well as mandatory. *In re McGill,* No. 06-32029, 2007 WL 1119939 at *7 (Bankr. E.D. Tenn. Apr. 13, 2007). *See also In re Cleaver*, 333 B.R. 430, 434-435 (Bankr. S.D. Ohio 2005) (finding that statute that included word "and" should be read in the conjunctive). This means in this case that all three elements of section (i) - actual damages, statutory damages, and attorney's fees - are to be included in a damages calculation.

The legislative history supports this plain language reading. It explains that section 110 provides that "if the preparer commits an inappropriate or deceptive act, the debtor is entitled to receive actual damages, *plus* statutory damages of $2000 or twice the amount paid to the preparer, which ever is greater, *plus* reasonable attorney's fees and costs of seeking such relief." 140 Cong. Rec. H 10,770 (October 4, 1994) (emphasis added). Thus, the bankruptcy court was required by the statute to award all three types of damages specified in subsection 110(i) (A) – (C); it had no discretion to pick and choose among the three.

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[12] Appellant states that under 11 U.S.C. §110(i) damages can be limited to "'the debtor's actual damages; -or- (B) the greater of – (i) $2,000; or (ii) twice the amount paid by the debtor to the bankruptcy petition preparer for the preparer's services…'" *Id.* However, section 110(i) does not include an "or" between subsections A, B, and C.

2. The Bankruptcy Court Did Not Abuse Its Statutory Discretion By Fining Mr. Lucas $500 for Each Violation.

The bankruptcy court was authorized under the statute to fine Mr. Lucas up to $500 for each violation of section 110(b) – (h). 11 U.S.C. §110(l)(1). Section 110(l) provides that "[a] bankruptcy preparer who fails to comply with any provision of subsection (b), (c), (d), (e), (f) (g), or (h) may be fined not more than $500 for each such failure." The bankruptcy court found, and Mr. Lucas stipulated, that Mr. Lucas violated two subsections of section 110 – subsections 110(e) and (f) – by advertising his services under a legal heading and by offering legal advice to his clients. Therefore, the bankruptcy court was entitled to impose a fine of up to $1000 ($500 for each violation), which it did.

The bankruptcy court did not abuse its discretion by fining Mr. Lucas the maximum amount permitted by the statute. Mr. Lucas strenuously resisted the statutory limitations on the services he may provide. *See* Resp. to Mot. for Sanctions [Dkt #6, Att. #3]. Further, Mr. Lucas's violations of section 110 are of a particularly serious nature and could greatly impact a debtor's bankruptcy case. Mr. Lucas did not merely forget to include his social security number on a bankruptcy filing. He provided legal advice to the Debtors that could have affected the chapter that the Debtors chose to file under and the exemptions that they claimed. Hr'g Tr. at 47 and 52 [Dkt #6, Att. #7]. And, by advertising under the heading of legal services, Mr. Lucas likely encouraged debtors to rely on his unlawful legal advice. Such serious violations warrant a meaningful penalty under the statute.

Regardless, Mr. Lucas does not contend in his appeal that the bankruptcy court abused its discretion when it fined him $500 per violation. *See generally* Appellant's

Brief [Dkt #4]. Rather, he states that he is unable to pay the fines. For the reasons stated below, this argument is without merit.

II. Mr. Lucas's Alleged Inability to Pay Is Not A Sufficient Reason to Vacate or Remit the Statutory Penalties Imposed By the Bankruptcy Court.

Mr. Lucas has forfeited any argument concerning his ability to pay. He argues for the first time on appeal that the monetary sanctions awarded by the bankruptcy court should be removed or suspended because "he has made sincere efforts to conform his actions to the requirements of the law and because severe hardship will result to him if he is required to pay the full amount." *Id.* at 11. Although Mr. Lucas was represented by counsel at the hearing on the sanctions motion, Mr. Lucas did not raise either of those arguments in the bankruptcy court. Therefore, it is too late for him to raise them now. *Hormel v. Helvering*, 312 U.S. 552, 556 (1941) (appellate court ordinarily does not give consideration to issues not raised below). *Elder v. Holloway*, 510 U.S. 510, 514 (1994); *See also Garcia v. American Marine Corp.*, 432 F.2d 6, 8 (5th Cir. 1970) (fact not presented at trial may not be asserted on appeal); *Smith v. Central Ariz. Water Conservation Dist.*, 418 F.3d 1028, 1033, (9th Cir. 2005) (facts not presented to the lower court are not part of the record on appeal).

In addition, in his opening brief, Mr. Lucas does not contend that Section 110 required the bankruptcy court to consider either Mr. Lucas's post-sanction behavior or financial means in determining the appropriate amount of sanctions and he has not identified anything in the language of the statute or the case law interpreting the statute that would support such a requirement. Regardless, a mention of an issue without reasoning and support is insufficient to raise an issue on appeal. *Hilao v. Estate of Marcos*, 103 F.3d 767, 778 n. 4 (9th Cir. 1996). Therefore, even if the issue had been raised at the bankruptcy court level, it would have been irrelevant to the process of determining the appropriate sanctions, and could not have been properly raised on appeal.

In any event, there is no basis to reverse the lower court on this ground because there is no evidence in the record that Mr. Lucas could not afford the fine imposed by the bankruptcy court. To the contrary, at the hearing, Mr. Lucas' counsel told the bankruptcy court that Mr. Lucas could afford a $1000 fine. Hr'g Tr. at 41 [Dkt #6, Att. #7] ("But we can afford a $1,000 fine…"). Based on that judicial admission, Mr. Lucas is estopped from arguing on appeal that he cannot pay the $1,000 fine.[13] *See Karkoukli's, Inc. v. Dohany*, 409 F.3d 279, 283 (6th Cir. 2005) (parties bound by statements in briefs and pleadings); *U.S. v. Bentson*, 947 F.2d 1353, 1356 (9th Cir. 1991), *cert. denied*, 504 U.S. 958 (1992) (statement made by attorney in closing argument constituted binding judicial admission).

CONCLUSION

For these reasons, the United States Trustee respectfully asks this Court to affirm the order entered below.

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[13] Mr. Lucas's arguments regarding his financial ability to pay the fines, although not relevant to this appeal, may be raised when collection efforts are attempted as, for example, a defense to a motion for a civil contempt order. However, to the United States Trustee's knowledge, no such collection efforts have begun.

Respectfully Submitted,

RAMONA D. ELLIOTT	**/s/Monica V. Kindt (0073085)**
GENERAL COUNSEL	**DANIEL M. McDERMOTT**
P. Matthew Sutko	**UNITED STATES TRUSTEE**
Associate General Counsel	Monica V. Kindt (0073085)
Wendy Cox	Assistant United States Trustee
Trial Attorney	United States Department of Justice
United States Department of Justice	Office of the United States Trustee
Executive Office for U. S. Trustees	36 E. Seventh Street, Suite 2030
Office of the General Counsel	Cincinnati, Ohio 45202
20 Massachusetts Ave., N.W., Ste 8100	(513) 684-6988 x 226
Washington, D.C. 20530	
(202) 307-1399	

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing was served via ECF or regular mail, on January 11, 2010, on the following:

Brady & Angela Kendall
5324 Colorado River Trail
Hamilton, Ohio 45011

Edward Lucas
E. L. Investments
854 Oak Street
Ludlow, Kentucky 41016

and by electronic service to:

Harold Jarnicki, Esq.
Chapter 7 Trustee

/s/Monica V. Kindt (0073085)
Monica V. Kindt

No. 05-996

In the Supreme Court of the United States

ROBERT LOUIS MARRAMA, PETITIONER

v.

CITIZENS BANK OF MASSACHUSETTS, ET AL.

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE FIRST CIRCUIT

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE SUPPORTING RESPONDENTS

PAUL D. CLEMENT
Solicitor General
Counsel of Record

THOMAS G. HUNGAR
Deputy Solicitor General

LISA S. BLATT
Assistant to the Solicitor General
Department of Justice
Washington, D.C. 20530-0001
(202) 514-2217

ROBERTA A. DEANGELIS
Acting General Counsel

P. MATTHEW SUTKO
KNIGHT ELSBERRY
Attorneys
Executive Office for United States Trustees
Washington, D.C. 20530

QUESTION PRESENTED

Whether 11 U.S.C. 706(a) deprives a bankruptcy court of its inherent power to sanction and deter bad faith conduct by denying a debtor's request to convert a chapter 7 bankruptcy case to chapter 13.

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11 U.S.C. 727(a)	3, 27
11 U.S.C. 727(a)(2)	7
11 U.S.C. 727(a)(2)-(6)	3
11 U.S.C. 727(b)	3
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11 U.S.C. 1112(a)	4
11 U.S.C. 1112(b)	28
Ch. 12, 11 U.S.C. 1201 *et seq.*	2
11 U.S.C. 1208(a)	4
11 U.S.C. 1208(c)	28
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In the Supreme Court of the United States

No. 05-996

ROBERT LOUIS MARRAMA, PETITIONER

v.

CITIZENS BANK OF MASSACHUSETTS, ET AL.

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE FIRST CIRCUIT

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE SUPPORTING RESPONDENTS

INTEREST OF THE UNITED STATES

The courts below found that petitioner, a debtor in bankruptcy, had made false declarations about his assets and financial affairs in furtherance of a scheme to place his assets beyond the reach of his creditors. Because of petitioner's bad faith conduct, the courts below did not allow petitioner to convert his chapter 7 case to chapter 13. Whether courts may act to deter and sanction a debtor's bad faith conduct in that manner is an issue of substantial importance to the United States.

The Attorney General appoints United States Trustees to supervise the administration of bankruptcy cases and trustees in regions comprising the vast majority of the federal judicial districts. 28 U.S.C. 581-589a. United States Trustees "serve as bankruptcy watch-dogs to prevent fraud, dishonesty, and overreaching in the bankruptcy arena." H.R. Rep. No. 595, 95th Cong., 1st Sess. 88 (1977). The United States Trustee Program thus "acts in the public interest to promote the efficiency and to protect and preserve the integrity of the bankruptcy system." U.S. Dep't of Justice, *United States Trustee Program Strategic Plan FY 2005-2010*, at 2 (visited Sept. 28, 2006) <http://www.usdoj.gov/ust/eo/ust_org/StrategicPlanFY2005-2010.pdf>. By statute, "[t]he United States trustee may raise and may appear and be heard on any issue in any case or proceeding under this Title." 11 U.S.C. 307.

In addition, the United States is the largest creditor in the Nation, and numerous federal agencies, including the Department of Housing and Urban Development, the Commerce Department's Economic Development Administration, the Small Business Administration, the Internal Revenue Service, and the Federal Deposit Insurance Corporation, frequently appear as creditors in chapter 7 proceedings. Because a bankruptcy estate's assets are typically scarce, the United States has an interest in preventing and deterring chapter 7 debtors from concealing assets that should be turned over to satisfy claims of the United States.

STATEMENT

1. a. A debtor commences a voluntary bankruptcy case by filing a petition in bankruptcy court. 11 U.S.C. 301. Four chapters—7, 11, 12, and 13—are potentially available to an individual debtor, and the debtor is required to elect one by checking the appropriate box on the petition. Fed. R. Bankr. P. Official Form 1.

Within 15 days after filing the petition, the debtor must file under penalty of perjury a schedule of assets and liabilities, a schedule of current income and current expenditures, and a statement of the debtor's financial affairs. 11 U.S.C. 521(1); Fed. R. Bankr. P. 1007(c); Official Form 6 (Schedules), Form 7 (Statement of Financial Affairs)).

b. Individual debtors typically file for relief under chapter 7 or chapter 13. Chapter 7 provides for a liquidation of a debtor's assets in exchange for a discharge of debts. 11 U.S.C. 701-727. Commencement of a chapter 7 case creates an "estate" that includes all of the debtor's interests in property as of the commencement of the case. 11 U.S.C. 541(a). The debtor must surrender all non-exempt estate property to the chapter 7 trustee, who takes custody of estate property, liquidates it, and disburses the proceeds to creditors in accordance with their rights and priorities under the Bankruptcy Code. 11 U.S.C. 507, 521(3) and (4), 704(1), 726.

A chapter 7 debtor is entitled to a discharge of his pre-petition debts unless the debtor is ineligible or the debts are of a type excepted from discharge by the Code. 11 U.S.C. 523, 727(a) and (b). Courts have the authority, however, to dismiss a chapter 7 case "for cause." 11 U.S.C. 707(a). Similarly, notwithstanding disbursement of estate assets to creditors, courts may deny a chapter 7 discharge altogether in specified circumstances, including when the debtor has committed acts of concealment or fraud. 11 U.S.C. 727(a)(2)-(6).

Chapter 13 provides for the adjustment of debts of an individual with regular income. 11 U.S.C. 1301-1330. In contrast to chapter 7, a chapter 13 debtor remains in possession of estate assets and receives a discharge of his debts only after he pays his creditors under a plan confirmed by the court. 11 U.S.C. 1304, 1306(b), 1321-1328.

c. Debtors may convert their cases from one chapter to another. 11 U.S.C. 706(a), 1112(a), 1208(a), 1307(a). As relevant here, Section 706(a) provides that "[t]he debtor may convert a case under this chapter to a case under chapter 11, 12, or 13 of this title at any time, if the case has not been converted under section 1112, 1208, or 1307 of this title." The Code also authorizes a court in a proceeding under chapter 13 to dismiss the case or convert it to a chapter 7 case "for cause." 11 U.S.C. 1307(c).

2. On March 11, 2003, petitioner filed a voluntary bankruptcy petition under chapter 7. In petitioner's schedules of assets, petitioner declared, under penalty of perjury, that (a) his Gloucester, Massachusetts, residence was the only real property interest he held; (b) he was the 100% beneficiary of Bo-Mar Realty Trust, a spendthrift trust that held real property in Maine; (c) the current market value of his interest in the trust was zero; and (d) the Internal Revenue Service (IRS) owed him no tax refunds. Pet. App. 10, 30.

Respondent Mark G. DeGiacomo is the chapter 7 trustee appointed in petitioner's case. Based on the trustee's investigation of petitioner's financial affairs (see 11 U.S.C. 704(4)), the trustee concluded that petitioner had failed to disclose two estate assets in his schedules and statement of financial affairs. First, petitioner had not disclosed that he, within one year before filing his chapter 7 petition, transferred residential real estate in York, Maine, having an unencumbered value of $85,000 to the Bo-Mar Realty Trust for no consideration and designated himself sole beneficiary and his girlfriend sole trustee. J.A. 29a-31a; Pet. App. 12, 30. Petitioner's acknowledged intent in that transaction was to protect the property from the claims of his creditors. *Id.* at 30. Second, petitioner had failed to disclose that in July 2002, he had filed an amended tax return that sought a tax refund from the IRS. *Id.* at 26-27, 30; J.A. 30a-31a. The chapter 7 trustee subsequently informed petitioner that the trustee would seek to avoid the transfer of the Maine property to the trust as a fraudulent conveyance. Pet. App. 14; J.A. 30a; see 11 U.S.C. 548. Thereafter, petitioner filed a notice under Section 706(a) seeking to convert his case to chapter 13. J.A. 11a.

The chapter 7 trustee opposed the conversion on the ground that petitioner had acted in bad faith by intentionally failing to disclose his requested federal tax refund and his transfer of the Maine property to the trust seven months before his chapter 7 petition. Pet. App. 30-31; J.A. 13a-18a. Respondent Citizens Bank of Massachusetts, a secured creditor, also opposed conversion on the ground that the debtor had acted in bad faith. Pet. App. 13; J.A. 19a-25a. Petitioner responded that his misstatements and omissions were inadvertent and that he sought to convert his case to chapter 13 because he had acquired additional rental income and gainful employment. Pet. App. 31; J.A. 33a.

3. a. After conducting a hearing on petitioner's request to convert, the bankruptcy court denied conversion on the ground that petitioner's misrepresentation of his financial affairs constituted "bad faith." Pet. App. 15, 31; J.A. 34a-35a; Supp. J.A. 33. The Bankruptcy Appellate Panel of the First Circuit affirmed. *Id.* at 9-28.

b. The First Circuit affirmed. Pet. App. 29-46. After examining the statutory text of Section 706(a), the court concluded that it could "discern no evidence that the Congress intended to override the presumptive power and responsibility of the bankruptcy court to weed out abuses of the bankruptcy process at any stage in the bankruptcy proceedings." *Id.* at 33. The court also rejected (*id.* at 37-38) petitioner's reliance on the Senate Report accompanying Section 706(a), which states that Section 706(a) gives the debtor "the one-time absolute right of conversion" and reflects the policy "that the debtor should always be given the opportunity to repay his debts." S. Rep. No. 989, 95th Cong., 2d Sess. 94 (1978). The court of appeals explained that those statements, when read in context, did not "negate[] nor undermine[] the overarching principle that the bankruptcy courts are duty bound to take all reasonable steps to preclude debtors from abusing or manipulating the bankruptcy process in order to undermine the essential purposes of the Bankruptcy Code." Pet. App. 38.

The court of appeals further observed that "the Code accords the bankruptcy court discretion to reconvert a chapter 13 case to chapter 7 * * * where the debtor has acted in 'bad faith.'" Pet. App. 39; see 11 U.S.C. 1307(c). The court explained that "it would ill serve general policies aimed at promoting the efficient administration of bankruptcy cases to insist that a bankruptcy court—already confronted with clear evidence of a debtor's bad faith—must indulge in the technical formality of converting the chapter 7 case to chapter 13, knowing full well that eventually the case must be reconverted by reason of that same evidence of bad faith." Pet. App. 39. The court also determined that the record "amply supported" the bankruptcy court's finding that petitioner acted in bad faith. *Id.* at 41.

c. While petitioner's appeal of the denial of his conversion motion was pending, the chapter 7 trustee recovered the Maine property from the trust in order to liquidate it for the benefit of petitioner's creditors. *Marrama* v. *DeGiacomo (In re Marrama)*, 316 B.R. 418, 421-422 (B.A.P. 1st Cir. 2004). Furthermore, Citizens Bank of Massachusetts filed a complaint under 11 U.S.C. 727(a)(2) seeking to deny the debtor a discharge on the grounds that petitioner had engaged in pre-bankruptcy transfers to defraud his creditors. The bankruptcy court granted the denial of a discharge. That order was affirmed by the court of appeals, which concluded that petitioner "transferred valuable assets belonging to him, less than a year before he petitioned for bankruptcy protection, with the actual intent to defraud his creditors." *Marrama* v. *Citizens Bank (In re Marrama)*, 445 F.3d 518, 524 (1st Cir. 2006).

SUMMARY OF ARGUMENT

A. Courts have the inherent power to respond to a party's misconduct in litigation by entering sanctions such as dismissal of the lawsuit or an award of attorney's fees. *Chambers* v. *NASCO, Inc.*, 501 U.S. 32 (1991); *Roadway Express, Inc.* v. *Piper*, 447 U.S. 752 (1980); *Link* v. *Wabash R.R.*, 370 U.S. 626 (1962). Similarly, Congress indicated in Section 105(a) of the Bankruptcy Code that bankruptcy courts may "tak[e] any action or mak[e] any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process." 11 U.S.C. 105(a).

B. Nothing in the text of Section 706(a) strips the bankruptcy court of its inherent authority, reinforced in Section 105(a), to prevent and deter abuses of the bankruptcy system by denying a debtor relief to which he would otherwise be entitled. Section 706(a) provides that the "[t]he debtor may convert a case under this chapter to a case under chapter 11, 12, or 13 of this title at any time" if the case has not been previously converted to chapter 7 under another chapter. 11 U.S.C.

706(a). The statute does not confer an absolute right, and nothing in the statutory text even mentions, much less impairs, the bankruptcy court's inherent discretion to deny relief in the face of a debtor's bad faith—discretion that is explicitly confirmed in Section 105(a).

C. The bankruptcy court's inherent power to deny conversion to chapter 13 is not foreclosed by Section 1307(c), which permits the court to dismiss a chapter 13 case or convert it to chapter 7 for cause (including the debtor's bad faith). To the contrary, that provision only underscores the appropriateness of denying conversion to chapter 13 in circumstances such as this. Congress's express authorization to convert a chapter 13 case into a chapter 7 liquidation indicates that a denial of rights under chapter 13 is a proper sanction for fraud. Section 1307(c) cannot be read to preclude a court from addressing fraud that is evident before the attempted conversion to chapter 13 or to require a conversion just so that the case can be reconverted to chapter 7. Under this Court's precedents, moreover, statutory and procedural sanctions generally do not displace a court's inherent power. *Chambers*, 501 U.S. at 42-51; *Link*, 370 U.S. at 630-632.

It would make little sense for the bankruptcy court to convert a case to chapter 13 under Section 706(a) when the court has already determined that the debtor has acted in bad faith such that his case should not proceed under chapter 13. Nor should a bad faith debtor have a right to convert to chapter 13 so that he may propose a plan under that chapter. The Code nowhere confers such a right, because Section 1307(c) allows the court, "for cause," to dismiss the chapter 13 case or convert it to chapter 7 at any time without any prerequisite that the debtor first be permitted to propose a plan.

D. Section 706(a)'s legislative history does not establish that Congress intended to displace the bankruptcy court's power to sanction bad faith debtors. The Senate Report to Section 706(a) states that the provision confers on the debtor "the one-time absolute right of conversion" so that "the debtor should always be given the opportunity to repay his debts." S. Rep. No. 989, 95th Cong., 2d Sess. 94 (1978). The off-hand reference to the debtor's "absolute" right may simply be a recognition of the fact that the right cannot be waived by agreement. The Report did not address the situation in which the right to convert has been forfeited by fraud, and it would be a mistake to assume that Congress intended to immunize fraud on courts and creditors. A Senate Report is not written and should not be read like legislative text, and petitioner's argument shows the hazards of doing so. In any event, the legislative history, when read in context, reflects an intent to confer rights only on an *honest* debtor who intends to "repay his debts." *Ibid.* The statute's history thus does not purport to cabin a court's inherent power to prevent an abuse of process.

E. A bankruptcy court has the discretion to deny conversion when the debtor intentionally misleads the trustee, creditors, or the bankruptcy court as to the debtor's financial affairs. A debtor who comes to the bankruptcy court seeking relief from his debts, but who in bad faith fails to disclose assets that are to be used to pay creditors, commits gross misconduct that threatens both the foundation and the integrity of the bankruptcy process. Because the bankruptcy court found that petitioner's misstatements of his financial affairs were made in bad faith, the court properly denied conversion in order to sanction the debtor and to prevent further abuse of process.

ARGUMENT

BANKRUPTCY COURTS POSSESS INHERENT POWER TO DENY CONVERSIONS WHEN SOUGHT BY BAD FAITH DEBTORS

A. Bankruptcy Courts Possess The Inherent Power To Sanction Bad Faith Conduct

1. This Court's precedents have "recognized the 'well-acknowledged' inherent power of a court to levy sanctions in response to abusive litigation practices." *Roadway Express, Inc.* v. *Piper*, 447 U.S. 752, 765 (1980) (citing *Link* v. *Wabash R.R.*, 370 U.S. 626, 632 (1962)). "It has long been understood that '[c]ertain implied powers must necessarily result to our Courts of justice from the nature of their institution,' powers 'which cannot be dispensed with in a Court, because they are necessary to the exercise of all others.'" *Chambers* v. *NASCO, Inc.*, 501 U.S. 32, 43 (1991) (quoting *United States* v. *Hudson*, 11 U.S. (7 Cranch) 32, 34 (1812)). "These powers are 'governed not by rule or statute but by the control necessarily vested in courts to manage their own affairs so as to achieve the orderly and expeditious disposition of cases.'" *Ibid.* (quoting *Link*, 370 U.S. at 630-631).

"A primary aspect" of a court's inherent powers is "the ability to fashion an appropriate sanction for conduct which abuses the judicial process." *Chambers*, 501 U.S. at 44-45. A court thus confronted with a party's bad faith conduct in seeking judicial relief or in litigating his cause of action has the discretion to respond with a variety of sanctions. This Court has recognized that "outright dismissal of a law suit * * * is within the court's discretion" and that "the 'less severe sanction' of an assessment of attorney's fees is undoubtedly within a court's inherent power as well." *Id.* at 45 (quoting *Roadway Express, Inc.*, 447 U.S. at 765).

A clear expression of congressional intent is required to displace a court's inherent power to sanction bad faith conduct. *Chambers*, 501 U.S. at 47. Accordingly, although "the exercise of the inherent power of lower federal courts can be limited by statute and rule," this Court will "'not lightly assume that Congress has intended to depart from established principles,' such as the scope of a court's inherent power." *Ibid.* (quoting *Weinberger* v. *Romero-Barcelo*, 456 U.S. 305, 313 (1982)).

2. The Bankruptcy Code, far from displacing the inherent powers of courts, expressly recognizes the bankruptcy court's authority to sanction litigants for abusive litigation practices. The Code states that "[n]o provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, sua sponte, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or *to prevent an abuse of process*." 11 U.S.C. 105(a) (emphasis added); see 132 Cong. Rec. 28,610 (1986) (statement of Sen. Hatch) (Section 105(a) "allows a bankruptcy court to take any action on its own, or to make any necessary determination to prevent an abuse of process and to help expedite a case in a proper and justified manner"). Thus, it is well established that bankruptcy courts have

the power to sanction parties or counsel for bad faith conduct in bankruptcy proceedings.[1]

To be sure, Section 105(a) does not empower bankruptcy courts to act contrary to other direct commands of the Code. Cf. *Northwest Bank Worthington* v. *Ahlers*, 485 U.S. 197, 206 (1988) ("whatever equitable powers remain in the bankruptcy courts must and can only be exercised within the confines of the Bankruptcy Code"). But it does expressly caution against reading provisions allowing a party to raise an issue as conferring an absolute right that would trump a court's ability to sanction misconduct. More broadly, Section 105(a) reflects Congress's intent not to displace the established power of courts to impose appropriate orders to prevent an abuse of process. Thus, absent an express provision in the Code that limits a court's inherent power, the bankruptcy court retains the discretion to impose appropriate sanctions in response to a litigant's bad faith.

B. The Text Of Section 706(a) Does Not Restrict A Court's Inherent Power To Deny Conversion When Requested By A Bad Faith Debtor

1. Section 706(a) does not expressly address, much less limit, a court's inherent power to sanction bad faith

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[1] See, *e.g.*, *In re Sunshine Jr. Stores, Inc.*, 456 F.3d 1291, 1304-1306 (11th Cir. 2006); *In re DeVille*, 361 F.3d 539, 548-551 (9th Cir. 2004); *In re Rimsat, Ltd.*, 212 F.3d 1039, 1046-1049 (7th Cir. 2000); *Pearson* v. *First N.H. Mortgage Corp.*, 200 F.3d 30, 42 n.7 (1st Cir. 1999); *Weiss* v. *First Citizens Bank & Trust Co. (In re Weiss)*, 111 F.3d 1159, 1171-1172 (4th Cir.), cert. denied, 522 U.S. 950 (1997); *Mapother & Mapother, PSC* v. *Cooper (In re Downs)*, 103 F.3d 472, 477 (6th Cir. 1996); *In re Huckfeldt*, 39 F.3d 829, 832 (8th Cir. 1994); *Citizens Bank & Trust Co.* v. *Case (In re Case)*, 937 F.2d 1014, 1023-1024 (5th Cir. 1991).

conduct by denying relief to which the debtor would otherwise be entitled. Section 706(a) provides:

> The debtor may convert a case under this chapter to a case under chapter 11, 12, or 13 of this title at any time, if the case has not been converted under section 1112, 1208, or 1307 of this title. Any waiver of the right to convert a case under this subsection is unenforceable.

11 U.S.C. 706(a). As an initial matter, the text is addressed to the *debtor,* and does not refer to the court's powers at all. By providing that "*[t]he debtor may* convert" a chapter 7 case to another chapter, Congress indicated its intent that conversion is to be initiated by the debtor, rather than another party or the court. But the language does not confer an absolute right on the debtor and does not direct the court to convert automatically upon the debtor's request.

In any event, the statutory text, at most, gives rise to a presumptive right of the debtor to a one-time conversion; it does not restrict, either expressly or implicitly, the ability of the court to exercise its inherent power to respond to abusive tactics or bad faith by the debtor. Section 706(a) is best understood as giving the right to raise the issue of conversion, but in keeping with the approach expressed in Section 105(a), such a provision should not be read to prevent courts from "taking any action * * * to prevent an abuse of process." 11 U.S.C. 105(a). Nor does Section 706(a) purport to confer rights on bad faith debtors. The statutory language "contains no intimation that the debtor should be accorded protection against his own willful misconduct, such as an intentional abuse of the bankruptcy process." Pet. App. 36.

Relying on this Court's recognition that "[t]he word 'may' customarily connotes discretion," *Jama* v. *Immigration & Customs Enforcement*, 543 U.S. 335, 346 (2005), petitioner's amicus argues that Section 706(a) vests debtors with unbounded discretion to decide whether to convert, thereby stripping the court of any power to deny relief. National Ass'n of Consumer Bankr. Att'ys (NACBA) Amicus Br. 8-13. The word "may," however, does not remotely rise to the level of a clear indication that Congress intended to restrict a court's inherent power to sanction a party's bad faith conduct by denying statutory relief to which that party would otherwise be entitled. While it is no doubt true that the term "may" suggests discretion, it is equally true that "in a system of laws discretion is rarely without limits." *Martin* v. *Franklin Capital Corp.,* 126 S. Ct. 704, 710 (2005) (quoting *Independent Fed'n of Flight Attendants* v. *Zipes*, 491 U.S. 754, 758 (1989)); see *System Fed'n No. 91* v. *Wright*, 364 U.S. 642, 648 (1961) ("discretion is never without limits"). Considerably more than the mere recognition of a discretionary right would be required to demonstrate that Congress stripped the courts of their inherent authority to deny relief sought in bad faith.[2]

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[2] The example proffered by petitioner's amicus (NACBA Amicus Br. 8) serves only to confirm the implausibility of petitioner's interpretation. A neighbor's statement to another that "You may use my rake at any time" may well "grant[] the other neighbor permission to use the rake at the latter's discretion," *ibid.*, but it does not confer *unlimited* discretion. Surely, for example, the other neighbor is not thereby authorized to grab the rake unceremoniously out of its owner's hands while the latter is raking his yard. Nor is it obvious that the discretion to borrow the rake would survive an intervening misuse of a borrowed shovel.

For similar reasons, petitioner's amicus errs in relying on the fact that Section 706(a) specifies two express preconditions to conversion—(1) absence of a prior conversion and (2) eligibility as a debtor, see 11 U.S.C. 706(d)—but does not expressly impose a good faith requirement. NACBA Amicus Br. 13-16. The *expressio unius* canon has no application to a requirement that a litigant refrain from bad faith, because that requirement is necessarily implicit whenever a party seeks relief from a court. In other words, because "[a]ll courts have inherent power and duty to prevent abuse of their jurisdiction," "Congress does not have to add to each and every statutory subsection and committee comment thereon the proviso, 'subject to bad faith.'" *In re Starkey*, 179 B.R. 687, 693 (Bankr. N.D. Okla. 1995).

2. The court of appeals also correctly concluded that Congress' use of the statutory phrase "at any time" in Section 706(a) refers to *the time frame* in which the debtor may convert; it does not speak to the *circumstances* under which conversion may occur. At most, that phrase confers an absolute right to convert without regard to time frame, not an absolute right to convert no matter what. Thus, "the debtor may seek to convert at any time during the pendency of the bankruptcy case, or in other words, * * * no artificial time constraints should impede an election to convert." Pet. App. 35. But that temporal phrase "hardly equates to the more broad circumstantial permission which Congress could have conferred, for example, by employing a phrase such as 'regardless of the circumstances.'" *Ibid.*; accord *In re Copper*, 426 F.3d 810, 816 (6th Cir. 2005).

Likewise, a court's inherent power to sanction abuse is not affected by the second sentence of Section 706(a), which provides that "[a]ny waiver of the right to convert a case under this subsection is unenforceable." 11 U.S.C. 706(a). "[I]n context this sentence functions strictly as a consumer protection provision against adhesion contracts, whereby a debtor's creditors might be precluded from attempting to prescribe a waiver of the debtor's right to convert to chapter 13 as a non-negotiable condition of its contractual agreements." Pet. App. 35. There is a difference between waiver and forfeiture, see, *e.g.*, *Kontrick* v. *Ryan*, 540 U.S. 443, 458 n.13 (2004), and an anti-waiver provision does not necessarily preclude a party from forfeiting a right through affirmative misconduct or immunize a party from the court's inherent authority to sanction misconduct.[3]

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[3] Petitioner also argues (Br. 26) that conversion cannot be denied on the basis of a debtor's bad faith because the Bankruptcy Rules do not specifically require motions to convert under Section 706(a) to be treated as contested matters under Rule 9014. As the court of appeals observed, however, the Code contemplates that parties in interest may contest at least some factual pre-conditions to conversion, such as "the absence of any prior conversions to chapter 13, and the debtor's ability to meet the eligibility requirements to file a chapter 13 petition in the first instance." Pet. App. 45. Moreover, the Rules provide that a debtor requesting conversion under Section 706(a) must seek that relief by motion. See Fed. R. Bankr. P. 1017(f)(2), 9013. The Rules thus also contemplate that the bankruptcy court will review the matter before ordering relief. In any event, nothing in Rule 9014(c) addresses, much less displaces, a court's inherent power to act, sua sponte or on motion of a party, in the face of a debtor's abuse of the bankruptcy process, nor do the Rules limit the court's ability to hold any hearing that may be necessary in such instances to resolve contested issues of material fact.

C. A Bankruptcy Court's Express Power To Dismiss A Chapter 13 Case Or Convert It To Chapter 7 Does Not Deprive The Court Of Its Inherent Authority To Deny Conversion In The First Instance

1. Section 1307(c) provides that "on request of a party in interest or the United States trustee and after notice and a hearing, the court may convert a case under [chapter 13] to a case under chapter 7 * * * , or may dismiss a case under [chapter 13], whichever is in the best interest of creditors and the estate, for cause." 11 U.S.C. 1307(c). A debtor's bad faith constitutes cause under Section 1307(c).[4] Petitioner and his amicus argue that because Congress empowers a bankruptcy court to respond to a debtor's bad faith by dismissal of the chapter 13 case or by reconversion of the case to chapter 7, Congress left no room under Section 706(a) for courts to deny conversion in the first instance even when the debtor seeks conversion in bad faith or the court is aware of pre-conversion efforts to defraud the court and creditors. Pet. Br. 24; NACBA Amicus Br. 18-20. That contention lacks merit.

The law is clear that "the inherent power of a court can be invoked even if procedural rules exist which sanction the same conduct." *Chambers*, 501 U.S. at 49. Thus, in *Link*, 370 U.S. at 630-632, this Court held that a court had the inherent authority to dismiss a suit sua sponte for lack of prosecution notwithstanding the fact that Federal Rule of Civil Procedure 41(b) appears to

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[4] See, *e.g.*, *Alt* v. *United States (In re Alt)*, 305 F.3d 413, 418-420 (6th Cir. 2002); *In re Lilley*, 91 F.3d 491, 496 (3d Cir. 1996); *Molitor* v. *Eidson (In re Molitor)*, 76 F.3d 218, 220 (8th Cir. 1996); *Eisen* v. *Curry (In re Eisen)*, 14 F.3d 469, 470 (9th Cir. 1994); *In re Love*, 957 F.2d 1350, 1354 (7th Cir. 1992).

require a motion by a party. Similarly, in *Chambers*, 501 U.S. at 42-50, the Court held that a court's inherent power to impose attorney's fees as a sanction was not foreclosed by Federal Rule of Civil Procedure 11 and 28 U.S.C. 1927, which authorize the imposition of attorney's fees as a sanction in specified circumstances. The Court explained that other mechanisms of sanctioning misconduct, either "taken alone or together, are not substitutes for the inherent power," and accordingly that federal courts are not "forbidden to sanction bad-faith conduct by means of the inherent power simply because that conduct could also be sanctioned under the statute or the Rules." *Chambers*, 501 U.S. at 46, 50. Thus, "if in the informed discretion of the court, neither the statute nor [procedural rules] are up to the task, the court may safely rely on its inherent power." *Id.* at 50.

There is no basis for limiting the court's inherent discretion to enter sanctions at the earliest appropriate opportunity, *i.e.*, by denying conversion in the first instance. "[I]t would ill serve general policies aimed at promoting the efficient administration of bankruptcy cases to insist that a bankruptcy court—already confronted with clear evidence of a debtor's bad faith—must indulge in the technical formality of converting the chapter 7 case to chapter 13, knowing full well that eventually the case must be reconverted by reason of that same evidence of bad faith." Pet. App. 39. As the court of appeals of appeals observed, the Code does not require "such pointless spinning of judicial wheels." *Ibid.* Indeed, far from undermining the authority to deny conversion as a sanction for bad faith, Section 1307(c) underscores the appropriateness of requiring chapter 7 liquidation as a sanction. The fact that

Congress expressly contemplated dismissal or conversion of chapter 13 proceedings as a sanction for bad faith conduct should not preclude a court hearing a chapter 7 case from imposing a like sanction for bad faith that precedes an effort to convert to chapter 13.

2. Petitioner and his amicus contend that forcing a court to grant a debtor's motion to convert, even in the face of fraud on the court or other egregious misconduct by the debtor, would serve the purpose of giving the debtor an opportunity to propose a repayment plan under 11 U.S.C. 1322. Pet. Br. 22-26; NACBA Amicus Br. 18-20, 23-24. In a similar vein, petitioner's amicus observes that the bankruptcy court cannot confirm a chapter 13 plan unless unsecured creditors will receive at least as much as they would under chapter 7. *Id.* at 19-20 (citing 11 U.S.C. 1325(a)(4), 1328(b)(2)). Amicus argues that those provisions, along with the power of the chapter 13 trustee to investigate the debtor's financial affairs, "provide[] powerful assurance that a debtor cannot convert a case to chapter 13 in order to evade his creditors." *Id.* at 19. Those contentions are flawed in several fundamental respects.

Section 1307(c) contains no requirement that a bankruptcy court must wait for a debtor to propose a repayment plan before the court can exercise its statutory power to dismiss or reconvert the case to chapter 7 upon a finding of a debtor's bad faith. The notion that bankruptcy courts cannot act under Section 1307(c) without a prior proposal by the debtor of a plan also conflicts with Section 105(a), which permits a court to raise, on its own motion, the issue of dismissal or conversion to prevent an abuse of process. 11 U.S.C. 105(a) ("No provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, *sua sponte*, taking any action or making any determination necessary or appropriate * * * to prevent an abuse of process.") (emphasis added).

The bankruptcy court's dismissal and conversion power under Section 1307(c), moreover, defeats the suggestion that Congress intended to confer on a bad faith debtor the right to propose a plan under chapter 13. And there is "neither a theoretical nor a practical reason that Congress would have chosen to treat a first-time motion to convert a chapter 7 case to chapter 13 under subsection 706(a) differently from the filing of a chapter 13 petition in the first instance." Pet. App. 36.

Petitioner's position similarly creates anomalous results that Congress could not have intended, as it would accord preferential treatment to bad faith debtors who initially sought relief under chapter 7, instead of chapter 13. For instance, when confronted with a bad faith debtor who initially files under chapter 13, a court unquestionably has the power to dismiss or convert the case pursuant to Section 1307(c), without waiting for the debtor to file a plan. By contrast, in petitioner's view, a bad faith debtor who initially requests chapter 7 relief but subsequently seeks to convert to chapter 13 is entitled to file a chapter 13 plan without the possibility of intervention by the court to prevent an abuse of process, at least until a plan is filed. Petitioner's proposal is wholly implausible; it finds no support in the Code, and it would frustrate the underlying purpose of the bankruptcy court's power to sanction bad faith conduct, namely, to protect the integrity of the bankruptcy system and deter similar abuses by other debtors.

In any event, there is no guarantee that creditors will be protected once a bad faith debtor converts his case to chapter 13. A debtor who has tried to defraud his creditors in chapter 7 may not mend his ways just because his case converts to chapter 13, particularly because the chapter 7 trustee will have been replaced by a new chapter 13 trustee (who presumably will have less experience with the debtor's past misconduct) and the debtor will have gained control over the assets of the estate. See, *e.g.*, *In re Copper*, 426 F.3d at 810-816 (debtor lied about assets and, on the eve of trial in which divorce-decree debt would be determined to be non-dischargeable, moved to convert with no intent to pay ex-wife under chapter 13); *In re Sully*, 223 B.R. 582, 583-586 (Bankr. M.D. Fla. 1998) (debtor hid settlement of personal injury action from trustee, and once misconduct was discovered, debtor moved to convert under chapter 13 with no intent to pay creditors); *Martin* v. *Cox*, 213 B.R. 571, 572-574 (E.D. Ark. 1996) (debtor who, *inter alia*, falsified documents, failed to list significant assets in petition, made false representations to bankruptcy court, and violated a bankruptcy court's preliminary injunction order attempted to convert to chapter 13 with no intent to propose chapter 13 plan), aff'd, 116 F.3d 480 (8th Cir. 1997) (Table). Indeed, it has been the experience of the United States Trustees that bad faith debtors who convert to chapter 13 on the heels of the chapter 7 trustee's discovery of concealed assets often never file a plan.

Requiring a court to respond to a debtor's bad faith only after the debtor has proposed a chapter 13 plan would thus shift to innocent creditors the risk that a chapter 13 plan will never be proposed or confirmed. And even if a plan is confirmed, there is no assurance that the debtor, who has already once attempted to defraud his creditors, will make payments under the plan.

Similarly, there is no guarantee that creditors would be protected while the case languishes in chapter 13 or even if the case is ultimately converted back to chapter 7. When a chapter 7 case is converted to chapter 13, the chapter 7 trustee no longer has the power to collect and liquidate assets or administer the estate for the benefit of creditors. 11 U.S.C. 348(e). Instead, conversion to chapter 13 permits the debtor to regain control of all estate assets. 11 U.S.C. 1306(b). Petitioner's proposal would thus unjustifiably open the door for bad faith debtors to mishandle or squander their assets in furtherance of a scheme to defraud creditors. See, *e.g.*, *In re Wampler*, 302 B.R. 601, 606 (Bankr. S.D. Ind. 2003) (after trustee learned of debtor's recovery of class action settlement, debtor refused to turn over recovery, sought conversion to chapter 13, and placed a large portion of the recovery "in a Certificate of Deposit, thereby diminishing its immediate value due to the penalty for earlier withdrawal"); *In re Sully*, 223 B.R. at 585 ("Conversion would afford the Debtor the use of the settlement funds, and shift the risk to creditors without any feasible likelihood of repayment."); *In re Calder*, 93 B.R. 739, 740 (Bankr. D. Utah 1988) (denying conversion to "prevent the debtor from further abuse of the system").

Finally, an approach that would require a court to wait for a chapter 13 plan to be filed before responding to the debtor's bad faith is even less justified for cases governed by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23. For bankruptcy cases filed after October 17, 2005, the bankruptcy court may confirm a chapter 13 plan only if "the action of the debtor in filing the petition was in good faith." § 102(g)(3), 119 Stat. 33 (to be codified at 11 U.S.C. 1325(a)(7)). Although petitioner's case was filed in 2003, before those changes became effective, the regime advanced by petitioner and his amicus would require a bankruptcy court, when confronted with a bad faith debtor's request to convert to chapter 13, to convert and give the debtor the opportunity to file a plan that Congress has categorically determined cannot be confirmed. Nothing in Section 706(a) requires that bizarre result.

D. The Legislative History Of Section 706(a) Does Not Reveal A Congressional Intent To Displace A Court's Inherent Power To Deny Relief To A Bad Faith Debtor

Petitioner asserts (Br. 20-23) that the legislative history of Section 706(a) supports his view that chapter 7 debtors who proceed in bad faith are nonetheless entitled to convert to chapter 13. There is no warrant for petitioner's apparent assumption that statements in congressional committee reports could suffice to override the inherent authority of the federal courts. As discussed, this Court will not "lightly assume" that Congress has limited or narrowed the scope of the inherent power. *Chambers*, 501 U.S. at 47. In any event, petitioner's interpretation of the legislative history is without merit.

1. The history of Section 706(a) contains no hint that Congress intended to require conversion when sought by a debtor acting in bad faith. The Senate Committee report accompanying Section 706(a) states:

> Subsection (a) of this section gives the debtor the one-time absolute right of conversion of a liquidation case to a reorganization or individual repayment plan

> case. If the case has already once been converted from chapter 11 or 13 to chapter 7, then the debtor does not have that right. The policy of the provision is that the debtor should always be given the opportunity to repay his debts, and a waiver of the right to convert a case is unenforceable.

S. Rep. No. 989, 95th Cong., 2d Sess. 94 (1978); accord H.R. Rep. No. 595, 95th Cong., 1st Sess. 380 (1977). Placing emphasis on the words "absolute" and "always" in that passage, petitioner and his amicus argue that Congress intended to render bankruptcy courts powerless to deny a bad faith debtor's attempt to convert a chapter 7 case to another chapter. Pet. Br. 19-23; NACBA Amicus Br. 20-22.

Petitioner and his amicus make the mistake of reading the legislative history as if it were statutory text. But a Senate Report is not written, and should not be read, in that fashion. The Senate Report attempts to explain the operation of Section 706(a), and in doing so makes an off-hand reference to an "absolute right." Whatever the meaning of that phrase were it included in the operative statutory text, it is clear from context that the phrase reflects an effort to explain the text's right to file a conversion motion free from any time bar, so long as the case has not previously been converted. That reading is consistent with the sentencing following the reference to the debtor's "one-time absolute right," as that sentence makes clear that "[i]f the case has already once been converted from chapter 11 or 13 to chapter 7, then the debtor does not have that right." S. Rep. No. 989, *supra*, at 94. As the court of appeals observed, the reference to the debtor's "absolute" right may also be referring to the fact that "the debtor's right to conversion cannot be waived by contract." Pet. App. 37.

Under any reading of the Code, moreover, the Report's reference to an "absolute" right cannot be understood in the all-encompassing sense urged by petitioner, because conversion is expressly *prohibited*—and the right thus inoperative—when the debtor is not qualified to be a debtor under the other chapter. 11 U.S.C. 706(d). Nor is it literally true, as petitioner's reading of the Report suggests, that debtors "always" have the opportunity to repay their debts under chapter 13: Section 1307(c) permits the court to dismiss or convert a chapter 13 case for cause, and thus a *bad faith* debtor has no right whatsoever to repay his debts under chapter 13.

In any event, Section 706(a)'s legislative history does not mention, much less purport to remove, a court's inherent power to sanction and deter abuses of the bankruptcy system. There is no suggestion in the quoted passage above that Congress was addressing a *dishonest* debtor who was trying to defraud his creditors with no intention of repaying his debts. To the contrary, the passage is obviously referring to the *honest* debtor, as the overarching intent of Section 706(a) is to confer rights on a debtor who actually intends "*to repay his debts*." S. Rep. No. 989, *supra*, at 94 (emphasis added). But "[w]here conversion to [chapter] 13 amounts to an attempt to escape debts rather than to repay them, the reason for the rule ceases." *In re Spencer*, 137 B.R. 506, 512 (Bankr. N.D. Okla. 1992).

As the court of appeals correctly concluded, "[a] legislative policy aimed at encouraging able debtors to undertake the voluntary repayment of their lawful credit obligations plainly is not served where the bankruptcy court has determined, as a threshold finding of fact, that the debtor is utilizing his subsection 706(a) conversion rights to advance an ongoing scheme to retain his non-exempt assets from bona fide creditors." Pet. App. 39; see *In re Wampler*, 302 B.R. at 605 ("[T]he statute was intended to give only the *honest* debtor an opportunity to voluntarily repay his debts * * *. Section 706(a) was not intended as a way for the dishonest debtor to abuse the bankruptcy process, perpetrate a fraud or engage in bad faith behavior."). Section 706(a)'s legislative history thus provides no support for stripping bankruptcy courts of their power to prevent an abuse of process or to sanction and deter bad faith conduct.

E. A Bankruptcy Court Properly Exercises Its Inherent Power When It Denies Conversion Of A Chapter 7 Case Based On The Debtor's Bad Faith

1. A bankruptcy court acts within its discretion in denying a debtor's request to convert to another chapter when the debtor intentionally misrepresents his financial condition in the bankruptcy proceeding. Such misconduct constitutes an egregious abuse of the bankruptcy system, which has always limited relief to the "*honest* but unfortunate" debtor. *Local Loan Co.* v. *Hunt*, 292 U.S. 234, 244-245 (1934) (emphasis added). "[T]he successful functioning of the bankruptcy act hinges both upon the bankrupt's veracity and his willingness to make a full disclosure" of his assets and financial condition. Pet. App. 33 (quoting *Boroff* v. *Tully (In re Tully)*, 818 F.2d 106, 110 (1st Cir. 1987)); *In re Little*, 245 B.R. 351, 353-354 (Bankr. E.D. Mo. 2000) ("Perhaps to a greater degree than any other segment of our justice system, Bankruptcy depends on the integ-

rity of the information supplied by its principal participant, the debtor.").

The importance of honest and full disclosure of a debtor's assets is particularly acute in cases filed under chapter 7. That chapter generally grants the debtor a complete discharge of his pre-petition debts. 11 U.S.C. 727. But the Code explicitly conditions such relief on the debtor's release to creditors of *all* his pre-petition and non-exempt assets. 11 U.S.C. 725, 726, 727(a). A debtor who files under chapter 7 thus has an incentive to try to conceal assets to obtain the benefit of relief from all of his debts while shielding assets from the prospect of liquidation. Such efforts strike at the structural foundation upon which chapter 7 is premised. Accordingly, a court may properly deny conversion relief to chapter 7 debtors either to prevent further abuse of process or to sanction and deter similar misconduct.

Petitioner contends that permitting courts to respond to debtor's bad faith would not be administrable or provide debtors fair notice of what conduct is permissible because "[w]hat constitutes 'extreme circumstances' is not 'capable of pragmatic and mechanical application.'" Pet. Br. 17 (quoting *In re Noll*, 172 B.R. 122, 124 (Bankr. M.D. Fla. 1994)). The bankruptcy court's power under Section 105(a) to act in the face of abuse of process, however, puts debtors on clear notice that the court has discretion to take appropriate action when confronted with misconduct. Section 105(a) likewise necessarily recognizes that bankruptcy courts are fully competent to determine whether a litigant is engaging in an abuse of process. In any event, petitioner has no plausible claim that debtors are unaware of their obligation of complete candor and disclosure in their statement of financial affairs and schedule of assets, as those obligations are expressly set forth in the Code and Rules. 11 U.S.C. 521; Fed. R. Bankr. P. 1008 (requiring "[a]ll petitions, lists, schedules, statements and amendments thereto" to be verified or supported by a declaration under penalty of perjury pursuant to 28 U.S.C. 1746).

"Bad faith," moreover, is a familiar concept in the law, and bankruptcy courts routinely consider whether a debtor's conduct constitutes bad faith in the course of assessing the existence of "cause" for dismissal or conversion to chapter 7 under 11 U.S.C. 1307(c). See p. 17 & n.4, *supra*; see 11 U.S.C. 707(a) (authorizing dismissal for cause); 11 U.S.C. 1112(b) (authorizing dismissal or conversion to chapter 7 for cause); 11 U.S.C. 1208(c) (authorizing dismissal for cause). Thus, the bankruptcy courts that have denied conversion relief under Section 706(a) for bad faith have adopted a standard that is substantially similar to the standard applied in determining whether a debtor's bad faith warrants dismissal or conversion to chapter 7 under Section 1307(c). As the court of appeals observed, courts generally consider "the totality of the circumstances," including such factors as "the accuracy of the debtor's financial statements," "any other attempts by the debtor to mislead the bankruptcy court or manipulate the bankruptcy process," and "the debtor's motivation in seeking to convert to chapter 13." Pet. App. 41.

2. The bankruptcy court here properly exercised its discretion to deny conversion of petitioner's case to chapter 13 because of petitioner's bad faith in filing his chapter 7 case. As the court of appeals observed, "[t]he instant case comports in all material respects with the

classic profile of playing fast and loose with the bankruptcy process." Pet. App. 42. Before filing for bankruptcy relief, petitioner transferred valuable property in an acknowledged attempt to shield it from his creditors, and he failed to disclose the transfer in filing for bankruptcy. While petitioner was prepared to face liquidation of the estate absent the fraudulently concealed assets, when the trustee discovered the non-disclosure and initiated steps to reclaim the property for the benefit of creditors, petitioner sought to convert the case to chapter 13, presumably not only to oust the chapter 7 trustee, but also to retain petitioner's interest in the concealed property and shield it from liquidation. *Ibid.*[5]

In refusing to transfer the case from chapter 7, the bankruptcy court properly sanctioned the debtor for his misconduct while preserving the interests of creditors. Because the case remained in chapter 7, the chapter 7 trustee was able to recover petitioner's Maine property and liquidate it for the benefit of creditors. *Marrama*, 316 B.R. at 421-423. In addition, based upon a finding that petitioner intended to defraud his creditors, petitioner was denied a discharge of his debts under

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[5] Petitioner challenges the bankruptcy court's factual finding that he acted in bad faith and the court's failure to conduct an evidentiary hearing. Pet. Br. 11, 22, 24. Both the bankruptcy appellate panel and the court of appeals rejected those contentions, Pet. App. 25-27, 41-44, and the petition did not seek this Court's review of those factbound issues. Pet. i. Moreover, as a result of subsequent proceedings in petitioner's chapter 7 case the court of appeals held that petitioner "transferred valuable assets belonging to him, less than a year before he petitioned for bankruptcy protection, with the actual intent to defraud his creditors." *Marrama* v. *Citizens Bank (In re Marrama)*, 445 F.3d 518, 524 (1st Cir. 2006). It does not appear that petitioner sought further review of that decision, which is now final, so he is precluded from challenging that factual determination.

11 U.S.C. 727. *Marrama* v. *Citizens Bank (In re Marrama)*, 445 F.3d 518 (1st Cir. 2006).

Denial of a chapter 7 discharge thus enabled petitioner's creditors to obtain estate assets under 11 U.S.C. 726, as well as to pursue any outstanding claims against petitioner post-bankruptcy. By contrast, converting the case to chapter 13 to permit petitioner to propose a plan would expose petitioner's creditors to the possibility of further abuse of the bankruptcy process, and would inevitably delay the proper disposition of the case. See pp. 20-22, *supra*. The bankruptcy court's denial of conversion to chapter 13 thus protected the rights of petitioner's innocent creditors and enabled the court to ensure the integrity of the bankruptcy process, in keeping with the core purposes of the court's inherent authority.

CONCLUSION

The judgment of the court of appeals should be affirmed.

Respectfully submitted.

PAUL D. CLEMENT
Solicitor General

THOMAS G. HUNGAR
Deputy Solicitor General

LISA S. BLATT
Assistant to the Solicitor General

ROBERTA A. DEANGELIS
Acting General Counsel

P. MATTHEW SUTKO
KNIGHT ELSBERRY
Attorneys
Executive Office for United States Trustees

SEPTEMBER 2006

BRIEF BANK — 'SUMMARY SHEET" *Printed Wed-10/11/06 9:34*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]* — Marrama v Citizens Bank of Mass.

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]* — Supreme Court

3. ("CCN") ***CURRENT*** CASE NO. — No.: 05-996

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]* — No.:

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(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC*** — **BANKRUPTCY**

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s)

- Whether 11 U.S.C. section 706(a) deprives a bankruptcy court of its inherent power to sanction and deter bad faith conduct by denying a debtors' request to convert a chapter 7 bankruptcy case to chapter 13.

&

√ Any Miscellaneous ***BACKGROUND***

√ **Background:**

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2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	United States Supreme Court
3. ("CCN") ***CURRENT*** CASE NO.	No.: 10-179
4. ("PCN") ***PRIOR*** CASE NO. - & COURT *[IF ANY]*	No.: 02-56002, 02-56067 Court: 9th Cir. *(Identify judge & cite, if any)*
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8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	• Whether, consistent with 28 U.S.C. 157 and Article III, a bankruptcy judge may enter final judgment on a bankruptcy estate’s compulsory counterclaim against a bankruptcy claimant, even when adjudication of the counterclaim requires resolution of issues that are not implicated by the claim against the estate.
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No. 10-179 $

In the Supreme Court of the United States

HOWARD K. STERN, EXECUTOR OF THE ESTATE OF
VICKIE LYNN MARSHALL, PETITIONER

v.

ELAINE T. MARSHALL, EXECUTRIX OF THE ESTATE
OF E. PIERCE MARSHALL

ON WRIT OF CERTIORARI %
TO THE UNITED STATES COURT OF APPEALS %
FOR THE NINTH CIRCUIT %

BRIEF FOR THE UNITED STATES $ AS AMICUS CURIAE SUPPORTING PETITIONER $

NEAL KUMAR KATYAL
Acting Solicitor General
Counsel of Record
TONY WEST
Assistant Attorney General
MALCOLM L. STEWART
Deputy Solicitor General
ERIC J. FEIGIN
Assistant to the Solicitor General
MICHAEL S. RAAB
ERIC FLEISIG-GREENE
Attorneys

Department of Justice
Washington, D.C. 20530-0001
SupremeCtBriefs@usdoj.gov
(202) 514-2217

QUESTIONS PRESENTED

Whether, consistent with 28 U.S.C. 157 and Article III, a bankruptcy judge may enter final judgment on a bankruptcy estate's compulsory counterclaim against a bankruptcy claimant, even when adjudication of the counterclaim requires resolution of issues that are not implicated by the claim against the estate.

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In the Supreme Court of the United States

No. 10-179

HOWARD K. STERN, EXECUTOR OF THE ESTATE OF '
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ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

BRIEF FOR THE UNITED STATES $ AS AMICUS CURIAE SUPPORTING PETITIONER $

INTEREST OF THE UNITED STATES $

This case presents the question whether Congress has authorized, and may constitutionally authorize a district court to refer to a bankruptcy judge the final adjudication of a compulsory counterclaim by a bankruptcy estate against a creditor who has filed a claim against the estate. The United States has a substantial interest in the outcome of the case because United States trustees—who are Department of Justice officials appointed by the Attorney General—supervise the administration of bankruptcy cases. See 28 U.S.C. 581-589a (2006 & Supp. II 2008). See also 11 U.S.C. 307 ("The United States trustee may raise and may appear and be heard on any issue in any [bankruptcy] case or proceeding."). The United States also has a substantial interest in this case because, although the court of appeals framed its holding as one of statutory construction, the court's analysis calls into question the scope of Congress's constitutional authority to authorize bankruptcy-judge adjudication of counterclaims filed by the estate. Cf. 28 U.S.C. 2403(a) (authorizing the United States to intervene in "any action, suit, or proceeding in a court of the United States * * * wherein the constitutionality of any Act of Congress affecting the public interest is drawn into question").

STATEMENT

1. Article I of the Constitution assigns to Congress the "Power * * * To establish * * * uniform Laws on the subject of Bankruptcies throughout the United States." U.S. Const. Art. I, § 8, Cl. 4. In exercising its plenary authority to regulate bankruptcy, Congress has given "special attention to the subject of making the bankruptcy laws inexpensive in their administration." *Katchen* v. *Landy*, 382 U.S. 323, 328 (1965) (quoting H.R. Rep. No. 1228, 54th Cong., 1st Sess. 2 (1896); S. Rep. No. 1916, 75th Cong., 3d Sess. 2 (1938)) (alterations omitted). To that end, it has both created specialized fora for the adjudication of bankruptcy matters and provided that such matters may be resolved summarily without a jury.

a. 1898 Bankruptcy Act, Ch. 541, 30 Stat. 544, vested district courts with original jurisdiction as "courts of bankruptcy," *id.* § 2, 30 Stat. 545, and empowered them to refer cases in whole or in part to bankruptcy "referees," *id.* § 22a, 30 Stat. 552. Those referees (later renamed "bankruptcy judges") were appointed by district courts for two-year terms and were removable by those courts for cause. *Id.* § 34, 30 Stat. 555. They were authorized, with certain exceptions, to "perform such part of the duties * * * as are by this Act conferred on courts of bankruptcy," "subject always to a review by the [district] judge." *Id.* § 38, 30 Stat. 555.

In 1973, this Court prescribed Bankruptcy Rules pursuant to 28 U.S.C. 2075. See 411 U.S. 995. Rule 102 provided for the automatic referral of all bankruptcy proceedings to a referee, while authorizing the district court to withdraw such a reference "for the convenience of the parties or other cause" on a case-by-case basis. *Id.* at 1003-1004. The set of proceedings committed to the referee for adjudication in the first instance included "counterclaims against a creditor who files claims against the estate." *Northern Pipeline Const.* v. *Marathon Pipe Line Co.*, 458 U.S. 50, 99 (1982) (White, J. dissenting); see 1973 Bankr. R. 306(c), 701 & advisory cmte. note. Cf. *Katchen*, 382 U.S. at 336 n.12 (noting pre-1973 appellate decisions "upholding summary jurisdiction to grant affirmative relief on related counterclaims that would also be defenses to [a creditor's] claim"). Rule 803 stated that "the judgment or order of the referee shall become final" unless appealed. 411 U.S. at 1088. On appeal, the district court was required to "accept the referee's findings of fact unless clearly erroneous." 1973 Bankr. R. 810, 411 U.S. at 1090.

b. The Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549, sought to "substantially expand[]" bankruptcy jurisdiction and to enlarge the role of specialized bankruptcy fora. H.R. Rep. No. 595, 95th Cong., 1st Sess. 13 (1977). Under the 1978 Act, the power to enter final judgment in all "civil proceedings arising under title 11 or arising in or related to cases under title

11" was vested in a set of newly created "United States Bankruptcy Courts," which replaced referees. 28 U.S.C. 151(a), 1471(b) and (c) (Supp. IV 1980). Judges of those new bankruptcy courts were appointed for 14-year terms by the President, with the advice and consent of the Senate. 28 U.S.C. 152 (Supp. IV 1980). Review of bankruptcy-court judgments was solely appellate in nature. 28 U.S.C. 160, 1334 (1976 & Supp. IV 1980).

The constitutionality of the 1978 Act was challenged shortly after its enactment. In *Northern Pipeline*, a bankrupt debtor attempted to prosecute various state-law claims in bankruptcy court against a company that had never made a claim against the debtor's estate or otherwise appeared in the bankruptcy proceedings. 458 U.S. at 56-57 (plurality opinion). This Court held that the bankruptcy court's exercise of jurisdiction over that suit conflicted with the requirement of Article III, Section 1 that "[t]he judicial Power of the United States shall be vested" in judges who have life tenure and protection from salary reduction. See *id.* at 88 & n.40 (plurality opinion); *id.* at 91 (Rehnquist, J., concurring in the judgment).

As this Court subsequently explained, although a majority of the Justices in *Northern Pipeline* agreed that the 1978 Act was unconstitutional as applied to the suit before it, the "divided Court was unable to agree on the precise scope and nature of Article III's limitations." *Thomas* v. *Union Carbide Agric. Prods. Co.*, 473 U.S. 568, 584 (1985). "The Court's holding in" *Northern Pipeline* therefore "establishes only that Congress may not vest in a non-Article III court the power to adjudicate, render final judgment, and issue binding orders in a traditional contract action arising under state law, without consent of the litigants, and subject only to ordinary appellate review." *Ibid.* Nevertheless, six Justices concluded that the statutory authorization for the bankruptcy court to adjudicate the state-law contract action at issue in the case was not severable from the remainder of the 1978 Act's grant of jurisdiction to bankruptcy courts, and the Court accordingly struck down the entire jurisdictional grant as unconstitutional. *Northern Pipeline*, 458 U.S. at 88 & n.40, 91-92 (plurality opinion); *id.* at 91-92 (Rehnquist, J., concurring in the judgment). The Court stayed its judgment for approximately three months to "afford Congress an opportunity to reconstitute the bankruptcy courts or to adopt other valid means of adjudication, without impairing the interim administration of the bankruptcy laws." *Id.* at 88 (plurality opinion); *id.* at 92 (Rehnquist, J., concurring in the judgment).

c. The Judicial Conference of the United States, concerned that Congress might not act before the Court's stay expired, requested that the Director of the Administrative Office of the United States Courts (Director) propose a rule for adoption by the courts that would allow for the continued operation of the bankruptcy system consistent with *Northern Pipeline*. Judicial Conf. of United States, *Report of Proceedings* 91 (Sept. 1982). The Director responded by circulating a memorandum and proposed rule setting forth "an interim measure, by which district courts may delegate many of their bankruptcy powers to bankruptcy judges." Memorandum from William E. Foley, Director, Administrative Office of the United States Courts (Dec. 3, 1982) (Foley Memorandum), reprinted in *Bankruptcy Court Act of 1983: Hearing on H.R. 3 Before the Subcomm. on Monopolies and Commercial Law of the Comm. on the Judiciary*, 98th Cong. 1st Sess. 160 (1983)

(*1983 Subcomm. Hearing*). When Congress ultimately failed to act before this Court's stay expired, a revised version of the Director's proposed rule was adopted, "with minor local variations," by all of the courts of appeals and district courts. Vern Countryman, *Scrambling To Define Bankruptcy Jurisdiction: The Chief Justice, the Judicial Conference, and the Legislative Process*, 22 Harv. J. Legis. 1, 23 (1985).

The interim rule scaled back the jurisdiction that the 1978 Act had conferred upon bankruptcy judges. Rather than vesting bankruptcy judges with original jurisdiction over "[a]ll cases under Title 11 and all civil proceedings arising under Title 11 or arising in or related to cases under Title 11," the interim rule provided that such matters would be "referred" to bankruptcy judges by the district court. Interim Bankr. R. § (c)(1), reprinted in *1983 Subcomm. Hearing* 161-163 (reproduced in the appendix). It additionally specified that such references could be withdrawn in whole or in part by the district court "at any time on its own motion or on timely motion by a party," and that the district court could review de novo a bankruptcy judge's determinations. *Id.* § (c)(2), (e)(2).

The interim rule also precluded bankruptcy judges from entering final judgment in a class of proceedings that the Director dubbed "*Marathon* claims" and in the rule were called "related proceedings." Foley Memorandum; Interim Bankr. R. § (d)(3)(B). The rule provided that in such proceedings a bankruptcy judge would simply "submit findings, conclusions, and a proposed judgment or order to the district judge" unless the parties consented to a different allocation of authority between the bankruptcy and district judges. *Ibid.* In other referred matters, however, a bankruptcy judge could enter final judgment. *Id.* § (d)(2). The set of proceedings in which bankruptcy courts could exercise that final-judgment authority included, *inter alia*, "counterclaims by the estate in whatever amount against persons filing claims [against] the estate." *Id.* § (d)(3)(A).

During the period that it was in effect, the interim rule was uniformly upheld against constitutional challenge by the courts of appeals. *Salomon* v. *Kaiser*, 722 F.2d 1574, 1581 (2d Cir. 1983); *Braniff Airways, Inc.* v. *Civil Aeronautics Bd.*, 700 F.2d 214, 215 (5th Cir.) (per curiam), cert. denied, 463 U.S. 1208 (1983); *White Motor Corp.* v. *Citibank, N.A.*, 704 F.2d 254, 263 (6th Cir. 1983); *Stewart* v. *Stewart*, 741 F.2d 127, 131 (7th Cir. 1984); *First Nat'l Bank of Tekamah* v. *Hansen*, 702 F.2d 728, 729 (8th Cir.), cert. denied, 463 U.S. 1208 (1983) (per curiam); *Lindquist* v. *Metropolitan Bank*, 730 F.2d 1204, 1205 (8th Cir. 1984) (per curiam); *Oklahoma Health Servs. Fed. Credit Union* v. *Webb*, 726 F.2d 624, 625 (10th Cir. 1984); *In re Colorado Energy Supply, Inc.*, 728 F.2d 1283, 1284-1285 (10th Cir. 1984); *Committee of Unsecured Creditors of F S Commc'ns Corp* v. *Hyatt Greenville Corp.*, 760 F.2d 1194, 1198-1199 (11th Cir. 1985).

d. Just over two years after this Court's decision in *Northern Pipeline*, Congress enacted the Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, 98 Stat. 333, which laid the foundation for the current bankruptcy system. The primary sponsor of the 1984 Act's jurisdictional provisions explained that those provisions were intended to codify the practice under the Judiciary's interim rule:

> The solution offered by my amendment has been at work in the last 18 months under the emergency bankruptcy rule known as the model rule and has

> been upheld by five circuit courts of appeal and 24 district courts. It has proven successful. Nothing need be changed. Congressional enactment of the model rule is the purpose of my amendment, and that is all that is necessary.

130 Cong. Rec. 6241 (1984) (statement of Rep. Kastenmeier); see *id.* at 6242 (statement of Rep. Kindness) ("The Kastenmeier-Kindness amendment is essentially a legislative enactment of the emergency bankruptcy rule, the model rule that has been in effect, under which the bankruptcy courts have been operating. It has been ruled constitutional by five circuits now, every place where the question has been raised. The Supreme Court has passed up the opportunity to review those cases.").

The 1984 Act vests the district courts with original jurisdiction over bankruptcy matters. 28 U.S.C. 1334(a)-(b). It further provides that district courts "may," as under the interim rule, "provide that any or all cases under title 11 and any or all proceedings arising under title 11 or arising in or related to a case under title 11 may be referred to the bankruptcy judges for the district." 28 U.S.C. 157(a). Under the 1984 Act (as under the interim rule), a district court "may withdraw, in whole or in part, any case or proceeding referred under this section, on its own motion or on timely motion of any party, for cause shown." 28 U.S.C. 157(d).

Also like the interim rule, the 1984 Act authorizes bankruptcy judges to enter final judgments in some types of proceedings but not others. In particular, bankruptcy judges may enter final judgments in "all core proceedings arising under title 11, or arising in a case under title 11," that are referred to them by a district court. 28 U.S.C. 157(b)(1). Bankruptcy courts' judgments in such proceedings are subject to appellate review by district courts, bankruptcy appellate panels, and circuit courts of appeals. See 28 U.S.C. 158. If a particular proceeding "is not a core proceeding but * * * is otherwise related to a case under title 11," however, a bankruptcy judge may not enter final judgment, but may instead submit proposed findings of fact and conclusions of law to the district court for de novo review. 28 U.S.C. 157(c)(1). The 1984 Act states that "[c]ore proceedings include, but are not limited to," various enumerated matters. 28 U.S.C. 157(b)(2). Those matters include "counterclaims by the estate against persons filing claims against the estate." 28 U.S.C. 157(b)(2)(C).

The 1984 Act also altered the manner in which bankruptcy judges are appointed. Those judges are no longer selected by the President (as they were under the 1978 Act), but instead are appointed by the courts of appeals for the circuits in which their judicial districts are located. 28 U.S.C. 152(a)(1). They "serve as judicial officers of the United States district court established under Article III of the Constitution." *Ibid.*

2. a. In 1996, Vickie Lynn Marshall (referred to interchangeably with the executor of her estate as "petitioner") filed for Chapter 11 bankruptcy relief in the Central District of California. Pet. App. 13. By local rule, the district court in the Central District of California "refers to the bankruptcy judges of this district, all cases under Title 11 and all proceedings under Title 11 or arising in or related to a case under Title 11." Gen. Order 266 (C.D. Cal. Oct. 9, 1984).

Petitioner's stepson, E. Pierce Marshall (referred to interchangeably with the executrix of his estate as "respondent"), filed a proof of claim in petitioner's bankruptcy case. Pet. App. 15. As construed by the courts below, that claim sought damages for alleged defamatory statements by petitioner and her attorneys to the effect that respondent had tortiously interfered with petitioner's rights in the estate of her recently deceased husband (respondent's father). *Id.* at 14-15 & n.11, 274-276. Petitioner answered the adversary complaint by asserting, *inter alia*, that she could not be held liable for defamation because the relevant statements were true. *Id.* at 16. Petitioner also filed a counterclaim for "tortious interference with her rights as [her late husband's] spouse." *Ibid*

The bankruptcy judge presiding over petitioner's Chapter 11 case held a trial. Pet. App. 18. It granted summary judgment for petitioner on respondent's defamation claim. *Ibid.* The bankruptcy court also found in petitioner's favor on petitioner's counterclaim, determining that respondent had tortiously interfered with petitioner's expectation in her late husband's estate. *Ibid.* The bankruptcy court determined that it had jurisdiction under 28 U.S.C. 157 to finally adjudicate the counterclaim. Pet. App. 294-296. In December 2000, it entered final judgment for petitioner in the total amount of $474,754,134. *Id.* at 301.

b. Respondent appealed to the district court. Pet. App. 24. The district court vacated the judgment on the ground that petitioner's tortious-interference counterclaim was not the type of matter on which bankruptcy judges may enter final judgment. *Id.* at 283. The district court acknowledged that the counterclaim "falls within the literal language of [28 U.S.C.] § 157(b)(2)(C)." *Id.* at 276. Based largely on perceived constitutional concerns, however, the court concluded that the counterclaim was too far attenuated from respondent's defamation claim to allow for decision by the bankruptcy judge. See *id.* at 265-283. The district court therefore treated the bankruptcy court's ruling as a *proposed* judgment subject to the district court's own independent review. *Id.* at 284; see 28 U.S.C. 157(c)(1).

c. During the pendency of the federal-court proceedings, petitioner and respondent were also participating in Texas probate-court proceedings concerning administration of the estate of petitioner's late husband, respondent's father. Pet. App. 11-13, 20. In the state court, respondent sought a declaration that his father's will and living trust were valid. *Id.* at 11. Petitioner challenged the validity of those instruments and sought recovery from respondent for tortious interference on essentially the same theory that she pressed in the bankruptcy court. *Id.* at 11-12.

After the bankruptcy court entered judgment in her favor, petitioner voluntarily dismissed her pending claims in the Texas probate proceedings. Pet. App. 20-21. Petitioner remained a party to the Texas proceedings, however, as a defendant in a declaratory judgment action brought by respondent to determine their respective rights to the decedent's estate. *Id.* at 21. Following a lengthy trial, the jury found that the will and trust were valid, and that petitioner did not in fact have a legitimate expectation of rights in the decedent's estate. *Id.* at 22. In December 2001, the Texas probate court entered an amended judgment in favor of respondent on all claims. *Id.* at 22-23.

d. When the Texas probate court entered that judgment, the district court was in the midst of its independent review of the bankruptcy court's decision on petitioner's tortious-interference counterclaim. Pet. App. 219, 222. Relying on principles of issue preclusion and res judicata, respondent filed a motion for summary judgment, which the district court denied. *Id.* at 217-234.

The district court proceeded to take additional evidence on petitioner's counterclaim. Pet. App. 25. In March 2002, it issued a lengthy opinion agreeing with the bankruptcy court that respondent had committed tortious interference. *Id.* at 90-214. It entered judgment in petitioner's favor, awarding a total of $88,585,534.66. *Id.* at 216.

e. Both parties appealed the district court's decision. Pet. App. 26. The court of appeals vacated the district court's judgment, holding that the probate exception to federal jurisdiction precluded the federal courts from adjudicating the case. *Marshall* v. *Marshall*, 392 F.3d 1118 (9th Cir. 2004). This Court reversed and remanded for consideration of additional issues, including the bankruptcy judge's jurisdiction to enter final judgment and respondent's arguments of issue and claim preclusion. *Marshall* v. *Marshall*, 547 U.S. 293, 315 (2006).

f. On remand, the court of appeals reversed the district court's judgment and ordered entry of judgment in favor of respondent. Pet. App. 5. The court of appeals concluded that "the Texas probate court's judgment was the earliest final judgment entered on matters relevant to this proceeding," and that "the district court erred when it did not afford preclusive effect to the Texas probate court's determination of relevant legal and factual issues." *Id.* at 65.

The court of appeals rejected petitioner's argument that the earliest final judgment in the case had in fact been issued by the bankruptcy court rather than by the probate court. In the court of appeals' view, the bankruptcy court had lacked jurisdiction to enter final judgment on petitioner's counterclaim. Pet. App. 55-56. The court of appeals agreed with petitioner "that her claim is a compulsory counterclaim because the 'operative facts underlying her action' are the same as those underlying [respondent's] defamation claim." *Id.* at 47 (internal quotation marks and alterations omitted). The court concluded, however, that the counterclaim was "not a 'core proceeding arising under title 11, or arising in a case under title 11' for which the bankruptcy court is empowered to enter a final judgment." *Id.* at 65 (quoting 28 U.S.C. 157(b)(1)) (brackets omitted).

The court of appeals acknowledged that 28 U.S.C. 157(b)(2)(C) defines the term "core proceedings" to include "counterclaims by the estate against persons filing claims against the estate." Pet. App. 45. The court held, however, that a bankruptcy judge may enter final judgment only on a claim "that meets Congress' definition of a core proceeding *and* arises under or arises in title 11." *Id.* at 43. In support of that conclusion, the court of appeals expressed concern that an "overly broad construction" of the term "core proceeding" would create a potential constitutional infirmity of the sort identified in *Northern Pipeline*. *Id.* at 50.

To avoid that perceived constitutional difficulty, the court of appeals adopted a test proposed in an amicus brief, under which "a counterclaim under § 157(b)(2)(C) is properly a 'core' proceeding 'arising in a case under' the Bankruptcy Code only if the counterclaim is so closely related to the proof of claim that the resolution of the counterclaim is necessary to resolve the allowance or disallowance of the claim itself." Pet. App. 50 (brackets omitted). The court concluded that petitioner's counterclaim did not satisfy that test. *Id.* at 51. The court explained that, "[e]ven if it were shown that the statements made by [petitioner's] attorneys were true," petitioner would be required to make additional showings in order to prevail on her tortious-interference claim. *Ibid.* The court concluded that, because "[n]othing in [respondent's] defamation claim puts these [additional] factual and legal questions at issue," resolution of the counterclaim was not necessary to adjudicate respondent's claim against the estate, and the counterclaim therefore was not a "core proceeding" under the test the court had adopted. See *id.* at 51-55.

SUMMARY OF ARGUMENT

The court of appeals erred in placing artificial limits on the authority of bankruptcy judges to enter final judgment on counterclaims against creditors who have filed claims against the estate. The 1984 Act continued the longstanding practice of permitting a district court to refer a bankruptcy estate's counterclaim against a creditor to an adjunct for final adjudication. Congress intended to, and did, codify that practice from the Judiciary's interim rule, which in turn approximated the procedures in place under the 1898 Act. That codification was an appropriate exercise of Congress's authority to prescribe uniform laws regulating bankruptcy. Nothing in Article III prohibits Congress from permitting a district judge to place an estate's counterclaim on equal footing with a claim that the creditor himself is pressing in front of the bankruptcy judge, particularly when the counterclaim arises from the same transaction or occurrence.

A. Section 157 of Title 28 divides proceedings that a district court may refer to a bankruptcy judge into two categories: (1) "core proceedings arising under title 11, or arising in a case under title 11," and (2) proceedings "otherwise related to a case under title 11." 28 U.S.C. 157(b)(1) and (c)(1). Bankruptcy judges may "hear and determine" (*i.e.*, enter final judgment in) the first category of proceedings, but are allowed only to "submit proposed findings of fact and conclusions of law to the district court" in the second. *Ibid.* The statute unambiguously places all "counterclaims by the estate against persons filing claims against the estate" in the first category, by including them in the statutory definition of "core proceedings." 28 U.S.C. 157(b)(2)(C).

That statutory language neither limits the types of counterclaims that may be referred for final adjudication, nor permits courts to engraft their own limits by judicial decision. By creating a subset of "core" proceedings in which a bankruptcy court may *not* enter final judgment, the court of appeals departed from the plain text of the statute, the decisions of this Court, and the Federal Rules of Bankruptcy Procedure. Congress incorporated many of the statutory examples of "core proceedings," including counterclaims, from the list of proceedings in which bankruptcy judges could enter final judgment under the Judiciary's interim rule. In enacting the 1984 Act, Congress intended to preserve rather than to reduce the scope of bankruptcy judges' authority under that rule.

B. Congress's express authorization for bankruptcy judges to enter final judgment on estate counterclaims, in accordance with the Judiciary's preexisting practice, was fully consistent with Article III. In delineating the scope of authority that bankruptcy judges may constitutionally exercise, this Court has consistently distinguished between persons who file claims against the estate and those who do not. By invoking the assistance of the bankruptcy court and seeking a portion of the res, respondent subjected himself to the court's authority, and the court could thereafter resolve all contested issues between respondent and the estate.

The bankruptcy court's constitutional authority in this context is particularly clear with respect to *compulsory* counterclaims. A compulsory counterclaim is by definition sufficiently tied to the initial claim that principles of sound judicial administration require the two to be decided together. Allowing the bankruptcy court to adjudicate a compulsory counterclaim does not substantially expand the bankruptcy judge's authority, and a contrary rule would entail significant delay and inefficiency.

C. In responding to this Court's decision in *Northern Pipeline*, Congress enacted various measures to ensure that bankruptcy judges function as arms of the Judiciary and independent from the political Branches. Congress installed a panoply of procedural safeguards to protect bankruptcy creditors' rights when it restructured the bankruptcy courts in the 1984 Act—including appointment and removal of bankruptcy judges by the Judiciary, as well as discretionary referral of matters from the district court to the bankruptcy judge.

ARGUMENT

I. $ THE BANKRUPTCY CODE EXPRESSLY AUTHORIZES DISTRICT COURTS TO REFER FINAL DECISION ON ESTATE COUNTERCLAIMS TO BANKRUPTCY JUDGES.

A. The plain text of 28 U.S.C. 157 unambiguously authorizes a bankruptcy judge, pursuant to a referral by the district court, to enter final judgment on any counterclaim brought by the estate against a person who has filed a claim against the estate. Section 157(a) permits district courts to refer to bankruptcy judges "all cases under title 11 and any or all proceedings arising under title 11 or arising in or related to a case under title 11." Section 157(b)(1) permits bankruptcy courts to "hear and determine" (*i.e.*, enter final judgment on) certain of these referred matters, including "all core proceedings arising under title 11, or arising in a case under title 11." And Section 157(b)(2)(C) defines the term "[c]ore proceedings" to include, without qualification, "counterclaims by the estate against persons filing claims against the estate."

Congress's unqualified inclusion of estate "counterclaims" in the definition of "core proceedings" identifies such counterclaims as among the matters that bankruptcy courts may finally decide under Section 157(b)(1). See *Kontrick* v. *Ryan*, 540 U.S. 443, 453 (2004) (recognizing that "in cataloging core bankruptcy proceedings" in Section 157(b)(2), "Congress authorized bankruptcy courts to adjudicate" those matters); *Granfinanciera, S.A.* v. *Nordberg*, 492 U.S. 33, 50 (1989) (recognizing that Congress "designated fraudulent conveyance actions 'core proceedings,' which bankruptcy judges may adjudicate and in which they may issue final judgments, if a district court has referred the matter to them") (citations omitted); *Marshall* v. *Marshall*, 547 U.S. 293, 303 (2006) (quoting Section 157(b)(1) and explaining that a "bankruptcy court may exercise plenary power only over 'core proceedings,'" as distinct from "noncore matters"). The plain text of the statute does not permit a court, for reasons of constitutional avoidance or otherwise, to "do[] violence" to "the facially unqualified reference to counterclaim jurisdiction" by artificially limiting its scope. *Commodities Futures Trading Comm'n* v. *Schor*, 478 U.S. 833, 842 (1985).

B. The court of appeals concluded (and respondent contends) that a bankruptcy judge's authority to enter final judgment on a particular matter depends on a "two-step approach," under which the bankruptcy court may enter judgment only on "a claim that meets Congress' definition of a core proceeding *and* arises under or arises in title 11." Pet. App. 43; see Br. in Opp. 34-35. The court's analysis assumes the existence of some "core proceedings" that do *not* "aris[e] under title 11, or aris[e] in a case under title 11." 28 U.S.C. 157(b)(1). That reading is incorrect.

"It is a fundamental canon of statutory construction that the words of a statute must be read in their context and with a view to their place in the overall statutory scheme." *Davis* v. *Michigan Dep't of Treasury*, 489 U.S. 803, 809 (1989). The 1984 Act does not direct the bankruptcy court to engage in the second step of the "two-step approach" that the court of appeals described; it establishes no standards for determining whether a particular "core proceeding" "aris[es] under title 11, or aris[es] in a case under title 11"; and it provides no guidance as to what the bankruptcy court should do if it concludes that a "core proceeding" does not satisfy that supposed independent prerequisite. In the absence of such provisions, the "two-step approach" mandated by the court below is both procedurally and substantively unworkable.

First, Section 157(b)(3) simply instructs the bankruptcy judge, "on the bankruptcy judge's own motion or on timely motion of a party," to make the binary determination "whether a proceeding [1] is a core proceeding under this subsection or [2] is a proceeding that is otherwise related to a case under title 11." 28 U.S.C. 157(b)(3); see Fed. R. Bankr. P. 7008(a), 7012(b), 9027(a)(1) and (e)(3) (requiring filings simply to state whether a proceeding is "core" or "non-core"). Neither Section 157(b)(3) nor any other provision of the statute directs the bankruptcy judge to make the further determination whether a particular "core" proceeding "aris[es] under title 11, or aris[es] in a case under title 11." Under the court of appeals' "two-step approach," however, that further inquiry is essential to the ultimate determination whether the bankruptcy judge can enter final judgment in any "core proceeding." Had Congress intended bankruptcy judges to undertake that further inquiry, it surely would have directed them to do so.

Second, the statute provides no standards for deciding whether a particular "core" proceeding "aris[es] under title 11, or aris[es] in a case under title 11." That lack of guidance stands in stark contrast with Congress's careful specification in Section 157(b)(2) of 16 different categories of "core" proceedings. To be sure, the statute's definition of "core proceeding" is not fully comprehensive, since Section 157(b)(2) states that "[c]ore proceedings include, but are not limited to," the enumerated categories. Under the court of appeals' approach, however, the Section 157(b)(2) categories will *never* resolve the question whether the bankruptcy judge can enter judgment on a particular matter. Rather, when a particular matter falls within Section 157(b)(2), the judge will *always* be required to make the further determination whether that matter "aris[es] under title 11, or aris[es] in a case under title 11"—without any statutory guidance for doing so. That requirement would largely negate Congress's effort in Section 157(b)(2) to clarify the line between those matters that the bankruptcy judge may finally adjudicate and those on which the judge may enter only a recommended disposition.

Third, the statute nowhere describes what authority bankruptcy judges might wield over referred proceedings that are "core" but do *not* "aris[e] under title 11, or aris[e] in a case under title 11." Section 157 contains only two subsections that tell bankruptcy judges how to dispose of proceedings that are referred to them. Section 157(b)(1) authorizes bankruptcy judges to enter final judgments on "core proceedings arising under title 11, or arising in a case under title 11," while Section 157(c)(1) authorizes them to submit proposed findings and conclusions in "a proceeding that is not a core proceeding but that is otherwise related to a case under title 11." Neither of those provisions would encompass a hypothetical "core" proceeding that does *not* "aris[e] under title 11, or aris[e] in a case under title 11." Congress's failure to specify the scope of the bankruptcy judge's authority in a proceeding of that nature strongly indicates that the statute does not contemplate any such proceedings.

The only interpretation that makes sense of the entire statute, therefore, is that the term "[c]ore proceedings" in Section 157(b)(2) is simply shorthand for the "core proceedings arising under title 11, or arising in a case under title 11" that Section 157(b)(1) authorizes bankruptcy courts to "hear and determine." Under that interpretation, the above-described incongruities disappear. To determine their authority over a referred proceeding, bankruptcy judges simply determine whether the proceeding is "core" or whether the proceeding is "otherwise related to a case under title 11" (Section 157(b)(3)). If it is the former, the bankruptcy judge may enter final judgment (Section 157(b)(1)); if it is the latter, the bankruptcy judge may only submit proposed findings and conclusions to the district court (Section 157(c)(1)). Because "counterclaims by the estate against persons filing claims against the estate" are among the matters designated as "core proceedings" by Section 157(b)(2)(C), they fall within the former category, and bankruptcy judges may enter final judgment on them.

C. The process by which Section 157(b)(2)(C) was developed confirms Congress's intent to allow bankruptcy courts, pursuant to referrals from district courts, to enter final judgment on an estate's counterclaims against bankruptcy claimants. As previously discussed (see pp. 7-8, *supra*), Congress modeled Section 157 on the interim rule that the Judicial Branch had adopted in the wake of *Northern Pipeline*. See 130 Cong. Rec. at 6241-6242. That rule, like Section 157, divided proceedings referred to bankruptcy judges into two categories: proceedings in which bankruptcy judges could only submit proposed findings and conclusions, and proceedings in which they could enter final judgment. Compare Interim Bankr. R. §§ (d)(2) and (3), with 28 U.S.C. 157(b)(1) and (c)(1).

More specifically, the interim rule provided that "[i]n related proceedings the bankruptcy judge may not enter a judgment or dispositive order, but shall submit findings, conclusions, and a proposed judgment or order to the district judge, unless the parties to the proceeding consent to entry of the judgment or order by the bankruptcy judge." Interim Bankr. R. § (d)(3)(B). The interim rule stated that "[r]elated proceedings include, but are not limited to, claims brought by the estate against parties who have not filed claims against the estate"—*i.e.*, the sorts of claims that were at issue in *Northern Pipeline Const.* v. *Marathon Pipe Line Co.*, see 458 U.S. 50, 56 (1982) (plurality opinion)—but that "[r]elated proceedings do not include" various enumerated matters. Interim Bankr. R. § (d)(3)(A). Among the matters specifically excluded from the term "related proceedings" were "counterclaims by the estate in whatever amount against persons filing claims [against] the estate." *Ibid.* With minor variations, Congress incorporated the interim rule's list of matters that were *not* "related proceedings" into the non-exhaustive list of "core proceedings" set forth in 28 U.S.C. 157(b)(2). Compare Interim Bankr. R. § (d)(3)(A), with 28 U.S.C. 157(b)(2)(A), (C), (D), (E), (G), (H), (I), (J), (L), and (N).

Nothing in the 1984 Act's text or history suggests that Congress intended to reduce the range of matters on which bankruptcy courts could enter final judgment under the interim rule. Congress had no reason to believe that the interim rule, which had been proposed and adopted by the Judiciary and had been repeatedly upheld by the courts of appeals, was inconsistent with *Northern Pipeline* or otherwise violated Article III. See 130 Cong. Rec. at 6241-6242; p. 7, *supra*. Congress's evident intent was simply to preserve the scope of bankruptcy judges' authority under the interim rule, which broadly permitted referral of counterclaims against bankruptcy claimants to bankruptcy judges for entry of final judgment.

II. $DISTRICT COURTS' REFERRAL OF FINAL DECISION ON COMPULSORY COUNTERCLAIMS TO BANKRUPTCY JUDGES IS FULLY CONSISTENT WITH ARTICLE III OF THE CONSTITUTION.

This Court's precedents "demonstrate * * * that Article III does not confer on litigants an absolute right to the plenary consideration of every nature of claim by an Article III court." *Schor*, 478 U.S. at 848. Consistent with that principle, neither the court of appeals nor respondent has suggested that a bankruptcy judge's final adjudication of a creditor's claim against a bankruptcy estate violates Article III.[1] And neither the court of appeals nor respondent has questioned the constitutional authority of the federal *district* court to decide petitioner's state-law counterclaim as part of the bankruptcy case. The narrow constitutional question presented is whether Congress, consistent with Article III, could authorize the bankruptcy judge to enter final judgment on petitioner's counterclaim (subject to appellate review as provided in 28 U.S.C. 158) rather than simply submitting proposed findings and conclusions to the district court. Congress's authorization for the bankruptcy court to enter judgment on that matter, in accordance with the Judiciary's interim-rule procedure, is consistent with this Court's precedents and with principles of sound judicial administration.

A. The court of appeals stated that a literal reading of Section 157(b)(2)(C), as encompassing all estate counterclaims against persons who have filed claims against the estate, "would certainly run afoul of the Court's holding in [*Northern Pipeline*]." Pet. App. 46. That

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[1] Respondent has, however, made the narrower argument that the bankruptcy judge lacked *statutory* authority to enter final judgment on the *particular* defamation claim here, on the ground that it is a "personal injury tort" that must be tried in district court under 28 U.S.C. 157(b)(5). Br. in Opp. 42. Respondent makes a similar argument regarding petitioner's tortious-interference counterclaim. *Id.* at 43. The court of appeals did not address those issues, and they are not within the scope of the questions on which this Court granted certiorari. To the extent that respondent's arguments were preserved below, they could be considered on remand were this Court to reverse the judgment of the court of appeals.

analysis reflects a misreading of *Northern Pipeline*. In that case, the Court held that a non-Article III bankruptcy judge could not finally adjudicate a suit filed by the debtor against a defendant who had *not* filed a claim against the estate. See 458 U.S. at 56 (plurality opinion); *id.* at 87; *id.* at 89-91 (Rehnquist, J., concurring in the judgment). But neither the plurality nor the concurring Justices disputed Justice White's statement in dissent that "if Marathon had filed a claim against the bankrupt in this case, the trustee could have filed and the bankruptcy judge could have adjudicated a counterclaim seeking the relief that is involved in these cases." *Id.* at 100-101. And the Court in *Schor* subsequently observed that "a significant factor" in *Northern Pipeline* was "the absence of consent to an initial adjudication before a non-Article III tribunal." 478 U.S. at 849.

In applying the Seventh Amendment to the bankruptcy context, the Court has sharply distinguished between persons who file claims against the estate and those who do not. In *Granfinanciera*, the Court explained that, "under the Seventh Amendment, a creditor's right to a jury trial on a bankruptcy trustee's preference claim depends upon whether the creditor has submitted a claim against the estate." 492 U.S. at 58; see *Katchen* v. *Landy*, 382 U.S. 323 (1965). The Court subsequently reiterated that a claimant against the estate is not entitled to trial by jury on a voidable-preference counterclaim because "by filing a claim against a bankruptcy estate the creditor triggers the process of 'allowance and disallowance of claims,' thereby subjecting himself to the bankruptcy court's equitable power." *Langenkamp* v. *Culp*, 498 U.S. 42, 44 (1990) (per curiam) (quoting *Granfinanciera*, 492 U.S. at 58).

In two respects, the question presented here differs from the issue discussed by this Court in *Granfinanciera* and *Langenkamp*. First, respondent does not assert a Seventh Amendment right to jury trial on petitioner's counterclaim, but rather objects to final adjudication of that counterclaim by a non-Article III judge. But there is no sound reason for a different outcome in the Article III context than in the Seventh Amendment one. Indeed, the Court in *Granfinanciera* equated the two inquiries, stating that with respect to a legal cause of action, "the question whether the Seventh Amendment permits Congress to assign its adjudication to a tribunal that does not employ juries as factfinders requires the same answer as the question whether Article III allows Congress to assign adjudication of that cause of action to a non-Article III tribunal." 492 U.S. at 53.

Second, whereas *Langenkamp*, *Granfinanciera*, and *Katchen* involved voidable-preference actions, petitioner's tortious-interference counterclaim alleges a different sort of wrong. The court of appeals attached controlling weight to that distinction. Pet. App. 49. The court reasoned that, whereas the bankruptcy court in *Katchen* was required to resolve the voidable-preference issue in order to determine whether the claimant's own claim against the estate should be allowed, see *ibid.* (citing *Katchen*, 382 U.S. at 330), disposition of petitioner's counterclaim would require resolution of additional issues beyond those posed by respondent's defamation claim against the estate, see *id.* at 55. The court of appeals read *Katchen* and *Northern Pipeline* to establish a constitutional rule, which the court imported into its construction of Section 157(b)(2)(C), that a bankruptcy court may enter final judgment on an estate counterclaim "only if the counterclaim is so closely related to the proof of claim that the resolution of the counterclaim is necessary to resolve the allowance or disallowance of the claim itself." *Id.* at 50.

The court of appeals was correct that the factual and legal overlap between claim and counterclaim was closer in *Katchen* than in this case. The *Katchen* Court's rationale for allowing bankruptcy-court adjudication of the estate's counterclaim, however, was not limited to the voidable-preference context. Rather, the Court relied on the broader rule, which it had previously applied to receivership proceedings, that "[b]y presenting their claims [the claimants against the estate] subjected themselves to all the consequences that attach to an appearance." *Katchen*, 382 U.S. at 335 (quoting *Alexander* v. *Hillman*, 296 U.S. 222, 241 (1935)). That principle, the Court explained, "is in harmony with the rule generally followed by courts of equity that having jurisdiction of the parties to controversies brought before them, they will decide all matters in dispute and decree complete relief." *Ibid.* (quoting *Alexander*, 296 U.S. at 242). Under that approach, respondent, by submitting a claim against the estate, subjected himself to the bankruptcy court's authority to resolve the estate's counterclaim, even though that process required resolution of issues beyond those implicated by respondent's defamation claim.[2]

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[2] The Court in *Granfinaciera*, after quoting with approval the passage from *Katchen* discussed above, distinguished the *Katchen* Court's rationale from the "waiver" theory adopted by this Court in *Schor*. See 492 U.S. at 59 n.14. The precise nature of that distinction is unclear. It is clear, however, that respondent—like the claimant in *Katchen*, and unlike the petitioner in *Schor*—has "laid claim" to a "disputed res" to be administered in the bankruptcy proceedings. *Ibid.* *Katchen*'s reasoning is therefore fully applicable here.

As in a voidable-preference case, moreover, resolution of petitioner's counterclaim is "part of the claims-allowance process" and is "integral to the restructuring of the debtor-creditor relationship through the bankruptcy court's equity jurisdiction." *Langenkamp*, 498 U.S. at 44 (emphasis omitted). The trustee's recovery of monetary awards on estate counterclaims furthers the objectives of the Bankruptcy Code by increasing the pool of assets available to creditors. Cf. *Alexander*, 296 U.S. at 242 (observing, in the receivership context, that "[n]othing is more clearly a part of the subject matter of the main suit than recovery of all that to the *res* belongs"). To be sure, *Northern Pipeline* makes clear that the interest in maximizing the estate is not a sufficient basis for requiring a stranger to the bankruptcy to appear as a defendant before a non-Article III tribunal. But once respondent invoked the assistance of the bankruptcy court by filing his own proof of claim, the bankruptcy court was authorized to "decide all matters in dispute" between respondent and the estate and to "decree complete relief." *Katchen*, 382 U.S. at 335 (quoting *Alexander*, 296 U.S. at 242).

B. Although Section 157(b)(2)(C) applies by its terms to all "counterclaims by the estate against persons filing claims against the estate," as this case comes to the Court, the constitutional question presented involves the application of Section 157(b)(2)(C) to a *compulsory* counterclaim. The court of appeals held that the overlap between respondent's claim and petitioner's counterclaim was sufficient to make the counterclaim compulsory, Pet. App. 47-48, and respondent did not contest that proposition in opposing certiorari.[3]

A compulsory counterclaim, by definition, "arises out of the transaction or occurrence that is the subject matter of the opposing party's claim." Fed. R. Civ. P. 13(a)(1)(A) (incorporated in relevant part by Fed. R. Bankr. P. 7013). The Federal Rules compel a party, on penalty of forfeiture, to raise any such counterclaim in its answer to the primary claim. *Ibid.* The reason behind that rule is that the court, in adjudicating the primary claim, will be required to address that transaction or occurrence in any event. See, *e.g.*, *Southern Constr.*

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[3] In light of respondent's failure to contest the matter in his brief in opposition, the Court may appropriately decide this case on the *assumption* that petitioner's counterclaim was "compulsory" within the meaning of Federal Rule of Civil Procedure 13(a). See Sup. Ct. R. 15.2. The Court should not decide whether petitioner's counterclaim is in fact compulsory, however, since that issue is outside the questions on which the Court granted certiorari, and the standards for distinguishing between compulsory and permissive counterclaims have practical importance well beyond the application and constitutionality of Section 157(b)(2)(C). Most obviously, the determination that a counterclaim is compulsory means that a defendant's failure to assert it will be treated as a forfeiture. In addition, under the Bankruptcy Code, "[a] governmental unit that has filed a proof of claim in [a bankruptcy] case is deemed to have waived sovereign immunity with respect to a claim against such governmental unit that is property of the estate and that *arose out of the same transaction or occurrence* out of which the claim of such governmental unit arose." 11 U.S.C. 106(b) (emphasis added). The italicized language closely tracks the text of Federal Rule Civil Procedure 13(a)(1)(A). An unduly broad view of the category of claims and counterclaims that "ar[i]se out of the same transaction or occurrence" might thus effectively expand the range of counterclaims that bankruptcy estates can assert against governmental bodies, in derogation of the canon that sovereign immunity waivers must be "strictly construed." *Department of the Army* v. *Blue Fox, Inc.*, 525 U.S. 255, 261 (1999) (citation omitted).

Co. v. *Pickard*, 371 U.S. 57, 60 (1962) (rule "was designed to prevent multiplicity of actions and to achieve resolution in a single lawsuit of all disputes arising out of common matters"); see also 6 Charles Alan Wright et al., *Federal Practice and Procedure* § 1409 (3d ed. 2010) (Wright).

As we explain above, *Katchen* supports the view that, if a creditor invokes the bankruptcy court's assistance by filing a claim against the estate, it thereby subjects itself to the bankruptcy court's jurisdiction over any counterclaims the estate may file. But even if the decision is read more narrowly, the square holding of the case is that, if the overlap between the initial claim and the counterclaim is sufficiently substantial, the bankruptcy judge may adjudicate the counterclaim and may enter affirmative relief against the claimant ordering him to surrender property that rightfully belongs to the estate. See *Katchen*, 382 U.S. at 335-338. While a compulsory counterclaim need not be a precise mirror image of the primary claim, the text and judicial-economic purposes of the rule dictate that a counterclaim is "compulsory" only when the allegations at the pleading stage overlap significantly enough for joint adjudication to make sense. 6 Wright §§ 1409, 1410. When a creditor invokes "the process of allowance and disallowance of claims," *Granfinanciera*, 492 U.S. at 58 (quoting *Katchen*, 382 U.S. at 336), permitting the bankruptcy court to adjudicate a compulsory counterclaim does not substantially expand the bankruptcy judge's power. By contrast, a rule requiring a claim and compulsory counterclaim to be adjudicated separately would entail significant "delay and expense" and would "dismember a scheme which Congress has prescribed." *Katchen*, 382 U.S. at 339.[4]

C. This case is further distinguishable from *Northern Pipeline* by virtue of the substantial structural differences between the 1978 and 1984 Bankruptcy Acts. "[T]he constitutionality of a given congressional delegation of adjudicative functions to a non-Article III body must be assessed by reference to the purposes underlying the requirements of Article III"—namely, "to safeguard litigants' 'right to have claims decided before judges who are free from potential domination by other branches of government'" and "to protect 'the role of the independent judiciary within the constitutional scheme of tripartite government.'" *Schor*, 478 U.S. at 848 (quoting *United States* v. *Will*, 449 U.S. 200, 218 (1980), and *Thomas* v. *Union Carbide Agric. Prods. Co.*, 473 U.S. 568, 583 (1985). Congress's post-*Northern Pipeline* re-

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[4] In *Schor*, the Court rejected an Article III challenge to the authority of the Commodities Futures Trading Commission (CFTC) to decide state-law counterclaims arising out of the same transaction or occurrence as certain federal reparations claims referred to the CFTC by statute. 478 U.S. 833. The Court recognized that such "counterclaim jurisdiction" was "necessary to make the reparations procedure workable." *Id.* at 856. It observed that it had previously upheld similar jurisdiction over state-law matters not only in *Katchen*, but also in an Article III case, *Reconstruction Fin. Corp.* v. *Bankers Trust Co.*, 318 U.S. 163, 168-171 (1943). *Schor*, 478 U.S. at 852 (explaining that, in the latter case, the Court "saw no constitutional difficulty in the initial adjudication of a state law claim by a federal agency, subject to judicial review, when that claim was ancillary to a federal law dispute"). The Court concluded "that the congressional authorization of limited CFTC jurisdiction over a narrow class of common law claims as an incident to the CFTC's primary, and unchallenged, adjudicative function does not create a substantial threat to the separation of powers." *Id.* at 854. Similar reasoning applies here.

structuring of the bankruptcy laws was consistent with both of these constitutional goals.

As to the first of those constitutional objectives, there is no "potential" for bankruptcy judges to be "dominat[ed] by other branches of government" because bankruptcy judges are insulated from both Congress and the Executive. Under the 1984 Act, bankruptcy judges are "appointed by the court of appeals of the United States for the circuit in which" their judicial district is located. 28 U.S.C. 152(a); compare *Northern Pipeline*, 458 U.S. at 53 (plurality opinion) (noting that the President appointed bankruptcy judges under the 1978 Act). They "serve as judicial officers of the United States district court established under Article III of the Constitution." 28 U.S.C. 152(a). Although there is no constitutional bar to lowering their pay, the same was true of bankruptcy referees under the 1898 Act, of whom the *Northern Pipeline* plurality observed that "the primary danger of a threat to the independence * * * came from within, rather than without, the judicial department." 458 U.S. at 80 n.31. And bankruptcy judges are removable only by the circuit judicial council, and only for cause, following a hearing. 28 U.S.C. 152(e).

As to the second goal, there is no threat to "the role of the independent judiciary within the constitutional scheme of tripartite government" because the Judiciary's employment of bankruptcy judges is entirely optional. District courts "may" refer certain bankruptcy-related matters to bankruptcy judges, but they are not required to do so. 28 U.S.C. 157(a); compare *Northern Pipeline*, 458 U.S. at 54 n.3 ("The ultimate repository of the [1978] Act's broad jurisdictional grant is the bankruptcy courts."); *id.* at 80 n.31 ("[T]he [1978] bankruptcy courts are independent of the United

States district courts.") (internal quotation marks omitted). Article III courts, moreover, exercise appellate jurisdiction over bankruptcy judges' rulings in referred matters, including de novo review of legal issues. 28 U.S.C. 157(b)(1), 158; cf. Paul Bator, *The Constitution as Architecture: Legislative and Administrative Courts Under Article III*, 65 Ind. L.J. 233, 269 (1989) ("The Constitution gives Congress wide discretion to assign the task of making the initial decision in a case arising under federal law to administrative agencies, but requires judicial review to assure the supremacy of law.").[5] And a district court always retains the authority to "withdraw, in whole or in part, any case or proceeding referred under this section, on its own motion or on timely motion of any party, for cause shown." 28 U.S.C. 157(d). Indeed, the district court in this case initially granted respondent's motion to withdraw the reference of the claim and counterclaim, before vacating the withdrawal and referring the matter back to the bankruptcy judge. See J.A. 123, 129-130.

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[5] The statute itself does not prescribe a standard of review. Courts by practice review a bankruptcy judge's legal conclusions de novo, see 10 *Collier on Bankruptcy* ¶ 8013.04 (15th ed. 2010), and the current federal rules (like the 1973 rules, see p. 3, *supra*) provide that findings of fact "shall not be set aside unless clearly erroneous," Fed. R. Bankr. P. 8013. That latter standard does not violate Article III, because even in cases of private right, "there is no requirement that, in order to maintain the essential attributes of the judicial power, all determinations of fact in constitutional courts shall be made by judges." *Crowell* v. *Benson*, 285 U.S. 22, 51 (1932); see *Reconstruction Fin. Corp.*, 318 U.S. at 170 (Article III satisfied even where agency's factfinding "may not be disturbed by a court" if "supported by evidence"); see also *Dickinson* v. *Zurko*, 527 U.S. 150, 161-162 (1999) (noting that substantial-evidence review is even more deferential than clear-error review).

CONCLUSION

The judgment of the court of appeals should be vacated and the case remanded for further proceedings.

Respectfully submitted.

NEAL KUMAR KATYAL
Acting Solicitor General

TONY WEST
Assistant Attorney General

MALCOLM L. STEWART
Deputy Solicitor General

ERIC J. FEIGIN
Assistant to the Solicitor General

MICHAEL S. RAAB
ERIC FLEISIG-GREENE
Attorneys

NOVEMBER 2010

APPENDIX 4

1. 28 U.S.C. 157 provides:

Procedures

(a) Each district court may provide that any or all cases under title 11 and any or all proceedings arising under title 11 or arising in or related to a case under title 11 shall be referred to the bankruptcy judges for the district.

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

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

(A) matters concerning the administration of the estate;

(B) allowance or disallowance of claims against the estate or exemptions from property of the estate, and estimation of claims or interests for the purposes of confirming a plan under chapter 11, 12, or 13 of title 11 but not the liquidation or estimation of contingent or unliquidated personal injury tort or wrongful death claims against the estate for purposes of distribution in a case under title 11;

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

(D) orders in respect to obtaining credit;

(E) orders to turn over property of the estate;

(F) proceedings to determine, avoid, or recover preferences;

(G) motions to terminate, annul, or modify the automatic stay;

(H) proceedings to determine, avoid, or recover fraudulent conveyances;

(I) determinations as to the dischargeability of particular debts;

(J) objections to discharges;

(K) determinations of the validity, extent, or priority of liens;

(L) confirmations of plans;

(M) orders approving the use or lease of property, including the use of cash collateral;

(N) orders approving the sale of property other than property resulting from claims brought by the estate against persons who have not filed claims against the estate;

(O) other proceedings affecting the liquidation of the assets of the estate or the adjustment of the debtor-creditor or the equity security holder relationship, except personal injury tort or wrongful death claims; and

(P) recognition of foreign proceedings and other matters under chapter 15 of title 11.

(3) The bankruptcy judge shall determine, on the judge's own motion or on timely motion of a party,

whether a proceeding is a core proceeding under this subsection or is a proceeding that is otherwise related to a case under title 11. A determination that a proceeding is not a core proceeding shall not be made solely on the basis that its resolution may be affected by State law.

(4) Non-core proceedings under section 157(b)(2)(B) of title 28, United States Code, shall not be subject to the mandatory abstention provisions of section 1334(c)(2).

(5) The district court shall order that personal injury tort and wrongful death claims shall be tried in the district court in which the bankruptcy case is pending, or in the district court in the district in which the claim arose, as determined by the district court in which the bankruptcy case is pending.

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

(2) Notwithstanding the provisions of paragraph (1) of this subsection, the district court, with the consent of all the parties to the proceeding, may refer a proceeding related to a case under title 11 to a bankruptcy judge to hear and determine and to enter appropriate orders and judgments, subject to review under section 158 of this title.

(d) The district court may withdraw, in whole or in part, any case or proceeding referred under this section, on its own motion or on timely motion of any party, for cause shown. The district court shall, on timely motion of a party, so withdraw a proceeding if the court determines that resolution of the proceeding requires consideration of both title 11 and other laws of the United States regulating organizations or activities affecting interstate commerce.

(e) If the right to a jury trial applies in a proceeding that may be heard under this section by a bankruptcy judge, the bankruptcy judge may conduct the jury trial if specially designated to exercise such jurisdiction by the district court and with the express consent of all the parties.

2. The Interim Bankruptcy Court Rule of 1983 provides:

"THE RULE"

ADMINISTRATION OF BANKRUPTCY SYSTEM

(a) Emergency resolution

The purpose of this rule is to supplement existing law and rules in respect to the authority of the bankruptcy judges of this district to act in bankruptcy cases and proceedings until Congress enacts appropriate remedial legislation in response to the Supreme Court's decision in *Northern Pipeline Construction Co. v. Marathon Pipe Line Co.*, — U.S. —, 102 S. Ct. 2858 (1982), or until March 31, 1984, whichever first occurs.

The judges of the district court find that exceptional circumstances exist. These circumstances include: (1) the unanticipated unconstitutionality of the grant of power to bankruptcy judges in section 241(a) of Public Law 95-598; (2) the clear intent of Congress to refer bankruptcy matters to bankruptcy judges; (3) the specialized expertise necessary to the determination of bankruptcy matters; and (4) the administrative difficulty of the district courts' assuming the existing bankruptcy caseload on short notice.

Therefore, the orderly conduct of the business of the court requires this referral of bankruptcy cases to the bankruptcy judges.

(b) Filing of bankruptcy papers

The bankruptcy court constituted by § 404 of Public Law 95-598 shall continue to be known as the United States Bankruptcy Court of this district. The Clerk of the Bankruptcy Court is hereby designated to maintain all files in bankruptcy cases and adversary proceedings. All papers in cases or proceedings arising under or related to Title eleven shall be filed with the Clerk of the Bankruptcy Court regardless of whether the case or proceeding is before a bankruptcy judge or a judge of the district court, except that a judgment by the district judge shall be filed in accordance with Rule 921 of the Bankruptcy Rules.

(c) Reference to bankruptcy judges

(1) All cases under Title eleven and all civil proceedings arising under Title eleven or arising in or related to cases under Title eleven are referred to the bankruptcy judges of this district.

(2) The reference to a bankruptcy judge may be withdrawn by the district court at any time on its own motion or on timely motion by a party. A motion for withdrawal of reference shall not stay any bankruptcy matter pending before a bankruptcy judge unless a specific stay is issued by the district court. If a reference is withdrawn, the district court may retain the entire matter, may refer part of the matter back to the bankruptcy judge, or may refer the entire matter back to the bankruptcy judge with instructions specifying the powers and functions that the bankruptcy judge may exercise. Any matter in which the reference is withdrawn shall be reassigned to a district judge in accordance with the court's usual system for assigning civil cases.

(3) Referred cases and proceedings may be transferred in whole or in part between bankruptcy judges within the district without approval of a district judge.

(d) Powers of bankruptcy judges

(1) The bankruptcy judges may perform in referred bankruptcy cases and proceedings all acts and duties necessary for the handling of those cases and proceedings except that the bankruptcy judges may not conduct:

(A) a proceeding to enjoin a court;

(B) a proceeding to punish a criminal contempt--

(i) not committed in the bankruptcy judge's actual presence; or

(ii) warranting a punishment of imprisonment;

(C) an appeal from a judgment, order, decree, or decision of a United States bankruptcy judge; or

(D) jury trials.

Those matters which may not be performed by a bankruptcy judge shall be transferred to a district judge.

(2) Except as provided in (d)(3), orders and judgments of bankruptcy judges shall be effective upon entry by the Clerk of the Bankruptcy Court, unless stayed by the bankruptcy judge or a district judge.

(3)(A) Related proceedings are those civil proceedings that, in the absence of a petition in bankruptcy, could have been brought in a district court or a state court. Related proceedings include, but are not limited to, claims brought by the estate against parties who have not filed claims against the estate. Related proceedings do not include: contested and uncontested matters concerning the administration of the estate; allowance of and objection to claims against the estate; counterclaims by the estate in whatever amount against persons filing claims the estate [*sic*]; orders in respect to obtaining credit; orders to turn over property of the estate; proceedings to set aside preferences and fraudulent conveyances; proceedings in respect to lifting of the automatic stay; proceedings to determine dischargeability of particular debts; proceedings to object to the discharge; proceedings in respect to the confirmation of plans; orders approving the sale of property where not arising from proceedings resulting from claims brought by the estate against parties who have not filed claims against the estate; and similar matters. A proceeding is not a related proceeding merely because the outcome will be affected by state law.

(B) In related proceedings the bankruptcy judge may not enter a judgment or dispositive order, but shall submit findings, conclusions, and a proposed judgment or order to the district judge, unless the parties to the proceeding consent to entry of the judgment or order by the bankruptcy judge.

(e) District court review

(1) A notice of appeal from a final order or judgment or proposed order or judgment of a bankruptcy judge or an application for leave to appeal an interlocutory order of a bankruptcy judge, shall be filed within 10 days of the date of entry of the judgment or order or of the lodgment of the proposed judgment or order. As modified by section (e)2A and B of this rule, the procedures set forth in Part VIII of the Bankruptcy Rules apply to appeals of bankruptcy judges' judgments and orders and the procedures set forth in Bankruptcy Interim Rule 8004 apply to applications for leave to appeal interlocutory orders of bankruptcy judges. Modification by the district judge or the bankruptcy judge of time for appeal is governed by Rule 802 of the Bankruptcy Rules.

(2)(A) A district judge shall review:

(i) an order or judgment entered under paragraph (d)(2) if a timely notice of appeal has been filed or if a timely application for leave to appeal has been granted;

(ii) an order or judgment entered under paragraph (d)(2) if the bankruptcy judge certifies that circumstances require that the order or judgment be approved by a district judge, whether or not the matter was controverted before the bankruptcy judge or any notice of appeal or application for leave to appeal was filed; and

(iii) a proposed order or judgment lodged under paragraph (d)(3), whether or not any notice of appeal or application for leave to appeal has been filed.

(B) In conducting review, the district judge may hold a hearing and may receive such evidence as appropriate and may accept, reject, or modify, in whole or in part, the order or judgment of the bankruptcy judge, and need give no deference to the findings of the bankruptcy judge. At the conclusion of the review, the district judge shall enter an appropriate order or judgment.

(3) When the bankruptcy judge certifies that circumstances require immediate review by a district judge of any matter subject to review under paragraph (d)(2), the district judge shall review the matter and enter an order or judgment as soon as possible.

(4) It shall be the burden of the parties to raise the issue of whether any proceeding is a related proceeding prior to the time of the entry of the order of judgment of the district judge after review.

(f) Local rules

In proceedings before a bankruptcy judge, the local rules of the bankruptcy court shall apply. In proceedings before a judge of the district court, the local rules of the district court shall apply.

(g) Bankruptcy rules and title IV of Public Law 95-598

Courts of bankruptcy and procedure in bankruptcy shall continue to be governed by Title IV of Public Law 95-598 as amended and by the bankruptcy rules prescribed by the Supreme Court of the United States pursuant to 28 U.S.C. § 2075 and limited by SEC. 405(d) of the Act, to the extent that such Title and Rules are not inconsistent with the holding of *Northern Pipeline Construction Co. v. Marathon Pipe Line Co.*, — U.S. —, 102 S. Ct. 2858 (1982).

(h) Effective date and pending cases

This rule shall become effective December 25, 1982, and shall apply to all bankruptcy cases and proceedings not governed by the Bankruptcy Act of 1898 as amended, and filed on or after October 1, 1979. Any bankruptcy matters pending before a bankruptcy judge on December 25, 1982 shall be deemed referred to that judge.

BRIEF BANK — "SUMMARY SHEET"

Printed Mon.-1/11/99 (16:46)

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*

IN RE MARUKO, INC. (MARUKO, INC. v. UST)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*

CTA9

3. ("CCN") ***CURRENT*** CASE NO.

No.: 98-55544

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*

No.: No. 97-CV-1145-K

Court: S.D.Cal. (District Judge Keep); 219 B.R. 567 (S.D.Cal. Feb. 24, 1998)

(Identify judge & cite, if any)

5. ("SO") ***SOURCE***

U.S. TRUSTEES

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*

Filed: August 19, 1998

Type: UST'S APPELLEE BRIEF

7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g., "UST/OGC"]*

Paul W. Bridenhagen (UST/OGC)
Mary M. Testerman (UST/Region 15-San Diego)

(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***

BANKRUPTCY

9. ("SU") ! ***SUMMARY*** OF KEY ISSUE(s)

&

√ Any Miscellaneous ***BACKGROUND***

! 28 U.S.C. 1930(a)(6), as amended, requires a "quarterly fee" to be paid in every case pending under chapter 11 based upon disbursements made in the case, without distinction as to the types of disbursements or to whether they have been made pre- or post-confirmation.

√ **Background:** District court properly rejected attempts to limit fees payable post-confirmation to the minimum amount. When Congress amended section 1930 to include fees on post-confirmation disbursements, it simply extended a debtor's obligation to pay quarterly fees into the post-confirmation period.

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[ORAL ARGUMENT REQUESTED]

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

No. 98-55544

IN RE MARUKO, INC.

Debtor.

****

MARUKO, Inc.
Appellant,
v.

UNITED STATES TRUSTEE,

Appellee.

BRIEF FOR THE APPELLEE

HARRY A. SHERR
United States Trustee

JOHN P. BOYL
Assistant U.S. Trustee

MARY M. TESTERMAN, (SBN 163514)
Attorney for U.S. Trustee
402 West Broadway, Suite 600
San Diego, CA 92101
(619) 557-5013

MARTHA L. DAVIS
General Counsel

PAUL BRIDENHAGEN
Attorney
Office of General Counsel
Department of Justice
Executive Office for
United States Trustees
901 E. St, N.W., Suite 780
Washington, D.C. 20530
(202) 307-1399

August 19, 1998

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JURISDICTION

The bankruptcy court had subject matter jurisdiction pursuant to 28 U.S.C. § 157. The district court had jurisdiction to hear the United States Trustee's appeal pursuant to 28 U.S.C. § 158(a). Appellee (hereinafter "United States Trustee") agrees with Appellant (hereinafter "Maruko") that this Court has appellate jurisdiction.[1]

STATEMENT OF THE ISSUE PRESENTED FOR REVIEW

The United States Trustee disagrees with Maruko's statement of the various issues that are properly before this Court. Maruko Brief, at 2-4. As set forth in the district court's order, the bankruptcy court made two critical rulings below: 1) that the application of section 1930(a)(6) to Maruko did not trigger or modify the confirmed plan and was not unconstitutional, and; 2) that the term "disbursement" under section 1930(a)(6) is limited to payments "coming from the bankruptcy estate." EOR, at 01465 (Ex. 57). As a result of these holdings, the bankruptcy court concluded that section 1930(a)(6) could be enforced without any constitutional violations, but it limited Maruko's obligation to pay quarterly

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[1] Although styled as a Joint Brief for Appellant Maruko and Japanese Co-Owners, the United States Trustee notes that only Maruko filed a Notice of Appeal in this case. Thus, the Japanese Co-Owners are not properly parties to this appeal. Fed.R.App.Pro. 4(a). Therefore, the United States Trustee will refer to that brief and the arguments therein belonging to Maruko.

fees following plan confirmation. Instead of requiring Maruko to pay a fee based on all disbursements made after the plan was confirmed on February 13, 1994, the bankruptcy court held that Maruko was only obligated to pay $250 per quarter, the minimum amount under § 1930(a)(6). EOR, at 01465 (Ex. 57).

As the district court noted, the United States Trustee appealed the second holding concerning the meaning of the term disbursement, but Maruko filed no cross-appeal. Consequently, the district court properly determined that Maruko's attempt to resurrect issues not preserved by the filing of a proper cross-appeal was untimely and improper. EOR, at 01466 (Ex. 57) citing <u>In re Ranch Ltd.</u> , 146 B.R. 833, 837 (Bankr. D. Colo. 1992) and <u>Frymine v. Paine Webber, Inc.</u>, 107 BR. 507, 514 (Bankr. E.D. Pa. 1989). The district court's decision in this regard is consistent with the law of the Supreme Court and this Circuit. <u>United States v. Bajakjian</u>, 118 S.Ct. 2028, 2032 & 2038 n. 11 (1998)(noting that respondent's failure to cross-appeal precluded consideration of issue not preserved below), <u>aff'g</u> 84 F.3d 334, 337 (9th Cir. 1996)(an appellee seeking a modification of a lower court's judgement must file a cross-appeal). As a consequence, the only issue properly presented before this court is the following:

> **Whether the district court erred when it ordered Maruko to pay quarterly fees on all post-confirmation disbursements made by it, according to the schedule for payments set forth in 28 U.S.C. § 1930(a)(6)**

STATEMENT OF THE CASE

This is a dispute over the calculation and collection of post-confirmation quarterly fees in a pending Chapter 11 bankruptcy case. On October 31, 1991, Maruko filed a petition for relief under the reorganization provisions of chapter 11 of the Bankruptcy Code. Maruko paid United States Trustee quarterly fees as required by 28 U.S.C. § 1930(a)(6) based upon its disbursements in the chapter 11 proceeding until confirmation of its chapter 11 plan on February 13, 1994. This was consistent with the operative language of 28 U.S.C. § 1930(a)(6) as it then existed, which required a fee to be paid each quarter in every chapter 11 case until "a plan is confirmed or the case is converted or dismissed, whichever occurred first."

On January 26, 1996, Congress amended section 1930(a)(6), deleting the words "until a plan is confirmed or" Section 211 of the Balanced Budget Downpayment Act, I, Pub. L. No. 104-99, 110 Stat. 26, 37-38 (1996) ("Public Law 104-99") (January 26, 1996). The amendment deleted plan confirmation as an event that terminated the fee payment obligation. Thus, Congress extended into the post-confirmation period the obligation to pay quarterly fees in all pending chapter 11 cases based on the amount of disbursements made in the case. <u>In re CF & I Fabricators of Utah, Inc.</u> -- F3d. --, 1998 WL 348030, *3 (10th Cir. 1998).

In accordance with this statutory change, the United States

Trustee requested Maruko to pay United States Trustee quarterly fees based upon its post-confirmation disbursements from and after January 27, 1996, because the case was still open and pending under chapter 11. In response, on September 17, 1996, Maruko filed a Motion for Determination that Reorganized Debtor has no Obligation for the Payment of Quarterly Fees to the United States Trustee pursuant to 28 U.S.C. §1930(a)(6) as Amended by Section 211 of the Balanced Budget Downpayment Act. EOR, at 0399 (Ex. 7). Subsequently, the Official Committee of Creditors Holding Unsecured Claims ("OCC"), Certain Japanese Co-Owners/Creditors of Maruko, ("Co-Owners"), by and through separate counsel, filed joinders to Maruko's Motion. EOR, at 0442-0457 (Exs. 10 & 11). Extensive briefing ensued, wherein Maruko, the OCC and the Co-Owners raised, and the United States Trustee opposed, various statutory and constitutional arguments against the collection of any post-confirmation fees from Maruko. EOR, at 0458-0550 (Exs. 12-23). In the alternative, Maruko, the OCC and the Co-Owners argued that if any fees were required to be paid, no post-confirmation payments made by reorganized Maruko should be considered in calculating the amount of the quarterly fees due. Under this alternative argument, they asserted that only the minimum fee set forth in section 1930(a)(6) could be charged. See, e.g., EOR, at 0516 (Ex. 21). The hearing on these issues occurred on December 12, 1996 and the bankruptcy court took the matter under submission.

On March 12, 1997, the bankruptcy court (Hon. Louise DeCarl Adler, Chief Judge) filed its Memorandum Decision.[2] EOR, at 0541-0549 (Ex. 24). This decision first held, in pertinent part, that 28 U.S.C. § 1930(a)(6), as amended, did not modify Maruko's confirmed plan, was constitutional and therefore required Maruko to pay post-confirmation quarterly fees from and after January 26, 1996. Second, the bankruptcy court held that the fee was to be calculated based upon disbursements from Maruko's bankruptcy estate. Upon further concluding that Maruko's bankruptcy estate ceased to exist post-confirmation, the court ordered the calculation and payment of the fee at the minimum applicable statutory rate. The bankruptcy court entered an Order in accordance with its Memorandum Decision on April 2, 1997. After unsuccessfully seeking reconsideration, the United States Trustee filed a timely Notice of Appeal of the bankruptcy court's April 2, 1997 Order, as well as an Objection to Jurisdiction of the Bankruptcy Appellate Panel. EOR (Exs. 31 & 40). Neither Maruko, nor any other party, filed a Notice of Appeal or Notice of Cross-Appeal concerning the April 2, 1997 Order. EOR, at 1712 (Ex. 62).

In a decision dated February 5, 1998, and subsequently

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[2] This decision is published at 206 B.R. 225 (Bankr. S.D. Cal. 1997)

amended on February 24, 1998, the district court (Hon. Judith N. Keep) reversed that portion of the bankruptcy court's decision limiting Maruko's obligation to pay quarterly fees to the minimum amount prescribed by the statute.[3] As discussed above, the district court declined to consider arguments challenging the constitutionality of amended section 1930(a)(6), but did, in the alternative, uphold the government's position on the applicability of the fees and the constitutionality of that application. Only Maruko, seeking to minimize the imposition of the quarterly fees, appealed from the district court's decision. EOR, at 1482 (Ex. 58).

SUMMARY OF THE ARGUMENT

The plain language of 28 U.S.C. § 1930(a)(6), as amended, requires a quarterly fee to be paid in every case pending under chapter 11 based on disbursements that have been made in the case, without distinction as to the types of disbursements or to whether the disbursements have been made pre- or post-confirmation. The majority of bankruptcy and district courts, including the district court below, have rejected attempts to limit fees payable post-confirmation to the minimum amount as being contrary to the plain language of section 1930(a)(6), the

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[3] In re Maruko, 219 B.R. 567 (S.D. Cal. 1998). The Amended Order (EOR, at 1463-1481) was issued sua sponte and does not appear to differ materially from the original order. Nonetheless, all citations to the district court's decision will be made to the Amended Order.

intent of Congress and rules of statutory construction, and without cognizable support in the case law interpreting the statute or its legislative history.

Section 1930(a)(6) does not distinguish between pre- and post-confirmation disbursements. Indeed, when Congress amended section 1930 to include fees on post-confirmation disbursements, it simply extended a debtor’s obligation to pay quarterly fees into the post-confirmation period. Rules of statutory construction require that a word be given the same meaning in all contexts within a single statute. Accordingly, the word "disbursements" found in section 1930 must be defined in the same way post-confirmation as it is pre-confirmation. Because pre-confirmation the term "disbursements" has been construed expansively to cover all disbursements of a debtor, logic dictates that post-confirmation "disbursements" also include all disbursements by a debtor. Further, the narrow definition of the term “disbursements” urged by Maruko as being only payments made from the bankruptcy estate will seriously undermine the mechanism that Congress has established to fund the United States Trustee Program.

Although failing to cross-appeal, Maruko seeks to raise several additional issues in its brief. Maruko argues that section 1142 of the Bankruptcy Code limits a bankruptcy court's jurisdiction to enforce payment of post-confirmation quarterly fees. Maruko Brief, at 15-17 This argument is without merit, however, because section 1142 is not jurisdictional. Instead, the grant of jurisdiction to the bankruptcy courts is made pursuant to the Judicial Code, 28 U.S.C. §§ 1334 and 157. As both of the courts below correctly recognized, the post-confirmation quarterly fees is a statutory user fee that arises independent of the plan due to the pendency of the bankruptcy case. EOR, at 1466 (Ex. 57). Pursuant to sections 1334 and 157(b)(1) of title 28, the bankruptcy court has jurisdiction to compel the debtor to comply with all laws relative to its bankruptcy case. Maruko's arguments to the contrary are simply wrong as a matter of law.

Maruko's argument that the United States Trustee's efforts to collect post-confirmation quarterly fees is an impermissible attempt to modify a confirmed plan is also without merit. The United States Trustee is merely attempting to collect a statutory user fee that arose post-confirmation and is, therefore, not affected by the plan. As the Supreme Court's decision in <u>Holywell v. Smith</u>, 503 U.S. 47, 58-59 (1992) makes clear, the imposition of fees on a debtor's post-confirmation activities cannot be said to conflict with either the reorganization plan or the Bankruptcy Code. Maruko's contention, citing <u>Plaut v. Spendthrift Farm, Inc.</u>, 514 U.S. 211 (1995), that Congress has violated separation of powers principles is also without basis, because payment of the quarterly fee does not require modification of any final judicial order.

ARGUMENT

I. PURSUANT TO 28 U.S.C. § 1930(a)(6), QUARTERLY FEES ARE CALCULATED BASED ON ALL DISBURSEMENTS MADE DURING THE PENDENCY OF A CHAPTER 11 CASE

The district court below noted that it could choose three options in resolving this appeal: "1) uphold the bankruptcy court's interpretation of 'disbursement' under § 1930(a)(6); 2) hold that all disbursements both pre- and post-confirmation are subject to the quarterly fee requirements under that section; or 3) hold that only certain types of disbursements are subject to the quarterly fee." EOR, at 1467-68 (Ex. 57). Applying this Court's decision in St. Angelo v. Victoria Farms, Inc., 38 F.2d 1525, 1534 (9th Cir.1994), the district court stated that "[g]iven that Congress amended § 1930(a)(6) to include post-confirmation disbursements, this court finds that quarterly fees should be applied to all of Maruko's post-confirmation payments. This court finds no reason to limit which type of disbursements should be subject to the fee." Thus, the district court correctly chose the second option listed above. For the reasons set forth below, that decision was a correct construction of the plain language of amended section 1930(a)(6) and this Court's decision in St. Angelo v. Victoria Farms, and should be affirmed.

A. As Originally Enacted, The Plain Language Of 28 U.S.C. § 1930(a)(6) Required Quarterly Fees To Be Paid During the Pre-Confirmation Period Based On All Disbursements Made During The Pendency Of A Chapter 11 Bankruptcy Case

On October 27, 1986, the President signed into law the Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1986, Pub. L. No. 99-554, 100 Stat. 3088 (1986)("1986 Act"). The 1986 Act expanded the pilot United States Trustee Program from 18 judicial districts to a permanent nationwide program. Section 117 of the 1986 Act amended 28 U.S.C. § 1930(a) by, among other things, creating a new quarterly fee for chapter 11 cases. Pursuant to the 1986 Act, a new subsection (6) was added to section 1930(a) following subsections (a)(1) - (5). As originally enacted, section 1930(a)(6) provided as follows:

> (6) In addition to the filing fee paid to the clerk, a quarterly fee shall be paid to the United States trustee, for deposit in the Treasury, in each case under chapter 11 of title 11 for each quarter (including any fraction thereof) until a plan is confirmed or the case is converted or dismissed, whichever occurs first. The fee shall be $150 for each quarter in which **disbursements** total less than $15,000; $300 for each quarter in which **disbursements** total $15,000 or more but less than $150,000; $750 for each quarter in which **disbursements** total $150,000 or more but less than $300,000; $2,250 for each quarter in which **disbursements** total $300,000 or more but less that $3,000,000; $3,000 for each quarter in which **disbursements** total $3,000,000 or more. The fee shall be payable on the last day of the calendar month following the calendar quarter for which the fee is owed.

(emphasis added).

Section 1930(a)(6) is straightforward. It requires payment of a statutory fee on a quarterly basis according to a sliding scale, which is tied to the amount of disbursements made in a case. As originally enacted, the quarterly fee applied in each pending chapter 11 case until a plan of reorganization was confirmed, or the case was converted or dismissed. The word "disbursement" is not, however, defined in the Bankruptcy Code, nor under any provisions of Title 28.

As this Court has previously recognized, however, there is no applicable legislative history concerning the 1986 Act addressing the definition of the word disbursement. St. Angelo v. Victoria Farms, Inc., 38 F.2d 1525, 1534 (9th Cir.1994). Because neither the statute, nor its legislative history defines the word disbursement, its meaning must be derived from the plain language of the statute and accepted canons of statutory construction. St. Angelo v. Victoria Farms, 38 F.2d at 1534, quoting Perrin v. United States, 444 U.S. 37, 42 (1979) ("[a] fundamental canon of statutory construction is that ... words will be interpreted as taking their ordinary, contemporary, common meaning.").

Applying its ordinary meaning, the Victoria Farms Court addressed the issue of what constitutes a disbursement under section 1930(a)(6) and construed the term “disbursements” very broadly to mean any payment made by or on behalf of the debtor.

Id. The Court reversed the district court's holding that a payment to a secured creditor by an escrow agent from the proceeds of the sale of the secured property did not constitute a disbursement. 38 F.3d at 1534-35. Noting the need to construe the term according to its ordinary meaning, the Court observed that the definition of "disburse" in Webster's Third New International Dictionary, was "to expend . . . pay out." Id. It further observed that the statute drew no distinction between payments to secured and unsecured creditors and that the sparse legislative history on the issue suggested Congress intended an expansive definition. Id. at n.10 and accompanying text. Accordingly, the Court determined that the term disbursements includes all payments made from the property of the debtor’s estate. Id.

Numerous courts have followed the broad construction of the term “disbursement” set forth in St. Angelo v. Victoria Farms during the pre-confirmation period. See, e.g., In re Flatbush Associates, 198 B.R. 75 (Bankr. S.D. N.Y. 1996); In re Hays Builders, Inc., 144 B.R. 778, 780 (Bankr.W.D.Tenn. 1992); In re Wernerstruck, Inc., 130 B.R. 86, 89 (S.D. 1991); In re Ozark Beverage, Inc., 105 B.R. 510, 511-12 (Bankr. E.D. Mo 1989).

It is understandable that the Victoria Farms Court discussed the “property of the estate” in connection with the term disbursements, since the disbursements in that case were all from property of the estate and the real issue before the Court was whether payments made from the proceeds of the sale of secured, versus unsecured, property constituted disbursements under section 1930(a)(6). As the district court below held, Victoria Farms cannot fairly be read as restricting the ordinary meaning of the term disbursements, which includes all payments, to “property of the estate.” The district court noted that Congress simply intended to extend the same fee into the post-confirmation period and did not intend to narrow the definition of disbursements. EOR, at 1470 (Ex. 57), citing In re Sedro-Woolley Lumber Co., Inc., 209 B.R. 987, 989 (Bankr. W.D. Wash.1997) ("To attribute substantive meaning to the phrase 'of the estate' is to impute an intention to the Court which it simply could not have formed in the circumstances as they existed at the time."); In re PJ. Keating Co., 205 B.R. 663, 665 (Bankr. D. Mass. 1997). See also In re A.H. Robbins Co., Inc.,219 B.R. 145, 147 (Bankr. E.D. Va., 1998) (“no cause to distinguish between payments made out of the bankruptcy estate and those derived from another source, because prior to the [1996] Amendment there was simply no other source for United States Trustee fees aside from the bankruptcy estate.”).

The district court further noted that “[w]ithout such an interpretation, the amendment would have little effect, the sliding scale of payments required by § 1930(a)(6) would be moot since post-confirmation payments would not be considered in calculating quarterly fees.” EOR, at 1470 (Ex. 57). Because Victoria Farms plainly held that the term disbursements is to be construed broadly, Maruko’s reliance on the phrase “property of the estate” to limit the definition of disbursements is misplaced.

Further, the legislative history of the 1986 Act indicates that Congress intended the users of the bankruptcy system to pay its incumbent costs. H.R. No. 764, 99th Cong., 2d Sess. 22, 26 (1986), reprinted in 1986 U.S. Code and Admin. News 5227 (1986): "The United States Trustee Program should not have to be self-funding. It provides a great service to our country's bankruptcy system. However, in this time of budget deficit concerns, self-funding becomes a necessity." United States Trustee v. Prines, 867 F.2d 478, 484(8th Cir. 1989)([t]he purpose of the quarterly fee provision is to ensure the trustee program is 'paid for by the users of the bankruptcy system'..."). Thus, Congress expressly intended that the beneficiaries of the bankruptcy system pay the incumbent costs associated with its benefits. The bankruptcy estate is not a user of a chapter 11 bankruptcy reorganization, it is merely the repository of the debtor's property between the filing of the case and confirmation of the plan. It is the debtor that seeks reorganization that is the user of the system and the entity that Congress intended would pay quarterly fees on all disbursements made during the case. Maruko’s focus on the isolated phrase “property of the estate” is, therefore, unduly narrow and incorrect.

B. As the Majority of Reported Cases Have Held, Nothing In The Recent Legislation Extending Quarterly Fee Obligations Into The Post-Confirmation Period Limits The Term "Disbursements" Or Otherwise Supports Maruko’s Attempt To Minimize Its Quarterly Fee Obligations

(1) The January 27, 1996 Amendment To Section 1930(a)(6) Extended Post-Confirmation The Same Quarterly Fee Requirements As Imposed Pre-Confirmation By The 1986 Act

On January 27, 1996, section 1930(a)(6) was amended pursuant to section 211 of the Balanced Budget Downpayment Act, I, Pub. L. No. 104-99, 110 Stat. 26, 37-38 (1996) ("Public Law 104-99"), by striking out the words "a plan is confirmed." The portion of section 1930(a)(6) which was amended (hereinafter "January 1996 Amendment" or "amended section 1930(a)(6)") provides as follows, with the language stricken by Public Law 104-99 redlined in the text:

> In addition to the filing fees paid to the clerk, a quarterly fee shall be paid to the United States trustee in each case under chapter 11 of title 11 for each quarter (including any fraction thereof) until [~~a plan is confirmed or~~] the case is converted or dismissed, whichever occurs first....

As is evident from the above-quoted text, the only change in the statute was the deletion of the words "a plan is confirmed or" from the text of section 1930(a)(6). The intended effect of this amendment was to extend a debtor's obligation to pay quarterly fees into the post-confirmation period. McLean Square Associates, G.P., 201 B.R. 436, 439 (Bankr. E.D. Va. 1996).

Although the legislative history of amended section 1930(a)(6) does not address the meaning of the word disbursement, it does very clearly reflect Congress' intent to extend post-confirmation the same quarterly fee payment made pre-confirmation under the 1986 Act. Both House Report 104-196 and the Joint Explanatory Statement of House Conference Report 104-378 provide that the quarterly fee assessment will simply continue post-confirmation, without discussing any change in the calculation of the fee:

> In addition, under section 111, the conferees agree to include an extension of post-confirmation quarterly fee payments made under Chapter 11 as proposed in both the House and Senate bills and expect that these fees will apply to all pending Chapter 11 cases with confirmed reorganization plans.

H.R. Conf. Rep. 104-378, 104th Cong., 1st Sess. (December 4, 1995); 141 Cong. Rec. H13894 (December 4, 1995) (emphasis added).

Consequently, as the weight of authority has held, the only logical inference to be drawn from Congress' failure to discuss a different basis for calculating the quarterly fee post-confirmation is that Congress intended that the fee be calculated on all disbursements post-confirmation, just as it is calculated on all disbursements pre-confirmation. EOR, at 1463, 1466-67

(Amended Order)(Congress did not indicate expressly or implicitly that it intended to change the meaning of "disbursement" simply because the quarterly fee would now be applied to the post-confirmation setting)[4]; In re A.H. Robins Company, Inc., 219 B.R. 145, 149 (Bankr E.D. Va. 1998)[5]; In re Hess' Sons, Inc., 218 B.R. 354 (Bankr. D. Md., 1998); In re Boulders on the River, Inc., 218 B.R. 528 (D. Or., 1997); In re Roy Stanley, Inc., 217 B.R. 23 (Bankr. N.D. N.Y. 1997); In re Pars Leasing; 217 B.R. 218, 219-220 (Bankr. W.D. Tex. 1997); In re Gates Community Chapel of Rochester, Inc., 212 B.R. 220, 225 (Bankr. W.D. N.Y.1997); In re Corporate Business Products, Inc., 209 B.R. 951 (Bankr. C.D. Cal. 1997); In re Sedro-Woolley Lumber Co., Inc., 209 B.R. 987 (Bankr. W.D. Wa. 1997); In re Keating, 205 B.R. 663 (Bankr. D. Mass. 1997); In re Bushnell, 1997 WL 70131860 (Bankr. D. Vt. 1997).

(2) Quarterly Fee Legislation Enacted On September 30, 1996 Demonstrates Congress' Intent To Increase Revenues And To Have Amended Section 1930(a)(6) Construed Broadly

As with the 1986 Act, there is no legislative history accompanying the January 1996 amendment that extended the obligation to pay quarterly fees into the post-confirmation

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[4] In re Maruko, 219 B.R. 567 (S.D. Cal, 1998).

[5] Although cited as a bankruptcy court decision, the district court concurred in this decision. A copy of the order in In re A.H. Robbins is attached in the addendum to this brief.

period that directly addresses the meaning of the word "disbursement." The legislative history of the January, 1996 amendment does, however, clearly articulate the reason for this amendment. As explained in the initial House Report from the Committee on Appropriations, which was reported from the House of Representatives on July 19,1995, Congress expressly considered the need to increase quarterly fee revenues by extending the fee into the post-confirmation period. In re Keating Co., 205 B.R. at 664 (quoting H.R. Rep. No. 104-196, 104th Cong., 1st Sess. at 16-17 (1995)).

On September 30, 1996, Additional legislation was enacted following the January, 1996 amendment, on September 30, 1996, to further augment quarterly fee revenues. That legislation was contained in Section 109 ("Section 109") of the General Provisions for the Department of Justice contained in Title I of the Omnibus Appropriations Act for Fiscal Year 1997, Public Law 104-208, 110 Stat. 3009, and affected quarterly fees in two ways. First, Section 109(a) amended the schedule of quarterly fee payments set forth in section 1930(a)(6). The schedule was amended by increasing the number of levels of fees from five to ten and by increasing significantly the maximum amount of fees applicable to large cases. For, example, in a case with quarterly disbursements of $3,000,000, the corresponding fee was increased from $5,000 to $8,000.

The second provision related to quarterly fees was set forth in Section 109(d), and provided that “notwithstanding any other provision of law, the fees under 28 U.S.C. 1930(a)(6) shall accrue and be payable from and after January 27, 1996, in all cases (including without limitation, any cases pending as of that date), regardless of confirmation status of their plans . . .” This amendment was enacted in response to bankruptcy court decisions which had held that post-confirmation quarterly fees could not be collected from debtors with plans confirmed prior to the effective date of the January 27, 1996 amendment to section 1930(a)(6). See, e.g., In re Precision Autocraft, Inc., 197 B.R. 901 (Bankr. W.D. Wash. 1996), rev’d United States Trustee vs. Precision Autocraft, Inc., et. al., 207 B.R. 692 (W.D. Wash. 1997)(reversing Bankruptcy Court based on §109(d) of Public law 104-208).

By enacting this clarifying legislation, Congress underscored its desire to increase quarterly fee revenues and expressly stated its intent that amended section 1930(a)(6) be applied to all pending chapter 11 cases, including those with plans confirmed prior to the effective date of the January 27, 1996 amendment.[6] The narrow construction of the term

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[6] The applicable conference report for this legislation expressly provides that the Amendment serves to "clarify that fees collected under post-confirmation status are to be assessed in all pending chapter 11 cases." H.R. Conf. Rep. No. 3620, 104th Cong. Sess., 142 Cong. Rec. H11644, H11850 (daily ed.

disbursement urged by Maruko is not only contrary to Congress' plain intent but would also defeat its intent and, therefore, it should be rejected. See, In re Corporate Business Products, Inc., 209 B.R. 951, 954 (Bankr. C.D. Cal. 1997) ("[i]t is implausible that Congress amended the statute in January of 1996 to make the elaborate sliding scale of fees applicable post confirmation, only to have the minimum fee apply post-confirmation."); In re Hess' Sons, Inc., 218 B.R., at 360 (Bankr. D. Md., 1998) ("as a revenue-generating mechanism, 28 U.S.C. § 1930(a)(6) fees are akin to a tax. Tax laws are to be construed in a light most favorable to the taxing authority as a matter of public policy"), citing Bob Jones University v. United States, 461 U.S. 574, 595 (1983)).

(3) Maruko's Construction Of The Term Disbursement Would Require Two Separate Definitions Of That Term And Is Contrary To The Plain Language Of The Statute

A final flaw in Maruko's analysis is that it necessarily requires differing definitions of the term disbursements for the pre-confirmation and post-confirmation periods. In the period before a reorganization plan is confirmed, courts would be bound by the broad definition of disbursements adopted in the St. Angelo v. Victoria Farms case. In the post-confirmation period, in contrast, Maruko urges that a much narrower definition

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September 28, 1996).

adopted. Black letter law dictates that such conflicting definitions of identical statutory language be avoided. Northern Plains Resource Council v. EPA, 645 F.2d 1349 (9th Cir. 1981).

The majority of courts have held that all disbursements made by the reorganized debtors constitute disbursements within the meaning of section 1930(a)(6). In re A.H. Robins Company, Inc., 219 B.R. 145, 149 (Bankr E.D. Va. 1998)[7]; In re Maruko, 219 B.R. 567 (S.D. Cal, 1998); In re Hess' Sons, Inc., 218 B.R. 354 (Bankr. D. Md., 1998); In re Boulders on the River, Inc., 218 B.R. 528 (D. Or., 1997); In re Roy Stanley, Inc., 217 B.R. 23 (Bankr. N.D. N.Y. 1997); In re Pars Leasing, 217 B.R. 218, 219-220 (Bankr. W.D. Tex. 1997); In re Gates Community Chapel of Rochester, Inc., 212 B.R. 220, 225 (Bankr. W.D. N.Y.1997); In re Corporate Business Products, Inc., 209 B.R. 951 (Bankr. C.D. Cal. 1997); In re Sedro-Woolley Lumber Co., Inc., 209 B.R. 987 (Bankr. W.D. Wa. 1997); In re Keating, 205 B.R. 663 (Bankr. D. Mass. 1997); In re Bushnell, 1997 WL 70131860 (Bankr. D. Vt. 1997). We urge this Court to do the same.

(4) Maruko's Arguments Concerning Payments Related To The Japanese Co-Owners Is Without Merit

Maruko argues that United States Trustee quarterly fees should not be based upon disbursements made by it to Japanese co-

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[7] Although cited as a bankruptcy court decision, the district court concurred in this decision. A copy of the order in In re A.H. Robbins is attached in the addendum to this brief.

owners from proceeds of the sales pursuant to 11 U.S.C. § 363(h) for two reasons: (1) that the turnover of funds from the "involuntary" sale of the Japanese co-owner's interests do not constitute disbursements because such interests were never property of the debtor's estate and (2) that since Maruko, as the section 363(h) "trustee" could not collect compensation based upon disbursements of co-owner's proceeds, the United States Trustee should not be entitled to use such proceeds in calculating its quarterly fee. These arguments are without merit

The section 363(h) sale was not an "involuntary" sale. The Debtor admits that the Japanese trustees caused Maruko to file for chapter 11 bankruptcy protection in the United States so it could take advantage of the remedy afforded by a section 363(h) sale. Maruko Brief, at 29. Further, the Debtor admits that the Japanese co-owners entered into stipulated judgments allowing the Maruko to sell the properties in this case. Id. Thus, both Maruko and the Japanese co-owners voluntarily consented to the jurisdiction of the United States bankruptcy court with regard to the section 363(h) property sales.

Maruko next argues that because the Japanese co-owner interests were never property of the estate, funds disbursed by the debtor to these co-owners is not subject to the United States Trustee quarterly fee and urges this court to follow the court's erroneous reasoning in the case, In re Meyer, 187 B.R. 650

(Bankr. W.D. Mo. 1995). That case interpreted this Court's decision in St. Angelo v. Victoria Farms[8] as limiting the term "disbursements" to property of the debtor's bankruptcy estate. This Court in St. Angelo v. Victoria Farms never held that a debtor's distribution of non-estate property could not be utilized in the calculation of United States Trustee quarterly fees; to the contrary, in the St. Angelo v. Victoria Farms decision, this Court provided the term "disbursement" with the broadest possible meaning in the factual context of the case by holding that the term meant "all payments". Id. at n. 10. Indeed, as the district court, in reversing the bankruptcy court in this case, correctly held "the St. Angelo court does not limit the language and intent of Congress in amending section 1930(a)(6), but instead provides an expansive definition for "disbursement" that is not limited to the bankruptcy estate context". In re Maruko, 219 B.R. 567, 571(S.D. Ca. 1998). Just as disbursements constitute **all payments** in the pre-confirmation context, disbursements include **all payments** of the reorganized debtor in the post-confirmation context. See, e.g., In re A.H. Robins Company, Inc., 219 B.R. 145, 149 (Bankr E.D. Va. 1998)(disbursements to be broadly construed); In re P.J. Keating Inc., 205 B.R. 663, 666-67(Bankr. D. Mass. 1997)(same).

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[8] St. Angelo v. Victoria Farms, Inc., 38 F.3d 1524(9th Cir. 1994), amended by 46 F. 3d 969(9th Cir. 1995).

Section 1930(a)(6) conditions the payment of United States Trustee quarterly fees **only** on the existence of a "case" and "disbursements". The payments made by the Maruko to the Japanese co-owners during the course of this case arose out of section 363(h) sales and the payments were made by Maruko in the context of the bankruptcy case. Thus, these payments constitute "disbursements" for the purpose of calculating United States Trustee quarterly fees. United States Trustee v. Prines, 867 F.2d 478, 484(8th Cir. 1989)([t]he purpose of the quarterly fee provision is to ensure the trustee program is 'paid for by the users of the bankruptcy system'...").

Second, Maruko asserts that, as the section 363(h) "trustee", it could not collect compensation based upon disbursements of co-owner's proceeds. It argues, therefore, the United States Trustee should not be entitled to use such proceeds in the calculation of United States Trustee quarterly fees. Maruko then notes that section 363(j) specifically prohibits the Trustee from charging a co-owner with the Trustee's statutory fees because those sales proceeds are held pursuant to a statutory trust created by section 363 of the Bankruptcy Code for the benefit of the co-owners who are not debtors and who never sought the services of the Trustee to effect a sale". Maruko Brief, at 31. Unlike section 363(j) which specifically excludes trustee compensation from being based upon such proceeds, there is no similar limitation on the payment of United States Trustee fees under 28 U.S.C. §1930(a)(6). Had Congress intended such a limitation, it should have provided same.

The limitation upon a trustee's compensation under section 363(j) and the requirement that a debtor pay United States Trustee quarterly fees based upon disbursements under §1930(a)(6) are not dissimilar in effect. Just as a trustee should not be able to profit from disbursements made from the receipt and distribution of non-estate property, a debtor should not be entitled to profit by invoking the jurisdiction of the bankruptcy court and oversight of the Office of the United States Trustee without having to pay the appropriate user fee. Maruko admits that it specifically invoked the jurisdiction of the United States courts to utilize the provisions of section 363(h), and these provisions were utilized by it the case and under the oversight the Office of the United States Trustee.[9] Maruko cannot now refuse to pay the user fee which arises as a result of its actions.

II. THE BANKRUPTCY COURT HAS JURISDICTION OVER A CLAIM FOR POST-CONFIRMATION QUARTERLY FEES.

Maruko, citing the now-reversed bankruptcy court's decision in <u>In re Gryphon at the Stone Mansion, Inc.</u>, 204 B.R. 460

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[9] The United States Trustee notes, analogously, that while a chapter 11 trustee's fees may be capped under section 326, all disbursements by the trustee are to be utilized in calculating United States Trustee fees under 28 U.S.C. §1930(a)(6).

(Bankr..W.D. Pa. 1997), rev’d 216 B.R. 764 (W.D. Pa. 1997) argues that the bankruptcy court lacked jurisdiction over the United States Trustee's claim for post-confirmation quarterly fees. The bankruptcy court in Gryphon held there was no such jurisdiction because it believed that a bankruptcy court's "post-confirmation jurisdiction is limited to ensuring that the terms of the plan are carried out." 204 B.R. at 462. The bankruptcy court misunderstood, as does Maruko, the nature of the jurisdictional inquiry.

The Gryphon bankruptcy court's opinion cited only one statutory provision, 11 U.S.C. § 1142, which does not purport to be a grant of jurisdiction. 204 B.R. at 462. Bankruptcy jurisdiction is defined in 28 U.S.C. § 1334, which is entitled "Bankruptcy cases and proceedings," and is found in Chapter 85 ("District Courts; Jurisdiction") of title 28. That statute provides that "the district courts shall have original but not exclusive jurisdiction of all civil proceedings arising under title 11, or arising in or related to cases under title 11. 28 U.S.C. § 1334(b). The grant of jurisdiction in section 1334 encompasses bankruptcy courts by virtue of § 157(a). In re Refrigeration Reclamation Corp., 186 B.R. 78, 80 (Bankr. M.D. Tenn. 1995) ("Title 11 nowhere purports to circumscribe the subject matter jurisdiction of the bankruptcy courts in chapter 11 cases."); Collier on Bankruptcy ¶ 1142.04[2] (15th ed. rev.

1998) ("[N]either section 1142 nor the terms of a plan confer jurisdiction upon a bankruptcy court. Bankruptcy jurisdiction is governed by 28 U.S.C. § 1334; this is so whether the matter at issue arises before or after confirmation of a plan.").

Thus, as the district court in Gryphon properly recognized in reversing the bankruptcy court, the jurisdictional inquiry must focus on section 1334, and should simply ask whether the proceeding is one "arising in * * * or related to [a] case[] under title 11." 28 U.S.C. § 1334(b). United States Trustee v. Gryphon at the Stone Mansion, Inc., 216 B.R., at 767.[10] As the courts have recognized, "related to" jurisdiction "is the broadest, [and] a court 'need only determine whether a matter is at least related to the bankruptcy.'" Donaldson, 104 F.3d 547, 552 (3d Cir. 1997), quoting In re Marcus Hook Dev. Park, Inc., 943 F.2d 261, 264 (3d Cir. 1991) (internal quotation marks omitted). See also, In re Boulders on the River, Inc., 218 B.R. 528, 542 (D. Or. 1997) (noting the Ninth Circuit's "related to" test is "whether the outcome of the proceeding could have any effect on the estate being administered" and holding that enforcement of a debtor's quarterly fee obligation is sufficiently related the administration of the estate to establish the jurisdiction of the bankruptcy court), quoting In re Fietz, 852 F.2d 455, 457 (9th Cir. 1988), quoting Pacor, Inc.

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[10] The district court's decision in Gryphon is currently on appeal to the Third Circuit, (Appeal No. 97-3670).

v. Higgings, 743 F.2d 984, 994 (3d Cir. 1984). The claim at issue in this case -- the United States Trustee's demand that Maruko pay the statutorily mandated post-confirmation quarterly fees -- clearly is "related to" the administration of the underlying bankruptcy proceeding, and thus the bankruptcy court properly ordered Maruko to pay post-confirmation fees. In re CF & I Fabricators of Utah, Inc., --F.3d --, 1998 WL 348030, *3 (10th Cir., June 30, 1998)(holding that enforcement of a the debtors' post-confirmation quarterly fee obligation is sufficiently "related to" the bankruptcy case to confer jurisdiction); In re A.H. Robbins, 219 B.R. at 152 (rejection bankruptcy court's jurisdictional analysis in Gryphon).

III. THE UNITED STATES TRUSTEE HAS NOT SOUGHT ANY MODIFICATION OF THE PLAN IN ATTEMPTING TO COLLECT POST-CONFIRMATION QUARTERLY FEES

Maruko also argues that collection of post-confirmation quarterly fees would result in an impermissible modification of the plan pursuant to 11 U.S.C. § 1127. This argument is without merit and is contrary to the clear weight of authority, including the only Circuit Court to have addressed the issue. See, e.g., In re CF & I Fabricators of Utah, Inc., -- F.3d --, 1998 WL 348030, *5 (10th Cir., June 30, 1998); In re A.H. Robbins Co, Inc., 219 B.R. 145, 148 (Bankr. E.D. Va. 1998); In re Maruko, Inc., 206 B.R.225, 228 (Bankr. S.D. Cal 1997); In re McLean Square Assoc., G.P., 201 B.R. 436 (E.D. Va. 1996). The United

States Trustee, by collecting a quarterly fee from the Maruko, is not attempting to modify in any way the treatment of any creditors or parties in interest under the Plan. The United States Trustee has sought only to collect a post-confirmation obligation of the Debtor that arose by operation of Federal bankruptcy law in, and by virtue of, the existence of the Debtor's bankruptcy case. _In re CF & I Fabricators of Utah, Inc._ -- F.3d --, 1998 WL 348030, *5 (UST fees does not modify plan, but is merely an "administrative expense attendant to an open case"), citing _In re McLean Square Assoc._, 201 B.R. 436, 441 (E.D. Va. 1996). Neither Maruko, nor its creditors (including the Japanese Co-owners) exist in a vacuum. Maruko is subject to the vagaries of the market and is not immune from post-confirmation changes in law. The United States Trustee does not believe that anyone would seriously contend that a post-confirmation change in tax statutes that imposed additional or higher income or sales taxes on a debtor's operation would necessarily result in the modification of its confirmed plan.[11]

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[11] The situation can also be analogized to one where a confirmed plan provides for the debtor to file one or more post-confirmation adversary proceedings but which does not provide that the debtor will have to pay any filing fees associated with the adversary proceedings. Like the United States Trustee's quarterly fees, the filing fees payable to the court clerk arise under section 1930 of title 28. For Maruko to argue that it is insulated from having to pay the adversary filing fees because its confirmed plan did not provide for the payment of such fees would be ludicrous. The confirmed plan does not bind the court clerk with respect to fees under section 1930 that arise post-confirmation, just as the plan

Congress' determination to extend the obligation to pay quarterly fees to open cases in which plans have been confirmed is indistinguishable from an increase in taxes. The fact that payment of such fees might make it more difficult for debtor to perform its plan obligations does not mean that the imposition of the fees modifies the plans. It simply means that the plan failed to take into account one of any number of potential roadblocks to the successful completion of the plans.

Maruko relies primarily on the now-reversed bankruptcy court decisions in <u>In re CF & I Fabricators of Utah, Inc.</u>, 199 B.R. 986 (Bankr. D. Utah 1996) and <u>In re Burk Development Co., Inc.</u>, 205 B.R. 778 (Bankr. D. La. 1997), as well as the Tenth Circuit Bankruptcy Appellate Panel's decision <u>In re Salina Speedway, Inc.</u>, 210 B.R. 851 (Bankr. 10th Cir. 1997) in support of its modification argument. However, the bankruptcy court in <u>Burk</u> expressly recognized that Congress could require payment of post-confirmation quarterly fees in confirmed cases without requiring reopening of confirmation orders. <u>Burk Development Co., Inc.</u>, 205 B.R., at 788; n. 23. Insofar as Maruko relies on <u>In re Salina Speedway</u> decision, it should be noted that this decision was effectively overruled by the Tenth Circuit. <u>In re CF & I Fabricators of Utah, Inc.</u> -- F.3d --, 1998 WL 348030, *8 (expressly rejecting holding in <u>In re Salina Speedway</u>). The

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does not bind the United States Trustee with respect to post-confirmation fees.

Tenth Circuit correctly recognized, as have most courts, that the United States Trustee is not seeking to modify the plan, but is only attempting to collect a debtor’s post-confirmation quarterly fee obligation. The United States Trustee urges this Court to reject Maruko’s arguments to the contrary.

IV. THE IMPOSITION OF POST-CONFIRMATION QUARTERLY FEES AT ISSUE HERE IS NOT AN IMPERMISSIBLE REOPENING BY CONGRESS OF A FINAL JUDGMENT.

Maruko argues further that enforcement of amended section 1930(a)(6) would be unconstitutional as a violation of the doctrine of Separation of Powers, citing Plaut v. Spendthrift Farm, Inc., 514 U.S. 211 (1995). In that case, the Supreme Court considered the constitutional validity of an amendment to the Securities and Exchange Act of 1934 that reopened final, unappealed dismissal judgments. Such a measure, the Court held, impermissibly trenched upon the power of the Judicial Branch to decide cases or controversies. Contrary to Maruko’s argument, that principle is not implicated by Congress's imposition of quarterly fees by amended section 1930(a)(6).

The argument that the fee is inconsistent with the plan is foreclosed by Holywell Corp. v. Smith, 503 U.S. 47, 58-59 (1992). In Holywell, the confirmed plan placed all of the debtor’s property in a trust and appointed a trustee to liquidate the trust assets and distribute the same to creditors of the debtors’ estates; the plan made no provision for the payment of post-confirmation taxes by the trustee or the filing of tax returns. The plan was confirmed by the Court, with no objection from the United States. When the IRS attempted to collect capital gains taxes, the trustee argued, inter alia, that the terms of the confirmed plan, which did not provide for the filing of tax returns or the payment of taxes post-confirmation, were binding on the United States and precluded the imposition of the taxes. 503 U.S. at 50-52.

The Supreme Court flatly rejected the trustee’s argument. The Court noted that the liability to pay the taxes did not accrue until the time for filing the returns, which was after the plan was confirmed in that case. The Court relied on the plain language of section 1141(a) of the Bankruptcy Code, which specifies that the plan is binding on the pre-confirmation claims of “creditors,” and section 101(10) of the Bankruptcy Code, which specifies that a “creditor” is an entity holding various pre-confirmation claims. The Court concluded that the plan could not bind the United States, or any other party, with respect to post-petition claims.

The post-confirmation fees at issue in the present case are no different than the post-confirmation taxes sought by the United States in Holywell. In each case, the liability did not accrue until events occurred post-confirmation. In re CF & I Fabricators of Utah, Inc. -- F.3d --, 1998 WL 348030, *6-7 (rejecting Separation of Powers argument).

V. MARUKO'S EQUITABLE OR POLICY ARGUMENTS CONCERNING THE AMOUNT OF QUARTERLY FEES MUST BE REJECTED

Maruko cites the now-reversed bankruptcy court decision in In re Beechknoll Nursing Homes, Inc., 206 B.R. 888 (Bankr. S.D. Ohio 1997) rev'd 216 B.R. 925 (S.D. Ohio 1998) for the proposition that quarterly fees should bear some relationship to the administration of cases. This argument is unavailing for several reasons.

First, contrary to the Maruko's argument, nothing in either the statute or its legislative history suggests that Congress intended to link the amount of effort expended by the United States Trustee in a given case with the amount of quarterly fees it pays. To the contrary, the relative ease of basing the quarterly fee on all disbursements indicates that Congress intended a straight forward system that was designed to avoid dragging the courts through a laborious process of deciding how much the United States Trustee should receive in each case.[12] Had Congress wished to create such a linkage, presumably it could have structured post confirmation fees along the lines of professional fees, which are limited according to various

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[12] Cf. In re Savage, 67 B.R. 700, 705-08 (D.R.I. 1986) (Congress established a percentage fee structure for compensating standing trustees that avoids the vicissitudes of individual cases to ensure that adequate funding exists to administer all cases).

criteria. 11 U.S.C. § 330 (court may award only reasonable compensation for actual and necessary services). Congress, however, has established the amount of the quarterly fee obligation relative only to the debtor's disbursements during the pendency of the chapter 11 case, with no other limitations.

Second, the Maruko’s argument disregards the fact that Congress has structured the fee in an equitable fashion and with full knowledge of the impact that it would have on chapter 11 debtors. Modest fees are assessed on a graduated scale according to the amount of disbursements made by a debtor. Congress also has imposed a ceiling so that no debtor would pay more than a fixed maximum in any quarter.

Finally, To the extent that Maruko is arguing equitable or policy considerations, such considerations do not allow a court to set aside the applicable bankruptcy law. Prisbrey v. Noble, 505 F.2d 170 (10th Cir. 1974). While bankruptcy courts apply equitable principles, a fundamental principle of equity is that "equity follows the law." Wedges v. Dixon County, 150 U.S. 182, 192 (1893). Congress has struck what it considers to be an equitable balance. Barring a constitutional infirmity, Congress' decision must be respected. TVA v. Hill, 437 U.S. 153 (1978).

CONCLUSION

The decision of the district court should be affirmed.

Respectfully submitted,

HARRY A. SHERR
United States Trustee

JOHN P. BOYL
Assistant U.S. Trustee

MARY M. TESTERMAN, (SBN 163514)
Attorney for the U.S. Trustee
402 West Broadway, Suite 600
San Diego, CA 92101
(619) 557-5013

MARTHA L. DAVIS
General Counsel

PAUL BRIDENHAGEN
Attorney
Office of General Counsel
Department of Justice
Executive Office for
United States Trustees
901 E. St, N.W., Suite 780
Washington, D.C. 20530
(202) 307-1399

August 19, 1998

CERTIFICATE OF COMPLIANCE WITH RULE 32(e)

Counsel hereby certifies that this brief is printed in a monospaced typeface and is 39 pages in length and complies with format and contains a word count of 8,085 in compliance with Rule 32(e)(1).

STATEMENT OF RELATED CASES

We believe that the consolidated appeal of In re Celebrity Home Entertainment and In re Celebrity Duplicating Services, Inc. Nos.98-55282 & 98-55285 presently pending before this Court is a related case within the meaning of this Circuit’s Rules.

CERTIFICATE OF SERVICE

I hereby certify that on this date, August 19, 1998, I filed with this Court an original and and fifteen (15) copies of the foregoing Brief of Appellant, United States Trustee, and served one copy of the brief upon the following counsel by first class postage pre-paid U.S. mail:

Arnold M. Quittner
Pachulski, Stang, Ziehl & Young, P.C.
10100 Santa Monica blvd, suite 100
Los Angeles, CA 90067

Joseph A. Eisenberg
Jeffer, Mangels, Butler & Marmaro, LLP
2121 Avenue of the Stars, Tenth Floor
Los Angeles, CA 90067-5010

Theodore W. Graham
Bobeck, Phleger & Harrison
550 West "C" Street, Suite 1300
San Diego, CA 92101

Paul Bridenhagen

BRIEF BANK — "SUMMARY SHEET" *Printed Tue-6/8/10 16:8*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	In re: Michael R. Mastro (Anthony Petrarca and Art Mazzola v. James Rigby, Chapter 7 Trustee and United States Trustee)
2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	BAP 9th Cir.
3. ("CCN") ***CURRENT*** CASE NO.	No.: 10-1037
4. ("PCN") ***PRIOR*** CASE NO. - & COURT *[IF ANY]*	No.: 09-16841 Court: Bankr. W.D. Wash. *(Identify judge & cite, if any)*
5. ("SO") ***SOURCE***	**U.S. TRUSTEES**
6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	Filed: May 27, 2010 Type: Brief of Appellee, United States Trustee
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8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	• 1). Whether an appeal is moot if the alleged error did not affect the outcome of the trustee election. 2). Whether appellants who did not object below lack standing to appeal the resolution of the election dispute. 3). Whether undersecured creditors are entitled to vote the unsecured portion of their claims in the trustee election.
10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)	
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ROBERT D. MILLER JR. *Acting United States Trustee for Region 18*
MARK H. WEBER, *Assistant United States Trustee*
THOMAS A. BUFORD III, *Trial Attorney* (MISSOURI BAR # 56460)
OFFICE OF THE UNITED STATES TRUSTEE
UNITED STATES DEPARTMENT OF JUSTICE
United States Courthouse, 700 Stewart Street, Suite 5103
Seattle, Washington 98101
Telephone: (206) 553-2000

RAMONA D. ELLIOTT, *General Counsel*
P. MATTHEW SUTKO, *Associate General Counsel*
WENDY COX, Trial Attorney
EXECUTIVE OFFICE FOR UNITED STATES TRUSTEE
UNITED STATES DEPARTMENT OF JUSTICE
20 Massachusetts Ave, N.W., Suite 8100
Washington, DC 20530
Attorneys for Appellee
UNITED STATES TRUSTEE

UNITED STATES BANKRUPTCY APPELLATE PANEL
OF THE NINTH CIRCUIT

In re: MICHAEL R. MASTRO,	Bankr. No. 09-16841
	Chapter 7
Debtor.	Honorable Samuel J. Steiner,
	Bankruptcy Judge, Presiding
ANTHONY PETRARCA;	
ART MAZZOLA,	
Appellants,	On appeal from the United States
v.	Bankruptcy Court for the Western
	District of Washington
JAMES RIGBY, CHAPTER 7 Trustee and	
UNITED STATES TRUSTEE,	
Appellees.	

BRIEF OF APPELLEE,
UNITED STATES TRUSTEE

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I. STATEMENT OF BASIS OF APPELLATE JURISDICTION

Sections 157(b)(1) and (2) of Title 28 of the United States Code confer jurisdiction upon bankruptcy courts to hear and determine all core proceedings under title 11 of the United States Code. The motion for resolution of a disputed trustee election under 11 U.S.C. § 702 of the Bankruptcy Code is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(A).

On January 15, 2010, the bankruptcy court affirmed the report of the United States Trustee regarding the disputed trustee election and ordered that the interim trustee, James Rigby, serve as the permanent trustee. This was a final order over which this Court has jurisdiction. 28 U.S.C. § 158(a)(1), (c)(1)(B). *See J.P. Morgan Inv. Mgmt., Inc. v. U. S. Trustee (In re Martech USA, Inc.)*, 188 B.R. 847, 850 (B.A.P. 9th Cir. 1995), *aff'd*, 90 F.3d 408 (9th Cir. 1996).

As explained in Section A of the Argument, this appeal should be dismissed for lack of jurisdiction because even if Appellants are right about the issue on appeal and this Court recalculates the votes, the numbers in the United States Trustee's report of the disputed election show that the outcome of the election will be the same. Therefore, the Appellants have no personal stake in this appeal.

II. STATEMENT OF ISSUES PRESENTED

1. Whether this appeal should be dismissed as moot because the numbers in the election report show that even excluding the unsecured claims of the

Undersecured Creditors,[1] not enough creditors requested an election to hold a valid election and creditors holding the majority of votes voted for the interim trustee, so he will continue as trustee regardless of how this appeal is resolved.

2. Whether if this Court believes this appeal is not moot, it should affirm because the alleged error did not affect the outcome of the election.

3. Whether Appellants lack standing to appeal the bankruptcy court's order resolving the disputed election because they did not file objections below or ask the bankruptcy court to resolve the disputed election.

4. Whether the bankruptcy court abused its discretion by counting the unsecured claims held by the Undersecured Creditors in determining that not enough creditors had requested an election and the interim trustee had received the majority of the votes cast.

III. STATEMENT OF THE CASE

This case concerns the election of a chapter 7 trustee. On July 10, 2009, three secured creditors filed an involuntary petition against the debtor, Michael R. Mastro, to which he consented on August 20, 2009. Under 11 U.S.C. § 301, Mr. Rigby was selected to serve as the interim trustee on August 21, 2009. At the section 341 meeting of unsecured creditors held October 28, 2009, Jerome

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[1] In this brief, the term "Undersecured Creditors" means those creditors who filed proofs of claims with both secured and unsecured portions.

Shulkin, an attorney representing several creditors, and holding proxies for others requested the election of a permanent chapter 7 trustee. The United States Trustee presided over the election.

Several parties raised general objections at the election. The United States Trustee filed a report of the disputed trustee election with the court showing the proofs of claims filed, the requests received and the votes cast, and providing an analysis of the election results under various scenarios. App., Tab B.[2] Several creditors filed objections to the United States Trustees' report and asked the bankruptcy court to resolve the disputes. App., Tabs C & J. The Appellants, Anthony Petrarca and Art Mazzola, however, did not.

The bankruptcy court held a hearing on December 4, 2009. The bankruptcy court determined that the solicitation of proxies was improper and required the disqualification of the votes voted by proxy. App., Tab A at 6. The bankruptcy court further determined that Undersecured Creditors were entitled to vote the unsecured portion of their claims. *Id.* at 8. The bankruptcy court concluded that creditors holding at least twenty percent by amount of the claims that could be voted had not requested an election as required to hold a valid election, and even if

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[2] "App." refers to the Appendix filed by the Appellants. Because the Appendix is not continuously paginated, pinpoint cites to materials in the Appendix refer to the court's electronically-stamped page numbers where those appear or to page numbers within the individual documents.

they had, Mr. Rigby received the majority of the votes. *See id*. at 9 (approving report of United States Trustee). The bankruptcy court entered its order directing that Mr. Rigby, the interim trustee, would serve as the permanent trustee in the bankruptcy case on January 15, 2010. *Id*. at 1-3.

The objecting parties did not appeal the decision, but the Appellants timely filed a notice of appeal to this Court on January 29, 2010. App., Tab Q.

IV. STATUTORY FRAMEWORK

Section 702 of title 11 permits creditors holding unsecured claims to elect a trustee of their choosing at the section 341 meeting of creditors. A creditor that holds an allowable, undisputed, fixed, liquidated, unsecured claim that is not entitled to priority may vote for a candidate for trustee as long as that creditor: 1) does not have an interest that is materially adverse to the interest of general unsecured creditors, and 2) is not an insider. 11 U.S.C. § 702(a). However, creditors may elect a trustee only if creditors holding at least twenty percent in amount of the eligible claims request an election. 11 U.S.C. § 702(b). If an election is properly requested, a trustee is elected if creditors holding at least twenty percent in amount of the eligible claims actually vote and one candidate receives a majority of the votes cast. 11 U.S.C. § 702(c). If no trustee is elected, the interim trustee serves as the permanent trustee in the case. 11 U.S.C. § 702(d).

The United States Trustee presides over the trustee election and files a report of the election with the bankruptcy court. Fed. R. Bankr. P. 2003(b) & (d). If the election is disputed, the United States Trustee tabulates the results of the election for each alternative presented by the dispute in its report. Fed. R. Bankr. P. 2003(d). The bankruptcy court will resolve the disputed election if within ten days after the United States Trustee files the election report it receives a motion requesting it to do so. *Id.* (2009).[3]

V. RELEVANT FACTS

The debtor in this case, Michael R. Mastro, is a large scale real estate developer and investor. Many of his secured creditors held real property as collateral and were undersecured by the time the case was filed. Mr. Mastro reported on his bankruptcy schedules unsecured debt in excess of $240 million and undersecured debt of over $ 100 million. App., Tab B at Ex. 1, p. 7, line 357, columns C & D.

Mr. Rigby, a chapter 7 panel trustee with over 25 years of experience, was selected as the interim trustee. Shortly thereafter, numerous secured creditors filed motions seeking to lift the automatic stay as to the properties securing their claims. After obtaining an extension of time to respond so he could review the relevant properties, Mr. Rigby did not oppose the motions, finding no legal basis for such

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[3] This case is governed by the 2009 version of the Bankruptcy Rules.

opposition.[4] *See* App., Tab O at 2, ¶ 7 & Exhibits at 3-4. Further, Mr. Rigby reported that there was unlikely to be many assets available for distribution to unsecured creditors. *See* App., Tab F at 3.

Mr. Shulkin and Mr. Driano represented several creditors, friends and relatives of Mr. Mastro, that held relatively small, unsecured claims. Mr. Shulkin proposed Brian Ward, an attorney and former real estate investment fund manager, as a candidate for trustee in the Mastro bankruptcy, and introduced Mr. Ward to a large group of similarly-situated creditors. *See* App., Tab O at 2-3. Although Mr. Ward had no experience as a bankruptcy trustee, Mr. Shulkin, Mr. Driano and Mr. Ward led the creditors to believe that if Mr. Ward were the trustee, he could obtain a larger distribution for the unsecured creditors than Mr. Rigby. *Id*.

A trustee election was held at the continued section 341 meeting of creditors on October 28, 2009.[5] Creditors filed over two hundred proofs of unsecured claims prior to the trustee election in the total amount of $180,717,663.32. *See* App., Tab B at 3 & Ex. 1, column H. No objections were filed to any of those

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[4] A creditor is entitled to relief from the automatic stay if the debtor does not have equity in the property and the property is not necessary to an effective reorganization. 11 U.S.C. § 362(d)(2). There was no intent to reorganize in this case.

[5] An election was requested at the initial 341 meeting of creditors, but that meeting was continued after it became clear that many unsecured creditors did not have adequate notice of the first meeting and were not present at that meeting. *See* App., Tab B at 2.

claims prior to the election. At the October 28 meeting, several creditors in attendance requested a trustee be elected. *See id*. at 7 and Ex. 1, column J. In addition, Mr. Shulkin and Mr. Driano requested an election on behalf of eighty creditors for whom they held proxies. *Id*. at 7 and Ex. 6.

The United States Trustee presided over the election and recorded the requests made and the votes cast. Mr. Shulkin and Mr. Rigby expressly reserved their right to object to the requests for election and ballots cast in the election. *See id.* at 1.

The United States Trustee filed a report of the disputed election on November 6, 2009. App., Tab B. The report tabulated the requests made and the votes cast under various scenarios based on the objections raised at the election. In the report, the United States Trustee calculated the pool of eligible claims as $180,717,663.32, by totaling the amount of all proofs of unsecured claims filed with the bankruptcy court or submitted to the United States Trustee prior to the election to which no one had filed a formal objection.[6] *Id*. at 3. The United States Trustee received valid requests for a trustee election from creditors holding unsecured claims in the amount of $ 18,934,153.89, which equaled 10.5% of the

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[6] Because Fed. R. Bankr. P. 2003(b)(3) permits only creditors that have filed proofs of claims prior to the election to vote, the United States Trustee did not include scheduled debts for which no proof of claim had been filed in the universe of claims that could be voted. *Id.* at 5-6.

eligible claims.[7] *Id*. at 2, 7, 11. The report also showed that Mr. Rigby received valid votes in the amount of $ 109,119,623.36 and Mr. Ward received valid votes in the amount of 8,239,101.50.[8] *Id*. at 13. The report concluded that in the United States Trustee's view, the statutory twenty percent requesting requirement was not met and so no valid election was held. *Id*. at 14. The report left the ultimate determination to the bankruptcy court, noting that if the bankruptcy court determined that a valid election was held, then Mr. Rigby received the majority of the votes and was elected trustee. *Id*.

Six creditors filed objections, but Appellants did not. The six creditors objected primarily on two grounds: 1) the requests for election made by proxy were improperly disqualified and 2) the Undersecured Creditors were not eligible to vote their unsecured claims because the amount of those claims could not be determined with certainty and because those creditors had an interest materially adverse to the general unsecured creditors. Therefore, the unsecured claims of the

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[7] The United States Trustee calculated the total amount of valid requests for an election by starting with the total amount of requests received and subtracting from that amount: 1) the requests by creditors that were not eligible to vote because they had not filed a proof of claim and 2) requests made only by proxies that were solicited in violation of Fed. R. Bankr. P. 2006. *Id*. at 10-11.

[8] The United States Trustee did not count the requests made or the votes cast by proxy by Mr. Shulkin because the proxies were solicited in violation of Fed. R. Bankr. P. 2006. App., Tab B at 7-11, 12. The United States Trustee also excluded requests made and votes cast by creditors who had not filed proofs of claims prior to the election as required by Fed. R. Bankr. P. 2003. *Id*. at 10-11, 13.

Undersecured Creditors could not be counted either for the purpose of calculating whether the requesting requirement had been satisfied or determining which candidate had received the most votes. The six objecting creditors, an Undersecured Creditor and the chapter 7 trustee briefed their positions and submitted the declarations of various witnesses and documentary evidence to the bankruptcy court. App., Tabs C-L, N-P. The United States Trustee also filed a brief. App., Tab M. Appellants filed no briefs and submitted no evidence. No evidence was proffered concerning any specific adverse interest held by any creditor. On December 4, 2009, the bankruptcy court held a hearing on the objections. On January 15, 2010, the bankruptcy court entered an order, overruling the objections, affirming the United States Trustee's report and making Mr. Rigby the permanent trustee. App., Tab A.

The bankruptcy court made several findings in connection with the objections to the report. The court "totally agree[d] ... that the solicitation of proxies in this case was improper and require[d] disqualification of the Shulkin Driano proxies." *Id.* at 6. Specifically, the court found, notwithstanding their statements to the contrary, that the evidence showed that Mr. Shulkin, Mr. Driano, and Mr. Ward, all attorneys, orally solicited proxies in violation of Rule 2006(d)(4). *Id.* at 7. And, they failed to timely file the proxy report required by Rule 2006(e). *Id.* at 8.

The bankruptcy court also ruled the Undersecured Creditors were entitled to vote their unsecured claims. *Id.* at 8. In addition, the court expressly found that the Undersecured Creditors had no interest materially adverse to the general unsecured creditors. *Id.* at 8-9.

All of the objecting parties accepted the decision of the bankruptcy court, but Appellants, neither of whom objected below, appealed. Appellants included five issues in the statement of issues filed in this Court, three of which relate to the disqualification of the proxy votes and two of which concern voting by the Undersecured Creditors. *See* Appellants' Designation of the Record and Statement of Issues. Appellants expressly abandoned the three issues relating to the disqualification of the proxy votes in their opening brief (Opening Brief of Appellants at 5) and argued only that the bankruptcy court erred by counting the votes of the Undersecured Creditors.

VI. APPLICABLE STANDARD OF REVIEW

Findings of fact are reviewed under the clearly erroneous standard. Fed. R. Bankr. P. 8013; *Salazar v. McDonald (In re Salazar)*, 430 F.3d 992, 994 (9th Cir. 2005). Conclusions of law are reviewed de novo. *In re Salazar*, 430 F.3d at 994. Mixed questions of law and fact are also reviewed de novo. *Murray v. Bammer (In re Bammer)*, 131 F.3d 788, 792 (9th Cir. 1997) (en banc).

The bankruptcy court's calculation of the percentage of eligible claims requesting an election is reviewed for abuse of discretion. *Caudill v. N.C. Machinery, Inc. (In re Am. Eagle Mfg., Inc.)*, 231 B.R. 320, 328 (B.A.P. 9th Cir. 1999). *See Berg v. Esposito (In re Oxborrow)*, 913 F.2d 751, 754 (9th Cir. 1990) ("[w]here the bankruptcy judge has exercised some supervisory powers over the election of a trustee his action should be examined to determine whether or not he has abused his discretion"). A court abuses its discretion when it fails to identify the correct legal rule or its application of the correct legal rule is illogical, implausible or without support in inferences that may be drawn from the facts in the record. *USAA Fed. Sav. Bank v. Thacker (In re Taylor)*, No. 08-60033, __ F.3d __, 2010 WL 1006927 at * 4 (9th Cir. Mar. 22, 2010). Under the abuse of discretion standard, this Court should affirm unless it is definitely and firmly convinced that the bankruptcy court committed a clear error of judgment. *Alonso v. Summerville (In re Summerville)*, 361 B.R. 133, 139 (B.A.P. 9th Cir. 2007).

VII. SUMMARY OF ARGUMENT

Mr. Rigby, a chapter 7 panel trustee with over 25 years of experience was appointed interim trustee in this case. Mr. Rigby has administered this complicated case for the past nine months. His duties have included appraising the debtor's assets, putting together deals designed to maximize the return on those assets, searching for additional estate assets and evaluating creditors' claims. *See* 11 U.S.C. § 704. Certain creditors sought to elect a different trustee, as is their right. Their candidate, Mr. Ward, has no prior bankruptcy experience. App., Tab O, Exhibits at 6. Those creditors requested a trustee election and an election was held. The United States Trustee recorded the requests made and the votes cast and reported to the bankruptcy court that the election was disputed. The report of the United States Trustee concluded that not enough creditors requested an election to hold a valid election and moreover, the majority of votes were cast for Mr. Rigby, so whether or not a valid election was held, Mr. Rigby should be the permanent trustee. App., Tab B at 14. Some creditors objected to the report, but Appellants did not. After considering the objections, responses, and evidence submitted by the parties, the bankruptcy court agreed with the United States Trustee. App., Tab A at 2-3, 9.

Appellants initially appealed both the inclusion of the Undersecured Creditors' claims and the disqualification of the proxy requests, but expressly abandoned the proxy disqualification issue in their opening brief. Opening Brief of Appellants at 5. As a result of that choice, it is difficult to understand how Appellants can benefit from the resolution of this appeal. The numbers in the report show that even if the claims of the Undersecured Creditors are not counted, not enough creditors requested an election to hold a valid election, and moreover, Mr. Rigby still received more votes than Mr. Ward. So Mr. Rigby becomes the permanent trustee under section 702 regardless of the outcome of this appeal.

Under those circumstances, this Court should dismiss the appeal as moot because Appellants no longer have a stake in the outcome of this appeal, given that Mr. Rigby will be the permanent trustee even if they win.

Federal courts can only decide cases if the plaintiff has suffered an injury in fact, traceable to the challenged action, and likely to be redressed by a favorable decision. *Nome Eskimo Cmty. v. Babbitt*, 67 F.3d 813, 815 (9th Cir. 1995). If any of those elements disappears while the litigation is pending, the case is moot and federal courts lack jurisdiction to hear it. *Id*. Appellants mooted their appeal when they confined it to the single issue of whether the votes of the Undersecured Creditors should have been counted. Because the numbers show that their candidate would not have been elected trustee even if the bankruptcy court had not counted those votes, their inability to elect their candidate for trustee is not traceable to the alleged error by the bankruptcy court as required for standing. And even if they obtained a favorable decision in this appeal, it would not redress their failure to elect Mr. Ward because under section 702, Mr. Rigby would still be the trustee. Thus, this appeal should be dismissed as moot. Or, if this Court decides the appeal is not moot, it should affirm the bankruptcy court's order because the error alleged by Appellants did not affect the outcome of the elections and was therefore, harmless.

Moreover, Appellants lack standing to pursue this appeal because neither of them filed written objections below to the report of the disputed election and neither participated in the hearing to resolve the disputed election. Attendance and objection generally are prerequisites to fulfilling the "person aggrieved" standard required for appellate standing in this Circuit. *Brady v. Andrew (In re Commercial W. Fin. Corp.)*, 761 F.2d 1329, 1335 (9th Cir. 1985). Although several other parties filed briefs and participated in the hearing regarding the election dispute, Appellants chose not to, so they lack standing to challenge the bankruptcy court's resolution of the election dispute on appeal.

Alternatively, the bankruptcy court did not err when it concluded the Undersecured Creditors could vote. The Undersecured Creditors met the statutory requirements for voting. Appellants do not directly challenge the bankruptcy court's findings that: 1) the claims were adequately liquidated to the extent the value of the collateral had previously been determined, and 2) the Undersecured Creditors did not have an interest adverse to the other unsecured creditors. Instead, Appellants contend that two cases, *In re Michelex, Ltd.*, 195 B.R. 993 (W.D. Mich. 1996) and *In re American Eagle Mfg.*, 231 B.R. 320, which they concede are not controlling precedent (*See* Opening Brief of Appellants at 12), required the bankruptcy court to exclude the Undersecured Creditors from the trustee election. But those cases do not support disenfranchising the Undersecured Creditors in this case. At best, they suggest that *if no proofs of claims are filed*, deficiency amounts scheduled by the debtor on secured debts should not be included in calculating the total number of votes that could be cast. More significantly, *Michelex* unequivocally directs that filed proofs of claims supersede the debtor's schedules when determining who can vote. 195 B.R. at 1008. In this case, the bankruptcy court did not rely on the debtor's schedules, but counted only the unsecured claims held by creditors who had filed proofs of those claims. Counting the Unsecured Creditors claims and allowing them to vote those claims was entirely consistent with the cases cited by Appellants.

VIII. ARGUMENT

A. THE APPEAL SHOULD BE DISMISSED AS MOOT BECAUSE THE NUMBERS IN THE REPORT SHOW THAT EVEN IF THE UNDERSECURED CREDITORS' CLAIMS ARE EXCLUDED, MR. RIGBY WILL STILL BE THE PERMANENT TRUSTEE SO APPELLANTS HAVE NO PERSONAL STAKE IN THIS APPEAL.

Appellants have mooted their appeal by confining it to the single issue of whether the bankruptcy court erred by counting the unsecured claims of the Undersecured Creditors. Appellants' sole contention on appeal is that the bankruptcy court abused its discretion by counting the unsecured claims of the Undersecured Creditors when calculating whether enough requests for an election had been made to hold a valid election and which candidate had received the most votes. The numbers in the United States Trustee's report show that those claims did not affect the outcome of the election and Mr. Rigby would still be the permanent trustee under 11 U.S.C. § 702 even if those claims were not counted. Because the resolution of this appeal cannot affect the outcome of the trustee election, it can afford Appellants no meaningful relief, and should be dismissed as moot.

Under 11 U.S.C. § 702(b), creditors that hold at least twenty percent in amount of the unsecured claims must request an election for a valid election to be held. The report of the disputed election adopted by the bankruptcy court, showed that creditors filed proofs of unsecured claims totaling $180,717,663.32. App., Tab B at 3 and Ex. 1 at p. 7, Line 357 of Column H. That figure included $51,498,544.39 in unsecured claims held by creditors that also held secured claims– i.e. Undersecured Creditors. *See Id.* at 5 and Ex. 4, Line 23 of column H. If the claims held by the Undersecured Creditors were not counted, the unsecured claims would total $180,717,663.32 - $51,498,544.39 or $129,219,118.93. Twenty percent of that amount is $25,843,823.79.

The report further showed, and the bankruptcy court agreed, after excluding the improperly solicited proxy requests, creditors holding unsecured claims in the amount of $18,934,153.89 requested an election.[9] App., Tab B at 10. That amount is less than $25,843,823.79. Therefore, even if the unsecured claims held

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[9] Appellants do not challenge the exclusion of the requests made by proxy. Opening Brief of Appellants at 5.

by Undersecured Creditors are not counted, not enough creditors requested an election to hold a valid election. Moreover, the report showed that Mr. Rigby received valid votes in the amount of $ 109,119,623.36 and Mr. Ward received valid votes in the amount of $ 8,239,101.50. *Id.* at 13. Excluding the votes cast by the Undersecured Creditors, all which were cast in favor of Mr. Rigby, Mr. Rigby received $109,119,623.36 - $ 51,498,544.39 or $ 57,621,078.97 votes – still far more than the $ 8.2 million received by Mr. Ward.

The mootness doctrine restricts judicial power to the decision of actual, live controversies. *Nome Eskimo Cmty.*, 67 F.3d at 815. Federal courts cannot decide a case unless the plaintiff has suffered an injury in fact, traceable to the challenged action, and likely to be redressed by a favorable decision. *Id*. If any of those elements disappear during the litigation, the case becomes moot and the court has no jurisdiction to decide the case. *Id*.

The numbers in the report show that Appellants' injury – the selection of Mr. Rigby, rather than Mr. Ward as permanent trustee – is not fairly traceable to the bankruptcy court's decision to allow the Undersecured Creditors to vote because Mr. Ward would not have been elected even if those votes were not counted.[10] *See Am. W. Airlines, Inv. v. Nat'l Mediation Bd.*, 119 F.3d 772, 777

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[10] Appellants have alleged no specific injury and requested no specific relief. The United States Trustee can conceive of no other injury to Appellants resulting from the disputed election.

(9th Cir. 1997) (dismissing as moot claim that NMB's determination to count ballot of discharged workers violated statute where outcome of election would have been the same if NMB had not counted those votes), *cert. denied*, 523 U.S. 1021 (1998). Moreover, because Mr. Rigby is entitled to be the trustee under section 702 regardless of the outcome of this appeal based on the numbers, there is no effective relief this Court can provide Appellants. Therefore, this appeal should be dismissed as moot. *See Ruiz v. City of Santa Maria*, 160 F.3d 543, 549 (9th Cir. 1998) (an action is moot when parties lack a legally cognizable interest in the outcome or when court can grant no effective relief), *cert. denied*, 527 U.S. 1022 (1999).

B. IF THIS COURT FINDS THIS APPEAL IS NOT MOOT, IT SHOULD AFFIRM THE BANKRUPTCY COURT'S ORDER BECAUSE THE ALLEGED ERROR HAD NO EFFECT ON THE OUTCOME OF THE ELECTION.

If this Court finds that it has jurisdiction to decide this appeal, it can affirm without reaching the merits of Appellants' arguments because as explained above, whether or not the claims of the Undersecured Creditors are counted in calculating the universe of claims, not enough requests were received to hold a valid election under 11 U.S.C.§ 702(b). Under 11 U.S.C. § 702(d), the interim trustee, "shall serve" as the permanent trustee unless somebody else is validly elected. In this case, even if the claims of the Undersecured Creditors are excluded as Appellants' argue they should be, and the percent of creditors requesting an election recalculated accordingly, the claims held by the creditors requesting an election still do not meet the twenty percent threshold required to elect a trustee under section 702(b). As explained in section A *supra*, the report shows that excluding the Undersecured Creditors' claims, creditors holding $129,219,118.93 were eligible to vote.[11] The report further shows that creditors holding claims in the amount of $ 18,934,153.89 – only 14.6% of the total claims – properly requested an election. *Id.* at 7. So there was no valid election and Mr. Rigby is the permanent trustee. Therefore, this Court should affirm the bankruptcy court's order directing that Mr. Rigby shall serve as the permanent trustee in this case because the alleged error was harmless. *See* 28 U.S.C. § 2111 (reviewing court should disregard errors that do not affect substantial rights of the parties).

C. APPELLANTS LACK STANDING TO PURSUE THIS APPEAL BECAUSE THEY DID NOT FILE OBJECTIONS BELOW TO THE REPORT OR SEEK RESOLUTION OF THE DISPUTED ELECTION.

This appeal should be dismissed for the additional reason that the Appellants lack standing to pursue it. A person must be aggrieved by an order of the bankruptcy court to have standing to appeal that order. *Fondiller v. Robertson (In re Fondiller)*, 707 F.2d 441, 443 (9th Cir. 1983). A "person aggrieved" is one

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[11] That figure is calculating by subtracting the amount of the Undersecured Creditors' unsecured claims ($ 51,498,544.39) from the total amount of unsecured claims ($ 180,717,663.32). App., Tab B at 3, 5.

who is "directly and adversely affected pecuniarily by the order of the bankruptcy court." *Id*. As a general rule in this Circuit, to fulfill the "person aggrieved," standard, a party is required to have appeared at the hearing before the bankruptcy court and objected to the action proposed to be taken, unless the party was not given notice of the hearing. *In re Commercial W. Fin. Corp.*, 761 F.2d at 1335. *Accord In re Ray*, 597 F.3d 871 (7th Cir. 2010); *Weston v. Mann (In re Weston)*, 18 F.3d 860, 864 (10th Cir. 1994).

Applying the same standard, the Tenth Circuit specifically held that a creditor lacked standing to appeal a bankruptcy court's order resolving a disputed chapter 7 trustee election because the creditor did not participate in the resolution of the disputed election before the bankruptcy judge. *In re Weston*, 18 F.3d at 864. In *Weston*, a group of creditors and the debtor argued against the election of a trustee at the 341 meeting. The United States Trustee filed a report of the disputed election. The creditors supporting the election filed a motion to resolve the dispute and the debtor filed an objection, but the objecting creditors did not file an objection. The bankruptcy judge held a hearing on the disputed election. The debtor appeared and presented his objections, but the objecting creditors did not appear. They also failed initially to appeal the bankruptcy court's order.[12] The

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[12] The objecting creditors appealed a later order also purporting to resolve the election.

Tenth Circuit held that the objecting creditors, "having chosen not to participate in the resolution of the disputed election before the bankruptcy judge, [had] no standing to appeal the bankruptcy court's resolution of the matter."[13] *Id.* at 864.

In this case, six parties filed two separate objections, and both the trustee and the United States Trustee filed responses, but neither of the Appellants filed a written objection to the report of the disputed election, asked the bankruptcy court to resolve the dispute or responded to any of the objections that were filed.[14] The bankruptcy court notified Appellants of the briefing schedule and the hearing on the disputed election [Bankr. Ct. Dkt # 562], but Appellants did not participate.[15] Therefore, their choice not to participate below means they do not have standing under the rule articulated in *Commercial West* to contest the bankruptcy court's

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[13] The court had previously found that it lacked jurisdiction to consider the merits of the appeal, but cited the appellants' lack of standing as an alternate ground for dismissal. *Id.* at 863-64.

[14] The Italian Club, Inc., Zacri, Inc., Lucille Schweitzer, Lisa Schweitzer, and Italian Community Hall filed a Motion for Resolution of Disputed Trustee Election and Objection to Trustee's Report of Disputed Election and Pauline Anderson filed the Objection by Pauline Anderson to US Trustee's Report and Brief in Support of Objection. App., Tabs C & J.

[15] Although counsel representing five of the objecting parties below also represents Appellants, there is no indication in the record that he spoke on behalf of anyone other than the objecting parties at the hearing regarding the disputed election.

order on appeal.[16]

D. ALTERNATIVELY THE BANKRUPTCY COURT DID NOT ERR BY COUNTING THE UNSECURED PORTION OF THE UNDERSECURED CREDITORS' CLAIMS BECAUSE SECTION 702(a) PERMITS THOSE CLAIMS TO BE VOTED.

The bankruptcy court did not err by counting the claims of the Undersecured Creditors when calculating the whether the twenty percent requesting threshold had been met or when tallying the votes cast for each candidate. Under section 702(a), a creditor may vote if he holds an allowable, undisputed, fixed, liquidated, unsecured claim that is not entitled to priority distribution, he does not have an interest materially adverse to the interest of the other general unsecured creditors, and is not an insider. 11 U.S.C. § 702(a).[17] No one contended below that the Undersecured Creditors were insiders or that their unsecured claims were not allowable, undisputed, unsecured or were entitled to priority distribution.[18] Moreover, after taking evidence and hearing oral argument

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[16] *But see In re Am. Eagle Mfg.*, 231 B.R. at 328 (finding appellees had standing despite their failure to participate in hearing because local rule requiring appearance at hearing was discretionary); *In re Martech*, 188 B.R. at 850 (finding standing where party attended meeting of creditors and voted). Neither of those cases addressed the additional standing requirement articulated in *Commercial West* that a party object and participate in the hearing.

[17] The text of Section 702 is reproduced in the Addendum to this brief.

[18] Appellants can not raise new issues on appeal that were not presented to the bankruptcy court. *See Animal Prot. Inst. of Am. v. Hodel*, 860 F.2d 920, 927 (9th Cir. 1988) ("Federal appellate courts generally do not consider issues first

from the parties regarding their objections, the bankruptcy court rejected the objecting parties' arguments that the amounts of the Undersecured Creditors' unsecured claims could not be determined with certainty and those creditors held an interest materially adverse to the other creditors. The bankruptcy court concluded that the Undersecured Creditors could vote their claims "if the value of the collateral was previously established by appraisal, assessment, or the amount set forth in the debtor's schedules" and it found no adverse interest. App., Tab A at 8-9. Appellants have not challenged any of those findings in their opening brief. Therefore, they have forfeited those arguments. *Indep. Towers of Wash. v. Washington*, 350 F.3d 925, 929 (9th Cir. 2003); *Greenwood v. Fed. Aviation Admin.*, 28 F.3d 971, 977 (9th Cir. 1994); *D.A.R.E. Am. v. Rolling Stone Magazine*, 270 F.3d 793, 793 (9th Cir. 2001).

In any event, those findings were correct. The objecting creditors argued below that the alleged uncertainty as to amount meant the claims were not fixed and liquidated. To the contrary, they were both. A claim is fixed to the extent liability has fastened. *In re Michelex, Ltd.*, 195 B.R. at 1007 n. 32. A fixed claim is one that is not contingent. *See* 11 U.S.C. § 101(5)(A) (defining "claim" as right to payment whether or not such right is . . . liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or

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raised on appeal.") (citing *Singleton v. Wulff*, 428 U.S. 106, 120 (1976)).

unsecured . . . ."); *In re Michelex, Ltd.*, 195 B.R. at 1007 n. 32. A debt is fixed if all events giving rise to liability occurred prior to the filing of the bankruptcy petition. *Fostvedt v. Dow (In re Fostvedt)*, 823 F.2d 305, 306 (9th Cir. 1987); *Nicholes v. Johnny Appleseed of Wash. (In re Nicholes)*, 184 B.R. 82, 88 (B.A.P 9th Cir. 1995). Debts of a contractual nature are fixed. *In re Nicholes*, 184 B.R. at 88. The objecting creditors contended below the Undersecured Creditors' claims were not fixed because the unsecured portion of the bifurcated claims could change. However, the term "fixed" has nothing to do with the amount of a claim; it addresses whether *liability* has attached. The partially secured debts owed to the Undersecured Creditors were contractual and not contingent on any future event as evidenced by their filed proofs of claims and supporting documents; no one has contended otherwise. So those claims were fixed claims as required by section 702(a).

The claims were also liquidated. The Ninth Circuit has defined the term "liquidated," explaining that a debt is liquidated if the amount of the debt can be readily determined. *Slack v. Wilshire Ins. Co. (In re Slack)*, 187 F.3d 1070, 1073 (9th Cir. 1999). A debt that is ascertainable by reference to an agreement or by a simple computation is liquidated. *In re Nicholes*, 184 B.R. at 89.[19] In this case,

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[19] Because the term "claim" is coextensive with the term "debt" (*Penn. Dep't of Pub. Welfare v. Davenport*, 495 U.S. 552, 558 (1990) (superseded by statute on other grounds)), a claim is liquidated to the same extent as a debt.

the Undersecured Creditors could readily calculate the value of their unsecured claims by subtracting the value of the collateral securing the debt (as determined by appraisal, assessment or the debtor's schedules) from the value of their unbifurcated secured claims.[20] The Undersecured Creditors had already calculated and stated the values of their unsecured claims in their proofs of claims before the election. Thus, their unsecured claims were liquidated for the purposes of section 702(a)(1).[21]

Finally, none of the Undersecured Creditors had interests materially adverse to the other unsecured creditors. The phrase "materially adverse" is not defined in the Code. According to the legislative history of section 702, the application of the standard requires a balancing of various factors such as the nature of the

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[20] The Bankruptcy Code separates an undersecured creditor's claim into two parts. He has a secured claim to the extent of the value of his collateral and he has an unsecured claim for the balance of his claims. 11 U.S.C. § 506(a).

[21] The Bankruptcy Code contemplates different valuations of claims for different purposes. *See* 11 U.S.C. § 506(a)(1) ("Such value shall be determined in light of the purpose of the valuation . . . ."). The liquidation requirement in section 702(a) ensures that the amount of votes an unsecured creditor is entitled to vote can be ascertained with some degree of certainty. The Undersecured Creditors filed proofs of claims which are prima facie evidence of the amount of the claims. Fed. R. Bankr. P. 3001(f); *Lundell v. Anchor Constr. Specialists, Inc.*, 223 F.3d 1035, 1039 (9th Cir. 2000). Thus, those claims are certain enough in amount to be counted in the trustee election. If the unsecured portion of an undersecured claim changes, the creditor can amend the claim (*See* Fed. R. Bankr. P. 7015) or the trustee can object to the allowance of the claim and the bankruptcy court will determine the amount of the claim. *See* 11 U.S.C. § 704(a)(5); 11 U.S.C. § 502(b).

adversity. S. Rep. No. 95-989, at 92 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5878, 1978 WL 8531. Courts have used a fact based analysis to determine whether a creditor holds a materially adverse interest to the other creditors under the specific circumstances of the case. *In re Poage*, 92 B.R. 659, 666 (N.D. Tex. 1988) (rejecting claim of adverse interest where objecting party failed to present sufficient factual basis). The objecting creditors failed below to identify a specific interest such as a preference held by any undersecured creditor that is materially adverse to the other unsecured creditors.[22] The bankruptcy court found that the Undersecured Creditors possessed no materially adverse interest to the general unsecured creditors in this case. App., Tab A at 8-9. Given the dearth of evidence to the contrary, it could reach no other conclusion. Based on those findings, the bankruptcy court correctly determined the Undersecured Creditors were entitled to vote in the trustee election.

Under section 702(b), a trustee cannot be elected unless eligible creditors holding at least twenty percent of eligible claims request an election. 11 U.S.C. §

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[22] Appellants' argument that all creditors who hold secured claims have a disqualifying adverse interest should be rejected out of hand. If that was Congress's intent, it would have expressly excluded secured creditors in section 702(a) in the same way it excluded "insiders." *See* 11 U.S.C. § 702(a)(3). Moreover, because the Undersecured Creditors know that they are likely to receive very little on the unsecured portion of their claims, unlike fully secured creditors, they have every incentive to maximize the return on their collateral and elect a trustee who will maximize the estate assets available for distribution to unsecured creditors.

702(b);[23] *In re Oxborrow*, 913 F.2d at 753. The purpose of the twenty percent requirement is to ensure that a substantial portion of the unsecured creditors support a trustee election and to discourage election of a trustee by attorneys for creditors. H.R. Rep. No. 95-595, at 102 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5787, 6063-6064, 1977 WL 9628.

The universe of eligible claims for the purpose of the twenty percent calculation are those claims "specified in subsection [702](a)(1) . . . that are held by creditors that may vote under subsection [702](a)." 11 U.S.C. § 702(b). Thus, under the plain meaning of the statute, if a creditor may vote his claims under section 702(a), then those claims are counted when determining whether section 702(b)'s twenty percent requesting requirement has been met. As explained above, the Undersecured Creditors were entitled to vote under 702(a) and their unsecured claims were the type described in section 701(a)(1), therefore, it would have been error *not* to count those claims in calculating whether the twenty percent requesting requirement had been met. 11 U.S.C. § 702(b).

E. THE *MICHELEX* DECISION IS CONSISTENT WITH THE BANKRUPTCY COURT'S REFUSAL TO DISENFRANCHISE THE UNDERSECURED CREDITORS.

Having abandoned all statutory arguments, Appellants rely entirely on *In re Michelex*, a decision by the bankruptcy court for the Western District of Michigan

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[23] The text of Section 702(b) is reproduced in the Addendum to this brief.

that they contend supports their position and *In re American Eagle Mfg.*, a decision by a panel of this Court that Appellants allege adopted *Michelex.* Appellants are wrong as to both contentions. First, *Michelex* does not hold that undersecured creditors cannot vote in trustee elections. The portion of the opinion on which Appellants rely is inapposite because it considers whether certain *scheduled* claims should be included initially in the pool of eligible claims without regard to whether proofs of those claims have been filed. It does not specifically address whether undersecured creditors *who have filed proofs of their unsecured claims* should be included in the universe of eligible claims. *See In re Michelex, Ltd.*, 195 B.R. at 1007. The *Michelex* court conceded that it was "debatable" whether unsecured claims held by undersecured creditors should be included in the universe of eligible claims solely on the basis of the debtor's schedules, but concluded that Schedule D should not be considered.[24] *Id.* It unequivocally advised, however, that proofs of claims properly filed before the election supersede the debtor's schedules (*id.* at 1008), suggesting that claims for which a timely proof of claim was filed should be included without regard to the debtor's schedules. Consistent with *Michelex*, the bankruptcy court in this case did not

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[24] A debtor is required to file certain schedules with his petition listing his assets and liabilities. 11 U.S.C. § 521(a)(1). On Schedule D, the debtor lists all the creditors who hold secured claims against the debtor. *See* Fed. R. Bankr. P. Official Form 6.

consider the Schedule D filed by the debtor. All of the Undersecured Creditors filed proofs of their unsecured claims, so under *Michelex*, the court properly counted those claims.

Similarly, in *American Eagle Mfg.*, a panel of this Court affirmed a bankruptcy court's decision not to include a *scheduled* unsecured deficiency in the universe of eligible votes after the debtor declined to file a proof of claim. 231 B.R. at 330-31. Nothing in the opinion indicates the bankruptcy court could have excluded the claim, if the creditor had filed a proof of claim. To the contrary, a proof of claim filed by the creditor under penalty of perjury likely would have assuaged the bankruptcy court's concerns that the claim was manufactured by an insider driving the election dispute and the amount of the claim was too nebulous. *See id*. at 330.

Second, Appellants' contention that the method used in *Michelex* was "adopted" by a panel of this Court in *American Eagle Mfg.* is inaccurate. As noted by that panel, there are a number of different ways of calculating the universe of eligible votes and no controlling Ninth Circuit precedent. *In re Am. Eagle Mfg., Inc.*, 231 B.R. at 329. Moreover, a bankruptcy court's calculation of whether the twenty percent requesting requirement is met is reviewed only for abuse of discretion. *Id.* at 328. Although the panel in *American Eagle Mfg.* declined to reverse a bankruptcy court that adopted the *Michelex* approach, it did not hold the method used in *Michelex* was the only lawful method or even the most appropriate method of calculating the universe of eligible claims. The panel affirmed because the bankruptcy court used a reasonable approach. *See In re Am.Eagle Mfg., Inc.*, 231 B.R. at 333.

In this case, the bankruptcy court did not include any claims in the universe of eligible claims based solely on the debtor's schedules.[25] All of the eligible claims were supported by timely filed proofs of claims. Therefore, to the extent *Michelex* and *American Eagle Mfg.* have any bearing on the issue before this Court, the bankruptcy court's decision to include those claims is consistent with the view that filed proofs of claims supersede the debtor's schedules when determining the claims that can be voted in a trustee election.

IX. CONCLUSION

For those reasons, the United States Trustee respectfully asks this Court to affirm the bankruptcy court's January 15, 2010 order.

Dated: May 27, 2010 Respectfully submitted,

By: /s/ Thomas A. Buford III
THOMAS A. BUFORD III
Attorney for Appellee, ROBERT D. MILLER JR.
Acting United States Trustee for Region 18

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[25] Appellants do not contend the bankruptcy court erred by excluding scheduled claims for which no proofs of claims had been filed from the universe of eligible claims. In any event, including such claims could only expand the universe and reduce the percentage of eligible claims requesting an election.

ADDENDUM

Title 11 - BANKRUPTCY
CHAPTER 7 - LIQUIDATION
SUBCHAPTER I - OFFICERS AND ADMINISTRATION

Sec. 702. Election of trustee

STATUTE:

(a) A creditor may vote for a candidate for trustee only if such creditor -

(1) holds an allowable, undisputed, fixed, liquidated, unsecured claim of a kind entitled to distribution under section 726(a)(2), 726(a)(3), 726(a)(4), 752(a), 766(h), or 766(i) of this title;

(2) does not have an interest materially adverse, other than an equity interest that is not substantial in relation to such creditor's interest as a creditor, to the interest of creditors entitled to such distribution; and

(3) is not an insider.

(b) At the meeting of creditors held under section 341 of this title, creditors may elect one person to serve as trustee in the case if election of a trustee is requested by creditors that may vote under subsection (a) of this section, and that hold at least 20 percent in amount of the claims specified in subsection (a)(1) of this section that are held by creditors that may vote under subsection (a) of this section.

(c) A candidate for trustee is elected trustee if -

(1) creditors holding at least 20 percent in amount of the claims of a kind specified in subsection (a)(1) of this section that are held by creditors that may vote under subsection (a) of this section vote; and

(2) such candidate receives the votes of creditors holding a majority in amount of claims specified in subsection (a)(1) of this section that are held by creditors that vote for a trustee.

(d) If a trustee is not elected under this section, then the interim trustee shall serve as trustee in the case.

CERTIFICATE OF SERVICE

I hereby certify that on May 27, 2010, I filed the foregoing BRIEF OF APPELLEE, UNITED STATES TRUSTEE with the Clerk of the Court for the Bankruptcy Appellate Panel of the Ninth Circuit by using the CM/ECF system. I certify that all parties of record to this appeal are represented by CM/ECF users and that service will be accomplished through the CM/ECF system.

/s/ Thomas A. Buford III

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WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]* McBride & Collier v. Stephen Callaway

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]* 5th Cir.

3. ("CCN") ***CURRENT*** CASE NO. No.: 10-30116

4. ("PCN") ***PRIOR*** CASE NO. - & COURT *[IF ANY]*

No.: 5:09-cv-1995

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(Identify judge & cite, if any)

5. ("SO") ***SOURCE*** **U.S. TRUSTEES**

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8. ("TO") ***TOPIC*** **BANKRUPTCY**

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***

• 1). Whether the district court lacked jurisdiction over the present appeal because it is moot. 2). Whether the district court in any event lacked subject matter jurisdiction over plaintiff's case. 3). Whether, even if the case were not moot and the district court had jurisdiction, the district court abused its discretion in denying plaintiff's request for a writ of prohibition.

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No. 10-30116

IN THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

MCBRIDE & COLLIER,

Plaintiff-Appellant,

v.

STEPHEN CALLAWAY,

Defendant-Appellee.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF LOUISIANA

BRIEF FOR APPELLEE

TONY WEST
Assistant Attorney General

STEPHANIE A. FINLEY
United States Attorney
THOMAS B. THOMPSON
Assistant United States Attorney

THOMAS M. BONDY
(202) 514-4825
STEPHANIE R. MARCUS
(202) 514-1633
Attorneys, Appellate Staff
Civil Division Room 7642
U.S. Department of Justice
950 Pennsylvania Ave., N.W.
Washington, D.C. 20530-0001

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STATEMENT REGARDING ORAL ARGUMENT

The appellee believes that this appeal can be resolved on the briefs, but stands ready to present oral argument if the Court believes argument would be helpful to its consideration of this case.

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 10-30116

MCBRIDE & COLLIER,

Plaintiff-Appellant,

v.

STEPHEN CALLAWAY,

Defendant-Appellee.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF LOUISIANA

BRIEF FOR APPELLEE

STATEMENT OF SUBJECT MATTER AND APPELLATE JURISDICTION

This is an action against Judge Stephen V. Callaway in his official capacity as United States Bankruptcy Court Judge for the Western District of Louisiana. R. 1 at 7-8; RE 3-4.[1] Plaintiff's complaint invoked the district court's jurisdiction under 28 U.S.C. §§ 1334, 1343, 157 and 1651. *Id*. Plaintiff challenged two standing orders issued by Judge Callaway on November 30, 2009. On January 25, 2010, the district court denied plaintiff's request for a writ of prohibition with respect to one of the two standing orders. R. 16 at 169-172; RE 52-55.

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[1] Citations are to the Record on Appeal and the page number therein, in the following form: "R. [docket number] at --." Cites to the Appellant's Record Excerpts will appear as "RE [page number] and cites to the Appellee's Record Excerpts will appear as "AP RE" [tab number].

The court kept the other standing order under advisement. *Id*. On February 4, 2010, plaintiff filed a notice of appeal from the district court’s order. R. 21, RE 62.

On March 5, 2010, the United States Bankruptcy Court for the Western District of Louisiana issued a new “Standing Order Regarding ‘No-Look’ Fees and Addendums” in Chapter 13 Cases. Pl. Br., Exh. A. That revised order -- signed by all three judges of the bankruptcy court -- expressly “supersede[d]” and “rescinded” the standing orders challenged here. *Id*. at 4-5.

On March 9, 2010, the district court explicitly dismissed plaintiff’s case as moot. R. 40, AP RE 1. Plaintiff did not file a notice of appeal from that final judgment. As set forth below, this Court lacks jurisdiction over the present appeal.

STATEMENT OF THE ISSUES PRESENTED FOR REVIEW

1. Whether this Court lacks jurisdiction over the present appeal because it is moot.

2. Whether the district court in any event lacked subject matter jurisdiction over plaintiff’s case.

3. Whether, even if the case were not moot and the district court had jurisdiction, the district court abused its discretion in denying plaintiff’s request for a writ of prohibition.

STATEMENT OF THE CASE

On November 30, 2009, Judge Stephen V. Callaway of the United States Bankruptcy Court for the Western District of Louisiana entered two standing orders addressing the award of attorney’s fees and expenses to debtors’ counsel in Chapter 13 cases: (1) the “Standing Order Regarding Reimbursement of Fees or Expenses Advanced by Debtor Counsel from Chapter 13 Bankruptcy Estate” (“first standing order”); and (2) the “Standing Order Regarding Utilization of a ‘No Look Fee with Sliding Scale’ for Chapter 13 Cases” (“second standing order”). R. 1, Exh. C & D, RE 17-36. On December 2, 2009, plaintiff McBride & Collier, a law firm that represents debtors in the Western District of Louisiana, filed an action in federal district court against Judge Callaway in his official capacity. R. 1 at 7-8, RE 3-4. Plaintiff sought a writ of prohibition and preliminary injunctive relief against enforcement of the standing orders. *Id*. at 7, 15-16, RE 3, 11-12. Judge Callaway moved to dismiss plaintiff’s case for lack of jurisdiction. R. 12.

On January 25, 2010, without ruling on the motion to dismiss, the district court denied plaintiff’s request for a writ of prohibition with respect to the first standing order. R. 16, RE 52-55. The court noted that the second standing order remained under advisement. *Id*. at 4, RE 55. On February 4, 2010, plaintiff filed a notice of appeal from the district court’s January 25, 2010 order. R. 21, RE 62.

On March 5, 2010, the United States Bankruptcy Court for the Western District of Louisiana issued a new “Standing Order Regarding ‘No-Look’ Fees” in Chapter 13 Cases. Pl. Br. Exh. A. That revised order, which was signed by all three bankruptcy judges in the Western District of Louisiana, including Judge Callaway, expressly “supersede[d]” the standing orders challenged by plaintiff in the present case, and also expressly "rescinded" both of those orders "retroactive to the date of their entry." *Id*. at 4-5. Accordingly, on March 9, 2010, the district court dismissed plaintiff's case as moot. R. 40, AP RE 1. Plaintiff did not file a notice of appeal from that final order.

STATEMENT OF FACTS

A. Statutory Framework.

Section 330 of the Bankruptcy Code provides bankruptcy courts with "discretion to award reasonable compensation to debtors' attorneys in bankruptcy cases." *In re Cahill*, 428 F.3d 536, 539 (5th Cir. 2005). Pursuant to Section 330(a)(4)(B), a court in a Chapter 13 case "may allow reasonable compensation to the debtor's attorney for representing the interests of the debtor in connection with the bankruptcy case based on a consideration of the benefit and necessity of such services to the debtor and the other factors set forth in this section." 11 U.S.C. § 330(a)(4)(B).[2] Section 329 mandates disclosure to the bankruptcy court of any payments by the debtor to attorneys or agreements to pay attorneys "made after one year before the date of the filing of the petition." 11 U.S.C. § 329(a). That section also authorizes the bankruptcy court to "review all

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[2] Individual debtors most commonly file for bankruptcy under Chapter 7 or Chapter 13 of the Bankruptcy Code. Under Chapter 13, "a debtor commits to repay some portion of his or her financial obligations" over a specified period "in exchange for retaining nonexempt assets and receiving a broader discharge of debt than is available under chapter 7." H.R. Rep. 109-31(I), 109th Cong., 1st Sess. at 10 (2005), *reprinted in* 2005 U.S.C.C.A.N. 88, 97; see 11 U.S.C. §§ 1321–1330.

attorney compensation and agreements for reasonableness, and to cancel excessive service agreements or order return of payments if they are excessive." *Barron* v. *Countryman*, 432 F.3d 590, 595 (5th Cir. 2005).

In reviewing compensation requests, the bankruptcy court considers "the nature, the extent, and the value of [the attorney's] services, taking into account all relevant factors," which include, *inter alia*, the time spent, the rates charged, and whether the services were necessary and performed "within a reasonable amount of time commensurate with the complexity, importance, and nature of the problem, issue, or task addressed." 11 U.S.C. § 330(a)(3). "[C]ompensation and reimbursement awarded under section 330(a)" is an allowed administrative expense of a bankruptcy estate. 11 U.S.C. § 503(b)(2).

B. Factual Background.

1. The "No-Look" Fee Procedure And The Challenged Standing Orders.

The Bankruptcy Court for the Western District of Louisiana has historically used a "no-look" procedure for awarding attorney's fees in Chapter 13 cases, under which attorneys may elect the "no-look" fee rather than filing a formal fee application. Pl. Br. Exh. A at 1. The "no-look" fee is a pre-calculated amount that the court has determined is reasonable attorney compensation for a typical case. *Id*. Attorneys could also file a formal fee application to seek more compensation, and the court could reduce the "no-look" fee if an attorney's work did not justify the standard "no-look" amount. *Id*.

On November 30, 2009, the bankruptcy court, per Judge Callaway, entered two standing orders governing the reimbursement of fees and expenses advanced by debtors’ counsel in Chapter 13 cases in the Shreveport and Monroe Divisions. R. 1, Exh. C, D, RE 17-36. The court’s first standing order provided that it would no longer routinely approve the reimbursement of filing, credit counseling and reporting fees advanced by debtor’s counsel as allowed administrative priority expenses under the then-applicable “No Look” Fee Addendum, but rather would allow such reimbursement only after consideration of a post-confirmation Formal Application. R. 1, Exh. C at 23-25, RE 19-21.

The court’s second standing order established a new “No Look” Fee using a sliding-scale formula. R. 1, Exh. D, RE 22-36. As the court explained, the “no-look” fee procedure had recently become subject to abuse, as the compensation received by some attorneys “exceeded the value of their services being performed using the guidelines set forth in 11 U.S.C. § 330(a)(3)[.]” *Id*. at 26, RE 22. The bankruptcy court found that substantial revisions to the then-current “no-look” fee were warranted, and accordingly promulgated a revised “no-look” procedure using sliding-scale compensation. *Id*. at 27-28, RE 23-24.

The court noted that, under its prior “no look” fee practice, it had allowed reimbursement of filing fees, credit counseling fees and charges for debtors’ credit reports paid by debtors’ counsel, and had considered such fees as administrative expenses of the estate under 11 U.S.C. § 503(b)(2). R. 1, Exh. C

22-23, RE 18-19. The court determined, however, that “the advancing of expenses * * * by Chapter 13 debtor’s counsel pre-filing may not entitle Chapter 13 debtor’s counsel to an administrative expense entitled to priority status and that can be reimbursed by the debtor or bankruptcy estate.” *Id*. at 24, RE 20. The court directed that “should such reimbursement be an allowed administrative priority expense that same must still meet other statutory and jurisprudential requirements which are not presently being met by utilization of the ‘No Look’ Fee[.]” *Id*. The first standing order thus required debtors’ counsel seeking reimbursement of such expenses to file a post-confirmation Formal Application. *Id*. at 25, RE 21.

2. District Court Proceedings And The New Standing Order.

On December 2, 2009, plaintiff filed an action in district court against Judge Callaway in his official capacity. R. 1 at 7-8, RE 3-4. Plaintiff sought a writ of prohibition and preliminary injunctive relief against enforcement of the two November 30, 2009 standing orders. *Id*.; R. 3, RE 41-42. Judge Callaway moved to dismiss plaintiff’s case for lack of jurisdiction on the grounds, *inter alia*, that plaintiff failed to satisfy the Article III case or controversy requirement, and that Congress had not waived sovereign immunity. R. 12.

On January 25, 2010, without ruling on the motion to dismiss, the district court denied plaintiff’s request for a writ of prohibition with respect to the first standing order. R. 16 at 169-172, RE 52-55. The court ruled that Judge Callaway acted "well within his sound discretion" under the Bankruptcy Code. R. 16 at 171, RE 54. The court noted that the second standing order remained under advisement. *Id*. at 172, RE 55.

On February 4, 2010, plaintiff filed a notice of appeal from the district court's ruling denying the writ of prohibition with respect to Judge Callaway's first standing order. R. 21, RE 62. The present interlocutory appeal thus involves only one of the two November 2009 standing orders issued by Judge Callaway.

On March 5, 2010, while this appeal was pending, the United States Bankruptcy Court for the Western District of Louisiana issued a new "Standing Order Regarding 'No-Look' Fees and Addendums" in Chapter 13 Cases. Pl. Br., Exh. A. That revised order was signed by all three bankruptcy judges in the Western District of Louisiana, including Judge Callaway. It expressly "supersedes" both of the standing orders challenged by plaintiff in the present case, and also expressly "rescind[s]" those orders "retroactive to the date of their entry." *Id*. at 4-5.

Accordingly, on March 9, 2010, the district court dismissed plaintiff's case as moot. R. 40, AP RE 1. Plaintiff did not file a notice of appeal from that final judgment.

SUMMARY OF ARGUMENT

Plaintiff seeks a writ of prohibition against a rescinded bankruptcy court order, in the context of a case that has been dismissed as moot, and where, in any event, the district court lacked jurisdiction from the outset. Under these circumstances, plaintiff's appeal must plainly be dismissed on jurisdictional grounds. And, even assuming *arguendo* that the case were not moot and that the district court had jurisdiction, plaintiff has not established, nor could it establish, entitlement to the extraordinary relief it seeks. This case is meritless in every respect.

1. Plaintiff challenges the district court's refusal to grant a writ of prohibition against enforcement of a standing order that not only has been expressly *rescinded*, but was also never applied to deny fees or expenses to plaintiff. Because the challenged standing order is no longer in effect, it cannot conceivably cause plaintiff any present or future harm. Plaintiff's action for a writ of prohibition has thus become moot. This basic point is controlling here.

Indeed, the district court recognized that the action had become moot, and, while this interlocutory appeal was pending, entered a final order expressly dismissing plaintiff's case on mootness grounds. Plaintiff has not appealed from that final order. It is thus abundantly clear that this Court cannot fashion any relief that could affect the parties' rights.

2. Even if the appeal were not moot, the district court lacked subject matter jurisdiction over plaintiff's complaint for several reasons: (1) plaintiff failed to present a justiciable case or controversy under Article III; (2) plaintiff lacks standing; and (3) Congress has not waived sovereign immunity. This Court need not reach any of these issues, if, as we urge, the appeal is dismissed as moot.

a. Plaintiff seeks an advisory opinion regarding the legality of a now-defunct standing order of the bankruptcy court. A proper case or controversy could have existed only if, in the context of an actual bankruptcy case, Judge Callaway had denied a request by plaintiff for reimbursement of fees and expenses pursuant to the standing order. No such case or controversy exists or has ever existed here.

b. Plaintiff similarly lacks standing to bring this action. Plaintiff has not shown that it has suffered or will imminently suffer any injury-in-fact. Indeed, plaintiff has not provided examples of any fee requests that it made that were denied under the rescinded standing order.

Plaintiff also failed to establish that the harm alleged in its complaint -- infringement of its First Amendment rights and predicted future monetary losses -- could be caused by, or fairly traceable to, the challenged standing order. The standing order did not limit or regulate plaintiff’s advertising. In addition, since plaintiff filed suit without first seeking reimbursement of fees and expenses in accordance with the order’s requirements, it failed to show that the standing order could cause it any financial harm.

Plaintiff’s claimed injury is also in no way redressable by the relief that it seeks. Plaintiff could not show that it is likely that a writ of prohibition against the standing order would have allowed it to obtain greater compensation in future bankruptcy cases. To the contrary, any such suggestion would have been wholly speculative, because, entirely apart from any standing order, Judge Callaway would have retained the authority and duty under the Bankruptcy Code to apply its provisions governing attorney compensation, and to deny or reduce plaintiff’s reimbursement requests consistent with such provisions. Article III standing precepts thus independently bar this suit, wholly apart from the fact that the case has now become moot.

c. Because plaintiff filed suit against Judge Callaway in his official capacity, this action cannot proceed absent a waiver of sovereign immunity. Although plaintiff invokes several federal statutes in its complaint, none contains the requisite waiver or provides authority for the district court to assert jurisdiction.

3. Even assuming *arguendo* that the case were not moot and that the district court had jurisdiction, the district court properly denied plaintiff’s request for a writ of prohibition. Again, there is no reason or need for this Court to reach this point, and we include it solely for the sake of completeness.

Courts will issue a writ of prohibition only in extraordinary circumstances to “confine an inferior court to a lawful exercise of its prescribed jurisdiction” where the court has committed “clear and indisputable” error, and plaintiff has no other avenue available to obtain relief. See *Kerr* v. *United States Dist. Ct. for the Northern Dist. of California*, 426 U.S. 394, 402-403 (1976). Plaintiff here could not meet this exacting standard. In issuing the challenged standing order, Judge Callaway acted well within his jurisdiction under the Bankruptcy Code and consistent with this Court's precedent. Moreover, appeal to the district court would have been readily available under 28 U.S.C. § 158 in any case in which Judge Callaway had applied the standing order to actually deny or reduce a request for fees and expenses. Such an appeal would not only have qualified as another avenue for plaintiff to obtain relief, but would also have provided a vehicle for review without the jurisdictional defects that underlie plaintiff's present action. In sum, there is no basis for any relief here on the merits, even if the fatal jurisdictional obstacles could somehow be overcome.

STANDARD OF REVIEW

This Court determines *de novo* whether the present appeal has become moot. See *Harris* v. *City of Houston*, 151 F.3d 186, 189 (5th Cir. 1998). This Court also reviews *de novo* whether the district court had subject matter jurisdiction. *Stiles* v. *GTE Southwest, Inc.*, 128 F.3d 904, 906 (5th Cir. 1999). The district court's denial of a writ of prohibition is reviewed for abuse of discretion. *Helstoski* v. *Meanor*, 442 U.S. 500, 506 (1979); *In re Corrugated Container Antitrust Litigation*, 614 F.2d 958, 962 (5th Cir.), *cert. denied*, 449 U.S. 888 (1980).

ARGUMENT

I. THIS COURT LACKS JURISDICTION OVER THE PRESENT APPEAL BECAUSE IT IS MOOT.

Under Article III of the Constitution, a plaintiff must allege an actual, ongoing case or controversy. *Lewis* v.

Continental Bank Corp., 494 U.S. 472, 477 (1990). A case is moot "when the issues presented are no longer 'live' or the parties lack a legally cognizable interest in the outcome." *Murphy* v. *Hunt*, 455 U.S. 478, 481 (1982) (internal quotations omitted). Moreover, "it is not enough that a dispute was very much alive when suit was filed, * * * [t]he parties must continue to have a personal stake in the outcome of the lawsuit." *Lewis*, 494 U.S. at 477-78 (internal quotations omitted); *Environmental Conserv. Org.* v. *City of Dallas*, 529 F.3d 519, 527 (5th Cir.), *cert. denied*, 129 U.S. 418 (2008). Thus, in an action for prospective relief, there must be "some present harm left to enjoin," for "[o]nce the movant is no longer in harm's way, a motion for an injunction becomes moot." *Taylor* v. *RTC*, 56 F.3d 1497, 1502 (D.C. Cir.), *amended in part on other grounds*, 66 F.3d 1226 (D.C. Cir. 1995).

As this Court has recognized, it is "beyond dispute that a request for injunctive relief generally becomes moot upon the happening of the event sought to be enjoined." *Harris*, 151 F.3d at 189. Article III limits federal courts "to resolving real and substantial controvers[ies] admitting of specific relief through a decree of conclusive character, as distinguished from an opinion advising what the law would be upon a hypothetical state of facts." *Lewis*, 494 U.S. at 477 (internal quotations omitted).

A. The Standing Order That Plaintiff Seeks To Enjoin Has Been Expressly Superseded And Rescinded.

1. On March 5, 2010, the bankruptcy court issued a new standing order governing reimbursement of fees in Chapter 13

cases. That order by its terms “supersede[d]” and “rescinded” the standing order that is the subject of this appeal. Pl. Br. Exh. A. Thus, plaintiff’s request for relief is plainly moot. Plaintiff sought a writ of prohibition against enforcement of a standing order that is now no longer in effect.

There is no “present harm left to enjoin” from the standing order. Nor is there any need for a preliminary injunction or writ of prohibition against enforcement of an order that has been “supersede[d]” by a new Standing Order signed by all three bankruptcy judges of the Western District of Louisiana, and that also has been “rescinded retroactive to the date of [its] entry.” Pl. Br. Exh A at 4. The relief sought here would be wholly ineffective as it would bar enforcement of an order that is no longer in force.

2. While the present interlocutory appeal was pending, the district court also entered a final order expressly dismissing plaintiff’s entire case as moot. March 9, 2010 Order, R. 40 at 320, AP RE 1 (“the captioned matter is hereby Dismissed as Moot. The Clerk is now requested to close this case.”). Plaintiff did not file a notice of appeal from this final order, and the applicable 60-day appeal period has now expired. Fed. R. App. P. 4(a)(1)(B). Thus, for this reason too, “‘[n]o order of this Court could affect the parties’ rights[.]’” *Marilyn T., Inc.* v. *Evans*, 803 F.2d 1383, 1384 (5th Cir. 1986) (quoting *Honig* v. *Students of the California School for the Blind*, 471 U.S. 148, 149 (1985)).

In short, not only has the issue of any prospective relief become moot, but plaintiff also has failed to appeal a final order expressly dismissing the entire case as moot. Under these circumstances, this Court should dismiss the appeal for lack of jurisdiction.[3]

B. The Present Case Does Not Fall Within Any Exception To Mootness.

Plaintiff acknowledges that the new March 5, 2010 Standing Order supersedes the challenged standing order issued by Judge Callaway. Pl. Br. 18. Plaintiff contends (Br. 18), however, that the case is not moot because, according to plaintiff, the March 2010 standing order continues to deny reimbursement of advance payments made by debtor's counsel for filing fees, debtor education and credit counseling fees. In support of this contention, plaintiff cites to cases applying the "voluntary cessation" doctrine, but appears to find them inapplicable by arguing that Judge Callaway "has not yet even ceased the same challenged action that is the subject of this appeal." Pl. Br. 19. Plaintiff also argues (Br. 19) that the case is "capable of repetition, yet evading review." Neither of these exceptions to mootness applies.

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[3] Plaintiff asserts that this Court has jurisdiction over appeals from "final orders" of the district court. Pl. Br. 1 (citing 28 U.S.C. §§ 158(d) and 1291). But the January 25, 2010 order that plaintiff appeals from is not final because the court took the second standing order under advisement. The district court did not rule on all of plaintiff's claims until it issued its final order on March 9, 2010 dismissing plaintiff's entire case as moot.

1. Plaintiff urges that "'a defendant's voluntary cessation of a challenged practice does not deprive a federal court of its power to determine the legality of the practice.'" Pl. Br. 18 (quoting *Gates* v. *Cook*, 376 F.3d 323, 337 (5th Cir. 2004)). The "voluntary cessation" analysis applies only when a defendant voluntarily ceases its challenged conduct and the court is concerned that the defendant may resume its behavior with a consequent impact on the plaintiff. *Gates*, 376 F.3d at 337; *Friends of the Earth, Inc.* v. *Laidlaw Environmental Serv. (TOC), Inc.*, 528 U.S. 167, 190 (2000).

There is no reasonable expectation here that Judge Callaway will reissue the challenged standing order. Because the challenged standing order has been superseded and rescinded by a new standing order issued not only by Judge Callaway, but also by the other bankruptcy judges in the Western District of Louisiana, there has been no "voluntary cessation." Rather, the case is moot because the challenged judicial order no longer exists, and a new, different standing order issued by three judges -- two of whom are not parties to the instant action -- has superseded it.

Plaintiff argues (Br. 19) that its appeal is not moot because the new March 2010 standing order continues to cause it harm by denying reimbursement of fees and expenses. Cases addressing whether a plaintiff's challenge to legislation becomes moot when the legislation is repealed or amended demonstrate the error in plaintiff's argument. In such cases, "the [Supreme] Court has upheld the general rule that repeal, expiration, or significant amendment to challenged legislation ends the ongoing controversy and renders moot a plaintiff's request for injunctive relief." *Federation of Advertising Ind. Representatives, Inc.* v. *City of Chicago*, 326 F.3d 924, 930 (7th Cir.), *cert. denied*, 540 U.S. 879 (2003). It is only where "there is evidence that the repeal was not genuine" that the Court has "refused to hold the case moot." *Id*. In short, "repeal of a contested ordinance moots a plaintiff's injunction request, absent evidence that the City plans to or already has reenacted the challenged law or one substantially similar." *Id*.; *McCorvey* v. *Hill*, 385 F.3d 846, 849 (5th Cir. 2004), *cert. denied*, 543 U.S. 1154 (2005).

Analogously, rescission of the challenged court order moots plaintiff's request for a writ of prohibition. Contrary to plaintiff's suggestion, the March 2010 standing order that supersedes and rescinds the order at issue here does not save the case from mootness. As an initial matter, even if the new order were exactly the same as the challenged order, this Court could not issue any effective relief because the other two bankruptcy judges who signed the order are not parties to this litigation. Even assuming that the Court had jurisdiction to issue a writ of prohibition under the circumstances of this case, such relief could not apply to non-parties. Indeed, the role of the other two bankruptcy judges in promulgating the March 2010 standing order in and of itself distinguishes the present action from cases in which courts have applied the voluntary cessation exception. Those two judges were necessary parties in issuing the March 2010 standing order. Thus, third parties were jointly responsible with Judge Callaway for the repeal of the challenged standing order. For this reason alone, the voluntary cessation doctrine does not apply here. *Chihuahuan Grasslands Alliance* v. *Kempthorne*, 545 F.3d 884, 893 (10th Cir. 2008) (voluntary cessation inapplicable when third parties' actions moot case).

There are other significant differences between the full bankruptcy court's March 2010 Standing Order and Judge Callaway's now-rescinded standing order that also confirm that this case is moot. Although plaintiff states (Br. 18) that the March 2010 Standing Order continues to deny it reimbursement of expenses, the portion of the order that plaintiff quotes belies this assertion. While Judge Callaway's now-defunct order made clear that advanced fees and expenses "may not entitle Chapter 13 debtor's counsel to an administrative expense entitled to priority status and that can be reimbursed by the debtor or bankruptcy estate," and required counsel seeking reimbursement of such fees to file a Formal Application (R. 1, Exh. C at 24-25, RE 20-21), the March 2010 Standing Order expressly recognizes that such fees and expenses "will be considered included in the no-look fee of $2800." Pl. Br. Exh. A at 2. Because the March 2010 Standing Order provides that such fees and expenses are considered included as part of a no-look fee, any legal issues raised in connection with the new order would be distinct from plaintiff's argument in support of a writ of prohibition in the present appeal -- i.e., that fees and expenses advanced by debtors counsel are reimbursable from the bankruptcy estate. Pl. Br. 6.

2. Plaintiff further maintains (Br. 19) that this action falls within the exception to mootness for cases that are “capable of repetition, yet evading review.” But “[t]his exception applies ‘only in exceptional situations . . . where the following two circumstances are simultaneously present: (1) the challenged action is in its duration too short to be fully litigated prior to cessation or expiration, and (2) there is a reasonable expectation that the same complaining party will be subject to the same action again.’” *Benavides* v. *Housing Auth. of the City of San Antonio*, 238 F.3d 667, 671 (5th Cir. 2001) (quoting *Spencer* v. *Kemna*, 523 U.S. 1, 17 (1998)). Plaintiff bears the burden of proving both prongs of the exception. Plaintiff has not met its burden and cannot do so.

Plaintiff has not shown, nor could it show, that its claim will evade review. Plaintiff relies solely on the fact that the challenged standing order was rescinded prior to the conclusion of this litigation. But plaintiff provides no evidence that bankruptcy court standing orders generally remain in effect for short durations of time, nor has plaintiff established that the March 2010 standing order is itself likely to be rescinded before a challenge to its application could be litigated.

Moreover, if the new standing order were applied to plaintiff in the context of an actual bankruptcy case, then there is no reason why a challenge to the order could not be litigated.

Indeed, plaintiff is currently challenging application of the March 2010 standing order in two specific bankruptcy cases that are pending in district court. See *White* v. *Clerk, U.S. Bankr. Court*, No. 5:10-cv-00645 (W.D. La.); *Dayries* v. *Clerk, U.S. Bankr. Court*, No. 5:10-cv-00646 (W.D. La.). Those cases demonstrate that plaintiff's challenge to the existing scheme will not, in any relevant sense, evade review.[4]

Nor has plaintiff established any "reasonable expectation" that it could be subject to the now-rescinded standing order in the future. To the contrary, Judge Callaway (along with the other two bankruptcy judges in the district) signed the March 2010 standing order, thereby agreeing that the order at issue here would no longer have any effect. As set forth above, unlike the challenged order in the present case, the March 2010 standing order recognizes that fees and expenses advanced by debtors' counsel are considered included in the no-look fee; if the total fees, including amounts advanced, exceed $2800, debtors' counsel may file a formal fee application. Plaintiff alleged here (Br. 12-17) that Judge Callaway's standing order would cause it injury

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[4] *Center for Individ. Freedom* v. *Carmouche*, 449 F.3d 655 (5th Cir. 2006), *cert. denied*, 549 U.S. 1112 (2007), upon which plaintiff relies (Br. 19), is thus distinguishable. That case involved a challenge to state campaign finance legislation, and "[c]ontroversy surrounding election laws, including campaign finance regulations, is one of the paradigmatic circumstances in which the Supreme Court has found that full litigation can never be completed before the precise controversy (a particular election) has run its course." *Id*. at 661. Here, if the bankruptcy court or district court denies plaintiff reimbursement of fees in a particular bankruptcy case, there is no reason that a challenge to such a denial could not be fully litigated.

by denying reimbursement for filing fees, fees for debtor education, and credit counseling fees advanced to the debtor. Thus, the March 2010 standing order does not implicate the same claim that plaintiff has asserted in the present appeal, and confirms that plaintiff’s claim is in no meaningful sense “capable of repetition.” This case is plainly moot.

II. THE DISTRICT COURT IN ANY EVENT LACKED SUBJECT MATTER JURISDICTION OVER PLAINTIFF’S COMPLAINT.

This Court need not proceed further to decide this case, as mootness is dispositive. We note for the sake of completeness, however, that in district court, Judge Callaway moved to dismiss plaintiff’s case for lack of subject matter jurisdiction on numerous grounds, including, *inter alia*, lack of an Article III case or controversy, no waiver of sovereign immunity, and lack of standing. If this interlocutory appeal were not moot and the district court had not already entered a final order of dismissal from which no appeal has been taken, the case in any event would have to be remanded with instructions to dismiss for lack of jurisdiction.

A. Plaintiff’s Complaint Does Not Satisfy The Article III Case Or Controversy Requirement.

Plaintiff has not challenged application of the pertinent order in any particular bankruptcy case; in fact, Judge Callaway never applied the standing order to deny or reduce any request for fees and expenses by plaintiff. A proper case or controversy would have arisen only if and when, in the context of an actual bankruptcy case, Judge Callaway had denied a fee request by plaintiff pursuant to the standing order. See *United States Nat'l Bank of Oregon* v. *Independent Ins. Agents of America, Inc.*, 508 U.S. 439, 446 (1993). No such scenario exists here.

In litigation challenging a court's standing order, "the focus must be on *application* of the standing order, and not its existence as an abstract matter." *United States* v. *Zingsheim*, 384 F.3d 867, 870 (7th Cir. 2004). Because plaintiff here challenged the standing order only as an abstract matter, it has failed to allege a case or controversy under Article III, even apart from the fact that the entire matter has now become moot.

B. Plaintiff Lacks Standing.

For similar reasons, plaintiff lacks standing and has lacked standing since the inception of the case. To establish standing under Article III, a plaintiff must show that it has suffered (1) a "concrete and particularized injury" that is actual or imminent; (2) caused by, or fairly traceable to, the defendant's challenged action; and (3) likely to be redressed by a favorable decision. *Lujan* v. *Defenders of Wildlife*, 504 U.S. 555, 560-61 (1992); *Little* v. *KPMG, LLP*, 575 F.3d 533, 540 (5th Cir. 2009). Plaintiff has the burden of proof on all three elements. *Id*. That burden has not been and cannot be met here.

To have standing, a plaintiff must show "actual injury redressable by the court," which "tends to assure that the legal questions presented to the court will be resolved, not in the rarified atmosphere of a debating society, but in a concrete factual context conducive to a realistic appreciation of the consequences of judicial action." *Doe* v. *Tangipahoa Parish Sch. Dist.*, 494 F.3d 494, 496 n.2 (5th Cir. 2007) (en banc) (internal quotations omitted). Here, plaintiff cannot establish any of the required elements of Article III standing; rather, it sought a decision from the district court on the validity of Judge Callaway's standing order in the abstract, without any factual context provided by an actual case.

1. Plaintiff has not shown that it has suffered or will imminently suffer any injury-in-fact. Indeed, plaintiff does not provide any concrete examples of denials of any fee requests under the now-rescinded standing order. That is not surprising, since the standing order was not applied to deny plaintiff reimbursement of fees or expenses. As the Supreme Court has repeatedly emphasized, "[a]llegations of possible future injury do not satisfy the requirements of Art. III." *E.g.*, *Whitmore* v. *Arkansas*, 495 U.S. 149, 158 (1990). Rather, a "threatened injury must be certainly impending to constitute injury in fact." *Id*. (internal quotations omitted). And plaintiff must demonstrate that "the injury complained of be, if not actual, then at least imminent[.]" *Lujan*, 504 U.S. at 564 n.2.

Here, plaintiff's alleged injuries were wholly conjectural. No actual instance of harm appeared in plaintiff's complaint. See R. 1 at 7-16, RE 3-12. Rather, plaintiff asserted that the standing order would cause it harm by denying reimbursement of fees advanced to debtors, thereby infringing on its free speech rights by interfering with its ability to advertise its willingness to advance costs to debtors in Chapter 13 bankruptcy cases. *Id*. at 9-12, RE 5-8. But the standing order did not limit or regulate plaintiff's advertising. Plaintiff's complaint did not cite any language in the standing order in support of its allegation concerning infringement of its right to commercial free speech, nor could it. Tellingly, the argument in plaintiff's opening appellate brief does not mention any alleged infringement of its right to commercial free speech. Pl. Br. 6-20. Plaintiff has thus abandoned any such argument.

Nor has plaintiff shown that the (now-defunct) standing order caused or would cause it any actual financial harm. Instead, plaintiff speculated that, under the terms of the order, its fee awards in Chapter 13 cases would decrease in the future. R. 1 at 10, RE 6. As plaintiff recognizes (Br. 13-14), however, the standing order did "make provision for the filing of an application for fees and expenses in excess of the 'no look' fee in the form of a formal fee application." Thus, plaintiff's estimate of future financial harm from application of the order was always conjecture. Without first attempting and being denied reimbursement under the standing order, plaintiff could not show injury-in-fact sufficient to support Article III standing.

Plaintiff's acknowledgment that it cannot satisfy the "person aggrieved" requirement for establishing appellate standing in bankruptcy cases further demonstrates its failure to adequately show injury-in-fact. See R. 1 at 15, RE 11. Under the "person aggrieved" standard, a private party must be "directly and adversely affected pecuniarily" by a bankruptcy court order to establish standing to appeal. *E.g., In re Coho Energy Inc.*, 395 F.3d 198, 203 (5th Cir. 2004) (internal quotations omitted). In its complaint, plaintiff attempted to justify seeking a writ of prohibition by acknowledging that it was "without an immediate avenue to attack the Standing Orders, given the necessity to be a person directly aggrieved in order to appeal[.]" R. 1 at 15, RE 11 (citing *In re LTV Steel Co., Inc.*, 560 F.3d 449 (6th Cir. 2009) (dismissing appeal of bankruptcy court's Standing Order because appellant did not satisfy "person aggrieved" standard)). Though plaintiff nonetheless claimed that it was "suffering exigent monetary harm," it nowhere identified how the standing order had caused it such harm. R. 1 at 15-16, RE 11-12.

Where, as here, "claimed anticipatory injury has not been shown to be more than uncertain potentiality," federal courts "consistently deny standing." *Prestage Farms, Inc.* v. *Board of Supervisors of Noxubee County, Mississippi*, 205 F.3d 265, 268 (5th Cir. 2000). Because plaintiff failed to establish any actual or imminent harm caused by the standing order, its alleged "future injury * * * [was] too conjectural and hypothetical to provide Article III standing." *Id*. Again, this is all apart from the fact that the case has now irrevocably mooted out.

2. Plaintiff likewise failed to establish that the harm alleged in its complaint -- infringement of its First Amendment rights and predicted future monetary losses -- could be caused

by, or fairly traceable to the challenged standing order. As set forth above, the standing order did not restrict plaintiff's advertising, and thus, plaintiff remained (and remains) free to advertise its services in any way it deemed appropriate consistent with the requirements of Bankruptcy Code Sections 526, 527 and 528 (which regulate advertising by debt relief agencies) and applicable legal ethics provisions. *Milavetz, Gallop & Milavetz, P.A.* v. *United States*, 130 S. Ct. 1324, 1333, 1339-40 (2010) (bankruptcy attorneys qualify as "debt relief agencies" under Bankruptcy Code, disclosure requirements applicable to debt relief agencies do not violate First Amendment).

3. Plaintiff's claimed injury was similarly not redressable by the relief that it sought. Plaintiff could not show that it was likely, as opposed to speculative, that a court order invalidating the challenged standing order would allow it to obtain greater compensation in future bankruptcy cases. To the contrary, any such suggestion was always conjectural, because even if plaintiff had obtained a writ of prohibition against enforcement of the challenged standing order, Judge Callaway would have retained the authority and duty under the Bankruptcy Code to apply its provisions governing attorney compensation and reimbursement of costs. See 11 U.S.C. §§ 329, 330. Under such provisions, Judge Callaway would have the authority to reduce fee requests submitted by plaintiff and other debtors' counsel on a case-by-case basis. It is only in a proper appeal under 28 U.S.C. § 158, where plaintiff in an actual case had submitted a

request for fees and expenses, and the court had denied or reduced the amount requested, that plaintiff might suffer actual financial harm that could be redressed by a court order.

C. There Is No Waiver Of Sovereign Immunity For The Present Action.

Again, this Court need not proceed beyond the mootness point. We add, however, out of an abundance of caution, that the United States cannot be sued absent a congressional waiver of sovereign immunity. *United States* v. *Nordic Village, Inc.*, 503 U.S. 30, 33-34 (1992). Such "waivers of the Government's sovereign immunity, to be effective, must be unequivocally expressed." *Id*. at 33. Because plaintiff sued Judge Callaway in his official capacity as a United States bankruptcy judge, sovereign immunity bars the present action absent the requisite congressional waiver.[5] See *Kentucky* v. *Graham*, 473 U.S. 159, 166 (1985) ("official-capacity suit is, in all respects other than name, to be treated as a suit against the entity"); *Williamson* v. *United States Dept. of Agriculture*, 815 F.2d 368, 380-81 (5th Cir. 1987) ("United States and its officers in pursuit of their official duties remain protected by sovereign immunity").

Plaintiff's action is distinguishable from cases in which a writ of mandamus or prohibition is sought against a judge or lower court in an ongoing case or controversy between adverse parties. Cf., *e.g.*, *In re Occidental Petroleum Corp.*, 217 F.3d

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[5] Plaintiff is not suing Judge Callaway for damages, and, in any event, such a suit would be barred by absolute judicial immunity. *E.g.*, *Mireles* v. *Waco*, 502 U.S. 9, 11-12 (1991).

293 (5th Cir. 2000) (corporation petitions for mandamus from district court order requiring production of documents in suit between corporation and employees). In such circumstances, sovereign immunity is not at issue because the underlying lawsuit is not against the judge in his official capacity.[6]

The All Writs Act, 28 U.S.C. § 1651, does not provide the requisite waiver or even an independent basis for federal jurisdiction. "It is well established that the All Writs Act, by itself, creates no jurisdiction in the district courts." *Singh* v. *Duane Morris LLP*, 538 F.3d 334, 341 (5th Cir. 2008) (internal quotations omitted). Rather, the Act "empowers [district courts] only to issue writs in aid of jurisdiction previously acquired on some other independent ground." *Id*. at 341; *Chandler* v. *Judicial Council of the Tenth Circuit*, 398 U.S. 74, 86 (1970). Absent the requisite waiver of sovereign immunity, no such independent ground for jurisdiction exists in this case.[7]

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[6] In addition, no exception to sovereign immunity would apply here because plaintiff has neither shown nor adequately alleged that Judge Callaway acted *ultra vires*. See, *e.g.*, *Alabama Rural Fire Ins. Co.* v. *Naylor*, 530 F.2d 1221, 1226-27 (5th Cir. 1976) (even if defendant federal officer's actions were legally wrong, exception to sovereign immunity inapplicable where plaintiff failed to establish that actions were outside statutory authority); see *infra* pp. 33-38 (Judge Callaway acted well within authority under Bankruptcy Code).

[7] The other statutes that plaintiff invoked -- 28 U.S.C. §§ 1334, 1343 and 157 -- also do not waive sovereign immunity or support district court jurisdiction. R. 1 at 7-8, RE 3-4. Section 1334 is inapplicable because plaintiff's action was not filed in connection with a bankruptcy petition, and its cause of action was not created or premised on a provision of the Bankruptcy Code. *Matter of Wood*, 825 F.2d 90, 92, 96 (5th Cir. 1987). Section 157 merely provides that district courts may refer

(continued...)

III. THE DISTRICT COURT PROPERLY DENIED PLAINTIFF'S REQUEST FOR A WRIT OF PROHIBITION.

Finally, even if this appeal were not moot and even if the district court had jurisdiction, plaintiff still would not be entitled to relief. The sole issue plaintiff raises on appeal is whether it is entitled to a writ of prohibition against enforcement of Judge Callaway's now-rescinded standing order. See Pl. Br. 6. But a writ of prohibition is "reserved for only the most extraordinary cases, or where the error of the district court is clear and indisputable." *In re Grand Jury Proceedings in the Matter of Fine*, 641 F.2d 199, 201 (5th Cir. 1981). Moreover, a writ of prohibition or other extraordinary remedy under the All Writs Act is available only if plaintiff has established that he lacks any other adequate remedy. *Kerr* v. *United States Dist. Ct. for the Northern Dist. of California*, 426 U.S. 394, 402-403 (1976); *In re Montes*, 677 F.2d 415, 416 (5th Cir. 1982). Plaintiff plainly cannot meet any of these stringent requirements, even apart from the dispositive absence of jurisdiction.

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[7](...continued) cases that fall within their jurisdiction under 28 U.S.C. § 1334 to the bankruptcy court; it does not provide any additional basis for district court jurisdiction. 28 U.S.C. § 157(a),(b). And plaintiff's reference to 28 U.S.C. § 1343 fares no better, since "this court has long recognized that suits against the United States under the civil rights statutes [including § 1343] are barred by sovereign immunity." *Affiliated Prof. Home Health Care Ag.* v. *Shalala*, 164 F.3d 282, 286 (5th Cir. 1999).

A. There Is No Basis For Seeking Extraordinary Relief To Vacate An Order That Has Already Been Rescinded.

In district court, plaintiff sought a writ of prohibition against enforcement of two standing orders issued by Judge Callaway, only one of which -- the Standing Order Regarding Reimbursement of Fees or Expenses -- is at issue here. Plaintiff asserts (Br. 6) that "McBride & Collier seek[s] a writ of prohibition from this Court to be issued to the Defendant-Appellee vacating his 'Standing Order Regarding Reimbursement of Fees or Expenses Advanced by Debtor Counsel * * *' dated November 30, 2009."[8] As an initial matter, there is absolutely no justification for seeking the extraordinary relief of a writ of prohibition to vacate an order that *has already been rescinded*. Any order from this Court vacating the November 30, 2009 standing order would have no effect. The challenged standing order has already been retroactively vacated to the date of its issuance, and was, in any event, never applied to deny or reduce any request for fees or expenses by plaintiff. For this reason alone, the district court's denial of the writ of prohibition would have to be affirmed, even assuming *arguendo* that this Court had jurisdiction to reach the merits.

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[8] In the court below, plaintiff also sought a preliminary injunction against enforcement of the standing order. R. 1 at 16, RE 12. As detailed above, in the order from which plaintiff appeals, the district court denied the writ of prohibition, and subsequently, while this appeal was pending, the court dismissed plaintiff's entire case as moot. R. 16 at 169-172, RE 52-55; R. 40 at 320, AP RE 1. Plaintiff does not renew its request for a preliminary injunction before this Court, nor could it given that any request for preliminary relief is entirely moot.

B. Plaintiff May Appeal Any Denial Of Fees Or Expenses In An Actual Bankruptcy Case, And Thus Had An Adequate Remedy If The Standing Order Were Enforced Against It.

Even if the challenged standing order had remained in effect, an adequate legal remedy would have been available to plaintiff. Under 28 U.S.C. § 158, federal district courts have jurisdiction over appeals from bankruptcy court orders entered in bankruptcy “cases and proceedings.” 28 U.S.C. 158(a). If Judge Callaway had actually applied the challenged standing order as a basis for denying or reducing a request for reimbursement of fees and expenses by plaintiff in a pending bankruptcy case, plaintiff would be adversely affected pecuniarily, and thus would presumably qualify as a “person aggrieved” for purposes of appellate standing. See *In re Coho Energy*, 395 F.3d at 202. An appeal in such circumstances would not only provide an adequate alternative remedy, but would provide a far superior vehicle for challenging the bankruptcy court’s standing order. See *Chandler*, 398 U.S. at 86 (denying petition for writ of mandamus or prohibition where “other avenues of relief on the merits may yet be open to” petitioner). Only such a direct appeal would provide the court with the necessary factual context in which to evaluate plaintiff’s claims. See *id*. at 88 (noting that petitioner had failed to pursue other avenues of review, and as a result, had left Court with insufficient record and “a very knotty jurisdictional problem as well”).

The Seventh Circuit’s decision in *Zingsheim*, *supra*, is instructive. The court there denied the United States’ mandamus petition to vacate a district court’s standing order governing downward departure motions in sentencing proceedings. 384 F.3d at 869-70. The court held that, “[b]ecause appeal provides an adequate legal remedy for both the defendant and the United States, it is inappropriate to issue an extraordinary writ such as mandamus.” *Id*. at 870. The court stated that “[m]andamus is doubly inappropriate because the United States does not want us to direct the district judge to carry out any judicial duty in Moore’s prosecution; instead it want us to blot the standing order from the books.” *Id*.

Similarly, plaintiff here is not seeking a writ of mandamus to direct Judge Callaway to carry out any judicial duty in a bankruptcy case; rather, plaintiff seeks a writ of prohibition to vacate an already-rescinded standing order. In fact, the present case is *less* appropriate for issuing an extraordinary writ because plaintiff is not seeking relief in the context of a bankruptcy case, whereas in *Zingsheim*, the United States sought the writ in an actual criminal prosecution. Nonetheless, because in *Zingsheim* the United States did not “protest any step the district court ha[d] taken with respect to [defendant] Moore,” and its petition for mandamus thus “deals with the [standing] order in the abstract, and not with its consequences,” mandamus relief was deemed unavailable. 384 F.3d at 870.

Here, plaintiff likewise challenges a standing order in the abstract, rather than objecting to a specific application of the order in a particular bankruptcy case. Thus, even assuming *arguendo* that there were problems with the merits of the bankruptcy court's standing order, the district court correctly declined to issue a writ of prohibition. See *Zingsheim*, 384 F.3d at 870. As set forth below, however, even if the merits of the now-rescinded standing order were properly at issue, the district court correctly held that Judge Callaway was acting "well within the established boundaries of his authority" under the Bankruptcy Code. R. 16 at 171, RE 54.

C. Plaintiff Has Not Demonstrated "Clear And Indisputable" Error By The Bankruptcy Court.

1. Extraordinary relief under the All Writs Act "has traditionally been used in the federal courts only to confine an inferior court to a lawful exercise of its prescribed jurisdiction or to compel it to exercise its authority when it is its duty to do so." *Kerr*, 426 U.S. at 402. Moreover, to demonstrate entitlement to a writ of prohibition, plaintiff must show that the bankruptcy court committed "clear and indisputable" error. *Id*. at 403; *In re Grand Jury Proceedings*, 641 F.2d at 201. Plaintiff cannot possibly meet these standards here.

In issuing the challenged standing order, Judge Callaway acted consistent with circuit precedent and his authority under the Bankruptcy Code. The Code provides bankruptcy courts with "discretion to award reasonable compensation to debtors' attorneys in bankruptcy cases." *In re Cahill*, 428 F.3d 536, 539 (5th Cir. 2005). Pursuant to Section 330(a)(4)(B), a bankruptcy court in a Chapter 13 case "may allow reasonable compensation to the debtor's attorney for representing the interests of the debtor in connection with the bankruptcy case based on a consideration of the benefit and necessity of such services to the debtor and the other factors set forth in this section." 11 U.S.C. § 330(a)(4)(B). In determining whether a request for compensation is reasonable, the bankruptcy court considers "the nature, the extent, and the value of [the attorney's] services, taking into account all relevant factors," which include, *inter alia*, the time spent, the rates charged, whether the services were necessary and performed "within a reasonable amount of time commensurate with the complexity, importance, and nature of the problem, issue, or task addressed." 11 U.S.C. § 330(a)(3).

Moreover, Section 329 mandates disclosure to the bankruptcy court of any payments by the debtor to attorneys or agreements to pay attorneys "made after one year before the date of the filing of the petition." 11 U.S.C. § 329(a). That section also authorizes the bankruptcy court to "review all attorney compensation and agreements for reasonableness, and to cancel excessive service agreements or order return of payments if they are excessive." *Barron* v. *Countryman*, 432 F.3d 590, 595 (5th Cir. 2005). In addition, Section 105(a) of the Bankruptcy Code allows bankruptcy courts to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title." 11 U.S.C. § 105(a). These statutory provisions give bankruptcy judges ample authority to carefully examine attorneys' requests for fees and reimbursement, and to reduce or deny requests that they find are excessive.

Circuit precedent also provides a sound basis for Judge Callaway's standing order. This Court has approved the use of general or standing orders that set forth what a bankruptcy court will consider to be a reasonable fee award in a typical Chapter 13 case. *Cahill*, 428 F.3d at 540. As this Court explained in approving a bankruptcy court's General Order that applied a precalculated lodestar amount to attorney fee awards, "General Order 2004-5 attempts to clarify and streamline bankruptcy courts' review of Chapter 13 attorneys' fee applications, addressing the need for both efficiency and flexibility in handling the large number of Chapter 13 cases that bankruptcy courts in the Southern District of Texas review each year." *Id*.; see *Barron*, 432 F.3d at 595-96 (local bankruptcy court rule that allowed fee of $2000 or less without formal application was "commonsense approach to the practicalities of Chapter 13 representation"). *Cahill* noted that the General Order at issue set forth the precalculated lodestar amount, but also contemplated that courts would "continue to analyze and adjust fee applications on a case-by-case basis[.]" 428 F.3d at 541.

Consistent with these principles, Judge Callaway's standing order set forth general rules on the reimbursement of fees and expenses advanced by debtors' counsel. R. 1 Exh. C at 21-25, RE 17-21. But at the same time, the order expressly allowed for case-by-case examinations of requests for fees and expenses advanced by debtors' counsel through use of a formal application. *Id*. at 25, RE 21. Thus, the standing order did not entirely preclude such reimbursement; rather, its purpose was to ensure compliance with “statutory and jurisprudential requirements” that the court found were “not presently being met by utilization of the ‘No Look’ Fee[.]” *Id*. at 24, RE 20.

2. Plaintiff insists (Br. 14) that a writ of prohibition is nonetheless warranted because the standing order “impermissibly denie[d] reimbursement of expenses to McBride & Collier while allowing the same reimbursement of expenses to other attorneys who receive deposits from their clients pre-petition.” Plaintiff alleges (Br. 13) that “all Chapter 13 debtors attorneys are effectively being reimbursed for the advancement of those same costs from property of the estate when those attorneys pay for the court costs, credit counseling fees, and debtor education fees by use of an attorney’s credit card.”

Even assuming the premise of plaintiff’s argument were correct –- that Chapter 13 debtors’ attorneys who require deposits from debtors pre-petition for filing fees but pay such fees themselves by attorney credit cards are essentially advancing such fees to debtors and must seek reimbursement from the bankruptcy estate –- plaintiff has made no showing that the standing order would have applied any differently to such situations. As the order made clear, debtors’ attorneys could not use the “no look fee” if they sought “reimbursement from the bankruptcy estate or the debtor for any sums advanced for filing fees, credit counseling fees, credit reporting fees, or any other fees or expenses advanced[.]” R. 1 Exh. C at 24, RE 20. Thus, if the scenario that plaintiff describes in its brief were the legal equivalent of advancing a fee to a debtor and seeking reimbursement post-petition, then the standing order would have presumably applied.

In any event, plaintiff's argument only underscores why its case should be dismissed for lack of jurisdiction. Due to the posture of the case -- a pre-application challenge to a standing order -- and the fact that the order was in any event rescinded soon after its issuance, there is no record upon which this Court could decide how the standing order would have applied to specific factual scenarios.

Plaintiff's reliance (Br. 9-10) on this Court's decision in *Barron, supra*, further shows the error in plaintiff's argument. As *Barron* illustrates, whether debtors retain a legal interest in amounts deposited with their attorneys pre-petition is a complicated question that depends on the facts of individual debtors' agreements with their attorneys. See 432 F.3d at 595-97 (setting forth categories of retainer agreements; examining appellant's retainer agreement and practice to determine which category applies and whether pre-petition fees were property of estate). Indeed, factual circumstances such as filing-fee payment arrangements between debtors and attorneys will vary from case-to-case, and contrary to plaintiff's suggestion, filing fees are not always paid by attorney credit card. See, *e.g.*, Bankruptcy Fee Schedule (U.S. Bankr. Court, W.D. Louisiana), http://www.lawb.uscourts.gov/court/Fees/fees.htm (court "accepts

Cash, Credit Card, Money Orders, Bank Cashier’s Checks, Attorney/Firm Checks * * * for payment of filing fees”). Again, because plaintiff filed this action without the benefit of any factual context, its unsupported generalizations regarding Chapter 13 practice do not come close to showing “clear or indisputable” error.

Plaintiff’s argument that Judge Callaway’s standing order was contrary to the weight of legal authority also fails to advance its position. Plaintiff acknowledges (Br. 14) that this Court has “never expressly addressed the issue of reimbursement of bankruptcy filing fees[.]” That admission alone ends the inquiry. Since there is no binding precedent that had required Judge Callaway to allow reimbursement of fees advanced by debtors’ counsel, it could hardly be “clear and indisputable” error for the Judge to have required that attorneys seeking such reimbursement file formal applications for the court’s consideration. And, though plaintiff contends (Br. 15) that the “vast weight of authority holds that filing fees and other related expenses are reimbursable under 11 U.S.C. § 330,” plaintiff admits (Br. 16) that none of the cases it cites “actually address reimbursement of expenses in the context of a Chapter 13 debtors attorney.” Plaintiff also cites (Br. 16) two Chapter 11 cases in which courts denied reimbursement of filing fees. The district court thus correctly held that there was no binding precedent requiring Judge Callaway to reimburse fees advanced by Chapter 13 debtors’ counsel. R. 16 at 171, RE 54.

* * * * *

In sum, plaintiff seeks extraordinary relief under the All Writs Act to enjoin enforcement of a bankruptcy court order that has been expressly rescinded, in the context of a case that has been dismissed as moot, and where the district court lacked subject matter jurisdiction from the outset. And, even if the merits of the now-defunct standing order were properly at issue, the district court correctly ruled that, consistent with circuit precedent, Judge Callaway acted "well within his sound discretion" under the Bankruptcy Code.

CONCLUSION

For the foregoing reasons, this Court should dismiss the present appeal for lack of jurisdiction. Even if jurisdiction existed over the appeal, the district court's denial of the writ of prohibition would have to be upheld.

Respectfully submitted,

TONY WEST
Assistant Attorney General

STEPHANIE A. FINLEY
United States Attorney
THOMAS B. THOMPSON
Assistant United States Attorney

THOMAS M. BONDY
(202) 514-4825

s/Stephanie R. Marcus
STEPHANIE R. MARCUS
(202) 514-1633
Attorneys, Appellate Staff
Civil Division Room 7642
U.S. Department of Justice
950 Pennsylvania Ave., N.W.
Washington, D.C. 20530-0001

JUNE 2010

CERTIFICATE OF SERVICE

I hereby certify that on this 7th day of June 2010, I filed the foregoing Brief For Appellee electronically with the Clerk of the United States Court of Appeals for the Fifth Circuit by using the appellate CM/ECF system. I also certify that on this 7th day of June 2010, I served the foregoing Brief For Appellee on the following counsel by electronic service via the CM/ECF system:

Bradley L. Drell
Gold, Weems, Bruser, Sues & Rundell
Post Office Box 6118
Alexandria, LA 71307-6118

s/ Stephanie R. Marcus
Stephanie R. Marcus

CERTIFICATE OF COMPLIANCE WITH RULE 32(a)

Pursuant to Fed. R. App. P. 32(a) and Fifth Circuit Rule 32, I hereby certify that:

1. This brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B) because it contains 9,816 words (excluding the parts of the brief exempted by Fed. R. App. P. 32(a)) according to the count of Corel Wordperfect X4.

2. This brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6) because it has been prepared in a monospaced typeface using Corel Wordperfect X4 with Courier New, 12 point font, which has 10.5 or fewer characters per inch.

s/ Stephanie R. Marcus
Stephanie R. Marcus

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I hereby certify that:

(1) any required privacy redactions have been made;

(2) the electronic submission is an exact copy of the paper document; and

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s/Stephanie R. Marcus
Stephanie R. Marcus

BRIEF BANK — "SUMMARY SHEET" *Printed Wed-4/23/08 14:5*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	McDonald v. Gordon and Walton
2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	D. Ga.
3. ("CCN") ***CURRENT*** CASE NO.	No.: 08–cv-1039-CC
4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*	No.: 07-61961-MHM Court: Bankr. Ga. *(Identify judge & cite, if any)*
5. ("SO") ***SOURCE***	**U.S. TRUSTEES**
6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	Filed: April 22, 2008 Type: Brief of United States Trustee as Appellee
7. **("AU") *PRINCIPAL AUTHORS & OFFICE*** [E.g.,"UST/OGC"]	James H. Morawetz, Guy G. Gebhardt, John Sheahan, P. Matthew Sutko *(UST/OGC: 202-307-1399/FAX-2397)*
8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	• Whether an appellant, who appeals only the denial of a reconsideration motion, may litigate the underlying merits order the appellant did not appeal; and whether an attorney can maintain possession of a pre-petition retainer that is property of the estate, perform post-petition work, and obtain more Compensation for that post-petition work than the Bankruptcy Code allows based on an argument that the attorney's possession of estate funds gave him a post-petition state law lien interest in the estate property.
10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)	
11. DO YOU RECOMMEND POSTING IN UST BRIEFBANK?	| x | YES | | NO ***NAME:*** Linda Figueroa ***DATE:***

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF GEORGIA
ATLANTA DIVISION

DIANA MCDONALD	:	CIVIL ACTION NO.
	:	08-cv-1039-CC
Appellant,	:	
vs.	:	
	:	
NEIL C. GORDON, Chapter 7 Trustee,	:	
and	:	
DONALD F. WALTON, United States	:	Bankruptcy Case No.
Trustee, Region 21,	:	07-61961-MHM
	:	
Appellees.	:	

BRIEF OF UNITED STATES TRUSTEE AS APPELLEE

ROBERTA A. DEANGELIS
Acting General Counsel
JOHN SHEAHAN
Executive Office for United States Trustees
Department of Justice
20 Massachusetts Ave, NW
Washington, DC 20530

GUY G. GEBHARDT
Assistant United States Trustee
Georgia Bar No. 288550
JAMES H. MORAWETZ
Trial Attorney
Georgia Bar No. 521900
Office of the United States Trustee
362 Richard B. Russell Building
75 Spring Street, SW
Atlanta, GA 30303
(404) 331-4437

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I. JURISDICTIONAL STATEMENT

This is an appeal from an order of the United States Bankruptcy Court for the Northern District of Georgia, dated February 4, 2008, which denied the motion seeking reconsideration of the bankruptcy court's Order on Application for Compensation of Diana McDonald, dated January 15, 2008. The bankruptcy court's February 4, 2008, order resolved all issues pertaining to McDonald's motion for reconsideration, and is therefore a final order over which this Court has jurisdiction pursuant to 28 U.S.C. §158(a)(1). *See In re Red Carpet Corp. of Panama City Beach*, 902 F.2d 883, 890 (11th Cir. 1990). McDonald's Notice of Appeal was filed on February 14, 2008, and is timely with respect to the bankruptcy court's order denying reconsideration.

II. ISSUE PRESENTED

Although McDonald's Statement of Issues Presented appears to seek review of various rulings contained in the bankruptcy court's January 15, 2008, compensation order, McDonald failed to preserve such issues for appeal. Consequently, the sole issue presented by this appeal is whether the bankruptcy court abused its discretion by denying McDonald's motion for reconsideration on the grounds that such motion improperly sought to relitigate issues already decided in the compensation order.

III. STATEMENT OF THE CASE

On February 5, 2007, Derrick Patterson commenced an individual chapter 11 bankruptcy case. (R-1).[1] On February 9, 2007, the bankruptcy court granted Patterson's motion to employ McDonald as counsel to the bankruptcy estate pursuant to 11 U.S.C. §327. (R-9). On May 25, 2007, the bankruptcy court ordered the appointment of a chapter 11 trustee for Patterson's estate (R-101), and on July 23, 2007, the Bankruptcy Court ordered that Patterson's case be converted to a chapter 7 liquidation. (R-140). On July 27, 2007, McDonald filed a certificate of consent withdrawing as Patterson's counsel. (R-151).

On August 27, 2007, McDonald filed an application seeking $13,679.90 in compensation for her services on behalf of the chapter 11 estate. (R-235). McDonald further sought permission to satisfy a portion of her fee through application of a prepetition retainer in the amount of $7,500. The chapter 7 trustee and the United States Trustee each objected to McDonald's fee application. (R-238,

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[1] Unless otherwise indicated, all references to the record on appeal are to the docket number assigned to the document by the Clerk of the Bankruptcy Court.

261). In addition, the chapter 7 trustee sought turnover of the $7,500 retainer from McDonald, on the grounds that the Patterson chapter 7 estate was likely to be administratively insolvent and McDonald's claim for fees, even if allowed, was subordinate to the administrative expenses of the chapter 7 estate pursuant to 11 U.S.C. § 726(b). (R-238).

On October 2, 2007, the bankruptcy court conducted a hearing on McDonald's fee application in which McDonald participated. On January 15, 2008, the bankruptcy court issued an order allowing McDonald's fees in the amount of $1,500 and ordering McDonald to turn over the full amount of the $7,500 retainer to the chapter 7 trustee (the "Compensation Order"). (R-293). In so ordering, the bankruptcy court held that: (i) under federal bankruptcy law, the retainer paid to McDonald remained property of the bankruptcy estate until such time as the fees were both earned and approved by the bankruptcy court; (ii) McDonald had failed to demonstrate that the retainer was a "security retainer" not subject to disgorgement; (iii) even if Patterson had intended to grant McDonald a security retainer, such retainers are not recognized under Georgia law; and (iv) evaluated under a lodestar analysis, the value of McDonald's services to the estate was only $1,500. *Id.*

On January 25, 2008, McDonald filed a motion for reconsideration of the Compensation Order (the "Reconsideration Motion"). (R-296). The sole issue raised in McDonald's reconsideration motion was whether the bankruptcy court correctly applied its lodestar analysis in determining the amount of McDonald's fee award. McDonald's motion for reconsideration did not raise any arguments concerning the priority of that award, nor did it address the nature of her interest in the retainer.

On February 4, 2008, the bankruptcy court entered an order denying the bulk of the Reconsideration Motion (the "Reconsideration Order"). (R-298). Although the bankruptcy court corrected a line of its decision which erroneously recited the amount of McDonald's lodestar award as $1,000 rather than $1,500, the court denied the balance of the motion as an "attempt to relitigate the issues already decided in the Compensation Order." *Id.*

On February 14, 2008, McDonald filed her notice of appeal. (R-303). McDonald's notice identified the order under appeal as the court's February 4, 2008, Reconsideration Order, and did not make reference to the initial January 15, 2008, Compensation Order.

IV. STANDARD OF REVIEW

The bankruptcy court's denial of the Reconsideration Motion is reviewed for abuse of discretion. *See Glass v. Seaboard Coast Line RR. Co.*, 714 F.2d 1107, 1109 (11th Cir. 1983). To the extent that the Court determines that it has jurisdiction to consider McDonald's other issues on appeal, the bankruptcy court's calculation of a reasonable fee to a bankruptcy professional under 11 U.S.C. § 330 is also reviewed for abuse of discretion, see *In re Citation Corp.*, 493 F.3d 1313 (11th Cir. 2007), while the factual findings of the bankruptcy court otherwise are reviewed for clear error and its conclusions of law are reviewed de novo. *See In re Chase & Sanborn Corp.*, 904 F.2d 588, 593 (11th Cir. 1990).

V. ARGUMENT

A. McDonald Cannot Revisit the Issues Decided in the Compensation Order through Her Appeal of the Reconsideration Order.

Although McDonald has sought review of the bankruptcy court's Reconsideration Order, she did not file a notice of appeal with respect to the underlying Compensation Order. Despite this, a considerable portion of McDonald's opening brief appears directed toward issues that were litigated in the Compensation Order but which were never raised in her subsequent Reconsideration Motion. *See,* *e.g.*, Appellant's Brief at 9-11 (discussing evidentiary findings in Compensation Order), 13-17 (discussing characterization of prepetition retainer).

In requesting that the Court revisit these rulings, McDonald overlooks the limited scope of this Court's review. On an appeal of a reconsideration order, the appellate court "may review the ruling only for abuse of discretion," and the appeal from the denial of reconsideration relief "does not bring up the underlying judgment for review." *Browder v. Director, Dept. of Corrections of Illinois*, 434 U.S. 257, 263 n.7 (1978). As such, courts have consistently recognized that an appeal of a reconsideration order may not be used to attack the merits of the underlying judgment. *See American Bankers Ins. Co. of Fla. v. Northwestern Nat. Ins. Co.*, 198 F.3d 1332, 1338 (11th Cir. 1999); *Glass v. Seaboard Coast Line RR. Co., supra*, 714 F.2d at 1109; *Jackson v. Seaboard Coast Line RR. Co.*, 678 F.2d 992, 1021 (11th Cir. 1982).

McDonald's failure to file a timely notice of appeal with respect to the underlying Compensation Order creates a jurisdictional defect that prevents this Court from reviewing the substantive rulings of that order. *See Whetstone Candy Co. v. Kraft Foods, Inc.*, 351 F.3d 1067, 1079-80 (11th Cir. 2003) (holding that "[w]here an appellant notices the appeal of a specified judgment only ... this court has no jurisdiction to review other judgments or issues which are not expressly referred to and which are not impliedly intended for appeal") (internal citations omitted). Accordingly, to the extent McDonald seeks to revisit the substantive rulings of the Compensation Order – including, without limitation, the bankruptcy court's rulings regarding the nature of her interest in the retainer – McDonald has failed to preserve those arguments for appeal, and they may not now be considered by this Court.

B. The Bankruptcy Court Did Not Abuse its Discretion in Declining to Grant McDonald's Motion for Reconsideration

Although McDonald cited no statutory authority in support of her motion for reconsideration, the bankruptcy court appears to have treated her motion as one for an amendment of judgment under Fed. R. Bankr. P. 9023 and Fed. R. Civ. P. 59. As the Eleventh Circuit has recognized, "[t]he only grounds for granting [a Fed. R. Bankr. P. 9023] motion are newly-discovered evidence or manifest errors of law or fact." *Kellogg v. Schreiber (In re Kellogg)*, 197 F.3d 1116, 1119 (11th Cir. 1999). By contrast, a motion for reconsideration "is not to serve as a vehicle to relitigate old matters or present the case under a new legal theory ... or to give the moving party another 'bite at the apple' by permitting the arguing of issues and procedures that could and should have been raised prior to judgment." *Mincey v. Head*, 206 F.3d 1106, 1137 (11th Cir. 2000) (internal citations omitted).

Applying the standard recited in *Kellogg*, the bankruptcy court denied the bulk of the Reconsideration Motion on the grounds that such motion was "an attempt to relitigate the issues already decided in the Compensation Order." (R-298). The bankruptcy court's determination is supported by the record. The Reconsideration Motion consists almost entirely of a discussion of the various services performed by McDonald in the Patterson bankruptcy case. At no point, however, does the Reconsideration Motion identify any newly-discovered evidence that could not have been presented by McDonald at the hearing on her fee application. Although the Reconsideration Motion appears to take issue with the weight given to certain evidence by the bankruptcy court, as well the bankruptcy court's assessment of the value of McDonald's services, the Reconsideration Motion does not expressly allege any errors of law by the bankruptcy court. Accordingly, the bankruptcy court did not abuse its discretion by denying the Reconsideration Motion.

C. The Bankruptcy Court Did Not Abuse its Discretion in its Calculation of the Reasonable Value of McDonald's Services

As noted, although the issue of the bankruptcy court's refusal to reconsider the Compensation Order has been preserved for appeal, the underlying rulings of the Compensation Order itself are not within this Court's appellate jurisdiction. Even if McDonald had properly raised the merits of the Compensation Order on appeal, however, there would be no basis for this Court to overturn that order.

A bankruptcy court's fee award under 11 U.S.C. § 330 is entitled to considerable deference, and an appellate court should reverse the bankruptcy court's decision only "if the bankruptcy court applied an incorrect legal standard, failed to follow proper procedures, or made factual findings that were clearly erroneous." *In re Citation Corp., supra*, 493 F.3d at 1318.

In the proceedings before the bankruptcy court, McDonald bore the burden of proving that her fee request was commensurate with the value of her services. *See In re Beverly Mfg. Corp.*, 841 F.2d 365, 371 (11th Cir. 1988). McDonald's brief does not discuss what evidence, if any, she relied on in attempting to meet this burden. By contrast, the Compensation Order contains the following specific findings in support of the bankruptcy court's conclusion that McDonald's services were not worth more than $1,500:

> Ms. McDonald seeks to charge an excessive amount for many of the services provided. For example, she charges 4.67 hours for preparation of a skeletal petition; 4.33 hours to gather documents; 2.5 hours to prepare and file a motion to withdraw (that was denied). The recitation in the Retainer Agreement of services to be provided evidences less than a full understanding of the services that an attorney for a Chapter 11 Debtor must undertake. Ms. McDonald filed only one, apparently incomplete, operating report for her client. She failed to adequately monitor her client's stewardship of the rental properties' income and expenses, with the result that rents were collected but not used to pay the expenses associated with the properties. When the Debtor finally filed his Statement of Financial Affairs and other schedules . . . it was apparent that monthly expense exceeded income and that the estate was illiquid and not likely capable of successful reorganization. The brief period prior to appointment of the Chapter 11 Trustee that the Debtors acted as debtor-in-possession resulted in severe erosion in the estate's financial condition.

(R-293 at 4-5).

Significantly, McDonald does not dispute any of the foregoing findings of the bankruptcy court. Instead, McDonald's argument appears to be that the bankruptcy court erred by relying on the statements of fact contained in the pleadings of the chapter 7 trustee and the United States Trustee, and by failing to "pinpoint or consider all the facts surrounding Appellant McDonald's representation of Debtor." (Br. 10). McDonald's criticism of the bankruptcy court on this point is difficult to understand, as McDonald's fee application was afforded the notice and hearing required by the Bankruptcy Code, and any evidence favorable to her position could have been presented at that hearing. In any event, McDonald's brief fails to specify what additional evidence, if any, she contends the bankruptcy court improperly failed to consider.

Nor does McDonald appear to allege that the bankruptcy court applied an incorrect legal standard. Indeed, the case identified by McDonald as providing the applicable legal standard for fee awards, *Johnson v. Georgia Highway Exp., Inc.*, 488 F.2d 714 (5th Cir. 1974), is the same authority relied on by the bankruptcy court in its discussion of McDonald's fees in the Compensation Order. (R-293 at 5). Instead, McDonald's principal argument on appeal is simply that the bankruptcy court should have included in its opinion a separate discussion of each of the twelve enumerated *Johnson* factors. McDonald cites to no authority, and the United States Trustee is aware of no authority, suggesting that such a level of detail is necessary in an order under 11 U.S.C. § 330. In any event, the United States Trustee notes that a number of the *Johnson* factors were directly or indirectly addressed in the bankruptcy court's findings of fact, including (1) the time and labor required; (2) the amount involved and the results obtained; and (3) the experience, reputation, and ability of the attorney. More importantly, McDonald does not identify which, if any, of the remaining factors would have been relevant or helpful to her application had they been discussed in greater detail. As such, McDonald has not demonstrated that the bankruptcy court's calculation of her fees was an abuse of discretion.

D. The Bankruptcy Court Did Not Err by Ordering McDonald to Turn over the Retainer to the Estate

Lastly, McDonald cannot demonstrate that the bankruptcy court erred by ordering her to return the full amount of the retainer to the chapter 7 trustee. Significantly, McDonald does not assert that she obtained full title to the retainer upon receipt, but concedes that she held the funds in trust for the estate and that the "[t]he client (or debtor) retains a propriety interest in the retainer." (Br. at 14).[2] In addition, McDonald does not appear to dispute the bankruptcy court's findings that the chapter 7 estate is administratively insolvent and that the chapter 7 administrative

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[2] The United States Trustee notes that, in contrast to certain of the authorities cited by McDonald, this is not a case in which the estate seeks the return of funds that had previously been awarded to a professional through an interim fee application under 11 U.S.C. § 331. *Compare, e.g., Specker Motor Sales Co. v. Eisen*, 393 F.3d 659 (6th Cir. 2004). Rather, the dispute in this case involves McDonald's relative entitlement to fees that had not yet been awarded to her. As a result, McDonald's lengthy discussion of whether a court can order disgorgement of fees previously awarded to a professional is inapposite to the present case.

claims will be entitled to payment ahead of chapter 11 administrative claims. Rather, McDonald's entire argument against disgorgement is that she holds a security interest in the retainer. (Br. at 15).

McDonald's argument fails for at least two reasons. First, as the bankruptcy court found, even assuming that retainer security interests are permissible under Georgia law, McDonald produced no evidence that such an interest was actually created. Under Georgia law, the question of whether a security interest arises in a particular transaction is determined by looking to the intent of the parties, rather than to the form of the transaction. *See Kubota Tractor Corp. v. Citizens & Southern Nat. Bank*, 403 S.E.2d 218, 220 (Ga. App. 1991). At no point in her arguments before the bankruptcy court or in her opening brief in this Court did McDonald identify a single piece of documentation to support her claim that Patterson intended to grant her a security interest. On the contrary, as the bankruptcy court observed, McDonald's actions during the bankruptcy case strongly indicate that no security interest was ever intended: McDonald's retention application in the bankruptcy court never disclosed that she was claiming a security interest in the retainer, and the bankruptcy court found nothing in the language of McDonald's retainer agreement that clearly stated an intention to create a security interest. (R-293 at 3). McDonald's brief offers no argument to rebut these factual findings of the bankruptcy court.

Secondly, even if Georgia law permitted McDonald to create a security interest in her pre-petition retainer, such an interest would be unenforceable in bankruptcy under the doctrine of federal preemption. As the Supreme Court has long held, the federal statutory scheme governing the compensation of bankruptcy professionals in bankruptcy cases is a pervasive scheme of regulation that preempts inconsistent state laws. *See Brown v. Gerdes*, 321 U.S. 178, 183 (1944) (Chandler Act amendments to the Bankruptcy Act of 1898 created "comprehensive supervision over compensation and allowances" under federal law and "provided centralized control" over attorney fees). This is because bankruptcy jurisdiction over professional fees in bankruptcy cases is "paramount and exclusive" and federal provisions governing professional compensation "cause any conflicting [state] procedure to give way." *Brown*, 321 U.S. at 183 (holding that under the Bankruptcy Act, bankruptcy courts, not state courts, fix compensation for attorneys representing the estate, even in state litigation) (citations omitted).

Through the Bankruptcy Code, Congress has established a comprehensive set of rules which dictate how attorneys may be retained at estate expense, how they are compensated by the estate, how they receive payment from the estate, and (of importance in the present case) what priority their payment receives. *See* 11 U.S.C. §§ 327, 330, 339, 503, 507. In this case, the enforcement of a state law lien in McDonald's favor would interfere with this comprehensive scheme by altering McDonald's payment priority for post-petition services in relation to other claimants under 11 U.S.C. § 726(b).

Under circumstances similar to the present case, courts have recognized that where pre-petition retainers are used to secure payment of post-petition legal services, any state law security interests in those retainers are preempted by the Bankruptcy Code. Thus, in *In re Mahendra*, 131 F.3d 750, 756 (8th Cir. 1997), the court held that an attorney's security interest in his retainer, "to the extent it was valid[,] . . . was extinguished on the petition date with respect to any future advances." *See also In re CK Liquidation Corp.*, 343 B.R. 376, 384 (D. Mass. 2006) (holding that application of state lien law to enforce security retainer of debtor's counsel was preempted by Bankruptcy Code); *In re 5900 Assocs., Inc.*, 468 F.3d 326, 329-30 (6th Cir. 2006) (holding that law firm and debtor cannot abrogate bankruptcy court's duty to review fees by entering into a state law contract).

Accordingly, the bankruptcy court did not err in ordering McDonald to return the full amount of the retainer to the chapter 7 trustee.

VI. CONCLUSION

For the foregoing reasons, the United States Trustee respectfully submits that the bankruptcy court's order denying reconsideration of its order setting McDonald's compensation and ordering disgorgement of McDonald's retainer must be affirmed in its entirety.

Respectfully submitted,

ROBERTA A. DEANGELIS
Acting General Counsel
JOHN SHEAHAN
Executive Office for United States Trustees
Department of Justice
20 Massachusetts Ave, NW
Washington, DC 20530

/s/ *Guy G. Gebhardt*
Guy G. Gebhardt, Esq.
Georgia Bar No. 288550
Assistant United States Trustee
E-mail: Guy.Gebhardt@usdoj.gov

[Signatures Continued on Next Page]

/s/ *James H. Morawetz*
James H. Morawetz
Georgia Bar No. 521900
Trial Attorney
E-mail: Jim.H.Morawetz@usdoj.gov

United States Department of Justice
Office of the United States Trustee
Suite 362, 75 Spring Street, SW
Atlanta, GA 30303
Telephone: (404) 331-4437

CERTIFICATE OF SERVICE

I hereby certify that I am over the age of 18 and that on this date I caused true and correct copies of the foregoing BRIEF OF UNITED STATES TRUSTEE AS APPELLEE to be deposited was this day sent by U.S. Mail, with correct first class postage affixed, addressed as follows:

Diana McDonald, Esq.
Law Office of Diana McDonald, LLC
2800 Peachtree Industrial Blvd., Suite C
Duluth, GA 30097

Michael Fredrick Holbein, Esq.
Arnall Golden & Gregory
171 17th Street, NW, Suite 2100
Atlanta, GA 30363-1031

Neil C. Gordon, Esq.
Arnall Golden & Gregory
171 17th Street, NW, Suite 2100
Atlanta, GA 30363-1031

This the 22nd day of April, 2008.

/s/ *James H. Morawetz*
JAMES H. MORAWETZ
Trial Attorney

BRIEF BANK — "SUMMARY SHEET" *Printed Wed-10/13/10 16:9*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	Joseph McGowan and Laura Kuhn McGowan v. Daniel M. McDermott, United States Trustee (In re Joseph McGowan)
2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	N. D. Ohio.
3. ("CCN") ***CURRENT*** CASE NO.	No.: 10-01302
4. ("PCN") ***PRIOR*** CASE NO. - & COURT *[IF ANY]*	No.: 09-19075 Court: Bankr. N.D. Ohio *(Identify judge & cite, if any)*
5. ("SO") ***SOURCE***	**U.S. TRUSTEES**
6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	Filed: September 28, 2010 Type: Brief of Appellee Daniel M. McDermott United States Trustee
7. **("AU")** ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*	Amy L. Good, Catherine B. Sevcenko, P. Mattew Sutko, Ramona D. Elliott, Andrew Vara *(UST/OGC: 202-307-1399/FAX-2397)*
8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") ● ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	● 1). Whether the bankruptcy court erred when it dismissed the McGowans' chapter 7 bankruptcy case based upon abuse under the totality of the circumstances of the debtor's financial situation, 11 U.S.C. § 707(b)(3)(B), even though the McGowans' case was not presumed abusive under the "means test" as set forth in 11 U.S.C.§ 707(b)(2). 2). Under § 707(b)(3)(B) did the bankruptcy court abuse its discretion in dismissing Joseph and Laura McGowan's chapter 7 case for abuse based on the totality of the circumstances of their financial situation?
10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)	
11. DO YOU RECOMMEND POSTING IN UST BRIEFBANK?	| x | YES | | NO ***NAME:*** Linda Figueroa ***DATE:***

Civ. Case No. 10-01302

In the
United States District Court
Northern District of Ohio

In re: Joseph McGowan and
Laura Kuhn McGowan
Debtors

Joseph McGowan and Laura Kuhn McGowan

Appellants

v.

Daniel M. McDermott
United States Trustee

Appellee

On Appeal from the United States Bankruptcy Court
for the Northern District of Ohio
Eastern Division

BRIEF OF THE APPELLEE DANIEL M. MCDERMOTT UNITED STATES TRUSTEE

Counsel for Appellee Daniel M. McDermott, United States Trustee

Ramona D. Elliott, General Counsel
P. Matthew Sutko, Associate General Counsel
Catherine B. Sevcenko, Trial Attorney
Office of the General Counsel
Executive Office for U.S. Trustees
United States Department of Justice
20 Massachusetts Avenue NW
Washington, D.C. 20530
(202) 307-1399

Andrew Vara, Assistant U.S. Trustee
Amy L. Good, Trial Attorney
Office of the U.S. Trustee
U.S. Department of Justice
H.M. Metzenbaum U.S. Courthouse
201 Superior Avenue, East
Cleveland, Ohio 44114
(216) 522-7800

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Legislative History

STATEMENT OF JURISDICTION

The bankruptcy court had jurisdiction to decide the United States Trustee's [1] motion to dismiss the bankruptcy case of debtors Joseph McGowan and Laura Kuhn McGowan under 28 U.S.C. §§ 157(a) and (b), and 1334(a). A dismissal of a chapter 7 case for abuse is a final order. See 28 U.S.C. § 158(a)(1); Belfance v. Black River Petroleum (In re Hess), 209 B.R. 79, 80 (6th Cir. BAP. 1997). The bankruptcy court entered the order granting the United States Trustee's motion to dismiss on May 3, 2010. The McGowans timely appealed the order of dismissal on May 17, 2010 under 28 U.S.C. § 158(c)(2) and Fed. R. Bankr. P. 8002(a) and 8002(b). This Court has jurisdiction under 28 U.S.C. § 158(a)(1).

STATEMENT OF ISSUES PRESENTED

1. Whether the bankruptcy court erred when it dismissed the McGowans' chapter 7 bankruptcy case based upon abuse under the totality of the circumstances of the debtor's

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[1] Congress authorized the United States Attorney General to appoint 21 United States trustees, each to serve in a specific geographic region of the United States. See generally, 28 U.S.C. § 581 et. seq. (establishing the United States Trustee Program). The United States trustees are senior officials of the Department of Justice. Id. The United States trustees "supervise the administration of cases and trustees" in all bankruptcy cases within his or her region through the exercise of a range of oversight responsibilities. 28 U.S.C. §586(a)(3). See generally, Morgenstern v. Revco, D.C., Inc. (In re Revco D.S. Inc.), 898 F. 2d 498, 500 (6th Cir. 1990) (explaining that United States trustees oversee the bankruptcy process, protect the public interest, and ensure that bankruptcy cases are conducted according to law). United States trustees may raise, appear, and be heard on any issue in any case or proceeding under Title 11. 11 U.S.C. § 307; See also, In re Revco, D.S, Inc., 898 F. 2d at 499-500 (upholding broad appellate standing of United States trustees). Section 707(b) explicitly authorizes United States Trustees to move to dismiss debtors' chapter 7 bankruptcy cases.

financial situation, 11 U.S.C. § 707(b)(3)(B), even though the McGowans' case was not presumed abusive under the "means test" as set forth in 11 U.S.C. § 707(b)(2).

2. Under § 707(b)(3)(B) did the bankruptcy court abuse its discretion in dismissing Joseph and Laura McGowan's chapter 7 case for abuse based on the totality of the circumstances of their financial situation?

STANDARD OF REVIEW

This Court reviews the bankruptcy court's findings of fact for clear error and reviews conclusions of law de novo. Nicholson v. Isaacman (In re Issacman), 26 F.3d. 629, 631(6th Cir. 1994). Whether the court may consider dismissal of a debtors' case under § 707(b)(3)(B) when the debtor's case is not presumed to be an abuse based on the § 707(b)(2) means test is a question of law reviewed de novo. The dismissal of a chapter 7 case for abuse under § 707(b)(3)(B) is an equitable determination reviewed under an abuse of discretion standard. See Behlke v. Eisen (In re Behlke), 358 F. 3d 429 (6th Cir. 2004).

STATEMENT OF THE CASE

Appellants Joseph Thomas McGowan and Laura Kuhn McGowan filed a voluntary petition for relief under chapter 7 of the Bankruptcy Code on September 25, 2009. (Bankruptcy Court Docket No. 1; UST Exhibit. 2).[2] The United States Trustee moved to dismiss the McGowans' case, asserting that it was abusive under 11 U.S.C. § 707(b)(1) and (b)(3)(B). (Docket No. 13). At the evidentiary hearing, conducted on April 20 and 21, 2010, John Weaver,

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[2] References to pleadings in the Bankruptcy Court Docket or the Docket itself are hereinafter identified as "Docket No. ___" followed by the applicable docket number or docket entry date. References to exhibits are hereinafter identified as "UST Ex. ___" and "Debtors Ex. ___".)

bankruptcy analyst for the United States Trustee, and Joseph McGowan testified. (See Transcript).[3] At the close of the United States Trustee's case, the McGowans orally moved for summary judgment in their favor arguing they had "passed" the means test provisions of § 707(b)(2), precluding dismissal under § 707(b)(3)(B). (Transcript at p. 97-101). The bankruptcy court denied the McGowans' motion. (Transcript at p. 104-105).

On May 3, 2010, after consideration of the evidence,[4] arguments of counsel, and the record, the bankruptcy court granted the United States Trustee's motion to dismiss the McGowans' chapter 7 case based upon the totality of their financial circumstances under 11 U.S.C. § 707(b)(3). (Docket No. 47).[5] Mr. and Mrs. McGowan filed a notice of appeal on May 17, 2010 along with an election to have this appeal considered by the District Court. (Docket Nos. 53 and 54).

A. Statutory Framework.

1. Overview of Chapter 7 Bankruptcy Relief.

The Bankruptcy Code establishes two primary forms of bankruptcy relief for individual debtors – chapter 7 and chapter 13. Under chapter 7, "an individual debtor receives an immediate unconditional discharge of personal liability for certain debts in exchange for relinquishing his or her nonexempt assets to a bankruptcy trustee for liquidation and distribution

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[3] The trial transcript is available in the McGowans' Appendix, Tab G.

[4] The bankruptcy court admitted into evidence the United States Trustee's Exhibits 2, 6, 7, 8, 9, 10, and 11 along with the Debtors' Exhibits B-1 to 51, C-1 to 11, D, E-1 and E-2, Exhibits G-1 to 4, H-1 to 17, I-1 and I-2, and J-1 to 14. (Transcript, p. 96, 183).

[5] The bankruptcy court's memorandum opinion is reproduced in the Addendum to this brief.

to creditors." H.R. Rep. 109-31(I), at 10; *see* 11 U.S.C. §§ 701-727. Under chapter 13, "a debtor commits to repay some portion of his or her financial obligations" over a specified period "in exchange for retaining nonexempt assets and receiving a broader discharge of debt than is available under chapter 7." H.R. Rep. 109-31(I), at 10; See 11 U.S.C. §§ 701-727.

In chapter 7 cases, creditors may look solely to debtors' pre-bankruptcy, non-exempt assets for payment. See 11 U.S.C. § 541 (limiting property of the estate to debtors' pre-petition assets). Debtors' post-bankruptcy income is not subject to creditor claims. Id. Subject to narrow exceptions, debtors receive a complete discharge of all their pre-petition debts in a chapter 7 case. See 11 U.S.C. § 727(b).[6]

2. Development of § 707(b)'s Two-Part Test for Determining Whether a Case Is Abusive.

Since 1984, Congress has enacted a series of tests to allow courts to dismiss chapter 7 cases, and thereby prevent unjust discharge of pre-petition debts. In 1984, Congress amended chapter 7 to permit dismissal of a chapter 7 bankruptcy case if a court found "substantial abuse." Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, § 312, 98 Stat. 333, 335. Two years later, Congress authorized the United States Trustee to seek dismissal of

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[6] Historically, in roughly 96% of chapter 7 cases, unsecured creditors received no payment. *See, e.g.*, Brief of the United States in *Lamie v. United States Trustee*, 2003 WL 21839367 at *38 (2003).

chapter 7 petitions for "substantial abuse." Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1986, Pub. L. No. 99-554, § 21, 100 Stat. 3088, 3101.

However, Congress found that these amendments were insufficient to control abuse of chapter 7. Congress identified, among other problems, the "inherent[] vague[ness]" of the "substantial abuse" standard, which led to disagreement in the courts about whether a debtor's ability to repay a significant portion of his or her debts out of future earnings constitutes substantial abuse, meriting dismissal. H.R. Rep. 109-31(I), at 12. Another problem was that the Bankruptcy Code established "a presumption in favor of granting the relief requested by the debtor," which influenced courts' decisions whether to find substantial abuse. 11 U.S.C. § 707(b) (2000 suppl. 4); See H.R. Rep. 109-31(I), at 12.

Responding to these perceived shortcomings, Congress held hearings over five years to identify reforms it could adopt "to ensure that debtors repay creditors the maximum they can afford." H.R. Rep. 109-31(I), at 2, 12. The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (the "2005 Act" or "BAPCPA"), S. 256, Pub. L. No. 109-8, 119 Stat. 23, implemented the reforms Congress identified in four ways.

First, Congress repealed the statutory presumption in favor of granting relief to the debtor. Compare 11 U.S.C. § 707(b) (1986) with 11 U.S.C. § 707(b) (2005).

Second, Congress lowered the standard for dismissal under all subsections of new § 707(b) from "substantial abuse" to mere "abuse." See 11 U.S.C. § 707(b)(1) (cases are now dismissed for "abuse"); 11 U.S.C. § 707(b)(2) (subjecting cases to dismissal for abuse); 11 U.S.C. § 707(b)(3) (providing for dismissal based upon abuse due to bad faith or totality of financial circumstances).

Third, Congress authorized dismissal when a mathematical formula, known as the "means test," yields monthly disposable income that exceeds a statutory threshold. See 11 U.S.C. § 707(b)(2). The 2005 Act provides specific criteria which, if satisfied, requires a court to presume the existence of abuse, requiring "dismissal [or conversion to chapter 13] based on a chapter 7 debtor' s ability to repay." H.R. Rep. 109-31(I), at 15. To determine if abuse exists, a court first compares the debtor's annualized "current monthly income" to the "median family income" of a similarly-sized family in the debtor's state of residence. If the debtor's current monthly income is below the median, then the presumption of abuse does not arise. See 11 U.S.C. § 707(b)(7); H.R. Rep. 109-31(I), at 15. When a debtor's current monthly income is above the median and his or her monthly disposable income meets or exceeds the statutory threshold amount, the presumption is triggered, and the debtor's case must be dismissed as abusive (or converted to chapter 13, if the debtor consents), absent an express showing of special circumstances by the debtor. See 11 U.S.C. § 707(b)(1) and (2).

Fourth, Congress enacted new § 707(b)(3) to provide for a dismissal for abuse where the presumption of abuse under §707(b)(2) does not arise or is rebutted. This section allows courts to dismiss cases based upon either a debtor's bad faith, 11 U.S.C. § 707(b)(3)(A), or the totality of a debtor's financial circumstances, 11 U.S.C. § 707(b)(3)(B). Even if the presumption of abuse does not arise or is rebutted under § 707(b)(2), this subsection provides a chapter 7 petition should be dismissed for abuse under § 707(b)(3) for bad faith or when "the totality of the circumstances. . .of the debtor's financial situation demonstrates abuse." 11 U.S.C. § 707(b)(3)(A) and (B).

Sections 707(b)(3)(A) and (B) of the 2005 Act represent a significant departure from old § 707(b). If a debtor engages in bad faith, the debtor's case is dismissed under § 707(b)(3)(A). If, instead, the totality of the debtor's financial circumstances including an ability to repay a portion of debt shows abuse, dismissal is mandated by § 707(b)(3)(B).

B. Factual Background.

Appellants Joseph Thomas McGowan and Laura Kuhn McGowan are both employed full time and have three children ages 17, 19, and 21. (Mem. Op., Addendum, p. 1) The McGowans' gross annual income is $131,360. (UST Ex. 11, page 5; Mem. Op., Addendum, p. 2). Mr. McGowan is a business development manager for Comfort Systems, USA and earns gross wages of $7,280 a month. (Docket No. 1, Schedule I) Mrs. McGowan is employed by St. Ignatius High School as an administrator and earns gross income of $3,660.67 a month. (Docket. No. 1, Schedule I; Mem. Op., Addendum, p. 1).

The McGowans filed their voluntary chapter 7 bankruptcy petition on September 25, 2009 seeking a discharge of their unsecured debts. (Docket No. 1; UST Ex. 2). Their scheduled debts total $780,544.75, including a first mortgage for $510,289, and a second mortgage totaling $31,966.

The McGowans's unsecured debts total $219,523.75, about twice their annual income (Docket No. 1, Schedules D and F; Mem. Op, Addendum, p. 2). This includes balances on 12 credit cards. (Docket No. 1, Schedule F). The McGowans scheduled four separate Chase credit cards, with a combined balance of $52,302. (Docket No. 1, Schedule F). They also have balances on credit cards from Bank of America ($24,471), Capital One ($11,898), American Express ($1,200), Target Bank ($10,147), CitiBank ($14,853), and Dick's Sporting Goods ($4,284). (Docket No.1, Schedule F). Finally, they scheduled two Discover cards with balances of $17,859 and $13,212. (Docket No. 1, Schedule F). In total, the McGowans seek to discharge $149,026 in credit card debt. (Docket No. 1, Schedule F).

The McGowans have interests in property with an aggregate value of $439,085.00, including a 4,300 square foot home valued at $380,000, with four-bedrooms, 3 ½ baths, and a two-car garage, located on roughly 2/3 of an acre in Shaker Heights.[7] (Docket No. 1, p. 39; Docket No. 40, para. 6, Stipulations of Fact; UST Ex. 1 and 11; Transcript at 20). They have

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[7] Property information available at http://www.zillow.com/homedetails/16250-Aldersyde-Dr-Shaker-Heights-OH-44120/33684640_zpid; and http://www.realtor.com/property-detail/16250-Aldersyde-Dr_Shaker-Heights_OH_44120_f6fe1103 (last visited Sept. 23, 2010).

interests in 401(k) and 403(b) accounts totaling $31,200. (Docket No.1, Schedules A and B). Their schedules also show a time-share in Epcot and a baby grand piano. (Id.).

Based upon the McGowans' schedule of current income, the parties stipulated that their scheduled net monthly income at the time of their bankruptcy filing totaled $8,302.04. (Docket No. 1, Schedule I; Docket No. 40, para 13; UST Ex. 11, para. 13). The McGowans total monthly expenses as originally filed on Schedule J amounted to $12,007.00, broken down as follows:

Item	Monthly Expense
Mortgage	$2,210
Home maintenance	$220
Food	$600
Clothing	$200
Recreation	$500
Real Estate Taxes	$1,014
College Tuition (son)	$720
College Tuition (daughter)	$1,730
Books	$220
Student Loans	$626
401(k) loan repayment	$433
Miscellaneous personal expenses	$500
Pet Expenses	$100

(Docket No. 1, Schedule J; Docket No. 40, para 14, Stipulations of Fact).

At trial, Mr. McGowan testified the family had tightened their household budget by doing five things:

- Eliminating a gym membership; (Transcript at 152);
- Eliminating a subscription to Golf Magazine and reducing their Plain Dealer subscription; (Transcript at 152);
- Reducing their monthly cell phone cost by $50 to $170; (Transcript at 152);
- Reducing cable and internet costs; (Transcript at 152-53);
- Eliminating membership to the Golf Dome and stopping golf lessons for their 17, 19, and 21-year-old children. (Transcript at 152-53).

On December 7, 2009, the United States Trustee filed a motion to dismiss the McGowans' chapter 7 bankruptcy because their income was well above the state median and a number of their scheduled expenses were excessive or impermissible. (Docket No. 13). The McGowans argued in response that 1) they have no disposable income; 2) their scheduled expenses are actually paid regardless of whether or not such expenses are proper; and 3) their financial difficulty did not arise from excessive spending but rather a failed business venture. (Docket No. 16, Objection of Debtors; Mem. Op., Addendum, p. 2).

On April 19, 2010, the day before the scheduled evidentiary hearing, and shortly before they filed the stipulations, the McGowans amended their Schedule J to increase their monthly expenses from $12,007 to $14,089. This included an increase in monthly mortgage payments from $2,210 to $3,371 based on a recalculation of the monthly payment over the 30-year term of the mortgage rather than scheduling the payment option they were using at the time they filed their petition, which "was inadequate to keep up with the accrual of interest." (Appellant Br. at 10-11). They also amended their Statement of Intention to indicate that they would keep their home and reaffirm the debt on their residence. (Docket No. 38, p. 3-5 and 6).[8]

The bankruptcy court conducted an evidentiary hearing on April 20 and 21, 2010. (Docket No. 40). At the close of the United States Trustee's case, the McGowans orally moved for summary judgment requesting a denial of the United States Trustee's motion to dismiss, asserting that they had "passed" the means test, and therefore their case could not be dismissed solely upon the ability to repay under § 707(b)(3)(B). (Transcript at 98-100). The bankruptcy court denied the motion for summary judgment at the hearing. (Transcript at 105).

After considering the merits of the United States Trustee's motion, the bankruptcy court concluded the McGowans' bankruptcy filing was an abuse "based on the totality of the circumstances of the debtors' financial situation" under 11 U.S.C. § 707(b)(3)(b), and it dismissed the McGowans' chapter 7 bankruptcy petition. (Mem. Op., Addendum, p. 11).

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[8] The amendments were filed by the McGowans on April 19, 2010 at 16:54:31. (Docket No. 38). The stipulations between the parties were filed by the McGowans about an hour and fifteen minutes later on April 19, 2010 at 18:13:45. (Docket No.40). The McGowans stipulated to their expenses as originally scheduled, and so it is unclear why they would also amend those same expenses. Since the amendments were filed in the late afternoon the day before the trial, the United States Trustee could only verify their accuracy through examining the McGowans at trial.

The bankruptcy court based its decision on four findings of fact. First, the McGowans had sufficient financial resources to pay back something to their creditors on the $219,523 in credit card and other unsecured debt they owe. (Mem. Op., Addendum, p.10). Second, the bankruptcy court found the McGowans could forego college expenses for their adult children, which would allow them to repay their debts. (Mem. Op., Addendum, p. 7). Third, it found that the McGowans should not pay their adult children's non-dischargeable, unsecured student loan payments because that amounted to preferential treatment over other general unsecured debts. (Mem. Op., Addendum, p. 8). Finally, the bankruptcy court noted the last-minute amendment to Schedule J increased the McGowans' expenses by $2,000, in part due to a $1,161 increase in their scheduled mortgage payments. [9] (Mem. Op., Addendum p. 8-9). Given that Mr. McGowan testified that he had not made any mortgage payments since September 2009, the bankruptcy court found there was no need to presume they would need to pay a higher mortgage expense. (Mem. Op., Addendum, p. 8-9; Transcript at 21).

The bankruptcy court also found the McGowans had not reduced their expenses and that the timing of their amended Schedule J and Statement of Intention was suspect. (Mem. Op., Addendum, p. 10). The court recounted the McGowans' unwillingness to make the sacrifices required to obtain bankruptcy relief. (Mem. Op., Addendum, p. 10).

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[9] In addition, the McGowans added a second mortgage in the amount of $150 on Amended Schedule J. (Docket No. 38, p. 4 Schedule J).

In particular, the bankruptcy court found that the McGowans:

- Wanted to pay themselves back for the money they borrowed from their retirement account rather than repay their lawful creditors; (See e.g., Mem. Op., Addendum, p. 8);
- Wanted to volunteer to pay over $30,000 a year for their adult children's college tuition, books, and college food expenses, while discharging nearly $150,000 in credit card debt (Mem. Op., Addendum p. 10);[10]
- Wanted to choose the unsecured creditors they would pay by paying back their children's student loans; (Mem. Op., Addendum p. 10);
- Wanted to engage in gamesmanship by filing an Amended Schedule J along with their Amended Statement of Intention on the eve of trial asserting a change of intent indicating they now wanted to keep their home. (Mem. Op., Addendum, p. 10).[11]

The judge also found other factors warranted dismissal, including their eve of trial amendments indicating they suddenly wanted to keep their home and the fact that the originally scheduled mortgage payment was significantly higher than the applicable IRS housing allowance of $1,080 for a household of five. (Mem. Op., Addendum, p. 9). It concluded that their stable above-median income, excessive expenses attributable to their mortgage, childrens' college

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[10] This breaks down to a $626 monthly student loan payment, $2,490 in direct tuition payments, plus $220 in monthly book payments.

[11] On May 12, 2010 an unopposed motion of the mortgage holder from relief from the bankruptcy stay was granted thereby allowing the mortgage holder to proceed with state court remedies including foreclosure upon the McGowans' home. (Docket No. 51).

related costs, student loan repayments, and retirement payments meant that granting the McGowans a chapter 7 discharge would be an abuse. (Mem. Op., Addendum, p. 10).

SUMMARY OF ARGUMENT

1. The bankruptcy court decision dismissing the McGowans' chapter 7 bankruptcy filing under 11 U.S.C. § 707(b)(3)(B) for abuse should be affirmed for two reasons. First, it did not err in considering the United States Trustee's motion to dismiss under § 707(b)(3)(B), even though the presumption of abuse did not arise under § 707(b)(2). Second, the bankruptcy court did not abuse its discretion when it found that granting the McGowans a chapter 7 discharge of their debts would constitute an abuse under the totality of the circumstances of the debtor's financial situation.

2. As the McGowans concede, most courts agree that whenever a debtor "passes" the § 707(b)(2) means test, meaning that the presumption of abuse does not arise or is rebutted, their case can still be dismissed under § 707(b)(3), which provides that a bankruptcy court "**shall** consider" if the totality of the circumstances of the debtor's financial situation nevertheless shows abuse. 11 U.S.C. § 707(b)(3) (emphasis added). This majority view is not surprising, or wrong, given § 707(b)(3)(B) says exactly that. Since the language of the statute is clear on its face, the McGowans' contrary interpretation relying solely on the legislative history is unpersuasive. The bankruptcy court considered the motion to dismiss consistently with the two-step process prescribed in § 707(b).

3. Nor did the bankruptcy court clearly err in its required § 707(b)(3)(B) analysis. The bankruptcy court applied the factors adopted by the Sixth Circuit in In re Krohn, 886 F. 2d 123 (6th Cir. 1989) that were relevant to totality of the circumstances of the McGowan's financial situation. These included the stability of their employment, amount of their income, and the nature and amount of their expenses. Specifically, the McGowans have a stable income of over $100,000 per year. They live in a ten-room, 4,300 square foot, house on almost 2/3 of an acre in Shaker Heights. They own three cars, a time-share in Florida, and wish to continue to provide generously for their adult children attending college. The bankruptcy court did not clearly err in finding those expenses could be reduced to create disposable income that could be used to repay creditors. Nor did the court act precipitously. Rather, it reviewed the evidence presented over a two-day evidentiary trial. As such, the court below did not abuse its discretion in dismissing the McGowan's chapter 7 case under § 707(b)(3)(B).

ARGUMENT

I. § 707(b)(3) Requires Bankruptcy Courts to Consider Dismissal for Abuse Even if the Debtors "Pass" the Means Test and the Presumption of Abuse Under § 707(b)(2) Does Not Arise or Is Rebutted.

Congress enacted the sweeping bankruptcy reform of 2005 to make sure that debtors would pay back to their creditors everything that they reasonably could. In re Hardacre, 338 B.R. 718, 720 (Bankr. N.D. Tex. 2006). The means test, as set forth in § 707(b)(2), plays a central role in achieving that goal. It is not, however, the only change in the 2005 Act designed to identify debtors able to pay back at least some of their debts. Thus it is not the only reform that affects this case. Congress also lowered the standard for dismissal of a chapter 7 case from "substantial abuse" to "abuse." See e.g., 11 U.S.C. § 707(b)(1) (stating that cases are dismissed for "abuse"); Morse v. Rudler (In re Rudler), 576 F.3d 37, 40 (1st Cir. 2009) (stating that the 2005 Act "relaxed the standard for dismissing a case as abusive."). In addition, the 2005 Act removed the presumption against abuse in favor of the debtor, further indicating Congress enacted a comprehensive effort to make sure debtors repaid their creditors to the extent possible. See, e.g., supra, p. 6.

In order to implement all these changes, the 2005 Act adopted a two-step process to review chapter 7 consumer cases for abuse. The means test is the first step. Ross-Tousey v. Neary (In re Ross-Tousey), 549 F.3d 1148, 1151 (7th Cir. 2008) ("The purpose of the means test is to distinguish between debtors who can repay a portion of their debts and debtors who cannot."). It limits presumption of abuse to those above-median-income chapter 7 debtors who have disposable income greater than a cut-off amount set in § 707(b)(2).[12] The standard and actual expenses which a debtor may claim are detailed in § 707(b)(2)(A)(ii), (iii), and (iv).

It is undisputed that the McGowans calculated their means test in such a way that their disposable income is lower than the minimum amount for a presumption of abuse. The means test, however, does not determine the outcome of their case. "Permitting a debtor to take the deduction – even where that deduction puts the debtor's current monthly income below the presumptive abuse threshold – does not insulate his case from dismissal." Ross-Tousey, 549 F.3d at 1151. It only establishes that the presumption of abuse does not arise. Id. "The statute should not be construed to give the means test more teeth, by way of interpreting the outcome

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[12] The statutory language of 11 U.S.C. § 707(b) is as follows:
(1) After notice and a hearing, the court, on its own motion or on a motion by the United States trustee..., may dismiss a case filed by an individual debtor under this chapter whose debts are primarily consumer debts, or, with the debtor's consent, convert such a case to a case under chapter 11 or 13 of this title if it finds that the granting of relief would be an abuse of the provisions of this chapter....

> (2)(A)(I) In considering under paragraph (1) whether the granting of relief would be an abuse of the provisions of this chapter, the court shall presume abuse exists if the debtor's current monthly income reduced by the amounts determined under clauses (ii), (iii), and (iv), and multiplied by 60 is not less than the lesser of -
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>> (I) 25 percent of the debtor's nonpriority unsecured claims in the case, or $6,575, whichever is greater; or
>>
>> (II) $10,950.

These amounts were in effect as of the date the McGowans filed their bankruptcy case. Adjustments to the amounts took effect for cases filed on or after April 1, 2010.

of the means test to be a conclusion." In re Barnett, No. 06-62414, 2007 WL 4510277, at *4 (Bankr. N.D. Ohio Dec. 18, 2007).

Therefore, if the presumption of abuse does not arise or is rebutted, a court must proceed to the second step of the § 707(b) analysis. A chapter 7 case may still be dismissed based upon either bad faith or the totality of the circumstances of the debtor's financial circumstances. Section 707(b)(3) provides:

> (I) 25 percent of the debtor's nonpriority unsecured claims in the case, or $6,575, whichever is greater; or
>
> (II) $10,950.

11 U.S.C. § 707(b)(3). These amounts were in effect as of the date the McGowans filed their bankruptcy case. Adjustments to the amounts took effect for cases filed on or after April 1, 2010.

> In considering under paragraph (1) whether the granting of relief would be an abuse of the provisions of this chapter in a case in which the presumption in subparagraph (A)(I) does not arise or is rebutted, the court **shall** consider -
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> > (A) whether the debtor filed the petition in bad faith; **or**
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> > (B) [whether] the totality of the circumstances (including whether the debtor seeks to reject a personal services contract and the financial need for such rejection as sought by the debtor) of the debtor's financial situation demonstrates abuse.

11 U.S.C. § 707(b)(3) (emphasis added).

Since the language of § 707(b) is unambiguous, this Court should apply the plain meaning of the text. Lamie v. United States Trustee, 540 U.S. 526, 534 (2004). Under

§ 707(b)(3), a bankruptcy court "shall" consider the totality of the circumstances of the debtor's financial situation, eliminating any discretion to skip the second part of the analysis. "[Section] 707(b)(3) is a separate test, meant to provide courts with discretion to deem a case abusive, even if the presumption of abuse does not arise under the means test or is rebutted." United States Trustee v. Hilmes (In re Hilmes), – B.R. – , No. 4:09-CV-732-Y, 2010 WL 3292807, at *10 (N.D. Tex. Aug. 19, 2010); accord 6 Lawrence P. King, Collier on Bankruptcy, ¶ 707.05[3][b] (15th ed. 2009) (stating that a bankruptcy court "must" consider bad faith and totality of the financial circumstances if a presumption of abuse does not arise or has been rebutted). The McGowans' argument that passing the means test precludes further review is also inconsistent with the language of § 707(b)(3), which requires a bankruptcy court to consider the "*totality* of the circumstances of the debtor's financial situation." Ross-Tousey, 549 F. 3d at 1162 (stating that the 707(b)(3)(B) analysis "can take into consideration a debtor's actual income and expenses").

The McGowans rely primarily on individual statements from the legislative history, rather than the statutory language, to support their theory that "passing" the means test entitled them to a discharge. Their authority has little or no weight. Appellants' Br. at 14-17; Bath Iron Works Corp. v. Director, Office of Workers' Compensation Programs, 506 U.S. 153, 166 (1993) ("[W]hen carefully read, we find the text of the statute unambiguous on the point at issue;

accordingly, we give no weight to a single reference by a single Senator during floor debate in the Senate.").

This two-step review also recognizes the difference between a dismissal based upon a presumption of abuse under the means test in § 707(b)(2) and the totality of the financial situation analysis in § 707(b)(3)(B). The first provides a mechanical, objective test based upon six month historical earnings. In re Henebury, 361 B.R. 595, 603 (Bankr. S.D. Fla. 2007) (noting means test is an "easily applied formula for determining" when a case is abusive). In contrast, § 707(b)(3)(B) is a subjective test providing for court consideration of all aspects of the debtor's finances, including current and known future income and expenses. In re Rudler, 576 F.3d 37, 51; Reed v. Anderson (In re Reed), 422 B.R. 214, 233 (C.D. Ca. 2009) (explaining § 707(b)(3) is an individualized test requiring courts to review if granting a chapter 7 discharge is warranted.)

As the McGowans have conceded, the two-step process to review cases for abuse is consistent with the holdings of the vast majority of cases. (Transcript at 100). In re Sullivan is typical: "the plain language of § 707(b)(3) . . . compels a conclusion that a court must consider a debtor's actual debt-paying ability in ruling on a motion to dismiss based on abuse where the presumption does not arise or is rebutted." In re Sullivan, 370 B.R. 314, 321 (Bankr. D. Mont. 2007) (quoting In re Sorrell, 359 B.R. 167 (Bankr. S.D. Ohio 2007)). See also In re Pak, 343 B.R. 239, 243 (Bankr. N.D. Cal. 2006) ("It would be counterintuitive to construe 'totality of the circumstances' [in § 707(b)(3)] to exclude a consideration of the debtor's ability to pay."); In re

Lenton, 358 B.R. 651, 663 (Bankr. E.D. Pa. 2006). The bankruptcy courts in the Northern District of Ohio agree with this conclusion. In re Barnett, 2007 WL 4510277 (Bankr. N.D. Ohio); In re Edighoffer, 375 B.R. 789 (Bankr. N.D. Ohio 2007); In re Kaminski, 387 B.R. 190 (Bankr. N.D. Ohio 2008); In re Haar, 360 B.R. 759 (Bankr. N.D. Ohio 2007); In re Mestemaker, 359 B.R. 849 (Bankr. N.D. Ohio 2007); In re Simmons, 357 B.R. 480 (Bankr. N.D. Ohio 2006) (noting where presumption of abuse does not arise under the § 707(b)(2) ability to repay standard, a § 707(b)(3) totality of the circumstances analysis shall be considered).

Therefore the McGowans are incorrect when they argue that the bankruptcy court should not have reviewed their case for abuse based on the totality of their financial situation, even though they "passed" the means test. Ross-Tousey, 549 F.3d at 1161-62. These two analyses are distinct. The bankruptcy court did not err in conducting an analysis under § 707(b)(3)(B), and its decision should be affirmed.

II. The Bankruptcy Court Did Not Abuse its Discretion in Dismissing the McGowan's Case under the Totality of the Financial Situation Test of 11 U.S.C. § 707(b)(3)(B).

A. Under the 2005 Act and Sixth Circuit Law, Ability to Pay Creditors Can Be Sufficient Grounds for Dismissing A Chapter 7 Case as Abusive.

In cases where the presumption of abuse does not arise or is rebutted, as here, § 707(b)(3) allows for a dismissal for abuse under two circumstances: upon a finding of "bad faith" under § 707(b)(3)(A) or due to the debtor's financial condition under § 707(b)(3)(B). These subsections are distinct from one another and provide separate and independent grounds for dismissal. In re Ross-Tousey, 549 F. 3d at 1162; In re Booker, 399 B.R. 662, 667 (Bankr. W.D. Mo. 2009). In the McGowans' case, the United States Trustee sought a dismissal based on their financial condition under § 707(b)(3)(B), and so bad faith, dishonesty, or other misconduct are irrelevant in this case.

In the Sixth Circuit, the leading cases decided under the former "substantial abuse" standard are In re Krohn and In re Behlke, which predicated dismissal either for lack of honesty or want of need, i.e. ability to pay. In re Krohn, 886 F.2d at 126; In re Behlke, 358 F.3d 433. Their rationale also applies to the current, lower, abuse standard so that bankruptcy courts in this circuit have continued to follow Krohn and Behlke. See e.g., In re Stewart, 383 B.R. 429 (Bankr. N.D. Ohio 2008); In re Wright, 364 B.R. 640, 643 (Bankr. N.D. Ohio 2007); In re Edighoffer, 375 B.R. 789 (Bankr. N.D. Ohio 2007); In re Mestemaker, 359 B.R. 849 (Bankr. N.D. Ohio, 2007).

Krohn listed several non-exclusive factors used to determine whether a case should be dismissed under the former § 707(b). Krohn, 886 F.2d at 126. The primary factor was a debtor's ability to repay his debts. Id. Other factors included whether the debtor has a stable source of future income, his eligibility for chapter 13 relief, the availability of state law and private negotiations to remedy his finances, and whether his expenses may be reasonably reduced. Id. at 126-27. However, a debtor's clear ability to pay would be sufficient grounds for dismissal in and of itself. Id. at 126; See also Behlke, 358 F.3d at 434-35 (stating that ability to pay standing alone could justify dismissal).

Notwithstanding the clear language of the statute and case law, the McGowans argue that a dismissal based upon the totality of the financial situation test under § 707(b)(3)(B) requires something more than an ability to repay, such as bad faith or some additional type of misconduct. See Appellants' Br. at 20-23. In support, the McGowans rely on the minority view set forth in In re Nockerts, 357 B.R. 497 (Bankr. E.D. Wis. 2006). However, the Nockerts decision is "of little persuasive value." Barnett, 2006 WL 4510277, at *4.

First, Nockerts was decided under the pre-2005 Act standard for dismissal in the Eastern District of Wisconsin, which was not in accord with Sixth Circuit law. In re Haar, 373 B.R. 493, 499 (Bankr. N.D. Ohio 2007); In re Augenstein, No. 06-13867, 2007 WL 6374910, at *5 (Bankr. N.D. Ohio June 14, 2007). In the Sixth Circuit, ability to pay can be the sole basis for a finding of abuse, whereas the Nockerts court stated that more than ability to pay is required. Compare In re Krohn, 886 F.2d at 126 (stating that ability to pay "alone may be sufficient to warrant dismissal") with Nockerts, 357 B.R. at 507 (stating that a case should not be dismissed if the only indicia of abuse is ability to pay).

The McGowans improperly attempt to blur the line between bad faith and financial circumstances in an attempt to resurrect the pre-BAPCPA totality of all the circumstances standard for dismissal. See, e.g., In re Henebury, 361 B.R. 607 (by bifurcating § 707(b)(3)(A) and (B), "the debtor's total financial situation as a measure of ability to pay, and bad faith are separate and sufficient grounds for dismissal. Either ability to pay or bad conduct in connection with the bankruptcy will warrant dismissal for abuse under § 707(b)(3)."). The 2005 Act made these two inquiries – bad faith and financial situation – "distinct." In re Barnett, 2007 WL 4510277, at *3. All that is required for dismissal is strong evidence that the McGowans are able to repay their creditors. Their financial information demonstrates such an ability. The bankruptcy court did not abuse its discretion in dismissing their case.

B. The Totality of the McGowan's Financial Situation Shows Their Ability to Repay Their Creditors.

In the McGowans' case, the bankruptcy court carefully reviewed their financial circumstances, especially their income and expenses, before determining they could repay their creditors, at least in part, and that therefore their case should be dismissed under § 707(b)(3)(B). (See Mem. Op, Addendum, p. 10 (noting debtors with higher income exceeding $100,000 a year should be able to repay some debt and McGowans earn over $130,000 and have expenses that could be eliminated or significantly reduced)).

1. The bankruptcy court did not commit clear error in finding that the McGowans' joint annual income of $130,000 and other assets indicate an ability to repay creditors.

The higher a debtor's income, the more likely it is that the case is abusive. In re Wadsworth, 383 B.R. 330, 333 (Bankr. N.D. Ohio 2007) ("Under any measure, a debtor, having a stable annual salary of almost $100,000.00, will be hard pressed to establish that they do not have the ability to pay some of their unsecured debt . . . ."); See also In re Durczynski, 405 B.R. 880 (Bankr. N.D. Ohio 2009) (finding the Debtors enjoyed a stable annual income in excess of $100,000 and devoted a significant portion of their income on unnecessary expenses); See In re Brenneman, 397 B.R. 866 (Bankr. N.D. Ohio 2008). The McGowans enjoy a gross income of $130,000 per year. (Mem. Op., Addendum, p. 2).

The bankruptcy court then considered how much of the McGowans' income could be considered disposable and thus available to their creditors. (Mem. Op., Addendum, p. 10). "Disposable income is defined as that income received by a debtor which is not reasonably necessary to be expended for the maintenance or support of a debtor or a dependent of the debtor." In re Zuccarell, 373 B.R. 508, 511 (Bankr. N.D. Ohio 2007) (citation omitted); see also In re Srikantia, 417 B.R. 505 (Bankr. N.D. Ohio 2009). The bankruptcy court was not required to calculate how much disposable income the McGowans could repay their creditors; the evidence simply needed to give it "the firm and distinct feeling that Debtor has, indeed, some disposable income."[13] See In re Edighoffer, 375 B.R. at 799 (Bankr. N.D. Ohio 2007). The bankruptcy court did not clearly err in concluding the McGowans had disposable income. It was

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[13] The United States Trustee's witness, Mr. Weaver, testified that based upon the McGowans' originally scheduled expenses, such modifications would leave the McGowans with $3,057.04 of monthly disposable income. (Transcript at 61). Mr. Weaver further testified that based upon the amendments to the scheduled expenses, modifications to the amended expenses would leave the Appellants with $2,783.04 of monthly excess income. (Transcript at 63). The McGowans never refuted this evidence.

enough that the McGowans had stable income exceeding $130,000 a year and planned to keep a house valued at $380,000. See In re Felske, 385 B.R. 649 (Bankr. N.D. Ohio 2008) (case dismissed where debtors had higher income and assets including house valued at $390,000).

2. The bankruptcy court did not commit clear error in finding that the McGowans' expenses could be reduced to allow them to repay their creditors.

If a bankruptcy court finds that expenses are unnecessary or excessive and may be reduced to create disposable income that could be used to repay creditors, it may dismiss under § 707(b)(3)(B). In determining the reasonableness of a debtor's expenses, the overarching goal is to establish a "fair division of a debtor's future income between his creditors and himself. A debtor should not be permitted to live extravagantly at his creditors' expense. However, it should be up to the debtor to decide how he spends his share once the appropriate allotment has been made." In re Lubinski, No. 07-31230, 2008 WL 2388127, at *6 (Bankr. N.D. Ohio June 6, 2008) (quoting In re Mars, 340 B.R. 844 (Bankr. W.D. Mich. 2006)).

Abuse under 11 U.S.C. § 707(b)(3)(B) may be found when a debtor attempts to continue paying excessive expenses without trying to repay unsecured creditors. In re Harter, 397 B.R. 860 (Bankr. N.D. Ohio 2008) (debtor with high household income and high expenses subject to dismissal of case). When evaluating a debtor's expenses, a bankruptcy court may consider less expensive alternatives and "make downward adjustments where necessary." In re Felske, 385

B.R. at 655. One benchmark of an allowable expense is one that is "frugal." In re Burge, 377 B.R. 573, 578 (Bankr. N.D. Ohio 2007).

The Court properly scrutinized the McGowans expenses. It did not clearly err in concluding mortgage payments originally scheduled in the amount of $2,210, then increased to $3,371, were excessive, especially since the McGowans had not made any payments since September, 2009. (Mem. Op., Addendum, p. 9). In re Violanti, 397 B.R. 852 (Bankr. N.D. Ohio 2008) (finding debtors earning over $100,000 with $2,500 housing expense could repay portion of debt if adjusted budget). It did not commit clear error when it determined that the McGowans' $433 monthly 401k loan repayment should be included as disposable income available to their creditors because it would be unfair to allow them to fund their own retirement while paying their creditors less than a 100% dividend. Behlke, 358 F.3d at 436; In re Glenn, 345 B.R. 831, 836 (Bankr, N.D. Ohio 2006).

A large portion of the McGowans' expenses relate to college costs of their two adult children. (Mem. Op., Addendum, p. 7). Their desire to help their children obtain college degrees is understandable, but the majority of courts hold that parents may not assist their adult children at the expense of their unsecured creditors. In re Baker, 400 B.R. 594, 598 (Bankr. N.D. Ohio 2009) ("Educational expenses for adult children are discretionary, and are not expenses that should be foisted upon a debtor's prepetition creditors.") (citation omitted); In re Hess, No. 07-31689, 2007 WL 3028422, at *3 (Bankr. N.D. Ohio Oct. 15, 2007) (citing cases); In re

Pfahler, No. 07-30044, 2007 WL 2156401, at *2 (Bankr. N.D. Ohio July 26, 2007) (same). The Court properly found college tuition totaling $2,450, books totaling $220, and other school related expenses were not appropriate expenditures for debtors seeking a chapter 7 discharge of debts. (Mem. Op., Addendum, p. 7).

Furthermore, debtors may not pay student loan obligations ahead of other unsecured creditors. In re Hester, 330 B.R. 809, 813 (Bankr. M.D. Florida 2005); In re Wessels, 311 B.R. 851, 855 (Bankr. N.D. Iowa 2005); In re Tucker, 150 B.R. 203, 204-05 (Bankr. N.D. Ohio 1992). Therefore, the bankruptcy court did not clearly err in deciding that the McGowans should devote the $626 per month they were paying for the children's unsecured student loan debt to repaying their creditors.

The McGowans argue that the facts in their case show they do not have the ability to pay. (Appellants' Br. at 24). They assume, without legal authority, that scheduled actual expenses may not be reviewed for reasonableness or excessiveness by the bankruptcy court. For instance, the McGowans contend monthly mortgage payments, as amended, of $3,371 are a proper expense. Yet they have not made a mortgage payment in more than eight months, and they are currently only obligated to pay $2,210 per month. Id. at 10-11. They rely on the means test calculations to support these mortgage payments. Id. at 24. But means test expense allowances are not relevant under a § 707(b)(3)(B) legal analysis. In re Booker, 399 B.R. 666 (holding that a court's 707(b)(3)(B) analysis is not "bound by the itemization of expenses which the debtors are entitled to deduct from that current monthly income pursuant to § 707(b)(2)"); accord Ross-Tousey, 549 F. 3d at 1161-62; Rudler, 576 F. 3d at 51.

The McGowans have not disputed any of the bankruptcy court's factual findings. They have not contested the legal basis for the bankruptcy court's findings regarding the expenses it found to be excessive or impermissible. (Appellants' Br. at 24-28). Rather, they focus on arguments which are only relevant to a motion to dismiss brought under the means test or on the basis of bad faith under § 707(b)(3)(A). Such arguments are irrelevant in this appeal. The bankruptcy court did not err in rejecting them.

CONCLUSION

For these reasons, the United States Trustee respectfully asks this Court to affirm the order entered below granting the United States Trustee's motion to dismiss under 11 U.S.C. § 707(b)(3)(B) and dismissing Mr. and Mrs. McGowans' chapter 7 bankruptcy case.

Dated:

Respectfully submitted,

/s/ Amy L. Good
Amy L. Good, Esq. (0055572)
Trial Attorney
Department of Justice
Office of the United States Trustee,
Suite 441, H.M. Metzenbaum U.S. Courthouse
201 Superior Avenue
Cleveland, Ohio 44114
amy.l.good@usdoj.gov

Attorney for U.S. Trustee Daniel M. McDermott

Of Counsel

P. Matthew Sutko
Catherine Sevcenko
Executive Office for United States Trustees
Department of Justice
20 Massachusetts Avenue, N.W.
Suite 8000
Washington, D.C. 20530
(202) 307-1399

Certificate of Service

I certify that on September 28, 2010, a copy of the foregoing "Brief of the Appellee United States Trustee" was filed electronically. Notice of this filing will be sent by operation of the Court's electronic filing system to all parties indicated on the electronic filing receipt. Parties may access this filing through the Court's system. A copy was also served by regular U.S. Mail upon Richard H. Nemeth, Esq., 526 Superior Avenue, Suite 410, Cleveland, Ohio 44114.

/s/ Amy L. Good
Amy L. Good

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In re: John David McIvor (Eisen, UST v. McIvor)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*
(E.D. MI)

3. ("CCN") ***CURRENT*** CASE NO.
No.: 06-cv-15232

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*
No.: 06-42566-MBM
Court: (Bankr. E.D. MI)
(Identify judge & cite, if any)

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Paul J. Randall, P. Matthew Sutko, Melissa Perry
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") ● ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***

● whether the court erred by ruling as a matter of law that the Debtor, could claim an "automobile ownership expense" for debt financing that took the Debtor outside § 707(b)(2)'s statutory means test even though this Debtor had no "automobile ownership expense" because he owned his car debt-free; or, if the Debtor passed the means test

Mores issues on page 2

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UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF MICHIGAN

In re:	Civil Case No. 06-cv-15232
JOHN DAVID McIVOR,	HON. PAUL V. GADOLA
Debtor.	Bankruptcy Case No. 06-42566-MBM

_____________________________________/

SAUL EISEN, U.S. TRUSTEE,

Appellant,

v.

JOHN DAVID McIVOR,

Appellee.
_____________________________________/

APPELLANT'S BRIEF ON APPEAL

Paul J. Randel (P58419)
Trial Attorney
Office of the United States Trustee
Department of Justice
211 West Fort Street - Suite 700
Detroit, Michigan 48226
Paul.Randel@usdoj.gov
(313) 226-4541

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In re:	Civil Case No. 06-cv-15232
JOHN DAVID McIVOR,	HON. PAUL V. GADOLA
Debtor.	Bankruptcy Case No. 06-42566-MBM

______________________________________/

SAUL EISEN, U.S. TRUSTEE,

Appellant,
v.

JOHN DAVID McIVOR,

Appellee.
______________________________________/

APPELLANT'S BRIEF ON APPEAL

STATEMENT OF THE ISSUES PRESENTED FOR REVIEW

The United States Trustee sought dismissal of this Debtor's chapter 7 case on two alternative grounds, (a) because the Debtor failed § 707(b)(2)'s means test and, (b) presuming the Debtor passed the means test, because the debtor's case merited dismissal under § 707(b)(3)(B)'s totality of the circumstances test. Given this, the issues presented to this Court for determination are whether the court below:

1. erred by ruling as a matter of law that the Debtor could claim an "automobile ownership expense" for debt financing that took the Debtor outside § 707(b)(2)'s statutory means test even though this Debtor had no "automobile ownership expense" because he owned his car debt-free; or, if the Debtor passed the means test,

2. erred by relying upon a statutory presumption against dismissing bankruptcy cases under § 707(b)'s "totality of the circumstances" test when Congress had repealed that statutory presumption in 2005?

Should this Court determine the court below erred on either ground, this Court should reverse and remand for adjudication of the United States Trustee's claims on their merits.

STATEMENT OF APPELLATE JURISDICTION

The United States Bankruptcy Court for the Eastern District of Michigan had jurisdiction over the underlying case, initiated by John D. McIvor, under 28 U.S.C. §§ 157(b) and 1334(a). This appeal is taken from a final order that the bankruptcy court entered on November 15, 2006, denying the United States Trustee's motion to dismiss this Debtor's chapter 7 bankruptcy case. The United States Trustee filed a timely notice of appeal under 28 U.S.C. § 158(c)(2) and Fed. R. Bankr. P. 8002(a) on November 22, 2006.[1] This Court has jurisdiction over this appeal under 28 U.S.C. § 158(a)(1).

STATEMENT OF APPLICABLE STANDARD OF APPELLATE REVIEW

In an appeal taken from a bankruptcy court order, a district court reviews the bankruptcy court's findings of fact under the clearly erroneous standard but reviews *de novo* the bankruptcy court's conclusions of law. *In re Isaacman*, 26 F.3d. 629, 631(6th Cir. 1994) (Citing *In re Zick*, 931

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[1] Congress has authorized the United States Attorney General to appoint 21 United States trustees, each to serve in a specific geographic region of the United States. *See generally* 28 U.S.C. § 581 et seq. (establishing the United States Trustee Program). The United States trustees are senior officials of the Department of Justice. *Id.* The United States trustees "supervise the administration of cases and trustees" in all bankruptcy cases within his or her region through the exercise of a range of oversight responsibilities. 28 U.S.C. § 586(a)(3). *See generally Morganstern v. Revco D.S. Inc. (In re Revco D.S., Inc.)*, 898 F.2d 498, 500 (6th Cir. 1990) (explaining that United States trustees oversee the bankruptcy process, protect the public interest, and ensure that bankruptcy cases are conducted according to law.). United States trustees may raise, appear, and be heard on any issue in any case or proceeding under Title 11. 11 U.S.C. § 307; *see also In re Revco D.S., Inc.*, 898 F.2d at 499-500 (upholding broad appellate standing of United States trustees).

F.2d 1124, 1126 (6th Cir.1991)). Whether the Bankruptcy court properly allowed the Debtor to deduct an ownership expense under the means test when he had no loan or lease payment is a question of law and is therefore subject to *de novo* review. Whether the bankruptcy court improperly applied a statutory presumption against dismissing the debtor's case under 11 U.S.C. § 707(b)(3) that Congress repealed in 2005 is also question of law subject to *de novo* review.

STATEMENT OF THE CASE

On March 6, 2006, John D. McIvor (the "Debtor") filed a petition for relief under chapter 7 of the Bankruptcy Code.[2] The United States Trustee filed a motion to dismiss the case under 11 U.S.C. § 707(b), asserting that it would be an abuse of chapter 7 to grant the Debtor a discharge.

The bankruptcy court denied the motion. The United States Trustee then timely filed this appeal.

STATEMENT OF THE FACTS

1. Statutory Background

On October 17, 2005, most provisions of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub.L. 109-8, 119 Stat. 27 (April 20, 2005) (the "BAPCPA") took effect, implementing changes to the Bankruptcy Code. As part of this effort, Congress significantly amended § 707(b) of the Bankruptcy Code, which governs dismissal of chapter 7 bankruptcy cases. Congress enacted the § 707(b) amendments to curb bankruptcy abuse by, *inter alia*, dismissing cases filed by chapter 7 debtors seeking to have their debts discharged despite having the ability to repay their creditors. *See* 151 Cong. Rec. S1856 (Mar. 1, 2005) (statement of Sen. Charles Grassley). Sen.

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[2] As used herein, the term "Bankruptcy Code" refers to 11 U.S.C. §§ 101 - 1529, *et seq.*

Grassley explained that the purpose behind the BAPCPA amendments, "is this simple: if repayment is possible, then [a debtor] will be channeled into chapter 13 of the Bankruptcy Code which requires people to repay a portion of their debt. . . ." *Id.*

As it existed prior to BAPCPA, § 707(b) only authorized dismissal based on a finding that allowing the debtor relief constituted a "substantial abuse" of chapter 7. Further, § 707(b) prior to its amendment by BAPCPA required courts to presume that a debtor was entitled to relief under chapter 7 of the Bankruptcy Code. Section 707(b) now authorizes dismissal where the court finds that the granting of relief would be an "abuse" of chapter 7. Moreover, BAPCPA repealed the former presumption in favor of granting a discharge to the debtor in § 707(b) and replaced it with a new presumption: it is now presumed that a case is an "abuse" of chapter 7 if a detailed mathematical formula set out in the statute (the "means test") yields an amount of monthly disposable income that is above a threshold amount specified in the statute.

The means test uses a series of calculations to determine whether the § 707(b)(2) presumption of abuse arises based on the debtor's ability to pay. *See* 11 U.S.C. § 707(b)(2)(A). Specifically, the means test calculates a debtor's current monthly income ("CMI"), as defined in 11 U.S.C. §101(10A), based on the debtor's income for the six calendar months preceding the bankruptcy filing. If the debtor's[3] annualized CMI falls below the applicable state median family income, the safe harbor provision of 11 U.S.C. § 707(b)(7) applies, and the presumption of abuse will not arise. If the debtor's CMI is above the applicable state median family income, the debtor

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[3] 11 U.S.C. § 707(b)(7) mandates that the CMI of the debtor and the debtor's spouse, regardless whether the spouse is filing bankruptcy, are used to determine whether the safe harbor provision of § 707(b)(7) applies. In this case the debtor is not married.

deducts certain standard and actual expenses to calculate his or her monthly disposable income. If the debtor's monthly disposable income is less than $100 per month (or $6,000 over 60 months), the presumption of abuse does not arise. If the debtor's monthly disposable income is equal to or exceeds $167 per month (or $10,000 over 60 months), the presumption of abuse arises. If the debtor's monthly disposable income is between $100 and $167 per month, the presumption of abuse arises if that amount, over 60 months, is sufficient to pay 25% of the debtor's nonpriority unsecured debt.

Each debtor with primarily consumer debts is required to file, in conjunction with their bankruptcy schedules and statement of financial affairs, a Statement of Current Monthly Income and Means Test Calculation, Official Form B22A (the "Means Test Form"). 11 U.S.C. § 521 and § 707(b)(2)(C). In Chapter 7 cases the main purpose of the Means Test Form[4] is to calculate monthly disposable income (ability to pay) following the formula set forth in 11 U.S.C. § 707(b)(2), and determine whether the presumption of abuse arises.

If no presumption of abuse arises under § 707(b)(2) based on the means test, or if the presumption is rebutted under 11 U.S.C. § 707(b)(2)(B) by the debtor demonstrating special circumstances that justify income or expense adjustments for which there is no reasonable alternative, 11 U.S.C. § 707(b)(3) directs courts to consider whether the case should nonetheless be dismissed as an "abuse" of chapter 7. In particular, the court "shall consider" whether the case was

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[4] Debtors who file chapter 13 cases complete and file Official Form B22C, which is similar but not identical to Official Form B22A. Official Form B22C is one tool utilized to determine the amount of monthly payments to be made by chapter 13 debtors into their repayment plans.

filed in “bad faith,” 11 U.S.C. § 707(b)(3)(A), or whether “the totality of the circumstances of the debtor’s financial situation. . . demonstrates abuse,” 11 U.S.C. § 707(b)(3)(B).

Accordingly, §§ 707(b)(2) and (b)(3) provide distinct and separate bases upon which the court may determine that a chapter 7 case is abusive: first, by presuming the case is an abuse based on the means test, or second, in cases where the presumption does not arise or is rebutted, by finding that the case is an abuse of chapter 7, based upon bad faith or upon the totality of the circumstances of the debtor’s financial situation.

2. Factual Background

On March 6, 2006, the Debtor filed a chapter 7 Petition in the United States Bankruptcy Court for the Eastern District of Michigan. B.Ct.Doc. 1. On the Petition, he identified himself as an individual with primarily consumer debts. B.Ct.Doc. 1, pg 1. The Debtor also filed his Means Test Form. B.Ct.Doc. 10. The Debtor’s Means Test Form shows monthly disposable income of $157.66. B.Ct.Doc. 10, Line 50. The Debtor determined that the presumption of abuse did not arise and checked the corresponding box at the top of his Means Test Form. B.Ct.Doc.10, pg. 1.

Relative to his motor vehicle, on line 22 of the Means Test Form, the Debtor included a deduction of $390 for “transportation vehicle operation” expense. This expense amount is taken from the IRS Transportation Standards, Operating Costs and Public Transportation Costs, published by the IRS. On Line 23 of the Means Test Form the Debtor included a deduction of $471 for a “transportation ownership/lease expense” even though he has no ownership or lease payment for his vehicle. This expense amount is taken from the IRS Transportation Standards, Ownership Costs, which are published by the IRS. Thus, the Debtor claimed a total transportation expense for his one vehicle of $861 per month ($471 IRS ownership cost and $390 IRS operating cost).

The United States Trustee recalculated the Debtor's monthly disposable income by eliminating the $471 deduction and instead allowed the Debtor an additional transportation vehicle operating expense of $200 on account of the age of the vehicle (for a total operating expense of $590).[5] The Debtor's monthly disposable income actually totaled $428.66, which when multiplied by 60, substantially exceeds $10,000 and the presumption of abuse therefore arises.

As required by 11 U.S.C. § 521(a), the Debtor also filed, under oath, schedules itemizing his current income ("Schedule I"), his current expenditures ("Schedule J"), and his total unsecured debts ("Schedule F"). B.Ct.Doc. 9. The Debtor's Schedule I listed his total net monthly income as of the Petition date as $3,414.84, B.Ct.Doc. 9, Line 16, and his Schedule J listed total monthly expenditures as $3,206.67. B.Ct.Doc. 9, Line 19. The Debtor attested on Schedule J that he has actual monthly net income of $208.17. B.Ct.Doc., Line 20.c. He scheduled $51,536.01 in unsecured nonpriority claims that are subject to Chapter 7 discharge. B.Ct.Doc. 9, Schedule F.

Within 10 days of the meeting of creditors as required by 11 U.S.C. § 704(b)(1)(A), the United States Trustee filed his statement indicating that the case was presumed to be an abuse. Within 30 days as required by 11 U.S.C. § 704(b)(2), the United States Trustee filed his motion to dismiss the case, based in part upon the presumption in 11 U.S.C. § 707(b)(2).

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[5] The Debtor's vehicle is a 1995 Dodge Ram pick up truck. B.Ct.Doc. 9, Schedule B, Line 25. The United States Trustee allows an additional $200 operating expense under the means test, based on the Internal Revenue Manual which allows such an expense for vehicles six years or older or with more than 75,000 miles. *See* Internal Revenue Manual, Part 5, (entitled Collecting Process), Chapter 8, § 5.8.5.5.2, Treatment of Non-Business Transportation Expenses, which may be found at the IRS website at http://www/irs/gov/irm/part5/ch08s05.html.

In addition to the claim under § 707(b)(2) based upon the presumption of abuse under the means test, the United States Trustee's motion to dismiss also contained a claim under 11 U.S.C. § 707(b)(3), that the bankruptcy filing is an abuse based on the totality of the circumstances of the Debtor's financial situation. Debtor's Schedules I and J demonstrate actual monthly net income of $208.17. Payments of this amount in a Chapter 13 plan would total $12,490 over the 60 month life of the plan, constituting a meaningful repayment to creditors.

SUMMARY OF ARGUMENT

The court below erred in denying the Untied States Trustee's motion to dismiss this debtor's bankruptcy case under 11 U.S.C. § 707(b)(2) and under § 707(b)(3)(B). Under § 707(b)(2), a debtor's case is presumed abusive as a matter of law and must be dismissed absent special circumstances if the debtor fails § 707(b)(2)'s "means test." Here the Debtor would have failed the means test but for the bankruptcy court's legal ruling that the Debtor could claim an "automobile ownership expense" for debt financing even though the debtor had no "automobile ownership expense" because he owned his car debt-free. Whether debtors can take phantom deductions under Congress' 2005 amendment to § 707 is an important question of law that arises relatively frequently in chapter 7 bankruptcy cases. This Court is one of the first appellate courts to consider it.

The bankruptcy court erred as a matter of law by misinterpreting the automobile expense debt financing allowance. In its application of the means test, the bankruptcy court interpreted § 707(b)(2) to allow the Debtor to subtract expenses that he does not incur on a monthly basis. Even though the Debtor does not make monthly payments to purchase or lease a car, the bankruptcy court ruled that in addition to a monthly car operating expense of $390, the Debtor also was entitled to subtract a monthly expense of $471 in calculating his monthly disposable income. This additional "imaginary" expense correspondingly reduced the Debtor's monthly disposable income under the means test. Allowing the Debtor to subtract ownership costs even though he has no applicable vehicle ownership expenses stands the means test on its head, eliminating disposable income otherwise reported on Official Form B22A of the Federal Rules of Bankruptcy Procedure and available to repay his creditors.

After disallowing an expense in this expense category that the Debtor does not actually incur, the Debtor's monthly disposable income under the means test is $428.66, which is well above the $166.67 threshold amount, and the presumption of abuse arises. This case must therefore be remanded to the bankruptcy court for further evidentiary proceedings on the United States Trustee's motion to dismiss in accordance with § 707(b)(2), including allowing the debtor an opportunity to rebut the presumption by demonstrating that special circumstances that justify an income or expense adjustment and for which there is no reasonable alternative exist in this case which militate against dismissal.[6]

In addition, the bankruptcy court erred by determining that the Debtor's filing was not an abuse based on the "totality of the circumstances" under 11 U.S.C. § 707(b)(3) because the bankruptcy court improperly applied a presumption in favor of the Debtor that Congress had repealed in 2005. Thus, the bankruptcy court must be reversed and the case remanded to the

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[6] It is premature to address the merits of a special circumstances rebuttal argument. However, some bankruptcy courts have ruled that extraordinary transportation expenses can constitute special circumstances that justify an expense adjustment that rebuts the presumption of abuse, while other courts would not consider these type of expense adjustments to qualify as special circumstances. *Compare In re Pederson*, 2006 WL 3000104, at *3-4 (Bankr. N.D. Iowa 2006) *with In re Johns*, 342 B.R. 626, 628-29 (Bankr. E.D. Okla.2006).

bankruptcy court for consideration of the United States Trustee's motion to dismiss under 11 U.S.C. § 707(b)(3)(B) based on the totality of the circumstances without application of any presumption in Debtor's favor.

ARGUMENT

I. THIS DEBTOR MAY NOT DEDUCT A MONTHLY CAR LOAN OR LEASE EXPENSE UNDER 11 U.S.C. § 707(b)(2) BECAUSE HE HAS NO MONTHLY LOAN OR LEASE PAYMENT OBLIGATION.

On Line 23 of his Official Form B22A, which is an official form of the Federal Rules of Bankruptcy Procedure, the Debtor claimed an allowance for the IRS Local Standard referred to as vehicle ownership cost, even though he owns his vehicle free and clear of liens. In denying the United States Trustee's Motion to Dismiss, the bankruptcy court allowed the Debtor to reduce his current monthly income ("CMI") by the amount of the vehicle ownership expense for one vehicle, $471, even though he does not have a monthly payment obligation associated with the vehicle. Because this holding is contrary to the plain language and legislative intent of 11 U.S.C. § 707(b)(2)(A)(ii)(I), it must be reversed.

A. The Plain Language of 11 U.S.C. § 707(b)(2) Limits the IRS Local Standards, Including the Local Standard referred to as Vehicle Ownership Cost, to Debtors for Whom the Expense is "Applicable".

Section 707(b)(2)(A)(ii)(I) of the Bankruptcy Code provides that a "debtor's monthly expenses shall be the debtor's *applicable* monthly expense amounts specified under the . . . Local Standards . . . issued by the Internal Revenue Service. . . ." 11 U.S.C. § 707(b)(2)(A)(ii)(I) (emphasis added). When the language of a statute is plain, as it is here, "the sole function of the courts – at least where the disposition required by the text is not absurd – is to enforce it according to its terms." *e.g.*, *Lamie v. United States Trustee*, 540 U.S. 526, 534 (2004). (Citations omitted.) *See also In re Hardacre*, 338 B.R. 718 (Bankr. N.D. Tex. 2006) (citing *United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235, 242 (1989) (plain language of the statute controls, unless a literal reading of the statute is contrary to the intention of the drafters).

The plain language of § 707(b)(2)(A)(ii)(I) specifically provides a two step process for bankruptcy courts to employ before the specific IRS expense amounts may be included in the debtor's allowed monthly expenses. First, the expense itself must be *applicable* to the debtor. Second, if the expense is *applicable* to the debtor, then the specified amount for the debtor's locale is selected from the IRS Local Standards.

The Court in *In re Wiggs*, __ B.R. __, 2006 WL 2246432 (Bankr.N.D.Ill. 2006), examined § 707(b)(2)(A)(ii)(I) as it applies in the context of § 1325 of the Bankruptcy Code and concluded that an ownership expense for the debtor's vehicle is not allowed when the debtor owns the vehicle free and clear. The *Wiggs* court determined that the statute is "clear and unambiguous," finding that the "term 'applicable' modifies the amounts specified to limit the expenses to only those that apply." *In re Wiggs*, 2006 WL 2246432 at *2. Thus, the debtors in *Wiggs* were not allowed to include the standard ownership expense for transportation ownership when they did not have a payment on the vehicle. *Id.* at *3. *Accord, In re Demonica*, 345 B.R. 895, 904 (Bankr. N.D. Ill. 2006).[7]

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[7] *Demonica* is relied on by the bankruptcy court in *In re Fowler*, 349 B.R. 414 (Bankr.D.Del. 2006), a case that is quoted at length and relied upon by the bankruptcy court in its November 15, 2006 Order. The *Fowler* court misconstrues *In re Demonica*. In fact, *In re Demonica* like the *In re Biggs* decision, held that a loan or lease payment was required in order to qualify for the IRS Transportation Ownership Cost expense Standard. The *In re Demonica* Court allowed the debtor to take an expense adjustment because the debtor in that case established that, he actually made payments on the vehicle at issue, even though he did not have a contractual liability on the vehicle loan. *In re Demonica*, 345 B.R. at 905.

11 U.S.C. § 707(b)(2)(A)(ii)(I) is clear and unambiguous. Reading the text of the provision as requiring a loan or lease payment obligation before vehicle ownership costs are deducted is not absurd. Indeed, by giving equal weight to the term "applicable" as it appears in § 707(b)(2)(A)(ii)(I), a plain reading of the statute leads to the conclusion that Congress necessarily restricted each of the categories of expense allowances in that section, including the IRS Local Standards for transportation, to those debtors for whom such expenses *apply*.[8]

B. The Internal Revenue Service's Application of Its Own Local Standard for Vehicle Acquisition, and Interpretive Case Law, Supports the United States Trustee's Reading of 11 U.S.C. § 707(b)(2)(A)(ii)(I).

To determine whether the expense Standards issued by the IRS are applicable, the most logical resource to consult is the source of the expense Standards, the IRS. On page two of its Collection Financial Standards under the heading "Transportation," the IRS provides as follows:

> The transportation standards consist of nationwide figures for monthly loan or lease payments referred to as ownership costs, and additional amounts for monthly operating costs . . . The ownership costs provide maximum allowances for the lease or purchase of up to two automobiles if allowed as a necessary expense ... If a taxpayer has a car payment, the allowable ownership cost added to the allowable operating cost equals the allowable transportation expense. If a taxpayer has no car

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[8] The plain meaning of the term "applicable" in § 707(b)(2)(A)(ii)(I) is bolstered by Congress' decision to use the same limiting language in the immediately following section, 11 U.S.C. § 707(b)(2)(A)(ii)(II). That section provides that a debtor's monthly expenses "may include, *if applicable*, the continuation of actual expenses paid by the debtor . . . for care and support of an elderly, chronically ill, or disabled household member or member of the debtor's immediate family . . . ." (Emphasis added.) This provision explicitly provides that in order to qualify for the care or support expense allowance, the debtor must actually incur an expense for the care or support of a qualifying family or household member. Because the term "applicable" is used in these two consecutive subsections of 11 U.S.C. § 707(b)(2), it should be given the same meaning, and both should be read to require that the debtor actually incur the type of expense. *See, e.g., U.S. v. Honken,* 184 F.3d 961, 969 (8th Cir. 1991), *citing Smith v. Sullivan,* 982 F.2d 308, 314 (8th Cir. 1992) (when the same words are used in different sections of the law, they are to be given the same meaning). That the IRS transportation ownership cost is a specified standardized amount, $471 for the first car, as opposed to the actual expense amount for care or support does not alter the fact that the term "applicable" in both subsections means that the debtor must still have a monthly expense obligation in order to qualify for the expense.

> payment, or no car, the operating costs portion of the transportation standard is used to come up with the allowable transportation expense.

See IRS Collection Standards, available at www.irs.gov/individuals/article/0,,id=96543,00.html. Thus, according to the IRS, if the debtor does not have a loan or lease payment obligation, then the Local Standard referred to as vehicle ownership cost is not "applicable." If the debtor's vehicle is subject to a monthly loan or lease payment obligation, however, then in addition to the vehicle "operating cost" expense, the "ownership cost" is also "applicable," and shall be the dollar amount specified by the IRS. *Id.*

This application of the means test is supported by the weight of bankruptcy court authority. *See, e.g., In re Barraza*, 346 B.R. 724, 728-29 (Bankr. N.D. Tex. 2006)(debtor not entitled to standard ownership allowance for vehicle without a loan or lease payment); *In re McGuire*, 342 B.R. 608, 613-14 (Bankr. W.D. Mo. 2006)(chapter 13 debtors not permitted standard ownership allowance for vehicle owned free and clear of liens)*; In re Hardacre*, 338 B.R. 718, 723-24 (Bankr N.D. Tex. 2006)(same). *See also*, *In re Harris*, __ B.R. __, 2006 WL 2933891, 3-4 (Bankr. E.D. Okla. 2006); *In re Oliver*, 350 B.R. 294, 301 (Bankr. W.D. Tex. 2006); *In re Demonica*, 345 B.R. at 895 (Bankr.N.D.Ill. 2006)(standard ownership allowance when debtor makes payment on vehicle even if not liable on note). *But see, In re Fowler*, 349 B.R. 414 (Bankr.D.Del. 2006)(debtors may deduct ownership expenses for a vehicle for which they do not make payments); *In re Haley*, __ B.R. __, 2006 WL 2987947 (Bankr. D.N.H. 2006)(same); *In re Farrar-Johnson*, __ B.R. __, 2006 WL 2662709 (Bankr. N.D.Ill. 2006)(debtors entitled to deduct IRS Local Standard for housing even though they had no actual housing expense).

In addition to the IRS Collection Financial Standards themselves, the IRS also publishes guidelines, including the Internal Revenue Manual, that support a reading of § 707(b)(2)(A)(ii)(I) that requires debtors to have an actual loan or lease payment obligation on a vehicle before the Local Standard referred to as ownership cost "applies." Because the IRS is the source of the Local and National Standards referenced in § 707(b)(2)(A)(ii)(I), the manner in which the IRS applies its own expense Standards in tax collection is instructive. *See, e.g.*, *Hardacre*, 338 B.R. at 726 ("Because the Local Standards are issued by the Internal Revenue Service, it is instructive to refer to publications of that organization for guidance as to the types of 'debt payments' that can reduce allowances under the Local Standards.").

The IRS Manual's Financial Analysis Handbook states, in relevant part, that:

> The transportation standards consist of nationwide figures **for loan or lease payments referred to as ownership costs[.]** If a taxpayer has a car payment, the allowable ownership cost added to the allowable operating cost equals the allowable transportation expense. **If a taxpayer has no car payment, only the operating cost portion of the transportation standard is used to figure the allowable transportation expense.**

Internal Revenue Service Manual, Financial Analysis Handbook, Pt. 5, ch. 15, § 5.15.1.7(4.B), available at http://www.irs.gov/irm/part5/ch15s01.html, (emphasis added). In addition, Chapter 8 of the Financial Analysis Handbook clarifies that the ownership expense is allowed only for the "purchase and/or lease of a vehicle." Internal Revenue Manual, Part 5, (entitled Collecting Process), Chapter 8, § 5.8.5.5.2, Treatment of Non-Business Transportation Expenses, at page 12 of 16 which may be found at the IRS website at http://www/irs/gov/irm/part5/ch08s05.html.

Recent revisions to the Collection Financial Standards also make clear that the "ownership cost" is calculated by the IRS based on the "five-year average of new and used car financing data compiled by the Federal Reserve Board of Governors." *See* IRS Collection Financial Standard, *supra* (at section entitled "Recent Revisions"). As such, the "ownership cost" is intended to account for the reasonable expense of financing a vehicle over five years and is inapplicable if a debtor has no such acquisition financing expense.

Accordingly, the IRS Collection Financial Standards and guidance in applying the expense standards published by the IRS make clear that the "ownership cost" portion of the Local Transportation Standards is intended to apply only in situations where the debtor has a monthly vehicle acquisition financing expense, *i.e.*, has a monthly vehicle lease or loan payment. *Cf. McGuire*, 342 B.R. at 613. ("Thus, if a debtor is not incurring expenses for the purchase or lease of a vehicle, the debtor cannot claim a vehicle ownership expense under the IRS standards.")

C. Congressional Intent Supports Allowing the IRS Local Standard for Vehicle Ownership Costs Only to Debtors Who Have an Applicable Ownership Expense.

Even if the language of the statute is considered ambiguous, which the United States Trustee disputes, then the United States Trustee's interpretation of § 707(b)(2)(A)(ii)(I) is necessary to give effect to the intent of Congress in enacting the means testing provisions of the BAPCPA. *See, e.g.*, *Owner-Operator Independent Driver's Ass'n, Inc. v New Prime, Inc.*, 192 F.3d 778, 785 (8th Cir. 1999)(while court's principal focus must be on the language of the relevant statute, court cannot ignore the broader perspective and may use legislative history to confirm most plausible construction of statute) (*citing Wisconsin Public Intervenor v. Mortier,* 501 U.S. 597, 610 (1991)).

In enacting the BAPCPA, Congress implemented the "means test to ensure that those who can afford to repay a portion of their unsecured debts are required to do so. . . . The means test takes into account the petitioner's income, debt burden, and allowable living expenses, which can vary significantly according to the debtor's place of residence <u>and particular circumstances</u>." 151 Cong. Rec. S2470, 2005 WL 562943 *S2470 (March 10, 2005)(emphasis added). The bankruptcy court's holding in this case is inconsistent with the legislative intent of the BAPCPA's means test provisions because the Debtor's "particular circumstances" do not include a monthly expense obligation for financing the acquisition of a vehicle.

Congressional intent to remove judicial discretion regarding whether a debtor with ability to pay should be dismissed from chapter 7, is demonstrated by early committee reports on the bankruptcy reform legislation introduced in 2000.[9] This legislative history provides:

> . . . [It] is intended to both remove unequivocally the bankruptcy court's discretion with regard to whether a debtor with ability to pay should be dismissed frm chapter 7, and to restrict as much as possible reliance upon judicial discretion to determine the debtor's ability to pay. Limited judicial discretion remains to deal with the hardship case, but that discretion is not to be abused by lax enforcement of the standards. . . .

146 Cong. Rec. S11683-11729 at 11700 (section by section explanation of HR 2415), Dec. 7, 2000.

By allowing every debtor who owns a car to take the IRS Transportation "ownership cost" expense in addition to the IRS Transportation "operating cost" expense and not limiting this expense allowance to debtors who really incur monthly vehicle acquisition finance expenses, the bankruptcy court has in fact reserved for itself more judicial discretion. Under the bankruptcy court's interpretation that the debtor's real expenses are irrelevant, many of the abuse motions will be considered under § 707(b)(3), where the court has broader discretion and no presumptions apply.

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[9] Because there is very little legislative history pertaining to the BAPCPA itself, legislative history pertaining to its substantially similar predecessor is instructive.

This result frustrates the purpose of the means test as a whole and is exactly the opposite of what Congress intended by adding the bright line means test under the BAPCPA. *Id.*

For all these reasons, the bankruptcy court's determination that § 707(b)(2)(A)(ii)(I) authorizes the Debtor to reduce his CMI for a vehicle ownership expense when the debtor has no ownership or lease payment must be reversed, and the case remanded to the bankruptcy court for further proceedings in accordance with the presumption of abuse that arises in this case under 11 U.S.C. § 707(b)(2).

II. ALTERNATIVELY, THE BANKRUPTCY COURT ERRED IN RELYING UPON A STATUTORY PRESUMPTION AGAINST DISMISSING THE DEBTOR'S CASE UNDER SECTION 707(b)(3)(B) BECAUSE CONGRESS REPEALED THAT PRESUMPTION IN 2005.

11 U.S.C. § 707(b)(1) provides that the court may dismiss a chapter 7 case "if it finds that the granting of relief would be an abuse of the provisions of this chapter." In turn, § 707(b)(3) provides that:

> In considering under paragraph (1) whether the granting of relief would be an abuse of the provisions of this chapter in a case in which the presumption in subparagraph (A)(I) of such paragraph does not arise or is rebutted, the court shall consider-
>
> > (A) whether the debtor filed the petition in bad faith; or
> >
> > (B) the totality of the circumstances (including whether the debtor seeks to reject a personal services contract and the financial need for such rejection as sought by the debtor) of the debtor's financial situation demonstrates abuse.

The United States Trustee's motion to dismiss was based, in part, on § 707(b)(3).

The totality of the circumstances of the Debtor's financial situation in this case indicates the Debtor has at least $208 per month in disposable income based upon Schedules I and J, which is more than the $166.67 per month threshold ability to pay amount set forth in § 707(b)(2). B.Ct.Doc. 16, pg. 3. Thus, the Debtor has the ability to repay his debts and his case should have been dismissed as an abuse of chapter 7 under 11 U.S.C. § 707(b)(3). The bankruptcy court decided to the contrary and denied the United States Trustee's motion to dismiss under § 707(b)(3).

First, at the conclusion of the hearing held on October 11, 2006, the court stated:

> While this case was filed after the enactment of the Bankruptcy Abuse Prevention and Consumer Protection Act, the Court finds that the standard for evaluating abuse under 707(b)(3) in the new Act is identical to the standard the court used for determining "substantial abuse" under the old Act. Under the old Act, when the trustee challenged a debtor's bankruptcy pursuant to 707(b) on the grounds of substantial abuse, there was a presumption in favor of granting the relief requested by the debtor. **The court finds that the presumption in favor of the debtor still operates under 707(b)(3).** The old case law that I would like to cite in support of that proposition is *In re Tefertiller*, 104 B.R. 513, which simply states that **707(b) provides that there shall be a presumption in favor of granting the relief requested by the debtor**.

B.Ct.Doc. 36, Transcript of October 11, 2006 Hearing, pg. 57 (Emphasis added).

Later, in the November 15, 2006 Order, the bankruptcy court stated the following:

> While the case was filed after the enactment of [the BAPCPA], the Court finds that the standard for evaluating abuse under § 707(b)(3) of the new act is identical to the standard used for determining "substantial abuse" pre-BAPCPA. Under the old Act, section 707(b) provided a presumption in favor of granting the relief requested by the debtor.

B.Ct.Doc. 37, Opinion Denying Trustee's Motion to Dismiss, pg. 8, (Citation omitted.). [10]

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[10] The bankruptcy court subsequently looked to pre-BAPCPA case law, interpreting "substantial abuse" under the former § 707(b) as set forth in *In re Krohn*, 886 F.2d 123 (6th Cir. 1989), to determine the relevant factors for consideration of a totality of the circumstances based abuse claim under Section 707(b)(3). In *Krohn*, the Sixth Circuit identified five factors to be used in determining whether a case was a "substantial abuse". Those factors include (1) whether the debtor enjoys a stable source of income; (2) whether the debtor is eligible for chapter 13; (3) whether there are state law remedies that may ease the debtor's financial problems; (4) the degree of relief that may be obtained through private negotiations; and (5) whether the debtor's expenses can be significantly reduced without depriving him of adequate food, clothing, shelter and other necessities. *Id.* at 126-27.

The BAPCPA amendments to § 707(b) of the Bankruptcy Code expressly repealed the presumption applied by the bankruptcy court in this case. Section 102(a) of the BAPCPA, Pub. L. No. 109-8, 119 Stat. 27 (April 20, 2005), states:

> (a) IN GENERAL. – Section 707 of Title 11, United States Code, is amended – (2) in subsection (b) --
> (B)....
> (III)....
> (ii) by striking the next to the last sentence.

Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 27. Prior to the BAPCPA, the "next to the last sentence" of § 707(b) read *"[t]here shall be a presumption in favor of granting the relief requested by the debtor."*[11] (Emphasis added.) By striking this sentence of § 707(b) Congress completely eliminated this presumption from the consideration of § 707 "abuse", including all cases under § 707(b)(3). *See, In re Simmons,* __ B.R. __, 2006 WL 3782959, *2 (Bankr. N.D. Ohio 2006). Because the statutory presumption that existed in favor of the Debtor has been legislatively removed, the bankruptcy court erred in applying that presumption in its analysis of the § 707(b)(3) totality of the circumstances claim in this case. *e.g., Stone v. I.N.S.*, 514 U.S. 386, 397 (1995) ("When Congress acts to amend a statute, we presume it intends its amendment to have real and substantial effect.") (*citing Reiter v. Sonotone Corp.*, 442

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[11] Pre-BAPCPA, § 707(b) read, in its entirety:

> After notice and a hearing, the court, on its own motion or on a motion by the United States Trustee, but not at the request or suggestion of any party in interest, may dismiss a case filed by an individual debtor under this chapter whose debts are primarily consumer debts if it finds that the granting of relief would be a substantial abuse of the provisions of this chapter. <u>There shall be a presumption in favor of granting the relief requested by the debtor</u>. In making a determination whether to dismiss a case under this section, the court may not take into consideration whether a debtor has made, or continues to make, charitable contributions (that meet the definition of "charitable contribution" under section 548(d)(3)) to any qualified religious or charitable entity or organization (as that term is defined in section 548(d)(4)).

(Emphasis added).

U.S. 330, 339 (1979) (Court must construe statute to give effect, if possible, to every provision)).

Thus, while the bankruptcy court addressed numerous factors in reaching its conclusion that the case is not an abuse based on the totality of the circumstances, it did so after it applied an impermissible presumption in Debtor's favor. The bankruptcy court applied a presumption that the debtor was entitled to chapter 7 relief which had the effect of establishing that the case was not an abuse under § 707(b)(3). For a discussion of presumptions in the law generally, *see* Eugene Wedoff, Judicial Discretion to Find Abuse Under § 707(b)(3), Am. Bankr. Inst. J., April 2006, at 50-51. Accordingly, the bankruptcy court must be reversed and this case remanded with instructions that if the debtor rebuts the presumption of abuse that applies under § 707(b)(2), the bankruptcy court analyze the United States Trustee's § 707(b)(3) motion to dismiss based on the totality of the circumstances without any presumption in favor of granting relief to the Debtor.

CONCLUSION

For all of these reasons, the United States Trustee respectfully asks this Court to reverse the November 15, 2006 Order entered by the bankruptcy court denying the United States Trustee's motion to dismiss, and remand this case to the bankruptcy court for further proceedings.

Respectfully submitted,
SAUL EISEN
UNITED STATES TRUSTEE
Ohio/Michigan Region 9

By: /s/ Paul J. Randel (P58419)
Paul.Randel@usdoj.gov
Trial Attorney, Office of the U.S. Trustee
Department of Justice
211 West Fort Street - Suite 700
Detroit, Michigan 48226
(313) 226-4541

Dated: December 28, 2006

BRIEF BANK — "SUMMARY SHEET"

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WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*

In re Cory and Regina McKain (Ocwen Loan Servicing, LLC v. Cory and Regina McKain)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*

E.D. La.

3. ("CCN") ***CURRENT*** CASE NO.

No.: 09-03662-MVL-JCW

4. ("PCN") ***PRIOR*** CASE NO. - & COURT *[IF ANY]*

No.: 08-10411

Court: Bankr. E.D. La.

(Identify judge & cite, if any)

5. ("SO") ***SOURCE***

U.S. TRUSTEES

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*

Filed: October 5, 2009

Type: Brief for the United States as Amicus Curiae in Support of Affirmance

7. **("AU")** ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*

Mary S. Langston, Catherine Sevcenko, P. Matthew Sutko, R. Michael Bolen

(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***

BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s)

&

√ Any Miscellaneous ***BACKGROUND***

• Did the bankruptcy court have authority under 11 U.S.C. § 105 to order injunctive relief to prevent future abuse of process by Appellee, a secured lender?

10. PATH TO FILE LOCATION:
(e.g., S:\OGC\BRFBANK\etc...)

11. DO YOU RECOMMEND POSTING IN UST BRIEFBANK?

| x | YES | | NO

NAME: Linda Figueroa

DATE:

UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF LOUISIANA

CIVIL ACTION NO. 09-03662-MVL-JCW
JUDGE MARY ANN VIAL LEMMON
MAGISTRATE JUDGE JOSEPH C. WILKINSON, JR

IN RE: CORY AND REGINA MCKAIN

ON APPEAL FROM THE UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF LOUISIANA
BANKRUPTCY CASE NO. 08-10411, SECTION A,
THE HONORABLE ELIZABETH W. MAGNER, PRESIDING

BRIEF FOR THE UNITED STATES, AS AMICUS CURIAE IN SUPPORT OF AFFIRMANCE

R. MICHAEL BOLEN
United States Trustee

MARY S. LANGSTON (22818)
Assistant United States Trustee
United States Department of Justice
Office of the United States Trustee
400 Poydras Street
Suite 2110
New Orleans, Louisiana 70130
Telephone: (504) 589-4093
Facsimile: (504) 589-4096

Of Counsel:
RAMONA D. ELLIOTT
General Counsel

P. MATTHEW SUTKO
Associate General Counsel for Appellate Practice

CATHERINE SEVCENKO
Trial Attorney
United States Department of Justice
20 Massachusetts Ave, N.W.,
Suite 8000
Washington, D.C. 20530
Telephone: (202) 305-2757
Facsimile: (202) 307-2397
COUNSEL FOR UNITED STATES

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OTHER

PRELIMINARY STATEMENT

The foreclosure crisis that has gripped this country includes thousands of debtors like the McKains in this case – people who are forced to litigate due to the systematic failures of large mortgage servicers who either could not, or would not, keep accurate records of what the debtors owed and how much of that debt they had paid back. The United States has brought a number of actions and otherwise sought to stop mortgage servicers from filing inaccurate proofs of claim and motions for relief from stay in bankruptcy cases that seek to force debtors to pay amounts that they do not owe to ensure that debtors receive the "fresh start" promised by the bankruptcy system. Ocwen is a major player in this unfortunate situation. *In re Ocwen Fed. Bank FSB Mort. Serv. Litig.*, 314 F. Supp. 2d 1376 (Jud. Pan. Mult. Lit. 2004); *In re Batiste*, 03-01398, 2009 WL 2849077 at *2 (Bankr. E.D. La. July 14, 2009) (expressing concern that Ocwen was "exhibiting a pattern of attempting to collect discharged debts") (leave to appeal granted, No. 9-5454 (E.D. La filed Oct. 2, 2009).

Bankruptcy courts have various tools to handle abuse of process and improper litigation tactics that occur in cases before them. Section 105 of Title 11 stands out because it allows bankruptcy courts to "prevent" abuse of process. Moreover, the court may act *sua sponte*, if necessary, rather than depending upon the debtor to have the resources to seek recourse in the judicial system. It is this unambiguous statutory power that provides the most effective legal tool for bankruptcy courts to work with mortgage lenders to re-establish industry standards and to work out procedures for correcting both mistakes in current cases and, more importantly, preventing their reoccurrence for debtors who have yet to enter the system.

INTEREST OF THE UNITED STATES

This Court has before it an issue of interest to the United States: under what circumstances a bankruptcy court may order injunctive relief under 11 U.S.C. § 105(a) against a party that has abused the bankruptcy system. The United States, through the Department of Justice, supervises the administration of chapter 13 bankruptcy cases in this district. 28 U.S.C. §§ 581-589. *In re Castillo*, 297 F.3d 940, 950 (9th Cir. 2002). The United States has a duty to act as the "enforcer of the bankruptcy laws" with a responsibility to "bring proceedings in the bankruptcy courts" if a "particular action taken or proposed to be taken deviated from the standards established by the . . . bankruptcy code." *In re A-1 Trash Pickup, Inc.*, 802 F.2d 774, 775-76 (4th Cir. 1986) (internal citations omitted) (stating that Congress expects the Department of Justice "to intervene whenever particular actions threaten[ ] an abuse of the bankruptcy system or its procedures.").

Therefore, the United States now addresses the bankruptcy court's authority to enter appropriate orders to remedy abusive conduct in the bankruptcy system by mortgage lenders and requests that this Court affirm the bankruptcy court's injunctive order. The United States submits this brief pursuant to 28 U.S.C. § 517 (authorizing Department of Justice to "attend to the interests of the United States in a suit pending in a court of the United States") and 11 U.S.C. § 307 (authorizing United States Trustee to "raise and . . . appear and be heard on any issue in any case or proceeding" under Title 11).

STATEMENT OF THE CASE

This is a case about a bankruptcy court's ability to protect itself, and the debtors before it, from further abuse of process by a creditor that has a record of "improperly administering loan[s] or attempting to collect fees and costs to which it is not entitled." *In re McKain*, No. 08-10411, at 3 (Bankr. E.D. La. May 1, 2009) ("Reasons"). The debtors, Cory and Regina Junior McKain, filed for chapter 13 bankruptcy relief to prevent the foreclosure of their home. A few weeks later, Defendant-Appellant Ocwen Loan Servicing, LLP sent them an invoice. The debtors filed an adversary complaint, alleging that the invoice violated the automatic stay that protected them from efforts to collect debts incurred before they filed their bankruptcy petition. 11 U.S.C. § 362. Ocwen did not appear at the first stay violation hearing. Hr'g Tr. 4:9-15 (July 22, 2008). After the bankruptcy court issued an order for Ocwen to appear, Ex. A [Dkt. #18], it conducted a hearing in which it suggested that Ocwen work with the court to reform its procedures to avoid similar problems in the future. Hr'g Tr. 38:1-9 (July 22, 2008). The bankruptcy court granted a continuance for Ocwen to review its procedures and report back. *Id.* 39:6-40:25. Instead, Ocwen settled with the debtors. At the hearing to approve the settlement, the bankruptcy court *sua sponte* imposed remedial action on Ocwen to prevent the errors in the McKain case from occurring again. Hr'g Tr. 6:12-7:15 (Feb. 17, 2009). That order prompted this appeal.

STATEMENT OF ISSUES

Did the bankruptcy court have authority under 11 U.S.C. § 105 to order injunctive relief to prevent future abuse of process by Ocwen?

STANDARD OF REVIEW

Appellant misstates the applicable standard of review. This is a core proceeding because it concerns the administration of bankruptcy estates and creditor-debtor relations. 28 U.S.C. § 157(b)(2)(A) & (O). A district court reviews findings of fact in a bankruptcy court decision for clear error and findings of law *de novo*. *In re Jay*, 432 F.3d 323, 325 (5th Cir. 2005). A grant of injunctive relief is reviewed for abuse of discretion. *ICEE Distr. Inc. v. J&J Snack Foods Corp.*, 325 F.3d 586, 594 (5th Cir. 2003).

SUPPLEMENTARY STATEMENT OF THE FACTS

The United States augments this Court's understanding of the facts as follows.

1. Invoice

The debtors, Cory and Regina McKain, filed for chapter 13 bankruptcy relief on February 29, 2008, when they were facing foreclosure of their home. Ocwen was informed that the debtors had filed the chapter 13 bankruptcy petition on March 4, 2008. Resp. to Mem. of Record at 3 [Dkt. #53]. Nevertheless, it sent the invoice that is at issue in this case on March 17, 2008.

The one-page invoice has several aspects that the McKains alleged violated the automatic stay that protected them from further collection activities for debts incurred before they petitioned for relief under chapter 13 of the Bankruptcy Code. 11 U.S.C. § 362. *See Addendum.*

- In a box captioned "Details of Amount Due," Ocwen listed charges for principal, interest, and escrow charges for the two months after the McKains filed their petition. However, immediately below those charges, under the same "Details of Amount Due" heading, and under a "Assessed Fees/Expense Outstanding" subheading, Ocwen listed $3,588.05 of fees and charges that had been accrued before the bankruptcy filing and were therefore to be repaid as part of the bankruptcy case. In front of each of these items, the notation "Info Only" appeared. The debtors alleged that the invoice was confusing. Hr'g Tr. 6:14-25.

The invoice listed amounts covered by the debtors' chapter 13 plan under the same heading as post-petition charges to be paid directly to Ocwen. It also contained four pre-printed notices that were also at issue in the underlying adversary proceeding:

- The McKains' home "was in foreclosure;"
- Failure to pay invoiced amounts would be reported to credit bureaus;
- Payments received would be credited according to "your mortgage note," regardless of the terms of the confirmed chapter 13 repayment plan; and
- Instruction to contact Ocwen directly, rather than through counsel, to work out any disagreement over the charges.

At the first hearing at which Ocwen appeared, the bankruptcy court indicated its strong interest in working with Ocwen to revise its procedures to protect it from further adversary complaints. Hr'g Tr. 18:22-19:4 (July 22, 2008) (stating the court wanted to "figure[] out what's going on and how to fix it not only in this case but anything in the future so lenders are not confused about what needs to happen"). In critiquing the invoice itself, the bankruptcy court made the following observations:

Foreclosure Statement: "I think that the language [describing the debtors' home as being in "foreclosure"] can be both misleading as well as upsetting to debtors who receive it, because they believe . . . that bankruptcies stop foreclosures. . . . I don't know why you mention it at all, frankly." Hr'g Tr. 22:20-23:13. (July 22, 2008).

Ambiguous Request for Payment: "I do not object to informational statements. . . . But I think you have to be very careful about how you do that. And I guess in the upper block the details of the amount due, what I think is confusing about this is that these as best I can tell are pre-petition proof of claim charges, and so to the extent that they were going to be disclosed on the statement, it seems to me it would be more appropriate to say the following charges have been included in a proof of claim in your case . . . or something to that effect so that you're making clear that this statement is not requesting payment of those fees and charges." Hr'g Tr. 24:4-16 (7/22/08)

Direct Contact with Ocwen: "The statement on contacting [Ocwen directly] – I would understand why a lender would want to know if there's a problem, but I agree with Mr. Myers [McKains' counsel] that getting . . . debtors to contact a lender about a problem is probably not the best way to handle it." Hr'g Tr. 23:14-23:25 (7/22/08).

Allocation of Payments: "So, just that statement [that Ocwen will allocate payment according to the loan contract] alone on this agreement is troublesome and, frankly, I don't even know why you'd make it at all. I guess in that case don't say anything. It's too complex and in this Court at least you're going to be held to an accounting based on the Bankruptcy Code, the jurisprudence in this courtroom and your own documents. So, that's my comment on that." Hr'g Tr. 30:1-7 (7/22/08).

2. Proof of Claim

On April 3, 2008 Ocwen filed a proof of claim in the McKains' case. The proof of claim was missing supporting documentation for certain fees, such as late fees, non-sufficient fund charge, escrow advances, and foreclosure fees. Claim 10-1, Ex. B (Itemization of Claim). In addition, there were discrepancies between the amounts on the proof of claim and the figures on the account statement that Ocwen sent to the McKains on March 17, 2008. Hr'g Tr. 6:1-13; 10:17-11:19; 13:2-15 (July 22, 2008).

Shortly after the McKains filed their petition in 2008, Ocwen transferred their loan to Greentree Servicing Company. [Dkt. #38]. Although the McKains' attorney pointed out several errors in the original proof of claim, neither Ocwen nor Greentree filed an amended proof of claim, apparently thinking that it was the responsibility of the other party. Ocwen Second Mot. For Leave to Amend at 3, Ex. C [Dkt. #119]. On September 16, 2009, and after this appeal commenced, Ocwen did file an amended proof of claim. [Dkt. #117]. Ocwen withdrew it and filed a second amended claim two days later on September 18, 2009, citing "the need for minor corrections." Second Mot. for Leave at 4 [Dkt. #119]. Ocwen's second amended proof of claim contains the same incomplete documentation as the first, although Ocwen had previously filed more complete set of back-up documentation in response to the bankruptcy court's direct order on October 10, 2008. [Dkt. #53].

3. Settlement

The McKains settled with Ocwen in February 2009. According to the motion filed with its second amended proof of claim, Ocwen paid $3,000 in attorney fees and removed various charges from the McKains' account, reserving the right to charge sheriff's fees were a foreclosure to take place in the future. Second Mot. For Leave, at 2 [Dkt. #119]. As part of the settlement, Ocwen agreed not to charge the McKains $4,980.03 as follows: Sheriff's Commission ($500)[1]; Inspection Fees ($21); two Broker Price Options ($230)[2]; Review of Bankruptcy Plan Fee ($150); Sheriff's Commission ($4,064.03)[3]; Property Inspection ($15).

4. Relief

After the bankruptcy court agreed to approve the settlement, it *sua sponte* ordered Ocwen to provide each debtor with an annual statement showing how it had processed the loan in the previous year, including an accounting of any additional fees that had accrued. Hr'g Tr. 6:14-7:2 (Feb. 17, 2009); Reasons at 11. In its written order, it also ordered Ocwen to set up separate accounts for each debtor, one to track repayment of debt through the bankruptcy process and another to track mortgage payments that fall due post-petition. [Dkt. #83]; *See also* Reasons at 9-10.

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[1] Because the McKains' property was never foreclosed upon, this fee was never charged to Ocwen. Hr'g Tr. 11:2-11; 32:9-33 (July 22, 2008).

[2] The "info only" statement sent to the McKains listed a $230 fee for "prev property valuation expense." The original proof of claim listed one BPO for $115, backed up with an invoice for that amount, dated January 24, 2007 [sic].

[3] This charge is not included in the first proof of claim or the March 17 invoice.

STATUTORY FRAMEWORK

This case concerns the power of a bankruptcy court to regulate the practice of bankruptcy law before it. The bankruptcy court's equitable powers that are at issue in this case derive from 11 U.S.C. § 105 ("Power of Court"), specifically subsection (a):

> The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title. No provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, *sua sponte*, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process.

This provision has two parts. The first part allows a bankruptcy court to 1) issue orders, i.e., commands directed to persons and others appearing before it; 2) issue procedures, i.e., rules of court governing how a party may litigate before the court; and 3) to render judgment, i.e., determine rights. These powers can be exercised when "necessary or appropriate" to carry out the provisions of Title 11, a broad grant of authority. *United States v. Sutton,* 786 F.2d 1305, 1308 (5th Cir. 1986); *In re Sadkin*, 36 F.3d 473, 479 (5th Cir. 1994) (stating that section 105(a) "provides equitable powers for the bankruptcy court to use at its discretion").

The second part permits a bankruptcy court to take "any action" or make "any determination" that is "necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process." Abuse of process has been defined as "maneuvers or schemes which would have the effect of undermining the integrity of the bankruptcy system." *In re Eagle-Picher Indus. Inc.*, 169 B.R. 135, 138 (Bankr. S.D. Ohio 1994). This power is only circumscribed to the extent that it cannot be used in contradiction to another provision in the Bankruptcy Code. *Marrama v. Citizens Bank of Massachusetts*, 549 U.S. 365, 375 (2007). The key word in this subsection of 105 is "prevent," which is a forward-looking concept. Congress gave bankruptcy courts the authority to take prophylactic measures to prevent a party from engaging in future abuse, such as providing account statements to demonstrate the debtors' payments both under a confirmed chapter 13 plan and for ongoing post-petition installments have been properly allocated.

The legislative history of section 105(a) provides support for this broad interpretation. The House Report concerning the 1978 Bankruptcy Code which superceded the Bankruptcy Act, states that section 105(a) was enacted to remove any doubt concerning the power of the new bankruptcy courts. Section 105(a) was enacted "for the sake of continuity from current law and ease of reference, and to cover any powers traditionally exercised by a bankruptcy court that are not encompassed by the All Writs [Act]."[4] H.R. Rep. No. 95-595, at 316-17 (1978), reprinted in 1978 U.S.C.C.A.N. 5963, 6273-74.

Section 105 is broader than a bankruptcy court's inherent authority to discipline a party for improper actions taken in bad faith related to the litigation. A bankruptcy court may of course sanction a party for bad faith under 11 U.S.C. § 105. *Campbell v. Countrywide Home Loans, Inc.*, 545 F.3d 348, 356 n.1 (5th Cir. 2008). However, the text of section 105(a) does not mention bad faith, indicating Congress's desire to give bankruptcy courts wide-ranging power to regulate, and protect, their dockets. Congress did create a bad faith requirement in other contexts, however, such as 11 U.S.C. § 707(b)(1), which allows dismissal of a chapter 7 case if the debtor filed it in "bad faith." Section 105 is more than a codification of the bankruptcy court's inherent

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[4] The All Writs Act "invests a court with a power essentially equitable." *Clinton v. Goldsmith*, 526 U.S. 529, 537 (1999). The Act serves as a residual source of authority to enter equitable remedies only subject to specific statutory constraints. *Id.*

power. Section 105 is instead a tool that allows a bankruptcy court to regulate its docket – both prospectively and retrospectively.

ARGUMENT

I. THE BANKRUPTCY COURT PROPERLY USED ITS POWERS UNDER 11 U.S.C. § 105 TO TAKE REMEDIAL STEPS TO IMPROVE OCWEN'S PROCEDURES FOR SERVICING MORTGAGES.

A. *This case involves a simple application of Section 105.*

Section 105 of Title 11 is a simple statutory provision designed to give bankruptcy courts the necessary tools to "prevent" abuse by participants in the bankruptcy system. *Bessette v. Avco Fin. Serv., Inc.*, 230 F.3d 439, 444-45 (1st Cir. 2000); *see In re Sanchez*, 372 B.R. 289, 311-12 (Bankr. S.D. Tex. 2007). Its application is governed by the text. First, a bankruptcy court must determine that it should act to prevent an abuse of process. *In re Eagle-Picher Indus., Inc.*, 285 F.3d 522, 529 (6th Cir. 2002). Once it has made that determination, the court must craft an order that is reasonably calculated to prevent that abuse. *Jove Eng'g Inc. v. IRS*, 92 F.3d 1539, 1554 (11th Cir. 1996) (plain meaning of Section 105 encompasses any order whether injunctive, compensatory, or punitive, if necessary to carry out provisions of the Bankruptcy Code). Unlike traditional injunctive relief, a bankruptcy court's power to act derives from the statute. Congress did not require that courts engage in special analysis or balancing tests to determine if the application of 105 powers would be appropriate. *See* 132 Cong. Rec. 28, 610 (1986) (statement of Sen. Hatch) (section 105(a) "allows a bankruptcy court to take any action on its own, or to make any necessary determination to prevent an abuse of process and to help expedite a case in a proper and justified manner"). Furthermore, in an analogous context, traditional injunctive analysis is "inapplicable to orders issued to protect a court's control of its docket." *Baum v. Blue Moon Ventures LLC*, 513 F.3d 181, 189 (5th Cir. 2008) (preventing vexatious filings).

Therefore, the issue before this Court is much simpler than suggested in Ocwen's brief. This Court must first determine if the bankruptcy court abused its discretion by determining that 1) Ocwen's behavior in the *McKain* case, 2) the six other cases in which the bankruptcy court found improper loan servicing by Ocwen, and 3) the fact that Ocwen was litigating 67 claims of mortgage abuse that had been consolidated in the Northern District of Illinois gave it sufficient grounds to anticipate similar abuse of process would continue. Secondly, this Court must determine if the remedy that the bankruptcy court ordered will address that identified problem. If the bankruptcy court did not abuse its discretion in identifying a problem and if its solution is designed to "prevent" further abuse, then this Court should affirm the decision below.

B. *Ocwen's servicing of the McKains' loan was an abuse of process.*

Ocwen asserts that neither its proof of claim nor any post petition fees were disputed in this case. Ocwen Br. at 2. This is not accurate. First, the McKains' attorney objected to both at the July 22, 2008 hearing. Hr'g Tr. 10:3-11; 11:12-12:12; 13:2-21 (July 22, 2008). Secondly, Ocwen has subsequently admitted that its proof of claim in the McKains' case was inaccurate. In its Second Amended Proof of Claim, it withdrew $791 worth of fees and agreed not to charge the McKains fees for reviewing the proof of claim ($150); sheriff's fees related to the actions taken toward foreclosure before the McKains filed for bankruptcy ($4,064.03); and property inspection fees ($15). [Dkt. #119].

In this case, Ocwen sent the debtors an invoice that stated that "Payments received are to be applied in accordance with your mortgage note. Payments will be first applied to bring you loan contractually current. Any additional funds received will be applied to outstanding fees and advances prior to being applied to principal." March 17, 2009 Invoice (*see Addendum*). Creditors are bound by the terms of a chapter 13 plan once it is confirmed. 11 U.S.C. § 1327.

The plan specifies how payments will be allocated – not the lender. *Cano v. GMAC Mortgage Co. (In re Cano)*, 08-07019, 2009 WL 2496320, at *17 (Bankr. S.D. Tex. Aug. 10, 2009) (stating that a mortgage lender may not divert amounts dedicated to arrearages, principal, or interest without court approval); *see Mendoza v. Temple-Inland Mortgage Corp. (In re Mendoza)*, 111 F.3d 1264, 1268 (5th Cir. 1997) (holding Bankruptcy Code permits modification of a plan to help debtor keep his home).

Moreover, the bankruptcy court acted based on the evidence that similar cases on its docket revealed evidence of Ocwen's systematic abuse. Reasons at 4. The record also reflected multi-district litigation against Ocwen in the Northern District of Illinois in which the plaintiffs' claims are based on "improper loan servicing practices," including charging unauthorized fees, incorrect posting of borrower payments and improper treatment of borrowers in default. Ocwen's Response to Memorandum to the Record (filed Oct. 10, 2008) (describing 67 lawsuits involving 95 loans) [Dkt. #53].

Accordingly, the record gave the court sufficient grounds to anticipate similar abuse of process would continue, and supported the use of section 105 authority to ensure Ocwen provided debtors with necessary information so that they and the court could monitor the crediting of their loan payments, both pre and post petition. The bankruptcy court acted to prevent a documented intended abuse of process – an exercise of power that falls squarely within the plain language of section 105(a). *See e.g., In re Sanchez*, 372 B.R. at 311 (holding that a bankruptcy court may sanction a creditor for contempt of the order confirming the debtor's repayment plan). The remedial relief ordered in this case allow the bankruptcy court to ensure Ocwen applies payments in accordance with the court's confirmation orders in chapter 13 cases. *Jones v. Wells Fargo*

Home Mortgage Inc. (In re Jones), No. 06-01093 at 10 (Bankr. E.D. La Oct. 1, 2009) ("*Jones Remand*") (*see Addendum*).

C. *The bankruptcy court ordered reasonable relief designed to ensure that Ocwen would provide accurate information to debtors and the court going forward.*

Section 105 gives a bankruptcy court "broad authority . . . to take any action that is necessary or appropriate 'to prevent an abuse of process.'" *Marrama*, 549 U.S. at 375 (citing 11 U.S.C. § 1051(a)); *see also In re Terrebonne Fuel & Lube, Inc.*, 108 F.3d 609, 613 (5th Cir. 1997). Furthermore, a bankruptcy court may impose an "appropriate" remedy and is not compelled to choose the most limited remedy available. *Rodriguez v. Countrywide Home Loans, Inc. (In re Rodriguez)*, 396 B.R. 436, 458 (Bankr. S.D. Tex. 2008). In this case, the bankruptcy court found that Ocwen's system created the potential for inaccurate accounting and unjustified demands for payment. Accordingly, it mandated that Ocwen produce an annual statement for each of its debtors to confirm that Ocwen recorded the debtor's payments and obligations accurately. May 1, 2009 Order Requiring Accounting Procedures [Dkt. #83]. The purpose was to "ensure that Ocwen is not abusing the claims process" and that Ocwen gave "notice of incurred post-petition fees or costs." Reasons at 12. The bankruptcy court acted within its powers when it ordered a remedy that is tailored to protect the bankruptcy system beyond the individual circumstance of the *McKain* case. *See Winnecour v. Countrywide Home Loans, Inc. (In re Selected Cases)*, 396 B.R. 138, 144 (Bankr. W.D. Pa. 2008) (stating that pay-off statements to debtors could "significantly improve the chapter 13 process in this District").

Secondly, the bankruptcy court expressed concerns about the accuracy of Ocwen's proofs of claim, both in the *McKain* case and other cases tried in the same court. The accounting procedures and statements are designed to improve Ocwen's track record in providing debtors with accurate information in a transparent way. Ocwen argues in its brief that "a bankruptcy court may exercise its equitable authority under section 105 ***'only as a means to fulfill some specific Code provision.'***" Ocwen Br. at 12 (citing *Northwest Bank Worthington v. Ahlers,* 485 U.S. 197, 206 (1988) (emphasis added in brief text). Even if that reading of the case law were correct, that is precisely what the bankruptcy court did in the *McKain* case. It exercised its discretion to impose procedural requirements on Ocwen to ensure that its filings in the court would comply with the provisions and rules of the Bankruptcy Code. The order creates a structure to make sure Ocwen files claims that comply with 11 U.S.C. § 501 (filing of proofs of claim); 11 U.S.C. § 1327 (binding creditors to the terms of confirmed plan); and Fed. R. Bankr. P. 3001 (requiring accuracy for proofs of claim). *Jones Remand*, slip op. at 11. Such an action is in complete harmony with the Code. Contrary to Ocwen's assertion that the bankruptcy court was engaged as a "roving commission to do equity," Ocwen Br. at 3, this is a tailored remedy to a documented problem.

In fact, the remedy that this Court chose to impose on Ocwen is commensurate with the actions of other bankruptcy courts faced with similar creditor abuse. Bankruptcy courts across the country have noted the mortgage servicing industry's continuing failure to comply with the Bankruptcy Code and Rules and have taken action to prevent the harm it causes to the courts, debtors, and other creditors. For example, the Eastern District of Louisiana affirmed the bankruptcy court's order to another mortgage servicer under its section 105 power to conduct an audit and amend proofs of claim. *In re Stewart*, No. 08-3225, 2009 WL 2448054 (E.D. La. Aug. 7, 2009,) appeal pending, No. 09-30832 (5th Cir. docketed Sept. 14, 2009). To encourage creditor compliance with the Code, a bankruptcy court may also limit a creditor's ability to amend proofs of claim to correct any inaccuracies identified in an objection. *In re DePugh*, No.

08-37521, 2009 WL 1657473 at *7 (Bankr. S.D. Tex. June 12, 2009) (forbidding amendments to an objected to proof of claim without prior leave of court). The District Court for the District of South Carolina has sanctioned creditors that provide inaccurate information to their counsel. *In re Kilgore*, 253 B.R. 179 (Bankr. D.S.C. 2000). Finally, an Ohio bankruptcy court has required that a mortgage servicer with a track-record of inaccurate proofs of claim file a supplemental worksheet with each proof of claim to help establish its veracity. *McDermott v. Countrywide Home Loans (In re O'Neal)*, Adv. No. 08-5031, slip op. (Bankr. N.D. Ohio filed July 31, 2009) (appeal pending).

The bankruptcy court below had the authority to take action to compel Ocwen to adhere to the Bankruptcy Code's provisions and rules that apply to creditors and their claims. The bankruptcy court acted based on the evidence before it in this case and the existence of similar cases. Reasons at 4 (six cases similar cases on the court's docket); Ocwen's Response to Memorandum to the Record (filed Oct. 10, 2008) (describing 67 lawsuits involving 95 loans) [Dkt. #53]. This record supported the use of section 105 authority to ensure Ocwen provided debtors with necessary information so that they and the court could monitor the crediting of their loan payments, both pre and post petition. The bankruptcy court thus took action to protect the integrity of the system by stopping the cat and mouse game Ocwen played with debtors by ignoring debtor protections in the Code and only fixing their mistakes when faced with potentially costly litigation. *Jones Remand*, slip op. at 15 (outlining costs to debtors when forced to litigate against another large mortgage servicer – Wells Fargo – on a case-by-case basis).

D. *The bankruptcy court did not need to rely upon its inherent powers to order remedial relief.*

The bankruptcy court's Section 105 powers were sufficient authority to order remedial relief. The court did not need to exercise its inherent powers, although it could issue remedial orders under its inherent powers as well as under section 105. *See Marrama,* 549 U.S. at 375. (describing a bankruptcy court's inherent authority and authority under section 105(a) to prevent an abuse); *Chambers v. NASCO Inc.*, 501 U.S. 32 (1991). "A primary aspect" of such powers is "the ability to fashion an appropriate sanction for conduct which abuses the judicial process." *Chambers*, 501 U.S. at 44-45. Although *Chambers* involved a sanction issued by a district court, the Fifth Circuit subsequently recognized that bankruptcy courts also have inherent authority to sanction bad faith conduct. *See In re Case*, 937 F.2d 1014, 1023 (5th Cir. 1991).

Contrary to Ocwen's assertion, Ocwen Br. at 16, 18, the bankruptcy court did find that Ocwen acted in bad faith. Reasons at 9. However, that finding is not a prerequisite to the remedial action in this case. Here, the bankruptcy court found that Ocwen had repeatedly administered loans improperly or attempted to collect fees and costs to which it was not entitled. Reasons at 3-4 (citing six examples). A bankruptcy court has power to issue injunctive relief under its inherent powers upon a finding of bad faith. As explained above, however, even if Ocwen were correct that it did not act in bad faith, the remedy here is an appropriate exercise of the bankruptcy court's section 105 power. *Cf.* 11 U.S.C. § 707(b)(1) (allowing dismissal of a chapter 7 case if the debtor filed in "bad faith"). Ocwen's arguments regarding section 105 and a bankruptcy court's inherent power are unpersuasive.

II. THE BANKRUPTCY COURT MUST BE ALLOWED TO TAKE ACTION NECESSARY TO PROTECT THE INTEGRITY OF PROCEEDINGS BEFORE IT.

A. *The injury to Ocwen is slight compared with the need of the bankruptcy court to regulate practice before it.*

Ocwen argues that it will be harmed by the remedy imposed, whereas the McKains will not. Ocwen discusses at great length the *Jones* cases, arguing that a voluntary arrangement suggested by another mortgage company cannot bind Ocwen. That is not the point. In its Reasons, the bankruptcy court highlighted six other instances in which Ocwen had mishandled mortgages before it within the last seven years, accounting for a 17% proven error rate, which the court speculated could in fact be much higher. Reasons at 5; Ocwen Response to Memo at 4-5 (describing multi-district litigation). [Dkt. #53] The bankruptcy court's earlier efforts to deter Ocwen from improper behavior before it with monetary sanctions had proven ineffective. Reasons at 9. The relief ordered by the bankruptcy court is a reasonable step towards curbing Ocwen's demonstrated pattern of mistakes and lack of transparency with debtors concerning how their mortgages are serviced during bankruptcy.

The issue is the harm to the system as a whole caused by Ocwen's behavior. Although there may be a remedy at law for the McKains, money will not help the bankruptcy court itself, the trustees, the United States trustees, creditors or other debtors forced to deal with Ocwen's cavalier attitude to court filings. The harm caused by Ocwen's actions can be erased by monetary settlements with those debtors who have the stamina and legal assistance to force Ocwen to service their loans correctly. *See* Ocwen Br. at 20. The bankruptcy court found a pattern of Ocwen attempting to collect money from debtors to which it was not entitled. Reasons at 13. It also noted that Ocwen appears impervious to monetary sanctions as a motivation to change its behavior. *Id.* The bankruptcy court had authority to defend its interests by compelling Ocwen to produce accurate annual account statements to demonstrate its compliance with the Bankruptcy Code and bankruptcy court orders. *Marrama*, 549 U.S. at 375.

B. *Ocwen cannot be irreparably harmed because it can influence the implementation and duration of the bankruptcy court's remedial relief.*

Ocwen cannot be irreparably harmed by being required to adhere to the tenets of the Bankruptcy Code. Mere injuries, however substantial, in terms of money, time and energy expended do not constitute irreparable harm. *See In re Stewart*, No. 08-3225, 2009 WL 1649731 at *4 (E.D. (concluding that asserted $238,000 cost of compliance with court ordered audit of all open proofs of claim did not demonstrate "that those injuries are irreparable under the law or that they even necessarily result absent a stay given appellant's continuing duty to correct and amend its pleadings"). Furthermore, Ocwen will not be harmed by having to produce documentation for a single bankruptcy court. National loan servicers are already responsible for complying with varying local rules in each court. In fact, Ocwen's existing network of local counsel should be able to handle this additional task, which merely verifies the accounting process that is the core of Ocwen's business.

Ocwen objects to the accounting procedures mandated in the bankruptcy court's order. But they are not a source of harm. If the bankruptcy court's prescription proves unworkable, or if Ocwen finds a more efficient method to achieve the same result, then its remedy is to file a motion to modify the bankruptcy court's order. Fed. R. Civ. P. 60(b)(5). Nor is there any reason to think that the court below would not be receptive. At the July 22, 2008 hearing, the court asked repeatedly for Ocwen's input: "It seems reasonable to me, frankly, [instituting statement of accruing additional debt] but I'll leave that to your client [Ocwen] what it wants to do. What I really need from you is some argument, proposal, something about what you want to say about post-petition accruing charges and how you want to do it, okay." Hr'g Tr. 37:11-15 (July 22, 2008). Nor was the bankruptcy court wedded to a particular solution. "Now, to the extent that I disagree, what you're probably going to hear from me, Mr. Balogh, is that I say, "Well, you know, we'll see. I don't know that's good." But, you know, I don't write your policy. You decide – your client decides what the policy is going to be and what it can and can't do and what it thinks is practical and what it thinks isn't." *Id.* 38:16-22 (July 22, 2008). Finally, the bankruptcy court agreed to a change requested by Wells Fargo, a servicer that had been ordered to follow the same accounting procedures that are at issue in this case. *Jones Remand*, slip op. at 22.

After seven months, Ocwen had not submitted a proposal to the bankruptcy court, choosing instead to settle with the debtor. At the settlement hearing, Ocwen refused either to accept the bankruptcy court's administrative order setting a procedure for providing post-petition account information or to make a counterproposal. Hr'g Tr. 6:4-13 (Feb. 17, 2009). Only then did the bankruptcy court impose the procedures outlined in its Reasons. *Id.* 6:14-7:19.

Ocwen's argument that the permanent injunction cannot be changed has no basis in law. To the contrary, Ocwen has a great deal of influence over the implementation, and duration, of the bankruptcy court's remedy. If it can reform its internal systems sufficiently to demonstrate a transparent accounting process and establish a track record of accurate proofs of claim, correspondence with debtors that complies with the Code, and attempts to collect only the money that it is genuinely owed, then it may certainly return to the bankruptcy court and ask that the remedial order be suspended. *Agostini v. Felton*, 521 U.S. 203, 215 (1997) (court errs when it refuses to modify an injunction in light of changed circumstances); *Baum v. Blue Moon Ventures*, LLC 513 F.3d 181, 188 (5th Cir. 2008) (court may modify injunction if circumstances change). No party – not Ocwen, the bankruptcy court, or the United States Trustee, is interested in setting up a long-term monitoring process. Rather, the goal is the same as it has always been: for the bankruptcy court to strike a balance between the interests of creditors and debtors so that the former can get paid and the latter receive the "fresh start" promised by the Code.

C. *The bankruptcy court's remedial relief serves the public interest.*

The United States through the Justice Department's United States Trustee Program acts as the "watchdog" of the public interest in bankruptcy matters. *In re Revco D.S., Inc.*, 898 F. 2d 498, 500 (6th Cir. 1990). The public interest will be harmed if the bankruptcy court's order is not implemented. The court's order requires Ocwen to provide precise information in annual accounting statements in an accessible format. Without this information, debtors and others will continue to be vulnerable to unwarranted claims and surprise demands for money. When approving an otherwise redundant chapter 13 plan provision, one bankruptcy court stated that the language would "drive home the message to Countrywide that it must adjust its accounting practices to conform with Ms. Winston's [confirmed] plan . . . [and] finally convey the message that while mortgages on primary residences are largely sacrosanct, [mortgage servicers] may not completely frustrate the public interest in having a workable means for debtors to achieve a fresh start to their economic lives." *In re Winston*, No. 08-11025, 2009 WL 2883158 at *6 (Bankr. N.D.N.Y. May 07, 2009).

The remedial injunction forces Ocwen to comply with the Bankruptcy Code and Rules to ensure accurate processing of debtors' loans. It is Ocwen's obligation to submit accurate filings to the bankruptcy court – not the job of debtors, trustees, or the United States Trustee to comb through each document to identify the errors. *In re Tran*, 369 B.R. 312, 318 (S.D. Tex. 2007) (holding that debtors should not bear the burden of objecting to an inaccurate proof of claim); *In re Stewart*, 2009 WL 2448054 at *22 (judicial remedies are necessary where proof of claims are deficient). Nor should debtors be forced to battle with Ocwen to correct the inaccuracies they have identified and the bankruptcy court has verified. *See In re Batiste*, 2009 WL 2849077 at *2 (chronicling Ocwen's seven-month delay and ultimate refusal to draft a post-discharge statement that the debtor's account was in good standing). The public interest is served when the bankruptcy system functions efficiently. Bankruptcy courts can, and should, take action to ensure that the information upon which decisions are made is accurate. *In re Stewart*, 2009 WL 2448054 at *22 (conducting "audits and attaching account histories to all proofs of claim will still serve the public interest").

III. OCWEN HAS NOT SHOWN THAT THE BANKRUPTCY COURT'S REMEDIAL ACTION IS IMPROPER.

The arguments in Ocwen's brief are not novel. Attacks on bankruptcy courts' jurisdiction, authority to issue injunctive relief, and ability to impose remedial orders have been argued – and rejected – in this, and other, courts. *See e.g.*, *McDermott v. Countrywide Home Loans (In re O'Neal)*, Adv. No. 08-5031, slip op. (Bankr. N.D. Ohio filed May 1, 2009) (appeal pending); *Walton v. Countrywide Home Loans, Inc. (In re Sanchez)*, No. 08-23337, slip op. (S.D. Fla. June 9, 2009). As the implications of the foreclosure crisis become clearer, bankruptcy courts throughout the country have taken action to prevent such abuse in cases on their dockets. *In re Prevo*, 394 B.R. 847, 848-49 (Bankr. S.D. Tex. 2008) (recognizing decisions from bankruptcy across the country condemning mortgage companies that "seem to believe that they are excused from complying with the fundamental requirements of the Bankruptcy Code and Rules"). The bankruptcy court here followed the lead of its sister-courts to balance the right of debtors to accuracy and transparency while keeping the burden of mortgage lenders at a minimum. The bankruptcy court's injunctive relief should be affirmed.

A. *The bankruptcy court has subject matter jurisdiction because this is a core proceeding.*

Ocwen suggests that the bankruptcy court did not have authority to issue a remedial order because the McKains and Ocwen had settled their dispute. That premise is incorrect. *See Cooter & Gell v. Hartmarx Corp.*, 496 U.S. 384, 395 (1990). A court possesses "ever present" jurisdiction to regulate the conduct of parties appearing before it. *Red Carpet Studios Div. of Source Advantage, Ltd. v. Sater*, 465 F.3d 642, 645 (6th Cir. 2006) (upholding a sanction under 28 U.S.C. § 1927 even though the underlying lawsuit in which the sanction arose had been settled and voluntarily dismissed).

Ocwen's brief does not discuss Title 28 of the United States Code that gives bankruptcy courts broad jurisdiction to hear cases. A matter involving the discipline of a party for misconduct in a bankruptcy case is a core bankruptcy proceeding under 28 U.S.C. § 157 because it concerns the administration of the estate. *Southmark Corp. v. Coopers & Lybrand (In re Southmark)*, 163 F.3d 925, 930 (5th Cir. 1999). A core proceeding is one that "invokes a substantive right provided by title 11 or if it is a proceeding that, by its nature, could arise only in the context of a bankruptcy case." *In re Wood*, 825 F.2d 90, 97 (5th Cir. 1987). See also 29 U.S.C. § 157(b)(1) ("bankruptcy judges may hear and determine . . . all core proceedings arising under title 11 or arising in a case under title 11"). Ocwen's misconduct in this case consists of sending an invoice to the debtors that arguably violated the automatic stay, a procedure unique to bankruptcy, and filing an inaccurate and undocumented proof of claim, a violation dependent on the existence of a bankruptcy case. The bankruptcy court characterized Ocwen's blanket assertion on a printed invoice form that it could determine how a debtor's payments would be allocated as "troubling to say the least." Reasons at 5. Ocwen's attitude undermines the authority of the bankruptcy court to assure creditors are repaid in accordance with the priorities of the code and debtors can preserve their homes if possible. *Mendoza*, 111 F.3d at 1269. Because federal bankruptcy law creates the procedures that Ocwen abused in the *McKain* case and because its misconduct could not occur outside the bankruptcy context, this resulting remedial action satisfies the fundamental definition of a core bankruptcy proceeding. *Southmark*, 163 F.3d at 930; *In re Bradley*, 371 B.R. 782, 785 (Bankr. W.D. Tex. 2007) (summarily concluding that motion for contempt under section 105 is core proceeding).

B. *The McKains' Settlement with Ocwen has no connection to the validity of the bankruptcy court's order of remedial relief.*

Ocwen attempts to remove itself from the authority of the bankruptcy court by arguing that this case was merely about an alleged violation of the automatic stay, an issue which is now moot due to the settlement between Ocwen and the McKains. Ocwen Br. at 14 (stating that section 362 is the "only Code provision at issue in the parties' dispute over the billing statement"). This misses the point. By filing a proof of claim in any bankruptcy case, a creditor becomes subject to the requirements of the Bankruptcy Code. *See* 11 U.S.C. 501. It becomes a party in interest responsible for its conduct before the court and subject to the court's overall authority. It is well-established that a court's power to order remedial action against a party survives the underlying case. *See Willy v. Coastal Corp.*, 503 U.S. 131, 138-39 (1991) (holding that Rule 11 sanctions may be imposed even where there is no subject matter jurisdiction over the merits of the related controversy, as the court's interest in having rules of procedure obeyed does not disappear).

Ocwen is also incorrect that bankruptcy courts only have jurisdiction over actions that could affect the estate. A bankruptcy court always has jurisdiction to enforce debtor rights, such protection under the automatic stay, receipt of accurate proofs of claim and transparent accounting. *Cano*, 2009 WL 2496320, at *18. Ocwen's actions in this litigation implicated many Code provisions beyond 11 U.S.C. § 362. Its overall track record before the bankruptcy court caused the court to impose this forward-looking remedial relief as authorized under 11 U.S.C. § 105. Reasons at 4; *In re Batiste*, 2009 WL 2849077 at *3 (stating "Ocwen has consistently shown an inability or refusal to comply with these basis statutory tenets [of the Bankruptcy Code]").

Ocwen's heavy reliance on *In re Schwamb* is misplaced. In that case, the bankruptcy court did not have jurisdiction to issue an injunction that prohibited a state court action for workmen's compensation reimbursement by an insurance company against Delta Airlines, which had paid a personal injury judgment to the debtor during his chapter 7 bankruptcy case. *In re Schwamb*, 169 B.R. 601 (E.D. La. 1994). The case fell outside the bankruptcy court's jurisdiction, including its "related to" limited jurisdiction under 28 U.S.C. 157(c).[5] *Id.* at 604. The *Schwamb* court held that the bankruptcy court could not enjoin third-party litigants unless failure to do so would adversely influence the debtor. *Id.* at 605. Here, Ocwen is a creditor subject to the core jurisdiction of the court in every case in which it files a claim. The two cases are not comparable.

Finally, Ocwen is incorrect that there is no longer a case or controversy. The bankruptcy court is addressing Ocwen's pattern of misbehavior under its section 105 remedial and preventative power. The rectification of one mishandled mortgage does not fix them all. This is a systematic problem. The bankruptcy court took action in tandem with other courts that are no longer willing to let mortgage servicers "nickel and dime" debtors and then look for "absolution"

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[5] A bankruptcy court may hear, but not determine, a proceeding that is not a case proceeding but is otherwise related to a bankruptcy case.

once they fix the problem after they are caught. *In re Prevo*, 394 B.R. at 848. Ocwen, like its competitors, cannot avoid its responsibilities by mooting out cases after it is proven that it did not service the loan properly. *Id.* at 849. The bankruptcy court's remedial injunction is a reasonable exercise of its power under 11 U.S.C. § 105 to regulate a mortgage lender before it that also contributes to the solution of a larger national problem.

CONCLUSION

For the reasons outlined above, the United States respectfully requests that this Court affirm the injunctive remedy that the bankruptcy court below placed on Ocwen.

Respectfully submitted, this 5th day of October, 2009.

R. MICHAEL BOLEN
United States Trustee

s/Mary S. Langston
MARY S. LANGSTON (22818)
Assistant United States Trustee
United States Department of Justice
400 Poydras Street
Suite 2110
New Orleans, Louisiana 70130
Telephone: (504) 589-4018
Facsimile: (504) 589-4096

CATHERINE SEVCENKO (pro hac vice)
Trial Attorney
United States Department of Justice
20 Massachusetts Ave, N.W.,
Suite 8000
Washington, D.C. 20530

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WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*
In re: Lynn Meade (Meade v. McVay, UST)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*
United States District Court for the Western District

3. ("CCN") ***CURRENT*** CASE NO.
No.: **EP-07-CV-121-DB**

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*
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(Identify judge & cite, if any)

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P. Matthew Sutko, Melissa R. Perry, Kevin Epstein
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***

- Was debtor eligible to claim the IRS Standard vehicle financing she expense allowance in calculating her disposable income under the Bankruptcy Code’s statutory means test, 11 U.S.C. § 707(b)(2) when owned her car debt-free and thus had no automobile vehicle financing expense

√ **Background:**

10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)

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IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF TEXAS
EL PASO DIVISION

In re LYNN MEADE
Civil No. EP-07-CV-121-DB

LYNN MEADE
Appellant

v.

CHARLES F. McVAY, United
States Trustee, Region 7,

Appellee

On Appeal from the United States Bankruptcy Court
for the Western District of Texas
El Paso Division

BRIEF OF THE APPELLEE CHARLES F. McVAY UNITED STATES TRUSTEE

CHARLES F. McVAY **UNITED STATES TRUSTEE** **REGION 7** **Kevin M. Epstein** Trial Attorney Department of Justice Office of the U.S. Trustee 615 E. Houston St., Room 533 P.O. Box 1539 San Antonio, Texas 78295-1539 (210) 472-4640 (210) 472-4649 Fax	**Of Counsel** **P. Matthew Sutko** **Melissa R. Perry** Executive Office for United States Trustees Department of Justice 20 Massachusetts Avenue, N.W. Suite 8000 Washington, D.C. 20530 (202) 307-1399

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STATUTES

RULE

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STATEMENT OF ISSUE PRESENTED

The issue before this Court on appeal is whether the court below erred in ruling that the debtor, Lynn Meade, was not eligible to claim the IRS Standard vehicle financing expense allowance in calculating her disposable income under the Bankruptcy Code's statutory means test, 11 U.S.C. § 707(b)(2) because she owned her car debt-free and thus had no automobile vehicle financing expense.

STATEMENT OF JURISDICTION

The United States Bankruptcy Court for the Western District of Texas had jurisdiction under 11 U.S.C. § 157 to decide the United States Trustee's motion to dismiss Ms. Meade's chapter 7 bankruptcy case.[1] This Court has jurisdiction under 28 U.S.C. § 158(a)(1) to decide Ms. Meade's timely appeal from the bankruptcy court's final order dismissing her bankruptcy case.

STATEMENT OF APPLICABLE STANDARD OF APPELLATE REVIEW

On appeal "conclusions of law are reviewed de novo, findings of fact are reviewed for clear error, and mixed questions of fact and law are reviewed de novo." *In re National Gypsum Company,* 208 F. 3d. 498, 503 (5th Cir. 2000). The issue whether a debtor is permitted under 11

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[1] United States Trustees are senior Justice Department officials appointed by the Attorney General to supervise the administration of bankruptcy cases and trustees. *See* 28 U.S.C. §§ 581-589 (specifying the powers and duties of United States Trustees); *Curry v. Castillo (In re Castillo),* 297 F.3d 940, 950 (9th Cir. 2002) ("The United States Trustee is the 'watchdog' of the bankruptcy system . . . charged with preventing fraud and abuse and with 'fill[ing] the vacuum' caused by possible creditor inactivity."). Congress explicitly authorized United States Trustees to file dismissal motions like the one the United States Trustee filed in Ms. Meade's case. *See* 11 U.S.C. § 707(b)(1) (court may dismiss chapter 7 case "on a motion by the United States trustee."); s*ee also* 11 U.S.C. § 307 (United States Trustees possess standing to raise and be heard on any issue in any bankruptcy case).

U.S.C. § 707(b)(2)(A)(ii)(I) to claim an expense for vehicle financing where the debtor has no automobile vehicle financing expense is an issue of law subject to de novo review.

STATEMENT OF THE CASE

On September 30, 2006, Ms. Lynn Meade filed a petition for relief under chapter 7 of the Bankruptcy Code (Record ("R.") at 1). On December 8, 2007, the United States Trustee filed a motion to dismiss her case under 11 U.S.C. § 707(b) on the ground it would be an abuse of chapter 7 to grant Ms. Meade a discharge of her debts. (R. at 4). The United States Trustee moved to dismiss Ms. Meade's case because her case was presumptively abusive under 11 U.S.C. § 707(b)(2). That section creates a statutory presumption that chapter 7 cases merit dismissal when debtors' current monthly income, reduced by allowable expenses, exceeds $166.67 per month. (*Id.*).

Before the bankruptcy court, the United States Trustee and Ms. Meade agreed that resolution of a single question of law would determine whether Ms. Meade's case was presumptively abusive and subject to dismissal on that ground. (R. at 8). That question was whether Ms. Meade could deduct a monthly expense for vehicle financing even though she had no monthly car loan or lease payment. (*Id.*) After conducting a hearing, the bankruptcy court agreed with the United States Trustee that Ms. Meade could not deduct a vehicle financing payment she did not have. (R. at 8). The court therefore ruled Ms. Meade's chapter 7 case was abusive under section 707(b)(2), and ordered her case to be dismissed. (*Id.*) Ms. Meade timely appealed that final order. (R. at 7).

STATEMENT OF THE FACTS

1. Statutory Framework - Overview of 11 U.S.C. § 707(b)(2)

On October 17, 2005, most provisions of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (the "BAPCPA"), S. 256, Pub. L. No. 109-8, 119 Stat. 23, took effect, implementing significant changes to the Bankruptcy Code. As part of this effort, Congress amended section 707(b) of the Bankruptcy Code, which governs dismissal of chapter 7 bankruptcy cases. Analysis of the means test, as contained within section 707(b)(2), is underpinned by Congress' general goal behind the complete overhaul of section 707(b), ensuring "that those who can afford to repay some portion of their unsecured debts be required to do so…." 151 CONG. REC. S2470 (March 10, 2005).

As it existed prior to BAPCPA, section 707(b) only authorized dismissal based on a finding that allowing the debtor relief constituted a "substantial abuse" of chapter 7. Further, section 707(b) prior to its amendment by BAPCPA required courts to presume that a debtor was entitled to relief under chapter 7 of the Bankruptcy Code. Section 707(b) now authorizes dismissal where the court finds that the granting of relief would be an "abuse" of chapter 7. As amended by the BAPCPA, section 707(b)(2) repealed the former presumption and replaced it with a new presumption: a case is an "abuse" of chapter 7 if a detailed mathematical formula set out in the statute, commonly referred to as the "means test," yields a minimum amount of monthly disposable income.

The means test uses a series of calculations to determine whether the section 707(b)(2) presumption of abuse arises. *See* 11 U.S.C. § 707(b)(2)(A). Specifically, the means test calculates a debtor's current monthly income, as defined under 11 U.S.C. § 101(10A) (hereafter "CMI"), based on the debtor's average income for the six calendar months preceding the month of the bankruptcy filing. If the debtor's CMI is above the applicable state median family income, as is the case here, 11 U.S.C. § 707(b)(2)(A) calculates the debtor's monthly disposable income available to repay creditors by reducing the CMI by certain categories of expenses identified in 11 U.S.C. § 707(b)(2)(A)(ii), (iii), and (iv). If a debtor's monthly disposable income, calculated by reducing the CMI by allowed expenses under 11 U.S.C. § 707(b)(2)(A)(ii) - (iv), is less than $100 per month (or $6,000 over 60 months), the presumption of abuse does not arise. 11 U.S.C. § 707(b)(2)(A).[2] If the debtor's monthly disposable income is equal to or exceeds $167 per month (or $10,000 over 60 months), the presumption of abuse does arise. *Id.* If the debtor's monthly disposable income is between $100 and $167 per month (between $6,000 and $10,000 over 60 months), the presumption of abuse arises if the disposable income, over 60 months, is sufficient to pay 25 percent of the debtor's nonpriority unsecured debt. *Id.*

If the presumption of abuse arises under section 707(b)(2) based on the means test, the debtor may attempt to rebut the presumption under 11 U.S.C. § 707(b)(2)(B) by demonstrating special circumstances that justify income or expense adjustments for which there is no reasonable alternative.

Each debtor with primarily consumer debts is required to file, in conjunction with his or her bankruptcy schedules and statement of financial affairs, a Statement of Current Monthly Income and Means Test Calculation, Official Form 22A of the Federal Rules of Bankruptcy Procedure ("Form 22A"). 11 U.S.C. § 521 and § 707(b)(2)(C). In chapter 7 cases the main purpose of the Form 22A is to calculate monthly disposable income (ability to pay) following the formula set forth in 11 U.S.C. § 707(b)(2), and determine whether the presumption of abuse arises.

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[2] Pursuant to 11 U.S.C. § 104, the dollar amounts set forth in Title 11 and applicable to the threshold amounts for determining when the presumption of abuse arises under the means test were adjusted based on the consumer price index for cases filed on or after April 1, 2007. This case is not subject to the dollar amount adjustments.

2. Factual Background

On September 30, 2006, Ms. Lynn Meade filed a petition seeking relief under chapter 7 of the Bankruptcy Code along with the required schedules and statements, including a Means Test Form. (R. at 1, 2). Ms. Meade's petition provided that her debts were primarily consumer debts as that term is used in the Code. (R. at 1).[3] Ms. Meade listed $45,963.60 in annual current monthly income on her Means Test Form, which exceeded the applicable median family income of $35,408.00 in Texas for a household of one person. (R. at 2).

Because Ms. Meade's current monthly income exceeded the applicable Texas median, she was required to complete the expense portion of the Means Test Form. Interim Fed. R. Bankr. P. 1007(b)(4). On her Means Test Form, Ms. Meade claimed monthly expenses of $3,836.33. (R. at 2). When subtracted from her reported current monthly income of $3,830.30 per month, Ms. Meade's Means Test Form showed -$6.03 in monthly disposable income. (*Id.*) Because the presumption of abuse does not arise if a debtor's monthly disposable income is below $100, the debtor checked the box on the first page of her Means Test Form indicating that the presumption of abuse did not arise. (*Id.*).

In calculating her expenses, however, Ms Meade deducted $471.00 at Line 23 of her Means Test Form, as a "Local Standards" transportation ownership/lease expense, Vehicle 1. (*Id.*). Ms. Meade owns one vehicle, a 1996 Subaru Legacy Wagon, but she owns the vehicle free of any monthly car or lease payment. (R. at 1).

Because Ms. Meade did not have a lease or car payment expense, the United States Trustee concluded Ms. Meade could not claim that $471 deduction under 11 U.S.C. §707(b)(2)(A). (R. at 4). Instead, the United States Trustee concluded applicable law allowed

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[3] On her Schedule F, titled "Creditors Holding Unsecured Claims," the debtor listed general unsecured debts totaling $274,180.00. (R. at 1).

Ms. Meade to take an additional $200 deduction under the IRS Transportation Standards for vehicle operation, because she was operating a vehicle over six years old and/or with reported mileage of 75,000 or more miles with no loan/lease payment obligation. *See* Internal Revenue Manual, Part 5, Chapter 8, Section 5, at 5.8.5.5.2 (09-01-2005).

Based on this additional operating expense adjustment and a few other minor adjustments, the United States Trustee calculated that Ms. Meade had $303.97 in monthly disposable income under 11 U.S.C. § 707(b)(2). (R. at 3, 4).[4] Because $303.97 exceeded the $166.67 threshold necessary to trigger the Bankruptcy Code's statutory presumption of abuse, the United States Trustee filed a statement with the bankruptcy court, as required by 11 U.S.C. 704(b)(1)(A), that the case was presumed to be an abuse. (R. at 9) and then filed a timely motion to dismiss the case under 11 U.S.C. § 707(b)(2). (R. at 4). The United States Trustee's motion explained that dismissal was appropriate because without the erroneous deduction Ms. Meade's case was presumptively abusive under 11 U.S.C. § 707(b)(2) (*Id.*).

At the hearing on the motion, the court ruled in favor of the United States Trustee, holding that the presumption of abuse did arise and that the debtor had not demonstrated special circumstances to rebut the presumption of abuse. (R. at 8). By order entered March 1, 2007, the bankruptcy court ordered Ms. Meade's chapter 7 bankruptcy case dismissed unless she voluntarily converted it to chapter 13 of the Bankruptcy Code before March 8, 2007. (R. at 6). Ms. Meade timely filed a notice of appeal from that order on March 3, 2007. (R. at 7).[5]

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[4] The motion contended that the amount of the expense on Line 32 of the Means Test Form for Other Necessary Expenses: Telecommunications Services should be $75 instead of $150. (R. at 4). In addition, the United States Trustee included a $36 deduction on Line 45, Chapter 13 Administrative Expenses where the debtor had included none. (R. at 4). The debtor did not dispute either adjustment. (R. at 5).

[5] Ms. Meade did not appeal from the court's ruling that she had not demonstrated special circumstances to rebut the presumption of abuse.

SUMMARY OF ARGUMENT

The bankruptcy court correctly granted the United States Trustee's motion to dismiss the debtor's case because the presumption of abuse arose in the case under 11 U.S.C. § 707(b)(2). The court dismissed the case based on its legal conclusion that Ms. Meade could not deduct a vehicle ownership expense loan or lease payment when she had none.

This ruling was correct for three reasons. First, Ms. Meade could claim only "applicable" expenses under section 707(b)(2), and she had no applicable vehicle ownership expense because she had no car loan and no car lease. By using the word "applicable," Congress limited eligibility for expenses under the Local Standards to debtors for whom the expenses actually apply. Because the vehicle acquisition/financing expense does not apply in Ms. Meade's case, the bankruptcy court correctly held that the she was not eligible to deduct it on her Means Test Form.

Second, construing the word "applicable" in section 707(b)(2)(A)(ii)(I) as conditioning eligibility for the IRS Local Standard for vehicle ownership on the debtor having a monthly car payment is consistent with the Internal Revenue Service's longstanding application of this standard. Because the IRS does not allow taxpayers to claim vehicle ownership expenses absent a monthly car payment expense, courts should not allow debtors to do so when applying the same Standard for means testing purposes. Indeed, both case law and legislative history underscore that Congress intended that the IRS' application of the Standards be considered in applying these Standards under 11 U.S.C. § 707(b)(2).

Finally, the bankruptcy court's order comports with sound notions of public policy and a primary purpose of Congress in passing the 2005 amendments to the Bankruptcy Code - including the amendments at issue in this appeal. The 2005 amendments were designed to ensure that debtors would repay their debts when they can. By preventing Ms. Meade from claiming a phantom expense, the court below acted in conformity with that purpose, and ensured that a debtor who has an ability to repay some of her debts will not receive bankruptcy relief without paying what she can.

ARGUMENT

I. The Bankruptcy Court's Order Should Be Affirmed Because Ms. Meade Was Not Eligible to Claim the Vehicle Ownership Expense Under the IRS Local Standards, and Therefore, the Expense was Not "Applicable" to Her.

The bankruptcy court order granting the United States Trustee's motion to dismiss Ms. Meade's case as a presumed abuse of chapter 7 should be affirmed because Ms. Meade was not entitled to deduct a vehicle ownership expense on her Means Test Form when she has no vehicle loan or lease payment. Like she did below, Ms. Meade argues on appeal that the plain language of section 707(b)(2)(A)(ii)(I) mandates that she be allowed vehicle acquisition expenses she does not have. (Appellant's Brief at 4-9). Ms. Meade fails to recognize, however, that the Code only allows debtors to claim "applicable" expenses, and her claimed vehicle ownership expenses are not applicable because she does not have a monthly car payment obligation. 11 U.S.C. § 707(b)(2)(A)(ii)(I).

Section 707(b)(2)(A)(ii)(I) of the Bankruptcy Code provides that a debtor's monthly expenses "shall be the debtor's *applicable* monthly expense amounts specified under the . . . Local Standards . . . issued by the Internal Revenue Service." 11 U.S.C. § 707(b)(2)(A)(ii)(I) (emphasis added). The statute specifically provides that before the specific IRS expense amounts may be included in the debtor's allowed monthly expenses, the expense itself must first be *applicable* to the debtor.

The Bankruptcy Code does not define the word "applicable," nor has the United States Trustee identified any Supreme Court decision that provides a definition. Where, as here, a statutory term is undefined, a basic principle of statutory construction provides that courts should give such terms their ordinary meanings. *E.g.*, *Smith v. U.S.*, 508 U.S. 223, 228 (1993) ("When a word is not defined by statute, we normally construe it in accord with its ordinary or natural meaning.") The dictionary defines "applicable" to mean applying or capable of being applied; relevant; suitable; appropriate. *Random House Unabridged Dictionary* (2006). Accordingly, such a meaning should be imparted to the term "applicable" as it appears in section 707(b)(2)(A)(ii)(I) absent clear indication that Congress intended to give such term a different meaning. *See Thompson v. Goetzmann*, 337 F.3d 489, 498 n.20 (5th Cir. 2003) ("dictionaries are a principal source for ascertaining the ordinary meaning of statutory language.").

The bankruptcy court's order is consistent with the word's ordinary, common sense definition. By inserting the word "applicable" in section 707(b)(2)(A)(ii)(I), Congress limited eligibility for expenses under the Local Standards to debtors for whom such expenses are "relevant; suitable; appropriate." Since Ms. Meade did not have vehicle financing expenses, the court below correctly found that they simply did not apply to *her*. *See In re Devilliers*, 2007 WL 92504, *6 (Bankr. E.D. La. Jan. 9, 2007) (debtor may claim IRS ownership expense only after "a determination is made as to the type of expenses allowed <u>and applicable</u> to the debtor"); *In re Wiggs*, 2006 WL 2246432, *2-3 (Bankr. N.D. Ill. 2006) (statute is "clear and unambiguous," and "term 'applicable' modifies the amounts specified to limit the expenses to only those that apply," such that debtors were not allowed ownership expense when they did not have a vehicle payment.).

By using the term “applicable” in this way, a determination of allowable expenses under the means test is a two-step process. The first step is eligibility - *i.e,* does the debtor qualify for an expense allowance in the category at issue? If so, then the second step is to quantify the expense amount the eligible debtor is allowed by looking at the IRS Standard amounts that are specified for the number of vehicles owned by the debtor and where the debtor lives. *See*, *e.g. In re Carlin*, 348 B.R. 795, 798 (Bankr. D. Or. 2006) (“There is nothing absurd in Congress drawing the line for vehicle ownership expense eligibility at those debtors who are making payments on the vehicle.”) Ms. Meade seeks to skip the first step and proceed directly to the second.

The debtor’s interpretation is not consistent with the ordinary reading of the word “applicable,” and her proposed usage would make the word surplusage in the statute. The debtor asserts that the plain language of section 707(b)(2)(A)(ii)(I) allows all debtors who simply own a vehicle to claim the ownership expense category (which represents vehicle acquisition financing costs) under the IRS Local Standards. (Appellant’s Brief at 6-9). To reach this conclusion, Ms. Meade suggests that the “better” reading of the word “applicable” in section 707(b)(2)(A)(ii)(I) is “expenses applicable to the debtor because of where he lives and how large his household is, it makes no difference whether he ‘actually’ has the expense.” *Id*., at 8.

Rather than providing a “better” reading, as Ms. Meade suggests, the debtor’s interpretation of the word “applicable” would render that word redundant in section 707(b)(2)(A)(ii)(I). Section 707(b)(2)(A)(ii)(I) expressly requires debtors to use the Local Standard “for the area in which the debtor resides, as in effect on the date of the order for relief.” If the meaning of “applicable” in that section is also simply a function of where the debtor resides, it would be redundant. It is a fundamental axiom of statutory construction that a court should try to give meaning to the whole statute and not render a portion of the statute as mere surplusage. *E.g., Gustafson v. Alloyd Co.*, 513 U.S. 561, 574 (1995) (Court avoids interpreting statutes in a way that "renders some words altogether redundant."). Although some courts have suggested that "applicable" refers in part to the county in which the debtor resides, *see, e.g., In re Wilson*, 356 B.R. 114, 119 (Bankr. D. Del. 2006); *In re Farrar-Johnson*, 353 B.R. 224, 230-31 (Bankr. N.D. Ill. 2006), the bankruptcy court's recognition below that the word "applicable" refers to whether the debtor qualifies for this expense gives meaning to the word without creating redundancy.

Given that Ms. Meade did not have an ownership or lease payment on her car, the IRS Ownership Cost Standard was not applicable to her. By excluding that inapplicable expense, the court below properly determined that the presumption of abuse arose in this case. Accordingly, the order entered below should be affirmed.

II. The Bankruptcy Court's Order Should Be Affirmed Because it is Supported By the Internal Revenue Service's Application of its Own Local Standard for Vehicle Acquisition Costs and Caselaw Analyzing Such Application by the IRS of its Own Standard.

The bankruptcy court's order disallowing a deduction for vehicle financing where Ms. Meade did not have a loan or lease payment on her car is also supported by the Internal Revenue Service's longstanding application of its own Standards. In providing which deductions debtors may take under the means test, Congress specifically stated that debtors are permitted to deduct "the debtor's *applicable* monthly expense amounts specified under the . . . Local Standards . . . issued by the *Internal Revenue Service*." (emphasis added). 11 U.S.C. § 707(b)(2)(A)(ii)(I).

On page two of its Collection Financial Standards under the heading "Transportation" the IRS provides as follows:

> The transportation standards consist of nationwide figures for monthly loan or lease payments referred to as ownership costs, and additional amounts for monthly operating costs . . . . The ownership costs provide maximum allowances for the lease or purchase of up to two automobiles if allowed as a necessary expense . . . . If a taxpayer has a car payment, the allowable ownership cost added to the allowable operating cost equals the allowable transportation expense**. If a taxpayer has no car payment, or no car, the operating costs portion of the transportation standard is used to come up with the allowable transportation expense.**

See IRS Collection Standards (emphasis added), available at ww.irs.gov/individuals/article/0,,id=96543,00.html; *see also* Internal Revenue Manual, Financial Analysis Handbook, Pt. 5, ch. 15, § 5.15.1.7(4.B), available at www.irs.gov/irm/part5/ch15s01.html.

The "ownership cost" was specifically calculated by the IRS based on the cost to finance the acquisition of a vehicle, and is not simply a cost associated with owning a car, such as repair or maintenance, as Ms. Meade suggests. (Appellant's Brief at 9.) Under the heading "Recent Revisions" to the Collection Financial Standards posted on the IRS website, the IRS notes that the "ownership cost" Standards are based on the "five-year average of new and used car financing data compiled by the Federal Reserve Board of Governors." *See id.* As such, the "ownership cost" expense is not applicable if a debtor does not have a monthly expense related to financing a car. *See In re Devilliers*, --- B.R. ---, 2007 WL 92504, *10 (Bankr. E.D. La. Jan. 9, 2007) (The ownership allowance "is not the equivalent of an allowance for depreciation or an invitation for a debtor to 'save' for the ultimate replacement of an existing vehicle. Instead, the deduction is designed to assist with the acquisition of a vehicle on credit.").

The IRS recognizes that the vehicle "ownership cost" portion of the Local Transportation Standards is intended to apply *only* in situations where the debtor has a monthly vehicle acquisition financing expense, *i.e.*, has a monthly vehicle lease or loan payment. Accordingly, the Local Standard for vehicle ownership is an expense that is not necessarily "applicable" to every debtor. This stands in stark contrast to the National Standards for food, clothing, and other items, which the IRS allows to all debtors based on their family size and income level "without questioning amounts actually spent." *See* Offer in Compromise Frequently Asked Questions, published by the Internal Revenue Service on its website at http://www.irs.gov/businesses/small/article/0,,id=108356,00.html#45. "Thus, if a debtor is not incurring expenses for the purchase or lease of a vehicle, the debtor cannot claim a vehicle ownership expense under the IRS standards."[6] *In re McGuire*, 342 B.R. 608, 613 (Bankr. W.D. Mo. 2006); *see also In re Ceasar*, --- B.R. ---, 2007 WL 777821, *5 (Bankr. W.D. La. Mar. 6, 2007) (agreeing with the *McGuire* line of cases and noting that courts that disagree give too little weight to the critical qualifying word "applicable.").

How the Internal Revenue Service applies the Standards that it developed for its own internal debt collection purposes is relevant and should be considered by courts in applying the same Standards in an analysis under section 707(b)(2). When Congress developed the means test, it "could have started from scratch, and created a system that was rigid but easy to administer, such as how many view workers' compensation or

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[6] Under the IRS Transportation Standards, in situations where the debtor has no loan or lease payment obligation on a vehicle that is over six years old and/or has reported mileage of 75,000 or more miles, an additional operating expense of $200 may be allowable. *See* Internal Revenue Manual, Part 5 (entitled Collecting Process), Chapter 8, § 5.8.5.5.2, Treatment of Non-Business Transportation Expenses, which may be found on the IRS website at http://www/irs/gov/irm/part5/ch08s05.html. In this case, the United States Trustee factored in the additional $200 allowance in its means test analysis. (R. at 3, 4).

social security schemes." *In re Slusher*, --- B.R. ---, 2007 WL 118009, *12 (Bankr. D. Nev. Jan. 17, 2007). Instead, Congress "incorporated into the Bankruptcy Code an existing, administrative system that the IRS had long had in place." *Id.* This incorporation "strongly suggests that courts should look to how the IRS determined those standards; that is, as to how the IRS would have applied them in similar circumstances." *Id.* at *14.

In stating that the amounts "specified" by the IRS Standards may be deducted from CMI to yield a debtor's disposable income, Congress "essentially read[ ] into the Code not only the actual numbers contained in the IRS Standards, but also the Manual's context for their application." *In re Howell*, --- B.R. ---, 2007 WL 1237832 at *3 (Bankr. D. Kan. Apr. 26, 2007). Thus, "if guidance is sought on the meaning of the IRS standards that Congress incorporated into the Bankruptcy Code, practical reason would suggest that court should consider the full manner by which the IRS uses these standards." *Slusher*, --- B.R. ---, 2007 WL 118009 at *14*; see also Howell*, 2007 WL 1237832 at *3 ("It is unlikely that Congress intended the Statute to merely import the numbers without their attendant meaning and context"); *In re Oliver*, 350 B.R. 294, 301 (Bankr. W.D. Tex. 2006) (holding that debtor is not entitled to vehicle ownership expense because IRS Financial Analysis Handbook and Internal Revenue Manual limit expense to individuals that have loan or lease payment); *In re Hardacre*, 338 B.R. 718, 726 (Bankr. N.D. Tex. 2006) (same).

Considering IRS practice in interpreting "applicable expenses in section 707(b)(2)(A)(ii)(I) does not negate the section's later allowance of "actual" monthly expenses in the IRS categories of "Other Necessary Expenses," as the debtor claims.

Rather, “a natural reading” of section 707(b)(2)(A)(ii)(I) indicates that the words “actual” and “applicable” limit the relevant expense deductions in different ways. *Slusher*, --- B.R. ---, 2007 WL 118009 at *13. For the categories for which the Local Standards apply, debtors may claim the standard expenses for which they are eligible, *i.e.* those that are “applicable” to the debtor; for the Other Necessary Expenses category, the debtors may claim the “amount they actually spend, *i.e.* their “actual” monthly expenses. “Had Congress intended to indiscriminately allow all expense amounts specified in the National and Local Standards, it would have written section 707(b)(2)(A)(ii)(I) to read, ‘The debtor’s monthly expenses shall be the monthly amounts specified under the National Standards and Local Standards . . .’ rather than ‘The debtor’s monthly expenses shall be *the debtor’s applicable* monthly expenses amounts specified under the National and Local Standards.’” *Id*. (emphasis in original).

Given the IRS’ historic application of its National Standards and Local Standards up to the time of BAPCPA’s enactment, “it would be quite odd if Congress intended to preclude courts from examining the context in which the authoring agency, the IRS, used and employed those standards.” *Id*. Nothing compels such an odd reading, and the court below correctly found, consistent with IRS practice, that the IRS vehicle Ownership Standards do not apply to this debtor.

III. The Bankruptcy Court’s Order Supports the Major Goals of the 2005 Amendments to the Bankruptcy Code and Will Not Lead to Unfair Distinctions Between Debtors.

The bankruptcy court’s order also comports with Congress’ goals and purpose in implementing bankruptcy reform. Congress amended the Bankruptcy Code in BAPCPA to rectify perceived abuses in the bankruptcy process. “Among the abuses identified by

Congress was the easy access to chapter 7 liquidation proceedings by consumer debtors who, if required to file under chapter 13, could afford to pay some dividend to their unsecured creditors." *Hardacre*, 338 B.R. at 720 *citing* 151 Cong. Rec. S2459, 2469-70 (March 10, 2005). A "primary goal" of BAPCPA was to "ensure that debtors repay creditors the maximum they can afford." *In re Lenton*, 358 B.R. 651 (Bankr. E.D. Pa. 2006) *citing* H.R. Rep. No. 109-31, pt. 1, at 1 (2005), *as reprinted in* 2005 U.S.C.C.A.N. 88, 89. In cases such as this one, where the debtor has no loan or lease payment, Congress has established a system which does not provide her an expense deduction for vehicle financing. "Allowing debtors to deduct from their disposable income a fictional ownership allowance would give debtors with unencumbered vehicles a windfall at the expense of their unsecured creditors." *Howell*, 2007 WL 1237832 at *3.

Ms. Meade suggests that limiting the vehicle ownership expense allowance to debtors with loan or lease payments will unfairly prejudice some debtors. (Appellant's Brief at 9-10). Ms. Meade crafts a scenario where a debtor has only one payment remaining on her vehicle on the date of filing yet still can claim an ownership deduction. *Id*. However, the debtor in this hypothetical stands a strong likelihood of having her case dismissed as an abuse under section 707(b)(3) based on the totality of the circumstances of this debtor's financial situation. The fact that this hypothetical debtor only has one car payment post-petition is a circumstance that would most likely suggest an ability to pay her unsecured debt at a level that demonstrates abuse. Where the presumption of abuse does not arise under § 707(b)(2), "the court must then consider a debtor's actual income and expenses in determining abuse based on ability to pay under § 707(b)(1) and (3)." *In re Mestemaker,* 2007 WL 79306 at *5 (Bankr. N.D. Ohio Jan. 10, 2007); *accord In re*

Haar, 2007 WL 521221, *2, *9 (Bankr. N.D. Ohio Feb. 20, 2007) (section 707(b)(3) is "completely independent from § 707(b)(2)," providing "an independent basis to dismiss a case for abuse").

Ms. Meade's alternative suggestion that allowing debtors to deduct the IRS Transportation Ownership/Lease expense even if they do not have a monthly car payment "would advance one of the underlying purposes of the statute," (Appellant's Brief at 9), conflicts with the primary legislative purpose for BAPCPA. Ms. Meade suggests that Congress "apparently" included reference to the Local and National Standards in section 707(b)(2)(a)(ii)(I) to provide a set of standard expenses that could easily be applied by all courts. (*Id.*) As set forth above, by mandating the use of the amounts specified in the Standards by the IRS, the expenses in these categories are easy to apply. Moreover, the requirement that a loan or lease payment obligation is a prerequisite to claiming the expense does not make application any more difficult. Further, Congress' main purpose in enacting the amendments was to "ensure that those who can afford to repay some portion of their unsecured debtor be required to do so … ." 151 CONG. REC. S2470 (March 10, 2005). Ms. Meade's reading of the statute conflicts with this stated purpose because it would allow debtors without a monthly vehicle payment to deduct expenses they do not actually incur and obtain an immediate discharge of debts, a portion of which they have an ability to repay.

CONCLUSION

For these reasons, the United States Trustee respectfully asks this Court to affirm the order granting the motion to dismiss the case entered below.

Dated: May 7, 2007

Respectfully submitted,

CHARLES F. McVAY
UNITED STATES TRUSTEE
REGION 7

By: **/s/ Kevin M. Epstein**
KEVIN M. EPSTEIN
Trial Attorney
Department of Justice
Texas Bar No. 00790647
Office of the U.S. Trustee
615 E. Houston St., Room 533
P.O. Box 1539
San Antonio, Texas 78295-1539
(210) 472-4640
(210) 472-4649 Fax

Of Counsel

P. Matthew Sutko
Melissa R. Perry
Executive Office
for United States Trustees
Department of Justice
20 Massachusetts Avenue, N.W.
Suite 8000
Washington, D.C. 20530
(202) 307-1399

CERTIFICATE OF SERVICE

I hereby certify that on the 7th day of May 2007, I electronically filed the foregoing with the Clerk of Court using the CM/ECF system and have mailed by United States Postal Service the document to the following non CM/ECF participant.

Counsel for Appellant
Edgar Borrego
2610 Montana
El Paso, TX 79903

/s/ Kevin M. Epstein
KEVIN M. EPSTEIN

APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

No. 07-2405

MILAVETZ, GALLOP & MILAVETZ, P.A.;
ROBERT J. MILAVETZ; BARBARA N. NEVIN;
JOHN DOE; MARY DOE, APPELLEES

v.

UNITED STATES OF AMERICA, APPELLANT

COMMERCIAL LAW LEAGUE OF AMERICA,
AMICUS ON BEHALF OF APPELLEE

Submitted: Mar. 11, 2008
Filed: Sept. 4, 2008
(Corrected Sept. 23, 2008)

APPEAL FROM THE UNITED STATES
DISTRICT COURT FOR THE
DISTRICT OF MINNESOTA

Before: BYE, SMITH, and COLLOTON, Circuit Judges.

SMITH, Circuit Judge.

Milavetz, Gallop & Milavetz, P.A., a law firm that practices bankruptcy law, the firm's president, a bank-

ruptcy attorney within the firm, and two clients[1] who sought bankruptcy advice from the firm brought suit against the United States seeking a declaratory judgment that certain provisions of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA)—11 U.S.C. §§ 526(a)(4) and 528(a)(4) and (b)(2)—did not apply to attorneys and law firms and are unconstitutional as applied to attorneys. The district court granted summary judgment to the plaintiffs and issued an order declaring that: (1) attorneys in the District of Minnesota were excluded from the definition of a "debt relief agency" as defined by BAPCPA; and (2) the challenged provisions were unconstitutional as applied to attorneys in the District of Minnesota. We affirm in part and reverse in part.

I. *Background*

On April 20, 2005, BAPCPA was signed into law, amending and adding multiple sections of the Bankruptcy Code ("the Code"). While some of these amendments became effective immediately, the vast majority became effective on October 17, 2005. *See* Pub. L. No. 109-8, § 1501(a), 119 Stat. 23 (2005) ("Except as otherwise provided in this Act, this Act and the amendments made by this act shall take effect 180 days after the date of enactment of this Act").

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[1] The client-plaintiffs sought prebankruptcy advice regarding the incurrence of additional debt prior to filing bankruptcy. The Bankruptcy Code precludes a debt relief agency from advising an assisted person from incurring additional debt in contemplation of bankruptcy. 11 U.S.C. § 526(a)(4). Thus, these client-plaintiffs are appearing on behalf of themselves and all others similarly situated who desire to exercise their First Amendment rights with attorneys regarding bankruptcy information.

One BAPCPA amendment added a new term, "debt relief agency," which is defined in § 101(12A) of the Code. 11 U.S.C. § 101(12A).[2] The amended Code restricts some actions of debt relief agencies, while requiring them to do others. *See* 11 U.S.C. § 526 ("Restrictions on debt relief agencies"); 11 U.S.C. § 528 ("Requirements for debt relief agencies"). For example, § 526(a)(4) bars a debt relief agency from advising a client "to incur more debt in contemplation" of a bankruptcy filing, 11 U.S.C. § 526(a)(4), while §§ 528(a)(4) and (b)(2) require debt relief agencies to include a disclosure in their bankruptcy-related advertisements directed to the general public declaring: "We are a debt relief agency. We help people file for bankruptcy relief under the Bankruptcy Code[,]' or a substantially similar statement." 11 U.S.C. § 528(a)(4), (b)(2). The plaintiffs sought alternative remedies. First, plaintiffs requested a declaratory judgment that attorneys did not fall within the definition of "debt relief agency." If the court determined that attorneys fell within the definition of debt relief agency, they challenged the constitutionality of §§ 526(a)(4) and 528(a)(4) and (b)(2), as applied to attorneys.

II. *Discussion*

A. *Debt Relief Agencies*

Initially, we address whether attorneys fall within the Code's definition of debt relief agencies. If they do not, we will have no need to address the constitutionality of §§ 526(a)(4) and 528(a)(4) and (b)(2), which only apply to debt relief agencies. *See Holtan v. Black*, 838 F.2d

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[2] Prior to BAPCPA, the term "debt relief agency" did not exist in the Code.

984, 986 n.3 (8th Cir. 1988) ("Federal courts must avoid passing upon constitutional questions unless they are essential to the disposition of the issues before them.") (citing *Three Affiliated Tribes v. Wold Engineering*, 467 U.S. 138, 157 (1984) ("It is a fundamental rule of judicial restraint, however, that this Court will not reach constitutional questions in advance of necessity of deciding them")).

> The term "debt relief agency" means *any person* who provides *any bankruptcy assistance* to an *assisted person* in return for the payment of money or other valuable consideration, or who is a bankruptcy petition preparer under section 110, but does not include—
>
> > (A) any person who is an officer, director, employee, or agent of a person who provides such assistance or of the bankruptcy petition preparer;
> >
> > (B) a nonprofit organization that is exempt from taxation under section 501(c)(3) of the Internal Revenue Code of 1986;
> >
> > (C) a creditor of such assisted person, to the extent that the creditor is assisting such assisted person to restructure any debt owed by such assisted person to the creditor;
> >
> > (D) a depository institution (as defined in section 3 of the Federal Deposit Insurance Act) or any Federal credit union or State credit union (as those terms are defined in section 101 of the Federal Credit Union Act), or any affiliate or subsidiary of such depository institution or credit union; or

> (E) an author, publisher, distributor, or seller of works subject to copyright protection under title 17, when acting in such capacity.

11 U.S.C. § 101(12A) (emphasis added).

Further, the Code defines the term "bankruptcy assistance" to mean:

> any goods or services sold or otherwise provided to an assisted person with the express or implied purpose of providing information, *advice, counsel*, document preparation, or filing, or attendance at a creditors' meeting or appearing in a case or proceeding on behalf of another *or providing legal representation* with respect to a case or proceeding under this title.

Id. at § 101(4A) (emphasis added).

Additionally, the Code defines the term "assisted person" as "any person whose debts consist primarily of consumer debts and the value of whose nonexempt property is less than $164,250."[3] *Id.* at § 101(3).

The plaintiffs argue that attorneys are not "debt relief agencies" because the definition of debt relief agencies makes no direct reference to attorneys, even though "attorney" is a defined term in the Code, *id.* at § 101(4),[4] but does include the term "bankruptcy petition pre-

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[3] When this suit was commenced, the dollar amount in § 101(3) was $150,000. Subsequently, on April 1, 2007, the amount was adjusted pursuant to 11 U.S.C. § 104. The change, however, is inconsequential for purposes of this case.

[4] "The term 'attorney' means attorney, professional law association, corporation, or partnership, authorized under applicable law to practice law." 11 U.S.C. § 101(4). This definition makes no reference to "debt relief agencies" or to subsection (12A).

parer" which, by definition, excludes debtor's attorneys and their staff. *See* 11 U.S.C. § 110(a)(1).[5] Plaintiffs contend that the omission of any reference to attorneys or lawyers while specifically including bankruptcy petition preparers shows Congress's intent to exclude attorneys from the definition of debt relief agencies. Because the plaintiffs contend that constitutionality issues arise in §§ 526(a)(4) and 528(a)(4) and (b)(2) if attorneys are debt relief agencies, they assert that the doctrine of constitutional avoidance should be used to interpret "debt relief agency" to exclude attorneys and thus avoid the potential constitutional issues.

Conversely, the government argues that attorneys are debt relief agencies because the broadly worded definition of the term plainly includes attorneys, *see* 11 U.S.C. § 101(12A) (defining "debt relief agency" as "any person who provides any bankruptcy assistance to an assisted person in return for the payment"), and providing legal representation is included in definition of bankruptcy assistance. *See id.* at 101(4A) ("bankruptcy assistance means any goods or services sold or otherwise provided to an assisted person with the express or implied purpose of providing . . . advice, counsel, . . . or legal representation with respect to a case or proceeding under this title").

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[5] "'[B]ankruptcy petition preparer' means a person, *other than an attorney for the debtor or an employee of such attorney* under the direct supervision of such attorney, who prepares for compensation a document for filing [by the debtor in connection with his bankruptcy case]." 11 U.S.C. § 110(a)(1) (emphasis added); *see also id.* at § 110(a)(2) (defining "document for filing" as used in § 110(a)(1)).

Whether attorneys fall within the Code's definition of debt relief agencies is an issue of first impression among the Courts of Appeals. Although the plain language of the definition appears to include bankruptcy attorneys and does not appear to be ambiguous, lower "[c]ourts that have addressed the issue of whether attorneys are debt relief agencies have not been unanimous." *In re Irons*, 379 B.R. 680, 685 (Bankr. S.D. Tex. 2007) (citing cases). Nevertheless, the majority of courts have held that compensated bankruptcy attorneys are debt relief agencies as that term is defined in the Code. *Id.* (finding debtor's counsel was a debt relief agency); *Olsen v. Gonzales*, 350 B.R. 906 (D. Or. 2006) (same); *In re Robinson*, 368 B.R. 492 (Bankr. E.D. Va. 2007) (finding debtor's counsel was debt relief agency); *Hersh v. United States*, 347 B.R. 19 (N.D. Tex. 2006) (finding that bankruptcy attorneys are debt relief agencies); *In re Norman*, No. 06-70859, 2006 WL 3053309 (Bankr. E.D. Va. 2006) (finding debtor's counsel qualified as a debt relief agency); *but see In re Attorneys at Law and Debt Relief Agencies*, 332 B.R. 66 (Bankr. S.D. Ga. 2005) (holding that attorneys are not debt relief agencies); *In re Reyes*, 361 B.R. 276 (Bankr. S.D. Fla. 2007) (finding that attorneys, generally, are not debt relief agencies, but ruling that debtor's counsel in case at bar was not a debt relief agency because service was provided pro bono and thus counsel did not receive valuable consideration in return for the bankruptcy assistance provided).

In this case, the district court acknowledged that the definition of debt relief agency, "at first glance," appeared to include attorneys, but it ultimately relied on the doctrine of constitutional avoidance to conclude that attorneys did not fall within the definition because if they did portions of §§ 526 and 528 would be unconstitu-

tional as applied to attorneys. The doctrine of constitutional avoidance dictates that "where an otherwise acceptable construction of a statute would raise serious constitutional problems, the Court will construe the statute to avoid such problems unless such construction is plainly contrary to the intent of Congress." *Edward J. DeBartolo Corp. v. Florida Gulf Coast Bldg. & Constr. Trades Council*, 485 U.S. 568, 575 (1988). Thus, if interpreting "debt relief agency" to include attorneys "would raise serious constitutional problems," then we should look for another interpretation "that may fairly be ascribed" to the definition that does not raise these concerns. *Id.* at 576-77. We will not, however, adopt an alternative interpretation that is "plainly contrary to the intent of Congress." *Id.* at 575.

"We review the district court's statutory interpretation de novo." *United States v. Mendoza-Gonzalez*, 520 F.3d 912, 914 (8th Cir. 2008). To interpret the statute we first "determine whether the language at issue has a plain and unambiguous meaning with regard to the particular dispute in the case." *Id.* (quoting *Robinson v. Shell Oil Co.*, 519 U.S. 337, 340 (1997)). "If so, we apply the plain language of the statute." *Id.* "A mere disagreement among litigants over the meaning of the statute does not prove ambiguity; it usually means that one of the litigants is simply wrong." *Bank of Am. Nat'l Trust & Sav. Ass'n v. 203 N. LaSalle St. P'ship*, 526 U.S. 434, 461 (1999).

The plain reading of the definition of debt relief agency, and the defined terms that make up that definition, leads us to conclude that attorneys who provide "bankruptcy assistance" to "assisted persons" are unambiguously included in the definition of "debt relief agen-

cies." *See Olsen*, 350 B.R. at 912 ("[I]t is the plain language of the Act that leads to the conclusion that attorneys are to be included in the definition of 'debt relief agency,'" and "[t]hus, further use of the tools of statutory construction is not necessary"). The statutory language sweeps broadly and clearly covers the legal services provided by attorneys to debtors in bankruptcy unless excluded by another provision.

Congress specifically listed five exclusions from the definition of "debt relief agency," and if it meant to exclude attorneys from that definition it could have explicitly done so. *Id.*; 11 U.S.C. § 101(12A). Moreover, if attorneys were not included in the definition of debt relief agencies, Congress would have had no reason to include § 526(d)(2), which expressly provides that nothing in §§ 526, 527, or 528 (the sections covering debt relief agencies) "shall be deemed to limit or curtail the authority or ability of a State . . . to determine and enforce qualifications for the practice of law under the laws of that State; or of a Federal court to determine and enforce the qualifications for the practice of law before that court." 11 U.S.C. § 526(d)(2)(A) and (B). The legislative history provides further indication that attorneys are included in the definition. *See* H.R. Rep. No. 109-31, 109th Cong., 1st Sess. at 4 (April 8, 2005) ("The bill's consumer protections include provisions strengthening professionalism standards *for attorneys* and others who assist consumer debtors with their bankruptcy cases") (emphasis added).[6]

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[6] Additionally, while we recognize that the Supreme Court has stated that "failed legislative proposals are a particularly dangerous ground on which to rest [a statutory interpretation]," *Lockhart v. United States*, 546 U.S. 142 (2005) (internal quotation marks and brackets

Because attorneys were not specifically excluded from the definition of debt relief agencies, we hold that attorneys that provide "bankruptcy assistance" to "assisted persons" are "debt relief agencies" as that term is defined by the Code. Interpreting the definition of "debt relief agency" to exclude bankruptcy attorneys would be contrary to Congress's intent.

B. *Constitutionality of § 526(a)(4)*

Having concluded that attorneys providing bankruptcy assistance to assisted persons are debt relief agencies under the Code, we now must determine whether the challenged provisions placing restrictions and requirements on debt relief agencies are unconstitutionally overbroad as applied to these types of attorneys.[7] One of the sections challenged by the plaintiffs in this case is § 526(a)(4), which states:

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omitted), we note that on March 9, 2005, Senator Feingold proposed amendment No. 93 to Congress which would have excluded attorneys from the definition of debt relief agencies, *see* 151 Cong. Rec. S2306-02, 2316 (daily ed. Mar. 9, 2005) (statement by Sen. Feingold) ("This amendment would exclude lawyers from the provisions dealing with 'debt relief agencies' . . . ."), but the Senate did not address the proposal.

[7] Even though a more narrowly drawn version of § 526(a)(4) would likely be valid as applied to the plaintiffs in this case, our analysis applies to all attorneys falling within the definition of debt relief agencies, not merely the plaintiff-attorneys. *See Members of City Council of City of Los Angeles v. Taxpayers for Vincent*, 466 U.S. 789, 798-99 (1984) (explaining that the overbreadth doctrine allows a party to challenge a broadly written statute "even though a more narrowly drawn statute would be valid as applied to the party in the case," as "the statute's very existence may cause others not before the court to refrain from constitutionally protected speech or expression") (internal quotations and citation omitted).

(a) A debt relief agency shall not—

. . .

> (4) advise an assisted person or prospective assisted person to incur more debt in contemplation of such person filing a case under this title or to pay an attorney or bankruptcy petition preparer fee or charge for services performed as part of preparing for or representing a debtor in a case under this title.

11 U.S.C. § 526(a)(4).

Plaintiffs assert that the prohibition against advising an assisted person or prospective assisted person to incur more debt in contemplation of bankruptcy violates the First Amendment. The parties disagree as to the level of scrutiny we apply to the constitutional analysis of this limitation on speech. Plaintiffs claim that we should review the constitutionality of § 526(a)(4) under the strict scrutiny standard as the restriction on attorney advice is content-based. *See Turner Broad. Sys., Inc. v. FCC*, 512 U.S. 622, 642 (1994) ("Our precedents thus apply the most exacting scrutiny to regulations that suppress, disadvantage, or impose differential burdens upon speech because of its content"). Under strict scrutiny review, the government has the burden to prove that the constraints on speech are supported by a compelling governmental interest and are narrowly tailored, such that the statutory effect does not prohibit any more speech than is necessary to serve the governmental interest. *Republican Party of Minnesota v. White*, 536 U.S. 765, 774-75 (2002).

In contrast, the government argues that § 526(a)(4)'s restrictions are a type of ethical regulation, invoking the more lenient standard outlined in *Gentile v. State Bar of Nev.*, 501 U.S. 1030 (1991). Under the *Gentile* standard, we would balance the First Amendment rights of the attorneys against the government's legitimate interest in regulating the activity in question—the prohibition of advising assisted persons to incur more debt in contemplation of bankruptcy—and then determine whether the regulations impose "only narrow and necessary limitations on lawyers' speech." *Id.* at 1075.

According to the government, § 526(a)(4) should be interpreted as merely preventing an attorney from advising an assisted person (or prospective assisted person) to take on more debt in contemplation of bankruptcy when the incurrence of such debt is done with the intent to manipulate the bankruptcy system, engage in abusive conduct, or take unfair advantage of the bankruptcy discharge. However, the plain language of the statute does not permit this narrow interpretation. Rather, § 526(a)(4) broadly prohibits a debt relief agency from advising an assisted person (or prospective assisted person) to incur *any* additional debt when the assisted person is contemplating bankruptcy. The statute's blanket prohibition applies even if the additional debt would not be discharged during the bankruptcy proceedings. 11 U.S.C. § 526(a)(4).

Thus, regardless of whether the government's interest in prohibiting the speech was legitimate (*Gentile* standard) or compelling (strict scrutiny standard), § 526(a)(4) is unconstitutionally overbroad as applied to attorneys falling within the definition of debt relief agencies because it is not narrowly tailored, nor narrowly

and necessarily limited, to restrict only that speech that the government has an interest in restricting. Instead, § 526(a)(4) prohibits attorneys classified as debt relief agencies from advising any assisted person to incur any additional debt in contemplation of bankruptcy; this prohibition would include advice constituting prudent pre-bankruptcy planning that is not an attempt to circumvent, abuse, or undermine the bankruptcy laws. Section 526(a)(4), as written, prevents attorneys from fulfilling their duty to clients to give them appropriate and beneficial advice not otherwise prohibited by the Bankruptcy Code or other applicable law.[8]

There are certain situations where it would likely be in the assisted person's, and even the creditors', best interest for the assisted person to incur additional debt in contemplation of bankruptcy. However, under § 526(a)(4)'s plain language an attorney is prohibited from providing this beneficial advice—even if the advice could help the assisted person avoid filing for bankruptcy altogether. For instance, it may be in the assisted person's best interest to refinance a home mortgage in contemplation of bankruptcy to lower the mortgage payments. This could free up additional funds to pay off other debts and avoid the need for filing bank-

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[8] Several bankruptcy courts are in agreement with our decision. *See Zelotes*, 363 B.R. at 667 ("Because § 526(a)(4) is not sufficiently 'narrowly tailored to achieve the desired objective,' it is unconstitutional as applied to bankruptcy attorneys."); *Hersh*, 347 B.R. at 25 (concluding that § 526(a)(4) is unconstitutional because: "(1) it prevents lawyers from advising clients to take lawful actions; and (2) it extends beyond abuse to prevent advice to take prudent actions," and therefore imposes "limitations on speech beyond what is 'narrow and necessary' "); *Olsen*, 350 B.R. at 916 ("[S]ection 526(a)(4) is overly restrictive in violation of the First Amendment" even if reviewed under *Gentile* standard).

ruptcy all together. *Hersh*, 347 B.R. at 24. Moreover, it may be in the client's best interest to incur additional debt to purchase a reliable automobile before filing for bankruptcy, so that the debtor will have dependable transportation to travel to and from work, which will likely be necessary to maintain the debtor's payments in bankruptcy. *Id.* Incurring these types of additional secured debt, which would often survive or could be reaffirmed by the debtor, may be in the debtor's best interest without harming the creditors.[9]

Factual scenarios other than these few hypothetical situations no doubt exist and may further illustrate why incurring additional debt in contemplation of bankruptcy may not be abusive or harmful to creditors. Nonetheless, § 526(a)(4), as written, does not allow attorneys falling within the definition of debt relief agencies to advise assisted persons (or prospective assisted persons)—i.e. clients (or prospective clients) meeting the definition of assisted person—to incur such debt. Thus, § 526(a)(4) is not narrowly tailored nor narrowly and necessarily limited to prevent only that speech which the government has an interest in restricting. Therefore,

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[9] *See* Erwin Chemerinsky, *Constitutional Issues Posed in the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005*, 79 Am. Bankr. L.J. 571, 579 (Summer 2005).

> [Section 526(a)(4)'s] prohibition is particularly troubling when it might be completely legal and even desirable for the client to incur such debt. For example, there may be instances where it is advisable for a client to obtain a mortgage, to refinance an existing mortgage to obtain a lower interest rate, or to buy a new car on time. There would be no fraud in doing so if the client intended to pay such debt notwithstanding the filing of a contemplated bankruptcy case. For example, the client may intend to keep all payments fully current and to reaffirm such debt once the case is filed.

we hold that § 526(a)(4) is substantially overbroad,[10] and unconstitutional as applied to attorneys who provide bankruptcy assistance to assisted persons, as those terms are defined in the Code.

C. *Constitutionality of § 528(a)(4) and (b)(2)*

The plaintiffs also challenged the constitutionality of §§ 528(a)(4) and (b)(2)(B), claiming that the advertising disclosure requirements mandated by those sections violate the First Amendment rights of bankruptcy attorneys through compelled speech. The disclosure requirements of § 528(a)(4) are supplemented by § 528(a)(3). These sections state:

(a) A debt relief agency shall—

. . .

> (3) clearly and conspicuously disclose in any advertisement of bankruptcy assistance services or of the benefits of bankruptcy directed to the general public (whether in general media, seminars or specific mailings, telephonic or electronic messages, or otherwise) that the services or benefits are with respect to bankruptcy relief under this title; and
>
> (4) clearly and conspicuously use the following statement in such advertisement: "We are a debt relief agency. We help people file for bankruptcy

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[10] *See Veneklase v. City of Fargo*, 248 F.3d 738, 747 (8th Cir. 2001) ("For us to find a statute unconstitutionally overbroad, its 'overbreadth . . . must not only be real, but substantial as well, judged in relation to the statute's plainly legitimate sweep.' ") (quoting *Broadrick v. Oklahoma*, 413 U.S. 601, 615 (1973)).

> > relief under the Bankruptcy Code." or [*sic*] a substantially similar statement.

11 U.S.C. § 528 (a)(3), (4).

Similarly, § 528(b)(2)(B) states:

> (2) An advertisement, directed to the general public, indicating that the debt relief agency provides assistance with respect to credit defaults, mortgage foreclosures, eviction proceedings, excessive debt, debt collection pressure, or inability to pay any consumer debt shall—
>
> . . .
>
> > (B) include the following statement: "We are a debt relief agency. We help people file for bankruptcy relief under the Bankruptcy Code." or a substantially similar statement.

11 U.S.C. § 528(b)(2)(B).

As both §§ 528(a)(4) and (b)(2)(B) require debt relief agencies—which includes attorneys providing bankruptcy assistance to assisted persons—to disclose in their advertising that "'We are a debt relief agency. We help people file for bankruptcy relief under the Bankruptcy Code.' or some substantially similar statement," the statutes compel speech that, similar to a restriction on speech, receives constitutional protection under the First Amendment. *See Wooley v. Maynard*, 430 U.S. 705, 714 (1977) ("[T]he right of freedom of thought protected by the First Amendment against state action includes both the right to speak freely and the right to refrain from speaking at all"); *Turner Broad. Sys., Inc.*, 512 U.S. at 642 (stating that "[l]aws that compel speak-

ers to utter or distribute speech bearing a particular message are subject to" constitutional scrutiny).

The government contends that Congress enacted § 528's disclosure requirements to address problems with deceitful or unclear advertising by bankruptcy attorneys, bankruptcy petition preparers, or other debt relief entities. This position is supported by legislative history. *See* 151 Cong. Rec. H2063-01, 2066 (daily ed. Apr. 14, 2005) (statement by Rep. Moran) (stating that certain BAPCPA provisions are intended to "[p]revent deceptive and fraudulent advertising practices by debt relief agencies . . ."). But before we can determine whether the government's justification for mandating the disclosures passes constitutional scrutiny, we must first decide the appropriate standard for reviewing the constitutionality of the required disclosures.

We find guidance for this issue from the Court in *Zauderer v. Office of Disciplinary Counsel of the Supreme Court of Ohio*, 471 U.S. 626 (1985). In *Zauderer*, the Supreme Court considered the constitutionality of a state bar disciplinary regulation requiring attorneys that advertised contingent-fee representation to disclose in their advertisements that clients may still have to bear certain costs even if the case was unsuccessful. *Id.* at 633. As the regulation only required an attorney to "include in his advertising purely factual and uncontroversial information about the terms under which his services w[ould] be available," and "the extension of First Amendment protection to commercial speech is justified principally by the value to consumers of the information such speech provides, [the attorney's] constitutionally protected interest in not providing any particular factual information in his advertising is minimal."

Id. at 651. The Court "recognize[d] that unjustified or unduly burdensome disclosure requirements might offend the First Amendment by chilling protected commercial speech," but held "that an advertiser's rights are adequately protected as long as disclosure requirements are *reasonably related* to the State's interest in preventing deception of consumers." *Id.* (emphasis added).

On the other hand, restrictions on non-deceptive advertising are reviewed under intermediate scrutiny. *See Cent. Hudson Gas & Elec. Corp. v. Pub. Serv. Comm'n of New York*, 447 U.S. 557, 564 (1980) (ruling that restrictions on commercial speech that is neither misleading nor related to unlawful activity must assert a "substantial interest to be achieved by [the] restrictions" and "the restrictions must directly advance the state interest involved"). Under this standard, the limitation must be narrowly drawn. *Id.* ("[I]f the governmental interest could be served as well by a more limited restriction on commercial speech, the excessive restrictions cannot survive").

The district court in this case reviewed § 528's disclosure requirements under the intermediate scrutiny standard, but we conclude that rational basis review is proper. The disclosure requirements here, like those in *Zauderer*, are intended to avoid potentially deceptive advertising. *See Zauderer*, 471 U.S. at 651, n.14 (rejecting a more strict analysis of the disclosure requirements at issue in that case, and noting that "the First Amendment interests implicated by disclosure requirements are substantially weaker than those at stake when speech is actually suppressed . . .").

By definition, debt relief agencies provide bankruptcy assistance to assisted persons (or prospective assisted persons) "with respect to a case or proceeding under [the Bankruptcy Code]." 11 U.S.C. §§ 101(4A), (12A). Section 528 generally requires debt relief agencies to disclose on its advertisements of bankruptcy assistance services directed to the general public that their services do in fact relate to bankruptcy and that they assist people in filing for bankruptcy. 11 U.S.C. § 528. As in *Zauderer*, the plaintiffs' "constitutionally protected interest in not providing [such] factual information in [their] advertising is minimal." 471 U.S. at 650. Further, the disclosure requirements are reasonably and rationally related to the government's interest in preventing the deception of consumer debtors, as the disclosure requirements are directed precisely at the problem targeted by Congress: ensuring that persons who advertise bankruptcy-related services to the general public make clear that their services do in fact involve filing for bankruptcy.[11]

Section 528 requires debt relief agencies to disclose: "'We are a debt relief agency. We help people file for bankruptcy relief under the Bankruptcy Code.' or a substantially similar statement," in all of their bankruptcy-

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[11] Without ruling on the issue, we note that at least one lower court has held that § 528's disclosure requirements are constitutionally valid even under the stricter intermediate scrutiny analysis, as the government's interest in protecting consumer debtors from misleading advertising is substantial, the disclosure requirements placed on bankruptcy attorneys directly advances the government's asserted interest, and the disclosure requirements are narrowly drawn to serve the government's interest. *See Olsen*, 350 B.R. at 920 (concluding that § 528 "passes constitutional muster" under either rational basis review or intermediate scrutiny review).

related advertising materials directed to the general public. 11 U.S.C. §§ 528(a)(4), (b)(2). The requirement does not prevent those attorneys meeting the definition of debt relief agencies "from conveying information to the public; it . . . only require[s] them to provide somewhat more information than they might otherwise be inclined to present." *Zauderer*, 471 U.S. at 650. Moreover, if any of these attorneys are concerned that the required disclosures will confuse the public, we note that nothing in the Code prevents them from identifying themselves in their advertisements as both attorneys and debt relief agencies. *Olsen*, 350 B.R. at 920. Simply put, attorneys that provide bankruptcy assistance to assisted persons are debt relief agencies under the Code, and the disclosure requirements of § 528 only require those attorneys to disclose factually correct statements on their advertising.[12] This does not violate the

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[12] We recognize that the broad definitions of debt relief agency, bankruptcy assistance, and assisted persons, might result in certain attorneys meeting the definition of debt relief agencies even though they do not represent debtors in bankruptcy nor help people file for bankruptcy relief under the Code. Nevertheless, these attorneys are still subjected to the disclosure requirements of § 528(a)(4) when they advertise "bankruptcy assistance services or . . . the benefits of bankruptcy directed to the general public," 11 U.S.C. § 528(a)(3), (4), or when they advertise to the general public that they "provide[] assistance with respect to credit defaults, mortgage foreclosures, eviction proceedings, excessive debt, debt collection pressure, or inability to pay any consumer debt." *Id.* at § 528(b)(2). But because § 528 permits a "substantially similar" disclosure to the one suggested by the Code, these attorneys can and should tailor their advertisement disclosure statements to factually represent the "bankruptcy assistance" they provide. These tailored disclosures will meet the requirements of § 528(a)(4) and (b)(2) as long as they are "substantially similar" to the suggested disclosure, a decision which will require a case-by-case determination. *See Olsen*, 350 B.R. at 919-20 (dismissing plaintiffs' claim that § 528 was uncon-

First Amendment. *Id.*; *see also In re Robinson*, 368 B.R. at 500-502 (finding that debtor's counsel was a debt relief agency subject to the strictures of § 528, and that § 528(a)(1)'s requirement for a written contract is constitutional); *In re Norman*, 2006 WL 3053309 at *4 (finding that debtor's counsel qualified as a debt relief agency and thus must comply with the requirements of § 528(a)(1)).

The challenged sections of § 528 only require debt relief agencies to include a disclosure on certain advertisements. Although less intrusive means may be conceivable to prevent deceptive advertising, § 528's disclosure requirements are reasonably related to the government's interest in protecting consumer debtors from deceptive advertising, and thus the section passes constitutional muster.

III. *Conclusion*

In sum, attorneys who provide bankruptcy assistance to assisted persons are debt relief agencies under the Bankruptcy Code, and § 526(a)(4) is unconstitutional as applied to these attorneys, but §§ 528(a)(4) and (b)(2) are constitutional. Accordingly, we affirm in part and reverse in part.

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stitutional, rejecting argument that attorney who met definition of debt relief agency but did not represent bankruptcy debtors was precluded from § 528's disclosure requirements because § 528 permits a "substantially similar" disclosure, which could be tailored to disclose that attorney advised clients about bankruptcy assistance matters but did not represent people in bankruptcy or file bankruptcy petitions, and stating that whether disclosure was "substantially similar" would require case-by-case determination).

COLLOTON, Circuit Judge, concurring in part and dissenting in part.

I concur in all but Part II.B of the opinion of the court. I disagree, however, with the court's holding that 11 U.S.C. § 526(a)(4) is unconstitutionally overbroad in violation of the First Amendment, and I would therefore reverse the district court's decision declaring this statutory provision unconstitutional.

Milavetz, Gallop, & Milavetz, P.A., mounts a facial attack on § 526(a)(4), arguing that the section's potential application to attorneys in hypothetical situations requires that the statute be declared impermissibly overbroad and unconstitutional. This case involves a facial challenge in the First Amendment context, "under which a law may be overturned as impermissibly overbroad because a substantial number of its applications are unconstitutional, judged in relation to the statute's plainly legitimate sweep." *Wash. State Grange v. Wash. State Republican Party*, 128 S. Ct. 1184, 1190 n.6 (2008). This "overbreadth doctrine," however, is "strong medicine that is used sparingly and only as a last resort." *New York State Club Ass'n, Inc. v. City of New York*, 487 U.S. 1, 14 (1988) (internal quotations omitted). It should be applied only when there is "a realistic danger that the statute itself will significantly compromise recognized First Amendment protections of parties not before the Court." *City Council of Los Angeles v. Taxpayers for Vincent*, 466 U.S. 789, 801 (1984). The Supreme Court recently emphasized that it has "vigorously enforced the requirement that a statute's overbreadth be *substantial*, not only in an absolute sense, but also relative to the stat-

ute's plainly legitimate sweep." *United States v. Williams*, 128 S. Ct. 1830, 1838 (2008).[13]

To resolve the constitutional challenge brought by Milavetz, we must first construe the disputed statute. When presented with a constitutional challenge to an Act of Congress, we have not only the power, but the duty, to adopt a narrowing construction that will avoid constitutional difficulties whenever possible. *Boos v. Barry*, 485 U.S. 312, 330-31 (1988). In *Boos*, for example, the Court considered a provision of federal legislation that made it unlawful "to congregate within 500 feet of any [embassy, legation, or consulate] and refuse to disperse after having been ordered so to do by the police." *Id.* at 329 (internal quotation omitted). The Court observed that "*[s]tanding alone*, this text is problematic because it applies to *any* congregation within 500 feet of an embassy for *any* reason." *Id.* at 330 (first emphasis

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[13] The district court purported to consider only an "as-applied" challenge to § 526(a)(4), rather than an overbreadth challenge, and ultimately declared the section "unconstitutional as applied to attorneys." *Milavetz, Gallop & Milavetz, P.A. v. United States*, 355 B.R. 758, 766 n.4, 769 (D. Minn. 2006). The majority correctly recognizes that the district court's approach is really an overbreadth analysis, and considers the statute under that framework. *See ante*, at 9 & n.7, 11, 13 & n.10. The "as applied" method of analysis, by contrast, considers the statute's application to a "particular claimant" based on "harm caused to the litigating party." *Turchick v. United States*, 561 F.2d 719, 721 n.3 (8th Cir. 1977). "The 'as applied' method vindicates a claimant whose conduct is within the First Amendment but invalidates the challenged statute *only to the extent of the impermissible application*." *Id.* (emphasis added). The district court and the majority have declared § 526(a)(4) unconstitutional in *all* of its applications to *all* attorneys, and the supporting reasoning is thus consistent with "facial overbreadth analysis." *Id.* (punctuation omitted).

added). Nonetheless, citing the "duty to avoid constitutional difficulties by [adopting a narrowing construction] if such a construction is fairly possible," the Court construed the statute narrowly to permit the dispersal of only congregations that are directed at an embassy, and to allow dispersal "only when the police reasonably believe that a threat to the security or peace of the embassy is present." *Id.* at 330-31 (internal quotation omitted). Similarly, in *United States v. X-Citement Video, Inc.*, 513 U.S. 64 (1994), the Court emphasized that "it is incumbent upon" a federal court to read a statute to eliminate constitutional doubts, "so long as such a reading is not plainly contrary to the intent of Congress." *Id.* at 78.

The challenged provision in this case provides in part that "[a] debt relief agency shall not . . . advise an assisted person or prospective assisted person to incur more debt in contemplation of such person filing a case under this title." 11 U.S.C. § 526(a)(4). Milavetz argues that according to this provision, a debt relief agency may not advise a client to incur *any* debt for *any* purpose when the client is contemplating the filing of a petition for bankruptcy. As such, Milavetz contends that an attorney could be sanctioned for "fulfilling his duty to his client to give legal and appropriate advice not otherwise prohibited by the Bankruptcy Code." (Brief of Appellee 30). Even under Milavetz's broad construction of the statute, a facial challenge resting on a "few hypothetical situations," *ante*, at [14a], is unlikely to justify invalidating a statute in *all* of its applications, because "the mere fact that one can conceive of some impermissible applications of a statute is not sufficient to render it susceptible to an overbreadth challenge." *Vincent*, 466 U.S. at 800.

It is unnecessary to resolve whether § 526(a)(4) is impermissibly overbroad when given its broadest reading, however, because the government suggests an acceptable narrowing construction of the statute that would avoid most constitutional difficulties. The government contends that "in contemplation of" filing for bankruptcy is a term of art that denotes an action taken with the intent to abuse the protections of bankruptcy laws. Under this view, the statute should be construed to prohibit only advice that a client engage in conduct for the purpose of manipulating the bankruptcy system.

The text, structure, and legislative history of § 526(a)(4) provide adequate support for a narrowing construction. Particularly given the latitude of federal courts to narrow a text to avoid constitutional difficulties, *see Boos*, 485 U.S. at 330-31, the words "in contemplation of . . . filing a case" need not create impermissible overbreadth. Rather, we may recognize that the phrase "in contemplation of" has been construed in the bankruptcy context to mean actions taken with the intent to abuse the protections of the bankruptcy system. Black's Law Dictionary reflects this understanding, defining "contemplation of bankruptcy" as "the thought of declaring bankruptcy because of the inability to continue current financial operations, *often coupled with action designed to thwart the distribution of assets in a bankruptcy proceeding*." *Black's Law Dictionary* 336 (8th ed. 2004) (emphasis added). American and English authorities construing the bankruptcy laws also support the proposition that the words "in contemplation of" may be understood to require an intent to abuse the bankruptcy laws. *In re Pearce*, 19 F. Cas. 50, 53 (D. Vt. 1843) (No. 10873) (concluding that an act was done "in contemplation of bankruptcy" if it was done "in anticipa-

tion of breaking or failing in his business, of committing an act of bankruptcy, or of being declared bankrupt at his own instance, on the ground of inability to pay his debts, *and intending to defeat the general distribution of effects, which takes place under a proceeding in bankruptcy*.") (emphasis added); *Morgan v. Brundrett*, 5 Barn. & Ad. 289, 296, 110 Eng. Rep. 798, 801 (K.B. 1833) (Parke, J.) (interpreting "in contemplation of bankruptcy" to mean that "the payment or delivery must be with intent to defeat the general distribution of effects which takes place under a commission of bankruptcy."); *Fidgeon v. Sharpe*, 5 Taunt. 539, 545-46, 128 Eng. Rep. 800, 802-03 (C.P. 1814) (Gibbs, C.J.) (An act made in contemplation of bankruptcy "must be intended in fraud of the bankrupt laws."); *cf. Buckingham v. McLean*, 54 U.S. 151, 167 (1851) ("To give to these words, contemplation of bankruptcy, a broad scope, and somewhat loose meaning, would not be in furtherance of the general purpose with which they were introduced."); *id.* at 169 (relying on English bankruptcy decisions as instructive authority on meaning of the former Bankrupt Act). Our duty to construe the statute to avoid constitutional difficulties counsels that we should look to these authorities for a plausible alternative to the broad construction urged by Milavetz.

The structure of § 526(a)(4) also supports a narrowing construction. The prohibitions of this statute can be enforced only through the civil remedies provided in § 526(c). An attorney who violates § 526(a)(4) can be sanctioned in just three situations: if a debtor sues the attorney for the available remedies—remittal of fees, actual damages, and reasonable attorney's fees and costs; if a state attorney general sues for a resident's actual damages; or if a court finds that the attorney in-

tentionally violated § 526(a)(4), and chooses to "impose an appropriate civil penalty." 11 U.S.C. § 526(c). The remedies for a violation thus emphasize actual damages. But legal and appropriate advice that would be protected by the First Amendment, yet prohibited by a broad reading of § 526(a)(4), should cause no damage at all. If an attorney advises a debtor to refinance his home to lower mortgage payments, or to purchase a reliable car to enable him to pay off his debts, *see ante*, at [13a-14a], then a debtor following that advice would suffer no damage. There is no reason to believe that a client could recover the remittal of attorney's fees or that a court would find a civil penalty "appropriate" as a remedy for legal advice that *benefits* both the debtor *and* his creditors. Rather, a debtor is likely to have a remedy against an attorney only in the case of an abusive bankruptcy petition, where the debtor may suffer damages if the petition is dismissed as abusive, *see* 11 U.S.C. § 707(b)(1), and where an attorney general or a court has reason to seek or impose sanctions against an abusive debt relief agency. The remedial focus of § 526 thus bolsters the proposition that § 526(a)(4) was aimed only at advice given by a debt relief agency that is designed to abuse the bankruptcy process.

The incorporation of an abusive purpose requirement into § 526(a)(4) is also consonant with the evident purpose of the statute. The government argues, and Milavetz acknowledges, that a principal goal of Congress in passing the statute was to "preclude debtors from taking on more debt knowing that it will later be discharged during bankruptcy." (Brief of Appellee 34). A narrowing construction of § 526(a)(4) is in accord with expressions of desire in the legislative history to address "misconduct by attorneys and other professionals," and

"abusive practices by consumer debtors who, for example, knowingly load up with credit card purchases or recklessly obtain cash advances and then file for bankruptcy relief." H.R. Rep. No. 109-31, pt. 1, at 5, 15 (2005) (internal quotation omitted), *as reprinted in* 2005 U.S.C.C.A.N. 88, 92, 101. Milavetz itself argues that a broad construction of § 526(a)(4) "goes beyond" this congressional purpose, and is "absurd," because it would prevent an attorney from advising a client to take actions that might avoid the need for filing bankruptcy altogether. (Brief of Appellee 34). Given our duty to construe an Act of Congress in a manner that eliminates constitutional doubts, there is no need to adopt a construction that one party says is absurd, that the other party says was unintended by Congress, and that sweeps in salutary legal activity that would be a strange target for a statute entitled the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005.

For these reasons, I would reverse the district court's decision declaring unconstitutional the provision codified at 11 U.S.C. § 526(a)(4).

APPENDIX B

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MINNESOTA

No. 05-CV-2626 (JMR/FLN)

MILAVETZ, GALLOP & MILAVETZ P.A.,
ROBERT J. MILAVETZ, BARBARA N.
NEVIN, JOHN DOE, AND MARY DOE

v.

UNITED STATES OF AMERICA

[Dec. 7, 2006]

ORDER

Plaintiffs ask the Court to declare portions of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA") unconstitutional. Defendant, United States of America ("the government") moves to dismiss for failure to state a claim upon which relief can be granted. Defendant's motion is denied; the debt relief agency sections of BAPCPA unconstitutionally impinge on attorneys' First Amendment rights.

I. *Background*

On April 20, 2005, BAPCPA was signed into law, and became effective on October 17, 2005. Among its terms, BAPCPA defines a new category of bankruptcy service

provider called a "debt relief agency." 11 U.S.C. § 101(12A) (2005). The law forbids debt relief agencies from doing certain things, and requires them to do others. This lawsuit challenges a number of these provisions.

BAPCPA bars a debt relief agency from advising a client "to incur more debt in contemplation" of a bankruptcy filing. 11 U.S.C. § 526(a)(4). BAPCPA further requires that debt relief agencies' advertisements declare: "We are a debt relief agency. We help people file for bankruptcy relief under the Bankruptcy Code," or a substantially similar statement. 11 U.S.C. § 528(a)(4), (b)(2).

Plaintiffs are bankruptcy attorneys, their law firm, and two unnamed members of the public. Their attack on the statute is based on the First Amendment to the United States Constitution. They allege BAPCPA's debt relief agency provisions are unconstitutional as applied to them. They, initially, claim BAPCPA's regulation of attorneys' advice violates the First Amendment. Next, they claim BAPCPA's advertising requirements contravene the First Amendment.[1] Ultimately, they contend Congress did not intend the debt relief agency requirements to apply to attorneys. The government moves to dismiss plaintiffs' First Amendment claims pursuant to Rule 12(b)(6) of the Federal Rules of

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[1] In a footnote, the government asks whether plaintiffs have standing to bring these claims, since they are in no danger of immediate harm. The government's query is misplaced; plaintiffs claim BAPCPA's debt relief agency sections both stifle and compel their speech, in violation of the U.S. Constitution. First Amendment jurisprudence makes clear that a claim that a law has a potential chilling effect on speech establishes standing. *Virginia v. Am. Booksellers Ass'n*, 484 U.S. 383, 392 (1988).

Civil Procedure ("Fed. R. Civ. P."). The government's motion is denied.

II. *Discussion*

A. *Motion to Dismiss*

A Rule 12(b)(6) motion to dismiss must be denied unless it appears beyond doubt that the plaintiff can prove no set of facts which would entitle him to relief. *See Murphy v. Lancaster*, 960 F.2d 746, 748 (8th Cir. 1992). In considering such a motion, the motion, the court construes the complaint, and all of its reasonable inferences, most favorably to plaintiff. *Westcott v. City of Omaha*, 901 F.2d 1486, 1488 (8th Cir. 1990).

B. *Unnamed Plaintiffs*

The complaint purports to set out the claims of two unnamed parties: John Doe and Mary Doe. The government denies there is any legal basis for anonymous plaintiffs in this lawsuit. Indeed, Fed. R. Civ. P. 10(a) is explicit: a complaint "shall include the names of all the parties." Notwithstanding Rule 10(a), plaintiffs claim their case falls within a limited realm of cases in which other interests—i.e., privacy and concern about embarrassment—outweigh the public's interest in open disclosure. Plaintiffs are incorrect.

There is a strong presumption against allowing parties to use a pseudonym. *See*, *e.g.*, *Doe v. Blue Cross & Blue Shield United of Wisconsin*, 112 F.3d 869, 872 (7th Cir. 1997); *Doe v. Frank*, 951 F.2d 320, 323-24 (11th Cir. 1992); *Southern Methodist Univ. Ass'n of Women Law Students v. Wynne & Jaffe*, 599 F.2d 707, 712-13 (5th Cir. 1979). The reasons are obvious and compelling: identification of litigants is recognized as important in a public proceeding. *See Blue Cross,* 112 F.3d at 872. A

party who invokes the judicial powers of the United States invites public scrutiny. "The people have a right to know who is using their courts." *Id.*

Limited exceptions to the party-publicity rule exist. Case law has recognized three factors which, if present, might support anonymity. They have been found when "(1) plaintiffs seeking anonymity were suing to challenge governmental activity; (2) prosecution of the suit compelled plaintiffs to disclose information 'of the utmost intimacy;' and (3) plaintiffs were compelled to admit their intention to engage in illegal conduct, thereby risking criminal prosecution." *Doe v. Stegall,* 653 F.2d 180, 185 (5th Cir. 1981) (quoting *Wynne & Jaffe,* 599 F.2d at 712-13). Although the listed factors are not exhaustive, they provide valuable guidance.

While the first factor is present here, the third is not. Plaintiffs argue their "wish to obtain legal advice from [plaintiff] attorneys . . . about prebankruptcy planning and filing bankruptcy" (1st Am. Compl. ¶ 10) suffices for the second factor. According to the Doe parties, the "financial situations of private citizens [are] clearly a matter of utmost intimacy, especially when they feel the need to seek advice about bankruptcy." (Pl.'s Brief 23).

Certainly, those facing bankruptcy are in financial straits; but that does not resolve the issue. Plaintiffs offer no case law to support their claim that merely seeking bankruptcy or financial advice is the kind of intimate personal information typically protected by the court. Bankruptcy is a public proceeding; the Doe plaintiffs are disclosing no medical information or deeply personal questions surrounding human reproduction or matters of that nature.

The Court finds the bankruptcy-seeking plaintiffs' interest in their financial privacy is outweighed by the public's stronger interest in maintaining open trials. Accordingly, the Doe plaintiffs shall amend their complaint to include their real names within 10 days of the date of this Order, or their claims will be dismissed.

C. *Constitutional Challenges*

1. *Attorney Advice: Section 526(a)(4)*

Plaintiffs claim BAPCPA's § 526(a)(4), titled "[r]estrictions on debt relief agencies," has "a chilling effect upon lawyers," in violation of their First Amendment rights. (1st Am. Compl. ¶ 39.) Section [526(a)(4)] states:

> A debt relief agency shall not . . . advise an assisted person or prospective assisted person to incur more debt in contemplation of such person filing a case under this title or to pay an attorney or bankruptcy petition preparer fee or charge for services performed as part of preparing for or representing a debtor in a case under this title.

11 U.S.C. § 526(a)(4).

The parties disagree as to the standard of review applied to the constitutional analysis of this section. Plaintiffs claim the standard of review for a restriction on lawful and truthful attorney advice is strict scrutiny. The government replies that § 526(a)(4)'s restrictions are merely a species of ethical regulation, invoking the more lenient standard outlined in *Gentile v. State Bar of Nev.*, 501 U.S. 1030 (1991). Under *Gentile*, the Court would balance the First Amendment rights of attorneys against the government's legitimate interest in regulating the activity in question, and then determine whether

the regulations impose "only narrow and necessary limitations on lawyers' speech." *Id.* at 1075. The Court rejects the government's proposed standard.

The "ethical rule" of which the government speaks appears to exist only in its pleadings; the statute discloses no quasi-religious or ethical principle. The government "cannot foreclose the exercise of constitutional rights by mere labels." See *NAACP v. Button*, 371 U.S. 415, 429 (1963). While the section is certainly a rule, nothing in § 526 alludes to ethics. The section is titled "Restrictions on debt relief agencies," and plainly prohibits certain acts. The advice the Section forecloses may be potentially advantageous to creditors, but this does not make it equivalent to ethics either in logic or in law.

When fairly viewed, the Court finds § 526(a)(4) to be a content-based regulation of attorney speech—it restricts attorneys from giving particular information and advice to their clients. Attorneys are forbidden to advise their clients concerning an entire subject—incurring more debt in contemplation of filing for bankruptcy. This is a plain regulation of speech. Beyond this, the forbidden speech trenches on two other important areas of concern.

First, the lawyer's advice to take on certain additional financial obligations in contemplation of bankruptcy may well be in the client's best interest.[2] A law

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[2] For example, it may be in the client's interest to obtain or refinance a home mortgage prior to filing bankruptcy, because one who has declared bankruptcy may well be denied a lower interest rate after the filing. If the client gets a lower rate mortgage, the refinanced mortgage may have smaller payments which could forestall, or even prevent the bankruptcy in the first place. Similar arguments can be made concern-

yer's highest duty is to the client, and the statute's forbidden advice may indeed be helpful to the client. Secondly, this statute does not restrict false statements—arguably implicating some "ethical" precept—it forbids truthful and possibly efficacious advice. If this is the government's view of legal ethics, it is a form of ethics unfamiliar to the Court.

As the United States Supreme Court has explained, "[g]overnment action that stifles speech on account of its message, or that requires the utterance of a particular message favored by the Government, contravenes th[e] essential [First Amendment] right[s]" of private citizens. *Turner Broad. Sys. v. FCC*, 512 U.S. 622, 641 (1994). For this reason, "governmental control over the content of messages expressed by private individuals" is unconstitutional except in narrow circumstances. *Id.*

As the Court finds § 526(a)(4) to be a content-based restriction on protected speech, it is subject to strict scrutiny. *Id.* Such a restriction can only survive if (1) narrowly tailored to achieve (2) a compelling state interest. *United States v. Playboy Entm't Group, Inc.*, 529 U.S. 803, 813 (2000). The Court finds the government has failed to meet its burden on the first point—§ 526(a)(4) is not narrowly tailored.

The government suggests § 526(a)(4) advances two compelling interests. First, it asserts an interest in protecting creditors. According to the government, § 526(a)(4)'s prohibition discourages prospective bankrupts from accumulating debt in a particular fashion,

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ing automobile loans, or incases where a client needs to co-sign undischargeable student loans. *See Hersh v. United States*, 347 B.R. 19, 24 (N.D. Tex. 2006).

thus deterring debtors from "gaming" the means test by improperly enlarging pre-existing debt, thereby diluting the assets of the bankruptcy estate otherwise available to creditors. Second, it claims § 526(a)(4) protects debtors from attorneys who might lead them to abusive practices which could ultimately result in a denial of discharge of debts under § 523(a)(2)(c). Finally, the government argues that § 523(a)(2)(c) protects the integrity of the bankruptcy system.

Even if the Court assumes the asserted interests are compelling, the restriction is not narrowly-tailored. The government claims the section is narrowly tailored because "it does not limit more speech than is necessary to accomplish this purpose." (Def.'s Brief 25.) The government is mistaken.

Attorneys have a First Amendment right—let alone an established professional ethical duty—to advise and zealously represent their clients. *Legal Serv. Corp. v. Velazquez*, 531 U.S. 533, 548-549 (2001). Section 526(a)(4) bars an attorney from advising a client to incur any kind of debt, including legitimate debt, in contemplation of bankruptcy. The lawyer has no duty to assist creditors—who are scarcely without their own resources, and may indeed have contributed to the potential-bankrupt's straits by making credit easy to obtain. The attorney's only duty is to the client, and to the law.

Incurring debt on the eve of bankruptcy can scarcely be considered malum in se. To the contrary, for some individuals incurring further obligations, even those which must be adjusted or set aside in the bankruptcy, may be financially prudent. "For example, there may be instances where it is advisable for a client to obtain a mortgage, to refinance an existing mortgage to obtain a

lower interest rate, or to buy a new car" before filing for bankruptcy. Erwin Chemerinksy, *Constitutional Issues Posed in the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005*, 79 AM. BANKR. L.J. 571, 578 (2005). If a client intends to reaffirm the debt after filing bankruptcy, there is no prejudice to the bankruptcy process. BAPCPA's § 526(a)(4) limitation on speech extends beyond any need to protect the bankruptcy process.[3] A lawyer who represents consumers contemplating bankruptcy bears the duty of zealous representation. Conversely, Congress does not have the power "to effect [a] serious and fundamental restriction on advocacy of attorneys." *See Velazquez*, 531 U.S. at 534. If upheld, this law would prevent lawyers from adequately and competently advising their clients. As such, it unconstitutionally impinges on expressions protected by the First Amendment of the Constitution.[4]

2. *Advertising: Section 528(a)(4), (b)(2)*

Plaintiffs challenge BAPCPA's advertising disclosure requirements, claiming § 528 violates their First Amendment rights. This section requires a denominated class, termed "debt relief agencies," to include

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[3] Even under the more lenient *Gentile* standard, § 526(a)(4) fails. *Gentile's* balancing test allows the law to impose "only narrow and necessary limitations on lawyers' speech." 501 U.S. 1030, 1075 (1991); *see also Hersh*, 347 B.R. at 24-25; *Olsen v. Gonzales*, 350 B.R. 906, 916 (D. Or. 2006); *Zelotes v. Martini*, 2006 WL 3231423 *4 (D. Conn. 2006).

[4] Plaintiffs further claim § 526(a)(4) is unconstitutionally vague and overbroad. The United States Supreme Court has expressed a strong preference for as-applied, as opposed to facial, challenges to the constitutionality of federal laws. *Sabri v. United States*, 541 U.S. 600 (2004). The Court finds this law unconstitutional as applied, and declines to expand its inquiry and consider whether it is also vague and overbroad.

particular, or substantially similar, language in their advertisements. Congress has prescribed that such agencies declare: "We are a debt relief agency. We help people file for bankruptcy relief under the Bankruptcy Code." 11 U.S.C. § 528(a)(4), (b)(2).

Here again, the Court must determine the appropriate standard of review. The choice turns on whether the statute regulates deceptive or truthful advertising. Statutes regulating deceptive commercial speech need only withstand rational basis review. *Zauderer v. Office of Disciplinary Counsel of the S. Ct. of Ohio*, 471 U.S. 626, 651-52 (1985). But restrictions on non-deceptive advertising must employ means that directly advance a substantial government interest. *Cent. Hudson Gas & Elec. Corp. v. Public Service Comm'n of New York*, 447 U.S. 557, 566 (1980).

The government argues that BAPCPA regulates deceptive advertising, citing evidence adduced before Congress showing "some bankruptcy lawyers did not mention in their advertisements that their ability to make 'debts disappear' derived from the use of the bankruptcy process." (Def.'s Brief 28.) Plaintiffs respond that, when Congress imposed these requirements on all advertisements of bankruptcy assistance, it mandated a blunderbuss which strikes truthful, as well as false or deceptive advertising. The Court agrees.

With very few exceptions, any party advertising debt relief services must include § 528's statutory statement. The present lawyer-plaintiffs advertise themselves as bankruptcy attorneys in newspapers, telephone directories, television, radio, and the internet. There is no evidence, however, suggesting their bankruptcy assistance advertisements are deceptive in any regard. Even as-

suming some debt relief agencies advertise an ability to make "debts disappear," there is no showing such a statement is deceptive. Under these circumstances, the Court finds it appropriate to analyze this question by applying intermediate scrutiny. *See Zauderer*, 471 U.S. at 641.

The government may only regulate truthful bankruptcy assistance advertisements if: (1) the regulation directly advances (2) a substantial government interest, and is (3) "narrowly drawn." *Cent. Hudson*, 447 U.S. at 566; *Zauderer*, 471 U.S. at 641. The Court finds that BAPCPA's § 528 advertising requirements fail to directly advance the government's purported substantial interest and are not narrowly drawn.

The government contends advertising, absent the compulsory statements, may mislead the lay community into thinking debts can be erased without payment or filing for bankruptcy. The government claims §§ 528(a)(4) and (b)(2) protect against consumer deception"by alerting [them] that a lawyer may use bankruptcy as a means to help them." (Def.'s Brief 28.) Setting aside the implausibility of anyone actually believing in a magic wand capable of making debt go away, it is most unlikely that the insertion of the statement "We are a debt relief agency, we help people file for bankruptcy relief under the Bankruptcy Code" prevents consumer deception; it may well increase it.

The term "debt relief agency" is simply a legislative contrivance. The public is more likely to be confused by an advertisement containing this Congressionally-invented term than one which advertises the services of a bankruptcy attorney.

Beyond this, however, the term "debt relief agency" is almost all-encompassing. It instantly swallows all persons who engage in"bankruptcy assistance," attorneys and non-attorneys alike. Congress's merger of both attorneys and non-attorneys is, itself, likely to confuse the public. There are many non-trivial differences between an attorney's services to his or her clients, and services non-lawyers are permitted to offer. Unlike those who only restructure debt, or perhaps provide bankruptcy forms, attorneys give legal advice and actually represent debtors in bankruptcy proceedings. The requirement that parties so dissimilarly-placed must use the same mandated disclosure statement is likely to cause consumer confusion. In this respect, § 528 fails to directly advance the government's stated interest in clarifying bankruptcy service advertisements.[5]

Section 528's advertising requirement is also not narrowly drawn. The narrowly drawn standard is "something short of a least-restrictive means standard." *Bd. of Tr. of the State Univ. of New York v. Fox*, 492 U.S. 469, 477 (1989). A narrowly drawn regulation designed to prevent deception "may be no broader than reasonably necessary to prevent the 'perceived evil.'" *In re R.M.J.*, 455 U.S. 191, 203 (1992). Section 528's language not only regulates misleading advertisements—those

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[5] At oral argument, the government's counsel acknowledged areas where the statute is vague. As an example, it appears that the quantum of bankruptcy advice a lawyer offers may require some attorneys to publish the mandated language and others not. The statute makes no distinction between a lawyer who only occasionally has a client facing bankruptcy and those who do so regularly. Quaere: does a 500-person law firm having a single lawyer who regularly does bankruptcy work have to put the disclaimer on every piece of the firm's advertising?

suggesting debts can disappear—it binds all who advertise bankruptcy services. This sweeping regulation goes beyond whatever problem it was designed to address. It broadly regulates absolutely truthful advertisements throughout an entire field of legal practice. The government has failed to show that this restriction on attorneys' commercial speech is justified. As applied to attorneys, this section of BAPCPA fails constitutional scrutiny. Thus, the government cannot prevail on its motion to dismiss.

D. *The "Debt Relief Agency" Definition*

Plaintiffs ask the Court to find attorneys beyond the scope of a BAPCPA "debt relief agency." According to the statute,

> [t]he term 'debt relief agency' means any person who provides any bankruptcy assistance to an assisted person in return for the payment of money or other valuable consideration, or who is a bankruptcy petition preparer under section 110.

11 U.S.C. § 101 (12A). This section, of course, makes no direct reference to either "attorney" or "lawyer." It does include the term "bankruptcy petition preparer," which, by definition, expressly excludes attorneys and their staff. *See* 11 U.S.C. § 110(a)(1) (2006). According to plaintiffs, the omission of any reference to attorneys or lawyers, while including a term which excludes attorneys, shows Congress must have intended to exclude attorneys from the "debt relief agency" definition. They also claim it would be absurd for attorneys to provide a statement telling their clients they have a right to an attorney, and that only attorneys can provide legal ad-

vice as required for debt relief agencies under 11 U.S.C. § 527(b).[6]

The government claims the statute includes attorneys because legal representation is included in "bankruptcy assistance," statutorily defined as:

> any goods or services sold or otherwise provided to an assisted person with the express or implied purpose of providing information, advice, counsel, document preparation, or filing, or attendance at a creditors' meeting or appearing in a case or proceeding on behalf of another or providing legal representation with respect to a case or proceeding under this title.

11 U.S.C. § 101(4A).

At first glance, this language might include attorneys. But the glance is deceiving: the statute contains a rule of construction for the term "debt relief agency." The statute provides that nothing in §§ 526, 527, and 528 —those sections imposing requirements on debt relief agencies—shall:

> be deemed to limit or curtail the authority or ability . . . of a State or subdivision or instrumentality thereof, to determine and enforce qualifications for the practice of law under the laws of that State.

11 U.S.C. § 526(d)(2)(A).

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[6] At least one court has found these arguments persuasive, holding that debtor attorneys are not "debt relief agencies." *In re Attorneys at Law and Debt Relief Agencies*, 332 B.R. 66, 69 (Bankr. S.D. Ga. 2005).

If lawyers are placed within the ambit of § 101 (4A), the placement conflicts with § 526(d)(2)(A). The conflict would exist because states would be deprived of their ability "to determine and enforce qualifications for the practice of law." If BAPCPA's debt relief agency sections apply to attorneys, it means Congress has taken upon itself the authority to determine the advice attorneys can give their clients and what attorney advertisements must say, thereby infringing on the state's traditional role of regulating attorneys. See *Leis v. Flynt*, 439 U.S. 438, 442 (1979) ("Since the founding of the Republic, the licensing and regulation of lawyers has been left exclusively to the States.")

This view is supported by the doctrine of constitutional avoidance. This doctrine counsels that, in construing a statute for ambiguity, the Court must opt for a construction which avoids grave constitutional questions. *Edward J. DeBartolo Corp. v. Florida Gulf Coast Bldg. & Constr. Trades Council*, 485 U.S. 568,575 (1988). The Court perceives a clear ambiguity in this statute—on one hand it appears to regulate a lawyer's practice; on the other, such regulation is specifically reserved to the states. As outlined above, these sections would be unconstitutional if applied to attorneys. For these reasons, the Court finds §§ 526, 527 and 528 do not apply to attorneys.

VI. *Conclusion*

The Court finds BAPCPA sections 526(a)(4) and 528(a)(4), (b)(2) are unconstitutional as applied to attorneys. Moreover, the Court finds the debt relief agency provisions of BAPCPA inapplicable to attorneys. There-

fore, the government's motion to dismiss [Docket No. 13] is denied.

IT IS SO ORDERED.

Dated: December 7th, 2006

/s/ JAMES M. ROSENBAUM
JAMES M. ROSENBAUM
United States Chief District Judge

APPENDIX C

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MINNESOTA

Case Number: 05-cv-2626 JMR/FLN

MILAVETZ, GALLOP & MILAVETZ P.A.,
ROBERT J. MILAVETZ, BARBARA N. NEVIN,
JOHN DOE, AND MARY DOE

v.

UNITED STATES OF AMERICA

[Apr. 19, 2007]

JUDGMENT IN A CIVIL CASE

☐ Jury Verdict. This action came before the Court for a trial by jury. The issues have been tried and the jury has rendered its verdict.

☒ Decision by Court. This action came to trial or hearing before the Court. The issues have been tried or heard and a decision has been rendered.

IT IS ORDERED AND ADJUDGED THAT:

1. Plaintiffs' motion for summary judgment [Docket No. 37] is granted.
2. BAPCPA's Title 11 U.S.C. Sections 526(a)(4) and 528(a)(4) and (b)(2) are declared unconstitutional,

as applied to attorneys in the District of Minnesota.

3. The Court finds that attorneys in the District of Minnesota are excluded from the term "debt relief agency," as defined in 11 U.S.C. § 101(12A); as such, Minnesota attorneys are relieved of any duties relating to BAPCPA-defined debt relief agencies imposed by that statute.

April 19, 2007 RICHARD D. SLETTEN, CLERK
Date

BY:
/s/ KATIE THOMPSON
KATIE THOMPSON, Deputy Clerk

APPENDIX D

UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

No. 07-2405

MILAVETZ, GALLOP & MILAVETZ, P.A., ET AL.,
APPELLEES

v.

UNITED STATES, APPELLANT

COMMERCIAL LAW LEAGUE OF AMERICA,
AMICUS ON BEHALF OF APPELLEE

APPEAL FROM U.S. DISTRICT COURT FOR THE
DISTRICT OF MINNESOTA—MINNEAPOLIS
(0:05-cv-02626-JMR)

ORDER

The petition for rehearing en banc is denied. The petition for rehearing by the panel is also denied.

Judge Riley, Judge Colloton, Judge Gruender, Judge Benton and Judge Shepherd would grant the petition for rehearing en banc.

December 05, 2008

Order Entered at the Direction of the Court:
Clerk, U.S. Court of Appeals, Eighth Circuit.

____
/s/ Michael E. Gans

APPENDIX E

1. 11 U.S.C. 101 provides in pertinent part:

Definitions

In this title the following definitions shall apply:

* * * * *

(3) The term "assisted person" means any person whose debts consist primarily of consumer debts and the value of whose nonexempt property is less than $150,000.

(4) The term "attorney" means attorney, professional law association, corporation, or partnership, authorized under applicable law to practice law.

(4A) The term "bankruptcy assistance" means any goods or services sold or otherwise provided to an assisted person with the express or implied purpose of providing information, advice, counsel, document preparation, or filing, or attendance at a creditors' meeting or appearing in a case or proceeding on behalf of another or providing legal representation with respect to a case or proceeding under this title.

* * * * *

(12) The term "debt" means liability on a claim.

(12A) The term "debt relief agency" means any person who provides any bankruptcy assistance to an assisted person in return for the payment of money or other valuable consideration, or who is a bank-

ruptcy petition preparer under section 110, but does not include—

(A) any person who is an officer, director, employee, or agent of a person who provides such assistance or of the bankruptcy petition preparer;

(B) a nonprofit organization that is exempt from taxation under section 501(c)(3) of the Internal Revenue Code of 1986;

(C) a creditor of such assisted person, to the extent that the creditor is assisting such assisted person to restructure any debt owed by such assisted person to the creditor;

(D) a depository institution (as defined in section 3 of the Federal Deposit Insurance Act) or any Federal credit union or State credit union (as those terms are defined in section 101of the Federal Credit Union Act), or any affiliate or subsidiary of such depository institution or credit union; or

(E) an author, publisher, distributor, or seller of works subject to copyright protection under title 17, when acting in such capacity.

* * * * *

2. 11 U.S.C. 526 provides:

Restrictions on debt relief agencies

(a) A debt relief agency shall not—

(1) fail to perform any service that such agency informed an assisted person or prospective assisted

person it would provide in connection with a case or proceeding under this title;

(2) make any statement, or counsel or advise any assisted person or prospective assisted person to make a statement in a document filed in a case or proceeding under this title, that is untrue and misleading, or that upon the exercise of reasonable care, should have been known by such agency to be untrue or misleading;

(3) misrepresent to any assisted person or prospective assisted person, directly or indirectly, affirmatively or by material omission, with respect to—

(A) the services that such agency will provide to such person; or

(B) the benefits and risks that may result if such person becomes a debtor in a case under this title; or

(4) advise an assisted person or prospective assisted person to incur more debt in contemplation of such person filing a case under this title or to pay an attorney or bankruptcy petition preparer fee or charge for services performed as part of preparing for or representing a debtor in a case under this title.

(b) Any waiver by any assisted person of any protection or right provided under this section shall not be enforceable against the debtor by any Federal or State court or any other person, but may be enforced against a debt relief agency.

(c)(1) Any contract for bankruptcy assistance between a debt relief agency and an assisted person that does not comply with the material requirements of this

section, section 527, or section 528 shall be void and may not be enforced by any Federal or State court or by any other person, other than such assisted person.

(2) Any debt relief agency shall be liable to an assisted person in the amount of any fees or charges in connection with providing bankruptcy assistance to such person that such debt relief agency has received, for actual damages, and for reasonable attorneys' fees and costs if such agency is found, after notice and a hearing, to have—

(A) intentionally or negligently failed to comply with any provision of this section, section 527, or section 528 with respect to a case or proceeding under this title for such assisted person;

(B) provided bankruptcy assistance to an assisted person in a case or proceeding under this title that is dismissed or converted to a case under another chapter of this title because of such agency's intentional or negligent failure to file any required document including those specified in section 521; or

(C) intentionally or negligently disregarded the material requirements of this title or the Federal Rules of Bankruptcy Procedure applicable to such agency.

(3) In addition to such other remedies as are provided under State law, whenever the chief law enforcement officer of a State, or an official or agency designated by a State, has reason to believe that any person has violated or is violating this section, the State—

(A) may bring an action to enjoin such violation;

(B) may bring an action on behalf of its residents to recover the actual damages of assisted persons arising from such violation, including any liability under paragraph (2); and

(C) in the case of any successful action under subparagraph (A) or (B), shall be awarded the costs of the action and reasonable attorneys'fees as determined by the court.

(4) The district courts of the United States for districts located in the State shall have concurrent jurisdiction of any action under subparagraph (A) or (B) of paragraph (3).

(5) Notwithstanding any other provision of Federal law and in addition to any other remedy provided under Federal or State law, if the court, on its own motion or on the motion of the United States trustee or the debtor, finds that a person intentionally violated this section, or engaged in a clear and consistent pattern or practice of violating this section, the court may—

(A) enjoin the violation of such section; or

(B) impose an appropriate civil penalty against such person.

(d) No provision of this section, section 527, or section 528 shall—

(1) annul, alter, affect, or exempt any person subject to such sections from complying with any law of any State except to the extent that such law is inconsistent with those sections, and then only to the extent of the inconsistency; or

(2) be deemed to limit or curtail the authority or ability—

(A) of a State or subdivision or instrumentality thereof, to determine and enforce qualifications for the practice of law under the laws of that State; or

(B) of a Federal court to determine and enforce the qualifications for the practice of law before that court.

No.

In the Supreme Court of the United States

UNITED STATES OF AMERICA, PETITIONER

v.

MILAVETZ, GALLOP & MILAVETZ, P.A., ET AL.

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

ELENA KAGAN
Solicitor General
Counsel of Record
MICHAEL F. HERTZ
Acting Assistant Attorney General
MALCOLM L. STEWART
Deputy Solicitor General
WILLIAM M. JAY
Assistant to the Solicitor General
MARK B. STERN
MARK R. FREEMAN
Attorneys

Department of Justice
Washington, D.C. 20530-0001
(202) 514-2217

QUESTIONS PRESENTED

Section 526(a)(4) of Title 11 of the United States Code provides that bankruptcy professionals who qualify as "debt relief agencies" and who are hired by consumer debtors for bankruptcy services may not advise those debtors "to incur more debt in contemplation of" filing a bankruptcy petition. The questions presented are as follows:

1. Whether Section 526(a)(4) precludes only advice to incur more debt with a purpose to abuse the bankruptcy system.

2. Whether Section 526(a)(4), construed with due regard for the principle of constitutional avoidance, violates the First Amendment.

PARTIES TO THE PROCEEDINGS

Petitioner is the United States of America. Respondents, who were appellees in the court of appeals, are Milavetz, Gallop & Milavetz, P.A.; Robert J. Milavetz; Barbara N. Nevin; Ronald Richardson (captioned as John Doe); and Lynette Richardson (captioned as Mary Doe). The district court denied the Doe respondents leave to proceed pseudonymously.

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In the Supreme Court of the United States

No.

UNITED STATES OF AMERICA, PETITIONER

v.

MILAVETZ, GALLOP & MILAVETZ, P.A., ET AL.

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

The Solicitor General, on behalf of the United States of America, respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Eighth Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals (App., *infra*, 1a-28a) is reported at 541 F.3d 785. The opinion of the district court denying the government's motion to dismiss (App., *infra*, 29a-44a) is reported at 355 B.R. 758.

JURISDICTION

The judgment of the court of appeals was entered on September 4, 2008. A petition for rehearing was denied on December 5, 2008 (App., *infra*, 47a). On February 20, 2009, Justice Alito extended the time within which to file a petition for a writ of certiorari to and including

April 6, 2009. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The First Amendment to the United States Constitution provides in relevant part that "Congress shall make no law * * * abridging the freedom of speech." The pertinent statutory provisions are reprinted in an appendix to this petition. App., *infra*, 48a-53a.

STATEMENT

This case involves a facial First Amendment challenge to 11 U.S.C. 526(a)(4), a provision of the Bankruptcy Code that regulates paid bankruptcy advice. Congress has established certain minimum standards of professional conduct for bankruptcy attorneys, bankruptcy petition preparers, and other "debt relief agencies" that charge consumer debtors for bankruptcy assistance. Section 526(a)(4) provides, *inter alia*, that debt relief agencies may not advise clients to incur additional debt "in contemplation of" filing a bankruptcy petition. The district court declared Section 526(a)(4) facially invalid under the First Amendment. A divided panel of the court of appeals affirmed. Shortly thereafter, the Fifth Circuit upheld Section 526(a)(4) against a substantially similar challenge and endorsed the reasoning of the dissenting opinion in this case. *Hersh* v. *United States ex rel. Mukasey*, 553 F.3d 743 (2008), petition for cert. pending, No. 08-1174 (filed Mar. 18, 2009).

1. Congress enacted Section 526(a)(4) as part of the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA), Pub. L. No. 109-8, 119 Stat. 23, "a comprehensive package of reform measures" designed "to improve bankruptcy law and practice by restoring per-

sonal responsibility and integrity in the bankruptcy system and ensure that the system is fair for both debtors and creditors." H.R. Rep. No. 31, 109th Cong., 1st Sess. Pt. 1, at 2 (2005) (*House Report*). Described by the House Report as "the most comprehensive set of [bankruptcy] reforms in more than 25 years," *id.* at 3, the BAPCPA both modified the substantive standards for bankruptcy relief and adopted new measures intended to curb a variety of abusive practices that Congress concluded had come to pervade the bankruptcy system.

After extensive hearings, Congress determined that misleading and abusive practices by bankruptcy professionals, including attorneys, had become a substantial cause of unnecessary bankruptcy petitions and, in some circumstances, jeopardized debtors' ability to obtain a discharge of their debts. For example, Congress heard evidence that a civil enforcement initiative undertaken by the United States Trustee Program had "consistently identified * * * misconduct by attorneys and other professionals" as among the sources of abuse in the bankruptcy system. *House Report* 5 (citation omitted). Congress responded by "strengthening professionalism standards for attorneys and others who assist consumer debtors with their bankruptcy cases." *Id.* at 17.

The BAPCPA added or strengthened several regulations on bankruptcy professionals' conduct. Those regulations are intended to protect the clients and prospective clients of bankruptcy professionals, the creditors of clients who do enter bankruptcy, and the bankruptcy system. The regulations require additional disclosures to clients about their rights and the professional's responsibilities; they protect clients against being overcharged, or charged for services never provided; and they discourage misuse of the bankruptcy system.

See, *e.g.*, 11 U.S.C. 110(b)-(h), 526-528, 707(b)(4)(C)-(D). Many of the regulations apply equally to bankruptcy attorneys, to bankruptcy petition preparers who are not attorneys, and to all other professionals who provide bankruptcy assistance to consumer debtors for a fee; those professionals are collectively termed "debt relief agenc[ies]." 11 U.S.C. 101(12A).[1]

Section 526 sets out four basic rules of professional conduct for debt relief agencies. Section 526(a)(1) requires debt relief agencies to perform all promised services. Section 526(a)(2) prohibits debt relief agencies from advising an assisted person to make statements that are untrue or misleading in seeking bankruptcy relief. Section 526(a)(3) precludes debt relief agencies from misrepresenting the services they will provide or the benefits and risks attendant to filing for bankruptcy. And Section 526(a)(4), the provision held unconstitutional below, states:

> A debt relief agency shall not * * * advise an assisted person or prospective assisted person to incur more debt in contemplation of such person filing a case under this title or to pay an attorney or bankruptcy petition preparer fee or charge for services performed as part of preparing for or representing a debtor in a case under this title.

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[1] The term "bankruptcy assistance" is defined to include providing an "assisted person" with advice, counsel (including "legal representation"), or document preparation or filing assistance "with respect to a case or proceeding under" the Bankruptcy Code. 11 U.S.C. 101(4A). An "assisted person" is "any person whose debts consist primarily of consumer debts" and whose nonexempt property is worth less than a specified, inflation-adjusted amount, currently $164,250. 11 U.S.C. 101(3); see 11 U.S.C. 104(a); 72 Fed. Reg. 7082 (2007).

The principal remedy for violations of Section 526 is a civil action by the debtor to recover the debtor's "actual damages," including any fees already paid. 11 U.S.C. 526(c)(2). The statute also authorizes state attorneys general to sue for debtors' actual damages or for injunctive relief to prevent violations. 11 U.S.C. 526(c)(3). The bankruptcy court may also impose an injunction or an "appropriate civil monetary penalty" for intentional or recurring violations, either on its own motion or at the request of the United States Trustee or the debtor. 11 U.S.C. 526(c)(5).

2. Respondents are a law firm, two of the firm's attorneys, and two prospective clients. App., *infra*, 1a-2a.[2] They filed this action against the United States, seeking a declaratory judgment that the attorney respondents are not obligated to comply with several of the BAPCPA's provisions regulating debt relief agencies' professional conduct, including the advice limitation in Section 526(a)(4). Respondents contended that licensed attorneys are not "debt relief agencies" within the meaning of the statute even if they provide bankruptcy-related advice to debtors. They also claimed that, to the extent the statute encompasses licensed attorneys, Section 526(a)(4) and other provisions of the BAPCPA violate the First Amendment. *Id.* at 2a.

The district court denied the government's motion to dismiss, App., *infra*, 29a-44a, and then granted summary judgment for respondents, *id.* at 45a. The court held that Section 526(a)(4) and the other challenged provisions violate the First Amendment. *Id.* at 33a-41a.

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[2] The district court denied the prospective clients leave to proceed pseudonymously, App., *infra*, 31a-33a, and they disclosed their identities in an amended complaint, see 05-CV-2626 Docket entry No. 34, at 3 (D. Minn. Dec. 15, 2006).

The court further held that attorneys do not fall within the statutory definition of "debt relief agency." *Id.* at 41a-43a.

3. The government appealed, contending in relevant part that attorneys unambiguously fall within the definition of "debt relief agency" and that the district court's constitutional holding was premised on a misreading of Section 526(a)(4). Gov't C.A. Br. 18-41, 49-54. The government explained that the phrase "in contemplation of" bankruptcy is a term of art with a specialized meaning. Based on that established understanding, the government argued, Section 526(a)(4) should be construed to forbid only advice that a client take on new debt on the eve of bankruptcy with the intent of abusing the bankruptcy system. The government further contended that, to the extent the term "in contemplation of" is ambiguous, the doctrine of constitutional avoidance supports the government's narrow reading of the term, which avoids the overbreadth that the district court perceived.

4. The court of appeals affirmed in part and reversed in part. The court unanimously agreed that attorneys may fall within the definition of "debt relief agency," but held by a divided vote that Section 526(a)(4) violates the First Amendment. App., *infra*, 1a-28a.[3]

a. The court of appeals rejected the government's proposed narrowing construction of Section 526(a)(4). App., *infra*, 12a. The court concluded that, under the only permissible interpretation of the statute's "plain language," Section 526(a)(4) prohibits debt relief agencies from advising consumer clients "to incur *any* additional debt when the assisted person is contemplating

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[3] The court unanimously rejected respondents' challenges to certain disclosure requirements imposed by 11 U.S.C. 528. App., *infra*, 15a-21a.

bankruptcy," *ibid.*, and that "this prohibition would include advice constituting prudent prebankruptcy planning that is not an attempt to circumvent, abuse, or undermine the bankruptcy laws," *id.* at 13a.

Based on that broad construction, the court of appeals held that Section 526(a)(4) is unconstitutionally overbroad.[4] App., *infra*, 12a-14a. The court explained that advice to take on new debt just before bankruptcy will sometimes be legitimate. As examples, the court observed that "it may be in the assisted person's best interest to refinance a home mortgage in contemplation of bankruptcy to lower the mortgage payments," or to purchase a car to ensure "dependable transportation * * * to and from work." *Id.* at 13a-14a. And the court stated that "[f]actual scenarios other than these few hypothetical situations no doubt exist." *Id.* at 14a. The court concluded that the First Amendment precludes regulation of such legitimate advice, and it noted its agreement with three district courts that had reached the same conclusion. See *id.* at 13a & n.8 (citing, *inter alia*, *Hersh* v. *United States*, 347 B.R. 19, 25 (N.D. Tex. 2006)).

The court of appeals did not identify the precise constitutional standard under which respondents' challenge should be evaluated. Respondents had argued that

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[4] The court of appeals did not limit its holding to the plaintiffs before it, but stated more generally that the statute was "unconstitutionally overbroad as applied to attorneys falling within the definition of debt relief agencies." App., *infra*, 12a; see *id.* at 10a n.7, 15a, 21a; see also *id.* at 23a n.13 (Colloton, J., concurring in part and dissenting in part). Nothing in the court of appeals' statutory and First Amendment analysis, moreover, suggests that the court would reach a different conclusion regarding the statute's application to non-attorney professionals who provide bankruptcy advice.

strict scrutiny should apply, while the government had contended that Section 526(a)(4) is a reasonable regulation of attorneys' professional conduct that is to be reviewed more deferentially under the standard announced in *Gentile* v. *State Bar*, 501 U.S. 1030, 1071-1076 (1991). The court acknowledged that the government had a "legitimate interest" in prohibiting advice that would assist debtors in abusing the bankruptcy system by accumulating more debt in contemplation of bankruptcy. App., *infra*, 12a. But the court held that, on its reading of Section 526(a)(4), the statute was insufficiently connected to that legitimate interest and therefore was unconstitutional under either strict scrutiny or the *Gentile* standard. *Id.* at 12a-13a.

b. Judge Colloton dissented in relevant part. He explained that, in his view, "[t]he text, structure, and legislative history of § 526(a)(4) provide adequate support for a narrowing construction," under which "the statute should be construed to prohibit only advice that a client engage in conduct for the purpose of manipulating the bankruptcy system." App., *infra*, 25a. He would have held that the statute, so construed, is constitutional. See *id.* at 22a, 25a, 28a.

First, Judge Colloton observed that the phrase "in contemplation of bankruptcy" is a term of art that "has been construed * * * to mean actions taken with the intent to abuse the protections of the bankruptcy system." App., *infra*, 25a; see *id.* at 25a-26a (collecting authorities). Second, Judge Colloton pointed out that the remedies for a violation of Section 526(a)(4) "emphasize actual damages," and he reasoned that a debtor who follows his attorney's bankruptcy advice is unlikely to be harmed as a result unless he is induced to file "an abusive bankruptcy petition, where the debtor may suffer damages if the petition is dismissed as abusive." *Id.* at 27a (citing 11 U.S.C. 707(b)(1)). Third, Judge Colloton pointed to legislative history that showed Congress's desire to address "abusive" practices by bankruptcy professionals and by debtors who "knowingly load up" on debt before filing for bankruptcy. *Id.* at 27a-28a (quoting *House Report* 5, 15). The dissent concluded: "Given our duty to construe an Act of Congress in a manner that eliminates constitutional doubts, there is no need to adopt a construction that [respondents] say[] is absurd, that the [government] says was unintended by Congress, and that sweeps in salutary legal activity that would be a strange target for a statute entitled the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005." *Id.* at 28a.

5. The court of appeals denied rehearing en banc by a vote of 6-5. See App., *infra*, 47a.

6. Thirteen days later, the Fifth Circuit upheld Section 526(a)(4) against a substantially similar First Amendment challenge, reversing one of the district court opinions on which the court of appeals in this case relied. *Hersh*, 553 F.3d at 752-764; see App., *infra*, 13a n.8. The court endorsed the reasoning and the authorities in Judge Colloton's dissenting opinion. See 553 F.3d at 750 n.6, 759 n.17.

7. Respondents have filed their own petition for a writ of certiorari, which seeks review of the court of appeals' holding that attorneys may be "debt relief agencies" for purposes of Section 526, as well as its holding (see note 3, *supra)* that Section 528's disclosure requirements are valid. See Pet. at ii, *Milavetz, Gallop & Milavetz, P.A.* v. *United States*, No. 08-1119 (filed Mar. 5, 2009). The government will address that petition in a separate response.

REASONS FOR GRANTING THE PETITION

A divided panel of the court of appeals has invalidated an Act of Congress, even though the statute can constitutionally be applied to a significant range of conduct. The court failed to give due regard to a narrowing construction that eliminates the perceived constitutional difficulty, and its ruling squarely conflicts with a Fifth Circuit decision that adopted the constitutionally unproblematic construction that the court rejected in this case. The Eighth Circuit's decision also threatens to undermine the important reforms that Congress crafted, after years of study, to reduce the abuse of the bankruptcy system, including abuse encouraged by lawyers. This Court's review is warranted to prevent those harms, to resolve the circuit conflict, and to effectuate Congress's efforts to craft a federal remedy for the provision of abusive bankruptcy advice.

I. THE CIRCUITS ARE IN CONFLICT OVER THE CONSTITUTIONALITY OF AN ACT OF CONGRESS

The court of appeals' decision in this case squarely conflicts with the Fifth Circuit's resolution of the same statutory and constitutional issues as are presented here. As the Fifth Circuit has recognized, Section 526(a)(4) imposes a modest requirement to refrain from urging a debtor to accumulate eve-of-filing debt that would abuse the bankruptcy system. The court of appeals here imposed its own, much more expansive construction and then struck down the statute, so interpreted, as overbroad. As a result, attorneys in the Eighth Circuit who qualify as "debt relief agencies" are free to urge even the most abusive practices without being subject to the federal sanctions and client-protection measures set out in Section 526(a)(4) and (c).

A. In *Hersh* v. *United States ex rel. Mukasey*, 553 F.3d 743 (5th Cir. 2008), petition for cert. pending, No. 08-1174 (filed Mar. 18, 2009), a bankruptcy attorney challenged Section 526(a)(4) on grounds substantially similar to those respondents raised here. Hersh contended that Section 526(a)(4) unambiguously prohibits attorneys from advising clients who are considering bankruptcy to incur *any* additional debt, and that Section 526(a)(4) so construed is unconstitutionally overbroad. *Id.* at 747 & n.3, 754, 762. A unanimous Fifth Circuit panel rejected both of these arguments. *Id.* at 752-764. The Fifth Circuit acknowledged the court of appeals' contrary holding in this case but stated that it "agree[d] with Judge Colloton's dissenting opinion." *Id.* at 750 n.6.[5]

1. The Fifth Circuit in *Hersh* agreed with the government that Section 526(a)(4) can be construed in a way that focuses directly on Congress's acknowledged purpose in enacting it: preventing attorneys from encouraging their clients to "load up" on debt to abuse the bankruptcy system. 553 F.3d at 758-761. The court noted that the term "in contemplation of bankruptcy" is often used as a term of art that connotes an intent to abuse the bankruptcy system. *Id.* at 758 (citing *Black's Law Dictionary* 336 (8th ed. 2004) (*Black's Law Dictionary*)). Indeed, a few years before Congress enacted the BAPCPA, the Fifth Circuit itself had described the abusive practice of "incurring card debt in contemplation of bankruptcy" with the term "loading up." *Id.* at

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[5] Like the respondents in this case, Hersh also argued that attorneys cannot be "debt relief agencies" subject to the restrictions imposed by Section 526(a)(4). See 553 F.3d at 751-752. The Fifth Circuit rejected that argument, *id.* at 752, as the court of appeals unanimously did here, see App., *infra*, 3a-10a.

758-759 (quoting *AT&T Universal Card Servs.* v. *Mercer (In re Mercer)*, 246 F.3d 391, 421 n.43 (5th Cir. 2001) (en banc)). The Fifth Circuit in *Hersh* noted that Judge Colloton had adopted the same reasoning in this case, and it cited Judge Colloton's dissenting opinion for additional supporting sources. *Id.* at 759 & n.17.

The court in *Hersh* also explained that the structure of Section 526 supported the specialized interpretation described above. See 553 F.3d at 759-760, 761. Like Judge Colloton, see App., *infra*, 26a-27a, the Fifth Circuit pointed out that violations of Section 526 may be remedied by awarding the debtor actual damages, which strongly suggests that the practices banned are practices that would actually harm the debtor. See 553 F.3d at 760. And the court noted that Section 526(a)(4) was enacted alongside, and placed together with, "three other rules of professional conduct designed to protect debtors." *Id.* at 761 (citing 11 U.S.C. 526(a)(1)-(3)).

The court in *Hersh* agreed with Judge Colloton that the legislative history and purpose of the BAPCPA supported its construction of Section 526(a)(4). It explained that numerous elements of the BAPCPA were demonstrably "intended to curb abuse," which the court took as further evidence that "as part of this plan, section 526(a)(4) is only meant to curb abusive practices." 553 F.3d at 761; accord App., *infra*, 26a-27a (Colloton, J., concurring in part and dissenting in part).

2. The Fifth Circuit further explained that, even if its reading of Section 526(a)(4) were not the most natural interpretation of the statute, that reading would be compelled by the doctrine of constitutional avoidance. The court identified numerous cases in which this Court had adopted an arguably countertextual construction in the interest of constitutional avoidance, including *Boos*

v. *Barry*, 485 U.S. 312 (1988), on which Judge Colloton had relied significantly, see App., *infra*, 23a-24a. See 553 F.3d at 756-758. As the Fifth Circuit noted, the avoidance doctrine may even require giving "[a] restrictive meaning [to] what appear to be plain words." *Id.* at 757 (quoting *United States* v. *Witkovich*, 353 U.S. 194, 199 (1957)) (first brackets in original).

The Fifth Circuit acknowledged Hersh's argument, identical to that advanced by respondents and endorsed by the court below, that the text of Section 526(a)(4) is so unambiguous that no narrowing construction is possible. See 553 F.3d at 754. The court concluded, however, that "the language of [the statute] can and should be interpreted only to prohibit attorneys from advising clients to incur debt in contemplation of bankruptcy when doing so would be an abuse or improper manipulation of the bankruptcy system." *Id.* at 761; see *id.* at 756. The court explained that, on that reading, "[S]ection 526(a)(4) has no application to good faith advice to engage in conduct that is consistent with a debtor's interest and does not abuse or improperly manipulate the bankruptcy system." *Id.* at 761.

3. The Fifth Circuit concluded that, if Section 526(a)(4) is construed in this manner, it is not facially unconstitutional. The court explained that a statute is not unconstitutionally overbroad unless the "overbreadth is substantial in relation to the statute's legitimate reach." 553 F.3d at 762 (citing *United States* v. *Williams*, 128 S. Ct. 1830, 1838 (2008)). Hersh did not dispute that Congress could validly regulate the sort of advice to engage in abusive conduct that all parties agreed was covered by Section 526(a)(4). See *id.* at 754-

756.[6] And under the court's narrowing construction, Section 526(a)(4) did not apply to *any* of Hersh's examples of speech that could not constitutionally be prohibited. *Id.* at 763. Accordingly, the Fifth Circuit found it "clear that the potential for the statute to prohibit protected speech is not by any means *substantial* in relation to the statute's legitimate reach." *Id.* at 764.

B. The Fifth Circuit's decision cannot be reconciled with the decision below. The Fifth Circuit adopted the government's proposed construction of Section 526(a)(4), whereas the court below found that construction to be foreclosed by the statutory text. As a result of those divergent statutory interpretations, the Fifth Circuit upheld the statute against a First Amendment challenge, while the court below invalidated Section 526(a)(4) as an unconstitutional infringement on the right of attorneys to provide non-abusive bankruptcy-related advice. And the Eighth Circuit, by a closely divided vote, has declined to reconsider its position en banc. App., *infra*, 47a.

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[6] The Fifth Circuit in *Hersh* noted various contexts in which the First Amendment permits Congress and the States to regulate that sort of unethical attorney advice. For instance, the First Amendment does not protect speech proposing an illegal transaction, and abusive accumulation of debt may amount to fraud or theft. See 553 F.3d at 755 (citing *Village of Hoffman Estates* v. *Flipside, Hoffman Estates, Inc.*, 455 U.S. 489, 496 (1982)). Further, the government has a sufficiently important interest in the judicial process, including the bankruptcy system, to justify regulation of attorneys' unethical conduct affecting that process. See *id.* at 755-756 (citing *Gentile* v. *State Bar*, 501 U.S. 1030 (1991), and Model Rules of Professional Conduct Rule 1.2(d)). The court in *Hersh* explained that the abusive accumulation of debt in contemplation of bankruptcy "is akin to committing a fraudulent act," and therefore "Congress can constitutionally prevent attorneys or other debt relief agencies from advising their clients to [commit such an act]." *Id.* at 756.

The question presented here is a recurring one, as substantially similar challenges to Section 526(a)(4) are also pending in the Second and Ninth Circuits.[7] Review by this Court is warranted to resolve the division in the courts of appeals over the constitutionality of this important federal statute.

II. THE COURT OF APPEALS ERRED IN HOLDING SECTION 526(a)(4) UNCONSTITUTIONALLY OVERBROAD

The court of appeals' decision in this case is erroneous. The court below acknowledged that Congress had a "legitimate interest" in restricting bankruptcy professionals from peddling abusive strategies to individuals who are facing bankruptcy. App., *infra*, 12a. The government construes the statute to further that interest directly, by prohibiting only advice that would lead to intentional abuse of the bankruptcy system.

The court of appeals did not dispute that Congress could enact such a prohibition without violating the First Amendment. Rather, the court held that Section 526(a)(4) *unambiguously* sweeps in other attorney advice, unrelated to abuse of the bankruptcy system, and that the statute is therefore fatally overbroad. Both the statutory premise and the constitutional conclusion are flawed. As the text, structure, and purposes of Section 526(a)(4) make clear, Congress forbade only advice to incur new debt for the purpose of abusing the bankruptcy system or defrauding creditors. That prohibition is consistent with the First Amendment.

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[7] See *Zelotes* v. *Adams*, No. 07-1853 (2d Cir. argued Oct. 10, 2008); *Connecticut Bar Ass'n* v. *United States*, No. 08-5901 (2d Cir.) (argument not yet scheduled); *Olsen* v. *Holder*, No. 07-35616 (9th Cir.) (argument not yet scheduled).

A. The court of appeals rejected the government's interpretation of Section 526(a)(4) in a single sentence, asserting that the statute's "plain language" precludes any construction other than the unconstitutionally overbroad one. App., *infra*, 12a. The court did not identify any statutory term that unambiguously compelled such a reading. Rather, without quoting the statutory text, the court stated that "[Section] 526(a)(4) broadly prohibits a debt relief agency from advising an assisted person (or prospective assisted person) to incur *any* additional debt when the assisted person is contemplating bankruptcy." *Ibid.* But the statute does not use the temporal phrase "*when* the assisted person is contemplating bankruptcy." Rather, the statute forbids advising the client "to incur more debt *in contemplation of* [bankruptcy]." 11 U.S.C. 526(a)(4) (emphasis added). The difference is significant, as Judge Colloton explained.

The statute's reference to debt incurred "in contemplation of [bankruptcy]" is reasonably read to mean debt incurred with the expectation of using the bankruptcy discharge to avoid full repayment. As Judge Colloton observed, "the phrase 'in contemplation of' has been construed in the bankruptcy context to mean actions taken with the intent to abuse the protections of the bankruptcy system." App., *infra*, 25a; see, *e.g.*, *Black's Law Dictionary* 336 (defining "contemplation of bankruptcy" as "[t]he thought of declaring bankruptcy because of the inability to continue current financial operations, *often coupled with action designed to thwart the distribution of assets in a bankruptcy proceeding*") (emphasis added). Indeed, more than a century of "American and English authorities construing the bankruptcy laws also support the proposition that the words 'in contemplation of' may be understood to require an intent to abuse the bankruptcy laws." App., *infra*, 25a (Colloton, J., concurring in part and dissenting in part); see *id.* at 25a-26a (citing cases); accord *Hersh*, 553 F.3d at 758-760. Congress's use of an established term of art may reasonably be understood to incorporate the same meaning that those authorities have given it. See, *e.g.*, *Wilkie* v. *Robbins*, 127 S. Ct. 2588, 2605 (2007).

The Eighth Circuit did not rebut the dissent's understanding of prior judicial decisions construing the phrase "in contemplation of" in the bankruptcy context. Nor did the court identify any reason to believe that Congress, in enacting Section 526(a)(4), intended to depart from that prior understanding. Indeed, the court did not respond to the dissent's analysis at all; it simply asserted without explanation that "the plain language of the statute does not permit this narrow interpretation." App., *infra*, 12a.

The statutory context and structure support the reading of the term "in contemplation of" that was endorsed by the dissent below and adopted by the Fifth Circuit in *Hersh*. See, *e.g.*, *Dolan* v. *USPS*, 546 U.S. 481, 486 (2006) ("A word in a statute may or may not extend to the outer limits of its definitional possibilities. Interpretation of a word or phrase depends upon reading the whole statutory text, considering the purpose and context of the statute, and consulting any precedents or authorities that inform the analysis."). The other three subdivisions of Section 526(a) unambiguously establish rules of professional conduct designed to protect debtors from abusive practices by the attorneys and other debt relief agencies who advise them. See 11 U.S.C. 526(a)(1) (prohibiting debt relief agencies from failing to perform promised services); 11 U.S.C. 526(a)(2) (prohibiting debt relief agencies from advising debtors to make false or misleading statements to obtain bankruptcy relief); 11 U.S.C. 526(a)(3) (prohibiting debt relief agencies from misrepresenting to debtors the risks or benefits of bankruptcy). Section 526(a)(4)'s placement alongside these other restrictions indicates that it is likewise properly read to target unethical communications by bankruptcy professionals—not, as the court below held, all manner of lawful and ethical attorney advice. See *Hersh*, 553 F.3d at 761.

Furthermore, the principal remedy for violation of each of Section 526's rules of professional conduct is a suit against the attorney (or other debt relief agency) to recover the debtor's "actual damages," as well as restitution of any fees paid by the debtor. 11 U.S.C. 526(c)(2). Congress's emphasis on the debtor's "actual damages" presupposes that the debtor has been injured by the attorney's conduct. As Judge Colloton noted, "legal and appropriate advice that would be protected by the First Amendment, yet prohibited by a broad reading of § 526(a)(4), should cause no damage at all." App., *infra*, 27a; accord *Hersh*, 553 F.3d at 759-760.

"In enacting the BAPCPA, Congress was attempting to address common abuses of the bankruptcy system. Congress concluded that there was a pervasive abuse * * * by debtors who incur debt before bankruptcy with the intention of having their debt discharged." *Hersh*, 553 F.3d at 760 (citing *House Report* 15). Construing Section 526(a)(4) in a way that focuses precisely on that goal is perfectly consistent with the statutory text, structure, and purpose.

B. Even if the court of appeals' broad reading of the statute were the most natural one, the court erred in adopting an interpretation that resulted in invalidating the statute when a plausible alternative reading is constitutionally unproblematic. Particularly in the context of a First Amendment overbreadth challenge, where the plaintiff's demand is to declare a statute invalid even though it may be legitimately applied in some or many circumstances, the federal courts have not only "the power to adopt narrowing constructions," but "the *duty* to avoid constitutional difficulties by doing so if such a construction is fairly possible." *Boos*, 485 U.S. at 330-331; see also, *e.g.*, *Broadrick* v. *Oklahoma*, 413 U.S. 601, 612 (1973). Indeed, respondents themselves urged the court of appeals to construe another provision, the term "debt relief agency," to avoid the same constitutional overbreadth objection. *E.g.*, Resp. C.A. Br. 17 ("A statute should be interpreted so as to avoid constitutional issues."). The term "debt relief agency," however, has a statutory definition that forecloses respondents' proposed construction. See 11 U.S.C. 101(12A) (defining "debt relief agency" as "any person who provides any bankruptcy assistance to an assisted person in return for * * * payment"); App., *infra*, 6a-10a. By contrast, the phrase "in contemplation of [bankruptcy]" is not defined and can reasonably be read to avoid constitutional problems, particularly in light of its status as a term of art in the bankruptcy context.

This Court has repeatedly applied saving constructions to avoid constitutional difficulties, even without the firm grounding in statutory text and context that the Fifth Circuit's reading of Section 526(a)(4) has. For instance, in *Boos*, this Court considered a First Amendment overbreadth challenge to a federal statute that made it unlawful "to congregate within 500 feet of any [embassy, legation, or consulate] and refuse to disperse after having been ordered so to do by the police." 485

U.S. at 329. The Court acknowledged that "[s]tanding alone, this text is problematic * * * because it applies to *any* congregation within 500 feet of an embassy for *any* reason." *Id.* at 330. Nevertheless, in accordance with the "duty to avoid constitutional difficulties" when a narrowing "construction is fairly possible," the Court construed the statute to apply "'only when the police reasonably believe that a threat to the security or peace of the embassy is present'"—a limitation that was unstated in the statute but ensured the validity of the Act. *Id.* at 330-331 (citation omitted). See also, *e.g.*, *Zadvydas* v. *Davis*, 533 U.S. 678, 689 (2001); *Edward J. DeBartolo Corp.* v. *Florida Gulf Coast Bldg. & Constr. Trades Council*, 485 U.S. 568, 576-578 (1988).

Federal courts construe federal statutes to avoid, not invite, constitutional difficulties. *E.g.*, *Boos*, 485 U.S. at 331. The court of appeals disregarded that important principle when it invalidated Section 526(a)(4) without adverting to the doctrine of constitutional avoidance or explaining why its interpretation of the disputed provision was the only plausible reading.

C. Even if the court of appeals' construction were so clearly required by the text of the statute as to overcome the avoidance doctrine, the court's overbreadth analysis would still be deficient. Because "invalidating a law that in some of its applications is perfectly constitutional * * * has obvious harmful effects," this Court has "vigorously enforced the requirement that a statute's overbreadth be *substantial*, not only in an absolute sense, but also relative to the statute's plainly legitimate sweep." *Williams*, 128 S. Ct. at 1838. The court of appeals failed to adhere to that principle when it struck down Section 526(a)(4) without giving proper weight to the statute's many legitimate applications.

Advice to engage in conduct that amounts to an abuse of the bankruptcy system is plainly subject to congressional regulation. Congress, the state legislatures and state bars, and the federal and state courts routinely require attorneys to abide by professional standards like Section 526(a)(4). Indeed, the conduct that Section 526(a)(4) targets falls squarely within the scope of Rule 1.2(d) of the Model Rules of Professional Conduct, which prohibits attorneys from advising their clients to engage in fraud. See, *e.g.*, *Attorney Grievance Comm'n* v. *Culver*, 849 A.2d 423, 443-444 (Md. 2004) (disciplining an attorney for advising and assisting a client to load up on debt before declaring bankruptcy). Those requirements serve valid and important governmental interests, both in protecting clients from unethical advice and in protecting the judicial process and other litigants from the harm that ensues when clients follow that unethical advice. As the Fifth Circuit noted, the constitutionality of Rule 1.2(d) has never been in doubt. *Hersh*, 553 F.3d at 756. Section 526(a)(4) regulates the very same conduct.

Section 526(a)(4) therefore may validly be applied to a significant category of unethical attorney advice. Against that legitimate sweep, the court below hypothesized two instances of legitimate, ethical advice to accumulate new debt on the eve of bankruptcy: buying a car and refinancing a mortgage.[8] App., *infra*, 13a-14a. The court added that "[f]actual scenarios other than these

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[8] The court assumed that merely refinancing an existing mortgage—that is, exchanging one loan for another with the same principal balance but a different interest rate, repayment period, or other terms—would constitute incurring "more debt" within the meaning of the statute. See App., *infra*, 13a. It is not at all clear that this understanding is correct.

few hypothetical situations no doubt exist." *Id.* at 14a. On that slim and concededly "hypothetical" basis, the majority held the statute unconstitutional as applied to all attorney conduct, including the abusive practices at which Section 526(a)(4) was directly aimed.

As Judge Colloton correctly pointed out, "a facial challenge resting on a 'few hypothetical situations' * * * is unlikely to justify invalidating a statute in *all* of its applications, because 'the mere fact that one can conceive of some impermissible applications of a statute is not sufficient to render it susceptible to an overbreadth challenge.'" App., *infra*, 24a (quoting *Members of the City Council* v. *Taxpayers for Vincent*, 466 U.S. 789, 800 (1984)). The court of appeals here did no more than posit "some impermissible applications" of Section 526(a)(4). *Taxpayers for Vincent*, 466 U.S. at 800. The court did note this Court's admonition that First Amendment challenges of this sort require *substantial* overbreadth compared to the statute's valid coverage. App., *infra*, 15a n.10. But the court merely asserted that "[Section] 526(a)(4) is substantially overbroad," *id.* at 15a, without ever explaining how its "few hypothetical situations" supported that conclusion.

III. THE QUESTION PRESENTED IS IMPORTANT

As this Court has repeatedly observed, judging the constitutionality of an Act of Congress is "the gravest and most delicate duty that this Court is called upon to perform." *Rostker* v. *Goldberg*, 453 U.S. 57, 64 (1981) (quoting *Blodgett* v. *Holden*, 275 U.S. 142, 148 (1927) (Holmes, J.)). The federal statute at issue here serves an important function in the administration of the Nation's bankruptcy laws, and the circuit conflict over the validity of that statute warrants this Court's review.

"The principal purpose of the Bankruptcy Code is to grant a 'fresh start' to the 'honest but unfortunate debtor.'" *Marrama* v. *Citizens Bank*, 549 U.S. 365, 367 (2007) (quoting *Grogan* v. *Garner*, 498 U.S. 279, 286-287 (1991)). Section 526(a)(4) is an important part of Congress's effort to preserve that focus on the "honest but unfortunate debtor" by curbing abuse of the bankruptcy system, including abuse that comes at the suggestion of a bankruptcy professional. By invalidating Section 526(a)(4), the court of appeals has frustrated that effort, and the conflict between the decision below and the Fifth Circuit's decision in *Hersh* also undermines Congress's decision "[t]o establish * * * *uniform* Laws on the subject of Bankruptcies throughout the United States." U.S. Const. Art. I, § 8, Cl. 4 (emphasis added); cf., *e.g.*, *Railway Labor Executives' Ass'n* v. *Gibbons*, 455 U.S. 457, 465-466, 471-472 (1982) (discussing the importance the Framers placed on uniform bankruptcy rules).

A. Congress has long been aware that the relief afforded by the bankruptcy laws creates a perverse incentive for debtors to amass additional debt in contemplation of obtaining a discharge. Congress has recognized that such conduct poses a fundamental threat to the Code's twin goals of affording debtors a fresh start while providing an orderly and equitable system of resolving creditors' claims. For example, when Congress enacted 11 U.S.C. 523(a)(2)(C), which creates a presumption that certain eve-of-bankruptcy debts are not dischargeable, the accompanying Senate Report emphasized that "[e]xcessive debts incurred within a short period prior to the filing of the petition present a special problem: that of 'loading up' in contemplation of bankruptcy." S. Rep. No. 65, 98th Cong., 1st Sess. 9 (1983). The report explained that "[a] debtor planning [to] file a petition with the bankruptcy court has a strong economic incentive to incur dischargeable debts for either consumable goods or exempt property," noting that "[i]n many instances, the debtor will go on a credit buying spree in contemplation of bankruptcy at a time when the debtor is, in fact, insolvent." *Ibid.* As the report concluded, "[n]ot only does this result in direct losses for the creditors that are the victims of the spree, but it also creates a higher absolute level of debt so that all creditors receive less in liquidation. During this period of insolvency preceding the filing of the petition, creditors would not extend credit if they knew the true facts." *Ibid.* As early as 1973, Congress was informed that "the most serious abuse of consumer bankruptcy is the number of instances in which individuals have purchased a sizable quantity of goods and services on credit on the eve of bankruptcy in contemplation of obtaining a discharge." *Report of the Commission on the Bankruptcy Laws of the United States*, H.R. Doc. No. 137, 93d Cong., 1st Sess. Pt. I, at 11 (1973).

Congress has accordingly enacted a number of protections against eve-of-bankruptcy attempts to abuse the system's protections. For instance, it authorized bankruptcy courts to dismiss a petition for "substantial abuse," 11 U.S.C. 707(b) (2000), which could include the debtor's purposeful accumulation of debt in contemplation of bankruptcy. *E.g.*, *Price* v. *United States Tr. (In re Price)*, 353 F.3d 1135, 1139-1140 (9th Cir. 2004). It precluded debtors from obtaining a discharge for debts obtained fraudulently. 11 U.S.C. 523(a)(2)(A). And it provided that certain categories of debts are presumed to be fraudulent and nondischargeable if they are incurred on the eve of bankruptcy. 11 U.S.C. 523(a)(2)(C) (2000).

B. When Congress enacted the BAPCPA in 2005, the House Report expressed concern that those earlier measures had not adequately restricted the ability of debtors to "knowingly load up with credit card purchases or recklessly obtain cash advances and then file for bankruptcy relief." *House Report* 15. Accordingly, Congress strengthened each of the aforementioned protections against bankruptcy abuse. See, *e.g.*, BAPCPA § 310, 119 Stat. 84 (11 U.S.C. 523(a)(2)(C)). Most fundamentally, Congress greatly expanded the bankruptcy courts' authority to dismiss petitions for "abuse" of the bankruptcy system, including in cases in which debtors purposefully incur additional debt in contemplation of filing a petition. See BAPCPA § 102, 119 Stat. 27; *House Report* 48-49. Congress permitted dismissal of a petition based on a less stringent showing of abuse; authorized "any party in interest" to file a motion to dismiss for abuse (except in some cases involving lower-income debtors); repealed the pre-existing presumption in favor of granting the relief sought by the debtor; and specified that bankruptcy courts must consider, in determining whether a petition should be dismissed for abuse when no presumption applies, "whether the debtor filed the petition in bad faith" and whether "the totality of the circumstances * * * of the debtor's financial situation demonstrates abuse." 11 U.S.C. 707(b)(1), (3) and (6); see *House Report* 49.

Congress also made another significant change, which heightened the importance of the professional-conduct regulations at issue in this case. The "principal consumer bankruptcy reform" in the 2005 legislation was the adoption of a "means testing" mechanism intended to ensure that debtors who have the ability to repay at least some of their debts will do so, through a structured repayment plan entered under Chapter 13 of the Bankruptcy Code, instead of obtaining a complete discharge under Chapter 7. *House Report* 48; see *id.* at 2 (describing means testing as the "heart" of the 2005 Act's reform provisions). See generally 11 U.S.C. 109(b) and (e) (eligibility for Chapter 7 and Chapter 13).

Under the means test, a debtor's petition for complete relief under Chapter 7 is presumed to be abusive if the debtor's current monthly income exceeds his statutorily allowed expenses, including payments for secured debt, by more than a prescribed amount. See 11 U.S.C. 707(b)(2)(A)(i) and (iii). If the court finds a petition to be abusive under this standard, it can dismiss the debtor's case or, with the debtor's consent, convert it to Chapter 13, which involves a repayment plan. 11 U.S.C. 707(b)(1). The means test, however, exacerbates the incentive for debtors to manipulate the system by "loading up" on certain debt in contemplation of filing, because payments on secured debts that qualify under Section 707(b)(2)(A)(iii) reduce the amount of the debtor's monthly income counted in the means test, and may therefore allow the debtor to remain eligible for a complete and immediate discharge of unsecured debt under Chapter 7.

C. Congress was accordingly concerned that the introduction of the means test would give attorneys an incentive to counsel their clients to take on additional debt before filing for bankruptcy. As one bankruptcy judge testified, "[t]he more debt that is incurred prior to filing, the more likely the debtor will qualify for chapter 7." *Bankruptcy Reform Act of 1998: Hearing on H.R. 3150 Before the Subcomm. on Commercial and Admin-*

istrative Law of the House Comm. on the Judiciary, 105th Cong., 2d Sess. Pt. I, at 25 (1998) (statement of Judge Randall J. Newsome). Thus, the bankruptcy judge testified that, "[p]erverse as it may seem, I can envision debtor's counsel advising their clients to buy the most expensive car that someone will sell them, and sign on to the biggest payment they can afford (at least until the bankruptcy is filed) as a way of increasing their deductions under [the means test]." *Ibid.*; see also *B9ankruptcy Reform Act of 1999: Hearing on H.R. 833 Before the Subcomm. on Commercial and Administrative Law of the House Comm. on the Judiciary*, 106th Cong., 1st Sess. Pt. II, at 30 (1999) (statement of Judge William Brown). And as discussed above, see p. 3, *supra*, Congress credited evidence compiled by the United States Trustee Program that "consistently identified," among the sources of bankruptcy abuse, "misconduct by attorneys and other professionals [and] problems associated with bankruptcy petition preparers." *House Report* 5 (quoting Antonia G. Darling & Mark A. Redmiles, *Protecting the Integrity of the System: The Civil Enforcement Initiative,* Am. Bankr. Inst. J., Sept. 2002, at 12).

Section 526(a)(4) is an important component of Congress's effort to prevent such efforts to circumvent of the means test. If a debtor is made financially worse off by following his attorney's unethical advice to incur more debt in an attempt to take advantage of the bankruptcy system, Section 526 provides him a remedy against the attorney, including both a refund of attorney's fees and actual damages. Section 526 also ensures that attorneys will be subject to a concrete sanction for giving such unethical advice; while state bars have a significant role to play in disciplining attorneys for unethical conduct, the additional remedy provided by Section 526 is both more uniform and more certain. Section 526 also facilitates the client's cooperation through its fee-shifting provision, 11 U.S.C. 526(c)(2), whereas a state bar must rely on public-spirited complainants.

Section 526(a)(4) thus serves both a compensatory and a deterrent function within Congress's carefully designed framework for reducing well-documented ways of abusing the bankruptcy system. The court of appeals' decision invalidating that important tool raises an important question that is worthy of this Court's review.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

ELENA KAGAN
Solicitor General

MICHAEL F. HERTZ
Acting Assistant Attorney General

MALCOLM L. STEWART
Deputy Solicitor General

WILLIAM M. JAY
Assistant to the Solicitor General

MARK B. STERN
MARK R. FREEMAN
Attorneys

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APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

No. 07-2405

MILAVETZ, GALLOP & MILAVETZ, P.A.;
ROBERT J. MILAVETZ; BARBARA N. NEVIN;
JOHN DOE; MARY DOE, APPELLEES

v.

UNITED STATES OF AMERICA, APPELLANT

COMMERCIAL LAW LEAGUE OF AMERICA,
AMICUS ON BEHALF OF APPELLEE

Submitted: Mar. 11, 2008
Filed: Sept. 4, 2008
(Corrected Sept. 23, 2008)

APPEAL FROM THE UNITED STATES
DISTRICT COURT FOR THE
DISTRICT OF MINNESOTA

Before: BYE, SMITH, and COLLOTON, Circuit Judges.

SMITH, Circuit Judge.

Milavetz, Gallop & Milavetz, P.A., a law firm that practices bankruptcy law, the firm's president, a bank-

ruptcy attorney within the firm, and two clients[1] who sought bankruptcy advice from the firm brought suit against the United States seeking a declaratory judgment that certain provisions of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA)—11 U.S.C. §§ 526(a)(4) and 528(a)(4) and (b)(2)—did not apply to attorneys and law firms and are unconstitutional as applied to attorneys. The district court granted summary judgment to the plaintiffs and issued an order declaring that: (1) attorneys in the District of Minnesota were excluded from the definition of a "debt relief agency" as defined by BAPCPA; and (2) the challenged provisions were unconstitutional as applied to attorneys in the District of Minnesota. We affirm in part and reverse in part.

I. *Background*

On April 20, 2005, BAPCPA was signed into law, amending and adding multiple sections of the Bankruptcy Code ("the Code"). While some of these amendments became effective immediately, the vast majority became effective on October 17, 2005. *See* Pub. L. No. 109-8, § 1501(a), 119 Stat. 23 (2005) ("Except as otherwise provided in this Act, this Act and the amendments made by this act shall take effect 180 days after the date of enactment of this Act").

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[1] The client-plaintiffs sought prebankruptcy advice regarding the incurrence of additional debt prior to filing bankruptcy. The Bankruptcy Code precludes a debt relief agency from advising an assisted person from incurring additional debt in contemplation of bankruptcy. 11 U.S.C. § 526(a)(4). Thus, these client-plaintiffs are appearing on behalf of themselves and all others similarly situated who desire to exercise their First Amendment rights with attorneys regarding bankruptcy information.

One BAPCPA amendment added a new term, "debt relief agency," which is defined in § 101(12A) of the Code. 11 U.S.C. § 101(12A).[2] The amended Code restricts some actions of debt relief agencies, while requiring them to do others. *See* 11 U.S.C. § 526 ("Restrictions on debt relief agencies"); 11 U.S.C. § 528 ("Requirements for debt relief agencies"). For example, § 526(a)(4) bars a debt relief agency from advising a client "to incur more debt in contemplation" of a bankruptcy filing, 11 U.S.C. § 526(a)(4), while §§ 528(a)(4) and (b)(2) require debt relief agencies to include a disclosure in their bankruptcy-related advertisements directed to the general public declaring: "We are a debt relief agency. We help people file for bankruptcy relief under the Bankruptcy Code[,]' or a substantially similar statement." 11 U.S.C. § 528(a)(4), (b)(2). The plaintiffs sought alternative remedies. First, plaintiffs requested a declaratory judgment that attorneys did not fall within the definition of "debt relief agency." If the court determined that attorneys fell within the definition of debt relief agency, they challenged the constitutionality of §§ 526(a)(4) and 528(a)(4) and (b)(2), as applied to attorneys.

II. *Discussion*

A. *Debt Relief Agencies*

Initially, we address whether attorneys fall within the Code's definition of debt relief agencies. If they do not, we will have no need to address the constitutionality of §§ 526(a)(4) and 528(a)(4) and (b)(2), which only apply to debt relief agencies. *See Holtan v. Black*, 838 F.2d

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[2] Prior to BAPCPA, the term "debt relief agency" did not exist in the Code.

984, 986 n.3 (8th Cir. 1988) ("Federal courts must avoid passing upon constitutional questions unless they are essential to the disposition of the issues before them.") (citing *Three Affiliated Tribes v. Wold Engineering*, 467 U.S. 138, 157 (1984) ("It is a fundamental rule of judicial restraint, however, that this Court will not reach constitutional questions in advance of necessity of deciding them")).

> The term "debt relief agency" means *any person* who provides *any bankruptcy assistance* to an *assisted person* in return for the payment of money or other valuable consideration, or who is a bankruptcy petition preparer under section 110, but does not include—
>
> > (A) any person who is an officer, director, employee, or agent of a person who provides such assistance or of the bankruptcy petition preparer;
> >
> > (B) a nonprofit organization that is exempt from taxation under section 501(c)(3) of the Internal Revenue Code of 1986;
> >
> > (C) a creditor of such assisted person, to the extent that the creditor is assisting such assisted person to restructure any debt owed by such assisted person to the creditor;
> >
> > (D) a depository institution (as defined in section 3 of the Federal Deposit Insurance Act) or any Federal credit union or State credit union (as those terms are defined in section 101 of the Federal Credit Union Act), or any affiliate or subsidiary of such depository institution or credit union; or

> (E) an author, publisher, distributor, or seller of works subject to copyright protection under title 17, when acting in such capacity.

11 U.S.C. § 101(12A) (emphasis added).

Further, the Code defines the term "bankruptcy assistance" to mean:

> any goods or services sold or otherwise provided to an assisted person with the express or implied purpose of providing information, *advice, counsel*, document preparation, or filing, or attendance at a creditors' meeting or appearing in a case or proceeding on behalf of another *or providing legal representation* with respect to a case or proceeding under this title.

Id. at § 101(4A) (emphasis added).

Additionally, the Code defines the term "assisted person" as "any person whose debts consist primarily of consumer debts and the value of whose nonexempt property is less than $164,250."[3] *Id.* at § 101(3).

The plaintiffs argue that attorneys are not "debt relief agencies" because the definition of debt relief agencies makes no direct reference to attorneys, even though "attorney" is a defined term in the Code, *id.* at § 101(4),[4] but does include the term "bankruptcy petition pre-

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[3] When this suit was commenced, the dollar amount in § 101(3) was $150,000. Subsequently, on April 1, 2007, the amount was adjusted pursuant to 11 U.S.C. § 104. The change, however, is inconsequential for purposes of this case.

[4] "The term 'attorney' means attorney, professional law association, corporation, or partnership, authorized under applicable law to practice law." 11 U.S.C. § 101(4). This definition makes no reference to "debt relief agencies" or to subsection (12A).

parer" which, by definition, excludes debtor's attorneys and their staff. *See* 11 U.S.C. § 110(a)(1).[5] Plaintiffs contend that the omission of any reference to attorneys or lawyers while specifically including bankruptcy petition preparers shows Congress's intent to exclude attorneys from the definition of debt relief agencies. Because the plaintiffs contend that constitutionality issues arise in §§ 526(a)(4) and 528(a)(4) and (b)(2) if attorneys are debt relief agencies, they assert that the doctrine of constitutional avoidance should be used to interpret "debt relief agency" to exclude attorneys and thus avoid the potential constitutional issues.

Conversely, the government argues that attorneys are debt relief agencies because the broadly worded definition of the term plainly includes attorneys, *see* 11 U.S.C. § 101(12A) (defining "debt relief agency" as "any person who provides any bankruptcy assistance to an assisted person in return for the payment"), and providing legal representation is included in definition of bankruptcy assistance. *See id.* at 101(4A) ("bankruptcy assistance means any goods or services sold or otherwise provided to an assisted person with the express or implied purpose of providing . . . advice, counsel, . . . or legal representation with respect to a case or proceeding under this title").

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[5] "'[B]ankruptcy petition preparer' means a person, *other than an attorney for the debtor or an employee of such attorney* under the direct supervision of such attorney, who prepares for compensation a document for filing [by the debtor in connection with his bankruptcy case]." 11 U.S.C. § 110(a)(1) (emphasis added); *see also id.* at § 110(a)(2) (defining "document for filing" as used in § 110(a)(1)).

Whether attorneys fall within the Code's definition of debt relief agencies is an issue of first impression among the Courts of Appeals. Although the plain language of the definition appears to include bankruptcy attorneys and does not appear to be ambiguous, lower "[c]ourts that have addressed the issue of whether attorneys are debt relief agencies have not been unanimous." *In re Irons*, 379 B.R. 680, 685 (Bankr. S.D. Tex. 2007) (citing cases). Nevertheless, the majority of courts have held that compensated bankruptcy attorneys are debt relief agencies as that term is defined in the Code. *Id.* (finding debtor's counsel was a debt relief agency); *Olsen v. Gonzales*, 350 B.R. 906 (D. Or. 2006) (same); *In re Robinson*, 368 B.R. 492 (Bankr. E.D. Va. 2007) (finding debtor's counsel was debt relief agency); *Hersh v. United States*, 347 B.R. 19 (N.D. Tex. 2006) (finding that bankruptcy attorneys are debt relief agencies); *In re Norman*, No. 06-70859, 2006 WL 3053309 (Bankr. E.D. Va. 2006) (finding debtor's counsel qualified as a debt relief agency); *but see In re Attorneys at Law and Debt Relief Agencies*, 332 B.R. 66 (Bankr. S.D. Ga. 2005) (holding that attorneys are not debt relief agencies); *In re Reyes*, 361 B.R. 276 (Bankr. S.D. Fla. 2007) (finding that attorneys, generally, are not debt relief agencies, but ruling that debtor's counsel in case at bar was not a debt relief agency because service was provided pro bono and thus counsel did not receive valuable consideration in return for the bankruptcy assistance provided).

In this case, the district court acknowledged that the definition of debt relief agency, "at first glance," appeared to include attorneys, but it ultimately relied on the doctrine of constitutional avoidance to conclude that attorneys did not fall within the definition because if they did portions of §§ 526 and 528 would be unconstitu-

tional as applied to attorneys. The doctrine of constitutional avoidance dictates that "where an otherwise acceptable construction of a statute would raise serious constitutional problems, the Court will construe the statute to avoid such problems unless such construction is plainly contrary to the intent of Congress." *Edward J. DeBartolo Corp. v. Florida Gulf Coast Bldg. & Constr. Trades Council*, 485 U.S. 568, 575 (1988). Thus, if interpreting "debt relief agency" to include attorneys "would raise serious constitutional problems," then we should look for another interpretation "that may fairly be ascribed" to the definition that does not raise these concerns. *Id.* at 576-77. We will not, however, adopt an alternative interpretation that is "plainly contrary to the intent of Congress." *Id.* at 575.

"We review the district court's statutory interpretation de novo." *United States v. Mendoza-Gonzalez*, 520 F.3d 912, 914 (8th Cir. 2008). To interpret the statute we first "determine whether the language at issue has a plain and unambiguous meaning with regard to the particular dispute in the case." *Id.* (quoting *Robinson v. Shell Oil Co.*, 519 U.S. 337, 340 (1997)). "If so, we apply the plain language of the statute." *Id.* "A mere disagreement among litigants over the meaning of the statute does not prove ambiguity; it usually means that one of the litigants is simply wrong." *Bank of Am. Nat'l Trust & Sav. Ass'n v. 203 N. LaSalle St. P'ship*, 526 U.S. 434, 461 (1999).

The plain reading of the definition of debt relief agency, and the defined terms that make up that definition, leads us to conclude that attorneys who provide "bankruptcy assistance" to "assisted persons" are unambiguously included in the definition of "debt relief agen-

cies." *See Olsen*, 350 B.R. at 912 ("[I]t is the plain language of the Act that leads to the conclusion that attorneys are to be included in the definition of 'debt relief agency,'" and "[t]hus, further use of the tools of statutory construction is not necessary"). The statutory language sweeps broadly and clearly covers the legal services provided by attorneys to debtors in bankruptcy unless excluded by another provision.

Congress specifically listed five exclusions from the definition of "debt relief agency," and if it meant to exclude attorneys from that definition it could have explicitly done so. *Id.*; 11 U.S.C. § 101(12A). Moreover, if attorneys were not included in the definition of debt relief agencies, Congress would have had no reason to include § 526(d)(2), which expressly provides that nothing in §§ 526, 527, or 528 (the sections covering debt relief agencies) "shall be deemed to limit or curtail the authority or ability of a State . . . to determine and enforce qualifications for the practice of law under the laws of that State; or of a Federal court to determine and enforce the qualifications for the practice of law before that court." 11 U.S.C. § 526(d)(2)(A) and (B). The legislative history provides further indication that attorneys are included in the definition. *See* H.R. Rep. No. 109-31, 109th Cong., 1st Sess. at 4 (April 8, 2005) ("The bill's consumer protections include provisions strengthening professionalism standards *for attorneys* and others who assist consumer debtors with their bankruptcy cases") (emphasis added).[6]

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[6] Additionally, while we recognize that the Supreme Court has stated that "failed legislative proposals are a particularly dangerous ground on which to rest [a statutory interpretation]," *Lockhart v. United States*, 546 U.S. 142 (2005) (internal quotation marks and brackets

Because attorneys were not specifically excluded from the definition of debt relief agencies, we hold that attorneys that provide “bankruptcy assistance” to “assisted persons” are “debt relief agencies” as that term is defined by the Code. Interpreting the definition of “debt relief agency” to exclude bankruptcy attorneys would be contrary to Congress’s intent.

B. *Constitutionality of § 526(a)(4)*

Having concluded that attorneys providing bankruptcy assistance to assisted persons are debt relief agencies under the Code, we now must determine whether the challenged provisions placing restrictions and requirements on debt relief agencies are unconstitutionally overbroad as applied to these types of attorneys.[7] One of the sections challenged by the plaintiffs in this case is § 526(a)(4), which states:

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omitted), we note that on March 9, 2005, Senator Feingold proposed amendment No. 93 to Congress which would have excluded attorneys from the definition of debt relief agencies, *see* 151 Cong. Rec. S2306-02, 2316 (daily ed. Mar. 9, 2005) (statement by Sen. Feingold) (“This amendment would exclude lawyers from the provisions dealing with ‘debt relief agencies’ . . . .”), but the Senate did not address the proposal.

[7] Even though a more narrowly drawn version of § 526(a)(4) would likely be valid as applied to the plaintiffs in this case, our analysis applies to all attorneys falling within the definition of debt relief agencies, not merely the plaintiff-attorneys. *See Members of City Council of City of Los Angeles v. Taxpayers for Vincent*, 466 U.S. 789, 798-99 (1984) (explaining that the overbreadth doctrine allows a party to challenge a broadly written statute “even though a more narrowly drawn statute would be valid as applied to the party in the case,” as “the statute’s very existence may cause others not before the court to refrain from constitutionally protected speech or expression”) (internal quotations and citation omitted).

(a) A debt relief agency shall not—

. . .

> (4) advise an assisted person or prospective assisted person to incur more debt in contemplation of such person filing a case under this title or to pay an attorney or bankruptcy petition preparer fee or charge for services performed as part of preparing for or representing a debtor in a case under this title.

11 U.S.C. § 526(a)(4).

Plaintiffs assert that the prohibition against advising an assisted person or prospective assisted person to incur more debt in contemplation of bankruptcy violates the First Amendment. The parties disagree as to the level of scrutiny we apply to the constitutional analysis of this limitation on speech. Plaintiffs claim that we should review the constitutionality of § 526(a)(4) under the strict scrutiny standard as the restriction on attorney advice is content-based. *See Turner Broad. Sys., Inc. v. FCC*, 512 U.S. 622, 642 (1994) ("Our precedents thus apply the most exacting scrutiny to regulations that suppress, disadvantage, or impose differential burdens upon speech because of its content"). Under strict scrutiny review, the government has the burden to prove that the constraints on speech are supported by a compelling governmental interest and are narrowly tailored, such that the statutory effect does not prohibit any more speech than is necessary to serve the governmental interest. *Republican Party of Minnesota v. White*, 536 U.S. 765, 774-75 (2002).

In contrast, the government argues that § 526(a)(4)'s restrictions are a type of ethical regulation, invoking the more lenient standard outlined in *Gentile v. State Bar of Nev.*, 501 U.S. 1030 (1991). Under the *Gentile* standard, we would balance the First Amendment rights of the attorneys against the government's legitimate interest in regulating the activity in question—the prohibition of advising assisted persons to incur more debt in contemplation of bankruptcy—and then determine whether the regulations impose "only narrow and necessary limitations on lawyers' speech." *Id.* at 1075.

According to the government, § 526(a)(4) should be interpreted as merely preventing an attorney from advising an assisted person (or prospective assisted person) to take on more debt in contemplation of bankruptcy when the incurrence of such debt is done with the intent to manipulate the bankruptcy system, engage in abusive conduct, or take unfair advantage of the bankruptcy discharge. However, the plain language of the statute does not permit this narrow interpretation. Rather, § 526(a)(4) broadly prohibits a debt relief agency from advising an assisted person (or prospective assisted person) to incur *any* additional debt when the assisted person is contemplating bankruptcy. The statute's blanket prohibition applies even if the additional debt would not be discharged during the bankruptcy proceedings. 11 U.S.C. § 526(a)(4).

Thus, regardless of whether the government's interest in prohibiting the speech was legitimate (*Gentile* standard) or compelling (strict scrutiny standard), § 526(a)(4) is unconstitutionally overbroad as applied to attorneys falling within the definition of debt relief agencies because it is not narrowly tailored, nor narrowly

and necessarily limited, to restrict only that speech that the government has an interest in restricting. Instead, § 526(a)(4) prohibits attorneys classified as debt relief agencies from advising any assisted person to incur any additional debt in contemplation of bankruptcy; this prohibition would include advice constituting prudent pre-bankruptcy planning that is not an attempt to circumvent, abuse, or undermine the bankruptcy laws. Section 526(a)(4), as written, prevents attorneys from fulfilling their duty to clients to give them appropriate and beneficial advice not otherwise prohibited by the Bankruptcy Code or other applicable law.[8]

There are certain situations where it would likely be in the assisted person's, and even the creditors', best interest for the assisted person to incur additional debt in contemplation of bankruptcy. However, under § 526(a)(4)'s plain language an attorney is prohibited from providing this beneficial advice—even if the advice could help the assisted person avoid filing for bankruptcy altogether. For instance, it may be in the assisted person's best interest to refinance a home mortgage in contemplation of bankruptcy to lower the mortgage payments. This could free up additional funds to pay off other debts and avoid the need for filing bank-

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[8] Several bankruptcy courts are in agreement with our decision. *See Zelotes*, 363 B.R. at 667 ("Because § 526(a)(4) is not sufficiently 'narrowly tailored to achieve the desired objective,' it is unconstitutional as applied to bankruptcy attorneys."); *Hersh*, 347 B.R. at 25 (concluding that § 526(a)(4) is unconstitutional because: "(1) it prevents lawyers from advising clients to take lawful actions; and (2) it extends beyond abuse to prevent advice to take prudent actions," and therefore imposes "limitations on speech beyond what is 'narrow and necessary' "); *Olsen*, 350 B.R. at 916 ("[S]ection 526(a)(4) is overly restrictive in violation of the First Amendment" even if reviewed under *Gentile* standard).

ruptcy all together. *Hersh*, 347 B.R. at 24. Moreover, it may be in the client's best interest to incur additional debt to purchase a reliable automobile before filing for bankruptcy, so that the debtor will have dependable transportation to travel to and from work, which will likely be necessary to maintain the debtor's payments in bankruptcy. *Id.* Incurring these types of additional secured debt, which would often survive or could be reaffirmed by the debtor, may be in the debtor's best interest without harming the creditors.[9]

Factual scenarios other than these few hypothetical situations no doubt exist and may further illustrate why incurring additional debt in contemplation of bankruptcy may not be abusive or harmful to creditors. Nonetheless, § 526(a)(4), as written, does not allow attorneys falling within the definition of debt relief agencies to advise assisted persons (or prospective assisted persons)—i.e. clients (or prospective clients) meeting the definition of assisted person—to incur such debt. Thus, § 526(a)(4) is not narrowly tailored nor narrowly and necessarily limited to prevent only that speech which the government has an interest in restricting. Therefore,

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[9] *See* Erwin Chemerinsky, *Constitutional Issues Posed in the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005*, 79 Am. Bankr. L.J. 571, 579 (Summer 2005).

> [Section 526(a)(4)'s] prohibition is particularly troubling when it might be completely legal and even desirable for the client to incur such debt. For example, there may be instances where it is advisable for a client to obtain a mortgage, to refinance an existing mortgage to obtain a lower interest rate, or to buy a new car on time. There would be no fraud in doing so if the client intended to pay such debt notwithstanding the filing of a contemplated bankruptcy case. For example, the client may intend to keep all payments fully current and to reaffirm such debt once the case is filed.

we hold that § 526(a)(4) is substantially overbroad,[10] and unconstitutional as applied to attorneys who provide bankruptcy assistance to assisted persons, as those terms are defined in the Code.

C. *Constitutionality of § 528(a)(4) and (b)(2)*

The plaintiffs also challenged the constitutionality of §§ 528(a)(4) and (b)(2)(B), claiming that the advertising disclosure requirements mandated by those sections violate the First Amendment rights of bankruptcy attorneys through compelled speech. The disclosure requirements of § 528(a)(4) are supplemented by § 528(a)(3). These sections state:

> (a) A debt relief agency shall—
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> . . .
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> > (3) clearly and conspicuously disclose in any advertisement of bankruptcy assistance services or of the benefits of bankruptcy directed to the general public (whether in general media, seminars or specific mailings, telephonic or electronic messages, or otherwise) that the services or benefits are with respect to bankruptcy relief under this title; and
> >
> > (4) clearly and conspicuously use the following statement in such advertisement: "We are a debt relief agency. We help people file for bankruptcy

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[10] *See Veneklase v. City of Fargo*, 248 F.3d 738, 747 (8th Cir. 2001) ("For us to find a statute unconstitutionally overbroad, its 'overbreadth . . . must not only be real, but substantial as well, judged in relation to the statute's plainly legitimate sweep.' ") (quoting *Broadrick v. Oklahoma*, 413 U.S. 601, 615 (1973)).

> > relief under the Bankruptcy Code." or [*sic*] a substantially similar statement.

11 U.S.C. § 528 (a)(3), (4).

Similarly, § 528(b)(2)(B) states:

> (2) An advertisement, directed to the general public, indicating that the debt relief agency provides assistance with respect to credit defaults, mortgage foreclosures, eviction proceedings, excessive debt, debt collection pressure, or inability to pay any consumer debt shall—
>
> . . .
>
> > (B) include the following statement: "We are a debt relief agency. We help people file for bankruptcy relief under the Bankruptcy Code." or a substantially similar statement.

11 U.S.C. § 528(b)(2)(B).

As both §§ 528(a)(4) and (b)(2)(B) require debt relief agencies—which includes attorneys providing bankruptcy assistance to assisted persons—to disclose in their advertising that "'We are a debt relief agency. We help people file for bankruptcy relief under the Bankruptcy Code.' or some substantially similar statement," the statutes compel speech that, similar to a restriction on speech, receives constitutional protection under the First Amendment. *See Wooley v. Maynard*, 430 U.S. 705, 714 (1977) ("[T]he right of freedom of thought protected by the First Amendment against state action includes both the right to speak freely and the right to refrain from speaking at all"); *Turner Broad. Sys., Inc.*, 512 U.S. at 642 (stating that "[l]aws that compel speak-

ers to utter or distribute speech bearing a particular message are subject to" constitutional scrutiny).

The government contends that Congress enacted § 528's disclosure requirements to address problems with deceitful or unclear advertising by bankruptcy attorneys, bankruptcy petition preparers, or other debt relief entities. This position is supported by legislative history. *See* 151 Cong. Rec. H2063-01, 2066 (daily ed. Apr. 14, 2005) (statement by Rep. Moran) (stating that certain BAPCPA provisions are intended to "[p]revent deceptive and fraudulent advertising practices by debt relief agencies . . ."). But before we can determine whether the government's justification for mandating the disclosures passes constitutional scrutiny, we must first decide the appropriate standard for reviewing the constitutionality of the required disclosures.

We find guidance for this issue from the Court in *Zauderer v. Office of Disciplinary Counsel of the Supreme Court of Ohio*, 471 U.S. 626 (1985). In *Zauderer*, the Supreme Court considered the constitutionality of a state bar disciplinary regulation requiring attorneys that advertised contingent-fee representation to disclose in their advertisements that clients may still have to bear certain costs even if the case was unsuccessful. *Id.* at 633. As the regulation only required an attorney to "include in his advertising purely factual and uncontroversial information about the terms under which his services w[ould] be available," and "the extension of First Amendment protection to commercial speech is justified principally by the value to consumers of the information such speech provides, [the attorney's] constitutionally protected interest in not providing any particular factual information in his advertising is minimal."

Id. at 651. The Court "recognize[d] that unjustified or unduly burdensome disclosure requirements might offend the First Amendment by chilling protected commercial speech," but held "that an advertiser's rights are adequately protected as long as disclosure requirements are *reasonably related* to the State's interest in preventing deception of consumers." *Id.* (emphasis added).

On the other hand, restrictions on non-deceptive advertising are reviewed under intermediate scrutiny. *See Cent. Hudson Gas & Elec. Corp. v. Pub. Serv. Comm'n of New York*, 447 U.S. 557, 564 (1980) (ruling that restrictions on commercial speech that is neither misleading nor related to unlawful activity must assert a "substantial interest to be achieved by [the] restrictions" and "the restrictions must directly advance the state interest involved"). Under this standard, the limitation must be narrowly drawn. *Id.* ("[I]f the governmental interest could be served as well by a more limited restriction on commercial speech, the excessive restrictions cannot survive").

The district court in this case reviewed § 528's disclosure requirements under the intermediate scrutiny standard, but we conclude that rational basis review is proper. The disclosure requirements here, like those in *Zauderer*, are intended to avoid potentially deceptive advertising. *See Zauderer*, 471 U.S. at 651, n.14 (rejecting a more strict analysis of the disclosure requirements at issue in that case, and noting that "the First Amendment interests implicated by disclosure requirements are substantially weaker than those at stake when speech is actually suppressed . . .").

By definition, debt relief agencies provide bankruptcy assistance to assisted persons (or prospective assisted persons) "with respect to a case or proceeding under [the Bankruptcy Code]." 11 U.S.C. §§ 101(4A), (12A). Section 528 generally requires debt relief agencies to disclose on its advertisements of bankruptcy assistance services directed to the general public that their services do in fact relate to bankruptcy and that they assist people in filing for bankruptcy. 11 U.S.C. § 528. As in *Zauderer*, the plaintiffs' "constitutionally protected interest in not providing [such] factual information in [their] advertising is minimal." 471 U.S. at 650. Further, the disclosure requirements are reasonably and rationally related to the government's interest in preventing the deception of consumer debtors, as the disclosure requirements are directed precisely at the problem targeted by Congress: ensuring that persons who advertise bankruptcy-related services to the general public make clear that their services do in fact involve filing for bankruptcy.[11]

Section 528 requires debt relief agencies to disclose: "'We are a debt relief agency. We help people file for bankruptcy relief under the Bankruptcy Code.' or a substantially similar statement," in all of their bankruptcy-

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[11] Without ruling on the issue, we note that at least one lower court has held that § 528's disclosure requirements are constitutionally valid even under the stricter intermediate scrutiny analysis, as the government's interest in protecting consumer debtors from misleading advertising is substantial, the disclosure requirements placed on bankruptcy attorneys directly advances the government's asserted interest, and the disclosure requirements are narrowly drawn to serve the government's interest. *See Olsen*, 350 B.R. at 920 (concluding that § 528 "passes constitutional muster" under either rational basis review or intermediate scrutiny review).

related advertising materials directed to the general public. 11 U.S.C. §§ 528(a)(4), (b)(2). The requirement does not prevent those attorneys meeting the definition of debt relief agencies "from conveying information to the public; it . . . only require[s] them to provide somewhat more information than they might otherwise be inclined to present." *Zauderer*, 471 U.S. at 650. Moreover, if any of these attorneys are concerned that the required disclosures will confuse the public, we note that nothing in the Code prevents them from identifying themselves in their advertisements as both attorneys and debt relief agencies. *Olsen*, 350 B.R. at 920. Simply put, attorneys that provide bankruptcy assistance to assisted persons are debt relief agencies under the Code, and the disclosure requirements of § 528 only require those attorneys to disclose factually correct statements on their advertising.[12] This does not violate the

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[12] We recognize that the broad definitions of debt relief agency, bankruptcy assistance, and assisted persons, might result in certain attorneys meeting the definition of debt relief agencies even though they do not represent debtors in bankruptcy nor help people file for bankruptcy relief under the Code. Nevertheless, these attorneys are still subjected to the disclosure requirements of § 528(a)(4) when they advertise "bankruptcy assistance services or . . . the benefits of bankruptcy directed to the general public," 11 U.S.C. § 528(a)(3), (4), or when they advertise to the general public that they "provide[] assistance with respect to credit defaults, mortgage foreclosures, eviction proceedings, excessive debt, debt collection pressure, or inability to pay any consumer debt." *Id.* at § 528(b)(2). But because § 528 permits a "substantially similar" disclosure to the one suggested by the Code, these attorneys can and should tailor their advertisement disclosure statements to factually represent the "bankruptcy assistance" they provide. These tailored disclosures will meet the requirements of § 528(a)(4) and (b)(2) as long as they are "substantially similar" to the suggested disclosure, a decision which will require a case-by-case determination. *See Olsen*, 350 B.R. at 919-20 (dismissing plaintiffs' claim that § 528 was uncon-

First Amendment. *Id.*; *see also In re Robinson*, 368 B.R. at 500-502 (finding that debtor's counsel was a debt relief agency subject to the strictures of § 528, and that § 528(a)(1)'s requirement for a written contract is constitutional); *In re Norman*, 2006 WL 3053309 at *4 (finding that debtor's counsel qualified as a debt relief agency and thus must comply with the requirements of § 528(a)(1)).

The challenged sections of § 528 only require debt relief agencies to include a disclosure on certain advertisements. Although less intrusive means may be conceivable to prevent deceptive advertising, § 528's disclosure requirements are reasonably related to the government's interest in protecting consumer debtors from deceptive advertising, and thus the section passes constitutional muster.

III. *Conclusion*

In sum, attorneys who provide bankruptcy assistance to assisted persons are debt relief agencies under the Bankruptcy Code, and § 526(a)(4) is unconstitutional as applied to these attorneys, but §§ 528(a)(4) and (b)(2) are constitutional. Accordingly, we affirm in part and reverse in part.

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stitutional, rejecting argument that attorney who met definition of debt relief agency but did not represent bankruptcy debtors was precluded from § 528's disclosure requirements because § 528 permits a "substantially similar" disclosure, which could be tailored to disclose that attorney advised clients about bankruptcy assistance matters but did not represent people in bankruptcy or file bankruptcy petitions, and stating that whether disclosure was "substantially similar" would require case-by-case determination).

COLLOTON, Circuit Judge, concurring in part and dissenting in part.

I concur in all but Part II.B of the opinion of the court. I disagree, however, with the court's holding that 11 U.S.C. § 526(a)(4) is unconstitutionally overbroad in violation of the First Amendment, and I would therefore reverse the district court's decision declaring this statutory provision unconstitutional.

Milavetz, Gallop, & Milavetz, P.A., mounts a facial attack on § 526(a)(4), arguing that the section's potential application to attorneys in hypothetical situations requires that the statute be declared impermissibly overbroad and unconstitutional. This case involves a facial challenge in the First Amendment context, "under which a law may be overturned as impermissibly overbroad because a substantial number of its applications are unconstitutional, judged in relation to the statute's plainly legitimate sweep." *Wash. State Grange v. Wash. State Republican Party*, 128 S. Ct. 1184, 1190 n.6 (2008). This "overbreadth doctrine," however, is "strong medicine that is used sparingly and only as a last resort." *New York State Club Ass'n, Inc. v. City of New York*, 487 U.S. 1, 14 (1988) (internal quotations omitted). It should be applied only when there is "a realistic danger that the statute itself will significantly compromise recognized First Amendment protections of parties not before the Court." *City Council of Los Angeles v. Taxpayers for Vincent*, 466 U.S. 789, 801 (1984). The Supreme Court recently emphasized that it has "vigorously enforced the requirement that a statute's overbreadth be *substantial*, not only in an absolute sense, but also relative to the stat-

ute's plainly legitimate sweep." *United States v. Williams*, 128 S. Ct. 1830, 1838 (2008).[13]

To resolve the constitutional challenge brought by Milavetz, we must first construe the disputed statute. When presented with a constitutional challenge to an Act of Congress, we have not only the power, but the duty, to adopt a narrowing construction that will avoid constitutional difficulties whenever possible. *Boos v. Barry*, 485 U.S. 312, 330-31 (1988). In *Boos*, for example, the Court considered a provision of federal legislation that made it unlawful "to congregate within 500 feet of any [embassy, legation, or consulate] and refuse to disperse after having been ordered so to do by the police." *Id.* at 329 (internal quotation omitted). The Court observed that "*[s]tanding alone*, this text is problematic because it applies to *any* congregation within 500 feet of an embassy for *any* reason." *Id.* at 330 (first emphasis

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[13] The district court purported to consider only an "as-applied" challenge to § 526(a)(4), rather than an overbreadth challenge, and ultimately declared the section "unconstitutional as applied to attorneys." *Milavetz, Gallop & Milavetz, P.A. v. United States*, 355 B.R. 758, 766 n.4, 769 (D. Minn. 2006). The majority correctly recognizes that the district court's approach is really an overbreadth analysis, and considers the statute under that framework. *See ante*, at 9 & n.7, 11, 13 & n.10. The "as applied" method of analysis, by contrast, considers the statute's application to a "particular claimant" based on "harm caused to the litigating party." *Turchick v. United States*, 561 F.2d 719, 721 n.3 (8th Cir. 1977). "The 'as applied' method vindicates a claimant whose conduct is within the First Amendment but invalidates the challenged statute *only to the extent of the impermissible application*." *Id.* (emphasis added). The district court and the majority have declared § 526(a)(4) unconstitutional in *all* of its applications to *all* attorneys, and the supporting reasoning is thus consistent with "facial overbreadth analysis." *Id.* (punctuation omitted).

added). Nonetheless, citing the "duty to avoid constitutional difficulties by [adopting a narrowing construction] if such a construction is fairly possible," the Court construed the statute narrowly to permit the dispersal of only congregations that are directed at an embassy, and to allow dispersal "only when the police reasonably believe that a threat to the security or peace of the embassy is present." *Id.* at 330-31 (internal quotation omitted). Similarly, in *United States v. X-Citement Video, Inc.*, 513 U.S. 64 (1994), the Court emphasized that "it is incumbent upon" a federal court to read a statute to eliminate constitutional doubts, "so long as such a reading is not plainly contrary to the intent of Congress." *Id.* at 78.

The challenged provision in this case provides in part that "[a] debt relief agency shall not . . . advise an assisted person or prospective assisted person to incur more debt in contemplation of such person filing a case under this title." 11 U.S.C. § 526(a)(4). Milavetz argues that according to this provision, a debt relief agency may not advise a client to incur *any* debt for *any* purpose when the client is contemplating the filing of a petition for bankruptcy. As such, Milavetz contends that an attorney could be sanctioned for "fulfilling his duty to his client to give legal and appropriate advice not otherwise prohibited by the Bankruptcy Code." (Brief of Appellee 30). Even under Milavetz's broad construction of the statute, a facial challenge resting on a "few hypothetical situations," *ante*, at [14a], is unlikely to justify invalidating a statute in *all* of its applications, because "the mere fact that one can conceive of some impermissible applications of a statute is not sufficient to render it susceptible to an overbreadth challenge." *Vincent*, 466 U.S. at 800.

It is unnecessary to resolve whether § 526(a)(4) is impermissibly overbroad when given its broadest reading, however, because the government suggests an acceptable narrowing construction of the statute that would avoid most constitutional difficulties. The government contends that "in contemplation of" filing for bankruptcy is a term of art that denotes an action taken with the intent to abuse the protections of bankruptcy laws. Under this view, the statute should be construed to prohibit only advice that a client engage in conduct for the purpose of manipulating the bankruptcy system.

The text, structure, and legislative history of § 526(a)(4) provide adequate support for a narrowing construction. Particularly given the latitude of federal courts to narrow a text to avoid constitutional difficulties, *see Boos*, 485 U.S. at 330-31, the words "in contemplation of . . . filing a case" need not create impermissible overbreadth. Rather, we may recognize that the phrase "in contemplation of" has been construed in the bankruptcy context to mean actions taken with the intent to abuse the protections of the bankruptcy system. Black's Law Dictionary reflects this understanding, defining "contemplation of bankruptcy" as "the thought of declaring bankruptcy because of the inability to continue current financial operations, *often coupled with action designed to thwart the distribution of assets in a bankruptcy proceeding*." *Black's Law Dictionary* 336 (8th ed. 2004) (emphasis added). American and English authorities construing the bankruptcy laws also support the proposition that the words "in contemplation of" may be understood to require an intent to abuse the bankruptcy laws. *In re Pearce*, 19 F. Cas. 50, 53 (D. Vt. 1843) (No. 10873) (concluding that an act was done "in contemplation of bankruptcy" if it was done "in anticipa-

tion of breaking or failing in his business, of committing an act of bankruptcy, or of being declared bankrupt at his own instance, on the ground of inability to pay his debts, *and intending to defeat the general distribution of effects, which takes place under a proceeding in bankruptcy*.") (emphasis added); *Morgan v. Brundrett*, 5 Barn. & Ad. 289, 296, 110 Eng. Rep. 798, 801 (K.B. 1833) (Parke, J.) (interpreting "in contemplation of bankruptcy" to mean that "the payment or delivery must be with intent to defeat the general distribution of effects which takes place under a commission of bankruptcy."); *Fidgeon v. Sharpe*, 5 Taunt. 539, 545-46, 128 Eng. Rep. 800, 802-03 (C.P. 1814) (Gibbs, C.J.) (An act made in contemplation of bankruptcy "must be intended in fraud of the bankrupt laws."); *cf. Buckingham v. McLean*, 54 U.S. 151, 167 (1851) ("To give to these words, contemplation of bankruptcy, a broad scope, and somewhat loose meaning, would not be in furtherance of the general purpose with which they were introduced."); *id.* at 169 (relying on English bankruptcy decisions as instructive authority on meaning of the former Bankrupt Act). Our duty to construe the statute to avoid constitutional difficulties counsels that we should look to these authorities for a plausible alternative to the broad construction urged by Milavetz.

The structure of § 526(a)(4) also supports a narrowing construction. The prohibitions of this statute can be enforced only through the civil remedies provided in § 526(c). An attorney who violates § 526(a)(4) can be sanctioned in just three situations: if a debtor sues the attorney for the available remedies—remittal of fees, actual damages, and reasonable attorney's fees and costs; if a state attorney general sues for a resident's actual damages; or if a court finds that the attorney in-

tentionally violated § 526(a)(4), and chooses to "impose an appropriate civil penalty." 11 U.S.C. § 526(c). The remedies for a violation thus emphasize actual damages. But legal and appropriate advice that would be protected by the First Amendment, yet prohibited by a broad reading of § 526(a)(4), should cause no damage at all. If an attorney advises a debtor to refinance his home to lower mortgage payments, or to purchase a reliable car to enable him to pay off his debts, *see ante*, at [13a-14a], then a debtor following that advice would suffer no damage. There is no reason to believe that a client could recover the remittal of attorney's fees or that a court would find a civil penalty "appropriate" as a remedy for legal advice that *benefits* both the debtor *and* his creditors. Rather, a debtor is likely to have a remedy against an attorney only in the case of an abusive bankruptcy petition, where the debtor may suffer damages if the petition is dismissed as abusive, *see* 11 U.S.C. § 707(b)(1), and where an attorney general or a court has reason to seek or impose sanctions against an abusive debt relief agency. The remedial focus of § 526 thus bolsters the proposition that § 526(a)(4) was aimed only at advice given by a debt relief agency that is designed to abuse the bankruptcy process.

The incorporation of an abusive purpose requirement into § 526(a)(4) is also consonant with the evident purpose of the statute. The government argues, and Milavetz acknowledges, that a principal goal of Congress in passing the statute was to "preclude debtors from taking on more debt knowing that it will later be discharged during bankruptcy." (Brief of Appellee 34). A narrowing construction of § 526(a)(4) is in accord with expressions of desire in the legislative history to address "misconduct by attorneys and other professionals," and

"abusive practices by consumer debtors who, for example, knowingly load up with credit card purchases or recklessly obtain cash advances and then file for bankruptcy relief." H.R. Rep. No. 109-31, pt. 1, at 5, 15 (2005) (internal quotation omitted), *as reprinted in* 2005 U.S.C.C.A.N. 88, 92, 101. Milavetz itself argues that a broad construction of § 526(a)(4) "goes beyond" this congressional purpose, and is "absurd," because it would prevent an attorney from advising a client to take actions that might avoid the need for filing bankruptcy altogether. (Brief of Appellee 34). Given our duty to construe an Act of Congress in a manner that eliminates constitutional doubts, there is no need to adopt a construction that one party says is absurd, that the other party says was unintended by Congress, and that sweeps in salutary legal activity that would be a strange target for a statute entitled the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005.

For these reasons, I would reverse the district court's decision declaring unconstitutional the provision codified at 11 U.S.C. § 526(a)(4).

APPENDIX B

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MINNESOTA

No. 05-CV-2626 (JMR/FLN)

MILAVETZ, GALLOP & MILAVETZ P.A.,
ROBERT J. MILAVETZ, BARBARA N.
NEVIN, JOHN DOE, AND MARY DOE

v.

UNITED STATES OF AMERICA

[Dec. 7, 2006]

ORDER

Plaintiffs ask the Court to declare portions of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA") unconstitutional. Defendant, United States of America ("the government") moves to dismiss for failure to state a claim upon which relief can be granted. Defendant's motion is denied; the debt relief agency sections of BAPCPA unconstitutionally impinge on attorneys' First Amendment rights.

I. *Background*

On April 20, 2005, BAPCPA was signed into law, and became effective on October 17, 2005. Among its terms, BAPCPA defines a new category of bankruptcy service

provider called a "debt relief agency." 11 U.S.C. § 101(12A) (2005). The law forbids debt relief agencies from doing certain things, and requires them to do others. This lawsuit challenges a number of these provisions.

BAPCPA bars a debt relief agency from advising a client "to incur more debt in contemplation" of a bankruptcy filing. 11 U.S.C. § 526(a)(4). BAPCPA further requires that debt relief agencies' advertisements declare: "We are a debt relief agency. We help people file for bankruptcy relief under the Bankruptcy Code," or a substantially similar statement. 11 U.S.C. § 528(a)(4), (b)(2).

Plaintiffs are bankruptcy attorneys, their law firm, and two unnamed members of the public. Their attack on the statute is based on the First Amendment to the United States Constitution. They allege BAPCPA's debt relief agency provisions are unconstitutional as applied to them. They, initially, claim BAPCPA's regulation of attorneys' advice violates the First Amendment. Next, they claim BAPCPA's advertising requirements contravene the First Amendment.[1] Ultimately, they contend Congress did not intend the debt relief agency requirements to apply to attorneys. The government moves to dismiss plaintiffs' First Amendment claims pursuant to Rule 12(b)(6) of the Federal Rules of

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[1] In a footnote, the government asks whether plaintiffs have standing to bring these claims, since they are in no danger of immediate harm. The government's query is misplaced; plaintiffs claim BAPCPA's debt relief agency sections both stifle and compel their speech, in violation of the U.S. Constitution. First Amendment jurisprudence makes clear that a claim that a law has a potential chilling effect on speech establishes standing. *Virginia v. Am. Booksellers Ass'n*, 484 U.S. 383, 392 (1988).

Civil Procedure ("Fed. R. Civ. P."). The government's motion is denied.

II. *Discussion*

A. *Motion to Dismiss*

A Rule 12(b)(6) motion to dismiss must be denied unless it appears beyond doubt that the plaintiff can prove no set of facts which would entitle him to relief. *See Murphy v. Lancaster*, 960 F.2d 746, 748 (8th Cir. 1992). In considering such a motion, the motion, the court construes the complaint, and all of its reasonable inferences, most favorably to plaintiff. *Westcott v. City of Omaha*, 901 F.2d 1486, 1488 (8th Cir. 1990).

B. *Unnamed Plaintiffs*

The complaint purports to set out the claims of two unnamed parties: John Doe and Mary Doe. The government denies there is any legal basis for anonymous plaintiffs in this lawsuit. Indeed, Fed. R. Civ. P. 10(a) is explicit: a complaint "shall include the names of all the parties." Notwithstanding Rule 10(a), plaintiffs claim their case falls within a limited realm of cases in which other interests—i.e., privacy and concern about embarrassment—outweigh the public's interest in open disclosure. Plaintiffs are incorrect.

There is a strong presumption against allowing parties to use a pseudonym. *See, e.g., Doe v. Blue Cross & Blue Shield United of Wisconsin*, 112 F.3d 869, 872 (7th Cir. 1997); *Doe v. Frank*, 951 F.2d 320, 323-24 (11th Cir. 1992); *Southern Methodist Univ. Ass'n of Women Law Students v. Wynne & Jaffe*, 599 F.2d 707, 712-13 (5th Cir. 1979). The reasons are obvious and compelling: identification of litigants is recognized as important in a public proceeding. *See Blue Cross,* 112 F.3d at 872. A

party who invokes the judicial powers of the United States invites public scrutiny. "The people have a right to know who is using their courts." *Id.*

Limited exceptions to the party-publicity rule exist. Case law has recognized three factors which, if present, might support anonymity. They have been found when "(1) plaintiffs seeking anonymity were suing to challenge governmental activity; (2) prosecution of the suit compelled plaintiffs to disclose information 'of the utmost intimacy;' and (3) plaintiffs were compelled to admit their intention to engage in illegal conduct, thereby risking criminal prosecution." *Doe v. Stegall,* 653 F.2d 180, 185 (5th Cir. 1981) (quoting *Wynne & Jaffe,* 599 F.2d at 712-13). Although the listed factors are not exhaustive, they provide valuable guidance.

While the first factor is present here, the third is not. Plaintiffs argue their "wish to obtain legal advice from [plaintiff] attorneys . . . about prebankruptcy planning and filing bankruptcy" (1st Am. Compl. ¶ 10) suffices for the second factor. According to the Doe parties, the "financial situations of private citizens [are] clearly a matter of utmost intimacy, especially when they feel the need to seek advice about bankruptcy." (Pl.'s Brief 23).

Certainly, those facing bankruptcy are in financial straits; but that does not resolve the issue. Plaintiffs offer no case law to support their claim that merely seeking bankruptcy or financial advice is the kind of intimate personal information typically protected by the court. Bankruptcy is a public proceeding; the Doe plaintiffs are disclosing no medical information or deeply personal questions surrounding human reproduction or matters of that nature.

The Court finds the bankruptcy-seeking plaintiffs' interest in their financial privacy is outweighed by the public's stronger interest in maintaining open trials. Accordingly, the Doe plaintiffs shall amend their complaint to include their real names within 10 days of the date of this Order, or their claims will be dismissed.

C. *Constitutional Challenges*

1. *Attorney Advice: Section 526(a)(4)*

Plaintiffs claim BAPCPA's § 526(a)(4), titled "[r]estrictions on debt relief agencies," has "a chilling effect upon lawyers," in violation of their First Amendment rights. (1st Am. Compl. ¶ 39.) Section [526(a)(4)] states:

> A debt relief agency shall not . . . advise an assisted person or prospective assisted person to incur more debt in contemplation of such person filing a case under this title or to pay an attorney or bankruptcy petition preparer fee or charge for services performed as part of preparing for or representing a debtor in a case under this title.

11 U.S.C. § 526(a)(4).

The parties disagree as to the standard of review applied to the constitutional analysis of this section. Plaintiffs claim the standard of review for a restriction on lawful and truthful attorney advice is strict scrutiny. The government replies that § 526(a)(4)'s restrictions are merely a species of ethical regulation, invoking the more lenient standard outlined in *Gentile v. State Bar of Nev.*, 501 U.S. 1030 (1991). Under *Gentile*, the Court would balance the First Amendment rights of attorneys against the government's legitimate interest in regulating the activity in question, and then determine whether

the regulations impose "only narrow and necessary limitations on lawyers' speech." *Id.* at 1075. The Court rejects the government's proposed standard.

The "ethical rule" of which the government speaks appears to exist only in its pleadings; the statute discloses no quasi-religious or ethical principle. The government "cannot foreclose the exercise of constitutional rights by mere labels." See *NAACP v. Button*, 371 U.S. 415, 429 (1963). While the section is certainly a rule, nothing in § 526 alludes to ethics. The section is titled "Restrictions on debt relief agencies," and plainly prohibits certain acts. The advice the Section forecloses may be potentially advantageous to creditors, but this does not make it equivalent to ethics either in logic or in law.

When fairly viewed, the Court finds § 526(a)(4) to be a content-based regulation of attorney speech—it restricts attorneys from giving particular information and advice to their clients. Attorneys are forbidden to advise their clients concerning an entire subject—incurring more debt in contemplation of filing for bankruptcy. This is a plain regulation of speech. Beyond this, the forbidden speech trenches on two other important areas of concern.

First, the lawyer's advice to take on certain additional financial obligations in contemplation of bankruptcy may well be in the client's best interest.[2] A law

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[2] For example, it may be in the client's interest to obtain or refinance a home mortgage prior to filing bankruptcy, because one who has declared bankruptcy may well be denied a lower interest rate after the filing. If the client gets a lower rate mortgage, the refinanced mortgage may have smaller payments which could forestall, or even prevent the bankruptcy in the first place. Similar arguments can be made concern-

yer's highest duty is to the client, and the statute's forbidden advice may indeed be helpful to the client. Secondly, this statute does not restrict false statements—arguably implicating some "ethical" precept—it forbids truthful and possibly efficacious advice. If this is the government's view of legal ethics, it is a form of ethics unfamiliar to the Court.

As the United States Supreme Court has explained, "[g]overnment action that stifles speech on account of its message, or that requires the utterance of a particular message favored by the Government, contravenes th[e] essential [First Amendment] right[s]" of private citizens. *Turner Broad. Sys. v. FCC*, 512 U.S. 622, 641 (1994). For this reason, "governmental control over the content of messages expressed by private individuals" is unconstitutional except in narrow circumstances. *Id.*

As the Court finds § 526(a)(4) to be a content-based restriction on protected speech, it is subject to strict scrutiny. *Id.* Such a restriction can only survive if (1) narrowly tailored to achieve (2) a compelling state interest. *United States v. Playboy Entm't Group, Inc.*, 529 U.S. 803, 813 (2000). The Court finds the government has failed to meet its burden on the first point—§ 526(a)(4) is not narrowly tailored.

The government suggests § 526(a)(4) advances two compelling interests. First, it asserts an interest in protecting creditors. According to the government, § 526(a)(4)'s prohibition discourages prospective bankrupts from accumulating debt in a particular fashion,

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ing automobile loans, or incases where a client needs to co-sign undischargeable student loans. *See Hersh v. United States*, 347 B.R. 19, 24 (N.D. Tex. 2006).

thus deterring debtors from “gaming” the means test by improperly enlarging pre-existing debt, thereby diluting the assets of the bankruptcy estate otherwise available to creditors. Second, it claims § 526(a)(4) protects debtors from attorneys who might lead them to abusive practices which could ultimately result in a denial of discharge of debts under § 523(a)(2)(c). Finally, the government argues that § 523(a)(2)(c) protects the integrity of the bankruptcy system.

Even if the Court assumes the asserted interests are compelling, the restriction is not narrowly-tailored. The government claims the section is narrowly tailored because “it does not limit more speech than is necessary to accomplish this purpose.” (Def.’s Brief 25.) The government is mistaken.

Attorneys have a First Amendment right—let alone an established professional ethical duty—to advise and zealously represent their clients. *Legal Serv. Corp. v. Velazquez*, 531 U.S. 533, 548-549 (2001). Section 526(a)(4) bars an attorney from advising a client to incur any kind of debt, including legitimate debt, in contemplation of bankruptcy. The lawyer has no duty to assist creditors—who are scarcely without their own resources, and may indeed have contributed to the potential-bankrupt’s straits by making credit easy to obtain. The attorney’s only duty is to the client, and to the law.

Incurring debt on the eve of bankruptcy can scarcely be considered malum in se. To the contrary, for some individuals incurring further obligations, even those which must be adjusted or set aside in the bankruptcy, may be financially prudent. “For example, there may be instances where it is advisable for a client to obtain a mortgage, to refinance an existing mortgage to obtain a

lower interest rate, or to buy a new car" before filing for bankruptcy. Erwin Chemerinksy, *Constitutional Issues Posed in the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005*, 79 AM. BANKR. L.J. 571, 578 (2005). If a client intends to reaffirm the debt after filing bankruptcy, there is no prejudice to the bankruptcy process. BAPCPA's § 526(a)(4) limitation on speech extends beyond any need to protect the bankruptcy process.[3] A lawyer who represents consumers contemplating bankruptcy bears the duty of zealous representation. Conversely, Congress does not have the power "to effect [a] serious and fundamental restriction on advocacy of attorneys." *See Velazquez*, 531 U.S. at 534. If upheld, this law would prevent lawyers from adequately and competently advising their clients. As such, it unconstitutionally impinges on expressions protected by the First Amendment of the Constitution.[4]

2. *Advertising: Section 528(a)(4), (b)(2)*

Plaintiffs challenge BAPCPA's advertising disclosure requirements, claiming § 528 violates their First Amendment rights. This section requires a denominated class, termed "debt relief agencies," to include

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[3] Even under the more lenient *Gentile* standard, § 526(a)(4) fails. *Gentile's* balancing test allows the law to impose "only narrow and necessary limitations on lawyers' speech." 501 U.S. 1030, 1075 (1991); *see also Hersh*, 347 B.R. at 24-25; *Olsen v. Gonzales*, 350 B.R. 906, 916 (D. Or. 2006); *Zelotes v. Martini*, 2006 WL 3231423 *4 (D. Conn. 2006).

[4] Plaintiffs further claim § 526(a)(4) is unconstitutionally vague and overbroad. The United States Supreme Court has expressed a strong preference for as-applied, as opposed to facial, challenges to the constitutionality of federal laws. *Sabri v. United States*, 541 U.S. 600 (2004). The Court finds this law unconstitutional as applied, and declines to expand its inquiry and consider whether it is also vague and overbroad.

particular, or substantially similar, language in their advertisements. Congress has prescribed that such agencies declare: "We are a debt relief agency. We help people file for bankruptcy relief under the Bankruptcy Code." 11 U.S.C. § 528(a)(4), (b)(2).

Here again, the Court must determine the appropriate standard of review. The choice turns on whether the statute regulates deceptive or truthful advertising. Statutes regulating deceptive commercial speech need only withstand rational basis review. *Zauderer v. Office of Disciplinary Counsel of the S. Ct. of Ohio*, 471 U.S. 626, 651-52 (1985). But restrictions on non-deceptive advertising must employ means that directly advance a substantial government interest. *Cent. Hudson Gas & Elec. Corp. v. Public Service Comm'n of New York*, 447 U.S. 557, 566 (1980).

The government argues that BAPCPA regulates deceptive advertising, citing evidence adduced before Congress showing "some bankruptcy lawyers did not mention in their advertisements that their ability to make 'debts disappear' derived from the use of the bankruptcy process." (Def.'s Brief 28.) Plaintiffs respond that, when Congress imposed these requirements on all advertisements of bankruptcy assistance, it mandated a blunderbuss which strikes truthful, as well as false or deceptive advertising. The Court agrees.

With very few exceptions, any party advertising debt relief services must include § 528's statutory statement. The present lawyer-plaintiffs advertise themselves as bankruptcy attorneys in newspapers, telephone directories, television, radio, and the internet. There is no evidence, however, suggesting their bankruptcy assistance advertisements are deceptive in any regard. Even as-

suming some debt relief agencies advertise an ability to make "debts disappear," there is no showing such a statement is deceptive. Under these circumstances, the Court finds it appropriate to analyze this question by applying intermediate scrutiny. *See Zauderer*, 471 U.S. at 641.

The government may only regulate truthful bankruptcy assistance advertisements if: (1) the regulation directly advances (2) a substantial government interest, and is (3) "narrowly drawn." *Cent. Hudson*, 447 U.S. at 566; *Zauderer*, 471 U.S. at 641. The Court finds that BAPCPA's § 528 advertising requirements fail to directly advance the government's purported substantial interest and are not narrowly drawn.

The government contends advertising, absent the compulsory statements, may mislead the lay community into thinking debts can be erased without payment or filing for bankruptcy. The government claims §§ 528(a)(4) and (b)(2) protect against consumer deception"by alerting [them] that a lawyer may use bankruptcy as a means to help them." (Def.'s Brief 28.) Setting aside the implausibility of anyone actually believing in a magic wand capable of making debt go away, it is most unlikely that the insertion of the statement "We are a debt relief agency, we help people file for bankruptcy relief under the Bankruptcy Code" prevents consumer deception; it may well increase it.

The term "debt relief agency" is simply a legislative contrivance. The public is more likely to be confused by an advertisement containing this Congressionally-invented term than one which advertises the services of a bankruptcy attorney.

Beyond this, however, the term "debt relief agency" is almost all-encompassing. It instantly swallows all persons who engage in"bankruptcy assistance," attorneys and non-attorneys alike. Congress's merger of both attorneys and non-attorneys is, itself, likely to confuse the public. There are many non-trivial differences between an attorney's services to his or her clients, and services non-lawyers are permitted to offer. Unlike those who only restructure debt, or perhaps provide bankruptcy forms, attorneys give legal advice and actually represent debtors in bankruptcy proceedings. The requirement that parties so dissimilarly-placed must use the same mandated disclosure statement is likely to cause consumer confusion. In this respect, § 528 fails to directly advance the government's stated interest in clarifying bankruptcy service advertisements.[5]

Section 528's advertising requirement is also not narrowly drawn. The narrowly drawn standard is "something short of a least-restrictive means standard." *Bd. of Tr. of the State Univ. of New York v. Fox*, 492 U.S. 469, 477 (1989). A narrowly drawn regulation designed to prevent deception "may be no broader than reasonably necessary to prevent the 'perceived evil.'" *In re R.M.J.*, 455 U.S. 191, 203 (1992). Section 528's language not only regulates misleading advertisements—those

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[5] At oral argument, the government's counsel acknowledged areas where the statute is vague. As an example, it appears that the quantum of bankruptcy advice a lawyer offers may require some attorneys to publish the mandated language and others not. The statute makes no distinction between a lawyer who only occasionally has a client facing bankruptcy and those who do so regularly. Quaere: does a 500-person law firm having a single lawyer who regularly does bankruptcy work have to put the disclaimer on every piece of the firm's advertising?

suggesting debts can disappear—it binds all who advertise bankruptcy services. This sweeping regulation goes beyond whatever problem it was designed to address. It broadly regulates absolutely truthful advertisements throughout an entire field of legal practice. The government has failed to show that this restriction on attorneys' commercial speech is justified. As applied to attorneys, this section of BAPCPA fails constitutional scrutiny. Thus, the government cannot prevail on its motion to dismiss.

D. *The "Debt Relief Agency" Definition*

Plaintiffs ask the Court to find attorneys beyond the scope of a BAPCPA "debt relief agency." According to the statute,

> [t]he term 'debt relief agency' means any person who provides any bankruptcy assistance to an assisted person in return for the payment of money or other valuable consideration, or who is a bankruptcy petition preparer under section 110.

11 U.S.C. § 101 (12A). This section, of course, makes no direct reference to either "attorney" or "lawyer." It does include the term "bankruptcy petition preparer," which, by definition, expressly excludes attorneys and their staff. *See* 11 U.S.C. § 110(a)(1) (2006). According to plaintiffs, the omission of any reference to attorneys or lawyers, while including a term which excludes attorneys, shows Congress must have intended to exclude attorneys from the "debt relief agency" definition. They also claim it would be absurd for attorneys to provide a statement telling their clients they have a right to an attorney, and that only attorneys can provide legal ad-

vice as required for debt relief agencies under 11 U.S.C. § 527(b).[6]

The government claims the statute includes attorneys because legal representation is included in "bankruptcy assistance," statutorily defined as:

> any goods or services sold or otherwise provided to an assisted person with the express or implied purpose of providing information, advice, counsel, document preparation, or filing, or attendance at a creditors' meeting or appearing in a case or proceeding on behalf of another or providing legal representation with respect to a case or proceeding under this title.

11 U.S.C. § 101(4A).

At first glance, this language might include attorneys. But the glance is deceiving: the statute contains a rule of construction for the term "debt relief agency." The statute provides that nothing in §§ 526, 527, and 528 —those sections imposing requirements on debt relief agencies—shall:

> be deemed to limit or curtail the authority or ability . . . of a State or subdivision or instrumentality thereof, to determine and enforce qualifications for the practice of law under the laws of that State.

11 U.S.C. § 526(d)(2)(A).

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[6] At least one court has found these arguments persuasive, holding that debtor attorneys are not "debt relief agencies." *In re Attorneys at Law and Debt Relief Agencies*, 332 B.R. 66, 69 (Bankr. S.D. Ga. 2005).

If lawyers are placed within the ambit of § 101 (4A), the placement conflicts with § 526(d)(2)(A). The conflict would exist because states would be deprived of their ability "to determine and enforce qualifications for the practice of law." If BAPCPA's debt relief agency sections apply to attorneys, it means Congress has taken upon itself the authority to determine the advice attorneys can give their clients and what attorney advertisements must say, thereby infringing on the state's traditional role of regulating attorneys. See *Leis v. Flynt*, 439 U.S. 438, 442 (1979) ("Since the founding of the Republic, the licensing and regulation of lawyers has been left exclusively to the States.")

This view is supported by the doctrine of constitutional avoidance. This doctrine counsels that, in construing a statute for ambiguity, the Court must opt for a construction which avoids grave constitutional questions. *Edward J. DeBartolo Corp. v. Florida Gulf Coast Bldg. & Constr. Trades Council*, 485 U.S. 568,575 (1988). The Court perceives a clear ambiguity in this statute—on one hand it appears to regulate a lawyer's practice; on the other, such regulation is specifically reserved to the states. As outlined above, these sections would be unconstitutional if applied to attorneys. For these reasons, the Court finds §§ 526, 527 and 528 do not apply to attorneys.

VI. *Conclusion*

The Court finds BAPCPA sections 526(a)(4) and 528(a)(4), (b)(2) are unconstitutional as applied to attorneys. Moreover, the Court finds the debt relief agency provisions of BAPCPA inapplicable to attorneys. There-

fore, the government's motion to dismiss [Docket No. 13] is denied.

IT IS SO ORDERED.

Dated: December 7th, 2006

/s/ JAMES M. ROSENBAUM
JAMES M. ROSENBAUM
United States Chief District Judge

APPENDIX C

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MINNESOTA

Case Number: 05-cv-2626 JMR/FLN

MILAVETZ, GALLOP & MILAVETZ P.A.,
ROBERT J. MILAVETZ, BARBARA N. NEVIN,
JOHN DOE, AND MARY DOE

v.

UNITED STATES OF AMERICA

[Apr. 19, 2007]

JUDGMENT IN A CIVIL CASE

☐ Jury Verdict. This action came before the Court for a trial by jury. The issues have been tried and the jury has rendered its verdict.

☒ Decision by Court. This action came to trial or hearing before the Court. The issues have been tried or heard and a decision has been rendered.

IT IS ORDERED AND ADJUDGED THAT:

1. Plaintiffs' motion for summary judgment [Docket No. 37] is granted.
2. BAPCPA's Title 11 U.S.C. Sections 526(a)(4) and 528(a)(4) and (b)(2) are declared unconstitutional,

as applied to attorneys in the District of Minnesota.

3. The Court finds that attorneys in the District of Minnesota are excluded from the term "debt relief agency," as defined in 11 U.S.C. § 101(12A); as such, Minnesota attorneys are relieved of any duties relating to BAPCPA-defined debt relief agencies imposed by that statute.

April 19, 2007 RICHARD D. SLETTEN, CLERK
Date

BY:
/s/ KATIE THOMPSON
KATIE THOMPSON, Deputy Clerk

APPENDIX D

UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

No. 07-2405

MILAVETZ, GALLOP & MILAVETZ, P.A., ET AL.,
APPELLEES

v.

UNITED STATES, APPELLANT

COMMERCIAL LAW LEAGUE OF AMERICA,
AMICUS ON BEHALF OF APPELLEE

APPEAL FROM U.S. DISTRICT COURT FOR THE
DISTRICT OF MINNESOTA—MINNEAPOLIS
(0:05-cv-02626-JMR)

ORDER

The petition for rehearing en banc is denied. The petition for rehearing by the panel is also denied.

Judge Riley, Judge Colloton, Judge Gruender, Judge Benton and Judge Shepherd would grant the petition for rehearing en banc.

December 05, 2008

Order Entered at the Direction of the Court:
Clerk, U.S. Court of Appeals, Eighth Circuit.

____
/s/ Michael E. Gans

APPENDIX E

1. 11 U.S.C. 101 provides in pertinent part:

Definitions

In this title the following definitions shall apply:

* * * * *

(3) The term “assisted person” means any person whose debts consist primarily of consumer debts and the value of whose nonexempt property is less than $150,000.

(4) The term “attorney” means attorney, professional law association, corporation, or partnership, authorized under applicable law to practice law.

(4A) The term “bankruptcy assistance” means any goods or services sold or otherwise provided to an assisted person with the express or implied purpose of providing information, advice, counsel, document preparation, or filing, or attendance at a creditors' meeting or appearing in a case or proceeding on behalf of another or providing legal representation with respect to a case or proceeding under this title.

* * * * *

(12) The term “debt” means liability on a claim.

(12A) The term “debt relief agency” means any person who provides any bankruptcy assistance to an assisted person in return for the payment of money or other valuable consideration, or who is a bank-

ruptcy petition preparer under section 110, but does not include—

(A) any person who is an officer, director, employee, or agent of a person who provides such assistance or of the bankruptcy petition preparer;

(B) a nonprofit organization that is exempt from taxation under section 501(c)(3) of the Internal Revenue Code of 1986;

(C) a creditor of such assisted person, to the extent that the creditor is assisting such assisted person to restructure any debt owed by such assisted person to the creditor;

(D) a depository institution (as defined in section 3 of the Federal Deposit Insurance Act) or any Federal credit union or State credit union (as those terms are defined in section 101of the Federal Credit Union Act), or any affiliate or subsidiary of such depository institution or credit union; or

(E) an author, publisher, distributor, or seller of works subject to copyright protection under title 17, when acting in such capacity.

* * * * *

2. 11 U.S.C. 526 provides:

Restrictions on debt relief agencies

(a) A debt relief agency shall not—

(1) fail to perform any service that such agency informed an assisted person or prospective assisted

person it would provide in connection with a case or proceeding under this title;

(2) make any statement, or counsel or advise any assisted person or prospective assisted person to make a statement in a document filed in a case or proceeding under this title, that is untrue and misleading, or that upon the exercise of reasonable care, should have been known by such agency to be untrue or misleading;

(3) misrepresent to any assisted person or prospective assisted person, directly or indirectly, affirmatively or by material omission, with respect to—

(A) the services that such agency will provide to such person; or

(B) the benefits and risks that may result if such person becomes a debtor in a case under this title; or

(4) advise an assisted person or prospective assisted person to incur more debt in contemplation of such person filing a case under this title or to pay an attorney or bankruptcy petition preparer fee or charge for services performed as part of preparing for or representing a debtor in a case under this title.

(b) Any waiver by any assisted person of any protection or right provided under this section shall not be enforceable against the debtor by any Federal or State court or any other person, but may be enforced against a debt relief agency.

(c)(1) Any contract for bankruptcy assistance between a debt relief agency and an assisted person that does not comply with the material requirements of this

section, section 527, or section 528 shall be void and may not be enforced by any Federal or State court or by any other person, other than such assisted person.

(2) Any debt relief agency shall be liable to an assisted person in the amount of any fees or charges in connection with providing bankruptcy assistance to such person that such debt relief agency has received, for actual damages, and for reasonable attorneys' fees and costs if such agency is found, after notice and a hearing, to have—

(A) intentionally or negligently failed to comply with any provision of this section, section 527, or section 528 with respect to a case or proceeding under this title for such assisted person;

(B) provided bankruptcy assistance to an assisted person in a case or proceeding under this title that is dismissed or converted to a case under another chapter of this title because of such agency's intentional or negligent failure to file any required document including those specified in section 521; or

(C) intentionally or negligently disregarded the material requirements of this title or the Federal Rules of Bankruptcy Procedure applicable to such agency.

(3) In addition to such other remedies as are provided under State law, whenever the chief law enforcement officer of a State, or an official or agency designated by a State, has reason to believe that any person has violated or is violating this section, the State—

(A) may bring an action to enjoin such violation;

(B) may bring an action on behalf of its residents to recover the actual damages of assisted persons arising from such violation, including any liability under paragraph (2); and

(C) in the case of any successful action under subparagraph (A) or (B), shall be awarded the costs of the action and reasonable attorneys'fees as determined by the court.

(4) The district courts of the United States for districts located in the State shall have concurrent jurisdiction of any action under subparagraph (A) or (B) of paragraph (3).

(5) Notwithstanding any other provision of Federal law and in addition to any other remedy provided under Federal or State law, if the court, on its own motion or on the motion of the United States trustee or the debtor, finds that a person intentionally violated this section, or engaged in a clear and consistent pattern or practice of violating this section, the court may—

(A) enjoin the violation of such section; or

(B) impose an appropriate civil penalty against such person.

(d) No provision of this section, section 527, or section 528 shall—

(1) annul, alter, affect, or exempt any person subject to such sections from complying with any law of any State except to the extent that such law is inconsistent with those sections, and then only to the extent of the inconsistency; or

(2) be deemed to limit or curtail the authority or ability—

(A) of a State or subdivision or instrumentality thereof, to determine and enforce qualifications for the practice of law under the laws of that State; or

(B) of a Federal court to determine and enforce the qualifications for the practice of law before that court.

BRIEF BANK — 'SUMMARY SHEET"

Printed Wed-9/12/07 13:35

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]* — Milavetz v. United States

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]* — Eighth Circuit Court of Appeals

3. ("CCN") ***CURRENT*** CASE NO. — No.: 07-2405

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]* — No.: 05-CV-02626

Court: District Court of Minnesota

(Identify judge & cite, if any)

5. ("SO") ***SOURCE*** — **U.S. TRUSTEES**

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]* — Filed: August 21, 2007

Type: Brief for Appellant

7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]* — Peter Keisler, Rachel Paulose, Mark B. Stern, Mark R. Freeman

(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC*** — **BANKRUPTCY**

9. ("SU") ● ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***

● Whether 11 U.S.C. § 526(a)(4), which precludes debt relief agencies from advising clients to incur additional debt in contemplation of filing a petition for bankruptcy, violates the First Amendment ?

Whether 11 U.S.C. § 528 which requires debt relief agencies to include certain disclosures in their advertisements, violates the First Amendment?

Whether 11 U.S.C. § 526, 527 & 528 regulate the professional conduct of attorneys?

10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)

11. DO YOU RECOMMEND POSTING IN UST BRIEFBANK? ☒ YES ☐ NO

NAME: Holly Walter

DATE:

No. 07-2405

IN THE UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

MILAVETZ, GALLOP & MILAVETZ P.A., ROBERT J. MILAVETZ,
BARBARA N. NEVIN, JOHN DOE, and MARY DOE,

Plaintiffs-Appellees,
v.

UNITED STATES OF AMERICA,

Defendant-Appellant.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MINNESOTA (ROSENBAUM, C.J.)

BRIEF FOR THE APPELLANT

PETER D. KEISLER
Assistant Attorney General

RACHEL K. PAULOSE
United States Attorney

MARK B. STERN
(202) 514-5089
MARK R. FREEMAN
(202) 514-5714
Attorneys, Appellate Staff
Civil Division, Room 7531
Department of Justice
950 Pennsylvania Ave., N.W.
Washington, D.C. 20530-0001

SUMMARY OF THE CASE AND STATEMENT REGARDING ORAL ARGUMENT

This case involves a facial First Amendment challenge to provisions of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23. As part of that Act, Congress established certain minimum standards of professional conduct for "debt relief agencies" — a term defined to include "any person" who provides professional bankruptcy assistance to consumer debtors in exchange for a fee. Among other requirements, Congress provided that debt relief agencies may not advise clients to incur additional debt in contemplation of filing a bankruptcy petition, see 11 U.S.C. § 526(a)(4), and required that debt relief agencies disclose in their advertisements the fact that they assist clients in filing for bankruptcy, see 11 U.S.C. § 528(a)(4), (b)(2). The district court held these provisions unconstitutional under the First Amendment, and further held that the term "debt relief agency" does not encompass licensed attorneys.

Because the district court has declared unconstitutional several provisions of an Act of Congress, the United States respectfully requests that the Court allocate 20 minutes per side for oral argument.

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IN THE UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

No. 07-2405

MILAVETZ, GALLOP & MILAVETZ P.A., ROBERT J. MILAVETZ,
BARBARA N. NEVIN, JOHN DOE, and MARY DOE,

Plaintiffs-Appellees,

v.

UNITED STATES OF AMERICA,

Defendant-Appellant.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MINNESOTA (ROSBENBAUM, C.J.)

BRIEF FOR THE APPELLANT

STATEMENT OF JURISDICTION

Plaintiffs invoked the jurisdiction of the district court under 28 U.S.C. § 1331. See JA9.[1] The district court entered final judgment in favor of plaintiffs on April 19, 2007. JA46. The United States filed a notice of appeal on June 13, 2007, within the time provided by Fed. R. App. P. 4(a)(1)(B). JA47. This Court has jurisdiction pursuant to 28 U.S.C. § 1291.

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[1] "JA__" denotes a citation to the joint appendix.

STATEMENT OF THE ISSUES

1. Whether 11 U.S.C. § 526(a)(4), which precludes debt relief agencies from advising clients to incur additional debt in contemplation of filing a petition for bankruptcy, violates the First Amendment.

H.R. Rep. No. 109-31 (2005)

Gentile v. State Bar of Nevada, 501 U.S. 1030 (1991)

Broadrick v. Oklahoma, 413 U.S. 601 (1973)

2. Whether 11 U.S.C. § 528, which requires debt relief agencies to include certain disclosures in their advertisements, violates the First Amendment.

Florida Bar v. Went For It, Inc., 515 U.S. 618 (1995)

Zauderer v. Office of Disciplinary Counsel of Supreme Court of Ohio, 471 U.S. 626 (1985)

3. Whether the term "debt relief agency," as defined in the Bankruptcy Code, includes bankruptcy attorneys.

11 U.S.C. § 101(12A)

11 U.S.C. § 101(4A)

Heintz v. Jenkins, 514 U.S. 291 (1995)

Goldfarb v. Virginia State Bar, 421 U.S. 773 (1975)

STATEMENT OF THE CASE

As part of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23 (2005), Congress established minimum standards of professional conduct for bankruptcy attorneys, bankruptcy petition preparers, and other "debt relief agencies" — anyone who provides professional bankruptcy assistance to consumer debtors in exchange for a fee. Among other requirements, Congress provided that debt relief agencies may not advise clients to incur additional debt in contemplation of filing a bankruptcy petition, see 11 U.S.C. § 526(a)(4), and required that debt relief agencies disclose in their advertisements the fact that they assist clients in filing for bankruptcy, see 11 U.S.C. § 528(a)(4), (b)(2).

Plaintiffs, who include consumer bankruptcy attorneys, filed this facial challenge alleging that the advice limitations in section 526(a)(4) and the disclosure requirements in section 528 violate the First Amendment. In addition, plaintiffs contended that the statutory term "debt relief agency" does not include attorneys. The district court (Rosenbaum, C.J.) granted summary judgment for plaintiffs, holding that each of the challenged provisions violates the First Amendment, and that attorneys do not fall within the statutory definition.

STATEMENT OF FACTS

A. Statutory Background

1. In the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, Congress enacted "a comprehensive package of reform measures" designed "to improve bankruptcy law and practice by restoring personal responsibility

and integrity in the bankruptcy system and ensure that the system is fair for both debtors and creditors." H.R. Rep. No. 109-31, pt. 1, at 2 (2005), reprinted in 2005 U.S.C.C.A.N. 88, 89 ("House Report"). Described by Congress as "the most comprehensive set of [bankruptcy] reforms in more than 25 years," id. at 3, the Act both modifies the substantive standards for bankruptcy relief and adopts new measures intended to curb a variety of abusive practices that Congress concluded had come to pervade the bankruptcy system.

As part of this reform package, Congress established certain minimum standards of professional conduct for bankruptcy attorneys, bankruptcy petition preparers, and other bankruptcy professionals — collectively termed "debt relief agencies" — who provide for-profit services to consumer debtors. The statute defines the term "debt relief agency" to include any person who, for a fee, "provides any bankruptcy assistance to an assisted person." 11 U.S.C. § 101(12A). "Bankruptcy assistance" includes any services intended to provide advice, counsel, or document preparation or filing assistance "with respect to a case or proceeding under this title," including in particular "providing legal representation." Id. § 101(4A).[2]

Misleading and abusive practices by such bankruptcy

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[2] An "assisted person" is "any person whose debts consist primarily of consumer debts and the value of whose nonexempt property is less than $164,250." Id. § 101(3); cf. id. § 104(a) (adjustment of dollar figures).

professionals, Congress determined, had become a substantial cause of unnecessary bankruptcy petitions and, in some circumstances, jeopardized debtors' ability to obtain a discharge of their debts. For example, Congress heard evidence that a civil enforcement initiative undertaken by the United States Trustee Program had "consistently identified * * * misconduct by attorneys and other professionals" as among the sources of abuse in the bankruptcy system. House Report, at 5 (citation omitted). Congress therefore responded in the 2005 Act by "strengthening professionalism standards for attorneys and others who assist consumer debtors with their bankruptcy cases." Id. at 17.

2. The new standards enacted by Congress are principally set forth in 11 U.S.C. §§ 707 and 526-528.[3]

Section 707, as amended by the 2005 Act, now requires bankruptcy attorneys to make their own reasonable investigation into the circumstances giving rise to the debtor's petition, including a specific inquiry into the veracity of the debtor's debt and asset schedules. See 11 U.S.C. § 707(b)(4)(C)-(D). The legislation further requires the attorney to certify that, in the attorney's professional judgment, the petition does not constitute an "abuse" under section 707(b). See ibid.

Section 526 lays down four basic rules of professional conduct. Section 526(a)(1) requires debt relief agencies to

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[3] For the Court's convenience, the pertinent provisions are reproduced in the addendum to this brief.

perform all promised services. Section 526(a)(2) prohibits debt relief agencies from advising an assisted person to make statements that are untrue or misleading in seeking bankruptcy relief. Section 526(a)(3) precludes debt relief agencies from misrepresenting the services they will provide, the benefits that will accrue, or the risks that may be entailed in filing for bankruptcy. Section 526(a)(4), which plaintiffs challenge in this litigation, states:

> A debt relief agency shall not * * * advise an assisted person or prospective assisted person to incur more debt in contemplation of such person filing a case under this title or to pay an attorney or bankruptcy petition preparer fee or charge for services performed as part of preparing for or representing a debtor in a case under this title.

11 U.S.C.§ 526(a)(4).

Sections 527 and 528 set forth several interrelated disclosure requirements. Section 527 requires debt relief agencies to provide specific notices to clients, including a description of the different types of relief available in the bankruptcy system. Section 528 similarly requires debt relief agencies to provide clients with written contracts that clearly explain the services that will be provided and the fees that will apply. See 11 U.S.C. § 528(a)(1)-(2).

In addition, section 528 requires debt relief agencies to "clearly and conspicuously disclose in any advertisement * * * directed to the general public" that the advertised debt-relief services “are with respect to bankruptcy relief under this title.” Id. § 528(a)(3). In particular, in any advertisements purporting to offer relief from “credit defaults, mortgage foreclosures, eviction proceedings, excessive debt, debt collection pressure, or inability to pay any consumer debt,” a debt relief agency must:

> (A) disclose clearly and conspicuously in such advertisement that the assistance may involve bankruptcy relief under this title; and
>
> (B) include the following statement: “We are a debt relief agency. We help people file for bankruptcy relief under the Bankruptcy Code.” or a substantially similar statement.

Id. § 528(b)(2); see also id. § 528(a)(4).

3. The primary remedy for violations of these sections is a civil action by the debtor to recover the debtor’s “actual damages,” including any fees already paid. See 11 U.S.C. § 526(c)(2). For violations of the professional conduct restrictions in section 526, the statute also permits the relevant state attorney general to file an action for the debtor’s actual damages, see id. § 526(c)(3), and authorizes the bankruptcy court to impose an “appropriate civil monetary penalty” if it determines that the violation was intentional or formed part of a clear and consistent pattern, id. § 526(c)(5).

B. Facts and Prior Proceedings

1. Plaintiffs are two consumer bankruptcy attorneys, their

law firm, and two members of the public. See JA8 (complaint).[4] In this civil action against the United States, plaintiffs seek a declaratory judgment that they are not obligated to comply with the advice limitations in section 526(a)(4) or the advertising disclosure requirements in section 528. In their district court papers, plaintiffs contended that attorneys are not "debt relief agencies" within the meaning of the statute. They also claimed that, to the extent the statute encompasses licensed attorneys, sections 526(a)(4), 528(a)(4), and 528(b)(2) violate the First Amendment.

2. The district court invalidated the challenged provisions. See Milavetz, Gallop & Milavetz P.A. v. United States, 355 B.R. 758 (D. Minn. 2006) (JA27-43).

a. The district court began by holding that the advice limitations in section 526(a)(4), as applied to attorneys, violate the First Amendment. See id. at 763-66. The court first concluded that section 526(a)(4) is a content-based restriction subject to strict scrutiny, rather than "a species of ethical regulation" subject to "the more lenient standard outlined in

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[4] The original complaint listed two unnamed plaintiffs (identified as John and Mary Doe) who claimed to be members of the public hoping to obtain bankruptcy-related advice from the attorney plaintiffs. JA8. The district court held that those parties could not use a pseudonym. See Milavetz, Gallop & Milavetz P.A. v. United States, 355 B.R. 758, 762-63 (D. Minn. 2006). Plaintiffs later amended their complaint to disclose the names of those parties. See No. 05-2626 (D. Minn.), docket #34.

Gentile v. State Bar of Nevada, 501 U.S. 1030 (1991)." See 355 B.R. at 764. The court explained that the provision could not be understood as a rule of professional conduct because, in the court's view, "the statute discloses no quasi-religious or ethical principle. * * * * While the section is certainly a rule, nothing in § 526 alludes to ethics." Ibid.

Turning to the merits, the district court applied strict scrutiny and held that section 526(a)(4) "unconstitutionally impinges on expressions protected by the First Amendment." Id. at 765. The court did not dispute that section 526(a)(4) is designed to curb fraud and abuse of the bankruptcy system. See ibid. It concluded, however, that the restriction "is not narrowly-tailored," because under the court's interpretation of the statute, section 526(a)(4) "bars an attorney from advising a client to incur any kind of debt, including legitimate debt, in contemplation of bankruptcy." Ibid.[5]

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[5] In holding section 526(a)(4) unconstitutional, the court relied in part on decisions from district courts in other circuits. Appeals from those decisions are now pending. See Hersh v. United States, 347 B.R. 19 (N.D. Tex. 2006), appeal docketed, Nos. 07-10226 & 07-10265 (5th Cir.); Zelotes v. Martini, 352 B.R. 17 (D. Conn. 2006), appeal docketed sub nom. Zelotes v. Adams, No. 07-1853 (2d Cir.); Olsen v. Gonzales, 350 B.R. 906 (D. Or. 2006), appeal docketed, No. 07-35616 (9th Cir.). Additional challenges to section 526(a)(4) are pending in other district courts. See Conn. Bar Ass'n v. United States, No. 06-729 (D. Conn.); In re Reyes, No. 07-20689 (S.D. Fla.).

b. The district court next invalidated the advertising disclosure requirements in section 528. See id. at 766-67. The court rejected the government's contention that section 528 prevents consumer deception by making clear that advertisements promising to prevent foreclosure, for example, or to make debts "disappear," are in fact advertisements offering assistance in filing for bankruptcy. Id. at 767. The district court expressed skepticism that any such disclosure was necessary, asserting "the implausibility of anyone actually believing in a magic wand capable of making debt go away." Ibid. In the court's view, moreover, the requirement in section 528 that debt relief agencies identify themselves using that "Congressionally-invented term" was unlikely to decrease consumer confusion and "may well increase it," particularly because the term applies to "attorneys and non-attorneys alike." Ibid. The district court thus held section 528 invalid under the First Amendment because it "fails to directly advance the government's stated interest in clarifying bankruptcy service advertisements." Ibid.

c. Finally, after ruling on plaintiffs' constitutional claims, the district court returned to plaintiffs' statutory argument that the term "debt relief agency" does not encompass licensed attorneys. See id. at 767-68. The court recognized that, although the definition of "debt relief agency" does not specifically mention attorneys, it includes any person who provides "bankruptcy assistance," which is defined to include, inter alia, "providing legal representation with respect to a case or proceeding under this title." See id. at 768.

Nevertheless, the district court ruled that attorneys are not debt relief agencies. Ibid. In so holding, the court relied on the preemption savings clause in section 526(d), which provides that nothing in sections 526 or 528 may "be deemed to limit or curtail the authority * * * of a State * * * to determine and enforce qualifications for the practice of law." 11 U.S.C. § 526(d)(2)(A). The district court reasoned that, if the term "debt relief agency" encompassed attorneys, it would "conflict[] with § 526(d)(2)(A)," "because states would be deprived of their ability" to establish qualifications for legal practice. 355 B.R. at 768. The district court also stated that its interpretation was supported by the doctrine of constitutional avoidance because, as the court had already held, the challenged provisions "would be unconstitutional if applied to attorneys." Ibid.

3. The district court subsequently granted plaintiffs' motion for summary judgment and entered a declaratory judgment

that sections 526(a)(4), 528(a)(4), and 528(b)(2) are "unconstitutional, as applied to attorneys in the District of Minnesota." JA44. The district court further declared that "attorneys in the District of Minnesota are excluded from the term 'debt relief agency,' as defined in 11 U.S.C. § 101(12A); as such, Minnesota attorneys are relieved of any duties relating to BAPCPA-defined debt relief agencies imposed by that statute." JA45. This appeal followed.

SUMMARY OF ARGUMENT

In enacting the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Congress sought to curb abuses of the bankruptcy system, both by debtors and by the professionals who represent them. Congress thus "strengthen[ed] professionalism standards for attorneys and others who assist consumer debtors with their bankruptcy cases," H.R. Rep. No. 109-31, pt. 1, at 17, by enacting a range of new provisions, including the two measures at issue here. Section 526(a)(4) precludes bankruptcy attorneys from encouraging their clients to abuse the protections of the Bankruptcy Code by deliberately accumulating new debt in contemplation of bankruptcy, while section 528 requires bankruptcy attorneys to disclose in their advertisements that the services they offer may in fact involve a petition for bankruptcy. Because the First Amendment does not disable Congress from regulating the professional conduct of bankruptcy attorneys in this manner, the judgment of the district court should be reversed.

I. Section 526(a)(4) provides that bankruptcy attorneys and other debt relief agencies may not advise their clients "to incur more debt in contemplation of" filing a petition for bankruptcy relief. 11 U.S.C. § 526(a)(4). This requirement is part of a broader effort by Congress in the 2005 legislation to address abuses of the bankruptcy system by debtors who amass additional debt on the eve of bankruptcy in order to take advantage of the Bankruptcy Code's discharge provisions or otherwise manipulate its protections. Among other amendments, the 2005 Act restricts the ability of debtors to discharge such debt, and it expands the authority of bankruptcy courts to dismiss petitions for abuse of the bankruptcy system — including in cases in which debtors abuse the Code by taking on additional debt in contemplation of filing a petition. In addition, the 2005 legislation imposes a new duty on bankruptcy attorneys personally to certify that the petitions filed by their clients do not constitute an abuse of the Code, and it authorizes bankruptcy courts to impose sanctions on attorneys for violations of that duty.

Section 526(a)(4) complements these provisions by precluding attorneys and other bankruptcy professionals from encouraging their clients to engage in such abuses. The district court did not suggest that debtors can properly take on additional debt to manipulate the bankruptcy system, or that attorneys are constitutionally entitled to encourage them to do so. Nevertheless, the district court declared section 526(a)(4) unconstitutional on its face because it believed that the provision would also encompass advice to engage in conduct consistent with the Bankruptcy Code and with the client's legitimate interests.

That reading extends section 526(a)(4) far beyond Congress's purpose. In precluding attorneys from urging their clients to take on additional debt "in contemplation of" a bankruptcy filing, Congress was concerned only with debt purposefully accumulated in order to manipulate the bankruptcy system. Neither the language of the statute nor relevant legislative history warrants the district court's assumption that section 526(a)(4) would prevent a lawyer from offering candid advice on the legality of a debtor's proposed course of conduct, or that it would prohibit an attorney from urging a client to take actions consistent with the Bankruptcy Code and the client's best interests. A statute should be construed to avoid, rather than to invite, constitutional difficulties, and the court erred in failing to apply this principle in construing section 526(a)(4).

Moreover, even under the district court's mistakenly broad reading of the statute, there is little dispute that section 526(a)(4) would be constitutionally applied in the category of cases at which the statute is actually aimed. In holding section 526(a)(4) invalid in all its applications to all attorneys in Minnesota, the district court failed to consider whether the assertedly impermissible applications would be substantial when judged in relation to the statute's plainly legitimate sweep.

II. Section 528 requires bankruptcy attorneys to disclose in their advertisements that the services they offer may in fact involve a petition for bankruptcy. See 11 U.S.C. § 528(b)(2); id. § 528(a)(4). Congress enacted this disclosure requirement in response to evidence of aggressive advertising tactics by attorneys and other bankruptcy professionals who offered enticing promises of relief — preventing foreclosures, stopping repossessions, making debts "disappear," and so on — without revealing that obtaining such relief would involve a petition for bankruptcy.

This limited requirement, which restricts no speech, is tailored to the problem identified by Congress and simply ensures that advertisements for debt relief assistance disclose that the advertiser provides bankruptcy services. In holding the provision invalid, the district court declared that the problem addressed by the legislation did not exist, asserting that it was "implausib[le]" that "anyone [would] actually believ[e] in a magic wand capable of making debt go away." 355 B.R. at 766-67. The court's declaration is without basis and fails even to acknowledge the evidence that prompted Congress's action.

III. After reaching and deciding plaintiffs' constitutional claims, the district court addressed plaintiffs' statutory argument and declared that the term "debt relief agency" does not encompass licensed attorneys. That conclusion is flatly at odds with the statutory language and congressional intent. The standards of professional conduct adopted by Congress in the 2005 legislation — including many provisions not challenged by plaintiffs here — apply to "debt relief agencies." That term is defined to include "any person" who, for a fee, "provides any bankruptcy assistance to an assisted person." 11 U.S.C. § 101(12A). "Bankruptcy assistance," in turn, includes "providing information, advice, [or] counsel * * * with respect to a case or proceeding under this title" — including in particular "providing legal representation." Id. § 101(4A).

By its plain terms, therefore, the 2005 Act applies to any person who provides "legal representation" to consumer debtors for a fee — a category that unmistakably includes bankruptcy attorneys. Indeed, as the legislative history makes clear, Congress enacted the "debt relief agency" reforms in response to evidence that specifically identified misconduct by attorneys as a cause of abusive bankruptcy filings. Congress regulated the professional conduct of bankruptcy attorneys as part of its broader effort in the 2005 legislation to curb bankruptcy abuses, and the district court could not properly excise attorneys from the scope of the statute.

STANDARD OF REVIEW

This Court reviews challenges to the constitutionality of a federal statute de novo. See, e.g., United States v. Mugan, 441 F.3d 622, 627 (8th Cir. 2006); United States v. Crawford, 115 F.3d 1397, 1400 (8th Cir. 1997). Issues of statutory interpretation are likewise subject to plenary review. See United States v. Weis, 487 F.3d 1148, 1151 (8th Cir. 2007).

ARGUMENT

I. CONGRESS CONSTITUTIONALLY REGULATED THE CONDUCT OF BANKRUPTCY PROFESSIONALS BY PRECLUDING THEM FROM ENCOURAGING CLIENTS TO ABUSE THE BANKRUPTCY SYSTEM BY TAKING ON ADDITIONAL DEBT IN CONTEMPLATION OF FILING A PETITION.

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 seeks to curb a variety of abusive practices by consumer debtors and their professional representatives. A principal concern of the legislation was to address the recurring problem of debtors' attempting to exploit the Bankruptcy Code's discharge provisions, or otherwise manipulate the bankruptcy system, by purposefully accumulating additional debt prior to filing a petition for relief. Among other reforms, the 2005 Act expanded the authority of the bankruptcy courts to dismiss petitions for such abuses and required attorneys affirmatively to certify that no basis exists for deeming their clients' petitions abusive.

Section 526(a)(4) complements these reforms by precluding bankruptcy professionals from encouraging their clients to abuse the bankruptcy system by taking on additional debt in contemplation of filing a bankruptcy petition. Because the provision is an unexceptional regulation of professional conduct that does not impinge upon the First Amendment rights of attorneys or their clients, the judgment of the district court should be reversed.

A. The 2005 Act Addresses Abuses Of The Code By Debtors Who Incur New Debt In Anticipation Of Bankruptcy And By Attorneys Who Encourage Clients To Engage In Such Conduct.

1. Abuses Of The System By Debtors Incurring Additional Debt In Contemplation Of Bankruptcy.

Congress has long been aware that the relief afforded by the bankruptcy laws creates a perverse incentive for debtors to amass additional debt in contemplation of obtaining a discharge. Congress has repeatedly expressed its view that such conduct poses a fundamental threat to the Code's twin goals of affording debtors a fresh start while providing an orderly and equitable system of resolving creditors' claims.

For example, when Congress enacted 11 U.S.C. § 523(a)(2)(C), which creates a presumption that certain eve-of-bankruptcy debts are not dischargeable, the accompanying Senate Report emphasized that "[e]xcessive debts incurred within a short period prior to the filing of the petition present a special problem: that of 'loading up' in contemplation of bankruptcy." S. Rep. No. 98-65, at 9 (1983). The report explained that "[a] debtor planning [to] file a petition with the bankruptcy court has a strong economic incentive to incur dischargeable debts for either consumable goods or exempt property," noting that "[i]n many instances, the debtor will go on a credit buying spree in contemplation of bankruptcy at a time when the debtor is, in fact, insolvent." Ibid. As the report concluded, "[n]ot only does this result in direct losses for the creditors that are the victims of the spree, but it also creates a higher absolute level of debt so that all creditors receive less in liquidation. During this period of insolvency preceding the filing of the petition, creditors would not extend credit if they knew the true facts." Ibid. Indeed, as early as 1973, Congress was informed that "the most serious abuse of consumer bankruptcy is the number of instances in which individuals have purchased a sizable quantity of goods and services on credit on the eve of bankruptcy in contemplation of obtaining a discharge." Report of the Commission of the Bankruptcy Laws of the United States, H.R. Doc. No. 93-137, pt. I, at 11 (July 1973).

In adopting the 2005 Act, Congress expressed concern that these earlier measures had not adequately restricted the ability of debtors to "knowingly load up with credit card purchases or recklessly obtain cash advances and then file for bankruptcy relief." H.R. Rep. No. 109-31, pt. 1, at 15 (2005), reprinted in 2005 U.S.C.C.A.N. 88, 101 ("House Report"). Accordingly, Congress took a series of new steps in the 2005 Act to combat the problem of debts incurred in contemplation of bankruptcy. Thus, the Act reduced the threshold amounts at which certain types of eve-of-bankruptcy debts, such as cash advances, become presumptively fraudulent and therefore nondischargeable.[6] See Pub. L. No. 109-8, § 310, 119 Stat. at 84 (amending 11 U.S.C. § 523(a)(2)(C)).

More fundamentally, Congress greatly expanded the authority of the bankruptcy courts to dismiss petitions for abuse of the bankruptcy system, including in cases in which debtors abuse the Code by purposefully incurring additional debt in contemplation of filing a petition. Even before the 2005 legislation, a bankruptcy court was authorized to dismiss a petition for "substantial abuse" under former 11 U.S.C. § 707(b)(1). Moreover, it was established that, under the "substantial abuse" standard, a debtor's purposeful accumulation of debt in contemplation of bankruptcy could justify dismissal. See In re Walton, 866 F.2d 981, 983-84 (8th Cir. 1989) ("substantial abuse"

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[6] One of the factors that bankruptcy courts consider in determining whether a debt is fraudulent and nondischargeable, moreover, is "[w]hether or not an attorney has been consulted concerning the filing of bankruptcy before the charges were made." In re Eashai, 87 F.3d 1082, 1087 (9th Cir. 1996); see also In re Mercer, 246 F.3d 391, 408 (5th Cir. 2001) (en banc) ("whether, prior to card-use, an attorney was consulted about bankruptcy").

inquiry included, but was not limited to, evidence of bad faith conduct by the debtor); see also, e.g., In re Price, 353 F.3d 1135, 1139-40 (9th Cir. 2004) (describing factors relevant to a finding of substantial abuse, including "[w]hether the debtor has engaged in eve-of-bankruptcy purchases"); In re Charles, 334 B.R. 207, 222 (Bankr. S.D. Tex. 2005) ("It is settled law that a debtor's good faith should be questioned if the debtor makes purchases in contemplation of a bankruptcy case."); In re Rathbun, 309 B.R. 901, 904 (Bankr. N.D. Tex. 2004); In re Aiello, 284 B.R. 756, 761 (Bankr. E.D.N.Y. 2002).[7]

In the 2005 Act, Congress reduced the threshold finding required under 11 U.S.C. § 707(b) for a bankruptcy court to dismiss a debtor's petition as abusive, from "substantial abuse" to merely "abuse," see House Report at 48, and it repealed the statutory presumption in favor of granting the relief sought by the debtor, see id. at 49; Pub. L. No. 109-8, § 102, 119 Stat. at 27. Congress further made clear that, in determining whether a petition should be dismissed for abuse, a bankruptcy court may

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[7] As the Supreme Court recently explained in the context of chapter 13 debtors, bad faith pre-petition conduct by the debtor justifies dismissal of the petition because such a debtor "is not a member of the class of 'honest but unfortunate debtor[s]' that the bankruptcy laws were enacted to protect." Marrama v. Citizens Bank, 127 S. Ct. 1105, 1111 (2007) (quoting Grogan v. Garner, 498 U.S. 279, 287 (1991)).

properly consider "whether the debtor filed the petition in bad faith" and whether "the totality of the circumstances * * * of the debtor's financial situation demonstrates abuse." 11 U.S.C. § 707(b)(3). At the same time, Congress authorized any party in interest — including, for example, unsecured creditors aggrieved by a debtor's eleventh-hour accumulation of new debt — to file a motion for such relief. See id. § 707(b)(1). Under prior law, only the United States Trustee, or the court on its own motion, could seek to dismiss a petition as abusive. See, e.g., In re Walton, 866 F.2d at 982.

2. Abuses Of The System By Lawyers And Other Bankruptcy Professionals.

Congress also responded in the 2005 Act to evidence that attorneys and other bankruptcy professionals often played a critical role in abuse of the bankruptcy system. Citing data collected by the U.S. Trustee Program, the House Report noted that the study "consistently identified," among the sources of bankruptcy abuse, "misconduct by attorneys and other professionals" and "problems associated with bankruptcy petition preparers." House Report at 5 (quoting Darling & Redmiles, Protecting the Integrity of the System: the Civil Enforcement Initiative, 21 Am. Bankr. Inst. J. 12 (Sept. 2002)).

The need to address misconduct by bankruptcy professionals was made particularly urgent by the "principal consumer bankruptcy reform" in the 2005 legislation, which was the adoption of a "means testing" mechanism intended to restrict debtors who have the ability to repay at least some of their debts from obtaining a complete discharge under chapter 7. See House Report at 48; see also id. at 3 (describing means testing as the "heart" of the 2005 Act's reform provisions). Under the new means-testing provision, a debtor's petition for complete relief under chapter 7 is presumed to be abusive if the debtor's income exceeds his unsecured debts by a certain ratio. See 11 U.S.C. § 707(b)(2)(A). The effect of the means test is to ensure that debtors who have the ability to repay a portion of their debts are channeled into chapter 13, which provides an opportunity for a structured repayment plan.

As Congress recognized, however, the means test exacerbates the incentive for debtors to manipulate the system by "loading up" on debt in contemplation of filing a petition, because a higher debt ratio can allow an otherwise borderline debtor to avoid the burdens of a chapter 13 repayment plan and obtain a complete and immediate discharge under chapter 7. Concern was expressed at the congressional hearings that attorneys would respond to the means test by counseling their clients to take on additional debt before filing for bankruptcy. As one bankruptcy judge testified, "[t]he more debt that is incurred prior to filing, the more likely the debtor will qualify for chapter 7." Thus, "[p]erverse as it may seem, I can envision debtor's counsel advising their clients to buy the most expensive car that someone will sell them, and sign on to the biggest payment they can afford (at least until the bankruptcy is filed) as a way of increasing their deductions under [the means test]." Bankruptcy Reform Act of 1998: Part I, Hearing on H.R. 3150 before House Judiciary Comm., 105th Cong. 25 (1998) (testimony of Judge Randall Newsome); see also Bankruptcy Reform Act of 1999 (Part II), Hearing before House Judiciary Comm., 106th Cong. 30 (1999) (testimony of Judge William Brown).

Congress addressed these problems in the 2005 Act by "strengthening professionalism standards for attorneys and others who assist consumer debtors with their bankruptcy cases" in return for a fee. House Report at 17. Under the amended provisions of the Code, an attorney who represents a consumer debtor in filing a bankruptcy petition must make her own reasonable investigation into the circumstances giving rise to the debtor's petition, including a specific inquiry into the veracity of the debtor’s debt and asset schedules. See 11 U.S.C. § 707(b)(4)(C)-(D). By signing the petition, the attorney personally certifies that she believes the petition is warranted by the facts, that she has no reason to believe the debtor’s schedules are incorrect, and that she has determined that the petition does not constitute an “abuse” under section 707(b). See ibid. Congress thus effectively required bankruptcy attorneys to warrant that their clients’ pre-petition conduct and financial circumstances — including any assumption of debt in contemplation of bankruptcy — do not provide grounds for dismissal of the petition as abuse of the bankruptcy system.

Section 526(a) complements these requirements by precluding attorneys and other “debt relief agencies” from deceiving their clients or advising them to abuse the bankruptcy system. Thus, section 526(a)(2) prohibits attorneys from encouraging clients to make false statements in a bankruptcy proceeding, and section 526(a)(3) bars attorneys from misrepresenting the risks and benefits of seeking bankruptcy relief. Similarly, section 526(a)(4), at issue here, precludes attorneys from encouraging their clients to abuse the bankruptcy system by taking on additional debt in contemplation of filing a bankruptcy petition.

B. Section 526(a)(4) Constitutionally Restricts Attorneys From Encouraging Clients To Take On Additional Debt In Contemplation of Bankruptcy.

1. The First Amendment Does Not Preclude Restrictions On Attorney Advice To Engage In Improper Conduct.

The district court did not suggest that the First Amendment bars Congress from restricting attorneys from encouraging their clients to abuse the bankruptcy system. Attorneys, like other professionals, are subject to various restrictions in urging their clients to undertake action. See, e.g., ABA Model Rules of Prof. Conduct R. 1.2(d) ("A lawyer shall not counsel a client to engage, or assist a client, in conduct that the lawyer knows is criminal or fraudulent, but a lawyer may discuss the legal consequences of any proposed course of conduct with a client and may counsel or assist a client to make a good-faith effort to determine the validity, scope, meaning, or application of the law."); accord Minn. R. Prof. Conduct 1.2(d).

Regulations of professional ethics of this kind do not violate the First Amendment. See Gentile v. State Bar of Nevada, 501 U.S. 1030, 1071-76 (1991) (discussing the standards governing regulation of attorney speech). Although the district court questioned whether section 526(a)(4) is properly regarded as a regulation of professional conduct, Congress clearly understood the regulation in this manner. See House Report at 17 (describing new provisions as "strengthening professionalism standards for attorneys and others who assist consumer debtors with their bankruptcy cases"). Indeed, the statute addresses conduct that has been held to fall squarely within the scope of Model Rule 1.2(d). See Attorney Grievance Comm'n of Maryland v. Culver, 381 Md. 241, 275-76 (2004) (attorney violated Rule 1.2(d) by advising a client to obtain credit card loans with the intent that the debt be discharged in bankruptcy).

2. Section 526(a)(4) Should Not Be Construed More Broadly Than Necessary To Achieve Congress's Purpose.

The district court's contrary ruling reflected its understanding that "[s]ection 526(a)(4) bars an attorney from advising a client to incur any kind of debt, including legitimate debt, in contemplation of bankruptcy." 355 B.R. at 765 (emphasis added). The court expressed concern that it might be "'advisable for a client to obtain a mortgage, to refinance an existing mortgage to obtain a lower interest rate, or to buy a new car' before filing for bankruptcy. If a client intends to reaffirm the debt after filing bankruptcy, there is no prejudice to the bankruptcy process." Ibid. (internal citation omitted) (quoting Erwin Chemerinksy, Constitutional Issues Posed in the Bankruptcy

Abuse Prevention and Consumer Protection Act of 2005, 79 Am. Bankr. L. J. 571, 578 (2005)). The district court noted that "[i]f the client gets a lower rate mortgage, the refinanced mortgage may have smaller payments which could forestall, or even prevent the bankruptcy in the first place," and that similar arguments might be made as to automobile loans. Id. at 764 n.2 (citing Hersh v. United States, 347 B.R. 19, 24 (N.D. Tex. 2006), appeal docketed, Nos. 07-10226 & 07-10265 (5th Cir.)). The court thus assumed that section 526(a)(4) would apply to advice by an attorney that is consistent both with the client's interests and with the policies of the Bankruptcy Code.

Reading the statute in this manner expands its scope far beyond Congress's purpose to prevent abuse and manipulation of the bankruptcy system. By providing that a debt relief agency shall not advise a client "to incur more debt in contemplation of such person filing a case under this title," § 526(a)(4) (emphasis added), Congress addressed only advice to a debtor to accumulate additional debt for the purpose of manipulating the bankruptcy system, such as by "loading up" on new debt in order to obtain a more advantageous discharge. Like section 526(a)(2), which precludes attorneys from advising clients to make false statements, section 526(a)(4) thus encompasses advice to engage in abusive conduct.

That interpretation follows from Congress's unmistakable purposes in the 2005 Act. As already discussed, section 526(a)(4) represents only one of many measures in the 2005 Act aimed at preventing abuses of the bankruptcy system by debtors and their professional representatives. Among other significant amendments, Congress enhanced the authority of bankruptcy courts to dismiss petitions as abusive, see 11 U.S.C. § 707(b)(1), expanded the definition of "abuse" to take account of a debtor's bad faith in seeking bankruptcy relief, see id. § 707(b)(3), and specifically required bankruptcy attorneys to investigate the facts underlying a debtor's petition and to certify that no basis exists for dismissing the petition as abusive, see 11 U.S.C. § 707(b)(4)(C)-(D). Against this background, it is apparent that Congress intended the phrase "to incur more debt in contemplation of" bankruptcy in section 526(a)(4) to refer to the recognized problem of debtors purposefully accumulating new debt in an effort to abuse the protections of the Bankruptcy Code. Cf. Report of the Commission of the Bankruptcy Laws of the United States, H.R. Doc. No. 93-137, pt. I, at 11 (observing that "the most serious abuse of consumer bankruptcy is the number of instances in which individuals have purchased a sizable quantity of goods and services on credit on the eve of bankruptcy in contemplation of obtaining a discharge" (emphasis added)).

That understanding, moreover, is consistent with Congress's repeated references, in the legislative histories cited above, to debts incurred to manipulate the bankruptcy system as debts incurred "in contemplation of" bankruptcy. See S. Rep. No. 98-65, at 9 ("In many instances, the debtor will go on a credit buying spree in contemplation of bankruptcy at a time when the debtor is, in fact, insolvent." (emphasis added)); see also Consumer Bankruptcy Reform Act of 1998, S. Rep. No. 105-253, at 83 (1998) (minority views) ("Clearly, debtors should not incur debts with the intention not to repay them, e.g., if they know that they are going to file for bankruptcy," but "debts incurred within 90 days prior to filing may not have been incurred in contemplation of bankruptcy, and thus the isolation of these debts for special treatment is somewhat arbitrary.").

Section 526(a)(4) therefore has no application to the hypothetical conduct that troubled the district court. An attorney would be free to advise a client to refinance her debts at a lower rate to prevent bankruptcy. 355 B.R. at 764 n.2.[8]

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[8] The district court also did not explain its assumption that (continued...)

An attorney could similarly advise a client to refinance a mortgage or buy a new car if the "client intends to reaffirm the debt after filing bankruptcy," id. at 765, assuming the debtor makes all necessary disclosures to the lender. In neither case would the attorney be advising the debtor to incur unnecessary debt for the purpose of abusing the bankruptcy system. Cf. Culver, 381 Md. at 275-76 (attorney violated Rule 1.2(d) by advising a client to obtain credit card loans with the intent that the debt be discharged in bankruptcy).

In other contexts, the phrase "in contemplation of bankruptcy" may assume a broader scope. Cf. Conrad, Rubin & Lesser v. Pender, 289 U.S. 472 (1933) (interpreting bankruptcy provision regarding attorney compensation); Tripp v. Mitschrich, 211 F. 424 (8th Cir. 1914) (same). Plainly, however, the same phrase also has an accepted narrower meaning. See Black's Law Dictionary 336 (8th ed. 2004) (defining "contemplation of bankruptcy" as "the thought of declaring bankruptcy because of the inability to continue current financial operations, often coupled with action designed to thwart the distribution of assets

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[8] (...continued)
refinancing an existing debt — that is, exchanging one loan for another with the same principal balance but a different interest rate or repayment period — would constitute incurring "more debt" within the meaning of section 526(a)(4).

in a bankruptcy proceeding"); see also United States v. Fox, 95 U.S. 670, 672 (1877) ("To legislate for the prevention of frauds * * * when committed in contemplation of bankruptcy, would seem to be within the competency of Congress."); In re Mercer, 246 F.3d 391, 421 n.43 (5th Cir. 2001) (en banc) (describing "loading up" as the practice of "incurring card debt in contemplation of bankruptcy"); id. at 421 (referring to "a dishonest but patient debtor who intends to incur card-debt in contemplation of discharge"); In re Charles, 334 B.R. at 222 ("It is settled law that a debtor's good faith should be questioned if the debtor makes purchases in contemplation of a bankruptcy case."); cf. 18 U.S.C. § 152(7) (prohibiting the fraudulent transfer or concealment of property "in contemplation of a case under title 11").[9] As the text and purposes of the 2005 Act make clear, it is this narrower sense in which Congress used the phrase in section 526(a)(4).

In any event, the district court erred in adopting the broadest possible reading of the statute without regard to whether it was required by the statutory language and

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[9] See also Webster's Third New International Dictionary 491 (1993) (defining "contemplation" to mean, inter alia, "the act of intending or considering a future event"); Random House Dictionary Unabridged 438 (2d ed. 1987) ("contemplate" means, inter alia, "to have as a purpose; intend").

congressional intent. It is fundamental that when "an otherwise acceptable construction of a statute would raise serious constitutional problems," a federal court must "construe the statute to avoid such problems unless such a construction would be plainly contrary to legislative intent." Planned Parenthood of Mid-Missouri and Eastern Kansas, Inc. v. Dempsey, 167 F.3d 458, 461 (8th Cir. 1999) (quoting Edward J. DeBartolo Corp. v. Fla. Gulf Coast Bldg. & Constr. Trades Council, 485 U.S. 568, 575 (1988)) (internal quotation marks omitted). "The ultimate question is whether the statute "can be construed in such a manner that [it] can be applied * * * without infringing upon constitutionally protected rights." Id. (quoting Rust v. Sullivan, 500 U.S. 173, 183 (1991)). Thus, "even when First Amendment interests are potentially affected, 'facial overbreadth has not been invoked when a limiting construction has been or could be placed on the challenged statute.'" Citizens for Equal Protection v. Bruning, 455 F.3d 859, 870 (8th Cir. 2006) (quoting Broadrick v. Oklahoma, 413 U.S. 601, 612 (1973)).

The district court departed from this principle in failing to adopt — or even address — readings of section 526(a)(4) that would avoid the constitutional difficulties that it postulated.

3. Section 526(a)(4) Does Not Preclude A Candid Discussion Of Legal Options.

The district court also erred in assuming that section 526(a)(4) would preclude a bankruptcy attorney from engaging in a candid discussion of a client's legal options. See 355 B.R. at 765. Rules governing legal practice commonly distinguish between a circumstance in which an attorney "counsels" — or, in this case, "advises" — a course of conduct, and a case in which an attorney simply discusses various options.

Thus, although the ABA Model Rules of Professional Conduct provide that "[a] lawyer shall not counsel a client to engage, or assist a client, in conduct that the lawyer knows is criminal or fraudulent," the same rule also provides that "a lawyer may discuss the legal consequences of any proposed course of conduct with a client and may counsel or assist a client to make a good-faith effort to determine the validity, scope, meaning, or application of the law." ABA Model Rule 1.2(d); accord Minn. R. Prof. Conduct 1.2(d). The commentary to Model Rule 1.2 underscores the point: "There is a critical distinction between presenting an analysis of legal aspects of questionable conduct and recommending the means by which a crime or fraud might be committed with impunity." ABA Model Rule 1.2, cmt 9. In section 526(a)(4), Congress intended the phrase "advise * * * to incur more debt" in the same sense of affirmative encouragement. Cf. Webster's Third New International Dictionary 32 (1993) (defining "advise" to mean, inter alia, "counsel" or "recommend").

Contrary to the district court's understanding, therefore, section 526(a)(4) does not forbid attorneys from providing "information and advice to their clients" concerning "an entire subject - incurring more debt in contemplation of filing for bankruptcy." 355 B.R. at 764. Like the model rules, section 526(a)(4) reaches only the conduct of an attorney in affirmatively urging ("advis[ing]") a client to pursue a particular course of conduct, without impairing the attorney's ability to offer a candid assessment of the client's legal options. Cf. ABA Model Rule 1.2, cmt 9 (explaining that the prohibition against advising clients to engage in fraud "does not preclude the lawyer from giving an honest opinion about the actual consequences that appear likely to result from a client's conduct").

The restriction in section 526(a)(4) thus parallels that in section 526(a)(2), which provides that a debt relief agency shall not "counsel or advise any assisted person or prospective assisted person to make a statement in a document filed in a case or proceeding under this title, that is untrue and misleading."

Congress's concern in both provisions was not to proscribe ordinary legal advice, but to prevent attorneys and other bankruptcy professionals from becoming the affirmative engines of bankruptcy abuse, thereby both undermining the policies of the Code and jeopardizing their clients' petitions for relief.

4. The Remedies For Violations of Section 526(a)(4) Are Consistent With Its Purpose Of Restricting Encouragement To Engage In Abusive Conduct That Jeopardizes A Client's Interests.

The remedial provisions of the statute underscore the error of the district court's interpretation. Congress's intent in section 526(a)(4) was to protect consumer debtors from active encouragement by their representatives to engage in conduct that abuses the bankruptcy system and may result in the dismissal of their petition or other sanctions. Consistent with that intent, the principal remedy for a violation of section 526(a)(4) is a suit against the attorney to recover the debtor's "actual damages," as well as restitution of any fees paid by the debtor. See id. § 526(c)(2); see also id. § 526(c)(3)(B) (authorizing suits by state attorney general to recover "actual damages" on debtor's behalf). The power of the bankruptcy court to impose an "appropriate civil penalty" is limited to cases of intentional violations and patterns of misconduct. See id. § 526(c)(5). Congress's emphasis in these provisions on the debtor's "actual damages” presupposes that the debtor has been injured by the attorney’s conduct: advice that is in the debtor’s best interests and fully consistent with the Bankruptcy Code does not trigger any remedial provision.

Quite apart from section 526(a)(4), moreover, an attorney faces sanctions under the Bankruptcy Code for actively encouraging a debtor to accumulate additional debt in order to facilitate a bankruptcy filing, because the 2005 Act requires attorneys to certify that the petitions filed by their clients are not abusive. As discussed above, the Act imposed a new duty on every bankruptcy attorney to make a reasonable investigation into the factual basis for the debtor’s petition (including a reasonable inquiry into the veracity of the debtor’s debt and asset schedules) and to certify that, in the attorney’s judgment, the petition will not be subject to dismissal for abuse. See 11 U.S.C. § 707(b)(4)(C)-(D); see also id. § 707(b)(4)(A)-(B) (authorizing civil monetary penalties against attorneys who make false certifications). At the same time, Congress lowered the standard for dismissing a petition as abusive, and it made clear that a bankruptcy court, in determining whether to grant such a motion, should consider whether the debtor has acted in bad faith. Id. §§ 707(b)(1), 707(b)(3); cf. In re Charles, 334 B.R.

207, 222 (Bankr. S.D. Tex 2005) ("It is settled law that a debtor's good faith should be questioned if the debtor makes purchases in contemplation of a bankruptcy case."). Under these circumstances, it is highly unlikely that a bankruptcy attorney could encourage a client to incur unnecessary debts in order to buttress an anticipated bankruptcy filing without violating her obligations under the Code. Section 526(a)(4) addresses the increased risk of dismissal resulting from such unethical attorney advice and provides the debtor with remedies against attorneys who encourage abusive conduct.

C. The District Court Failed To Apply Basic Principles of Overbreadth Analysis.

Even outside the context of ethical rules governing attorneys and other closely regulated professions, a statute may not be invalidated on its face solely because of posited concerns raised by some of its potential applications. As this Court has observed, "[t]he aim of facial overbreadth analysis is to eliminate the deterrent or 'chilling' effect an overbroad law may have on those contemplating conduct protected by the First Amendment," Turchick v. United States, 561 F.2d 719, 721 (8th Cir. 1977), but "the overbreadth doctrine permits the facial invalidation of laws that inhibit the exercise of First Amendment rights" only when "the impermissible applications of the law are substantial when judged in relation to the statute’s plainly legitimate sweep.” Republican Party of Minn., Third Congressional Dist. v. Klobuchar, 381 F.3d 785, 791 (8th Cir. 2004) (quoting City of Chicago v. Morales, 527 U.S. 41, 52 (1999)). See also Broadrick v. Oklahoma, 413 U.S. 601, 615 (1973)) (“[O]verbreadth of a statute must not only be real, but substantial as well, judged in relation to the statute’s plainly legitimate sweep.”).

The district court disclaimed any intention of striking down the statute as overbroad, stating that it was, instead, holding it unconstitutional “as applied.” 355 B.R. at 766 n.4. By this, the court apparently meant that it was striking down the statute with respect to all applications to attorneys, but no more.

This characterization misperceives the issue. Even under the district court’s own interpretation of the statute, section 526(a)(4) could constitutionally be applied to prohibit attorneys from urging their clients to abuse the bankruptcy system. The district court did not, however, invalidate the statute as applied to the facts of a particular case. Instead, it declared the statute unconstitutional as applied to all attorneys in the District of Minnesota. See JA44, JA46.

The district court's error is highlighted by its invalidation of section 526(a)(4) in its entirety, without addressing that part of the statute that precludes an attorney from advising a client to incur additional debt in order to pay the attorney's own fees. See 11 U.S.C. § 526(a)(4) ("A debt relief agency shall not * * * advise an assisted person or prospective assisted person to incur more debt * * * to pay an attorney or bankruptcy petition preparer fee or charge for services performed as part of preparing for representing a debtor in a case under this title."). Plaintiffs make no allegation that they have encouraged or plan to encourage clients to take on additional debt in order to pay their own fees, see, e.g., JA8 (complaint); JA22 (Nevin affidavit), and a challenge to that part of the statute was not properly before the district court.

More fundamentally, the district court's willingness to strike down section 526(a)(4) on its face, without addressing this part of the statute, underscores the court's failure to recognize the nature of the issues presented by this facial challenge and its failure to adopt a reading of the statute that avoids constitutional questions to the extent possible.

II. THE ADVERTISING DISCLOSURE REQUIREMENTS OF SECTION 528 ARE NARROWLY TAILORED TO ADDRESS A PROBLEM SPECIFICALLY DOCUMENTED BY CONGRESS.

The district court's invalidation of the advertising disclosure requirements in 11 U.S.C. § 528 was equally unwarranted. In bankruptcy reform hearings preceding the 2005 legislation, Congress heard evidence of "increasingly aggressive lawyer advertising" that offered to make consumers' debts "disappear," yet failed even to "mention bankruptcy." See Bankruptcy Abuse Prevention and Consumer Protection Act of 2003, Hearing on H.R. 975 Before House Judiciary Comm., 108th Cong. 55 (2003).[10] One retailer testified that some of his customers, who were misled by such lawyer advertisements, "did not even understand that they had filed for bankruptcy." Bankruptcy Reform Act of 1999 (Part II), Hearing on H.R. 833 Before House Judiciary Comm., 106th Cong. 123 (1999).[11] Indeed, as Congress was aware, the Federal Trade Commission ("FTC") had issued a consumer alert in 1997 warning that many debt-relief advertisements offering to "wipe out" consumer debts, or to "stop credit harassment, foreclosures, [and] repossessions," regularly failed to disclose that "such relief may be spelled

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[10] See No. 05-2626 (D. Minn.), docket #16, exh.A.

[11] See No. 05-2626 (D. Minn.), docket #43, exh.C.

b-a-n-k-r-u-p-t-c-y." See Bankruptcy Reform Act of 1998 (Part III), Hearing on H.R. 3150 Before House Judiciary Comm., 105th Cong. 90, 90-92 (1998) ("FTC Alert").[12] The FTC Alert remains in effect today.[13]

To address these problems, Congress enacted 11 U.S.C. § 528, which requires debt relief agencies to "clearly and conspicuously disclose in any advertisement * * * directed to the general public" that the advertised services "are with respect to bankruptcy relief under this title." Id. § 528(a)(3). In particular, in any advertisements offering bankruptcy assistance services — including any advertisements purporting to offer relief from "credit defaults, mortgage foreclosures, eviction proceedings, excessive debt, debt collection pressure, or inability to pay any consumer debt" — a debt relief agency must:

> (A) disclose clearly and conspicuously in such advertisement that the assistance may involve bankruptcy relief under this title; and
>
> (B) include the following statement: "We are a debt relief agency. We help people file for bankruptcy relief under the Bankruptcy Code." or a substantially similar statement.

Id. § 528(b)(2); see also id. § 528(a)(3), (4).

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[12] See No. 05-2626 (D. Minn.), docket #43, exh.B.

[13] See http://www.ftc.gov/bcp/conline/pubs/alerts/bankrupt.shtm (last visited Aug. 20, 2007).

The district court analyzed section 528 under the standards applicable to regulations of commercial speech, which are typically sustained if they are "narrowly drawn" to advance a "substantial government interest." See Florida Bar v. Went For It, Inc., 515 U.S. 618, 623 (1995); Central Hudson Gas & Elec. Corp. v. Public Serv. Comm'n, 447 U.S. 557 (1980). A still more lenient standard is applicable to regulations that require advertisements to disclose "purely factual and uncontroversial information." Such restrictions are valid if they are "reasonably related" to the government's "interest in preventing deception of consumers" and are not "unduly burdensome." Zauderer v. Office of Disciplinary Counsel of Supreme Court of Ohio, 471 U.S. 626, 650-52 (1985) (upholding state rule requiring attorney advertisements to disclose that "clients might be liable for significant litigation costs even if their lawsuits were unsuccessful").

The disclosure requirement in section 528 is plainly constitutional under either standard. By definition, debt relief agencies provide services to consumer debtors "with respect to a case or proceeding under [the bankruptcy laws]." See 11 U.S.C. § 101(4A); id. § 101(12A). Section 528 merely requires bankruptcy attorneys to identify themselves truthfully as "debt relief agencies" under the Bankruptcy Code and to disclose that their advertised services do in fact relate to bankruptcy. As in Zauderer, plaintiffs' "constitutionally protected interest in not providing [such] factual information in [their] advertising is minimal," 471 U.S. at 651, and there is little doubt that the disclosure requirement is reasonably related to the government's interest in preventing the deception of consumer debtors.

The disclosure requirement in section 528 also satisfies the more stringent standard generally governing regulations of commercial speech. See Olsen v. Gonzales, 350 B.R. 906, 920 (D. Or. 2006) (concluding that section 528 "passes constitutional muster" under either the Zauderer or the Central Hudson test). Section 528 does not "burden substantially more speech than necessary" to further the government's legitimate interests. United States v. Edge Broadcasting Co., 509 U.S. 418, 430 (1993). Indeed, the statute restricts no speech at all. See Olsen, 350 B.R. at 921; see also Zauderer, 471 U.S. at 651 (emphasizing that "disclosure requirements trench much more narrowly on an advertiser's interests than do flat prohibitions on speech").

The disclosure requirement in section 528 is directed precisely to the problem targeted by Congress: ensuring that persons who advertise bankruptcy-related services make clear that their services in fact involve filing for bankruptcy. This targeted requirement advances a substantial interest in preventing the problem identified by the FTC Alert: deceptive advertisements that promise to "wipe out" debts or prevent foreclosures, but fail to disclose that "such relief may be spelled b-a-n-k-r-u-p-t-c-y." See FTC Alert, 105th Cong. at 92. As the FTC Alert makes clear, such advertisements have the potential to mislead consumers into filing for bankruptcy without adequately considering the implications. See ibid. (warning that "bankruptcy stays on your credit report for 10 years, and can hinder your ability to get credit, a job, insurance, or even a place to live"). It is well within Congress's authority to require reasonable disclosures in attorney advertisements to prevent such deception. See generally Bates v. State Bar of Arizona, 433 U.S. 350, 384 (1977) (states may require attorney advertisements to include "a warning or disclaimer * * * so as to assure that the consumer is not misled").

In holding section 528 invalid, the district court simply declared that the problem addressed by the legislation does not exist. The court expressed skepticism that advertisements offering "debt relief" but failing to mention bankruptcy could "mislead the lay community," proclaiming it "implausib[le]" that "anyone [would] actually believ[e] in a magic wand capable of making debt go away." 355 B.R. at 766-67. The district court offered no basis for setting aside Congress's determination in this manner. Indeed, the district court failed even to acknowledge the FTC's findings or the hearing testimony before Congress, which amply demonstrate that section 528 "targets a concrete, nonspeculative harm." Florida Bar, 515 U.S. at 629. See also Zauderer, 471 U.S. at 652-53 (explaining that the courts "need not require the State to 'conduct a survey of the * * * public before it [may] determine that the [advertisement] had a tendency to mislead'" (quoting FTC v. Colgate-Palmolive Co., 380 U.S. 374, 391-92 (1965))).

The district court likewise erred in declaring that the required disclosures under section 528 would not "prevent[] consumer deception" and "may well increase it." 355 B.R. at 767. Deriding the term "debt relief agency" as "simply a legislative contrivance," the court asserted that the mandated disclosure would only tend to confuse the public. See ibid. The district court's conclusion that section 528 would not prevent consumer deception, however, merely reflects its antecedent conclusion that there is no problem to be remedied. The court's further assumption that a federal statute can be invalidated because it requires advertisers truthfully to state their legal status — i.e., that they are "debt relief agencies" under the Bankruptcy Code — is without foundation in law or logic.

Nor does the disclosure requirement violate the First Amendment because it applies to "attorneys and non-attorneys alike." 355 B.R. at 767. The district court believed that the fact that "parties so dissimilarly-placed must use the same mandated disclosure statement is likely to cause consumer confusion." Ibid. Yet it was Congress's judgment that bankruptcy attorneys and other bankruptcy professionals are similarly situated with regard to the deceptive practices targeted by the statute — Congress was not required to adopt different disclosure rules to address the same harm. And in any event, nothing in section 528 precludes attorneys from identifying themselves as attorneys, or from listing the particular legal services they provide. See Olsen, 350 B.R. at 920 ("[S]ection 528 does not prohibit consumer bankruptcy attorneys from identifying themselves as both bankruptcy attorneys and 'debt relief agencies' in advertisements."); see also Zauderer, 471 U.S. at 650 (disclosure requirements do not "prevent attorneys from conveying information to the public," but "only require them to provide somewhat more information than they might otherwise be inclined to present").

III. THE STATUTE REGULATES THE PROFESSIONAL CONDUCT OF ATTORNEYS AS WELL AS OTHER BANKRUPTCY PROFESSIONALS.

After reaching and deciding plaintiffs' constitutional claims, the district court further held that the statutory term "debt relief agency" does not encompass licensed attorneys. In so holding, the court not only rendered its constitutional holdings superfluous, but also exempted bankruptcy attorneys from nearly all of the professional conduct regulations adopted by Congress in the 2005 legislation, including many provisions not challenged by plaintiffs here. See, e.g., 11 U.S.C. § 526(a)(1) (requirement to perform all promised services); id. § 527 (requirement to provide written notice of debtor's rights and obligations in bankruptcy); id. § 528(a)(1)-(2) (requirement to prepare a written contract with clear notice of applicable fees).

The district court's conclusion on this score is flatly contrary to the statutory text and congressional intent. Congress defined the term "debt relief agency" to include "any person" who, for a fee, "provides any bankruptcy assistance to an assisted person." 11 U.S.C. § 101(12A). "Bankruptcy assistance," in turn, is defined to include "providing information, advice, counsel, document preparation, or filing

* * * with respect to a case or proceeding under this title," including in particular "appearing in a case or proceeding on behalf of another" or "providing legal representation." Id. § 101(4A) (emphasis added). By its plain terms, therefore, the statute applies to "any person" who provides "legal representation" to consumer debtors for a fee — a category that unmistakably includes bankruptcy attorneys. See Hersh, 347 B.R. at 22; Olsen, 350 B.R. at 912.

Congress's inclusion of attorneys was not inadvertent. As we have noted, a principal concern of the 2005 legislation was to prevent abuses of the bankruptcy system, not merely by debtors, but also by the professionals who represent them. The House Report accompanying the 2005 Act cited a study that "consistently identified," among the sources of bankruptcy abuse, "misconduct by attorneys and other professionals." House Report at 5 (quoting Darling & Redmiles, Protecting the Integrity of the System: the Civil Enforcement Initiative, 21 Am. Bankr. Inst. J. 12 (Sept. 2002)). Similarly, in expressing concern that the new means-testing provision would encourage the assumption of additional debt in contemplation of bankruptcy, one bankruptcy judge testified before Congress that "[p]erverse as it may seem, I can envision debtor's counsel advising their clients to buy the most expensive car that someone will sell them, and sign on to the biggest payment they can afford (at least until the bankruptcy is filed) as a way of increasing their deductions under [the means test].” 105th Cong. at 25 (testimony of Judge Randall Newsome). And in adopting the advertising disclosure requirements in section 528, Congress heard evidence of “increasingly aggressive lawyer advertising” that offered to make consumers’ debts “disappear” but failed to mention bankruptcy. See 108th Cong. at 55. Congress responded to these concerns by enacting new provisions designed to “strengthen[] professionalism standards for attorneys and others who assist consumer debtors with their bankruptcy cases” in return for a fee. House Report at 17 (emphasis added).

The district court nevertheless declared that attorneys are exempt from the debt relief agency provisions of the 2005 Act, observing that the statutory definition of “debt relief agency” “makes no direct reference to either ‘attorney' or ‘lawyer.’” 355 B.R. at 768. As already discussed, however, the definition specifically does include “any person” who, for a fee, “provid[es] legal representation with respect to a case or proceeding under [the Bankruptcy Code].” 11 U.S.C. § 101(12A); id. § 101(4A). Congress was not obliged to state, in addition, that a rule applicable to any person who provides "legal representation" will apply to attorneys. See generally Heintz v. Jenkins, 514 U.S. 291, 294-95, 298 (1995) (lawyers who engage in debt collection are "debt collectors" under the Fair Debt Collection Practices Act, even though the statute does not specifically refer to lawyers or the practice of law); Goldfarb v. Virginia State Bar, 421 U.S. 773, 787-88 (1975) (noting the "heavy presumption against implicit exemptions," and accordingly refusing to construe the Sherman Act to exempt lawyers).

The district court also mistakenly concluded that reading the statute to encompass attorneys would "conflict" with the preemption savings clause in 11 U.S.C. § 526(d). That section provides that nothing in sections 526 or 528 may "be deemed to limit or curtail the authority * * * of a State * * * to determine and enforce qualifications for the practice of law." 11 U.S.C. § 526(d)(2)(A). See 355 B.R. at 768. The conflict is illusory. The challenged provisions create substantive standards of conduct for debt relief agencies in the federal bankruptcy system; they do not purport to regulate state bar admission or other "qualifications for the practice of law." Indeed, section 526(d) distinguishes between restrictions on conduct and qualifications for legal practice, expressly preempting state rules of conduct “to the extent” they are inconsistent with the federal debt relief agency requirements, see 11 U.S.C. § 526(d)(1), while leaving undisturbed state bar admission requirements, see id. § 526(d)(2)(A).

Finally, the district court wrongly believed that, notwithstanding the plain text of the statute, it could exclude attorneys from the scope of the statute under the rubric of constitutional avoidance. Constitutional avoidance cannot be used to rewrite a statute in a manner contrary to congressional intent. See, e.g., Miller v. French, 530 U.S. 327, 341 (2000) (“[T]he canon of constitutional doubt permits [a court] to avoid such questions only where the savings construction is not ‘plainly contrary to the intent of Congress.’” (quoting Edward J. DeBartolo Corp., 485 U.S. at 575)).

In this case, the district court’s reliance on the canon of avoidance was particularly anomalous because the court had already declared the challenged provisions unconstitutional. As discussed in Part I above, the district court erred in failing to apply the canon of constitutional avoidance when it interpreted section 526(a)(4) far more broadly than either the text or congressional intent required, generating constitutional issues that could properly have been avoided. It likewise erred in invoking the canon of avoidance to remove attorneys from the scope of the professional conduct standards in the 2005 Act, nullifying the statutory language and frustrating Congress's intent.

CONCLUSION

For the foregoing reasons, the judgment of the district court should be reversed.

Respectfully submitted,

PETER D. KEISLER
Assistant Attorney General

RACHEL K. PAULOSE
United States Attorney

MARK B. STERN
(202) 514-5089
MARK R. FREEMAN
(202) 514-5714
Attorneys, Appellate Staff
Civil Division, Room 7531
Department of Justice
950 Pennsylvania Ave., N.W.
Washington, D.C. 20530-0001

AUGUST 2007

CERTIFICATE OF COMPLIANCE

I hereby certify that the foregoing brief complies with the type-volume limitation of Fed. R. App. Rule 32(a)(7)(C). The brief contains 10,967 words, according to the count of Corel WordPerfect 12.

I also certify that the computer diskette containing the full text of the foregoing brief has been scanned for viruses and, to the best of our ability and technology, is virus-free.

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Mark R. Freeman

CERTIFICATE OF SERVICE

I hereby certify that on this 21st day of August, 2007, I caused copies of the foregoing brief and accompanying joint appendix, including one electronic copy of the brief, to be filed with the Court by Federal Express overnight delivery; and caused additional copies of the same brief and joint appendix, including one electronic copy of the brief, to be served by Federal Express overnight delivery on the following counsel:

Alan S. Milavetz, Esq.
Chad W. Schulze, Esq.
Joseph A. Rymanowski, Jr., Esq.
Milavetz, Gallop & Milavetz P.A.
6500 France Avenue, South
Edina, MN 55435
952-920-7777

____
Mark R. Freeman

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BANKRUPTCY

9. ("SU") ● ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***

● Whether 11 U.S.C. § 526(a)(4), which precludes debt relief agencies from advising clients to incur additional debt in contemplation of filing a petition for bankruptcy, violates the First Amendment ?
Whether 11 U.S.C. § 528 which requires debt relief agencies to include certain disclosures in their advertisements, violates the First Amendment?
Whether 11 U.S.C. § 526, 527 & 528 regulate the professional conduct of attorneys?

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FOR THE EIGHTH CIRCUIT

MILAVETZ, GALLOP & MILAVETZ P.A., ROBERT J. MILAVETZ,
BARBARA N. NEVIN, JOHN DOE, and MARY DOE,

Plaintiffs-Appellees,
v.

UNITED STATES OF AMERICA,

Defendant-Appellant.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MINNESOTA (ROSENBAUM, C.J.)

REPLY BRIEF FOR THE APPELLANT

PETER D. KEISLER
Assistant Attorney General

RACHEL K. PAULOSE
United States Attorney

MARK B. STERN
(202) 514-5089
MARK R. FREEMAN
(202) 514-5714
Attorneys, Appellate Staff
Civil Division, Room 7531
Department of Justice
950 Pennsylvania Ave., N.W.
Washington, D.C. 20530-0001

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REPLY BRIEF FOR THE APPELLANT

INTRODUCTION AND SUMMARY

In the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, Congress enacted a series of provisions designed to "strengthen[] professionalism standards for attorneys and others who assist consumer debtors with their bankruptcy cases." H.R. Rep. No. 109-31, pt. 1, at 17. Among them are the measures challenged here, which preclude attorneys from advising their clients to take on additional debt in contemplation of bankruptcy, see 11 U.S.C. § 526(a)(4), and require specified disclosures in attorney advertisements, id. § 528(a)(4), (b)(2).

Notwithstanding Congress's belief that it was adopting these provisions to establish stronger "professionalism standards for attorneys," plaintiffs devote much of their brief to arguing that attorneys are exempt from all of the professional conduct regulations established by the 2005 Act. That interpretation founders on the plain language of the statute, which makes the professional conduct regulations in the 2005 Act applicable to "any person" who provides paid "legal representation" to consumer debtors. See 11 U.S.C. § 101(4A); id. § 101(12A).

Plaintiffs fare no better on the merits of their constitutional claims. Section 526(a)(4) prohibits an attorney from advising a debtor "to incur more debt in contemplation of such person filing a case under this title." As plaintiffs appear to acknowledge, Congress enacted this provision in recognition of the fact that debtors frequently "load up" with new debt on the eve of bankruptcy in an effort to game the bankruptcy system. Plaintiffs do not suggest that attorney advice to take on new debt for such a purpose is protected by the First Amendment. Instead, they contend that the statute should be struck down because, in plaintiffs' view, the "plain language" of section 526(a)(4) also prohibits advice to engage in entirely legitimate transactions.

That interpretation is neither required by the statutory text nor consistent with Congress's purposes in the 2005 Act. As our opening brief establishes (at 31-33), Congress and the federal courts have often described pre-petition debts amassed for improper purposes as debts incurred "in contemplation of" bankruptcy. _See also_ _Black's Law Dictionary_ 336 (8th ed. 2004) (explaining that the phrase "contemplation of bankruptcy" typically connotes "action designed to thwart the distribution of assets in a bankruptcy proceeding"). Plaintiffs make no reference to these authorities, nor do they attempt to explain why this Court should adopt the broadest possible reading of the statute in order to sustain their facial challenge.

Finally, plaintiffs press their challenge to the advertising disclosure requirements in 11 U.S.C. § 528. As plaintiffs do not dispute, Congress enacted section 528 in response to evidence of aggressive lawyer advertisements that promised to wipe out debts, halt foreclosures, and prevent repossessions, yet failed even to mention that any such relief would require a petition for bankruptcy. The disclosures provided in section 528 are narrowly drawn to address the problem identified by Congress, and they burden no more speech than necessary to advance the government's substantial interest in preventing consumers from being misled into filing for bankruptcy relief inadvertently or without adequate consideration of the consequences.

Plaintiffs urge the Court to invalidate section 528 on the same ground that the Supreme Court invalidated the provisions of

Ohio law at issue in Zauderer v. Office of Disciplinary Counsel of Supreme Court of Ohio, 471 U.S. 626, 650-52 (1985). See Br. 44, 47. But plaintiffs misread the Court's decision: although the Court in Zauderer struck down some of the Ohio rules in question, it upheld the disclosure requirements analogous to those at issue here. Plaintiffs' facial challenge to section 528 fails for the same reasons.

ARGUMENT

I. CONGRESS ENACTED THE "DEBT RELIEF AGENCY" PROVISIONS OF THE 2005 ACT TO REGULATE ATTORNEYS AS WELL AS OTHER BANKRUPTCY PROFESSIONALS.

1. In enacting the 2005 bankruptcy amendments, Congress was concerned not merely with abuses by debtors, but also with abuses committed by — and at the encouragement of — debtors' professional representatives in the bankruptcy system. See generally Gov. Br. 23-28. Accordingly, as part of "a comprehensive package of reform measures," Congress enacted the "debt relief agency" provisions of the 2005 Act to "strengthen[] professionalism standards for attorneys and others who assist consumer debtors with their bankruptcy cases." H.R. Rep. No. 109-31, pt. 1, at 2, 17 (2005), reprinted in 2005 U.S.C.C.A.N. 88, 89, 103 ("House Report").

Plaintiffs do not attempt to reconcile their arguments with this declaration of congressional intent. Instead, they argue at length that when Congress enacted the "debt relief agency" provisions in 11 U.S.C. §§ 526-528, it did <u>not</u> in fact create "professionalism standards for attorneys," but only regulated "others who assist consumer debtors with their bankruptcy cases."

That argument founders on the plain language of the statute. Congress defined "debt relief agency" to include "any person" who, for a fee, "provides any bankruptcy assistance to an assisted person." 11 U.S.C. § 101(12A). "Bankruptcy assistance," in turn, includes providing "advice" or "counsel" "with respect to a case or proceeding under this title" — including in particular "appearing in a case or proceeding on behalf of another" or "<u>providing legal representation</u>." <u>Id.</u> § 101(4A) (emphasis added). Plaintiffs cannot plausibly insist that regulations governing persons who provide "legal representation" for a fee exclude the very persons who provide such legal representation.

2. Plaintiffs' arguments to the contrary fail at every turn. They stress, for example, that the definition of debt relief agency "does not explicitly use the terms 'attorney' or 'lawyer.'" Br. 11. But the definition <u>does</u> use the term "bankruptcy assistance," which in turn explicitly includes "legal representation." 11 U.S.C. § 101(4A). Plaintiffs do not explain why Congress would define "bankruptcy assistance" to include "legal representation" if it meant to exclude lawyers from the statute's scope. Nor do plaintiffs make any attempt to

distinguish Heintz v. Jenkins, 514 U.S. 291 (1995), in which the Supreme Court held that lawyers who engage in debt collection are "debt collectors" under the Fair Debt Collection Practices Act, even though the statute does not specifically refer to lawyers or the practice of law. Id. at 294-96; see also Goldfarb v. Virginia State Bar, 421 U.S. 773, 786-88 (1975) (refusing to create an implicit exception to the Sherman Act for attorneys).[1]

Similarly mistaken is plaintiffs' reliance on 11 U.S.C. § 527(b), which requires debt relief agencies to inform debtors that in the bankruptcy system "you can represent yourself, you can hire an attorney to represent you, or you can get help in some localities from a bankruptcy petition preparer who is not an attorney." Ibid. Plaintiffs urge that it would be "entirely illogical" to require attorneys to inform clients of their right to hire an attorney. Br. 21. By the plain terms of the statute,

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[1] Amicus Commercial Law League of America argues that attorneys should not be deemed "debt relief agencies" lest the 2005 Act be interpreted to apply to attorneys for creditors. Amicus Br. 2-4. This is an entirely new argument, not advanced by plaintiffs in this Court or below, and amicus is not entitled to raise it on their behalf. See Rehrs v. Iams Co., 486 F.3d 353, 358 (8th Cir. 2007); McCleskey v. Zant, 499 U.S. 467, 523 n.10 (1991).

In any event, the argument is baseless. The debt relief agency provisions apply only when an attorney advises an "assisted person." See 11 U.S.C. § 101(12A). An "assisted person," in turn, is "any person whose debts consist primarily of consumer debts and the value of whose nonexempt property is less than $164,250." Id. § 101(4A). The Code thus plainly contemplates that "debt relief agencies" are persons who advise debtors, not creditors. See House Report at 17 (explaining that the statute provides "professionalism standards for attorneys and others who assist consumer debtors with their bankruptcy cases" (emphasis added)).

however, the disclosures are mandatory only "to the extent applicable." 11 U.S.C. § 527(b). Moreover, plaintiffs' logic would presumably also exclude bankruptcy petition preparers from the definition of "debt relief agency." But see 11 U.S.C. § 101(12A) (defining "debt relief agency" to include, inter alia, "any person * * * who is a bankruptcy petition preparer").

Nor is there any merit to plaintiffs' suggestion that, notwithstanding the plain text of the statute, a court may exclude attorneys from the definition of "debt relief agency" under the rubric of constitutional avoidance. Br. 17. As our opening brief describes (at 33-34, 53-54), the avoidance canon permits — indeed, requires — a court to adopt any reasonable construction of a statute that avoids a serious constitutional question; it does not permit a court to disregard an unambiguous expression of congressional intent. Congress enacted the debt relief agency provisions to establish "professionalism standards for attorneys and others who assist consumer debtors with their bankruptcy cases," House Report at 17 (emphasis added), and plaintiffs cannot properly invoke the doctrine of avoidance to frustrate that intent.[2]

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[2] Furthermore, plaintiffs' "avoidance" argument would exempt bankruptcy attorneys not merely from the two provisions whose constitutionality they challenge, but also from the many other professional conduct regulations in the 2005 Act whose validity is undisputed. See, e.g., 11 U.S.C. 526(a)(1) (requirement to perform all promised services); id. § 527 (requirement to provide written notice of debtors' rights and obligations in bankruptcy);
(continued...)

3. As a fallback argument, plaintiffs contend that permitting Congress to regulate attorneys would permissibly intrude on the power of the states and violate the Tenth Amendment. See Br. 22-24. This assertion is baseless. It cannot seriously be disputed that Congress may provide rules for the conduct of attorneys practicing in the federal courts, including in the federal bankruptcy courts. See, e.g., 28 U.S.C. § 1927; Fed. R. Civ. P. 11; Fed. R. Bankr. P. 9011; cf. Chambers v. NASCO, Inc., 501 U.S. 32 (1991). In fact, federal law commonly provides rules of professional conduct for attorneys in regulatory areas that, like bankruptcy, reflect uniquely federal concerns. See, e.g., 15 U.S.C. § 7245 (Securities and Exchange Commission); 31 C.F.R. Part 10 (Internal Revenue Service); 37 C.F.R. Part 10 (Patent and Trademark Office).[3]

Plaintiffs' reliance on the preemption savings clause in section 526(d) is misplaced for similar reasons. That section

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[2] (...continued)
id. § 528(a)(1)-(2) (requirement to prepare a written contract with clear notice of applicable fees).

[3] In Leis v. Flynt, 439 U.S. 438 (1979), relied upon by plaintiffs, the Supreme Court emphasized the authority of the states to regulate and discipline lawyers in their respective jurisdictions. See Br. 24. The Court in Leis, however, merely rejected a claim that the Fourteenth Amendment prohibits state courts from denying pro hac vice admission to attorneys from other states. See 439 U.S. at 441-45. Nothing in Leis casts doubt on the authority of the federal government to regulate attorneys practicing before federal tribunals. See In re Desilets, 291 F.3d 925, 929 (6th Cir. 2002) ("Leis does not hold that state rules govern practice in federal courts.").

provides that nothing in the 2005 Act shall "limit or curtail the authority * * * of a State * * * to determine and enforce qualifications for the practice of law under the laws of that State." 11 U.S.C. § 526(d)(2)(A). As discussed in our opening brief (at 52-53), the 2005 Act does not purport to regulate state bar admission or other "qualifications for the practice of law." The preemption savings clause merely ensures that nothing in the 2005 Act will limit the ability of the states to decide who may become members of their respective bars.

II. CONGRESS CONSTITUTIONALLY PROHIBITED BANKRUPTCY ATTORNEYS FROM ENCOURAGING THEIR CLIENTS TO ABUSE THE BANKRUPTCY SYSTEM BY TAKING ON ADDITIONAL DEBT IN CONTEMPLATION OF FILING A PETITION.

1. As discussed at length in our opening brief, Congress has long been aware that debtors frequently abuse the protections of the Bankruptcy Code by "loading up" with new debt on the eve of bankruptcy. See House Report at 15 (expressing concern over the continued ability of debtors to "knowingly load up with credit card purchases or recklessly obtain cash advances and then file for bankruptcy relief"); S. Rep. No. 98-65, at 9 (1983) (noting special problem posed by "'loading up' in contemplation of bankruptcy"); Report of the Commission of the Bankruptcy Laws of the United States, H.R. Doc. No. 93-137, pt. I, at 11 (July 1973) (concluding that "the most serious abuse of consumer bankruptcy is the number of instances in which individuals have purchased a sizable quantity of goods and services on credit on

the eve of bankruptcy in contemplation of obtaining a discharge”).

In hearings preceding the 2005 Act, moreover, Congress heard evidence that “misconduct by attorneys and other professionals” had been “consistently identified” by the U.S. Trustee Program as a source of abusive bankruptcy filings. See House Report at 5 (citation omitted). Other witnesses, including bankruptcy judges, informed Congress that these problems were likely to be exacerbated by the new “means testing” provisions in the 2005 legislation, which create an incentive for unethical attorneys to encourage their clients to run up additional debt on the eve of bankruptcy in order to obtain a full discharge of their debts under chapter 7. See generally Gov. Br. at 23-25. It was against this background that Congress enacted 11 U.S.C. § 526(a)(4).

None of this is controverted. To the contrary, plaintiffs acknowledge that Congress’s purpose in the 2005 legislation was to “prevent abuses of the bankruptcy system,” including in particular to “preclude debtors from taking on more debt knowing that it will later be discharged in bankruptcy.” Br. 34 (citing House Report, at 1-5). Nor do plaintiffs deny that Congress can properly restrict attorneys from encouraging their clients to commit such abuses: plaintiffs do not suggest that attorneys enjoy a categorical First Amendment privilege to advise their clients to subvert the bankruptcy process. Their contention, instead, is that section 526(a)(4) must be read expansively to encompass not only advice to engage in abusive conduct, but also advice "to incur <u>any</u> debt for <u>any</u> purpose when the client will be filing or is contemplating filing for bankruptcy" — even legitimate debt designed to mitigate or avoid the need for bankruptcy altogether. Br. 30.

2. That gets matters exactly backwards. Plaintiffs are not entitled to insist upon the broadest possible interpretation of section 526(a)(4) in order to secure its invalidation. As plaintiffs themselves recognize elsewhere in their brief, "[w]hen the validity of an Act of Congress is drawn in question, and even if a serious doubt of constitutionality is raised, it is a cardinal principle that [the courts] will first ascertain whether a construction of the statute is fairly possible by which the question may be avoided." Br. 17 (quoting <u>Crowell</u> v. <u>Benson</u>, 285 U.S. 22, 62 (1932)). Yet plaintiffs make no mention of this principle in defending their sweeping interpretation of section 526(a)(4). If plaintiffs believe that the canon of avoidance may be jettisoned merely because they have raised a First Amendment overbreadth claim, they are mistaken: "Even when First Amendment interests are potentially affected, 'facial overbreadth has not been invoked when a limiting construction has been or could be placed on the challenged statute.'" <u>Citizens for Equal</u>

Protection v. Bruning, 455 F.3d 859, 870 (8th Cir. 2006) (quoting Broadrick v. Oklahoma, 413 U.S. 601, 612 (1973)).

Plaintiffs' interpretation of section 526(a)(4) is plainly not compelled by the terms of the statute. As we explained in our opening brief (and as plaintiffs do not dispute), Congress and the federal courts have both commonly described pre-petition debts amassed for improper purposes as debts incurred "in contemplation of" bankruptcy. See Gov. Br. 31-33. That use of the phrase reflects settled connotations in the bankruptcy context. See Black's Law Dictionary 336 (8th ed. 2004) (explaining that the phrase "contemplation of bankruptcy" typically connotes "action designed to thwart the distribution of assets in a bankruptcy proceeding"). See also, e.g., United States v. Fox, 95 U.S. 670, 672 (1877) ("To legislate for the prevention of frauds * * * when committed in contemplation of bankruptcy, would seem to be within the competency of Congress."); In re Mercer, 246 F.3d 391, 421 n.43 (5th Cir. 2001) (en banc) (describing "loading up" as the practice of "incurring card debt in contemplation of bankruptcy"); In re Charles, 334 B.R. 207, 222 (Bankr. S.D. Tex. 2005) ("It is settled law that a debtor's good faith should be questioned if the debtor makes purchases in contemplation of a bankruptcy case."); cf. 18 U.S.C. § 152(7) (prohibiting fraudulent transfer or concealment of assets "in contemplation of a case under title 11").

Plaintiffs address none of these authorities, relying instead on this Court's 1914 decision in Tripp v. Mitschrich, 211 F. 424 (1914). See Br. 33. But that decision undermines plaintiffs' position here. The Court in Tripp interpreted section 60d of the Bankruptcy Act of 1898, which granted bankruptcy courts the authority to reexamine transfers of property made by a debtor to an attorney "in contemplation of filing a petition," and to direct that any "excess" payment be returned to the estate for the benefit of creditors. See 211 F. at 426. Like section 526(a)(4), that provision was manifestly directed to the prevention of abuse. Indeed, this Court in Tripp cited with approval the Supreme Court's earlier decision in In re Wood, 210 U.S. 246 (1908), in which the Court explained that Congress enacted section 60d precisely because debtors' pre-petition payments to attorneys are "'capable of abuse.'" 210 U.S. at 251 (quoting Furth v. Stahl, 205 Pa. 439 (1903)); see also id. at 258 (purpose of section 60d was to "prevent the diminution of the estate"). Far from supporting plaintiffs' interpretation, therefore, Tripp underscores Congress's use of the phrase "in contemplation of" bankruptcy to address abusive pre-petition conduct.

Plaintiffs' unbounded construction of section 526(a)(4), moreover, would require the Court to disregard the context in which Congress placed the provision. Section 526(a)(4) is one of four subsections of section 526(a). The other three subsections indisputably provide rules of professional conduct designed to protect debtors from abusive practices by bankruptcy attorneys and other debt relief agencies. See 11 U.S.C. § 526(a)(1) (debt relief agencies must perform all promised services); id. § 526(a)(2) (prohibiting debt relief agencies from advising debtors to make false or misleading statements to obtain bankruptcy relief); id. § 526(a)(3) (prohibiting debt relief agencies from misrepresenting to debtors the services to be provided or the costs or benefits of filing for bankruptcy relief). Against this background, plaintiffs cannot reasonably claim that Congress intended the fourth subsection to prohibit "accurate, truthful, non-fraudulent advice." Br. 29.

Plaintiffs are thus quite wrong to insist that section 526(a)(4) prohibits "routine and prudent pre-bankruptcy planning" that is "not an attempt to circumvent or undermine federal bankruptcy laws." Br. 31. Echoing the district court, for example, plaintiffs contend that the statute "prevents attorneys from recommending that their clients obtain or refinance a home mortgage, apply for a home equity line of credit, or take on an auto loan for a vehicle that is needed to get to work, prior to filing for bankruptcy." Ibid. But as we made clear in our opening brief (at 31-32), section 526(a)(4) has no application to such advice, nor to any other good-faith advice similarly consistent with the policies of the Bankruptcy Code and with the client's best interests. Nor, for the same reason, does section 526(a)(4) prohibit an attorney from advising a client to co-sign a child's student loan, or to borrow money to pay for mandatory credit counseling.[4] Br. 32. Section 526(a)(4) simply prevents attorneys and other professionals from becoming the affirmative engines of bankruptcy abuse.

3. Understood in this manner, there is little doubt that section 526(a)(4) satisfies the First Amendment. As we have noted, even plaintiffs do not contend that they have a First Amendment right to encourage their clients to file abusive bankruptcy petitions, or to load up on new debt prior to bankruptcy with the intent that the debt be discharged. As the Supreme Court made clear in _Gentile_ v. _State Bar of Nevada_, 501 U.S. 1030 (1991), attorneys are not merely agents of their clients but also officers of the courts, and for that reason may be "subject to ethical restrictions on speech to which an ordinary citizen would not be." _Id._ at 1071. The Court in _Gentile_ quoted with approval Justice Stewart's dispositive

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[4] Indeed, it is unclear that merely co-signing a child's student loan would even constitute incurring "more debt" within the meaning of section 526(a)(4). _Cf._ Gov. Br. 31 n.8 (same, refinancing an existing mortgage). As for credit counseling, plaintiffs identify no reason why the statute should be read to impair debtors' ability to obtain the very counseling that Congress required in the 2005 Act as a condition of chapter 7 relief. _See_ 11 U.S.C. § 109(h). Because such debt is not incurred to defraud creditors or abuse the bankruptcy system, it does not implicate section 526(a)(4).

concurrence in In re Sawyer, 360 U.S. 622 (1959), in which he rejected the notion "that a lawyer can invoke the constitutional right of free speech to immunize himself from even-handed discipline for proven unethical conduct," because "[a] lawyer belongs to a profession with inherited standards of propriety and honor, which experience has shown necessary in a calling dedicated to the accomplishment of justice. * * * Obedience to ethical precepts may require abstention from what in other circumstances might be constitutionally protected speech." Id. at 646-47 (Stewart, J., concurring in judgment); see Gentile, 501 U.S. at 1071. See also Ohralik v. Ohio State Bar Ass'n, 436 U.S. 447, 460 (1978) (sustaining a restriction on attorney solicitation because the government "bears a special responsibility for maintaining standards among members of the licensed professions"); Goldfarb, 421 U.S. at 792 (the government's interest "in regulating lawyers is especially great since lawyers are essential to the primary governmental function of administering justice, and have historically been 'officers of the courts'").

Plaintiffs insist that section 526(a)(4) does not regulate professional conduct and should not be analyzed under the principles discussed in Gentile. That contention is difficult to fathom. Section 526(a)(4) provides a bankruptcy-specific rule of conduct akin to Model Rule of Professional Conduct 1.2(d), which states that an attorney may not "counsel a client to engage, or assist a client, in conduct that the lawyer knows is criminal or fraudulent." Accord Minn. R. Prof. Conduct 1.2(d). As we observed in our opening brief, that rule has been applied to precisely the conduct that section 526(a)(4) addresses. See Attorney Grievance Comm'n of Maryland v. Culver, 381 Md. 241, 275-76 (2004) (attorney violated Rule 1.2(d) by advising a client to obtain credit card loans with the intent that the debt be discharged in bankruptcy). Moreover, Congress itself described the "debt relief agency" provisions of the 2005 Act as "professionalism standards for attorneys." See House Report at 17 (describing the new provisions as "strengthening professionalism standards for attorneys and others who assist consumer debtors with their bankruptcy cases").[5]

Plaintiffs' attack on section 526(a)(4) as a "content-based constraint[] on free speech," Br. 27, is thus entirely misplaced. Rules of professional conduct for attorneys are necessarily content-based; ethical rules could hardly be otherwise. Model Rule 1.2(d), which precludes attorneys from advising clients to engage in fraud, is no less a content-based restriction on

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[5] Plaintiffs assert that the Gentile rule is inapplicable because section 526(a)(4) "does not allude to ethics." Br. 37. But neither did the Nevada rule at issue in Gentile, yet the Supreme Court had little difficulty recognizing it as a regulation of professional conduct. See 501 U.S. at 1060-62. Even Model Rule 1.2(d) would not qualify as an ethical rule under plaintiffs' test.

attorney speech. The district court therefore erred in striking down section 526(a)(4) on its face as content-based. Indeed, the district court's facial invalidation of section 526(a)(4) was improper on any ground: as we noted in our opening brief (at 39-41), the statute is undoubtedly constitutional in many of its applications, even on the district court's own broad reading.[6]

Nor is there any merit to plaintiffs' analogy to Legal Services Corp. v. Velazquez, 531 U.S. 533 (2001). Br. 38. The statute at issue in that case conditioned the receipt of federal funds on an attorney's agreement not to challenge the validity of state or federal welfare laws. Id. at 538. The provision did not seek to regulate attorney ethics or avoid client abuses. Instead, the statute prevented attorneys from making "all the reasonable and well-grounded arguments necessary for proper resolution of the case." Id. at 545. Section 526(a)(4) does nothing of the kind. To the contrary, it prevents attorneys from jeopardizing their clients' interests through conduct designed to

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[6] As plaintiffs do not dispute, the district court failed to consider whether "the impermissible applications of the law are substantial when judged in relation to the statute's plainly legitimate sweep." Republican Party v. Klobuchar, 381 F.3d 785, 791 (8th Cir. 2004) (quoting Chicago v. Morales, 527 U.S. 41, 52 (1999)). In particular, plaintiffs do not attempt to defend the district court's invalidation of section 526(a)(4) in its entirety, without addressing that part of the statute that precludes attorneys from advising clients to incur yet more debt in order to pay their own fees. See 11 U.S.C. § 526(a)(4). Plaintiffs have made no allegations that they intend to engage in such conduct, and a challenge to that provision was not properly before the district court. See Gov. Br. 41.

subvert the bankruptcy system. Because section 526(a)(4) embodies a bankruptcy-specific regulation of professional conduct that does not impinge upon the First Amendment rights of attorneys or their clients, the judgment of the district court should be reversed.

III. CONGRESS CONSTITUTIONALLY REQUIRED THE DISCLOSURES IN SECTION 528 TO PREVENT THE DECEPTION OF CONSUMER DEBTORS.

1. As plaintiffs do not dispute, Congress enacted the disclosure requirements in 11 U.S.C. § 528 in response to aggressive lawyer advertisements that promised to wipe out debts, halt foreclosures, and prevent repossessions, yet failed even to mention that any such relief would require a petition for bankruptcy. See generally Gov. Br. 42-43. The same concerns had motivated the Federal Trade Commission in 1997 to issue an official consumer alert (which remains in effect today) warning consumers not to be misled, because "bankruptcy stays on your credit report for 10 years, and can hinder your ability to get credit, a job, insurance, or even a place to live." Bankruptcy Reform Act of 1998 (Part III), Hearing on H.R. 3150 Before House Judiciary Comm., 105th Cong. 90, 90-92 (1998) ("FTC Alert"). Section 528 thus requires bankruptcy attorneys to identify themselves truthfully as a "debt relief agency" in any advertisement promoting bankruptcy services, and to disclose in such advertisements the fact that they "help people file for

bankruptcy relief under the Bankruptcy Code." 11 U.S.C. § 528(b)(2); see also id. § 528(a)(3), (4).

In plaintiffs' view, this modest disclosure requirement unconstitutionally compels attorney speech and burdens advertisements that are "entirely harmless." Br. 47. Rather than require disclosures in advertisements, plaintiffs claim, Congress was required under the First Amendment to relegate misled consumers to their post-hoc remedies, such as "submit[ting] complaints against particular attorneys to the state bar of the offending attorney." Br. 47.

These contentions are flawed in multiple respects. As our opening brief explains (at 44-48), the Supreme Court has repeatedly made clear that attorneys may be required to make reasonable disclosures in their advertisements to prevent consumer deception. See, e.g., Zauderer v. Office of Disciplinary Counsel of Supreme Court of Ohio, 471 U.S. 626, 650-52 (1985); Bates v. State Bar of Arizona, 433 U.S. 350, 384 (1977) (states may require attorney advertisements to include "a warning or disclaimer * * * so as to assure that the consumer is not misled"). Plaintiffs make no effort to distinguish these authorities.

The particular disclosure requirement in section 528, moreover, addresses precisely the problem targeted by Congress: ensuring that those who advertise bankruptcy-related services disclose that their services in fact involve bankruptcy relief, so that consumers will not be inadvertently misled into filing a petition for bankruptcy. Section 528 does not burden substantially more speech than necessary to accomplish that important end; indeed, it restricts no speech at all. See Zauderer, 471 U.S. at 651 (emphasizing that "disclosure requirements trench much more narrowly on an advertiser's interests than do flat prohibitions on speech"). Whether analyzed under the Zauderer standard for factual disclosures, see 471 U.S. at 650-52, or under the "substantial government interest" test applicable to commercial speech regulations generally, see Florida Bar v. Went For It, Inc., 515 U.S. 618, 623 (1995), section 528 easily passes constitutional muster.

2. Plaintiffs urge that section 528 is invalid for the same reasons that the Supreme Court struck down the Ohio rule at issue in Zauderer. See Br. 44, 47. But plaintiffs misread the Court's decision. Although the Court in Zauderer struck down certain speech restrictions under Ohio law, it upheld the disclosure requirements analogous to those in section 528. See 471 U.S. at 650-52 (upholding discipline against attorney for failing to disclose in advertisements that "clients might be liable for significant litigation costs even if their lawsuits were unsuccessful"). The Supreme Court emphasized that disclosure requirements do not "prevent attorneys from conveying information

to the public," but merely "require[] them to provide somewhat more information than they might otherwise be inclined to present." Id. at 650. Accordingly, the Court held, "an advertiser's rights are adequately protected as long as disclosure requirements are reasonably related to the State's interest in preventing deception of consumers." Id. at 651. That standard is plainly satisfied here.

Plaintiffs also assert that section 528 sweeps more broadly than necessary because it would apply to any advertisement by any attorney who "happens to discuss" bankruptcy "with even a single client." Br. 48. Here again, plaintiffs would expand the statute far beyond the scope established by Congress. By their terms, the disclosure requirements in section 528 apply only to advertisements "of bankruptcy assistance services or of the benefits of bankruptcy directed to the general public," 11 U.S.C. § 528(a)(3) (emphasis added), including advertisements offering aid with "credit defaults, mortgage foreclosures, eviction proceedings," and the like, see id. § 528(b)(2). An attorney who merely "happens to discuss" bankruptcy with a client therefore would not be required to make the required disclosures — except to the extent that attorney specifically advertises bankruptcy assistance.

Finally, plaintiffs contend that the disclosures required under section 528 are themselves misleading, asserting that potential clients may be uncertain what the term "debt relief agency" means, or may assume that every attorney who makes the disclosures is equally experienced in bankruptcy law. Br. 49-50. Such speculation is not a proper basis for invalidating an Act of Congress, particularly where Congress has targeted a "concrete, nonspeculative harm," Florida Bar, 515 U.S. at 629, and has not burdened more speech than necessary to accomplish its ends. In any event, nothing in section 528 precludes attorneys from providing more information in their advertisements than the minimum disclosures required by the statute. See Zauderer, 471 U.S. at 650 (disclosure requirements do not "prevent attorneys from conveying information to the public," but "only require them to provide somewhat more information than they might otherwise be inclined to present").

CONCLUSION

For the foregoing reasons, the judgment of the district court should be reversed.

Respectfully submitted,

PETER D. KEISLER
Assistant Attorney General

RACHEL K. PAULOSE
United States Attorney

MARK B. STERN
(202) 514-5089
MARK R. FREEMAN **s/ Mark Freeman**
(202) 514-5714
Attorneys, Appellate Staff
Civil Division, Room 7531
Department of Justice
950 Pennsylvania Ave., N.W.
Washington, D.C. 20530-0001

OCTOBER 2007

CERTIFICATE OF COMPLIANCE

I hereby certify that the foregoing brief complies with the type-volume limitation of Fed. R. App. Rule 32(a)(7)(C). The brief contains 5,242 words, according to the count of Corel WordPerfect 12.

I also certify that the computer diskette containing the full text of the foregoing brief has been scanned for viruses and, to the best of our ability and technology, is virus-free.

s/ Mark Freeman
____
Mark R. Freeman

CERTIFICATE OF SERVICE

I hereby certify that on this 11th day of October, 2007, I caused copies of the foregoing brief, including one electronic copy, to be filed with the Court by Federal Express overnight delivery; and caused additional copies of the same brief, including one electronic copy, to be served by Federal Express overnight delivery on the following counsel:

Alan S. Milavetz, Esq.
Chad W. Schulze, Esq.
Joseph A. Rymanowski, Jr., Esq.
Milavetz, Gallop & Milavetz P.A.
6500 France Avenue, South
Edina, MN 55435
952-920-7777

s/ Mark Freeman

Mark R. Freeman

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2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	8th Cir
3. ("CCN") ***CURRENT*** CASE NO.	No.: 07-2405
4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*	No.: 05-cv-02626-JMR Court: D. Minn. *(Identify judge & cite, if any)*
5. ("SO") ***SOURCE***	**U.S. TRUSTEES**
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9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	• Whether 11 U.S.C. § 526(a)(4) may be construed in a manner so as to avoid, not invite, constitutional difficulties and a facial invalidation of the statute.
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No. 07-2405

IN THE UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

MILAVETZ, GALLOP & MILAVETZ P.A., ROBERT J. MILAVETZ,
BARBARA N. NEVIN, JOHN DOE, and MARY DOE,

Plaintiffs-Appellees,

v.

UNITED STATES OF AMERICA,

Defendant-Appellant.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MINNESOTA (ROSENBAUM, C.J.)

PETITION FOR REHEARING AND REHEARING EN BANC

GREGORY G. KATSAS
Assistant Attorney General

FRANK J. MAGILL, JR.
United States Attorney

MARK B. STERN
(202) 514-5089
MARK R. FREEMAN
(202) 514-5714
Attorneys, Appellate Staff
Civil Division, Room 7531
Department of Justice
950 Pennsylvania Ave., N.W.
Washington, D.C. 20530-0001

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INTRODUCTION AND SUMMARY

Pursuant to Federal Rules of Appellate Procedure 35 and 40, the United States respectfully asks that the Court grant rehearing of the panel's decision in this case and suggests that the case warrants rehearing en banc.

A divided panel of this Court struck down an Act of Congress as facially invalid under the First Amendment. Section 526(a)(4) of Title 11 provides that bankruptcy attorneys and other persons providing paid bankruptcy assistance to consumer debtors may not advise their clients "to incur more debt in contemplation of such person filing a case under this title." The panel majority concluded that this section must be interpreted broadly to encompass even entirely lawful and ethical attorney advice that is consistent with the Bankruptcy Code. For this reason, the majority reasoned, the statute sweeps beyond Congress's legitimate objective of preventing attorneys from encouraging their clients to "load up" on new debt on the eve of bankruptcy in order to abuse the protections of the Bankruptcy Code.

As Judge Colloton explained in his dissenting opinion, the majority's reading creates constitutional difficulties where none need exist. The Act regulates advice "in contemplation of" filing for bankruptcy, a term of art that "has been construed in the bankruptcy context to mean actions taken with the intent to abuse the protections of the bankruptcy system." Slip op. 21 (Colloton, J., dissenting). Section 526(a)(4) can thus be construed, consistent with the First Amendment, to prohibit "only advice that a client engage in conduct for the purpose of manipulating the bankruptcy system." Id. at 21. As the dissent explained, "[t]he text, structure, and legislative history of § 526(a)(4) provide adequate support for [this] narrowing construction," ibid., and there is no indication that Congress intended the statute to sweep more broadly. And as the dissent stressed, when a federal court is "presented with a constitutional challenge to an Act of Congress, we have not only the power, but the duty, to adopt a narrowing construction that will avoid constitutional difficulties whenever possible." Id. at 20 (citing Boos v. Barry, 485 U.S. 312, 330-31 (1988)).

The panel majority erred in disregarding principles of constitutional avoidance and construing section 526(a)(4) expansively to encompass all manner of lawful and ethical attorney advice. As the dissent's analysis demonstrates, the statute is amenable to a narrowing construction that is consistent with Congress's intent and avoids all constitutional difficulties, and the majority should have adopted that construction rather than strike down the statute. The facial invalidation of section 526(a)(4) presents an issue of exceptional importance that warrants review by the full Court.

STATEMENT

1. Congress enacted the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, to address a variety of abusive practices by consumer debtors and their professional representatives. A principal concern of the legislation was to address the recurring problem of debtors' attempting to exploit the Bankruptcy Code's discharge provisions, or otherwise manipulate the bankruptcy system, by purposefully amassing new debt prior to filing a petition for relief. Congress expressed concern that earlier measures had not adequately restricted the ability of debtors to "knowingly load up with credit card purchases or recklessly obtain cash advances and then file for bankruptcy relief." H.R. Rep. No. 109-31, pt. 1, at 15 (2005), reprinted in 2005 U.S.C.C.A.N. 88, 101 ("House Report"). Accordingly, Congress enacted a variety of new measures to combat the problem of debts incurred in contemplation of bankruptcy, such as reducing the threshold amounts at which certain eve-of-bankruptcy debts become presumptively fraudulent and therefore nondischargeable. See Pub. L. No. 109-8, § 310, 119 Stat. at 84 (amending 11 U.S.C. § 523(a)(2)(C)).

Congress also responded to evidence that attorneys and other bankruptcy professionals often play a critical role in abuse of the bankruptcy system. Citing a study by the U.S. Trustee Program, Congress noted that the study "consistently identified," among the sources of bankruptcy abuse, "misconduct by attorneys and other professionals" and "problems associated with bankruptcy petition preparers." House Report at 5 (quoting Darling & Redmiles, Protecting the Integrity of the System: the Civil Enforcement Initiative, 21 Am. Bankr. Inst. J. 12 (Sept. 2002)).

Congress addressed these problems by "strengthening professionalism standards for attorneys and others who assist consumer debtors with their bankruptcy cases" in return for a fee. House Report at 17. Under the amended provisions of the Code, an attorney who represents a consumer debtor in filing a bankruptcy petition must make her own reasonable investigation into the circumstances giving rise to the debtor's petition, including a specific inquiry into the veracity of the debtor's debt and asset schedules. See 11 U.S.C. § 707(b)(4)(C)-(D). By signing the petition, the attorney personally certifies that she believes the petition is warranted by the facts, that she has no reason to believe the debtor's schedules are incorrect, and that she has determined that the petition does not constitute an "abuse" under section 707(b). See ibid. Congress thus effectively required bankruptcy attorneys to warrant that their clients' pre-petition conduct and financial circumstances — including any assumption of debt in contemplation of bankruptcy — do not provide grounds for dismissal of the petition as an abuse of the bankruptcy system. See 11 U.S.C. § 707(b) (authorizing courts to dismiss petitions for abuse); cf. Marrama v. Citizens Bank, 127 S. Ct. 1105, 1111 (2007) (dismissal of bankruptcy petitions for bad-faith pre-petition conduct by the debtor).

Section 526(a) complements these requirements by prohibiting bankruptcy attorneys from misleading their clients or encouraging them to abuse the bankruptcy system. Section 526(a)(1) prohibits attorneys from failing to provide all promised services. Section 526(a)(2) prohibits attorneys from encouraging clients to make false statements in a bankruptcy proceeding. Section 526(a)(3) bars attorneys from misrepresenting the risks and benefits of seeking bankruptcy relief. Finally, section 526(a)(4) precludes attorneys from encouraging their clients to abuse the bankruptcy system by taking on additional debt in contemplation of filing a bankruptcy petition. Section 526(a)(4) states:

> A debt relief agency shall not * * * advise an assisted person or prospective assisted person to incur more debt in contemplation of such person filing a case under this title or to pay an attorney or bankruptcy petition preparer fee or charge for services performed as part of preparing for or representing a debtor in a case under this title.

11 U.S.C. § 526(a)(4).

2. Plaintiffs filed this facial challenge alleging that the advice limitations in section 526(a)(4) violate the First Amendment. In addition, plaintiffs challenged certain advertising disclosure requirements in 11 U.S.C. § 528 and contended that the restrictions are categorically inapplicable to

lawyers because, in their view, the statutory term "debt relief agency" does not include attorneys. The district court (Rosenbaum, C.J.) granted summary judgment for plaintiffs, holding that each of the challenged provisions violates the First Amendment and that attorneys do not fall within the statutory definition. See 355 B.R. 758 (D. Minn. 2006).

On the government's appeal, a panel of this Court unanimously concluded that attorneys are encompassed by the term "debt relief agency" and that the advertising requirements do not violate the First Amendment. Slip op. 3-9, 13-18.

The panel divided, however, on the constitutionality of section 526(a)(4). The panel majority concluded that the statute is facially overbroad because, in its view, the Act must be interpreted to prohibit advice "to incur any additional debt when the assisted person is contemplating bankruptcy," including "prudent prebankruptcy planning that is not an attempt to circumvent, abuse, or undermine the bankruptcy laws." Id. at 10-11. The majority thus held that the Act applies even "where it would likely be in the assisted person's, and even the creditors', best interest for the assisted person to incur additional debt in contemplation of bankruptcy." Id. at 11.

As examples, the panel hypothesized that "it may be in the assisted person's best interest to refinance a home mortgage in contemplation of bankruptcy to lower the mortgage payments," and that "it may be in the client's best interest to incur additional debt to purchase a reliable automobile before filing for bankruptcy, so that the debtor will have dependable transportation to travel to and from work." Id. at 11-12. The panel observed that "[i]ncurring these types of additional secured debt, which would often survive or could be reaffirmed by the debtor, may be in the debtor's best interest without harming the creditors." Id. at 12. Because the panel believed that section 526(a)(4) must be construed to prohibit these hypothetical examples of lawful attorney advice, it held the statute unconstitutional on its face. Id. at 13.

Dissenting, Judge Colloton stressed that "[w]hen presented with a constitutional challenge to an Act of Congress, we have not only the power, but the duty, to adopt a narrowing construction that will avoid constitutional difficulties whenever possible." Id. at 20 (citing Boos v. Barry, 485 U.S. at 330-31). Observing that the phrase "in contemplation of bankruptcy" is a term of art that has "been construed in the bankruptcy context to mean actions taken with the intent to abuse the protections of the bankruptcy system," id. at 21 (collecting authorities), the dissent explained that the text, structure, and legislative history of the Act all support reading section 526(a)(4) narrowly to prohibit "only advice that a client engage in conduct for the purpose of manipulating the bankruptcy system." Ibid. Such a narrowing construction, the dissent observed, is also consistent with the statute's remedial scheme, which focuses on the debtor's "actual damages" — thus suggesting that Congress did not intend to regulate lawful and appropriate attorney advice. Id. at 22-23 (citing 11 U.S.C. § 526(c)).

Finally, the dissent emphasized that a narrowing construction would conform the statute with Congress's undisputed intent in the 2005 bankruptcy amendments, which was to address "'misconduct by attorneys and other professionals'" and limit "'abusive practices by consumer debtors,'" including in particular the practice of "'load[ing] up'" on debt prior to bankruptcy. Id. at 23 (quoting House Report at 5, 15). The dissent concluded: "Given our duty to construe an Act of Congress in a manner that eliminates constitutional doubts, there is no need to adopt a construction that one party says is absurd, that the other party says was unintended by Congress, and that sweeps in salutary legal activity that would be a strange target for a statute entitled the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005." Ibid.

ARGUMENT

In enacting the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Congress addressed the longstanding problem of debtors' "loading up" on new debt prior to filing a petition for bankruptcy relief. Section 526(a)(4) complements these reforms by precluding bankruptcy professionals from encouraging their clients to abuse the bankruptcy system by deliberately amassing new debt on the eve of bankruptcy. Understood in this manner, the provision is an unexceptional regulation of professional conduct that does not impinge upon the First Amendment rights of attorneys or their clients. See Gentile v. State Bar of Nevada, 501 U.S. 1030, 1071-76 (1991). Indeed, the statute addresses conduct that has been held to fall squarely within the scope of Model Rule of Professional Conduct 1.2(d), which prohibits attorneys from advising their clients to engage in fraud. See Attorney Grievance Comm'n of Maryland v. Culver, 381 Md. 241, 275-76 (2004) (attorney violated Rule 1.2(d) by advising a client to obtain credit card loans with the intent that the debt be discharged in bankruptcy).

The panel majority did not doubt that section 526(a)(4) could be constitutionally applied to prohibit this sort of advice. Nor did the majority dispute that Congress’s purpose in the statute was to address such abuses: even plaintiffs do not contend that Congress meant to prohibit bankruptcy attorneys from providing lawful, appropriate advice to debtors. Nevertheless, the panel rejected the government’s interpretation in a single sentence, stating that the “plain language” of section 526(a)(4) precludes any narrowing construction. Slip op. 10. The majority hypothesized two instances — buying a car and refinancing a mortgage[1] — in which an attorney might ethically advise a client to accumulate new debt on the eve of bankruptcy, adding that "[f]actual scenarios other than these few hypothetical situations no doubt exist." Id. at 12. On this basis, the majority held the statute unconstitutional on its face.[2]

This analysis is flawed in every respect. First, as the dissent noted, "[e]ven under Milavetz's broad construction of the statute, a facial challenge resting on a 'few hypothetical situations' * * * is unlikely to justify invalidating a statute in all of its applications, because 'the mere fact that one can conceive of some impermissible applications of a statute is not sufficient to render it susceptible to an overbreadth challenge.'" Id. at 20-21 (quoting City Council of Los Angeles v. Taxpayers for Vincent, 466 U.S. 789, 800 (1984)). The Supreme Court has frequently reiterated this principle in emphasizing the burden that a plaintiff must overcome to establish the facial invalidity of an Act of Congress. See, e.g., United States v.

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[1] The panel evidently assumed, without explanation, that merely refinancing an existing mortgage — that is, exchanging one loan for another with the same principal balance but a different interest rate or repayment period — would constitute incurring "more debt" within the meaning of the statute.

[2] The panel observed that several district courts in other circuits have also declared section 526(a)(4) invalid. Slip Op. 11 n.8. Each of those decisions is now on appeal. See Zelotes v. Adams, No. 07-1853 (2d Cir.) (argued Oct. 10, 2008); Hersh v. United States, No. 07-10226 (5th Cir.) (argued April 2, 2008); Olsen v. Mukasey, No. 07-35616 (9th Cir.) (oral argument not yet scheduled). This Court is the only appellate court that has ruled on the validity of the statute.

Williams, 128 S. Ct. 1830, 1844 (2008).

In any event, as the dissent noted, "[i]t is unnecessary to resolve whether § 526(a)(4) is impermissibly overbroad when given its broadest reading" because the statute can be read narrowly to prohibit only advice to incur new debt for the purpose of manipulating the bankruptcy system. Slip op. 21. As the dissent explained, such a reading is consistent with the text, purpose, and structure of section 526(a)(4), and avoids all constitutional concerns. Id. at 21-23.

Under fundamental principles of constitutional avoidance, the majority erred in rejecting that interpretation in favor of striking down the statute. As the dissent stressed, in considering a constitutional challenge to an Act of Congress, a federal court has "not only the power, but the duty, to adopt a narrowing construction that will avoid constitutional difficulties whenever possible." Id. at 20. Indeed, "even when First Amendment interests are potentially affected, 'facial overbreadth has not been invoked when a limiting construction has been or could be placed on the challenged statute.'" Citizens for Equal Protection v. Bruning, 455 F.3d 859, 870 (8th Cir. 2006) (quoting Broadrick v. Oklahoma, 413 U.S. 601, 612 (1973)). Thus, in Boos v. Barry, 485 U.S. 312 (1988), the Supreme Court considered a First Amendment facial overbreadth challenge to a federal statute that made it unlawful "to congregate within 500 feet of any [embassy, legation, or consulate] and refuse to disperse after having been ordered so to do by the police." Id. at 329. The Court acknowledged that "[s]tanding alone, this text is problematic because it applies to any congregation within 500 feet of an embassy for any reason." Id. at 330. Nevertheless, in accordance with the "duty to avoid constitutional difficulties" when a narrowing "construction is fairly possible," the Court construed the statute to apply "only when the police reasonably believe that a threat to the security or peace of the embassy is present" — a requirement nowhere in the statute but necessary to ensure the validity of the Act. Id. at 330-31.

Section 562(a)(4) is plainly open to a construction that effectuates the statutory text, upholds Congress's purposes, and avoids all constitutional concerns. The statute provides that bankruptcy attorneys "shall not * * * advise an assisted person * * * to incur more debt in contemplation of such person filing a case under this title." The majority believed this language precludes any narrowing construction. Slip op. 10. But as the dissent observed, "the phrase 'in contemplation of' has been construed in the bankruptcy context to mean actions taken with the intent to abuse the protections of the bankruptcy system." Id. at 21. See, e.g., Black's Law Dictionary 336 (8th ed. 2004) (defining "contemplation of bankruptcy" as "the thought of declaring bankruptcy because of the inability to continue current financial operations, often coupled with action designed to thwart the distribution of assets in a bankruptcy proceeding" (emphasis added)). Indeed, as the dissent demonstrated, this understanding has a long pedigree. Id. at 21-22; see, e.g., In re Pearce, 21 Vt. 611, 19 F. Cas. 50, 53 (D. Vt. 1843) (No. 10873) (an act was done "in contemplation of bankruptcy" if it was done "in anticipation of breaking or failing in his business * * * and intending to defeat the general distribution of effects, which takes place under a proceeding in bankruptcy"); Morgan v. Brundrett, 5 Barn. & Ad. 289, 296, 110 Eng. Rep. 798, 801 (K.B. 1833) (Parke, J.) (interpreting "in contemplation of bankruptcy" to mean that "the payment or delivery must be with intent to defeat the general distribution of effects which takes place under a commission of bankruptcy"); Fidgeon v. Sharpe, 5 Taunt. 539, 545-46, 128 Eng. Rep. 800, 802-03 (C.P. 1814) (Gibbs, C.J.) (an act made in contemplation of bankruptcy "must be intended in fraud of the bankrupt laws").

That Congress intended section 526(a)(4) only to prohibit advice to abuse the bankruptcy process is also apparent from the remedy provisions of the statute. As the dissent observed, the principal remedy for a violation of section 526(a)(4) is a suit against the attorney to recover the debtor's "actual damages," as well as restitution of any fees paid by the debtor. Id. at 23 (citing 11 U.S.C. § 526(c)). Congress's emphasis on the debtor's "actual damages" presupposes that the debtor has been injured by the attorney's conduct. But as the dissent noted, "legal and appropriate advice that would be protected by the First

Amendment, yet prohibited by a broad reading of § 526(a)(4), should cause no damage at all.” Ibid.

The majority’s broad interpretation of section 526(a)(4) also entirely disregards the statutory context. Section 526(a)(4) is one of four subsections of section 526(a). The other three subsections indisputably provide rules of professional conduct designed to protect debtors from abusive practices by their attorneys and other debt relief agencies. See 11 U.S.C. § 526(a)(1) (debt relief agencies must perform all promised services); id. § 526(a)(2) (prohibiting debt relief agencies from advising debtors to make false or misleading statements to obtain bankruptcy relief); id. § 526(a)(3) (prohibiting debt relief agencies from misrepresenting to debtors the costs or benefits of bankruptcy). Construed in pari materia with these provisions, section 526(a)(4) is clearly targeted at advice to engage in abusive conduct — not, as the majority held, all manner of lawful and ethical attorney advice.

The sweeping construction advanced by plaintiffs and adopted by the panel majority is thus in no sense compelled by the statutory text. Nor is it consistent with the purposes of the statute: even plaintiffs acknowledged that “a principal goal of Congress in passing the statute was to ‘preclude debtors from taking on more debt knowing that it will later be discharged during bankruptcy.’” Slip op. 23 (quoting Brief of Appellee 34). As the dissent rightly concluded, there is “no need to adopt a construction that one party says is absurd, that the other party says was unintended by Congress, and that sweeps in salutary legal activity that would be a strange target for a statute entitled the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005." Ibid.

It is the duty of a federal court to construe federal statutes to avoid, not invite, constitutional difficulties, provided any plausible construction can be found that saves the validity of the statute. As the dissent's analysis demonstrates, this Court can and should adopt such a construction here.

CONCLUSION

For the foregoing reasons, the Court should grant rehearing en banc and sustain the validity of 11 U.S.C. § 526(a)(4).

Respectfully submitted,

GREGORY G. KATSAS
Assistant Attorney General

FRANK J. MAGILL, JR.
United States Attorney

MARK B. STERN
(202) 514-5089

s/ Mark R. Freeman
____
MARK R. FREEMAN
(202) 514-5714
Attorneys, Appellate Staff
Civil Division, Room 7531
Department of Justice
950 Pennsylvania Ave., N.W.
Washington, D.C. 20530-0001

CERTIFICATE OF SERVICE

I hereby certify that on October 20, 2008, I electronically filed the foregoing petition for rehearing with the Clerk of the Court for the United States Court of Appeals for the Eighth Circuit by using the CM/ECF system. All participants in the case for whom service is required are registered CM/ECF users and will be served by the CM/ECF system.

s/ Mark R. Freeman
MARK R. FREEMAN

ADDENDUM:

Corrected Slip Opinion

United States Court of Appeals
FOR THE EIGHTH CIRCUIT

No. 07-2405

Milavetz, Gallop & Milavetz, P.A.; *
Robert J. Milavetz; Barbara N. Nevin; *
John Doe; Mary Doe, *
*
Appellees, *
* Appeal from the United States
v. * District Court for the
* District of Minnesota.
United States of America, *
*
Appellant, *
*
*
Commercial Law League of America, *
*
Amicus on Behalf *
of Appellee. *

Submitted: March 11, 2008
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Before BYE, SMITH, and COLLOTON, Circuit Judges.

SMITH, Circuit Judge.

Milavetz, Gallop & Milavetz, P.A., a law firm that practices bankruptcy law, the firm's president, a bankruptcy attorney within the firm, and two clients[1] who sought bankruptcy advice from the firm brought suit against the United States seeking a declaratory judgment that certain provisions of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA)—11 U.S.C. §§ 526(a)(4) and 528(a)(4) and (b)(2)—did not apply to attorneys and law firms and are unconstitutional as applied to attorneys. The district court granted summary judgment to the plaintiffs and issued an order declaring that: (1) attorneys in the District of Minnesota were excluded from the definition of a "debt relief agency" as defined by BAPCPA; and (2) the challenged provisions were unconstitutional as applied to attorneys in the District of Minnesota. We affirm in part and reverse in part.

I. *Background*

On April 20, 2005, BAPCPA was signed into law, amending and adding multiple sections of the Bankruptcy Code ("the Code"). While some of these amendments became effective immediately, the vast majority became effective on October 17, 2005. *See* Pub. L. No. 109-8, § 1501(a), 119 Stat. 23 (2005) ("Except as otherwise provided in this Act, this Act and the amendments made by this act shall take effect 180 days after the date of enactment of this Act").

One BAPCPA amendment added a new term, "debt relief agency," which is defined in § 101(12A) of the Code. 11 U.S.C. § 101(12A).[2] The amended Code

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[1] The client-plaintiffs sought prebankruptcy advice regarding the incurrence of additional debt prior to filing bankruptcy. The Bankruptcy Code precludes a debt relief agency from advising an assisted person from incurring additional debt in contemplation of bankruptcy. 11 U.S.C. § 526(a)(4). Thus, these client-plaintiffs are appearing on behalf of themselves and all others similarly situated who desire to exercise their First Amendment rights with attorneys regarding bankruptcy information.

[2] Prior to BAPCPA, the term "debt relief agency" did not exist in the Code.

restricts some actions of debt relief agencies, while requiring them to do others. *See* 11 U.S.C. § 526 ("Restrictions on debt relief agencies"); 11 U.S.C. § 528 ("Requirements for debt relief agencies"). For example, § 526(a)(4) bars a debt relief agency from advising a client "to incur more debt in contemplation" of a bankruptcy filing, 11 U.S.C. § 526(a)(4), while §§ 528(a)(4) and (b)(2) require debt relief agencies to include a disclosure in their bankruptcy-related advertisements directed to the general public declaring: "'We are a debt relief agency. We help people file for bankruptcy relief under the Bankruptcy Code[,]'or a substantially similar statement." 11 U.S.C. § 528(a)(4), (b)(2). The plaintiffs sought alternative remedies. First, plaintiffs requested a declaratory judgment that attorneys did not fall within the definition of "debt relief agency." If the court determined that attorneys fell within the definition of debt relief agency, they challenged the constitutionality of §§ 526(a)(4) and 528(a)(4) and (b)(2), as applied to attorneys.

II. *Discussion*

A. *Debt Relief Agencies*

Initially, we address whether attorneys fall within the Code's definition of debt relief agencies. If they do not, we will have no need to address the constitutionality of §§ 526(a)(4) and 528(a)(4) and (b)(2), which only apply to debt relief agencies. *See Holtan v. Black*, 838 F.2d 984, 986 n.3 (8th Cir. 1988) ("Federal courts must avoid passing upon constitutional questions unless they are essential to the disposition of the issues before them.") (citing *Three Affiliated Tribes v. Wold Engineering,* 467 U.S. 138, 157 (1984) ("It is a fundamental rule of judicial restraint, however, that this Court will not reach constitutional questions in advance of necessity of deciding them")).

> The term "debt relief agency" means *any person* who provides *any bankruptcy assistance* to an *assisted person* in return for the payment of money or other valuable consideration, or who is a bankruptcy petition preparer under section 110, but does not include–

> (A) any person who is an officer, director, employee, or agent of a person who provides such assistance or of the bankruptcy petition preparer;
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> (B) a nonprofit organization that is exempt from taxation under section 501(c)(3) of the Internal Revenue Code of 1986;
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> (C) a creditor of such assisted person, to the extent that the creditor is assisting such assisted person to restructure any debt owed by such assisted person to the creditor;
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> (D) a depository institution (as defined in section 3 of the Federal Deposit Insurance Act) or any Federal credit union or State credit union (as those terms are defined in section 101 of the Federal Credit Union Act), or any affiliate or subsidiary of such depository institution or credit union; or
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> (E) an author, publisher, distributor, or seller of works subject to copyright protection under title 17, when acting in such capacity.

11 U.S.C. § 101(12A) (emphasis added).

Further, the Code defines the term "bankruptcy assistance" to mean:

> any goods or services sold or otherwise provided to an assisted person with the express or implied purpose of providing information, *advice*, *counsel*, document preparation, or filing, or attendance at a creditors' meeting or appearing in a case or proceeding on behalf of another *or providing legal representation* with respect to a case or proceeding under this title.

Id. at § 101(4A) (emphasis added).

Additionally, the Code defines the term "assisted person" as "any person whose debts consist primarily of consumer debts and the value of whose nonexempt property is less than $164,250."[3] *Id.* at § 101(3).

The plaintiffs argue that attorneys are not "debt relief agencies" because the definition of debt relief agencies makes no direct reference to attorneys, even though "attorney" is a defined term in the Code, *id.* at § 101(4),[4] but does include the term "bankruptcy petition preparer" which, by definition, excludes debtor's attorneys and their staff. *See* 11 U.S.C. § 110(a)(1).[5] Plaintiffs contend that the omission of any reference to attorneys or lawyers while specifically including bankruptcy petition preparers shows Congress's intent to exclude attorneys from the definition of debt relief agencies. Because the plaintiffs contend that constitutionality issues arise in §§ 526(a)(4) and 528(a)(4) and (b)(2) if attorneys are debt relief agencies, they assert that the doctrine of constitutional avoidance should be used to interpret "debt relief agency" to exclude attorneys and thus avoid the potential constitutional issues.

Conversely, the government argues that attorneys are debt relief agencies because the broadly worded definition of the term plainly includes attorneys, *see* 11

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[3] When this suit was commenced, the dollar amount in § 101(3) was $150,000. Subsequently, on April 1, 2007, the amount was adjusted pursuant to 11 U.S.C. § 104. The change, however, is inconsequential for purposes of this case.

[4] "The term 'attorney' means attorney, professional law association, corporation, or partnership, authorized under applicable law to practice law." 11 U.S.C. § 101(4). This definition makes no reference to "debt relief agencies" or to subsection (12A).

[5] "'[B]ankruptcy petition preparer' means a person, *other than an attorney for the debtor or an employee of such attorney* under the direct supervision of such attorney, who prepares for compensation a document for filing [by the debtor in connection with his bankruptcy case]." 11 U.S.C. § 110(a)(1) (emphasis added); *see also id.* at § 110(a)(2) (defining "document for filing" as used in § 110(a)(1)).

U.S.C. § 101(12A) (defining "debt relief agency" as "any person who provides any bankruptcy assistance to an assisted person in return for the payment"), and providing legal representation is included in definition of bankruptcy assistance. *See id.* at 101(4A) ("bankruptcy assistance means any goods or services sold or otherwise provided to an assisted person with the express or implied purpose of providing . . . advice, counsel, . . . or legal representation with respect to a case or proceeding under this title").

Whether attorneys fall within the Code's definition of debt relief agencies is an issue of first impression among the Courts of Appeals. Although the plain language of the definition appears to include bankruptcy attorneys and does not appear to be ambiguous, lower "[c]ourts that have addressed the issue of whether attorneys are debt relief agencies have not been unanimous." *In re Irons*, 379 B.R. 680, 685 (Bankr. S.D. Tex. 2007) (citing cases). Nevertheless, the majority of courts have held that compensated bankruptcy attorneys are debt relief agencies as that term is defined in the Code. *Id.* (finding debtor's counsel was a debt relief agency); *Olsen v. Gonzales*, 350 B.R. 906 (D. Or. 2006) (same); *In re Robinson*, 368 B.R. 492 (Bankr. E.D. Va. 2007) (finding debtor's counsel was debt relief agency); *Hersh v. United States*, 347 B.R. 19 (N.D. Tex. 2006) (finding that bankruptcy attorneys are debt relief agencies); *In re Norman*, No. 06-70859, 2006 WL 3053309 (Bankr. E.D. Va. 2006) (finding debtor's counsel qualified as a debt relief agency); *but see In re Attorneys at Law and Debt Relief Agencies*, 332 B.R. 66 (Bankr. S.D. Ga. 2005) (holding that attorneys are not debt relief agencies); *In re Reyes*, 361 B.R. 276 (Bankr. S.D. Fla. 2007) (finding that attorneys, generally, are not debt relief agencies, but ruling that debtor's counsel in case at bar was not a debt relief agency because service was provided pro bono and thus counsel did not receive valuable consideration in return for the bankruptcy assistance provided).

In this case, the district court acknowledged that the definition of debt relief agency, "at first glance," appeared to include attorneys, but it ultimately relied on the doctrine of constitutional avoidance to conclude that attorneys did not fall within the definition because if they did portions of §§ 526 and 528 would be unconstitutional as applied to attorneys. The doctrine of constitutional avoidance dictates that "where an otherwise acceptable construction of a statute would raise serious constitutional problems, the Court will construe the statute to avoid such problems unless such construction is plainly contrary to the intent of Congress." *Edward J. DeBartolo Corp. v. Florida Gulf Coast Bldg. & Constr. Trades Council*, 485 U.S. 568, 575 (1988). Thus, if interpreting "debt relief agency" to include attorneys "would raise serious constitutional problems," then we should look for another interpretation "that may fairly be ascribed" to the definition that does not raise these concerns. *Id.* at 576–77. We will not, however, adopt an alternative interpretation that is "plainly contrary to the intent of Congress." *Id.* at 575.

"We review the district court's statutory interpretation de novo." *United States v. Mendoza-Gonzalez*, 520 F.3d 912, 914 (8th Cir. 2008). To interpret the statute we first "determine whether the language at issue has a plain and unambiguous meaning with regard to the particular dispute in the case." *Id.* (quoting *Robinson v. Shell Oil Co.*, 519 U.S. 337, 340 (1997)). "If so, we apply the plain language of the statute." *Id.* "A mere disagreement among litigants over the meaning of the statute does not prove ambiguity; it usually means that one of the litigants is simply wrong." *Bank of Am. Nat'l Trust & Sav. Ass'n v. 203 N. LaSalle St. P'ship*, 526 U.S. 434, 461 (1999).

The plain reading of the definition of debt relief agency, and the defined terms that make up that definition, leads us to conclude that attorneys who provide "bankruptcy assistance" to "assisted persons" are unambiguously included in the definition of "debt relief agencies." *See Olsen*, 350 B.R. at 912 ("[I]t is the plain language of the Act that leads to the conclusion that attorneys are to be included in the definition of 'debt relief agency,'" and "[t]hus, further use of the tools of statutory construction is not necessary"). The statutory language sweeps broadly and clearly covers the legal services provided by attorneys to debtors in bankruptcy unless excluded by another provision.

Congress specifically listed five exclusions from the definition of "debt relief agency," and if it meant to exclude attorneys from that definition it could have explicitly done so. *Id.*; 11 U.S.C. § 101(12A). Moreover, if attorneys were not included in the definition of debt relief agencies, Congress would have had no reason to include § 526(d)(2), which expressly provides that nothing in §§ 526, 527, or 528 (the sections covering debt relief agencies) "shall be deemed to limit or curtail the authority or ability of a State . . . to determine and enforce qualifications for the practice of law under the laws of that State; or of a Federal court to determine and enforce the qualifications for the practice of law before that court." 11 U.S.C. § 526(d)(2)(A) and (B). The legislative history provides further indication that attorneys are included in the definition. *See* H.R. Rep. No. 109-31, 109th Cong. 1st Sess. at 4 (April 8, 2005) ("The bill's consumer protections include provisions strengthening professionalism standards *for attorneys* and others who assist consumer debtors with their bankruptcy cases") (emphasis added).[6]

Because attorneys were not specifically excluded from the definition of debt relief agencies, we hold that attorneys that provide "bankruptcy assistance" to "assisted persons" are "debt relief agencies" as that term is defined by the Code.

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[6] Additionally, while we recognize that the Supreme Court has stated that "failed legislative proposals are a particularly dangerous ground on which to rest [a statutory interpretation]," *Lockhart v. United States*, 546 U.S. 142 (2005) (internal quotation marks and brackets omitted), we note that on March 9, 2005, Senator Feingold proposed amendment No. 93 to Congress which would have excluded attorneys from the definition of debt relief agencies, *see* 151 Cong. Rec. S2306–02, 2316 (daily ed. Mar. 9, 2005) (statement by Sen. Feingold) ("This amendment would exclude lawyers from the provisions dealing with 'debt relief agencies' . . . ."), but the Senate did not address the proposal.

Interpreting the definition of "debt relief agency" to exclude bankruptcy attorneys would be contrary to Congress's intent.

B. *Constitutionality of § 526(a)(4)*

Having concluded that attorneys providing bankruptcy assistance to assisted persons are debt relief agencies under the Code, we now must determine whether the challenged provisions placing restrictions and requirements on debt relief agencies are unconstitutionally overbroad as applied to these types of attorneys.[7] One of the sections challenged by the plaintiffs in this case is § 526(a)(4), which states:

> (a) A debt relief agency shall not–
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> . . .
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> (4) advise an assisted person or prospective assisted person to incur more debt in contemplation of such person filing a case under this title or to pay an attorney or bankruptcy petition preparer fee or charge for services performed as part of preparing for or representing a debtor in a case under this title.

11 U.S.C. § 526(a)(4).

Plaintiffs assert that the prohibition against advising an assisted person or prospective assisted person to incur more debt in contemplation of bankruptcy violates

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[7] Even though a more narrowly drawn version of § 526(a)(4) would likely be valid as applied to the plaintiffs in this case, our analysis applies to all attorneys falling within the definition of debt relief agencies, not merely the plaintiff-attorneys. *See Members of City Council of City of Los Angeles v. Taxpayers for Vincent*, 466 U.S. 789, 798–99 (1984) (explaining that the overbreadth doctrine allows a party to challenge a broadly written statute "even though a more narrowly drawn statute would be valid as applied to the party in the case," as "the statute's very existence may cause others not before the court to refrain from constitutionally protected speech or expression") (internal quotations and citation omitted).

the First Amendment. The parties disagree as to the level of scrutiny we apply to the constitutional analysis of this limitation on speech. Plaintiffs claim that we should review the constitutionality of § 526(a)(4) under the strict scrutiny standard as the restriction on attorney advice is content-based. *See Turner Broad. Sys., Inc. v. FCC*, 512 U.S. 622, 642 (1994) ("Our precedents thus apply the most exacting scrutiny to regulations that suppress, disadvantage, or impose differential burdens upon speech because of its content"). Under strict scrutiny review, the government has the burden to prove that the constraints on speech are supported by a compelling governmental interest and are narrowly tailored, such that the statutory effect does not prohibit any more speech than is necessary to serve the governmental interest. *Republican Party of Minnesota v. White*, 536 U.S. 765, 774–75 (2002).

In contrast, the government argues that § 526(a)(4)'s restrictions are a type of ethical regulation, invoking the more lenient standard outlined in *Gentile v. State Bar of Nev.*, 501 U.S. 1030 (1991). Under the *Gentile* standard, we would balance the First Amendment rights of the attorneys against the government's legitimate interest in regulating the activity in question—the prohibition of advising assisted persons to incur more debt in contemplation of bankruptcy—and then determine whether the regulations impose "only narrow and necessary limitations on lawyers' speech." *Id.* at 1075.

According to the government, § 526(a)(4) should be interpreted as merely preventing an attorney from advising an assisted person (or prospective assisted person) to take on more debt in contemplation of bankruptcy when the incurrence of such debt is done with the intent to manipulate the bankruptcy system, engage in abusive conduct, or take unfair advantage of the bankruptcy discharge. However, the plain language of the statute does not permit this narrow interpretation. Rather, § 526(a)(4) broadly prohibits a debt relief agency from advising an assisted person (or prospective assisted person) to incur *any* additional debt when the assisted person is contemplating bankruptcy. The statute's blanket prohibition applies even if the additional debt would not be discharged during the bankruptcy proceedings. 11 U.S.C. § 526(a)(4).

Thus, regardless of whether the government's interest in prohibiting the speech was legitimate (*Gentile* standard) or compelling (strict scrutiny standard), § 526(a)(4) is unconstitutionally overbroad as applied to attorneys falling within the definition of debt relief agencies because it is not narrowly tailored, nor narrowly and necessarily limited, to restrict only that speech that the government has an interest in restricting. Instead, § 526(a)(4) prohibits attorneys classified as debt relief agencies from advising any assisted person to incur any additional debt in contemplation of bankruptcy; this prohibition would include advice constituting prudent prebankruptcy planning that is not an attempt to circumvent, abuse, or undermine the bankruptcy laws. Section 526(a)(4), as written, prevents attorneys from fulfilling their duty to clients to give them appropriate and beneficial advice not otherwise prohibited by the Bankruptcy Code or other applicable law.[8]

There are certain situations where it would likely be in the assisted person's, and even the creditors', best interest for the assisted person to incur additional debt in contemplation of bankruptcy. However, under § 526(a)(4)'s plain language an attorney is prohibited from providing this beneficial advice—even if the advice could help the assisted person avoid filing for bankruptcy altogether. For instance, it may be in the assisted person's best interest to refinance a home mortgage in contemplation of

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[8] Several bankruptcy courts are in agreement with our decision. *See Zelotes*, 363 B.R. at 667 ("Because § 526(a)(4) is not sufficiently 'narrowly tailored to achieve the desired objective,' it is unconstitutional as applied to bankruptcy attorneys."); *Hersh*, 347 B.R. at 25 (concluding that § 526(a)(4) is unconstitutional because: "(1) it prevents lawyers from advising clients to take lawful actions; and (2) it extends beyond abuse to prevent advice to take prudent actions," and therefore imposes "limitations on speech beyond what is 'narrow and necessary'"); *Olsen*, 350 B.R. at 916 ("[S]ection 526(a)(4) is overly restrictive in violation of the First Amendment" even if reviewed under *Gentile* standard).

bankruptcy to lower the mortgage payments. This could free up additional funds to pay off other debts and avoid the need for filing bankruptcy all together. *Hersh*, 347 B.R. at 24. Moreover, it may be in the client's best interest to incur additional debt to purchase a reliable automobile before filing for bankruptcy, so that the debtor will have dependable transportation to travel to and from work, which will likely be necessary to maintain the debtor's payments in bankruptcy. *Id.* Incurring these types of additional secured debt, which would often survive or could be reaffirmed by the debtor, may be in the debtor's best interest without harming the creditors.[9]

Factual scenarios other than these few hypothetical situations no doubt exist and may further illustrate why incurring additional debt in contemplation of bankruptcy may not be abusive or harmful to creditors. Nonetheless, § 526(a)(4), as written, does not allow attorneys falling within the definition of debt relief agencies to advise assisted persons (or prospective assisted persons)—i.e. clients (or prospective clients) meeting the definition of assisted person—to incur such debt. Thus, § 526(a)(4) is not narrowly tailored nor narrowly and necessarily limited to prevent only that speech which the government has an interest in restricting. Therefore, we hold that §

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[9] *See* Erwin Chemerinsky, *Constitutional Issues Posed in the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005*, 79 Am. Bankr. L.J. 571, 579 (Summer 2005).

> [Section 526(a)(4)'s] prohibition is particularly troubling when it might be completely legal and even desirable for the client to incur such debt. For example, there may be instances where it is advisable for a client to obtain a mortgage, to refinance an existing mortgage to obtain a lower interest rate, or to buy a new car on time. There would be no fraud in doing so if the client intended to pay such debt notwithstanding the filing of a contemplated bankruptcy case. For example, the client may intend to keep all payments fully current and to reaffirm such debt once the case is filed.

526(a)(4) is substantially overbroad,[10] and unconstitutional as applied to attorneys who provide bankruptcy assistance to assisted persons, as those terms are defined in the Code.

C. *Constitutionality of § 528(a)(4) and (b)(2)*

The plaintiffs also challenged the constitutionality of §§ 528(a)(4) and (b)(2)(B), claiming that the advertising disclosure requirements mandated by those sections violate the First Amendment rights of bankruptcy attorneys through compelled speech. The disclosure requirements of § 528(a)(4) are supplemented by § 528(a)(3). These sections state:

> (a) A debt relief agency shall–
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> . . .
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> (3) clearly and conspicuously disclose in any advertisement of bankruptcy assistance services or of the benefits of bankruptcy directed to the general public (whether in general media, seminars or specific mailings, telephonic or electronic messages, or otherwise) that the services or benefits are with respect to bankruptcy relief under this title; and
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> (4) clearly and conspicuously use the following statement in such advertisement: "We are a debt relief agency. We help people file for bankruptcy relief under the Bankruptcy Code." or a substantially similar statement.

11 U.S.C. § 528 (a)(3), (4).

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[10] *See Veneklase v. City of Fargo*, 248 F.3d 738, 747 (8th Cir. 2001) ("For us to find a statute unconstitutionally overbroad, its 'overbreadth . . . must not only be real, but substantial as well, judged in relation to the statute's plainly legitimate sweep.'") (quoting *Broadrick v. Oklahoma*, 413 U.S. 601, 615 (1973)).

Similarly, § 528(b)(2)(B) states:

> (2) An advertisement, directed to the general public, indicating that the debt relief agency provides assistance with respect to credit defaults, mortgage foreclosures, eviction proceedings, excessive debt, debt collection pressure, or inability to pay any consumer debt shall–
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> . . .
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> > (B) include the following statement: "We are a debt relief agency. We help people file for bankruptcy relief under the Bankruptcy Code." or a substantially similar statement.

11 U.S.C. § 528(b)(2)(B).

As both §§ 528(a)(4) and (b)(2)(B) require debt relief agencies—which includes attorneys providing bankruptcy assistance to assisted persons—to disclose in their advertising that "'We are a debt relief agency. We help people file for bankruptcy relief under the Bankruptcy Code.' or some substantially similar statement," the statutes compel speech that, similar to a restriction on speech, receives constitutional protection under the First Amendment. *See Wooley v. Maynard*, 430 U.S. 705, 714 (1977) ("[T]he right of freedom of thought protected by the First Amendment against state action includes both the right to speak freely and the right to refrain from speaking at all"); *Turner Broad. Sys., Inc.*, 512 U.S. at 642 (stating that "[l]aws that compel speakers to utter or distribute speech bearing a particular message are subject to" constitutional scrutiny).

The government contends that Congress enacted § 528's disclosure requirements to address problems with deceitful or unclear advertising by bankruptcy attorneys, bankruptcy petition preparers, or other debt relief entities. This position is supported by legislative history. *See* 151 Cong. Rec. H2063-01, 2066 (daily ed. Apr. 14, 2005) (statement by Rep. Moran) (stating that certain BAPCPA provisions are intended to "[p]revent deceptive and fraudulent advertising practices by debt relief agencies . . ."). But before we can determine whether the government's justification for mandating the disclosures passes constitutional scrutiny, we must first decide the appropriate standard for reviewing the constitutionality of the required disclosures.

We find guidance for this issue from the Court in *Zauderer v. Office of Disciplinary Counsel of the Supreme Court of Ohio*, 471 U.S. 626 (1985). In *Zauderer*, the Supreme Court considered the constitutionality of a state bar disciplinary regulation requiring attorneys that advertised contingent-fee representation to disclose in their advertisements that clients may still have to bear certain costs even if the case was unsuccessful. *Id.* at 633. As the regulation only required an attorney to "include in his advertising purely factual and uncontroversial information about the terms under which his services w[ould] be available," and "the extension of First Amendment protection to commercial speech is justified principally by the value to consumers of the information such speech provides, [the attorney's] constitutionally protected interest in not providing any particular factual information in his advertising is minimal." *Id.* at 651. The Court "recognize[d] that unjustified or unduly burdensome disclosure requirements might offend the First Amendment by chilling protected commercial speech," but held "that an advertiser's rights are adequately protected as long as disclosure requirements are *reasonably related* to the State's interest in preventing deception of consumers." *Id.* (emphasis added).

On the other hand, restrictions on non-deceptive advertising are reviewed under intermediate scrutiny. *See Cent. Hudson Gas & Elec. Corp. v. Pub. Serv. Comm'n of New York*, 447 U.S. 557, 564 (1980) (ruling that restrictions on commercial speech that is neither misleading nor related to unlawful activity must assert a "substantial interest to be achieved by [the] restrictions" and "the restrictions must directly advance the state interest involved"). Under this standard, the limitation must be narrowly drawn. *Id.* ("[I]f the governmental interest could be served as well by a more limited restriction on commercial speech, the excessive restrictions cannot survive").

The district court in this case reviewed § 528's disclosure requirements under the intermediate scrutiny standard, but we conclude that rational basis review is proper. The disclosure requirements here, like those in *Zauderer*, are intended to avoid potentially deceptive advertising. *See Zauderer*, 471 U.S. at 651, n.14 (rejecting a more strict analysis of the disclosure requirements at issue in that case, and noting that "the First Amendment interests implicated by disclosure requirements are substantially weaker than those at stake when speech is actually suppressed . . .").

By definition, debt relief agencies provide bankruptcy assistance to assisted persons (or prospective assisted persons) "with respect to a case or proceeding under [the Bankruptcy Code]." 11 U.S.C. §§ 101(4A), (12A). Section 528 generally requires debt relief agencies to disclose on its advertisements of bankruptcy assistance services directed to the general public that their services do in fact relate to bankruptcy and that they assist people in filing for bankruptcy. 11 U.S.C. § 528. As in *Zauderer*, the plaintiffs' "constitutionally protected interest in not providing [such] factual information in [their] advertising is minimal." 471 U.S. at 650. Further, the disclosure requirements are reasonably and rationally related to the government's interest in preventing the deception of consumer debtors, as the disclosure requirements are directed precisely at the problem targeted by Congress: ensuring that persons who advertise bankruptcy-related services to the general public make clear that their services do in fact involve filing for bankruptcy.[11]

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[11] Without ruling on the issue, we note that at least one lower court has held that § 528's disclosure requirements are constitutionally valid even under the stricter intermediate scrutiny analysis, as the government's interest in protecting consumer debtors from misleading advertising is substantial, the disclosure requirements placed on bankruptcy attorneys directly advances the government's asserted interest, and the disclosure requirements are narrowly drawn to serve the government's interest. *See Olsen*, 350 B.R. at 920 (concluding that § 528 "passes constitutional muster" under either rational basis review or intermediate scrutiny review).

Section 528 requires debt relief agencies to disclose: "'We are a debt relief agency. We help people file for bankruptcy relief under the Bankruptcy Code.' or a substantially similar statement," in all of their bankruptcy-related advertising materials directed to the general public. 11 U.S.C. §§ 528(a)(4), (b)(2). The requirement does not prevent those attorneys meeting the definition of debt relief agencies "from conveying information to the public; it . . . only require[s] them to provide somewhat more information than they might otherwise be inclined to present." *Zauderer*, 471 U.S. at 650. Moreover, if any of these attorneys are concerned that the required disclosures will confuse the public, we note that nothing in the Code prevents them from identifying themselves in their advertisements as both attorneys and debt relief agencies. *Olsen*, 350 B.R. at 920. Simply put, attorneys that provide bankruptcy assistance to assisted persons are debt relief agencies under the Code, and the disclosure requirements of § 528 only require those attorneys to disclose factually correct statements on their advertising.[12] This does not violate the First Amendment.

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[12] We recognize that the broad definitions of debt relief agency, bankruptcy assistance, and assisted persons, might result in certain attorneys meeting the definition of debt relief agencies even though they do not represent debtors in bankruptcy nor help people file for bankruptcy relief under the Code. Nevertheless, these attorneys are still subjected to the disclosure requirements of § 528(a)(4) when they advertise "bankruptcy assistance services or . . . the benefits of bankruptcy directed to the general public," 11 U.S.C. § 528(a)(3),(4), or when they advertise to the general public that they "provide[] assistance with respect to credit defaults, mortgage foreclosures, eviction proceedings, excessive debt, debt collection pressure, or inability to pay any consumer debt." *Id.* at § 528(b)(2). But because § 528 permits a "substantially similar" disclosure to the one suggested by the Code, these attorneys can and should tailor their advertisement disclosure statements to factually represent the "bankruptcy assistance" they provide. These tailored disclosures will meet the requirements of § 528(a)(4) and (b)(2) as long as they are "substantially similar" to the suggested disclosure, a decision which will require a case-by-case determination. *See Olsen*, 350 B.R. at 919–20 (dismissing plaintiffs' claim that § 528 was unconstitutional, rejecting argument that attorney who met definition of debt relief agency but did not represent bankruptcy debtors was precluded from § 528's disclosure requirements because § 528 permits a "substantially similar" disclosure,

Id.; *see also In re Robinson*, 368 B.R. at 500–502 (finding that debtor's counsel was a debt relief agency subject to the strictures of § 528, and that § 528(a)(1)'s requirement for a written contract is constitutional); *In re Norman*, 2006 WL 3053309 at *4 (finding that debtor's counsel qualified as a debt relief agency and thus must comply with the requirements of § 528(a)(1)).

The challenged sections of § 528 only require debt relief agencies to include a disclosure on certain advertisements. Although less intrusive means may be conceivable to prevent deceptive advertising, § 528's disclosure requirements are reasonably related to the government's interest in protecting consumer debtors from deceptive advertising, and thus the section passes constitutional muster.

III. *Conclusion*

In sum, attorneys who provide bankruptcy assistance to assisted persons are debt relief agencies under the Bankruptcy Code, and § 526(a)(4) is unconstitutional as applied to these attorneys, but §§ 528(a)(4) and (b)(2) are constitutional. Accordingly, we affirm in part and reverse in part.

COLLOTON, Circuit Judge, concurring in part and dissenting in part.

I concur in all but Part II.B of the opinion of the court. I disagree, however, with the court's holding that 11 U.S.C. § 526(a)(4) is unconstitutionally overbroad in violation of the First Amendment, and I would therefore reverse the district court's decision declaring this statutory provision unconstitutional.

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which could be tailored to disclose that attorney advised clients about bankruptcy assistance matters but did not represent people in bankruptcy or file bankruptcy petitions, and stating that whether disclosure was "substantially similar" would require case-by-case determination).

Milavetz, Gallop, & Milavetz, P.A., mounts a facial attack on § 526(a)(4), arguing that the section's potential application to attorneys in hypothetical situations requires that the statute be declared impermissibly overbroad and unconstitutional. This case involves a facial challenge in the First Amendment context, "under which a law may be overturned as impermissibly overbroad because a substantial number of its applications are unconstitutional, judged in relation to the statute's plainly legitimate sweep." *Wash. State Grange v. Wash. State Republican Party*, 128 S. Ct. 1184, 1190 n.6 (2008). This "overbreadth doctrine," however, is "strong medicine that is used sparingly and only as a last resort." *New York State Club Ass'n, Inc. v. City of New York*, 487 U.S. 1, 14 (1988) (internal quotations omitted). It should be applied only when there is "a realistic danger that the statute itself will significantly compromise recognized First Amendment protections of parties not before the Court." *City Council of Los Angeles v. Taxpayers for Vincent*, 466 U.S. 789, 801 (1984). The Supreme Court recently emphasized that it has "vigorously enforced the requirement that a statute's overbreadth be *substantial*, not only in an absolute sense, but also relative to the statute's plainly legitimate sweep." *United States v. Williams*, 128 S. Ct. 1830, 1838 (2008).[13]

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[13] The district court purported to consider only an "as-applied" challenge to § 526(a)(4), rather than an overbreadth challenge, and ultimately declared the section "unconstitutional as applied to attorneys." *Milavetz, Gallop & Milavetz, P.A. v. United States*, 355 B.R. 758, 766 n.4, 769 (D. Minn. 2006). The majority correctly recognizes that the district court's approach is really an overbreadth analysis, and considers the statute under that framework. *See ante*, at 9 & n.7, 11, 13 & n.10. The "as applied" method of analysis, by contrast, considers the statute's application to a "particular claimant" based on "harm caused to the litigating party." *Turchick v. United States*, 561 F.2d 719, 721 n.3 (8th Cir. 1977). "The 'as applied' method vindicates a claimant whose conduct is within the First Amendment but invalidates the challenged statute *only to the extent of the impermissible application*." *Id*. (emphasis added). The district court and the majority have declared § 526(a)(4) unconstitutional in *all* of its applications to *all* attorneys, and the supporting reasoning is thus consistent with "facial overbreadth analysis." *Id*. (punctuation omitted).

To resolve the constitutional challenge brought by Milavetz, we must first construe the disputed statute. When presented with a constitutional challenge to an Act of Congress, we have not only the power, but the duty, to adopt a narrowing construction that will avoid constitutional difficulties whenever possible. *Boos v. Barry*, 485 U.S. 312, 330-31 (1988). In *Boos*, for example, the Court considered a provision of federal legislation that made it unlawful "to congregate within 500 feet of any [embassy, legation, or consulate] and refuse to disperse after having been ordered so to do by the police." *Id.* at 329 (internal quotation omitted). The Court observed that "*[s]tanding alone,* this text is problematic because it applies to *any* congregation within 500 feet of an embassy for *any* reason." *Id.* at 330 (first emphasis added). Nonetheless, citing the "duty to avoid constitutional difficulties by [adopting a narrowing construction] if such a construction is fairly possible," the Court construed the statute narrowly to permit the dispersal of only congregations that are directed at an embassy, and to allow dispersal "only when the police reasonably believe that a threat to the security or peace of the embassy is present." *Id.* at 330-31 (internal quotation omitted). Similarly, in *United States v. X-Citement Video, Inc.*, 513 U.S. 64 (1994), the Court emphasized that "it is incumbent upon" a federal court to read a statute to eliminate constitutional doubts, "so long as such a reading is not plainly contrary to the intent of Congress." *Id.* at 78.

The challenged provision in this case provides in part that "[a] debt relief agency shall not . . . advise an assisted person or prospective assisted person to incur more debt in contemplation of such person filing a case under this title." 11 U.S.C. § 526(a)(4). Milavetz argues that according to this provision, a debt relief agency may not advise a client to incur *any* debt for *any* purpose when the client is contemplating the filing of a petition for bankruptcy. As such, Milavetz contends that an attorney could be sanctioned for "fulfilling his duty to his client to give legal and appropriate advice not otherwise prohibited by the Bankruptcy Code." (Brief of Appellee 30). Even under Milavetz's broad construction of the statute, a facial challenge resting on a "few hypothetical situations," *ante*, at 12, is unlikely to justify invalidating a statute in *all* of its applications, because "the mere fact that one can conceive of some impermissible applications of a statute is not sufficient to render it susceptible to an overbreadth challenge." *Vincent*, 466 U.S. at 800.

It is unnecessary to resolve whether § 526(a)(4) is impermissibly overbroad when given its broadest reading, however, because the government suggests an acceptable narrowing construction of the statute that would avoid most constitutional difficulties. The government contends that "in contemplation of" filing for bankruptcy is a term of art that denotes an action taken with the intent to abuse the protections of bankruptcy laws. Under this view, the statute should be construed to prohibit only advice that a client engage in conduct for the purpose of manipulating the bankruptcy system.

The text, structure, and legislative history of § 526(a)(4) provide adequate support for a narrowing construction. Particularly given the latitude of federal courts to narrow a text to avoid constitutional difficulties, *see Boos*, 485 U.S. at 330-31, the words "in contemplation of . . . filing a case" need not create impermissible overbreadth. Rather, we may recognize that the phrase "in contemplation of" has been construed in the bankruptcy context to mean actions taken with the intent to abuse the protections of the bankruptcy system. Black's Law Dictionary reflects this understanding, defining "contemplation of bankruptcy" as "the thought of declaring bankruptcy because of the inability to continue current financial operations, *often coupled with action designed to thwart the distribution of assets in a bankruptcy proceeding*." *Black's Law Dictionary* 336 (8th ed. 2004) (emphasis added). American and English authorities construing the bankruptcy laws also support the proposition that the words "in contemplation of" may be understood to require an intent to abuse the bankruptcy laws. *In re Pearce*, 19 F. Cas. 50, 53 (D. Vt. 1843) (No. 10873) (concluding that an act was done "in contemplation of bankruptcy" if it was done "in anticipation of breaking or failing in his business, of committing an act of bankruptcy, or of being declared bankrupt at his own instance, on the ground of inability to pay his debts, *and intending to defeat the general distribution of effects, which takes place under a proceeding in bankruptcy*.") (emphasis added); *Morgan v. Brundrett*, 5 Barn. & Ad. 289, 296, 110 Eng. Rep. 798, 801 (K.B. 1833) (Parke, J.) (interpreting "in contemplation of bankruptcy" to mean that "the payment or delivery must be with intent to defeat the general distribution of effects which takes place under a commission of bankruptcy."); *Fidgeon v. Sharpe*, 5 Taunt. 539, 545-46, 128 Eng. Rep. 800, 802-03 (C.P. 1814) (Gibbs, C.J.) (An act made in contemplation of bankruptcy "must be intended in fraud of the bankrupt laws."); *cf. Buckingham v. McLean*, 54 U.S. 151, 167 (1851) ("To give to these words, contemplation of bankruptcy, a broad scope, and somewhat loose meaning, would not be in furtherance of the general purpose with which they were introduced."); *id.* at 169 (relying on English bankruptcy decisions as instructive authority on meaning of the former Bankrupt Act). Our duty to construe the statute to avoid constitutional difficulties counsels that we should look to these authorities for a plausible alternative to the broad construction urged by Milavetz.

The structure of § 526(a)(4) also supports a narrowing construction. The prohibitions of this statute can be enforced only through the civil remedies provided in § 526(c). An attorney who violates § 526(a)(4) can be sanctioned in just three situations: if a debtor sues the attorney for the available remedies – remittal of fees, actual damages, and reasonable attorney's fees and costs; if a state attorney general sues for a resident's actual damages; or if a court finds that the attorney intentionally violated § 526(a)(4), and chooses to "impose an appropriate civil penalty." 11 U.S.C. § 526(c). The remedies for a violation thus emphasize actual damages. But legal and appropriate advice that would be protected by the First Amendment, yet prohibited by a broad reading of § 526(a)(4), should cause no damage at all. If an attorney advises a debtor to refinance his home to lower mortgage payments, or to purchase a reliable car to enable him to pay off his debts, *see ante*, at 11-12, then a debtor following that advice would suffer no damage. There is no reason to believe that a client could recover the remittal of attorney's fees or that a court would find a civil penalty "appropriate" as a remedy for legal advice that *benefits* both the debtor *and* his creditors. Rather, a debtor is likely to have a remedy against an attorney only in the case of an abusive bankruptcy petition, where the debtor may suffer damages if the petition is dismissed as abusive, *see* 11 U.S.C. § 707(b)(1), and where an attorney general or a court has reason to seek or impose sanctions against an abusive debt relief agency. The remedial focus of § 526 thus bolsters the proposition that § 526(a)(4) was aimed only at advice given by a debt relief agency that is designed to abuse the bankruptcy process.

The incorporation of an abusive purpose requirement into § 526(a)(4) is also consonant with the evident purpose of the statute. The government argues, and Milavetz acknowledges, that a principal goal of Congress in passing the statute was to "preclude debtors from taking on more debt knowing that it will later be discharged during bankruptcy." (Brief of Appellee 34). A narrowing construction of § 526(a)(4) is in accord with expressions of desire in the legislative history to address "misconduct by attorneys and other professionals," and "abusive practices by consumer debtors who, for example, knowingly load up with credit card purchases or recklessly obtain cash advances and then file for bankruptcy relief." H.R. Rep. No. 109-31, pt.1, at 5, 15 (2005) (internal quotation omitted), *as reprinted in* 2005 U.S.C.C.A.N. 88, 92, 101. Milavetz itself argues that a broad construction of § 526(a)(4) "goes beyond" this congressional purpose, and is "absurd," because it would prevent an attorney from advising a client to take actions that might avoid the need for filing bankruptcy altogether. (Brief of Appellee 34). Given our duty to construe an Act of Congress in a manner that eliminates constitutional doubts, there is no need to adopt a construction that one party says is absurd, that the other party says was unintended by Congress, and that sweeps in salutary legal activity that would be a strange target for a statute entitled the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005.

For these reasons, I would reverse the district court's decision declaring unconstitutional the provision codified at 11 U.S.C. § 526(a)(4).

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1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	United States v. Milavetz, Gallop & Milavetz, P.A., et al.
2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	United States Supreme Court
3. ("CCN") ***CURRENT*** CASE NO.	No.: 08-1225
4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*	No.: 07-2405 Court: 8th Cir. *(Identify judge & cite, if any)*
5. ("SO") ***SOURCE***	**U.S. TRUSTEES**
6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	Filed: April 3, 2009 Type: Petition for a Writ of Certiorari
7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*	Office of the Solicitor General *(UST/OGC: 202-307-1399/FAX-2397)*
8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	• (1) Whether Section 526(a)(4) precludes only advice to incur more debt with a purpose to abuse the bankruptcy system. (2) Whether Section 526(a)(4), construed with due regard for the principle of constitutional avoidance, violates the First Amendment.
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In the Supreme Court of the United States

UNITED STATES OF AMERICA, PETITIONER

v.

MILAVETZ, GALLOP & MILAVETZ, P.A., ET AL.

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

ELENA KAGAN
Solicitor General
Counsel of Record
MICHAEL F. HERTZ
Acting Assistant Attorney General
MALCOLM L. STEWART
Deputy Solicitor General
WILLIAM M. JAY
Assistant to the Solicitor General
MARK B. STERN
MARK R. FREEMAN
Attorneys

Department of Justice
Washington, D.C. 20530-0001
(202) 514-2217

QUESTIONS PRESENTED

Section 526(a)(4) of Title 11 of the United States Code provides that bankruptcy professionals who qualify as "debt relief agencies" and who are hired by consumer debtors for bankruptcy services may not advise those debtors "to incur more debt in contemplation of" filing a bankruptcy petition. The questions presented are as follows:

1. Whether Section 526(a)(4) precludes only advice to incur more debt with a purpose to abuse the bankruptcy system.

2. Whether Section 526(a)(4), construed with due regard for the principle of constitutional avoidance, violates the First Amendment.

PARTIES TO THE PROCEEDINGS

Petitioner is the United States of America. Respondents, who were appellees in the court of appeals, are Milavetz, Gallop & Milavetz, P.A.; Robert J. Milavetz; Barbara N. Nevin; Ronald Richardson (captioned as John Doe); and Lynette Richardson (captioned as Mary Doe). The district court denied the Doe respondents leave to proceed pseudonymously.

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ON PETITION FOR A WRIT OF CERTIORARI
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PETITION FOR A WRIT OF CERTIORARI

The Solicitor General, on behalf of the United States of America, respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Eighth Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals (App., *infra*, 1a-28a) is reported at 541 F.3d 785. The opinion of the district court denying the government's motion to dismiss (App., *infra*, 29a-44a) is reported at 355 B.R. 758.

JURISDICTION

The judgment of the court of appeals was entered on September 4, 2008. A petition for rehearing was denied on December 5, 2008 (App., *infra*, 47a). On February 20, 2009, Justice Alito extended the time within which to file a petition for a writ of certiorari to and including

April 6, 2009. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The First Amendment to the United States Constitution provides in relevant part that "Congress shall make no law * * * abridging the freedom of speech." The pertinent statutory provisions are reprinted in an appendix to this petition. App., *infra*, 48a-53a.

STATEMENT

This case involves a facial First Amendment challenge to 11 U.S.C. 526(a)(4), a provision of the Bankruptcy Code that regulates paid bankruptcy advice. Congress has established certain minimum standards of professional conduct for bankruptcy attorneys, bankruptcy petition preparers, and other "debt relief agencies" that charge consumer debtors for bankruptcy assistance. Section 526(a)(4) provides, *inter alia*, that debt relief agencies may not advise clients to incur additional debt "in contemplation of" filing a bankruptcy petition. The district court declared Section 526(a)(4) facially invalid under the First Amendment. A divided panel of the court of appeals affirmed. Shortly thereafter, the Fifth Circuit upheld Section 526(a)(4) against a substantially similar challenge and endorsed the reasoning of the dissenting opinion in this case. *Hersh* v. *United States ex rel. Mukasey*, 553 F.3d 743 (2008), petition for cert. pending, No. 08-1174 (filed Mar. 18, 2009).

1. Congress enacted Section 526(a)(4) as part of the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA), Pub. L. No. 109-8, 119 Stat. 23, "a comprehensive package of reform measures" designed "to improve bankruptcy law and practice by restoring per-

sonal responsibility and integrity in the bankruptcy system and ensure that the system is fair for both debtors and creditors." H.R. Rep. No. 31, 109th Cong., 1st Sess. Pt. 1, at 2 (2005) (*House Report*). Described by the House Report as "the most comprehensive set of [bankruptcy] reforms in more than 25 years," *id.* at 3, the BAPCPA both modified the substantive standards for bankruptcy relief and adopted new measures intended to curb a variety of abusive practices that Congress concluded had come to pervade the bankruptcy system.

After extensive hearings, Congress determined that misleading and abusive practices by bankruptcy professionals, including attorneys, had become a substantial cause of unnecessary bankruptcy petitions and, in some circumstances, jeopardized debtors' ability to obtain a discharge of their debts. For example, Congress heard evidence that a civil enforcement initiative undertaken by the United States Trustee Program had "consistently identified * * * misconduct by attorneys and other professionals" as among the sources of abuse in the bankruptcy system. *House Report* 5 (citation omitted). Congress responded by "strengthening professionalism standards for attorneys and others who assist consumer debtors with their bankruptcy cases." *Id.* at 17.

The BAPCPA added or strengthened several regulations on bankruptcy professionals' conduct. Those regulations are intended to protect the clients and prospective clients of bankruptcy professionals, the creditors of clients who do enter bankruptcy, and the bankruptcy system. The regulations require additional disclosures to clients about their rights and the professional's responsibilities; they protect clients against being overcharged, or charged for services never provided; and they discourage misuse of the bankruptcy system.

See, *e.g.*, 11 U.S.C. 110(b)-(h), 526-528, 707(b)(4)(C)-(D). Many of the regulations apply equally to bankruptcy attorneys, to bankruptcy petition preparers who are not attorneys, and to all other professionals who provide bankruptcy assistance to consumer debtors for a fee; those professionals are collectively termed "debt relief agenc[ies]." 11 U.S.C. 101(12A).[1]

Section 526 sets out four basic rules of professional conduct for debt relief agencies. Section 526(a)(1) requires debt relief agencies to perform all promised services. Section 526(a)(2) prohibits debt relief agencies from advising an assisted person to make statements that are untrue or misleading in seeking bankruptcy relief. Section 526(a)(3) precludes debt relief agencies from misrepresenting the services they will provide or the benefits and risks attendant to filing for bankruptcy. And Section 526(a)(4), the provision held unconstitutional below, states:

> A debt relief agency shall not * * * advise an assisted person or prospective assisted person to incur more debt in contemplation of such person filing a case under this title or to pay an attorney or bankruptcy petition preparer fee or charge for services performed as part of preparing for or representing a debtor in a case under this title.

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[1] The term "bankruptcy assistance" is defined to include providing an "assisted person" with advice, counsel (including "legal representation"), or document preparation or filing assistance "with respect to a case or proceeding under" the Bankruptcy Code. 11 U.S.C. 101(4A). An "assisted person" is "any person whose debts consist primarily of consumer debts" and whose nonexempt property is worth less than a specified, inflation-adjusted amount, currently $164,250. 11 U.S.C. 101(3); see 11 U.S.C. 104(a); 72 Fed. Reg. 7082 (2007).

The principal remedy for violations of Section 526 is a civil action by the debtor to recover the debtor's "actual damages," including any fees already paid. 11 U.S.C. 526(c)(2). The statute also authorizes state attorneys general to sue for debtors' actual damages or for injunctive relief to prevent violations. 11 U.S.C. 526(c)(3). The bankruptcy court may also impose an injunction or an "appropriate civil monetary penalty" for intentional or recurring violations, either on its own motion or at the request of the United States Trustee or the debtor. 11 U.S.C. 526(c)(5).

2. Respondents are a law firm, two of the firm's attorneys, and two prospective clients. App., *infra*, 1a-2a.[2] They filed this action against the United States, seeking a declaratory judgment that the attorney respondents are not obligated to comply with several of the BAPCPA's provisions regulating debt relief agencies' professional conduct, including the advice limitation in Section 526(a)(4). Respondents contended that licensed attorneys are not "debt relief agencies" within the meaning of the statute even if they provide bankruptcy-related advice to debtors. They also claimed that, to the extent the statute encompasses licensed attorneys, Section 526(a)(4) and other provisions of the BAPCPA violate the First Amendment. *Id.* at 2a.

The district court denied the government's motion to dismiss, App., *infra*, 29a-44a, and then granted summary judgment for respondents, *id.* at 45a. The court held that Section 526(a)(4) and the other challenged provisions violate the First Amendment. *Id.* at 33a-41a.

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[2] The district court denied the prospective clients leave to proceed pseudonymously, App., *infra*, 31a-33a, and they disclosed their identities in an amended complaint, see 05-CV-2626 Docket entry No. 34, at 3 (D. Minn. Dec. 15, 2006).

The court further held that attorneys do not fall within the statutory definition of "debt relief agency." *Id.* at 41a-43a.

3. The government appealed, contending in relevant part that attorneys unambiguously fall within the definition of "debt relief agency" and that the district court's constitutional holding was premised on a misreading of Section 526(a)(4). Gov't C.A. Br. 18-41, 49-54. The government explained that the phrase "in contemplation of" bankruptcy is a term of art with a specialized meaning. Based on that established understanding, the government argued, Section 526(a)(4) should be construed to forbid only advice that a client take on new debt on the eve of bankruptcy with the intent of abusing the bankruptcy system. The government further contended that, to the extent the term "in contemplation of" is ambiguous, the doctrine of constitutional avoidance supports the government's narrow reading of the term, which avoids the overbreadth that the district court perceived.

4. The court of appeals affirmed in part and reversed in part. The court unanimously agreed that attorneys may fall within the definition of "debt relief agency," but held by a divided vote that Section 526(a)(4) violates the First Amendment. App., *infra*, 1a-28a.[3]

a. The court of appeals rejected the government's proposed narrowing construction of Section 526(a)(4). App., *infra*, 12a. The court concluded that, under the only permissible interpretation of the statute's "plain language," Section 526(a)(4) prohibits debt relief agencies from advising consumer clients "to incur *any* additional debt when the assisted person is contemplating

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[3] The court unanimously rejected respondents' challenges to certain disclosure requirements imposed by 11 U.S.C. 528. App., *infra*, 15a-21a.

bankruptcy," *ibid.*, and that "this prohibition would include advice constituting prudent prebankruptcy planning that is not an attempt to circumvent, abuse, or undermine the bankruptcy laws," *id.* at 13a.

Based on that broad construction, the court of appeals held that Section 526(a)(4) is unconstitutionally overbroad.[4] App., *infra*, 12a-14a. The court explained that advice to take on new debt just before bankruptcy will sometimes be legitimate. As examples, the court observed that "it may be in the assisted person's best interest to refinance a home mortgage in contemplation of bankruptcy to lower the mortgage payments," or to purchase a car to ensure "dependable transportation * * * to and from work." *Id.* at 13a-14a. And the court stated that "[f]actual scenarios other than these few hypothetical situations no doubt exist." *Id.* at 14a. The court concluded that the First Amendment precludes regulation of such legitimate advice, and it noted its agreement with three district courts that had reached the same conclusion. See *id.* at 13a & n.8 (citing, *inter alia*, *Hersh* v. *United States*, 347 B.R. 19, 25 (N.D. Tex. 2006)).

The court of appeals did not identify the precise constitutional standard under which respondents' challenge should be evaluated. Respondents had argued that

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[4] The court of appeals did not limit its holding to the plaintiffs before it, but stated more generally that the statute was "unconstitutionally overbroad as applied to attorneys falling within the definition of debt relief agencies." App., *infra*, 12a; see *id.* at 10a n.7, 15a, 21a; see also *id.* at 23a n.13 (Colloton, J., concurring in part and dissenting in part). Nothing in the court of appeals' statutory and First Amendment analysis, moreover, suggests that the court would reach a different conclusion regarding the statute's application to non-attorney professionals who provide bankruptcy advice.

strict scrutiny should apply, while the government had contended that Section 526(a)(4) is a reasonable regulation of attorneys' professional conduct that is to be reviewed more deferentially under the standard announced in *Gentile* v. *State Bar*, 501 U.S. 1030, 1071-1076 (1991). The court acknowledged that the government had a "legitimate interest" in prohibiting advice that would assist debtors in abusing the bankruptcy system by accumulating more debt in contemplation of bankruptcy. App., *infra*, 12a. But the court held that, on its reading of Section 526(a)(4), the statute was insufficiently connected to that legitimate interest and therefore was unconstitutional under either strict scrutiny or the *Gentile* standard. *Id.* at 12a-13a.

b. Judge Colloton dissented in relevant part. He explained that, in his view, "[t]he text, structure, and legislative history of § 526(a)(4) provide adequate support for a narrowing construction," under which "the statute should be construed to prohibit only advice that a client engage in conduct for the purpose of manipulating the bankruptcy system." App., *infra*, 25a. He would have held that the statute, so construed, is constitutional. See *id.* at 22a, 25a, 28a.

First, Judge Colloton observed that the phrase "in contemplation of bankruptcy" is a term of art that "has been construed * * * to mean actions taken with the intent to abuse the protections of the bankruptcy system." App., *infra*, 25a; see *id.* at 25a-26a (collecting authorities). Second, Judge Colloton pointed out that the remedies for a violation of Section 526(a)(4) "emphasize actual damages," and he reasoned that a debtor who follows his attorney's bankruptcy advice is unlikely to be harmed as a result unless he is induced to file "an abusive bankruptcy petition, where the debtor may suffer damages if the petition is dismissed as abusive." *Id.* at 27a (citing 11 U.S.C. 707(b)(1)). Third, Judge Colloton pointed to legislative history that showed Congress's desire to address "abusive" practices by bankruptcy professionals and by debtors who "knowingly load up" on debt before filing for bankruptcy. *Id.* at 27a-28a (quoting *House Report* 5, 15). The dissent concluded: "Given our duty to construe an Act of Congress in a manner that eliminates constitutional doubts, there is no need to adopt a construction that [respondents] say[] is absurd, that the [government] says was unintended by Congress, and that sweeps in salutary legal activity that would be a strange target for a statute entitled the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005." *Id.* at 28a.

5. The court of appeals denied rehearing en banc by a vote of 6-5. See App., *infra*, 47a.

6. Thirteen days later, the Fifth Circuit upheld Section 526(a)(4) against a substantially similar First Amendment challenge, reversing one of the district court opinions on which the court of appeals in this case relied. *Hersh*, 553 F.3d at 752-764; see App., *infra*, 13a n.8. The court endorsed the reasoning and the authorities in Judge Colloton's dissenting opinion. See 553 F.3d at 750 n.6, 759 n.17.

7. Respondents have filed their own petition for a writ of certiorari, which seeks review of the court of appeals' holding that attorneys may be "debt relief agencies" for purposes of Section 526, as well as its holding (see note 3, *supra*) that Section 528's disclosure requirements are valid. See Pet. at ii, *Milavetz, Gallop & Milavetz, P.A.* v. *United States*, No. 08-1119 (filed Mar. 5, 2009). The government will address that petition in a separate response.

REASONS FOR GRANTING THE PETITION

A divided panel of the court of appeals has invalidated an Act of Congress, even though the statute can constitutionally be applied to a significant range of conduct. The court failed to give due regard to a narrowing construction that eliminates the perceived constitutional difficulty, and its ruling squarely conflicts with a Fifth Circuit decision that adopted the constitutionally unproblematic construction that the court rejected in this case. The Eighth Circuit's decision also threatens to undermine the important reforms that Congress crafted, after years of study, to reduce the abuse of the bankruptcy system, including abuse encouraged by lawyers. This Court's review is warranted to prevent those harms, to resolve the circuit conflict, and to effectuate Congress's efforts to craft a federal remedy for the provision of abusive bankruptcy advice.

I. THE CIRCUITS ARE IN CONFLICT OVER THE CONSTITUTIONALITY OF AN ACT OF CONGRESS

The court of appeals' decision in this case squarely conflicts with the Fifth Circuit's resolution of the same statutory and constitutional issues as are presented here. As the Fifth Circuit has recognized, Section 526(a)(4) imposes a modest requirement to refrain from urging a debtor to accumulate eve-of-filing debt that would abuse the bankruptcy system. The court of appeals here imposed its own, much more expansive construction and then struck down the statute, so interpreted, as overbroad. As a result, attorneys in the Eighth Circuit who qualify as "debt relief agencies" are free to urge even the most abusive practices without being subject to the federal sanctions and client-protection measures set out in Section 526(a)(4) and (c).

A. In *Hersh* v. *United States ex rel. Mukasey*, 553 F.3d 743 (5th Cir. 2008), petition for cert. pending, No. 08-1174 (filed Mar. 18, 2009), a bankruptcy attorney challenged Section 526(a)(4) on grounds substantially similar to those respondents raised here. Hersh contended that Section 526(a)(4) unambiguously prohibits attorneys from advising clients who are considering bankruptcy to incur *any* additional debt, and that Section 526(a)(4) so construed is unconstitutionally overbroad. *Id.* at 747 & n.3, 754, 762. A unanimous Fifth Circuit panel rejected both of these arguments. *Id.* at 752-764. The Fifth Circuit acknowledged the court of appeals' contrary holding in this case but stated that it "agree[d] with Judge Colloton's dissenting opinion." *Id.* at 750 n.6.[5]

1. The Fifth Circuit in *Hersh* agreed with the government that Section 526(a)(4) can be construed in a way that focuses directly on Congress's acknowledged purpose in enacting it: preventing attorneys from encouraging their clients to "load up" on debt to abuse the bankruptcy system. 553 F.3d at 758-761. The court noted that the term "in contemplation of bankruptcy" is often used as a term of art that connotes an intent to abuse the bankruptcy system. *Id.* at 758 (citing *Black's Law Dictionary* 336 (8th ed. 2004) (*Black's Law Dictionary*)). Indeed, a few years before Congress enacted the BAPCPA, the Fifth Circuit itself had described the abusive practice of "incurring card debt in contemplation of bankruptcy" with the term "loading up." *Id.* at

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[5] Like the respondents in this case, Hersh also argued that attorneys cannot be "debt relief agencies" subject to the restrictions imposed by Section 526(a)(4). See 553 F.3d at 751-752. The Fifth Circuit rejected that argument, *id.* at 752, as the court of appeals unanimously did here, see App., *infra*, 3a-10a.

758-759 (quoting *AT&T Universal Card Servs.* v. *Mercer (In re Mercer)*, 246 F.3d 391, 421 n.43 (5th Cir. 2001) (en banc)). The Fifth Circuit in *Hersh* noted that Judge Colloton had adopted the same reasoning in this case, and it cited Judge Colloton's dissenting opinion for additional supporting sources. *Id.* at 759 & n.17.

The court in *Hersh* also explained that the structure of Section 526 supported the specialized interpretation described above. See 553 F.3d at 759-760, 761. Like Judge Colloton, see App., *infra*, 26a-27a, the Fifth Circuit pointed out that violations of Section 526 may be remedied by awarding the debtor actual damages, which strongly suggests that the practices banned are practices that would actually harm the debtor. See 553 F.3d at 760. And the court noted that Section 526(a)(4) was enacted alongside, and placed together with, "three other rules of professional conduct designed to protect debtors." *Id.* at 761 (citing 11 U.S.C. 526(a)(1)-(3)).

The court in *Hersh* agreed with Judge Colloton that the legislative history and purpose of the BAPCPA supported its construction of Section 526(a)(4). It explained that numerous elements of the BAPCPA were demonstrably "intended to curb abuse," which the court took as further evidence that "as part of this plan, section 526(a)(4) is only meant to curb abusive practices." 553 F.3d at 761; accord App., *infra*, 26a-27a (Colloton, J., concurring in part and dissenting in part).

2. The Fifth Circuit further explained that, even if its reading of Section 526(a)(4) were not the most natural interpretation of the statute, that reading would be compelled by the doctrine of constitutional avoidance. The court identified numerous cases in which this Court had adopted an arguably countertextual construction in the interest of constitutional avoidance, including *Boos*

v. *Barry*, 485 U.S. 312 (1988), on which Judge Colloton had relied significantly, see App., *infra*, 23a-24a. See 553 F.3d at 756-758. As the Fifth Circuit noted, the avoidance doctrine may even require giving "[a] restrictive meaning [to] what appear to be plain words." *Id.* at 757 (quoting *United States* v. *Witkovich*, 353 U.S. 194, 199 (1957)) (first brackets in original).

The Fifth Circuit acknowledged Hersh's argument, identical to that advanced by respondents and endorsed by the court below, that the text of Section 526(a)(4) is so unambiguous that no narrowing construction is possible. See 553 F.3d at 754. The court concluded, however, that "the language of [the statute] can and should be interpreted only to prohibit attorneys from advising clients to incur debt in contemplation of bankruptcy when doing so would be an abuse or improper manipulation of the bankruptcy system." *Id.* at 761; see *id.* at 756. The court explained that, on that reading, "[S]ection 526(a)(4) has no application to good faith advice to engage in conduct that is consistent with a debtor's interest and does not abuse or improperly manipulate the bankruptcy system." *Id.* at 761.

3. The Fifth Circuit concluded that, if Section 526(a)(4) is construed in this manner, it is not facially unconstitutional. The court explained that a statute is not unconstitutionally overbroad unless the "overbreadth is substantial in relation to the statute's legitimate reach." 553 F.3d at 762 (citing *United States* v. *Williams*, 128 S. Ct. 1830, 1838 (2008)). Hersh did not dispute that Congress could validly regulate the sort of advice to engage in abusive conduct that all parties agreed was covered by Section 526(a)(4). See *id.* at 754-

756.[6] And under the court's narrowing construction, Section 526(a)(4) did not apply to *any* of Hersh's examples of speech that could not constitutionally be prohibited. *Id.* at 763. Accordingly, the Fifth Circuit found it "clear that the potential for the statute to prohibit protected speech is not by any means *substantial* in relation to the statute's legitimate reach." *Id.* at 764.

B. The Fifth Circuit's decision cannot be reconciled with the decision below. The Fifth Circuit adopted the government's proposed construction of Section 526(a)(4), whereas the court below found that construction to be foreclosed by the statutory text. As a result of those divergent statutory interpretations, the Fifth Circuit upheld the statute against a First Amendment challenge, while the court below invalidated Section 526(a)(4) as an unconstitutional infringement on the right of attorneys to provide non-abusive bankruptcy-related advice. And the Eighth Circuit, by a closely divided vote, has declined to reconsider its position en banc. App., *infra*, 47a.

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[6] The Fifth Circuit in *Hersh* noted various contexts in which the First Amendment permits Congress and the States to regulate that sort of unethical attorney advice. For instance, the First Amendment does not protect speech proposing an illegal transaction, and abusive accumulation of debt may amount to fraud or theft. See 553 F.3d at 755 (citing *Village of Hoffman Estates* v. *Flipside, Hoffman Estates, Inc.*, 455 U.S. 489, 496 (1982)). Further, the government has a sufficiently important interest in the judicial process, including the bankruptcy system, to justify regulation of attorneys' unethical conduct affecting that process. See *id.* at 755-756 (citing *Gentile* v. *State Bar*, 501 U.S. 1030 (1991), and Model Rules of Professional Conduct Rule 1.2(d)). The court in *Hersh* explained that the abusive accumulation of debt in contemplation of bankruptcy "is akin to committing a fraudulent act," and therefore "Congress can constitutionally prevent attorneys or other debt relief agencies from advising their clients to [commit such an act]." *Id.* at 756.

The question presented here is a recurring one, as substantially similar challenges to Section 526(a)(4) are also pending in the Second and Ninth Circuits.[7] Review by this Court is warranted to resolve the division in the courts of appeals over the constitutionality of this important federal statute.

II. THE COURT OF APPEALS ERRED IN HOLDING SECTION 526(a)(4) UNCONSTITUTIONALLY OVERBROAD

The court of appeals' decision in this case is erroneous. The court below acknowledged that Congress had a "legitimate interest" in restricting bankruptcy professionals from peddling abusive strategies to individuals who are facing bankruptcy. App., *infra*, 12a. The government construes the statute to further that interest directly, by prohibiting only advice that would lead to intentional abuse of the bankruptcy system.

The court of appeals did not dispute that Congress could enact such a prohibition without violating the First Amendment. Rather, the court held that Section 526(a)(4) *unambiguously* sweeps in other attorney advice, unrelated to abuse of the bankruptcy system, and that the statute is therefore fatally overbroad. Both the statutory premise and the constitutional conclusion are flawed. As the text, structure, and purposes of Section 526(a)(4) make clear, Congress forbade only advice to incur new debt for the purpose of abusing the bankruptcy system or defrauding creditors. That prohibition is consistent with the First Amendment.

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[7] See *Zelotes* v. *Adams*, No. 07-1853 (2d Cir. argued Oct. 10, 2008); *Connecticut Bar Ass'n* v. *United States*, No. 08-5901 (2d Cir.) (argument not yet scheduled); *Olsen* v. *Holder*, No. 07-35616 (9th Cir.) (argument not yet scheduled).

A. The court of appeals rejected the government's interpretation of Section 526(a)(4) in a single sentence, asserting that the statute's "plain language" precludes any construction other than the unconstitutionally overbroad one. App., *infra*, 12a. The court did not identify any statutory term that unambiguously compelled such a reading. Rather, without quoting the statutory text, the court stated that "[Section] 526(a)(4) broadly prohibits a debt relief agency from advising an assisted person (or prospective assisted person) to incur *any* additional debt when the assisted person is contemplating bankruptcy." *Ibid.* But the statute does not use the temporal phrase "*when* the assisted person is contemplating bankruptcy." Rather, the statute forbids advising the client "to incur more debt *in contemplation of* [bankruptcy]." 11 U.S.C. 526(a)(4) (emphasis added). The difference is significant, as Judge Colloton explained.

The statute's reference to debt incurred "in contemplation of [bankruptcy]" is reasonably read to mean debt incurred with the expectation of using the bankruptcy discharge to avoid full repayment. As Judge Colloton observed, "the phrase 'in contemplation of' has been construed in the bankruptcy context to mean actions taken with the intent to abuse the protections of the bankruptcy system." App., *infra*, 25a; see, *e.g.*, *Black's Law Dictionary* 336 (defining "contemplation of bankruptcy" as "[t]he thought of declaring bankruptcy because of the inability to continue current financial operations, *often coupled with action designed to thwart the distribution of assets in a bankruptcy proceeding*") (emphasis added). Indeed, more than a century of "American and English authorities construing the bankruptcy laws also support the proposition that the words 'in contemplation of' may be understood to require an intent to abuse the bankruptcy laws." App., *infra*, 25a (Colloton, J., concurring in part and dissenting in part); see *id.* at 25a-26a (citing cases); accord *Hersh*, 553 F.3d at 758-760. Congress's use of an established term of art may reasonably be understood to incorporate the same meaning that those authorities have given it. See, *e.g.*, *Wilkie* v. *Robbins*, 127 S. Ct. 2588, 2605 (2007).

The Eighth Circuit did not rebut the dissent's understanding of prior judicial decisions construing the phrase "in contemplation of" in the bankruptcy context. Nor did the court identify any reason to believe that Congress, in enacting Section 526(a)(4), intended to depart from that prior understanding. Indeed, the court did not respond to the dissent's analysis at all; it simply asserted without explanation that "the plain language of the statute does not permit this narrow interpretation." App., *infra*, 12a.

The statutory context and structure support the reading of the term "in contemplation of" that was endorsed by the dissent below and adopted by the Fifth Circuit in *Hersh*. See, *e.g.*, *Dolan* v. *USPS*, 546 U.S. 481, 486 (2006) ("A word in a statute may or may not extend to the outer limits of its definitional possibilities. Interpretation of a word or phrase depends upon reading the whole statutory text, considering the purpose and context of the statute, and consulting any precedents or authorities that inform the analysis."). The other three subdivisions of Section 526(a) unambiguously establish rules of professional conduct designed to protect debtors from abusive practices by the attorneys and other debt relief agencies who advise them. See 11 U.S.C. 526(a)(1) (prohibiting debt relief agencies from failing to perform promised services); 11 U.S.C. 526(a)(2) (prohibiting debt relief agencies from advising debtors to make false or misleading statements to obtain bankruptcy relief); 11 U.S.C. 526(a)(3) (prohibiting debt relief agencies from misrepresenting to debtors the risks or benefits of bankruptcy). Section 526(a)(4)'s placement alongside these other restrictions indicates that it is likewise properly read to target unethical communications by bankruptcy professionals—not, as the court below held, all manner of lawful and ethical attorney advice. See *Hersh*, 553 F.3d at 761.

Furthermore, the principal remedy for violation of each of Section 526's rules of professional conduct is a suit against the attorney (or other debt relief agency) to recover the debtor's "actual damages," as well as restitution of any fees paid by the debtor. 11 U.S.C. 526(c)(2). Congress's emphasis on the debtor's "actual damages" presupposes that the debtor has been injured by the attorney's conduct. As Judge Colloton noted, "legal and appropriate advice that would be protected by the First Amendment, yet prohibited by a broad reading of § 526(a)(4), should cause no damage at all." App., *infra*, 27a; accord *Hersh*, 553 F.3d at 759-760.

"In enacting the BAPCPA, Congress was attempting to address common abuses of the bankruptcy system. Congress concluded that there was a pervasive abuse * * * by debtors who incur debt before bankruptcy with the intention of having their debt discharged." *Hersh*, 553 F.3d at 760 (citing *House Report* 15). Construing Section 526(a)(4) in a way that focuses precisely on that goal is perfectly consistent with the statutory text, structure, and purpose.

B. Even if the court of appeals' broad reading of the statute were the most natural one, the court erred in adopting an interpretation that resulted in invalidating the statute when a plausible alternative reading is constitutionally unproblematic. Particularly in the context of a First Amendment overbreadth challenge, where the plaintiff's demand is to declare a statute invalid even though it may be legitimately applied in some or many circumstances, the federal courts have not only "the power to adopt narrowing constructions," but "the *duty* to avoid constitutional difficulties by doing so if such a construction is fairly possible." *Boos*, 485 U.S. at 330-331; see also, *e.g.*, *Broadrick* v. *Oklahoma*, 413 U.S. 601, 612 (1973). Indeed, respondents themselves urged the court of appeals to construe another provision, the term "debt relief agency," to avoid the same constitutional overbreadth objection. *E.g.*, Resp. C.A. Br. 17 ("A statute should be interpreted so as to avoid constitutional issues."). The term "debt relief agency," however, has a statutory definition that forecloses respondents' proposed construction. See 11 U.S.C. 101(12A) (defining "debt relief agency" as "any person who provides any bankruptcy assistance to an assisted person in return for * * * payment"); App., *infra*, 6a-10a. By contrast, the phrase "in contemplation of [bankruptcy]" is not defined and can reasonably be read to avoid constitutional problems, particularly in light of its status as a term of art in the bankruptcy context.

This Court has repeatedly applied saving constructions to avoid constitutional difficulties, even without the firm grounding in statutory text and context that the Fifth Circuit's reading of Section 526(a)(4) has. For instance, in *Boos*, this Court considered a First Amendment overbreadth challenge to a federal statute that made it unlawful "to congregate within 500 feet of any [embassy, legation, or consulate] and refuse to disperse after having been ordered so to do by the police." 485

U.S. at 329. The Court acknowledged that "[s]tanding alone, this text is problematic * * * because it applies to *any* congregation within 500 feet of an embassy for *any* reason." *Id.* at 330. Nevertheless, in accordance with the "duty to avoid constitutional difficulties" when a narrowing "construction is fairly possible," the Court construed the statute to apply "'only when the police reasonably believe that a threat to the security or peace of the embassy is present'"—a limitation that was unstated in the statute but ensured the validity of the Act. *Id.* at 330-331 (citation omitted). See also, *e.g.*, *Zadvydas* v. *Davis*, 533 U.S. 678, 689 (2001); *Edward J. DeBartolo Corp.* v. *Florida Gulf Coast Bldg. & Constr. Trades Council*, 485 U.S. 568, 576-578 (1988).

Federal courts construe federal statutes to avoid, not invite, constitutional difficulties. *E.g.*, *Boos*, 485 U.S. at 331. The court of appeals disregarded that important principle when it invalidated Section 526(a)(4) without adverting to the doctrine of constitutional avoidance or explaining why its interpretation of the disputed provision was the only plausible reading.

C. Even if the court of appeals' construction were so clearly required by the text of the statute as to overcome the avoidance doctrine, the court's overbreadth analysis would still be deficient. Because "invalidating a law that in some of its applications is perfectly constitutional * * * has obvious harmful effects," this Court has "vigorously enforced the requirement that a statute's overbreadth be *substantial*, not only in an absolute sense, but also relative to the statute's plainly legitimate sweep." *Williams*, 128 S. Ct. at 1838. The court of appeals failed to adhere to that principle when it struck down Section 526(a)(4) without giving proper weight to the statute's many legitimate applications.

Advice to engage in conduct that amounts to an abuse of the bankruptcy system is plainly subject to congressional regulation. Congress, the state legislatures and state bars, and the federal and state courts routinely require attorneys to abide by professional standards like Section 526(a)(4). Indeed, the conduct that Section 526(a)(4) targets falls squarely within the scope of Rule 1.2(d) of the Model Rules of Professional Conduct, which prohibits attorneys from advising their clients to engage in fraud. See, *e.g.*, *Attorney Grievance Comm'n* v. *Culver*, 849 A.2d 423, 443-444 (Md. 2004) (disciplining an attorney for advising and assisting a client to load up on debt before declaring bankruptcy). Those requirements serve valid and important governmental interests, both in protecting clients from unethical advice and in protecting the judicial process and other litigants from the harm that ensues when clients follow that unethical advice. As the Fifth Circuit noted, the constitutionality of Rule 1.2(d) has never been in doubt. *Hersh*, 553 F.3d at 756. Section 526(a)(4) regulates the very same conduct.

Section 526(a)(4) therefore may validly be applied to a significant category of unethical attorney advice. Against that legitimate sweep, the court below hypothesized two instances of legitimate, ethical advice to accumulate new debt on the eve of bankruptcy: buying a car and refinancing a mortgage.[8] App., *infra*, 13a-14a. The court added that "[f]actual scenarios other than these

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[8] The court assumed that merely refinancing an existing mortgage—that is, exchanging one loan for another with the same principal balance but a different interest rate, repayment period, or other terms—would constitute incurring "more debt" within the meaning of the statute. See App., *infra*, 13a. It is not at all clear that this understanding is correct.

few hypothetical situations no doubt exist." *Id.* at 14a. On that slim and concededly "hypothetical" basis, the majority held the statute unconstitutional as applied to all attorney conduct, including the abusive practices at which Section 526(a)(4) was directly aimed.

As Judge Colloton correctly pointed out, "a facial challenge resting on a 'few hypothetical situations' * * * is unlikely to justify invalidating a statute in *all* of its applications, because 'the mere fact that one can conceive of some impermissible applications of a statute is not sufficient to render it susceptible to an overbreadth challenge.'" App., *infra*, 24a (quoting *Members of the City Council* v. *Taxpayers for Vincent*, 466 U.S. 789, 800 (1984)). The court of appeals here did no more than posit "some impermissible applications" of Section 526(a)(4). *Taxpayers for Vincent*, 466 U.S. at 800. The court did note this Court's admonition that First Amendment challenges of this sort require *substantial* overbreadth compared to the statute's valid coverage. App., *infra*, 15a n.10. But the court merely asserted that "[Section] 526(a)(4) is substantially overbroad," *id.* at 15a, without ever explaining how its "few hypothetical situations" supported that conclusion.

III. THE QUESTION PRESENTED IS IMPORTANT

As this Court has repeatedly observed, judging the constitutionality of an Act of Congress is "the gravest and most delicate duty that this Court is called upon to perform." *Rostker* v. *Goldberg*, 453 U.S. 57, 64 (1981) (quoting *Blodgett* v. *Holden*, 275 U.S. 142, 148 (1927) (Holmes, J.)). The federal statute at issue here serves an important function in the administration of the Nation's bankruptcy laws, and the circuit conflict over the validity of that statute warrants this Court's review.

"The principal purpose of the Bankruptcy Code is to grant a 'fresh start' to the 'honest but unfortunate debtor.'" *Marrama* v. *Citizens Bank*, 549 U.S. 365, 367 (2007) (quoting *Grogan* v. *Garner*, 498 U.S. 279, 286-287 (1991)). Section 526(a)(4) is an important part of Congress's effort to preserve that focus on the "honest but unfortunate debtor" by curbing abuse of the bankruptcy system, including abuse that comes at the suggestion of a bankruptcy professional. By invalidating Section 526(a)(4), the court of appeals has frustrated that effort, and the conflict between the decision below and the Fifth Circuit's decision in *Hersh* also undermines Congress's decision "[t]o establish * * * *uniform* Laws on the subject of Bankruptcies throughout the United States." U.S. Const. Art. I, § 8, Cl. 4 (emphasis added); cf., *e.g.*, *Railway Labor Executives' Ass'n* v. *Gibbons*, 455 U.S. 457, 465-466, 471-472 (1982) (discussing the importance the Framers placed on uniform bankruptcy rules).

A. Congress has long been aware that the relief afforded by the bankruptcy laws creates a perverse incentive for debtors to amass additional debt in contemplation of obtaining a discharge. Congress has recognized that such conduct poses a fundamental threat to the Code's twin goals of affording debtors a fresh start while providing an orderly and equitable system of resolving creditors' claims. For example, when Congress enacted 11 U.S.C. 523(a)(2)(C), which creates a presumption that certain eve-of-bankruptcy debts are not dischargeable, the accompanying Senate Report emphasized that "[e]xcessive debts incurred within a short period prior to the filing of the petition present a special problem: that of 'loading up' in contemplation of bankruptcy." S. Rep. No. 65, 98th Cong., 1st Sess. 9 (1983). The report explained that "[a] debtor planning [to] file a petition with the bankruptcy court has a strong economic incentive to incur dischargeable debts for either consumable goods or exempt property," noting that "[i]n many instances, the debtor will go on a credit buying spree in contemplation of bankruptcy at a time when the debtor is, in fact, insolvent." *Ibid.* As the report concluded, "[n]ot only does this result in direct losses for the creditors that are the victims of the spree, but it also creates a higher absolute level of debt so that all creditors receive less in liquidation. During this period of insolvency preceding the filing of the petition, creditors would not extend credit if they knew the true facts." *Ibid.* As early as 1973, Congress was informed that "the most serious abuse of consumer bankruptcy is the number of instances in which individuals have purchased a sizable quantity of goods and services on credit on the eve of bankruptcy in contemplation of obtaining a discharge." *Report of the Commission on the Bankruptcy Laws of the United States*, H.R. Doc. No. 137, 93d Cong., 1st Sess. Pt. I, at 11 (1973).

Congress has accordingly enacted a number of protections against eve-of-bankruptcy attempts to abuse the system's protections. For instance, it authorized bankruptcy courts to dismiss a petition for "substantial abuse," 11 U.S.C. 707(b) (2000), which could include the debtor's purposeful accumulation of debt in contemplation of bankruptcy. *E.g.*, *Price* v. *United States Tr. (In re Price)*, 353 F.3d 1135, 1139-1140 (9th Cir. 2004). It precluded debtors from obtaining a discharge for debts obtained fraudulently. 11 U.S.C. 523(a)(2)(A). And it provided that certain categories of debts are presumed to be fraudulent and nondischargeable if they are incurred on the eve of bankruptcy. 11 U.S.C. 523(a)(2)(C) (2000).

B. When Congress enacted the BAPCPA in 2005, the House Report expressed concern that those earlier measures had not adequately restricted the ability of debtors to "knowingly load up with credit card purchases or recklessly obtain cash advances and then file for bankruptcy relief." *House Report* 15. Accordingly, Congress strengthened each of the aforementioned protections against bankruptcy abuse. See, *e.g.*, BAPCPA § 310, 119 Stat. 84 (11 U.S.C. 523(a)(2)(C)). Most fundamentally, Congress greatly expanded the bankruptcy courts' authority to dismiss petitions for "abuse" of the bankruptcy system, including in cases in which debtors purposefully incur additional debt in contemplation of filing a petition. See BAPCPA § 102, 119 Stat. 27; *House Report* 48-49. Congress permitted dismissal of a petition based on a less stringent showing of abuse; authorized "any party in interest" to file a motion to dismiss for abuse (except in some cases involving lower-income debtors); repealed the pre-existing presumption in favor of granting the relief sought by the debtor; and specified that bankruptcy courts must consider, in determining whether a petition should be dismissed for abuse when no presumption applies, "whether the debtor filed the petition in bad faith" and whether "the totality of the circumstances * * * of the debtor's financial situation demonstrates abuse." 11 U.S.C. 707(b)(1), (3) and (6); see *House Report* 49.

Congress also made another significant change, which heightened the importance of the professional-conduct regulations at issue in this case. The "principal consumer bankruptcy reform" in the 2005 legislation was the adoption of a "means testing" mechanism intended to ensure that debtors who have the ability to repay at least some of their debts will do so, through a structured repayment plan entered under Chapter 13 of the Bankruptcy Code, instead of obtaining a complete discharge under Chapter 7. *House Report* 48; see *id.* at 2 (describing means testing as the "heart" of the 2005 Act's reform provisions). See generally 11 U.S.C. 109(b) and (e) (eligibility for Chapter 7 and Chapter 13).

Under the means test, a debtor's petition for complete relief under Chapter 7 is presumed to be abusive if the debtor's current monthly income exceeds his statutorily allowed expenses, including payments for secured debt, by more than a prescribed amount. See 11 U.S.C. 707(b)(2)(A)(i) and (iii). If the court finds a petition to be abusive under this standard, it can dismiss the debtor's case or, with the debtor's consent, convert it to Chapter 13, which involves a repayment plan. 11 U.S.C. 707(b)(1). The means test, however, exacerbates the incentive for debtors to manipulate the system by "loading up" on certain debt in contemplation of filing, because payments on secured debts that qualify under Section 707(b)(2)(A)(iii) reduce the amount of the debtor's monthly income counted in the means test, and may therefore allow the debtor to remain eligible for a complete and immediate discharge of unsecured debt under Chapter 7.

C. Congress was accordingly concerned that the introduction of the means test would give attorneys an incentive to counsel their clients to take on additional debt before filing for bankruptcy. As one bankruptcy judge testified, "[t]he more debt that is incurred prior to filing, the more likely the debtor will qualify for chapter 7." *Bankruptcy Reform Act of 1998: Hearing on H.R. 3150 Before the Subcomm. on Commercial and Admin-*

istrative Law of the House Comm. on the Judiciary, 105th Cong., 2d Sess. Pt. I, at 25 (1998) (statement of Judge Randall J. Newsome). Thus, the bankruptcy judge testified that, "[p]erverse as it may seem, I can envision debtor's counsel advising their clients to buy the most expensive car that someone will sell them, and sign on to the biggest payment they can afford (at least until the bankruptcy is filed) as a way of increasing their deductions under [the means test]." *Ibid.*; see also *B9ankruptcy Reform Act of 1999: Hearing on H.R. 833 Before the Subcomm. on Commercial and Administrative Law of the House Comm. on the Judiciary*, 106th Cong., 1st Sess. Pt. II, at 30 (1999) (statement of Judge William Brown). And as discussed above, see p. 3, *supra*, Congress credited evidence compiled by the United States Trustee Program that "consistently identified," among the sources of bankruptcy abuse, "misconduct by attorneys and other professionals [and] problems associated with bankruptcy petition preparers." *House Report* 5 (quoting Antonia G. Darling & Mark A. Redmiles, *Protecting the Integrity of the System: The Civil Enforcement Initiative,* Am. Bankr. Inst. J., Sept. 2002, at 12).

Section 526(a)(4) is an important component of Congress's effort to prevent such efforts to circumvent of the means test. If a debtor is made financially worse off by following his attorney's unethical advice to incur more debt in an attempt to take advantage of the bankruptcy system, Section 526 provides him a remedy against the attorney, including both a refund of attorney's fees and actual damages. Section 526 also ensures that attorneys will be subject to a concrete sanction for giving such unethical advice; while state bars have a significant role to play in disciplining attorneys for unethical conduct, the additional remedy provided by Section 526 is both more uniform and more certain. Section 526 also facilitates the client's cooperation through its fee-shifting provision, 11 U.S.C. 526(c)(2), whereas a state bar must rely on public-spirited complainants.

Section 526(a)(4) thus serves both a compensatory and a deterrent function within Congress's carefully designed framework for reducing well-documented ways of abusing the bankruptcy system. The court of appeals' decision invalidating that important tool raises an important question that is worthy of this Court's review.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

ELENA KAGAN
Solicitor General

MICHAEL F. HERTZ
Acting Assistant Attorney General

MALCOLM L. STEWART
Deputy Solicitor General

WILLIAM M. JAY
Assistant to the Solicitor General

MARK B. STERN
MARK R. FREEMAN
Attorneys

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APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

No. 07-2405

MILAVETZ, GALLOP & MILAVETZ, P.A.;
ROBERT J. MILAVETZ; BARBARA N. NEVIN;
JOHN DOE; MARY DOE, APPELLEES

v.

UNITED STATES OF AMERICA, APPELLANT

COMMERCIAL LAW LEAGUE OF AMERICA,
AMICUS ON BEHALF OF APPELLEE

Submitted: Mar. 11, 2008
Filed: Sept. 4, 2008
(Corrected Sept. 23, 2008)

APPEAL FROM THE UNITED STATES
DISTRICT COURT FOR THE
DISTRICT OF MINNESOTA

Before: BYE, SMITH, and COLLOTON, Circuit Judges.

SMITH, Circuit Judge.

Milavetz, Gallop & Milavetz, P.A., a law firm that practices bankruptcy law, the firm's president, a bank-

ruptcy attorney within the firm, and two clients[1] who sought bankruptcy advice from the firm brought suit against the United States seeking a declaratory judgment that certain provisions of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA)—11 U.S.C. §§ 526(a)(4) and 528(a)(4) and (b)(2)—did not apply to attorneys and law firms and are unconstitutional as applied to attorneys. The district court granted summary judgment to the plaintiffs and issued an order declaring that: (1) attorneys in the District of Minnesota were excluded from the definition of a "debt relief agency" as defined by BAPCPA; and (2) the challenged provisions were unconstitutional as applied to attorneys in the District of Minnesota. We affirm in part and reverse in part.

I. *Background*

On April 20, 2005, BAPCPA was signed into law, amending and adding multiple sections of the Bankruptcy Code ("the Code"). While some of these amendments became effective immediately, the vast majority became effective on October 17, 2005. *See* Pub. L. No. 109-8, § 1501(a), 119 Stat. 23 (2005) ("Except as otherwise provided in this Act, this Act and the amendments made by this act shall take effect 180 days after the date of enactment of this Act").

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[1] The client-plaintiffs sought prebankruptcy advice regarding the incurrence of additional debt prior to filing bankruptcy. The Bankruptcy Code precludes a debt relief agency from advising an assisted person from incurring additional debt in contemplation of bankruptcy. 11 U.S.C. § 526(a)(4). Thus, these client-plaintiffs are appearing on behalf of themselves and all others similarly situated who desire to exercise their First Amendment rights with attorneys regarding bankruptcy information.

One BAPCPA amendment added a new term, "debt relief agency," which is defined in § 101(12A) of the Code. 11 U.S.C. § 101(12A).[2] The amended Code restricts some actions of debt relief agencies, while requiring them to do others. *See* 11 U.S.C. § 526 ("Restrictions on debt relief agencies"); 11 U.S.C. § 528 ("Requirements for debt relief agencies"). For example, § 526(a)(4) bars a debt relief agency from advising a client "to incur more debt in contemplation" of a bankruptcy filing, 11 U.S.C. § 526(a)(4), while §§ 528(a)(4) and (b)(2) require debt relief agencies to include a disclosure in their bankruptcy-related advertisements directed to the general public declaring: "We are a debt relief agency. We help people file for bankruptcy relief under the Bankruptcy Code[,]' or a substantially similar statement." 11 U.S.C. § 528(a)(4), (b)(2). The plaintiffs sought alternative remedies. First, plaintiffs requested a declaratory judgment that attorneys did not fall within the definition of "debt relief agency." If the court determined that attorneys fell within the definition of debt relief agency, they challenged the constitutionality of §§ 526(a)(4) and 528(a)(4) and (b)(2), as applied to attorneys.

II. *Discussion*

A. *Debt Relief Agencies*

Initially, we address whether attorneys fall within the Code's definition of debt relief agencies. If they do not, we will have no need to address the constitutionality of §§ 526(a)(4) and 528(a)(4) and (b)(2), which only apply to debt relief agencies. *See Holtan v. Black*, 838 F.2d

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[2] Prior to BAPCPA, the term "debt relief agency" did not exist in the Code.

984, 986 n.3 (8th Cir. 1988) ("Federal courts must avoid passing upon constitutional questions unless they are essential to the disposition of the issues before them.") (citing *Three Affiliated Tribes v. Wold Engineering*, 467 U.S. 138, 157 (1984) ("It is a fundamental rule of judicial restraint, however, that this Court will not reach constitutional questions in advance of necessity of deciding them")).

> The term "debt relief agency" means *any person* who provides *any bankruptcy assistance* to an *assisted person* in return for the payment of money or other valuable consideration, or who is a bankruptcy petition preparer under section 110, but does not include—
>
> > (A) any person who is an officer, director, employee, or agent of a person who provides such assistance or of the bankruptcy petition preparer;
> >
> > (B) a nonprofit organization that is exempt from taxation under section 501(c)(3) of the Internal Revenue Code of 1986;
> >
> > (C) a creditor of such assisted person, to the extent that the creditor is assisting such assisted person to restructure any debt owed by such assisted person to the creditor;
> >
> > (D) a depository institution (as defined in section 3 of the Federal Deposit Insurance Act) or any Federal credit union or State credit union (as those terms are defined in section 101 of the Federal Credit Union Act), or any affiliate or subsidiary of such depository institution or credit union; or

> (E) an author, publisher, distributor, or seller of works subject to copyright protection under title 17, when acting in such capacity.

11 U.S.C. § 101(12A) (emphasis added).

Further, the Code defines the term "bankruptcy assistance" to mean:

> any goods or services sold or otherwise provided to an assisted person with the express or implied purpose of providing information, *advice, counsel*, document preparation, or filing, or attendance at a creditors' meeting or appearing in a case or proceeding on behalf of another *or providing legal representation* with respect to a case or proceeding under this title.

Id. at § 101(4A) (emphasis added).

Additionally, the Code defines the term "assisted person" as "any person whose debts consist primarily of consumer debts and the value of whose nonexempt property is less than $164,250."[3] *Id.* at § 101(3).

The plaintiffs argue that attorneys are not "debt relief agencies" because the definition of debt relief agencies makes no direct reference to attorneys, even though "attorney" is a defined term in the Code, *id.* at § 101(4),[4] but does include the term "bankruptcy petition pre-

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[3] When this suit was commenced, the dollar amount in § 101(3) was $150,000. Subsequently, on April 1, 2007, the amount was adjusted pursuant to 11 U.S.C. § 104. The change, however, is inconsequential for purposes of this case.

[4] "The term 'attorney' means attorney, professional law association, corporation, or partnership, authorized under applicable law to practice law." 11 U.S.C. § 101(4). This definition makes no reference to "debt relief agencies" or to subsection (12A).

parer" which, by definition, excludes debtor's attorneys and their staff. *See* 11 U.S.C. § 110(a)(1).[5] Plaintiffs contend that the omission of any reference to attorneys or lawyers while specifically including bankruptcy petition preparers shows Congress's intent to exclude attorneys from the definition of debt relief agencies. Because the plaintiffs contend that constitutionality issues arise in §§ 526(a)(4) and 528(a)(4) and (b)(2) if attorneys are debt relief agencies, they assert that the doctrine of constitutional avoidance should be used to interpret "debt relief agency" to exclude attorneys and thus avoid the potential constitutional issues.

Conversely, the government argues that attorneys are debt relief agencies because the broadly worded definition of the term plainly includes attorneys, *see* 11 U.S.C. § 101(12A) (defining "debt relief agency" as "any person who provides any bankruptcy assistance to an assisted person in return for the payment"), and providing legal representation is included in definition of bankruptcy assistance. *See id.* at 101(4A) ("bankruptcy assistance means any goods or services sold or otherwise provided to an assisted person with the express or implied purpose of providing . . . advice, counsel, . . . or legal representation with respect to a case or proceeding under this title").

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[5] "'[B]ankruptcy petition preparer' means a person, *other than an attorney for the debtor or an employee of such attorney* under the direct supervision of such attorney, who prepares for compensation a document for filing [by the debtor in connection with his bankruptcy case]." 11 U.S.C. § 110(a)(1) (emphasis added); *see also id.* at § 110(a)(2) (defining "document for filing" as used in § 110(a)(1)).

Whether attorneys fall within the Code's definition of debt relief agencies is an issue of first impression among the Courts of Appeals. Although the plain language of the definition appears to include bankruptcy attorneys and does not appear to be ambiguous, lower "[c]ourts that have addressed the issue of whether attorneys are debt relief agencies have not been unanimous." *In re Irons*, 379 B.R. 680, 685 (Bankr. S.D. Tex. 2007) (citing cases). Nevertheless, the majority of courts have held that compensated bankruptcy attorneys are debt relief agencies as that term is defined in the Code. *Id.* (finding debtor's counsel was a debt relief agency); *Olsen v. Gonzales*, 350 B.R. 906 (D. Or. 2006) (same); *In re Robinson*, 368 B.R. 492 (Bankr. E.D. Va. 2007) (finding debtor's counsel was debt relief agency); *Hersh v. United States*, 347 B.R. 19 (N.D. Tex. 2006) (finding that bankruptcy attorneys are debt relief agencies); *In re Norman*, No. 06-70859, 2006 WL 3053309 (Bankr. E.D. Va. 2006) (finding debtor's counsel qualified as a debt relief agency); *but see In re Attorneys at Law and Debt Relief Agencies*, 332 B.R. 66 (Bankr. S.D. Ga. 2005) (holding that attorneys are not debt relief agencies); *In re Reyes*, 361 B.R. 276 (Bankr. S.D. Fla. 2007) (finding that attorneys, generally, are not debt relief agencies, but ruling that debtor's counsel in case at bar was not a debt relief agency because service was provided pro bono and thus counsel did not receive valuable consideration in return for the bankruptcy assistance provided).

In this case, the district court acknowledged that the definition of debt relief agency, "at first glance," appeared to include attorneys, but it ultimately relied on the doctrine of constitutional avoidance to conclude that attorneys did not fall within the definition because if they did portions of §§ 526 and 528 would be unconstitu-

tional as applied to attorneys. The doctrine of constitutional avoidance dictates that "where an otherwise acceptable construction of a statute would raise serious constitutional problems, the Court will construe the statute to avoid such problems unless such construction is plainly contrary to the intent of Congress." *Edward J. DeBartolo Corp. v. Florida Gulf Coast Bldg. & Constr. Trades Council*, 485 U.S. 568, 575 (1988). Thus, if interpreting "debt relief agency" to include attorneys "would raise serious constitutional problems," then we should look for another interpretation "that may fairly be ascribed" to the definition that does not raise these concerns. *Id.* at 576-77. We will not, however, adopt an alternative interpretation that is "plainly contrary to the intent of Congress." *Id.* at 575.

"We review the district court's statutory interpretation de novo." *United States v. Mendoza-Gonzalez*, 520 F.3d 912, 914 (8th Cir. 2008). To interpret the statute we first "determine whether the language at issue has a plain and unambiguous meaning with regard to the particular dispute in the case." *Id.* (quoting *Robinson v. Shell Oil Co.*, 519 U.S. 337, 340 (1997)). "If so, we apply the plain language of the statute." *Id.* "A mere disagreement among litigants over the meaning of the statute does not prove ambiguity; it usually means that one of the litigants is simply wrong." *Bank of Am. Nat'l Trust & Sav. Ass'n v. 203 N. LaSalle St. P'ship*, 526 U.S. 434, 461 (1999).

The plain reading of the definition of debt relief agency, and the defined terms that make up that definition, leads us to conclude that attorneys who provide "bankruptcy assistance" to "assisted persons" are unambiguously included in the definition of "debt relief agen-

cies." *See Olsen*, 350 B.R. at 912 ("[I]t is the plain language of the Act that leads to the conclusion that attorneys are to be included in the definition of 'debt relief agency,'" and "[t]hus, further use of the tools of statutory construction is not necessary"). The statutory language sweeps broadly and clearly covers the legal services provided by attorneys to debtors in bankruptcy unless excluded by another provision.

Congress specifically listed five exclusions from the definition of "debt relief agency," and if it meant to exclude attorneys from that definition it could have explicitly done so. *Id.*; 11 U.S.C. § 101(12A). Moreover, if attorneys were not included in the definition of debt relief agencies, Congress would have had no reason to include § 526(d)(2), which expressly provides that nothing in §§ 526, 527, or 528 (the sections covering debt relief agencies) "shall be deemed to limit or curtail the authority or ability of a State . . . to determine and enforce qualifications for the practice of law under the laws of that State; or of a Federal court to determine and enforce the qualifications for the practice of law before that court." 11 U.S.C. § 526(d)(2)(A) and (B). The legislative history provides further indication that attorneys are included in the definition. *See* H.R. Rep. No. 109-31, 109th Cong., 1st Sess. at 4 (April 8, 2005) ("The bill's consumer protections include provisions strengthening professionalism standards *for attorneys* and others who assist consumer debtors with their bankruptcy cases") (emphasis added).[6]

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[6] Additionally, while we recognize that the Supreme Court has stated that "failed legislative proposals are a particularly dangerous ground on which to rest [a statutory interpretation]," *Lockhart v. United States*, 546 U.S. 142 (2005) (internal quotation marks and brackets

Because attorneys were not specifically excluded from the definition of debt relief agencies, we hold that attorneys that provide "bankruptcy assistance" to "assisted persons" are "debt relief agencies" as that term is defined by the Code. Interpreting the definition of "debt relief agency" to exclude bankruptcy attorneys would be contrary to Congress's intent.

B. *Constitutionality of § 526(a)(4)*

Having concluded that attorneys providing bankruptcy assistance to assisted persons are debt relief agencies under the Code, we now must determine whether the challenged provisions placing restrictions and requirements on debt relief agencies are unconstitutionally overbroad as applied to these types of attorneys.[7] One of the sections challenged by the plaintiffs in this case is § 526(a)(4), which states:

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omitted), we note that on March 9, 2005, Senator Feingold proposed amendment No. 93 to Congress which would have excluded attorneys from the definition of debt relief agencies, *see* 151 Cong. Rec. S2306-02, 2316 (daily ed. Mar. 9, 2005) (statement by Sen. Feingold) ("This amendment would exclude lawyers from the provisions dealing with 'debt relief agencies' . . . ."), but the Senate did not address the proposal.

[7] Even though a more narrowly drawn version of § 526(a)(4) would likely be valid as applied to the plaintiffs in this case, our analysis applies to all attorneys falling within the definition of debt relief agencies, not merely the plaintiff-attorneys. *See Members of City Council of City of Los Angeles v. Taxpayers for Vincent*, 466 U.S. 789, 798-99 (1984) (explaining that the overbreadth doctrine allows a party to challenge a broadly written statute "even though a more narrowly drawn statute would be valid as applied to the party in the case," as "the statute's very existence may cause others not before the court to refrain from constitutionally protected speech or expression") (internal quotations and citation omitted).

(a) A debt relief agency shall not—

. . .

> (4) advise an assisted person or prospective assisted person to incur more debt in contemplation of such person filing a case under this title or to pay an attorney or bankruptcy petition preparer fee or charge for services performed as part of preparing for or representing a debtor in a case under this title.

11 U.S.C. § 526(a)(4).

Plaintiffs assert that the prohibition against advising an assisted person or prospective assisted person to incur more debt in contemplation of bankruptcy violates the First Amendment. The parties disagree as to the level of scrutiny we apply to the constitutional analysis of this limitation on speech. Plaintiffs claim that we should review the constitutionality of § 526(a)(4) under the strict scrutiny standard as the restriction on attorney advice is content-based. *See Turner Broad. Sys., Inc. v. FCC*, 512 U.S. 622, 642 (1994) ("Our precedents thus apply the most exacting scrutiny to regulations that suppress, disadvantage, or impose differential burdens upon speech because of its content"). Under strict scrutiny review, the government has the burden to prove that the constraints on speech are supported by a compelling governmental interest and are narrowly tailored, such that the statutory effect does not prohibit any more speech than is necessary to serve the governmental interest. *Republican Party of Minnesota v. White*, 536 U.S. 765, 774-75 (2002).

In contrast, the government argues that § 526(a)(4)'s restrictions are a type of ethical regulation, invoking the more lenient standard outlined in *Gentile v. State Bar of Nev.*, 501 U.S. 1030 (1991). Under the *Gentile* standard, we would balance the First Amendment rights of the attorneys against the government's legitimate interest in regulating the activity in question—the prohibition of advising assisted persons to incur more debt in contemplation of bankruptcy—and then determine whether the regulations impose "only narrow and necessary limitations on lawyers' speech." *Id.* at 1075.

According to the government, § 526(a)(4) should be interpreted as merely preventing an attorney from advising an assisted person (or prospective assisted person) to take on more debt in contemplation of bankruptcy when the incurrence of such debt is done with the intent to manipulate the bankruptcy system, engage in abusive conduct, or take unfair advantage of the bankruptcy discharge. However, the plain language of the statute does not permit this narrow interpretation. Rather, § 526(a)(4) broadly prohibits a debt relief agency from advising an assisted person (or prospective assisted person) to incur *any* additional debt when the assisted person is contemplating bankruptcy. The statute's blanket prohibition applies even if the additional debt would not be discharged during the bankruptcy proceedings. 11 U.S.C. § 526(a)(4).

Thus, regardless of whether the government's interest in prohibiting the speech was legitimate (*Gentile* standard) or compelling (strict scrutiny standard), § 526(a)(4) is unconstitutionally overbroad as applied to attorneys falling within the definition of debt relief agencies because it is not narrowly tailored, nor narrowly

and necessarily limited, to restrict only that speech that the government has an interest in restricting. Instead, § 526(a)(4) prohibits attorneys classified as debt relief agencies from advising any assisted person to incur any additional debt in contemplation of bankruptcy; this prohibition would include advice constituting prudent pre-bankruptcy planning that is not an attempt to circumvent, abuse, or undermine the bankruptcy laws. Section 526(a)(4), as written, prevents attorneys from fulfilling their duty to clients to give them appropriate and beneficial advice not otherwise prohibited by the Bankruptcy Code or other applicable law.[8]

There are certain situations where it would likely be in the assisted person's, and even the creditors', best interest for the assisted person to incur additional debt in contemplation of bankruptcy. However, under § 526(a)(4)'s plain language an attorney is prohibited from providing this beneficial advice—even if the advice could help the assisted person avoid filing for bankruptcy altogether. For instance, it may be in the assisted person's best interest to refinance a home mortgage in contemplation of bankruptcy to lower the mortgage payments. This could free up additional funds to pay off other debts and avoid the need for filing bank-

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[8] Several bankruptcy courts are in agreement with our decision. *See Zelotes*, 363 B.R. at 667 ("Because § 526(a)(4) is not sufficiently 'narrowly tailored to achieve the desired objective,' it is unconstitutional as applied to bankruptcy attorneys."); *Hersh*, 347 B.R. at 25 (concluding that § 526(a)(4) is unconstitutional because: "(1) it prevents lawyers from advising clients to take lawful actions; and (2) it extends beyond abuse to prevent advice to take prudent actions," and therefore imposes "limitations on speech beyond what is 'narrow and necessary' "); *Olsen*, 350 B.R. at 916 ("[S]ection 526(a)(4) is overly restrictive in violation of the First Amendment" even if reviewed under *Gentile* standard).

ruptcy all together. *Hersh*, 347 B.R. at 24. Moreover, it may be in the client's best interest to incur additional debt to purchase a reliable automobile before filing for bankruptcy, so that the debtor will have dependable transportation to travel to and from work, which will likely be necessary to maintain the debtor's payments in bankruptcy. *Id.* Incurring these types of additional secured debt, which would often survive or could be reaffirmed by the debtor, may be in the debtor's best interest without harming the creditors.[9]

Factual scenarios other than these few hypothetical situations no doubt exist and may further illustrate why incurring additional debt in contemplation of bankruptcy may not be abusive or harmful to creditors. Nonetheless, § 526(a)(4), as written, does not allow attorneys falling within the definition of debt relief agencies to advise assisted persons (or prospective assisted persons)—i.e. clients (or prospective clients) meeting the definition of assisted person—to incur such debt. Thus, § 526(a)(4) is not narrowly tailored nor narrowly and necessarily limited to prevent only that speech which the government has an interest in restricting. Therefore,

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[9] *See* Erwin Chemerinsky, *Constitutional Issues Posed in the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005*, 79 Am. Bankr. L.J. 571, 579 (Summer 2005).

> [Section 526(a)(4)'s] prohibition is particularly troubling when it might be completely legal and even desirable for the client to incur such debt. For example, there may be instances where it is advisable for a client to obtain a mortgage, to refinance an existing mortgage to obtain a lower interest rate, or to buy a new car on time. There would be no fraud in doing so if the client intended to pay such debt notwithstanding the filing of a contemplated bankruptcy case. For example, the client may intend to keep all payments fully current and to reaffirm such debt once the case is filed.

we hold that § 526(a)(4) is substantially overbroad,[10] and unconstitutional as applied to attorneys who provide bankruptcy assistance to assisted persons, as those terms are defined in the Code.

C. *Constitutionality of § 528(a)(4) and (b)(2)*

The plaintiffs also challenged the constitutionality of §§ 528(a)(4) and (b)(2)(B), claiming that the advertising disclosure requirements mandated by those sections violate the First Amendment rights of bankruptcy attorneys through compelled speech. The disclosure requirements of § 528(a)(4) are supplemented by § 528(a)(3). These sections state:

(a) A debt relief agency shall—

. . .

> (3) clearly and conspicuously disclose in any advertisement of bankruptcy assistance services or of the benefits of bankruptcy directed to the general public (whether in general media, seminars or specific mailings, telephonic or electronic messages, or otherwise) that the services or benefits are with respect to bankruptcy relief under this title; and
>
> (4) clearly and conspicuously use the following statement in such advertisement: "We are a debt relief agency. We help people file for bankruptcy

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[10] *See Veneklase v. City of Fargo*, 248 F.3d 738, 747 (8th Cir. 2001) ("For us to find a statute unconstitutionally overbroad, its 'overbreadth . . . must not only be real, but substantial as well, judged in relation to the statute's plainly legitimate sweep.' ") (quoting *Broadrick v. Oklahoma*, 413 U.S. 601, 615 (1973)).

> > relief under the Bankruptcy Code." or [*sic*] a substantially similar statement.

11 U.S.C. § 528 (a)(3), (4).

Similarly, § 528(b)(2)(B) states:

> (2) An advertisement, directed to the general public, indicating that the debt relief agency provides assistance with respect to credit defaults, mortgage foreclosures, eviction proceedings, excessive debt, debt collection pressure, or inability to pay any consumer debt shall—
>
> . . .
>
> > (B) include the following statement: "We are a debt relief agency. We help people file for bankruptcy relief under the Bankruptcy Code." or a substantially similar statement.

11 U.S.C. § 528(b)(2)(B).

As both §§ 528(a)(4) and (b)(2)(B) require debt relief agencies—which includes attorneys providing bankruptcy assistance to assisted persons—to disclose in their advertising that "'We are a debt relief agency. We help people file for bankruptcy relief under the Bankruptcy Code.' or some substantially similar statement," the statutes compel speech that, similar to a restriction on speech, receives constitutional protection under the First Amendment. *See Wooley v. Maynard*, 430 U.S. 705, 714 (1977) ("[T]he right of freedom of thought protected by the First Amendment against state action includes both the right to speak freely and the right to refrain from speaking at all"); *Turner Broad. Sys., Inc.*, 512 U.S. at 642 (stating that "[l]aws that compel speak-

ers to utter or distribute speech bearing a particular message are subject to" constitutional scrutiny).

The government contends that Congress enacted § 528's disclosure requirements to address problems with deceitful or unclear advertising by bankruptcy attorneys, bankruptcy petition preparers, or other debt relief entities. This position is supported by legislative history. *See* 151 Cong. Rec. H2063-01, 2066 (daily ed. Apr. 14, 2005) (statement by Rep. Moran) (stating that certain BAPCPA provisions are intended to "[p]revent deceptive and fraudulent advertising practices by debt relief agencies . . ."). But before we can determine whether the government's justification for mandating the disclosures passes constitutional scrutiny, we must first decide the appropriate standard for reviewing the constitutionality of the required disclosures.

We find guidance for this issue from the Court in *Zauderer v. Office of Disciplinary Counsel of the Supreme Court of Ohio*, 471 U.S. 626 (1985). In *Zauderer*, the Supreme Court considered the constitutionality of a state bar disciplinary regulation requiring attorneys that advertised contingent-fee representation to disclose in their advertisements that clients may still have to bear certain costs even if the case was unsuccessful. *Id.* at 633. As the regulation only required an attorney to "include in his advertising purely factual and uncontroversial information about the terms under which his services w[ould] be available," and "the extension of First Amendment protection to commercial speech is justified principally by the value to consumers of the information such speech provides, [the attorney's] constitutionally protected interest in not providing any particular factual information in his advertising is minimal."

Id. at 651. The Court "recognize[d] that unjustified or unduly burdensome disclosure requirements might offend the First Amendment by chilling protected commercial speech," but held "that an advertiser's rights are adequately protected as long as disclosure requirements are *reasonably related* to the State's interest in preventing deception of consumers." *Id.* (emphasis added).

On the other hand, restrictions on non-deceptive advertising are reviewed under intermediate scrutiny. *See Cent. Hudson Gas & Elec. Corp. v. Pub. Serv. Comm'n of New York*, 447 U.S. 557, 564 (1980) (ruling that restrictions on commercial speech that is neither misleading nor related to unlawful activity must assert a "substantial interest to be achieved by [the] restrictions" and "the restrictions must directly advance the state interest involved"). Under this standard, the limitation must be narrowly drawn. *Id.* ("[I]f the governmental interest could be served as well by a more limited restriction on commercial speech, the excessive restrictions cannot survive").

The district court in this case reviewed § 528's disclosure requirements under the intermediate scrutiny standard, but we conclude that rational basis review is proper. The disclosure requirements here, like those in *Zauderer*, are intended to avoid potentially deceptive advertising. *See Zauderer*, 471 U.S. at 651, n.14 (rejecting a more strict analysis of the disclosure requirements at issue in that case, and noting that "the First Amendment interests implicated by disclosure requirements are substantially weaker than those at stake when speech is actually suppressed . . .").

By definition, debt relief agencies provide bankruptcy assistance to assisted persons (or prospective assisted persons) "with respect to a case or proceeding under [the Bankruptcy Code]." 11 U.S.C. §§ 101(4A), (12A). Section 528 generally requires debt relief agencies to disclose on its advertisements of bankruptcy assistance services directed to the general public that their services do in fact relate to bankruptcy and that they assist people in filing for bankruptcy. 11 U.S.C. § 528. As in *Zauderer*, the plaintiffs' "constitutionally protected interest in not providing [such] factual information in [their] advertising is minimal." 471 U.S. at 650. Further, the disclosure requirements are reasonably and rationally related to the government's interest in preventing the deception of consumer debtors, as the disclosure requirements are directed precisely at the problem targeted by Congress: ensuring that persons who advertise bankruptcy-related services to the general public make clear that their services do in fact involve filing for bankruptcy.[11]

Section 528 requires debt relief agencies to disclose: "'We are a debt relief agency. We help people file for bankruptcy relief under the Bankruptcy Code.' or a substantially similar statement," in all of their bankruptcy-

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[11] Without ruling on the issue, we note that at least one lower court has held that § 528's disclosure requirements are constitutionally valid even under the stricter intermediate scrutiny analysis, as the government's interest in protecting consumer debtors from misleading advertising is substantial, the disclosure requirements placed on bankruptcy attorneys directly advances the government's asserted interest, and the disclosure requirements are narrowly drawn to serve the government's interest. *See Olsen*, 350 B.R. at 920 (concluding that § 528 "passes constitutional muster" under either rational basis review or intermediate scrutiny review).

related advertising materials directed to the general public. 11 U.S.C. §§ 528(a)(4), (b)(2). The requirement does not prevent those attorneys meeting the definition of debt relief agencies "from conveying information to the public; it . . . only require[s] them to provide somewhat more information than they might otherwise be inclined to present." *Zauderer*, 471 U.S. at 650. Moreover, if any of these attorneys are concerned that the required disclosures will confuse the public, we note that nothing in the Code prevents them from identifying themselves in their advertisements as both attorneys and debt relief agencies. *Olsen*, 350 B.R. at 920. Simply put, attorneys that provide bankruptcy assistance to assisted persons are debt relief agencies under the Code, and the disclosure requirements of § 528 only require those attorneys to disclose factually correct statements on their advertising.[12] This does not violate the

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[12] We recognize that the broad definitions of debt relief agency, bankruptcy assistance, and assisted persons, might result in certain attorneys meeting the definition of debt relief agencies even though they do not represent debtors in bankruptcy nor help people file for bankruptcy relief under the Code. Nevertheless, these attorneys are still subjected to the disclosure requirements of § 528(a)(4) when they advertise "bankruptcy assistance services or . . . the benefits of bankruptcy directed to the general public," 11 U.S.C. § 528(a)(3), (4), or when they advertise to the general public that they "provide[] assistance with respect to credit defaults, mortgage foreclosures, eviction proceedings, excessive debt, debt collection pressure, or inability to pay any consumer debt." *Id.* at § 528(b)(2). But because § 528 permits a "substantially similar" disclosure to the one suggested by the Code, these attorneys can and should tailor their advertisement disclosure statements to factually represent the "bankruptcy assistance" they provide. These tailored disclosures will meet the requirements of § 528(a)(4) and (b)(2) as long as they are "substantially similar" to the suggested disclosure, a decision which will require a case-by-case determination. *See Olsen*, 350 B.R. at 919-20 (dismissing plaintiffs' claim that § 528 was uncon-

First Amendment. *Id.*; *see also In re Robinson*, 368 B.R. at 500-502 (finding that debtor's counsel was a debt relief agency subject to the strictures of § 528, and that § 528(a)(1)'s requirement for a written contract is constitutional); *In re Norman*, 2006 WL 3053309 at *4 (finding that debtor's counsel qualified as a debt relief agency and thus must comply with the requirements of § 528(a)(1)).

The challenged sections of § 528 only require debt relief agencies to include a disclosure on certain advertisements. Although less intrusive means may be conceivable to prevent deceptive advertising, § 528's disclosure requirements are reasonably related to the government's interest in protecting consumer debtors from deceptive advertising, and thus the section passes constitutional muster.

III. *Conclusion*

In sum, attorneys who provide bankruptcy assistance to assisted persons are debt relief agencies under the Bankruptcy Code, and § 526(a)(4) is unconstitutional as applied to these attorneys, but §§ 528(a)(4) and (b)(2) are constitutional. Accordingly, we affirm in part and reverse in part.

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stitutional, rejecting argument that attorney who met definition of debt relief agency but did not represent bankruptcy debtors was precluded from § 528's disclosure requirements because § 528 permits a "substantially similar" disclosure, which could be tailored to disclose that attorney advised clients about bankruptcy assistance matters but did not represent people in bankruptcy or file bankruptcy petitions, and stating that whether disclosure was "substantially similar" would require case-by-case determination).

COLLOTON, Circuit Judge, concurring in part and dissenting in part.

I concur in all but Part II.B of the opinion of the court. I disagree, however, with the court's holding that 11 U.S.C. § 526(a)(4) is unconstitutionally overbroad in violation of the First Amendment, and I would therefore reverse the district court's decision declaring this statutory provision unconstitutional.

Milavetz, Gallop, & Milavetz, P.A., mounts a facial attack on § 526(a)(4), arguing that the section's potential application to attorneys in hypothetical situations requires that the statute be declared impermissibly overbroad and unconstitutional. This case involves a facial challenge in the First Amendment context, "under which a law may be overturned as impermissibly overbroad because a substantial number of its applications are unconstitutional, judged in relation to the statute's plainly legitimate sweep." *Wash. State Grange v. Wash. State Republican Party*, 128 S. Ct. 1184, 1190 n.6 (2008). This "overbreadth doctrine," however, is "strong medicine that is used sparingly and only as a last resort." *New York State Club Ass'n, Inc. v. City of New York*, 487 U.S. 1, 14 (1988) (internal quotations omitted). It should be applied only when there is "a realistic danger that the statute itself will significantly compromise recognized First Amendment protections of parties not before the Court." *City Council of Los Angeles v. Taxpayers for Vincent*, 466 U.S. 789, 801 (1984). The Supreme Court recently emphasized that it has "vigorously enforced the requirement that a statute's overbreadth be *substantial*, not only in an absolute sense, but also relative to the stat-

ute's plainly legitimate sweep." *United States v. Williams*, 128 S. Ct. 1830, 1838 (2008).[13]

To resolve the constitutional challenge brought by Milavetz, we must first construe the disputed statute. When presented with a constitutional challenge to an Act of Congress, we have not only the power, but the duty, to adopt a narrowing construction that will avoid constitutional difficulties whenever possible. *Boos v. Barry*, 485 U.S. 312, 330-31 (1988). In *Boos*, for example, the Court considered a provision of federal legislation that made it unlawful "to congregate within 500 feet of any [embassy, legation, or consulate] and refuse to disperse after having been ordered so to do by the police." *Id.* at 329 (internal quotation omitted). The Court observed that "*[s]tanding alone*, this text is problematic because it applies to *any* congregation within 500 feet of an embassy for *any* reason." *Id.* at 330 (first emphasis

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[13] The district court purported to consider only an "as-applied" challenge to § 526(a)(4), rather than an overbreadth challenge, and ultimately declared the section "unconstitutional as applied to attorneys." *Milavetz, Gallop & Milavetz, P.A. v. United States*, 355 B.R. 758, 766 n.4, 769 (D. Minn. 2006). The majority correctly recognizes that the district court's approach is really an overbreadth analysis, and considers the statute under that framework. *See ante*, at 9 & n.7, 11, 13 & n.10. The "as applied" method of analysis, by contrast, considers the statute's application to a "particular claimant" based on "harm caused to the litigating party." *Turchick v. United States*, 561 F.2d 719, 721 n.3 (8th Cir. 1977). "The 'as applied' method vindicates a claimant whose conduct is within the First Amendment but invalidates the challenged statute *only to the extent of the impermissible application*." *Id.* (emphasis added). The district court and the majority have declared § 526(a)(4) unconstitutional in *all* of its applications to *all* attorneys, and the supporting reasoning is thus consistent with "facial overbreadth analysis." *Id.* (punctuation omitted).

added). Nonetheless, citing the "duty to avoid constitutional difficulties by [adopting a narrowing construction] if such a construction is fairly possible," the Court construed the statute narrowly to permit the dispersal of only congregations that are directed at an embassy, and to allow dispersal "only when the police reasonably believe that a threat to the security or peace of the embassy is present." *Id.* at 330-31 (internal quotation omitted). Similarly, in *United States v. X-Citement Video, Inc.*, 513 U.S. 64 (1994), the Court emphasized that "it is incumbent upon" a federal court to read a statute to eliminate constitutional doubts, "so long as such a reading is not plainly contrary to the intent of Congress." *Id.* at 78.

The challenged provision in this case provides in part that "[a] debt relief agency shall not . . . advise an assisted person or prospective assisted person to incur more debt in contemplation of such person filing a case under this title." 11 U.S.C. § 526(a)(4). Milavetz argues that according to this provision, a debt relief agency may not advise a client to incur *any* debt for *any* purpose when the client is contemplating the filing of a petition for bankruptcy. As such, Milavetz contends that an attorney could be sanctioned for "fulfilling his duty to his client to give legal and appropriate advice not otherwise prohibited by the Bankruptcy Code." (Brief of Appellee 30). Even under Milavetz's broad construction of the statute, a facial challenge resting on a "few hypothetical situations," *ante*, at [14a], is unlikely to justify invalidating a statute in *all* of its applications, because "the mere fact that one can conceive of some impermissible applications of a statute is not sufficient to render it susceptible to an overbreadth challenge." *Vincent*, 466 U.S. at 800.

It is unnecessary to resolve whether § 526(a)(4) is impermissibly overbroad when given its broadest reading, however, because the government suggests an acceptable narrowing construction of the statute that would avoid most constitutional difficulties. The government contends that "in contemplation of" filing for bankruptcy is a term of art that denotes an action taken with the intent to abuse the protections of bankruptcy laws. Under this view, the statute should be construed to prohibit only advice that a client engage in conduct for the purpose of manipulating the bankruptcy system.

The text, structure, and legislative history of § 526(a)(4) provide adequate support for a narrowing construction. Particularly given the latitude of federal courts to narrow a text to avoid constitutional difficulties, *see Boos*, 485 U.S. at 330-31, the words "in contemplation of . . . filing a case" need not create impermissible overbreadth. Rather, we may recognize that the phrase "in contemplation of" has been construed in the bankruptcy context to mean actions taken with the intent to abuse the protections of the bankruptcy system. Black's Law Dictionary reflects this understanding, defining "contemplation of bankruptcy" as "the thought of declaring bankruptcy because of the inability to continue current financial operations, *often coupled with action designed to thwart the distribution of assets in a bankruptcy proceeding*." *Black's Law Dictionary* 336 (8th ed. 2004) (emphasis added). American and English authorities construing the bankruptcy laws also support the proposition that the words "in contemplation of" may be understood to require an intent to abuse the bankruptcy laws. *In re Pearce*, 19 F. Cas. 50, 53 (D. Vt. 1843) (No. 10873) (concluding that an act was done "in contemplation of bankruptcy" if it was done "in anticipa-

tion of breaking or failing in his business, of committing an act of bankruptcy, or of being declared bankrupt at his own instance, on the ground of inability to pay his debts, *and intending to defeat the general distribution of effects, which takes place under a proceeding in bankruptcy*.") (emphasis added); *Morgan v. Brundrett*, 5 Barn. & Ad. 289, 296, 110 Eng. Rep. 798, 801 (K.B. 1833) (Parke, J.) (interpreting "in contemplation of bankruptcy" to mean that "the payment or delivery must be with intent to defeat the general distribution of effects which takes place under a commission of bankruptcy."); *Fidgeon v. Sharpe*, 5 Taunt. 539, 545-46, 128 Eng. Rep. 800, 802-03 (C.P. 1814) (Gibbs, C.J.) (An act made in contemplation of bankruptcy "must be intended in fraud of the bankrupt laws."); *cf. Buckingham v. McLean*, 54 U.S. 151, 167 (1851) ("To give to these words, contemplation of bankruptcy, a broad scope, and somewhat loose meaning, would not be in furtherance of the general purpose with which they were introduced."); *id.* at 169 (relying on English bankruptcy decisions as instructive authority on meaning of the former Bankrupt Act). Our duty to construe the statute to avoid constitutional difficulties counsels that we should look to these authorities for a plausible alternative to the broad construction urged by Milavetz.

The structure of § 526(a)(4) also supports a narrowing construction. The prohibitions of this statute can be enforced only through the civil remedies provided in § 526(c). An attorney who violates § 526(a)(4) can be sanctioned in just three situations: if a debtor sues the attorney for the available remedies—remittal of fees, actual damages, and reasonable attorney's fees and costs; if a state attorney general sues for a resident's actual damages; or if a court finds that the attorney in-

tentionally violated § 526(a)(4), and chooses to "impose an appropriate civil penalty." 11 U.S.C. § 526(c). The remedies for a violation thus emphasize actual damages. But legal and appropriate advice that would be protected by the First Amendment, yet prohibited by a broad reading of § 526(a)(4), should cause no damage at all. If an attorney advises a debtor to refinance his home to lower mortgage payments, or to purchase a reliable car to enable him to pay off his debts, *see ante*, at [13a-14a], then a debtor following that advice would suffer no damage. There is no reason to believe that a client could recover the remittal of attorney's fees or that a court would find a civil penalty "appropriate" as a remedy for legal advice that *benefits* both the debtor *and* his creditors. Rather, a debtor is likely to have a remedy against an attorney only in the case of an abusive bankruptcy petition, where the debtor may suffer damages if the petition is dismissed as abusive, *see* 11 U.S.C. § 707(b)(1), and where an attorney general or a court has reason to seek or impose sanctions against an abusive debt relief agency. The remedial focus of § 526 thus bolsters the proposition that § 526(a)(4) was aimed only at advice given by a debt relief agency that is designed to abuse the bankruptcy process.

The incorporation of an abusive purpose requirement into § 526(a)(4) is also consonant with the evident purpose of the statute. The government argues, and Milavetz acknowledges, that a principal goal of Congress in passing the statute was to "preclude debtors from taking on more debt knowing that it will later be discharged during bankruptcy." (Brief of Appellee 34). A narrowing construction of § 526(a)(4) is in accord with expressions of desire in the legislative history to address "misconduct by attorneys and other professionals," and

"abusive practices by consumer debtors who, for example, knowingly load up with credit card purchases or recklessly obtain cash advances and then file for bankruptcy relief." H.R. Rep. No. 109-31, pt. 1, at 5, 15 (2005) (internal quotation omitted), *as reprinted in* 2005 U.S.C.C.A.N. 88, 92, 101. Milavetz itself argues that a broad construction of § 526(a)(4) "goes beyond" this congressional purpose, and is "absurd," because it would prevent an attorney from advising a client to take actions that might avoid the need for filing bankruptcy altogether. (Brief of Appellee 34). Given our duty to construe an Act of Congress in a manner that eliminates constitutional doubts, there is no need to adopt a construction that one party says is absurd, that the other party says was unintended by Congress, and that sweeps in salutary legal activity that would be a strange target for a statute entitled the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005.

For these reasons, I would reverse the district court's decision declaring unconstitutional the provision codified at 11 U.S.C. § 526(a)(4).

APPENDIX B

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MINNESOTA

No. 05-CV-2626 (JMR/FLN)

MILAVETZ, GALLOP & MILAVETZ P.A.,
ROBERT J. MILAVETZ, BARBARA N.
NEVIN, JOHN DOE, AND MARY DOE

v.

UNITED STATES OF AMERICA

[Dec. 7, 2006]

ORDER

Plaintiffs ask the Court to declare portions of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA") unconstitutional. Defendant, United States of America ("the government") moves to dismiss for failure to state a claim upon which relief can be granted. Defendant's motion is denied; the debt relief agency sections of BAPCPA unconstitutionally impinge on attorneys' First Amendment rights.

I. *Background*

On April 20, 2005, BAPCPA was signed into law, and became effective on October 17, 2005. Among its terms, BAPCPA defines a new category of bankruptcy service

provider called a "debt relief agency." 11 U.S.C. § 101(12A) (2005). The law forbids debt relief agencies from doing certain things, and requires them to do others. This lawsuit challenges a number of these provisions.

BAPCPA bars a debt relief agency from advising a client "to incur more debt in contemplation" of a bankruptcy filing. 11 U.S.C. § 526(a)(4). BAPCPA further requires that debt relief agencies' advertisements declare: "We are a debt relief agency. We help people file for bankruptcy relief under the Bankruptcy Code," or a substantially similar statement. 11 U.S.C. § 528(a)(4), (b)(2).

Plaintiffs are bankruptcy attorneys, their law firm, and two unnamed members of the public. Their attack on the statute is based on the First Amendment to the United States Constitution. They allege BAPCPA's debt relief agency provisions are unconstitutional as applied to them. They, initially, claim BAPCPA's regulation of attorneys' advice violates the First Amendment. Next, they claim BAPCPA's advertising requirements contravene the First Amendment.[1] Ultimately, they contend Congress did not intend the debt relief agency requirements to apply to attorneys. The government moves to dismiss plaintiffs' First Amendment claims pursuant to Rule 12(b)(6) of the Federal Rules of

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[1] In a footnote, the government asks whether plaintiffs have standing to bring these claims, since they are in no danger of immediate harm. The government's query is misplaced; plaintiffs claim BAPCPA's debt relief agency sections both stifle and compel their speech, in violation of the U.S. Constitution. First Amendment jurisprudence makes clear that a claim that a law has a potential chilling effect on speech establishes standing. *Virginia v. Am. Booksellers Ass'n*, 484 U.S. 383, 392 (1988).

Civil Procedure ("Fed. R. Civ. P."). The government's motion is denied.

II. *Discussion*

A. *Motion to Dismiss*

A Rule 12(b)(6) motion to dismiss must be denied unless it appears beyond doubt that the plaintiff can prove no set of facts which would entitle him to relief. *See Murphy v. Lancaster*, 960 F.2d 746, 748 (8th Cir. 1992). In considering such a motion, the motion, the court construes the complaint, and all of its reasonable inferences, most favorably to plaintiff. *Westcott v. City of Omaha*, 901 F.2d 1486, 1488 (8th Cir. 1990).

B. *Unnamed Plaintiffs*

The complaint purports to set out the claims of two unnamed parties: John Doe and Mary Doe. The government denies there is any legal basis for anonymous plaintiffs in this lawsuit. Indeed, Fed. R. Civ. P. 10(a) is explicit: a complaint "shall include the names of all the parties." Notwithstanding Rule 10(a), plaintiffs claim their case falls within a limited realm of cases in which other interests—i.e., privacy and concern about embarrassment—outweigh the public's interest in open disclosure. Plaintiffs are incorrect.

There is a strong presumption against allowing parties to use a pseudonym. *See, e.g.*, *Doe v. Blue Cross & Blue Shield United of Wisconsin*, 112 F.3d 869, 872 (7th Cir. 1997); *Doe v. Frank*, 951 F.2d 320, 323-24 (11th Cir. 1992); *Southern Methodist Univ. Ass'n of Women Law Students v. Wynne & Jaffe*, 599 F.2d 707, 712-13 (5th Cir. 1979). The reasons are obvious and compelling: identification of litigants is recognized as important in a public proceeding. *See Blue Cross,* 112 F.3d at 872. A

party who invokes the judicial powers of the United States invites public scrutiny. "The people have a right to know who is using their courts." *Id.*

Limited exceptions to the party-publicity rule exist. Case law has recognized three factors which, if present, might support anonymity. They have been found when "(1) plaintiffs seeking anonymity were suing to challenge governmental activity; (2) prosecution of the suit compelled plaintiffs to disclose information 'of the utmost intimacy;' and (3) plaintiffs were compelled to admit their intention to engage in illegal conduct, thereby risking criminal prosecution." *Doe v. Stegall,* 653 F.2d 180, 185 (5th Cir. 1981) (quoting *Wynne & Jaffe,* 599 F.2d at 712-13). Although the listed factors are not exhaustive, they provide valuable guidance.

While the first factor is present here, the third is not. Plaintiffs argue their "wish to obtain legal advice from [plaintiff] attorneys . . . about prebankruptcy planning and filing bankruptcy" (1st Am. Compl. ¶ 10) suffices for the second factor. According to the Doe parties, the "financial situations of private citizens [are] clearly a matter of utmost intimacy, especially when they feel the need to seek advice about bankruptcy." (Pl.'s Brief 23).

Certainly, those facing bankruptcy are in financial straits; but that does not resolve the issue. Plaintiffs offer no case law to support their claim that merely seeking bankruptcy or financial advice is the kind of intimate personal information typically protected by the court. Bankruptcy is a public proceeding; the Doe plaintiffs are disclosing no medical information or deeply personal questions surrounding human reproduction or matters of that nature.

The Court finds the bankruptcy-seeking plaintiffs' interest in their financial privacy is outweighed by the public's stronger interest in maintaining open trials. Accordingly, the Doe plaintiffs shall amend their complaint to include their real names within 10 days of the date of this Order, or their claims will be dismissed.

C. *Constitutional Challenges*

1. *Attorney Advice: Section 526(a)(4)*

Plaintiffs claim BAPCPA's § 526(a)(4), titled "[r]estrictions on debt relief agencies," has "a chilling effect upon lawyers," in violation of their First Amendment rights. (1st Am. Compl. ¶ 39.) Section [526(a)(4)] states:

> A debt relief agency shall not . . . advise an assisted person or prospective assisted person to incur more debt in contemplation of such person filing a case under this title or to pay an attorney or bankruptcy petition preparer fee or charge for services performed as part of preparing for or representing a debtor in a case under this title.

11 U.S.C. § 526(a)(4).

The parties disagree as to the standard of review applied to the constitutional analysis of this section. Plaintiffs claim the standard of review for a restriction on lawful and truthful attorney advice is strict scrutiny. The government replies that § 526(a)(4)'s restrictions are merely a species of ethical regulation, invoking the more lenient standard outlined in *Gentile v. State Bar of Nev.*, 501 U.S. 1030 (1991). Under *Gentile*, the Court would balance the First Amendment rights of attorneys against the government's legitimate interest in regulating the activity in question, and then determine whether

the regulations impose "only narrow and necessary limitations on lawyers' speech." *Id.* at 1075. The Court rejects the government's proposed standard.

The "ethical rule" of which the government speaks appears to exist only in its pleadings; the statute discloses no quasi-religious or ethical principle. The government "cannot foreclose the exercise of constitutional rights by mere labels." See *NAACP v. Button*, 371 U.S. 415, 429 (1963). While the section is certainly a rule, nothing in § 526 alludes to ethics. The section is titled "Restrictions on debt relief agencies," and plainly prohibits certain acts. The advice the Section forecloses may be potentially advantageous to creditors, but this does not make it equivalent to ethics either in logic or in law.

When fairly viewed, the Court finds § 526(a)(4) to be a content-based regulation of attorney speech—it restricts attorneys from giving particular information and advice to their clients. Attorneys are forbidden to advise their clients concerning an entire subject—incurring more debt in contemplation of filing for bankruptcy. This is a plain regulation of speech. Beyond this, the forbidden speech trenches on two other important areas of concern.

First, the lawyer's advice to take on certain additional financial obligations in contemplation of bankruptcy may well be in the client's best interest.[2] A law

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[2] For example, it may be in the client's interest to obtain or refinance a home mortgage prior to filing bankruptcy, because one who has declared bankruptcy may well be denied a lower interest rate after the filing. If the client gets a lower rate mortgage, the refinanced mortgage may have smaller payments which could forestall, or even prevent the bankruptcy in the first place. Similar arguments can be made concern-

yer's highest duty is to the client, and the statute's forbidden advice may indeed be helpful to the client. Secondly, this statute does not restrict false statements—arguably implicating some "ethical" precept—it forbids truthful and possibly efficacious advice. If this is the government's view of legal ethics, it is a form of ethics unfamiliar to the Court.

As the United States Supreme Court has explained, "[g]overnment action that stifles speech on account of its message, or that requires the utterance of a particular message favored by the Government, contravenes th[e] essential [First Amendment] right[s]" of private citizens. *Turner Broad. Sys. v. FCC*, 512 U.S. 622, 641 (1994). For this reason, "governmental control over the content of messages expressed by private individuals" is unconstitutional except in narrow circumstances. *Id.*

As the Court finds § 526(a)(4) to be a content-based restriction on protected speech, it is subject to strict scrutiny. *Id.* Such a restriction can only survive if (1) narrowly tailored to achieve (2) a compelling state interest. *United States v. Playboy Entm't Group, Inc.*, 529 U.S. 803, 813 (2000). The Court finds the government has failed to meet its burden on the first point—§ 526(a)(4) is not narrowly tailored.

The government suggests § 526(a)(4) advances two compelling interests. First, it asserts an interest in protecting creditors. According to the government, § 526(a)(4)'s prohibition discourages prospective bankrupts from accumulating debt in a particular fashion,

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ing automobile loans, or incases where a client needs to co-sign undischargeable student loans. *See Hersh v. United States*, 347 B.R. 19, 24 (N.D. Tex. 2006).

thus deterring debtors from "gaming" the means test by improperly enlarging pre-existing debt, thereby diluting the assets of the bankruptcy estate otherwise available to creditors. Second, it claims § 526(a)(4) protects debtors from attorneys who might lead them to abusive practices which could ultimately result in a denial of discharge of debts under § 523(a)(2)(c). Finally, the government argues that § 523(a)(2)(c) protects the integrity of the bankruptcy system.

Even if the Court assumes the asserted interests are compelling, the restriction is not narrowly-tailored. The government claims the section is narrowly tailored because "it does not limit more speech than is necessary to accomplish this purpose." (Def.'s Brief 25.) The government is mistaken.

Attorneys have a First Amendment right—let alone an established professional ethical duty—to advise and zealously represent their clients. *Legal Serv. Corp. v. Velazquez*, 531 U.S. 533, 548-549 (2001). Section 526(a)(4) bars an attorney from advising a client to incur any kind of debt, including legitimate debt, in contemplation of bankruptcy. The lawyer has no duty to assist creditors—who are scarcely without their own resources, and may indeed have contributed to the potential-bankrupt's straits by making credit easy to obtain. The attorney's only duty is to the client, and to the law.

Incurring debt on the eve of bankruptcy can scarcely be considered malum in se. To the contrary, for some individuals incurring further obligations, even those which must be adjusted or set aside in the bankruptcy, may be financially prudent. "For example, there may be instances where it is advisable for a client to obtain a mortgage, to refinance an existing mortgage to obtain a

lower interest rate, or to buy a new car" before filing for bankruptcy. Erwin Chemerinksy, *Constitutional Issues Posed in the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005*, 79 AM. BANKR. L.J. 571, 578 (2005). If a client intends to reaffirm the debt after filing bankruptcy, there is no prejudice to the bankruptcy process. BAPCPA's § 526(a)(4) limitation on speech extends beyond any need to protect the bankruptcy process.[3] A lawyer who represents consumers contemplating bankruptcy bears the duty of zealous representation. Conversely, Congress does not have the power "to effect [a] serious and fundamental restriction on advocacy of attorneys." *See Velazquez*, 531 U.S. at 534. If upheld, this law would prevent lawyers from adequately and competently advising their clients. As such, it unconstitutionally impinges on expressions protected by the First Amendment of the Constitution.[4]

2. *Advertising: Section 528(a)(4), (b)(2)*

Plaintiffs challenge BAPCPA's advertising disclosure requirements, claiming § 528 violates their First Amendment rights. This section requires a denominated class, termed "debt relief agencies," to include

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[3] Even under the more lenient *Gentile* standard, § 526(a)(4) fails. *Gentile's* balancing test allows the law to impose "only narrow and necessary limitations on lawyers' speech." 501 U.S. 1030, 1075 (1991); *see also Hersh*, 347 B.R. at 24-25; *Olsen v. Gonzales*, 350 B.R. 906, 916 (D. Or. 2006); *Zelotes v. Martini*, 2006 WL 3231423 *4 (D. Conn. 2006).

[4] Plaintiffs further claim § 526(a)(4) is unconstitutionally vague and overbroad. The United States Supreme Court has expressed a strong preference for as-applied, as opposed to facial, challenges to the constitutionality of federal laws. *Sabri v. United States*, 541 U.S. 600 (2004). The Court finds this law unconstitutional as applied, and declines to expand its inquiry and consider whether it is also vague and overbroad.

particular, or substantially similar, language in their advertisements. Congress has prescribed that such agencies declare: "We are a debt relief agency. We help people file for bankruptcy relief under the Bankruptcy Code." 11 U.S.C. § 528(a)(4), (b)(2).

Here again, the Court must determine the appropriate standard of review. The choice turns on whether the statute regulates deceptive or truthful advertising. Statutes regulating deceptive commercial speech need only withstand rational basis review. *Zauderer v. Office of Disciplinary Counsel of the S. Ct. of Ohio*, 471 U.S. 626, 651-52 (1985). But restrictions on non-deceptive advertising must employ means that directly advance a substantial government interest. *Cent. Hudson Gas & Elec. Corp. v. Public Service Comm'n of New York*, 447 U.S. 557, 566 (1980).

The government argues that BAPCPA regulates deceptive advertising, citing evidence adduced before Congress showing "some bankruptcy lawyers did not mention in their advertisements that their ability to make 'debts disappear' derived from the use of the bankruptcy process." (Def.'s Brief 28.) Plaintiffs respond that, when Congress imposed these requirements on all advertisements of bankruptcy assistance, it mandated a blunderbuss which strikes truthful, as well as false or deceptive advertising. The Court agrees.

With very few exceptions, any party advertising debt relief services must include § 528's statutory statement. The present lawyer-plaintiffs advertise themselves as bankruptcy attorneys in newspapers, telephone directories, television, radio, and the internet. There is no evidence, however, suggesting their bankruptcy assistance advertisements are deceptive in any regard. Even as-

suming some debt relief agencies advertise an ability to make "debts disappear," there is no showing such a statement is deceptive. Under these circumstances, the Court finds it appropriate to analyze this question by applying intermediate scrutiny. *See Zauderer*, 471 U.S. at 641.

The government may only regulate truthful bankruptcy assistance advertisements if: (1) the regulation directly advances (2) a substantial government interest, and is (3) "narrowly drawn." *Cent. Hudson*, 447 U.S. at 566; *Zauderer*, 471 U.S. at 641. The Court finds that BAPCPA's § 528 advertising requirements fail to directly advance the government's purported substantial interest and are not narrowly drawn.

The government contends advertising, absent the compulsory statements, may mislead the lay community into thinking debts can be erased without payment or filing for bankruptcy. The government claims §§ 528(a)(4) and (b)(2) protect against consumer deception"by alerting [them] that a lawyer may use bankruptcy as a means to help them." (Def.'s Brief 28.) Setting aside the implausibility of anyone actually believing in a magic wand capable of making debt go away, it is most unlikely that the insertion of the statement "We are a debt relief agency, we help people file for bankruptcy relief under the Bankruptcy Code" prevents consumer deception; it may well increase it.

The term "debt relief agency" is simply a legislative contrivance. The public is more likely to be confused by an advertisement containing this Congressionally-invented term than one which advertises the services of a bankruptcy attorney.

Beyond this, however, the term "debt relief agency" is almost all-encompassing. It instantly swallows all persons who engage in"bankruptcy assistance," attorneys and non-attorneys alike. Congress's merger of both attorneys and non-attorneys is, itself, likely to confuse the public. There are many non-trivial differences between an attorney's services to his or her clients, and services non-lawyers are permitted to offer. Unlike those who only restructure debt, or perhaps provide bankruptcy forms, attorneys give legal advice and actually represent debtors in bankruptcy proceedings. The requirement that parties so dissimilarly-placed must use the same mandated disclosure statement is likely to cause consumer confusion. In this respect, § 528 fails to directly advance the government's stated interest in clarifying bankruptcy service advertisements.[5]

Section 528's advertising requirement is also not narrowly drawn. The narrowly drawn standard is "something short of a least-restrictive means standard." *Bd. of Tr. of the State Univ. of New York v. Fox*, 492 U.S. 469, 477 (1989). A narrowly drawn regulation designed to prevent deception "may be no broader than reasonably necessary to prevent the 'perceived evil.'" *In re R.M.J.*, 455 U.S. 191, 203 (1992). Section 528's language not only regulates misleading advertisements—those

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[5] At oral argument, the government's counsel acknowledged areas where the statute is vague. As an example, it appears that the quantum of bankruptcy advice a lawyer offers may require some attorneys to publish the mandated language and others not. The statute makes no distinction between a lawyer who only occasionally has a client facing bankruptcy and those who do so regularly. Quaere: does a 500-person law firm having a single lawyer who regularly does bankruptcy work have to put the disclaimer on every piece of the firm's advertising?

suggesting debts can disappear—it binds all who advertise bankruptcy services. This sweeping regulation goes beyond whatever problem it was designed to address. It broadly regulates absolutely truthful advertisements throughout an entire field of legal practice. The government has failed to show that this restriction on attorneys' commercial speech is justified. As applied to attorneys, this section of BAPCPA fails constitutional scrutiny. Thus, the government cannot prevail on its motion to dismiss.

D. *The "Debt Relief Agency" Definition*

Plaintiffs ask the Court to find attorneys beyond the scope of a BAPCPA "debt relief agency." According to the statute,

> [t]he term 'debt relief agency' means any person who provides any bankruptcy assistance to an assisted person in return for the payment of money or other valuable consideration, or who is a bankruptcy petition preparer under section 110.

11 U.S.C. § 101 (12A). This section, of course, makes no direct reference to either "attorney" or "lawyer." It does include the term "bankruptcy petition preparer," which, by definition, expressly excludes attorneys and their staff. *See* 11 U.S.C. § 110(a)(1) (2006). According to plaintiffs, the omission of any reference to attorneys or lawyers, while including a term which excludes attorneys, shows Congress must have intended to exclude attorneys from the "debt relief agency" definition. They also claim it would be absurd for attorneys to provide a statement telling their clients they have a right to an attorney, and that only attorneys can provide legal ad-

vice as required for debt relief agencies under 11 U.S.C. § 527(b).[6]

The government claims the statute includes attorneys because legal representation is included in "bankruptcy assistance," statutorily defined as:

> any goods or services sold or otherwise provided to an assisted person with the express or implied purpose of providing information, advice, counsel, document preparation, or filing, or attendance at a creditors' meeting or appearing in a case or proceeding on behalf of another or providing legal representation with respect to a case or proceeding under this title.

11 U.S.C. § 101(4A).

At first glance, this language might include attorneys. But the glance is deceiving: the statute contains a rule of construction for the term "debt relief agency." The statute provides that nothing in §§ 526, 527, and 528 —those sections imposing requirements on debt relief agencies—shall:

> be deemed to limit or curtail the authority or ability . . . of a State or subdivision or instrumentality thereof, to determine and enforce qualifications for the practice of law under the laws of that State.

11 U.S.C. § 526(d)(2)(A).

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[6] At least one court has found these arguments persuasive, holding that debtor attorneys are not "debt relief agencies." *In re Attorneys at Law and Debt Relief Agencies*, 332 B.R. 66, 69 (Bankr. S.D. Ga. 2005).

If lawyers are placed within the ambit of § 101 (4A), the placement conflicts with § 526(d)(2)(A). The conflict would exist because states would be deprived of their ability "to determine and enforce qualifications for the practice of law." If BAPCPA's debt relief agency sections apply to attorneys, it means Congress has taken upon itself the authority to determine the advice attorneys can give their clients and what attorney advertisements must say, thereby infringing on the state's traditional role of regulating attorneys. See *Leis v. Flynt*, 439 U.S. 438, 442 (1979) ("Since the founding of the Republic, the licensing and regulation of lawyers has been left exclusively to the States.")

This view is supported by the doctrine of constitutional avoidance. This doctrine counsels that, in construing a statute for ambiguity, the Court must opt for a construction which avoids grave constitutional questions. *Edward J. DeBartolo Corp. v. Florida Gulf Coast Bldg. & Constr. Trades Council*, 485 U.S. 568,575 (1988). The Court perceives a clear ambiguity in this statute—on one hand it appears to regulate a lawyer's practice; on the other, such regulation is specifically reserved to the states. As outlined above, these sections would be unconstitutional if applied to attorneys. For these reasons, the Court finds §§ 526, 527 and 528 do not apply to attorneys.

VI. *Conclusion*

The Court finds BAPCPA sections 526(a)(4) and 528(a)(4), (b)(2) are unconstitutional as applied to attorneys. Moreover, the Court finds the debt relief agency provisions of BAPCPA inapplicable to attorneys. There-

fore, the government's motion to dismiss [Docket No. 13] is denied.

IT IS SO ORDERED.

Dated: December 7th, 2006

/s/ JAMES M. ROSENBAUM
JAMES M. ROSENBAUM
United States Chief District Judge

APPENDIX C

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MINNESOTA

Case Number: 05-cv-2626 JMR/FLN

MILAVETZ, GALLOP & MILAVETZ P.A.,
ROBERT J. MILAVETZ, BARBARA N. NEVIN,
JOHN DOE, AND MARY DOE

v.

UNITED STATES OF AMERICA

[Apr. 19, 2007]

JUDGMENT IN A CIVIL CASE

☐ Jury Verdict. This action came before the Court for a trial by jury. The issues have been tried and the jury has rendered its verdict.

☒ Decision by Court. This action came to trial or hearing before the Court. The issues have been tried or heard and a decision has been rendered.

IT IS ORDERED AND ADJUDGED THAT:

1. Plaintiffs' motion for summary judgment [Docket No. 37] is granted.
2. BAPCPA's Title 11 U.S.C. Sections 526(a)(4) and 528(a)(4) and (b)(2) are declared unconstitutional,

as applied to attorneys in the District of Minnesota.

3. The Court finds that attorneys in the District of Minnesota are excluded from the term "debt relief agency," as defined in 11 U.S.C. § 101(12A); as such, Minnesota attorneys are relieved of any duties relating to BAPCPA-defined debt relief agencies imposed by that statute.

<u>April 19, 2007</u>
Date

<u>RICHARD D. SLETTEN, CLERK</u>

BY:
/s/ <u>KATIE THOMPSON</u>
KATIE THOMPSON, Deputy Clerk

APPENDIX D

UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

No. 07-2405

MILAVETZ, GALLOP & MILAVETZ, P.A., ET AL.,
APPELLEES

v.

UNITED STATES, APPELLANT

COMMERCIAL LAW LEAGUE OF AMERICA,
AMICUS ON BEHALF OF APPELLEE

APPEAL FROM U.S. DISTRICT COURT FOR THE
DISTRICT OF MINNESOTA—MINNEAPOLIS
(0:05-cv-02626-JMR)

ORDER

The petition for rehearing en banc is denied. The petition for rehearing by the panel is also denied.

Judge Riley, Judge Colloton, Judge Gruender, Judge Benton and Judge Shepherd would grant the petition for rehearing en banc.

December 05, 2008

Order Entered at the Direction of the Court:
Clerk, U.S. Court of Appeals, Eighth Circuit.

/s/ Michael E. Gans

APPENDIX E

1. 11 U.S.C. 101 provides in pertinent part:

Definitions

In this title the following definitions shall apply:

* * * * *

(3) The term “assisted person” means any person whose debts consist primarily of consumer debts and the value of whose nonexempt property is less than $150,000.

(4) The term “attorney” means attorney, professional law association, corporation, or partnership, authorized under applicable law to practice law.

(4A) The term “bankruptcy assistance” means any goods or services sold or otherwise provided to an assisted person with the express or implied purpose of providing information, advice, counsel, document preparation, or filing, or attendance at a creditors' meeting or appearing in a case or proceeding on behalf of another or providing legal representation with respect to a case or proceeding under this title.

* * * * *

(12) The term “debt” means liability on a claim.

(12A) The term “debt relief agency” means any person who provides any bankruptcy assistance to an assisted person in return for the payment of money or other valuable consideration, or who is a bank-

ruptcy petition preparer under section 110, but does not include—

(A) any person who is an officer, director, employee, or agent of a person who provides such assistance or of the bankruptcy petition preparer;

(B) a nonprofit organization that is exempt from taxation under section 501(c)(3) of the Internal Revenue Code of 1986;

(C) a creditor of such assisted person, to the extent that the creditor is assisting such assisted person to restructure any debt owed by such assisted person to the creditor;

(D) a depository institution (as defined in section 3 of the Federal Deposit Insurance Act) or any Federal credit union or State credit union (as those terms are defined in section 101of the Federal Credit Union Act), or any affiliate or subsidiary of such depository institution or credit union; or

(E) an author, publisher, distributor, or seller of works subject to copyright protection under title 17, when acting in such capacity.

* * * * *

2. 11 U.S.C. 526 provides:

Restrictions on debt relief agencies

(a) A debt relief agency shall not—

(1) fail to perform any service that such agency informed an assisted person or prospective assisted

person it would provide in connection with a case or proceeding under this title;

(2) make any statement, or counsel or advise any assisted person or prospective assisted person to make a statement in a document filed in a case or proceeding under this title, that is untrue and misleading, or that upon the exercise of reasonable care, should have been known by such agency to be untrue or misleading;

(3) misrepresent to any assisted person or prospective assisted person, directly or indirectly, affirmatively or by material omission, with respect to—

(A) the services that such agency will provide to such person; or

(B) the benefits and risks that may result if such person becomes a debtor in a case under this title; or

(4) advise an assisted person or prospective assisted person to incur more debt in contemplation of such person filing a case under this title or to pay an attorney or bankruptcy petition preparer fee or charge for services performed as part of preparing for or representing a debtor in a case under this title.

(b) Any waiver by any assisted person of any protection or right provided under this section shall not be enforceable against the debtor by any Federal or State court or any other person, but may be enforced against a debt relief agency.

(c)(1) Any contract for bankruptcy assistance between a debt relief agency and an assisted person that does not comply with the material requirements of this

section, section 527, or section 528 shall be void and may not be enforced by any Federal or State court or by any other person, other than such assisted person.

(2) Any debt relief agency shall be liable to an assisted person in the amount of any fees or charges in connection with providing bankruptcy assistance to such person that such debt relief agency has received, for actual damages, and for reasonable attorneys' fees and costs if such agency is found, after notice and a hearing, to have—

> (A) intentionally or negligently failed to comply with any provision of this section, section 527, or section 528 with respect to a case or proceeding under this title for such assisted person;
>
> (B) provided bankruptcy assistance to an assisted person in a case or proceeding under this title that is dismissed or converted to a case under another chapter of this title because of such agency's intentional or negligent failure to file any required document including those specified in section 521; or
>
> (C) intentionally or negligently disregarded the material requirements of this title or the Federal Rules of Bankruptcy Procedure applicable to such agency.

(3) In addition to such other remedies as are provided under State law, whenever the chief law enforcement officer of a State, or an official or agency designated by a State, has reason to believe that any person has violated or is violating this section, the State—

> (A) may bring an action to enjoin such violation;

(B) may bring an action on behalf of its residents to recover the actual damages of assisted persons arising from such violation, including any liability under paragraph (2); and

(C) in the case of any successful action under subparagraph (A) or (B), shall be awarded the costs of the action and reasonable attorneys'fees as determined by the court.

(4) The district courts of the United States for districts located in the State shall have concurrent jurisdiction of any action under subparagraph (A) or (B) of paragraph (3).

(5) Notwithstanding any other provision of Federal law and in addition to any other remedy provided under Federal or State law, if the court, on its own motion or on the motion of the United States trustee or the debtor, finds that a person intentionally violated this section, or engaged in a clear and consistent pattern or practice of violating this section, the court may—

(A) enjoin the violation of such section; or

(B) impose an appropriate civil penalty against such person.

(d) No provision of this section, section 527, or section 528 shall—

(1) annul, alter, affect, or exempt any person subject to such sections from complying with any law of any State except to the extent that such law is inconsistent with those sections, and then only to the extent of the inconsistency; or

(2) be deemed to limit or curtail the authority or ability—

(A) of a State or subdivision or instrumentality thereof, to determine and enforce qualifications for the practice of law under the laws of that State; or

(B) of a Federal court to determine and enforce the qualifications for the practice of law before that court.

BRIEF BANK — "SUMMARY SHEET" *Printed Wed-10/28/09 13:30*

WESTLAW CODES

1. **("TI")** ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	Milavetz, Gallop & Milavetz, P.A., et al. v. United States
2. **("CO")** ***CURRENT*** COURT *[E.g., "CTA9"]*	United States Supreme Court
3. **("CCN")** ***CURRENT*** CASE NO.	No.: 08-1119 and 08-1225
4. **("PCN")** ***PRIOR*** CASE NO. - & COURT *[IF ANY]*	No.: 07-2405 Court: 8th Cir. *(Identify judge & cite, if any)*
5. **("SO")** ***SOURCE***	**U.S. TRUSTEES**
6. **("DA")** ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	Filed: October 21, 2009 Type: Brief for the United States
7. **("AU")** ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*	Malcolm Stewart, William Jay, Mark Freeman, Ramona Elliott, P. Matthew Sutko *(UST/OGC: 202-307-1399/FAX-2397)*
8. **("TO")** ***TOPIC***	**BANKRUPTCY**
9. **("SU")** • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	• (1) Whether an attorney who provides bankruptcy assistance to a consumer debtor in return for valuable consideration, and who does not fall within one of the listed exceptions, is a "debt relief agency" under the Bankruptcy Code. (2) Whether Section 526(a)(4) precludes only advice to incur more debt with a purpose to abuse the bankruptcy system. (3) Whether Section 526(a)(4), construed with due regard for the principle of constitutional avoidance, violates the First Amendment. (4) Whether the advertising-disclosure requirements of Section 528 violate the First Amendment.
10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)	
11. DO YOU RECOMMEND POSTING IN UST BRIEFBANK?	☒ YES ☐ NO ***NAME:*** Linda Figueroa ***DATE:***

Nos. 08-1119 and 08-1225

In the Supreme Court of the United States

MILAVETZ, GALLOP & MILAVETZ, P.A., ET AL.,
PETITIONERS

v.

UNITED STATES OF AMERICA

UNITED STATES OF AMERICA, PETITIONER

v.

MILAVETZ, GALLOP & MILAVETZ, P.A., ET AL.

ON WRITS OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

BRIEF FOR THE UNITED STATES

RAMONA D. ELLIOTT
General Counsel

P. MATTHEW SUTKO
Associate General Counsel

Executive Office for United States Trustees
Washington, D.C. 20530

ELENA KAGAN
Solicitor General
Counsel of Record

TONY WEST
Assistant Attorney General

MALCOLM L. STEWART
Deputy Solicitor General

WILLIAM M. JAY
Assistant to the Solicitor General

MARK B. STERN
MARK R. FREEMAN
Attorneys

Department of Justice
Washington, D.C. 20530-0001
(202) 514-2217

QUESTIONS PRESENTED

In the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23, Congress enacted regulations governing the professional conduct of any "debt relief agency," a term that Congress defined to include "any person who provides any bankruptcy assistance" to a consumer debtor for valuable consideration, with enumerated exceptions. 11 U.S.C. 101(12A). Section 526(a)(4) of Title 11 provides that a "debt relief agency" may not advise a debtor "to incur more debt in contemplation of" filing a bankruptcy petition. Section 528 of Title 11 requires "debt relief agencies" to include certain disclosures in advertisements to the public of bankruptcy-related services. The questions presented are as follows:

1. Whether an attorney who provides bankruptcy assistance to a consumer debtor in return for valuable consideration, and who does not fall within one of the listed exceptions, is a "debt relief agency" under the Bankruptcy Code.
2. Whether Section 526(a)(4) precludes only advice to incur more debt with a purpose to abuse the bankruptcy system.
3. Whether Section 526(a)(4), construed with due regard for the principle of constitutional avoidance, violates the First Amendment.
4. Whether the advertising-disclosure requirements of Section 528 violate the First Amendment.

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In the Supreme Court of the United States

No. 08-1119

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ON WRITS OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

BRIEF FOR THE UNITED STATES

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-28a) is reported at 541 F.3d 785.[1] The opinion of the district court denying the government's motion to dismiss (Pet. App. 29a-44a) is reported at 355 B.R. 758.

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[1] Unless otherwise noted, all references to "Pet. App." are to the appendix to the government's petition in No. 08-1225.

JURISDICTION

The judgment of the court of appeals was entered on September 4, 2008. A petition for rehearing was denied on December 5, 2008 (Pet. App. 47a). The petition for a writ of certiorari in No. 08-1119 was filed on March 5, 2009. On February 20, 2009, Justice Alito extended the government's time within which to file a petition for a writ of certiorari to and including April 6, 2009, and the petition in No. 08-1225 was filed on April 3, 2009. The petitions for writs of certiorari were granted on June 8, 2009. The jurisdiction of this Court rests on 28 U.S.C. 1254(1).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The First Amendment provides, in relevant part, that "Congress shall make no law * * * abridging the freedom of speech." The pertinent statutory provisions are reprinted in the appendix to this brief. App., *infra*, 1a-14a.

STATEMENT

This case involves a pre-enforcement challenge under the First Amendment to provisions of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA or 2005 Act), Pub. L. No. 109-8, 119 Stat. 23. The 2005 Act established certain minimum standards of professional conduct for "debt relief agencies." The district court held that two of those provisions violate the First Amendment and that the statutory term "debt relief agency" does not encompass licensed attorneys. Pet. App. 29a-44a.

The court of appeals reversed in part. The court held that attorneys may be "debt relief agencies" under the

2005 Act, and it upheld the statute's advertising-disclosure requirements. Pet. App. 3a-10a, 15a-21a. By a divided vote, however, the court held that the statutory provision restricting debt relief agencies from advising their clients to take on new debt "in contemplation of" bankruptcy violates the First Amendment. *Id.* at 10a-15a; see *id.* at 22a-28a (Colloton, J., concurring in part and dissenting in part).

1. The 2005 Act was "a comprehensive package of reform measures" designed "to improve bankruptcy law and practice by restoring personal responsibility and integrity in the bankruptcy system and ensure that the system is fair for both debtors and creditors." H.R. Rep. No. 31, 109th Cong., 1st Sess. Pt. 1, at 2 (2005) (*House Report*). Described by the House Committee as "the most comprehensive set of [bankruptcy] reforms in more than 25 years," *id.* at 3, the 2005 Act both modified the substantive standards for bankruptcy relief and adopted new measures intended to curb a variety of abusive practices that Congress concluded had come to pervade the bankruptcy system.

After extensive hearings, Congress determined that misleading and abusive practices by bankruptcy professionals, including attorneys, had become a substantial cause of unnecessary bankruptcy petitions and had sometimes jeopardized debtors' ability to obtain a discharge of their debts. For example, Congress heard evidence that a civil enforcement initiative undertaken by the United States Trustee Program had "consistently identified * * * misconduct by attorneys and other professionals" as among the sources of abuse in the bankruptcy system. *House Report* 5 (citation omitted). Congress responded to that evidence by "strengthening professionalism standards for attorneys and others who assist consumer debtors with their bankruptcy cases." *Id.* at 17.

The 2005 Act added or enhanced a variety of regulations on bankruptcy professionals' conduct. Those regulations are intended to protect the clients and prospective clients of bankruptcy professionals, the creditors of clients who do enter bankruptcy, and the bankruptcy system. The regulations require additional disclosures to clients about their rights and the professional's responsibilities; they protect clients against being overcharged, or charged for services never provided; and they discourage misuse of the bankruptcy system. See, *e.g.*, 11 U.S.C. 110(b)-(h), 526-528, 707(b)(4)(C)-(D).

Many of the regulations apply to "debt relief agenc[ies]" generally. Under the Bankruptcy Code's definition, "any person" becomes a debt relief agency by providing "any bankruptcy assistance" for a fee to a consumer debtor, known as an "assisted person."[2] 11 U.S.C. 101(12A). "Bankruptcy assistance" includes, inter alia, "advice, counsel, document preparation, or filing, or attendance at a creditors' meeting or appearing in a case or proceeding on behalf of another or providing legal representation with respect to a case or proceeding under this title." 11 U.S.C. 101(4A).[3]

Section 526 of Title 11 sets out four basic rules of professional conduct for debt relief agencies, each of which protects clients against specific unethical prac-

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[2] An "assisted person" is "any person whose debts consist primarily of consumer debts and the value of whose nonexempt property is less than" an inflation-adjusted sum, currently $164,250. 11 U.S.C. 101(3); see 11 U.S.C. 104(a); 72 Fed. Reg. 7082 (2007).

[3] The 2005 Act establishes five specific exceptions to the definition of "debt relief agency" for in-house preparers, tax-exempt nonprofits, creditors, banks, and copyright owners. 11 U.S.C. 101(12A)(A)-(E).

tices. Section 526(a)(1) requires debt relief agencies to perform all promised services. Section 526(a)(2) prohibits debt relief agencies from advising assisted persons to make statements that are untrue or misleading in seeking bankruptcy relief. Section 526(a)(3) precludes debt relief agencies from misrepresenting the services they will provide or the benefits and risks attendant to filing for bankruptcy. And Section 526(a)(4), the provision held unconstitutional below, states:

> A debt relief agency shall not * * * advise an assisted person or prospective assisted person to incur more debt in contemplation of such person filing a case under this title or to pay an attorney or bankruptcy petition preparer fee or charge for services performed as part of preparing for or representing a debtor in a case under this title.

11 U.S.C. 526(a)(4).

Section 528 includes several disclosure requirements that apply when a debt relief agency advertises its services to the general public. First, advertisements that promote either "bankruptcy assistance services" or "the benefits of bankruptcy" must make clear that the services or benefits "are with respect to bankruptcy relief under [the Bankruptcy Code]." 11 U.S.C. 528(a)(3); see 11 U.S.C. 528(b)(1) (defining what advertisements are covered). Second, advertisements that promote "assistance with respect to" certain consumer debt or credit problems must disclose that the assistance "may involve" filing for bankruptcy relief. 11 U.S.C. 528(b)(2)(A). Third, advertisements in either of these two categories must also include either a specified disclaimer—"We are a debt relief agency. We help people file for bankruptcy relief under the Bankruptcy

Code."—"or a substantially similar statement." 11 U.S.C. 528(a)(4) and (b)(2)(B).[4]

The principal remedy for violations of Sections 526 and 528 is a civil action by the debtor to recover his "actual damages," including any fees already paid. 11 U.S.C. 526(c)(2). For violations of Section 526, the statute also authorizes state attorneys general to sue for debtors' actual damages or for injunctive relief to prevent violations. 11 U.S.C. 526(c)(3). For intentional or recurring violations of that provision, the bankruptcy court may also impose an injunction or "an appropriate civil penalty," either on its own motion or at the request of the United States Trustee or the debtor. 11 U.S.C. 526(c)(5).

2. Petitioners are a law firm, two of the firm's attorneys, and two prospective clients. J.A. 37a-38a. They filed this action against the United States, seeking a declaratory judgment that the attorney respondents are not obligated to comply with several of the BAPCPA's provisions regulating debt relief agencies' professional conduct, including Section 526(a)(4) and the advertising-disclosure provisions of Section 528. Petitioners contended that licensed attorneys are not "debt relief agenc[ies]" within the meaning of the statute, even if they provide bankruptcy-related advice to debtors. They also argued that, to the extent the statute encompasses licensed attorneys, the challenged provisions violate the First Amendment. Pet. App. 2a.

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[4] Section 528 also requires disclosure to an "assisted person" once a debt relief agency begins to provide that person with "bankruptcy assistance services." The debt relief agency must execute a written contract with the client that explains what services the debt relief agency will provide and what fees the client will have to pay. 11 U.S.C. 528(a)(1) and (2).

The district court denied the government's motion to dismiss, Pet. App. 29a-44a, and then granted summary judgment for petitioners, *id.* at 45a. The district court held that Section 526(a)(4) and the advertising-disclosure requirements of Section 528 violate the First Amendment. *Id.* at 33a-41a. The court further held, apparently in the alternative, that attorneys do not fall within the statutory definition of "debt relief agency." *Id.* at 41a-43a.

3. The government appealed, contending that attorneys unambiguously fall within the definition of "debt relief agency" and that the district court's constitutional holdings were premised on a misreading of the statute. In particular, the government explained that the phrase "in contemplation of" bankruptcy in Section 526(a)(4) has a long historical pedigree in bankruptcy law: in this context, the phrase is properly construed to forbid only advice encouraging a client to take on new debt on the eve of bankruptcy with the intent of abusing the bankruptcy system. The government further contended that, to the extent the term "in contemplation of" is ambiguous, the doctrine of constitutional avoidance supports the government's narrow reading of the term, which avoids the overbreadth that the district court perceived.

4. The court of appeals affirmed in part and reversed in part. The court unanimously held that attorneys may fall within the definition of "debt relief agency," and it reversed the district court's invalidation of the advertising disclosure requirements in Section 528. The court held by a divided vote, however, that Section 526(a)(4) as applied to attorneys violates the First Amendment. See Pet. App. 1a-28a.

a. The court of appeals first concluded that attorneys for consumer debtors may fall within the definition of "debt relief agency." Pet. App. 3a-10a. The court noted that Congress had specifically defined both "debt relief agency" and several terms used in the definition of "debt relief agency." *Id.* at 4a-5a. Those definitions "sweep[] broadly," the court concluded, "and clearly cover[] the legal services provided by attorneys to debtors in bankruptcy unless excluded by another provision." *Id.* at 9a. The court noted that Congress had adopted five specific exceptions to the definition of "debt relief agency," none of which covered petitioners. *Ibid.* The court of appeals also concluded that constitutional-avoidance considerations could not justify petitioners' reading of the term "debt relief agency" because that reading was foreclosed by the statute's plain language. *Id.* at 8a.

b. The court of appeals rejected petitioners' constitutional challenge to Section 528's disclaimer requirements. Pet. App. 15a-21a. The court concluded that, because Section 528 regulates potentially misleading commercial advertising by imposing disclosure requirements, it is not subject to any of the forms of heightened scrutiny that apply to restrictions on commercial speech. *Id.* at 18a (citing *Zauderer* v. *Office of Disciplinary Counsel of the Supreme Court*, 471 U.S. 626, 651 n.14 (1985)). Applying the *Zauderer* standard, the court held that Section 528 is "directed precisely at the problem targeted by Congress: ensuring that persons who advertise bankruptcy-related services to the general public make clear that their services do in fact involve filing for bankruptcy." *Id.* at 19a. The court noted that the statements contained in the required disclaimer are "factually correct" because attorneys subject to the requirement are "debt relief agenc[ies]" as the Code uses that term. *Id.* at 20a. The court of appeals also observed that, because the statute permits the substitution of a "substantially similar" disclaimer, any attorney who does not actually assist with bankruptcy filings can "tailor" the disclosure statement to assuage any concern about its accuracy. *Id.* at 20a n.12.

c. The court of appeals further held, over Judge Colloton's dissent, that Section 526(a)(4) violates the First Amendment. Pet. App. 10a-15a; see *id.* at 22a-28a (Colloton, J., concurring in part and dissenting in part). The court rejected the government's proposed narrowing construction of the statute. The court concluded that, under what the majority described as the only permissible interpretation of the statute's "plain language," Section 526(a)(4) prohibits debt relief agencies from advising consumer clients "to incur *any* additional debt when the assisted person is contemplating bankruptcy." *Id.* at 12a. The court stated that "this prohibition would include advice constituting prudent prebankruptcy planning that is not an attempt to circumvent, abuse, or undermine the bankruptcy laws." *Id.* at 13a.

Based on that broad construction, the court of appeals held that Section 526(a)(4) is unconstitutionally overbroad. Pet. App. 12a-15a. The court explained that advice to take on new debt just before bankruptcy will sometimes be legitimate. As examples, the court observed that "it may be in the assisted person's best interest to refinance a home mortgage in contemplation of bankruptcy to lower the mortgage payments," or to purchase a car to ensure "dependable transportation * * * to and from work." *Id.* at 13a-14a. The court further posited that "[f]actual scenarios other than these few hypothetical situations no doubt exist." *Id.* at 14a. The court concluded that the First Amendment prohibits regulation of such legitimate advice and that Section 526(a)(4) is therefore "unconstitutional as applied to attorneys who provide bankruptcy assistance to assisted persons." *Id.* at 15a.[5]

d. Judge Colloton dissented in relevant part. Pet. App. 22a-28a. He explained that, in his view, "[t]he text, structure, and legislative history of § 526(a)(4) provide adequate support for a narrowing construction," under which "the statute should be construed to prohibit only advice that a client engage in conduct for the purpose of manipulating the bankruptcy system." *Id.* at 25a. Judge Colloton concluded that Section 526(a)(4), so construed, is constitutional. See *id.* at 22a, 25a, 28a.

First, Judge Colloton observed that the phrase "in contemplation of bankruptcy" is a term with a long history and "has been construed * * * to mean actions taken with the intent to abuse the protections of the bankruptcy system." Pet. App. 25a; see *id.* at 25a-26a (collecting authorities). Second, Judge Colloton pointed out that the remedies for a violation of Section 526(a)(4) "emphasize actual damages," and he reasoned that a debtor who follows his attorney's bankruptcy advice is

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[5] The court of appeals did not identify the precise constitutional standard under which petitioners' challenge should be evaluated. Petitioners had argued that strict scrutiny should apply, while the government had contended that Section 526(a)(4) is a reasonable regulation of attorneys' professional conduct that is to be reviewed more deferentially under the standard announced in *Gentile* v. *State Bar*, 501 U.S. 1030, 1071-1076 (1991). The court acknowledged that the government had a "legitimate interest" in prohibiting advice that would assist debtors in abusing the bankruptcy system. Pet. App. 12a. But the court held that, on its reading of Section 526(a)(4), the statute was insufficiently connected to that interest and therefore was unconstitutional under either strict scrutiny or the *Gentile* standard. *Id.* at 12a-13a.

unlikely to be harmed as a result unless he is induced to file "an abusive bankruptcy petition, where the debtor may suffer damages if the petition is dismissed as abusive." *Id.* at 27a (citing 11 U.S.C. 707(b)(1)). Third, he identified legislative history reflecting Congress's desire to address "abusive" practices by bankruptcy professionals and by debtors who "knowingly load up" on debt before filing for bankruptcy. *Id.* at 27a-28a (quoting *House Report* 5, 15). Judge Colloton concluded: "Given our duty to construe an Act of Congress in a manner that eliminates constitutional doubts, there is no need to adopt a construction that [petitioners] say[] is absurd, that the [government] says was unintended by Congress, and that sweeps in salutary legal activity that would be a strange target for a statute entitled the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005." *Id.* at 28a.

5. The court of appeals denied the government's petition for rehearing en banc by a vote of 6-5. See Pet. App. 47a.

SUMMARY OF ARGUMENT

I. Attorneys are not exempt from the definition of "debt relief agency" under the Bankruptcy Code. The definition encompasses "any person" who provides specified services to specified clients, subject to five specific exceptions. None of those exceptions includes attorneys, either expressly or by implication. 11 U.S.C. 101(12A). Attorneys therefore are debt relief agencies if they provide the specified clients with the specified services, known as "bankruptcy assistance." *Ibid.* Indeed, "bankruptcy assistance" is expressly defined to include certain services that can *only* be performed by lawyers, such as providing "legal representation" or "appearing in a [bankruptcy] case" on behalf of a consumer debtor. 11 U.S.C. 101(4A). That language would be surplusage if attorneys were categorically ineligible to be debt relief agencies. And the legislative history confirms that Congress was targeting abusive conduct *by attorneys* in bankruptcy cases.

Petitioners contend, on various theories, that their reading must prevail in the absence of an express reference to "attorneys" in the statute. But the statute's application to attorneys is clear. In light of the broad statutory definition of "debt relief agency" and the unmistakable inclusion of legal services within the scope of "bankruptcy assistance," the absence of the term "attorney" from the definitions is immaterial. When a person provides the services specified, he falls within the coverage of the statute, regardless of whether he possesses a law license. Nor, contrary to petitioners' arguments, does this natural reading of the statute create any absurd results.

In any event, there is no reason to adopt a clear statement rule, as petitioners suggest, in interpreting the term "debt relief agency." Congress's regulation of debt relief agencies does not infringe on any traditional power of the States; federal laws, agencies, and courts (including this Court) have long regulated the conduct of attorneys and other professionals within federal spheres of interest, such as bankruptcy. And the doctrine of constitutional avoidance provides no reason to adopt petitioners' proposed construction of the statute. That construction itself would not fully cure the constitutional problem petitioners perceive, and it would exempt attorneys from a variety of client-protection measures to which there is *no* constitutional objection. The Court therefore should reject petitioners' proposed interpretation even if it finds that the statute does not plainly cover lawyers.

II. Section 526(a)(4) is not unconstitutionally overbroad. The court of appeals' decision to the contrary rested on its view that the statute prohibits advice "to incur any additional debt when the assisted person is contemplating bankruptcy." Pet. App. 12a (emphasis omitted). But the statute does not use the temporal term "when" at all; rather, it uses the phrase "in contemplation of [bankruptcy]," a phrase that has long been read to incorporate an element of intent to abuse the bankruptcy laws. Read in accordance with that long history, Section 526(a)(4) prohibits only advice to take on debt with an intent to abuse the bankruptcy laws, such as advice to charge a vacation, concert tickets, or some similar purchase to a credit card, knowing that the purchaser will enjoy the full benefit of the purchase and then shed most or all of the debt in bankruptcy.

The structure and legislative history of the statute confirm that Congress regulated only *abusive* bankruptcy advice. The problem that Congress sought to combat was the phenomenon of "loading up" on debt with the intent of gaining relief through bankruptcy. That purpose is manifest in the other provisions Congress adopted to limit eligibility for a complete discharge under Chapter 7 of the Bankruptcy Code; indeed, those provisions create incentives to take on more debt to affect the eligibility determination. Section 526(a)(4) is properly read as a reasonable and targeted way of combating those incentives. Surrounding provisions of the statute, which specify other rules of professional conduct and provide remedies for clients injured by the unethical advice, confirm the correctness of this reading.

The court of appeals rejected this construction in a single terse reference to the "plain language" of the statute. Pet. App. 12a. Petitioners likewise insist that Section 526(a)(4) should be read more broadly—unconstitutionally broadly. But petitioners must establish not only that their reading of Section 526(a)(4) is the better one (which they cannot), but that it is the *only* plausible one. In light of the long history of the key phrase that Congress used and the history and structure of the statute, petitioners cannot rebut "the reasonable presumption that Congress did not intend the alternative which raises serious constitutional doubts." *E.g.*, *Hawaii* v. *Office of Hawaiian Affairs*, 129 S. Ct. 1436, 1445 (2009) (citation omitted).

Adopting the correct interpretation of Section 526(a)(4) eliminates the overbreadth that the court of appeals perceived. By narrowly prohibiting attorneys from advising clients to commit acts that are criminal, fraudulent, or (at a minimum) abusive of the federal judicial system, Section 526(a)(4) parallels a long-accepted principle of legal ethics that has been enshrined in state law for decades. This Court has established that attorneys in judicial proceedings may be "subject to ethical restrictions on speech to which an ordinary citizen would not be." *Gentile* v. *State Bar*, 501 U.S. 1030, 1071 (1991). Attorneys representing clients at the bar of a federal bankruptcy court owe a professional obligation to the tribunal not to counsel their clients to take action that directly subverts the bankruptcy system. The First Amendment does not excuse attorneys from that obligation, nor does it prevent Congress from providing federally enforceable remedies for clients harmed by their attorneys' breach of that obligation.

III. The court of appeals correctly upheld the advertising-disclosure requirements of Section 528. Disclosure requirements applied to commercial speech receive more deferential scrutiny than do restrictions on the content of commercial advertising. As this Court has squarely held, a requirement that attorney advertising include specified factual disclosures need only be "reasonably related to the State's interest in preventing deception of consumers." *Zauderer* v. *Office of Disciplinary Counsel of the Supreme Court*, 471 U.S. 626, 651 (1985). Petitioners' reliance on cases involving forced political speech and outright restrictions on truthful commercial speech therefore is unavailing: *Zauderer* sets out the controlling standard here.

The advertising-disclosure requirements readily satisfy that standard. Congress documented the problem it sought to combat: misleading attorney advertisements that offered to provide relief from debt, a halt to foreclosure, and the like, without adequately disclosing that obtaining these forms of relief requires filing for bankruptcy and suffering the attendant consequences. Congress was entitled to determine that such advertisements are misleading unless they properly disclose that the benefits touted entail a bankruptcy filing.

Petitioners contend that the two-sentence disclaimer specified in the statute is misleading and, therefore, unconstitutional. But petitioners principally object to including the phrase "debt relief agency," a statutorily defined term whose natural *and* legal meanings encompass consumer bankruptcy attorneys. Requiring debt relief agencies to identify themselves as such is entirely accurate and proper. Petitioners may well desire to call themselves "attorneys" in their advertising, but nothing in Section 528 precludes them from doing so, or from providing any additional information they wish. Indeed, Congress also specified that debt relief agencies may vary the text of the prescribed disclosure and use any "substantially similar statement." 11 U.S.C. 528(a)(4) and (b)(2)(B). Accordingly, Section 528 is constitutional on its face.

Petitioners also argue, for the first time in this litigation, that *their* advertising is not misleading and does not require any disclaimer. But petitioners' past advertisements are not in the record, nor are their plans for future advertising. This late-raised as-applied challenge therefore provides no basis to disturb the judgment of the court of appeals.

ARGUMENT

I. THE BAPCPA'S "DEBT RELIEF AGENCY" PROVISIONS ENCOMPASS ATTORNEYS AS WELL AS OTHER BANKRUPTCY PROFESSIONALS

Petitioners contend (Br. 12-35) that the BAPCPA's "debt relief agency" regulations do not apply to licensed attorneys. As the court of appeals recognized, that argument is foreclosed by the plain language of the statute. Pet. App. 3a-10a; accord *Hersh* v. *United States ex rel. Mukasey*, 553 F.3d 743, 749-752 (5th Cir. 2008) (same), petition for cert. pending, No. 08-1174 (filed Mar. 18, 2009).

A. Attorneys Who Provide "Legal Representation" Or Other "Bankruptcy Assistance" To Consumer Debtors Are "Debt Relief Agencies"

1. Attorneys who provide paid legal representation to consumer debtors in bankruptcy proceedings are "debt relief agencies" under a straightforward reading of the pertinent statutory definitions. See *Burgess* v.

United States, 128 S. Ct. 1572, 1577 (2008) ("Statutory definitions control the meaning of statutory words . . . in the usual case.") (quoting *Lawson* v. *Suwannee Fruit & S.S. Co.*, 336 U.S. 198, 201 (1949)). Subject to five enumerated exceptions that make no reference to attorneys, Congress defined the term "debt relief agency" to include "any person" who, for a fee, "provides any bankruptcy assistance to an assisted person." 11 U.S.C. 101(12A). "Assisted person[s]" include consumer debtors. 11 U.S.C. 101(4A); see note 2, *supra*. "Bankruptcy assistance" means:

> any goods or services sold or otherwise provided to an assisted person with the express or implied purpose of providing information, *advice*, *counsel*, document preparation, or filing, or attendance at a creditors' meeting or *appearing in a case or proceeding on behalf of another* or *providing legal representation* with respect to a case or proceeding under this title.

11 U.S.C. 101(4A) (emphases added). The term "debt relief agency" thus encompasses "any person" who "advi[ses]," "counsel[s]," "appear[s] in a [bankruptcy] case or proceeding on behalf of," or provides "legal representation with respect to a [bankruptcy] case" to, a consumer debtor in exchange for a fee.

Bankruptcy attorneys fall within that definition when they perform one or more of the specified services for the specified type of client. "[A]ny person" is a capacious term that encompasses any attorney. See *Ali* v. *Federal Bureau of Prisons*, 128 S. Ct. 831, 832 (2008) ("any" is naturally read to have an expansive meaning); 11 U.S.C. 101(41) (broad definition of "person"). And the services defined as bankruptcy assistance are often provided by lawyers. Indeed, because *only* attorneys can provide "legal representation" or "appear[] in a [bankruptcy] case" on behalf of a consumer debtor, see, *e.g.*, 11 U.S.C. 110(e)(2)(A) (bankruptcy petition preparers may not provide legal advice), petitioners' reading of the term "debt relief agency" would render those aspects of the statutory definition superfluous.[6] That alone is a sufficient reason to reject petitioners' construction. See, *e.g.*, *TRW Inc.* v. *Andrews,* 534 U.S. 19, 31 (2001); *Kawaauhau* v. *Geiger*, 523 U.S. 57, 62 (1998).

In light of those unambiguous textual indicia, the absence of the word "attorney" from the definition of "debt relief agency" is immaterial. A debt relief agency is defined by the services it performs and the clients for whom it performs them, and "any person" who performs those services may qualify. See 11 U.S.C. 101(4A) and (12A), 110(a). Analogously, the Fair Debt Collection Practices Act does not specifically refer to lawyers or the practice of law, but it defines a "debt collector" as "any person" who engages in the debt collection busi-

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[6] One amicus brief suggests that the phrase "legal representation" refers to the "unauthorized practice of law" by non-attorneys such as bankruptcy petition preparers. NACBA Br. 34. That is an unnatural reading: a person becomes a "debt relief agency" by providing "legal representation" (or other "bankruptcy assistance") only if he is not already a debt relief agency by virtue of being a bankruptcy petition preparer. See 11 U.S.C. 101(12A). Thus, the reference to "legal representation" (or other "bankruptcy assistance") is relevant only to persons other than bankruptcy petition preparers, such as attorneys. See 11 U.S.C. 110(a)(1) (attorneys are not bankruptcy petition preparers). Moreover, bankruptcy petition preparers are already prohibited from offering "legal advice" or signing documents on behalf of any debtor; those prohibitions, and the bankruptcy court's authority to enforce them, are altogether separate from the "debt relief agency" provisions. See 11 U.S.C. 110(e)(2), (i), (j) and (k).

ness, 15 U.S.C. 1692a(6), and this Court has held that attorneys are debt collectors "whenever they meet the general 'debt collector' definition." *Heintz* v. *Jenkins*, 514 U.S. 291, 295 (1995). Indeed, the Court in *Heintz* held that any reading of the term "debt collector" that would exempt lawyers *per se* was "outside the range of reasonable interpretations of the [statute's] express language." *Id.* at 298. Accord, *e.g.*, *Goldfarb* v. *Virginia State Bar*, 421 U.S. 773, 787-788 (1975) (noting the "heavy presumption against implicit exemptions," and accordingly refusing to construe the Sherman Act to exempt lawyers). To construe the BAPCPA term "debt relief agency" to exclude lawyers would be even more unwarranted, because that term is defined by reference to services some of which *only* lawyers can perform.

2. The BAPCPA's definition of "debt relief agency" is subject to five exceptions, none of which mentions attorneys, and none of which encompasses attorneys as a class. Rather, the exceptions apply to employees of regulated entities, tax-exempt nonprofits, creditors, banks, and copyright owners. See 11 U.S.C. 101(12A)(A)-(E). As the court of appeals observed, Congress's decision to include five carefully tailored exceptions from the definition of "debt relief agency" but not to make an exception for attorneys strongly implies that no such exception was intended. Pet. App. 9a; see *Hersh*, 553 F.3d at 751; accord, *e.g.*, *NLRB* v. *Town & Country Elec., Inc.*, 516 U.S. 85, 90-91 (1995).

Petitioners contend (Br. 19-23) that two of the exemptions *implicitly* suggest that the term "debt relief agency" does not encompass attorneys. Neither exemption can bear the weight petitioners place on it. The exclusion of "any person who is an officer, director, employee, or agent of a person who provides [bankruptcy] assistance," 11 U.S.C. 101(12A)(A), ensures that a regulated attorney's administrative assistant or process server is not separately required to comply with the notice and disclosure provisions of the statute.[7] The exclusion for creditors, which applies only "to the extent that the creditor is assisting such assisted person to restructure any debt owed by such assisted person to the creditor," 11 U.S.C. 101(12A)(C), makes clear that an attorney acting solely in her capacity as a creditor of the debtor (*e.g.*, a divorce lawyer to whom the debtor owes fees) is not required to comply with the debt relief agency provisions of the Act. That exemption says nothing about whether attorneys are covered when they provide bankruptcy assistance.

3. The relevant legislative history confirms the plain meaning of the statutory text. The abuses of the bankruptcy system that Congress sought to address in the 2005 Act included abuses committed by—and at the encouragement of—debtors' professional representatives.

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[7] Petitioners note (Br. 19-20) that the exemption for "an officer, director, employee, or agent" does not exempt a partner; they assert that lawyers often practice in partnerships; and they argue that, if law firms were covered by the "debt relief agency" definition, Congress would necessarily have included "partners" in the list of exempted employees. But the absence of an exemption for partners does not suggest that partnerships are excluded from the term "any person," because principals (such as partners) differ from employees, agents, officers, and directors in relevant respects. A law firm (or other business entity) is *itself* a debt relief agency if its attorneys or other personnel provide the specified services to consumer debtors under the firm's name, and as a matter of partnership law that designation may well have consequences for the partners. It is therefore unsurprising that Congress did not exempt principals who have the title "partner." In any event, petitioners' premise is flawed: law firms are often organized as corporations or other non-partnership entities, and indeed, the petitioner firm is a corporation, not a partnership. J.A. 37a.

The House Report cited a study by the United States Trustee Program that "consistently identified," among the sources of bankruptcy abuse, "misconduct by attorneys and other professionals." *House Report* 5 (quoting Antonia G. Darling & Mark A. Redmiles, *Protecting the Integrity of the System: The Civil Enforcement Initiative*, Am. Bankr. Inst. J., Sept. 2002, at 12 (Darling & Redmiles)). Similarly, in adopting the advertising disclosure requirements in 11 U.S.C. 528, Congress heard evidence of "increasingly aggressive lawyer advertising" that offered to make consumers' "debts disappear," but failed to explain that such relief would require a petition for bankruptcy having significant consequences for the debtor's ability to obtain credit in the future. *Bankruptcy Abuse Prevention and Consumer Protection Act of 2003, and the Need for Bankruptcy Reform: Hearing on H.R. 975 Before the Subcomm. on Commercial and Administrative Law of the House Comm. on the Judiciary*, 108th Cong., 1st Sess. 55 (2003) (*2003 Hearings*) (statement of Dean Sheaffer, National Retail Federation). Congress responded by enacting the debt relief agency provisions of the 2005 Act to "strengthen[] professionalism standards *for attorneys* and others who assist consumer debtors with their bankruptcy cases." *House Report* 17 (emphasis added).

B. Construing The Term "Debt Relief Agency" To Encompass Attorneys Does Not Lead To Absurd Results

Petitioners contend (Br. 24) that treating attorneys as debt relief agencies would lead to "absurd" results. For the most part, the supposed absurdities repackage petitioners' claims of unconstitutionality, see *id.* at 24, 28, and may be rejected for the same reasons, see pp. 27, 28-46, 64-68, *infra*. In addition, however, petitioners argue that an attorney who represents small creditors in bankruptcy cases could be deemed a "debt relief agency" on the theory that a creditor with debts consumer of his own may be an "assisted person." A "debt relief agency" must include in its public advertising the sentence "We help people file for bankruptcy relief under the Bankruptcy Code," or "a substantially similar statement." 11 U.S.C. 528(a)(4). Petitioners contend (Br. 24) that if an attorney represents a client who appears as a creditor in a bankruptcy proceeding but whose own unrelated consumer debts bring the client within the statutory definition of "assisted person," the attorney's public advertising must state that he "help[s] people file for bankruptcy relief," even if the attorney does not actually provide such assistance and the statement is consequently untrue.

The premise of petitioners' argument is mistaken. A creditor in a bankruptcy proceeding is not an "assisted person" within the most natural reading of that statutory term, even if the creditor owes debts of his own. An "assisted person" is "any person whose debts consist primarily of consumer debts and the value of whose nonexempt property is less than" an inflation-adjusted sum, currently $164,250. 11 U.S.C. 101(3); see note 2, *supra*. Nothing in the bankruptcy laws depends on whether a creditor's own debts are "primarily * * * consumer debts," or on the value of a creditor's "nonexempt property." Indeed, the very concept of "exempt" property presupposes a bankruptcy filing by the person whose assets are at issue. See 11 U.S.C. 522(b) (describing the property that "an individual *debtor* may exempt from [the] property of the estate") (emphasis added). The natural inference is that the term "assisted person" is limited to debtors in actual or potential bankruptcy proceedings and does not encompass creditors in such proceedings who happen to owe unrelated debts.[8]

In any event, petitioners do not suggest that the BAPCPA's "debt relief agency" provisions will produce absurd results as applied to petitioners themselves or to bankruptcy lawyers generally—only that the provisions cannot sensibly be applied to bankruptcy attorneys who represent creditors exclusively. And if the term "assisted person" is read to encompass certain creditors in bankruptcy proceedings, construing the term "debt relief agency" to exclude lawyers will not eliminate the anomalous consequences that petitioners identify, because non-attorneys who assist such creditors in bankruptcy cases and advertise their services are also required to make the disclosure mandated by Section 528(a)(4). For those reasons too, the absurdities petitioners purport to fear are best avoided not by reading attorneys out of the term "debt relief agency," but by construing the term "assisted person," in accordance

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[8] Additional evidence in the statute confirms that creditors are not "assisted persons." Section 527, for example, requires debt relief agencies to provide "assisted persons" with information relevant only to debtors, see 11 U.S.C. 527(b), and expressly cross-references provisions applicable only to debtors, see, *e.g.*, 11 U.S.C. 527(a)(1) (instructing debt relief agencies to provide assisted persons with the "notice required under section 342(b)(1)," a provision that applies only to "individual[s]" who "commence[] * * * a case under this title"). Likewise, the written-contract provisions of Section 528 provide that a contract must be signed within five days "after the first date on which such agency provides any bankruptcy assistance services to an assisted person, but *prior to such assisted person's petition under this title being filed*." 11 U.S.C. 528(a)(1) (emphasis added). The legislative history confirms that common-sense understanding. See *House Report* 17 (explaining that Congress enacted the debt-relief-agency provisions of BAPCPA to "strengthen[] professionalism standards for attorneys and others who assist consumer debtors with their bankruptcy cases").

with Congress's evident intent, as limited to debtors in actual or potential bankruptcy proceedings.

C. The Application Of The BAPCPA To Attorney Conduct Does Not Intrude On Any Traditional State Prerogative

Petitioners suggest (Br. 33-34) that construing the term "debt relief agency" to encompass attorneys would "displace" the role of States in an area they have traditionally regulated. Petitioners contend on that basis (Br. 35) that this Court should require a clear statement of intent to cover attorneys, and that the BAPCPA's definition of "debt relief agency" does not contain the requisite clear statement because it "does not even mention the word 'attorney.'" Those arguments are misconceived.

First, construing the term "debt relief agency" to encompass lawyers does not bar the States from regulating attorney conduct performed in connection with actual or potential bankruptcy proceedings. To the contrary, state law that is not inconsistent with the BAPCPA is expressly saved from preemption. 11 U.S.C. 526(d)(1). A statute allowing concurrent regulation of attorney conduct does not raise any concern that might call for a clear-statement rule.

Second, the BAPCPA's regulation of bankruptcy attorneys is of a piece with a long history of federal regulation of lawyers who practice before federal tribunals or in areas of uniquely federal concern. *E.g.*, 11 U.S.C. 105(a) (recognizing bankruptcy courts' authority to "tak[e] any action or mak[e] any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process"); 11 U.S.C. 329 (requiring bankruptcy lawyers to surrender certain unreasonable fees); Fed. R. Bankr. P. 9011(c);

see 28 U.S.C. 1927; Fed. R. Civ. P. 11(c); Fed. R. App. P. 46(c); Sup. Ct. R. 8.1; see also *Goldsmith* v. *United States Bd. of Tax Appeals*, 270 U.S. 117, 121-123 (1926) (upholding an Article I tribunal's authority to admit lawyers and accountants to practice and prescribe qualifications for admission); 15 U.S.C. 7245 (providing for the Securities and Exchange Commission to issue "minimum standards of professional conduct for attorneys appearing and practicing before the Commission"); 31 C.F.R. 10.20 *et seq.* (rules for practice before the Internal Revenue Service); 37 C.F.R. 10.20 *et seq.* (Patent and Trademark Office Code of Professional Responsibility). See generally *Roadway Express, Inc.* v. *Piper*, 447 U.S. 752, 766 (1980) ("The power of a court over members of its bar is at least as great as its authority over litigants."). Federal rules of practice in an area of direct federal interest can even preempt state unauthorized-practice laws, see *Sperry* v. *Florida ex rel. Florida Bar*, 373 U.S. 379, 400 n.43, 403 (1963), a step Congress did not deem necessary here, see 11 U.S.C. 526(d)(2)(A). Bankruptcy is a subject of particular federal concern, see U.S. Const. Art. I, § 8, Cl. 4, and there is nothing improper or unusual in Congress's decision in BAPCPA to regulate attorney conduct that threatens the integrity of the bankruptcy system.

Third, even if a clear-statement requirement applied in this setting, it would be satisfied here. Section 101(4A)'s inclusion of "legal representation" as a service that triggers debt-relief-agency status eliminates any reasonable doubt that attorneys are covered, even though that definitional provision does not contain the term "attorney" or "lawyer." A clear-statement rule is not a magic-words requirement; the requisite clear statement may even come from reading multiple provisions together, so long as the meaning is unambiguous. See *BFP* v. *RTC*, 511 U.S. 531, 546 (1994) ("The Bankruptcy Code can of course override by implication when the implication is unambiguous."); cf. *Kimel* v. *Florida Bd. of Regents*, 528 U.S. 62, 76 (2000).

D. The Canon Of Constitutional Avoidance Provides No Basis For Construing The Term "Debt Relief Agency" To Exclude Attorneys

Petitioners further contend that the Court should construe the term "debt relief agency" to exclude attorneys in order to avoid constitutional difficulties. Petitioners correctly state (Br. 31) the general proposition that the avoidance canon permits—indeed, requires—a court to adopt any permissible construction of a statute that avoids a serious constitutional question. See generally pp. 43-46, *infra*. That principle, however, provides no sound basis for departing from the BAPCPA's explicit definition of "debt relief agency."

First, by referring to "legal representation" and other services specific to attorneys, Congress has foreclosed petitioners' purported saving construction, which would render those terms superfluous. See pp. 17-18, *supra*. The avoidance canon is a tool for choosing among permissible constructions; it is not a basis for adopting a construction that the statute unambiguously precludes. See, *e.g.*, *HUD* v. *Rucker*, 535 U.S. 125, 134-135 (2002); *Miller* v. *French*, 530 U.S. 327, 341 (2000). The text of the statute and its "legislative history and purpose," *CFTC* v. *Schor*, 478 U.S. 833, 841 (1986), make clear that the term "debt relief agency" encompasses lawyers who perform the relevant bankruptcy-related services.

Second, construing the term to exclude attorneys would not avoid the constitutional questions. Petitioners' constitutional challenges go to the statute's substantive requirements, not directly to the inclusion of attorneys. On petitioners' theory, for example, Section 528(b)(2) is unconstitutional as applied to bankruptcy petition preparers as well, because "no person" would voluntarily refer to himself as a "debt relief agency" in his advertising. Pet. Br. 88. Adopting petitioners' reading of "debt relief agency" therefore would not avoid the constitutional questions that petitioners identify; it would postpone them only until a non-attorney plaintiff filed a similar suit.

Third, petitioners' construction would undermine the efficacy of other statutory provisions whose constitutionality is not in question. See, *e.g.*, 11 U.S.C. 526(a)(1) (debt relief agencies may not fail to perform services they promised to undertake); 11 U.S.C. 527(a)(2) (debt relief agencies must provide their clients with certain admonitions about the requirements of the bankruptcy process). Application of those requirements to attorneys raises no serious constitutional concern. But petitioners' interpretation of the 2005 Act would make all BAPCPA regulation of "debt relief agencies" inapplicable to lawyers. That would disserve Congress's intent to establish "professionalism standards *for attorneys* and others who assist consumer debtors with their bankruptcy cases." *House Report* 17 (emphasis added).

II. SECTION 526(a)(4) IS NOT UNCONSTITUTIONALLY OVERBROAD

The court of appeals erred in holding that Section 526(a)(4) violates the First Amendment. The court interpreted Section 526(a)(4) to prohibit attorneys from advising debtors to incur "any" additional debt prior to bankruptcy. Pet. App. 13a. In the court's view, "this prohibition would include advice constituting prudent prebankruptcy planning that is not an attempt to circumvent, abuse, or undermine the bankruptcy laws." *Ibid.* In so holding, the court rejected the government's proposed narrowing construction of Section 526(a)(4) in a single sentence, asserting that the statute's "plain language" precludes any construction other than an unconstitutionally overbroad one. *Id.* at 12a.

Both the court's statutory premise and its constitutional conclusion are flawed. "The first step in overbreadth analysis is to construe the challenged statute; it is impossible to determine whether a statute reaches too far without first knowing what the statute covers." *United States* v. *Williams*, 128 S. Ct. 1830, 1838 (2008). As the text, structure, and purposes of Section 526(a)(4) demonstrate, Congress forbade only advice to incur new debt for the purpose of abusing the bankruptcy system or defrauding creditors. The First Amendment does not prevent Congress from regulating the professional conduct of bankruptcy attorneys in this manner. Because Section 526(a)(4) may reasonably be read in a manner that preserves its constitutional validity, the judgment of the court of appeals should be reversed.

A. Section 526(a)(4) Regulates Advice To Incur New Debt For The Purpose Of Abusing The Bankruptcy Code Or Defrauding Creditors

1. The court of appeals ignored the historical meaning of the phrase "in contemplation of bankruptcy"

a. The court of appeals concluded that Section 526(a)(4) "broadly prohibits a debt relief agency from advising an assisted person (or prospective assisted person) to incur any additional debt when the assisted person is contemplating bankruptcy." Pet. App. 12a (emphasis omitted). Section 526(a)(4), however, does not use the temporal language "*when* the assisted person is contemplating bankruptcy." Rather, the statute forbids attorneys from advising clients "to incur more debt *in contemplation of* [bankruptcy]." 11 U.S.C. 526(a)(4) (emphasis added). As Judge Colloton observed, "the phrase 'in contemplation of' has been construed in the bankruptcy context to mean actions taken with the intent to abuse the protections of the bankruptcy system." Pet. App. 25a; see *Hersh*, 553 F.3d at 758 (Congress's use of the phrase "in contemplation of" bankruptcy "suggests that the statute is directed at situations in which a debtor intends to abuse the bankruptcy system").

Black's Law Dictionary, for example, defines "contemplation of bankruptcy" as "[t]he thought of declaring bankruptcy because of the inability to continue current financial operations, *often coupled with action designed to thwart the distribution of assets in a bankruptcy proceeding*." *Black's Law Dictionary* 336 (8th ed. 2004) (emphasis added). That understanding of the term goes back more than a century and a half, to both American and English authorities examining whether particular transfers made just before bankruptcy were in fact made "in contemplation of bankruptcy." See *Black's Law Dictionary* 257 (2d ed. 1910) (citing cases). Those authorities read the phrase as incorporating an element of intent to frustrate the bankruptcy law, not simply an awareness that a bankruptcy was impending.

Members of Congress have used the term "in contemplation of bankruptcy" in the same manner. See, *e.g.*, S. Rep. No. 65, 98th Cong., 1st Sess. 9 (1983) (*1983*

Senate Report) (describing the problem of "[e]xcessive debts incurred within a short period prior to the filing of the petition" as " 'loading up' in contemplation of bankruptcy"); *ibid.* ("In many instances, the debtor will go on a credit buying spree in contemplation of bankruptcy at a time when the debtor is, in fact, insolvent."); *Report of the Commission on the Bankruptcy Laws of the United States*, H.R. Doc. No. 137, 93d Cong., 1st Sess. Pt. I, at 11 (1973) (*Bankruptcy Commission Report*) ("[T]he most serious abuse of consumer bankruptcy is the number of instances in which individuals have purchased a sizable quantity of goods and services on credit on the eve of bankruptcy in contemplation of obtaining a discharge.").

b. Of the cases treating "in contemplation of bankruptcy" as incorporating an element of abusive purpose, most have involved preferential transfers—*i.e.*, payments made on the eve of bankruptcy to one or more favored creditors. Such transfers are generally contrary to the bankruptcy-law principle that all similarly situated creditors should share proportionately in the bankrupt's remaining assets. See, *e.g.*, 11 U.S.C. 547(b). Some early bankruptcy statutes in this country and in England provided that transfers "in contemplation of bankruptcy" were void. Interpreting those statutes, several courts held that they required proof of intent to violate the bankruptcy laws' framework for protecting creditors—*i.e.,* an "intention of giving a preference in contemplation of bankruptcy." *Jones* v. *Howland*, 49 Mass. (8 Met.) 377, 386 (1844); accord *In re Pearce*, 19 F. Cas. 50, 53 (D. Vt. 1843) (No. 10,873) (concluding that an act was done "in contemplation of bankruptcy" if a person did it "in anticipation of breaking or failing in his business, of committing an act of bankruptcy, or of being declared bankrupt at his own instance, on the ground of inability to pay his debts, *and intending to defeat the general distribution of effects, which takes place under a proceeding in bankruptcy*.") (emphasis added); see also *Paulding* v. *Chrome Steel Co.*, 94 N.Y. 334, 338, 340-341 (1894) (interpreting state law that voided transfers "in contemplation of the insolvency of [the] company").

As the court explained in *Jones*, the indispensable element under those statutes was the debtor's "design" or "view to give [the transferee] a preference over the general creditors." 49 Mass. (8 Met.) at 385, 386. The court drew on English decisions establishing that principle. See *id.* at 384 (construing "'the meaning of those words' (in contemplation of bankruptcy)" as requiring an "'intent to defeat the general distribution of effects which takes place under a commission of bankrupt'") (quoting *Morgan* v. *Brundrett*, 5 Barn. & Ad. 289, 296, 110 Eng. Rep. 798, 801 (K.B. 1833) (Parke, J.)); *id.* at 385 (an act made in contemplation of bankruptcy "must be intended in fraud of the bankrupt laws") (quoting *Fidgeon* v. *Sharpe*, 5 Taunt. 539, 545-546, 128 Eng. Rep. 800, 802-803 (C.P. 1814) (Gibbs, C.J.)).

In many of the above cases, the debtor had made a payment to a favored creditor on the eve of bankruptcy, and the question was whether he had done so with the abusive purpose of preventing the equal distribution of assets that the bankruptcy system seeks to achieve. Section 526(a)(4), conversely, is directed at the amassment of additional debt (rather than the distribution of the debtor's existing assets) on the eve of bankruptcy. In both instances, the debtor intends to disfavor a subset of creditors by taking advantage of the bankruptcy system.[9]

c. In light of that history, Congress's use of the phrase "in contemplation of [bankruptcy]" suggests a focus on the accumulation of debt with intent to abuse the bankruptcy system or defeat the bankruptcy laws. For example, advising a debtor to obtain unsecured credit on the eve of bankruptcy and then to dissipate it on purchases (*e.g.*, a vacation or lavish banquet) that do not become part of the bankruptcy estate, knowing that the bankruptcy discharge will allow her to avoid repayment of the debt, is an abuse of the bankruptcy system.

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[9] Petitioners assert (Br. 60-61) that this Court gave a different reading to the phrase "in contemplation of bankruptcy" in *Conrad, Rubin & Lesser* v. *Pender*, 289 U.S. 472 (1933), but in fact, that case, too, involved a statute intended to combat abuse of the bankruptcy system, and the Court interpreted the statute in accord with that purpose. Congress had granted bankruptcy courts the authority to reexamine transfers of property made to a debtor's attorney "in contemplation of the filing of a petition," and to direct that any "excess" payment be returned to the estate for the benefit of creditors—a means of combating the same sort of preferential conveyances as in the cases discussed above. 11 U.S.C. 96(d) (1928). The debtor's attorney objected to turning over an excessive eve-of-bankruptcy payment, and the only question before the Court was whether, "as [a] matter of law," the payment was precluded from being "in contemplation of bankruptcy" because the debtor was pursuing other options in addition to bankruptcy. 289 U.S. at 478-479. The Court saw no such limitation and confirmed the factual finding that the debtor had been contemplating bankruptcy when it had made the excessive payment to its attorneys. See *ibid.* Thus, even if the Court could be said to have construed the statutory term comprehensively, rather than merely to have rejected artificial limitations on it, its holding is consistent with the discussion above, because the Court sustained recouping the payment as abusive. Moreover, in that case the Court did not construe the statute in light of the doctrine of constitutional avoidance or hold that its construction was the only reasonable one.

Cf. *Attorney Grievance Comm'n* v. *Culver*, 849 A.2d 423, 443-444 (Md. 2004) (attorney violated state ethics rules by urging a client to obtain new credit cards and new cash advances with the intent of discharging the debt in bankruptcy). Similarly, advising a debtor to take on additional debt as a way of circumventing the Bankruptcy Code's means testing mechanism is an attempt to defeat the bankruptcy laws. As discussed more fully below, eligibility for a Chapter 7 discharge often turns on a means test that examines the amount by which the debtor's income exceeds his statutorily allowed expenses, including expenses for secured debt. See pp. 35-37, *infra*. If a client is presumed ineligible under this means test, an unscrupulous attorney who advises the client to take on additional debt as a way of becoming eligible for a complete discharge under Chapter 7 is abusing the bankruptcy system. Section 526(a)(4) prohibits an attorney or other debt relief agency from advising debtors to engage in such manipulative conduct.

2. The legislative history of Section 526(a)(4), and its place in the larger statutory scheme, confirm that it targets abusive practices and does not broadly encompass all advice to incur new debt at a time when bankruptcy is imminent

a. Congress has long been aware that the relief afforded by the bankruptcy laws creates a perverse incentive for debtors to amass additional debt with the expectation of obtaining a discharge. Congress has also recognized that this practice poses a fundamental threat to the Bankruptcy Code's twin goals of affording debtors a fresh start while providing an orderly and equitable system of resolving creditors' claims.

As early as 1973, Congress was informed that "the most serious abuse of consumer bankruptcy is the number of instances in which individuals have purchased a sizable quantity of goods and services on credit on the eve of bankruptcy in contemplation of obtaining a discharge." *Bankruptcy Commission Report* 11. A decade later, Congress enacted 11 U.S.C. 523(a)(2)(C) (1988), which created a presumption that certain eve-of-bankruptcy debts are not dischargeable. The accompanying Senate Report emphasized that "[e]xcessive debts incurred within a short period prior to the filing of the petition present a special problem: that of 'loading up' in contemplation of bankruptcy." *1983 Senate Report* 9. The report explained that "[a] debtor planning [to] file a petition with the bankruptcy court has a strong economic incentive to incur dischargeable debts for either consumable goods or exempt property," noting that "[i]n many instances, the debtor will go on a credit buying spree in contemplation of bankruptcy at a time when the debtor is, in fact, insolvent." *Ibid.* As the report concluded, "[n]ot only does this result in direct losses for the creditors that are the victims of the spree, but it also creates a higher absolute level of debt so that all creditors receive less in liquidation. During this period of insolvency preceding the filing of the petition, creditors would not extend credit if they knew the true facts." *Ibid.*

Congress has enacted a number of protections against eve-of-bankruptcy attempts to abuse the system's protections. Even before the 2005 Act, Congress authorized bankruptcy courts to dismiss a petition for "substantial abuse," 11 U.S.C. 707(b) (2000), which could include the debtor's purposeful accumulation of debt in contemplation of bankruptcy. *E.g.*, *Price* v. *United*

States Tr. (In re Price), 353 F.3d 1135, 1139-1140 (9th Cir. 2004). Congress also precluded debtors from obtaining a discharge for debts arising from the fraudulent acquisition of money or credit, 11 U.S.C. 523(a)(2)(A) (2000), and as noted above, it provided that certain categories of debts are presumed nondischargeable if they are incurred on the eve of bankruptcy, 11 U.S.C. 523(a)(2)(C) (2000).

b. When Congress enacted the BAPCPA in 2005, the House Committee expressed concern that those earlier measures had not adequately restricted the ability of debtors to "knowingly load up with credit card purchases or recklessly obtain cash advances and then file for bankruptcy relief." *House Report* 15. Accordingly, Congress strengthened each of the aforementioned protections against bankruptcy abuse. See, *e.g.*, BAPCPA § 310, 119 Stat. 84 (11 U.S.C. 523(a)(2)(C)). In particular, Congress greatly expanded the bankruptcy courts' authority to dismiss petitions or deny relief for "abuse" of the bankruptcy system, including in cases in which debtors purposefully incur additional debt in contemplation of filing a petition. See BAPCPA § 102, 119 Stat. 27 (11 U.S. 707(b)); *House Report* 48-49. Among other reforms, Congress permitted dismissal of a petition based on a less stringent showing of abuse, see § 102(a)(2)(B)(i)(III), 119 Stat. 27 (11 U.S.C. 707(b)(1)); authorized "any party in interest" to file a motion to dismiss for abuse (except in some cases involving lower-income debtors), see 11 U.S.C. 707(b)(1) and (6); and repealed the pre-existing presumption in favor of granting the relief sought by the debtor, see 11 U.S.C. 707(b) (2000). See generally *House Report* 49.

Congress also made another significant change that underscored the need for direct regulation of attorneys who practice in the federal bankruptcy system. The "principal consumer bankruptcy reform" in the 2005 Act was the adoption of a "means testing" mechanism intended to ensure that debtors who have the ability to repay at least some of their debts will do so, through a structured repayment plan entered under Chapter 13 of the Bankruptcy Code, instead of obtaining a complete discharge under Chapter 7. *House Report* 48; see *id.* at 2 (describing means testing as the "heart" of the 2005 Act's reform provisions). See generally 11 U.S.C. 109(b) and (e) (eligibility for Chapter 7 and Chapter 13).

Under the means test, a debtor's petition for complete relief under Chapter 7 is presumed to be abusive if the debtor's current monthly income exceeds his statutorily allowed expenses, including payments for secured debt, by more than a prescribed amount. See 11 U.S.C. 707(b)(2)(A)(i) and (iii).[10] If the court finds a petition to be abusive under this standard, it can dismiss the debtor's case or, with the debtor's consent, convert it to Chapter 13, which involves a repayment plan. 11 U.S.C. 707(b)(1). The means test, however, exacerbates the incentive for debtors to manipulate the system by "loading up" on certain debt in contemplation of filing, because payments on secured debts that qualify under Section 707(b)(2)(A)(iii) offset the debtor's monthly income under the formula. Increasing the amount of such payments may therefore reduce the difference between the debtor's income and his allowable expenses, and thus

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[10] If the presumption does not apply, or if it is rebutted, the petition may still be dismissed for abuse: in those circumstances, the 2005 Act directed that bankruptcy courts consider "whether the debtor filed the petition in bad faith" and whether "the totality of the circumstances * * * of the debtor's financial situation demonstrates abuse." 11 U.S.C. 707(b)(3).

allow the debtor to remain eligible for a complete and immediate discharge of unsecured debt under Chapter 7.

Congress was accordingly concerned that the introduction of the means test would give attorneys an incentive to counsel their clients to take on additional debt before filing for bankruptcy. As one bankruptcy judge testified, "[t]he more debt that is incurred prior to filing, the more likely the debtor will qualify for chapter 7." *Bankruptcy Reform Act of 1998: Hearing on H.R. 3150 Before the Subcomm. on Commercial and Administrative Law of the House Comm. on the Judiciary*, 105th Cong., 2d Sess. Pt. I, at 25 (1998) (*1998 Hearings*) (statement of Judge Randall J. Newsome). Thus, the bankruptcy judge testified that, "[p]erverse as it may seem, I can envision debtor's counsel advising their clients to buy the most expensive car that someone will sell them, and sign on to the biggest payment they can afford (at least until the bankruptcy is filed) as a way of increasing their deductions under [the means test]." *Ibid.*; see also *Bankruptcy Reform Act of 1999: Hearing on H.R. 833 Before the Subcomm. on Commercial and Administrative Law of the House Comm. on the Judiciary*, 106th Cong., 1st Sess. Pt. II, at 30 (1999) (*1999 Hearings*) (statement of Judge William Brown). And as discussed above, see p. 21, *supra*, Congress credited evidence compiled by the United States Trustee Program that "consistently identified," among the sources of bankruptcy abuse, "misconduct by attorneys and other professionals [and] problems associated with bankruptcy petition preparers." *House Report* 5 (quoting Darling & Redmiles 12).

c. Congress responded to these concerns by "strengthening professionalism standards for attorneys and others who assist consumer debtors with their bankruptcy cases" in return for a fee. *House Report* 17. Under the amended provisions of the Code, an attorney who represents a consumer debtor in filing a bankruptcy petition must make her own reasonable investigation into the circumstances giving rise to the debtor's petition, including a specific inquiry into the veracity of the debtor's debt and asset schedules. See 11 U.S.C. 707(b)(4)(C)-(D). By signing the petition, the attorney personally certifies that the debtor's petition "is well grounded in fact," 11 U.S.C. 707(b)(4)(C)(ii)(I); that the attorney has "no knowledge * * * that the information in the schedules filed with such petition is incorrect," 11 U.S.C. 707(b)(4)(D); and that the debtor's petition "does not constitute an abuse" under Section 707(b), 11 U.S.C. 707(b)(4)(C)(ii)(II). Congress thus effectively required bankruptcy attorneys to warrant that their clients' prepetition conduct and financial circumstances—including any assumption of debt in contemplation of bankruptcy—do not provide grounds for dismissal of the petition as an abuse of the bankruptcy system.

As the foregoing discussion demonstrates, Congress enacted the BAPCPA to protect creditors and the bankruptcy system from abusive eve-of-bankruptcy conduct. That overall statutory focus reinforces the conclusion that the phrase "in contemplation of [bankruptcy]" in Section 526(a)(4) should be construed, in accordance with its historically accepted meaning, as limited to advice that debtors incur additional debt to abuse the bankruptcy system or defeat the administration of the bankruptcy laws. See *Davis* v. *Michigan Dep't of the Treasury*, 489 U.S. 803, 809 (1989) ("It is a fundamental canon of statutory construction that the words of a statute must be read in their context and with a view to their place in the overall statutory scheme.").

d. Section 526(a)(4) is one of four subsections of Section 526(a). The other three subsections establish rules of professional conduct that are clearly designed to protect debtors from abusive practices by their attorneys and other debt relief agencies. See 11 U.S.C. 526(a)(1) (requiring debt relief agencies to perform all promised services); 11 U.S.C. 526(a)(2) (prohibiting debt relief agencies from advising debtors to make false or misleading statements to obtain bankruptcy relief); 11 U.S.C. 526(a)(3) (prohibiting debt relief agencies from misrepresenting to debtors the costs or benefits of bankruptcy). The placement of Section 526(a)(4) as the fourth item in this list strongly implies that Congress likewise intended that provision to target abusive conduct by debt relief agencies.[11]

The BAPCPA's remedial provisions similarly belie petitioners' contention that Section 526(a)(4) prohibits debt relief agencies from advising debtors to incur additional debt in circumstances where such conduct would be lawful and prudent. As the Fifth Circuit observed, the principal remedy for a violation of Section 526(a)(4) is a suit against the attorney to recover the debtor's "actual damages," as well as restitution of any fees paid by the debtor. *Hersh*, 553 F.3d at 759-760 (citing 11 U.S.C. 526(c)). "Congress's emphasis on actual damages for violations of section 526(a)(4) strongly suggests that Congress viewed that section as aimed at advice to debtors which if followed would have a significant risk of

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[11] Similarly, Section 526(c) establishes a malpractice remedy against any debt relief agency whose "intentional or negligent failure to file any required document" causes the client to suffer dismissal or conversion of her bankruptcy case. 11 U.S.C. 526(c)(2)(B).

harming the debtor." *Id.* at 760. By contrast, "legal and appropriate advice that would be protected by the First Amendment, yet prohibited by a broad reading of § 526(a)(4), should cause no damage at all." Pet. App. 27a (Colloton, J., concurring in part and dissenting in part). "The remedial focus of § 526 thus bolsters the proposition that § 526(a)(4) was aimed only at advice given by a debt relief agency that is designed to abuse the bankruptcy process." *Ibid.*[12]

3. A federal rule of professional conduct in this setting serves an important function

Amici NACBA et al. assert (Br. 18-20) that reading Section 526(a)(4) as an ethical rule of this nature would render the provision "superfluous," because the Bankruptcy Code already penalizes debtors when they engage in abusive bankruptcy conduct and attorneys are already subject to state-law ethical obligations. That reasoning is flawed.

To be sure, the client who takes the attorney's unethical advice may well suffer adverse consequences under bankruptcy law, including having her petition dismissed. 11 U.S.C. 707(b)(2) and (3). Congress determined, however, that when such a consequence results from an attorney's misconduct, remedies should lie against the attorney—including compensation for the client. See 11 U.S.C. 526(c)(2)(A). Invalidation of Section 526(a)(4)

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[12] Amici NACBA et al. observe (Br. 22) that Section 526(c)(3) permits not only recovery of actual damages, but also disgorgement of fees, when a client can establish that a debt relief agency has "intentionally or negligently failed to comply with any provision of [Section 526]." But even though actual damages are not required in every case, Section 526's emphasis on private enforcement of the statute, by the clients themselves, serves to confirm that Congress expected that violations would harm clients.

would render that remedy unavailable with respect to a significant category of improper attorney advice.

Although an attorney who engages in the conduct that Section 526(a)(4) prohibits may be subject to discipline by a state bar, providing a federal remedy under the Bankruptcy Code serves important purposes. First, the Code creates a uniform nationwide standard, appropriate to bankruptcy practice. Second, the Code gives a client a private right of action against an unethical attorney who has violated Section 526(a)(4), and it encourages such actions in the public interest by providing for fee-shifting. 11 U.S.C. 526(c)(2). State bar rules rarely if ever are privately enforceable. Third, the Code permits the federal court to enjoin an attorney from violating Section 526 again in any State or district, 11 U.S.C. 526(c)(3)(A) and (5)(A), whereas an unethical practitioner who has been sanctioned under the law of one jurisdiction may continue to provide unethical advice in another. Indeed, a practitioner in a particular bankruptcy court may not even be licensed by that State's bar. See, *e.g.*, *Rittenhouse* v. *Delta Home Improvement, Inc. (In re Desilets)*, 291 F.3d 925, 930-931 (6th Cir. 2002).

4. Section 526(a)(4) does not cover petitioners' examples of appropriate debt counseling or the provision of information concerning a client's legal options

For the reasons set forth above, Section 526(a)(4) does not cover the hypothetical scenarios that troubled the court of appeals. See Pet. App. 13a-14a (postulating two situations in which "it would likely be in the assisted person's, and even the creditors', best interest for the assisted person to incur additional debt" before bankruptcy, and speculating that "[f]actual scenarios other than these few hypothetical situations no doubt exist").

Contrary to the court's interpretation, an attorney would be free to advise a client to refinance her home mortgage at a lower rate to prevent bankruptcy, provided all appropriate disclosures were made to the lender.[13] See *id.* at 13a. Likewise, an attorney could lawfully advise a client to incur "additional secured debt" to purchase a reliable automobile and thereby ensure her ability to get to work, assuming again that appropriate disclosures were made. See *id.* at 14a. In neither case would the attorney be advising the debtor to incur unnecessary debt for the purpose of abusing the bankruptcy system. See *Hersh*, 553 F.3d at 761. The similar examples cited by petitioners (Br. 48-53) are outside the scope of the statute for the same reason.

Petitioners also suggest (Br. 41) that Section 526(a)(4) unconstitutionally prohibits attorneys from "participat[ing] in a discussion with the client weighing the pros and cons of a client's pending decision to incur more debt." That contention reflects a misreading of the statutory text, even assuming it refers only to discussions of "loading up" on debt in contemplation of bankruptcy. Section 526(a)(4) does not bar discussions *about* incurring new debt (however abusive the transaction might be), but only affirmative advice "*to incur* more debt in contemplation of" filing a petition for bankruptcy. 11 U.S.C. 526(a)(4) (emphasis added).[14]

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[13] The court of appeals did not explain its apparent assumption that refinancing an existing debt—that is, exchanging one loan for another with the same principal balance but a different interest rate or repayment period—would constitute incurring "more debt" within the meaning of Section 526(a)(4).

[14] The statute unambiguously requires affirmative encouragement to incur more debt, although that encouragement might be communicated in a variety of ways (both direct and indirect).

Rules governing legal practice commonly distinguish between discussion of options and affirmative advice or encouragement. For example, while the ABA Model Rules of Professional Conduct provide that "[a] lawyer shall not counsel a client to engage, or assist a client, in conduct that the lawyer knows is criminal or fraudulent," the same rule states that "a lawyer may discuss the legal consequences of any proposed course of conduct with a client and may counsel or assist a client to make a good faith effort to determine the validity, scope, meaning or application of the law." Model Rules of Prof'l Conduct R. 1.2(d). The commentary to Model Rule 1.2 underscores the point: "There is a critical distinction between presenting an analysis of legal aspects of questionable conduct and recommending the means by which a crime or fraud might be committed with impunity." *Id.* R. 1.2, cmt. 9. Section 526(a)(4)'s use of the phrase "advise * * * *to incur* more debt" captures the same distinction between discussion and affirmative encouragement. Cf. *Webster's Third New International Dictionary* 32 (1993) (defining "advise" to mean, *inter alia*, "counsel" or "recommend").

B. The Court of Appeals Disregarded Basic Principles Of Constitutional Avoidance

To the extent that the proper interpretation of Section 526(a)(4) is open to question, the court of appeals was not justified in adopting the broadest possible interpretation of the provision and then declaring it unconstitutional as so construed. Federal courts construe federal statutes to avoid, not invite, constitutional difficulties. *Boos* v. *Barry*, 485 U.S. 312, 331 (1988). Particularly in the context of a First Amendment overbreadth challenge, where the plaintiff contends that a statute is invalid even though it may be legitimately applied in some or many circumstances, the federal courts have not only "the *power* to adopt narrowing constructions," but "the *duty* to avoid constitutional difficulties by doing so if such a construction is fairly possible." *Id.* at 330-331 (emphasis added); see also, *e.g.*, *Broadrick* v. *Oklahoma*, 413 U.S. 601, 613 (1973) ("Facial overbreadth has not been invoked when a limiting construction has been or could be placed on the challenged statute.").[15] In this case, however, the court of appeals held Section 526(a)(4) unconstitutional without adverting to the doctrine of constitutional avoidance or explaining why its broad interpretation of Section 526(a)(4) was the *only* available reading of the statute. See, *e.g.*, *Edward J. DeBartolo Corp.* v. *Florida Gulf Coast Bldg. & Constr. Trades Council*, 485 U.S. 568, 575 (1988) ("*[E]very* reasonable construction must be resorted to, in order to save a statute from unconstitutionality.") (emphasis added; citation omitted).

This Court has repeatedly applied saving constructions to avoid invalidating Acts of Congress far less amenable to a narrowing interpretation. In *Boos*, the Court considered a First Amendment overbreadth challenge to a statute that made it unlawful "to congregate within 500 feet of any [embassy, legation, or consulate] and

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[15] Petitioners argue (Br. 31-35) that the Court should construe the term "debt relief agency" to avoid the same constitutional overbreadth objection. As discussed at pp. 26-27, *supra*, however, petitioners' proposed construction is foreclosed by the statutory definition of the term "debt relief agency," and it would seriously undermine numerous regulations of debt relief agencies that are unquestionably constitutional. By contrast, the phrase "in contemplation of [bankruptcy]" is not defined and can reasonably be read to avoid constitutional problems, particularly in light of the interpretation that phrase has historically been given in the bankruptcy context.

refuse to disperse after having been ordered so to do by the police." 485 U.S. at 329 (citation omitted). The Court acknowledged that "[s]tanding alone, this text is problematic * * * because it applies to *any* congregation within 500 feet of an embassy for *any* reason." *Id.* at 330. Nevertheless, citing the federal courts' "duty to avoid constitutional difficulties" when a narrowing "construction is fairly possible," the Court construed the statute to apply "'only when the police reasonably believe that a threat to the security or peace of the embassy is present'"—a limitation unstated in the statutory text but necessary to ensure the validity of the Act. *Id.* at 330-331 (citation omitted). See also, *e.g.*, *Zadvydas* v. *Davis*, 533 U.S. 678, 689 (2001); *Edward J. DeBartolo Corp.*, 485 U.S. at 576-578. Here, the interpretation of Section 526(a)(4) that was advanced by the government and endorsed by the dissent below, and that the Fifth Circuit adopted in *Hersh*, see 553 F.3d at 754, is consistent with the text of that provision and with the BAPCPA's overall structure and purposes. The court of appeals erred in refusing to adopt it.

Petitioners contend (Br. 64-66) that adopting a narrowing construction, instead of reading the statute to its broadest extent (and then striking it down as overbroad), would create a problem of "vagueness" and would therefore "chill" lawful advice. As explained above, however, the government's construction of Section 526(a)(4) as limited to a particular set of abusive practices is firmly tethered to the text, history, and purpose of the statute. See pp. 28-40, *supra*. The impropriety of those practices is already well-established, and even if it were not, any attorney signing a bankruptcy petition must already certify that the petition "does not constitute an abuse under [11 U.S.C. 707(b)(1)]." 11

U.S.C. 707(b)(4)(C)(ii)(II). That certification requires familiarity with longstanding precedent interpreting the Bankruptcy Code's references to "abuse" and "substantial abuse." See, *e.g.*, *Price*, 353 F.3d at 1139-1140.[16] Thus, attorneys are already required to be on notice of the practices that are treated as abusive under the Bankruptcy Code; Section 526(a)(4) simply bars attorneys from encouraging their clients to commit one such abusive practice.

C. Section 526(a)(4) Is Consistent With The First Amendment

If Section 526(a)(4) is given the limiting construction described above, the provision easily satisfies the First Amendment. The advice that Section 526(a)(4) covers is subject to reasonable regulation in the service of the government's valid interests in protecting the bankruptcy system and its participants from unethical conduct.

1. A licensed attorney's ethical obligations to the bench and the profession sometimes require her to exercise a degree of restraint in what she advocates and how. "'Membership in the bar is a privilege burdened with conditions,' to use the oft-repeated statement of Cardozo, J." *Gentile* v. *State Bar*, 501 U.S. 1030, 1066 (1991) (quoting *In re Rouss*, 221 N.Y. 81, 84 (1917), cert.

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[16] Indeed, amici NACBA et al. acknowledge (Br. 19) the substantial commonality between the required certification and the conduct that Section 526(a)(4) prohibits on the government's reading. Contrary to amici's contentions, however, the government's reading does not make Section 526(a)(4) superfluous: the certification provides some protection against abusive *filings*, whereas Section 526(a)(4) specifically prohibits a certain type of unethical *advice* that may or may not lead to an abusive filing. Section 526(a)(4) also prescribes different, more client-protective remedies. Compare 11 U.S.C. 526(c)(2), with 11 U.S.C. 707(b)(4)(B).

denied, 146 U.S. 661 (1918)). As the Court held in *Gentile*, attorneys are not merely self-interested actors and agents of their clients, but also licensed officers of the courts. For that reason, attorneys may be "subject to ethical restrictions on speech to which an ordinary citizen would not be." *Id.* at 1071; see *Goldfarb*, 421 U.S. at 792 (the government's interest "in regulating lawyers is especially great since lawyers are essential to the primary governmental function of administering justice, and have historically been 'officers of the courts'"). "This does not mean, of course, that lawyers forfeit their First Amendment rights, only that a less demanding standard applies." *Gentile*, 501 U.S. at 1082 (O'Connor, J., concurring).

In articulating those principles, the Court in *Gentile* broke no new ground. Rather, the Court explained that five Justices in *In re Sawyer*, 360 U.S. 622 (1959), had agreed that "lawyers in pending cases were subject to ethical restrictions on speech to which an ordinary citizen would not be." *Gentile*, 501 U.S. at 1071. Justice Stewart's controlling concurrence in *Sawyer* rejected the notion "that a lawyer can invoke the constitutional right of free speech to immunize himself from even-handed discipline for proven unethical conduct," because "[a] lawyer belongs to a profession with inherited standards of propriety and honor, which experience has shown necessary in a calling dedicated to the accomplishment of justice." 360 U.S. at 646 (Stewart, J., concurring in the result). Justice Stewart concluded that "[o]bedience to ethical precepts may require abstention from what in other circumstances might be constitutionally protected speech." *Id.* at 646-647. Four other Members of the Court agreed. See *id.* at 666-669 (Frankfurter, J., dissenting). See also *Ohralik* v. *Ohio*

State Bar Ass'n, 436 U.S. 447, 460 (1978) (sustaining a restriction on attorney solicitation because the government "bears a special responsibility for maintaining standards among members of the licensed professions"); *In re Primus*, 436 U.S. 412, 422 (1978); *Cohen* v. *Hurley*, 366 U.S. 117, 124 (1961) ("[L]awyers must operate * * * as assistants to the court in search of a just solution to disputes.").

2. Respondents are incorrect in contending (Br. 66-67) that Section 526(a)(4), in its application to respondents' provision of legal advice, is subject to strict scrutiny rather than to the *Gentile* standard. There is no basis on which to distinguish bar members' obligations when practicing in bankruptcy court, or when counseling debtors who are considering the initiation of bankruptcy proceedings, from Gentile's obligations as a practitioner in the Nevada trial court. Bankruptcy is a judicial function performed by judicial officers appointed and supervised by the Article III judiciary. A bankruptcy petition both invokes the "core * * * federal bankruptcy power" to undertake "the restructuring of debtor-creditor relations," and also potentially brings related adversary proceedings within the bankruptcy court's jurisdiction. *Northern Pipeline Constr. Co.* v. *Marathon Pipe Line Co.*, 458 U.S. 50, 71 (1982) (plurality opinion). And bankruptcy courts generally have the same implicit powers as other federal courts to admit and discipline attorneys and otherwise enforce "submission to their lawful mandates," *Chambers* v. *NASCO, Inc.*, 501 U.S. 32, 43 (1991) (quoting *Anderson* v. *Dunn*, 19 U.S. (6 Wheat.) 204, 227 (1821)). See, *e.g.*, *Price* v. *Lehtinen* (*In re Lehtinen*), 564 F.3d 1052, 1058 (9th Cir. 2009), petition for cert. pending, No. 09-113 (filed July 24, 2009); *Jones* v. *Bank of Santa Fe (In re Courtesy Inns, Ltd.)*, 40 F.3d

1084, 1089 (10th Cir. 1994); see also *Marrama* v. *Citizens Bank*, 549 U.S. 365, 375-376 (2007).

An attorney who advises or otherwise assists in an abuse of the bankruptcy system breaches his obligations to the tribunal and to the judicial system. The fairness and public reputation of bankruptcy proceedings are directly harmed when the bankruptcy discharge is misused to gain an improper benefit at an unsecured creditor's expense, or when the standards of eligibility for the discharge are gamed by taking on new and unnecessary debt on the eve of bankruptcy. Cf. *Marrama*, 549 U.S. at 375 (bankruptcy court's authority "'to prevent an abuse of process'" is "surely adequate" to order a halt to "action prejudicial to creditors") (quoting 11 U.S.C. 105(a)).

Contrary to petitioners' contention (Br. 75-76), the principles announced in *Gentile* are not limited to attorney conduct in connection with criminal litigation. Although Gentile's unethical conduct included public statements about a pending criminal matter, the ethical rule he violated related to any "adjudicative proceeding," 501 U.S. at 1033 (opinion of Kennedy, J.) (quoting Nev. Sup. Ct. R. 177(1)), and the Court's opinion drew on cases from the civil as well as criminal context, see *id.* at 1071, 1073-1074. The considerations that were held to justify the ethical rule there—preventing improper considerations from influencing the outcome of the proceeding or tainting the venire—were not limited to criminal trials or to trial-level proceedings. See *id.* at 1075; cf. *Caperton* v. *A.T. Massey Coal Co.*, 129 S. Ct. 2252, 2259 (2009).

Petitioners' reliance (Br. 35-36, 43) on *Legal Services Corp.* v. *Velazquez*, 531 U.S. 533 (2001), is misplaced. The statute at issue in *Velazquez* conditioned the receipt of federal funds on an attorney's agreement not to challenge the validity of state or federal welfare laws. *Id.* at 538. The provision did not purport to regulate attorney ethics or avoid client abuses, but rather prevented attorneys from making "all the reasonable and well-grounded arguments necessary for proper resolution of the case." *Id.* at 545. Section 526(a)(4), by contrast, prevents attorneys from *subverting* the bankruptcy process and jeopardizing their clients' interests by encouraging abuses of the Bankruptcy Code.

3. Section 526(a)(4) is constitutional under the *Gentile* standard. As the Fifth Circuit explained in *Hersh*, Section 526(a)(4) provides a bankruptcy-specific analogue to Rule 1.2(d) of the Model Rules of Professional Conduct, which states that an attorney may not "counsel a client to engage, or assist a client, in conduct that the lawyer knows is illegal or fraudulent." 553 F.3d at 756 (citation omitted). Versions of that rule are in effect throughout the Nation, including in petitioners' home State. Rule 1.2(d) has never been challenged under the First Amendment, much less held to violate it. *Ibid.*[17] Indeed, the court of appeals acknowledged that Section 526(a)(4) is supported by a legitimate government inter-

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[17] *Culver* illustrates the application of Rule 1.2(d) to the kind of advice that Section 526(a)(4) prohibits. In *Culver*, the client expressed concern about taking on more debt. Attorney Culver not only "advised her to obtain more credit cards and take cash advances on the cards to pay his fees," but also "explained *that she would not have to repay that money* because he would represent her to have the debts discharged in bankruptcy." 889 A.2d at 429 (emphasis added). He even gave her an application for a credit card. *Id.* at 444. The state court unanimously concluded that because the client could not repay the debt and "the bankruptcy discussions were in the context of present intent to avoid repaying the debt," Culver had committed a fraudulent act in violation of Rule 1.2(d). *Ibid.*

est; the court's conclusion that the statute was nonetheless unconstitutional depended on its adoption of petitioners' overly broad reading of the statute's scope. See Pet. App. 12a.

Amicus American Bar Association (ABA) suggests (Br. 10-11 & n.15) that Section 526(a)(4) is infirm because Congress has not barred *debtors* from assuming more debt in contemplation of bankruptcy. That argument lacks merit, for several reasons. First, in some cases covered by Section 526(a)(4), the client's conduct will itself be illegal. See, *e.g.*, *Hersh*, 553 F.3d at 755 ("Taking out loans without intending to repay them may also be considered theft under state law."); see also 18 U.S.C. 157 (bankruptcy fraud statute); 1 *Collier on Bankruptcy* ¶ 7.07[1][a] at 7-121 (Dec. 1996) (*Collier*) ("Misrepresenting one's financial status, presumably to profit by inducing others to extend goods or services on credit, seems to qualify."). In those cases, the attorney unquestionably has no First Amendment right to advise the client to engage in that conduct. Neither an attorney nor any other individual has a constitutional right to participate in the commission of a crime. Offers to engage in unlawful activity "enjoy no First Amendment protection." *Williams*, 128 S. Ct. at 1841; see also *Pittsburgh Press Co.* v. *Pittsburgh Comm'n on Human Relations*, 413 U.S. 376, 388-389 (1973) (same rule applies to unlawful activity that is not criminally proscribed). An attorney's recommendation that a client incur additional debt in order to defraud creditors is not constitutionally protected "abstract advocacy of illegality"; it is "speech * * * that is intended to induce or commence illegal activities." *Id.* at 1842; see also *Brandenburg* v. *Ohio*, 395 U.S. 444, 447-448 (1969) (per curiam).

In other cases, the client may not be susceptible to prosecution because he lacks the requisite intent. Cf. *Culver*, 849 A.2d at 429. Even in that situation, however, the government has a strong interest in preventing the rendering of professional advice that could lead to the subversion of the bankruptcy system. Cf. *Roadway Express*, 447 U.S. at 765 (relying on the "well-acknowledged inherent power of a court" to remedy and prevent "abusive litigation practices") (citation omitted). That is especially so in a context like this one, in which the sole reason why the client is not guilty of a crime may well be that he has relied on advice from counsel to undertake a particular course of action, which itself may be sufficient to defeat the intent element. See 1 *Collier* ¶ 7.07[1][d] at 7-130 (June 2004) (advice of counsel may be a defense to bankruptcy fraud). The ABA's position would insulate attorneys from liability by virtue of their very success in insulating their clients. That double-fisted protection for abusive bankruptcy practices cannot be constitutionally required.

Attorneys have long been subject to discipline, or to malpractice liability, for recommending courses of action that are unethical even if not illegal (or tortious). For instance, an attorney may be disciplined for involvement in concealing assets, even if the concealment does not satisfy all of the elements of an unlawful fraudulent conveyance. *In re Kenyon*, 491 S.E.2d 252, 254 (S.C. 1997) ("We do not have to find fraudulent conveyances—only fraudulent or dishonest conduct."); accord *In re Conduct of Hockett*, 734 P.2d 877, 882-883 (Or. 1987).

The authority to impose discipline for unethical conduct is on particularly strong ground where, as here, the attorney's improper advice affects not only the client, but the judicial system to which the attorney owes a professional obligation. See *Gentile*, 501 U.S. at 1075-1076 (describing the "substantial state interest" in "protect[ing] the integrity and fairness of a State's judicial system" against prejudicial conduct by "officers of the court," who "have a duty to protect its integrity"). Thus, for example, attorneys may be sanctioned for advising their clients to engage in various unethical conduct (such as hiring a lawyer strategically to force a judge's recusal) that the client may lawfully undertake but that is prejudicial to the administration of the legal system. See *McCuin* v. *Texas Power & Light Co.*, 714 F.2d 1255, 1264-1266 (5th Cir. 1983) ("Lawyers are not permitted to do everything for a client that he would stoop to do himself had he but their knowledge."); *Grievance Adm'r* v. *Fried*, 570 N.W.2d 262, 264, 267 (Mich. 1997). The same principle applies here: rules of professional conduct "may demand some adherence to the precepts of [the judicial] system in regulating [attorneys'] speech as well as their conduct" when that speech, if acted upon, directly undermines that system. *Gentile*, 501 U.S. at 1074.[18]

D. The Court Of Appeals Failed To Apply Basic Principles Of Overbreadth Analysis

Because "invalidating a law that in some of its applications is perfectly constitutional * * * has obvious harmful effects," this Court has "vigorously enforced the requirement that a statute's overbreadth be *substantial*, not only in an absolute sense, but also relative to the stat-

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[18] The same First Amendment standard logically applies to the work of bankruptcy petition preparers, who owe equivalent professional obligations to the tribunal that will adjudicate the petitions they prepare. See 11 U.S.C. 110(h)-(k) (providing for discipline of bankruptcy petition preparers).

ute's plainly legitimate sweep." *Williams*, 128 S. Ct. at 1838. The court of appeals failed to adhere to that principle when it struck down Section 526(a)(4) as applied to attorneys without giving proper weight to the statute's admittedly legitimate applications.

As shown above, Section 526(a)(4) may validly be applied to a significant category of unethical attorney advice. Against that legitimate sweep, the court below hypothesized two instances of legitimate, ethical advice to accumulate new debt on the eve of bankruptcy: buying a car and refinancing a mortgage. Pet. App. 13a-14a. The court speculated that "[f]actual scenarios other than these few hypothetical situations no doubt exist." *Id.* at 14a. On that slim and concededly "hypothetical" basis, the majority held the statute unconstitutional as applied to *all* attorney conduct, including the abusive practices at which Section 526(a)(4) was directly aimed.

That approach was misconceived. As explained above, Section 526(a)(4) as properly construed does not cover the hypothetical examples discussed by the court. See pp. 41-42, *supra*. But even if some situations could be hypothesized in which Section 526(a)(4) prohibits attorney speech without a constitutionally adequate justification, that is no basis for invalidating all applications of the provision to attorneys, as the court of appeals did here. As Judge Colloton observed, "a facial challenge resting on a 'few hypothetical situations' * * * is unlikely to justify invalidating a statute in *all* of its applications, because 'the mere fact that one can conceive of some impermissible applications of a statute is not sufficient to render it susceptible to an overbreadth challenge.'" Pet. App. 24a (quoting *Members of the City Council* v. *Taxpayers for Vincent*, 466 U.S. 789, 800

(1984)). That correct understanding of overbreadth analysis precludes invalidation of Section 526(a)(4).

III. THE COURT OF APPEALS CORRECTLY REJECTED PETITIONERS' CHALLENGE TO THE ADVERTISING-DISCLOSURE REQUIREMENTS OF 11 U.S.C. 528

Petitioners' challenge to the advertising-disclosure requirements of 11 U.S.C. 528 is likewise without merit. Those requirements apply only to publicly disseminated offers to perform bankruptcy-related services for a fee; they impose no restriction on what advertisers may say; and they mandate the inclusion of only a brief disclaimer whose substance is factually accurate and whose precise wording may be varied as needed. Applying the First Amendment standard that governs commercial advertising disclaimers, the court of appeals correctly concluded that Section 528's modest disclosure requirements are "reasonably and rationally related to the government's interest in preventing the deception of consumer debtors." Pet. App. 19a.

A. Disclosure Requirements In Commercial Advertising Must Bear A "Reasonable Relationship" To A Valid State Interest

1. Attorney advertisements are quintessential commercial speech. See, *e.g.*, *Florida Bar* v. *Went For It, Inc.*, 515 U.S. 618, 623 (1995) (*Went For It*); *Virginia State Bd. of Pharmacy* v. *Virginia Citizens Consumer Council, Inc.*, 425 U.S. 748, 773 n.25 (1976). While this Court has invalidated categorical bans on advertisements of legal services, *Bates* v. *State Bar*, 433 U.S. 350 (1977), it has recognized that attorney advertising and other forms of solicitation may be regulated without triggering the requirements of strict scrutiny. See, *e.g.*, *Went For It*, 515 U.S. at 623-624. In addition, the Court

has drawn a sharp distinction between commercial-speech regulations that *preclude* an advertiser from communicating a truthful commercial message, see, *e.g.*, *Rubin* v. *Coors Brewing Co.*, 514 U.S. 476 (1995); *Edenfield* v. *Fane*, 507 U.S. 761 (1993), and disclosure requirements, which simply mandate the inclusion of *additional* information that helps to prevent deception of the public. The Court has held that disclosure requirements are subject to more deferential scrutiny than are outright restrictions on advertising content. See *Zauderer* v. *Office of Disciplinary Counsel of the Supreme Court*, 471 U.S. 626, 650-652 (1985); see also *In re R.M.J.*, 455 U.S. 191, 201 (1982); *Bates*, 433 U.S. at 384 (States may require attorney advertisements to include a "warning or disclaimer * * * so as to assure that the consumer is not misled").

That distinction is particularly significant in the context of advertising to promote legal advice and related services, such as bankruptcy assistance, because of the difficulty consumers have in evaluating both the promotion and the provision of these services. The Court has recognized this difficulty on numerous occasions. "[B]ecause the public lacks sophistication concerning legal services, misstatements that might be overlooked or deemed unimportant in other advertising may be found quite inappropriate in legal advertising." *Bates*, 433 U.S. at 383; see *Virginia State Bd. of Pharmacy*, 425 U.S. at 773 n.25 (noting that lawyers "do not dispense standardized products" but "render professional *services* of almost infinite variety and nature, with the consequent enhanced possibility for confusion and deception if they were to undertake certain kinds of advertising"). Disclosure requirements are an important part of the solution to the problem. Even when striking down outright restrictions on advertising, the Court has emphasized that the government "retains the power to correct omissions that have the effect of presenting an inaccurate picture." *Bates*, 433 U.S. at 375. Under the First Amendment, "the preferred remedy is more disclosure, rather than less." *Ibid.*

Because of the lesser burden imposed by disclosure provisions, this Court has prescribed a standard of review less searching than the intermediate-scrutiny analysis it has applied to content prohibitions in the attorney-advertising context. The leading decision is *Zauderer*, which involved an Ohio attorney disciplined for violating a variety of bar rules related to advertising. The Court upheld a disclosure requirement analogous to Section 528, see 471 U.S. at 650-652, even as it struck down several other bar rules that affirmatively restricted speech, see *id.* at 632-633, 639.

Ohio required attorneys who advertise their willingness to represent clients for a contingency fee to include a statement concerning whether the fee arrangement would require the client to pay court costs even in the event of a loss. The Court specifically rejected the argument that the State was required to demonstrate that Zauderer's "advertisement, absent the required disclosure, would be false or deceptive," that "the disclosure requirement directly advances the relevant governmental interest," or that the requirement "constitutes the least restrictive means of doing so." 471 U.S. at 650. Such arguments, the Court explained, "overlook[] material differences between disclosure requirements and outright prohibitions on speech." *Ibid.* The Court further explained that, "in virtually all [its] commercial speech decisions" up to that point, it had "emphasized that because disclosure requirements trench much more narrowly on an advertiser's interests than do flat prohibitions on speech, 'warning[s] or disclaimer[s] might be appropriately required . . . in order to dissipate the possibility of consumer confusion or deception.'" *Id.* at 651 (quoting *R.M.J.*, 455 U.S. at 201).

Accordingly, the Court in *Zauderer* held that disclosure requirements applicable to attorney advertising need only be "reasonably related to the State's interest in preventing deception of consumers." 471 U.S. at 651; accord *id.* at 656 (Brennan, J., concurring in part, concurring in the judgment in part and dissenting in part) (agreeing, "[w]ith some qualifications," that "a State may impose commercial-advertising disclosure requirements" that satisfy that reasonable-relationship standard). The Court concluded that the challenged state bar rule "easily pass[ed] muster under this standard" because "[t]he State's position"—that contingent-fee advertising is deceptive if it does not clarify the client's liability for costs—was "reasonable enough to support [the disclosure] requirement." *Id.* at 652-653.

2. Petitioners fundamentally misconceive these governing principles. For example, petitioners compare (Br. 76-77) the disclosure requirements of Section 528 to the kind of forced political speech at issue in *Wooley* v. *Maynard*, 430 U.S. 705 (1977) ("Live Free or Die" motto), and *West Virginia State Board of Education* v. *Barnette*, 319 U.S. 624 (1943) (Pledge of Allegiance). "[T]he interests at stake in this case," however, are simply "not of the same order." *Zauderer*, 471 U.S. at 650-651. As in *Zauderer*, Congress in enacting Section 528 did not seek "to 'prescribe what shall be orthodox in politics, nationalism, religion, or other matters of opinion,'" but merely prescribed what disclaimers will ensure that a particular class of "commercial advertising"

is not misleading. *Id.* at 651 (quoting *Barnette*, 319 U.S. at 642). In the latter context, the Court explained, "an advertiser's rights are adequately protected as long as disclosure requirements are reasonably related to the State's interest in preventing deception of consumers." *Ibid.*[19]

Petitioners are likewise mistaken in contending (Br. 90-94) that Section 528 must be analyzed under the framework of intermediate scrutiny set out in *Central Hudson Gas & Electric Corp.* v. *Public Service Commission*, 447 U.S. 557 (1980). This Court rejected the identical argument in *Zauderer*. Although the Court applied the *Central Hudson* standard in analyzing and invalidating Ohio's affirmative restrictions on attorney advertisements (such as the State's prohibition on the use of even truthful, nonmisleading illustrations), *Zauderer*, 471 U.S. at 632-633, 639, the Court specifically declined to analyze the disclosure requirement under the same principles, explaining that there are "material differences between disclosure requirements and outright prohibitions on speech," *id.* at 650. The Court further explained that "the First Amendment interests implicated by disclosure requirements are substantially weaker than those at stake when speech is actually suppressed." *Id.* at 652 n.14. The court of appeals in this case was therefore correct in analyzing Section 528 under the

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[19] Petitioners (Br. 77, 79, 83) and amici NACBA et al. (Br. 27-28) are similarly wrong in relying on *Riley* v. *National Federation of the Blind of North Carolina, Inc.*, 487 U.S. 781 (1988). The Court in *Riley* struck down a disclosure requirement outside the context of commercial advertising, while reiterating that "[p]urely commercial speech is more susceptible to compelled disclosure requirements." *Id.* at 796 & n.9 (citing *Zauderer*, *supra*).

disclosure principles discussed in *Zauderer* rather than under *Central Hudson*. See Pet. App. 18a.[20]

B. Section 528 Is A Reasonable Means Of Combating A Documented Risk Of Consumer Deception

Section 528 is a reasonable response to the problem Congress identified: advertising that promotes debt-relief services without disclosing that those services entail a bankruptcy filing and its attendant consequences. By using either the statutory disclaimer or a permissible alternative ("a substantially similar statement") in their public advertising, debt relief agencies make clear the nature of the services they are offering. Under the governing *Zauderer* standard, Section 528 is constitutional.

1. Section 528 responded to "increasingly aggressive lawyer advertising"

In hearings preceding the 2005 Act, Congress heard evidence of "increasingly aggressive lawyer advertising"

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[20] In any event, Section 528 would survive First Amendment scrutiny even under the *Central Hudson* standard. See Pet. App. 19a n.11 (citing *Olsen* v. *Gonzales*, 350 B.R. 906, 920 (D. Or. 2006), appeal pending, No. 07-35616 (9th Cir. filed July 24, 2007)). Section 528 "targets a concrete, nonspeculative harm." *Went For It*, 515 U.S. at 629. Indeed, as the court of appeals recognized, the statute is "directed precisely at the problem targeted by Congress: ensuring that persons who advertise bankruptcy-related services to the general public make clear that their services do in fact involve filing for bankruptcy." Pet. App. 19a. The requirement of a two-line disclosure does not "burden substantially more speech than necessary to further the government's legitimate interests." *United States* v. *Edge Broad. Co.*, 509 U.S. 418, 430 (1993). Indeed, as already noted, the statute restricts no speech at all, but merely requires the disclosure of factually correct information. See *Olsen*, 350 B.R. at 921. As this Court observed in *Zauderer*, petitioners' "constitutionally protected interest in *not* providing [such] factual information in [their] advertising is minimal." 471 U.S. at 651.

for bankruptcy services that offered to make consumers' debts "disappear" but failed even to "mention bankruptcy." *2003 Hearings* 55. One retailer testified that some of his customers had been misled by such attorney advertisements and "d[id] not even understand that they ha[d] filed for bankruptcy." *1999 Hearings* 123 (statement of Michael Moore, National Retail Federation). In 1997, the Federal Trade Commission (FTC) warned that many debt-relief advertisements offering to "[w]ipe out" consumer debts, or to "[s]top credit harassment, foreclosures, [and] repossessions," regularly fail to disclose that such "relief may be spelled b-a-n-k-r-u-p-t-c-y." *1998 Hearings* Pt. III, at 90-92. The FTC observed that such advertisements have the potential to mislead consumers into filing for bankruptcy without knowledge or appreciation of the consequences. See *id.* at 92 (warning that "bankruptcy stays on your credit report for 10 years, and can hinder your ability to get credit, a job, insurance, or even a place to live").[21]

The legislative record contains sample advertisements that gave Congress ample reason for concern. Print advertisements for law firms included such large-print headlines as "Stop Worrying About Your Bills For The New Year" and "ATTENTION: TOO MUCH DEBT?!" *1998 Hearings* Pt. III, at 93, 94. Such advertisements prominently asserted that the law firm could "Consolidate and Lower Your Bills" or that "*Federal Law Provides For*: (A) Consolidation (one low monthly

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[21] An updated version of the 1997 FTC alert was issued in 2008 and remains in effect today. See Division of Consumer & Bus. Educ., FTC, *FTC Consumer Alert: Advertisements Promising Debt Relief May Be Offering Bankruptcy* (May 2008) <http://www.ftc.gov/bcp/edu/pubs/consumer/alerts/alt015.shtm>.

payment) (B) Liquidation (eliminate debts)." *Ibid.* References to the form of relief from debt that the firms would pursue were oblique at best, such as a star footnote referring to "U.S. Bankruptcy law," *id.* at 94, and a statement that the "forms of consolidation" include "court-assisted consolidation, like Chapter 13 bankruptcy," *id.* at 93.

Despite a legislative record extending over at least three hearings and several years, petitioners assert (Br. 92) that Congress did not identify a "substantial" interest in protecting the targets of such advertisements because the evidence did not "actually demonstrate that any consumer has been, in fact, deceived by this advertising." This Court held in *Zauderer*, however, that such a showing is not required: "When the possibility of deception is as self-evident as it is in this case, we need not require the [government] to 'conduct a survey of the . . . public before it [may] determine that the [advertisement] had a tendency to mislead.'" 471 U.S. at 652-653 (quoting *FTC* v. *Colgate-Palmolive Co.*, 380 U.S. 374, 391-392 (1965)) (alterations in original); cf. *Hersh*, 553 F.3d at 766 (noting that "the government has a compelling interest in ensuring that those who enter bankruptcy know what it entails") (citing *House Report* 4). The evidence in the legislative record was sufficient for Congress reasonably to conclude that advertisements promising debt relief while downplaying the role of bankruptcy are inherently misleading. Cf. *Zauderer*, 471 U.S. at 653.

2. *Section 528 addresses the identified problem directly and flexibly*

In enacting Section 528, Congress responded directly to the deceptive practices that the FTC and others had identified. Section 528 requires debt relief agencies to "disclose in any advertisement of bankruptcy assistance services or of the benefits of bankruptcy directed to the general public" that the advertised services "are with respect to bankruptcy relief under this title." 11 U.S.C. 528(a)(3). In particular, if a debt relief agency's public advertisement offers "bankruptcy assistance services" (*ibid.*), or "indicat[es] that the debt relief agency provides assistance with respect to credit defaults, mortgage foreclosures, eviction proceedings, excessive debt, debt collection pressure, or inability to pay any consumer debt" (11 U.S.C. 528(b)(2)), the advertisement must include either the statutorily approved statement ("We are a debt relief agency. We help people file for bankruptcy relief under the Bankruptcy Code.") or a "substantially similar statement." 11 U.S.C. 528(a)(4) and (b)(2)(B).

The solution that Congress devised—a two-line statement that identifies an attorney or other covered person as a "debt relief agency" under governing law and explains that the offered services include "help[ing] people file for bankruptcy relief under the Bankruptcy Code"—"is reasonably and rationally related to the government's interest in preventing the deception of consumer debtors." Pet. App. 19a. Indeed, as the court of appeals explained, Section 528 is "directed precisely at the problem targeted by Congress: ensuring that persons who advertise bankruptcy-related services to the general public make clear that their services do in fact involve filing for bankruptcy." *Ibid.* Section 528 performs the modest but important function of enabling consumers to recognize advertisements promoting bankruptcy services for what they really are.

3. The Section 528 disclosures are factual in nature and are not misleading

The disclosure requirements imposed by Section 528(a)(4) and (b)(2)(B) apply only to persons who are "debt relief agenc[ies]" within the meaning of the BAPCPA. See 11 U.S.C. 528(a) and (b)(2). The disclosures that those provisions specify—*i.e.*, "We are a debt relief agency" and "We help people file for bankruptcy relief under the Bankruptcy Code"—are factually accurate and create no potential danger that potential customers will be misled as to the functions that the advertiser performs. As in *Zauderer*, petitioners' "constitutionally protected interest in *not* providing [such] factual information in [their] advertising is minimal." 471 U.S. at 651.

a. Section 528(a)(4)'s disclosure requirements apply only to persons who are "debt relief agenc[ies]" within the meaning of Section 101(12A). As applied to such persons, the statement "We are a debt relief agency" is by definition an accurate description of the advertiser's legal status. As a matter of ordinary English usage, moreover, the term "debt relief agency" accurately describes the persons subject to the disclosure requirement. Under the BAPCPA, that term is limited to persons who provide "bankruptcy assistance to an assisted person" or who act as "bankruptcy petition preparer[s]." 11 U.S.C. 101(12A); see 11 U.S.C. 101(4A) (definition of "bankruptcy assistance"). Persons who perform those functions are naturally understood to provide "debt relief." And they are "agencies" in the accepted sense in which that word is used to describe service-oriented businesses—*e.g.*, travel agencies, advertising agencies, employment agencies, modeling agencies, and public relations agencies.[22]

Petitioners urge (Br. 88) that consumer bankruptcy attorneys "are entitled to call themselves 'attorneys' in their advertising." As the court of appeals recognized, however, nothing in the BAPCPA prevents them from doing so. See Pet. App. 20a ("[N]othing in the Code prevents [petitioners] from identifying themselves in their advertisements as both attorneys and debt relief agencies."). In enacting Section 528, Congress has not "prevent[ed] attorneys from conveying information to the public; it has only required them to provide somewhat more information than they might otherwise be inclined to present." *Zauderer*, 471 U.S. at 650.

Relying on *R.M.J.*, *supra*, petitioners argue (Br. 88) that Section 528 is nonetheless invalid because "attorneys should not be compelled to use any label * * * other than one of their own choosing that is accurate and not deceptive." *R.M.J.*, however, involved a *prohibition* on attorneys' using any phrase other than those on an approved list to describe their legal practice. 455 U.S. at 194-196. Here, by contrast, petitioners are free to advertise their practice in any manner they please, pro-

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[22] Amici NACBA et al. contend (Br. 26), based on a declaration submitted in other litigation by an NACBA member, that potential clients have expressed concern that a "debt relief agency" might be thought a government agency. As the record in that case shows, the author of that declaration bears considerable responsibility for the problem he encountered, as he advertised on his website that he has been "designated as a Federal Debt Relief Agency by an Act of Congress and the President of the United States." C.A. App. at 62, *Connecticut Bar Ass'n* v. *United States*, No. 08-4797-cv (2d Cir. argued Sept. 24, 2009).

vided they also comply with the basic disclosure requirements in Section 528.[23]

b. Petitioners do not dispute the accuracy of the second half of the statutory disclaimer, *i.e.*, that the person sponsoring the advertisement "help[s] people file for bankruptcy relief under the Bankruptcy Code." See Pet. Br. 87 (asserting that petitioners already mention bankruptcy in their advertising). Rather, they contend that the statement is required even in contexts in which it does not serve the core congressional purpose; they speculate, for example, that some law firms will be debt relief agencies by virtue of representing debtors, but will also wish to advertise to creditors that they perform services listed in Section 528(b)(2). But even as applied to that hypothetical and presumably narrow class, the required disclaimer is not misleading, much less inaccurate.[24] In these circumstances, it simply provides some extraneous information.

Petitioner's argument suggests, at most, that Section 528's purposes could have been achieved had Congress defined somewhat more narrowly the category of advertisements for which the specified disclosures are required. But as the Court held in *Zauderer*, the standard of review in this context is not whether the statute is

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[23] Petitioners have not asserted that the requirement to include the short disclaimer in their advertising is burdensome for reasons other than the content of the disclaimer. Cf. *Ibanez* v. *Florida Dep't of Bus. & Prof'l Regulation*, 512 U.S. 136, 146-147 & n.11 (1994) (disclaimer required to accompany the term "specialist" was so unduly detailed that no one would use it on a business card or letterhead, thus effectively prohibiting the use of the term "specialist" in those contexts).

[24] The record does not reflect that petitioners themselves advertise any legal services beyond representing debtors in bankruptcy. See J.A. 38a-39a.

narrowly tailored, but only whether it is "reasonably related to the State's interest"—here (as in *Zauderer*) the interest in preventing deception of consumers. See 471 U.S. at 651 n.14 ("reject[ing] [the] contention that [the Court] should subject disclosure requirements to a strict 'least restrictive means' analysis," because disclosure requirements are themselves less restrictive than other regulations); see also *Went For It*, 515 U.S. at 632 ("[T]he 'least restrictive means' test has no role in the commercial speech context.").

Moreover, Congress had valid reasons for making the disclosure requirement contingent on the content of the advertisement rather than on the advertiser's own characterization of the target audience. Advertisements frequently tout more than one service, see, *e.g.*, *1998 Hearings* Pt. III, at 95 (advertisement for bankruptcy, divorce, and personal injury representation), and the advertiser has only limited ability to choose or predict in advance who will see its communications. Congress reasonably concluded that advertisements offering "assistance with respect to * * * mortgage foreclosures [or] eviction proceedings," 11 U.S.C. 528(b)(2), may well implicate the same interests as advertisements promoting debt relief, because consumers desperate to stave off foreclosure or eviction may be attracted by the automatic stay of proceedings that a bankruptcy filing triggers. See *1998 Hearings* Pt. III, at 92 (FTC alert noting that ads may promote the ability to "'STOP credit harassment [or] foreclosures'" or to "'Keep Your Property.'"). In any event, law firms and other entities that do not provide bankruptcy assistance services to assisted persons for compensation are not "debt relief agenc[ies]" and therefore are not covered by Section 528; that threshold eligibility determination will rule out many of petitioners' hypothetical applications to creditors' counsel.[25]

4. By its terms, Section 528 permits debt relief agencies to alter the wording of the required disclosures

Quibbles over the fit between the statutory disclaimer language and particular hypothetical situations are ultimately not relevant in this pre-enforcement challenge, which asserts that Section 528's disclaimer requirements are unconstitutional as applied to *all* attorneys. And if the statutory disclosures inaccurately describe the services that a particular debt relief agency performs, Section 528 establishes a mechanism by which the inaccuracy can be avoided. Any "substantially similar statement" may be substituted for the language set out in the statute. 11 U.S.C. 528(a)(4) and (b)(2)(B). Thus, if a particular debt relief agency engages in the type of public advertising that triggers the disclosure requirements (see 11 U.S.C. 528(a)(3) and (b)(2)), but nevertheless avoids ever "help[ing] people file for bankruptcy relief under the Bankruptcy Code," that debt relief agency presumably could tailor the disclaimer that it would include in its advertisements. The statutory option to customize the disclaimer further ameliorates any concern about the requirement's potential applications to hypothetical outlier cases.

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[25] As explained above, a creditor is not an "assisted person," and representing creditors does not make an attorney a "debt relief agency." See pp. 22-24, *supra*. The assertion by amici NACBA et al. (Br. 28-30) that the disclaimer is "affirmatively false" rests on the misreading of "assisted person" as including creditors.

C. Petitioners Cannot Avoid Section 528's Disclosure Requirements By Asserting That Their Own Advertising Is Not Deceptive

Petitioners contend (Br. 87) that Section 528(a)(4) and (b)(2)(B) are unconstitutional as applied to their own advertising because that advertising is not deceptive and therefore does not raise the concerns that prompted Congress to act.[26] That assertion has no support in the record. Petitioners brought this action as a pre-enforcement challenge to Section 528, and they did not submit any past or future advertisements into evidence. Neither their petition for a writ of certiorari nor their brief in the court of appeals advanced the theory that they are entitled to an as-applied exemption from Section 528(a)(4) and (b)(2)(B) based on the non-deceptive content of their own prior advertising. See Pet. 22-30; Pet. C.A. Br. 41-50.

In any event, the Court in *Zauderer* specifically rejected the contention that the disclosure requirement challenged in that case would be unconstitutional unless the particular "advertisement, absent the required disclosure, would be false or deceptive." 471 U.S. at 650. To combat the deceptive practices of attorneys who promote the benefits of bankruptcy relief without the necessary explanation, Congress required all debt relief agencies who engage in specified forms of public advertising to comply with the basic disclosure requirements of Section 528(a)(4) and (b)(2)(B). That legislative judgment

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[26] Petitioners assert that they "do not state in their advertisements that they can 'wipe out' unpaid bills, make debts 'disappear,' or 'stop credit harassment, foreclosures, or repossessions' *without mentioning that these things are accomplished through bankruptcy*," and that their advertisements "specifically mention 'bankruptcy' multiple times." Br. 87 (emphasis added).

is both reasonable and consistent with the First Amendment.[27]

The as-applied challenge that petitioners belatedly assert is especially ill-conceived because Section 528 allows regulated parties to substitute a "substantially similar statement" for the statement that the advertiser "help[s] people file for bankruptcy relief under the Bankruptcy Code." 11 U.S.C. 528(a)(4) and (b)(2)(B). See p. 68, *supra*. If the references to bankruptcy in petitioners' advertisements are suitably prominent (unlike, for example, the use of a star footnote in the advertisement appearing in the legislative history, see p. 62, *supra*), then petitioners may be able to satisfy Section 528's requirements with only modest changes to their advertising, or even none at all. Petitioners' new as-applied challenge logically depends on the proposition that their own advertisements contain references to bankruptcy that are clear enough to satisfy Congress's concerns, but are not "substantially similar" to the statement that petitioners "help people file for bankruptcy relief under the Bankruptcy Code." Petitioners have not suggested what such advertisements would look like, let alone shown that their own advertisements fall within this hypothetical category. And they assuredly have not shown how adopting the Section 528 formulation or "a substantially similar statement" would meaningfully curtail their ability to advertise their services. This Court therefore should uphold the statutory disclosure requirements.

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[27] This Court also granted certiorari on the question whether Section 528 violates the Due Process Clause. 08-1119 Pet. ii. Petitioners have not separately argued that issue and have accordingly abandoned it.

CONCLUSION

The judgment of the court of appeals should be reversed as to Section 526(a)(4) and in all other respects affirmed.

Respectfully submitted.

ELENA KAGAN
Solicitor General

TONY WEST
Assistant Attorney General

MALCOLM L. STEWART
Deputy Solicitor General

WILLIAM M. JAY
Assistant to the Solicitor General

MARK B. STERN
MARK R. FREEMAN
Attorneys

RAMONA D. ELLIOTT
General Counsel

P. MATTHEW SUTKO
Associate General Counsel
Executive Office for United States Trustees

OCTOBER 2009

STATUTORY APPENDIX

1. 11 U.S.C. 101 provides in pertinent part:

Definitions

In this title the following definitions shall apply:

* * * * *

(3) The term "assisted person" means any person whose debts consist primarily of consumer debts and the value of whose nonexempt property is less than $150,000.

(4) The term "attorney" means attorney, professional law association, corporation, or partnership, authorized under applicable law to practice law.

(4A) The term "bankruptcy assistance" means any goods or services sold or otherwise provided to an assisted person with the express or implied purpose of providing information, advice, counsel, document preparation, or filing, or attendance at a creditors' meeting or appearing in a case or proceeding on behalf of another or providing legal representation with respect to a case or proceeding under this title.

* * * * *

(12) The term "debt" means liability on a claim.

(12A) The term "debt relief agency" means any person who provides any bankruptcy assistance to an assisted person in return for the payment of money or other valuable consideration, or who is a bankruptcy petition preparer under section 110, but does not include—

(A) any person who is an officer, director, employee, or agent of a person who provides such assistance or of the bankruptcy petition preparer;

(B) a nonprofit organization that is exempt from taxation under section 501(c)(3) of the Internal Revenue Code of 1986;

(C) a creditor of such assisted person, to the extent that the creditor is assisting such assisted person to restructure any debt owed by such assisted person to the creditor;

(D) a depository institution (as defined in section 3 of the Federal Deposit Insurance Act) or any Federal credit union or State credit union (as those terms are defined in section 101 of the Federal Credit Union Act), or any affiliate or subsidiary of such depository institution or credit union; or

(E) an author, publisher, distributor, or seller of works subject to copyright protection under title 17, when acting in such capacity.

* * * * *

2. 11 U.S.C. 110 provides in pertinent part:

Penalty for persons who negligently or fraudulently prepare bankruptcy petitions

(a) In this section—

(1) "bankruptcy petition preparer" means a person, other than an attorney for the debtor or an employee of such attorney under the direct supervision of such attor-

ney, who prepares for compensation a document for filing; and

(2) "document for filing" means a petition or any other document prepared for filing by a debtor in a United States bankruptcy court or a United States district court in connection with a case under this title.

* * * * *

(e)(1) A bankruptcy petition preparer shall not execute any document on behalf of a debtor.

(2)(A) A bankruptcy petition preparer may not offer a potential bankruptcy debtor any legal advice, including any legal advice described in subparagraph (B).

(B) The legal advice referred to in subparagraph (A) includes advising the debtor—

(i) whether—

(I) to file a petition under this title; or

(II) commencing a case under chapter 7, 11, 12, or 13 is appropriate;

(ii) whether the debtor's debts will be discharged in a case under this title;

(iii) whether the debtor will be able to retain the debtor's home, car, or other property after commencing a case under this title;

(iv) concerning—

(I) the tax consequences of a case brought under this title; or

(II) the dischargeability of tax claims;

(v) whether the debtor may or should promise to repay debts to a creditor or enter into a reaffirmation agreement with a creditor to reaffirm a debt;

(vi) concerning how to characterize the nature of the debtor's interests in property or the debtor's debts; or

(vii) concerning bankruptcy procedures and rights.

* * * * *

3. 11 U.S.C. 526 provides:

Restrictions on debt relief agencies

(a) A debt relief agency shall not—

(1) fail to perform any service that such agency informed an assisted person or prospective assisted person it would provide in connection with a case or proceeding under this title;

(2) make any statement, or counsel or advise any assisted person or prospective assisted person to make a statement in a document filed in a case or proceeding under this title, that is untrue and misleading, or that upon the exercise of reasonable care, should have been known by such agency to be untrue or misleading;

(3) misrepresent to any assisted person or prospective assisted person, directly or indirectly, affirmatively or by material omission, with respect to—

(A) the services that such agency will provide to such person; or

(B) the benefits and risks that may result if such person becomes a debtor in a case under this title; or

(4) advise an assisted person or prospective assisted person to incur more debt in contemplation of such person filing a case under this title or to pay an attorney or bankruptcy petition preparer fee or charge for services performed as part of preparing for or representing a debtor in a case under this title.

(b) Any waiver by any assisted person of any protection or right provided under this section shall not be enforceable against the debtor by any Federal or State court or any other person, but may be enforced against a debt relief agency.

(c)(1) Any contract for bankruptcy assistance between a debt relief agency and an assisted person that does not comply with the material requirements of this section, section 527, or section 528 shall be void and may not be enforced by any Federal or State court or by any other person, other than such assisted person.

(2) Any debt relief agency shall be liable to an assisted person in the amount of any fees or charges in connection with providing bankruptcy assistance to such person that such debt relief agency has received, for actual damages, and for reasonable attorneys' fees and costs if such agency is found, after notice and a hearing, to have—

(A) intentionally or negligently failed to comply with any provision of this section, section 527, or section 528 with respect to a case or proceeding under this title for such assisted person;

(B) provided bankruptcy assistance to an assisted person in a case or proceeding under this title that is dismissed or converted to a case under another chapter of this title because of such agency's intentional or negligent failure to file any required document including those specified in section 521; or

(C) intentionally or negligently disregarded the material requirements of this title or the Federal Rules of Bankruptcy Procedure applicable to such agency.

(3) In addition to such other remedies as are provided under State law, whenever the chief law enforcement officer of a State, or an official or agency designated by a State, has reason to believe that any person has violated or is violating this section, the State—

(A) may bring an action to enjoin such violation;

(B) may bring an action on behalf of its residents to recover the actual damages of assisted persons arising from such violation, including any liability under paragraph (2); and

(C) in the case of any successful action under subparagraph (A) or (B), shall be awarded the costs of the action and reasonable attorneys' fees as determined by the court.

(4) The district courts of the United States for districts located in the State shall have concurrent jurisdiction of any action under subparagraph (A) or (B) of paragraph (3).

(5) Notwithstanding any other provision of Federal law and in addition to any other remedy provided under

Federal or State law, if the court, on its own motion or on the motion of the United States trustee or the debtor, finds that a person intentionally violated this section, or engaged in a clear and consistent pattern or practice of violating this section, the court may—

(A) enjoin the violation of such section; or

(B) impose an appropriate civil penalty against such person.

(d) No provision of this section, section 527, or section 528 shall—

(1) annul, alter, affect, or exempt any person subject to such sections from complying with any law of any State except to the extent that such law is inconsistent with those sections, and then only to the extent of the inconsistency; or

(2) be deemed to limit or curtail the authority or ability—

(A) of a State or subdivision or instrumentality thereof, to determine and enforce qualifications for the practice of law under the laws of that State; or

(B) of a Federal court to determine and enforce the qualifications for the practice of law before that court.

4. 11 U.S.C. 528 provides:

Requirements for debt relief agencies

(a) A debt relief agency shall—

(1) not later than 5 business days after the first date on which such agency provides any bankruptcy assistance services to an assisted person, but prior to such assisted person's petition under this title being filed, execute a written contract with such assisted person that explains clearly and conspicuously—

(A) the services such agency will provide to such assisted person; and

(B) the fees or charges for such services, and the terms of payment;

(2) provide the assisted person with a copy of the fully executed and completed contract;

(3) clearly and conspicuously disclose in any advertisement of bankruptcy assistance services or of the benefits of bankruptcy directed to the general public (whether in general media, seminars or specific mailings, telephonic or electronic messages, or otherwise) that the services or benefits are with respect to bankruptcy relief under this title; and

(4) clearly and conspicuously use the following statement in such advertisement: "We are a debt relief agency. We help people file for bankruptcy relief under the Bankruptcy Code." or a substantially similar statement.

(b)(1) An advertisement of bankruptcy assistance services or of the benefits of bankruptcy directed to the general public includes—

(A) descriptions of bankruptcy assistance in connection with a chapter 13 plan whether or not chapter 13 is specifically mentioned in such advertisement; and

(B) statements such as "federally supervised repayment plan" or "Federal debt restructuring help" or other similar statements that could lead a reasonable consumer to believe that debt counseling was being offered when in fact the services were directed to providing bankruptcy assistance with a chapter 13 plan or other form of bankruptcy relief under this title.

(2) An advertisement, directed to the general public, indicating that the debt relief agency provides assistance with respect to credit defaults, mortgage foreclosures, eviction proceedings, excessive debt, debt collection pressure, or inability to pay any consumer debt shall—

(A) disclose clearly and conspicuously in such advertisement that the assistance may involve bankruptcy relief under this title; and

(B) include the following statement: "We are a debt relief agency. We help people file for bankruptcy relief under the Bankruptcy Code." or a substantially similar statement.

5. 11 U.S.C. 707 provides in pertinent part:

Dismissal of a case or conversion to a case under chapter 11 or 13

* * * * *

(b)(1) After notice and a hearing, the court, on its own motion or on a motion by the United States trustee, trustee (or bankruptcy administrator, if any), or any party in interest, may dismiss a case filed by an individual debtor under this chapter whose debts are primarily consumer debts, or, with the debtor's consent, convert such a case to a case under chapter 11 or 13 of this title, if it finds that the granting of relief would be an abuse of the provisions of this chapter. In making a determination whether to dismiss a case under this section, the court may not take into consideration whether a debtor has made, or continues to make, charitable contributions (that meet the definition of "charitable contribution" under section 548(d)(3)) to any qualified religious or charitable entity or organization (as that term is defined in section 548(d)(4)).

(2)(A)(i) In considering under paragraph (1) whether the granting of relief would be an abuse of the provisions of this chapter, the court shall presume abuse exists if the debtor's current monthly income reduced by the amounts determined under clauses (ii), (iii), and (iv), and multiplied by 60 is not less than the lesser of—

(I) 25 percent of the debtor's nonpriority unsecured claims in the case, or $6,000, whichever is greater; or

(II) $10,000.

(ii)(I) The debtor's monthly expenses shall be the debtor's applicable monthly expense amounts specified under the National Standards and Local Standards, and the debtor's actual monthly expenses for the categories specified as Other Necessary Expenses issued by the Internal Revenue Service for the area in which the debtor resides, as in effect on the date of the order for relief, for the debtor, the dependents of the debtor, and the spouse of the debtor in a joint case, if the spouse is not otherwise a dependent. Such expenses shall include reasonably necessary health insurance, disability insurance, and health savings account expenses for the debtor, the spouse of the debtor, or the dependents of the debtor. Notwithstanding any other provision of this clause, the monthly expenses of the debtor shall not include any payments for debts. In addition, the debtor's monthly expenses shall include the debtor's reasonably necessary expenses incurred to maintain the safety of the debtor and the family of the debtor from family violence as identified under section 309 of the Family Violence Prevention and Services Act, or other applicable Federal law. The expenses included in the debtor's monthly expenses described in the preceding sentence shall be kept confidential by the court. In addition, if it is demonstrated that it is reasonable and necessary, the debtor's monthly expenses may also include an additional allowance for food and clothing of up to 5 percent of the food and clothing categories as specified by the National Standards issued by the Internal Revenue Service.

(II) In addition, the debtor's monthly expenses may include, if applicable, the continuation of actual expenses paid by the debtor that are reasonable and necessary for care and support of an elderly, chronically ill, or disabled household member or member of the debtor's immediate family (including parents, grandparents, siblings, children, and grandchildren of the debtor, the dependents of the debtor, and the spouse of the debtor in a joint case who is not a dependent) and who is unable to pay for such reasonable and necessary expenses.

(III) In addition, for a debtor eligible for chapter 13, the debtor's monthly expenses may include the actual administrative expenses of administering a chapter 13 plan for the district in which the debtor resides, up to an amount of 10 percent of the projected plan payments, as determined under schedules issued by the Executive Office for United States Trustees.

(IV) In addition, the debtor's monthly expenses may include the actual expenses for each dependent child less than 18 years of age, not to exceed $1,500 per year per child, to attend a private or public elementary or secondary school if the debtor provides documentation of such expenses and a detailed explanation of why such expenses are reasonable and necessary, and why such expenses are not already accounted for in the National Standards, Local Standards, or Other Necessary Expenses referred to in subclause (I).

(V) In addition, the debtor's monthly expenses may include an allowance for housing and utilities, in excess of the allowance specified by the Local Standards for housing and utilities issued by the Internal Revenue Service, based on the actual expenses for home energy costs if the debtor provides documentation of such actual expenses and demonstrates that such actual expenses are reasonable and necessary.

(iii) The debtor's average monthly payments on account of secured debts shall be calculated as the sum of—

(I) the total of all amounts scheduled as contractually due to secured creditors in each month of the 60 months following the date of the petition; and

(II) any additional payments to secured creditors necessary for the debtor, in filing a plan under chapter 13 of this title, to maintain possession of the debtor's primary residence, motor vehicle, or other property necessary for the support of the debtor and the debtor's dependents, that serves as collateral for secured debts;

divided by 60.

(iv) The debtor's expenses for payment of all priority claims (including priority child support and alimony claims) shall be calculated as the total amount of debts entitled to priority, divided by 60.

(B)(i) In any proceeding brought under this subsection, the presumption of abuse may only be rebutted by demonstrating special circumstances, such as a serious medical condition or a call or order to active duty in the Armed Forces, to the extent such special circumstances that justify additional expenses or adjustments of current monthly income for which there is no reasonable alternative.

* * * * *

(3) In considering under paragraph (1) whether the granting of relief would be an abuse of the provisions of this chapter in a case in which the presumption in subparagraph (A)(i) of such paragraph does not arise or is rebutted, the court shall consider—

(A) whether the debtor filed the petition in bad faith; or

(B) the totality of the circumstances (including whether the debtor seeks to reject a personal services contract and the financial need for such rejection as sought by the debtor) of the debtor's financial situation demonstrates abuse.

* * * * *

BRIEF BANK — "SUMMARY SHEET" *Printed Thu-5/28/09 15:27*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*
In re Milford Connecticut Associates, L.P. (Milford Connecticut Associates, L.P., Success-Treuhand GMBH, and Petillo Enterprises v. Diana G. Adams, United States Trustee, Paradigm CF Corporation, and Richard Belford, Chapter 7 Trustee)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*
D. Ct.

3. ("CCN") ***CURRENT*** CASE NO.
No.: 3:08-cv-01183-SRU

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*
No.: 04-30511 (ASD)
Court: Bankr. Ct.
(Identify judge & cite, if any)

5. ("SO") ***SOURCE***
U.S. TRUSTEES

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*
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7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*
Alicia M. Leonhard, Carrie Weinfeld, P. Matthew Sutko, Kim McCabe
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***
- Whether the bankruptcy court erred in finding that there was cause, under 11 U.S.C. § 1112(b), to dismiss or convert the debtor's chapter 11 case to a case under chapter 7; and whether the bankruptcy court abused its discretion when it converted the debtor's chapter 11 case to a case under chapter 7.

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UNITED STATES DISTRICT COURT
DISTRICT OF CONNECTICUT

In re:	:	Chapter 7
MILFORD CONNECTICUT ASSOCIATES, L. P., Debtor.	:	Case No. 04-30511 (ASD)
MILFORD CONNECTICUT ASSOCIATES, L. P., SUCCESS-TREUHAND GMBH, and PETILLO ENTERPRISES, Appellants, v. DIANA G. ADAMS, UNITED STATES TRUSTEE, PARADIGM CF CORPORATION, and RICHARD BELFORD, CHAPTER 7 TRUSTEE, Appellees.	:	Civil Action No. 3:08-cv-01183-SRU

BRIEF OF APPELLEE UNITED STATES TRUSTEE

Of Counsel:

RAMONA ELLIOT General Counsel P. MATTHEW SUTKO CARRIE WEINFIELD Office of the General Counsel Executive Office for United States Trustees United States Department of Justice 20 Massachusetts Avenue, N.W. Washington, D.C. 20530 Telephone: 202.305.0550	ALICIA M. LEONHARD (ct27844) KIM MCCABE Assistant United States Trustees Office of the United States Trustee United States Department of Justice 150 Court Street, Suite 302 New Haven, Connecticut 06510 Telephone: 203.773.2210 Facsimile: 203.773.2217 Alicia.M.Leonhard@usdoj.gov

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I. INTRODUCTION AND STATEMENT OF JURISDICTION

This is an appeal filed by chapter 7 debtor Milford Connecticut Associates, L.P. (the "Debtor), Success-Treuhand GmbH ("ST"), an equity security holder of the Debtor, and Petillo Enterprises ("Petillo"), an unsecured creditor of the Debtor (collectively, the "Appellants").[1] The Appellants appeal a final order of the bankruptcy court, entered on June 17, 2008, that converted the Debtor's chapter 11 case to a case under chapter 7, for cause, under 11 U.S.C. § 1112(b) (the "Conversion Order"). [RA, Exhibit 2, at 16.] The Conversion Order granted the United States Trustee's Amended Motion and Memorandum of Law in Support of Her Motions for Orders Either Converting the Debtor's Chapter 11 Case to One under Chapter 11 or Directing the Appointment of a Chapter 11 Trustee (the "Conversion Motion"). [RA, Exhibit 6, at 126.]

The bankruptcy court had jurisdiction over the Conversion Motion under 28 U.S.C. §§ 157(b)(2)(A) and 1334. The Conversion Order is a final order under 28 U.S.C. § 158(a)(1). *See In re Firstcent Shopping Center, Inc*., 141 B.R. 546, 550 (S.D.N.Y. 1992) (order converting a bankruptcy case is a final appealable order). *See also In re Pegasus Agency, Inc.*, 101 F.3d 882, 885 (2d Cir. 1996) (a bankruptcy court order is final if it "completely resolve[s] all of the issues pertaining to a discrete claim, including issues as to the proper relief") (citations omitted). On June 27, 2008, the Debtor filed a timely Notice of Appeal.[2] [RA, Exhibit 1, at 1.] This Court,

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[1] "RA" refers to the excerpts from the record on appeal filed with this brief. "Exhibit [#]" refers to the document in the RA, and "at #" refers to the consecutively numbered pages in the RA.

[2] On June 30, 2008, the Debtor filed an Amended Notice of Appeal. [RA, Exhibit 1, at 4.] On June 30, 2008, ST filed a Notice of Appeal and an Amended Notice of Appeal. [RA, Exhibit 1, at 10 and 13.] On June 30, 2008, Petillo filed a Notice of Appeal. [RA, Exhibit 1 at 7.]

therefore, has jurisdiction to hear the appeal under 28 U.S.C. § 158(a)(1).

II. STATEMENT OF ISSUES PRESENTED[3]

A. Whether the bankruptcy court clearly erred in finding that there was cause, under 11 U.S.C. § 1112(b), to dismiss or convert the Debtor's chapter 11 case to a case under chapter 7; and

B. Whether the bankruptcy court abused its discretion when it converted the Debtor's chapter 11 case to a case under chapter 7.

III. STANDARD OF APPELLATE REVIEW

The bankruptcy court's finding that there was cause to convert or dismiss a case under 11 U.S.C. § 1112(b) is reviewed under the clearly erroneous standard. *Cedar Shore Resort, Inc. v. Mueller (In re Cedar Shore Resort, Inc.),* 235 F.3d 375, 379 (8th Cir. 2000). *See also C-TC 9th Avenue Partnership v. Norton Co. (In re C-TC 9th Avenue Partnership),* 113 F.3d 1304, 1312 n.6 (2d Cir. 1997) (a finding of cause under Section 1112(b) based on bad faith is reviewed under the clearly erroneous standard) (citation omitted). *See also In re 1820-1838 Amsterdam Equities, Inc.*, 176 B.R. 127, 130 (S.D.N.Y. 1994) (the bankruptcy court's finding of cause under Section 1112(b) was reviewed under the clearly erroneous standard). "[A] district court's findings of fact must be liberally construed and found to be in consonance with the judgment if the judgment has support in the record evidence. . . . This is so even if the findings are not as

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[3] The Debtor also appeals the bankruptcy court's order denying confirmation of its plan of reorganization (the "2004 Plan") entered on March 10, 2008. *See* Appellant's Brief, at 21-24. The United States Trustee's participation in this appeal is limited to the issues arising from the entry of the Conversion Order. Appellee Paradigm CF Corporation. *f.k.a*. Mercury Capital Corporation ("Paradigm") will address whether the bankruptcy court abused its discretion in denying confirmation of the 2004 Plan.

specific or detailed as might be desired." *In re Fossum*, 764 F.2d 520, 522 (8th Cir. 1985) (citations and internal quotations marks omitted). In making findings under Section 1112(b), "[t]he bankruptcy court is not required . . . to rigidly apply the enumerated grounds for cause or to analyze one subsection of § 1112(b) in a way that excludes consideration of all other factors favoring conversion." *Loop Corp. v. United States Trustee*, 379 F.3d 511, 515 n.2 (8th Cir. 2004), *cert. denied*, 543 U.S. 1055).

A bankruptcy court's decision to convert or to dismiss a chapter 11 case under 11 U.S.C. § 1112(b) is reviewed for abuse of discretion. *See C-TC 9th Avenue Partnership*, 113 F.3d at 1312 (applying the abuse of discretion standard in an appeal of a decision dismissing a chapter 11 case under Section 1112(b)). *See also In re Tiana Queen Motel, Inc.*, 749 F.2d 146, 151 (2d Cir. 1984) (court's decision to convert rather than dismiss under Section 1112(b) was not an abuse of discretion) and *Cedar Shore Resort*, 235 F.3d at 379 (the decision to convert or dismiss will only be reversed if the bankruptcy court abused its discretion). A court's ruling is not an abuse of discretion unless it is based "on an erroneous view of the law or on a clearly erroneous assessment of the evidence." *Cooter & Gell v. Hartmarx Corp.*, 496 U.S. 384, 405 (1990). An appellate court reviews the bankruptcy court's conclusions of law *de novo* and its findings of fact for clear error. *In re Ionosphere Clubs, Inc.*, 922 F.2d 984, 988 (2d Cir. 1990).

IV. STATEMENT OF FACTS

A. The Debtor

The Debtor is a limited partnership organized under the laws of the State of New Jersey. [RA, Exhibit 3, at 18.] The Debtor's partners are ST and United States Land Resources ("United") (collectively, the "Equity Security Holders"). [RA, Exhibit 15, at 216, Question No.

21.a.] Lawrence Berger ("Mr. Berger") is the president of United. [RA, Exhibit 16, at 221.] Each Equity Security Holder owns a fifty percent interest in the Debtor. [RA, Exhibit 15, at 216, Question No. 21.a.]

The Debtor's sole asset is a parcel of commercial real property located at 265 Gate Lane, Milford, Connecticut (the "Real Property"). [RA, Exhibit 12, at 179.] The Debtor purchased the Real Property in 1986. [RA, Exhibit 11, at 179.] At the time the Debtor purchased the Real Property, there were two lessees, Owens-Illinois ("Owens") and Diversified Hospitality ("Diversified"). [RA, Exhibit 4, at 17, Lines 15-18, and Exhibit 12, at 179.] After Owens and Diversified vacated the premises, the Debtor leased the Real Property to Koenig Corporation ("Koenig"). [RA, Exhibit 12, at 179-180.] Koenig, however, filed bankruptcy and vacated the Real Property in the early 1990s. [RA, Exhibit 12, at 180.] Since that time, the Real Property has been vacant and has generated no cash flow. [RA, Exhibit 12, at 180, and Exhibit 4, at 74, Lines 19-25, and 75, Lines 1-10.] The Real Property, which the Debtor values at $10 million, is encumbered by a mortgage held by Paradigm CF Corporation, *f.k.a*. Mercury Capital Corporation ("Paradigm") in the approximate amount of $5.6 million and a tax lien of up to $1.6 million held by the City of Milford, Connecticut ("Milford"). [RA, Exhibit 8, at 149, and Exhibit 4, at 120, Lines 10-19.]

B. The 1999 Case

On March 29, 1999, the Debtor filed a voluntary chapter 11 petition (Case No. 99-31119) in the Bankruptcy Court for the District of Connecticut (the "1999 Case"). [RA, Exhibit 24, at 415, ECF Doc. No. 1.] The Debtor filed the 1999 Case to resolve a tax lien recorded on the Real Property, which Milford had transferred to Connecticut Freezer, Inc. ("CFI"). [RA, Exhibit 12, at 181.]

On June 29, 1999, the Debtor filed a disclosure statement (the “1999 Disclosure Statement”) and a plan of reorganization (the “1999 Plan”). [RA, Exhibit 24, at 419, ECF Doc. Nos. 37 and 38.] The 1999 Plan provided that United would contribute funds to the Debtor to rehabilitate the Real Property and to make initial payments to creditors under the Plan. [RA, Exhibit 25, at 437, § IV, and Exhibit 26, at 439, § VI.] The 1999 Plan also provided that once the rehabilitation was complete, the Debtor would lease the Real Property and use the rental income to complete the balance of payments under the Plan. [*Id.*] The bankruptcy court approved the 1999 Disclosure Statement on August 4, 1999. [RA, Exhibit 24, at 420, ECF Doc. No. 53.] After a trial on confirmation, the bankruptcy court entered an order confirming the 1999 Plan on December 22, 1999. [RA, Exhibit 24, at 425, ECF Doc. No. 90.] Under the terms of the 1999 Plan, United satisfied the claims of CFI and other creditors, but the Debtor did not complete the rehabilitation of the Real Property. [RA, Exhibit 12, at 181, and Exhibit 4, at 75, Lines 11-16.]

Two months after confirmation, in February 2000, Paradigm loaned the Debtor $3 million and took a first lien on the Real Property. [RA, Exhibit 12, at 180-181.] The Debtor has been delinquent in its obligations to Paradigm since 2000. [RA, Exhibit 12, at 181.] On May 30, 2003, the bankruptcy court entered a final decree and then closed the 1999 Case on July 1, 2003, after more than four years. [RA, Exhibit 24, at 428, ECF Doc. No. 116.]

C. The 2004 Case

Seven months after the 1999 Case closed, on February 6, 2004 (the “Petition Date”), the Debtor filed a new chapter 11 case in the Bankruptcy Court for the District of Connecticut (Case

No. 04-30511) (the “2004 Case”). [RA, Exhibit 23, at 375, ECF Doc. No. 1.] The Debtor filed the 2004 Case to stay a foreclosure judgment in favor of Paradigm entered in the Connecticut Superior Court. [RA, Exhibit 8, at 149.]

1. Assets and Liabilities

The Debtor filed its bankruptcy schedules and statement of financial affairs on June 22, 2004, more than three months late.[4] [RA, Exhibit 23, at 377, ECF Doc. No. 30.] On Schedule A, the Debtor valued the Real Property at $10 million. [RA, Exhibit 11, at 8.] The valuation was premised upon the future development of the Real Property as a shopping center and the impending approval by Lowe’s of an adjacent property as a site for a new store that the Debtor claimed would make the Real Property desirable to national retailers. [RA, Exhibit 12, at 182.] In 2005, the bankruptcy court determined that the fair market value of the Real Property was $6.2 million, after hearing expert appraisal testimony during a hearing on Paradigm’s motion for relief from the automatic stay. [RA, Exhibit 13, at 204.] In 2008, an appraisal commissioned by Paradigm set the value of the Real Property at $7.8 million based on its condition at the time. [RA, Exhibit 4, at 111, Lines 11-15.] In 2008, the Debtor’s appraiser estimated that the value of the Real Property was $9.2 million. [RA, Exhibit 4, at 97, Lines 17-19.]

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[4] Under 11 U.S.C. § 521(a)(1) and Fed. R. Bankr. P. 1007(c), debtors must file their schedules and statement of financial affairs “with the petition or within fifteen days thereafter” unless the bankruptcy court orders an extension of the deadline. Fed. R. Bankr. P. 1007(c). The Debtor did not file its schedules and statement of financial affairs on the Petition Date. On February 27, 2004, the bankruptcy court entered an order extending the deadline for the Debtor to file its schedules and statement of financial affairs to March 8, 2004. [RA, Exhibit 23, at 376, ECF Doc. No. 17.] The Debtor did not file them on this date, nor did it seek any further extensions of the deadline. [RA, Exhibit 23, at 376-377.]

On Schedule D, the Debtor listed two secured creditors with claims totaling $4.4 million, including Paradigm ($4.3 million) and Retail Stores Credit Corp. ($100,000). [RA, Exhibit 14, at 209.] By 2008, Paradigm's secured claim had grown to more than $5.6 million. [RA, Exhibit 8, at 149.] On Schedule E, the Debtor scheduled a priority tax claim in the amount of $162,601 owed to Milford for real property taxes. [RA, Exhibit 15, at 211.] Milford filed proofs of claim in 2008 and asserted a secured claim totaling $408,080.26 and a separate unclassified claim for $1,057,016.96. [RA, Exhibit 28, at 444 and 446.] On Schedule F, the Debtor listed nine general unsecured creditors with claims totaling $3,594,020. [RA, Exhibit 15, at 212.] The largest claimant was United, with a claim of $3.5 million. [RA, Exhibit 15 at 212.] Scheduled non-insider general unsecured claims totaled $94,000. [RA, Exhibit 15, at 212.]

2. Monthly Operating Reports ("MORs")

During the pendency of the 2004 Case, the Debtor consistently filed untimely and incomplete MORs.[5] Eight months after the Petition Date, on October 4, 2004, the Debtor filed MORs for February through August 2004. [RA, Exhibit 22, at 371, and Exhibit 23, at 378, ECF Doc. No. 37.] A year later, on November 9, 2005, the Debtor filed MORs for August 2004 through September 2005. [RA, Exhibit 21, at 269, and Exhibit 23, at 390, ECF Doc. No. 187.] On April 3, 2007, the Debtor filed MORs for October 2005 through March 2007. [RA, Exhibit 20, at 266, and Exhibit 23, at 397, ECF Doc. No. 187.] On January 17, 2008, the Debtor filed MORs for April through December 2007. [RA, Exhibit 18, at 243, and Exhibit 23, at 397, ECF

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[5] Under the United States Trustee's Operating Guidelines and Reporting Requirements for Debtors in Possession and Trustees (the "Operating Guidelines"), debtors in possession must file MORs, signed under penalty of perjury, by the twentieth of the month following the reporting period. *See* Operating Guidelines, at 4, ¶ 9, attached as Appendix A.

Doc. No. 192.] On April 7, 2008, the Debtor filed MORs for January and February 2008. [RA, Exhibit 17, at 231, and Exhibit 23, at 404, ECF Doc. No. 233.] On May 21, 2008, the Debtor filed MORs for March and April 2008. [RA, Exhibit 16, at 218, and Exhibit 23, at 406, ECF Doc. No. 247.]

According to the MORs and Mr. Berger's testimony, the Debtor had no cash or bank accounts. [RA, Exhibits 16-21, and Exhibit 4, at 62, Lines 1-8.] The MORs and Mr. Berger also disclosed that United paid the Debtor's expenses during the 2004 Case, and the payments were reflected in the schedules of the cash disbursements included in the MORs.[6] [RA, Exhibits 16-21, and Exhibit 4, at 60, Lines 18-25, and 61, Lines 1-7.] The MORs, however, did not consistently follow the proper format or contain all of the financial information required by the Operating Guidelines.[7] The MORs generally disclosed only the value of the Real Property, cash disbursements, loans payable to United and pre-petition liabilities. [RA, Exhibits 16-21.] From October 1, 2005 through March 31, 2007, the Debtor filed only unsworn spreadsheets setting forth United's quarterly disbursements on behalf of the Debtor. [RA, Exhibit 20, at 268.] None of the MORs disclosed unpaid accrued post-petition liabilities, except as to United, as the Operating Guidelines require. [RA, Exhibits 16-21.] In the MOR for November 2007, the Debtor first admitted that it owed post-petition real property taxes to Milford, [RA, Exhibit 18, at

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[6] During the pendency of the 2004 Case, United paid the Debtor's insurance, United States Trustee quarterly fees, professional fees, travel expenses and miscellaneous expenses for Mr. Berger. [RA, Exhibits 16-21.]

[7] Under the Operating Guidelines, MORs must contain, among other things, a statement of cash receipts and disbursements, an accrual based income and expense statement, a balance sheet, a schedule of post-petition liabilities, and a schedule post-petition taxes payable. *See* Operating Guidelines, at 4-5, ¶ 9, and RA, Exhibits 16-20.

262], but in none them did the Debtor disclose the amount of the delinquency. [RA, Exhibits 16-20.] The MORs disclosed no payments whatsoever to Milford until April 2008 when the bankruptcy court ordered the Debtor to cure the post-petition delinquency as a condition of continuing the hearing on the Conversion Motion (the "Continuance Order").[8] [RA, Exhibit 5, at 124, and Exhibit 16, at 229.]

3. Quarterly Fees

Throughout the 2004 Case, the Debtor was untimely in its payment of its quarterly fee obligations.[9] The Debtor's first quarterly fee payment was due on April 30, 2004. The Debtor did not make this payment of $250.00, which was the minimum payment at the time, until April 2005. [RA, Exhibit 21, at 329.] During the ensuing sixteen quarters, the Debtor paid the required fee late eight times. [RA, Exhibit 20, at 268, Exhibit 19, at 263, and Exhibit 16, at 229.]

4. Chapter 11 Plan Confirmation

On June 24, 2005, Paradigm filed a disclosure statement (the "Paradigm Disclosure Statement") and a creditor's plan of reorganization (the "Paradigm Plan"). [RA, Exhibit 23, at 379, ECF Doc. Nos. 46-47.] The Paradigm Plan provided for the immediate sale of the Real Property to satisfy the claims of creditors. [RA, Exhibit 8, at 149.]

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[8] The bankruptcy court entered the Continuance Order on April 23, 2008. [RA, Exhibit 5. at 124-125.] As a condition to granting the Debtor's motion for a continuance of the hearing on the Conversion Motion, the bankruptcy court ordered the Debtor to pay Milford all taxes that were due on January 31, 2008, plus $10,000, and to begin monthly payments to Paradigm in the amount of $34,026.19. [RA, Exhibit 5 at 124-125.]

[9] All chapter 11 debtors are required to pay quarterly fees to the United States Trustee, based on their quarterly cash disbursements, within thirty days of the close of each calendar quarter. A copy of 28 U.S.C. § 1930(a)(6) is attached as Appendix B.

On August 31, 2005, the United States Trustee filed a motion to convert the 2004 Case to a case under chapter 7 (the “First Conversion Motion”) because the Debtor had failed to file MORs or to propose a plan of reorganization. [RA, Exhibit 23, at 381, ECF Doc. No. 69.] On September 9, 2005, the United States Trustee filed a motion for an order directing the appointment of a chapter 11 trustee (the “Chapter 11 Trustee Motion”). [RA, Exhibit 23, at 382, ECF Doc. No. 72.] The First Conversion Motion and the Chapter 11 Trustee Motion are collectively referred to as the “UST Motions.”

On September 12, 2005, the Debtor filed a disclosure statement (the “2004 Disclosure Statement”) and a plan of reorganization (the “2004 Plan”). [RA, Exhibit 23, at 383, ECF Doc. Nos. 78-79.] The 2004 Plan provided for the sale of the Real Property within thirty months of confirmation of the 2004 Plan. [RA, Exhibit 11, at 171.] On October 6, 2005, the bankruptcy court approved the Paradigm Disclosure Statement, as amended on October 3, 2005, and the 2004 Disclosure Statement, as amended on October 3, 2005. [RA, Exhibit 23, at 386, ECF Doc. No. 106.] On October 7, 2008, the bankruptcy court entered an amended order approving both disclosure statements and setting a date for the hearing on confirmation. [RA, Exhibit 23, at 387, ECF Doc. No. 107.] On November 10, 2005, the bankruptcy court held an evidentiary hearing on the competing plans and the UST Motions. [RA, Exhibit 23, at 390, November 10, 2005 Docket Entry.]

5. Paradigm’s Appeal of the First Confirmation Order

On November 21, 2005, the bankruptcy court denied confirmation of the Paradigm Plan and confirmed the 2004 Plan (the “First Confirmation Order”). [RA, Exhibit 10, at 162-163.] The bankruptcy court did not decide the UST Motions. [*Id.*]

Paradigm filed a notice of appeal of the First Confirmation Order on November 29, 2005. [RA, Exhibit 23, at 390, ECF Doc. No. 133.] On December 7, 2005, the Debtor filed a notice of cross appeal. [RA, Exhibit 23, at 391, ECF Doc. No. 140.] Paradigm filed a motion for a stay pending appeal on December 1, 2005 (the "Motion for Stay Pending Appeal"). [RA, Exhibit 23, at 391, ECF Doc. No. 137.] On December 21, 2005, the bankruptcy court entered a stipulated order regarding the Motion for Stay Pending Appeal (the "Stipulated Stay Order"). [RA, Exhibit 9, at 159-160.] The bankruptcy court granted the stay but provided that:

> The Debtor is fully authorized as debtor-in-possession to market, negotiate, sell, lease and/or option [the Real Property] during the pendency of [Paradigm's] appeal, fully binding the Debtor subject only to Court approval pursuant to the requirements of 11 U.S.C. § 363 and all other applicable provisions of the Bankruptcy Code and the Federal Rules of Bankruptcy Procedure and [Paradigm's] rights to object. Further, [Paradigm] shall not solicit offers for the Real Property nor negotiate with potential buyers for the Real Property, and if [Paradigm] receives any offers or communications from potential buyers, [Paradigm] will direct them to the Debtor during the pendency of the appeal.

[RA, Exhibit 9, at 160.]

On appeal, Paradigm argued, among other things, that the bankruptcy court erred when it determined that the 2004 Plan was feasible, under 11 U.S.C. § 1129(a)(3), proposed in good faith, under 11 U.S.C. § 1129(a)(11), complied with the best interests of creditors test of 11 U.S.C. § 1129(a)(7), and did not unfairly discriminate against Paradigm under 11 U.S.C. § 1129(b)(1). [RA, Exhibit 8, at 150.] In the cross appeal, the Debtor argued that the Paradigm Plan was not confirmable. [RA, Exhibit 8, at 150-151.]

6. The First Appeal Decision

On October 20, 2006, the District Court for the District of Connecticut vacated the First Confirmation Order and remanded the case to the bankruptcy court. *See Mercury Capital*

Corporation v. Milford Connecticut Associates, LP, 354 B.R. 1, 4 (D. Conn. 2006) (the "First Appeal Decision"). [RA, Exhibit 8, at 144.] The district court found that the bankruptcy court did not abuse its discretion in finding that the 2004 Plan was feasible. [RA, Exhibit 8, at 153-154.] However, it remanded two issues to the bankruptcy court for further consideration: (a) whether the 2004 Plan should include a provision explicitly requiring United to fund the 2004 Plan in light of United's history of failing to meet the Debtor's financial obligations and (b) whether the separate classification of the claims of Paradigm and Milford violated 11 U.S.C. § 1129(b)(1). [RA, Exhibit 8, at 158.]

7. The Denial of Confirmation of the 2004 Plan on Remand

Upon remand and after a hearing, the bankruptcy court denied confirmation of the 2004 Plan on March 10, 2008 (the "Order Denying Confirmation"). [RA, Exhibit 7, at 141.] The bankruptcy court undertook a "fresh analysis" of the 2004 Plan under the confirmation standards of 11 U.S.C. § 1129. [RA, Exhibit 7, at 142.] The bankruptcy court "determine[d] on remand, and in light of the track record of the Debtor, that the [2004 Plan] is not feasible under the standards of 11 U.S.C. § 1129(a)(11)." [RA, Exhibit 7, at 143.] The bankruptcy court noted that the "centerpiece of the [2004 Plan] was an exclusive 30-month marketing window for the Real Property," but that the Debtor had not engaged in any meaningful attempts to market the Real Property during the twenty-seven months since confirmation of the 2004 Plan, and "has utterly failed to advantage itself of the generous sale opportunity" provided under the 2004 Plan. [RA, Exhibit 7, at 140 and 142.] In fact, the Debtor had argued that it needed additional time to rehabilitate and refinance or sell the Real Property under the 2004 Plan. [RA, Exhibit 7, at 142.] The bankruptcy court found that the Debtor could not establish that the 2004 Plan "offers a reasonable assurance of success" because the Debtor had admitted that it could not consummate the 2004 Plan within the required time frame and that it required additional time to effectuate the 2004 Plan.[10] [RA, Exhibit 7, at 142-143.]

The Debtor filed a notice of appeal of the Order Denying Confirmation, a motion for leave to appeal and a motion for a stay pending appeal on March 20, 2008.[11] [RA, Exhibit 23, at 399, ECF Doc. No. 208-210.] On May 7, 2008, the bankruptcy court denied the motion for a stay pending appeal. [RA, Exhibit 23, at 405, ECF Doc. No. 244.] On May 16, 2008, the district court denied leave to appeal. [RA, Exhibit 22, at 405, ECF Doc. No. 246.]

8. Conversion of the 2004 Case to a Case under Chapter 7

On May 2, 2008, the United States Trustee filed the Conversion Motion. [RA, Exhibit 6, at 126.] After a contested hearing at which the bankruptcy court heard testimony from Mr. Berger and appraisers for both the Debtor and Paradigm, the bankruptcy court issued a decision converting the Debtor's chapter 11 case to a case under chapter 7 (the "Conversion Decision") on June 17, 2008. [RA, Exhibit 3, at 17, Exhibit 4, at 28-123, and Exhibit 23, at 406, ECF Doc. No. 251.]

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[10] The bankruptcy court noted that at a status conference on confirmation of the 2004 Plan on remand, held on March 4, 2008, the Debtor had requested thirty additional months to effectuate the 2005 Plan. [RA, Exhibit 3, at 20, n.3.] At the hearing on the Conversion Motion, however, the Debtor asserted that it would be able to consummate the 2004 Plan in eighteen months. [RA, Exhibit 4, at 66, Lines 6-9.]

[11] An order denying confirmation of a chapter 11 plan of reorganization is an interlocutory order. *See Flor v. BOT Financial Corp. (In re Flor)*, 79 F.3d 281, 283 (2d Cir. 1996). An order denying confirmation of a plan becomes a final order only after the bankruptcy court has converted or dismissed the case or confirmed a modified plan. *In re Broken Bow Ranch*, 33 F.3d 1005, 1005 (8th Cir. 1994).

The bankruptcy court found, based on evidence presented at the contested hearing on the Conversion Motion and on the entire record of the 2004 Case, that:

1. The Debtor filed its schedules and statement of financial affairs over four months late. [RA, Exhibit 3, at 22.]

2. The Debtor did not propose a plan of reorganization for over nineteen months. [RA, Exhibit 3, at 22.]

3. The Debtor made its quarterly fee payments late. [RA, Exhibit 3, at 22.]

4. "[The Debtor] has been chronically and severely late in filing required Monthly Operating Reports," and the form of the MORs often did not conform with the Operating Guidelines for MORs. [RA, Exhibit 3, at 22.]

5. The appraisals submitted by the Debtor and Paradigm showed that there was a sufficient equity cushion to satisfy Paradigm's secured claim. [RA, Exhibit 3, at 23.]

6. The Debtor made no payments to Paradigm during the case and it made no payments to Milford toward accrued and accruing real property taxes. [RA, Exhibit 3, at 23.]

7. Mr. Berger testified credibly that "in the marketplace outside of bankruptcy, the Debtor's protracted and insular approach to the marketing and development of the Real Property was a prudent and commercially reasonable course of conduct." [RA, Exhibit 3, at 23.] The bankruptcy court also noted that:

> this position neglects the fact that in the "real world" the Debtor would long ago have had to account for and accept the non-bankruptcy consequences of the financial arrangements it made with its creditors – most notably, [Paradigm]. Indeed, the very reason the Debtor entered into the "bankruptcy world" was to *avoid* the consequences of its "real world" obligations – most notably, an impending foreclosure of the Real Property by [Paradigm]. In essence, the Debtor wants all the benefits of chapter 11 without accepting the concomitant constraints.

[RA, Exhibit 3, at 26.] (Emphasis in original.)

8. Mr. Berger's testimony demonstrated that the Debtor intended to "park" the Real Property in bankruptcy until it had determined that market conditions were optimal. [RA, Exhibit 3, at 25.]

9. In light of the 1999 Case, the Real Property "has been languishing in bankruptcy for nearly a full decade without a good faith effort toward reorganization." [RA, Exhibit 3, at 25, n.8.]

In sum, the bankruptcy court concluded that the Debtor "seriously neglected its reporting and other administrative responsibilities as a chapter 11 debtor-in-possession." [RA, Exhibit 3, at 24.] The bankruptcy court further found that the deficiencies were compounded by the Debtor's "utter and complete disregard of its responsibilities as a bankruptcy fiduciary," [RA, Exhibit 3, at 25], and that the Debtor had accepted the benefits of bankruptcy but failed to meet its obligations of full disclosure and expeditious administration. [RA, Exhibit 3, at 26-27.] These failures, the bankruptcy court held, constituted "more than ample cause," under 11 U.S.C. § 1112(b), to convert the chapter 11 case to a case under chapter 7, "to place the administration of the Debtor's estate in the hands of an independent fiduciary charged with . . . liquidating that estate with due expedition." [RA, Exhibit 3, at 24.]

On June 17, 2008, the bankruptcy court entered the Conversion Order. [RA, Exhibit 2, at 16, and Exhibit 23, at 406, ECF Doc. No. 252.] On June 17, 2008 Richard Belford was appointed as interim trustee and thereafter qualified as the permanent trustee under 11 U.S.C. §

702 (the “Trustee”).[12] [RA, Exhibit 23, at 406, ECF Doc. No. 252.]

The Debtor filed a notice of appeal of the Conversion Order on June 27, 2008 and an amended notice of appeal on June 30, 2008. [RA, Exhibit 1, at 1 and 4, and Exhibit 23, at 407, ECF Doc. Nos. 258 and 263.] ST and Petillo filed notices of appeal on June 30, 2008. [RA, Exhibit 1, at 7 and 13, Exhibit 23, at 407, ECF Doc. Nos. 259 and 262, and 408, ECF Doc. No. 264.] The Debtor did not seek a stay pending appeal. [RA, Exhibit 23, at 407-413.]

V. SUMMARY OF ARGUMENT

The bankruptcy court did not clearly err when it determined that there was cause, under 11 U.S.C. § 1112(b), to convert or dismiss the 2004 Case. There is substantial evidence in the record to support the bankruptcy court’s findings that the Debtor breached its fiduciary duties of expeditious administration and disclosure. The record shows that, for nearly ten years, through two chapter 11 cases, the Debtor allowed the Real Property, its sole asset, to remain vacant, despite promises to develop the Real Property as a shopping center to satisfy the claims of its creditors. During the 2004 Case, the Debtor took no meaningful steps to develop and sell or refinance the Real Property to effectuate the 2004 Plan, and compounding this unreasonable delay was the Debtor’s blatant disregard of its administrative obligations as a chapter 11 debtor.

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[12] On August 14, 2008, Petillo and another creditor, Cummings & Lockwood (“CL”), made a request to the United States Trustee for an election of a trustee under 11 U.S.C. § 702. The United States Trustee held the election on September 15, 2008 but could not appoint the elected trustee due to an election controversy (the “Election Controversy”). Under Fed. R. Bank. P. 2003(d)(2), the United States Trustee filed a Report of Election Controversy with the bankruptcy court on October 24, 2008, [RA, Exhibit 23, at 412, ECF Doc. No. 299], and on November 3, 2008, Petillo and CL filed a motion to resolve the Election Controversy (the “Election Motion”). [*Id.*, ECF Doc. No. 300.]. On December 8, 2008, just prior to the hearing on the Election Controversy, Petillo and CL withdrew the Election Motion and CL withdrew its claim. [RA, Exhibit 23, at 413, Doc. Nos. 307-308.] Therefore, by operation of 11 U.S.C. § 702(d), Richard Belford became the permanent trustee.

During this time, steadily increasing unpaid taxes diminished the value of the Real Property to creditors. The record also shows that the Debtor failed to file timely, complete and accurate MORs during the four years that the 2004 Case was pending, which was a breach of the Debtor's fiduciary duty of full, open and honest disclosure of its financial affairs. After finding cause under Section 1112(b) based on substantial evidence in the record, the bankruptcy court properly exercised its discretion when it ordered conversion of the 2004 Case to a case under chapter 7 rather than ordering dismissal or the appointment of a chapter 11 trustee. This Court should, therefore, affirm the Conversion Order.

VI. ARGUMENT

The bankruptcy court did not clearly err when it converted the debtor's case to a case under chapter 7 under 11 U.S.C. § 1112(b). Section 1112(b) of the Bankruptcy Code provides in part:

> (b) Except as provided in subsection (c) of this section, on request of a party in interest or the United States Trustee . . ., and after notice and a hearing, the court may convert a case under this chapter to a case under chapter 7 of this title or may dismiss a case under this chapter, whichever is in the best interest of creditors and the estate, for cause, including –
>
> > (1) continuing loss to or diminution of the estate and absence of a reasonable likelihood of rehabilitation;
> >
> > (2) inability to effectuate a plan;
> >
> > (3) unreasonable delay by the debtor that is prejudicial to creditors; [and]
> >
> > ****
> >
> > (10) nonpayment of any fees or charges required under chapter 123 of title 28.

11 U.S.C. § 1112(b)(1), (2), (3) and (10) (1994).[13]

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[13] In 2005, Congress amended Section 1112(b) when it enacted the Bankruptcy Abuse Prevention and Consumer Protection Act ("BAPCPA"). Amended Section 1112(b) applies to cases filed after the statute's effective date of October 17, 2005 (the "Effective Date").

Section 1112(b) requires a two-step analysis. *In re Hampton Hotel Investors, L.P.*, 270 B.R. 346, 358 (Bankr. S.D.N.Y. 2001) (citing *Rollex Corp. v. Associated Materials (In re Superior Siding and Window, Inc.*), 14 F.3d 240, 242 (4th Cir. 1994)). First, the bankruptcy court must determine whether there is "cause" to convert or dismiss. *Id*. at 359. In addition to the specific examples set forth in Section 1112(b), "cause" may also include unenumerated examples. *See C-TC 9th Avenue Partnership,* 113 F.2d at 1311 (examples of cause enumerated in Section 1112(b) are not exhaustive and the court should consider other factors as they arise) (citation omitted). After the bankruptcy court finds cause, it then must decide, in its discretion, whether it is in the best interests of creditors and the bankruptcy estate to dismiss the case or to convert it to a case under chapter 7. *Hampton Hotel Investors*, 270 B.R. at 359.

A. Cause Existed under 11 U.S.C. § 1112(b) to Convert the Debtor's Case to a Case Under Chapter 7 Because the Debtor Breached Its Fiduciary Duties.

The Bankruptcy Code imposes fiduciary duties on chapter 11 debtors. *Commodity Futures Trading Commission v. Weintraub*, 471 U.S. 343, 355 (1985). *See also In re Adelphia Communications*, 544 F.3d 420, 424 (2d Cir. 2008) (the debtor in possession is the bankruptcy estate's fiduciary). A debtor's failure to fulfill its fiduciary duties as a debtor in possession constitutes cause under Section 1112(b). *In re Telemark Mgt. Co.,* 41 B.R. 501, 507 (Bankr. N.D.N.Y. 1989) (citation omitted). *See also Matter of E. Paul Kovacs and Co., Inc.,* 16 B.R. 203, 205 (Bankr. D. Conn. 1981) (breach of fiduciary duties is an unenumerated example of cause to convert or dismiss a case under Section 1112(b)).

See, e.g., In re Ryan, 380 B.R. 275, 276 (Bankr. S. D. Fla. 2007) (BAPCPA expressly provides that its provisions apply to cases filed after the Effective Date). Because the 2004 Case was filed prior to the Effective Date, the 1994 version of Section 1112(b) governs.

Outside of bankruptcy, a company's fiduciary duties run to its shareholders. *In re Integrated Resources, Inc*., 147 B.R. 650, 658 (S.D.N.Y. 1992). A company's relationship to its creditors "is governed by principles of commercial law and the marketplace, where no fiduciary obligations are, in the usual instance, owed." *In re Herberman*, 122 B.R. 273, 282, n.12 (Bankr. W. D. Tex. 1990).

"However, the fiduciary's obligations in bankruptcy and the standards upon which they are measured are not the same, for all types of transactions, as those applied outside of bankruptcy." *In re Schipper,* 109 B.R. 832, 836 (Bankr. N. D. Ill. 1989), *aff'd,* 112 B.R. 917 (N. D. Ill. 1990), *aff'd*, 933 F.2d 513 (1991). In bankruptcy, the debtor must "further the diverse interests of the debtor, creditors and equity holders, alike." *Integrated Resources*, 147 B.R. at 658 (quoting *In re Lionel Corp*., 772 F.2d 1063, 1071 (2d Cir. 1983)). Chapter 11 debtors have an "obligation to treat all parties, not merely the shareholders, fairly." *Weintraub*, 471 U.S. at 356. "[A] fiduciary - the debtor in possession - is proscribed from acting solely in its self interest to the exclusion of the other interests which the debtor in possession has the fiduciary obligation to protect." *In re SunCruz Casinos*, 298 B.R. 821, 830 (Bankr. S. D. Fla. 2003) (citation omitted). *See also In re Herberman*, 122 B.R. at 282 (fiduciary duties in bankruptcy impose limitations on business decisions). *See also State of Illinois, Department of Revenue v. Schechter*, 195 B.R. 380, 384 (N. D. Ill. 1996) (chapter 11 trustee has a fiduciary duty to operate the debtor's business to maximize the value of the estate). Thus, the business discretion of a debtor in possession is limited by the fiduciary duties that arise in chapter 11. *See Herberman*, 122 B.R. at 280 (in chapter 11, the debtor's business discretion must be exercised for the benefit of the bankruptcy estate, not the debtor itself).

1. The Debtor Breached Its Duty of Expeditious Administration.

While in chapter 11, a debtor in possession has a fiduciary duty to expeditiously administer the bankruptcy estate for the benefit of creditors. *In re Van Brunt*, 46 B.R. 29, 30 (Bankr. D. Wis. 1984). Cause, therefore, exists under Section 1112(b) where the debtor has failed to expeditiously administer the estate. *Id.*

> Debtors should not continue in control of their businesses under the umbrella of the reorganization court beyond the point at which reorganization no longer remains a realistic undertaking, unless liquidation would proceed more expeditiously and less expensively under the control of the debtor . . . . [Where] there is nothing in the record . . . to suggest that is that the debtor-in-possession is either better able or more motivated to proceed promptly with an efficient liquidation than is an experienced fiduciary whose commitment is to the promotion of parity among interested parties rather than to self-interest [conversion to chapter 7 is warranted].

In re Wright Airlines, Inc., 51 B.R. 96, 99 (Bankr. N. D. Ohio 1985) (quoting *In re L. S. good & Co.*, 8 B.R. 315, 318 (Bankr. N. D. W. Va. 1980). Debtors in possession may not "utilize chapter 11 to prolong control of an insolvent enterprise where no benefit to the public or creditors is plausible." *In re Hi-Toc Development* Corp., 159 B.R. 691, 693 (S.D.N.Y. 1993). *See also In re Halpern*, 229 B.R. 67, 75 (Bankr. E.D.N.Y. 1999) (case would be dismissed where debtor was given ample opportunity to sell estate's real property but did not do so; risk of further delay fell disproportionately on creditors who were not compensated for the added risk).

a. The Debtor Acknowledged at Trial that Any Development of the Real Property Was Uncertain Because It Was Conditioned on a Number of Events Occurring Over a Lengthy Period of Time.

At the hearing on the Conversion Motion, Mr. Berger testified that to sell the Real Property at the Debtor's optimal price, the Debtor would have to develop the Real Property as a shopping center. [RA, Exhibit 4, at 55, Lines 17-25, 56, Lines 1-25, 57, Lines 1-19, 81, Line 25, and 82, Lines 1-10.] To build a shopping center, Mr. Berger testified, the Debtor would have to change the zoning of the Real Property from industrial to commercial use, which would take up to eight months to complete. [RA, Exhibit 4, at 71, Lines 22-25, 108, Lines 1-25, and 109, Lines 1-8.]

Mr. Berger also testified that the Debtor would have to enter into a long-term lease agreement with a national retailer that would anchor the shopping center. [RA, Exhibit 4, at 36, Lines 1-9 and 18-25.] According to Mr. Berger, signing a national retail tenant is a long process, requiring multiple contacts and communications with prospective lessees. [RA, Exhibit 4, at 41, Lines 11-25, and 42, Lines 1-6.] Mr. Berger testified that the profitability of the Lowe's store in the neighboring parcel had to be established before any national retailer would make a firm commitment to build a store on the Real Property. [RA, Exhibit 4, at 37, Lines 20-25, 38, Lines 1-5, and 43, Lines 4-13.] Mr. Berger could not predict exactly how long it would take for Lowe's to become sufficiently profitable to attract tenants to the Real Property, but he estimated that it could take as little as four months or as long as a year. [RA, Exhibit 4, at 33, Lines 16-18, 37, Lines 20-25, 38, Lines 1-5, 46, Lines 4-13, and 47, Lines 1-19.] He testified that, after the success of Lowe's had been established, it would take many months for a retailer to make a decision whether to lease space for a store on the Real Property. [RA, Exhibit 4, at 41, Lines 11-25, and 42, Lines 1-6.] Mr. Berger noted that "[t]hat doesn't happen in a week or a month, or even four or five months. That's a process that takes time." [RA, Exhibit 4, at 41, Line 25, and 42, Lines 1-7.] Then, it would take an additional two or three months for the Debtor and the retailer to negotiate and sign a lease. [RA, Exhibit 4, at 47, Lines 20-25, and 48, Lines 1-15.]

Once the Debtor had signed an agreement with a national tenant, it would then have to obtain financing to build the store or sell the Real Property to another developer. [RA, Exhibit 4, at 48, Lines 4-15, and 49, Lines 17-24.] According to Mr. Berger, the Debtor would not be able to obtain financing to begin the development or find a buyer for the Real Property until a national retailer had entered into a lease of the Real Property. [RA, Exhibit 4, at 81, Lines 9-24.]

b. The Debtor Failed to Take Any Meaningful Steps to Complete the Development Plans for the Real Property during the 2004 Case.

Mr. Berger's testimony also shows that, during the 2004 Case, the Debtor did nothing to complete its development plans for the Real Property to effectuate the 2004 Plan. The Debtor did not attempt to rezone the Real Property for retail use. [RA, Exhibit 4, at 71, Lines 21-25, and 72, Lines 1-8.] As of May 22, 2008, the date of the hearing on the Conversion Motion, the Debtor had not even applied to Milford for a change in the zoning designation of the Real Property. [RA, Exhibit 4, at 71, Lines 21-25, and 72, Lines 1-8.] Milford's approval of the zoning change was not assured and the process would take up to eight months to complete. [RA, Exhibit 4, at 107, Lines 17-25, 112, Lines 24-25, and 113, Lines 4-11.]

Moreover, the Debtor did not make any serious efforts to interest national retailers in the development of the Real Property. During the 2004 Case, the Debtor did little more than contact potential national tenants. [RA, Exhibit 4, at 36, Lines 1-9 and 18-25, 42 Lines 20-25, and 43, Lines 1-3.] When the bankruptcy court asked Mr. Berger what else, if anything, the Debtor had done to further the development of the Real Property, Mr. Berger answered, "there's really nothing else to do." [RA, Exhibit 4, 52, Lines 9-19.]

The Debtor did not retain a broker in the 2004 Case to seek tenants for the Real Property,[14] although a broker, who is not licensed in Connecticut (the "Broker"), was allegedly contacting national retailers on behalf of the Debtor. [RA, Exhibit 4, at 54, Lines 7-18, 70, Lines 20-25, and 71, Lines 1-12.] Mr. Berger admitted that the Broker had had little success interesting national retailers in the Real Property, even though he had been contacting them for at least two years. [RA, Exhibit 4, at 82, Lines 23-25, and 83, Lines 1-9.] The Broker was unsuccessful, according to Mr. Berger, because "the circumstances haven't been right until now." [RA, Exhibit 4, at 83, Lines 5-9.] As he testified, "the tenant will come, particularly if Lowe's does well." [RA, Exhibit 4, at 55, Lines 1-6.]

The Debtor's only other step was to talk with adjacent property owners, including a developer named Ceruzzi ("Mr. Ceruzzi"), who was a potential purchaser of the Real Property. [RA, Exhibit 4, at 72, Lines 9-14, 75, Lines 17-25, and 76, Lines 1-8.] Mr. Berger admitted, however, that his last contact with Mr. Ceruzzi had been at least a year prior to the hearing on the Conversion Motion and he was unsure of the nature and timing of the Broker's contacts with Mr. Ceruzzi. [RA, Exhibit 4, at 72, Lines 9-24, and 73, Lines 1-8.]

c. The Debtor's Promises to Complete the Development Under the 2004 Plan Were Unrealistic at Best and Illusory at Worst.

Mr. Berger's testimony and the record of the 2004 Case show that the Debtor's promises to develop and sell or refinance the Real Property within the timetable set forth in the 2004 Plan were unrealistic at best and illusory at worst. At the hearing on confirmation of the 2004 Plan in November 2005, Mr. Berger had assured the bankruptcy court that the Debtor would be able to

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[14] Under 11 U.S.C. § 327(a), debtors in possession must obtain an order of the bankruptcy court before they retain professionals, such as attorneys, accountants and brokers.

develop and sell or refinance the Real Property within thirty months. [RA, Exhibit 4, at 79, Lines 6-12, and Exhibit 29, at 453, Lines 12-25, and 454, Lines 1-9.] At that time, the Debtor asserted that Lowe's mere agreement in 2005 to build a store on the neighboring property would facilitate the Debtor's rehabilitation of the Real Property and ensure the viability of the 2004 Plan. [RA, Exhibit 12, at 182, § II, and Exhibit 29, at 453, Lines 12-25, and 454, Lines 1-9.] The Debtor, however, did not rehabilitate, sell or refinance the Real Property within thirty months. [RA, Exhibit 4, at 86, Lines 17-23.] In 2008, Mr. Berger testified that the Debtor required an additional eighteen months to develop the Real Property because the **success** of the Lowe's store, which had opened two months before the hearing on the Conversion Motion, had to be established before any national retailers would even consider entering into a long term lease of the Real Property. [RA, Exhibit 4, at 33, Lines 16-17, 37, Lines 20-25, 38, Lines 1-5, 43, Lines 4-13, and 66, Lines 6-9.]

Mr. Berger blamed the Debtor's failure to develop the Real Property during the 2004 Case on the lack of retail development in the area and the uncertainty surrounding Lowe's profitability. [RA, Exhibit 4, at 33, Lines 7-17, 43, Lines 4-13, 49, Lines 17-25, 51, Lines 23-25, 52, Lines 1-8, and 55, Lines 1-6.] The Debtor also blamed the appeal of the First Confirmation Order, which it claimed chilled interest in the Real Property. *See* Appellant's Brief, at 15, n.5. However, the Stipulated Stay Order explicitly authorized the Debtor "to market, negotiate, sell, lease and/or option the [Real Property]" during the pendency of the appeal and that any transaction that the Debtor consummated would be "fully binding the Debtor subject only to Court approval pursuant to the requirements of 11 U.S.C. § 363 and all other applicable provisions of the Bankruptcy Code and the Federal Rules of Bankruptcy Procedure." [RA,

Exhibit 9, at 160.] Nonetheless, the Debtor continued its pattern of inaction and did not take any steps to begin to rehabilitate or to market the Real Property in the year that the appeal of the First Confirmation Order was pending. [RA, Exhibit 4, at 67, Lines 21-25, and 68, Lines 1-17.]

The record also shows that the Debtor would not have been able to complete its plans during the additional eighteen-month period that Mr. Berger claimed was sufficient. Based on the testimony of the Debtor's appraiser at the hearing on the Conversion Motion, it would take up eight months to obtain a zoning change. [RA, Exhibit 4, at 107, Lines 17-25.] According to Mr. Berger, the profitability of Lowe's would not be known for up to a year. [RA, Exhibit 4, at 33, Lines 16-18, 37, Lines 20-25, 38, Lines 1-5, 46, Lines 2-25, and 47, Lines 1-19.] It would take more than five months after that for a retailer to make a decision regarding the Real Property and several more months for the Debtor and a retailer to negotiate a lease. [RA, Exhibit 4, at 41, Lines 11-25, and 42, Lines 1-6.] Only after the Debtor had a signed lease, after over two years or more, would the Debtor be in a position to attempt to sell the Real Property or to obtain a loan to complete the development. [RA, Exhibit 4, at 81, Lines 9-24.]

d. The Debtor's Inaction Was Not Reasonable.

The Debtor argued that its inaction was reasonable because it was meant to maximize the return to its unsecured creditors and the Equity Security Holders. *See* Appellant's Brief, at 20. According to the Debtor, selling the Real Property before it was developed would be a breach of its fiduciary duties to its unsecured creditors and the Equity Security Holders. *Id*. However, the record shows that the Debtor's inaction diminished the value of the Real Property. For example, the Debtor's admitted failure to pay real property taxes both pre- and post-petition diminished the equity in the Real Property by up to $1.6 million. [RA, Exhibit 4, at 69, Lines 17-25, and 70, Lines 1-9.]

The Debtor's inaction also resulted in missed opportunities to maximize the value of the Real Property during a robust commercial real estate market. Mr. Berger admitted at the hearing on the Conversion Motion that "the retail world thinks we're going to have a recession, and they are going a little slower than they would have gone six months or a year ago when things were booming in the commercial real estate market." [RA, Exhibit 4, at 53, Lines 10-12.] He also admitted that "you've just gone through what I think is the spike for the foreseeable future of the run up in the value of the [Real Property]." [RA, Exhibit 4, at 56, Lines 20-22.]

As Paradigm's appraiser testified,

> [a]s far as the economy, I think its not news when I say that we're in an economic slowdown, and the economic slowdown affects the retail market in particular. . . . Most retailers are on the fence. . . . They may not be closing stores. They're definitely thinking twice about opening a new store."

[RA, Exhibit 4, at 116, Line 25, and 117, Lines 1-12.]

The Debtor argued that the bankruptcy court's decision to convert was inconsistent with its finding that Mr. Berger credibly testified that "in the marketplace outside of bankruptcy, the Debtor's protracted and insular approach to the marketing and development of the Real Property was a prudent and commercially reasonable course of conduct." [RA, Exhibit 3, at 23.] *See* Appellant's Brief, at 16. The Debtor ignored, however, the bankruptcy court's caveat that

> [t]his position neglects the fact that in the "real world" the Debtor would long ago have had to account for and accept the non-bankruptcy consequences of the financial arrangements it made with its creditors – most notably, [Paradigm]. Indeed, the very reason the Debtor entered into the "bankruptcy world" was to *avoid* the consequences of its "real world" obligations – most notably, an impending foreclosure of the Real Property by [Paradigm]. In essence, the Debtor wants all the benefits of Chapter 11 without accepting the concomitant constraints.

[RA, Exhibit 3, at 26.]

In sum, the record shows that the Debtor failed to take basic steps to rehabilitate and sell or refinance the Real Property to effectuate the 2004 Plan. The Debtor did not even begin the process of rezoning the Real Property, which is a condition precedent to any development as a shopping center, much less enter into serious negotiations with national retailers or seek a buyer or lender. [RA, Exhibit 4, at 71, Lines 21-25, and 72, Lines 1-8.] In chapter 11, where creditors are generally stayed, under 11 U.S.C. § 362[15], from exercising their remedies, the debtor's duties run "to the estate as a whole, and not to one group." *Weintrau*b, 471 U.S. at 355-356. It was, therefore, not reasonable for the Debtor to wait to develop the Real Property until it considered conditions optimal for the Equity Security Holders, while its creditors went unpaid for four years.

The Debtor has done nothing but blame outside forces – the appeal of the First Confirmation Order, the lack of retail development in the area, and the uncertainty surrounding the Lowe's store, for example – for its failure to expeditiously administer the 2004 Case. [RA, Exhibit 4, at 33, Lines 7-17, 43, Lines 4-13, 49, Lines 17-25, 51, Lines 23-25, 52, Lines 1-8, and 55, Lines 1-6.] The bankruptcy court, therefore, did not clearly err when it found that the Debtor breached its duty of expeditious administration by failing to make a good faith effort toward reorganization. [RA, Exhibit 3, at 25.]

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[15] Section 362 sets forth the "automatic stay" provisions of the Bankruptcy Code.

e. The Debtor Admitted That it Was Delinquent on Post-Petition Real Property Taxes and that It Had Made No Payments to Paradigm.[16]

The Debtor's duty of expeditious administration also requires the Debtor to timely pay post-petition tax obligations, and a breach of that duty warrants conversion or dismissal under Section 1112(b). *See Matter of Whitehurst*, 198 B.R. 981, 984 (Bankr. N. D. Ala. 1996) (failure to pay post-petition taxes is a breach of fiduciary duty warranting conversion or dismissal). *See also Matter of Santiago Vela*, 87 B.R. 229, 232 (Bankr. D. P.R. 1988) (debtor's failure to remain current on post-petition Federal taxes constituted unreasonable delay under Section 1112(b)). Likewise, the debtor's delay in carrying out its administrative responsibilities demonstrates cause to convert or dismiss a case under Section 1112(b). *Hampton Hotel Investors*, 270 B.R. at 358.

The bankruptcy court did not clearly err when it found that the Debtor had failed to pay post-petition real property taxes or to make any payments to Paradigm during the 2004 Case. [RA, Exhibit 3, at 23.] Mr. Berger admitted that the Debtor was delinquent on its post-petition real property taxes and that the Debtor had made no tax payments to Milford since it filed the chapter 11 case in 2004, except for $10,000 paid in the few months prior to the hearing on the Conversion Motion under the Continuance Order. [RA, Exhibit 4, at 69, Lines 17-25, and 70, Lines 5-14.] Mr. Berger was unsure of the exact delinquency but estimated that post-petition accrued taxes totaled between $400,000 to $500,000, based on an estimated yearly tax bill of

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[16] The failure to pay taxes also constitutes a breach of the Debtor's duty to protect and preserve property. *See In re Smart World Technologies, LLC*, 423 F.3d 166, 176 (2d Cir. 2005) (debtor has a fiduciary duty to maximize the value of the estate).

$120,000.[17] [RA, Exhibit 4, at 69, Line 3-8, and 70, Lines 1-4.] Mr. Berger also admitted that the Debtor had made no payments to Paradigm since 2000 except for the funds paid in April 2008 and thereafter under the Continuance Order. [RA, Exhibit 4, at 70, Lines 10-14.]

f. The Debtor Failed to Timely Carry Out Its Administrative Duties.

The record also supports the bankruptcy court's finding that the Debtor neglected its administrative duties. [RA, Exhibit 3, at 22 and 24.] There is no dispute, and the Debtor admits, that it filed its schedules and statement of financial affairs more than four months late, as the bankruptcy court found. [RA, Exhibit 3, at 22, and Exhibit 23, at 377, ECF Doc. No. 30.] *See also* Appellant's Brief, at 12.

The Debtor argued, without factual support or legal authority, that this delay was harmless because no creditors were prejudiced. *See* Appellant's Brief, at 12-13. The Debtor, however, had an absolute duty to timely complete and file its schedules and statement of financial affairs. *See In re Russell*, 392 B.R. 315, 358 (Bankr. E. D. Tenn. 2008) ("This duty is crucial to the working of the bankruptcy system"). *See also In re Haverland*, 150 B.R. 768, 771-772 (Bankr. S. D. Cal. 1993) (compliance with the duty to complete schedules truthfully is essential to the efficient and expeditious administration of the bankruptcy case).

Because of the Debtor's delay, the United States Trustee was forced to continue the Section 341 meeting of creditors, which was originally set for March 8, 2004, five times. [RA, Exhibit 23, at 375, ECF Doc. No. 6, 376, March 8, 2004, April 12, 2004, April 24, 2004, and May 10, 2004 Docket Entries, and 377, June 7, 2004 Docket Entry.] The Debtor's delay in filing

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[17] Paradigm's appraiser testified that the total tax delinquency was over $1.6 million. [RA, Exhibit 4, at 265, Lines 1-14.]

its schedules and statement of financial affairs for five months deprived the United States Trustee and creditors of the opportunity to examine the Debtor under oath within the first twenty to forty days of the 2004 Case as required by the Bankruptcy Code and the Federal Rules of Bankruptcy Procedure. *See* 11 U.S.C. § 343 (the debtor shall appear and submit to examination under oath at the meeting of creditors under Section 341(a)) and Fed. R. Bankr. P. 2003(a) (the Section 341(a) meeting "shall be held no fewer than twenty and no more than forty days after the petition date").

Likewise, the MORs, executed by Mr. Berger under penalty of perjury, show that the bankruptcy court did not err when it found that the Debtor was consistently untimely in meeting its quarterly fee obligations. [RA, Exhibit 3, at 22, Exhibit 16, at 229, Exhibit 19, at 263, and .Exhibit 20, at 268.] Instead of meeting its quarterly fee obligations within thirty days of the close of each calendar quarter, the Debtor made sporadic and untimely payments. [RA, Exhibit 16, at 229, Exhibit 19, at 263, and Exhibit 20, at 268.] The record also reflects that the Debtor did not file a disclosure statement and plan until nineteen months after the Petition Date and only after Paradigm had filed the Paradigm Disclosure Statement and the Paradigm Plan and the United States Trustee had filed the UST Motions. [RA, Exhibit 3, at 22, Exhibit 23, at 379, ECF Doc. Nos. 46-47, 381, ECF Doc. No. 69, 382, ECF Doc. No. 72, and 383, ECF Doc. Nos. 78-79.] The bankruptcy court's findings of fact with respect to the Debtor's delay in administration of the 2004 Case have ample support in the record and were not, therefore, clearly erroneous.

2. The Debtor Breached Its Duty of Disclosure.

Debtors in possession have a duty to provide open, honest and straightforward disclosure of their financial affairs to the bankruptcy court and creditors. *In re Marvel Entertainment, Inc.*, 140 F.3d 463, 474 (3d Cir. 1998). *See also In re Sal Caruso Cheese, Inc.*, 107 B.R. 808, 817 (Bankr. N.D.N.Y. 1989) (debtors have a duty of honest and open disclosure of financial information). The filing of MORs is "very high on the list of fiduciary obligations imposed upon a debtor in possession." *Matter of Berryhill*, 127 B.R. 427, 433 (Bankr. N. D. Ind. 1991).

> Timely and accurate financial disclosure is the life blood of the chapter 11 process. Monthly Operating Reports are much more than busy work imposed upon a chapter 11 debtor for no reason other than to require it to do something. They are the means by which creditors can monitor the debtors post-petition operations.

Id. at 433.

For this reason, the untimely submission of MORs constitutes cause to convert or dismiss a chapter 11 case under Section 1112(b). *Whitehurst*, 198 B.R. at 983 n.11. *See also In re Braue*r, 80 B.R. 903, 905 (N. D. Ill.1987) (failure to file financial reports warrants conversion or dismissal). *See also In re Cloisters of Brevard, Inc.*, 117 B.R. 722, 723 (Bankr. M. D. Fla. 1990) (the untimely submission of MORs is a breach of fiduciary duty). The bankruptcy court should not allow a pattern of untimely filing of MORs; otherwise, the debtor "could always conveniently argue that all operating reports had been filed." *Whitehurst*, 198 B.R. at 984. "Neither the court nor creditors should have to coerce or implore the debtor into fulfilling the obligations imposed upon it." *Id*. *See also In re Roma Group*, 165 B.R. 779, 780 (S.D.N.Y. 1994) (the failure to file MORs, "whether based on inability to do so or otherwise, undermines the Chapter 11 process and constitutes cause for dismissal or conversion of Chapter 11 proceedings"). *See also In re All Denominational New Church*, 268 B.R. 536, 538 (B.A.P. 8th Cir. 2001) (failure to file MORs undermines the bankruptcy process and warrants conversion or dismissal under Section 1112(b)) (citing *First National Bank v. Kerr (In re Kerr)*, 908 F.2d 400, 404 (8th Cir. 1990)).

The Debtor argued that there is no precedent for conversion under the facts of the 2004 Case and that the cases cited by the bankruptcy court in the Conversion Decision do not provide authority for a finding of cause and conversion under Section 1112(b).[18] *See* Appellant's Brief, at 16-17. However, both cases cited by the bankruptcy court properly state the law regarding a debtor's duty of disclosure and the consequences of a breach of that duty. *In re Momentum Mfg. Corp*, 25 F.3d 1132, 1136 (2d Cir. 1994) sets forth the principle that "[f]ull and fair disclosure is required during the entire reorganization process; it begins . . . on day one with the filing of the chapter 11 petition." (citation and internal quotation marks omitted.) In *In re Tornheim*, 181 B.R. 161, 164 (Bankr. S.D.N.Y. 1995), the bankruptcy court specifically held that cause existed under Section 1112(b) where the debtors had breached their duty of disclosure by failing to file MORs. Contrary to the Debtor's argument, there is substantial authority holding that debtors have a duty of disclosure and that a breach of that duty constitutes cause under Section 1112(b).

The bankruptcy court did not clearly err when it found that the Debtor breached its duty of disclosure. The record shows the Debtor's pervasive pattern of disregard of its obligation to file MORs. The Debtor filed the 2004 Case on February 6, 2004. [RA, Exhibit 23, at 375, ECF Doc. No. 1.] Yet, the Debtor did not file any MORs until October 10, 2004. [ER, Exhibit 23, at

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[18] Ironically, the Debtor has cited no cases in support of its argument that the bankruptcy court clearly erred in finding cause under Section 1112(b). The cases the Debtor cited involved facts and legal issues that have no relevance to Section 1112(b). *See In re Pinnacle Brands, Inc.*, 259 B.R. 46 (Bankr. D. Del. 2001) (debtor properly declined to assume and assign a contract where assumption and assignment would benefit a creditor to the detriment of the estate). *See also* Appellant's Brief, at 19-20. *See also In re DN Associates*, 3 F.3d 512, 516 (1st Cir. 1993), where the court approved a fee application of debtor's counsel where the work benefitted both creditors and equity security holders). *See also* Appellant's Brief, at 19, n.5.

378, ECF Doc. No. 37.] After that, the Debtor filed no more MORs until November 9, **2005**, when it filed MORs for thirteen months. [RA, Exhibit 23, at 390, ECF Doc. No. 128.] Sixteen months later, on April 3, 2007, the Debtor filed MORs for October 2005 through March 2007. [RA, Exhibit 23, at 397, ECF Doc. No. 187.] Then, another nine months elapsed, when, on January 18, 2008, the Debtor filed MORs for April through December 2007. [RA, Exhibit 23, at 397, ECF Doc. No. 192.] On April 7, 2008, the Debtor filed MORs for January and February 2008. [RA, Exhibit 23, at 404, ECF Doc. No. 233.] Finally, on May 21, 2008, the Debtor filed MORs for March and April 2008. [RA, Exhibit 23, at 406, ECF Doc. No. 247.]

The Debtor admits that it filed its MORs untimely but argues that untimely filing is not grounds for conversion because “there is no claim, evidence or finding that the MORs were inaccurate in any way or how any party in interest was prejudiced by the late filing.” *See* Appellant’s Brief, at 13. In fact, as the bankruptcy court found, the MORs did not follow the format set forth in the Operating Guidelines. [RA, Exhibit 3, at 22.] As a result, the Debtor failed to disclose essential financial information to creditors, the United States Trustee and the bankruptcy court. *See* Operating Guidelines, at 4, ¶ 9, and RA, Exhibits 16-22.

The record shows that the MORs were incomplete. The Debtor generally filed the form of MOR in use during the time of the 2004 Case. [RA, Exhibits 16, 17, 18, 19, and 21.] The MORs, however, contained only a statement of cash receipts and disbursements showing amounts contributed by United and an accounting of the Debtor’s post-petition debt to United arising from the contributions. [RA, Exhibit 16-22.] In the October 2005 through March 2007 MORs, the Debtor abandoned the proper format altogether and filed only unsworn spread sheets listing United’s quarterly disbursements on behalf of the Debtor. [RA, Exhibit 20, at 268.]

The record also shows that the MORs were inaccurate. The Debtor's schedules of post-petition liabilities showed no accrued real property tax debt even though the Debtor admitted that it had accrued delinquent post-petition real property tax obligations in the hundreds of thousands of dollars. [RA, Exhibit 18, at 262.] By failing to file complete, accurate and timely MORs, the Debtor failed to keep creditors, the United States Trustee and the bankruptcy court apprised of its true financial condition, including that it owed delinquent post-petition real property taxes of between $400,000 to $500,000. [RA, Exhibit 4, at 69, Lines 3-8, and 70, Lines 1-4.] The bankruptcy court, therefore, did not clearly err when it found that the Debtor breached the duty of disclosure by failing to file timely and complete MORs over the four years that the 2004 Case was pending in chapter 11.

B. Converting the 2004 Case to a Case Under Chapter 7 Was in the Best Interest of Creditors and the Bankruptcy Estate.

The bankruptcy court did not abuse its discretion when it converted the 2004 Case to a case under chapter 7. Once the bankruptcy court determined that there was cause under Section 1112(b), it had broad discretion to dismiss or to convert the 2004 Case to chapter 7. *See, e.g. In re AdBrite Corp.*, 290 B.R. 209, 215 (Bankr. S.D.N.Y. 2003) (once the movant has established cause, the bankruptcy court has broad discretion to convert or dismiss the case). *See also Hampton Hotel Investors*, 274 B.R. at 359 (it is within the discretion of the bankruptcy court to convert or dismiss a chapter 11 case under Section 1112(b)). The bankruptcy court "must exercised its sound judgment in reaching a determination and must ascertain that the decision is in the best interest of creditors." *In re Gonic Realty Trust*, 909 F.2d 624, 626-627 (1st Cir.1990). It is not required to give exhaustive reasons for its decision. *Matter of Koerner,* 800 F.2d 1358, 1368 (5th Cir. 1986); *accord Gonic Realty*, 909 F.2d at 627. Conversion, rather than dismissal, is appropriate where the debtor breached its fiduciary duties as a chapter 11 debtor. *Hampton Hotel Investors*, 274 B.R. at 359.

The Debtor argued that the bankruptcy court "elevated the interest of one creditor, Paradigm, for a quick sale over the interest of the entire estate" to the detriment of unsecured creditors and the Equity Security Holders. *See* Appellant's Brief, at 20. The Debtor does not cite any facts or findings in support of this contention, and there is no indication in the record that the bankruptcy court converted the case solely for the benefit of Paradigm. In fact, as amply demonstrated in this brief, the bankruptcy court explicitly converted the 2004 Case because the Debtor's breach of fiduciary duties warranted placing "the administration of the estate in the hands of an independent fiduciary." [RA, Exhibit 3, at 24.]

Nonetheless, in a single asset real estate case like the 2004 Case, conversion is appropriate "where the debtor is oblivious to the fiduciary duties imposed upon it in dealing with property of the estate," even if the secured creditor is fully secured. *E. Paul Kovacs*, 16 B.R. at 205-206. *See also In re Albany Partners, Ltd.*, 749 F.2d 670, 674 (11th Cir. 1984) (court properly exercised its discretion under Section 1112(b) in dismissing a case where the debtor used chapter 11 to frustrate the legitimate efforts of secured creditors to enforce their rights).

The Debtor also argued that the bankruptcy court should have ordered the appointment of a chapter 11 trustee, under 11 U.S.C. § 1104(a)(2), rather than converting the 2004 Case to a case under chapter 7. *See* Appellant's Brief, at 30. The Debtor asserted that Petillo and ST would have preferred a chapter 11 trustee and that a chapter 11 trustee would have been able to operate the Debtor's business and propose an orderly plan to sell the Real Property. *Id*. A chapter 7 trustee, the Debtor argued, "has no authority to manage the Property, pay for insurance and effectuate an orderly sale plan" because "his mandate is to liquidate assets as quickly as possible." *Id.*

Section 1104(a)(2) provides that:

> (a) The bankruptcy court shall order the appointment of a chapter 11 trustee . . . .
> (2) if such appointment is in the interests of creditors, any equity security holders, and other interests of the estate . . .

11 U.S.C. § 1104(a)(2).

Ordering the appointment of a trustee under Section 1104(a)(2) is within the discretion of the bankruptcy court. *In re Deena Packaging Industries,* 29 B.R. 705, 706 (Bankr. S.D.N.Y. 1983). In determining whether the appointment of a chapter 11 trustee is in the best interests of creditors, the bankruptcy court must consider "the protection of the public interests, the interests of creditors . . . and the facilitation of a reorganization that will benefit both." *In re 1031 Tax Group, LLC*, 374 B.R. 78, 91 (Bankr. S.D.N.Y. 2007) (citation omitted).

The Debtor's argument is flawed for several reasons. First, the Debtor cited no cases that hold that certain creditors' mere desire for a chapter 11 trustee warrants granting relief under Section 1104(a)(2). *See* Appellant's Brief, at 30. On the contrary, no single factor is dispositive in the bankruptcy court's exercise of its discretion to order the appointment of a chapter 11 trustee. The standard is flexible and the bankruptcy court must consider "the practical realities and necessities" in the exercise of its broad discretion. *In re Euro-American Lodging Corp.*, 365 B.R. 421, 428-429 (Bankr. S.D.N.Y. 2007). *Cf. In re Superior Siding and Window, Inc.,* 14 F.3d 240, 244 (4th Cir. 1994) (in determining the best interests of creditors and the estate under Section 1112(b), the bankruptcy court must consider the impact of its decision on the interests of all creditors; it is not based upon "tallying the votes of the unsecured creditors and yielding to the majority interest”).

Second, chapter 11 trustees are generally appointed to preserve the debtor’s going concern value for the benefit of creditors. *See In re Curlew Valley Associates*, 14 B.R. 506, 512 (Bankr. D. Utah 1981) (chapter 11 trustees may operate the debtor’s business to preserve its going concern value). *See also U. S. ex rel. Harrison v. Estate of Deutscher*, 115 B.R. 592, 597 (M. D. Tenn. 1990) (a chapter 11 trustee’s “operation of the business is the rule”). Here, the Debtor was not operating when it was in chapter 11, and the Debtor has, in fact, not had any cash flow since the early 1990s. [RA, Exhibit 4, at 74, Lines 19-25, and 75, Lines 1-10, Exhibit 12, at 181, and Exhibit 25, at 433-444.] Thus, there was no business for a chapter 11 trustee to operate, no going concern value to protect, and no benefit to creditors or the estate in allowing the Debtor to remain in chapter 11 with a trustee in control.

Third, a chapter 7 trustee’s main duty is not simply to “liquidate assets as quickly as possible,” as the Debtor asserted. *See* Appellant’s Brief, at 30. The fiduciary duties of a chapter 7 trustee run to both creditors and equity security holders and require the trustee to maximize the value of the estate. *Germain v. Connecticut National Bank*, 988 F.2d 1323, 1330 n.8 (2d Cir. 1993). *See also In re Fournier*, 169 B.R. 282, 284-285 (Bankr. D. Conn. 1994) (chapter 7 trustee’s primary role is to diligently and expeditiously maximize distributions to creditors). *See also Weintraub*, 471 U.S. at 355 (trustee’s duties run to creditors and shareholders).

The bankruptcy court did not abuse its discretion in converting the case to chapter 7 rather than ordering dismissal or the appointment of a chapter 11 trustee. The bankruptcy court properly applied the law and its factual findings were not clearly erroneous. The bankruptcy court first found that there was cause, under Section 1112(b), based on the entire record which demonstrated the Debtor's breach of fiduciary duties. [RA, Exhibit 3, at 24.] Then, the bankruptcy court, in its discretion, ordered conversion, rather than dismissal or the appointment of a chapter 11 trustee, "to place the administration of the Debtor's estate in the hands of an independent fiduciary charged with . . . liquidating that estate with due expedition." [RA, Exhibit 3, at 24.] *See also Hampton Hotel Investors*, 270 B.R. at 358-359 (Section 1112(b) requires a two step process – the determination of cause, and then a decision to convert or dismiss, whichever is in the best interests of creditors and the estate).

VII. CONCLUSION

Based on the foregoing, the United States Trustee respectfully requests that the Court affirm the Conversion Order.

Dated: New Haven, Connecticut
March 23, 2009

Respectfully submitted,

DIANA G. ADAMS
UNITED STATES TRUSTEE

By: */s/ Alicia M. Leonhard*
Alicia M. Leonhard (ct27844)
Kim McCabe
Assistant United States Trustees
Office of the United States Trustee
United States Department of Justice
150 Court Street, Suite 302
New Haven, Connecticut 06510
Phone: 203.773.2210
Facsimile: 203.773.2217
Alicia.M.Leonhard@usdoj.gov

U.S. Department of Justice
Office of the United States Trustee

Region 2 - New York, Connecticut and Vermont

OPERATING GUIDELINES AND REPORTING REQUIREMENTS FOR DEBTORS IN POSSESSION AND TRUSTEES

(Revised 2/1/08)

Title 28, §586(a)(3) of the United States Code directs the United States Trustee to supervise the administration of all Chapter 11 cases. To comply with this charge, the United States Trustee for Region 2 has established the Operating Guidelines and Reporting Requirements for Chapter 11 debtors and trustees. Chapter 11 debtors, trustees and their attorneys must notify the United States Trustee of significant matters affecting their case. The United States Trustee must be served with copies of all papers filed in the case, except as otherwise directed by the Court or the United States Trustee.

Timely compliance with each of the following requirements is essential. Failure to comply may result in a motion to dismiss or convert this case to liquidation under Chapter 7, for the appointment of a Chapter 11 trustee or examiner, or for imposition of sanctions. If you believe that the requirements should be waived or varied in your case, you should immediately submit a written request to the appropriate Field Office of the United States Trustee. Contact information may be obtained from the United States Trustee website, http://www.usdoj.gov/ust/r02/. If you are represented by counsel, please contact your attorney with questions regarding this material.

GUIDELINES AND OPERATING REQUIREMENTS

1. **List of Creditors.** When the petition is filed, a list of the debtor's twenty (20) largest unsecured creditors, excluding insiders, must be filed with the Clerk of the Bankruptcy Court. The complete name, address, e-mail address, telephone number, fax number and name of contact of each creditor must be supplied .

2. **Initial Debtor Interviews.** In chapter 11 cases, the United States Trustee generally requires the debtor and its counsel to meet with a member of the staff of the United States Trustee at an initial debtor interview prior to the Section 341 meeting of creditors. The purpose of the meeting is to discuss the debtor's particular financial situation, its operating framework under Chapter 11, and the requirements of the United States Trustee.

At the meeting, the debtor is required to furnish the following documentation and such other information as requested. If no initial debtor interview is scheduled, such materials must be provided to the United States Trustee within fifteen days of the petition filing.[1]

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[1] If the debtor is a "small business debtor" these documents must be filed along with the petition. 11 (continued...)

-Copies of the debtor's last two filed income tax returns, including all applicable schedules.
-Copy of the most recently issued or prepared financial statements (inclusive of balance sheet, income statement, and statement of cash flows).
- A schedule of aged accounts receivable.
-Specimen (voided) checks that verify the opening of "debtor in possession" bank accounts (see "Bank Accounts"), and a listing of the authorized signatories (not the signature card).
-Proof that all applicable insurance is in place (see “Insurance”).
- A listing of all disbursements for the ninety days prior to the filing, which may take the form of a check register for an individual.
-Copies of all licenses and/or permits (including licenses to intellectual property and certificates evidencing ownership of intellectual property).
-Copies of all written policies given to customers regarding the sale of personally identifiable information.

3. **Meeting of Creditors.** A meeting of creditors will be held by the United States Trustee within 20 to 40 days after the filing of a voluntary petition. The debtor and debtor's attorney are required to appear. All creditors and other parties in interest are notified of the meeting by the Clerk of the Bankruptcy Court. The debtor(s) will be examined under oath by the representative of the United States Trustee, creditors, and other parties in interest in attendance pursuant to 11 U.S.C. §§ 341 and 343, and Fed. R. Bankr. P. Rule 2003(b).

4. **Books and Records.** Debtor’s books and records (i.e. general ledger accounts) must be closed as of the petition date and new books and records opened. The old books and records must be retained and be available to the United States Trustee.

5. **Bank Accounts**. All pre-petition bank accounts controlled by the debtor must be closed immediately upon the filing of the petition, and the debtor shall immediately open new debtor-in-possession operating, payroll, and tax accounts at a United States Trustee Authorized Depository. A list of approved depositories is available on the United States Trustee Website, www.usdoj.gov/ust/r02/ In addition, individual debtors engaged in business as sole proprietors should open a separate debtor-in-possession account for payment of personal living expenses. All business revenues must be deposited into the general operating account, with amounts needed to fund the other accounts being transferred to those accounts as necessary. Deposits, other than transfers from the operating accounts, should not be made directly to the payroll or tax accounts. Any deviation from the three required Debtor In Possession Accounts must be approved by the United States Trustee prior to the Initial Debtor Interview.

Disbursements other than by numbered check are prohibited. Counter checks are prohibited. Requests to use, create or maintain petty cash accounts must be submitted to the United States Trustee in writing.

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[1] (...continued)
U.S.C. §1116

The checks for each account must bear the case name, case number, the words "Debtor-In-Possession", and the type of account (operating, payroll or tax) imprinted on the face of each check, in substantially the following form:

ABC, Inc.
Debtor-in-Possession, 08-XXXXX
OPERATING ACCOUNT
123 Main Street
New York, NY 10004

No. 00001

____________________, *20*______

*Pay to the Order of*______________________________ *$*____________

____ *Dollars*

____

00XXX-XXX-00-XXXXX 000XXX-XX00

Within fifteen days of filing the petition, the debtor must provide the United States Trustee with a sworn statement describing all pre-petition accounts by depository name, account number and account name, verifying that each such pre-petition account has been closed. A form that complies with this requirement can be obtained from the United States Trustee Website, www.usdoj.gov/ust/r02/. Additionally, proof of closing old accounts and opening new accounts must be provided.

6. **Insurance.** Within fifteen days of filing the petition, the debtor must provide the United States Trustee with proof of the insurance coverage required by these guidelines. The proof must disclose, at a minimum, the effective date and the termination date of coverage; the type and limits of coverage provided, and the identity of all loss payees. Binders dated after the filing of the petition must be accompanied by paid receipts. Debtor should instruct its insurance companies to list the United States Trustee as a Certificate Holder. Upon expiration or other termination of any coverage, the debtor shall immediately provide the United States Trustee with adequate proof of replacement coverage. Debtor shall maintain at least the following coverage, where appropriate:

a. General comprehensive liability
b. Property (personal & theft)
c. Casualty and theft
d. Workers' compensation
e. Vehicle
f. Product Liability
g. Flood insurance
h. Directors and Officers Liability
i. Professional malpractice
j. Other coverage customary or prudent in the debtor's business, or required by law.
k. Proof of Renewal of Insurance during pendency of the case.

7. **Physical Inventory**. Within thirty (30) days of filing the petition, debtor, if requested by the United States Trustee, shall provide the United States Trustee with a physical inventory as of the petition date. The inventory shall be itemized and indicate cost values. For purpose of this reporting requirement, "inventory" is defined as all goods in possession of the debtor intended for sale to

customers. It includes finished goods and unfinished goods. It does not include fixed assets owned by the debtor.

8. **Rental Property Records**. Debtors who own commercial or residential rental property shall provide the United States Trustee with a rent roll as of the petition date within fifteen (15) days from the filing of the petition. The rent roll shall consist of (1) a description of each property owned, (2) rental price of each unit, (3) security or other deposits held, (4) occupancy and payment status of each unit, (5) name, address, and phone number of the management company, if any, and (6) the monthly management fee.

9. **Monthly Operating Reports**. Debtor must electronically file an original monthly operating report with the Clerk of the Bankruptcy Court, and serve a copy upon the United States Trustee.[2] A copy should also be provided to the creditors committee, if one has been appointed in the case. **Notwithstanding local ECF requirements, the United States Trustee will not accept service of the operating reports via electronic transmission.**

The monthly operating reports must be prepared using the forms provided herein. These forms are also located on our website at http://www.usdoj.gov/ust/r02. Compliance with Local Rules and filing procedures in each jurisdiction is required. The debtor is also required to attach to the monthly operating report a photocopy of each month's bank statements. If bank statements are not available at the time the monthly operating report is filed, they should be submitted separately, as soon as the debtor-in-possession receives them. A bank reconciliation should be prepared and attached to the operating report.

The monthly operating report is based on a calendar month (e.g. January 1 - January 31), and all reports must be filed by the 20th day of the month following the reporting period.[3] Such reports shall disclose all transactions of the calendar month immediately preceding the due date. The first report shall include all transactions for the period of the first month the debtor is in bankruptcy. It is recognized that in almost all cases, this first report will only be for a partial month. The partial month report should not be combined with that of the first full month.

Debtors have a continuing obligation to file monthly operating reports until the court approves and confirms the Plan of Reorganization. After confirmation, debtors are required to file a Post-Confirmation Operating Report. The Post-Confirmation Operating Report includes, among other things, all payments made under the Plan of Reorganization and payments made in the ordinary course of doing business. The reports must be filed until the courts enters a Final Decree, dismisses the case, or converts the case to another chapter in bankruptcy. The original report must be electronically filed with the Clerk of the Bankruptcy Court, and a copy served upon the United States Trustee. The report must be

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[2] In districts with ECF, the signature filed with the Court should be submitted in the manner required by the Court. The copy served on the United States Trustee must contain the actual signature of the preparer.

[3] Reports for the Rochester and Buffalo Divisions of the Western District of New York are due on the 15th day of the month, as are reports for the Southern District of New York.

filed by the 20th day of the month following the reporting period.[4] The Post-Confirmation Operating Reports may be obtained from the local office in the Region.

10. **Taxes.** Upon payment of each payroll, debtor shall transfer from the operating account to the debtor's tax account sufficient funds to pay any liability associated with the payroll. Taxes shall be paid from the tax account accompanied by appropriate tax deposit coupons. State and local taxes shall also be paid from the tax account. Sales and use taxes shall be deposited to the tax account at least weekly. All tax returns and reports must be timely filed and accompanied by payment in full of any liability. A copy of each return and verification of payment of taxes due must be served on the United States Trustee with the monthly operating report.

11. **Employment of Principals and Professionals**. Pursuant to 11 U.S.C. §327 and Fed. R. Bank R. P. 2014, the debtor or trustee must apply for an order of the Court approving the employment of professionals, unless local rules otherwise direct. A copy of any application to employ or compensate a professional (including, but not limited to, lawyers, accountants, financial advisors, appraisers, auctioneers, real estate agents/brokers, and consultants) must be served upon the United States Trustee. Applications to employ such persons must be filed, and an order approving such employment must be entered, prior to any services being rendered to the debtor.

Each applicant's affidavit must disclose any relationship or contact applicant has with the debtor, any creditor, party in interest, their attorneys and accountants, and employees of the United States Trustee. A general statement that the applicant is disinterested and does not represent an interest adverse to the estate is *not* sufficient.

No later than the date of the first meeting of creditors, the debtor shall provide the following information regarding employment and compensation of its principals: name and position of the individual; detailed description of the duties and responsibilities; reasons why employment of the individual is necessary for successful reorganization; details of the compensation sought; details of any other benefits or consideration to be received, including but not limited to use of vehicles, housing, expense reimbursement, insurance, and pension or profit sharing; and, each individual's salary and benefit history for the year immediately preceding the filing of the petition.

12. **Pre-Petition Financial Statements**. Within fifteen (15) days of the petition filing, debtor shall provide the United States Trustee with copies of the debtor's most recent audited and unaudited financial statements.

13. **Federal Income Tax Returns**. Within fifteen (15) days of the petition filing, debtor shall provide the United States Trustee with copies of the debtor's federal income tax returns for the two years prior to the filing.

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[4] **Exception – Southern District of New York Local Rule**: Pursuant to Local Bankruptcy Rule 3021-1(c) of the Southern District of New York, Debtors have to file post-confirmation status reports with the Court every January 15th, April 15th, July 15th, and October 15th until a final decree has been entered.

14. **Change of Address**. The debtor must notify the United States Trustee, in writing within 10 days, of any change of address or telephone number of the debtor. The debtor must also file with the Clerk of the Bankruptcy Court a change of address form.

15. **United States Trustee Quarterly Fees**. Debtors in Chapter 11 cases must pay a quarterly fee to the United States Trustee Program for each calendar quarter, or portion thereof, between the date of filing the petition and the date the court enters a final decree closing the case, dismisses the case or converts the case to another chapter in bankruptcy. The quarterly fee is calculated by totaling the debtor's disbursements as reported on the Monthly Operating Reports for the three-month calendar quarter, according to the following chart. The quarterly fee amount will be estimated if disbursements for all of the months of a calendar quarter that the case is open have not been reported to the United States Trustee. The estimated fee is based on, a) reported disbursement history, b) initial financial data submitted when the case was filed, or c) an estimation done by the United States Trustee office. If you calculated the fee to be less than the estimated quarterly fee, you must submit the reports supporting your estimation to the United States Trustee. **A minimum fee of $325.00 is due even if there are no disbursements during a calendar quarter. There is no proration of the fee.**

TOTAL QUARTERLY DISBURSEMENTS	QUARTERLY FEE
$0 to $14,999.99	$325.00
$15,000 to $74,999.99	$650.00
$75,000 to $149,999.99	$975.00
$150,000 to $224,999.99	$1,625.00
$225,000 to $299,999.99	$1,950.00
$300,000 to $999,999.99	$4,875.00
$1,000,000 to $1,999,999.99	$6,500.00
$2,000,000 to $2,999,999.99	$9,750.00
$3,000,000 to $4,999,999.99	$10,400.00
$5,000,000 to $14,999,999.99	$13,000.00
$15,000,000 to $29,999,999.99	$20,000.00
$30,000,000 or more	$30,000.00

Quarterly fees are due no later than one month following the end of each calendar quarter. Failure to pay quarterly fees may result in the conversion or dismissal of the case. Payment of that quarter's fees and any past due fees and interest, if applicable, must be made before the effective date of a confirmed Plan of Reorganization and quarterly fees will continue to accrue until entry of the final decree, or until the case is converted or dismissed. Failure to pay these fees may result in a motion by the United States Trustee to convert the case to a Chapter 7 case.

The debtor will receive a bill or statement from the Executive Office for the United States Trustees, Washington, D.C., for each calendar quarter, prior to the payment due date. A check for the quarterly fee, made payable to "United States Trustee", should be mailed with the tear-off portion of the statement form to:

United States Trustee Payment Center
P.O. Box 70937
Charlotte, NC 28272-0937

The address shown above is a lockbox at a bank. It may NOT be used for service of process, correspondence or any purpose other than payment of quarterly fees. Any other correspondence or documents sent to the lockbox other than the payment form will be destroyed.

The debtor is responsible for timely payment of the quarterly fee. Failure to receive a bill from the Executive Office for the United States Trustees does not excuse the debtor from timely payment.

Failure to pay the quarterly fee is cause for conversion or dismissal of the chapter 11 case pursuant to 11 U.S.C. § 1112(b)(4)(K) (for cases filed on or after October 17, 2005) or 11 U.S.C. §1112(b)(10) (for cases filed before October 17, 2005).

16. **Interest Assessment on Unpaid Quarterly Fees**. Pursuant to 31 U.S.C. §3717, the United States Trustee Program will begin assessing interest on unpaid Chapter 11 quarterly fees charged in accordance with 28 U.S.C. §1930(a) effective October 1, 2007. Interest assessed on past due amounts first appeared on the October 2007 statements. The interest rate assessed is the rate in effect as determined by the Treasury Department at the time your account becomes past due. If payment of the full principal amount past due is received within thirty (30) days of the date of the notice of initial interest assessment, the interest assessed will be waived.

17. **Quarterly Fees After Confirmation of Plan**. Quarterly fees continue to accrue after the Plan of Reorganization has been confirmed. After confirmation, the debtor is required to file Post-Confirmation Operating Reports, and to continue to pay quarterly fees following subject to the same payment guidelines outlined in Paragraph 15 and 16 above until a Final Decree is entered by the court or the case is dismissed or converted to another chapter.

18. **Additional Notice Requirements.** The United States Trustee must be advised immediately of any significant change in debtor's business. Significant changes include, but are not limited to, casualty or theft losses, changes in insurance coverage, or allegations of violations of laws, ordinances, or regulations, including but not limited to the failure to pay taxes, which could affect the continued operation of the debtor's business.

19. **Waiver of Modification of Reporting Requirements**. The reporting requirements of the United States Trustee's office may be waived or modified only after a request in writing demonstrating sufficient cause for the requested action, and specifying what alternative is to be provided (i.e., the form and detail) for reporting on that estate. No waiver or modification shall be effective unless in writing and signed by the United States Trustee or an authorized delegate.

20. **Disclosure of Intent to use Taxpayer Identifying Number**. Pursuant to the Debt Collection Improvements Act of 1996, Public Law 104-134, Title III, §31001(i)(3)(A), 110 Stat. 1321-365, codified at 31 U.S.C. §3701, the United States Trustee intends to use the debtor's Taxpayer Identifying Number (TIN) as reported by the debtor or debtor's counsel in connection with the chapter 11 bankruptcy proceeding for the purpose of collecting and reporting on any delinquent debt, including chapter 11 quarterly fees and interest, if applicable, that are owed to the United States Trustee.

The United States Trustee will provide the debtor's TIN to the Department of Treasury for its use in attempting to collect overdue debts. Treasury may take the following steps: (1) submit the debt to the Internal Revenue Service Offset Program so that the amount owed may be deducted from any payment made by the federal government to the debtor, including but not limited to tax refunds; (2) report the delinquency to credit reporting agencies; (3) send collection notices to the debtor; (4) engage private collection agencies to collect the debt and (5) engage the United States Attorney's office to sue for collection. Collection costs will be added to the total amount of the debt.

AMENDMENTS TO OPERATING REQUIREMENTS
and
SOLICITATION OF COMMENTS AND SUGGESTIONS

The United States Trustee reserves the right to revise, modify or amend these guidelines and requirements from time to time, and as is appropriate in an individual case. Comments or suggestions regarding these guidelines or other policies and procedures of the Office of The United States Trustee are sought and appreciated and should be directed to the United States Trustee for Region 2 at the address shown below:

DIANA G. ADAMS
UNITED STATES TRUSTEE
REGION 2
33 Whitehall Street, 21st Floor
New York, New York 10004-2112

U.S. Code collection

TITLE 28 > PART V > CHAPTER 123 > § 1930

§ 1930. Bankruptcy fees

(a) The parties commencing a case under title 11 shall pay to the clerk of the district court or the clerk of the bankruptcy court, if one has been certified pursuant to section 156 (b) of this title, the following filing fees:

(1) For a case commenced under—

(A) chapter 7 of title 11, $245, and

(B) chapter 13 of title 11, $235.

(2) For a case commenced under chapter 9 of title 11, equal to the fee specified in paragraph (3) for filing a case under chapter 11 of title 11. The amount by which the fee payable under this paragraph exceeds $300 shall be deposited in the fund established under section 1931 of this title.

(3) For a case commenced under chapter 11 of title 11 that does not concern a railroad, as defined in section 101 of title 11, $1,000.

(4) For a case commenced under chapter 11 of title 11 concerning a railroad, as so defined, $1,000.

(5) For a case commenced under chapter 12 of title 11, $200.

(6) In addition to the filing fee paid to the clerk, a quarterly fee shall be paid to the United States trustee, for deposit in the Treasury, in each case under chapter 11 of title 11 for each quarter (including any fraction thereof) until the case is converted or dismissed, whichever occurs first. The fee shall be $250 for each quarter in which disbursements total less than $15,000; $500 for each quarter in which disbursements total $15,000 or more but less than $75,000; $750 for each quarter in which disbursements total $75,000 or more but less than $150,000; $1,250 for each quarter in which disbursements total $150,000 or more but less than $225,000; $1,500 for each quarter in which disbursements total $225,000 or more but less than $300,000; $3,750 for each quarter in which disbursements total $300,000 or more but less than $1,000,000; $5,000 for each quarter in which disbursements total $1,000,000 or more but less than $2,000,000; $7,500 for each quarter in which disbursements total $2,000,000 or more but less than $3,000,000; $8,000 for each quarter in which disbursements total $3,000,000 or more but less than $5,000,000; $10,000 for each quarter in which disbursements total $5,000,000 or more. The fee shall be payable on the last day of the calendar month following the calendar quarter for which the fee is owed.

(7) In districts that are not part of a United States trustee region as defined in section 581 of this title, the Judicial Conference of the United States may require the debtor in a case under chapter 11 of title 11 to pay fees equal to those

UNITED STATES DISTRICT COURT
DISTRICT OF CONNECTICUT

In re: MILFORD CONNECTICUT ASSOCIATES, L. P., Debtor.	Chapter 7 Case No. 04-30511 (ASD)
MILFORD CONNECTICUT ASSOCIATES, L. P., SUCCESS-TREUHAND GMBH, and PETILLO ENTERPRISES, Appellants, v. DIANA G. ADAMS, UNITED STATES TRUSTEE, PARADIGM CF CORPORATION, and RICHARD BELFORD, CHAPTER 7 TRUSTEE, Appellees.	Civil Action No. 3:08-cv-01183-SRU

CERTIFICATE OF SERVICE

I hereby certify that on March 23, 2009, a copy of foregoing Brief of Appellee United States Trustee was filed electronically and served by mail on anyone unable to accept electronic filing. Notice of this filing will be sent by e-mail to all parties by operation of the court's electronic filing system or by mail to anyone unable to accept electronic filing as indicated on the Notice of Electronic Filing. Parties may access this filing through the court's CM/ECF System.

In addition, in accordance with Fed. R. Bankr. P. 8005, I certify that I caused the Brief of Appellee United States Trustee to be served on the following parties by first class mail:

Jeffrey M. Sklarz, Esq.
Zeisler & Zeisler, P.C.
558 Clinton Ave., P.O. Box 3186
Bridgeport, CT 06605-0186
Attorney for Appellant Milford Connecticut Associates, L.P.

Dean W. Baker, Esq.
Law Offices of Dean Baker
205 Church St. Suite 506
New Haven, CT 06510
Attorney for Appellant Success-Treuhand, GmbH

Bruce Buechler, Esq.
Lowenstein Sandler
65 Livingston Avenue
Roseland, NJ 07068-1791
Attorney for Appellee Paradigm CF Corporation

Matthew B. Woods, Esq.
Goldman, Gruder & Woods
200 Connecticut Ave.
Norwalk, CT 06854
Attorney for Appellee Paradigm CF Corporation

Douglas S. Skalka, Esq.
Neubert, Pepe & Monteith, P.C.
195 Church St. 13th Floor
New Haven, CT 06510
Attorney for Appellee Richard Belford, Chapter 7 Trustee

Louis J. Testa, Esq.
Neubert, Pepe & Monteith, P.C.
195 Church St. 13th Floor
New Haven, CT 06510
Attorney for Appellee Richard Belford, Chapter 7 Trustee

Carl T. Gulliver, Esq.
Coan, Lewendon, Gulliver & Miltenberger
495 Orange St.
New Haven, CT 06511
Attorney for Appellee Petillo Enterprises

James Berman, Esq.
Zeisler & Zeisler, P.C.
558 Clinton Ave., Po Box 3186
Bridgeport, CT 06605-0186
Attorney for Appellant Milford Connecticut Associates, L.P.

Dated: New Haven, Connecticut
March 23, 2009

/s/ Alicia M. Leonhard
Alicia M. Leonhard (ct27844)
Assistant United States Trustee
Office of the United States Trustee
United States Department of Justice
150 Court Street, Suite 302
New Haven, Connecticut 06510
Telephone: 203.773.2210
Facsimile: 203.773.2217
Alicia.M.Leonhard@usdoj.gov

BRIEF BANK — 'SUMMARY SHEET"

Printed Mon-5/23/11 11:16

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	In re: Miller (Miller v. Cameron and USA)
2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	10th Cir. BAP
3. ("CCN") ***CURRENT*** CASE NO.	No.: UT-07-085
4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*	No.: 07-20270 Court: Bankr. Utah *(Identify judge & cite, if any)*
5. ("SO") ***SOURCE***	**U.S. TRUSTEES**
6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	Filed: September 2007 Type: Brief of Intervenor, United States of America
7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*	Brett Tolman, Daniel Price, Peter Keisler, J. Christopher Kohn, Tracy J. Whitaker Jeannine R. Lesperance *(UST/OGC: 202-307-1399/FAX-2397)*
8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") ● ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	●Whether year-to-date data from a pay stub subsequent to a missing pay stub constitutes “other evidence of payment received . . . by the debtor from any employer” within the meaning of 11 U.S.C. § 521(a)(1)(B)(iv)? 2.Whether 11 U.S.C. § 521(i)(1)’s provision for “automatic” dismissal on the 46th day of the case gives rise to an unconstitutional deprivation of property without due process?
10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)	
11. DO YOU RECOMMEND POSTING IN UST BRIEFBANK?	☒ YES ☐ NO ***NAME:*** Holly Walter ***DATE:***

UNITED STATES BANKRUPTCY APPELLATE PANEL

OF THE TENTH CIRCUIT

In re BRANDON L. MILLER and AMY L. MILLER, also known as Amy L. Folden, Debtors.	BAP No. UT-07-085 Bankr. No. 07-20270 Chapter 13
BRANDON L. MILLER, Appellant, v. J. VINCENT CAMERON, Trustee, Appellee, UNITED STATES OF AMERICA, Intervenor.	

BRIEF OF INTERVENOR, UNITED STATES OF AMERICA

BRETT L. TOLMAN
United States Attorney

DANIEL PRICE
Assistant United States Attorney
185 South State Street, Suite 400
Salt Lake City, Utah 84111
(801) 325-3234

PETER D. KEISLER
Assistant Attorney General

J. CHRISTOPHER KOHN
TRACY J. WHITAKER
JEANNINE R. LESPERANCE
Attorneys, Civil Division
U.S. Department of Justice
P.O. Box 875
Ben Franklin Station
Washington, D.C. 20044
(202) 616-2236 (telephone)
(202) 307-0494 (facsimile)

Dated: September 27, 2007

Statement regarding Oral Argument: Oral Argument Is Requested

TABLE OF CONTENTS

TABLE OF AUTHORITIES

[FILED SEPARATELY TO PRESERVE CODES]

BRIEF OF INTERVENOR, UNITED STATES OF AMERICA

The United States of America, as intervenor pursuant to 28 U.S.C. § 2403, hereby files this brief in support of the constitutionality of 11 U.S.C. § 521(i)(1). In accordance with Fed. R. Bankr. P. 8010(a)(2), the United States adopts appellant's statement of the basis of appellate jurisdiction.

STATEMENT OF THE ISSUES

1. Whether year-to-date data from a pay stub subsequent to a missing pay stub constitutes "other evidence of payment received . . . by the debtor from any employer" within the meaning of 11 U.S.C. § 521(a)(1)(B)(iv)?

2. Whether 11 U.S.C. § 521(i)(1)'s provision for "automatic" dismissal on the 46th day of the case gives rise to an unconstitutional deprivation of property without due process?[1]

STATEMENT OF THE CASE

The United States adopts appellant's statement of the case. For convenience, however, the United States summarizes the essential facts and describes the opinion below here.

I. Background

Brandon L. Miller ("Debtor") and his wife filed a joint petition for bankruptcy protection under chapter 13 on January 24, 2007. Section 521(a)(1) of title 11 requires the debtor to file certain documents with the bankruptcy court. Specifically, § 521(a)(1)(B)(iv) requires the debtor to file "copies of all payment advices or other evidence of payment received within 60 days

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[1] Appellant cites as his second issue whether the court below erred in raising compliance with § 521's filing provisions *sua sponte*. Appellant did not challenge the court's authority to raise such issues in the proceedings below. See Appendix ("APP") 67-76. The BAP ordinarily will not consider issues raised for the first time on appeal. In re Black, 292 B.R. 693, 699 (10th Cir. BAP 2003). Moreover, it is established that bankruptcy courts have the power to raise issues *sua sponte*. See, e.g., Hayes v. Production Credit Ass'n, 955 F.2d 49, 1992 WL 26785 *7-8 (10th Cir. 1992) (Table); see also 11 U.S.C. § 105(a) ("No provision of this title . . . shall be construed to preclude the court from, sua sponte, taking any action . . . .").

before the date of the filing of the petition, by the debtor from any employer of the debtor." 11 U.S.C. § 521(a)(1)(B)(iv).

Debtor timely filed three pay stubs from his employer for the four pay periods occurring in the 60-day period prior to the petition date. APP 95. Debtor was missing, and did not file, the pay stub for the third such pay period. Id. For the third pay period Debtor filed a calculation of the data missing from the pay stub, drawn from the year-to-date information on the fourth pay stub. Id.

At a May 2, 2007, confirmation hearing, the bankruptcy court, *sua sponte*, questioned whether Debtor's case was not "automatically dismissed" on the 46th day following the petition due to Debtor's failure to file the missing pay stub, pursuant to 11 U.S.C. § 521(i)(1). Id. Section 521(i)(1) provides:

> Subject to paragraphs (2) and (4) and notwithstanding section 707(a),[[2]] if an individual debtor in a voluntary case under chapter 7 or 13 fails to file all of the information required under subsection (a)(1) within 45 days after the date of the filing of the petition, the case shall be automatically dismissed effective on the 46th day after the date of the filing of the petition.

11 U.S.C. § 521(i)(1). Subparagraph (2) permits any party in interest to seek a dismissal order where the time set forth in § 521(i)(1) has expired. 11 U.S.C. § 521(i)(2). Subparagraph (4) permits a trustee to move the court, before the time set forth in § 521(i)(1) has expired, to decline to dismiss the case if the debtor attempted in good faith to comply with § 521(a)(1)(B)(iv) and if administration of the case would be in the best interest of creditors. 11 U.S.C. § 521(i)(4).

The Debtor and Trustee agreed below that the year-to-date calculation satisfied the

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[2] 11 U.S.C. § 707(a) provides that the bankruptcy court may dismiss petitions after notice and a hearing "for cause."

requirements of § 521(a)(1)(B)(iv). APP 71, 89. Debtor also argued, however, that to the extent the calculation was not sufficient, the "automatic dismissal" provision of 11 U.S.C. § 521(i) does not afford due process as required by the United States Constitution. APP 72; U.S. Const. amend. V.

II. Decision Below

On July 12, 2007, the bankruptcy court ruled that a calculation using year-to-date data does not satisfy the requirements of § 521(a)(1)(B)(iv) and that, as a result, Debtor's chapter 13 petition was "automatically dismissed" on the 46th day following the petition date (March 11, 2007). APP 106. The court ruled further that § 521(i)(1)'s dismissal provision is constitutional. APP 104-05.

Specifically, the court held that a calculation based on year-to-date information from another pay stub does not constitute "other evidence of payment received" within the meaning of § 521(a)(1)(B)(iv). The court disagreed with other reported decisions on the issue, all of which hold that a calculation based on year-to-date information is sufficient, stating that "they do not analyze the language of § 521(a)(1)(B)(iv)" but "either implicitly or explicitly invok[e] equitable considerations to reach arguably just results." APP 99. Parsing the statute, the court concluded that the phrase "received . . . by the debtor from any employer of the debtor" modifies not only the word "payment" but the entire object "payment advices or other evidence of payment." APP 100. The court concluded that a calculation by a lawyer cannot constitute "other evidence of payment" because it is not "received" directly from an employer. APP 101. The court bolstered her reading by pointing out that using a calculation may lead to error; if the pay stub contains errors or if the deductions from gross income vary, the net income calculation may be incorrect. Id. The court offered, however, that a calculation or replacement payment advice obtained from the employer may suffice; alternatively, the debtor may seek an extension of time to provide the required evidence under § 521(i)(3) or may ask the trustee to move to administer the case despite the defective filing under § 521(i)(4). Id., n. 18.

The court also found § 521(i)(1) to be constitutional. Interpreting Debtor's argument as both a facial and as-applied challenge, the court first rejected Debtor's facial challenge. The court noted that a facial challenge requires a constitutionally recognized deprivation of life, liberty or property in a manner that affords inadequate procedural safeguards. APP 103. The court held that the Debtor lost no cognizable property interest when his petition was dismissed because the "nation's bankruptcy laws are a matter of legislative largesse and do not provide debtors with constitutionally protected interests in the mere continued existence of a bankruptcy case." Id. The court held also that, to the extent Debtor had a cognizable interest in the non-dismissal of his bankruptcy case, the Bankruptcy Code itself provides all the notice that is constitutionally due in that it shows clearly the consequences for non-filing of required information. APP 104. The court noted further that the Code permits the Debtor to petition the court for an extension, seek guidance from the court regarding compliance, and challenge any erroneous determination. Id.

With respect to Debtor's as-applied challenge, the court construed the challenge to argue only that a dismissal by the clerk, without an order from the court, would be unconstitutional. The court agreed that the power to dismiss a petition, even pursuant to § 521(i)(1)'s "automatic" dismissal provision, rests solely with the court. APP 105. The court also noted that the dismissal decision was made by the court in this case, and concluded that Debtor had "no basis for an as-applied challenge to § 521(i)(1) . . . ." Id.

ARGUMENT

I. THIS PANEL NEED NOT ADDRESS THE CONSTITUTIONALITY OF § 521(i) BECAUSE THE BANKRUPTCY COURT ERRED IN HOLDING THAT A CALCULATION BASED ON YEAR-TO-DATE INFORMATION ON A PAY STUB IS NOT "OTHER EVIDENCE OF PAYMENT" WITHIN THE MEANING OF § 521(a).

The United States has intervened herein to support the constitutionality of § 521(i). Debtor's constitutional challenge may be avoided because the bankruptcy court erred in holding that a calculation extrapolated from year-to-date information on another pay stub is not "other evidence of payment" within the meaning of § 521(a)(1)(B)(iv). See Rumsfeld v. Forum for Academic & Inst'l Rights, 547 U.S. 47, 56 (2006) ("[W]hether a statute is constitutional fairly includes the question of what that statute says.")

Broken into component phrases, § 521(a)(1)(B)(iv) requires filing of:

- copies of
- all payment advices or other evidence of payment
- received
- within 60 days before the date of the filing of the petition
- by the debtor from any employer of the debtor

The court held that "received ... by the debtor from any employer of the debtor" modifies "payment advices or other evidence of payment" and that, therefore, only evidence that the debtor receives directly from an employer fulfills the debtor's duties under the statute. APP 100. According to the "rule of the last antecedent," both phrases following "received" are most logically read to modify the word "payment." Barnhart v. Thomas, 540 U.S. 20, 26-27 (2003).[3]

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[3] The Supreme Court explained that "the grammatical 'rule of the last antecedent,'" provides that "a limiting clause or phrase . . . should ordinarily be read as modifying only the noun or phrase that it immediately follows." Id. (citing 2A N. Singer, Sutherland on Statutory Construction § 47.33, p. 369 (6th rev. ed. 2000)).

Congress was concerned about the payments the debtor received in the 60-day period prior to the petition date. Nothing in the Code indicates that "evidence" should be read differently from its ordinary meaning, as governed by the Federal Rules of Evidence, or that a court could not consider evidence of payment such as deposit slips or bank statements, which are not received from an employer.

Moreover, even under the court's reading, the calculation derived from year-to-date information could be construed as having been received from an employer. The calculation itself is not evidence - it is merely math. The evidence in the calculation is the year-to-date information, which was received from the employer via the subsequent pay stub.

In addition, the court failed to consider fully the language of the statute in construing § 521(a)(1)(B)(iv) and concluding that she was required to dismiss Debtor's case. APP 101 ("There is simply no room for 'substantial compliance' or similar equitable theories; either the required documents are filed or they are not.") Section 521(a)(1)(B) provides: "(a) The debtor shall – (1) file – (A) a list of creditors; and (B) unless the court orders otherwise --" the payment advices, among other things. The prefatory phrase "unless the court orders otherwise" has a plain meaning – that the court has the power to order otherwise. Although Congress set forth no particular standard against which such an order would be measured (*e.g.*, substantial compliance), it is reasonable to assume that the court has some power to grant relief consistent with, and in furtherance of, other provisions of the Code. See, e.g., In re Brickey, 363 B.R. 59, 63-64 (Bankr. N.D.N.Y. 2007) (recognizing limits on the court's ability to "order otherwise"); cf. In re Jackson, 348 B.R. 487, 497-500 (Bankr. S.D. Iowa 2006) (court may "order otherwise"

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if dismissal would “foster rather than prevent an abuse of process”).

The Court also speculated that a calculation using year-to-date information is likely to lead to error. Section 521(a)(1)(B)(iv) is most reasonably interpreted to require the Debtor to submit the evidence that he or she has received and, if misplaced, can reasonably obtain. See In re Tay-Kwamya, 367 B.R. 422, 425 (Bankr. S.D.N.Y. 2007) (§ 521 “only requires the filing of documents which actually exist.”) Such evidence must be weighed, like any other evidence, to the extent that it is reliable and probative. Although a calculation may be more prone to error than a pay stub itself, in a chapter 13 case such as this, the trustee, creditors and the court are free to take that into consideration in the confirmation process when deciding whether the debtor’s proposed payments suffice. See 11 U.S.C. § 1325(b)(2). Moreover, pay stubs themselves are not immune from error.

All other bankruptcy courts having addressed the adequacy of calculations based on year-to-date information for purposes of § 521(a)(1)(B)(iv) have held them to be sufficient. See In re Wojda, 371 B.R. 656, 659-60 (Bankr. W.D.N.Y. 2007); In re Reynolds, 370 B.R. 393, 396-97 (Bankr. N.D. Okla. June 5, 2007); Tay-Kwamya, 367 B.R. at 425-26; In re Luders, 356 B.R. 671, 673 (Bankr. W.D. Va. 2006); see also In re Svigel, slip copy, 2007 WL 1747117 *2 (10th Cir. BAP Jun. 18, 2007) (holding that bankruptcy court erred in failing to consider whether a year-to-date calculation constituted “other evidence of payment” for purposes of § 521(a)(1)(B)(iv)). Here, the court did not hold that the calculation submitted was unreliable or inaccurate; rather, she held that the case was dismissed automatically because such calculation, regardless of its reliability, did not meet the requirements of the statute as a matter of law. In this, the court erred.

II. DEBTOR’S CONSTITUTIONAL CHALLENGE ENTITLES HIM TO NO RELIEF.

A. THE AUTOMATIC DISMISSAL PROVISION OF § 521(i)(1) IS NOT UNCONSTITUTIONAL ON ITS FACE.

The court interpreted Debtor's submissions to include both facial and as-applied challenges to § 521(i) under the due process clause of the United States Constitution. U.S. CONST. amend. V.[4] With respect to the facial challenge, the court noted correctly that the Debtor must show two things – the existence of a constitutionally protected property interest and an absence of adequate process before deprivation of such interest. APP 103. The court concluded that the Debtor lacked a constitutionally protected interest in not having his petition dismissed, quoting Supreme Court precedent for the proposition that there is "no constitutional right to obtain a discharge . . . ." Id. (quoting United States v. Kras, 409 U.S. 434, 446 (1973)). For present purposes, we assume that the debtor has a protected interest in avoiding dismissal of his case. Although Congress was not required to create a bankruptcy regime, it has done so and we assume that Congress intended its procedures to satisfy minimal standards of due process.[5]

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[4] Debtor mistakenly invoked the fourteenth amendment (action by the states), rather than the fifth (action by the federal government).

[5] "A plaintiff has a property interest in those things to which [he or] she has 'a legitimate claim of entitlement.'" Richman v. Straley, 48 F.3d 1139, 1143 (10th Cir. 1995) (quoting Board of Regents v. Roth, 408 U.S. 564, 577 (1972)). If such interest rises to the level of a constitutional right, the deprivation of such interest will be subject to a strict constitutional test; if such interest does not rise to the level of a constitutional right, a deprivation of such interest must, nevertheless, meet a more "lenient" constitutional standard. See In re Stewart, 175 F.3d 796, 811 (10th Cir. 1999). In Stewart, the Tenth Circuit noted that "[b]ankruptcy laws regulating economic activity do not involve constitutionally protected conduct" and "discharge in bankruptcy is not a constitutional right but is only a civil remedy afforded by statute . . . ." Id. However, the Stewart court nonetheless reviewed whether a certain provision of the Code was unconstitutionally vague or violated the equal protection clause, applying "less rigorous constitutional standards." Id. Here, although the right to file a bankruptcy petition arises from the Bankruptcy Code and not from the Constitution itself, the Debtor nevertheless may have a property interest to the extent that the Bankruptcy Code affords him a right to relief. Other courts having addressed the issue hold that due process affords a debtor some procedural protection before his or her petition is dismissed. See, e.g., Sheets v. Livy, 97 F.2d 674, 675 (4th

The court correctly rejected debtor's facial challenge to § 521. APP 104. A statute may be held unconstitutional on its face only if "no set of circumstances exists under which the Act would be valid." United States v. Salerno, 481 U.S. 739, 745 (1987). Here, there are adequate procedural safeguards in place to satisfy due process. The bankruptcy court concluded that § 521 "itself provides a clear directive that certain documents must be filed within 45 days after the petition date . . . . It is unclear how much more notice could be provided than to engrain [sic] the deadline in the statute itself." APP 104. The court also noted that the Code affords debtors other avenues for relief from dismissal, including petitioning the court regarding compliance with their filing requirements, seeking an extension to file, and challenging any decision they deem erroneous. Id..

Due process requires only that the applicable procedures "are reasonable and give the aggrieved party adequate notice and an opportunity to meaningfully participate." Santana v. City of Tulsa, 359 F.3d 1241, 1244 (10th Cir. 2004); see also Cleveland Bd. of Educ. v. Loudermill, 470 U.S. 532, 546 (1985). Under § 521(a), the Debtor is required to file certain information, including "payment advices," "unless the court orders otherwise." 11 U.S.C. § 521(a)(1)(B). This suggests that a Debtor can move for a declaration that the information filed constitutes "other evidence of payment" within the meaning of § 521(a)(1)(B)(iv). See Fed. R. Bankr. P. 9013. In addition, the Debtor can move, before the 45 day period expires, for additional time to file the necessary papers. 11 U.S.C. § 521(i)(3). Moreover, if the court dismisses the case *sua sponte*, the Debtor can move for relief from the dismissal order on the ground that it was entered inappropriately. Fed. R. Bankr. P. 9024. The Debtor is further

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Cir. 1938); In re Baldwin, 362 B.R. 413, 418-19 (8th Cir. BAP 2006); In re Krueger, 88 B.R. 238, 241 (9th Cir. BAP 1988); Odom Enter., Inc. v. IRS, 25 B.R. 313, 315 (E.D. Ark. 1982).

protected in that, if a party in interest moves for dismissal under § 521(i)(2), Rule 9013 requires such motion to be served on the debtor. Fed. R. Bankr. P. 9013. The local rules also afford the Debtor due process. Under the court's standing orders, the clerk's authority is limited to dismissal pursuant to specified local rules, none of which addresses the debtor's failure to produce documents required under § 521. See Standing Order #2, U.S. Bankr. Court for the District of Utah, Rule 5003-1 [Exhibit A]. Moreover, dismissal by the clerk only follows the debtor's failure to respond to a motion to dismiss or a notice of failure to comply served on the debtor by the trustee. Id.; see also Standing Order #1, U.S. Bankr. Court for the District of Utah, Rule 2083-1 [Exhibit B].

The case In re Tennant, 318 B.R. 860 (9th Cir. BAP 2004), also is instructive. In Tennant, the bankruptcy court dismissed a chapter 13 petition *sua sponte*, pursuant to its general powers under 11 U.S.C. § 105(a), after the debtor failed to file a statement of financial affairs within 15 days of the petition date. Id. at 863-64. The court noted that "the concept of procedural due process requires a notice and an opportunity to be heard." Id. at 870. The court also noted that the term "after notice and a hearing," as defined in the code, at 11 U.S.C. § 102(1),[6] is a "flexible" concept and "depends on what is appropriate in the particular circumstance." Id. The Tennant court concluded:

> A dismissal without notice and an opportunity to be heard would not be appropriate where substantive issues are to be determined, but if a case involves only very narrow procedural aspects, a court can dismiss a Chapter 13 case without further notice and a hearing if the debtor was provided 'with notice of the requirements to be met.'

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[6] Section 102(1) provides that notice and a hearing means "such notice as is appropriate in the particular circumstances, and such opportunity for a hearing as is appropriate in the particular circumstances . . . ." 11 U.S.C. § 102(1).

Id. (quoting In re Meints, 222 B.R. 870, 872 (D. Neb. 1998)). Likewise, here, the Code itself gave the Debtor ample notice of the requirements to be met.

Debtor's facial challenge to § 521 fails because the statute and applicable rules afford notice and multiple opportunities to be heard. The Debtor cannot show that the statute would be unconstitutional in its application in every case. Salerno, 481 U.S. at 745.

B. DEBTOR LACKS STANDING TO BRING AN AS-APPLIED CHALLENGE BECAUSE THE HARM OF WHICH HE COMPLAINS IS HYPOTHETICAL.

The Debtor does not question Congress' right to limit his access to the bankruptcy courts. He challenges the applicable procedures, arguing that his case should not be dismissed without notice and a hearing. The Supreme Court has opined that "[a]s a general rule, if there is no constitutional defect in the application of the statute to a litigant, he does not have standing to argue that it would be unconstitutional if applied to third parties in hypothetical situations." County Court v. Allen, 442 U.S. 140, 154-55 (1979); see also Broadrick v. Oklahoma, 413 U.S. 601, 610-611 (1973); United States v. Mendes, 912 F.2d 434, 440 (10th Cir. 1990). The Debtor here seeks a declaration of unconstitutionality based on a hypothetical situation – that a case could be "automatically dismissed" without notice or a hearing by the clerk's entry, in violation of due process. The Debtor ignores, however, that he himself had notice, in the form of discussion at his confirmation hearing as well as a written scheduling order from the court, and an opportunity to be heard, of which he took full advantage by filing two briefs. Below, the Debtor did not suggest that the process made available to him was defective in any way. APP 72-75. The Debtor thus lacks standing to raise a constitutional challenge based on how § 521(i) might hypothetically be applied to someone else. Allen, 442 U.S. at 154-55; Mendes, 912 F.2d at 440.

The Debtor now complains that the court's raising of the issue *sua sponte* at confirmation and setting a briefing schedule was inadequate because "[i]t is conceivable that, given notice that compliance with § 521(a)(1) was at issue, Appellant may have been able to present testimony or other evidence that would support his position that he had supplied other evidence of payment." Appellant's brief at 26. The obvious flaw in this argument is that, by the time the court raised the issue at confirmation, the time to comply with § 521(a)(1) had long passed. What the Debtor submitted under § 521(a)(1) was a matter of record and undisputed. Moreover, Debtor did not ask the court to continue the confirmation hearing and to leave the record open for further evidence. Finally, the Debtor fails to adduce any evidence that he would have presented had the issue arisen prior to confirmation. That the Debtor could "conceivably," or hypothetically, have done so if such evidence existed is irrelevant to whether the Debtor was afforded due process in this case. Allen, 442 U.S. at 154-55; Mendes, 912 F.2d at 440.

CONCLUSION

For the foregoing reasons, the United States respectfully requests that the Bankruptcy Appellate Panel uphold the constitutionality of 11 U.S.C. § 521(i)(1), or avoid the constitutional question by holding that a calculation using year-to-date information, if otherwise reliable, satisfies the requirements set forth in § 521(a)(1)(B)(iv).

STATEMENT OF REASONS FOR ORAL ARGUMENT

Oral argument is appropriate in this appeal because it presents both an issue of statutory interpretation which is a matter of first impression to the panel and raises a constitutional challenge to a new provision of the Bankruptcy Code.

Respectfully submitted,

PETER D. KEISLER

Assistant Attorney General

BRETT L. TOLMAN
United States Attorney

DANIEL PRICE
185 South State Street, Suite 400
Salt Lake City, Utah 84111
(801) 325-3234

____
J. CHRISTOPHER KOHN
TRACY J. WHITAKER
JEANNINE R. LESPERANCE
Attorneys, Civil Division
U.S. Department of Justice
P.O. Box 875, Ben Franklin Station
Washington, D.C. 20044
(202) 616-2236
(202) 307-0494 (facsimile)

CERTIFICATE OF SERVICE

I hereby certify that, on the 27th day of September, 2007, I caused a copy of the foregoing to be served via facsimile upon:

Stephen M. Enderton
234 East 3900 South, Suite One
Salt Lake City, Utah 84107
Fax: (801) 281-0952

Scott T. Blotter
Office of the Chapter 13 Trustee
47 West 200 South, Suite 600
Salt Lake City, Utah 84101
Fax: (801) 415-0233

Office of the United States Trustee
405 South Main Street, Suite 300
Salt Lake City, Utah 84111
Fax: (801) 524-5628

____
Jeannine R. Lesperance

BRIEF BANK — “SUMMARY SHEET”

Printed Wed.-5/5/4 (16:26)

WESTLAW CODES

1. (“TI”) TITLE OF CASE [E.g., “SMITH v. U.S. TRUSTEE (IN RE SMITH)”]
United States Mineral Products Company v. Official Committee of Asbestos Bodily Injury and Property Damage Claimants, et al. (In re United States Mineral Products Company)

2. (“CO”) CURRENT COURT [E.g., “CTA9"]
CA3

3. (“CCN”) CURRENT CASE NO.
No.: 04-1363 & 04-1443

4. (“PCN”) PRIOR CASE NO. & COURT [IF ANY]
No.:
Court: USDC Del.
(Identify judge & cite, if any)

5. (“SO”) SOURCE
U.S. TRUSTEES

6. (“DA”) DATE OF FILING & TYPE OF BRIEF [E.g., “Opening Brief,” “Reply,” “Amicus,” etc.]
Filed: April 2004
Type: Brief for UST

7. (“AU”) PRINCIPAL AUTHORS & OFFICE [E.g.,“UST/OGC”]
Tara Leigh Grove, Esq., Civil/DOJ
P. Matthew Sutko, Esq., OGC/DOJ
(UST/OGC: 202-307-1399/FAX-2397)

8. (“TO”) TOPIC
BANKRUPTCY

9. (“SU”) ● SUMMARY OF KEY ISSUE(s) & √ Any Miscellaneous BACKGROUND

● 1) Whether the bankruptcy court properly adhered to the procedural scheme of 11 U.S.C. §1104(a) by directing the appointment of a trustee after notice, a hearing and upon the request of a party in interest. 2) Whether the bankruptcy court abused its discretion in determining that the appointment of a trustee was in the interest of the parties.

√ **Background:**

10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)
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DATE: Mon.-5/3/4 (16:05)

IN THE UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

Nos. 04-1363 & 04-1433

In re: UNITED STATES MINERAL PRODUCTS COMPANY,
Debtor

UNITED STATES MINERAL PRODUCTS COMPANY
Appellant

v.

OFFICIAL COMMITTEE OF ASBESTOS BODILY INJURY
AND PROPERTY DAMAGE CLAIMANTS, et al.
Appellees

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF DELAWARE

BRIEF FOR APPELLEE UNITED STATES TRUSTEE

STATEMENT OF SUBJECT MATTER AND APPELLATE JURISDICTION

The bankruptcy court had jurisdiction under 28 U.S.C. § 157(a) and (b) to hear the underlying case, a voluntary petition under Chapter 11 of the Bankruptcy Code, 11 U.S.C. § 1101, et seq. See also 28 U.S.C. §§ 151, 1334(a). On September 9, 2003, the bankruptcy court entered an order directing the United States Trustee to appoint a Chapter 11 trustee to oversee the bankruptcy proceeding. Appendix ("A") 7. The bankruptcy court's directive constituted a final and immediately appealable order. See In re Marvel Entertainment Group, Inc., 140 F.3d 463, 470 (3d Cir. 1998).

On September 15, 2003, the debtor United States Mineral Products Company ("U.S. Mineral" or "debtor") filed a timely notice of appeal from that order to the district court. A1445-47; see Fed. R. Bankr. P. 8002(a). Appellant James P. Verhalen ("Verhalen") filed a timely notice of appeal to the district court on September 18, 2003. A1565-67. The district court had jurisdiction to hear the appeal under 28 U.S.C. § 158(a). On January 16, 2004, the district court affirmed the appointment of the trustee. A9, A16. The debtor subsequently filed a timely notice of appeal to this Court from the district court's decision on February 10, 2004. A1-3. Verhalen filed a timely notice of appeal to this Court on February 11, 2004. A4-6. This Court has jurisdiction to hear the appeal under 28 U.S.C. § 158(d).

STATEMENT OF THE ISSUES PRESENTED FOR REVIEW

(1) Whether the bankruptcy court properly adhered to the procedural scheme of 11 U.S.C. § 1104(a) by directing the appointment of a trustee after notice, a hearing, and upon the request of a party in interest.

(2) Whether the bankruptcy court abused its discretion in determining that the appointment of a trustee was in the interests of the parties.

STATEMENT OF THE CASE

United States Mineral Products Company, a former manufacturer of asbestos-containing products, filed a voluntary petition under

Chapter 11 of the Bankruptcy Code, 11 U.S.C. 1101, et seq., on July 23, 2001. See A11, A474; Bankr. Case No. 01-02471, Doc. No. 1. After two years of negotiations, the debtor failed to propose a plan of reorganization that was acceptable to all creditors.

After a hearing in August 2003, the bankruptcy court concluded, in light of the "acrimony" among the parties, that they would be unable to formulate a plan of reorganization absent the intervention of a Chapter 11 trustee. A1403-04. The court therefore directed the appointment of a trustee pursuant to the interests-of-the-parties test of 11 U.S.C. § 1104(a)(2). A1403. The district court affirmed the bankruptcy court's decision, stating that the "distrust and animosity" among the parties justified the appointment of a trustee. A15-16. The debtor and Verhalen subsequently appealed.

STATEMENT OF FACTS

I. Statutory Background

A. Appointment of a Chapter 11 Trustee

When a debtor files for bankruptcy under Chapter 11, see 11 U.S.C. § 1101, et seq., all of its assets are transferred to a new legal entity: the estate. See 11 U.S.C. 541(a); In re O'Dowd, 233 F.3d 197, 202 (3d Cir. 2000). At that time, the debtor becomes the "debtor-in-possession" and is responsible for administering the estate. See 11 U.S.C. § 1107(a).

The debtor, as a "debtor-in-possession," serves as a fiduciary to the creditors of the estate. In re United Healthcare System, Inc., 200 F.3d 170, 177 n.9 (3d Cir. 1999). In that fiduciary role, the debtor must "refrain from acting in a manner which could damage the estate, or hinder a successful reorganization." Marvel, 140 F.3d at 471 (quoting Petit v. New England Mortgage Services, Inc., 182 B.R. 64, 69 (D. Me. 1995)). Thus, the debtor must provide "[o]pen, honest and straightforward disclosure to the Court and creditors." Id. at 474 (internal quotation marks omitted). In addition, the debtor has an obligation to "protect and conserve property in its possession for the benefit of creditors." Ibid. (In re Ionosphere Clubs, Inc., 113 B.R. 164, 169 (Bankr. S.D.N.Y. 1990)).[1]

Although the Code provides the debtor with this opportunity to operate the bankruptcy estate, section 1104(a) of the Bankruptcy Code states that the debtor should be replaced by a Chapter 11 trustee in certain circumstances. The provision states that "[a]t any time after the commencement of the case but before confirmation of a plan, on request of a party in interest or the United States

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[1] The filing of the Chapter 11 petition similarly changes the role of the debtor's management. Before bankruptcy, the debtor's management is a fiduciary to the corporation and the shareholders. After filing the petition, the management serving as the debtor-in-possession is a fiduciary to the estate as well as its creditors. See Commodity Futures Trading Commission v. Weintraub, 471 U.S. 343, 355 (1985).

trustee, and after notice and a hearing, the [bankruptcy] court shall order the appointment of a trustee":

> (1) for cause, including fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor by current management, either before or after the commencement of the case, or similar cause, but not including the number of holders of securities of the debtor or the amount of assets or liabilities of the debtor; or
>
> (2) if such appointment is in the interests of creditors, any equity security holders, and other interests of the estate, without regard to the number of holders of securities of the debtor or the amount of assets or liabilities of the debtor.

11 U.S.C. § 1104(a).

If the bankruptcy court concludes that either of the above standards has been satisfied, the court will direct the United States Trustee[2] to appoint, subject to the court's approval, a "disinterested person" to serve as the Chapter 11 trustee. 11 U.S.C. § 1104(d).

B. Section 524(g) Injunction for Asbestos Claims

One provision of the Bankruptcy Code specifically addresses bankruptcies involving asbestos claims. See Pub. L. 103-394, § 111(a), 108 Stat. 4106 (codified at 11 U.S.C. § 524(g) & (h)).

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[2] United States Trustees are Justice Department officials appointed by the Attorney General to supervise the administration of bankruptcy cases. See 28 U.S.C. §§ 581-89; In re Columbia Gas Systems, Inc., 33 F.3d 294, 296 (3d Cir. 1994) (noting that United States Trustees oversee the bankruptcy process, protect the public interest, and ensure that bankruptcy cases are conducted according to law) (citing H.R. Rep. No. 95-595 at 109 (1977)).

As Congress recognized, asbestos-related health problems have a long latency period; the effects of exposure to asbestos can remain hidden for as many as thirty years. H.R. Rep. No. 103-835 at 40 (1994). As a result, it can be difficult for asbestos companies in bankruptcy to be certain of resolving all (or even most) of the potential tort claims against them. See ibid. Thus, as part of the Bankruptcy Reform Act of 1994, Congress provided a procedural mechanism through which a debtor corporation can resolve all asbestos-related tort claims, including potential future claims. See Pub. L. 103-394, § 111(a); H.R. Rep. No. 103-835 at 40-41.

Section 524(g) allows debtor asbestos companies to create a special trust out of which all present and future tort claims will be paid. See 11 U.S.C. § 524(g)(1)(B), (2)(B)(i); H.R. Rep. No. 103-835 at 41. The trust must satisfy strict procedural requirements, including obtaining the approval of 75% of a specially created class of asbestos creditors. See 11 U.S.C. § 524(g)(2)(B)(ii)(IV)(bb); H.R. Rep. No. 103-835 at 41. The trust must also provide "reasonable assurance" that it will pay present and future claims "in substantially the same manner." 11 U.S.C. § 524(g)(2)(B)(ii)(V). If the trust satisfies the statutory mandates, then a court can issue an injunction requiring any present or future asbestos tort claimants to seek compensation via the trust, and not from the debtor or any company that later acquires the debtor's assets. See 11 U.S.C. § 524(g)(1), (3)(A).

As a result, a third-party entity can purchase the assets of the debtor, without also taking on the debtor's potential future asbestos-related liability. See 11 U.S.C. § 524(g)(3)(A)(ii).

II. Facts Of This Case

A. The Bankruptcy Proceedings

1. On July 23, 2001, U.S. Mineral filed a voluntary petition for bankruptcy under Chapter 11. See A11, A474; Bankr. Case No. 01-02471, Doc. No. 1. U.S. Mineral is a closely-held business. See A10. James Verhalen (the other appellant in the present action) owns outright a majority of the company's stock and controls a substantial portion of the remaining shares. See A11; Bankr. Case No. 01-02471, Doc. No. 165 (schedules filed by debtor on September 5, 2001) (Part 13: List of Equity Security Shareholders).

U.S. Mineral, which manufactures and sells spray-applied fire resistive material, insulation and acoustical products to the construction industry, see A10, A511, was in most respects a financially stable company when it filed the Chapter 11 petition, see A11. However, the company was facing mounting tort lawsuits, arising out of its manufacture and sale of asbestos-containing products between 1954 and 1972. See A11. U.S. Mineral sought protection under Chapter 11 primarily to resolve these asbestos claims. See ibid.

U.S. Mineral's bankruptcy case was a "rather modest" one. A11. According to the debtor, the company had a market value of \$13.4 million. See A620, A1374. The company's liabilities consisted of approximately \$3 million in trade debt and around \$10 million in liquidated asbestos claims. See A11.

On August 8, 2001, the United States Trustee appointed two committees to represent the major creditor interests in the case: an Official Committee of General Unsecured Creditors ("Trade Committee") and an Official Committee of Asbestos Claimants ("Asbestos Committee"). Bankr. Case No. 01-02471, Doc. Nos. 80, 81; see 11 U.S.C. § 1102(a)(1) (noting the authority of the United States Trustee to appoint creditors' committees). Later, on October 28, 2002, the bankruptcy court appointed a Legal Representative to look out for the interests of "future unknown asbestos claimants[.]" A58.

2. The debtor, the only party with the authority to file a reorganization plan,[3] had difficulty proposing a plan that was acceptable to all parties. On August 1, 2002, more than one year after the petition was filed, U.S. Mineral reported to the bankruptcy court that its negotiations with the asbestos creditors

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[3] The Bankruptcy Code provided the debtor with an exclusive right to file a plan during the first 120 days of the bankruptcy case. See 11 U.S.C. § 1121(b). Later, the bankruptcy court repeatedly granted U.S. Mineral's requests for extensions of its "exclusivity" period, see, e.g., A264-65, A332-33, A334-36, A369-71, A439-41, A466-68, A480-82, despite the Asbestos Committee's "continuing objection to exclusivity," A508; see A279-91, A533-39.

had reached an "impasse," A36, and asked the court to appoint a mediator. See A34-39. The bankruptcy court appointed a mediator on October 11, 2002. A43. However, even after mediation, U.S. Mineral failed to propose a plan that gained the assent of the other parties. See, e.g., A343 (statement of the Asbestos Committee at a February 27, 2003 hearing, predicting "very difficult waters ahead" in the negotiations); A449 (statement of U.S. Mineral at a May 1, 2003 hearing that it was "obvious" there would be no confirmed plan by July 23, 2003); A732 (statement by the Legal Representative at a July 31, 2003 hearing that mediation had reached an "impasse").

One major point of dispute among the parties was the proper market value of the debtor. An expert retained by the Asbestos Committee opined that U.S. Mineral was worth between $20 and $42 million. See A49. By contrast, Curtis Securities ("Curtis"), an investment banking firm retained by the debtor, estimated that the "fair market value" of U.S. Mineral was $13.4 million. A620.

3. At a May 29, 2003 hearing, the debtor stated that the protracted bankruptcy proceedings were taking a serious financial toll on the company. The debtor asserted that its professional fees (for attorneys, accountants, investment bankers, and other specialists) had "exceeded $2 million." A476.[4] The debtor

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[4] Under the Bankruptcy Code, a debtor's estate must pay the fees of the professionals retained by the debtor, see 11 U.S.C. §§ 327, 330(a), as well as those retained by creditors' committees, see 11 U.S.C. §§ 330(a), 1103. See 11 U.S.C. § 503(b)(2). As

suggested that, if professional fees continued to accrue at the same rate, it would lose another $1 million by March 2004. See ibid. The company was not readily able to shoulder these costs because of an economic downturn in the construction industry. See A475-76 (noting that the debtor's revenues had fallen by as much as 25 and 36 percent in certain areas).

The bankruptcy court stated that it did not "know really what to do" to help the debtor minimize its professional fees other than to "push hard" to get the case "out of Chapter 11 and into a confirmed plan." A479. The court found, in light of the relatively small nature of the company, that the parties should be able to reach plan confirmation by the end of October. See A475. The court announced that its "goal" was "to get this case into a confirmed plan" by the end of the year, and he informed the parties that he would "start shoving awful hard in the next couple of months if this thing doesn't start to move." A478.

4. The events of the subsequent months did not, however, serve to reduce tensions among the parties. In Summer 2003, the parties discovered that the debtor had failed to list a number of creditors and claims on its original schedules of assets and

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administrative expenses, these fees have first claim to the estate's assets. See 11 U.S.C. § 507(a)(1).

liabilities, including a potential $1 million claim held by the Wausau Insurance Companies. See A743-44, A822.[5]

At a July 31, 2003 hearing, the debtor's counsel stated that U.S. Mineral's management had failed to inform their bankruptcy attorney about the potential $1 million liability, see A744, because they "didn't think [Wausau] had a valid claim," A743. The bankruptcy court made clear that the debtor was required to report this creditor, regardless of the management's analysis of the worthiness of the claim. See A743-44. The court directed the debtor to amend its schedules of assets and liabilities to include this creditor along with any other potential claimants that were previously omitted. A707, A743-44.

5. At the July 31, 2003 hearing, the bankruptcy court once again expressed its dissatisfaction with the parties' continued failure to formulate a consensual reorganization plan. The court did not want to fall back on the "wholly objectionable alternative of having competing plans" that would inevitably lead to considerable additional litigation. A741. Therefore, the court indicated that, if the debtor could not "come up with a consensual plan by the end of August," the court would "appoint a Chapter 11

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[5] Wausau had previously obtained an approximately $6.5 million judgment against U.S. Mineral. See A833. U.S. Mineral paid all but $950,000 of that judgment. See A743, A833. The dispute later went to arbitration, and the arbitrator ordered U.S. Mineral to pay a little over $1 million (the remaining $950,000 plus approximately $100,000 in defense costs). See A833, A1685.

Trustee" who could sell the company's assets and prepare a reorganization plan. A741.

6. On August 25, 2003, U.S. Mineral proposed a reorganization plan. See A1171-88. The plan stated that the company's existing equity holders (such as Verhalen) would not receive anything from the reorganization. See A1175, A1210 (stating that "Old Common Stock shall be canceled and each holder thereof . . . shall receive nothing").

The plan envisioned the creation of an Asbestos Trust, which would "assume all liabilities and obligations" of the debtor with respect to asbestos-related claims. A1207 ("Plan Overview"). The Asbestos Trust would be partly funded with $22 million in insurance proceeds. A1208.[6] The rest of the funds for the Trust would come from an auction of the company. Ibid.

U.S. Mineral had previously made clear that its management (which included Verhalen)[7] would participate in the auction and might repurchase the company. See A731, A1385. The debtor nominated Curtis, the investment banking firm that had estimated the debtor's market value at $13.4 million, to conduct the auction. See A610-15, 1373-75.

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[6] The company had separate insurance coverage for its non-asbestos claims. See A1381.

[7] At the time, Verhalen was the company's Chairman and Chief Executive Officer. See Bankr. Case No. 01-02471, Doc. No. 1707, Appendix A (Verhalen Employment Agreement).

The debtor's reorganization plan provided that the funds from the auction would be used first to pay non-asbestos creditors, such as members of the Trade Committee. See A1207 ("Plan Overview"). The plan stated that the trade creditors would be paid in full. See A1172, A1174. The "remaining proceeds" from the auction would be transferred to the Asbestos Trust. A1207.

The plan also contained provisions for enjoining future asbestos litigation against the debtor or any company that purchased its assets at auction. See A1181-83. The plan provided that, if a sufficient number of creditors agreed to the reorganization proposal, the bankruptcy court could issue an injunction pursuant to 11 U.S.C. § 524(g). See A1181-83, A1237-38. Alternatively, if the parties could not agree on a plan, and the debtor was forced to resort to the "cramdown" provisions of the Bankruptcy Code,[8] the plan presumed that the bankruptcy court could

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[8] The so-called "cramdown" process permits a debtor to impose a reorganization plan on a dissenting class of creditors. See 11 U.S.C. § 1129(b); Bank of America National Trust and Savings Association v. 203 North LaSalle Street Partnership, 526 U.S. 434, 441 (1999). In order for a debtor to effectuate a "cramdown," its plan must satisfy most of the requirements of other confirmed plans, see 11 U.S.C. § 1129(a), such as being accepted by at least one class of impaired creditors, see 11 U.S.C. § 1129(a)(10); LaSalle, 526 U.S. at 441. In addition, the plan must be "fair and equitable" to the dissenting class of creditors. See 11 U.S.C. § 1129(b); see also 11 U.S.C. § 1129(b)(2)(B) (stating that, to be "fair and equitable" to a class of unsecured creditors, the plan must provide the holder of each claim in the dissenting class with full value, or the plan must not provide any value to holders of claims with a lower priority than the dissenting class).

issue a similar injunction pursuant to its "broad equitable powers" under 11 U.S.C. § 105(a). A1237.

7. At the subsequent hearing on August 27, 2003, the asbestos creditors identified what they viewed as the flaws in the debtor's reorganization plan. The Legal Representative first observed that the plan would not guarantee an injunction pursuant to 11 U.S.C. § 524(g). The Representative asserted that, absent a section 524(g) injunction, it was "questionable" whether any prospective buyer could purchase the debtor's assets free and clear of future asbestos claims. A1384. The Representative reasoned that bidders at the auction would "necessarily reduce the amount that they would be willing to pay based upon the specter of successor liability." A1384. As a result of this low bidding, the auction would not provide the maximum value to the asbestos creditors. <u>See</u> A1384-85.

The Legal Representative was also concerned that the auction would be run by Curtis, the debtor's investment banking firm. <u>See</u> A1385. The Representative noted that the debtor's management would be a bidder in the auction, and suggested that other potential bidders might question Curtis's "independen[ce]." <u>Ibid</u>. The Representative stated that, "[u]nder those circumstances, we would not be surprised if no one bid." <u>Ibid</u>. The Asbestos Committee "concur[red]" with the Legal Representative's assessment of the situation. A1386.

8. After listening to the parties' objections, the bankruptcy court denied U.S. Mineral's motion to appoint Curtis to supervise the debtor's proposed auction. See A1402-03. The court observed that this proposal "might have been an excellent way to proceed" six months or one year earlier before Curtis Securities had provided an appraisal of the debtor. Ibid. However, in August 2003, the motion was "ill-advised." A1403. The court noted the intense "acrimony" that had developed among the parties by August 2003, and stated that the appointment of Curtis would "just . . . lead to more problems." Ibid.

9. At the August 27, 2003 hearing, the parties shared their views on the wisdom of appointing a Chapter 11 trustee. The Asbestos Committee contended that a Chapter 11 trustee could "resolve the disputes among the different parties by filing his own plan," and declared definitively that it "support[ed] the appointment of a Trustee[.]" A1389; see A1392 ("[A] Trustee, not burdened by somebody controlling him and free to make the right decisions about maximizing value in this case . . . would serve us all, and I would ask Your Honor to return where we left on July 31, recognizing we have failed to reach agreement, and to do what is necessary to protect the estate, rather than a particular party."). In its pleadings, the Committee similarly declared that the bankruptcy court "should authorize the appointment of a

disinterested trustee to take charge of this reorganization effort." A805.

U.S. Mineral, by contrast, strongly opposed the appointment of a Chapter 11 trustee. See A1375 ("implor[ing]" the bankruptcy court "not to appoint a Chapter 11 Trustee in this case"). The debtor asserted first that, once a trustee was appointed, each party would be able to file its own reorganization plan, thereby unnecessarily "confus[ing]" its assorted creditors. Ibid.[9] U.S. Mineral further argued that a Chapter 11 trustee would not benefit the estate because any trustee would be "very expensive[.]" Ibid. (asserting that "[i]n addition to his fees, the Trustee would have a retinue of professionals, attorneys, accountants, investment bankers and others").

During the August 2003 proceeding, the debtor announced that its professional fees totaled more than $4 million. A1381. The burden created by these fees led the debtor to describe itself as a "wasting asset[.]" Ibid. The Trade Committee similarly stated that it was "extremely distressed" about these "extraordinary" administrative costs that had put the debtor on the "verge of demise." A1393.

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[9] Likewise, the Trade Committee opposed the appointment of a Chapter 11 trustee, in part because the Committee envisioned a proliferation of plans that would "create still further litigation[.]" A1396.

The United States Trustee agreed that the debtor's financial position was indeed troubling. See A1401-02. The United States Trustee suggested that the appointment of a Chapter 11 trustee might help alleviate that problem. See A1402.[10] The United States Trustee expressed its view that the debtor's substantial professional fees were largely attributable to the "constant bickering" among the parties and their "inability . . . to come to some resolution[.]" A1401-02. The United States Trustee advised the Court that a Chapter 11 trustee, at least if he had the parties' "confidence," could "get people to the table" and help the parties resolve the case, thereby substantially reducing future expenditures. A1402.

10. On September 9, 2003, the bankruptcy court issued an order directing the United States Trustee to appoint a Chapter 11 trustee for the estate. A7. As the court explained at the August 2003 hearing, the court concluded that the appointment of a Chapter 11 trustee was "in the interest of creditors under Section 1104(a)(2)." A1403. Noting that the debtor's principal Verhalen was a "potential creditor" of the company, the court expressed concern about the "the acrimony . . . between the creditor-bodies and [this] principal[.]" Ibid. The bankruptcy court found that,

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[10] The United States Trustee declined at the August 2003 hearing to take a firm position on the propriety of appointing a Chapter 11 trustee, A1400, but nonetheless attempted to aid the proceedings by commenting on the relevant considerations, see A1400-02.

due to the acrimony among the parties, "a neutral third person [was] . . . absolutely essential to maximize the value of this estate and to construct a plan that's acceptable to creditors." A1403-04.

In addition, the court found that "the debtor's late filing of amended schedule[s] listing numerous additional creditors is troublesome and raises the question regarding the credibility of the debtor." A1404. The court stated that simply because "these creditors may be paid off from insurance proceedings" or "the debtor didn't think they needed to list them" was "no excuse" for failing to include all creditors on the initial schedules of assets and liabilities. Ibid. The court observed: "We wouldn't tolerate that in a consumer debtor, and certainly aren't going to tolerate it in a business as sophisticated as this one[.]" Ibid.

The bankruptcy court based its appointment of a trustee solely on the interest-of-the-parties test in section 1104(a)(2). See A7, A1403-04. The court did not purport to find "cause" for a trustee under section 1104(a)(1). See ibid.

11. On September 15, 2003, U.S. Mineral appealed the bankruptcy court's order, A1445-47, and moved to stay the appointment of a trustee pending its appeal to the district court. See A1460-74. Verhalen also appealed the bankruptcy court's decision, A1565-67, and joined the debtor's stay motion, see A1609-15. The bankruptcy court denied the stay request, A1698, observing

that "the tenor of this case has steadily deteriorated to the point where the parties are merely unable to work constructively with one another." A1697. A Chapter 11 trustee was needed to break this "impasse," A1696, and move the parties toward a final reorganization plan. See A1697-98.

B. The District Court's Decision

The district court affirmed the appointment of a Chapter 11 trustee. See A9-16. The court first found that the parties clearly had "notice and a hearing" prior to the trustee appointment. A15. The bankruptcy court at the July 2003 hearing had "put the parties on notice" that it planned to appoint a Chapter 11 trustee if they failed to formulate a consensual plan by the end of August. A12.

The district court also determined that the bankruptcy court's ruling satisfied the interests-of-the-parties standard of section 1104(a)(2). The court found that "the distrust and animosity between the parties and their unwillingness or inability to cooperate" on almost every issue "constitute[d] substantial justification for the appointment of a neutral officer to bring resolution to the case." A15. The court added that "[t]he fact that the bankruptcy court sua sponte suggested such a resolution" demonstrated "responsible judicial oversight, not an abuse of discretion." A16.

SUMMARY OF ARGUMENT

1. In directing the appointment of a Chapter 11 trustee, the bankruptcy court clearly adhered to the procedural scheme established by the Bankruptcy Code. First, the court provided ample notice to the parties by announcing at the July 2003 hearing that it planned to appoint a trustee if the parties failed to develop a consensual reorganization plan. Second, the parties had ample opportunity for a hearing in late August 2003, when the court listened to arguments on the trustee issue. While the debtor "implore[d]" the court not to appoint a trustee, A1375, the Asbestos Committee urged the court to make the appointment, stating that such a neutral third party could "resolve" the parties' multiple "disputes," A1389; see A1391-92. The bankruptcy court thereby satisfied the statutory requirements for notice and a hearing, and, in so doing, clearly provided the parties with due process.

Finally, the bankruptcy court ordered the appointment of a trustee after the Asbestos Committee specifically requested such relief. Because the bankruptcy court acted "on request of a party in interest," 11 U.S.C. § 1104(a), this Court need not consider whether a bankruptcy court could, in certain circumstances, appoint a trustee sua sponte.

2. The bankruptcy court plainly exercised sound discretion in directing the appointment of a Chapter 11 trustee. After two years

of protracted bankruptcy proceedings, the debtor's business seemed to be on the "verge of demise," A1393, largely due to the debtor's expenditure of $4 million on bankruptcy-related professional fees, A1381. The parties thus needed for the reorganization proceeding to come to a close. Yet, due to the intense acrimony among the parties, they were unable to agree on a reorganization plan.

The events of the Summer 2003 only increased the tensions among the parties. The asbestos creditors were unhappy with the debtor's proposed reorganization plan because it failed to adhere to the statutory scheme in 11 U.S.C. § 524(g) for addressing future asbestos claims. The asbestos creditors were also displeased by the debtor's nomination of its own investment banking firm to conduct an auction of the company's assets, particularly since the company's existing management would be among the bidders. Finally, the creditors' distrust and animosity grew further when the debtor revealed that for two years it had failed to report a creditor with a $1 million claim.

In light of the acrimony among the parties, and the dwindling resources of the debtor's estate, the bankruptcy court properly found that it was in the parties' interests – indeed, that it was "absolutely essential" – to appoint a "neutral third person" who could construct an "acceptable" reorganization plan and thereby "maximize the value of this estate[.]" A1403-04. The bankruptcy court thus had ample reason to direct the appointment of a

Chapter 11 trustee pursuant to the interests-of-the-parties test of section 1104(a)(2).

In applying the “flexible” standard of section 1104(a)(2), Marvel, 140 F.3d at 474, the bankruptcy court was not required to find that the debtor had intentionally engaged in wrongdoing. An analysis of fault on the part of the debtor would have been required only if the bankruptcy court had purported to find “cause” for a trustee pursuant to section 1104(a)(1). Section 1104(a)(2) demanded instead that the bankruptcy court look to the “practical realities and necessities” of the case. Ionosphere Clubs, 113 B.R. at 168 (internal quotation marks omitted). Because of the “level of acrimony” in this case, the appointment of a trustee was the “only way” to “ensure that reorganization [would] proceed.” In re Marvel, 140 F.3d at 474 (internal quotation marks omitted). Thus, in the context of this case, the appointment of a Chapter 11 trustee was clearly a sound exercise of discretion.

STANDARD OF REVIEW

This Court reviews the decision of the bankruptcy court according to the same standard as the district court. In re Kiwi International Air Lines, Inc., 344 F.3d 311, 316 (3d Cir. 2003). This Court examines the bankruptcy court’s factual findings for clear error and conducts plenary review of its legal determinations. Ibid. This Court reviews the bankruptcy court’s ultimate decision to order the appointment a trustee for abuse of discretion. <u>In re Sharon Steel Corp.</u>, 871 F.2d 1217, 1225 (3d Cir. 1989).

ARGUMENT

I. The Bankruptcy Court Adhered To The Procedural Scheme Established By The Bankruptcy Code In Directing The Appointment Of A Chapter 11 Trustee.

The bankruptcy court, in ordering the appointment of a Chapter 11 trustee, clearly complied with the procedural provisions of section 1104(a). The provision states that a bankruptcy court should order such an appointment "after notice and a hearing" and upon the "request of a party in interest or the United States trustee[.]" 11 U.S.C. § 1104(a). The court provided the parties with ample notice of the possible trustee appointment at the July 2003 hearing; it held a hearing addressing the issue in August 2003; and it ordered the appointment of a trustee only after receiving a specific "request" for such an appointment from the Asbestos Committee. Thus, the appellants' procedural challenges cannot be sustained.

A. The Bankruptcy Court Properly Ordered the Appointment of a Trustee On the Request of a Party in Interest.

The bankruptcy court directed the appointment of a Chapter 11 trustee only after the Asbestos Committee requested such decisive action. At the August 2003 hearing, the Asbestos Committee made clear that it "support[ed] the appointment of a Trustee[.]" A1389. Indeed, the Committee "ask[ed]" the court to appoint such a neutral third-party, who could "cut through" the parties' multiple disputes and "make the right decisions about maximizing value in this case." A1391-92; see also A805 (pleading filed by the Asbestos Committee stating that the bankruptcy court "should authorize the appointment of a disinterested trustee to take charge of this reorganization effort"). Because the bankruptcy court ordered the appointment of a trustee "on request of a party in interest," 11 U.S.C. § 1104(a), this Court need not decide whether a bankruptcy court might have the authority to direct such an appointment sua sponte.

Verhalen, however, appears to assume that a party can "request" the appointment of a Chapter 11 trustee only by filing a formal motion, see Brief of Appellant Verhalen at 12, 18-21. Nothing in the statute mandates such a limitation.

Because the Bankruptcy Code does not define the term "request," see 11 U.S.C. § 101, this Court gives the word "its ordinary, plain and generally accepted meaning," Shell Oil Co. v. Federal Power Commission, 334 F.2d 1002, 1010-11 (3d Cir. 1964). A "request" is defined as "the act of asking for something," i.e., "the expression of a desire or wish[.]" Webster's New International Dictionary 1929 (1981). The Asbestos Committee thus clearly made a "request" when it "ask[ed]" the bankruptcy court to order the appointment of a Chapter 11 trustee. As a result, when the bankruptcy court directed the trustee appointment, it was acting upon the "request" of the Asbestos Committee.

It is immaterial that the bankruptcy court itself initially suggested the appointment of a Chapter 11 trustee at the July 2003 hearing, see A741. The Bankruptcy Code does not limit a bankruptcy court's discretion to make suggestions to the parties. Indeed, given the acrimony among the parties, the bankruptcy court's suggestion for a Chapter 11 trustee was, as the district court cogently observed, "responsible judicial oversight, not an abuse of discretion," A16.

Nor does it matter that the bankruptcy court characterized its decision as granting its "own motion" for a Chapter 11 trustee, A1404. Regardless of the terminology used by the bankruptcy court, when it directed the appointment of a Chapter 11 trustee, it was properly acting "on request of a party in interest," 11 U.S.C. § 1104(a); cf. MOL, Inc. v. Peoples Republic of Bangladesh, 736 F.2d 1326, 1329 (9th Cir. 1984) ("The true nature of the action . . . does not depend on terminology."). As a result, this Court need not decide whether a bankruptcy court could, in certain circumstances, order the appointment of a Chapter 11 trustee sua sponte.

B. The Debtor and Verhalen Were Clearly on Notice of the Possible Trustee Appointment and Had Ample Opportunity for a Hearing.

The bankruptcy court, in ordering the appointment of a Chapter 11 trustee, clearly complied with the Bankruptcy Code's flexible standard for "notice and a hearing," 11 U.S.C. § 1104(a). The Code provides that the phrase "after notice and a hearing" requires only "such notice as is appropriate in the particular circumstances, and such opportunity for a hearing as is appropriate in the particular circumstances[.]" 11 U.S.C. § 102(1)(A). The bankruptcy court's actions more than satisfied this standard.

As the district court observed, the bankruptcy court "put the parties on notice," A12, at the July 2003 hearing that it was inclined to appoint a Chapter 11 trustee if the parties could not agree upon a reorganization plan by the end of August. And, at the August 2003 hearing, the parties clearly litigated the trustee issue. The debtor "implore[d]" the bankruptcy court "not to appoint a Chapter 11 Trustee," arguing that such an appointment would lead to a "confus[ing]" number of reorganization proposals, and would be unduly costly. A1375. The Asbestos Committee, by contrast, "support[ed]" the appointment of a neutral Chapter 11 trustee, A1389, who could "cut through" the countless disagreements among the parties and "make the right decisions about maximizing value in this case[.]" A1391-92. The United States Trustee asserted that a Chapter 11 trustee might be able to "get people to the table," and resolve a reorganization proceeding that had been mired in "constant bickering[.]" A1401-02. The August 2003 proceeding thus plainly satisfied the "hearing" requirement of section 1104(a).

C. The Bankruptcy Court's Decision Clearly Accorded With Due Process Requirements.

Because the bankruptcy court adhered to the notice and hearing provisions of section 1104(a), the court's decision plainly complied with constitutional due process requirements. See

Cleveland Board of Education v. Loudermill, 470 U.S. 532, 542 (1985) (due process requires that a party be given notice and an opportunity for a hearing).

Verhalen, in challenging the trustee appointment on due process grounds, appears to concede that the parties had notice prior to the bankruptcy court's August 2003 decision. See Brief of Appellant Verhalen at 23. Indeed, during the district court proceeding on the trustee issue, Verhalen admitted that he was put on "notice" by the bankruptcy court's July 2003 announcement that the court might appoint a trustee. See A1882-83 (counsel for Verhalen stating that the bankruptcy court's July 2003 comment was "the first notice that Verhalen received that the issue of a Trustee was on the table"). Because Verhalen was on notice of the trustee issue, he also had ample opportunity to present evidence and argument on the matter at the August 2003 hearing. See In re Lowenschuss, 171 F.3d 673, 685-86 (9th Cir. 1999) (concluding that, because the debtor received notice of a party's request for a Chapter 11 trustee, the debtor had adequate opportunity for a hearing).

However, Verhalen contends that due process principles required the bankruptcy court to provide the parties with notice and a hearing prior to the court's July 2003 statement that it might in the future appoint a trustee. This contention is specious. Verhalen attempts to characterize the bankruptcy court's July 2003 comment (that it planned to appoint a trustee if the parties failed to agree on a reorganization plan) as a "ruling[.]" Brief of Appellant Verhalen at 23. However, the court's contingent statement was clearly not a final determination on the appointment issue, and therefore did not require notice or a hearing, see 11 U.S.C. § 1104(a); see also Herwins v. City of Revere, 163 F.3d 15, 18 (1st Cir. 1998) ("Due process normally requires notice and opportunity for some kind of hearing prior to a final deprivation of liberty or property.") (internal citations and quotation marks omitted) (emphasis added); Propert v. District of Columbia, 948 F.2d 1327, 1331 (D.C. Cir. 1991) (same).

U.S. Mineral contends that the notice and hearing provided by the bankruptcy court were insufficient because the court did not, prior to rendering its August 2003 decision, announce the specific grounds for its decision. See Brief of Appellant U.S. Mineral at 16-17. The debtor thus argues that it had "no opportunity," id. at 16, to rebut the evidence relied upon by the bankruptcy court. This due process argument is meritless.

First, the debtor suggests that it lacked an opportunity to rebut the bankruptcy court's "allegation" that Verhalen was a creditor of U.S. Mineral. Brief of Appellant U.S. Mineral at 18. However, the bankruptcy court made no such allegation. Instead, the court observed that Verhalen was a "potential creditor" of the estate, A1403.[11] In any event, the bankruptcy court's central

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[11] Of course, as the debtor observes, Brief of Appellant U.S. Mineral at 18 n.4, Verhalen now appears to be an actual creditor of

finding was not this "potential creditor" issue. Instead, the court was primarily concerned that, because of Verhalen's acrimonious relationship with the asbestos creditors, he would have difficulty leading the parties toward a consensual reorganization plan. See A1403-04 (noting that "the acrimony . . . between the creditor bodies and the [debtor's] principal" made it "absolutely essential" for the court to appoint "a neutral third person" who could "construct a plan that's acceptable to creditors").

Second, with respect to the issue of "acrimony," the debtor itself acknowledged the acrimonious nature of the parties' negotiations. Indeed, at the August 2003 hearing, the debtor argued in favor of its auction plan in part by referring to the "contentious" negotiations among the parties. A1380. The debtor asserted that an auction was necessary because these strained negotiations had prevented the parties from settling on a market value for the debtor. See ibid. Given U.S. Mineral's acknowledgment of – indeed, reliance on – the acrimonious nature of the parties' relationship, the debtor can hardly complain that the

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the estate. On February 13, 2004, the Chapter 11 trustee moved to reject Verhalen's employment agreement with the company. Bankr. Case No. 01-02471, Doc. No. 1707. On March 22, 2004, the bankruptcy court granted the trustee's motion. Bankr. Case No. 01-02471, Doc. No. 1787. The debtor asserts that this action "will cause Mr. Verhalen to file a proof of claim for rejection damages," thereby rendering him a "creditor of the estate." Brief of Appellant U.S. Mineral at 18 n.4.

bankruptcy court relied the same fact in directing the appointment of a trustee.[12]

Third, with respect to the debtor's two-year delay in reporting certain creditors, the debtor not only had an opportunity but did in fact argue that this omission was an "honest mistake," Brief of Appellant U.S. Mineral at 18. At the July 2003 hearing, the debtor's counsel asserted that the debtor's management had failed to inform him about Wausau's $1 million claim, not because the managers were intentionally hiding anything, but because they "didn't think [Wausau] had a valid claim," A743.

Finally, U.S. Mineral asserts that the bankruptcy court, in deciding the trustee issue, was required to rely solely on evidence presented at the August 27, 2003 hearing, and could not look to the entire record in the case. Brief of Appellant U.S. Mineral at 17-19. The debtor attempts to rely on In re Indian Palms Associates, Ltd., 61 F.3d 197 (3d Cir. 1995), but that decision provides no support for the debtor's contention.

In Indian Palms, a bank that held the first mortgage on the debtor's main asset requested relief from the automatic stay.

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[12] The debtor suggests that the bankruptcy court, in deciding the trustee issue, could not take into account the acrimony among the parties, unless the court found that the debtor was the cause of the acrimony or had otherwise engaged in "wrongdoing." Brief of Appellant U.S. Mineral at 19, 27. As discussed infra, the debtor's argument rests on a fundamental misinterpretation of section 1104(a)(2)'s interests-of-the-parties test. The debtor incorrectly assumes that section 1104(a)(2) requires the bankruptcy court to find some sort of malfeasance on the part of the debtor.

Indian Palms, 61 F.3d at 199. The bankruptcy court agreed to lift the stay, but the district court reversed. See ibid. On appeal to this Court, the bank argued in part that the district court had improperly admitted documents that were part of the bankruptcy proceeding, but that had not been specifically presented to the bankruptcy court during the hearing on the stay matter. See id. at 203. This Court noted that, if the hearing on the bank's motion for relief from the stay were deemed an "independent" adversary proceeding, the bankruptcy court and appellate courts reviewing its decision could not rely on documents from the underlying bankruptcy case (unless consideration of the documents could be justified under the doctrine of judicial notice). Id. at 204. The Court found, however, that the proceeding for relief from the stay was "sufficiently associated with the general administration of the debtor's estate" that the "relevant record" included the entire bankruptcy proceeding. Id. at 204-05.

This Court's reasoning in Indian Palms makes clear that when the bankruptcy court considers an issue directly related to the administration of the estate (such as authorizing the appointment of a Chapter 11 trustee), the "relevant record" must include the entire bankruptcy proceeding. Thus, the bankruptcy court was not required to rely solely on evidence presented at the August 2003 hearing.

Indeed, U.S. Mineral concedes that "this Court has recognized that the entire bankruptcy proceeding may constitute the 'record' of the case[.]" Brief of Appellant U.S. Mineral at 20. The debtor, however, attempts to demonstrate that an exception to this general rule applies in this case. The debtor relies on this Court's statement that a party "should be given a fair opportunity to rebut and put into perspective the evidence admitted against its position." Indian Palms, 61 F.3d at 205. As discussed, the debtor was indeed provided with such a "fair opportunity." Thus, there was no due process violation.[13]

II. The Bankruptcy Court Properly Exercised Its Discretion In Concluding That The Intervention Of A Trustee Was In The Interests Of The Parties.

The record before the bankruptcy court amply supported the court's decision to appoint a Chapter 11 trustee pursuant to the interests-of-the-parties test of 11 U.S.C. § 1104(a)(2). As this

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[13] The debtor also quotes this Court's statement that "[i]t is understood, for example, that the facts relating to the merits of the case will be decided on the basis of evidence admitted into the trial record." Indian Palms, 61 F.3d at 205 (emphasis in original). According to U.S. Mineral, this statement demonstrates that the bankruptcy court could not rely on the entire bankruptcy record "to make a finding relating to the merits" of the trustee appointment. Brief of Appellant U.S. Mineral at 20 (emphasis in original). However, this Court appears to have been simply explaining how the principle it had just announced – that a party should have a "fair opportunity" to rebut adverse evidence – generally plays out in the trial context. See Indian Palms, 61 F.3d at 205 (citing Andrews v. Bechtel Power Corp., 780 F.2d 124, 142 (1st Cir. 1984), in which a plaintiff unsuccessfully argued at an employment discrimination trial that the district court should take judicial notice of evidence presented in a request for class certification). This Court did not hold that a bankruptcy court, in adjudicating a matter that directly impacts the general interests of the parties and the estate (such as the trustee appointment in this case), cannot consider facts and evidence from the entire bankruptcy proceeding.

Court has emphasized, section 1104(a)(2) "'envisions a flexible standard,'" Marvel, 140 F.3d at 474 (quoting Sharon Steel, 871 F.2d at 1226), that provides the bankruptcy court with considerable discretion in determining the propriety of a trustee appointment, see ibid.; Ionosphere Clubs, 113 B.R. at 168 (stating that "[w]ith respect to whether a trustee should be appointed under Code § 1104(a)(2), courts eschew rigid absolutes and look [ ] to the practical realities and necessities" of a particular case) (internal quotation marks omitted). Thus, although the appointment of a trustee is the "'exception, rather than the rule,'" and must be based on clear and convincing evidence, Marvel, 140 F.3d at 471 (quoting Sharon Steel, 871 F.2d at 1225), this Court has recognized that the bankruptcy court is best positioned to determine whether that standard has been satisfied. For that reason, this Court affirms the bankruptcy court's decision to direct the appointment of a trustee, unless the decision amounts to an abuse of discretion. Sharon Steel, 871 F.2d 1225-26. Under the facts of this case, the appointment of a trustee plainly was not an abuse of discretion.

A. The Acrimony Among the Parties Amply Justified the Appointment of a Chapter 11 Trustee in This Case.

The acrimony among the parties, particularly when viewed in light of the mounting economic pressures faced by the debtor, amply justified the bankruptcy court's decision to direct the appointment of a Chapter 11 trustee. See Marvel, 140 F.3d at 472-75 (concluding that acrimony among parties to a bankruptcy proceeding can justify the appointment of a Chapter 11 trustee). Due to the parties' "constant bickering," A1401, negotiations were often at an "impasse," A36 (statement of debtor); A732 (comment of Legal Representative), rendering it extremely unlikely the parties would be able to agree on a reorganization plan before the estate's assets were dissipated by administrative fees.

The debtor was (in its own words) becoming a "wasting asset," A1381, as it depleted more and more of its resources to pay the attorneys, accountants, investment bankers, and other specialists involved in the bankruptcy proceeding. By the time the bankruptcy court decided the trustee issue in August 2003, the debtor had spent $4 million on these professional fees, A1381, a sum that represented a massive expense for a debtor with an asserted market value of only $13.4 million, <u>see</u> A620, A1374. This considerable depletion of the debtor's assets was clearly not serving the "interests" of the creditors or the estate.[14]

Indeed, the Trade Committee stated at the August 2003 hearing that it was "extremely distressed" about the "extraordinary" administrative costs that had put the debtor on the "verge of demise[.]" A1393. Thus, although the Trade Committee did not

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[14] Although section 1104(a)(2) states that a court can also take into account the interests of "any equity security holders," the debtor's prior equity holders apparently did not have a financial stake in the reorganization. <u>See</u> A1175, A1210 (debtor's reorganization plan stating that "Old Common Stock shall be canceled and each holder thereof . . . shall receive nothing").

support the appointment of a Chapter 11 trustee, see A1393-94, these comments demonstrate that the Committee was likely to benefit from any action that sped the reorganization process and thereby reduced the financial burden on the debtor.

As the bankruptcy court observed as early as May 2003, the only clear way to minimize the debtor's bankruptcy-related expenditures, and thereby preserve the estate, was to "push hard" to get the case "out of Chapter 11 and into a confirmed plan." A479. Yet the parties proved intransigent. The acrimony among the parties kept negotiations at a standstill.

Unfortunately, the events of the Summer 2003 further added to the tensions among the parties. The asbestos creditors were upset by the selection of Curtis, the debtor's investment banking firm, to run the debtor's proposed auction. The creditors, noting that the debtor's management planned to bid at the auction, suggested that other potential bidders might assume that Curtis was working on behalf of management and therefore be "scared away" from participating in the auction. A1385. Whether or not the nomination of Curtis was intended to (or even was likely to) deter competition and thereby help U.S. Mineral's old equity owners repurchase the company, the debtor could not have supposed that this nomination would enhance its credibility with the asbestos creditors. The choice to hire the investment banking firm that had provided a hotly-contested estimate of the company's market value was only likely to fuel the existing acrimony among the parties.

The debtor's failure to include a guarantee for a section 524(g) injunction in its reorganization plan further suggested to the asbestos creditors that the debtor was not acting in their best interests. As the Legal Representative observed, see A1384, without such an injunction, no prospective buyer could be certain of purchasing the debtor's assets free and clear of future asbestos claims, and would discount its auction bid accordingly. Thus, the debtor's proposed auction did not appear calculated to produce the maximum return for creditors.[15]

In addition, the debtor's belated admission of a potential $1 million claim against it did not instill confidence or trust among the parties. Even if that two-year omission was in fact an

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[15] U.S. Mineral argues, see Brief of Appellant U.S. Mineral at 34-35, that the bankruptcy court could provide similar injunctive relief via section 363(f). See 11 U.S.C. § 363(f) (providing five circumstances under which estate property can be sold "free and clear" of other interests in the property). The debtor relies on In re Trans World Airlines, Inc., 322 F.3d 283 (3d Cir. 2003), which held that a bankruptcy court could use section 363(f) to enjoin former employees of a bankrupt airline from bringing their employment-related claims against the purchaser of the airline, id. at 285, 289-91.

Trans World Airlines, however, does not suggest that a bankruptcy court could use section 363(f) to enjoin future claims. As Congress recognized in enacting section 524(g), because future (and as yet unknown) asbestos claimants cannot participate in a bankruptcy proceeding, and therefore "by definition[] do not have their own voice," H.R. Rep. No. 103-835 at 40, those claimants can be subject to an injunction only if it is issued pursuant to "high" procedural and substantive standards, id. at 41. A garden-variety section 363(f) injunction would not satisfy those standards. For the same reason, it is highly unlikely that, absent such procedural and substantive protections, a bankruptcy court could bind future claimants by issuing an injunction pursuant to 11 U.S.C. § 105(a), as the debtor's reorganization plan proposed, see A1237.

"honest mistake," Brief of Appellant U.S. Mineral at 18, that omission was bound to undermine the debtor's "credibility," A1404, in any future negotiations with the asbestos creditors. Cf. Petit, 182 B.R. at 69 ("Open, honest and straightforward disclosure to the Court and creditors is intrinsic to the entire reorganization process.") (internal quotation marks omitted).

In light of the continuing depletion of the debtor's assets, it was clearly in the interests of the parties to formulate and confirm a reorganization plan as quickly as possible. However, given the distrust and acrimony among the parties, no such reorganization was likely to take place absent the intervention of a neutral Chapter 11 trustee. In these circumstances, the bankruptcy court's decision to appoint a Chapter 11 trustee demonstrated "responsible judicial oversight, not an abuse of discretion," A16; see Marvel, 140 F.3d at 475 (noting that, when the parties are "sharply divided on many issues, and are presently incapable of resolving them," the court can exercise its discretion to direct the appointment of a trustee) (internal quotation marks omitted); Petit, 182 B.R. at 70 (concluding that, when the "antagonism and animosity" among the parties "reache[s] a particular intensity . . . which is complicating efforts to 'reorganize' the Debtor," the "appointment of a trustee may be the only way that the bankruptcy court can ensure that reorganization will proceed").

B. The Interests-of-the-Parties Test of Section 1104(a)(2) Does Not Require a Finding of Wrongdoing on the Part of the Debtor.

The debtor contends that a bankruptcy court cannot direct the appointment of a trustee "merely" because of "acrimony" that renders the parties unable to agree on a plan. Brief of Appellant U.S. Mineral at 26. Instead, the debtor insists, there must be clear and convincing evidence that any "acrimony, distrust and delay" are attributable to the improper actions of the debtor. Id. at 27.

The debtor's contention that a bankruptcy court must have evidence of wrongdoing on the part of the debtor, see Brief of Appellant U.S. Mineral at 26-33, conflates the two parts of section 1104(a). Section 1104(a)(1) focuses on the misconduct of the debtor. That provision "mandat[es]" the appointment of a trustee upon "a specific finding of cause," Marvel, 140 F.3d 474, i.e., that the debtor is guilty of fraud, dishonesty, incompetence, gross mismanagement, or similar improprieties. See 11 U.S.C. § 1104(a)(1). The bankruptcy court in this case, however, relied solely upon the interest-of-the-parties test of section 1104(a)(2), which involves more "flexible" considerations, Marvel, 140 F.3d at 474, and "allows appointment of a trustee even when no 'cause' exists." Sharon Steel, 871 F.2d at 1226.

Thus, a court must find debtor misconduct only if the court directs the appointment of a trustee pursuant to section 1104(a)(1). It is therefore not surprising that, in almost every case cited by the appellants as demonstrating the need for a finding of "blameworthy" or "egregious" conduct, Brief of Appellant U.S. Mineral at 31 n.7, 33; Brief of Appellant Verhalen at 31, the bankruptcy court found "cause" for a trustee under section 1104(a)(1). See, e.g., Marvel, 140 F.3d at 473-75 (concluding that both sections 1104(a)(1) and (a)(2) justified the appointment of a trustee); In re Cajun Electric Power Coop., Inc., 74 F.3d 599, 600 (5th Cir. 1996) (adopting on rehearing the opinion of the dissent at 69 F.3d 746, 751 (5th Cir. 1995)) (relying solely on section 1104(a)(1)); Bellevue Place Associates v. Caisse Centrale des Banques Populaires, 1994 WL 687474 at *6 (N.D. Ill. 1994) (affirming the appointment of a trustee under both sections 1104(a)(1) and (a)(2)); In re V. Savino Oil & Heating Co., 99 BR. 518, 527 (Bankr. E.D.N.Y. 1989) (finding "cause" for a trustee under section 1104(a)(1)); In re The Bible Speaks, 74 B.R. 511, 512 (Bankr. D. Mass. 1987) (concluding that "both grounds" exist for appointing a trustee).

The sole case relied upon by the debtor involving only section 1104(a)(2) is Petit v. New England Mortgage Services, Inc., 182 B.R. 64 (D. Me. 1995). In Petit, the court found evidence raising the "specter" that the debtor had given preferential transfers to certain creditors. Id. at 70. The court indicated that, although this evidence did not necessarily demonstrate that the debtor had committed fraud or other misconduct under section 1104(a)(1), the evidence supported the appointment of a trustee under section 1104(a)(2). See ibid.

The Petit court then offered another justification for the appointment of a trustee pursuant to section 1104(a)(2). The court stated that, because of the "antagonism and animosity" among the parties, the appointment of a trustee appeared to be the "only way" to "ensure that reorganization [would] proceed." Petit, 182 B.R. at 70. The court did not suggest that this justification for a trustee depended on the "specter" of the debtor's wrongdoing. Instead, like the bankruptcy court in the present case, the Petit court stressed the fact that the parties' intense "antagonism and animosity" were hindering reorganization efforts. See also Marvel, 140 F.3d at 474-75 (focusing on this aspect of Petit). Thus, Petit is fully consistent with the bankruptcy court's decision to direct the appointment of a trustee under section 1104(a)(2).[16]

Most significantly, this Court's reasoning in In re Marvel Entertainment Group, Inc., 140 F.3d 463 (3d Cir. 1998),

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[16] Nor is the bankruptcy court's determination undermined by In re G-I Holdings, Inc., 295 B.R. 502 (D. N.J. 2003). The bankruptcy court in G-I Holdings acknowledged that acrimony can constitute a basis for appointing a trustee, but concluded that the conflict among the parties in that case had not reached the requisite level of intensity. See id. at 511. Furthermore, the bankruptcy court found insufficient evidence that "a trustee's control would augment the success of the debtor's reorganization or facilitate that reorganization effort[.]" Ibid. (internal quotation marks omitted). The district court's conclusion in G-I Holdings that the bankruptcy court did not abuse its discretion in declining the request for a trustee merely underscores that such a decision "must be made on a case-by-case basis." Id. at 507.

substantially undermines the debtor's assertion that section 1104(a)(2) requires a finding of fault. U.S. Mineral contends that, to justify a trustee appointment based on "acrimony," the bankruptcy court must find that such acrimony was "caused by actions of the debtor." Brief of Appellant U.S. Mineral at 27. However, in Marvel, this Court made clear that such a finding of fault is relevant only to a determination of "cause" under section 1104(a)(1). See Marvel, 140 F.3d at 474 (concluding that the district court had properly exercised its discretion "in appointing a trustee under § 1104(a)(1) because of the [debtor-in-possession's] contribution to the acrimony with [the relevant] creditors").

By contrast, in concluding that the acrimony among the parties also justified the appointment of a trustee under section 1104(a)(2), the Marvel Court did not mention any fault or wrongdoing on the part of the debtor. See Marvel, 140 F.3d at 474-75. Instead, this Court focused on more practical considerations, noting the district court's finding that "the selection of a plan, whatever its details, [was] in the best interests of all parties, and the best way to achieve that result [was] to appoint a trustee." Id. at 474 (internal quotation marks omitted). The district court had determined that the "sharp[] divi[sions]," id. at 475 (internal quotation marks omitted), among the parties were unduly hindering this needed reorganization. See id. at 474-75. As a result, the case required the intervention of a neutral third-party. See ibid. This Court concluded that, under those circumstances, the appointment of a Chapter 11 trustee was a "proper exercise of discretion under the flexible § 1104(a)(2) standard." Id. at 474.[17]

Thus, the interests-of-the-parties test created by section 1104(a)(2), and relied upon by the bankruptcy court, does not require a court to assign blame to a particular party. Instead, the "'flexible standard'" of that provision gives a court the "discretion" to appoint a trustee "'when to do so would serve the parties' and estate's interests.'" Marvel, 140 F.3d at 474 (quoting Sharon Steel, 871 F.2d at 1226); see also Sharon Steel, 871 F.2d at 1226 ("Subsection (a)(2) allows appointment of a trustee even when no 'cause' exists."). As this Court made clear in Marvel, when the "level of acrimony" becomes so acute that the parties cannot resolve their disagreements, the bankruptcy court may, in its discretion, conclude that the "'only way'" to "'ensure that reorganization will proceed'" is to direct the appointment of a Chapter 11 trustee. Marvel, 140 F.3d at 474 (quoting Petit, 182

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[17] There is no reason to be concerned that this Court's decision in Marvel, which permits the appointment of a trustee upon a finding of "acrimony," will allow creditors to "force the appointment of a Chapter 11 trustee by withholding consent to a reasonable plan offer," Brief of Appellant U.S. Mineral at 33. See Marvel, 140 F.3d at 473 (rejecting an identical argument in the section 1104(a)(1) context). Clearly, if creditors are in fact intentionally "withholding consent" to a "reasonable" plan offer, it would not be in the parties' interests for the court to grant the creditors' request for a Chapter 11 trustee. Thus, the bankruptcy court would exercise its sound discretion to refuse the request.

B.R. at 70). Thus, under section 1104(a)(2), the bankruptcy court orders the trustee’s appointment, not to penalize any party for particular wrongdoing, but instead to help all parties move toward a successful reorganization.

CONCLUSION

For the foregoing reasons, the judgment of the district court, upholding the decision of the bankruptcy court, should be affirmed.

Respectfully submitted,

PETER D. KEISLER
Assistant Attorney General

COLM F. CONNOLLY
United States Attorney

ROBERT M. LOEB
(202) 514-4332
TARA LEIGH GROVE
(202) 514-1201
Attorneys, Appellate Staff
Civil Division, Room 9539
Department of Justice
601 D Street, N.W.
Washington, D.C. 20530-0001

APRIL 2004

CERTIFICATE OF COMPLIANCE PURSUANT TO F.R.A.P. 32(a)

I certify, pursuant to Fed. R. App. P. 32(a)(7)(B) and (C) that the attached brief for the appellee is a monospaced typeface (Courier New), has 10.5 or fewer characters per inch, and contains 10,439 words.

APRIL 20, 2004

TARA LEIGH GROVE
Attorney

STATEMENT OF RELATED CASES

Counsel for appellee United States Trustee are not aware of any related cases, as defined in Third Circuit Rule 28.1(a)(2).

CERTIFICATE OF SERVICE

I hereby certify that on April 20, 2004, I filed and served the foregoing Brief for the Appellee by causing an original and ten copies to be delivered to the Clerk of the Court by Federal Express and by further causing two copies to be delivered via Federal Express to:

Ian C. Bifferato
Bifferato, Bifferato, & Gentilotti
1308 Delaware Avenue
P.O. Box 2165
Wilmington, DE 19899

James N. Lawlor
Wollmuth, Maher, & Deutsch
One Gateway Center, 9th Floor
Newark, NJ 07102

J. Gregg Miller
Pepper Hamilton
18th & Arch Streets
3000 Two Logan Square
Philadelphia, PA 19103

John J. Preefer
60 East 42nd Street
New York, NY 10165

Frederick B. Rosner
Jaspan Schlesinger Hoffman
1201 North Orange Street, Suite 1001
Wilmington, DE 19801

Michael L. Temin
Wolf, Block, Schorr & Solis-Cohen
1650 Arch Street, 22nd Floor
Philadelphia, PA 19103

TARA LEIGH GROVE
Attorney

BRIEF BANK — "SUMMARY SHEET"

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WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	United States Trustee v. John E. S. Mohr and Shelley I. Staddon (In re: John E. S. Mohr and Shelley I. Staddon)
2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	S. D. Ohio
3. ("CCN") ***CURRENT*** CASE NO.	No.: 3:10-0176
4. ("PCN") ***PRIOR*** CASE NO. - & COURT *[IF ANY]*	No.: 09-30487 Court: Bankr. S. D. Ohio *(Identify judge & cite, if any)*
5. ("SO") ***SOURCE***	**U.S. TRUSTEES**
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7. **("AU")** ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*	MaryAnne Wilsbacher, Noah M. Schottenstein, P. Matthew Sutko, Ramona D. Elliott, Daniel M. McDermott *(UST/OGC: 202-307-1399/FAX-2397)*
8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	• (1) Did the bankruptcy court err when it refused to consider evidence on an element of proof in the case: whether the debtors had "primarily consumer debts" under 11 U.S.C. § 707(b)? (2) Did the bankruptcy court err when it held that meaning of the term "debt" under 11 U.S.C. § 707(b) included amounts that a creditor may not assert against the debtor due to the statutory limitation on damages for lost future rent under 11 U.S.C. § 502(b)(6)?
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IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF OHIO

In re:

JOHN E. S. MOHR &
SHELLEY I. STADDON,

Debtors,

UNITED STATES TRUSTEE,

Appellant,

v.

JOHN E. S. MOHR &
SHELLEY I. STADDON,

Appellees.

District Court Case No. 3:10-0176

On appeal from the United States
Bankruptcy Court for the Southern
District of Ohio, Case No. 09-30487

ORAL ARGUMENT REQUESTED

BRIEF FOR THE UNITED STATES TRUSTEE, APPELLANT

RAMONA D. ELLIOTT
General Counsel

P. MATTHEW SUTKO
Associate General Counsel

NOAH M. SCHOTTENSTEIN
Trial Attorney

Executive Office for United States Trustees
United States Department of Justice
20 Massachusetts Avenue N.W.
Washington, D.C. 20530
Telephone: (202) 305-2796
Facsimile: (202) 305-2397
Email: noah.m.schottenstein@usdoj.gov

DANIEL M. MCDERMOTT
United States Trustee for Region 9

MARYANNE WILSBACHER
Assistant United States Trustee

Office of the United States Trustee
United States Department of Justice
170 North High Street, Suite 200
Columbus, Ohio 43215
Telephone: (614) 469-7411 x 212
Facsimile: (614) 469-7448
Email: maryanne.wilsbacher@usdoj.gov

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STATEMENT OF APPELLATE JURISDICTION

This Court has appellate jurisdiction under 28 U.S.C. § 158(a)(1), which confers jurisdiction on the district courts of the United States to hear appeals "from final judgments, orders, and decrees" of bankruptcy judges. The bankruptcy court's order denying the United States Trustee's motion to dismiss or convert the debtors' case for abuse under 11 U.S.C. § 707(b) was entered on March 15, 2010.

An order denying a section 707(b) motion to dismiss is a final, appealable order. See Morse v. Rudler (In re Rudler), 576 F.3d 37, 43 (1st Cir. 2009); Ross-Tousey v. Neary (In re Ross-Tousey), 549 F.3d 1148, 1153 (7th Cir. 2008); U.S. Trustee v. Cortez (In re Cortez), 457 F.3d 448, 453-54 (5th Cir. 2006); Stuart v. Koch (In re Koch), 109 F.3d 1285, 1287 (8th Cir. 1997); but see Barben v. Donovan (In re Donovan), 532 F.3d 1134, 1137 (11th Cir. 2008) (holding that an order denying a motion to dismiss a Chapter 7 case for substantial abuse, under the earlier version of section 707(b), was not appealable).

The United States Trustee's notice of appeal was timely filed under 28 U.S.C. § 158(c)(2) and Fed. R. Bankr. P. 8002(a) on March 25, 2010.

STATEMENT OF THE ISSUES

This appeal raises two separate and independent issues concerning whether the bankruptcy court abused its discretion when it determined that the debtors did not have primarily consumer debts under 11 U.S.C. § 707(b).

1. Did the bankruptcy court err when it refused to consider evidence on an element of proof in the case: whether the debtors had "primarily consumer debts" under section 707(b); and

2. Did the bankruptcy court err when it held that meaning of the term "debt" under section 707(b) included amounts that a creditor may not assert against the debtor due to the statutory limitation on damages for lost future rent under 11 U.S.C. § 502(b)(6)?

If this Court agrees with the United States Trustee on either question, then this Court should reverse the order of the bankruptcy court entered below.

STANDARD OF REVIEW

This Court reviews a bankruptcy court's findings of fact for clear error and conclusions of law de novo. Behlke v. U.S. Trustee (In re Behlke), 358 F.3d 429, 433 (6th Cir. 2004). Questions of statutory interpretation are also reviewed de novo. West v. AK Steel Corp., 484 F.3d 395, 402 (6th Cir. 2007). Clear error exists "when factual findings were induced by an erroneous view not supported by substantial evidence or made without properly taking into account substantial evidence to the contrary." Indmar Prod. Co. v. Comm'r of Internal Revenue, 444 F.3d 771, 778 (6th Cir. 2006).

Whether a lower court "failed to consider or accord proper weight or significance to relevant evidence" is a question of law reviewed de novo. Id.

STATEMENT OF THE CASE

I. Statutory framework

A. Dismissal or conversion of a bankruptcy case under 11 U.S.C. § 707

The "principal purpose of the Bankruptcy Code is to grant a fresh start to the honest but unfortunate debtor." Marrama v. Citizens Bank of Mass., 549 U.S. 365, 367 (2007). Most typically, individual debtors choose between two forms of relief under the Bankruptcy Code: chapter 7 and chapter 13. In a chapter 7 case, the debtor receives an immediate discharge of debt in exchange for the liquidation of all non-exempt assets. See 11 U.S.C. § 701, *et seq*. In a chapter 13 case, the debtor retains non-exempt assets, but must repay creditors over a period of time. See 11 U.S.C. § 1301, *et seq*.

Chapter 7 treats consumer debtors differently from business debtors. The original version of section 707 only permitted dismissal "for cause," but in 1984 Congress amended section 707 to add a second, separate basis for dismissal of a chapter 7 case — section 707(b), which permitted dismissal if the bankruptcy court found that granting a chapter 7 discharge to a debtor with primarily consumer debts would constitute "substantial abuse." Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, § 312, 98 Stat. 355, 381 (1984). Congress enacted this amendment "as part of a package of consumer credit amendments" in response to "concerns that some debtors who could easily pay their creditors might resort to chapter 7 to avoid their obligations." H.R. Rep. 109-31 (2005) at 10, *reprinted in* 2005 U.S.C.C.A.N. 88, 92. Thus, for over 25 years, the Bankruptcy Code has required that the debtor have "primarily consumer debts" in order to be subject to dismissal for abuse under section 707(b).

In 2005, Congress found that this amendment was insufficient to control abuse of chapter 7. Congress believed that the utility of section 707(b) was limited for several reasons, including confusion about what would permit the court to dismiss under the "substantial abuse" standard and "a presumption that favors granting a debtor a discharge." H.R. Rep. 109-31 at 12. In light of "a generally consistent upward trend" in consumer bankruptcy cases and the belief that bankruptcy relief was "too readily available" and "used as a first resort, rather than a last resort," Congress concluded that reforms were necessary. Id. at 4. In particular, Congress was concerned about "the pursuit of Chapter 7 liquidations instead of Chapter 13 debt repayment plans by consumer debtors who could afford to repay some of their debts." Morse v. Rudler (In re Rudler), 576 F.3d 37, 40 (1st Cir. 2009).

Congress therefore enacted the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA), Pub. L. No. 109-8, 119 Stat. 23, in order "to correct perceived abuses of the bankruptcy system." Milavetz, Gallop & Milavetz, P.A. v. U.S., 130 S. Ct. 1324 (2010). Specifically, BAPCPA implemented "needs-based reforms" to shift debtors "into chapter 13 . . . as opposed to chapter 7." H.R. Rep. 109-31 at 12. "The heart of the bill's consumer bankruptcy reforms . . . is intended to ensure that debtors repay creditors the maximum they can afford." Id. at 2. As described by the Sixth Circuit, "Congress enacted the BAPCPA in order to require above-median income debtors to make more funds available for the payment of unsecured creditors." Schultz v. U.S., 529 F.3d 343, 347 (6th Cir. 2008).

Congress substantially revised section 707(b) under BAPCPA. Id. As amended, section 707(b) now states "[a]fter notice and a hearing, the court . . . may dismiss a case filed by an individual debtor under this chapter whose debts are primarily consumer debts . . . if it finds that the granting of relief would be an abuse of the provisions of this chapter." 11 U.S.C. § 707(b)(1).

Congress reversed the presumption in favor of granting consumer debtors a discharge in bankruptcy, reduced the requirement for dismissal from substantial abuse to mere abuse, and provided three tests for finding abuse: means testing, bad faith, and totality of the circumstances. Schultz, 529 F.3d at 347. The "centerpiece" of these reforms is the section 707(b)(2) means test, which requires debtors with primarily consumer debts "to demonstrate financial eligibility to avoid the presumption that their bankruptcy filing is an abuse of the bankruptcy proceedings." Id. In addition, under section 707(b)(3), if the presumption of abuse is avoided, abuse may still be found if the debtor has acted in bad faith or if the totality of the debtor's financial circumstances demonstrates an ability to repay creditors. Id. And instead of just dismissal, the court could convert a chapter 7 case to one under chapter 13. Eisen v. Thompson, 370 B.R. 762, 773 (N.D. Ohio 2007) (stating that BAPCPA "signaled a sea change in the bankruptcy world . . . [n]ow, any debtor who is likely to have the ability to repay even a small portion of his or her debts . . . will have to participate in a partial repayment plan under Chapter 13.").

Congress has established a special series of procedures in order to discover and prevent consumer debtors from abusing the availability of a chapter 7 discharge. The United States Trustee is required to convene and preside at a meeting of creditors where the debtor may be examined. 11 U.S.C. § 341. In a chapter 7 case, this meeting must occur no fewer than 21 days and no later than 40 days after the case has been filed. Fed. R. Bankr. P. 2003(a). "[T]he meeting also serves to ensure that the debtor has a basic understanding of particular parts of the

Bankruptcy Code." 3 COLLIER ON BANKRUPTCY § 341.01 (2010); see 11 U.S.C. § 341(d) (listing the information to be provided to a chapter 7 debtor).

When an individual seeks relief under chapter 7, the United States Trustee is required to review all materials filed by the debtor, and within 10 days of the section 341 meeting, file a statement as to whether a presumption of abuse arises under the section 707(b)(2) means test. 11 U.S.C. § 704(b)(1). Within 30 days of filing the statement required by section 704(b)(1), if a presumption of abuse arises, the United States Trustee is required to file (1) a motion to dismiss or convert under section 707(b)(2) or (2) a statement explaining the reason for declining to do so. 11 U.S.C. § 704(b)(2); see Fed. R. Bankr. P. 1017(e) (implementing the timing requirements of section 704(b)(2)). But if a debtor is not correctly identified as a consumer debtor, then they are never subjected to the means test and may not be subject to dismissal under section 707(b)(3)(A) for bad faith or section 707(b)(3)(B) for the ability to repay creditors.

B. Limitations on claims under 11 U.S.C. § 502(b)(6)

Section 502(b)(6) of title 11 "limits a lessor's claim to actual past damages for unpaid rent due under the lease, plus a maximum of one year or 15% (not to exceed three years) for the loss of future rent." Vause v. Capital Poly Bag, Inc. (In re Vause), 886 F.2d 794, 799 (6th Cir. 1989). By enacting section 502(b)(6), "Congress intended to compensate landlords for their actual damages while placing a limit on large future, speculative damages which would displace other creditors' claims." Id. at 801-02.

C. Eligibility for chapter 13 relief under 11 U.S.C. § 109(e)

Only "an individual with regular income that owes, on the date of the filing of the petition, noncontingent, liquidated" unsecured and secured debts below the specified statutory maximum may be a chapter 13 debtor. 11 U.S.C. § 109(e). "[T]he eligibility requirements of section 109(e) create a gateway into the bankruptcy process, not an ongoing limitation on the jurisdiction of the bankruptcy courts." Glance v. Carroll (In re Glance), 487 F.3d 317, 321 (6th Cir. 2007).

The Sixth Circuit determines section 109(e) eligibility in the same way that the amount in controversy is determined for the purpose of diversity jurisdiction. Comprehensive Accounting Corp. v. Pearson (In re Pearson), 773 F.2d 751, 757 (6th Cir. 1985). That approach is well settled and not in dispute. "Generally, the amount claimed by the plaintiff in the complaint rules, as long as claimed in good faith." Charvat v. GVN Mich., Inc., 561 F.3d 623, 628 (6th Cir. 2009). "Dismissal is proper, however, if the amount alleged in the complaint was never recoverable in the first instance." Id. If "from the face of the pleadings, it is apparent, to a legal certainty, that the plaintiff cannot recover the amount claimed . . . the suit will be dismissed." Id.

II. Statement of the facts

Prior to the initiation of their chapter 7 bankruptcy case, John Mohr and his wife Shelley Staddon ("the Mohrs") were the sole owners of a HobbyTown USA franchise, which they operated through a limited liability company named Staddon-Mohr LLC. Docket Entry Number 1 at 39. The business closed in December 2008. Id. From January 2007 until June 1, 2008, Mr. Mohr earned just over $32,000 in income from the HobbyTown franchise. Id. at 34. Starting in

October 2008, Mr. Mohr began to do consulting work. Id. As reported in their bankruptcy schedules, Mr. Mohr earns $48,000 per year as a government contracts consultant and Ms. Staddon earns $71,680 per year as a teacher for a local school district, where she has been continuously employed for the past six years. Id. at 30. The Mohrs' scheduled gross income is almost $120,000 per year and their monthly take-home pay is $7,400.66. Id. This is 168% of the median income for a family of four in Ohio. U.S. CENSUS BUREAU, STATE MEDIAN FAMILY INCOME BY FAMILY SIZE (2008), *available at* http://www.justice.gov/ust/eo/bapcpa/20081001/bci_data/median_income_table.htm.

When the Mohrs filed for bankruptcy they had a balance of $356,644.31 outstanding on their first mortgage, which they listed as a consumer debt. Id. at 16. The Mohrs have approximately $58,243.80 in consumer credit card debt, $32,670.80 (56%) of which was incurred in the two years prior to their bankruptcy case. Id. at 20, 22. The Mohrs also owe a total of $26,046.67 on their student loans. Id. at 26. All together, the Mohrs owe a total of $440,934.78 in consumer debts. Id. at 16, 20-26.

The Mohrs also have business debts, which arise from three sources. The first source is a $55,000 balance on a SBA loan, which is secured by their home. Id. at 16. The second source is approximately $74,282.34 in outstanding accounts payable and business taxes for the HobbyTown franchise. Id. at 19-27.

The third source of business debt relates to a claim for breach of contract that arose when the HobbyTown franchise broke its long-term commercial lease with the lessor, Don Wright Realty. See Claims Register Entry Number 7. Mr. Mohr was a guarantor on the commercial lease for the HobbyTown franchise. Id. The Mohrs' bankruptcy schedules listed the liability on the claim as the balance left due on the entirety of the lease, in the amount of $340,000. Doc. No. 1 at 22. Therefore, the Mohrs scheduled $469,282.34 in business debts.

Don Wright Realty's claim, as amended in order to reflect the section 502(b)(6) limitation on damages for loss of future rent, is at most valued at $86,840.96.[1] Claim No. 7. Accordingly, the maximum amount that the Mohrs may owe on the HobbyTown franchise's scheduled business debts is $216,123.30, which is less than the Mohrs' $440,934.78 in consumer debts.[2]

III. Statement of the proceedings below

On January 31, 2009, the Mohrs commenced their case by filing a voluntary petition for relief under chapter 7 of the Bankruptcy Code. Doc. No. 1. On the cover page of their petition, the Mohrs designated the nature of their debts as "primarily business debts." Id. at 1.

The United States Trustee believed that the value of Don Wright Realty's claim was substantially less than the amount the Mohrs had listed in their bankruptcy schedules for two reasons. First, because the Mohrs were only one month behind on the lease, had not rejected their lease when they filed for bankruptcy, and had not yet incurred $340,000 in actual liability. Transcript at 44. Second, because the maximum value of Don Wright Realty's claim for future

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[1] A question about whether the claim should be valued at $79,750.08 or $86,840.96 was raised during the proceedings. Doc. No. 49 at 6. But there appears to be no factual dispute that the claim should be valued at any amount greater than $86,840.96.

[2] The Mohrs scheduled a business debt for sales tax in the amount of $5,570.90 on their petition. Doc. No. 1 at 18. The State of Ohio filed a proof of claim for sales tax in the amount of $90,484.16. Claim No. 10. But even including the full value of the amount claimed, the Mohrs' business debts would be $301,036.56, which is still less than the $440,934.78 in consumer debts.

damages was limited by section 502(b)(6), and the Mohrs could not owe a debt greater than the statutory cap on damages. Id. at 38.

On June 1, 2009, the United States Trustee timely filed a motion to dismiss the Mohrs' case for abuse under 11 U.S.C. § 707, listing three reasons.[3] Doc. No. 41. First, for cause under section 707(a), because the Mohrs' caused an unreasonable and consequential delay in the administration of their bankruptcy case by improperly asserting that they were business debtors. Id. at 2, 4. Second, for bad faith under section 707(b)(3)(A), because the Mohrs failed to adequately support their contention that the nature of their debts were "primarily business." Id. at 5. Third, based upon the totality of the circumstances under section 707(b)(3)(B), because the Mohrs would have up to $2,400 per month in discretionary income to repay their creditors up to $144,000 over the life of a five-year chapter 13 repayment plan after making reasonable adjustments to their housing costs. Id. at 5; tr. at 48.

In response, the Mohrs argued that the limitations on claims under section 502(b)(6) did not apply when determining the value and nature of the claims for a motion to dismiss under

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[3] The United States Trustee is an official of the United States Department of Justice appointed by the Attorney General to supervise the administration of bankruptcy cases in this district. 28 U.S.C. § 581(a)(9). "The United States trustee may raise and may appear and be heard on any issue in any case or proceeding under this title but may not file a plan pursuant to section 1121(c) of this title." 11 U.S.C. § 307. Courts have repeatedly held that the United States Trustee has standing under section 307 to appear and be heard on any issue in any bankruptcy case, despite the lack of pecuniary interest in the outcome. See Morgenstern v. Revco D.S., Inc. (In re Revco D.S., Inc.), 898 F.2d 498, 500 (6th Cir. 1990); see also United Artists Theater Co. v. Walton (In re United Artists Theater Co.), 315 F.3d 217, 225 (3d Cir. 2003); Stanley v. McCormick (In re Donovan Corp.), 215 F.3d 929, 930 (9th Cir. 2000) ("The United States trustee may . . . intervene and appear at any level of the proceedings from the bankruptcy court on . . . as either a party or an amicus."); Scott v. U.S. Trustee, 133 F.3d 917 (4th Cir. 1997).

section 707, and therefore they were not subject to dismissal under any part of section 707 because they properly designated themselves as business debtors. Doc. No. 61 at 2-3.

On September 3, 2009, the bankruptcy court held a hearing on the United States Trustee's motion to dismiss. Tr. at 4. At the hearing, the court primarily discussed two issues: (1) if section 502(b)(6) should be applied when determining if the Mohrs have primarily consumer debts under section 707(b) and (2) if the Mohrs' failure to apply section 502(b)(6) when scheduling the value of Don Wright Realty's claim could be included as a basis for dismissal under section 707(a). Id. at 28.

At the conclusion of the hearing, the bankruptcy court authorized further briefing on the scope of the inquiry the court should make on debt characterization issues. Id. at 73. The court explained "[i]t is also very difficult to determine how far one goes in a preliminary determination, whether it be for the purposes of Chapter 13 eligibility or whether it's for the purposes of determining whether someone is subject to the 707(b) . . . tests." Id. at 76.

On March 15, 2010, the bankruptcy court issued its written opinion. Doc. No. 94 ("Opinion"). First, the court held that whether the Mohrs have primarily consumer or business debts should be determined by the amounts the Mohrs listed in their bankruptcy schedules as of the date the petition was filed, rather than the evidence presented at the hearing. Id. at 8. The court, relying on section 109(e) case law, reasoned that Congress intended section 707(b) motions to require "keeping the focus on the Debtors' scheduled debts to minimize litigation over threshold inquiries and maximize efficiency." Id. at 6-7. Therefore, the court would only conduct an independent review of the truth of those facts when "prompted by any indicia that his or her calculation is not in good faith or is not an accurate measure of the debt." Id. at 8.[4] "At that point, the court will entertain evidence presented by a trustee or other parties in interest contradicting the debtor's schedules to the extent the evidence sheds light on a debt as it exists on the petition filing date." Id.

Second, the bankruptcy court held that section 502(b)(6) could not be applied when scheduling debts and calculating whether a debtor has primarily consumer debts. Id. at 10. The court reasoned that because the "cap is only activated by optional and unpredictable post-petition bankruptcy events . . . it is not appropriately applied" when estimating the value of a debt prior to a formal objection to a proof of claim. Id. at 10. The court believed there was "no clear place to schedule the section 502(b)(6) cap" and capping the debt would not be appropriate because creditors "would be left without an accurate calculation of the full accelerated lease debt as it was owed under the terms of the agreement on the petition filing date." Id.

Accordingly, the bankruptcy court found that the Mohrs have primarily business debts, based upon the amounts they had scheduled in their petition. Id. at 12. The court denied the United States Trustee's motion for relief under section 707(b) because the abuse provisions did not apply to the Mohrs' conduct, and section 707(a) because the Mohrs had "properly listed the full lease debt in their schedules," and without this evidence the Mohrs' ability to repay was insufficient to support dismissal. Id. at 12, 15.

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[4] Although the court does not define the phrase "accurate measure," the opinion indicates that this refers to the mathematical computation of the liability, without consideration of extrinsic factors such as statutory limitations or mitigation. See Op. at 8, fn. 8.

On March 15, 2010, the bankruptcy court entered a separate order denying the United States Trustee's motion to dismiss. Doc. No. 93. On March 25, 2010, the United States Trustee filed a timely notice of appeal. Doc. No. 97.

SUMMARY OF THE ARGUMENT

In this case, the United States Trustee sought dismissal of the Mohrs' chapter 7 bankruptcy case for abuse because the Mohrs have the ability to repay their creditors up to $2,400 per month without financial hardship. The bankruptcy court denied the United States Trustee's motion, holding that the Mohrs were not subject to dismissal for abuse because it found that the Mohrs did not have primarily consumer debts. This finding was dependent upon the valuation of a single, contingent debt. The court reasoned that the Mohrs were allowed to value a contingent debt at its hypothetical maximum value, rather than the amount that the Mohrs were actually liable to pay. The court was wrong because the value of a debt should be determined by the facts and applicable legal principles, not the whim of a debtor.

According to 11 U.S.C. § 707(b), a bankruptcy court may dismiss or convert a case filed by an individual debtor if two conditions are met: (1) if the individual debtor has primarily consumer debts and (2) if the granting of relief would be an abuse of chapter 7 of the Bankruptcy Code. This case turns on the dollar value of a single debt — a claim for damages based on lost future rent arising from the Mohrs' breach of a real estate lease — for the purpose of determining whether an individual has primarily consumer debts. The Mohrs valued the debt at $340,000. The United States Trustee valued the debt at no greater than $86,840.96. If the Mohrs are correct, they have primarily business debts and are not subject to dismissal under section 707(b). If the United States Trustee is correct, the Mohrs have primarily consumer debts.

The bankruptcy court accepted the Mohrs' valuation for two separate and independent reasons. First, the court concluded that section 707(b) required the court to accept the Mohrs' value as presumptively true because they put the amount in their bankruptcy schedules, and would not let the United States Trustee provide evidence to establish that the Mohrs only owed a fraction of the amount listed in their bankruptcy schedules.

Second, the court ruled that the statutory limitation on damages for lost future rent under 11 U.S.C. § 502(b)(6) did not affect the valuation of the debt, rejecting the United States Trustee's argument that the value of a debt based on a claim for damages could only include the amount of damages that could actually be asserted against a debtor.

This Court should reverse the decision of the bankruptcy court on both grounds. First, whether a debtor has primarily consumer debts is an element of the United States Trustee's cause of action under section 707(b), and moving parties are allowed to introduce evidence in order to establish elements of proof. There was no basis under section 707(b), the Federal Rules of Bankruptcy Procedure, or the Federal Rules of Evidence to presume that the Mohrs' number was factually correct and prevent the United States Trustee from offering evidence to the contrary.

Second, the amount of debt that the Mohrs owe on the claim for damages, as the term debt is used in section 707(b), is at most $86,840.96 because section 502(b)(6) limits the Mohrs' liability on the claim to no more than $86,840.96. The Sixth Circuit has ruled that the value of a debt is determined by the extent of a debtor's liability on a claim, and the value of a contingent liability, such as damages for lost future rent, is determined by the net present value of the liability: the value of the contingency discounted by the probability that it will become real. The presence of section 502(b)(6) establishes that the likelihood of the Mohrs being liable for no more than $86,840.96 is almost certain and that the likelihood of the Mohrs being liable for the full amount of $340,000 is virtually nil.

But even if this Court agrees with only one of the United States Trustee's arguments, this Court should still reverse the decision of the bankruptcy court. If this Court agrees with the first argument, but not the second, then the United States Trustee may show that the Mohrs only incurred liability based upon a missed rent payment and therefore the Mohrs have primarily consumer debts. If this Court agrees with the second argument, but not the first, then the United States Trustee may show that the value of the Mohrs' liability was limited by law and therefore the Mohrs have primarily consumer debts.

ARGUMENT

I. The bankruptcy court erred when it refused to consider evidence showing that the Mohrs' business debts are considerably less than the amount the Mohrs scheduled in their bankruptcy petition

The bankruptcy court made two errors when it refused to consider the United States Trustee's evidence that the Mohrs' valuation of Don Wright Realty's claim was incorrect. First, the court erroneously interpreted section 707(b) as requiring presumptive reliance upon a debtor's bankruptcy schedules as of the date the petition was filed — a presumption that trumps actual evidence. Second, the court erroneously refused to consider evidence on a contested question of fact. Accordingly, the bankruptcy court abused its discretion when it found that the Mohrs have primarily business debts because it had no basis in law or fact for the decision.

A. The plain language of section 707(b) requires proof that a debtor have primarily consumer debts, not proof that a debtor failed to schedule the value of debts in good faith

A claim for relief under section 707(b) presents no basis to deviate from normal judicial rules and procedures. The purpose of section 707(b) is to discern the truth of a debtor's circumstances, as Congress enacted section 707(b) in order to "deny Chapter 7 relief to the dishonest or non-needy debtor." Behlke v. U.S. Trustee (In re Behlke), 358 F.3d 429, 434 (6th Cir. 2004) (citing In re Krohn, 886 F.2d 123, 126 (6th Cir. 1989)). The requirement that debtors have primarily consumer debts is the lynchpin of a statutory scheme that brings individual debtors into a system of increased oversight in order to ascertain whether the consumer debtor is "honest, in the sense that his relationship with his creditors has been marked by essentially honorable and undeceptive dealings, and whether he is "needy" in the sense that his financial predicament warrants the discharge of his debts in exchange for liquidation of his assets." Id. The correct classification of a debtor as a consumer debtor under the statute is essential to its proper function because it changes the legal implications of a case.

1. A bankruptcy court is required to apply ordinary trial rules and procedures in a contested matter

The prosecution of a motion to dismiss under section 707(b) is a garden variety contested matter. Fed. R. Bankr. P. 1017(f). Under Rule 9014, the ordinary principles of trial apply in a contested matter, even though much of the pre-trial procedure is truncated in the interests of time and simplicity. Khachikyan v. Hahn (In re Khachikyan), 335 B.R. 121, 125-126 (B.A.P. 9th Cir. 2005).

The rule governing this section 707(b) contested matter, Rule 9014(c), provides that Rules 7026 and 7028-36 “shall apply.” Fed. R. Bankr. P. 9014(c). Those 7000 series rules make discovery provisions of the Federal Rules of Civil Procedure applicable to contested matters. And under Rule 9017, the Federal Rules of Evidence apply to bankruptcy proceedings. Fed. R. Bankr. P. 9017. Finally, Rule 9014(d) mandates “[t]estimony” “shall be taken” to resolve “all disputed material factual issues” in contested matters. Fed. R. Bankr. P. 9014(d).

Therefore, the Bankruptcy Rules required the bankruptcy court to take evidence on the material issue of whether the Mohrs have primarily consumer debts and to do so in the same manner as a normal adversarial proceeding. Khachikyan, 335 B.R. at 125-26. The court’s failure to do so violated the Bankruptcy Rules and was an error of law.

The ordinary rules and procedures of adjudication govern the threshold calculations in a contested matter the same as in any other disputed issue. A statutory threshold requirement, i.e., a circumstance element in a statutory cause of action, is a substantive element of the movant’s claim for relief. Arbaugh v. Y&H Corp., 546 U.S. 500, 515-16 (2006). In Arbaugh, the Supreme Court considered whether the statutory requirement that an employer must have 15 employees in order to be liable under Title VII for employment discrimination was “a substantive ingredient of a Title VII claim for relief.” Id. at 503. The Supreme Court held that it was, stating “the threshold number of employees for application of Title VII is an element of a plaintiff’s claim for relief.” Id. at 515-16.

There is a well established process for prosecuting a claim for relief. The “ordinary default rule” is that the moving party has the burden to prove their claims. Schaffer ex rel. Schaffer v. Weast, 546 U.S. 49, 56 (2005). The preponderance of the evidence standard is the presumptive standard of proof in a civil action, unless the statute indicates otherwise or "particularly important individual interests or rights are at stake." Grogan v. Garner, 498 U.S. 279, 286 (1991). And the preponderance of the evidence standard is what other bankruptcy courts have applied when determining whether a debtor has primarily consumer debts. See In re Srikantia, 417 B.R. 505, 509 (Bankr. N.D. Ohio 2009); In re Reavis, No. 06-11721, 2007 WL 2219519, at *5 (Bankr. N.D. Okla. July 30, 2007). This process should have been applied below.

2. The bankruptcy court's interpretation of section 707(b) cannot be reconciled with the text, legislative history, and statutory context

But in this case, the bankruptcy court announced a novel procedure that substantially obstructs the proper function of section 707(b) by undermining the ability of the United States Trustee to identify individuals as consumer debtors. Whether a debtor has primarily consumer debts is a question of fact that requires a bankruptcy court to determine if the aggregate amount of consumer debt exceeds 50% of the debtor's total debt. In re Hlavin, 394 B.R. 441, 447 (Bankr. S.D. Ohio 2008). But the court believed that the question of whether a debtor has primarily consumer debts should be presumptively determined by the information stated in the debtors' bankruptcy schedules. Neither the text of the statute, the legislative history, nor the statutory context support the court's interpretation of section 707(b).

That a factual requirement may be threshold to the substantive analysis for abuse under sections 707(b)(2) and (3) does not make its truthful determination any less important. The plain language of section 707(b) only requires that an individual debtor have primarily consumer debts in order to be subject to dismissal for abuse. See § 707(b)(1). There is nothing in the text of the statute to suggest that the debtor's good or bad faith should control the determination of whether the debts in question are primarily consumer or business in nature.

"If the language of the statute is clear, then the inquiry is complete, and the court should look no further." Brilliance Audio, Inc. v. Haights Cross Commc'ns, Inc., 474 F.3d 365, 371 (6th Cir. 2007). Nevertheless, the bankruptcy court looked beyond the statute's plain meaning and premised its decision upon policy considerations that "favor preventing threshold inquiries from dominating or unduly delaying the case." Op. at 5-6 (citing §704(b)(2)).

The legislative history of section 707(b), which the bankruptcy court failed to consult, does not support the court's conclusion. Congress enacted BAPCPA because it was concerned about consumer debtors that were turning to chapter 7 in order to avoid their financial obligations. H.R. Rep. 109-32 at 10. Congress explicitly stated "the heart of the bill's consumer bankruptcy reforms . . . is intended to ensure that debtors repay creditors the maximum they can afford." Id. at 2.

Furthermore, the statutory context demonstrates that the primary purpose of BAPCPA and the revised section 707(b) is to identify and prevent abusive conduct. Had Congress wished to provide any kind of factual presumption in favor of the debtor or restriction on the factual inquiry premised upon the good faith of the debtor, it could have done so — as it did before the recent removal of the presumption in favor of granting the debtor a discharge. See Schultz v. U.S., 529 F.3d 343, 347 (6th Cir. 2008) (describing the changes to section 707(b)). It makes little sense to infer that the limitations period under section 704(b)(2) suggests reliance upon the debtor when section 707(b) is silent and all other evidence indicates an intent to place debtors under greater scrutiny than ever before. See Burns v. United States, 501 U.S. 129, 136 (1991)

("An inference drawn from congressional silence certainly cannot be credited when it is contrary to all other textual and contextual evidence of congressional intent.").

B. A court may not rely on a debtor's good faith to the exclusion of other evidence as a basis for deciding a contested question of fact

Under Federal Rule of Bankruptcy Procedure 9014, a bankruptcy court must "make findings of fact and conclusions of law before entering an order that has the status of a judgment." Khachikyan, 335 B.R. at 126-27. When there is a disputed issue of material fact, Rule 9014(d) requires the court to take evidence and hear testimony in a trial. Id. During these proceedings, the bankruptcy court must apply the Federal Rules of Evidence. Fed. R. Bankr. P. 9017.

Factual determinations must be based on evidence. Indmar Prod. Co. v. Comm'r of Internal Revenue, 444 F.3d 771, 778 (6th Cir. 2006). It is erroneous for a court to make a factual determination "without properly taking into account substantial evidence to the contrary." Id.

The bankruptcy court did not properly take into account the United States Trustee's substantial evidence to the contrary when it found that the Mohrs have primarily consumer debts. If the court wished to exclude the United States Trustee's evidence because of concern for "unduly delaying the case," it could have conducted an analysis under Federal Rule of Evidence 403. See U.S. v. Smithers, 212 F.3d 306, 316 (6th Cir. 2000). It did not.

Instead, the bankruptcy court explained that it did not need to consider any evidence besides a debtor's bankruptcy schedules, except in unusual circumstances, because "a debtor does not have unbridled authority to manipulate the scheduling of debt or how it is used in threshold calculations." Op. at 8. The court reasoned that it could rely upon the Mohrs' good faith efforts when scheduling their debts because "a debtor must accurately calculate" the debt in question or face objections. Id. The court would need to engage in an independent review of the facts only if "prompted by any indicia that his or her calculation is not in good faith or is not an accurate measure of the debt." Id.

The bankruptcy court's theory does not justify the court's decision to bury its head in the sand and ignore contrary evidence in the record in order to avoid making a routine factual determination on a disputed issue, as required under Rule 9014(d). Khachikyan, 335 B.R. at 126-27. Even if a debtor does not have "unbridled authority to manipulate the scheduling of debt," it does not mean that the information listed is factually or legally correct. A debtor's good faith does not mean that the debtor (1) accurately listed the amount of debt and (2) applied the correct legal rules to classify the debt. A debtor's good faith does not render contradictory evidence superfluous. A debtor's good faith does not mean that facts should go untested.

Because the bankruptcy court failed to comply with Rule 9014(d) and refused to take into account the substantial evidence in the record to the contrary, its finding that the Mohrs have primarily business debts is erroneous and should be reversed. Indmar, 444 F.3d at 778.

C. Section 109(e) is irrelevant to the determination of whether a debtor has primarily consumer debts under section 707(b)

The bankruptcy court substantially relied upon the Sixth Circuit case law governing how to calculate a debtor's eligibility for chapter 13 bankruptcy relief under section 109(e) when deciding how to calculate whether the Mohrs have primarily consumer debts under section 707(b). Op. at 5. The court believed that the interests motivating the speedy resolution of eligibility issues under section 109(e) — avoiding litigation on the value of a debt in order to determine the authority of a court to litigate the value of the same debt later in the proceedings — equally applied to litigating whether a debtor has primarily consumer debts in order to litigate the question of abuse. Id. at 5-6.

But how questions of eligibility are resolved under section 109(e) should not inform a motion to dismiss under section 707(b) because the statutes contain different textual limitations and serve different purposes. And even if a comparison was appropriate, the bankruptcy court fundamentally misunderstood the section 109(e) jurisprudence when it rendered its decision.

1. Substantial differences in statutory text and purpose render any comparison between section 109(e) and section 707(b) inapposite

Although the debt eligibility requirements of section 109(e) and whether a debtor has primarily consumer debts are both threshold issues, they are not threshold in the same context. The interests that may motivate an expedited determination of the debtor's ability to proceed in chapter 13 under section 109(e) in order to reach the merits of a case do not apply to a motion to dismiss under section 707(b), where the determination of whether a debtor has primarily consumer debts is the first part of a two-step analysis on the merits of the United States Trustee's claim for relief.

Section 109(e) establishes when an individual may initiate bankruptcy proceedings under chapter 13 of the Bankruptcy Code. Comprehensive Accounting Corp. v. Pearson (In re Pearson), 773 F.2d 751, 754 (6th Cir. 1985); see Glance v. Carroll (In re Glance), 487 F.3d 317, 321 (6th Cir. 2007) (describing section 109(e) as "a gateway into the bankruptcy process.").

According to Pearson, because section 109(e) is structured as an independent limitation on the proceedings and contains an explicit limitation restricting the debt eligibility analysis to debts owed on the date of the filing of the petition, the court believed that there was an interest in avoiding protracted litigation about whether a debtor is proceeding in the correct chapter of the Bankruptcy Code in order to reach the merits of the case. 773 F.2d at 756-57.

But whatever interest there may be in avoiding protracted litigation on the "threshold" issue of whether a debtor may proceed under chapter 13 does not apply to the "threshold" issue of whether a debtor has primarily consumer debts for the purposes of section 707(b). The text of section 707(b) is not structured as an independent limitation on who may initiate chapter 7 proceedings and there is no language that indicates an intent to rely on a debtor's schedules. See § 707(b)(1). Instead, section 707(b) provides a cause of action that allows the United States Trustee to obtain relief from a consumer debtor who would abuse the privilege of a chapter 7 discharge.

Identifying whether a debtor has primarily consumer debts is an element on the merits of the United States Trustee's claim for relief — one that is absolutely integral to the purpose of the statute, as it is part of a larger statutory scheme that requires the United States Trustee to identify consumer debtors and then determine whether a consumer debtor is engaging in an abuse of the bankruptcy system. See supra Part I.A. In contrast, an inquiry into whether a debtor may proceed under chapter 13 in order to obtain bankruptcy relief does not go to the merits of whether the debtor ultimately deserves bankruptcy relief any more than an inquiry into whether jurisdiction exists goes to the merits of a plaintiff's cause of action. See Ernst v. Rising, 427 F.3d 351, 367 (6th Cir. 2005) ("Dismissals of actions that do not reach the merits of a claim, such as dismissals for lack of jurisdiction, ordinarily are without prejudice.") (citation omitted). The text, statutory structure, and policy interests motivating section 109(e) and section 707(b) are too different for section 109(e) to inform a section 707(b) analysis.

2. Even if section 109(e) were considered persuasive, the bankruptcy court fundamentally misunderstood the Sixth Circuit's section 109(e) jurisprudence

To the extent that section 109(e) may inform the analysis, the bankruptcy court erred when it interpreted Pearson to instruct bankruptcy courts to rely on the good faith of the debtor to the extreme of denying the obvious reality of a situation. Op. at 6-7. Pearson holds that the section 109(e) analysis follows the amount in controversy jurisprudence. Pearson, 773 F.2d at 757. The Sixth Circuit's amount in controversy jurisprudence is simple: The plaintiff may establish that the amount in controversy requirement is met by a good faith statement in the complaint, but an opposing party may rebut this presumption and require the plaintiff to prove the amount is recoverable to a legal certainty. Charvat v. GVN Mich., Inc., 561 F.3d 623, 628 (6th Cir. 2009).

In this case, the bankruptcy court confused how, for the purpose of establishing jurisdiction, a good faith statement relieves the plaintiff from the initial burden of persuasion with relieving the plaintiff from the entire burden of proof. Pearson, nor any of its known progeny, suggest this extreme deviation from the procedure explained in Charvat.

II. The bankruptcy court erred when it held that the value of a debt included amounts that are unrecoverable under 11 U.S.C. § 502(b)(6) when determining whether the Mohrs have primarily consumer debts under 11 U.S.C. § 707(b)

Even if the bankruptcy court was forced to rely on the Mohrs' bankruptcy schedules when determining whether the Mohrs have primarily consumer or business debts, the court still should have found that the Mohrs have primarily consumer debts because Don Wright Realty's claim for damages was limited by law under section 502(b)(6). The bankruptcy court, however, interpreted the statutory limitation on damages under section 502(b)(6) to only operate upon an objection to a claim and therefore held that the value of the debt is the amount scheduled by the Mohrs, rather than the amount that Don Wright Realty could actually claim. Op. at 10. But the value of a debt is independent of whether or not there has been an objection to a claim.

The value of a debt is based on the value of the debtor's liability on the claim. And the value of a claim for loss of future rent is determined by the net present value of the claim. Calculating the net present value of a claim requires estimating the amount of money a creditor has the legal right to receive from the estate. Thus, it was erroneous for the court to refuse to consider the statutory limitation on damages found in section 502(b)(6) when calculating the value of Don Wright Realty's claim.

A. The value of a debt based on a claim for lost future rent is determined by the net present value of the debtor's liability on the claim

"The term debt means liability on a claim." 11 U.S.C. § 101(12). A claim is defined as a right to payment. 11 U.S.C. § 101(5). The meanings of debt and claim are understood to be coextensive. Glance, 487 F.3d at 320. For a right to payment to exist, there must be a valid legal basis for the creditor's demand — an "enforceable obligation." Id. at 321. "[A] creditor's demand without any legal basis is not even a claim under the Code." Id. The inclusion or omission of claims without a valid legal basis in a debtor's schedules does not change the nature or amount of debt that a debtor has. Id.

When the value of a claim is indeterminate, a bankruptcy court may estimate the value of a contingent or unliquidated claim for the purpose of allowance — in other words, recognizing the validity of the debt — if fixing the value of the claim would unduly delay the administration of the case. 11 U.S.C. § 502(c)(1). And because allowance confirms that the debt is valid and payable by the estate, it follows that estimating the value of a claim for the purpose of allowance is the same as determining if there is a valid legal basis for the claim.

Damages for future lease payments are evaluated as contingent liabilities. Liabilities are contingent if future events need to occur in order for a creditor to be able to demand payment. Glance, 487 F.3d at 322. Because the amount of lost rental income depends upon the ability of the landlord to mitigate and re-rent the property, the value of a creditor's claim for damages is contingent. Manhattan Prop. v. Irving Trust Co., 291 U.S. 320, 331 (1934) ("Since many events may occur which will absolve the tenant from further obligation for rent, the claim is said to be too contingent."); see Saddleback Valley Cmty. Church v. El Toro Materials Co. (In re El Toro Materials Co.), 504 F.3d 978, 979-82 (9th Cir. 2007) (citing Manhattan Prop. v. Irving Trust Co.).

According to the Sixth Circuit, a contingent liability should be valued at its net present value. "To determine a contingent liability, one must discount it by the probability that the contingency will occur and the liability will become real." In re Oakes, No. 92-3935, 1993 WL

339725, at *3 (6th Cir. Sept. 3, 1993). The debtor in Oakes had scheduled the full value of a debt guarantee and attempted to rely on the scheduled value of a debt as proof of pre-petition insolvency for the purposes of an avoidance action under 11 U.S.C. § 547. The Sixth Circuit stated that including "contingent liabilities at full value . . . would cause an absurd result" because "[c]ontingent liabilities are uncertain and frequently never become actual liabilities." Id. (citing Matter of Xonics Photochemical, Inc., 841 F.2d 198, 200 (7th Cir. 1988)). Therefore, a contingent liability needs to be reduced to its present value to reflect the likelihood that the debtor will actually be obligated to pay the contingent obligation. Id.

The method of determining the value of a contingent claim used in Oakes was applied to resolve the question of whether a debtor has primarily consumer debts under section 707(b) in the case In re Cox. No. 08-61964, 2009 WL 1586674 (Bankr. N.D. Ohio Feb. 13, 2009). The facts of Cox are substantially similar to this case — the debtors had personally guaranteed a business loan and, based on the face value of the guarantee, asserted that they had primarily business debts. The United States Trustee argued that if the contingent liability was valued at its estimated present value instead of the hypothetical full value, then the debtors would have primarily consumer debts and be subject to dismissal under section 707(b). Id. at *1. The bankruptcy court agreed, holding that "the proper analysis for analyzing contingent liabilities is the same as that for analyzing contingent claims: they are to be estimated, using the same rules." Id. at *4. Therefore, citing Xonics, the bankruptcy court ordered further fact finding would be necessary to estimate the value of the debt. Id.

In the Mohrs' case, the bankruptcy court's task was made even easier because, as shown below, the net present value of the Mohrs' liability on Don Wright Realty's claim is fixed by statute.

B. The net present value of a debtor's liability for damages based on lost future rent must be calculated in consideration of section 502(b)(6)'s limitation on damages

1. A statutory cap on damages affects the net present value of a claim for damages

In the Bankruptcy Act of 1934, Congress enacted the predecessor of section 502(b)(6) to place a cap on damages allowed under the Bankruptcy Code. Vause v. Capital Poly Bag, Inc. (In re Vause), 886 F.2d 794, 801-03 (6th Cir. 1989) (describing the history of section 502(b)(6)). "Congress intended to compensate landlords for their actual damages while placing a limit on large future, speculative damages which would displace other creditors' claims." Vause, 886 F.2d at 801-02. Section 502(b)(6) "limits a lessor's claim for damages to actual past damages for unpaid rent due under the lease . . . plus a maximum of one year or 15% (not to exceed three years) for the loss of future rent." Id. at 798-99.

When read *in pari materia*, the Bankruptcy Code requires that the court consider section 502(b)(6) when determining whether a debtor has primarily consumer debts under section 707(b). The amount of the debt is determined by the debtor's liability on a claim. § 101(12). Therefore, the bankruptcy court needs to estimate the value of the claim. Cox, 2009 WL 1586674, at *4. Under the Bankruptcy Code, a claim exists to the extent that the creditor has a valid legal basis to receive payment from the estate. Glance, 487 F.3d at 321. Damages for future lease payments are considered contingent liabilities. Manhattan Prop., 291 U.S. at 331. A contingent liability needs to be reduced to its present value to reflect the likelihood that the debtor will actually be obligated to pay the contingent obligation. Oakes, 1993 WL 339725, at *3. Because the net present value of the contingent liability for lost rent is fixed by statute, a court must consider the effect of the limitation on damages under section 502(b)(6): A lessor's right to payment for lost rent is capped at a maximum of one year or 15% (not to exceed three years) for the loss of future rent. Vause, 886 F.2d at 798-99.

2. Relevant authority contradicts the bankruptcy court's reading of section 502(b)(6)

In contrast to this well-established framework, the bankruptcy court's decision cannot be reconciled with how the Sixth Circuit interprets section 502(b)(6) or how other courts have applied claim limitations in analogous situations.

First, the bankruptcy court's interpretation of section 502(b)(6) — that it should only be considered after a formal objection has been made — is inconsistent with the Sixth Circuit's rules of statutory interpretation. In Vause, the Sixth Circuit rejected a bankruptcy court's interpretation of the word "due" in section 502(b)(6) because it was extremely literal and based on a study of the word in isolation from the rest of statute. The Sixth Circuit, quoting Judge Learned Hand, admonished the bankruptcy court "to remember that statutes always have some purpose or object to accomplish, whose sympathetic and imaginative discovery is the surest guide to their meaning." Vause, 886 F.2d at 800 (citation omitted).

The bankruptcy court's interpretation of section 502(b)(6) fails to consider the adjudicatory structure and evidentiary function of section 502 as a whole. Under section 502(a), claims are presumptively allowed unless a party in interest objects. 11 U.S.C. § 502(a); see Fed.

R. Bankr. P. 3001(f) (stating that a proof of claim properly filed under section 502 "shall constitute prima facie evidence of the validity and amount of the claim."). This allows the parties in interest and the court to spend scarce resources on adjudicating claims that are worth more than the cost of their prosecution, rather than waste resources on uncontested claims and pricing creditors with less valuable claims entirely out of the ability to participate in the proceedings and receive a distribution from the estate.

Under section 502(b), however, the court is not permitted to allow certain categories of claims. 11 U.S.C. § 502(b); see Travelers Cas. and Sur. Co. of Am. v. Pac. Gas and Elec. Co., 549 U.S. 443, 449 (2007) ("But even where a party in interest objects, the court "shall allow" the claim "except to the extent that" the claim implicates any of the nine exceptions enumerated in section 502(b)."). If a claim is not allowable, there is no valid legal basis for the right to receive payment from the estate and thus there is no debt for the purposes of the Bankruptcy Code. Glance, 487 F.3d at 321. Although improper claims may slip through the allowance process without objection, it does not mean that a legally enforceable obligation actually existed in the first place. Therefore, amounts in excess of the statutory cap cannot be considered debts under the Bankruptcy Code.

Second, the bankruptcy court's decision is inconsistent with the case law. Even if section 502(b)(6) "is only activated by optional and unpredictable post-petition bankruptcy events," it would make no sense to require the court to ignore the obvious implications of the section 502(b)(6) limitations within the context of an exercise that is intended to establish a present value for claims that may or may not be fully activated by future events. See Oakes, 1993 WL 339725, at *3. The vast majority of courts have had no problem applying future claim limitations when making preliminary determinations in order "to prevent raising form over substance." In re Scovis, 249 F.3d 975, 983 (9th Cir. 2001) (applying 11 U.S.C. § 506(a) even though it "speaks in the terms of an allowed claim."); see In re McClaskie, 92 B.R. 285, 287 (Bankr. S.D. Ohio 1988) (concluding that the court should not "close its eyes" and rely upon an "overly technical reading of section 506(a) and its impact upon a case to ignore the obvious.").

The bankruptcy court, despite recognizing this case law, failed to establish a coherent basis for treating section 502(b)(6) differently. The court could only provide one case in support of its position, In re Blair. No. 07-50262, 2007 Bankr. LEXIS 4242 (Bankr. S.D. Ohio Dec. 13, 2007). But Blair is a practically unreasoned judgment: it contains no independent analysis and the cases it cites for the proposition that section 502(b)(6) should not determine eligibility for bankruptcy relief only conclude that disputed debts are presumably included in the section 109(e) calculation. Id. at *8. And aside from Blair, the court relies upon two novel statements without providing authority or other explanation: (1) there is "no clear place to schedule the section 502(b)(6) cap" and (2) capping the debt would not be appropriate because other parties in interest would be left without an accurate calculation of the hypothetical full value of the claim. These unsupported propositions provide no basis in statutory or case law to support the bankruptcy court's decision.

CONCLUSION

For these reasons, the United States Trustee respectfully asks this Court to reverse the order entered below and to remand for further proceedings.

Respectfully submitted,

Dated: June 18, 2010

DANIEL M. MCDERMOTT
UNITED STATES TRUSTEE FOR REGION 9

By: /s/ Noah M. Schottenstein
Noah M. Schottenstein (VA #79031)
Trial Attorney

Executive Office for United States Trustees
United States Department of Justice
20 Massachusetts Avenue NW
Washington, D.C. 20530
Telephone: (202) 305-2796
Facsimile: (202) 305-2397
Email: noah.m.schottenstein@usdoj.gov
Attorney for the United States Trustee

CERTIFICATE OF SERVICE

I hereby certify that on June 18, 2010, a copy of the foregoing Brief for the United States Trustee, Appellant was served on the following registered ECF participants, electronically through the court's ECF System at the email address registered with the court:

Lester R. Thompson	lthompson@thompsonanddeveny.com

/s/ Noah M. Schottenstein
Noah M. Schottenstein

BRIEF BANK — "SUMMARY SHEET"

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WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	United States Trustee v. John E. S. Mohr & Shelley I. Staddon (In re: John E. S. Mohr & Shelley I. Staddon)
2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	S. D. Ohio
3. ("CCN") ***CURRENT*** CASE NO.	No.: 10-0176
4. ("PCN") ***PRIOR*** CASE NO. - & COURT *[IF ANY]*	No.: 09-30487 Court: Bankr. S.D. Ohio *(Identify judge & cite, if any)*
5. ("SO") ***SOURCE***	**U.S. TRUSTEES**
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7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*	Mary Anne Wilsbacher, Noah M. Schottenstein, P. Matthew Sutko, Ramona D. Elliott, Daniel M. McDermott *(UST/OGC: 202-307-1399/FAX-2397)*
8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	• (1) Did the bankruptcy court err when it refused to consider evidence on an element of proof in the case: whether the debtors had "primarily consumer debts" under 11 U.S.C. § 707(b)? (2) Did the bankruptcy court err when it held that meaning of the term "debt" under 11 U.S.C. §707(b) included amounts that a creditor may not assert the debtor due to the statutory limitation on damages for lost future rent under 11 U.S.C. § 502(b)(6)?
10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)	
11. DO YOU RECOMMEND POSTING IN UST BRIEFBANK?	☒ YES ☐ NO ***NAME:*** Linda Figueroa ***DATE:***

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF OHIO

In re:

JOHN E. S. MOHR &
SHELLEY I. STADDON,

Debtors,

UNITED STATES TRUSTEE,

Appellant,

v.

JOHN E. S. MOHR &
SHELLEY I. STADDON,

Appellees.

District Court Case No. 3:10-0176

On appeal from the United States
Bankruptcy Court for the Southern
District of Ohio, Case No. 09-30487

ORAL ARGUMENT REQUESTED

REPLY BRIEF FOR THE UNITED STATES TRUSTEE, APPELLANT

RAMONA D. ELLIOTT
General Counsel

P. MATTHEW SUTKO
Associate General Counsel

NOAH M. SCHOTTENSTEIN
Trial Attorney

Executive Office for United States Trustees
United States Department of Justice
20 Massachusetts Avenue, N.W.
Washington, D.C. 20530
Telephone: (202) 305-2796
Facsimile: (202) 305-2397
Email: noah.m.schottenstein@usdoj.gov

DANIEL M. MCDERMOTT
United States Trustee for Region 9

MARYANNE WILSBACHER
Assistant United States Trustee

Office of the United States Trustee
United States Department of Justice
170 North High Street, Suite 200
Columbus, Ohio 43215
Telephone: (614) 469-7411 x 212
Facsimile: (614) 469-7448
Email: maryanne.wilsbacher@usdoj.gov

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INTRODUCTION

This appeal presents two distinct questions. They are whether (1) 11 U.S.C. § 707(b) required the court to accept as true the Mohrs' valuation of their debts as alleged in their bankruptcy petition and (2) the Mohrs' did not need to apply 11 U.S.C. § 502(b)(6)'s limitation on damages when they listed the debt in their bankruptcy petition.

In the opening brief, the United States Trustee demonstrated the bankruptcy court's holdings on these issues were erroneous. First, the United States Trustee established that the question of whether an individual has primarily consumer debts is a question fact, and the bankruptcy court erred by declining to make a factual determination based on the evidence. Second, the United States Trustee established that because a claim for damages based on lost future rent is a contingent obligation, it should be valued at the net present value of the liability rather than the full, face value of the liability, and this means that the Mohrs have primarily consumer debts and are therefore subject to dismissal under section 707(b).

In response, the Mohrs concede bankruptcy courts should make an independent determination of the facts, but argue that this bankruptcy court was entitled to rely solely on the allegations in the pleadings when determining if the Mohrs have primarily consumer debts under section 707(b). On the second issue, they argue that the correct value of a claim for lost future rent is the face value of the lease because section 502(b)(6)'s limitation on damages is only operative upon an objection to the claim.

Both of the Mohrs' arguments are unconvincing because they are premised on the belief that the question of whether an individual has primarily consumer debts must be decided based upon the information known to the court at the time the bankruptcy petition is filed, instead of based on the true facts as developed through the trial process. The Mohrs' approach is based on their novel reading of 11 U.S.C. § 109(e), a section that is irrelevant to whether the United States Trustee should be granted relief from abuse under section 707(b). Section 109(e) establishes the maximum amount of debt that an individual may have in order to commence chapter 13 bankruptcy proceedings and has nothing to do with determining abuse under section 707(b).

Given this, the United States Trustee seeks two alternative forms of relief on appeal. First, there is no dispute that if the section 502(b)(6) limitations are applied, then the Mohrs have primarily consumer debts. Therefore, if this Court agrees that section 502(b)(6) should have been applied, this Court may reverse the decision of the bankruptcy court as clearly erroneous, hold that the Mohrs have primarily consumer debts, and remand the proceedings for the bankruptcy court to determine whether the Mohrs' case should be dismissed or converted to one under chapter 13.

Alternatively, if this Court does not believe that the section 502(b)(6) limitations should have been applied, this Court should still reverse the decision of the bankruptcy court and remand the proceedings in order to allow the United States Trustee to develop evidence for the purpose of determining the actual value of the Mohrs' liability on Don Wright Realty's claim for damages.

ARGUMENT

I. The Mohrs concede that the bankruptcy court should make an independent determination of the facts based on the evidence

The parties appear to agree on the bankruptcy court's ability to make a factual determination on whether the Mohrs have primarily consumer debts under section 707(b). As the Mohrs state, "Pearson does not preclude the [bankruptcy court] from examining this issue . . . a court can make an independent determination as to . . . whether certain debts are consumer in nature or non-consumer, as well as a determination of the amounts of such claims." Appellee's Brief at 11. Therefore, for the reasons stated on pages 15-21 of the United States Trustee's opening brief, the court below erred by creating a presumption rather than adjudicating the factual dispute. Consequently, the only remaining question on appeal is whether the bankruptcy court erroneously determined that the Mohrs had primarily business debts.

II. The evidence shows that the Mohrs have primarily consumer debts

The Mohrs do not dispute that they would have primarily consumer debts and thus be subject to dismissal or conversion if Don Wright Realty's claim for damages is valued at the actual amount that the Mohrs are liable to pay. See Appellant's Brief at 9. Still, the Mohrs argue that, based on Pearson, the bankruptcy court was entitled to solely consider the amounts as initially set forth in the bankruptcy petition and the proofs of claim when determining if a debtor is subject to dismissal under section 707(b). See Appellee's Brief at 13. The Mohrs' brief, however, primarily repeats the reasoning of the bankruptcy court without responding to the arguments raised by the United States Trustee. See Appellant's Brief at 13-15. Among other things, they do not rebut that Rule 9014(d) requires the bankruptcy court to take evidence and hear testimony, and that Pearson is irrelevant because it concerns a debtor's eligibility to initiate chapter 13 proceedings under section 109(e). Id. at 21.

As the United States Trustee explained, the value of a debt based on a claim for damages that are contingent upon the occurrence of future events, such as a landlord's ability to re-rent the property after the breach of a lease, are determined by the net present value of that liability. See Appellant's Brief at 25. Here, there are two potential methods of determining the value of the Mohrs' debt to Don Wright Realty. The simplest, and most direct method, is for this Court to hold that section 502(b)(6) applies to the question of whether the Mohrs have primarily consumer debts. Id. at 28.

This Court may do so because a debt only exists to the extent that there is a valid legal basis for the creditor's claim. Glance v. Carroll (In re Glance), 487 F.3d 317, 321 (6th Cir. 2007). The value of Don Wright Realty's claim is subject to section 502(b)(6)'s limitation on damages. Vause v. Capital Poly Bag, Inc. (In re Vause), 886 F.2d 794, 798-799 (6th Cir. 1989). Therefore, the Mohrs only owe a debt to Don Wright Realty to the extent allowed by section 502(b)(6), which is an amount no greater than $86,840.96. See Appellant's Brief at 9.

In contrast, the Mohrs state that the amount of their debt to Don Wright Realty should be valued at $587,336.17. See Appellee's Brief at 13. But the Mohrs do not explain why their amount should control, and their attempts to distinguish the case law regarding the valuation of debts fails to demonstrate any meaningful difference between those cases and the current case. Id. at 8.

Thus, if this Court were to decide that section 502(b)(6) applies, the Mohrs would then have primarily consumer debts and be subject to dismissal or conversion under section 707(b).

See Appellant's Brief at 9-10. On remand, the bankruptcy court would simply be required decide whether the Mohrs case should be dismissed or converted to one under chapter 13.

In the alternative, this Court could hold that the amount of damages that the Mohrs owe Don Wright Realty for breach of the HobbyTown USA lease must be specifically determined. Id. at 16. This scenario presents substantial questions of fact that were not developed in the bankruptcy court, which would require further discovery and many factual determinations that must be made in accord with the Federal Rules of Evidence. Id. at 20; see Indmar Prod. Co. v. Comm'r of Internal Revenue, 444 F.3d 771, 778 (6th Cir. 2006). The bankruptcy court would be required to hear evidence regarding whether the Mohrs had repudiated the lease prior to filing for bankruptcy or if the lease was appropriately terminated post-petition, Don Wright Realty's attempt to mitigate the loss, and the correct amount of damages based on Don Wright Realty's actual and expected future losses. This inquiry would be further complicated because of how the Mohrs have conducted their bankruptcy proceedings — the lease is technically held by Staddon-Mohr LLC, and the Mohrs have not initiated a separate bankruptcy case for their limited liability company or explained the financial circumstances of Staddon-Mohr LLC and the Mohrs' legal relationship to their closely held company.

Ultimately, it appears as if these elongated proceedings would also lead to finding that the Mohrs have primarily consumer debts because Don Wright Realty does not contest the applicability of section 502(b)(6) to its claim and does not defend the amount of damages it originally claimed, which the Mohrs rely upon in order to assert that they have primarily business debts. See Appellee's Brief at 11. Don Wright Realty acknowledges that its claim is at most valued at $86,840.96. See Appellant's Brief at 9. This would still leave the Mohrs' business debts at $216,123.30, which is less than their $440,934.78 in consumer debts. Id.

Accordingly, through either the lack of factual development or the failure to apply section 502(b)(6), the bankruptcy court erred when it found that the Mohrs did not have primarily consumer debts and their case was not subject to dismissal or conversion to chapter 13 proceedings.

CONCLUSION

For these reasons, the United States Trustee respectfully asks this Court to reverse the order entered below and to remand for further proceedings.

Respectfully submitted,

Dated: August 11, 2010

DANIEL M. MCDERMOTT
UNITED STATES TRUSTEE FOR REGION 9

By: /s/ Noah M. Schottenstein
Noah M. Schottenstein (VA #79031)
Trial Attorney

Executive Office for United States Trustees
United States Department of Justice
20 Massachusetts Avenue NW
Washington, D.C. 20530
Telephone: (202) 305-2796
Facsimile: (202) 305-2397
Email: noah.m.schottenstein@usdoj.gov
Attorney for the United States Trustee

CERTIFICATE OF SERVICE

I hereby certify that on August 11, 2010, a copy of the foregoing Reply Brief for the United States Trustee, Appellant was served on the following registered ECF participants, electronically through the court's ECF System at the email address registered with the court:

Lester R. Thompson lthompson@thompsonanddeveny.com

/s/ Noah M. Schottenstein

Noah M. Schottenstein

BRIEF BANK — “SUMMARY SHEET” *Printed Wed-5/28/08 10:27*

WESTLAW CODES

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2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	9th Cir.
3. ("CCN") ***CURRENT*** CASE NO.	No.: 07-16016
4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*	No.: Nc-06-01131-BSKu Court: BAP, 9th Cir. *(Identify judge & cite, if any)*
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7. **("AU") *PRINCIPAL AUTHORS & OFFICE*** [E.g.,"UST/OGC"]	John S. Wesolowski, Walter Theus, P. Matthew Sutko, Roberta A. DeAngelis *(UST/OGC: 202-307-1399/FAX-2397)*
8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	• Did the bankruptcy court abuse its discretion by converting this case from Chapter 11 to Chapter 7, given the court’s findings under 11 U.S.C. § 1112(b) that conversion, rather than dismissal, was “in the best interest of creditors and the estate?”
10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)	
11. DO YOU RECOMMEND POSTING IN UST BRIEFBANK?	| x | YES | | NO ***NAME:*** Linda Figueroa ***DATE:***

No. 07-16016

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

AMR MOHSEN,
Debtor-Appellant

v.

UNITED STATES TRUSTEE
Appellee.

ON APPEAL FROM THE UNITED STATES BANKRUPTCY APPELLATE
PANEL OF THE NINTH CIRCUIT

BRIEF FOR APPELLEE

Statement of Subject Matter and Appellate Jurisdiction

Pursuant to 28 U.S.C. § 157(a), the bankruptcy court had jurisdiction to hear and decide the United States Trustee's motion under 11 U.S.C. § 1112(b) to convert Amr Mohsen's ("Mr. Mohsen") bankruptcy case from chapter 11 to chapter 7. The bankruptcy court entered an order converting the case on December 22, 2005. Mr. Mohsen timely filed a motion for reconsideration on January 3, 2006. See 28 U.S.C. § 158(c)(2) and Fed. R. Bankr. P. 8002(b). Pursuant to 28 U.S.C. § 157, the bankruptcy court had jurisdiction to hear and decide Mr. Mohsen's motion for reconsideration. An order denying the motion for reconsideration was entered on March 22, 2006. Mr. Mohsen filed a timely notice of appeal on March 31, 2006. See 28 U.S.C. § 158(c)(2) and Fed. R. Bankr. P. 8002(b). On March 28, 2007, the Bankruptcy Appellate Panel of the Ninth Circuit filed its Memorandum and Judgment, affirming the bankruptcy court's orders granting the United States Trustee's motion to convert, and denying Mr. Mohsen's motion for reconsideration. On April 11, 2007, Mr. Mohsen filed a petition for rehearing and rehearing *en banc*. See Fed. R. Bankr. P. 8015. On May 1, 2007 the appellate panel denied all relief requested in the motion for rehearing. The orders converting the bankruptcy case to chapter 7 and denying the motion for reconsideration are final orders for purposes of appeal.

On May 24, 2007, Mr. Mohsen filed a timely Notice of Appeal of the appellate panel's May 1, 2007 Order Denying Motion for Rehearing and En Banc Review. See Fed. R. App. P. 4(a)(1)(B). This Court has jurisdiction to hear this matter under 28 U.S.C. § 158(d)(1).

Statement of the Issue

> Did the bankruptcy court abuse its discretion by converting this case from chapter 11 to chapter 7, given the court's findings under 11 U.S.C. § 1112(b) that conversion, rather than dismissal, was "in the best interest of creditors and the estate?"

Standard of Review

A bankruptcy court's findings of fact are reviewed for clear error and its conclusions of law are reviewed *de novo*. Price v. United States Trustee (In re Price), 353 F.3d 1135, 1138 (9th Cir. 2004). The standard of appellate review of the conversion or dismissal of a chapter 11 bankruptcy case is abuse of discretion. See, e.g., Marsch v. Marsch (In re Marsch), 36 F.3d 825, 828 (9th Cir. 1994); Pioneer Liquidating Corp. V. United States Trustee (In re Consolidated Pioneer Mortgage Entities), 264 F.3d 803, 806 (9th Cir. 2001). A court abuses its discretion if it does not apply the correct law or if it rests its decision on a clearly erroneous finding of material fact. In re At Home Corp., 392 F.3d 1064, 1967 (9th Cir.) (citation omitted), cert. denied, 126 S.Ct 338 (2005); In re Consolidated Pioneer Mortgage Entities, 264 F.3d at 806.

Statement of the Case

Mr. Amr Mohsen filed chapter 11 bankruptcy on February 5, 2005. At the time of the bankruptcy filing, Mr. Mohsen was incarcerated. Mr. Mohsen intended to utilize the bankruptcy automatic stay (11 U.S.C. section 362(a)) to prevent foreclosure and allow him time to market and sell his real property. Shortly after filing, secured creditor Silicon Valley Bank sought relief from stay to conduct a foreclosure sale. The bankruptcy court granted the relief from stay motion, but delayed its effectiveness until October 1, 2005, giving Mr. Mohsen approximately four months to try to sell the property. As of October 3, 2005, Mr. Mohsen had not been successful in selling his property and the property was sold at a foreclosure sale. Thereafter, the United States Trustee[1] brought a motion under 11 U.S.C. section 1112(b) to convert the case to chapter 7, arguing conversion was in the best interest of the creditors of the estate because a trustee could liquidate the remaining assets for the benefit of creditors. Mr. Mohsen brought a competing motion to dismiss the case asserting that the interests of creditors would be better served by dismissal. The bankruptcy court granted the United States Trustee's motion to convert and denied Mr. Mohsen's motion to dismiss. Mr. Mohsen filed a motion for

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[1] In his Opening Brief, Mr. Mohsen occasionally refers to the United States Trustee as the "Chapter 11 Trustee". See, e.g., Appellant's Opening Brief, pp. 6:13, 10:10, 14:12, 21:14. Chapter 11 trustees are private sector individuals appointed by United States Trustees under 11 U.S.C. § 1104 to administer chapter 11 cases. There was never a Chapter 11 trustee appointed in this case.

The United States Trustee is an official of the United States Department of Justice, charged by statute with the duty to oversee and supervise the administration of bankruptcy cases. 28 U.S.C. § 586(a); see generally Morganstern v. Revco D.S., Inc. (In re Revco D.S., Inc.), 898 F.2d 498, 500 (6th Cir. 1990) (explaining that United States Trustees oversee the bankruptcy process, protect the public interest, and ensure that bankruptcy cases are conducted according to law). The United States Trustees may raise, appear, and be heard on any issue in any case or proceeding under title 11. 11 U.S.C. § 307; see also In re Donovan Corp., 215 F.3d 929, 930 (9th Cir. 2000) (upholding broad appellate standing of United States Trustee).

reconsideration, which was denied. Mr. Mohsen appealed to the bankruptcy appellate panel, which affirmed the bankruptcy court's decision. Mr. Mohsen filed a petition for rehearing and rehearing *en banc*, which was denied by the appellate panel. Mr. Mohsen then appealed to this Court.

Statement of Facts[2]

Mr. Mohsen filed a voluntary petition for relief under chapter 11 of the Bankruptcy Code on February 8, 2005. ER Tab 28, p. 242, docket #1 and ER Tab 27, p. 240. He filed to prevent the foreclosure sale of his residence in Los Gatos, California (the "Residence"), which was scheduled for the following day. Appellant's Opening Brief at 6:4-9. Mr. Mohsen's stated intention was to utilize the automatic stay to market and sell the Residence himself, using the proceeds to pay creditors. Id.

At the time of filing, Mr. Mohsen's estate included the Residence which was valued at $10 million, $100,000 in antique rugs, a fire insurance claim valued at $116,000, and real property in Cairo, Egypt valued at $250,000.[3] ER Tab 25, pp.

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[2] Mr. Mohsen did not provide separate excerpts of record for this appeal. He redesignated his original Appendix filed with the appellate panel and the UST's Excerpts of Record filed with the appellate panel as the designation of record in this appeal. The United States Trustee has prepared Supplemental Excerpts of Record for this appeal. Citations to these supplemental excerpts will be to ER Tab __, p. __.

[3] The United States Trustee was informed by Mr. Mohsen's bankruptcy counsel that the actual value of the assets was double the amount listed in Mr. Mohsen's schedules. See, ER Tab 22 at

202-08. His liabilities included secured debt against the Residence[4] and more than $741,000 in unsecured nonpriority debt.[5] Id. at pp. 210-17. In addition, while no priority tax debt was scheduled, the IRS filed a claim asserting that Mr. Mohsen owed over $2 million in priority debt, and $379,000 in unsecured nonpriority debt as a result of unfiled returns. ER Tab 23, p. 190-91. At the time of the filing, Mr. Mohsen was incarcerated, and had no income due to his inability to work. ER Tab 26, p. 237.

Shortly after filing, in March 2005, secured creditor Silicon Valley Bank filed a motion for relief from stay, seeking to continue foreclosure proceedings on the Residence. ER Tab 28, p. 247, docket #36. On June 29, 2005, the bankruptcy court orally granted the relief from stay motion, ruling that the stay would terminate on October 1, 2005, and that any trustee's sale

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182:6-9. The amount scheduled reflects Mr. Mohsen's one-half community property interest and does not reflect his non-filing spouse's one-half community property interest. Id.

[4] The secured debt against the residence included a first deed of trust in favor of Silicon Valley Bank estimated at $3 million, a second deed of trust in favor of Washington Mutual estimated at $3 million, a Santa Clara County tax lien estimated at $30,964, a disputed deed of trust in favor of Manchester Williams estimated at $42,000, a mechanic's lien in favor of Ravcast estimated at an unknown amount and a contingent and disputed deed of trust in favor of the United States of America estimated at $1 million. ER Tab 25, p. 210.

[5] While Mr. Mohsen scheduled $741,000 in unsecured debt, unsecured claims in the amount of $21,709,244 were filed. ER Tab 24, pp. 192-99.

could take place on or after October 3, 2005. Id. at p. 260, docket #92. As of October 3, 2005, Mr. Mohsen had not been successful in finding a buyer for the Residence and Silicon Valley Bank foreclosed. Appellant's Opening Brief at 6:9-12.

On or about November 21, 2005, the United States Trustee filed a Motion to Convert the bankruptcy case to chapter 7 (the "Conversion Motion"). ER Tab 28 at p. 265, docket # 136 and 137. The bases for the Conversion Motion were: (1) Mr. Mohsen's primary asset had been lost to foreclosure; (2) as a result of the foreclosure Mr. Mohsen was unwilling or unable to reorganize; (3) creditors had received no payments during the ten months that the bankruptcy case had been pending; and (4) it was in the best interest of those creditors and the estate to convert the case so that an independent chapter 7 trustee could perform an orderly liquidation of the remaining assets and use the funds to pay creditors. ER Tab 21 at pp. 177-80. As of the filing of the Conversion Motion, Mr. Mohsen's estate consisted of the real property located in Cairo, Egypt valued at $250,000, the antique rugs valued at $100,000, a fire insurance claim valued at $116,000, pending adversary proceedings against State Farm and Polytex Corporation, and funds in the Debtor-in-possession bank account totaling approximately $80,000. Id. at 178-79. None of the assets were claimed exempt in their entirety. Id.; ER Tab 25 at p. 209. The United States of America, as a creditor, filed papers supporting conversion. ER Tab 18, pp. 153-55.

Mr. Mohsen filed an opposition to the Conversion Motion, arguing that certain unsecured creditors supported dismissal rather than conversion, and that his tax issues were best dealt with outside bankruptcy. ER Tab 15, pp. 129-34. In support of his position, Mr. Mohsen identified eleven creditors who supported dismissal. ER Tab 16 at p. 136. Of the eleven unsecured creditors who supported dismissal, nine were "insiders." Specifically, three were family members and six were close friends that loaned Mr. Mohsen money to fund a retainer to pay bankruptcy counsel in the bankruptcy case of Aptix Corporation, a company for which Mr. Mohsen was the founder and former chief executive officer. ER Tab 25 at pp. 214-15; ER Tab 11, pp. 102:21 - 103:2. An objection to the Conversion Motion was also filed by Mr. Mohsen's brother, Aly Mohsen. ER Tab 19, p. 156.

In response to the Conversion Motion, on or about November 23, 2005, Mr. Mohsen filed a motion to dismiss (the "Dismissal Motion"), conceding that chapter 11 rehabilitation was unlikely and that he would not be able to fund a plan of reorganization, but arguing that dismissal was in the best interest of unsecured creditors. ER Tab 28 at p. 266, docket # 138 and 139; ER Tab 20 at pp. 158:17-24 and 161:18-21. The essence of Mr. Mohsen's argument was that: (1) unsecured creditors would fare better if the case were dismissed, as they would not have to wait in line behind higher priority creditors to get paid; and (2) the only method for dealing with the IRS claim against Mr. Mohsen was outside of bankruptcy. See ER Tab 20, pp. 160-63. Further, in response to the United States Trustee's argument in her Conversion Motion that he did not desire to use his non-exempt assets to pay creditors, Mr. Mohsen responded,

> This is false. [Mr. Mohsen] has consistently stated that he intends to pay his creditors in full. [Mr. Mohsen] has a strong moral obligation to repay his creditors. By far, [Mr. Mohsen's] largest [unsecured] creditor is his brother, Ali [sic] Mohsen, and [Mr. Mohsen] plans to repay his brother with all of his ability. Also, another substantial body of creditors is family friends and community members who loaned [Mr. Mohsen] money after his incarceration. [Mr. Mohsen] intends to pay these creditors in full as well.

Id. at 163:1-7. At no point did Mr. Mohsen state an intent to repay any specific creditors other than his brother and other "insiders."

On December 14, 2005, the United States Trustee filed an objection to the Dismissal Motion, citing Mr. Mohsen's inconsistent positions with regard to his tax liability and disputing the idea that the tax issue could only be dealt with outside of bankruptcy. ER Tab 17, pp. 149-52. In addition, the United States Trustee raised concerns that as Mr. Mohsen was currently incarcerated and unemployed, the only assets available to creditors were those assets that were currently held by the bankruptcy estate, and allowing the case to dismiss may result in

Mr. Mohsen's assets being sent to Egypt to support his family. Id. at p. 151.

At the December 21, 2005, hearing on the Conversion Motion and the Dismissal Motion, the bankruptcy court expressed concern that there was no way that Mr. Mohsen could pay his creditors in full. ER Tab 11 at 94:7-11. The bankruptcy court also expressed its concern that Mr. Mohsen and the unsecured creditors who supported dismissal wanted the case dismissed so that they could reverse the priorities of the Bankruptcy Code and pay insiders and unsecured creditors in front of priority creditors such as the IRS. Id. at 99:24 - 102:19. Finally, the bankruptcy court expressed its concern that if the case were dismissed, Mr. Mohsen's assets would be sent to Egypt or would otherwise be kept for the benefit of insider creditors, at the expense of Mr. Mohsen's other creditors. Id. at 94:12 - 100:8. The bankruptcy court based this second concern on information it had learned about Mr. Mohsen while presiding over the Aptix Corporation bankruptcy. Id. at 94:12 - 98:25.[6] Immediately after the bankruptcy court made these statements, Mr. Mohsen's counsel informed the court that as of the hearing date, Mr. Mohsen's wife

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[6] Aptix Corporation was a company in which Mr. Mohsen was a substantial shareholder, and he was the company's president, chief executive officer and chairman of the board. ER Tab 13, p. 123; ER Tab 26, p. 224. Aptix Corporation filed a voluntary chapter 11 petition on April 23, 2004 (N.D. Cal. Case No. 04-52590) and was converted to a chapter 7 case on November 10, 2005.

had returned to Egypt because Mr. Mohsen had "been unable to support and fund the living expenses for his family so [his] wife is now in Egypt because she can't afford to live [in the United States.]" Id. at 99:17-19.

Ultimately, the bankruptcy court found that the proper standard for determining whether to convert or dismiss Mr. Mohsen's case was the best interest of all creditors, not just unsecured creditors. Id. at 100:9-14 and 102:14-19. Thereafter, the bankruptcy court found that the interests of all creditors and the estate were best served by conversion, stating,

> What I think is important under all of the circumstances. . . I think it's important that there be an orderly winddown of whatever is left.
> . . . .
> If the trustee decides to not administer these assets, for whatever reason, they're going to be abandoned back to Mohsen. And then he can pick and choose whatever he wants to do with them. And if he wants to pay those folks back, there's nothing in the bankruptcy law that precludes him from paying back whoever he wants to pay back.
>
> But I think that it's important that somebody independent like a Chapter 7 trustee take a look at it, that there be basically a fair shake for all the creditors as to who gets paid or who doesn't get paid out of whatever the trustee develops.

Id. at 107:1-17. An order converting the case to chapter 7 was entered on December 22, 2005. ER Tab 14, p. 128. Carol Wu was appointed chapter 7 trustee on the same day. ER Tab 28 at p. 268, docket #150.

On January 3, 2006, Mr. Mohsen filed a motion to reconsider the order converting the case to chapter 7 (the "Reconsideration

Motion"). ER Tabs 12 and 13, pp. 111-27. The United States Trustee filed an opposition to the reconsideration motion. ER Tab 10, pp. 86-90. The chapter 7 trustee also filed an opposition. ER Tab 9, p. 82.

At the hearing on the Reconsideration Motion, Mr. Mohsen's counsel freely acknowledged that Mr. Mohsen wanted the case dismissed to prevent a chapter 7 trustee from pursuing non-exempt assets that existed in Egypt:

> The Court: I almost have to say under all of these circumstances why does [Mr. Mohsen] care whether it's a conversion or dismissal? He is [sic] yes, "Well, I may want to pay some of these people." You're free to pay them all, some of them, whatever you want to do.
>
> Mr. Levin: The issue, Your Honor, is that there is – there is a possibly nonexempt[7] asset in the form of real property in Egypt. And if – and that is what – that is what is motivating [Mr. Mohsen].
>
> The Court: So if that's nonexempt, and if the Trustee can recover it, why isn't that a good thing? Why should that asset go – why should that asset go to nobody, or go to certain select creditors that [Mr. Mohsen] favors, as opposed just to liquidating that asset and the money goes to whoever gets it . . . . under the Code?
>
> Mr. Levin: To answer the question with another question, . . . when [a] voluntary case is not successful. . . why does that voluntary case

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[7] Individual debtors are entitled to set aside certain property as exempt from the claims of creditors in bankruptcy cases. <u>See</u> 11 U.S.C. § 522; Cal. Code Civ. P. § 703.140. A non-exempt asset is an asset that is available to pay creditor claims.

> necessarily result in the surrender of nonexempt assets to creditors who had not done anything to enforce their rights with regard to a nonexempt asset? [It] affects a penalty on a debtor who wants to try to reorganize under chapter 11.
>
> The Court: No. It also . . . penalizes the creditor, who may not be able to go to Egypt to try and collect their obligation or may not be a close friend of [Mr. Mohsen] such that they're not going to participate in any dividend, but they might otherwise get some sort of a dividend if you liquidate in a chapter 7, and whatever there is is paid out *pro rata* to all of these creditors.

ER Tab 8 at 60:11 - 61:18.

Ultimately, the bankruptcy court denied the motion stating,

> I haven't seen anything in [the Reconsideration Motion] that really impresses me as being new and different to the extent that it would change the way I viewed the situation originally.
>
> * * *
>
> This is one of those cases that almost cries out for a trustee to go through and look at everything to make sure that the system is not taken advantage of in one way or another.
>
> The integrity of the process, in my view, in the circumstances of this case requires there to be a trustee.

Id. at 53:14 - 54:6. An order denying the Reconsideration Motion was entered on March 22, 2006. ER Tab 7, p. 50.

On March 31, 2006, Mr. Mohsen filed a notice of appeal. ER Tab 6, p. 48. Following briefing and oral argument, on March 28, 2007, the Bankruptcy Appellate Panel of the Ninth Circuit issued a memorandum and judgment affirming the bankruptcy court's orders. ER Tab 5, pp. 36-45; ER Tab 1, p. 3. The appellate panel found that the United States Trustee had met her burden of establishing “cause” under 11 U.S.C. § 1112(b), and ruled that the bankruptcy court’s reasons for conversion were sound. ER Tab 5 at 42:1-3. As stated by the appellate panel, these reasons included (a) that there would be an estate for a chapter 7 trustee to administer, (b) that conversion would allow for continuing jurisdiction of estate property by the court, and would provide for a trustee to facilitate liquidation of the estate, and (c) Mr. Mohsen’s incarceration would impair his ability to protect assets or generate revenue. Id. at 42:4 - 43:11.

The appellate panel also considered the Reconsideration Motion, despite the fact that Mr. Mohsen had not briefed the issue. The panel concluded that it was not an abuse of discretion for the bankruptcy court to have relied partially upon a November 5, 2003, order entered by the United States District Court for the Northern District of California in the Aptix v. Quickturn Design Systems case[8] in deciding to convert rather than dismiss, because it was a public record and the bankruptcy court could properly take judicial notice of it. Id. at 44:3-7. The panel further ruled that Mr. Mohsen’s argument that the bankruptcy court misapplied the “best interest of creditors”

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[8] The district court’s November 5, 2003 order found, among other things, that the grant by Aptix Corporation of a security interest to Mohsen was a fraudulent transfer. ER Tab 13, p. 127:6-9.

standard by discounting the views of unsecured creditors who were friends and family who supported dismissal, was “more than a little tendentious,” since Mr. Mohsen had sought to ignore the fact that the Internal Revenue Service ($2.3 million claim), another federal agency ($1 million claim) and Aptix Corporation ($2 million)[9] did not support dismissal. The appellate panel noted that during his year as a debtor in possession, Mr. Mohsen had never objected to these claims. Id. at 44:8-13.

On April 11, 2007, Mr. Mohsen filed a petition for rehearing and rehearing *en banc*. ER Tab 4, p. 8. On May 1, 2007 the appellate panel denied all relief requested in the motion for rehearing. ER Tab 3, p. 6.

On May 24, 2007, Mr. Mohsen appealed the appellate panel’s May 1, 2007 order denying motion for rehearing and en banc review to this Court. ER Tab 2, p. 5.

Summary of the Argument

As a threshold matter, Mr. Mohsen did not appeal the underlying bankruptcy appellate panel memorandum decision or judgment filed March 28, 2007; his Notice of Appeal simply states that he appeals “from the judgement entered in this action on the 1st day of May, 2007.” ER Tab 2, p. 5. The May 1, 2007

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[9] Actually, the claim filed by Aptix Corporation is for $20 million. ER Tab 24, p. 196.

"judgement" is the Order Denying Motion for Rehearing and En Banc Review Court. Thus, as a technical matter, that is the only order subject to appeal, and should be reviewed for abuse of discretion. In re Fowler, 394 F.3d 1208, 1214 (9th Cir. 2005).

Assuming that this Court reaches the merits of this appeal, the bankruptcy court did not abuse its discretion by converting Mr. Mohsen's chapter 11 case to chapter 7 under 11 U.S.C. § 1112(b). Mr. Mohsen concedes that cause existed under section 1112(b) to convert or dismiss his case. Before this Court, Mr. Mohsen argues the court below erred by converting his chapter 11 bankruptcy case to chapter 7 rather than dismissing it. But conversion was well within the court's broad discretion given its legitimate concern that Mr. Mohsen wanted dismissal so he could retain the power to (a) use his limited assets to prefer his friends' and family's unsecured claims outside bankruptcy at the expense of higher priority claimants, and (b) ensure estate assets he held in Egypt would not be liquidated in a chapter 7 case for the benefit of his creditors. Both the bankruptcy court and the appellate panel agree that the conversion order prevented those injustices and that conversion was "in the best interest of creditors and the estate" under section 1112(b). Their rulings merit affirmance.

Mr. Mohsen's main argument before this Court is that the lower courts utilized the wrong standard in determining whether the case should be converted or dismissed. He contends that the proper standard is whether the creditors will suffer "plain legal prejudice" if the case were dismissed, primarily relying on Matter of International Airport Inn Partnership, 517 F.2d 510 (9th Cir. 1975), a case decided under the Bankruptcy Act of 1898, which was repealed in 1978, and a handful of post-1978 bankruptcy decisions from outside the Ninth Circuit. However, this standard has nothing to do with section 1112(b) of the Bankruptcy Code. The standard under 11 U.S.C. section 1112(b) is not whether there is plain legal prejudice to creditors if the case is dismissed; rather, once cause has been established, the standard is whether conversion or dismissal is in the best interest of creditors and the estate. 11 U.S.C. § 1112(b). And the non-statutory "plain legal prejudice" test Mr. Mohsen desires would strip bankruptcy courts of the broad discretion they have under section 1112(b) to consider all relevant factors in deciding whether conversion or dismissal of a chapter 11 case is in the creditors' interest.

Mr. Mohsen also argues that the bankruptcy court should have considered the "vote" of a minority of hand-picked creditors, most of them insiders, who "voted" to have the case dismissed rather than converted. However, he ignores the interests of other unsecured and priority creditors who filed claims that were deemed allowed – creditors who represent over 95% of the total amount of unsecured claims in the case. The bankruptcy court properly concluded that conversion of the case was in the best interest of all the creditors, including the over $23 million in unsecured and priority claimants who did not support Mr. Mohsen's dismissal motion.

Mr. Mohsen further claims that the bankruptcy court failed to consider certain equitable issues, including the lack of incentive on the part of the chapter 7 trustee to file tax returns, and the resulting prejudice to unsecured creditors. But these issues were adequately addressed by the lower court, albeit not with the result that Mr. Mohsen wanted.

Finally, Mr. Mohsen contends that the bankruptcy court erred when it denied his Reconsideration Motion. However, that order should be affirmed because Mr. Mohsen does not demonstrate that there were any manifest errors of fact or law, or manifest injustice.

Argument

Mr. Mohsen did not appeal the underlying bankruptcy appellate panel memorandum decision or judgment entered March 28, 2007; his notice of appeal simply states that he appeals "from the judgement entered in this action on the 1st day of May, 2007." ER Tab 2, p. 5. The May 1, 2007 "judgement" is the Order Denying Motion for Rehearing and En Banc Review. ER Tab 3, p. 6. Accordingly, as a technical matter, that is the only order subject to appeal, and should be reviewed for abuse of discretion. In re Fowler, 394 F.3d at 1214. The panel did not abuse its discretion in denying the motion for the reasons we discuss in Section III, below. However, should this Court wish to entertain the merits of Mr. Mohsen's attack upon the conversion order, the United States Trustee addresses the merits below.

I. The bankruptcy court did not abuse its discretion by converting Mr. Mohsen's chapter 11 bankruptcy case to chapter 7.

Congress granted bankruptcy courts broad discretion to convert or dismiss a chapter 11 bankruptcy case for "cause" pursuant to 11 U.S.C. § 1112(b). See, e.g., In re Consolidated Pioneer Mortgage Entities), 264 F.3d at 806-07 (9th Cir. 2001)(decision to convert a case to chapter 7 is within bankruptcy court's discretion); Loop Corp. v. United States Trustee, 379 F.3d 511, 515 (8th Cir. 2004)(bankruptcy court has broad discretion in deciding to dismiss or convert chapter 11 case).

Once cause for relief under section 1112(b) is established, a court is given the discretion to choose between converting the case to chapter 7 or dismissing the case outright, "whichever is in the best interest of creditors and the estate." 11 U.S.C. § 1112(b); See also, Nelson v. Meyer (In re Nelson), 343 B.R. 671, 675 (9th Cir. BAP 2006) (citations omitted). The "best interest of creditors and the estate" standard implies a balancing test that is applied on a case-by-case basis. In re Staff Inv. Co., 146 B.R. 256, 260 (E.D. Cal. 1993). Ultimately, the determination of the "best interest of creditors and the estate" is a matter for sound judicial discretion. Id.

In the proceedings in the bankruptcy court, Mr. Mohsen conceded that cause existed to dismiss or convert this case under 11 U.S.C. § 1112(b). ER Tab 20 at 161:18-19. Mr. Mohsen does not contend that cause is an issue in this appeal. Appellant's Opening Brief at 26:20-25.

Nor does he dispute that section 1112(b) explicitly provides that the decision to convert or dismiss be based upon what is in the "best interest of creditors and the estate." Id. at 25:8-12. Mr. Mohsen further concedes that the bankruptcy court has wide discretion in determining whether to convert or dismiss a chapter 11 case. Id. at 25:8-9. Thus, the sole question before this Court is whether the bankruptcy court abused its discretion when it determined that conversion, and not dismissal, was in the best interest of all creditors and the estate.

A. The bankruptcy court correctly defined the scope of the best interests of creditors and the estate test.

Bankruptcy Code section 1112(b) as in effect at the time Mr. Mohsen's bankruptcy case was filed provided in pertinent part:

> " . . . on request of a party in interest or the United States trustee or bankruptcy administrator, and after notice and a hearing, the court may convert a case under this

> chapter to a case under chapter 7 of this title or may dismiss a case under this chapter, whichever is in the best interest of creditors and the estate, for cause, . . ."

11 U.S.C. section 1112(b)(emphasis added).[10]

The evaluation of creditors' best interests requires a bankruptcy court to consider the collective interest of **all** creditors, not just the majority. See In re Superior Siding & Window, Inc., 14 F.3d 240, 243 (4th Cir. 1994) (the fundamental policy of equality among creditors, which is central to the bankruptcy system, is not served by merely "tallying the votes of the unsecured creditors and yielding to the majority interest."); In re Continental Holdings, Inc., 170 B.R. 919, 937 (Bankr. N.D. Ohio 1994) (a court may not base its decision to convert or dismiss a case on the consensus of the majority of creditors and reasoning that "to hold otherwise would be to promote collusion between the debtor and certain creditors to the detriment of other creditors."); In re Staff Inv. Co., 146 B.R. at 260 ("There is no specific numerosity requirement inherent in section 1112(b) best interest test. The interest of a single creditor with a large enough claim will suffice.").

Here, the bankruptcy court rejected Mr. Mohsen's argument

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[10] In April 2005, certain provisions of the Bankruptcy Code, including 11 U.S.C. section 1112, were amended by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub.L. No. 109-8, 119 Stat. 37 (2005), signed into law on April 20, 2005. These amendments did not affect cases that were pending at the time, such as Mr. Mohsen's case.

that the law required the bankruptcy court to accede to the wishes of one subset of creditors, stating, "No, the law is that . . . I take [the interests of the creditors supporting dismissal] into consideration and I make a judgment about what I think is best. It's not controlled by a vote of the creditors." ER Tab 8 at 62:1-3.[11]

The bankruptcy court correctly defined the scope of the best interest of creditors test and therefore, the next inquiry is whether the bankruptcy court abused its discretion by converting this case to a chapter 7 case.

B. The record amply establishes that the bankruptcy court considered the interests of all creditors and of the estate in determining that conversion was appropriate.

The record reveals that the bankruptcy court appropriately considered the interests of not only unsecured creditors, but the interests of all creditors, including priority creditors, the interests of the estate, and the integrity of the bankruptcy system in coming to the conclusion that conversion was in the best interest of creditors and the estate.

First, the bankruptcy court found that conversion was best

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[11] Mr. Mohsen asserts that the bankruptcy court should not have considered the claims of the IRS and the California Franchise Tax Board, since they "were overstated and can be eliminated" (Appellant's Opening Brief, p. 53); the Aptix and Amidhouzour claims, since they were barred by the statute of limitations (Id.); and the bond forfeiture claim of the United States of America, since it was worthless (Id.). But Mr. Mohsen never objected to these filed claims, and they are deemed allowed pursuant to 11 U.S.C. § 502(a).

because dismissal could result in a select group of insider creditors being paid, while non-insider creditors received nothing. ER Tab 11 at 107:13-18; ER Tab 8 at 60:22 - 61:3 and 61:12-18. Through dismissal, Mr. Mohsen sought to retain the power to prefer his family and friends.[12] ER Tab 11 at 102:21 - 103:10. Under his scheme, dismissal would enable him to use his limited assets, which were far below the sum of his total indebtedness, to funnel cash to insiders while leaving all other creditors with no prospect of recovery. ER Tab 24, p. 199 and Tab 20 at 163:1-7; ER Tab 25 at pp. 201, 202-08, 210-17. Given that, the court below did not abuse its discretion by ruling that dismissal would serve to "[penalize] the creditor, who may not be able to go to Egypt to try and collect their obligation or may not be a close friend of [Mr. Mohsen] such that they're not going to participate in any dividend, but they otherwise might get some sort of a dividend if you liquidate in a chapter 7." ER Tab 8 at 61:13-17.

Second, the bankruptcy court considered the interests of the estate's priority creditors – those who had a right under the Bankruptcy Code to be paid before Mr. Mohsen's friends and family

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[12] Those insiders did not appeal the conversion order. Mr. Mohsen lacks standing to advance arguments on their behalf. Wedges/Ledges of California, Inc. v. City of Phoenix, 24 F.3d 56, 61 (9th Cir. 1994); U.S. v. 5.96 Acres of Land, 593 F.2d 884, 887 (9th Cir. 1979); In re Umpqua Shopping Center, Inc., 111 B.R. 303, 305-306 (BAP 9th Cir. 1990) (citations omitted).

and other unsecured creditors.[13] Specifically, in response to Mr. Mohsen's assertion that the "creditors" wanted the case dismissed, the bankruptcy court reminded Mr. Mohsen's counsel that priority creditors were also "creditors" under the Bankruptcy Code and that the bankruptcy court was also required to consider the interests of those creditors. ER Tab 11 at 100:9 - 101:1. Further, the bankruptcy court expressed concern that by voting for dismissal, the unsecured creditors were attempting to reverse the priority scheme of the Bankruptcy Code and attempting to recover funds outside of bankruptcy that properly belonged to the IRS or other higher priority creditors inside bankruptcy. Id. at 99:24 - 100:8 and 101:11 - 102:19.

Finally, the bankruptcy court considered the interests of the estate in general and the integrity of the system. ER Tab 8 at 54:2-8 and 60:22 - 61:18. Mr. Mohsen's plan would have enabled him to prefer "insider" unsecured creditors.[14] ER Tab 20 at 163:1-7. Further, when the bankruptcy court inquired as to why Mr. Mohsen cared whether the case was converted or dismissed, he admitted that the reason he wanted to dismiss his case was

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[13] See 11 U.S.C. §§ 503, 507 and 726.

[14] In a chapter 7 case, the chapter 7 trustee is an impartial and independent appointee whose duties include collecting and reducing to money the property of the bankruptcy estate, and distributing the money to creditors in accordance with the priorities established by the Bankruptcy Code. See 11 U.S.C. §§ 704, 726.

simply because he did not want the bankruptcy estate property to be sold by a neutral party such as a trustee to repay his creditors. ER Tab 8 at 60:11 - 61:11. Based on this information and the record as a whole, the bankruptcy court did not abuse its discretion by determining that the integrity of the system was at risk and was best protected by conversion. As the court found:

> [T]his is one of those cases that almost cries out for a trustee to go through and look at everything to make sure that the system is note taken advantage of in one way or another.
>
> The integrity of the process, in my view, in the circumstances of this case requires there to be a trustee.

Id. at 54:2-8.

II. Mr. Mohsen's novel arguments in support of reversal lack merit.

Mr. Mohsen does not deny that section 1112(b)'s text explicitly establishes a best interest of the creditors test for determining whether to convert, and does not deny that courts possess broad discretion when making such a calculus. Nonetheless, he raises a number of novel theories as to why the court below could not convert his case in order to maximize creditor recoveries and ensure equitable payment of claims. None of his novel theories have merit.

A. The "plain legal prejudice" doctrine is not applicable.

Mr. Mohsen spends more than 25 pages advocating an irrelevant test for determining whether courts must convert or dismiss chapter 11 cases, arguing the bankruptcy court had to dismiss the case because it could not convert it to chapter 7 under section 1112(b) unless dismissal would result in "plain legal prejudice to creditors." Applying that test, he argues that the bankruptcy court's findings regarding: (a) discrimination among creditors, (b) difficulty of creditors in collecting debts outside of bankruptcy, (c) the incarceration of Mr. Mohsen and his inability to generate revenue to pay his debts, and (d) the integrity of the system, did not rise to "plain legal prejudice." Appellant's Opening Brief at pp. 26-52. He also contends that the bankruptcy court rested its decision on improper speculations that were not evidence. Id. at 48-49.[15]

Mr. Mohsen's "plain legal prejudice" argument is wrong for three independent reasons. First, the test has nothing to do with section 1112(b), draws no support from the text, and cannot replace the statutory test expressly set out in section 1112(b), which allows conversion whenever conversion is in the "best interest of creditors and the estate." This is a wholly different test than "plain legal prejudice." See 11 U.S.C. § 1112(b).

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[15] Mr. Mohsen argues that it was error for the bankruptcy court to convert the case based on "speculations" that he would favor his insider creditors, and that his assets may be sent to Egypt. Appellant's Opening Brief, p. 48. But these were reasonable inferences for the court to draw under the circumstances. See Leyda v. Alliedsignal, Inc., 322 F.3d 199, 208 (2nd Cir. 2003) (appellate court must accept trial court's findings of fact based on inferences from other facts unless they are clearly erroneous).

Second, it impermissibly strips bankruptcy courts of their broad discretion under section 1112(b) to determine whether to convert or dismiss. See, H. Rep. 595, 95th Cong., 1st Sess 405 (1977) (stating "Subsection (b) [of section 1112] gives wide discretion to the court to make an appropriate disposition of the case when a party in interest requests."); Toibb v. Radloff, 501 U.S. 157, 165 (1991) (the Code gives courts substantial discretion to dismiss a case where a debtor files an untenable plan of reorganization); Pioneer Liquidating Corp. v. United States Trustee (In re Consol. Pioneer Mortgage Entities), 248 B.R. 368, 375 (9th Cir. BAP 2000), aff'd sub nom. In re Consolidated Pioneer Mortgage Entities, 264 F.3d 803 (9th Cir. 2001)(A bankruptcy court is given wide discretion to convert a chapter 11 case to chapter 7 for "cause"); In re Johnston, 149 B.R. 158, 160 (9th Cir. BAP 1992) (the bankruptcy court is given wide discretion to convert a case to Chapter 7 for cause); Hedquist v. U.S. Trustee (In re Hedquist), 450 F.3d 801, 804 (8th Cir. 2006) (The bankruptcy court has broad discretion in deciding whether to dismiss a Chapter 11 bankruptcy case); In re AMC Mortg. Co., Inc., 213 F.3d 917, 920 (6th Cir. 2000) (The bankruptcy court has broad discretion to dismiss a Chapter 11 case under 11 U.S.C. § 1112(b)); In re Woodbrook Associates, 19 F.3d 312, 316 (7th Cir. 1994) (A bankruptcy court has broad discretion under 11 U.S.C. § 1112(b) to dismiss a Chapter 11 case for cause); Lumber Exch. Bldg. Ltd. P'ship. v. Mut. Life Ins. Co. (In re Lumber Exch. Bldg. Ltd. P'ship), 968 F.2d 647, 648 (8th Cir. 1992) (bankruptcy court has broad discretion in deciding whether to dismiss or convert a chapter 11 case); In re Gonic Realty Trust, 909 F.2d 624, 626-627 (1st Cir. 1990) (a court shall exercise its judgment in reaching a decision that is in the creditors' best interest); Hall v. Vance, 887 F.2d 1041, 1044 (10th Cir. 1989) (The bankruptcy court has broad discretion under § 1112(b)); Koerner v. Colonial Bank (In re Koerner), 800 F.2d 1358, 1367 (5th Cir. 1986) (Legislative history indicates that in acting upon a request for conversion, the bankruptcy court is afforded wide discretion); Albany Partners, Ltd. V. Westbrook (In re Albany Partners, Ltd.), 749 F.2d 670, 674 (11th Cir. 1984) (determination of cause under 11 U.S.C. § 1112(b) is subject to judicial discretion under the particular circumstances of each case); All Denominational New Church v. United States Trustee (In re All Denominational New Church), 268 B.R. 536, 538 (8th Cir. BAP 2001) (The bankruptcy court has "broad discretion" in deciding whether to dismiss or convert a Chapter 11 case).

Last, Mr. Mohsen's wholly inapplicable test is satisfied here in any event, as it would have produced "plain legal prejudice to creditors" to allow Mr. Mohsen to dismiss so that he could discriminate among creditors, disadvantage some, and shield estate assets that he had in Egypt.

Put simply, Mr. Mohsen's "plain legal prejudice" rule has no application in section 1112(b) cases. The doctrine as announced in International Airport Inn Partnership was a judicial gloss on section 59g of the Bankruptcy Act of 1898, which did not contain any statutory test for dismissal.[16] But section 59g of the Bankruptcy Act of 1898 was repealed 30 years ago[17] and has never governed motions to convert or dismiss in cases filed under the Bankruptcy Code – section 1112(b) governs these motions. And, it appears that conversion of that case was not an option in International Airport Inn Partnership, or ever an issue, because the bankruptcy court was not measuring whether conversion or dismissal was in the best interest of the creditors. Id., 517 F.2d at 511-12.

The United States Trustee has found only four appellate cases in this circuit that have applied the "plain legal

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[16] Section 59g of the Bankruptcy Act of 1898 provided in pertinent part:

> A voluntary or involuntary petition shall not be dismissed upon the application of the petitioner or petitioners . . . until after notice to the creditors as provided in section 94 of this title, and to that end the court shall, upon entering an application for dismissal, require the bankrupt to file a list . . . of all his creditors, with their addresses, shall cause such notice to be sent to the creditors of the pendency of such application and shall delay the hearing thereon for a reasonable time to allow all creditors and parties in interest an opportunity to be heard. . . .

[17] Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, Sec. 101 et. seq.

prejudice" doctrine under the Code, and none involve section 1112(b). See In re Ditter, 2001 WL 791733 (9th Cir. 2001)(unpublished disposition not involving section 1112(b)); In re Leach, 130 B.R. 855 (9th Cir. BAP 1991)(not involving section 1112(b)); Gill v. Hall (In re Hall), 15 B.R. 913 (9th Cir. BAP 1981)(same); In re Hickman, – B.R. –, 2008 WL 916997 (9th Cir. BAP 2008)(same). See also In re Bartee, 317 B.R. 362, 366 (9th Cir. BAP 2004)(". . . a voluntary Chapter 7 debtor is entitled to dismissal of his case so long as such dismissal will cause no 'legal prejudice' to interested parties")(citation omitted).[18]

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[18] Mr. Mohsen cites four bankruptcy court decisions that have applied the "plain legal prejudice" test to motions under section 1112(b); three of these cases are 20 years old (all authored by the same bankruptcy judge) and the fourth is 13 years old. See In re Kimble, 96 B.R. 305 (Bankr. D. Mont. 1988) (finding that the plain legal prejudice standard should be applied when determining whether to dismiss a chapter 11 case under 11 U.S.C. § 1112(b)); In re Geller, 74 B.R. 685 (Bankr. E.D. Pa. 1987); In re Smith, 77 B.R. 496 (Bankr. E.D. Pa. 1987); In re Mazzocone, 183 B.R. 402 (Bankr. E.D. Pa. 1995). No circuit court has ever ruled this way. Indeed, the decisions of Bankruptcy Judge David Scholl in the Geller, Smith and Mazzocone cases are directly contrary to the district court decision in In re Mechanical Maintenance, Inc., 128 B.R. 382 (E.D. Pa. 1991). The district court in that case criticized the use of the "plain legal prejudice" standard in connection with section 1112(b) motions as a misreading of the statute, stating that "the court was wrong to hold that a debtor's voluntary motion to dismiss is reflexively to be granted whenever cause exists but is not negated by a showing of 'plain legal prejudice' to creditors." 128 B.R. at 388.

Mr. Mohsen also cites a number of other chapter 7 cases that allegedly applied the "plain legal prejudice" standard to motions to dismiss. See In re Rajneesh Neo-Sannyas Intern. Commune, 59 B.R. 49 (Bankr. D. Ore 1986); In re Astin, 77 B.R. 537 (Bankr. W.D. Va. 1987); In re Kimball, 19 B.R. 300 (Bankr. D. Me. 1982);

B. The bankruptcy court properly considered the best interest of all creditors, not just a minority in amount.

Mr. Mohsen urges dismissal based on his view that the bankruptcy court did not give proper consideration to the creditors' "vote" based on the claims filed in the case. Appellant's Opening Brief, pp. 53-55. Mr. Mohsen essentially argues that since certain creditors did not file claims in the case, or because he disputed certain filed claims (i.e., the Internal Revenue Service (total claim of $2,393,663), the Franchise Tax Board (total claim of $4,510), Aptix Corporation (filed claim of $20,000,000) and bond forfeiture claim ($1,000,000)), then these creditors should not have any "standing" and their claims should not have been considered by the bankruptcy court in making its determination to convert or dismiss this case. Appellant's Opening Brief at 53; see also ER Tab 12, pp. 114-17. But Mr. Mohsen ignores the fact that because

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<u>In re Turboff</u>, 120 B.R. 849 (Bankr. S.D. Tex. 1990); <u>In re Klein</u>, 39 B.R. 530 (Bankr. E.D.N.Y. 1984); <u>In re Schwartz</u>, 58 B.R. 923 (Bankr. S.D.N.Y. 1986); <u>In re Turpen</u>, 244 B.R. 431 (8th Cir. BAP 2000); <u>In re Heatly</u>, 51 B.R. 518 (Bankr. E.D. Pa. 1985); <u>In re Barnes</u>, 275 B.R. 889 (Bankr. E.D. Cal. 2002); <u>In re Hull</u>, 339 B.R. 304 (Bankr. E.D.N.Y. 2006); <u>In re Sible</u>, 95 B.R. 192 (Bank. D. Mont. 1989). <u>See</u> <u>also</u> <u>In re Richmond Unified School Dist.</u>, 133 B.R. 221 (Bankr. N.D. Cal. 1991 (chapter 9 case). But these cases are inapposite because as noted above, they have nothing to do with motions to convert or dismiss under section 1112(b), which has its own standard of "best interest of creditors and the estate."

no objection was filed to these claims, they are deemed allowed under 11 U.S.C. section 502(a).[19]

In his Reconsideration Motion, Mr. Mohsen noted that fourteen creditors holding claims totaling $743,576 supported dismissal of the case. ER Tab 12, p. 115. This figure includes the claims of at least nine close friends and family members, including Aly Mohsen (his brother) who has a claim of $500,000. Id. However, Mr. Mohsen ignores the over $23 million in claims filed by the Internal Revenue Service, the United States of America (bond forfeiture claim) and Aptix Corporation in his calculation. As noted above, the evaluation of the best interest of creditors requires a bankruptcy court to consider the collective interest of all creditors, not just a numerical majority. In re Superior Siding & Window, Inc., 14 F.3d at 243. Here, Mr. Mohsen actually had only a small minority of the amount of creditors' claims that favored dismissal – the United States Trustee calculates this minority at something less than 5% of total claims filed.

C. The bankruptcy court considered the equitable issues.

Mr. Mohsen alternatively urges reversal based on his view that the bankruptcy court abused its discretion by not

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[19] A creditor in a chapter 11 case has standing to raise and appear and be heard on any issue in the case. 11 U.S.C. section 1109. Mr. Mohsen's contention that creditors with deemed allowed claims in the case do not have "standing" and should not be considered by the bankruptcy court is thus erroneous.

considering Mohsen's equitable arguments. Appellant's Opening Brief, pp. 55-56. In particular, he notes that the bankruptcy court could have taken a "wait and see" approach with respect to the IRS claim, which he contends was overstated and could have been eliminated if the final tax returns had been filed. Id. at 55. But it is clear that the bankruptcy court considered this issue. For example, Mr. Mohsen's counsel and the bankruptcy court had the following exchange:

> The Court: Mr. Levin, you want – do you want to – do you want to get all the tax returns filed, figure out what all the priority claims are and pay all of those as a condition of dismissal?
>
> Mr. Levin: My only concern with that, Your Honor, is that it is not – it's not – nothing with this debtor is simple.
>
> The Court: I appreciate that.
>
> Mr. Levin: And it's not just a matter of filing some returns. There were some – there were – there was a transaction in 2001 which is probably going to end up in the tax court. And I don't – and my concern is it would just add another layer of expense to keep the Chapter 11 case open while this tax controversy is decided.

ER Tab 11 at 103:12-24.

Mr. Mohsen is also wrong when he asserts that the chapter 7 trustee lacked incentive to file the tax returns. Appellant's Opening Brief, p. 55. His argument seems to be that since the chapter 7 trustee's compensation base does not include payments to estate professionals, there is no incentive for the trustee to hire an accountant to prepare the tax returns, and thus she would simply pay everything to the IRS. Appellant's Opening Brief, pp. 13:8 - 14:2, 55. But this misstates the law. Disbursements on which a trustee's compensation are based include disbursements to administrative claimants, such as attorneys and accountants. In re Vona, 333 B.R. 191 (Bankr. E.D.N.Y. 2005); In re Nardelli, 327 B.R. 488 (Bankr. M.D. Fla. 2005); In re Orient River Inv., 133 B.R. 729 (Bankr. E.D. Pa. 1991).[20] Thus, the trustee would receive the same compensation regardless of whether she disburses the funds to creditors or to professionals or to a combination of the two.

More importantly, however, the trustee is a representative of the estate and has a fiduciary duty to maximize assets available to creditors and the estate. See, 11 U.S.C. §§ 321 and 323(a). Failure to fulfill the fiduciary duty may subject the trustee to liability. See Fed. R. Bankr. P. 2010. Thus, Mr. Mohsen's argument that the fee structure acts as a disincentive for the trustee to reduce the tax claims is without merit.

Similarly, his premise that the unsecured creditors are prejudiced because the IRS may get paid ahead of them is misplaced. See 11 U.S.C. §§ 507, 726 (giving IRS and other tax claims priority in payment over Mr. Mohsen's friends' and

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[20] But see In re Testaverde, 317 B.R. 51, 54 (E.D.N.Y. 2004) (finding that a trustee's attorney is not a "party in interest," thus payments made to the attorney cannot be included in computing the trustee's compensation).

family's unsecured claims). The Bankruptcy Code describes and mandates the treatment and priority of claims to be paid in the case. If the IRS has an allowed claim that is entitled to priority over unsecured claims, then so be it. This is not prejudice, this is simply Bankruptcy Code priority. Further, Mr. Mohsen has stated that he wants to pay all of his creditors in full. See, e.g., ER Tab 20 at 163:1-7. But nothing prevents him from voluntarily paying his brother and his friends after he receives his chapter 7 discharge, if he so chooses; he can pay from exempt assets or post-conversion income.[21]

Finally, it is clear that the bankruptcy court considered the equities of the case when it expressed concern that Mohsen was attempting to reverse the Bankruptcy Code priorities by getting the case dismissed so that he could pay insiders and other unsecured creditors ahead of the IRS:

> ". . . we just reverse the priorities. We say: Well, if the case stays here then it's the priority claims that get paid and the IRS, if they're owed money, because they have a priority over the unsecured. And if it's dismissed, then it's the unsecureds that get some money and the IRS and the priority creditors don't get anything." ER Tab 11 at 101:11-17.

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[21] Mr. Mohsen also argues that after dismissal, the IRS can commence an involuntary bankruptcy against him, or pursue state court remedies to collect its debt. Appellant's Opening Brief, p. 56:11-13. However, this ignores the fact that there is a remedy for the IRS and other creditors to collect their debts that is already in place – the converted chapter 7 case. Further, this appears to be a rehash of the erroneous "plain legal prejudice" arguments made by Mr. Mohsen. See Appellant's Opening Brief, pp. 27-40.

III. The bankruptcy court did not abuse its discretion in denying Mr. Mohsen's motion for reconsideration.

Before the Bankruptcy Appellate Panel of the Ninth Circuit, Mr. Mohsen did not brief or address the bankruptcy court's denial of his motion for reconsideration; citing U.S. v. Montoya, 45 F.3d 1286, 1300 (9th Cir. 1995), the appellate panel noted the issue was "technically waived". ER Tab 5, p. 43. Nonetheless, since Mr. Mohsen was without counsel, the panel addressed the Reconsideration Motion and found that the bankruptcy court did not abuse its discretion by considering the District Court's November 5, 2003 order, since it was a public record of which the bankruptcy court could properly take judicial notice. Id. at 44:3-7. The panel also ruled that Mr. Mohsen's other primary argument before the bankruptcy court – that the bankruptcy court had misapplied the law by discounting the creditors' support for dismissal – was "more than a little tendentious" since he had excluded from consideration the large claims of the Internal Revenue Service ($2.3 million), another federal government claim (the $1 million bond forfeiture claim) and Aptix Corporation ($20 million, but mistakenly listed at $2 million in the panel's decision). Id. at 44:8-21. The panel concluded by stating: "Mohsen's arguments do not meet the standards for reconsideration in any case: there was no newly-discovered evidence, nor any manifest error of law or fact." Id. at 44:22-24.

A. <u>**There were no manifest errors of fact**</u>.

Before this Court, Mr. Mohsen alleges the following three manifest errors of fact resulted in conversion rather than dismissal:

1. The bankruptcy court erroneously referred to "the detriment of the <u>creditors</u>" when only one creditor, Quickturn Design Systems, was named in the District Court order referred to by the bankruptcy court;

2. The bankruptcy court misinterpreted Judge Alsup's order relating to Aptix and failed to recognize that the monetary transactions described by Judge Alsup relating to Aptix (". . . [moving] cash in and out of the corporation to and from [Mr. Mohsen]. Aptix and Dr. Mohsen pay only the creditors they choose, while attempting to immunize assets from all other creditors") were not wrongful or fraudulent; and

3. The bankruptcy court inaccurately referred to a finding by Judge Alsup regarding the subordination of Mr. Mohsen's security interest granted by Aptix. Appellant's Opening Brief, pp. 57-58.

However, Mr. Mohsen failed to properly raise these points as manifest errors of fact before the bankruptcy court, and cannot now raise them before this Court; they have been waived. <u>In re America West Airlines, Inc.</u>, 217 F.3d 1161, 1165 (9th Cir. 2000)(absent exceptional circumstances, appellate court will generally not consider arguments raised for the first time on appeal, although it has discretion to do so).

Further, even if these issues were raised below, the bankruptcy court did not commit error, much less manifest error. Judge Alsup's order did not form the foundation of the bankruptcy court's ruling; at most, the court below used it to buttress its ruling that dismissal could result in a select group of insiders being paid, while other creditors received nothing.

Alternatively, the court below did not commit reversible error by using the plural form of the word "creditor." Appellant's Opening Brief at 57:16 - 58:4. The District Court had referred to the arrangement where "Aptix and Dr. Mohsen pay only the <u>creditors</u> they choose, while attempting to immunize assets from all other <u>creditors</u>." ER Tab 13, p. 124:19-20 (emphasis added). Nor did the bankruptcy court commit error by considering or referring to the District Court's order; as the appellate panel noted, that order is public record and the bankruptcy court could properly take judicial notice of it. ER Tab 5 at 44:3-7. Mr. Mohsen appears to want to re-litigate the merits of Judge Alsup's order. But that order is final and unappealable and the bankruptcy court had a right to take judicial notice of it.

B. There were no manifest errors of law.

Mr. Mohsen alleges that the bankruptcy court made the following two manifest errors of law, and each is meritless:

1. The bankruptcy court applied the wrong legal standard in deciding to convert rather than dismiss this case; and

2. The bankruptcy court did not properly consider the "vote" of the creditors. Appellant's Opening Brief, pp. 59-60.

Both of these arguments were raised in connection with the original motions to convert or dismiss. However, in his Reconsideration Motion, Mr. Mohsen did not raise the issue of whether the bankruptcy court erred by using the proper legal standard ("best interest of creditors and the estate") instead of the erroneous "plain legal prejudice" standard urged by Mr. Mohsen. Accordingly, that issue has been waived in connection with the motion for reconsideration. In re America West Airlines, Inc., 217 F.3d at 1165. And even if it had been raised, the bankruptcy court did not commit error, because the proper legal standard for determining whether the case should be converted or dismissed pursuant to section 1112(b) is which remedy is in the best interest of the creditors and the estate. See Section II.A. above.

Further, in deciding to convert this case to chapter 7, the bankruptcy court considered the interest of all the creditors, not just those preferred by Mr. Mohsen. In re Superior Siding & Window, Inc., 14 F.3d at 243.

C. There was no manifest injustice.

Finally, Mr. Mohsen alleges the bankruptcy court did not consider the manifest injustice to the "confirmed" unsecured creditors, the estate and himself, which he alleges outweighed any prejudice to the IRS. Appellant's Opening Brief, p. 60. But this argument presumes that the IRS is not a creditor, despite the fact that it has filed a claim in the amount of $2,393,363, to which no objection was ever filed by Mr. Mohsen. ER Tab 23, p. 190. And the bankruptcy court was properly concerned about the claims of creditors other than the insiders, friends and others who "voted" for dismissal:

> "But I think that it's important that somebody independent like a chapter 7 trustee take a look at it, that there be basically a fair shake for all the creditors as to who gets paid or who doesn't get paid out of whatever the trustee develops." ER Tab 11, 107:13-17.

In fact, the bankruptcy court converted the case to prevent any injustice and to ensure equality of distribution according to the priorities set forth in the Bankruptcy Code.

Conclusion

For these reasons, the United States Trustee respectfully asks this Court to affirm the bankruptcy appellate panel's order affirming the bankruptcy court's December 22, 2005 order converting Mr. Mohsen’s case to chapter 7, and affirming the bankruptcy court’s March 22, 2006 order denying reconsideration.

Respectfully submitted,

ROBERTA A. DEANGELIS
Acting General Counsel
P. MATTHEW SUTKO
Associate General Counsel
WALTER THEUS
Office of the General Counsel
Executive Office for U.S. Trustees
U.S. Department of Justice
20 Massachusetts Ave., N.W.
Suite 8100
Washington, D.C. 20530

JOHN S. WESOLOWSKI, CA Bar #127007
Office of the U.S. Trustee
U.S. Department of justice
280 S. First Street, Suite 268
San Jose, CA 95113

By:______________________________
John S. Wesolowski
Attorney for United States
Trustee

ADDENDUM

11 U.S.C. § 1112

Sec. 1112. Conversion or dismissal

(a) The debtor may convert a case under this chapter to a case under chapter 7 of this title unless –

- (1) the debtor is not a debtor in possession
- (2) the case originally was commenced as an involuntary case under this chapter; or
- (3) the case was converted to a case under this chapter other than on the debtor's request.

(b) Except as provided in subsection (c) of this section, on request of a party in interest or the United States trustee or bankruptcy administrator, and after notice and a hearing, the court may convert a case under this chapter to a case under chapter 7 of this title or may dismiss a case under this chapter, whichever is in the best interest of creditors and the estate, for cause, including –

- (1) continuing loss to or diminution of the estate and absence of a reasonable likelihood of rehabilitation;
- (2) inability to effectuate a plan
- (3) unreasonable delay by the debtor that is prejudicial to creditors;
- (4) failure to propose a plan under section 1121 of this title within any time fixed by the court;
- (5) denial of confirmation of every proposed plan and denial of a request made for additional time for filing another plan or a modification of a plan;
- (6) revocation of an order of confirmation under section 1144 of this title, and denial of confirmation of another plan or a modified plan under section 1129 of this title;
- (7) inability to effectuate substantial consummation of a confirmed plan;
- (8) material default by the debtor with respect to a confirmed plan;
- (9) termination of a plan by reason of the occurrence of a condition specified in the plan; or
- (10) nonpayment of any fees or charges required under chapter 123 of title 28.

(c) The court may not convert a case under this chapter to a case under chapter 7 or this title if the debtor is a farmer or a corporation that is not a moneyed, business, or commercial corporation, unless the debtor requests such conversion.

(d) The court may convert a case under this chapter to a case under chapter 12 or 13 of this title only if –
  (1) the debtor requests such conversion
  (2) the debtor has not been discharged under section 1141(d) of this title; and
  (3) if the debtor requests conversion to chapter 12 of this title, such conversion is equitable.

(e) Except as provided in subsections (c) and (f), the court, on request of the United State trustee, may convert a case under this chapter to a case under chapter 7 of this title or may dismiss a case under this chapter, whichever is in the best interest of creditors and the estate if the debtor in a voluntary case fails to file, within fifteen days after the filing of the petition commencing such case or such additional time as the court may allow, the information required by paragraph (1) of section 521, including a list containing the names and addresses of the holders of the twenty largest unsecured claims (or of all unsecured claims if there are fewer than twenty unsecured claims), and the approximate dollar amounts of each of such claims.

(f) Notwithstanding any other provision of this section, a case may not be converted to a case under another chapter of this title unless the debtor may be a debtor under such chapter.

Certificate of Compliance

Pursuant to Fed. R. App. P. 32(a)(7)(c) and Ninth Circuit Rule 32-1, I hereby certify that the foregoing brief is monospaced (in Courier New, 12 point font), has 10.5 or fewer characters per inch, and contains 11,116 words, according to the count of Corel Wordperfect 12.

John S. Wesolowski

Certificate of Service

I hereby certify that on this 27th day of May, 2008, I filed and served the foregoing Brief for Appellee and the accompanying Appellee’s Supplemental Excerpts of Record by causing an original and fifteen copies of the brief and five copies of the excerpts to be sent to the Clerk of this Court by Federal Express, and by causing two copies of the brief and a copy of the excerpts to be sent by Federal Express or first class mail (as indicated below) to:

Amr Mohsen
U.S. Penitentiary, No. 92949-011
3901 Klein Boulevard
Lompoc, CA 93436
(via federal express)

Amr Mohsen
Federal Correction Institution, No. 92949-011
P.O. Box 9000
Safford, AZ 85548
(via first class mail)

Carol Wu, Chapter 7 trustee
c/o Dennis D. Davis, Esq.
Goldberg, Stinnett, Davis & Linchey
44 Montgomery Street, Suite 2900
San Francisco, CA 94104
(via federal express)

Lynne C. Knight

STATEMENT OF RELATED CASES

Counsel for appellee are not aware of any prior or related appeals.

BRIEF BANK — "SUMMARY SHEET" *Printed Fri-12/19/08 9:28*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	In re: Moutousis (Moutousis v. McDermott)
2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	E.D. Mich.
3. ("CCN") ***CURRENT*** CASE NO.	No.: 08-cv-14268
4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*	No.: 08-50700 Court: Bankr. E.D. Mich. *(Identify judge & cite, if any)*
5. ("SO") ***SOURCE***	**U.S. TRUSTEES**
6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	Filed: December 17, 2008 Type: Appellee's Response Brief on Appeal
7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*	Jill Gies, Saleela Salahuddin, P. Matthew Sutko, Daniel McDermott *(UST/OGC: 202-307-1399/FAX-2397)*
8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	• Whether the bankruptcy court abused its discretion by dismissing the Debtor's chapter 7 petition under 11 U.S.C. § 707 (b)(3)(B), which allows courts to dismiss chapter 7 petitions when the totality of the circumstances of a debtor's financial situation demonstrates abuse.
10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)	
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UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF MICHIGAN

In re: **PHILLIP MOUTOUSIS,** **FAYE MOUTOUSIS** Debtors. _____________________________________/	Bankruptcy Case No. 08-50700-SWR Chapter 7 HON. STEVEN W. RHODES
PHILLIP MOUTOUSIS, **FAYE MOUTOUSIS** Appellants. vs. **DANIEL M. McDERMOTT,** **UNITED STATES TRUSTEE,** Appellee. _____________________________________/	Civil Case No.08-CV-14268 HON. STEPHEN J. MURPHY

APPELLEE'S RESPONSE BRIEF ON APPEAL

Jill M. Gies (P56345)
Trial Attorney
Office of the United States Trustee
Department of Justice
211 West Fort Street - Suite 700
Detroit, Michigan 48226
Jill.M.Gies@usdoj.gov
(313) 226-7913

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UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF MICHIGAN

In re:	Bankruptcy Case No. 08-50700-SWR Chapter 7 HON. STEVEN W. RHODES
PHILLIP MOUTOUSIS, **FAYE MOUTOUSIS**	
Debtors.	
_______________________________________/	
PHILLIP MOUTOUSIS, **FAYE MOUTOUSIS**	Civil Case No.08-CV-14268 HON. STEPHEN J. MURPHY
Appellants.	
vs.	
DANIEL M. McDERMOTT, **UNITED STATES TRUSTEE,**	
Appellee.	
_______________________________________/	

APPELLEE'S RESPONSE BRIEF

JURISDICTIONAL STATEMENT

The bankruptcy court had jurisdiction under 28 U.S.C. §§ 157 (a) and (b), and 1334(a) to issue its final order granting the United States Trustee's motion to dismiss the Debtors' chapter 7 bankruptcy case. The bankruptcy court entered this order, which also gave the Debtors the option to file a motion to convert their case to a chapter 13 proceeding, on September 26, 2008. The Debtors filed a notice of appeal, which is timely under 28 U.S.C. §§ 158(a) and (c)(2), on October 5, 2008. This Court has appellate jurisdiction under 28 U.S.C. § 158(a)(1), a statutory provision under which district courts have jurisdiction to hear appeals from final judgments, orders, and decrees of bankruptcy judges.

STATEMENT OF THE ISSUE

Whether the bankruptcy court abused its discretion by dismissing the Debtors' chapter 7 petition under 11 U.S.C. § 707(b)(3)(B), which allows courts to dismiss chapter 7 petitions when the totality of the circumstances of a debtor's financial situation demonstrates abuse.

STANDARD OF REVIEW

In an appeal taken from a bankruptcy court order, a district court reviews a bankruptcy court's conclusions of law *de novo* and its findings of fact for clear error. *See In re Holland*, 151 F.3d 547, 548 (6th Cir. 1998); Fed. R. Bankr. P. 8013 ("[the bankruptcy court's] [f]indings of fact, whether based on oral or documentary evidence, shall not be set aside unless clearly erroneous"). The bankruptcy court's holding that the Debtors' case should be dismissed for abuse based on the totality of the circumstances of the Debtors' financial situation under 11 U.S.C. § 707(b)(3)(B) is subject to review on appeal for abuse of discretion. *See In re DSC, Ltd.*, 486 F.3d 940, 944 (6th Cir. 2007) (stating "[d]ismissal of a bankruptcy case is reviewed for abuse of discretion"). "A bankruptcy court abuses its discretion when 'it relies upon clearly erroneous findings of fact or when it improperly applies the law or uses an erroneous legal standard.'" *Riverview Trenton R.R. Co. v. DSC, Ltd. (In re DSC)*, 486 F.3d 940, 944 (6th Cir. 2007) (quoting *In re Eastown Auto Co.*, 215 B.R. 960, 963 (B.A.P. 6th Cir. 1998)). The burden of proof is on the party that seeks to reverse the bankruptcy court's holding. *See In re Lewis*, 392 B.R. 308, 311 (E.D. Mich. 2008).

STATEMENT OF THE CASE

On April 30, 2008, the Debtors filed a voluntary bankruptcy petition under chapter 7 of the Bankruptcy Code, 11 U.S.C. § 701 *et seq*. On June 4, 2008, the United States Trustee[1] filed a motion to dismiss the Debtors' petition on the grounds that the totality of the Debtors' financial circumstances demonstrates abuse under 11 U.S.C. § 707(b)(3) because the Debtors have sufficient means to repay their unsecured debts. Granting the motion to dismiss, the bankruptcy court agreed with the United States Trustee and found abuse under section 707(b)(3). In its order, the bankruptcy court also gave the Debtors the opportunity to file a motion to convert their case to a chapter 13, as section 707(b)(1) allows it to do. The Debtors did not move to convert. Instead, they appealed the dismissal order to this Court.

STATEMENT OF THE FACTS

I. Statutory Background

The Bankruptcy Code establishes two primary forms of bankruptcy for individual debtors – chapter 7 and chapter 13. Under chapter 7, "an individual debtor receives an immediate unconditional discharge of personal liability for certain debts in exchange for relinquishing his or her nonexempt assets to a bankruptcy trustee for liquidation and distribution to creditors." H.R. Rep. 109-31(I), at 10; *see* 11 U.S.C. §§ 701-727. Under chapter 13, "a debtor commits to repay some portion of his or her financial obligations" over a specified period "in exchange for retaining

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[1] United States Trustees "serve as bankruptcy watch-dogs to prevent fraud, dishonesty, and overreaching in the bankruptcy arena." H.R. Rep. No. 95-595, at 88 (1977). The United States Trustee Program therefore acts in the public interest to promote and preserve the efficiency and integrity of the bankruptcy system. Congress has provided that "[t]he United States trustee may raise and may appear and be heard on any issue in any case or proceeding . . . ." 11 U.S.C. § 307. *See Thompson v. Greenwood*, 507 F.3d 416, n.3 (6th Cir. 2007) (stating "[t]he United States Trustee is an interested party by statute").

nonexempt assets and receiving a broader discharge of debt than is available under chapter 7." H.R. Rep. 109-31(I), at 10; *see* 11 U.S.C. §§ 1321-1330.

The difference between chapter 7 and 13 is dramatic. In chapter 7 cases, creditors may look solely to debtors' pre-bankruptcy, non-exempt assets for payment. *See* 11 U.S.C. § 541 (limiting property of the estate to a debtor's pre-petition debts). Debtors' post-bankruptcy income is not subject to creditor claims. *Id*. Subject to narrow exceptions, debtors receive a complete discharge of all their pre-petition debts in a chapter 7 proceeding. *See* 11 U.S.C. § 727(b). In roughly 96% of chapter 7 cases, unsecured creditors receive no payment. *See, e.g.*, Brief of the United States in *Lamie v. United States Trustee*, 2003 WL 21839367 at *38 (2003).

Chapter 13 is different because debtors must use post-petition income to fund a chapter 13 payment plan. *See* 11 U.S.C. § 1306(a)(2) (property of the bankruptcy estate also includes post-petition income); 11 U.S.C. § 1325 (concerns chapter 13 repayment plans). In chapter 13, debtors receive a discharge only after they have fully completed their chapter 13 repayment plans. *See* 11 U.S.C. §§ 1328(a) and (c); *see also* 11 U.S.C. § 1328(b) (listing exceptions to this rule).

Since 1984, Congress has enacted a series of tests that have allowed courts to dismiss chapter 7 cases, and thereby prevent unjust discharge of pre-petition debts. In 1984, Congress amended chapter 7 to permit dismissal of a chapter 7 bankruptcy petition under section 707(b) if a court found "substantial abuse." Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, § 312, 98 Stat. 333, 335. Congress enacted this amendment to respond "to concerns that some debtors who could easily pay their creditors might resort to chapter 7 to avoid their obligations." H.R. Rep. 109-31(I), at 12 (internal quotation omitted). Two years later, Congress again amended this provision to authorize the United States Trustee to seek dismissal of chapter 7 petitions for "substantial abuse." Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1986, Pub. L. No. 99-554, § 21, 100 Stat. 3088, 3101.

After twenty-years' experience, Congress found that these amendments were insufficient to control abuse of chapter 7. Congress identified, among other problems, the "inherent[] vague[ness]" of the "substantial abuse" standard, which led to disagreement in the courts about whether a debtor's ability to repay[2] a significant portion of his or her debts out of future income constitutes substantial abuse, meriting dismissal. H.R. Rep. 109-31(I), at 12. Another problem was that the Bankruptcy Code established "a presumption in favor of granting the relief requested by the debtor," which influenced courts' decisions whether to find substantial abuse. 11 U.S.C. § 707(b) (2000 suppl. 4); *See* H.R. Rep. 109-31(I), at 12.

Responding to these perceived shortcomings of the Bankruptcy Code, Congress held hearings over five years to identify what reforms it could adopt "to ensure that debtors repay creditors the maximum they can afford." H.R. Rep. 109-31(I), at 2; *See Id.* at 12. The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (the "2005 Act"), S. 256, Pub. L. No. 109-8, 119 Stat. 23, implemented the reforms Congress identified in four ways.

First, Congress repealed the statutory presumption in favor of granting relief to the debtor. *Compare* 11 U.S.C. § 707(b)(1986) *with* 11 U.S.C. § 707(b)(2005).

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[2] In evaluating whether substantial abuse existed, courts jointly considered both the debtor's conduct and the debtor's ability to pay his debts outside bankruptcy or through a chapter 13 repayment plan. *See, e.g., In re Stewart*, 175 F.3d 796 (10th Cir. 1999); *In re Lamanna*, 153 F.3d 1 (1st Cir. 1998); *In re Krohn*, 886 F.2d 123 (6th Cir. 1989); *In re Kelly*, 841 F.2d 908, 915 (9th Cir. 1988). Most courts recognized that a debtor's ability to pay a portion of his debt was the predominant factor when determining whether to dismiss a chapter 7 case. *Id.*

Second, Congress lowered the standard for dismissal under all subsections of new section 707(b) from "substantial abuse" to mere "abuse." *See* 11 U.S.C. § 707(b)(1) (cases are now dismissed for "abuse"); 11 U.S.C. § 707(b)(2) (subjecting cases to dismissal for abuse); 11 U.S.C. § 707(b)(3) (same). To address the vagueness of the "substantial abuse" standard, the 2005 Act authorizes the bankruptcy court to dismiss a petition filed under chapter 7 or, with the debtor's consent, to convert such a petition to a case under chapter 11 or 13 "if it finds that the granting of relief would be an abuse of the provisions of this chapter." 11 U.S.C. § 707(b)(1).

Third, Congress authorized dismissal when a mathematical formula, known as the "means test," yields monthly disposable income that exceeds a statutory threshold. *See* 11 U.S.C. § 707(b)(2). The 2005 Act provides specific criteria which, if satisfied, require a court to presume the existence of abuse, requiring "dismissal [or conversion to chapter 13] based on a chapter 7 debtor's ability to repay." H.R. Rep. 109-31(I), at 15. To determine if abuse exists, a court first compares the debtor's annualized "current monthly income" to the "median family income" of a similarly-sized family in the debtor's state. If the debtor's current monthly income is below the median, then the presumption of abuse does not arise. 11 U.S.C. § 707(b)(7); *see* H.R. Rep. 109-31(I), at 15. Section 707(b)(2), as originally enacted, requires debtors to file a statement of current monthly income and other calculations disclosing whether a presumption of abuse arises. *See* 11 U.S.C. §§ 521(a)(1)(B)(ii), 707(b)(2)(C); Fed. R. Bankr. P. 1007(b)(1)(B). Where a debtor's monthly disposable income meets or exceeds the statutory threshold amount, this triggers a presumption of abuse, and the debtor's case must be dismissed (or converted, if the debtor consents, to chapter 13), absent an express showing of special circumstances by the debtor. *See* 11 U.S.C. § 707(b)(1) and (2).

Fourth, Congress enacted new section 707(b)(3). This section allows courts to dismiss cases based upon either a debtor's bad faith, 11 U.S.C. § 707(b)(3)(A), or the totality of a debtor's financial circumstances, 11 U.S.C. § 707(b)(3)(B). Even if the presumption of abuse does not arise or is rebutted under section 707(b)(2), a chapter 7 petition may be dismissed for abuse under section 707(b)(3), which requires the bankruptcy court to consider whether "the totality of the circumstances. . .of the debtor's financial situation demonstrates abuse." *Id.* § 707(b)(3)(B).

Sections 707(b)(3)(A) and (B) of the 2005 Act represent a significant departure from old section 707(b) because they clarify that cases can be dismissed either solely for misconduct, under section 707(b)(3)(A), or solely based upon the totality of the circumstances of a debtor's financial situation, under section 707(b)(3)(B). *See, e.g.*, *In re Henebury*, 361 B.R. 595, 607 (Bankr. S.D. Fla. 2007) (By bifurcating sections 707(b)(3)(A) and (B), "the debtor's total financial situation as a measure of ability to pay, and bad faith are separate and sufficient grounds for dismissal. Either ability to pay or bad conduct in connection with the bankruptcy will warrant dismissal for abuse under §707(b)(3).").

II. Factual and Procedural Background

The Debtors, Phillip and Faye Moutousis, are married and filed their voluntary chapter 7 bankruptcy petition with the United States Bankruptcy Court for the Eastern District of Michigan on April 30, 2008. The Debtors have two adult dependents who are eighteen and twenty-one-years-old, respectively. *See* Schedule I. Mr. Moutousis is an engineer. *Id.* He has worked for the same employer for more than thirteen years. *Id*. Mr. Moutousis' annual gross income, between 2006 and 2007, grew from $89,744.00 annually to $104,411.00 annually. Statement of Fin. Affairs at No. 1. Mr. Moutousis' current monthly gross wages listed in his bankruptcy papers are $9,943.33, so his annualized base gross salary would be approximately $120,000. Schedule I.

Mrs. Moutousis does not work. *Id*. The Debtors make a voluntary monthly 401(k) contribution and a monthly 401(k) loan repayment. *Id*. The Debtors lease two cars and maintain a third car for their adult son. Schedules B and G. The Debtors listed credit card, and related unsecured debt, of $162,810.05. Schedule F. The Debtors owe money on seven different revolving charge accounts: a Citibank card, a Citibank/Sears card, a Citibank USA card, an HSBC/Art Van card, a Lowes card, a Sears and Best Buy card, and another Sears card. *Id*. The Debtors owe more than one thousand dollars on each of these cards, with the highest amount owed on a single card being $34,288.00. *Id*.

The Debtors claim all their household furnishings, electronics, jewelry, and other personal property is worth only $9,462.00. Schedule B.

The Debtors live in Sterling Heights, Michigan (Macomb County). Schedule A. The Debtors' Schedule A indicates an estimated market value for their home to be $365,900. Schedule A. However, the Debtors state that "the true market value of the property, although difficult to determine, is substantially less . . . ." Appellants' Br. at 6. The Debtors have home mortgages totaling $346,461, which includes a fifteen-year fixed first mortgage and a home equity line of credit. *Id*. The Debtors' aggregate monthly mortgage payments are $3,213.15. *Id*.; Schedule J.

According to local mortgage standards for Macomb County, Michigan, which are based on IRS collection financial standards derived from the U.S. Census Bureau and Bureau of Labor Statistics data, the Debtors' mortgage amount is more than three times the applicable IRS housing standard of $1,097 for a family of four residing in Macomb County, Michigan. *See* U.S. Trustee Program, "Bankruptcy Allowable Living Expenses," http://www.usdoj.gov/ust/eo/bapcpa/20080317/bci_data/housing_charts/irs_housing_charts_MI.htm.

The Debtors' monthly mortgage amount of $3,213.15 is also more than twice the median monthly housing costs for households in Macomb County of approximately $1,401. *See* U.S. Census Bureau, "Macomb County, Michigan," http://factfinder.census.gov/home/saff/main.html?_lang=en.

On June 4, 2008, the United States Trustee filed a motion to dismiss the Debtors' petition as an abuse of chapter 7 under 11 U.S.C. § 707(b)(1) and (b)(3)(B). *See* United States Trustee Mot. To Dismiss at 1-2. The United States Trustee argued that the totality of the Debtors' financial circumstances demonstrates abuse. The United States Trustee alleged that the totality of the Debtors' financial circumstances reveal they had the ability to repay their debts. The United States Trustee argued that the Debtors' income deductions for retirement contributions and a retirement loan repayment associated with their 401(k) should be considered disposable income available for loan repayment. *Id*. at 3. The United States Trustee also argued that the Debtors' housing costs, which included mortgage payments, property taxes, and insurance and association dues, are excessive and unreasonable, especially considering the Debtors' mortgaged property is undersecured and only subject to a fifteen-year mortgage term, rather than to a conventional thirty-year mortgage term with a corresponding lower monthly payment. The United States argued that, even if the

Debtors found replacement housing of $2,194, an amount equivalent to twice the county median under the IRS standards, this would result in monthly expenses of $3,882.27 and net disposable income of $936.81, which would enable the Debtors to pay their unsecured creditors. *Id.*

At the initial hearing on the motion, conducted on July 21, 2008, the United States Trustee argued that the Debtors have three potential sources of funding from which to pay a meaningful portion of their unsecured debts. First, the Debtors received a tax refund in 2007 of $8,851, an amount that suggests the Debtors were over-withholding, and an appropriate adjustment would make approximately $700 per month available for unsecured debt repayment. July 21, 2008 Hr'g Tr. 2:22-25. Second, the Debtors could pare back their voluntary 401(k) contributions for a while, which would allow them to pay at least $500 per month to help satisfy their debts. *Id.* at 3:2-11. Finally, the Debtors' housing cost were excessive, and with replacement housing of even twice the IRS standard, the Debtors could reconfigure their budget to make approximately $936.00 per month available for unsecured debt repayment. *Id.* at 3:12-22.

After the parties submitted briefs, the bankruptcy court held a second hearing on September 15, 2008. At the end of the hearing, the bankruptcy court, issued an oral opinion granting the United States Trustee's motion to dismiss the Debtors' chapter 7 case, finding the totality of the circumstances of the Debtors' financial situation demonstrated abuse under 11 U.S.C. § 707(b)(3). Sept. 15, 2008 Hr'g Tr. 7:11-25; 8:1-4. The bankruptcy court also granted a request by counsel for the Debtors to have the option to convert their case to chapter 13. *Id.* at 8:11-13. In granting the motion, the bankruptcy court agreed with the United States Trustee that the Debtors made "a choice to incur expenses for housing that is not fair to their creditors" and that their housing expenses were excessive and not reasonably necessary for their support. *Id*. 7:16-17. The bankruptcy court concluded that if the Debtors were to pay "a reasonable amount for their housing[,]" they would have "substantial money left over each month" to pay their unsecured creditors. *Id*. at 7:23-25; 8:1-4. On September 26, 2008, the bankruptcy court issued its order granting the United States Trustee's motion. Sept. 26, 2008 Order Granting United States Trustee Mot. To Dismiss. Pursuant to 28 U.S.C. § 158(a), the Debtors timely filed a notice of appeal to this Court.

SUMMARY OF THE ARGUMENT

The bankruptcy court's dismissal of the Debtors' chapter 7 petition, which also gave the Debtors the opportunity to convert their case to chapter 13, should be affirmed on the ground that the bankruptcy court did not abuse its discretion in finding abuse under section 707(b)(3)'s "totality of the circumstances" inquiry. There are three supporting reasons for affirming the bankruptcy court's dismissal. **First**, the bankruptcy court properly applied the statutory framework of new section 707(b)(3)(B) when it found that the totality of the circumstances of the Debtors' financial situation demonstrated abuse since the Debtors have the financial ability to repay a portion of their unsecured debts. The Debtors' challenges to the bankruptcy court's dismissal are premised upon an incorrect understanding of the relevant statutory provisions and case law. **Second**, the bankruptcy court did not need to rely on non-financial *Krohn* factors. The Debtors incorrectly characterize the *Krohn* analysis before this Court, and do not bring to this Court's attention that, even under *Krohn's* analysis of old, superceded, section 707(b), a debtor's ability to repay debt, by itself, was sufficient to warrant dismissal. The Debtors also fail to recognize that *Krohn* was superceded by statute with the enactment of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005. **Finally**, the bankruptcy court did not abuse its discretion by ruling without first conducting an evidentiary hearing because there were no disputed material factual issues surrounding the Debtors' ability to repay their unsecured debts. Federal Rule of Bankruptcy Procedure 9014(d) requires an evidentiary hearing only where there are disputed issues of material fact. In this case, the bankruptcy court relied upon financial data the Debtors submitted under penalty of perjury. The Debtors' data established the Debtors' income, assets, and debts, which the bankruptcy court relied upon. In summary, the bankruptcy court correctly concluded, based on an undisputed factual record and two separate motion hearings, that, because the totality of the Debtors' financial situation demonstrates that they have an ability to repay their unsecured debts, granting relief would be an abuse of chapter 7.

ARGUMENT

I. The Bankruptcy Court Did Not Abuse Its Discretion in Dismissing the Debtors' Chapter 7 Petition Based on the "Totality of the Circumstances" under Section 707(b)(3)(B).

A. The Bankruptcy Court Properly Applied the Statutory Framework of New Section 707(b)(3)(b) When it Found That the Totality of the Circumstances of the Debtors' Financial Situation Demonstrated Abuse Because the Debtors Have an Ability To Repay Their Unsecured Debts.

1.

To determine whether providing chapter 7 relief to a debtor constitutes abuse under 11 U.S.C. § 707(b)(3)(B), a bankruptcy court can consider only the "totality of the circumstances" of the debtor's "financial situation." *See* 11 U.S.C. § 707(b)(3)(B). Under this new Bankruptcy Code section, a bankruptcy court should "take into consideration a debtor's *actual* income and expenses" when determining whether to dismiss a debtor's case for abuse under section 707(b)(3)(B)'s "totality of circumstances" test. *Ross-Tousey v. Neary (In re Ross-Tousey)*, No. 07-2503 at 27, available at http://www.ca7.uscourts.gov/tmp/JC0OP5E3.pdf (7th Cir. Dec. 17, 2008) (citing *In re Zaporski*, 366 B.R. 758, 768 (Bankr. E.D. Mich. 2007)) (emphasis added).

In this case, the bankruptcy court did not abuse its discretion in applying section 707(b)(3)(B)'s financial circumstances test. Applying it, the court ruled that the totality of the circumstances of the Debtors' financial situation meant it would be an abuse of the bankruptcy system to grant the Debtors chapter 7 relief because the Debtors have an ability to repay their unsecured debts. Sept. 15, 2008 Hr'g Tr. 7:23-25. The bankruptcy court correctly applied the law. The bankruptcy court's holding is supported by substantial evidence in the record. Given that, the bankruptcy court's order merits affirmance.

Both the written and oral record provide a basis for the bankruptcy court's conclusion that the Debtors have an ability to repay their unsecured debts under the financial circumstances test. Indeed, but for their choice to maintain a home that requires abnormally high monthly mortgage payments on an undersecured property, and their choice to do this under an accelerated fifteen-year mortgage, the Debtors can make substantial payments to their creditors outside bankruptcy. Even more could be devoted to creditors if the Debtors reduced or stopped their retirement planning for a while, maintained fewer than three cars, and stopped over-withholding on their taxes.

Prior to filing bankruptcy, the Debtors chose to pay an accelerated mortgage and incur exceptionally high housing costs; lease two cars and maintain a third car for their adult son; and, continue to choose to not both work. However, the bankruptcy court ruled that the Debtors could not maintain such a lifestyle while simultaneously discharging $162,810.05 in credit card and related unsecured debt, and thereby pay their creditors nothing. *See* Schedule F. Such a discharge would be unfair in this case because, as the bankruptcy court ruled, section 707(b)(3)(B)'s financial circumstances test revealed that a more modest lifestyle would yield meaningful payments to creditors. Sept. 15, 2008 Hr'g Tr. 7:23-25; 8:1-4. The bankruptcy court's ruling was well-within the ambit of its statutory discretion.

The Debtors made clear to the bankruptcy court that their obligations were "primarily consumer debts." July 21, 2008 Hr'g Tr. 3:23-24. The record made clear to the bankruptcy court that the Debtors' annual income, earned solely by Mr. Moutousis, is approximately $120,000 per year and remains reliable. *Id.* 2:15-19; Schedule I. The record also made clear that the Debtors' carry an accelerated fifteen-year fixed first mortgage, and the Debtors' monthly mortgage payment exceeds applicable IRS mortgage standards by at least three times. *Id.* 3:12-17; Schedule A; Schedule D; Mot. To Dismiss at 3; Resp. Br. in Supp. of Mot. To Dismiss at 1-2, 4. The record also made clear that the Debtors' mortgage amount significantly exceeds the value of their mortgaged property. July 21, 2008 Hr'g Tr. 3:12-22; Sept. 15, 2008 Hr'g Tr. 6:16-24.

After submission of the written record and two separate hearings on the motion to dismiss, the bankruptcy court ruled, explaining that the Debtors "make a choice to incur expenses for housing that is not fair to their creditors." Sept. 15, 2008 Hr'g Tr. 7:15-17. The bankruptcy court further explained that the Debtors' housing expenses are "excessive and not reasonably necessary for their support." *Id.* 7:17-18. The bankruptcy court also observed that, "from a financial perspective, it's questionable whether it's even good judgment to continue to pay on a mortgage when the debt substantially exceeds the value of the property." *Id*. 7:20-23. The bankruptcy court went on to conclude that, "if these [D]ebtors were to pay a reasonable amount for their housing, they would have substantial money left over each month to pay their unsecured creditors." *Id*. 7:23-25-8:1.

All of the bankruptcy court's conclusions have a basis in the undisputed factual record submitted to the court in numerous written pleadings and during two separate hearings on the United States Trustee's motion. The bankruptcy court was within its discretion in finding abuse under section 707(b)(3)(B) since the totality of the circumstances of the Debtors' financial situation demonstrates an ability to repay unsecured debts. *See*, *e.g., In re Behlke*, 358 F.3d 429 (6th Cir. 2004) (affirming dismissal when debtors had ability to pay creditors $634 per month); *In re Lamanna,* 153 F.3d 1 (1st Cir. 1998) (affirming dismissal under superceded section 707(b) when debtor had $771 in monthly disposable income); *Hebbring v. United States Trustee,* 463 F.3d 902 (9th Cir. 2006) (affirming dismissal under superceded section 707(b) because debtor had $615 available each month to pay creditors).

2.

The Debtors primarily "take issue with the bankruptcy court's reliance on one factor. . .the size of their mortgage payments . . . in determining that they were not treating their creditors fairly." Appellants' Br. at 11. The Debtors suggest that non-ability to repay factors exonerate their choice to maintain a relatively comfortable lifestyle while paying their creditors nothing. The Debtors fail to persuade based on two main reasons.

First, the Debtors misunderstand the bankruptcy court's power to dismiss when, as here, a debtor's financial situation allows for repayment of debts. Second, the Debtors' challenge demonstrates an incorrect understanding of section 707(b)(3)(B) and relevant case law.

When, under the financial circumstances test, a debtor has an ability to pay, but does not do so, a case can be dismissed under section 707(b)(3)(B) for abuse. This is because, as numerous courts have recognized, the terms "totality of [the] circumstances" and "financial situation" in the 2005 Act "clearly encompass a debtor's ability to pay." *In re Lenton*, 358 B.R. 651, 663 (Bankr. E.D. Pa. 2006); *In re Sullivan*, 370 B.R. 314, 321(Bankr. D. Mont. 2007) ("[T]he plain language of § 707(b)(3). . . is clear and compels a conclusion that a court must consider a debtor's actual debt-paying ability in ruling on a motion to dismiss based on abuse where the presumption does not arise or is rebutted" (quoting *In re Sorrell*, 359 B.R. 167 (Bankr. S.D. Ohio 2007)); *In re Pak*, 343 B.R. 239 (Bankr. N.D. Cal. 2006) ("It would be counterintuitive to construe 'totality of the circumstances' [in section 707(b)(3)] to exclude a consideration of the debtor's ability to pay.").

Since the Debtors are, by their own admission, paying a "much higher than normal" mortgage at an accelerated rate, *see* Appellants' Br. at 12, and doing so on a property that is worth tens of thousands of dollars less than the value of their multiple mortgages, the bankruptcy court did not abuse its discretion under its statutory limits, and was within its discretion, in concluding that the Debtors' mortgage was "excessive and not reasonably necessary for their support . . . [and] if these debtors were to pay a reasonable amount for their housing, they would have substantial money left over each month" to pay their debt obligations to unsecured creditors. Sept. 15, 2008 Hr'g Tr. 7:17-18, 23-25. Indeed, as the Debtors themselves explain to this Court in their statement of the case, "the true market value of the property, although difficult to determine, is substantially less than double the [2008] state equalized value" of the property, Appellants' Br. at 6, and they are continuing to pay a "much higher than normal monthly mortgage payment" amount. *Id*. at 12.

The Debtors' concede that the totality of the circumstances of a debtor's financial situation should, at a minimum, include his ability to repay his debts. Appellants' Br. at 12-13. However, the Debtors claim that such an ability to repay cannot be based on, by their own words, "one *undisputed* fact, a much higher than normal monthly mortgage payment . . . ." *Id*. (emphasis added). The Debtors' contention ignores the reality that the bankruptcy court did look at their entire financial situation under the new financial circumstances test, and concluded that the Debtors, by living more modestly, can repay a meaningful portion of their debts. *See* Sept. 15, 2008 Hr'g Tr. 7:23-25. Having made that finding, the bankruptcy court concluded dismissal was proper under section 707(b)(3)(B). *Id*. Certainly, "[w]hen conducting any 'ability to pay' analysis, a court is often considering multiple [financial] factors," *In re Haar*, 373 B.R. 493, 500 (Bankr. N.D. Ohio 2007), such as the debtor's assets, liabilities, and expected future income, and whether any of the debtor's obligations are secured by unnecessary luxury goods. *Id*. The bankruptcy court did not ignore any financial factors in its analysis. Rather, it simply balanced the Debtors' financial factors in a way that the Debtors do not like.

In dismissing the Debtors' chapter 7 case for abuse, the bankruptcy court acknowledged the undisputed facts on the record that, but for the Debtors' "excessive" spending on their housing expenses, they would be able to meet their debt obligations to unsecured creditors. Sept. 15, 2008 Hr'g Tr. 7:17. Indeed, the record is replete with evidence to support the bankruptcy court's conclusion that the Debtors have the ability to repay their unsecured debt, but for their mortgages. *See, e.g.*, *Behlke*, 358 F.3d at 438 (holding, under pre-2005 Act section 707(b), that bankruptcy courts have broad discretion to evaluate facts supporting dismissal based on the totality of the circumstances of a debtor's financial situation).

Both on the written and oral record, the bankruptcy court was made aware that it was solely owing to the Debtors' accelerated fifteen-year fixed first mortgage payments that the Debtors' expenses exceeded their monthly gross income. Schedule J; Sept. 15, 2008 Hr'g Tr. 6:16-21. With respect to the Debtors' expected future income, the bankruptcy court was made aware that Mr. Moutousis has worked for the same employer as an engineer for more than thirteen years and earns a six-figure annual salary of approximately $120,000, whereas Mrs. Moutousis does not work. Schedule I. Accordingly, in finding abuse, the bankruptcy court made clear that it was balancing all financial factors, in accordance with the statutory framework of section 707(b)(3)(B), asserting, "from a *financial* perspective, it's questionable whether it's even in good judgment to continue to pay on a mortgage when the debt substantially exceeds the value of the property." Sept. 15, 2008 Hr'g Tr. 7:20-23 (emphasis added).

As recognized in the Sixth Circuit, in reviewing for abuse of discretion, a court may reverse "only . . . if left with a definite and firm conviction that the bankruptcy court committed a clear error in judgment." *Behlke,* 358 F.3d at 438. "'The question is not how the reviewing court would have ruled, but rather whether a reasonable person could agree with the bankruptcy court's decision; if reasonable persons could differ as to the issue, then there is no abuse of discretion.'" *Id.* (quoting *Mayor of Baltimore v. W. Va. (In re Eagle-Picher Indus., Inc.)*, 285 F.3d 522, 529 (6th Cir. 2002)).

The bankruptcy court, in concluding that the Debtors would have an ability to pay a meaningful portion of their unsecured debts if they were to pay a "reasonable amount" for their housing, did not err in its judgment and did not abuse its discretion. Sept. 15, 2008 Hr'g Tr. 7:24.

B. The Bankruptcy Court Properly Analyzed only Financial Circumstance Factors Relevant to Section 707(b)(3)(B), Not the Legally Irrelevant, Non-Financial, *Krohn* Factors of Section 707(b)(3)(A), in Performing the Financial Circumstances Test under the 2005 Act.

The Debtors also seek reversal on the ground that the bankruptcy court did not explicitly address the non-financial factors the Sixth Circuit discussed in *In re Krohn*, 886 F.2d 123 (6th Cir. 1989), which applied the version of section 707(b) that Congress superceded with enactment of the 2005 Act. *See In re Krohn*, 886 F.2d. 123 (6th Cir. 1989); Appellants' Br. at 8. The Debtors note that *Krohn* listed a number of bad faith and conduct-type factors that the courts could consider when deciding whether to dismiss for substantial abuse under superceded section 707(b). Appellants' Br. at 9; *see Krohn,* 886 F.2d at 126 (discussing "lack of honesty and want of need"). The Debtors suggest that this is significant because they did not engage in bad faith type conduct. *Id*. at 12-13. This leads the Debtors to conclude the bankruptcy court's dismissal order must be reversed, and the case remanded, because the bankruptcy court did not take any bad faith or conduct-type factors into account. *Id*. at 14.

However, the Debtors fail to note that neither the superceded statute nor the 2005 Act requires courts to make bad faith findings in ability to repay cases such as the one before this Court. In *Krohn*, the Sixth Circuit made clear that superceded section 707(b)'s substantial abuse standard allowed courts to ". . . deny Chapter 7 relief to the dishonest *or* non-needy debtor . . ." *Krohn*, 886 F.2d at 126 (citing *In re Walton*, 866 F.2d at 983) (emphasis added). By using the disjunctive "or," the *Krohn* panel acknowledged that the superceded standard allowed cases to be dismissed either for bad faith or an ability to repay. *Id*. (stating that ability to repay "alone may be sufficient to warrant dismissal. A court would not be justified in concluding that a debtor is needy and worthy of a discharge where his disposable income permits liquidation of his consumer debts with relative ease").

Because either bad faith or ability to repay could justify dismissal under the superceded statute, the *Krohn* panel listed both bad faith and ability to repay factors as ones that could justify dismissal for substantial abuse. *Id*. However, *Krohn* allowed for dismissal for either. *Id*.

The *Krohn* approach, contrary to what the Debtors suggest, does not mandate both bad faith and ability to repay findings. Were there ever any doubt on this point, the Sixth Circuit resolved it in 2004 by expressly holding bankruptcy courts could dismiss under superceded section 707(b) without making bad faith findings. *In re Behlke*, 358 F.3d 429, 435 (6th Cir. 2004) (affirming dismissal under superceded section 707(b) because "[t]he bankruptcy court committed no legal error in finding substantial abuse absent a finding of "dishonesty").

Congress codified the approach used in *Behlke* in 2005 by disentangling bad faith cases from ability to repay cases. *See In re Haar*, 373 B.R. 493, 499-500 (Bankr. N.D. Ohio 2007) (asserting "nothing in the structure of the 'totality of the circumstances' test of § 707(b)(3) suggest that a debtor's ability to repay an obligation must, as a prerequisite for dismissal, be coupled with other factors"). Congress accomplished this by bifurcating section 707(b) into sections 707(b)(3)(A) and (B). The former authorizes dismissal for bad faith, the latter when debtors have an ability to repay.

Under the plain language of new section 707(b)(3)(B), a court deciding whether to dismiss a chapter 7 case for abuse must consider whether "the totality of the circumstances (including whether the debtor seeks to reject a personal services contract and the financial need for such rejection as sought by the debtor) of the debtor's financial situation demonstrates abuse."[3] 11 U.S.C. § 707(b)(3)(B). The requirement in section 707(b)(3)(B) that courts focus on the "totality of the circumstances" impacting the "financial situation" of a debtor mandates that courts weigh financial factors only, not other factors. This assessment of a debtor's financial situation is compelled by both the plain text and structure of the statutory language, and is consistent with one of the main objectives of Congress in reforming the bankruptcy system: ensuring that debtors who actually have the ability to repay a significant portion of their debt do so. *See* H.R. Rep. 109-31(I) at 5 and n.18 (2005) (Congress enacted section 707(b) to issue a "clear mandate requiring these debtors to repay their debts."); *Perlin v. Hitachi Capital Am. Corp.*, 497 F.3d 364, 371 (3d Cir. 2007) (noting the 2005 Act amendments to section 707(b) "respond to many of the factors contributing to the increase in consumer bankruptcy filings, such as lack of personal financial accountability, the proliferation of serial filings, and the absence of effective oversight to eliminate abuse in the system") (quoting H.R. Rep. No. 109-31 at 2 (2005)); *see also* Bankruptcy Revision: Hearing on S. 256 Before the S.

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[3] The language contained in the parenthetical was a compromise on an earlier provision that would have been more strict in limiting the ability of debtors, such as highly paid recording artists, to reject personal services contracts. 6 *Collier on Bankruptcy* ¶ 707.5[3][b] (Alan N. Resnick & Henry J. Sommer eds., 15th ed. rev. 2008). As explained in the conference report on an earlier version of the bill, "among the considerations in applying the 'totality of the circumstances' test for 'abuse' is whether an individual debtor seeks to reject a personal services contract and the *financial need* for such rejection as sought by the debtor.'" H.R. Rep. No. 105-794, at 123 (1998) (Conf. Rep.) (emphasis added). This legislative focus on "financial need" is in keeping with the application of section 707(b)(3)(B) to require consideration of financial factors exclusively. *See, e.g.*, *In re Calhoun*, – B.R. –, 2008 WL 4885278 (Bankr. D.S.C. Nov. 10, 2008) (holding that the ability to pay alone without mitigating factors is sufficient to establish abuse).

Comm. on the Judiciary, 108th Cong. (2005) (statement of Sen. John Cornyn) (stating that "Bankruptcy relief should be available to those who are unable to pay – not to those who are simply unwilling to pay").

The government's case against these Debtors under the 2005 Act was premised solely upon a section 707(b)(3)(B) ability to repay theory. *See* United States Trustee Mot. To Dismiss at 1-2; Resp. Br. in Supp. Mot. To Dismiss at 2-3; Sept. 15, 2008 Hr'g Tr. at 6:16-25; July 21, 2008 Hr'g Tr. at 2:9-25; 3:1-22. The bankruptcy court, in relying upon uncontested facts drawn from the bankruptcy petition and schedules that these Debtors filed under penalty of perjury, found that the Debtors had such an ability if they lived a more modest lifestyle. Sept. 15, 2008 Hr'g Tr. at 7:15-25. The court made all the findings it needed to determine they had an ability to repay. Indeed, the amount of debt the Debtors' carry is almost the same as the amount of debt the debtors carried in *Behlke*, where the Sixth Circuit affirmed dismissal. *See Behlke*, 358 F.3d at 432, 436 (affirming dismissal under superceded statute because debtors "had an ability to pay their creditors out of future income to the tune of $634.00 per month" when those creditors were owed "$163,944.00 in unsecured nonpriority debt").[4]

Without doubt, the Debtors' petition and schedules appear to raise legitimate questions whether they may have engaged in bad faith conduct. Their schedules list $162,810.05 in credit card and related unsecured debts, but they claim to have only $9,462.00 in property to show for it. *Compare* Schedule F *with* Schedule B. This certainly raises significant questions that the United

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[4] Notably, the debtors in *Behlke* earned significantly less than the Debtors in this case do. Whereas in *Behlke* the debtors' "gross income for 1999 was $93,116.00 and their gross income for 2000 was $93,036.00[,]" *Behlke*, 358 F.3d at 432, the Debtors in this case earn approximately $120,000 annually. *See* Schedule I.

States Trustee could have pursued. Resolution of those unanswered questions might have justified the filing of a bad faith section 707(b)(2)(A) count. It might even have justified filing a complaint seeking to deny these debtors a discharge of their debts under 11 U.S.C. §§ 727(a)(2), (3) or (5).

However, the government never relied upon section 707(b)(3)(A) or a bad faith theory before the bankruptcy court. Instead, the United States Trustee relied upon a section 707(b)(3)(B) ability to repay theory. *See* United States Trustee Mot. To Dismiss at 1-2; Resp. Br. in Supp. Mot. To Dismiss at 2-3; Sept. 15, 2008 Hr'g Tr. at 6:16-25; July 21, 2008 Hr'g Tr. at 2:9-25; 3:1-22.

Since the United States Trustee sought dismissal only under a section 707(b)(3)(B) theory, the bankruptcy court considered factors relevant to this statutory provision by applying the financial circumstances test.[5] The Debtors cannot fault the court for failing to consider factors it did not need to evaluate because their bankruptcy petition and schedules established an ability to repay.

C. The Bankruptcy Court Did Not Abuse its Discretion When It Ruled Without an Evidentiary Hearing Because There Were No Disputed Material Factual Issues Surrounding the Debtors' Ability To Repay Their Unsecured Debts.

Debtors' final challenge to the bankruptcy court's decision is based on the lack of an evidentiary hearing. Appellants' Br. 11-12. The Debtors' suggestion that section 707(b) motions

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[5] To the extent that the Debtors rely on *In re Seeburger*, 392 B.R. 735 (Bankr. N.D. Ohio Aug. 8, 2008), *see* Appellants' Br. at 13-14, a case with no precedential value before this Court and minimal, if any, factual alignment with the Debtors' case, as support for its argument to consider non-financial *Krohn* factors, the Debtors are unpersuasive. This is because, as discussed *supra*, the *Krohn* approach was superceded with the enactment of section 707(b)(3)(B), and does not mandate a consideration of both bad faith and an ability to repay factors. To the extent that the Debtors rely on *In re Zaporski*, 366 B.R. 758 (Bankr. E.D. Mich. 2007), *see* Appellants' Br. at 14, as purported support for considering non-financial *Krohn* factors in a "totality of the circumstances" analysis, such reliance is inapposite. As the *Zaporski* court clearly stated, "in reviewing the totality of [the debtor's] circumstances . . . the Court will properly consider, as one of those circumstances, his ability to repay his creditors . . . ." *Zaporski*, 366 B.R. at 771. Moreover, all the factors that the *Zaporski* court evaluated in determining that the totality of the circumstances of the debtor's financial situation were, in fact, financial factors that impacted the debtor's ability to repay his unsecured debts – namely, the debtor's "substantial income at a stable job; a substantial equity on his balance sheet; a substantial pension plan . . . a substantial 401(k) account . . . ." *Id*. 773-774.

mandate an evidentiary hearing is legally incorrect. Federal Rule of Bankruptcy Procedure 1017(e) provides that dismissal under section 707(b) must be made "on motion." Fed. R. Bankr. P. 1017(e); *See also* Fed. R. Bankr. P. 1017(f) (specifying that 707(b) motions to convert or dismiss should be filed as motions under Rule 9013). Federal Rule of Bankruptcy Procedure 9013 governs motions. Fed. R. Bankr. P. 9013. This rule, along with Bankruptcy Rule 9014, provides that motions create contested matters.

Bankruptcy Rule 9014(d) requires testimony of witnesses in contested matters only to decide disputed matters: "Testimony of witnesses with respect to *disputed* material factual issues shall be taken in the same manner as testimony in an adversary proceeding." Fed. R. Bankr. P. 9014(d) (emphasis added); *see also Hebbring*, 463 F.3d at 908 (holding that the bankruptcy court was "not required to hold an evidentiary hearing" on the United States Trustee's motion to dismiss for substantial abuse "because there were no disputed issues of material fact") (citing Fed. R. Bankr. P. 9014(d)); *Zick v. Indus. Ins. Svcs., Inc.*, 931 F.2d 1124, 1129 (6th Cir. 1991) (concluding that the "formalities" of a "full-blown evidentiary hearing" were not required in pre-2005 Act bad faith dismissal action because dismissal was granted within the "court's sound discretion" based on the facts and matters presented to the court).

The case before this Court commenced when the United States Trustee filed a motion to dismiss. *See* Mot. To Dismiss. Therefore, Rule 9014(d), and its standard for when an evidentiary hearing is required, applies.

In this case, there were no material disputed facts. Therefore, no evidentiary hearing was required, pursuant to Rule 9014(d). All facts raised in the written and oral record came from the

Debtors' sworn petition, schedules and statement, or from statements made by the Debtors' counsel during the two separate hearings on the motion to dismiss held on July 21, 2008 and September 15, 2008, all submitted under penalty of perjury. The Debtors do not dispute the facts on the written or oral record concerning their income, their expenses, their assets, or their liabilities. The Debtors also do not dispute the bankruptcy court's right to rely on these facts.[6]

Given the absence of material facts in dispute, the bankruptcy court acted properly by not wasting limited judicial resources on conducting an unnecessary evidentiary hearing.

CONCLUSION

For the foregoing reasons, the order of the bankruptcy court should be affirmed.

DANIEL M. McDERMOTT
UNITED STATES TRUSTEE
Region 9

By: /s/ Jill M. Gies (P56345)
Jill.Gies@usdoj.gov
Office of the United States Trustee
United States Department of Justice
Attorney for the United States Trustee
211 West Fort Street - Suite 700
Detroit, Michigan 48226
313.226.7913

Of Counsel: Ramona D. Elliott
General Counsel

P. Matthew Sutko
Associate General Counsel

Saleela Khanum Salahuddin
Attorney
Executive Office for the United States Trustee
United States Department of Justice

Dated: December 17, 2008

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[6] When the bankruptcy court stated that it "d[id not]see how an evidentiary hearing would help," July 21, 2008 Hr'g Tr. 11:5-6, the Debtors' counsel did not contest the absence of factual issues in dispute, and volunteered to brief the legal issues under review.

UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF MICHIGAN

In re:	Bankruptcy Case No. 08-50700-SWR Chapter 7 HON. STEVEN W. RHODES
PHILLIP MOUTOUSIS, **FAYE MOUTOUSIS**	
Debtors. _______________________________________/	
PHILLIP MOUTOUSIS, **FAYE MOUTOUSIS**	Civil Case No.08-CV-14268 HON. STEPHEN J. MURPHY
Appellants.	
vs.	
DANIEL M. McDERMOTT, **UNITED STATES TRUSTEE,**	
Appellee. _______________________________________/	

CERTIFICATE OF SERVICE

I hereby certify that on December 17, 2008, I electronically filed the foregoing paper with the Clerk of the Court using the ECF system which will send notification of such filing to the following: R. Soren Andersen, andersenrs@comcast.net, , and I hereby certify that I have mailed by United States Postal Service the paper to the following non-ECF participants: Phillip Moutousis and Faye Moutousis, 2105 Forest Mead Dr., Sterling Heights, MI 48314

DANIEL M. McDERMOTT
UNITED STATES TRUSTEE
Region 9

By /s/ Karen Riggs
Karen.Riggs@usdoj.gov
Paralegal Specialist
Office of the U.S. Trustee
211 West Fort St - Suite 700
Detroit, Michigan 48226
313.226.7259

Dated: December 17, 2008

BRIEF BANK — "SUMMARY SHEET" Printed Fri.-5/28/99 (16:37)

WESTLAW CODES

1. ("TI") TITLE OF CASE [E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]
In re MTS Jim Baker Trucking —
Murdock Transp. Systems, Inc. & Seth Murdock v. Office of United States Trustee

2. ("CO") CURRENT COURT [E.g., "CTA9"]
BAP-9 (9th Cir. Bankr. Appellate Panel)

3. ("CCN") CURRENT CASE NO.
No.: CC 98-1396

4. ("PCN") PRIOR CASE NO. & COURT [IF ANY]
No.: LA 98-20538-ER
Court: U.S. Bankruptcy Court, Central District of California (Judge Robles)
(Identify judge & cite, if any)

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7. ("AU") PRINCIPAL AUTHORS & OFFICE [E.g.,"UST/OGC"]
Peter Burke (OUST-Los Angeles) (213-894-6811)
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") TOPIC
BANKRUPTCY

9. ("SU") • SUMMARY OF KEY ISSUE(s) & / Any Miscellaneous BACKGROUND

• 1) Standing to appeal; 2) Jurisdiction to impose 1-year bar against refiling; 3) Personal jurisdiction over non-debtor principals; 4) Whether imposition of refiling bar on Debtor & principal violated due process when motion only sought to bar Debtor; 5) Whether the Court abused its discretion by finding bad faith based on a report of a Chapter 11 Trustee in a related case.

/ **Background:** Three related petitions were filed & a Chapter 11 trustee was appointed in one case. The UST filed a motion to dismiss and sought a 180-day bar against Debtors. Court imposed a 365-day bar based on the motion and a report filed only in the related case and did not let Mr. Murdock to speak on his behalf. The BAP affirmed as to the Debtor but remanded as to Mr. Murdock.

10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)
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UNITED STATES BANKRUPTCY APPELLATE PANEL
OF THE NINTH CIRCUIT

In re MTS JIM BAKER TRUCKING, Debtor in Possession, _____________________________ SETH MURDOCK; MURDOCK TRANSPORATION SYSTEMS, INC., Appellants vs. OFFICE OF THE UNITED STATES TRUSTEE, Appellee _____________________________	BAP No. CC-98-1396 Case No. LA 98-20538-ER

Appeal From The United States Bankruptcy Court
For The Central District of California

Honorable Ernest Robles
Bankruptcy Judge, Presiding

APPELLEE MAUREEN A. TIGHE, UNITED STATES TRUSTEE
OPENING BRIEF

MAUREEN A. TIGHE
United States Trustee
Terri Hawkins Andersen
Assistant U.S. Trustee
Alvin P. Mar, SBN 151482
Staff Attorney
Peter S. Burke, SBN 196273
Staff Attorney
OFFICE OF THE U.S. TRUSTEE
221 N. Figueroa Street
Suite 800
Los Angeles, Calif. 90012
TEL: (213) 894-7247
FAX: (213) 894-2603

November 19, 1998

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UNITED STATES BANKRUPTCY COURT CENTRAL DISTRICT OF CALIFORNIA LOCAL BANKRUPTCY RULES

I.

JURISDICTION

The statutory basis of jurisdiction of this appeal is 28 U.S.C. §§ 158(a) and 158(b)(1). The statutory basis of jurisdiction for the Bankruptcy Court was 28 U.S.C. §§ 157, 1334.

II.

STATEMENT OF ISSUES ON APPEAL

A. Whether Appellants have standing to appeal the provisions of the order which enjoined other entities from filing a voluntary petition for 365 days.

B. Whether the Bankruptcy Court had subject matter jurisdiction to find that the petition was filed in bad faith and to impose on Debtor, Seth Murdock and affiliates of the Debtor, based on this finding, a 365 day bar from filing voluntary bankruptcy petitions.

C. Whether the Bankruptcy Court had personal jurisdiction over Appellants.

D. Whether the Bankruptcy Court committed clear error when it made a finding of bad faith with respect to this Debtor.

E. Whether the Bankruptcy Court abused its discretion by enjoining Debtor, Seth Murdock and Murdock Transportation System, Inc. from filing a voluntary petition for 365 days.

F. Whether the procedural due process rights of the Appellants were violated by the Bankruptcy Court when it imposed a 365 day bar on their ability to file a voluntary bankruptcy petition.

III.

STANDARD OF REVIEW

A bankruptcy court's exercise of subject matter jurisdiction is reviewed *de novo*. Securities and Exchange Commission v. Colello, 139 F.3d 674 (9th Cir. 1998). Similarly, a determination of whether a bankruptcy court had personal jurisdiction over the parties to the appeal is a question of law which is subject to *de novo* review. Omeluk v. Langsten Slip & Batbyggeri A/S, 52 F.3d 267, 269 (9th Cir. 1995). Furthermore, a claim that one's due process rights have been violated is reviewed *de novo*. Gonzalez-Julio v. I.N.S., 34 F.3d 820, 823 (9th Cir. 1994). Finally, all issues of law, such as the court's statutory authority to enjoin the filing of a voluntary petition or the standing of Appellants to appeal an order, are reviewed *de novo*. AT & T Universal Card Services v. Black (In re Black), 222 B.R. 896, 899 (9th Cir. BAP 1998). Therefore, these issues are reviewed directly by this Court.

Orders dismissing a bankruptcy case for bad faith are reviewed for an abuse of discretion. Leavitt v. Soto (In re Leavitt), 209 B.R. 935, 938 (9th Cir. BAP 1997); Marsch v. Marsch (In re Marsch), 36 F.3d 825, 827 (9th Cir. 1994). Similarly, the grant of an injunction is discretionary and is reviewed for an abuse of discretion. Parsons v. Plotkin (In re Pacific Land Sales, Inc.), 187 B.R. 302, 308 (9th Cir. BAP

1995). A finding of bad faith, however, is reviewed for clear error. In re Marsch, 36 F.3d at 827; In re Leavitt, 209 B.R. at 938. Under this standard, if the trial court's account of the evidence is plausible in light of the record viewed in its entirety, a reviewing court may not reverse even if convinced that it would have weighed the evidence differently as trier of fact. Anderson v. City of Bessemer City, N.C., 470 U.S. 564, 574, 105 S.Ct. 1504, 1511-12, 84 L.Ed.2d 518 (1985); In re Leavitt, 209 B.R. at 938. Indeed, reversal under the clearly erroneous standard is only warranted if the reviewing court on the entire evidence is left with the definite and firm conviction that a mistake has been committed. United States v. United States Gypsum Co., 333 U.S. 364, 395, 68 S.Ct. 525, 542, 92 L.Ed. 746 (1948); In re Leavitt, 209 B.R. at 938.

IV.

INTRODUCTION

The issues in this case arise from the Bankruptcy Court's attempt to protect the Bankruptcy system from abuse where there was evidence of a pattern and practice of abuse by Seth Murdock, the principal of this Debtor and of several related debtors. This pattern and practice of abuse was made known to the Bankruptcy Court at the hearing on a motion to appoint a Chapter 11 Trustee in the Western XPress, Inc. case and through, among other things, the Report that was filed by the Chapter 11 Trustee that was appointed. Through these sources, the Bankruptcy Court received evidence which suggested that Seth Murdock had attempted shift assets from one entity to another for his own financial benefit to the detriment of the rights of various creditors in this case and related cases. In fact, the Chapter 11 Trustee stated on the record that hundreds of thousands of dollars in assets were missing from the Western XPress, Inc. estate. Based on this record, it was appropriate for the Bankruptcy Court to take steps to prevent further abuses of the bankruptcy system by Seth Murdock.

V.

STATEMENT OF THE CASE[1]

The Debtor in Possession, MTS Jim Baker Trucking, dba Jim Baker Trucking filed a chapter 11 petition in the United States Bankruptcy Court on March 18, 1998. A.R. Tab 9. The bankruptcy petition was signed by Seth Murdock as president of the corporation. The corporation was not represented by counsel. A.R. Tab 9, page 95. The lack of an attorney as well as its failure to comply with the reporting requirements of the United States Trustee resulted in the filing of a motion to dismiss or convert this case under 11 U.S.C. §1112(b) which was set for hearing on April 30, 1998. A.R. Tabs 10 and 11. In addition, the identity of the Debtor was in question because only the face sheet of the petition listed MTS Jim Baker Trucking as the Debtor; all other pages of the voluntary Chapter 11 petition, including a duplicate face sheet, referred to the Debtor as Murdock Transportation

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[1] All references herein to “E.R.” are to Appellant’s Excerpts of Record. All references to “A.R.” are to Appellee’s Excerpts of Record filed concurrently herewith.

Systems, Inc. A.R. Tab 9. This issue was not clarified until Appellants filed their opening brief in the MTS Jim Baker Trucking case which admits that the Debtor in that case was erroneously named on page one of the petition as MTS Jim Baker Trucking, and that the true and correct name of the Debtor is Murdock Transportation Systems, Inc., dba Jim Baker Trucking. Appellants Opening Brief at 5, n. 3. Based on this admission, the United States Trustee will treat the Debtor in the MTS Jim Baker Trucking case and Murdock Transportation System, Inc. as the same entity (hereinafter “MTS, Inc.”).

Hearings on two other related Chapter 11 petitions were pending before the Bankruptcy Court on April 30, 1998, the date when the U.S. Trustee’s motion to dismiss or convert MTS’s Chapter 11 case was calendared. The petition of the first of the two related Chapter 11 petitions, Western Motor Xpress, Inc. (hereinafter “Western”) reflects the signature of Seth Murdock as president of the corporation, A.R. Tab 1, page 2, while the Statement of Financial Affairs of the second related Chapter 11 case, Espinosa Cartage Company, Inc., (hereinafter “Espinosa”) indicated that Seth Murdock was also the president of that corporation. A.R. Tab 13, page 160.

The first of these cases, Western, was filed on April 3, 1998 under case number LA 98-23236-ER. A.R. Tab 1. An emergency hearing was held on April 15, 1998 with respect to creditor Durable Sales’ motion to appoint a Chapter 11 Trustee. A.R. Tabs 2 and 3. Evidence was submitted which indicated that the Estate appeared to have used cash collateral to pay for operating expenses and payroll. A. R.

Tab 4, page 32, lines 17-18. The United States Trustee joined in the motion to appoint a Chapter 11 Trustee on the grounds that Western failed to perform its duties under 11 U.S.C. §1107 to account for property of the estate and comply with the United States Trustee’s reporting requirements. A.R. Tab 5. At the April 15, 1998 hearing on the motion for the appointment of a Chapter 11 Trustee, Durable Sales presented evidence that Western’s accounts receivable were being diverted. A.R. Tab 16, pages 247-249. The Bankruptcy Court directed the appointment of a Chapter 11 Trustee at the April 15, 1998 hearing. A.R. Tab 16, pages 250-251. That order included an injunction against Seth Murdock and any person involved in the current management of Western or their agents or representatives preventing their return to Western’s premises or from obtaining, taking, diverting, or otherwise withdrawing any funds, mail, checks, or other items from any post office boxes in the names of Western or MTS, Inc. A.R. Tab 6, pages 50 and 51. A subsequent report filed by the Chapter 11 Trustee further confirmed that Western’s accounts receivable had been diverted. A.R. Tab 7, page 59, lines 16-26. This report was presented to the Bankruptcy Court at the hearing on April 30, 1998.

The second related Chapter 11 case of Espinosa, case number LA 98-20715-ER, was filed on March 19, 1998. A.R. Tab 12. Because the Debtor in that case, like that of MTS, Inc., was not represented by counsel, a motion to dismiss for failure to comply with Former Local Bankruptcy Rule 102(7)(a) was filed by the United States Trustee and set for hearing on

April 30, 1998. A.R Tabs 14 and 15. Hearings on the United States Trustee’s motion to dismiss the Chapter 11 petition of Espinosa for failure to comply with Former Local Bankruptcy Rule 102(7)(a), the U.S. Trustee’s motion to dismiss or convert the related Chapter 11 petition of MTS, Inc. under 11 U.S.C. §1112(b), and the status conference and hearing on the final injunction in Western, were all calendared for April 30, 1998.

The Bankruptcy Court reviewed the Chapter 11 Trustee’s Report in Western, which indicated continued diversion of monies to other related entities, the lack of accounting records, and the commingling of business operations. A.R. Tab 7; E.R. Tab 10, pages 51, 73. At the hearing, the Bankruptcy Court ordered its preliminary injunction, rendered at the April 15, 1998 hearing, to become final, with certain allowances for previous management to gain entry to Western’s business premises. A.R. Tab 8.

The Bankruptcy Court also heard argument on the U.S. Trustee’s motions in MTS, Inc. and Espinosa. At the hearings, the Bankruptcy Court enjoined the Debtor, its principal, Seth Murdock, any entity in which Seth Murdock was an officer, director, employee, or in which Murdock held a controlling interest on the date on which the Debtor’s case was filed from filing a voluntary bankruptcy petition for a period of 365 days. E.R. Tab 10, pages 71-75. The order containing these provisions (hereinafter “the Order”) was entered on May 15, 1998. E.R. Tab 5.

VI.

SUMMARY OF ARGUMENT

First, Appellants do not have standing to obtain all the relief that they request. While they do have standing to appeal the relief that was granted against them, they do not have standing to appeal the relief that was granted against the other entities. Therefore, this Court’s consideration of the appeal
should be limited to issues which relate to findings of bad faith and the right of Appellants to file a voluntary petition.

Secondly, the Bankruptcy Court had subject matter jurisdiction concerning the dismissal of the case for bad faith and the issuance of a bar against Appellants, among others, from filing a voluntary petition for 365 days because such relief was necessary to enable the Court to efficiently administer the Western estate and to prevent diversion of Estate assets.

Furthermore, the Bankruptcy Court had personal jurisdiction over Appellants. The United States Trustee’s Motion to Dismiss the MTS, Inc. case was served on Appellants and gave them notice that the United States Trustee was seeking a bar against filing a voluntary petition against the Debtor, as well as any other relief that the Court deemed appropriate. A.R. Tab 10, pages 108 and 109. Therefore, the service of the Notice of Motion and Motion to Dismiss in the MTS, Inc. case was sufficient to enable the Court to obtain personal jurisdiction over Appellants.

The Bankruptcy Court’s finding of bad faith does not constitute clear error and is adequately supported by the record. Similarly, the Bankruptcy Court's decision to enjoin MTS, Inc. does not constitute an abuse of discretion, based on the record and the fact that the Bankruptcy Court made a finding of bad faith. Further, while the United States Trustee contends that the Bankruptcy Court had the authority to enjoin Seth Murdock, she acknowledges that Seth Murdock should not be bound by such an injunction until he has an opportunity to show cause why it should not be issued.

Finally, Debtor's due process rights were not violated when the Bankruptcy Court enjoined the Debtor from filing a voluntary petition for 365 days because it was served with the motion to dismiss and because the motion requested injunctive relief against the Debtor, among other reasons. Furthermore, Seth Murdock's right to notice was respected by the Bankruptcy Court because he was served with the motion. The Court's refusal to allow him to speak on his own behalf, however, was problematic. This deficiency can be remedied on remand by providing Mr. Murdock with an opportunity to show cause why the injunction should not be imposed.

VII.

ARGUMENT

A. <u>Appellants Do Not Have Standing to Appeal the Order as to the Other Non-Debtor Entities</u>

Before this Court can consider the other issues raised by Appellants, it must determine whether Appellants have standing to obtain the appellate relief that they seek. Standing is a threshold question that relates to the jurisdiction of the court to consider the appeal. City of South Lake Tahoe v. California Tahoe Regional Planning Agency, 625 F.2d 231, 232 (9th Cir. 1980). Therefore, this Court can only review the Order to the extent that Appellants have standing to seek such review.

It is black letter law that a party may only appeal to protect its own interests and does not have standing to file an appeal to protect the interests of another. Estate of Bishop v. Bechtel Power Corp., 905 F.2d 1272, 1276 (9th Cir. 1990); Morrison Knudsen Co., Inc. v. CHG International, Inc., 811 F.2d 1209, 1214 (9th Cir. 1987). A party does not have standing to appeal unless it is aggrieved by the order. Bryant v. Technical Research Co., 654 F.2d 1337, 1343 (9th Cir. 1981). Furthermore, an indirect financial stake in another party’s claims is insufficient to create standing on appeal. Evanston Insurance Co. v. Fred A. Tucker & Co., Inc., 872 F.2d 278, 280 (9th Cir. 1989); Libby, McNeill, and Libby v. City National Bank, 592 F.2d 504, 511-512 (9th Cir. 1978); SEC v. Secs. Northwest, Inc., 573 F.2d 622, 625-626 (9th Cir. 1978)(Principal has no standing to appeal order relating to liquidation of debtor to minimize his liability for debtor’s unpaid taxes).

In the instant case, Appellants do not have a direct stake in the interest of the other non-Debtor entities in being able to file a voluntary petition before May 15, 1999. They only have a direct stake in protecting their own right to file a voluntary petition. If the principal in Secs. Northwest, Inc. did not have standing to appeal an order relating to the debtor's liquidation to minimize his tax liability, then certainly the Appellants do not have standing to appeal the part of the Order which enjoins the other non-debtor entities from filing a voluntary petition. Instead, Appellants only have standing to appeal the Order to the extent that it bars them from filing a voluntary petition. Therefore, the Court should limit its consideration of the appeal to the issues that relate to the finding of bad faith and the right of MTS, Inc. and Seth Murdock to file a voluntary petition before May 15, 1999.

B. The Bankruptcy Court had Subject Matter Jurisdiction Over the Issues Before It.

1. The Instant Contested Matter Constitutes a Core Proceeding

The United States Trustee agrees that subject matter jurisdiction of the bankruptcy courts is grounded in and limited by statute. Celotex Corp. v. Edwards, 514 U.S. 300, 307, 115 S.Ct. 1493, 1498, 131 L.Ed.2d 403 (1995). The Celotex court noted, however, that Congress intended to grant comprehensive jurisdiction to the bankruptcy courts so that they might deal efficiently and expeditiously with all matters connected with the bankruptcy estate. 514 U.S. 300, 308, 115 S.Ct. 1493, 1499, 131 L.Ed.2d 403 (1995). Furthermore, the statutory grant of subject matter jurisdiction to bankruptcy courts is not contained in Title 11. Title 11 of the United States Code sets forth the rights of parties in the bankruptcy system and the authority to provide specific relief in cases over which it has jurisdiction. In fact, it is well settled that an allegation that a court does not have the statutory authority to provide a specific form of relief does not implicate the subject matter jurisdiction of the court. Steel Company v. Citizens for a Better Environment, 118 S.Ct. 1003, 1010, 140 L.Ed. 2d 210 (1998).

Instead the subject matter jurisdiction of the Bankruptcy Court is governed by 28 U.S.C. §§ 1334 and 157. Section 1334(b) provides that ". . . the district courts shall have original but not exclusive jurisdiction of all civil proceedings arising under title 11, or arising in or related to cases under title 11." Section 157(a) of Title 28 of the United States Code permits the district court to refer "any or all proceedings arising under title 11 or arising in or related to a case under title 11 . . . to the bankruptcy judges for the district." In turn, section 157(b) permits bankruptcy judges to hear all core proceedings arising under Title 11 which include matters concerning the administration of the estate. Furthermore, Section 157(b)(2)(O) of Title 28 of the United States Code reflects the fact that other proceedings affecting the liquidation of the assets of the estate are also core proceedings.

The Bankruptcy Court at the hearing on April 30, 1998 was concerned about addressing the appropriate remedy to preserve the rights of the creditors in the related Chapter 11 case of Western to ensure that the property of that Estate would neither be dissipated nor transferred to other affiliated companies which may seek relief under the Bankruptcy Code. The Bankruptcy Court had previously received evidence of the diversion of accounts receivable, at the hearing on the appointment of a Chapter 11 Trustee in Western, which was subsequently confirmed by the Report of the Chapter 11 Trustee. A.R. Tab 7, page 59, lines 16-26. This Report led the Bankruptcy Court to make final its preliminary injunction against Seth Murdock and others from obtaining unlimited access to Western's business premises. A.R. Tab 8. The bar against refiling was issued to minimize the risk of further dissipation of assets in Western. Therefore, the instant contested matter concerns the administration of the estate and the liquidation of assets and thus is a core proceeding. As a result, the Bankruptcy Court had subject matter jurisdiction over the issuance of the injunctions.

2. The Bankruptcy Court Had the Authority to Enjoin Appellants From Filing Voluntary Petitions

As was explained above, the subject matter jurisdiction of the Bankruptcy Court over the instant contested matter is provided by the fact that it arises in a case under Title 11, and relates to the efficient administration and liquidation of assets of the Western Estate, among others. Therefore, the issue of the Bankruptcy Court's authority to enjoin non-debtor entities does not affect the Bankruptcy Court's subject matter jurisdiction, but instead relates to the Bankruptcy Court's statutory authority to grant such injunctive relief.

In any event, the United States Trustee disagrees with Appellant's construction of section 349(a).[2] Appellants

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[2] 11 U.S.C. § 349(a) provides:
Unless the court, for cause, orders otherwise, the dismissal of a case under this title does not bar the discharge, in a later case under this title, of debts that were dischargeable in the case dismissed;

wrongly contend that section 349(a) provides that a bar on refiling can only be issued to the extent provided for by section 109(g). Appellant’s Opening Brief at 13-14. This argument presumes that the phrase “[u]nless the court, for cause, orders otherwise,” only modifies the clause preceding the semi-colon and that it does not apply to the rest of subsection 349(a). The courts in the Ninth Circuit have not addressed this issue. The majority of the courts which have analyzed this issue, however, have rejected this approach, have determined that the phrase “[u]nless the court, for cause, orders otherwise,” modifies the entire subsection and have concluded that they can enjoin refiling independent of the authorization in section 109(g). In re Casse, 219 B.R. 657, 662 (Bankr. E.D. N.Y. 1998); Stathatos v. United States Trustee for Northern District of Texas (In re Stathatos), 163 B.R. 83, 88 (N.D. Tex. 1993) (Court affirmed bar of two years); Jolly v. Great Western Bank (In re Jolly), 143 B.R. 383, 387 (E.D. Va. 1992); Benefield v. United States Trustee, 1991 WL 542279, *2 (N.D. Tex. 1991) (Court affirmed bar of one year); Lerch v. Federal Land Bank of St. Louis (In re Lerch), 94 B.R. 998, 1001 (N.D. Ill. 1989) (Court affirmed bar of two years); In re McKissie, 103 B.R. 189, 193 (Bankr. N.D. Ill. 1989) (Debtors barred from filing a voluntary petition for one year); In re Stuart Glass & Mirror, Inc., 77 B.R. 332, 334 (Bankr. S.D. Fla. 1987) (Court barred corporate debtor from

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> nor does the dismissal of a case under this title prejudice the debtor with regard to the filing of a subsequent petition under this title, except as provided in section 109(g) of this title.

filing a voluntary petition for two years pursuant to section 105). These courts have noted the fact that “nor” is used to create a conjunction between the two clauses and have found that the semi-colon does not create two independent clauses. See e.g. Jolly, 143 B.R. at 387. In fact, the only courts to adopt the construction suggested by Appellants are from the 10th Circuit. In re Freiouf, 938 F.2d 1099, 1103 (10th Cir. 1991). The majority view appears to be the better reading of the statute. If a court can permanently enjoin a debtor from ever obtaining a discharge of its then existing debts for cause, it certainly should be able to impose the less draconian remedy of enjoining the filing of a voluntary petition for one year. In re Dilley, 125 B.R. 189, 197 (Bankr. N.D. Ohio 1991).

Furthermore, section 109(g) was adopted to limit bad faith filings. In re Kinney, 51 B.R. 840, 846 (Bankr. C.D. Cal. 1985) (Mund, J.). When creative debtors attempt to avoid its restrictions, a bankruptcy court may utilize the authority in section 105 to enforce this intent. In fact, section 105(a) specifically authorizes the Bankruptcy Court to issue any order which is necessary to carry out the provisions of the Code or to prevent an abuse of process. Since sections 349(a) and 109(g) do not prohibit the exercise of this power, there is no reason to conclude that the Bankruptcy Court did not have this power to exercise at its discretion. Therefore, the Bankruptcy Court at least had the discretion to enjoin MTS, Inc. from filing a voluntary petition for 365 days.

This analysis also suggests that the Bankruptcy Court had the power to enjoin non-debtors from filing a voluntary petition for a period of time if cause is found. This is especially true where the Court dismisses a case for bad faith, and where the bad faith conduct was committed by the non-debtor who is the principal and sole shareholder of the Debtor. Therefore, not only did the Court have subject matter jurisdiction over the instant contested matter, but it also had the authority to enjoin the Appellants from filing a voluntary petition for 365 days.

C. <u>The Bankruptcy Court had Personal Jurisdiction Over the Appellants</u>.

A court obtains personal jurisdiction over a party by actual service of process or by voluntary appearance. <u>Burnham v. Superior Court of California, County of Marin</u>, 495 U.S. 604, 615, 110 S.Ct. 2105, 2113, 109 L.Ed.2d 631 (1990)(Service of process is sufficient to confer personal jurisdiction); <u>Veek v. Commodity Enterprises, Inc.</u>, 487 F.2d 423, 425 (9th Cir. 1973). In the context of a bankruptcy proceeding, the bankruptcy court acquires personal jurisdiction through compliance with Federal Rule of Bankruptcy Procedure 9014, which governs contested matters and requires that notice and an opportunity for a hearing “be afforded the party against whom relief is sought”. Rule 9014 also requires service of the motion in accordance with Federal Rule of Bankruptcy Procedure 7004. Specifically, it authorizes service of process on an individual by mailing it to the place where the individual regularly conducts a business or profession. Fed. Rule Bankr. P. 7004(b)(1).

In the instant case, Appellants do not contend that the Court did not have personal jurisdiction over Debtor. Appellant’s Opening Brief at 15. In fact, Appellants could not make this contention because Debtor consented to the Court’s personal jurisdiction by filing the voluntary petition.

Instead, Appellants merely contend that the Bankruptcy Court did not have personal jurisdiction over the non-debtor entities. Appellant’s Opening Brief at 15. The only other Appellant who is a non-debtor entity is Seth Murdock. The motion to dismiss or convert the case of MTS, Inc. was served on Seth Murdock at the address on listed for the Debtor on the first page of the voluntary petition. A.R. Tab 9, pages 93; A.R. Tab 10, page 121. This service satisfies Bankruptcy Rule 7004(b)(1) with respect to Seth Murdock because the address that was listed on the petition was the only address that the United States Trustee had for Mr. Murdock, and it was reasonable to conclude that he regularly conducts business at this address, since he signed the petition as the President of the Debtor. Therefore, since Seth Murdock did receive notice of the United States Trustee’s Motion, the Court did obtain personal jurisdiction over Mr. Murdock and the alleged jurisdictional defect does not exist.

D. The Bankruptcy Court’s Finding of Bad Faith Does Not Constitute Clear Error

Section 1112(b) does not expressly require that a petition be filed in good faith, but evidence of bad faith or of an intent to abuse the reorganization process is sufficient “cause” upon which a case can be dismissed. In re Marsch, 36 F.3d at 828; In re Thirtieth Place, Inc., 30 B.R. 503, 505 (9th Cir. Bankr. 1983); In re ACI Sunbow, LLC, 206 B.R. 213, 217 (Bankr. S.D. Cal. 1997). A determination of whether a petition was filed in bad faith is within the Bankruptcy Court’s discretion. In re Arnold, 806 F.2d 937, 939 (9th Cir. 1986); In re Thirtieth Place, Inc., 30 B.R. at 505. Detriment to the secured creditor is not the only harm resulting from a bad faith filing. “A bad faith filing is an abuse of the bankruptcy process and is offensive to the integrity of the bankruptcy system.” In re Yukon Enterprises, Inc., 39 B.R. 919, 922 (Bankr. C.D. Cal. 1984). Delay prejudicial to creditors as well as abuse of process have been found to support the finding of bad faith. In re Ortiz, 200 B.R. 485 (D.Puerto Rico 1996).

In this case, the Bankruptcy Court specifically found that the petition was filed in bad faith and dismissed the case based, in part, on this finding. E.R. Tab 10, pages 72-73. Furthermore, contrary to the assertions of the Appellants, the record does support this finding. First of all, the Court stated on the record at the hearing on April 30, 1998 that its finding of bad faith was based on the report of the Chapter 11 Trustee who was appointed to represent the Western Estate. E.R. Tab 10, page 73, lines 1-5. While this report was filed in the Western case, the Bankruptcy Court was entitled to take judicial notice of it pursuant to Federal Rule of Evidence 201, made applicable by Federal Rule of Bankruptcy Procedure 9017. Therefore, because the Bankruptcy Court took judicial notice of this report it is part of the record and was before the Bankruptcy Court.

The Trustee’s Report informed the Court, among other things, that Seth Murdock had attempted to obtain assets of the Western Estate for his own personal benefit, A.R. Tab 7, page 56, lines 8 to 11, that attempts were made to persuade customers of Western to send payments for accounts receivable belonging to Western to a Post Office Box in the name of MTS, Inc., A.R. Tab 7, page 59, lines 16-26, that $25,000 was withdrawn from a Western bank account on March 2, 1998, A.R. Tab 7, page 62, lines 7-9, and that it was necessary to inform the customers of Western of the pendency of the bankruptcy proceeding to prevent Seth Murdock from being able to divert receivables from Western. A.R. Tab 7, page 60, lines 8-12. Furthermore, the Trustee discovered that Mr. Murdock had used 5-6 different social security numbers and 4-5 different birth dates, and that he pled guilty to felony perjury on May 18, 1989. A.R. Tab 7, page 61.[3] In fact, the Trustee stated on the record at the hearing on April 30, 1998 that “... there are hundreds and hundreds of thousands of dollars that are missing from this case.” E.R. Tab 10, page 54, lines 15-20.

The finding of bad faith is also supported by the evidence that was submitted to the Bankruptcy Court at the hearing on April 15, 1998 where the Bankruptcy Court appointed a Chapter 11 Trustee in the Western case and entered a preliminary injunction against Seth Murdock. At this hearing

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[3] A copy of the guilty plea is attached to the Trustee’s Report as Exhibit D. A.R. Tab 7, page 67.

the Court was presented with copies of invoices and address labels. A.R. Tab 16, pages 247-249. This evidence was offered to show that invoices of account receivables of Western were being sent to debtors of the Estate which requested the debtors to send payment to a P.O. Box in Irvine, California, which was close to the residence of Mr. Murdock. Id. Therefore, this evidence supports the statements in the Trustee’s report that Mr. Murdock appears to have diverted funds from the Western estate for his personal use. Finally, Durable Sales, Inc. filed declarations which stated that Western was not segregating the cash collateral of Durable Sales, Inc. A.R. 4, page 32.

Therefore, the Court had been presented with evidence that a significant amount of money had disappeared from the Western Estate, that Mr. Murdock appeared to be behind this diversion and that Western had not been segregating, and was using, the cash collateral of at least one of its secured creditors. The fact that these activities occurred with respect to the Western case, and not the instant case, is not material since Mr. Murdock is the president of Western and MTS, Inc. A.R. Tab 1, page 2; A.R. Tab 9, page 95. This is buttressed by the fact that the creditors who appeared at the hearing on April 30, 1998 expressed a concern that Mr. Murdock would continue to play fast and loose with the bankruptcy system. E.R. Tab 10, page 67. Thus, the record is more than sufficient to enable the Bankruptcy Court to make a finding of bad faith. In no way can this Court conclude that there is no evidence in the record to support the finding of bad faith, as

Appellants contend. Appellant’s Opening Brief at 15-16. Neither can this Court conclude, viewing the record as a whole, that it is left with the definite and firm conviction that a mistake has been made. Therefore, this Court cannot conclude that the finding of bad faith constitutes clear error, and must affirm this finding.

E. The Bankruptcy Court Did not Abuse Its Discretion By Enjoining Murdock Transportation Systems, Inc. From Filing a Voluntary Petition For 365 Days

As was explained above at section VI.B.2., bankruptcy courts have the discretion, pursuant to 11 U.S.C. § 349(a), to enjoin a debtor from filing a petition in the future for cause. Certainly, where a court has dismissed the case for bad faith, where the Debtor has failed to comply with the reporting requirements of the United States Trustee and where the principal of the Debtor has been alleged to have diverted funds from another estate, it cannot constitute an abuse of discretion for the court to enter the injunction. Therefore, the Bankruptcy Court did not abuse its discretion by enjoining MTS, Inc. from filing a voluntary petition for 365 days. Furthermore, the United States Trustee contends that the Court had sufficient cause to enjoin Seth Murdock as well. The United States Trustee acknowledges, however, that he should not be enjoined without having an opportunity to show cause why he should not be subject to such an injunction.

F. Debtor Was Provided Due Process, But It Would Be Appropriate to Remand the Case to Provide Seth Murdock with an Opportunity to Respond Consistent With His Due Process Rights.

The Due Process Clause generally requires that parties be given notice that, under the circumstances, is reasonably calculated to provide adequate notice of the pendency of the hearing and an opportunity to respond. Mullane v. Central Hanover Bank & Trust, Co., 339 U.S. 306, 314, 70 S.Ct. 652, 657, 94 L.Ed. 865 (1950), quoted in Walthall v. United States, 131 F.3d 1289, 1294 (9th Cir. 1997). Bankruptcy courts have recognized that due process does not require notice of all possible ramifications of a hearing, but instead is a flexible standard that only requires the procedural protections required by the facts of the case. In re Michigan General Corp., 78 B.R. 479, 485 (Bankr. N.D. Tex. 1987); In re Petro, 18 B.R. 566, 569 (Bankr. E.D. Pa. 1982). In fact, the Petro Court specifically found that “due process does not require informing the debtor of all the possible ramifications of a dismissal hearing.” 18 B.R. at 569.

In the instant case, the due process rights of the Debtor were not violated. The Debtor was served with the United States Trustee’s Motion to Dismiss, which requested the imposition of an 180 day bar as to the Debtor, **and such other relief as the Court deemed to be appropriate**, based on the Debtor’s failure to comply with the reporting requirements of the United States Trustee and its failure to obtain counsel. A.R. Tab 10. These allegations alone are typically sufficient to impose an 180 day bar on the Debtor pursuant to section

349(a). In re Huerta, 137 B.R. 356,375 (Bankr.C.D.Cal. 1992); Stuart Glass & Mirror, Inc., 77 B.R. at 334.[4]

Furthermore, Debtor was informed of the pendency of the hearing and of its right to object to the relief requested. A.R. Tab 10, page 106. Debtor, however, failed to so object and failed to have an attorney appear in Court on its behalf pursuant to Former Local Rule 102(7). The fact that the Debtor did not receive express notice that the Bankruptcy Court might make a finding of bad faith did not affect the ability of the Debtor to hire counsel and prepare for the hearing. In fact, Debtor's failure to obtain counsel prevented it from being able to make any arguments at the hearing. Furthermore, the request for such other relief that the Court deemed appropriate was sufficient to put the Debtor on notice that it could be subject to relief such as the relief that was imposed, and that the Court might take notice of other facts that were presented. It certainly was not unreasonable to expect that the Court might exercise its discretion to impose a bar longer than 180 days, given the activity that was alleged to have occurred with respect to the Western case. Therefore, the due process rights of the Debtor were not violated.

The service of the Motion to Dismiss on Seth Murdock

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[4] Appellants reliance on Memphis Light, Gas & Water v. Craft, 436 U.S. 1, 14, 98 S.Ct. 1554, 1563, 56 L.Ed. 2d 30 (1978) is misplaced. In that case, the Supreme Court merely held that where one does not receive notice of one's rights to present objections to the requested relief, the notice is insufficient for due process purposes. 435 U.S. at 14-15, 98 S.Ct. at 1563.

also was sufficient to put him on notice that he might be enjoined from filing a voluntary petition in the future. A.R. Tab 10, page 108. While the Motion did not request this relief, it was reasonable to conclude that it might be imposed since he is the principal of all three debtors. In fact, he had already been subject to injunctive relief with respect to Western and was alleged to have diverted assets from the Western Estate. Therefore, because he was the principal of MTS, Inc., and because the United States Trustee sought to enjoin MTS, Inc., it was not unreasonable for him to conclude that he might be subject to further injunctive relief in this case.

The United States Trustee acknowledges, however, that Seth Murdock did not have an opportunity to respond to the Court’s statement that it was inclined to bar him personally from filing a voluntary petition for 365 days. In fact the Court did not allow him to speak. E.R. Tab 10, page 71, lines 19-20. Therefore, if the Court is not inclined to affirm the Order as it applies to Seth Murdock, the United States Trustee requests that the case be remanded to the Bankruptcy Court to provide Mr. Murdock with an opportunity to show cause why he should not be enjoined from filing a voluntary petition for 365 days from the entry of the Order.

VIII.

CONCLUSION

For the reasons stated above, the United States Trustee requests that the Court a) affirm the finding of bad faith b) affirm the injunction that is applicable to Murdock

Transportation Services, Inc. and c) remand the case to the Bankruptcy Court to provide Seth Murdock an opportunity to show cause why he should not be subject to the injunction.

Dated: November 19, 1998

OFFICE OF THE UNITED STATES TRUSTEE

By:_______________________________
PETER BURKE
Attorney for the U.S. Trustee
221 N. Figueroa St., Suite 800
Los Angeles, California 90012
TEL: (213) 894-7247
FAX: (213) 894-2603

ADDENDUM

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PROOF OF SERVICE BY MAIL

STATE OF CALIFORNIA
COUNTY OF LOS ANGELES

I am employed in the County of Los Angeles, state of California, in the Office of the Unites States Trustee under the supervision of a member of the bar of this court at whose direction the service hereinafter described was made; I am over the age of 18 and not a party to the within action; and my business address is: 221 N. Figueroa St., Suite 800, Los Angeles California 90012.

On November 19, 1998, I served the foregoing document described as: APPELLEE MAUREEN A. TIGHE, UNITED STATES TRUSTEE OPENING BRIEF on the interested parties at their last known address in the action by placing a true and correct copy thereof in a sealed envelope with sufficient postage thereon full prepaid, in the United States Mail at Los Angeles, California, addressed as follows:

Appellant:
Murdock Transportation Systems, Inc.
dba Jim Baker Trucking
P. O. Box 11503
Santa Rosa, CA 95406

ATTORNEY FOR APPELLANT, MURDOCK TRANSPORTATION SYSTEMS, INC.:
Nancy Hoffmeier Zamora, Esq.
Zamora & Hoffmeier
520 South Grand Avenue, Suite 675
Los Angeles, CA 90071

ATTORNEY FOR APPELLANT, SETH MURDOCK:
Judith Seeds Miller, Esq.
Miller & Miller
16130 Ventura Boulevard, Suite 650
Encino, CA 91436-2543

I declare under the penalty of perjury that the foregoing is true and correct.

DATED: November 19, 1998

____
STEPHANIE HILL

BRIEF BANK — "SUMMARY SHEET" Printed Fri.-5/28/99 (16:37)

WESTLAW CODES

1. ("TI") TITLE OF CASE [E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]
In re MTS Jim Baker Trucking —
Murdock Transp. Systems, Inc. & Seth Murdock v. Office of United States Trustee

2. ("CO") CURRENT COURT [E.g., "CTA9"]
BAP-9 (9th Cir. Bankr. Appellate Panel)

3. ("CCN") CURRENT CASE NO.
No.: CC 98-1396

4. ("PCN") PRIOR CASE NO. & COURT [IF ANY]
No.: LA 98-20538-ER
Court: U.S. Bankruptcy Court, Central District of California (Judge Robles)
(Identify judge & cite, if any)

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Peter Burke (OUST-Los Angeles) (213-894-6811)
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") TOPIC
BANKRUPTCY

9. ("SU") • SUMMARY OF KEY ISSUE(s) & / Any Miscellaneous BACKGROUND

• 1) Standing to appeal; 2) Jurisdiction to impose 1-year bar against refiling; 3) Personal jurisdiction over non-debtor principals; 4) Whether imposition of refiling bar on Debtor & principal violated due process when motion only sought to bar Debtor; 5) Whether the Court abused its discretion by finding bad faith based on a report of a Chapter 11 Trustee in a related case.

/ **Background:** Three related petitions were filed & a Chapter 11 trustee was appointed in one case. The UST filed a motion to dismiss and sought a 180-day bar against Debtors. Court imposed a 365-day bar based on the motion and a report filed only in the related case and did not let Mr. Murdock to speak on his behalf. The BAP affirmed as to the Debtor but remanded as to Mr. Murdock.

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UNITED STATES BANKRUPTCY APPELLATE PANEL
OF THE NINTH CIRCUIT

In re

MTS JIM BAKER TRUCKING,

Debtor in Possession,

SETH MURDOCK; MURDOCK
TRANSPORATION SYSTEMS,
INC.,
Appellants

vs.

OFFICE OF THE UNITED STATES
TRUSTEE,
Appellee

BAP No. CC-98-1396

Case No. LA 98-20538-ER

Appeal From The United States Bankruptcy Court
For The Central District of California

Honorable Ernest Robles
Bankruptcy Judge, Presiding

APPELLEE MAUREEN A. TIGHE, UNITED STATES TRUSTEE OPENING BRIEF

MAUREEN A. TIGHE
United States Trustee
Terri Hawkins Andersen
Assistant U.S. Trustee
Alvin P. Mar, SBN 151482
Staff Attorney
Peter S. Burke, SBN 196273
Staff Attorney
OFFICE OF THE U.S. TRUSTEE
221 N. Figueroa Street
Suite 800
Los Angeles, Calif. 90012
TEL: (213) 894-7247
FAX: (213) 894-2603

November 19, 1998

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I.

JURISDICTION

The statutory basis of jurisdiction of this appeal is 28 U.S.C. §§ 158(a) and 158(b)(1). The statutory basis of jurisdiction for the Bankruptcy Court was 28 U.S.C. §§ 157, 1334.

II.

STATEMENT OF ISSUES ON APPEAL

A. Whether Appellants have standing to appeal the provisions of the order which enjoined other entities from filing a voluntary petition for 365 days.

B. Whether the Bankruptcy Court had subject matter jurisdiction to find that the petition was filed in bad faith and to impose on Debtor, Seth Murdock and affiliates of the Debtor, based on this finding, a 365 day bar from filing voluntary bankruptcy petitions.

C. Whether the Bankruptcy Court had personal jurisdiction over Appellants.

D. Whether the Bankruptcy Court committed clear error when it made a finding of bad faith with respect to this Debtor.

E. Whether the Bankruptcy Court abused its discretion by enjoining Debtor, Seth Murdock and Murdock Transportation System, Inc. from filing a voluntary petition for 365 days.

F. Whether the procedural due process rights of the Appellants were violated by the Bankruptcy Court when it imposed a 365 day bar on their ability to file a voluntary bankruptcy petition.

III.

STANDARD OF REVIEW

A bankruptcy court’s exercise of subject matter jurisdiction is reviewed *de novo*. Securities and Exchange Commission v. Colello, 139 F.3d 674 (9th Cir. 1998). Similarly, a determination of whether a bankruptcy court had personal jurisdiction over the parties to the appeal is a question of law which is subject to *de novo* review. Omeluk v. Langsten Slip & Batbyggeri A/S, 52 F.3d 267, 269 (9th Cir. 1995). Furthermore, a claim that one’s due process rights have been violated is reviewed *de novo.* Gonzalez-Julio v. I.N.S., 34 F.3d 820, 823 (9th Cir. 1994). Finally, all issues of law, such as the court’s statutory authority to enjoin the filing of a voluntary petition or the standing of Appellants to appeal an order, are reviewed *de novo*. AT & T Universal Card Services v. Black (In re Black), 222 B.R. 896, 899 (9th Cir. BAP 1998). Therefore, these issues are reviewed directly by this Court.

Orders dismissing a bankruptcy case for bad faith are reviewed for an abuse of discretion. Leavitt v. Soto (In re Leavitt), 209 B.R. 935, 938 (9th Cir. BAP 1997); Marsch v. Marsch (In re Marsch), 36 F.3d 825, 827 (9th Cir. 1994). Similarly, the grant of an injunction is discretionary and is reviewed for an abuse of discretion. Parsons v. Plotkin (In re Pacific Land Sales, Inc.), 187 B.R. 302, 308 (9th Cir. BAP

1995). A finding of bad faith, however, is reviewed for clear error. In re Marsch, 36 F.3d at 827; In re Leavitt, 209 B.R. at 938. Under this standard, if the trial court's account of the evidence is plausible in light of the record viewed in its entirety, a reviewing court may not reverse even if convinced that it would have weighed the evidence differently as trier of fact. Anderson v. City of Bessemer City, N.C., 470 U.S. 564, 574, 105 S.Ct. 1504, 1511-12, 84 L.Ed.2d 518 (1985); In re Leavitt, 209 B.R. at 938. Indeed, reversal under the clearly erroneous standard is only warranted if the reviewing court on the entire evidence is left with the definite and firm conviction that a mistake has been committed. United States v. United States Gypsum Co., 333 U.S. 364, 395, 68 S.Ct. 525, 542, 92 L.Ed. 746 (1948); In re Leavitt, 209 B.R. at 938.

IV.

INTRODUCTION

The issues in this case arise from the Bankruptcy Court's attempt to protect the Bankruptcy system from abuse where there was evidence of a pattern and practice of abuse by Seth Murdock, the principal of this Debtor and of several related debtors. This pattern and practice of abuse was made known to the Bankruptcy Court at the hearing on a motion to appoint a Chapter 11 Trustee in the Western XPress, Inc. case and through, among other things, the Report that was filed by the Chapter 11 Trustee that was appointed. Through these sources, the Bankruptcy Court received evidence which suggested that Seth Murdock had attempted shift assets from one entity to another for his own financial benefit to the detriment of the rights of various creditors in this case and related cases. In fact, the Chapter 11 Trustee stated on the record that hundreds of thousands of dollars in assets were missing from the Western XPress, Inc. estate. Based on this record, it was appropriate for the Bankruptcy Court to take steps to prevent further abuses of the bankruptcy system by Seth Murdock.

V.

STATEMENT OF THE CASE[1]

The Debtor in Possession, MTS Jim Baker Trucking, dba Jim Baker Trucking filed a chapter 11 petition in the United States Bankruptcy Court on March 18, 1998. A.R. Tab 9. The bankruptcy petition was signed by Seth Murdock as president of the corporation. The corporation was not represented by counsel. A.R. Tab 9, page 95. The lack of an attorney as well as its failure to comply with the reporting requirements of the United States Trustee resulted in the filing of a motion to dismiss or convert this case under 11 U.S.C. §1112(b) which was set for hearing on April 30, 1998. A.R. Tabs 10 and 11. In addition, the identity of the Debtor was in question because only the face sheet of the petition listed MTS Jim Baker Trucking as the Debtor; all other pages of the voluntary Chapter 11 petition, including a duplicate face sheet, referred to the Debtor as Murdock Transportation

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[1] All references herein to “E.R.” are to Appellant’s Excerpts of Record. All references to “A.R.” are to Appellee’s Excerpts of Record filed concurrently herewith.

Systems, Inc. A.R. Tab 9. This issue was not clarified until Appellants filed their opening brief in the MTS Jim Baker Trucking case which admits that the Debtor in that case was erroneously named on page one of the petition as MTS Jim Baker Trucking, and that the true and correct name of the Debtor is Murdock Transportation Systems, Inc., dba Jim Baker Trucking. Appellants Opening Brief at 5, n. 3. Based on this admission, the United States Trustee will treat the Debtor in the MTS Jim Baker Trucking case and Murdock Transportation System, Inc. as the same entity (hereinafter “MTS, Inc.”).

Hearings on two other related Chapter 11 petitions were pending before the Bankruptcy Court on April 30, 1998, the date when the U.S. Trustee’s motion to dismiss or convert MTS’s Chapter 11 case was calendared. The petition of the first of the two related Chapter 11 petitions, Western Motor Xpress, Inc. (hereinafter “Western”) reflects the signature of Seth Murdock as president of the corporation, A.R. Tab 1, page 2, while the Statement of Financial Affairs of the second related Chapter 11 case, Espinosa Cartage Company, Inc., (hereinafter “Espinosa”) indicated that Seth Murdock was also the president of that corporation. A.R. Tab 13, page 160.

The first of these cases, Western, was filed on April 3, 1998 under case number LA 98-23236-ER. A.R. Tab 1. An emergency hearing was held on April 15, 1998 with respect to creditor Durable Sales’ motion to appoint a Chapter 11 Trustee. A.R. Tabs 2 and 3. Evidence was submitted which indicated that the Estate appeared to have used cash collateral to pay for operating expenses and payroll. A. R.

Tab 4, page 32, lines 17-18. The United States Trustee joined in the motion to appoint a Chapter 11 Trustee on the grounds that Western failed to perform its duties under 11 U.S.C. §1107 to account for property of the estate and comply with the United States Trustee’s reporting requirements. A.R. Tab 5. At the April 15, 1998 hearing on the motion for the appointment of a Chapter 11 Trustee, Durable Sales presented evidence that Western’s accounts receivable were being diverted. A.R. Tab 16, pages 247-249. The Bankruptcy Court directed the appointment of a Chapter 11 Trustee at the April 15, 1998 hearing. A.R. Tab 16, pages 250-251. That order included an injunction against Seth Murdock and any person involved in the current management of Western or their agents or representatives preventing their return to Western’s premises or from obtaining, taking, diverting, or otherwise withdrawing any funds, mail, checks, or other items from any post office boxes in the names of Western or MTS, Inc. A.R. Tab 6, pages 50 and 51. A subsequent report filed by the Chapter 11 Trustee further confirmed that Western’s accounts receivable had been diverted. A.R. Tab 7, page 59, lines 16-26. This report was presented to the Bankruptcy Court at the hearing on April 30, 1998.

The second related Chapter 11 case of Espinosa, case number LA 98-20715-ER, was filed on March 19, 1998. A.R. Tab 12. Because the Debtor in that case, like that of MTS, Inc., was not represented by counsel, a motion to dismiss for failure to comply with Former Local Bankruptcy Rule 102(7)(a) was filed by the United States Trustee and set for hearing on

April 30, 1998. A.R Tabs 14 and 15. Hearings on the United States Trustee’s motion to dismiss the Chapter 11 petition of Espinosa for failure to comply with Former Local Bankruptcy Rule 102(7)(a), the U.S. Trustee’s motion to dismiss or convert the related Chapter 11 petition of MTS, Inc. under 11 U.S.C. §1112(b), and the status conference and hearing on the final injunction in Western, were all calendared for April 30, 1998.

The Bankruptcy Court reviewed the Chapter 11 Trustee’s Report in Western, which indicated continued diversion of monies to other related entities, the lack of accounting records, and the commingling of business operations. A.R. Tab 7; E.R. Tab 10, pages 51, 73. At the hearing, the Bankruptcy Court ordered its preliminary injunction, rendered at the April 15, 1998 hearing, to become final, with certain allowances for previous management to gain entry to Western’s business premises. A.R. Tab 8.

The Bankruptcy Court also heard argument on the U.S. Trustee’s motions in MTS, Inc. and Espinosa. At the hearings, the Bankruptcy Court enjoined the Debtor, its principal, Seth Murdock, any entity in which Seth Murdock was an officer, director, employee, or in which Murdock held a controlling interest on the date on which the Debtor’s case was filed from filing a voluntary bankruptcy petition for a period of 365 days. E.R. Tab 10, pages 71-75. The order containing these provisions (hereinafter “the Order”) was entered on May 15, 1998. E.R. Tab 5.

VI.

SUMMARY OF ARGUMENT

First, Appellants do not have standing to obtain all the relief that they request. While they do have standing to appeal the relief that was granted against them, they do not have standing to appeal the relief that was granted against the other entities. Therefore, this Court's consideration of the appeal should be limited to issues which relate to findings of bad faith and the right of Appellants to file a voluntary petition.

Secondly, the Bankruptcy Court had subject matter jurisdiction concerning the dismissal of the case for bad faith and the issuance of a bar against Appellants, among others, from filing a voluntary petition for 365 days because such relief was necessary to enable the Court to efficiently administer the Western estate and to prevent diversion of Estate assets.

Furthermore, the Bankruptcy Court had personal jurisdiction over Appellants. The United States Trustee's Motion to Dismiss the MTS, Inc. case was served on Appellants and gave them notice that the United States Trustee was seeking a bar against filing a voluntary petition against the Debtor, as well as any other relief that the Court deemed appropriate. A.R. Tab 10, pages 108 and 109. Therefore, the service of the Notice of Motion and Motion to Dismiss in the MTS, Inc. case was sufficient to enable the Court to obtain personal jurisdiction over Appellants.

The Bankruptcy Court's finding of bad faith does not constitute clear error and is adequately supported by the record. Similarly, the Bankruptcy Court's decision to enjoin MTS, Inc. does not constitute an abuse of discretion, based on the record and the fact that the Bankruptcy Court made a finding of bad faith. Further, while the United States Trustee contends that the Bankruptcy Court had the authority to enjoin Seth Murdock, she acknowledges that Seth Murdock should not be bound by such an injunction until he has an opportunity to show cause why it should not be issued.

Finally, Debtor's due process rights were not violated when the Bankruptcy Court enjoined the Debtor from filing a voluntary petition for 365 days because it was served with the motion to dismiss and because the motion requested injunctive relief against the Debtor, among other reasons. Furthermore, Seth Murdock's right to notice was respected by the Bankruptcy Court because he was served with the motion. The Court's refusal to allow him to speak on his own behalf, however, was problematic. This deficiency can be remedied on remand by providing Mr. Murdock with an opportunity to show cause why the injunction should not be imposed.

VII.

ARGUMENT

A. Appellants Do Not Have Standing to Appeal the Order as to the Other Non-Debtor Entities

Before this Court can consider the other issues raised by Appellants, it must determine whether Appellants have standing to obtain the appellate relief that they seek. Standing is a threshold question that relates to the jurisdiction of the court to consider the appeal. City of South Lake Tahoe v. California Tahoe Regional Planning Agency, 625 F.2d 231, 232 (9th Cir. 1980). Therefore, this Court can only review the Order to the extent that Appellants have standing to seek such review.

It is black letter law that a party may only appeal to protect its own interests and does not have standing to file an appeal to protect the interests of another. Estate of Bishop v. Bechtel Power Corp., 905 F.2d 1272, 1276 (9th Cir. 1990); Morrison Knudsen Co., Inc. v. CHG International, Inc., 811 F.2d 1209, 1214 (9th Cir. 1987). A party does not have standing to appeal unless it is aggrieved by the order. Bryant v. Technical Research Co., 654 F.2d 1337, 1343 (9th Cir. 1981). Furthermore, an indirect financial stake in another party's claims is insufficient to create standing on appeal. Evanston Insurance Co. v. Fred A. Tucker & Co., Inc., 872 F.2d 278, 280 (9th Cir. 1989); Libby, McNeill, and Libby v. City National Bank, 592 F.2d 504, 511-512 (9th Cir. 1978); SEC v. Secs. Northwest, Inc., 573 F.2d 622, 625-626 (9th Cir. 1978)(Principal has no standing to appeal order relating to liquidation of debtor to minimize his liability for debtor's unpaid taxes).

In the instant case, Appellants do not have a direct stake in the interest of the other non-Debtor entities in being able to file a voluntary petition before May 15, 1999. They only have a direct stake in protecting their own right to file a voluntary petition. If the principal in Secs. Northwest, Inc. did not have standing to appeal an order relating to the debtor's liquidation to minimize his tax liability, then certainly the Appellants do not have standing to appeal the part of the Order which enjoins the other non-debtor entities from filing a voluntary petition. Instead, Appellants only have standing to appeal the Order to the extent that it bars them from filing a voluntary petition. Therefore, the Court should limit its consideration of the appeal to the issues that relate to the finding of bad faith and the right of MTS, Inc. and Seth Murdock to file a voluntary petition before May 15, 1999.

B. The Bankruptcy Court had Subject Matter Jurisdiction Over the Issues Before It.

1. The Instant Contested Matter Constitutes a Core Proceeding

The United States Trustee agrees that subject matter jurisdiction of the bankruptcy courts is grounded in and limited by statute. Celotex Corp. v. Edwards, 514 U.S. 300, 307, 115 S.Ct. 1493, 1498, 131 L.Ed.2d 403 (1995). The Celotex court noted, however, that Congress intended to grant comprehensive jurisdiction to the bankruptcy courts so that they might deal efficiently and expeditiously with all matters connected with the bankruptcy estate. 514 U.S. 300, 308, 115 S.Ct. 1493, 1499, 131 L.Ed.2d 403 (1995). Furthermore, the statutory grant of subject matter jurisdiction to bankruptcy courts is not contained in Title 11. Title 11 of the United States Code sets forth the rights of parties in the bankruptcy system and the authority to provide specific relief in cases over which it has jurisdiction. In fact, it is well settled that an allegation that a court does not have the statutory authority to provide a specific form of relief does not implicate the subject matter jurisdiction of the court. Steel Company v. Citizens for a Better Environment, 118 S.Ct. 1003, 1010, 140 L.Ed. 2d 210 (1998).

Instead the subject matter jurisdiction of the Bankruptcy Court is governed by 28 U.S.C. §§ 1334 and 157. Section 1334(b) provides that ". . . the district courts shall have original but not exclusive jurisdiction of all civil proceedings arising under title 11, or arising in or related to cases under title 11." Section 157(a) of Title 28 of the United States Code permits the district court to refer "any or all proceedings arising under title 11 or arising in or related to a case under title 11 . . . to the bankruptcy judges for the district." In turn, section 157(b) permits bankruptcy judges to hear all core proceedings arising under Title 11 which include matters concerning the administration of the estate. Furthermore, Section 157(b)(2)(O) of Title 28 of the United States Code reflects the fact that other proceedings affecting the liquidation of the assets of the estate are also core proceedings.

The Bankruptcy Court at the hearing on April 30, 1998 was concerned about addressing the appropriate remedy to preserve the rights of the creditors in the related Chapter 11 case of Western to ensure that the property of that Estate would neither be dissipated nor transferred to other affiliated companies which may seek relief under the Bankruptcy Code. The Bankruptcy Court had previously received evidence of the diversion of accounts receivable, at the hearing on the appointment of a Chapter 11 Trustee in Western, which was subsequently confirmed by the Report of the Chapter 11 Trustee. A.R. Tab 7, page 59, lines 16-26. This Report led the Bankruptcy Court to make final its preliminary injunction against Seth Murdock and others from obtaining unlimited access to Western's business premises. A.R. Tab 8. The bar against refiling was issued to minimize the risk of further dissipation of assets in Western. Therefore, the instant contested matter concerns the administration of the estate and the liquidation of assets and thus is a core proceeding. As a result, the Bankruptcy Court had subject matter jurisdiction over the issuance of the injunctions.

2. The Bankruptcy Court Had the Authority to Enjoin Appellants From Filing Voluntary Petitions

As was explained above, the subject matter jurisdiction of the Bankruptcy Court over the instant contested matter is provided by the fact that it arises in a case under Title 11, and relates to the efficient administration and liquidation of assets of the Western Estate, among others. Therefore, the issue of the Bankruptcy Court's authority to enjoin non-debtor entities does not affect the Bankruptcy Court's subject matter jurisdiction, but instead relates to the Bankruptcy Court's statutory authority to grant such injunctive relief.

In any event, the United States Trustee disagrees with Appellant's construction of section 349(a).[2] Appellants

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[2] 11 U.S.C. § 349(a) provides:

> Unless the court, for cause, orders otherwise, the dismissal of a case under this title does not bar the discharge, in a later case under this title, of debts that were dischargeable in the case dismissed;

wrongly contend that section 349(a) provides that a bar on refiling can only be issued to the extent provided for by section 109(g). Appellant's Opening Brief at 13-14. This argument presumes that the phrase "[u]nless the court, for cause, orders otherwise," only modifies the clause preceding the semi-colon and that it does not apply to the rest of subsection 349(a). The courts in the Ninth Circuit have not addressed this issue. The majority of the courts which have analyzed this issue, however, have rejected this approach, have determined that the phrase "[u]nless the court, for cause, orders otherwise," modifies the entire subsection and have concluded that they can enjoin refiling independent of the authorization in section 109(g). In re Casse, 219 B.R. 657, 662 (Bankr. E.D. N.Y. 1998); Stathatos v. United States Trustee for Northern District of Texas (In re Stathatos), 163 B.R. 83, 88 (N.D. Tex. 1993) (Court affirmed bar of two years); Jolly v. Great Western Bank (In re Jolly), 143 B.R. 383, 387 (E.D. Va. 1992); Benefield v. United States Trustee, 1991 WL 542279, *2 (N.D. Tex. 1991) (Court affirmed bar of one year); Lerch v. Federal Land Bank of St. Louis (In re Lerch), 94 B.R. 998, 1001 (N.D. Ill. 1989) (Court affirmed bar of two years); In re McKissie, 103 B.R. 189, 193 (Bankr. N.D. Ill. 1989) (Debtors barred from filing a voluntary petition for one year); In re Stuart Glass & Mirror, Inc., 77 B.R. 332, 334 (Bankr. S.D. Fla. 1987) (Court barred corporate debtor from

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> nor does the dismissal of a case under this title prejudice the debtor with regard to the filing of a subsequent petition under this title, except as provided in section 109(g) of this title.

filing a voluntary petition for two years pursuant to section 105). These courts have noted the fact that “nor” is used to create a conjunction between the two clauses and have found that the semi-colon does not create two independent clauses. See e.g. Jolly, 143 B.R. at 387. In fact, the only courts to adopt the construction suggested by Appellants are from the 10th Circuit. In re Freiouf, 938 F.2d 1099, 1103 (10th Cir. 1991). The majority view appears to be the better reading of the statute. If a court can permanently enjoin a debtor from ever obtaining a discharge of its then existing debts for cause, it certainly should be able to impose the less draconian remedy of enjoining the filing of a voluntary petition for one year. In re Dilley, 125 B.R. 189, 197 (Bankr. N.D. Ohio 1991).

Furthermore, section 109(g) was adopted to limit bad faith filings. In re Kinney, 51 B.R. 840, 846 (Bankr. C.D. Cal. 1985) (Mund, J.). When creative debtors attempt to avoid its restrictions, a bankruptcy court may utilize the authority in section 105 to enforce this intent. In fact, section 105(a) specifically authorizes the Bankruptcy Court to issue any order which is necessary to carry out the provisions of the Code or to prevent an abuse of process. Since sections 349(a) and 109(g) do not prohibit the exercise of this power, there is no reason to conclude that the Bankruptcy Court did not have this power to exercise at its discretion. Therefore, the Bankruptcy Court at least had the discretion to enjoin MTS, Inc. from filing a voluntary petition for 365 days.

This analysis also suggests that the Bankruptcy Court had the power to enjoin non-debtors from filing a voluntary petition for a period of time if cause is found. This is especially true where the Court dismisses a case for bad faith, and where the bad faith conduct was committed by the non-debtor who is the principal and sole shareholder of the Debtor. Therefore, not only did the Court have subject matter jurisdiction over the instant contested matter, but it also had the authority to enjoin the Appellants from filing a voluntary petition for 365 days.

C. The Bankruptcy Court had Personal Jurisdiction Over the Appellants.

A court obtains personal jurisdiction over a party by actual service of process or by voluntary appearance. Burnham v. Superior Court of California, County of Marin, 495 U.S. 604, 615, 110 S.Ct. 2105, 2113, 109 L.Ed.2d 631 (1990)(Service of process is sufficient to confer personal jurisdiction); Veek v. Commodity Enterprises, Inc., 487 F.2d 423, 425 (9th Cir. 1973). In the context of a bankruptcy proceeding, the bankruptcy court acquires personal jurisdiction through compliance with Federal Rule of Bankruptcy Procedure 9014, which governs contested matters and requires that notice and an opportunity for a hearing “be afforded the party against whom relief is sought”. Rule 9014 also requires service of the motion in accordance with Federal Rule of Bankruptcy Procedure 7004. Specifically, it authorizes service of process on an individual by mailing it to the place where the individual regularly conducts a business or profession. Fed. Rule Bankr. P. 7004(b)(1).

In the instant case, Appellants do not contend that the Court did not have personal jurisdiction over Debtor. Appellant’s Opening Brief at 15. In fact, Appellants could not make this contention because Debtor consented to the Court’s personal jurisdiction by filing the voluntary petition.

Instead, Appellants merely contend that the Bankruptcy Court did not have personal jurisdiction over the non-debtor entities. Appellant’s Opening Brief at 15. The only other Appellant who is a non-debtor entity is Seth Murdock. The motion to dismiss or convert the case of MTS, Inc. was served on Seth Murdock at the address on listed for the Debtor on the first page of the voluntary petition. A.R. Tab 9, pages 93; A.R. Tab 10, page 121. This service satisfies Bankruptcy Rule 7004(b)(1) with respect to Seth Murdock because the address that was listed on the petition was the only address that the United States Trustee had for Mr. Murdock, and it was reasonable to conclude that he regularly conducts business at this address, since he signed the petition as the President of the Debtor. Therefore, since Seth Murdock did receive notice of the United States Trustee’s Motion, the Court did obtain personal jurisdiction over Mr. Murdock and the alleged jurisdictional defect does not exist.

D. The Bankruptcy Court’s Finding of Bad Faith Does Not Constitute Clear Error

Section 1112(b) does not expressly require that a petition be filed in good faith, but evidence of bad faith or of an intent to abuse the reorganization process is sufficient “cause” upon which a case can be dismissed. In re Marsch, 36 F.3d at 828; In re Thirtieth Place, Inc., 30 B.R. 503, 505 (9th Cir. Bankr. 1983); In re ACI Sunbow, LLC, 206 B.R. 213, 217 (Bankr. S.D. Cal. 1997). A determination of whether a petition was filed in bad faith is within the Bankruptcy Court’s discretion. In re Arnold, 806 F.2d 937, 939 (9th Cir. 1986); In re Thirtieth Place, Inc., 30 B.R. at 505. Detriment to the secured creditor is not the only harm resulting from a bad faith filing. “A bad faith filing is an abuse of the bankruptcy process and is offensive to the integrity of the bankruptcy system.” In re Yukon Enterprises, Inc., 39 B.R. 919, 922 (Bankr. C.D. Cal. 1984). Delay prejudicial to creditors as well as abuse of process have been found to support the finding of bad faith. In re Ortiz, 200 B.R. 485 (D.Puerto Rico 1996).

In this case, the Bankruptcy Court specifically found that the petition was filed in bad faith and dismissed the case based, in part, on this finding. E.R. Tab 10, pages 72-73. Furthermore, contrary to the assertions of the Appellants, the record does support this finding. First of all, the Court stated on the record at the hearing on April 30, 1998 that its finding of bad faith was based on the report of the Chapter 11 Trustee who was appointed to represent the Western Estate. E.R. Tab 10, page 73, lines 1-5. While this report was filed in the Western case, the Bankruptcy Court was entitled to take judicial notice of it pursuant to Federal Rule of Evidence 201, made applicable by Federal Rule of Bankruptcy Procedure 9017. Therefore, because the Bankruptcy Court took judicial notice of this report it is part of the record and was before the Bankruptcy Court.

The Trustee’s Report informed the Court, among other things, that Seth Murdock had attempted to obtain assets of the Western Estate for his own personal benefit, A.R. Tab 7, page 56, lines 8 to 11, that attempts were made to persuade customers of Western to send payments for accounts receivable belonging to Western to a Post Office Box in the name of MTS, Inc., A.R. Tab 7, page 59, lines 16-26, that $25,000 was withdrawn from a Western bank account on March 2, 1998, A.R. Tab 7, page 62, lines 7-9, and that it was necessary to inform the customers of Western of the pendency of the bankruptcy proceeding to prevent Seth Murdock from being able to divert receivables from Western. A.R. Tab 7, page 60, lines 8-12. Furthermore, the Trustee discovered that Mr. Murdock had used 5-6 different social security numbers and 4-5 different birth dates, and that he pled guilty to felony perjury on May 18, 1989. A.R. Tab 7, page 61.[3] In fact, the Trustee stated on the record at the hearing on April 30, 1998 that “... there are hundreds and hundreds of thousands of dollars that are missing from this case.” E.R. Tab 10, page 54, lines 15-20.

The finding of bad faith is also supported by the evidence that was submitted to the Bankruptcy Court at the hearing on April 15, 1998 where the Bankruptcy Court appointed a Chapter 11 Trustee in the Western case and entered a preliminary injunction against Seth Murdock. At this hearing

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[3] A copy of the guilty plea is attached to the Trustee’s Report as Exhibit D. A.R. Tab 7, page 67.

the Court was presented with copies of invoices and address labels. A.R. Tab 16, pages 247-249. This evidence was offered to show that invoices of account receivables of Western were being sent to debtors of the Estate which requested the debtors to send payment to a P.O. Box in Irvine, California, which was close to the residence of Mr. Murdock. Id. Therefore, this evidence supports the statements in the Trustee’s report that Mr. Murdock appears to have diverted funds from the Western estate for his personal use. Finally, Durable Sales, Inc. filed declarations which stated that Western was not segregating the cash collateral of Durable Sales, Inc. A.R. 4, page 32.

Therefore, the Court had been presented with evidence that a significant amount of money had disappeared from the Western Estate, that Mr. Murdock appeared to be behind this diversion and that Western had not been segregating, and was using, the cash collateral of at least one of its secured creditors. The fact that these activities occurred with respect to the Western case, and not the instant case, is not material since Mr. Murdock is the president of Western and MTS, Inc. A.R. Tab 1, page 2; A.R. Tab 9, page 95. This is buttressed by the fact that the creditors who appeared at the hearing on April 30, 1998 expressed a concern that Mr. Murdock would continue to play fast and loose with the bankruptcy system. E.R. Tab 10, page 67. Thus, the record is more than sufficient to enable the Bankruptcy Court to make a finding of bad faith. In no way can this Court conclude that there is no evidence in the record to support the finding of bad faith, as

Appellants contend. Appellant’s Opening Brief at 15-16. Neither can this Court conclude, viewing the record as a whole, that it is left with the definite and firm conviction that a mistake has been made. Therefore, this Court cannot conclude that the finding of bad faith constitutes clear error, and must affirm this finding.

E. The Bankruptcy Court Did not Abuse Its Discretion By Enjoining Murdock Transportation Systems, Inc. From Filing a Voluntary Petition For 365 Days

As was explained above at section VI.B.2., bankruptcy courts have the discretion, pursuant to 11 U.S.C. § 349(a), to enjoin a debtor from filing a petition in the future for cause. Certainly, where a court has dismissed the case for bad faith, where the Debtor has failed to comply with the reporting requirements of the United States Trustee and where the principal of the Debtor has been alleged to have diverted funds from another estate, it cannot constitute an abuse of discretion for the court to enter the injunction. Therefore, the Bankruptcy Court did not abuse its discretion by enjoining MTS, Inc. from filing a voluntary petition for 365 days. Furthermore, the United States Trustee contends that the Court had sufficient cause to enjoin Seth Murdock as well. The United States Trustee acknowledges, however, that he should not be enjoined without having an opportunity to show cause why he should not be subject to such an injunction.

F. Debtor Was Provided Due Process, But It Would Be Appropriate to Remand the Case to Provide Seth Murdock with an Opportunity to Respond Consistent With His Due Process Rights.

The Due Process Clause generally requires that parties be given notice that, under the circumstances, is reasonably calculated to provide adequate notice of the pendency of the hearing and an opportunity to respond. Mullane v. Central Hanover Bank & Trust, Co., 339 U.S. 306, 314, 70 S.Ct. 652, 657, 94 L.Ed. 865 (1950), quoted in Walthall v. United States, 131 F.3d 1289, 1294 (9th Cir. 1997). Bankruptcy courts have recognized that due process does not require notice of all possible ramifications of a hearing, but instead is a flexible standard that only requires the procedural protections required by the facts of the case. In re Michigan General Corp., 78 B.R. 479, 485 (Bankr. N.D. Tex. 1987); In re Petro, 18 B.R. 566, 569 (Bankr. E.D. Pa. 1982). In fact, the Petro Court specifically found that “due process does not require informing the debtor of all the possible ramifications of a dismissal hearing.” 18 B.R. at 569.

In the instant case, the due process rights of the Debtor were not violated. The Debtor was served with the United States Trustee’s Motion to Dismiss, which requested the imposition of an 180 day bar as to the Debtor, **and such other relief as the Court deemed to be appropriate**, based on the Debtor’s failure to comply with the reporting requirements of the United States Trustee and its failure to obtain counsel. A.R. Tab 10. These allegations alone are typically sufficient to impose an 180 day bar on the Debtor pursuant to section

349(a). In re Huerta, 137 B.R. 356,375 (Bankr.C.D.Cal. 1992); Stuart Glass & Mirror, Inc., 77 B.R. at 334.[4]

Furthermore, Debtor was informed of the pendency of the hearing and of its right to object to the relief requested. A.R. Tab 10, page 106. Debtor, however, failed to so object and failed to have an attorney appear in Court on its behalf pursuant to Former Local Rule 102(7). The fact that the Debtor did not receive express notice that the Bankruptcy Court might make a finding of bad faith did not affect the ability of the Debtor to hire counsel and prepare for the hearing. In fact, Debtor's failure to obtain counsel prevented it from being able to make any arguments at the hearing. Furthermore, the request for such other relief that the Court deemed appropriate was sufficient to put the Debtor on notice that it could be subject to relief such as the relief that was imposed, and that the Court might take notice of other facts that were presented. It certainly was not unreasonable to expect that the Court might exercise its discretion to impose a bar longer than 180 days, given the activity that was alleged to have occurred with respect to the Western case. Therefore, the due process rights of the Debtor were not violated.

The service of the Motion to Dismiss on Seth Murdock

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[4] Appellants reliance on Memphis Light, Gas & Water v. Craft, 436 U.S. 1, 14, 98 S.Ct. 1554, 1563, 56 L.Ed. 2d 30 (1978) is misplaced. In that case, the Supreme Court merely held that where one does not receive notice of one's rights to present objections to the requested relief, the notice is insufficient for due process purposes. 435 U.S. at 14-15, 98 S.Ct. at 1563.

also was sufficient to put him on notice that he might be enjoined from filing a voluntary petition in the future. A.R. Tab 10, page 108. While the Motion did not request this relief, it was reasonable to conclude that it might be imposed since he is the principal of all three debtors. In fact, he had already been subject to injunctive relief with respect to Western and was alleged to have diverted assets from the Western Estate. Therefore, because he was the principal of MTS, Inc., and because the United States Trustee sought to enjoin MTS, Inc., it was not unreasonable for him to conclude that he might be subject to further injunctive relief in this case.

The United States Trustee acknowledges, however, that Seth Murdock did not have an opportunity to respond to the Court’s statement that it was inclined to bar him personally from filing a voluntary petition for 365 days. In fact the Court did not allow him to speak. E.R. Tab 10, page 71, lines 19-20. Therefore, if the Court is not inclined to affirm the Order as it applies to Seth Murdock, the United States Trustee requests that the case be remanded to the Bankruptcy Court to provide Mr. Murdock with an opportunity to show cause why he should not be enjoined from filing a voluntary petition for 365 days from the entry of the Order.

VIII.

CONCLUSION

For the reasons stated above, the United States Trustee requests that the Court a) affirm the finding of bad faith b) affirm the injunction that is applicable to Murdock

Transportation Services, Inc. and c) remand the case to the Bankruptcy Court to provide Seth Murdock an opportunity to show cause why he should not be subject to the injunction.

Dated: November 19, 1998

OFFICE OF THE UNITED STATES TRUSTEE

By:_______________________________
PETER BURKE
Attorney for the U.S. Trustee
221 N. Figueroa St., Suite 800
Los Angeles, California 90012
TEL: (213) 894-7247
FAX: (213) 894-2603

ADDENDUM

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PROOF OF SERVICE BY MAIL

STATE OF CALIFORNIA
COUNTY OF LOS ANGELES

I am employed in the County of Los Angeles, state of California, in the Office of the Unites States Trustee under the supervision of a member of the bar of this court at whose direction the service hereinafter described was made; I am over the age of 18 and not a party to the within action; and my business address is: 221 N. Figueroa St., Suite 800, Los Angeles California 90012.

On November 19, 1998, I served the foregoing document described as: APPELLEE MAUREEN A. TIGHE, UNITED STATES TRUSTEE OPENING BRIEF on the interested parties at their last known address in the action by placing a true and correct copy thereof in a sealed envelope with sufficient postage thereon full prepaid, in the United States Mail at Los Angeles, California, addressed as follows:

Appellant:
Murdock Transportation Systems, Inc.
dba Jim Baker Trucking
P. O. Box 11503
Santa Rosa, CA 95406

ATTORNEY FOR APPELLANT, MURDOCK TRANSPORTATION SYSTEMS, INC.:
Nancy Hoffmeier Zamora, Esq.
Zamora & Hoffmeier
520 South Grand Avenue, Suite 675
Los Angeles, CA 90071

ATTORNEY FOR APPELLANT, SETH MURDOCK:
Judith Seeds Miller, Esq.
Miller & Miller
16130 Ventura Boulevard, Suite 650
Encino, CA 91436-2543

I declare under the penalty of perjury that the foregoing is true and correct.

DATED: November 19, 1998

____
STEPHANIE HILL

BRIEF BANK — 'SUMMARY SHEET" *Printed Tue-7/31/07 13:8*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	In re: Nellson Nutraceutical, Inc., et al.(UST and Official Committee of Unsecured Creditors v. Nellson Nutraceutical, Inc. et al.)
2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	United States District Court for the District of Delaware
3. ("CCN") ***CURRENT*** CASE NO.	No.: 06-00520-GMS, 06-00521-GMS
4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*	No.: 06-10072 Court: United States Bankruptcy Court for the District of Delaware *(Identify judge & cite, if any)*
5. ("SO") ***SOURCE***	**U.S. TRUSTEES**
6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	Filed: July 30, 2007 Type: Appellant UST's Brief in on Mootness Grounds Opposition to Appellees' Motion to Dismiss Appeal
7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*	William Harrington, Joseph McMahon, John P. Sheahan *(UST/OGC: 202-307-1399/FAX-2397)*
8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") ● ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	● (i) Whether the doctrine of "equitable mootness" is applicable to an appeal of an employer compensation order in absence of a confirmed plan of reorganization; and (ii) whether an appeal of an employee compenation order is constitutionally moot when funds have been disbursed to officers of the debtor pursuant to the order under appeal. √ **Background:**
10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)	
11. DO YOU RECOMMEND POSTING IN UST BRIEFBANK?	| x | YES | | NO ***NAME:*** Holly Walter ***DATE:***

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF DELAWARE

Civil Action No. 06-00520-GMS, 06-00521-GMS

In re: NELLSON NUTRACEUTICAL, INC., et al.

Debtors.

Bankruptcy Case No. 06-10072(CSS)

UNITED STATES TRUSTEE AND
OFFICIAL COMMITTEE OF UNSECURED CREDITORS

Appellants,

v.

NELLSON NUTRACEUTICAL, INC., et al.

***Appellees*.**

APPEAL FROM THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE
(Christopher S. Sontchi, Judge)

APPELLANT UNITED STATES TRUSTEE'S BRIEF IN OPPOSITION TO APPELLEES' MOTION TO DISMISS APPEAL ON MOOTNESS GROUNDS

UNITED STATES DEPARTMENT OF JUSTICE
OFFICE OF THE UNITED STATES TRUSTEE
William K. Harrington (Bar No. 4051)
Joseph J. McMahon, Jr. (Bar No. 4819)
J. Caleb Boggs Federal Building
844 King Street, Suite 2207, Lockbox 35
Wilmington, DE 19801
Telephone: (302) 573-6491
Facsimile: (302) 573-6497

UNITED STATES DEPARTMENT OF JUSTICE
EXECUTIVE OFFICE FOR UNITED STATES TRUSTEES
Office of the General Counsel
Roberta A. DeAngelis

John P. Sheahan (Bar No. 3999)
20 Massachusetts Avenue, NW
Washington, DC 20530

Counsel for Appellant United States Trustee

DATED: July 30, 2007

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INTRODUCTION

On July 18, 2006, the Debtors obtained bankruptcy court approval of a self-styled "management incentive plan" (the "MIP"), under which they were authorized to pay more than a million dollars in bonuses to their senior managers and other employees. Both the United States Trustee and the Official Committee of Unsecured Creditors have appealed from this order. These appeals assert that the MIP impermissibly circumvents 11 U.S.C. § 503(c), a provision of the Bankruptcy Code restricting payments to insiders, which Congress recently enacted in order to address growing concerns regarding excessive management compensation in corporate bankruptcy cases.

Having paid their senior managers and others several hundred thousands of dollars under the auspices of the bankruptcy court's MIP order, the Debtors now seek to evade appellate review of that order by asserting that the U.S. Trustee's appeal is constitutionally and equitably moot. Both of these arguments are foreclosed by the Third Circuit's decision in United States Trustee v. Official Committee of Equity Security Holders (In re Zenith Electronics Corp.), 329 F.3d 338 (3d Cir. 2003), the facts of which are indistinguishable on all relevant points from the present appeal.

In particular, Zenith forecloses any contention by the Debtors that this appeal is equitably moot. In Zenith, the Third Circuit held that the doctrine of equitable mootness was viable, at most, only in the limited circumstances of an appeal that seeks to unwind a confirmed and substantially consummated plan of reorganization. No such circumstances are presented by this appeal, which involves an order in a pre-confirmation contested matter, and no plan has yet been proposed by the Debtors. As a result, the doctrine of equitable mootness is inapplicable to this appeal as a matter of law.

Zenith also forecloses the Debtors' contention that the U.S. Trustee's appeal is constitutionally moot. Although the Debtors suggest that this appeal no longer presents a case or controversy because the Debtors have already made a distribution of funds under the MIP, this Court may still grant effective relief by ordering the Debtors' managers to disgorge the funds they improperly paid themselves under the MIP, or by ordering the Debtors to take appropriate action to recover any voidable transfers made to other persons. On this point, the facts of this appeal are indistinguishable from Zenith, which held that an appeal of a professional fee award was not constitutionally moot notwithstanding the fact that the professionals, who did not participate in the appeal, had already been paid. Moreover, although the Debtors speculate that the transferees of MIP payments may be able to raise defenses to disgorgement, the mere possibility that such defenses will be raised in a later proceeding is insufficient to render this appeal moot. As a result, this appeal presents a live case or controversy for this Court to determine, and is not constitutionally moot.

Accordingly, the Debtors' motion to dismiss should be denied.

STATEMENT OF THE CASE

The U.S. Trustee appeals from the Bankruptcy Court's order entered on July 18, 2006, which approved the MIP and authorized payments thereunder up to an aggregate amount of $1.395 million. [A-2][1]. The United States Trustee's notice of appeal was timely filed on July 27, 2006. [A-3]. The Official Committee of Unsecured Creditors appointed in the Debtors' cases has also appealed from

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[1] Appellees's Appendix was filed on June 26, 2007 [Docket No. 7].

the order. [A-4].

STATEMENT OF FACTS

On January 28, 2006, the Debtors filed voluntary petitions for relief under chapter 11 of the Bankruptcy Code. The Debtors continue in possession of their properties and are operating and managing their business as debtors and debtors in possession pursuant to 11 U.S.C. § 1107(a) and 1108.

On April 28, 2006, the Debtors filed their Motion for Entry of an Order Authorizing and Approving Payments Under Management Incentive Plan. [A-1]. In that motion, the Debtors sought authority to implement and make payments under the MIP. The U.S. Trustee and the Committee objected to the MIP motion on grounds that it was a veiled attempt to seek approval of a management retention plan in contravention of recently-enacted section 503(c) of the Bankruptcy Code. Following an evidentiary hearing held on July 10 and 13, 2006, the bankruptcy court granted the MIP Motion by an order dated July 18, 2006. [A-2].

Under the terms of the MIP, nine members of Debtors' senior management received semi-annual bonus payments, purportedly for their assistance in managing the Debtors' reorganization and the resulting additional responsibilities which they assumed. Payments under the MIP were calculated based on the Debtors' financial performance during calendar year 2006. Payments under the MIP commenced shortly after the U.S. Trustee and the Committee filed their notices of appeal, and the Debtors ultimately paid approximately $550,000 under the MIP before the program expired.

Discovery received by the U.S. Trustee and the Committee in connection with the MIP hearing revealed that in March or April, 2006, after the Debtors had filed for bankruptcy, the

Debtors implemented a second, previously-undisclosed employee bonus program, which paid the Debtors' employees (including its senior managers) an additional bonus of up to 70% of their base pay. [B-1,2].[2] Although the 2006 bonus plan was not disclosed to the bankruptcy court until the hearing on the MIP in July, 2006, the bankruptcy court approved a modified version of that plan over the objection of the U.S. Trustee on May 14, 2007. [B-3,4,5].

A chapter 11 plan has neither been proposed nor confirmed in the Debtors' bankruptcy cases. The Debtors are presently engaged in an effort to sell substantially all of their operating assets to a third-party purchaser. [B-6].

ARGUMENT

The Debtors offer two arguments in support of their motion to dismiss this appeal. First, the Debtors urge the Court to invoke the doctrine of "equitable mootness" and to dismiss the appeal on the grounds that a reversal of the MIP order would be inequitable. Appellee Br. at 7. Second, the Debtors urge the Court to dismiss this appeal on the grounds of "constitutional mootness" under the theory that because the Debtors have already made MIP payments, the Court cannot vacate the MIP order without violating the due process rights of the MIP beneficiaries, and therefore "there is absolutely no form of relief that this Court could fashion." Id. at 6. Each of these arguments is contrary to controlling precedent of the Third Circuit.

A. The Third Circuit Has Rejected the Doctrine of Equitable Mootness Except in Narrow Circumstances Not Applicable Here

In Zenith, a case decided under a highly similar set of facts to the present appeal, the Third Circuit observed that "when a court has jurisdiction to hear an appeal, it has a 'virtually unflagging

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[2] Appellant United States Trustee's Appendix has been filed contemporaneously herewith.

obligation' to exercise that jurisdiction." Zenith, 329 F.3d at 347 (quoting Colorado River Water Conservation Dist. v. United States, 424 U.S. 800, 817 (1976)). In keeping with this principle, the Third Circuit clarified that the doctrine of equitable mootness is only "a limited and well-defined exception" to the appellate court's obligation to exercise jurisdiction, which is applicable only to the single, limited circumstance of an appeal that would unravel a confirmed and consummated plan of reorganization. Id. As the Third Circuit observed,

> [Equitable mootness] has been carefully developed to apply only in that rare situation in which a successful appeal would undo a complicated reorganization. It would make little sense, in light of this carefully considered doctrine, and in light of our "virtually unflagging obligation" to exercise our jurisdiction, to allow courts to dismiss appeals on the basis of an ad hoc weighing of the equities of a successful appeal.

Id. (emphasis added).

Zenith arose from the U.S. Trustee's appeal of an unstayed order of the bankruptcy court that awarded compensation to professionals retained by an committee of equity security holders. See id. at 341. In the proceedings below, the district court concluded that the U.S. Trustee's appeal was equitably moot, on the exact same grounds that the Debtors now raise in the present case: because the fees awarded to the professionals had already been disbursed, any order requiring them to return such fees would be inequitable. See id. at 342. However, the Third Circuit reversed, holding that the doctrine of equitable mootness was inapplicable and that the district court had abused its discretion by relying on equitable considerations to dismiss an appeal. See id. at 347.

The Debtors do not cite Zenith in their discussion of equitable mootness, but instead rely on the earlier Third Circuit decision of In re Continental Airlines, 91 F.3d 553, 560 (3d Cir. 1996). The decision in Continental, however, involved an appeal that had become moot due to the confirmation of a plan, and much of the test set forth in Continental is meaningless outside the context of a confirmed and consummated plan of reorganization. See, e.g., Continental, 91 F.3d at 560, 565 (holding that "foremost consideration" in determining whether appeal is equitably moot is "whether the reorganization plan has been substantially consummated" and noting that "central animating force" of equitable mootness is importance of encouraging reliance on confirmed reorganization plans). As a result, as Zenith and other subsequent decisions by courts within the Third Circuit have recognized, the test set forth in Continental is simply inapplicable in cases, such as the present appeal, where no plan of reorganization exists. See Zenith, 329 F.3d at 347; see also In re Main, 239 B.R. 59, 73 (Bankr. E.D. Pa. 1999) (holding that under Continental, "the 'equitable mootness' doctrine has been confined . . . to situations where a party has appealed a bankruptcy order confirming a plan of reorganization").[3]

B. The U.S. Trustee's Appeal Is Not Constitutionally Moot Because an Effective Remedy, Disgorgement, Is Available

In the alternative, the Debtors suggest that the Court should dismiss the U.S. Trustee's appeal on grounds of constitutional mootness. As explained by the Third Circuit in Continental, constitutional mootness arises "only if events have taken place during the pendency of the appeal that make it impossible for the court to grant any effectual relief whatever." Continental, 91 F.3d at 558 (internal citations omitted). Although the MIP payments have already been disbursed, this

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[3] In arguing that the doctrine of equitable mootness has applicability beyond plan confirmation orders, the Debtors rely on a series of decisions from courts outside the Third Circuit and/or that predate the Third Circuit's decision in Zenith. See Mine Management, Inc. v. Wolfe (In re Mountain Laurel Resources Co.), 2000 WL 341913 (4th Cir. Apr. 3, 2000); Huntington Nat'l Bank v. Shawnee Hills, Inc. (In re Shawnee Hills, Inc.), 2002 WL 31681538 (S.D. W. Va. Nov. 19, 2002); In re Quality Spice Corp., 107 B.R. 843 (D.N.J. 1989). None of these decisions justify a departure from the rule unequivocally expressed by the Third Circuit in Zenith, by which this Court remains bound.

Court can still order effective relief, either through the remedy of disgorgement or through an order compelling the Debtors to commence avoidance actions to recover any transfers made in violation of the Bankruptcy Code. See 11 U.S.C. § 549 (providing that debtor may avoid unauthorized post-petition transfers), In re Kmart Corp., 359 F.3d 866 (7th Cir. 2004) (noting that transfers made under order authorizing payments to critical vendors, which was later reversed, would be recovered for estate through adversary proceedings). In addition, if the MIP payments are found to have been improper, the Debtors may possess claims against any officers or professionals who breached their fiduciary duties in connection with the MIP. See Sample v. Morgan, 914 A.2d 657 (Del. Ch. 2007) (holding, on defendant's motion to dismiss, that shareholder stated claim for breach of fiduciary duty where management allegedly harmed company through improper approval and implementation of management retention plan).

As the Third Circuit and other courts have recognized, where the remedy of disgorgement is available, an appeal is not constitutionally moot. See Zinchiak v. CIT Small Bus. Lending Corp. (In re Zinchiak), 406 F.3d 214, 223 n.10 (3d Cir. 2005) (debtor's appeal of order permitting foreclosure of property was not moot, notwithstanding subsequent foreclosure and sale of property, where debtor could still seek disgorgement from lender); Zenith, 329 F.3d at 340 n.1 ("[B]ecause the Bankruptcy Court can order the Professionals to disgorge the monies requested by the Trustee, the appeal is not constitutionally moot."); see also Focus Media, Inc. v. National Broad. Co. (In re Focus Media, Inc.), 378 F.3d 916, 923 (9th Cir. 2004) (disgorgement of attorney's fees previously paid by bankruptcy estate); Lawrence Athletic Club v. Scroggin (In re Scroggin), 364 B.R. 772, 779 (B.A.P. 10th Cir. 2007) (disgorgement of funds garnished pursuant to bankruptcy court judgment); Rajala v. Hodes (In re Hodes), 289 B.R. 5 (D. Kan. 2003) (disgorgement from attorneys who were permitted to draw down retainers).

Although the Debtors do not dispute that disgorgement is a form of effective relief, they suggest that this appeal is nevertheless moot because the MIP beneficiaries may have various defenses in the event the Debtors are forced to seek disgorgement from them. In particular, the Debtors suggest that the MIP beneficiaries are "faultless" persons who "earned every penny paid to them under the MIP." Appellee Br. at 6. In addition, the Debtors argue that a reversal of the MIP order would violate these beneficiaries' due process rights. See id.[4]

The Debtors' attempt to limit this Court's appellate jurisdiction cannot be reconciled with the Third Circuit's decision in Zenith. That case, like the present appeal, involved an appeal of a bankruptcy contested matter in which the relief sought was the disgorgement of estate funds paid to third parties. If ordering disgorgement would violate the due process rights of the MIP payees in this case, the same would have been true of the third-party payees in Zenith. Moreover, although the Debtors cite Zenith in passing as a case "where the parties to an appeal continued to exist and could be ordered to disgorge monies received under the order on appeal," see Appellee Br. at 6, there is no reason to distinguish Zenith on that basis. As the docket in Zenith indicates, the professionals whose fees were at issue did not file a brief, did not participate in oral argument, and did not otherwise appear in the proceedings before the Third Circuit. [B-7]. The Debtors do not dispute that the MIP payees continue to exist, and there is no reason why their ability to repay improperly received funds should be any different from that of the professionals in Zenith.

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[4] Notably, the Debtors do not raise any arguments with respect to their own due process rights, but instead contend only that the reversal would violate the due process rights of the individual recipients of MIP disbursements. The Debtors, however, lack standing to raise due process arguments on behalf of third parties. See United States v. Palma, 760 F.2d 475, 477 (3d Cir. 1985).

By suggesting that the court should dismiss this appeal because of the defenses that their employees might raise in a later proceeding, the Debtors erroneously conflate the issue of mootness with the substantive merits of a hypothetical avoidance action by the Debtors (which is not presently before the Court).[5] In any event, there is no reason to assume (as the Debtors apparently do) that their employees would necessarily prevail on an equitable defense to disgorgement. The principal beneficiaries of the MIP payments are not rank-and-file employees ignorant of the intricacies of bankruptcy litigation, but rather are the highest-ranking members of the Debtors' management. These are the same persons who designed the MIP, made the calculated decision to commence disbursements under the MIP notwithstanding the U.S. Trustee's appeal, and who presumably continue to direct the Debtors' litigation strategy. If these persons are prejudiced by a disgorgement order, it is because of a risk that they willingly assumed.

In any case, the Debtors have failed to demonstrate that disgorgement of any improper MIP payments would violate due process. Notably, the Debtors do not raise any arguments with respect to their own due process rights, but instead contend only that the reversal would violate the due process rights of the individual recipients of MIP disbursements. The Debtors, however, lack standing to raise due process arguments on behalf of third parties. See United States v. Palma, 760 F.2d 475, 477 (3d Cir. 1985).

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[5] Indeed, by emphasizing the allegedly faultless nature of the MIP beneficiaries as grounds for dismissal, the Debtors urge this Court to adopt a rule similar to the holding of the Ninth Circuit in S.S. Retail Stores Corp. v. Ekstrom (In re S.S. Retail Stores Corp.), 216 F.3d 882 (9th Cir. 2000). where the court dismissed, as moot, an appeal challenging an attorney fee award in part due to the fact that the attorneys had "performed . . . superbly" and the fact that there was no allegation of wrongdoing. Id. at 885. The Third Circuit, however, expressly rejected the holding in S.S. Retail Stores and has cautioned that such equitable considerations are irrelevant in a determination of mootness. See Zenith, 329 F.3d at 347.

Moreover, the Debtors fail to identify any way in which the due process rights of individual MIP beneficiaries have been violated. The Debtors have vigorously defended the MIP program at the direction of their management (who are themselves beneficiaries of MIP payments). The relief granted by the bankruptcy court was directed to the Debtors, not their individual employees, and no employees have sought to intervene in this matter. Moreover, reversing the bankruptcy court's MIP order will not deprive the MIP payees of their day in court, because the Debtors must still commence an appropriate action under 11 U.S.C § 549 to avoid the unauthorized MIP payments. If such actions are commenced, the MIP payees will have an opportunity to assert defenses to repayment, if any, and will receive all the due process to which they are constitutionally entitled. See, e.g., Kmart, 359 F.3d at 871 (where order authorizing payment to vendors was appealed, beneficiaries who had received payment under order did not have due process right to participate in appeal).

In addition, none of the authorities cited by the Debtors support the proposition that this case should be deemed constitutionally moot because of due process concerns. The principal authority relied on by the Debtors is a Second Circuit decision, Official Committee of Unsecured Creditors of LTV Aerospace & Defense Co. v. Official Committee of Unsecured Creditors of LTV Steel Co. (In re Chateaugay Corp.), 988 F.2d 322, 327 (2d Cir. 1993), in which the court held that an appeal of a bankruptcy court order authorizing the debtor to make pension payments was moot. The court declined to exercise its jurisdiction in that case, however, not because of any due process concern, but rather due to its subjective view that disgorgement would cause "unfair hardship"to the pension beneficiaries, combined with its "strong policies favoring settlement" and other equitable considerations. Id. at 326. In stark contrast, as discussed above, the Third Circuit specifically prohibited use of such factors in Zenith, and it is Zenith, not Chateaugay, that is binding on this

Court.[6]

The remaining cases cited by the Debtors are equally inapposite. Rochman v. Northeast Utilities Service Group (In re Public Service Co.), 963 F.2d 469 (1st Cir. 1992), involved an appeal of a confirmed reorganization plan, in which the court determined both that the appeal was equitably moot and that unwinding the confirmation order was no longer possible. No such circumstance is present here. Evergreen Int'l. Airlines, Inc. v. Pan Am Corp. (In re Pan Am Corp.), No. 94 CIV. 8093 (DLC), 1995 WL 366356 (S.D.N.Y. June 20, 1995), was decided under the rule set forth in Chateaugay, and like Chateaugay relied on equitable rather than constitutional mootness in reaching its result. See id. at *4 (concluding that reversal of order would be "impracticable" and would pose "unfair hardship on faultless beneficiaries"). Credit Alliance Corp. v. Dunning-Ray Insurance Agency, Inc. (In re Blumer), 66 B.R. 109 (B.A.P. 9th Cir. 1986), supports the U.S. Trustee's argument in this matter, holding that an appeal was not constitutionally moot because the court could order effective relief through disgorgement. See id. at 113. Finally, Carr v. King (In re Carr), 321 B.R. 702 (Bankr. E.D. Va. 2005), erroneously cites Blumer for the proposition that a court cannot order disgorgement from a third-party transferee, and further arises from an appeal taken in connection with the final distribution to creditors under a chapter 7 case, a circumstance that is far more analogous to the consummation of a chapter 11 plan rather than to the non-plan-related payments at issue in this appeal. Accordingly, this Court should deny the Debtors' motion to

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[6] In Chateaugay, the Second Circuit appears to have held that the appeal of the pension order was both equitably and constitutionally moot. See Chateaugay, 988 F.2d at 325. However, the only discussion in the decision relevant to the issue of constitutional mootness was the Second Circuit's observation that a second order of the bankruptcy court, which was not appealed, also required the debtors to make the same payments. See id. at 327. The Debtors do not allege that any comparable circumstance is present in this case.

dismiss the U.S. Trustee's appeal on the grounds of constitutional mootness.

CONCLUSION

For the foregoing reasons, the U.S. Trustee respectfully requests that this Court deny the Debtors' Motion.

Respectfully submitted,

KELLY BEAUDIN STAPLETON
UNITED STATES TRUSTEE

BY: William K. Harrington, Esquire
William K. Harrington, Esquire (# 4051)
Joseph J. McMahon, Jr. (# 4819)
Trial Attorneys
United States Department of Justice
Office of the United States Trustee
J. Caleb Boggs Federal Building
844 King Street, Room 2207, Lockbox 35
Wilmington, DE 19801
(302) 573-6491
(302) 573-6497 (Fax)

Roberta A. DeAngelis
Acting General Counsel
John P. Sheahan (# 3999)
Trial Attorney
United States Department of Justice
Executive Office for United States Trustees
20 Massachusetts Avenue, NW
Washington, DC 20530

Date: July 30, 2007

BRIEF BANK — "SUMMARY SHEET"

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WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*
In re Nellson Nutraceutical, et al. (United States Trustee v. Nellson Nutraceutical, Inc., et al.)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*
D. Del.

3. ("CCN") ***CURRENT*** CASE NO.
No.: 1:06-cv-00520-GMS

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William K. Harrington, Joseph J. McMahon, Thomas P. Tinker, John P. Sheahan, P. Matthew Sutko, Ramona D. Elliott, Roberta A. DeAngelis
(UST/OGC: 202-307-1399/FAX-2397)

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9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***
• Did the bankruptcy court err when it approved debtor's motion to implement the management incentive program, on the grounds that the management incentive program was not subject to the limitations set forth in 11 U.S.C. § 503(c)(1)?

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IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF DELAWARE

In re	:	
NELLSON NUTRACEUTICAL, INC., *et al.*,	:	Bankr. Case No. 06-10072 (CSS)
Debtors.	:	

UNITED STATES TRUSTEE,	:	
Appellant,	:	
v.	:	Civil Action No. 06-520 (GMS)
NELLSON NUTRACEUTICAL, INC., *et al.*,	:	
Appellees.	:	

APPELLANT'S BRIEF

ROBERTA A. DEANGELIS,
ACTING UNITED STATES TRUSTEE
FOR REGION THREE

WILLIAM K. HARRINGTON, ESQUIRE (# 4051)
ASSISTANT UNITED STATES TRUSTEE
JOSEPH J. MCMAHON, JR., ESQUIRE (# 4819)
THOMAS P. TINKER, ESQUIRE
TRIAL ATTORNEYS
UNITED STATES DEPARTMENT OF JUSTICE
OFFICE OF THE UNITED STATES TRUSTEE
J. CALEB BOGGS FEDERAL COURTHOUSE
844 KING STREET, SUITE 2207, LOCKBOX 35
WILMINGTON, DE 19801
(302) 573-6491
(302) 573-6497 (FAX)

OF COUNSEL:

RAMONA D. ELLIOTT, ESQUIRE
GENERAL COUNSEL
P. MATTHEW SUTKO, ESQUIRE
ASSOCIATE GENERAL COUNSEL
JOHN P. SHEAHAN, ESQUIRE
TRIAL ATTORNEY
UNITED STATES DEPARTMENT OF JUSTICE
EXECUTIVE OFFICE FOR
UNITED STATES TRUSTEES
20 MASSACHUSETTS AVENUE, N.W.,
SUITE 8217
WASHINGTON, D.C. 20530
(202) 307-1399
(202) 307-2397 (FAX)

Date: December 7, 2009

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PRELIMINARY STATEMENT

In 2005, Congress enacted the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. 109-8, 119 Stat. 23 (Apr. 20, 2005) ("BAPCPA") in order to remedy various abuses of the bankruptcy system. One of the specific abuses at which BAPCPA was directed was the practice by bankrupt companies of paying their top executives large bonuses through key employee retention programs. These programs, which are commonly known as KERPs, would ostensibly reward those executives for remaining at their jobs during the bankruptcy. In practice, these bonuses effectively would come at the expense of trade vendors, employees, and other creditors who were being paid less than the full amount of their claims through the bankruptcy process. See Statement of Senator Edward Kennedy on the Bankruptcy Bill (March 1, 2005) (noting "glaring abuses of the bankruptcy system by the executives of giant companies . . . who lined their own pockets, but left thousands of employees and retirees out in the cold") (*quoted in In re Dana Corp.*, 358 B.R. 567, 575 (Bankr. S.D.N.Y. 2006)).

BAPCPA sought to curb the proliferation of KERPs by adding section 503(c)(1) to the Bankruptcy Code. 11 U.S.C. § 503(c)(1). That section provides, in relevant part, that "there shall neither be allowed, nor paid . . . a transfer made to, or an obligation incurred for the benefit of, an insider . . . for the purpose of inducing such person to remain with the debtor's business" unless the debtor can satisfy a stringent test designed to demonstrate the necessity and reasonableness of such payments. 11 U.S.C. § 503(c)(1). In addition, even if this test is met, BAPCPA imposes a monetary limit on the amount that can be paid to an insider under a KERP. 11 U.S.C. § 503(c)(1)(C).

In this case, Nellson Neutraceutical, Inc. and its affiliates (collectively, "Nellson" or the "Debtors"), sought to do precisely what section 503(c)(1) of the Bankruptcy Code is designed to prohibit. On the eve of its bankruptcy, Nellson adopted a KERP that obligated Nellson to pay its senior managers retention bonuses for the stated purpose of encouraging those managers to remain employed by Nellson. After the Debtors' chief executive officer was informed that the new bankruptcy laws limit the availability of KERPs, the Debtors developed and filed the "management incentive plan,"or MIP, to "replace" the KERP.

The bankruptcy court nevertheless approved a modified version of the MIP on the grounds that it was not adopted for the "primary purpose" of retention, and that section 503(c)(1) was therefore inapplicable. The bankruptcy court's conclusion was erroneous for at least two reasons. First, by holding that section 503(c)(1) is inapplicable to payments that have retention as one purpose, but not as their "primary purpose," the bankruptcy court failed to apply the plain terms of the Bankruptcy Code, which contains no such limitation. Second, even if the bankruptcy court's interpretation of section 503(c)(1) were correct, the court erred by approving the MIP because the uncontradicted evidence in the record below demonstrates that retention was the primary, if not the exclusive, purpose of the MIP.

STATEMENT OF APPELLATE JURISDICTION

This appeal is taken from a final order entered by the United States Bankruptcy Court for the District of Delaware. This Court has appellate jurisdiction under 28 U.S.C. § 158(a)(1).

STATEMENT OF ISSUE PRESENTED

Did the bankruptcy court err when it approved Nellson's motion to implement the MIP, on the grounds that the MIP was not subject to the limitations set forth in 11 U.S.C. § 503(c)(1)?

STATEMENT OF STANDARD OF APPELLATE REVIEW

The bankruptcy court's interpretation of Section 503(c)(1) is a legal question that this court reviews *de novo*. *See, e.g., In re Sharon Steel Corp.*, 871 F.2d 1217, 1222-23 (3d Cir. 1989); *In re Hechinger Inv. Co. of Del., Inc.*, 276 B.R. 43, 45 (D. Del. 2002). The bankruptcy court's factual findings regarding the purpose of the MIP are reviewed for clear error, *In re Sterten*, 546 F.3d 278, 282 (3d Cir. 2008), while its ultimate conclusions drawn from those facts are subject to plenary review. *Sharon Steel*, 871 F.2d at 1222-23.

STATEMENT OF THE CASE

On January 28, 2006, the Debtors filed voluntary petitions for relief under chapter 11 of the Bankruptcy Code. 11 U.S.C. § 1101 et seq. On April 28, 2006, the Debtors filed their Motion for Entry of an Order Authorizing and Approving Payments Under Management Incentive Plan (the "MIP Motion"). In the MIP Motion, the Debtors sought authority to implement and make payments under the MIP. The United States Trustee[1] and the official committee of the Debtors' unsecured creditors (the "Committee")[2] objected to the MIP Motion on grounds that it was a thinly-veiled attempt to pay insiders in contravention of Section 503(c)(1). Following an evidentiary hearing, the

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[1] The United States Trustee an official of the United States Department of Justice. The United States Trustee is charged with responsibility for supervising the administration of bankruptcy cases. *See generally* 28 U.S.C. § 586(a) (describing responsibilities); 11 U.S.C. § 307 (describing broad standing to raise issues).

[2] Section 1102 of the Bankruptcy Code directs and authorizes the United States Trustee to appoint an official unsecured creditors' committee. Members of the committee are fiduciaries and represent the entire unsecured creditor body without regard to the types of claims which individual unsecured creditors hold against the debtor. *See In re Kensington International LLC*, 368 F.3d 289, 315 (3d Cir. 2004); *Westmoreland Human Opportunities, Inc. v. Walsh*, 246 F.3d 233, 256 (3d Cir. 2001) (describing fiduciary responsibilities of the committee and its members).

bankruptcy court granted the MIP Motion by order dated July 18, 2006. The United States Trustee and the Committee timely filed notices of appeal from that order.[3] On October 9, 2008, this Court denied the Debtors' motion to dismiss the appeal as moot.

STATEMENT OF THE FACTS

I. On the eve of its bankruptcy, Nellson adopts a KERP for the stated purpose of retaining senior management.

Nellson, a manufacturer of weight loss, sports training, wellness and medical products, filed a petition for reorganization relief under chapter 11 of the Bankruptcy Code along with six of its affiliates on January 28, 2006. Bankr. Ct. Dkt. 1. Approximately one month earlier, and in anticipation of its bankruptcy, Nellson adopted a Key Employee Retention Plan (the "KERP"). The KERP provided for the payment of a "Retention Bonus" to nine "insiders" who were members of Nellson's senior management. The proposed bonus payments aggregated $710,000 and required that the beneficiaries remained employed by the Nellson for the first half of the 2006 calendar year. Joint Trial Exhibits 21 and 38.

The KERP recited that Nellson was "currently pursuing a restructuring of its debt and equity structure" and that the participants in the KERP were "critical to the successful accomplishment of the Restructuring or any alternative thereto that preserves the going concern value of the Business." The terms of the KERP recited that it was "both necessary and appropriate to induce the Participants to remain in the service of Nellson and to devote his or her full time, attention, energy and effort to the Business." KERP at 1. The KERP provided for participants to have vested "Retention Bonuses" by June 20, 2006 at the latest, so long as the participant "has remained regularly employed

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[3] The Committee subsequently stipulated to dismissal of its appeal.

by Nellson." The Retention Bonuses would also vest earlier if a participant were terminated for any reason other than "for cause," or if there were "constructive termination" or the occurrence of a "capital event" including the confirmation of a plan of reorganization under chapter 11. KERP, at 2-4.

It is undisputed that the pre-bankruptcy KERP was a retention plan. As Nellson's counsel conceded, the KERP "was done to basically tell the employees that there was going to be a mechanism to retain them so that they didn't quit during the restructuring." 7/13/06 Tr., at 197:11-16.

II. <u>Following the commencement of the bankruptcy cases, Nellson replaces the KERP with the MIP, which contains similar terms and is designed to serve the same purposes.</u>

Nellson adopted the MIP after the bankruptcy cases were filed. Joint Trial Exhibit 20, at 1. The MIP provided for payments related to two separate time periods: the first half of the 2006 calendar year (ending on July 2, 2006), and the second half of the year. Under the terms of the MIP, nine "insiders"[4] who were members of Nellson's senior management were to receive semi-annual bonus payments of respectively $680,000 and $715,000. For each time period, top-level management personnel would be entitled to payment if Nellson reached 50%[5] of the "earnings before income, taxes, depreciation and amortization" ("EBITDA") budgeted for that period. The amount of each MIP payment would increase as higher EBITDA thresholds were reached. For the

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[4] Eight of the nine members of senior management participating in the MIP were also participants in the KERP. The MIP substituted one senior executive for another. *Compare* Joint Trial Exhibit 20 *with* Joint Trial Exhibit 38 (Exhibit A to each document lists the participants).

[5] When filed, the MIP provided for compensation based on Nellson attaining an initial threshold of 50% of budgeted EBITDA; after the United States. Trustee and the Committee objected to the MIP, Nellson revised that threshold to 75% of budgeted EBITDA.

first half-year, the maximum payments and the timing of those payments under the MIP were roughly the same as the timing and amounts identified in the KERP. Joint Trial Exhibit 20 (Exhibit A); Joint Trial Exhibits 21 and 38 (Exhibit A).

The MIP provided for the waiver of rights under the KERP, but with such waiver being void if the beneficiary "does not receive any Plan Payment to which he or she is entitled under the Plan on or before the completion of such Plan . . . ." Joint Trial Exhibit 20, at 6-7.

As with the KERP, the beneficiaries' rights under the MIP were expressly linked to their willingness to remain employed by Nellson during the bankruptcy. Management participants in the MIP would be entitled to incentive payments if they remained employed by Nellson, provided that the 50% EBITDA threshold was met for each half-year period. Assuming the EBITDA threshold was attained, they would also be entitled to the payments even if (i) they were terminated other than for cause during the first half year or (ii) there were a "Capital Event" such as confirmation of a Chapter 11 plan of reorganization, a sale of Nellson's business as a going concern, or certain changes in control of Nellson. MIP, at 2-5.

Nellson's CEO, Jeffrey Dias, acknowledged that participants in the MIP were selected in order to "make sure" that essential employees would "stay in place." 7/10/06 Tr., at 13:24-14:7. As Mr. Dias explained, "It's been my experience that, you know, the race horses are skittish. I mean, the folks who are really the best in a leadership situation are the ones who are most likely to be concerned about their future. They're the most marketable people. They have the most alternatives available to them for employment." *Id.* at 17:17–18:1. Mr. Dias then further expressed concern that potential participants in the MIP might leave if the MIP were not approved, *id.* at 22:21-23, and he speculated as to the impact on Nellson were that to happen, *id.* at 23:23–24:10.

Mr. Dias described the MIP as "a very moderate cost of insurance." *Id.* at 24:25. Mr. Dias further conceded that the MIP was intended to "replace" the KERP, and that it was adopted because he had been advised that KERPs were no longer permissible under the Bankruptcy Code. *Id.* at 47:10-24.

After Mr. Dias prepared the list of MIP participants and the amounts of incentive payments for which they would be eligible under the MIP,[6] he submitted the information to William Creelman, the engagement manager for Nellson's financial advisors, and asked that he link the payments to the performance of the company. 7/10/06 Tr., at 104:17-20. The financial advisors then developed a payment structure tied to Nellson's achievement of budgeted EBITDA at the half-year and full-year marks. The initial performance thresholds for incentive payments were well below budgeted EBITDA. As noted above, the first threshold for incentive payments was actual EBITDA performance at 50% of the budgeted EBITDA for the applicable time period. Creelman acknowledged that, if Nellson achieved only 50% of budgeted EBITDA, "it wouldn't be a good thing for the company." 7/10/06 Tr., at 100-101. One of the approving board members, William Lenihan, testified he was aware, at the time Nellson filed the MIP Motion, that Nellson's actual EBITDA performance for the first quarter was somewhere between 110 to 113% of the budgeted EBITDA for that time period. 7/13/06 Tr., at 72:23 – 73:3.

Until objections were filed in court, Nellson's financial advisors did no independent investigation into market incentive compensation levels. Mr. Creelman was unaware of the ordinary

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[6] In addition to the fact that eight of the nine members of senior management participating in the MIP were KERP participants, the projected payments under the MIP to those eight senior managers were nearly identical to the projected payments to those individuals under the KERP. *Compare* Joint Trial Exhibit 20 (Exh. A) *with* Joint Trial Exhibit 21 (Exh. A).

course incentive plan[7], which had substantially higher EBITDA thresholds for the payment of incentive bonuses when compared to the MIP (the lowest threshold for a MIP incentive payment being 50% of budgeted EBITDA, as opposed to being 93% of budgeted EBITDA under the "ordinary course" plan). 7/10/06 Tr., at 103:4-9. Mr. Creelman was also unaware that 60% of Nellson's business was tied up in long term contracts that did not expire in 2006. *Id.* at 105:23-106:2.

III. <u>The bankruptcy court approves the MIP based on its holding that the compensation limitations set by section 503(c)(1) were not triggered.</u>

Both the United States Trustee and the Creditors' Committee objected to the Nellson's motion for authority to implement the MIP on the grounds that the MIP violated section 503(c)(1) of the Bankruptcy Code.[8] Because it was undisputed that Nellson could not meet the test for

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[7] At the time the MIP was created, Nellson already had a post-petition incentive compensation plan for Nellson's management. This "ordinary course" incentive plan was separate from, and in addition to, the MIP. *See* Joint Trial Exhibit 9.

[8] Section 503(c)(1) provides:

> Notwithstanding subsection (b) [allowing the payment of administrative expenses in certain circumstances], there shall neither be allowed, nor paid –
>
> (1) a transfer made to, or an obligation incurred for the benefit of, an insider of the debtor for the purpose of inducing such person to remain with the debtor's business, absent a finding by the court based upon evidence in the record that –
>
> (A) the transfer or obligation is essential to retention of the person because the individual has a bona fide job offer from another business at the same or greater rate of compensation;
> (B) the services provided by the person are essential to the survival of the business; and
> (C) either

approval of an employee retention plan under Section 503(c)(1), the sole questions before the bankruptcy court was whether that section was triggered, and whether the MIP was an "obligation incurred . . . for the purpose of inducing [a] person to remain with the debtor's business" within the meaning of the statute. The bankruptcy court concluded that the MIP was not such a retention plan, and approved Nellson's motion.

The bankruptcy court reasoned that Section 503(c)(1) does not require Nellson to prove the complete absence of any "retention purpose." Conversely, the court reasoned that Section 503(c)(1) does not require the objecting party to prove that retention was the "sole" purpose:

> I think reading the purpose as meaning the sole purpose would lead to an absurd result. And I think reading the purpose as a purpose would lead to an absurd result . . . Any kind of incentive plan or salary has, as part of it, the idea of keeping the employees receiving that payment in your employment.

7/13/06 Tr., at 271:24 – 272:5. The court stated:

> So, I read Section 503(c) as only being applicable to payments to insiders that are for the primary purpose of inducing the payee to remain with the debtor. Whether a payment is for the primary

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> (i) the amount of the transfer made to, or obligation incurred for the benefit of, the person is not greater than an amount equal to 10 times the amount of the mean transfer or obligation of a similar kind given to nonmanagement employees for any purpose during the calendar year in which the transfer is made or the obligation is incurred; or
>
> (ii) if no such similar transfers were made to, or obligations were incurred for the benefit of, such nonmanagement employees during such calendar year, the amount of the transfer or obligation is not greater than an amount equal to 25 percent of the amount of any similar transfer or obligation made to or incurred for the benefit of such insider for any purpose during the calendar year before the year in which such transfer is made or obligation is incurred[.]

> purpose of inducing retention is a question of fact to be determined on a case-by-case basis, with the debtor bearing the burden of proof.

Id. at 272:21 – 273:1. Applying that standard to the MIP, the bankruptcy court stated:

> In this case, there are two factors of the program as proposed that I find troubling in making the MIP as proposed, primarily for the purpose of retention. And I believe, however, both – the debtor has offered to change both.
>
> First, I was trouble – I am troubled by proposing a budget — budgeted EBITDA target as low as 50 percent. I think it's important to focus on operational results. That's the – that's what you're trying to incentivize management to achieve.
>
> But if you set operational results at such a low level, that even if they were to achieve it, it doesn't take particularly extraordinary effort to achieve it, you're really not rewarding people for doing a good job. You're rewarding people for staying around.
>
> Similarly, I'm troubled by the capital events section of the program. Again, to me, those change of control type provisions really smack of the retention program as opposed to an incentive program.

Id. at 273:6-23. The court determined that two changes should therefore be made: the Capital Events should be removed as a triggering event for payment and the EBITDA threshold should be increased to 75%:

> With those changes, I will approve the MIP. And I find that with those changes, the MIP would not be primarily for the purpose of inducing retention.

Id. at 274:3-5. The bankruptcy court then approved the MIP by order entered on July 18, 2006, based on the amount of compensation being "within the realm of a sound exercise of the debtors' business judgment." *Id.* at 275:4-7.

On July 27, 2006, the United States Trustee timely filed her notice of appeal from the bankruptcy court's order. Bankr. Ct. Dkt. 512. After the appeal was docketed, Nellson sought to dismiss the United States Trustee's appeal as moot. District Court Dkt. 5. On October 9, 2008, this Court denied Nellson's motion to dismiss, and then denied Nellson's motion for reconsideration of that order on December 4, 2008. District Ct. Dkt. 20, 26.

SUMMARY OF ARGUMENT

Section 503(c)(1) restricts the payment of retention bonuses to senior management of chapter 11 debtors. Prior to enactment of the BAPCPA in 2005, such bonuses were subject to review under a "sound business purpose" test. Congressional concern with the use of retention bonuses to enrich senior management at the expense of labor, trade vendors and other constituencies in bankruptcy cases led Congress to curtail the availability and size of such bonuses.

The bankruptcy court erred in concluding that Section 503(c)(1) only restricts those obligations or transfers to insiders that have a "primary" purpose of retention. Statutory interpretation begins (and, in the absence of ambiguity, ends) with an examination of the text's plain meaning. The plain meaning of the statutory phrase "for the purpose of inducing such person to remain with the debtor's business" does not require a judicial inquiry into whether Nellson has one or more purposes in proposing a payment to an employee, or whether there is a leading purpose among several purposes proposed to be served by the transfer. Rather, per the statutory language, if the proposed obligation or transfer clearly serves *any* retentive purpose, it is subject to Section 503(c)(1).

Even if the language of Section 503(c)(1) is ambiguous, basic canons of statutory construction dictate that this Court reject the bankruptcy court's interpolation of the word "primary" into Section 503(c)(1). First, interpolation of words into a statute is justified only where the language is equivocal or where literal interpretation of the language leads to absurd results. Neither of these circumstances is present here; to the contrary, interpolation of the word "primary" as a modifier of "purpose" in Section 503(c)(1) frustrates the remedial purpose of the statute. Second, Section 503(c)(1) is part of remedial legislation designed to curb a host of abuses that harm the interests of "stakeholders." The systemic harm addressed by Section 503(c)(1) is excessive compensation of management in return for continued employment during the bankruptcy cases. Section 503(c)(1) must be read broadly to effect its remedial purpose. Third, the text of the BAPCPA indicates that, when Congress wanted to use the word "primary" or "primarily" as a modifier, it did so. Accordingly, the omission of the word "primary" from Section 503(c)(1) is intended to be purposeful. In this case, it is undisputed that retention was at least a partial purpose of the MIP. Accordingly, under the correct statutory standard, the MIP violates Section 503(c)(1).

The bankruptcy court also erred in concluding that the MIP was not designed to induce senior managers to remain with the debtor's business. The testimony of Nellson's own witnesses conclusively demonstrates that the purpose of the MIP was, at all times, the same as that of the KERP which it replaced: to reward Nellson's senior managers for remaining employed. Accordingly, the bankruptcy court erred when it found that Nellson had met its burden of demonstrating that retention was not the "primary purpose" of the MIP.

ARGUMENT

I. Section 503(c)(1) of the Bankruptcy Code applies to the MIP because it is undisputed that retention was at least one of the purposes of the MIP, and Section 503(c)(1) is not limited to programs that have retention as their sole or "primary" purpose.

BAPCPA amended the Bankruptcy Code to, *inter alia*, add 11 U.S.C. § 503(c), which restricts the allowance and payment of administrative expenses to a debtor's officers, managers and consultants. The addition of 11 U.S.C. § 503(c) to the Code was spurred by public concern that excessive compensation (particularly bonus compensation) was being paid to management of chapter 11 debtors-in-possession.

Prior to enactment of the BAPCPA, retention payments were frequently made in chapter 11 cases by means of KERPs. Before 11 U.S.C. § 503(c) was enacted, no specific provisions of the Bankruptcy Code addressed compensation to a debtor's management. Debtors-in-possession typically requested approval of employment compensation under 11 U.S.C. §§ 363(b) and 365, and their requests for approval of management compensation proposals, including KERPs, were evaluated by bankruptcy courts under the "sound business purpose" test, which was essentially a "business judgment" rule. *See, e.g., The Dai-Ichi Kangyo Bank, Ltd. v. Montgomery Ward Holding Corp. (In re Montgomery Ward Holding Corp.),* 242 B.R. 147, 153 (D. Del. 1999) (citing *Committee of Equity Sec. Holders v. Lionel Corp. (In re Lionel Corp.)*, 722 F.2d 1063, 1071 (2d Cir. 1983); *In re EaglePicher Holdings, Inc.*, No. 05-12601, 2005 WL 4030132 at *6 (Bankr. S.D. Ohio Aug. 26, 2005).

Through the enactment of the BAPCPA, Congress responded to concerns that it was inappropriate for corporate executives to be paid excessive amounts for continued service during the bankruptcy case while labor, pensioners, trade vendors and other stakeholders shouldered the "pain" associated with the bankruptcy process. *See In re Nellson Neutraceutical, Inc.*, 369 B.R. 787, 801 (Bankr. D. Del. 2007) ("Although there is little in the way of legislative history, it is widely acknowledged that [11 U.S.C. § 503(c)] was a response to perceived abuses of the bankruptcy system by 'the executives of giant companies . . . who lined their own pockets, but left thousands of employees and retirees out in the cold.'") (quoting statement of Senator Edward Kennedy, as cited in *In re Dana Corp.*, 358 B.R. 567, 575 (Bankr. S.D.N.Y. 2006)). Section 503(c)(1) significantly alters pre-BAPCPA, management compensation practices by curtailing retention payments. This appeal centers on the meaning of Section 503(c)(1), and "[i]t is axiomatic that statutory interpretation begins with the language of the statute itself." *Government of Virgin Islands v. Knight*, 989 F.2d 619, 633 (3d Cir. 1993). A statutory language analysis must precede any resort to legislative history or case law as "[t]here is, of course, no more persuasive evidence of the purpose of a statute than the words by which the legislature undertook to give expression to its wishes." *United States v. American Trucking Ass'ns, Inc.*, 310 U.S. 534, 543 (1930). The statutory language is the best indicia of Congress' intent as "much less thought is spent on the future implications of committee reports and explanations on the floor than in choosing the words of a statute." *Paskel v. Heckler*, 768 F.2d 540, 543-44 (3d Cir. 1985).

The plain meaning of the statutory phrase "for the purpose of inducing such person to remain with the debtor's business" unambiguously prohibits payments to insiders where the payment clearly serves a retentive purpose. Section 503(c)(1)'s text does not require that bankruptcy courts hierarchically order the bankrupt corporation's reasons for making proposed payments to insiders to discern the main or "primary" purpose. Rather, the statutory language directs the bankruptcy court to determine whether the proposed payment is being made to keep the employee in place. If the proposed payment has a retentive purpose, it may not be allowed or paid unless Nellson can demonstrate that it meets the conditions in Section 503(c)(1), something that Nellson did not attempt to do. *See In re Dana Corp.*, 351 B.R. 96, 102 (Bankr. S.D.N.Y. 2006) (rejecting debtors' request to pay bonuses to insiders upon debtors' emergence from chapter 11 and, in doing so, employing "a familiar fowl analogy" – "if it walks like a duck (KERP) and quacks like a duck (KERP), it's a duck (KERP).").

"Words may be interpolated in a statute . . . 'only when the statutory language is equivocal or where literal interpretation leads to an absurdity' so gross as to shock general moral or common sense." *See Hatfried, Inc. v. Commissioner of Internal Revenue*, 162 F.2d 628, 631 (3d Cir. 1947) (internal citation omitted). Neither of these conditions is satisfied here. There is nothing equivocal about the express language of Section 503(c)(1). To the contrary, interpolation of the word "primary" as a modifier of the word "purpose" in Section 503(c)(1) leads to equivocation: bankruptcy courts will be forced to divine from the record whether retention was the primary, secondary, or tertiary purpose of the proposed payments in determining whether Section 503(c)(1) applies.

Further, the BAPCPA was enacted, in part, to remedy the abusive effects of retention pay upon the bankruptcy system. A remedial statute should be broadly construed to effectuate the remedial purpose. *See Idahoan Fresh v. Advantage Produce, Inc.*, 157 F.3d 197, 202 (3d Cir. 1998); *In re Waters*, 384 B.R. 432, 441 (Bankr. N.D. W. Va. 2008) ("In construing the new provisions [of a new statute], courts should endeavor to give the statute a construction that defeats 'evasions employed to continue the mischief sought to be remedied by the statute.'") (internal citation omitted). Interpolation of the word "primary" as a modifier of "purpose" in Section 503(c)(1) limits the Section's applicability and, by extension, hampers the effort to protect innocent creditors and equity security holders from management's enrichment and/or entrenchment efforts via "pay to stay" strategies.

Finally, the text of the BAPCPA demonstrates that, when Congress wanted to use the words "primary" or "primarily" as modifiers, it expressly did so. For example, "health care business" is defined as a public or private entity . . . that is *primarily* engaged in offering to the general public [certain] facilities and services . . . ." BAPCPA § 1101(a)(2) (bracketed text and emphasis added). The term "small business debtor" in the BAPCPA excludes "a person whose *primary* activity is the business of owning or operating real property or activities incident thereto." *Id.* § 432(a) (emphasis added). Similarly, in amending certain disclosure obligations respecting open end credit plans, Congress provided in the BAPCPA that the disclosure obligations did not apply to "any charge card account, the *primary* purpose of which is to require payment of charges in full each month." *Id.* § 1301(a) (emphasis added). Accordingly, in light of the appearance of the word "primary" in other sections of the BAPCPA, the absence of the word "primary" from Section 503(c)(1) should not be construed as an accident. *See Russello v. United States*, 464 U.S. 16, 23 (1983) ("[W]here Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress acts purposefully in the disparate inclusion or exclusion.").

II. Even if the bankruptcy court correctly applied a "primary purpose" test, its conclusion that retention was not the primary purpose of the MIP is not supported by the evidence and was erroneous.

The bankruptcy court erred in applying Section 503(c)(1) to the basic facts as evidenced in the record. The bankruptcy court's conclusion that the MIP did not have the "primary purpose" of inducing Nellson's insiders to remain with the business is an "ultimate fact," (e.g., "the driver was negligent") as opposed to a "historical" or "inferred" fact (e.g., "the sky was blue on Sunday, January 28"). *See Sharon Steel*, 871 F.2d at 1222-23. In this Circuit, this Court conducts a plenary review of ultimate facts. *See id.* The evidentiary record below does not contain a sufficient factual basis for the bankruptcy court to conclude that the MIP's purpose (primary or otherwise) was not retention.

The Third Circuit distinguishes among three types of facts - basic facts, inferred factual conclusions, and ultimate facts.[9] Here, the bankruptcy court concluded, after considering the basic or historical facts, that the "primary purpose" of the MIP was not retention. The evidentiary record considered by the bankruptcy court, however, does not support the bankruptcy court's conclusion regarding the "primary purpose." With few exceptions, the MIP was identical to a management

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[9] Basic facts are the historical and narrative events elicited from evidence, and inferred factual conclusions are drawn from basic facts. *See Universal Minerals, Inc. v. C.A. Hughes & Co.*, 669 F.2d 98, 102 (3d Cir. 1981). Findings of these two types of facts are subject to the clearly erroneous standard. *See id.* Ultimate facts are expressed in the language of a standard of law. *See id. (quoting Smith v. Harris,* 644 F.2d 985, 990 n. 1 (3d Cir. 1981)). An ultimate fact is the final resulting effect which is reached by processes of logical reasoning from evidentiary facts. *See Hickey v. The Ritz-Carlton Restaurant & Hotel Co. of Atlantic City*, 96 F.2d 748, 750 (3d Cir. 1938). When reviewing an ultimate fact, the Third Circuit Court of Appeals applies a mixed standard of review, accepting the trial courts' finding of historical or narrative facts unless they are clearly erroneous, but exercising a plenary review of the trails court's choice and interpretation of legal precepts and its application of those precepts to the historical facts. *See Sharon Steel*, 871 F.2d at 1223.

retention plan devised by Nellson on the eve of bankruptcy – essentially, Nellson took that retention plan and re-labeled it. The basic facts were conceded by Nellson's own CEO: He testified that the MIP was designed to replace the KERP and that half of the purpose of the MIP was "to keep people focused or to not lose people."

In light of the testimony regarding Nellson's motivation for enacting the MIP, the bankruptcy court erred when it concluded, as an ultimate fact, that employee retention was not the "primary purpose" of the MIP. Rather, the only logical conclusion that may be drawn from the evidence below is that the predominant (if not the exclusive) purpose of the MIP was to encourage senior management to remain employed by Nellson, just like the KERP that it supplanted. Accordingly, even if the "primary purpose" test employed by the bankruptcy court was the correct standard under section 503(c)(1), the bankruptcy court erred by concluding that Nellson satisfied that test.

[Continued on next page – space intentionally left blank]

CONCLUSION

WHEREFORE the United States Trustee requests that this Court issue an order reversing the bankruptcy court's July 18, 2006 order.

Respectfully submitted,

ROBERTA A. DeANGELIS
ACTING UNITED STATES TRUSTEE

BY: /s/ Joseph J. McMahon, Jr.
William K. Harrington, Esquire (# 4051)
Assistant United States Trustee
Joseph J. McMahon, Jr., Esquire (# 4819)
T. Patrick Tinker, Esquire
Trial Attorneys
United States Department of Justice
Office of the United States Trustee
J. Caleb Boggs Federal Building
844 King Street, Room 2207, Lockbox 35
Wilmington, DE 19801
(302) 573-6491
(302) 573-6497 (Fax)

Of counsel:

Ramona D. Elliott, Esquire
General Counsel
P. Matthew Sutko, Esquire
Associate General Counsel
John P. Sheahan, Esquire
Trial Attorney
United States Department of Justice
Executive Office for
United States Trustees
20 Massachusetts Avenue, N.W., Suite 8217
Washington, D.C. 20530
(202) 307-1399
(202) 307-2397 (Fax)

Date: December 7, 2009

BRIEF BANK — "SUMMARY SHEET"

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WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE
[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]

In re Nellson Nutraceutical, et al. (United States Trustee v. Nellson Nutraceutical, Inc., et al.)

2. ("CO") ***CURRENT*** COURT
[E.g., "CTA9"]

D. Del.

3. ("CCN") ***CURRENT*** CASE NO.

No.: 1:06-cv-00520-GMS

4. ("PCN") ***PRIOR*** CASE NO. - & COURT
[IF ANY]

No.: 06-10072

Court: Bankr. Del.

(Identify judge & cite, if any)

5. ("SO") ***SOURCE***

U.S. TRUSTEES

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF
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William K. Harrington, Joseph J. McMahon, Thomas P. Tinker, John P. Sheahan, P. Matthew Sutko, Ramona D. Elliott, Roberta A. DeAngelis

(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***

BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s)

&

√ Any Miscellaneous ***BACKGROUND***

• Did the bankruptcy court err when it approved debtor's motion to implement the management incentive program, on the grounds that the management incentive program was not subject to the limitations set forth in 11 U.S.C. § 503(c)(1)?

10. PATH TO FILE LOCATION:
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11. DO YOU RECOMMEND POSTING IN UST BRIEFBANK?

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NAME: Linda Figueroa

DATE:

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF DELAWARE

In re	:	
NELLSON NUTRACEUTICAL, INC., *et al.*,	:	Bankr. Case No. 06-10072 (CSS)
Debtors.	:	

UNITED STATES TRUSTEE,	:	
Appellant,	:	
v.	:	Civil Action No. 06-520 (GMS)
NELLSON NUTRACEUTICAL, INC., *et al.*,	:	
Appellees.	:	

APPELLANT'S REPLY BRIEF

ROBERTA A. DEANGELIS,
ACTING UNITED STATES TRUSTEE
FOR REGION THREE

WILLIAM K. HARRINGTON, ESQUIRE (# 4051)
ASSISTANT UNITED STATES TRUSTEE
JOSEPH J. MCMAHON, JR., ESQUIRE (# 4819)
THOMAS P. TINKER, ESQUIRE
TRIAL ATTORNEYS
UNITED STATES DEPARTMENT OF JUSTICE
OFFICE OF THE UNITED STATES TRUSTEE
J. CALEB BOGGS FEDERAL COURTHOUSE
844 KING STREET, SUITE 2207, LOCKBOX 35
WILMINGTON, DE 19801
(302) 573-6491
(302) 573-6497 (FAX)

OF COUNSEL:

RAMONA D. ELLIOTT, ESQUIRE
GENERAL COUNSEL
P. MATTHEW SUTKO, ESQUIRE
ASSOCIATE GENERAL COUNSEL
JOHN P. SHEAHAN, ESQUIRE
TRIAL ATTORNEY
UNITED STATES DEPARTMENT OF JUSTICE
EXECUTIVE OFFICE FOR
UNITED STATES TRUSTEES
20 MASSACHUSETTS AVENUE, N.W.,
SUITE 8217
WASHINGTON, D.C. 20530
(202) 307-1399
(202) 307-2397 (FAX)

Date: March 22, 2010

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ARGUMENT

Section 503(c) of the Bankruptcy Code imposes significant limitations on "insider" payment obligations that a debtor incurs "for the purpose of inducing such person to remain with the debtor's business." 11 U.S.C. § 503(c)(1). In an effort to escape the plain meaning of this section, the Debtors urge this Court to rewrite the statute by substituting the term "primary purpose" for "purpose." Nothing in the language or purpose of Section 503(c)(1) supports such an interpolation. Furthermore, although the Debtors argue that their management incentive plan ("MIP") is a true incentive plan and not a prohibited retention plan ("KERP"), this is a distinction without a difference, since the Debtors' own testimony and the undisputed factual findings below conclusively demonstrate that one purpose of the MIP was retention. As a result, regardless of whether it also served to incentivize the Debtors' management, the MIP is subject to Section 503(c)(1), and the bankruptcy court erred by holding that such section was inapplicable.

I. CONSISTENT WITH ITS REMEDIAL PURPOSE, SECTION 503(c)(1) MUST BE APPLIED AS DRAFTED: TO LIMIT THE PAYMENT OF BONUSES TO SENIOR CORPORATE EXECUTIVES FOR A RETENTIVE PURPOSE.

Bankruptcy Code Section 503(c)(1) conditions and restricts the bankruptcy court's ability to allow bonuses to corporate insiders.[1] Section 503(c)(1) was the product of Congress' reasoned determination that the practice of bankrupt corporations awarding bonuses to senior executives must be sharply constrained. Accordingly, the statute prohibits payments to this limited group when such payments are "for the purpose of inducing such person to remain with the debtor's business" absent evidence that (i) the payment is essential to retention because the insider has a bona fide job offer paying as much or more than his current position, (ii) the services provided by the insider are

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[1] Insiders of a corporate debtor include directors, officers and other persons in control of the debtor. 11 U.S.C. § 101(31)(B). The Debtors do not dispute that the executives benefitted by the MIP are insiders.

essential to the survival of the business, and (iii) the payments are capped at a prescribed figure (ten times the mean bonus amount paid to non-management employees during the relevant calendar year, or twenty-five percent of the amount paid to the insider during the prior calendar year if no bonuses were paid to non-management employees during the relevant calendar year). *See* 11 U.S.C. § 503(c)(1). Thus, while the statute does not prohibit bonuses used to encourage senior executives to remain with a bankrupt debtor, the statute substantially curtails allowance of such bonuses.

The Debtors argue that courts must interpolate the word "primary" into Section 503(c)(1) so as to avoid absurd results. However, the Debtors cannot point to any reason why a failure to adopt their proposed interpolation would lead to absurdity under the facts of this case. Instead, the Debtors speculate that enforcement of the plain terms of the statute may lead to absurdity in other cases, and suggest that unless their revision of Section 503(c)(1) is adopted, courts will disapprove normal salary, health insurance benefits, and pension contributions for senior executives. Appellees' Br., at 8.

In addition to being irrelevant to the facts of this appeal, which deals with a challenge to a bonus program and not to employee salaries and benefits paid in the ordinary course, the Debtors' attempt to draw an analogy between the MIP and the payment of ordinary wages and benefits overlooks a fundamental difference between those types of obligations. Under normal circumstances, an employee who terminates his employment does not forfeit his right to accrued but unpaid salary or benefits. As a result, a debtor's payment of its normal payroll obligations is not for the "purpose" of retention because employees are generally entitled to be paid for their past work without regard to whether they have promised to continue working in the future. By contrast, bonuses under KERP and similar programs, including the MIP in this case, are payable by definition only to persons who are still employees at some specified date in the future. As a result, even if is assumed that the payment of salary obligations has some retentive effect, such payment lacks the retentive hallmarks of a KERP.

Alternatively, the Debtors suggest that this Court should create an exception to Section 503(c)(1) for payments that are "for the purpose of incentivizing such person to create value for the debtor and the estate." Appellees' Br., at 1. Again, nothing in the text of the statute supports the result the Debtors seek. Section 503(c)(1) fails to use such labels as "retention bonuses" and "incentive compensation" (or any other labels).

The court's responsibility under section 503(c)(1) is not to select one of a series of "labels" as the primary purpose of a payment. Rather, the Court must simply determine whether the proposed payments were for the purpose of inducing the senior executives to remain with the Debtors. The statute does not call for conjectures as to which of several purposes is "primary." If the evidentiary record demonstrates that the compensation being sought for insiders is for the purpose of inducing retention, then the inquiry as to whether Section 503(c)(1) applies should stop at that point, and the limitations established by Congress should be applied. The statute applies to a narrow group of employees, and its broad remedial purpose needs to be given effect.

As detailed in the United States Trustee's opening brief, standard canons of statutory construction dictate this result. Appellant's Br., at 15-16. The Debtors' construction of Section 503(c)(1) does not square with the statutory text or its remedial purpose. When Congress considered it important that a matter be "primary," Congress knew how to craft such language. Indeed, the inclusion of particular language in one section of an enactment, combined with the absence of that language in another section of the same act, is evidence that the legislature intended a disparate result. *Russello v. United States*, 464 U.S. 16, 23 (1983). Here, Congress used the term "primary" or "primarily" in at least three other parts of the relevant act. *See* Appellant's Br., at 16.

Accordingly, this Court should reject Debtors' suggestion that the adjective "primary" must be interpolated into the statute.

II. EVEN IF A "PRIMARY PURPOSE" STANDARD APPLIES, THE BANKRUPTCY COURT'S DECISION WAS ERRONEOUS BECAUSE THE UNCONTRADICTED TESTIMONY BELOW DEMONSTRATES THAT RETENTION WAS THE PRIMARY PURPOSE OF THE MIP.

Even if section 503(c)(1) does contain a "primary purpose" requirement, the extensive evidentiary record demonstrates that such a standard was satisfied in this case. As discussed in the United States Trustee's opening brief, the Debtors' own CEO admitted at trial that the MIP was designed to replace the pre-petition KERP, which the Debtors abandoned due to concerns that it did not comply with Section 503(c)(1). 7/13/06 Tr., at 197:11-16, 7/10/06 Tr., at 13:24-14:7. In addition, the admitted purpose of the MIP, like the KERP it replaced, was to dissuade employees from leaving. *Id.* at 17:17–21; 22:21-23. The Debtors' own brief, while arguing that the MIP had additional purposes, does not rebut this testimony. Appellees' Br., at 18 (stating that purpose of MIP was "not merely to retain employees").

In arguing that the MIP should not be subject to Section 503(c)(1), the Debtors also place considerable emphasis on the fact that the MIP targets for a subsequent period were not met, and also argue that the compensation paid to their executives under the MIP was objectively reasonable. Appellant's Br., at 15-17. Neither of these facts has any bearing on the Section 503(c)(1) analysis. There is a fundamental difference between the MIP payments for the first incentive period, which are the subject of this appeal, and the MIP payments for the second period, which were never paid. In particular, when the Debtors sought approval of the MIP, the quarter to which it pertained was already in progress, and the Debtors were aware that their actual financial performance was already above the initial threshold for payments under the MIP. 7/13/06 Tr., at 72:23 – 73:3. As a result, the fact that the Debtors subsequently missed their targets for a future reporting period does not alter the essentially guaranteed nature of the MIP payments from the first period which are at issue in this appeal.

Moreover, the applicability of Section 503(c)(1) does not hinge on whether the payments proposed are commercially reasonable, or whether the executives of the debtor are deserving of such bonuses. Unlike prior law, which authorized the payment of retention bonuses according to the debtor's business judgment, section 503(c)(1) operates as a categorical prohibition on retention payments unless the stringent requirements of the section were met – which they were not in this case. As a result, even if this Court were to accept as true the Debtors' self-serving claim that their insiders were being paid "less than reasonable market compensation" absent the MIP, Appellees' Br. at 11, that fact cannot override the plain terms of Section 503(c)(1).

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CONCLUSION

The lower court erred by interpolating the word "primary" before "purpose" in section 503(c)(1). Such a judicial interpolation has no sound basis in the statute. Moreover, such an interpolation was unnecessary under the facts of this case, given the MIP's clear, stated purpose of inducing senior corporate executives to remain with the Debtors during the bankruptcy case. The United States Trustee therefore respectfully requests that this Court reverse the lower court's order.

Respectfully submitted,

ROBERTA A. DeANGELIS
ACTING UNITED STATES TRUSTEE

BY: /s/ Joseph J. McMahon, Jr.
William K. Harrington, Esquire (# 4051)
Assistant United States Trustee
Joseph J. McMahon, Jr., Esquire (# 4819)
T. Patrick Tinker, Esquire
Trial Attorneys
United States Department of Justice
Office of the United States Trustee
J. Caleb Boggs Federal Building
844 King Street, Room 2207, Lockbox 35
Wilmington, DE 19801
(302) 573-6491
(302) 573-6497 (Fax)

Of counsel:

Ramona D. Elliott, Esquire
General Counsel
P. Matthew Sutko, Esquire
Associate General Counsel
John P. Sheahan, Esquire
Trial Attorney
United States Department of Justice
Executive Office for
United States Trustees
20 Massachusetts Avenue, N.W., Suite 8217
Washington, D.C. 20530
(202) 307-1399
(202) 307-2397 (Fax)

Date: March 22, 2010

BRIEF BANK — 'SUMMARY SHEET" *Printed Thu-8/11/05 11:37*

WESTLAW CODES

1. **("TI")** *TITLE* OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	In re Northern Routes Transportation, Inc.
2. **("CO")** *CURRENT* COURT *[E.g., "CTA9"]*	D. Mont.
3. **("CCN")** *CURRENT* CASE NO.	No.: CV-05-32-BU-RFC
4. **("PCN")** *PRIOR* CASE NO. & COURT *[IF ANY]*	No.: Court: Bankr. D. Mont. *(Identify judge & cite, if any)*
5. **("SO")** *SOURCE*	U.S. TRUSTEES
6. **("DA")** *DATE* OF FILING *& TYPE* OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	Filed: July 2005 Type: Appellee- UST Brief
7. **("AU")** *PRINCIPAL AUTHORS & OFFICE [E.g.,"UST/OGC"]*	Neal Jensen, AUST *(UST/OGC: 202-307-1399/FAX-2397)*
8. **("TO")** *TOPIC*	BANKRUPTCY
9. **("SU")** ● *SUMMARY* OF KEY ISSUE(s) & √ Any Miscellaneous *BACKGROUND*	● 1. Whether the Bankruptcy Court erred in refusing to grant the appellant Northern Routes Transportation, Inc. permission to pay in full selected pre-petition debts, where binding Ninth Circuit Court of Appeals precedent holds that such payments are contrary to the requirements of the Bankruptcy Code. 2. Whether, if the District Court were to decide that binding precedent does not prohibit payment of certain “critical” or “necessary” pre-petition claims, the development of criteria to establish what claims meet those descriptions should be left to the Bankruptcy Court.
10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)	F:\General Counsel\BriefBank-Web\NorthernRoutes\Northern01.wpd
11. DO YOU RECOMMEND POSTING IN UST BRIEFBANK?	| X | YES | | NO *NAME:* Steven Eggert *DATE:* Thu-8/11/05 11:19

Neal G. Jensen
Assistant United States Trustee
Office of United States Trustee
Liberty Center, Suite 204
301 Central Avenue
Great Falls, MT 59403
Phone (406) 761-8777
Fax (406) 761-8895
neal.g.jensen@usdoj.gov
State Bar I.D. No. 738
(Attorney for United States Trustee/Appellee)

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MONTANA
BUTTE DIVISION

In re	)	
	)	
NORTHERN ROUTES	)	Case No. CV-05-32-BU-RFC
TRANSPORTATION, INC.,	)	
	)	
Debtor.	)	
	)	

BRIEF OF APPELLEE UNITED STATES TRUSTEE

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STATUTES AND RULES

STATEMENT OF JURISDICTION

The United States Bankruptcy Court for the District of Montana had jurisdiction over the Chapter 11 reorganization case of appellant Northern Routes Transportation, Inc. under 28 U.S.C. § 157(a). That court denied appellant's motion seeking authority to pay pre-petition debts by Order dated April 5, 2005. Appellant filed a timely notice of appeal on April 14, 2005. This Court has jurisdiction over this appeal under 28 U.S.C. § 158(a)(1).

STATEMENT OF ISSUES PRESENTED ON APPEAL

1. Whether the Bankruptcy Court erred in refusing to grant the appellant Northern Routes Transportation, Inc. permission to pay in full selected pre-petition debts, where binding Ninth Circuit Court of Appeals precedent holds that such payments are contrary to the requirements of the Bankruptcy Code.

2. Whether, if the District Court were to decide that binding precedent does not prohibit payment of certain "critical" or "necessary" pre-petition claims, the development of criteria to establish what claims meet those descriptions should be left to the Bankruptcy Court.

STANDARD OF APPELLATE REVIEW

On appeal, a bankruptcy court's conclusions of law are reviewed *de novo* and its factual findings are reviewed for clear error. *In re Summers*, 332 F.3d 1240, 1242 (9th Cir.2003). Because the issues presented in this appeal are legal, the standard of review is *de novo*.

STATEMENT OF THE CASE AND STATEMENT OF FACTS

Appellant Northern Routes Transportation, Inc. ("Northern Routes") filed a voluntary petition under Chapter 11 of the United States Bankruptcy Code on February 22, 2005. Contemporaneous with that filing, Northern Routes filed motions seeking authority to pay in full certain of its pre-petition debts. On March 3, 2005, the United States Trustee and Northern

Routes stipulated that they would submit to the Bankruptcy Court the issues of (1) whether that court had the legal authority to authorize the payment of pre-petition debts; and (2) if it did have that authority, the general criteria under which such payments would be appropriate.

After the parties briefed the issues, the Bankruptcy Court denied the motions by Order dated April 5, 2005. The court ruled that under the Ninth Circuit decision of *In re B & W Enterprises, Inc.*, 713 F.2d 534 (9th Cir.1983), no legal authority existed for a bankruptcy court to approve payment in full of selected pre-petition claims. Because of this conclusion the Bankruptcy Court did not reach the issue of the circumstances under which such payments might be appropriate.

Northern Routes filed a timely notice of appeal on April 14, 2005.

ARGUMENT

A. The Bankruptcy Court appropriately followed Ninth Circuit precedent in concluding that payment in full of certain creditors immediately following a Chapter 11 filing violates the priority scheme established under the Bankruptcy Code.

In its Order of April 5, 2005, the Bankruptcy Court for the District of Montana denied Northern Routes' motions seeking authority to pay in full the claims of certain select prepetition unsecured creditors. In reaching this decision, the Bankruptcy Court reaffirmed "that the bright line rule articulated by this Court in *In re Timberhouse Post and Beam, Ltd.*, 196 B.R. 547, 15 Mont. B.R. 317 (Bankr. D. Mont. 1996), is the prevailing law in the District of Montana." This conclusion was based upon "the bright line rule set forth in *B & W Enterprises*, [713 F.2d 534 (9th Cir. 1983); and citing other cases], that a pre-petition unsecured claim cannot be elevated to an administrative expense since the scheme of the 1978 Bankruptcy Code does not allow this Court to change the classification of claims set by Congress in the Code." Order of April 5, 2005, at 2.

This Court's consideration of the issues presented by this appeal can start and end with the Ninth Circuit's decision in *In re B & W Enterprises, Inc.*, 713 F.2d 534 (9th Cir. 1983). In

B & W, the Ninth Circuit clearly held that bankruptcy courts do not have the authority, equitable or otherwise, to elevate unsecured creditors' claims in priority over the claims of other unsecured creditors. 713 F.2d at 538. The appellants in *B & W* were unsecured creditors whose pre-petition claims were paid in exchange for their agreement to continue to provide services or goods to the Chapter 11 debtors. The debtors and the creditors agreed that this continuation of goods and services was "necessary and essential to the operation of the debtor's business following the petition for bankruptcy under Chapter 11." 713 F.2d at 534. After the cases were converted to Chapter 7, the Chapter 7 trustee sought to recover those payments. The appellants sought to retain the payments based on equitable rules known as the "Six Months Rule" and the "Necessity of Payment Rule."

The Court of Appeals discussed the Six Months Rule and the Necessity of Payment Rule separately. "The Six Months Rule," the court noted, "stems from the historical practice of initiating railroad receiverships with an order appointing a receiver who was granted court authorization to pay certain pre-petition debts for labor, equipment, supplies or improvements from post-petition operating receipts." 713 F.2d at 536. This equitable rule was given statutory recognition by Congress in the Bankruptcy Act, and was later retained under the Bankruptcy Code in 1978. *See* 11 U.S.C. § 1171(b). As noted in *B & W*, however, in structuring the Code "Congress placed the provision involved here, § 1171(b), which incorporates the equity receivership rules, in subchapter IV of title 11. This subchapter deals exclusively with railroad reorganizations." *Id*. The court concluded:

> The intent of Congress could hardly be more clear. It has deliberately limited the applicability of the Six Months Rule to the area of railroad reorganizations, the focus of concern to which it traditionally has been limited. Accordingly, we find under the Bankruptcy Code, the Six Months Rule is applicable only in cases concerning railroads.

713 F.2d at 537.

The Ninth Circuit noted that the historical development of the Necessity of Payment Rule paralleled that of the Six Months Rule, and affirmed that this rule "was created for and has been applied only to railroad cases." *Id.* The Necessity of Payment Rule was historically invoked as justification for the payment of pre-petition debts paid under duress to assure continued supplies or services essential to the continued operation of a railroad. Recognizing that, unlike the Six Months Rule, Congress specifically did *not* choose to codify the Necessity of Payment Rule, the Ninth Circuit wrote:

> However, unlike the Six Months Rule, it is not clear that the Necessity of Payment Rule has been retained in the Bankruptcy Act of 1978, 11 U.S.C. § 101 *et seq*. We need not reach the question whether the Necessity of Payment Rule has survived the 1978 Act, however, for, if it has, *we would decline to apply it beyond the context of railroad reorganizations*.

Id. (emphasis added).

Finally, the Ninth Circuit considered whether any of the Bankruptcy Court's general equitable powers granted by the Bankruptcy Code would allow such court to "overrule the priority scheme" contained in the Code and therefore apply rules similar to the Six Months Rule and the Necessity of Payment Rule "when appropriate." Noting that what the debtor sought was the "elevation" of some pre-petition unsecured creditors over others pre-petition creditors of the same class, the Court concluded: "This is not a power given the courts by the 1978 Act." *Id.* While 11 U.S.C. § 510(c) specifically allows Bankruptcy Courts to subordinate certain claims to others of the same class under certain circumstances, nothing in the Code allows a Court to "elevate" one or more pre-petition claims over all others of the same class:

> Section 507 establishes the priorities of creditors intended by Congress; and section 1123 requires that a chapter 11 plan must "provide the same treatment for each claim or interest of a particular class." 11 U.S.C. § 1123. _*There is no indication that Congress intended the courts to fashion their own rules of super-priorities within any given priority class.*

Id. (emphasis added).

Northern Routes attempts to distinguish *B & W*. It points out that in *B & W,* the debtors paid pre-petition creditors without bankruptcy court approval and while the cases were pending in Chapter 11. After the cases were converted to Chapter 7, the Chapter 7 trustee sought to recover the amounts paid from the creditors. While the debtors in *B & W* clearly should have sought court permission before paying the creditors, nothing whatsoever in the *B & W* analysis indicates that the Court would have reached a different result if such permission had been sought. The Court could presumably have held that the payments were avoidable as unauthorized post-petition transfers under § 549(a) of the Bankruptcy Code without considering the Six Months Rule or the Necessity of Payment Rule; it nevertheless fully considered those rules and refused to apply them or any other equitable doctrine to approve payments that ran afoul of the priority scheme established by the Bankruptcy Code.

Furthermore, the *B & W* analysis is not dependent in any way upon that case having been converted. To the contrary, the Ninth Circuit clearly viewed its decision as being consistent with 11 U.S.C. § 507, which establishes payment priorities for all chapters of the Bankruptcy Code, and 11 U.S.C. § 1123, which requires that a Chapter 11 plan provide the same treatment for each member of every class of claims or interest. *Id*.

Northern Routes finally claims that its case differs from *B & W* because the payments it wished to make "are necessary for the continued viability of the business enterprise." As was noted above, this precise assertion was made in *B & W*, 713 F.2d at 534, and the Ninth Circuit did not find this to be a sufficient justification to depart from the statutory priority scheme.

In conclusion, it is sufficient to dispose of this appeal to recognize that the Ninth Circuit has spoken very clearly in this area. This case is not legally distinguishable from *B & W*. While other courts in other Circuits may have chosen to deviate from our precedent, Judge Kirscher has reiterated his Court's decision in *In re Timberhouse Post and Beam, Ltd*., 196 B.R. 547 (Bankr. D. Mont. 1996), to adopt "the bright line rule set forth in *B & W Enterprises*" and other cases "that a prepetition unsecured claim cannot be elevated to an administrative expense since the scheme of the 1978 Bankruptcy Code does not allow this Court to change the classification of claims set by Congress in the Code." *See* the Bankruptcy Court's Order, dated April 5, 2005, at pp. 2-3. For the same reasons now being argued before this Court, Northern Routes strongly urged the Bankruptcy Court to abandon its bright line rule. In the end, however, Judge Kirscher held:

> After reviewing the applicable law, the Court declines to abandon its prior ruling in *Timberhouse*. Section 507 of Title 11 specifically sets forth the manner in which prepetition claims are to be paid, including the claims of Debtor's drivers and employees, which appear to have third tier priority under § 507(a)(3). *The Court's ruling furthers one of the long-standing principals of the Bankruptcy Code – equality of treatment of unsecured creditors*."

Order of April 5, 2005, at 3 (emphasis added).

This Court should affirm the Bankruptcy Court's Order denying of the motions to pay pre-petition creditors

B. If this Court were to determine that certain payments of pre-petition claims are permissible notwithstanding Circuit Court precedent, the case should be remanded to the Bankruptcy Court for the development of criteria to be used in determining what claims might appropriately be paid.

Because the Bankruptcy Court concluded that its "bright line test" prohibiting payments of pre-petition claims of "critical" or "necessary" vendors was still required under *B & W*, that court did not reach the issue of what criteria would be applied in determining what claims could be paid under another test. In its brief, Northern Routes asks this Court to adopt criteria to be applied. While this Court could presumably develop such criteria, the United States Trustee believes that, as a matter of judicial prudence, the initial development of such standards should be left to the Bankruptcy Court. That court routinely deals with issues related to the needs of insolvent businesses, and is best situated to develop an appropriate test or tests. Therefore, if this Court determines that it is not bound by *B & W* and adopts an alternative test, the United States Trustee requests that the case be remanded to the Bankruptcy Court for the development of appropriate criteria to be used in applying the test adopted by this Court.

CONCLUSION

Based upon the foregoing, the United States Trustee respectfully requests that this Court affirm the April 5, 2005, decision of the Bankruptcy Court, denying Northern Routes' motions to pay certain pre-petition creditors.

DATED this ____ day of July, 2005.

ILENE J. LASHINSKY
United States Trustee

____

NEAL G. JENSEN
Assistant United States Trustee
(Attorney for Appellee)

CERTIFICATE OF MAILING

I, the undersigned, Neal G. Jensen, Assistant United States Trustee, do hereby certify under penalty of perjury that a copy of the within and foregoing United States Trustee's Appeal Brief was sent by first class mail postage prepaid on the ____ day of July, 2005, at Great Falls, Montana, and directed to the following:

James A. Patten
Patten, Peterman, Bekkedahl & Green
2817 2nd Avenue North, Ste. 300
Billings, MT 59101
(Attorney for Debtor/Appellant)

____
Neal G. Jensen

BRIEF BANK — "SUMMARY SHEET" *Printed Wed-11/12/08 11:22*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*
In re: Northwest Airlines Corporation, et al. (Lazard Freres & Co., LLC v. Diana G. Adams, et al.)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*
S.D.N.Y.

3. ("CCN") ***CURRENT*** CASE NO.
No.:1:08-cv-03456-NRB

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*
No.: 05-B-17930 (ALG)
Court: Bankr. S.D.N.Y.
(Identify judge & cite, if any)

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Brian S. Masumoto, Linda Riffkin, P. Matthew Sutko
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s)

&

√ Any Miscellaneous ***BACKGROUND***

• Whether the bankruptcy court abused its discretion in denying debtor's request for a Completion or Success Fee under 11 U.S.C. § 330.

10. PATH TO FILE LOCATION:
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IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

In re Northwest Airlines Corporation *et al.*, Debtors

Civil Nos. 08-03456 (NRB) and 08-0350 (NRB)

Lazard Frères & Co. LLC,
Appellant,
v.

Diana G. Adams, United States Trustee
Carval Investors, LLC; and
Association of Flight Attendants- CWA, AFL-CIO,
Appellees.

Official Committee of Unsecured Creditors of Northwest Airlines Corporation
Appellant,

v.

Diana G. Adams, United States Trustee
Carval Investors, LLC; and
Association of Flight Attendants- CWA, AFL-CIO
Appellees.

On Appeal from the United States Bankruptcy Court
for the Southern District of New York

BRIEF OF APPELLEE UNITED STATES TRUSTEE

Brian S. Masumoto
Trial Attorney

Linda Riffkin
Assistant United States Trustee

Office of the United States Trustee
33 Whitehall Street, 21st Floor
New York, NY 10004
Phone: (212) 510-0500
Facsimile: (212) 668-2255

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STATEMENT OF JURISDICTION

The United States Bankruptcy Court for the Southern District of New York had jurisdiction over the Northwest Airlines Corporation chapter 11 bankruptcy cases under 28 U.S.C. § 157(a) and (b) and 1334(a). On February 29, 2008, the bankruptcy court entered an order ("Order") approving a final fee award of $5,455,645 to Lazard Frères & Co. ("Lazard"), financial advisors to the Official Committee of Unsecured Creditors ("Committee"). [P-15; ECF 8103 and P-16, ECF 8105].[1] The Order denied Lazard's request to for a 60% "success" or "completion" fee of $3,250,000, because Lazard had failed not only to secure pre-approval of the fee but also to meet its burden of demonstrating that enhancement was warranted under 11 U.S.C. § 330(a). *Id*. Lazard and the Committee appealed the Order by notice of appeal filed under 28 U.S.C. § 158(c)(2) and Fed. R. Bankr. P. 8002 on March 10, 2008. [P-17; ECF Doc. No. 8123]. This Court has jurisdiction over this appeal under 28 U.S.C. § 158(a)(1).

STANDARD OF REVIEW

A bankruptcy court's ultimate award of fees is reviewed for abuse of discretion. *In re Babcock & Wilcox Company*, 526 F.3d 824 (5th Cir. 2008). Under this standard, an appellate court "accept[s] [the Bankruptcy Court's] factual findings unless clearly erroneous but review[s] its conclusions of law *de novo*." *Bank Brussels Lambert v. Coan (In re AroChem Corp.)*, 176 F.3d 610, 620 (2d Cir. 1999) (*citing In re McLean Industries*, 30 F.3d 385, 387 (2d Cir. 1994)).

STATEMENT OF ISSUE PRESENTED

Where compensation is not pre-approved under 11 U.S.C. § 328(a), a bankruptcy court may award estate professionals "reasonable compensation for actual, necessary services" under 11 U.S.C. § 330(a)(1)(A). In determining "reasonable" compensation, a bankruptcy court may consider a non-

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[1] "P-15" and "P-16" refers to Lazard's Designation Number of the Record on Appeal. For convenience, this brief will cross-reference the document to the corresponding docket entry on the electronic case filing system in the bankruptcy case, *In re Northwest Airlines Corp.* No. 05-17930 (Bankr. S.D.N.Y.).

exclusive list of five "relevant factors" pertaining to the "nature, the extent and the value" of the services rendered, including "the customary compensation charged by comparably skilled practitioners" in non-bankruptcy cases. 11 U.S.C. § 330(a)(3)(E).[2] A professional bears the burden of proving that its fees are both necessary and "reasonable." If it fails to do so, the bankruptcy court may "award compensation that is less than the amount of compensation that is requested . . . ." 11 U.S.C. § 330(a)(2). Bankruptcy courts may enhance fees calculated under the lodestar method, which incorporates many of the factors prescribed under 11 U.S.C. § 330(a)(3), only if a professional adduces evidence of "truly exceptional results." Lazard failed to meet its burden of proving that its work merited a 60% bonus. Given Lazard's failure to meet its burden of proof, did the bankruptcy court abuse its discretion in declining to enhance its fees?

STATEMENT OF THE CASE

A. Statutory Framework

The Bankruptcy Code, 11 U.S.C. § 101 *et seq.*, regulates the retention, compensation and payment of bankruptcy professionals, such as attorneys, accountants and financial advisors, in chapter 11 and 7 cases. It grants significant discretion to bankruptcy courts in calculating reasonable professional fees in order to protect estate assets and to promote the integrity of the bankruptcy system. The United States Trustee has standing to object to bankruptcy professional fee applications in chapter 11 and 7 cases. 28 U.S.C. § 586(a)(3)(A); 11 U.S.C. §§ 307 and 330(a)(2).

Section 1102(a) authorizes the United States Trustee to appoint one or more unsecured creditors' committees. A creditors' committee may hire bankruptcy professionals to assist it in fulfilling its responsibilities "with the court's approval . . . ." 11 U.S.C. § 1103. These professionals, as well as those employed by the debtor, are entitled to first priority payment under 11 U.S.C. §§ 503(a) and 507(a)(1) ahead of general unsecured creditors.

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[2] The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub.L. 109-8, 119 Stat 23 (2005) ("BAPCPA"), became effective on October 17, 2005. This appeal involves 11 U.S.C. § 330(a) in its pre-amendment form.

The Bankruptcy Code provides two mechanisms for compensating committee professionals. Section 328(a), which is inapplicable here, authorizes a committee to employ professionals "on any reasonable terms and conditions of employment, including on a retainer, on an hourly basis, or on a contingent fee basis . . . ." 11 U.S.C. § 328(a). Section 328(a) permits a bankruptcy court subsequently to award different compensation only if the pre-approved "terms and conditions of employment prove to have been improvident in light of developments not capable of being anticipated at the time of the fixing of such terms and conditions . . . ."

Section 330(a) authorizes a bankruptcy court to pay committee professionals "reasonable" compensation for their "actual and necessary services." 11 U.S.C. § 330(a)(1)(A). The court may authorize reimbursement of the professionals' "actual" expenses if they are "necessary." 11 U.S.C. § 330(a)(1)(B). Section 330's requirements regarding reasonable compensation and reimbursement of necessary expenses are particularly important in the context of a creditors' committee, because its professionals' fees are paid by the bankruptcy estate, not the committee members. 11 U.S.C. § 503(b)(3).

Bankruptcy professionals bear the burden of demonstrating their entitlement to fees and expenses under 11 U.S.C. § 330(a). If a professional fails to meet his burden of proof under 11 U.S.C. § 330(a), the bankruptcy court, with or without an objection from a party in interest, may award compensation "less than the amount of compensation that is requested . . . ." 11 U.S.C. § 330(a)(2). Moreover, section 330(a)(4) prohibits the bankruptcy court from awarding compensation for "unnecessary duplication of services . . . or . . . services that were not . . . reasonably likely to benefit the debtor's estate . . . or . . . necessary to the administration of the estate . . . ." 11 U.S.C. § 330(a)(4). Section 331 authorizes bankruptcy professionals to seek interim compensation on the same basis as under section 330(a).

United States Trustees are officials of the Department of Justice appointed by the Attorney General to supervise the administration of bankruptcy cases and trustees. *See* 28 U.S.C. §§ 581-589 (specifying the powers and duties of United States Trustees).[3] Congress has expressly authorized United States Trustees to comment upon and object to fee applications filed by bankruptcy professionals. 28 U.S.C. § 586(a)(3)(A); 11 U.S.C. §§ 307 and 330(a)(2). The United States Trustees have issued guidelines regarding bankruptcy professional fee applications in chapter 11 and 7 cases. 28 C.F.R. Pt. 58, App. A (1996).

B. Procedural and Factual History

1. The Chapter 11 Cases

On September 14, 2005, Northwest Airlines Corporation and twelve of its direct and indirect subsidiaries ("Northwest" or "Debtors") filed petitions under chapter 11 of the Bankruptcy Code, 11 U.S.C. § 1101, *et seq.* The Bankruptcy Court entered an order directing the joint administration of the cases on September 14, 2005. [ECF Doc. No. 5.] At the time of the filing, Northwest operated the world's fourth largest airline (as measured by revenue passenger miles). [AJDRA ¶ 1, p. 3, ¶ 7; ECF Doc. No. 35][4]

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[3] *See also In re Columbia Gas Sys., Inc.*, 33 F.3d 294, 296 (3d Cir. 1994) (United States Trustees oversee the bankruptcy process, protect the public interest, and ensure that bankruptcy cases are conducted according to law) (*citing* H.R. Rep. No. 95-595, 109 (1977)); *United States Trustee v. Revco D.S., Inc. (In re Revco D.S., Inc.)*, 898 F.2d 498, 499 (6th Cir. 1990) ("[t]he United States trustee, an officer of the Executive Branch, represents . . . [the] public interest . . . ."); *In re Castillo*, 297 F.3d 940, 950 (9th Cir. 2002) ("The United States Trustee is the 'watchdog' of the bankruptcy system . . . charged with preventing fraud and abuse and with 'fill[ing] the vacuum caused by possible creditor inactivity . . . .").

[4] "AJDRA" refers to the Appellees' [CarVal Investors, Inc. and Association of FlightAttendants – CWA, AFL-CIO] Joint Designation of Additional Items for Inclusion in the Record on Appeal."

2. Lazard's Retention Application and Orders

On September 30, 2005, the United States Trustee appointed the Committee pursuant to Section 1102(a) of the Bankruptcy Code.[5] [ECF Doc. No. 444]. After negotiating with Lazard for several weeks over the terms of its employment, the Committee filed an application ("Application") to retain Lazard as one of its two financial advisors on November 8, 2005. [ECF Doc. No. 948]. *Order* at 5. Under the Application, which memorialized the parties' agreement, the Committee proposed to retain Lazard on specified, pre-approved terms under 11 U.S.C. § 328(a). *Id*. Specifically, Lazard agreed to accept a flat "Monthly Advisory Fee" of $275,000 plus expenses, and the Committee and Lazard agreed to defer consideration of Larzard's "entitlement, if any, to an additional 'success' or 'completion' fee to the latter part of the Debtors' Chapter 11 case . . . ." *Id*. The Application, at ¶ 18(c), provided:

> (c) Other Fees. It is agreed that all matters relating to Lazard Frères' *entitlement, if any,* to an additional "success" or "completion" fee *shall be deferred until the latter part of the Company's chapter 11 case*, and that Lazard Frères shall be required to comply with the applicable notice procedures required by the Court and the Office of the U.S. Trustee.

Id. (emphasis added).

On November 29, 2005, the bankruptcy court entered an interim order authorizing the Committee to retain Lazard as a financial advisor, retroactive through October 6, 2005 (the "Interim Retention Order"). [AJDRA ¶10; ECF Doc. 1272]. The Interim Retention Order affirmed Lazard's agreement with the Committee insofar as it did not pre-approve a completion or success fee. It authorized Lazard to be compensated only to the extent of its Monthly Advisory Fee and expenses, subject to challenge under 11 U.S.C. § 328(a). *Id*. at 2-3. The Interim Retention Order preserved the United States Trustee's right to object to any interim or final fee applications filed by Lazard on any grounds, including, without limitation, the reasonableness standard of 11 U.S.C. § 330, the bankruptcy

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[5] The United States Trustee reprints the principal, pre-BAPCPA statutes it relies upon, 11 U.S.C. §§ 328, 330(a), 503, 507 and 1102 and 1103, in an addendum attached to this brief.

rules, or any local rules or orders of the court. The Interim Retention Order also required Lazard to maintain contemporaneous time records for services rendered in half-hour increments. *Id.*[6]

On July 20, 2006, the bankruptcy court entered a final order (the "Final Retention Order") employing Lazard as a financial advisor to the Committee. [P-1; ECF Doc. No. 3112]. The Final Retention Order incorporated the provisions of the Interim Retention Order. *Id.*

Neither the Application nor the Interim Retention Order nor the Final Retention Order defined goals for Lazard, such as a recapitalization, a percentage repayment for creditors or other "success," which, if met, would entitle it to a bonus. *Id.* Accordingly, nothing negotiated by the parties and approved by the bankruptcy court bound the court under 11 U.S.C. § 328(a) in determining whether Lazard was entitled to any future fee enhancement. *Id.*

On July 30, 2007, Lazard filed a final application for allowance of compensation and for reimbursement of expenses in the Debtors' cases for the period from October 6, 2005 through May 31,

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[6] The Interim Retention Order provided:

> ORDERED that to the extent accrued during this interim retention, Lazard Frères shall receive (a) its Monthly Advisory Fees as set forth in the Engagement Letter, and (b) reimbursement of Lazard Frères' expenses, which in each case shall not hereafter be subject to challenge except under the standard of review set forth in section 328(a) of the Bankruptcy Code; and it is further
>
> ORDERED that, notwithstanding anything to the contrary set forth above, the Office of the United States Trustee retains the right to object to any interim or final fee application filed by Lazard Frères (including any request for the reimbursement of expenses) on any grounds provided for under the Bankruptcy Code (including, without limitation, the reasonableness standard provided for in section 330 thereof), the Bankruptcy Rules, or any Local Rules or Orders of this Court;
>
> ORDERED that, notwithstanding anything to the contrary in the Bankruptcy Code, the Federal Rules of Bankruptcy Procedures, the Local Rules of this Court, any orders of this Court or any guidelines regarding submission and approval of fee applications, Lazard Frères and its professionals shall only be required to maintain contemporaneous time records for services rendered in half-hour increments . . . .

2007 (the "Final Fee Application"). The Final Fee Application sought bankruptcy court approval of Lazard's total Monthly Advisory Fees for the twenty month period from October 6, 2005 through May 31, 2007 of $5,455,645.00, reimbursement of expenses for the same period in the amount of $167,915.12 and a completion fee (the "Completion Fee Request") in the amount of $3,250,000.00 for a total compensation request of $8,873,560.12. [P-2 at 1; ECF Doc. No. 7431]. During the course of the Debtors' case, Lazard received interim payments of fees and reimbursement of expenses totaling $4,298,208.95, leaving the net amount of compensation requested in the Final Fee Application of $4,575,351.17 (which amount included Lazard's Completion Fee Request of $3,250,000).[7]

The United States Trustee filed an objection to both FTI's and Lazard's completion fees on September 4, 2007 on the same grounds. *In re Northwest Airlines*, 382 B.R. at 637; *citing* ECF Doc. No. 7558. The United States Trustee argued that fee enhancements were not warranted in these bankruptcy cases. The United States Trustee noted that bankruptcy courts only award fee enhancements in rare circumstances in which the professionals prove that their results were exceptional and their standard hourly rates did not fairly compensate them for the services rendered. *Id.* The United States Trustee argued that Lazard, like FTI, failed to justify its entitlement to a completion fee and failed to provide any evidence that its blended hourly rate of $876 per hour did not fairly compensate Lazard for the services it rendered. *Id.*

The Association of Flight Attendants – CWA, AFL-CIO (the "AFA") filed an objection to Lazard's Completion Fee on September 4, 2007. *In re Northwest Airlines,* 382 B.R. at 637-38, *citing* ECF Doc. No. 7566. The AFA argued that Lazard had not provided any evidence establishing its entitlement to a fee enhancement. Furthermore, the AFA argued that most of the cost savings in the bankruptcy cases came from labor concessions in which Lazard had little, or no involvement. *Id.* at 638.

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[7] According to its Final Fee Application, during the period from October 6, 2007 through May 31, 2007, Lazard rendered 6,227.2 hours of services in connection with the Debtors' cases. [P-2, Ex. B; ECF 7431]

Carval Investors LLC ("CarVal") filed an objection to FTI's and Lazard's requests for completion fees on September 4, 2007. *In re Northwest Airlines,* 382 B.R. at 638, *citing* ECF Doc. No. 7567. CarVal argued that Lazard's retention pursuant to section 328(a) required the bankruptcy court to find that the monthly compensation agreement was improvident in light of developments not capable of being anticipated at the time Lazard's retention was approved before any success or completion fee could be granted. *Id.* CarVal argued that because no parameters for computing the success or completion fee were included in its retention application, Lazard failed to meet its burden of proof under section 328(a) and its request should therefore be denied. *Id.*

On November 2, 2007, with respect to the unopposed portion of Lazard's compensation – the pre-approved fixed monthly compensation of $275,000 per month – the bankruptcy court entered an order awarding Lazard total Monthly Advisory Fees of $5,455,645.00 and reimbursement of expenses of $167,915.12 for the period October 6, 2005 through May 31, 2007 on a final basis for a total of $5,623,560.12. [P-9 at 2; ECF Doc. No. 7749].[8]

3. The Hearing on Lazard's Request for a Completion Fee

On November 19, 2007, the Bankruptcy Court conducted a hearing to consider the requests for awards of completion fees from both Lazard and FTI. [P-10; ECF Doc. No. 7857].[9]
At the hearing, Lazard introduced as its sole witness, David S. Kurtz, the co-head of Lazard's restructuring group. [P-10, (Kurtz) at 13:2-20; ECF Doc. No. 7857]. Mr. Kurtz testified that, in general, Lazard is compensated on an "individual assignment basis." [P-10, (Kurtz) at 14:12-14; ECF Doc. No. 7857].

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[8] Based upon Lazard's total Monthly Advisory Fee award of $5,455,645.00 and the reported 6,227.2 hours of services rendered during the period October 6, 2005 through May 31, 2007, Lazard's average hourly rate for the services it rendered was $876.00 per hour. *In re Northwest Airlines,* 382 B.R. at 637. If Lazard's Completion Fee were added to its total Monthly Advisory Fee, its average hourly rate for the services rendered would be $1,398.00 per hour (($5,455,645 + $3,250,000 = $8,705,645) ÷ 6,227.2 hours = $1,398.00).

[9] The Bankruptcy Court had previously ruled on the non-success/completion fee portions of both FTI's and Lazard's Final Fee Applications. *See In re Northwest Airlines,* 382 B.R. at 634 and n. 1.

Lazard typically undertakes an engagement in the restructuring world (as opposed to non-restructuring assignments) on the basis of a fixed monthly fee with a completion fee at the end of the assignment. [P-10, (Kurtz) at 14:16-22; ECF Doc. No. 7857]. Mr. Kurtz testified that Lazard never seeks compensation on an hourly basis for any of its services. [P-10, (Kurtz) at 14:23-25; ECF Doc. No. 7857].

Mr. Kurtz chronicled the circumstances surrounding the retention of Lazard and FTI as financial advisors for the Committee. On October 6, 2005, Lazard and FTI negotiated an increase in the combined monthly compensation proposed by the Committee from $500,000 per month to $550,000 per month (providing Lazard with its monthly compensation of $275,000 per month). [P-10, (Kurtz) at 26:2-27:1; ECF Doc. No. 7857]. Lazard continued its discussions with the Committee regarding a completion fee after October 6, 2005, until Lazard finally accepted the Committee's reluctance to agree to a completion fee without knowing the outcome of the bankruptcy cases. [P-10, (Kurtz) at 28:2-29:25; ECF Doc. No. 7857].

After testifying regarding the circumstances surrounding Lazard's retention by the Committee, as well as the services rendered by Lazard in the bankruptcy case, Mr. Kurtz testified as to the circumstances surrounding Lazard's request for a completion fee. Mr. Kurtz testified that approximately fourteen months after the commencement of the bankruptcy case, he broached the subject of a completion fee with the chairman of the Committee during late November or early December 2006. [P-10, (Kurtz) at 30:12-31:3; ECF Doc. No. 7857] Lazard arrived at its request for a $4 million completion fee with the Committee by preparing a report [P-19; ECF Doc. No. 8154] analyzing the monthly compensation and success fees earned by financial advisors to creditors committees in other large complex cases of similar size and magnitude to the Debtors' cases. [P-10, (Kurtz) at 31:12-33:20; ECF Doc. No. 7857]. During this period in late November to early December 2006, the Committee, once again, declined to agree on a success fee at that time. [P-10, (Kurtz) at 34:3-5; ECF Doc. No. 7857].

After the Debtors' plan of reorganization was confirmed in May 2007, the Committee considered and accepted Lazard's proposal of a completion fee of $4 million. [P-10, (Kurtz) at 34:6-35:15; ECF Doc. No. 7857] Subsequent to the Committee's acceptance of Lazard's proposal of a $4 million completion fee, Lazard engaged in several negotiations with the Debtors over Lazard's request for a completion fee. Ultimately, Lazard and the Debtors agreed upon Lazard's request for a completion fee in the amount of $3,250,000. [P-10, (Kurtz) at 35:16-36-16; ECF Doc. No. 7857].

In addition to Mr. Kurtz's testimony, the record was supplemented both during the hearing and afterwards with documentary evidence, including deposition transcripts, and charts regarding various analysis of fees. Following the hearing, post-trial memoranda of law were submitted by various parties, including Lazard. [P-11; ECF Doc. No. 7913; P-12; ECF Doc. No. 7915; P-13; ECF Doc. No. 7919; P-14; ECF Doc. No. 7920].

4. The Bankruptcy Court's Decision

On February 29, 2008, the bankruptcy court denied Lazard's request for a completion fee. *See In re Northwest Airlines,* 382 B.R. at 652. In reaching this decision, the court determined that it had not pre-approved Lazard's fee enhancement request under 11 U.S.C. § 328(a). *In re Northwest Airlines,* 382 B.R. at 639. Furthermore, the bankruptcy court determined that Lazard's request for a success fee failed to meet the standards set forth in 11 U.S.C. § 330.

In reaching this determination, the bankruptcy court noted that the Lazard Retention Application provided that Lazard would be retained under sections 328(a) and 1103(a) and that there would not be a challenge to its Monthly Advisory Fees and requests for reimbursement of expenses, except under the standard of review under 328(a).[10] *In re Northwest Airlines,* 382 B.R. at 640. However, the court further noted that although the terms of the underlying letter engaging Lazard were incorporated into the Lazard

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[10] The Court observed that the United States Trustee retained the right to object to any fee application filed by Lazard on any grounds provided by the Bankruptcy Code, "including without limitation, the reasonableness standard provided for in Section 330." *See In re Northwest Airlines,* 382 B.R. at 636.

Retention Order, those terms provided only that Lazard was entitled to seek a "success" or "completion" fee at some later date. *Id.* The bankruptcy court explicitly rejected Lazard's argument that its compensation agreement was pre-approved by the Court and that payment of a completion fee, reviewable only under the standards of 328(a), was ever contemplated by the Lazard Retention Order. *Id.* Accordingly, the bankruptcy court considered Lazard's Completion Fee Request under the standards set forth in section 330(a)(3) of the Bankruptcy Code. *Id.* at 641.

In connection with this review, the bankruptcy court noted that Lazard had tried to evade the evidentiary standards outlined in section 330 by instead attempting to substitute a "market" theory approach. The court was not persuaded by this approach. *Id.* at 643-44. The bankruptcy court observed that Section 330(a)(3) provided specific criteria for the court to consider in reviewing a fee request, including factors such as the time spent on the services, the rates charged, and whether the services were appropriate to the nature of the issue or task addressed. *Id.* at 644-645. In order to apply these factors, the bankruptcy court stated that courts had adopted what has been identified as the "lodestar analysis." *Id.* at 645. Relying on the Supreme Court's decision in *Pennsylvania v. Delaware Valley Citizens' Council for Clean Air*, 478 U.S. 546, 566 (1986), Judge Morris found that the Supreme Court had found that the typical lodestar analysis implemented most, if not all, of the factors set forth in section 330(a)(3). *In re Northwest Airlines,* 382 B.R. at 645. The loadstar amount, Judge Morris found, reflected the novelty and complexity of the matter, the quality of the representation and the results achieved, and she concluded that enhancements to that lodestar amount were proper only in rare and exceptional cases supported by specific evidence and detailed findings. *Id.* at 645, *citing Blum v. Stenson,* 465 U.S. 886, 898-901 (1984).

In this case, in considering all the evidence presented under Section 330(a)(3), the bankruptcy court rejected Lazard's request for a success or completion fee. The court found it unclear whether she could find, with reasonable certainty, the success being claimed by both Lazard and FTI was solely attributable to either professional. *In re Northwest Airlines,* 382 B.R. at 651. It appeared to the bankruptcy court that Lazard performed the analysis and tasks appropriate for its engagement as financial advisors to the Committee. The bankruptcy court stated that the fact that the reorganization was successful was precisely the result contemplated by Congress when it enacted chapter 11 of the Bankruptcy Code. Therefore, the bankruptcy court found that Lazard's application for a success or completion fee did not meet the standards outlined under Section 330(a) of the Bankruptcy Code. *Id*.

In denying the Completion Fee Request, the bankruptcy court fully considered Lazard's argument that its Completion Fee Request should be granted because the payment of a completion fee to a financial advisor was the customary practice in large chapter 11 cases. The bankruptcy court reviewed each bankruptcy case and retention application relied on by both Lazard and FTI as support for their respective positions that a market based approach should be applied to the facts herein. The bankruptcy court concluded that the retention agreements in the cases relied upon by both Lazard and FTI were distinguishable from the agreement set forth in the Lazard Retention Application. In the cases relied upon, where a success, transactional or restructuring fee was awarded, the terms specifying when such fees would be awarded were specifically set forth in the respective retention agreements. In the instant case, the bankruptcy court noted that the Lazard Final Retention Order did not reference or incorporate by reference any objective guidelines to determine whether they were entitled to a success or completion fee, much less how much the fee should be. *Id.* at 648. The bankruptcy court found Lazard's market-driven approach unpersuasive absent compliance with the standards set forth in section 330(a). *Id.*

On February 29, 2008, the bankruptcy court entered an Order Denying Allowances of Completion Fee Requests of Lazard Frères & Co., LLC. [P-16; ECF Doc. No. 8105]. Lazard timely filed its Notice of Appeal on March 10, 2008. [P-17; ECF Doc. No. 8123].

SUMMARY OF ARGUMENT

The bankruptcy court did not abuse its discretion in denying Lazard's request for a success or completion fee of $3,250,000. The bankruptcy court properly determined that the appropriate standard of review for these additional fees was 11 U.S.C. § 330(a)(3). Under the standards set forth in section 330(a)(3), a court considering whether to award fees to a professional retained in the case is required to consider a number of factors including such factors as the time spent on the services, whether the services were reasonable and beneficial, the rates charged for the services, and whether the services were performed within a reasonable amount of time commensurate with the complexity of the task addressed. In reaching the determination that these factors under section 330(a)(3) must be considered, the Bankruptcy Court correctly rejected Lazard's argument that the sole factor to be considered was "a market" theory – that is, whether Lazard's fees were consistent with the fees charged in the marketplace.

The court also correctly held that Lazard did not adduce evidence of "truly exceptional results" required for lodestar enhancement. The bankruptcy court's decision was amply supported by the evidence of record and should be affirmed.

ARGUMENT

The Bankruptcy Court Did Not Abuse Its Discretion In Denying Lazard's Request For A Completion Or Success Fee.

A. The bankruptcy court properly reviewed Lazard's fee enhancement request for "reasonableness" under 11 U.S.C. § 330.

As the bankruptcy court properly concluded, the standard of review to be applied to the Completion Fee Request was section 330(a)(3) of the Bankruptcy Code. Lazard does not assert here, as it did below, that its Completion Fee Request was pre-approved as part of the Final Retention Order or that its Completion Fee Request should be considered under section 328(a) of the Bankruptcy Code. *See* Lazard's Brief ("Br.") at 11. Rather, Lazard instead argues that the court below erred in failing to rely on Section 330(a)(3)(E) to the exclusion of the other factors set forth in Section 330(a)(3). *See* Br. at 12. This argument fails.

1. Section 330(a)(3) is the Proper Standard of Review

Section 328(a) authorizes a committee to obtain prior court approval of a professional's compensation plan, such as through a contingent fee arrangement. Pre-approval eliminates any uncertainty as to the professional's compensation arising from the bankruptcy court's *post-facto* review under section 330(a)(1). *Daniels v. Barron (In re Barron)*, 325 F.3d 690, 692 -93 (5th Cir. 2003). Section 328(a) permits a bankruptcy court subsequently to award different compensation if "developments, which made the approved plan improvident, had been incapable of anticipation at the time the award was granted . . . ." *Id.* at 693.

The Committee and Lazard could have protected themselves by obtaining prior bankruptcy court approval of Lazard's completion fee under section 328(a). They chose not to do so, however. *Id.* As an initial matter, as Lazard and the Committee concede, the bankruptcy court properly reviewed Lazard's entitlement to fee enhancement under 11 U.S.C. § 330(a)(3).[11] *See In re Northwest Airlines,* 382 B.R. at 644.

2. Bankruptcy courts have substantial discretion in awarding fees under 11 U.S.C. § 330(a).

Section 330(a) grants a bankruptcy court broad discretion to pay committee professionals what the court determines to be a "reasonable" fee for "actual" services that are "necessary." 11 U.S.C. § 330(a). *Cahill*, 428 F.3d at 539; *In re Busy Beaver Building Centers, Inc.*, 19 F.3d 833, 840 (3rd Cir. 1994). In determining "reasonable" compensation, a bankruptcy court may consider a non-exclusive list of five "relevant factors" pertaining to the "nature, the extent and the value" of the services rendered, "including — (A) the time spent on such services; (B) the rates charged for such services; (C) whether the services were necessary to the administration of, or beneficial at the time at which the

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[11] Abandoning a position it adopted previously [P-6, ECF Doc. No. 7586], in its appellate brief Lazard concedes that "[t]he Bankruptcy Court concluded, and Lazard does not dispute, that the proper standard for determining the reasonableness of a professional's completion fee, not otherwise approved under section 328 of the Bankruptcy Code, is that provided for in section 330 of the Bankruptcy Code." Br. at 11. *Note omitted.*

services were rendered toward the completion of, a case under this title; (D) whether the services were performed within a reasonable amount of time . . . ; and (E) whether the compensation is reasonable based on the customary compensation charged by comparably skilled practitioners in cases other than cases under this title . . . ." 11 U.S.C. § 330(a)(3). *In re Teraforce Tech. Corp.*, 347 B.R. 838, 846 – 847 (Bankr. N.D. Tex. 2006).

Section 330(a)(2) expressly authorizes bankruptcy courts, in the exercise of their discretion, to "award compensation that is less than the amount requested . . . ." *Cahill*, 428 F.3d at 539. Moreover, section 330(a)(4) prohibits the bankruptcy court from awarding compensation for "unnecessary duplication of services . . . or . . . services that were not . . . reasonably likely to benefit the debtor's estate . . . or . . . necessary to the administration of the estate . . . ." Section 331 authorizes bankruptcy professionals to seek interim compensation on the same basis as under section 330(a). *See Teraforce Tech. Corp.,* 347 B.R. at 846-47.

Bankruptcy courts use the "lodestar" method, which was adopted from non-bankruptcy, fee-shifting cases, to calculate "reasonable" fees under section 330(a). *See Matter of First Colonial Corp. of Am.,* 544 F.2d 1291 (5th Cir.1977), *cert. denied*, 431 U.S. 904 (1977), *citing Johnson v. Georgia Highway Express, Inc.,* 488 F.2d 714 (5th Cir.1974) (interpreting the Civil Rights Act of 1964, 42 U.S.C. A. 2000e-5(k)). "A court computes the lodestar by multiplying the number of hours [a professional] would reasonably spend for the same type of work by the prevailing hourly rate in the community . . . A court then may adjust the lodestar up or down based on the factors contained in § 330 and its consideration of the twelve factors listed in *Johnson* . . . ."[12] *Cahill*, 428 F.3d at 539-40.

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[12] *Cahill* summarized the *Johnson* factors in a footnote as "(1) the time and labor required; (2) the novelty and difficulty of the questions; (3) the skill requisite to perform the legal service properly; (4) the preclusion of other employment by the attorney due to acceptance of the case; (5) the customary fee; (6) whether the fee is fixed or contingent; (7) time limitations imposed by the client or the circumstances; (8) the amount involved and the results obtained; (9) the experience, reputation and ability of the attorneys; (10) the "undesirability" of the case; (11) the nature and length of the professional relationship with the client; and (12) awards in similar cases . . . ." *Id., citing Johnson,* 488 F.2d at 719. "The lodestar analysis takes into account each of the factors specifically mentioned in § 330(a)(3) plus additional relevant [*Johnson*] factors . . . ." *Commercial*

Over the last fifteen years, the United States Supreme Court, in interpreting various fee-shifting statutes,[13] has limited a Federal court's ability to enhance attorneys' fees beyond the lodestar. The Court has held that the lodestar is *presumed* to be the reasonable fee,[14] and that "[a]n upward adjustment may be justified in the rare case where the applicant offers specific evidence to show that the quality of service rendered was superior to that one should reasonably expect in light of the hourly rates charged and that the success was exceptional . . . ." *Delaware I*, 478 U.S. at 565. Accordingly, enhancements to the "lodestar" amount are proper only in rare and exceptional cases supported by specific evidence and detailed findings. *In re Brous,* 370 B.R. 563, 569 (Bankr. S.D.N.Y. 2007) (*citing Connolly v. Harris Trust Co. Of Cal. (In re MiniScribe),* 309 F.3d 1234, 1243 (10th Cir. 2002)).

The applicant – here Lazard – bears the burden of proving both "the reasonableness and necessity of fees requested in the fee application . . . ." *Cont'l Ill. Nat'l Bank & Trust Co. of Chicago v. Charles N. Wooten, Ltd. (Matter of Evangeline Ref. Co.),* 890 F.2d 1312, 1326 (5th Cir.1989). "This burden is not to be taken lightly, especially given that every dollar expended on legal fees results in a dollar less that is available for distribution to the creditors or use by debtor." *In re Pettibone Corp.*, 74 B.R. 293, 299-300 (Bankr. N.D. Ill. 1987). The applicant bears the specific burden "of proving the prevailing 'community rate' . . . ." *In re El Paso Ref., Inc.*, 257 B.R. 809, 833 (Bankr. W.D. Tex. 2000).

Fin. Servs., Inc. v. Houlihan Lokey (In re Commercial Fin. Servs., Inc.), 427 F.3d 804, 811 (10th Cir. 2005).

[13] *Farrah v. Hobby*, 113 S.Ct. 566 (1992) (Civil Rights Attorneys Fees Award Act); *City of Burlington v. Dague*, 112 S.Ct. 2638 (1992) (Solid Waste Disposal Act and Clean Water Act); *Blanchard v. Bergeron*, 489 U.S. 87 (1989) (Civil Rights Attorneys Fees Award Act); *Pennsylvania v. Delaware Valley Citizens Council*, 483 U.S. 711 (1987) (*Delaware II*)(Clean Air Act); *Pennsylvania v. Delaware Valley Citizens' Council*, 478 U.S. 546 (1986) (*Delaware I*) (same); *Blum v. Stenson*, 465 U.S. 886 (1984) (Civil Rights Attorneys Fees Award Act); *Hensley v. Eckerhart*, 461 U.S. 424 (1983) (same).

[14] "[W]hen . . . the applicant for a fee has carried his burden of showing that the claimed rate and number of hours are reasonable, the resulting product is presumed to be the reasonable fee . . . ." *Blum,* 465 U.S. at 897

3. Lazard's Argument that Primacy Be Given to § 330(a)(3)(E) to the Exclusion of all Other Factors Must Be Rejected

Rather than considering all the nonexclusive factors of section 330(a)(3), Lazard misapplies section 330(a)(3) by giving primacy to subsection (E). By its statutory terms, subsection (E) is only one of a non-exhaustive set of five factors warranting judicial consideration in determining reasonable compensation in a particular case. *In re Commercial Fin. Servs., Inc.*, 427 F.3d at 811-12 (holding that "[b]ased on the statutory language alone, under 11 U.S.C. § 330(a)(3), a bankruptcy court is directed to consider at least five factors, among which four either explicitly or implicitly direct a bankruptcy court to examine the amount of time spent on a project . . . ."). Section 330 prescribes that courts may award only "reasonable compensation" and that courts "*shall consider* the nature, the extent, and the *value* of such services, taking into account *all relevant factors* . . . ." (Emphasis added) 11 U.S.C. § 330(a)(3). Lazard's interpretation would eliminate the bankruptcy court's discretion to determine reasonableness based upon the factors listed in subsection (a)(3), among others. *See Cahill*, 428 F.3d at 539.

The language of section 330 makes it clear that a court is expected to take into account all relevant factors. The word "factors" is in the plural. There is nothing in the statutory language that even suggests that one factor be given primacy to the exclusion of other factors. *See Lamie v. United States Trustee*, 540 U.S. 526, 534 (2004) (interpreting 11 U.S.C. § 330(a) and stating that "[i]t is well established that 'when the statute's language is plain, the sole function of the courts - at least where the disposition required by the text is not absurd - is to enforce it according to its terms. . .'") (internal citations omitted). At most, therefore, market or customary rates charged by similarly situated professionals is only one of several factors that a court considers in reviewing a request for fees under section 330(a)(3). Had Congress intended to restrict the bankruptcy court's analysis of comparability to one factor it could have done so. But clearly, it did not. *Cf. Miller Buckfire & Co., LLC v. Citation Corp. (In re Citation Corp.)*, 493 F.3d 1313, 1320 (11th Cir. Ala. 2007) ("Four of the five required statutory factors [of 11 U.S.C. § 330(a)(3)] either explicitly or implicitly direct a bankruptcy court to examine the amount of time spent on either the project as a whole or to examine the time spent on individual units of the professional's work."); *In re Collida*, 270 B.R. 209, 214 (Bankr. S.D. Tex. 2001) (finding that the court must consider all the factors set forth in section 330).

Having acknowledged the applicability of section 330 to the determination of the reasonableness of its Completion Fee Request, Lazard may not now selectively apply only one factor under section 330 in an effort to achieve the same result as if its entire request for compensation (including the Completion Fee) were pre-approved under section 328. By urging the Court to award it the same compensation that has been awarded to financial advisors in other comparable bankruptcy cases, Lazard ignores the circumstances under which it was retained. At the time of its retention, with the exception of two cases (out of eight bankruptcy cases) – those being the *Delta Airlines*[15] and *Calpine*[16] bankruptcy cases – the compensation of the financial advisors that Lazard currently relies upon to justify its Completion Fee had already been determined. *See* [P-19; ECF Doc. No. 8154]. Accordingly, Lazard was in a position to roughly calculate what success or completion fee it would likely seek and shelter it from challenge other than on an "improvident" basis pursuant to section 328. Alternatively, Lazard could have sought to guarantee a completion fee under section 328, without fixing the amount of the Completion Fee.[17]

However, as Lazard conceded at the hearing, the Committee had made it clear that it was not prepared to retain Lazard on any basis that guaranteed a completion fee to Lazard. [P-10, (Kurtz) 28:9-20; ECF Doc. No. 7857]. Therefore, as the bankruptcy court stated, Lazard, a sophisticated party who touted its experience in other chapter 11 actions, knew or should have known when it bargained as part of its

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[15] On September 14, 2005, Delta Airlines filed a chapter 11 case in the United States Bankruptcy Court for the Southern District of New York under the case number 05-17923.

[16] On December 20, 2005, Calpine Corporation filed a chapter 11 case in the United States Bankruptcy Court for the Southern District of New York under the case number 05-60200.

[17] While it is not clear whether Lazard's Completion Fee could have properly availed itself of the pre-approved standard under section 328 if Lazard's Retention Application did not specify the amount of the Completion Fee or some basis for determining the amount of such Completion Fee, in the current case Lazard knowingly did not provide for a Completion Fee under section 328.

retention for the right to make a request for a success or completion fee, that the "right to deny" a request is the companion to the "right to make" the same request. *In re Northwest Airlines,* 382 B.R. at 652.

Lazard's admitted goal, to achieve the same result whether a financial advisor's compensation is pre-approved under section 328 or entirely subject to section 330,[18] opens the door to circumstances that run counter to the intended purpose of ensuring the reasonableness of compensation authorized pursuant to section 330. Lazard's application of the market-driven approach invites potential abuses that would remain resistant to Court oversight. As applied in the instant case, a market-driven approach that almost exclusively focuses on fees earned in other allegedly comparable cases, decouples the professional's responsibility from the very case for which the professional has been retained. Under Lazard's approach, the very same arguments for a completion fee could, and presumably would, be advanced even if the results in a particular case were unexpectedly unsuccessful, and the bankruptcy court would be powerless to exercise its discretion to ensure the reasonableness of the compensation awarded to financial advisors.

As the bankruptcy court explicitly found, in every case cited by Lazard to support its request for its Completion Fee, the financial advisor or investment banker had managed to include specific terms establishing an entitlement to a completion fee in their respective retention orders. *Id. at 646-51*.[19]

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[18] *See* Br. at 18 ("the market for such [completion] fees is the same regardless of whether they are pre-approved under section 328 or subject to a reasonableness review under section 330.")

[19] Judge Morris analyzed each case and each retention application advanced by FTI and Lazard in support of their market-driven approach to justifying their requests for a success or completion fee, and Judge Morris distinguished each retention application for the respective financial advisors from the retention applications for FTI and Lazard in the instant case. In *In re Mirant Corp.*354 B.R. 113 (Bankr. N.D. Tex. 2006) and *In re NorthWestern Corp.* 344 B.R. 40 (D. Del. 2006) Judge Morris noted that all of the financial advisors in those cases had been retained pursuant to section 328 with the terms of their monthly compensation as well as the terms of their "success fees" or "restructuring fee" fully disclosed in their respective retention applications. Similarly, the retention applications for each financial advisor referred to by either FTI or Lazard as professionals retained pursuant to section 328 in *In re Adept Bus. Solutions, Inc.* No. 02-11289 (Bankr. S.D.N.Y,), *In re Delta Airlines*, No. 05-17923 (Bankr. S.D.N.Y.), *In re UAL Corp.* No. 01-48191 (Bankr. N.D. Ill.), as well as the instant case (*In re Northwest Airlines Corp.*), all contained full disclosures of the terms under which the financial advisor was entitled to a success, completion, transaction, or restructuring fee and the manner in which the fee would be calculated. The only exception was the financial advisor in *Howard & Zukin Capital v. High River Ltd. P'ship*, 369 B.R. 111 (S.D.N.Y. 2007), wherein, although the entitlement to the transaction fee was guaranteed, the

In contrast, as even Lazard conceded at the hearing before the bankruptcy court, [P-10, (Kurtz) 58: 23-25 and 59: 1-3; ECF Doc. No. 7857], the Retention Application specifically contemplated the possibility that Lazard might not be entitled to any completion fee at all. Yet, Lazard continues to ignore the fact that its request can be denied and has proceeded solely as if the only question is whether the fees it is seeking are comparable to the fees customarily charged by financial advisors in other cases. Clearly, Section 330(a)(3) contemplates that all factors will be considered by the court, not just one. *Cf. In reWilliams*, 384 B.R. 191, 194-95 (Bankr. N.D. Ohio, 2007) (in a review of fees under 330(a)(4)(B) which incorporates section 330, court noted that by statute it must consider the factors under 330(a)(3) and listed those factors); *Harris v. Dublin (In re U-Can Rent, Inc.)*, 262 B.R. 147, 151 (Bankr. M.D. Ga. 2001) ("Section 330(a)(3) lists five nonexclusive factors the court must consider in determining the amount of compensation that may be awarded to a trustee.")

4. The Bankruptcy Court Properly Distinguished Lazard's Reliance upon *Howard* in Support of Lazard's Request for a Completion Fee.

The bankruptcy court properly concluded that Lazard's reliance upon *Howard, see Howard,* 369 B.R. at 114-15 (citing to *In re Ames Dept. Stores, Inc.*, 76 F.3.d 66, 71 (2d Cir. 1996)), was misplaced as the facts in *Howard* were distinguishable from those of the instant case. In *Howard,* the Bankruptcy Court awarded a financial advisor approximately $4 million in fees related to financial restructuring services rendered to XO Communications ("XO"). The financial advisor appealed claiming that the bankruptcy court's calculation of its fees based solely on secured debt was an error. Unlike in the instant case, in *Howard*, the financial advisor's retention order, referencing the terms of an engagement letter, provided from the very beginning of the case that there would be a transaction fee awarded to the financial advisor if a plan of reorganization was confirmed.

Specifically, the day after filing its Chapter 11 petition, XO filed a proposed plan of reorganization that addressed two different outcomes. Under Plan A, which involved the influx of

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calculation of the amount of the transaction fee was deferred until later in the case and governed by section 330 (rather than section 328).

new capital from certain investors, the retention order (which incorporated the terms of a modified engagement letter entered into between XO and the financial advisor) provided that the financial advisor would receive a transaction fee of $20 million. Under Plan B, which involved the implementation of a stand-alone restructuring without raising any additional capital, the retention order provided that the reasonableness of the transaction fee for the financial advisor would be considered at a subsequent hearing. *Howard*, 369 B.R. at 113. Therefore, as the bankruptcy court herein correctly found, *see In re Northwest Airlines,* 382 B.R. at 648, in *Howard*, unlike this case, the retention order clearly contemplated that there would be a transaction fee awarded to the financial advisor. The only issue would be the amount of the fee if Plan B was confirmed.

Moreover, while it is true that in *Howard* the Court found that both the parties and the Court agreed that the Second Circuit had established a "market-driven" approach to fees awarded to professionals, *Howard*, 369 B.R. at 114-15, the Court also made it clear that market factors were only one of the factors to be considered by a court reviewing a request for fees. Not only did the Court set forth all the factors to be considered when reviewing a request for fees under Section 330(a)(3), see *Howard*, 369 B.R. at 115, n.3, but it specifically rejected the financial advisor's argument that the Bankruptcy Court erred by (i) looking at the unsuccessful outcome of the restructuring, taking creditor recoveries into account, and by (ii) considering whether the services were reasonable and beneficial when rendered. *Id*. at 119-20. The Court specifically found that the Bankruptcy Court had not abused its discretion when considering all this information – all factors to be considered under Section 330(a)(3). *Id*. at 120.

While Lazard would no doubt admit that the market-driven approach in *Ames*, as applied to attorneys billing by the hour, is not inconsistent with the lodestar approach, Lazard rejects the lodestar approach for those financial advisors who do not typically bill on an hourly basis. As noted above, that conclusion is inconsistent with the Tenth and Eleventh Circuits that hold that where the compensation of financial advisors is reviewable under section 330 (as opposed to section 328), the lodestar or adjusted lodestar approach is applicable. *See Miller Buckfire & Co., LLC v. Citation Corp.*, 493 F.3d 1313, 1318 (11th Cir. 2007); *Houlihan Lokey Howard & Zukin Cap. v. Unsecured Liquidating Trust*, 427 F.3d 804, 811 (10th Cir. 2005). In the Second Circuit, *Howard* is not inconsistent with the adjusted lodestar approach, which considers various fee rates, the comparison of compensation of comparable professionals, and the results obtained in determining reasonableness under section 330.

Lazard ignores the most obvious and perhaps the most significant difference between its compensation arrangement and those it cites in *Howard* and other supposedly comparable bankruptcy cases. In each example cited by Lazard, the financial advisor's entitlement to a completion fee was essentially "guaranteed" (*i.e.,* where the terms of the professional's entitlement to the fee were fully disclosed, and where, with the exception of the *Howard* case, the basis for calculating the fee was also fully disclosed at the time of retention). In the instant case, however, where Lazard's entitlement to a completion fee was not guaranteed at the time of Lazard's retention by the Committee. *See In re Northwest Airlines,* 382 B.R. at 646-51. The lack of a guaranteed completion fee would seem to mandate the application of the lodestar or adjusted lodestar approach. In the instant case, just as in *Howard*, where the examples of cases displaying the compensation arrangements of various financial advisors are determined to be not relevant to the case at hand, the bankruptcy court may properly ignore such examples. *See Howard*, 369 B.R. at 117 ("Without evidence that the cited restructuring cases possess these similarities to the instant case, the Bankruptcy Court was well within its discretion in declining to rely on them . . . .").

5. **Lazard failed to adduce evidence of "truly exceptional results," meriting an upward adjustment of the lodestar.**

Here, after considering all the evidence presented, the bankruptcy court, having previously concluded that Lazard's failure to provide terms for the determination of the Completion Fee mandated the application of the lodestar (or adjusted lodestar) approach, correctly denied the request for a success or completion fee under Section 330. *In re Northwest Airlines,* 382 B.R. 643-45. This decision was amply supported by the evidence of record.

Beginning with the presumption that the lodestar constitutes reasonable compensation, the fee applicant bears the burden of proving that an upward adjustment is necessary in a particular case. *See Blum,* 465 U.S. at 697-98. To be entitled to an upward adjustment from the lodestar, the fee applicant is required to provide specific evidence of superior service and exceptional success. *See Delaware I*, 478 U.S. at 565; *Blum,* 465 U.S. 899; *Brous*, 370 B.R. at 569.

Lazard's market-driven approach to its Completion Fee Request makes no attempt to prove either superior service or exceptional success. Lazard's reliance upon the compensation earned by other financial advisors in what it regarded as comparable cases to justify its Completion Fee Request does not take into consideration the existence of superior service or exceptional success. In fact, even if the instant case were acknowledged to be an abject failure by all parties, Lazard's application of its market-driven approach would justify a Completion Fee Request.

There was nothing superior about the services Lazard rendered. In particular, as the bankruptcy court found, Lazard performed the type of analysis and tasks appropriate for an engagement of the kind for which it was retained. *See In re Northwest Airlines,* 382 B.R. at 651. In fact, even Lazard conceded at the hearing that it had not performed any extraordinary services for the estate. [P-10, (Kurtz) at 58: 23-25 and 59: 1-3; ECF Doc. No. 7857]. While a plan of reorganization was confirmed in this case, as the bankruptcy court appropriately observed, a successful reorganization of the Debtors was precisely the result contemplated by Congress when it enacted chapter 11 of the Bankruptcy Code, and this fact would not justify an award of a success or completion fee. Moreover, the bankruptcy court's observation, regarding the apprehension that it felt if it were to award large bonuses or completion fees to multiple professionals claiming responsibility for the same successes, was justified. Indeed, as stated above, care must be taken by the court before awarding any fees to professionals, "given that every dollar expended on legal fees results in a dollar less that is available for distribution to the creditors or use by debtor." *In re Pettibone Corp.*, 74 B.R. 293, 299 - 300 (Bankr. N.D. Ill. 1987).

The bankruptcy court's caution is amply supported by *In re Molten Metal Technology, Inc.*, 345 B.R. 26 (Bankr. D.Mass. 2006). In *Molten Metal,* the bankruptcy court acknowledged that the fee applicant performed at a high level of skill. The bankruptcy court also acknowledged the exceptional results achieved in the cases, which began as an administratively insolvent case with a $20 million deficit, but ultimately resulted in a 5% distribution to unsecured creditors. Nevertheless, the bankruptcy court did not find the "rare and limited circumstances in which an upward adjustment is warranted" where the responsibility for the exceptional outcome was attributable to "the team and not just one player." *Molten Metal*, 345 B.R. at 29. In the instant case where no exceptional results have been alleged, and where Lazard cannot claim to be solely responsible for the "success" of the case, no fee enhancement is appropriate.

In sum, Lazard's interpretation and application of the market-driven approach to financial advisors' compensation is inconsistent with the statutory language and intent of the applicable statutes and, therefore, should not be adopted. Accepting Lazard's approach would mean that a financial advisor may seek to be retained by proposing a monthly compensation arrangement as the sole source of its compensation even while possessing all of the information necessary to calculate the completion fee it intends to seek at some point later in the case. There would appear to be nothing to stop such a financial advisor from requesting a completion fee only after the firm has successfully insinuated itself into the case, making it uneconomic for it to be replaced. If Lazard's approach is adopted, a financial advisor will suffer no detriment by hiding the amount of its intended completion fee because the same analysis on which the fee request will be based later in the case is the same analysis that would have been employed if the firm had proposed its completion at the time of its retention. Such a lack of transparency cannot be conducive to the efficient administration of a bankruptcy case and may quite likely result in a greater cost to the creditors of the estate. Accordingly, the Court should reject a market based approach as the sole factor in considering a request for fees by a professional in a bankruptcy proceeding.

CONCLUSION

Based on the foregoing, the United States Trustee respectfully requests that the Court affirm the Bankruptcy Court's Decision and grant such other and further relief as may be just and proper.

Dated: New York, NY
July 16, 2008

Respectfully submitted,

DIANA G. ADAMS
UNITED STATES TRUSTEE

By: /s/ Brian S. Masumoto
Brian S. Masumoto
Trial Attorney

Linda A. Riffkin
Assistant United States Trustee
Office of the United States Trustee
33 Whitehall Street, 21st Floor
New York, NY 10004
(212) 510-0500

STATUTORY ADDENDUM

11 U.S.C. § 328(a). Limitation on Compensation of Professional Persons

(a) The trustee, or a committee appointed under section 1102 of this title, with the court's approval, may employ or authorize the employment of a professional person under section 327 0r 1103 of this title, as the case may be, on any reasonable terms and conditions of employment, including on a retainer, on an hourly basis, or on a contingent fee basis. Notwithstanding such terms and conditions, the court may allow compensation different from the compensation provided under such terms and conditions after the conclusion of such employment, if such terms and conditions prove to have been improvident in light of developments not capable of being anticipated at the time of the fixing of such terms and conditions.

11 U.S.C. § 330(a). Compensation of officers

(a)(1) After notice to the parties in interest and the United States Trustee and a hearing, and subject to sections 326, 328, and 329, the court may award to a trustee, an examiner, a professional person employed under section 327 or 1103--

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

(B) reimbursement for actual, necessary expenses.

(2) The court may, on its own motion or on the motion of the United States Trustee, the United States Trustee for the District or Region, the trustee for the estate, or any other party in interest, award compensation that is less than the amount of compensation that is requested.

(3) In determining the amount of reasonable compensation to be awarded, the court shall consider the nature, the extent, and the value of such services, taking into account all relevant factors, including--

(A) the time spent on such services;

(B) the rates charged for such services;

(C) whether the services were necessary to the administration of, or beneficial at the time at which the service was rendered toward the completion of, a case under this title;

(D) whether the services were performed within a reasonable amount of time commensurate with the complexity, importance, and nature of the problem, issue, or task addressed; and

(E) whether the compensation is reasonable based on the customary compensation charged by comparably skilled practitioners in cases other than cases under this title.

(4)(A) Except as provided in subparagraph (B), the court shall not allow compensation for--

(I) unnecessary duplication of services; or

(ii) services that were not--

(I) reasonably likely to benefit the debtor's estate; or
(II) necessary to the administration of the case.

(B) In a chapter 12 or chapter 13 case in which the debtor is an individual, the court may allow reasonable compensation to the debtor's attorney for representing the interests of the debtor in connection with the bankruptcy case based on a consideration of the benefit and necessity of such services to the debtor and the other factors set forth in this section.

(5) The court shall reduce the amount of compensation awarded under this section by the amount of any interim compensation awarded under section 331, and, if the amount of such interim compensation exceeds the amount of compensation awarded under this section, may order the return of the excess to the estate.

(6) Any compensation awarded for the preparation of a fee application shall be based on the level and skill reasonably required to prepare the application.

11 U.S.C. § 503. Allowance of administrative expenses

(a) An entity may timely file a request for payment of an administrative expense, or may tardily file such request if permitted by the court for cause.

(b) After notice and a hearing, there shall be allowed administrative expenses, other than claims allowed under section 502(f) of this title, including--

* * *

(2) compensation and reimbursement awarded under section 330(a) of this title;

11 U.S.C. § 507(a). Priorities

(a) The following expenses and claims have priority in the following order:

(1) First, administrative expenses allowed under section 503(b) of this title, and any fees and charges assessed against the estate under chapter 123 of title 28.

1102. Creditors’ and equity security holders' committees

(a)(1) Except as provided in paragraph (3), as soon as practicable after the order for relief under chapter 11 of this title, the United States trustee shall appoint a committee of creditors holding unsecured claims and may appoint additional committees of creditors or of equity security holders as the United States trustee deems appropriate.

Section 1103. Powers and duties of committees

(a) At a scheduled meeting of a committee appointed under section 1102 of this title, at which a majority of the members of such committee are present, and with the court's approval, such committee may select and authorize the employment by such committee of one or more attorneys, accountants, or other agents, to represent or perform services for such committee.

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

In re	:	Chapter 11
NORTHWEST AIRLINES CORPORATION, <u>et</u> <u>al.</u>,	:	Case No. 05-17930 (ALG)
	:	(Jointly Administered)
Debtors.	:	
LAZARD FRÈRES & CO., LLC	:	District Court
Appellant,	:	Case No. 08-CV-03456 (NRB)
v.	:	
DIANA G. ADAMS, UNITED STATES TRUSTEE; CARVAL INVESTORS, LLC; AND ASSOCIATION OF FLIGHT ATTENDANTS – CWA, AFL-CIO,	:	
Appellees.		
OFFICIAL COMMITTEE OF UNSECURED CREDITORS OF NORTHWEST AIRLINES CORPORATION	:	District Court
	:	Case No. 08-CV-03500 (NRB)
Appellant,	:	
v.	:	
DIANA G. ADAMS, UNITED STATES TRUSTEE; CARVAL INVESTORS, LLC; AND ASSOCIATION OF FLIGHT ATTENDANTS – CWA, AFL-CIO,	:	
Appellees.	x	

AFFIRMATION OF SERVICE

I, Brian S. Masumoto, declare under penalty of perjury that:

1. I am a trial attorney with the Office of the United States Trustee for Region 2.

2. On July 16, 2008, I caused true and correct copies of the Brief of Appellee United States Trustee in the above-entitled bankruptcy appeal to be served by Federal Express upon each of the parties to the appeal listed below.

Dated: New York, NY
July 16, 2008

/s/ Brian S. Masumoto
Brian S. Masumoto (BM-8116)
Trial Attorney

Honorable Naomi Reice Buchwald
Daniel Patrick Moynihan
United States Courthouse
500 Pearl Street
Room 2270
New York, New York 10007

Philip G. Barber
Alan W. Kornberg
PAUL, WEISS, RIFKIND, WHARTON & GARRISON LLP
1285 Avenue of the Americas
New York, New York 10019-6064

Scott L. Hazan
John A. Bougiamas
OTTERBOURG, STEINDLER, HOUSTON & ROSEN, P.C.
230 Park Avenue
New York, New York 10169

Sean C. Southard
KLESTADT & WINTERS, LLP
292 Madison Avenue, 17th Floor
New York, New York 10017

Robert S. Clayman
GUERRIERI, EDMOND, CLAYMAN & BARTOS, P.C.
1625 Massachusetts Ave., N.W., Suite 700
Washington, D.C. 20036-2243

BRIEF BANK — "SUMMARY SHEET" *Printed Wed-6/18/08 9:14*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	In re Pamela Page Nowlin (Nowlin v. Peake)
2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	5th Cir.
3. ("CCN") ***CURRENT*** CASE NO.	No.: 08:20066
4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*	No.: 4:07-cv-2446 Court: D. Tex. *(Identify judge & cite, if any)*
5. ("SO") ***SOURCE***	**U.S. TRUSTEES**
6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	Filed: June 17, 2008 Type: Brief of United States Trustee as Appellee Supporting Affirmance -
7. **("AU")** ***PRINCIPAL AUTHORS & OFFICE*** [E.g.,"UST/OGC"]	William Kanter, Edward Himmelfarb, Matthew Sutko, *(UST/OGC: 202-307-1399/FAX-2397)*
8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	• Whether the debtor's historical "Disposable Income" is the starting point in determining "projected disposable income" under section 1325, but courts may take into account significant changes in the debtor's financial condition if necessary to reflect the debtor's ability to fund a plan.
10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)	
11. DO YOU RECOMMEND POSTING IN UST BRIEFBANK?	| x | YES | | NO — ***NAME:*** Linda Figueroa ***DATE:***

No. 08-20066

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

In re PAMELA PAGE NOWLIN,

Debtor.

PAMELA PAGE NOWLIN,

Debtor-Appellant,

v.

DAVID G. PEAKE,

Chapter 13 Trustee-Appellee.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF TEXAS

BRIEF FOR THE UNITED STATES
AS AMICUS CURIAE SUPPORTING AFFIRMANCE

OF COUNSEL:

ROBERTA A. DEANGELIS
Acting General Counsel

P. MATTHEW SUTKO
Associate General Counsel
Executive Office for United States Trustees
Department of Justice
20 Massachusetts Avenue, N.W.
Washington, D.C. 20530

GREGORY G. KATSAS
Acting Assistant Attorney General

WILLIAM KANTER
(202) 514-4575
EDWARD HIMMELFARB
(202) 514-3547
Attorneys, Appellate Staff
Civil Division, Room 7646
Department of Justice
950 Pennsylvania Avenue, N.W.
Washington, D.C. 20530

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Chapter 13 Trustee-Appellee.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF TEXAS

BRIEF FOR THE UNITED STATES
AS AMICUS CURIAE SUPPORTING AFFIRMANCE

Pursuant to Rule 29 of the Federal Rules of Appellate Procedure, the United States submits this brief as amicus curiae supporting affirmance of the district court's order.

STATEMENT OF THE ISSUE

Whether the starting point in computing a debtor's "projected disposable income" is the debtor's "disposable income," as defined in section 1325(b)(2), multiplied by the number of months in the chapter 13 plan, with the amount subject to adjustment if it fails to predict a debtor's actual ability to fund a plan.

INTEREST OF THE UNITED STATES

The Attorney General appoints United States Trustees to supervise the administration of bankruptcy cases and trustees in regions comprising the vast majority of the federal judicial districts. 28 U.S.C. 581-589a. United States Trustees "serve as bankruptcy watch-dogs to prevent fraud, dishonesty, and overreaching in the bankruptcy arena." H.R. Rep. No. 595, 95th Cong., 1st Sess. 88, reprinted in 1978 U.S.C.C.A.N. 5963, 6049. The United States Trustee Program thus acts in the public interest to promote the efficiency, and to protect and preserve the integrity, of the bankruptcy system. To this end, Congress has provided that "[t]he United States trustee may raise and may appear and be heard on any issue in any case or proceeding." 11 U.S.C. 307. See In re Donovan Corp., 215 F.3d 929, 930 (9th Cir. 2000).

This case involves a dispute over the interpretation of "projected disposable income," 11 U.S.C. 1325(b)(1)(B), as it affects the confirmation of a plan under chapter 13 of the Bankruptcy Code. The United States Trustee is authorized, among other things, to "supervise the administration of cases and trustees" in chapter 13 cases, monitor chapter 13 plans, and file comments with the court regarding such chapter 13 plans in connection with a plan confirmation hearing under section of the Code. 28 U.S.C. 586(a)(3)(C).

In 2007, more than 310,000 persons filed bankruptcy petitions under chapter 13.[1] In chapter 13 cases, with so-called above-median debtors,[2] the question of statutory interpretation presented in this case has occurred frequently and is continuing to occur. In fact, there are already scores of bankruptcy court decisions that have faced this statutory issue.

This is only the third case in which the meaning of "projected disposable income" has been presented to a court of appeals.[3] We have filed an amicus brief in both previous cases, In re Kagenveama, ___ F.3d ___, 2008 WL 2278681 (9th Cir. June 5, 2008), and In re Lanning, No. 08-3009 (10th Cir.). The Lanning case is awaiting decision.

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[1] See http://www.uscourts.gov/bnkrpctystats/sept2007/f2table.xls (Excel spreadsheet).

[2] An above-median debtor is the name often used in referring to a debtor whose current monthly income under 11 U.S.C. 101(10A), multiplied by 12, is above the annual median income in the state of a family of comparable size. See 11 U.S.C. 1325(b)(3).

[3] Three bankruptcy appellate panels have decided the proper interpretation of the term, and all have adopted the interpretation presented by the United States in this brief. In re Pak, 378 B.R. 257 (B.A.P. 9th Cir. 2007); In re Kibbe, 361 B.R. 302 (B.A.P. 1st Cir. 2007); and In re Lanning, 380 B.R. 17 (B.A.P. 10th Cir. 2007), appeal pending, No. 08-3009 (10th Cir.).

In this brief, the United States respectfully offers this Court its views on the correct interpretation of section 1325(b). See 28 U.S.C. 517 (authorizing Department of Justice "to attend to the interests of the United States in a suit pending in a court of the United States").

STATEMENT OF FACTS

A. Statutory Background.

In 2005, Congress passed and the President signed into law the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23 (BAPCPA).

One of the innovations of the BAPCPA was means-testing. In section 707 of the Bankruptcy Code, which addresses dismissal of abusive chapter 7 petitions, Congress established special rules for debtors whose current monthly income, reduced by certain permitted expenses, exceeded a threshold for abuse under a specified formula. 11 U.S.C. 707(b)(2). This amendment changed the way these expenses were computed; some were no longer the debtor's actual expenses but instead were standard expenses under the National Standards and Local Standards issued by the Internal Revenue Service for the debtor's area of residence. 11 U.S.C. 707(b)(2)(A)(ii).

Congress also applied means-testing to chapter 13 cases, in which the debtor seeks not to liquidate his debts, as in chapter 7, but rather to establish a plan for repaying all or part of those debts. Before the BAPCPA amendments were enacted, section 1325, governing confirmation of a chapter 13 plan, required such a plan to provide that all of the debtor's "projected disposable income" during the plan period would be used to repay debts. Disposable income was calculated from the debtor's actual income and expenses set forth on Schedules I and J, which the debtor was required to file.

But the BAPCPA amended section 1325 to change the definition of "disposable income." The new section 1325(b)(2) defines "disposable income" to mean "current monthly income received by the debtor * * * less amounts reasonably necessary to be expended" for maintenance or support or necessary business expenses. 11 U.S.C. 1325(b)(2).[4] This definition incorporates two changes: first, it defines "disposable income" based on an average of past monthly income figures; and second, for debtors with higher income levels, it requires the use of the same standard expenses mandated for certain debtors under section 707(b)(2). Specifically, section 1325(b)(3) now directs that reasonable expenses be determined "in accordance with subparagraphs (A) and (B) of section 707(b)(2)" for those chapter 13 debtors whose current monthly income, multiplied by 12, is greater than the median family income for a family of the corresponding size. 11 U.S.C. 1325(b)(3). Chapter 13 debtors in this class are

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[4] "Current monthly income" means the "average monthly income from all sources" that the debtor received during the six-month period ending the last calendar month before the debtor filed his bankruptcy petition. 11 U.S.C. 101(10A).

typically referred to as "above-median" debtors. To be clear, an above-median debtor is not one whose income places him in the top half of all debtors; it is one whose income places him in the top half of families of his size in his state of residence.

Under current bankruptcy rules, such a debtor must file Official Form 22C,[5] which sets forth the debtor's income and expenses in accordance with standard numbers issued by the IRS. Because a debtor must also file the traditional Schedules I and J setting forth actual income and expenses, it often becomes apparent that there is a significant difference between the above-median debtor's disposable income under Schedules I and J and his disposable income under Form 22C. In some cases, the use of Form 22C captures a temporary increase in the debtor's disposable income that does not continue into the plan period, while in other cases the use of Form 22C results in a lower amount of disposable income. In these and other cases, it may become clear that the historical circumstances that produced a particular income figure will change prospectively.

For the convenience of the Court, we have attached in an addendum to this brief the pre-BAPCPA text of section 1325, the current text of section 1325, and a redlined version showing the changes to section 1325 made by the BAPCPA.

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[5] The form was previously known as "B22C." We will use the current form name "22C" throughout.

B. Facts.

1. The debtor, Pamela Page Nowlin, a single woman with no children, filed for bankruptcy under chapter 13 on September 14, 2006. RE 1-39. Along with her petition, the debtor filed a Schedule I (Current Income), Schedule J (Current Expenditures), and Form 22C. Schedule I showed current monthly wages of $7,145.86. RE 21. After payroll deductions that included a monthly 401(k) contributions totaling $1,062.51 and monthly 401(k) loan repayments totaling $1,134.79, Schedule I reported net monthly income of $3,035.64. RE 21. After $2,840.00 in household expenses, Schedule J showed a monthly surplus of $195.64. RE 22.

The debtor's Form 22C indicated a current monthly income of $7,420.53, or $89,046.36 annually. ER 50-51. Because her current monthly income exceeded the median family income for a single-person household in Texas, the debtor qualified as an "above-median" debtor for purposes of 11 U.S.C. 1325. While the debtor's Form 22C disclosed monthly disposable income of $28.67, ER 54, the debtor later stipulated at a hearing that the correct amount was $38.67. RE 96.

The debtor filed a chapter 13 plan with her petition that called for 60 payments of $195.00 per month. RE 40, 96. This figure appears to have been based on the monthly surplus resulting from subtracting Schedule J monthly expenses from Schedule I net monthly income. RE 96. Over the 60-month life of this plan, unsecured creditors would receive only $980.45, or about 3% of the amount they are owed. RE 135 ¶ 5.

At the hearing to consider confirmation, the debtor testified that the $1,134.79 monthly 401(k) loan payments would end within the first two years of her proposed five-year repayment plan. RE 136 ¶ 6. David Peake, the Chapter 13 Trustee, objected to confirmation, arguing that once the 401(k) loan is paid off, the debtor will have an additional $1,134.79 per month in disposable income that should be made available to make increased payments to unsecured creditors under the plan. RE 113. The debtor countered that the post-petition change in expenses caused by the cessation of 401(k) loan payments should not be considered part of her "projected disposable income" pursuant to 11 U.S.C. 1325(b)(1)(B). RE 103.

2. The bankruptcy court denied confirmation of the debtor's plan, holding that the term "projected disposable income" under 11 U.S.C. 1325(b)(1)(B) must include the income dedicated to the 401(k) loan repayment that will become available once the debtor has finished paying off the loan. RE 141-42. The bankruptcy court's decision resulted in an increase in the debtor's disposable income by $947.30 during months 25 through 60 of the plan, which would in turn significantly increase the required payments to unsecured creditors. RE 142.

The bankruptcy court expressly rejected an interpretation of "projected disposable income" that would simply "multiply [the debtor's] disposable income as of the petition date by the length of the Plan," without accounting for significant future changes in financial status that the debtor knew at the time of petition would take place before the plan had ended. RE 138. The bankruptcy court held, instead, that "projected disposable income" must "account for events which will definitely occur during the term of the Plan that would alter either the income or expense side of the disposable income calculation." RE 138-39.

The district court affirmed. "When an allowed deduction for [the debtor's] current consumption no longer exists," the court stated, "the amount that had been applied to that expense shifts to pay the people she owes." In re Nowlin, 2007 WL 4623043, at *1 (S.D. Tex. Dec. 28, 2007). The district court held that "[d]ebtors must use projected disposable income that includes expected changes to the allowed expenses during the term of the plan." Id.

SUMMARY OF ARGUMENT

The BAPCPA amendments to section 1325 have created important interpretive questions about the proper way to understand "projected disposable income." As the case law reflects, there are different ways that courts have interpreted and applied that statutory language in light of the amendments. The interpretation offered here by the debtor should be rejected, because it fails to take into account all the language in the statute.

The debtor interprets the term "projected disposable income" to require use of the historical "disposable income" figure throughout the chapter 13 plan period, regardless of the debtor's actual income and expenses during that period. In this case, the debtor's historical "disposable income" was artificially low, because her expenses included repayment of a loan that would be paid off completely less than half way into the five-year chapter 13 plan. The debtor's interpretation does not account for the usual meaning of "projected" income or for the statutory phrases "to be received" and "will be applied to make payments" in section 1325(b)(1)(B). Mechanically extending into the future an historical monthly income calculation, which may bear no relationship to actual income that the debtor will receive in the future, would either attribute to the debtor future income that does not exist, as in the case of a debtor with a short-term pre-petition increase in income, or, when the debtor has a financial change for the better after filing the petition, as in this case, permit the debtor to avoid using income that does exist to repay creditors.

Like the bankruptcy court and the district court below, the bankruptcy appellate panels of the First, Ninth, and Tenth circuits have rejected the construction of "projected disposable income" that the debtor advances here. Although the Ninth Circuit's recent decision in In re Kagenveama adopts the interpretation urged here by the debtor, that decision fails to take into account some of the language of the statute and should not be followed.

As the lower court decisions here and the bankruptcy appellate panel decisions show, the proper meaning of "disposable income" requires the historical income figure to be projected as an initial matter, subject to adjustment to account for any significant increases or decreases in the debtor's income that are likely in particular cases. Such adjustments may be necessary in individual cases to ensure that the income attributed to a debtor in his chapter 13 plan is actually income that is "projected" and "to be received" and that "will be applied to make payments" to unsecured creditors. While a simple multiplication of the initial disposable income number by the relevant number of months is a presumptive starting point, the proper interpretation allows adjustments to be made in appropriate cases. This interpretation is also consistent with the overall goals of chapter 13.

ARGUMENT

THE DEBTOR'S HISTORICAL "DISPOSABLE INCOME" IS THE STARTING POINT IN DETERMINING "PROJECTED DISPOSABLE INCOME" UNDER SECTION 1325, BUT COURTS MAY TAKE INTO ACCOUNT SIGNIFICANT CHANGES IN THE DEBTOR'S FINANCIAL CONDITION IF NECESSARY TO REFLECT THE DEBTOR'S ABILITY TO FUND A PLAN.

Congress's amendments to section 1325 three years ago have caused serious interpretive problems. Courts have taken three different approaches to analyzing what "projected disposable income" means in confirming a chapter 13 plan. We will discuss each of the three approaches and explain why the debtor's approach here is mistaken and why our interpretation is most consistent with the statutory language and the policies of the Bankruptcy Code. In doing so, we will explain the error in the

Ninth Circuit's decision in In re Kagenveama, ___ F.3d ___, 2008 WL 2278681 (9th Cir. June 5, 2008), which entirely ignores critical language of section 1325.

A. The Courts Have Offered Three Different Interpretations Of Section 1325.

1. The BAPCPA amendments in 2005 to section 1325 created a significant change in the law. Before these amendments were enacted, section 1325(b)(1) provided that if the trustee or the holder of an allowed unsecured claim objected to the confirmation of a chapter 13 plan, the court was not permitted to approve the plan unless it provided that "all of the debtor's projected disposable income to be received in the three-year period beginning on the date that the first payment is due under the plan will be applied to make payments under the plan." 11 U.S.C. 1325(b)(1)(B) (2000 ed.). The term "disposable income" was defined as income received by the debtor that was "not reasonably necessary to be expended" for "maintenance or support of the debtor or a dependent" or for necessary business expenses if the debtor was engaged in a business. 11 U.S.C. 1325(b)(2)(A) (2000 ed.). Under that former law, a debtor's projected disposable income was calculated simply by subtracting the debtor's expenses on Schedule J from the debtor's income on Schedule I, two forms that a chapter 13 debtor was required to file.

In contrast, under the BAPCPA amendments, section 1325(b)(1) now provides that:

> (b)(1) If the trustee or the holder of an allowed unsecured claim objects to the confirmation of the plan, then the court may not approve the plan unless, as of the effective date of the plan – * * * (B) the plan provides that all of the debtor's projected disposable income to be received in the applicable commitment period beginning on the date that the first payment is due under the plan will be applied to make payments to unsecured creditors under the plan.

11 U.S.C. 1325(b)(1). And now, "disposable income" is defined expressly to mean "current monthly income received by the debtor * * * less amounts reasonably necessary to be expended" for maintenance or support or necessary business expenses. 11 U.S.C. 1325(b)(2). "Current monthly income" is defined as the "average monthly income from all sources" that the debtor received during the six-month period ending the last calendar month before the debtor filed the chapter 13 petition. 11 U.S.C. 101(10A). It is, in other words, an historical figure representing the monthly average of the period shortly before the petition was filed. An above-median debtor – one whose current monthly income, multiplied by 12, is above the annual median income in the state of a family of comparable size – calculates these figures on Form 22C.

2. The minority position taken in a number of bankruptcy court decisions is that section 1325 requires "projected disposable income" to be computed by taking the historical "disposable income" figure, as defined in section 1325(b)(2), and simply multiplying it by the number of months in the debtor's chapter 13 plan. In the first decision out of the courts of appeals, the Ninth Circuit has adopted that interpre-

tation. In re Kagenveama, supra.

Their underlying rationale is that "disposable income" was defined for the first time in the 2005 amendments and is used nowhere else than in the phrase "projected disposable income" in section 1325(b)(1)(B). Thus, the argument goes, "projected disposable income," while still undefined in the Code, must mean nothing more than "disposable income" that is projected out through the plan period – in other words, that is multiplied by the number of months in the plan. See In re Kagenveama, ___ F.3d at ___, 2008 WL 2278681, at *3 ("To get from the statutorily defined 'disposable income' to 'projected disposable income,' 'one simply takes the calculation . . . and does the math.'") (quoting In re Alexander, 344 B.R. 742, 749 (Bankr. E.D.N.C. 2006)).

Some courts have found this strict mathematical approach to be difficult to rationalize in cases in which the debtor's income or expenses changed significantly from the pre-petition period on which the historical disposable income figure is based. A handful of those courts have determined projected disposable income based on the income and expense figures used in Schedules I and J. See, e.g., In re Demonica, 345 B.R. 895, 900 (Bankr. N.D. Ill. 2006); In re Riggs, 359 B.R. 649, 652-53 (Bankr. E.D. Ky. 2007).

But most of the courts that have been dissatisfied with limiting the term "projected disposable income" to a mere computational requirement have not simply invoked Schedules I and J. Rather, while starting with the historical disposable income figure, they have read "projected disposable income" as permitting the use of credible evidence of significant changes in income and expenses that are likely over the life of the debtor's chapter 13 plan. See, e.g., In re Lanning, 380 B.R. 17 (B.A.P. 10th Cir. 2007), appeal pending, No. 08-3009 (10th Cir.); In re Pak, 378 B.R. 257 (B.A.P. 9th Cir. 2007); In re Kibbe, 361 B.R. 302 (B.A.P. 1st Cir. 2007); In re Jass, 340 B.R. 411, 418-19 (Bankr. D. Utah 2006). These courts have noted that this reading of "projected disposable income" aligns with a debtor's actual financial situation over the life of the debtor's chapter 13 repayment plan.

B. The Debtor's Mechanical Approach To Section 1325(b) And The Ninth Circuit's Decision In Kagenveama Are Flawed.

The debtor in this case argues in favor of the strict mathematical approach. She contends that section 1325 and Form 22C require a "mechanical calculation" for determining what must be paid to unsecured creditors. Debtor Br. 20. She recognizes that the Code fails to define "projected disposable income," Debtor Br. 4, but argues that it is no more than a multiple of historical "disposable income." See Debtor Br. 7-8. The Ninth Circuit has taken the same approach in In re Kagenveama, supra. This mechanical approach to section 1325 is flawed.

To begin with, a mechanical interpretation fails to consider the term "projected" in its proper context. See Hibbs v. Winn, 542 U.S. 88, 101 (2004) (statutory words must be construed in context). The use of the term "projected" in the economic and financial context of this statute suggests a forecast or estimate of an expected future financial reality. See The Random House Dict. of the English Lang. 1546 (2d ed. 1987) (defining to "project" as, inter alia, "to set forth or calculate (some future thing); *They projected the building costs for the next five years.*"); Webster's Third New Int'l Dict. 1813 (1993) (defining "projected" as, inter alia, "planned for future execution: contrived, proposed," as "[projected] outlays for new plant and equipment"). While the calculation of "projected" financial data may well begin with historical data, it does not necessarily (or even usually) end there, nor does it entail a rigid and inviolable assumption, made by the debtor, that projected income will be identical with past income even when the available facts demonstrate otherwise. The debtor's and the Ninth Circuit's mechanical test ignores this context of the statutory language.

Even more important, while both the debtor, Debtor Br. 6-14, and the Ninth Circuit, In re Kagenveama, ___ F.3d at ___, 2008 WL 2278681, at *3, assert that they are merely applying the plain meaning of section 1325(b)(1)(B), that is simply not correct. Their interpretation fails to take into account other language in the same statutory provision. First, although section 1325(b)(1)(B) explicitly refers to the income "to be received by the debtor" (emphasis added), the mechanical test fails to address cases in which the historical income required to be used may have no relationship to the actual income "to be received." A fairly typical case is In re Lanning, 380 B.R. 17 (B.A.P. 10th Cir. 2007), appeal pending, No. 08-3009 (10th Cir.), in which the debtor received a buyout from her employer during the six-month period preceding her filing under chapter 13. As a result of the buyout and the accompanying loss of her job, the debtor had an artificially high "current monthly income" and an artificially low actual income during the period covered by her chapter 13 plan. Under the mechanical test, the projection (i.e., multiplication) of her artificially high pre-petition income over the plan period would have resulted in fictitious "deemed" income that would never have been "received by the debtor" within the meaning of section 1325(b)(1)(B). See 380 B.R. at 21. Neither the debtor in this case nor the Ninth Circuit in Kagenveama makes any effort to address this language in the same statutory provision, despite their purported reliance on "plain meaning." Cf. In re Kagenveama, ___ F.3d at ___, 2008 WL 2278681, at *8 (Bea, J., concurring in part and dissenting in part) (because statute speaks of income "to be received," "even if a debtor's projected disposable income is zero at the time he seeks plan confirmation, he must commit to pay such disposable income as he receives it – should he receive it – during the applicable commitment period").

The mechanical test also fails to take into account another statutory phrase in section 1325(b)(1)(B), as well: "will be applied to make payments." For reasons similar to those we discussed in connection with the "to be received" requirement, fictitious income cannot "be applied to make payments." Both the debtor here and the Ninth Circuit base their understanding of "projected disposable income" strictly on the historical "current monthly income" figure, minus expenses. In cases like Lanning, projecting forward this deemed or hypothetical income does not permit it to be applied to make payments, for the simple reason that it does not exist. Under the mechanical test, either the debtor is charged with income that does not exist and cannot be "applied to make payments" under the plan, or the plan must be rejected, in which case the debtor is denied recourse to chapter 13 simply because of the receipt of a buyout and the loss of a job at about the time the petition was filed. Neither the debtor here nor the Ninth Circuit even attempts to explain the phrase "be applied to make payments" in the same statutory provision.[6] It is no answer to say that the chapter 13 plan may be amended under section 1329 to take into account changed financial circumstances. See In re Kagenveama, ___ F.3d at ___, 2008 WL 2278681, at *5, *7. In a case like Lanning, the mechanical test would likely preclude confirmation of any chapter 13 plan in the first place. See 11 U.S.C. 1325(a)(6)

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[6] The Ninth Circuit mentions the phrase in passing when it holds that there is no applicable commitment period when there is no projected disposable income to pay out during it. In re Kagenveama, ___ F.3d at ___, 2008 WL 2278681, at *6 ("When read together, only 'projected disposable income' has to be paid out over the 'applicable commitment period.' When there is no 'projected disposable income,' there is no 'applicable commitment period."). For her part, the debtor here cites this language only to show that the 2005 BAPCPA amendment added the phrase "to unsecured creditors." Debtor Br. 17.

(court shall confirm a plan only if "the debtor will be able to make all payments under the plan and to comply with the plan").

Although the present case has a different fact pattern from that in Lanning, any interpretation of section 1325(b)(1)(B) must take into account all of the language in the provision. If the interpretation cannot account for two phrases in the statute, which create serious interpretive issues in other fact situations, the interpretation must be incorrect. It is well established that courts "must, if possible, construe a statute to give every word some operative effect." Cooper Indus., Inc. v. Aviall Servs., Inc., 543 U.S. 157, 167 (2004) (citing United States v. Nordic Village, Inc., 503 U.S. 30, 35-36 (1992)). The debtor's interpretation would require the Court to ignore this statutory maxim.

C. To Give Content To All Parts Of The Statute, Section 1325 Must Be Read To Require That The Historical Figure Be Used As A Starting Point, Subject To Adjustment Based On Significant Changes In The Debtor's Financial Condition.

The correct interpretation of section 1325 uses historical "current monthly income" as the starting point for determining "projected disposable income," but also takes into account significant changes in the debtor's income or expenses that affect the debtor's ability to fund a plan.

1. In our view, the assessment of "projected disposable income" in the current version of the statute must, as a general matter, be based on the newly defined

"disposable income" in section 1325(b)(2), which in turn is based on an historical calculation of "current monthly income," computed as the average of the six month before the petition was filed. But there are circumstances in which the debtor's financial condition is projected to change significantly from that pre-petition period and, in such circumstances, it will not be appropriate to use the historical calculation. As the bankruptcy court expressed the point: Section 1325(b) "requires the Debtor to account for any events which will definitely occur during the term of the Plan that would alter either the income or the expense side of the disposable income calculation." App. 138-39.

Our interpretation not only is faithful to the new definition of "disposable income" in section 1325(b)(2) as an historical number but also treats "projected" disposable income as a future-oriented concept, as required by the language of section 1325(b)(1). See In re Pak, 378 B.R. at 264-65; In re Kibbe, 361 B.R. at 307-08. This interpretation requires the use of the historical income figure called for in the definition of "disposable income" as a starting point, and it calls for a presumption that the historical figure should be carried forward throughout the term of the plan, absent evidence to the contrary. But in order to take into account the future-orientation of the remaining language of the statute, and to ensure that projected disposable income is, in fact, a projection, it allows that presumption to be rebutted whenever the debtor is likely to experience (or actually has experienced) either a significant increase or a significant decrease in net income after the filing of the chapter 13 plan.

The reason for having a starting presumption that the historical disposable income figure should be applied mathematically to derive the projected disposable income is that, while "projected disposable income" is certainly not the same as "disposable income," it is appropriate in construing the former phrase to give effect to the definition of the latter. Section 1325(b)(2) provides a definition "[f]or purposes of this subsection." 11 U.S.C. 1325(b)(2). The only time that "disposable income" is used in "this subsection," section 1325(b), other than in the definition itself, is in the term "projected disposable income." Thus, we accept that a court should begin by applying the historical "disposable income" figure as a starting point and by presumptively carrying that figure forward over the plan period.[7]

At the same time, however, this initial presumption that the historical current monthly income will be used must necessarily be rebuttable. "[P]arties contending that a debtor's Form B22C disposable income figure does not accurately project the

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[7] Congress may well have expected that the historical figure, computed generally with standard rather than actual expenses, would result in a higher disposable-income total for "above-median" debtors and a greater amount designated for repayment to creditors under the debtor's chapter 13 plan. But the fact that this is often not the case does not authorize a court to ignore Form 22C altogether in determining projected disposable income and base it instead on Schedules I and J in the ordinary case. Such decisions cannot find support in the statutory language. See, e.g., In re Demonica, 345 B.R. 895, 900 (Bankr. N.D. Ill. 2006); In re Riggs, 359 B.R. 649, 652-53 (Bankr. E.D. Ky. 2007).

debtor's future ability to fund a plan must present documentation similar to that required by section 707(b)(2)(B)(ii) in support of their claim." In re Lanning, 380 B.R. at 25. See also In re Pak, 378 B.R. at 267 ("It makes no sense to interpret 'projected disposable income,' governing debtors' future payments under their chapter 13 plans, as cast in stone by their pre-bankruptcy history, without any opportunity for the trustee, creditors or the debtor to offer rebutting evidence as to changed income circumstances before the effective date of the plan.").

Thus, contrary to the debtor's argument here, Debtor Br. 7, application of the historical income figure to the plan period is not the end of the matter in all cases. There are situations in which a debtor has had, or is likely to have, significant changes in income after the period in which the historical "current monthly income" is computed, and in order to give full effect to the statutory text those changes must be taken into account in "project[ing]" the debtor's future disposable income.

There are two types of case that section 1325 must be able to address. First, a debtor may have either a significant increase in income at about the time he files his chapter 13 petition or a predictable increase later. For example, a debtor may be unemployed during the six-month period in which "current monthly income" is calculated but may accept a high-paying job at about the time he files his petition. See In re Pak, supra (debtor was unemployed for three years but found a job paying over $100,000 two months before filing his petition). Such a debtor would have an artificially low "disposable income" but might well be able to fund a chapter 13 plan that would repay most or all of his unsecured debt.

Second, conversely, a debtor may suffer a significant loss of income – for example, by losing a job – at about the time he files his chapter 13 petition, as in Lanning. Such a debtor would have a relatively high "current monthly income," based on an average of the six months preceding the month in which the petition was filed. Yet if that historical income were simply extended forward for purposes of the chapter 13 plan, it would not reflect the actual income available to the debtor during that future period. See, e.g., In re Lanning, 380 B.R. at 25 ("Where it is shown that Form B22C disposable income fails accurately to predict a debtor's actual ability to fund a plan, that figure may be subject to modification."). To put it in statutory terms, the future disposable income thus computed would not be the debtor's "projected" disposable income (because it would demonstrably not be based on a reliable estimate of future income) nor would it be the disposable income actually "received" by the debtor during the applicable commitment period. 11 U.S.C. 1325(b)(1)(B). Moreover, because the income amount determined by the mechanical test is merely deemed or hypothetical and not actually received, the income could not be "applied to make payments to unsecured creditors." Id. In such a case, therefore, the court must take into account the significant loss of income in order to apply section 1325(b) faithfully.[8]

2. The debtor argues that allowing any adjustment of the historical disposable income figure is at odds with the plain meaning of section 1325 and with congressional intent. Debtor Br. 11-12. That argument is unpersuasive.

We have already explained why the adjustment of the historical figure in some cases is actually compelled by the statutory language and why the statutory text does not support the debtor's notion of a standardized formula that is unrelated to any actual income to be received. Adjustment of the historical figure is sometimes necessary to ensure that the income is "to be received" and "applied to make payments." In the debtor's mechanical view of section 1325(b)(1)(B), those two critical phrases in the statute become surplusage.

3. The debtor raises two other objections to taking into account changes in a debtor's financial condition. Both of these objections mistakenly assume the only alternative to the mechanical test is to project forward the net income figure from

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[8] We recognize that some of these concerns with the statutory text do not arise in the same manner in our first example, when the debtor finds himself with a significant <u>increase</u> in income at about the time he files his petition. With an increase in income, the lower historical figure would actually be received by the debtor and could be applied to pay unsecured creditors. But it would still not be an accurate "project[ion]" of the debtor's disposable income to be "received" during the plan period; thus, the debtor's proposed interpretation is irreconcilable with the statutory text in these circumstances also. In any event, section 1325(b) should be interpreted in one uniform way for all above-median debtors, and the rebuttable presumption approach should be applied across the board.

Schedules I and J.

First, the debtor argues, Debtor Br. 17-18, that unless the mechanical test is used, the new requirement of section 1325(b)(1)(B) that all of the debtor's projected disposable income be applied to make payments to unsecured creditors will have the "absurd result" of making no funds available to pay secured creditors. This argument is meritless. No matter what the definition is of projected disposable income or which test is used, the plan must apply all of the projected disposable income to make payments to unsecured creditors. The addition of the phrase "unsecured creditors" has no bearing on the issue presented here. Under either interpretation, priority and secured creditors are paid first, after which the plan must provide for payment to unsecured creditors from whatever disposable income is projected.[9]

Second, the debtor argues, Br. 18-19, that "projecting the difference between schedules I and J does not take into account types of income which Congress has excluded in measuring a debtor's ability to pay," such as Social Security income. Debtor Br. 18. But the argument is completely misdirected. It is not our position that the courts should simply project forward the monthly net income on Schedules I and

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[9] The debtor appears to assume, incorrectly, that "the difference between schedules I and J," Debtor Br. 17, is always going to be greater than historical "current monthly income." In fact, in Lanning, which we have discussed in the text, the debtor's "current monthly income" on Form 22C was $5,344, while the monthly net income on Schedules I and J was about $149. In re Lanning, 380 B.R. at 19-20.

J. Nor is that what the bankruptcy court held in this case. To the contrary, the bankruptcy court merely required consideration of known changes in income or expenses: "[T]his Court holds that 'projected disposable income,' as it is used in § 1325(b), requires the Debtor to account for any events which will definitely occur during the term of the Plan that would alter either the income or expense side of the disposable income calculation." RE 143-44. It is not even the position of the Chapter 13 Trustee to rely entirely on Schedules I and J. See Ch. Trustee Br. 12 ("disposable income under Form B22C serves as a baseline for calculating projected disposable income subject to adjustment, both upward and downward, based upon known future circumstances"); id. at 14 ("CMI provides the court with a baseline from which it may make equitable deviations."). No one in this case "[r]el[ies] simply on the difference between schedules I and J." Debtor Br. 19.

4. We would be the first to admit that the language of section 1325 is not a model of clarity. But our interpretation gives effect to all the statutory language far more faithfully than the mechanical test advocated by the debtor and adopted by the Ninth Circuit in Kagenveama. Almost as important, it better furthers the overall goal of chapter 13.

Chapter 13 focuses on having debtors devote future income to paying their creditors. Indeed, BAPCPA placed additional emphasis on this goal of paying future income to creditors when it added language to section 707(b) permitting a court, with the debtor's consent, to convert an abusive chapter 7 case to chapter 13, as an alternative to dismissal. 11 U.S.C. 707(b)(1). While the mechanical test does require future income to be used to pay creditors, that future income is measured exclusively by reference to historical income, and in some cases, like this one, it bears little relation to the actual income available to the debtor. In contrast, our interpretation permits a court to consider the actual income that can "be applied to make payments" under the plan in those cases in which a different amount of actual income is available to a debtor because of changed circumstances. The use of actual income in such cases is an important measure of fairness, both to creditors in cases like this one, in which the debtor's actual future income is greater than her historical income, and to debtors in cases like In re Lanning, in which a temporary pre-petition payment to the debtor was not reflective of the debtor's continuing income or ability to fund a chapter 13 plan.

5. In short, the Court should consider all of the language of section 1325(b)(1)(B), and not just the phrase "projected disposable income." For the reasons we have given, the language of that section, read as a whole, does not support a purely mechanical test that is never subject to adjustment in light of significant changes in income or expenses after the filing of the petition.

CONCLUSION

For the foregoing reasons, the order of the district court should be affirmed.

Respectfully submitted,[10]

GREGORY G. KATSAS
Acting Assistant Attorney General

WILLIAM KANTER
(202) 514-4575
EDWARD HIMMELFARB
(202) 514-3547
Attorneys, Appellate Staff
Civil Division, Room 7646
Department of Justice
950 Pennsylvania Avenue, N.W.
Washington, D.C. 20530

OF COUNSEL:

ROBERTA A. DEANGELIS
Acting General Counsel

P. MATTHEW SUTKO
Associate General Counsel
Executive Office for United States Trustees
Department of Justice
20 Massachusetts Avenue, N.W.
Washington, D.C. 20530

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[10] The Department of Justice gratefully acknowledges the assistance of Dov Fox, a law student at Yale University, in the preparation of this brief.

CERTIFICATE OF COMPLIANCE

I certify that this brief is proportionately spaced, using Times Roman font, 14 point type. Based on a word count under Corel Word Perfect 12, this brief contains 6,874 words, excluding the table of contents, table of authorities, addenda, and certificates of counsel.

Edward Himmelfarb
Attorney for the United States
as Amicus Curiae

CERTIFICATE OF SERVICE

I hereby certify that on June 17, 2008, I served the foregoing Brief for the United States as Amicus Curiae in Support of Affirmance on the following by causing two copies of the brief to be sent by Federal Express, for next business day delivery, to:

Reese W. Baker, Esq.
Baker & Associates
5151 Katy Freeway, Suite 200
Houston, TX 77007

David Ronald Jones, Esq.
Porter Hedges
1000 Main Street, 36th Floor
Houston, TX 77002-6336

I also certify that I filed the brief by causing seven copies to be sent to the Clerk, United States Court of Appeals for the Fifth Circuit, by Federal Express, for next business day delivery.

Edward Himmelfarb
Attorney for the United States
as Amicus Curiae

ADDENDUM – STATUTES

Current Version

⇒§ 1325. **Confirmation of plan**

(a) Except as provided in subsection (b), the court shall confirm a plan if--

(1) the plan complies with the provisions of this chapter and with the other applicable provisions of this title;

(2) any fee, charge, or amount required under chapter 123 of title 28, or by the plan, to be paid before confirmation, has been paid;

(3) the plan has been proposed in good faith and not by any means forbidden by law;

(4) the value, as of the effective date of the plan, of property to be distributed under the plan on account of each allowed unsecured claim is not less than the amount that would be paid on such claim if the estate of the debtor were liquidated under chapter 7 of this title on such date;

(5) with respect to each allowed secured claim provided for by the plan--

(A) the holder of such claim has accepted the plan;

(B)(i) the plan provides that--

(I) the holder of such claim retain the lien securing such claim until the earlier of--

(aa) the payment of the underlying debt determined under nonbankruptcy law; or

(bb) discharge under section 1328; and

(II) if the case under this chapter is dismissed or converted without completion of the plan, such lien shall also be retained by such holder to the extent recognized by applicable nonbankruptcy law;

(ii) the value, as of the effective date of the plan, of property to be distributed under the plan on account of such claim is not less than the allowed amount of such claim; and

(iii) if--

(I) property to be distributed pursuant to this subsection is in the form of periodic payments, such payments shall be in equal monthly amounts; and

(II) the holder of the claim is secured by personal property, the amount of such payments shall not be less than an amount sufficient to provide to the holder of such claim adequate protection during the period of the plan; or

(C) the debtor surrenders the property securing such claim to such holder;

(6) the debtor will be able to make all payments under the plan and to comply with the plan;

(7) the action of the debtor in filing the petition was in good faith;

(8) the debtor has paid all amounts that are required to be paid under a domestic support obligation and that first become payable after the date of the filing of the petition if the debtor is required by a judicial or administrative order, or by statute, to pay such domestic support obligation; and

(9) the debtor has filed all applicable Federal, State, and local tax returns as required by section 1308.

For purposes of paragraph (5), section 506 shall not apply to a claim described in that paragraph if the creditor has a purchase money security interest securing the debt that is the subject of the claim, the debt was incurred within the 910-day preceding the date of the filing of the petition, and the collateral for that debt consists of a motor vehicle (as defined in section 30102 of title 49) acquired for the personal use of the debtor, or if collateral for that debt consists of any other thing of value, if the debt was incurred during the 1-year period preceding that filing;

(b)(1) If the trustee or the holder of an allowed unsecured claim objects to the confirmation of the plan, then the court may not approve the plan unless, as of the effective date of the plan--

(A) the value of the property to be distributed under the plan on account of such claim is not less than the amount of such claim; or

(B) the plan provides that all of the debtor's projected disposable income to be received in the applicable commitment period beginning on the date that the first payment is due under the plan will be applied to make payments to unsecured creditors under the plan.

(2) For purposes of this subsection, the term "disposable income" means current monthly income received by the debtor (other than child support payments, foster care payments, or disability payments for a dependent child made in accordance with applicable nonbankruptcy law to the extent reasonably necessary to be expended for such child) less amounts reasonably necessary to be expended--

(A)(i) for the maintenance or support of the debtor or a dependent of the debtor, or for a domestic support obligation, that first becomes payable after the date the petition is filed; and

(ii) for charitable contributions (that meet the definition of "charitable contribution" under section 548(d)(3) [FN1] to a qualified religious or charitable entity or organization (as defined in section 548(d)(4)) in an amount not to exceed 15 percent of gross income of the debtor for the year in which the contributions are made; and

(B) if the debtor is engaged in business, for the payment of expenditures necessary for the continuation, preservation, and operation of such business.

(3) Amounts reasonably necessary to be expended under paragraph (2), other than subparagraph (A)(ii) of paragraph (2), shall be determined in accordance with subparagraphs (A) and (B) of section 707(b)(2), if the debtor has current monthly income, when multiplied by 12, greater than--

(A) in the case of a debtor in a household of 1 person, the median family income of the applicable State for 1 earner;

(B) in the case of a debtor in a household of 2, 3, or 4 individuals, the highest median family income of the applicable State for a family of the same number or fewer individuals; or

(C) in the case of a debtor in a household exceeding 4 individuals, the highest median family income of the applicable State for a family of 4 or fewer individuals, plus $525 per month for each individual in excess of 4.

(4) For purposes of this subsection, the "applicable commitment period"--

(A) subject to subparagraph (B), shall be--

(i) 3 years; or

(ii) not less than 5 years, if the current monthly income of the debtor and the debtor's spouse combined, when multiplied by 12, is not less than--

(I) in the case of a debtor in a household of 1 person, the median family income of the applicable State for 1 earner;

(II) in the case of a debtor in a household of 2, 3, or 4 individuals, the highest median family income of the applicable State for a family of the same number or fewer individuals; or

(III) in the case of a debtor in a household exceeding 4 individuals, the highest median family income of the applicable State for a family of 4 or fewer individuals, plus $525 per month for each individual in excess of 4; and

(B) may be less than 3 or 5 years, whichever is applicable under subparagraph (A), but only if the plan provides for payment in full of all allowed unsecured claims over a shorter period.

(c) After confirmation of a plan, the court may order any entity from whom the debtor receives income to pay all or any part of such income to the trustee.

Former Version

§ 1325. Confirmation of plan

(a) Except as provided in subsection (b), the court shall confirm a plan if—

(1) The plan complies with the provisions of this chapter and with the other applicable provisions of this title;

(2) any fee, charge, or amount required under chapter 123 of title 28, or by the plan, to be paid before confirmation, has been paid;

(3) the plan has been proposed in good faith and not by any means forbidden by law;

(4) the value, as of the effective date of the plan, of property to be distributed under the plan on account of each allowed unsecured claim is not less than the amount that would be paid on such claim if the estate of the debtor were liquidated under chapter 7 of this title on such date;

(5) with respect to each allowed secured claim provided for by the plan—

(A) the holder of such claim has accepted the plan;

(B)

(i) the plan provides that the holder of such claim retain the lien securing such claim; and

(ii) the value, as of the effective date of the plan, of property to be distributed under the plan on account of such claim is not less than the allowed amount of such claim; or

(C) the debtor surrenders the property securing such claim to such holder; and

(6) the debtor will be able to make all payments under the plan and to comply with the plan.

(b)

(1) If the trustee or the holder of an allowed unsecured claim objects to the confirmation of the plan, then the court may not approve the plan unless, as of the effective date of the plan—

(A) the value of the property to be distributed under the plan on account of such claim is not less than the amount of such claim; or

(B) the plan provides that all of the debtor's projected disposable income to be received in the three-year period beginning on the date that the first payment is due under the plan will be applied to make payments under the plan.

(2) For purposes of this subsection, "disposable income" means income which is received by the debtor and which is not reasonably necessary to be expended—

(A) for the maintenance or support of the debtor or a dependent of the debtor, including charitable contributions (that meet the definition of "charitable contribution" under section 548 (d)(3)) to a qualified religious or charitable entity or organization (as that term is defined in section 548 (d)(4)) in an amount not to exceed 15 percent of the gross income of the debtor for the year in which the contributions are made; and

(B) if the debtor is engaged in business, for the payment of expenditures necessary for the continuation, preservation, and operation of such business.

(c) After confirmation of a plan, the court may order any entity from whom the debtor receives income to pay all or any part of such income to the trustee.

§ 1325. Confirmation of plan

(a) Except as provided in subsection (b), the court shall confirm a plan if (*)—

(1) the plan complies with the provisions of this chapter and with the other applicable provisions of this title;

(2) any fee, charge, or amount required under chapter 123 of title 28, or by the plan, to be paid before confirmation, has been paid;

(3) the plan has been proposed in good faith and not by any means forbidden by law;

(4) the value, as of the effective date of the plan, of property to be distributed under the plan on account of each allowed unsecured claim is not less than the amount that would be paid on such claim if the estate of the debtor were liquidated under chapter 7 of this title on such date;

(5) with respect to each allowed secured claim provided for by the plan—

(A) the holder of such claim has accepted the plan;

(B) ~~(i) the plan provides that the holder of such claim retain the lien securing such claim; and~~

(i) the plan provides that—

(I) the holder of such claim retain the lien securing such claim until the earlier of—

(aa) the payment of the underlying debt determined under nonbankruptcy law; or

(bb) discharge under section 1328; and

(II) if the case under this chapter is dismissed or converted without completion of the plan, such lien shall also be retained by such holder to the extent recognized by applicable nonbankruptcy law;

(ii) the value, as of the effective date of the plan, of property to be distributed under the plan on account of such claim is not less than the allowed amount of such claim; and

(iii) if—

(I) property to be distributed pursuant to this subsection is in the form of periodic payments, such payments shall be in equal monthly amounts; and

(II) the holder of the claim is secured by personal property, the amount of such payments shall not be less than an amount sufficient to provide to the holder of such claim adequate protection during the period of the plan; or

(C) the debtor surrenders the property securing such claim to such holder; ~~and~~

(6) the debtor will be able to make all payments under the plan and to comply with the plan~~.~~;

(7) the action of the debtor in filing the petition was in good faith;

(8) the debtor has paid all amounts that are required to be paid under a domestic support obligation, and that first become payable after the date of the filing of the petition if the debtor is required by a judicial or administrative order, or by statute, to pay such domestic support obligation; and

(9) the debtor has filed all applicable Federal, State, and local tax returns as required by section 1308. For purposes of paragraph (5), section 506 shall not apply to a claim described in that paragraph if the creditor has a purchase money security interest securing the debt that is the subject of the claim, the debt was incurred within the 910-day (**) preceding the date of the filing of the petition, and the collateral for that debt consists of a motor vehicle (as defined in section 30102 of title 49) acquired for the personal use of the debtor, or if collateral for that debt consists of any other thing of value, if the debt was incurred during the 1-year period preceding that filing.

(b) (1) If the trustee or the holder of an allowed unsecured claim objects to the confirmation of the plan, then the court may not approve the plan unless, as of the effective date of the plan—

(A) the value of the property to be distributed under the plan on account of such claim is not less than the amount of such claim; or

(B) the plan provides that all of the debtor's projected disposable income to be received in the ~~three-year~~ applicable commitment period beginning on the date that the first payment is due under the plan will be applied to make payments to unsecured creditors under the plan.

(2) For purposes of this subsection, the term "disposable income" means current monthly income ~~which is~~ received by the debtor (other than child support payments, foster care payments, or disability payments for a dependent child made in accordance with applicable nonbankruptcy law to the extent reasonably necessary to be expended for such child) less amounts ~~and which is not~~ reasonably necessary to be expended—

(A) (i) for the maintenance or support of the debtor or a dependent of the debtor, or for a domestic support obligation, that first becomes payable after the date the petition is filed; and

(ii) for ~~including~~ charitable contributions (that meet the definition of "charitable contribution" under section 548(d)(3) to a qualified religious or charitable entity or organization (as ~~that term is~~ defined in section 548(d)(4)) in an amount not to exceed 15 percent of ~~the~~ gross income of the debtor for the year in which the contributions are made; and

(B) if the debtor is engaged in business, for the payment of expenditures necessary for the continuation, preservation, and operation of such business.

(3) Amounts reasonably necessary to be expended under paragraph (2) shall be determined in accordance with subparagraphs (A) and (B) of section 707(b)(2), if the debtor has current monthly income, when multiplied by 12, greater than—

(A) in the case of a debtor in a household of 1 person, the median family income of the applicable State for 1 earner;

(B) in the case of a debtor in a household of 2, 3, or 4 individuals, the highest median family income of the applicable State for a family of the same number or fewer individuals; or

(C) in the case of a debtor in a household exceeding 4 individuals, the highest median family income of the applicable State for a family of 4 or fewer individuals, plus $525 per month for each individual in excess of 4.

(4) For purposes of this subsection, the "applicable commitment period"—

(A) subject to subparagraph (B), shall be—

(i) 3 years; or

(ii) not less than 5 years, if the current monthly income of the debtor and the debtor's spouse combined, when multiplied by 12, is not less than—

(I) in the case of a debtor in a household of 1 person, the median family income of the applicable State for 1 earner;

(II) in the case of a debtor in a household of 2, 3, or 4 individuals, the highest median family income of the applicable State for a family of the same number or fewer individuals; or

(III) in the case of a debtor in a household exceeding 4 individuals, the highest median family income of the applicable State for a family of 4 or fewer individuals, plus $525 per month for each individual in excess of 4; and

(B) may be less than 3 or 5 years, whichever is applicable under subparagraph (A), but only if the plan provides for payment in full of all allowed unsecured claims over a shorter period.

(c) After confirmation of a plan, the court may order any entity from whom the debtor receives income to pay all or any part of such income to the trustee.

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WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*
Olsen, et al. v. Mukasey, et al. (In re Olsen, et al.)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*
9th Cir.

3. ("CCN") ***CURRENT*** CASE NO.
No.: 07-cv-35616, 07-35762

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*
No.: 05-cv-06365-HO
Court: D. Oregon
(Identify judge & cite, if any)

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U.S. TRUSTEES

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*
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P. Matthew Sutko, Mark R. Freeman, Mark B. Stern, Karin J. Immergut and Jeffrey S. Bucholtz
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***
• Whether Section 526 (a)(4) Constitutionally Prohibits Bankruptcy Attorneys from encouraging their clients to abuse the bankruptcy system.

√ **Background:**

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Nos. 07-35616, 07-35762

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

ERIC OLSEN, KEVIN D. SWARTZ,
JASON C. MCBRIDE,

Plaintiffs-Cross-Appellants,

v.

MICHAEL B. MUKASEY, in his official capacity
as Attorney General of the United States of America;
ILENE LASHINSKY, in her official capacity
as United States Trustee,

Defendants-Appellants.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF OREGON

COMBINED RESPONSE AND REPLY BRIEF FOR APPELLANTS

JEFFREY S. BUCHOLTZ
Acting Assistant Attorney General

KARIN J. IMMERGUT
United States Attorney

MARK B. STERN
(202) 514-5089
MARK R. FREEMAN
(202) 514-5714
Attorneys, Appellate Staff
Civil Division, Room 7228
Department of Justice
950 Pennsylvania Ave., N.W.
Washington, D.C. 20530-0001

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INTRODUCTION AND SUMMARY

In the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, Congress enacted a series of provisions designed to "strengthen[] professionalism standards for attorneys and others who assist consumer debtors with their bankruptcy cases." H.R. Rep. No. 109-31, pt. 1, at 17 (2005) ("House Report"). Among those provisions are the measures challenged here, which preclude attorneys from urging their clients to take on additional debt in contemplation of bankruptcy, see 11 U.S.C. § 526(a)(4), and require certain disclosures in attorney advertisements, id. § 528(a)(4), (b)(2). As we established in our opening brief, the district court erred in striking down section 526(a)(4) on its face, and plaintiffs' arguments on cross-appeal are equally without merit.

Section 526(a)(4) prohibits an attorney from advising a debtor "to incur more debt in contemplation of such person filing a case under this title." As plaintiffs do not dispute, Congress enacted this provision in recognition of the fact that debtors frequently "load up" with new debt on the eve of bankruptcy in an effort to game the bankruptcy system. Plaintiffs do not suggest that an attorney's encouragement to amass new debt for such a purpose is protected by the First Amendment. Instead, they contend that the statute should be struck down because, in their view, section 526(a)(4) must be read expansively to encompass not only advice to engage in abusive conduct, but also advice to incur "any debts where a bankruptcy filing is considered, regardless of whether the intended course of action is fraudulent or perfectly legal." Br. 7 (emphasis added).

That interpretation is neither required by the statutory text nor consistent with Congress's purposes in the 2005 Act. Congress did not prohibit all attorney advice regarding new debt prior to bankruptcy; it prohibited attorneys from encouraging their clients to run up additional debt "in contemplation of" filing a bankruptcy petition. That choice of words is significant: as our opening brief explains (at 23-29), the phrase "in contemplation of" bankruptcy has a well-recognized connotation of abusive purpose. See, e.g., Black's Law Dictionary 336 (8th ed. 2004) (explaining that the phrase "contemplation of bankruptcy" typically connotes "action designed to thwart the distribution of assets in a bankruptcy proceeding"). Congress's placement of this provision in the context of other measures that are plainly addressed to abusive conduct by bankruptcy attorneys further underscores the error of plaintiffs' interpretation. Plaintiffs cannot properly insist that the Court adopt the broadest possible reading of the statute in order to sustain their facial challenge.

On cross-appeal, plaintiffs renew their claims that the advertising disclosure requirements in section 528 violate the First Amendment, and that the "debt relief agency" provisions as a whole are unconstitutionally vague on their face. The district court correctly rejected both contentions.

As plaintiffs do not dispute, Congress enacted section 528 in response to evidence of aggressive lawyer advertisements that promised to wipe out debts, halt foreclosures, and prevent repossessions, yet failed to mention that any such relief would require a petition for bankruptcy. The disclosures provided in section 528 are narrowly drawn to address the problem identified by Congress, and they burden no more speech than necessary to advance the government's substantial interest in preventing consumers from being misled into filing for bankruptcy relief inadvertently or without adequate consideration of the consequences. Plaintiff McBride's suggestion that section 528 compels him to make false or misleading statements is itself demonstrably false.

Plaintiffs' "vagueness" claim is yet farther afield. Congress did not violate the Constitution by enacting a regulation of bankruptcy professionals that uses terms intimately familiar to such professionals. Plaintiffs' various efforts to conjure ambiguities in the statutory language do not provide a proper basis for invalidating a federal statute on its face.

Finally, pressing an argument that plaintiffs themselves elected not to renew (and have thus waived) on appeal, amicus urges the Court to hold that bankruptcy attorneys are categorically exempt from the professional conduct regulations in the 2005 Act. That interpretation disregards Congress's explicit purpose in the Act to adopt "professionalism standards <u>for attorneys</u> and others who assist consumer debtors with their bankruptcy cases." House Report at 17 (emphasis added). It also founders on the plain text of the statute, which makes the "debt relief agency" provisions applicable to "any person" who provides paid “legal representation” to consumer debtors — a category that unmistakably includes bankruptcy attorneys.

ARGUMENT

I. SECTION 526(a)(4) CONSTITUTIONALLY PROHIBITS BANKRUPTCY ATTORNEYS FROM ENCOURAGING THEIR CLIENTS TO ABUSE THE BANKRUPTCY SYSTEM.

A. Section 526(a)(4) Should Not Be Construed More Broadly Than Necessary To Achieve Congress’s Purposes.

Congress enacted section 526(a)(4) to address a specific and recurring type of abuse under the Bankruptcy Code. As discussed at length in our opening brief (at 14-21), Congress has long been aware that debtors can abuse the protections of the Bankruptcy Code by “loading up” with new debt in anticipation of filing a bankruptcy petition. See House Report at 15 (expressing concern over the continued ability of debtors to “knowingly load up with credit card purchases or recklessly obtain cash advances and then file for bankruptcy relief”); S. Rep. No. 98-65, at 9 (1983) (noting special problem posed by “‘loading up’ in contemplation of bankruptcy”); Report of the Commission of the Bankruptcy Laws of the United States, H.R. Doc. No. 93-137, pt. I, at 11 (July 1973) (concluding that “the most serious abuse of consumer bankruptcy is the number of instances in which individuals have purchased a sizable quantity of goods and services on credit on the eve of bankruptcy in contemplation of obtaining a discharge”).

In hearings preceding the 2005 Act, Congress heard evidence that "misconduct by attorneys and other professionals" had been "consistently identified" by the U.S. Trustee Program as a source of abusive bankruptcy filings. See House Report at 5 (citation omitted). Other witnesses, including bankruptcy judges, informed Congress that these problems were likely to be exacerbated by the new "means testing" provisions in the 2005 legislation, which create an incentive for unethical attorneys to encourage their clients to run up additional debt on the eve of bankruptcy in order to obtain a full discharge of their debts under chapter 7. See Gov. Br. at 18-20. It was to address such abusive practices that Congress enacted section 526(a)(4).

None of this is controverted. Plaintiffs do not argue that Congress intended section 526(a)(4) to sweep more broadly, let alone that Congress actually sought to thwart, in the district court's words, "lawful actions in contemplation of bankruptcy that benefit the debtor and creditors." 350 B.R. at 916. Nor do plaintiffs deny that Congress can properly restrict attorneys from encouraging their clients to abuse the Bankruptcy Code: plaintiffs do not suggest that attorneys enjoy a categorical First Amendment privilege to advise their clients to subvert the bankruptcy process.

Instead, plaintiffs' contention is that, irrespective of Congress's intent, section 526(a)(4) must be read expansively to encompass not only advice to engage in abusive conduct, but also advice to incur "any debts where a bankruptcy filing is considered, regardless of whether the intended course of action is fraudulent or perfectly legal." Br. 7 (emphasis added).

This gets matters exactly backwards. Plaintiffs are not entitled to insist upon the broadest possible interpretation of section 526(a)(4) in order to secure its invalidation. It is a "cardinal principle" of statutory interpretation that "where an otherwise acceptable construction of a statute would raise serious constitutional problems, the Court will construe the statute to avoid such problems unless such construction is plainly contrary to the intent of Congress." Edward J. DeBartolo Corp. v. Fla. Gulf Coast Bldg. & Constr. Trades Council, 485 U.S. 568, 575 (1988); see, e.g., Apache Survival Coalition v. United States, 21 F.3d 895, 903 (9th Cir. 1994). It does not matter for these purposes that plaintiffs assert a First Amendment overbreadth claim. Indeed, "[f]acial overbreadth has not been invoked when a limiting construction has been or could be placed on the challenged statute." United States v. Esparza-Ponce, 193 F.3d 1133, 1137 (9th Cir. 1999) (quoting Broadrick v. Oklahoma, 413 U.S. 601, 613 (1973)).

B. Plaintiff’s Sweeping Interpretation Of Section 526(a)(4) Is Neither Required By The Text Of The Statute Nor Consistent With Congress’s Purposes.

Plaintiffs’ interpretation of section 526(a)(4) is plainly not compelled by the terms of the statute. Section 526(a)(4) does not prohibit all attorney advice regarding debt incurred prior to bankruptcy, as plaintiffs repeatedly assert. Rather, Congress provided that attorneys may not encourage their clients to run up new debt “in contemplation of * * * filing a case under this title.” 11 U.S.C. § 526(a)(4) (emphasis added).

That choice of phrase is significant. As we explained in our opening brief, the phrase “in contemplation of” bankruptcy carries a recognized connotation of abusive purpose. See Black’s Law Dictionary 336 (8th ed. 2004) (explaining that the phrase “contemplation of bankruptcy” typically connotes “action designed to thwart the distribution of assets in a bankruptcy proceeding”); Gov. Br. 23-26. Indeed, Congress has previously employed the same phrase in the same sense in discussing abuses of the bankruptcy laws. See, e.g., S. Rep. No. 98-65, at 9 (describing the phenomenon of “‘loading up’ in contemplation of bankruptcy,” in which “the debtor will go on a credit buying spree in contemplation of bankruptcy at a time when the debtor is, in fact, insolvent” (emphasis added)); Report of the Commission of the Bankruptcy Laws of the United States, H.R. Doc. No. 93-137, Part I, at 11 (observing that “the most serious abuse of consumer bankruptcy is the number of instances in which individuals have purchased a sizable quantity of goods and services on credit on the eve of bankruptcy in contemplation of obtaining a discharge" (emphasis added)).[1]

This interpretation is reinforced by the statutory context in which Congress placed the provision. Section 526(a)(4) is one of four subsections of section 526(a). The other three subsections indisputably provide rules of professional conduct designed to protect debtors from abusive practices by bankruptcy attorneys and other debt relief agencies. See 11 U.S.C. § 526(a)(1) (debt relief agencies must perform all promised services); id. § 526(a)(2) (prohibiting debt relief agencies from advising debtors to make false or misleading statements to obtain

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[1] The federal courts themselves have commonly described pre-petition debts amassed for improper purposes as debts incurred "in contemplation of" bankruptcy. See, e.g., United States v. Fox, 95 U.S. 670, 672 (1877) ("To legislate for the prevention of frauds * * * when committed in contemplation of bankruptcy, would seem to be within the competency of Congress."); In re Mercer, 246 F.3d 391, 421 n.43 (5th Cir. 2001) (en banc) (describing "loading up" as the practice of "incurring card debt in contemplation of bankruptcy"); In re Charles, 334 B.R. 207, 222 (Bankr. S.D. Tex. 2005) ("It is settled law that a debtor's good faith should be questioned if the debtor makes purchases in contemplation of a bankruptcy case.").

Plaintiffs urge that these cases involved statutes dealing with fraud. Br. 6-7. But as plaintiffs themselves acknowledge, incurring debt with the intent that it be discharged in bankruptcy is fraudulent. Br. 8; see also, e.g., Uniform Fraudulent Transfer Act §§ 4-5 (1984). It was hardly unreasonable for Congress to expect that, in this context, courts would construe a statute targeting actions taken by debtors "in contemplation of" bankruptcy as directed to abusive practices.

bankruptcy relief); id. § 526(a)(3) (prohibiting debt relief agencies from misrepresenting to debtors the services to be provided or the costs or benefits of filing for bankruptcy relief). Plaintiffs urge that these sister provisions should be disregarded because the literal language of section 526(a)(4) "is not so limited to malfeasance." Br. 10. But it is a "fundamental canon that the words of a statute must be read in their context and with a view to their place in the overall statutory scheme." Paul Revere Ins. Group v. United States, 500 F.3d 957, 962 (9th Cir. 2007) (quoting Wilderness Soc'y v. U.S. Fish & Wildlife Serv., 353 F.3d 1051, 1060 (9th Cir. 2003) (en banc)). Given Congress's singular focus in section 526(a) on abusive conduct by bankruptcy attorneys, it is apparent that Congress did not enact, as the fourth item in this list, a sweeping prohibition on lawful and ethical attorney advice.

Moreover, plaintiffs make no attempt to reconcile their reading of section 526(a)(4) with the other textual indicia of Congress's intent discussed in our opening brief. We explained, for example, that plaintiffs' unbounded interpretation of the phrase "in contemplation of" would render the second half of section 526(a)(4) superfluous: if, as plaintiffs insist, the "in contemplation of" language embraces any debt incurred for any purpose, it would have been unnecessary for Congress separately to forbid attorneys from advising debtors to incur debt to pay the attorney’s own legal fees. See Gov. Br. 25-26. Similarly, we explained that the principal remedy for a violation of section 526(a)(4) is a suit against the attorney for the debtor’s “actual damages,” 11 U.S.C. § 526(c)(2), a term that presupposes that the debtor has been injured by the attorney’s advice. Gov. Br. 27-28. Plaintiffs offer no response to these arguments, which underscore that Congress did not prohibit ordinary ethical attorney advice.

Plaintiffs’ expansive interpretation of section 526(a)(4) should therefore be rejected as inconsistent with the text and structure of the 2005 Act. At a minimum, it is clear that plaintiffs’ reading is not the only plausible construction of the statute. Under principles of constitutional avoidance, no more is required to reject plaintiffs’ arguments. “[A]s between two possible interpretations of a statute, by one of which it would be unconstitutional and by the other valid, [a court’s] plain duty is to adopt that which will save the Act.” Rust v. Sullivan, 500 U.S. 173, 190 (1991) (quoting Blodgett v. Holden, 275 U.S. 142, 148 (1927)).

C. Section 526(a)(4) Provides A Bankruptcy-Specific Rule Of Professional Conduct That Constitutionally Precludes Attorneys From Encouraging Debtors To Abuse The Bankruptcy Code.

Understood as a narrow prohibition against advising debtors to run up additional debt in order to subvert the bankruptcy process, there is little doubt that section 526(a)(4) satisfies the First Amendment.

Plaintiffs do not contend that they enjoy a First Amendment right to encourage their clients to file abusive bankruptcy petitions, or to load up on new debt prior to bankruptcy with the intent that the debt be discharged. As the Supreme Court stressed in Gentile v. State Bar of Nevada, 501 U.S. 1030 (1991), attorneys are not merely agents of their clients but are also officers of the courts, and for that reason may be "subject to ethical restrictions on speech to which an ordinary citizen would not be." Id. at 1071. The Court in Gentile quoted with approval Justice Stewart's dispositive concurrence in In re Sawyer, 360 U.S. 622 (1959), in which he rejected the notion "that a lawyer can invoke the constitutional right of free speech to immunize himself from even-handed discipline for proven unethical conduct," because "[a] lawyer belongs to a profession with inherited standards of propriety and honor, which experience has shown necessary in a calling dedicated to the accomplishment of justice. * * * Obedience to ethical precepts may require abstention from what in other circumstances might be constitutionally protected speech." Id. at 646-47 (Stewart, J., concurring in judgment); see Gentile, 501 U.S. at 1071. See also Ohralik v. Ohio State Bar Ass'n, 436 U.S. 447, 460 (1978) (sustaining a restriction on attorney solicitation because the government “bears a special responsibility for maintaining standards among members of the licensed professions”); Goldfarb v. Virginia State Bar, 421 U.S. 773, 792 (1975) (the government’s interest “in regulating lawyers is especially great since lawyers are essential to the primary governmental function of administering justice, and have historically been ‘officers of the courts’”).

Plaintiffs do not dispute that, under the principles discussed in Gentile, Congress can lawfully regulate the professional conduct of bankruptcy attorneys, including by imposing sanctions for unethical advice. Rather, plaintiffs insist that section 526(a)(4) is not a regulation of professional conduct at all, and that Gentile is thus inapplicable. Br. 10-11. That contention is difficult to fathom. Congress expressly described the “debt relief agency” provisions of the 2005 Act as “professionalism standards for attorneys.” See House Report at 17 (debt relief agency provisions “strengthen[] professionalism standards for attorneys and others who assist consumer debtors with their bankruptcy cases”). Section 526(a)(4) simply provides a bankruptcy-specific rule of conduct akin to Model Rule of Professional Conduct 1.2(d), which states that an attorney may not “counsel a client to engage, or assist a client, in conduct that the lawyer knows is criminal or fraudulent.” Accord Oregon R. Prof. Conduct 1.2(c). Restrictions of this kind do not violate the First Amendment. Indeed, Rule 1.2(d) has been applied to precisely the conduct that section 526(a)(4) addresses. See Attorney Grievance Comm'n of Maryland v. Culver, 381 Md. 241, 275-76 (2004) (attorney violated Rule 1.2(d) by advising a client to obtain credit card loans with the intent that the debt be discharged in bankruptcy).

Plaintiffs argue that Congress could not have intended section 526(a)(4) as an ethical rule because the relevant conduct is already prohibited by state bar rules. Br. 8. This contention encapsulates the error of plaintiffs' argument. The fact that state bar rules already prohibit attorney advice to abuse the Bankruptcy Code is pertinent only because it underscores that Congress broke no new constitutional ground in adopting a federal rule to the same effect. Congress undoubtedly has the power to provide uniform rules of conduct for attorneys in the federal bankruptcy courts, irrespective of state law. Cf. U.S. Const., Art. I, § 8, cl. 4. Moreover, section 526 supplies a new federal cause of action for aggrieved debtors to recover their "actual damages" from unethical attorney advice. See 11 U.S.C. § 526(c). The First Amendment does not bar Congress from regulating legal practice in the federal courts in this manner, any more than it prohibits states from authorizing malpractice claims against attorneys based on the content of their advice.

Plaintiffs further urge that the principles discussed in Gentile are inapplicable because that case involved public statements by an attorney in advance of a criminal trial, rather than "private, confidential speech between attorney and client." Br. 11. That distinction, however, cuts against plaintiffs here. Whatever protections may apply to public speech by attorneys on matters of public interest, it is when lawyers serve "as trusted agents of their clients, and as assistants to the court in search of a just solution to disputes," Cohen v. Hurley, 366 U.S. 117, 124 (1961), that the government's interest in preventing unethical attorney conduct reaches its zenith. See Gentile, 501 U.S. at 1071; Ohralik, 436 U.S. at 460.[2]

Nor is there any merit to plaintiff's characterization of section 526(a)(4) as an impermissible "content-based restriction on protected speech." Br. 11. Ethical rules governing attorneys and other professionals are typically content-based. Model Rule 1.2(d), which precludes attorneys from advising clients to engage in fraud, is no less a content-based restriction on speech, but

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[2] Plaintiffs mistakenly rely on Florida Bar v. Went For It, Inc., 515 U.S. 618 (1995), in urging that advice from lawyers to clients is entitled to maximum protection. Br. 5. The Court in that case stressed that, although "[t]here are circumstances in which we will accord speech by attorneys * * * the strongest protection our Constitution has to offer," the "standards and conduct of state-licensed lawyers have traditionally been subject to extensive regulation." 515 U.S. at 634, 635. Accordingly, the Court rejected a First Amendment challenge to a bar rule restricting direct-mail solicitations by lawyers. Id. at 635.

plaintiffs do not suggest that rule is unconstitutional. The district court therefore erred in striking down section 526(a)(4) on its face as "content based." 350 B.R. at 915 n.5.

Indeed, the district court's facial invalidation of section 526(a)(4) was improper on any ground: as we noted in our opening brief, the statute is undoubtedly constitutional in many of its applications, even on the district court's own broad reading. See Gov. Br. 32-34. Plaintiffs do not deny the inadequacy of the district court's analysis on this score. In particular, plaintiffs do not attempt to defend the district court's invalidation of section 526(a)(4) in its entirety, without discussing (or even mentioning) the portion of the statute that precludes attorneys from advising clients to incur yet more debt in order to pay the attorney's own fees. See 11 U.S.C. § 526(a)(4); Gov. Br. 33-34.[3]

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[3] In addition, as we explained in our opening brief, plaintiff McBride lacks standing to challenge section 526(a)(4), and the district court erred in enjoining the statute as applied to him. See Gov. Br. 34-35. McBride asserts that he has standing because he "meets the statutory definition of debt relief agency." Br. 16. But that fact alone is not sufficient. Section 526(a)(4) applies only to debt relief agencies who advise clients "in contemplation of * * * filing a case under this title." 11 U.S.C. § 526(a)(4); see also ibid. ("preparing for or representing a debtor in a case under this title"). In the complaint, however, McBride alleges that he does not "represent clients in bankruptcy matters nor does he file petitions for relief under the Bankruptcy Code." ER50 (compl. ¶ 12). He therefore lacks standing to challenge section 526(a)(4).

II. THE ADVERTISING DISCLOSURE REQUIREMENTS OF SECTION 528 ARE NARROWLY TAILORED TO ADDRESS A PROBLEM SPECIFICALLY DOCUMENTED BY CONGRESS.

On cross-appeal, plaintiff McBride renews his challenge to 11 U.S.C. § 528, which requires bankruptcy attorneys and other "debt relief agencies" to disclose in their advertisements the fact that they assist clients in filing for bankruptcy. McBride contends that this requirement "compels [him] to make an untrue and misleading statement in advertisements," and thus violates his First Amendment rights. Br. 17.

The district court rightly dismissed this claim. See 350 B.R. 919-21. Section 528 provides a narrowly tailored disclosure requirement that is designed to protect consumer debtors by preventing a particular type of deception documented by Congress. McBride's "compelled speech" claim should accordingly be rejected.

A. Congress Enacted Section 528 In Response To Misleading Attorney Advertisements That Promised Debt Relief But Failed To Explain That A Bankruptcy Petition Was Required.

In bankruptcy reform hearings preceding the 2005 legislation, Congress heard evidence of "increasingly aggressive lawyer advertising" that offered to make consumers' debts "disappear," yet failed even to "mention bankruptcy." See Bankruptcy Abuse Prevention and Consumer Protection Act of 2003, Hearing on H.R. 975 Before House Judiciary Comm., 108th Cong. 55 (2003). One retailer testified that some of his customers, who have been misled by such lawyer advertisements, "do not even understand that they have filed for bankruptcy." Bankruptcy Reform Act of 1999 (Part II), Hearing on H.R. 833 Before House Judiciary Comm., 106th Cong. 123 (1999). Indeed, as Congress was aware, the Federal Trade Commission ("FTC") had issued a consumer alert in 1997 warning that many debt-relief advertisements offering to "wipe out" consumer debts, or to "stop credit harassment, foreclosures, [and] repossessions," regularly failed to disclose that such "relief may be spelled b-a-n-k-r-u-p-t-c-y." See Bankruptcy Reform Act of 1998 (Part III), Hearing on H.R. 3150 Before House Judiciary Comm., 105th Cong. 90, 90-92 (1998) ("FTC Alert"). The result was that consumers were unwittingly being lured into filing for bankruptcy without an adequate appreciation of the consequences. Id. at 92. The FTC Alert remains in effect today.[4]

To address these problems, Congress enacted 11 U.S.C. § 528, which requires debt relief agencies to "clearly and conspicuously disclose in any advertisement * * * directed to the general public" that the advertised services "are with respect to bankruptcy relief under this title." Id. § 528(a)(3). In particular, in any advertisement offering "bankruptcy assistance" services, including any advertisement purporting to offer relief

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[4] See http://www.ftc.gov/bcp/conline/pubs/alerts/bankrupt.shtm (last visited Feb. 20, 2008).

from “credit defaults, mortgage foreclosures, eviction proceedings, excessive debt, debt collection pressure, or inability to pay any consumer debt,” a debt relief agency must:

> (A) disclose clearly and conspicuously in such advertisement that the assistance may involve bankruptcy relief under this title; and
>
> (B) include the following statement: “We are a debt relief agency. We help people file for bankruptcy relief under the Bankruptcy Code.” or a substantially similar statement.

Id. § 528(b)(2); see also id. § 528(a)(3)-(4); id. § 101(4A) (definition of “bankruptcy assistance”).

As the district court recognized, this limited disclosure requirement is well within Congress’s authority to enact, regardless whether it is analyzed under the general principles applicable to commercial speech regulations, see Florida Bar v. Went For It, Inc., 515 U.S. 618 (1995); Central Hudson Gas & Elec. Corp. v. Public Serv. Comm’n, 447 U.S. 557 (1980), or under the more lenient standards applicable to mandatory disclosures of factual and other uncontroversial information in advertisements, see Zauderer v. Office of Disciplinary Counsel of Supreme Court of Ohio, 471 U.S. 626, 650-52 (1985) (upholding state rule requiring attorney advertisements to disclose that “clients might be liable for significant litigation costs even if their lawsuits were unsuccessful”). See 350 B.R. at 920 (concluding that section 528 “passes constitutional muster” under either the Zauderer or the Central Hudson test).

Section 528 requires bankruptcy attorneys to identify themselves truthfully as "debt relief agencies" under the Bankruptcy Code, and to disclose that their advertised services do in fact relate to bankruptcy. As in Zauderer, plaintiffs' "constitutionally protected interest in not providing [such] factual information in [their] advertising is minimal," 471 U.S. at 651, and there is little doubt that the disclosure requirement is reasonably related to the government's interest in preventing the deception of consumer debtors. Nor does section 528 "burden substantially more speech than necessary" to further the government's legitimate interests. United States v. Edge Broadcasting Co., 509 U.S. 418, 430 (1993). Indeed, as the district court noted, the statute restricts no speech at all. 350 B.R. at 921; see Zauderer, 471 U.S. at 651 (emphasizing that "disclosure requirements trench much more narrowly on an advertiser's interests than do flat prohibitions on speech").

Moreover, the disclosure requirement in section 528 is directed precisely to the problem targeted by Congress: ensuring that persons who advertise bankruptcy-related services make clear that their services may in fact involve filing for bankruptcy. This targeted requirement advances the government's substantial interest in preventing the problem identified by the FTC Alert: deceptive advertisements that promise to "wipe out" debts or prevent foreclosures, but fail to disclose that such "relief may be spelled b-a-n-k-r-u-p-t-c-y." See FTC Alert, 105th Cong. at 92. As the FTC Alert explains, such advertisements have the potential to mislead consumers into filing for bankruptcy without adequately considering the implications. See ibid. (warning that "bankruptcy stays on your credit report for 10 years, and can hinder your ability to get credit, a job, insurance, or even a place to live"). It is well within Congress's authority to require reasonable disclosures in attorney advertisements to prevent such deception. See generally Bates v. State Bar of Arizona, 433 U.S. 350, 384 (1977) (states may require attorney advertisements to include a "warning or disclaimer * * * so as to assure that the consumer is not misled").

B. Section 528 Does Not Compel McBride To Make False Or Misleading Statements In Advertisements.

McBride contends, however, that the disclosures required by section 528 are "flatly false" as applied to him. Br. 18. Asserting that he does not actually "help people file for bankruptcy relief," Br. 18, McBride argues that section 528 violates his First Amendment rights by requiring him to state: "We are a debt relief agency. We help people file for bankruptcy relief under the Bankruptcy Code." 11 U.S.C. § 528(b)(2)(B).

This contention fails in multiple respects. First, McBride's insistence that he does not help clients file for bankruptcy is difficult to reconcile with the declaration that he filed in district court, in which McBride states that he does "advise some clients and potential clients that they should file bankruptcy" and that "I find it necessary to sometimes advise clients to incur new debt prior to a planned bankruptcy." ER-17 (¶¶ 4, 6).[5] Congress did not violate the First Amendment by requiring attorneys who advertise bankruptcy services of this kind to state that they "help people file for bankruptcy relief." Indeed, the distinction that McBride now attempts to draw — between helping clients with "excessive debt obligations" on the one hand and "help[ing] people file for bankruptcy relief" on the other, see Br. 18 — is precisely the sort of circumlocution that Congress determined to be deceptive to consumer debtors. See § 528(b)(2) (referring to advertisements for assistance with "excessive debt").

In any event, the disclosures in section 528 apply only to the extent that an attorney actually advertises "bankruptcy assistance services" to the public, and need only be included in "such advertisement[s]." 11 U.S.C. § 528(a)(3)-(4); id. § 528(b)(2). McBride thus has no obligation to state that he "helps people file for bankruptcy relief" except to the extent that he affirmatively advertises his bankruptcy services to the general public.

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[5] At the same time, plaintiffs' complaint alleges that McBride "does not represent clients in bankruptcy matters nor does he file petitions for relief under the Bankruptcy Code." ER50.

Moreover, as the district court recognized, section 528 permits attorneys to use their own "substantially similar" disclosure in lieu of the particular statement provided in the statute. 350 B.R. at 920; see 11 U.S.C. § 528(a)(4); id. § 528(b)(2)(B). To the extent McBride advertises bankruptcy assistance services, therefore, he is free to modify the required statement to reflect his actual practices, so long as he makes clear that his services "are with respect to bankruptcy relief" under the Bankruptcy Code. See 11 U.S.C. § 528(a)(3). Nor does section 528 prevent McBride from providing additional explanation or details regarding the services he offers. The statute merely requires attorneys "to insert a two-line admonition into certain advertisements," 350 B.R. at 921, in order to ensure that debtors are not misled into filing for bankruptcy. Nothing about this requirement offends the First Amendment. See Zauderer, 471 U.S. at 650 (disclosure requirements do not "prevent attorneys from conveying information to the public," but "only require them to provide somewhat more information than they might otherwise be inclined to present").

III. THE DISTRICT COURT CORRECTLY REJECTED PLAINTIFFS' CONTENTION THAT THE "DEBT RELIEF AGENCY" PROVISIONS OF THE 2005 ACT ARE UNCONSTITUTIONALLY VAGUE ON THEIR FACE.

Plaintiffs' cross-appeal also challenges the district court's dismissal of their claim that the "debt relief agency" provisions of the 2005 Act, 11 U.S.C. §§ 526-528, are unconstitutionally vague. The debt relief agency provisions apply to "any person who provides bankruptcy assistance to an assisted person." 11 U.S.C. § 101(12A). An "assisted person," in turn, is "any person whose debts consist primarily of consumer debts and the value of whose nonexempt property is less than $164,250."[6] Id. § 101(3). Plaintiffs urge that the Bankruptcy Code does not define terms such as "value," "nonexempt property," and "primarily consumer debts" with sufficient precision, and that consequently the entire statutory scheme is unconstitutionally vague on its face. Br. 25.

The district court was plainly correct to reject this contention.[7] See 350 B.R. at 921-22. A statute violates the Constitution if it is so vague that "it fails to provide people of ordinary intelligence a reasonable opportunity to understand what conduct it prohibits." Hill v. Colorado, 530 U.S. 703, 732

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[6] Cf. 11 U.S.C. § 104 (adjustment of dollar figures for inflation).

[7] The district court did not hold, as plaintiffs contend, that plaintiffs lack standing to assert a facial vagueness claim: the court rejected that claim on the merits. See 350 B.R. at 922. Rather, the court referred to standing and ripeness only to underscore the point that plaintiffs cannot invalidate a federal statute on its face merely by speculating about circumstances in which disagreement about the meaning of statutory terms might arise. See, e.g., id. at 921 (rejecting plaintiffs' speculative arguments as "an abstract challenge that is not ripe for review and does not demonstrate facial unconstitutionality"); ibid. ("Again, this needs an as applied challenge . . . ."); id. at 922 ("In a facial challenge, plaintiffs fail to show [that] the lack of absolute precision in the definitions encourages arbitrary enforcement.").

(2000). The "debt relief agency" provisions of the 2005 Act easily exceed that constitutional threshold. Terms such as "value," "nonexempt," and "primarily consumer debts" are accessible to any person of ordinary intelligence and, in any event, reflect concepts with which bankruptcy practitioners and other "debt relief agencies" will be intimately familiar. An entire provision of the Bankruptcy Code is devoted to defining "exempt" property, see 11 U.S.C. § 522, and the same provision expressly defines "value" for purposes of appraising such property, see id. § 522(a)(2). In this and countless other regards, attorneys such as plaintiffs must be conversant in the language of debts, asset value, and exemptions simply to assist their clients in filing bankruptcy petitions. See, e.g., 11 U.S.C. § 521(a)(1)(B) (debtor's debt and asset schedules); 11 U.S.C. § 707(b)(4)(C)-(D) (duty of bankruptcy attorney to investigate veracity of debtor's debt and asset schedules). If that were not enough, the federal reporters are thick with judicial decisions elaborating the meaning of these concepts.

Indeed, while plaintiffs assert that "attorneys cannot know if their client is an assisted person because of the vagueness of the Bankruptcy Code," Br. 26, the declarations that plaintiffs filed in district court demonstrate their own facility with the statutory terms. See ER-13 (Olsen declaration) ("I routinely advise clients and potential clients that have less than $150,000 in nonexempt assets."); ER-17 (McBride, same); ER-19 (Swartz, same).

Against this background, plaintiffs cannot seriously contend that the 2005 Act is so vague that a reasonable person cannot understand what conduct it addresses. Congress used terms of common understanding in the field to define the obligations of bankruptcy professionals; it was not required to achieve scientific exactitude. "[P]erfect clarity and precise guidance have never been required even of regulations that restrict expressive activity." Ward v. Rock Against Racism, 491 U.S. 781, 794 (1989). "Condemned to the use of words, we can never expect mathematical certainty from our language." Grayned v. City of Rockford, 408 U.S. 104, 110 (1972). See Gospel Missions of America v. City of Los Angeles, 419 F.3d 1042, 1047-48 (9th Cir. 2005); California Teachers Ass'n v. State Bd. of Education, 271 F.3d 1141, 1151-54 (9th Cir. 2001).

Nor are plaintiffs entitled to invalidate a federal statute on its face by speculating about circumstances in which the statutory terms might be ambiguous. See Br. 26-31. As the Supreme Court has explained, "[t]here is little doubt that imagination can conjure hypothetical cases in which the meaning of these terms will be in nice question." American Communications Ass'n v. Douds, 339 U.S. 382, 412 (1950). But "speculation about possible vagueness in hypothetical situations not before the Court will not support a facial attack on a statute when it is surely valid 'in the vast majority of its intended applications.'" Hill, 530 U.S. at 733 (quoting United States v. Raines, 362 U.S. 17, 23 (1960)). Plaintiffs are free to bring as-applied challenges if and when the circumstances they imagine actually arise. See 350 B.R. at 921-22.

IV. CONGRESS ENACTED THE "DEBT RELIEF AGENCY" PROVISIONS OF THE 2005 ACT TO REGULATE ATTORNEYS AS WELL AS OTHER BANKRUPTCY PROFESSIONALS.

Finally, plaintiffs urged in the district court that, as a statutory matter, the "debt relief agency" provisions of the 2005 Act do not apply to bankruptcy attorneys. The district court expressly rejected that contention, see 350 B.R. at 911-12, and plaintiffs have not renewed it on appeal. Indeed, they have taken the opposite view.[8] Nonetheless, amicus now urges the Court to hold that bankruptcy attorneys are exempt from all of the professional conduct regulations established by the 2005 Act. See Brief of Nat'l Ass'n of Consumer Bankruptcy Attorneys ("NACBA Br.") at 3-10.

This Court ordinarily "do[es] not consider on appeal an issue raised only by an amicus." Swan v. Peterson, 6 F.3d 1373, 1383 (9th Cir. 1993). That principle has particular force here: plaintiffs themselves have waived the issue, and amicus has filed

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[8] See Br. 16 (urging that plaintiff McBride, an attorney, "meets the statutory definition of a debt relief agency and is, therefore, subject to the restrictions of Section 526(a)(4).").

its own facial challenge to the 2005 Act in which its arguments can be addressed in the ordinary course of litigation. See No. 3:06-cv-00729-CFD (D. Conn.).

In any event, the argument advanced by amicus reflects a fundamental misunderstanding of the language and purpose of the statutory scheme. Congress defined the term "debt relief agency" to include "any person" who, for a fee, "provides any bankruptcy assistance to an assisted person." 11 U.S.C. § 101(12A). "Bankruptcy assistance," in turn, includes "providing information, advice, counsel, document preparation, or filing * * * with respect to a case or proceeding under this title," including in particular "appearing in a case or proceeding on behalf of another" or "providing legal representation." Id. § 101(4A) (emphasis added). By its plain terms, therefore, the statute encompasses "any person" who "counsel[s]," "appear[s] in a case or proceeding on behalf of," or provides "legal representation" to a consumer debtor in exchange for a fee — a category that unmistakably includes bankruptcy attorneys.

Congress chose this definition for a reason. As we explained in our opening brief (at 18-21), Congress was concerned not merely with abuses by debtors, but also with abuses committed by — and at the encouragement of — debtors' professional representatives in the bankruptcy system. For example, the House Report accompanying the 2005 Act cited a study that "consistently identified," among the sources of bankruptcy abuse, "misconduct by attorneys and other professionals." House Report at 5 (2005) (quoting Darling & Redmiles, Protecting the Integrity of the System: the Civil Enforcement Initiative, 21 Am. Bankr. Inst. J. 12 (Sept. 2002)). Similarly, in adopting the advertising disclosure requirements in 11 U.S.C. § 528, Congress heard evidence of "increasingly aggressive lawyer advertising" that offered to make consumers' debts "disappear," but failed to explain that such relief would require a petition for bankruptcy. See 108th Cong. 55 (2003). As part of "a comprehensive package of reform measures," therefore, Congress enacted the debt relief agency provisions of the 2005 Act to "strengthen[] professionalism standards for attorneys and others who assist consumer debtors with their bankruptcy cases." House Report at 2, 17 (emphasis added).

Amicus makes no attempt to reconcile its arguments with this declaration of congressional intent, and its efforts to derive a contrary purpose from the text of the statute fail at every turn.

Amicus urges, for example, that the definition of "debt relief agency" does not expressly refer to lawyers or attorneys. NACBA Br. 4-5. The definition does, however, use the term "bankruptcy assistance," which in turn explicitly includes "legal representation." 11 U.S.C. § 101(4A). Congress was not required to state, in addition, that a statute regulating persons who provide "legal representation" encompasses the very persons who provide such representation. See Heintz v. Jenkins, 514 U.S. 291, 294-95, 298 (1995) (lawyers who engage in debt collection are "debt collectors" under the Fair Debt Collection Practices Act, even though the statute does not specifically refer to lawyers or the practice of law); Goldfarb v. Virginia State Bar, 421 U.S. 773, 787-88 (1975) (noting the "heavy presumption against implicit exemptions," and accordingly refusing to construe the Sherman Act to exempt lawyers).

Amicus speculates that Congress intended the phrase "providing legal representation" to refer only to the unauthorized practice of law. NACBA Br. 6. That contention disregards not only the statutory text, which contains no such limitation, but also Congress's explicit intent in the 2005 Act, which was to provide rules of professional conduct "for attorneys and others who assist consumer debtors with their bankruptcy cases." House Report at 17 (emphasis added).[9]

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[9] The opinion on which amicus relies, In re Attorneys and Debt Relief Agencies, 332 B.R. 66 (Bankr. S.D. Ga. 2005), is hardly authority to the contrary. That opinion was issued sua sponte by the bankruptcy judge, unconnected to any pending case or proceeding, and without allowing the government any opportunity to submit briefing or argument. The government appealed to the district court, which held that the bankruptcy judge's opinion was unappealable precisely because it was not an actual order in a pending case. See In re Attorneys and Debt Relief Agencies, 353 B.R. 318, 322-23 (S.D. Ga. 2006).

Amicus further contends that interpreting the 2005 Act to encompass lawyers would impermissibly invade the authority of state governments to regulate the bar. NACBA Br. 8-9. This assertion is baseless. It cannot seriously be disputed that Congress may provide rules for the conduct of attorneys practicing in the federal courts, including in the federal bankruptcy courts. See, e.g., 28 U.S.C. § 1927; Fed. R. Civ. P. 11; Fed. R. Bankr. P. 9011; cf. Chambers v. NASCO, Inc., 501 U.S. 32 (1991). Indeed, federal law commonly supplies rules of professional conduct for attorneys in regulatory areas that, like bankruptcy, reflect uniquely federal concerns. See, e.g., 15 U.S.C. § 7245, 17 C.F.R. Part 205 (Securities and Exchange Commission); 31 U.S.C. § 330, 31 C.F.R. Part 10 (Internal Revenue Service); 35 U.S.C. § 2(b)(2)(D), 37 C.F.R. Part 10 (Patent and Trademark Office).

Amicus's reliance on the preemption savings clause in section 526(d) is misplaced for similar reasons. NACBA Br. 7-8. Section 526(d) provides that nothing in the 2005 Act shall "be deemed to limit or curtail the authority * * * of a State * * * to determine and enforce qualifications for the practice of law under the laws of that State." 11 U.S.C. § 526(d)(2)(A). The provisions that plaintiffs challenge create substantive rules of conduct for debt relief agencies in the federal bankruptcy system; the Act does not purport to regulate state bar admission or other “qualifications for the practice of law.” In fact, section 526(d) expressly distinguishes between restrictions on conduct and qualifications for legal practice, preempting state rules of conduct “to the extent” they are inconsistent with the federal debt relief agency requirements, see 11 U.S.C. § 526(d)(1), while leaving undisturbed state bar admission requirements, see id. § 526(d)(2)(A). The preemption savings clause merely ensures that nothing in the 2005 Act will limit the ability of the states to decide who may become members of their respective bars.

Finally, amicus wrongly suggests that, notwithstanding the plain text of the statute, this Court may exclude attorneys from the scope of the 2005 Act under the rubric of constitutional avoidance. NACBA Br. 10. As an initial matter, amicus’s interpretation would “avoid” far more than plaintiffs’ constitutional arguments: its reading would exempt bankruptcy attorneys not merely from section 526(a)(4) and from the advertising disclosure requirements in section 528, but also from the many other professional conduct regulations in the 2005 Act whose constitutionality is not in dispute. See, e.g., 11 U.S.C. § 526(a)(1) (requirement to perform all promised services); id. § 527 (requirement to provide written notice of debtors’ rights and obligations in bankruptcy); id. § 528(a)(1)-(2) (requirement to prepare a written contract with clear notice of applicable fees). Congress enacted these measures precisely to prevent the "abuse of debtors by their own lawyers," In re Irons, 379 B.R. 680, 687 (Bankr. S.D. Tex. 2007), and amicus does not suggest that these provisions by themselves present any constitutional difficulty.

More fundamentally, the avoidance canon permits — indeed, requires — a court to adopt any permissible construction of a statute that avoids a serious constitutional question, but it does not permit a court to disregard an unambiguous expression of congressional intent. Congress enacted the debt relief agency provisions to establish "professionalism standards for attorneys and others who assist consumer debtors with their bankruptcy cases." House Report at 17 (emphasis added). Amicus cannot invoke the doctrine of avoidance to frustrate that purpose.

CONCLUSION

For the foregoing reasons, the Court should reverse the judgment of the district court with respect to the constitutionality of 11 U.S.C. § 526(a)(4), and in all other respects affirm.

Respectfully submitted,

JEFFREY S. BUCHOLTZ
Acting Assistant Attorney General

KARIN J. IMMERGUT
United States Attorney

MARK B. STERN
(202) 514-5089
MARK R. FREEMAN
(202) 514-5714
Attorneys, Appellate Staff
Civil Division, Room 7228
Department of Justice
950 Pennsylvania Ave., N.W.
Washington, D.C. 20530-0001

FEBRUARY 2008

CERTIFICATE OF COMPLIANCE WITH RULE 32(a)(7)(C) OF THE FEDERAL RULES OF APPELLATE PROCEDURE

Pursuant to Rule 32(a)(7)(C) of the Federal Rules of Appellate Procedure, I hereby certify that:

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Mark R. Freeman

CERTIFICATE OF SERVICE

I hereby certify that on this 21st day of February, 2008, I caused copies of the foregoing brief to be filed with the Court by Federal Express overnight delivery, and caused copies to be served by electronic mail and Federal Express overnight delivery upon the following counsel:

Keith D. Karnes, Esq.
Olsen, Olsen & Daines, LLC
1599 State St.
Salem, OR 97301
(503) 362-9393
kkarnes@olsendaines.com

Douglas R. Ricks
Vanden Boss & Chapman LLP
319 SW Washington St. #520
Portland, OR 97204
(503) 241-4869
doug@vbcattorneys.com

Jonathan S. Massey
Jonathan S. Massey P.C.
7504 Oldchester Road
Bethesda, MD 20817
(301) 915-0990
jmassey@erols.com

____
Mark R. Freeman

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2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	9th Cir.
3. ("CCN") ***CURRENT*** CASE NO.	No.: 07-35616, 07-35762
4. ("PCN") ***PRIOR*** CASE NO. - & COURT *[IF ANY]*	No.: 6:05-cv-06365-HO Court: D. Or. *(Identify judge & cite, if any)*
5. ("SO") ***SOURCE***	**U.S. TRUSTEES**
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8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	• A). Milavetz requires reversal of the District Court's Invalidation of Section 526(a)(4). B). Milavetz forecloses plaintiffs' challenge to the advertising disclosure requirements to 11 U.S.C. § 528. C). Milavetz underscores the absence of merit in plaintiffs' vagueness argument. D). Milavetz establishes that attorneys may be "debt relief agencies".
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Nos. 07-35616, 07-35762

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

ERIC OLSEN, KEVIN D. SWARTZ,
JASON C. MCBRIDE,

Plaintiffs-Cross-Appellants,

v.

ERIC H. HOLDER, JR., in his official capacity
as Attorney General of the United States of America;
ILENE LASHINSKY, in her official capacity
as United States Trustee,

Defendants-Appellants.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF OREGON

SUPPLEMENTAL BRIEF FOR APPELLANTS/CROSS-APPELLEES

TONY WEST
Assistant Attorney General

DWIGHT HOLTON
United States Attorney

MARK B. STERN
(202) 514-5089
MARK R. FREEMAN
(202) 514-5714
Attorneys, Appellate Staff
Civil Division, Room 7228
Department of Justice
950 Pennsylvania Ave., N.W.
Washington, D.C. 20530-0001

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as Attorney General of the United States of America;
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as United States Trustee,

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ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF OREGON

SUPPLEMENTAL BRIEF FOR APPELLANTS/CROSS-APPELLEES

INTRODUCTION AND SUMMARY

Appellants/cross-appellees the Attorney General, et al., respectfully submit this brief pursuant to the Court's June 1, 2010 order, which directs the parties to file simultaneous supplemental briefs "addressing the significance, if any, of the Supreme Court's decision in Milavetz, Gallop & Milavetz, P.A. v.

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[1] Pursuant to Fed. R. Civ. P. 25(d), Attorney General Eric Holder should be substituted for Alberto Gonzales as defendant-appellant.

United States, --- U.S. ---, 130 S. Ct. 1324 (2010), on the issues raised in this appeal."

The Supreme Court in Milavetz rejected First Amendment challenges to 11 U.S.C. § 526(a)(4) and 11 U.S.C. § 528 identical to those pressed by plaintiffs here. The Court's decision requires reversal of the district court's invalidation of Section 526(a)(4), forecloses plaintiffs' principal arguments on appeal, and underscores the lack of merit in their few remaining contentions.

ARGUMENT

A. Milavetz Requires Reversal of the District Court's Invalidation of Section 526(a)(4).

The district court's conclusion that 11 U.S.C. § 526(a)(4) violates the First Amendment is foreclosed under Milavetz. The district court struck down Section 526(a)(4) because it believed that the statute "is not sufficiently narrow to achieve the legitimate interest of preventing abuse in the bankruptcy system." Olsen v. Gonzales, 350 B.R. 906, 916 (D. Or. 2006). Like the Eighth Circuit in Milavetz, the district court believed that the statute could "ensnare[] advice regarding lawful actions in contemplation of bankruptcy that benefit the debtor and creditors," such as advice to use a secured loan to buy a reliable car. Ibid.; see Milavetz, Gallop & Milavetz P.A. v. United States, 541 F.3d 785, 793 (8th Cir. 2008), rev'd, 130 S. Ct. 1324 (2010) (concluding that Section 526(a)(4) prohibits attorneys “from providing this beneficial advice — even if the advice could help the assisted person avoid filing for bankruptcy altogether.”).

The Supreme Court squarely rejected that view in Milavetz. Section 526(a)(4), the Court explained, does not broadly prohibit attorney advice, but “prohibits a debt relief agency only from advising an assisted person to incur more debt when the impelling reason for the advice is the anticipation of bankruptcy.” 130 S. Ct. at 1337. Such prohibited advice, the Court observed, “will generally consist of advice to ‘load up’ on debt with the expectation of obtaining its discharge — i.e., conduct that is abusive per se.” Id. at 1336; see also id. at 1338 n.6 (explaining that, under the interpretation adopted by the Court, “advice to refinance a mortgage or purchase a reliable car prior to filing because doing so will reduce the debtor’s interest rates or improve his ability to repay is not prohibited, as the promise of enhanced financial prospects, rather than the anticipated filing, is the impelling cause”). “[T]he language of the statute, together with other evidence of its purpose, makes this narrow reading of § 526(a)(4) not merely a plausible interpretation but the more natural one.” Id. at 1339.

The Court accordingly reversed the Eighth Circuit’s invalidation of Section 526(a)(4) under the First Amendment. Ibid. Following Milavetz, the Second Circuit has rejected an identical challenge to Section 526(a)(4). See Adams v. Zelotes, __ F.3d ___, 2010 WL 1960188, at *2 (2d Cir. May 18, 2010) (concluding that Milavetz "directly foreclosed" the plaintiff's First Amendment challenge).

The same result should obtain here. The district court identified no constitutional infirmity in Section 526(a)(4) apart from the issues resolved by the Supreme Court in Milavetz. Indeed, the case upon which the district court relied for its constitutional analysis, see 350 B.R. at 916 (quoting Hersh v. United States, 347 B.R. 19, 24 (N.D. Tex. 2006)), was itself reversed on appeal, see Hersh v. United States, 553 F.3d 743 (5th Cir. 2008), and the Supreme Court denied review of that decision in light of Milavetz, see 130 S. Ct. 1878 (2010).

B. Milavetz Forecloses Plaintiffs' Challenge to the Advertising Disclosure Requirements of 11 U.S.C. § 528.

In their cross-appeal, plaintiffs contend that the advertising disclosure requirements in 11 U.S.C. § 528 compel speech from plaintiff McBride in violation of the First Amendment. Pl. Br. 16-19. This claim too is foreclosed under Milavetz, which rejected an identical challenge by a Minnesota law firm. See 130 S. Ct. at 1339-41. The Supreme Court held that, contrary to plaintiffs' arguments here (Pl. Br. 17 & n.2), the validity of Section 528's disclosure requirements is not governed by the Central Hudson test for commercial speech restrictions, but rather by the "less exacting scrutiny" of

Zauderer v. Office of Disciplinary Counsel of Supreme Court of Ohio, 471 U.S. 626 (1985). See Milavetz, 130 S. Ct. at 1339-40.

Under that standard, the Supreme Court explained, Section 528 satisfies the requirements of the First Amendment because the required disclosures are factually correct and are "reasonably related" to the government's legitimate "interest in preventing deception of consumers." Ibid. (quoting Zauderer, 471 U.S. at 651). The required disclosures, the Court reasoned, "are intended to combat the problem of inherently misleading commercial advertisements — specifically, the promise of debt relief without any reference to the possibility of filing for bankruptcy, which has inherent costs." Id. at 1340. The disclosures "entail only an accurate statement identifying the advertiser's legal status and the character of the assistance provided, and they do not prevent debt relief agencies like Milavetz from conveying any additional information." Ibid. In addition, the Court stressed, Section 528 gives a debt relief agency the "flexibility to tailor the disclosures to its individual circumstances," provided it does so in a manner "substantially similar" to the statutory examples. Id. at 1341. Milavetz accordingly leaves no room for plaintiff McBride's claim that Section 528 violates the Constitution.[2]

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[2] Plaintiff McBride argues that he does not, in fact, "help people file for bankruptcy relief under the Bankruptcy Code," and (continued...)

C. Milavetz Underscores the Absence of Merit in Plaintiffs' Vagueness Argument.

Plaintiffs additionally argue that the "debt relief agency" provisions as a whole, 11 U.S.C. §§ 526-528, are unconstitutionally vague. See Pl. Br. 19-31. While there was no identical claim before the Court in Milavetz, the Supreme Court's opinion nonetheless underscores the lack of merit in plaintiffs' vagueness arguments. In urging that Section 526(a)(4) violated the First Amendment, for example, the plaintiffs in Milavetz argued that the provision would be unconstitutionally vague if the Court endorsed the government's view that the statute is limited to "abusive" conduct. See 130 S. Ct. at 1338. The Supreme Court rejected that contention, explaining that any such vagueness argument was "fatally undermined" by the fact that the term "abuse" appears elsewhere in the Bankruptcy Code and draws constitutionally sufficient meaning from those contexts. See ibid. (emphasizing that "[a]ttorneys and other professionals who

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[2] (...continued)
that consequently the required disclosures are invalid as to him. As we explained in our response/reply brief (at 21-23), this contention is without merit. Section 528 applies only to the extent that an attorney actually advertises "bankruptcy assistance services" to the public, and need only be included in "such advertisment[s]." 11 U.S.C. § 528(a)(3)-(4); id. § 528(b)(2). McBride thus has no obligation to state that he "helps people file for bankruptcy relief" except to the extent that he advertises such services to the public. Moreover, as the Supreme Court stressed in Milavetz, the statute affords McBride the "flexibility to tailor the disclosures to [his] individual circumstances." 130 S. Ct. at 1341.

give debtors bankruptcy advice must know of these provisions and their consequences”).

As we explain in our response/reply brief (at 23-27), plaintiffs’ vagueness challenge here fails for the same reasons. The statutory terms that plaintiffs challenge as impermissibly vague – such as “value,” “nonexempt,” and “primarily consumer debts,” see Pl. Br. 25 — are not only comprehensible to any person “of ordinary intelligence,” Hill v. Colorado, 530 U.S. 703, 732 (2000), but also reflect concepts with which bankruptcy professionals must already be familiar from other provisions of the Bankruptcy Code. See, e.g., 11 U.S.C. § 522 (defining “exempt” property); id. § 522(a)(2) (defining “value” for purposes of appraising exempt property). Plaintiffs’ own declarations additionally make clear that they have no difficulty understanding the statutory terms. See Gov’t Response/Reply Br. at 25-26.

D. Milavetz Establishes That Attorneys May Be “Debt Relief Agencies.”

Finally, as discussed in our response/reply brief (at 27-33), amicus National Association of Consumer Bankruptcy Attorneys contends that the statutory term “debt relief agency” does not encompass licensed attorneys. The Supreme Court in Milavetz expressly rejected that argument: “[W]e hold that attorneys who provide bankruptcy assistance to assisted persons are debt relief agencies within the meaning of the BAPCPA." 130 S. Ct. at 1333; see generally id. at 1331-33.

CONCLUSION

For the foregoing reasons, the Court should reverse the judgment of the district court with respect to the constitutionality of 11 U.S.C. § 526(a)(4) and in all other respects affirm.

Respectfully submitted,

TONY WEST
Assistant Attorney General

DWIGHT HOLTON
United States Attorney

MARK B. STERN
(202) 514-5089
MARK R. FREEMAN
(202) 514-5714
Attorneys, Appellate Staff
Civil Division, Room 7228
Department of Justice
950 Pennsylvania Ave., N.W.
Washington, D.C. 20530-0001

JUNE 15, 2010

CERTIFICATE OF COMPLIANCE

I hereby certify that this brief complies with the type-volume limitations of the Court's June 1, 2010 order. The brief is produced in 12-point monospaced typeface (Courier New), double-spaced, and does not exceed 15 pages in length.

s/ Mark R. Freeman
____
Mark R. Freeman

CERTIFICATE OF SERVICE

I hereby certify that on this 15th day of June, 2010, I caused copies of the foregoing brief to be filed with the Court and served on opposing counsel via the CM/ECF system.

s/ Mark R. Freeman

Mark R. Freeman

BRIEF BANK — “SUMMARY SHEET”

Printed Thu-9/24/09 11:13

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*: In re Marlynn Renee O’Neal (Daniel M. McDermott United States Trustee for Region 9 v. Countrywide Home Loans, Inc.)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*: N.D. Ohio

3. ("CCN") ***CURRENT*** CASE NO.: No.: 05:09-mc-0082

4. ("PCN") ***PRIOR*** CASE NO. - & COURT *[IF ANY]*: No.: 07-51027

Court: Bankr. N.D. Ohio

(Identify judge & cite, if any)

5. ("SO") ***SOURCE***: **U.S. TRUSTEES**

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*: Filed: September 9, 2009

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(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***: **BANKRUPTCY**

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s)

&

√ Any Miscellaneous ***BACKGROUND***

• Did the bankruptcy court abuse its discretion by finding that there was sufficient evidence to justify remedial action.

10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)

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NAME: Linda Figueroa

DATE:

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

IN RE :	}	CHAPTER 13
}		
MARLYNN RENEE O'NEAL,	}	CASE NO. 07-51027
	}	
Debtor.	}	ADVERSARY NO. 08-5031
}		
}		

....

}		
DANIEL M. MCDERMOTT,	}	
United States Trustee	}	
For Region 9	}	
}		
Plaintiff/Appellee	}	NO.5:09MC82
	}	
v.	}	
	}	Judge: Christopher A. Boyko
COUNTRYWIDE HOME LOANS, INC.,	}	
}		
Defendant/Appellant	}	

UNITED STATES TRUSTEE'S MEMORANDUM IN OPPOSITION TO COUNTRYWIDE'S MOTION FOR A STAY PENDING APPEAL

DANIEL M. MCDERMOTT
United States Trustee for Region 9

DEAN WYMAN #0007848
Senior Trial Attorney
Office of the United States Trustee
Suite 441
H.M. Metzenbaum U.S. Courthouse
201 Superior Avenue, East
Cleveland, Ohio 44114
216-522-7800, ext. 231
216-522-7193
Dean.P.Wyman@usdoj.gov

INTRODUCTION

Countrywide Home Loans Inc. has not demonstrated that it is entitled to the extraordinary relief of a stay pending appeal. Accordingly, Countrywide should comply with the bankruptcy court's reasonable order that it file a four-page worksheet with each of its proofs of claim. There is substantial evidence in the record to support the bankruptcy court's finding that Countrywide's system for servicing mortgage loans, including the loan of debtor Marlynn O'Neal, "is reckless."[1] The bankruptcy court's remedial order is a modest and warranted exercise of its discretion to regulate the adjudication of cases before it. Countrywide is not likely to prevail on appeal.

Countrywide will not face any, much less irreparable, harm if it complies with the bankruptcy court's remedial order during the appeal. Countrywide admits that its purported harm – $9,000 per year in compliance costs – is monetary. In contrast, trustees, the courts, and other Countrywide home mortgage customers face continuing harm by bearing the burden of identifying, and fighting against, Countrywide's persistent presentation of inaccurate information. The balance of harms weighs against Countrywide.

Countrywide has had ample opportunity to make its case: the liability and remedy phases of the trial below; a motion to withdraw the reference, and reconsideration thereof; and a stay application before the bankruptcy court. Although Countrywide has a right to a full review on the merits by this Court, further delay harms the public interest. Countrywide's lack of coordination and inattention to debtors' rights – problems which the bankruptcy court's order is designed to resolve – continues. On July 24, 2009, the bankruptcy court of this district

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[1] McDermott v. Countrywide Home Loans, Inc. (In re O'Neal), No. 08-5031 at 21 (Bankr. E.D. Ohio filed May 1, 2009) ("Liability Mem. Op.").

sanctioned Countrywide in an unrelated case for filing a baseless motion for relief from stay. In re Barber, No. 03-40045 (N.D. Ohio filed July 24, 2009) (Woods, J.).[2] On September 3, 2009, after the stay below had expired, Countrywide filed, and then withdrew, a proof of claim that did not comply with the bankruptcy court's remedial order. The United States Trustee therefore respectfully asks this Court to deny Countrywide's motion for a stay pending appeal.

FACTS

The problems underlying this case began approximately four years ago when Countrywide failed to record correctly the short-sale of debtor Marlynn O'Neal's property at 327 Ira Avenue, Akron, Ohio that satisfied her mortgage obligation in full.

Ms. O'Neal executed a mortgage on the Ira Avenue property in favor of Ameriquest Mortgage Company in the amount of $69,300 on or about May 8, 2004.[3] McDermott v. Countrywide Home Loans, Inc. (In re O'Neal), No. 08-5031 at 3 (Bankr. E.D. Ohio filed May 1, 2009) ("Liability Mem. Op.") (Attached as Exhibit 2). Countrywide was the loan servicer. Id. In April 2005, Ms. O'Neal allowed a third party, Mr. Jacob Wilhite of Faith Financial Group of Ohio, LLC to negotiate on her behalf with Countrywide when she fell behind on her mortgage payments and faced foreclosure. Id. at 4. Mr. Wilhite negotiated a $13,000 short sale with Countrywide that fully satisfied Ms. O'Neal's mortgage obligation. Id. at 4-5. Countrywide paid $5,700 to Wells Fargo and kept the balance. Id. at 8. In October 2005, Countrywide acknowledged receipt of the pay-off amount, which satisfied the claims against Ms. O'Neal, but

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[2] A copy of In re Barber is attached to this Opposition as Exhibit 1.

[3] This assignment, dated June 30, 2008, was not filed with the Summit Country recorder's office until July 25, 2008 (document number 55560031). McDermott v. Countrywide Home Loans, Inc. (In re O'Neal), No. 08-5031 at 17 (Bankr. E.D. Ohio filed May 1, 2009).

failed to code her account as closed. Id. at 9 (reciting Countrywide's explanations for the oversight). From April 2006 until December 2006, Ms. O'Neal telephoned Countrywide at least six times to correct her account information to show payment in full so that Countrywide would stop sending her demands for payment. Id. at 10-12. That correction was never made. Id. at 13. At the liability trial, Mr. Smith, a Countrywide representative, admitted that Countrywide personnel had recognized their error, which was memorialized in Countrywide's computer system. Hr'g Tr. at 75 (4/24/09).

On April 11, 2007, Ms. O'Neal filed a voluntary petition under the individual debt adjustment provisions of chapter 13 of the Bankruptcy Code, 11 U.S.C. §§ 1301, et seq., in the Northern District of Ohio. In re O'Neal, No. 07-51027 (N.D. Ohio filed Apr. 11, 2007). Ms. O'Neal disclosed the sale of the Ira Avenue property in her bankruptcy "Statement of Financial Affairs" filed in the bankruptcy case. [Dkt #1, p. 34].

On May 1, 2007, Countrywide Home Loans, Inc. filed a Proof of Claim, No. 4-1, on behalf of Wells Fargo Bank, N.A. in which it asserted that Ms. O'Neal was indebted in the amount of $88,859.06 by reason of a note and mortgage on the Ira Avenue property. (Attached as Exhibit 3). On May 1, 2007, Countrywide Home Loans Inc. also filed an objection to confirmation of Ms. O'Neal's chapter 13 repayment plan on the grounds that she had not made provision for re-payment of the mortgage that they claimed she still owed. [Dkt #16]. The objection contained no supporting documentation. On the same day, Ms. O'Neal filed a response with documentation demonstrating that her house had been sold and that Countrywide had accepted a $13,000 short sale in satisfaction of the loan. [Dkt #17]. On May 2, 2007, Ms. O'Neal objected to Countrywide's Proof of Claim. [Dkt #19]. Instead of immediately correcting its obvious error, Countrywide waited until the bankruptcy court sustained Ms. O'Neal's objection to Countrywide's Proof of Claim on June 6, 2007. [Dkt #27]. Only then, the day before the scheduled hearing, did Countrywide "voluntarily" withdraw its objection to confirmation of Ms. O'Neal's chapter 13 plan, prompting the bankruptcy court to cancel the hearing. [Dkt. #28]. Cf. Appellant Mot. at 3 (Countrywide's representation of its actions).

On February 28, 2008, the United States Trustee filed an adversary proceeding against Countrywide for "engaging in bad faith conduct that abused the judicial process" in the Marlynn O'Neal bankruptcy case under 11 U.S.C. § 105(a), the court's inherent powers, and Local Bankruptcy Rule 2090-2(c).[4] Compl. of United States Trustee, McDermott v. Countrywide Home Loans, Inc. (In re O'Neal), No. 08-5031 (Bankr. N.D. Ohio filed Feb. 28, 2008). After briefing on Countrywide's motion to dismiss, which the bankruptcy court denied, and its motion to withdraw the reference of the adversary proceeding under 28 U.S.C. § 157(d), which the district court denied,[5] the bankruptcy court held a trial on liability only on April 24, 2009. On May 1, 2009, the bankruptcy court found that "[a] reasonable investigation [by Countrywide] of Countrywide's records would have shown that Countrywide had no factual basis for asserting a claim in Ms. O'Neal's bankruptcy case or objecting to confirmation of her chapter 13 plan." Liability Mem. Op. at 22. The court further concluded that the Countrywide system was "designed to allow each actor in the process to act with indifference to the truth, and to rely

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[4] The text of the local rule is as follows: Court's Inherent Power. When necessary to control or eliminate disruptive, abusive, or unprofessional practices or conduct, this Court, through its inherent powers, may after notice and hearing sanction any attorney or party.

[5] Fokkena v. Countrywide Home Loans, Inc. (In re O'Neal), No. 5:08-MC-0043 (N.D. Ohio filed August 20, 2008) (Gwin, J.).

solely on the limited information made available at each step." Id. at 21. The bankruptcy court concluded that Countrywide's conduct "was not reasonable, was reckless and is sanctionable pursuant to §105 and Federal Rule of Bankruptcy Procedure 9011." Id. at 22.

After the bankruptcy court heard argument on possible corrective action, it issued its remedial order on July 31 that required Countrywide (1) within 75 days to file a four-page worksheet with every proof of claim pending before its judge only; and (2) immediately begin filing the worksheet with new proofs of claim. McDermott v. Countrywide Home Loans, Inc. (In re O'Neal), No. 08-5031, at 10 (Bankr. N.D. Ohio filed July 31, 2009) [Dkt #98] ("Remedy Mem. Op.") (attached as Exhibit 4). The worksheet requires Countrywide to list in one place evidence required of it by law in order to substantiate a proof of claim, such as information about the initial lender, current note-holder, payment history, and arrearage (pre-and post-petition). Id. at Ex. A, ("worksheet") (attached as Exhibit 5). Failure to attach the worksheet will result in an attorney fee sanction of at least $300. Id. at 10. The bankruptcy court's intent was to craft a narrowly tailored remedy "likely to prevent the same type of error and abuse of process that took place in this case from taking place in other bankruptcy cases." Id. at 9.

On August 10, 2009, Countrywide appealed the bankruptcy court's order and moved for a stay pending appeal. Fed. R. Bankr. P. 8005. The bankruptcy court held a hearing to consider the motion for stay pending appeal on August 25, 2009. Countrywide did not present any evidence to show the harm it would face if the stay were not granted. McDermott v. Countrywide Home Loans, Inc. (In re O'Neal), No. 08-5031, at 2 (Bankr. N.D. Ohio filed Sept. 4, 2009) [Dkt #114] ("Stay Mem. Op.") (attached as Exhibit 6). The bankruptcy court found that Countrywide had not demonstrated that it met the requirements for a stay pending appeal. It denied Countrywide's stay motion on September 4, 2009, a day after Countrywide filed an emergency motion for a stay in this Court.

ARGUMENT

In this district, a bankruptcy court's denial of a stay pending appeal is reviewed for abuse of discretion. City of Akron v. Akron Thermal, LP (In re Akron Thermal), No. 5:09 MC 10, 2009 WL 414669, at *7 (N.D. Ohio Feb. 19, 2009). The abuse of discretion standard in the context of a stay challenge "encompasses a de novo review of the law and a clearly erroneous review of the facts with respect to the underlying issues." Id. (citations omitted).

In order for Countrywide to sustain its burden of proof to obtain a stay pending appeal, it must show that: (1) it has made "a strong showing of likelihood of success on the merits;" (2) that it will be irreparably injured absent a stay; (3) a stay will not substantially injure the other parties interested in the proceeding; and (4) the public interest lies with granting the stay. Nken v. Holder, 129 S. Ct. 1749, 1761 (2009). A stay is not a matter of right, and "the party requesting a stay bears the burden of showing that the circumstances justify an exercise of that discretion." Id. at 1760-61. Finally, the success on the merits which must be demonstrated is inversely proportional to the harm: the less damaging the harm, the stronger the legal arguments must be. Nevertheless, even if the harm element weighs heavily in favor of the movant, "he is still required to show, at a minimum, 'serious questions going to the merits.'" Am. Civil Liberties Union v. Nat'l Sec. Agency/Central Sec. Service, 467 F.3d 590, 591 (6th Cir. 2006) (edits and citations omitted) (Mem. Op.). Countrywide fails to meet the standard for granting a stay pending appeal.

A. Countrywide is Unlikely to Succeed on the Merits

1. The bankruptcy court had the power to issue its remedial order.

The bankruptcy court's remedial order falls squarely within its authority to take action to ensure the proper implementation of the Bankruptcy Code and Rules. Stay Mem. Op. at 3. In particular, Section 105(a) of title 11 gives a bankruptcy court two powers: (1) to "issue any order, process or judgment that is necessary or appropriate to carry out provisions of this title;" and (2) "*sua sponte* tak[e] any action or mak[e] any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process." 11 U.S.C. § 105(a). This broad language allows a bankruptcy court "to do whatever is necessary to aid its jurisdiction, anything arising in or relating to a bankruptcy case." Allard v. Weitzman (In re DeLorean Motor Co.), 991 F.2d 1236, 1242 (6th Cir. 1993) (citing 2 Collier on Bankruptcy ¶ 105.02 at 105-03 (15th ed. 1987)).

The underlying purpose of section 105 is to give bankruptcy courts the necessary tools to prevent abuse of the Bankruptcy Code itself. Bessette v. Avco Fin. Serv., Inc., 230 F.3d 439, 444-45 (1st Cir. 2000); In re Sanchez, 372 B.R. 289, 311-12 (Bankr. S.D. Tex. 2007). In this particular case, the bankruptcy court found that Countrywide's system was "reckless" and caused submission of deficient and incomplete proofs of claim. Liability Mem. Op. at 21-23. Its mandated worksheet does no more than create a structure to make sure Countrywide files claims that comply with 11 U.S.C. § 501 (filing of proofs of claim), 11 U.S.C. § 502 (allowance of claims), and Fed. R. Bankr. P. 3001 (required information for a proof of claim). See Stay Mem. Op. at 5. Such an action is in complete harmony with the Code and serves to "preserve the judicial integrity" of a federal court. In re Foreclosure Cases, No. 1:07-cv-2282, 2007 WL

3232430, at *2 (N.D. Ohio Oct. 31, 2007); see 11 U.S.C. § 105(d) (allowing bankruptcy courts to take action at status hearings to "ensure the case is handled expeditiously and economically").

2. The bankruptcy court did not abuse its discretion by finding that there was sufficient evidence to justify remedial action.

The bankruptcy court did not commit clear error when it found Countrywide's handling of the O'Neal case warranted remedial action. Liability Mem Op. at 23; Remedy Mem. Op. at 8. Countrywide admits it filed a proof of claim and objection to confirmation in error. Appellant Emergency Motion for Stay Pending Appeal at 3. Given Countrywide's records, it was not clear error to find that Ms. O'Neal called Countrywide at least six times to correct her account information but that Countrywide continued to send her bills for a mortgage that she no longer had. Liability Mem. Op. at 10-13 (citing United States Trustee Exhibits 17, 23-27, 29). Nor did the bankruptcy commit an error of law when it rejected Countrywide's explanation that its actions in the O'Neal case should be excused because of a computer error. Appellant Mot. at 1. Computer mistakes are not an acceptable excuse for objecting to a debtor's plan or filing a proof of claim without legal basis. In re Wingard, 382 B.R. 892, 902 (Bankr. W.D. Pa. 2008) (quoting In re McCormick, 203 B.R. 521, 524 (Bankr. D. N.H. 1996) (describing computer programming error defense as a "non-starter")).

The bankruptcy court also did not abuse its discretion when it did not accept Countrywide's representations that it had acted to correct its systematic problems. Liability Mem. Op. at 21. Countrywide only offered one witness whose involvement in filing Proofs of Claim had ended a year before the hearing. Remedy Mem. Op. at 6. Therefore, the bankruptcy court did not abuse its discretion when it concluded that Countrywide's assertion that "it had addressed the problems with inaccurate information . . . was simply that – an assertion without support of current credible evidence." Id.

Given the catalogue of Countrywide's missteps, the bankruptcy court did not abuse its discretion when it determined that Ms. O'Neal's case was not an isolated incident but rather an example of systemic abuse. Liability Mem. Op. at 21. Ms. O'Neal's lengthy, yet unsuccessful, efforts to correct her account could reasonably allow the bankruptcy court to conclude that "under Countrywide's standard operating procedures, no Countrywide employee is expected to review the documents or the file to determine whether the documents being made available are sufficient or accurate." Liability Mem. Op. at 14. It was not an abuse of discretion for the bankruptcy court to find, given the facts of Ms. O'Neal's case, that such lack of oversight would result in more than isolated problems.

Case law supports the bankruptcy court's finding of systematic abuse. Other courts have noted Countrywide's systematic problems. See, e.g. In re Parsley, 384 B.R. 138 (Bankr. S.D. Tex. 2008) (44 page opinion outlining misrepresentations by Countrywide and its local counsel); In re Selected Cases in Which Chapter 13 Trustee Seeks Relief Against Countrywide Home Loans, Inc., 396 B.R. 138 (Bankr. W.D. Pa. 2008) (describing settlement agreement concerning 293 cases where Countrywide allegedly failed to properly post mortgage payments under chapter 13 plans).

Nor has Countrywide's track record improved during the pendency of this matter. In fact, a week before the bankruptcy court issued its remedial order, another judge in the Northern District sanctioned Countrywide and its counsel $3000 for filing a baseless motion for relief from stay. In re Barber, No. 03-40045, at 9-10 (Bankr. N.D. Ohio filed July 24, 2009) (Woods, J.)

(Exhibit 1). The relief ordered by the bankruptcy court in the O'Neal case is a modest step towards curbing Countrywide's systematic misconduct.

3. Countrywide's subject matter jurisdiction argument should not be revisited.

This Court does not need to consider Countrywide's argument that the bankruptcy court did not have subject matter jurisdiction to enter remedial action. This same argument was raised before, and rejected by, the district court when it considered Countrywide's motion to remove the reference from the bankruptcy court. Fokkena v. Countrywide Home Loans, Inc. (In re O'Neal), No. 5:08-MC-0043 at 3-4 (N.D. Ohio filed Aug. 20, 2008) (Gwin, J.) (holding that the United States trustee's motion for sanctions did not present an issue of criminal contempt before the bankruptcy court, which had jurisdiction over the issue). It is therefore the law of this case the remedial action requested in this case is not criminal and that the bankruptcy court has the authority to order Countrywide to take action to ensure that other debtors would be spared Ms. O'Neal's ordeal. Stay Mem. Op. at 6 (stating it is "established for the purposes of this adversary proceeding that this Court has subject matter jurisdiction"); See Rouse v. DaimlerChrysler Corp., 300 F.3d 711, 715 (6th Cir. 2002) (stating general rule that "findings made at one point in the litigation become the law of the case for subsequent stages of that same litigation"). As such, the district court's holding should not be "lightly disturbed." Gillig v. Advanced Cardiovascular Systems, Inc., 67 F.3d 586, 590 (6th Cir. 1995). A court has a duty to correct any erroneous decision made earlier in the litigation, meaning that any review of a previous decision of a colleague-court must be done under an abuse of discretion standard. Id.

There is no reason for this Court to revisit Countrywide's standing and jurisdiction arguments. Like the district court in this case, other courts have rejected them. For example, careful review of the language of 11 U.S.C. § 307 and the legislative history that led to the creation of the United States Trustees Program demonstrates that Congress intended to give United States Trustees a broad role to "ensure honesty and fairness in the administration of bankruptcy cases and to prevent and ferret out fraud." Walton v. Countrywide Home Loans, Inc. (In re Sanchez), No. 08-23337-CIV, 2009 WL 1905035, at *2 (S.D. Fla. June 9, 2009). As no statute or case law expressly prohibits a United States Trustee from initiating an adversary proceeding, and such an ability is in keeping with the Program's broader watchdog role, standing is not an issue. Id. at *4.

Furthermore, a bankruptcy court has an interest in protecting the integrity of the judicial system against improper conduct, including creditor abuse, providing a basis for jurisdiction to order remedial action. In re Taylor, 407 B.R. 618, 636 (Bankr. E.D. Pa. 2009) (citing cases). Specifically, an adversary proceeding against a lender relating to an improper Proof of Claim or motion for relief from the automatic stay resulting from improperly servicing a mortgage loan falls under a bankruptcy court's "arising under" jurisdiction pursuant to 28 U.S.C. 1334(b) and 28 U.S.C. 157(b)(2). Rodriguez v. Countrywide Home Loans, Inc. (In re Rodriguez), 396 B.R. 436, 448-49 (Bankr. S.D. Tex. 2008) (denying Countrywide's motion to dismiss for lack of jurisdiction against Debtor's claims that Countrywide improperly applied payments under the terms of the chapter 13 plan). Accordingly, this Court has no reason to re-consider Countrywide's jurisdictional arguments.

4. The bankruptcy court did not abuse its discretion in finding that Countrywide was on notice that sanctions under Federal Rule of Bankruptcy Procedure 9011 were a possibility.

The bankruptcy court did not abuse its discretion by finding that Countrywide was on notice that Federal Rule of Bankruptcy Procedure 9011 was a potential basis for ordering remedial relief in this case. Stay Mem. Op. at 5. It is beyond dispute a bankruptcy court has the power to take corrective action under Rule 9011 for filing inaccurate claims; the issue is whether Countrywide received sufficient notice that sanctions were an option. Appellant Mot. at 12. Notice is a fact question. It is undisputed that Countrywide filed an inaccurate proof of claim and meritless objection to confirmation, precisely the conduct that Rule 9011 addresses. The United States Trustee included Local Rule 2090-2(c) in its complaint, which prohibits "unprofessional practices or conduct." Compl. at ¶ 7. This district court, when denying Countrywide's motion to withdraw the reference, concluded that the bankruptcy court had authority to mandate corrective action in part because of Rule 9011. Stay Mem. Op. at 5 (discussing the Fokkena v. Countrywide Home Loans, Inc., No. 5:08-MC-0043 at 3-4). The bankruptcy court did not abuse its discretion in finding that Countrywide should have been aware that "Rule 9011 was in full play." Id.

B. Countrywide Will Not Suffer Irreparable Harm if the Stay is Not Granted

Countrywide alleges that it will be irreparably harmed if it is required to accurately explain and document its proofs of claim. Appellant Mot. at 16. Countrywide, however, provides no compelling evidence that it will suffer any harm from the worksheet requirement instituted by the bankruptcy court. Countrywide must show that the harm it alleges if the stay is not granted will be: (1) substantial; (2) likely to occur; and (3) supported by adequate proof. Ohio ex rel. Celebrezze, 812 F.2d 288, 290 (6th Cir. 1987) (citation omitted).

At the hearing before the bankruptcy court on the stay, Countrywide's counsel introduced no evidence to support its motion for a stay pending appeal. Stay Mem. Op. at 2; Hr'g Tr. at 2 (Aug. 25, 2009). Instead he argued that Countrywide's harm "arises by virtue of the, I would submit, unauthorized threat of sanction arising from the compulsion to utilize a form that I would submit is not authorized by statute or rule. And it further arises from the entry of the Sanctions Order [sic] without an appropriate statutory foundation." Hr'g Tr. at 17:15-21 (Aug. 25, 2009). The worksheet does not require any information that is not also required by the Code. Therefore, the bankruptcy court did not err in rejecting Countrywide's argument that the worksheet is "rule-making in disguise." Stay Mem. Op. at 6. Having to fill out a form, even if the requirement were unjustified, which this one is not, is not irreparable harm. The bankruptcy court correctly determined that Countrywide did not meet its burden on this element to demonstrate its entitlement to a stay pending appeal.

At the stay hearing, Countrywide did not present any evidence to support its contention that its costs would increase due to the need to complete the worksheet. The bankruptcy court reasonably concluded that Countrywide's harm argument was "bare allegation." Stay Mem. Op. at 7. To bolster its harm argument, Countrywide submitted a Declaration from Kelly May, Vice President, Bankruptcy, Bank of America with its motion to this Court.[6] Michigan Coalition of Radioactive Material Users, Inc. v. Griepentrog, 945 F.2d 150, 154 (6th Cir. 1991) (stating that

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[6] This is an improper augmentation of the record on appeal. The United States Trustee reserves the right to object to this – and any other – improperly introduced evidence.

party moving for a stay pending appeal must provide specific facts and affidavits in support of assertions that the factors warranting a stay exist). Ms. Kelly declared that it would cost Countrywide $75 per loan to file the required worksheets, resulting in a cost of $21,600 to bring existing cases into compliance and an annual cost of $9,000 going forward. Appellant Mot., Ex. D at 2. (Countrywide claims additional costs related to property valuation). It is black-letter law that financial loss alone cannot constitute irreparable harm. Celebrezze, 812 F.2d at 290 ("economic loss does not constitute irreparable harm, in and of itself") (citing Wisconsin Gas Co. v. F.E.R.C., 758 F.2d 669, 674 (D.C. Cir. 1985)).

Even if economic loss could constitute irreparable harm, these amounts at issue here are trivial. According to its Mid-Year 2009 Investor Handbook, BAC Home Loans Servicing (f.k.a. Countrywide Home Loans, Inc.) funded more than $195 billion in first mortgage loan products in the first half of 2009.[7] By comparison, the Eastern District of Louisiana, reviewing a bankruptcy decision in another case involving Wells Fargo's abusive mortgage practices, held that the $238,000 cost to conduct audits of all open proofs of claim did not constitute irreparable harm. In re Stewart, No. 08-3225, 2009 WL 1649731 at *4 (E.D. La. June 10, 2009). Countrywide cannot credibly claim irreparable harm from costs that are a fraction of that amount.

Compliance with the bankruptcy court's order will not cause Countrywide competitive harm. In fact, the remedy that the bankruptcy court chose to impose on Countrywide is modest compared to the action of other bankruptcy courts faced with similar creditor abuse by Countrywide's competitors. For example, Wells Fargo has been ordered to conduct internal

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[7] Available at http://investor.bankofamerica.com/phoenix.zhtml?c=71595&p=irol-irhome (last visited Sept. 14, 2009).

audits and amend proofs of claim. In re Stewart, No. 08-3225, 2009 WL 2448054, *12 (E.D. La. Aug. 7, 2009) (affirming bankruptcy court order requiring creditor to conduct an audit and amend proofs of claim); see also Wells Fargo Bank, N.A. v. Jones, 391 B.R. 577 (E.D. La. 2008) (affirming power of bankruptcy court to order audits if elements for an injunction are met); In re McKain, No. 08-10411, at 9 (Bankr. E.D. La filed May 1, 2009) (order instituting accounting procedures). The bankruptcy court did not err in ordering its modest and tailored remedial action.

C. Issuing the Stay Would Injure Other Parties in Interest and the Public Interest

______Countrywide suggests that the United States Trustee will not be harmed if a stay is granted. The United States Trustee is not appearing in this case in his personal capacity but as a Justice Department officer representing the United States, which acts as the "watchdog" of the public interest. Morganstern v. Revco D.S. Inc. (In re Revco D.S., Inc.), 898 F.2d 498, 500 (6th Cir. 1990) (explaining that United States Trustees oversee the bankruptcy process, protect the public interest, and ensure that bankruptcy cases are conducted according to law). The United States Trustee serves the public interest, which will benefit by requiring Countrywide to comply with the bankruptcy court's order to provide precise information in proofs of claim without further delay.

The bankruptcy court found that "The bankruptcy system, and each player in it, is served by putting an end to Countrywide's abuse of the claims process in bankruptcy and having accurate and easy to understand information sooner rather than later." Stay Mem. Op. at 10 (citing cases). The bankruptcy court's worksheet achieves this objective. Nor is Countrywide capable of monitoring itself to ensure compliance. The abatement of the bankruptcy court's remedial order ended on August 31, 2009, activating the requirement that Countrywide submit the court's worksheet with its proofs of claim. Not 48 hours later, Countrywide's local counsel submitted a proof of claim without the requisite information. In re Phillips, No. 09-53318 (N.D. Ohio filed Sept. 3, 2009) [Dkt #25] (withdrawing proof of claim). The filing was only withdrawn after the United States Trustee brought the problem to the attention of Countrywide's counsel. This incident indicates that Countrywide's system is still broken. Accurate record-keeping and filings are not optional. Remedy Mem. Op. at 6-7. The public interest will be served by insisting that Countrywide take a step towards reform by implementing the bankruptcy court's remedial order.

CONCLUSION

For the reasons given above, the United States Trustee respectfully requests that Countrywide's Motion for Stay be denied.

Respectfully submitted,
Daniel M. McDermott
United States Trustee
Region 9

/s/ Dean Wyman
Dean Wyman #0007848
Senior Trial Attorney
U.S. Department of Justice
Office of the U.S. Trustee
H.M. Metzenbaum U.S. Courthouse
201 Superior Ave., #441
Cleveland, Ohio 44114
(216) 522-7800 ext. 231 (direct dial)
(216) 522-7193 (facsimile)
Dean.P.Wyman@usdoj.gov

Certificate of Service

I certify I mailed a copy of the foregoing “Memorandum In Opposition To Stay Pending Appeal” on this 14th day of September, 2009 to counsel for Countrywide Home Loans, Inc.:

Robert C Folland, Esq.
Jeremy M Campana, Esq.,
Thompson Hine LLP
3900 Key Tower, 127 Public Square
Cleveland, OH 44114

and

Thomas A. Connop, Esq.
LOCKE LORD BISSELL & LIDDELL LLP
2200 Ross Avenue, Suite 2200
Dallas, Texas 75201

and

I hereby certify that on the 14th day of September, 2009, a copy of the foregoing pleading was filed electronically. Notice of this filing will be sent by operation of the Court’s electronic filing system to all parties indicated on the electronic filing receipt. Parties may access this filing through the Court’s system.

/s/ Dean Wyman
Dean Wyman

EXHIBIT 1

CASE NO.: 5:09MC82

In re Diane Elaine Barber, Main Case No. 03-40045 (Bankruptcy Judge Woods, available at www.ohnb.uscourts.gov, issued on July 24, 2009.

2009 JUL 24 PM 12:52
OHIO
YOUNGSTOWN

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF OHIO

IN RE: * CASE NUMBER 03-40045
*
DIANE ELAINE BARBER, * CHAPTER 7
*
Debtor. * HONORABLE KAY WOODS

****

SECOND ORDER REGARDING SHOW CAUSE APPEARANCE

****

The is the second order by this Court concerning Order to Appear and Show Cause ("Show Cause Order") (Doc. # 58), which the Court issued on April 23, 2009. The Show Cause Order directed one or more representatives of (i) Countrywide Home Loans, Inc. and Countrywide Home Loans Servicing, L.P. (collectively, "Countrywide"), and (ii) Carlisle, McNellie, Rini, Kramer & Ulrich, Co., L.P.A. ("Carlisle Firm") (Countrywide and the Carlisle Firm collectively, the "Show Cause Parties") to appear for a Show Cause Hearing ("Show Cause Hearing") on May 21, 2009, and show cause why they should not be sanctioned for (1) violating the Order Authorizing Compromise and/or (2) taking other unauthorized actions in the instant bankruptcy case. The Court held the Show Cause Hearing on May 21, 2009, at which the Show Cause Parties were represented by counsel.

Subsequent to the Show Cause Hearing, this Court issued Order Regarding Show Cause Appearance ("First Order") (Doc. # 60) on May 27, 2009. The First Order set forth the facts concerning the chapter 7 case filed by Diane Elaine Barber ("Debtor") and the adversary proceeding (Adv. Proc. 03-04162) against Countrywide concerning various causes of action relating to Countrywide's mortgage and Debtor's residence, which are incorporated herein by reference. The adversary proceeding resulted in a settlement that, among other things, required Debtor to deed her residence to Countrywide. Although Debtor took the required action and deeded the property to Countrywide, Countrywide, through the Carlisle Firm, filed Motion for Relief from Stay and Abandonment ("Motion for Relief") (Doc. # 50).

The First Order also directed the Show Cause Parties to "provide the Court with detailed, written confirmation of their proposed and/or implemented procedural changes" that were made or were being made in response to the Court's concerns regarding the Show Cause Parties' actions in filing the Motion for Relief. The Court requested such information to determine whether sanctions are warranted.

On June 19, 2009, the Show Cause Parties filed Response to May 27, 2009 Order Regarding Show Cause Appearance ("Response") (Doc. # 62), which contained the responses of Countrywide and the Carlisle Firm. The Carlisle Firm set forth its standard practice and stated that it had instituted an additional requirement for an attorney to review all cases associated with a particular bankruptcy case prior to filing a motion for relief from stay. The Carlisle Firm attributed its error in filing the Motion for Relief in this case to "human error" when the attorney handling the case "missed" the existence of the adversary proceeding that would have rendered the Motion for Relief moot and without substantive basis. (Resp. at 2.) Countrywide described its internal procedures when an adversary proceeding is filed, which require Countrywide's Case Management Group to inform its Bankruptcy Department about (i) the resolution of adversary proceedings, and (ii) any additional actions that may be required. Countrywide also attributed the fact that it transferred Debtor's loan back to its Bankruptcy Department and "neglected to service the loan in a manner consistent with the settlement" to "human error." (*Id.* at 3.)

I. LAW

Federal courts, including bankruptcy courts, have both statutory and inherent authority to impose sanctions upon parties for abuse of the litigation process. *Maloof v. Level Propane Gasses, Inc.*, 316 Fed. Appx. 373, 376 (6th Cir. 2008). "Federal Rule of Bankruptcy Procedure 9011, which is modeled upon Federal Rule of Civil Procedure 11, authorizes a bankruptcy judge to impose sanctions upon an attorney who has filed a motion that was not grounded in fact or warranted by existing law or a good faith argument for the extension, modification, or reversal of existing law."[1] *Ibid.* 11

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[1] Specifically, Rule 9011 provides:

> (b) Representations to the court. By presenting to the court (whether by signing, filing, submitting, or later advocating) a

U.S.C. § 105(a) also grants bankruptcy courts broad authority to enforce the U.S. Bankruptcy Code.[2] *In re Cabrera-Mejia*, 402 B.R.

> petition, pleading, written motion, or other paper, an attorney or unrepresented party is certifying that to the best of the person's knowledge, information, and belief, <u>formed after an inquiry reasonable under the circumstances</u>,--
>
> > (1) it is not being presented for any <u>improper purpose</u>, such as to harass or to cause unnecessary delay or needless increase in the cost of litigation;
> >
> > (2) the claims, defenses, and other legal contentions therein are warranted by existing law or by a nonfrivolous argument for the extension, modification, or reversal of existing law or the establishment of new law;
> >
> > (3) <u>the allegations and other factual contentions have evidentiary support</u> or, if specifically so identified, are likely to have evidentiary support after a reasonable opportunity for further investigation or discovery; and
> >
> > (4) the denials of factual contentions are warranted on the evidence or, if specifically so identified, are reasonably based on a lack of information or belief.
>
> (c) Sanctions. If, after notice and a reasonable opportunity to respond, the court determines that subdivision (b) has been violated, the court may, subject to the conditions stated below, impose an appropriate sanction upon the attorneys, law firms, or parties that have violated subdivision (b) or are responsible for the violation.
>
> > . . . .
> >
> > (2) Nature of sanction; limitations. <u>A sanction imposed for violation of this rule shall be limited to what is sufficient to deter repetition of such conduct or comparable conduct by others similarly situated</u>. . . . [S]anction may consist of, or include, directives of a nonmonetary nature, an order to pay a penalty into court . . . .

FED. R. BANK. P. 9011 (West 2008) (emphasis added).

[2] Section 105(a) provides:

> The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title. No provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, sua sponte, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, <u>or to prevent an abuse of process</u>.

335, 345-46 (Bankr. C.D. Cal. 2008). "In addition, all federal courts, including bankruptcy courts, have inherent powers to enforce their orders and judgments." *Id.* at 346.

Both Rule 9011 and 11 U.S.C. § 105(a) impose an affirmative duty upon attorneys appearing before a bankruptcy court.

> Attorneys and the parties they represent have a duty not to file, or cause to be filed, groundless or meritless claims. To this end, attorneys and their clients have an affirmative duty to conduct a minimal factual investigation into their allegations, in order to assure themselves and the court that a factual basis for their claims exists. By signing a motion, an attorney affirmatively represents to the court: (1) that the attorney has, in fact, conducted such an investigation, and (2) that a factual basis for the motion exists. When evidence contrary to his client's contentions is raised, an attorney may not simply rely on his client's word; rather, the attorney must independently assure himself that his client's claim is based on fact.

In re Thompson, No. 01-10399-RLJ-13, 2003 Bankr. LEXIS 2197, *3-4 (Bankr. N.D. Tex. April 8, 2003) (internal citations omitted). The test for imposing sanctions under Rule 9011 is whether the individual's conduct was reasonable at the time the motion was filed. *Maloof*, 316 Fed. Appx. at 376. *See also, Knowles Building Co. v. Zinni (In re Zinni)*, 261 B.R. 196 (6th Cir. 2001) ("Pursuant to Bankruptcy Rule 9011(b)(3), an attorney is certifying to the court that the factual allegations in a pleading have evidentiary support. 'The test for imposing Rule 9011 sanctions is whether the individual's conduct was reasonable under the circumstances.'" *Id.*

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11 U.S.C. § 105 (West 2008) (emphasis added).

at 203 (quoting *Mapother & Mapother, P.S.C. v. Cooper (In re Downs)*, 103 F.3d 472, 481 (6th Cir. 1996))).

Bankruptcy courts also "have the inherent power to impose sanctions on a scope broader than that of Bankruptcy Rule 9011, including monetary sanctions." *In re Zinni*, 261 B.R. at 203. Whereas statutory powers to grant sanctions reach "only certain individuals or conduct, the inherent power extends to a full range of litigation abuses." *Chambers v. NASCO, Inc.*, 501 U.S. 32, 46 (1991). The bankruptcy "court may sanction a party that causes to be filed, through its attorney, a motion that such party knew or should have known to be baseless or wholly unsupported by fact." *In re Thompson,* 2003 Bankr. LEXIS 2197 at *6. A "court has inherent authority to sanction an attorney or his client when such party has acted wantonly or in bad faith." *Ibid.*

II. ANALYSIS

Although this Court is cognizant that humans make errors, the instant circumstances are troubling because "human error" is the asserted cause for error by both Countrywide and its counsel. Further, there is nothing in the Response to suggest that, absent the Court's action in setting the Motion for Relief for hearing, either Countrywide or the Carlisle Firm would have found their mistake and withdrawn the motion. The Motion for Relief was filed on April 2, 2009, and it was withdrawn on April 10, 2009. Although the Motion for Relief was withdrawn eight days after it was filed, the withdrawal occurred *only after* this Court issued Notice of Hearing on April 3, 2009 (Doc. # 52), which set the Motion for Relief for hearing on April 16, 2009.

It appears that neither Countrywide nor the Carlisle Firm conducted even a minimal factual investigation before filing the Motion for Relief. In light of the fact that Countrywide owned the property that was the subject of the Motion for Relief, the loan should have been cancelled. Countrywide had actual knowledge that it had no basis whatsoever to seek relief from stay since the property was already deeded in its name.

The instant chapter 7 case, which was filed on January 6, 2003, was more than six years old when the Carlisle Firm filed the Motion for Relief. Debtor received a discharge on May 8, 2003 - six years ago. The age of this case and the long-ago discharge were readily apparent from the face of the PACER docket of Debtor's bankruptcy case.

In response to the Show Cause Order, the Carlisle Firm represents that it has imposed an additional requirement for its attorneys to take - *i.e.*, a review of all associated cases - before filing motions for relief from stay. This Court believes that review of all associated cases should be part of the standard review process; however, a review of the main case docket, alone, in the instant case would have alerted the Carlisle Firm that this case was exceedingly old. The age of this case and the date of discharge constituted "red flags" that should have given Countrywide and the Carlisle Firm pause before seeking relief from stay. Why would Countrywide require relief from stay in a chapter 7 case in which a discharge had been entered six years ago? The Carlisle Firm apparently made no inquiry at all to determine if relief from stay was appropriate.

Given that even cursory review by either of the Show Cause Parties would have prevented filing the groundless Motion for Relief, the claimed "human error" appears to rise to the level of systemic failure. Under the circumstances, there was nothing reasonable about the behavior of either Show Cause Party, and there was no possible proper purpose for filing the Motion for Relief. Further, the Court finds that both Countrywide and the Carlisle Firm acted wantonly and in bad faith. "Wanton acts include those that are reckless . . . . A reckless act includes one that is committed with disregard for the truth, especially when reasons to doubt the information's veracity are obvious." *In re Thompson*, 2003 Bankr. LEXIS 2197 at *8.

Both Show Cause Parties failed in their affirmative duty to the Court and to the process of justice. As such, this Court may impose sanctions "sufficient to deter repetition of such conduct or comparable conduct by others similarly situated." FED. R. BANKR. P.

9011 (West 2008). Other bankruptcy courts have imposed sanctions in response to similarly baseless filings: *In re Thompson*, 2003 Bankr. LEXIS 2197 (Bankr. N.D. Tex. April 8, 2003) (creditor and counsel jointly and severally liable for expenses, fees, and sanctions totaling $3,075.00 for single motion for relief); *In re Cabrera-Mejia*, 402 B.R. 335 (Bankr. C.D. Cal. 2008) (sanctions of $21,000.00 for 21 motions for relief); and *In re Haque*, 395 B.R. 799 (Bankr. S.D. Fla. 2008) (sanctions of $95,130.45 for 45 affidavits prepared by counsel and signed by creditor with no review).

This is not the first time Countrywide has appeared before a bankruptcy court for a baseless motion for relief from stay. In *In re Parsley*, 384 B.R. 138 (Bankr. S.D. Tex. 2008), Judge Jeff Bohm issued a forty-four page opinion outlining misrepresentations by Countrywide and its counsel (not the Carlisle Firm) regarding a motion for relief. In the *Parsley* case, Judge Bohm declined to assess sanctions, in the "hope that [Countrywide] would reevaluate its policies and procedures in order to improve upon the accuracy of payment histories and to ensure that its actions do not undermine the integrity of the bankruptcy system." *Id.* at 184. The bankruptcy court further stated that it "trust[ed] that . . . Countrywide will mend their broken practices." *Ibid.* Countrywide's current conduct demonstrates that it has not heeded Judge Bohm's warning.

In light of all of the above, this Court finds that monetary sanctions against Countrywide and the Carlisle Firm are appropriate. This Court hereby imposes a sanction in the amount of Three Thousand Dollars ($3,000.00) as an appropriate and least severe sanction to deter further such acts by Countrywide and the Carlisle Firm. Countrywide and the Carlisle Firm are jointly and severally liable for this sanction, which is payable to the Clerk of Court within ten (10) days after entry of this Order.

IT IS SO ORDERED.

Kay Woods

HONORABLE KAY WOODS
UNITED STATES BANKRUPTCY JUDGE

EXHIBIT 2

CASE NO.: 5:09MC82

Daniel M. McDermott, United States Trustee v. Countrywide Home Loans, Adv. No. 08-5031 (Bankruptcy Judge Shea-Stonum, unpublished but available at www.ohnb.uscourts.gov, 5/1/09).

IT IS SO ORDERED.

Dated: 04:59 PM May 01 2009

Marilyn Shea-Stonum
MARILYN SHEA-STONUM JZ
U.S. Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

IN RE:	)	CASE NO. 07-51027
	)	
Marlynn R. O'Neal,	)	CHAPTER 13
	)	
DEBTOR.	)	
	)	
Daniel M. McDermott, United States Trustee for Region 9,	)	ADVERSARY NO. 08-5031
	)	JUDGE MARILYN SHEA-STONUM
PLAINTIFF,	)	
	)	
vs.	)	
	)	
Countrywide Home Loans,	)	**MEMORANDUM OPINION**
	)	
DEFENDANT.	)	

This proceeding is before the Court on the complaint of the United States Trustee alleging that Countrywide Home Loans[1] engaged in conduct that abused the judicial process.

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[1] Bank of America recently acquired Countrywide Financial. On April 28, 2009, I heard on national news that Bank of America Corp. planned to retire the "Countrywide" name. According to the news report, the "Countrywide" operations will be combined with the bank's mortgage operations and will be

The United States Trustee requests that this Court enter an order pursuant to 11 U.S.C. § 105(a) and Local Bankruptcy Rule 2090-2 imposing monetary sanctions against Countrywide and enjoining Countrywide from engaging in bad faith and abusive practices in connection with its preparation, verification, filing and prosecution of pleadings and proofs of claim in bankruptcy cases.

The Court held a trial in this proceeding on April 24, 2009. Appearing at the trial were Dean Wyman and Paul Randel, counsel for the United States Trustee, and Thomas Connop, Robert Folland and Jeremy Campana, counsel for Countrywide. During the trial the parties presented evidence in the form of exhibits and testimony from John Smith, Ted McClatchey, Jacob Wilhite, Donald Gaines, Ryan Kay, Jerry Edmunds, and Robert Whittington.

In addition, prior to the trial, counsel filed a list of facts which they agree are not in dispute [docket # 68] (the "Stipulations"). At the conclusion of trial, counsel agreed to the admission of Countrywide Exhibits A-Q, T, W-AA, and CC-AAA, and UST Exhibits 1-30. The Court admitted UST Exhibit 31 over the objection of Countrywide's counsel.

JURISDICTION

This proceeding arises in a case referred to this Court by General Order No. 84 entered in this district on July 16, 1984. It is determined to be a core proceeding pursuant to 28 U.S.C. §§ 157(b)(2)(A), (B) and (O) over which this Court has jurisdiction pursuant to 28 U.S.C. § 1334.

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known by the name "Bank of America Home Loans."

FINDINGS OF FACT

1. On or about May 8, 2004, Marlynn R. O'Neal executed a mortgage (the "Mortgage") in favor of Ameriquest Mortgage Company in the amount of $69,300.00. The Mortgage was filed with the Summit County Fiscal Officer on or about May 18, 2004, under recording number 55049953. The real estate subject to this mortgage is located at 327 Ira Avenue, Akron, Ohio and is referred to herein as the "Property". *See* Stipulations.

2. On or about May 8, 2004, Marlynn R. O'Neal executed a "Fixed Rate Note" (the "Note") in favor of Ameriquest Mortgage Company in the amount of $69,300.00. *See* Stipulations.

3. Under a "Pooling and Servicing Agreement" dated as of September 1, 2004, between Park Place Securities, Inc., Depositor; Countrywide Home Loans Servicing LP, Master Servicer; and Wells Fargo Bank, N.A., Trustee, Countrywide Home Loans Servicing, LP agreed to service loans in accordance with the terms of the respective mortgage loans. Article III, Section 3.01, p. 72. *See* Stipulations.

4. Countrywide Home Loans and/or Countrywide Home Loans Servicing, LP serviced Ms. O'Neal's loan evidenced by the Note and Mortgage. *See* Stipulations.

5. On or about April 7, 2005, a "Complaint for Money, Foreclosure, and Other Equitable Relief" was filed in the Court of Common Pleas of Summit County, Ohio (the "Foreclosure Action"). The plaintiff in the Foreclosure Action was "Wells Fargo Bank, N.A. For The Benefit of the Certificateholders of Asset-Backed Pass-Through Certificates, Series 2004-MCW1 c/o Countrywide Home Loans, Inc. 6400 Legacy

Drive Plano Tx. 75024." The defendants were Marlynn R. O'Neal aka Marilynn Renee O'Neal and "Unknown Spouse, if Any, of Marlynn R. O'Neal aka Marilynn Renee O'Neal." The plaintiff was represented by the law firm of Maguire & Schneider, L.L.P. ("M&S") through attorneys Jerry L. Kaltenbach and Manbir S. Sandhu. *See* Stipulations.

6. In the Foreclosure Action, the plaintiff sought to foreclose upon the Property. *See* Stipulations.

7. In response to an unsolicited mailing from Faith Financial Group of Ohio, LLC ("Faith Financial") promising help to homeowners facing foreclosure, Ms. O'Neal contacted Jacob Wilhite ("Mr. Wilhite"), one of the owners of Faith Financial. Faith Financial had obtained Ms. O'Neal's address from the files of the state court in which the Foreclosure Action was filed.

8. Mr. Wilhite follows the real estate investing system taught in seminars given by Louis Brown of Georgia. Mr. Wilhite established Faith Financial to implement the techniques he learned after attending one of those seminars.

9. Under the guise of helping her, Mr. Wilhite talked Ms. O'Neal into giving him authority to contact Countrywide on her behalf. *See* Countrywide Exhibit DD. Mr. Wilhite testified that from the outset his goal was to get Countrywide to accept a short sale and then sell the property to a third party for more.

10. At some point, Mr. Wilhite offered the Property for sale at a meeting of the Akron Canton Real Estate Investment Association. Mr. Edmonds, Jr. approached Mr. Wilhite and said he had a buyer for the Property.

11. On July 13, 2005, Mr. Wilhite, on his own behalf, tendered a proposal to Countrywide, offering to purchase the Property from Marlynn O'Neal for an aggregate purchase price of $5,000.00, subject to satisfaction of the Mortgage. *See* Countrywide Exhibit WW.

12. On or about August 17, 2005, Countrywide countered Mr. Wilhite's short payoff offer requesting a minimum payoff amount of $13,000.00. *See* Countrywide Exhibit YY.

13. Mr. Wilhite tendered a Standard Real Estate Purchase and Sale Agreement to Countrywide, representing he was the Buyer for the Property and Marlynn O'Neal was the Seller, for a total purchase price of $13,000.00.

14. On September 13, 2005, Countrywide approved the short payoff offer submitted by Mr. Wilhite to satisfy Marlynn O'Neal's loan for $13,000.00. *See* Countrywide Exhibit YY pg. 11. Mr. Smith testified that in some circumstances, Countrywide, as a servicer, does not have authority to accept short sales. However, in this case, he testified Countrywide had "delegated authority" from its investor, Wells Fargo,[2] to negotiate and accept a short sale.

15. Mr. Wilhite represented to Countrywide that the closing of this short payoff sale would occur on or about October 13, 2005.

16. In the meantime, Mr. Wilhite caused the Debtor to sign additional documents.

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[2] Mr. Smith continually referred to Wells Fargo as its "investor." The Court believes the relationship between Wells Fargo and Countrywide is described better as a customer relationship: Countrywide provided services to its customer Wells Fargo and Wells Fargo acted as trustee for the ultimate holders of the mortgagee's rights under the Mortgage and Note.

Debtor, as "Beneficiary", and Faith Financial as "Trustee of the 327 Ira Ave Residential Land Trust" signed a "Land Trust Agreement"prepared by Mr. Wilhite. *See* Stipulations. In addition, the Debtor executed and delivered to Faith Financial an "Assignment of Beneficial Interest in Land Trust", prepared by Mr. Wilhite, conveying all her "rights, powers, privileges, and beneficial interest" under the Land Trust Agreement to Faith Financial. *See* Stipulations. The Debtor also executed a "Standard Warranty Deed" purporting to transfer the Property to the "327 Ira Ave Residential Land Trust, Faith Financial Group of Ohio LLC as Trustee." The Standard Warranty Deed recited it was supported by consideration in "the sum of Ten Dollars ($10.00) and other valuable consideration." The Court doubts, based on Mr. Wilhite's testimony, that that any consideration was actually tendered to the Debtor by either "327 Ira Ave Residential Land Trust," Faith Financial, or Mr. Wilhite.

17. The purported conveyance of the Property by the Debtor to "327 Ira Ave Residential Land Trust" was not disclosed to Countrywide by Marlynn O'Neal, Faith Financial, or Mr. Wilhite. This deed was recorded on or about September 19, 2005, with the Summit County Fiscal Officer under recording number 55235443.

18. On September 19, 2005, Mr. Wilhite, as "Agent of Faith Financial Group of Ohio, LLC as Trustee" caused to be filed with the Summit County Fiscal Officer, under recording number 95157756, a "Statement of Reason for Exemption from Real Property Conveyance Fee" regarding the transaction referenced in the September 14, 2005 Standard Warranty Deed. *See* Stipulations. According to the "Statement of Reason for Exemption from Real Property Conveyance Fee," the purported

conveyance of the Property to "Faith Financial as Trustee" was represented to be "exempt from the fees required by division (F)(3) section 319.54 of the Revised Code of Ohio, for the reason checked below." The reason checked by Mr. Wilhite was because the transfer was: "to a trustee of a trust, when the grantor of the trust has reserved an unlimited power to revoke the trust." Other than its filing in the public records, the "Statement of Reason for Exemption from Real Property Conveyance Fee" was not disclosed to Countrywide by Marlynn O'Neal, Faith Financial, or Mr. Wilhite.

19. On or about October 11, 2005, Marlynn R. O'Neal executed a "Warranty Deed" in which deed the grantor is listed as the "327 Ira Avenue Land Trust, Faith Financial Group of Ohio, LLC, Trustee" and the grantee is identified as "Donald Gaines." The real estate subject to this deed is located at 327 Ira Avenue, Akron, Ohio. The deed was recorded with the Summit County Fiscal Officer on or about February 6, 2006 under recording number 52285575. Mr. Gaines paid $70,000.00 for the transfer of this real estate. *See* Stipulations.

20. The fact Donald Gaines was the purchaser of the Property was not disclosed to Countrywide prior to closing by Marlynn O'Neal, Faith Financial, or Mr. Wilhite.

21. On or about October 11, 2005, Bankers Title & Escrow Agency, Inc. ("Bankers Title"), as Settlement Agent, received $70,006.19 in deposits for the conveyance of the Property to Donald Gaines. Jared Pauley was the agent from Bankers Title responsible for this transaction. Bankers Title distributed the proceeds from the sale as set forth on Countrywide Exhibit JJ.

22. Based on Mr. Wilhite's remark that "If Ms. O'Neal was in foreclosure and she was losing the property anyways, why would she want any money from it?" the Court believes that Ms. O'Neal did not receive any of the proceeds from the sale.

23. In contrast, Faith Financial received $15,000. Countrywide Exhibit II. Easy Home Construction, a company owned by Mr. Edmonds, received $33,333.01. Countrywide Exhibit NN. Easy Home Construction did not perform $33,000 worth of work on the Property. Bankers Title received $5,037.50. Countrywide Exhibits MM and OO.

24. Countrywide received $13,000 from the sale of the Property. *See* Countrywide Exhibit JJ. Bankers Title did not request a lien release from Countrywide. At the conclusion of its "claims process," Countrywide paid $5,700 of these proceeds to Wells Fargo and retained the balance for fees that it claimed under the Servicing Agreement.

25. Countrywide's files contain two copies, sent to it by facsimile, of what purport to be HUD-1 Statements showing a contract sale price for the Property of $13,000 and not listing any of the settlement amounts disbursed by Bankers Title. The last page of these documents bear the signatures of Marlynn O'Neal and Donald Gaines. Based on the testimony of Donald Gaines, the Court doubts whether the first two pages, as they appear in Countrywide's files, were attached to the third page at the time it was signed. *See* Countrywide Exhibits UU and VV.

26. Presumably the original HUD-1 Statements would be contained in Bankers Title's closing file. However, the closing file at Bankers Title pertaining to this matter is missing. Mr. Kay testified that the records of Bankers Title reflect the existence of a closing file, but a notation in the records shows possession of the file was given to

"Madelyn O'Neal for copies."

27. On or about October 28, 2005, Kevin Kilker at Countrywide Home Loans, Inc. acknowledged receipt of the payoff amount in the amount of $13,000.00, and sent a closing note to Countrywide Home Loans, Inc. personnel. The workout status on Countrywide Home Loans, Inc.'s records was also changed to closed. UST Exhibit 15, "CHL-ONEAL 001186." Mr. Kilker further instructed Deanna to "issue a reconveyance on this short sale" and he instructed Kristin to "update the borrower's credit report." UST Exhibit 16, "CHL-ONEAL 001482." Countrywide Home Loans, Inc. did not cause any notation to be made on the Note showing that it had been paid in full. UST Exhibit 2.

28. On January 18, 2006, a "Notice of Dismissal" was filed in the Foreclosure Action. M&S through attorney Manbir S. Sandhu filed this notice. *See* Stipulations.

29. Following Countrywide's acceptance of the short sale funds, Ms. O'Neal's loan account was not properly coded to indicate within Countrywide's records that the loan was inactive. Countrywide continued to send statements to Ms. O'Neal, to cause forced placed insurance to be in place, purportedly had the lawn mowed, and purportedly did drive by inspections of the property even after accepting the short sale.

30. Mr. Smith testified that "Lock Out Code 3" was assigned to Ms. O'Neal's loan account signifying a property has been foreclosed upon or conveyed to a third party. However, the account remained active on Countrywide's system because the "claims process" between Countrywide and Wells Fargo had not been completed.

31. Ms. O'Neal contacted Countrywide many times following its acceptance of the short sale to inquire why she was continuing to get bills from Countrywide. Countrywide's AS 400 system reflects these inquiries. *See, e.g.,* UST Exhibit 17.

32. In response to the inquiry from Ms. O'Neal on April 24, 2006, Samuel Cooper of Countrywide Home Loans, Inc. sent an e-mail to Pedro Elizalde and Kristin Bradley of Countrywide Home Loans, Inc. in which he stated:

"Hello, H/O [homeowner] called in wanted to know why she is still getting bills for mort payments. Loan notes showed we recvd funds for approved SPO but loan is still opened on the books. Can one of you look into this?"

UST Exhibit 18, "CHL-ONEAL 001622"

33. On April 24, 2006, Kristin Bradley of Countywide Home Loans, Inc. sent an e-mail to Kevin Kilker, with a copy to Samuel Cooper and Pedro Elizalde under the caption in part: "Loan . . . SPO Sale Loan still open" in which she stated:

"This shortsale was completed back in October 05 but the homeowner is still receiving bills for mortgage payments. Do you know if there is a way to fix this? Please let me know as soon as possible.

UST Exhibit 19, "CHL-ONEAL 001623"

34. On April 24, 2006, Kevin Kilker of Countywide Home Loans, Inc. sent an e-mail to Sarah Galvan of Countrywide Home Loans, Inc. under the caption: "Fw Loan . . . . SPO Sale Loan still open," in which he stated:

"Sarah. Do you know how to prevent this?

UST Exhibit 20, "CHL-ONEAL 001624"

35. On April 28, 2006, Kristin Bradley of Countrywide Home Loans, Inc., reviewed the O'Neal loan and noted "fees due still pending. will f/u [follow up]." Plaintiff UST

Exhibit 22 , "CHL-ONEAL 001265."

36. On August 29, 2006, Ms. O'Neal telephoned Countrywide Home Loans, Inc. She spoke to Porshi Jones. The notes of this call reflect:

> Mrs. states her loan should be paid off. States she completed a short sale. Notes show the last pay off demand was in Feb. At this time chl does not show funds received for the payoff. Called Jacob on 3 way at 330-310-4310. states we should speak with Jarod from Banker Title & Trust at 216-421-9999. left a message for mr to call back mrs and 3 way me. Gave my contact info.

UST Exhibit 23. "CHL-ONEAL 001271.

37. On September 9, 2006, Ms. O'Neal had a telephone conversation with Jarrett Silva of Countrywide Home Loans, Inc. The notes of this call state:

> "H/O STATED THAT SHE SOLD THE H/O BACK ON OCT 14, 2005 . . . STATED THAT SHE IS CURRENTLY HAVING THE PAPER WORK SENT TO CHL TO HAVE MATTER CLEARED UP . . .

UST Exhibit 24, "CHL-ONEAL 001275."

38. On November 12, 2006, Ms. O'Neal had a telephone conversation with Casey Ford of Countrywide Home Loans, Inc. The notes of this call state:

> "mrs std she has sold this prop a while ago, infrmd I don't see we rcvd pyoff, std she alrdy workd this out with someone, std she spoke with someone here with the title co on 3 way a while ago and they resolvd, infrmd I don't see it has been rslvd, per those notes the person from the title co was supposed to cll bck with info on the pyoof and we never rcvd a cll bck, infrmd she needs to get info togthr from pyoff so we can rsrch bcaus it is affctng her crdt, mrs std she would see wat she can do . . ."

UST Exhibit 25, "CHL-ONEAL 001282."

39. On November 14, 2006, Ms. O'Neal had a telephone conversation with Porshi Jones of Countrywide Home Loans, Inc. The notes of this call state:

"mrs. called to verify the property has been sold and paid off with chl. Advised at this time the loan is still showing active. Jacob never called back with the wiring information to show the loan paid off. Called on 3 way office is not open. Mrs. will call back as soon as the office opens left message for Mr to call me back."

UST Exhibit 26, "CHL-ONEAL 001283."

40. On December 6, 2006, Ms. O'Neal had a telephone conversation with Porshi Jones at Countrywide Home Loans, Inc. The notes of this call state:

"States this loan was paid off 10/14/2005. Sending the proof of bank wire and the loa. Sent lotus note to S. Galvan to get a status update."

UST Exhibit 27, "CHL-ONEAL 001287."

41. On December 11, 2006, Kristin Bradley sent an e-mail to Sarah Galvan, with copies to Jomo Kenyatta, Peter Otero and Porshi Jones under the caption "Re . . . Short Sale, O'Neal, P. Otero" in which she stated:

I updated everything to reflect as a shortsale, I'm just waiting for investor reimbursement for supplemental fees. Hopefully it will be fully closed out by the end of the year.

UST Exhibit 28, "CHL-ONEAL 001626, 001627, and 001628.

42. On December 11, 2006, Ms. O'Neal had a telephone conversation with Porshi Jones at Countrywide Home Loans, Inc. The notes of this call state:

"Called Mrs advised the short sale was completed in 10/2005. Advised waiting for investor information before the loan could be closed. It should be closed out by the end of the year. Advised will submit credit correction from October 2005-to 12/2006. Attempted to submit credit correction, System shows not reported. will no change status."

UST Exhibit 29, "CHL-ONEAL001288."

43. On February 8, 2007, Wendy Scharf of Countrywide Home Loans, Inc. noted in the

Countrywide system that she had "reviewed loan, suppl funds still pending." UST Exhibit 30, "CHL-ONEAL 001299."

44. Notwithstanding these repeated inquiries, Countrywide did not properly correct its records to show that Countrywide had accepted $13,000 in full satisfaction of Ms. O'Neal's loan.

45. Ultimately, the claim process concluded resulting in over $7,000 in fees being attributed to Countrywide and less than $6,000 of the $13,000 payment being attributed to Wells Fargo.

46. On or about April 10, 2007, Marlynn R. O'Neal filed a voluntary petition for relief under chapter 13 of the Bankruptcy Code with the United States Bankruptcy Court for the Northern District of Ohio. She was represented by Robert M. Whittington, Jr. Under the fee agreement between Mr. Whittington and the Debtor, the Debtor promised to pay $2,000 through her plan for basic bankruptcy services.

47. Along with the petition, Ms. O'Neal also filed schedules and a statement of financial affairs. Ms. O'Neal did not identify owning any real estate in "Schedule A" because at the time she filed her bankruptcy case, she did not hold record title to the Property. In her "Statement of Financial Affairs, Ms. O'Neal identified a transfer on September 15, 2005 of real estate located at 327 Ira Avenue, Akron, Ohio to the "Faith Financial Trust dba 327 Ira Ave. Residential Land Trust." Statement of Financial Affairs, response to question number 10(a). Ms. O'Neal did not list any other transfers in her "Statement of Financial Affairs."

48. Ms. O'Neal appropriately did not schedule Countrywide Home Loans Inc.,

Ameriquest Mortgage Company or Wells Fargo Bank as creditors.

49. Although not listed as a creditor, Countrywide somehow became aware of the Debtor's bankruptcy case. Notwithstanding the acceptance of a short sale and the alleged designation of Ms. O'Neal's loan account as "Lockout Code 3," and the numerous entries in the loan history kept by Countrywide revealing that Ms. O'Neal's loan account was only open because the "claims process" was incomplete, a "bankruptcy technician" at Countrywide referred Ms. O'Neal loan account to M&S for the purpose of representing Countrywide in Ms. O'Neal's bankruptcy case.

50. Although all of the details of the arrangement were not provided to the Court, generally Countrywide and M& S had an arrangement whereby emails would be sent to M&S identifying new matters. Instructions for the scope of the representation with respect to the matter would be contained in the email and documents deemed by Countrywide to be relevant to the representation would be made available on a business partner web site. The documents made available by Countrywide are automatically uploaded to the website upon initiation of the referral. Apparently under Countrywide's standard operating procedures, no Countrywide employee is expected to review the documents or the file to determine whether the documents being made available are sufficient or accurate.[3] The attorneys to whom the matters

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[3] Mr. Smith testified that the placement of Lock Out Code 3 on Ms. O'Neal's loan account should have resulted in the bankruptcy technician reviewing the file and escalating it to management for further review. In this case, however, as seems consistent with Countrywide's inability to correctly follow its internal operating procedures with respect to Ms. O'Neal's loan account, the bankruptcy technician purportedly did not review the file or escalate it to management. Instead, the

are referred don't have access to any other documents through the website.

51. In this case, Ms. O'Neal's loan account was referred to M&S by email instructing M&S to file a proof of claim and objection to confirmation on behalf of Countrywide, as servicer. The Mortgage and Note were made available to M&S on the business partner web site. The loan history, including the notes captured by Countrywide's AS 400 system, were not.

52. On May 1, 2007, a Proof of Claim was filed in Ms. O'Neal's bankruptcy case on behalf of Wells Fargo Bank, N.A. by Ted P. McClatchey, Esq., then an associate with the law firm of M&S. At the time he filed the Proof of Claim Mr. McClatchey had not reviewed the foreclosure file in his law firm. He only reviewed those documents made available on the business partner web site.

53. The Proof of Claim form indicates that the name and address where notices should be sent is:

Wells Fargo Bank, N.A.
c/o Countrywide Home Loans, Inc.
7105 Corporate Drive, PTX B-209
Plano, TX 75024

The "Proof of Claim" states that the amount of $88,859.06 was due at the time the case was filed and that the amount of $88,859.06 represented a secured claim. The collateral purportedly securing the claim was described as the Property and the "Proof of Claim" states that there was a pre-petition arrearage in the amount of $19,474.30. The Proof of Claim further stated in paragraph 6 that "The amount of all payments on

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bankruptcy technician referred the matter directly to an attorney.

this claim has been credited and deducted for the purpose of making this proof of claim." UST Exhibit 8-1.

54. Exhibit A to the "Proof of Claim" consists of a "Proof of Claim Calculation." This attachment alleges that the principal balance owed was in the amount of $69,111.76 and that there were 28 payments in the amount of $696.55 each, for an arrearage of $19,503.40. This exhibit alleges that the total amount due is $88,859.06. UST Exhibit 8-2.

55. A copy of the Note was attached to the Proof of Claim.

56. A copy of the Mortgage was also attached to the Proof of Claim.

57. No assignment or other evidence of transfer of the Note and Mortgage from Ameriquest Mortgage Company was attached to the Proof of Claim.

58. Ted P. McClatchey also filed an "Objection To Confirmation of Chapter 13 Plan" (the "Objection to Confirmation") on behalf of Countrywide Home Loans, Inc. UST Exhibit 9. The Objection to Confirmation asserts that the Debtor's plan fails to properly provide for its secured claim.

59. The debtor, through her attorney Robert M. Whittington, Jr. filed a response to the Objection to Confirmation and an "Objection To Allowance of Claim" (the "Claim Objection"). UST Exhibit 10 and 11, respectively. The debtor stated that she conveyed the Property on September 14, 2005 and that Countrywide Home Loans, Inc. "accepted a short-sale payment of $13,000.00 in satisfaction of its interest" in the Property and that Countrywide Home Loans, Inc. was paid out of escrow from the sale.

60. On June 6, 2007, the Court entered an "Order Sustaining Objection to Allowance of Claim." Doc. 27. On June 6, 2007, Countrywide Home Loans, Inc. withdrew the Objection to Confirmation. Doc. 28

61. On June 18, 2007, the Court confirmed debtor's plan. Doc. 30

62. In March 2008, Ms. O'Neal passed away.

63. It was not until July 25, 2008 that an assignment was filed with the Summit County recorder's office showing an assignment from "Ameriquest Mortgage Company" to "Wells Fargo Bank N.A. For The Benefit of Certificate Holders of Asset-Backed." The recording number for this document is 55560031. This assignment is dated June 30, 2008. The mortgage that is the subject of this assignment is the mortgage in favor of Ameriquest Mortgage Company executed by the debtor on or about May 8, 2004. This assignment includes the provision that the mortgage is assigned:

> Together with the Note or Notes therein described or referred to, the money due or to become due thereon with interest, and all rights accrued or to accrue under said Mortgage.

UST Exhibit 31.

DISCUSSION

The findings of fact in this case plainly give rise to many additional questions and issues, only some of which are germane to the dispute pending before this Court. The dispute before the Court centers around the acts of Countrywide that ultimately resulted in the filing of a proof of claim and objection to confirmation in Ms. O'Neal's bankruptcy case that had no basis in fact.

The UST argues that Countrywide Home Loans, Inc. was reckless and acted in bad faith in this case. He points to (1) the filing of a Proof of Claim and Objection To Confirmation of Plan when Countrywide knew that it had accepted a short-sale payoff from Ms. O'Neal in October, 2005; (2) the filing of the Proof of Claim and Objection To Confirmation even though Ms. O'Neal had telephoned Countrywide Home Loan, Inc. repeatedly in 2006 to complain of ongoing receipt of statements showing a growing delinquency after that short sale closing; (3) the filing of the "Proof of Claim and Objection To Confirmation of Plan on behalf of Wells Fargo, N.A. when there had been no assignment of mortgage filed with the Summit County Fiscal Officer of the Mortgage from Ameriquest Mortgage Company to Wells Fargo Bank, N.A. Trustee Wells Fargo Bank, N.A., under that certain Servicing Agreement relating to Park Place Securities, Inc., 2004-MCW1 Asset Back Pass Through Certificates, Series 2004-MCW1 prior to the filing of the Proof of Claim and Objection To Confirmation were filed by Countrywide Home Loans, Inc.; (4) the incorrect statement made by Countrywide Home Loans, Inc. in the Proof of Claim when it stated that all credits had been deducted from the amount it said was owed; and (5) the filing of the satisfaction of Ms. O'Neal's mortgage on or about July 25, 2008 when Countrywide Home Loans, Inc. had accepted the short- sale payoff in October, 2005. Countrywide denies that these acts are evidence of reckless, intentional or bad faith behavior. In addition, Countrywide denies a systemic problem. Countrywide suggests that at most is was negligent and that its errors are off set by Ms. O'Neal's involvement with Faith Financial.

It is undisputed that the Court has inherent authority to sanction a party. *Red Carpet Studios Division of Source Advantage v. Sater*, 465 F. 3d 642, 645 (6th Cir. 2006), *reh'g denied* January 17, 2007; *In re Workman*, 392 B.R. 189, 194 (Bankr. D.S.C. 2007)(Court has inherent authority to sanction party).

> Federal courts, including bankruptcy courts, have inherent and statutory authority to impose sanctions upon parties for their abuse of the litigation process. *See Rathbun v. Warren City Schools (In re Ruben)*, 825 F.2d 977, 982-84 (6th Cir.1987). In particular, 28 U.S.C. § 1927 provides that "[a]ny attorney or other person admitted to conduct cases in any court of the United States or any Territory thereof who so multiplies the proceedings in any case unreasonably and vexatiously may be required by the court to satisfy personally the excess costs, expenses, and attorneys' fees reasonably incurred because of such conduct." Likewise, Federal Rule of Bankruptcy Procedure 9011, which is modeled upon Federal Rule of Civil Procedure 11, authorizes a bankruptcy judge to impose sanctions upon an attorney who has filed a motion that was not grounded in fact or warranted by existing law or a good faith argument for the extension, modification, or reversal of existing law.[fn omitted] *See* Fed. R. Bankr.P. 9011(b)-(c). The test for imposing such sanctions is "whether the individual's conduct was reasonable under the circumstances." *In re Downs*, 103 F.3d at 481; *see also Ruben*, 825 F.2d at 984 ("[T]he standard for section 1927 determinations in this circuit is an objective one, entirely different from determinations under the bad faith rule.... There must be some conduct on the part of the subject attorney that trial judges, applying the collective wisdom of their experience on the bench, could agree falls short of the obligations owed by a member of the bar to the court and which, as a result, causes additional expense to the opposing party."). In applying this test, the bankruptcy court should not rely on the benefit of hindsight, but rather should assess the party's conduct by what was reasonable to believe at the time the motion was submitted. *In re Downs*, 103 F.3d at 481 (quoting *McGhee v. Sanilac County*, 934 F.2d 89, 93 (6th Cir.1991)).

Maloof v. Level Propane Gasses, Inc. (In re Level Propane Gasses, Inc.), 2008 WL 2952779 (6th Cir. July 30 2008); *see also Followell v. Mills, 2009 WL 723132* (6th Cir. March 18, 2009) (finding bad faith is not a prerequisite to an award of sanction under either Rule 9011 or § 1927 and reckless conduct to be sufficient to support such an award). Rule 9011(c) provides the Court with the ability to sanction the party responsible for the Rule 9011(b) violation. Fed. R. Civ. P. 9011(c) ("If after notice and a reasonable opportunity to respond, the court determines that subdivision (b) has been violated, the court may ... impose an appropriate sanction upon the attorneys, law firms, or parties that have violated subdivision (b) or are responsible for the violation.")

> [C]ourts have utilized their inherent authority to prevent and sanction abuses of judicial power. *See In re Courtesy Inns, Ltd.*, 40 F.3d at 1090 (bankruptcy court had inherent authority to sanction debtor's president for bad faith filing of bankruptcy petition); *Engel v. Bresset (In re Engel)*, 246 B.R. 784, 789-90 (Bankr.M.D.Pa.2000)(§ 105 authorizes bankruptcy court to exercise its inherent powers to sanction attorney's bad faith filing of inaccurate schedules); *First Fed. Sav. and Loan Ass'n of Largo v. Froid (In re Froid)*, 106 B.R. 293, 296 (Bankr.M.D.Fla.1989) (power to correct abusive practices acknowledged but no sanctions entered against creditor who filed and prosecuted discharge complaint); *Mortgage Mart, Inc. v. Rechnitzer (In re* Chisum), 68 B.R. 471, 473 (9th Cir. BAP 1986) (recognizing power of bankruptcy court to impose sanctions on parties and counsel who willfully abuse the judicial process, but not finding sanctions appropriate against debtor and his attorney for their repeated bankruptcy filings).

Kerney v. Capital One Financial Corp. (In re Sims), 278 B.R. 457, 481 (Bankr. E.D. Tenn. 2002) (finding a complaint alleging a creditor "knowingly and willingly" and "systematic[ally]" filed claims in excess of the amounts to which it was entitled in chapter 13 proceedings nationwide withstands motion to dismiss); *see also In re Kilgore*, 253 B.R. 179 (Bankr. D.S.C. 2000) (Court imposed sanctions under Fed. R. Bankr. P. 9011 and 11 U.S.C. § 105 upon mortgagee which Court noted was sophisticated creditor. The basis for the sanctions was inaccurate representations by creditor in support of motion for relief from stay); *In re Fagan*, 376 B.R. 81 (Bankr. S.D.N.Y. 2007)(Court imposed sanctions even though creditor withdrew motion for relief from stay).

The test for imposing such sanctions is "whether the individual's conduct was reasonable under the circumstances," or was reckless. *See In re Downs*, 103 F.3d at 481; *Ruben*, 825 F.2d at 984; and *Followell v. Mills*, 2009 WL 723132. A party is reckless when it "knows, or has reason to know . . . of facts which create a high degree of risk of . . . harm to another, and deliberately proceeds to act, or fail to act, in conscious disregard of, or indifference to, that risk." *Exxon Shipping Company v. Baker*, 128 S. Ct. 2605, 2622, 171 L. Ed. 2d 570, 76 U.S. 4603 (2008)(quoting with approval from 2 Restatement (Second) Torts, Section 550, Comment a, pp. 587-588). Countrywide's system is reckless. It appears to me designed to allow each actor in the process to act with indifference to the truth, and to rely solely on the limited information made available at each step. It is no defense that the actors in the process made mistakes, the system allows those mistakes to be hidden from the view of the next actor in the chain; thereby encouraging this type of error, or at a minimum, delaying the discovery of these errors. The errors in this case were plentiful, from the failure to properly account for the receipt of short sale funds to the failure to correctly identify the holder of the Note and Mortgage. They evidence Countrywide's disregard for diligence and accuracy. The cumulative impact of each of the errors in this case rises to the level of sanctionable conduct in this case.

Regular players in the system, like Countrywide, regardless of the name under which they do business, should be able to (and should be required to) maintain accurate records and provide their counsel with information capable of being relied upon. *See* 253 B.R. at 190-191 (The broad language of § 105, granting bankruptcy courts the power to prevent abuse of the judicial process, encompasses the court's authority to sanction a creditor for its misconduct in providing its attorney with incorrect information.). In the context of matters relating to the automatic stay, the bankruptcy court in the District of South Carolina sanctioned a creditor for failure to maintain and provide accurate information to counsel. *Id.*

> The court must expect that parties, especially sophisticated creditors, base such motions on a proper factual basis and at least accurately represent the

> state of their own records. More and more frequently, in these days of national lenders and frequent assignments of notes and mortgages, this Court is confronted with creditors who file relief from stay motions asserting that debtors are in arrears when in fact, after a reasonable inquiry, it appears that they are current in their payments. Such a lack of diligence by the creditors is not only a problem for the Court and the debtors, who can not only least afford the additional costs in attorney's fees but whose reorganization in some cases is dependent upon the retention of the collateral which is the subject of such motions, but is also even a problem for the creditors' attorneys that file these motions. To effectively be able to prosecute these motions and represent the truth of the matter alleged, these attorneys must be able to rely upon their clients and the information provided to them.
>
> *In re Asbill*, C/A No. 98-05819-W (Bankr.D.S.C.02/01/1999); aff'd C/A No. 3:99-0773-19 (D.S.C.02/23/2000).

With respect to Countrywide's argument that its errors are somehow off set by the actions of Ms. O'Neal in this case, the Court is entirely unpersuaded. There is no evidence in the record to support that Ms. O'Neal was other than a victim of a predator whose business operations are enabled by and depend upon a mortgage servicing industry that is unconcerned with the accuracy of records and information. Mr. Wilhite's testimony that the effect of his actions were of no consequence because Ms. O'Neal "was in foreclosure and she was going to lose the house anyways" underscores this point.

A reasonable investigation of Countrywide's records would have shown that Countrywide had no factual basis for asserting a claim in Ms. O'Neal's bankruptcy case or objecting to confirmation of her chapter 13 plan. Countrywide's conduct was not reasonable, was reckless and is sanctionable pursuant to § 105 and Rule 9011.

Having determined that Rule 9011 and § 105 have been violated, the next question for the Court is what are the appropriate sanctions for Countrywide's violations. Monetary sanctions may be appropriate, but the Court will also consider sanctions sufficient to deter repetition of this conduct or comparable conduct by others, including how Countrywide can modify its internal practices to ensure the accuracy of its filings in future bankruptcy cases. Therefore, a trial with respect to the issue of sanctions shall be held on **May 11, 2009 at 9:30 a.m.** in the Bankruptcy Courtroom, Second Floor, U.S. Courthouse and Federal Building, 2 South Main Street, Akron, Ohio.

In addition, a telphonic pre-trial conference shall be held on **May 5, 2009 at 10:30 a.m.**

###

cc: Thomas Connop
Robert Folland
Jeremy Campana
Dean Wyman
Paul Randel

EXHIBIT 3

CASE NO.: 5:09MC82

Proof of Claim filed in Case No.: 07-51027, Claim No. 4-1, filed 5/1/07.

FORM B10 (Official Form 10) (04/07)

United States Bankruptcy Court - Northern District of Ohio

PROOF OF CLAIM

Name of Debtor
Marylnn Renee O'Neal

Case Number
07-51027

NOTE: This form should not be used to make a claim for an administrative expense arising after the commencement of the case. A "request" for payment of an administrative expense may be filed pursuant to 11 U.S.C. § 503.

Name of Creditor (The person or other entity to whom the debtor owes money or property):
Wells Fargo Bank, N.A.

Name and address where notices should be sent:
Wells Fargo Bank, N.A.
c/o Countrywide Home Loans, Inc.
7105 Corporate Drive, PTX-B-209
Plano, TX 75024

Telephone number: 800-669-6607

☐ Check box if you are aware that anyone else has filed a proof of claim relating to your claim. Attach copy of statement giving particulars.

☒ Check box if you have never received any notices from the bankruptcy court in this case.

☐ Check box if the address differs from the address on the envelope sent to you by the court.

This Space is for Court Use Only

Last 4 digits of account or other number by which creditor identifies debtor:
35819301

Check here if this claim ☐ replaces ☐ amends a previously filed claim dated:____________

1. Basis for Claim
- ☐ Goods sold
- ☐ Services performed
- ☒ Money loaned
- ☐ Personal injury/wrongful death
- ☐ Taxes
- ☐ Other____________________
- ☐ Retiree benefits as defined in 11 U.S.C. § 1114(a)
- ☐ Wages, salaries, and compensation (fill out below)

Last four digits of SS #: __________
Unpaid compensation for services performed
from __________ (date) to __________ (date)

2. Date debt was incurred: May 8, 2004

3. If court judgment, date obtained:

4. Classification of Claim. Check the appropriate box or boxes that describe your claim and state the amount of the claim at the time case filed.
See reverse side for important explanations.

Unsecured Nonpriority Claim $____________

☐ Check this box if: a) there is no collateral or lien securing your claim, or b) your claim exceeds the value of the property securing it, or c) none or only part of your claim is entitled to priority.

Unsecured Priority Claim.

☐ Check this box if you have an unsecured claim, all or part of which is entitled to priority

Amount entitled to priority $____________

Specify the priority of the claim:

Secured Claim

☒ Check this box if your claim is secured by collateral (including a right of setoff).

Brief Description of Collateral:
☒ Real Estate ☐ Motor Vehicle ☐ Other __________

Value of Collateral: $____________
327 Ira Avenue
Akron, OH 44301

Amount of arrearage and other charges at time case filed included in the secured claim, if any: $ 19,474.30

- ☐ Domestic support obligations under 11 U.S.C. § 507(a)(1)(A) or (a)(1)(B)
- ☐ Wages, salaries, or commissions (up to $10,950),* earned within 180 days before filing of the bankruptcy petition or cessation of the debtor's business, whichever is earlier - 11 U.S.C. § 507(a)(4).
- ☐ Contributions to an employee benefit plan - 11 U.S.C. § 507(a)(5).
- ☐ Up to $2,425* of deposits toward purchase, lease, or rental of property or services for personal, family, or household use - 11 U.S.C. § 507(a)(7).
- ☐ Taxes or penalties owed to governmental units - 11 U.S.C. § 507(a)(8).
- ☐ Other - Specify applicable paragraph of 11 U.S.C. § 507(a)(______).

* *Amounts are subject to adjustment on 4/1/2010 and every 3 years thereafter with respect to cases commenced on or after the date of adjustment.*

5. Total Amount of Claim at Time Case Filed: $

	88,859.06		88,859.06
(unsecured)	(secured)	(priority)	(Total)

☒ Check this box if claim includes interest or other charges in addition to the principal amount of the claim. Attach itemized statement of all interest or additional charges.

6. **Credits:** The amount of all payments on this claim has been credited and deducted for the purpose of making this proof of claim.
7. **Supporting Documents:** *Attach copies of supporting documents,* such as promissory notes, purchase orders, invoices, itemized statements of running accounts, contracts, court judgments, mortgages, security agreements, and evidence of perfection of lien. DO NOT SEND ORIGINAL DOCUMENTS. If the documents are not available, explain. If the documents are voluminous, attach a summary.
8. **Date-Stamped Copy:** To receive an acknowledgment of the filing of your claim, enclose a stamped, self-addressed envelope and copy of this proof of claim

This Space is for Court Use Only

Date
May 1, 2007

Sign and print the name and title, if any, of the creditor or other person authorized to file this claim (attach copy of power of attorney, if any):
/s/ Ted P. McClatchey, Attorney
Ted P. McClatchey, Attorney

Penalty for presenting fraudulent claim: Fine of up to $500,000 or imprisonment for up to 5 years, or both. 18 U.S.C. §§ 152 and 3571.

```
POC010-02 ETEDESCO  Proof of Claim Calculation  4/27/07 11:23:08
 Display  POC Date: 4/27/2007  POC Time: 11:23:04
  Case Number: 07-51027/OH/N   CFC Loan Number:    35819301
  Social Security Number:xxx-xx-1915 Loan Type:B/C D-FIX Original
  Contract Rate:   9.990 %     Principal Balance:      69,111.76
     Payments in arrears:   28 1/01/2005       4/11/2007
              28  payments at  696.55 each = 19,503.40

19,503.40
  Other          Previous Bankruptcy Fees: =              .00
  Allowable      NSF Fees:                 =              .00
  Charges:       Foreclosure Fees:         =              .00
                 Property Inspection Fees: =            64.41
                 Uncollected Late Charges: =              .00
                 Accrued Late Charges:     =              .00
                 Escrow Shortage:          =           179.49
                 Appraisal Fee:            =              .00
                           :               =              .00
                           :               =              .00
Partial Balance: <.00  >  Charges Total:   =           243.90
                         Sub-Total:                 19,747.30
                 Interest on Plan:         =              .00
                         Total Due:                 88,859.06
 Cmd3-Exit         Cmd6-Print        Cmd12-Previous
HELP-POC Help
```

tabbies
EXHIBIT
A

3581930l Loan No. 0078292448 - 5522

FIXED RATE NOTE

THIS LOAN HAS A PREPAYMENT PENALTY PROVISION.

EXHIBIT
B

May 8, 2004
[Date]

Orange
[City]

327 IRA AVENUE, AKRON, OH 44301
[Property Address]

1. BORROWER'S PROMISE TO PAY

In return for a loan that I have received, I promise to pay U.S. $ 69,300.00 (this amount is called "principal"), plus interest, to the order of the Lender. The Lender is Ameriquest Mortgage Company .

I understand that the Lender may transfer this Note. The Lender or anyone who takes this Note by transfer and who is entitled to receive payments under this Note is called the "Note Holder."

2. INTEREST

Interest will be charged on unpaid principal until the full amount of principal has been paid. I will pay interest at a yearly rate of 9.990 %.

The interest rate required by this Section 2 is the rate I will pay before and after any default described in Section 6(B) of this Note.

3. PAYMENTS

(A) Time and Place of Payments

I will pay principal and interest by making payments every month.
I will make my monthly payments on the first day of each month beginning on **July 1, 2004.**

I will make these payments every month until I have paid all of the principal and interest and any other charges described below that I may owe under this Note. My monthly payments will be applied to interest before principal. If, on **June 1, 2034**, I still owe amounts under this Note, I will pay those amounts in full on that date, which is called the "Maturity Date."

I will make my monthly payments at: **505 City Parkway West, Suite 100, Orange, CA 92868**

or at a different place if required by the Note Holder.

(B) Amount of Monthly Payments

My monthly payments will be in the amount of U.S. $607.65.

4. BORROWER'S RIGHT TO PREPAY

I may repay this Note at any time as provided for in this paragraph. If within the first 3.00 year(s), I prepay in any 12 month period an amount exceeding 20% of the original principal balance under this Note, I will pay a prepayment charge to Note Holder equal to one percent (1%) of the original principal amount of the mortgage.

5. LOAN CHARGES

If a law, which applies to this loan and which sets maximum loan charges, is finally interpreted so that the interest or other loan charges collected or to be collected in connection with this loan exceed the permitted limits, then; (i) any such loan charged shall be reduced by the amount necessary to reduce the charge to the permitted limit; and (ii) any sums already collected from me which exceeded permitted limits will be refunded to me. The Note Holder may choose to make this refund by reducing the principal I owe under this Note or by making a direct payment to me. If a refund reduces principal, the reduction will be treated as a partial prepayment.

6. BORROWER'S FAILURE TO PAY AS REQUIRED

(A) Late Charges for Overdue Payments

If the Note Holder has not received the full amount of any monthly payment by the end of **fifteen** calendar days after the date it is due, I will pay a late charge to the Note Holder. The amount of the charge will be 5.000 % of my overdue payment of principal and interest. I will pay this late charge promptly but only once on each late payment.

(B) Default

If I do not pay the full amount of each monthly payment on the date it is due, I will be in default.

(C) Notice of Default

If I am in default, the Note Holder may send me a written notice telling me that if I do not pay the overdue amount by a certain date, the Note Holder may require me to pay immediately the full amount of principal which has not been paid and all the interest that I owe on that amount. That date must be at least 30 days after the date on which the notice is delivered or mailed me.

Initials:
M. O. ____ ____

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(D) No Waiver by Note Holder

Even if, at a time when I am in default, the Note Holder does not require me to pay immediately in full as described above, the Note Holder will still have the right to do so if I am in default at a later time.

(E) Payment of Note Holder's Costs and Expenses

If the Note Holder has required me to pay immediately in full as described above, the Note Holder will have the right to be paid back by me for all its costs and expenses in enforcing this Note to the extent not prohibited by applicable law. Those expenses include, for example, reasonable attorney's fees.

7. GIVING OF NOTICES

Unless applicable law requires a different method, any notice that must be given to me under this Note will be given by delivering it or by mailing it by first class mail to me at the Property Address above or at a different address if I give the Note Holder a notice of my different address.

Any notice that must be given to the Note Holder under this Note will be given by mailing it by first class mail to the Note Holder at the address stated in Section 3(A) above or at a different address if I am given a notice of that different address.

8. OBLIGATIONS OF PERSONS UNDER THIS NOTE

If more than one person signs this Note, each person is fully and personally obligated to keep all of the promises made in this Note, including the promise to pay the full amount owed. Any person who is a guarantor, surety or endorser of this Note is also obligated to do these things. Any person who takes over these obligations, including the obligations of a guarantor, surety, or endorser of this Note, is also obligated to keep all of the promises made in this Note. The Note Holder may enforce its rights under this Note against each person individually or against all of us together. This means that any one of us may be required to pay all of the amounts owed under this Note.

9. WAIVERS

I and any other person who has obligations under this Note waive the rights of presentment and notice of dishonor. "Presentment" means the right to require the Note Holder to demand payment of amounts due. "Notice of Dishonor" means the right to require the Note Holder to give notice to other persons that amounts due have not been paid.

10. UNIFORM SECURED NOTE

This Note is a uniform instrument with limited variations in some jurisdictions. In addition to the protections given to the Note Holder under this Note, a Mortgage, Deed of Trust, or Security Deed (the "Security Instrument"), dated the same date as this Note, protects the Note Holder from possible losses which might result if I do not keep promises that I make in this Note. That Security Instrument describes how and under what conditions I may be required to make immediate payment in full of all amounts I owe under this Note. Some of those conditions are described as follows:

Transfer of the Property or a Beneficial Interest in Borrower. If all or any part of the Property or any interest in it is sold or transferred (or if a beneficial interest in Borrower is sold or transferred and Borrower is not a natural person) without Lender's prior written consent, Lender may at its option, require immediate payment in full of all sums secured by this Security Instrument. However, this option shall not be exercised by Lender if prohibited by federal law as of the date of this Security Instrument.

If the Lender exercises this option, Lender shall give Borrower notice of acceleration. The notice shall provide a period of not less than 30 days from the date the notice is delivered or mailed within which Borrower must pay all sums secured by this Security Instrument. If Borrower fails to pay these sums prior to the expiration of this period, Lender may invoke any remedies permitted by this Security Instrument without further notice or demand on Borrower.

WITNESS THE HAND(S) AND SEAL(S) OF THE UNDERSIGNED

Marlyn R. O'Neal (Seal)
Borrower: Marlynn R. O'Neal
SSN: 270-68-1915

_______________________________(Seal)
Borrower:
SSN:

_______________________________(Seal)
Borrower:
SSN:

_______________________________(Seal)
Borrower:
SSN:

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200-20H (Rev. 7/03)

Return To:

Ameriquest Mortgage Company
P.O. Box 11507,
Santa Ana, CA 92711

TRUE AND CERTIFIED COPY

EXHIBIT
C

[Space Above This Line For Recording [illegible]]

MORTGAGE

DEFINITIONS

Words used in multiple sections of this document are defined below and other words are defined in Sections 3, 11, 13, 18, 20 and 21. Certain rules regarding the usage of words used in this document are also provided in Section 16.

(A) "Security Instrument" means this document, which is dated May 8, 2004 , together with all Riders to this document.
(B) "Borrower" is Marlynn R. O'Neal

Borrower is the mortgagor under this Security Instrument.
(C) "Lender" is Ameriquest Mortgage Company

Lender is a Corporation
organized and existing under the laws of Delaware

Lender's address is 1100 Town and Country Road, Suite 200 Orange, CA 92868

Lender is the mortgagee under this Security Instrument.
(D) "Note" means the promissory note signed by Borrower and dated May 8, 2004. The Note states that Borrower owes Lender sixty-nine thousand three hundred and 00/100 Dollars (U.S. $ 69,300.00) plus interest. Borrower has promised to pay this debt in regular Periodic Payments and to pay the debt in full not later than June 1, 2034.
(E) "Property" means the property that is described below under the heading "Transfer of Rights in the Property."
(F) "Loan" means the debt evidenced by the Note, plus interest, any prepayment charges and late charges due under the Note, and all sums due under this Security Instrument, plus interest.
(G) "Riders" means all Riders to this Security Instrument that are executed by Borrower. The following Riders are to be executed by Borrower [check box as applicable]:

☐ Adjustable Rate Rider
☐ Balloon Rider
☐ VA Rider
☐ Condominium Rider
☐ Planned Unit Development Rider
☐ Biweekly Payment Rider
☐ Second Home Rider
☐ 1-4 Family Rider
☐ Other(s) [specify]

(H) "Applicable Law" means all controlling applicable federal, state and local statutes, regulations, ordinances and administrative rules and orders (that have the effect of law) as well as all applicable final, non-appealable judicial opinions.
(I) "Community Association Dues, Fees, and Assessments" means all dues, fees, assessments and other charges that are imposed on Borrower or the Property by a condominium association, homeowners association or similar organization.
(J) "Electronic Funds Transfer" means any transfer of funds, other than a transaction originated by check, draft, or similar paper instrument, which is initiated through an electronic terminal, telephonic instrument, computer, or magnetic tape so as to order, instruct, or authorize a financial institution to debit or credit an account. Such term includes, but is not limited to, point-of-sale transfers, automated teller machine transactions, transfers initiated by telephone, wire transfers, and automated clearinghouse transfers.
(K) "Escrow Items" means those items that are described in Section 3.
(L) "Miscellaneous Proceeds" means any compensation, settlement, award of damages, or proceeds paid by any third party (other than insurance proceeds paid under the coverages described in Section 5) for: (i) damage to, or destruction of, the Property; (ii) condemnation or other taking of all or any part of the Property; (iii) conveyance in lieu of condemnation; or (iv) misrepresentations of, or omissions as to, the value and/or condition of the Property.
(M) "Mortgage Insurance" means insurance protecting Lender against the nonpayment of, or default on, the Loan.
(N) "Periodic Payment" means the regularly scheduled amount due for (i) principal and interest under the Note, plus (ii) any amounts under Section 3 of this Security Instrument.

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(O) "RESPA" means the Real Estate Settlement Procedures Act (12 U.S.C. Section 2601 et seq.) and its implementing regulation, Regulation X (24 C.F.R. Part 3500), as they might be amended from time to time, or any additional or successor legislation or regulation that governs the same subject matter. As used in this Security Instrument, "RESPA" refers to all requirements and restrictions that are imposed in regard to a "federally related mortgage loan" even if the Loan does not qualify as a "federally related mortgage loan" under RESPA.
(P) "Successor in Interest of Borrower" means any party that has taken title to the Property, whether or not that party has assumed Borrower's obligations under the Note and/or this Security Instrument.

TRANSFER OF RIGHTS IN THE PROPERTY

This Security Instrument secures to Lender: (i) the repayment of the Loan, and all renewals, extensions and modifications of the Note; and (ii) the performance of Borrower's covenants and agreements under this Security Instrument and the Note. For this purpose, Borrower does hereby mortgage, grant and convey to Lender the following described property located in the
County of SUMMIT :
[Type of Recording Jurisdiction] [Name of Recording Jurisdiction]
Legal Description Attached Hereto and Made a Part Hereof.

Parcel ID Number: 68-32102 which currently has the address of
327 IRA AVENUE [Street]
AKRON [City], Ohio 44301 [Zip Code]
("Property Address"):

TOGETHER WITH all the improvements now or hereafter erected on the property, and all easements, appurtenances, and fixtures now or hereafter a part of the property. All replacements and additions shall also be covered by this Security Instrument. All of the foregoing is referred to in this Security Instrument as the "Property."

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BORROWER COVENANTS that Borrower is lawfully seised of the estate hereby conveyed and has the right to mortgage, grant and convey the Property and that the Property is unencumbered, except for encumbrances of record. Borrower warrants and will defend generally the title to the Property against all claims and demands, subject to any encumbrances of record.

THIS SECURITY INSTRUMENT combines uniform covenants for national use and non-uniform covenants with limited variations by jurisdiction to constitute a uniform security instrument covering real property.

UNIFORM COVENANTS. Borrower and Lender covenant and agree as follows:

1. Payment of Principal, Interest, Escrow Items, Prepayment Charges, and Late Charges. Borrower shall pay when due the principal of, and interest on, the debt evidenced by the Note and any prepayment charges and late charges due under the Note. Borrower shall also pay funds for Escrow Items pursuant to Section 3. Payments due under the Note and this Security Instrument shall be made in U.S. currency. However, if any check or other instrument received by Lender as payment under the Note or this Security Instrument is returned to Lender unpaid, Lender may require that any or all subsequent payments due under the Note and this Security Instrument be made in one or more of the following forms, as selected by Lender: (a) cash; (b) money order; (c) certified check, bank check, treasurer's check or cashier's check, provided any such check is drawn upon an institution whose deposits are insured by a federal agency, instrumentality, or entity; or (d) Electronic Funds Transfer.

Payments are deemed received by Lender when received at the location designated in the Note or at such other location as may be designated by Lender in accordance with the notice provisions in Section 15. Lender may return any payment or partial payment if the payment or partial payments are insufficient to bring the Loan current. Lender may accept any payment or partial payment insufficient to bring the Loan current, without waiver of any rights hereunder or prejudice to its rights to refuse such payment or partial payments in the future, but Lender is not obligated to apply such payments at the time such payments are accepted. If each Periodic Payment is applied as of its scheduled due date, then Lender need not pay interest on unapplied funds. Lender may hold such unapplied funds until Borrower makes payment to bring the Loan current. If Borrower does not do so within a reasonable period of time, Lender shall either apply such funds or return them to Borrower. If not applied earlier, such funds will be applied to the outstanding principal balance under the Note immediately prior to foreclosure. No offset or claim which Borrower might have now or in the future against Lender shall relieve Borrower from making payments due under the Note and this Security Instrument or performing the covenants and agreements secured by this Security Instrument.

2. Application of Payments or Proceeds. Except as otherwise described in this Section 2, all payments accepted and applied by Lender shall be applied in the following order of priority: (a) interest due under the Note; (b) principal due under the Note; (c) amounts due under Section 3. Such payments shall be applied to each Periodic Payment in the order in which it became due. Any remaining amounts shall be applied first to late charges, second to any other amounts due under this Security Instrument, and then to reduce the principal balance of the Note.

If Lender receives a payment from Borrower for a delinquent Periodic Payment which includes a sufficient amount to pay any late charge due, the payment may be applied to the delinquent payment and the late charge. If more than one Periodic Payment is outstanding, Lender may apply any payment received from Borrower to the repayment of the Periodic Payments if, and to the extent that, each payment can be paid in full. To the extent that any excess exists after the payment is applied to the full payment of one or more Periodic Payments, such excess may be applied to any late charges due. Voluntary prepayments shall be applied first to any prepayment charges and then as described in the Note.

Any application of payments, insurance proceeds, or Miscellaneous Proceeds to principal due under the Note shall not extend or postpone the due date, or change the amount, of the Periodic Payments.

3. Funds for Escrow Items. Borrower shall pay to Lender on the day Periodic Payments are due under the Note, until the Note is paid in full, a sum (the "Funds") to provide for payment of amounts due for: (a) taxes and assessments and other items which can attain priority over this Security Instrument as a lien or encumbrance on the Property; (b) leasehold payments or ground rents on the Property, if any; (c) premiums for any and all insurance required by Lender under Section 5; and (d) Mortgage Insurance premiums, if any,

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or any sums payable by Borrower to Lender in lieu of the payment of Mortgage Insurance premiums in accordance with the provisions of Section 10. These items are called "Escrow Items." At origination or at any time during the term of the Loan, Lender may require that Community Association Dues, Fees, and Assessments, if any, be escrowed by Borrower, and such dues, fees and assessments shall be an Escrow Item. Borrower shall promptly furnish to Lender all notices of amounts to be paid under this Section. Borrower shall pay Lender the Funds for Escrow Items unless Lender waives Borrower's obligation to pay the Funds for any or all Escrow Items. Lender may waive Borrower's obligation to pay to Lender Funds for any or all Escrow Items at any time. Any such waiver may only be in writing. In the event of such waiver, Borrower shall pay directly, when and where payable, the amounts due for any Escrow Items for which payment of Funds has been waived by Lender and, if Lender requires, shall furnish to Lender receipts evidencing such payment within such time period as Lender may require. Borrower's obligation to make such payments and to provide receipts shall for all purposes be deemed to be a covenant and agreement contained in this Security Instrument, as the phrase "covenant and agreement" is used in Section 9. If Borrower is obligated to pay Escrow Items directly, pursuant to a waiver, and Borrower fails to pay the amount due for an Escrow Item, Lender may exercise its rights under Section 9 and pay such amount and Borrower shall then be obligated under Section 9 to repay to Lender any such amount. Lender may revoke the waiver as to any or all Escrow Items at any time by a notice given in accordance with Section 15 and, upon such revocation, Borrower shall pay to Lender all Funds, and in such amounts, that are then required under this Section 3.

Lender may, at any time, collect and hold Funds in an amount (a) sufficient to permit Lender to apply the Funds at the time specified under RESPA, and (b) not to exceed the maximum amount a lender can require under RESPA. Lender shall estimate the amount of Funds due on the basis of current data and reasonable estimates of expenditures of future Escrow Items or otherwise in accordance with Applicable Law.

The Funds shall be held in an institution whose deposits are insured by a federal agency, instrumentality, or entity (including Lender, if Lender is an institution whose deposits are so insured) or in any Federal Home Loan Bank. Lender shall apply the Funds to pay the Escrow Items no later than the time specified under RESPA. Lender shall not charge Borrower for holding and applying the Funds, annually analyzing the escrow account, or verifying the Escrow Items, unless Lender pays Borrower interest on the Funds and Applicable Law permits Lender to make such a charge. Unless an agreement is made in writing or Applicable Law requires interest to be paid on the Funds, Lender shall not be required to pay Borrower any interest or earnings on the Funds. Borrower and Lender can agree in writing, however, that interest shall be paid on the Funds. Lender shall give to Borrower, without charge, an annual accounting of the Funds as required by RESPA.

If there is a surplus of Funds held in escrow, as defined under RESPA, Lender shall account to Borrower for the excess funds in accordance with RESPA. If there is a shortage of Funds held in escrow, as defined under RESPA, Lender shall notify Borrower as required by RESPA, and Borrower shall pay to Lender the amount necessary to make up the shortage in accordance with RESPA, but in no more than 12 monthly payments. If there is a deficiency of Funds held in escrow, as defined under RESPA, Lender shall notify Borrower as required by RESPA, and Borrower shall pay to Lender the amount necessary to make up the deficiency in accordance with RESPA, but in no more than 12 monthly payments.

Upon payment in full of all sums secured by this Security Instrument, Lender shall promptly refund to Borrower any Funds held by Lender.

4. Charges; Liens. Borrower shall pay all taxes, assessments, charges, fines, and impositions attributable to the Property which can attain priority over this Security Instrument, leasehold payments or ground rents on the Property, if any, and Community Association Dues, Fees, and Assessments, if any. To the extent that these items are Escrow Items, Borrower shall pay them in the manner provided in Section 3.

Borrower shall promptly discharge any lien which has priority over this Security Instrument unless Borrower: (a) agrees in writing to the payment of the obligation secured by the lien in a manner acceptable to Lender, but only so long as Borrower is performing such agreement; (b) contests the lien in good faith by, or defends against enforcement of the lien in, legal proceedings which in Lender's opinion operate to prevent

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the enforcement of the lien while those proceedings are pending, but only until such proceedings are concluded; or (c) secures from the holder of the lien an agreement satisfactory to Lender subordinating the lien to this Security Instrument. If Lender determines that any part of the Property is subject to a lien which can attain priority over this Security Instrument, Lender may give Borrower a notice identifying the lien. Within 10 days of the date on which that notice is given, Borrower shall satisfy the lien or take one or more of the actions set forth above in this Section 4.

Lender may require Borrower to pay a one-time charge for a real estate tax verification and/or reporting service used by Lender in connection with this Loan.

5. Property Insurance. Borrower shall keep the improvements now existing or hereafter erected on the Property insured against loss by fire, hazards included within the term "extended coverage," and any other hazards including, but not limited to, earthquakes and floods, for which Lender requires insurance. This insurance shall be maintained in the amounts (including deductible levels) and for the periods that Lender requires. What Lender requires pursuant to the preceding sentences can change during the term of the Loan. The insurance carrier providing the insurance shall be chosen by Borrower subject to Lender's right to disapprove Borrower's choice, which right shall not be exercised unreasonably. Lender may require Borrower to pay, in connection with this Loan, either: (a) a one-time charge for flood zone determination, certification and tracking services; or (b) a one-time charge for flood zone determination and certification services and subsequent charges each time remappings or similar changes occur which reasonably might affect such determination or certification. Borrower shall also be responsible for the payment of any fees imposed by the Federal Emergency Management Agency in connection with the review of any flood zone determination resulting from an objection by Borrower.

If Borrower fails to maintain any of the coverages described above, Lender may obtain insurance coverage, at Lender's option and Borrower's expense. Lender is under no obligation to purchase any particular type or amount of coverage. Therefore, such coverage shall cover Lender, but might or might not protect Borrower, Borrower's equity in the Property, or the contents of the Property, against any risk, hazard or liability and might provide greater or lesser coverage than was previously in effect. Borrower acknowledges that the cost of the insurance coverage so obtained might significantly exceed the cost of insurance that Borrower could have obtained. Any amounts disbursed by Lender under this Section 5 shall become additional debt of Borrower secured by this Security Instrument. These amounts shall bear interest at the Note rate from the date of disbursement and shall be payable, with such interest, upon notice from Lender to Borrower requesting payment.

All insurance policies required by Lender and renewals of such policies shall be subject to Lender's right to disapprove such policies, shall include a standard mortgage clause, and shall name Lender as mortgagee and/or as an additional loss payee. Lender shall have the right to hold the policies and renewal certificates. If Lender requires, Borrower shall promptly give to Lender all receipts of paid premiums and renewal notices. If Borrower obtains any form of insurance coverage, not otherwise required by Lender, for damage to, or destruction of, the Property, such policy shall include a standard mortgage clause and shall name Lender as mortgagee and/or as an additional loss payee.

In the event of loss, Borrower shall give prompt notice to the insurance carrier and Lender. Lender may make proof of loss if not made promptly by Borrower. Unless Lender and Borrower otherwise agree in writing, any insurance proceeds, whether or not the underlying insurance was required by Lender, shall be applied to restoration or repair of the Property, if the restoration or repair is economically feasible and Lender's security is not lessened. During such repair and restoration period, Lender shall have the right to hold such insurance proceeds until Lender has had an opportunity to inspect such Property to ensure the work has been completed to Lender's satisfaction, provided that such inspection shall be undertaken promptly. Lender may disburse proceeds for the repairs and restoration in a single payment or in a series of progress payments as the work is completed. Unless an agreement is made in writing or Applicable Law requires interest to be paid on such insurance proceeds, Lender shall not be required to pay Borrower any interest or earnings on such proceeds. Fees for public adjusters, or other third parties, retained by Borrower shall not be paid out of the insurance proceeds and shall be the sole obligation of Borrower. If the restoration or repair is not economically feasible or Lender's security would be lessened, the insurance proceeds shall be

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applied to the sums secured by this Security Instrument, whether or not then due, with the excess, if any, paid to Borrower. Such insurance proceeds shall be applied in the order provided for in Section 2.

If Borrower abandons the Property, Lender may file, negotiate and settle any available insurance claim and related matters. If Borrower does not respond within 30 days to a notice from Lender that the insurance carrier has offered to settle a claim, then Lender may negotiate and settle the claim. The 30-day period will begin when the notice is given. In either event, or if Lender acquires the Property under Section 22 or otherwise, Borrower hereby assigns to Lender (a) Borrower's rights to any insurance proceeds in an amount not to exceed the amounts unpaid under the Note or this Security Instrument, and (b) any other of Borrower's rights (other than the right to any refund of unearned premiums paid by Borrower) under all insurance policies covering the Property, insofar as such rights are applicable to the coverage of the Property. Lender may use the insurance proceeds either to repair or restore the Property or to pay amounts unpaid under the Note or this Security Instrument, whether or not then due.

6. **Occupancy.** Borrower shall occupy, establish, and use the Property as Borrower's principal residence within 60 days after the execution of this Security Instrument and shall continue to occupy the Property as Borrower's principal residence for at least one year after the date of occupancy, unless Lender otherwise agrees in writing, which consent shall not be unreasonably withheld, or unless extenuating circumstances exist which are beyond Borrower's control.

7. **Preservation, Maintenance and Protection of the Property; Inspections.** Borrower shall not destroy, damage or impair the Property, allow the Property to deteriorate or commit waste on the Property. Whether or not Borrower is residing in the Property, Borrower shall maintain the Property in order to prevent the Property from deteriorating or decreasing in value due to its condition. Unless it is determined pursuant to Section 5 that repair or restoration is not economically feasible, Borrower shall promptly repair the Property if damaged to avoid further deterioration or damage. If insurance or condemnation proceeds are paid in connection with damage to, or the taking of, the Property, Borrower shall be responsible for repairing or restoring the Property only if Lender has released proceeds for such purposes. Lender may disburse proceeds for the repairs and restoration in a single payment or in a series of progress payments as the work is completed. If the insurance or condemnation proceeds are not sufficient to repair or restore the Property, Borrower is not relieved of Borrower's obligation for the completion of such repair or restoration.

Lender or its agent may make reasonable entries upon and inspections of the Property. If it has reasonable cause, Lender may inspect the interior of the improvements on the Property. Lender shall give Borrower notice at the time of or prior to such an interior inspection specifying such reasonable cause.

8. **Borrower's Loan Application.** Borrower shall be in default if, during the Loan application process, Borrower or any persons or entities acting at the direction of Borrower or with Borrower's knowledge or consent gave materially false, misleading, or inaccurate information or statements to Lender (or failed to provide Lender with material information) in connection with the Loan. Material representations include, but are not limited to, representations concerning Borrower's occupancy of the Property as Borrower's principal residence.

9. **Protection of Lender's Interest in the Property and Rights Under this Security Instrument.** If (a) Borrower fails to perform the covenants and agreements contained in this Security Instrument, (b) there is a legal proceeding that might significantly affect Lender's interest in the Property and/or rights under this Security Instrument (such as a proceeding in bankruptcy, probate, for condemnation or forfeiture, for enforcement of a lien which may attain priority over this Security Instrument or to enforce laws or regulations), or (c) Borrower has abandoned the Property, then Lender may do and pay for whatever is reasonable or appropriate to protect Lender's interest in the Property and rights under this Security Instrument, including protecting and/or assessing the value of the Property, and securing and/or repairing the Property. Lender's actions can include, but are not limited to: (a) paying any sums secured by a lien which has priority over this Security Instrument; (b) appearing in court; and (c) paying reasonable attorneys' fees to protect its interest in the Property and/or rights under this Security Instrument, including its secured position in a bankruptcy proceeding. Securing the Property includes, but is not limited to, entering the Property to make repairs, change locks, replace or board up doors and windows, drain water from pipes, eliminate building or other code violations or dangerous conditions, and have utilities turned on or off. Although

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Lender may take action under this Section 9, Lender does not have to do so and is not under any duty or obligation to do so. It is agreed that Lender incurs no liability for not taking any or all actions authorized under this Section 9.

Any amounts disbursed by Lender under this Section 9 shall become additional debt of Borrower secured by this Security Instrument. These amounts shall bear interest at the Note rate from the date of disbursement and shall be payable, with such interest, upon notice from Lender to Borrower requesting payment.

If this Security Instrument is on a leasehold, Borrower shall comply with all the provisions of the lease. If Borrower acquires fee title to the Property, the leasehold and the fee title shall not merge unless Lender agrees to the merger in writing.

10. Mortgage Insurance. If Lender required Mortgage Insurance as a condition of making the Loan, Borrower shall pay the premiums required to maintain the Mortgage Insurance in effect. If, for any reason, the Mortgage Insurance coverage required by Lender ceases to be available from the mortgage insurer that previously provided such insurance and Borrower was required to make separately designated payments toward the premiums for Mortgage Insurance, Borrower shall pay the premiums required to obtain coverage substantially equivalent to the Mortgage Insurance previously in effect, at a cost substantially equivalent to the cost to Borrower of the Mortgage Insurance previously in effect, from an alternate mortgage insurer selected by Lender. If substantially equivalent Mortgage Insurance coverage is not available, Borrower shall continue to pay to Lender the amount of the separately designated payments that were due when the insurance coverage ceased to be in effect. Lender will accept, use and retain these payments as a non-refundable loss reserve in lieu of Mortgage Insurance. Such loss reserve shall be non-refundable, notwithstanding the fact that the Loan is ultimately paid in full, and Lender shall not be required to pay Borrower any interest or earnings on such loss reserve. Lender can no longer require loss reserve payments if Mortgage Insurance coverage (in the amount and for the period that Lender requires) provided by an insurer selected by Lender again becomes available, is obtained, and Lender requires separately designated payments toward the premiums for Mortgage Insurance. If Lender required Mortgage Insurance as a condition of making the Loan and Borrower was required to make separately designated payments toward the premiums for Mortgage Insurance, Borrower shall pay the premiums required to maintain Mortgage Insurance in effect, or to provide a non-refundable loss reserve, until Lender's requirement for Mortgage Insurance ends in accordance with any written agreement between Borrower and Lender providing for such termination or until termination is required by Applicable Law. Nothing in this Section 10 affects Borrower's obligation to pay interest at the rate provided in the Note.

Mortgage Insurance reimburses Lender (or any entity that purchases the Note) for certain losses it may incur if Borrower does not repay the Loan as agreed. Borrower is not a party to the Mortgage Insurance.

Mortgage insurers evaluate their total risk on all such insurance in force from time to time, and may enter into agreements with other parties that share or modify their risk, or reduce losses. These agreements are on terms and conditions that are satisfactory to the mortgage insurer and the other party (or parties) to these agreements. These agreements may require the mortgage insurer to make payments using any source of funds that the mortgage insurer may have available (which may include funds obtained from Mortgage Insurance premiums).

As a result of these agreements, Lender, any purchaser of the Note, another insurer, any reinsurer, any other entity, or any affiliate of any of the foregoing, may receive (directly or indirectly) amounts that derive from (or might be characterized as) a portion of Borrower's payments for Mortgage Insurance, in exchange for sharing or modifying the mortgage insurer's risk, or reducing losses. If such agreement provides that an affiliate of Lender takes a share of the insurer's risk in exchange for a share of the premiums paid to the insurer, the arrangement is often termed "captive reinsurance." Further:

(a) Any such agreements will not affect the amounts that Borrower has agreed to pay for Mortgage Insurance, or any other terms of the Loan. Such agreements will not increase the amount Borrower will owe for Mortgage Insurance, and they will not entitle Borrower to any refund.

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(b) Any such agreements will not affect the rights Borrower has - if any - with respect to the Mortgage Insurance under the Homeowners Protection Act of 1998 or any other law. These rights may include the right to receive certain disclosures, to request and obtain cancellation of the Mortgage Insurance, to have the Mortgage Insurance terminated automatically, and/or to receive a refund of any Mortgage Insurance premiums that were unearned at the time of such cancellation or termination.

11. Assignment of Miscellaneous Proceeds; Forfeiture. All Miscellaneous Proceeds are hereby assigned to and shall be paid to Lender.

If the Property is damaged, such Miscellaneous Proceeds shall be applied to restoration or repair of the Property, if the restoration or repair is economically feasible and Lender's security is not lessened. During such repair and restoration period, Lender shall have the right to hold such Miscellaneous Proceeds until Lender has had an opportunity to inspect such Property to ensure the work has been completed to Lender's satisfaction, provided that such inspection shall be undertaken promptly. Lender may pay for the repairs and restoration in a single disbursement or in a series of progress payments as the work is completed. Unless an agreement is made in writing or Applicable Law requires interest to be paid on such Miscellaneous Proceeds, Lender shall not be required to pay Borrower any interest or earnings on such Miscellaneous Proceeds. If the restoration or repair is not economically feasible or Lender's security would be lessened, the Miscellaneous Proceeds shall be applied to the sums secured by this Security Instrument, whether or not then due, with the excess, if any, paid to Borrower. Such Miscellaneous Proceeds shall be applied in the order provided for in Section 2.

In the event of a total taking, destruction, or loss in value of the Property, the Miscellaneous Proceeds shall be applied to the sums secured by this Security Instrument, whether or not then due, with the excess, if any, paid to Borrower.

In the event of a partial taking, destruction, or loss in value of the Property in which the fair market value of the Property immediately before the partial taking, destruction, or loss in value is equal to or greater than the amount of the sums secured by this Security Instrument immediately before the partial taking, destruction, or loss in value, unless Borrower and Lender otherwise agree in writing, the sums secured by this Security Instrument shall be reduced by the amount of the Miscellaneous Proceeds multiplied by the following fraction: (a) the total amount of the sums secured immediately before the partial taking, destruction, or loss in value divided by (b) the fair market value of the Property immediately before the partial taking, destruction, or loss in value. Any balance shall be paid to Borrower.

In the event of a partial taking, destruction, or loss in value of the Property in which the fair market value of the Property immediately before the partial taking, destruction, or loss in value is less than the amount of the sums secured immediately before the partial taking, destruction, or loss in value, unless Borrower and Lender otherwise agree in writing, the Miscellaneous Proceeds shall be applied to the sums secured by this Security Instrument whether or not the sums are then due.

If the Property is abandoned by Borrower, or if, after notice by Lender to Borrower that the Opposing Party (as defined in the next sentence) offers to make an award to settle a claim for damages, Borrower fails to respond to Lender within 30 days after the date the notice is given, Lender is authorized to collect and apply the Miscellaneous Proceeds either to restoration or repair of the Property or to the sums secured by this Security Instrument, whether or not then due. "Opposing Party" means the third party that owes Borrower Miscellaneous Proceeds or the party against whom Borrower has a right of action in regard to Miscellaneous Proceeds.

Borrower shall be in default if any action or proceeding, whether civil or criminal, is begun that, in Lender's judgment, could result in forfeiture of the Property or other material impairment of Lender's interest in the Property or rights under this Security Instrument. Borrower can cure such a default and, if acceleration has occurred, reinstate as provided in Section 19, by causing the action or proceeding to be dismissed with a ruling that, in Lender's judgment, precludes forfeiture of the Property or other material impairment of Lender's interest in the Property or rights under this Security Instrument. The proceeds of any award or claim for damages that are attributable to the impairment of Lender's interest in the Property are hereby assigned and shall be paid to Lender.

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All Miscellaneous Proceeds that are not applied to restoration or repair of the Property shall be applied in the order provided for in Section 2.

12. Borrower Not Released; Forbearance By Lender Not a Waiver. Extension of the time for payment or modification of amortization of the sums secured by this Security Instrument granted by Lender to Borrower or any Successor in Interest of Borrower shall not operate to release the liability of Borrower or any Successors in Interest of Borrower. Lender shall not be required to commence proceedings against any Successor in Interest of Borrower or to refuse to extend time for payment or otherwise modify amortization of the sums secured by this Security Instrument by reason of any demand made by the original Borrower or any Successors in Interest of Borrower. Any forbearance by Lender in exercising any right or remedy including, without limitation, Lender's acceptance of payments from third persons, entities or Successors in Interest of Borrower or in amounts less than the amount then due, shall not be a waiver of or preclude the exercise of any right or remedy.

13. Joint and Several Liability; Co-signers; Successors and Assigns Bound. Borrower covenants and agrees that Borrower's obligations and liability shall be joint and several. However, any Borrower who co-signs this Security Instrument but does not execute the Note (a "co-signer"): (a) is co-signing this Security Instrument only to mortgage, grant and convey the co-signer's interest in the Property under the terms of this Security Instrument; (b) is not personally obligated to pay the sums secured by this Security Instrument; and (c) agrees that Lender and any other Borrower can agree to extend, modify, forbear or make any accommodations with regard to the terms of this Security Instrument or the Note without the co-signer's consent.

Subject to the provisions of Section 18, any Successor in Interest of Borrower who assumes Borrower's obligations under this Security Instrument in writing, and is approved by Lender, shall obtain all of Borrower's rights and benefits under this Security Instrument. Borrower shall not be released from Borrower's obligations and liability under this Security Instrument unless Lender agrees to such release in writing. The covenants and agreements of this Security Instrument shall bind (except as provided in Section 20) and benefit the successors and assigns of Lender.

14. Loan Charges. Lender may charge Borrower fees for services performed in connection with Borrower's default, for the purpose of protecting Lender's interest in the Property and rights under this Security Instrument, including, but not limited to, attorneys' fees, property inspection and valuation fees. In regard to any other fees, the absence of express authority in this Security Instrument to charge a specific fee to Borrower shall not be construed as a prohibition on the charging of such fee. Lender may not charge fees that are expressly prohibited by this Security Instrument or by Applicable Law.

If the Loan is subject to a law which sets maximum loan charges, and that law is finally interpreted so that the interest or other loan charges collected or to be collected in connection with the Loan exceed the permitted limits, then: (a) any such loan charge shall be reduced by the amount necessary to reduce the charge to the permitted limit; and (b) any sums already collected from Borrower which exceeded permitted limits will be refunded to Borrower. Lender may choose to make this refund by reducing the principal owed under the Note or by making a direct payment to Borrower. If a refund reduces principal, the reduction will be treated as a partial prepayment without any prepayment charge (whether or not a prepayment charge is provided for under the Note). Borrower's acceptance of any such refund made by direct payment to Borrower will constitute a waiver of any right of action Borrower might have arising out of such overcharge.

15. Notices. All notices given by Borrower or Lender in connection with this Security Instrument must be in writing. Any notice to Borrower in connection with this Security Instrument shall be deemed to have been given to Borrower when mailed by first class mail or when actually delivered to Borrower's notice address if sent by other means. Notice to any one Borrower shall constitute notice to all Borrowers unless Applicable Law expressly requires otherwise. The notice address shall be the Property Address unless Borrower has designated a substitute notice address by notice to Lender. Borrower shall promptly notify Lender of Borrower's change of address. If Lender specifies a procedure for reporting Borrower's change of address, then Borrower shall only report a change of address through that specified procedure. There may be only one designated notice address under this Security Instrument at any one time. Any notice to Lender shall be given by delivering it or by mailing it by first class mail to Lender's address stated herein unless

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Lender has designated another address by notice to Borrower. Any notice in connection with this Security Instrument shall not be deemed to have been given to Lender until actually received by Lender. If any notice required by this Security Instrument is also required under Applicable Law, the Applicable Law requirement will satisfy the corresponding requirement under this Security Instrument.

16. Governing Law; Severability; Rules of Construction. This Security Instrument shall be governed by federal law and the law of the jurisdiction in which the Property is located. All rights and obligations contained in this Security Instrument are subject to any requirements and limitations of Applicable Law. Applicable Law might explicitly or implicitly allow the parties to agree by contract or it might be silent, but such silence shall not be construed as a prohibition against agreement by contract. In the event that any provision or clause of this Security Instrument or the Note conflicts with Applicable Law, such conflict shall not affect other provisions of this Security Instrument or the Note which can be given effect without the conflicting provision.

As used in this Security Instrument: (a) words of the masculine gender shall mean and include corresponding neuter words or words of the feminine gender; (b) words in the singular shall mean and include the plural and vice versa; and (c) the word "may" gives sole discretion without any obligation to take any action.

17. Borrower's Copy. Borrower shall be given one copy of the Note and of this Security Instrument.

18. Transfer of the Property or a Beneficial Interest in Borrower. As used in this Section 18, "Interest in the Property" means any legal or beneficial interest in the Property, including, but not limited to, those beneficial interests transferred in a bond for deed, contract for deed, installment sales contract or escrow agreement, the intent of which is the transfer of title by Borrower at a future date to a purchaser.

If all or any part of the Property or any Interest in the Property is sold or transferred (or if Borrower is not a natural person and a beneficial interest in Borrower is sold or transferred) without Lender's prior written consent, Lender may require immediate payment in full of all sums secured by this Security Instrument. However, this option shall not be exercised by Lender if such exercise is prohibited by Applicable Law.

If Lender exercises this option, Lender shall give Borrower notice of acceleration. The notice shall provide a period of not less than 30 days from the date the notice is given in accordance with Section 15 within which Borrower must pay all sums secured by this Security Instrument. If Borrower fails to pay these sums prior to the expiration of this period, Lender may invoke any remedies permitted by this Security Instrument without further notice or demand on Borrower.

19. Borrower's Right to Reinstate After Acceleration. If Borrower meets certain conditions, Borrower shall have the right to have enforcement of this Security Instrument discontinued at any time prior to the earliest of: (a) five days before sale of the Property pursuant to any power of sale contained in this Security Instrument; (b) such other period as Applicable Law might specify for the termination of Borrower's right to reinstate; or (c) entry of a judgment enforcing this Security Instrument. Those conditions are that Borrower: (a) pays Lender all sums which then would be due under this Security Instrument and the Note as if no acceleration had occurred; (b) cures any default of any other covenants or agreements; (c) pays all expenses incurred in enforcing this Security Instrument, including, but not limited to, reasonable attorneys' fees, property inspection and valuation fees, and other fees incurred for the purpose of protecting Lender's interest in the Property and rights under this Security Instrument; and (d) takes such action as Lender may reasonably require to assure that Lender's interest in the Property and rights under this Security Instrument, and Borrower's obligation to pay the sums secured by this Security Instrument, shall continue unchanged. Lender may require that Borrower pay such reinstatement sums and expenses in one or more of the following forms, as selected by Lender: (a) cash; (b) money order; (c) certified check, bank check, treasurer's check or cashier's check, provided any such check is drawn upon an institution whose deposits are insured by a federal agency, instrumentality or entity; or (d) Electronic Funds Transfer. Upon reinstatement by Borrower, this Security Instrument and obligations secured hereby shall remain fully effective as if no acceleration had occurred. However, this right to reinstate shall not apply in the case of acceleration under Section 18.

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20. Sale of Note; Change of Loan Servicer; Notice of Grievance. The Note or a partial interest in the Note (together with this Security Instrument) can be sold one or more times without prior notice to Borrower. A sale might result in a change in the entity (known as the "Loan Servicer") that collects Periodic Payments due under the Note and this Security Instrument and performs other mortgage loan servicing obligations under the Note, this Security Instrument, and Applicable Law. There also might be one or more changes of the Loan Servicer unrelated to a sale of the Note. If there is a change of the Loan Servicer, Borrower will be given written notice of the change which will state the name and address of the new Loan Servicer, the address to which payments should be made and any other information RESPA requires in connection with a notice of transfer of servicing. If the Note is sold and thereafter the Loan is serviced by a Loan Servicer other than the purchaser of the Note, the mortgage loan servicing obligations to Borrower will remain with the Loan Servicer or be transferred to a successor Loan Servicer and are not assumed by the Note purchaser unless otherwise provided by the Note purchaser.

Neither Borrower nor Lender may commence, join, or be joined to any judicial action (as either an individual litigant or the member of a class) that arises from the other party's actions pursuant to this Security Instrument or that alleges that the other party has breached any provision of, or any duty owed by reason of, this Security Instrument, until such Borrower or Lender has notified the other party (with such notice given in compliance with the requirements of Section 15) of such alleged breach and afforded the other party hereto a reasonable period after the giving of such notice to take corrective action. If Applicable Law provides a time period which must elapse before certain action can be taken, that time period will be deemed to be reasonable for purposes of this paragraph. The notice of acceleration and opportunity to cure given to Borrower pursuant to Section 22 and the notice of acceleration given to Borrower pursuant to Section 18 shall be deemed to satisfy the notice and opportunity to take corrective action provisions of this Section 20.

21. Hazardous Substances. As used in this Section 21: (a) "Hazardous Substances" are those substances defined as toxic or hazardous substances, pollutants, or wastes by Environmental Law and the following substances: gasoline, kerosene, other flammable or toxic petroleum products, toxic pesticides and herbicides, volatile solvents, materials containing asbestos or formaldehyde, and radioactive materials; (b) "Environmental Law" means federal laws and laws of the jurisdiction where the Property is located that relate to health, safety or environmental protection; (c) "Environmental Cleanup" includes any response action, remedial action, or removal action, as defined in Environmental Law; and (d) an "Environmental Condition" means a condition that can cause, contribute to, or otherwise trigger an Environmental Cleanup.

Borrower shall not cause or permit the presence, use, disposal, storage, or release of any Hazardous Substances, or threaten to release any Hazardous Substances, on or in the Property. Borrower shall not do, nor allow anyone else to do, anything affecting the Property (a) that is in violation of any Environmental Law, (b) which creates an Environmental Condition, or (c) which, due to the presence, use, or release of a Hazardous Substance, creates a condition that adversely affects the value of the Property. The preceding two sentences shall not apply to the presence, use, or storage on the Property of small quantities of Hazardous Substances that are generally recognized to be appropriate to normal residential uses and to maintenance of the Property (including, but not limited to, hazardous substances in consumer products).

Borrower shall promptly give Lender written notice of (a) any investigation, claim, demand, lawsuit or other action by any governmental or regulatory agency or private party involving the Property and any Hazardous Substance or Environmental Law of which Borrower has actual knowledge, (b) any Environmental Condition, including but not limited to, any spilling, leaking, discharge, release or threat of release of any Hazardous Substance, and (c) any condition caused by the presence, use or release of a Hazardous Substance which adversely affects the value of the Property. If Borrower learns, or is notified by any governmental or regulatory authority, or any private party, that any removal or other remediation of any Hazardous Substance affecting the Property is necessary, Borrower shall promptly take all necessary remedial actions in accordance with Environmental Law. Nothing herein shall create any obligation on Lender for an Environmental Cleanup.

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NON UNIFORM COVENANTS. Borrower and Lender further covenant and agree as follows:

22. Acceleration; Remedies. Lender shall give notice to Borrower prior to acceleration following Borrower's breach of any covenant or agreement in this Security Instrument (but not prior to acceleration under Section 18 unless Applicable Law provides otherwise). The notice shall specify: (a) the default; (b) the action required to cure the default; (c) a date, not less than 30 days from the date the notice is given to Borrower, by which the default must be cured; and (d) that failure to cure the default on or before the date specified in the notice may result in acceleration of the sums secured by this Security Instrument, foreclosure by judicial proceeding and sale of the Property. The notice shall further inform Borrower of the right to reinstate after acceleration and the right to assert in the foreclosure proceeding the non-existence of a default or any other defense of Borrower to acceleration and foreclosure. If the default is not cured on or before the date specified in the notice, Lender at its option may require immediate payment in full of all sums secured by this Security Instrument without further demand and may foreclose this Security Instrument by judicial proceeding. Lender shall be entitled to collect all expenses incurred in pursuing the remedies provided in this Section 22, including, but not limited to, costs of title evidence.

23. Release. Upon payment of all sums secured by this Security Instrument, Lender shall discharge this Security Instrument. Borrower shall pay any recordation costs. Lender may charge Borrower a fee for releasing this Security Instrument, but only if the fee is paid to a third party for services rendered and the charging of the fee is permitted under Applicable Law.

24. Certain Other Advances. In addition to any other sum secured hereby, this Security Instrument shall also secure the unpaid principal balance of, plus accrued interest on, any amount of money loaned, advanced or paid by Lender to or for the account and benefit of Borrower, after this Security Instrument is delivered to and filed with the Recorder's Office, SUMMIT
County, Ohio, for recording. Lender may make such advances in order to pay any real estate taxes and assessments, insurance premiums plus all other costs and expenses incurred in connection with the operation, protection or preservation of the Property, including to cure Borrower's defaults by making any such payments which Borrower should have paid as provided in this Security Instrument, it being intended by this Section 24 to acknowledge, affirm and comply with the provision of Section 5301.233 of the Revised Code of Ohio.

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BY SIGNING BELOW, Borrower accepts and agrees to the terms and covenants contained in this Security Instrument and in any Rider executed by Borrower and recorded with it.

Witnesses:

Kareena D Sibley

Kareena D Sibley

Marlynn R. O'Neal (Seal)
Marlynn R. O'Neal -Borrower

____

_______________ (Seal)
-Borrower

_______________ (Seal)
-Borrower

_______________ (Seal)
-Borrower

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-Borrower

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-Borrower

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STATE OF OHIO, Summit County ss:

KDS On this ~~May 8, 2004~~ 8th day of May 2004, before me, a
Day Month/Year
Notary Public in and for said County and State, personally appeared
KDS- ~~[illegible]~~ Marlynn R. O'Neal

the individual(s) who executed the foregoing instrument and acknowledged that he/she/they did examine and read the same and did sign the foregoing instrument, and that the same is his/her/their free act and deed.

IN WITNESS WHEREOF, I have hereunto set my hand and official seal.

My Commission Expires: 10-15-2006

Kareena D Sibley
Notary Public

Prepared By:
Jeremy Wildeman
202 Montrose W. Ave., # 240,Akron, OH 44321

KAREENA D. SIBLEY
Notary Public
In and for the State of Ohio
My Commission Expires
Oct. 15, 2006

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M.D

BORROWER NAME:

LOAN NUMBER: 0078292448 - 5522

LEGAL DESCRIPTION

EXHIBIT A

SITUATED IN THE CITY OF AKRON, COUNTY OF SUMMIT AND STATE OF OHIO:

AND KNOWN AS BEING LOT NO. 31 IN THE LEWIS MILLER ALLOTMENT AS RECORDED IN PLAT BOOK 12, PAGE 30.

BE THE SAME MORE OR LESS, BUT SUBJECT TO ALL LEGAL HIGHWAYS.

PPN: 68-32102
327 IRA AVENUE
AKRON, OHIO 44301

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LGLDLTR (08/03)

EXHIBIT 4

CASE NO.: 5:09MC82

Daniel M. McDermott, United States v. Countrywide Home Loans, Inc., (Bankruptcy Judge Shea-Stonum, unpublished but available at www.ohnb.uscourts.gov 7/31/09)(without appendix).

IT IS SO ORDERED.

Dated: 03:07 PM July 31 2009

Marilyn Shea-Stonum
MARILYN SHEA-STONUM
U.S. Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

IN RE:	)	CASE NO. 07-51027
	)	
Marlynn R. O'Neal,	)	CHAPTER 13
	)	
DEBTOR.	)	
	)	
Daniel M. McDermott, United States Trustee for Region 9,	)	ADVERSARY NO. 08-5031
	)	JUDGE MARILYN SHEA-STONUM
PLAINTIFF,	)	
	)	
vs.	)	
	)	
Countrywide Home Loans, Inc.,	)	**MEMORANDUM OPINION**
	)	
DEFENDANT.	)	

In a prior Memorandum Opinion[1] entered on the docket of this adversary proceeding on May

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[1] All capitalized terms (unless otherwise defined herein) shall have the meaning ascribed to them in the prior Memorandum Opinion.

1, 2009, this Court found that certain conduct of Countrywide Home Loans, Inc.[2] ("Countrywide") was not reasonable, was reckless and is sanctionable pursuant to § 105 and Federal Rule of Bankruptcy Procedure 9011. On May 11, 2009, the Court held a trial with respect to the issue of sanctions. Although monetary sanctions may have been appropriate, the UST did not ask for them. Therefore, the focus is on sanctions "sufficient to deter repetition of such conduct or comparable conduct by others similarly situated," including how Countrywide can modify and improve internal practices to ensure the accuracy of filings in future bankruptcy cases. *See* Fed. R. Bankr. P. 9011(c)(2).

Such improvement is necessary not just in light of what happened in Ms. O'Neal's bankruptcy case, but because of the sloppy participation of Countrywide in many chapter 13 cases across the country. As the Court noted during the trial, the problems created by the mortgage servicing industry have been pervasive in many of the cases on this Court's docket and have been the subject of respected empirical studies. The UST cited to the "Mortgage Study"[3] and specifically

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[2] On May 8, 2009, the parties to this litigation filed the following stipulation:

> Countrywide Home Loans, Inc. is a wholly owned subsidiary of Countrywide Financial Corporation. Countrywide Financial Corporation is a wholly owned subsidiary of Bank of America Corporation. On April 27, 2009, Countrywide Home Loans Servicing, LP, a subsidiary of Bank of America, N.A., changed its name to BAC Home Loans Servicing, L.P. Countrywide Home Loans, Inc., has transferred the servicing rights to loans it previously serviced or it has contracted with BAC Home Loans Servicing, LP to subservice those loans on its behalf.

The United States Trustee ("UST") asks the Court to impose sanctions upon Countrywide and its successors and/or assigns. The defendant presented no evidence to support any other result.

[3] The Mortgage Study, led primarily by Tara Twomey and Katherine Porter, is a multistate study designed to facilitate research on the intersection of mortgage

to the field data analyzed most recently by one of the most deservedly respected scholars working to shed light on bankruptcy practices across the country. In the article cited by the UST, that scholar notes

> [M]ortgage companies frequently do not comply with bankruptcy law. A majority of mortgage claims are missing one or more of the required pieces of documentation for a bankruptcy claim. Furthermore, fees and charges on claims often are poorly identified, making it impossible to verify if such fees are legally permissible or accurate. In nearly all cases [studied], debtors and mortgage companies disagree on the amount of the outstanding mortgage debt.

Porter, *supra* note 2, at 121; *see also*, Hank E. Hildebrand, III, *The Sad State of Mortgage Service Providers*, 22 SEP Am. Bankr. Inst. J. 10 (September 2003) ("mortgage servicers are having a very difficult time dealing with chapter 13"); Deb Miller Testimony before the United States Senate Judiciary Subcommittee on administrative oversight, available at http://judiciary.senate.gov/hearings/testimony.cfm (May 6, 2008) (there are "systemic problems in the mortgage servicing industry").

Despite these known problems, most claims in bankruptcy do not draw an objection. Porter, *supra* note 2, at 168 (the vast majority of all claims (96%) pass undisturbed through the bankruptcy system without objection). Although the consumer debtors' bar should make it a routine part of their representation to scrutinize mortgage claims, the reality is that the typical consumer bankruptcy practitioner deals with extensive information gathering and documentation requirements for very modest compensation; against that busy backdrop few practitioners undertake a careful review of every mortgage claim. *Id.* Those that do often find themselves dealing with initial information from

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lending and bankruptcy. Katherine Porter, *Misbehavior and Mistake in Bankruptcy Mortgage Claims*, 87 Tex. L. Rev. 121, 140-44 (Jan. 31, 2009).

the mortgage claimant that sometimes appears designed to be deliberately impenetrable.[4] The cryptic presentation of the information by mortgage holders or those charged with servicing the mortgage holders' contract with the mortgagor can have the effect of visiting upon the mortgagor significant cost in getting the most basic information about the mortgage status as perceived by the mortgagee. This may or may not be part of an actual design to discourage mortgagors from asserting their rights. Whether that is an intended consequence of the mortgagee's agent's behavior, it is often the effect of that behavior. In addition, such behavior places significant unwarranted burdens on the limited resources of this Court.

The UST asked the Court to grant injunctive relief requiring (1) that Countrywide's filings be verified by a responsible person and (2) that an auditor be appointed to review the verification process and audit every proof of claim filed by Countrywide in open and pending chapter 13 cases in the Northern District of Ohio at the time of the entry of the order in this adversary proceeding. In addition, the UST requested that Countrywide be required to provide information about its Bankruptcy Ombudsman on all notices transmitted to debtors with respect to the status or payment terms of their residential loan or mortgage and to publish information about its Bankruptcy Ombudsman on its Web site.

Countrywide argued that the relief sought by the UST is unsupported by the record before the Court and beyond the scope of the Court's authority to grant. In addition, Countrywide claimed that its voluntarily implemented measures to improve the accuracy of the information in its filings

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[4] The Court bases this conclusion on nearly 15 years of handling chapter 13 dockets. I am taking this judicial notice based upon my experiences with the more than 12,700 chapter 13 cases on my docket since Sept. 19, 1994.

are sufficient.

The evidence presented by the UST on the issue of sanctions consisted solely of the opinions of three other courts addressing problems with mortgage servicers and the testimony of John Smith, the representative of Countrywide who testified during the liability phase of trial.[5] The opinions cited by the UST provide minimal assistance to this Court in determining the appropriate sanctions in this case. Two of the opinions address the propriety of monetary sanctions against Countrywide pursuant to § 362(h) and Federal Rule of Bankruptcy Procedure 9011. *See* Exhibits 35 and 36. The third addresses misconduct by a law firm. *See* Exhibit 37.

John Smith testified that Countrywide has made voluntary changes to its practices to improve its handling of loans in bankruptcy. He testified that Countrywide created a "Bankruptcy Ombudsman" office in late 2008 to resolve issues that cannot be resolved by Countrywide's bankruptcy loans/loss mitigation department (the "Bankruptcy Department").[6] Countrywide's

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[5] The conduct of the plaintiff in this adversary proceeding puzzles the Court. Immediately upon the filing of this litigation in February 2008, an article addressing the activity of the U.S. Trustee program in filing this and two other adversary proceedings in bankruptcy courts in Atlanta and Miami, respectively, appeared in the Wall Street Journal. The Court assumes that article was the result of some form of press release. Initially counsel from the Executive Office of the UST program appeared to be coordinating plaintiff's activities in these three cases.

At the mutual request of the parties, pretrials scheduled in this matter were adjourned several times while the parties purportedly engaged in extensive discovery. In light of such purportedly extensive discovery and "central office" involvement, the Court simply cannot understand the completely truncated case presented by the plaintiff at the remedial phase of this litigation.

[6] According to Mr. Smith's testimony, the Bankruptcy Department consists of approximately 12 individuals nationally.

Bankruptcy Ombudsman office operates separate and apart from the Bankruptcy Department and Mr. Smith's personal knowledge of the Bankruptcy Ombudsman's offices' current practices and procedures was limited. In addition, Mr. Smith testified that he oversaw the creation of "validation teams" whose role was to review proofs of claim after they are prepared but before they are filed. The "validation teams" consist of approximately 40 individuals nationally. Although Mr. Smith helped establish the initial protocols for the "validation teams" and supervised the "validation teams" after their creation, his personal knowledge of their practices and procedures does not extend past mid 2008 when the supervision of the "validation teams" was transferred to someone else in Countrywide's operation.

Mr. Smith also testified that Countrywide has adopted some but not all of the "best practices" suggested by the National Association of Chapter Thirteen Trustees' Mortgage Liaison Committee. These voluntary acts should not be minimized but they are not enough and they have happened far too slowly. For instance, one of the recent improvements touted by Countrywide is the development of a system that purportedly allows Countrywide to accurately apply and track payments in bankruptcy cases. This development is long overdue. For at least the past decade, the inability of mortgage servicers to maintain accurate accounting of payments in bankruptcy situations has been noted as problematic and subjected mortgage servicers to liability. *In re Ronemus*, 201 B.R. 458 (Bankr. N.D. Tex. 1996) (finding the servicer's records wholly incredible); *see also In re Maxwell*, 281 B.R. 101 (Bankr. D. Mass. 2002). Countrywide's actions are perhaps not so "voluntary," but instead are the result of firm warnings from bankruptcy courts throughout the country. In fact, though perhaps Countrywide sees such action as voluntary, this Court wonders why record keeping necessary to the filing of accurate pleadings in bankruptcy cases should ever have been viewed as optional. Countrywide is reactive rather than proactive with respect to improving its handling of loans in bankruptcy.

I am not the first judge to address Countrywide's systemic problems. In a lengthy opinion from the Southern District of Texas, the bankruptcy court recites facts that bear a strikingly familiar pattern: lack of communication and carelessness leading to errors and unreliable information. *In re Parsley*, 384 B.R. 138 (Bankr. S.D. Tex. 2008). That bankruptcy judge asks "What kind of culture condones blockading personnel from communicating with outside counsel? What kind of culture discourages the checking of outside counsel's work? What kind of culture promotes payment histories that are so confusing to the vast majority of persons...[?]" *Id.* at 184. Despite the detailed picture painted by the bankruptcy court, that court did not affirmatively sanction Countrywide; rather, it admonished Countrywide to improve its procedures. "This Court would hope that this entity would reevaluate its policies and procedures in order to improve upon the accuracy of payment histories and to ensure that its actions do not undermine the integrity of the bankruptcy system." *Id.*

One problem with relying on the mortgage servicing industry to voluntarily improve its practices is the industry's incentive to increase costs. Its interests are not aligned with the borrower, nor even in some circumstances with its investor.[7]

> Mortgage servicers do not have a customer relationship with homeowners; they work for the investors who own the mortgage-backed securities. Borrowers cannot shop for a loan based on the quality of the servicing, and they have virtually no ability to

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[7] Indeed, as noted in the prior Memorandum Opinion in this case, an apparent driving force in Countrywide's failure to document the satisfaction of Ms. O'Neal's note and to release the mortgage was Countrywide's internal pursuit of its own fees that amounted to 56 % of the short-sale proceeds.

> change servicers if they are dissatisfied with the servicers' conduct. The only exit strategy for a dissatisfied borrower is refinancing the mortgage, and even then, the homeowner may find the new loan assigned to the prior servicer. Because their customers are the trustees who hire them to collect on behalf of investors, servicers have few reputational or financial constraints pushing them to work to satisfy homeowners with their performance.
>
> In fact, servicers have a financial incentive to impose additional fees on consumers. Mortgage servicers earn revenue in three major ways. First, they receive a fixed fee for each loan. Typical arrangements pay servicers between 0.25% and 0.50% of the note principal for each loan. Second, servicers earn "float" income from interest accrued between when consumers pay and when those funds are remitted to investors. Third, servicers often are permitted to retain all, or part, of any default fees, such as late charges, that consumers pay. In this way, a borrower's default can boost a servicer's profits. A significant fraction of servicers' total revenue comes from retained-fee income. Because of this structure, servicers' incentives upon default may not align with investors' incentives. Servicers have incentives to make it difficult for consumers to cure defaults.

Porter, *supra* note 2, at 126-27.

In this case, as set forth more fully in the prior Memorandum Opinion, it is apparent that Countrywide's system for filing proofs of claim was designed to allow each actor in the process to act with indifference to the truth, and to rely solely on the limited information made available at each step. Sanctions are necessary to deter repetition of such conduct or comparable conduct. Fed. R. Bankr. P. 9011(c)(2). "When a court metes out a sanction, it must exercise such power with restraint and discretion. *Chambers v. NASCO, Inc.*, 501 U.S. 32, 44, 111 S.Ct. 2123, 2132-33, 115 L.Ed.2d 27 (1991). The sanction levied must thus be commensurate with the egregiousness of the conduct." *Mapother & Mapother, P.S.C. v. Cooper (In re Downs)*, 103 F.3d 472, 478 (6th Cir. 1996). In this case, in order for a sanction to be sufficient it must address not only Countrywide's conduct, but also the lack of resources of debtors' counsel to challenge the claims in many appropriate instances.

I am unconvinced, based on the evidence before me, that Countrywide's voluntarily implemented "improvements" have sufficiently altered the nature of Countrywide's business model to prevent the same type of error and abuse of process from taking place in other bankruptcy cases. Nor am I persuaded, based on the evidence presented, that the specific sanctions sought by the UST are appropriately granted in this case. The UST failed to show that the cost of putting an auditor in place would be offset by the resulting benefits. The UST failed to show that providing an individual debtor with information about how to reach Countrywide's Bankruptcy Ombudsman would deter Countrywide's future conduct. In essence, the UST's suggested sanctions ignore the judicial setting in which mortgagee's rights are asserted in bankruptcy. What is needed are solutions that invigorate the procedures contemplated by the Bankruptcy Code and Rules, and that nourish the roots of the bankruptcy system, rather than simply propping up the tree. Focus and communication must improve as early as possible in the bankruptcy process. One of the systemic solutions suggested by Professor Porter is to standardize the form of itemization for mortgage claims by requiring claimants to provide as an attachment to the proof of claim details for each claim such as the type of loan, its interest rate and payment adjustment dates.[8] I find this type of solution to be narrowly tailored and likely to prevent the same type of error and abuse of process that took place in this case from taking place in other bankruptcy cases.

Therefore, beginning immediately, Countrywide and its successors and assigns are ordered

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[8] The Bankruptcy Rules Committee is studying this approach as it considers amending Fed. R. Bankr. P. 3001. At its June 1 and 2, 2009 meeting, the Committee on Rules of Practice and Procedure adopted the recommendations of the Advisory Committee on Bankruptcy Rules and approved publishing for public comment proposed amendments to Rule 3001 prescribing in greater detail the supporting information required to accompany certain proofs of claim. The proposed amendments are expected to be published in August 2009 and will be posted online at www.uscourts.gov/rules.

to complete the attached worksheet (the "Worksheet") for each new proof of claim filed by Countrywide, its successors or assigns before this Court. A copy of the completed Worksheet shall be attached to the proof of claim at the time of filing. In addition, within 75 days from the date of this Order, Countrywide, its successors and assigns are ordered to complete the Worksheet for all previously filed proofs of claim in cases currently pending on this Court's docket and file a copy of the completed Worksheet as a supplement to the previously filed proof of claim. If Countrywide, its successors and assigns fail to use and properly complete the Worksheet in support of their claims, the Court will award monetary sanctions against Countrywide, its successors and/or assigns including, but not limited to, a minimum of $300 for attorney's fees incurred by the debtor or trustee in contesting the claims of Countrywide, its successors and/or assigns, as well as any other compensatory damages that the debtor might prove.

Counsel who seek sanctions against Countrywide, its successors and/or assigns as the result of the failure to use and properly complete the Worksheet should file a motion with the Court and serve the motion on Countrywide, its successors and/or assigns, the Debtor, the Trustee and Dean Wyman of the UST's office for Region 9.

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cc: Thomas Connop
Robert Folland
Jeremy Campana
Dean Wyman
Paul Randel

EXHIBIT 5

CASE NO.: 5:09MC82

Daniel M. McDermott, United States v. Countrywide Home Loans, Inc., (Bankruptcy Judge Shea-Stonum, unpublished but available at www.ohnb.uscourts.gov 7/31/09)(Worksheet attached as Appendix)

EXHIBIT A

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF OHIO
EASTERN DIVISION AT AKRON

In re:	)	Case No. <00-00000>
	)	
<NAME OF DEBTOR(S)>,	)	Chapter < 7 > < 11 > < 13 >
	)	
Debtor(s).	)	Judge Shea-Stonum
	)	
	)	<u>ADDENDUM TO PROOF OF CLAIM</u>

I. LOAN DATA

A. IDENTIFICATION OF COLLATERAL (check all that apply):

☐ Real Estate <ADDRESS>

- ☐ Residential
- ☐ Commercial

B. VALUE OF COLLATERAL: ____________________________________

C. SOURCE OF COLLATERAL VALUATION: ________________________

D. ORIGINAL LENDER: ____

E. CURRENT NOTE HOLDER OR NON-HOLDER WITH THE RIGHTS OF A HOLDER:____

F. CURRENT LOAN SERVICER:________________________________.

BUSINESS CONTACT:_____________________________

Telephone Number:__________________________

Fax Number:________________________________

E-mail:______________________________________.

Payments should be made payable to:__________.

Address to which payments are to be sent:_____________.

NAME OF CREDITOR'S ATTORNEY:________________

Telephone Number:__________________________

Fax Number:________________________________

E-mail:______________________________________

G. DATE OF LOAN: ____

H. ORIGINAL PRINCIPAL AMOUNT DUE UNDER NOTE:________________

I. ORIGINAL INTEREST RATE ON NOTE: ____________________________

☐ Fixed

☐ Adjustable

J. CURRENT INTEREST RATE: ______________________________________

☐ Fixed

☐ Adjustable

K. ORIGINAL MONTHLY PAYMENT AMOUNT: ______________________

L. CURRENT MONTHLY PAYMENT AMOUNT: _______________________

M. THE MONTHLY PAYMENT <INCLUDES AN ESCROW AMOUNT OF $_________ FOR REAL ESTATE TAXES, PROPERTY INSURANCE, OTHER> OR < DOES NOT INCLUDE AN ESCROW AMOUNT>.

N. DATE LAST PAYMENT RECEIVED: ________________________________

O. AMOUNT OF LAST PAYMENT RECEIVED: __________________________

P. AMOUNT HELD IN SUSPENSE ACCOUNT:________________________

Q. NUMBER OF PAYMENTS DUE: __________________________________

II. AMOUNT ALLEGED TO BE DUE AS OF THE PETITION DATE

	Description of Charge (attach invoice and proof of payment for items H through K)	Total Amount of Charges	Number of Charges Incurred	Dates Charges Incurred
A.	PRINCIPAL	$		
B.	INTEREST	$		

EXHIBIT A

C.	TAXES	$	▨	▨
D.	INSURANCE	$	▨	▨
E.	LATE FEES	$		
F.	NON-SUFFICIENT FUNDS FEES	$		
G.	PAY-BY-PHONE FEES	$		
H.	BROKER PRICE OPINIONS	$		
I.	FORCE-PLACED INSURANCE	$		
J.	PROPERTY INSPECTIONS	$		
K.	OTHER CHARGES (describe in detail and state contractual basis for recovering the amount from the debtor)	$		

TOTAL OF PRE-PETITION DEBT: $_______________

III. AMOUNT OF ALLEGED POST-PETITION DEFAULT

	Description of Charge (attach invoice and proof of payment for items H through K)	Total Amount of Charges	Number of Charges Incurred	Dates Charges Incurred
A.	PRINCIPAL	$	▨	▨
B.	INTEREST	$	▨	▨
C.	TAXES	$	▨	▨
D.	INSURANCE	$	▨	▨
E.	LATE FEES	$		
F.	NON-SUFFICIENT FUNDS FEES	$		
G.	PAY-BY-PHONE FEES	$		
H.	BROKER PRICE OPINIONS	$		
I.	FORCE-PLACED INSURANCE	$		

J.	PROPERTY INSPECTIONS	$		
K.	OTHER CHARGES (describe in detail and state the contractual basis for recovering the amount from the debtor)	$		

TOTAL OF POST-PETITION DEBT: $______________

IV. TOTAL INDEBTEDNESS

A. TOTAL PRE-PETITION DEBT (from section II): $________________

B. TOTAL POST-PETITION DEBT (from section III): $________________

C. LESS AMOUNT HELD IN SUSPENSE: $________________

TOTAL PRE-PETITION AND POST-PETITION INDEBTEDNESS OF DEBTOR(S) OWED TO MOVANT AS OF THE DATE OF THIS MOTION, <DATE>: $________________

V. AN ITEMIZED, PLAIN ENGLISH PAYMENT HISTORY FROM THE INCEPTION OF THE LOAN FORWARD IS ATTACHED TO THIS WORKSHEET AS EXHIBIT 1.

This Worksheet was prepared by:

____
<Signature>
<Name>
<Title>
<Street Address>
<City, State and Zip Code>
<Phone Number>

EXHIBIT 6

CASE NO.: 5:09MC82

Daniel M. McDermott, United States v. Countrywide Home Loans, Inc., (Bankruptcy Judge Shea-Stonum, unpublished but available at www.ohnb.uscourts.gov (9/4/09).

IT IS SO ORDERED.

Dated: 09:58 AM September 04 2009

Marilyn Shea-Stonum
MARILYN SHEA-STONUM
U.S. Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

IN RE:	)	CASE NO. 07-51027
	)	
Marlynn R. O'Neal,	)	CHAPTER 13
	)	
DEBTOR.	)	
	)	
Daniel M. McDermott, United States Trustee for Region 9,	)	ADVERSARY NO. 08-5031
	)	
	)	JUDGE MARILYN SHEA-STONUM
PLAINTIFF,	)	
	)	
vs.	)	
	)	
Countrywide Home Loans, Inc.,	)	**OPINION RE: COUNTRYWIDE**
	)	**HOME LOANS, INC.'S MOTION**
DEFENDANT.	)	**TO STAY PENDING APPEAL**

In prior Memorandum Opinions[1] entered on the docket of this adversary proceeding on May 1, 2009 and July 31, 2009, this Court found that the United States Trustee had carried its burden of proof with respect to the liability of Countrywide for its conduct and awarded sanctions against

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[1] All capitalized terms (unless otherwise defined herein) shall have the meaning ascribed to them in the prior Memorandum Opinions.

Countrywide. Countrywide filed a notice of appeal to the District Court and a motion to stay the sanctions pending the appeal (the "Stay Motion"). [Docket # 103]. The Court scheduled a hearing on the Stay Motion for August 25, 2009 and abated the sanctions until August 31, 2009. The United States Trustee filed a Memorandum in Opposition to Motion to Stay Pending Appeal. [Docket # 100].

Under Bankruptcy Rule 8005, in order for Countrywide to obtain a stay pending appeal, Countrywide must prove that (1) it has made a "strong showing of likelihood of success on the merits;" (2) it will be irreparably injured absent a stay; (3) a stay will not substantially injure the other parties interested in the proceeding; and (4) the public interest lies with granting the stay. *See Mich. Coalition of Radioactive Material Users, Inc. v. Griepentrog*, 945 F.2d 150, 153 (6th Cir. 1991) (holding the factors are interrelated considerations that must be balanced together); *Rossi, McCreery and Assoc., Inc. v. Abbo (In re Abbo)*, 191 B.R. 680 (Bankr. N.D. Ohio 1996) (applying the factors set forth in *Griepentrog* to a motion for stay pursuant to Bankruptcy Rule 8005). "The movant must address each factor, regardless of its relative strength, providing specific facts and affidavits supporting its assertions that these factors exist." *Griepentrog*, 945 F.2d at 154.

At the hearing on the Stay Motion, counsel did not present any evidence to the Court. Therefore, the Court heard oral argument from counsel for Countrywide and counsel for the United States Trustee and took the Stay Motion under advisement. For the reasons set forth below in the Court's analysis of each factor, the Stay Motion is denied.

Likelihood of Success on the Merits

The first factor to be considered is whether Countrywide has shown the likelihood of success on the merits on appeal. Countrywide is required to demonstrate "more than the mere 'possibility' of success on the merits." *Griepentrog*, 945 F.2d at 153-54 (citing *Mason County Medical Ass'n v. Knebel*, 563 F.2d 256 (6th Cir. 1997)). The movant must show "serious questions going to the merits." *American Civil Liberties Union v. National Sec. Agency/Central Sec. Service*, 467 F.3d 590, 591 (6th Cir. 2006). The strength required is inversely proportional to the amount of harm Countrywide must show will befall it if a stay is not granted.

Bankruptcy Courts have the inherent power to sanction vexatious conduct before the court. *In re Rainbow Magazine, Inc.*, 77 F.3d 278, 284 (9th Cir. 1996) cited by Judge Gwin in his order denying Countrywide's motion to withdraw the reference in this adversary proceeding [docket # 38]. Judge Gwin further wrote, "Bolstering the conclusion that bankruptcy courts have sanction authority, Federal Rules of Bankruptcy Procedure 9011 specifically authorizes such sanctions. Fed. R. Bankr. P. 9011. (fn omitted) Additionally, Rule 9011 'is only one of a number of statutes and rules that enable a court to impose sanctions upon counsel and others.'" Opinion and Order, docket # 38, p. 3-4 (citations omitted).

> Section 105 grants bankruptcy courts broad powers "to implement the provisions of Title 11 and to prevent an abuse of the bankruptcy process." *In re Volpert*, 110 F.3d 494, 500 (7th Cir.1997); see also *In re Weiss*, 111 F.3d at 1159; *Burd v. Walters (In re Walters)*, 868 F.2d 665 (4th Cir.1989); *GE Capital Mortgage v. Asbill*, C/A No. 3:99-0773-19 (D.S.C.2/23/2000) ("It is clear from the very terms of this statute that Congress gave the Bankruptcy Court broad inherent discretionary powers to ensure that the motions made and issues raised before it are managed efficiently and justly"). The broad language of § 105, granting bankruptcy courts the power to prevent abuse of the judicial process must encompass the court's authority to sanction a creditor for its misconduct in providing its attorney with incorrect information on which to base a motion.

In re Kilgore, 253 B.R. 179 (Bankr. D.S.C. 2000).

Section 105 provides that the Court may

> issue any order, process or judgment that is necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process. No provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, sua sponte, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process.

11 U.S.C. § 105.

Countrywide raises the following issues in support of its argument that it has presented a serious question as to the merits: 1) the relief, akin to a mandatory injunction, granted under § 105 is unsupported by the facts; 2) Rule 9011 was not available as a basis for the imposition of sanctions; 3) there is no basis for the entry of injunctive relief; 4) the Court lacked subject matter jurisdiction to enter the relief.

After this Court found that Countrywide's manner of dealing with outside counsel deprived such counsel of appropriate information to prepare accurate proofs of claim and file them as directed by Countrywide, the defendant was afforded a full opportunity to address what, if any, remedy might be appropriate. Countrywide responded to that opportunity by calling a single witness whose personal involvement in Countrywide's processing of proofs of claim to be filed in bankruptcy courts around the country had ended almost a year prior to that hearing. Countrywide's assertion that it had addressed the problems with inaccurate information that had been amply demonstrated in the liability phase of the trial was simply that–an assertion without support of current credible evidence.

Notwithstanding the paucity of proof adduced by Countrywide at the remedial phase of the trial, this Court found that the request of the UST for the appointment of an auditor to review all claims filed by Countrywide in this Court might not be the most efficient route to ensuring the accuracy of claims filed by Countrywide. Instead, this Court focused on a tool by which Countrywide could communicate clearly with outside counsel and, in turn, with other parties in bankruptcy cases, i.e., debtors, their counsel, the chapter 13 trustee, holders of other claims secured by the same collateral, and Countrywide's own customers, to name a few. What is to be communicated? The basic data that would allow the person preparing a proof of claim to be filed on behalf of Countrywide's customer(s) to provide accurate information. This narrowly tailored remedy requires nothing more of Countrywide than to show that it has done the work necessary to file accurate proofs of claim. It is totally in keeping with the duty of any party seeking to participate in distributions to be made by trustees in bankruptcy cases and, most particularly, by chapter 13 trustees who rely on the information in proofs of claim to initiate the flow of funds to creditors in chapter 13 cases.

Countrywide's argument that it was not on notice that Rule 9011 might be a basis for relief ordered in this case is completely disingenuous. Since Judge Gwin ruled on Countrywide's motion to withdraw the reference, making specific reference to Rule 9011, Countrywide has been on notice that Rule 9011 was a factor in this case. When the UST established beyond any doubt that Countrywide filed a proof of claim in the bankruptcy case of Marlynn O'Neal that totally ignored the history of the acceptance by Countrywide of a short sale payoff of her note and thus the satisfaction of her mortgage, Rule 9011 was in full play.

Countrywide's argument that nothing supports relief that "is in the nature of injunctive relief" is again nothing more than an empty argument. What has been ordered is a remedy for Countrywide's violation of Rule 9011 and 11 U.S.C. § 105 that is tailored to promote accurate transmission of information critical to the efficient and fair administration of bankruptcy cases on this Court's docket, particularly chapter 13 cases where the filing of inaccurate proofs of claim by a party claiming a large secured claim shifts the cost of dealing with such inaccuracies to the chapter 13 trustee, debtors and their counsel, and sometimes to other creditors. The sanction ordered is not rulemaking in disguise, nor does it improperly limit or prohibit Countrywide's use of the Official Proof of Claim Form. To the contrary, the sanction requires Countrywide to fill the Official Proof of Claim Form with the accurate and complete information which the worksheet should help it gather.

Finally, Countrywide's argument that the Court lacks subject matter jurisdiction was raised before the district court in the motion to withdraw the reference. The argument was rejected by the district court. It is therefore, established for the purpose of this adversary proceeding that this Court has subject matter jurisdiction.

For the above reasons, the Court finds that Countrywide has not shown a "strong likelihood of success on the merits." This factor does not weigh in favor of granting Countrywide's request for a stay pending appeal.

Irreparable Injury Absent A Stay

The Sixth Circuit has set forth the following test to evaluate the second factor:

> In evaluating the harm that will occur depending upon whether or not the stay is granted, we generally look to three factors: (1) the substantiality of the injury alleged; (2) the likelihood of its occurrence; and (3) the adequacy of the proof provided. *Ohio ex rel. Celebrezze*, 812 F.2d at 290 (*citing Cuomo*, 772 F.2d at 977). In evaluating the degree of injury, it is important to remember that
>
>> [t]he key word in this consideration is irreparable. Mere injuries, however substantial, in terms of money, time and energy necessarily expended in the absence of a stay, are not enough. The possibility that adequate compensatory or other corrective relief will be available at a later date, in the ordinary course of litigation, weighs

> heavily against a claim of irreparable harm.
>
> *Sampson v. Murray*, 415 U.S. 61, 90, 94 S.Ct. 937, 953, 39 L.Ed.2d 166 (1974) (*quoting Virginia Petroleum Jobbers Ass'n v. Federal Power Comm'n*, 259 F.2d 921, 925 (D.C.Cir.1958)). In addition, the harm alleged must be both certain and immediate, rather than speculative or theoretical. *See Wisconsin Gas Co. v. Federal Energy Regul. Comm'n*, 758 F.2d 669, 674 (D.C.Cir.1985). In order to substantiate a claim that irreparable injury is likely to occur, a movant must provide some evidence that the harm has occurred in the past and is likely to occur again. *Id.*

Griepentrog, 945 F.2d at 154.

In this case, Countrywide alleges in its Stay Motion that if the Court's order is not stayed, Countrywide will incur a greater cost in servicing loans. Countrywide proceeds simply with argument, having offered no proof at either the remedial phase of the trial or at the hearing on the its Stay Motion in support of this bare allegation. Countrywide suggests that the sanction will place it at a competitive disadvantage relative to other mortgage servicers and cites to *Basicomputer Corp. v. Scott*, 973 F.2d 507 (6th Cir. 1992), in support of its suggestion that a competitive disadvantage, assuming it exists, can constitute irreparable harm. In *Basicomputer*, a case involving the breach of a non-compete clause in an employment contract, the Sixth Circuit did find that damages flowing from competitive losses and losses of customer goodwill are difficult to calculate and "often amount to irreparable injury because the damages flowing from such losses are difficult to compute." *Id.* at 512. It also found, however, that there were facts in the record sufficient to support such a finding. *Id.* ("[T]he record contains ample evidence to support the court's findings ... These facts are sufficient to support a finding that Basic would suffer competitive injury and loss of goodwill.").

Once again in this case, Countrywide has presented no evidence in support of its notion that it will suffer competitive loss if a stay is not issued. Indeed, all that is being required of Countrywide is to demonstrate that it has attended to the details necessary to present accurate proofs of claim to this Court. In addition, John Smith testified in the remedial phase of this proceeding that Countrywide already has "validation teams" in place whose purpose is to review proofs of claims before they are filed. Countrywide has presented no evidence in support of why it would be such a burden for the validation teams to provide the information required by the Bankruptcy Code and Rules in the plain English format of the Worksheet. (If in fact it is because Countrywide does not currently gather all of this information prior to filing a proof of claim, then perhaps its claimed "competitive disadvantage" is really just requiring Countrywide to play on the same level as the other players.) There is no proof that Countrywide will suffer irreparable harm if a stay is not granted. *See In re Stewart*, 2009 WL 1649731 (E.D. La. 2009) (The district court denied a motion for stay pending appeal of the bankruptcy court's order requiring Wells Fargo to conduct an audit of all proofs of claim filed and to amend and supplement the filed proofs of claim where necessary to comply with the principles espoused by the bankruptcy court in that case. In part, the district court's decision was based on a finding that Wells Fargo failed to prove irreparable injury as a matter of law, given its continuing obligation to file accurate proofs of claim and to correct inaccurate proofs of claim under Fed. R. Bankr. P. 9011 and 11 U.S.C. § 105.). Irreparable harm cannot be assumed, it must be proven. Therefore, this factor does not weigh in favor of granting Countrywide's Stay Motion.

No Substantial Injury To The Other Parties Interested In The Proceeding

The third factor requires Countrywide to show that other interested parties will not suffer substantial injury if a stay is granted. Bankruptcy cases adjust the rights of all creditors. If a claimant asserts inaccurate amounts due to it, and particularly in amounts greater than what is actually owed, the limited resources of the chapter 13 trustee and sometimes the Court must be expended in sorting out the ensuing confusion. Distributions to other claimants are suspended, and sometimes the viability of a particular chapter 13 case is destroyed because of the resulting time and cost factors.

The district court in *In re Stewart*, noted

> the interests of other debtors in the Eastern District of Louisiana are certainly at issue, and these interests are relevant whether as parties or generally as the public. Without resolving the unique issues present in this motion, the Court proceeds under the most conservative application of "parties" and addresses the interests of the debtors under the fourth factor. Putting aside the interests of other debtors, the Court finds that the harm accruing to the other named party in this case, Dorothy Stewart, is minimal if a stay is not granted. However, given that the movant's injury necessarily resulting from the injunction is unclear, the Court does not find this factor to be particularly helpful in assessing whether or not a stay should be granted in this case.

In re Stewart, 2009 WL 1649731 at *5. While it is true that the harm to Ms. O'Neal in this particular case would be minimal, as the court found in *Stewart,* the other potentially affected debtors' interests lay in accurate and evidentiary based proofs of claim. If the stay is granted, debtors may make decisions in their individual cases based on inaccurate proofs of claim. In Akron, the chapter 13 trustee pays proofs of claim as filed; thus, inaccurate proofs of claim affect the debtor, the creditors and all other participants. On my docket to date this year there have been approximately 800 chapter 13 cases filed. Obviously Countrywide has not asserted a claim in each of those cases, but the UST has adduced sufficient evidence to show that Countrywide's practices can dilute the efficient and fair administration of those cases.

Where Does The Public Interest Lay?

Finally, the Court must consider the fourth factor - whether granting a stay would serve the public interest. *Griepentrog,* 954 F.2d at 155. The potential for public consequences as the result of granting a stay is of particular import. *See, e.g., Weinberger v. Romero-Barcelo*, 465 U.S. 305, 312 (1982).

Countrywide suggests that the public interest is better served by a stay because it views the Court's sanction as rulemaking. However, as addressed above, the Court's sanctions are not rulemaking in disguise. The sanction applies only to Countrywide and were meted out in light of the evidence presented at the hearings in this matter which led the Court to the conclusion that Countrywide has abused the judicial process by continuing to file proofs of claim in cases on this Court's docket without regard to the accuracy of their content. The Worksheet required by the Court's order requires similar information to that required by Official Form No. 10, but asks that the information be presented in an accessible, easy to understand format that will encourage the preparer of the Worksheet to have and seek to include only accurate information.

The public interest is served by allowing the sanction to become effective immediately. The bankruptcy system, and each player in it, is served by putting an end to Countrywide's abuse of the claims process in bankruptcy and having accurate and easy to understand information sooner rather than later. *In re Harris*, 2007 WL 1306483, *4 ("The public interest - especially preventing abuse of the bankruptcy process - favors a quick decision of the dispute."); *In re Stewart*, 2009 WL 1649731, *5 (the district court found judicial efficiency to be a significant public interest and in light of the expenditure of judicial resources required to get to a proper proof of claim, the district court found the public interest weighs against granting the request for a stay). Having found that the public interest is better served by stopping abusive practices sooner rather than later, the Court finds this factor weighs against granting Countrywide's request for a stay pending appeal.

CONCLUSION

Considering all four factors together, the Court finds Countrywide's Motion for Stay Pending Appeal not to be well taken and it is denied.

###

cc: Thomas Connop
Robert Folland
Jeremy Campana
Dean Wyman
Paul Randel

BRIEF BANK — "SUMMARY SHEET"

Printed Thu-9/3/09 9:46

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*
In re On-Site Sourcing Inc., et al. (The Official Committee of Unsecured Creditors v. Office of the United States Trustee)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*
E.D. Va.

3. ("CCN") ***CURRENT*** CASE NO.
No.: 1:09-cv-823

4. ("PCN") ***PRIOR*** CASE NO. - & COURT *[IF ANY]*
No.: 09-10816-RGM
Court: Bankr. E.D. Va.
(Identify judge & cite, if any)

5. ("SO") ***SOURCE***
U.S. TRUSTEES

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*
Filed: August 27, 2009
Type: Brief of Appellee United States Trustee

7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*
Martha L. Davis, John Sheahan, P. Matt Sutko, Clarkson McDow
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***
• Did the bankruptcy court err by denying a motion to place proceeds of the sale of the debtor's assets into a trust for the benefit of unsecured creditors, to the exclusion of higher-priority creditors?

10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)

11. DO YOU RECOMMEND POSTING IN UST BRIEFBANK?
| x | YES | | NO
NAME: Linda Figueroa
DATE:

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF VIRGINIA
ALEXANDRIA DIVISION

	)	
In Re:	)	
	)	
ON-SITE SOURCING, INC., ET AL.,	)	Civil Action No. 1:09-cv-823
	)	
Debtors.	)	
	)	
THE OFFICIAL COMMITTEE OF	)	
UNSECURED CREDITORS,	)	
	)	
Appellant,	)	
	)	
v.	)	BK Case No. 09-10816-RGM
	)	Chapter 11
OFFICE OF THE UNITED STATES	)	Jointly Administered
TRUSTEE,	)	
	)	
Appellee.	)	
	)	

On Appeal from An Order of the United States Bankruptcy Court
Entered June 2, 2009

BRIEF OF APPELLEE UNITED STATES TRUSTEE

Martha L. Davis (Va. Bar No. 20249)
Office of the United States Trustee
115 South Union Street, Suite 210
Alexandria, VA 22314
(703) 557-7180
(703) 557-7279 (Facsimile)

Counsel for W. Clarkson McDow, Jr.
United States Trustee, Region 4

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	)	
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	)	Chapter 11
OFFICE OF THE UNITED STATES	)	Jointly Administered
TRUSTEE,	)	
	)	
Appellee.	)	
	)	

On Appeal from An Order of the United States Bankruptcy Court
Entered June 2, 2009

BRIEF OF APPELLEE
UNITED STATES TRUSTEE

OPENING STATEMENT

This is an appeal from an order entered by the bankruptcy court on June 2, 2009, which affects the distribution of proceeds from the sale of the debtors' assets. The underlying sale order is final and is not at issue in this appeal. By the June 2 order that is the subject of this appeal, the bankruptcy court denied the request of the Committee of Unsecured Creditors to place some of the sale proceeds into a trust for the sole benefit of general unsecured creditors, to the detriment of other creditors whose claims would otherwise be entitled to a higher priority. The bankruptcy court instead held that those funds, like any other assets of the bankruptcy estate, should be distributed according to the terms of the debtors' eventual chapter 11 plan and in compliance with the distribution rules established by the Bankruptcy Code. The bankruptcy court's ruling was not an abuse of discretion, and should be affirmed.

STANDARD OF REVIEW

This matter came before the bankruptcy court on debtors' motion to sell assets out of the ordinary course of business pursuant to 11 U.S.C. § 363(b)(1). Because section 363(b)(1) does not specify the grounds upon which a sale should be approved, the applicable standard of review is whether the bankruptcy court abused its discretion in declining to approve certain terms of sale. See Morris v. Zabu Holding Co. (In re Morris), 385 B.R. 823, 828 (E.D. Va. 2008) (bankruptcy court's decision to lift the automatic stay under § 362 is reviewed for abuse of discretion because statute does not define "cause") citing Robbins v. Robbins (In re Robbins), 964 F.2d 342, 345 (4th Cir. 1992). Cf. Committee of Equity Security Holders v. Lionel Corp. (In re Lionel Corp.), 722 F.2d 1063, 1068 (2d Cir. 1983)(under analogous sale provision of the Bankruptcy Act of 1898, appellate review was limited to abuse of discretion).

STATEMENT OF THE FACTS

On February 4, 2009, On-Site Sourcing, Inc., DocuForce, Inc. and On-Site LA, Inc. (“debtors” or “On-Site”) filed voluntary petitions under the reorganization provisions of chapter 11 of the Bankruptcy Code. On-Site was reportedly one of the world’s largest independent litigation support providers, offering combined resources of forensics, electronic processing and online document review services. In 2007, the company began experiencing dramatic revenue declines due to changes in the paper and electronic discovery markets. In an effort to preserve its going-concern value, On-Site entered into an agreement to sell substantially all its assets to a competitor, Integreon Discovery Solutions (DC), Inc., subject to higher and better offers.

The bankruptcy cases were filed to facilitate that sale. Shortly before the bankruptcy filings, Integreon had purchased all of debtors’ secured debt totaling approximately $36 million so in addition to being a competitor and the stalking horse bidder, Integreon was also debtors’ secured creditor/lender. On February 5, the day after the bankruptcies were filed, debtors filed a motion to establish bid procedures to sell substantially all of their property to Integreon which had made a credit bid of $28.8 million, or to the highest bidder.

On February 19, 2009, the United States Trustee appointed a Committee of Unsecured Creditors pursuant to 11 U.S.C. § 1102(a)(1).

On February 23, 2009, the court approved debtors’ motion to establish bid procedures. Following the marketing period, debtors filed a notice on March 25, 2009, that Integreon was the only and, therefore, successful bidder of their assets.

During this process, the Committee of Unsecured Creditors along with debtors and Integreon negotiated changes to the original asset purchase agreement which resulted in

Integreon agreeing to a number of concessions. See Term Sheet attached as Exhibit A to the Notice of Material Changes to Terms of Asset Purchase Agreement, filed April 9, 2009. (R. Ex J). Among other things, Integreon agreed to forgive all debtors' outstanding indebtedness above and beyond the purchase price; it agreed to fund budgeted expenses as well as pay additional cash sums; and it agreed to relinquish or exclude certain assets from the sale. Part of these concessions flowed to the debtors' estates and part of them went to a separate trust to pay "creditors holding allowed general unsecured claims after the payment of any unpaid Committee professional fees and expenses." ("Collateral Carve-Out"). (R. Ex. J). The specific assets to be carved-out or contributed to the unsecured creditors trust were (1) an undivided one-half interest in debtors' tax refunds; (2) a lump sum payment of $132,500; and (3) payment of $225,000 toward the professional fees of the committee less any amount previously contributed.

The last paragraph of the Term Sheet states as follows:

> Integreon and the Committee recognize that the creation of such a separate trust remains subject to approval by the Bankruptcy Court. <u>If the Court does not approve the establishment of such a trust, it is understood and agreed that Integreon will not be expected or required to provide any further consideration for the sale and the sale shall go forward with all of the assets provided for herein being received by the On-Site Estate including, without limitation, the Collateral Carve-Out</u>.

Emphasis Added. (R. Ex. J).

The United States Trustee filed an objection to the Notice of Material Changes because the Collateral Carve-Out appeared to allow unsecured creditors to receive a distribution without assuring that administrative and priority claims would first be paid in full. According to the debtors' bankruptcy schedules, their prepetition debt totaled approximately $37 million in secured debt, $421,000 in priority debt, and over $6.6 million in general debt.[1]

On April 22, 2009, the bankruptcy court conducted a hearing on debtors' motion to approve the sale. At that hearing, the United States Trustee's counsel amplified his concerns that in a chapter 11 case, pre-petition unsecured creditors should be paid pursuant to a plan or, if the case was going to be converted, according to the chapter 7 statutory distribution scheme. The proposed trust by-passed these statutory mechanisms and effectively allowed unsecured creditors to be paid ahead of administrative and priority creditors.

The court approved the sale but declined to approve the trust finding that it was a *sub rosa* chapter 11 plan. (R. Ex. M 64:25-72:2). The court directed the debtors to hold the assets that would have gone into the trust in a segregated account pending further order of the court. In so ruling, the court did not foreclose the possibility that a plan might be proposed that would provide for the creation of a trust. (R. Ex. M 71:18-72:2, 74:5-19) Likewise, the court did not foreclose the possibility that another vehicle might be proposed for the court to consider. (R. Ex. M 74:13-19).

The sale hearing was continued to April 28, 2009, for the presentation of the sale order. At that point, because of some confusion, the court clarified its earlier ruling that it was not approving the carve-out and again suggested that the payment to unsecured creditors would have to await future developments:

> THE COURT: . . . What I thought I was saying and what I intended to say is that the carve-out is not approved. I think Mr. Frankel's comments were right on point on that.
>
> You're circumventing the usual processes of the chapter, of Chapter 11, to the

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[1] In addition to prepetition debts, there are usually administrative expenses which are expenses that arise after the commencement of a case. See 11 U.S.C. § 503(b).

> detriment of other creditors, other classes of creditors, administrative, secured, whatever they may be, and the timing within which those claims are created.
>
> At the same time, and, therefore, you revert back to what you had agreed to, which was in the time [sic] sheet.
>
> Now, as an accommodation and because I didn't think that there would be need to invade this, at least to any significant expense, what I envisioned was that the normal process of Chapter 11 would be followed and whatever agreements or negotiations resolved is what they will resolve.
>
> It may well be that you can have a strict distribution in accordance with what the distribution would be in Chapter 7. There may be some other reasons to modify. I don't know those. I'm not privy to everything that's going on.
>
> But I envisioned the Chapter 11 process to progress. There is an absolute priority rule. And unless that can be modified, that's going to control the disposition of the thing.

(R. Ex. N 12:11- 13:21).

By order entered April 30, 2009, the court approved the sale with the Committee's express support even as the order also indicated that "[b]y separate order, the Court has found and determined that the Collateral Carve-Out circumvents the ordinary Chapter 11 distribution process and violates the absolute priority rule. The Committee does not consent to the Court's denial of the Collateral Carve-Out." (R. Ex. P ¶ L). Paragraph 20 of the sale order provides that Integreon would pay to the debtors all the funds that would have gone into the unsecured creditors trust to be held in a separate bank account pending further order of the court. (R. Ex. P ¶ 20).

On June 2, 2009, the court entered a separate order denying the Collateral Carve-Out. (R. Ex. Q). The Committee filed a timely appeal on June 12, 2009.[2]

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[2] As of this date, the chapter 11 debtors have not filed a disclosure statement and plan. The United States Trustee has filed a motion to convert the case to chapter 7 which is set for hearing September 22, 2009. In his motion, the United States Trustee suggested in the alternative that the court set a deadline for debtors to file a plan.

ARGUMENT

I. IN APPROVING A SALE OF SUBSTANTIALLY ALL OF DEBTORS' ASSETS, THE COURT DID NOT ABUSE ITS DISCRETION IN DENYING THE PROVISIONS THAT WOULD HAVE FUNNELED PART OF THE SALE PROCEEDS INTO A TRUST FOR THE SOLE BENEFIT OF UNSECURED CREDITORS AND TO THE DETRIMENT OF HIGHER PRIORITY CREDITORS

Section 363(b)(1) of the Bankruptcy Code provides that "[t]he trustee,[3] after notice and a hearing, may use, sell, or lease, other than in the ordinary course of business, property of the estate . . . ." In the seminal case of Committee of Unsecured Creditors v. Lionel Corp. (In re Lionel Corp.), 722 F.2d 1063 (2d Cir. 1983), the Second Circuit observed that although § 363(b) appears to provide courts with "virtually unfettered discretion" to authorize sales, courts do not have carte blanche.

> Several reasons lead us to this conclusion: the statute requires notice and a hearing, and these procedural safeguards would be meaningless absent a further requirement that reasons be given for whatever determination is made; similarly, appellate review would effectively be precluded by an irreversible order; and finally, such construction of § 363(b) swallows up Chapter 11's safeguards. In fact, the legislative history surrounding the enactment of Chapter 11 makes evident Congress' concern with rights of equity interests as well as those of creditors.

Id. at 1069 (footnote omitted).

The Lionel Court concluded that "[t]he history surrounding the enactment in 1978 of current Chapter 11 and the logic underlying it buttress our conclusion that there must be some articulated business justification, other than appeasement of major creditors, for using, selling or leasing property out of the ordinary course of business before the bankruptcy judge may order

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[3] In a chapter 11 case, the debtor in possession performs the function of a trustee. 11 U.S.C. § 1107(a).

such disposition under section 363(b)." Id. at 1071. In reaching this decision, a court should consider "all salient factors pertaining to the proceeding" including factors such as "the likelihood that a plan of reorganization will be proposed and confirmed in the near future, [and] the effect of the proposed disposition on future plans of reorganization." Id.

Thus, when a significant transaction arises in a case which requires court approval prior to the submission of a plan, courts may properly consider whether the transaction is a *sub rosa* plan of reorganization "or an attempt to circumvent the chapter 11 requirements for confirmation." In re Chrysler, LLC, 405 B.R. 84, 95-96 (Bankr. S.D.N.Y. 2009) (citing Motorola v. Committee of Unsecured Creditors (In re Iridium Operating LLC), 478 F.3d 452, 466 (2d Cir. 2007)(citing Pension Benefit Guaranty Corp. v. Braniff Airways, Inc. (In re Braniff Airways, Inc.) 700 F.2d 935, 940 (5th Cir. 1983).

In this instance, whether the sale of debtors' assets to Integreon was appropriate is not contested. Rather, the question is whether it was appropriate for the court, in the context of considering that sale, to deny one of the proposed changes to the underlying sale agreement that would have allowed some of the sale proceeds to be channeled into a trust that would only benefit general unsecured creditors. Considering the record, and the court's reasoning, the bankruptcy court's decision was entirely appropriate and should be affirmed.

A. The Bankruptcy Court Did Not Err In Denying The Carve-Out Because To Have Done So Would Have Been Tantamount To Approving A *Sub Rosa* Plan

The Bankruptcy Code provides a structure whereby claims have a certain order of priority in distribution.

> U.S. bankruptcy law imposes a hierarchy on claims referred to as the "absolute priority rule." Under this rule, unless the senior

> creditors agree otherwise, priority claims are required to be satisfied in full before junior claims are entitled to any distribution from the debtor's estate. Secured claims have the highest priority under the absolute priority rule, inasmuch as no portion of the value of a secured creditor's collateral may be distributed to any other claimant unless the lien on such property is discharged or "adequately protected." Creditors whose claims arose postpetition (known as "administrative claimants"), certain prepetition claims and certain prepetition taxes are all "priority claims." General unsecured prepetition claims are junior to such priority claims and senior only to subordinated unsecured prepetition debt (to the extent provided in the instruments governing such subordinated debt) and the interests of equity holders. Section 507 of the Bankruptcy Code establishes the relative priorities of the priority claims against the debtor's estate.

James E. Millstein & Shari Siegel, <u>Strategic Investments and Acquisitions in the Chapter 11 Context</u>, 754 PLI/CORP 353, 368 (1991). This priority scheme applies regardless of whether the case is in chapter 11 or chapter 7. <u>See</u> 11 U.S.C. §§ 507 (describing Code priorities), 726 (explaining distribution scheme in chapter 7), and 1129(a)(9) (detailing required treatment of administrative and priority claims under chapter 11 plan). <u>See</u> <u>Ford Motor Credit Co. v. Reynolds & Reynolds Co. (In re JKJ Chevrolet, Inc</u>.), 26 F.3d 481, 484 (4th Cir. 1994) (Bankruptcy Code's policy is equitable distribution among creditors of the same class and in accordance with the priorities set forth in §§ 507, 726).

As the court points out in its memorandum opinion, the unsecured creditors trust effectively predetermined the yet-to-be drafted plan of reorganization because it would have permitted unsecured creditors to be paid even though claims of a higher order of priority were not being paid in full. Counsel for the Committee candidly admitted that this provision was designed to trump the distribution scheme under the Bankruptcy Code.

THE COURT: The trust gets the money and where does the money go from the trust?

MR. GOLD: The trust - - it goes into the trust and it will be distributed pro rata.

THE COURT: Pro rata to whom?

MR. GOLD: To general unsecured creditors with allowed claims.

THE COURT: What about priority creditors or administrative claimants?

MR. GOLD: They will be satisfied from the estate.

THE COURT: What if there is not enough money?

MR. GOLD: That's the whole point.

THE COURT: It is, isn't it.

MR. GOLD: That's the point.

(R. Ex. M 55:1-15).

Although the Committee apparently believes that the bankruptcy court should have closed its eyes to the ramifications of these proposed terms, it would have been error for the court to have done so. In re Lionel Corp., 722 F.2d at 1071 (reversing lower courts' approval of a sale for failing to consider factors); In re Continental Air Lines, Inc. 780 F.2d at 1227-8 (reversing lower courts' approval of leases for failing to consider *sub rosa* plan arguments); see also United States v. AWECO, Inc. (In re AWECO, Inc.), 725 F.2d 293, 299 (5th Cir. 1984) (reversing approval of settlement with junior claimant that may have prevented a senior claimant from being paid in full due to insufficient factual record). Here, the bankruptcy court examined the terms and acted properly in declining to approve them - at least not in the format presented and without the disclosures and processes that attend confirmation of a plan.

B. There Was No Business Justification for The Carve-Out

The bankruptcy court was also correct in finding that there was no good business reason for the debtors to include the Carve-Out. The business justification for a transaction goes to what is in the best interest of the estate and will aid the reorganization. In re Lionel Corp. 733 F.2d at 1071. The Committee counters that the Carve-Out must have been supported by good business reasons because the sale itself was approved. But this falls short of explaining why it was necessary to the sale and to the estate, to have a Carve-Out funding an unsecured creditors trust while other creditors of a higher priority would not be paid in full first. The Committee's own argument that "waiting until the confirmation of plan . . . was not an option . . . given the expedited sale process" suggests that the Carve-Out was nothing more what it appeared to be - a device that would distribute funds to unsecured creditors in lieu of a plan. Appellant's Brief at 23.

The Committee also seeks to justify the Carve-Out in terms of being a form of settlement between the Committee and Integreon. Even assuming, *arguendo*, this was the case, the parties did not file a motion to approve the settlement as required by Rule 9019 of the Federal Rules of Bankruptcy Procedure. Moreover, the fact remains that if there was a *quid pro quo*, neither the sale nor the Committee's support for the sale was made contingent on the bankruptcy court's approval of the Carve-Out. In fact, just the opposite occurred: the parties made contingency plans and specifically *agreed* that the assets would go to the estates if the Carve-Out was not approved. (R. Ex. J). Denial of the Carve-Out did not affect the sale price, alter Integreon's obligations, or change the Committee's continuing support for the sale.

C. The Bankruptcy Court Did Not Abuse Its Discretion

Relying on Official Unsecured Creditors' Committee v. Stern (In re SPM Manufacturing Corp.), 984 F.2d 1305 (1sth Cir. 1993) and In re World Health Alternatives, Inc., 344 B.R. 291 (Bankr. D. Del. 2006), the Committee argues the court should not have considered the absolute priority rule in the context of a section 363 sale, because that provision only applies to the confirmation of a chapter 11 plan. As demonstrated above, however, whether a section 363 transaction amounts to a *sub rosa* plan of reorganization is an appropriate consideration in chapter 11. SPM would not have had occasion to consider whether there was a *sub rosa* plan since it was a chapter 7 case, and it does not appear that World Health ever considered the absolute priority issue in that context.

Once a court finds that certain terms of a section 363 sale constitute a *sub rosa* plan, it is not an abuse of the court's discretion to excise the offending terms. In re Continental Air Lines, Inc. 780 F.2d at 1228. In making this determination it is implicit that the court would have to consider what some of the chapter 11 requirements were including, for example, the chapter 11 distribution scheme and the absolute priority rule. Thus, although the absolute priority rule may not apply to a section 363 sale in the strictest sense of the word, it is nevertheless an appropriate consideration which influences the "appropriate protective measures" that a court may need to adopt. Id.

It also bears repeating that the bankruptcy court did not preclude the creation of a trust if it was brought forward in the form of a proposed plan of reorganization. In a somewhat similar circumstance, the Fourth Circuit rejected the proposed creation of an emergency treatment fund as part of the Dalkon Shield litigation in the A.H. Robins bankruptcy case, because it was not part of a plan:

> The Bankruptcy Code does not permit a distribution to unsecured creditors in a Chapter 11 proceeding except under and pursuant to a plan of reorganization that has been properly presented and approved. 11 U.S.C. § 1121 provides for the filing of a plan of reorganization. Sections 1122-1129 set forth the required contents of a plan, the classification of claims, the requirements of disclosure of the contents of the plan, the method for accepting the plan, any modification thereof, the hearing required on confirmation of the plan and the requirements for confirmation. The clear language of these statutes, as well as the Bankruptcy Rules applicable thereto, does not authorize the payment in part of in full, or the advance of monies to or for the benefit of unsecured claimants prior to the approval of the plan of reorganization. The creation of the Emergency Treatment Program has no authority to support it in the Bankruptcy Code and violates the clear policy of Chapter 11 reorganizations by allowing piecemeal, pre-confirmation payments to certain unsecured creditors.

Official Committee of Equity Security Holders v. Mabey, 832 F.2d 299, 302 (4th Cir. 1987).

Accordingly, it was entirely appropriate for the bankruptcy court to consider possible confirmation-related issues when it was asked to approve a significant transaction - the sale of substantially all the debtors' assets - prior to a plan being proposed. "Undertaking reorganization piecemeal pursuant to § 363(b) should not deny creditors the protection they would receive if the proposals were first raised in the reorganization plan." In re Continental Air Lines, Inc., 780 F.2d at 1227-8.

II. THE COMMITTEE'S ARGUMENT THAT A SECURED CREDITOR MAY "GIFT" PROPERTY TO JUNIOR CREDITORS IS INAPPOSITE BECAUSE THE SALE PROCEEDS WERE PROPERTY OF THE ESTATE.

The gravamen of the Committee's argument on appeal is that a secured creditor can "gift" part of its collateral to whomever it wants and that, in this case, the bankruptcy court should have approved the "gift" that would have gone into a trust to be established solely for the benefit of unsecured creditors. The Committee cites Official Unsecured Creditors' Committee v. Stern (In re SPM Manufacturing Corp.), 984 F.2d 1305 (1sth Cir. 1993) and In re World Health Alternatives, Inc., 344 B.R. 291 (Bankr. D. Del. 2006) for the proposition that the absolute priority rule does not prevent secured creditors from gifting their own property as they see fit.

The United States Trustee contends that these cases are inapplicable because this court does not need to decide the "gift" issue in order to resolve this appeal. That stems from the fact that whatever assets the secured creditor, Integreon, might arguably have "gifted" to the unsecured creditors' trust, those assets are property of the bankruptcy estates. With the purported donor gone and the sale transaction now complete, the issue of whether the "gift" should have been allowed has not been preserved.[4] The only question that remains is one of distribution: whether the Carve-Out funds should remain with the estates to be distributed under the Bankruptcy Code, or whether they should be distributed to an unsecured creditors trust in derogation of the Code's priorities. That issue should be decided by determining whether the bankruptcy court abused its discretion in excising the Carve-Out terms from the proposed sale.

In any event, SPM and World Health can be distinguished.[5] They are also not binding on this court . In SPM, the Bank was owed $9 million and held a perfected first lien on most of the debtor's assets. While the case was pending under chapter 11, the Bank and the Committee of Unsecured Creditors executed an agreement to cooperate in various matters and to share the

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[4] The Term Sheet expressly provided that "Integreon and the Committee recognize that the creation of such a separate trust remains subject to approval by the Bankruptcy Court. If the Court does not approve the establishment of such a trust, it is understood and agreed . . . the sale shall go forward with all of the assets provided for herein being received by the On-Site Estate including, without limitation, the Collateral Carve-Out." (R. Ex. J).

[5] As addressed earlier, neither court had occasion to consider whether there was a *sub rosa* plan.

proceeds they received either in a reorganization or liquidation of the debtor. The first $3 million of proceeds would be shared 90% to the Bank and 10% to the Committee. The second $3 million would be shared 80% to the Bank and 20% to the Committee. The debtor's assets eventually sold for $5 million, the Bank was granted relief from the automatic stay, and the case was converted to chapter 7. The Bank and the Committee then filed a joint motion to require the delivery of the sale proceeds to the Bank. The motion indicated that after it received the proceeds, the Bank would distribute funds to the Committee's counsel in accordance with the sharing agreement. The bankruptcy court approved the distribution to the Bank but rejected the motion to the extent it requested approval for the Bank to share the proceeds. Instead, the Bank was ordered to deliver the proceeds to the chapter 7 trustee. The First Circuit reversed the lower courts based on one crucial fact: "Any sharing between the [Bank] and the general unsecured creditors was to occur *after* distribution of the estate property, having no effect whatever on the bankruptcy distributions to other creditors." 984 F.2d at 1312 (emphasis in original). Because the agreement did not become operative until after there was a proper distribution of estate assets, the Circuit did not find that the distribution came at the expense of priority creditors.

Unlike SPM, this case did not involve a sale to a third party; it involved a sale of estate property to the secured lender. Whatever Integreon might arguably have contributed to the unsecured creditors trust, it was bargaining with assets that were property of the estates. The bankruptcy court was correct in asserting its jurisdiction over that property and in considering the absolute priority rule as well as other plan confirmation issues since any future distribution - whether in chapter 11 pursuant to a plan or in chapter 7 - will come from the bankruptcy estates. Integreon is no longer in the picture, having consummated the sale and released its liens. Since the assets have been released or conveyed to the estates, free and clear of any liens, the rights of other creditors, such as administrative and priority creditors, would be adversely affected by any order that would require debtors to distribute those assets other than pursuant to the Bankruptcy Code's scheme of distribution.

World Health is more analogous to the facts presented here as it involved a quick sale of substantially all the debtor's assets. There, the Committee actually filed an objection to the bid procedures and DIP financing motion, while it reserved its right to object to the sale motion. At the sale hearing, the Committee advised the court that it was withdrawing its objection due to a settlement with the Bank. The sale was approved, and debtor subsequently filed a motion to approve the settlement pursuant to Rule 9019 of the Federal Rules of Bankruptcy Procedure. Under the settlement the Bank would pay $1,625,000 to the Committee's counsel for distribution to allowed general unsecured claims after payment of professional fees and/or investigation and prosecution of estate causes of action against parties other than the Bank. The settlement specifically preserved the Committee's right to challenge the Bank's position until the court entered a final nonappealable order and in the event the court did not approve the settlement, the Committee had an additional five days to proceed. While there are a number of differences, one critical fact that distinguishes World Health was that "non-approval would enable [the Bank] to keep the $1,625,000." 344 B.R. at 300. Here, the assets did not revert back to Integreon but flowed into the estates. Another difference is that World Health involved the approval of a settlement motion.

Fundamentally, carve-outs pose troubling issues - not so much for the concept - but because the imprimatur of the bankruptcy court is sought to bless transactions that are otherwise portrayed as not involving property of the estate and serve to redistribute property in accord with a private agreement, instead of pursuant to the Bankruptcy Code.[6] Although it is often stated that the property at stake "belongs" to the secured creditor, such conclusions bear closer scrutiny. Section 541 provides for the creation of a bankruptcy estate upon the filing of a bankruptcy petition. Property included in the estate is defined very broadly and includes property that is subject to a security interest. United States v. Whiting Pools, Inc., 462 U.S. 198, 203-04, 103 S.Ct. 2309, 2313, 76 L.Ed.2d 515 (1983) ("Although Congress might have safeguarded the interests of secured creditors outright by excluding from the estate any property subject to a secured interest, it chose instead to include such property in the estate and to provide secured creditors with 'adequate protection' for their interests."). See Motorola, Inc. v. Official Committee of Unsecured Creditors (In re Iridium Operating LLC), 478 F.3d 452, 461 (2d 2007) (declining to apply SPM to a proposed carve-out because until the settlement was approved, the property on which lender held its liens was still property of the estate).

Similarly, in this case, the assets that were to have been "gifted" to the unsecured creditors trust constituted property of the estate as they represented either property or proceeds of the debtors' property, albeit subject to Integreon's secured claim. 11 U.S.C. § 541 (a)(6) (property includes "proceeds, product, offspring, rents, or profits of or from property of the estate . . ."). Integreon was bargaining with estate property vis-a-vis its own lien and whatever

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[6] Carve-outs also raise a host of other questions such as who will administer the funds in the carve-out. Ironically, parties usually seek to distribute the asserted "non-estate" property within the framework of the Bankruptcy Code such as asking the chapter 7 trustee to distribute the property and limiting distributions to only "allowed" claims. In SPM, for example, the Court of Appeals noted that the parties had asked the court to order the chapter 7 trustee to oversee the distribution of the proceeds to general unsecured creditors. 984 F.2d at 1319. In World Health the bankruptcy court points out that the case was being converted to chapter 7 which would terminate the existence of the Committee of Unsecured Creditors and it was not prepared to decide the myriad other practical issues that had been posed. 344 B.R. at 303.

it conceded or contributed was also estate property. The bankruptcy court properly concluded as much.

CONCLUSION

For the foregoing reasons, the order of the bankruptcy court should be affirmed.

Respectfully submitted,

/s/ Martha L. Davis
Martha L. Davis, Trial Attorney
Va. Bar No. 20249
Office of the United States Trustee
115 South Union Street, Suite 210
Alexandria, VA 22314
Phone: (703) 557-7180
Fax: (703) 557-7279
martha.davis@usdoj.gov

Counsel for W. Clarkson McDow, Jr.
United States Trustee, Region 4

CERTIFICATE OF SERVICE

I hereby certify that on the 27th day of August, 2009, I electronically filed the foregoing Brief of Appellee with the Clerk of Court using the CM/ECF system. I also certify that a true and correct copy of the foregoing Brief of Appellee was served electronically on the following:

Michael E. Hastings, Esq.
Brandy M. Rapp, Esq.
LECLAIRRYAN, A Professional Corp.
1800 Wachovia Tower, Drawer 1200
Roanoke, VA 24006
and
Craig B. Young, Esq.
Jonathan L. Gold, Esq.
LECLAIRRYAN, A Professional Corp.
225 Reinekers Lane, Suite 700
Alexandria, VA 22314
Counsel for Appellant
Committee of Unsecured Creditors

Michael A. Condyles, Esq.
Loc Pfeiffer, Esq.
Peter J. Barrett, Esq.
KUTAK ROCK LLP
111 East Main Street, Suite 800
Richmond, VA 23219-3500
Counsel for Debtors

Jerry Hall, Esq.
Karen B. Dine, Esq.
PILLSBURY WINTHROP SHAW
PITTMAN LLP
2300 N Street, N.W.
Washington, DC 20037
Counsel for Integreon Discovery
Solutions (DC), Inc.

/s/ Martha L. Davis
Martha L. Davis, Trial Attorney
Va. Bar No. 20249
Office of the United States Trustee
115 South Union Street, Suite 210
Alexandria, VA 22314
Phone: (703) 557-7180
Fax: (703) 557-7279
martha.davis@usdoj.gov

Counsel for W. Clarkson McDow, Jr.
United States Trustee, Region 4

BRIEF BANK — 'SUMMARY SHEET" *Printed Tue-3/6/07 15:12*

WESTLAW CODES

1. ("TI") *TITLE* OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	In re: Otero (McVay V. Otero)
2. ("CO") *CURRENT* COURT *[E.g., "CTA9"]*	(W.D. Tex)
3. ("CCN") *CURRENT* CASE NO.	**No.:** 06-CA-436-PRM consolidated with EP-06-CA-437-PRM
4. ("PCN") *PRIOR* CASE NO. & COURT *[IF ANY]*	**No.:** 06-30691 **Court:** (Bankr. W.D. Tex.) ***(Identify judge & cite, if any)***
5. ("SO") *SOURCE*	**U.S. TRUSTEES**
6. ("DA") *DATE* OF FILING *& TYPE* OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	**Filed:** February 2007 **Type:** Reply Brief of Appellant Charles F. McVay, UST
7. ("AU") *PRINCIPAL AUTHORS & OFFICE* *[E.g.,"UST/OGC"]*	Kevin M. Epstein, P. Matthew Sutko, David Levine ***(UST/OGC: 202-307-1399/FAX-2397)***
8. ("TO") *TOPIC*	**BANKRUPTCY**
9. ("SU") ● *SUMMARY* OF KEY ISSUE(s) & √ Any Miscellaneous *BACKGROUND*	● Are retirement loans “debts” under 11 U.S.C. § 101(12) of the Bankruptcy code? Are retirement loans secured uner 11 U.S.C. 506? Does allowing debtors to claim retirement loan repayments under the means test contravene public policy objectives of BAPCPA **√ Background:**
10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)	
11. DO YOU RECOMMEND POSTING IN UST BRIEFBANK?	| x | YES | | NO ***NAME:*** Holly Walter ***DATE:***

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF TEXAS
EL PASO DIVISION

In re ELBERT FRANK OTERO and
STEPHANIE LYNN OTERO,
Civil No. EP-06-CA-436-PRM
(consolidated with EP-06-CA-437-PRM)

CHARLES F. McVAY, United
States Trustee, Region 7

Appellant

v.

ELBERT FRANK OTERO and,
STEPHANIE LYNN OTERO,

Appellees

On Appeal from the United States Bankruptcy Court
for the Western District of Texas
El Paso Division

REPLY BRIEF OF THE APPELLANT
CHARLES F. McVAY, UNITED STATES TRUSTEE

CHARLES F. McVAY UNITED STATES TRUSTEE REGION 7 Kevin M. Epstein Trial Attorney Department of Justice Office of the U.S. Trustee 615 E. Houston St., Room 533 P.O. Box 1539 San Antonio, Texas 78295-1539 (210) 472-4640 (210) 472-4649 Fax	**Of Counsel** P. Matthew Sutko David Levine Executive Office for United States Trustees Department of Justice 20 Massachusetts Avenue, N.W. Suite 8000 Washington, D.C. 20530 (202) 307-1399

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INTRODUCTION

The United States Trustee's opening brief establishes that the bankruptcy court erred when it ruled that 11 U.S.C. § 707(b)(2)(A)(iii) permits debtors to deduct retirement loan repayments, and that the debtors therefore passed section 707(b)(2)'s means test. The debtors have proffered a variety of arguments to support the bankruptcy court's ruling. In the end, however, they critically fail to explain how money a debtor borrows from his own retirement account can ever be a "debt" – much less a secured debt owed to a secured creditor – within the meaning of the Bankruptcy Code. The unavoidable fact is that section 707(b)(2)(A)(iii) only allows a deduction under the means test for payments on account of "debts" that are "secured," calculated with reference to amounts due to "secured" creditors. The debtors' retirement plan loan repayments do not qualify under section 707(b)(2)(A)(iii) for at least three reasons.

First, retirement loans are not "debts" under 11 U.S.C. § 101(12) of the Bankruptcy Code because no debtor-creditor relationship exists between the debtors and their retirement plan administrator. Second, retirement loans are not "secured" obligations under 11 U.S.C. § 506 of the Bankruptcy Code because the debtors' interest in their retirement accounts was never property of their bankruptcy estate. Third, allowing debtors to claim retirement loan repayments under the means test would contravene the public policy objectives of bankruptcy reform legislation – to require debtors to repay their debts when they can.

Without the deduction for retirement plan loan repayments, the parties agree that the statutory presumption of abuse arises in this case. The debtors can only rebut this presumption by establishing "special circumstances" as defined in 11 U.S.C. § 707(b)(2)(B). Before the bankruptcy court ruled on the United States Trustee's motion to dismiss, the parties stipulated that the court would first decide only the legal issue of whether retirement plan loan repayments are allowable expenses under 11 U.S.C. § 707(b)(2)(A)(iii). If necessary, the parties agreed that "special circumstances" would be addressed at a later evidentiary hearing. Notwithstanding this stipulation, however, the bankruptcy court denied the United States Trustee's motion to dismiss without hearing any evidence, and found that the debtors' continued retirement loan repayments constituted "special circumstances."

As the United States Trustee established in the opening brief, the bankruptcy court erred by holding these debtors established special circumstances to rebut their failure to pass the means test because (a) the bankruptcy court did not hold an evidentiary hearing on this issue in violation of Bankruptcy Rule 9014(d), (b) these debtors never argued loan repayments constituted a special circumstance, and (c) these retirement plan loan repayments do not constitute special circumstances.

The debtors contend that retirement plan loan repayments are *per se* special circumstances if those payments bring the debtors monthly disposable income under 11 U.S.C. § 707(b)(2) under the presumption threshold. That argument must be wrong. Congress included in Section 707(b)(2)(A) the deductions to income to which debtors are always allowed. Allowing retirement plan loan repayments as *per se* special circumstances is equivalent to reading into Section 707(b)(2)(A) that retirement plan loan repayments are always allowable deductions, something Congress did not do. Second, the Bankruptcy Code provides examples of "special circumstances," and the principle of *ejusdem generis* provides that when general words follow specific words, the general must be of a similar nature to the specific words. Here, loan repayments are not similar to a serious medical condition or a call to duty in the armed forces.

Finally, the court's order discharging the debtor should be vacated pending a final hearing on the issue of special circumstances, so that the bankruptcy court can determine (i) whether the case should be dismissed and no discharge entered or (ii) whether the debtors can establish "special circumstances" to rebut the presumption of abuse and receive their discharge.

II. Section 707(b)(2)(A)(iii) does not permit debtors to deduct retirement account loan repayments.

A. Debtors have not established the money they borrowed from their own retirement accounts qualifies as a "debt" under the Bankruptcy Code.

In his opening brief, the United States Trustee established that a debtor's retirement loan is not a "debt" under the Bankruptcy Code – a conclusion the Second Circuit has reached, and which the Sixth Circuit has followed. App. Brief at 17-19. In response, the debtors ask this Court to split with the Second and Sixth Circuits by ruling their retirement loans are debts under the Code. They do so under a misplaced theory that the plans have recourse against the debtors' property. The debtors reach this erroneous conclusion by misreading two cases, *Johnson v. Home State Bank*, 501 U.S. 78 (1991) and *In re Lindsey*, 995 F.2d 626 (5th Cir. 1993), *cert. denied*, 114 S.Ct. 1053 (1994).

These cases, however, are irrelevant. Both cases dealt with traditional debtor-creditor transactions in which third parties had claims against estate property that the debtors owned. In *Johnson*, that property was the debtor's farm, which the debtor was using and sought to retain through a chapter 13 repayment plan. *Johnson*, 501 U.S. at 80. In *Lindsey*, the debtor-partnership had control of farming property. *Lindsey*, 995 F.2d at 626. In both cases, the courts concluded that the lenders' contractual right to foreclose on the debtors' property was sufficient to qualify the obligation as a debt under the Bankruptcy Code, even though the debtors were not personally liable. *Johnson*, 501 U.S. at 84-85; *Lindsey*, 995 F.2d at 628.

In stark contrast, it is the retirement plan administrator, not the debtors, who have control of the funds in their retirement accounts. Further, unlike the property in *Johnson* and *Lindsey*, the debtors' retirement accounts are not property of the debtors' bankruptcy estate under section 541 of the Bankruptcy Code. *See* 11 U.S.C. § 541 (defining property of the estate). Those cases do not rebut the point established in the United States Trustee's opening brief that the retirement plan is not a debt because the retirement plan cannot assert any right of payment against the debtors' bankruptcy estate.

Two additional factors differentiate *Johnson* and *Lindsey* from this case. First, *Johnson* and *Lindsey* were the product of traditional two party relationships involving a borrower and a lender. In contrast, unlike the banks in *Johnson* and *Lindsey*, the debtors in this case borrowed their own money. *Cf. In re Fulton*, 211 B.R. 247, 263 (Bankr. S.D. Ohio 1997) (noting, "by way of instruction," that "if the [retirement plan] administrator were to allow loans in excess of an employee's contributions, such loans would more properly be considered as 'debts.'").

Second, a retirement loan is distinct from the type of non-recourse loan at issue in *Lindsey* for three additional reasons. First, individuals can only "borrow" amounts that they previously contributed to their retirement account and cannot borrow new or additional money. *See In re Devine*, 1998 WL 386380 at * 9 (Bankr. E.D. Pa. 1998) (finding that an analogy between a mortgage and a retirement loan transaction was "strained," in part because a retirement plan, "no matter how it might be structured, gave the debtor a 'loan' of his own money."). Second, the bank in *Lindsey* presumably received some additional consideration, such as a higher interest rate or business goodwill, in exchange for relinquishing its powerful remedy of pursuing the individual partners' personal assets. *Lindsey*, 995 F.2d at 626-27 (noting that, "as with any non-recourse obligation, the note limited possible remedies," and that the debtor-partnership would not be personally liable for repayment). The debtors in this case provided no such additional consideration when they borrowed from their retirement accounts. Finally, if an individual fails to repay a retirement loan, such failure merely changes the nature of the withdrawal from a loan into a taxable distribution. It does not transform the withdrawal into a debt within the meaning of the Bankruptcy Code.

B. No valid right of setoff exists to transform debtors' retirement loans into a "secured debt" under 11 U.S.C. § 506(a).

In his opening brief, the United States Trustee also demonstrated that the debtors' interest in their retirement accounts is not property of their bankruptcy estate under section 541. Accordingly, the United States Trustee argued that the debtors' interest cannot be a secured claim under section 506(a) of the Bankruptcy Code. Section 506(a) limits a secured claim to the extent of a creditor's interest in the bankruptcy estate's interest in the property.

Debtors concede this point, but note that section 506(a) also provides that an allowed claim "that is subject to setoff under section 553 of [the Bankruptcy Code]" is also a secured claim "to the extent of the amount subject to setoff." Section 553 of the Bankruptcy Code[1]does not create an independent right to setoff, rather it

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[1] Section 553(a) provides, in relevant part: "Except as otherwise provided in this section and in sections 362 and 363 of this title, this title does not affect any right of a creditor to offset a mutual debt owing by such creditor to the debtor that arose before the commencement of the case under this title against a claim of such creditor against the debtor that arose before the commencement of the case. . ."

> recognizes and preserves rights of setoff in bankruptcy cases if four conditions exist: (i) the creditor holds a "claim against the debtor that arose before the commencement of the case, (ii) the creditor owes a "debt" to the debtor that also arose before the commencement of the case, (iii) the claim and debt are "mutual," and (iv) the claim and debt are each valid and enforceable.

4 Collier on Bankruptcy ¶ 506.03[1][b] at 506-16 (15th ed. Rev. 2005).

Unfortunately for the debtors, no valid right of setoff exists under section 553(a). As the United States Trustee has already established, no creditor holds a claim against the debtors. In addition, even assuming for the sake of argument that the debtors' obligation to repay their retirement loans is a "debt" and the retirement plan's obligation to repay the funds in the debtors' retirement accounts is a "claim," the claim and the debt are not "mutual."

In order to satisfy the mutuality requirement, the debt and claim must be owed by each entity in the same rights or capacities. "Thus, for example, where the debt of an entity arises from a fiduciary duty, or is in the nature of a trust, there is no mutuality." *In re County of Orange*, 183 B.R. 609, 619 (Bankr. C.D. Cal. 1995); *see Dakin v. Bayly*, 290 U.S. 143, 146 (1933) (funds held in trust for a particular purpose may not be setoff against creditor's claims); *Fore Improvement Corp. v. Selig*, 278 F.2d 143, 145 (2d Cir. 1960); *Cohen v Savings Building & Loan Co.*, 896 F.2d 54, 57-58 (3d Cir. 1990); *In re Bob Richards Chrysler – Plymouth Corp.*, 473 F.2d 262, 265 (9th Cir. 1973).

This rule has been described in the following terms:

> If A in his individual capacity owes $100 to B in B's individual capacity, and B likewise owes $50 to A, the obligations are 'mutual.' On the other hand, if A in his individual capacity owes $100 to B, but B owes $50 to A in A's capacity as trustee of a trust, or as a fiduciary or agent for some other party, the obligations are not mutual because they are not acting in the same 'capacity.'

5 Collier on Bankruptcy ¶ 553.03[3][c] at 553-34 (15th ed. Rev. 2005). In this case, the debtors "owe" the plan administrator on account of the money the debtors borrowed from their retirement accounts. However, the retirement plan's obligation to receive the loan repayments and to remit funds in their retirement accounts are fiduciary obligations.

Because no setoff rights exist and because the debtors' bankruptcy estate does not have any interest in the debtors' retirement accounts, no secured debt exists under section 506(a) of the Bankruptcy Code.

III. The Bankruptcy Court Abused its Discretion by Holding that the Debtors' Retirement Plan Loan Repayments Constituted "Special Circumstances" Sufficient to Rebut the Presumption of Abuse Under § 707(b)(2).

Where the claim of special circumstances is contested, a court may only find that a debtor has demonstrated special circumstances to rebut the presumption of abuse after considering evidence. 11 U.S.C. § 707(b)(2)(B); Fed. R. Bankr. P. 9014. Section 707(b)(2)(B) of the Bankruptcy Code has strict requirements about what a debtor must establish before the court may find special circumstances to rebut the presumption:

> (ii) In order to establish special circumstances, the debtor shall be required to itemize each additional expense or adjustment of income and to provide –
>
> > (I) documentation for such expense or adjustment to income; and
> > (II) a detailed explanation of the special circumstances that make such expenses or adjustment to income necessary and reasonable.
>
> (iii) The debtor shall attest under oath to the accuracy of any information provided to demonstrate that additional expenses or adjustments to income are required.

No evidentiary hearing, however, was held in this case. Instead, the parties agreed that the bankruptcy court would decide on the briefs the legal issue regarding the propriety of deducting retirement plan loan repayments from the Means Test Form, and that if a hearing was needed on special circumstances, it would be held at a later date after the United States

Trustee conducted discovery on the issue (R. 26). By ruling without an evidentiary hearing, the bankruptcy court erred in finding special circumstances as an alternative ground for denying the motion to dismiss.

Appellees essentially argue that the court did not err because retirement plan loan contributions represent special circumstances *per se*. According to their brief, a bankruptcy court does not need to hold an evidentiary hearing because these payments may automatically be deducted from the disposable income determined under 11 U.S.C. § 707(b)(2)(A)(ii) in determining whether the presumption of abuse was rebutted under section 707(b)(2)(B). That argument, however, would effectively rewrite the statute. Congress specifically listed in 11 U.S.C. § 707(b)(2)(A)(ii) those items which may always be deducted. Adopting appellees' argument that a court can simply deduct the retirement plan loan repayments in determining whether special circumstances exist would essentially add to the statute an additional category of expenses that can always be deducted in the means test. Congress knew how to specify which expense categories are always deductible from current monthly income and it did so in 11 U.S.C. § 707(b)(2)(A)(ii). Courts may not add additional categories of allowable expenses to that list and retirement loan repayments are not on the list.

Moreover, Congress provided that the statutory presumption of abuse could only be rebutted by "special circumstances such as a serious medical condition or a call or order to active duty in the Armed Forces." 11 U.S.C. § 707(b)(2)(B)(I) (emphasis added). "Under the doctrine of '*ejusdem generis,'* where general words follow the enumeration of particular classes of persons or things, the general words will be construed as applicable only to persons or things of the same general nature or class as those enumerated." *First Am. Title*

Ins. Co. v. First Trust Nat'l Ass'n (In Re Biloxi Casino Belle Inc.), 368 F.3d 491, 500 n. 8 (5th Cir. 2004). Therefore, only circumstances that are similar in nature to a “serious medical condition” or “a call or order to active duty in the Armed Forces” are sufficient to rebut the statutory presumption of abuse. *In re Hanks*, 2007 WL 60812 (Bankr. D. Utah 2007).

Retirement plan loan repayments are not similar in nature to a “serious medical condition” or “a call or order to active duty in the Armed Forces,” and therefore their existence does not constitute a special circumstance sufficient to rebut the presumption of abuse. *See In re Johns*, 342 B.R. 626, 629 (Bankr. E.D. Okla. 2006) (rejecting debtors' argument that their need to repay 401(k) loans and continue to make 401(k) contributions qualified as “special circumstances,” noting specifically that “the circumstances in the present case do not rise to the same level as a serious medical condition or a call to active duty.”). Therefore, the bankruptcy court abused its discretion in finding that the debtors established special circumstances to rebut the presumption of abuse.

The United States Trustee does recognize that the debtors did allege special circumstances based on future health care costs for their son. The debtors have provided no documentation to the United States Trustee on that issue. Moreover, the bankruptcy court has never heard testimony or considered other evidence on that issue. Therefore, the court should remand this case so that the debtors may attempt to demonstrate that they can establish special circumstances pursuant to section 707(b)(2)(B).

IV. The Court Should Order the Bankruptcy Court to Vacate the Order Granting Discharge.

The bankruptcy court entered two separate orders on November 2, 2006. The first order denied the United States Trustee's motion to dismiss. The second order granted the debtors a discharge. Both orders were final and appealable under 28 U.S.C. § 158(a)(1). Further, debtors do not dispute that the discharge order was entered erroneously. Appellee's Brief at 27. Nevertheless, debtors assert without citation to any case that the United States Trustee is barred from appealing the erroneously entered discharge order because he did not first seek relief under Federal Rule of Civil Procedure 60(a) ("Rule 60(a)").

This gets the law entirely backwards. Under 28 U.S.C. § 158, this Court has jurisdiction to hear appeals from any final judgment, order or decree. *Cf.* David G. Knibb Federal Court of Appeals Manual, 28 (4th ed. 2000) ("Courts of appeals have jurisdiction over appeals 'from all final decisions of the district courts,' unless direct review by the Supreme Court is required."). Neither 28 U.S.C. § 158 nor Rule 60(a)2 says that rule 60 is a prerequisite to filing a notice of appeal.

By its plain language, Rule 60(a) relief is discretionary because the Rule provides that you "may" seek it – not that you are ever required to seek it. The United States Trustee has not been able to uncover a single court to ever hold that litigating a rule 60(a) motion is a prerequisite to filing a notice of appeal. To the contrary, commentators and courts presume that appeals can be filed without litigating Rule 60(a) motions. Knibb, Federal Court of Appeals Manual 452-454 (recognizing that Rule 60(a) motions and appeals are not mutually exclusive and that Rule 60(a) motions may be filed while an appeal is pending); *United States v. 1,431.80 Acres of Land*, 466 F.2d 820, 822 (8th Cir. 1972) (per curiam) (district

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2 Pursuant to Federal Rule of Bankruptcy Procedure 9024, Federal Rule of Civil Procedure 60 applies to this case.

court's retention of jurisdiction for future ministerial orders does not affect finality of original order)**;** *Rice v. Sunrise Express, Inc.*, 209 F.3d 1008, 1014 (7th Cir. 2000) (recognizing that a Rule 60(a) motion can be filed when a case is on appeal with leave from the appellate court).

Given the debtors' frank acknowledgment that the discharge order was not properly entered, this Court should vacate that order.

V. CONCLUSION

For these reasons, the United States Trustee respectfully asks this Court to reverse the order denying the motion to dismiss the case entered below and remand this case with instructions to the bankruptcy court to correctly apply the statutory provisions of 11 U.S.C. § 707(b)(2) and to vacate its Order Granting Discharge.

Dated: February 12, 2007

Respectfully submitted,

CHARLES F. McVAY
UNITED STATES TRUSTEE
REGION 7

By: **/s/ Kevin M. Epstein**
KEVIN M. EPSTEIN
Trial Attorney
Department of Justice
Texas Bar No. 00790647
Office of the U.S. Trustee
615 E. Houston St., Room 533
P.O. Box 1539
San Antonio, Texas 78295-1539
(210) 472-4640
(210) 472-4649 Fax

Of Counsel

P. Matthew Sutko
David Levine
Executive Office

for United States Trustees
Department of Justice
20 Massachusetts Avenue, N.W.
Suite 8000
Washington, D.C. 20530
(202) 307-1399

CERTIFICATE OF SERVICE

I hereby certify that on the 12th day of February 2007, I electronically filed the foregoing with the Clerk of Court using the CM/ECF system which will send notification of such filing to the following:

<u>Counsel for Appellees</u>
E.P. Bud Kirk
6006 N. Mesa, Suite 806
El Paso, TX 79912

<u>/s/ Kevin M. Epstein</u>
KEVIN M. EPSTEIN

BRIEF BANK — “SUMMARY SHEET”

Printed Mon.-1/11/99 (16:21)

WESTLAW CODES

1. (“TI”) ***TITLE*** OF CASE *[E.g., “SMITH v. U.S. TRUSTEE (IN RE SMITH)”]*	U.S. TRUSTEE v. PADILLA (IN RE DANNY PADILLA)
2. (“CO”) ***CURRENT*** COURT *[E.g., “CTA9”]*	CTA9 (U.S. Court of Appeals, 9th Cir.)
3. (“CCN”) ***CURRENT*** CASE NO.	No.: 98-55099
4. (“PCN”) ***PRIOR*** CASE NO. & COURT *[IF ANY]*	No.: CC-96-1890-HMaV Court: 9th Cir. BAP; 214 B.R. 496 (Oct. 24, 1997) *(Identify judge & cite, if any)*
5. (“SO”) ***SOURCE***	**U.S. TRUSTEES**
6. (“DA”) ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., “Opening Brief,” “Reply,” “Amicus,” etc.]*	Filed: April 1, 1998 Type: BRIEF FOR THE APPELLANT, UNITED STATES TRUSTEE
7. (“AU”) ***PRINCIPAL AUTHORS & OFFICE*** *[E.g., “UST/OGC”]*	Anthony J. Ciccone (UST/OGC) Deborah R. Kant (Civil/Appellate) *(UST/OGC: 202-307-1399/FAX-2397)*
8. (“TO”) ***TOPIC***	**BANKRUPTCY**
9. (“SU”) ! ***SUMMARY*** OF KEY ISSUE(s)	! Whether Debtor’s admitted “credit-card bustout” (i.e., accumulation of large credit-card debt in anticipation of filing bankruptcy) evidenced “bad faith” sufficient to constitute “cause” for dismissal under 11 U.S.C. § 707(a).
&	
√ Any Miscellaneous ***BACKGROUND***	√ **Background:** Bky. Court granted UST’s § 707(a) Motion To Dismiss, but BAP reversed finding that while “bad faith” may be “cause” for dismissal, here there was insufficient evidence of bad faith & creditors are thus limited to lesser remedies, such as challenges to discharge under §§ 523 & 727. UST then appealed to CTA9.
10. PATH TO FILE LOCATION: (e.g., S:\GENERAL COUNSEL\BRFBANK\etc...)	S:\General Counse\BrfBank\ToWest\PADILLA1.wpd
11. DO YOU RECOMMEND POSTING IN UST BRIEFBANK?	☒ YES ☐ NO ***NAME:*** Anthony J. Ciccone ***DATE:*** Thu.-9/17/98 (10:56)

No. 98-55099

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

In Re DANNY PADILLA,

Debtor.

UNITED STATES TRUSTEE,

Appellant,

v.

DANNY PADILLA,

Appellee.

ON APPEAL FROM THE UNITED STATES BANKRUPTCY PANEL OF THE NINTH CIRCUIT

BRIEF FOR THE APPELLANT UNITED STATES TRUSTEE

MARTHA L. DAVIS
General Counsel
ANTHONY J. CICCONE
Executive Office for U.S. Trustees
Washington, D.C. 20530

FRANK W. HUNGER
Assistant Attorney General

WILLIAM KANTER
202 514-4575
DEBORAH RUTH KANT
202 514-3518
Attorneys, Appellate Staff
Civil Division, Room 9540
Department of Justice
601 D Street, N.W.
Washington, D.C. 20530-0001

APRIL 1, 1998

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

No. 98-55099

In Re DANNY PADILLA,

Debtor.

UNITED STATES TRUSTEE,

Appellant,

v.

DANNY PADILLA,

Appellee.

ON APPEAL FROM THE UNITED STATES BANKRUPTCY PANEL
OF THE NINTH CIRCUIT

BRIEF FOR THE UNITED STATES TRUSTEE

STATEMENT OF SUBJECT MATTER AND APPELLATE JURISDICTION

a. Under the Bankruptcy Code, 11 U.S.C. 101-1300 and 28 U.S.C. 157(b), debtor, Danny Padilla filed a voluntary petition for Chapter 7 liquidation in the United States Bankruptcy Court for the Central District of California. The debtor appealed the bankruptcy court's dismissal of his petition for bad faith under 11 U.S.C. 707(a). The Ninth Circuit's Bankruptcy Appellate Panel ("the panel" or "bankruptcy panel") properly asserted jurisdiction over this dismissal order under 28 U.S.C. 158(c), which authorizes appeals to bankruptcy appellate panels from bankruptcy courts' final orders.

b. This Court has jurisdiction over the appeal by the U.S. Trustee under 28 U.S.C. 158(d), which authorizes appeals to the federal courts of appeals from bankruptcy appellate panels' "final decisions, judgments, orders, and decrees." As explained fully in Part I, *infra*, the panel's order is appealable under the four factor balancing approach this Court employs for determining whether orders are final for purposes of 28 U.S.C. 158(d). Walthall v. United States, 131 F.3d 1289, 1292 (9th Cir.1997), In Re Vylene Enterprises, Inc., 968 F.2d 887, 894 (9th Cir. 1992) (citations omitted). The bankruptcy panel's reversal of the bankruptcy court's dismissal of the petition "effectively determines the outcome of the case," and "resolves and seriously affects substantive rights and finally determines the discrete issue." *See* In Re Frontier Properties, 979 F.2d 1358, 1363 (9th Cir. 1992).

c. The bankruptcy panel entered its order on October 24 1997. The United States Trustee filed a timely notice of appeal on December 22, 1998 under Fed. R. App. P. 4(a)(1) and 6(b).

STATEMENT OF ISSUES PRESENTED FOR REVIEW

(1) Whether, under 28 U.S.C. 158(d), the court of appeals has jurisdiction over the appeal of the panel's order remanding the case and reinstating the petition when, as here, the underlying bankruptcy court order is final; the order conclusively determines the legal issue in the case; and an immediate appeal could obviate subsequent judicial proceedings.

(2) Whether a petition based on a credit card bust-out -- whereby a debtor intentionally accumulates large consumer debt beyond his ability to repay in anticipation of later seeking a

discharge in bankruptcy -- constitutes bad faith under 11 U.S.C. 707(a) and hence is subject to dismissal under that subsection.

STANDARD OF REVIEW

The issue of jurisdiction and the scope of a dismissal of a bankruptcy petition for cause or bad faith under 11 U.S.C. 707(a) are legal questions, subject to *de novo* review.

STATEMENT

1. The Nature of the Case. In this bankruptcy proceeding, the U.S. Trustee moved for a dismissal of the debtor's petition for bad faith under section 707(a) since the petition was based on a credit card bust-out. A credit card bust-out occurs when debtors intentionally accumulate large consumer debt far beyond their ability to repay with the obvious intent to later seek a bankruptcy discharge. The bankruptcy court agreed with the U.S. Trustee that petitions based on credit card bust-outs constitute bad faith under the Code and thus dismissed the petition. The Ninth Circuit bankruptcy panel reversed and remanded, re-instituting the petition. While, the panel did not disagree that the debtor committed a credit card bust-out, the bankruptcy panel held that credit card bust-outs did not warrant dismissal of the petition under section 707(a).

The U.S. Trustee appeals this ruling.

2. Statutory Scheme of Relevant Provisions of the Bankruptcy Code. Under Chapter 7 of the Bankruptcy Code of 1978, 11 U.S.C. 101 *et seq*., a debtor can receive a discharge of all his/her debts. Several provisions of the Code set forth exceptions to the general rule of discharge. Section 727 permits an individual creditor or the U.S. Trustee to move to deny a debtor a discharge in its entirety if, among other things, the debtor is not an individual, the debtor has concealed financials documents, made false claims, or the debtor's activities indicate an intent to defraud a particular creditor or evade certain debts. 11 U.S.C. 727. For example, section 727(a)(2) provides that an individual's debts may not be discharged if, *inter alia*,

> the debtor, with the intent to hinder, delay, or defraud a creditor or an officer of the estate * * *, has transferred, removed, destroyed, mutilated, or concealed * * * property of the debtor, within one year before the date of * * * the petition; or * * * property of the estate, after the date of the filing of the petition.

Ibid. Similarly, section 523(a)(2) permits an individual creditor to challenge the dischargeability of particular debts for money, property, services etc., if obtained by

> (A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's * * * financial condition;
>
> (B) use of a statement in writing — (i) that is materially false; (ii) respecting the debtor's * * * financial condition; (iii) on which the creditor * * * reasonably relied and (iv) that the debtor cause to be made or published with intent to deceive; or
>
> (C) for purposes of subparagraph (A) * * * , consumer debts owed to a single creditor and aggregating more than $1,000 for "luxury goods or services" incurred * * * within 60 days before the order for relief under this title * * * are presumed to be nondischargeable.

11 U.S.C. 523(a)(2).

The Code also provides for dismissal of the entire petition in bankruptcy by the court or on motion of the U.S. Trustee in certain other circumstances. Under section 707(a) of the Code, a court may dismiss the petition by the debtor if there are grounds for a "for cause" dismissal including:

> (1) unreasonable delay by the debtor that is prejudicial to creditors; (2) nonpayment of any fees or charges required under chapter 123 of Title 28; and (3) [the] failure of the debtor * * * to file within fifteen days * * * the information required by

> paragraph (1) of section 521, but only on a motion of the United States trustee.

11 U.S.C. 707(a). The legislative history of section 707(a) explains that the list of grounds supporting a for cause dismissal is "illustrative," not "exhaustive." S. Rep. No. 95-989 at 94 (July 14, 1978), reprinted in 1978 U.S.C.C.A.N. 5787, 5880. Subsection 707(b) likewise provides for dismissal of the petition *sua sponte* or on motion of the United States Trustee "if * * * the granting such relief would be a substantial abuse of the provisions of this chapter." 11 U.S.C. 707(b). Subsection 707(b) provides that there is a presumption in favor of granting bankruptcy relief in favor of the debtor. *Ibid*. Congress added subsection 707(b) to section 707 in the 1984 consumer credit amendments to the Bankruptcy Code. As the Senate Report to this subsection emphasized, one ground supporting a dismissal for substantial abuse is if the debtor has the ability to pay his debts. S. Rep. No. 98-65 at 54 (1983).

As explained above, the United States Trustee is authorized to move for dismissal of the petition under section 707. The United States Trustee -- not to be confused with the private individual who is appointed as bankruptcy trustee for a particular case -- is an Executive Branch official who is responsible for "protecting the public interest and ensuring that bankruptcy cases are conducted according to the law." H.R. Rep. No. 95-595 at 109 (1978), reprinted in 1978 U.S.C.C.A.N. 5963, 6070; see 28 U.S.C. 586; 11 U.S.C. 307; H.R. Rep. No. 99-764 at 27 (1986), reprinted in 1986 U.S.C.C.A.N. 5227, 5240 (U.S. Trustee has "standing to raise, appear, and be heard on any issue in any case or proceeding under Title 11, U.S. Code -- except that the U.S. Trustee may not file a plan in a chapter 11 case"). *See, infra*, text at 17-18 (explaining U.S. Trustee's special role as enforcer of the Code).

3. <u>Factual Background and Proceedings Below</u>. On April 19 1996, Danny Padilla filed a voluntary petition in bankruptcy under Chapter 7 (ER 1).[1] A few months later, the United States Trustee filed a motion to dismiss the petition under section 707(a) on the ground that the debtor's pre-petition activities constituted bad faith and thus a ground for dismissal under that subsection *(id. at 40-43)*. Specifically, the U.S. Trustee argued that the debtor incurred large consumer debt of approximately $100,000 in the ten month period preceding the petition in anticipation of filing the bankruptcy petition *(<u>ibid</u>.)*. Given that his income was in the mid $20,000 range and that his income exceeded his regular monthly expenses by only $120, the U.S. Trustee argued that the debtor incurred this debt as a "credit card bust-out" -- *i.e.,* the debtor had no ability to repay the debt and incurred the debt with the intent to later seek a bankruptcy discharge *(<u>ibid</u>.)*. The debtor's statement of financial affairs (a required attachment to a bankruptcy petition) showed that the debtor had incurred this debt in the ten month period preceding his filing of the Chapter 7 petition *(ER 65)*. The statement also showed that the debtor incurred gambling losses of about $50,000 to $80,000 between December 1994 to September 1995 *(<u>id</u>. at 27, Statement of Financial Affairs at 5)*. The schedules submitted with the petition revealed that the debtor sold items such as diamond rings, a Rolex watch, a television, VCR etc., to friends, tenants, and family members to finance the gambling *(<u>id</u>. at 27-28, 65)*. In keeping with this lavish life style, the record showed that debtor took a trip to the Phillipines the year before filing and transferred $3,000 to his friends in the three month period preceding filing *(<u>id</u>. at 25, 29, 65, Statement of Financial Affairs at 3, 7)* .

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[1] ER refers to the Excerpts of Record filed with this brief.

In view of the above facts, the U.S. Trustee urged dismissal of the petition based on bad faith under 11 U.S.C. 707(a) *(ibid.)*. The bankruptcy court agreed, and dismissed the petition under section 707(a). Thereafter, the debtor appealed to the Bankruptcy Appellate Panel of the Ninth Circuit ("the bankruptcy panel" or "the panel") (ER 56). The bankruptcy panel reversed, and remanded with instructions that the petition be re-instated (ER 59-67).

4. The Bankruptcy Court's Decision. In dismissing the petition, the bankruptcy court held that the debtor's credit card-bust out scheme constituted bad faith for purposes of section 707(a). The bankruptcy court ruled another policy factor favored dismissal (ER 50-51, *Bankruptcy Court Transcript at 7-8*). While the largest unsecured creditor -- the debtor owed American Express $50,000 -- did not seek an exception from discharge for the debt under sections 523 or 727, the bankruptcy court concluded that the U.S. Trustee has a separate interest in insuring that the Bankruptcy Code is not used by debtors for credit-card bust-out schemes *(ibid.)*.[2]

5. The Bankruptcy Appellate Panel's Decision. In reversing the final order of dismissal by the bankruptcy court, the bankruptcy panel agreed that the facts showed that the debtor had indeed engaged in a credit card bust-out scheme (ER 65). The panel also held, in agreement with bankruptcy court, that section 707(a) authorized dismissals for lack of good faith and that the U.S. Trustee could bring such dismissal motion as part of his "duty to prevent abuses in filing of petitions for relief under the Code" (ER 67). In this regard, the bankruptcy panel acknowledged

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[2] The bankruptcy court observed that "ultimately the public * * * has to pay the price of all of this discharged debt. * * * It's the people that have to pay the increased interest rates because of people discharging their debts * * *." *Ibid.*

the substantial case authority holding that the list of grounds for dismissal under section 707(a) is illustrative, not exhaustive *(id. at 62)*.

However, the bankruptcy panel disagreed that a credit card bust-out constituted bad faith for purposes of a section 707(a) dismissal (ER 65-66). Permitting dismissals of petitions for credit card bust-outs, in the view of the bankruptcy panel, did not comport with the purpose of the Bankruptcy Code *(ibid.)*. The bankruptcy panel reasoned that the debtor did not lie or mislead the bankruptcy court *(ibid.)*. Given these circumstances, incurring large debt in anticipation of filing for bankruptcy -- a credit card bust-out -- did not embody bad faith within the meaning of section 707(a) *(ibid.)*. Rather, credit card bust-out schemes, in the bankruptcy panel's view, should only be subject to objections by creditors to dischargeability of individual debts -- on a debt-by-debt basis -- through section 523, or alternatively to objections to discharge altogether for reasons like fraud or concealment under section 727 of the Code *(id. at 66)*. In the absence of these circumstances, the panel concluded that the Code could properly be used to give debtors 'a fresh start' and discharge all debts of a credit card bust-out scheme.

STATUTES INVOLVED

The relevant portions of the Bankruptcy Code are set out in the statutory addendum to this brief.

SUMMARY OF THE ARGUMENT

Section 707 of the Bankruptcy Code authorizes dismissal of petitions in bankruptcy "for cause." In other words, debtors are not entitled to bankruptcy relief when their filing constitutes an improper use of the Code or overreaching. The question this case presents is whether petitions based on credit card bust-out schemes -- debtors who accumulate vast consumer debt beyond their ability to repay and with the intent to seek a bankruptcy discharge -- constitute such an improper use, falling within section 707(a)'s dismissals "for cause." To state the issue is to answer it. The bankruptcy appellate panel in holding to the contrary committed clear error.

As a threshold matter, however, the panel's order reversing the bankruptcy court's dismissal of the petition and reinstating it, is appealable under 28 U.S.C. 158(d). This Court's precedent makes clear that final orders of the bankruptcy courts which present dispositive, legal issues are appealable. This Court applies a four factor balancing test determining appealability in the bankruptcy context. Under this test, a bankruptcy panel's order remanding the case is appealable if an immediate appeal could avoid piecemeal litigation, enhance judicial economy, and not disturb the bankruptcy's court's premier role in developing facts. Here, this is clearly the case. The bankruptcy panel's disagreement with the bankruptcy court -- its holding that credit card bust-outs as a blanket matter do not constitute bad faith for purposes of dismissal under section 707(a) -- does not depend on any further factual development. Equally important, the issue is a discrete, legal issue. Should this Court hold that credit card bust-outs are subject to dismissal under section 707(a), additional, more time-consuming judicial proceedings will be avoided.

With respect to the merits, many courts have held that a section 707(a) dismissal is justified when there is bad faith, an improper use of the Code, or, quite simply, overreaching. It should be obvious that debtors who commit credit card bust-outs are not using the Code in good faith and are not the "honest but unfortunate" debtor that the Code is aimed at assisting with a fresh start. The panel's suggestion that a debtor must lie or mislead a court in order for there to be bad faith unduly narrows, indeed distorts, what a bad faith dismissal "for cause" should be. In any event, the U.S. Trustee's conclusion that debtors who engage in credit card bust-out schemes are not entitled to use the Bankruptcy Code is consistent with the purposes of bankruptcy relief. Congress entrusted the U.S. Trustee to administer and enforce the Code, as well as prevent this kind of overreaching. The panel's reasoning that only an individual creditor can object to dischargeability of particular debts on a debt-by-debt basis under sections 523, or that objections can only be made to deny discharge altogether for reasons of like outright fraud under section 727 of the Code misses the mark; this reasoning does not protect the larger public interest from broader misuse of the Code beyond outright fraud. Dismissing an entire bankruptcy petition, as the U.S. Trustee urged in this case, does. Section 707(a) in fact authorizes the U.S. Trustee to protect against system-wide bankruptcy misuse, such as credit-card bust-out schemes -- neither section 523 or 727 authorize denial of discharge altogether where, as here, there is no showing actual fraudulent intent. Congress assigned the U.S. Trustee the unique role of policing use of the Code; here, the policing is well within the bounds of the statute, and the panel's holding unjustifiably eviscerates it.

ARGUMENT

I. THIS COURT HAS JURISDICTION OVER THE APPEAL UNDER 28 U.S.C. 158(d).

Section 158(d) of Title 28 vests jurisdiction in the federal courts of appeals over appeals from bankruptcy appellate panels for "all final decisions, judgments, orders and decrees." 28 U.S.C. 158(d). This Court balances the following four factors in determining whether orders, including remands as in this case, are final for purposes of section 158(d):

> (1) the need to avoid piecemeal litigation; (2) judicial efficiency (3) the systemic interest in preserving the bankruptcy court's role as the finder of fact; and (4) whether delaying review would cause either party irreparable harm.

See. e.g., Walthall v. United States, 131 F.3d 1289, 1292 (9th Cir.1997); In Re Vylene Enterprises Inc., 968 F.2d 887, 895-96 (9th Cir. 1992). This balancing approach reflects this Court's recognition that there are certain proceedings in bankruptcy that are so conclusive and distinctive to the outcome that they should be appealable as of right. *See ibid.* These factors also seek to preserve the primacy of the bankruptcy court as the finder of fact.

This Court has thus held that bankruptcy appellate orders reversing and remanding **final** orders of the bankruptcy courts are appealable when they present legal issues and when the remand orders do not require further factual findings on a central issue. *See, e.g.,* In Re Kelly, 841 F.2d 908, 911 (9th Cir. 1988). Indeed, even where the bankruptcy panel's order does remand for further factual development on a central issue, the Court has held that the Court has jurisdiction under section 158(d) if the central issue is legal in nature and its disposition could (1) obviate the need for further judicial proceedings by disposing of the entire case or (2) materially aid the bankruptcy court in reaching its disposition on remand. Walthall v. United States, 131 F.3d at 1292.

Applying the above principles to the present case, this Court plainly has jurisdiction over the bankruptcy panel's remand based on its holding that a credit card bust-out could not as a matter of law constitute bad faith for purposes of a section 707(a) dismissal. First, the remand order squarely presents a purely legal issue. In other words, the appeal here does not implicate the bankruptcy court's role as finder of fact since the remand was not based on further factual development -- in fact both the bankruptcy court and panel agreed that the debtor had engaged in a credit card bust-out scheme. Secondly, and perhaps more importantly, under the four-factor balancing test of Vylene Enterprises, judicial efficiency will be enhanced by immediate appeal. An immediate decision reversing the decision below will end the litigation now and permanently; piecemeal litigation would be avoided. In contrast, if reversal were to come later -- after the remand to the bankruptcy court, after proceedings in that court on bankruptcy and discharge, after another final decision in the bankruptcy court, and after yet another decision of the bankruptcy panel -- judicial resources would be wasted. Accordingly, under *Vylene Enterprises*' balancing approach, this Court has jurisdiction in this case.

This Court's ruling in the Kelly case is instructive. There, the Court held that the bankruptcy panel's remand on the proper test for "substantial abuse" under a section 707(b) dismissal was appealable under 28 U.S.C. 158(d), for the issue was "clearly one of law." In Re Kelly, 841 F.2d at 911. *A fortiorari*, the bankruptcy panel's remand here interpreting the scope of a section 707(a) dismissal on bad faith to exclude credit card bust-outs must also be appealable under 28 U.S.C. 158(d). Indeed, even if the remand required further factual development -- which it does not -- it is appealable, as this Court has ruled, for it obviates the need for further judicial proceedings. *See* Walthall v. United States, 131 F.3d at 1292.

II. PETITIONS BASED ON CREDIT CARD BUST-OUTS SCHEMES ARE PROPERLY SUBJECT TO DISMISSAL UNDER 11 U.S.C. 707(a) SINCE SUCH SCHEMES ARE AN IMPROPER USE OF BANKRUPTCY AND CONSTITUTE BAD FAITH .

A. Bad Faith Is A Ground For A Dismissal 'For Cause' Under Section 707(a).

Section 707(a) of title 11 of the Bankruptcy Code provides that a court may dismiss a bankruptcy petition,

> only after notice and a hearing and only for cause, including --
>
> (1) unreasonable delay by the debtor that is prejudicial to creditors;
> and (2) nonpayment of any fees or charges required under chapter

> 123 of Title 28; and (3) the failure of the debtor * * * to file within fifteen days * * * the information required by paragraph (1) of section 521, but only on a motion of the United States trustee.

11 U.S.C. 707(a). As the text makes clear, a case may be dismissed on any ground constituting "for cause" and the statute sets out a few specific examples such as unreasonable delay or nonpayment of required fees. The legislative history of section 707(a), too, emphasizes that the list of grounds supporting a for cause dismissal is "illustrative," not "exhaustive." S. Rep. No. 95-989 at 94 (1978), reprinted in 1978 U.S.C.C.A.N. 5787, 5880.

Many courts, including the Supreme Court, have ruled that a prerequisite to bankruptcy relief is good faith. Thus, the Supreme Court has declared that bankruptcy is of course equitable and for "the **honest** but unfortunate debtor." Brown v. Felsen, 442 U.S. 127, 128 (1979) (citation omitted) (emphasis added). Consistent with this reasoning, the Fifth Circuit has also observed that the Bankruptcy Code of 1978 is "endowed with requirements of good faith in the construction of many of its provisions" and that "[e]very bankruptcy statute since 1898 has incorporated literally, or by judicial interpretation, a standard of good faith for the commencement, prosecution, and confirmation of bankruptcy proceedings." In Re Little Creek Development Co., 779 F.2d 1068, 1071-72 (5th Cir. 1986).

Indeed, in *Little Creek*, the Fifth Circuit held that good faith is an inherent condition to the operation of the automatic stay provisions of the Code. *Ibid*. Accordingly, the court of appeals held that bad faith constituted an implied ground for lifting the stay under the "for cause" language of 11 U.S.C. 362(d), the subsection that provides relief from the automatic stay. That provision authorizes a court to grant relief from a stay -- like section 707(a) -- "for cause." 11 U.S.C. 362(d)(1). Based on similar reasoning, the Sixth Circuit held that given the bedrock principle that the Bankruptcy Code requires good faith before receiving its relief, the absence of good faith in filing embodies a "for cause" ground for dismissal within the meaning of section 707(a). In Re Zick, 931 F.2d 1124, 1126-29 (6th Cir. 1991). In so doing, the Sixth Circuit explained that "including" is not limiting language, and that it is appropriate to incorporate the Bankruptcy Code's good faith requirement into the parameters of section 707(a). *Ibid*.

These holdings reflect the broader concerns that underlie Congress' enactment of section 707. Subsection 707(b), for instance, authorizes dismissal of petitions based on substantial abuse, such as when debtors have the clear ability to repay their debts. *See, e.g.,* In Re Kelly 841 F.2d 908, 914-15 (9th Cir. 1988); In Re Huckfeldt, 39 F.3d 829, 831 (8th Cir. 1994). Subsection 707(a), as discussed above, protects the public from misuse of the Bankruptcy Code by authorizing outright dismissals of bankruptcy cases in circumstances that supply a "for cause" ground for dismissal. The fundamental thrust of section 707 is to protect the public interest by preventing any kind of misuse of the Code.

For all these reasons, the lack of good faith is a "for cause" ground for dismissal under section 707(a). Neither the bankruptcy court nor the bankruptcy panel erred in so holding (ER 50-51,67). To be sure, the Eighth Circuit has ruled that it prefers dismissals based on this kind of improper use of the Code or misconduct to be called "for cause" rather than "bad faith." In Re Huchfeldt 39 F.3d at 832. But, the terminology is interchangeable for purposes of section 707(a). In *Huckfeldt*, the court of appeals held that a debtor's motive for filing a petition --evasion of debts imposed by a divorce decree and an attempt to "unload" all the debts incurred in a 12 year marriage to his spouse -- supported a "for cause" dismissal. *Id*. at 830, 832-33. This motive constitutes bad faith. But whatever the label, section 707(a) protects against improper use of bankruptcy relief.

B. Debtors Who Accumulate Large Debt With The Intent To Seek A Later Bankruptcy Discharge -- A Credit Card Bust-Out -- Are Not Entitled To Bankruptcy Relief And Hence Their Petitions Are Subject To Dismissal Under Section 707(a).

A credit card bust-out is just such an improper use of bankruptcy relief and should be dismissed for bad faith by operation of section 707(a)'s authorization for dismissal "for cause." As the Sixth Circuit in *Zick* ruled, there are a variety of circumstances that manifest bad faith -- an improper use of the Bankruptcy Code -- such as, concealed assets, excessive and continued lavish lifestyle, and an intent to avoid one single large creditor. In Re Zick, 931 F.2d at 1128. Bad faith is "conduct akin to fraud, misconduct, or gross negligence." *Ibid*.. Quite simply, any circumstances that reveal "the unfairness of the debtor's use of Chapter 7 under the facts" fall within the scope of a bad faith dismissal under section 707(a). *Ibid*. Consequently, an intent to evade the debts incurred in a marriage by operation of a divorce decree as in Huckfeldt, or an intent to evade a judgment of a court awarding damages for breach of contract as in Zick, are improper uses of the Code justifying a section 707(a) dismissal. Moreover, as the Sixth Circuit ruled in Zick, an examination of the pre-petition activities of the debtor may also indicate bad faith. In Re Zick, 931 F.2d at 1125-26, 1129. In *Zick*, the debtor left a company, signed a non-competition agreement, solicited his former company's customers, a court awarded damages against him for these activities, and then immediately thereafter, filed a petition in bankruptcy. *Ibid*.

Here, it is clear that a credit card bust-out scheme is exactly the kind of improper use of the Code -- or bad faith -- that section 707(a) is aimed at preventing. It can hardly be appropriate to incur large amounts of consumer debt beyond any intent to pay -- indeed with the obvious intent to avoid repaying by filing for bankruptcy. It would distort the purposes of bankruptcy relief beyond recognition to allow people to incur large debt in anticipation of filing a bankruptcy petition and obtaining a discharge. A credit card bust-out embodies the species of misconduct that the courts of appeals in *Zick*, and *Huckfeldt* have held reveal bad faith or 'for cause', and warrant dismissal of the petition.

Both the bankruptcy court and panel found that the debtor engaged in a credit card bust-out (ER 50, 65). The debtor's petition and required attachments undisputedly show a credit card bust-out. In fact, as the panel found, the debtor incurred some of these debts to subsidize his gambling (ER 27-28, 65). Debtor prior to filing engaged in a lavish lifestyle, purchasing and selling expensive items (ER 25, 29, 65). Equally important, the debtor incurred debt of almost $100,000 in the ten month period preceding his filing when his monthly income exceeded his expenses by only $120 (ER 42, 65). Based on these facts, both the bankruptcy court and panel found the debtor engaged in a credit card bust-out.

And based on these findings and this record, there should certainly be no question that the debtor is not entitled to seek haven in a bankruptcy discharge. This kind of conduct is an improper use of the Code; it is "akin to fraud, misconduct or gross negligence" under the Sixth Circuit's reasoning. The debtor's use of the Code, in short, reveals "unfairness, *see*, Zick, 931 F.2d at 1128. The bankruptcy panel committed serious legal error in holding the credit card bust-outs do not constitute bad faith for purposes of dismissal under section 707(a). Neither logic nor common sense supports the panel's conclusion. Moreover, as we showed above, this conclusion betrays a misunderstanding of the purposes of bankruptcy relief.

In the panel's view, since the debtor did not lie and mislead the court, there was no bad faith (ER 65). But, there is no requirement that a debtor must lie to a court in order for there to be bad faith or the type of misconduct that is a "for cause" ground for a section 707(a) dismissal. And, while the panel did declare that there was no intent to abuse the bankruptcy process, this is simply wrong (ER 65). Use of the bankruptcy process to accumulate debt with the obvious intent to subsequently file for bankruptcy to eliminate it is a paradigmatic misuse of bankruptcy.

It is well-established that the U.S. Trustee administers the Bankruptcy Code and, in that capacity, has important and independent role in insuring the laws of the Code are properly enforced. *See, e.g.,* In Re Columbia Gas Sys. Inc., 33 F.3d 294, 296-97 (3d Cir. 1994); In Re Clark, 927 F.2d 793, 795-96 (4th Cir. 1991); In Re Revco D.S. Inc., 898 F.2d 498, 499-500 (6th Cir. 1990). Thus, the Sixth and Fourth Circuits have ruled that "[t]he trustee serves the role of 'protecting the public interest and ensuring that bankruptcy cases are conducted according to law.' " In Re Clark, 927 F.2d at 795; In Re Revco, 898 F.2d at 500 (further citation omitted). In fact, the Fourth Circuit acknowledged this role of the U.S. Trustee in a suit where the U.S. Trustee sought to enforce dismissal of the petition by virtue of very same section at issue in this case, section 707, albeit a different subsection. In Re Clark, 927 F.2d at 793. There, the U.S. Trustee sought dismissal based on substantial abuse under subsection (b).[3] *Ibid.*

Congress established the office of the U.S. Trustee in enacting the Bankruptcy Code of 1978 "to aid in the administration of bankruptcy" and to serve as enforcer of the Code, representing the larger public interest. H. Rep. No. 95-595 at 404, reprinted in 1978 U.S.C.C.A.N. 5787,

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[3] While the U.S. Trustee did not assert below that a credit card bust-out constitutes a substantial abuse for purposes of subsection 707(b), a credit card bust-out falls within the parameters of subsection (b) as well as (a).

5963, 6360, 6049, 6070-71 (1977). Congress likened the role of the U.S. Trustee to that of a prosecutor, explaining

> the prosecutor is not an assistant to the court, but has an independent executive duty to pursue. Likewise, the United States trustee will be responsible for certain administrative, or executive duties, * * * That he [the trustee] will frequently appear in the same bankruptcy court does not detract from his independent obligation to execute and enforce the bankruptcy laws.

Id. at 6072. Congress declared in no uncertain terms, that the U.S. Trustee acts as watchdog preventing "fraud, dishonesty and overreaching in the bankruptcy area." *Id.* at 6049.

Here, the U.S. Trustee determined that using the Code for credit card bust-outs schemes constitutes the kind of overreaching that warrants dismissal under section 707(a). This determination, as we showed, *supra at 13-17,* is in keeping with the purposes of bankruptcy relief; it is supported by the language of section 707(a) and substantial case authority. The bankruptcy court agreed, and exercised appropriate discretion in dismissing the case.

It bears emphasis that the Trustee's conclusion on credit card bust-out schemes is true whether a bust-out is called 'bad faith' or "for cause" within the meaning of section 707(a). Either way, debtors who engage in this practice are not entitled to bankruptcy relief.

It is no answer to declare as the bankruptcy appellate panel reasoned, that creditors may challenge, in an adversarial context, the dischargeability of particular debts under, *e.g.*, section 523(a)(2), or that individual creditors or the U.S. Trustee may oppose discharge altogether under section 727(a)(2) for reasons like outright fraud and concealment. These remedies, *see text supra at 3-4,* apply where it can be shown that a debtor’s fraudulent intent warrants denial of discharge, or when other grounds not relevant here exist, such as when the debtor is not an individual, or has disobeyed a court order. 11 U.S.C. 727(a)(1), (6)(A). The availability of these remedies does not, however, negate the U.S. Trustee’s right to seek dismissal “for cause” under section 707(a) where, as here, a debtor’s pre-petition conduct evidences bad faith which may not rise to the level of fraudulent intent contemplated by Code sections 523(a)(2) and 727(a)(2). Stated simply, section 707(a) allows the U.S. Trustee and the bankruptcy court to protect against systemic abuses of the bankruptcy process -- such as credit card bust-out schemes. In this case, where there was no showing of actual fraudulent intent by the debtor, section 707(a) provides the only remedy against abuse of the system.

The Trustee's determination that the debtors who seek a bankruptcy discharge for credit card bust-outs are not entitled to a discharge is consistent with the Trustee's role in administering the Bankruptcy Code and preventing overreaching. Congress contemplated that the U.S. Trustee and bankruptcy courts would examine any impact on the larger public interest. Accordingly, dismissing petitions based on an indisputable credit card bust-out under section 707(a) comports with the public interest and with the Bankruptcy Code scheme.

CONCLUSION

For the foregoing reasons, the bankruptcy appellant panel's decision should be reversed and the debtor's petition in bankruptcy should be dismissed pursuant to 11 U.S.C. 707(a).

Respectfully submitted,

FRANK W. HUNGER
Assistant Attorney General

WILLIAM KANTER
(202) 514-4575
DEBORAH RUTH KANT
(202) 514-3518
Appellate Staff, Civil Division

Department of Justice
Room 9540
601 D St., N.W.
Washington, D.C. 20530-0001

APRIL 1998

STATEMENT OF RELATED CASES

There are no cases related to the instant appeal pending in this Court.

CERTIFICATE OF SERVICE

I hereby certify that on April 1, 1998, I served two copies of the Brief For the Appellant United States Trustee upon opposing counsel by overnight mail:

J. Elliot McIntosh
Law Office of J. Elliot McIntosh
9214 Eglise Avenue
Downey, CA 90240

____

DEBORAH RUTH KANT
Attorney

CERTIFICATE OF COMPLIANCE WITH NINTH CIRCUIT RULE 32(e)

I certify that this brief has been prepared with a monospaced type face of no more than 10.5 characters per inch, and that the brief does not exceed 40 pages in length.

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DEBORAH RUTH KANT
Attorney

BRIEF BANK — "SUMMARY SHEET" *Printed Fri.-6/30/0 (13:06)*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	U.S. TRUSTEE v. PADILLA (IN RE DANNY PADILLA)
2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	CTA9 (U.S. Court of Appeals, 9th Cir.)
3. ("CCN") ***CURRENT*** CASE NO.	No.: 98-55099
4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*	No.: CC-96-1890-HMaV Court: 9th Cir. BAP; 214 B.R. 496 (Oct. 24, 1997) *(Identify judge & cite, if any)*
5. ("SO") ***SOURCE***	**U.S. TRUSTEES**
6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	Filed: May 21, 1998 Type: REPLY BRIEF FOR THE APPELLANT, U.S. TRUSTEE
7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g., "UST/OGC"]*	Deborah R. Kant (Civil/Appellate: 202-514-3518) Anthony J. Ciccone (UST/OGC) *(UST/OGC: 202-307-1399/FAX-2397)*
8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") ! ***SUMMARY*** OF KEY ISSUE(s) & */* Any Miscellaneous ***BACKGROUND***	! Whether Debtor's admitted "credit-card bustout" (i.e., accumulation of large credit-card debt in anticipation of filing bankruptcy) evidenced "bad faith" sufficient to constitute "cause" for dismissal under 11 U.S.C. § 707(a). (Note: Reply also addresses mootness of appeal after entry of discharge.) */* **Background:** Bky. Court granted UST's § 707(a) Motion To Dismiss, but BAP reversed finding that while "bad faith" may be "cause" for dismissal, here there was insufficient evidence of bad faith & creditors are thus limited to lesser remedies, such as challenges to discharge under §§ 523 & 727. UST then appealed to CTA9.
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No. 98-55099

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

In Re DANNY PADILLA,

Debtor.

UNITED STATES TRUSTEE,

Appellant,

v.

DANNY PADILLA,

Appellee.

ON APPEAL FROM THE UNITED STATES BANKRUPTCY PANEL
OF THE NINTH CIRCUIT

REPLY BRIEF FOR THE APPELLANT UNITED STATES TRUSTEE

MARTHA L. DAVIS
General Counsel
ANTHONY J. CICCONE
Executive Office for U.S. Trustees
Washington, D.C. 20530

FRANK W. HUNGER
Assistant Attorney General

WILLIAM KANTER
202 514-4575
DEBORAH RUTH KANT
202 514-3518
Attorneys, Appellate Staff
Civil Division, Room 9540
Department of Justice
601 D Street, N.W.
Washington, D.C. 20530-0001

May 21, 1998

IN THE UNITED STATES COURT OF APPEALS
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In Re DANNY PADILLA,

Debtor.

UNITED STATES TRUSTEE,

Appellant,

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DANNY PADILLA,

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ON APPEAL FROM THE UNITED STATES BANKRUPTCY PANEL
OF THE NINTH CIRCUIT

REPLY BRIEF FOR THE UNITED STATES TRUSTEE

This appeal presents the straightforward question of whether debtors who accumulate excessive debt far beyond their means to repay, and in obvious anticipation of filing for bankruptcy, are entitled to seek and obtain a bankruptcy protection. The answer to this question has to be no, and section 707(a) protects precisely against this type of misuse of the Bankruptcy Code. 11 U.S.C. 707(a). The debtor in his response does little to address this important question. Instead, he relies on other inapposite provisions of the Code that address concerns — for example the prevention of actual fraud or concealment of assets — different than those of section 707(a). Section 707(a), in contrast, is aimed at a broader goal, namely protecting the public interest by preventing systemic misuse or unfair use of the Code. The debtor in essence ignores section 707, and its authorization for dismissals of bankruptcy petitions "for cause." We file this reply to clarify any misapprehensions raised by the debtor's brief and to address two threshold jurisdictional questions.

I. THE ORDER OF THE BANKRUPTCY PANEL REVERSING THE BANKRUPTCY COURT'S DISMISSAL OF THE CASE FOR BAD FAITH IS APPEALABLE.

In our opening brief, we demonstrated that the bankruptcy appellate panel's ("bankruptcy panel") order here is final under 28 U.S.C. 158(d). In determining finality under 28 U.S.C. 158(d), this Court has established specialized rules for bankruptcy proceedings, recognizing that "'certain proceedings in a bankruptcy case are so distinct and conclusive either to the rights of individual parties or the ultimate outcome."' In Re Rega Properties, 894 F.2d 1136, 1138 (9th Cir. 1990) (citations omitted). Accordingly, this Court has undertaken a "pragmatic approach," *ibid.*, and has developed a four-part test.[1/] Furthermore, as explained in our main brief at 11-12, this Court has held that bankruptcy appellate orders reversing and remanding **final** orders of the bankruptcy courts are appealable when they present legal issues and when the remand orders do not require further factual findings on a central issue. This order falls squarely within these parameters; the bankruptcy panel's

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[1/] The four-part test consists of:

> (1) the need to avoid piecemeal litigation; (2) judicial efficiency; (3) the systemic interest in preserving the bankruptcy court's role as the finder of fact; and (4) whether delaying review would cause either party irreparable harm.

See. e.g., Walthall v. United States, 131 F.3d 1289, 1292 (9th Cir.1997); In Re Vylene Enterprises Inc., 968 F.2d 887, 895-96 (9th Cir. 1992).

holding that credit card bust-out schemes do not fall within section 707(a)'s dismissal for cause provision satisfies the four-part test because it presents a purely legal issue, the resolution of which could dispose of the entire case and avoid further time-consuming judicial proceedings. 11 U.S.C. 707(a).

Debtor largely ignores this Court's pragmatic, four-part test, and cites general propositions of law with little analysis. Deb. Br. 7-10. Moreover, debtor is wrong in implying that if there is the potential for further proceedings, the order is not final. Deb. Br. 10. This Court's four-part test contradicts this erroneous proposition. Indeed, this proposition flies in the face of this Court's holding in In Re Kelly, 841 F.2d 908, 911 (9th Cir. 1988), that the bankruptcy panel's remand, establishing the test for dismissals for "substantial abuse" under subsection 707**(b)**, is appealable. Debtor's reliance on In Re Rega Properties and In Re Lievsay is thus misplaced. Deb. Br. 7-10. Those cases do not set forth a broad rule of law declaring that whenever there are possible further proceedings in bankruptcy which could affect the outcome, an order is not final. In Re Lievsay, 118 F.3d 661 (9th Cir. 1997); In Re Rega Properties, 894 F.2d 1136 (9th Cir.), *cert. denied*, 498 U.S. 898 (1990). In fact, Rega Properties emphasized the specialized set of rules for determining bankruptcy finality and directed most of its discussion to situations where the bankruptcy court denies motions to dismiss. In Re Rega Properties, 894 F.2d at 1138. Further, Rega did not address any discrete legal issue that would satisfy this Court's four-part test for section 158(d) appealability. *Ibid*. Similarly, Lievsay involved an appeal where, unlike here, the underlying bankruptcy court's order was not final. Here, the bankruptcy court **granted** the dismissal motion, and the bankruptcy panel reversed. In Re Lievsay, 118 F.3d at 661. In any event, none of these cases purported to modify this Court's basic four-part test set forth in In Re

Vylene Enterprises Inc., 968 F.2d 887, 895-96 (9th Cir. 1992).[2]

Debtor is equally wide of the mark in suggesting that the panel's decision amounts to a disagreement over facts and not an appealable legal issue. Deb. Br. 9. The bankruptcy court and the bankruptcy panel agreed that: the debtor incurred the excessive debt to subsidize his gambling, the debtor prior to filing engaged in a lavish lifestyle, purchasing and selling expensive items, and the debtor incurred debt of almost $100,000 in the ten month period preceding his filing when his monthly income exceeded his expenses by only $120 (ER 27-29, 42, 50, 65).[3] Debtor's statement of financial affairs and attached schedules, in any event, speak for themselves (ER 25-29). Where the lower courts parted company is on whether this set of facts — called a credit card bust-out — constitute a "for cause" or bad faith ground for dismissal within the meaning of section 707(a). Stated differently, there are no further findings of fact on the central issue of whether the bankruptcy filing warrants a section 707(a) dismissal "for cause."

Nonetheless, even if further factual development follows a remand, this Court has made it clear that remands are final under section 158(d) if the legal issue could cut off further proceedings or materially aid the bankruptcy court in its resolution of the issues. *See* Opening Br. 11. And, a holding by this Court that filings based on credit card bust-out schemes are properly subject to a section 707(a) dismissal would certainly cut off further proceedings.

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[2] Nor does this Court's decision in In Re Universal Life Church, Inc., 128 F.3d 1294, 1300 (9th Cir. 1997) dictate the conclusion that the remand order in this case is not appealable as debtor suggests. Deb. Br. 8. The Court lacked jurisdiction over the order there because the district court, acting as an appellate court, did not rule on the issue on appeal. *Id.* at 1330.

[3] "ER" refers to the Excerpts of Record filed with our opening brief.

II. THIS APPEAL IS NOT MOOT.

In this case, the U.S. Trustee filed a timely notice of appeal from the bankruptcy panel's order reversing the bankruptcy court's dismissal and remanding the case to the bankruptcy court for reinstatement of the petition (ER 59-67). Despite this notice, the bankruptcy court implemented the remand and entered a discharge for debtor on February 3, 1998 (ER 75). By virtue of this discharge, debtor argues that this appeal is now moot. Deb. Br. 12. This appeal, however, is not moot. Simply put, this Court has jurisdiction to reverse the reinstatement order of the bankruptcy panel and set aside the discharge, because debtor's right to receive the discharge is already before this Court by virtue of the government's notice of appeal, and hence the bankruptcy court lacked jurisdiction to enter any discharge.

The remand and reinstatement order is clearly an appealable final order under 28 U.S.C. 158(d), *see* Opening Br.10-12 and text above. As such, the bankruptcy court below lacked jurisdiction to implement any remand and issue a discharge, for it is well-settled that "an appeal to the circuit court deprives a district court of jurisdiction as to any matters involved in the appeal." Thomas, Head and Greisen Employees Trust v. Buster, 95 F.3d 1449, 1490 n.19 (9th Cir. 1996) (citations omitted), *cert. denied*, 117 S. Ct. 1247 (1997). A timely notice of appeal deprives a district court or the relevant lower court of jurisdiction to enter subsequent orders. As the Supreme Court elucidated,

> the filing of a notice of appeal is an event of jurisdictional significance — it confers jurisdiction on the court of appeals and divests the district court of its control over those aspects of the case involved in the appeal.

Griggs v. Provident Consumer Discount Co., 459 U.S. 56, 58 (1982).

Equally important, this Court has made it clear that it has appellate jurisdiction to: (1) determine the jurisdiction of a district court to enter an order after the filing of a notice of appeal, even when there is no separate notice of appeal filed as to that subsequent order and (2) if the district court lacked jurisdiction, to rule on the merits of a subsequent order and to set aside such an order. Thomas, Head and Greisen Employees Trust v. Buster, 95 F.3d at 1460 n.19. No notice of appeal for the subsequent order is required in these circumstances because the district court has been divested of jurisdiction as a result of the filing of the earlier notice of appeal. *See, e.g.,* Griggs v. Provident Consumer Bank, 459 U.S. at 58. A notice of appeal filed in these circumstances is unnecessary because the district court simply did not have jurisdiction to enter the subsequent order -- the case is now in the court of appeals. These principles of course apply equally to bankruptcy courts sitting as a trial court.

This Court has before it on appeal the reversal of the bankruptcy court's order dismissing the Chapter 7 petition for bad faith under section 707(a) and remanding the case for reinstatement of the petition. At issue, then, is debtor's right to file the bankruptcy petition in the first place and his right to receive a discharge. As such, the bankruptcy court had no jurisdiction to proceed with the remand and enter a discharge — because the remand and ability to receive a discharge are already on appeal. In other words, this Court on appeal is ruling on debtor's right to receive a discharge: a dismissal of the petition for bad faith under section 707(a) forecloses the discharge and an affirmance of the bankruptcy panel's rejection of a section 707(a) dismissal permits the discharge to proceed. In fact, a discharge here, barring a dismissal for bad faith, would be a foregone conclusion since none of the creditors objected and debtor otherwise would qualify for a discharge. *See* In Re Lelon C. Dietz, 914 F.2d 161, 164 (9th Cir. 1990).

Accordingly, this Court has the power to grant complete relief to the U.S. Trustee by dismissing the petition for bad faith under section 707(a) and setting aside the discharge. *See* Thomas, Head and Greisen Employees Trust v. Buster, 95 F.3d at 1460 n.19. The appeal is therefore not moot. For these reasons, debtor's assertions — that without the filing of another notice of appeal from the discharge unlawfully entered by the bankruptcy court or without the filing of a stay in the courts below, this Court cannot enter relief by revoking the discharge — are without merit.[4/] Deb. Br. 12.

Indeed, even if the bankruptcy court had the jurisdiction to enter the discharge — which it did not — the appeal is not moot in this case, because the order of discharge in these particular circumstances is a ministerial act: the discharge was automatic once debtor's petition was reinstated. It is well-settled that the payment of money or post-judgment orders implementing a money judgment does not moot an appeal. The payment of money can be undone and the post-judgment orders rescinded. So too here — if this Court reverses and orders dismissal of the petition under section 707(a), the ministerial act of discharge in this case can easily be undone by the bankruptcy court. The order of discharge therefore does not moot this appeal. The bankruptcy court, on remand from this Court, would simply need to aside the ministerial acts of closure and the discharge.

[4/] A stay of the bankruptcy proceedings, however, may be necessary in some Chapter 11 reorganization proceedings. This Court has ruled that a stay is warranted in certain Chapter 11 reorganization proceedings even when there is a pending appeal, because the interest in the orderly administration of the bankruptcy estate pursuant to a reorganization plan is paramount. *See* In Re Roberts Farms, Inc., 652 F.2d 793, 796 (9th Cir. 1981). *See also* In Re Dorwin Cook, 730 F.2d 1324, 1326 (9th Cir. 1984) (appeals moot when appeals were from interlocutory orders pursuant to the Chapter 11, and no notice of appeal filed from confirmation Chapter 11 plan before debtor voluntarily converted Chapter 11filing to Chapter 7). The present case however is a Chapter 7 case and these considerations ought not to apply.

III. SECTION 707(a) PROTECTS AGAINST SYSTEMIC MISUSE OF THE BANKRUPTCY PROCESS AND DISCHARGE, INCLUDING CREDIT CARD BUST-OUTS.

The language of section 707, its legislative history and purpose, and section 707 jurisprudence all show that dismissals under this section are warranted whenever access to the bankruptcy process or discharge results in an improper use of the Code or shows overreaching. *See* Opening Br. 15-20. The purpose of both subsections 707(a) and (b) are to protect the public from unfair use of the bankruptcy system, and to prevent filings that cumulatively would result in systemic misuse of bankruptcy. *Ibid*. Further, the U.S. Trustee in conjunction with the bankruptcy courts are uniquely situated to help prevent such misuse by employing the section 707(a) dismissal mechanism. *See id.* at 17-19. Credit card bust-out schemes are certainly just such an unfair use of the Code, and fall squarely within section 707(a)'s provision for dismissals "for cause" or for bad faith. *See id.* at 15-20.

Debtor nonetheless disregards or misunderstands the specialized and unique nature of the section 707 dismissal mechanism; he mistakenly relies on sections 523(a)(2) and 727(a)(2), equating them with the section 707(a) mechanism. 11 U.S.C. 523(a)(2), 727(a)(2). These two other provisions, however, function differently or have different objectives from those of section 707(a). Section 523(a)(2) permits individual creditors to object to particular debts, debt-by-debt, on grounds of fraud or false financial documents. 11 U.S.C. 523(a)(2). Section 707(a) in contrast authorizes a bar to access to the bankruptcy process and a blanket bar to discharge of **all** debts. Section 727(a)(2) bars discharge by motion of the U.S. Trustee or individual creditors when the debtor has committed actual fraud, or the debtor has disobeyed a court order, or on other grounds not relevant here. *See* Opening Br. 19. Neither of these sections protect against system-wide misuse of the bankruptcy process that do not involve actual fraud, as does section 707.

For these reasons, debtor's assertions that there must be actual fraud, concealment of assets, or misrepresentations in his financial schedules do not withstand analysis. *See* Deb. Br. 15-16. These assertions write section 707 out of the Code altogether. Nothing in section 707 requires that bad faith or "for cause" dismissals be based only on a showing of actual fraud or lying. Nor does the case law on section 707(a) require proof of actual fraud. *See* cases & text in Opening Br. 13-16.

Finally, debtor is simply wrong in declaring that a section 707(a) dismissal deprives him of due process protections available under sections 523 and 727. Deb. Br. 17. In a section 707(a) proceeding, the debtor has notice of the U.S. Trustee's motion to dismiss or the court's own motion, there is a hearing, and the debtor has an opportunity to respond and conduct full discovery. The U.S. Trustee carries the burden of establishing that dismissal is warranted under section 707. This process is similar to the process by which a creditor may object to the dischargeability of particular debts or to discharge altogether.[5/]

[5/] Moreover, the notion that a debtor may exempt certain income under state law by virtue of 11 U.S.C. 522(b)(1), (2) after filing the petition has no bearing on whether particular facts — like gambling debts paid off prior to filing the petition — may manifest, together with other facts, a credit card bust-out. *See* Deb. Br. 18.

CONCLUSION

For the foregoing reasons and for those stated in our opening brief, the bankruptcy appellant panel's decision should be reversed, the debtor's petition in bankruptcy should be dismissed pursuant to 11 U.S.C. 707(a), and the bankruptcy court's discharge should be set aside.

Respectfully submitted,

FRANK W. HUNGER
Assistant Attorney General

WILLIAM KANTER
(202) 514-4575
DEBORAH RUTH KANT
(202) 514-3518
Appellate Staff, Civil Division
Department of Justice
Room 9540
601 D St., N.W.
Washington, D.C. 20530-0001

MAY 1998

CERTIFICATE OF SERVICE

I hereby certify that on May 21, 1998, I served two copies of the Reply Brief For the Appellant United States Trustee upon opposing counsel by overnight mail:

Michael T. Doudna
Richardo A. Nicol
J. Elliot McIntosh
Pacific Law Group
600 W. Santa Ana Blvd Suite 816
Santa Ana, CA 92701

DEBORAH RUTH KANT
Attorney

CERTIFICATE OF COMPLIANCE WITH NINTH CIRCUIT RULE 32(e)

I certify that this brief has been prepared with a monospaced type face of no more than 10.5 characters per inch, and that the brief does not exceed 20 pages in length.

DEBORAH RUTH KANT
Attorney

BRIEF BANK — 'SUMMARY SHEET"

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WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*
Pak v. eCast Settlement Corp. (In re Pak)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*
B.A.P. 9th Cir.

3. ("CCN") ***CURRENT*** CASE NO.
No.: 07-1201

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*
No.: 05-49326
Court: Bankr. N. D. Cal
(Identify judge & cite, if any)

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U.S. TRUSTEES

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7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*
Minnie Loo and Lauren Chen
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") ● ***SUMMARY*** OF KEY ISSUE(s)

&

√ Any Miscellaneous ***BACKGROUND***

●Whether the bankruptcy court erred in holding that the debtor's projected disposable income under 1325(b)(1) of the bankruptcy code is not determined by simply multiplying the debtor's disposable income as defined in section 1325(b)(2) by the number of months in the chapter 13 plan with no other adjustments

√ **Background:**

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NAME: Holly Walter
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MINNIE LOO, AUST (SBN 106613)
MARGARET MCGEE (SBN 142722)
MATTHEW R. KRETZER (SBN 157949)
LAURENT CHEN (SBN 191661)
UNITED STATES DEPARTMENT OF JUSTICE
OFFICE OF THE UNITED STATES TRUSTEE
1301 Clay Street, Suite 690N
Oakland, California 94612-5217
Telephone: (510) 637 3200

Attorneys for Acting United States Trustee
SARA L. KISTLER

UNITED STATES BANKRUPTCY APPELLATE PANEL OF THE NINTH CIRCUIT

In re John Pak Debtor(s)	BAP No. NC-07-1201 BK. No. 05-49326
John Pak, Appellant v. Martha G. Bronitsky, Trustee, et al. Appellees	

ON APPEAL FROM THE UNITED STATES BANKRUPTCY COURT FOR THE NORTHERN DISTRICT OF CALIFORNIA

BRIEF FOR APPELLEE THE UNITED STATES

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STATEMENT OF JURISDICTION

The bankruptcy court had jurisdiction over the debtor's bankruptcy case under 28 U.S.C. §§ 157(a) and (b), and 1334(a). The bankruptcy court denied confirmation of the debtor's chapter 13 plan by order entered December 27, 2006. Appellant's Appendix Excerpts of the Record (hereinafter "ER") 236. On May 10, 2007, the bankruptcy court dismissed the debtor's bankruptcy case. ER 253. The debtor timely filed a notice of appeal of the dismissal order on May 17, 2007. ER 254-255. Under 28 U.S.C. § 158(a)(1) and (b)(1), and the Amended Order Continuing the Bankruptcy Appellate Panel of the Ninth Circuit, this Court has jurisdiction of the appeal of the dismissal order.

STATEMENT OF ISSUE

Whether the bankruptcy court erred in holding that the debtor's projected disposable income under section 1325(b)(1) of the Bankruptcy Code is not determined by simply multiplying the debtor's disposable income, as defined in section 1325(b)(2), by the number of months in the chapter 13 plan, with no other adjustments.[1]

STANDARD OF REVIEW

In an appeal taken from a bankruptcy court order, this Court reviews the bankruptcy court's findings of fact under the clearly erroneous standard but reviews *de novo* the bankruptcy court's conclusions of law. In re

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[1] The same issue is currently pending before the Court of Appeals for the Ninth Circuit. See In re Kagenveama (9th Cir. Case No. 06-17083) and In re Garcia (9th Cir. Case No. 07-55078). The Ninth Circuit heard oral argument in these cases on August 17, 2007. If the Ninth Circuit were to rule on the issue, it would constitute a binding precedent on the issue before this Court.

Shook, 278 B.R. 815, 820 (B.A.P. 9th Cir 2002). Interpretations of the Bankruptcy Code that present legal questions are reviewed *de novo*. In re Been, 153. F.3d 1034, 1036 (9th Cir. 1998). The question of statutory interpretation of the phrase "projected disposable income" presented in this case is an issue of law and subject to *de novo* review.

STATEMENT OF CASE

On October 31, 2005, John Pak filed for bankruptcy protection under chapter 7 of the Bankruptcy Code. ER 1-3. On April 14, 2006, the United States Trustee filed a motion to dismiss Mr. Pak's case under 11 U.S.C. § 707(b)(3), asserting it would be an abuse of chapter 7 to grant Mr. Pak a discharge without attempting to repay his debt. Appendix to Principal Brief of Appellee-Claimant eCast Settlement Corporation, Tab 2, pp. 7-17. On May 18, 2006, the bankruptcy court granted the United States Trustee's section 707(b)(3) motion. Appendix to Principal Brief of Appellee-Claimant eCast Settlement Corporation, Tab 3, pp. 18-32. On May 31, 2006, the bankruptcy court granted Mr. Pak's request to convert his bankruptcy case to a case under chapter 13 of the Bankruptcy Code.

On August 29, 2006, two of Mr. Pak's creditors, American Express Centurion Bank and eCAST Settlement Corporation, filed a joint objection to confirmation of Mr. Pak's proposed chapter 13 plan under 11 U.S.C. § 1324(a). ER 138-145. On August 30, 2006, the chapter 13 trustee filed an objection to confirmation of Mr. Pak's proposed chapter 13 plan under section 1324(a). ER 124-135. The Trustee asserted that the bankruptcy court could not confirm Mr. Pak's proposed chapter 13 plan because it did not propose to pay unsecured creditors all of Mr. Pak's "projected disposable income" over the plan term, as required by 11 U.S.C. § 1325(b)(1). ER 125.

STATEMENT OF FACTS

A. Statutory Background

In 2005, Congress passed and the President signed into law the Bankruptcy Abuse Prevention and Consumer Protection Act, Pub. L. No. 109-8, 119 Stat. 23 (2005) (BAPCPA).

One of the innovations of the BAPCPA was means-testing. In section 707 of the Bankruptcy Code, which addresses dismissal of abusive chapter 7 petitions, Congress established special rules for debtors whose current monthly income, reduced by certain permitted expenses, exceeded a threshold for abuse under a specified formula. 11 U.S.C. § 707(b)(2). This amendment changed the way these expenses were computed; some were no longer the debtor's actual and reasonable expenses but instead were standard expenses under the National Standards and Local Standards issued by the Internal Revenue Service for the debtor's area of residence. 11 U.S.C. § 707(b)(2)(A)(ii).

Congress also applied means-testing to chapter 13 cases, like this one. Before the BAPCPA amendments were enacted, section 1325, governing confirmation of a chapter 13 plan, required such a plan to provide that all of the debtor's "projected disposable income" during the plan period would be used to repay debts. Disposable income was calculated from the debtor's actual income and expenses set forth on Schedules I and J. But the BAPCPA amended section 1325 to change the definition of "disposable income."

The new section 1325(b)(2) defines "disposable income" to mean "current monthly income received by the debtor . . . less amounts reasonably necessary to be expended" for the maintenance or support or necessary business expenses. 11 U.S.C. § 1325(b)(2).[2] This definition incorporates two changes: first, it defines "disposable income" based on an average of past monthly income and expense figures; and second, for debtors with income above the state median, it specifies that "amounts reasonably necessary to be expended" are to be calculated using the same standard expenses mandated for certain chapter 7 debtors under section 707(b)(2). Specifically, section 1325(b)(3) now directs that reasonable expenses be determined "in accordance with subparagraphs (A) and (B) of section 707(b)(2)" for those chapter 13 debtors whose current monthly income, multiplied by 12, is greater than the median family income for a family of the corresponding size. 11 U.S.C. § 1325(b)(3). Chapter 13 debtors in this class are typically referred to as "above-median" debtors. Debtors, such as Mr. Pak, whose annualized current monthly income is below median, are not limited to the standard expenses in section 707(b)(2) in determining amounts reasonably necessary to be expended.

Under current bankruptcy rules, individual debtors with primarily consumer debts must file Official Form 22[3], which sets forth the debtor's income and expenses in accordance with standard numbers issued by the

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[2] "Current monthly income" means the "average monthly income from all sources" that the debtor received during the six-month period ending the last calendar month before the debtor filed his bankruptcy petition. 11 U.S.C. § 101(10A).

[3] In a chapter 7 context, the form is known as Statement of Current Monthly Income and Means-Test Calculation (Form 22A); in a chapter 13 context, the form is known as Statement of Current Monthly Income and Calculation of Commitment Period and Disposable Income (Form 22C).

IRS. Because a debtor must also file the traditional Schedules I and J setting forth actual income and expenses, it often becomes apparent that there is a significant difference between the debtor's disposable income under Schedules I and J and his disposable income under Form 22. In some cases, like the present case, it is clear that the historical circumstances that produced a particular income figure will change prospectively because the debtor acquired a higher paying job immediately prior to filing bankruptcy.

B. Factual Background

The debtor, John Pak, filed a chapter 7 petition on October 31, 2005.[4] For approximately four of the six months prior to his bankruptcy filing, Mr. Pak was unemployed. In August 2005, two months before his bankruptcy filing, Mr. Pak obtained new employment as a software engineer earning $8,666.67 per month, or $104,004.04 annually.

Mr. Pak's schedules of income and expenses (Schedules I and J), filed with his bankruptcy petition, reflected his income earned from his new job, indicated that his net monthly take home pay was $5,530.20, that his monthly expenses were $3,718.00, and that he had net monthly income of $1,812.20. ER 20-21. Mr. Pak also filed with his bankruptcy petition Form 22A. Form 22A directs debtors to calculate their "current monthly income" by averaging their gross income received during the six months prior to the month of the bankruptcy filing. Since Mr. Pak had been unemployed for most of this period, his "current monthly income," $2,666.67 ($32,000.04 annually), was much lower than his income as of the date of his bankruptcy filing.

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[4] Because this case was commenced after October 16, 2005, it is subject to the amendments to the Bankruptcy Code made by the BAPCPA.

Because Mr. Pak's own bankruptcy schedules reflected actual monthly disposable income of $1,812.20, the United States Trustee moved under 11 U.S.C. § 707(b)(3) to dismiss his case because granting Mr. Pak relief under chapter 7 of the Bankruptcy Code when he had the ability to repay a substantial portion of his $172,931.24 in scheduled unsecured debt would have been an abuse of the provisions of chapter 7. See 11 U.S.C. §§ 707(b)(1); (b)(3)(B). In a published decision, the bankruptcy court granted the United States Trustee's motion to dismiss with a 14-day stay to allow Mr. Pak an opportunity to request conversion to chapter 13. See In re Pak, 343 B.R. 239 (Bankr. N.D. Cal. 2006). On May 26, 2006, Mr. Pak requested conversion to chapter 13, and the bankruptcy court granted that request on May 31, 2006. ER 56-64.

Proceeding in chapter 13, Mr. Pak filed amended Schedules I and J, which showed a total combined monthly income of $5,411.69, and total monthly expenses of $4,421.99, for monthly net income of $989.70. ER 78-83. Mr. Pak also filed a Statement of Current Monthly Income and Calculation of Commitment Period and Disposable Income (Form 22C), showing his "current monthly income" to be $2,888.89 ($34,666.68 annually). ER 91-96.

Mr. Pak's amended chapter 13 plan (the Plan) proposed to pay $300 per month for thirty-five months and $322.20 for one month. The Plan estimated that unsecured creditors would receive 1.6 percent of their claims. ER 113-114. Mr. Pak asserted that these payments constituted more than his "projected disposable income" which he calculated by multiplying his "disposable income," the average of his earnings during the six months preceding the bankruptcy filing, by the number of months of the Plan. ER

168-182.

The chapter 13 trustee (the "Trustee"), American Express Centurion Bank, eCAST Settlement Corporation, and United States Trustee objected to confirmation of the Plan under section 1324(a). The objecting parties argued that the Bankruptcy Code required the bankruptcy court to consider a debtor's actual and anticipated future income when determining "projected disposable income" under section 1325(b)(1)(B). ER 124-60.

By order entered December 27, 2006, the bankruptcy court denied Plan confirmation. ER 236. The court held that, "[i]n determining whether a plan provides all of the debtor's 'projected disposable income,' a court should attempt to predict what the debtor's disposable income during the term of the plan will be, using the definition of 'current monthly income' set forth in 11 U.S.C. § 101(10A)." In re Pak, 357 B.R. 549, 552 (Bankr. N.D. Cal. 2006).

Mr. Pak timely appealed the order denying confirmation of debtor's Plan, but the Bankruptcy Appellate Panel dismissed the appeal because the order denying confirmation is an interlocutory order. ER 239-248.

At a subsequent hearing before the bankruptcy court, Mr. Pak waived his right to amend the Plan and the court dismissed the case. ER 253. Mr. Pak timely appealed the dismissal order on May 17, 2007.

SUMMARY OF ARGUMENT

The BAPCPA amendments to section 1325 have created important interpretive questions about the proper way to understand "projected disposable income." As the case law reflects, there are three ways to interpret and apply that statutory language in light of the amendments. The interpretation adopted by the bankruptcy court should be affirmed because it takes into account all the language in the statute.

The debtor interpreted the term "projected disposable income" to require use of the historical "disposable income" figure throughout the chapter 13 plan period, regardless of the debtor's actual income and expenses during that period. In this case, the debtor's historical "disposable income" was far lower than his actual disposable income, with the result that his chapter 13 plan called for the application of payments far below his actual disposable income. However, debtor's interpretation does not account for the usual meaning of "projected" income or for the statutory phrases "to be received" and "will be applied to make payments" in section 1325(b)(1)(B). Blindly extending into the future an historical monthly income calculation, which bears no relationship to actual income that the debtor will receive in the future, makes it impossible for the plan to apply available future income to make payments to unsecured creditors in accordance with the statute.

In contrast with this interpretation, the best interpretation of section 1325(b), as adopted by the bankruptcy court, is one that gives meaning to "disposable income" by requiring its use in determining the "disposable income" that is to be projected as an initial matter, subject to adjustment to account for any significant increases or decreases in the debtor's income that are likely in particular cases. Such adjustments may be necessary in individual cases to ensure that the income attributed to a debtor in his chapter 13 plan is actually income that is "projected" and "to be received" and that "will be applied to make payments" to unsecured creditors. While a simple multiplication of the initial disposable income number by the relevant number of months is a presumptive starting point, this approach allows adjustments to be made. This interpretation is also consistent with the overall goals of chapter 13.[5]

ARGUMENT

THE BANKRUPTCY COURT CORRECTLY HELD THAT A DEBTOR'S "PROJECTED DISPOSABLE INCOME" UNDER SECTION 1325(b) IS PRESUMED TO BE BASED ON A DEBTOR'S "CURRENT MONTHLY INCOME" WHICH CAN BE REBUTTED BY EVIDENCE OF SUBSTANTIAL CHANGE IN POST-PETITION FINANCIAL SITUATION

1. **Section 1325(b): Before and After BAPCPA**

The BAPCPA amendments in 2005 to section 1325 created a significant change in the law. Before these amendments were enacted, section 1325(b)(1) provided that if the trustee or the holder of an allowed unsecured claim objected to the confirmation of a chapter 13 plan, the court was not permitted to approve the plan unless it provided that "all of the debtor's projected disposable income to be received in the three-year period beginning on the date that the first payment is due under the plan will be applied to make payments under the plan." 11 U.S.C. 1325(b)(1) (2000 ed.). The term "disposable income" was defined as income received by the debtor that was "not reasonably necessary to be expended" for "maintenance

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[5] A third interpretation, while agreeing that "projected disposable income" is forward-looking, calculates "projected disposable income" by using the debtor's actual income at the moment of filing as captured on debtor's Schedule I. Under this approach, the court <u>must</u> take into account the debtor's actual income as reported on Schedule I. <u>See</u> <u>In re Fuller</u>, 346 B.R. 472, 485 (Bankr. S.D. Ill. 2006); <u>In re Demonica</u>, 345 B.R. 895, 900 (Bankr. N.D. Ill. 2006); <u>In re Hardacre</u>, 338 B.R. 718, 722 (Bankr. N.D. Tex. 2006). In our view, there is no statutory basis for <u>requiring</u> the court to take into account the debtor's Schedules I and J in every case, and this interpretation gives too little effect to Congress's definition of "disposable income."

or support of the debtor or a dependent" or for necessary business expenses if the debtor was engaged in a business. 11 U.S.C. § 1325(b)(2) (2000 ed.). As the bankruptcy court below recognized, pre-BAPCPA, courts routinely projected or estimated a debtor's disposable income during the plan confirmation process by taking into account anticipated changes in their financial circumstances during the term of the plan. Pak, 357 B.R. at 553.

In contrast, under the BAPCPA amendments, section 1325(b)(1) now requires that a chapter 13 plan "provide that all of the debtor's projected disposable income . . .be applied to make payments to unsecured creditors . . ." 11 U.S.C. § 1325(b)(1).

"Projected disposable income" is not defined under the Bankruptcy Code; however, section 1325(b)(2) defines "disposable income" as "current monthly income received by the debtor . . . less amounts reasonably necessary to be expended" for maintenance or support or necessary business expenses. 11 U.S.C. § 1325(b)(2). "Current monthly income" is defined as the "average monthly income from all sources" that the debtor received during the six-month period ending the last calendar month before the debtor filed the chapter 13 petition. 11 U.S.C. § 101(10A).

In this case, filed by a debtor whose annualized current monthly income is below the state median income, the Bankruptcy Code calculates disposable income by subtracting "reasonably necessary" expenses from his current monthly income. The debtor's own schedules I and J reflect disposable income of $989.70, based on total monthly income of $5,411.69 and monthly expenses of $4,421.99. In contrast, the debtor's Form 22C reflected much lower current monthly income of $2,888.89, and no disposable income, because he was unemployed during most of the six-month period prior to his bankruptcy filing.

2. The Debtor's Interpretation Fails To Give Content To Three Statutory Phrases

Mr. Pak urges this Court to adopt a strict, mechanical approach where "projected disposable income" is simply monthly "disposable income" (based on prepetition "current monthly income") multiplied (projected out) by the number of months of the proposed plan.[6]

Mr. Pak adopts a contextually invalid interpretation of the term "projected" and wholly fails to account for two other important phrases in section 1325(b)(1)(B). Statutory words must be construed in context. Hibbs v. Winn, 542 U.S. 88, 101 (2004).

First, the debtor asserts that to "project" disposable income means to use the income data for the six months prior to filing, *i.e.* "current monthly income," and apply that amount over the applicable commitment period. In the economic and financial context – which is plainly the relevant context for purposes of this statute – the calculation of "projected" financial data may well begin with historical data, but it does not necessarily (or even usually) end there, and it certainly does not entail a rigid and inviolable assumption that projected income will necessarily be identical to past income even when the available facts demonstrate otherwise. To the contrary, in context the term "projected" must be understood to refer to a forecast or estimate of an expected future financial reality. See The

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[6] Courts that have adopted this approach include: In re Berger, 2007 WL 1704403 (Bankr. M.D. Ga. June 11, 2007); In re Kolb, 366 B.R. 802 (Bankr. S.D. Ohio 2007); In re Tranmer, 355 B.R. 234 (Bankr. D. Mont. 2006); In re Alexander, 344 B.R. 742 (Bankr. E.D.N.C. 2006); In re Barr, 341 B.R. 181 (Bankr. M.D.N.C. 2006); In re Rotunda, 349 B.R. 324 (Bankr. N.D.N.Y. 2006); In re Guzman, 345 B.R. 640 (Bankr. E.D. Wis. 2006).

Random House Dict. Of the English Lang. 1546 (2d ed. 1987) (defining to "project" as, inter alia, "to set forth or calculate (some future thing); *They projected the building costs for the next five years.*"); Webster's Third New Int'l Dict. 1813 (1993) (defining "projected" as, *inter alia*, "planned for future execution: contrived, proposed," as "[projected] outlays for new plant and equipment").

Second, section 1325(b)(1)(B) states that the court may not approve a plan unless it provides that all the debtor's projected disposable income "to be received" during the plan period is applied to make payments to unsecured creditors. To the extent historical income bears no relationship with actual income "to be received" by the debtor, the debtor's interpretation is inconsistent with the statutory language.

Third, the debtor's interpretation also ignores the statutory phrase "will be applied to make payments." If projected disposable income is based on an historical figure, minus expenses, there will be some cases in which income in the plan is only deemed, or hypothetical, and not actually received. A fairly typical case would be one in which a debtor lost a job or obtained a job with lesser pay at about the time he filed a chapter 13 petition. In such a case, the debtor's current monthly income, an average of the past six months' income, would reflect the income from the previous job, and the debtor's disposable income (the current monthly income less expenses) would not reflect the loss of that job. Projecting that figure forward would require the debtor to apply a hypothetical income that was not actually "received" in the future "to make payments" under the plan.

These are more than mere policy objections to the debtor's interpretation. They are critical textual flaws. It is well established that courts "must, if possible, construe a statute to give every word some operative effect." Cooper Indus., Inc. v. Aviall Servs., Inc., 543 U.S. 157, 167 (2004) (citing United States v. Nordic Village, Inc., 503 U.S. 30, 35-36 (1992)). The debtor's interpretation fails to heed this statutory maxim.

3. The Bankruptcy Court's Interpretation Draws Substantial Support From The Better-Reasoned Case Law.

This Court should adopt the bankruptcy court's interpretation of section 1325(b) that not only gives meaning to the new definition of "disposable income" in section 1325(b)(2) as an historical number but also treats "projected" disposable income as a future-oriented concept, as required by the language of section 1325(b)(1).

More specifically, this Court should allow that presumption to be rebutted whenever the debtor is likely to experience (or actually has experienced) either a significant increase or decrease in income after the filing of the chapter 13. Most courts that have addressed this issue have adopted this approach.[7]

However, the definition of "current monthly income," as defined in 11 U.S.C. § 101(10A), excludes certain income, such as Social Security payments, which is included in Schedule I. Without abandoning the statutory definition of "disposable income," the bankruptcy court held that

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[7] Bankruptcy courts that have adopted this "presumption" interpretation include In re Meek, 2007 WL 1830817 (Bankr.D.Idaho June 27, 2007); In re Lanning, 2007 WL 1451999 (Bankr.D.Kan. May 15, 2007); In re Mullen, 2007 WL 1452234 (Bankr. D. Or. May 14, 2007); In re Zimmerman, 2007 WL 295452 (Bankr. N.D. Ohio Jan. 29, 2007); In re Slusher, 359 B.R. 290 (Bankr. D. Nev. 2007); In re Casey, 356 B.R. 519 (Bankr. E.D. Wash. 2006); In re Foster, 2006 WL 2621080 (Bankr. N.D. Ind. 2006); In re Risher, 344 B.R. 833 (Bankr. W.D. Ky. 2006); In re Grady, 343 B.R. 747 (Bankr. N.D. Ga. 2006); In re Jass, 340 B.R. 411 (Bankr. D. Utah 2006).

"a court should attempt to predict what the debtor's disposable income during the term of the plan will be, using the definition of 'current monthly income' set forth in 11 U.S.C. § 101(10A)." Pak, 357 B.R. at 552.

The only appellate decision on this issue has reached the same conclusion. In In re Kibbe, 361 B.R. 302 (1st Cir. B.A.P. 2007), the bankruptcy court faced very similar facts to those presented in this case. During the six-month period prior to her filing, the debtor had been employed, but she had procured a higher paying job just prior to her bankruptcy filing. Id. at 306. As a result, she was a below-median debtor whose "current monthly income," as indicated on Form 22C, was almost $4,000 lower than her actual monthly income as identified in Schedule I. Id. at 306-07.

The Bankruptcy Appellate Panel in Kibbe concluded that Form 22C must be the starting point for any determination of 'projected disposable income', but if the parties establish that "current monthly income" set forth on Form 22C is not an accurate reflection of debtor's current financial condition, the debtor's "anticipated *actual* income," subject to the income exclusions in the definition of "current monthly income," is the "projected disposable income." Kibbe, 361 B.R. at 314 (emphasis in original). The Bankruptcy Appellate Panel reasoned that "[a]ttaching the word 'projected' to a historical calculation assumes, without justification, that a debtor's circumstances will not change after the date of the case commencement or during the plan commitment period." Id., at 312. In a footnote, the BAP ". . .reject[ed] the view espoused in Barr and its adherents that the term 'projected' is a synonym for 'multiplied.' Congress was not hesistant in using the term 'multiplied' when the context so demanded. See, e.g. §§

727(a)(2)(A)(I), and 1325(b)(3) and (4). The word 'multiplied' is quite different from the word 'projected.' The former requires only mathematical acumen; the latter, mathematic acumen adjusted by deliberation and discretion." Id., at 312 fn 9.

4. The Bankruptcy Court's Approach Comports With BAPCPA's Goals And Treats Debtors and Creditors Fairly.

Unlike chapter 7, which allows a debtor to discharge his obligations, chapter 13 focuses on having debtors devote future income to pay their creditors. Indeed, BAPCPA placed additional emphasis on this goal when it added language to section 707(b) permitting a court, with a debtor's consent, to convert an abusive chapter 7 case to chapter 13, as an alternative to dismissal. 11 U.S.C. § 707(b)(1). The interpretation of the bankruptcy court permits a court to consider the actual income that can "be applied to make payments" under the plan in cases in which a different amount of actual income is available to a debtor because of changed circumstances. This is an important measure of fairness, both to the debtor in cases in which the debtor's prospective income is below his historical income, and to creditors in cases in which the debtor will earn significant additional income that is not reflected in the historical calculation.[8]

CONCLUSION

For these reasons, we respectfully ask this Court to affirm the order of

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[8] This measure of fairness is built into the Bankruptcy Code through §§ 1323 and 1329, which permit modification of a plan when a debtor's financial circumstances change. See Mullen, 2007 WL 1452234 at *8; Zimmerman, 2007 WL 295452. Debtor's interpretation of "projected disposable income" would render both of these sections superfluous.

the bankruptcy court in its entirety.

Minnie Loo
Assistant United States Trustee

By: ____________________________
Laurent Chen
Attorneys for Acting U.S. Trustee
Sara L. Kistler

BRIEF BANK — "SUMMARY SHEET"

Printed Mon.-1/11/99 (17:09)

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	**IN RE PALM COAST (UST v. MARVIN BLOOM)**
2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	CTA2
3. ("CCN") ***CURRENT*** CASE NO.	No.: 96-5009
4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*	No.: 95-CIV-3592-SAS Court: S.D.N.Y. (District Judge Scheindlin); 188 B.R. 741 (S.D.N.Y. Nov. 1, 1995) *(Identify judge & cite, if any)*
5. ("SO") ***SOURCE***	**U.S. TRUSTEES**
6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	Filed: MARCH 18, 1996 Type: OPENING BRIEF FOR APPELLANT-UST
7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*	Jeanne M. Crouse (UST/OGC) Robert D. Kamenshine (CIVIL/APPELLATE) *(UST/OGC: 202-307-1399/FAX-2397)*
8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") ! ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	! Under 11 U.S.C. 327, the Bankruptcy Court may authorize a case trustee to retain his own firm only in the capacity of "attorney or accountant," not of real estate broker. Section 327(a)'s broad conflict-of-interest provisions require appointment of a "disinterested" party with no "adverse interest." √ **Background:** The Court of Appeals agreed with the UST and reversed the District Court's opinion in *In re Palm Coast (UST v. Bloom)*, 101 F.3d 253, 257-58 (2d Cir., Nov. 27, 1996) ("Read in the light of the common law of trusts, sec. 327 must be interpreted to prohibit the trustee from hiring himself in any non-lawyer or non-accountant capacity").
10. PATH TO FILE LOCATION: (e.g., S:\GENERAL COUNSEL\BRFBANK\etc...)	S:\GENERAL COUNSEL\BrfBank\To-West-Net\GROUP03 West-Net\PalmCo1.wpd
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No. 96-5009

IN THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

In RE PALM COAST: MANTANZA SHORES
LIMITED PARTNERSHIP A CONNECTICUT LIMITED PARTNERSHIP,

Debtor.

UNITED STATES TRUSTEE,

Appellant,
v.

MARVIN J. BLOOM, TRUSTEE,

Appellee.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

BRIEF FOR APPELLANT

OF COUNSEL:

MARTHA L. DAVIS
General Counsel

JEANNE M. CROUSE
Attorney

Executive Office for
United States Trustees

FRANK W. HUNGER
Assistant Attorney General

WILLIAM KANTER
(202) 514-4575
ROBERT D. KAMENSHINE
(202) 514-2494
Attorneys, Appellate Staff
Civil Division, Room 3617
Department of Justice
Washington, D.C. 20530-0001

MARCH 18,1996

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IN THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

No. 96-5009

In RE PALM COAST: MANTANZA SHORES
LIMITED PARTNERSHIP A CONNECTICUT LIMITED PARTNERSHIP,

Debtor.

UNITED STATES TRUSTEE,

Appellant,

v.

MARVIN J. BLOOM, TRUSTEE,

Appellee.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

BRIEF FOR APPELLANT

STATEMENT OF SUBJECT MATTER AND APPELLATE JURISDICTION

A. The district court had subject matter jurisdiction of this case by virtue of 28 U.S.C. 158(a)(1).

B. The district court's judgment, entered November 22, 1995, in favor of the appellee is a final judgment that this Court has jurisdiction to review pursuant to 28 U.S.C. 1291.

C. On January 22, 1996, the appellant filed a timely notice of appeal. See Fed. R. App. P. 4(a)(1).

STATEMENT OF THE ISSUE PRESENTED FOR REVIEW

Whether under the Bankruptcy Code's section governing the trustee's employment of professional persons, 11 U.S.C. 327, the bankruptcy court may authorize the trustee to retain his own firm in a capacity other than "attorney or accountant," here as real estate broker.

STATEMENT OF THE CASE

A. Nature of the Case and Course of Proceedings Below.

This case involves a bankruptcy trustee's attempt to select as a real estate broker to market the bankrupt's land, a firm of which the trustee is an officer. Over the objection of the United States Trustee,[1] the bankruptcy court approved the appointment, and the district court, Hon. Shira A. Scheindlin, affirmed the decision. The United States Trustee then filed the present appeal.[2]

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[1] The United States Trustee, unlike the private individual who is appointed as trustee for a particular case, is an Executive Branch official who is responsible for "protecting the public interest and ensuring that bankruptcy cases are conducted according to the law." H.R. Rep. No. 95-595, 95th Cong., 2d Sess. 109 (1978), reprinted in 1978 U.S.C.C.A.N. 5963, 6070. See 28 U.S.C. 586; 11 U.S.C. 307.

[2] The United States Trustee has standing to pursue this appeal, under 11 U.S.C. 307. United States Trustee v. Price Waterhouse, 19 F.3d 138, 141 (3d Cir. 1994); In re Clark, 927 F.2d 793, 796 (4th Cir. 1991); In re Revco D.S., Inc., 898 F.2d (continued...)

B. Statutory Scheme.

Under the Bankruptcy Code, 11 U.S.C. 327(a), "[e]xcept as otherwise provided [in Section 327], the trustee, with the court's approval, may employ one or more attorneys, accountants, appraisers, auctioneers, or other professional persons, that do not hold or represent an interest adverse to the estate, and that are disinterested persons, to represent or assist the trustee * * *." Section 327 goes on to establish four exceptions to the qualifications in subsection 327(a). One of these, 327(d), provides that "[t]he court may authorize the trustee to act as attorney or accountant for the estate if such authorization is in the best interest of the estate."

C. Statement of Facts.

Palm Coast: Mantanza Shores Limited Partnership (Palm Coast) was formed for the purpose of buying, developing, and selling an undeveloped parcel of real estate in Florida. JA 7.[3] Subsequently, Palm Coast filed for bankruptcy relief under the provisions of Chapter 11, and a trustee, Marvin J. Bloom (Bloom) was appointed. Ibid. Bloom, an officer of Keen Realty Consultants, Inc. (Keen), sought to retain the firm as real estate broker to the estate. Ibid. Bloom requested the

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[2](...continued) 498, 499-500 (6th Cir. 1990).

[3] Pages preceded by "JA" refer to pages of the Joint Appendix.

bankruptcy court's permission to appoint Keen. Ibid. The court granted the request. Ibid.

D. Bankruptcy Court's Decision And Order.

The bankruptcy court determined that the language of 327(d) was only permissive, not prohibitive, and that the statute did not bar the appointment of Keen. JA 7. The court's order concluded that (1) Keen "represents no interest adverse to the Debtor, or to the estate, in the manner in which it is to be retained," (2) "its employment is necessary and would be in the best interests of the Trustee, and the estate," and (3) "the matter is one justifying the retention of a real estate consultant." JA 12.

E. District Court's Decision.

On appeal taken by the United States Trustee, the district court affirmed. JA 10-11. It held that "the plain meaning of the statute * * * simply allows the trustee to retain his or her firm as an attorney or accountant to the Debtor," and contains "no express statutory limitation on the trustee's ability to hire his or her own firm to serve in any other capacity, including that of real estate broker." Id. at 10. The court observed that "[i]f Congress intended to prevent trustees from retaining their own firms in a non-lawyer or non-accountant capacity, the legislature could have so provided." Ibid.

SUMMARY OF ARGUMENT

Section 327 of the Bankruptcy Code, "Employment of professional persons," empowering the trustee to obtain various professional services for the estate, does not permit him to appoint his own firm as a realtor. In fact, subsection 327(a)'s broad conflict of interest provisions -- requiring appointment of a "disinterested" party with no "adverse" "interest" -- bar a trustee's appointment of his firm in any professional capacity. By virtue of the trustee's position as an "insider," i.e., a person in control of the debtor partnership, the firm in which he serves as an officer but which he seeks to hire, is an "interested" party. Moreover, a trustee's employment of his own firm violates the most basic principles of law governing the conduct of fiduciaries, the requirement of undivided loyalty.

Thus, for a trustee's self-dealing to be valid, assuming the bankruptcy court's approval, the appointment must fall within one of the four subsequent exceptions to the standards of subsection 327(a). The only exception relied on by Bloom is subsection 327(d). But this highly specific exception to broad standards states only that the trustee may employ him or herself within two professional capacities -- "attorney or accountant." It is well established that such an exception may not be expanded beyond its terms.

Finally, even if the subsection is analyzed as a grant of power, not as an exception to a prohibition, the result is the same. Congress's specificity and the absence of any conflicting legislative history compel the conclusion that the Code grants to the trustee no self-dealing power as to any other professional services.

ARGUMENT

UNDER 11 U.S.C. 327, THE BANKRUPTCY COURT MAY AUTHORIZE THE TRUSTEE TO RETAIN HIS OWN FIRM ONLY IN THE CAPACITY OF "ATTORNEY OR ACCOUNTANT," NOT OF REAL ESTATE BROKER.

Neither the language nor the statutory scheme of Section 327 supports the district court's decision permitting the trustee to appoint his own firm as a realtor. Section 327 of the Bankruptcy Code deals with a trustee's "Employment of professional persons." See generally, Gindin, Professionals In Bankruptcy Proceedings: Appointment, Right To Compensation And Conflicts Of Interest, 21 Seton Hall L. Rev. 895 (1991). The Code, 327(a), authorizes the trustee to employ professionals, with court approval, but imposes a broad conflict of interest limitation -- that the appointed professional "not hold or represent an interest adverse to the estate," and be a "disinterested person[]". See In re Prince, 40 F.3d 356, 360-61 (11th Cir. 1994). Subsection (a) states that the terms under which it both empowers and limits the trustee apply "[e]xcept as otherwise provided in this section" (emphasis supplied).

This language makes clear that each of Section 327's next four subsections, ((b) through (e)), including subsection (d) at issue here, establishes an exception to subsection 327(a)'s conflict of interest standards.[4] If a prospective appointee fails to meet either of Subsection 327(a)'s "interest adverse" or "disinterested person[]" standards, and fails to qualify under one of the four exceptions, he or she may not be appointed. In re Leisure Dynamics, 32 B.R. 753 (Bankr. D. Minn.), order aff'd, 33. B.R. 121 (D. C. Minn. 1983); In re Roberts, 46 B.R. 815, 822 (Bankr. D. Utah 1985), aff'd in part, rev'd in part and remanded on other grounds, 75 B.R. 402 (D. Utah 1987).

A. Subsection 327(a) Bars Approval Of Keen's Appointment.

Subsection 327(a)'s standards make per se invalid a trustee's appointment of him or herself, or of his or her firm,[5] to serve in any professional capacity.[6] An examination of how these standards apply to Bloom's selection of Keen demonstrates this point. First, Bloom's appointment of his own firm is the

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[4] The fifth, subsection (f), prohibits the trustee from employing a person who has served as "an examiner in the case."

[5] The trustee's appointment of a firm of which he or she is an officer is equivalent to a self-appointment. See In re Butler Indus., Inc., 114 B.R. 695, 698 (C.D. Cal. 1990), appeal dismissed, 8 F.3d 25 (9th Cir. 1993); Fed. R. Bankr. P. 2014(b).

[6] For this reason, Section 327 goes on, in subsection 327(d), explicitly to permit the trustee, with the bankruptcy court's approval, to appoint him or herself as attorney or accountant for the estate.

appointment of an "interested," and therefore disqualified person. Under the Bankruptcy Code "an insider" is not a "disinterested person[]." 11 U.S.C. 101(14)(A). In cases where, as here, "the debtor is a partnership," a person "in control of the debtor" is an "insider." 11 U.S.C. 101(31)(C)(v). A trustee, such as Bloom, is therefore an "insider" because he is such a person "in control" (see 11 U.S.C. 1107 (trustee and debtor in possession stand in same shoes)).

Moreover, Bloom's affiliation with the real estate firm, Keen, causes Keen to fail the disinterestedness requirement. Bloom's insider status is imputed to the real estate firm in which he serves as an officer. See In re Michigan Interstate Ry. Co., 32 B.R. 327, 330 (Bankr. E.D. Mich. 1983) ("'insider' characteristics of one lawyer associated with the firm, whether he or she be an associate, a special partner, or a capital partner, are sufficient to strip the firm of its claim to disinterestedness"); In re Paolino, 80 B.R. 341, 345 (Bankr. E.D. Pa. 1987) ("[w]hen one member of a firm is disqualified for interest, all members of that firm must be similarly disqualified").[7]

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[7] Bloom's employment of his firm may trigger the second of subsection 327(a)'s two standards, that of "adverse" "interest." See also 11 U.S.C. 101(14)(E) defining a "disinterested person" as one who "does not have an interest materially adverse to the interest of the estate * * * by reason of any direct or indirect relationship to, connection with, or interest in, the debtor * * * or for any other reason." Any (continued...)

B. Bloom's Employment Of Keen Violates His Fiduciary Obligations.

The explicit constraints of Section 327(a) are not the only ones operative upon the trustee. As with any trustee, a bankruptcy trustee owes a fiduciary duty, one of undivided loyalty to the trust's beneficiaries, here to the debtor's estate and its creditors. This duty prohibits "self-dealing" and requires the trustee to avoid any conflict of interest between his personal interests and those of the trust. See Woods v. City National Bank & Trust Co., 312 U.S. 262, 268 (1940); Bogert, The Law of Trusts and Trustees, § 541 at 155 (2d ed. 1993). Further, the trustee may not place him or herself in a position that would give the appearance of impropriety. Knapp v. Seligson (In re Ira Haupt & Co.), 361 F.2d 164, 168 (2d Cir. 1966); In re Gem Tire & Serv. Co., 117 B.R. 874, 877 (Bankr. S. D. Tex. 1990).

Here, in an apparent effort to mitigate the conflict of interest problem resulting from his service as both trustee and as an officer of the firm that he seeks to employ, Bloom allowed Palm's creditors to negotiate a percentage fee agreement with Keen, rather than doing so himself.[8] But significantly, "[w]ith

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[7](...continued)
firm that a trustee owns or directs would have an interest adverse to that of the estate in that the trustee monitors fees to keep them low, while he maintains an interest in seeing that his firm is well compensated for time and resources expended.

[8] The percentage arrangement would give Keen an incentive to maximize the sale price of Palm's land.

respect to the percentage of commissions sought for Keen's services, the Trustee, <u>on behalf of Keen</u>, negotiated the amount with counsel to [creditor] ITT and counsel to certain limited partners" (emphasis supplied). Reply To U.S. Trustee's Objection To The Retention Of Keen Realty Consultants, Inc. As Real Estate Broker, 4 n.2, ADD 2.[9] One of the creditors testified in support of Keen's appointment, "[w]e recognize we had to give <u>the trustee</u> and the realty company an incentive" and "have done that on the best terms available" (emphasis supplied). JA 27. Once the commission agreement was negotiated, Bloom "switched hats" and signed the contract as trustee. <u>Id</u>. at 20 .

For all Bloom's efforts, he nevertheless violated the equitable principle that a fiduciary may serve only one master. <u>Woods</u>, 312 U.S. at 269. Once a trustee's personal interests are implicated, his independence and disinterestedness are compromised. It is "generally, if not always, humanly impossible for the same person to act fairly in two capacities and on behalf of two interests in the same transaction." Bogert, <u>The Law of Trusts and Trustees</u>, § 543 at 227. Because of that reality, the standards governing disinterestedness have been strictly construed and applied. <u>See</u> <u>Meredith</u> v. <u>Thralls</u>, 144 F.2d 473, 474-75 (2d Cir.), <u>cert. denied</u>, 323 U.S. 758 (1944); <u>Pierson & Gaylen</u> v. <u>Creel & Atwood (In Re Consolidated Bancshares, Inc.)</u>,

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[9] Page numbers preceded by "ADD" refer to pages of the Addendum to this brief.

785 F.2d 1249, 1256 n.6 (5th Cir. 1986).[10] In this case, Bloom's retention of Keen conflicts with his duty of undivided loyalty to the estate.

C. Subsection 327(d) Does Not Permit The Disputed Appointment, Either As An Exception To Section 327(a)'s Bar And To General Fiduciary Standards, Or As An Independent Grant Of Power.

We have established that "[e]xcept as otherwise provided," within the rest of Section 327, subsection 327(a)'s requirements as well as general fiduciary standards, would clearly preclude the appointment of Keen.[11] But the appointment does not fall within any of the stated exceptions. Subsection (d), the only one that Bloom has invoked, permits the trustee to employ him or herself, again with court approval, within only two professional capacities -- "attorney[s] or accountant[s]."[12] See S. Rep. No. 95-989, 95th Cong., 2d Sess. 38 (1978), reprinted in, 1978

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[10] In fact, the prohibition against self-dealing has been so strictly enforced that a reorganization trustee was surcharged $40,000 in profits that he permitted his employees to earn. Mosser v. Darrow, 341 U.S. 267, 271-75 (1951).

[11] Even under the old bankruptcy law, that did not specifically address this issue, this Court expressed serious concerns about a trustee's self-dealing. Knapp v. Seligson (In re Ira Haupt & Co.), 361 F.2d at 168-69 (appointment as attorney). See also, SEC v. Kenneth Bove & Co., 451 F. Supp. 355, 358-59 (S.D.N.Y. 1978).

[12] This section permits but does not compel the court to authorize the retention of the trustee as "attorney or accountant." The court's discretion is limited by consideration of "the best interest" of the estate. See In re Gem Tire & Serv. Co., 117 B.R. at 878.

U.S.C.C.A.N 5787, 5824; Kelbon, Herman, and Bell, Conflicts, The Appointment Of "Professionals," And Fiduciary Duties Of Major Parties In Chapter 11, 8 Bankr. Dev. J. 349, 398-400 (1991).

As a highly specific exception to otherwise broad conflict of interest prohibitions, subsection 327(d) should not be expanded beyond its terms. See Israel-British Bank (London) Ltd. v. FDIC, 536 F.2d 509, 513 (2d Cir.), cert. denied, 429 U.S. 978 (1976) ("normal rule of construction is that where words of exception are used, they are to be strictly construed to limit the exception"). In the case of legal and accounting services, Congress made a judgment not to establish a flat prohibition on trustee-self dealing, but to rely instead on the sound discretion of the bankruptcy court to permit this practice only when it served the best interests of the estate.[13]

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[13] "The purpose of permitting the trustee to serve as his own counsel [or accountant] is to reduce costs." S. Rep. No. 95-989, 95th Cong., 2d Sess. 39 (1978), reprinted in, 1978 U.S.C.C.A.N. 5787, 5825.

Congress, however, made no such judgment as to the trustee serving as a realtor. All but one of the relevant prior lower court decisions support this conclusion. See Assistant United States Trustee v. John Galt, Ltd., 130 B.R. 464, 465-66 (S.D. W. Va. 1989); In re Blue, 146 B.R. 856, 858 (Bankr. W.D. Okla. 1992); In re Alexander, 129 B.R. 183 (Bankr. D. Minn. 1991); In re Continental Nut Co., 44 B.R. 48, 49 (Bankr. E.D. Cal. 1984). The one decision supporting the district court's holding, In re Wilkinson Distributing Co., 106 B.R. 658, 660 (Bankr. D. Haw. 1989), did so without explanation.

Here, it is undisputed that Keen was retained as a realtor, not as an "attorney or accountant." Therefore, subsection 327(d)'s specifically limited exception does not apply. Thus, any discussion of the merits of this appointment in terms of the best interests of the estate and its creditors, a discussion that would be appropriate as to the appointment of the trustee as an attorney or accountant, is simply irrelevant here.

Even if subsection 327(d) were viewed as a further grant of power to the trustee, not as an exception to a prohibition, there is no merit to the point that the subsection does not "express[ly]" limit a trustee's power to hire his or her own real estate firm. Congress's specificity in authorizing this type of arrangement as to legal and accounting services, and the absence of clearly contrary evidence of legislative intent, easily support the conclusion that Congress has granted no such permission as to other professional services. See National R.R. Passenger Corp. v. National Ass'n of R.R. Passengers, 414 U.S. 453, 457 (1974); American Land Title Ass'n v. Clarke, 968 F.2d 150, 155 (2d Cir. 1992), cert. denied, 113 S. Ct. 2959 (1993). Congress did not have to go on and make this any more explicit.

CONCLUSION

For the foregoing reasons, the decision of the district court should be reversed.

Respectfully submitted,

FRANK W. HUNGER
Assistant Attorney General

WILLIAM KANTER
(202) 514-4575
ROBERT D. KAMENSHINE
(202) 514-2494
Attorneys, Appellate Staff
Civil Division, Room 3617
Department of Justice
Washington, D.C. 20530-0001

OF COUNSEL:

MARTHA L. DAVIS
General Counsel

JEANNE M. CROUSE
Attorney

Executive Office for
United States Trustees

MARCH 18, 1996

CERTIFICATE OF SERVICE

I hereby certify that on this 18th day of March, 1996, I served the foregoing Brief For Appellant upon counsel by causing copies to be mailed, postage prepaid to:

Kenneth P. Silverman, Esquire
Andrew S. Muller, Esquire
Jaspan, Ginsberg, Schlesinger,
Silverman & Hoffman
300 Garden City Plaza
Garden City, New York 11530-3324

ROBERT D. KAMENSHINE
Attorney

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CTA2

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7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g., "UST/OGC"]*

Jeanne M. Crouse (UST/OGC)
Robert D. Kamenshine (CIVIL/APPELLATE)
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***

BANKRUPTCY

9. ("SU") ! ***SUMMARY*** OF KEY ISSUE(s)

&

√ Any Miscellaneous ***BACKGROUND***

! Under 11 U.S.C. 327, the Bankruptcy Court may authorize a case trustee to retain his own firm only in the capacity of "attorney or accountant," not of real estate broker. Section 327(a)'s broad conflict-of-interest provisions require appointment of a "disinterested" party with no "adverse interest."

√ **Background:** The Court of Appeals agreed with the UST and reversed the District Court's opinion in *In re Palm Coast (UST v. Bloom)*, 101 F.3d 253, 257-58 (2d Cir., 11/27/96) ("Read in the light of the common law of trusts, section 327 must be interpreted to prohibit the trustee from hiring himself in any non-lawyer or non-accountant capacity").

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No. 96-5009

IN THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

In RE PALM COAST: MANTANZA SHORES
LIMITED PARTNERSHIP A CONNECTICUT LIMITED PARTNERSHIP,

Debtor.

UNITED STATES TRUSTEE,

Appellant,

v.

MARVIN J. BLOOM, TRUSTEE,

Appellee.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

REPLY BRIEF FOR APPELLANT

OF COUNSEL:

MARTHA L. DAVIS
General Counsel

JEANNE M. CROUSE
Attorney

Executive Office for
United States Trustees

MAY 3, 1996

FRANK W. HUNGER
Assistant Attorney General

WILLIAM KANTER
(202) 514-4575
ROBERT D. KAMENSHINE
(202) 514-2494
Attorneys, Appellate Staff
Civil Division, Room 3617
Department of Justice
Washington, D.C. 20530-0001

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ON APPEAL FROM THE UNITED STATES DISTRICT COURT
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REPLY BRIEF FOR APPELLANT

I. THE STANDARDS OF SUBSECTION 327(a), AS WELL AS GENERAL FIDUCIARY STANDARDS, PRECLUDE A BANKRUPTCY COURT FROM APPROVING A TRUSTEE'S SELF-EMPLOYMENT AS A PROFESSIONAL.

A. Language And Structure.

In claiming that the Bankruptcy Code, 11 U.S.C. 327, authorizes his self-dealing, the trustee, Bloom, ignores both the provision's language and structure. Whatever may be said as to the provision's application in other contexts, for example the issue of whether it allows post facto authorization of a trustee's otherwise valid retention of professionals[1], there is nothing "'indeterminate'" (applees. br. 17) here.

Subsection (a), establishing the standards for a trustee's appointment of professionals, applies "[e]xcept as otherwise provided in this section" (emphasis supplied). Subsection (d) goes on to authorize a trustee, with the bankruptcy court's approval, to appoint himself as attorney or accountant for the estate. For such an appointment, just as any other involving the trustee's appointment of a professional,[2] the bankruptcy court must make an individualized determination as to whether the appointment is in the best interest of the estate.

But the clear import of the first word of section 327, "[e]xcept," (emphasis supplied) is that without subsection (d)'s specific authorization, the standards of subsection (a) would preclude the bankruptcy court from approving any such self-dealing appointments of professionals.[3] If subsection(a) permit

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[1] In Re Jarvis, 53 F.3d 416, 419 (1st Cir. 1995) (applees. br. 16).

[2] In re Martin, 817 F.2d 175, 182 (1st Cir. 1987) (applees. br. 16); In re BH & P, Inc., 949 F.2d 1300, 1315 (3rd Cir. 1991) (removal of attorneys) (applees. br. 16).

[3] Contrary to Bloom's assertion (applees. br. 19 n.4), in In re Equitable Ctr., 24 F.3d 245, 1994 WL 171162 (9th Cir. May 5, 1994) (unpublished opinion), the Ninth Circuit, has not "declined to create a per se rule regarding §327(d) * * *."
(continued...)

ted these appointments, subsection (d) would be redundant, contrary to normal rules of statutory construction.[4] See Bailey v. United States, 116 S. Ct. 501, 506-07 (1995); Field v. Mans, 116 S. Ct. 437, 442-43 n.7 (1995).

B. The Standards Of Subsection 327(a).

There is ample support for Congress' conclusion that a specific exception, such as subsection (d), would be necessary

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[3] (...continued)
Rather, the court stated that "we need not decide this legal issue" (1994 WL 171162 at *3) because the parties, including the United States Trustee, had stipulated to the employment. The stipulation by the United States Trustee was a mistake, made only eight months after the Program was first certified in the region that included the Western District of Washington.

Significantly, the court rejects Bloom's contention (applees. br. 18-19) that "[a] more thorough analysis of all of the cases cited by the U.S. Trustee in support of a per se bar with regard to §327(d) do not in fact establish a per se rule at all." Rather, citing In re Continental Nut Co., 44 B.R. 48, 49 (Bankr. E.D. Cal. 1984), In re Alexander, 129 B.R. 183, 185 (Bankr. D. Minn. 1991), and In re Galt, 130 B.R. 464, 465-66 (Bankr. S.D. W. Va. 1989) (discussed by Bloom, applees. br. 20-23), the court states that "some courts have held that a trustee may not employ itself in any professional capacity other than 'as attorney or accountant for the estate'" (emphasis supplied). 1994 WL 171162 at *2.

[4] Thus, In re Harold & Williams Dev. Co., 977 F.2d 906, 909-10 (4th Cir. 1992) (quoted in applees. br. 16-17), emphasizing that the courts "must take care not to fashion absolute prohibitions beyond those legislatively mandated without some measure of assurance that the purposes of the Bankruptcy Code always will be served thereby," is irrelevant here. Unlike the present case, section 327 does not provide textual and structural guidance as to whether the same professional could be employed in a dual capacity as attorney and accountant.

for any self-employment by a trustee to be valid. As explained in our principal brief, subsection 327(a)'s conflict of interest standards (at 7-8), as well as generally applicable standards of fiduciary conduct (at 8-10), would preclude a bankruptcy court from approving a trustee's self-employment as a professional, here as a real estate broker.

In response, Bloom first totally ignores the problem self-employment poses as to a trustee's fiduciary duty of undivided loyalty to the debtor's estate and its creditors, a duty that prohibits "self-dealing" and requires the trustee to avoid any conflict of interest, real or apparent, between his personal interests and those of the trust. In particular, Bloom declines to justify how, as we discussed in our principal brief (at 9), he "wore two hats," the estate's and Keen's, in negotiating the _percentage rate_ of the commission to be paid.

For the same reason, Bloom's discussion of subsection 327(a)'s "interest adverse to the estate" standard is unpersuasive. His lengthy exposition of the affidavit filed by Keen's president (applees. br. 8) and the letter agreement between Bloom and Keen does not respond to the inherent conflict that inevitably is involved in determining a professional's rate of compensation.

As for the requirement that the professional appointed by the trustee be "disinterested," _i.e_., not an "insider." 11 U.S.C. 101(14), Bloom acknowledges that "the present situation is identical to that where a trustee retains as his attorneys, a law firm in which he or she is a member" (emphasis supplied) (applees. br. 12). This is the very circumstance for which Congress found it necessary to enact a specific exception to subsection 327(a)'s standards. Bloom further acknowledges that "[i]ndeed [he] is in control of this partnership debtor's estate," yet never explains his reason for asserting (applees. br. 10-12) that only prepetition control falls within the definition of an "insider" as a "person in control of the [d]ebtor" (emphasis supplied). 11 U.S.C. 101(31)(C)(v). Indeed, given the broad anti-conflict of interest objective of section 327(a), there was ample reason for Congress to have concluded that self-employment by a trustee does fail the requirement that the appointed professional be "disinterested."[5]

II. NO EXCEPTION TO SUBSECTION 327(a) AND GENERAL FIDUCIARY STANDARDS SUPPORTS BLOOM'S SELF-EMPLOYMENT.

Since section 327 has no exception for a trustee's self-employment as a real estate broker, like that for self-employment as an attorney or accountant, the anti-conflict of interest

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[5] In re Begun, 162 B.R. 168 (Bankr. N.D. Ill. 1993) is cited by Bloom as providing "persuasive guidance for the instant case" (applees. br. 13), but provides none. In Begun, the trustee did not seek to hire himself or his firm as a broker; nor did the objecting party urge that the firm be disqualified under section 327(a). Rather, the case turned on the brokerage firm's failure to disclose ownership interests held by a partner in the trustee's law firm, and by a relative of another member of the firm.

constraints of subsection 327(a), as well as general fiduciary standards, apply here with full force. Consequently, without regard to Keen's particular merits as a realtor (applees br. 17-18), the bankruptcy court was not empowered to approve Bloom's appointment of his own firm.

CONCLUSION

For the foregoing reasons, as well as those stated in our principal brief, the decision of the district court should be reversed.

Respectfully submitted,

FRANK W. HUNGER
Assistant Attorney General

WILLIAM KANTER
(202) 514-4575
ROBERT D. KAMENSHINE
(202) 514-2494
Attorneys, Appellate Staff
Civil Division, Room 3617
Department of Justice
Washington, D.C. 20530-0001

OF COUNSEL:

MARTHA L. DAVIS
General Counsel

JEANNE M. CROUSE
Attorney

Executive Office for
United States Trustees

MAY 3, 1996

CERTIFICATE OF SERVICE

I hereby certify that on this 3rd day of May, 1996, I served the foregoing Reply Brief For Appellant upon counsel by causing copies to be mailed, postage prepaid to:

Kenneth P. Silverman, Esquire
Andrew S. Muller, Esquire
Jaspan, Ginsberg, Schlesinger,
  Silverman & Hoffman
300 Garden City Plaza
Garden City, New York 11530-3324

ROBERT D. KAMENSHINE
Attorney

BRIEF BANK — "SUMMARY SHEET"

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7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g., "UST/OGC"]*

Jeanne M. Crouse (UST/OGC)
Robert D. Kamenshine (CIVIL/APPELLATE)

(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***

BANKRUPTCY

9. ("SU") ! ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***

! In UST appeal — on conflict-of-interest grounds under 11 U.S.C. 327 — of orders allowing case trustee to serve as real estate broker, this Supplemental Brief addressed issue of "finality" for appellate jurisdiction under 28 U.S.C. 158(d) and/or "collateral order doctrine" of *Cohen v. Beneficial Indus. Loan*, 337 U.S. 541 (1949).

√ **Background:** The Court of Appeals agreed with the UST and reversed the District Court's opinion in *In re Palm Coast (UST v. Bloom)*, 101 F.3d 253, 257-58 (2d Cir., 11/27/96) ("Read in the light of the common law of trusts, section 327 must be interpreted to prohibit the trustee from hiring himself in any non-lawyer or non-accountant capacity").

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OF COUNSEL:

MARTHA L. DAVIS
General Counsel

JEANNE M. CROUSE
Attorney

Executive Office for
United States Trustees

AUGUST 23, 1996

FRANK W. HUNGER
Assistant Attorney General

WILLIAM KANTER
(202) 514-2560
ROBERT D. KAMENSHINE
(202) 514-2494
Attorneys, Appellate Staff
Civil Division, Room 7124
Department of Justice
Washington, D.C. 20530-0001

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IN THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

No. 96-5009

In RE PALM COAST: MANTANZA SHORES
LIMITED PARTNERSHIP A CONNECTICUT LIMITED PARTNERSHIP,

Debtor.

UNITED STATES TRUSTEE,

Appellant,

v.

MARVIN J. BLOOM, TRUSTEE,

Appellee.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

SUPPLEMENTAL BRIEF FOR APPELLANT

This supplemental brief is filed after argument pursuant to this Court's order of August 9, 1996. The brief addresses this Court's appellate jurisdiction over this case.

More specifically, the issue is: Whether there is appellate jurisdiction, under 28 U.S.C. 158(d)[1] or the collateral order doctrine (Cohen v. Beneficial Indust. Loan Corp., 337 U.S. 541 (1949))[2] over an appeal by the United States Trustee from the judgment of a district court, rendered prior to the end of the bankruptcy case, construing the Code (11 U.S.C. 327(a) and (d)) to permit the trustee in bankruptcy to employ himself as real estate broker for the estate, and approving such employment.

THIS COURT HAS APPELLATE JURISDICTION TO REVIEW THE DISTRICT COURT'S JUDGMENT IN THE PRESENT CASE.

A. Introduction.

In pursuing this appeal, the United States Trustee is carrying out the vital function established by Congress, to

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[1] This section provides:

> The courts of appeals shall have jurisdiction of appeals from all final decisions, judgments, orders, and decrees entered under subsections (a) and (b)of this section.

28 U.S.C. 158(a) in part provides:

> The district courts of the United States shall have jurisdiction to hear appeals
>
> (1) from final judgments, orders, and decrees.

[2] Under the doctrine of Cohen, "a court of appeals may review an interlocutory order that (1) conclusively determines a disputed question, (2) resolves an important issue completely separable from the merits of the action, and (3) is effectively unreviewable on appeal from a final judgment." In re Johns-Manville Corp., 824 F.2d 176, 180 (1987).

police the integrity of the bankruptcy system.[3] See United States Trustee v. Revco D.S., Inc. (In re Revco D.S., Inc.), 898 F.2d 498, 499 (6th Cir. 1990), In re Plaza de Diego Shopping Ctr., Inc., 911 F.2d 820, 825-26 (1st Cir. 1990). The United States Trustee is seeking to ensure that the appointment of a professional, here a real estate broker, under 11 U.S.C. 327, is consistent with that section's stringent conflict of interest standards. The question is more fundamental than even whether under particularized circumstances a professional whose appointment is desired is disinterested or has an interest adverse to the estate, and is therefore rendered ineligible to serve. The question is whether a bankruptcy trustee ever may appoint himself to serve as a professional in a capacity other than attorney or accountant.

The United States Trustee's efforts to avoid an unlawful appointment would be totally frustrated if appellate review of the statutory issue underlying the appointment were to be delayed to the end of the case, when final fees are awarded. Because the issue has been finally decided by the courts below, and because the district court's ruling irreparably harms the United States

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[3] Other participants in the bankruptcy proceeding may challenge appointments believed to violate the terms of section 327. But, as a practical matter, the experience of the United States Trustee has been that such challenges most often are brought by the United States Trustee.

Trustee's interest in preventing an unlawful appointment, this Court has jurisdiction to adjudicate this case.

B. Appellate Jurisdiction In The Special Context Of Bankruptcy.

Fortunately, the approach to issues of appellate jurisdiction developed in the special context of bankruptcy supports a finding of jurisdiction here. As this Court has observed, "[t]he finality requirement is less rigidly applied in bankruptcy than in ordinary civil litigation, and 'orders in bankruptcy cases may be immediately appealed if they finally dispose of discrete disputes within the larger case.'" In re Johns-Manville Corp., 920 F.2d 121, 126 (2d Cir. 1990) (emphasis in original) (quoting In re Saco Local Dev. Corp., 711 F.2d 441, 444 (1st Cir. 1983)). See also Bowers v. Connecticut Nat'l Bank, 847 F.2d 1019, 1022 (2d Cir. 1988).

Bankruptcy cases have unique characteristics in that they "frequently involve protracted proceedings with many parties participating," and "reviewing discrete portions of the action only after a plan of reorganization is approved" would "waste time and resources." In re Amatex Corp., 755 F.2d 1034, 1039 (3d Cir. 1985). Thus, "courts have permitted appellate review of orders that in other contexts might be considered interlocutory." Ibid. See also In re Dow Corning Corp., 86 F.3d 482, 488 (6th Cir. 1996); In re BH & P, Inc., 949 F.2d 1300, 1306 (3d Cir. 1991) (quoting F/S Airlease II, Inc. v. Simon, 844 F.2d 99, 103

(3d Cir.), cert. denied, 488 U.S. 852 (1988); In re Greene County Hospital, 835 F.2d 589, 594 (5th Cir.), cert. denied, 488 U.S. 820 (1988); Saco, 711 F.2d at 444-45.

C. Appellate Review Of Appointment Decisions.

The courts of appeals have taken differing approaches as to the question of whether orders involving the employment of professionals under 11 U.S.C. 327 are appealable as final under 28 U.S.C. 158(d). The Third Circuit has broadly held that during the pendency of a bankruptcy proceeding there is appellate jurisdiction to review a district court's determination under section 327's conflict of interest standards. In BH & P, the district court affirmed the decision of the bankruptcy court that neither the trustee nor the law firm that the trustee had appointed qualified as a disinterested party.

On appeal by the trustee and the law firm challenging their removal and disqualification, the Third Circuit held "that the district court's order removing [the trustee and law firm] due to an actual conflict of interest was final." 949 F.2d at 1307. The court used a flexible approach in which it considered "the impact of the matter on the assets of the bankruptcy estate, the preclusive effect of a decision on the merits, and whether the interests of judicial economy will be furthered" (quoting Airlease, 844 F.2d at 104). Id. at 1306. The court stressed that "the issues centering upon the bankruptcy court's disqualification and removal of [the trustee and the law firm] could well affect the assets in the three on-going Chapter 7 proceedings." Id. at 1307. Further, the court noted that "[r]esolution of the issues raised on appeal will eliminate the need for further consideration of conflict of interest issues," and will curtail "[f]urther delay attendant to the conflict of interest dispute * * *."[4] Ibid. See also United States Trustee v. Price Waterhouse, 19 F.3d 138 (3d Cir. 1994) (reviewing merits of order permitting employment of accounting firm that was statutorily disqualified).

The decision involving circumstances most closely resembling those in the present case is Michel v. Federated Department Stores, Inc. (In re Federated Dep't Stores, Inc.), 44 F.3d 1310, (6th Cir. 1995). There, the Sixth Circuit found that "[t]he validity of the retention order [,involving the statutory requirement that the professional be disinterested,] should have been decided before granting compensation from the bankruptcy estate." Id. at 1317. The court further held "that a valid appointment under § 327(a) is a condition precedent to the decision to grant or deny compensation." Id. at 1320. See also In re Middleton Arms Ltd. Partnership, 119 B.R. 131, 132-34 (M. D. Tenn.), aff'd, 934 F.2d 723 (6th Cir. 1991).

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[4] Prior to BH & P, in Airlease the Third Circuit held "that orders of both the bankruptcy court and the district court granting nunc pro tunc approval of [a professional's appointment] as a broker were final." 844 F.2d at 104.

Other courts of appeals, however, have found a lack of appellate jurisdiction to review district court decisions involving the trustee's employment of professionals. The principal reason for reaching this result was the courts' view that whatever the problem with the employment, it could be effectively remedied without immediate resort to an appeal. A closer review of these decisions reveals that none involved a fundamental issue of statutory power such as that raised by the present case. The decisions finding appointment orders to be interlocutory do not involve cases in which the Bankruptcy Code flatly prohibits the employment. The issue posed here is whether the trustee lacks the power to employ a whole category of professionals, that is, self-employment in capacities other than those of attorney or accountant.

In <u>In re Westwood Shake & Shingle, Inc.</u>, 971 F.2d 387 (9th Cir. 1992), involving an appeal by a firm suing the debtor, the court held that it lacked appellate jurisdiction to review an order approving the appointment, under section 327(e), of a law firm as special counsel to represent the trustee in a state case in which the bankrupt firm was the defendant. The plaintiff firm in the state case claimed that the law firm had a conflict of interest in that it represented two other parties whose interests in connection with the bankruptcy proceeding were adverse to those of the trustee. The district court, in the course of sustaining the appointment, had noted that "if settlement negotiations were initiated in the state court proceeding, the conflict would be 'overwhelming,' and the parties would be required to obtain separate counsel." 971 F.2d at 388-89. Significantly, the court of appeals stressed that "[t]he bankruptcy court retains the power to remove * * * [the] special counsel * * * should conflict problems arise and [his] representation of the trustee fails to conform to the disinterestedness standards of 11 U.S.C. 327(a)." Id. at 390.

In In re Firstmark Corp., 46 F.3d 653 (7th Cir. 1995), creditors challenged the appointment of law firms respectively representing the debtors and the official creditors committee. In holding that it lacked jurisdiction, the court "decline[d] to adopt" the "flexible approach" of the Third Circuit to determine the issue of finality in bankruptcy appeals. Id. at 659. The court emphasized that the parties had not demonstrated the existence of harm -- that there was "no reason why the appeal cannot wait until the case has ended" (id. at 658), since if it ultimately were determined that the firms should have been disqualified, "the [objecting creditors] simply seeks return of all fees paid to the law firms for work on the bankruptcy case." Id. at 660.

In In re Delta Servs. Indus., 782 F.2d 1267 (5th Cir. 1986), the court relied on two non-bankruptcy Supreme Court decisions[5]

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[5] Firestone Tire & Rubber Co. v. Risjord, 449 U.S. 368 (continued...)

to hold that there was no appellate jurisdiction to review an order denying a motion to disqualify counsel for the interim trustee on grounds of the failure to meet the standards of section 327(a). The court stated that "[w]e can discern no basis for granting greater appealability to orders denying motions to disqualify counsel in bankruptcy cases than to those in the ordinary civil case."[6] 782 F.2d at 1272. But see In re W.F. Development Corp., 905 F.2d 883 (5th Cir. 1990), cert. denied, 499 U.S. 921 (1991) (reviewing without mention of any jurisdictional problem the disqualification of attorney for debtor and limited partners).

D. Appellate Jurisdiction Here.

While we disagree with the inflexible approach taken by the courts of appeals that have found a lack of appellate jurisdiction in the above cases, and endorse that of the Third and Sixth Circuits, the present case is unique in the issue it

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[5](...continued) (1981) (orders denying motions to disqualify counsel in a civil case not finally appealable decisions under 28 U.S.C. 1291, and not within 'collateral order' exception of Cohen); Richardson-Merrell, Inc. v. Koller, 472 U.S. 424, 440 (1985) ("orders disqualifying counsel in civil cases * * * not collateral orders subject to appeal as 'final judgments' within meaning of 28 U.S.C. §1291").

[6] Also, in Spears v. United States Trustee, 26 F.3d 1023 (10th Cir. 1994), involving an appeal by the trustee for the debtor, the court found there was no appellate jurisdiction to review the bankruptcy court's discretionary decision denying retroactive employment of counsel and granting prospective employment. But see In re Jarvis, 53 F.3d 416 (1st Cir. 1995) (reaching merits of denial of retroactive employment of broker).

presents. This case does not involve a discretionary act of appointment based on an alleged conflict of interest that may or may not materialize. Rather this Court confronts a question of law regarding statutory construction that will not change over time. In drafting sections 327 and 101(14), Congress concluded that the harm occurs at the moment of appointment and, for that reason, has forbade outright the employment of certain professionals. See Federated Department Stores, 44 F.3d at 1318-19. Thus, this case differs significantly from others in which the courts of appeals have treated employment orders as interlocutory.

Considerations of finality do not demand that this Court allow to stand until the end of the proceeding the Trustee's self-appointment to serve in a professional capacity that, as we have argued, the Code per se does not permit. This is so whether one considers finality under 28 U.S.C. 158(d) or applies the collateral order doctrine of Cohen.

With regard to jurisdiction under section 158(d), this case meets the standards of finality articulated by the Third Circuit. The issue before this Court does have an "impact on the assets of the bankruptcy estate." Airlease, 844 F.2d at 104. Here, the sole asset of the estate is a tract of land to be marketed by the trustee's own real estate firm. The qualifications and projected efforts of the real estate broker selected to market the property are critical to the likelihood of success in obtaining the best possible price. Moreover, the terms of the commission to be paid to the firm -- a commission that the case trustee negotiated on behalf of his firm -- also directly affect the net proceeds that will be available to distribute to the creditors. Any selection by a trustee of the real estate firm of which he is an officer would raise serious doubts as to whether the selection has been based on the relative merits of the competing firms, both in terms of the services they will provide and the cost of those services. Finally, resolution of the fundamental issue of statutory power raised in this appeal "will eliminate the need for further consideration of conflict of interest issues, freeing the bankruptcy court to adjudicate the more substantive issues relating to the estate[] in question" and "curtail[]" "[f]urther delay attendant to the conflict of interest dispute * * *." BH & P, 949 F.2d at 1307.

Even if the bankruptcy issue in this case were to be deemed interlocutory, there still would be appellate jurisdiction under the doctrine in Cohen. It is clear that the district court's order "conclusively determines a disputed question" and "resolves an important issue separable from the merits of the action."[7] In re Johns-Manville Corp., 824 F.2d 176, 180 (2d Cir. 1987)[8].

The critical question is whether the order "is effectively unreviewable on appeal from a final judgment." As discussed above, the selection by the trustee of his own firm places in question the relative merits of that firm in terms of its capacity to maximize the return from the sale of the estate. Thus, the rendering of brokerage services by the trustee (through Keen) is contrary to the terms of section 327 and could not effectively be remedied simply by an eventual disgorgement of Keen's commission.[9] Keen will remain statutorily ineligible to serve as a professional in this case from the first day of appointment until the conclusion of its services. The bankruptcy

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[7] The court in Delta Services found, under the Cohen standards, that the issue regarding the appointment of counsel was not separate from the merits of the action because an inquiry into the alleged conflict of interest would have "entangle[d]" the court "in the merits of Delta's liquidation." 782 F.2d at 1272-73. Whatever the validity of this holding, this is not the case here. Only the legality of the appointment, per se, is at issue.

[8] In this case, this Court found to be interlocutory a discretionary decision by the bankruptcy court to refuse to order the appointment of an additional creditors' committee. Johns-Manville did not present a question of law involving statutory construction.

[9] We further note, assuming the district court's order to be not otherwise reviewable at this time, the possibility of this Court's permitting the Trustee to obtain certification of the issue by the district court. 28 U.S.C. 1292(b). See Connecticut Nat'l Bank v. Germain, 503 U.S. 249 (1992); Spears v. United States Trustee, 26 F.3d 1023, 1025 (10th Cir. 1994); In re Continental Investment Corp., 637 F.2d at 7.

court acted beyond the scope of the statute in permitting the trustee to retain his brokerage firm. To treat this order as interlocutory would effectively nullify the strict provisions that Congress has incorporated in section 327.

In sum, this case presents a basic and discrete issue of statutory interpretation, the resolution of which will directly affect the marketing of the estate, and consequently the ultimate return to the creditors. There is appellate jurisdiction to review that issue without regard to whether jurisdiction exists as to other bankruptcy issues involving the appointment of professionals.

CONCLUSION

For the foregoing reasons, as well as those stated in our principal and reply briefs, the decision of the district court should be reversed.

Respectfully submitted,

FRANK W. HUNGER
Assistant Attorney General

WILLIAM KANTER
(202) 514-2560
ROBERT D. KAMENSHINE
(202) 514-2494
Attorneys, Appellate Staff
Civil Division, Room 7124
Department of Justice
Washington, D.C. 20530-0001

OF COUNSEL:

MARTHA L. DAVIS
General Counsel

JEANNE M. CROUSE
Attorney

Executive Office for
United States Trustees
AUGUST 23, 1996

CERTIFICATE OF SERVICE

I hereby certify that on this 23rd day of August, 1996, I served the foregoing Supplemental Brief For Appellant upon counsel by causing copies to be mailed, postage prepaid to:

Kenneth P. Silverman, Esquire
Andrew S. Muller, Esquire
Jaspan, Ginsberg, Schlesinger,
  Silverman & Hoffman
300 Garden City Plaza
Garden City, New York 11530-3324

ROBERT D. KAMENSHINE
Attorney

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Diana G. Adams, UST v. Portrait Corporation of America

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District Court for the Southern District of New York

3. ("CCN") ***CURRENT*** CASE NO.
No.: 07-0245

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*
No.: 06-22541
Court: Bankr. SDNY
(Identify judge & cite, if any)

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U.S. TRUSTEES

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Alicia M. Leonhard, Trial Attorney and Linda A. Riffkin, Assistant United States Trustee
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") ● ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***

● Whether the Bankruptcy Court erred in authorizing Cadwalader's retention, when the Court held that, as a matter of law, Cadwalader represented many adverse interests to the estate and was not disinterested, disqualifying factors under 11 U.S.C. Section 327(a).

√ **Background:**

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IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

In re PORTRAIT CORPORATION OF AMERICA, *et al.*, Debtors

Civil No. 07-0245 (SCR)

DIANA G. ADAMS,
ACTING UNITED STATES TRUSTEE

Appellant,

v.

PORTRAIT CORPORATION OF AMERICA, *et al.*,

Appellees.

On Appeal from the United States Bankruptcy Court
for the Southern District of New York, White Plains Division

BRIEF OF APPELLANT UNITED STATES TRUSTEE

Alicia M. Leonhard
Trial Attorney
Linda A. Riffkin
Assistant United States Trustee

Office of the United States Trustee
33 Whitehall Street, 21st Floor
New York, NY 10004
Phone: (212) 510.0508
Facsimile: (212) 668.2255
Alicia.M.Leonhard@usdoj.gov

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STATUTES

RULES

I. PRELIMINARY STATEMENT

This is an appeal from a final order of the Bankruptcy Court, entered November 22, 2006 (the "Employment Order"). [RA, Exhibit 7, at 20.][1] The Employment Order granted the Debtors' Motion Pursuant to Sections 327(a) and 328(a) of the Bankruptcy Code and Bankruptcy Rule 2014(a) Authorizing the Employment and Retention of Cadwalader Wickersham & Taft ("Cadwalader") as Attorneys for the Debtors (the "Employment Application"). [RA, Exhibit 20, at 232.] The Employment Order approved the employment of Cadwalader, as "transition counsel" for chapter 11 debtors Portrait Corporation of America, Inc. ("PCA") and eight related entities (collectively, the "Debtors"), over the objection of the United States Trustee for Region 2 (the "United States Trustee").

II. SUMMARY OF ARGUMENT

This Court should reverse the Employment Order for three reasons. First, the Bankruptcy Court expressly and correctly held that Cadwalader represented many interests adverse to the Debtors' bankruptcy estate and was not disinterested, disqualifying factors under 11 U.S.C. Section 327(a). Second, the Bankruptcy Court created an unauthorized exception to the mandatory disinterestedness provisions of Section 327(a) by finding that the facts and circumstances of the case warranted approving Cadwalader's employment. Third, there is no provision in the Bankruptcy Code for "transition counsel," but if there were, the requirements of Section 327(a) that counsel not hold adverse interests and be disinterested would still apply. The United States Trustee respectfully submits this brief in support of reversal of the Employment

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[1] "RA" refers to the Record on Appeal. "Exhibit [#]" refers to the document in the RA, and "at #" refers to the consecutively numbered pages in the RA.

Order.[2]

III. JURISDICTION

The Bankruptcy Court had jurisdiction over the Employment Application under 28 U.S.C. Sections 157(b)(2)(A) and 1334. The Employment Order is a final order under 28 U.S.C. Section 158(a)(1). *See, e.g., In re Pegasus Agency, Inc.*, 101 F.3d 882, 885 (2d Cir. 1996) (a bankruptcy court order is final if it "completely resolve[s] all of the issues pertaining to a discrete claim, including issues as to the proper relief"). *See also In re Kurtzman,* 220 B.R. 538, 540 (S.D.N.Y. 1998) (orders approving retention are final, appealable orders within the meaning of 28 U.S.C. Section 158(a)(1)). On November 30, 2006, the United States Trustee filed a timely Notice of Appeal. [RA, Exhibit 1, at 1.] This Court, therefore, has jurisdiction to hear the appeal under 28 U.S.C. Section 158(a)(1).

IV. STATEMENT OF ISSUE PRESENTED

Whether the Bankruptcy Court erred in authorizing Cadwalader's retention, when the Court held that, as a matter of law, Cadwalader represented many adverse interests to the estate and was not disinterested, disqualifying factors under 11 U.S.C. Section 327(a).

---

[2] The United States Trustee "may raise and may appear and be heard on any issue in any case or proceeding under this title but may not file a plan pursuant to section 1121(c) of this title." 11 U.S.C. Section 307. Under Section 307, the United States Trustee has standing to appeal an order entered under 11 U.S.C. Section 327(a). *United States Trustee v. Price Waterhouse,* 19 F.3d 138, 141 (3d Cir. 1994).

V. STANDARD OF REVIEW

"[R]etention . . . orders involve[ ] interpretations of law and '[t]his court applies a plenary review of the bankruptcy court's conclusion[s] of law, using a *de novo* standard.'" *In re Federated Department Stores, Inc.*, 44 F.3d 1310, 1315 (6th Cir. 1995) (quoting *In re Eagle-Picher Industries, Inc.*, 999 F.2d 969, 972 (6th Cir. 1993)). An appellate court "accept[s] [the Bankruptcy Court's] factual findings unless clearly erroneous but review[s] its conclusions of law *de novo*." *Bank Brussels Lambert v. Coan (In re AroChem Corp.*), 176 F.3d 610, 620 (2d Cir. 1999) (citing *In re McLean Industries*, 30 F.3d 385, 387 (2d Cir. 1994). *See also In re Globo Comunicacoes e Participacoes S.A.*, 317 B.R. 235, 245 (S.D.N.Y. 2004) (findings of fact are reviewed under the clearly erroneous standard, conclusions of law are reviewed under the *de novo* standard and mixed questions of fact and law are subject to *de novo* review) (citing *In re Enron Corp.*, 306 B.R. 33, 37 (S.D.N.Y. 2004)). Once a bankruptcy court finds that a professional does not meet the requirements of 11 U.S.C. Section 327(a), it is an error of law to approve the employment of that professional. *See In re Mercury*, 280 B.R. 35, 55 (Bankr. S.D.N.Y. 2002), (under Section 327(a), the Bankruptcy Court does not have the authority to approve the retention of a professional who has a conflict of interest), *aff'd*, 122 Fed. App. 528 (2d Cir. 2004) and *In re Harold and Williams Development Co.*, 977 F.2d 906, 909 (4th Cir. 1992) (the Bankruptcy Court may only approve professionals who meet the requirements of Section 327(a)).

VI. STATEMENT OF THE CASE

A. Statutory Framework

Attorneys retained as bankruptcy counsel for debtors in chapter 11 cases must comply with 11 U.S.C. Section 327(a) which provides, in part, that:

> (a) Except as otherwise provided in this section, the trustee,[3] with the court's approval, may employ one or more **attorneys**, . . . or other professional persons, **that do not hold or represent an interest adverse to the estate[4] and that are disinterested persons**, to represent or assist the trustee in carrying out the trustee's duties under this title.

11 U.S.C. Section 327(a) (emphasis added). The term "disinterested person" is defined in 11 U.S.C. Section 101(14) as a person that

> (A) is not a creditor, an equity security holder or an insider;
>
> (B) is not and was not, within 2 years before the date of the filing of the petition, a director, officer, or employee of the debtor; **and does not have an interest materially adverse to the interest of the estate or any class of creditors or equity security holders, by reason of any direct or indirect relationship to, connection with, or interest in, the debtor, or for any other reason.**

11 U.S.C. Section 101(14) (2005) (emphasis added). The term adverse interest is not defined in the Bankruptcy Code. The Second Circuit, however, has defined the term as:

> (1) to possess or assert any economic interest that would tend to lessen the value of the bankruptcy estate or that would create either an actual or potential dispute in which the estate is a rival claimant; or (2) to possess a predisposition under circumstances that render such a bias against the estate.

In re Worldcom, 311 B.R.151, 163 (Bankr. S.D.N.Y. 2004) (quoting *In re AroChem*, 176 F.3d at 623). "The 'materially adverse' standard incorporated in the disinterestedness test and the

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[3] The term "trustee" means the debtor-in-possession in chapter 11 cases because debtors-in-possession are given all of the rights and powers of a trustee under 11 U.S.C. Section 1107. *Hartford Underwriters Ins. Co. v. Union Planters Bank,* 530 U. S. 1, 6, 120 S. Ct. 1942, 1947 n.3 (2000).

[4] Section 327 distinguishes between "holding" and "representing" an interest. *In re Worldcom*, 311 B.R. at 164 n.9 (quoting *In re AroChem,* 176 F.3d at 629). Representing an adverse interest "means to serve as an agent or attorney for any individual or entity holding such an adverse interest." *Id*. (citing *In re Envirodyne Indus., Inc.*, 150 B.R. 1008, 1016-17 (Bankr. N. D. Ill.1993)).

‘interest adverse to the estate’ language in section 327(a) overlap . . . and form a single test to judge conflicts of interest.” *In re Granite Partners, L.P.*, 219 B.R. 22, 33 (Bankr. S.D.N.Y. 1998) (citing *In re BH & P, Inc.*, 949 F.2d 1300, 1314 (3d Cir. 1991); *In re Martin*, 817 F.2d 175, 179 n.4 (1st Cir.1987); *In re Leslie Fay Cos.*, 175 B.R. 525, 532 (Bankr. S.D.N.Y. 1994); *In re CF Holding Corp.*, 164 B.R. 799, 806 (Bankr. D. Conn. 1994); *In re Tinley Plaza Assocs.*, 142 B.R. 272, 277 (Bankr. N. D. Ill. 1992)). The disinterestedness provision of Section 327(a) is mandatory. *In re Granite Partners*, 219 B.R. at 34. *See also In re Harold & Williams Development Co.*, 977 F.2d at 910 (the disinterestedness requirement of Section 327(a) is a “congressionally established” *per se* rule).

B. Procedural and Factual History

1. The Chapter 11 Cases

On August 31, 2006, Cadwalader filed chapter 11 petitions on behalf the Debtors. [RA, Exhibit 21, at 266-267, ¶ 1, & Exhibit 22, at 296, ECF Doc. No. 1.) The Bankruptcy Court entered an order directing the joint administration of the cases on September 1, 2006. [RA, Exhibit 22, at 299, ECF Doc. No. 23.] The Debtors operate portrait studios through a licensing agreement with Wal-Mart in 2,500 stores in the United States, Canada, Mexico, Germany, and the United Kingdom. [RA, Exhibit 21, at 268, ¶¶ 2-4.] The Debtors filed the cases because a downturn in business made it difficult to service their significant secured and unsecured debt. [RA, Exhibit 21, at 270, ¶¶ 6-8.]

On the petition date, the Debtors’ debts totaled approximately $283 million. [RA, Exhibit 21, at 270-272.] This amount included $11 million owed to Wells Fargo Foothill (“Wells Fargo”) under a secured credit facility, $50 million in secured bonds, $165 million in senior unsecured bonds, owned by Goldman Sachs, Whippoorwill Associates ("Whippoorwill") and others (the "Senior Notes"), $30 million in subordinated unsecured bonds owned by Goldman Sachs and others, and $22 million in trade debt purchased by Whippoorwill from AgfaPhoto USA. [RA, Exhibit 21, at 270-272, ¶¶ 9-14.] Other trade claims totaled $5 to $6 million. [RA, Exhibit 21, at 272, ¶ 15.] After the petition date, the Court approved a debtor-in-possession loan to the Debtors from Wells Fargo, which provided the Debtors with a $45 million revolving line of credit, to be used to, among other things, satisfy Wells Fargo's pre-petition claim (the "Roll Up") and fund working capital needs. [RA, Exhibit 22, at 308, ECF Doc. No. 88.]

The Debtors claimed that, on the petition date, they had an "agreement in principle" with an *ad hoc* committee of holders of the Senior Notes (the "*Ad Hoc* Committee"), on the terms of a chapter 11 plan of reorganization (the "Pre-Negotiated Plan"). [RA, Exhibit 21, at 273, ¶ 16.] Wal-Mart, however, was not a party to the Pre-Negotiated Plan, even though the Debtors admitted that

> The Debtors' business is completely dependent upon their relationship with Wal-Mart inasmuch as all of the Portrait Studios in North America are located in Wal-Mart stores and currently operate under the Wal-Mart tradename. The Debtors' operations within Wal-Mart Stores represent a substantial percentage of the Debtors' historical annual consolidated revenue. The Debtors' business simply cannot be reorganized – much less survive – without the support of Wal-Mart.

[RA, Exhibit 21, at 283, ¶ 49.] On the petition date, the Debtors claimed to have a separate "agreement in principle" with Wal-Mart [RA, Exhibit 21, at 284, ¶ 51], but as of October 26, 2006, the Debtors and Wal-Mart had not come to any agreement on the Debtors' future as a Wal-Mart licensee, and the creditors were contemplating renegotiating the Pre-Negotiated Plan due to a decrease in the value of the Debtors during the bankruptcy case. [RA, Exhibit 14, at 100, lines

3-5; 101, lines 12-25; & 102, lines 1-5.]

2. The Employment Application

On August 31, 2006, Cadwalader filed the Employment Application and the Affidavit of John H. Bae ("Bae") (the "Bae Affidavit"). [RA, Exhibit 20, at 232.] Bae is a member of Cadwalader. [RA, Exhibit 20, at 246, ¶ 2.] The Bae Affidavit disclosed that Cadwalader had current and on-going attorney-client relationships with nine parties with significant connections to the Debtors' bankruptcy cases in matters unrelated to the cases. These parties included (1) Wells Fargo (the Debtors' pre-petition and DIP lender), (2) Wal-Mart (licensor upon which the Debtors' business depends), (3) Whippoorwill (bond and trade claim holder and member of the creditors' committee), (4) and (5) GS Mezzanine Partners II, L.P. and GS Mezzanine Partners II Offshore, L.P. (bondholders and Goldman Sachs-related entities), (6) AIG Global Investment Corp ("AIG") (bondholder and member of the creditors' committee), (7) Travelers Indemnity Company, (8) The Prudential Company of America; and (9) the Bank of New York. [RA, Exhibit 20, at 250, ¶¶ 14-15 & 255, Annex I.]

On September 17, Cadwalader filed a Supplemental Affidavit of John H. Bae (the "Supplemental Bae Affidavit"). [RA, Exhibit 19, at 223.] Among other things, the Supplemental Bae Affidavit disclosed the following:

1. Attorneys in Cadwalader's Capital Markets Department and Global Finance Department represent Goldman Sachs & Company and several of its affiliates in a number of areas, including performing services relating to loan originations, purchasing and selling loans securitizations, swaps and other related matters.

2. Attorneys in Cadwalader's Capital Markets Department represent Wells Fargo

and several of its affiliates relating to residential mortgage securitizations.

3. Attorneys in Cadwalader's Washington, D.C. office represent Wal-Mart in a discreet, confidential matter.

[RA, Exhibit 19, at 225, ¶¶ 5-7.]

Bae averred that even though Cadwalader had significant attorney-client relationships with every major constituency in the case, the relationships did not create adverse interests at that time. [RA, Exhibit 19, at 225, ¶¶ 8-10 & 226, ¶ 11.] If adverse interests arose, Bae maintained that the Debtor would hire "conflicts counsel."[5] [RA, Exhibit 19, at 226, ¶ 12.]

On September 12, 2006, the United States Trustee filed an objection to the Employment Application (the "Objection"). [RA, Exhibit 18, at 208.] The United States Trustee argued that Cadwalader had connections with every major constituency in the Debtors' case, including Wal-Mart, on which the Debtors' business depended, Wells Fargo, the pre-petition and DIP lender, and Goldman Sachs, bondholder, and Whippoorwill and AIG, bondholders and members of the creditors' committee. The United States Trustee also argued that Cadwalader was not disinterested, under Section 327(a), because it would not sue any of the nine clients who were significant parties-in-interest in the Debtors' cases. Moreover, Cadwalader's representation of those parties gave rise to the perception of a disincentive to act zealously for the Debtors. In

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[5] Conflicts counsel is a type of retention that has arisen in the Bankruptcy Courts for the Southern District of New York and the District of Delaware in light of increasing numbers of mega- and bega- cases and the proliferation of national and international law firms. In cases where bankruptcy counsel have attorney-client relationships with peripheral creditors or parties-in-interest in a case, the Bankruptcy Court will approve conflicts counsel to handle all matters related to those clients. *See In re Enron*, 2003 WL 223455, at *7 (S.D.N.Y. February 3, 2003) (conflicts counsel represented creditors' committee with respect to all matters in which committee counsel had conflict of interest). Conflicts counsel appropriately handle discrete issues. *See id.* at *9 (conflicts counsel handled matters related to structured finance transactions).

sum, this perception, coupled with Cadwalader's inability to sue virtually all of the major players in the case, raised issues with respect to the current and future conduct of the case, including the conduct of the negotiations with Wal-Mart. [RA, Exhibit 18, at 214-217.]

At the hearing on the Employment Application on September 22, 2006, Bae admitted that Cadwalader would not sue its clients, arguing that the inability to sue was irrelevant because the bankruptcy case was consensual and there were no litigation issues with any of the creditors.[6] [RA, Exhibit 16, at 167, lines 14-25; 168, lines 1-25; & 170, lines 1-6.] With respect to Wal-Mart, Bae argued, the Debtors' principals were handling negotiations, and the Debtors would hire conflicts counsel to "paper" any resolution of the Wal-Mart licensing agreement. [RA, Exhibit 16, at 168, lines 7-15.]

At the September 22, 2006 hearing, the United States Trustee argued that Cadwalader had conflicting duties of loyalty arising from the inability to sue its own clients. [RA, Exhibit 16, at 159, line 25; & 160, lines 1-14.] The inability to sue was tantamount to an acknowledgment that Cadwalader represented interests adverse to the estate. [RA, Exhibit 16, at 157, lines 15-19.] Hence, Cadwalader could not be retained under section 327(a). [RA, Exhibit 16, at 160, lines 15-25, & 161, lines 1-4.] After hearing argument from the parties, the Bankruptcy Court took the matter under advisement. [RA, Exhibit 16, at 190, lines 13-14.]

3. The Bankruptcy Court's Bench Decision

On October 19, 2006, the Bankruptcy Court issued an oral ruling from the bench approving Cadwalader's retention under 11 U.S.C. Section 327(a). [RA, Exhibit 15, at 127-

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[6] Bae specifically stated that "frankly, if the debtor [had] come to us and said 'we want to sue Wal-Mart,' we could not have taken that case and we would not have taken that case, but it's not about that." [RA, Exhibit 16, at 167, lines 20-23.]

133.] The Bankruptcy Court approved the retention despite his finding that Cadwalader had "material client relationships with almost all the principal constituents in this chapter 11 case . . . ." [RA, Exhibit 15, at 128, lines 1-15.] Specifically, the Court stated that:

> I cannot imagine any Court authorizing the retention of a law firm for the debtor with so many client relationships, and important client relationships which, without question, do constitute, quote, "an interest adverse to the estate," and render Cadwalader not a, quote, "disinterested person." I might point out that an adverse interest, within the meaning of the Bankruptcy Code, is not a situation where there is actual raging conflict. An adverse interest, within the meaning of Section 327(a) is any interest where the parties in a negotiation, no matter how friendly, would sit on the other side of the table from each other.

[RA, Exhibit 15, at 129, at 3-13.] The Bankruptcy Court further found that Cadwalader's relationship with Wal-Mart was prejudicial to the Debtors:

> In the Wal-Mart situation, Wal-Mart, I am told, Wal-Mart, either directly or with the assistance of counsel, is negotiating directly with the president of Portrait Corporation of America, apparently without counsel. Extremely prejudicial. And we're told that in order to document any agreement that may result, conflicts counsel would be retained. Well, it would certainly be unusual, and that is really a big understatement. . . . In effect, this debtor has no outside counsel or independent counsel to advise it.

[RA, Exhibit 15, at 129, line 25; and 130, lines 1-6 & 12-13.] Ultimately, however, the Bankruptcy Court approved what it called an "unapprovable" retention, reasoning that denial would result in delay and cost, the plan was negotiated pre-petition, there were no present controversies between the creditors, and no creditors opposed the Employment Application. [RA, Exhibit 15, at 132, lines 14-25; & 133, lines 1-21.]

On October 20, 2006, a day after the oral ruling, the Bankruptcy Court initiated a conference call with Cadwalader and the United States Trustee and expressed concerns regarding previously undisclosed controversies in the Debtors' case. [RA, Exhibit 11, at 63, ¶ 5.] The Court informed Cadwalader and the United States Trustee that it was not inclined to sign any retention order for Cadwalader until the matters were resolved. [RA, Exhibit 11, at 63, ¶ 5.]

4. Cadwalader's Withdrawal and Retention as "Transition Counsel"

At a hearing on October 26, 2006, Bae informed the Court of Cadwalader's decision to withdraw as counsel for the Debtors because "Cadwalader took very seriously Your Honor's comments and concerns regarding conflicts that the Court has -- that the United States Trustee's Office has identified, and that Your Honor has remarked on." [RA, Exhibit 14, at 111, lines 11-15.] Cadwalader expressed its desire to stay on as "transition counsel" until the Debtors selected a new firm if an appropriate order could be worked out with the United States Trustee. [RA, Exhibit 14, at 111, lines 18-25; & 112, lines 1-6.] Bae admitted that he had "never prepared such an order in [his] career." [RA, Exhibit 14, at 112, lines 8-9.] The Bankruptcy Court stated that "it may be that such an order will be appropriate." [RA, Exhibit 14, at 112, lines 10-11.]

The United States Trustee and Cadwalader could not come to an agreement on a form of order. On October 31, 2006, Cadwalader settled a proposed employment order (the "Proposed Order") on the parties-in-interest to the case. [RA, Exhibit 13, at 78.] The Creditors' Committee and the United States Trustee filed objections to the Proposed Order.[7] [RA, Exhibit 11, at 61; & Exhibit 12, at 70.]

5. The Employment Order

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[7] On November 16, 2006, the Bankruptcy Court approved the employment of Kasowitz Benson Torres & Friedman, LLP ("Kasowitz") as Section 327(a) Counsel for the Debtors. [RA, Exhibit 22, at 320, ECF Doc. No. 186.] Kasowitz filed a disclosure statement and plan on January 31, 2007. [RA, Exhibit 22, at 333, ECF Doc. Nos. 287 & 288.]

The Court held a hearing on the Proposed Order on November 22, 2006. [RA, Exhibit 8, at 23.] The Court overruled the objections of the United States Trustee and the Creditors' Committee and entered the Proposed Order (the "Employment Order"), stating:

> My ruling . . . reflects the plain fact, which is evident to everybody, that the firm has rendered a significant service to the debtor -- debtors prior to its withdrawal . . . And so for the reasons that I previously expressed in my oral ruling, the unique circumstances of this case as it was then postured, I will grant the application.

[RA, Exhibit 8, at 32, lines 21-25; & 33, lines 1-2.] The Employment Order provided in part that

> [I]t is
>
> ORDERED that, pursuant to sections 327(a) and 328(a) of the Bankruptcy Code, the Debtors, as debtors in possession, are authorized to employ and retain Cadwalader as their attorneys, in accordance with Cadwalader's normal hourly rates and disbursement policies as set forth in the Bae Affidavit, effective as of the commencement of these cases; and it is further
>
> . . .
>
> ORDERED that Cadwalader shall represent the Debtors until such time as the Debtors promptly select new counsel, and shall continue to represent the Debtors and assist such new counsel during a reasonable transition period so as to facilitate the efficient administration of the Debtors' estates;

[RA, Exhibit 7, at 21-22.] On November 30, 2006, the United States Trustee filed a timely Notice of Appeal. [RA, Exhibit 1, at 1.]

VII. <u>ARGUMENT</u>

This Court Should Reverse the Employment Order Because the Bankruptcy Court Committed Three Errors of Law in Approving Cadwalader's Retention Under 11 U.S.C. Section 327(a).

In an appeal of a retention order entered by the Bankruptcy Court, the appellate court reviews conclusions of law under the *de novo* standard of review. *In re Federated Dept. Stores, Inc.*, 44 F.3d at 1315. The Bankruptcy Court does not have discretion to approve the employment of professionals who do not meet the disinterestedness requirements of 11 U.S.C.

Section 327(a). *In re Mercury*, 280 B.R. at 55. *See also Childress v. Middleton Arms L.P. (In re Middleton Arms Ltd. Partnership*), 934 F.2d 723, 725 (6th Cir. 1991) (the court may not use its equitable powers to approve employment of a person who is not disinterested) and *In re Federated Dept. Stores, Inc.*, 44 F.3d at 1319 (the Bankruptcy Court's approval of professional that was not disinterested based on "equitable considerations" and "familiarity with the debtors' business operations" was error).

In this case, the Bankruptcy Court committed three errors. The Bankruptcy Court properly held that Cadwalader was not disinterested, *i.e.*, that Cadwalader held many adverse interests. [RA, Exhibit 15, at 127, line 25; 128-129; & 130, lines 1-13.] On this basis, Cadwalader was ineligible for retention under the specific requisites of 11 U.S.C. Section 327(a). *See, e.g., In re Granite Partners,* 219 B.R. at 32-33 (the Section 327(a) requirements are mandatory and apply at retention and throughout the case). The Bankruptcy Court's first error, therefore, was to approve Cadwalader's retention in the face of its own holding and the mandatory language of Section 327(a).

Second, the Bankruptcy Court erred when it held that the facts and circumstances of the case warranted Cadwalader's retention. In so holding, the Bankruptcy Court misapplied the law. Section 327(a) does not authorize the court to approve the retention of counsel under an economic benefit test. If proposed counsel are not disinterested, the Bankruptcy Court cannot approve their retention. Bankruptcy courts have the authority to consider the facts and circumstances in deciding retention matters but only after determining that counsel have met the disinterestedness requirement of Section 327(a). *See In re Harold & Williams Development Co.,* 977 F.2d at 910 (court may look at facts and circumstances only after disinterested requirement has been met).

Third, the Bankruptcy Court erred in approving the retention of Cadwalader as "transition counsel." The Bankruptcy Code does not provide for "transition counsel" and, even if it did, counsel would have to meet the mandatory disinterestedness requirement of Section 327(a). For these reasons, the Employment Order should be reversed.

A. Because the Court Properly Held that Cadwalader Did Not Meet the Mandatory Disinterestedness Standard of 11 U.S.C. Section 327(a), the Court Erred By Entering the Employment Order.

Under Section 327(a) of the Bankruptcy Code, a chapter 11 debtor may employ "one or more attorneys . . . , **that do not hold or represent an interest adverse to the estate, and that are disinterested persons**[.]" 11 U.S.C. Section 327(a) (emphasis added). Disinterestedness is defined in 11 U.S.C. Section 101(14) as a person that "does not have an interest materially adverse to the interest of the estate or any class of creditors or equity security holders, by reason of any direct or indirect relationship to, connection with, or interest in, the debtor, or for any other reason." 11 U.S.C. Section 101(14). The 'materially adverse' standard of Section 101(14) incorporated in the disinterestedness test and the 'interest adverse to the estate' language in section 327(a) overlap . . . and form a single test to judge conflicts of interest." *In re Granite Partners,* 219 B.R. at 33 (citations omitted).

Section 327(a) "serves the important policy of ensuring that the professionals' service presents no conflict of interest." *In re Vouzianas,* 259 F.3d 103, 107 (2d Cir. 2001). *See also Kravit, Gass & Weber, S.C. v. Michel (In re Crivello)*, 134 F.3d 831, 836 (7th Cir.1998) (Section 327(a) ensures that "professionals . . . tender undivided loyalty and provide untainted advice and assistance in furtherance of their fiduciary responsibilities) (quoting *Rome v. Braunstein*, 19 F.3d

54, 58 (1st Cir.1994)). .

The disinterestedness provision of Section 327(a) is mandatory and applies at the time of retention and throughout the case. *In re Granite Partners*, 219 B.R. at 32-33. The disinterestedness requirement of Section 327(a) is much stricter than the conflict of interest provisions in the New York Code of Professional Responsibility because Section 327(a) does not allow for the waiver of conflicts of interest. *Id.* at 34.

A professional is not disinterested where the professional had "either a meaningful incentive to act contrary to the interests of the estates . . . , **or the reasonable perception of one**." *Id.* at 36 (emphasis added). *See also In re Leslie Fay Companies, Inc.*, 175 B.R. at 534 (debtor's counsel investigating a client "had a perceptible economic incentive not to pursue the possibility of claims . . . with the same vigor and intensity it might have otherwise applied"). *See also Rome v. Braunstein*, 19 F.3d at 59 (court must determine whether competing interest of a court-appointed professional "created either a meaningful incentive to act contrary to the best interests of the estate and its sundry creditors-an incentive sufficient to place those parties at more than acceptable risk-or the reasonable perception of one"); *accord Electro-Wire Products, Inc. v. Sirote & Permutt, P.C. (In re Prince)*, 40 F.3d 356, 360-361 (11th Cir. 1994) and *In re Crivello*, 134 F.3d at 835. "To be disinterested is 'to prevent even the appearance of a conflict irrespective of the integrity of the person or firm under consideration.'" *In re Vebeliunas*, 231 B.R. 181, 191 (Bankr. S.D.N.Y. 1999) (quoting *In re Codesco*, 18 B.R. 997, 999 (Bankr. S.D.N.Y. 1982)). Therefore,

> because section 327(a) is designed to limit even appearances of impropriety to the extent reasonably practicable, doubt as to whether a particular set of facts gives rise to a disqualifying conflict of interest normally should be resolved in favor of disqualification.

In re Angelika Films 57th, Inc., 227 B.R. 29, 39 (Bankr. S.D.N.Y. 1998) (citing *In re Rancourt*, 207 B.R. 338, 359 (Bankr. D. N. H. 1997), *aff'd*, 246 B.R. 176 (S.D.N.Y. 2000).

Counsel who cannot sue or investigate clients who are parties in a bankruptcy case have adverse interests and are, therefore, not disinterested. *See In re Granite Partners*, 219 B.R. at 40 ("the preconceived refusal to sue a potential defendant at the beginning of an investigation constitutes a disqualifying adverse interest"). *See also In re Leslie Fay*, 175 B.R. at 535 (refusal to sue debtor's accountants and auditors who were also clients rendered counsel not disinterested); *In re Amdura Corp.*, 121 B.R. 862, 871 (Bankr. D. Colo. 1990) (debtor's counsel was not disinterested because counsel would not sue a bank that was a client and a creditor of the debtor); and *In re Envirodyne Indust. Inc.*, 150 B.R. 1008, 1014 n.7 (Bankr. N. D. Ill. 1993) (counsel could not be retained under Section 327(a) because of refusal to investigate or represent debtors in a leveraged buy out).

Here, Cadwalader admitted that it would not sue clients who were significant parties-in-interest in the Debtors' case. [RA, Exhibit 16, at 167, lines 14-23.] For example, Cadwalader represented Wal-Mart, the party on which the Debtors' business depended. [RA, Exhibit 21, at 283, ¶ 49; Exhibit 19, at 225, ¶ 7.] Cadwalader left the negotiations over new contract terms with Wal-Mart to the Debtors' managers rather than sit across the table from its client. [RA, Exhibit 16, at 168, lines 7-15.] Cadwalader represented Wells Fargo, the pre-petition secured lender and DIP lender and would not investigate the validity of the liens because of the connections. [RA, Exhibit 16, at 163, lines 12-25; & 164, lines 1-8; Exhibit 19, at 225, ¶ 6; & Exhibit 20, at 250-251, ¶15; & 255.] Bond holder Goldman Sachs was also one of Cadwalader's significant clients. [RA, Exhibit 16, at 161, lines 11-25; Exhibit 19, at 225, ¶ 5; &

Exhibit 20, at 250-251, ¶ 15; & 255.] Based on these facts, Cadwalader had adverse interests which made Cadwalader not disinterested and, therefore, ineligible for retention under Section 327(a) of the Bankruptcy Code.

The Bankruptcy Court itself held that Cadwalader was not disinterested:

> We are not aware of any case in which a law firm has satisfied the standards set forth in Section 327(a), which is that, quote, "Attorneys . . . . do not hold or represent an interest adverse to the estate, and . . . are disinterested persons," under circumstances similar to those presented here by Cadawalader.
>
> Those circumstances are that Cadwalader has material client relationships with almost all the principal constituents in this chapter 11 case
>
> I cannot imagine any Court authorizing the retention of a law firm for the debtor with so many client relationships, and important client relationships which, without question, do constitute, quote, "an interest adverse to the estate," and render Cadwalader not a, quote, "disinterested person."

[RA, Exhibit 15, at 128, lines 2-10; & 129, lines 3-7.]

Moreover, the Bankruptcy Court held that Cadwalader’s adverse interests were prejudicial to the Debtors in the Wal-Mart negotiations:

> In the Wal-Mart situation, Wal-Mart, I am told, Wal-Mart, either directly or with the assistance of counsel, is negotiating directly with the president of Portrait Corporation of America, apparently without counsel. Extremely prejudicial. And we're told that in order to document any agreement that may result, conflicts counsel would be retained. Well, it would certainly be unusual, and that is really a big understatement.
>
> If the crucial negotiations with an adverse third party and again, bear in mind that adverse does not mean that the parties are engaged in legal warfare, it means that they are on the opposite side of a bargaining table, that they have interests which are different from each other, and that certainly is the case with Wal-Mart. In effect, this debtor has no outside counsel or independent counsel to advise it.

[RA, Exhibit 15, at 129, line 25 and 130, lines 1-13.]

The Section 327(a) disinterestedness requirement is mandatory. *In re Granite Partners,* 219 B.R. at 32-33. The Bankruptcy Court recognized this and held that Cadwalader was not disinterested because it held many adverse interests. [RA, Exhibit 15, at 128-129 & 130, lines 1-13.] Thus, it was error for the Bankruptcy Court to enter the Employment Order under 11 U.S.C. Section 327(a).

B. Cadwalader Was Not Eligible for Employment Because It Was Not Disinterested and the Bankruptcy Court Erred When It Held that the Facts and Circumstances of the Case Warranted Approving Cadwalader's Employment.

The Bankruptcy Court held that the facts and circumstances of the case warranted approving the Employment Order despite the fact that Cadwalader was not disinterested. The Bankruptcy Court, in essence, created an exception to the disinterestedness requirement of 11 U.S.C. Section 327(a). Thus, based on the Bankruptcy Court's ruling, in situations where no party opposes the retention, a plan is negotiated pre-petition, there are no present controversies between creditors and the debtors, a plan will be presented early in the case, and the professional provides valuable services, the disinterestedness requirement of Section 327(a) will not apply.

On the contrary, these facts and circumstances did not warrant approving Cadwalader's retention for three reasons. First, the Bankruptcy Court has an independent duty to review employment applications whether creditors object or not. *In re Drexel Burnham Lambert Group, Inc.*, 112 B.R. 584, 586 (Bankr. S.D.N.Y. 1990); *In re Interwest Business Equipment, Inc.*, 23 F.3d 311, 317 (10th Cir. 1994) Thus, the lack of creditor objection was irrelevant to the Bankruptcy Court's review.

Second, the Bankruptcy Court may only consider the facts and circumstances after it has determined that the professional is disinterested under Section 327(a). *See In re Harold & Williams Development Co.*, 977 F.2d at 910 (the Bankruptcy Court's discretion with regard to employment applications is circumscribed by the disinterestedness requirement of Section 327(a), which is a “congressionally established” per se rule). These facts and circumstances include “the protection of the interests of the bankruptcy estate and its creditors, and the efficient, expeditious, and economical resolution of the bankruptcy proceeding.” *In re Vouzianas*, 259 F.3d at 107 (quoting *In re AroChem*, 176 F.3d at 621)).

Thus, the Bankruptcy Court may disapprove an application not only for lack of disinterestedness but also for other reasons that serve the best interests of the bankruptcy estate and creditors. *In re Vebeliunas*, 231 B.R. at 194-95. The Bankruptcy Court may disapprove the application of a disinterested professional if the facts and circumstances warrant. *In re Vouzianas*, 259 F.2d at 108. No authority exists, however, under which a court may approve the retention of an estate professional who is not disinterested under Section 327(a), even if under the facts and circumstances, that retention might benefit the estate by mitigating delay and cost. That arrangement – and the Bankruptcy Court’s ruling in this case – created an unauthorized exception to the disinterestedness requirement of Section 327(a).

Third, a law firm that is not disinterested proceeds in its representation of a debtor at its own risk, as noncompliance with Section 327(a) can lead to forfeiture of fees. *In re Mercury*, 280 B.R. at 56-57 (citing *In re Intech Capital Corp.*, 87 B.R. 232, 234 (Bankr. D. Conn. 1988)). See also In re Angelika Films, 246 B.R.176, 179 (S.D.N.Y. 2000) (provision of valuable services does not mitigate the failure to comply with Section 327(a)). The fact that Cadwalader may have provided valuable services to the estate did not excuse Cadwalader’s lack of disinterestedness. Thus, the facts and circumstances of this case did not warrant the retention of Cadwalader. The Bankruptcy Court misapplied the law and created an unwarranted exception to the mandatory disinterestedness requirement of 11 U.S.C. Section 327(a).

C. The Bankruptcy Court Improperly Approved Cadwalader as "Transition Counsel."

No provision of the Bankruptcy Code authorizes the retention of transition counsel. The term "transition counsel" was coined by Cadwalader as a way to obtain approval of the retention after its withdrawal from representation of the Debtors on October 26, 2006 until such time as Section 327(a) counsel was retained by the Debtors. [RA, Exhibit 14, at 111, lines 18-25; & 112, lines 1-9.] Even if "transition counsel" were appropriate under the Bankruptcy Code, any transition counsel retained under Section 327(a) would have to meet the disinterestedness requirement. As discussed above at Sections A and B, Cadwalader did not.

Retention of Cadwalader as "transition counsel" is likewise inappropriate under 11 U.S.C. Section 327(e), which provides:

> The trustee, with the court's approval, may employ, for a specified special purpose, other than to represent the trustee in conducting the case, an attorney that has represented the debtor, if in the best interest of the estate, and if such attorney does not represent or hold any interest adverse to the debtor or to the estate with respect to the matter on which the attorney is to be employed.

11 U.S.C. Section 327(e). The "threshold requirement" of Section 327(e) is that the attorney be employed for a "special purpose," not to represent the trustee in "conducting the case," which, in a chapter 11 case includes "assisting in the formulation of a plan and assisting the trustee in carrying out the required investigations." *In re Neuman,* 138 B.R. 683, 685 (S.D.N.Y. 1992). *See also In re Tidewater Memorial Hospital, Inc.*, 110 B.R. 221, 228 (Bankr. E. D. Va. 1989) ("the 'special purpose' to be served by counsel appointed under § 327(e) must not be related to the debtor's reorganization since this is tantamount to representing the debtor in the conduct of the case") (citations omitted). Special counsel must "not hold an adverse interest 'with respect to the matter on which such attorney is to be employed,'" which is a less stringent standard that

the one set forth in Section 327(a). *In re AroChem Corp*., 181 B.R. 693, 699 (Bankr. D. Conn. 1995), *aff'd*, 176 F.3d 610 (2d Cir. 1999). However, counsel who cannot meet the disinterestedness standard of Section 327(a) cannot "bypass this requirement through employment as special counsel." *In re Neuman*, 138 B.R. at 686 (quoting *Tidewater Memorial Hospital*, 110 B.R. at 228).

In this case, the Debtors employed Cadwalader to conduct the bankruptcy case, not to handle special, non-bankruptcy matters. [RA, Exhibit 20, at 240, ¶ 25.] In addition, resort to Section 327(e) would not cure Cadwalader's lack of disinterestedness. Therefore, on the foregoing two grounds, the Court improperly ordered retention of Cadwalader as transition counsel.

VIII. CONCLUSION

Based on the foregoing, the United States Trustee respectfully request that the Court reverse the Employment Order.

Dated: New York, NY
February 20, 2007

Respectfully submitted,

DIANA G. ADAMS
ACTING UNITED STATES TRUSTEE

By: */s/ Alicia M. Leonhard*
Alicia M. Leonhard
Trial Attorney

Office of the United States Trustee
33 Whitehall Street, 21st Floor
New York, NY 10004
(212) 510.0508

UNITED STATES DISTRICT COURT FOR THE
SOUTHERN DISTRICT OF NEW YORK

DIANA G. ADAMS, ACTING UNITED STATES TRUSTEE, Appellant, v. PORTRAIT CORPORATION OF AMERICA, *et al.*, Appellees.	:	Civil No. 07-0245 (SCR)

AFFIRMATION OF SERVICE

I, Alicia M. Leonhard, declare under penalty of perjury that:

1. I am a trial attorney with the Office of the United States Trustee for Region 2.

2. On February 20, 2007, I caused true and correct copies of the Brief of Appellant United States Trustee and the Record on Appeal in the above-entitled bankruptcy appeal to be served by Federal Express upon each of the parties to the appeal listed below.

Dated: New York, NY
February 20, 2007

/s/ Alicia M. Leonhard
Alicia M. Leonhard

Jeffrey R. Gleit, Esq.,
Kasowitz, Benson Torres & Friedman, LLP
1633 Broadway
New York, NY 10019

Angela J. Somers, Esq.
Cadwalader, Wickersham & Taft
One World Financial Center
New York, NY 10281

Kristopher M. Hansen, Esq.
Stroock & Stroock & Lavan LLP
180 Maiden Lane
New York, NY 10038

BRIEF BANK — “SUMMARY SHEET”

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WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*
In re Jimmy Dean Pearson, et al. (Pearson, et al. v. Stewart, et al.)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*
10th Cir.

3. ("CCN") ***CURRENT*** CASE NO.
No.: 08-8060

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*
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Court: BAP 10th Cir.
(Identify judge & cite, if any)

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8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***
• Whether the Appellate Panel erred in ruling debtors can claim a vehicle ownership deduction under section § 707(b)(2)(A)(ii)(I) when they have no associated ownership expenses.

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IN THE UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

In re JIMMY DEAN PEARSON AND JEANETTE LUCILLE PEARSON,
Debtors.

MARK R. STEWART,
Chapter 13 Trustee/Appellant,
v.

JIMMY DEAN PEARSON AND JEANETTE LUCILLE PEARSON,
Debtors/Appellees.

ON APPEAL FROM THE UNITED STATES BANKRUPTCY
APPELLATE PANEL OF THE TENTH CIRCUIT

BRIEF FOR THE UNITED STATES AS *AMICUS CURIAE* SUPPORTING REVERSAL

RAMONA D. ELLIOTT, General Counsel
P. MATTHEW SUTKO, Associate General Counsel
Department of Justice
Executive Office for United States Trustees
20 Massachusetts Ave., N.W.
Washington, D.C. 20530
Telephone: (202) 307-1399
Facsimile: (202) 307-2397
E-mail: p.matthew.sutko@usdoj.gov

ROBERT J. SCHNEIDER, Trial Attorney
Department of Justice
Office of the United States Trustee
One Newark Center, Ste 2100
Newark, NJ 07102
Telephone: (973) 645-3014
Facsimile: (973) 645-5993
E-mail: robert.j.schneider@usdoj.gov

COUNSEL FOR THE UNITED STATES

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The United States submits this brief under Fed. R. App. P. 29 as *amicus curiae* supporting reversal as sought by Appellant Mark R. Stewart, the chapter 13 trustee.

INTEREST OF THE UNITED STATES

This appeal calls upon this Court to interpret 11 U.S.C. 1325(b)(3), a statutory provision affecting chapter 13 bankruptcy cases. Section 1325(b)(3) makes two chapter 7 provisions – 11 U.S.C. 707(b)(2)(A) and (B) – applicable to chapter 13 cases.

The United States has a direct interest in the proper construction of these provisions because United States Trustees, who are Justice Department officials appointed by the Attorney General, supervise the administration of chapter 7 and chapter 13 bankruptcy cases in all federal judicial districts within this circuit. 28 U.S.C. 581-589a. *See also* H.R. Rep. No. 95-595, at 88 (1977) (United States Trustees "serve as bankruptcy watch-dogs to prevent fraud, dishonesty, and overreaching in the bankruptcy arena").

This appeal affects the United States' interests for two distinct reasons:

First, by applying section 1325(b)(3), this Court will determine how much above-median-income chapter 13 debtors must repay their creditors in their repayment plans. The United States has an interest in that question because United

States Trustees “supervise the administration of [chapter 13] cases and trustees,” monitor chapter 13 plans, and file comments with the court regarding such plans in connection with plan confirmation hearings under section 1324. *See* 28 U.S.C. 586(a)(3)(C).

Second, because section 1325(b)(3) incorporates portions of the chapter 7 means test, this appeal will also determine what expenses above-median-income chapter 7 debtors can claim on the means test. The means test determines whether an above-median-income debtor’s chapter 7 case should be dismissed as abusive. *See* 11 U.S.C. 707(b)(1) and (2). United States Trustees play a unique role in chapter 7 means test cases because section 704(b) requires them to review all such cases and, whenever a case is deemed presumptively abusive under the statute, either seek its dismissal or file a statement declining to seek dismissal.[1] *See Schultz v. United States,* 529 F.3d 343, 348 (6th Cir. 2008) (describing United States Trustee’s duties to enforce chapter 7 means test).

Given these interests, the United States submits this brief to share its views on the application of sections 1325(b)(3) and 707(b)(2)(A). *See* 28 U.S.C. 517 (authorizing the Department of Justice “to attend to the interests of the United

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[1] In fiscal year 2007, United States Trustees filed 3,370 motions to dismiss under section 707(b)(2) and 1,441 statements declining to seek dismissal when a presumption of abuse existed.

States in a suit pending in a court of the United States"). *See also* 11 U.S.C. 307 ("The United States trustee may raise and may appear and be heard on any issue in any case or proceeding.").

STATEMENT OF THE ISSUE

The Bankruptcy Code allows debtors to claim a vehicle ownership expense, in a set amount, when "applicable." 11 U.S.C. 707(b)(2)(A)(ii)(I). The expense amount is a standardized dollar value debtors may claim to account for vehicle loan or lease payments. The debtors in this case claimed such a set amount for two vehicles, even though they have no loan or lease payments for one of the vehicles.

The question presented is: Did the bankruptcy appellate panel err in ruling that the debtors could claim the standard ownership expense amount on the vehicle for which they had no associated ownership expense?

STATUTORY BACKGROUND

This appeal involves the interpretation of provisions added to the Bankruptcy Code by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005.[2] The 2005 Act significantly altered how debtors obtain chapter 13 bankruptcy relief.

In a chapter 13 case, a chapter 13 trustee may insist the debtor devote all of his "projected disposable income" to repay unsecured creditors over a period of up to five years. *See* 11 U.S.C. 1325(b)(1). For above-median-income chapter 13 debtors like the debtors in this appeal, "disposable income" is determined by deducting certain permitted expenses from the debtors' current monthly income. *See* 11 U.S.C. 1325(b)(2) ("disposable income" means current monthly income less amounts reasonably necessary to be expended); 11 U.S.C. 101(10A) (definition of "current monthly income").

Above-median-income chapter 13 debtors determine their permitted expenses by employing the formula found in 11 U.S.C. 707(b)(2)(A) and (B). *See* 11 U.S.C. 1325(b)(3) (incorporating those provisions). Permitted expenses include certain "applicable" expense amounts and certain prescribed "actual" expenses

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[2] Pub. L. No. 109-8, 119 Stat. 23 (2005). The 2005 Act applies to the debtors' bankruptcy case as it was filed after the Act's October 17, 2005, general effective date.

under section 707(b)(2)(A)(ii)(I). Permitted expenses also include certain additional expenses identified in other subsections of section 707(b)(2)(A).

The "applicable" expense amounts referred to in section 707(b)(2)(A)(ii)(I) are not the debtor's actual expenses; instead, they are static amounts listed in the Internal Revenue Service's Local and National Standards, which may be greater or less than the debtor's actual monthly expenditure for a category for which the IRS has adopted a standard.[3] *Id*.

The IRS Local Standards include two separate "transportation" amounts: (1) an operating expense amount and (2) an ownership expense amount. Operating expenses include vehicle maintenance, fuel, state and local registration, required inspection, parking fees, tolls, and driver's license fees. *See IRS Internal Revenue Manual*, § 5.15.1.9, *available at* http://www.irs.gov/irm/part5/ch15s01.html.

Independent of operating expenses, debtors can claim, when "applicable," a standardized ownership expense amount to reflect monthly lease or purchase payments for up to two vehicles. *Id.* The ownership expense amounts adopted in

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[3] The IRS Collection Financial Standards are used by the IRS in assessing a taxpayer's ability to pay past-due taxes. Because the debtors filed their case on October 16, 2006, the Collection Financial Standards in effect as of that date are applicable. *See* 11 U.S.C. 707(b)(2)(A)(ii)(I). The IRS Local Transportation Expense Standards for the West Census Region for cases filed between October 1, 2006, and January 31, 2007, are included in the Appendix filed by the Appellant chapter 13 trustee ("Aplt. App.") at 65.

the IRS Standards are based on the average cost of financing a vehicle as determined annually by the Federal Reserve Board.[4] *Id.*

This appeal poses the question whether a standardized vehicle ownership expense amount deduction is "applicable" under section 707(b)(2)(A)(ii)(I) when the debtors have no associated vehicle ownership expense. As the debtors in this appeal have no loan or lease payments on one of their vehicles, this Court must determine whether they may nonetheless claim the IRS Local Standard ownership expense amount for that vehicle and thereby reduce their plan payments by $322 for each month of their 60-month repayment plan.

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[4] For the debtors' geographic region, the standard *operating* expense amount for two vehicles is $420. The standard *ownership* expense amount is $471 for the first vehicle and $332 for the second vehicle. For vehicles six or more years old or with 75,000 miles, an additional $200 per month may be added to the operating expense amount for up to two older vehicles. *See IRS Internal Revenue Manual*, § 5.8.5.6.3, *available at* http://www.irs.gov/irm/part5/ch08s05.html.

STATEMENT OF FACTS

On October 10, 2006, Jimmy Dean Pearson and Jeanette Lucille Pearson ("Debtors") filed a voluntary petition under chapter 7 of the Bankruptcy Code, 11 U.S.C. 701, *et seq*. Aplt. App. at 1 (Docket Sheet for Bankruptcy Case No. 06-20528). On December 26, 2006, the Debtors' case was voluntarily converted to chapter 13. *Id*. at 12.

The Debtors own two cars, a Buick and an Oldsmobile. *Id*. at 28, 29. They own the Buick free of liens and still owe a small amount on the Oldsmobile, which is inoperable. *Id*. at 28, 29.

The Debtors filed an initial chapter 13 means test form calculating monthly disposable income of $252.[5] *Id.* at 14-20. The Debtors claimed a $461 monthly vehicle ownership expense deduction on the Buick[6] and a $328 ownership expense deduction on the Oldsmobile.[7] *Id.* at 16.

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[5] The chapter 13 means test form, Fed. R. Bankr. P. Official Form 22C, facilitates the computation of a chapter 13 debtor's income and expenses under the 2005 Act. The means test form was approved by the Judicial Conference of the United States, and the Federal Rules of Bankruptcy Procedure require all chapter 13 debtors to file the form. *See* Fed. R. Bankr. P. 1007(b)(6).

[6] The Debtors claimed the $471 standard expense amount for a first vehicle minus a $10 average monthly loan payment.

[7] The Debtors claimed the $332 standard expense amount for a second vehicle minus a $4 average monthly loan payment.

The Debtors next sought approval of a chapter 13 repayment plan proposing to pay unsecured creditors a total of $15,120 over five years. Docket No. 19 at 3. The trustee objected to confirmation of the plan, arguing among other things that the Debtors could not reduce their disposable income by claiming an ownership expense amount for vehicles on which they were making no associated ownership expense payments. Docket No. 36 at 3.

In an order dated April 11, 2007, the bankruptcy court directed the Debtors to file an amended means test form claiming the vehicle ownership expense for only one vehicle. Aplt. App. at 30-33. The Debtors responded by filing an amended means test form claiming ownership interest expense amounts of $463[8] on the Buick and $320[9] on the Oldsmobile. Docket No. 59. The Debtors also filed an amended plan proposing, in addition to the payments included in their initial plan, payment of the Oldsmobile's outstanding $1,500 loan. Docket No. 56. Under this amended plan, the Debtors proposed to pay unsecured creditors only $12,060. *Id*.

The trustee objected to the amended plan, and on June 19, 2007, the

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[8] The Debtors claimed the $471 standard expense amount for a first vehicle minus an $8 average monthly loan payment.

[9] The Debtors claimed the $332 standard expense amount for a second vehicle minus a $12 average monthly loan payment.

bankruptcy court denied confirmation. Aplt. App. at 41. The court allowed the Debtors to claim the ownership expense amount for the Oldsmobile (which had indebtedness) but not for the Buick (which did not). *Id*. The court directed the Debtors to file an amended plan and means test form that calculated monthly disposable income after claiming the ownership expense amount for the Oldsmobile, but not the Buick. *Id*.

The Debtors responded by filing an amended means test form showing monthly disposable income of $342, up from $252 on their initial chapter 13 means test form. *Id*. at 34-40. On the amended means test form the Debtors claimed an ownership expense amount of $459[10] for the Oldsmobile; as for the Buick, they did not claim an ownership expense amount, but they did take an additional $200 "older vehicle" allowance as an operating expense. *Id*. at 36. The Debtors also filed a second amended plan proposing to pay unsecured creditors $19,200, up from $12,060 on their prior amended plan. Docket No. 67.

The trustee objected to this plan on the grounds that it was not feasible given the amount it proposed to pay unsecured creditors. Docket No. 72. As a result, the Debtors filed a third amended plan in which total payments to unsecured creditors

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[10] The Debtors claimed the $471 standard expense amount for a first vehicle minus a $12 average monthly loan payment.

over the life of the plan were reduced to $18,497. Aplt. App. at 42-45. On August 28, 2007, the bankruptcy court entered an order confirming the third amended plan. *Id*. at 46.

The Debtors then filed an appeal to the United States Bankruptcy Appellate Panel of the Tenth Circuit of the order confirming their third amended plan and, through it, the previous denial of confirmation of their earlier plans. *Id*. at 47. The Debtors argued that they should not have had to file an amended means test form and plan, as they should have been allowed to claim the ownership expense amount for both the Oldsmobile and the fully-paid-off Buick. *Id*. at 52.

The appellate panel acknowledged the reported decisions on both sides of the issue, and ultimately agreed with the Debtors and the courts which "conclude that the word 'applicable' refers to the amount listed in the tables of Local Standards."[11] *Id*. at 57. The appellate panel found that the chapter 13 trustee's interpretation of section 707(b)(2)(A)(ii)(I), which requires debtors to have associated vehicle ownership expenses before they can claim a vehicle ownership expense amount, would mean "'applicable expenses' are in reality only 'actual expenses.'" *Id*. at 58. As Congress used the distinct terms "actual expenses" and "applicable expense amounts," the appellate panel determined that the IRS

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[11] The panel's decision is reported at 390 B.R. 706.

Standards are "applicable" regardless of whether a debtor actually has associated vehicle ownership expenses. *Id.* As a result, the appellate panel reversed the bankruptcy court's order confirming the Debtors' third amended plan, and held that the Debtors can claim the vehicle ownership expense amount for the fully-paid-off Buick. *Id*. at 59.

On August 19, 2008, the chapter 13 trustee filed a timely notice of appeal to this Court.

SUMMARY OF ARGUMENT

The Debtors seek to shield over $6,000 from their unsecured creditors by claiming a standardized vehicle ownership expense amount under section 707(b)(2)(A)(ii)(I) for a vehicle on which they have no ownership expense.[12] The bankruptcy appellate panel allowed the Debtors to claim this expense amount.

Its ruling conflicts with the overwhelming weight of bankruptcy appellate panel and district court rulings, and it is wrong for at least five reasons.

1. The Debtors cannot claim this standardized ownership expense amount because section 707(b)(2)(A)(ii)(I) allows it only when "applicable." The standardized vehicle ownership amount deduction is not applicable to the Debtors'

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[12] Section 1325(b)(3) incorporates section 707(b)(2)(A)(ii)(I) into the Debtors' chapter 13 bankruptcy case.

Buick because they have no associated ownership expense for that vehicle.

2. Giving the word “applicable” its ordinary definition in section 707(b)(2)(A)(ii)(I) allows debtors who have a particular monthly expense to claim the corresponding standard expense amount yet prevents debtors who lack a particular monthly expense from claiming phantom expense amounts. This construction also gives meaning to every word in the section, unlike the appellate panel’s construction.

3. The 2005 Act’s legislative history supports allowing debtors to claim expense amounts under section 707(b)(2)(A)(ii)(I) only when they incur associated expenses. The Act’s House Report reveals Congress enacted the new law to ensure debtors would repay their debts when able, and to eliminate loopholes and incentives for debtor abuse in discharging debts when a portion could be repaid. Allowing the Debtors to claim a fictional expense amount diverges from the purpose of the 2005 Act.

4. Reading the word “applicable” in section 707(b)(2)(A)(ii)(I) to require a loan or lease payment also fosters sound public policy. Barring above-median-income debtors from claiming inapplicable ownership expense amounts is fair because it simply prevents them from claiming a monthly expense for a cost they do not incur. This interpretation does not hurt lower-income debtors, because they are not subject to section 707(b)(2)(A)(ii)(I). *See* 11 U.S.C. 1325(b)(3). It is also fair to creditors because they will receive payments when debtors have the financial ability to repay.

5. Finally, the bankruptcy system has two safety valves to ensure higher-income debtors without loan or lease payments will not suffer by being denied phantom vehicle expenses. First, debtors with older vehicles receive an additional $200 monthly operating expense allowance per vehicle for up to two older vehicles. Second, debtors can modify their court-confirmed repayment plan under section 1329(a) if they need a new car during the course of repaying their creditors.

ARGUMENT

THE APPELLATE PANEL ERRED IN RULING DEBTORS CAN CLAIM A VEHICLE OWNERSHIP DEDUCTION UNDER SECTION 707(b)(2)(A)(ii)(I) WHEN THEY HAVE NO ASSOCIATED OWNERSHIP EXPENSES

The United States asks this Court to reverse the appellate panel's ruling that section 707(b)(2)(A)(ii)(I) allows debtors to reduce their disposable income available to repay creditors by claiming an inapplicable vehicle ownership expense. This case presents an issue of statutory interpretation reviewed *de novo*. *Rupp v. United Sec. Bank (In re Kunz)*, 489 F.3d 1072, 1077 (10th Cir. 2007).

I. A Vehicle Ownership Expense Amount is "Applicable" Under Section 707(b)(2)(A)(ii)(I) Only When a Debtor is Making a Corresponding Loan or Lease Payment

A. Vehicle ownership expense amounts are not "applicable" to a debtor who makes no loan or lease payment

Section 707(b)(2)(A)(ii)(I) allows a debtor to claim monthly expenses including "the debtor's *applicable* monthly expense amounts specified under the . . . Local Standards . . . issued by the Internal Revenue Service for the area in which the debtor resides." 11 U.S.C. 707(b)(2)(A)(ii)(I) (emphasis added). Since the IRS Local Standards include a standard vehicle ownership expense amount, debtors may claim such expense amount for their geographic region, provided it is "applicable."[13]

As "applicable" is not defined in the Bankruptcy Code, it should be given its ordinary meaning. *Smith v. United States*, 508 U.S. 223, 228 (1993) ("When a word is not defined by statute, we normally construe it in accord with its ordinary or natural meaning."); *Biodiversity Legal Found. v. Babbitt*, 146 F.3d 1249, 1254

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[13] In calculating disposable income debtors are entitled to claim the full amount specified under the IRS Local Standard provided they incur some vehicle ownership expense, i.e., provided the expense is "applicable." *See* 11 U.S.C. 707(b)(2)(A)(ii)(I) (applicable expense amount "shall be" the amount "specified" under the IRS Local Standard). *See also Fokkena v. Hartwick (In re Hartwick),* 373 B.R. 645, 650 (D. Minn. 2007) (any vehicle ownership expense will make debtor eligible for full IRS standard amount).

(10th Cir. 1998) ("Since Congress did not define or otherwise explain [statutory language] within the statute, we assume Congress intended the words to be given their ordinary meaning.").

This Court has held that the ordinary meaning of statutory language "may [be] discover[ed] through the use of dictionaries." *Biodiversity Legal Found. v. Babbitt*, 146 F.3d at 1254. The word "applicable" is defined as "capable of being applied: having relevance . . . fit, suitable, or right to be applied: APPROPRIATE." *Webster's Third New Int'l Dictionary* at 105 (1981) (emphasis in original).

The appellate panel's interpretation is inconsistent with the ordinary, common-sense definition of "applicable" because it allows debtors to claim a monthly vehicle ownership expense amount when they have no associated monthly loan or lease expenses. *See Neary v. Ross-Tousey (In re Ross-Tousey)*, 368 B.R. 762, 767 (E.D. Wis. 2007) (section 707(b)(2)(A)(ii)(I) does not make such "fixed allowances guaranteed to every car owner").

The point here is simple – debtors have no section 707(b)(2)(A)(ii)(I) vehicle ownership expense amounts "capable of being applied" to them if they do not make loan or lease payments. *Ransom v. MBNA Am. Bank, N.A. (In re Ransom)*, 380 B.R. 799, 807-08 (B.A.P. 9th Cir. 2007). The overwhelming majority of lower appellate decisions agree on this point, and reject the appellate panel's contrary interpretation. *See Tate v. Lentz*, 2008 WL 4489761 at *3 (S.D. Miss. Sept. 29, 2008); *Babin v. Powell (In re Powell)*, 392 B.R. 407, 408 (B.A.P. 8th Cir. 2008); *Babin v. Wilson (In re Wilson)*, 383 B.R. 729, 734 (B.A.P. 8th Cir. 2008); *In re Ransom*, 380 B.R. at 807-08, *appeal pending* No. 08-15066 (9th Cir.); *Grossman v. Sawdy (In re Sawdy)*, 384 B.R. 199, 204 (E.D. Wis. 2008); *Meade v. McVay (In re Meade)*, 384 B.R. 132, 136 (W.D. Tex. 2008); *Wieland v. Thomas (In re Thomas)*, 382 B.R. 793, 797 (D. Kan. 2008); *United States Trustee v. Deadmond (In re Deadmond)*, 2008 WL 191165 at *4 (D. Mont. Jan. 22, 2008)*;* *Fokkena v. Hartwick (In re Hartwick)*, 373 B.R. 645, 650 (D. Minn. 2007)*; In re Ross-Tousey*, 368 B.R. at 765, *appeal pending* No. 07-2503 (7th Cir.). *But see Hildebrand v. Kimbro (In re Kimbro)*, 389 B.R. 518, 523-25 (B.A.P. 6th Cir. 2008), *appeal pending* No. 08-5871 (6th Cir.) (divided court concluded "applicable" simply directs debtors to pick out and use the dollar amounts set forth in tables published as part of the IRS's Local Standards); *Brunner v. Armstrong (In re Armstrong)*, 2008 WL 4426144 at *4-5 (E.D. Wash. Sept. 24, 2008) (allowing debtor to claim ownership expense amount on vehicle owned free and clear of liens).

B. The appellate panel's interpretation of section 707(b)(2)(A)(ii)(I) suffers from three flaws the chapter 13 trustee's interpretation avoids: (a) confusing the distinction between "applicable" and "actual"; (b) rendering "applicable" superfluous; and (c) defining "applicable" inconsistently with its intended use in the immediately following subsection

The appellate panel concluded section 707(b)(2)(A)(ii)(I) entitles debtors to claim vehicle ownership expenses even when they have no associated loan or lease payment. Rather than read "applicable" as an eligibility requirement, the panel adopted the reasoning of reported decisions that held "applicable" simply directs debtors to pick out and use the dollar amounts set forth in tables published by the IRS, allowing all debtors to claim the ownership expense amount. *See Pearson v. Stewart (In re Pearson),* 390 B.R. 706, 714 (B.A.P. 10th Cir. 2008).

This interpretation suffers from three flaws:

First, it confuses the distinction between the words "actual" and "applicable" in section 707(b)(2)(A)(ii)(I). The panel held that requiring debtors to incur a monthly cost in an expense category before deducting the corresponding IRS standard expense amount would read "applicable" as meaning "actual." *In re Pearson*, 390 B.R. at 714. This led the panel to rule "applicable" cannot mean debtors must have an associated expense because that would give identical meaning to two different words in the same statute.

This conclusion places fails to recognize the words "applicable" and "actual" have different meanings in section 707(b)(2)(A)(ii)(I) because "expense amounts" – the words following "applicable" in the statute – do *not* refer to "actual" costs. *See In re Hartwick*, 373 B.R. at 650 ("actual" expense does not control the amount of the vehicle ownership expense deduction under section 707(b)(2)(A)(ii)(I)). To the contrary, the vehicle ownership "expense amounts" are static numbers drawn from the IRS Local and National Standards, not the debtor's actual vehicle ownership expenses.

Contrary to the appellate panel's assertion, the chapter 13 trustee's interpretation of section 707(b)(2)(A)(ii)(I) does not require the use of the debtor's "actual" monthly vehicle ownership costs – it simply requires the court to determine whether such vehicle ownership costs exist. *See In re Sawdy*, 384 B.R. at 214 (the standard vehicle ownership expense amount "is to be used if and only if the debtor actually has the monthly expense of an actual car payment"). Once it is determined that a debtor has a loan or lease payment,[14] the amount used in the

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[14] Section 707(b)(2) provides that monthly expenses may not include any "payments for debts." Although not raised by the appellate panel below, two members of a divided Sixth Circuit bankruptcy appellate panel found that this provision shows Congress intended to allow an ownership expense even when a debtor has no debt payment on a vehicle. *In re Kimbro*, 389 B.R. at 523. This reading misinterprets the term "payments for debts"; the standard expense amount allowed to debtors where applicable is *not* a "payment" for a "debt." The

means test form is the IRS standard vehicle ownership expense amount, not the debtor's actual monthly expenditures.

Thus, the chapter 13 trustee's interpretation does not read "applicable" as meaning "actual," but instead gives each word its proper meaning: debtors may claim actual expenses in some expense categories, and may claim standard expense amounts in other expense categories when applicable to their factual situation. *See In re Thomas*, 382 B.R. at 797 (use of the word "'applicable' . . . does not suggest an intent by Congress that the numbers should simply be plucked from the Standards for a debtor's expenses under the means test as if in a vacuum, without reference to the *context and meaning* of those numbers" (emphasis in original)); *In re Ross-Tousey*, 368 B.R. at 765 (United States Trustee's interpretation "gives meaning to the distinction between 'applicable' and 'actual' without taking a

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"payment for debts" language exists merely to ensure debtors do not double-deduct actual payments for debts, first under section 707(b)(2)(A)(ii)(I) and then again for certain categories in the IRS's "Other Necessary Expenses" – such as secured debt payments and repayment of delinquent tax debts – that are already allowed elsewhere under the means test. *See IRS Internal Revenue Manual*, § 5.15.1.10, *available at* http://www.irs.gov/irm/part5/ch15s01.html (listing categories of Other Necessary Expenses). *See also* 707(b)(2)(A)(iii) (permitting deduction for secured debts); 707(b)(2)(A)(iv) (permitting deduction for tax debts). The "payment for debts" language also ensures debtors do not deduct student loan payments under the means test, even though the IRS categorizes them as an "Other Necessary Expense." *See In re Knight*, 370 B.R. 429, 436-37 (Bankr. N.D. Ga. 2007) (plain language of section 707(b)(2)(A)(ii) "precludes deduction" of student loan payments as an expense).

further step to conclude that ‘applicable’ means ‘nonexistent’ or ‘fictional’”).

Indeed, the appellate panel’s interpretation would be wrong even if “applicable” and “actual” were read as meaning the same thing in section 707(b)(2)(A)(ii)(I), as there is nothing inherently wrong with two different words within a single section being synonyms. *Cf. Wachovia Bank v. Schmidt*, 546 U.S. 303, 314 (2006) (“Congress may well have comprehended the words ‘located’ and ‘established,’ as used in [28 U.S.C.] § 1348, not as contrasting, but as synonymous or alternative terms”). Therefore, even if this Court concludes that “applicable” must be read as synonymous with “actual” in section 707(b)(2)(A)(ii)(I), the Debtors are ineligible for a vehicle ownership expense amount on the Buick because they have no “actual” ownership expense associated with the Buick.

Second, the appellate panel’s reading of “applicable” renders the word superfluous. The panel’s interpretation is the same as if the statute simply read: “[t]he debtor’s monthly expenses shall be the debtor’s ~~applicable~~ monthly expense amounts [under the IRS standards].” *See In re Ransom*, 380 B.R. at 808 (concluding that the Debtors’ construction would “read[] ‘applicable’ right out of the Bankruptcy Code”). After all, striking out the word “applicable” would still lead debtors to the same line under the IRS Local Standards – if that is all Congress intended, there was no need to use the word “applicable.” Yet Congress inserted the word “applicable” before the words “monthly expense amounts,” so that word must be read as adding something to section 707(b)(2)(A)(ii)(I). *See In re Deadmond*, 2008 WL 191165 at *4 (“The word [applicable] must mean something, and if some monthly expenses are applicable, then other monthly expenses are not applicable.”); *In re Ross-Tousey*, 368 B.R. at 765 (“Had Congress intended to indiscriminately allow all expense amounts specified in the National and Local Standards, it would have written 707(b)(2)(A)(ii)(I) [without using the word ‘applicable.’]”).

As the appellate panel’s interpretation renders the word “applicable” superfluous, it should be rejected. *See, e.g., United States v. Nordic Village, Inc.*, 503 U.S. 30, 36 (1992) (referring to “the settled rule that a statute must, if possible, be construed in such fashion that every word has some operative effect”); *Toomer v. City Cab*, 443 F.3d 1191, 1194 (10th Cir. 2006) (“When construing a statute, we should give effect, if possible, to every clause and word.”). The proper interpretation is that adopted by the majority of lower appellate courts, which gives full meaning to “applicable” by requiring debtors to actually have monthly vehicle ownership costs before they can claim the standard vehicle ownership expense amount.

Third, and significantly, the chapter 13 trustee’s interpretation permits a reading of “applicable” in section 707(b)(2)(A)(ii)(I) that is consistent with the meaning of the same word in the immediately following subsection. This is consistent with “the normal rule of statutory construction that identical words used in different parts of the same act are intended to have the same meaning.” *Gustafson v. Alloyd Co.,* 513 U.S. 561, 570 (1995) (internal quotations and citations omitted).

Specifically, “applicable” in section 707(b)(2)(A)(ii)(I) means “capable of being applied” or “appropriate.” The immediately following subsection, 707(b)(2)(A)(ii)(II), uses “applicable” in precisely the same way – *i.e.*, debtors get expenses when they actually incur them. It provides, in relevant part, that “the debtor’s monthly expenses may include, *if applicable*, the continuation of *actual* expenses paid by the debtor . . . for care and support of an elderly, chronically ill, or disable household member or member of the debtor’s immediately family. . . .” 11 U.S.C. 707(b)(2)(A)(ii)(II) (emphasis added).

Subsections (I) and (II) use “applicable” for different purposes – in (I) to allow standardized expense amounts and in (II) to allow actual expenses. But in the latter, Congress clearly intended to allow expenses only if they apply to a particular debtor. Under accepted rules of statutory construction, the same meaning of “applicable” in 707(b)(2)(A)(ii)(II) should be given to the word in

707(b)(2)(A)(ii)(I).

II. Reading Section 707(b)(2)(A)(ii)(I) to Limit Vehicle Ownership Expense Amounts to Debtors with Associated Vehicle Ownership Expenses Fulfills Two Goals of the 2005 Act: Ensuring Above-Median-Income Debtors Repay Their Debts When They Can, and Eliminating Abuse

A. Congress passed the 2005 Act to maximize debtor repayment to creditors and eliminate opportunities for bankruptcy abuse

To the extent section 707(b)(2)(A)(ii)(I) is ambiguous regarding Congress's reference to "applicable monthly expense amounts specified under" the IRS Standards, this Court may look to the 2005 Act's legislative history to determine the statute's objectives and illuminate its text. *See, e.g., United States ex rel. Sikkenga v. Regence Bluecross Blueshield of Utah*, 472 F.3d 702, 710 (10th Cir. 2006) (resort to legislative history appropriate where "statute is capable of being understood by reasonably well-informed persons in two or more different senses"); *Exxon Corp. v. Lujan*, 970 F.2d 757, 761 (10th Cir. 1992) (if legislative history clearly reveals Congress's intent regarding ambiguous statutory language, courts are bound to apply the statute consistent with that intent).

The legislative history establishes that the 2005 Act's purpose was to "ensure that debtors repay creditors the maximum they can afford." H.R. Rep. No. 109-31(I), at 1 (2005), *reprinted in* 2005 U.S.C.C.A.N. 88, 89.[15] Indeed, this intent

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[15] There is no Senate Report or Conference Report to the 2005 Act.

was deemed so important that it was expressed in the very first paragraph of the House Report, and was reiterated where the means test was specifically addressed. *Id*. at 89, 97-100.

Given the obvious importance to Congress that "debtors repay creditors the maximum they can afford," the statute should be interpreted in accordance with the overarching goal underpinning the 2005 Act. *See In re Thomas*, 382 B.R. at 798 ("If a debtor were permitted a car ownership allowance when he actually incurs no such expense, application of the means test would not accurately reflect the debtor's ability to repay creditors, and the purpose of the statute would be frustrated."). The Debtors can pay over $6,000 more to their unsecured creditors than required by the appellate panel's interpretation. As a result, the panel's interpretation is flawed.

In addition, the 2005 Act sought to eliminate "loopholes and incentives [in the bankruptcy system] that allow and – sometimes – even encourage opportunistic personal filings and abuse." H.R. Rep. No. 109-31(I), at 5 (2005), *reprinted in* 2005 U.S.C.C.A.N. 88, 92. In amending the Bankruptcy Code to curtail abuse, Congress certainly did not intend to enact a "loophole" that allows debtors to shield money from creditors by claiming deductions to which they are not entitled. To effect Congress's intent to thwart abuse, the statute must be read to limit debtors to only those deductions for which they really have expenses.

Thus, ensuring that above-median-income debtors claim vehicle ownership expense amounts only when they have associated ownership expenses fulfills Congress's intent that such debtors repay their debts when able. *See, e.g.*, *In re Wilson*, 383 B.R. at 733 ("[T]he purpose [of the 2005 Act] was to require above-median income debtors to make more funds available to their unsecured creditors and to do so by limiting the court's authority to allow expenses[.]"); *In re Ransom*, 380 B.R. at 807 ("[W]hat is important is the payments that debtors actually make, not how many cars they own, because the payments that debtors make are what actually affect their ability to make payments to their creditors."); *In re Ross-Tousey*, 368 B.R. at 766 ("The statute is only concerned about protecting the debtor's ability to continue owning a car, and if the debtor already owns the car, the debtor is adequately protected.").

B. The appellate panel's interpretation of section 707(b)(2)(A)(ii)(I) would yield results that conflict with Congressional intent

The appellate panel's interpretation of section 707(b)(2)(A)(ii)(I) would frustrate the 2005 Act's goal of proper repayment by allowing above-median-income debtors to claim phantom expenses that do not apply to them. *See, e.g.*, *In re Wilson*, 383 B.R. at 734 ("It would turn the logic of [the 2005 Act] on its head to allow above-median debtor such a deduction"); *In re Ross-Tousey*, 368 B.R. at 766 (when a debtor "has no monthly ownership expenses, it makes no sense to deduct an ownership expense to shield it from creditors.").

Under the appellate panel's reading of section 707(b)(2)(A)(ii)(I), a higher-income debtor with an inoperable car "rusting away in his backyard" could claim the ownership expense amount simply because the car is an "automobile" that he "owns." *In re Ross-Tousey*, 368 B.R. at 768. This statutory reading has been rejected by lower appellate courts because it "defies common sense." *In re Deadmond*, 2008 WL 191165 at *4.

III. Barring Above-Median-Income Debtors From Claiming Phantom Vehicle Ownership Expenses Implements Sound Bankruptcy Policy

A. Reading section 707(b)(2)(A)(ii)(I) to limit vehicle ownership expenses to debtors with a loan or lease payment is fair to debtors and creditors

The chapter 13 trustee's reading of section 707(b)(2)(A)(ii)(I) as limiting vehicle ownership expenses to debtors with loan or lease payments is fair, as it establishes a threshold for claiming a standardized ownership expense amount that is consistent for all chapter 13 debtors. Significantly, section 1325(b)(2) independently requires below-median-income debtors to incur an expense to claim a deduction. *See* 11 U.S.C. 1325(b)(2) (allowing such debtors only "reasonably necessary" expenses). Reading "applicable" as requiring above-median-income debtors to have associated expenses means these debtors will not be able to claim phantom expenses unavailable to less well-off debtors.

Nor does the chapter 13 trustee's interpretation adversely affect below-median-income debtors – those most likely to file bankruptcy petitions – because such debtors are not subject to section 707(b)(2)(A)(ii)(I). *See* 11 U.S.C. 1325(b)(3). Below-median-income debtors represent approximately 73% of the individuals who seek chapter 13 protection.[16] Similarly, in chapter 7 bankruptcies, section 707(b)(2)(A)(ii)(I) only applies to the 10% of debtors with above-median incomes.[17] *See Schultz v. United States*, 529 F.3d 343, 347 (6th Cir. 2008) (under section 707(b)(7), presumption of abuse cannot arise with respect to below-median-income debtors).

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[16] There were 307,521 non-business chapter 13 cases filed in fiscal year 2007. *See* U.S. Courts, Bankruptcy Statistics, 2007 Fiscal Year by Chapter, *available at* http://www.uscourts.gov/bnkrpctystats/sept2007/f2table.xls. Of these, the United States estimates that 83,030 cases may have been filed by above-median-income debtors based on a 2006 survey across a sample of nine judicial districts that estimated 27% of chapter 13 cases were filed by above-median-income debtors. *See The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005: Evaluation of the Effects of Using IRS Expense Standards to Calculate a Debtor's Monthly Disposable Income*, RAND Institute for Civil Justice at x, 23, *available at* http://www.usdoj.gov/ust/eo/public_affairs/reports_studies.

[17] During fiscal year 2007, according to data collected by the U.S. Trustee Program, 451,012 non-business chapter 7 cases were filed nationwide, excluding the judicial districts in Alabama and North Carolina, whose data were not collected. Of these cases, only 10% had above-median incomes and were thereby subject to the means test and the requirements of section 707(b)(2)(A)(ii)(I).

This interpretation is also fair to creditors. Congress enacted the 2005 Act because under prior law "some bankruptcy debtors [were] able to repay a significant portion of their debts" yet were not required to do so. H.R. Rep. No. 109-31(I), at 5 (2005), *reprinted in* 2005 U.S.C.C.A.N. 88, 92. The chapter 13 trustee's interpretation of section 707(b)(2)(A)(ii)(I) ensures that above-median-income debtors will not avoid repaying their debts by claiming expense amounts for which they have no associated expense.

B. Other Bankruptcy Code provisions adequately protect above-median-income debtors who own vehicles, but lack ownership expenses

Under the chapter 13 trustee's interpretation of section 707(b)(2)(A)(ii)(I), at least two safety valves are available to prevent hardship to above-median-income debtors who own vehicles but have no vehicle ownership expenses.

First, every debtor who owns a vehicle, whether or not subject to a loan or lease payment, receives a separate vehicle *operating* expense under the IRS Local Standards. Operating expenses include vehicle insurance, maintenance, fuel, state and local registration, required inspection, parking fees, tolls, and driver's license fees.[18] And, debtors who own unencumbered vehicles six or more years old or

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[18] In a recent decision, a divided Sixth Circuit bankruptcy appellate panel incorrectly characterized many of these operating expenses as "ownership expenses" and failed to acknowledge that all debtors who own vehicles receive the

with 75,000 or more miles receive an additional $200 monthly operating expense deduction per vehicle for up to two older vehicles. *See IRS Internal Revenue Manual*, § 5.8.5.6.3, *available at* http://www.irs.gov/irm/part5/ch08s05.html. *See also In re Wilson*, 383 B.R. at 734 (recognizing $200 additional allowance).

Second, any debtor who needs a new vehicle during the course of his chapter 13 plan can move to modify his plan to reduce payments to creditors to account for the new expense. *See* 11 U.S.C. 1329(a); *In re Wilson*, 383 B.R. at 734 ("[I]n the event a debtor needs a new car during the course of a case, the debtor can move to modify the plan based on changed circumstances."). Plan modification is appropriate for such debtors because financing the vehicle usually indicates a substantial change in ability to pay not accounted for at plan confirmation. *Cf. Storey v. Pees (In re Storey)*, 392 B.R. 266, 272 (B.A.P. 6th Cir. 2008) (plan modification possible if debtor's circumstances change post-confirmation).

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operating expense allowance under the IRS Local Standards. *In re Kimbro*, 389 B.R. at 531.

CONCLUSION

For these reasons, the United States respectfully asks this Court to reverse the order of the Bankruptcy Appellate Panel for the Tenth Circuit and remand for further proceedings.

Respectfully submitted,

RAMONA D. ELLIOTT
General Counsel

P. MATTHEW SUTKO
Associate General Counsel

Department of Justice
Executive Office for United States Trustees
20 Massachusetts Avenue, N.W.
Washington, D.C. 20530
Telephone: (202) 307-1399
Facsimile: (202) 307-2397
E-mail: p.matthew.sutko@usdoj.gov

By /s/ Robert J. Schneider
ROBERT J. SCHNEIDER
Trial Attorney

Department of Justice
Office of the United States Trustee
One Newark Center, Suite 2100
Newark, NJ 07102
Telephone: (973) 645-3014
Facsimile: (973) 645-5993
E-mail: robert.j.schneider@usdoj.gov

CERTIFICATE OF COMPLIANCE WITH FED. R. APP. P. 32(a)

I hereby certify that the foregoing brief complies with the typeface requirements in Fed. R. App. P. 32(a)(5), the page and type-volume limitation in Fed. R. App. P. 32(a)(7), and Tenth Circuit Rule 32. I also certify that the foregoing brief is proportionally spaced, using Times Roman font, 14 point type. Based on a word count under Corel WordPerfect 12, this brief contains 6711 words excluding the table of contents, table of authorities, addenda, and certificates of counsel.

/s/ Robert J. Schneider
Robert J. Schneider
Attorney for the United States
as *Amicus Curiae*

CERTIFICATE OF SERVICE

I hereby certify that on October __, 2008, I served the Brief for the United States as *Amicus Curiae* Supporting Reversal on the following by sending one copy of the brief by first class mail, postage prepaid, to:

Mark R. Stewart, Esq.
Chapter 13 Standing Trustee
P.O. Box 865
Cheyenne, WY 82003
Appellant/Chapter 13 Trustee

Ken McCartney, Esq.
P.O. Box 1364
Cheyenne, WY 82003
Counsel for Debtors/Appellees

I also certify that on October ___, 2008, I filed the brief by sending an original and seven copies to the Clerk of the United States Court of Appeals for the Tenth Circuit, by Federal Express at the following address:

Office of the Clerk
United States Court of Appeals for the Tenth Circuit
Byron White U.S. Courthouse
1823 Stout Street
Denver, CO 80257

I also certify that on October __, 2008, an electronic copy of the brief in PDF format was attached to an e-mail sent to esubmission@ca10.uscourts.gov pursuant to the Tenth Circuit General Order filed August 10, 2007.

I also certify that all privacy redactions have been made to the extent necessary, and, with the exception of any such redactions, the electronic copy of the brief is an exact copy of the written brief filed with the Court.

I also certify that the electronic copy of the brief has been scanned for viruses using eTrust Antivirus, version 7.1.192, last updated October 14, 2008, and, according to the program, is free of viruses.

/s/ Robert J. Schneider
Robert J. Schneider
Attorney for the United States
as *Amicus Curiae*

BRIEF BANK — “SUMMARY SHEET” *Printed Wed-12/17/08 11:30*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	In re: Jimmy Dean Pearson and Jeanette Lucille Pearson (Stewart v. Pearson, et al.)
2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	10st Cir.
3. ("CCN") ***CURRENT*** CASE NO.	No.: 08-8060
4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*	No.: 07-097 Court: B.A.P. 10th Cir. *(Identify judge & cite, if any)*
5. ("SO") ***SOURCE***	**U.S. TRUSTEES**
6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	Filed: December 16, 2008 Type: Response of the United States, *Amicus Curiae* Supporting Reversal, to Appellee’s Status Report and Suggestion of Mootness
7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*	Robert Schneider and Matthew Sutko *(UST/OGC: 202-307-1399/FAX-2397)*
8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	• When a court dismisses an appeal as moot should it also vacate the lower court orders that are being appealed?
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COURT OF APPEALS DOCKET NO. 08-8060

IN THE UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

In re JIMMY DEAN PEARSON AND JEANETTE LUCILLE PEARSON,
Debtors.

MARK R. STEWART,
Chapter 13 Trustee/Appellant,
v.

JIMMY DEAN PEARSON AND JEANETTE LUCILLE PEARSON,
Debtors/Appellees.

ON APPEAL FROM THE UNITED STATES BANKRUPTCY
APPELLATE PANEL OF THE TENTH CIRCUIT

RESPONSE OF THE UNITED STATES, *AMICUS CURIAE* SUPPORTING REVERSAL, TO APPELLEE'S STATUS REPORT AND SUGGESTION OF MOOTNESS

RAMONA D. ELLIOTT, General Counsel
P. MATTHEW SUTKO, Associate General Counsel
Department of Justice
Executive Office for United States Trustees
20 Massachusetts Ave., N.W.
Washington, D.C. 20530
Telephone: (202) 307-1399
Facsimile: (202) 307-2397
E-mail: p.matthew.sutko@usdoj.gov

ROBERT J. SCHNEIDER, Trial Attorney
Department of Justice
Office of the United States Trustee
One Newark Center, Ste 2100
Newark, NJ 07102
Telephone: (973) 645-3014
Facsimile: (973) 645-5993
E-mail: robert.j.schneider@usdoj.gov

COUNSEL FOR THE UNITED STATES

The United States, as *amicus curiae* supporting reversal, files this brief pursuant to the order of this Court dated December 16, 2008, which established a time to file a response to the "Appellee's Status Report and Suggestion of Mootness" filed by Appellees Jimmy Dean Pearson and Jeanette Lucille Pearson, which this Court has construed as a motion to dismiss this appeal as moot.

The United States agrees that the appeal is now moot and should be dismissed. But the order dismissing the case should also vacate the order and opinion of the Bankruptcy Appellate Panel for the Tenth Circuit. *See Shawnee Tribe v. United States*, 405 F.3d 1121, 1135 (10th Cir.2005) ("'When causes beyond the appellant's control make a case moot pending appeal, a federal appellate court generally should vacate the judgment below and remand with a direction to dismiss.'" (quoting *McClendon v. City of Albuquerque*, 100 F.3d 863, 868 (10th Cir.1996)). Vacating the lower court's order "eliminates a judgment, review of which was prevented through happenstance" and prevents a moot judgment "from spawning any legal consequences." *See Marc Development v. F.D.I.C.*, 12 F.3d 948, 949 (1993).

Indeed, it is the "established practice" of the United States Supreme Court when a case becomes moot on appeal to vacate the judgment of lower courts. *See United States v. Munsingwear*, 340 U.S. 36, 39-40 (1950); *see also Radian Guar.*, *Inc. v. Whitfield*, 128 S. Ct. 2901 (2008) (relying upon *Munsingwear* in ruling "[j]udgment vacated, and case remanded to the United States Court of Appeals for the Third Circuit with instructions to dismiss the case as moot"); *Arave v. Hoffman*, 128 S. Ct. 749 (2008) (relying on *Munsingwear* in ruling "[b]ecause [responent's] claim for ineffective assistance of counsel during pretrial plea bargaining is moot, we vacate the judgment of the Court of Appeals to the extent that it addressed that claim"); *Selig v. Pediatric Specialty Care, Inc*., 127 S.Ct. 3000 (2007) (relying upon *Munsingwear* in ruling "[j]udgment vacated with respect to the individual capacity claims against Ray Hanley and Roy Jeffus, and case remanded to the United States Court of Appeals for the Eighth Circuit with instructions to dismiss the appeal as moot with respect to these claims").

This appeal is moot due to causes beyond the control of both the Appellant and the United States. As a result, the precedent established by the Tenth Circuit and the Supreme Court require the bankruptcy appellate panel's decision and order to be vacated.

WHEREFORE, the United States respectfully requests that this Court dismiss the appeal as moot and vacate the bankruptcy appellate panel's decision and order.

Respectfully submitted,

RAMONA D. ELLIOTT
General Counsel

P. MATTHEW SUTKO
Associate General Counsel

Department of Justice
Executive Office for United States Trustees
20 Massachusetts Avenue, N.W.
Washington, D.C. 20530
Telephone: (202) 307-1399
Facsimile: (202) 307-2397
E-mail: p.matthew.sutko@usdoj.gov

By /s/Robert J. Schneider
ROBERT J. SCHNEIDER
Trial Attorney

Department of Justice
Office of the United States Trustee
One Newark Center, Suite 2100
Newark, NJ 07102
Telephone: (973) 645-3014
Facsimile: (973) 645-5993
E-mail: robert.j.schneider@usdoj.gov

CERTIFICATE OF SERVICE

I hereby certify that on December 16, 2008, I served the Response of the United States, *Amicus Curiae* Supporting Reversal, to Appellee's Status Report and Suggestion of Mootness on the following by sending one copy by first class mail, postage prepaid, to:

Mark R. Stewart, Esq.
Chapter 13 Standing Trustee
P.O. Box 865
Cheyenne, WY 82003
Appellant/Chapter 13 Trustee

Ken McCartney, Esq.
P.O. Box 1364
Cheyenne, WY 82003
Counsel for Debtors/Appellees

I also certify that on December 16, 2008, I filed the Response of the United States, *Amicus Curiae* Supporting Reversal, to Appellee's Status Report and Suggestion of Mootness by sending an original to the Clerk of the United States Court of Appeals for the Tenth Circuit, by Federal Express at the following address:

Office of the Clerk
United States Court of Appeals for the Tenth Circuit
Byron White U.S. Courthouse
1823 Stout Street
Denver, CO 80257

I also certify that on December 16, 2008, an electronic copy of the brief in

PDF format was attached to an e-mail sent to esubmission@ca10.uscourts.gov pursuant to the Tenth Circuit General Order filed August 10, 2007.

I also certify that all privacy redactions have been made to the extent necessary, and, with the exception of any such redactions, the electronic copy of the brief is an exact copy of the written brief filed with the Court.

I also certify that the electronic copy of the brief has been scanned for viruses using eTrust Antivirus, version 7.1.192, last updated December 16, 2008, and, according to the program, is free of viruses.

/s/ Robert J. Schneider
Robert J. Schneider
Attorney for the United States
as *Amicus Curiae*

BRIEF BANK — "SUMMARY SHEET"

Printed Fri-5/29/09 10:18

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*

In re Jesus Armando Perez (Charles F. McVay, United States Trustee Region 19 v. Jesus Armando Perez)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*

D. Colo.

3. ("CCN") ***CURRENT*** CASE NO.

No.: 07-cv-02301-MSK

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*

No.: 06-01202 SBB

Court: Bankr. Colo.

(Identify judge & cite, if any)

5. ("SO") ***SOURCE***

U.S. TRUSTEES

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*

Filed: November 12, 2008

Type: Submission of the United States Trustee as Amicus Curiae

7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*

Gregory M. Garvin

(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***

BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s)

&

√ Any Miscellaneous ***BACKGROUND***

• A.) Does a bankruptcy judge have authority to propose dismissal of a 727 complaint by the plaintiff where the plaintiff has received no consideration for the dismissal? B.) Does a bankruptcy judge have authority to dismiss a 727 complaint where there has not been notice to all creditors with regard to the intended dismissal?

10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)

11. DO YOU RECOMMEND POSTING IN UST RIEFBANK?

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NAME: Linda Figueroa

DATE:

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO

Civil Action No. 07-cv-02301-MSK

In re: JESUS ARMANDO PEREZ

Debtor

CHARLES F. McVAY,
United States Trustee Region 19

Plaintiff

v.

JESUS ARMANDO PEREZ

Defendant/Appellant.

SUBMISSION OF THE UNITED STATES TRUSTEE AS AMICUS CURIAE

The United States Trustee for Region 19, Charles F. McVay, is not a party to this appeal. He submits this pleading as amicus curiae in response to the Court's September 12, 2008, request that he provide a legal brief or position statement on two issues pertaining to dismissal of a section 727 action when no consideration is received by the dismissing plaintiff. (Courtroom Minutes, 09/12/2008).

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STATUTES AND RULES

I. SUMMARY

The two issues posed by this Court are:

A. "What authority does a bankruptcy judge have with regard to proposed dismissal of a 727 complaint by the plaintiff where the plaintiff has received no consideration for the dismissal."

Summary of Response:

We are not aware of any statute that expressly authorizes a bankruptcy court to prohibit dismissal in such a circumstance. Some courts have expressed concern that debtors improperly purchase a discharge when they advance a sum to a plaintiff in return for the plaintiff dismissing a section 727 action. That concern typically would not be implicated when, as in this case, the plaintiff receives no consideration for withdrawing the section 727 complaint.

Furthermore, that issue is not presented in this appeal. The court below has not indicated whether it would require the United States Trustee to prosecute a section 727 action against his wishes.

Separation of powers issues would be implicated, however, were the court below ever to require the United States, acting through the United States Trustee, to prosecute a complaint the United States had concluded it could no longer advance. Such a denial would impact the discretionary authority of the Executive Branch to determine which cases it will prosecute, or cease prosecuting. But this Court need not address abstract questions about separation of powers in this appeal because they are not before this Court.

B. “What authority does the bankruptcy judge have in considering the request to dismiss a 727 complaint where there has not been notice to all creditors with regard to the intended dismissal.”

<u>Summary Response</u>:

A section 727 complaint may be dismissed without notice being provided to creditors. *See* Fed. R. Bankr. P. 7041 (a section 727 complaint may be dismissed without notice being provided to anyone other than the trustee and the United States Trustee). We are unaware of any court having invalidated Rule 7041 on the ground that its notice provisions violated a vested right of some party.

Courts may, however, require additional notice under the rule, and should do so when the court, in the court’s exercise of discretion, deems that appropriate. *See* Fed. R. Bankr. P. 7041 (court may require that notice of proposed settlements be sent “to such other persons as the court may direct.”). Providing such notice might enable other parties to seek permission to substitute themselves in place of the dismissing plaintiff.[1]

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[1] Courts disagree whether a new party plaintiff may be substituted after the deadlines set forth in fed. R. Bankr. P. 4004 have expired.

II. DISCUSSION

Except as set forth herein, the United States Trustee does not offer a position regarding these two issues as they may apply in other factual contexts or offer a position on any other issues presented by Perez's appeal.

A. The "Abuse of Discretion" Standard Applies To Dismissal Rule 7041.

"Under Fed. R. Bankr. P. 7041, a plaintiff may dismiss a complaint objecting to discharge after providing notice to the case trustee and the United States Trustee and an opportunity to weigh in. In addition, the rule gives the bankruptcy judge the discretion, on a case by case basis, to require notice to additional parties in interest and also to place conditions upon such dismissal as may be appropriate under the circumstances of the individual case to protect the integrity of the bankruptcy system." *McKissack v. McKissack (In re McKissack)*, 320 B.R. 703, 711 (Bankr. D. Colo. 2005). *See* Fed. R. Bankr. P. 7041. When reviewing a trial court's application of Rule 7041, appellate courts apply the "abuse of discretion" standard. *See, e.g., Kallstrom v. Kallstrom (In re Kallstrom)*, 298 B.R. 753, 757 (B.A.P. 10th Cir. 2003). An abuse of discretion arises "when the appellate court has a definite and firm conviction that the lower court made a clear error of judgment or exceeded the bounds of permissible choice in the circumstances." *Id.* (citations and quotations omitted).

B. A Bankruptcy Court May Require Notice Of Dismissal To Creditors.

In this case, the United States Trustee complied fully with the notice requirement of Rule 7041. As evidenced by the United States Trustee's certificate of service of his Notice Pursuant

To L.B.R. 202 of United States Trustee's And Defendant's Stipulation of Dismissal Of Adversary Proceeding ("Notice"), the Notice was mailed to the debtor/defendant, his counsel and the panel trustee assigned in the case. (AD Ex. 16).

In his Notice, the United States Trustee did request that all creditors receive the Notice through delivery by the Bankruptcy Noticing Center ("BNC"). (AD Ex. 16)(on the bottom of the Notice, the United States Trustee included the following: "CLERK OF THE COURT: PLEASE SEND TO BNC"). When such a request is made by the United States Trustee, the BNC generally sends notice to creditors. The record in this case, however, does not reflect whether the Notice was sent by the clerk to the BNC or whether the BNC delivered notice to creditors.

It is within a bankruptcy court's discretion to provide notice to creditors of a plaintiff's motion to dismiss a discharge complaint. Rule 7041 authorizes the bankruptcy courts to order additional notice to "such other persons as the court may direct, and only on order of the court containing terms and conditions which the court deems proper." Fed. R. Bankr. P. 7041. In its denial of the parties' Stipulation, the bankruptcy court in this case cited, among its several concerns, the absence of notice to creditors. *See United States Trustee v. Perez (In re Perez)*, 374 B.R. 800, 810-11, 816 (Bankr. D. Colo. 2007).

When a court exercises discretion granted by a rule or statute in a way that does not further the purpose of the rule or statute, the court abuses its discretion. *See, e.g.*, *U.S. v. $9,020.00 In U.S. Currency*, 30 Fed.Appx. 855, 859 (10th Cir. 2002) ("The overriding purpose of Rule C(6) is to identify claimants and allow them standing in the forfeiture to proceed in defense. . . . Therefore, failing to allow amendment under these circumstances was also an abuse of discretion"); *Ebel v. Ebel (In re Ebel),* No. 96-1190, 1997 WL 428574 *5 (10th Cir. July 30, 1997)("revisiting issues already addressed is not the purpose of Rule 60(b) . . . and the bankruptcy court abused its discretion in granting relief on that basis").

Various courts have suggested the notice provisions of Rule 7041 address two policy goals – preventing "trafficking in discharges" and providing a mechanism to allow a section 727 action to proceed when the prosecuting plaintiff no longer wishes to continue that pursuit.

C. The Concern That the Debtor is Trafficking in a Discharge is Not Present Here.

Because section 727 non-dischargeability actions are prosecuted by the plaintiff to protect the integrity of the bankruptcy system for the benefit of all creditors, public policy considerations caution against allowing debtors to "buy" their discharge by paying consideration exclusively to the plaintiff bringing the section 727 action -- especially if no benefit is received by the creditor body as a whole.

This policy concern was noted by the lower court in this case. As that court stated, "a debtor may not obtain a discharge by paying a creditor who has filed a § 727(a) complaint in exchange for dismissal of the complaint. This policy of preventing the trafficking of discharges is articulated in Federal Rule of Bankruptcy Procedure 7041, which governs the dismissal of adversary proceedings in bankruptcy." *In re Perez*, 374 B.R. at 817; *see also*, *State Bank of India v. Chalsani (In re Chalasani)***,** 92 F.3d 1300, 1310 (2d. Cir. 1996) ("Because discharge is a statutory right undergirded by public policy considerations, it is not a proper subject for negotiation and the exchange of a *quid pro quo"*); *McKissack*, 320 B.R. at 718 ("[t]he case law makes it clear that public policy concerns arise where the circumstances of a request for dismissal of a § 727 action create the appearance that the debtor is purchasing his discharge. Where a creditor moves to dismiss a § 727 action in return for a consideration paid only to that creditor, such *quid pro quo* is likely to contravene that public policy and the motion would probably be denied")(citations omitted)).

A general review of the case law reveals that the existence of a *quid pro quo* largely impacts whether some courts will even consider dismissal of the section 727 action. *See, e.g., Kallstrom*, 298 B.R. at 753 (stating that "discharge is not a proper subject for negotiation and the exchange of a *quid pro quo*" between a debtor and creditors) (*quoting Chalsani*, 92 F.3d at 1310).

Because no payment is to be made in this case, the United States Trustee does not address courts' differing approaches when consideration is paid.[2]

In this case, no "trafficking" of discharge occurred. The court below specifically found that, "claims [under § 727] are not being bought and sold." *In re Perez*, 374 B.R. at 817.

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[2] When payment is being tendered, courts' approaches usually differ depending on: a) the circumstances of the "purchase," b) whether the funds are going exclusively to the plaintiff or the creditor body as a whole and, c) whether, in the court's view, the opportunity of other parties to intervene overcomes the concern over trafficking in discharges. For cases collecting and summarizing the different court approaches when consideration is paid, *see*, *In re McKissack,* 320 B.R. at 711-18; *WM Cameron & Co. v. Gresham* (*In re Gresham),* 2006 WL 2924622 *2 (Bankr.N.D.Tex. Oct. 21, 2006); *In re Sheffer,* 350 B.R. 402, 406 (Bankr.W.D.Ky. 2006); *Wolinsky v. Maynard (In re Maynard)* 269 B.R. 535, 540-41 (D.Vt. 2001).

Even though Defendant Perez was not “buying” a discharge, the lower court stated, nonetheless, that the entry of a “discharge for the Defendant on a false Social Security number . . . would be an extension of the original trafficking of the false Social Security number . . . [which] would aid and abet the original perpetration of misappropriating a Social Security number, and the use and trafficking of the Defendant's false Social Security.” *Id*.

This extends the definition of “trafficking” well beyond the concept of “buying” of a discharge as contemplated by Rule 7041.[3] Absent paying money or similar consideration in exchange for a discharge, the public policy concern of trafficking in discharges is not present. *See, In re McKissack*, 320 B.R. at 718 (“[b]ut those public policy considerations are not present where the proposed dismissal is without consideration).

D. <u>Notice to Creditors</u>.

Section 727 actions are brought to vindicate the rights of more than just the named plaintiff; a successful action will deny discharge of all creditors’ debts. For that reason, some

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[3] The advisory committee note to Rule 7041 provides that:

> Dismissal of a complaint objecting to a discharge raises special concerns because the plaintiff may have been induced to dismiss by an advantage given or promised by the debtor or someone acting in his interest. Some courts by local rule or order have required the debtor and his attorney or the plaintiff to file an affidavit that nothing has been promised to the plaintiff in consideration of the withdrawal of the objection. By specifically authorizing the court to impose conditions in the order of dismissal this rule permits the continuation of this statutory practice.

Fed. R. Bankr. P. 7041, Advisory Committee Note (1983).

courts have exercised their discretion under Rule 7041 to require notice of proposed dismissal to all creditors so another party, if interested, can seek to substitute itself as the prosecuting plaintiff.[4] *See, generally, In re Chalsani,* 92 F.3d at 1311-13; *The Cadle Co. v. Reed,* 392 B.R. at 680*; In re McKissack,* 320 B.R. at 711-18. By ordering notice to creditors in such cases, bankruptcy courts believe the second purpose underlying Rule 7041 is served. When no consideration is being paid by the debtor – the specific factual circumstance for which this Court seeks input – only this second policy concern is present.

E. Requiring A United States Trustee to Continue Prosecuting a Section 727 Action Would Implicate Separation of Powers Concerns.

A plaintiff cannot generally be forced to litigate claims it no longer wishes to pursue – *i.e.,* "the time-honored judicial policy which favors consensual dispute resolution, and the right which a plaintiff always has to decline to continue prosecuting a claim." *In re Grosse*, Nos. 94-18498, 96-1024, 1997 WL 668059, * 4 (Bankr. E.D. Pa. Oct. 15, 1997); *see also, The Cadle Co. v. Reed*, 392 B.R. at 679 (same, quoting *In re Grosse*, *supra*); *In re McKissack,* 320 B.R. at 718 (the court, "may not press a creditor into involuntary servitude by forcing it to forego a proposed monetary settlement and continue prosecution of an action it no longer wishes to pursue. Under Rule 7041, the Court may certainly refuse to permit dismissal or it may set appropriate conditions for dismissal. But the Court cannot compel an unwilling plaintiff to continue

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[4] For a general discussion of courts' differing views on the procedural mechanism through which other parties may be substituted for a plaintiff in a section 727 action, *see McKissack*, 320 B.R. at 703.

prosecution of the case"); *Hass*, 273 B.R. at 55 ("Courts have long recognized (i) unwilling plaintiffs cannot (and probably should not) be compelled to continue litigating, and (ii) new, and willing, parties can be substituted as plaintiffs").

Separation of powers principles could be implicated if a court were to require the United States, acting through the United States Trustee, to prosecute a section 727 action despite the United States' judgment that such prosecution was not appropriate.

Fortunately, that issue is not presented to this Court in this appeal. Again, the court below has not indicated whether it would require the United States Trustee to prosecute the section 727 action against his wishes.

And the United States Trustee cannot formulate a response to such a hypothetical order in a vacuum. Should the issue ever arise in this case, the United States Trustee will evaluate whether to appeal such an order, or determine it is appropriate, based upon the facts known to the United States Trustee at that time, to prosecute his section 727 complaint.

Certainly, such an order would raise separation of power issues. Although analysis of separation of powers issues in the context of section 727 and Rule 7041 appears non-existent, this issue is not foreign to the federal judiciary.

Courts have most often examined separation of powers issues in the context of the executive branch's prosecution of criminal cases, and its request to dismiss criminal prosecutions under Rule 48(a) of the Federal Rules of Criminal Procedure.

Fed. R. Crim. P. 48(a) requires “leave of court” before the Attorney General or United States Attorney may file a dismissal of an indictment, information or complaint. Tenth Circuit decisions addressing judicial review of these dismissals hold that, “[a] court is generally required to grant a prosecutor’s Rule 48(a) motion to dismiss unless dismissal is clearly contrary to manifest public interest.” *United States v. Carrigan*, 778 F.2d 1454, 1463 (10th Cir. 1985) (relying on *United States v. Cowan*, 524 F.2d 504, 513 (5th Cir. 1975)); *see also, United States v. Robertson*, 45 F.3d 1423, 1437 n. 14 (10th Cir. 1995)(same). This discretion, however, does not mean that the judiciary may impose its views on the merits of a prosecution upon the Executive Branch.

The Fifth Circuit in *United States v. Cowan*, the very case upon which the Tenth Circuit relied on in *Carrigan*, delved considerably into the separation of powers issues. The Fifth Circuit held that the judicial power of review embodied in Rule 48(a) was not, “intended to confer on the Judiciary the power and authority to usurp or interfere with the good faith exercise of the Executive power to take care that the laws are faithfully executed.” *United States v. Cowan*, 524 F.2d at 513. The Fifth Circuit elaborated that under Rule 48(a), “[t]he Executive remains the absolute judge of whether a prosecution should be initiated and the first and presumptively the best judge of whether a pending prosecution should be terminated.” *Id.*

The Fifth Circuit also observed that the “manifest public interest” to be protected by the judiciary is not present merely because the trial court judge believes the case to be meritorious and that prosecution would be in the “public interest.” That had been the specific view of the trial court in *Cowan*. In rejecting this view, the Fifth Circuit stated, in unmistakable terms, that a trial court's own view that a prosecution should proceed and is in the public best interest is, "**legally insufficient** to overcome the presumption of the government's good faith and establish its betrayal of the public interest." *Id*. at 514 (emphasis added).

Recently, after cataloging circuit authority, the Seventh Circuit followed this basic rule in *In re United States*, 345 F.3d 450, 453–54 (7th Cir. 2003). In *In re United States*, the Seventh Circuit noted the general language contained in various circuit court opinions related to the "public interest" or "bad faith." In examining these general statements of law, the Seventh Circuit stated that it was, "unaware, however, of any appellate decision that actually upholds a denial of a motion to dismiss a charge on such basis." *Id*. at 453. The Seventh found this as "not surprising," because, "[t]he Constitution's 'take Care' clause (art. II, § 3) places the power to prosecute in the executive branch." *Id*.

These same separation of powers considerations could be triggered by a bankruptcy court's determination not to allow a United States Trustee to dismiss a section 727 complaint. Section 509 of Title 28 provides that "[a]ll functions of other officers of the Department of Justice and all functions of agencies and employees of the Department of Justice are vested in the Attorney General." Section 516 of Title 28 provides:

> Except as otherwise authorized by law, the conduct of litigation in which the United States, an agency, or officer thereof is a party, or is interested, and securing evidence therefor, is reserved to officers of the Department of Justice, under the direction of the Attorney General.

Section 519 of Title 28 similarly provides that "[e]xcept as otherwise authorized by law, the Attorney General shall supervise all litigation to which the United States, an agency, or officer thereof is a party. . . ."[5] 28 U.S.C. § 519.

In *Shaw v. Garrison*, 293 F. Supp. 937, 944-45 (E.D. La.) (three judge panel),[6] *aff'd*., 393 U.S. 220 (1968),[7] the court held that Fed. R. Civ. P. 19 does not authorize a party to compel a Justice Department official, in that case the Attorney General, to participate in a civil action as an involuntary plaintiff. In *Shaw*, Jim Garrison, a state court prosecutor, indicted Clay Shaw for conspiring with Lee Harvey Oswald to assassinate President Kennedy. Shaw sued Garrison in federal court, seeking to enjoin the state court prosecution.

Shaw also sought to bring the Attorney General into the action as an involuntary plaintiff pursuant to Fed. R. Civ. P. 19. *Shaw*, 293 F. Supp. at 943. The court held that Rule 19 cannot be used to join the Attorney General as an involuntary plaintiff, concluding "we cannot interfere with the Attorney General's decision which would constitute an infringement by us upon the discretion of the executive branch of the United States Government." *Id.*, at 944. The court reached this conclusion because the Attorney General has "discretion in deciding whether the

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[5] The "except as otherwise authorized by law" language in sections 516 and 519 recognizes that Congress has given some governmental entities independent litigating authority and they can "sue and be sued" without the participation of the Attorney General. *See, e.g., FHA Region 4 v. Burr*, 309 U.S. 242 (1940).

[6] *See* 28 U.S.C. § 2281 (repealed Aug. 12, 1976, Pub. L. 94-381, § 1, 90 Stat. 1119) (providing that requests for injunctions restraining the enforcement of certain state statutes be heard by three judge panels).

[7] *See* 28 U.S.C. § 1253 (authorizing direct appeal to the Supreme Court from cases in which three judge panels grant or deny requests for injunctions).

United States is concerned in a particular civil action." *Id.*; *Accord Jones v. City of Buffalo*, 901 F. Supp. 19, 21 (D.D.C. 1995) (dismissing Attorney General as involuntary plaintiff because plaintiff "presented . . . no basis for joining the Attorney General"), *aff'd. per curiam*, No. 95-7273, 1996 WL 174352 (D.C. Cir. Apr. 25, 1996); *Nutrition 21 v. Thorne Research, Inc*., 130 F.R.D. 671 (W.D. Wash. 1990) (holding that section 516 prevents the joinder of the United States as an involuntary plaintiff under Rule 19 unless the United States has expressly consented to joinder by statute), *rev'd. on other grounds*, 930 F.2d 1351 (Fed. Cir. 1991); *New Jersey E.P.A. v. Gloucester Environmental Management Services, Inc.*, 668 F. Supp. 404, 407 (D. N.J. 1987) (refusing to join the United States as an involuntary plaintiff).

Similar concerns would exist were the court below ever to require the United States to prosecute a section 727 action.

Dated: November 12, 2008.

Respectfully submitted,

CHARLES F. McVAY
UNITED STATES TRUSTEE

/s/ Gregory M. Garvin
By: Gregory M. Garvin, MO #38460
Assistant U.S. Trustee
999 18th Street, Suite 1551
Denver, Colorado 80202
(303) 312-7242 telephone
(303) 312-7259 facsimile
gregory.garvin@usdoj.gov

CERTIFICATE OF SERVICE

I hereby certify that a copy of the **SUBMISSION OF THE UNITED STATES TRUSTEE AS AMICUS CURIAE** was mailed, postage prepaid, at the date set forth below to the following individuals.

Dated: November 12, 2008

John A. Berman
1660 Lincoln St., Suite 1750
Denver, CO 80264-1701
Attorney for Appellant

/s/ Gregory M. Garvin
Office of the United States Trustee

BRIEF BANK — "SUMMARY SHEET" *Printed Wed-3/17/10 16:42*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*
In re: Larry Dwaine McGuire (Noel Perez v. United States Trustee)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*
D. Nev.

3. ("CCN") ***CURRENT*** CASE NO.
No.: 3:09-cv-00758-LRH-RAM

4. ("PCN") ***PRIOR*** CASE NO. - & COURT *[IF ANY]*
No.: BK-N-09-53599, 09-00015
Court: Bankr. Nev.
(Identify judge & cite, if any)

5. ("SO") ***SOURCE***
U.S. TRUSTEES

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*
Filed: March 16, 2010
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William Cossitt, Catherine Sevcenko, P. Matthew Sutko, Ramona D. Elliott, Nicolas Strozza, Sara Kistler
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***
- Did the bankruptcy court abuse its discretion in determining that the bankruptcy preparer charged excessive fees to prepare bankruptcy petitions for his clients?

10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)

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DATE:

IN THE UNITED STATES DISTRICT COURT

DISTRICT OF NEVADA

In re:	)	**3:09-CV-00758-LRH-RAM**
	)	
LARRY DWAINE McGUIRE,	)	**BK-N-09-53599-GWZ**
	)	
Debtor.	)	**Chapter 7**
	)	**Appeal No. 09-00015**
	)	
NOEL PEREZ,	)	
	)	
Appellant,	)	
	)	
vs.	)	
	)	
UNITED STATES TRUSTEE,	)	
	)	
Appellee.	)	
	)	

BRIEF OF APPELLEE UNITED STATES TRUSTEE

RAMONA D. ELLIOTT
General Counsel

P. MATTHEW SUTKO
Associate General Counsel

CATHERINE SEVCENKO
Trial Attorney

Executive Office for United States Trustees
20 Massachusetts Ave., N.W., Ste. 8000
Washington, D.C. 20530
Tel: (202) 307-1405

SARA KISTLER
Acting United States Trustee for Region 17

NICHOLAS STROZZA
Assistant United States Trustee

WILLIAM COSSITT
Trial Attorney

Office of the United States Trustee
U.S. Department of Justice
300 Booth Street, Room 2129
Reno, NV 89509
Tel: (775) 784-5335
Fax: (775) 784-5531
USTPRegion17.RE.ECF@usdoj.gov

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INTRODUCTION

This is an appeal from a bankruptcy court decision interpreting section 110 of title 11 which regulates the activity of bankruptcy petition preparers.[1] Appellant Noel Perez, who does business as a bankruptcy petition preparer under the business name "Slamdunkem," has appealed an order of the United States Bankruptcy Court for the District of Nevada requiring him to disgorge two hundred dollars in each of the one hundred forty-nine cases in which he overcharged for preparing the debtors' bankruptcy filings.[2] He charged $350 in each of the cases but the bankruptcy court determined a reasonable fee was $150. He was also conditionally sanctioned fifty dollars in each of those cases for otherwise violating section 110. In addition to overcharging, Mr. Perez violated section 110(c) by not putting his entire social security number on documents he prepared for filing, and he violated section 110(g) by handling the filing fees in each of the cases. Mr. Perez does not appeal or dispute the bankruptcy court's factual determination that he committed the actions that were sanctioned.

Appellant Mr. Noel Perez has appealed from the bankruptcy court's decision to disgorge fees and impose conditional sanctions. He argues that section 110 is unconstitutional and that his fees are proper because they represent market rates.

JURISDICTIONAL STATEMENT

The bankruptcy court had jurisdiction over a challenge to fees charged by a bankruptcy petition preparer. 28 U.S.C. § 157. The bankruptcy court entered its final order disgorging fees

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[1] For the convenience of the Court, a copy of section 110 has been attached to the Addendum hereto.

[2] An example of what Mr. Perez prepared in each bankruptcy case is included in the United States Trustee's Appendix II (hereinafter "USTA II") at pgs. 3-66.

on December 10, 2009, which Mr. Perez timely appealed. This Court has jurisdiction over this appeal. 28 U.S.C. § 158(a)(1).

ISSUES PRESENTED

1. Did the bankruptcy court correctly assign the burden of proof?
2. Are the bankruptcy preparer provisions of section 110 of title 11 unconstitutionally vague?
3. Did the court below abuse its discretion in determining that Mr. Perez charged excessive fees to prepare bankruptcy petitions for his clients?

APPLICABLE STANDARDS OF REVIEW

"The bankruptcy court's conclusions of law are reviewed de novo, and its findings of fact are reviewed for clear error." In re Doser, 412 F.3d 1056, 1061 (9th Cir. 2005). "A challenge to the constitutionality of a statute is also reviewed de novo." Id. The bankruptcy court's application of law to fact under section 110 is reviewed for abuse of discretion. In re Agyekum, 225 B.R. 695, 698 (B.A.P. 9th Cir. 1998). This Court "must have a definite and firm conviction that the court below committed a clear error of judgment . . . before reversal is proper." In re Crowe, 243 B.R. 43, 47 (B.A.P. 9th Cir.), aff'd 246 F.3d 673 (9th Cir. 2000). A reduction in an award of fees should not be reversed unless there is "a definite and firm conviction that the bankruptcy court committed clear error in the conclusion it reached after weighing all of the relevant factors." See In re Eliapo, 468 F.3d 592, 596 (9th Cir. 2006).

STATEMENT OF THE CASE

A. STATUTORY FRAMEWORK

In 1994, Congress enacted section 110 of title 11 as part of the Bankruptcy Reform Act, Pub. L. No. 103-394, 308, 108 Stat. 4135 (Oct. 22, 1994), to address the "growing problem of bankruptcy preparers who abuse the system in the course of preparing documents for debtors to file in bankruptcy court." 140 Cong. Rec S. 4506 (daily ed. Apr. 20, 1994) (statement of Senator Metzenbaum); see also In re Doser, 412 F.3d at 1061. Although the Bankruptcy Code and other laws expressly addressed attorney misconduct, the enactment of section 110 created statutory legal tools to regulate non-attorneys seeking to profit at the expense of individuals unwilling or financially unable to hire legal counsel. See In re Gavin, 181 B.R. 814, 820 (Bankr. E.D. Pa. 1995). The legislative history expresses Congress's concerns in enacting this statute:

> This section adds a new section to * * * title 11 * * * to create standards and penalties pertaining to bankruptcy petition preparers. Bankruptcy petition preparers not employed or supervised by any attorney have proliferated across the country. While it is permissible for a petition preparer to provide services solely limited to typing, far too many of them also attempt to provide legal advice and legal services to debtors. These preparers often lack the necessary legal training and ethics regulation to provide such services in an adequate and appropriate manner. These services may take unfair advantage of persons who are ignorant of their rights both inside and outside the bankruptcy system.

H.R. Rep. 103-834, 103rd Cong., 2nd Sess. 40-41 (Oct. 4, 1994); 140 Cong. Rec. H10770 (Oct. 4, 1994).

Congress passed section 110 to tackle petition preparers who prey on the poor and unsophisticated. It was hoped that the new law would address the abuses of bankruptcy petition preparers and at least provide minimal protection to consumers. "The petition is essential to the proper operation of the bankruptcy process, and all parties suffer if a petition is improperly prepared." In re Doser, 412 F.3d at 1062 (citing In re Moore, 283 B.R. 852, 857 (Bankr. E.D.N.C. 2002)).

Section 110 regulates "bankruptcy petition preparers." A bankruptcy petition preparer is defined as "a person other than an attorney or an employee of an attorney, who prepares for compensation a document for filing" in a bankruptcy case. 11 U.S.C. § 110(a).

The statute requires bankruptcy petition preparers to sign each document prepared for filing in a bankruptcy case and to include on each document the preparer's name, address and Social Security number. 11 U.S.C. § 110(b) and (c). Bankruptcy petition preparers are also required to provide the debtor a copy of each document for filing. 11 U.S.C. § 110(d). Section 110 prohibits petition preparers from executing documents on behalf of debtors, from advertising their services as "legal," and from collecting or receiving any payment from the debtor for court fees in connection with the filing of the petition. 11 U.S.C. §§ 110(e), (f), and (g). The statute provides for fines of not more than $500 for each violation of these requirements. 11 U.S.C. § 110(l).

Section 110 authorizes additional methods of enforcement against bankruptcy petition preparers, including actions for damages for the negligent or intentional disregard of the Bankruptcy Code or any "fraudulent, unfair, or deceptive act," and for injunctive relief. 11 U.S.C. §§ 110(i) and (j). The statute provides that any fees "in excess of the value of services" rendered shall be disallowed and ordered to be turned over to the bankruptcy trustee. 11 U.S.C. § 110(h)(3)(A).

In 2005, Congress enacted the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005. Pub. L. No. 109-8, 119 Stat. 23 (2005). Although the Act as a whole provided sweeping changes to the Bankruptcy Code, the changes to section 110 are not germane to the fee issue in this case, other than the addition of a provision to section 110(h) allowing the Supreme Court to set maximum fees, or the Judicial Conference to set fee guidelines, for bankruptcy petition preparers. H.R. 109-31, Pt. 1, 109th Cong., 1st Sess. 62-63 (2005). As discussed below, neither the Supreme Court or the Judicial Conference have chosen to act on setting bankruptcy petition preparer fees.

B. COUNTER-STATEMENT OF THE FACTS

Mr. Perez is a bankruptcy petition preparer conducting business as “Slamdunkem.” United States Trustee’s Appendix I (hereinafter “USTA I”) at 9, lls. 10-11. Mr. Perez is the sole owner and manager of “Slamdunkem, LLC” a Nevada limited liability company. USTA I at 9, lls. 12-13. Mr. Perez advertises bankruptcy petition preparer services on TV, radio, the Yellow Pages, and a website: www.slamdunkem.com. USTA I at 111-112; 162; 293-295; 374-386. In those advertisements he promises his clients enhanced services such as: “Certified Bankruptcy Petition Preparer that guarantees full compliance with court filing requirements”, “Comprehensive step-by-step process to help navigate the complex process of bankruptcy case filing,” and “explanation of the court requirements”. USTA I at 374-375. He also offers “guidance to ensure success in your bankruptcy case,” including an explanation of the differences between chapter 7 and chapter 13. USTA I at 99-104.

On or about July 21, 2009, a letter with attachments was sent by the Office of the United States Trustee by first class mail to all known petition preparers in Northern Nevada. USTA I at 264-265. Mr. Perez received this mailing. USTA I at 154, lls. 20-23. The attachments to the July 21, 2009 letter included the orders and findings of fact and conclusions of law that had been entered by bankruptcy judges in the District of Nevada in the cases: Sattiewhite BK-S-08-20843-BAM, Archie BK-N-09-50273-GWZ and Burkett BK-N-09-50143-GWZ. USTA I at 264-265; 344-362. These orders were sent as examples of cases where bankruptcy petition preparers could not charge more than $150 for their services.

On September 2, 2009, the United States Trustee filed a motion for an order to show cause against Mr. Perez in the case of Gia M. Schwartz, in the District of Nevada, Case no. BK-09-50071. The United States Trustee's motion was granted by the order entered September 2, 2009 setting the show cause hearing for October 7, 2009.

At the conclusion of the hearing to show cause, which was attended by Mr. Perez and telephonically by his counsel Donald Harris, the bankruptcy court ordered Mr. Perez to disgorge two hundred dollars to Ms. Schwartz for overcharging. USTA I at 245-247. In addition, the court set a hearing date for a motion to be filed by the United States Trustee regarding the amount being charged by Mr. Perez in the other bankruptcy cases filed in the District of Nevada. USTA I at 248-251. At that time, Mr. Perez had filed eighty-five bankruptcy cases after August 1, 2009, which was selected because it was ten days after the United States Trustee had sent her July 21, 2009 letter. USTA I at 240-242.

The United States Trustee filed such a motion on October 19, 2009. The United States Trustee's motion sought disgorgement of fees and sanctions against Mr. Perez. It was accompanied by a supporting declaration by Robbin Little, who is a paralegal for the United States Trustee. USTA I at 253-278. At the time the United States Trustee filed her motion, Mr. Perez had filed one hundred thirteen cases after August 1, 2009.[3] USTA I at 253-262. By the hearing date for the United States Trustee's motion, November 12, 2009, Mr. Perez was the bankruptcy petition preparer for one hundred fifty-two cases submitted after August 1, 2009. USTA I at 279-291.

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[3] The United States Trustee mailed notice of her motion to the debtors in all of these cases. Notice of Hearing, Bankruptcy Court Docket # 10.

In each case, Mr. Perez, under the penalty of perjury, identified himself as the bankruptcy petition preparer on the Official Form B280 Disclosure Of Compensation Of Bankruptcy Petition Preparer, including his name, address and either his redacted Tax Identification Number xxxxxxxxx-44-001, or his redacted social security number, xxxxx-6559. USTA II at 67-374. For one hundred forty-eight of them, Mr. Perez was paid a fee of $350, for three he was not paid a fee, and for the remaining one he was paid a fee of $450. USTA I at 125-128. For each case, Mr. Perez had the debtors bring in a money order or other certified funds made out to the bankruptcy clerk for the filing fee ($299) or the initial installment of the filing fee ($75), which his runner then delivered with the bankruptcy filings to the clerk. USTA I at 131-134; 300-339.

Mr. Perez filed an opposition to the United States Trustee's motion on November 3, 2009, which relied upon the supporting declaration of Walt McKenna. USTA I at 21-53. Mr. Perez did not file any declaration disputing the allegations of fact in the United States Trustee's motion; the McKenna declaration addressed only the value of Mr. Perez's services. USTA I at 87-88.

The United States Trustee's motion was heard on November 12, 2009. USTA I at 61. Mr. Perez, Mr. McKenna, and Ms. Little testified and numerous exhibits were introduced to create a fairly extensive record. USTA I at 61-222. At the hearing, Mr. Perez failed to introduce any evidence to rebut the United States Trustee's allegations that his actions violated section 110. USTA I at 87-88. The bankruptcy court issued its decision on December 10, 2009. USTA I at 3-6.

On that date, all of the 152 cases at issue were open and pending in the District of Nevada bankruptcy court. USTA II at 375-527.[4]

C. BANKRUPTCY COURT DECISION

During the hearing, the bankruptcy court rejected all of Mr. Perez's arguments supporting his opposition to the United States Trustee's motion for disgorgement. The bankruptcy court found that Mr. Perez was the bankruptcy petition preparer, as that term is defined in 11 U.S.C. § 101(a)(1). USTA I at 13, lls. 16-18. It then determined that Mr. Perez had charged excessive fees for his services. It found section 110(h) controls a reasonable fee for bankruptcy petition preparers. The burden of proof is on the bankruptcy petition preparer in every case where the fee is challenged to establish that the fee charged was reasonable and did not exceed the value of the limited services that may be properly provided. USTA I at 13, lls. 21-26.

The bankruptcy court found that Mr. Perez was provided due process and had been given adequate and proper notice to allow for full and complete defense against the United States Trustee's motion. USTA I at 9, lls. 2-8. It rejected his argument that section 110 is unconstitutionally vague. USTA I at 11-12.

The bankruptcy court also rejected Mr. Perez's argument that the debtors' perceived value of his services determines what he can properly charge. Instead, the bankruptcy court found that the proper test of value for Mr. Perez's services is what a typist would charge – in this case, approximately thirty dollars an hour. USTA I at 13-14. No evidence was introduced that it

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[4] The United States Trustee mailed notice of entry of the order granting her motion to all the debtors. Notice of Entry of Order With Certificate of Service, Bankruptcy Court Docket # 25. Appellant also mailed his Notice of Appeal to the debtors. Bankruptcy Court Docket # 27. Copies of Bankruptcy Court Docket #'s 10, 25 and 27 will be submitted should the Court require.

took Mr. Perez more than five hours to process and prepare the documents, pleadings, and papers on file in each of the cases under consideration. USTA I at 14, lls. 6-8. Therefore, he was ordered to disgorge by May 14, 2010 $200 to each debtor(s) whom he had charged. This represented the difference between the $350 he charged in all but one of the cases and the proper value of his services pursuant to section 110(h)(3)(A)(i). USTA I at 14, lls. 8-11.

The bankruptcy court also found that Mr. Perez had violated section 110(c) by not putting his entire social security number on documents prepared for filing in each of the 152 cases. USTA I at 14, lls. 15-19. It also determined that Mr. Perez violated section 110(g) by handling the filing fees in each of them. USTA I at 14, lls. 20-21.[5]

For these violations of section 110, the bankruptcy court sanctioned Mr. Perez fifty dollars for each of the 149 cases in which he charged a fee, pursuant to section 110(l). USTA I at 14, lls. 26-28. However, the sanction was held in abeyance until May 14, 2010; if Mr. Perez commits no further violations of section 110 by May 14, 2010, the sanction shall not be payable. USTA I at 14-15.

On December 21, 2009, Mr. Perez timely filed a notice of appeal.

SUMMARY OF THE ARGUMENT

Much of this appeal is governed by the Ninth Circuit case In re Doser. Scott v. United States Trustee (In re Doser), 412 F.3d 1056 (9th Cir. 2005). Doser rejected the constitutional arguments made by Mr. Perez in this appeal, holding that subsection (h) of section 110 is not void for vagueness. Id. at 1062-64. The Doser Court also held that a bankruptcy petition

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[5] Since the United States Trustee's Motion did not allege any violation of Section 110(i), whether Mr. Perez may have acted fraudulently, unfairly, or deceptively, was not before the bankruptcy court. USTA I at 13, lls. 19-20.

preparer's fee cannot exceed what a professional typist or word processor would charge. Id. at 1062-63, 1065. Doser noted the purpose of section 110 – to protect debtors unfamiliar with bankruptcy from being exploited – and therefore implicitly contradicts Mr. Perez's contention that bankruptcy petition preparers should be able to charge what a debtor is willing to pay. Id. at 1061. Mr. Perez's other arguments concerning the burden of proof and his allegations that the bankruptcy court followed the United States Trustee's Guidelines rather than the statute are also without merit. The decision below should be affirmed.

ARGUMENT

I. The bankruptcy court correctly assigned the burden of proof.

Mr. Perez's first argument is that the bankruptcy court failed to place the burden of proof on the United States Trustee regarding the reasonableness of the fees Mr. Perez charged in the 152 cases before the bankruptcy court.[6] Appellant Br. at 10-11.

The bankruptcy court applied the proper burden of proof on Mr. Perez to show his fees were reasonable. In re Doser, 281 B.R. 292, 313 (Bankr. D. Idaho 2002), aff'd, 292 B.R. 652 (D. Idaho 2002), aff'd on other grounds, 412 F.3d 1056 (9th Cir. 2005) (holding the bankruptcy petition preparer "bears the burden of establishing she is entitled to them [fees] once a question regarding their reasonableness is raised.") (citing In re Bush, 275 B.R. 69, 85-86 (Bankr. D. Idaho 2002) and Matter of Geraci, 138 F.3d 314, 318 (7th Cir. 1998)). Other courts have reached

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[6] Pursuant to the agreement of the parties and the order of the bankruptcy court, the United States Trustee filed her motion and noticed it for hearing in just this case, McGuire, BK-N-09-53599-GWZ, for judicial economy, instead of filing the same motion in all of the cases that Mr. Perez filed after August 1, 2009. USTA I at 240-251; See U.S. Trustee v. Taub, 2007 WL 2238181 (Bankr. D. Or. 2007)(Case No. 07-6056-fra) (citing In re Reynoso, 315 B.R. 544 (B.A.P. 9th Cir. 2004), aff'd 477 F.3d 1117 (9th Cir. 2007)); see also, 11 U.S.C. §§ 105 and 102(1).

the same conclusion. See In re Springs, 358 B.R. 236, 242 (Bankr. M.D.N.C. 2006) (citing In re Froehlich, 23 Fed.Appx. 572, 574, 2001 WL 1530594 (7th Cir. 2001)).

Mr. Perez fails to cite any authority that assigns the burden of proof to the movant when an objection to a bankruptcy petition preparer's fees is filed. Appellant Br. at 10-11. The only case he cites is *Bolling v. Sharpe*, 347 U.S. 497, 499 (1954), which discusses the concepts of due process and equal protection in the context of racial segregation. Appellant Br. at 10.

Even if the United States Trustee had the burden of proof on the reasonableness of the fees Mr. Perez charged, she carried that burden. The bankruptcy court found that in the Ninth Circuit "the value of a bankruptcy petition preparer's services must be measured by the very limited proper scope of those services: typing." USTA I at 12, lls. 5-13. The United States Trustee submitted the declaration and testimony of Robbin Little, establishing the cost of typing services in Reno, Nevada to be $30 per hour, which the bankruptcy court found sufficient. USTA I at 14, lls. 2-8. Mr. Perez introduced no rebuttal evidence as to what a typist in Reno would charge. USTA I at 166-169. Therefore the United States Trustee demonstrated that Mr. Perez's $350 fee was not reasonable and thus not allowable under section 110.

II. Section 110 is not unconstitutionally vague.

A. Doser forecloses the argument that section 110 is void for vagueness in the Ninth Circuit

Mr. Perez argues that the Bankruptcy Code and the implementing rules and guidance are unconstitutionally vague. Appellant Br. at 12-21. He fails to cite In re Doser, however, which holds that Congress acted within its power when it enacted section 110 and that the section is not unconstitutionally vague or overbroad and that it does not violate the First Amendment. Doser, 412 F.3d at 1059.[7] It rejected the argument that section 110(h), which gives courts the authority to disgorge fees in excess of the value of the services rendered, is void for vagueness. Id. at 1062-63. Instead, it ruled that a "person of ordinary intelligence would know when a fee is excessive when compared to the limited services that may be permissibly performed by a BPP [bankruptcy petition preparer]," namely transcribing information from the debtor onto the bankruptcy forms. Id. This holding forecloses the success of Mr. Perez's constitutional argument.

B. Mr. Perez's arguments do not cast doubt on the rationale of Doser.

Even if this were not a settled question in the Ninth Circuit, Mr. Perez's argument that section 110(h) is vague would fail. The Supreme Court has held that a vagueness challenge can only succeed if the enactment is "impermissibly vague in all of its applications." Hotel & Motel Ass'n of Oakland v. City of Oakland, 344 F.3d 959, 971 (9th Cir. 2003) (quoting Village of Hoffman Estates v. Flipside, Hoffman Estates, Inc., 455 U.S. 489, 494-95 (1982)). Because section 110(h) does not impose any criminal sanction or implicate free speech concerns, a facial challenge would require Mr. Perez to "establish that no set of circumstances exists under which [section 110(h)] would be valid." Hotel & Motel, at 971 (quoting United States v. Salerno, 481 U.S. 739, 745, 107 S.Ct. 2095, 95 L.Ed.2d 697 (1987).

Mr. Perez cites one case in his constitutional argument with respect to vagueness – Grayned v. City of Rockford (dealing with a city anti noise ordinance prohibiting disruptive picketing adjacent to a school that is in session). Appellant Brief at 17. He fails to carry his

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[7] Doser separately held that the April 2005 amendments to Section 110 "do not affect our analysis." 412 F.3d at 1059, n.1.

burden to show that section 110 is void for vagueness. Appellant Br. at 16. Nor is there a persuasive argument to make. Section 110 sets out a clear framework for bankruptcy petitioner preparers to establish their fees.

First, section 110 unambiguously defines a petition preparer as "a person, other than an attorney or an employee of an attorney, who prepares for compensation a document for filing" by a debtor in a bankruptcy case. 11 U.S.C. § 110(a)(1). "Person" is a definable term under section 101(41) and includes a corporation. This provides adequate and fair notice of what parties the statute reaches: Mr. Noel Perez and "Slamdunkem, LLC" (his business).

Second, section 110(h) unequivocally prohibits the collection of fees "found to be in excess of the value of services rendered for the documents prepared" by a bankruptcy petition preparer. This section specifies the prohibited conduct: collection of excessive fees. The Bankruptcy Code is clear that the bankruptcy court shall disallow and order the immediate turnover to the bankruptcy trustee of any fee paid to a bankruptcy petition preparer that exceeds the value of services rendered. 11 U.S.C. § 110(h)(3)(A). Mr. Perez was therefore on notice that disgorgement would occur in the event a bankruptcy court deemed his fees to be too high. Mr. Perez was afforded notice and his due process rights were not violated.

C. Mr. Perez's discussion of the United States Trustee Guidelines and former Local Rule 9011 are irrelevant.

Mr. Perez wrongly argues that the Nevada bankruptcy courts have applied section 110(h) in such a way that it becomes void for vagueness because the courts are essentially applying the Region 17 United States Trustee Program Guidelines For Petition Preparers In the District Of

Nevada (hereinafter "Guidelines") and former Local Rule 9011,[8] instead of the statute itself. Appellant Br. at 12-21. Since the statute allows the setting of bankruptcy petition preparer fees by the Supreme Court, or the Judicial Conference, and they have not acted, Mr. Perez posits that the court is impermissibly imposing the United States Trustee's policy determination that his $350 fee was excessive. Appellant Br. at 18-19. This argument is unpersuasive.

First, the Guidelines are policy documents. They do not have the force of law. Therefore, they cannot be constitutional or unconstitutional. As Mr. Perez points out, section 2075 of title 28 prohibits any judicial or administrative rule from enhancing or restricting anyone's rights under the Bankruptcy Code. Appellant Br. at 18-19. Therefore, former Local Rule 9011 also has no bearing on any constitutional argument.

In fact, Mr. Perez himself admits that former Local Rule 9011 and the United States Trustee Guidelines "as written and as applied by this Court, *do not establish the allowable fee for bankruptcy petition preparers. Section 110(h) controls."* Appellant Br. at 13 (emphasis supplied by Mr. Perez). The United States Trustee's motion was based upon section 110; it does not cite or rely upon as a legal authority former Local Rule 9011 or the Guidelines. USTA I at 17-20. Under the terms of section 110, Mr. Perez has overcharged his clients and under 110(h), the bankruptcy court had the authority to order him to disgorge those fees.

Mr. Perez's argument that the bankruptcy court allowed the Guidelines and former Local Rule 9011 to replace section 110 impermissibly is not supported by the record in this case. The

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[8] For the convenience of the Court, a copy of former LR 9011 is attached to the Addendum hereto. Former Local Rule 9011 was in effect when this matter was heard on November 12, 2009, but was deleted when the Local Rules were amended, effective December 1, 2009. A copy of the Guidelines is located at USTA I pgs. 369-373.

bankruptcy court stated on record that it was applying section 110 only. USTA I at 96-98. When addressing former Local Rule 9011 – which regulated the practice of bankruptcy petition preparers – the court stated "we the judges, make the factual determinations" and make an "independent determination" of whether a fee is warranted. USTA I at 96-97. Subsection (d) of former Local Rule 9011merely stated that the "United States trustee may issue guidelines in connection with the provisions of 11 U.S.C. § 110 setting forth positions that the trustee will generally follow in relation to petition preparers." USTA I at 97. The rule stated that the United States Trustee could make her interpretation public. It did not say that the courts had to accept her view – nor did the bankruptcy court in this case do so without independent analysis.

Finally, the bankruptcy court acknowledged that the United States Trustee's Guidelines provide assistance to bankruptcy petition preparers but that they do not bind the court. USTA I at 92. The Guidelines do not state that they are binding on the bankruptcy courts, just the opposite:

> These *Guidelines* shall in no way modify rules, orders or guidelines issued by Ninth Circuit courts. Each provision in the *Guidelines* shall be applied strictly unless in conflict with the United States Bankruptcy Code, the Bankruptcy Rules, Nevada Statutes, Ninth Circuit or United States District Court rules, orders or case law binding in the Ninth Circuit or the District of Nevada.

Addendum hereto.

The Guidelines are simply what they state they are: policy statements, no more no less. The bankruptcy court recognized this when it stated that the Guidelines do not "say the court is going to follow them. It doesn't give an imprimatur of per se application." USTA I at 98. The United States Trustee issued these informational Guidelines to identify under what circumstances she might exercise her prosecutorial discretion to seek relief under section 110, but they do no purport to constrain the United States Trustee's power to respond differently, much less a court's.

Mr. Perez's authorities holding that rules, especially local rules, cannot conflict with the Bankruptcy Code are irrelevant because former Local Rule 9011 and the Guidelines, in fact and as applied by the bankruptcy court, do not conflict with the Bankruptcy Code. Appellant Br. at 18-20; USTA I at 96-98.

D. Mr. Perez's interpretation of "any services" in section 110(h) is incorrect.

Mr. Perez argues that a bankruptcy petition preparer's activities, and thus ability to charge fees, cannot be limited to typing because section 110(h) uses the phrase "any services." Appellant Br. at 20-21. Based on this argument, Mr. Perez posits that the Guidelines conflict with section 110 because they limit a bankruptcy petition preparer's services to "secretarial" or "clerical" services. This has no merit.

Mr. Perez attempts to manufacture some meaningful difference between "secretarial," "clerical," or "typing" services, as used in the Guidelines, and "any services," the language used in section 110(h)(3)(A), to limit the court's authority to order disgorgement for "any service". This construction ignores the bulk of section 110 which lays out numerous restrictions on what a bankruptcy petition preparer may do. See e.g., 11 U.S.C. § 110(e)(1) (prohibiting a bankruptcy petition preparer from executing documents); 11 U.S.C. § 110(e)(2) (prohibiting legal advice); 11 U.S.C. § 110(f) (prohibiting the use of the word "legal" in advertising); 11 U.S.C. § 110(g) (prohibiting handling of court fees).

Other than suggesting that a bankruptcy petition preparer might charge a debtor for providing a ride to the courthouse, Mr. Perez does not explain what "services" he could provide beyond preparation of documents that would not otherwise be prohibited by section 110. Appellate Br. at 20-21. Were he to invent such a service, then this Court could determine whether it was allowed under section 110 and whether the charge was reasonable, should the United States Trustee decide to challenge it. That scenario is not before this Court; the issue here is Mr. Perez's excessive fee for his services.

III. The fees charged by Mr. Perez were excessive.

When determining appropriate fees for a bankruptcy petition preparer under section 110(h), "the proper reference point is what professional typists or word processors would charge . . . other sorts of services are improper, and those services can *perforce* not be compensated." Doser, 412 F.3d at 1065 (citation omitted). Other courts have also rejected Mr. Perez's argument and have uniformly held that scrivener services are an appropriate measure of compensation for the services rendered by a bankruptcy petition preparer. In re McDonald, 318 B.R. 37, 46 (Bankr. E.D.N.Y. 2004) (deciding that $50 was a reasonable hourly rate); In re Guttierez, 248 B.R. 287, 297-298 (Bankr.W.D.Tex. 2000) (stating the only service a bankruptcy petition preparer can safely offer is transcription of dictated or handwritten notes for a fee of $50).

The bankruptcy court applied Doser and found that the rate for typing services in Reno is $30 per hour, which is consistent with the evidence showing that typists in Reno charge between $10 and $32.50 per hour. The United States Trustee filed a declaration prior to the hearing, which formed the basis for the United States Trustee's contention that Mr. Perez's $350 fee was excessive. USTA I at 281. Mr. Perez offered no rebuttal evidence in this regard. USTA I at 166-170. The bankruptcy court then multiplied the $30 per hour typing rate times the reasonable number of hours it would take to prepare the documents and determined the reasonable fee to be

$150 – rather than the $350 Mr. Perez had charged his clients. USTA I at 14, lls. 6-8. This is in keeping with Ninth Circuit law. A fee of $214 was found to be excessive in In re Doser, and a fee of $100 was affirmed. 412 F.3d at 1065.

The bankruptcy court's factual finding that $150 is a reasonable fee for a bankruptcy petition preparer is not "clear error" and therefore must be affirmed. Smith v. Jackson, 84 F.3d 1213, 1221 (9th Cir. 1996); In re Agyekum, 225 B.R. 695, 698 (B.A.P. 9th Cir. 1998); In re Crowe, 243 B.R. 43, 47 (B.A.P. 9th Cir.), aff'd 246 F.3d 673 (9th Cir. 2000). Given this record, the court below did not abuse its discretion in determining that a fee of $350 was excessive.

IV. A finding of negligence or fraud is not necessary to order disgorgement under section 110.

Mr. Perez cites In re Stacy for the argument that a requirement for "negligent" or "fraudulent" action is implicit in section 110. In re Stacy, 193 B.R. 31, 35 (Bankr. D. Or. 1996); Appellant Br. at 22. In fact, the Stacy court only mentions negligence and fraud when addressing the United States Trustee's allegations under section 110(j)(2)(a)(i)(III). Stacy, 193 B.R. at 35. Nowhere in the opinion does it hold that negligence or fraud are implicit anywhere else in section 110 except for subsection 110(j)(2)(a)(i)(III). In this matter, the United States Trustee has never alleged a violation of subsection 110(j)(2)(a)(i)(III). USTA I at 13, lls. 19-20.

The subsections of 110 that the United States Trustee's motion alleged Mr. Perez violated are not based upon negligence or fraud and contain their own statutory penalties. For example, pursuant to section 110©, a bankruptcy petition preparer shall place his social security number after his signature on each document he prepares for filing. In re Crawford, 194 F.3d 954, 960 (9th Cir. 1999), cert. denied, 528 U.S. 1189 (2000). Section 110(h)(3)(B) provides that all fees charged by a bankruptcy petition preparer may be forfeited in any case in which the bankruptcy petition preparer fails to comply with subsection 110(c). Mr. Perez does not dispute that in the 152 cases cited in the United States Trustee's motion, as supplemented, he did not include his full social security number on any of the documents he prepared for filing. Appellant Br. at 4-9; USTA II at 67-374.

Similarly, a bankruptcy petition preparer shall not collect or receive any payment from the debtor for the court fees in connection with filing the petition. 11 U.S.C. § 110(g). This subsection prohibits a bankruptcy petition preparer not only from taking payment for the filing fee but also from receiving a cashier's check or other form of payment from the debtor which is made payable to the bankruptcy clerk. In re Buck, 307 B.R. 157, 163-64 (C.D. Cal. 2004). Section 110(h)(3)(B) provides that all fees charged by a bankruptcy petition preparer may be forfeited in any case where the bankruptcy petition preparer fails to comply with subsection 110(g). Mr. Perez does not dispute that in all 152 cases, he collected from the debtors at least the initial filing fee for the bankruptcy clerk, as reflected in the clerk's log book. Appellant Br. at 4-9; USTA I at 280, 300-339.

Therefore, whether Mr. Perez engaged in negligent or fraudulent activity is irrelevant.

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CONCLUSION

For these reasons, the United States Trustee respectfully requests this Court to affirm the decision below.

Respectfully submitted,

/S/ NICHOLAS STROZZA

Nicholas Strozza
Assistant United States Trustee – Region 17

Office of the United States Trustee
Department of Justice
300 Booth Street, Room 2129
Reno, NV 89509
Tel: (775) 784-5335
Fax: (775) 784-5531
USTPRegion17.RE.ECF@usdoj.gov

RAMONA D. ELLIOTT
General Counsel

P. MATTHEW SUTKO
Associate General Counsel

CATHERINE B. SEVCENKO
Trial Attorney

Executive Office for the United States Trustees
Department of Justice
20 Massachusetts Avenue, N.W.
Washington, D.C. 20530
(202) 307-1399

ADDENDUM

1. Section 110 U.S. Bankruptcy Code.
2. Former Local Rule 9011.

CERTIFICATE OF SERVICE

I, Kimberly A. Flores, under penalty of perjury declare: That declarant is, and was when the herein described service took place, a citizen of the United States, over 18 years of age, and not a party to nor interested in, the within action; that on or before March 15, 2010, I filed with the Clerk of the Court, using CM/ECF, which also will cause to be served upon registered users and registered filers, the foregoing BRIEF OF APPELLEE UNITED STATES TRUSTEE. In addition, the persons identified below were also served by Federal Express, postage-prepaid, as follows:

DELIVERY BY FEDERAL EXPRESS:

DONALD HARRIS, ESQ.
158 E. MARKET STREET, #302
SANDUSKY OH 44870

NOEL PEREZ
550 EAST PLUMB LANE, SUITE 302
RENO NV 89502

HAND DELIVERY:

J. CRAIG DEMETRAS
230 EAST LIBERTY STREET
RENO NV 89501

/s/ Kimberly A. Flores
An employee of the Office of the United States Trustee

ADDENDUM

Effective: December 26, 2007

United States Code Annotated Currentness
Title 11. Bankruptcy (Refs & Annos)
Chapter 1. General Provisions (Refs & Annos)
➡ **§ 110. Penalty for persons who negligently or fraudulently prepare bankruptcy petitions**

(a) In this section--

(1) "bankruptcy petition preparer" means a person, other than an attorney for the debtor or an employee of such attorney under the direct supervision of such attorney, who prepares for compensation a document for filing; and

(2) "document for filing" means a petition or any other document prepared for filing by a debtor in a United States bankruptcy court or a United States district court in connection with a case under this title.

(b)(1) A bankruptcy petition preparer who prepares a document for filing shall sign the document and print on the document the preparer's name and address. If a bankruptcy petition preparer is not an individual, then an officer, principal, responsible person, or partner of the bankruptcy petition preparer shall be required to--

(A) sign the document for filing; and

(B) print on the document the name and address of that officer, principal, responsible person, or partner.

(2)(A) Before preparing any document for filing or accepting any fees from a debtor, the bankruptcy petition preparer shall provide to the debtor a written notice which shall be on an official form prescribed by the Judicial Conference of the United States in accordance with rule 9009 of the Federal Rules of Bankruptcy Procedure.

(B) The notice under subparagraph (A)--

(i) shall inform the debtor in simple language that a bankruptcy petition preparer is not an attorney and may not practice law or give legal advice;

(ii) may contain a description of examples of legal advice that a bankruptcy petition preparer is not authorized to give, in addition to any advice that the preparer may not give by reason of subsection (e)(2); and

(iii) shall--

(I) be signed by the debtor and, under penalty of perjury, by the bankruptcy petition preparer; and

(II) be filed with any document for filing.

(c)(1) A bankruptcy petition preparer who prepares a document for filing shall place on the document, after the preparer's signature, an identifying number that identifies individuals who prepared the document.

(2)(A) Subject to subparagraph (B), for purposes of this section, the identifying number of a bankruptcy petition preparer shall be the Social Security account number of each individual who prepared the document or assisted in its preparation.

(B) If a bankruptcy petition preparer is not an individual, the identifying number of the bankruptcy petition preparer shall be the Social Security account number of the officer, principal, responsible person, or partner of the bankruptcy petition preparer.

(3) [Repealed. Pub.L. 109-8, Title II, § 221(3)(B), Apr. 20, 2005, 119 Stat. 60]

(d) A bankruptcy petition preparer shall, not later than the time at which a document for filing is presented for the debtor's signature, furnish to the debtor a copy of the document.

(e)(1) A bankruptcy petition preparer shall not execute any document on behalf of a debtor.

(2)(A) A bankruptcy petition preparer may not offer a potential bankruptcy debtor any legal advice, including any legal advice described in subparagraph (B).

(B) The legal advice referred to in subparagraph (A) includes advising the debtor--

(i) whether--

(I) to file a petition under this title; or

(II) commencing a case under chapter 7, 11, 12, or 13 is appropriate;

(ii) whether the debtor's debts will be discharged in a case under this title;

(iii) whether the debtor will be able to retain the debtor's home, car, or other property after commencing a case under this title;

(iv) concerning--

(I) the tax consequences of a case brought under this title; or

(II) the dischargeability of tax claims;

(v) whether the debtor may or should promise to repay debts to a creditor or enter into a reaffirmation agreement with a creditor to reaffirm a debt;

(vi) concerning how to characterize the nature of the debtor's interests in property or the debtor's debts; or

(vii) concerning bankruptcy procedures and rights.

(f) A bankruptcy petition preparer shall not use the word “legal” or any similar term in any advertisements, or advertise under any category that includes the word “legal” or any similar term.

(g) A bankruptcy petition preparer shall not collect or receive any payment from the debtor or on behalf of the debtor for the court fees in connection with filing the petition.

(h)(1) The Supreme Court may promulgate rules under section 2075 of title 28, or the Judicial Conference of the United States may prescribe guidelines, for setting a maximum allowable fee chargeable by a bankruptcy petition preparer. A bankruptcy petition preparer shall notify the debtor of any such maximum amount before preparing any document for filing for a debtor or accepting any fee from the debtor.

(2) A declaration under penalty of perjury by the bankruptcy petition preparer shall be filed together with the petition, disclosing any fee received from or on behalf of the debtor within 12 months immediately prior to the filing of the case, and any unpaid fee charged to the debtor. If rules or guidelines setting a maximum fee for services have been promulgated or prescribed under paragraph (1), the declaration under this paragraph shall include a certification that the bankruptcy petition preparer complied with the notification requirement under paragraph (1).

(3)(A) The court shall disallow and order the immediate turnover to the bankruptcy trustee any fee referred to in paragraph (2) found to be in excess of the value of any services--

(i) rendered by the bankruptcy petition preparer during the 12-month period immediately preceding the date of the filing of the petition; or

(ii) found to be in violation of any rule or guideline promulgated or prescribed under paragraph (1).

(B) All fees charged by a bankruptcy petition preparer may be forfeited in any case in which the bankruptcy petition preparer fails to comply with this subsection or subsection (b), (c), (d), (e), (f), or (g).

(C) An individual may exempt any funds recovered under this paragraph under section 522(b).

(4) The debtor, the trustee, a creditor, the United States trustee (or the bankruptcy administrator, if any) or the court, on the initiative of the court, may file a motion for an order under paragraph (2).

(5) A bankruptcy petition preparer shall be fined not more than $500 for each failure to comply with a court order to turn over funds within 30 days of service of such order.

(i)(1) If a bankruptcy petition preparer violates this section or commits any act that the court finds to be fraudulent, unfair, or deceptive, on the motion of the debtor, trustee, United States trustee (or the bankruptcy administrator, if any), and after notice and a hearing, the court shall order the bankruptcy petition preparer to pay to the debtor**--**

(A) the debtor's actual damages;

(B) the greater of--

(i) $2,000; or

(ii) twice the amount paid by the debtor to the bankruptcy petition preparer for the preparer's services; and

(C) reasonable attorneys' fees and costs in moving for damages under this subsection.

(2) If the trustee or creditor moves for damages on behalf of the debtor under this subsection, the bankruptcy petition preparer shall be ordered to pay the movant the additional amount of $1,000 plus reasonable attorneys' fees and costs incurred.

(j)(1) A debtor for whom a bankruptcy petition preparer has prepared a document for filing, the trustee, a creditor, or the United States trustee in the district in which the bankruptcy petition preparer resides, has conducted business, or the United States trustee in any other district in which the debtor resides may bring a civil action to enjoin a bankruptcy petition preparer from engaging in any conduct in violation of this section or from further acting as a bankruptcy petition preparer.

(2)(A) In an action under paragraph (1), if the court finds that--

(i) a bankruptcy petition preparer has--

(I) engaged in conduct in violation of this section or of any provision of this title;

(II) misrepresented the preparer's experience or education as a bankruptcy petition preparer; or

(III) engaged in any other fraudulent, unfair, or deceptive conduct; and

(ii) injunctive relief is appropriate to prevent the recurrence of such conduct,

the court may enjoin the bankruptcy petition preparer from engaging in such conduct.

(B) If the court finds that a bankruptcy petition preparer has continually engaged in conduct described in subclause (I), (II), or (III) of clause (i) and that an injunction prohibiting such conduct would not be sufficient to prevent such person's interference with the proper administration of this title, has not paid a penalty imposed under this section, or failed to disgorge all fees ordered by the court the court may enjoin the person from acting as a bankruptcy petition preparer.

(3) The court, as part of its contempt power, may enjoin a bankruptcy petition preparer that has failed to comply with a previous order issued under this section. The injunction under this paragraph may be issued on the motion of the court, the trustee, or the United States trustee (or the bankruptcy administrator, if any).

(4) The court shall award to a debtor, trustee, or creditor that brings a successful action under this subsection reasonable attorneys' fees and costs of the action, to be paid by the bankruptcy petition preparer.

(k) Nothing in this section shall be construed to permit activities that are otherwise prohibited by law, including rules and laws that prohibit the unauthorized practice of law.

(l)(1) A bankruptcy petition preparer who fails to comply with any provision of subsection (b), (c), (d), (e), (f), (g), or (h) may be fined not more than $500 for each such failure.

(2) The court shall triple the amount of a fine assessed under paragraph (1) in any case in which the court finds that a bankruptcy petition preparer--

(A) advised the debtor to exclude assets or income that should have been included on applicable schedules;

(B) advised the debtor to use a false Social Security account number;

(C) failed to inform the debtor that the debtor was filing for relief under this title; or

(D) prepared a document for filing in a manner that failed to disclose the identity of the bankruptcy petition preparer.

(3) A debtor, trustee, creditor, or United States trustee (or the bankruptcy administrator, if any) may file a motion for an order imposing a fine on the bankruptcy petition preparer for any violation of this section.

(4)(A) Fines imposed under this subsection in judicial districts served by United States trustees shall be paid to the United States trustees, who shall deposit an amount equal to such fines in the United States Trustee Fund.

(B) Fines imposed under this subsection in judicial districts served by bankruptcy administrators shall be deposited as offsetting receipts to the fund established under section 1931 of title 28, and shall remain available until expended to reimburse any appropriation for the amount paid out of such appropriation for expenses of the operation and maintenance of the courts of the United States.

possible (e.g., email, facsimile, or hand delivery) within one business day after the order is entered, unless the court orders otherwise.

LR 9009. LOCAL FORMS.

In addition to the official forms prescribed by the Judicial Conference of the United States, the court may provide additional forms, copies of which are available from the clerk and on the court's website.

LR 9010. ATTORNEYS - NOTICE OF APPEARANCE.

Any corporation, partnership, or other business entity, except when acting as a bankruptcy trustee for a corporation or partnership, must be represented by an attorney.

LR 9011. *PRO SE* PARTIES.

(a) Petition preparers.

(1) When a nonlawyer petition preparer is alleged to be in violation of 11 U.S.C. § 110(b) through (g), the court will find the facts and, if warranted, impose the fines set forth in those provisions.

(2) When the fees charged by a nonlawyer petition preparer are alleged to be excessive, the court will find the facts and, if warranted, disallow the excess fee and order it turned over to the bankruptcy trustee or the debtor as warranted by the facts of the case.

(b) Injunctions against petition preparers under 11 U.S.C. § 110(j).

(1) An action seeking an injunction under 11 U.S.C. § 110(j) must be brought in bankruptcy court.

(2) The bankruptcy court will find the facts and order an injunction if warranted.

(3) The bankruptcy court will award a successful plaintiff its fees and costs in bringing an action under 11 U.S.C. § 110(j)(3).

(c) Certification of facts to the district court under 11 U.S.C. § 110(i).

(1) A certification of facts proceeding under 11 U.S.C. § 110(i) starts in bankruptcy court on a motion by the debtor, the trustee, a creditor, or on the court's own motion. The court must:

(A) Give notice to the accused preparer; and

(B) Conduct a hearing before certifying facts to the district court.

(2) In its certification to the district court, the bankruptcy court will include:

(A) Findings of fact it made during the bankruptcy proceeding;

(B) The transcript and the record in the proceeding;

(C) The court's finding of the debtor's actual damages under 11 U.S.C. § 110(i)(1)(A);

(D) The court's finding as to whether the greater sum for inclusion in the penalty under 11 U.S.C. § 110(i)(1)(B) is $2,000 or twice the amount paid by the debtor to the preparer; and

(E) The court's finding as to the amount of the movant's reasonable attorney's fees and costs in connection with the certification proceedings.

(3) When it issues its decision and certifies facts to the district court, the bankruptcy court will also advise the prevailing party in the bankruptcy proceeding that it should file a motion in the district court for imposition of further sanctions under 11 U.S.C. § 110(i).

(4) When the certification of facts is before the district court:

(A) No in-person hearing is required unless the court directs otherwise;

(B) At the hearing, no new evidence will be received, and the hearing will be on the record only;

(C) Only the affected parties will be allowed to submit briefs;

(D) The bankruptcy court's findings of fact will be reviewed under the abuse of discretion standard; and

(E) The bankruptcy court's conclusions of law will be reviewed de novo.

(d) Petition preparer guidelines. The United States trustee may issue guidelines in connection with the provisions of 11 U.S.C. § 110 setting forth positions that the trustee will generally follow in relation to petition preparers. The trustee may revise the guidelines, and when they are revised, they will be reissued in full with a notation of the effective date of the revision. Copies of the guidelines will be available from the United States trustee.

LR 9014. MOTION PRACTICE AND CONTESTED MATTERS - BRIEFS AND MEMORANDA OF LAW.

(a) Hearings and court calendars.

(1) Unless the court directs otherwise, all hearings (including motions in adversary proceedings, objections and other matters for which a hearing is necessary) must be set by counsel or persons acting *pro se* on the calendar of the judge to whom the case is assigned. The court may set any matter for hearing whether or not a hearing is required by statute or rules.

(2) Each judge will maintain a motion calendar and may adopt specific court

BRIEF BANK — "SUMMARY SHEET" *Printed Mon-5/23/11 14:12*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*
In re Gregory E. Perkins and Laura M. Perkins, et al. (Gregory E. Perkins and Laura M. Perkins, MGP Auburn Greshem, LLC, MGP Kedizie Motzart, LLC I and MGP Kedzie Motzart, LLC II)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*
N.D. Ill.

3. ("CCN") ***CURRENT*** CASE NO.
No.: 1:09-cv-02742

4. ("PCN") ***PRIOR*** CASE NO. - & COURT *[IF ANY]*
No.: 08-21919
Court: Bankr. N.D. Ill.
(Identify judge & cite, if any)

5. ("SO") ***SOURCE***
U.S. TRUSTEES

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*
Filed: July 2, 2009
Type: Appellee United States Trustee's Responsive Brief

7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*
Cameron M. Gulden, Paul Bridenhagen, P. Matthew Sutko, William T. Neary
_
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***

- Whether the district court abused its discretion under 11 U.S.C. §§ 1112(b)(4)(F) and (b)(4)(K) in converting the debtors' four chapter 11 cases to cases under chapter 7, where (a) none of the three corporate debtors nor the individual debtors paid any statutorily-required fees at any point during their chapter 11 cases, (b) the individual debtors repeatedly failed to timely file their monthly operating reports ("MORs"), and (c) the three corporate entities either failed to file any MORs or filed shell documents entitled MORs but which contained no financial information whatsoever.

10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)

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IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

In re: GREGORY E. PERKINS and	)	
LAURA M. PERKINS, *et al*.	)	BANKR. CASE NOS. 08-21919,
	)	08-33409, 08-33410 and 08-33411
Debtors	)	
	)	
GREGORY E. PERKINS and	)	
LAURA M. PERKINS,	)	CASE NO. 09 C 02742-21919
	)	
MGP AUBURN GRESHEM, LLC,	)	
	)	
MGP KEDZIE MOTZART, LLC I and	)	
	)	
MGP KEDZIE MOTZART, LLC II,	)	HON. BLANCHE M. MANNING
	)	
Appellants,	)	
	)	
v.	)	
	)	
WELLS FARGO BANK, N.A.,	)	
	)	
LASALLE BANK, N.A, and	)	
	)	
WILLIAM T. NEARY,	)	
UNITED STATES TRUSTEE,	)	
	)	
Appellees.	)	

APPELLEE UNITED STATES TRUSTEE'S RESPONSIVE BRIEF

Cameron M. Gulden
UNITED STATES DEPARTMENT OF JUSTICE
OFFICE OF THE UNITED STATES TRUSTEE
219 South Dearborn Street, Room 873
Chicago, Illinois 60604
Telephone (312) 886-2614

Attorney for the Appellee,

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BASIS OF APPELLATE JURISDICTION

The United States Bankruptcy Court for the Northern District of Illinois had jurisdiction over these four bankruptcy cases under 28 U.S.C. § 157(b) and § 1334. On March 19, 2009, the bankruptcy court issued a final order under 11 U.S.C. § 1112(b) converting those four Chapter 11 cases into cases under Chapter 7 of the Bankruptcy Code. The Debtors timely filed a notice of appeal of that final order on March 26, 2009. This Court, therefore, has jurisdiction to hear this appeal from the bankruptcy court under 28 U.S.C. § 158(a).

STATEMENT OF THE ISSUE

Whether the bankruptcy court abused its discretion under 11 U.S.C. §§ 1112(b)(4)(F) and (b)(4)(K) in converting the Debtors' four Chapter 11 cases to cases under Chapter 7, where (a) none of the three corporate Debtors nor the individual Debtors paid any statutorily-required fees at any point during their Chapter 11 cases, (b) the individual Debtors repeatedly failed to timely file their monthly operating reports ("MORs"), and (c) the three corporate entities either failed to file any MORs or filed shell documents entitled MORs but which contained no financial information whatsoever.

APPLICABLE STANDARD OF REVIEW

A bankruptcy court's decision to dismiss or convert a Chapter 11 case for cause is reviewed for an abuse of discretion. *In re Woodbrook Assocs.*, 19 F.3d 312, 316 (7th Cir. 1994); *Han v. Linstrom*, 2002 WL 31049846, at *4 (N.D. Ill. Sept. 12, 2004). This Court reviews the bankruptcy court's findings of fact under the clearly erroneous standard, and reviews conclusions of law under the *de novo* standard. *Woodbrook Assocs.*, 19 F.3d at 316.

STATEMENT OF THE CASE

The Debtors appeal an order of the United States Bankruptcy Court for the Northern District of Illinois converting four administratively-consolidated Chapter 11 cases to cases under Chapter 7. Docket of *In re Gregory and Laura Perkins dba MGP Global Real Estate LLC*, No. 08-21919 (hereinafter "Perkins Dkt.") Dkt. #167. Under Chapter 11 (11 U.S.C. §§ 1101-1174) of the Bankruptcy Code, debtors are generally provided the opportunity retain their assets and to reorganize their finances pursuant to a plan of reorganization. Chapter 7 (11 U.S.C. §§ 701-784), in contrast, provides for an orderly liquidation of a debtor's assets and provides that debtors may retain only limited amounts of certain exempt assets.

The bankruptcy court's order converting the Debtors' cases was issued pursuant to the Motion of the United States Trustee to Dismiss or Convert Cases. Perkins Dkt. #151.[1] In their brief, Debtors' apparently concede that the bankruptcy court did not abuse its discretion by converting the case of the individual debtors and the cases of MGP I and MGP II. They argue only that the bankruptcy court abused its discretion by converting one of the corporate cases, Kedzie Motzart case. Appellants' Brief at 12.

On March 30, 2009, the Debtors filed a motion asking the bankruptcy court to make additional findings, Perkins Dkt. #178, and by order dated April 2, 2009, that motion was stricken. Perkins Dkt. #182. Although that April 2, 2009, order is addressed in Appellants' Brief (at 12-15), the Debtors did not file a notice of appeal concerning that order.

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[1] Debtors' notice of appeal identifies another order, also entered on March 19, 2009, concerning a motion to lift the automatic stay, filed on behalf of Appellee LaSalle Bank. The United States Trustee takes no position on Debtors' appeal of that order and does not address it herein.

STATEMENT OF THE FACTS

Gregory and Laura Perkins ("Perkins" or "individual Debtors") filed their individual Chapter 11 case, No. 08-21919, on August 20, 2008. Perkins Dkt. #1. Petitions were filed under Chapter 11 on behalf of the three corporate Debtors, MGP Auburn Greshem I, LLC, No. 08-33410 ("MGP I"), MGP Auburn Greshem II, LLC, No.08-33409 ("MGP II") and MGP Kedzie Motzart, LLC, No. 08-33411 ("KM" or "Kedzie Motzart") on December 5, 2008. MGP I Dkt. #1, MGP II Dkt. #1 and KM Dkt. #1. MGP I, MGP II and KM are property-owning-and-managing Limited Liability Corporations and Debtor Gregory Perkins holds the position of the managing member of each of them. MGP I Dkt. #1, MGP II Dkt. #1 and KM Dkt. #1. In addition, each Chapter 11 petition was signed by Mr. Perkins in his capacity as the managing member.[2] At the time the corporate cases were filed, however, Mr. Perkins was not in control of the corporate Debtors, as each of the Debtors was in receivership. *See generally* MGP I Dkt. #42, MGP II Dkt. #37 and KM Dkt. #30 (Motions to Compel Receiver to Turn Over Property to the Debtor). *See also* March 18, 2009, Transcript at pp. 5-6 (stating Debtors not in control of assets). On January 7, 2009, pursuant to the Debtors' motion, the bankruptcy court entered an order providing for the joint administration of the corporate cases with the individual Debtors' case, No. 08-21919. Perkins Dkt. # 95.

During the four months from the time the Chapter 11 cases of MGP I, MGP II and KM were filed in December 2008 to the day those cases were converted in March 2009, none of the

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[2] Gregory and Laura Perkins have ownership interests in MGP I of 51% and in MGP II of 47%. Appellant's Brief at 5-6. The record does not reflect what ownership interest they have, if any, in Kedzie Motzart.

corporate Debtors filed any substantive monthly operating reports ("MORs").[3] Further, no statutory fees due under 28 U.S.C. § 1930(a)(6) were paid in any of the cases of MGP I, MGP II and KM. Perkins Dkt. #151. Similarly, Gregory and Laura Perkins paid no statutory fees during the seven months from the time they filed their case in August 2008 to the day their case was converted in March 2009, which included the third and fourth quarters of 2008. Perkins Dkt. #151. The individual Debtors also did not timely file their MORs for August, September, October and November 2008, but instead filed them collectively on January 13, 2009. Perkins Dkt. #103-105. They later filed their December 2008 and January 2009 MORs on March 7, 2009. Perkins Dkt. #136-137. The February 2009 MOR was never filed. See Perkins Dkt.

On March 11, 2009,[4] the United States Trustee filed a motion to dismiss or convert the cases, based on the Debtors' failure to file MORs and their failure to pay quarterly fees under 28 U.S.C. § 1930(a)(6). Perkins Dkt. #151.[5] The motion was set to be heard on shortened notice as requested on March 18, 2009. Perkins Dkt. #151. Initially, the Debtors stated they had no

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[3] Sections 1107(a), 1106(a)(1) and 704(8) of the Bankruptcy Code requires debtors in possession to file reports showing receipts and the disposition of money and property received, changes in liability and assets, disbursements made, and verification of timely payment of its ongoing obligations, including taxes. Fed. R. Bankr. P. 2015(a)(3). The United States Trustee requires Chapter 11 debtors to submit these reports on a monthly basis. *See* United States Trustee Manual, Volume 3: Chapter 11 Case Administration, Subchapter 3-3.3 (Financial Reports), available at http://www.usdoj.gov/ust/eo/ust_org/ustp_manual/volume3/vol3ch03.htm#3-3.3 *For a discussion of the importance of MORs, see infra,* at 7- 8.

[4] Although the docket indicates the United States Trustee's motion was filed on March 9, 2009, the United States Trustee actually filed the motion on March 11, 2009, as indicated on the motion itself.

[5] The transcript from the March 18, 2009, hearing indicates that Mr. Driscoll, counsel for a secured lender, handed the motion to dismiss or convert to the bankruptcy judge for the clerk to file and serve. However, this is simply a transcription error, since the motion is signed by the United States Trustee and is reflected properly on the docket.

objection to the motion and informed the bankruptcy court they would be "converting the cases to a chapter 7 at this point . . . ." March 11, 2009, Transcript at p. 9. On the day the United States Trustee's motion was to be heard, counsel for the Debtors appeared in court with an "Emergency Motion Pursuant to Bankruptcy Rules 9023 and 9024" that was filed that same day and sought to (a) amend the order entered at the end of trial on a motion to lift the stay in MGP II case and (b) delay any ruling on the United States Trustee's motion to dismiss or convert. Perkins Dkt. #153. Because neither the Court, the United States Trustee, nor the creditors that were present had an opportunity to review the motion, the hearing on both the Emergency Motion and the United States Trustee's Motion to Dismiss or Convert were continued to the following day. Perkins Dkt. #157.

On March 19, 2009, the Debtors' Emergency Motion was denied because the Debtors offered no new evidence. March 19, 2009, Transcript at p. 32. The bankruptcy court then granted the United States Trustee's motion and converted each of the Debtors' Chapter 11 cases to Chapter 7. Perkins Dkt. #167. On March 26, 2009, the Debtors filed their notice of appeal. Perkins Dkt. #174. Later, on March 30, 2009, the Debtors filed a motion asking the bankruptcy court to make additional findings, Perkins Dkt. #178, and on April 2, 2009, that motion was stricken. Perkins Dkt. #182.

SUMMARY OF ARGUMENT

The March 19, 2009, order that is the basis for this appeal converted all four of the Debtors' cases. The Debtors' appellate brief challenges only the order converting Kedzie Motzart and does not challenge the court's order converting either the individual debtors' case or the cases of MGP I and MGP II. With respect to Kedzie Motzart, Debtors do not dispute the fact that

Kedzie Motzart did not timely file MORs throughout the case, nor do they claim that the statutory fees owed under 28 U.S.C. § 1930(a)(6) were ever paid. Consequently, the record supports the bankruptcy court's decision to dismiss that case for failure of Kedzie Motzart to timely file its MORs and for failing to pay statutory fees. The Debtors only argument that the bankruptcy court abused its discretion in converting the Kedzie Motzart case is the claim that the bankruptcy court failed to recognize an alleged financing agreement that Debtors claimed existed for the benefit of Kedzie Motzart. However, that in no way changes the fact that the Debtor's failure to file reports or pay fees formed an independent basis to convert, which merits affirmance regardless of any alleged financing agreement.[6]

I. THE BANKRUPTCY COURT DID NOT ABUSE ITS DISCRETION BY CONVERTING THE KEDZIE MOTZART CASE, BECAUSE THE DEBTORS' FAILURE TIMELY TO FILE MONTHLY OPERATING REPORTS AND PAY STATUTORY FEES WAS CAUSE FOR DISMISSAL UNDER SECTION 1112(B)(4)(F) AND (B)(4)(K)

Although the March 19, 2009, order converted the four cases of the individual and corporate Debtors, Debtors contend only that the bankruptcy court abused its discretion in converting the Kedzie Motzart case, Case No. 08-33411. Appellants' Brief at 12. Because the Debtors do not argue in their brief that the bankruptcy court abused its discretion by converting either the case of the individual Debtors or the cases of MGP I and MGP II, they appear to concede that the March 19, 2009, order converting those cases can be affirmed. The United States Trustee will therefore limit his discussion of conversion under § 1112(b) to the Kedzie Motzart case.

Section 1112(b) of the Bankruptcy Code enables the court to administer Chapter 11 cases

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[6] Debtors, however, — to the extent that such an agreement might have affected the bankruptcy court's decision on the motion to dismiss or convert — failed to offer any admissible evidence to establish the existence of such an agreement at the hearing on the United States Trustee's motion to dismiss or convert.

on its docket, and specifically "grants the authority to convert or dismiss a chapter 11 case to one under chapter 7." *In re Johnson*, 2008 WL 696917, at *6 (Bankr. E.D. Pa. Mar. 11, 2008); *see also In re Kholyavka*, 2008 WL 3887653, at *3 (Bankr. E.D. Pa. Aug. 20 2008) (citing *In re Timbers of Inwood Forest*, *Ltd.*, 808 F.2d 363, 371 (5th Cir. 1987)).

The United States Trustee's motion to dismiss or convert stated two grounds: (1) that the Debtors failed to file required MORs, and (2) that the Debtors failed to pay any of the quarterly fees due under 28 U.S.C. § 1930(a)(6). These grounds are two of the nonexclusive examples of "cause" for dismissal or conversion expressly set forth in section 1112(b). *In re Johnson*, 2008 WL 696917, at *6. In this regard, the pertinent portions of subsection 1112(b) provide as follows:

> (4) For purposes of this subsection. The term cause" includes –
>
> * * *
>
> (F) unexcused failure to satisfy timely any filing or reporting requirement established by this title or by any rule applicable to a case under this chapter;
>
> * * *
>
> (K) failure to pay any fees or charges required under chapter 123 of title 28;
>
> * * *

The Debtors do not dispute the United States Trustee's contention that Kedzie Motzart filed no MORs during its Chapter 11 case, nor do they claim that Kedzie Motzart paid any of the statutory fees owed. *See* Appellants' Brief at 12. Though Appellants never address the issue in their brief, the failure to file timely monthly operating reports "is a serious breach of the debtor's fiduciary obligations and 'undermines the Chapter 11 process.'" *In re Rey*, 2006 WL 2457435, at *8 (Bankr. N.D. Ill. Aug. 21, 2006) (*quoting All Denominational Church*, 268 B.R. 536, 538 (B.A.P. 8th Cir. 2001)).[7] MORs are "'the life blood' of chapter 11, enabling creditors to keep tabs on the debtor's post-petition operations." *Id.* (*quoting In re Berryhill*, 127 B.R. 427, 433 (Bankr. N.D. Ind. 1991)). Failure to file MORs has consistently been held to be grounds for dismissal, and "[e]ven before the amendment of § 1112 to expressly identify failure to timely file operating reports as cause for dismissal or conversion under § 1112(b), such relief was the consequence to debtors who did not discharge that duty." *In re Kholyavka*, 2008 WL 3887653, at *4 (referencing pre-BAPCPA case of *In re Rey*, 2006 WL 2457435).

"A debtor seeking relief in a bankruptcy court must travel a two-way street," *In re Kang*, 18 B.R. 680 (Bankr. N.D. Ill. 1982), and filing timely MORs "is a *quid pro quo* for the protection the debtor enjoys under the reorganization provisions of the Bankruptcy Code." *In re Kholyavka*, 2008 WL 3887653, at *4. The "failure to file monthly operating reports, whether based on inability to do so or otherwise, undermines the Chapter 11 process and constitutes cause for dismissal or conversion of the Chapter 11 proceeding." *All Denominational Church*, 268 B.R. at 538.

A debtor's failure to pay the quarterly, statutory fees required under 28 U.S.C. § 1930(a)6), is equally recognized as cause for dismissal or conversion of a Chapter 11 case. *See, e.g., In re Tornheim*, 181 B.R. 161, 164 (Bankr. S.D.N.Y. 1995) (holding that "[t]his omission without more, provides cause to convert or dismiss the case"); *In re Markhorn Indus.*,

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[7] The *Rey* and *All Denominational Church* cases involved cases filed prior to 2005, in which the failure to file MORs was a cause for conversion or dismissal that was not expressly listed under a prior version of the statute, but rather was developed under case law. *In re Rey*, 2006 WL 2457435, at *8. Section 1112(b) was amended pursuant to the Bankruptcy Abuse and Consumer Protection Act of 2005, Pub. L. No. 109-8, to include section 1112(b)(4)(F), which made the failure to timely file such reports an express cause for conversion or dismissal.

Inc. 100 B.R. 432, 434-35 (Bankr. N.D. Ill. 1989) (finding that cause exists where debtor has no funds to pay fees); *see also In re Motorworks, Inc.*, 85 B.R. 661, 662 (Bankr. S.D. Ga. 1988) (dismissing case based in part on unpaid fees where debtor had no apparent prospect of paying fees).

The record in this case concerning Kedzie Motzart's failure to file any MORs or to pay any statutory fees is undisputed and there is, consequently, a solid factual and legal basis supporting the bankruptcy court's decision to convert the cases under § 1112(b)(4)(F) ("unexcused failure to satisfy timely any filing or reporting requirement ") and § 1112(b)(4)(K) ("failure to pay any fees or charges required under chapter 123 of title 28").

The only argument raised by the Debtors in support of their claim that the bankruptcy court abused its discretion by converting the Kedzie Motzart case is the contention that Kedzie Motzart had entered into an agreement with American Chartered Bank to complete financing within 45 days. Appellant's Brief at 12. Even if true, it would not change the fact that the bankruptcy court properly converted the Kedzie Motzart case under subsections 1112(b)(4)(F) and (b)(4)(K). Therefore, the order should be affirmed because the Debtors do not suggest that the bankruptcy court lacked cause to convert under subsections 1112(b)(4)(F) and (b)(4)(K).

In any event, the Debtors had only offered into evidence a commitment letter setting forth the terms of the alleged financing agreement. March 19, 2009, Transcript at 2. The bankruptcy court held, however, that the proffered document was not evidence admissible to support Kedzie Motzart's claim that it had arranged needed financing. March 19, 2009, Transcript at 32. Specifically, in connection with its denial of the debtor's emergency motion, the bankruptcy court stated that the debtors didn't "have anybody from any lender who is willing to state under oath a position that is parallel to [the] hearsay documents" that Debtors offered, unsuccessfully, as evidence of such an agreement. *Id.*

In their brief, the Debtors contend that they were somehow disadvantaged by the absence, with the permission of the bankruptcy court, of the attorney for creditor American Chartered Bank. Debtors do not claim, however, that at the March 19, 2009, hearing they had a fact witness who was available and willing to testify that the alleged agreement actually existed and they did not proffer such a witness at the hearing. *See generally* March 19, 2009, Transcript. Therefore, to the extent that such an agreement might have somehow affected the bankruptcy court's decision on the motion to dismiss or convert, Debtors failed to offer any admissible evidence to establish the existence of such an agreement at the hearing on the United States Trustee's motion.

II. THE ORDER DENYING THE RULE 7052 MOTION WAS NOT APPEALED AND ANY RELATED ISSUES ARE NOT PROPERLY BEFORE THIS COURT.

The cases were converted on March 19, 2009, and from that order the Debtors appealed on March 26, 2009. Perkins Dkt. Entry #174. The Rule 7052 motion was not filed until March 30, Perkins Dkt. Entry #178, after the bankruptcy court had already been divested of jurisdiction under 28 U.S.C. § 158(a) and the order striking that motion was entered on April 2, 2009. Perkins Dkt. Entry #182. That order was never appealed, the 10 days allowed under Rule 8002(a) having long since passed, and any issues regarding the separate Rule 7052 motion and subsequent order are not properly before this Court.

CONCLUSION

For these reasons, the United States Trustee respectfully requests the Court affirm the order entered below.

Respectfully submitted,

William T. Neary
UNITED STATES TRUSTEE

Dated: July 2, 2009

/S/ Cameron M. Gulden
Cameron M. Gulden
UNITED STATES DEPARTMENT OF JUSTICE
OFFICE OF THE UNITED STATES TRUSTEE
219 South Dearborn Street, Room 873
Chicago, Illinois 60604
(312) 886-2614

CERTIFICATE OF SERVICE

I, Cameron M. Gulden, an attorney, state that the above United States Trustee's Responsive Brief was filed on July 2, 2009, and served on all parties identified as Registrants on the service list below through the Court's Electronic Notice for Registrants and, as to all other parties on the service list below, I caused a copy to be sent via First Class Mail to the address(es) indicated on July 2, 2009.

/s/ Cameron M. Gulden

SERVICE LIST

Registrants Served Through the Court's Electronic Notice For Registrants

Mark E. Abraham mabraham@gouldratner.com

Kevin A Ameriks kameriks@bnrpc.com, kevina@gmail.com

Amy A Aronson amyaronson@comcast.net, amyaronson@comcast.net

Brian A. Audette baudette@perkinscoie.com

Darren L Besic dbesic@aol.com

A Stewart Chapman northerndistrict@atty-pierce.com, schapman@atty-pierce.com

David E Cohen davidecohen@lawcohen.com

Rufus Cook cook-revak@ameritech.net

Kevin C. Driscoll kevin.driscoll@btlaw.com, kathy.bruhnke@btlaw.com

Kenneth B Drost kdrost@kbdpc.com, rsmith@kbdpc.com

J Mark Fisher mfisher@schiffhardin.com, edocket@schiffhardin.com; sricciardi@schiffhardin.com

Karen R Goodman kgoodman@shefskylaw.com, il24@ecfcbis.com;sfdocket@shefskylaw.com

Michael J Halpin mhalpin@atty-pierce.com, northerndistrict@atty-pierce.com

Fred R Harbecke fredrharbecke@sbcglobal.net

Forrest L Ingram fingram@fingramlaw.com

Michael J McKitrick mmckitrick@dmfirm.com

William T Neary USTPRegion11.ES.ECF@usdoj.gov

John O. Noland Jr. nolandjohn@sbcglobal.net

Guy M Petruzzelli gpetruzzelli@noonanandlieberman.com, knoonan@noonanandlieberman.com

Christopher H Purcell shermlaw13@aol.com

Steven R Rappin dolswang@hrolaw.com, rarredondo@hrolaw.com

Deborah L. Thorne dthorne@btlaw.com, kbruhnke@btlaw.com

David S Yen dyen@lafchicago.org, davidsyen@yahoo.com

Parties Served via First Class Mail

Gregory E. Perkins
Laura M. Perkins
13723 Legend Trail Lane
Orland Park, IL 60462

BRIEF BANK — 'SUMMARY SHEET" *Printed Fri-12/1/06 11:5*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE
[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]

In re Perlin

2. ("CO") ***CURRENT*** COURT
[E.g., "CTA9"]

CTA3

3. ("CCN") ***CURRENT*** CASE NO.

No.: 06-3199

4. ("PCN") ***PRIOR*** CASE NO.
& COURT
[IF ANY]

No.:

Court: Bankr. MD Pa.

(Identify judge & cite, if any)

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U.S. TRUSTEES

6. ("DA") ***DATE*** OF FILING
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7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*

Isaac J. Lidsky, Attorney Civil Division

(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***

BANKRUPTCY

9. ("SU") ● ***SUMMARY*** OF KEY ISSUE(s)

&

√ Any Miscellaneous ***BACKGROUND***

● Whether a bankruptcy court may consider a business debtor's income and expenses when assessing the debtor's good faith in filing a bankruptcy petition pursuant to a motion to dismiss for cause under 11 U.S.C. § 707(a).

√ **Background:**

10. PATH TO FILE LOCATION:
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No. 06-3199

IN THE UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

IN RE: STEVEN PERLIN, ET AL.

Hitachi Capital America Corp.,

Appellant

ON APPEAL FROM THE UNITED STATES BANKRUPTCY COURT
FOR THE MIDDLE DISTRICT OF PENNSYLVANIA

BRIEF FOR THE UNITED STATES TRUSTEE AS *AMICUS CURIAE* SUPPORTING REVERSAL

OF COUNSEL:

ROBERTA A. DEANGELIS
Acting General Counsel

WALTER THEUS
P. MATTHEW SUTKO
Attorneys, Office of the General Counsel
Executive Office for United States Trustees
Department of Justice
20 Massachusetts Avenue, NW
Washington, DC 20530

PETER D. KEISLER
Assistant Attorney General

ROBERT M. LOEB
(202) 514-4332
ISAAC J. LIDSKY
(202) 514-3180
Attorneys, Appellate Staff
Civil Division, Room 7217
Department of Justice
950 Pennsylvania Avenue NW
Washington, DC 20530-0001

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No. 06-3199

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Hitachi Capital America Corp.,

Appellant

ON APPEAL FROM THE UNITED STATES BANKRUPTCY COURT
FOR THE MIDDLE DISTRICT OF PENNSYLVANIA

BRIEF FOR THE UNITED STATES TRUSTEE
AS *AMICUS CURIAE* SUPPORTING REVERSAL

STATEMENT OF INTEREST OF THE UNITED STATES TRUSTEE

The United States Trustee supervises the administration of bankruptcy cases throughout the United States. 28 U.S.C. § 581–89. United States Trustees “serve as bankruptcy watch-dogs to prevent fraud, dishonesty, and overreaching in the bankruptcy arena.” S. Rep. No. 989, 95th Cong., 2d Sess. 88 (1978). The United States Trustee Program thus acts in the public interest to promote the efficiency and to protect and preserve the integrity of the bankruptcy system. To this end, Congress has provided that "[t]he United States trustee may raise and may appear and be heard on any issue in any case or proceeding." 11 U.S.C. § 307.

The United States Trustee regularly moves under 11 U.S.C. § 707(a) to dismiss bankruptcy petitions filed in bad faith.[1] That provision is a critical tool with which the United States Trustee sanctions and deters fraud upon, and abuses of, the bankruptcy system.

By dramatically limiting the scope of § 707(a), the district court's erroneous construction undermines the United States Trustee's—and bankruptcy courts'—ability to protect creditors (and the institution of bankruptcy) from petitions filed in bad faith by debtors with primarily non-consumer debts ("business debtors").

Moreover, a number of federal agencies, including the Department of Housing and Urban Development, the Commerce Department's Economic Development Administration, the Small Business Administration, the Internal Revenue Service, and the Federal Deposit Insurance Corporation, regularly appear as creditors in chapter 7 proceedings. Thus, the United States also has a direct interest in preventing debtors

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[1] The United States Trustee employs the recently amended 11 U.S.C. § 707(b) to move to dismiss petitions for cause when debtors primarily have consumer debts. Section 707(b)(2)'s "means test" defines a formula that triggers a rebuttable presumption that a petition should be dismissed. Section 707(b)(3) alternatively provides for the dismissal of consumer debt petitions when "the debtor filed the petition in bad faith" or "the totality of the circumstances . . . of the debtor's financial situation demonstrates abuse."

who have the ability to repay some or all of their debts from filing in bad faith under chapter 7 in order to have those debts discharged.

STATEMENT OF THE ISSUE PRESENTED

Whether a bankruptcy court may consider a business debtor's income and expenses when assessing the debtor's good faith in filing a bankruptcy petition pursuant to a motion to dismiss for cause under 11 U.S.C. § 707(a).

STATEMENT[2]

Dr. Perlin is a radiologist. Along with his wife, he owned and operated a medical imaging clinic, which leased imaging equipment from Hitachi. The Perlins personally guaranteed the unsecured lease obligations to Hitachi. Their clinic went out of business, and Dr. and Mrs. Perlin subsequently filed a chapter 7 bankruptcy petition. Their schedules and statements of affairs reflect approximately $31,000 per month in income and approximately $31,000 in monthly living expenses. The Perlins' debts are primarily business debts.

Soon after the filing of the petition, Hitachi filed a motion to dismiss the case under 11 U.S.C. § 707(a), alleging that the petition was filed in bad faith.[3] According

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[2] The facts giving rise to this dispute are set forth in greater detail in Appellant's opening brief.

[3] Section 707(a) states:

(continued...)

to Hitachi, the bankruptcy was the latest in a number of strategies that the debtors had adopted to avoid paying their unsecured obligation to Hitachi of approximately $1.2 million. In its motion to dismiss, Hitachi described in detail the debtors' lavish lifestyle and asserted that the debtors had made no effort to cut expenses or to otherwise free up any funds for the payment of their debts.

In denying the motion to dismiss, the bankruptcy court concluded that it was prohibited from considering a debtor's monthly income and expenses when assessing the good faith of a debtor's bankruptcy petition under 11 U.S.C. § 707(a). Because most of the debtor's obligations arose from their imaging business § 707(b) of the Bankruptcy Code—which applies when the debtor's "debts are primarily consumer debts"—is not applicable to the Perlins' petition. The court reasoned that Congress, by expressly enacting § 707(b) to limit the availability of chapter 7 relief for consumer

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[3](...continued)
The court may dismiss a case under this chapter only after notice and a hearing and only for cause, including --

(1) unreasonable delay by the debtor that is prejudicial to creditors;

(2) nonpayment of any fees or charges required under chapter 123 of title 28; and

(3) failure of the debtor in a voluntary case to file, within fifteen days or such additional time as the court may allow after the filing of the petition commencing such case, the information required by paragraph (1) of section 521, but only on a motion by the United States trustee.

debtors who could afford to repay some of their debts from income, implicitly prohibited courts from considering a debtor's ability to repay when determining if a case should be dismissed for bad faith under § 707(a).

Hitachi now appeals, arguing that bankruptcy courts can consider business debtors' ability to repay under § 707(a).

ARGUMENT

A BANKRUPTCY COURT CAN CONSIDER A DEBTOR'S INCOME AND EXPENSES WHEN ASSESSING A DEBTOR'S BAD FAITH PURSUANT TO A MOTION TO DISMISS FOR CAUSE UNDER 11 U.S.C. § 707(a).

A. The purpose of the Bankruptcy Code is to "relieve the honest debtor from the weight of oppressive indebtedness, and permit him to start afresh free from the obligations and responsibilities consequent upon business misfortunes." Williams v. U.S. Fidelity & Guaranty Co., 236 U.S. 549, 554–55 (1915) (emphasis added). The Code gives to the "honest but unfortunate debtor who surrenders for distribution the property which he owns at the time of bankruptcy, a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of pre-existing debt." Local Loan Co. v. Hunt, 292 U.S. 234, 244 (1934) (internal citations omitted, emphasis added). This Court has long recognized bankruptcy courts' broad, equitable authority to achieve those ends. See, e.g., 11 U.S.C. § 105(a)

("The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title."); In re Owens Corning, 419 F.3d 195, 209 n.13 (3d Cir. 2005) (construing § 105(a)'s grant of authority broadly to authorize the equitable remedy of substantive consolidation).

Concordant with a bankruptcy court's broad authority is its obligation under § 707(a) to "decide whether [a] petitioner has abused the provisions, purpose, or spirit of bankruptcy law" by filing a petition in bad faith. In re Tamecki, 229 F.3d 205, 207 (3d Cir. 2000). The breadth and equitable nature of bankruptcy courts' authority underpins the basis for and methodology of a § 707(a) analysis; that provision empowers bankruptcy courts' to guard against abuses of the Bankruptcy Code through a searching, totality of the circumstances inquiry. See, e.g., ibid.; In re Integrated Telecom Express, Inc., 384 F.3d 108, 119 (3d Cir. 2004).

It is thus fundamentally inconsistent with both the nature of bankruptcy courts' authority and the purpose of § 707(a) to restrict the factors a bankruptcy court may properly consider when deciding whether a petition was filed in bad faith. In short, there is no basis for excluding debtors' income and expenses from this analysis. And doing so needlessly sanctions, if it does not invite, abuse of the Bankrtuptcy Code by forcing the bankruptcy court to turn a blind eye to evidence that may directly demonstrate a debtor's bad faith.

B. This Court's precedent clearly allows (indeed encourages) a bankruptcy court to consider a debtor's income and expenses when it assesses the debtor's bad faith in filing a chapter 7 petition under an 11 U.S.C. § 707(a) motion to dismiss.

"Section 707(a) allows a bankruptcy court to dismiss a petition for cause if the petitioner fails to demonstrate his good faith in filing." Tamecki, 229 F.3d at 207 (citing In re Zick, 931 F.2d 1124, 1126-27 (6th Cir. 1991); In re Marks, 174 B.R. 37, 40 (E.D. Pa. 1994)); see also In re Lilley, 91 F.3d 491 (3d Cir. 1996) (Chapter 13 case may be dismissed for lack of good faith); In re SGL Carbon Corp., 200 F.3d 154 (3d Cir. 1999) (lack of good faith may constitute "cause" for dismissal of Chapter 11 case).[4]

"Whether the good faith requirement has been satisfied is a 'fact intensive inquiry' in which the court must examine 'the totality of facts and circumstances' and

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[4] Like this case, Tamecki concerned the debtor's anticipated ability to repay his debts. The debtor filed his bankruptcy petition in anticipation of the finalization of divorce proceedings that would dissolve his tenancy by the entirety with his spouse and result in his receipt of sufficient money to both repay his debts and to give him a financial fresh start. The Tamecki court found that this combination of circumstances was sufficient to support the bankruptcy court's determination that the debtor had not filed in good faith. Id. at 208. Considered in the context of the instant dispute, Tamecki illustrates the impropriety of the legal rule announced by the bankruptcy court. At the core of Tamecki was the idea that the debtor was able to pay (some portion of) his debts and his invocation of bankruptcy's protections was thus in bad faith. That Tamecki's anticipated ability to repay his debts came not from income but instead from a sale of property should not matter in the bad faith analysis.

determine where a ‘petition falls along the spectrum ranging from the clearly acceptable to the patently abusive.’” Integrated Telecom Express, 384 F.3d at 119 (quoting SGL, 200 F.3d at 162). “[C]ourts in this circuit have uniformly held that ‘[a]t the very least, good faith requires a showing of honest intention.’” Tamecki, 229 F.3d at207 (quoting Marks, 174 B.R. at 40). “Dismissal based on lack of good faith * * * is generally utilized only in those egregious cases that entail concealed or misrepresented assets and/or sources of income, lavish lifestyles, and intention to avoid a large single debt based upon conduct akin to fraud, misconduct or gross negligence.’” Ibid. (quoting Zick, 931 F.2d at 1129) (emphasis added). “Courts can determine good faith only on an ad hoc basis * * *, and the decision to dismiss a petition for lack of good faith rests within the sound discretion of the bankruptcy court.” Ibid.

Given that the § 707(a) analysis is a “fact intensive inquiry in which the court must examine the totality of facts and circumstances,” it seems clear that a bankruptcy court may (and should) consider a debtor’s income and expenses. It is similarly clear that in order to determine whether a debtor’s chapter 7 petition “entail[ed] concealed or misrepresented * * * sources of income, lavish lifestyles, [or an] intention to avoid a large single debt,” a bankruptcy court must consider the debtor’s income and expenses. Finally, a prohibition against a bankruptcy court’s consideration of income and expenses cannot be reconciled with "[resting] the decision to dismiss a petition for lack of good faith * * * within the sound discretion of the bankruptcy court" or recognizing that a bankruptcy court's dismissal determination must be made on an "ad hoc basis."

In short, this Court's precedent renders plain the central role of a debtor's income and expenses in a bankruptcy court's assessment of the debtor's bad faith pursuant to a motion to dismiss the debtor's petition under § 707(a).

C. Nothing in § 707(b) supercedes this Court's precedent by prohibiting the consideration of a business debtor's income and expenses under § 707(a).

The Bankruptcy Code does not expressly prohibit a court's consideration of a debtor's income and expenses when making a § 707(a) for cause determination. Purporting to apply the principle "*expressio unius est exclusio alterius,*" the bankruptcy court inferred the existence of such a prohibition in the § 707(a) business debt context from the express discussion of debtors' income and expenses in § 707(b)'s consumer debt provisions.

Section 707(b) expressly treats consumer debtors' income and expenses in its "means test." 11 U.S.C. § 707(b)(2).[5] The means test, however, does much more than

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[5] The provision states, in pertinent part:

In considering * * * whether the granting of relief would be an abuse of

(continued...)

sanction the consideration of debtors' income and expenses. Rather, § 707(b)(2)'s means test defines a specific formula based on income and expenses that triggers a rebuttable presumption of bad faith in the consumer debt context. It makes sense to consider the inclusion of the means test in § 707(b) and not § 707(a) in determining whether § 707(a) contains a similar statutory presumption of bad faith (clearly, it does not). It makes little sense, however, to deem the means test's reference to debtors' income and expenses a prohibition against consideration of the same under § 707(a).

The bankruptcy court's negative implication is further belied by§ 707(b)(3), which implicitly extends consideration of a consumer debtor's income and expenses beyond § 707(b)(2)'s means test, providing for the dismissal of petitions when "the debtor filed the [consumer debt] petition in bad faith" or "the totality of the circumstances . . . of the debtor's financial situation demonstrates abuse." Put another way, as the means test does not purport to augment the universe of factors courts *may* consider in the bad faith analysis (under § 707(b) or otherwise), it is difficult to

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[5](...continued)
the provisions of this chapter, the court shall presume abuse exists if the debtor's current monthly income reduced by the amounts [defined herein] and multiplied by 60 is not less than the lesser of–

> (I) 25 percent of the debtor's nonpriority unsecured claims in the case, or $6,000, whichever is greater; or
> (II) $10,000.
> 11 U.S.C. § 707(b)(2).

fathom a negative implication with respect to appropriate bad faith factors in the § 707(a) business debt context on the basis of the means test.

The court's reasoning is further undermined by the legislative purpose of the recent amendments to § 707(b) by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23 (which did not alter the text of § 707(a)). Most notably, the primary purpose of the inclusion of the means testwas to protect against abuses of the bankruptcy system by consumer debtors—to strengthen, not limit, controls on bankruptcy abuse. Ibid. There is nothing in the text or legislative history of the Act to suggest that Congress intended to loosen restrictions against bad faith filings in the business debt, or any other, context.

It is doubly problematic to imply from a strengthening of protections against bankruptcy abuse by consumer debtors a loosening of protections against abuse by business debtors.

CONCLUSION

For the foregoing reasons, the decision of the bankruptcy court should be reversed.

Respectfully submitted,

OF COUNSEL:

ROBERTA A. DEANGELIS
Acting General Counsel

WALTER THEUS
P. MATTHEW SUTKO
Attorneys, Office of the General Counsel
Executive Office for United States Trustees
Department of Justice
20 Massachusetts Avenue, NW
Washington, DC 20530

PETER D. KEISLER
Assistant Attorney General

ROBERT M. LOEB
(202) 514-4332
ISAAC J. LIDSKY
(202) 514-3180
Attorneys, Appellate Staff
Civil Division, Room 7217
Department of Justice
950 Pennsylvania Avenue NW
Washington, DC 20530-0001

SEPTEMBER 2006

/s/ Isaac Lidsky

CERTIFICATION OF BAR MEMBERSHIP

Counsel for the federal government need not be members of this Circuit's bar.

CERTIFICATE OF COMPLIANCE

I certify that this brief was prepared using WordPerfect 12, Times New Roman font, 14-point type, and complies with the type-volume limitation set forth in Fed. R. App. P. 29(d) and 32(a)(7)(B). This brief contains 2531words.

September 21, 2006

/s/ Isaac Lidsky
Isaac J. Lidsky

CERTIFICATE OF SERVICE

I hereby certify that on September 21, 2006, I transmitted the original and nine copies of the foregoing "Brief for the United States Trustee as *Amicus Curiae* Supporting Reversal" to the Clerk of the U.S. Court of Appeals for the Third Circuit by Federal Express and by electronic submission. Also on that date, I served two copies of this brief by Federal Express upon the counsel listed below.

Simon Kimmelman
Valerie Hamilton
Sterns & Weinroth
One State Street Square Office Building
50 West State Street, Suite 1400
Trenton, New Jersey 08607-1298
(609) 989-5064

Paul J. Winterhalter
1717 Arch Street, Suite 4110
Philadelphia, PA 19103
(215) 564-4119

/s/ Isaac Lidsky
Isaac J. Lidsky

BRIEF BANK — "SUMMARY SHEET"

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WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*
Personal Electric Transportation Inc., et al. v. U.S. Trustee (In re Personal Electric Transportation, Inc. v. UST)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*
9th Cir.

3. ("CCN") ***CURRENT*** CASE NO.
No.: 07-16630

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*
No.: 1:cv-07-00198-DAE/LEK
Court: D. Haw.
(Identify judge & cite, if any)

5. ("SO") ***SOURCE***
U.S. TRUSTEES

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7. **("AU") *PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*
William Kanter, Michael E. Robinson, P. Matthew Sutko
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***
•Whether the District Court correctly dismissed the appeal for lack of jurisdiction because the notice of appeal was untimely filed.

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IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

In re: PERSONAL ELECTRIC TRANSPORTS, INC.,

Debtor-Appellant,

and

ANTHONY P. LOCRICCHIO,

Appellant,

v.

OFFICE OF THE UNITED STATES TRUSTEE,

Appellee.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF HAWAII

BRIEF FOR APPELLEE OFFICE OF THE UNITED STATES TRUSTEE

JEFFREY BUCHOLTZ
Acting Assistant Attorney General

EDWARD H. KUBO, JR.
United States Attorney

WILLIAM KANTER
(202) 514-4575
MICHAEL E. ROBINSON
(202) 514-1371
Attorneys, Appellate Staff
Civil Division, Room 7539
Department of Justice
950 Pennsylvania Ave., N.W.
Washington, D.C. 20530-0001

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FOR THE NINTH CIRCUIT

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and

ANTHONY P. LOCRICCHIO,

Appellant,

v.

OFFICE OF THE UNITED STATES TRUSTEE,

Appellee.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF HAWAII

BRIEF FOR APPELLEE OFFICE OF THE UNITED STATES TRUSTEE

STATEMENT OF JURISDICTION

This appeal arises out of bankruptcy proceedings instituted by the Debtor, Personal Electric Transports, Inc., and the Debtor's principals, Anthony and Barbara Locricchio. The bankruptcy court had jurisdiction pursuant to 28 U.S.C. § 157(b)(1). On February 14, 2007, the bankruptcy court issued orders dismissing the case pursuant to 11 U.S.C. § 1112(b), denying the application of Richard C. DeWaele to serve as Debtor's pro bono counsel, and denying a motion for recusal of the bankruptcy judge. On February 26, 2007, Personal Electric Transports filed timely motions for reconsideration and rehearing of the orders dismissing the case and denying recusal. Mr. DeWaele also sought rehearing on his application to serve as pro bono counsel. The Official Unsecured Creditors' Committee subsequently filed its own motion for rehearing of the order dismissing the case. On March 5, 2007, the bankruptcy court denied the motions for reconsideration and rehearing filed by the Debtor and by Mr. DeWaele. On March 7, 2007, the court issued an order denying the Unsecured Creditors' Committee's motion.

On March 16, 2007, the Debtor, the Locricchios and Mr. DeWaele filed a notice of appeal from the three March 5, 2007 orders denying the motions for reconsideration and rehearing filed by Personal Electric Transports and Mr. DeWaele. On May 2, 2007, Personal Electric Transports filed a motion for a stay pending appeal in district court. On June 25, 2007, the district court (Hon. David Alan Ezra) issued an order dismissing the appeal for lack of jurisdiction (on the ground that the notice of appeal was untimely under 28 U.S.C. § 158), and denying the motion for a stay as moot. On July 5, 2007, Personal Electric Transports filed a motion for rehearing with regard to the district court's June 25, 2007 order. The district court denied the motion for rehearing on August 13, 2007.

On August 24, 2007, the Debtor filed a timely notice of appeal from the August 24, 2007. Fed. R. App. P. 4(a)(1)(B). This Court has jurisdiction over the appeal under 28 U.S.C. § 158(d).

STATEMENT OF THE ISSUES

The bankruptcy court entered orders on March 5, 2007, denying reconsideration and rehearing of its prior orders dismissing the case, denying recusal, and denying Mr. DeWaele's application to serve as pro bono counsel. The Debtor filed a notice of appeal from these orders on March 16, 2007. The issues presented are:

1. Whether the Debtor's notice of appeal to the district court, filed more than 10 days after the March 5, 2007 bankruptcy court orders, was untimely, depriving the district court of jurisdiction over the appeal.

2. Whether the pendency of the Unsecured Creditors' Committee's motion for reconsideration of dismissal affected the deadline for the Debtor's notice of appeal.

3. Whether the closing of the bankruptcy court at 4:00 p.m. effectively curtailed the Debtor's right to appeal.

STATEMENT OF THE CASE

A. Nature of the Case.

This case involves the timeliness of the Debtor's notice of appeal to the district court following the bankruptcy court's denial of reconsideration of its order dismissing the Debtor's bankruptcy case. The Debtor, Personal Electric Transports, Inc., was in the business of developing electric vehicles for manufacture and sale. The Debtor's principals were Anthony and Barbara Locricchio. The Debtor filed for bankruptcy under chapter 7 of the Bankruptcy Code, then subsequently converted the case to one under chapter 11. The former chapter 7 trustee moved to reconvert the case to chapter 7, which the United States Trustee supported. The bankruptcy court (Hon. Robert J. Faris), however, concluded that the Debtor had virtually no chance of reorganizing; therefore, instead of ruling on the motion to reconvert, the bankruptcy court dismissed the case pursuant to 11 U.S.C. § 1112(b). The bankruptcy court also denied the Debtor's motion for recusal and Richard C. DeWaele's application to serve as counsel pro bono.

The Debtor and Mr. DeWaele sought reconsideration of the bankruptcy court's orders, which the bankruptcy court denied on March 5, 2007. Eleven days later, on March 16, 2007, the Debtor and DeWaele filed a notice of appeal to the district court. Because the notice of appeal was a day late, the district court held that it lacked jurisdiction to consider the appeal and dismissed the suit. After seeking rehearing of the district court's order, the Debtor and Anthony Locricchio filed this appeal.

The Debtor and Locricchio argue on appeal that the notice of appeal was not out of time because the district court did not finally dispose of all the issues in the case until it ruled on the Unsecured Creditors' Committee's motion on March 7. Alternatively, appellants argue that they were prevented from filing a timely appeal because the bankruptcy court closed at 4:00, allegedly in violation of 28 U.S.C. § 452 and Fed. R. Bankr. P. 5001, which require federal bankruptcy courts to be deemed always open for the purpose of filing any pleading or other proper paper. These arguments lack merit.

B. Statutory and Regulatory Framework.

1. The Bankruptcy Code establishes several basic forms of bankruptcy, two of which are at issue here. Under Chapter 7, which governs liquidations, "an individual debtor receives an immediate unconditional discharge of personal liability for certain debts in exchange for relinquishing his or her nonexempt assets to a bankruptcy trustee for liquidation and distribution to creditors." H.R. Rep. No. 31, 109 Cong., pt. 1, 1st Sess. 10 (2005), *reprinted in* 2005 U.S.C.C.A.N. 88, 97; see 11 U.S.C. §§ 701–727. By contrast, in a Chapter 11 bankruptcy, the debtor usually

administers the bankruptcy estate, exercising most of the rights and fiduciary duties of a trustee. The debtor is then known as a "debtor in possession." 11 U.S.C. § 1107.

Under 11 U.S.C. § 1112(b), the court is authorized to convert a case under Chapter 11 to a case under Chapter 7 or to dismiss the case, "whichever is in the best interests of creditors and the estate, if the movant establishes cause." "Cause" under § 1112(b) includes "substantial or continuing loss to or diminution of the estate and the absence of a reasonable likelihood of rehabilitation." 11 U.S.C. §1112(b)(4)(A).

2. Under 28 U.S.C. § 158(a)(1), the district courts of the United States shall have jurisdiction to hear appeals "from final judgments, orders, and decrees" of the bankruptcy courts. Such appeals "shall be taken in the same manner as appeals in civil proceedings generally are taken to the courts of appeals from the district courts and in the time provided by Rule 8002 of the Bankruptcy Rules." 28 U.S.C. § 158(c)(2). Rule 8002(a) of the Federal Bankruptcy Rules provides, in turn, that "[t]he notice of appeal shall be filed with the clerk [of the bankruptcy court] within 10 days of the date of the entry of the judgment, order, or decree appealed from."

3. In pertinent part, 28 U.S.C. § 452 provides: "All courts of the United States shall be deemed always open for the purpose of filing papers, issuing and returning process, and making motions and orders." Rule 5001 of the Federal Rules of Bankruptcy Procedure is to the same effect: "The [bankruptcy] courts shall be

deemed always open for the purpose of filing any pleading or other proper paper, issuing and returning process, and filing, making, or entering motions, orders and rules." Fed. R. Bankr. P. 5001(a).

C. Statement of Facts and Procedural History.

1. The Debtor, Personal Electric Transports, Inc., was in the business of developing electric vehicles for manufacture and sale. The Debtor's principals were Anthony and Barbara Locricchio. The Debtor's largest creditor is the Los Angeles Department of Water and Power ("LADWP") which lent significant amounts for the Debtor to develop its business.

The Debtor filed a bankruptcy petition under Chapter 7 on February 17, 2006. On May 22, 2006, the Debtor converted its case to Chapter 11. On June 1, 2006, the former Chapter 7 trustee moved to reconvert the case back to Chapter 7 to allow the trustee to complete his liquidation of the estate. The U.S. Trustee[1] joined the trustee's motion.

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[1] United States Trustees are Justice Department officials appointed by the Attorney General to supervise the administration of chapter 7 and chapter 11 bankruptcy cases in all federal judicial districts within this circuit. 28 U.S.C. 581-589a. See also H.R. Rep. No. 95-595, at 88 (1977) (United States Trustees "serve as bankruptcy watch-dogs to prevent fraud, dishonesty, and overreaching in the bankruptcy arena"); *Curry v. Castillo (In re Castillo)*, 297 F.3d 940, 950 (9th Cir. 2002) (citing this legislative history). 28 U.S.C. 586(a)(8) authorizes United States Trustees to file motions to dismiss chapter 11 bankruptcy cases under section 1112 of the Bankruptcy Code whenever material grounds exist for seeking such relief.

On July 7, 2006, the bankruptcy court held a hearing on the trustee's motion to reconvert. At the hearing, Mr. Locricchio stated that the Debtor should be given the opportunity to reorganize and that he would know quickly whether his plan would work and whether his sources of money would come through. Tr. 23-30 (July 7, 2006) (Supplemental ER Vol. I at 23-30).[2] The Court stated that it was "deeply skeptical" of the Debtor's prospects for reorganization but gave the Debtor an opportunity to show that reorganization was practical. *Id.* at 32 (Supplemental ER Vol. I at 32). The court set a deadline for the filing of a disclosure statement and reorganization plan. The court also scheduled a hearing to address both the disclosure statement and the trustee's motion to reconvert. The Court expressly warned the parties that, in addition to re-conversion to Chapter 7, the Court would also consider dismissal of the case. *Id.* at 32-33 (Supplemental ER Vol. I at 32-33).

The hearing on the motion to reconvert was ultimately heard on January 29, 2007. Prior to the January 29, 2007 hearings, however, the Debtor and the Creditors' Committee filed a series of "Emergency Ex-Parte Motions." On January 22, 2007, the Debtor filed an Emergency Ex-Parte Motion To Strike Any Response That

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[2] "Supplemental ER" followed by the Volume Number, refers to the Supplemental Excerpts of Record filed with this brief. "ER," followed by the Volume Number, refers to the two-volume Excerpts of Record filed with Appellants' opening brief.

Disclosure Statement Is Unsatisfactory and Does Not Meet the Standard For Submission. On January 26, 2007, the Creditors' Committee filed an Emergency Ex-Parte Motion to Strike Hearing of Former Chapter 7 Trustee To Reconvert Case to Chapter 7. See ER Vol. I at 18. Also on January 26, 2007, the Debtor filed an Emergency Ex-Parte Motion to Stay All Proceedings. See *ibid.* In this last pleading, the Debtor suggested that the Court should recuse itself.

At the hearing on January 29, 2007, the court orally ruled that there was no basis for its recusal. Tr. 23 (Jan. 29, 2007) (Supplemental ER Vol. I at 60). The court also disapproved the Debtor's Amended Disclosure Statement and denied the remaining motions. *Id.* at 23-30 (Supplemental ER Vol. I at 60-67). Finally, the court ruled that the case would be dismissed. *Id.* at 30 (Supplemental ER Vol. I at 67). The court entered written orders consistent with these oral rulings on February 14, 2006. ER Vol. I at 40-51.

2. On February 26, 2007, the Locricchios and the Debtor filed three motions seeking reconsideration of the court's order dismissing the case, rehearing on the issue of recusal, and rehearing of the order of dismissal based on new evidence. ER Vol. II at 28-47, 48-69, 70-116. The Debtor (through attorney Richard DeWaele) also filed a motion for rehearing of the court's February 15, 2007 order denying DeWaele's application to serve as pro bono counsel for the Debtor. *Id.* at

117-128. On March 5, 2007, the bankruptcy court denied the motions for reconsideration and rehearing filed by the Debtor and by Mr. DeWaele. See ER Vol. I at 32-33, 34-35, 36-39.

The Official Unsecured Creditors' Committee filed its own motion for rehearing of the order dismissing the case on March 5, 2007. *Id.* at 10-27, 30. On March 7, 2007, the court issued an order denying the Unsecured Creditors' Committee's motion. *Id.* at 29-31. The bankruptcy court noted that the rehearing motion was untimely under Fed. R. Civ. P. 59 (made applicable by Fed. R. Bankr. P. 9014); and while the motion may have been timely under Fed. R. Civ. P. 60(b) (also made applicable by Fed. R. Bankr. P. 9014), the Committee had not made the showing that the rule requires. *Id.* at 30 n.1. The bankruptcy court went on to deny the motion because the rehearing motion "merely rehashe[d] arguments which others [had] already raised and add[ed] nothing new," and because it already had "disposed of nearly identical arguments made by other parties." *Id.* at 31.

On March 16, 2007, the Debtor and the Locricchios filed a notice of appeal; but the notice specified that the appeal was only from the bankruptcy court's March 5, 2007 orders:

> Debtor in Possession PERSONAL ELECTRIC TRANSPORTS, INC., and its principals, Anthony and Barbara Locricchio, pro se, and appeals under 28 U.S.C.

> 158(a) from the ORDER DENYING MOTION FOR RECONSIDERATION AND MOTION FOR REHEARING ON ORDER DISMISSING CASE filed on March 5, 2007; ORDER DENYING MOTION FOR REHEARING ON ISSUE OF NEED TO RECUSE JUDGE FARRIS (sic) filed on March 5, 2007; ORDER DENYING MOTION FOR REHEARING ON RICHARD C. DEWAELE OF INTENT TO CONTINUE TO APPEAR AS PRO BONO COUNSEL FOR DEBTOR IN POSSESSION, PERSONAL ELECTRIC TRANSPORTS, INC. filed on March 5, 2007.

ER Vol. I at 27. The notice of appeal nowhere mentions the bankruptcy court's March 7, 2007 order denying the Unsecured Creditors' motion.

3. On May 2, 2007, Personal Electric Transports filed a motion for a stay pending appeal in district court. See ER Vol. I at 8. On May 10, 2007, the United States Trustee filed a motion to dismiss the appeal, arguing that the notice of appeal was untimely filed. See ER Vol. I at 20. On June 25, 2007, the district court issued an order granting the United States Trustee's motion to dismiss, and denying the motion for a stay as moot. See ER Vol. I at 17-26. The district court noted that the Supreme Court recently had held that "'the timely filing of a notice of appeal in a civil case is a jurisdictional requirement,'" *id.* at 25 (quoting *Bowles v. Russell*, 127 S. Ct. 2360, 2366 (2007)), and that "[t]here is no reason that this long-standing rule of law should not apply to an appeal of an order of the Bankruptcy Court," *id.* at 26.

On July 5, 2007, Personal Electric Transports filed a motion for rehearing, which the district court denied on August 13, 2007. See *id.* at 6-14. Thereafter, the Debtor filed this appeal on August 24, 2007. *Id.* at 1-3.

SUMMARY OF THE ARGUMENT

1. The district court correctly dismissed the appeal for lack of jurisdiction because the notice of appeal was untimely. A party to a bankruptcy action must file a notice of appeal within 10 days after entry of the order being appealed. Because the time for appealing bankruptcy decisions to the district courts is prescribed by statute, the failure to file a timely notice of appeal within the prescribed time is a jurisdictional defect barring appellate review.

2. The notice of appeal to the district court in this case was filed late. After the bankruptcy court entered orders dismissing the case and denying the Debtor's various other motions on February 14, 2007, the Debtor and the Locricchios filed timely motions for reconsideration and rehearing on February 26, 2007, tolling the time for appeal. When the bankruptcy court denied the motions for reconsideration on March 5, 2007, the Debtor and the Locricchios had 10 days – until March 15, 2007 – to appeal from the orders denying reconsideration. See 28 U.S.C. § 158(c)(2) and Fed. R. Bankr. P. 8002. The Debtor and the Locricchios, however, filed a notice of appeal on March 16, 2007, 11 days after entry of the bankruptcy court's March 2007

orders. Therefore, the district court properly dismissed the appeal for lack of jurisdiction.

3. The fact that the bankruptcy court did not issue an order denying the Official Creditors' Committee motion for reconsideration until March 7, 2007, did not make the Debtor's and the Locricchios' March 16, 2007 notice of appeal timely. The Committee's motion for reconsideration was filed on March 5, 2007, more than 10 days after the bankruptcy court's February 14, 2007 order of dismissal. As the bankruptcy court noted, that motion was untimely under Fed. R. Civ. P. 59 (made applicable by Fed. R. Bankr. P. 9014) and the Committee had not made any showing that Fed. R. Civ. P. 60(b) applied. Therefore, the Committee's motion did not toll the time for filing a notice of appeal from the court's March 5, 2007 order denying reconsideration of the Debtor's and the Locricchios' motion for reconsideration.

This is particularly true here because the Debtor and the Locricchios did not appeal the March 7 order, or even have standing to appeal the order. The notice of appeal does not identify the bankruptcy court's March 7 order; nor does it name the Creditors' Committee as a party, as Fed. R. Bankr. P. 8001 requires. Rather, the notice of appeal specifies only the bankruptcy court's three March 5, 2007 orders; and it lists only the Debtor and its principals as parties to the appeal. Under this Court's precedents, this mistake is fatal to the Debtors' appeal. See *In re Dudley*, 249 F.3d

1170, 1174 (9th Cir. 2001); *United States v. Arkison (In re Cascade Roads, Inc.)*, 34 F.3d 756, 761 (9th Cir. 1994). As the district court held, because the notice of appeal failed to designate the Creditors' Committee order, the date of the order, or the name of the Creditors' Committee as a party, neither the district court nor the parties involved had any notice that the order was on appeal or that the notice was timely filed.

4. The Debtor argues that it was unable to file its notice of appeal on March 15, 2007, because the courthouse had no night depository box for accepting a filing after the court's normal business hours. This failure, the Debtor claims, was essentially a denial of access to the courts in violation of 28 U.S.C. § 452 and Fed. R. Bankr. P. 5001. As a preliminary matter, this argument was not raised in the Debtor's opposition to the motion to dismiss the appeal as untimely, and therefore was waived. Assuming the argument was not waived, however, the bankruptcy court's failure to have a night depository box for after-hours filings did not excuse the late filing of the notice of appeal in this case. The requirement that the courts shall be deemed always open for purposes for filing papers has been interpreted uniformly to mean that the clerk's office need not be kept open around the clock; and while some clerks' offices have established night depositories to accommodate after-hours filings, they are not mandatory. In the absence of such a night depository, papers can

validly be filed after hours only by in-hand delivery to the clerk or other proper official. The Debtor and the Locricchios do not contend that they actually attempted to file the notice of appeal after hours. And, knowing that the courthouse closed for business at 4:00 p.m., and that the court had no night deposit box for late filings, both the Debtor and counsel should have taken care to file the notice of appeal before the official close of business, or to make arrangements with the clerk's office to file the notice of appeal after hours.

STANDARD OF REVIEW

This Court reviews de novo "jurisdictional issues in bankruptcy cases." *In re Wiersma*, 483 F.3d 933, 938 (9th Cir. 2007). The timeliness of a notice of appeal from the bankruptcy court to the district court is a question of law reviewed de novo. *Bigelow v. Stoltenberg (In re Weston)*, 41 F.3d 493, 491 (9th Cir. 1994).

ARGUMENT

THE DISTRICT COURT CORRECTLY DISMISSED THE APPEAL FOR LACK OF JURISDICTION BECAUSE THE NOTICE OF APPEAL WAS UNTIMELY FILED.

A. The Timely Filing Of A Notice Of Appeal In Bankruptcy Cases Is Jurisdictional.

"Generally, a party to a bankruptcy action must file a notice of appeal within ten days after entry of the order being appealed." *In re Wiersma*, 483 F.3d 933, 938 (9th Cir. 2007) (citing Fed. R. Bankr. P. 8002(a)). See also 28 U.S.C. § 158(c)(2). The requirement of a timely appeal "is jurisdictional." *In re Wiersma*, 483 F.3d at 938 (citing *Preblich v. Battley*, 181 F.3d 1048, 1056 (9th Cir. 1999)). That is, "'the failure to timely file a notice of appeal is a jurisdictional defect barring appellate review.'" *Ibid.* (brackets removed) (quoting *Lopez v. Long (In re Long)*, 255 B.R. 241, 243 (B.A.P. 10th Cir. 2000)). See also *In re Slimick*, 928 F.2d 304, 306 (9th Cir. 1990) ("The untimely filing of a notice of appeal is jurisdictional.").

The Supreme Court's recent decision in *Bowles v. Russell*, 127 S. Ct. 2360 (2007), confirms that the time limit for filing a notice of appeal in bankruptcy cases, because it is statutorily prescribed, is jurisdictional. In *Bowles*, the Supreme Court held that "the taking of an appeal [in civil cases] within the prescribed time is 'mandatory and jurisdictional.'" 127 S. Ct. at 2363. In doing so, the Court recognized "the jurisdictional significance of the fact that a time limitation is set forth in a statute." *Id.* at 2364. Time constraints set out in a statute "limit a court's jurisdiction," *id.* at 2365, while time prescriptions set forth in rules of court are merely "claims-processing rules," and do not implicate a court's subject-matter jurisdiction, *id.* at 2364.

In bankruptcy cases, a district court's appellate jurisdiction to review final judgments, orders and decrees of bankruptcy judges is established by 28 U.S.C. §§ 158(a)(1) and 158(c)(2). While subsection 158(a)(1) provides the general grant of appellate jurisdiction, subsection 158(c)(2) establishes the time for appealing bankruptcy decisions to the district courts, requiring that such appeals "shall be taken in the same manner as appeals in civil proceedings generally are taken to the courts of appeals from the district courts," and "in the time provided by Rule 8002 of the Bankruptcy Rules." 28 U.S.C. § 158(c)(2). Federal Rule of Bankruptcy Procedure 8002(a) requires a notice of appeal be filed within ten days of the bankruptcy court's order unless an appellant had filed one of the motions identified in Fed. R. Bankr. P. 8002(b) within that ten day period. Because the time for filing a bankruptcy appeal is "statute-based," *Bowles*, 127 S. Ct. at 2365, the requirement of a timely-filed appeal is, as this Court has held, "jurisdictional." *In re Wiersma*, 483 F.3d at 938.[3]

B. The District Court Properly Dismissed The Appeal For Lack Of Jurisdiction Because The Notice Of Appeal Was Untimely.

The notice of appeal to the district court was filed late. On February 14, 2007, the bankruptcy court entered orders dismissing the case, denying the Debtor's emergency ex parte motion to stay all proceedings, denying Debtor's emergency ex parte motion for an order to strike any response that its disclosure statement was unsatisfactory, and denying the Creditors' Committee's emergency ex parte motion to strike the hearing on the trustee's motion to reconvert the case to Chapter 7. See ER Vol. I at 40-51. The Debtor and the Locricchios (the Debtor's principals) timely filed motions for reconsideration and rehearing on February 26, 2007. These motions temporarily tolled the time for filing an appeal. See *Bigelow v. Stoltenberg (In re Weston)*, 41 F.3d 493, 495 (9th Cir. 1994) (stating that a motion for reconsideration

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[3] *Cf. Kontrick v. Ryan*, 540 U.S. 443, 454 (2004) (holding that failure to comply with the time requirement in Fed. R. Bankr. P. 4004 did not affect a court's subject-matter jurisdiction). Critical to the Court's analysis in *Kontrick* was the fact that "[n]o statute . . . specifies a time limit for filing a complaint objecting to the debtor's discharge." 540 U.S. at 448. See also *Bowles v. Russell*, 127 S. Ct. 2360, 2364 (2007). By contrast to the time limit in Bankruptcy Rule 4004, the time limit for appeals to the district court in bankruptcy cases is derived from 28 U.S.C. § 158.

filed within 10 days after entry of judgment is considered to be a Fed. R. Bankr. P. 9023 motion and tolls the time for filing a notice of appeal).

The bankruptcy court denied the motions for reconsideration and rehearing by orders entered March 5, 2007. ER Vol. I at 32-33, 34-35, 36-39. The Debtor and the Locricchios' then had ten days – or until March 15, 2007 – to appeal from the orders denying reconsideration and rehearing as well as from the underlying orders dismissing the case and denying the Debtor's ex parte motions. See 28 U.S.C. § 158(c)(2) (an appeal from a final bankruptcy judgment, order or decree "shall be taken in the same manner as appeals in civil proceedings generally are taken to the courts of appeals from the district courts and in the time provided by Rule 8002 of the Bankruptcy Rules"); Fed. R. Bankr. P. 8002(a) ("The notice of appeal shall be filed with the clerk within 10 days of the date of the entry of the judgment, order, or decree appealed from."). The Debtor and the Locricchios, however, filed a notice of appeal on March 16, 2007, 11 days after entry of the bankruptcy court's March 5, 2007 orders. Therefore, the district court correctly concluded that the March 16, 2007 notice of appeal was untimely and properly dismissed the appeal for lack of jurisdiction. See *In re Wiersma*, 483 F.3d at 938 ("[T]he failure to timely file a notice of appeal is a jurisdictional defect barring appellate review.") (citation and internal quotation marks omitted).

C. The Fact That The Bankruptcy Court Did Not Enter An Order Denying The Unsecured Creditors' Motion For Rehearing Until March 7, 2007, Does Not Make The Notice Of Appeal Involved In This Case Timely.

Debtor and Mr. Locricchio argue that "[t]he final adjudication of all issues related to this matter did not occur until March 7, 2007 when the final order of the Court was entered related to the issues filed by the Official Creditors Committee all of which are directly part of the issues on Appeal." Br. for Appellants at 13. Thus, they contend, "the filing date for the Notice of Appeal was March 17, 2007," and not March 15, 2007. *Ibid.* As a consequence, Debtor and Mr. Locricchio argue, the notice of appeal in this case was, in fact, timely filed. *Id.* at 14.

1. The fact that the bankruptcy court did not issue an order denying the Official Creditors' Committee motion for reconsideration until March 7, 2007, did not make the Debtor's and the Locricchio's March 16, 2007 notice of appeal timely. Unlike the Debtor and the Locricchios, the Committee did not file any pleadings to toll the appeal period for the bankruptcy court's February 14, 2007 order dismissing the case and denying various ex parte motions, including the Committee's ex parte motion to strike the hearing on the trustee's motion to reconvert the case to Chapter 7. Therefore, as the bankruptcy court noted, the Creditors' Committee March 5, 2007 motion was untimely under Fed. R. Civ. P. 59 (made applicable by Fed. R. Bankr. P.

9014) and the Committee made no showing that Fed. R. Civ. P. 60(b) applied. See ER Vol. I at 30 n.1. As a consequence, the Committee's March 5, 2007 motion could not have tolled the time for filing an appeal from the district court's March 5, 2007 order. See *Mt. Graham Red Squirrel v. Madigan*, 954 F.2d 1441, 1462 (9th Cir. 1992); *Straw v. Bowen*, 866 F.2d 1167, 1171 (9th Cir. 1989).[4]

2. The Debtor and the Locricchios, in any event, did not appeal the March 7 order. The notice of appeal makes no mention of the bankruptcy court's March 7 order; nor does the notice of appeal name the Official Creditors' Committee as a party. Rather, the notice of appeal specifies that only the bankruptcy court's three March 5, 2007 orders are being appealed; and it lists only the Debtor in Possession and its principals as parties to the appeal. See ER Vol. I at 27.

Bankruptcy Rule 8001(a) makes clear that a notice of appeal from a judgment, order, or decree of a bankruptcy judge "shall (1) conform substantially to the appropriate Official Form, (2) contain the names of all parties to the judgment, order, or decree appealed from and the names, addresses, and telephone numbers of their

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[4] The Debtor's and the Locricchios' motion for reconsideration did not toll the time for filing the Committee's motion for reconsideration. Both motions, to be timely, had to be filed within 10 days of entry of the February 14, 2007 judgment. See *Wages v. IRS*, 915 F.2d 1230, 1233 n. 3 (9th Cir.1990) (successive Rule 59 motions generally do not affect the finality of the judgment), *cert denied*, 498 U.S. 1096 (1991).

respective attorneys, and (3) be accompanied by the prescribed fee." Fed. R. Bankr. P. 8001(a). The Official Form requires the party appealing to identify the judgment, order or decree of the bankruptcy judge being appealed and its date and the names of all parties to the judgment, order or decree being appealed. Given the clear requirements of Rule 8001(a), the Debtor's failure to mention either the March 7, 2007 order or the Official Creditors' Committee in its notice of appeal means that the notice was effective only as to the March 5, 2007 order.[5]

In this regard, Debtor's reliance on *Fadayiro v. Ameriquest Mortg. Co.*, 371 F.3d 920, 922 (7th Cir. 2004), and *In re Dudley*, 249 F.3d 1170, 1174 (9th Cir. 2001), see Br. for Appellants at 12, 15, is misplaced. These cases suggest that nothing in Rule 8001(a) requires that "strict and literal compliance with the rule and the forms should be deemed jurisdictional in the sense that a failure to comply,

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[5] Indeed, it is not even clear that the Debtor or the Locricchios would have had standing to appeal the March 7 order, which disposes of a motion filed not by them but by another party. Because bankruptcy cases "generally affect the rights of many," an appellant must demonstrate not only an "injury in fact," in the Article III sense; "[t]he appellant [also] must be a 'person aggrieved' by the bankruptcy court's order." *Duckor Spradling & Metzger v. Baum Trust (In re P.R.T.C.)*, 177 F.3d 774, 777 (9th Cir.1999). A person is "aggrieved" if the bankruptcy court's order diminishes his property, increases his burdens, or detrimentally affects his rights. *Ibid.* The March 7 order, which simply denies the Creditors' Committee the same relief already denied the Debtor and the Locricchios, did not diminish the Debtor's or Locricchios' property, increase their burdens, or detrimentally affect their rights, particularly when they had an independent right to appeal their own order.

however innocuous, spells doom for the appeal." *Fadayiro*, 249 F.3d at 922. Thus, this Court held that, although debtors had listed only the bankruptcy court's order denying their motion for reconsideration in their notice of appeal, the district court also had jurisdiction to consider the underlying order denying their exemption claim as well, since the debtors had listed the names of all parties to the order appealed from in their notice of appeal and the district court had considered the merits of the underlying order along with the denial of the reconsideration motion. See *Dudley*, 249 F.3d at 1173-74. Under these circumstances, the Court held, "Fed. R. Bankr. P. 8001(a) does not require that a notice of appeal to the district court designate the order appealed from." *Id.* at 1174. The Court's holding, however, relies primarily on the fact that,

> [u]nlike Rule 3(c) [of the Federal Rules of Appellate Procedure], Rule 8001(a) does *not* require that notices of appeal to the district court "designate the judgment, order or part thereof appealed from." Rather, the bankruptcy rule requires only that a notice "contain the *names* of all parties to the judgment, order, or decree appealed from."

United States v. Arkison (In re Cascade Roads, Inc.), 34 F.3d 756, 761 (9th Cir. 1994) (cited in *Dudley*, 249 F.3d at 1174).

This case, as the district court noted (ER Vol. I at 24), differs from, *Dudley* and *Fadayiro* in many respects. First, while it would be fair to assume that the Debtor and the Locricchios intended to appeal both from the March 5, 2007 orders denying reconsideration and the underlying orders dismissing the case and denying recusal, see *Dudley*, 249 F.3d at 1173, no such assumption can be made with regard to the Debtor's and the Locricchios' intent to appeal the bankruptcy court's March 7, 2007 order. The latter order responded to a motion filed solely by the Creditors' Committee, not to any motion filed by the Debtor or the Locricchios.

As the district court also observed, "unlike the *In re Dudley* case . . . Debtors are not trying to incorporate the orders underlying their motions for reconsideration and/or for rehearing which they designated in the Notice. Other than the various underlying motions having been heard on the same day in January, Debtors provide no explanation of how the Creditors Committee Order is related or 'interlocked' with the three orders they designated in their appeal." ER Vol. I at 25.

More important, unlike the debtors in *Dudley* and *Arkison*, the Debtor and the Locricchios did not name the principal party to the March 7, 2007 order – the Creditors' Committee – in their notice of appeal. As the district court held, "[t]his mistake is fatal to Debtors' appeal, because naming all parties to the order appealed from is a clear requirement of Rule 8001." ER Vol. I at 24. See *Dudley*, 249 F.3d at 1174 ("The trustee does not contend that the Dudleys failed to list the names of all of the parties to the order appealed from in their notice of appeal to the district court.");

Arkison, 34 F.3d at 761 (Rule 8001(a) "requires . . . that a notice [of appeal] 'contain the *names* of all parties to the judgment, order, or decree appealed from'"). *Cf. Fadayiro*, 371 F.3d at 923 ("*All* the information required by Rule 8001(a) was in fact supplied by the appellant . . . .").

The argument (Br. for Appellants at 15), that the failure to list the Creditors' Committee or the Creditors' Committee order in the notice of appeal was "innocuous" since "the Creditors' Committee did in fact receive the Notice of Appeal," is unavailing. The court in *Fadayiro* explained the importance of naming all the parties to an appeal:

> A bankruptcy will often spawn multiple subproceedings. Whereas in normal civil litigation it can be safely assumed that everyone who is not an appellant must be an appellee, that is not a safe assumption in bankruptcy. Many parties will be bystanders to a particular adversary proceeding, or other subproceedings, that has given rise to the appeal. It is therefore important that the notice of appeal name the appellees.

371 F.3d at 922. As the district court in this case noted, "[w]ithout either designating the Creditors Committee Order, the date of the order, or listing the Creditors Committee as a party, this Court, nor the other parties involved have any notice that the order is on appeal or that the Notice was timely filed." ER Vol. I at 24.

D. The Bankruptcy Court's Failure To Provide A Receptacle For After-Hours Filing Did Not Curtail The Debtor's Right To Appeal.

The Debtor argues that it was unable to file its notice of appeal on March 15, 2007, the day the notice of appeal was due, because the courthouse had no drop box or other mechanism for accepting a filing after the court's normal business hours. Therefore, the Debtor claims, it had no choice but to file the notice of appeal on the following day. See Br. for Appellants at 10-11, 16-17.

Barbara Locricchio stated in her declaration that when she attempted to file three notices of appeal on March 15, 2007, the bankruptcy clerk informed her that it would be more efficient to file one notice of appeal for all the orders to avoid paying the same filing fee three times. ER Vol. II at 4-5. Mrs. Locricchio decided to take the three notices of appeal back and she and Mr. DeWaele then consolidated the appeal issues in one notice of appeal. Mrs. Locricchio declared, however, that she could not file the new notice that same day "because, unlike the U.S. District Court, the Bankruptcy court does not have an after hours filing receptacle which would have time stamped the document." *Ibid.* See also Declar. of Richard C. DeWaele (ER Vol. II at 8-9).

Although neither Mrs. Locricchio nor Mr. DeWaele declared that he or she "presented the combined Notice for filing later that same day, only to discover that the office was closed," ER Vol. I at 13, the Debtor claims that the court's failure to provide an after-hours filing procedure "was essentially a denial of access to the courts" in violation of 28 U.S.C. § 452, which provides that "[a]ll courts shall be deemed always open for the purpose of filing proper papers, issuing and returning process, and making motions and orders," and Fed. R. Bankr. P. 5001, to the same effect. Br. for Appellants at 16.

1. As a preliminary matter, this argument has been waived. As the district court noted, the Debtor and the Locricchios failed to raise the argument in their opposition to the Trustee's motion to dismiss and "provide no explanation for failing to raise this argument in their opposition . . . ." ER Vol. I at 13.[6] Rather, after the

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[6] The only reference to Barbara Locricchio's attempt to file notices of appeal on March 15, 2007, in the Debtors' Opposition to the Motion to Dismiss Appeal was the following:

> 10) For information of this Court only as it references Appellants conduct with regard to the notice, on March 15, 2007 (ten (10) days after the March 5th Orders had been entered by Judge Farris, Appellants prepared and sought to file multiple Notices of Appeal with the Federal District Bankruptcy Court only to learn that additional Orders related to the Notices of Appeal had been subsequently received in the ordinary mail.
>
> 11) The multiple notice of Appeals were then combined into one overall Notice of Appeal that was then filed nine (9) days after the Final Order entered by the Court on March 7, 2007. The Notice of Appeal was filed

district court granted the motion to dismiss, the Debtors raised the issue for the first time in their motion for rehearing. As this Court has held, "[f]ailure to raise an issue on appeal results in waiver of that issue." *Mendoza v. Block*, 27 F.3d 1357, 1363 (9th Cir. 1994). See also *Preblich v. Battley*, 181 F.3d 1048, 1056 (9th Cir.1999) ("We generally refuse to consider issues raised for the first time in a petition for rehearing."); *Alexopulos v. Riles*, 784 F.2d 1408, 1411 (9th Cir. 1986) (holding that plaintiff's tolling argument was waived for failure to raise the issue in opposition to summary judgment even though the general statute of limitations issue had been briefed). For this reason, the district court correctly held that the Debtor and the Locricchios had waived their "access to the courts" argument, and this Court may affirm on this basis without reaching the merits of the argument.

2. If the Court does reach the merits, however, the district court correctly ruled that the bankruptcy court's failure to have a "night depository box" for after-

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> when it became clear that the Court was not going to issue any other orders or address other rehearing issues requested by Appellants herein. . . .

Supplemental ER Vol. II at 87-88. No argument was made that the Debtor believed the filing date had been preserved or that the late filing of the notice of appeal on March 16, 2007, should be excused because the bankruptcy court failed to provide an after-hours receptacle for the filing of documents outside of normal business hours. The Argument section focused solely on the timeliness of the notice of appeal filed on March 16, 2007, in light of the fact that the final order issued by the bankruptcy court was entered on March 7, 2007.

hours filings did not excuse the late filing of the notice of appeal in this case. The Debtor suggests that the language in 28 U.S.C. § 452 and in Fed. R. Bankr. P. 5001 that the federal bankruptcy courts shall be deemed "always open" for filing purposes means that the bankruptcy court was required "to provide an after hours filing procedure," and that the court's failure to do so "was essentially a denial of access to the courts . . . ." The Debtor is mistaken.

Before 1948, when the lower federal courts sat in terms, judgments of the court remained under its control only during the term. See *Hill v. Hawes*, 320 U.S. 520, 524 (1944); *Bronson v. Schulten*, 104 U.S. 410, 415 (1881). Revisions to the Judicial Code in 1948 ended the significance of terms of court; the federal courts are now "always open," and the expiration of a term or session "in no way affects the power of the court to do any act or take any proceeding." 28 U.S.C. § 452. See *Northern Calif. Power Agency v. NRC*, 393 F.3d 223, 224 (D.C. Cir. 2004).

As the First Circuit has held, however, the requirement that the courts shall be deemed "always open" for purposes of filing papers "has been interpreted uniformly to mean that the clerk's office need not be kept open around the clock." *McIntosh v. Antonino*, 71 F.3d 29, 35 (1st Cir. 1995) (citing *Greenwood v. State of N.Y. Office of Mental Health*, 842 F.2d 636, 639 (2d Cir. 1988); *Casalduc v. Diaz*, 117 F.2d 915, 916 (1st Cir.), *cert. denied*, 314 U.S. 639 (1941); and 12 Charles A. Wright & Arthur

R. Miller, *Federal Practice and Procedure* § 3081, at 179 (1990)). As part of their general rulemaking authority, courts may set business hours and other conditions, as they deem necessary and reasonable, for the filing of papers. See Fed. R. Civ. P. 83. This rulemaking authority also applies to bankruptcy courts. See Fed. R. Bankr. P. 9029.

The United States Bankruptcy Court for the District of Hawaii has established that its business hours shall be from 8:30 a.m. to 4:00 p.m.[7] Local Bankruptcy Rule 5005 sets forth the general requirements for filing papers with the court. Local Rule 5005-1(a) specifically provides that "[d]ocuments shall be filed with the clerk of the Bankruptcy Court." Local Rule 5005, however, does not provide a mechanism for after-hours filing. These rules appear to be well within the bankruptcy court's authority and reasonably related to the efficient operation of the court. See *In re Bradshaw*, 283 B.R. 814, 817-18 (1st Cir. B.A.P. 2002) (holding that local bankruptcy rules providing that all filings, including facsimile filings, had to be received in the office of the clerk between the hours of 8:30 a.m. and 4:30 p.m., or be deemed received on the following day, appeared to be within the court's general rulemaking authority).

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[7] See http://www.hib.uscourts.gov/courtinfo/location_menu.htm#.

While some clerks' offices have established so-called "night depositories" to accommodate after-hours filings, they are not mandatory. See *McIntosh*, 71 F.3d at 35 & n.5. In the absence of a night depository, papers can validly be filed after hours, but only by in-hand delivery to the clerk or other proper official. See *id.* at 35 ("[T]he word 'filing' as used [in Fed. R. Civ. P. 77(a), whose language is substantially identical to 28 U.S.C. § 452,] is a word of art. It 'means delivery into the actual custody of the proper officer.'") (quoting *Casalduc*, 117 F.2d at 916); see *ibid.* ("[O]utside of ordinary business hours, merely leaving papers in a closed or vacant office does not constitute 'filing' sufficient for commencement of an action.").

As explained, the declarations of Richard DeWaele and Barbara Locricchio state that Barbara Locricchio initially went to the clerk's office on March 15, 2007, with three separate notices of appeal. When the clerk suggested that it might be more efficient to file one notice of appeal to avoid paying the same filing fee three times, Mrs. Locricchio took back the three notices so that they could be consolidated in one appeal. ER Vol. II at 4-5; 8-9. Although the declarations then assert that "the consolidated Notice of Appeal could not be filed that day because . . . the Bankruptcy court does not have an after hours filing receptacle which would have time stamped the document," *id.* at 5, 9, the declarations "do[] not state that Debtors presented the combined Notice for filing later that same day, only to discover that the office was closed. Instead, the declaration[s] read[] that the notice was filed the next day." For these reasons, the district court concluded, "it is unclear whether Debtors even made a second attempt to file the Appeal on the deadline." ER Vol. I at 13.

In any event, it was the Debtor's responsibility, along with its counsel, to make sure that the notice of appeal was timely filed. Knowing that the courthouse closed for business at 4:00 p.m., and that the court had no night deposit box for late filings, both the Debtor and counsel should have taken care to file the notice of appeal before the official close of business, or to make arrangements with the clerk's office for an after-hours filing. Local restrictions on the time and manner of filing must be observed. See *In re Bradshaw*, 283 B.R. at 818.

In this regard, the bankruptcy court clerk's suggestion of a way to save filing fees did not extend the time period in which to file the notice of appeal; nor did the Debtor or the Locricchios seek or obtain a court order extending the time to file the notice. Therefore, there is no basis for their belief that "the filing date had been preserved." ER Vol. II at 5, 8-9.

3. The Debtor's and the Locricchio's reliance on *In re Warren*, 20 B.R. 900 (Bankr. 1982), see Br. for Appellants at 16, also is unavailing. In that case, by order of the court, September 23, 1981, had been set as the last day for filing a complaint to object to the discharge of debts in a bankruptcy proceeding. The plaintiff filed his

complaint on September 23, 1981, at 5:55 p. m. The defendant objected to the complaint as untimely, arguing that the complaint had to be filed by the court's official close of business at 5:00 p.m. on September 23. The bankruptcy court rejected the argument, ruling that, "[b]ecause plaintiff's complaint was, in fact, filed on September 23rd (the last day for filing complaints to dischargeability of debts), it was timely filed." 900 B.R. at 902. *Warren* is inapposite because, unlike the debtor in that case, the Debtor here did not file its notice of appeal after hours on the day it was due, but on the following day.

CONCLUSION

For the foregoing reasons, the Court should affirm the district court's dismissal of the appeal as untimely.

Respectfully submitted,

JEFFREY BUCHOLTZ
Acting Assistant Attorney General

EDWARD H. KUBO, JR.
United States Attorney

Michael E Robinson
WILLIAM KANTER
(202) 514-4575
MICHAEL E. ROBINSON
(202) 514-1371
Attorneys, Appellate Staff
Civil Division, Room 7539
Department of Justice
950 Pennsylvania Ave., N.W.
Washington, D.C. 20530-0001

APRIL 2008

STATEMENT OF RELATED CASES

Counsel is unaware of any related cases pending in this or any other court.

CERTIFICATE OF COMPLIANCE

I certify that:

Pursuant to Fed. R. App. P. 32(a)(7)(C) and Ninth Circuit Rule 32, this brief is proportionally spaced, using WordPerfect 9 in Times New Roman font, has a typeface of 14 points or more and contains 8,043 words, excluding portions exempted in Rule 32(a)(7)(B)(iii), according to the word count feature on the undersigned's computer.

Michael E Robinson

MICHAEL E. ROBINSON

CERTIFICATE OF SERVICE

I hereby certify that on this 9th day of April, 2008, I filed the foregoing Brief for Appellee Office of the United States Trustee and served it upon the following persons, by causing an original and fifteen copies to be delivered via United States mail to:

Ms. Molly Dwyer
Clerk, United States Court of Appeals
for the Ninth Circuit
95 Seventh Street
San Francisco, CA 94103-1526

and by causing two copies to be delivered via United States mail to:

Anthony P. Locricchio, Esquire
903 Maunawili Cir.
Kailua, HI 96734
(808) 261-8372

Richard C. DeWaele, Esquire
P.O. Box 6326
Kaneohe, HI 96744
(808) 714-1170

Michael E Robinson
MICHAEL E. ROBINSON,
Counsel for Appellee United States

BRIEF BANK — "SUMMARY SHEET" *Printed Wed-4/23/08 8:59*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	In re Shawn Eugene Petro, et al. (Petro, et al. V. Hildebrand) Company)
2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	B.A.P. 6th Cir.
3. ("CCN") ***CURRENT*** CASE NO.	No.: 08-8009
4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*	No.: 07-06638 Court: Bankr. Tenn. *(Identify judge & cite, if any)*
5. ("SO") ***SOURCE***	**U.S. TRUSTEES**
6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	Filed: April 21, 2008 Type: Brief for the United States Trustee As Amicus Curiae Supporting Reversal
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8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	•Whether the bankruptcy court erred in holding that the debtor's projected disposable income under section 1325(b)(1) of the Bankruptcy Code is determined by multiplying the debtors' disposable income, as defined in section 1325(b)(2), by the number of months in the chapter 13 plan, with no other adjustments.
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BEFORE THE UNITED STATES BANKRUPTCY APPELLATE PANEL
FOR THE SIXTH CIRCUIT

SHAWN EUGENE PETRO
CLARA ALICIA PETRO

Debtors,

HENRY E. HILDEBRAND III, TRUSTEE

Appellant

BAP No. 08-8009

Bankr. No. 07-06638
Chapter 13

BRIEF FOR THE UNITED STATES TRUSTEE AS AMICUS CURIAE SUPPORTING REVERSAL

ROBERTA A. DEANGELIS
Acting General Counsel

P. MATTHEW SUTKO
THOMAS C. KEARNS
Executive Office for United States Trustees
Department of Justice
20 Massachusetts Avenue, N.W.
Washington, D.C. 20530

RICHARD F. CLIPPARD
United States Trustee

ELIZABETH R. DERRICK
Assistant United States Trustee
Office of the United States Trustee
Department of Justice
701 Broadway
Nashville, TN 37023
Telephone: (615) 736-2258

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STATEMENT OF JURISDICTION

The United States Bankruptcy Court for the Middle District of Tennessee had jurisdiction over the debtors' bankruptcy case under 28 U.S.C. 157(a) and (b), and 1334(a). The bankruptcy court overruled the chapter 13 trustee's objection to confirmation by order entered January 31, 2008. [Dkt. 48 (Memorandum Opinion), Dkt. 53(Order Confirming chapter 13 Plan)]. The chapter 13 trustee timely filed a notice of appeal with the bankruptcy court. [Dkt. 56]. Under 28 U.S.C. 158(a)(1) and (b)(1), this Court has jurisdiction over this appeal.

INTEREST OF THE UNITED STATES

The United States Trustee submits this brief as amicus curiae supporting reversal of the Bankruptcy Court's order. Cf., Fed. R. App. P. 29(a) (amicus participation). The Attorney General appoints United States Trustees to supervise the administration of bankruptcy cases and trustees. 28 U.S.C. 581-589a. United States Trustees "serve as bankruptcy watch-dogs to prevent fraud, dishonesty, and overreaching in the bankruptcy arena." H.R. Rep. No. 95-595, at 88 (1977). The United States Trustee Program thus acts in the public interest to promote the efficiency, and to protect and preserve the integrity, of the bankruptcy system. To this end, Congress has provided that "[t]he United States trustee may raise and may appear and be heard on any issue in any case or proceeding." 11 U.S.C. 307. See Thompson v. Greenwood, 507 F.3d 416, 420 n.3 (6th Cir. 2007); In re Revco D.S., Inc., 898 F.2d 498, 500 (6th Cir. 1990).

This case involves a dispute over confirmation of a plan under chapter 13 of the Bankruptcy Code. The United States Trustee is authorized, among other things, to "supervise the administration of cases and trustees" in chapter 13 cases, monitor chapter 13 plans, and file comments with the court regarding such chapter 13 plans in connection with a plan confirmation hearing under section 1324 of the Code. 28 U.S.C. 586(a)(3)(C).

In 2007, more than 310,000 persons filed bankruptcy petitions under chapter 13.[1] In chapter 13 cases, with so-called above-median debtors,[2] the question of statutory interpretation presented in this case has occurred frequently and is continuing to occur

In this brief, the United States Trustee respectfully offers this Court his views on the correct interpretation of section 1325(b). See 28 U.S.C. 517 (authorizing Department of Justice "to attend to the interests of the United States in a suit pending in a court of the United States").

STANDARD OF REVIEW

This Court reviews the bankruptcy court's findings of fact under the clearly erroneous standard but reviews de novo the bankruptcy court's conclusions of law. In re Isaacman, 26 F3d. 629, 631(6th Cir. 1994) (Citing In re Zick, 931 F.2d 1124, 1126 (6th Cir.1991)). The question of statutory interpretation of the phrase "projected disposable income" presented in this case is an issue of law and subject to de novo review.

STATEMENT OF THE ISSUE

Whether the Bankruptcy Court erred in holding that the debtors' projected disposable income under section 1325(b)(1) of the Bankruptcy Code is determined by multiplying the debtors' disposable income, as defined in section 1325(b)(2), by the number of months in the chapter 13 plan, with no other adjustments.

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[1] See http://www.uscourts.gov/bnkrpctystats/sept2007/f2table.xls (Excel spreadsheet).

[2] An above-median debtor is the name often used in referring to a debtor whose current monthly income under 11 U.S.C. 101(10A), multiplied by 12, is above the annual median income in the state of a family of comparable size. See 11 U.S.C. 1325(b)(3).

STATEMENT OF THE CASE

A. Statutory Framework.

In 2005, Congress passed and the President signed into law the Bankruptcy Abuse Prevention and Consumer Protection Act, Pub. L. No. 109-8, 119 Stat. 23 (2005).

One of the innovations of the 2005 amendments was means-testing. In section 707 of the Bankruptcy Code, which addresses dismissal of abusive chapter 7 petitions, Congress established special rules for debtors whose current monthly income, reduced by certain permitted expenses, exceeded a statutorily prescribed amount. 11 U.S.C. 707(b)(2). This amendment changed the way these expenses are computed; some are no longer the debtor's actual and reasonable expenses but instead are standard expenses under the National Standards and Local Standards issued by the Internal Revenue Service for the debtor's area of residence. 11 U.S.C. 707(b)(2)(A)(ii).

Congress also applied means-testing to chapter 13 cases, in which the debtor seeks not to liquidate his debts, as in chapter 7, but rather to establish a plan for repaying all or part of those debts. 11 U.S.C. 1325(b)(3). Before the 2005 amendments were enacted, section 1325, governing confirmation of a chapter 13 plan, required such a plan to provide that all of the debtor's "projected disposable income" during the plan period would be used to repay debts. 11 U.S.C. 1325(b)(1)(B) (2000 ed.). Disposable income was calculated from the debtor's actual income and expenses set forth on Schedules I and J, which the debtor was required to file. See In re Austin, 299 B.R.482, 487 (Bankr. E.D. Tenn. 2003)(in context of chapter 7 section 707(b) motion, calculating debtor's disposable income for ability to fund a chapter 13 plan); In re Breeden, 304 B.R. 318, 319 (Bankr. N.D. Ohio 2003)(confirmed plan provides payment of disposable income as calculated by Schedules I and J).

But section 1325 was amended in 2005 to change the definition of "disposable income." The new section 1325(b)(2) defines "disposable income" to mean "current monthly income received by the debtor * * * less amounts reasonably necessary to be expended" for maintenance or support or necessary business expenses. 11 U.S.C. 1325(b)(2).[3] This definition incorporates two changes: first, it defines "disposable income" based on an average of past monthly income and expense figures; and second, for debtors with higher income levels, it requires the use of the same standard expenses mandated for certain debtors under section 707(b)(2). Specifically, section 1325(b)(3) now directs that reasonable expenses be determined "in accordance with subparagraphs (A) and (B) of section 707(b)(2)" for those chapter 13 debtors whose current monthly income, multiplied by 12, is greater than the median family income for a family of the corresponding size. 11 U.S.C. 1325(b)(3). Chapter 13 debtors in this class are typically referred to as "above-median" debtors. To be clear, an above-median debtor is not one whose income places him in the top half of all debtors; it is one whose income places him in the top half of families of his size in his state of residence.

Under current bankruptcy rules, such a debtor must file a Fed. R. Bankr. P. Official Form 22C,[4] setting forth the debtor's income and expense amounts taken from the IRS standards. Because a debtor must also file the traditional Schedules I and J setting forth actual income and expenses, it often becomes apparent there is a significant difference between the above-median debtor's disposable income under Schedules I and J and his disposable income under Form 22C. In some cases, the use of Form 22C captures a temporary increase in the debtor's disposable income that does

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[3] "Current monthly income" means the "average monthly income from all sources" that the debtor received during the six-month period ending the last calendar month before the debtor filed his bankruptcy petition. 11 U.S.C. 101(10A).

[4] The form was previously known as "B22C." We will use the current form name "22C" throughout.

not continue into the plan period, but in other cases, like the present case, the use of Form 22C actually results in a lower amount of disposable income. In this and other cases, it may become clear that the historical circumstances that produced a particular income figure will change prospectively.

B. Facts.

The debtors, Shawn Petro and Clara Petro, filed a chapter 13 petition on September 12, 2007. Accompanying their petition were two different sets of forms disclosing income and expenses and computing those figures in different ways. The first set of forms, the traditional Schedules I and J,[5] showed a total monthly income of $9,720, less payroll deductions of $1,828.67 and total monthly expenses of $1,772.97, for a monthly net income of $1386.33. [Dkt. 1]. The second form, Form 22C,[6] which is a new form developed for use after the enactment of the BAPCPA, showed the debtors' statutorily defined "current monthly income" to be $6,786.67 ($81,440.04 annually), which

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[5] A chapter 13 petition must be accompanied by a variety of schedules to illustrate the debtor's financial situation. Schedule I (Current Income of Individual Debtor(s)) requires the debtor to compute net monthly take home pay, along with additional sources of income. Schedule J (Current Expenditures of Individual Debtor(s)) requires the debtor to set forth estimates of the average monthly expenses of the debtor and his family. At the bottom of Schedule J, the total monthly expenses are deducted from the total income figure from Schedule I.

[6] Form 22C is a new form developed after the enactment of the 2005 Act. Entitled "Statement of Current Monthly Income and Calculation of Commitment Period and Disposable Income," this form provides for the computation of the debtor's income and expenses pursuant to the definitions and rules found in BAPCPA. As we will explain, those definitions and rules are different from those that are found in Schedules I and J.

after computing deductions claimed[7] under BAPCPA, showed monthly disposable income of <$670.66>. [Dkt. 5 at 5].

The income discrepancy is the result of debtor Clara Petro obtaining employment in July 2007. [Dkt. 1, Schedule I ("Joint Debtor's CMI and Schedule I income differ because she has only been working since July 2007")]. Schedule I included her actual $4,000 monthly income, while her Form 22C current monthly income was calculated at only $1,066.77, based on the average of Ms. Petro's income in the six months preceding bankruptcy (during four and one-half months of which Ms. Petro was unemployed).

The debtors filed a chapter 13 plan that called for total monthly payments of $1,439.75, with approximately $322 per month, or $19,000 total, to be paid to unsecured creditors over the life of the plan. [Dkt. 2]. Unsecured creditors stand to receive approximately 23% on account of their claims. In re Petro, 381 B.R. 233, 235 (Bankr. M.D. Tenn. 2008).

The chapter 13 trustee objected to confirmation, arguing that the debtors' plan failed to provide that all of the debtors' projected disposable income would be applied to make payments to unsecured creditors under the plan as required by 11 U.S.C. 1325(b)(1). [Dkt. 47]. The chapter 13

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[7] Among the expense deductions claimed by debtors is a vehicle ownership expense in the amount of $332 for a vehicle owned free and clear by the debtors. It is the United States Trustee's position that this deduction is applicable only if the debtor has a vehicle loan or lease payment at the time of the bankruptcy filing, and in this case should have been disallowed by the Bankruptcy Court. See, e.g., Babin v. Wilson (In re Wilson), ___ B.R. ___, 2008 WL 681102 (B.A.P. 8th Cir. March 14, 2008); Ransom v. MBNA America Bank, N.A. (In re Ransom), 380 B.R. 799, 807-08 (B.A.P. 9th Cir. 2007), appeal filed (No. 08-15066 9th Cir.). However, this issue is waived because it was neither raised nor briefed below, and the United States Trustee shall not address it in this amicus brief.

trustee argued that when the debtors' actual income varies substantially from current monthly income, the court must utilize the actual income figure in calculating current monthly income.[8]

The bankruptcy court overruled the objection of the chapter 13 trustee and found that section 1325(b)(2) and Form 22C "require the application of a strictly mathematical formula in determining 'projected disposable income.'" In re Petro, 381 B.R. at 235. The bankruptcy court concluded that "projected disposable income shall be calculated based upon Congress' mechanical approach of current monthly income as determined by the []22C less the 707(b)(2) expenses for these above-median debtors." In re Petro, 381 B.R. at 242.

SUMMARY OF ARGUMENT

The 2005 amendments to section 1325 have created important interpretive questions about the proper way to understand "projected disposable income." As the case law reflects, there are different ways that courts have interpreted and applied that statutory language in light of the amendments. The interpretation adopted below by the bankruptcy court should be reversed, because it fails to take into account all the language in the statute.

The bankruptcy court interpreted the term "projected disposable income" to require use of the historical "disposable income" figure throughout the chapter 13 plan period, regardless of the debtor's actual income and expenses during that period. In this case, the debtors' historical "disposable income" was artificially low because Ms. Petro was only employed for a portion of the statutory look back period. Under the bankruptcy court's interpretation, the debtors' low disposable

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[8] Using debtors' Schedule I income at the time of filing of $9,720, less those section 707(b)(2) expenses claimed by the debtors under Form 22C of $7457.33, and less additional payroll expenses of $640 associated with Ms. Petro's actual income, debtors' actual post-petition disposable monthly income appears sufficient to pay unsecured creditors approximately $1,623 per month, or $97,000 over the 60 month term of the plan. Under this scenario, unsecured creditors would receive100% on account of their claims.

income figure would be "projected" over the entire plan period, with the result that debtors would be required to make small plan payments while having significant excess disposable income based on Ms. Petro's actual income, her having obtained a job shortly before filing. If this were what the statute actually required, that would be one thing. But the Bankruptcy Court's interpretation does not account for the usual meaning of "projected" income or for the statutory phrases "to be received" and "will be applied to make payments" in section 1325(b)(1)(B). Mechanically extending into the future an historical monthly income calculation, which may bear no relationship to actual income that the debtor will receive in the future, will either permit debtors to avoid using income that does exist to repay creditors, as in this case, or attribute to debtors future income that does not exist (when the debtors have a financial change for the worse).

In contrast, the chapter 13 trustee better reads the term "disposable income" as requiring this historical income figure to be projected as an initial matter, subject to adjustment to account for any significant increases or decreases in the debtor's income that are likely in particular cases. Such adjustments may be necessary in individual cases to ensure that the income attributed to debtors in their chapter 13 plan is actually income that is "projected" and "to be received" and that "will be applied to make payments" to unsecured creditors. While a simple multiplication of the initial disposable income number by the relevant number of months is a presumptive starting point, this correct approach allows adjustments to be made in appropriate cases. This interpretation is also consistent with the overall goals of chapter 13.

ARGUMENT

THE BANKRUPTCY COURT ERRED IN HOLDING THAT A DEBTOR'S "PROJECTED DISPOSABLE INCOME" UNDER SECTION 1325(b) OF THE BANKRUPTCY CODE IS BASED SOLELY ON "DISPOSABLE INCOME" AS CALCULATED BY FORM 22C, WITHOUT REGARD TO ACTUAL DEMONSTRABLE CHANGES IN INCOME

Congress's amendments to section 1325 three years ago have led the bankruptcy courts to take three different approaches to analyzing what "projected disposable income" means in confirming a chapter 13 plan. We discuss each, and explain why the chapter 13 trustee's interpretation is most consistent with the statutory language and the policies of the Bankruptcy Code.

A Section 1325(b): Before and After BAPCPA

The 2005 amendments to section 1325 created a significant change in the law. Before these amendments were enacted, section 1325(b)(1) provided that if the trustee or the holder of an allowed unsecured claim objected to the confirmation of a chapter 13 plan, the court was not permitted to approve the plan unless it provided that "all of the debtor's projected disposable income to be received in the three-year period beginning on the date that the first payment is due under the plan will be applied to make payments under the plan." 11 U.S.C. 1325(b)(1)(B) (2000 ed.). The term "disposable income" was defined as income received by the debtor that was "not reasonably necessary to be expended" for "maintenance or support of the debtor or a dependent" or for necessary business expenses if the debtor was engaged in a business. 11 U.S.C. 1325(b)(2)(A) (2000 ed.). Under that former law, a debtor's projected disposable income was calculated simply by subtracting the debtor's expenses on Schedule J from the debtor's income on Schedule I, two forms that a chapter 13 debtor was required to file.

In contrast, under the 2005 amendments, section 1325(b)(1) now provides that when the chapter 13 trustee or an unsecured creditor objects to confirmation, the plan must provide "that all of the debtor's projected disposable income to be received in the applicable commitment period beginning on the date that the first payment is due under the plan will be applied to make payments to unsecured creditors under the plan." 11 U.S.C. 1325(b)(1). And now, "disposable income" is defined expressly to mean "current monthly income received by the debtor * * * less amounts reasonably necessary to be expended" for maintenance or support or necessary business expenses. 11 U.S.C. 1325(b)(2). "Current monthly income" is defined as the "average monthly income from all sources" that the debtor received during the six-month period ending the last calendar month before the debtor filed the chapter 13 petition. 11 U.S.C. 101(10A). It is, in other words, an historical figure representing the monthly average of the period shortly before the petition was filed. An above-median debtor – one whose current monthly income, multiplied by 12, is above the annual median income in the state of a family of comparable size – calculates these figures on Form 22C.

The minority position taken in a number of bankruptcy court decisions, and by the court below, is that section 1325 requires "projected disposable income" to be computed by taking the historical "disposable income" figure, as defined in section 1325(b)(2), and simply multiplying it by the number of months in the debtor's chapter 13 plan. See, e.g., In re Mancl, 381 B.R. 537, 541 (W.D. Wis. 2008), appeal filed (No. 08-1635 7th Cir.).

Their underlying rationale is that "disposable income" was defined for the first time in the 2005 amendments and is used nowhere else than in the phrase "projected disposable income" in section 1325(b)(1)(B). Thus, the argument goes, "projected disposable income," while still undefined in the Code, must mean nothing more than "disposable income" that is projected out through the plan period – in other words, that is multiplied by the number of months in the plan.

Some courts have found this strict mathematical approach to be difficult to rationalize in cases in which the debtor's income or expenses changed significantly from the pre-petition period on which the historical disposable income figure is based. A handful of those courts have determined projected disposable income based solely on the income and expense figures used in Schedules I and J. See, e.g., In re Demonica, 345 B.R. 895, 900 (Bankr. N.D. Ill. 2006); In re Riggs, 359 B.R. 649, 652-53 (Bankr. E.D. Ky. 2007).

But most courts read "projected disposable income" in section 1325 as presumptively starting with the historical disposable income figure but allowing significant changes in the debtor's income or expenses to be considered when that figure inaccurately projects the debtor's ability to fund a chapter 13 plan over the life of that plan. See, e.g., In re Pak, 378 B.R. 257 (B.A.P. 9th Cir. 2007); In re Kibbe, 361 B.R. 302 (B.A.P. 1st Cir. 2007); In re Lanning, 380 B.R. 17 (B.A.P. 10th Cir. 2007), appeal filed (No. 08-3009 10th Cir.); In re Chriss-Price, 376 B.R. 648, 651-52 (Bankr.M.D.Tenn.2006); In re Jass, 340 B.R. 411, 418-19 (Bankr. D. Utah 2006).

B. The Bankruptcy Court's Mechanical Approach To Section 1325(b) Is Flawed.

The Bankruptcy Court found that section 1325 and Form 22C create "a mathematical formula" for determining what must be paid to the unsecured creditors, and that a court cannot stray from this rigid, mechanical test and consider other factors in making this determination. In re Petro, 381 B.R. at 235. While the Code fails to define "projected disposable income", the court nonetheless determined that "projected disposable income" had the same meaning as "disposable income" for above median debtors, with the "the new computation of 'disposable income' [] simply projected out over the time of the applicable commitment period...". In re Petro, 381 B.R. at 240, quoting In re Musselman, 379 B.R. 583, 587 (Bankr. E.D.N.C. 2007).

This approach to section 1325 is flawed for at least three reasons. First, it is founded upon a contextually incorrect interpretation of the term "projected." See Hibbs v. Winn, 542 U.S. 88, 101 (2004) (statutory words must be construed in context). The use of the term "projected" in the economic and financial context of this statute suggests a forecast or estimate of an expected future financial reality. See The Random House Dict. of the English Lang. 1546 (2d ed. 1987) (defining to "project" as, inter alia, "to set forth or calculate (some future thing); *They projected the building costs for the next five years.*"); Webster's Third New Int'l Dict. 1813 (1993) (defining "projected" as, inter alia, "planned for future execution: contrived, proposed," as "[projected] outlays for new plant and equipment").[9] While the calculation of "projected" financial data may well begin with historical data, it does not necessarily (or even usually) end there, nor does it entail a rigid and inviolable assumption, made by the bankruptcy court, that projected income will be identical with past income even when the available facts demonstrate otherwise. The Bankruptcy Court's mechanical test ignores this context of the statutory language.

Second, the bankruptcy court wholly failed to account for two other important phrases in section 1325(b)(1)(B). For one thing, the statute refers to the income "to be received by the debtor," but the mechanical test fails to address cases in which the historical income required to be used may have no relationship to the actual income "to be received." The court seems to dismisses these cases as merely "impractical results." In re Petro, 381 B.R. at 241. But when one is trying to understand statutory language and the results of an interpretation are impractical, the proper course is to make absolutely certain that one's interpretation takes all the relevant language into account.[10] In this case, by ignoring the textual phrase "to be received" in section 1325(b)(1)(B), when historical income

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[9] See also In re Chriss-Price, 376 B.R. 648 (Bankr. M.D.Tenn. 2006)("'Projected' is defined as '[t]o calculate estimate or predict (something in the future) based on present data or trends.'") (citing the American Heritage Dictionary of the English Language (4th ed. 2000)).

[10] It is unnecessary to decide whether the results of the mechanical test are "absurd" or merely "impractical." In re Petro, 381 B.R. at 240. That test not only is not compelled by the statutory language but, as we show here, also fails to take into account other language in the same section.

bears no relationship with actual income "to be received" by the debtor, the bankruptcy court fails to adhere to the statutory language.

Third, the mechanical test ignores this statutory phrase, as well: "will be applied to make payments." If projected disposable income is based strictly on an historical figure, minus expenses, there will be some cases in which income in the plan is only deemed, or hypothetical, and not actually received. In such cases, the deemed or hypothetical income cannot be applied to make payments for the simple reason that it does not exist. Take a fairly typical example, in which the debtor lost her job at about the time she filed a chapter 13 petition. In that case, the debtor's current monthly income, an average of the past six months income, reflects the income from that job, and the debtor's disposable income (the current monthly income less expenses) would not reflect the loss of that job. Projecting that figure forward would require the debtor to apply deemed or hypothetical income that was not actually "received" in the future "to make payments" under the plan. Or else it would deprive the debtor of recourse to chapter 13 simply because she had lost a job at about the time she filed.

These problems with the bankruptcy court's interpretation are more than mere policy issues; they are critical textual flaws. It is well established that courts "must, if possible, construe a statute to give every word some operative effect." Cooper Indus., Inc. v. Aviall Servs., Inc., 543 U.S. 157, 167 (2004) (citing United States v. Nordic Village, Inc., 503 U.S. 30, 35-36 (1992)). Affirmance of the bankruptcy court's decision would require the Court to ignore this statutory maxim.

C. The Chapter 13 Trustee's Interpretation Appropriately Gives Content To All Parts Of The Statute.

This Court should adopt the interpretation of section 1325(b), which not only gives meaning to the new definition of "disposable income" in section 1325(b)(2) as an historical number but also treats “projected” disposable income as a future-oriented concept, as required by the language of section 1325(b)(1).

"Projected disposable income" in the current version of the statute will, as a general matter, be based on the newly defined "disposable income" in section 1325(b)(2), which in turn will be based on an historical calculation of current monthly income, computed as the average of the six month before the petition was filed. But there are circumstances in which the debtor's financial condition changes significantly from that pre-petition period and that, in such circumstances, it will not be appropriate to use the historical calculation. "Where it is shown that Form B22C disposable income fails accurately to predict a debtor's actual ability to fund a plan, that figure may be subject to modification," albeit in "exception[al]" cases. In re Lanning, 380 B.R. at 25.

This interpretation not only is faithful to the new definition of "disposable income" in section 1325(b)(2) as an historical number but also treats "projected" disposable income as a future-oriented concept, as required by the language of section 1325(b)(1). See In re Pak, 378 B.R. at 264-65; In re Kibbe, 361 B.R. at 307-08. The interpretation requires the use of the historical income figure called for in the definition of "disposable income" as a starting point, and it calls for a presumption that the historical figure should be carried forward throughout the term of the plan, absent evidence to the contrary. But in order to take into account the future-orientation of the remaining language of the statute, and to ensure that projected disposable income is, in fact, a projection, it allows that presumption to be rebutted whenever the debtor is likely to experience (or actually has experienced) either a significant increase or a significant decrease in income after the filing of the chapter 13 plan.

The reason for having a starting presumption that the historical disposable income figure should be applied mathematically to derive the projected disposable income is that, while "projected disposable income" is not the same as "disposable income," it is appropriate in construing the former phrase to give effect to the definition of the latter. Section 1325(b)(2) provides a definition "[f]or purposes of this subsection." 11 U.S.C. 1325(b)(2). The only time that "disposable income" is used in "this subsection," section 1325(b), other than in the definition itself, is in the term "projected disposable income." Thus, we accept that a court should begin by applying the historical "disposable income" figure as a starting point and by presumptively carrying that figure forward over the plan period.[11]

At the same time, however, this initial presumption that the historical current monthly income will be used must necessarily be rebuttable. "Parties contending that a debtor's Form B22C disposable income figure does not accurately project the debtor's future ability to fund a plan must present documentation similar to that required by section 707(b)(2)(B)(ii) in support of their claim." In re Lanning, 380 B.R. at 25. See also In re Pak, 378 B.R. at 267 ("It makes no sense to interpret 'projected disposable income,' governing debtors' future payments under their chapter 13 plans, as cast in stone by their pre-bankruptcy history, without any opportunity for the trustee, creditors or the debtor to offer rebutting evidence as to changed income circumstances before the effective date of the plan.").

Thus, contrary to the bankruptcy court's interpretation, application of the historical income figure to the plan period is not the end of the matter in all cases. To the contrary, there are situations in which a debtor has or is likely to have significant changes in income after the period in which the

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[11] Congress may well have expected that the historical figure, computed generally with standard rather than actual expenses, would result in a higher disposable-income total for "above-median" debtors and a greater amount designated for repayment to creditors under the debtor's chapter 13 plan. But the fact that this is often not the case does not authorize a court to ignore the statutory definition altogether. Thus, the decisions that ignore Form 22C in determining projected disposable income and base it instead on Schedules I and J in the ordinary case cannot find support in the statutory language. See, e.g., In re Demonica, 345 B.R. 895, 900 (Bankr. N.D. Ill. 2006); In re Riggs, 359 B.R. 649, 652-53 (Bankr. E.D. Ky. 2007).

historical "current monthly income" is computed, and in order to give full effect to the statutory text those changes must be taken into account in "project[ing]" the debtor's future disposable income.

There are two types of exceptional case that section 1325 must be able to address. First, a debtor may suffer a significant loss of income – for example, by losing a job – at about the time he files his chapter 13 petition. Such a debtor would have a relatively high "current monthly income," based on an average of the six months preceding the month in which the petition was filed. Yet if that historical income were simply extended forward for purposes of the chapter 13 plan, it would not reflect the actual income available to the debtor during that future period.

Second, a debtor may be unemployed during the six-month period in which "current monthly income" is calculated but may accept a job at about the time he files his chapter 13 petition. See In re Pak, supra (debtor was unemployed for three years but found a job paying over $100,000 two months before filing his petition). Such a debtor, as in this case, would have an artificially low "disposable income" but might well be able to fund a chapter 13 plan that would repay most or all of his unsecured debt. That would be precisely the situation in this case if the mechanical test were used. To put it in statutory terms, the future disposable income thus computed would not be the debtors' "projected" disposable income (because it would demonstrably not be based on a reliable estimate of future income) nor would it be the disposable income "received" by the debtors during the applicable commitment period. 11 U.S.C. 1325(b)(1)(B). In a case like this, therefore, the court must take into account the debtors' significant increase in income in order to apply section 1325(b) faithfully.[12]

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[12] We recognize that when the debtor find himself with a significant increase in income, the lower historical figure would actually be received by the debtor and could be applied to pay unsecured creditors. But it would still not be an accurate "project[ion]" of the debtor's disposable income to be "received" during the plan period, and thus the Bankruptcy Court's interpretation is (continued...)

The United States Trustee is the first to admit that the language of section 1325 is not a model of clarity. But while our interpretation is necessarily based on certain inferences from context, it gives effect to all the statutory language far more faithfully than the Bankruptcy Court's interpretation. Almost as important, it better furthers the overall goal of chapter 13.

Chapter 13 focuses on having debtors devote future income to paying their creditors. Indeed, BAPCPA placed additional emphasis on this goal of paying future income to creditors when it added language to section 707(b) permitting a court, with the debtor's consent, to convert an abusive chapter 7 case to chapter 13, as an alternative to dismissal. 11 U.S.C. 707(b)(1). While the bankruptcy court's interpretation does require future income to be used to pay creditors, that future income is measured exclusively by reference to historical income, and in some cases, like this one, bears no relation to the actual income available to the debtor. In contrast, our interpretation permits a court to consider the actual income that can "be applied to make payments" under the plan in those cases in which a different amount of actual income is available to a debtor because of changed circumstances. The use of actual income in such cases is an important measure of fairness, both to the debtor in cases like In re Lanning, 380 B.R. 17 (B.A.P. 10th Cir. 2007), in which the debtor will earn significantly lower income than reflected in the historical calculation, and to creditors in cases such as this and In re Pak, 378 B.R. 257 (B.A.P. 9th Cir. 2007), in which the debtors' actual and anticipated future income is above their historical income.

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[12](...continued)
irreconcilable with the statutory text in these circumstances also. And in any event, section 1325(b) should be interpreted in one uniform way for all above-median debtors, so the rebuttable presumption approach should be applied across the board.

CONCLUSION

For the foregoing reasons, the United States Trustee respectfully asks this Court to reverse the order entered below and remand the case with instructions that the bankruptcy court determine the debtors' projected disposable income in accordance with this Court's opinion.

STATEMENT REGARDING ORAL ARGUMENT

The United States Trustee stands ready to participate at oral argument should this Court deem his participation to be useful in deciding this appeal.

Respectfully submitted,

RICHARD F. CLIPPARD
United States Trustee

P. Matthew Sutko
Thomas C. Kearns
Executive Office for United States Trustees
Department of Justice
20 Massachusetts Avenue, N.W. Suite 8110
Washington, D.C. 20530
Telephone: (202) 307-1405

CERTIFICATE OF SERVICE

I hereby certify that on the __ day of April, 2008 the original and 5 true and correct copies of the foregoing were sent by Federal Express to the Office of the Clerk of the U.S. Bankruptcy Appellate Panel of the Sixth Circuit, Potter Stewart Courthouse, 100 East Fifth Street, Room 532 Cincinnati, OH 45202-3988, and that true and correct copies were deposited in the United States Mail, First Class, postage prepaid to the following:

Henry E. Hildebrand
Chapter 13 Standing Trustee
P.O. Box 190664
Nashville, TN 37219-0664

Mary Elizabeth Ausbrooks
Attorney for the Debtors
Clark & Washington
813 2nd Avenue, S.
Nashville, TN 37210

Thomas C. Kearns
Attorney for the United States Trustee
as Amicus Curiae

BRIEF BANK — "SUMMARY SHEET" *Printed Tue-11/24/09 16:49*

WESTLAW CODES

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In re Christopher Phillips (Christopher Phillips v. United States Trustee)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*

BAP 9th Cir.

3. ("CCN") ***CURRENT*** CASE NO.

No.: 09-1114

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Thomas A. Burford, Catherine Sevcenko, P. Matthew Sutko, Ramona D. Elliott, Robert D. Miller

(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***

BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***

• (1) Whether the Bankruptcy Court properly denied debtor's discharge pursuant to section 727(a)(2)(B) after finding that debtor intentionally concealed a claim pending against an insurance company. (2) Whether the Bankruptcy Court properly denied debtor's discharge pursuant to section 727(a)(4)(A) after finding that debtor knowingly and fraudulently made material false oaths on his schedules and at his Section 341 meeting.

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UNITED STATES BANKRUPTCY APPELLATE PANEL
OF THE NINTH CIRCUIT

In re CHRISTOPHER PHILLIPS, Debtor.	B.A.P. Case No. 09-1114
CHRISTOPHER PHILLIPS, Appellant, vs. UNITED STATES TRUSTEE, Appellee.	Bankr. Case No. 08-14147 Adv. Pro. No. 08-1338 Bankruptcy Court for the Western District of Washington

BRIEF OF APPELLEE UNITED STATES TRUSTEE

RAMONA D. ELLIOT
General Counsel
P. MATTHEW SUTKO
Associate General Counsel
CATHERINE SEVCENKO
Trial Attorney
Executive Office for United States Trustees
20 Massachusetts Avenue N.W.
Washington, DC 20530

ROBERT D. MILLER JR.
Acting United States Trustee, Region 18
THOMAS A. BUFORD III
Attorney for the United States Trustee
700 Stewart Street
Suite 5103
Seattle, WA 98101
206-553-2000 (voice)
206-553-2566 (fax)

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I. Whether the Bankruptcy Court properly denied Dr. Phillips's discharge pursuant to Section 727(a)(2)(B) after finding that Dr. Phillips intentionally concealed a claim pending against an insurance company.

II. Whether the Bankruptcy Court properly denied Dr. Phillips's discharge pursuant to Section 727(a)(4)(A) after finding that Dr. Phillips knowingly and fraudulently made material false oaths on his schedules and at his Section 341 meeting.

B. STATEMENT OF FACTS

I. SUBSTANTIVE HISTORY

A. Dr. Phillips's claim against Standard Insurance Company

In November 2002, Dr. Phillips obtained a Disability Income Insurance policy from Standard Insurance Company. App. 3, P. 2.[1] [2] On March 22, 2008, Dr. Phillips signed, and on March 27, 2008, Standard received Claim No. 00VD7339 ("the Claim") from Dr. Phillips for benefits under the Policy. App. 3, P. 2-3. Standard asked Dr. Phillips to supply additional information before Standard would process the Claim. App. 3, P. 3. Dr. Phillips filed the above-referenced petition under Chapter 7 of the Bankruptcy Code on July 2, 2008 ("the Petition Date"). App. 3, P. 2. Nancy L. James was appointed to serve as the Chapter 7 trustee. Id. On July 31, 2008, Dr. Phillips appeared and testified at a Section 341 meeting of creditors. Id. The Claim remained pending on the Petition Date and on the date of the Section 341 Meeting. App. 3, P. 3. The maximum value of the Claim was $1,116,000 over the life of the policy. App. 20. Dr. Phillips stood to receive $3,000 per month, potentially until

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[1] The copy of the Appendix to Dr. Phillips's Brief that he served upon the United States Trustee is not continuously paginated. The United States Trustee will cite to tab number followed by page number within each tab ("App. _, P. _").

[2] Dr. Phillips and the United States Trustee stipulated to the facts contained in App. 3 and these facts were incorporated by reference into the Bankruptcy Court's ruling on this matter. App. 5, P. 2.

Dr. Phillips was 67 years old. Id.[3]

Both prior and subsequent to the Petition Date and 341 Meeting, Dr. Phillips and Standard were in communication regarding the Claim and Standard's request for more information to support the Claim. Id. In order to process the Claim, Standard requested information regarding Dr. Phillips's physical condition and his medical practice prior to making the Claim. See, e.g., App. 15, 17, 18, and 19. To further the processing, Dr. Phillips and Standard exchanged numerous communications regarding the Policy and the Claim, including the following:

Date of Letter	Letter Author	Letter Recipient
February 12, 2008	Maureen Rotter	Christopher Phillips
March 27, 2008	Maureen Rotter	Christopher Phillips
April 3, 2008	Maureen Rotter	Christopher Phillips
April 17, 2008	Maureen Rotter	Christopher Phillips
May 8, 2008	Maureen Rotter	Christopher Phillips
May 13, 2008	Christopher Phillips	Maureen Rotter
May 20, 2008	Maureen Rotter	Christopher Phillips
May 27, 2008	Marisa Kragerud	Christopher Phillips
May 29, 2008	Marisa Kragerud	Christopher Phillips
June 11, 2008	Marisa Kragerud	Christopher Phillips
June 13, 2008	Marisa Kragerud	Christopher Phillips
July 2, 2008	Marisa Kragerud	Christopher Phillips
July 8, 2008	Marisa Kragerud	Christopher Phillips
July 25, 2008	Marisa Kragerud	Christopher Phillips
August 1, 2008	Marisa Kragerud	Christopher Phillips
August 15, 2008	Marisa Kragerud	Christopher Phillips
August 18, 2008 (1)	Christopher Phillips	Marisa Kragerud
August 18, 2008 (2)	Christopher Phillips	Marisa Kragerud

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[3] At the time of trial, Standard had paid Ms. James approximately $52,000 on account of the Claim. Supp. App. 1, P. 12.

August 28, 2008	Debbie McClellan	Christopher Phillips
September 3, 2008	Unknown	Christopher Phillips
September 8, 2008	Marisa Kragerud	Christopher Phillips
September 19, 2008	Christopher Phillips	Marisa Kragerud

App. 3, P. 3-4. Dr. Phillips received and read each above-listed letter that was addressed to him. App. 3, P. 4. Dr. Phillips authored each above-listed letter that was sent by him. Id. In addition to these written communications, Dr. Phillips had several phone conversations with representatives of Standard. App. 15, 16, and 19. Further, Dr. Phillips hired an attorney to pursue the Claim. App. 15, P. 1-2, and Supp. App. 1, P. 112-114.[4]

B. Dr. Phillips's failure to disclose the Claim

Dr. Phillips did not include the Claim or the Policy on his Schedule B, which was filed on the Petition Date. Id. Dr. Phillips, however, did include other potential claims on his Schedule B. Id. and Supp. App. 2.[5] Dr. Phillips did not include potential payments from Standard on Line 17 of his Schedule I. Supp. App. 3.

At the Section 341 meeting, Dr. Phillips testified that (i) prior to filing, he reviewed his Petition and Schedules, (ii) the Petition and Schedules were true and accurate, and (iii) no changes needed to be made to the Petition and Schedules. Id. Dr. Phillips did not disclose the Claim or the Policy at the Section 341 Meeting. Id. On the same date as the Section 341 Meeting, Dr. Phillips filed an Amended Schedule B ("the First Amended Schedule B"), which did not disclose the existence of the Claim or the Policy. Supp. App. 4. On September 9, 2008, Standard informed Rory Livesey, Ms. James's attorney in this matter, of the existence of the Claim, the Policy, and Standard's

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[4] The United States Trustee has attached a supplemental appendix and will cite to such as "Supp. App. _, P. _."

[5] The other potential claims include claims against International Optical, Tom Foster, Ann Foster, Valley Eye & Laser Center, Inc., Paul Joos, M.D., Peter Jones, M.D., Chris Monson, M.D., Viet Bui, M.D., Richard Lomas, M.D., Lomas Laser & Eye Care Center, Inc., Dr. Phillips's landlord, Dr. Phillips's neighbor, various media outlets, and the Hazeldon Clinic.

denial of the Claim. App. 3, P. 4. On the same date, Mr. Livesey informed Ms. James and the United States Trustee of the information he received from Standard. Id. On September 15, 2008, Standard filed Adv. Pro. No. 08-1232 against Dr. Phillips, which sought a determination by the Court that any debt Dr. Phillips owed to Standard was nondischargeable in Dr. Phillips's bankruptcy proceeding. Id. Two days later, Dr. Phillips filed with the Court his amendment to his Schedule B to disclose the Claim ("the Second Amended Schedule B"). Supp. App. 5. On October 7, 2008, Dr. Phillips filed his amendment to Schedule C to exempt the value of the Claim ("the Amended Schedule C"). Id.

On October 15, 2008, Dr. Phillips appeared and testified at a Rule 2004 exam. Id. At the Rule 2004 exam, Dr. Phillips testified that he did not disclose the Claim and the Policy on his Schedule B or at the Section 341 Meeting because he forgot about the Claim and the Policy. Id. Dr. Phillips repeated this testimony at trial. Supp. App. 1, P. 12. In addition, Dr. Phillips testified at trial that he did not include possible payments from Standard on Schedule I because he "did not think about [the Claim]." Supp. App. 1, P. 19. At trial, the evidence demonstrated that Dr. Phillips's only sources of income on the Petition Date were a Veteran's Administration disability payment of $3,275 per month and gifts from his family. App. 15, P. 1, and Supp. App. 1, P. 20.

C. Dr. Phillips's mental competency

At trial, Dr. Phillips called Dr. Judith Cohen. Supp. App. 1, P. 29-57. Dr. Cohen testified that she first examined Dr. Phillips on November 20, 2008. Supp. App. 1, P. 32. Dr. Cohen testified that, every day between late fall 2007 and November 20, 2008, Dr. Phillips would have the capacity to form intent but his ability to follow through with an act might have been impaired. Supp. App. 1, P. 51-52, 56-57. Dr. Cohen, however, testified that she did not have any direct knowledge of Dr. Phillips's capacity or ability on the Petition Date or on July 31, 2008, the date of the Section 341 meeting. Supp. App. 1, P. 56-57.

In addition to Dr. Cohen's testimony, Dr. Phillips introduced a Psychiatric Discharge Summary, dated April 18, 2008, from the Menninger Clinic ("the Psychiatric Summary"). App. 13. The Psychiatric Summary states the following regarding Dr. Phillips's mental status at discharge:

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> Dr. Phillips was appropriately groomed and attired. Attitude and behavior in examination was cooperative. Psychomotor exam was negative for tics or tremors. He was alert and oriented in all spheres, and cognitively intact. His speech was normal in volume, tone, rate, and amount. His mood was "normal." Affect was euthymic and congruent with stated mood. Thought process was logical and goal-directed. Thought content was appropriate. He reported no suicidal or homicidal ideation and expressed no intent or plan to harm himself or others. He reported no auditory or visual hallucinations and did not appear to be responding to internal or unseen stimuli. Attention and concentration intact. Fund of knowledge was above average. Insight was fair. Judgment was intact. Abstract thinking was intact.

App. 13, P. 3.

To rebut Dr. Phillips's assertion that he was not mentally capable of forming the intent to defraud his creditors, the United States Trustee introduced documentary and testimonial evidence. Ms. James testified that she had been a Chapter 7 trustee for over twenty-four years and had administered approximately 16,000 cases. Supp. App. 1, P. 11-12. Ms. James testified that she conducted the Section 341 Meeting and had no reason to believe that Dr. Phillips was mentally incompetent. Supp. App. 1, P. 100-01. Further, Ms. James testified that she attended the Rule 2004 Exam and that she had no reason to believe that Dr. Phillips was mentally incompetent. Supp. App. 1, P. 101-02.

The United States Trustee also called Jeffrey Wells to rebut Dr. Cohen's testimony. Supp. App. 1, P. 115. Mr. Wells has been a bankruptcy attorney since 1985. He represented Dr. Phillips's medical practice in a bankruptcy case which he filed on October 18, 2008. Supp. App. 1, P. 115-16. Mr. Wells testified that he met with Dr. Phillips two or three times between August and October 2008. Supp. App. 1, P. 116-17. Mr. Wells testified that he had no reason to believe that Dr. Phillips was mentally incompetent. Supp. App. 1, P. 118.

Dr. Phillips testified extensively regarding his litigation activities[6] in the months between the Petition Date and November 20, 2008, which was the date Dr. Phillips first met with Dr. Cohen. During this time, Dr. Phillips pursued unemployment benefits from the State of Washington. Supp.

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[6] Dr. Phillips, in addition to having a medical degree, has a juris doctorate and, at the time of trial, was more than half way through obtaining his master's degree in business administration. App. 5, P. 2.

App. 1, P. 87. The State of Washington initially denied that claim. Id. On September 4, 2008, Dr. Phillips appeared and argued his case. Supp. App. 6. Dr. Phillips's argument included well-crafted objections and citations to relevant authority. Supp. App. 6, P. 181-82. On September 5, 2008, Dr. Phillips filed an objection to this denial, complete with case law and argument. Supp. App. 7. On October 7, 2008, Dr. Phillips filed a petition for review of the denial of his claim with the Employment Security Commission. Supp. App. 8. Dr. Phillips's petition included numerous assignments of error and citations of authority. Id. On November 3, 2008, Dr. Phillips filed a separate petition with review with the King County Superior Court. Supp. App. 9. On November12, 2008, Dr. Phillips again argued the issue before the Employment Security Commission. Supp. App. 10. Due to Dr. Phillips's efforts, the Employment Security Commission overturned their initial denial of his claim. Supp. App. 1, P. 95.

In addition to successfully representing himself in obtaining unemployment benefits, Dr. Phillips successfully represented himself in matters before the Bankruptcy Court. FIA Card Services filed an adversary proceeding to determine the dischargeability of a debt against Dr. Phillips. Supp. App. 1, P. 96. Dr. Phillips represented himself in this proceeding. Id. On October 29, 2008, Dr. Phillips filed a four-page answer to the Complaint which included affirmative defenses and a request for a jury trial. Sup. App. 11. Also on October 29, 2008, Dr. Phillips filed a thirteen-page motion to dismiss the adversary proceeding, replete with extensive legal research and multiple exhibits. Supp. App. 12. In response to Dr. Phillips's motion to dismiss, the plaintiff in that proceeding agreed to dismissal of the action with prejudice. Supp. App. 1, P. 96-97.

In addition to FIA Card Services, Prairie Eye Center filed an adversary proceeding against Dr. Phillips. Supp. App. 1, P. 97. Dr. Phillips represented himself in this proceeding. Id. On October 28, 2008, Dr. Phillips filed a twelve-page answer and counterclaim to Prairie Eye Center's complaint which included affirmative defenses and a request for jury trial. Supp. App. 13. Also on October 28, 2009, filed a separate twelve-page motion to dismiss the complaint. Supp. App. 14. After arguing the motion to dismiss, Dr. Phillips was successful in having Prairie Eye Center's complaint dismissed by the Bankruptcy Court. Supp. App. 1, P. 97-98.

II. PROCEDURAL HISTORY

On December 5, 2008, the United States Trustee filed a Complaint to deny Dr. Phillips's discharge. App. 1. On March 3, 2009, the Bankruptcy Court conducted a trial on the merits of the United States Trustee's Complaint. App. 5, P. 1. On March 18, 2009, the Bankruptcy Court entered a letter ruling that contained the Bankruptcy Court's findings of fact and conclusions of law, and found that Dr. Phillips violated Section 727(a)(2) and (4). App. 5. On March 23, 2009, the Bankruptcy Court entered an order denying Dr. Phillips's discharge pursuant to Section 727(a)(2)(A), Section 727(a)(2)(B) and Section 727(a)(4)(A). App. 6. On April 1, 2009, Dr. Phillips filed a motion for reconsideration of the Bankruptcy Court's order denying his discharge. App. 7. On April 2, 2009, Dr. Phillips filed a notice of appeal of the Bankruptcy Court's order denying his discharge. App. 10. On April 8, 2009, the Bankruptcy Court denied Dr. Phillips's motion to reconsider, indicating that the notice of appeal had removed the Bankruptcy Court's jurisdiction over the matter. On April 17, 2009, Dr. Phillips filed a motion for the Bankruptcy Court to reconsider its order denying Dr. Phillips's motion for reconsideration and a motion to amend his original motion to reconsider. App. 8. On May 26, 2009, the Bankruptcy Court entered an order granting Dr. Phillips's motion to reconsider and amended the Bankruptcy Court's order denying discharge to provide that Dr. Phillips's discharge was denied pursuant to Section 727(a)(2)(B) and Section 727(a)(4)(A).[7] App. 9, P. 9.

C. SUMMARY OF ARGUMENT

The Bankruptcy Court denied Dr. Phillips's discharge pursuant to Section 727(a)(2)(B) and Section 727(a)(4)(A). In order to overturn the Bankruptcy Court's decision, Dr. Phillips must succeed in overturning the Bankruptcy Court's ruling on both Section 727(a)(2) and (a)(4); each ruling independently serves as the basis for denial of Dr. Phillips's discharge. As discussed below, the Bankruptcy Court properly denied Dr. Phillips's discharge pursuant to Section 727(a)(2) because Dr. Phillips intentionally concealed his interest in the Claim by omitting such from his Schedule B,

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[7] The Bankruptcy Court initially also denied Dr. Phillips's discharge pursuant to Section 727(a)(2)(A). App. 5, P. 6. The Bankruptcy Court revised its earlier opinion and removed Section 727(a)(2)(A) as grounds for denial of Dr. Phillips's discharge.

Amended Schedule B, and 341 Meeting testimony. The Bankruptcy Court properly denied Dr. Phillips's discharge pursuant to Section 727(a)(4) because Dr. Phillips knowingly and fraudulently made material false oaths on his Schedule B, Amended Schedule B, and at the Section 341 Meeting.

D. STANDARD OF REVIEW

The Bankruptcy Court's findings of fact are reviewed for clear error. In re Searles, 317 B.R. 368, 373 (9th Cir. BAP 2004). The Bankruptcy Court's finding of intent to defraud is a finding of fact. In re Adeeb, 787 F.2d 1339, 1342 (9th Cir. 1986). Therefore, the Bankruptcy Court's finding of intent is reviewed for clear error. Id. The Bankruptcy Court's conclusions of law are reviewed *de novo*. Searles, 317 B.R. at 373.

E. ARGUMENT

I. THE BANKRUPTCY COURT PROPERLY DENIED DR. PHILLIPS'S DISCHARGE PURSUANT TO SECTION 727(A)(2)(B) BECAUSE DR. PHILLIPS INTENTIONALLY CONCEALED THE CLAIM AND POLICY WITH THE INTENT TO HINDER, DELAY, OR DEFRAUD HIS CREDITORS.

Section 727(a)(2) provides that a debtor's discharge may be denied if

> the debtor, with intent to hinder, delay, or defraud a creditor or an officer of the estate charged with custody of property under this title, has transferred, removed, destroyed, mutilated, or concealed, or has permitted to be transferred, removed, destroyed, mutilated, or concealed--
>
> ...
>
> (B) property of the estate, after the date of the filing of the petition;

11 U.S.C. § 727(a)(2). It is undisputed that Dr. Phillips did not disclose the Claim or the Policy on his Schedule B or on his First Amended Schedule B. It is undisputed that, when asked at the Section 341 Meeting, Dr. Phillips testified that (i) prior to filing, he reviewed his Petition and Schedules; (ii) the Petition and Schedules were true and accurate; and (iii) no changes needed to be made to the Petition and Schedules. At trial, the only disputed issue with respect to Section 727(a)(2) was Dr. Phillips's intent when he concealed this asset. See, e.g., App. 5, P. 2; and Supp. App. 1, P. 120-21, 126.

A. Dr. Phillips intentionally concealed the claim.

To sustain an objection to discharge pursuant to Section 727(a)(2), the plaintiff must show actual fraud. In re Woodfield, 978 F.2d 516, 518 (9th Cir. 1992). "A debtor's fraudulent intent may be established by circumstantial evidence or by inferences drawn from his or her course of conduct." In re Roberts, 331 B.R. 876, 884 (9th Cir. BAP 2005); In re Wills, 243 B.R. 58, 64 (9th Cir. BAP 1999). "Denial of discharge, however, need not rest on a finding of intent to *defraud*. Intent to hinder or delay is sufficient." In re Bernard, 96 F.3d 1279, 1281 (9th Cir. 1996) (emphasis in original).

The Bankruptcy Court found that Dr. Phillips intentionally concealed the Claim with intent to hinder, delay, or defraud his creditors. The Bankruptcy Court's finding of intent is a finding of fact. Adeeb, 787 F.2d at 1342. Therefore, the Bankruptcy Court's finding of intent is reviewed for clear error. Id.

The Bankruptcy Court's finding of intent is well supported by the record. Both at the Rule 2004 Exam and at trial, Dr. Phillips testified that he did not disclose the Claim in his Schedules or in his testimony at the Section 341 Meeting because he forgot about the Claim. The Bankruptcy Court heard this testimony, observed Dr. Phillips's demeanor, and determined that this testimony was not credible. App. 5, P. 4.

The Bankruptcy Court's determination that Dr. Phillips had not forgotten about the policy is based upon an extensive amount of evidence. Dr. Phillips had numerous oral and written communications, both before and after the Petition Date and the Section 341 Meeting, with Standard regarding the Claim. Between February 12, 2008, and July 2, 2008, the evidence at trial showed that Dr. Phillips received and read at least eleven letters from Standard. App. 3, P. 3-4. In addition, Dr. Phillips authored at least one letter to Standard and participated in at least two phone conversations with representatives from Standard. App. 15. In one of those conversations, Dr. Phillips represented to Standard that he had consulted with an attorney who specialized in disability insurance law. Id. After the Petition Date, Dr. Phillips continued to communicate extensively with Standard. App. 4, P. 4. Between July 2, 2008, the Petition Date, and September 17, 2008, the date the Second Amended Schedule B was filed, Dr. Phillips received and read seven letters from Standard. Id. During the same time period, Dr. Phillips authored two letters to Standard. Id. In addition, on August 8, 2008, Dr. Phillips participated in an extensive phone conversation with a representative of Standard. App. 19. During that conversation, Dr. Phillips disputed Standard's authority to request further information regarding the Claim, stated that he had spent weeks and thousands of dollars assembling information to support the Claim, and stated that he "was getting ready to sue" Standard over the claim. Id.

In addition to his activity pursuing the Claim, Dr. Phillips testified at trial that his financial condition was challenging. Dr. Phillips, in addition to being bankrupt, testified that his only income was a government disability payment and gifts from his family. Dr. Phillips further testified that the income from the Claim would be helpful to his financial situation.

Upon completing his investigation in this case, the United States Trustee filed his Complaint alleging that Dr. Phillips fraudulently concealed the Claim. Dr. Phillips's initial defense to this allegation was that he forgot about the Claim. When considering the volume, depth, and timing of communications between Dr. Phillips and Standard, Dr. Phillips's "I forgot" defense is not credible. In re Newell, 321 B.R. 885 (Bankr. N.D. Ohio 2005) (holding that activity in close proximity to the petition date belies the defense that a debtor forgot). Similarly, Dr. Phillips's retention of an attorney and his "weeks of work" that cost "thousands of dollars" in pursuit of the Claim are equally persuasive. App. 19, P. 1. Further, the income that would be paid as a result of the Claim was crucial to Dr. Phillips considering that, on the Petition Date, he was subsisting on government disability and gifts from family. Finally, Dr. Phillips's Schedule B listed numerous other claims, including many upon which Dr. Phillips had taken no action to prosecute. Taken together, the preponderance of the evidence shows that Dr. Phillips intentionally concealed the Claim. As such, the Bankruptcy Court's finding was not clearly erroneous and should be affirmed.

B. Dr. Phillips was mentally capable of intentionally defrauding his creditors.

In an effort to counter the conclusion that he intentionally concealed the Claim, Dr. Phillips sought to introduce evidence that he was mentally incapable of intentionally defrauding his creditors. To support his allegation, Dr. Phillips introduced two pieces of evidence: the April 18, 2008, Psychiatric Summary from the Menninger Clinic and the testimony of a mental health expert who analyzed Dr. Phillips after the Complaint was filed. To demonstrate Dr. Phillips's mental capacity, the United States Trustee introduced documentary evidence of Dr. Phillips's high level of functioning in complex litigation and testimony from bankruptcy professionals who interacted with Dr. Phillips. The Bankruptcy Court carefully considered Dr. Phillips's contention and, citing overwhelming evidence to the contrary, rejected it.

The evidence cited by Dr. Phillips to further his claim of mental incompetence is not persuasive because the Psychiatric Summary describes an individual in good mental health and Dr. Cohen's opinion is both remote in time and contradicted by Dr. Phillips's actions. The Psychiatric Summary states that Dr. Phillips was appropriately groomed and attired. His attention, concentration, and judgment were intact. Dr. Phillips had a normal mood and affect. The Psychiatric Summary describes someone who, far from being mentally incompetent, was alert, oriented, and whose thought process was logical and goal-oriented. Further, the Psychiatric Summary directly contradicts Dr. Cohen's opinion that Dr. Phillips's executive functions were impaired every day between late fall of 2007 and November 20, 2008.

Dr. Cohen's opinion is further cast into doubt when, as the Bankruptcy Court did, one considers the complex and numerous pieces of litigation in which Dr. Phillips successfully represented himself during the summer and fall of 2008. Dr. Phillips overturned the State of Washington's denial of his unemployment benefits claim. In doing so, Dr. Phillips drafted multiple pleadings and argued the matter at multiple hearings. Supp. App. 1, P. 86-98. Concurrently, Dr. Phillips defended himself successfully in two adversary proceedings before the Bankruptcy Court. Dr. Phillips answered and filed a motion to dismiss the complaint of FIA Card Services. Supp. App. 11 and 12. After reviewing the lengthy and well-drafted motion to dismiss, FIA Card Services consented to dismiss the proceeding with prejudice. Further, on October 28, 2008, Dr. Phillips filed a twelve-page answer and counter-claim to the complaint of Prairie Eye Center. Supp. App. 13. On the same date, Dr. Phillips filed a separate twelve-page motion to dismiss Prairie Eye Center's complaint. Supp. App. 14. Prairie Eye Center, unlike FIA Card Services, did not consent to dismissal of their complaint. However, after argument by Dr. Phillips, the Bankruptcy Court dismissed Prairie Eye Center's complaint. Dr. Phillips's answers and motions to dismiss in these adversary proceedings documents were filed less than three weeks before Dr. Phillips's initial meeting with Dr. Cohen. The number and complexity of these documents directly contradicts Dr. Cohen's testimony that Dr. Phillips's executive functioning was impaired every day between late fall of 2007 and November 20, 2008.

In addition to being contradicted by Dr. Phillips's successful litigation activity, Dr. Cohen's opinion is contradicted by other testimony taken at trial. First, Ms. James testified that she conducted the Section 341 Meeting and was present at the Rule 2004 Exam. Ms. James testified that, on both occasions, she had no reason to believe that Dr. Phillips was incapable of conducting his personal affairs. Further, Ms. James testified that, on both occasions, Dr. Phillips was appropriately dressed, answered the questions that were asked of him, and appeared to understand and follow both proceedings. In addition, Mr. Wells, the attorney hired by Dr. Phillips to handle Seattle Eye Surgeons' bankruptcy proceeding, testified at trial. He met with Dr. Phillips two or three times during the period from early August 2008 to October 18, 2008. Mr. Wells testified that, at each meeting, Dr. Phillips was appropriately dressed, answered the questions Mr. Wells asked, and appeared to understand the purpose of filing the corporate bankruptcy. Mr. Wells testified that he never doubted Dr. Phillips's mental competency.

Taken together, the evidence at trial demonstrates that the Court's finding that Dr. Phillips was mentally capable of intentionally defrauding his creditors was not clearly erroneous. With the exception of Dr. Cohen's testimony, all evidence supports the Bankruptcy Court's finding. The Psychiatric Summary describes Dr. Phillips as logical and goal-oriented. The Bankruptcy Court heard two bankruptcy professionals with more than forty-five years of combined experience testify that Dr. Phillips fully participated in multiple bankruptcy proceedings, answered the questions asked of him in appropriate manner, and otherwise gave no appearance of being unfit to handle his affairs. The documentary evidence shows Dr. Phillips successfully representing himself in multiple pieces of complex litigation. After hearing the testimony at trial and considering the documents in evidence, the Bankruptcy Court determined that the evidence demonstrated that Dr. Phillips had the mental capacity to defraud his creditors. That finding, far from being clearly erroneous, is well supported by the evidence in the record and should be affirmed.

C. Dr. Phillips was required to schedule the Claim and Policy.

Dr. Phillips argues that the Claim and the Policy are not property of the estate because Ms. James did not assume the Policy as an executory contract. Whether the Policy is an executory contract has no bearing on the resolution of this case, however. As this Court has stated, "[t]he parties debate whether an executory contract is property of the estate as if that question is relevant to the preparation of schedules and to whether the [executory contract] was required to be scheduled. It is not relevant to either . . . ." In re JZ L.L.C., 371 B.R. 412, 416 (9th Cir. BAP 2007). Rather, the issue is whether Dr. Phillips's failure to list the Claim and Policy on his Schedules justifies denial of his discharge. Id. (stating an executory contract "still must be scheduled," regardless of "whether and when" it becomes property of the estate). Dr. Phillips's argument overlooks the fact that an executory contract must be listed on Schedule G. Dr. Phillips, despite listing a lease on Schedule G, did not disclose the Claim or the Policy on Schedule G. Supp. App. 3. Therefore, Dr. Phillips's failure to include them on Schedule G constitutes concealment of property of the estate and violates Section 727(a)(2)(B).

In addition, Dr. Phillips's argument misstates the nature of the Policy. The Policy is not an executory contract. An executory contract requires "performance [that] is due to some extent on both sides." In re Texscan Corp., 976 F.2d 1269, 1272 (9th Cir. 1992). Furthermore, "the obligations of both parties are so far unperformed that the failure of either party to complete performance would constitute a material breach and thus excuse the performance of the other." Id. Case law does not support Dr. Phillips's argument that activity related to filing and adjudicating a claim makes the Policy an executory contract. In re Baird, 567 F.3d 1207, 1212 (10th Cir. 2009); In re Sudbury, 153 B.R. 776, 779 (Bankr. N.D. Ohio 1993) (citing cases for the rule that an insured's obligation to cooperate does not make an insurance policy an executory contract under the Countryman definition).

Dr. Phillips raises the executory contract argument for the first time on appeal. He did not introduce any evidence to the Bankruptcy Court regarding any obligation either he or Standard had remaining under the Policy. Indeed, the words "executory contact" were neither contained in Dr. Phillips's Trial Brief nor were uttered at trial. App. 4 and Supp. App. 1. In his opening brief to this

Court, Dr. Phillips has asserted for the first time that the Policy was an executory contract. As a general rule, this Court does not consider arguments raised for the first time on appeal. Raich v. Gonzales, 500 F.3d 850, 868 (9th Cir. 2007).

To support his new theory, Dr. Phillips points to a Policy Data sheet introduced at trial by the United States Trustee. App. 20. The Policy Data sheet does not outline any obligations of either Standard or Dr. Phillips. The Policy Data sheet does not address whether either party has performed all or none of the obligations that Dr. Phillips asserts remained under the Policy. The document does not address the issue that Dr. Phillips's argument is based upon. Without any evidence to support his argument, Dr. Phillips's late-found assertion that the Policy is an executory contract is without merit.

Even if Dr. Phillips was correct that the Policy is an executory contract, which it is not, it would not provide grounds to avoid denial of discharge under Section 727(a)(2)(B). First, if an executory contract is rejected, the rights that an estate has under the contract remain property of the estate. Section 365(g) provides that, if an executory contract is rejected, such rejection "constitutes a breach of such contract . . . immediately before the date of the filing of the petition." 11 U.S.C. 365. Section 365(g) does not state that the estate's rights under the contract are abandoned. Rather, numerous courts have recognized that the deemed breach under Section 365(g) simply gives the non-debtor party a claim against the estate. See, e.g., In re Columbia Gas Systems, Inc., 50 F.3d 233, 239 (3d Cir. 1995) ("Rejection leaves the nonbankrupt with a claim against the estate just as would a breach in the nonbankruptcy context."). Courts are clear that a contract is not terminated simply because it is rejected. See, e.g., In re Austin Development Co., 19 F.3d 1077, 1083 (5th Cir. 1994); In re Picnic 'N Chicken, Inc., 58 B.R. 523, 530 (Bankr. S.D. Cal. 1986). In this case, even if the Policy were an executory contract, the estate's purported rejection of the Policy would have no effect on the Bankruptcy Court's denial of Dr. Phillips's discharge. While a deemed breach might have an effect on what legal rights the estate holds under the Policy, it is the estate that holds those rights regardless of any deemed rejection.

Finally, Dr. Phillips's description of the Claim as a contract, executory or otherwise, is incorrect. Dr. Phillips submitted the Claim to Standard on March 22, 2008. Dr. Phillips's rights with regard to the Claim accrued on that date. On July 2, 2008, the estate acquired Dr. Phillips's rights under the Claim. 11 U.S.C. § 541. While future steps may have been acts necessary to determine Dr. Phillips's right to compensation under the Claim, the right itself was established on the date the Claim was made. As such, the Claim was not an executory contract and no assumption was needed.

D. The Bankruptcy Court's findings with respect to Section 727(a)(2) are not clearly erroneous.

The Bankruptcy Court denied Dr. Phillips's discharge pursuant to Section 727(a)(2)(B). Many of the facts underlying this ruling were stipulated. The only issue that remained at trial was Dr. Phillips's intent when he concealed the Claim and the Policy in his Schedules and at his Section 341 Meeting. Dr. Phillips has offered several, often-contradictory theories at different times in an effort to counter the allegation of fraudulent intent, including (i) that he forgot about the Claim and the Policy when filling out his Schedules; (ii) that he intentionally omitted the Policy because it had no cash value (App. Brief, P. 3); (iii) that he intentionally omitted the Policy because he intended to return to work (App. Brief, P. 3); (iv) that his schedules and statements were too difficult to fill out correctly (App. Brief, P. 2); and (v) that he was mentally incapable of intentionally defrauding his creditors. At trial, Dr. Phillips introduced evidence to support his allegations that he forgot about the Claim and that he did not have the mental capacity to defraud his creditors. The Bankruptcy Court considered this evidence, heard the testimony, and found that the evidence showed that Dr. Phillips had the ability to and, in fact, did intentionally conceal the Claim and the Policy. The evidence supports the Bankruptcy Court's finding, and, therefore, the Bankruptcy Court's ruling should be affirmed.

II. THE BANKRUPTCY COURT PROPERLY DENIED DR. PHILLIPS'S DISCHARGE PURSUANT TO SECTION 727(A)(4)(A) BECAUSE DR. PHILLIPS KNOWINGLY AND FRAUDULENTLY MADE SEVERAL FALSE OATHS RELATING TO MATERIAL FACTS IN THE CASE.

Section 727(a)(4) provides that a discharge may be denied if "the debtor knowingly and fraudulently, in or in connection with the case- (A) made a false oath or account...." 11 U.S.C. 727(a)(4). To deny a discharge under Section 727(a)(4)(A), a court must find that "(1) the debtor made a false oath in connection with the case; (2) the oath related to a material fact; (3) the oath was made knowingly; and (4) the oath was made fraudulently." Roberts, 331 B.R. at 882; Wills, 243 B.R. at 62.

As discussed below, Dr. Phillips knowingly and fraudulently made false oaths when he signed his Schedules and when he testified at the Section 341 Meeting that his Schedules were complete and accurate. Dr. Phillips's false oaths were material because the oaths related to the Claim, which is an asset of the estate and for which the Trustee was holding approximately $52,000 at the time of trial. Dr. Phillips argues that the Claim was exempt and, therefore, his false oaths are immaterial. Dr. Phillips's argument, however, misstates the nature of exempt property and was properly rejected by the Bankruptcy Court.

A. Dr. Phillips's declaration on his Schedules and his testimony at the Section 341 Meeting were false oaths.

False statements on a debtor's schedules and statements are false oaths under Section 727(a)(4)(A). In re Chalik, 748 F.2d 616, 618 (11th Cir. 1984); Searles, 317 B.R. at 378. A debtor's false oath may involve an affirmatively false statement or an omission from the debtor's statements and schedules. Wills, 243 B.R. at 62. A false oath is complete when made. Searles, 317 B.R. at 377. The parties have stipulated that Dr. Phillips's Schedule B and Section 341 testimony were false. These statements were made under penalty of perjury and constitute false oaths.

B. Dr. Phillips made material false oaths.

Materiality is broadly defined. An omission may be material even if it is not financially prejudicial to creditors, if it aids in understanding the debtor's financial affairs and transactions. Wills, 243 B.R. at 63.

> The purpose of § 727(a)(4) "is to ensure that dependable information is supplied to those interested in the administration of the bankruptcy estate so that they can rely upon it without the need for the trustee or other interested parties to dig out these true facts in examination or investigations;" the opportunity to obtain a fresh start is thus conditioned upon truthful disclosure."

In re Aubrey, 118 B.R. 268, 274 (Bankr. 9th Cir. 1990), quoting In re Martin, 88 B.R. 319, 323 (7th Cir. 1983). A false oath is material if the false oath "bears a relationship to the debtor's business transactions or estate, or concerns the discovery of assets, business dealings, or the existence and disposition of the debtor's property." Wills, 243 B.R. at 62.

The Bankruptcy Court's finding that Dr. Phillips's false oaths were material was well supported by the evidence. The oaths concerned concealment of the Claim, which is an asset of the estate. At trial, Ms. James testified that she, serving as Chapter 7 trustee, had been paid approximately $52,000 by Standard on account of the Claim. Ms. James testified that she was being paid an additional $3,000 per month on account of the Claim. Therefore, Dr. Phillips's multiple false oaths regarding the Claim concerned the discovery of assets of the estate and the existence and disposition of Dr. Phillips's property. If undiscovered, Dr. Phillips's false oaths would have caused financial prejudice to the estate.

Dr. Phillips argues that the Claim is exempt, and, therefore, his false oaths regarding the Claim were not material. Dr. Phillips misstates the relationship between exemptions and property of the estate. Under Dr. Phillips's argument, if a debtor determines that an asset is exempt, there is no duty to report such on the debtor's schedules and a debtor cannot fraudulently conceal an asset. In the vast majority of cases in which there are no non-exempt assets, debtors would not be required to schedule any assets. Trustees, creditors, and the courts would have no ability to review the debtor's exemptions. This result is absurd and is incongruous with a bankruptcy system built on open and full disclosure by honest but unfortunate debtors.

Dr. Phillips's argument is rebutted by his own actions. For instance, on his Schedule B, Dr. Phillips listed numerous assets that were fully exempt. Supp. App. 3, P. 137-42. Dr. Phillips's disclosure of these exempt assets does not comport with his current argument. Given the incredible effects that Dr. Phillips's argument would have on the bankruptcy system and the fact that Dr. Phillips's schedules do not comport with his argument, the Bankruptcy Court correctly rejected Dr. Phillips's argument that exempt property need not be listed on a debtor's schedules.

C. Dr. Phillips knowingly made false oaths.

A debtor acts knowingly if "he or she acts deliberately and consciously." Roberts, 331 B.R. at 884. A false statement is made knowingly when made voluntarily and intentionally. In re Leija, 270 B.R. 497, 501 (Bank. E.D. Cal. 2001). As demonstrated by the volume and extent of communication between Dr. Phillips and Standard, he knowingly chose to omit the claim from his Schedules and Section 341 meeting testimony. Dr. Phillips did so because he needed the income that Standard would pay to him on the Claim. His defense that he forgot the Claim is not credible when compared to his active pursuit of it. Dr. Phillips spent weeks of time, thousands of dollars, and engaged attorneys in pursuit of the Claim. App. 15, P. 1-2; App. 19, P. 1; and Supp. App. 1, P. 113-14. He made the decision that he would sue Standard if they denied the Claim. Supp. App. 1, P. 114. Dr. Phillips defense is further weakened by the number of speculative claims that he listed on Schedule B. In contrast to his constant and costly work in pursuit of the Claim, Dr. Phillips had taken no action on most of the others claims. Supp. App. 1, P. 85-86. The evidence admitted at trial supports the Bankruptcy Court's finding of fact that Dr. Phillips's false oaths were made knowingly.

D. Dr. Phillips fraudulently made false oaths.

A false oath is fraudulently made when a debtor gives the oath with the intent and purpose of deceiving creditors. Roberts, 331 B.R. at 884. The objecting party must demonstrate actual intent. Id. Similar to fraudulent intent under Section 727(a)(2), a "debtor's fraudulent intent may be established by circumstantial evidence or by inferences drawn from his or her course of conduct." Id. ("The analysis of what constitutes intent to defraud with respect to Section 727(a)(2) is applicable under Section 727(a)(4)."); see also Wills, 243 B.R. at 64.

As discussed above, the evidence shows that the oaths were made fraudulently as part of Dr. Phillips's efforts to conceal the Claim. The Bankruptcy Court was not clearly erroneous in determining that Dr. Phillips fraudulently made a false oath.

E. The Court's findings with respect to Section 727(a)(4) are not clearly erroneous.

The Bankruptcy Court denied Dr. Phillips's discharge pursuant to Section 727(a)(4)(A). The evidence supports the Bankruptcy Court's finding that, when he concealed the Claim and the Policy in his Schedules and in his Section 341 Testimony, Dr. Phillips knowingly and intentionally made material false oaths. Therefore, the Bankruptcy Court's ruling should be affirmed.

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D. Conclusion

The Bankruptcy Court properly denied Dr. Phillips discharge pursuant to Section 727(a)(2)(B) and (a)(4)(A). After considering the documentary and testimonial evidence, the Bankruptcy Court found that Dr. Phillips fraudulently concealed property of the estate and knowingly and fraudulently gave material false oaths to further his concealment. The evidence supports the Bankruptcy Court's finding of facts. Therefore, the United States Trustee respectfully requests that this Court affirm the Bankruptcy Court's decision.

DATED November 23, 2009.

ROBERT D. MILLER JR.
Acting United States Trustee

/s/ Thomas A. Buford III
Thomas A. Buford III, Missouri Bar #56460
Attorney for United States Trustee

Certificate of Service

Under penalty of perjury, I certify that, on the date this document was filed, a copy of this document, along with a copy of the Supplemental Appendix, was mailed via first-class mail as follows:

Christopher Phillips
43 Parkedge Cr.
Dartmouth, Nova Scotia B2V 2V1
Canada

and electronically transmitted as follows:

Medicineandlaw@yahoo.com

In addition, on the date this document was filed, four copies of the Supplemental Appendix were mailed to the Court as follows:

Richard H. Chambers United States Court of Appeals Building
125 South Grand Avenue
Pasadena, California 91105.

/s/Thomas A. Buford III
Thomas A. Buford III, Missouri Bar #56460

BRIEF BANK — "SUMMARY SHEET" *Printed Thu-4/14/11 13:50*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*
Christopher Phillips v. United States Trustee (In re Christopher Phillips)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*
9th Cir.

3. ("CCN") ***CURRENT*** CASE NO.
No.: 10-60032

4. ("PCN") ***PRIOR*** CASE NO. - & COURT *[IF ANY]*
No: 09-01399
Court: B.A.P. 9th Cir.
(Identify judge & cite, if any)

5. ("SO") ***SOURCE***
U.S. TRUSTEES

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*
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Type: Brief for the United States

7. **("AU")** ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*
Thomas A. Buford, III, Catherine Sevcenko, P. Matthew Sutko, Ramona D. Elliott, Mark H. Weber, Robert D. Miller, Jr.
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***
• 1). Did the bankruptcy court abuse its discretion when it found that Dr. Phillips violated section 727(a)(2)(B) of title 11 when he failed to list his pending disability claims against an insurance company for $3,000 a month on his bankruptcy schedules or disclose it at his meeting of creditors? 2). Did the bankruptcy court abuse its discretion when it found that Dr. Phillips violated section 727(a)(4)(A) of title 11 when he filed bankruptcy schedules and testified at his creditors meeting under oath, yet did not reveal his pending disability claim for $3,000 per month against an insurance company?

10. PATH TO FILE LOCATION:
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11. DO YOU RECOMMEND POSTING IN UST BRIEFBANK?| x | | | ***NAME:*** Linda Figueroa
YES NO ***DATE:***

No. 10-60032
IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

In re CHRISTOPHER PHILLIPS,
Debtor

CHRISTOPHER PHILLIPS,
Debtor-Appellant

v.

UNITED STATES TRUSTEE,
Appellee

ON APPEAL FROM THE UNITED STATES BANKRUPTCY APPELLATE PANEL FOR THE NINTH CIRCUIT

BRIEF FOR THE UNITED STATES

RAMONA D. ELLIOTT
General Counsel

P. MATTHEW SUTKO
Associate General Counsel

CATHERINE SEVCENKO
Trial Attorney

Executive Office for United States Trustees
Department of Justice
20 Massachusetts Avenue, N.W.
Washington, D.C. 20530
Phone: (202) 307-1399
Fax: (202) 307-2397

ROBERT D. MILLER, JR.
Acting United States Trustee for Region 18

MARK H. WEBER
Regional Assistant
United States Trustee

THOMAS A. BUFORD III
Trial Attorney

Department of Justice
700 Stewart Street
Suite 5103
Seattle, WA 98101
Phone: (206) 553-2000
Fax: (206) 553-2566

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JURISDICTIONAL STATEMENT

This appeal arises out of the United States Trustee's complaint to deny Dr. Phillips's discharge because he failed to disclose his primary asset – a disability insurance claim – on his bankruptcy schedules. Denial of discharge is a core matter that falls under a bankruptcy court's jurisdiction pursuant to 28 U.S.C. § 157(b)(1). On March 23, 2009, the bankruptcy court entered an order denying Dr. Phillips's discharge. A denial of discharge affects substantive rights and resolves the debtor's bankruptcy case and is thus a final order subject to appeal under 28 U.S.C. § 158(a); *see Law Offices of Nicholas A. Franke, v. Tiffany (In re Lewis*), 113 F.3d 1040, 1044 (9th Cir. 1997).

Dr. Phillips filed a motion for reconsideration on April 1, 2009. The bankruptcy court had jurisdiction to consider his motion under 28 U.S.C. § 157. It ultimately amended its grounds for denying his discharge on May 26, 2009.

Dr. Phillips filed a timely notice of appeal of the bankruptcy court's original order on April 2, 2009 to the Bankruptcy Appellate Panel of the Ninth Circuit. 28 U.S.C. § 158(c)(2); Fed. R. Bankr. P. 8002(a). It was timely because his motion for reconsideration, filed April 1, tolled the deadline to file a notice of appeal. 28 U.S.C. § 158(c)(2); Fed. R. Bankr. P. 8002(b). *See also* Fed. R. App. P. 4(a)(B)(i) (stating that a notice of appeal filed after entry of judgment but before a motion to alter or amend the judgment has been decided becomes effective once the last remaining motion is decided). Therefore, the appellate panel had jurisdiction to review the denial of discharge under 28 U.S.C. § 158(c)(1).

The bankruptcy appellate panel affirmed the bankruptcy court's order on April 6, 2010. Mr. Phillips filed a timely notice of appeal on April 12, 2010. This Court has jurisdiction to hear this matter under 28 U.S.C. § 158(d)(1).

STATEMENT OF THE ISSUES

1. Did the bankruptcy court abuse its discretion when it found that Dr. Phillips violated section 727(a)(2)(B) of title 11 when he failed to list his pending disability claim against an insurance company for $3,000 a month on his bankruptcy schedules or disclose it at his meeting of creditors?
2. Did the bankruptcy court abuse its discretion when it found that Dr. Phillips violated section 727(a)(4)(A) of title 11 when he filed bankruptcy schedules and testified at his creditors meeting under oath, yet did not reveal his pending disability claim for $3,000 per month against an insurance company?

STATEMENT OF THE CASE

I. Statutory Framework

With limited exceptions, debtors who file chapter 7 bankruptcy are eligible to have their pre-bankruptcy unsecured debts discharged. 11 U.S.C. § 524(a).

Provided that they meet the requirements of the Bankruptcy Code, they will generally receive that discharge. 11 U.S.C. § 727(a). A discharge under section 727(a) releases the debtor from liability for debts that arose before the case was filed, with limited exceptions. *See* 11 U.S.C. § 727(b). Here, Dr. Phillips had 3.9 million dollars in unsecured debts. In exchange, the pre-petition property of chapter 7 debtors, regardless of the character of their interest in that property, becomes property of the bankruptcy estate and is distributed to creditors. *See* 11 U.S.C. § 541; *see also Schwab v. Reilly*, 130 S.Ct. 2652, 2662-63 (2010) (stating this).

For this bargain to work, debtors must give a full and accurate picture of their financial situation. 11 U.S.C. § 521. Accordingly, if they fail to provide complete information about their financial circumstances, conceal property from the bankruptcy trustee, or fail to testify truthfully about their affairs, they can be denied their discharge. This allows creditors to pursue recovery of unpaid debt outside of bankruptcy. *See generally*, 11 U.S.C. §727(a). The chapter 7 trustee, a creditor, or the United States Trustee[1] may object to the granting of a discharge on the basis of any of the grounds set forth in section 727. 11 U.S.C. § 727(c)(1).

The Bankruptcy Code outlines twelve situations under which a bankruptcy court may not grant a discharge. 11 U.S.C. § 727(a)(1)-(12). Two subsections of section 727 are at issue in this case. First, section 727(a)(2) prohibits discharge if "the debtor, with intent to hinder, delay, or defraud a creditor . . . has transferred, removed, destroyed, mutilated, or concealed . . . (B) property of the estate, after the date of the filing of the petition[.]" Second, section 727(a)(4) prohibits discharge to an otherwise qualified debtor who "knowingly and fraudulently, in or in connection with the case – (A) ma[kes] a false oath or account[.]"

A denial of discharge means the independent chapter 7 trustee continues to liquidate the debtor's non-exempt assets for distribution to creditors, but those creditors are free to pursue the debtors after bankruptcy for the unpaid balance. *See* 11 U.S.C. § 727(b) (regarding effect of discharge). The Bankruptcy Code broadly defines assets of the estate, which generally include "all legal or equitable

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[1] The United States Trustee Program is a unit of the Department of Justice charged by Congress to, among other things, appoint trustees and supervise the administration of chapter 7 cases. *See* 28 U.S.C. § 586. United States Trustees "serve as bankruptcy watch-dogs to prevent fraud, dishonesty, and overreaching in the bankruptcy arena." H.R. Rep. No. 95-595, at 88 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6049; *Curry v. Castillo (In re Castillo)*, 297 F.3d 940, 950 (9th Cir. 2002) (stating this).

interests of the debtor in property as of the commencement of the case." 11 U.S.C. § 541(a).

II. Statement of Facts[2]

Dr. Phillips is an ophthalmologist, specializing in Lasik eye surgery. A. at 21, 204. He also has a law degree. A. at 77. At the time of trial, he had almost completed an MBA as well. *Id.* Dr. Phillips finished a medical fellowship in Boston in 2004 and then practiced there for three years. A. at 122. He then moved to Seattle and after a few months working at the Lomas Lasik Eye Care Center, he bought the practice in the fall of 2007. *Id.*

Dr. Phillips's financial difficulties began after patients began complaining that he appeared to be under the effect of narcotics. A. at 122, 129 (Dr. Phillips's trial testimony). Due to Dr. Phillips's addiction to painkillers, A. at 100, 129, 199, 203-04, the State of Washington restricted him from practicing medicine until he successfully underwent treatment. A. at 122-23, 203. Dr. Phillips first sought treatment at the Hazelden Clinic, where he stayed for a week, and then entered the

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[2] Under local rule 30-1, parties are to file "Excerpts of the Record." Appellant's brief refers to an "appendix." To be consistent, we have used "A." to refer to Dr. Phillips's appendix and "Supp. A." to refer to the United States Trustee's supplemental record excerpts. If the Court wishes, we will re-submit the brief with the correct terminology.

Menninger Clinic on March 22, 2008. A. at 123-25, 199. He was discharged approximately a month later at the end of April. A. at 128, 199.

A. Dr. Phillips's Efforts to Regain Financial Stability

At the same time that Dr. Phillips was attempting to regain his medical license by undergoing treatment, he began to make arrangements to maintain his financial well-being in spite of his inability to practice medicine. He pursued a threefold strategy: (1) filing a claim for disability based on a policy he had acquired in 2002 from the Standard Insurance Company; (2) seeking bankruptcy protection; and (3) applying for unemployment assistance.

1. Dr. Phillips's Claim for Disability Benefits from Standard Insurance

In January or early February of 2008, Dr. Phillips informed the Standard Insurance Company, from which he had obtained a disability insurance policy in 2002, that he intended to file a claim. A. at 145; A. at 214 (letter dated February 12, 2008 from Standard acknowledging Dr. Phillips's intent to file a claim); A. at 209. He did not submit the actual application, however, until March 22 – the day he arrived at the Menninger Clinic. A. at 126, 144. He testified he submitted the claim when he was informed that he would not be "be practicing medicine for a long time." A. at 145-46.

The claim could have paid Dr. Phillips as much as $3,000 per month until he was 67 years old, an aggregate potential total of approximately $1.1 million dollars. A. at 209. Dr. Phillips also relied upon two additional sources of income – his veteran's disability benefits and help from his family. A. at 82.

After Dr. Phillips submitted his claim, Standard asked for additional information. Between March 22 and July 2, 2008, when Dr. Phillips filed his chapter 7 petition, he received ten letters from Standard and wrote Standard one in return. A. at 17 (stipulated exhibit list); A. at 41 (bankruptcy appellate panel recitation of facts). Supp. A. at 117-136. In addition, he spoke with Standard representatives three times on the phone, including a detailed initial interview with a Standard claims processor on June 4. A. at 202-206.

Between the time he filed his bankruptcy petition and his meeting of creditors on July 31, Dr. Phillips received two more letters from Standard, including one sent six days before his meeting of creditors. A. at 17. Supp. A. at 140. On August 8, he had a lengthy telephone conversation with a Standard claims processor concerning the company's documentation requirements for his claim. A. at 212-13. During this same period, Dr. Phillips spent additional time collecting the billing data that Standard requested, which he claimed had cost him several thousand dollars and took several weeks to assemble. A. at 212. He also disputed with Standard the propriety of turning over the information, claiming that revealing the information would violate patient privacy. *Id.* He also received a letter from Standard dated August 1. Supp. A, at 141. In addition, he wrote Standard twice on August 18, once to provide an updated address and again to request another application so that he could submit an additional claim. Supp. A. at 149, 150.

2. Dr. Phillips Seeks a Chapter 7 Discharge of His Three Million Dollars in Unsecured Debt.

At the beginning of March 2008 – shortly before he began therapy at Menninger, but after he contacted Standard Insurance – Dr. Phillips hired a bankruptcy attorney. A at 131, 134-5, 145. At that point he starting working "on the core" of his [bankruptcy] application." A. at 131-32, 145. He continued to work on gathering information until he filed his petition on July 2, 2008. A. at 131; *see* Supp. A. at 39-103 (Voluntary Petition). He sought discharge of 3.9 million dollars in unsecured non-priority debt. Supp. A. at 58.

It is undisputed that Dr. Phillips did not include his claim for disability benefits, worth up to 1.1 million dollars, on his schedule B, when he filed his petition on July 2, 2008. Supp. A. at 45-48; A. at 21 (bankruptcy court findings of fact); *compare* A. at 2 (United States Trustee Complaint) *with* A. at 6 (Dr.

Phillips's admissions in his Answer); *see also* A. at 79 (Dr. Phillips's testimony); Fed. R. Bankr. P. Official Form 6, Schedule B, #9 (requiring debtor to disclose interests in insurance policies). Dr. Phillips remembered to list claims against other entities, however. These included a claim for libel and slander which he intended to file against two local television stations. A. at 148; Supp. A. at 46-47.

On July 31, 2008, less than a week after he had received a letter from Standard regarding his claim, Supp. A. at 140, Dr. Phillips fully participated at a meeting of creditors required by section 341 of title 11. A. at 162-63. Dr. Phillips answered questions under oath, and he gave no indication that he was not capable of handling his financial affairs. A. at 162 (testimony of chapter 7 trustee). He swore under oath that he had reviewed his petition and schedules, that they were true and accurate, and that no further changes needed to be made. A. at 6 (admissions in Dr. Phillips's Answer); A. at 136, 183.

On the same day as the creditors' meeting, Dr. Phillips submitted an amended schedule B, which also did not list his claim against Standard. Supp. A. at 106.

3. Dr. Phillips's Claim for Unemployment Benefits

Dr. Phillips applied to the State of Washington for unemployment benefits sometime between March 16-22, 2008, approximately the same time that he checked into the Menninger Clinic. A. at 149; Supp. A. at 177. His application was denied and the denial reviewed by the beginning of April 2008. Supp. A. at 173. The Employment Security Department's records show that a letter informing Dr. Phillips of this determination was mailed to him on April 4, 2008. Supp. A. at 179. Dr. Phillips claimed he never received the letter, although he checked his mail "close" to every day at that time. *Id.* This was the same period he was at the Menninger Clinic, located in Houston, Texas.[3] A. at 25 (Dr. Phillips testimony).

Dr. Phillips continued to pursue his unemployment benefits claim vigorously. Between March and August 2008, he filed weekly claims for benefits. Supp. A. at 180. He repeatedly called the Department of Employment Security between March and August 2008 to determine the status of his application and the reason that he was not receiving funds. *Id.* On August 7, 2008 he appealed the denial of benefits. *Id.* On September 4, 2008, he represented himself unsuccessfully in a telephonic hearing to determine if he had filed a timely appeal. A. at 149, 151, 153. Dr. Phillips then sought further review by filing an action in King County Superior Court. A. at 149-50, 155; Supp. A. at 168-169. After writing his own briefs, he represented himself in a second telephonic hearing with

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[3] Address available at: www.menningerclinic.com/contactus.htm (last visited Sept. 29, 2010).

an administrative law judge on November 12, 2008. A. at 155-56; Supp. A. at 170-181 (excepts). As a result of his efforts, the earlier adverse decisions were reversed, and Dr. Phillips began receiving unemployment benefits. A. at 157.

B. Dr. Phillips's Standard Disability Claim Comes to Light.

After reviewing his claim, Standard rescinded Dr. Phillips's policy on August 28, 2008 based on alleged false statements Dr. Phillips made when he applied for coverage. Supp. A. at 155-162. It sent Dr. Phillips a check for $8,400 as a refund of his premium payments. A. at 172-73; Supp. A. at 154.

Dr. Phillips testified that he first realized that his claim against Standard was not listed on his Schedule B on August 29, 2008 when he received the check from Standard returning his premium payments. A. at 136. In the course of investigating the reason for the refund, Dr. Phillips testified that he "discovered Standard was not on the schedules." A. at 173. He also testified that he immediately notified his attorney of the omission. A. at 140.

The record contains a redacted e-mail from Dr. Phillips to his personal bankruptcy attorney, William Malaier, dated September 3, 2008. It states "I already informed David of the possibility of receiving income from the disability policy. While I made the claim in March, there is [sic] a waiting period of 90 days. There is also a question as to when the disability would actually start." A. at 202.

Dr. Phillips explained "[i]f, and only if, I win, the MAXIMUM amount I would receive to cover the time I was disabled before filing bankruptcy would be $6,600. This is the amount I asked David to include on the schedules." *Id.* (emphasis in original). He concluded the e-mail with "I noticed that David has already e-mailed me. I suspect the schedules are attached. I am sure the above information is already in the schedules." *Id.* The record does not disclose any e-mail from Dr. Phillips noting the schedules did not include the claim or asking his attorneys to amend the schedule to include it.

At the beginning of September, the chapter 7 trustee[4] learned about Dr. Phillips's claim for the first time when Standard notified the trustee's attorney about the claim and its subsequent rescission of Dr. Phillips's policy. A. at 75. On September 15, Standard sued Dr. Phillips and the chapter 7 trustee for a declaratory judgment to enforce rescission of the policy and to declare any obligations that Dr. Phillips might have to Standard to be non-dischargeable. Supp. A. at 182-186 [Bankr. Dkt. # 44.] Standard paid the chapter 7 trustee the disability payments that Dr. Phillips claimed – $3,000 per month – under a reservation of rights from the time the lawsuit was filed until it was settled. A. at

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[4] A chapter 7 trustee is the fiduciary who administers the debtor's estate for the benefit of creditors. *See* 11 U.S.C. § 704 (listing a trustee's duties).

74. The trustee eventually received $52,000 from Standard, the sole asset in Dr. Phillips's estate. A. at 74-75, 183.

Dr. Phillips amended his schedule B to include his claim against Standard on September 17, 2008 – two days after Standard filed its lawsuit, and nearly three weeks after he testified that he discovered the omission. A. at 140; Supp. A. at 109; [Bankr. Dkt. # 46.] On October 7, Dr. Phillips amended his schedule C to exempt the claim. Supp. A. at 112 [Bankr. Dkt. # 58.]

A complete time-line is available as an Addendum to this brief.

At trial, Dr. Phillips offered three explanations for his failure to disclose his disability claim against Standard.

Initially, he testified that "I simply forgot it." A. at 79, 82. He explained that he did not think about the Standard claim just as "I didn't think about my auto insurance or my health insurance or my pet insurance." A. at 81.

Subsequently, he explained that he had assumed that he had listed the Standard claim on his schedules. A. at 135, 176. He considered his testimony at the meeting of creditors to be true and accurate because he thought that the claim was listed on his schedule B. A. at 136, 141.

In his brief to this Court, Dr. Phillips asserts for the first time, without record citation, that he provided "the Bankruptcy Trustee copies of documents relating to the insurance contract as part of the initial bankruptcy disclosure required of all debtors" but that he did not go through his schedule "line by line" to make sure that the "contract" was listed. Phillips Br. at 7.

He also blamed his withdrawal from methadone and well as the stress due to the litigation and investigations against him stemming from the closure of his medical practice for causing lapses in memory. A. at 132.

C. The Bankruptcy Court Rules Dr. Phillips Should Not Be Allowed to Discharge His Debts.

On December 5, 2008, the United States Trustee filed a complaint to deny Dr. Phillips's discharge under sections 727(a)(2) and (4) of title 11, alleging that he intentionally concealed his claim against Standard and knowingly made false oaths.

After a trial, the United States Bankruptcy Court for the Western District of Washington denied Dr. Phillips a discharge. A. at 25, 37. It found that Dr. Phillips concealed property of the estate post-petition with the intent to "hinder, delay, or defraud his creditors." *Id.*; *see* 11 U.S.C. § 727(a)(2)(B). The bankruptcy court also found that Dr. Phillips knowingly and fraudulently made false oaths by failing to disclose his claim against Standard. A. at 26. It found that failure to disclose the claim on his schedules and at the creditors' meeting, all instances in which information is given under penalty of perjury, constituted a false oath. A. at

25. The court found the omission was material based on the facts of this case and because it was "doubtless" that failure to disclose "directly concerned the discovery of assets." *Id.* It concluded that the false oath was knowingly and fraudulent made based on its analysis of the first count under section 727(a)(2)(B).

The bankruptcy court also rejected Dr. Phillips's explanation that he forgot about the Standard claim, finding that unlikely because of his extensive communications with Standard around the same time that he filed his bankruptcy petition. A. at 23. The court also found it "virtually impossible" that Dr. Phillips would forget about his claim given his "dire financial straits" at the time. *Id.*

The bankruptcy court also rejected Dr. Phillips's defense of mental impairment on two grounds: first, his sophisticated handling of his legal affairs during the time that he failed to disclose his claim; and second, the testimony of the trustee and one of Dr. Phillips's attorneys that he appeared to grasp the bankruptcy process without difficulty. A. at 24. On reconsideration, the court pointed out that the State of Washington's prohibition on Dr. Phillips against performing eye surgery did not demonstrate that he was incapable of forming intent to conceal his disability claim from his creditors. A. at 34.

The bankruptcy court denied Dr. Phillips's discharge on March 23, 2009. It reaffirmed that order on May 26, 2009 when it denied Dr. Phillips's motion for reconsideration. A. at 37. Dr. Phillips then pursued his appeal to the bankruptcy appellate panel of the Ninth Circuit. A. at 29-31 (explaining timing of appeal).

D. The Bankruptcy Appellate Panel Upholds the Bankruptcy Court's Ruling that Dr. Phillips Should Not Be Able To Discharge His Debts.

On April 6, 2010, the bankruptcy appellate panel affirmed the bankruptcy court in an unpublished opinion. *Phillips v. United States Trustee (In re Phillips),* No. 09-1114 (B.A.P. 9th Cir. Apr. 6, 2010), A. at 38-62. Starting with the false oath count, it held that Dr. Phillips's actions in failing to list, or subsequently identify, the claim against Standard on his schedules or at his creditors' meeting was a false oath. A. at 51-52. It also affirmed the bankruptcy court's finding that the omission was material, rejecting Dr. Phillips's argument that the disability payments were exempt and thus it did not matter whether he scheduled them or not. A. at 53.

The bankruptcy appellate panel held on two grounds that the bankruptcy court did not commit clear error in concluding that Dr. Phillips acted "knowingly and fraudulently." First, given the extensive communication Dr. Phillips had with Standard around the time he filed his petition, the appellate panel agreed that he could not have "forgot[ten]" about the claim. A. at 56. Second, the evidence that he was successfully defending his interests in multiple lawsuits outweighed his expert's testimony about his possible psychological impairment. A. at 56-57. The panel held that it was "entirely plausible" that Dr. Phillips made false oaths that violated section 727(a)(2)(B) and thus affirmed the bankruptcy court's decision. A. at 58.

Relying on the same facts, especially his testimony at the meeting of creditors, the bankruptcy appellate panel found no clear error regarding the bankruptcy court's determination that Dr. Phillips intentionally concealed his disability claim to hinder, delay or defraud his creditors under section 727(a)(2)(B). A. at 59-60.

STANDARD OF REVIEW

In denial of discharge cases, this Court reviews decisions of the bankruptcy appellate panel de novo. *Retz v. Samson* (*In re Retz)*, 606 F.3d 1189, 1196 (9th Cir. 2010). This Court applies the same standard of review as the panel applied to the bankruptcy court's decision. *Boyajian v. New Falls Corp. (In re Boyajian)*, 564 F.3d 1088, 1090 (9th Cir. 2009). In this case, the bankruptcy appellate panel reviewed the bankruptcy court's conclusions of law *de novo* and its findings of fact for clear error. *Phillips v. United States Trustee (In re Phillips)*, No. 09-1114, slip op. at 13 (B.A.P. 9th Cir. Apr. 6, 2010) ("Mem. Op."), A. at 50. A court's factual determination is clearly erroneous if it is “illogical, implausible, or without support in the record.” *Retz,* 606 F.3d at 1196 (citations omitted).

The bankruptcy appellate panel reviewed the bankruptcy court’s finding of fact that Dr. Phillips acted with intent to “hinder, delay, or defraud his creditors” for clear error. Mem. Op. at 13, A. at 50. It similarly reviewed the bankruptcy court’s factual finding that Dr. Phillips “knowingly and fraudulently made a false oath” for clear error. *Id. See also Beverly Bank v. Adeeb (In re Adeeb*), 787 F.2d 1339, 1342 (9th Cir. 1986) (holding that a debtor’s intent is reviewed for clear error). Therefore, the bankruptcy court’s finding of intent is reviewed for clear error. *Id.*

SUMMARY OF THE ARGUMENT

The bankruptcy court did not abuse its discretion in denying Dr. Phillips’s chapter 7 discharge because Dr. Phillips failed to disclose a disability claim that he was pursuing against Standard Insurance Company that had a potential value of approximately 1.1 million dollars. Dr. Phillips omitted this asset – which turned out to be the sole significant asset in his estate – three times: on his original bankruptcy petition, on his first amended petition, and at his meeting of creditors. This repeated failure to disclose hindered his creditors under section 727(a)(2)(B) of the Bankruptcy Code and provides grounds for denial of discharge. In addition, his failure to disclose constituted a false oath under section 727(a)(4)(A), a separate and independent ground for denying discharge.

The bankruptcy court did not clearly err when it found that Dr. Phillips concealed his disability claim with the intent to “hinder, delay, or defraud” his creditors under section 727(a)(2)(B). It is undisputed that Dr. Phillips concealed his disability claim, meeting the requirement that the debtor conceal an asset.

The second element – intent – is met as well for three reasons. First, Dr. Phillips failed to disclose his disability claim on three separate occasions: on his original schedule, on his amended schedule, and at his meeting of creditors. This pattern of concealment indicates intent.

Second, Dr. Phillips has admitted that he did not disclose his disability claim until after Standard Insurance brought it to the attention of the Trustee. Even after the claim came to light, Dr. Phillips did not take immediate action to amend his petition, but waited to step forward until Standard filed suit for a declaratory judgment to confirm that the policy was void. His reluctance to disclose the claim and failure to inform the trustee about it shows his intent to “hinder, delay, or defraud” his creditors.

Third, Dr. Phillips scheduled several claims against third parties on his original schedule B and amended his schedule the first time to add another potential claim. According to Dr. Phillips's own notations on his schedule, many of these claims had little chance of yielding funds for his creditors. They included claims for defamation against unnamed media outlets, a claim for malicious prosecution against the City of Renton, and "for various torts, including conversion." The fact that Dr. Phillips listed these claims supports the bankruptcy court's finding that he knew he was required to schedule unresolved legal claims. The fact that he neglected to mention the two claims with a specific long-term pay-out – his disability and unemployment claims – also supports the bankruptcy court's finding that he intended to keep these potential sources of income from his creditors. The bankruptcy court's decision that Dr. Phillips intended to conceal his disability claim from his creditors should be affirmed.

Nor did the bankruptcy court clearly err when it found that Dr. Phillip's failure to reveal his claim against Standard constituted a false oath under section 727(a)(4) because this oversight meets the three elements of a false oath. First, it is uncontested that Dr. Phillips stated under penalty of perjury that his schedules were accurate when they were not.

Second, the estimates of the claim's value ranged from $6,600 (Dr. Phillips's estimation on his second amended schedule B) to a potential of $1.1 million (bankruptcy court). The trustee settled with Standard for $52,000.

Therefore, the claim had significant value and was material to the bankruptcy estate.

Finally, the bankruptcy court did not commit clear error in ruling that Dr. Phillips omitted his disability claim knowingly and fraudulently. During the period that he was preparing to file (March 2008) and the time he revealed the existence of the claim (September 2008), Dr. Phillips communicated with Standard on 22 occasions or, on average, nearly once a week for seven months. At trial he complained about the money and time he had to spend complying with Standard's follow-up requests for information. In light on his frequent and sometimes acrimonious exchanges with Standard, the bankruptcy court did not clearly err in finding unpersuasive Dr. Phillips's explanation that omitting his disability claim was an oversight.

And the bankruptcy court did not err in rejecting Dr. Phillips's defenses. It did not commit clear error finding the testimony of a clinical psychologist, who first started treating Dr. Phillips five months after the events at issue in this case, less credible than the testimony of the trustee and Dr. Phillips's attorney, who testified he understood the bankruptcy process. And it did not commit clear error in rejecting Dr. Phillips's claims of impairment because at the same time Dr.

Phillips, who had graduated from law school, was defending himself in multiple court cases with notable success.

Dr. Phillips’s legal arguments are meritless. His argument that the Standard insurance policy would never have benefitted his creditors, and therefore his failure to disclose it is harmless error, fails on three grounds. First, debtors must list all assets, even those they think are worthless. Second, his claim that the policy is an executory contract, and therefore not in the estate, is wrong as a matter of law: an insurance policy is not an executory contract, and even if it were, he was obligated to list it on his schedules. Third, his disability payments were not exempt but even if they had been, Dr. Phillips was still required to disclose them so that the trustee and creditors could verify his assertion. All of Dr. Phillips’s legal arguments are based on a false premise: that his omissions did not affect the outcome of his bankruptcy case and therefore they were excusable. This is wrong as a matter of law. The concept of “no harm, no foul” does not exist in the Bankruptcy Code. It is also wrong as a matter of fact: the claim Dr. Phillips concealed turned out to be worth $52,000.

Because the bankruptcy court did not make any error – much less clear error – in its findings of fact and correctly applied the law, the decision below should be affirmed.

ARGUMENT

I. The Bankruptcy Court Did Not Abuse its Discretion When it Denied Dr. Phillip's Discharge under Section 727(a)(2)(B) Because it Did Not Commit Clear Error in Concluding That He Intentionally Concealed His Disability Claim with the Intent to Hinder, Delay, or Defraud His Creditors.

The bankruptcy court did not commit clear error when it found that Dr. Phillips had intentionally concealed his disability claim against Standard Insurance to shield the benefits from his creditors.

Section 727(a)(2)(B) precludes giving a chapter 7 debtor a discharge if he "with intent to hinder, delay, or defraud a creditor or an officer of the estate . . . has . . . concealed, or has permitted to be . . . concealed . . . (B) property of the estate, after the date of the filing of the petition. 11 U.S.C. § 727(a)(2)(B). A party seeking denial of discharge under section 727(a)(2) must prove two things. First it must show by the preponderance of the evidence that the debtor concealed property. *Hughes v. Lawson (In re Lawson)*, 122 F.3d 1237, 1240 (9th Cir. 1997). Second, a party challenging the debtor's discharge must show "a subjective intent on the debtor's part to hinder, delay or defraud a creditor" by concealing the property. *Emmit Valley Assoc. v. Woodfield (In re Woodfield*) 978 F.2d 516, 518 (9th Cir. 1992).

A. It is undisputed that Dr. Phillips did not disclose his claim against Standard Insurance on his bankruptcy schedules or at his creditors meeting, thus concealing it from his creditors.

Dr. Phillips has admitted that he did not disclose his claim against Standard, although he was obligated to do so. 11 U.S.C. § 521(1) (requiring debtors to file a "schedule of assets and liabilities"); *Cusano v. Klein*, 264 F.3d 936, 946 (9th Cir. 2001) (requiring debtors to prepare their schedules "carefully, completely, and accurately") (citations and quotations omitted). If a debtor fails to list a claim against a third party on his bankruptcy schedules, he has concealed it and his discharge can be denied. *Crawforth v. Bachman (In re Bachman)*, No. 06-6027, 2007 WL 4355620 at *7 (Bankr. D. Idaho Dec. 10, 2007) (denying a chapter 7 discharge in part because the debtor failed to disclose a personal injury claim).

In his brief to this Court, Dr. Phillips asserts for the first time that he provided "the Bankruptcy Trustee copies of documents relating to the insurance contract as part of the initial bankruptcy disclosure required of all debtors" but that he did not go through his schedule "line by line" to make sure that the "contract" was listed. Phillips Br. at 7. He does not provide a record citation, and the United States Trustee is unaware of any such disclosure. In any case, this Court should disregard facts alleged for the first time on appeal. *Ministry of Defense of the Islamic Republic of Iran v. Gould, Inc.*, 969 F.2d 764, 773 (9th Cir. 1992).

B. The bankruptcy court did not commit clear error in finding that Dr. Phillips intended to conceal his claim against Standard, worth up to 1.1 million dollars, from his creditors.

The bankruptcy court did not clearly err in finding that Dr. Phillips intended to conceal his disability claim. A debtor's intent does need not be fraudulent to meet the requirements of section 727(a)(2). It is sufficient to show that the debtor intended to hinder or delay a creditor. *Wolkowitz v. Beverly (In re Beverly)*, 374 B.R. 221, 242-43 (B.A.P. 9th Cir. 2007) ("As the requirement is stated in the disjunctive, it suffices to demonstrate any of the three alternatives, intent either to hinder or to delay or to defraud creditors."). A finding of intent is subject to clear error review. *In re Adeeb*, 787 F.2d at 1342. Intent may be established by circumstantial evidence or inferred from a debtor's course of conduct. *Id.* at 1343; *Devers v. Bank of Sheridan* (*In re Devers)*, 759 F.2d 751, 753-54 (9th Cir. 1985); *Roberts v. Erhard* (*In re Roberts)*, 331 B.R. 876, 884 (B.A.P. 9th Cir. 2005).

Dr. Phillips's course of conduct demonstrates that he intended to conceal the Standard claim. This is so for two reasons.

First, it is undisputed that Dr. Phillips failed on three separate occasions to reveal his claim against Standard Insurance. He did not disclose it on his bankruptcy schedules when he filed his petition on July 2, 2008. He did not disclose the claim on his amended schedule B (list of potential assets). He did not reveal it at the meeting of creditors on July 31, 2008. Furthermore, all three times he affirmed under penalty of perjury that the information he was providing was true and accurate, yet still omitted the claim.

Nor has Dr. Phillips challenged the finding of the bankruptcy court that he first revealed the insurance claim on September 17, 2008 — two days after Standard moved the bankruptcy court for a declaratory judgment against the chapter 7 trustee that the policy was void. Failure to inform the trustee of an estate asset is evidence of intent to hinder, delay, or defraud creditors. *Retz,* 606 F.3d at 1203. Therefore, the bankruptcy court did not commit clear error in finding that Dr. Phillips intended to conceal his claim.

Second, Dr. Phillips scheduled many claims against third parties. Listing one claim on a bankruptcy schedule, yet omitting others indicates intent to conceal because it is clear that the debtor is aware of the requirement to list contingent assets. *See White v. Wyndham Vacation Ownership, Inc.*, – F.3d – , No. 09-5626, 2010 WL 3155161, at *7 (6th Cir. Aug. 11, 2010) (chapter 13 case).

Dr. Phillips indicated on his Schedule B that his contingent claims were not a promising source of repayment for his creditors. On his original schedule B, Dr. Phillips listed "potential claims" against International Optical and various other parties "for various torts including conversion." He listed claims against Dr. Richard Lomas for defamation and fraudulent misrepresentation. He listed potential claims against a "neighbor" and the "media" for libel and slander and a "potential malpractice claim" against Hazeldon Foundation. He either noted that they were "likely uncollectible" or that their values were listed as "unknown." Supp. App. at 45-48.

In contrast, Dr. Phillips did not list his disability claim against Standard Insurance for which he expected to collect $3,000 each month until he reached the age of 67. He also did not list the weekly claims for state unemployment benefits that he was filing at the time he filed his petition.

On his first amended schedule B, Dr. Phillips added a "potential claim" against the City of Renton for "malicious prosecution." Supp. A. at 106. He did not provide more specific information for any other entry. He did not add his claim against Standard or his claim for unemployment benefits at that time.

Relying on a bankruptcy case from the Middle District of Florida, Dr. Phillips argues that "actual intent" must be proven by "a pattern of omissions." Phillips Br. at 12. n. 27 (citing *In re Slater*, 318 B.R. 881, 888 (Bankr. M.D. Fla. 2004) (denying debtor's discharge under 11 U.S.C. 727(a)(4)). Even if this were the standard, which it is not, the record in this case shows a pattern of omissions: Dr. Phillips failed on three occasions to disclose his disability claim.

Furthermore, failure to disclose a single asset is sufficient to provide grounds for denial of discharge in the Ninth Circuit. *See e.g., Hughes v. Lawson (In re Lawson)*, 122 F.3d 1237, 1240 (9th Cir. 1997) (affirming denial of discharge based on concealing the transfer of a deed of trust); *Duggins v. Heffron*, 128 F.2d 546, 548 (9th Cir. 1942) (affirming denial of discharge based on transfer of single property); *Creasy v. Birdsell, (In re Creasy*), 138 Fed. App'x 45, 46 (9th Cir. 2005) (denial of discharge based on omission of business interest).

C. The bankruptcy court did not commit clear error in concluding Dr. Phillips's actions hindered his creditors.

Finally, Dr. Phillips's failure to disclose his claim against Standard "hinder[ed], delay[ed], or defraud[ed]" his creditors. 11 U.S.C. § 707(a)(2). The claim would have given him benefits of $3,000 per month for approximately 30 years. It turned out to be the only asset in his estate. A. at 75. When Dr. Phillips concealed this asset, he kept his creditors from discovering the sole source of potential recovery, which “hinded” and “delayed” them from receiving some of the money owed to them. *See Crawforth*, 2007 WL 4355620 at *7; *Woodfield*, 978 F.2d at 519 (putting cash beyond creditors’ reach satisfied requirements of section 727(a)(2)).

II. The Bankruptcy Court Did Not Abuse Its Discretion When It Denied Dr. Phillips’s Discharge under Section 727(a)(4) Because It Did Not Commit Clear Error in Finding His Omission of the Standard Disability Claim Constituted a False Oath.

The bankruptcy court did not err when it concluded that Dr. Phillips made a false oath under section 727(a)(4)(A) when he omitted the Standard claim from his original schedules, his amended Schedule B, and did not disclose it at his meeting of creditors. A debtor makes a false oath if he (1) makes a false statement or omission, (2) regarding a material fact, and (3) does so knowingly and fraudulently. *Khalil v. Dev. Surety & Indem.Co. (In re Khalil*), 379 B.R. 163, 172 (B.A.P. 9th Cir. 2007), *aff’d* 578 F.3d 1167 (9th Cir. 2009); *Retz*, 606 F.3d at 1197 (dividing “knowingly” and “fraudulently” into separate elements).

“Because a determination concerning fraudulent intent depends largely upon an assessment of the credibility and demeanor of the debtor, deference to the bankruptcy court's factual findings is particularly appropriate.” *Williamson v.*

Fireman's Fund Ins. Co., 828 F.2d 249, 252 (4th Cir. 1987). The bankruptcy court did not err in concluding that all the elements were met.

A. Dr. Phillips's undisputed failure to disclose his disability claim is a false oath.

First, Dr. Phillips's failure to disclose his claim against Standard is a false oath. An omission of information constitutes a false oath. *Roberts*, 331 B.R. at 882 (stating omission can be a false oath). It is undisputed that Dr. Phillips omitted his disability claim against Standard from his original petition and amended Schedule B.

False statements at a meeting of creditors also constitute false oaths. *Farmers Co-op Ass'n of Talmage, Kan. v. Strunk*, 671 F.2d 391, 395 (10th Cir. 1982); *Homer National Bank v. Farber* (*In re Farber)*, 35 F.3d 562, at *3-*4 (5th Cir. 1994). *See also Retz*, 606 at 1205 (comparing debtor's statements in creditors' meetings with evidence in the case in supporting denial of discharge under 11 U.S.C. § 727(a)(5) for failure to account for missing assets). Dr. Phillips stated under oath at his meeting of creditors that his schedules were accurate. It is undisputed that they were not. The bankruptcy court did not commit clear error in finding Dr. Phillips made a false oath.

B. Dr. Phillips concealed a material fact when he did not disclose his claim against Standard.

Second, the false oath is related to a material fact. "A fact is material 'if it bears a relationship to the debtor's business transactions or estate, or concerns the discovery of assets, business dealings, or the existence and disposition of the debtor's property.'" *In re Khalil*, 379 B.R. at 173 (citation omitted). The insurance claim represented a primary source of income for Dr. Phillips. *See* A. at 82. It was potentially worth more than one million dollars. A. at 35. Standard settled the claim with the trustee for over $50,000. A. at 190. In fact, it turned out to be the only asset in the estate. A. at 75. The bankruptcy court did not clearly err in finding that the claim had a relationship to Dr. Phillips's estate and was therefore material.

C. The bankruptcy court did not commit clear error in finding that Dr. Phillips knew he was concealing his disability claim and thus acted fraudulently in doing so.

Third, Dr. Phillips acted knowingly when he omitted the Standard claim. A debtor "acts knowingly if he or she acts deliberately and consciously." *Retz*, 606 F. 3d at 1198 (quotation marks and citations omitted). Dr. Phillips omitted the claim from his schedules on two separate occasions and failed to mention it on a third (meeting of creditors). *See Williamson*, 828 F.2d at 252 (finding it "significant" that the debtor made three false oaths in affirming the bankruptcy court's finding of fraudulent intent). Furthermore, Standard sent Dr. Phillips a letter regarding his claim on July 2, 2008 – the day he filed for bankruptcy. Supp. A. at 137. Standard sent him another letter six days before his meeting of creditors on July 31 and another one the day after. Supp. A. at 140-142. Nevertheless he did not reveal any information about his disability claim on his schedules or to his creditors.

A debtor’s actions can belie a claim of ignorance. Dr. Phillips was deeply involved in pursuing his disability claim against Standard. He spent hundreds of hours collecting the information that Standard required to process his claim. Phillips Br. at 7-8. He even hired someone for “thousands of dollars” to help him do so. *Id.* at n.7. He found the requests so onerous that he threatened to sue Standard. Supp. A. at 146. The bankruptcy court did not clearly err in finding that Dr. Phillips must have known about the claim in the same time period in which he filed his petition and met with his creditors.

Finally, Dr. Phillips’s failure to disclose the insurance claim demonstrates fraudulent intent. To demonstrate fraudulent intent, the United States Trustee bore the burden of showing that (1) Dr. Phillips made false representations or omissions which (2) he knew at the time were false and which (3) he made with the intention and purpose of deceiving his creditors. *Retz*, 606 F. 3d at 1198-99; *Khalil*, 379 B.R. at 173.

Intent is usually proven by circumstantial evidence or by inferences drawn from the debtor's conduct. *Devers v. Bank of Sheridan, Mont. (In re Devers)*, 759 F.2d 751, 753-54 (9th Cir. 1985). Reckless indifference or disregard for the truth may be circumstantial evidence of intent, but is not sufficient, alone, to constitute fraudulent intent. *Khalil*, 379 B.R. at 173-75.

Dr. Phillips testified that he discovered on August 29, 2008 that the Standard claim was not listed on his schedule B. A. at 136. He did not take decisive action afterwards, a course of conduct that supports the bankruptcy court's finding that he intended to deceive his creditors for three reasons.

First, the only supporting evidence of Dr. Phillips's claim that he did not know that the Standard claim was not on his schedules is a redacted e-mail from him to his bankruptcy attorney that he sent at 10:30 at night four days after he claimed he discovered that the disability claim was missing from his schedules. A. at 203. In it, he tells his attorney that he already informed "David of the possibility of receiving income from the disability policy" and that he has asked David to include the amount of "$6,600" on his schedules to reflect the value of the benefits he would have received from his eligibility date to the date he filed the petition. *Id.* The e-mail does not request information about when his amended schedule would be filed. Nor does the record show that Dr. Phillips made any attempt to follow-up to make sure that the amended schedule had been filed.

Second, even after he discovered the omission of the claim – a key inaccuracy in his bankruptcy petition – Dr. Phillips did not bring the error to the trustee's attention. A. at 75. The trustee only found out about the claim when Standard disclosed it in the first week of September. *Id.* Dr. Phillips did not file an amended schedule B disclosing the Standard claim until the claim became public knowledge when Standard filed for a declaratory judgment in the bankruptcy case to declare the policy void. Supp. A. at 182-186. It was only two days after that – on September 17, three weeks after he testified he found out about the omission – that Dr. Phillips amended his Schedule B. Supp. A. at 109 [Bankr. Dkt #46]. Fraud cannot be absolved by disclosing what has, or will shortly be, generally known. *McClenny v. CH & R Enters., Inc.*, 205 F.3d 1334, at *1 (4th Cir. 2000) (table case) (per curiam); *Beauchamp v. Hoose, (In re Beauchamp)*, 236 B.R. 727, 734 (B.A.P. 9th Cir. 1999). Only after Standard revealed the existence of the disputed claim, did Dr. Phillips disclose it.

Third, the amended Schedule B fails to provide full information concerning the claim. Dr. Phillips added three items. First, he listed a "Disability claim/Potential increase in disability income" as a "counterclaim." Supp. A. at 109. He did not name the insurance company, as required by the schedule.[5] He noted the "current value" of the claim at $6,600. Second, he listed a "potential claim for unpaid unemployment income" with an "unknown value." Supp. A. at 110. He noted that the claim was "likely uncollectible as claim has been previously denied." *Id.* He did not mention his then-pending appeal. Third, he listed "refunded disability insurance premiums dating back to 2002 (yet to be received).[6] *Id.* He also added "Debtor does not believe he is entitled to these funds" and valued the refund at $8,260.13. Again, he did not specify Standard Insurance by name.

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[5] In contrast, he had consistently scheduled his term life insurance policy as being with "New York Life Insurance Co." and provided the company's address and policy number. He valued the policy at zero, however.

[6] The notation that he had not received the funds contradicts his trial testimony: "On August 29th, 2008, I received a check from Standard for a refund of the policy premiums I had paid. That was strange because what kind of insurance company refunds policy premiums? So it was a new asset." A. at 172. The letter rescinding his policy also indicated that the refund check for his premiums was enclosed. Supp. A. at 155. On his motion for reconsideration, Dr. Phillips introduced evidence that the letter he received from Standard only contained a copy of the check because the original had been sent to his Massachusetts address. A. at 33. The bankruptcy court ruled, however, that the precise time he received the check was irrelevant to its ruling and therefore declined to admit the exhibits demonstrating that Dr. Phillips received the actual check at a later date. A. at 34.

In light of these contradictions and lack of precision, the bankruptcy court did not clearly err when it found that Dr. Phillips intended to deceive his creditors by hiding his disability claim.

III. The Bankruptcy Court Did Not Commit Clear Error Rejecting Dr. Phillips's Justifications for his Actions Nor Did It Err in Rejecting His Legal Arguments That the Omission Did Not Matter.

A. Dr. Phillips's justifications for his actions do not excuse his behavior and the bankruptcy court did not commit clear error in rejecting them.

Dr. Phillips provided two grounds to excuse his failure to put the Standard claim on his schedules. First, he claimed he forgot. Second, he explained that he was not capable of understanding his bankruptcy due to his substance abuse. Neither of these excuses survive scrutiny.

First, the bankruptcy court did not clearly err in finding that it was "virtually impossible" that Dr. Phillips could have forgotten about the claim in light of his interaction with Standard and his precarious financial situation at the time. A. at 23; A. at 132 (admitting communications with Standard). *See Bachman*, 2007 WL 4355620 at *7 (rejecting the debtor's assertion that she "plain didn't even think" about a $47,000 personal injury settlement when she filled out her schedules). Dr. Phillips received a letter from Standard dated July 2 – the day he filed his bankruptcy petition. Supp. A. at 137. He received another letter shortly before his meeting of creditors. Supp. A. at 140. Dr. Phillip's numerous interactions with Standard just before and after July 2008 refute his contention that he forgot about the policy.

Furthermore, an action that is repeated is very unlikely to be inadvertent. *Devers*, 759 F.2d at 754 (repeated sale of secured assets combined with failure to report the sales evidenced fraudulent intent). Dr. Phillips "forgot" to list his claim on three occasions.

The bankruptcy court did not commit clear error in finding that Dr. Phillips would not forget about a claim that he was pursuing at the same time as he was involved in his bankruptcy case and which would provide his main source of income. *C & H Elec. v. Newell (In re Newell)*, 321 B.R. 885 (Bankr. N.D. Ohio 2005) (holding that activity around the time of filing undermines the debtor's explanation that he forgot about the asset). The policy benefit was a major potential source of income outside of Dr. Phillips existing governmental disability payments and family assistance. A. at 82. In addition, Dr. Phillips had to hire someone at considerable expense to collect the billing information that Standard required. Phillips Br. at 8, n.7. The "number and magnitude" of his interactions with Standard supports the court's finding that Dr. Phillips did not forget about his disability claim. *Devers*, 759 F.2d at 754; *Retz*, 606 F.3d at 1196 (giving a bankruptcy court's credibility judgments special deference).

B. The bankruptcy court did not clearly err in finding that Dr. Phillips had the mental capacity to understand the necessity of disclosing his claim against Standard Insurance.

The bankruptcy court did not clearly err in finding that Dr. Phillips had the mental capacity to understand his actions and to attempt to hide his disability claim from his creditors. A. at 24. At the same time that he allegedly lacked the necessary executive functioning to understand the import of his bankruptcy schedules, he discussed his bankruptcy with two attorneys, participated without incident in the meeting of creditors, and, acting *pro se*, litigated a successful appeal of denial of unemployment benefits by the State of Washington. A. at 131, 157, 162-163. Also in the fall of 2008, Dr. Phillips successfully filed, briefed, and argued two motions to dismiss adversary proceedings in his bankruptcy case. A. at 158-160. Finally, he was able to defend himself against numerous complaints by patients so that he would not lose his medical license. A. at 129.

Furthermore, Dr. Phillips's evidence supporting his alleged lack of mental capacity is not persuasive. He relies upon his discharge report from the Menninger clinic. A. at 199. But that document records that Dr. Phillips "denied decreased energy or concentration." *Id.* Furthermore, he "was alert and oriented in all spheres and cognitively intact." A. at 116 (recitation at trial of discharge document). His "thought process was logical and goal-directed." A. at 117.

In addition, Dr. Phillips relies on the testimony of a clinical psychologist, Dr. Judith Cohen, but she did not begin treating him until November 2008, after the events at issue in this case. A. at 94, 112. She had no personal knowledge of his mental capacity in July 2008, when Dr. Phillips filed his bankruptcy petition, his first amended petition, and attended his meeting of creditors – in all three instances failing to disclose his claim against Standard. A. at 118-119.

In contrast, the trustee testified that Dr. Phillips appeared fully engaged at the meeting of creditors. A. at 162-64. The attorney who filed the bankruptcy petition for Dr. Phillips's medical practice in August 2008 testified that Dr. Phillips understood the purpose of the filing. A. at 179. The attorney also testified that he had no reason to suspect that Dr. Phillips was not mentally capable of handling his financial affairs. A. at 180. In light of the evidence that Dr. Phillips was handling his financial affairs at a sophisticated level, the bankruptcy court's finding that he had the mental capacity to understand the content and import of his bankruptcy case was not clearly erroneous.

C. The bankruptcy court did not err in rejecting Dr. Phillips's argument that the omission of the Standard claim was "immaterial."

Dr. Phillips's defense in this case is based on the premise of "no harm, no foul," namely that any proceeds from the disability claim would not have been available to creditors, so that it does not matter that he failed to disclose it. This argument has no merit. *Chalik v. Moorefield (In re Chalik),* 748 F.2d 616, 618 (11th Cir. 1984) (stating that the defense that an omitted asset is worthless is "specious"); *Jensen v. Slater (In re Slater),* 318 B.R. 881, 888 (Bankr. M.D. Fla. 2004) (same). Dr. Phillips' reasoning is misguided for two reasons.

1. The fact that Dr. Phillips's disability claim may have been exempt does not excuse his failure to disclose it.

Dr. Phillip's argument that his disability policy is an exempt asset and thus his failure to list it did not matter is incorrect for three reasons.

First, Dr. Phillips was required to disclose all his assets, including his interests in those that were potentially exempt. When a debtor files for bankruptcy, all interests in property are placed in the estate. 11 U.S.C. § 541; *see also Schwab,* 130 S. Ct. at 2662-63 (stating this). It is well-established that contingent interests in future income are estate property. *See Neuton v. Danning (In re Neuton),* 922 F.2d 1379, 1382-83 (9th Cir. 1990). This includes rights in insurance policies.

Minaco Gp. of Cos., Ltd. v. First State Underwriters Agency of New England Reinsurance Corp. (In re Minaco), 799 F.2d 517, 519 (9th Cir. 1986). Failure to schedule an asset, including a cause of action, means the asset remains in the estate and does not revert to the debtor. *Cusano*, 264 F.3d at 945-46.

All assets start out in the estate but can subsequently be removed from the estate through the exemption process. *In re Yonikus I*, 974 F.2d 901, 905 (7th Cir. 1992). Therefore, a debtor may not claim a property interest to be exempt until he has included that asset in his bankruptcy estate. *In re Yonikus II*, 996 F.2d 866, 869 (7th Cir. 1993) ("Before an exemption can be claimed, it must be estate property."). To claim, as Dr. Phillips does, that an asset is exempt and therefore not in the estate "puts the cart before the horse." *Id.*

Second, a debtor must fully disclose what assets he seeks to remove from the estate. 11 U.S.C. § 522(l); Fed. R. Bankr. P. 4003(a). Full disclosure is required to give the trustee or creditor a chance to object to a debtor's claimed exemption. Fed. R. Bankr. P. 4003(b); *Yonikus I*, 974 at 904-05. Therefore, the debtor has no discretion in what he chooses to reveal. *Woodson*, 839 F.2d at 615-16. The bankruptcy system can only function when debtors fully disclose their financial situation so that the trustee and creditors have accurate information without having to conduct their own investigations. *Retz*, 606 F.3d at 1196 (citation omitted); *Chalik*, 748 F.2d at 618. By failing to disclose his claim, Dr. Phillips prevented the trustee and creditors from analyzing to what extent – if any – his claim would be exempt. He should not be able to benefit from his failure to abide by the requirements of the Bankruptcy Code.

Third, Dr. Phillips is not correct that his failure to disclose the disability claim was harmless because his interest in it was exempt, and therefore his creditors would not have benefitted from the proceeds. There is no such thing as a "no harm, no foul" defense in the context of section 727. A debtor does not have to harm creditors to warrant denial of discharge because "lack of injury to creditors is irrelevant for purposes of denying a discharge in bankruptcy." *Bernard v. Scheaffer (In re Bernard*), 96 F.3d 1279, 1281-82 (9th Cir. 1996) (quoting *In re Adeeb*, 787 F.2d at 1343). Therefore, even if Dr. Phillips were correct that his disability claim was exempt, the bankruptcy court did not err in denying his discharge.

2. Dr. Phillips is incorrect that his disability policy is an executory contract that the trustee failed to reaffirm and thus it is not property of the estate.

As an initial matter, this Court should not consider Dr. Phillips's executory contract argument because he did not raise it at the trial level. *See* Supp. A. at 189-

191 (excerpt from the United States Trustee's BAP brief making argument with record cites). Courts generally do not consider new arguments on appeal. *Raich v. Gonzales*, 500 F.3d 850, 868 (9th Cir. 2007). Here, the bankruptcy appellate panel did not address the United States Trustee's argument that the executory contract argument had been waived but rejected Dr. Phillips's legal theory on the merits. A. at 54, n.7

The bankruptcy appellate panel correctly rejected Dr. Phillips's theory that the insurance policy was an executory contract that the trustee failed to affirm and thus it was not in the estate. His argument fails for at least four reasons.

First, an insurance policy is not an executory contract. *Olah v. Baird (In re Baird)*, 567 F.3d 1207, 1212 (10th Cir. 2009).

Second, a debtor must list all insurance policies so that the trustee can determine whether they are assets. *Nealon v. Shute (In re Shute)*, 38 F.2d 769, 770 (9th Cir. 1930).

Third, all contracts must be listed on a debtor's schedules. *Diamond Z Trailer, Inc. v. JZ LLC (In re JZ LLC*), 371 B.R. 412, 416 (B.A.P. 9th Cir. 2007). Under Dr. Phillips's theory that an insurance policy is an executory contract, he was obligated to list it on his Schedule G – "Executory Contracts and Unexpired Leases." Dr. Phillips failed to list the Standard policy anywhere on his schedules.

Fourth, as the bankruptcy appellate panel pointed out, the disability *claim* is not executory but an accrued right to benefits. A. at 17, n.7; *see Morehead v. Waldock Inv. Co. (In re Morehead)*, No. 05-141, 2006 WL 1966970 (N.D. W.Va. July 12, 2006) (noting the bankruptcy court found the debtor's disability insurance claim to be an asset of the estate available to creditors); *In re Reiland*, 377 B.R. 232, 234 (Bankr. D. Minn 2007)*, vacated as moot on other grounds, Reiland v. Sullivan*, Nos. 08-923 & 08-924, 2008 WL 4876758 (D. Minn. Nov. 12, 2008) (describing claim against disability insurer as an asset of the estate).

Even if Dr. Phillips were correct that his disability policy were executory, it would not rescue his legal argument. He had an "express, affirmative duty to disclose all assets, including contingent and unliquidated claims," such as his disability claim against Standard. *Hamilton v. State Farm Fire & Cas. Co.*, 270 F.3d 778, 785 (9th Cir. 2001). The bankruptcy appellate panel did not err in rejecting Dr. Phillips's legal argument and denying his discharge because he did not disclose his disability claim against Standard.

CONCLUSION

For the reasons presented above, the United States Trustee respectfully requests this Court to affirm the bankruptcy court's denial of Dr. Phillips's chapter 7 discharge.

October 7, 2010

Respectfully submitted,

/s/ Catherine B. Sevcenko

ROBERT D. MILLER, JR.
Acting United States Trustee for
Region 18

MARK H. WEBER
Regional Assistant United States
Trustee

THOMAS A. BUFORD, III
Trial Attorney

Department of Justice
700 Stewart Street, Suite 5103
Seattle, WA 98101
Ph: (206) 553-2000
Fax: (206) 553-2566

RAMONA D. ELLIOTT
General Counsel

P. MATTHEW SUTKO
Associate General Counsel

CATHERINE B. SEVCENKO
Trial Attorney

Executive Office for United States
Trustees
Department of Justice
20 Massachusetts Avenue, N.W.
Washington, D.C. 20530
Ph: (202) 307-1399
Fax: (202) 307-2397

CERTIFICATE OF COMPLIANCE WITH FRAP 32(a)(7)(c)

I hereby certify that the foregoing brief complies with the typeface requirements in FRAP 32(a)(5) and the page and type-volume limitation in FRAP 28.1(e) & 32(a)(7). I also certify that the foregoing brief was prepared using Corel Word Perfect 12, is proportionately spaced, using Times New Roman font, 14 point type. Based on a word count under Corel WordPerfect 12, this brief contains 10,847 words excluding the table of contents, table of authorities, and certificates of counsel.

/s/Catherine B. Sevcenko
Catherine B. Sevcenko

CERTIFICATE OF SERVICE

Under penalty of perjury, I certify that, on the date this document was filed, October 7, 2010, a copy of this document, along with a copy of the Supplemental Appendix, was mailed via first-class mail as follows:

Christopher Phillips
43 Parkedge Cr.
Dartmouth, Nova Scotia B2V 2V1
Canada

In addition, on the date this document was filed, four copies of the Supplemental Record Excerpts/Appendix were mailed to the Court as follows:

Clerk, United States Court of Appeals
for the Ninth Circuit
95 Seventh Street
San Francisco, CA 94103

/s/ Catherine B. Sevcenko
Catherine Sevcenko
Trial Attorney
Office of the General Counsel
U.S. Trustees Program
20 Massachusetts Avenue, NW
Suite 8000
Washington, DC 20530
(202) 305-2757
catherine.b.sevcenk@usdoj.gov

ADDENDUM

TIME-LINE OF EVENTS
FEBRUARY - DECEMBER, 2008

Time Line

Key:
§§ Event related to Standard disability claim §§
§§ Event related to Dr. Phillips's bankruptcy §§
§§ Event related to Dr. Phillip's unemployment benefits §§

Date	**Event**
November 2002	§§ Dr. Phillips obtains disability insurance from Standard Insurance Company. §§
Late 2007- Early 2008	State of Washington informs Dr. Phillips he can no longer practice medicine until he completes treatment for addiction to narcotics.
Late 2007 - Prior to February 12, 2008	§§ Dr. Phillips makes inquiry to Standard about how to file a claim for disability benefits. §§
February 12, 2008	§§ Letter from Disability Benefits Processor Maureen Rotter to Dr. Phillips acknowledging his intent to file a claim. §§
Early March 2008	§§ Dr. Phillips retains bankruptcy counsel and begins completing what he calls the "core" portion of his bankruptcy schedule.§§
March 16-22, 2008	§§ Dr. Phillips applies to the State of Washington for unemployment benefits.§§
March 22, 2008	Dr. Phillips checks into Menninger Clinic for treatment.
March 22, 2008	§§ Dr. Phillips files a disability claim with Standard.§§
March 27, 2008	§§ Letter from Disability Benefits Processor Maureen Rotter to Dr. Phillips requesting an additional claim form.§§
April 2008 (Beginning)	§§ State of Washington denies Dr. Phillips's request for unemployment benefits.§§
April 3, 2008	§§ First letter from Maureen Rotter to Dr. Phillips regarding missing information.§§
April 4, 2008	§§ Determination letter from the Employment Security Department mailed to Dr. Phillips.§§

April 17, 2008	§§ Second letter from Maureen Rotter to Dr. Phillips regarding missing information.§§
April 18, 2008	Dr. Phillips is discharged from the Menninger Clinic.
May 8, 2008	§§ Third letter from Maureen Rotter to Dr. Phillips regarding missing information.§§
May 13, 2008	§§ Letter from Dr. Phillips to Maureen Rotter regarding missing information.§§
May 20, 2008	§§ Letter from Maureen Rotter to Dr. Phillips acknowledging receipt of missing information.§§
May 27, 2008	§§ Letter from Disability Claim Specialist Marisa Kragerud to Dr. Phillips.§§
May 29, 2008	§§ Letter from Marisa Kragerud to Dr. Phillips requesting more information.§§
June 4, 2008	§§ Interview of Dr. Phillips by Marisa Kragerud regarding the specifics of his claim.§§
June 7, 2008	§§ Memorandum from the desk of Marisa Kragerud concerning Dr. Phillips's request for copies of his claim paperwork.§§
June 11, 2008	§§ Letter from Marisa Kragerud to Dr. Phillips.§§
June 13, 2008	§§ Letter from Marisa Kragerud to Dr. Phillips.§§
July 2, 2008	§§ Letter from Marisa Kragerud to Dr. Phillips.§§
July 2, 2008	§§ Dr. Phillips files his bankruptcy petition.§§
July 8, 2008	§§ Letter from Marisa Kragerud to Dr. Phillips.§§
July 25, 2008	§§ Letter from Marisa Kragerud to Dr. Phillips.§§
July 31, 2008	§§ Dr. Phillips testifies at his meeting of creditors under oath.§§
July 31, 2008	§§ Dr. Phillips files his first amended Schedule B.§§
August 1, 2008	§§ Letter from Marisa Kragerud to Dr. Phillips.§§
August 6, 2008	§§ Email from Sandy Johnson, a vocational case manager with Standard, to Marisa Kragerud forwarding an August 5 e-mail from Dr. Phillips.§§

Summer 2008	§§ Dr. Phillips repeatedly calls the Department of Employment Security to determine the status of his application for unemployment benefits and the reason that he was not receiving funds.§§
August 7, 2008	§§ Dr. Phillips appeals the denial of unemployment benefits.§§
August 8, 2008	§§ Telephone conversation between case manager Sandy Johnson and Dr. Phillips concerning the company’s documentation requirements for his claim.§§
August 11, 2008	§§ Follow-up telephone conversation between Marisa Kragerud and Dr. Phillips concerning documentation requirements.§§
August 15, 2008	§§ Letter from Marisa Kragerud to Dr. Phillips.§§
August 18, 2008 (1)	§§ Letter from Dr. Phillips to Marisa Kragerud regarding his address change.§§
August 18, 2008 (2)	§§ Letter from Dr. Phillips to Marisa Kragerud regarding a request for an additional claim form.§§
August 28, 2008	§§ Letter from Debbie McClellan, Director of Individual Underwriting, to Dr. Phillips denying benefits, returning his premiums, and rescinding his policy.§§
August 29, 2008	§§ Dr. Phillips receives the letter from Debbie McClellan and allegedly realizes that his claim against Standard was not listed on his Schedule B.§§
September 3, 2008	§§ E-mail from Dr. Phillips to his counsel discussing the omitted disability claim.§§
September 3, 2008	§§ Letter from unidentified Standard employee to Dr. Phillips.§§
September 4, 2008	§§ Dr. Phillips represents himself unsuccessfully in a telephonic hearing related to his unemployment benefit appeal.§§
September 8, 2008	§§ Letter from Marisa Kragerud to Dr. Phillips.§§
September 9, 2008	§§ Standard informs the Chapter 7 trustee’s attorney about Dr. Phillips disability claim and its denial of benefits.§§
September 15, 2008	§§ Standard sues for a declaratory judgment that Dr. Phillips’s disability policy is void.§§

September 17, 2008	§§ DR. PHILLIPS FILES HIS SECOND AMENDED SCHEDULE B, DISCLOSING HIS DISABILITY CLAIM FOR THE FIRST TIME.§§
September 19, 2008	§§ Letter from Dr. Phillips to Marisa Kragerud.§§
October 7, 2008	§§ Dr. Phillips amends his Schedule C to exempt the value of his disability claim.§§
October 15, 2008	§§ Dr. Phillips appears and testifies at a Rule 2004 exam.§§
October 28, 2008	§§ Dr. Phillips files a motion to dismiss an adversary complaint filed by Prairie Eye Center (08-1241), which is granted on December 31, 2008 [Dkt. #s 5, 38].§§
October 29, 2008	§§ Dr. Phillips files a motion to dismiss an adversary complaint filed by FIA credit card services (08-1240); the parties stipulate to dismissal on November 5, 2008. [Dkt. #s 8-10].§§
November 12, 2008	§§ Dr. Phillips represents himself in a second telephonic hearing related to his unemployment benefits appeal, obtaining reversal of the earlier adverse decisions, allowing him to begin to receive unemployment benefits.§§
November 20, 2008	Dr. Phillips begins therapy sessions with clinical psychologist Dr. Cohen.
December 5, 2008	§§ The United States Trustee files a complaint seeking to deny Dr. Phillips's discharge under section 727(a)(2) and under section 727(a)(4)(A).§§

Statement of Related Cases

The United States Trustee is unaware of any related cases other than the one identified in statement attached to Dr. Phillips's brief.

/s/ Catherine B. Sevcenko
Catherine B. Sevcenko

BRIEF BANK — 'SUMMARY SHEET" *Printed Thu-8/11/05 10:41*

WESTLAW CODES

1. **("TI")** *TITLE* OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]* — Phon v UST (In re Food Cash and Carry Trading, Inc.)

2. **("CO")** *CURRENT* COURT *[E.g., "CTA9"]* — 9th Cir. BAP

3. **("CCN")** *CURRENT* CASE NO. — No.: NC-04-1634

4. **("PCN")** *PRIOR* CASE NO. & COURT *[IF ANY]* — No.: 9th Cir. BAP

   Court: NC-04-1634

   (Identify judge & cite, if any)

5. **("SO")** *SOURCE* — U.S. TRUSTEES

6. **("DA")** *DATE* OF FILING *& TYPE* OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]* — Filed: Aug. 2005

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7. **("AU")** *PRINCIPAL AUTHORS & OFFICE [E.g.,"UST/OGC"]* — Minnie Loo, AUST

   (UST/OGC: 202-307-1399/FAX-2397)

8. **("TO")** *TOPIC* — BANKRUPTCY

9. **("SU")** ● *SUMMARY* OF KEY ISSUE(s) & √ Any Miscellaneous *BACKGROUND*

   ● 1. Whether the bankruptcy court, pursuant to 11 U.S.C. § 330(a), abused its discretion in disallowing all of Phon's requested fees, and ordering him to return $43,262, where he: (a) violated Bankruptcy Code section 327 and Federal Rule of Bankruptcy Procedure (Rule) 2014(a), by failing to make various disclosures in his employment application; (b) violated 11 U.S.C. § 329 and Rule 2016(b), by misrepresenting the post-petition timing of the payment of his retainer; and (c) violated the confirmation order, by not making plan distributions when required and paying himself attorney fees without bankruptcy court authority.

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MINNIE LOO, Assistant U.S. Trustee (106613)
ANDREW D. VELEZ-RIVERA (143481)
MARGARET H. McGEE (142722)
MATTHEW R. KRETZER (157949)
U.S. DEPARTMENT OF JUSTICE
OFFICE OF THE U.S. TRUSTEE
1301 Clay Street, Suite 690-N
Oakland, California 94612-5217
Telephone: (510) 637-3200

Attorneys for Appellee,
Acting United States Trustee, Sara L. Kistler

UNITED STATES BANKRUPTCY APPELLATE PANEL

OF THE NINTH CIRCUIT

In re FOOD CASH AND CARRY TRADING, INC., Debtor.	Bankr. No. 99-46230 TT (Chapter 7) Bankruptcy Judge, Leslie Tchaikovsky, presiding
LEWIS PHON, Appellant, v. SARA L. KISTLER, ACTING UNITED STATES TRUSTEE, and FOOD CASH AND CARRY TRADING, INC., DEBTOR, Appellees.	**BAP No. NC-04-1634** An Appeal from the United States Bankruptcy Court for the Northern District of California

BRIEF OF APPELLEE,
THE ACTING UNITED STATES TRUSTEE

Appellee, Sara L. Kistler, Acting United States Trustee (U.S. Trustee), respectfully submits this Brief in support of the Order (I) Disallowing Fees and Costs of Former Counsel to Debtor in Possession, Lewis Phon, and (II) Requiring Disgorgement of All Fees Received (Fee Order).

I.

STATEMENT OF SUBJECT MATTER AND APPELLATE JURISDICTION

The bankruptcy court had jurisdiction of the underlying chapter 7 case, under 28 U.S.C. § 157. On October 26, 2004, the bankruptcy court, (Hon. Leslie Tchaikovsky, presiding), entered its Fee Order. The Fee Order denied allowance of all fees requested by Lewis Phon, Esq. (Phon), and requires Phon to return $43,262 to the chapter 7 trustee of the bankruptcy estate of Food Cash and Carry Trading, Inc. (Debtor). Following the November 10, 2004 entry of an order denying Phon's motion for reconsideration, Phon timely filed a notice of appeal of the Fee Order on November 22, 2004. Under 28 U.S.C. § 158(a)(1) and (b)(1), and the Amended Order Continuing the Bankruptcy Appellate Panel of the Ninth Circuit, this Panel has jurisdiction of the appeal of the Fee Order.

II. STATEMENT OF ISSUES PRESENTED ON APPEAL

At issue in this appeal are the following discrete issues concerning Phon's fees for services as counsel to the former debtor-in-possession.

1. Whether the bankruptcy court, pursuant to 11 U.S.C. § 330(a),[1] abused its discretion in disallowing all of Phon's requested fees, and ordering him to return $43,262, where he: (a) violated Bankruptcy Code section 327 and Federal Rule of Bankruptcy Procedure (Rule) 2014(a), by failing to make various disclosures in his employment application; (b) violated 11 U.S.C. § 329 and Rule 2016(b), by misrepresenting the post-

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[1] Unless specifically indicated, all statutory references herein are to the "Bankruptcy Code." 11 U.S.C. §§ 101 *et seq*.

petition timing of the payment of his retainer; and (c) violated the confirmation order, by not making plan distributions when required and paying himself attorney fees without bankruptcy court authority.

2. Whether the bankruptcy court, pursuant to 11 U.S.C. § 330(a), abused its discretion in finding unreasonable $15,773.33 of $33,840 total pre-confirmation fees that Phon incurred: (a) on services rendered prior to the entry of a retention order; (b) spending excessive time reviewing plan ballots; (c) charging fees pertaining to another bankruptcy estate to the Debtor's estate; (d) performing services benefitting the Debtor's principal, as opposed to the estate; and (e) drafting two inadequate disclosure statements and plans – of seven total versions.

3. Whether the bankruptcy court, pursuant to 11 U.S.C. § 330(a) and the confirmation order, abused its discretion in finding unreasonable $31,840 of $62,100 total post-confirmation fees: (a) that Phon incurred performing services in connection with another case, and negotiating an unsuccessful compromise with a claimant; and (b) the time details of which Phon "clumped" in his fee application.

III. STANDARDS OF APPELLATE REVIEW

This Panel may overturn the Fee Order only if it determines the bankruptcy court has abused its discretion. Franke v. Tiffany (In re Lewis), 113 F.3d 1040, 1043 (9th Cir. 1997); Movitz v. Baker (In re Triple Star Welding, Inc.), 324 B.R. 778, 788 (B.A.P. 9th Cir. 2005). That discretion is ample, for the "bankruptcy court has broad and inherent authority to deny any and all compensation where an attorney fails to meet the requirements of" Bankruptcy Code section 330. Lewis, 113 F.3d at 1045. Under the abuse-of-discretion standard, this Panel "must have a definite and firm conviction that the court below committed a clear error of judgment in the conclusion it reached, before reversal is proper." In re Crowe, 243 B.R. 43, 47 (B.A.P. 9th Cir.), aff'd, 246 F.3d 673 (9th

Cir. 2000). The bankruptcy court's findings of fact are reviewed for clear error, and its conclusions of law *de novo*. Lewis, 113 F.3d at 1043; Fed. R.Bankr.P. 8013.

IV. STATEMENT OF THE CASE

A. Nature of the Case.

Phon is a solo practitioner in San Francisco, who represented the Debtor in both pre- and post-confirmation proceedings during the chapter 11 phase of its bankruptcy case. (U.S. TRUSTEE App., Exh. A, pp.2-14).[2] The Debtor ceased operations long ago, and its case is now in chapter 7. (Id., p.6, l.9-12).

This appeal arises from Phon's First and Final Fee Application (Fee Applica- tion), in which he sought a final allowance of fees for legal services, in the amount of $95,940. (App., Exh, 8). The U.S. Trustee and the Debtor [3] objected to the allowance of all fees requested, and sought the return of all monies paid to Phon during the case. (U.S. TRUSTEE App., Exh. A, p.6, l.3-13). The bankruptcy court held an extended evidentiary hearing on Phon's Fee Application. (Id., p.7, l.17-18).

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[2] Phon has not continuously paginated his excerpts of record, as required pursuant to B.A.P. Rule 8009(b)-1. Therefore, certain excerpts contained in the U.S. Trustee's Appendix, (U.S. TRUSTEE App.), necessarily duplicate those of Phon's Appendix, (App.). The U.S. Trustee's excerpts have been continuously paginated, and are referred to accordingly in this Appellee's Brief.

[3] Certain parties participating below have either changed or are not involved at this appellate stage. First, the Debtor, which objected to the allowance of Phon's fees along with the U.S. Trustee, is a co-appellee here. It is the U.S. Trustee's understanding, however, that the Debtor will not be filing a brief.

Second, Sara L. Kistler is now the other co-appellee. Ms. Kistler was named Acting U.S. Trustee for Region 17, effective January 9, 2005, and has substituted in this appeal for William T. Neary, the prior U.S. Trustee and original co-appellee. B.A.P. Rule 8018(b)-1; Fed.R.App.P. 43(c); Fed.R.Bankr.P. 7025.

On October 4, 2004, the bankruptcy court filed a 22-page Memorandum of Decision. (U.S. TRUSTEE App., Exh. A). Of the total $95,940 of fees for which Phon sought a final allowance, the court determined that only $49,033.33 of fees, (*i.e.,* approximately half), were reasonable under Bankruptcy Code section 330. (U.S. TRUSTEE App., Exh. B). Ultimately, though, due to Phon's many statutory and regulatory violations, the bankruptcy court disallowed all fees, and ordered Phon to return $43,262 of prior payments to the chapter 7 trustee. (Id.)

B. Statements of Facts and Prior Proceedings.

The appellate parties generally do not dispute the facts. The background of this appeal, nonetheless, is extensive and complex.

1. The Related Bankruptcy Case of Doris Ma.

The Debtor filed a voluntary petition under chapter 11 on July 29, 1999, and originally was assigned to another Oakland bankruptcy judge. (U.S. TRUSTEE App., Exh. A, p.2, l.5-11). A few months earlier, Doris Ma, an individual, filed a chapter 13 petition in the bankruptcy court, with Phon as counsel of record. (Id.) Ma's lower-numbered case had been assigned to the Hon. Leslie Tchaikovsky. (Id.)

On October 22, 1999, the Debtor's case was transferred to Judge Tchaikovsky, who treated the Debtor's case and Doris Ma's as related cases. (U.S. TRUSTEE App., Exh. A, p.2, l.12-p.3, l.4). Ma, a creditor, had guaranteed certain of the Debtor's debts, and along with the Debtor, had pledged her personal real estate to help secure such debts. (Id.) The Debtor, an Asian food wholesaler and retailer, operated its business from Ma's real property, in downtown Oakland. (Id.) The Debtor paid Ma rent, and Ma was a salaried employee of the Debtor. (Id.) Ma also was the ex-wife of the Debtor's sole owner, William Cheung. (Id., p.2, l.7-9).

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Great International Import/Export Corporation (Great International) was a secured creditor with a cross-collateralized claim. (U.S. TRUSTEE App., Exh. A, p.2, l.19-23). Its pending foreclosure proceedings led to the commencement of both the Debtor's bankruptcy case and Ma's. (Id.)

2. The Problems With Phon's Employment Applications.

a. Phon's Failure to Disclose His Connections With Doris Ma.

On September 21, 1999, Phon filed his initial employment application. (U.S. TRUSTEE App., Exh. A, p.2, l.23-26). In the application and accompanying verified statement, Phon averred under penalty of perjury that he was not "affiliated" with the Debtor's creditors. (Id., p.16, l.11-16). The bankruptcy court determined that Phon's particular use of the term "affiliated" constituted a "deficiency" in the application. (Id.) That application, therefore, was denied without prejudice, pending Phon's explanation of "affiliated." (Id., p.2, l.23-26).

In his amended employment application, filed on December 27, 1999, Phon indicated that " 'affiliated' included 'being employed by the debtor, and having any relationship with the debtor, [or] the debtor's creditors.' " (Id., p.9, l.9-14, & p.16, l.15-24). Phon, however, did not disclose any relationship with Doris Ma, or that he represented her in her individual bankruptcy case, in his amended application or verified statement. (Id., p.16, l.15-24).

b. The Untimeliness of Phon's Employment Applications.

As set forth above, Phon did not file his initial employment application until September 21, 1999 – *i.e.*, two months into the Debtor's case. (U.S. TRUSTEE App., Exh. A, p.2, l.23-26). "When a deficiency was noted in the form of the application, it took [Phon] several more months to file an amended application." (Id., p.9, l.24-25). Phon's filing of his amended application on December 27, 1999 came approximately five months into the case. (Id., p.9, l.9-14.) The bankruptcy court entered Phon's retention order on

January 12, 2000 – *i.e.*, almost five and a half months after the commencement of the Debtor's case. (Id.)

Phon did not seek the entry of a retroactive retention order. (U.S. TRUSTEE App., Exh. A, p.9, l.9-14). Thus, the court's retention order did not approve Phon's employment on a retroactive basis. (Id.)

c. Phon's Misrepresentations of His Retainer.

In his Rule 2016 Statement, Phon stated that the Debtor had paid him a retainer of $3,830, which his employment application referred to as a "pre-petition" retainer. (U.S. TRUSTEE App., Exh. A, p.15, l.5-13). "On various occasions, Phon [also] represented that he had received the retainer one or two days prior to the filing of the bankruptcy petition." (Id.) On May 17, 2004, though, in a declaration supporting the Fee Application, Phon revealed for the first time in almost five years that the retainer actually was paid, not at once, but in three separate installments, and paid ***after*** the commencement of the Debtor's case, not before. (Id.)

3. The Various Disclosure Statements and Plans.

Pursuant to bankruptcy court order, Phon drafted and filed a proposed plan and disclosure statement of the Debtor on November 30, 1999. (U.S. TRUSTEE App., Exh. A, p.3, l.3-11). The court denied approval of the disclosure statement, though, on the grounds that both it and the plan were "grossly insufficient." (Id.)

Throughout 2000, Phon drafted five more amended plans and disclosure statements. (U.S. TRUSTEE App., Exh. A, p.3, n.1). But, "[t]he Court denied approval of each amended disclosure statement on both substantive and technical grounds." (Id.)

In an order entered September 18, 2000, Great International obtained relief from the automatic stay. (U.S. TRUSTEE App., Exh. A, p.3, l.15-24). Following its foreclosure sale of the Debtor's real estate, it entered into a settlement with the Debtor, which the bankruptcy court approved in an order entered November 1, 2000. (Id.) Pursuant to the settlement, Great International paid $95,000 to the Debtor. (Id.) With Phon's agreement, the funds were deposited into his trust account for eventual payments to creditors, once the Debtor's plan was confirmed. (Id., & p.19, l.1-3).

The Debtor's Sixth Amended Plan (Plan) was confirmed in an order entered April 6, 2001. (U.S. TRUSTEE App., Exh. A, p. 4, l.7-9). The Plan provided for the $95,000 to be paid to general unsecured creditors on the "effective date," *i.e.*, 20 days following the date of entry of the confirmation order. (Id., p.18, l.19-26).

Though still holding $95,000 in his trust account, Phon did not make the required Plan distributions within 20 days of the effective date, *i.e.*, by May 6, 2001. (U.S. TRUSTEE App., Exh. A, p.19, l.1-10). Instead, it appeared Phon did not make creditor distributions until late 2001 and 2002. (Id.) By as late as the spring of 2003, Phon still had not distributed $13,364.14 of the $95,000. (Id.) He later paid that balance over to the Debtor's new counsel, (id., p.19, n.7), who then paid tax creditors in 2003. (U.S. TRUSTEE App., Exh. C, p.30, l.8-11).

The Plan first required Phon to obtain bankruptcy court approval for the payment of his fees, and second, reserved jurisdiction for the allowance of Phon's pre- and post-confirmation fees. In particular, Article G of the Plan provides: "[n]o court appointed professionals, including debtor's counsel, shall be paid until their fees are approved by the court." (U.S. TRUSTEE App., Exh. A, p.12, l.13-15). Article L of the Plan states:

> The Bankruptcy Court shall retain jurisdiction after confirmation of the Plan (b) to fix and determine expenses of administration and compensation whether existing before or after the confirmation of this Plan; ...

(Id., l.8-13).

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4. The Debtor's Post-Confirmation Skirmishes With Morgan Lincoln.

Ten days after confirmation, on April 16, 2001, Morgan Lincoln International Corporation (Morgan Lincoln), an administrative claimant, moved to convert the case to chapter 7 and to reconsider the confirmation order. (U.S. TRUSTEE App., Exh. A, p.4, l.9-18). Morgan Lincoln's motions would consume the Debtor's case throughout the remainder of 2001, and most of 2002. (Id.)

Morgan Lincoln contended that, as a supplier to the Debtor, it had an administrative expense claim of $387,312.35. (U.S. TRUSTEE App., Exh. A, p.4, l.9-18). Morgan Lincoln also argued that the disclosure statement failed to disclose its administrative claim, and that the confirmed Plan failed because the Debtor had insufficient funds to pay the claim on the effective date. (Id.)

In opposition, the Debtor alleged that Morgan Lincoln's principal, Alice Huang (Huang), who also was the Debtor's manager and romantically involved with William Cheung, (the Debtor's principal), had purchased merchandise for the Debtor from another entity she controlled. (U.S. TRUSTEE App., Exh. A, p.4, l.19-26). The Debtor alleged that Huang attended the confirmation hearing at which the Plan was confirmed, and did not then object. (Id., p.5, l.2-3).

Under the circumstances, Judge Tchaikovsky determined that she could resolve Morgan Lincoln's post-confirmation motions only by holding an evidentiary hearing. (U.S. TRUSTEE App., Exh. A, p.5, l.4-9). To that end, between April and October 2001, the Debtor and Morgan Lincoln took discovery. (Id.) But, Morgan Lincoln's counsel later sought to withdraw, and was authorized to do so in an order entered October 15, 2001. (Id.)

That withdrawal notwithstanding, the Debtor, in papers drafted by Phon, filed a motion to settle Morgan International's administrative claim on January 9, 2002. (U.S. TRUSTEE App., Exh. A, p.5, l.9-13). The bankruptcy court denied approval of the compromise, on the grounds "it impermissibly impaired the rights of creditors under the Plan." (Id.) Discussions between the Debtor and Morgan Lincoln then continued throughout 2002. (Id., p.13, l.18-p.14, l.2).

Eventually, due to Morgan Lincoln's failure to obtain new counsel, it could not continue prosecuting its post-confirmation motions to convert and reconsider. (U.S. TRUSTEE App., Exh. A, p.5, l.14-18). On November 2, 2002, those motions were dropped from the court's calendar. (Id.)

5. The Various Pre- and Post-Confirmation Payments to Phon.

Pre-Confirmation Payments. Between January and September, 2000, while Phon drafted various of the Debtor's six amended disclosure statements and plans, he received five payments from the Debtor, totaling $35,932. (U.S. TRUSTEE App., Exh. A, p.17, l.20-p.18, l.5). Phon contended in his Fee Application that the Debtor had transferred the money to build up a fund for eventual creditor distributions under the Plan. (Id., p.18, l.5-7). But, when the Debtor made the payments, four years earlier, Phon did not seek court approval for the transfers, or disclose the transfers in any manner. (Id., p.18, l.10-12).

Of the total $32,932 Phon received prior to confirmation of the Plan, he returned $10,500 to the Debtor, and applied the $25,432 balance to his post-confirmation fees. (Id., p.18, l.13-17). Phon did not seek court approval before he took the funds for his personal use, and he neither disclosed nor provided notice of the payment of such fees to the bankruptcy court, the creditors or the U.S. Trustee. (Id.) None of these funds were used for creditor distributions under the confirmed Plan. (Id.)

Post-Confirmation Payments. Phon has admitted receiving an additional $47,000 from the Debtor and third parties between April and June, 2001, *i.e.*, after the Plan was confirmed. (Id., p.20, l.10-23). Without seeking or obtaining court approval, Phon also applied this money to his post-confirmation fees. (Id.)

6. Phon's Fee Applications and the Debtor's Turnover Motion.

On November 26, 2002, soon after Morgan Lincoln's post-confirmation motions were dropped, Phon filed a notice of hearing of his initial Fee Application, which Application he did not file until December 6, 2002. (U.S. TRUSTEE App., Exh. A, p.5, l.18-p.6, l.2, & Exh. D, p.54, Docket nos. 193 & 194). William Cheung, the Debtor's principal (Cheung), filed a *pro se* objection to the application on December 31, 2002. (U.S. TRUSTEE App., Exh. A, p.6, l.4-9). Phon then continued the hearing on his fee application several times during 2003, and eventually dropped it from the calendar. (Id.)

On March 12, 2004, the Debtor filed a motion for turnover and disgorgement against Phon, seeking the return of $98,102. (U.S. TRUSTEE App., Exh. A, p.6, l.14-16). On March 24, 2004, the U.S. Trustee filed an objection to the allowance of Phon's fees, and concurred in the Debtor's turnover motion. (App., Exh. 3). In his response, Phon admitted receiving $50,031 from the Debtor prior to confirmation of the Plan, but argued he returned all but $36,012 to the Debtor and had not applied any of the funds to his pre-confirmation fees. (U.S. TRUSTEE App., Exh. A, p.7, l.3-13). Instead, Phon contended that he applied the funds to his post-confirmation fees, because they no longer were property of the estate and, thus, bankruptcy court approval was not required. (Id.)

The bankruptcy court held a hearing on the Debtor's turnover motion on April 19, 2004. (App., Exh. 16). Phon, however, was permitted to supplement his initial Fee Application, and did so in various papers filed in May and June, 2004. (App., Exh. 8, and U.S. TRUSTEE App., Exh. D, pp. 57-58). As supplemented, Phon sought the allowance of fees of $95,040, consisting of $33,840 in pre-confirmation fees, and $61,200 in post-confirmation fees. (U.S. TRUSTEE App., Exh. A, p.8, l.23-p.9, l.8, & p.13, l.4-13).

The bankruptcy court held two extended evidentiary hearings on the Fee Application and the turnover motion on July 8 and August 2, 2004, at which Phon was represented personally by separate counsel and gave testimony. (U.S. TRUSTEE App., Exh. A, p.7, l.17-20). Post-hearing papers by Phon and the Debtor followed. (Id.) The bankruptcy court took the matter under submission, (id.), and filed its Memorandum on October 4, 2004. (Id., p.1).

7. The Bankruptcy Court's Memorandum of Decision.

The Memorandum sets forth the bankruptcy court's findings of fact and conclusions of law. The court first determined the extent to which Phon's requested fees were unreasonable under Section 330. (U.S. TRUSTEE App., Exh. A, p.8, l.21-p.14, l.9). The court next concluded that Phon's requested fees needed to be denied in their entirety, given his many violations of the Bankruptcy Code and Rules, and the terms of the Debtor's confirmed reorganization plan. (Id., p.14, l.9-p.22, l.7).

The court first found that $15,773.33 of $33,840 total fees that Phon incurred pre-confirmation were unreasonable. (U.S. TRUSTEE App., Exh. A, p.11, l.13-16). The court concluded that part of the fees were for services Phon rendered prior to the entry of the retention order. (Id., p.8, l.21-p.10, l.3). Also, the court found that Phon spent excessive time reviewing plan ballots; charged fees pertaining to another bankruptcy estate to the Debtor's estate; performed services benefitting the Debtor's principal, rather than the estate; and spent excessive time drafting amended versions of a disclosure statement and plan. (Id., p.10, l.9-p.11, l.12).

Second, the bankruptcy court ruled that it had jurisdiction to adjudicate the allowance of Phon's post-confirmation fees in light of the specific terms of the Plan and this Panel's own decisional law. (U.S. TRUSTEE App., Exh. A, p.11, l.24-p.13, l.2). The court also found that $31,840 of $62,100 total fees that Phon incurred post-confirmation were unreasonable. (Id., p.14, l.3-9). The court concluded that Phon performed services in connection with another case, and that he also unjustifiably continued negotiating the compromise with Great International – after the bankruptcy court had denied approval of the compromise and advised him of its specific substantive problem. (Id., p.13, l.4-p.14, l.2). The court also found that Phon "clumped" the entries in his time details and charged his time in unauthorized increments in his Fee Application. (Id.)

Turning to its blanket disallowance, the bankruptcy court concluded that Phon violated various basic disclosure provisions of the Bankruptcy Code and Rules. (U.S.

TRUSTEE App., Exh. A, p.14, l.9-p.22, l.7). First, the court found that Phon misrepresented the timing of the payment of his retainer – it was paid post-petition, yet Phon had represented in various papers that it had been paid pre-petition. (Id., p.14, l.22-p.15, l.20). The bankruptcy court also found that Phon, in violation of basic bankruptcy law, neither sought nor obtained court authority for payment of the post-petition retainer under Section 363(b)(1), and the payment of the retainer also violated Section 330(a). (Id.)

Second, the bankruptcy court held that Phon failed to disclose various connections concerning Doris Ma in his employment application. (U.S. TRUSTEE App., Exh. A, p.15, l.20-p.17, l.19). Third, with regard to the $35,932 the Debtor transferred to Phon pre-confirmation for eventual Plan distributions, the bankruptcy court ruled that Phon failed to disclose the payments, as required. (Id., p.17, l.19-p.18, l.1). Judge Tchaikovsky ruled further that none of the payments were made with court authority, as required under Section 363(b)(1). (Id.)

The bankruptcy court also found that, after confirmation, Phon actually never used the money for creditor payments, as the Plan required. (U.S. TRUSTEE App., Exh. A, p.18, l.12-17). Instead, he used them to fund the Debtor's defense of Morgan Lincoln's post-confirmation motions. (Id.) The court ruled that Phon's funding of the litigation ran afoul of the specific terms of the confirmation order. (Id., p.18, l.18-p.20, l.8).

Fourth, the court also identified many entries in Phon's time records showing that he had engaged in discussions with the Debtor's principal so that a third-party, on the principal's behalf, could purchase former property of the estate at a foreclo- sure sale. (U.S. TRUSTEE App., Exh. A, p.21, l.9-p.22, l.7). This, Judge Tchai- kovsky pointedly called "unethical," adding: "[t]he Debtor's conduct, and Phon's cooperation in it, may constitute a bankruptcy crime." See 18 U.S.C. § 153. (Id.)

8. The Fee Order.

On October 26, 2004, the bankruptcy court entered the Fee Order. (U.S. TRUSTEE, Exh. B). The Fee Order provided that, "but for Phon's violations of the Bankruptcy Code and Federal Rules of Bankruptcy Procedure (Rules) and his unethical and perhaps criminal conduct, the Court would allow Phon $49,033.33 in pre- and post-confirmation fees and $916 in pre-confirmation costs." (Id., p.26, l.12-16). Due to Phon's violations of the Bankruptcy Code, the Rules and the Plan, the Fee Order disallowed all of Phon's requested fees and costs, and granted the Debtor's turnover motion to the extent consistent with the Memorandum. (Id., p.26, l.17-p.3, l.7). The Fee Order, moreover, required Phon to refund $43,262 of prior payments to the chapter 7 trustee. (Id., p.26, l.24-27).

After his motion to reconsider failed, Phon appealed the Fee Order on November 22, 2004, without appealing the denial of reconsideration. (U.S. TRUSTEE App., Exh. E).

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V. SUMMARY OF ARGUMENT

Based upon the sworn evidence presented, and also upon detailed knowledge culled from presiding over the Debtor's case for over five years, the bankruptcy court disallowed all fees for legal services rendered by Phon, due to his failures to disclose and other misfeasance, and ordered him to disgorge $43,262. The court did not abuse its broad discretion in doing so, and its disallowance should be affirmed.

Phon repeatedly violated the most basic of statutes and rules governing the employment and compensation of professionals in bankruptcy cases. Indeed, as the court's meticulous Memorandum shows, Phon's performance – rife with non-disclosures, misrepresentations, untimeliness, and draft after draft – was responsible for much of the case's stumbling.

Phon does not challenge the bankruptcy court's key conclusions – because he cannot. To the contrary, the court's findings relating to Phon's non-disclosures and misrepresentations go entirely uncontested – and are even admitted – in Phon's Opening Brief. Based as they are on unassailable facts and binding Ninth Circuit law, such conclusions cannot be contested, and merit affirmance of the bankruptcy court's exercise of discretion in sanctioning Phon for that misconduct.

VI. ARGUMENT

A. The Bankruptcy Court Did Not Abuse Its Broad Discretion in Disallowing All of Phon's Fees, and Ordering Phon to Disgorge $43,262.

1. The Ninth Circuit has Virtually No Tolerance for Non-Disclosure.

The Ninth Circuit and this Panel have pointedly and repeatedly recognized the importance of scrupulous compliance with the bankruptcy system's disclosure requirements, and have made plain that bankruptcy courts should sanction non-compliant attorneys. Lewis, 113 F.3d at 1040; Neben & Starrett, Inc. v. Chartwell Financial Corp. (In re Park-Helena Corp.), 63 F.3d 877 (9th Cir. 1995), cert. denied, 516 U.S. 1049 (1996); Mehdipour v. Marcus & Millichap (In re Mehdipour), 202 B.R. 474, 480 (B.A.P. 9th Cir. 1996). In addition to Section 327(a) and Rules 2014 and 2016, the bankruptcy courts also have broad and inherent authority to deny any and all compensation where attorneys fail to comply with the disclosure requirements for employment and compensation. Lewis, 113 F.3d at 1045.

Under Ninth Circuit law, once a bankruptcy court concludes that a non-disclosing attorney has acted with " 'complete disregard' for the procedures and requirements of the Bankruptcy Rules and the Bankruptcy Code," the court has "discretion over whether to permit [counsel] to receive any fees at all, regardless of their excessiveness or reasonableness." Lewis, 113 F.3d at 1045-46. That is, "given the gravity of counsel's transgressions," a threshold inquiry into the appro- priate amount of the fee under Section 330 is not required. Id., 113 F.3d at 1046.

Here, the court below properly exercised that discretion because Phon violated the most basic rules governing professional compensation – Sections 327, 329 and 330, and

Bankruptcy Rules 2014 and 2016. Phon's omissions and misrepresentations go to the heart of the self-reporting system the Bankruptcy Code requires professionals to follow. In order to properly discharge their judicial functions, bankruptcy courts rely exclusively on lawyers' voluntary, complete, and truthful compliance with Rule 2014. Proper disclosure is necessary to enable the court to make an informed decision as to whether the applicant meets the statutory requirements for employment under Section 327(a), *i.e.*, that such person does not "hold or represent an adverse interest to the estate" and is a "disinterested person." 11 U.S.C. § 327(a); Park-Helena, 63 F.3d at 881. Phon repeatedly violated that system, and, given that, the court below acted well within its broad discretion imposing sanctions for that misconduct.

To enable bankruptcy courts to determine properly whether proposed attor- neys meet Section 327(a)'s requirements, Rule 2014(a), in relevant part, requires:

> The application shall state the specific facts showing the necessity for the employment ... and ... **all of the person's connections** with the debtor, creditors, [and] any other party in interest [ ]. The application shall be accom- panied by a verified statement ... setting forth the person's connections [ ].

Fed.R.Bankr.P. 2014(a) (bold added).

This Panel has ruled that: "the disclosure rules are not discretionary." Mehdipour v. Marcus & Millichap (In re Mehdipour), 202 B.R. 474, 480 (B.A.P. 9th Cir. 1996). It is controlling law in this circuit that professionals comply with those statutes and rules by making all the disclosures they contemplate:

> **All** facts that may be pertinent to a court's determination of whether an attorney is disinterested or holds an adverse interest to the estate must be disclosed. ... The **duty** of professionals is **to disclose all connections** ... They cannot pick and choose which connections are irrelevant or trivial ... No matter how old the connection, no matter how trivial it appears, the professional seeking employment must disclose it. ...

Park-Helena, 63 F.3d at 882 ((applying Bankruptcy Rule 2014 (bold added)).

In the Ninth Circuit, a professional person's failure to comply with the requirements of § 327(a) at any time during his or her employment may result in a denial of compensation. Lewis, 113 F.3d at 1045; Park-Helena, 63 F.3d at 882; see also 11

U.S.C. § 328(c). The disclosure requirements of Rule 2014 are applied "strictly" and "literally, even if the results are sometimes harsh." Id., 63 F.3d at 881. Negligent or inadvertent omissions "do not vitiate the failure to disclose." Id. The failure to comply with the disclosure rules is a sanctionable violation, even if proper disclosure would have shown that the attorney had not actually violated any Bankruptcy Code provision or Bankruptcy Rule. Id., 63 F.3d at 880.

2. The Bankruptcy Court Properly Concluded that Phon's Failure to Disclose His Connections to Doris Ma was Sanctionable.

Here, the bankruptcy court correctly followed applicable law in concluding that Phon failed to comply with Section 327 and Rule 2014(a) by failing to disclose his connections with Doris Ma in his initial and amended employment applications and verified statements. As indicated above, Ma was a creditor in the Debtor's case by virtue of her landlord, employee and guarantor ties to the Debtor. (See pp. 4-5 above). She also was the debtor in a related bankruptcy case, with Phon as her bankruptcy counsel, and the ex-wife of the Debtor's sole owner. (Id.)

Phon does not dispute any one of the foregoing ties, their depth, or that he also failed to amend his employment application and verified statement at any point to disclose his connections. To the contrary, Phon now admits he failed to disclose his connections in the Debtor's case. (Opening Brief, p.8, l.9-10).

In this regard, Phon points to other filed papers he prepared which refer to the Debtor's ties to Doris Ma, (Opening Brief, p.8, l.1-11). But, the Ninth Circuit has long held that such extraneous references fail to satisfy the applicable regulatory requirement of attorney disclosure. In re Haldeman Pipe & Supply Co., 417 F.2d 1302, 1304-05 (9th Cir. 1969)(strictly construing General Order No. 44 under Bankruptcy Act). Pursuant to the unambiguous provisions of Rule 2014(a), it is in "the application" and "verified statement" in which all connections must be disclosed, not any other papers. Fed.R.Bankr.P. 2014(a). Thus, it is not sufficient that information concerning an applicant's connections "might be mined from petitions, schedules, section 341 meeting testimony, or other sources." In re American Thrift & Loan Ass'n, 137 B.R. 381, 387 (Bankr. S.D. Cal. 1992) (disallowing all fees of debtor's counsel due to failure to disclose receipt of potential preferences), In re Hathaway Ranch Partnership, 116 B.R. 208, 219-20 (Bankr. C.D. Cal. 1990) (denying debtor's counsel's revised employment applica- tion where connections not disclosed in original application). See also 9 Collier on Bankruptcy, ¶2014.04, at 2014-6 (15th ed. 2004) ("The fact that disclosure was made elsewhere [ ] is not likely to ameliorate a court's reaction to incomplete disclosure.")

Alone, Phon's failure to disclose his connections to Doris Ma justified the disallowance of all his fees and disgorgement under Ninth Circuit law. While Phon also is quick to point out that the bankruptcy court and the U.S. Trustee became aware of his connections, (Opening Brief, p.4, l.4-8), this transparent attempt to displace his non-compliance also fails. As Judge Tchaikovsky noted, (U.S. TRUSTEE App., Exh. A, p.16, l.25 - p.17, l.19), a bankruptcy court simply has no duty to search the file to ferret out information about either a lawyer's adverse interests or other evidence of his noncompliance with Section 327. In re BH & P, Inc., 949 F.2d 1300, 1317 (3rd Cir. 1991). Like the court, the U.S. Trustee also has no duty to search the record for connections or conflicts. In re Marine Outlet, Inc., 135 B.R. 154, 156 (Bankr. M.D. Fla. 1991). Thus, the court properly recognized that only Phon bore the burden of disclosing all connections – not the court, the U.S. Trustee, or any other party.

3. Phon's Failure to Disclose Exactly When His Retainer was Paid was Also Properly Sanctionable.

In addition to not disclosing his connections to Doris Ma, Phon received a $3,830 post-petition retainer without either proper disclosure or prior court authority. Exactly like the offending lawyer in Lewis, Phon misrepresented the timing of his retainer payments. Counsel in Lewis received $30,000 of his $40,000 retainer post-petition, but disclosed in an amended employment application that he had received the entire retainer pre-petition.

Id., 113 F.3d at 1042-43. Here, Phon received his entire retainer post-petition, in 1999, but disclosed for five years in his Rule 2016(b) statement that it had been paid pre-petition. Only in his amended Fee Application, in 2004, did Phon disclose that he had been paid the retainer post-petition. Even further, Phon failed to seek or obtain court approval for his post-petition retainer under either Section 363(b)(1) or the seminal law of this Panel. United States Trustee v. Knudsen Corp. (In re Knudsen Corp.), 84 B.R. 668 (B.A.P. 9th Cir. 1988). Phon's acceptance of an unauthorized post-petition retainer also violated Section 330(a). 11 U.S.C. § 330(a)(1).

Again, either alone, or coupled with Phon's failure to disclose his connections to Doris Ma, (see pp.16-18 above), this misrepresentation justified the disallowance of all of Phon's fees and disgorgement under Ninth Circuit law. Phon offered no explanation or justification for this critical five-year misrepresentation in the lower court. (U.S. TRUSTEE App., Exh. A, p. 15, l.19). His Opening Brief also is completely silent about the post-petition payment of his retainer.

The bankruptcy court correctly held that Phon's misrepresentation concerning his retainer violates Rule 2016(b), justifying wholesale disallowance and disgorgement.[4] In

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[4] In note 8 of its Memorandum, the bankruptcy court calculated the disgorge- ment amount of $43,262 as the sum of (a) the $3,830 retainer, (b) $29,262 in "pre-petition" funds the Debtor paid Phon, and (c) $14,000 in "post-petition" payments. Because these three components actually add up to $46,092, rather than $43,262, the U.S. Trustee has re-examined the arithmetic, and the three separate sources of money constituting the court's total disgorgement amount.

According to the U.S. Trustee's calculation, the court's $43,262 total actually is the sum of (a) the $3,830 retainer (including the filing fee); (b) $25,432 in "pre-confirmation" (not "pre-petition") funds the Debtor paid Phon, which Phon applied post-confirmation, (U.S. TRUSTEE App., Exh. A, p.18, l.15-17); and (c) $14,000 in "post-confirmation" (not "post-petition") payments, (Id., p.20, l.14-17).

Thus, the court's $43,262 total disgorgement amount is correct, but in a minor

Park-Helena, the Ninth Circuit held that, by failing to disclose the payment of his retainer by the corporate debtor's president, the debtor's attorney violated the disclosure requirements of Rules 2014 and 2016(b). Id., 63 F.3d at 880-882. In so holding, the Ninth Circuit noted that the fiduciary duties of disclosure under Rule 2014(a) and Rule 2016(b) are similar and overlapping. Id., 63 F.3d at 881. ("The disclosure requirements of Rule 2014 are applied as strictly as the requirements of Rule 2016 and section 329 ..."). Thus, the Ninth Circuit affirmed the disallowance of all fees for counsel's violations. Id.

4. Phon's Violation of the Confirmation Order Also Warranted Disgorgement.

In disallowing Phon's fees, the bankruptcy court also concluded that Phon ignored the provisions of the Plan requiring creditor distributions from the money in his trust account. (U.S. TRUSTEE App., Exh. A, p.18, l.4 - p.20, l.8). In response, Phon argues that, once Morgan Lincoln sought reconsideration of the confirmation order, he "was caught in an awkward situation." (Opening Brief, p.13, l.17). That is, on the one hand, he would be violating the order by not making timely distribu- tions, and on the other hand, he believed he could be personally liable if he made the distributions and the order were later vacated. (Id., p.13, l.17-22).

Phon's argument, made without citation to any authorities whatsoever, (id.), fails precisely for the two reasons the bankruptcy court noted. That is, first, the motion for reconsideration did not prevent the confirmation order from becoming final. Fed.R.Bankr.P. 9024; Fed.R.Civ.P. 60(b) ("A motion under this subdivision (b) does not affect the finality of a judgment or suspend its operation.") And second, in a sharp retort

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oversight, the court's semantical references to the three components were slightly mistaken. That is, the court used the terms "pre-petition" and "post-petition," to actually refer to "pre-confirmation" and "post-confirmation," respectively.

In his Opening Brief, Phon does not dispute either the total disgorgement amount, any of its component parts, or the court's semantical references.

to his personal liability argument, Phon also made most of the creditor distributions before the court disposed of the reconsideration motion. (U.S. TRUSTEE App., Exh. A, p.19, l.11 - p.20, l.8). As Phon admits, no party in interest – himself included – sought a stay of the confirmation order. (Opening Brief, p.14, l.7-9). His "awkward situation" argument, moreover, fails to take account of both the insulating effect of the final confirmation order, and its commanding nature.[5]

Given the clear Plan provisions specifying the use to which the money held by Phon was to be put, Phon violated his Plan obligations by appropriating the money for himself, rather than using it as the Plan directed. Although Phon alleges he did so to protect the funds and himself, the lower court did not accept that characterization, and instead determined Phon transferred those funds to himself in satisfaction of his fees. (Id., p.19, l.11 - p.20, l.8). That is not clearly erroneous, and merits affirmance.

In disallowing Phon's fees for a different violation of the confirmation order, the court also concluded that Phon applied to his post-confirmation fees $25,342 of funds paid to him prior to confirmation, without prior notice and court approval. (U.S. TRUSTEE App., Exh. A, p.18, l.12-17). Phon does not dispute that the payments were for attorney fees, or that they violated the unambiguous requirements of Articles G and L of the confirmed Plan, requiring post-confirmation approval and reserving jurisdiction, respectively. (Id., p.12, l.13-15). The court's findings here, too, are not clearly erroneous and merit affirmance.[6]

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[5] In this regard, Phon mistakenly asserts that the U.S. Trustee and the Debtor failed to raise his non-compliance with the confirmation order in the lower court. (Opening Brief, p.13, l.2-3). The U.S. Trustee indeed did so in her supplemental objection to Phon's Fee Application. (U.S. TRUSTEE, App., Exh. F, p. 76, l.13-15).

[6] With respect to the lower court's sanctioning of Phon for his non-disclosure of post-confirmation fees, (U.S. TRUSTEE App., Exh. A., p.20, l.24-26),

5. The Bankruptcy Court Properly Concluded that Phon's Failure to Seek Approval of the Plan Down Payments was Sanctionable.

In disallowing Phon's fees, the bankruptcy court also concluded that the $35,932 cash which the Debtor transferred to Phon pre-confirmation for eventual creditor distributions was a transfer outside the ordinary course of business, for which he did not seek or obtain court approval under Section 363(b)(1). (U.S. TRUSTEE App., Exh. A, p.17, l.3 - p.18, l.18). In Monday-morning quarter- backing, and without citation to any authorities, Phon purports to split hairs. (Opening Brief, p.15, l.16 - p.16, l.26).

The court's conclusion was sound. First, Phon did not treat the transfers as "down payments" for later creditor distributions. Rather, he returned some of the money to the Debtor, and paid himself with the balance. (U.S. TRUSTEE App., Exh. A, p.17, l.20 - p.18, l.5). Second, even had Phon made the distributions, it was not he who had disbursing authority under the Plan and confirmation order. Instead, it was Zili Yu, the President of the Debtor, who was designated as disbursing agent. (U.S. TRUSTEE App., Exh. F, p. 70, l.11-12). Third, as the court stated, the "down payments" were entirely undisclosed. Phon presented no evidence that the transfers were disclosed on the Debtor's operating reports. Quite the contrary, in all of the Debtor's disclosure statements – which Phon was drafting and filing at precisely the same time as he was receiving the "down

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Phon questions whether he was required to file post-confirmation Rule 2016(b) statements. (Opening Brief, p.16, l.27 - p.19, l.11). In light of Phon's pre-confirmation non-disclosures, however, the Panel need not reach the question of whether Rule 2016(b) applies post-confirmation. *Cf.*, John G. Berg Assocs. v. Township of Pennsauken (In re John G. Berg Assocs.), 138 B.R. 782, 787 (Bankr. E.D. Pa. 1992)("There is no end-point to the application of § 329 and F.R.B.P. 2016."); and In re Florence Tanners, Inc., 209 B.R. 439, 444 (Bankr. E.D. Mich. 1997)(nothing in confirmed plan excuses counsel from filing a Rule 2016(b) statement).

payments" – he failed to reveal his receipt and continued possession of the money. (Id., at p. 77, l.12-24).

Also, the transfers were highly unorthodox. In the U.S. Trustee's experience, very rare is it that chapter 11 debtors make pre-confirmation transfers to their lawyers for post-confirmation distributions. If anything, it is the U.S. Trustee's experience that the few debtors-in-possession able to segregate cash for plan purposes prior to confirmation establish self-managed reserves that are held at approved depositories under Section 345, and disclosed in their operating reports.

6. The Panel Should Give No Weight to Misconstructions and Misleading Characterizations in Phon's Opening Brief.

In disallowing Phon's fees, the bankruptcy court's independent review of Phon's time records further led it to conclude that he failed to disclose the December, 2001 marriage between the Debtor's principal, Cheung, and Alice Huang. (U.S. TRUSTEE App., Exh. A, p.21, l.10 - p.22, l.7). The court's time-record review also led it to conclude that Phon assisted Cheung in arranging for a third party – Huang – to act on his behalf to purchase the Debtor's foreclosed real estate. (Id.) Phon spends considerable energy alleging for the first time that he failed to disclose the marriage between Huang and Cheung because he discovered it later, and that he simply did not counsel Cheung to purchase the Debtor's real estate. (See Opening Brief, at p.4, l.14 - p.12, l.17). Phon also contends that, in light of the court's independent, post-hearing review of his time records, he had no opportunity to explain his individual time entries. (Id., p. 10, l.27 - p.12, l.1).

Phon's explanations misconstrue the court's Memorandum, and are also misleading. In any event, even if true, Phon's allegations constitute harmless error.

The bankruptcy court did not base its disallowance on Phon's failure to disclose the 2001 Huang-Cheung marriage in his 1999 employment application and verified statement. Rather, the court appears to have pointed to Phon's failure to disclose the marriage in the proposed compromise between the Debtor and Morgan Lincoln, of which Huang was a principal. (U.S. TRUSTEE App., Exh. A, p.21, l.21 - p.22, l.4). Phon prepared and filed that failed proposal in January, 2002, *i.e.,* after Huang and Cheung were married. (Id., p.5, l.9-13).

Otherwise, Phon's argument that he had no opportunities to explain his abbreviated time records is misleading. To begin with, as the fee applicant, it was Phon's burden to present both decipherable time records, and a Fee Application narrative explaining such records. Woods v. City Nat. Bank & Trust Co., 312 U.S. 262, 268 (1941); Pfeiffer v. Couch (In re Xebec), 147 B.R. 518, 524 (Bankr. 9th Cir. 1992); In re S.T.N. Enters., Inc., 70 B.R. 823, 833-34 (Bankr. D. Vt. 1987). The court, moreover, was entitled to exercise its independent duty to review Phon's time records. In re Busy Beaver Bldg. Centers., Inc., 19 F.3d 833, 843-44 (3rd Cir. 1994).

But, more importantly, Phon was given at least five opportunities to explain his time records – but he never did. Not only did Phon have (1 and 2) the narratives to his two fee applications, but he also had (3) his own testimony at the evidentiary hearings, where he was represented by separate counsel, (App., Exhs. 16-18), (4) his post-hearing papers (U.S. TRUSTEE, App., Exh. G), and (5) his motion to reconsider the Fee Order, (App., Exh. 12), which was denied.[7] Therefore, relative to the ordinary fee applicant, the court actually conferred Phon with numerous significant opportunities to elaborate on his time records.

B. Alternatively, the Bankruptcy Court Acted Within its Discretion Under the Compensation Provisions of the Bankruptcy Code in Denying A Portion of Phons's Fee Request.

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[7] Phon's reconsideration motion, though not on appeal, is significant; it is there that Phon specifically contended that he first knew of the Cheung-Huang marriage only after it happened, and of Huang's possible involvement in Great International's foreclosure sale. (See App., Exh. 12.)

Phon's many instances of misconduct – separately and collectively – justified the bankruptcy court's total disallowance of fees. If this Panel affirms the court's Fee Order, it need not consider the subsidiary issue of whether the court erred in reducing Phon's fee request. But, should this Panel reach that issue, it should affirm the reduction, given the lower court's findings and the record before it.

In determining the amount of reasonable compensation to be awarded to an attorney, bankruptcy courts are required to consider the nature, extent, and value of services rendered to the estate, taking into account all statutorily-enumerated factors. 11 U.S.C. § 330(a)(3). Section 330(a)(4)(A) prohibits the court from allowing compensation for services that were not either reasonably likely to benefit the debtor's estate nor necessary to its proper administration. 11 U.S.C. § 330(a)(4)(A); Smith v. Hale (In re Smith), 305 F.3d 1078, 1085-86 (9th Cir. 2002).

Counsel has the duty to exercise proper billing judgment. Unsecured Creditors' Comm. v. Puget Sound Plywood, Inc., 924 F.2d 955, 958-59 (9th Cir. 1991). In assessing such judgment, or lack thereof, bankruptcy courts must consider events reasonably known and anticipated at the time services were rendered, rather than exercise judicial hindsight. Smith, 305 F.3d at 1806. Thus, before undertaking a project, counsel "is obligated to consider": (1) whether the probable cost of legal services is disproportionate to the probable benefit, (2) the extent to which the estate or creditors will suffer if the services are not rendered, (3) the extent to which the estate or creditors will benefit if the services are rendered, and (4) the likelihood of the disputed issues being resolved successfully. Puget Sound, 924 F.2d at 959. If counsel fails either to consider these factors or scale fees accordingly despite considering them, then the excess fees must be subtracted from the allowance requested. Id. As measured in cost-benefit terms, unjustifiable services and services that do not benefit the estate also must be disallowed. In re Riverside-Linden Investment Co., Inc., 925 F.2d 320, 322 (9th Cir. 1991).

As the applicant, Phon bore the burden of establishing that he met these compensation standards. Woods, 312 U.S. at 268; Xebec, 147 B.R. at 524. As set forth below, even had Phon not misrepresented his connections and the circumstances of his retainer, he failed to meet this burden under Section 330.

C. The Bankruptcy Court Did Not Err in Concluding That Over Half of Phon's Pre-Confirmation Fees Were Unreasonable Under Section 330.

The court found that $15,733.33 of Phon's $33,840 total pre-confirmation fees were unreasonable. (U.S. TRUSTEE App., Exh. A., p. 11, l.13-16). Phon disputes neither this finding nor its sub-parts, and the court below did not err in reducing Phon's fee request in that amount.

First, under the circumstances, the bankruptcy court was well within its discretion in finding unreasonable and disallowing fees for services rendered during the five-and-a-half month period preceding the entry of the retention order. It is hornbook bankruptcy law that a chapter 11 lawyer's failure to obtain a retention order simply precludes the payment of his fees. Okamoto v. THC Fin'l Corp. (THC Fin'l Corp.), 837 F.2d 389 (9th Cir. 1988); DeRonde v. Shirley (In re Shirley), 134 B.R. 940, 943 (B.A.P. 9th Cir. 1992); 11 U.S.C. § 327(a). There "is no unjust hardship in requiring attorneys to observe the strict requirements of § 327 because professionals are charged with knowledge of the law." Andrew v. Coopersmith (In re Downtown Investment Club III), 89 B.R. 59, 63-64 (B.A.P. 9th Cir. 1987).

Second, Phon never sought or obtained a retroactive retention order. That is, he never presented any evidence trying to justify his delays in filing his employment applications, and never established the existence of extraordinary circumstances justifying retroactive relief. Atkins v. Wain, Samuel & Co. (In re Atkins), 69 F.3d 970, 973 (9th Cir.

1995). Therefore, in light of the strict scriptures of Section 330 and binding law, the bankruptcy court indeed was obligated to disallow Phon's pre-retention fees.[8]

The court's discretion also extended properly to excessive fees Phon incurred drafting serial disclosure statements and plans of the Debtor. Phon drafted <u>seven</u> total versions of these papers, the first six of which had "substantive" and "techni- cal" faults, rendering them unapprovable. If anything, because the court held that fees for only the second and third amended versions of the papers were excessive, rather than fees for also the fourth through seventh versions, it actually gave Phon substantial deference respecting this particular task. In chapter 11, fees incurred in drafting unconfirmable plans are at risk. <u>See</u> <u>In re Wire Cloth Prods, Inc.</u>, 130 B.R. 798, 807-08 (Bankr. N.D. Ill. 1991) (disallowing half of fees requested by debtor's attorney for drafting a plan that was "invalid as a matter of law.")

Furthermore, the lower court did not abuse its discretion in determining that Phon's inept drafting of serial disclosure statements and plans – even when told how to fix the documents – needlessly multiplied the proceedings. There was substantial, undisputed support in the record for that finding. (U.S. TRUSTEE App., Exh. A., p.11, l.3-13). Fees incurred in needlessly multiplicative proceedings may be disallowed. <u>Riverside-Linden</u>, 925 F.2d at 324-25. Thus, the lower court acted within its discretion in disallowing those fees here.

Furthermore, the lower court acted well within its discretion in disallowing fees for excessive time reviewing plan ballots. Indeed, the Bankruptcy Code specifically directs the court to examine "whether the services were performed within a reasonable amount of

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[8] In Doris Ma's related chapter 11 case, the bankruptcy court denied allowance of <u>all</u> of Phon's requested fees, totaling $83,990, based largely on Phon's unjustified failure to obtain a retention order. (U.S. TRUSTEE, App., Exh. H, p.90).

time commensurate with the complexity, importance, and nature of the [ ] task addressed." 11 U.S.C. § 330(a)(3)(D).

Also well within the court's discretion was the disallowance of fees for services rendered to another estate. See In re Main, Inc., 239 B.R. 59, 71 (Bankr. E.D. Pa. 1999) (ordering return of fees attributable to services not benefitting debtor's estate). Similarly, Judge Tchaikovsky was well within her discretion to find unreasonable all fees for services rendered for the benefit of the Debtor's principal, rather than the Debtor. Bankruptcy courts ordinarily deny such fees. See, e.g., In re Angelika Films 57th, Inc., 227 B.R. 29 (Bankr. S.D.N.Y. 1998) (disallowing all fees sought by counsel to corporate chapter 11 debtor, where attorneys represented interests of debtor's principal over those of estate).

In light of the foregoing, the bankruptcy court did not abuse its discretion in ruling that over half of Phon's pre-confirmation fees were unreasonable.

D. The Bankruptcy Court Did Not Abuse its Discretion in Concluding That $31,840 of Phon's Post-Confirmation Fees Were Unreasonable Under Section 330.

The court found that $31,840 of Phon's $62,100 total post-confirmation fees were unreasonable. (U.S. TRUSTEE App., Exh. A, p.11, l.24-p.13, l.2). That finding was not clearly erroneous, and the court below did not abuse its discretion in reducing fees in light of that finding. In particular, the court ruled that it had post-confirmation jurisdiction to adjudicate Phon's fees, held that 50 percent of fees Phon incurred litigating Morgan Lincoln's post-confirmation motions was reasonable, and noted many other shortcomings with Phon's post-confirmation services and Fee Application. (Id.). These determinations have not been disputed by Phon, were entirely proper exercises of discretion, and should be upheld.

First, based on the clear and specific terms of Articles G and L of the confirmed Plan, the bankruptcy court correctly held that it had post-confirmation jurisdiction to adjudicate the allowance of Phon's pre- and post-confirmation fees, and that Phon was required to apply for an allowance order prior to the payment of such fees. (Id., p.12, l.8 - p.13, l.3) Even without specific jurisdictional provisions, bankruptcy courts generally have "broad authority to oversee implementation of the plan." Captain Blythers, Inc. v. Thompson (In re Captain Blythers, Inc.), 311 B.R. 530, 537-38 (B.A.P. 9th Cir. 2004), quoting In re Consolidated Pioneer Mortgage Entities, 264 F.3d 803, 807 (9th Cir. 2001). Confirmation of a chapter 11 plan does not automatically divest a bankruptcy court of jurisdiction, and bankruptcy courts "must" retain post-confirmation jurisdiction – including over fee matters – to ensure the plans they confirm are consummated. Chase Manhattan Bank v. Sultan Corp. (In re Sultan Corp.), 81 B.R. 599, 602 (B.A.P. 9th Cir. 1987) (post-confirmation compensation adjudicated pursuant to retention of jurisdiction in confirmed plan). Here, not only did the confirmed Plan expressly reserve jurisdiction for the allowance of all of Phon's fees, but it also specifically required Phon to seek an allowance order. (U.S. TRUSTEE App., Exh. A, p.11, l.8-15). The court, furthermore, had substantial support in the record for its conclusion that the non-estate source of the funds used to pay Phon's post-confirmation fees did not excuse him from seeking an allowance order, as the Plan expressly required. First, as the court noted, Articles G and L of the Plan did not provide for the automatic allowance of Phon's fees to the extent paid with non-estate property. (U.S. TRUSTEE App., Exh. A, p.12, l.15-16). Furthermore, to the extent paid by the Debtor, the funds used to pay Phon post-confirmation had not revested in the Debtor by virtue of confirmation. In re Powers, 93 B.R. 513, 516-17 (Bankr. S.D. Tex. 1988) (plan provision reserving post-confirmation jurisdiction over compensation to professionals negates automatic revesting provision of Section 1141(b)).

Also, the court correctly concluded that Phon unjustifiably continued negotiating a compromise with Morgan Lincoln, after she had both denied approval of the compromise and advised Phon of the specific substantive problem with the deal. In chapter 11 cases, bankruptcy courts routinely disallow fees for legal services incurred in pursuing needless compromises that fail to meet approval. See In re Big Rivers Elec. Corp., 233 B.R. 768, 784-88 (Bankr. W.D. Ky. 1999).

Last, the court also found that Phon "clumped" the entries in his time records and charged his time in unauthorized increments in his Fee Application.[9] Clumping disparate time entries into a single entry aggravates a court's review of a fee appli- cation, by preventing it from determining whether each discrete task in the "clump" was completed within a reasonable period of time. Hence, fees for services which have been lumped together may be disallowed. In re Dutta, 175 B.R. 41, 46-47 (B.A.P. 9th Cir. 1994) (upholding disallowance based on " 'lumping' problem.")

For the foregoing reasons, it was an entirely appropriate exercise of judicial discretion for the bankruptcy court to hold that over 50 percent of the fees Phon incurred post-confirmation was unreasonable.

VII. CONCLUSION

For these reasons, the United States Trustee respectfully asks this Court to affirm the bankruptcy court's Fee Order in its entirety.

Dated: August 5, 2005	Respectfully submitted,
Of Counsel:	
ROBERTA DeANGELIS Acting General Counsel	MINNIE LOO (CA 106613) Assistant United States Trustee, Region 17
P. MATTHEW SUTKO Office of the General Counsel Executive Office for U.S. Trustees	ANDREW D. VELEZ-RIVERA (CA 143481) Office of United States Trustee, Region 17 U.S. Department of Justice

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[9] The court's governing guidelines prohibit "clumping" and require that applicant professionals record their time in six-minute maximum increments. Guidelines for Compensation and Expense Reimbursement of Professionals, §§ I.12 and 14.

U.S. Department of Justice
20 Massachusetts Ave., NW
Suite 8110
Washington, DC 20530

1301 Clay Street, Suite 690-N
Oakland, CA 94612
Tel: (510) 637-3200
Fax: (510) 637-3220

By: ______________________________
Andrew D. Velez-Rivera
Attorneys for Appellee,
Acting United States Trustee
Sara L. Kistler

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CERTIFICATE OF SERVICE

I, Andrew D. Velez-Rivera, declare as follows: I am a citizen of the United States and over the age of 18 years and not a party to the within action. My business address is 1301 Clay Street, Suite 690-N, Oakland, California 94612. Except as stated below, on August 5, 2005, I served by regular mail a copy of the documents entitled:

- Brief of Appellee, the Acting United States Trustee
- Appendix (Excerpts of Record) of Appellee, the Acting United States Trustee

by enclosing a true and correct copy of said documents in envelopes with delivery charges thereon fully prepaid, which envelopes were then sealed and mailed from Oakland, California, addressed to the following persons.

Appellant
Lewis Phon, Esq.
350 Sansome Street, Suite 230
San Francisco, CA 94104

Debtor's Counsel (Brief Only)
Mariam Marshall, Esq.,
Marshall & Ramos, LLP
350 Frank Ogawa Plaza, Suite 600
Oakland, CA 94612

Chapter 7 Trustee (Brief Only)
Tevis T. Thompson, Jr.
(placed in trustee's box at U.S. Trustee's Office)

Proposed Counsel to U.S. Trustee (Brief Only)
Daniel Linchey
Goldberg, Stinnett, Meyers & Davis
44 Montgomery Strret, Suite 2900
San Francisco, CA 94104

Under penalty of perjury of the laws of the United States, I declare that the foregoing is true and correct.

By: ______________________________
Andrew D. Velez-Rivera

BRIEF BANK — "SUMMARY SHEET"

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WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*
CRG Partners Group, LLC v. William T. Neary, United States Trustee (In re Pilgrim's Pride)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*
N.D. Tex.

3. ("CCN") ***CURRENT*** CASE NO.
No.: 4:10-cv-668-Y

4. ("PCN") ***PRIOR*** CASE NO. - & COURT *[IF ANY]*
No.: 08-45664
Court: Bankr. N.D. Tex.
(Identify judge & cite, if any)

5. ("SO") ***SOURCE***
U.S. TRUSTEES

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*
Filed: October 29, 2010
Type: Brief of Appellee William T. Neary, United States Trustee

7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*
Lisa L. Lambert, Erin Schmidt, Noah Schottenstein, P. Matthew Sutko, Ramona D. Elliott, William T. Neary
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***
• Did the bankruptcy court abuse its discretion when it denied CRG's request for a fee enhancement because CRG had already received reasonable compensation under 11 U.S.C. § 330?

10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)

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IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF TEXAS
FT. WORTH DIVISION

IN RE:	)	
	)	Bankruptcy Case No 08-45664
PILGRIM'S PRIDE,	)	
	)	Honorable Russell F. Nelms
DEBTOR	)	
______________________________________	)	
	)	
CRG PARTNERS GROUP, LLC,	)	District Court Case No 4:10-CV-688-Y
	)	
APPELLANT(S),	)	Honorable Terry R. Means
	)	
v.	)	
	)	
WILLIAM T. NEARY,	)	
UNITED STATES TRUSTEE,	)	
	)	
APPELLEE(S)	)	
	)	

ON APPEAL FROM THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF TEXAS

BRIEF OF APPELLEE WILLIAM T. NEARY, UNITED STATES TRUSTEE

RAMONA D. ELLIOTT
General Counsel

P. MATTHEW SUTKO
Associate General Counsel

NOAH SCHOTTENSTEIN
Trial Attorney
Executive Office for United States Trustees
Department of Justice
20 Massachusetts Avenue, N.W.
Washington, D.C. 20530
Phone: (202) 307-1399
Fax: (202) 307-2397

WILLIAM T. NEARY
United States Trustee for Region 6

LISA L. LAMBERT (TX 11844250, NY)
ERIN SCHMIDT
Trial Attorneys

Department of Justice
Office of the U.S. Trustee
1100 Commerce, Room 976
Dallas, TX 75242
Phone: (214) 767-8967
Fax: (214) 767-8971

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INTRODUCTION

On December 18, 2009, CRG Partners Group, LLC, applied for a $1 million fee enhancement under 11 U.S.C. § 330. The United States Trustee filed an objection to CRG's application, arguing that CRG had already received $5.98 million in reasonable compensation, as calculated pursuant to the hourly rates provided in CRG's retention agreement. The bankruptcy court agreed with the United States Trustee and denied CRG's application. This appeal followed.

JURISDICTIONAL STATEMENT

This Court has appellate jurisdiction under 28 U.S.C. § 158(a)(1), which confers jurisdiction on the district courts of the United States to hear appeals "from final judgments, orders, and decrees" of bankruptcy judges. The bankruptcy court's final order denying CRG's application for a fee enhancement under section 330 was entered on June 20, 2010. CRG timely filed a notice of appeal under 28 U.S.C. § 158(c)(2) and Fed. R. Bankr. P. 8002(a) on July 2, 2010.

STATEMENT OF THE ISSUE

Did the bankruptcy court abuse its discretion when it denied CRG's request for a fee enhancement because CRG had already received reasonable compensation?

STANDARD OF REVIEW

A bankruptcy court's fee determination is reviewed for abuse of discretion. *Caplin & Drysdale v. Babcock & Wilcox Co. (In re Babcock & Wilcox Co.)*, 526 F.3d 824, 826 (5th Cir. 2008) (per curiam). "A bankruptcy court abuses its discretion when it (1) applies an improper legal standard or follows improper procedures in calculating the fee award or (2) rests its decision on findings of fact that are clearly erroneous." *Id.* (citation omitted). "This Court reviews the bankruptcy court's findings of fact for clear error and its legal conclusions de novo." *Id.*

STATEMENT OF THE CASE

I. Statutory Framework

A. The compensation of a chapter 11 debtor's professionals under 11 U.S.C. § 330.

When a debtor files a bankruptcy case to reorganize under chapter 11 of the Bankruptcy Code, the debtor becomes a "debtor-in-possession." 11 U.S.C. § 1101. The debtor-in-possession maintains control over the debtor's property, but also obtains rights, powers, and fiduciary duties. 11 U.S.C. §§ 1106-08. This control includes the ability to hire employees to manage business operations, 11 U.S.C. § 363(b), and to retain professionals to assist the debtor-in-possession with the reorganization of the bankruptcy estate. 11 U.S.C. §§ 327-28. When a debtor in possession employs a professional in both respects, such as with restructuring professionals like CRG, the professional may be retained as an employee of the estate, but remains subject to the Bankruptcy Code's requirements governing notices and disclosures, conflicts of interest, and bankruptcy court supervision of the professional's fees. *See* 11 U.S.C.

§§ 327, 330; Fed. R. Bankr. P. 2014, 2016(a).

Section 330 allows a bankruptcy court to award "reasonable compensation for actual, necessary services rendered by the . . . professional." 11 U.S.C. § 330(a)(1)(A). "The court may, on its own motion or on the motion of the United States Trustee . . . award compensation that is less than the amount of compensation that is requested" to a reasonable amount. 11 U.S.C. § 330(a)(2). "In determining the amount of reasonable compensation to be awarded to a [professional], the court shall consider the nature, the extent, and the value of such services, *taking into account all relevant factors, including* —

(A) the time spent on such services;

(B) the rates charged for such services;

(C) whether the services were necessary to the administration of, or beneficial at the time at which the service was rendered toward the completion of, a case under this title;

(D) whether the services were performed within a reasonable amount of time commensurate with the complexity, importance, and nature of the problem, issue, or task addressed;

(E) with respect to a professional person, whether the person is board certified or otherwise has demonstrated skill and experience in the bankruptcy field; and

(F) whether the compensation is reasonable based on the customary compensation charged by comparably skilled practitioners in cases other than cases under this title.

11 U.S.C. § 330(a)(3) (emphasis added).

B. The United States Trustee's statutory duty to review and object to section 330 fee applications under 28 U.S.C. § 586(a)(3)(A).

The United States Trustee is an official of the United States Department of Justice appointed by the Attorney General to supervise the administration of bankruptcy cases in this district. 28 U.S.C. § 581(a)(6). The United States Trustee has a statutory obligation to review applications for compensation under section 330 and to object to applications the United States Trustee considers to be inappropriate. 28 U.S.C. § 586(a)(3)(A).

II. Statement of the Facts

The Pilgrim's Pride Corporation produces and distributes chicken and chicken-related products. *R. 851-52.* In December 2008, Pilgrim's Pride and six related entities filed for chapter 11 bankruptcy relief. *R. 2009:20*.

In the five years prior to filing for bankruptcy relief, Pilgrim's Pride had employed Bain Consulting to assist with restructuring its operations. *R. 2035:7*. Pilgrim's Pride, however, was dissatisfied with Bain and sought to replace them prior to filing for bankruptcy relief. *R. 2036:9.* Pilgrim's Pride therefore interviewed five candidates for the position of Chief Restructuring Officer. *R. 2035:11*. A Pilgrim's Pride director testified that Pilgrim's Pride interviewed restructuring candidates based on qualifications and hourly rates. *R. 2047:15-25; 2048:17-23.*

CRG participated in the bidding to replace Bain, and offered to charge less than market rates to win the business from the competitors: $550 per hour. *R. 2057:18-2058:20*. Employing CRG allowed Pilgrim's Pride to save "a lot of money in excess fees" in comparison to Bain. *R. 2045:21-22*. Subsequently, CRG was employed under section 363(b). *R. 888.*

Although the Bankruptcy Code determines compensation under section 330(a) only for those bankruptcy professionals appointed by the court under section 327(a) and 1103(a), the section 363(b) order provided that CRG's fees would be determined under a section 330 "reasonableness standard." *R. 890.* The order, by approving the section 363(b) application, also provided that CRG would receive compensation for additional personnel at $175-550 per hour, reimbursement for all out-of-pocket expenses, an additional 4.5% of fees paid for administrative expenses, the bi-weekly payment of professional fees and expenses, and a substantial retainer. *R. 856*. And unlike some other professionals retained in the bankruptcy case, CRG did not include a provision for a bonus or a contingent success fee that would be reviewed under section 330 standards. *See*, *e.g.*, *R. 919* (approving a success fee); *R. 936* (discussing a success fee or restructuring fee disclosed in the employment application). In total, CRG offered to charge less than Bain was charging to oversee and manage Pilgrim's Pride's entire reorganization process. *R. 2035-36*.

This arrangement continued unchanged throughout the bankruptcy case, which proceeded in "a very traditional way." *R. 2010:4-16* (reviewing the history of the bankruptcy case). In the midst of the reorganization, another company, JBS Group, offered to purchase Pilgrim's Pride and sponsor the chapter 11 reorganization plan. *Id.* (describing the JBS Group's offer as "key to the company's emergence" from bankruptcy). The sale price was sufficient to provide for the full payment of all creditors, with some recovery to equity security holders. *Id.* The plan was confirmed and became effective on December 28, 2009. *Id.*

III. Statement of the Proceedings Below

After the chapter 11 reorganization plan had been confirmed, the bankruptcy court approved $5.98 million in reasonable compensation under the lodestar calculation, based upon the hourly rates provided in the employment order. *R. 2110*. CRG then filed an amended application "for an upward adjustment to its reasonable fees" under section 330. *R. 891*. Although CRG did not specify the amount of the upward adjustment in the motion, it later clarified that it was seeking a $1 million fee enhancement. *R. 2027*.

In support of this application, CRG argued that there were two reasons justifying an upward adjustment based on the lodestar calculation of its fees under section 330. The first was CRG's "exceptional efficiency" and the "spectacular" result of the full repayment to all creditors. *R. 898-99*. The second was that CRG, as the restructuring firm, received compensation that was significantly lower than what the financial advisors and investment bankers received due to its below-market billing rates. *R. 900-03*. CRG stated that had it billed at comparable rates, it would have received an additional $3 million. *R. 901*.

The United States Trustee objected to CRG's application for a fee enhancement. *R. 1956*. The United States Trustee argued that CRG already received reasonable compensation for its services under the section 330 lodestar calculation. *R. 1959-61*. A fee enhancement was not necessary because CRG was compensated at the billing rates it proposed when it competitively bid to be employed by Pilgrim's Pride, rates which were approved by the bankruptcy court in CRG's application for employment. *R. 1961*. Furthermore, there were no exceptional circumstances or delays that the bankruptcy court failed to consider when determining reasonable compensation, nor any factor relating to CRG's skills and experience that was not already incorporated into its billing rate. *Id.*

A hearing on the fee enhancement was held on June 1, 2010. *R. 2006-99*. At the hearing, the bankruptcy court received testimony regarding CRG's performance in the case and heard argument regarding the correct standard for determining whether a fee enhancement should be awarded under section 330. *Id.*

First, CRG called Blake Lovette, a member of Pilgrim's Pride's board of directors, who testified about Pilgrim's Pride's successful reorganization. *R. 2033-44*. Lovette stated that CRG did an excellent job facilitating the operational and financial restructuring, which saved Pilgrim's Pride a lot of time and money. *R. 2045-46.* But Lovette also testified that there were other major factors that contributed to the successful reorganization, including:

1. Don Jackson, Pilgrim's Pride's new chief executive officer, who was hired during Pilgrim's Pride bankruptcy, was a "superior operating person . . . he was able to effect a turnaround program that led the company out of a negative cash flow." *R. 2040:22; R. 2041:8;*
2. A substantial improvement in commodity feed prices, which was a "big factor" that led to Pilgrim's Pride bankruptcy filing. *R. 2044:16-23*; *R. 2048:24-2049:13*; and
3. The willingness of JBS Group to sponsor the chapter 11 repayment plan. *R. 2044:21-2045:2*; *R. 2051:5-24; 2064:6-23*.

The bankruptcy court also heard from William Snyder, a managing partner from CRG who served as Pilgrim's Pride's chief restructuring officer. *R. 2054*. Mr. Snyder testified regarding his knowledge of other professionals' rates in the case, CRG's methods for monitoring its competitors' billing rates, and the below-market rates to win the employment contract with Pilgrim's Pride. *R. 2056:1-16*; *R. 2058:6-20*.

Finally, the bankruptcy court heard from Professor Nancy Rappoport, an expert on professional fees and the chair of Pilgrim's Pride's fee review committee. *R. 2071*. Professor Rappoport testified that although CRG did an excellent job, the result in the case could not be solely attributed to CRG's performance. *R. 2082:3-7*; *R. 2084:18-25*; *R. 2085:1-2*.

The parties also disputed what legal standard governed whether a fee enhancement is justified. After CRG applied for its fee enhancement, but prior to the July 1, 2010, hearing, the Supreme Court decided *Perdue v. Kenny*, 130 S. Ct. 1662 (2010). In *Perdue*, the Court held that a fee enhancement for superior performance or results in a lodestar calculation under a different statutory fee-shifting scheme was only available in three circumstances: (1) when the "lodestar calculation does not adequately measure the attorney's true market value," such that the attorney would not be compensated at the rate the attorney would receive outside of fee-shifting statutes; (2) "if the attorney's performance includes an extraordinary outlay of expenses and the litigation is exceptionally protracted"; or (3) if there has been an "exceptional delay in the payment of fees." *Perdue*, 130 S. Ct. at 1674-75. At the hearing, the parties presented this legal standard issue to the bankruptcy court.

CRG did not deny that if *Perdue* was instructive, there would be no factual basis for the bankruptcy court to grant CRG's application for a fee enhancement. *R. 2088:11-14*. Rather, CRG argued that *Perdue* was irrelevant because fee-shifting cases were not well suited to fee determinations in the bankruptcy context and that CRG deserved a fee enhancement based upon the relative amount of fees received by each professional pursuant to its lodestar calculation, based on *In re Mirant Corp.*, 354 B.R. 113, 143-44 (Bankr. N.D. Tex. 2006). *R. 2089-2093*.

The United States Trustee argued that the fee-shifting case law was relevant because the Fifth Circuit relies upon it when determining reasonable compensation under section 330. *R. 2094:20-25*; *R. 2095:1-8*. The United States Trustee also noted that other circuit courts have similarly relied on fee-shifting law when addressing enhancements, while explicitly recognizing the differences between fee shifting and fee determinations under section 330. R. 2029 (citing to *Burgess v. Klenske (In re Manoa Fin. Co.),* 853 F.2d 687, 690-91 (9th Cir. 1988) (reviewing the case law)).

The bankruptcy court announced its decision at a hearing on June 8, 2010. *R. 2113*. The bankruptcy court analyzed the interests behind fee shifting statutes and section 330 and concluded that those interests "suggest that *Perdue* should apply with greater force in bankruptcy cases than fee shifting cases." *R. 2116:9-11*. The bankruptcy court then analyzed whether a fee enhancement was necessary for CRG to receive reasonable compensation under the *Perdue* criteria, with adjustments to conform the analysis to bankruptcy practice. *R. 2117:1-13*. Accordingly, the bankruptcy court denied CRG's request for a fee enhancement. *R. 2122:5-6*.

SUMMARY OF THE ARGUMENT

In this case, the United States Trustee objected to CRG's application for a $1 million fee enhancement under section 330 of the Bankruptcy Code because CRG had already received $5.98 million as reasonable compensation for its services. The bankruptcy court, after considering the testimony, evidence, and legal arguments presented by the parties, agreed with the United States Trustee and denied CRG's application for a fee enhancement. The bankruptcy court held that the $5.98 million in compensation pursuant to the billing rates CRG agreed to in its retention agreement was presumptively reasonable. Furthermore, the bankruptcy court held that there were no circumstances to indicate that a fee enhancement was necessary to provide reasonable compensation under the standard established by the Supreme Court in *Perdue v. Kenny*. 130 S. Ct. 1662 (2010).

The bankruptcy court did not abuse its discretion when it entered the order denying the enhancement. First, the bankruptcy court did not err when it decided that the billing rates CRG agreed to in its retention agreement were sufficient to provide a reasonable rate of compensation under the section 330 lodestar determination. The record shows that CRG deliberately under-priced its services in comparison to its competitors to win the restructuring contract with Pilgrim's Pride and that the superior result in Pilgrim's Pride's bankruptcy case could not be solely attributed to CRG's efforts. CRG could have negotiated for higher rates or a contingency fee. It chose not to do so. Section 330 does not require that all professionals be compensated at comparable billing rates. That other professionals such as financial advisors and investment bankers were able to negotiate greater compensation does not render CRG's decision to accept employment at a lower rate unreasonable under the Bankruptcy Code.

In contrast to the bankruptcy court's reasoned findings, CRG's arguments on appeal are unpersuasive and inconsistent. CRG argues that the Supreme Court's fee-shifting jurisprudence should not apply in bankruptcy cases. But this case is decided under Fifth Circuit law, and since 1977, the Fifth Circuit's section 330 jurisprudence has referenced fee-shifting case law. Therefore, the bankruptcy court was correct to deny CRG's request for a $1 million fee enhancement under *Perdue*.

The bankruptcy court applied the correct legal standard, and its factual determinations were based upon ample evidence in the record. Thus, this Court should affirm the order entered below. But if this Court holds that the bankruptcy court applied the wrong legal standard, then remand — not reversal, as CRG asserts — would be appropriate for the bankruptcy court to consider CRG's application for a fee enhancement under the applicable standard.

ARGUMENT

I. The bankruptcy court correctly decided that a fee enhancement was not appropriate under 11 U.S.C. § 330 because CRG had already received reasonable compensation, as calculated pursuant to the hourly rates provided in CRG's retention agreement.[1]

Under section 330(a)(1)(A), a bankruptcy court may award "reasonable compensation for actual, necessary services." § 330(a)(1)(A). The bankruptcy court is specifically authorized to award compensation that is less than the amount requested in the fee application. 11 U.S.C. § 330(a)(2). The Bankruptcy Code directs the bankruptcy court to "consider the nature, the extent, and the value of such services, taking into account all relevant factors, including" a non-exhaustive list of factors when determining if the compensation requested in a fee application is reasonable. 11 U.S.C. § 330(a)(3) (listing factors such as the time spent on services, the rates charged for services, and whether the compensation is reasonable compared to equally skilled practitioners outside of bankruptcy practice); *see* 11 U.S.C. § 101(3) (stating that under title 11,

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[1] Because the court below did not award a fee enhancement, it was not necessary for it to determine whether section 330 would allow one in other circumstances, and the United States Trustee takes no position on that issue in this appeal. R. 2029:23-2030:13.

“includes" and "including" are not limiting terms).

The legislative history of section 330 states that the purpose of the section is to strike a balance “between moderation in the interest of the estate and its security holders and the need to be ‘generous enough to encourage’ lawyers and others to render the necessary and exacting services that bankruptcy cases often require.” S. Rep. 95-989 (1978) at 40, *reprinted in* 1978 U.S.C.C.A.N. 5787, 5827. In light of the “sordid chapters” in the history of fees in corporate bankruptcy reorganizations, Congress recognized that bankruptcy fees are a matter of concern to the “public interest” and that in a bankruptcy case, “fees are not a matter for private agreement.” *Id.* Amendments to section 330 indicate Congress’s continuing concern with the “widespread disparity in the fees paid, in the standards and laws used to set them, and in the maneuvering lawyers used to get them.” 103 Cong. Rec. S. 14597 (Oct. 7, 1994) (statement of Sen. Metzenbaun).

Thus, in order to determine whether a fee award is reasonable, Congress required the bankruptcy courts to look at the cost of comparable services outside of bankruptcy. But this reference to the comparable cost of services is “a point of reference, not a controlling determinant of what shall be allowed in bankruptcy cases.” *Id.* The Third Circuit, for example, has described the purpose of section 330 as requiring the bankruptcy court to review “the fee application much as a sophisticated non-bankruptcy client would review a legal bill.” *In re Busy Beaver Building Centers,* 19 F.3d 833, 848 (3d Cir. 1994).

A fee applicant carries the burden of proving the reasonableness of the compensation under section 330. *Caplin & Drysdale v. Babcock & Wilcox Co. (In re Babcock & Wilcox Co.),* 526 F.3d 824, 827 (5th Cir. 2008) (per curiam)(citation omitted). The Fifth Circuit has "traditionally used the lodestar method" to determine a reasonable amount of professional fees under section 330. *In re Cahill*, 428 F.3d 536, 539 (5th Cir. 2005). The first step in determining a reasonable fee under the lodestar method is to multiply the number of hours reasonably worked by the prevailing community rates for similar work. *Id.* at 540. Once a reasonable fee has been calculated under the lodestar method, the inquiry often ends because of the strong presumption that the lodestar constitutes reasonable compensation. *Pennsylvania v. Del. Valley Citizens' Council for Clean Air*, 478 U.S. 546, 565 (1986). As described by the Supreme Court, the lodestar method is virtuous because it produces a fee award that approximates the fee that would be received in a comparable case, is "objective" and "readily administrable," permits meaningful judicial review, and produces "reasonably predictable results." *Perdue v. Kenny*. 130 S. Ct. 1662, 1672 (2010).

A bankruptcy court may take the second step when a professional is dissatisfied with the result of the lodestar determination. Within the Fifth Circuit, a bankruptcy court can adjust the lodestar rate in consideration of the factors listed in *Johnson v. Georgia Highway Express, Inc.*, 488 F.2d 714, 717 (5th Cir. 1974), and the section 330 factors to ensure that the amount in an "atypical case will be adjusted to reflect the specifics of that case." *Cahill*, 428 F.3d at 539.

After a bankruptcy court determines the fee in accordance with section 330, the lodestar, and the applicable *Johnson* factors, the bankruptcy court can shift to the enhancement request. The applicant also bears the burden on the proof required for an enhancement. *Perdue v. Kenny*, 130 S.Ct.1662, 1672 (2010). As the Supreme Court has stated, "many of the *Johnson* factors 'are subsumed within the initial calculation' of the lodestar." *Del. Valley Citizens' Council for Clean Air*, 478 U.S. at 565 (citation omitted). Therefore, factors such as the "novelty [and] complexity of the issues," "the special skill and experience of counsel," the "quality of representation," and the "results obtained" from the litigation are presumably fully reflected in the lodestar amount, and thus cannot serve as independent bases for increasing the basic fee award. *Id.* "Although upward adjustments of the lodestar figure are still permissible [when authorized by applicable law], such modifications are proper only in certain "rare" and "exceptional" cases, supported by both "specific evidence" on the record and detailed findings" by the bankruptcy court. *Id.* The Supreme Court recently clarified that superior performance or the result obtained may only provide a basis for a fee enhancement in case where enhancement is authorized when it "is not adequately taken into account in the lodestar calculation," such as when the method used to determine the hourly rate does not reflect the market rate for the professional or when there have been exceptional delays in the payment of fees. *Perdue*, 130 S. Ct. at 1673-74.

Here, although CRG received less compensation than other professionals, the evidence in the record shows that the bankruptcy court did not commit clear error in finding that CRG received a reasonable fee under section 330. First, CRG's billing rate was the one it sought to gain an advantage over its competitors in acquiring the work. *R. 2057:18-2058:20*. The Bankruptcy Court expressed concern about professionals underbidding competitors at the commencement of the case and then equalizing the fees to the competitors' rates by seeking an enhancement. R. 2087. Second, CRG did not bear any significant risk of loss, as the retention agreement provided for the bi-weekly payment of all professional fees and expenses and a substantial retainer. *R. 856*. Third, as the bankruptcy court found there were no unanticipated circumstances that made the previously established rate unreasonable. *R. 2120:1-13*. Finally, the evidence at trial demonstrated that the exceptional results were not due solely to the performance of CRG. *R. 2121:6-21*. For example, the efforts of Pilgrim's Pride's chief executive officer Don Jackson, the improvement in commodity feed prices, and JBS Group's willingness to provide funding for the reorganization plan were all major factors that contributed to the success of the bankruptcy case. *R. 2040-41*; *R. 2044-49*; *R. 2051:5-24*; *R. 2064:6-23*.

Essentially, the bankruptcy court followed the statement in *Perdue* that "[t]here is nothing unfair about compensating these [professionals] . . . *at the very rate they requested*." *Perdue*, 130 S.Ct. at 1676 n.7. CRG was paid at the hourly rate it requested and accordingly received $5.98 million in fees for its services. Therefore, the bankruptcy court's order awarding CRG the compensation at the rate CRG requested at the beginning of the case should be affirmed.

II. CRG's argument that fee-shifting cases should not be considered relevant to fee awards under the Bankruptcy Code is inconsistent with the Fifth Circuit authority.

It has been the law of the Fifth Circuit for over 30 years — since 1977 — that the fee-shifting jurisprudence established in *Johnson v. Georgia Highway Express, Inc.*, 488 F.2d 714, 717 (5th Cir. 1974), is "equally useful" whenever an award of fees is authorized by statute, including in bankruptcy. *Am. Benefit Life Ins. Co. v. Baddock (In re First Colonial Corp.)*, 544 F.2d 1291, 1298 (5th Cir. 1977). *Johnson* established twelve factors for a court to consider when determining if a fee award is reasonable. *Johnson*, 488 F.2d at 717-18 (listing those factors). Although they may require some modifications, these factors apply equally in other contexts because they "establish an objective basis for determining the amount of compensation that is reasonable" and make "meaningful review of that determination possible on appeal." *First*

Colonial, 544 F.2d at 1298.

The adoption of the lodestar method for determining reasonable compensation under section 330 "further refined" the *Johnson* factors. *Lawler v. Teofan (Matter of Lawler)*, 807 F.2d 1207, 1211 (5th Cir. 1987). As such, the Fifth Circuit has continued to hold that fee-shifting cases are "quite persuasive" when determining what is a "reasonable" fee under section 330. *Babcock & Wilcox Co.*, 526 F.3d at 828; *see, e.g., TransAmerican Natural Gas Corp. v. Zapata P'ship, Ltd. (In re Fender)*, 12 F.3d 480, 478 (5th Cir. 1994) *see also Cahill*, 428 F.3d at 541. Other circuit courts agree. *See, e.g., Connolly v. Harris Trust Co. (In re Miniscribe Corp.)*, 309 F.3d 1234, 1244 (10th Cir. 2002); *Boddy v. United States Bankruptcy Court* (*In re Boddy*), 950 F.2d 334, 337 (6th Cir. 1991). These cases all indicate that the Fifth Circuit has already considered and rejected the distinctions between fee-shifting and bankruptcy cases that CRG depends upon in order to contend that *Perdue* should not apply. *See* Appellant's Brief at 22-23, 26-28. Just as the Fifth Circuit has incorporated the "reasonable and necessary" standards from fee shifting into bankruptcy, correspondingly three circuits have engrafted the enhancement standards from fee shifting cases into bankruptcy. *In re UNR Indus., Inc.,* 986 F.2d 207 (7th Cir. 1993); *In re Apex Oil Co*., 960 F.2d 728 (8th Cir. 1992); *Burgess v. Klenske* (*In re Manoa Fin*.), 853 F.2d 687 (9th Cir. 1988); *see also Fender,* 12 F.3d at 488 (suggesting, without discussion, that enhancement allowed in bankruptcy through same fee shifting standards but remanding award). [2]

Still, CRG argues that it may receive a fee enhancement after the determination of its fees

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[2] These cases were decided under a version of section 330 that existed before the 1994 amendments to section 330(a)(2) of the Bankruptcy Code. See footnote 1.

under the *Johnson* criteria. Appellant's Brief at 15-17. But *Johnson* is a civil-rights fee-shifting case. *See Johnson*, 488 F.2d at 715 (stating that the case concerns the adequacy of attorney's fees awarded in a Title VII class action). The Fifth Circuit has recently affirmed the significance of *Johnson* to the determination of reasonable compensation under section 330. *See, e.g., Cahill*, 428 F.3d at 539. CRG cannot reconcile its contention that the Supreme Court's decision in *Perdue*, a case involving an enhancement in a civil rights fee shifting case, has no import while simultaneously recognizing that the Fifth Circuit engrafts the fee review standards of the *Johnson* criteria into its section 330 determination.

CONCLUSION

For these reasons, the United States Trustee respectfully asks this Court to affirm the order entered below.

RAMONA D. ELLIOTT
General Counsel

P. MATTHEW SUTKO
Associate General Counsel
NOAH SCHOTTENSTEIN
Trial Attorney
Executive Office for United States Trustees
Department of Justice
20 Massachusetts Avenue, N.W.
Washington, D.C. 20530
Ph: (202) 307-1399
Fax: (202) 307-2397

WILLIAM T. NEARY
United States Trustee for Region 6

/s/ Lisa L. Lambert
Lisa L. Lambert
Trial Attorney
State Bar of Texas No. 11844250 (also NY)
Erin Marie Schmidt
Trial Attorney
State Bar of Texas No. 24033042
Department of Justice
1100 Commerce Street, Rm. 976
Dallas, TX 75242
Ph: (214) 767-8967
Fax: (214) 767-8971

Certificate of Service

I, Lisa L. Lambert, certify that a copy of this brief was served by electronic notice and by first class United States mail on October 29, 2010. In addition, courtesy copies of the brief will be hand-delivered to the Court on Monday, November 1, 2010.

/s/ Lisa L. Lambert
Lisa L. Lambert
Trial Attorney

Joseph M. Coleman
Robert J. Taylor
KANE RUSSELL COLEMAN & LOGAN PC
3700 Thanksgiving Tower
1601 Elm Street
Dallas, Texas 75201

James F. Wallack, Esq.
Gregory O. Kaden, Esq.
Vanessa V. Peck, Esq.
GOULSTON & STORRS, P.C.
400 Atlantic Avenue
Boston, Massachusetts 02110-3333

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P. Matthew Sutko, Esq., EOUST
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! 1) Whether the district court erred in authorizing a law firm to represent a chapter 11 debtor when the court has not ruled upon the U.S. Trustee's objection that payments from the debtor to the law firm were preferential transfers.
2) Whether a law firm received preferential transfers when the debtor paid all of the firm's outstanding bills in full on the eve of bankruptcy, making a substantially large payment four days before the bankruptcy petitions were filed.

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No. 01-2775

IN THE UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

In re Pillowtex, Inc.

DONALD WALTON, the ACTING UNITED STATES TRUSTEE,

Appellant.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF DELAWARE, SITTING IN BANKRUPTCY

BRIEF FOR THE APPELLANT

Of Counsel:

JOSEPH A. GUZINSKI
Acting General Counsel
P. MATTHEW SUTKO
Attorney, Office of the General Counsel
Executive Office For U. S. Trustees
U.S. Department of Justice
901 E. Street, N.W.
Washington, D.C. 20530

ROBERT D. McCALLUM, JR.
Assistant Attorney General

WILLIAM KANTER
(202) 514-4575
ANNE MURPHY
(202) 514-3688
Attorneys, Appellate Staff
Civil Division, Room 9108
U.S. Department of Justice
601 D. Street, N.W.
Washington, D.C. 20530-0001

IN THE UNITED STATES COURT OF APPEALS
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DONALD WALTON, the ACTING UNITED STATES TRUSTEE,

Appellant.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF DELAWARE, SITTING IN BANKRUPTCY

BRIEF FOR THE APPELLANT

STATEMENT OF SUBJECT MATTER AND APPELLATE JURISDICTION

The district's court order authorizing the retention of Jones, Day, Reavis and Pogue ("Jones Day") as counsel to the chapter 11 debtor is an appealable final order. See United States Trustee v. First Jersey Securities, Inc. (In re First Jersey Securities, Inc.), 180 F.3d 504, 508 (3d Cir. 1999); In re Marvel Entertainment Group, Inc., 140 F.3d 463, 471 (3d Cir. 1998). The United States Trustee has standing to appeal from the retention order. See 11 U.S.C. § 307; United States Trustee v. Price Waterhouse, 19 F.3d 138, 140 (3d Cir. 1994).

Because "this is an appeal from a district court exercising original jurisdiction in bankruptcy," this Court has appellate jurisdiction under 28 U.S.C. § 1291. Marvel Entertainment Group, 140 F.3d at 470.

QUESTIONS PRESENTED

In this Circuit, a law firm that has received a preferential transfer from the debtor in a chapter 11 reorganization bankruptcy is disqualified from representing the debtor. United States Trustee v. First Jersey Securities, Inc. (In re First Jersey Securities, Inc.), 180 F.3d 504 (3d Cir. 1999).

The questions presented are:

I. Whether the district court erred in authorizing a law firm to represent a chapter 11 debtor when the court had not ruled upon the U.S. Trustee's objection that payments from the debtor to the law firm were preferential transfers.

II. Whether a law firm received preferential transfers when the debtor paid all of the firm's outstanding bills in full on the eve of bankruptcy, making a payment of $778,157.33 four days before the bankruptcy petitions were filed.

STATEMENT OF THE CASE

This case is an appeal from an order of the district court, sitting in bankruptcy, authorizing Pillowtex, Inc. to retain Jones Day as its chapter 11 bankruptcy counsel. The United States Trustee objected to Pillowtex's application to retain Jones Day, arguing that Jones Day had received payments from Pillowtex that were avoidable as preferences. The district court did not rule on the U.S. Trustee's objections, and did not determine whether or not Jones Day had received a preference. Instead, the court authorized Pillowtex's retention of Jones Day, and ordered that Jones Day would have to return the preference and waive fees if the preference issue were ever decided adversely to Jones Day.

The U.S. Trustee appeals the retention order.

FACTS AND PRIOR PROCEEDINGS

A. Statutes Principally At Issue.

This appeal involves the provisions of the Bankruptcy Code that apply when the debtor in possession in a reorganization bankruptcy case employs legal counsel to represent it. One provision in particular, 11 U.S.C. § 327(a), establishes general principles that apply to the employment of professional persons, including lawyers, by either the bankruptcy trustee or the debtor in possession.[1]

This case also involves the preference provision of the Bankruptcy Code, 11 U.S.C. § 547(b). That provision describes the circumstances under which the trustee or debtor in possession may avoid "preferences," payments made during the period shortly before the bankruptcy petition was filed and during which the debtor is presumed to have been insolvent.

The statutory basis for the United States Trustee's oversight of the application for employment is also relevant because the appeal is brought by the United States Trustee as part of his oversight of bankruptcy matters in Delaware.

i. 11 U.S.C. § 327(a): Employment of Professionals.

The Bankruptcy Code requires professionals who assist the bankruptcy trustee or the debtor in possession to have certain characteristics that allow them to perform their fiduciary obligations to the debtor loyally.[2] The professional must "not hold or

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[1] The statutes principally at issue are set forth in an Addendum to this brief.

[2] Although the Code itself refers only to the employment of professionals by "the trustee," the provisions of Section 327 applies equally to debtors in possession. See 11 U.S.C. § 1107(b) (describing rights of debtor in possession); First Jersey, 180 F.3d at 509; In re T & D Tool, Inc., 125 B.R. 116 (E.D. Pa. 1991); Matter of Roger J. Au & Son, Inc., 71 B.R. 238 (Bankr. N.D. Ohio 1986). Because (continued...)

represent an interest adverse to the estate." 11 U.S.C. § 327(a). The professional must also be a "disinterested person[]." *Ibid.* A disinterested person is "not a creditor." 11 U.S.C. § 101(14)(A). Nor does a disinterested person have "an interest materially adverse to the interest of the estate or of any class of creditors * * * by reason of any direct or indirect relationship to, connection with, or interest in, the debtor * * * or for any other reason." *Id.*, § 101(14)(E).

Congress clarified in a separate provision of the Bankruptcy Code that a professional's prior relationship with an entity that goes into bankruptcy reorganization does not, standing alone, preclude the professional from continuing to represent the debtor. Rather, "[n]otwithstanding section 327 * * * a person is not disqualified for employment under section 327 of this title by a debtor in possession solely because of such person's employment by or representation of the debtor before the commencement of the case." 11 U.S.C. § 1107(b).

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[2](...continued)
this case concerns a debtor in possession, rather than a trustee, we will refer in this brief to the obligations of the debtor in possession.

ii. 11 U.S.C. § 547(b): Preferences.

_____Congress in Section 547 authorized trustees and debtors in possession[3] to set aside certain transfers of funds to creditors, made shortly before the bankruptcy filing, as "preferences." Congress restricted the debtor's ability to extend preferential treatment to creditors for two reasons. First, "by permitting the trustee to avoid pre-bankruptcy transfers that occur within a short period before bankruptcy, creditors are discouraged from racing to the courthouse to dismember the debtor during the debtor's slide into bankruptcy." Collier on Bankruptcy, ¶ 547.01 (Lawrence P. King ed., 15th ed. 2000). "Second, and more important, the preference provisions facilitate the prime bankruptcy policy of equality of distribution among creditors of the debtor." *Ibid.*

The preference provision generally authorizes the debtor in possession to "avoid any transfer of an interest of the debtor in property" that satisfies five criteria. See 11 U.S.C. § 547(b). First, the transfer of the property interest must be "to or for the benefit of a creditor." *Id.*, § 547(b)(1). The transfer must be made "for or on

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[3] Although the language of the Code refers to the powers of the Trustee to set aside avoidable preferences, a debtor in possession in a bankruptcy reorganization also may avoid preferential transfers under Section 547. See 11 U.S.C. § 1107(a) (providing that "a debtor in possession shall have all of the rights * * * and powers * * * of a trustee"); Matter of Hughes, 704 F.2d 820, 822 (5th Cir. 1983).

account of an antecedent debt owed by the debtor before such transfer was made," and it must have been "made while the debtor was insolvent." *Id.*, § 547(b)(2) and (3). The transfer ordinarily must have been made "on or within 90 days before the date of the filing of the petition." *Id.*, § 547(b)(4)(A).[4] Finally, it must allow the preferred creditor to "receive more than such creditor would receive" in a bankruptcy liquidation, if the transfer had never been made. *Id.*, § 547(b)(5).

The preference provision also exempts from avoidance certain types of transfers that would otherwise be avoidable under the general principles of Section 547(b). See 11 U.S.C. § 547(c). The most important statutory exemption for purposes of this case is the exemption for payments made in the ordinary course of business. See 11 U.S.C. § 547(c)(2). This exemption is designed to "leave undisturbed normal financial relations, because it does not detract from the general policy of the preference section to discourage unusual action by either the debtor or his creditors during the debtor's slide into bankruptcy." H.R. Rep. No. 95-595 at 373 (1977), reprinted in 1978 U.S.C.C.A.N. 5787,6329. Under Subsection (c)(2), the debtor in possession "may not avoid" a transfer that was made "in payment of a debt incurred by the debtor in the ordinary course of business or financial affairs of the

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[4] The debtor is "presumed to have been insolvent" during the 90 day preference period. 11 U.S.C. § 547(f).

debtor and the transferee" if the transfer is "made in the ordinary course of business or financial affairs of the debtor and the transferee" and is "made according to ordinary business terms." 11 U.S.C. § 547(c)(2).

iii. Oversight Responsibilities of the United States Trustee.

Congress has authorized the Attorney General to appoint twenty-one United States Trustees ("U.S. Trustees"), each to serve in a specific geographic region of the United States. See generally 28 U.S.C. § 581 *et seq.* (establishing U.S. Trustee Program). The U.S. Trustee must "supervise the administration of cases and trustees" in all bankruptcy cases within his or her region through a range of oversight responsibilities. 28 U.S.C. § 586(a)(3). See generally United States Trustee v. Columbia Gas Sys., Inc. (In re Columbia Gas Sys., Inc.), 33 F.3d 294, 296 (3d Cir. 1994) (explaining that Unites States Trustees oversee the bankruptcy process, protect the public interest, and ensure that bankruptcy cases are conducted according to law).

The U.S. Trustee's responsibilities include monitoring bankruptcy court filings, such as plans and disclosure statements, monitoring creditors' committees and the progress of bankruptcy cases, and bringing to the attention of the United States Attorneys any possible criminal activity occurring in the bankruptcy context. *Id.*, § 586(a)(3)(B), (C), (E), (F). Of particular relevance to this case, U.S. Trustees are responsible for "monitoring applications filed under section 327 of title 11 and, whenever the United States trustee deems it to be appropriate, filing with the court comments with respect to the approval of such applications." *Id.*, § 586(a)(3)(H).

B. Facts and District Court Proceedings.

i. **Pillowtex's Application To Retain Jones Day.**

_____Starting in 1996, the law firm of Jones, Day, Reavis and Pogue ("Jones Day") represented the Pillowtex Corporation and its corporate affiliates ("Pillowtex").[5] Jones Day provided "a variety of legal services" for Pillowtex, ranging from corporate and financial services to services involving intellectual property and employee benefits.[6] During the course of their professional relationship, Jones Day's lawyers "worked closely with [Pillowtex's] management and other professionals," and Jones Day became "well acquainted with [Pillowtex's] corporate history, debt structure, business and operational difficulties and related matters."[7]

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[5] See Application of Debtors and Debtors In Possession For An Order Authorizing Them To Retain And Employ Jones, Day, Reavis & Pogue As Counsel ("Application"), at 4, App. 68.

[6] *Ibid.* As used in this brief, the term "Pillowtex" refers collectively to all of the debtors. The Pillowtex Corporation is "the direct parent of Debtor Pillowtex, Inc., * * * and the direct or indirect parent of each of the other Debtors." Application at 2, App. 66.

[7] *Ibid.*

On November 14, 2000, Pillowtex filed voluntary petitions for relief under chapter 11 of the Bankruptcy Code.[8] Jones Day helped Pillowtex to prepare its filings to initiate the bankruptcy reorganization cases.[9] At the same time that it filed its petitions, Pillowtex also applied for an order authorizing it to retain Jones Day as legal counsel in the bankruptcy reorganization.[10]

In its application to retain Jones Day, Pillowtex represented that Jones Day, as "one of the largest law firms in the United States" with particular expertise in bankruptcy and restructuring, was "particularly wellsuited for the type of representation" that Pillowtex required.[11] The Pillowtex bankruptcy involved substantial assets; when Pillowtex filed its petitions, it had "$1 billion in trade debt, $750 million in senior secured debt and $400 million in subordinated debt."[12] Pillowtex also stated in its application to retain Jones Day that its existing

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[8] Application at 2, App. 66.

[9] *Id.* at 4, App. 68.

[10] See generally Application, App. 65 - 82.

[11] Application at 3, App. 67.

[12] Statement of Berry Spears on behalf of the senior lenders, Transcript of Omnibus Hearing of May 8, 2001, before Hon. Sue L. Robinson, Chief Judge ("Transcript") at 38-39, App. 212-213.

relationship with Jones Day gave Jones Day particular insight into its needs.[13] Pillowtex stated that Jones Day intended to charge Pillowtex at its usual hourly rate, and that it had paid Jones Day a $300,000 retainer on November 13, the day before the petition was filed, "for services rendered or to be rendered and for reimbursement of expenses" in connection with legal services provided "in contemplation of, and in connection with," the bankruptcy case.[14]

Pillowtex also disclosed its payments to Jones Day for legal services for the one-year period that preceded the bankruptcy filing. Pillowtex had "made payments to Jones Day aggregating $2,516,014.00 during the year immediately preceding the Petition Date on account of fees and expenses incurred by Jones Day[.]"[15] Almost a million dollars had been paid in the three-month period before the petitions in bankruptcy were filed: Pillowtex stated that it had made "$997,569.36 of the Prepetition Payments to Jones Day during the 90 days immediately preceding the Petition Date."[16]

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[13] See Application at 4, 6, App. 68, 70.

[14] Application at 7, App. 71.

[15] *Id.* at 8, App. 72.

[16] *Id.* at 9, n.4, App. 73.

Pillowtex disclosed the date and amount of each payment to Jones Day during the year.[17] Although the payment schedule was uneven, Pillowtex generally made a monthly payment to Jones Day, in an amount ranging from a low of $40,759.09 (in November 2000), to a high of $203,520.69 (in November 1999).[18] No payments were made in May, August or October, 2000. Two extraordinary additional payments were made during the course of the year: $450,573.79 was paid on December 27, 1999,

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[17] See Application at 8, App. 72.

[18] Application at 8, App. 72. The full table of amounts disclosed on particular dates is as follows:

Date	Payment Amount
11/29/99	$203,520.69
12/27/99	$450,573.79
12/30/99	$155,912.06
02/23/00	$181,550.01
03/31/00	$67,482.73
04/30/00	$146,520.71
06/30/00	$180,585.22
07/07/00	$132,299.71
09/11/00	$78,652.94
11/03/00	$40,759.09
11/10/00	$778,157.33

The table does not show the $300,000 retainer paid on November 13, 2000, which was disclosed separately.

and $778,157.33 was paid on November 10, 2000, four days before the bankruptcy petitions were filed. And shortly after Pillowtex made the $778,157.33 payment for prior bills on November 10 2000, it also gave Jones Day a $300,000 retainer in anticipation of future legal services.

ii. **The U.S. Trustee's Objection.**

The U.S. Trustee reviewed Pillowtex's application to retain Jones Day, as authorized by 28 U.S.C. § 586(a)(3)(H) and 11 U.S.C. § 307. The U.S. Trustee objected to Pillowtex's application on the ground that at least some of the payments made within the preference period (the 90 day period immediately before the petition was filed) were avoidable as preferential transfers.[19] The U.S. Trustee described the elements of a preference under the statute, and concluded that each of the elements had been satisfied by some of the payments made by Pillowtex to Jones Day.[20]

The U.S. Trustee acknowledged that under the preference provision "certain transfers that would otherwise be voidable as preferences are not subject to avoidance," but pointed out that Jones Day bore the burden of proof of proving that

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[19] See Objection of the United States Trustee To Debtors' Application For Order Authorizing Them To Retain And Employ Jones, Day, Reavis & Pogue As Counsel (Docket # 34) ("Objection"), App. 122.

[20] See Objection at 2-3, App. 123-124.

the transfers at issue were not avoidable.[21] The U.S. Trustee explained that "any defense that [Jones Day] could apply to the avoidance of the payments in question is limited."[22] He therefore concluded that Jones Day had "received voidable preferences * * *."

Citing this Court's decision in United States Trustee v. First Jersey Securities, Inc. (In re First Jersey Securities, Inc.), 180 F.3d 504 (3d Cir. 1999), which holds that a person who has received a preferential transfer is not a "disinterested person" within the meaning of the Bankruptcy Code, the U.S. Trustee stated that "Jones Day is not a disinterested person and cannot be retained to represent the debtors in possession."[23] He accordingly sought an order from the court denying Pillowtex's application to retain Jones Day.[24]

iii. **The Parties' Positions Before The District Court.**

In their brief in support of Pillowtex's application to retain Jones Day, Pillowtex and Jones Day did not deny that Pillowtex's payments to Jones Day during the preference period represented a departure from the ordinary course of its business

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[21] Objection at 3, App. 124.

[22] *Ibid.*

[23] Objection at 4, App. 125.

[24] *Ibid.*

relationship with Jones Day.[25] Rather, the brief explained that Jones Day "was brought current on its fees and expenses prior to the chapter 11 filing" – an event that involved extraordinary payments from Pillowtex to Jones Day – "because, as the U.S. Trustee acknowledges, professionals cannot be creditors of the debtors."[26] Jones Day acknowledged that the U.S. Trustee had taken the position that "by becoming current on it[s] fees Jones Day received payments faster than it had historically, thereby preventing the firm from successfully asserting an ordinary course of business defense." The firm responded that "it defies common sense to argue that a professional should be disqualified based on the professional's efforts to comply with the Bankruptcy Code."[27]

Jones Day and Pillowtex also contested the U.S. Trustee's view that Jones Day had received preferential payments during the preference period. They argued first that the payments received shortly before the bankruptcy filing "were substantially within the historical pattern of payments between Jones Day and [Pillowtex], which

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[25] See Brief of Debtors And Debtors In Possession And Jones, Day, Reavis & Pogue In Support Of Debtors' Application For An Order Authorizing Them To Retain And Employ Jones, Day, Reavis & Pogue As Counsel, ("Pillowtex Brief"), App. 128.

[26] Pillowtex Brief at 1, App. 132.

[27] *Ibid.*

included wide swings in the timing of payments."[28] Jones Day and Pillowtex also emphasized that to the extent that Jones Day's legal services were provided in connection with the bankruptcy, Pillowtex "agreed and understood, in connection with [its] decision to engage Jones Day to prepare for the bankruptcy filing, that Jones Day * * * would have to be paid currently for all services and expenses incurred in connection with the bankruptcy filings in order to represent [Pillowtex] in the chapter 11 proceedings."[29]

In any event, Jones Day believed that it was "not necessary or appropriate for the Debtors' estates to incur the time and expense of litigating the preference issue[.]"[30] Rather, Jones Day proposed to "eliminate any potential conflict or appearance of conflict" by agreeing that "if a preference action against the firm is initiated and a final order is entered determining that Jones Day in fact received a preference, Jones Day will return to the Debtors' estates the full amount of the preferential payment and waive any related claim."[31] Jones Day also challenged the

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[28] Pillowtex Brief at 2, App. 133.

[29] *Ibid.*

[30] *Ibid.*

[31] *Ibid.*

U. S. Trustee's view that it was disqualified from representing Pillowtex because it was Pillowtex's creditor.[32]

The district court, sitting in bankruptcy, heard argument on the preference issue at an omnibus hearing in the Pillowtex bankruptcies but it did not hold an evidentiary hearing or seek development of the pertinent facts. An attorney from Jones Day explained to the bankruptcy court that the firm had "fees outstanding" and was "also continuing to work, including primarily working to prepare the company for [c]hapter 11."[33] He explained that Jones Day was "under a mandate by the Bankruptcy Code not to be a creditor" and stated that accordingly "[w]e have to be paid in full."[34]

Jones Day's lawyer told the court that when it became clear that Pillowtex would have to file for bankruptcy, Jones Day "got payments that brought our fees current, and then we were paid currently thereafter."[35] He explained that in addition to "invoices that had already been outstanding that were paid," the firm "had to

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[32] See Pillowtex Brief at 2-3, 11-13, App. 133-134, 142-144.

[33] Transcript of Omnibus Hearing of May 8, 2001, before Hon. Sue L. Robinson, Chief Judge ("Transcript") at 30, App. 204.

[34] *Ibid.*

[35] Transcript at 31, App. 205.

basically instantaneously generate invoices and be paid for" its ongoing work for Pillowtex during the period immediately before the bankruptcy petition was filed.[36]

Jones Day's attorney expressed its opinion to the bankruptcy court that Pillowtex's acceleration of payments immediately before the bankruptcy filing was "the industry practice," something that is "done in every case."[37] As the lawyer explained, the firm's position was that if it was "owed one day of time" at the time of the filing, it would be "a creditor who is arguably disqualified," and that it therefore had no choice but to get "an instantaneous payment at some point to get fully caught up."[38]

The U.S. Trustee disagreed with Jones Day's perception of what constitutes ordinary business practices in bankruptcy retentions. He told the court that customarily "professionals entering bankruptcy cases protect themselves from the preference issue by obtaining a retainer, and they would draw down on the retainer during the 90 day period so as to avoid raising the issue of whether or not they received preferential payments."[39] Paying hundreds of thousands of dollars of

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[36] Transcript at 31, App. 205.

[37] *Ibid.*

[38] *Ibid.*

[39] Transcript at 33, App. 207. Payments taken from a retainer generally are (continued...)

accrued fees on the eve of bankruptcy was not typical. The U.S. Trustee also explained that Jones Day had not dealt with its payment for pre-petition services by receiving a retainer from Pillowtex, and that the transfers raised serious issues because Pillowtex "wired approximately three quarters of a million dollars to the Jones Day firm" almost immediately before the bankruptcy filing, in a situation where "there is a myriad of unsecured creditors in this case [who] were not paid on the same terms that Jones Day was paid."[40] The U.S. Trustee pointed out that the remaining unsecured creditors were "looking at the prospect of not receiving 100 cents on the dollar,' and questioned "why we should treat the Jones Day firm differently than those creditors?"[41]

iv. **The district court's order.**

The district court did not determine whether Jones Day had received preferential payments from Pillowtex and it therefore did not determine whether Jones Day was ineligible under First Jersey to represent Pillowtex. Instead, the court

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[39](...continued)
not preferential, for reasons that differ depending on the type of retainer employed. Pillowtex did not provide Jones Day with the $300,000 retainer – which the U.S. Trustee does not challenge as a preference – until November 13, 2000, the day before the bankruptcy petitions were filed. See Application at 7, App. 71.

[40] Transcript at 33, App. 207.

[41] *Id.* at 33-34, App. 207-208.

adopted Jones Day's suggestion that it authorize the firm's retention subject to certain conditions.[42]

The Order authorizing Pillowtex to retain Jones Day provides that the court has determined "subject to the provisions of this Order," that "the U.S. Trustee Objections should be overruled and the legal and factual bases set forth in the Application, the Affidavit, the Disclosure of Compensation and the Amended Disclosure of Compensation establish just cause for the relief granted herein[.]"[43] It also provides that "[s]ubject to the provisions of this Order, Jones Day does not hold or represent any interest adverse to the Debtors' estates and is a 'disinterested person,' as defined in section 101(14) of the Bankruptcy Code and as required by section 327(a) of the Bankruptcy Code."[44]

The Retention Order is subject to one condition: "[u]pon any determination by final order that Jones Day received one or more avoidable preferential transfers pursuant to section 547 of the Bankruptcy Code, Jones Day shall promptly return the same to the Debtors' estates and waive any unsecured claim it has by virtue thereof

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[42] Jones Day drafted the retention order. See Transcript at 42, App. 216.

[43] Order Authorizing Debtors and Debtors In Possession To Retain and Employ Jones, Day, Reavis & Pogue As Counsel ("Retention Order") at 1, App. Vol. I at 1.

[44] *Id.* at 2, App. 2.

as a condition of its employment and retention in these bankruptcy cases."[45] The order makes no provision for the return of fees or expenses for any period during which Jones Day might have been wrongfully acting as counsel for Pillowtex before the judicial preference determination was made.

The U.S. Trustee appeals from the district court's conditional Retention Order.

STATEMENT OF RELATED CASES AND PROCEEDINGS

Counsel is unaware of any cases or proceedings related to this case.

STATEMENT OF THE STANDARD OF REVIEW

Because this case involves the interpretation of the Bankruptcy Code in light of undisputed facts, this Court's review of the order of the district court sitting in bankruptcy is *de novo*. See Cinicola v. Scharffenberger, 248 F.3d 110, 115 n.1 (3d Cir. 2001).[46]

SUMMARY OF THE ARGUMENT

1. This Court held in First Jersey that a law firm that receives a preferential transfer has an actual conflict of interest with the debtor that disqualifies the firm

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[45] Retention Order at 3, App. 3.

[46] The district court in this case entered the retention order sitting in bankruptcy. It did not exercise appellate jurisdiction of a prior decision of the bankruptcy court. See In re Marvel Entertainment Group, Inc., 140 F.3d 463, 470 (3d Cir. 1998).

from representing the debtor in the bankruptcy proceedings. See First Jersey, 180 F.3d at 509. This Court's decision is manifestly correct: the duty of debtor's counsel to seek out preferences and recapture them for the debtor's estate conflicts directly with the law firm's interest in keeping the fees that it has received during the preference period. Many other courts have also so held.

2. Jones Day's argument below that any conflict was merely "potential" unless the court judicially determined that it had received a preference is erroneous. Not only did this Court squarely hold in First Jersey that the receipt of a preference gives rise to an actual conflict, but this Court has held in other cases that an actual conflict of interest arises where there is a present possibility that the firm's work for its client might be tainted by self interest. That possibility arises in the preference situation, because the counsel for the debtor cannot be expected to pursue with great vigor a preference action to recover its own fees for the benefit of the bankruptcy estate. Jones Day's theory that its receipt of the $800,000 on the eve of bankruptcy created only a potential rather than an actual conflict is therefore mistaken.

3. Under these circumstances, the district court erred in authorizing Jones Day's retention without first deciding whether Jones Day suffered from a disqualifying actual conflict of interests. Rather than determining whether the retention would violate First Jersey, the court authorized Jones Day's retention on condition that Jones Day repay to the estate any amounts found to be preferences if a preference action were ever instituted. The court accordingly did not reach the merits of the United States Trustee's pending objection to Jones Day's retention on the ground that Jones Day had received a preferential transfer.

The conditional retention order puts Jones Day in the difficult position of having to decide whether to pursue a preference action on Pillowtex's behalf against itself, on the basis of a construction of the Bankruptcy Code that Jones Day deems to be "frivolous." Transcript at 32, App. 206. The court's conditional retention order is inconsistent with this Court's cases, and it should be vacated.

4. There is nothing frivolous about the U.S. Trustee's objection that Jones Day has received a preference. On the contrary, at least some of Pillowtex's payments to Jones Day satisfy every element of the preference statute and are not exempt from avoidance under the exemption for payments made in the ordinary course of business.

ARGUMENT

I. The District Court Erred in Authorizing Pillowtex to Retain Jones Day Without Ruling on the United States Trustee's Objection That Jones Day Had Received a Preference That Disqualifies it from Representing Pillowtex.

A. **First Jersey requires that preference objections be decided as part of the court's determination whether to authorize a debtor to employ a law firm as bankruptcy counsel.**

This Court in First Jersey[47] held both that the Section 327(a) of the Bankruptcy Code "mandates disqualification [of professionals] when there is an actual conflict of interest" and that a law firm that receives a preferential transfer has an actual conflict of interest with the debtor. First Jersey, 180 F.3d at 509. Indeed, this Court in First Jersey expressly stated that "a preferential transfer to" a law firm from its debtor client "would constitute an *actual conflict of interest* between counsel and the debtor, and would require the firm's disqualification." First Jersey, 180 F.3d at 509. See also *id.* at 514 (concluding that "the preferential payment [to the law firm] was a preference, creating an actual conflict of interest, and thus, disqualifying [the firm] as counsel for the debtor"); *ibid.* (holding that the preferential payment "created an actual conflict of interest, and therefore disqualification is mandatory").

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[47] United States Trustee v. First Jersey Securities, Inc. (In re First Jersey Securities, Inc.), 180 F.3d 504 (3d Cir. 1999).

This Court's holdings in First Jersey are manifestly correct. Because a preferential payment is subject to avoidance by the debtor in possession (see 11 U.S.C. § 547(b)), a law firm that receives a preferential payment from its debtor client has an actual conflict of interest. The debtor's interest in avoiding preferential transfers and returning preference amounts to the bankruptcy estate for the benefit of the creditors – which would involve suing the law firm and collecting on the judgment – cannot be reconciled with the firm's own interest in retaining the payment that it has received from the debtor. Moreover, a firm that has received a preferential payment cannot be a "disinterested person" who can properly be retained under Subsection 327(a), because the avoidable preferential transfer gives the firm "an interest materially adverse to the interest of the estate * * *." 11 U.S.C. § 101(14)(E).[48] For these reasons, this Court was plainly right to hold both that a law firm's receipt of preferential payments from its client creates an actual conflict and that the conflict absolutely disqualifies the firm from representing the debtor.

This is a serious matter. Every debtor, including Pillowtex, has a fiduciary duty to protect the interests of its creditors. CFTC v. Weintraub, 471 U.S. 343, 355

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[48] An interest is adverse to the estate "when counsel has 'a competing economic interest tending to diminish estate values or to create a potential or actual dispute in which the estate is a rival claimant.'" First Jersey, 180 F.3d at 509 (quoting In re Caldor, Inc., 193 B.R. 165, 171 (Bankr. S.D.N.Y. 1996)).

(1985) (holding debtors in possession have a fiduciary duty to their creditors); Official Comm. of Unsecured Creditors of United Healthcare Sys., Inc. v. United Healthcare Sys., Inc. (In re United Healthcare Sys., Inc.), 200 F.3d 170, 177 n.9 (3d Cir. 1999), cert. denied, 530 U.S. 1204 (2000) (applying Weintraub and 11 U.S.C. § 1107(a) to hold "a debtor-in-possession[] is a fiduciary for its estate and its creditors"). If the debtor in possession's estate has been diminished because of preferences, the debtor's fiduciary duty requires it to recoup the preference for the benefit of its creditors. That would be practically difficult, if not impossible, if the law firm approved by the court to counsel the debtor were the potential target. For this reason, First Jersey requires law firms to be free from the taint of preference in order to be appointed debtors' counsel.

The district court's conditional Retention Order is therefore in error. The district court declined to determine whether or not Jones Day had received preferential transfers from Pillowtex, and it accordingly made no findings about Pillowtex's payments to Jones Day. In declining to determine whether Jones Day had received a preference, the court apparently overlooked this Court's instruction that disqualification is mandatory for firms that have received preferential transfers. See First Jersey, 180 F.3d at 509, 514. Given that plain instruction in First Jersey, the court should at a minimum have determined whether preferential transfers had taken place, so that it could avoid approving the retention of a law firm with a disqualifying actual conflict of interests.[49]

B. **Jones Day's conflict is actual, not potential.**

The court's mistaken failure to determine whether First Jersey required Jones Day's disqualification error may have been based, in part, upon a misunderstanding of the distinction between actual and potential conflicts of interest. Because this Court has recognized that a lawyer who has a potential conflict of interest may be retained subject to disqualification at the court's discretion,[50] Jones Day argued in the

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[49] The bankruptcy court has disapproved on at least one occasion a conditional retention order based upon a law firm's offer to waive any claim against the debtor's estate for pre-petition fees if it were later determined to have received preferential payments with respect to those fees. See In re Michigan General Corporation, 77 B.R. 97, 104 (Bankr. N.D. Tex., 1987). The bankruptcy court in Michigan General first pointed out that "the reluctance of the firm to admit its creditor status before a judicial determination of the issue necessarily implies an adversarial relationship" between the firm and the estate. *Id.*, 77 B.R. at 104. The court also observed that "the ethical constraint against the acceptance of employment when the interests of an attorney may impair his independent professional judgment * * * militates against allowing counsel to at once represent an estate in bankruptcy and be sued by the same estate over attorney fees paid." *Ibid.* The bankruptcy court accordingly concluded that although it had "no doubt that the 'waiver' of creditor status by [the firm] is wholly ineffectual to cure the conflict of interest created when a putative creditor represents the estate, if there were any doubt it would be resolved against the representation of the estates" by the firm that might have received the preference. *Ibid.* The same reasoning applies to the conditional retention order entered in this case.

[50] See First Jersey, 180 F.3d at 509 (applying In re Marvel Entertainment (continued...)

district court that any conflict based upon the allegedly preferential transfers was merely a potential conflict until a judicial determination had been made that the challenged transfers were preferential. See Pillowtex Brief at 8, App. 139. Jones Day took the position, citing First Jersey, that "an actual conflict of interest could not exist unless a court finally determines, after an evidentiary hearing, that the professional received an avoidable preference." *Ibid.*

Jones Day's position that no actual conflict can exist absent a judicial determination to that effect is mistaken – not only has this Court unambiguously held that a firm that receives a preference has an actual conflict of interest, but Jones Day's proposed distinction between actual and potential conflicts loses sight of the real problem in a situation involving preferences.

Contrary to Jones Day's view, the conflict in a preference case arises whenever the law firm may have received a preference, and not when the preference is judicially found to have occurred. This Court has recognized that a firm's conflict of interest with its debtor client is actual if the case involves a present possibility that the firm's actions on behalf of its client might be tainted by self-interest. See In re BH & P Inc., 949 F.2d 1300, 1315 (3d Cir. 1991). This Court in BH & P rejected a law firm's

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[50](...continued)
Group, Inc., 140 F.3d 463, 476 (3d Cir. 1998)).

argument that its conflict with a debtor in bankruptcy was merely potential because the conflict would arise only if the bankruptcy estate of one debtor were in fact large enough to satisfy the claims of another debtor represented by the same counsel. See *ibid.* Instead, this Court affirmed the district court's view that under these circumstances the conflict was actual; "'the "actuality" of the conflict * * * was the possibility that the parties would favor one estate over the other in their attempt to serve all of them,'" rather than any inconsistency between the estates' future claims. *Id.* at 1314 (quoting district court's opinion). Significantly for this case, the district court in BH & P relied for its view of an "actual conflict" upon a preferential transfer case, also quoted with approval in this Court's opinion, explaining that in the preference situation "'[t]he 'actuality' of the conflict is not *per se* that counsel might hold a preference [under § 547], rather it is that counsel will be tempted to neglect its duties to the estate by being less than zealous in its investigation of the preference.'" *Ibid.* (quoting In re Michigan General, 78 B.R. 479, 483-84 (1987)).

This Court in BH & P thus acknowledged the commonsense reality that the conflict that arises from the preferential transfer (a conflict between the debtor's interest in regaining the amount of the preference for the estate and the lawyer's interest in keeping its fee) arises as soon as counsel for the debtor in possession has a reason to be less diligent than he or she might otherwise be in investigating the preference claim against the estate. Because "[i]t is the duty of counsel for the debtor in possession to survey the landscape in search of property of the estate, defenses to claims, preferential transfers, fraudulent conveyances and other causes of action that may yield a recovery to the estate * * * [a]ny potential conflict of interest represents a potential to overlook an asset or defense of the estate." In re McKinney Ranch Associates, 62 B.R. 249, 254 (Bankr. C.D. Cal. 1986).[51]

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[51] Courts generally have held that lawyers whose fee arrangements with debtors may involve preferential transfers are disqualified from then representing the debtor. See In re 419 Company, 133 B.R. 867, 869, 870 (Bankr. N.D. Ohio, 1991) (holding that because fee payments might be preferential, they "create[] a potential dispute in which the estate may be a rival," requiring disqualification "to preserve the integrity of the bankruptcy system"); In re Decor Corporation, 171 B.R. 277, 283 (Bankr. S.D. Ohio, 1994) (holding that because payments that a firm received to avoid creditor status "may well constitute preferential payments," the firm's "role as a prospective defendant may constitute a disqualifying adverse interest * * * because [the firm] loses its ability to independently and objectively represent the Debtor"); In re Atlanta Sporting Club, 137 B.R. 550, 553 (Bankr. N.D. Ga. 1991) (pointing out that debtor that "may have an action against [its attorneys] for a preferential or fraudulent transfer" could not retain the attorneys); In re Michigan General Corporation, 78 B.R. 479, 483-84 ([t]he 'actuality of the conflict is not *per se* that counsel might hold a preference, rather it is that counsel will be tempted to neglect its duties to the estate by being less than zealous in its investigation of the preference"). The bankruptcy court in In re American Thrift & Loan Ass'n, 137 B.R. 381, 387 (Bankr. S.D. Ca.,1992) discerned another threat to the debtor's ability to secure diligent representation from a firm that might have received a preference: "assuming the firm recognizes the problem, as it should, the firm may also hesitate to recommend that the debtor pursue other persons or entities similarly situated to recover assets for the benefit of the estate because the parallel circumstances might be recognized by the client or some third party."

Thus, as this Court in BH & P envisioned, the conditional retention order in this case places Jones Day, as counsel for the debtor, in the awkward position of determining whether to pursue a preference action against itself. As this case demonstrates, when a firm has acted in good faith, its understandable interest in defending itself against what it views as "frivolous" preference claims makes it highly unlikely that the firm, in its capacity as counsel for the debtor, will recommend that its client sue it to recover a potential preference.[52] Jones Day in this case was entirely candid in stating that it viewed any litigation of the preference issue as a waste of the estate's resources.[53] Under these circumstances, however, the practical effect of the conditional retention order is to preclude litigation to determine whether counsel has an actual conflict of interest, for which "disqualification is mandatory." First Jersey, 180 F.3d at 514.

Jones Day's own litigation position in the district court further underscores the difficulties inherent in its view. Jones Day's solution to the ethical problem posed by the preference issue was to "eliminate any potential conflict or appearance of conflict" by "agree[ing]" to repay – if a future court order directed it to do so – any

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[52] Transcript at 32, App. 206.

[53] See Pillowtex Brief at 2, App. 133 (arguing that "it is not necessary or appropriate for the Debtors' estates to incur the time and expense of litigating the preference issue raised by the U.S. Trustee").

preferences that it had received. Pillowtex Brief at 2, App. 133.[54] But Jones Day's "agreement" does no more than describe its existing obligations under the law: if a court determined that Jones Day had received a preference, Jones Day would have little choice but to return that money to the bankruptcy estate. Thus, however useful Jones Day's "agreement" may appear to be at a superficial level, it imposes no new obligations upon Jones Day and it cannot in fact be effective to "eliminate any potential conflict" between Jones Day and its debtor client.[55]

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[54] Jones Day also stated that if it were found to have received a preference, it would waive its claims against the estate for the returned fees. Retention Order at 2, App. 2. In avoiding creditor status a firm often may resort to "the ultimate 'curative' measure," the "waiver of its unsecured claim." In re Decor Corporation, 171 B.R. at 283. See also In re Eastern Charter Tours, Inc., 167 B.R. 995, 997 (Bankr. M.D. Ga., 1994) (finding an accountant disqualified because of outstanding pre-petition fees, but suggesting that the court would revisit the issue "[s]hould [the accountant] wish to waive his claim for pre-petition services"); In re Creative Restaurant Management, Inc., 139 B.R. 902, 915 (Bankr. W. D. Mo. 1992) (explaining that the U.S. Trustee "will not object to an application to retain an attorney, who is a creditor, if such attorney agrees to waive its claim, since the attorney then has no incentive to put his own claim ahead of the interests of the debtor"). A waiver conditioned upon a judicial preference determination is ineffective to remove the conflict that results from a preference, however, because the conflict involves the firm's reluctance to pursue the preference action against itself in the first place.

[55] More importantly, of course, the "agreement" to repay preferences does nothing to relieve the actual conflict of interest, which is the tension between the debtor's interests and the interest of the firm that might have received a preference.

In addition to its failure to take seriously the disqualifying nature of an actual conflict of interest, the conditional retention order also undermines the U.S. Trustee's statutory obligation to monitor retention applications filed under Section 327(a). See 28 U.S.C. § 586(a)(3)(H). Congress has instructed the U.S. Trustee to monitor proceedings in bankruptcy, and has expressly authorized him in carrying out that responsibility to "fil[e] with the court comments with respect to the approval of" applications for the retention of professionals. *Ibid.* The U.S. Trustee accordingly objected to Jones Day's retention, based upon his view that the firm had received preferential transfers. But because the district court entered the conditional retention order instead of determining whether Jones Day received a preference, the U.S. Trustee's views upon the preference issue were not heard and determined. The conditional retention order thus overlooks the oversight role that Congress created for the U.S. Trustee.

Because a firm that has received a preferential transfer is absolutely disqualified from serving as counsel to the debtor in possession, the district court's conditional retention order is inconsistent with this Court's cases. This Court should remand the case so that the district court can determine whether Pillowtex made payments to Jones Day that are avoidable as preferences under the Bankruptcy Code, and to disqualify Jones Day if Jones Day has an actual conflict of interests.[56]

II. The U.S. Trustee's Claim That Jones Day Received A Preference Is Not "Frivolous."

In the district court, Jones Day argued that the U. S. Trustee's view that preferences exist is "frivolous." Transcript at 32, App. 206.[57] In the careful exercise of his professional judgment, however, the U.S. Trustee has determined that at least some of Pillowtex's pre-petition payments to Jones Day are preferences.

A. **All Of The Elements Of 11 U.S.C. § 547(b) Are Satisfied.**

Pillowtex's pre-petition payments to Jones Day include payments that satisfy all of the five elements set forth in the preference provision, 11 U.S.C. § 547(b).

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[56] A remand is necessary because the preference issue implicates various questions of fact – such as the nature of the services rendered, the delinquency of the payments and the payment terms that ordinarily subsisted between Jones Day and Pillowtex – that have neither been determined nor stipulated as part of the record.

[57] Jones Day also contended that its actions in securing full payment of its overdue bills were somehow compelled by the Bankruptcy Code, which prohibits the retention of a professional who is a creditor of the debtor. See Pillowtex Brief at 1, App. 132; Price Waterhouse, 19 F.3d at 141-142. Courts have sometimes construed the Bankruptcy Code to allow bankruptcy counsel to prepare cases for bankruptcy without thereby becoming creditors of the debtor. See, *e.g.*, In re Martin, 817 F.2d 175, 180 (1st. Cir. 1987). No court, however, has ever held that a firm could invoke the Code's prohibition upon representation by creditors to justify its receipt of a preference.

First, the challenged payments were made "on or within 90 days before the date of the filing of the petition" in bankruptcy. 11 U.S.C. § 547(b)(4). Next, all were made by the debtor in possession "to or for the benefit of a creditor" and "for or on account of an antecedent debt owed by the debtor before such transfer was made." *Id.*, § (b)(1), (b)(2). The disputed payments were made by Pillowtex to Jones Day. Jones Day was a creditor because Pillowtex owed it money for legal services. And Pillowtex incurred a debt to Jones Day "when the law firm performed legal services on the debtor's behalf." First Jersey, 180 F.3d at 510-511. Accordingly, to the extent that Jones Day performed legal services before being paid for those services, payments from Pillowtex to Jones Day were made "for or on account of an antecedent debt owed by the debtor" before the payments were made. 11 U.S.C. § 547(b)(2).

Fourth, the payments that Pillowtex made to Jones Day during the preference period were presumptively made while Pillowtex was insolvent. See 11 U.S.C. § 547(f) (statutory presumption that debtor is insolvent during the 90 day preference period). And finally, to the extent that Jones Day had not taken a retainer as security, it was an unsecured creditor with respect to Pillowtex. Because Jones Day did not obtain its $300,000 retainer until November 13, 2000, the eve of the bankruptcy filing, its receipt of payment in full for its services during the preference period allowed it to receive more than it would have been paid, absent the challenged transfers, in a chapter 7 liquidation. See 11 U.S.C. § 547(b)(5).

A straightforward application of Section 547 to Pillowtex's payments to Jones accordingly shows that every statutory elements of an avoidable preferential transfer is satisfied by at least some of Pillowtex's payments to Jones Day.

B. Pillowtex's Payments To Jones Day Do Not All Qualify For The Exemption For Payments Made In The Ordinary Course Of Business.

The preference provision generally "aims to ensure that creditors are treated equitably, both by deterring the failing debtor from treating preferentially its most obstreperous or demanding creditors" and by discouraging creditors themselves from putting undue pressure upon the debtor. Fiber Lite Corporation v. Molded Acoustical Products, Inc. (In re Molded Acoustical Products, Inc.), 18 F.3d 217, 219 (3d Cir. 1994). See also First Jersey, 180 F. 3d at 511 (explaining that Congress's "overriding intent in enacting Section 547(b) was to promote equal distribution among a debtor's creditors").

In addition to treating creditors equally, however, Congress also wanted to encourage businesses experiencing financial difficulties to stay afloat. It accordingly exempted from the trustee's avoidance power the debtor's payments on debts made "in the ordinary course" of business between the debtor and the creditor. See 11 U.S.C. § 547(c)(2). The "ordinary course exemption to the preference rule is formulated to induce creditors to continue dealing with a distressed debtor so as to kindle its chances of survival without a costly detour through, or a humbling ending in, the sticky web of bankruptcy." In re Molded Acoustical Products, Inc., 18 F.3d at 219 (citing H.R. Rep. No. 95-595 at 373-374 (1977), reprinted in 1987 U.S.C.C.A.N. 5787, 5963, 6138)).

"The preference provisions are designed not to disturb normal debtor-creditor relationships, but to derail unusual ones which threaten to heighten the likelihood of the debtor filing for bankruptcy at all and, should that contingency materialize, to then disrupt the paramount bankruptcy policy of the equitable treatment of creditors." See Molded Acoustical Products, Inc. 18 F.3d at 224. Thus, a hallmark of a payment that does not qualify for the ordinary course exemption even though it occurs as part of an ongoing debtor-creditor relationship is that it allows the creditor unusual advantages that are withheld from other creditors. See Molded Acoustical Products, Inc. 18 F.3d at 225 (recommending that creditor be allowed ordinary course exemption for its payment if the creditor "does not unfairly overreach, impel insolvency, or inequitably advantage itself at other creditors' expense by * * * commanding more stringent repayment schedules than its competitors" and observing that "it is * * * unusual behavior designed to improve the lot of one creditor at the expense of others at a time when bankruptcy looms on the horizon of an infirm debtor-to-be that invokes the need to subdue a creditor's predilection toward self-aggrandizing behavior").

The ordinary course exemption applies only when each of the three statutory elements is satisfied. See 11 U.S.C. § 547(c)(2). A payment that is exempt from avoidance must be 1) incurred in the ordinary course of both the debtor's and the creditor's business, and 2) made and received in the course of the debtor's and creditor's respective businesses, and 3) made according to ordinary business terms. See *ibid.*

Interpreting the third element – that the payment be made according to ordinary business terms – in light of the twin statutory goals of encouraging ordinary business transactions and discouraging creditors' attempts to gain advantage at the expense of others, this Court has explained that the pre-bankruptcy business relationship between creditor and the debtor is crucial to understanding the scope of the business terms that will be regarded as "ordinary" for purposes of the exemption. Thus, in addition to looking to industry credit and payment standards, "when the parties have had an enduring, steady relationship, one whose terms have not significantly changed during the pre-petition insolvency period," the terms that subsisted over the course of that relationship may constitute "ordinary business terms" despite considerable divergence from prevailing industry standards. Molded Acoustical Products, Inc. 18 F.3d at 226.

See also First Jersey, 180 F.3d at 512 (explaining that "the determination of what is 'in the ordinary course of business' is subjective, calling for the Court to consider whether the transfer was ordinary as between the debtor and the creditor").

Under these standards, some of the payments that Pillowtex made to Jones Day during the preference period are almost certainly exempt from avoidance as payments made in the ordinary course of business. Any payments for Jones Day's legal services that fell due during the preference period in accordance with the ordinary payment terms that subsisted between Jones Day and Pillowtex in their pre-bankruptcy relationship will be exempt as payments in the ordinary course.

In addition to paying bills that had fallen due in the ordinary course of business, however, Pillowtex also made payments to Jones Day that were inconsistent with the pre-bankruptcy relationship between Pillowtex and Jones Day. Jones Day has candidly stated that it accelerated Pillowtex's payment schedule during the preference period, so that in addition to "invoices that had already been outstanding that were paid," the firm would "basically instantaneously generate invoices and be paid for" its ongoing work for Pillowtex. Statement of Gregory M. Gordon, Esq. for Jones Day, Transcript at 31, App. 205. It is undisputed both that these accelerated payments were inconsistent with the ordinary terms of Pillowtex's relationship with Jones Day and that they came about in anticipation of the bankruptcy filing.

In addition to receiving accelerated payments, Jones Day also received payment in full on all of its legal bills, even those that had long been overdue.[58] Jones Day thus received full payment from the debtor on all its outstanding bills on the eve of bankruptcy, whereas other unsecured creditors did not – precisely the result that the preference provisions are intended to forestall. See First Jersey, 180 F.3d at 511 (explaining that Congress's "overriding intent in enacting § 547(b) was to promote equal distribution among a debtor's creditors").

For these reasons, the U.S. Trustee interprets this Court's cases to require a finding that some of the payments from Pillowtex to Jones Day that occurred during the preference period are voidable as preferential transfers.

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[58] The U.S. Trustee understands that Pillowtex was behind on some of the bills submitted by Jones Day. The amount of the seriously delinquent payments, however, must determined on remand.

CONCLUSION

For the foregoing reasons, the Conditional Retention Order should be vacated, and the case remanded for further proceedings on the U.S. Trustee's objections.

Respectfully submitted,

Of Counsel:

JOSEPH A. GUZINSKI
Acting General Counsel
P. MATTHEW SUTKO
Attorney, Office of the General Counsel
Executive Office For U. S. Trustees
U.S. Department of Justice
901 E. Street, N.W.
Washington, D.C. 20530

ROBERT D. McCALLUM, JR.
Assistant Attorney General

WILLIAM KANTER
(202) 514-4575
ANNE MURPHY
(202) 514-3688
Attorneys, Appellate Staff
Civil Division, Room 9108
U.S. Department of Justice
601 D. Street, N.W.
Washington, D.C. 20530-0001

OCTOBER 2001

BRIEF BANK — "SUMMARY SHEET" Printed Tue.-4/13/4 (8:54)

WESTLAW CODES

1. ("TI") TITLE OF CASE [E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"] In re Pillowtex, Inc.

2. ("CO") CURRENT COURT [E.g., "CTA9"] CA3

3. ("CCN") CURRENT CASE NO. No.: 01-2775

4. ("PCN") PRIOR CASE NO. & COURT [IF ANY]
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7. ("AU") PRINCIPAL AUTHORS & OFFICE [E.g.,"UST/OGC"]
Anne Murphy, Esq., Appellate Staff, DOJ
P. Matthew Sutko, Esq., EOUST
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") TOPIC BANKRUPTCY

9. ("SU") ! SUMMARY OF KEY ISSUE(s)
! 1) Whether the district court erred in authorizing a law firm to represent a chapter 11 debtor when the court has not ruled upon the U.S. Trustee's objection that payments from the debtor to the law firm were preferential transfers.
2) Whether a law firm received preferential transfers when the debtor paid all of the firm's outstanding bills in full on the eve of bankruptcy, making a substantially large payment four days before the bankruptcy petitions were filed.

10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...) C:\WINNT\Profiles\rschnell\Desktop\TEMP\Pillwtx02.wpd

11. DO YOU RECOMMEND POSTING IN UST BRIEFBANK?
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No. 01-2775

IN THE UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

In re Pillowtex, Inc.

DONALD WALTON, the ACTING UNITED STATES TRUSTEE,

Appellant.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF DELAWARE, SITTING IN BANKRUPTCY

REPLY BRIEF FOR THE APPELLANT

Of Counsel:

JOSEPH A. GUZINSKI
Acting General Counsel
P. MATTHEW SUTKO
Attorney, Office of the General Counsel
Executive Office For U. S. Trustees
U.S. Department of Justice
901 E. Street, N.W.
Washington, D.C. 20530

ROBERT D. McCALLUM, JR.
Assistant Attorney General

WILLIAM KANTER
(202) 514-4575
ANNE MURPHY
(202) 514-3688
Attorneys, Appellate Staff
Civil Division, Room 9108
U.S. Department of Justice
601 D. Street, N.W.
Washington, D.C. 20530-0001

IN THE UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

In re Pillowtex, Inc.

DONALD WALTON, the ACTING UNITED STATES TRUSTEE,

Appellant.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF DELAWARE, SITTING IN BANKRUPTCY

REPLY BRIEF FOR THE APPELLANT

In our opening brief, we explained that because this Court held in First Jersey[1] that a law firm that has received a preferential transfer from a debtor client has an actual conflict of interest~~s~~ that disqualifies it from representing that client in bankruptcy, the district court in this case was required to decide whether Jones Day had a disabling conflict before the court authorized Jones Day's retention as bankruptcy counsel for Pillowtex. Only by resolving the preference issue could the district court satisfy itself that Pillowtex would not be represented by counsel with a

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[1] United States Trustee v. First Jersey Securities, Inc. (In re First Jersey Securities, Inc.), 180 F.3d 504 (3d Cir. 1999).

disabling conflict. See 11 U.S.C. 327(a) (court may approve employment of professionals that "do not hold or represent an interest adverse to the estate * * *").

Jones Day's response does nothing to address the fact that the plain language of Section 327(a) of the Code allows the appointment only of conflict-free counsel.[2] This section simply makes no provision for retention of counsel, such as Jones Day, who might be conflict-free, but who also might have a disabling conflict of interests. Bankruptcy courts accordingly must adjudicate objections based upon conflict of interest or lack of disinterestedness before authorizing a firm's retention.

Nor does Jones Day respond to the practical problems that would arise if debtors could employ lawyers with impermissible conflicts of interest. Jones Day neither disputes that a preference is a disabling conflict, nor denies that, unlike Pillowtex's other unsecured creditors, it received 100 cents on the dollar on all of its outstanding legal bills just as Pillowtex went into bankruptcy. Instead, Jones Day argues that because it disclosed its payments to Pillowtex and because the U.S. Trustee "has no economic interest in the potential claim," it was appropriate for the district court to "address the concerns raise by preference allegations without the

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[2] See, e.g., In re Marvel Entertainment Group, Inc., 140 F.3d 463, 475 (3d Cir. 1998) ("The Bankruptcy Code allows the trustee of a bankruptcy estate to employ attorneys to assist him in his duties. 11 U.S.C. § 327(a). In determining the standards under which an attorney may serve in this capacity, we must, of course, begin with the language of the statute.").

necessity of an actual adjudication of whether a preferential payment occurred." Jones Day's Answering Brief ("Br.") at 15, 13.

Jones Day's defense of the district court's decision to allow it to represent Pillowtex without first determining whether it had a disabling conflict of interests, despite the undisputed facts giving rise to the U.S. Trustee's concerns, only confirms that the conditional retention order was entered in error. As we shall show, Jones Day's own arguments demonstrate that the conditional order authorizing Jones Day's retention is hopelessly inconsistent with First Jersey and with the Bankruptcy Code's requirement that debtors' counsel be conflict-free.[3]

ARGUMENT

1. This Court held in First Jersey a law firm's receipt of a preferential transfer from a debtor creates an actual conflict of interests that disqualifies the firm from representing the debtor. See First Jersey, 180 F.3d at 514 (discussed in Trustee's Br. at 24 - 25). Jones Day does not dispute that this is the holding of First Jersey. Jones Day nonetheless contends that First Jersey is not directly pertinent here because "[t]he First Jersey court was not presented with the issue of whether it might be appropriate" to retain counsel without actually adjudicating whether a preference had occurred,

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[3] See 11 U.S.C. § 327(a).

and because the Court "made no statements regarding a bankruptcy court's discretion when presented with preference allegations." Br. at 13.

Jones Day's argument about what this Court failed to say in First Jersey overlooks entirely the Court's *holding* in First Jersey that a law firm that has received a preferential transfer has a disqualifying conflict and cannot represent the debtor in the bankruptcy proceedings. As a matter of common sense and logic, the only way for the bankruptcy court to be sure that it is not authorizing the retention of a firm with a disabling conflict, in violation of both First Jersey and the Bankruptcy Code itself, is to adjudicate the preference issue before authorizing the retention. First Jersey's holding therefore precludes the type of conditional retention order that the district court approved in this case.

Significantly, Jones Day cites no case - from this or any other circuit - for the novel proposition that bankruptcy courts have discretion to authorize the retention of firms that may be barred by statute from acting as debtor's counsel. We are unaware of any such decision. To the contrary, we thought it universally accepted that "the debtors in this case could not employ accountants or other professional who were not 'disinterested.'" United States Trustee v. Price Waterhouse (In re Sharon Steel Corp.), 19 F.3d 138, 141(3rd Cir. 1994). See also Vouzianas and Nota Vouzianas v. Ready & Pontisakos (In re Vouzianas), 259 F.3d 103, 106 (2d Cir. 2001) (holding that 11 U.S.C. § 327(a) allows a debtor in possession or a trustee "with the court's approval" to employ attorneys "that do not hold or represent an interest adverse to the estate, and that are disinterested persons").

Neither the Bankrupcty Code itself nor the decisions interpreting it support Jones Day's argument that the district court had discretion to decline to determine whether Jones Day had a disqualifying conflict before the court authorized its retention. See Br. at 10-11. The district court has no discretion to disregard either the plain terms of the Bankruptcy Code, which require that the debtor's professional have no interest adverse to the estate,[4] or this Court's holding in First Jersey. Indeed, even if a bankruptcy court's retention decisions ordinarily are reviewable under an abuse of discretion standard, as Jones Day contends, the district court's legal error must be reversed because an error of law is inherently an abuse of discretion; as this Court has explained, "a court 'abuses its discretion when its ruling is founded on an error of law or a misapplication of law to the facts.'" Montrose Medical Group Participating Savings Plan v. Bulger, 243 F.3d 773, 780 (3d Cir. 2001).[5] Accord:

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[4] See 11 U.S.C. § 327(a).

[5] To the extent that Jones Day argues that the district court always has discretion to determine whether a conflict is actual or potential, its view is erroneous. Indeed, Jones Day quotes this Court's statement that "denomination of a conflict as potential or actual and the decision whether to disqualify a

(continued...)

Cooter & Gell v. Hartmax Corp., 496 U.S. 384, 405 (1990) (explaining that "[a] district court would necessarily abuse its discretion if it based its ruling on an erroneous view of the law or on a clearly erroneous assessment of the evidence").

2. As a threshold matter, Jones Day is wrong to suggest that the U.S. Trustee has argued that "the mere fact that the U.S. Trustee has alleged that Jones Day received preferential payments * * * by itself create[s] an actual conflict of interest mandating disqualification." Br. at 12. Of course, the U.S. Trustee has taken no such position. Rather, the U.S. Trustee has explained that if Jones Day has a conflict with Pillowtex at all, then that conflict is an actual conflict under the rule of law announced by this Court in First Jersey. Because Jones Day has taken and retained payments that may be preferential and it "will not be advising the Debtors to seek to recover payments made to Jones Day[,]" the conflict of interests, if any, has been in place since Jones Day's retention was approved and is an actual conflict today.

In no sense, therefore, is any conflict of interests "created by the U.S. Trustee's allegations." *Ibid.* On the contrary, if any conflict of interest exists, it has been

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[5](...continued)
professional based upon that determination in situations not yet rising to the level of actual conflict are matters committed to the bankruptcy court's sound exercise of discretion." In re BH & P Inc., 949 F.2d 1300, 1317 (3d Cir. 1991) (quoted at Br. 10). This Court in BH & P thus did not suggest that bankruptcy courts have discretion over matters concerning actual conflicts of interest.

created by Jones Day's receipt of substantial payments from the debtor within the preference period and outside the ordinary course of business. Saying that the U.S. Trustee is responsible for creating the conflict of interests is no more sensible than saying that the person who sets off the fire alarm must be responsible for setting the fire.

For the same reason, Jones Day is also mistaken when it asserts that the U.S. Trustee's position implies that "any law firm would be disqualified * * * as having an actual conflict of interest whenever any party alleged that the firm had received a preferential transfer, regardless of the merits of the allegations." Br. at 18. The U.S. Trustee's point is that when non-frivolous preference allegations are made, they must be resolved before retention is authorized because the receipt of a preferential transfer gives rise to an actual conflict of interest that would disqualify the firm. The ultimate disposition of the preference issue, of course, will depend upon whether the preference allegations are ultimately borne out by the facts.

3. On appeal, as it did in the district court, Jones Day takes the position that "[t]he conditions in the Retention Order * * * eliminate any potential conflict of interest created by the U.S. Trustee's allegations." Br. at 13. Jones Day is mistaken for at least two reasons. Br. at 13. First, although it is quite true that "courts have uniformly recognized that a professional can take steps to eliminate its adverse interest by waiving any claim it has against the estate," (Br. at 13), the waiver eliminates the possibility of a disabling conflict because the law firm actually waives its claim when it undertakes the representation and before it starts work for the client. The cases that Jones Day itself cites and quotes acknowledge this principle. See Br. at 27 (quoting bankruptcy court opinions explaining that "'Creditors may only be employed by the estate if they waive their pre-petition claim' * * * 'A creditor is not a disinterested person and consequently cannot qualify for employment by a debtor [u]nless [he] waives his pre-petition claim'"). These cases show that the courts do, indeed, agree that after a firm has waived its pre-petition claim, then it is not a creditor of the debtor and it may properly proceed with the representation.

Jones Day, however, asks this Court to endorse a quite different principle. Jones Day has not waived any portion of its claim for pre-petition fees. On the contrary, Jones Day has insisted that it has no intention of waiving any of its claim to pre-petition fees (fees that the debtor had already paid, in full, before the filing of the bankruptcy petition) unless a judge finds that it has received a preferential transfer — an event which would, in any event, require the disgorgement of the fees. Jones Day thus does not seek the court's permission to represent the debtor after it has waived its claim. Rather, Jones Day asks the court to approve its retention and allow it to work for the debtor before it has waived its claim for pre-petition fees.

The "conditional retention" mechanism proposed by Jones Day thus allows a bankruptcy court to approve the retention of a law firm even if it is acknowledged that the firm may have a disqualifying conflict with the debtor. Jones Day has failed to cite a single case approving such an arrangement, which simply cannot be reconciled with the Bankruptcy Code's unqualified requirement that professionals be conflict-free. See 11 U.S.C. § 327(a). Indeed, the bankruptcy court in the only reported case to consider a "conditional waiver"of this type deemed that waiver to be "wholly ineffectual to cure the conflict of interest created when a putative creditor represents the estate * * *." In re Michigan General Corporation, 77 B.R. 97, 104 (Bankr. N.D. Tex. 1987).[6] And the law in this Circuit is particularly clear in precluding a firm from representing a debtor if it has a disqualifying conflict of interests caused by the receipt of a preferential transfer. See First Jersey, 180 F.3d at 509, 514. As a matter of law, therefore, the conditional retention order is inconsistent with both the Bankruptcy Code and this Court's cases, and it should be vacated.

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[6] The conditional waiver rejected in Michigan General was proposed by the same law firm that represents the Official Committee of Unsecured Creditors in this case. That Committee has supported Jones Day's determination that no hearing on the preference issue should be required in light of the conditional waiver.

4. Furthermore, Jones Day's theory that disclosure of its pre-petition payments to Pillowtex is sufficient to eliminate any conflict of interests is based upon mistaken reasoning. Jones Day starts with the premise that "[b]ecause Jones Day will either prevail [at a hearing to determine whether it received preferences] or be required to return any transfer and waive its claim * * * the U.S. Trustee is, in reality, not seeking disqualification of Jones Day but is instead seeking to use the retention process to recover an alleged preference for the benefit of the Debtors' estates * * * ." Br. at 32. Jones Day then reasons that because "the U.S. Trustee has no economic interest in the recovery of any payments and the parties with the economic interest do not believe it is worthwhile for the estate to incur the expense of litigating the U.S. Trustee's allegations" the U.S. Trustee's objections to retention are insignificant, and it concludes that the conditional retention order should be affirmed. *Id.* at 33. Jones Day's argument is wrong at every step.

First, Jones Day is mistaken when it assumes that if it is found to have received a preferential transfer, it will simply then "waive its claim," so that "the U.S. Trustee's position will not actually result in the disqualification of Jones Day." Br. at 32. Jones Day assumes the conclusion of its own argument — that the conditional retention order is appropriate, and that it is permissible for Jones Day to represent Pillowtex even though it may suffer from a disabling conflict of interests, provided that it returns preferential transfers to Pillowtex if a court ultimately directs it to do so.

Contrary to Jones Day's apparent view, the U.S. Trustee has never endorsed this view of the law.[7] Rather, the U.S. Trustee in his opening brief expressly sought a remand "so that the district court can determine whether Pillowtex made payments to Jones Day that are avoidable as preferences under the Bankruptcy Code, <u>and to disqualify Jones Day if Jones Day has an actual conflict of interests</u>." Trustee's Br. at 33-34 (emphasis added). Jones Day has consistently refused to waive any portion of its claim to pre-petition fees, or to agree to a hearing on whether the fee payments were preferential.[8] Under <u>First Jersey</u>, if the fee payments are, in fact, preferential,

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[7] Jones Day is also mistaken when it argues that the U.S. Trustee's settlement of a similar dispute with KPMG, a firm of accountants, undermines the U.S. Trustee's position here. See, *e.g.*, Br. at 18-19. The United States Trustee Program, after a lengthy, deliberate, and thoughtful consideration of the issue, has concluded that conditional retention orders of the type entered in this case are inappropriate. Having reached this conclusion, the United States Trustee Program has sought to oppose such orders whenever practical. Given scarce Justice Department and judicial resources, however, the government has compromised other disputes, but compromise is not tantamount to agreement. This practice is fully consistent with the decision of the Solicitor General of the United States to pursue this appeal.

[8] Jones Day's statement that it "should not be disqualified simply because it chooses to challenge the merits of the preference allegations" is hard to reconcile with its position that the U.S. Trustee does not seek to have it disqualified at all.

then Jones Day is disqualified from representing Pillowtex, and the disqualification is mandatory. See First Jersey, 180 F.3d at 509 (explaining that receipt of a preferential transfer "would constitute an *actual conflict of interest* between counsel and the debtor, and would require the firm's disqualification"); *id.* at 514 (concluding that "the preferential payment [to the law firm] was a preference, creating an actual conflict of interest, and thus, disqualifying [the firm] as counsel for the debtor"); *ibid.* (holding that the preferential payment "created an actual conflict of interest, and therefore disqualification is mandatory"). At other points in its argument, Jones Day itself expressly acknowledges the principle that a conflict requires disqualification: it explains, for example, that unless any determination of the preference issue has preclusive effect, "there would still remain the possibility that Jones Day at some point would be ordered to return a preferential payment, becoming a creditor and requiring disqualification." Br. at 30, n.10 (emphasis added). See also Br. at 18 (explaining Jones Day's view that "any law firm would be disqualified under this Court's decision in Marvel as having an actual conflict of interest" under certain circumstances) (emphasis added).

Moreover, if Jones Day is found to have received preferences from Pillowtex, it will be in the position — albeit with the approval of the district court — of having represented and accepted fees from a client with respect to which it had a disabling conflict. Although in this appeal the U.S. Trustee seeks only a hearing upon the preference issues, Jones Day should be assured that the U.S. Trustee is not "in reality * * * seeking to use the retention process to recover an alleged preference for the benefit of the Debtors' estates" — rather, he is performing his statutory obligation to defend the integrity of the Bankruptcy Code.

Based upon its mistaken view that the U.S. Trustee is merely pursuing a preference action, Jones Day concludes that litigating that action "simply makes no sense where there has been full and adequate disclosure" of its payments to Pillowtex. But the Bankruptcy Code mandates both that prospective counsel disclose its payments to the debtor (11 U.S.C. § 329) and that it be free of conflicts. *Id.*, § 327(a). Jones Day presents no authority for the proposition that disclosure can be used as a substitute for disinterestedness, particularly where, as here, the disclosure itself raises the possibility that counsel has a disqualifying conflict of interest with the debtor.

Moreover, although Jones Day argues in part that disclosure was sufficient to eliminate its conflict of interest problems because the "Retention Order does not preclude the ability of anyone * * * from seeking to pursue a preference action against Jones Day on behalf of the estate," (Br. at 31), Jones Day also repeatedly assures the Court that none of the parties with standing to pursue a preference action against Jones Day has any intention of doing so. See, *e.g.,* Br. at 30 (stating that "the parties with the real interest in any potential recovery * * * have advised the [c]ourt that they see no merit in the allegations and would rather not proceed" with preference litigation). Jones Day's suggestion that disclosure will be sufficient to allow the parties to identify and correct conflict issues is therefore empty. Jones Day nonetheless both criticizes the participation of the U.S. Trustee as a party with "no economic interest in the potential claim," (Br. at 30; see also Br. at 15, 33), and represents that all of the parties that do have an economic interest have no interest in pursuing the preference issue. See Br. at 24, 30.

Jones Day's argument simply confirms the importance of, and necessity for, the U.S. Trustees. Congress created the U.S. Trustees precisely because the integrity of bankruptcy proceedings could not be adequately protected by market forces and the bankruptcy bar. See 28 U.S.C. 586; see also H.R. Rep. No. 595, 109 (1977), *reprinted in* 1987 U.S.C.C.A.N. 5787, 6070 (explaining that the U.S. Trustees are responsible for "protecting the public interest and ensuring that bankruptcy cases are conducted according to law"). This Court, accordingly, has recognized that "Congress was cognizant that the U.S. Trustee would have no pecuniary interest in the cases" under his supervision, and it has endorsed Congress's view that "one of the principal *advantages* of the new system was that the Trustee 'functions only as an impartial administrator.'" *U.S. Trustee* v. *Columbia Gas Systems, Inc. (In re Columbia*

Gas Systems, Inc.), 33 F.3d 294, 299 (3d Cir. 1994) (emphasis added). Indeed, this Court has acknowledged a particular "need to hear the Trustee * * * where there is no other party interested in bringing the statute to the court's attention." *Ibid.* Jones Day's complaints about the U.S. Trustee's lack of a financial interest in the case thus merely demonstrate that the U.S. Trustee is doing the job that Congress has charged him with — objecting to an aspect of a bankruptcy proceeding that would be not be brought to the court's attention by any of the other parties to the proceeding.[9]

5. Finally, Jones Day devotes a considerable portion of its brief to a discussion of how attorneys' fees incurred in preparing a bankruptcy petition may be paid in a manner consistent with the Bankruptcy Code. See Br. at 21-23 (discussing cases); 33-36 (discussing Jones Day's view of how fee issues should be addressed in practice). That issue, however, is presented only tangentially in this appeal, in which the U.S. Trustee primarily seeks to have the Order conditionally authorizing Jones Day's retention vacated as inconsistent with this Court's cases and with the Code.

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[9] Jones Day also argues that the U.S. Trustee should refrain from litigating the preference issue because the U.S. Trustee's litigation "in most likely some summary proceeding, could potentially preclude parties with an economic interest in the potential claim from later re-litigating the same issue." Br. at 30. To the extent that Jones Day is arguing that a summary proceeding would be insufficient for proper litigation of the preference issue — a view that seems hard to reconcile with its primary argument that no hearing is necessary at all — its difficulties could be resolved by ensuring that an adequate evidentiary hearing is conducted.

In any event, Jones Day's discussion of fees omits entirely the crucial distinction between fees for work performed in the pre-bankruptcy course of the client's business and fees for work performed in preparing the bankruptcy petition. As Jones Day discusses at length, and as the U.S. Trustee noted in his opening brief (at 34, n.57), courts have construed the Bankruptcy Code to allow lawyers to recover at least some of the fees incurred in helping their clients prepare bankruptcy filings even though the Code could be read to provide that the pre-petition fees render the lawyer disqualified as a creditor. See, *e.g.*, In re Martin, 817 F.2d 175 (1st Cir. 1987); Br. at 21-22 (discussing In re American Thrift & Loan Ass'n, 137 B.R. 381, 383 (Bankr. S.D. Cal. 1992) and other cases). Jones Day and the U.S. Trustee agree that concerns about pre-petition fees for work in preparation for bankruptcy may sometimes also be alleviated by a firm's use of certain types of retainers and by the waiver of claims for pre-petition fees. See Br. at 34-35. This Court has not yet had occasion to consider the extent of the constraints that the Bankruptcy Code places upon attorneys' fees incurred in helping a client prepare for bankruptcy, and the issue has not been presented or briefed in this appeal.

Although a hearing on the preference issue may well address some fees that Jones Day incurred in preparation for Pillowtex's bankruptcy filing, fees of this type do not lie at the heart of the U.S. Trustee's concern in this case. Rather, the U.S.

Trustee is particularly concerned that shortly before the petition was filed, Jones Day received from a bankrupt debtor full payment of all of its outstanding legal bills, including bills long past due and incurred for non-bankruptcy work, while the debtor's other creditors received only cents on the dollar.[10] The purpose of the preference provisions is to prevent precisely such inequalities between creditors. See First Jersey, 180 F.3d at 511. As First Jersey makes clear, law firms are not exempt from the Code's preference prohibition. Nor is there any reason to suppose that lawyers, as a class, should be accorded favorable treatment over other classes of creditors as a client slides into bankruptcy.

Jones Day has disputed neither the facts that form the basis for the U.S. Trustee's allegation that Jones Day received a preference, nor the legal framework established by the Bankruptcy Code and by this Court. At a minimum, a hearing should be held to determine whether Jones Day received preferential transfers from Pillowtex.

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[10] Under the plan just filed by the debtors in the bankruptcy court, general unsecured creditors would receive approximately one cent on the dollar for their claims.

Jones Day does not dispute that it received full payment on long-overdue bills. It contends, however, that those payments occurred within the ordinary course of its business with Pillowtex because the "Debtor's payment history to Jones Day had been erratic[.]" Br. at 35, n.14.

CONCLUSION

For the foregoing reasons and for the reasons set forth in our opening brief, the Conditional Retention Order should be vacated, and the case remanded for further proceedings on the U.S. Trustee's objections.

Respectfully submitted,

ROBERT D. McCALLUM, JR.
Assistant Attorney General

WILLIAM KANTER
(202) 514-4575
ANNE MURPHY
(202) 514-3688
Attorneys, Appellate Staff
Civil Division, Room 9108
U.S. Department of Justice
601 D. Street, N.W.
Washington, D.C. 20530-0001

Of Counsel:

JOSEPH A. GUZINSKI
Acting General Counsel
P. MATTHEW SUTKO
Attorney, Office of the General Counsel
Executive Office For U. S. Trustees
U.S. Department of Justice
901 E. Street, N.W.
Washington, D.C. 20530

JANUARY 2002

BRIEF BANK — "SUMMARY SHEET"

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WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	Danny R. Planavsky v. United States Trustee for Region 2
2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	N.D.N.Y
3. ("CCN") ***CURRENT*** CASE NO.	No.: 6:10-cv-001126-GLS
4. ("PCN") ***PRIOR*** CASE NO. - & COURT *[IF ANY]*	No.: 01-63125 Court: Bankr. N.D.N.Y. *(Identify judge & cite, if any)*
5. ("SO") ***SOURCE***	**U.S. TRUSTEES**
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7. **("AU") *PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*	Erin P. Champion, Noah M. Schottenstein, P. Matthew Sutko, Ramona D. Elliott, Guy Van Baalen, Tracy Hope Davis *(UST/OGC: 202-307-1399/FAX-2397)*
8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") ● ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	● Did the bankruptcy court abuse its discretion when it converted Mr. Planavsky's chapter 11 bankruptcy case to chapter 7, under 11 U.S.C. § 1112(b)?
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UNITED STATES DISTRICT COURT
FOR THE
NORTHERN DISTRICT OF NEW YORK

DANNY R. PLANAVSKY,
Appellant

v. CIVIL NO. 6:10-CV-1126 GLS

UNITED STATES TRUSTEE FOR REGION 2,
Appellee

ON APPEAL FROM THE UNITED STATES BANKRUPTCY COURT FOR THE NORTHERN DISTRICT OF NEW YORK

APPELLEE'S BRIEF

RAMONA D. ELLIOTT
General Counsel

P. MATTHEW SUTKO
Associate General Counsel

NOAH M. SCHOTTENSTEIN
Trial Attorney

Executive Office for United States Trustees
United States Department of Justice
20 Massachusetts Avenue N.W.
Washington, D.C. 20530
Telephone: (202) 305-2796
Facsimile: (202) 305-2397
Email: noah.m.schottenstein@usdoj.gov

TRACY HOPE DAVIS
United States Trustee for Region 2

GUY VAN BAALEN
Assistant United States Trustee

ERIN P. CHAMPION
Trial Attorney

Office of the United States Trustee
United States Department of Justice
10 Broad Street, Suite 105
Utica, New York 13501
Telephone: (315) 793-8191
Facsimile: (315) 793-8133
Email: Erin.Champion@usdoj.gov

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INTRODUCTION

On May 16, 2001, Mr. Danny R. Planavsky voluntarily filed for chapter 11 bankruptcy relief. On June 29, 2010, the United States Trustee filed a second motion to convert Mr. Planavsky's chapter 11 case to chapter 7, under 11 U.S.C. § 1112(b), based on Mr. Planavsky's inability to effectuate a plan of reorganization and the unreasonable delay that has been prejudicial to his creditors. The bankruptcy court granted the motion, finding cause to convert the case under section 1112(b). This appeal followed.

STATEMENT OF APPELLATE JURISDICTION

This Court has appellate jurisdiction under 28 U.S.C. § 158(a)(1), which confers jurisdiction on the district courts of the United States to hear appeals "from final judgments, orders, and decrees" of bankruptcy judges. The bankruptcy court's final order granting the United States Trustee's motion to convert Mr. Planavsky's chapter 11 bankruptcy case to chapter 7, under 11 U.S.C. § 1112(b), was entered on August 6, 2010. Mr. Planavsky timely filed a notice of appeal under 28 U.S.C. § 158(c)(2) and Fed. R. Bankr. P. 8002(a) on August 18, 2010.

STATEMENT OF THE ISSUES

Did the bankruptcy court abuse its discretion when it converted Mr. Planavsky's chapter 11 bankruptcy case to chapter 7, under 11 U.S.C. § 1112(b)?

STANDARD OF REVIEW

This Court reviews a bankruptcy court's decision to convert or dismiss a chapter 11 case under 11 U.S.C. § 1112(b) for abuse of discretion. C-TC 9th Ave. P'ship v. Norton Co. (In re C-TC 9th Ave. P'ship), 113 F.3d 1304, 1312 (2d Cir. 1997). A bankruptcy court abuses its discretion when it bases its decision on "an error of law or a clearly erroneous finding of fact, or a decision that, 'though not necessarily the product of legal error or a clearly erroneous factual finding[,] cannot be located within the range of permissible decisions.'" Jasco Tools, Inc. v. Dana Corp. (In re Dana Corp.), 574 F.3d 129, 145 (2d Cir. 2009) (citations omitted).

STATEMENT OF THE CASE

I. Statutory Framework.

A. Dismissal Under 11 U.S.C. § 1112(b) (2000).

Mr. Planavsky's case was commenced on May 16, 2001, which preceded the effective date of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA"). The statutory authority for the United States Trustee's motion to convert is therefore governed by the provisions of the Bankruptcy Code that were in effect prior to the 2005 amendments. Accordingly, all references made herein are to the pre-2005 statutory provisions that were applicable at the time the case was filed in 2001.

Prior to the 2005 amendments under BAPCPA, section 1112(b) stated that "after notice and a hearing, the court may convert a case under this chapter to a case under chapter 7 of this title or may dismiss a case under this chapter, whichever is in the best interest of creditors and the estate, for cause." 11 U.S.C. § 1112(b). Section 1112 then lists several subsections that provide examples of cause, "including — . . . (2) inability to effectuate a plan" and "(3) unreasonable delay by the debtor that is prejudicial to creditors." 11 U.S.C. §§ 1112(b)(2), (3). Under 11 U.S.C. § 102(3), "including" is "not limiting," so section 1112(b)'s list was not exhaustive.

B. The Proposal and Confirmation of Chapter 11 Reorganization Plans.

A chapter 11 debtor may file a reorganization plan at any time, including when the case is commenced. 11 U.S.C. § 1121. This plan must conform to the requirements of the Bankruptcy Code, be accepted by the creditors, and be confirmed by the bankruptcy court before the debtor may enact the reorganization plan. 11 U.S.C. §§ 1123 (establishing requirements for the content of a plan), 1126 (requiring creditor acceptance of a plan), 1129 (establishing requirements for the bankruptcy court to confirm a plan). Before a debtor may solicit support for a reorganization plan, it must also provide creditors with a disclosure statement providing "adequate information" allowing a creditor to make an "informed judgment" about the viability of the reorganization plan. 11 U.S.C. § 1125. The disclosure statement often includes historic information, assumptions, accounting and valuation calculations, anticipated litigation, management information, business conditions, tax consequences, and other legal, financial, or economic circumstances that would be relevant to a creditor's decision to accept or reject a proposed plan.

Disclosure statements must be approved by the bankruptcy court. 11 U.S.C. § 1125(b). And if the proposed reorganization plan is modified, the disclosure statement must be modified and re-approved by the bankruptcy court. 11 U.S.C. § 1127(c).

II. Statement of the Facts.

A. Mr. Planavsky's Real Estate Holdings and Municipal Tax Liabilities.

The appellant, Mr. Danny R. Planavsky, leases commercial and residential real estate in multiple locations in or around Broome and Tioga Counties, New York. See Debtor's Chapter 11 Plan of Reorganization, Bankr. Dkt. 239. Mr. Planavsky's assets primarily consist of fifteen commercial properties, having a total value of approximately $3.2 million. Bankr. Dkt. 1. According to Mr. Planavsky's section 1125 disclosure statement and his proposed reorganization plan, his liabilities primarily consisted of mortgage liens secured against the commercial properties in the approximate amount of $1.8 million and statutory tax liens of $1.6 million dollars for unpaid property taxes at the time the case was filed. Bankr. Dkts. 239, 240.

Prior to filing for bankruptcy relief, Mr. Planavsky attempted to resolve the property tax disputes with the municipal taxing authorities in an effort to reduce his liabilities. Id. Mr. Planavsky did this by challenging the tax-assessed valuation of his properties through municipal assessment review proceedings. Id.

Mr. Planavsky's efforts were unsuccessful and the resulting $1.6 million dollars in property tax liabilities became the focus of Mr. Planavsky's reorganization efforts in bankruptcy. Id.

B. Mr. Planavsky's Tax Litigation Within His Bankruptcy Case.

Mr. Planavsky continued to litigate the amount of his tax liabilities within his bankruptcy case. When Mr. Planavsky filed for bankruptcy in 2001, he had no equity in his properties because his secured mortgage and municipal tax claims exceeded the value of the properties. Bank. Dkts. 55, 292, 293. Therefore, in 2002, Mr. Planavsky initiated multiple actions, including a separate proceeding against the municipal taxing authorities, requesting that the bankruptcy court establish the value of his commercial properties and determine his tax liability under 11 U.S.C. § 505 (allowing the bankruptcy court to determine the amount or legality of a tax liability). Bankr. Dkts. 46, 50, 54, 60, 91. Throughout these proceedings, Mr. Planavsky argued that the actual market value of his properties was lower than the tax-assessed value and therefore his property tax liabilities, estimated to be over $1.6 million dollars at the time, should be lowered accordingly. Id.

Mr. Planavsky's first attempt to reduce his tax liability lasted over five years and was unsuccessful. In January 2007, several municipal defendants sought dismissal of the first adversary proceeding. Following a hearing in June 2007, the bankruptcy court dismissed Mr. Planavsky's first adversary proceeding in favor of the movants on the basis that Mr. Planavsky failed to comply with the bankruptcy court's October 31, 2006, unwritten order directing Mr. Planavsky to procure independent appraisals regarding the value of his properties. Planavsky v. County of Broome (In re Planavsky), No. 02-80262-6-dd (Bankr. N.D.N.Y. June 5, 2007), aff'd, Planavsky v. Town of Union, No. 6:07-0832 (N.D.N.Y. Apr. 25, 2008). In August 2008, the bankruptcy court entered an order with respect to the remaining defendants in the first adversary proceeding, assigning the case to mediation and ordering the parties to select a mediator. Planavsky v. County of Broome (In re Planavsky), No. 02-80262-6-dd (Bankr. N.D.N.Y. August 22, 2008) Again, Mr. Planavsky failed to comply with the order. Transcript of hearing on United States Trustee's Motion to Convert at 16:7-8, July 22, 2010.

Mr. Planavsky did not propose a chapter 11 reorganization plan for more than six years. Ultimately, he filed one on August 18, 2007. Bankr. Dkt. 239. Mr. Planavsky's reorganization plan relied on rent receipts from residential properties and a commercial warehouse storage facility. Id. Mr. Planavsky acknowledged that the amount necessary to fund the plan was unknown and would be contingent upon the outcome of the property tax litigation. Id. Mr.

Planavsky's disclosure statement and reorganization plan indicated that his primary tenant, which is his son, would be funding the proposed reorganization plan to extent there would be a deficiency. Bankr. Dkt. 240. The disclosure statement also listed Mr. Planavsky's properties and his personal opinion of their respective values. Id.; see 11 U.S.C. § 1125 (requiring the debtor to disclose "adequate information" that would allow creditors to make an informed judgment about whether to support a proposed reorganization plan).

The United States Trustee objected to Mr. Planavsky's disclosure statement on three grounds: (1) the disclosure statement did not describe in detail or provide a basis for how Mr. Planavsky obtained his values for the properties; (2) the disclosure statement did not adequately address each creditor class and the amount of their claims; and most significantly (3) the disclosure statement failed to adequately disclose a succinct financial analysis, containing Mr. Planavsky's projected receipts and disbursements, upon which creditors could make a determination to accept or reject the proposed plan of reorganization. Bankr. Dkt. 333 (Exhibit A). Further litigation and multiple hearings regarding the deficiencies within the disclosure statement followed. It was not until September 9, 2008 — after Mr. Planavsky amended the disclosure statement four times and added two addendums to it, which took another year — that the bankruptcy court was able to approve a disclosure statement. It then set a hearing for November 17, 2008, to consider Mr. Planavsky's proposed chapter 11 reorganization plan. Bankr. Dkt. 289.

The United States Trustee then objected to that plan on the basis that it was not feasible because Mr. Planavsky failed to show that confirmation would not likely be followed by liquidation or further need of reorganization. Bankr. Dkt. 294; see 11 U.S.C. § 1129 (describing the requirements for plan confirmation). The objection relied upon the monthly financial operating reports that Mr. Planavsky had filed in the case. Bankr. Dkt. 333 (Exhibit A). Those demonstrated that his rental receipts would likely be insufficient to cover his proposed payments under the plan. Bankr. Dkt. 333 (Exhibit A). This was consistent with his fourth amended disclosure statement, in which Mr. Planavsky projected a $3,257.19 per month deficit under the proposed repayment plan. Bankr. Dkt. 286.

The United States Trustee also argued Mr. Planavsky had not shown he had an ability to fund the shortfall, since both the plan and the disclosure statement did not provide any evidence of either Mr. Planavsky's or his son's ability to satisfy the monthly shortfall. Bankr. Dkt. 294. Furthermore, Mr. Planavsky's proposed reorganization plan was not feasible because it failed to adequately provide for the full repayment of the $1.6 million tax debt owed to the municipal taxing authorities, which was secured against his income generating properties. 11 U.S.C. §1129(8); Bankr. Dkts. 292, 293. For these reasons, the United States Trustee argued that Mr. Planavsky's plan did not meet the feasibility requirements under 11 U.S.C. §1129(11) because, based on his monthly operating reports, he could have no success in reorganizing without a significant reduction in his priority tax liability claims. Id. Further reorganization would likely be necessary after confirmation of Mr. Planavsky's plan, and therefore it did not comply with the requirement of section 1129(11).

After Mr. Planavsky filed his reorganization plan and approved disclosure statement in 2008, he continued to litigate his tax liabilities, leaving the various objections to his plan and disclosure statement unresolved. In January 2009, Mr. Planavsky filed a second adversary complaint against the same municipal defendants that were involved in his first adversary proceeding. After the bankruptcy court granted a series of continuances, in May 2010, the court dismissed the second adversary proceeding primarily based on res judicata and laches. Planavsky v. Broome County, No. 09-80001-6-dd (Bankr. N.D.N.Y. May 5, 2010).

By the time Mr. Planavsky's second adversary proceeding was dismissed in May 2010, he had been under the protection of the Bankruptcy Code for nine years. During this period of time, Mr. Planavsky could not resolve the ongoing objections to his reorganization plan. Furthermore, his financial condition continued to deteriorate. In support of the motion to convert Mr. Planavsky's case, the United States Trustee submitted a compilation of Mr. Planavsky's monthly operating reports for the years 2008, 2009, and 2010. Bankr. Dkt. 333 (Exhibit A). The compilation showed that Mr. Planavsky's 2009 income and expenses suffered a monthly shortfall of $9,264.56 under the reorganization plan's proposed payments, almost three times greater than the $3,257.19 deficit projected in his 2008 fourth amended disclosure statement, with no proof that he had a viable method for funding that deficit. Bankr. Dkts. 280, 333. Furthermore, Mr. Planavsky's monthly operating reports for the period of January through May 2010 indicated that, in contrast to 2007, when Mr. Planavsky generated $.45 for every $1 dollar needed to make the payments required by his plan, Mr. Planavsky now only had $.17 available. Bankr. Dkt. 333 (Exhibit A).

III. Statement of the Proceedings Below.

Subsequently, on June 29, 2010, the United States Trustee moved to convert Mr. Planavsky's case for cause under 11 U.S.C. §1112(b). Bankr. Dkt. 333. The United States Trustee asserted two arguments. First, the case should be converted under 11 U.S.C. §1112(b)(2) based on Mr. Planavsky's inability to confirm or propose a viable plan, as evidenced by the nine-year financial history reflected in the monthly operating reports. Second, the case should be converted under 11 U.S.C. §1112(b)(3) based on Mr. Planavsky's unreasonable delay in advancing the case and the resulting prejudice to his creditors because they had been prevented from foreclosing on the properties for nearly ten years.

On July 15, 2010, Mr. Planavsky filed an opposition to the United States Trustee's motion to convert his case. Bankr. Dkt. 336. Mr. Planavsky argued that any delay he caused in the case was a result of his participation in "vigorous litigation" concerning the tax disputes. Id at 1. Mr. Planavsky alleged that notwithstanding the unfavorable result of the property tax litigation, his reorganization plan could be still confirmed. Id at 1-2. Mr. Planavsky further argued that the United States Trustee relied on a "convoluted analysis" in reviewing his financial reports and that the motion to convert was "premature." Id. at 2-3. Mr. Planavsky maintained that his business was in fact profitable and he was able to meet his obligations. Id. at 3. Mr. Planavsky, however, provided no documentary support for his argument.

At a hearing held on July 22, 2010, the United States Trustee argued that despite Mr. Planavsky's nine years of bankruptcy protection to reorganize his business and reach a resolution on his tax debts, there was "absolutely no ability to reorganize." Transcript of hearing on United States Trustee's Motion to Convert at 12: 4-14, July 22, 2010. What Mr. Planavsky characterized as "vigorous litigation," was really a dilatory tactic. Id. None of the financial records provided by Mr. Planavsky demonstrated an ability to successfully reorganize or fund a reorganization plan. Tr. at 8-11. And Mr. Planavsky's tax liabilities continued to rise, having now reached $1.8 million. Tr. at 4:25, 5:1. Finally, Mr. Planavsky's assertion that his son would fund his reorganization plan was unsubstantiated and, nevertheless, failed to make Mr. Planavsky's rental operations an independent and viable going concern. Tr. at 16: 22-25.

Mr. Planavsky did not seek to put on evidence at the section 1112(b) hearing. Instead, he suggested he could prove that his case was feasible at a confirmation hearing. Tr. at 15: 1-17. Despite that, Mr. Planavsky acknowledged the shortfall in his income, but suggested that he would present evidence at confirmation proving the financial wherewithal of his son in order to satisfy the deficiency in income to make plan payments. Id. Mr. Planavsky did not ask for permission to present evidence at this hearing, and presented none. To the contrary, Mr. Planavsky asserted that his plan could be confirmed on the terms set forth in his fourth amended disclosure statement. Tr. at 14:13-16. The bankruptcy court, however, noted that its ruling in a related adversary proceeding would already necessitate further amendments to the disclosure statement. Tr. at 14:17-20.

The bankruptcy court agreed with the United States Trustee and held that sufficient cause for conversion of the case to chapter 7 existed under section 1112(b). Tr. at 17: 12-20. The court held that there was an inability to effectuate a plan, based on the lack of income as shown in the record; and that the creditors "have waited nearly a decade to be paid back on prepetition debt." Id. The court noted that Mr. Planavsky had not taken any action in the two months since his second adversary proceeding had been dismissed, he had not complied with the outstanding mediation order, and that he had failed to reply to numerous requests for proof that his son would supplement his income. Id. As the court explained, "things need to be done and they are not, yet again." Id.

SUMMARY OF THE ARGUMENT

Mr. Planavsky was given over nine years to begin repaying his creditors by confirming a chapter 11 repayment plan. He never succeeded, and his deteriorating financial condition could give no one any expectation that he ever would. Having been so patient, the bankruptcy court did not abuse its discretion by converting the case to chapter 7, which will allow the debtor's assets to be liquidated to repay some of the debts he owes his creditors.

The bankruptcy court converted Mr. Planavsky's chapter 11 bankruptcy case to one under chapter 7 under 11 U.S.C. § 1112(b) for two sound reasons: (1) his nine year delay has been prejudicial to his creditors and (2) his inability to confirm a chapter 11 reorganization plan, based upon insufficient income to fund the reorganization plan. Given those facts, the court ordered that Mr. Planavsky's case be converted to one under chapter 7 of the Bankruptcy Code.

This was not an abuse of the bankruptcy court's broad discretion. The record shows that the nine year delay was unreasonable and prejudicial to Mr. Planavsky's creditors due to (1) the extreme amount of time Mr. Planavsky spent litigating with municipal taxation authorities, (2) Mr. Planavsky's inability to propose a confirmable plan after almost a decade under the protection of the automatic stay, and (3) Mr. Planavsky's failure to comply with a bankruptcy court order directing Mr. Planavsky to seek mediation to resolve a remaining disputed issue within a pending adversary proceeding. The record also shows that Mr. Planavsky could not confirm a chapter 11 reorganization plan because, as Mr. Planavsky acknowledged, there was insufficient income to support the proposed plan payments without substantial assistance from his son. But this assistance never came, and Mr. Planavsky never offered any proof that his son could actually provide it.

Mr. Planavsky's arguments on appeal — that his due process rights were violated by the conversion and that the conversion order was erroneous due to the "law of the case" doctrine — are unpersuasive. First, he never presented these arguments to the bankruptcy court and has therefore waived them on appeal. Second, these arguments fail on their merits. The due process argument fails because the bankruptcy court provided the notice and hearing required by the Bankruptcy Code. The "law of the case" argument fails because the doctrine does not apply to factual determinations and it does not bind the bankruptcy court's discretion.

Because the bankruptcy court's factual determinations were based upon ample evidence in the record, its findings were not clearly erroneous and this Court should affirm the order entered below.

ARGUMENT

I. The Bankruptcy Court Did Not Clearly Err When It Found Cause to Convert Mr. Planavsky's Chapter 11 Bankruptcy Case to One Under Chapter 7 Under 11 U.S.C. § 1112(b).

Under section 1112(b), a bankruptcy court may convert a chapter 11 case to one under chapter 7 "for cause." § 1112(b). Section 1112(b) sets forth a list of ten examples of what could constitute cause, "including" the "inability to effectuate a plan" and "unreasonable delay by the debtor that is prejudicial to creditors." §§ 1112(b)(2), (3). "[T]his list is illustrative, not exhaustive." C-TC 9th Ave. P'ship v. Norton Co. (In re C-TC 9th Ave. P'ship), 113 F.3d 1304, 1311 (2d Cir. 1997); 11 U.S.C. § 102(3) (stating that "including" is "not limiting" in the Bankruptcy Code).

Ultimately, the bankruptcy court must decide whether the debtor's efforts "have proven inadequate to the task of reorganizing his affairs effectively within a reasonable amount of time." A. Illum Hansen, Inc. v. Tiana Queen Motel, Inc. (In re Tiana Queen Motel, Inc.), 749 F.2d 146, 150 (2d Cir. 1984). This judgment is a matter of the bankruptcy court's discretion. C-TC, 113 F.3d at 1312; In re Abijoe Realty Corp., 943 F.2d 121, 128 n.12 (1st Cir. 1991) ("[T]he determination of cause under section 1112(b) is subject to judicial discretion under the circumstances of each case.”).

In this case, the bankruptcy court did not clearly err when it found cause to convert Mr. Planavsky’s chapter 11 case to one under chapter 7. There is substantial support in the record for the court’s finding that (1) the nine-year delay in the case was unreasonable and prejudicial to Mr. Planavsky’s creditors and (2) there was no reasonable likelihood that a chapter 11 reorganization plan could be confirmed. Accordingly, the bankruptcy court’s order converting Mr. Planavsky’s case should be affirmed.

A. The Bankruptcy Court Did Not Clearly Err When It Found That There Had Been Unreasonable Delay That Was Prejudicial to Mr. Planavsky’s Creditors.

Whether cause exists to convert a debtor’s case under section 1112(b)(3) based on delay that has been unreasonable and prejudicial to creditors must be considered within the context of the bankruptcy case. Tiana Queen, 749 F.2d at 152; compare In re Sphere Holding Corp., 162 B.R. 639, 643 (E.D.N.Y. 1994) (determining that a three month delay in filing monthly operating reports caused by the incapacity of the debtor’s attorney was reasonable) with In re William Steiner, Inc., 139 B.R. 356, 358 (Bankr. D. Md. 1992) (holding that a two year delay in filing a reorganization plan was unreasonable in light of the circumstance that the only significant debt in the case was a state tax claim).

In Tiana Queen, the chapter 11 debtors litigated the value of three properties in the estate, and obtained continuances based on repeated assurances to the bankruptcy court that a cash infusion from a sale necessary for the reorganization plan was imminent. Id. at 151. The bankruptcy court converted the case under section 1112(b) because the case had been paralyzed by litigation and there was no evidence of progress toward confirmation after 15 months. Id.

The Second Circuit affirmed, explaining that although there is no fixed amount of time allowed to confirm a reorganization plan, the bankruptcy judge was not required to grant the "debtors' repeated pleas for more time . . . at the expense of secured creditors" when the debtors had a "proven record for overestimating their chances of success" and an "inability to devise a reorganization plan grounded in reality." Id. at 152. The Second Circuit held that the bankruptcy court did not abuse its discretion because the debtors' failed to demonstrate "that their prospects for prompt rehabilitation were based upon anything more substantial than [the debtors'] boundless confidence." Id.

In Mr. Planavsky's case, the record similarly demonstrates that after nine years, his inability to take meaningful, timely steps to advance the reorganization process has been unreasonable and prejudicial to his creditors. Mr. Planavsky's case was six years old before he filed a proposed reorganization plan and a disclosure statement. Bankr. Dkt. 239, 240. In the main bankruptcy case, the majority of docket activity included Mr. Planavsky's adjournments and the filing of monthly operating reports. And Mr. Planavsky's involvement in so called "vigorous litigation" did nothing more than keep his tax creditors at bay while he enjoyed the protections of the Bankruptcy Code. Tr. at 12:4-14. Rather than actively prosecute his bankruptcy case, Mr. Planavsky (1) engaged in dilatory discovery tactics, (2) refused to comply with court orders, (3) filed frivolous responses to the objections to his disclosure statement and reorganization plan, and (4) brought claims that were without any merit.

For example, consider Mr. Planavsky's first adversary proceeding, which was commenced on October 29, 2002, against Broome County and ten other municipal defendants. Planavsky v. County of Broome (In re Planavsky), No. 02-80262-6-dd (Bankr. N.D.N.Y. June 5, 2007). After years of discovery orders with little progress, in March 2007, the bankruptcy court granted Mr. Planavsky until May 21, 2007, to procure independent appraisals to support his claims in the adversary proceeding or face dismissal. Id. Mr. Planavsky failed to comply with that order and on June 5, 2007 the bankruptcy court dismissed a number of the claims against the municipal defendants. Id. Mr. Planavsky appealed the dismissal, which was affirmed by this Court on August 28, 2008. Planavsky v. Town of Union, No. 6:07-0832 (N.D.N.Y. Apr. 25, 2008) (stating that Mr. Planavsky had failed to comply with the bankruptcy court's orders within the established time limits, had not mentioned any trouble complying with the orders, did not request an extension of time, and had apparently made no attempt to comply with the orders).

Next, Mr. Planavsky repeatedly failed to comply with his statutory obligations regarding his disclosure statements and reorganization plan. See 11 U.S.C. §§ 1125 (governing the requirements for a disclosure statement), 1129 (governing the requirements for plan confirmation). In response to repeated objections to his disclosure statement, Mr. Planavsky ultimately filed four amended disclosure statements. Bankr. Dkts. 240, 263, 278, 280. None of these contained new substantive information or disclosures sufficient to respond to the United States Trustee's objections and provide creditors and parties in interest with a reasonable basis to vote on his proposed reorganization plan. Id. This caused needless delays in the case and further prejudice to Mr. Planavsky's creditors.

Most recently, Mr. Planavsky further frustrated the proceedings by filing the second adversary proceeding on January 11, 2009, which involved nearly the same causes of actions against the same defendants. Bankr. Dkt. 301. This adversary proceeding was ultimately dismissed by bankruptcy court on May 5, 2010, in a 22 page decision, primarily due to res judicata and laches. Planavsky v. Broome County, No. 09-80001-6-dd (Bankr. N.D.N.Y. May 5, 2010).

In addition, the second adversary proceeding wasted time and resources beyond the immediate cost of its prosecution. This is because it was filed after the bankruptcy court approved the fourth amended disclosure statement and had set a plan confirmation hearing. As Mr. Planavsky acknowledged, the bankruptcy court's dismissal of the 2009 adversary proceeding required another amendment to the disclosure statement, which reset the entire plan confirmation process. Tr. at 14:13-20. Also, as the bankruptcy court noted, both during and for two months following the dismissal of the second adversary proceeding, Mr. Planavsky disregarded the outstanding objections to his reorganization plan and ignored the court's previous orders to seek appraisals and mediation for any remaining claims. Tr. at 16: 6-19. No reasonable end to the proceedings was in sight.

Based on these facts, the bankruptcy court did not clearly err when it found cause to convert Mr. Planavsky's case for unreasonable delay and prejudice to his creditors. Over the past nine years, Mr. Planavsky has repeatedly refused to take actions that would materially advance the case — as the bankruptcy court stated, "[t]hings need to be done and they are not, yet again." Tr. at 16:12-13. Because Mr. Planavsky cannot reorganize "his affairs effectively within a reasonable amount of time," like the debtors in Tiana Queen, the bankruptcy court's decision converting his case should be affirmed. Tiana Queen, 749 F.2d at 152.

B. The Bankruptcy Court Did Not Clearly Err When It Found That Mr. Planavsky Was Unable to Effectuate a Chapter 11 Reorganization Plan.

Cause also exists under section 1112(b)(2) when a debtor is unable to effectuate a reorganization plan. Id. at 151. Within the Second Circuit, conversion is justified when there is no reasonable probability that the debtor will be able to confirm a reorganization plan and emerge from bankruptcy. C-TC 9th Ave. P'Ship, 113 F.3d at 1311; see, e.g., In re Woodbrook Assocs., 19 F.3d 312, 316 (7th Cir. 1994) (holding that conversion is appropriate when "the court determines that it is unreasonable to expect that a plan can be confirmed in the chapter 11 case.").

When making such a determination, a bankruptcy court is not required to rely upon the "good faith" of a debtor's proposed rehabilitation plan after a debtor has demonstrated the inability to make good on a proposal over the course of the proceedings. Tiana Queen, 749 F.2d at 151. A bankruptcy court need not "blindly accept" a debtor's mere optimism about the prospects of reorganization based on speculation, such as a windfall financial recovery from litigation, as fact. Loop Corp. v. U.S. Trustee, 379 F.3d 511, 518 (8th Cir. 2004). Instead, a court should assess the evidence critically, in light of the debtor's history on the record, the reorganization plan's potential costs to the estate, and the debtor's ability to achieve a confirmable plan with the creditors. Id. "There must be a reasonable possibility of a successful reorganization within a reasonable time." First Jersey Nat'l Bank v. Brown (In re Brown), 951 F.2d 564, 572 (3d Cir. 1991) (quotation omitted) (expressing concern about the viability of a reorganization plan that could not be funded without the consent of the debtor's non-filing husband).

_____The bankruptcy court did not clearly err when it found that there was no reasonable possibility that Mr. Planavsky would be able to confirm a reorganization plan. This is because the evidence in the record developed over the past nine years demonstrated that Mr. Planavsky's financial problems could not be rehabilitated through a reorganization plan. An analysis of Mr. Planavsky's 2009 income and expense statements showed an significant and unrefuted monthly shortfall of $9,264.56. Bankr. Dkt. 333 (Exhibit A). And the most recent financial history provided by Mr. Planavsky's monthly operating reports for the period of January through May 2010 indicated that, in contrast to 2007, when Mr. Planavsky generated $.45 for every $1 dollar needed to make the payments required by his plan, he now only had $.17 available. Id.

Even Mr. Planavsky did not dispute that he would be unable to make the payments required under the reorganization plan. He simply projected that he had a monthly shortfall of only $3,257.19 per month in payments under the reorganization plan. Bankr. Dkt. 280 at 4. But this amount did not take into account that Mr. Planavsky's property tax liabilities far exceeded what he proposed to pay in his plan. Bankr. Dkt. 239 at 3. These liabilities, which are fully secured by statutory liens, must be satisfied in full for the plan to be confirmed. 11 U.S.C. §1129(8).

Mr. Planavsky acknowledged these problems concerning his inability to generate enough income to satisfy his payment obligations under the reorganization plan, but alleged that his son would supplement plan payments for a successful reorganization to occur. Tr. at 15. But despite multiple requests for information and four amendments to his disclosure statement, Mr. Planavsky never offered any evidence that the restructuring plan would allow him to reverse his declining revenue from his rental operations or that his son is capable of financing the reorganization plan — as the bankruptcy court observed, "[t]here's been no proof provided the trustee with regard to income being supplemented by the son even after numerous requests." Tr. at 16:14-16. Nor did Mr. Planavsky ever obtain financing from his son.

Consequently, there is no evidence in the record to support Mr. Planavsky's belief that he is capable of meeting his obligations under a restructuring plan or that the reorganization would result in a viable business, especially as his financial condition made no significant improvement despite receiving the benefits of bankruptcy protection during the boom years of 2002-2008. Bankr. Dkt. 333 (Exhibit A). His tax liabilities are too high and his income is too low. The bankruptcy court was not required to adhere to his unreasonable belief that he would be able to reduce his tax liabilities. Loop, 379 F.3d at 518. Therefore, Mr. Planavsky's history of dilatory and litigious behavior, including his unwillingness to mediate with his tax creditors, his repeated submission of inadequate disclosure statements, and his refusal to address objections to the reorganization plan, all suggest that there is no "reasonable possibility of a successful reorganization within a reasonable time." Brown, 951 F.2d at 572.

In light of this evidence, the bankruptcy court did not clearly err when it found that there was no reasonable likelihood to expect a chapter 11 reorganization plan to be confirmed.

II. Mr. Planavsky's Arguments on Appeal Are Unavailing.

Mr. Planavsky raises two arguments on appeal: (1) his due process rights were violated because his bankruptcy case was converted from one under chapter 11 to one under chapter 7 without an evidentiary hearing and (2) the conversion order was erroneous due to the bankruptcy court's deviation from "the law of the case." Appellant's Brief at 2-3. This Court does not need to consider those arguments because they have been raised for the first time on appeal.

A. Because Mr. Planavsky Did Not Initially Present His Arguments to the Bankruptcy Court, They Have Been Waived on Appeal.

"An argument raised for the first time on appeal is typically forfeited." Katel L.L.C. v. AT & T Corp., 607 F.3d 60, 68 (2d Cir. 2010). "[T]his rule is prudential, not jurisdictional," and an appellate court "may consider a forfeited argument if there is a risk that 'manifest injustice' would otherwise result." Id. But "the circumstances normally do not militate in favor of an exercise of discretion to address new arguments on appeal where those arguments were available to the parties below and they proffer no reason for their failure to raise the arguments below." In re Nortel Networks Corp. Sec. Litig., 539 F.3d 129, 133 (2d Cir. 2008).

There is no risk of "manifest injustice" here. Mr. Planavsky had two opportunities to present these arguments to the bankruptcy court. First, he could have raised these arguments when he filed his written opposition to the United States Trustee's motion to convert his bankruptcy case. Bankr. Dkt. 336. Second, he could have raised these arguments at the hearing on the conversion motion. See generally Transcript. He did not. And the record shows no reason why he could not have raised them below. Therefore, Mr. Planavsky has waived these arguments.

B. Even If This Court Decided to Consider Mr. Planavsky's Arguments, They Are Entirely Without Merit.

1. The Bankruptcy Court Provided the Due Process Required Under the Bankruptcy Code Prior to Converting Mr. Planavsky's Case.

First, the bankruptcy court did not violate Mr. Planavsky's due process rights by converting his case without holding an additional evidentiary hearing. Section 1112(b) provides that "after notice and a hearing, the court may convert a case under this chapter to a case under chapter 7 of this title." § 1112(b). The Bankruptcy Code defines "notice and a hearing" as "notice as is appropriate in the particular circumstances, and such opportunity for a hearing as is appropriate in the particular circumstances." 11 U.S.C. § 102(1)(A). Additionally, the Bankruptcy Code "authorizes an act without an actual hearing if such notice is given properly and if such a hearing is not requested timely by a party in interest." § 102(1)(B)(I).

The Second Circuit has held that a bankruptcy court need not always hold "a full evidentiary hearing prior to the entry of a conversion order." Tiana Queen, 749 F.2d at 150. In this circuit, "[w]hen the record is sufficiently well developed to allow the bankruptcy court to draw the necessary inferences to [convert] a Chapter 11 case for cause, the bankruptcy court may do so." C-TC 9th Ave. P'ship, 113 F.3d at 1312. The Eighth Circuit has also held that a chapter 11 case can be converted or dismissed without an evidentiary hearing. Loop, 379 F.3d at 519.

In Tiana Queen, the Second Circuit affirmed a conversion order under circumstances very similar to Mr. Planavsky's case. Tiana Queen, 749 F.2d at 150. Like Mr. Planavsky, the debtors in Tiana Queen argued that a section 1112(b) conversion was entered without "notice and a hearing" because the bankruptcy court did not hold a "full evidentiary hearing" prior to the entry of the conversion order. Id. The Second Circuit rejected this argument, explaining that "the record reveals that the appellants were on notice that the conversion . . . was being considered." Id. As the Second Circuit observed, "the appellants had ample opportunity to argue against conversion" over the course "of a period of several months" when "the debtors, the secured and unsecured creditors, and the United States Trustee gave their views on the critical issues" of the likelihood of rehabilitation of the estate and prejudice to the creditors. Id. Thus, there was "no such specific need for further development of the record." Id.

In Mr. Planavsky's case, the record was sufficiently developed, based on nine years of failure to confirm a plan. Mr. Planavsky had the ability to put on evidence, but chose not to do so. Mr. Planavsky received notice of the United States Trustee's motion to convert. Bankr. Dkt. 334. Mr. Planavsky had an opportunity to respond to the United States Trustee's motion, and utilized that opportunity by submitting a written opposition to the bankruptcy court and participating at the court's hearing on the motion to convert. See generally Transcript. But, Mr. Planavsky never requested a separate evidentiary hearing, or ever described what new, specific evidence would have been presented at an additional hearing. Id.

In addition, much of the evidence in the record that established cause for the conversion was based upon material that Mr. Planavsky supplied. Mr.

Planavsky's monthly operating reports, for example, documented his deteriorating financial position. Bankr. Dkt. 333 (Exhibit A). And Mr. Planavsky estimated that he would be unable to meet his financial obligations under his proposed reorganization plan. Bankr. Dkt. 280 at 4. Finally, Mr. Planavsky never challenged the accuracy of the data that he submitted, so it was reasonable for the court to rely upon it when it found cause to convert Mr. Planavsky's bankruptcy case. To the extent that there is no evidence on the record concerning Mr. Planavsky's ability to obtain third-party funding from his son, that is Mr. Planavsky's fault: Despite multiple requests from the case trustee, Mr. Planavsky never submitted any proof to support his contention that his son could or would come to Mr. Planavsky's rescue. Tr. at 16:14-16. And that this never happened at any point in the case's nine-year history is telling.

Mr. Planavsky cannot now complain that — despite having multiple opportunities to submit favorable evidence on the record, filing a written objection to the motion to convert, and participating at oral argument on whether his case should be converted — the bankruptcy court failed to provide him with adequate process prior to conversion solely because it did not conduct an additional evidentiary hearing. Just like in Tiana Queen, since the record was sufficiently developed at the time the court considered the motion to convert, the bankruptcy court did not deny Mr. Planavsky his procedural rights by ruling without an additional evidentiary hearing. Tiana Queen, 749 F.2d at 150; see also C-TC 9th Ave. P'ship, 113 F.3d at 1312; accord Loop, 379 F.3d at 519.

2. The Law of the Case Doctrine Is Inapplicable.

Second, Mr. Planavsky cannot rely upon the law of the case doctrine to excuse his refusal to timely obtain appraisals of his properties for the years in which he is contesting his tax liability on such properties. The "law of the case" doctrine states, "when a court decides upon a rule of law, that decision should continue to govern the same issues in subsequent stages of the same case." Arizona v. California, 460 U.S. 605, 618 (1983). "Application of the law of the case doctrine varies depending upon the context" and a trial court my revise an order "at any time before the entry of final judgment." Rezzonico v. H & R Block, Inc., 182 F.3d 144, 148 (2d Cir. 1999). "The law of the case doctrine is discretionary, not mandatory" and "does not purport to be a legally binding limitation on the court's authority to reconsider such matters." Id. at 149.

The law of the case doctrine does not apply because Mr. Plavansky is attempting to rely upon the order establishing the value in 2002 for a limited subset of his properties located within the city of Binghamton for the purpose of determining his 2001 tax liability on the properties. Bankr. Dkt. 60. The bankruptcy court made a limited finding of fact regarding the 2002 value of the property and did not announce a rule of law. Furthermore, on February 17, 2010, the bankruptcy court held that proper valuation for purposes of 11 U.S.C. §505 (determining tax liability) is a "moving target" and that Mr. Planavsky had the burden of establishing such value for each year under which he sought consideration. In re Planavsky, No. 01-63125-6-dd (Bankr. N.D.N.Y. Feb. 17, 2010). Mr. Planavsky could have appealed this decision. He did not.

The "law of the case" doctrine does not require a property's value in 2002 to control in tax assessments nearly a decade later, nor does it allow Mr. Planavsky to engage in a collateral attack on the bankruptcy court's February 2010 order to avoid suffering the consequences from his refusal to comply with that order.

CONCLUSION

For these reasons, the United States Trustee respectfully asks this Court to affirm the order entered below.

Dated: December 6, 2010

Respectfully submitted,

RAMONA D. ELLIOTT
General Counsel

P. MATTHEW SUTKO
Associate General Counsel

NOAH M. SCHOTTENSTEIN
Trial Attorney

Executive Office for United States Trustees
United States Department of Justice
20 Massachusetts Avenue N.W.
Washington, D.C. 20530
Telephone: (202) 305-2796
Facsimile: (202) 305-2397
Email: noah.m.schottenstein@usdoj.gov

TRACY HOPE DAVIS
United States Trustee for Region 2

GUY VAN BAALEN
Assistant United States Trustee

By: /s/ Erin P. Champion
ERIN P. CHAMPION (Bar I.D. 510812)
Trial Attorney

Office of the United States Trustee
United States Department of Justice
10 Broad Street, Suite 105
Utica, New York 13501
Telephone: (315) 793-8191
Facsimile: (315) 793-8133
Email: Erin.Champion@usdoj.gov

PLAZA de DIEGO I

(Cite as: 1990 WL 728534 (USTBRIEFS))

[*1] Title (TI):	IN RE PLAZA DE DIEGO SHOPPING CENTER -&- IN RE ROBERT L. COLEY, UST — PETITION FOR WRIT OF MANDAMUS -&- BRIEF OF APPELLANT
Court (CO):	CTA1, U.S. Court of Appeals (1st Cir.)
Current-Case (CCN):	No. 90-1038
Previous-Case (PCN):	No. N/A
Source (SO):	U.S. TRUSTEES
Date-of-Filing (DA):	January 25, 1990
Author (AU):	Martha L. Davis (202-307-1399)
Topic (TO):	BANKRUPTCY — Whether District Court improperly appointed a case trustee, notwithstanding that under 11 U.S.C. § 1104(c) only U.S. Trustee has authority to appoint a trustee.
Summary (SU):	The District Court's appointment should be set aside either under a writ of mandamus or, alternatively, pursuant to 28 U.S.C. § 1291 and the "collateral order" rule of Cohen v. Beneficial Industrial Loan Corp., 337 U.S. 541, 545-47 (1949). Accord: In re Plaza de Diego, 911 F.2d 820 (1st Cir. 1990) (where UST was willing to appoint case trustee, it was ultra vires for District Court to supplant UST by appointing case trustee directly).

No. 90-1038

IN THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

IN RE: ROBERT L. COLEY, UNITED STATES TRUSTEE,
Petitioner.

IN RE: PLAZA DE DIEGO SHOPPING CENTER, INC.

ON PETITION FOR A WRIT OF MANDAMUS TO, AND APPEAL FROM THE DECISION OF, THE
UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF PUERTO RICO

PETITION FOR A WRIT OF MANDAMUS & BRIEF OF APPELLANT

OF COUNSEL:

JOHN E. LOGAN
General Counsel

MARTHA L. DAVIS
Attorney
Executive Office
For United States Trustees
Washington, D.C. 20530

STUART M. GERSON
Assistant Attorney General

WILLIAM KANTER
(FTS/202) 633-3618

DWIGHT G. RABUSE
(FTS/202) 633-3159
Attorneys, Appellate Staff
Civil Division, Room 3631
Department of Justice
Washington, D.C. 20530

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1 Collier on Bankruptcy ¶ 3.01 (15th ed. 1989)

IN THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT
NO. 90-1038

IN RE: ROBERT L. COLEY, UNITED STATES TRUSTEE,
Petitioner.

[*3]

IN RE: PLAZA DE DIEGO SHOPPING CENTER, INC.

ON PETITION FOR A WRIT OF MANDAMUS TO, AND APPEAL FROM THE DECISION OF,

THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF PUERTO RICO

PETITION FOR A WRIT OF MANDAMUS & BRIEF OF APPELLANT

STATEMENT OF THE ISSUE PRESENTED AND RELIEF SOUGHT

1. Whether this Court should issue a writ of mandamus directing the district court to withdraw its appointment of a bankruptcy trustee since, pursuant to 11 U.S.C. 1104(c), only the United States Trustee has the authority to appoint the trustee.

2. In the alternative, whether this Court should, pursuant to 28 U.S.C. 1291 and the "collateral order" rule of Cohen v. Beneficial Industrial Loan Corp., 337 U.S. 541, 545-47 (1949), set aside the district court's order appointing a trustee.

STATEMENT OF THE FACTS

This case arises from the decision of the court below that it, rather than the U.S. Trustee, would appoint the bankruptcy trustee to administer the debtor's affairs.

After the debtor, the Plaza De Diego Shopping Center, Inc., filed for bankruptcy under Chapter 11, its shareholders initiated Racketeer Influenced and Corrupt Organization Act (RICO) [**FN**1] actions against three of the shopping center's creditors. One of the creditors then moved for the appointment of a trustee pursuant to 11 U.S.C. 1104(a). The Office of the United States Trustee also moved for the appointment of trustee, on the grounds of mismanagement by the debtor-in-possession.

On June 19, 1989, Chief U.S. District Judge Perez-Gimenez, sitting, he believed, as a bankruptcy judge, ordered the appointment of a trustee. [**FN**2] He further ordered that the U.S. Trustee within five days submit for his consideration the names of three candidates for trustee. Judge Perez-Gimenez' order further stated that he would review the U.S. Trustee's candidates -- and any candidates suggested by "any party in interest" -- and that the court would then "approve the appointment of one of the candidates." Slip. op. at 4. [**FN**3]

The U.S. Trustee objected, and filed a motion to alter or amend the order on the ground that under 11 U.S.C. 1104(c) the U.S. Trustee, not the court, is to appoint the trustee, subject only to the court's approval. With this motion, the U.S. Trustee submitted a Notice of Appointment naming Mr. Roberto Lopez Alvarez as trustee, subject to the court's confirmation. On June 29, 1989, the court, without explanation, denied approval to the appointment of Mr. Alvarez and again directed the U.S. Trustee to submit three candidates for the court's consideration.

Subsequently, during an "emergency" hearing on other bankruptcy matters convened on July 13, 1989, the district court, sua sponte and over the objection of the U.S. Trustee, "expanded" the scope of the hearing to include the matter of appointing a trustee. The court put forward the name of its suggested trustee candidate, one Pedro J. Fuste. After finding that members of the creditors committee generally approved of the idea of Mr. Fuste serving as trustee, Judge Perez-Gimenez declared his intention to confirm Mr. Fuste's "appointment", and gave the U.S. Trustee until July 18 to inform the court of its position on his proposed action. The U.S. Trustee again objected, reminding the court that only the U.S. Trustee has authority under the bankruptcy laws to make this appointment.

[*4] In its Opinion and Order of July 20, 1989, the district court confirmed the appointment of Mr. Fuste as trustee. In support of its decision, the court explained that the state of the debtor's affairs made quick action in appointing a trustee imperative, and that it had chosen to ask for candidates and make the appointment itself "in order to expedite the process of selecting a qualified trustee." Slip op. at 5.

The court rejected the U.S. Trustee's argument that this unusual method of appointing the trustee violated 11 U.S.C. 1104(c). While conceding that "the statute does speak of the submission of 'one disinterested person"' by the U.S. Trustee, Judge Perez-Gimenez concluded that the statute was not "meant to preclude" the method he had adopted. Slip op. at 8. Furthermore, the court opined that it had not in fact usurped the U.S. Trustee's appointment power, since, in the court's view, "the appointment of the trustee power remained at all time in the U.S. Trustee, while the power of approval remained at all times in the Court." Accordingly, the court stated, its appointment was merely "a time saving measure with the success of the Chapter 11 reorganization in mind," made pursuant to its inherent equitable power to "do what needs to be done." Id. at 10.

STATEMENT REGARDING JURISDICTION

It appears that Judge Perez-Gimenez, the Chief Judge for the United States District Court for the District of Puerto Rico, believed throughout these proceedings that he was acting as a bankruptcy court judge, rather than as a district court judge sitting in bankruptcy. Were the decision to appoint Mr. Fuste truly that of the bankruptcy court, appeal therefrom properly would lie in the district court pursuant to 28 U.S.C. 158(a). As we explain below, however, the decision below could not have been that of the bankruptcy court. Under the revised Bankruptcy Code it is not possible for a federal district judge to act as the bankruptcy court. It is possible, however, for the federal district court to assert original jurisdiction over the bankruptcy, with the district court sitting in bankruptcy. When a district judge makes a final bankruptcy decision pursuant to the district court's original jurisdiction, as opposed to the district court's appellate jurisdiction to review a bankruptcy judge's determination, the appeal lies in the circuit court of appeals.

Under the Bankruptcy Reform Act of 1978, 11 U.S.C. 101 et seq., original jurisdiction over bankruptcy cases was vested in the bankruptcy courts. In Northern Pipeline Construction Co. v. Marathon Pipeline Co., 458 U.S. 50 (1982), however, the Supreme Court held that bankruptcy court jurisdiction over "non-core" bankruptcy disputes was unconstitutional. Following the Marathon Pipeline decision, Congress amended the Bankruptcy Code through passage of the Bankruptcy Amendments and Federal Judgeship Act of 1984. [**FN**4] The 1984 amendments cured the constitutionality problem by providing that "the district court shall have original and exclusive jurisdiction of all cases under title 11." 28 U.S.C. 1334(a) (1985).

[*5] As a result of the 1984 Act, bankruptcy courts became adjuncts of the district courts. [**FN**5] Functionally, though, bankruptcy courts were revested with the authority to adjudicate "core" bankruptcy disputes in the first instance. The Act provided that while the district courts possess original jurisdiction over bankruptcies, "[e]ach district court may provide that any or all cases under title 11 * * * shall be referred to the bankruptcy judges for the district." 28 U.S.C. 157(a).

At this time all district courts, including Puerto Rico's, have provided by rule for the automatic reference of all title 11 cases to bankruptcy judges. See 1 Collier on Bankruptcy ¶ 3.01 (15th ed. 1989). Reference is not irrevocable, however, and a case may be withdrawn by the district court at any time. 28 U.S.C. 157(d). There is no provision in the Code, however, for a district court judge to act as a bankruptcy judge.

Notwithstanding his inability to so act, Judge Perez-Gimenez appears to have believed that he was acting as a bankruptcy judge throughout the proceedings below. The case was captioned and docketed as a bankruptcy court case, and all files were kept in the bankruptcy court. Judge Perez-Gimenez' Opinion and Order of June 29, like all other orders in this case, was issued as a decision of "The United States Bankruptcy Court for the District of Puerto Rico." Moreover, that opinion seems clearly to assume that in making the appointment of the trustee, Judge Perez-Gimenez was acting as judge of the bankruptcy court.

For the reasons already stated, however, Judge Perez-Gimenez could not have been acting as the de jure bankruptcy judge. Rather, once Puerto Rico's two bankruptcy judges had recused themselves from this case, it necessarily reverted to the jurisdiction of the district court, notwithstanding the fact that Judge Perez-Gimenez never formally withdrew the reference from the bankruptcy court. This conclusion is supported both by the case law and the structure of the bankruptcy appeals process itself.

For example, a similar jurisdictional question was presented in Klenske v. Goo (In re Monoa Finance Company, Inc.), 781 F.2d 1370 (9th Cir. 1986), where a district judge had assumed control of a case following the bankruptcy judge's refusal. The papers in the case, however, continued to be filed in the bankruptcy court, some with bankruptcy court and some with district court headings. After the judge granted summary judgment in one dispute in the litigation, the losing party appealed to the Ninth Circuit. Initially, the party prevailing on summary judgment argued that the court of appeals lacked jurisdiction over a direct appeal from what it believed was a decision of the bankruptcy court.

The Ninth Circuit disagreed, reasoning that a bankruptcy decision by a district court judge can only be a decision of the district court. While acknowledging that the trial judge believed himself to be "sitting as the bankruptcy court," the court of appeals concluded that this could not change the fact that "he is a district judge." Id. at 1372. In holding that appeal from the district judge's decision was properly made to the court of appeals, the Ninth Circuit observed that it was "logical to assume" that Congress had provided in 11 U.S.C. 158 for appeals from final bankruptcy court decisions to be lodged in the district court "to prevent an appeal to this court before an Article III judge had ruled on an issue." Id. This concern, however, was "not present if the original decision was made by an article III district judge." Id. [**FN**6]

[*6] The Klenske court also emphasized the a strong practical considerations why the decision of the district judge, sitting in bankruptcy, must be appealed to the court of appeals:

> if appeal is not taken to this court, it would go to the district court of the district that includes the bankruptcy court, 28 U.S.C. 158(a) * * * it does not make sense to have appeals from an Article III judge heard by * * * another judge of that judge's district court. We accordingly will hold that we will treat an appeal from the decision of a district court judge sitting as a bankruptcy court as an appeal from a final decision of a district court appealable under 28 U.S.C. 1291.

Id.

The same considerations, obviously, obtain here. There is no jurisdictional reason for the decision of Chief District Judge Perez-Gimenez to be reviewed by another district judge. Nor does it make any practical "sense" to appeal his decision to the district court. Accordingly, relief is properly sought from this Court. [**FN**7]

STATEMENT OF REASONS WHY THE WRIT SHOULD ISSUE

I. A WRIT OF MANDAMUS SHOULD ISSUE TO DIRECT THE DISTRICT COURT TO WITHDRAW ITS APPOINTMENT OF A TRUSTEE, AND, AS REQUIRED BY 11 U.S.C. 1104(C), PERMIT THE UNITED STATES TRUSTEE TO APPOINT THE STANDING TRUSTEE

A writ should issue "to confine the [district court] to a lawful exercise of its prescribed jurisdiction." Roche v. Evaporated Milk Association, 319 U.S. 21, 26 (1943). Contrary to law and over the government's repeated objections, the court below assumed to itself the authority to appoint the trustee. Therefore, the preemptory writ is appropriate to correct a course of action "amounting to a 'judicial usurpation of power.'" Will v. United States, 389 U.S. 90, 95 (1967) quoting DeBeers Consol. Mines, Ltd. v. United States, 525 U.S. 212, 217 (1945). Mandamus is necessary to return the authority to appoint trustees the rightful party: the United States Trustee. [**FN**8]

11 U.S.C. 1104(c) plainly states that the U.S. Trustee, not the court, shall appoint the trustee in bankruptcy cases. The statute provides:

> If the court orders the appointment of a trustee * * * then the United States trustee, after consultation with the parties in interest, shall appoint, subject to the court's approval, one disinterested person other than the United States Trustee to serve as trustee * * * in the case.

(emphasis supplied). Obviously, the statute admits of no interpretation other than that urged by the government. Where, as here, the court decides that a trustee is to be appointed, the U.S. Trustee makes the appointment, subject only to the court's approval. Nothing in section 1104(c), or any other provision of the Bankruptcy Code, reposes the power of appointment in the bankruptcy or district courts.

In view of this statute's clarity, it is, of course, unnecessary to look further to interpret its meaning. "The 'plain purpose' of legislation * * * is to be determined in the first instance with reference to the plain language of the statute itself." Board of Governors of the Federal Reserve System v. Dimension Financial Corp., 474 U.S. 361, 373 (1986). See also Burlington Northern R.R. Co. v. Oklahoma Tax Comm'n, 107 S.Ct. 1855, 1860 (1987) ("When we find the terms of a statute unambiguous, judicial inquiry is complete"). Nonetheless, a look behind this unambiguous statute reveals that Congress had many good reasons to get bankruptcy judges out of the business of appointing trustees. Indeed, the U.S. Trustees were created for the express purpose of taking on many of the ministerial and administrative duties, including the selection of trustees, previously born by bankruptcy judges. Contrary to the district court's opinion, the statute was "meant to preclude" the method of appointment employed by Judge Perez-Gimenez. The court's decision to name its own candidate as trustee in this case is more than a mere usurpation of the U.S. Trustee's authority; it is precisely the practice that Congress intended to stop.

A. The Legislative History Behind 11 U.S.C. 1104(c) Confirms That Congress Intended To Prohibit The Appointment of Trustees By The Courts.

[*7] Section 1104(c) was added to the Bankruptcy Code through enactment of the "Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1986" [**FN**9] ("the 1986 Act"). Prior to the 1986 Act, U.S. Trustees were empowered to appoint trustees in specified districts under the U.S. Trustee pilot program in effect following enactment of the Bankruptcy Reform Act of 1978 ("the 1978 Act"). Under the 1978 Act, 11 U.S.C. 151104 provided -- in language identical to the current section 1104(c) -- for U.S. Trustees in pilot program districts to appoint bankruptcy case trustees. The 1986 Act transmogrified the United States Trustee program from the pilot program that had been in effect in 18 judicial districts to a permanent, nationwide program. [**FN**10]

In the course of expanding the U.S. Trustee program, the 1986 Act amended the Bankruptcy Code to accommodate the more comprehensive role of the U.S. Trustees. Among the changes was an amended 11 U.S.C. 1104(c), the statutory provision governing the appointment of trustees in Chapter 11 cases. Prior to the 1986 Act, section 1104(c) permitted the appointment of trustees by the court in non-pilot program districts. The amended section 1104(c), however, codified the pilot-program's trustee appointment provision, former 11 U.S.C. 151104 (1978). As amended, section 1104(c) states unambiguously that the U.S. Trustee, not the court, "shall appoint, subject to the court's approval, one disinterested person other than the United States Trustee to serve as trustee in the case."

Thus, in view of the statute's evolution, section 1104(c) is best understood in light of the legislative history behind section 151104 of the 1978 Act and the history of the 1986 amendments. That history demonstrates that Congress shifted the power of appointment from judges to the U.S. Trustees for two reasons: (1) to free bankruptcy judges from burdensome administrative tasks and, more important, (2) to avoid the possibility or appearance of a conflict of interest necessarily arising when a judge must decide matters litigated between a trustee of his own selection and other parties to the bankruptcy. [**FN**11] See generally H.R. Rep. No. 595, 95th Cong. 1st Sess. 88-89 reprinted in U.S. Code Cong. & Admn. News 5787, 6049-6061. [Hereinafter "the 1978 legislative history."]

A principal concern for Congress was the operation of "bankruptcy rings," among bankruptcy lawyers and the courts, wherein judges appointed practioners well known to them as trustees, set their compensation, and then ruled on disputes between their hand-picked candidates and parties to the bankruptcy. [**FN**12]

Accordingly, the 1978 Act sought to remedy these problems by relegating judges to a purely judicial role. In the pilot districts U.S. Trustees were "to perform the supervisory and appointing functions [previously handled] by bankruptcy judges." Under the new scheme, a bankruptcy judge was merely to decide that a trustee was necessary to administer the debtor's affairs. The U.S. Trustee would select the case trustee, and it was expected that appointment would be confirmed in all but the most extraordinary cases. As the House Report explains:

> **[*8]** If the court determines that a trustee is to be appointed in the case, the bill separates the court from the appointing process. The United States Trustee will make the appointment, after consultation with parties in interest and subject to approval by the court. The court's approval should in most cases be perfunctory, and is available mainly as a safeguard against impropriety on the part of the United States Trustee. Under current chapter X, the court appoints the trustee. The court's involvement in the process not only appears to be improper when the court must later rule in the litigation between the court's appointee (the trustee) and an adverse party, but had also led to cronyism in some instances and unqualified or incompetent trustees. Again, the separation of the court from the administration of the case should lead to fairer and more efficient administration.

Id. at 6194.

Following the success of the pilot program, the U.S. Trustee system was made permanent and universal in the 1986 Act. The legislative history behind the 1986 Act, reiterates and confirms the congressional conclusion that judge- appointed trustees are a bad idea. As the House report on the 1978 bill explains:

> The handling of both administrative and judicial functions by the bankruptcy courts had eroded the public confidence in the bankruptcy system. An example of this could be seen in the appointment by the bankruptcy court of private trustees to administer bankrupt debtors estates. In many cases, these trustees appeared in bankruptcy courts before the very same judges who appointed them to make recommendations regarding matters of the estate. In such circumstances, a trustee would often be reluctant to take positions, contrary to the judge who appointed the trustee, even though the trustee was supposed to be an impartial administrator of the estate. This awkward relationship between trustees and judges created

> an improper appearance of favoritism, cronyism, and bias, and generate great disrespect for the bankruptcy system.

The report then notes that to help accomplish the separation of judicial and administrative functions, "[t]he U.S. Trustees were given responsibility for many of the administrative functions that had previously been handled by the bankruptcy courts (such as appointing individuals to serve as private trustees to handle administrative duties in chapter 7 and chapter 13 cases * * * and appointing a trustee in Chapter 11 reorganization proceedings when ordered by the court). H.R. Rep. No. 764, 99th Cong., 2nd Sess. 28 reprinted in 1986 U.S. Code Cong. & Ad. News 5227, 5230. [hereinafter "the 1986 Legislative History"]. [**FN**13]

Not surprisingly, the plain-meaning interpretation of the statute, clearly supported by the legislative history, has been accepted in the opinions of the courts which have examined the respective roles of the courts and the U.S. Trustees under the Bankruptcy Code amendments. "As the legislative history of the Bankruptcy Code indicates, the establishment of the office of the United States trustee is designed to accomplish the separation of judicial and administrative functions currently performed by bankruptcy judges." In re Kontaratos, 15 B.R. 298, 299 (Bkrtcy. App. 1st Cir. 1981). As a result of the 1978 and 1986 Acts, "[t]he U.S. Trustee, rather than the court * * * will appoint trustees, supervise administration of bankruptcy cases, and exercise any other function prescribed by the Attorney General * * *" id. at 300.

[*9] Indeed, Congress' decision to vest the authority to select the trustee in the U.S. Trustee has been held even to limit the grounds on which a court may veto the U.S. Trustee's appointment of a trustee. In the case of In re Lathrop Mobile Investors, 55 B.R. 766 (Bkrtcy. App. 9th Cir. 1985), a bankruptcy appellate panel reviewed an appeal "rais[ing] questions as to the respective roles of the bankruptcy judge and the United States Trustee in the appointment process for a Chapter 11 trustee." Id. at 767. In the underlying case, the bankruptcy judge, in chambers, refused to confirm the U.S. Trustee's appointee because the proposed trustee was not drawn from the county's bankruptcy panel. On the U.S. Trustee's motion for reconsideration, the bankruptcy court again refused to confirm, and ordered the U.S. Trustee to choose an appointee from the county panel.

The appellate panel reversed for the "fundamental reason [that] the trial court's procedure was inappropriate * * *" id. at 768. The appellate court reasoned that under Chapter 11 there was no legitimate ground for constricting the U.S. Trustee's choices to members of the trustee panels, and certainly no basis for vetoing the U.S. Trustee's appointment in chambers, since a public proceeding would best promote the avoidance of any appearance of cronyism -- the very end which the amendments, by lodging the appointment power in the U.S. Trustee, sought to achieve. In sum, the plain meaning of section 1104(c), its legislative history, and its interpretation by the courts all demonstrate that the U.S. Trustee, not the district court, should have appointed the trustee in this case.

B. The Court Below Had No "Equitable Authority" To Appoint A Trustee.

Despite the apparent clarity of the statute, the court below "d[id] not believe, as the U.S. Trustee asserts, that this order [appointing the trustee] order contravenes the plain meaning of Section 1104(c)." Slip op. at 8. While conceding that "the statute does speak of the submission of 'one disinterested person," Judge Perez-Gimenez reasoned that he was not obligated to "read statutory words with a computer's ease" since the bankruptcy courts "operate under the overriding consideration that equitable principles govern the exercise of bankruptcy jurisdiction." Id. (citations omitted).

The appointment order was justified on the ground that "in the case at bar equitable considerations mandated an expedited approval procedure such as that contemplated by our order." Slip op. at 8-9. In addition to its "inherent" equitable power, the court found the authority to make the appointment in "the broad equity power granted by Section 105(a)." Id. at 10.

Contrary to Judge Perez-Gimenez view, however, neither section 105(a) nor the supposed inherent equity power of the bankruptcy court extends to override section 1104(c)'s clear command that the U.S. Trustee appoint bankruptcy trustees. Moreover, on the facts of this case, there was no advantage in the court rather the U.S. Trustee making the appointment.

[*1]0 11 U.S.C. 105(a) provides simply that "[t]he bankruptcy court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title." By its terms, it provides no warrant for the court to disregard the express commands of the Bankruptcy Code. Even as a court of equity, the bankruptcy court's equitable discretion is limited, and cannot be used in a manner inconsistent with the commands of the Bankruptcy Code. See, e.g., Johnson v. First National Bank of Montevideo, Minnesota, 719 F.2d 270 cert. denied 465 U.S. 1012 (1983); In re Alcap Manufacturing Co., 457 F. Supp. 1247 (D. Conn. 1978).

Moreover, in the instant case, the court's decision to appoint the trustee was neither "necessary" nor "apopriate" to protect the interests of creditors or the estate. Once the court ordered the appointment of a trustee, the U.S. Trustee acted promptly in consulting creditors and then appointing Mr. Roberto Lopez Alvarez as trustee. [**FN**14] Furthermore, since the court denied (without explanation) confirmation of Mr. Alvarez' appointment before it "appointed" its candidate, Mr. Fuste, as trustee, its actions cannot be defended as expediting the administration of the bankruptcy. Certainly there was an interest in arresting the "rapid deterioration" (Slip op. at 4) of the debtor's estate, but that objective justified only the rapid appointment of a trustee, not the rapid ultra vires appointment of a trustee by the court. Nothing in the record indicates that confirmation of the U.S. Trustee's appointee, Mr. Alvarez, would not have served these laudable objectives equally well.

II. THE ORDER APPOINTING THE COURT'S CANDIDATE, MR. FUSTE, IS AN APPEALABLE COLLATERAL

ORDER REVIEWABLE BY THIS COURT UNDER 28 U.S.C. 1291.

The sequence of the district court's actions, beginning with the June 20, 1989 order that the U.S. Trustee submit the names of three candidates for the court's review for appointment as trustee, through its order of July 20, 1989 "confirming" the appointment Mr. Fuste, constitute an ultra vires course of conduct amenable to correction through a writ of mandamus from this Court directing that the district court comply with 11 U.S.C. 1104(c). In the alternative, however, we submit that the July 20 order "confirming the appointment" of Mr. Fuste is an appealable collateral order subject to review by this Court under the doctrine of Cohen v. Beneficial Industrial Loan Corp., 337 U.S. 541, 545-47 (1949).

As we have explained above, [**FN**15] despite Judge Perez-Gimenez apparent impression that his orders were those of the bankruptcy court, the order appointing Mr. Fuste to be trustee could have only been that of the district court. Moreover, while this order does not conclusively resolve all issues among the parties to the bankruptcy litigation, it is clearly an appealable collateral order, ripe for review by this Court.

Within the scheme of the Bankruptcy Code, district courts [**FN**16] ordinarily review appeals from the final decisions of the bankruptcy courts. See 28 U.S.C. 158(a). These decisions are in turn appealable to the circuit courts of appeal, pursuant to 28 U.S.C. 158(d). When, however, the district court exercises its original jurisdiction over a bankruptcy case, review is to be had in the court of appeals pursuant to 28 U.S.C. 1291. See e.g., Triangali v. Hathaway Machinery Co., Inc., 796 F.2d 553 (1st Cir. 1986) ("Of course, this appeal coming directly from the district court, falls within the scope of 28 U.S.C. 1291").

[*1]1 In bankruptcy cases the finality requirement of section 1291 is more liberally and pragmatically applied than in most civil litigation. This owes to the special nature of bankruptcy litigation, in which separable issues ripe for final disposition more readily arise. Like other circuits, [**FN**17] this Court has held repeatedly that "in the bankruptcy context, the word 'final' has a somewhat special meaning. It is not limited to the single final order issued at the very end of an entire bankruptcy case" Triangali, supra, 796 F.2d at 558. Instead, in view of the relevant legislative history, it is clear that "Congress has long provided that orders in bankruptcy cases may be immediately appealed if they finally dispose of discrete disputes within the larger case" In re Saco Local Development Co., 711 F.2d 441, 445 (1983) (emphasis in original). Accordingly, "the concept of finality under [section 1291] has traditionally been applied in a more pragmatic and less technical way in bankruptcy cases than in other situations." A.H. Robbins Co. v. Piccinin, 788 F.2d 994, 1009 (4th Cir. 1986) quoted with approval in Triangoli, supra, at 558.

Thus, this Court has concluded that a " 'proceeding within a bankruptcy case * * * [not the entire case, is] the relevant 'judicial unit' for purposes of finality * * * *" id., at 558, quoting Saco, supra at 445. (elipses in original).

There is little question that the court's order of July 20 is exactly the sort of "discrete proceeding" appropriate for collateral review. Put simply, there is nothing left for the district court to do on the appointment issue. Judge Perez-Gimenez' choice as trustee is in place, and the U.S. Trustee's objection to the circumvention of 11 U.S.C. 1104(c) stands. Nothing that will happen in the overall bankruptcy dispute from this point forward will cure the district court's error, nor can the dispute between the court and the U.S. Trustee come into sharper focus. In these circumstances, this "order that conclusively determines a separable dispute" (Saco, supra, at 809 F.2d at 153) is ripe for review.

In sum, whether this Court chooses to issue mandamus to cure the district court's repeated refusal to recognize the U.S. Trustee's exclusive authority to appoint case trustees, or chooses to treat particularly the July 20 order through which the court below purported to appoint the trustee, it is clear that the district court's action was ultra vires and cannot stand. Review by this Court is appropriate to compel compliance with 11 U.S.C. 1104(c).

CONCLUSION

For the reasons set forth above, we respectfully request that a writ of mandamus issue directing the district court to permit the U.S. Trustee to appoint the Trustee or, in the alternative, that the district court's order of July 20 be reversed.

OF COUNSEL:
JOHN E. LOGAN
General Counsel
MARTIE DAVIS
Attorney
[*1]2 Executive Office
For United States Trustees
Washington, D.C. 20530

STUART M. GERSON
Assistant Attorney General
WILLIAM KANTER
(FTS/202) 633-3618

DWIGHT G. RABUSE
(FTS/202) 633-3159
Attorneys, Appellate Staff
Civil Division, Room 3631
Department of Justice
Washington, D.C. 20530
JANUARY 1990

CERTIFICATE OF SERVICE

I hereby certify that on this 25th day of January, 1990, I served the foregoing Petition for a Writ of Mandamus and Brief of Appellant by causing copies to be mailed, postage prepaid, to:

Jose Cardona Jimenez, Esq.
Condominio El Centro II
Suite 228
Hato Rey, Puerto Rico 00918

Pedro J. Fuste
Park Boulevard, Apt. 505
Santurce, Puerto Rico 00913

Maria Luise Contreras, Esq.
Post Office Box 2124
San Juan, Puerto Rico 00903

Arturo Garcia, Esq.
McConnell, Valdes & Kelly
GPO Box 4225
San Juan, Puerto Rico 00936

Dora Penagaricano, Esq.
Rodriguez, Ramon, Pena & Diaz
Post Office Box 2392
Hato Rey, Puerto Rico 00919

Juan M. Perez-Giminez
Chief Judge
Post Office Box 3671
Old San Juan Station
San Juan, Puerto Rico 00904

DWIGHT G. RABUSE

FOOTNOTES

FN1. 18 U.S.C. (& Supp. IV) 1961 - 1968.

FN2. Puerto Rico's two bankruptcy judges had recused themselves from this case. The case file was held in the bankruptcy court, and Judge Perez-Gimenez' orders were issued as "bankruptcy court" orders. Although he is a district court judge, he apparently never withdrew the reference of the case to the bankruptcy court, thus generating some confusion as to where appeal in this case lies. See "STATEMENT REGARDING JURISDICTION" infra.

FN3. "Slip op." citations are to the court's "Order and Opinion" of July 20, 1989.

FN4. Pub. L. 98-353, 98 Stat. 333 (1984).

FN5. 28 U.S.C. 151 provides that bankruptcy judges constitute a unit of the district court known as the bankruptcy court.

FN6. See also In re Matter of Hawaii Corp., 796 F.2d 1139, 1141 (9th Cir. 1986) ("this appeal comes to us directly from a federal district judge sitting in bankruptcy * * * * Appellate jurisdiction over appeals from district judges sitting in bankruptcy exists under 28 U.S.C. § 1291, the statute governing final decisions of a district court.")

FN7. Understandably, we have protected our appeal rights by noticing appeal both to the district court and to this Court.

Specifically, on July 12, 1989, we filed a notice of appeal to the district court from Judge Perez-Gimenez' order of June 20, 1989, which ordered the United States Trustee to submit the names of three candidates for appointment to the court, and from the order of June 29, 1989, wherein the court denied the United States Trustee's appointment of Roberto Lopez Alvarez as trustee. On July 28, 1989 we filed a notice of appeal to the district court from the order of July 18, 1989, wherein Judge Perez-Gimenez appointed Pedro J. Fuste as trustee. The July 28 order was confirmed by order of July 20, 1989.

On September 13, 1989, we filed a notice of appeal to this Court from the order of July 18, 1989, purporting to appoint Mr. Fuste as trustee. This notice of appeal, however, was at some point diverted from its intended recipient, the clerk of the district court, to the bankruptcy court. All of the U.S. Trustees' appeals (including, erroneously, the notice of appeal intended for the Court of Appeals) were then docketed as appeals to the district court, and a briefing deadline of January 2, 1990 was set. On December 20, 1989 the clerk of the district court "pursuant to instructions received from the Clerk's Office of the U.S. Circuit Court of Appeals" referred the September 13, 1989 appeal to this Court.

On December 22, 1989, the U.S. Trustee moved for a consolidation of the pending protective appeals to the district court and an extension of time to file a brief in the district court until January 29, 1990. This motion has been granted. On January 25, 1990, the U.S. Trustee requested the district court to stay disposition of the appeals to the district court, pending disposition of the petition and appeal to this Court.

FN8. As this Court has stated previously, a writ of mandamus is properly sought in cases involving "challenges to the authority of the district court to act." In re United States, 565 F.2d 173 (1st Cir. 1977). See also In re Arvedon, 523 F.2d 914, 916 (1st Cir. 1975); In re Ellsberg, 446 F.2d 954, 956 (1st Cir. 1971); In re Melvin, 546 F.2d 1, 2 (1st Cir. 1976).
Moreover, even should the decision of Judge Perez-Giminez be viewed as a decision of the bankruptcy court rather than the district court, mandamus from this Court is nonetheless appropriate. As we explained above, infra pp. 5-6, the Revised Bankruptcy Code established bankruptcy courts as adjuncts of the district courts. Accordingly, mandamus from this court to the bankruptcy court is, jurisdictionally, a species of mandamus to the district court. In any event, it is well settled that mandamus may be directed from a superior court to an inferior tribunal "in aid of appellate jurisdiction" even when, "no appeal has been perfected" to the superior court. FTC v. Dean Foods Co. 384 U.S. 597, 602-603 (1965). See also Refractarios Monterrey, S.A. v. Ferro Corp., 606 F.2d 966, 971 (Ct. Pat. App. 1979).

FN9. Pub. L. No. 99-554, 100 Stat. 3088 (1986).

FN10. Pursuant to the transition provisions of section 302 of the 1986 Act, the United States Trustee program became effective in Puerto Rico on August 23, 1987.

FN11. As the House Report states:

> It is enough of a reason for change that these functions and duties of the bankruptcy judge constitute no part of his judicial responsibilities, and divert him from the important judicial and legal work that must be done in bankruptcy cases. However, if that were the system's only vice, adjustments less than those proposed in the bill might suffice. Deeper problems arise because of the inconsistency between the judicial and administrative roles of the bankruptcy judges. The inconsistency places him in an untenable position of conflict, and seriously compromises his impartiality as an arbiter of bankruptcy disputes.

1978 Legislative History at 6050.

FN12. The House Report observes that:

> litigants and observers frequently object to the apparent, and in many case real, cronyism between bankruptcy judges and their trustees. The "bankruptcy ring" is reflected not only in the appearance of unfairness in bankruptcy judges ruling in litigation between their appointees and third parties, but also in the awarding of compensation by the appointing authority * * * *.
> There is an unusually close relationship between the bankruptcy judges and the bankruptcy bar, especially the debtors' and trustees' bars. They are in frequent contact with the judge as a result of the necessity for the judge's review of the administrative actions of the trustee or debtor in possession. Usually, a trustee is appointed by the bankruptcy judge, and is appointed in numerous cases before the same judge. Debtor's attorneys make frequent appearances in the same court representing numerous different debtors. All of these contacts and relationships have led to a feeling among bankruptcy practioners that there is a "bankruptcy ring" that has an inside track on all bankruptcy matters the judge's favoritism.

1978 Legislative History at 6056.

FN13. See also 1986 Legislative History at 5241: "Section 219 amends 11 U.S.C. to make it clear that the U.S. Trustee can seek the appointment of a trustee or examiner in a chapter 11 case. If the court orders the appointment to be made, the U.S. Trustee makes the appointment, subject to the court's approval." (emphasis supplied).

FN14. Two creditors, City Federal Savings Bank and the Banco National, supported the appointment of Mr. Fuste and filed oppositions to the U.S. Trustee's Motion to Alter or Amend the court's order appointing Fuste. They were, however, consulted by the U.S. Trustee prior to the decision to appoint Mr. Alvarez.

FN15. See pp. 4-9, supra.

FN16. Or bankruptcy appellate panels established pursuant to 28 U.S.C. 158(b) by the judicial council of the circuit.

FN17. See, e.g., A.H. Robbins Co. v. Piccinin, 788 F.2d 994, 1009 (4th Cir. 1986); In re Amatex Corp., 755 F.2d 1034, 1039 (3d Cir. 1985); In re Olson, 730 F.2d 1109-10 (8th Cir. 1984); In re UNR Industries, Inc., 725 F.2d 1111, 1115-16 (7th Cir. 1984).

1990 WL 728534 (USTBRIEFS)

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(Cite as: 1990 WL 728535 (USTBRIEFS))

[*1] Title (TI):	IN RE PLAZA DE DIEGO SHOPPING CENTER -&- IN RE ROBERT L. COLEY — UST PETITION FOR WRIT OF MANDAMUS -&- REPLY BRIEF OF APPELLANT
Court (CO):	CTA1, U.S. Court of Appeals (1st Cir.)
Current-Case (CCN):	No. 90-1038
Previous-Case (PCN):	No. N/A
Source (SO):	U.S. TRUSTEES
Date-of-Filing (DA):	April 23, 1990
Author (AU):	Martha L. Davis (202-307-1399)
Topic (TO):	BANKRUPTCY — Whether District Court improperly appointed a case trustee, notwithstanding that under 11 U.S.C. § 1104(c) only U.S. Trustee has authority to appoint a trustee.
Summary (SU):	The District Court's appointment should be set aside either under a writ of mandamus or, alternatively, pursuant to 28 U.S.C. § 1291 and the "collateral order" rule of Cohen v. Beneficial Industrial Loan Corp., 337 U.S. 541, 545-47 (1949). Accord: In re Plaza de Diego, 911 F.2d 820 (1st Cir. 1990) (where UST was willing to appoint case trustee, it was ultra vires for District Court to supplant UST by appointing case trustee directly).

Nos. 90-1038 and 90-1163
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IN RE: ROBERT L. COLEY, UNITED STATES TRUSTEE,
Petitioner.

IN RE: PLAZA DE DIEGO SHOPPING CENTER, INC.

ON PETITION FOR A WRIT OF MANDAMUS TO, AND APPEAL FROM THE DECISION OF, THE
UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF PUERTO RICO

PETITION FOR A WRIT OF MANDAMUS & REPLY BRIEF OF APPELLANT

OF COUNSEL:

JOHN E. LOGAN
General Counsel

MARTHA L. DAVIS
Attorney
Executive Office
For United States Trustees
Washington, D.C. 20530

STUART M. GERSON
Assistant Attorney General

WILLIAM KANTER
(FTS/202) 633-1597

JENNIFER H. ZACKS
(FTS/202) 633-4826
Attorneys, Appellate Staff
Civil Division, Room 3617
Department of Justice
Washington, D.C. 20530

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PETITION FOR A WRIT OF MANDAMUS & REPLY BRIEF OF APPELLANT

In our opening brief we demonstrated that although the language and legislative history of 1104(c) unequivocally vest the right to appoint a trustee in the U.S. Trustee, the district court [**FN**1], acting entirely without legal authority, arrogated that power to itself. As we showed, this ultra vires action presents precisely the " 'usurpation of judicial power' " that mandamus is designed to correct. In re Puerto Rico Electric Power Authority, 687 F.2d 501, 503 (1st Cir. 1982) (quoting DeBeers Consolidated Mines v. United States, 325 U.S. 212, 217 (1945)). In the alternative, this Court has jurisdiction to reverse the district court's invalid appointment of a trustee as an appealable final order or under the collateral order doctrine of Cohen v. Beneficial Industrial Loan Corp., 337 U.S. 541, 545-47 (1949).

[*2] 1. City Federal apparently concurs with our interpretation of the relevant statute, admitting that "[s]ection 1104(c) plainly provides that the U.S. Trustee appoints [the trustee in bankruptcy]." Br. at 26. Nor does City Federal contest our reading of 1104(c)'s legislative history, acknowledging that Congress intended to withdraw the courts' power to appoint trustees in order to eliminate the "favoritism or cronyism that obviously compromised the integrity of the bankruptcy system." Br. at 31. [**FN**2] Since under 1104(c) only the U.S. Trustee has the authority to appoint a trustee, the court's appointment of a trustee "exceeded it discretion 'to such a degree that is actions amount[] to a "usurpation of power," ' " making mandamus appropriate. In re Recticel Foam Corp., 859 F.2d 1000, 1006 (1st Cir. 1988) (citations omitted).

However, City Federal argues that "enforcement of a plain reading of § 1104(c)" is not necessary because compliance would produce detrimental "delays associated with repeated approval proceedings." Br. at 26, 27. As we noted in our opening brief, the prospect of delays cannot justify the court's exceeding its statutory authority. Br. at __. In any event, no delay would have been occurred if the court, in compliance with 1104(c), had promptly approved an appointment made by the U.S. Trustee.

City Federal also contends that the district court's actions were "only a measure taken pursuant to the authority reserved to the court of approving the appointment by the U.S. Trustee." Br. at 29. In fact, the court did not approve any appointment made by the U.S. Trustee. On the contrary, Mr. Lopez Alvarez, the trustee appointed by the U.S. Trustee, was rejected by the court. (App. at 172). Judge Perez-Gimenez then issued an order stating "we hereby APPOINT Mr. Pedro J. Fuste as operating trustee." (App. at 309). (capitalization in original). The court's right to approve appointments made by the U.S. Trustee does not include the authority to make appointments.

Nor, contrary to City Federal's contention, was the court acting within its statutory authority when it "requested the U.S. Trustee to submit three candidates [for trustee] instead of one." Br. at 28. The procedure ordered by the court directly contradicts the statutory requirement that the U.S. Trustee appoint "one disinterested person." 11 U.S.C. 1104(c) (emphasis added). In addition, the order deprived the U.S. Trustee of his appointment authority, in that it provided that parties in interest other than the U.S. Trustee could "submit additional candidates for [the court's] approval." slip op at 2; See App. at 154. An order providing that the court may select a trustee proposed by some party other than the U.S. Trustee cannot be construed as a legitimate exercise of the court's power to approve appointments made by the U.S. Trustee. [**FN**3]

Contrary to City Federal's contention, the district court's ultra vires actions cannot be justified on the grounds that "there was barely any consultation with the parties in interest," City Federal and Banco Nacional, concerning the appointment of a trustee. [**FN**4] Br. at 33. 1104(c) requires that the U.S. Trustee "make a good faith effort to get input from the parties in interest" concerning the appointment of a trustee. See In re Capital Services & Investments, Inc., 90 B.R. 382, 385 (Bankr. C.D. Ill. 1988). Here, the record reveals extensive consultation between City Federal and the United States Trustee, including meetings with two different assistant U.S. Trustees to discuss candidates for the trustee position and the delivery to City Federal of the resumes of the three candidates under consideration. Br. at 34-35 & n.15. Indeed, City Federal concedes that an Assistant U.S. Trustee, after submitting the resumes of two candidates to City Federal "requested undersigned counsel to indicate, as soon as possible, City Federal's position as to these * * * candidates." Br. at 35. The U.S. Trustee also sought the input of Banco Nacional regarding the appointment of a trustee by telephoning counsel and sending Banco Nacional the resumes of the three candidates under consideration. App. at 203-04; 249-50.

[*3] Despite this consultation concerning the appointment of a trustee, City Federal complains that the U.S. Trustee "never informed any of the parties that her office was contemplating a challenge to the June 20 order and that the submission would include one candidate, not three." Br. at 34. (emphasis in original). Certainly, information regarding contemplated litigation positions is not covered by the consultation requirement of 1104(c). Nor should it be necessary for the U.S. Trustee to inform the parties that he intends to comply with the governing statute.

Since the record shows that the U.S. Trustee conferred with the parties in interest, City Federal's citation of In re Capital Services & Investments, Inc., 90 B.R. 382 (Bankr. C.D. Ill. 1988) is entirely inapposite. In that case, the United States Trustee refused to disclose to the creditors the name of the person he intended to appoint as trustee and informed the parties in interest that "anyone trying to change his decision would be brought up on charges before the attorney disciplinary commission." Id. at 384. See also In re Ruffin, Inc., 10 B.R. 862, 863 (D. R.I. 1981) (inadequate consultation where parties were never contacted by the United States Trustee regarding the appointment of a trustee.).

The gravamen of City Federal's grievance appears to be that "the U.S Trustee failed to include [Mr. Fuste, the candidate supported by City Federal] as a candidate for appointment as trustee in his submission to the * * * court." Br. at 35-36. However, section 1104(c)'s consultation requirement does not oblige the U.S. Trustee to select the candidate preferred by a particular creditor.

Finally, even if the U.S. Trustee's consultation with the parties in interest could be considered in some way deficient, the court still would not be justified in its ultra vires appointment of a trustee. For example, in In re Capital Services & Investments, Inc., only minimal consultation occurred, but the court nonetheless approved the U.S. Trustee's appointment, after determining that the trustee was experienced and disinterested. 90 B.R. at 386.

2. City Federal argues that mandamus is not available in this case because the U.S. Trustee will be able to vindicate his right to appoint a trustee through "an end-of-case appeal." Br. at 22. However, the special circumstances of this case prevent the U.S. Trustee from challenging the court's ultra vires appointment of a trustee at the end of the case. [**FN**5] The relevant statutory provision permits the appointment of a trustee only "before confirmation of a plan." 11 U.S.C. 1104(a) (emphasis added). Because a chapter 11 case generally ends with the confirmation of a reorganization plan, forcing the U.S. Trustee to wait until the end of the case to obtain review of the court's appointment will deprive him of the opportunity for any meaningful relief. By the terms of the statute no trustee can be appointed after confirmation of the plan. Therefore, even if at the end of the case the court's appointment was found to have been invalid, the U.S. Trustee would be precluded by statute from making a valid appointment.

[*4] Such preclusion would also exist as a practical matter. When the plan is confirmed, the trustee's oversight of the reorganization ends. After the trustee's duties have been fully performed, a claim regarding the validity of the trustee's initial appointment would presumably be moot. Thus, the U.S. Trustee cannot protect its right to appoint the trustee through an appeal at the end of the bankruptcy proceeding. As this Court has stated where, as here, the circumstances of an order "would make an end-of-case appeal ineffectual or leave legitimate interests unduly at risk" a writ of mandamus may issue. Recticel, 859 F.2d at 1005-06.

3. In the alternative, Judge Perez-Gimenez' order is reviewable as an appealable final order. City Federal erroneously suggests that the U.S. Trustee "has conceded that the order [that is the] subject of this appeal is not a final * * * order." Br. at 11-12. On the contrary, as our opening brief demonstrated, the court's order is immediately appealable because in the bankruptcy context an order is final when it "finally dispose[s] of [a] discrete dispute[] within the larger case" In re Saco Local Development Co., 711 F.2d 441, 445 (1st Cir. 1983) Contrary to appellee's assertion, the court's order is not merely "a step in the procedural ladder," (Br. at 12), but conclusively and finally determines the rights of the U.S. Trustee under 1104(c) with respect to the power to appoint the trustee. In addition, the question of where the appointment power lies under 1104(c) is entirely separate from any issues involved in the larger bankruptcy case.

City Federal suggests that the court's appointment of a trustee is not appealable because "the court may, at the request of a party terminate the trustee's appointment and restore the debtor to possession and management of the * * * estate" Br. at 14. However, returning possession to the debtor in no way cures the court's violation of the plain terms of 1104(c). The usurpation of the exclusive appointment authority of the U.S. Trustee occurs when the court appoints a trustee, regardless of the later actions of the trustee or the court. [**FN**6] In a similar case, the Sixth Circuit held that the denial of the U.S. Trustee's right to compel the appointment of an examiner under 11 U.S.C. 1104(b)(2) was an appealable final order. See In re Revco (Morgenstern v. Revco D.S., Inc.), No. 89-4545 (6th Cir. Mar. 14, 1990), slip op. at ___.

4. Alternatively, this Court has jurisdiction under the collateral order doctrine of Cohen v. Beneficial Industrial Loan Corp., 337 U.S. 541, 545-47 (1949). Under this doctrine, a court of appeals has jurisdiction to hear an interlocutory order involving:

> (1) an issue unrelated to the merits of the main dispute, capable of review without disrupting the main trial; (2) a complete resolution of the issue, not one that is "unfinished" or "inconclusive"; (3) a right incapable of vindication on appeal from final judgment; and (4) and important and unsettled question of controlling law, not merely a question of the proper exercise of the trial court's discretion.

[*5] United States v. Sorren, 605 F.2d 1211, 1213 (1st Cir. 1979). This Court has summarized these four requisites as separability, finality, urgency and importance. In Re Continental Inv. Corp., 637 F.2d 1, 5 (1st Cir. 1980). The order issued by the district court satisfies each of these requirements and thus is subject to immediate review by this Court.

The court's order appointing a trustee is clearly collateral to the merits of any substantive dispute regarding Plaza's chapter 11 case. The court's order also conclusively resolves the issue of the appointment authority of the U.S. Trustee. The finality of the order is not affected by the fact that the court may later terminate the appointment of the trustee. As this Court has held, the requirement of finality is met even when the trial court judge retains the right to reconsider in light of later developments so long as the judge has "effectively rejected the claim as proffered." In re Continental, 637 F.2d at 5.

The claim here also satisfies the criteria of urgency, "the dispositive criterion of interlocutory appealability." Id. at 6. As explained above, should the case proceed to the approval of a reorganization plan, the right of the U.S. Trustee to appoint a trustee would be permanently lost. Finally, the issue presented is of clear importance for bankruptcy proceedings and involves "unsettled questions of controlling law." Sorren, 605 F.2d at 1213. Contrary to City Federal's contention, the record on appeal is sufficiently developed to permit review. Although the trustee may be engaged in "the preliminary stages of the administration of the estate," (Br. at 16), this appeal challenges only his initial appointment.

CONCLUSION

For the foregoing reasons, and those expressed in our opening brief, we respectfully request that a writ of mandamus issue directing the district court to permit the U.S. Trustee to appoint the Trustee or, in the alternative, that the district court's order of July 20 be reversed.

OF COUNSEL:
JOHN E. LOGAN
General Counsel

MARTHA L. DAVIS
Attorney
Executive Office
For United States Trustees
Washington, D.C. 20530

STUART M. GERSON
Assistant Attorney General

WILLIAM KANTER
(FTS/202) 633-1597

JENNIFER H. ZACKS
(FTS/202) 633-4826
Attorneys, Appellate Staff
Civil Division, Room 3617
Department of Justice
Washington, D.C. 20530
APRIL 1990

CERTIFICATE OF SERVICE

I hereby certify that on this 23th day of April, 1990, I served the foregoing Petition for a Writ of Mandamus and Reply Brief of Appellant by causing copies to be mailed, postage prepaid, to:

Jose Cardona Jimenez, Esq.
Condominio El Centro II
Suite 228
Hato Rey, Puerto Rico 00918

Pedro J. Fuste
Park Boulevard, Apt. 505
Santurce, Puerto Rico 00913

Maria Luise Contreras, Esq.
[*6] Post Office Box 2124
San Juan, Puerto Rico 00903

Arturo Garcia, Esq.
McConnell, Valdes & Kelly
GPO Box 4225

San Juan, Puerto Rico 00936

Dora Penagaricano, Esq.
Rodriguez, Ramon, Pena & Diaz (check)
Post Office Box 2392
Hato Rey, Puerto Rico 00919

Juan M. Perez-Gimenez
Chief Judge
Post Office Box 3671
Old San Juan Station
San Juan, Puerto Rico 00904

JENNIFER H. ZACKS

FOOTNOTES

FN1. City Federal repeatedly refers to Judge Perez-Gimenez' order as that of the "bankruptcy court" See e.g., Br. at 11, 14, 17, 20. As we showed in our opening brief, this order can only have been issued by the district court sitting in bankruptcy.

FN2. City Federal suggests that because the particular judge involved in this case "is not a bankruptcy judge who is in close daily contact with the bankruptcy bar" that 1104(c) is not applicable. Br. at 33 n.14. However, 1104(c) is a prophylactic rule, whose application does not depend on the actual existence of impropriety in any particular case.

FN3. City Federal asserts that the Assistant U.S. Trustee "agreed" to this appointment procedure. Br. at 6. However, her verbal indication at the hearing that she would comply with the court's order cannot estop the government from challenging that order. The U.S. Trustee protected his statutory power of appointment by refusing to submit three names, requesting reconsideration, and taking a prompt appeal.

FN4. City Federal also criticizes the certification of consultation filed by the U.S. Trustee because the "obvious inference from this certification" was that the creditors consented to the appointment. Br. at 34. Since consent is entirely different from consultation, no such inference can be drawn from the certification that "the United States Trustee's Office has consulted the [listed] parties in interest." App. at 167.

FN5. For this reason City Federal's comments regarding the general presumption against piecemeal appeals are not germane.

FN6. In contrast, in a case not involving the appointment authority of the U.S. Trustee, the court's power to reinstate the debtor might well preclude review. Where it is the trustee's future actions that may produce the threatened harm, the return of the debtor to possession will generally resolve the matter. Under these circumstances, the appointment of a trustee could be found nonappealable. All the cases cited by City Federal in which a court found the appointment of a trustee to be nonappealable involve such a situation. Br. at __.

1990 WL 728535 (USTBRIEFS)

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WESTLAW CODES

1. **("TI")** ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	In re Ronald Andre W. Poch (Ronald Andre W. Poch v. Donald F. Walton, United States Trustee, Region 21)
2. **("CO")** ***CURRENT*** COURT *[E.g., "CTA9"]*	N. D. Ga.
3. **("CCN")** ***CURRENT*** CASE NO.	No.: 1:09-cv-00450-WSD
4. **("PCN")** ***PRIOR*** CASE NO. & COURT *[IF ANY]*	No.: 08-68429-MHM Court: Bankr. N.D. Ga. *(Identify judge & cite, if any)*
5. **("SO")** ***SOURCE***	**U.S. TRUSTEES**
6. **("DA")** ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	Filed: June 16, 2009 Type: Brief of Appellee Donald F. Walton United States Trustee Region 21
7. **("AU")** ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*	James H. Morawetz, Guy G. Gebhardt, Paul Bridenhagen, P. Matthew Sutko, Donald F. Walton *(UST/OGC: 202-307-1399/FAX-2397)*
8. **("TO")** ***TOPIC***	**BANKRUPTCY**
9. **("SU")** • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	• Whether the bankruptcy court abused its discretion in denying the appellant's motion for the immediate entry of a chapter 7 discharge or in granting the United States trustee's motion for an extension of the deadlines for filing a motion to dismiss the case for abuse under 11 U.S.C. § 707(b) or a complaint objecting to appellant's discharge under 11 U.S.C. § 727.
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IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF GEORGIA
ATLANTA DIVISION

IN RE:	:	**CASE NO. 1:09-cv-0450-WSD**
	:	
RONALD ANDREW POCH,	:	
	:	
Appellant,	:	**Appeal from United States**
v.	:	**Bankruptcy Court for the**
	:	**Northern District of Georgia,**
DONALD F. WALTON,	:	**Case No. 08-68429**
United States Trustee, Region 21,	:	
	:	
Appellee.	:	
....	:	
	:	
IN RE:	:	
	:	
RONALD ANDREW POCH,	:	
	:	
DEBTOR.	:	

BRIEF OF APPELLEE DONALD F. WALTON, UNITED STATES TRUSTEE, REGION 21

GUY G. GEBHARDT
Assistant United States Trustee
JAMES H. MORAWETZ
Trial Attorney
United States Department of Justice
Office of the United States Trustee
Suite 362, Russell Federal Building
75 Spring Street, SW
Atlanta, GA 30303
Tel: (404) 331-4437
Fax: (404) 331-4464

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STATEMENT OF BASIS OF APPELLATE JURISDICTION

This is an appeal from two interlocutory orders entered by the United States Bankruptcy Court for the Northern District of Georgia in the Appellant's chapter 7 bankruptcy case, one denying a motion by the Appellant for the immediate entry of a chapter 7 discharge [BC #86][1] and the other granting a motion by the United States Trustee for an extension of the deadlines for filing a motion to dismiss the case for abuse under 11 U.S.C. § 707(b) or a complaint objecting to Appellant's discharge under 11 U.S.C. § 727 [BC #87].

This court has jurisdiction under 28 U.S.C. § 158(a) to hear appeals from "interlocutory orders and decrees of bankruptcy judges" entered in bankruptcy cases, but only "with leave of court."[2] To date, this court has not granted leave to hear this

---

[1] Documents in the record transmitted to the district court by the bankruptcy court are identified by the designation, "BC#," followed by the docket number assigned to the document by the clerk of the bankruptcy court.

[2] 28 U.S.C. § 158(a) provides as follows:

> The district courts of the United States shall have jurisdiction to hear appeals
> (1) from final judgments, orders, and decrees;
> (2) from interlocutory orders and decrees issued under section 1121 (d) of title 11 increasing or reducing the time periods referred to in section 1121 of such title; and
> (3) with leave of the court, from other interlocutory orders and decrees; and, with leave of the court, from interlocutory orders and decrees, of

appeal, and the United States Trustee contends, in Section 1 of the Argument portion of this Brief, that such leave should not be granted.

STATEMENT OF ISSUES

If this court grants Appellant's Motion for Leave to Appeal, the issues on appeal are whether the bankruptcy court abused its discretion in denying the Appellant's motion for the immediate entry of a chapter 7 discharge or in granting the United States Trustee's motion for an extension of the deadlines for filing a motion to dismiss the case for abuse under 11 U.S.C. § 707(b) or a complaint objecting to Appellant's discharge under 11 U.S.C. § 727.

APPLICABLE STANDARD OF REVIEW

On appeal from a decision of the bankruptcy court, the district court applies a clearly erroneous standard to the bankruptcy court's findings of fact and conducts a *de novo* review of conclusions of law. *See* Fed. R. Bankr. P. 8013; *Resyn Corp. v. United States*, 851 F.2d 660, 664 (3d Cir.1988); *In re Jersey City Medical Center*, 817

> bankruptcy judges entered in cases and proceedings referred to the bankruptcy judges under section 157 of this title. An appeal under this subsection shall be taken only to the district court for the judicial district in which the bankruptcy judge is serving.

F.2d 1055, 1059 (3d Cir.1987); *In re Winthrop Nurseries, Inc.*, 50 F.3d 72, 73 (1st Cir. 1995).

STATEMENT OF THE CASE

The Appellant, Ronald Andrew Poch (the "**Appellant,**" "**Poch**," or the "**Debtor**"), commenced his bankruptcy case by filing a voluntary petition for relief under chapter 7 of the Bankruptcy Code on May 5, 2008. The bankruptcy court docket reflects that the section 341 meeting of creditors was held and concluded on June 10, 2008. On June 12, 2008, the bankruptcy court entered an order finding that the case was not subject to dismissal under 11 U.S.C. § 521(i)(1).[3] [BC #14].

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[3] 11 U.S.C. § 521(i)(1) provides as follows:

> (1) Subject to paragraphs (2) and (4) and notwithstanding section 707 (a), if an individual debtor in a voluntary case under chapter 7 or 13 fails to file all of the information required under subsection (a)(1) within 45 days after the date of the filing of the petition, the case shall be automatically dismissed effective on the 46th day after the date of the filing of the petition.

Paragraphs (2) and (4) of section 521(i) provide, respectively, as follows:

> (2) Subject to paragraph (4) and with respect to a case described in paragraph (1), any party in interest may request the court to enter an order dismissing the case. If requested, the court shall enter an order of dismissal not later than 5 days after such request.
>
> ...

On July 15, 2008, the United States Trustee filed a motion for authorization to conduct an examination of Poch pursuant to Rule 2004 of the Federal Rules of Bankruptcy Procedure. [BC# 16]. The United States Trustee asserted in this motion that Poch had filed bankruptcy schedules listing indebtedness of over $450,000 on two credit card accounts, while scheduling property valued at only $22,800 and reporting gross income in his statement of financial affairs of only $19,200 in 2007 and $17,500 in 2006. The United States Trustee stated that he desired to conduct a Rule 2004 examination "to inquire about the debtor's assets, liabilities, income, expenses, financial transaction, and other matters pertaining to the administration of this case and the debtor's entitlement to a discharge." *Id.* The bankruptcy court entered an order authorizing the United States Trustee to conduct the examination on July 17, 2009. [BC# 17].

A few weeks later, on August 11, 2008, the United States Trustee filed a motion for an extension of the deadlines for filing motion to dismiss under section 707(b) or

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> (4) Notwithstanding any other provision of this subsection, on the motion of the trustee filed before the expiration of the applicable period of time specified in paragraph (1), (2), or (3), and after notice and a hearing, the court may decline to dismiss the case if the court finds that the debtor attempted in good faith to file all the information required by subsection (a)(1)(B)(iv) and that the best interests of creditors would be served by administration of the case.

a complaint objecting to discharge under section 727. [BC# 20]. The United States Trustee asserted in this motion that these deadlines were set to expire on that date and that he had commenced the Rule 2004 examination of Poch but had not been able to conclude it because Poch had failed to produce all the records he had been asked to produce. On August 28, 2008, Poch filed a Motion for Discharge, in which he asserted that he was entitled to a discharge because no party had filed a complaint objecting to his discharge pursuant to 11 U.S.C. § 727(c), no party had filed a "Presumption of Abuse" under 11 U.S.C. § 707(b), and the chapter 7 trustee had issued a report stating that there was no non-exempt property available for distribution from the bankruptcy estate. [BC# 23].

On September 15, 2008, the United States Trustee filed an objection to Poch's Motion for Discharge. [BC #29]. In this pleading, the United States Trustee listed some of the additional information and documentation he was seeking from Poch, including bank statements and cancelled checks pertaining to three bank accounts. Following a hearing, the bankruptcy court entered an order on January 30, 2009, granting the United States Trustee's motion for an extension of the deadlines for filing a section 707(b) motion to dismiss and a section 727 objection to discharge, finding that the United States Trustee had shown that Poch had "failed to produce the information requested or to appear for a continued Bankruptcy Rule 2004 examination." [The "**Extension Order**," BC# 87]. Having granted those extensions, the court entered a separate order on the same date denying Poch's Motion for Discharge [BC# 86]. Poch filed a notice of appeal from both orders on February 9, 2009 [BC# 98].

Simultaneously with the filing of his notice of appeal, Poch filed a "Motion for Extension of Time to File Appeal and Leave to Appeal" [the "**Motion for Leave to Appeal**" [BC# 99]. In this regard, Rule 8001(b) of the Federal Rules of Bankruptcy Procedure provides as follows:

> An appeal from an interlocutory judgment, order, or decree of a bankruptcy judge as permitted by 28 U.S.C. § 158(a)(3) shall be taken by filing a notice of appeal, as prescribed in subdivision (a) of this rule, accompanied by a motion for leave to appeal prepared in accordance with Rule 8003 and with proof of service in accordance with Rule 8008.

Because he had already filed a notice of appeal [BC #98], Poch presumably intended for the Motion for Leave to Appeal to be considered as a request for additional time to prepare a motion for leave to appeal that complied with the requirements of Fed. R. Bankr. P. 8003(a).[4] The United States Trustee filed an

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[4] The Appellant's Motion for Leave to Appeal did not meet any of the requirements of Fed. R. Bankr. P. 8003(a), which provides, in pertinent part, as follows:

Answer in opposition to the Motion for Leave to Appeal on February 18, 2009 [BC# 105]. On February 13, 2009, prior to the filing of that Answer, the bankruptcy court entered an order denying the motion. [BC# 104].

Subsection (b) of Bankruptcy Rule 8003 provides that in cases where a motion for leave to appeal is filed under 28 U.S.C. § 158(a), "[t]he clerk shall transmit the notice of appeal, the motion for leave to appeal and any answer thereto to the clerk of the district court ... as soon as all parties have filed answers or the time for filing an answer has expired" and that "[t]he motion and answer shall be submitted without oral argument unless otherwise ordered." Fed. R. Bankr. P. 8003(b). In accordance with that provision, the clerk of the bankruptcy court on February 19, 2009, transmitted to this court copies of the Motion for Leave to Appeal and the United States Trustee's Answer thereto, along with copies of the Notice of Appeal and the Extension Order. [DC #1].[5] The order denying Poch's motion for the entry of a chapter 7 discharge [BC

> **a) Content of motion; answer.** A motion for leave to appeal under 28 U.S.C. § 158(a) shall contain: (1) a statement of the facts necessary to an understanding of the questions to be presented by the appeal; (2) a statement of those questions and of the relief sought; (3) a statement of the reasons why an appeal should be granted; and (4) a copy of the judgment, order, or decree complained of and of any opinion or memorandum relating thereto. ...

[5] Documents separately filed of record in the district court are identified by the designation, "DC#," followed by the docket number assigned to the document by

#86] was transmitted to the district court as an addendum on March 9, 2009. [DC #4]. To date, this court has not issued a ruling on the Motion for Leave to Appeal.

On February 27, 2009, Poch filed a motion in the bankruptcy court seeking a stay of the Extension Order pending appeal. [BC #113]. The effect of such a stay would, of course, have been to extinguish the United States Trustee's ability to file a section 707(b) motion to dismiss or a section 727 objection to discharge, inasmuch as the initial 60-day deadlines for filing such pleadings had long since expired.[6] The

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the clerk of the district court.

[6] The time limitation for filing a motion to dismiss pursuant to section 707(b) is set forth Fed. R. Bankr. P. 1017, as follows:

> **Dismissal or Conversion of Case; Suspension**
> ...
> **(e) Dismissal of an individual debtor's chapter 7 case, or conversion to a case under chapter 11 or 13, for abuse.** The court may dismiss or, with the debtor's consent, convert an individual debtor's case for abuse under § 707(b) only on motion and after a hearing on notice to the debtor, the trustee, the United States trustee, and any other entity as the court directs.
>
> (1) Except as otherwise provided in § 704(b)(2), a motion to dismiss a case for abuse under § 707(b) or (c) may be filed only within 60 days after the first date set for the meeting of creditors under § 341(a), unless, on request filed before the time has expired, the court for cause extends the time for filing the motion to dismiss. ...

The time limitation for filing an objection to discharge is set forth in Fed. R. Bankr. P. 4004, as follows:

bankruptcy court entered an order denying the motion for stay on March 5, 2009, based on findings that Poch had failed to show a likelihood of success on appeal or to describe how providing the information requested by the United States Trustee would constitute irreparable injury [BC# 116]. On March 9, 2009, Poch filed a motion in this court for an order "staying the Bankruptcy proceeding" pending Appeal. [DC# 5]. The United States Trustee filed a response in opposition to that motion on March 18, 2009. [DC #8].

STATEMENT OF FACTS

This appeal arises from efforts by the United States Trustee to obtain information and records from Poch under Rule 2004 of the Federal Rules of Bankruptcy Procedure for the purpose of determining whether cause exists to seek the dismissal of his chapter 7 bankruptcy case as abusive pursuant to 11 U.S.C. § 707(b)

> **Grant or Denial of Discharge**
> **(a) Time for filing complaint objecting to discharge; notice of time fixed.** In a chapter 7 liquidation case a complaint objecting to the debtor's discharge under § 727(a) of the Code shall be filed not later than 60 days following the first date set for the meeting of creditors under § 341(a). ...
> **(b) Extension of time.** On motion of any party in interest, after hearing on notice, the court may extend for cause the time for filing a complaint objecting to discharge. The motion shall be filed before the time has expired.

or to file a complaint objecting to his discharge pursuant to 11 U.S.C. § 727.[7] In his motion for authorization to conduct the examination, the United States Trustee stated that Poch had scheduled unsecured debt totaling more than $450,000 on two credit card accounts but had scheduled property valued at only $22,800 and reported gross income in his statement of financial affairs of only $19,200 in 2007 and $17,500 in 2006. [BC #16]. The United States Trustee sought to use the Rule 2004 examination to secure additional information regarding Poch's credit card purchases and other pre-petition financial transactions in an effort to determine whether the granting of a chapter 7 discharge would be an abuse of the bankruptcy process.

---

[7] The provisions of Rule 2004 relevant to this case are as follows:

> **(a) Examination on motion.** On motion of any party in interest, the court may order the examination of any entity.
>
> **(b) Scope of examination.** The examination of an entity under this rule or of the debtor under § 343 of the Code may relate only to the acts, conduct, or property or to the liabilities and financial condition of the debtor, or to any matter which may affect the administration of the debtor's estate, or to the debtor's right to a discharge. ...
>
> **(c) Compelling attendance and production of documentary evidence.** The attendance of an entity for examination and for the production of documents ... may be compelled as provided in Rule 9016 for the attendance of a witness at a hearing or trial. ...
> ...

On August 11, 2008, the United States Trustee filed a motion for an extension of the deadlines for filing a section 707(b) motion to dismiss or a section 727 objection to discharge. [BC #20]. The United States Trustee asserted in this motion that those deadlines were set to expire on that date and that the Rule 2004 examination of Poch, which had commenced on that date, had not been concluded because Poch not yet produced all of the information and records the United States Trustee had asked him to produce. [BC #20]. Poch responded by objecting to the requested extensions [BC #25, 26, 34, & 75], and moving for the immediate entry of a chapter 7 discharge [BC# 23]. At no point has Poch objected to any of the United States Trustee's requests for information or records, nor has he sought a protective order based on allegations that the purpose of the investigation was to abuse or harass or that the scope of the investigation otherwise exceeded the permissible scope of discovery under Rule 2004. Consequently, the bankruptcy court has never issued a ruling on the dispute that gives rise to this appeal.

SUMMARY OF ARGUMENT

1. The interlocutory orders from which this appeal is taken arise from discovery efforts undertaken by the United States Trustee pursuant to Bankruptcy Rule 2004 and do not involve any controlling question of law as to which there is substantial ground for difference of opinion, nor would an immediate appeal from the orders materially advance the ultimate termination of any litigation. Consequently, leave to appeal the orders should be denied and the appeal dismissed.

2. The bankruptcy court did not abuse its discretion in granting the United States Trustee's motion to extend the deadlines for filing a section 707(b) motion to dismiss or a section 727 objection to discharge.

3. Having granted the requested extensions, the bankruptcy court likewise did not abuse its discretion in denying Poch's motion for the immediate entry of a chapter 7 discharge.

4. The bankruptcy court acted properly in granting the United States Trustee's motion for authorization to conduct a Rule 2004 examination of Poch on an *ex parte* basis.

5. The filing by the chapter 7 trustee of a report of no distribution had no bearing on whether the case should be dismissed as abusive pursuant to section 707(b) or whether the debtor's discharge should be denied under section 727.

6. The entry of the order finding that the case was not subject to dismissal under section 521(i)(1) of the Bankruptcy Code likewise had no bearing on the availability of relief under section 707(b) or 727.

7. The United States Trustee was not required to file a statement under section 704(b) of the Bankruptcy Code as to whether the case was presumed to be abusive in order to preserve his ability to file a motion to dismiss the case as abusive under section 707(b)(3).

8. The record contains no support for Poch's contentions that the bankruptcy court failed to consider any of his pleadings.

ARGUMENT

1. Poch's Motion for Leave to Appeal Should Be Denied, as this Interlocutory Appeal Arises from a Simple Discovery Dispute and Involves No Controlling Issue of Law.

Because 28 U.S.C. § 158(a) and Fed. R. Bankr. P. 8003 provide no criteria to apply in determining whether to grant leave to appeal an interlocutory bankruptcy court order, district courts have generally applied the standards in 28 U.S.C. § 1292(b), which governs discretionary interlocutory appeals from district courts to courts of appeals, in making this determination. *See In re Ashoka Enterprises, Inc.*, 156 B.R. 343, 346 (S.D. Fla. 1993); *In re Celotex Corp.*, 187 B.R. 746, 749 (M.D. Fla. 1995) (citing *In re Charter Co.*, 778 F.2d 617, 620 (11th Cir. 1985)); *Gache v. Balaber-Strauss*, 198 B.R. 662, 664 (Bankr. S.D.N.Y. 1996).

Under section 1292(b), a district court may certify an interlocutory order for immediate appeal to the court of appeals when it is of the opinion that "that such order involves a controlling question of law as to which there is substantial ground for difference of opinion and that an immediate appeal from the order may materially advance the ultimate termination of the litigation ..." 28 U.S.C. § 1292(b). Section 1292(b) appeals "were intended, and should be reserved, for situations in which the court of appeals can rule on a pure, controlling question of law without having to delve beyond the surface of the record in order to determine the facts." *McFarlin v. Conseco Servs., LLC*, 381 F.3d 1251, 1259 (11th Cir. 2004) (citations omitted).

> The legal question must be stated at a high enough level of abstraction to lift the question out of the details of the evidence or facts of a particular case and give it general relevance to other cases in the same area of law. And the answer to that question must substantially reduce the amount of litigation left in the case. ... Because permitting piecemeal appeals is bad policy, permitting liberal use of § 1292(b) interlocutory appeals is bad policy.

Id.

The Extension Order that Poch seeks to appeal does not, of course, purport to adjudicate the issue of whether cause exists to dismiss his case pursuant to section 707(b) or to deny his discharge pursuant to section 727. Rather, its purpose is simply to allow the United States Trustee additional time to investigate those issues pursuant to Rule 2004 in order to determine whether and to what extent grounds may exist for such relief. No controlling question of law is presented by the Extension Order that would serve to advance the ultimate resolution of that question. "In general, discovery orders do not present 'controlling questions of law' capable of significantly advancing litigation so as to justify interlocutory appeal." *State of Florida ex rel. Butterworth v. Industrial Chemicals*, 145 F.R.D. 585, 589 (N.D.Fla. 1991) (citing *North Carolina Assoc. of Black Lawyers v. North Carolina Board of Law Examiners*, 538 F.2d 547, 548-49 (4th Cir.1976)). *See also In re American Freight System, Inc.*, 194 B.R. 659, 662 (D. Kan. 1996).

The order denying Poch's motion for the immediate entry of a discharge likewise presents no controlling question of law. Rather, it simply begs the question of whether the information and records requested by the United States Trustee pursuant to Rule 2004 will establish facts that would support a dismissal of his case under section 707(b) or a denial of his discharge under section 727. Poch's request for the immediate entry of a chapter 7 discharge is simply an effort to moot those issues without providing the information and records requested from him. Poch has not demonstrated that this discovery dispute differs materially from the type of routine discovery disputes from which interlocutory appeals are discouraged on the ground that they contravene the policy against piecemeal litigation.

2. The Bankruptcy Court Did Not Abuse Its Discretion in Granting the United States Trustee's Motion to Extend the Deadlines for Filing a Section 707(b) Motion to Dismiss or Section 727 Objection to Discharge.

A Rule 2004 examination "is properly used as a pre-litigation device to determine whether there are grounds to bring an action to determine a debtor's right to discharge or the dischargeability of a particular debt." *In re Bennett Funding Group, Inc.*, 203 B.R. 24, 28 (Bankr. N.D.N.Y. 1996) (citation omitted). "In this regard, courts have recognized that Rule 2004 examinations are broad and unfettered and in the nature of fishing expeditions." *In re Enron Corp.*, 281 B.R. 836, 840 (Bankr. S.D.N.Y. 2002). *See also In re Wilcher*, 56 B.R. 428, 433 (Bankr. N.D.Ill. 1985); *In re Recoton Corp.*, 307 B.R. 751, 755 (Bankr. S.D.N.Y. 2004) ("The scope of Rule 2004 examination is very broad, broader even than discovery under the Federal Rules of Civil Procedure.") (citations omitted); *In re Drexel Burnham Lambert Group, Inc.*, 123 B.R. 702, 711 (Bankr. S.D.N.Y. 1991).

The effect of dismissing a chapter 7 case is similar to the effect of denying the debtor's discharge in that it prevents the issuance of a discharge.[8] It follows that a

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[8] Denial of the debtor's discharge under section 727 is, however, a more serious sanction in that, unlike a dismissal, it precludes, pursuant to 11 U.S.C. § 523 (a)(10), any subsequent discharge of the debts that were or could have been scheduled in the case. Section 523(a)(10) provides as follows:

> **Exceptions to discharge.**
> (a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt –
> ...
> (10) that was or could have been listed or scheduled by the debtor in a prior case concerning the debtor under this title or under the Bankruptcy Act in which the debtor waived discharge, or was denied a discharge under section 727(a)(2), (3), (4), (5), (6), or (7) of this title, or under section 14c(1), (2), (3), (4), (6), or (7) of such Act; ...

Rule 2004 examination is also properly used as a pre-litigation device to determine whether grounds exist to seek dismissal of a chapter 7 case as abusive pursuant section 707(b). *See generally 2435 Plainfield Ave. v. Township of Scotch Plains (In re 2435 Plainfield Ave.)*, 223 B.R. 440, 456 (Bankr. D.N.J. 1998) ("A Rule 2004 exam has been explained as a broad investigation into the financial affairs of the debtor for the purpose of the discovery of assets of the estate and the exposure of fraudulent conduct."); *In re Symington*, 209 B.R. 678, 684 (Bankr. D.Md. 1997) (Rule 2004 examination "represents a threshold inquiry into the assets and conduct of debtors bankruptcy"); *In re Valley Forge Plaza Assocs.*, 109 B.R. 669, 674 (Bankr. E.D.Pa. 1990).

Poch obviously would prefer to receive a chapter 7 discharge without providing the information and records sought by the United States Trustee in connection with the Rule 2004 examination. However, by filing a voluntary petition for relief under chapter 7, he assumed a duty under the Bankruptcy Code and the Bankruptcy Rules to provide complete and accurate information concerning his assets, his liabilities, and any financial transactions that might affect his entitlement to a discharge or the administration of his case. "The debtor's obligation to provide the required information is a cost imposed on the debtor for the benefit of obtaining bankruptcy relief." *In re Russell*, 392 B.R. 315, 358 (Bankr. E.D.Tenn, 2008). Further, the debtor's fulfillment of that duty is "crucial to the working of the bankruptcy system." *Id.*, citing *Eastern Diversified Distributors, Inc. v. Matus (In re Matus)*, 303 B.R. 660 (Bankr. N.D.Ga. 2004).

"An abuse of discretion arises when the ... court's decision rests upon a clearly erroneous finding of fact, an errant conclusion of law, or an improper application of law to fact." *United States v. Baker*, 432 F.3d 1189, 1202 (11th Cir. 2005). Poch has not established that the bankruptcy court based its decision to extend the deadlines for filing a section 707(b) motion to dismiss or a section 727 objection to discharge on a clearly erroneous finding of fact, an errant conclusion of law, or an improper application of law to fact.

3. The Bankruptcy Court Did Not Abuse its Discretion in Denying Poch's Motion for the Immediate Entry of a Chapter 7 Discharge.

Fed. R. Bankr. P. 4004(c)(1) specifies, in pertinent part as follows:

> In a chapter 7 case, on expiration of the time fixed for filing a complaint objecting to discharge and the time fixed for filing a motion to dismiss the case under Rule 1017(e), the court shall forthwith grant the discharge unless:
>
> ...
>
> (E) a motion to extend the time for filing a complaint objecting to the discharge is pending;

> (F) a motion to extend the time for filing a motion to dismiss the case under Rule 1017(e)(1)[9] is pending;

There has been no period in this case when the time fixed by the bankruptcy court and/or the bankruptcy rules for filing a complaint objecting to discharge or a motion to dismiss had expired and there was no motion to extend those deadlines pending. It follows that the bankruptcy court did not err in denying Poch's motion for the entry of a chapter 7 discharge.

4. The Court Did Not Violate Poch's Due Process Right or Otherwise Err in Granting the United States Trustee's Motion to Examine Him Pursuant to Fed. R. Bankr. P. 2004 on an *Ex Parte* Basis.

> Rule 2004 provides for an *ex parte* procedure. The party seeking a Rule 2004 examination of the debtor files a motion, with or without notice to the debtor, and the court can enter an order for the examination without allowing the debtor an opportunity to object. Fed. R. Bankr.P. 2004(a). The ... debtor can raise any objections to the examination by filing a motion. *In re Dinubilo*, 177 B.R. 932 (E.D.Cal. 1993); *In re Sutera*, 141 B.R. 539 (Bankr. D.Conn. 1992). This procedure recognizes the debtor's legal duty to testify to facts relevant to administration of the bankruptcy case.

In re Russell, 392 B.R. 315, 360 (Bankr. E.D.Tenn. 2008). *See also In re Symington*, 209 B.R. 678, 689 (Bankr. D.Md.1997) ("Rule 2004 motions are generally granted *ex parte*, as was the case here, without the advance notice required to be given in a

---

[9] Fed. R. Bankr. P. 1017(e) governs motions to dismiss under 11 U.S.C. § 707(b).

contested matter) (citing 9 COLLIER ON BANKRUPTCY ¶ 2004.01[2] (15th ed. rev.1996)).

Contrary to Poch's contention at paragraph 24 of his Brief on appeal, a motion to authorize a Rule 2004 examination does not constitutes a contested matter. *See In re Martin*, 403 B.R. 359, 362 (Bankr. D.S.C. 2009) ("Because Rule 2004 examinations are independent of a complaint or contested matter, the examination need not be tied to specific factual allegations and is subject to fewer objections on grounds of relevance that apply to discovery under Fed.R.Civ.P. 26."); *In re Russell*, 392 B.R. 315, 324 (Bankr. E.D.Tenn. 2008) ("Under the bankruptcy statutes and procedural rules, neither the meeting of creditors nor a Rule 2004 examination is part of a contested matter or an adversary proceeding."); *In re Symington*, 209 B.R. 678, 689 (Bankr. D.Md. 1997) ("The filing of a motion for Rule 2004 examination does not per se create a contested matter governed by the Federal Rules of Civil Procedure."). Because a motion to authorize a Rule 2004 examination does not initiate a contested matter, Fed. R. Bankr. P. 9014(c) does not apply to such a motion, with the result that the discovery rules set forth in Rules 26 and Rules 28 through 37 of the Federal Rules of Civil Procedure, which are made applicable to contested matters by Rule 9014(c) and Fed. R. Bankr. P. 7026 and 7028-37, do not apply to such a motion, either.

Poch has never filed a motion in the bankruptcy court seeking to limit the scope of the United States Trustee's Rule 2004 examination, nor has he objected to any request for information or records made by the United States Trustee based on allegations that its purpose is to abuse or harass or that it otherwise exceeds the permissible scope of discovery under Rule 2004. His due process rights in this regard remain fully intact.

5. The Filing of a Report of No Distribution Has No Bearing on the Availability of Relief under Section 707(b) or Section 727.

Poch appears to contend that the question of whether cause exists to dismiss his case under section 707(b) or to deny his discharge under section 727 was rendered moot by the chapter 7 trustee's filing of a Report of No Distribution in the case. The bankruptcy court docket reflects that the chapter 7 trustee filed a Report of No Distribution on June 11, 2008, but withdrew it on September 8, 2008. [BC# 27]. Poch apparently takes the position, without benefit of any supporting argument or authority, that the trustee's withdrawal of this report was ineffective. However, even had the chapter 7 trustee not withdrawn the Report of No Distribution, the filing of that document would have had no bearing on the availability of the sanctions provided by sections 707(b) and 727.

A Report of No Distribution is simply a statement by the chapter 7 trustee that, after a diligent investigation, he or she has found no assets to fund a distribution to unsecured creditors. The issue of whether unsecured creditors will receive a distribution is unrelated to the issue of whether the debtor is entitled to receive a discharge, except in the sense that a discharge would be rendered moot by payment of all creditor claims in full. The filing of a Report of No Distribution by no means entitles the debtor to receive a discharge in a chapter 7 case in which the deadlines for filing a section 707(b) motion to dismiss or a section 727 objection to discharge have not expired. *See, e.g., In re Fieser*, 248 B.R. 648 (Bankr. M.D.Fla. 1999) (granting section 727(a) denial of discharge based on complaint filed by United States Trustee in case in which chapter 7 trustee had filed report of no distribution).

6. Likewise, the Entry of an Order Finding that a Case Is Not Subject to Dismissal under 11 U.S.C. § 521(i)(1) Has No Bearing on the Availability of Relief under Section 707(b) or Section 727.

Poch apparently takes the position that the order entered by the bankruptcy court on June 12, 2008, finding that the case was not subject to dismissal under 11 U.S.C. § 521(i)(1)[10] [BC #14] absolved him of any duty to provide the information requested by the United States Trustee. Section 521(a)(1) of the Bankruptcy Code

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[10] The text of this subsection appears at fn.3, infra.

requires debtors to file various documents, including, a list of creditors, schedules of assets and liabilities, a statement of financial affairs, and copies of all payment advices or other evidence of payment received by the debtor from any employer within 60 days before the date of the filing of the petition; and section 521(i)(1) enforces these requirements by providing for the automatic dismissal of cases in which the information required under subsection (a)(1) is not filed. This statutory provision simply has no relevance to the ability of a creditor or the United States Trustee to file a motion to dismiss a chapter 7 case as abusive under section 707(b), to object to the debtor's discharge under section 727, or to seek information pursuant to Rule 2004 to determine whether relief under section 707 or 727 is warranted. Indeed, the court's order of June 12, 2008, specifically provided that "this does not prevent the United States Trustee or Chapter 7 Trustee from requesting by any authorized means, including but not limited to motion, that the Debtor supply further information." [BC #14].

7. The United States Trustee Was Not Required to File a Statement under Section 704(b) as to Whether the Case Was Presumed to Be Abusive as a Prerequisite to Filing a Motion to Dismiss the Case as Abusive under Section 707(b)(3).

Section 707(b)(1) of the Bankruptcy Code provides for the dismissal of chapter 7 cases that are deemed abusive, stating as follows:

> After notice and a hearing, the court, on its own motion or on a motion by the United States trustee, trustee (or bankruptcy administrator, if any), or any party in interest, may dismiss a case filed by an individual debtor under this chapter whose debts are primarily consumer debts, or, with the debtor's consent, convert such a case to a case under chapter 11 or 13 of this title, if it finds that the granting of relief would be an abuse of the provisions of this chapter. ...

11 U.S.C. § 707(b)(1).

Sections 707(b)(2) and 707(b)(3) establish different standards pursuant to which the "abuse" referred to in section 707(b)(1) may be established. Section 707(b)(2) provides that "the court shall presume abuse exists" if the debtor's disposable income, as determined by the formula set forth therein, generally referred to as the "means test," exceeds certain specified limits. 11 U.S.C. § 707(b)(2)(A)(i). If a presumption of abuse does not arise under section 707(b)(2), the court may nevertheless find that the granting of chapter 7 relief would be an abuse under section 707(b)(3), which provides as follows:

> In considering under paragraph (1) whether the granting of relief would be an abuse of the provisions of this chapter in a case in which the presumption in subparagraph (A)(i) of [paragraph (2)] does not arise or is rebutted, the court shall consider —
>
> (A) whether the debtor filed the petition in bad faith; or
>
> (B) the totality of the circumstances (including whether the debtor seeks to reject a personal services contract and the financial need for such rejection as sought by the debtor) of the debtor's financial situation demonstrates abuse.

11 U.S.C. § 707(b)(3).

The United States Trustee is obligated by 11 U.S.C. § 704(b) to take the following actions with regard to chapter 7 cases filed by debtors who are individuals:

> (1) With respect to a debtor who is an individual in a case under this chapter —
>
> (A) the United States trustee (or the bankruptcy administrator, if any) shall review all materials filed by the debtor and, not later than 10 days after the date of the first meeting of creditors, file with the court a statement as to whether the debtor's case would be presumed to be an abuse under section 707 (b); and
>
> (B) not later than 5 days after receiving a statement under subparagraph (A), the court shall provide a copy of the statement to all creditors.
>
> (2) The United States trustee (or bankruptcy administrator, if any) shall, not later than 30 days after the date of filing a statement under paragraph (1), either file a motion to dismiss or convert under section 707 (b) or file a statement setting forth the reasons the United States trustee (or the bankruptcy administrator, if any) does not consider such a motion to be appropriate, if the United States trustee (or the bankruptcy administrator, if any) determines that the debtor's case should be presumed to be an abuse under section 707 (b) and the product of the debtor's current monthly income, multiplied by 12 is not less than—
>
> (A) in the case of a debtor in a household of 1 person, the median family income of the applicable State for 1 earner; or
>
> (B) in the case of a debtor in a household of 2 or more individuals, the highest median family income of the applicable State for a family of the same number or fewer individuals.

11 U.S.C. § 704(b).

Poch contends that because the United States Trustee did not file in this case a statement pursuant to section 704(b)(1)(A) "as to whether the debtor's case would be presumed to be an abuse under section 707(b)," he is barred from filing a motion to dismiss under section 707(b). However, a statement as to whether the a presumption of abuse arises under section 707(b) has no application or relevance to a motion to dismiss which is based on section 707(b)(3) rather than section 707(b)(2), because a motion to dismiss under section 707(b)(3) is not predicated on presumed abuse. Rather, the considerations for determining whether a case is abusive under section 707(b)(3) are "whether the debtor filed the petition in bad faith" and whether the "totality of the circumstances ... of the debtor's financial situation demonstrates abuse."

While Poch cites *In re Draisey*, 385 B.R. 274 (Bankr. D.Minn. 2008), as support for his argument, that decision was reversed by the Bankruptcy Appellate Panel for the Eighth Circuit in October, 2008 in *In re Draisey*, 395 B.R. 79 (8th Cir. B.A.P. 2008), and virtually every other court that has considered the issue has likewise ruled that the failure to file a 10-day statement under section 704(b)(1)(A) does not affect the ability of the United States Trustee's ability to file a motion to dismiss under section 707(b)(3). *See Turner v. Close (In re Close)*, 384 B.R. 856, 871 (D.Kan.2008) *aff'g* 353 B.R. 915 (Bankr. D.Kan. 2006); *In re Perrotta*, 390 B.R. 26, 31 (Bankr. D.N.H. 2008); *In re Ansar*, 383 B.R. 344, 348 (Bankr. D.Minn. 2008); *In* *re Byrne*, 376 B.R. 700, 704 (Bankr. W.D.Ark. 2007); *In re Clark*, 393 B.R. 578, 584-85 (Bankr. E.D.Tenn. 2008); *In re Fennell*, 395 B.R. 905 (Bankr. D.S.C. 2008). The United States Trustee is aware of no extant contrary authority supporting Poch's argument.

8. The Record Contains No Support for Poch's Contentions that the Bankruptcy Court Failed to Consider Any of His Various Pleadings.

Poch contends that the bankruptcy court failed to consider numerous pleadings that he filed, including his Objection [BC #25] and Supplemental Objection [BC #34] to the United States Trustee's Motion for Extension of Deadlines [BC #25], his Response to the United States Trustee's Objection to Debtor's Motion for Discharge [BC #38], his hearing brief filed on October 14, 2008[BC #45], his hearing brief filed on October 20, 2008 [BC #50], his "Objection to 2004 Examination" filed on October 31, 2008 [BC #56], his "Objection to and Motion to Strike Statement of the United States Trustee in Response to (i) Debtor's Motion for Reconsideration; (ii) Debtor's Motion to Withhold Rulings; (iii) Debtor's Hearing Brief; and (iv) Affidavit of Ronald Poch in Support of Hearing Brief" filed on November 5, 2008 [BC #59], and his "Renewed Objection to the United States Trustee's Motion for Extention (sic) of Deadlines, and Objection to the United States Trustee's Supplemental Motion for Extention (sic) of Deadlines and Amendment to Supplemental Motion for Extention (sic) of Deadlines" filed on December 9, 2008 [BC #75]. However, Poch cites to nothing in the record that would support a finding that the bankruptcy court failed to consider any of these pleadings.

CONCLUSION

For the foregoing reasons, the United States Trustee respectfully requests this court to enter an order denying the Appellants Motion for Leave to Appeal and dismissing this appeal or, in the alternative, affirming the interlocutory orders from which the appeal is taken.

Respectfully submitted,

DONALD F. WALTON
UNITED STATES TRUSTEE

By: ***/s/ Guy G. Gebhardt***
GUY G. GEBHARDT
Georgia Bar No. 288550
Assistant United States Trustee
Email: Guy.G.Gebhardt@usdoj.gov

By: ***/s/ James H. Morawetz***
JAMES H. MORAWETZ
Georgia Bar No. 521900
Trial Attorney
Email: Jim.H.Morawetz@usdoj.gov

United States Department of Justice
Office of the United States Trustee
Suite 362, 75 Spring Street, SW
Atlanta, GA 30303
Telephone: (404) 331-4437
Facsimile: (404) 331-4464

CERTIFICATE OF SERVICE

I certify that I am over the age of 18 and that on this date I caused a true and correct copy of the foregoing Brief to be deposited in the U.S. Mail, first class postage prepaid, addressed as follows:

Ronald Andrew Poch
33 Waterstone Way
Acworth, GA 30101

Done this the 16th day of June, 2009.

s/ *James H. Morawetz*
JAMES H. MORAWETZ
Trial Attorney
Georgia Bar No. 521900

BRIEF BANK — “SUMMARY SHEET” *Printed Tue-5/6/08 16:7*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*
In re Leonard Powell and Margaret Powell, et al. (Babin v. Powell, et al.)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*
BAP 8th Cir.

3. ("CCN") ***CURRENT*** CASE NO.
No.: 08-6008

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*
No.: 07-bk-71169B
Court: Bankr. Ark.
(Identify judge & cite, if any)

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6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*
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Jim Hollis, Thomas C. Kearns, David Levine, P. Matthew Sutko, Charles W. Tucker
Nancy J. Gargula
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***
•Whether the bankruptcy court erred as a matter of law in overruling the Chapter 13 Trustee’s objection to confirmation and confirming the Chapter 13 plans of David and the Powells by misinterpreting when debtors can claim a vehicle Ownership expense under 11 U.S.C. § 707(b)(2).

10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)

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UNITED STATES BANKRUPTCY APPELLATE PANEL
FOR THE EIGHTH CIRCUIT

IN RE: LEONARD POWELL and Bkr. Case No. 5:07-bk-71169B
MARGARET POWELL
Debtors

JOYCE BABIN, Chapter 13 Trustee Appellant

v. Appeal No. 08-6008

LEONARD POWELL and MARGARET POWELL Appellees

IN RE: CHO PUN DAVIS Bkr. Case No. 5:07-bk-71175B
Debtor
JOYCE BABIN,
Chapter 13 Trustee Appellant

v. Appeal No. 08-6009

CHO PUN DAVIS Appellee

ON APPEAL FROM THE UNITED STATES BANKRUPTCY COURT
FOR THE WESTERN DISTRICT OF ARKANSAS

BRIEF OF THE UNITED STATES TRUSTEE AS *AMICUS CURIAE* SUPPORTING APPELLANT

Of Counsel

ROBERTA A. DeANGELIS
General Counsel

P. MATTHEW SUTKO
THOMAS C. KEARNS
United States Department of Justice
Executive Office for the United States Trustee

NANCY J. GARGULA
United States Trustee

CHARLES W. TUCKER
Assistant United States Trustee
United States Department of Justice
Office of the U.S. Trustee
200 West Capitol, Suite 1200
Little Rock, AR 72201

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STATEMENT OF APPELLATE JURISDICTION

The bankruptcy court had jurisdiction over this matter pursuant to 28 U.S.C. § 1334(b) and § 157(b)(2)(L). The Bankruptcy Appellate Panel has jurisdiction over this appeal pursuant to 28 U.S.C. § 158(a)(1) and (b) and Federal Rule of Bankruptcy Procedure 8001. Joyce Babin, Chapter 13 Trustee, appeals from orders of the United States Bankruptcy Court, Western District of Arkansas, overruling her Objection to Confirmation of Chapter 13 Plan filed in the cases of Leonard and Margaret Powell ("the Powells") and Cho Pun Davis ("Davis") and confirming their plans.

Davis and the Powells filed their Chapter 13 cases and proposed plans on April 20, 2007. On June 4, 2007, the Chapter 13 Trustee timely objected to each plan. The objections to confirmation of the respective plans were heard on October 17, 2007. At the hearing, the court allowed the parties until December 14, 2007 to file briefs. On February 26 and 27, 2008, the bankruptcy court entered discrete orders overruling the Chapter 13 Trustee's objections to confirmation and confirming the plans of Davis and the Powells, respectively. On March 6, 2008, the Chapter 13 Trustee filed her notice of appeal in each case.

INTEREST OF THE UNITED STATES

The Attorney General appoints United States Trustees to supervise the administration of bankruptcy cases and trustees in regions comprising the vast majority of federal judicial districts. 28 U.S.C. §§ 581-589a. United States Trustees "serve as bankruptcy watchdogs to prevent fraud, dishonesty, and overreaching in the bankruptcy arena." H.R. Rep. No. 595, 95th Cong., 1st Sess. 88 (1977). The United States Trustee Program thus acts in the public interest to promote the efficiency and to protect and preserve the integrity of the bankruptcy system. By statute, "[t]he United States Trustee may raise and may appear and be heard on any issue in any case or proceeding under this Title." 11 U.S.C. § 307. *See also In re Revco D.S., Inc.,* 898 F.2d 498, 499-500 (6th Cir. 1990) (upholding broad appellate standing of United States Trustees).

These cases involve a dispute over confirmation of a plan under Chapter 13 of the Bankruptcy Code. In this matter, the United States Trustee has two separate and distinct interests. First, the United States Trustee has the statutory duty to oversee the administration of Chapter 13 cases, which includes monitoring and, if necessary, objecting to Chapter 13 plans under 11 U.S.C. § 1324. 28 U.S.C. § 586(a)(3)(C). Second, the United States Trustee has an interest in this appeal because the issue on appeal directly implicates 11 U.S.C. § 707(b), which the United States Trustee oversees pursuant to duties set forth in 11 U.S.C. § 704(b), and under which United States Trustees regularly seek relief involving the same legal issue.

The question of law involved in these appeals is not limited to Davis and the Powells. Rather, it will apply globally to thousands of debtors in a myriad of different financial circumstances who will file bankruptcy cases in this district and nationally. For this reason, the United States Trustee respectfully offers this Court her views on whether the bankruptcy court can confirm the Debtors' plans when the Debtors claim the IRS Standard expense allowance for a vehicle in the calculation of disposable income even though the Debtors have no vehicle financing expense because they own the vehicle debt free.

STATEMENT OF ISSUES PRESENTED FOR REVIEW

The Chapter 13 Trustee objected to confirmation of the plans filed by Davis and the Powells on the grounds that all of their disposable income was not committed to the plan, as required under 11 U.S.C. § 1325(b)(1)(B). The bankruptcy court overruled the Chapter 13 Trustee's objections and confirmed the plans, holding that Davis and the Powells could properly claim the IRS Standard expense allowance for vehicle ownership, notwithstanding the fact that neither Davis nor the Powells had vehicle loans or lease payments, thereby substantially reducing the funds available to pay creditors under the plans.

In these cases, Davis's and the Powells' income both exceed the family median income for the State of Arkansas. In Chapter 13 bankruptcy cases, when a debtor's income exceeds the applicable state's median family income, 11 U.S.C. § 1325(b)(3) requires debtors to determine their expenses in accordance with the "means test" provisions of 11 U.S.C. § 707(b)(2)(A) and (B). Given that 11 U.S.C. § 707(b)(2)(A)(ii)(I) allows only "applicable" vehicle ownership expenses to be deducted under the means test, the issue presented to this Court for determination is whether the bankruptcy court erred by holding that the Davis and the Powells could claim the IRS Standard expense allowance for vehicle financing in the calculation of their disposable income, even though they have no vehicle financing expense because they own their cars debt free.

STANDARD OF REVIEW

The Bankruptcy Appellate Panel reviews the bankruptcy court's factual findings for clear error and the conclusions of law *de novo*. *DeBold v. Case,* 452 F.3d 756, 761 (8th Cir. 2006); *Litzinger v. Litzinger (In re Litzinger),* 340 B.R. 897, 903 (B.A.P. 8th Cir. 2006); *Ford v. Student Loan Guarantee Foundation (In re Ford),* 269 B.R. 673, 675 (B.A.P. 8th Cir. 2001) [citing *Andresen v. Nebraska Student Loan Program, Inc. (In re Andresen),* 232 B.R. 127, 128 (B.A.P. 8th Cir. 1999)]; *Eibert v. Pelican (In re Eibert),* 162 F.3d 523, 525 (8th Cir. 1998). In this case, the facts are not in dispute. Therefore, the bankruptcy court's interpretations of the relevant provisions, including 11 U.S.C. §§ 707(b)(2), 1322(a), and 1325, are legal conclusions that are reviewed *de novo*.

STATUTORY FRAMEWORK AND BACKGROUND

I. Statutory Framework

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA") altered the analysis bankruptcy courts must employ when determining whether to confirm proposed Chapter 13 repayment plans. When, as here, a trustee or holder of an allowed unsecured claim objects to plan confirmation, 11 U.S.C. § 1325(b)(1) conditions plan confirmation upon the debtors committing all of their "projected disposable income" to payments to unsecured creditors through the Chapter 13 plan. "Disposable income" is the current monthly income received by the debtors (other than child support payments, foster care payments, or disability payments for a dependent child) less amounts reasonably necessary to be expended. 11 U.S.C. § 1325(b)(2). The term "current monthly income" is the average monthly income from all sources that the debtors receive during the six-month period ending on the last day of the calendar month immediately preceding the date of the commencement of the case, including any amount paid by a third party on a regular basis for the household expenses of the debtor or the debtor's dependents, but excluding benefits received under the Social Security Act. 11 U.S.C. § 101(10A). For above-median-income debtors, the "amounts reasonably necessary to be expended" are determined "in accordance with"

§ 707(b)(2)(A)[1] and (B), which provides various specific expense categories from which debtors may reduce their "current monthly income."[2] 11 U.S.C. § 1325(b)(3).

The "means test" provisions of §§ 707(b)(2)(A) and (B) are used in determining the expenses of Chapter 13 debtors, like these debtors, whose income exceeds their state's family median income. 11 U.S.C. § 1325(b)(3). In determining expenses, § 707(b)(2)(A)(ii)(I) provides that a debtor's "monthly expenses shall be the debtor's *applicable* monthly expense amounts specified under the National Standards and Local Standards and the debtor's actual monthly expenses for the categories specified as Other Necessary Expenses issued by the Internal Revenue Service for the area in which the debtor resides." 11 U.S.C. § 707(b)(2)(A)(ii)(I) (emphasis added).

II. Factual Background

Davis owns outright a 1998 Chevrolet Cavalier. Her Cavalier is not encumbered by any debt, and she makes no monthly payments for her ownership of the vehicle. App. p. 1.[3] In her Form 22C, Davis claims the IRS Standard "Transportation

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[1] As amended by the BAPCPA, § 707(b)(2) repealed the former presumption in favor of the debtor, and replaced it with a new presumption. A case is an "abuse" of Chapter 7 if a detailed mathematical formula set out in the statute, commonly referred to as the "means test," yields a minimum amount of monthly disposable income. The means test uses a series of calculations to determine whether the § 707(b)(2) presumption of abuse arises in Chapter 7 cases. *See* 11 U.S.C. § 707(b)(2)(A).

[2] Form 22C, which debtors must file pursuant to Interim Federal Rule of Bankruptcy Procedure 1007(b)(6), serves, in part, to calculate debtor's "current monthly income."

[3] In this brief, "App." followed by a number refers to the Appendix to this Brief, including the bankruptcy court's opinion in both the Davis and Powell cases and the IRS Collection Financial Standards in effect at the time of filing both cases.

Ownership Lease Expense" in the amount of $471 for her Chevrolet Cavalier.[4]

The Powells own a 2003 Dodge Dakota free and clear of liens, and make no monthly payment for their ownership of the vehicle. App. p 10.[5] At Line 29 of their Form 22C, the Powells take a deduction of $332 for "Local Standards: Transportation Ownership Lease Expense; Vehicle 2," for their Dodge Dakota.[6]

The Chapter 13 Trustee objected to confirmation of the plans of Davis and the Powells, claiming the plans failed to provide all of their disposable income for the payment of creditors, contrary to 11 U.S.C. §§ 1325(a)(3) and (b)(1)(B). The Chapter 13 Trustee argued that the Debtors had more income to devote to paying creditors because they were improperly claiming the IRS Standard expense for vehicle financing expenses, even though these Debtors have no vehicle or lease payments. App. pp. 2, 11.

On February 26, 2008, the United States Bankruptcy Court for the Western District of Arkansas entered an order overruling the Chapter 13 Trustee's objection and confirming Davis' Chapter 13 plan. The next day, February 27, 2008, the same court

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[4] This amount is in addition to the "vehicle operation expense" for two or more vehicles of $343 taken by Davis on Line 27. Because her vehicle is over six years old, the United States Trustee would also allow Davis an additional $200 operating expense per vehicle, based on the Internal Revenue Manual which allows such an additional vehicle operating expenses. *See* Internal Revenue Manual, Part 5 (entitled Collecting Process), Chapter 8, § 5.8.5.5.2, Treatment of Non-Business Transportation Expenses, which may be found on the IRS website at http://www/irs/gov/irm/part5/ch08s05.html.

[5] See Footnote 3, *supra.*

[6] This amount is in addition to the "vehicle operation expense" for two or more vehicles of $343 taken by the Powells on Line 27. *See* Internal Revenue Manual, Part 5 (entitled Collecting Process), Chapter 8, § 5.8.5.5.2, Treatment of Non-Business Transportation Expenses, which may be found on the IRS website at http://www/irs/gov/irm/part5/ch08s05.html.

entered an order overruling the Chapter 13 Trustee's objection and confirming the Powells' Chapter 13 plan. The court ruled that Davis and the Powells were entitled to reduce their disposable income by the amount of the IRS Standard expenses allowance for vehicle financing costs even though they had no vehicle financing costs. On March 6, 2008, the Trustee timely filed her notice of appeal of the court's orders of February 26, 2008 and February 27, 2008.

SUMMARY OF ARGUMENT

The bankruptcy court erred as a matter of law in overruling the Chapter 13 Trustee's objection to confirmation and confirming the Chapter 13 plans of Davis and the Powells. It did so by misinterpreting when debtors can claim a vehicle ownership expense under 11 U.S.C. § 707(b)(2). The court held that Davis was entitled to deduct $471 in vehicle ownership expenses for her 1998 Chevrolet Cavalier, even though that vehicle was owned free and clear of encumbrances. The court also held that the Powells were entitled to deduct $332 for their 2003 Dodge Dakota, even though that vehicle was owned free and clear of debt.

This conclusion of law by the bankruptcy court is incorrect because the law allows these Debtors to claim only "applicable" expenses under § 707(b)(2), and they have no applicable vehicle ownership expenses because neither vehicle is subject to a loan or lease payment. This Court has already resolved this issue and reached the same conclusion in *In re Wilson*, 383 B.R. 729, 2008 WL 681102 (B.A.P. 8th Cir. March 14, 2008), and should follow that decision here.

By using the word "applicable," Congress limited eligibility for expenses under Local Standards to debtors for whom the expenses apply. Because the vehicle acquisition/financing expense does not apply with respect to these Debtors' vehicles, the bankruptcy court erred in holding they were eligible to deduct the vehicle ownership expenses under their means test.

Significantly, the bankruptcy court's interpretation of "applicable" in § 707(b)(2) has the erroneous effect of applying the means test in a manner that is inconsistent with the Internal Revenue Service's longstanding application of this standard. Under § 707(b)(2), the means test looks to the IRS to establish certain standard expenses. 11 U.S.C. § 707(b)(2)(A)(i)(I). In applying its standards to taxpayers, the IRS does not allow taxpayers to claim vehicle ownership expenses absent a monthly car expense. *See* IRS Collection Financial Standards attached hereto as Exhibit 4 of the Addenda.[7] Congress's use of "applicable" in § 707(b)(2) means this expense should be denied to debtors like Davis and the Powells who do not have a car loan or lease, for the same reasons the IRS does not allow taxpayers to claim such phantom expenses.

Finally, the bankruptcy court's orders overruling the Chapter 13 Trustee's objections to confirmation of the plans of Davis and the Powells conflict with sound notions of public policy and the primary purpose of Congress in passing bankruptcy reform legislation in 2005, including the amendments at issue in this appeal. The 2005 legislation was intended to ensure that debtors repay their debts when they can. By

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[7] The IRS revised its Collection Financial Standards, effective October 1, 2007, and such revisions were made applicable to bankruptcy cases filed as of January 1, 2008. Because the Davis and Powell cases were filed on April 20, 2007, only the Collection Financial Standards in effect prior to October 1, 2007, are applicable to these cases. For the Court's convenience, a true and correct PDF copy of the Collection Financial Standards applicable to these cases is included in the Appendix, pp. 13-23, and incorporated herein by reference. It is important to note, however, that the revisions made by the IRS effective October 1, 2007, do not change any result in these cases. As set forth in the current Collection Financial Standards, the Local Standard for Vehicle Operation is still made expressly contingent on the existence of a loan or lease payment on a vehicle. *See* App. pp. 13-23. As explained by the IRS, the recent revisions to the Local Standards were made to create equal allowances for first and second vehicles, add a separate public transportation allowance, and reorganize the manner in which taxpayers in certain counties calculate their transportation operating expenses. *See id.,* under heading "Recent Revisions."

allowing Davis and the Powells to claim a fictional expense for each of their vehicles, the bankruptcy court subverted that purpose.

ARGUMENT

I.

THE BANKRUPTCY COURT ERRED IN HOLDING THAT DAVIS AND THE POWELLS WERE ELIGIBLE TO CLAIM THE IRS LOCAL STANDARDS FOR VEHICLE OWNERSHIP FOR THEIR VEHICLES BECAUSE THE EXPENSE WAS NOT APPLICABLE TO THEM.

The bankruptcy court's orders overruling the Chapter 13 trustee's objection to confirmation of the Davis and Powell plans should be reversed because they fail to recognize that the Bankruptcy Code only allows debtors to claim vehicle expenses that are applicable to the debtors. 11 U.S.C. § 707(b)(2)(A)(ii)(I). Davis and the Powells do not have any "applicable" vehicle ownership expense because they own their respective vehicles outright. Their attempt to claim what is a phantom expense is prohibited by the Bankruptcy Code because the Code allows debtors to claim only "applicable" expenses, not phantom ones. For this reason, the orders entered by the bankruptcy court merit reversal.

A. Vehicle ownership expenses are allowable only if "applicable" to the debtors.

Section 707(b)(2)(A)(ii)(I) of the Bankruptcy Code provides that a "debtor's monthly expenses shall be the debtor's *applicable* monthly expense amounts specified under the...Local Standards...issued by the Internal Revenue Service." 11 U.S.C. § 707(b)(2)(A)(ii)(I) (emphasis added). The statute expressly provides that before the specific IRS expense amounts may be included in the debtor's allowed monthly expenses, the expense must itself first be applicable to the debtor. *Id.*

The Bankruptcy Code does not define the word "applicable," nor has the United States Trustee identified any United States Supreme Court or United States Court of Appeals for the Eighth Circuit decision that provides a definition in the bankruptcy context. Where, as here, a statutory term is undefined, a basic principle of statutory construction provides that courts should give such terms their ordinary meanings. *E.g., Smith v. U.S.*, 508 U.S. 223, 228 (1993) ("When a word is not defined by statute, we normally construe it in accord with its ordinary or natural meaning."); s*ee also Watson v. Ray*, 192 F.3d 1153, 1155 (8th Cir. 1999) (stating that, "When interpreting a statute the court starts with the statute's plain meaning."). The dictionary defines "applicable" to mean applying or capable of being applied; relevant; suitable; appropriate. *Random House Unabridged Dictionary* (2006). Accordingly, such a meaning should be imparted to the term "applicable" as it appears in section 707(b)(2)(A)(ii)(I) absent clear indication that Congress intended to give such term a different meaning. *See Schumacher v. Cargill Meat Solutions Corp.,* 515 F.3d 867, 871 (8th Cir. 2007) ("In the absence of a statutory definition or clear contrary legislative intent, statutory terms are given their plain, ordinary, and commonly understood meaning. This court often turns to a commonly used dictionary to ascertain a word's ordinary meaning." (citations omitted)); *Hutchins v. Champion International Corporation*, 110 F.3d 1341, 1344 (8th Cir. 1997)("Ordinary meaning is determined by the dictionary definition of the word and the context in which it is used.").

This Court has recently held that "a vehicle ownership expense is only applicable if a debtor is in fact incurring such an expense." *See In re Wilson*, 383 B.R. 729, 2008 WL 681102 (B.A.P. 8th Cir. March 14, 2008). In *Wilson,* Chapter 13 debtors sought to claim vehicle ownership expenses for two vehicles they owned outright. *Id.* at *2. This Court concluded that "debtors who do not incur vehicle ownership expenses are not permitted to claim the IRS Standard deductions for such expenses because such expenses are not applicable under § 707(b)(2)(A)(ii)(I)." *Id.* at *4. *See also In re Ransom*, 380 B.R. 799 (B.A.P. 9th Cir. 2007) (holding that under § 707(b)(2)(A)(ii)(I) the deduction of a vehicle ownership expense only applies to the debtor when he or she has that particular expense); *Wieland v. Thomas,* 382 B.R. 793 (D. Kan. 2008) (stating that the court is more persuaded by the trustee's argument that the statute should be construed to allow a car ownership expense only if the debtor in fact incurs such an expense in the form of a car payment, and it believes that the Tenth Circuit would adopt such an interpretation); *In re Meade*, ___ B.R. ___, 2008 WL 792060 (W.D. Tex. Jan. 24, 2008) (stating the court is of the opinion that the plain meaning of "applicable" necessitates an existing ownership or lease payment for a debtor to claim an ownership or lease payment deduction); *In re Deadmond*, ___ B.R. ___, 2008 WL 191165 (D. Mont. Jan. 22, 2008) (following the rationale in *Ransom*) (stating that "[W]hen the debtor has no monthly ownership expenses, it makes no sense to deduct an ownership expense to shield it from the creditors"); *In re Ross-Tousey*, 368 B.R. 762, 764-67 (E.D. Wis. 2007) (holding that word "applicable" in section 707(b)(2)(A)(ii)(I) means that "ownership expenses must exist" in the form of an actual loan or lease payment); *Fokkena v. Hartwick*, 373 B.R.

645, 650 (D. Minn. 2007) (finding that "word 'applicable' in [section 707(b)(2)(A)(ii)(I)] means that, before the expense amount can be included in the debtor's allowed monthly expenses, the expense itself must actually be applicable to the debtor–in other words, the debtor must actually have a loan or lease payment obligation"). *Cf. In re Devilliers*, 358 B.R. 849, 859 (Bankr. E.D. La. 2007) (stating that debtors may claim IRS ownership expense only after "a determination is made as to the type of expenses allowed and applicable to the debtor"); *In re Carlin*, 348 B.R. 795, 798 (Bankr. D. Or. 2006) (finding that statute plainly and unambiguously does not allow the vehicle operating expense at issue to "free and clear" owners).

The bankruptcy court's order is inconsistent with the ordinary, common sense definition of "applicable" because it allows debtors like Davis and the Powells to deduct expenses that do not apply to them. Here, Davis and the Powells seek to claim a loan or lease payment, but they have none. If the expense, which Davis does not incur on a monthly basis, is disallowed, in a 60-month repayment plan under Chapter 13 of the Bankruptcy Code, Davis will have the ability to repay her unsecured creditors $36,336.60, which is fifty-nine percent (59%) of her total scheduled unsecured claims. Likewise, the Powells will have the ability to repay their unsecured creditors $17,460.00, which amount will pay in excess of one hundred percent (100%) of their total scheduled unsecured claims. By inserting the word "applicable" in section 707(b)(2)(A)(ii)(I), Congress limited eligibility for expenses under the Local Standards to debtors for whom such expenses are "relevant; suitable; appropriate"--thereby excluding phantom ones. Because neither Davis nor the Powells have vehicle financing expenses for their vehicles, the IRS ownership expense does not apply to those vehicles.

The court below concluded that Davis and the Powells could deduct vehicle expenses they do not have because "applicable" in § 707(b)(2)(A)(ii)(I) refers solely to the number of vehicles claimed and where the debtors reside, not whether the debtors own their car free and clear of liens. In other words, according to the bankruptcy court, "applicable" in the statute refers to the number of standardized expenses these debtors can claim. This interpretation by the court not only contradicts this Court's holding in *Wilson* but also effectively rewrites the statute. For the court's interpretation to be correct, the statute would need to read "[t]he debtor's monthly expenses shall be the ~~debtors'~~ applicable [number of] monthly expense amounts...." 11 U.S.C. § 707(b)(2)(A)(ii)(I) (as modified). Such statement is not in the statute. Nowhere does it state "applicable" means the "number" of expenses. Because "applicable" follows the word "debtors," it is clear that the statute asks debtors to claim the IRS standard expenses that apply to them. For these reasons, Davis and the Powells should not be allowed deductions for inapplicable phantom expenses they do not have.

The bankruptcy court's proffered numerical definition also fails to appreciate that a debtor's ability to pay creditors is not affected by mere vehicle *ownership* but by *payments* on a car. Accordingly, § 707(b)(2)(A)(ii)(I) does not focus on how many cars a debtor owns, but how many cars he or she makes *payments* on every month. *See In re Wilson*, 383 B.R. 729, 2008 WL 681102 at *3 (B.A.P. 8th Cir. March 14, 2008), *citing Ross-Tousey,* 368 B.R. at 766 ("The statute is only concerned about protecting the debtor's ability to continue owning a car, and if the debtor already owns the car, the debtor is adequately protected."); s*ee also Hartwick,* 373 B.R. at 652 (same).

Hartwick and *Ross-Tousey* reversed the bankruptcy court rulings in those cases because those courts, like the bankruptcy court here, failed to give the word "applicable" its ordinary meaning. Instead, bankruptcy courts, like the one in these cases, made an arbitrary distinction between the word "actual" and "applicable" expenses in § 707(b)(2)(A)(ii)(I). *See, e.g., In re Fowler*, 349 B.R. 414, 418 (Bankr. D. Del. 2006) ("The use of 'actual' with respect to the Other Necessary Expenses and 'applicable' with respect to the National and Local Standards must mean that Congress intended two different applications.") The bankruptcy court here agreed that "applicable" and "actual" must have different meanings as Congress used both terms in the statute and, therefore, debtors like Davis and the Powells need not have any "actual" expense for the Ownership Expense Standard to be "applicable." App. pp. 6-7. This logic is misguided, however. As the *Ross-Tousey* court explained, there is no indication in section 707(b)(2)(A)(ii)(I) that Congress intended the words "applicable" and "actual" to have essentially *opposite* meanings. *Ross-Tousey,* 368 B.R. at 765. Rather, as *Ross-Tousey* held, the better reading of "applicable" in the context of section 707(b)(2)(A)(ii)(I) is that it may have two meanings: first, the ownership expense is "applicable" if the debtor makes a loan or lease payment on a vehicle, and second, the *amount* allowed to the debtor is the "applicable" amount provided under the IRS Standards, and not the "actual" amount." *Id.*, *see also Hartwick*, 373 B.R. at 653. "This reading gives meaning to the distinction between 'applicable' and 'actual' without taking a further step to conclude that 'applicable' means "nonexistent' or 'fictional.'" *Ross-Tousey,* 365 B.R. at 765.

By using the term "applicable" in this way, a determination of allowable expenses under the means test is a two-step process. The first step is eligibility—*i.e.,* does the debtor qualify for an expense allowance in the category at issue? If so, then the second step is to quantify the expense amount the eligible debtor is allowed by looking at the IRS Standard amounts that are specified for the number of vehicles owned by the debtor and where the debtor lives. *See, e.g., Carlin*, 348 B.R. at 798 ("There is nothing absurd in Congress drawing the line for vehicle ownership expense eligibility at those debtors who are making payments on the vehicle."). The bankruptcy court's ruling impermissibly skips the first step of determining whether Davis and the Powells are *eligible* for the ownership expense by virtue of having a loan or lease payment for a vehicle, and proceeds directly to the second—only considering the *amount* the IRS would allow eligible taxpayers to claim for the number of vehicles they own and where they reside.

B. The UST's construction of "applicable" in § 707(b)(2) has the salutary effect of treating transportation costs the same way in bankruptcy cases that the IRS treats them.

Reversal of the bankruptcy court's orders will have the additional benefit of treating inapplicable, phantom expenses in bankruptcy cases the way the IRS has long treated them. In providing which deductions debtors may take under the means test, Congress specifically stated that debtors are permitted to deduct "the debtor's *applicable* monthly expense amounts specified under the...Local Standards...issued by the *Internal*

Revenue Service." 11 U.S.C. § 707(b)(2)(A)(ii)(I) (emphasis added). Accordingly, how the Internal Revenue Service applies the Standards that it developed for its own internal debt collection purposes is instructive on the question of how the same Standards might be applied in bankruptcy cases under section 707(b)(2). *See, e.g., Hartwick*, 373 B.R. at 650-51 ("in order to determine whether the expense Standards issued by the IRS are 'applicable,' the most logical resource to consult is the IRS"); s*ee also In re Slusher,* 359 B.R. 290, 309 (Bankr. D. Nev. 2007) ("if guidance is sought on the meaning of the IRS standards Congress incorporated into the Bankruptcy Code, practical reason would suggest that courts should consider the full manner by which the IRS uses these standards.").

The IRS Collection Financial Standards in effect as of the date of Davis' and the Powells' bankruptcy filings[8] fully support the United States Trustee's construction of the term "applicable" and provide as follows:

> The transportation standards consist of nationwide figures for monthly loan or lease payments referred to as ownership costs, and additional amounts for monthly operating costs....The ownership costs provided maximum allowances for the lease or purchase of up to two automobiles if allowed as a necessary expense....If a taxpayer has a car payment, the allowable ownership cost added to the allowable operating cost equals the allowable transportation expense. **If a taxpayer has no car payment, or no car, the operating costs portion of the transportation standard is used to come up with the allowable transportation expense.**

See IRS Collection Standards (App. pp. 13-23); *see also* Internal Revenue Manual, Financial Analysis Handbook, Pt. 5, ch. 15, § 5.15.1.7(4.B), available at

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[8] *See* Footnote 7, *supra.*

http://www.irs.gov/irm/part5/ch15s01.html#d0e182771. In addition, Chapter 8 of the Financial Analysis Handbook clarifies that the ownership expense is allowed only for the "purchase and/or lease of a vehicle." Internal Revenue Manual, Part 5 (entitled Collecting Process), Chapter 8, § 5.8.5.5.2, Treatment of Non-Business Transportation Expenses, at page 12 of 16, which may be found at the IRS website at http://www/irs/gov/irm/part5/ch08s05.html.

As of the date Davis and the Powells filed their bankruptcy petitions,[9] the "ownership cost" was specifically calculated by the IRS based on the cost to finance the acquisition of a vehicle, and not simply a cost associated with owning a car, such as repair or maintenance. The "ownership cost" Standards are based on the **"five-year average of new and used car financing data compiled by the Federal Reserve Board of Governors."** *See* IRS Collection Financial Standards, *supra* (at section entitled "Recent Revisions.") (emphasis added). As such, the IRS does not treat the "ownership cost" expense as applicable when a taxpayer does not have a monthly expense related to financing a car. In exercising its discretion to collect taxes, the IRS recognizes that taxpayers may claim the vehicle "ownership cost" portion of the Local Transportation Standards only in situations where the taxpayer has a monthly vehicle acquisition financing expense, *i.e.,* has a monthly vehicle loan or lease payment. *See id.*

The bankruptcy court agreed that Congress did incorporate the IRS's Local Standards into the bankruptcy code, but ruled that the Internal Revenue Manual (IRM) is not incorporated into the bankruptcy code. App. p. 6.

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[9] *See* Footnote 7, *supra.*

Some courts, however, consider the IRM an aid in interpreting the language of § 707(b)(2)(A)(ii)(I). *See In re Ransom,* 380 B.R. at 805. This Court itself relied on the IRM in its analysis. *See In re Wilson*, 383 B.R. 729, 2008 WL 681102 at *3 (B.A.P. 8th Cir. March 14, 2008). In stating that the amounts "specified" by the IRS Standards may be deducted from current monthly income to yield a debtor's disposable income, Congress "essentially read [ ] into the Code not only the actual numbers contained in the IRS Standards, but also the Manual's context for their application." *In re Howell,* 366 B.R. 153, 157 (Bankr. D. Kan. 2007). Thus, "if guidance is sought on the meaning of the IRS Standards that Congress incorporated into the Bankruptcy Code, practical reason would suggest that court should consider the full manner by which the IRS uses these standards." *In re Slusher*, 359 B.R. at 309; *see also In re Howell*, 366 B.R. at 157 ("It is unlikely that Congress intended the Statute to merely import the numbers without their attendant meaning and context."); *In re Oliver*, 350 B.R. 294, 301 (Bankr. W.D. Tex. 2006) (holding that debtor is not entitled to vehicle ownership expense because IRS Financial Analysis Handbook and Internal Revenue Manual limit expense to individuals that have loan or lease payment); *In re Hardacre*, 338 B.R. 718, 726 (Bankr. N.D. Tex. 2006) (same).

Unlike the bankruptcy court, the court in *Thomas* was not dissuaded by the statute's failure to refer to or incorporate the IRM, which instructs that the numbers in the standards represent caps. *Wieland v. Thomas,* 382 B.R. 793, 798 (D. Kan. 2008). The *Thomas* court stated that:

> "the statute as written sufficiently adopts the numbers in their context as part of the National and Local Standards created by the IRS. It is also

> worth noting that the committee report accompanying the statute makes specific reference to the IRS's Financial Analysis Handbook in connection with the National and Local Standards. *See* H.R. Rep. No. 109-31(I); 2005 U.S.C.C.A.N. 88, 99-100. Thus, it does not appear that Congress intended to adopt only the numbers contained in the Standards without the context and meaning provided by the IRS in creating the Standards and in its normal application of those numbers as set forth in the Handbook and Manual. Although the proper interpretation is dictated by the language of the statute itself, the court notes that its interpretation comports with the purposes of BAPCPA."

Id.

Given the IRS's historic application of its National Standards and Local Standards up to the time of BAPCPA's enactment, "it would be quite odd if Congress intended to preclude courts from examining the context in which the authoring agency, the IRS, used and employed those standards." *See Slusher,* 359 B.R. at 309. Nothing compels such an odd reading. Consistent with IRS practice, this Court should hold that courts should use the IRM as a tool in interpreting the IRS Vehicle Ownership Standards with regards to the means test.

The court below also expressed concern that the IRM differs from § 707(b)(2)'s means test because the IRM lets taxpayers deduct the actual amount of their car payment up to the cap set out in the IRS's Local Standards, but the means test allows debtors to claim the full amount of the Local Standard, even if their car payment is less. App. p. 6. That concern is irrelevant. The relevant point is that the IRS prohibits individuals from claiming a car payment when they have none. The exact same thing happens under the means test because a debtor without an "applicable" car expense cannot claim a car payment either.

Further, considering IRS practice in interpreting "applicable" expenses in section 707(b)(2)(A)(ii)(I) does not negate the section's later allowance of "actual" monthly expenses in the IRS categories of Other Necessary Expenses. Rather, "a natural reading" of section 707(b)(2)(A)(ii)(I) indicates that the words "actual" and "applicable" limit the relevant expense deductions in different ways. *Slusher,* 359 B.R. at 308. "Had Congress intended to indiscriminately allow all expense amounts specified in the National and Local Standards, it would have written section 707(b)(2)(A)(ii)(I) to read, "The debtor's monthly expenses shall be the monthly amounts specified under the National Standards and the Local Standards....' rather than 'The debtor's monthly expenses shall be *the debtor's applicable* monthly expense amounts specified under the National and Local Standards." *Id.* (Emphasis in original).

II.

THE BANKRUPTCY COURT'S ORDERS CONFLICT WITH THE MAJOR GOALS OF THE 2005 AMENDMENTS TO THE BANKRUPTCY CODE.

The bankruptcy court's orders in the Davis and Powell cases are also inconsistent with Congress's goals and purpose in implementing bankruptcy reform. Congress amended the Bankruptcy Code in 2005 to rectify perceived abuses in the bankruptcy process. "Among the abuses identified by Congress was the easy access to chapter 7 liquidation proceedings by consumer debtors who, if required to file under chapter 13, could afford to pay some dividend to their unsecured creditors." *In re Hardacre,* 338 B.R. 718, 720 (Bankr. N.D. Tex. 2006) (*citing* 151 Cong. Rec. S2459, 2469-70

(March 10, 2005)). A "primary goal" of the 2005 Reform Act was to "ensure that debtors repay creditors the maximum they can afford." *Thomas*, 382 B.R. at 798; *see also In re Lenton*, 358 B.R. 651 (Bankr. E.D. Pa. 2006) (*citing* H.R. Rep. No. 109-31, pt. 1, at 1 (2005), *reprinted in* 2005 U.S.C.C.A.N. 88, 89). In cases such as these, where Davis and the Powells have no loan or lease payment, Congress has established a system which does not provide them an expense deduction for vehicle financing. "Allowing debtors to deduct from their disposable income a fictional ownership allowance would give debtors with unencumbered vehicles a windfall at the expense of their unsecured creditors." *In re Howell,* 366 B.R. 153, 157 (Bankr. D. Kan. 2007).

CONCLUSION

For all of these reasons, the United States Trustee respectfully asks this Court to reverse the February 26, 2008 Order entered by the Bankruptcy Court in the Davis case and the February 27, 2008 Order entered in the Powell case, denying the Chapter 13 Trustee's objections to confirmation of the Debtors' plans and Order confirming the Debtors' plans, and remand these cases to the Bankruptcy Court for further proceedings.

Respectfully submitted,

NANCY J. GARGULA
UNITED STATES TRUSTEE

CHARLES W. TUCKER
ASSISTANT UNITED STATES TRUSTEE

By Jim Hollis
Jim Hollis (AR Bar No. 78072)
Trial Attorney
200 West Capitol, Suite 1200
Little Rock, AR 72201
Telephone: (501) 324-7357
Fax: (501) 324-7388
E-mail: jim.hollis@usdoj.gov

CERTIFICATE OF COMPLIANCE WITH L.R. BAP 8TH CIR. 8010A

The undersigned hereby certifies that the foregoing Amicus Curiae Brief complies with the type-volume limitations of L.R. BAP 8th Cir. 8010A. The Amicus Curiae Brief was prepared with word processing software, Microsoft Word 2003. The typeface used is CG Times with 12-point typeface. The total number of words, exclusive of pages containing the table of contents, table of citations, statement of the basis of appellate jurisdiction, statement of the issues, and standard of review is 5,348.

The undersigned further certifies that one computer diskette, appropriately labeled, containing the full text in one document has been provided to the Eighth Circuit Bankruptcy Appellate Panel, along with the filing of the Amicus Curiae Brief on behalf of the United States Trustee. The computer diskette is certified to be virus-free.

The undersigned further certifies that on April 28, 2008, two copies of the United States Trustee's Amicus Curiae Brief have been sent for filing to the Eighth Circuit Bankruptcy Appellate Panel by United States Priority Mail and to the following parties by United States Mail, postage prepaid:

Jack Martin, Esq.
2706 American Drive
Springdale, AR 72764
Attorney for Appellees

Joyce Bradley Babin, Esq.
Chapter 13 Trustee
Post Office Box 8064
Little Rock, AR 72203-8064

The Honorable Ben Barry
United States Bankruptcy Judge
35 East Mountain, Room 316
Fayetteville, AR 72701

Jim Hollis

Jim Hollis

BRIEF BANK — “SUMMARY SHEET”

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WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	Jim G. Price v. United States, et al.
2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	United States Supreme Court
3. ("CCN") ***CURRENT*** CASE NO.	No.: 09-113
4. ("PCN") ***PRIOR*** CASE NO. - & COURT *[IF ANY]*	No.: 05-17421 Court: 9th Cir. *(Identify judge & cite, if any)*
5. ("SO") ***SOURCE***	**U.S. TRUSTEES**
6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	Filed: October 28, 2009 Type: Brief for the United States in Opposition
7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*	Malcolm Stewart, Jeffrey Wall *(UST/OGC: 202-307-1399/FAX-2397)*
8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	• Whether, based on petitioner’s breach of professional legal ethics in the course of a bankruptcy case, the bankruptcy court had the authority to suspend him from practicing before it for three months.
10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)	
11. DO YOU RECOMMEND POSTING IN UST BRIEFBANK?	☒ YES ☐ NO ***NAME:*** Linda Figueroa ***DATE:***

No. 09-113

In the Supreme Court of the United States

JIM G. PRICE, PETITIONER

v.

UNITED STATES BANKRUPTCY COURT FOR THE
NORTHERN DISTRICT OF CALIFORNIA

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

BRIEF FOR THE UNITED STATES TRUSTEE IN OPPOSITION

ELENA KAGAN
Solicitor General
Counsel of Record
TONY WEST
Assistant Attorney General
WILLIAM KANTER
ROBERT D. KAMENSHINE
Attorneys

Department of Justice
Washington, D.C. 20530-0001
(202) 514-2217

QUESTION PRESENTED

Whether, based on petitioner's breach of professional legal ethics in the course of a bankruptcy case, the bankruptcy court had the authority to suspend him from practicing before it for three months.

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NORTHERN DISTRICT OF CALIFORNIA

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

BRIEF FOR THE UNITED STATES TRUSTEE IN OPPOSITION[1]

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-18a) is reported at 564 F.3d 1052. The opinion of the bankruptcy appellate panel (Pet. App. 19a-44a) is reported at 332 B.R. 404. The opinion of the bankruptcy court (Pet. App. 45a-70a) is unreported.

JURISDICTION

The judgment of the court of appeals was entered on April 28, 2009. The petition for a writ of certiorari was

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[1] Although the petition for a writ of certiorari does not identify the United States Trustee as a party to the case, the United States Trustee was a party in the court of appeals, see Pet. App. 1a, and is therefore a party to the proceedings in this Court under Supreme Court Rule 12.6.

filed on July 24, 2009. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. In late 2003, debtor Patricia Lehtinen retained petitioner to represent her in filing for bankruptcy. Lehtinen told petitioner that she wanted to secure a home improvement loan, perform various repairs on her house, and then sell the house to repay debts. Petitioner offered to serve as her attorney in filing the bankruptcy petition and as her real estate broker in listing her house for sale. In December 2003, with petitioner's assistance, Lehtinen filed for bankruptcy under Chapter 13. Pet. App. 47a-48a.

Pursuant to their retention agreement, petitioner agreed to attend the meeting of creditors held pursuant to 11 U.S.C. 341. On February 19, 2004, Lehtinen attended that meeting, but petitioner did not attend. Rather, petitioner sent in his stead another attorney who was not a member of his firm. Pet. App. 48a. Petitioner did not notify Lehtinen that he would be absent from the meeting, nor did he secure her consent to another attorney's appearance. *Ibid.*

In March and April 2004, petitioner advised Lehtinen to list her house for $340,000 to $345,000 in order to induce a quick sale. Pet. App. 50a-51a. Meanwhile, petitioner arranged for Lehtinen to receive a home improvement loan, but the mortgage company conditioned the loan on Lehtinen's using petitioner as her broker. *Id.* at 49a-50a. Lehtinen decided to list the house through another broker without performing any improvements, and shortly thereafter she accepted an offer for $390,000. *Id.* at 52a.

On June 3, 2004, Lehtinen attended the confirmation hearing, but petitioner again did not attend. Pet. App. 52a-53a. Petitioner was absent because he had agreed to represent another client at a hearing that afternoon in a different courthouse. *Id.* at 53a. The bankruptcy court confirmed Lehtinen's plan, but it also issued an order for petitioner to appear at a hearing on July 8, 2004, and show cause why he should not be required to disgorge any compensation received from Lehtinen for his failure to attend the creditors' meeting and confirmation hearing. *Ibid.* The next day, on June 4, 2004, petitioner sent Lehtinen a letter stating that her case had been dismissed at the confirmation hearing—a statement that was not true and that petitioner had made no attempt to verify. *Id.* at 53a-54a.

At the July 8 hearing, the bankruptcy court ordered petitioner to reduce by $300 the fee of $1500 that he had charged Lehtinen for representing her in the bankruptcy case. Pet. App. 55a. After receiving a letter from Lehtinen describing petitioner's conduct in greater detail, however, the court issued an order for petitioner to appear for a second hearing on July 26, 2004. *Ibid.* The order identified four instances of petitioner's alleged misconduct, and stated that "the facts point to a clear conflict of interest between [petitioner] acting as the debtor's lawyer, soliciting the debtor to use his services as a real estate broker, and serving as a loan broker." *Id.* at 5a (internal quotation marks and citation omitted). The order therefore required petitioner to show cause "why [he] should not be sanctioned pursuant to this court's inherent sanction power * * * for bad faith conduct" and "why he should not be suspended or disbarred from practice in this court." *Id.* at 4a (internal quotation marks omitted). The court also ordered Lehtinen to appear and testify at the hearing. *Ibid.*

2. a. Following the July 26 hearing, the bankruptcy court determined that petitioner had violated several provisions of the California Business & Professions Code and the California Rules of Professional Conduct. Pet. App. 45a-70a; see *id.* at 69a. The court found that petitioner had intentionally failed to appear at the creditors' meeting and confirmation hearing, *id.* at 59a, 64a, and had pressured Lehtinen to hire him as her real estate broker, *id.* at 68a. The court stated that petitioner's "conduct in this case was outrageously improper, unprofessional and unethical under any reading of California's ethical standards for attorneys." *Ibid.* The court therefore ordered petitioner "to disgorge to [Lehtinen] the entire balance of the $1,500 fee he was paid in this case." *Id.* at 70a. Moreover, "[i]n light of the egregious nature of [petitioner's] conduct," the court suspended petitioner "from the practice of law in the United States Bankruptcy Court for the Northern District of California for a period of three months," with the exception of any "cases and adversary proceedings already filed in which [petitioner] has already made an appearance as the attorney of record." *Ibid.* Petitioner appealed and obtained a stay of his suspension. *Id.* at 5a.

b. The bankruptcy appellate panel held that the bankruptcy court had authority to sanction petitioner, but it vacated the portion of the bankruptcy court's order that suspended petitioner from practice, and it remanded for further proceedings to reconsider the appropriate sanction. Pet. App. 19a-44a. The panel concluded that "the bankruptcy court could discipline" petitioner, and that the court had "afforded [petitioner] due process." *Id.* at 30a. In the panel's view, petitioner "ha[d] not shown that the bankruptcy court clearly erred in its factual findings, nor that it lacked clear and convincing evidence." *Ibid.* But while the panel determined that "discipline was appropriate," *ibid.*, it remanded the case so that the bankruptcy court could "consider the ABA Standards in determining the appropriate sanction," *id.* at 31a. See *id.* at 44a ("[T]he record does not disclose that the court considered all appropriate factors in determining what sanction to impose.").

c. The court of appeals affirmed the order of the bankruptcy appellate panel. Pet. App. 1a-18a. Although the decision under review was non-final, the court of appeals found that it possessed jurisdiction because the appeal presented a question of law, *i.e.*, whether the bankruptcy court had authority to sanction petitioner. *Id.* at 6a. On the merits, the court of appeals held that bankruptcy courts possess inherent power to sanction attorneys appearing before them for bad faith or willful misconduct. *Id.* at 8a-11a. The court further held that petitioner had received adequate notice of the possible suspension, *id.* at 12a-15a, and that the Northern District of California Civil Local Rules did not require the bankruptcy court to refer the suspension action to a standing committee, *id.* at 16a-18a.

ARGUMENT

The decision of the court of appeals is correct and does not conflict with any decision of this Court or of any other court of appeals. Further review is not warranted.

1. a. As a threshold matter, there is a substantial question whether the court of appeals had jurisdiction to hear petitioner's appeal. The bankruptcy appellate panel vacated the decision of the bankruptcy court and remanded for that court to "consider[] all appropriate fac-

tors in determining what sanction to impose." Pet. App. 44a. Ten courts of appeals have held that "a decision by the district court on appeal remanding the bankruptcy court's decision for further proceedings in the bankruptcy court is not final, and so is not appealable * * * , unless the further proceedings contemplated are of a purely ministerial character." *In re Lopez*, 116 F.3d 1191, 1192 (7th Cir.), cert. denied, 522 U.S. 1014 (1997); see *id.* at 1192 (citing cases from eight other courts of appeals); see *In re Swegan*, 555 F.3d 510, 512 (6th Cir. 2009).

The Third and Ninth Circuits, however, have adopted a more liberal approach to appealability. See, *e.g.*, *United States Trustee* v. *Gryphon at the Stone Mansion, Inc.*, 166 F.3d 552, 556 (3d Cir. 1999). As relevant here, the Ninth Circuit has held that it possesses "jurisdiction over a non-final order in a bankruptcy case where 'the appeal concerns primarily a question of law.'" Pet. App. 6a (quoting *DeMarah* v. *United States*, 62 F.3d 1248, 1250 (9th Cir. 1995)). This Court would be required to consider that jurisdictional issue if it granted the petition, see *Bender* v. *Williamsport Area Sch. Dist.*, 475 U.S. 534, 541 (1986), and the Court might ultimately conclude that it could not reach the merits of petitioner's claims, see *United States* v. *Corrick*, 298 U.S. 435, 440 (1936).

b. At the least, the non-final nature of the decision below counsels against further review at this time. The remand by the bankruptcy appellate panel leaves open the possibility that the bankruptcy court will not suspend petitioner once it "consider[s] all appropriate factors." Pet. App. 44a. In the event that petitioner is again suspended, he may raise his current claims—together with any other claims that might arise during the proceedings on remand—in a new petition for a writ of certiorari. See *Major League Baseball Players Ass'n* v. *Garvey*, 532 U.S. 504, 508 n.1 (2001). Accordingly, review by this Court would be premature at this time.

2. a. On the merits, petitioner argues (Pet. 3-5) that bankruptcy courts lack inherent authority to sanction the bad faith misconduct of attorneys who appear before them. That contention lacks merit. This Court's precedents have "recognized the 'well-acknowledged' inherent power of a court to levy sanctions in response to abusive litigation practices." *Roadway Express, Inc.* v. *Piper*, 447 U.S. 752, 765 (1980) (citing *Link* v. *Wabash R.R.*, 370 U.S. 626, 632 (1962)). "It has long been understood that '[c]ertain implied powers must necessarily result to our Courts of justice from the nature of their institution,' powers 'which cannot be dispensed with in a Court, because they are necessary to the exercise of all others.'" *Chambers* v. *NASCO, Inc.*, 501 U.S. 32, 43 (1991) (quoting *United States* v. *Hudson*, 11 U.S. (7 Cranch) 32, 34 (1812)).

"A primary aspect" of a court's inherent powers is "the ability to fashion an appropriate sanction for conduct which abuses the judicial process." *Chambers*, 501 U.S. at 44-45. A court thus confronted with a party's bad faith misconduct in the course of proceedings has the discretion to respond with a variety of sanctions. *Id.* at 45. And just as courts can sanction parties for their bad faith conduct, so too can courts can sanction parties' counsel for the same types of misconduct. *Roadway Express*, 447 U.S. at 766 ("The power of a court over members of its bar is at least as great as its authority over litigants."). Here, the bankruptcy court imposed a sanction—suspending petitioner from accepting new cases before that court for three months—less severe than others that have been upheld as within courts' inherent authority. *Chambers*, 501 U.S. at 45.

A clear expression of congressional intent is required to displace a court's inherent power to sanction bad faith conduct. *Chambers*, 501 U.S. at 47. The Bankruptcy Code, far from displacing the inherent powers of courts, expressly recognizes the bankruptcy court's authority to sanction litigants for abusive litigation practices. The Code states that "[n]o provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, sua sponte, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or *to prevent an abuse of process*." 11 U.S.C. 105(a) (emphasis added); see 132 Cong. Rec. 28,610 (1986) (statement of Sen. Hatch) (Section 105(a) "allows a bankruptcy court to take any action on its own, or to make any necessary determination to prevent an abuse of process and to help expedite a case in a proper and justified manner.").

Accordingly, it is well established that bankruptcy courts have the power to sanction parties or counsel for bad faith conduct in bankruptcy proceedings. See, *e.g.*, *In re Sunshine Jr. Stores, Inc.*, 456 F.3d 1291, 1304-1306 (11th Cir. 2006); *In re DeVille*, 361 F.3d 539, 548-551 (9th Cir. 2004); *In re Rimsat, Ltd.*, 212 F.3d 1039, 1046-1049 (7th Cir. 2000); *Pearson* v. *First N.H. Mortgage Corp.*, 200 F.3d 30, 42 n.7 (1st Cir. 1999); *Weiss* v. *First Citizens Bank & Trust Co.*, 111 F.3d 1159, 1171-1172 (4th Cir.), cert. denied, 522 U.S. 950 (1997); *Mapother & Mapother, PSC* v. *Cooper*, 103 F.3d 472, 477 (6th Cir. 1996); *In re Huckfeldt*, 39 F.3d 829, 832 (8th Cir. 1994); *Citizens Bank & Trust Co.* v. *Case*, 937 F.2d 1014, 1023-1024 (5th Cir. 1991). Petitioner identifies no decision holding that bankruptcy courts lack such authority.

b. Petitioner's reliance (Pet. 3, 5-6) on *In re Sheridan*, 362 F.3d 96 (1st Cir. 2004), is misplaced. In *In re Sheridan*, the bankruptcy court did not sanction counsel in the course of an ongoing bankruptcy case. *Id.* at 107. Rather, the court presided over an omnibus disciplinary proceeding to investigate potential ethical violations that spanned many closed bankruptcy cases. *Ibid.* Absent the consent of the parties, however, a bankruptcy court may enter a final judgment only with respect to "core" proceedings, or proceedings related to the administration of a bankruptcy case. *Id.* at 99-100 (citing *Northern Pipeline Constr. Co.* v. *Marathon Pipe Line Co.*, 458 U.S. 50, 86-87 (1982)). The First Circuit held in *In re Sheridan* that the omnibus disciplinary action involved in that case was not a core proceeding, and thus "in th[o]se particular circumstances[] the bankruptcy court was not empowered to arrive at a *final* resolution of the disciplinary matter absent further district court participation and oversight." *Id.* at 110.

Nothing in *In re Sheridan* casts doubt on the result in the present case. As the court of appeals concluded, "[t]he circumstances here are clearly different," Pet. App. 7a n.1, because the bankruptcy court sanctioned petitioner for his bad faith misconduct in the context of an ongoing bankruptcy case. The First Circuit in *In re Sheridan* "d[id] not question that the case law overwhelmingly suggests that the bankruptcy court possesses the requisite authority, either inherent or statutory, to regulate its bar as necessary and appropriate." 362 F.3d at 110. For that reason, the First Circuit made explicit that its opinion did not extend to other types of disciplinary proceedings, including proceedings conducted during the course of a bankruptcy case. *Id.* at 111.[2]

c. Petitioner is also incorrect in arguing (Pet. 6-7) that the bankruptcy court acted in violation of the Northern District of California Civil Local Rules. As the court of appeals explained, see Pet. App. 17a, Civil Local Rule 11-6(a)(2) permits bankruptcy courts, *inter alia*, to "[i]mpose other appropriate sanctions" for attorney misconduct. In electing to suspend petitioner from bringing new bankruptcy cases in the Northern District for three months, rather than to initiate contempt proceedings or refer petitioner to the California Bar, the bankruptcy court imposed the sort of "other appropriate sanctions" contemplated by Civil Local Rule 11-6(a)(2). The lower courts' interpretation of their own Rules does not warrant this Court's review. And because the court of appeals affirmed the order of the bankruptcy appellate panel, which remanded the case to the bankruptcy court to reconsider the appropriate sanction, further review of the specific sanction that was previously imposed would be premature at this time. See pp. 6-7, *supra*.

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[2] Although the court of appeals considered and rejected petitioner's contention (Pet. 5) that his disciplinary hearing was not a core proceeding, see Pet. App. 6a-7a & n.1, the bankruptcy appellate panel declined to consider that argument on the ground that "[petitioner] ha[d] waived any issue respecting the core or non-core nature of the disciplinary proceeding." *Id.* at 27a; see *id.* at 27a-28a.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

ELENA KAGAN
Solicitor General
TONY WEST
Assistant Attorney General
WILLIAM KANTER
ROBERT D. KAMENSHINE
Attorneys

OCTOBER 2009

BRIEF BANK — "SUMMARY SHEET" *Printed Wed-6/11/08 12:24*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]* — In re Jeffrey J. Prosser (UST v. Prosser)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]* — D. V.I.

3. ("CCN") ***CURRENT*** CASE NO. — No.: 03:07-cv-00156-CVG

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]* — No.: 06-30009-JKF

Court: D. V.I.

(Identify judge & cite, if any)

5. ("SO") ***SOURCE*** — **U.S. TRUSTEES**

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]* — Filed: February 25, 2008

Type: Brief of United States Trustee as Appellee

7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]* — James H. Morawetz, Guy G. Gebhardt, Matthew Sutko,

(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC*** — **BANKRUPTCY**

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***

- Whether the Bankruptcy Court abused its discretion or had "cause" under 11 U.S.C. § 1112(b) to convert this bankruptcy case from a chapter 11 case to a case under chapter 7 of the Bankruptcy Code.

10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)

11. DO YOU RECOMMEND POSTING IN UST BRIEFBANK? | x | YES | | NO

NAME: Linda Figueroa

DATE:

IN THE DISTRICT COURT OF THE VIRGIN ISLANDS
DIVISION OF ST. THOMAS AND ST. JOHN

In re:	:	D.C. APP. CIVIL NO. 07-00156-CVG
	:	
	:	
JEFFREY J. PROSSER,	:	Bankr. Case No. 06-30009-JKF
	:	
	:	
Debtor.	:	

BRIEF OF UNITED STATES TRUSTEE AS APPELLEE

On Appeal from the District Court of the Virgin Islands
Division of St. Thomas and St. John, Bankruptcy Division

GUY G. GEBHARDT
Assistant United States Trustee
Georgia Bar No. 288550

JAMES H. MORAWETZ
Trial Attorney
Georgia Bar No. 521900

United States Department of Justice
Office of the United States Trustee
362 Richard B. Russell Building
75 Spring Street, SW
Atlanta, GA 30303
(404) 331-4437

Attorneys for Appellee Donald F. Walton
United States Trustee, Region 21

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STATEMENT OF BASIS OF APPELLATE JURISDICTION

This Court has jurisdiction over these appeals under 28 U.S.C. § 158(a).

STATEMENT OF ISSUES

The issue before this Court on appeal is whether the Bankruptcy Court abused its discretion in converting this bankruptcy case from a Chapter 11 case to a case under Chapter 7 of the Bankruptcy Code.

APPLICABLE STANDARD OF REVIEW

A district court applies a clearly erroneous standard to a bankruptcy court's findings of fact and conducts a *de novo* review of conclusions of law. *See* Fed. R. Bankr. P. 8013; *Resyn Corp. v. United States*, 851 F.2d 660, 664 (3d Cir.1988); *In re Jersey City Medical Center*, 817 F.2d 1055, 1059 (3d Cir.1987); *In re Winthrop Nurseries, Inc.*, 50 F.3d 72, 73 (1st Cir.1995). "Courts have generally held that the decision regarding whether to convert or dismiss a Chapter 11 bankruptcy case is reviewed only for abuse of discretion." *Kates v. Mazzocone (In re: Mazzocone)*, 180 B.R. 782, 785 (E.D.Pa.1995) (citations omitted). *See In re SGL Carbon*, 200 F.3d 154 (3d Cir. 1999); *Marsch v. Marsch (In re Marsch)*, 36 F.3d 825, 828 (9th Cir.1994).

STATEMENT OF THE CASE

The Appellant, Jeffrey J. Prosser ("**Prosser**" or the "**Debtor**"), commenced this bankruptcy case on July 31, 2006, by filing a voluntary petition for relief under Chapter 11 of the Bankruptcy Code. (Docket No. 1).[1] On December 19, 2006, his primary creditors, Greenlight Capital Qualified, L.P., Greenlight Capital, L. P., and Greenlight Capital Offshore, Ltd. (collectively, "**Greenlight**") and Rural Telephone Finance Cooperative (the "**RTFC**") filed motions under 11 U.S.C. § 1112(b) seeking conversion of the case to Chapter 7. (Docket Nos. 174 & 178). Following an evidentiary hearing held on January 9, 2007, the Bankruptcy Court entered an order on February 13, 2007 (the "**Examiner Order**," Docket No. 370) together with a Memorandum Opinion (the "**Examiner Opinion**," Docket No. 371) denying the motions to convert without prejudice but directing, *sua sponte*, the appointment of an Examiner to "investigate and report on Prosser's prospects for proposing and confirming a plan." (Examiner Opinion, pp. 34-5). In reaching this decision, the Bankruptcy Court concluded that "[g]rounds for conversion clearly exist[ed]" but that the appointment of an examiner was the preferable alternative for creditors and the bankruptcy estate at that time. (*Id.*, p. 35). On March 12, 2007, the United States Trustee filed a Notice of Appointment of Steven A. Felsenthal to serve as Examiner in the case (Docket No. 415), and on April 5, 2007, the Bankruptcy Court entered an order approving that appointment. (Docket No. 465).

On July 18, 2007, Greenlight filed a renewed motion for conversion of the case to Chapter 7. (Docket No. 684). That motion came before the Bankruptcy Court for a hearing on September

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[1] Documents comprising the record on appeal that are filed of record in the bankruptcy case are referenced in this Brief by the docket number assigned them by the Clerk of the Bankruptcy Court.

21, 2007 (the "**Conversion Hearing**"), at which the Examiner recommended that the case be converted. (Docket No. 863, p. 47). *See also* Examiner's Fourth Interim Report, p.44.[2] The Bankruptcy Court entered its order converting the case to Chapter 7 on October 3, 2007 (the "**Conversion Order**," Docket No. 865). Prosser filed a Motion to Reconsider that Order on October 5, 2007 (Docket No. 870), and the Bankruptcy Court entered orders denying that motion on November 29, 2007 (Docket No. 1058) and December 5, 2007 (Docket No. 1108). Prosser filed a timely notice of appeal to this Court on December 7, 2007. (Docket No. 1110).

STATEMENT OF FACTS

According to his original and amended bankruptcy schedules filed in this case (Docket Nos. 26 and 359), Prosser's liabilities exceed his assets by over $147 million. His primary source of income from which to fund a Chapter 11 plan consisted of monies received from two corporations, Emerging Communications, Inc. ("**EmCom**") and Innovative Communication Company, LLC ("**ICC, LLC**"). As noted by the Bankruptcy Court in the Examiner Opinion, Prosser is the sole owner of ICC, LLC, which in turn owns or controls 100% of the stock of EmCom (52% through direct ownership and the 48% through its ownership of the remaining shareholder, Innovative Communications Subsidiary Company, LLC). EmCom in turn is the sole owner of Innovative Communication Corporation ("**New ICC**"), which through non-debtor corporations owns a number of USVI cable and telecommunications companies, including Vitelco, the Virgin Islands telephone company, along with the largest daily newspaper in the USVI. (Docket No. 371, pp.2-3). EmCom derives all its revenues from New ICC, and ICC, LLC, derives all of its revenues from EmCom.

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[2] The Examiner's Fourth Interim Report was not filed of record in the bankruptcy case but was designated as Item R-93 in the Joint Counter-Designation of Additional Items to be Included in the Record on Appeal filed by Appellees RTFC and Greenlight. It will be referred to hereafter simply as "the **Examiner's Report**."

EmCom and ICC, LLC filed voluntary petitions for relief under Chapter 11 of the Bankruptcy Code on the same date that Prosser filed his Chapter 11 petition.[3] Also before the Bankruptcy Court at the January 9, 2007, hearing on the motions to convert filed by Greenlight and the RTFC were motions filed by the United States Trustee seeking the appointment of a Chapter 11 trustee in EmCom and ICC, LLC bankruptcy cases. The Bankruptcy Court granted those motions (Examiner Opinion, pp. 14-22),[4] and subsequently approved the appointment of Stanford Springel (the "**Trustee**") to serve as Chapter 11 trustee in those cases.[5]

On July 6, 2007, the Trustee filed a motion for authorization to vote EmCom's stock in such a manner as to assume operational control over New ICC and its subsidiaries. (Case No. 06-30008, Docket No. 738). At a hearing on that motion held on September 6, 2007, the Trustee offered undisputed testimony that Prosser was "out of the money" in the EmCom and ICC, LLC cases and "was not going to get anything" from the sale of New ICC and its subsidiaries, "no matter what the price ..." (Docket No. 829, p. 123). The Trustee further testified that, notwithstanding Prosser's lack of equity in New ICC and its subsidiaries, he had been receiving a salary in excess of $1.5 million per year from those companies, plus $11,000 per month for expenses, (Docket No. 829, p. 54-5),[6] over a period in which those companies were accruing an indebtedness of at least $10 million to the

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[3] *In re: Emerging Communications, Inc.*, Case No. 06-30007, and *In re: Innovative Communication Company, LLC,* Case No. 06-30008.

[4] Those rulings are currently on appeal to this court in *In re: Innovative Communication Company, LLC* (D.C. Civil App. No. 07-00036), and *In re: Emerging Communications, Inc.*, (D.C. Civil App. No. 07-00037).

[5] Case No. 06-30007, Docket No. 543; Case No. 06-30008, Docket No. 523).

[6] See also Docket No. 297, p. 147; Docket No. 324, p. 88; Examiner Opinion, p. 33.

Pension Benefit Guaranty Corporation for unpaid pension plan contributions. (Docket No. 829, p. 126).

In an effort to satisfy the claims of Greenlight and RTFC, Prosser had negotiated a financing commitment during the pendency of the bankruptcy cases that would have resulted in his owing an initial stake of 70% of the companies without any investment on his part. (Docket No. 828, p. 63). As summarized by the Bankruptcy Court during the hearing on September 7, 2007:

> So, now we have before this Court somebody who negotiated a 70 percent return on an investment without contributing a single dime, not a single dime, for keeping that investment going when he's already out of the money in companies that are returning, apparently, enough of a profit that he can take $50,000 twice a month out of this company to put into his own pocket to support a very nice lifestyle, meanwhile not paying pension liabilities to the tune of $10 million for his employees.

Id. at p. 151.

During the 14-months that this case was pending as a Chapter 11 case prior to the entry of the Conversion Order, Prosser made no progress toward securing confirmation of a Chapter 11 plan of reorganization or liquidation. Although he filed a Joint Plan of Reorganization with ICC, LLC and EmCom on January 8, 2007 (Docket No. 245), he concedes that plan was unconfirmable (Examiner Opinion, p. 27),[7] and he never filed the disclosure statement that is a prerequisite under 11 U.S.C. § 1125 to seeking acceptances of a Chapter 11 plan. Prosser contends in his Brief on appeal that the Conversion Order was entered "less than two days before [he] was going to file a

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[7] In addition, the Conversion Order contains a finding, at p. 5, that this plan was unconfirmable.

plan of liquidation." (Appellant's Brief, p. 1). However, to this date he has never disclosed, either to the Bankruptcy Court or to this Court, what the terms of such a plan might have been. As shown *infra* in this Brief, the obstacles to confirmation of any plan of liquidation Prosser might have proposed were both numerous and formidable. The Examiner concluded that Prosser did not have a "reasonable likelihood of confirming a plan of reorganization or liquidation," and that it was in the best interests of the estate, as well as Prosser himself, to convert the case. (Docket No. 863, p. 76)

SUMMARY OF ARGUMENT

Bankruptcy courts possess broad discretion when determining whether to dismiss or convert a Chapter 11 case. The court below did not abuse that discretion in this case. In particular, the Bankruptcy Court was authorized by the evidence of record to conclude that 1) Prosser had failed either to schedule a potential claim by the IRS or to provide the IRS with written notice of the bar date in the case, 2) Prosser had failed to cooperate fully with the Examiner in providing access to his books and records, including bank account records, 3) Prosser had failed to demonstrate that he had the ability to propose a confirmable plan of liquidation, and 4) 1) the cost of litigation would be substantially greater in Chapter 11 than in Chapter 7.

ARGUMENT

THE BANKRUPTCY COURT DID NOT ABUSE ITS DISCRETION IN CONVERTING THE CASE TO CHAPTER 7.

A. Legal Standards Governing Conversion.

"The bankruptcy court has broad discretion in deciding whether to dismiss or convert a Chapter 11 case." *In re Lumber Exchange Bldg. Ltd. Partnership*, 968 F.2d 647, 648 (8th Cir.1992), citing *In re Gonic Realty Trust*, 909 F.2d 624, 626-27 (1st Cir.1990), and *In re Koerner,* 800 F.2d 1358, 1368 (5th Cir.1986). "This standard of review is supported by the legislative history of 11 U.S.C. § 1112(b); the applicable House and Senate reports both state that this section was intended to give 'wide discretion to the court to make an appropriate disposition of the case' and to allow the court 'to use its equitable powers to reach an appropriate result in individual cases.' Senate Comm. on the Judiciary, Bankruptcy Reform Act of 1978, S.Rep. No. 989, 95th Cong., 2d Sess. 117 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5903 ('Senate Report'); House Comm. on the Judiciary, Bankruptcy Reform Act of 1978, H.Rep. No. 595, 95th Cong., 2d Sess. 405-06 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6361-32 ('House Report')." *Kates v. Mazzocone, supra*, 180 B.R. at 785.

The statutory requisite for dismissal or conversion of a Chapter 11 case based on a motion by a party other than the debtor is set forth at 11 U.S.C. § 1112(b)(1), as follows:

> Except as provided in paragraph (2) of this subsection, subsection (c) of this section, and section 1104 (a)(3),[8] on request of a party in interest, and after notice

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[8] Paragraph (2), subsection 1112(c), and section 1104(a)(3) provide, respectively, as follows:

> The relief provided in paragraph (1) shall not be granted absent unusual circumstances specifically identified by the court that establish that such relief is not in the best interests of creditors and the estate, if the debtor or another party in interest objects and establishes

> and a hearing, absent unusual circumstances specifically identified by the court that establish that the requested conversion or dismissal is not in the best interests of creditors and the estate, the court *shall* convert a case under this chapter to a case under chapter 7 or dismiss a case under this chapter, whichever is in the best interests of creditors and the estate, if the movant establishes cause.

(Emphasis supplied). See *In re 3 Ram, Inc.*, 343 B.R. 113, 117 (Bankr.E.D.Pa. 2006).

Paragraph (4) of section 1112(b) sets forth a list of examples of events or conduct that constitute cause within contemplation of subsection 1112(b)(1), including "substantial or continuing loss to or diminution of the estate and the absence of a reasonable likelihood of reorganization," "gross mismanagement of the estate," and "failure to comply with an order of the court."[9]

> that –
>
> (A) there is a reasonable likelihood that a plan will be confirmed within the time frames established in sections 1121 (e) and 1129 (e) of this title, or if such sections do not apply, within a reasonable period of time; and
>
> (B) the grounds for granting such relief include an act or omission of the debtor other than under paragraph (4)(A) –
>
> (i) for which there exists a reasonable justification for the act or omission; and
>
> (ii) that will be cured within a reasonable period of time fixed by the court.

11 U.S.C. § 1112(b)(2).

> The court may not convert a case under this chapter to a case under chapter 7 of this title if the debtor is a farmer or a corporation that is not a moneyed, business, or commercial corporation, unless the debtor requests such conversion.

11 U.S.C. § 1112(c).

> [T]he court shall order the appointment of a trustee –
>
> ...
>
> (3) if grounds exist to convert or dismiss the case under section 1112, but the court determines that the appointment of a trustee or an examiner is in the best interests of creditors and the estate.

11 U.S.C. § 1104(a).

[9] Paragraph (4) provides in its entirety as follows:

"However, this list is not exhaustive, and the court is free to consider other factors as they arise and to use its equitable powers to reach an appropriate result in individual cases." *In re All Denominational New Church*, 268 B.R. 536, 538 (8th Cir.BAP 2001), citing *Hatcher v. U.S. Trustee (In re Hatcher)*, 218 B.R. 441, 448 (8thCir.BAP1998), aff'd, 175 F.3d 1024 (8th Cir.1999). *See* 11 U.S.C. § 102(3) (" 'includes and 'including' are not limiting"); *In re 3 Ram, Inc.*, *supra*, 343 B.R. at 117 ("While the enumerated examples of 'cause' to convert or dismiss a chapter 11 case now listed in § 1112(b)(4) have changed under BAPCPA, the fact that they are illustrative, not exhaustive

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(4) For purposes of this subsection, the term "cause" includes –

(A) substantial or continuing loss to or diminution of the estate and the absence of a reasonable likelihood of rehabilitation;

(B) gross mismanagement of the estate;

(C) failure to maintain appropriate insurance that poses a risk to the estate or to the public;

(D) unauthorized use of cash collateral substantially harmful to 1 or more creditors;

(E) failure to comply with an order of the court;

(F) unexcused failure to satisfy timely any filing or reporting requirement established by this title or by any rule applicable to a case under this chapter;

(G) failure to attend the meeting of creditors convened under section 341 (a) or an examination ordered under rule 2004 of the Federal Rules of Bankruptcy Procedure without good cause shown by the debtor;

(H) failure timely to provide information or attend meetings reasonably requested by the United States trustee (or the bankruptcy administrator, if any);

(I) failure timely to pay taxes owed after the date of the order for relief or to file tax returns due after the date of the order for relief;

(J) failure to file a disclosure statement, or to file or confirm a plan, within the time fixed by this title or by order of the court;

(K) failure to pay any fees or charges required under chapter 123 of title 28;

(L) revocation of an order of confirmation under section 1144;

(M) inability to effectuate substantial consummation of a confirmed plan;

(N) material default by the debtor with respect to a confirmed plan;

(O) termination of a confirmed plan by reason of the occurrence of a condition specified in the plan; and

(P) failure of the debtor to pay any domestic support obligation that first becomes payable after the date of the filing of the petition.

has not") (citing *In re TCR of Denver*, LLC, 338 B.R. 494, 500 (Bankr.D.Col.2006); 7 COLLIER ON BANKRUPTCY § 1112.01[2][a] at 1112-8-1112-9 (15th ed. rev.2005)).

> While no longer an enumerated ground under amended § 1112, conversion or dismissal of a Chapter 11 bankruptcy case is appropriate where the court finds that the proposed plan is not feasible and that a feasible plan is not possible. *Fossum v. Federal Land Bank (In re Fossum)*, 764 F.2d 520, 521 (8th Cir.1985). See also *Michigan National Bank v. Charfoos (In re Charfoos)*, 979 F.2d 390, 395 (6th Cir.1992) (quoting *Toibb v. Radloff*, 501 U.S. 157, 111 S.Ct. 2197, 115 L.Ed.2d 145 (1991)) ("it is recognized that generally 'bankruptcy courts [have] substantial discretion to dismiss ... [where] the debtor files an untenable plan of reorganization.'"); *In re Brown*, 951 F.2d 564, 572 (3d Cir.1991) (quoting *United Sav. Assoc. v. Timbers of Inwood Forest, Ltd.*, 484 U.S. 365, 108 S.Ct. 626, 98 L.Ed.2d 740 (1988)) (discussing § 1112(b) and stating that "there must be 'a reasonable possibility of a successful reorganization within a reasonable time.' "); *In re Anderson*, 52 B.R. 159, 162-63 (Bankr.D.N.D.1985) (failure of the debtor to meet the confirmation prerequisite of 11 U.S.C. § 1129(a)(11) is cause for dismissal under § 1112(b)). If the Chapter 11 case cannot achieve a reorganization within the statutory requirements of the Code, then there is no point in expending estate assets on administrative expenses, or delaying creditors in the exercise of their nonbankruptcy law rights. *In re Brown*, 951 F.2d at 572. See also *In re L.B.G. Properties*, 72 B.R. 65, 68 (Bankr.S.D.Fla.1987) (Chapter 11 does not provide an unlimited opportunity to seek a successful reorganization).

In re 3 Ram, Inc., *supra*, 343 B.R. at 118.

B. The Bankruptcy Court Did Not Commit Clear Error in Finding That Cause to Convert Existed under Section 1112(b) of the Bankruptcy Code.

"Pursuant to Rule 8013 of the Federal Rules of Bankruptcy Procedure, on appeal, findings of fact by the bankruptcy court are set aside if clearly erroneous." *Schlumberger Resource Management Svcs. v. Cellnet Data Systems (In re CellNet Data Systems, Inc.)*, 327 F.3d 242, 244 (3d Cir.2003). See also *Gen. Motors Acceptance Corp. v. Dykes (In re Dykes)*, 10 F.3d 184, 185 (3d Cir.1993). "The decision to convert the case to Chapter 7 is within the bankruptcy court's discretion [and] ...will be reversed only if based on an erroneous conclusion of law or when the record contains no evidence on which [the bankruptcy court] rationally could have based that decision." *Pioneer Liquidating Corporation v. U.S. Trustee (In re Consolidated Pioneer Mortg. Entities*), 264 F.3d 803, 806-7 (9th Cir.2001) (Citations and internal quotation marks omitted).

As a debtor in possession, Prosser had a fiduciary obligation to place the economic interests of creditors above his own. *See Integrated Solutions, Inc. v. Service Support Specialties, Inc.*, 124 F.3d 487, 498 (3d Cir.1997) ("So long as the debtor remains in possession, [he] bears essentially the same fiduciary obligation to the creditors as does the trustee for the debtor out of possession."). The evidence of record in this case shows that he violated this fiduciary obligation by continuing to pay himself over $1.5 million per year from the revenues of New ICC and its subsidiaries while those companies were accruing over $10 million in liabilities for unpaid contributions to their employ pension plans. Furthermore, Prosser made no showing that he had the ability to propose a confirmable Chapter 11 plan. The evidence of record in this case amply supports the Bankruptcy Court's decision to convert the case to Chapter 7.

In his brief on appeal, Prosser focuses on four specific findings that he contends were not supported by the evidence.

1. The Bankruptcy Court did not base its ruling on an erroneous finding regarding whether the IRS had a claim in the case.

The Bankruptcy Court accurately observed in the Conversion Order that the Bankruptcy Code requires a debtor to list all claims, including contingent claims, that Prosser failed to schedule the IRS as a creditor, and that, according to the case docket, he also failed to provide the IRS with proper notice of the claims bar date "in the event [it] has a claim." None of these findings or conclusions is subject to reasonable dispute. The Examiner reported that Prosser had received substantial sums of money from New ICC in the form of loans which New ICC "never expected him to repay" but had neither scheduled these receipts as claims on his bankruptcy schedules nor reported them as income on his income tax returns. In the Examiner Opinion, the Court observed that "[t]he audited consolidated financial statements show 'net advances' to Prosser of approximately $13 million in 2005 and 2004 and of over $14 million in 2003, at a time when Prosser was personally indebted to New ICC in an amount in excess of $156 million." (Docket No. 371, p. 25) (footnotes omitted).[10] It is no surprise under these circumstances that the Examiner anticipated that "the Internal Revenue Service may have a substantial claim in the Debtor's bankruptcy." (Examiner's Report, p. 10). Prosser does not contend that the IRS has no basis upon which to assert a claim but asserts that there is "no basis to assume that the IRS will file a claim in the next several weeks." Brief of Appellant, p.9. Whether and to what extent the IRS may ultimately assert a claim in the case, however, is not the issue upon which the Court was focusing in the Conversion order. Rather, the point the Court was presumably making with regard to the potential IRS claim was that Prosser had displayed a lack of candor unbefitting a debtor in possession case

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[10] The Examiner reported that '[f]rom 1998 through 2005, New ICC loaned an aggregate amount of $156,612,000 to the Debtor and ICC LLC, which is a single member limited liability company owned by the Debtor." (Examiner's Report, p. 13) (footnote omitted).

by failing either to schedule such a claim or to provide the IRS with a written bar date notice. That this is the case is not open to question.

2. <u>The Record Fully Documents Prosser's Lack of Co-Operation with the Examiner.</u>

The duties of the Examiner as specified by the Bankruptcy Court in the Examiner Opinion were "to investigate the income and expenses claimed and to prepare a report on the reasonable likelihood of rehabilitation." (Docket No. 371, p. 29). In this regard, the Examiner Order specifically ordered Prosser to cooperate with the examiner. (Docket No. 372, p. 2). The issue of Prosser's cooperation with the Examiner subsequently arose at a hearing held on May 16, 2007, at which time the Bankruptcy Court set a two-week deadline for Prosser to provide the Examiner certain information. (Docket No. 593, pp. 49-50). Notwithstanding these directives, and notwithstanding Prosser's role as a fiduciary for creditors, the Examiner found it necessary to seek an order compelling Prosser to provide him with the information in question. On June 20, 2007, the Examiner filed a "Motion to Compel Debtor to Provide Examiner Access to Certain Personnel and Records" (the "**Motion to Compel**," Docket No. 627), alleging that despite his continued efforts to schedule a time to review Prosser's accounting and business records and those of his various business entities, including New ICC and its subsidiaries, Prosser had failed to make these records available to him. Prosser's response was to oppose the motion. (Docket No. 656). In a response to that opposition filed on July 6, 2007, the Trustee in the corporate cases asserted that Prosser had likewise failed to provide him with requested information. (Docket No. 666, ¶ 3).

On August 3, 2007, the Court entered an order granting the Motion to Compel and directing Prosser to provide the Examiner and his professionals "immediate, full complete and unfettered access to any and all [of his] personnel, books, records, documents and accounts, including bank accounts" and those of any entities or organizations in which he had any interest or exercised any influence or control." (Docket No. 729, p. 1) In the Conversion Order, the Court found that

> as of the hearing on September 21, 2007, Debtor still had not released to the Examiner his personal checking account statement and had not requested, or only recently requested, records from his bank and, although information was sought for a time period of 10 years, *no effort was made by Debtor to provide recent information*.

(Docket No. 865, p. 5) (emphasis supplied).

While Prosser maintains in his brief on appeal that he has "cooperated fully with the Trustee and Examiner" and that "[t]he record is replete with examples of [such] cooperation," he has cited no examples of such cooperation. Further, his cooperation in providing some requested information does not excuse his failure to provide other information requested by the Examiner. The Court's statement regarding the requested bank records was obviously not directed to Prosser's delay in providing the Examiner with records for the past 10 years but rather to his delay in providing "recent information." The Debtor has offered this Court no basis upon which to question the Bankruptcy Court's finding that "no effort was made by Debtor to provide [such] information."

3. Prosser Failed Utterly to Demonstrate that He Has the Ability to Propose a Confirmable Plan of Liquidation.

Prosser asserts at page 1 of his brief on appeal that the Bankruptcy Court entered the Conversion Order "less than two days before [he] was going to file a plan of liquidation." However, he has never provided the Bankruptcy Court with any summary of the terms of this plan, nor has he provided this Court with any clue to as to what the terms of this plan might have been.

The obstacles to confirmation of any such plan are clearly formidable. In his analysis of the Prosser's prospects for securing confirmation of a plan of liquidation pursuant to the "cramdown" procedure available under 11 U.S.C. § 1129(b)(2)(B), the Examiner noted that because Greenlight and RTFC would control the unsecured creditor class and because they have announced their unwillingness to support any plan proposed by Prosser, Prosser would have to obtain the consenting vote of an impaired class consisting of a secured creditor in order to comply with 11 U.S.C. § 1129(a)(10).[11] The Examiner questioned Prosser's ability to do this because his secured creditors appeared to be "adequately collateralized" and therefore entitled to full payment of their claims, rendering them unimpaired. (Examiner's Report, pp. 34-8). Further, even assuming Prosser could obtain acceptance by an impaired class, the Examiner concluded that he could not meet the "best interest of creditors" requirement established by 11 U.S.C. § 1129(a)(7)(A)[12] without liquidating certain property that he had expressed an unwillingness to part with. (*Id.* at pp. 38-9). Confirmation of any plan proposed by the Debtor would also have raised the issue of how to estimate his "projected disposable income" over the 5-year period beginning on the date the first payment was due under the plan, so as to determine the amount of plan payments needed to satisfy 11 U.S.C.

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[11] Under 11 U.S.C. § 1129(a)(10), a plan can be confirmed only if "at least one class of claims that is impaired under the plan has accepted the plan, determined without including any acceptance of the plan by any insider."

[12] Section 1129(a)(7)(A) specifies that a plan can be confirmed only if, with respect to each impaired class of claims or interests –

> each holder of a claim or interest of such class –
> (i) has accepted the plan; or
> (ii) will receive or retain under the plan on account of such claim or interest property of a value, as of the effective date of the plan, that is not less than the amount that such holder would so receive or retain if the debtor were liquidated under chapter 7 of this title on such date ...

§ 1129(a)(15).[13] As noted by the Bankruptcy Court at pages 3 &4 of the Conversion Order, the Trustee for the corporate debtors had terminated Prosser's employment with New ICC,[14] rendering any estimate of his projected disposable income over the next five years a speculative endeavor at best.[15] Finally, the Court was entirely correct in its observation that, although Prosser admitted his

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[13] Section 1129(a)(15) establishes the following requirement for confirmation of a Chapter 11 plan:

> In a case in which the debtor is an individual and in which the holder of an allowed unsecured claim objects to the confirmation of the plan –
>
> (A) the value, as of the effective date of the plan, of the property to be distributed under the plan on account of such claim is not less than the amount of such claim; or
>
> (B) the value of the property to be distributed under the plan is not less than the projected disposable income of the debtor (as defined in section 1325 (b)(2)) to be received during the 5-year period beginning on the date that the first payment is due under the plan, or during the period for which the plan provides payments, whichever is longer.

[14] On September 7, 2007, the Court entered an order in the ICC, LLC bankruptcy case (Case No. 06-30008, Docket No. 870) authorizing the Trustee to vote EmCom's shares of stock in New ICC to remove the directors and officers of New ICC and take any related corporate action necessary to transfer exercise control over that corporation. On October 3, 2007, the Bankruptcy Court directed the appointment of a trustee in New ICC's own Chapter 11 case, *In re: Innovative Communication Corporation*, Case No. 07-30012 (Docket No. 112), and on October 4, 2007, the Bankruptcy Court entered an order approving the appointment of Stanford Springel as Chapter 11 trustee in that case, as well.

[15] In this regard, Prosser's counsel engaged in the following colloquy with the Court during the Conversion Hearing:

> THE COURT: But unless he's going to pay – well, I mean the test isn't that clear, but in all probability he's going to have to commit his post-petition earnings for five years to this plan. That's what –
> MR. CRAIG: Sure.
> THE COURT: Okay, so what are those earnings going to be? What are they coming from?
> MR. CRAIG: He may not have any, Your Honor.
> THE COURT: Well, then he's not too likely to confirm a plan.
> MR. CRAIG: Well, sure he can.
> THE COURT: I don't think so.
> MR. CRAIG: And, Your Honor, he has to be able to allocate whatever --

wife would have to contribute her interest in their jointly owned property in order for a plan to succeed, there was no evidence of any agreement by his wife to do so. (Docket No. 865, p. 3). Even assuming the correctness of Prosser's assertion that his wife was willing to participate in the sale of their jointly owned property, such willingness does not equate to an agreement to contribute her portion of the proceeds from a sale to fund his hypothetical Chapter 11 plan.

By the time the Bankruptcy Court entered the Conversion Order on October 3, 2007, over fourteen months had transpired since Prosser filed his petition for relief under Chapter 11. Prosser had the right, if he chose to do so, to file a plan of reorganization and disclosure statement at any time during the fourteen months the case was pending in Chapter 11. As previously indicated, Prosser filed a joint plan with ICC, LLC and EmCom on January 8, 2007, but failed to file a disclosure statement (Examiner Opinion, p. 16, Conversion Order, p. 6), and the Bankruptcy Court found the plan to be unconfirmable as a matter of law (Conversion Order, p. 6). The Court found that "[g]rounds for conversion clearly exist[ed]" as early as February 13, 2007, when the Examiner Opinion was entered. (Docket No. 371, p. 35). Over six months passed between the entry of the Examiner Order and the entry of the Conversion Order, during which Prosser could have filed a new Chapter 11 plan, along with a disclosure statement, yet he again failed to do so.

> whatever his net disposal income is. And, Your Honor, the cases -- there aren't very many on this issue yet, but there are situations where it's acknowledged that may be a negative number, and if it is a negative number, the financial standard to be met is (a)(7), liquidation value. Okay?
>
> THE COURT: I understand. We're talking about a gentleman who, even though my math likes to put him into multiple millions of dollars improperly, still makes a million to a year before all of this issue with the Trustee happened has an earning potential, which I still believe the courts will be looking at in Chapter 11 for the five years post-petition, that is very high.

(Docket No. 863, pp. 58-9.

The Court was clearly authorized to conclude from the evidence of record in this case that Prosser could not propose a confirmable plan of liquidation, with the result that there was "no likelihood of a reasonable prospect of rehabilitation of [his] financial affairs in a Chapter 11." (Conversion Order, p. 6).

4. The cost of litigation would be greater in Chapter 11 than in Chapter 7.

Prosser's two major creditors, RTFC and Greenlight, have made it clear that they will not support any plan proposed by him, and Prosser does not dispute that the only manner in which he could obtain confirmation of a plan would be pursuant to the "cram down," provisions of 11 U.S.C. § 1129(b). The correctness of the Examiner's conclusion that "any attempt by the Debtor to cramdown a plan would be rife with difficulties and costly to the estate" (Examiner's Report, p. 32) is not reasonably open to question. Among the issues that would have to be litigated in such a scenario would be Prosser's ability to create an accepting class to satisfy 11 U.S.C. § 1129(a)(10),[16] whether the payments to non-accepting classes were at least equivalent to what such creditors would receive in a Chapter 7 liquidation,[17] whether Prosser was committing all of his projected disposable income to the plan so as to satisfy 11 U.S.C. § 1129(a)(15),[18] and whether he had satisfied the pre-confirmation disclosure requirements established by 11 U.S.C. § 1125. Prosser's counsel freely acknowledged that an attempt by Prosser to confirm a plan would entail litigation, stating,

> there's some other requirements under 1129, and when we get to confirmation, we'll have to fight over those ... We're just saying we will file that plan. There will be objections. We

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[16] See footnote 11, *infra*.

[17] See footnote 12, *infra*.

[18] See footnote 13, *infra*.

> will have some debates, and Your Honor will resolve that. If it doesn't get confirmed, you can convert.

(Docket No. 863, pp. 52-3).

The Bankruptcy Court clearly did not abuse its discretion in concluding that the avoidance of such litigation was in the best interest of the bankruptcy estate and its creditors.

CONCLUSION

"'[A]n abuse of discretion exists where the district court's decision rests upon a clearly erroneous finding of fact, an errant conclusion of law, or an improper application of law to fact.' *In re SGL Carbon Corp.*, 200 F.3d [154], at 159 [(3d Cir.1999)] (quoting *ACLU v. Black Horse Pike Reg'l Bd. of Ed.*, 84 F.3d 1471, 1476 (3d Cir.1996))." *In re Integrated Telecom Express, Inc.*, 384 F.3d 108, 118 (3d Cir.2004). It is clear that the Bankruptcy Court's decision to convert this case from Chapter 11 to Chapter 7 was not predicated on any clearly erroneous finding of fact, errant conclusion of law, or improper application of law to fact. Any one of the numerous reasons articulated in the Conversion Order was sufficient by itself to support the decision to convert the case. For the foregoing reasons, the United States Trustee respectfully requests the Court to enter an order affirming the Bankruptcy Court's order.

Respectfully submitted,
DONALD F. WALTON
UNITED STATES TRUSTEE

By: ____________________________
Guy G. Gebhardt
Georgia Bar No. 288550
Assistant United States Trustee
E-mail: Guy.G.Gebhardt@usdoj.gov

[Signatures of Counsel Continued on Next Page]

By: ___________________________
James H. Morawetz
Georgia Bar No. 521900
Trial Attorney
E-mail: E-mail: Jim.H.Morawetz@usdoj.gov

United States Department of Justice
Office of the United States Trustee
Suite 362, 75 Spring Street, SW
Atlanta, GA 30303
Telephone: (404) 331-4437
Facsimile: (404) 331-4464

Dated: February 25, 2008

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2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	3rd Cir
3. ("CCN") ***CURRENT*** CASE NO.	No.: 08-2692
4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*	No.: 3-07-cv-00156 Court: D. V.I. *(Identify judge & cite, if any)*
5. ("SO") ***SOURCE***	**U.S. TRUSTEES**
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8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	• Whether the district court err by affirming the bankruptcy division's order converting the appellant's bankruptcy case from chapter 11 to chapter 7, when that order was based on findings of fact supported by ample evidence in the record.
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UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

08-2692

IN RE: JEFFREY J. PROSSER

Appeal from the District Court of the Virgin Islands
Division of St. Thomas and St. John

Case No.3-07-cv-00156

BRIEF OF APPELLEE DONALD F. WALTON, UNITED STATES TRUSTEE, REGION 21

Of Counsel:

RAMONA ELLIOTT
General Counsel
P. MATTHEW SUTKO
WALTER W. THEUS, JR.
Office of the General Counsel

Executive Office for United States Trustees
United States Department of Justice
20 Massachusetts, Ave. NW, Ste 8100
Washington, D.C. 20530
Tel: (202) 307-1399

Prepared and submitted by:

GUY G. GEBHARDT
Assistant United States Trustee
JAMES H. MORAWETZ
Trial Attorney

United States Department of Justice
Office of the United States Trustee
Suite 362, Russell Federal Building
75 Spring Street, SW
Atlanta, GA 30303
Tel: (404) 331-4437
Fax: (404) 331-4464

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STATEMENT OF BASIS OF APPELLATE JURISDICTION

This is an appeal from an order of the District Court of the Virgin Islands affirming a decision of that Court's Bankruptcy Division. This Court has jurisdiction over this appeal under 28 U.S.C. §§ 158(d)(1) and 1291.

STATEMENT OF ISSUES

Did the District Court err by affirming the Bankruptcy Division's order converting the Appellant's bankruptcy case from chapter 11 to chapter 7, when that order was based on findings of fact supported by ample evidence in the record?

STATEMENT OF THE CASE

The Appellant, Jeffrey J. Prosser ("**Prosser**," the "**Debtor**," or the "**Appellant**"), filed a voluntary petition for relief under chapter 11 of the Bankruptcy Code on July 31, 2006, in the Bankruptcy Division of the District Court of the Virgin Islands, Division of St. Thomas and St. John. (JA-13, Vol.2, p. 380).[1] On December 19, 2006, his primary creditors, Greenlight Capital Qualified, L.P., Greenlight Capital, L.P., and Greenlight Capital Offshore, Ltd. (collectively, "**Greenlight**") and Rural Telephone Finance Cooperative (the "**RTFC**") filed motions under 11 U.S.C.

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[1] Documents in the record on appeal are identified by the document number assigned to the document in the Joint Appendix submitted by the Appellant, followed by the Volume number and page number where the document appears in the Joint Appendix.

§ 1112(b) seeking conversion of the case to chapter 7. (JA-27, Vol.3, p. 864 and JA-30, Vol.3, p. 922, respectively). Following an evidentiary hearing held on January 9, 2007, the Bankruptcy Division entered a Memorandum Opinion (the "**Examiner Opinion**," JA-60, Vol.6, pp. 2524) and Order (the "**Examiner Order**," (JA-61, Vol.6, p. 2560) on February 13, 2007, denying the motions to convert without prejudice but directing, *sua sponte*, the appointment of an Examiner to "investigate and report on Prosser's prospects for proposing and confirming a plan." (Examiner Opinion, pp. 34-5; JA-60, Vol.6, p. 2557-8). In reaching this decision, the Bankruptcy Division concluded that "[g]rounds for conversion clearly exist[ed]" but that the appointment of an examiner was the preferable alternative at that time for creditors and the bankruptcy estate. *Id.* at p. 35, 2558. On March 12, 2007, the United States Trustee filed a Notice of Appointment of Steven A. Felsenthal to serve as Examiner in the case (JA-65, Vol.6, p. 2651), and on April 5, 2007, the Bankruptcy Division entered an order approving that appointment. (JA-71, Vol.6, p. 2906).

On July 18, 2007, Greenlight filed a renewed motion for conversion of the case to chapter 7. (JA-86, Vol.8, p. 3602). That motion came before the Bankruptcy Division for a hearing on September 21, 2007 (the "**Conversion Hearing**"), at which the Examiner recommended unequivocally that the case be converted. (JA-122, Vol.10, pp. 4907-08). *See also* Examiner's Fourth Interim Report, p.44; JA-103, Vol.9, p.4107).[2] The Bankruptcy Division entered its order converting the case to chapter 7 on October 3, 2007 (the "**Conversion Order**," JA-123, Vol. 10, p. 4925). Prosser filed a Motion to Reconsider the Conversion Order on October 5, 2007 (JA-125, Vol.10, p. 4935), and the Bankruptcy Division entered orders denying that motion on November 29, 2007 (JA-148, Vol.13, p. 6061) and December 5, 2007 (JA-150, Vol.13, p. 6224). Prosser filed a notice of appeal to the District Court on December 7, 2007, (JA-151, Vol.13, p. 6225), and on June 6, 2008, the District Court entered a Memorandum Opinion (JA-181, Vol.14, p. 6823) and Order (JA-182, Vol.14, p. 6833) affirming the orders of the Bankruptcy Division. Prosser filed a timely notice of appeal to this Court on June 9, 2008. (JA-183, Vol.14, p. 6836).

STATEMENT OF FACTS

According to his original and amended bankruptcy schedules filed in this case (JA-16, Vol.2, p. 555 and JA-58, Vol.6, p. 2374, respectively), Prosser's liabilities exceed his assets by over $147 million. At the time he commenced his bankruptcy case, Prosser's primary source of income consisted of monies received from two

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[2] The Examiner's Fourth Interim Report was not filed of record in the Bankruptcy Division but was before the Bankruptcy Division at the Conversion Hearing (*see* Conversion Hearing Transcript, pp. 46-7; JA-122, Vol.10, pp. 4878-9) and was included in the record before the District Court as Item R-93 of Joint Counter-Designation of Additional Items to be Included in the Record on Appeal filed by Appellees RTFC and Greenlight. It is before this Court as JA-103, Vol 9, p. 4107, and will be referred to hereafter as "the **Examiner's Report**."

corporations, Innovative Communication Company, LLC ("**ICC, LLC**") and Emerging Communications, Inc. ("**EmCom**"). As noted in the Examiner Opinion, Prosser is the sole owner of ICC, LLC, which in turn owns or controls 100% of the stock of EmCom (52% through direct ownership and the 48% through ownership of the remaining shareholder, Innovative Communications Subsidiary Company, LLC) (Examiner Opinion, p.2; JA-60, Vol.6, p. 2525). EmCom, in turn, is the sole owner of Innovative Communication Corporation ("**New ICC**"), which through non-debtor corporations owns a number of USVI cable and telecommunications companies, including Vitelco, the Virgin Islands telephone company, and the largest daily newspaper in the USVI. *Id.* at pp. 2-3, 2525-6. EmCom derives all its revenues from New ICC, and ICC, LLC, derives all of its revenues from EmCom. *Id.*

EmCom and ICC, LLC filed voluntary petitions for relief under chapter 11 of the Bankruptcy Code on the same date that Prosser filed his chapter 11 petition.[3] Also before the Bankruptcy Division at the January 9, 2007, hearing on the initial motions to convert filed by Greenlight and the RTFC were motions filed by the United States Trustee seeking the appointment of a chapter 11 trustee in the EmCom and ICC, LLC bankruptcy cases (the "**Corporate Cases**"). The Bankruptcy Division granted those

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[3] *In re: Emerging Communications, Inc.*, Case No. 06-30007, and *In re: Innovative Communication Company, LLC,* Case No. 06-30008.

motions (Examiner Opinion, pp. 14-22; JA-60, Vol.6, pp. 2537-45),[4] and subsequently approved the appointment of Stanford Springel (the "**Trustee**") to serve as chapter 11 trustee in those cases. (JA-67, Vol.6, p. 2718).

At a hearing held on September 6, 2007, on a motion by the Trustee for authorization to vote EmCom's stock in such a manner as to assume operational control over New ICC and its subsidiaries, the Trustee offered undisputed testimony that Prosser was "out of the money" in the EmCom and ICC, LLC cases and "was not going to get anything" from the sale of New ICC and its subsidiaries "no matter what the price ..." (9/6/07 Transcript, p.123; JA-107, Vol.10, p.4520). The Trustee further testified that, notwithstanding Prosser's lack of equity in New ICC and its subsidiaries, he had been receiving a salary in excess of $1.5 million per year from those companies, plus $11,000 per month for expenses, *Id.* at pp. 54-5, 4451-2,[5] over a period in which those companies were accruing millions of dollars of liability to the Pension Benefit Guaranty Corporation for unpaid pension plan contributions. *Id.* at pp.125-6, 4522-3.

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[4] Those rulings are currently on appeal to the District Court of the Virgin Islands in *In re: Innovative Communication Company, LLC* (D.C. Civil App. No. 07-00036), and *In re: Emerging Communications, Inc.*, (D.C. Civil App. No. 07-00037).

[5] *See also* Examiner Opinion at p.33 (JA-60, Vol.6, pp.2556-7), and Prosser's testimony at 1/17/07 Transcript, p.147 (JA-54, Vol.4, p.1604) and 1/19/07 Transcript, p.324 (JA-55, Vol.5, p.1968).

In an effort to satisfy the claims of Greenlight and RTFC, Prosser negotiated a financing commitment during the pendency of the bankruptcy cases that would have resulted in his owning an initial stake of 70% of the companies without any investment on his part. (9/7/07 Transcript, p.63; JA-106, Vol.9, p.4243). As summarized by the Bankruptcy Division during the hearing on September 7, 2007:

> So, now we have before this Court somebody who negotiated a 70 percent return on an investment without contributing a single dime, not a single dime, for keeping that investment going when he's already out of the money in companies that are returning, apparently, enough of a profit that he can take $50,000 twice a month out of this company to put into his own pocket to support a very nice lifestyle, meanwhile not paying pension liabilities to the tune of $10 million for his employees.

Id. at p. 151, 4331.

During the more than 14 months this case was pending as a chapter 11 case prior to the entry of the Conversion Order, Prosser made no progress toward securing confirmation of a chapter 11 plan of reorganization or liquidation. Although he filed a Joint Plan of Reorganization with ICC, LLC and EmCom on January 8, 2007, he conceded that plan was unconfirmable (Examiner Opinion, p. 27; JA-60, Vol.6, p.2550),[6] and he never filed the disclosure statement that is a prerequisite under 11 U.S.C. § 1125 to seeking acceptances of a chapter 11 plan. (Conversion Order, p.5; JA-123, Vol.10, p.4929). Furthermore, Prosser has never disclosed to the Bankruptcy

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[6] In addition, the Conversion Order contains a finding, at p. 5, that this plan was unconfirmable. (JA-123, Vol.10, p.4929)

Division, the District Court, or this Court what the terms of a confirmable chapter 11 plan would be if he proposed one. During the Conversion Hearing, Prosser's counsel stated: "We just ask for another couple of weeks to file the plan, and then we can get into the substance of all these issues that they want to raise." (Conversion Hearing Transcript, p.81; JA-122, Vol.10, p.4193). The Court responded that nothing had prevented Prosser from "putting a plan on the table" prior to the hearing and added: "[T]hat's the problem. It's always ... a day late and a dollar short." *Id.* at p.82, 4914. The Examiner concluded that Prosser did not have a "reasonable likelihood of confirming a plan of reorganization or liquidation" (Examiner's Report, p.43; JA-103, Vol.9, p.4149) and that it was in the best interests of the bankruptcy estate, as well as Prosser himself, to convert the case. (Conversion Hearing Transcript, p.76; JA-122, Vol.10, p. 4908).

The primary reason articulated by the Bankruptcy Division for its decision to convert the case was that the case was "over 14 months old and there is no likelihood of a reasonable prospect of rehabilitation of Debtor's financial affairs in a Chapter 11." (Conversion Order, p.6; JA-123, Vol.10, p.6). In addition, the Court articulated several other factors that militated in favor of conversion, including that 1) the cost of litigation would be less in a chapter 7 because "in light of the acrimony between the RTFC and Greenlight on the one hand and Debtor on the other, a Chapter 7 Trustee as an independent fiduciary will be better able to assess what is in the best interest of the estate," *Id.* at p.3, 4927; 2) although Prosser conceded that it would be necessary to have his wife's agreement and cooperation in order to confirm a plan and sell assets, there was no showing that her agreement would or could be obtained, *Id.*; 3) there was information of record indicating that the IRS "may have a claim," yet Prosser had failed either to list the IRS as a creditor or to provide it with notice of the claims bar date, *Id.* at p.4, 4928; and 4) although he had been ordered to provide the Examiner and the Trustee with "immediate, full, complete and unfettered access" to his financial records, including bank account records, Prosser "still had not released to the Examiner his personal checking account statement and had not requested, or only recently requested, records from his bank." *Id.* at 5, 4929.

On appeal to the District Court, Prosser contended that the record did not support any of the latter four findings. The District Court examined two of the findings – that there was no showing of any agreement by his wife to cooperate and that he had not complied with the order to make his financial records available to the Examiner – and found support in the record for both of them. (District Court Memorandum Opinion, pp. 8-9; JA-181, Vol.14, pp.6830-1). The Court concluded that "[i]n light of the entire record, the Court ... did not abuse its discretion in converting this case from a Chapter 11 to a Chapter 7 proceeding." *Id.* at 10, 6832.

APPLICABLE STANDARD OF REVIEW

In an appeal from an order entered by a bankruptcy court, the appellate court, whether it be the district court or the court of appeals on appeal from the district court, applies a clearly erroneous standard to the bankruptcy court's findings of fact and conducts a *de novo* review of conclusions of law. *See* Fed. R. Bankr. P. 8013; *Resyn Corp. v. United States*, 851 F.2d 660, 664 (3d Cir.1988); *In re Jersey City Medical Center*, 817 F.2d 1055, 1059 (3d Cir.1987); *In re Winstar Communications, Inc.*, 554 F.3d 382, 400 (3rd Cir. 2009); *In re Winthrop Nurseries, Inc.*, 50 F.3d 72, 73 (1st Cir.1995). "Courts have generally held that the decision regarding whether to convert or dismiss a Chapter 11 bankruptcy case is reviewed only for abuse of discretion." *Kates v. Mazzocone (In re Mazzocone)*, 180 B.R. 782, 785 (E.D.Pa.1995) (citations omitted). *See also In re SGL Carbon*, 200 F.3d 154 (3d Cir. 1999); *Marsch v. Marsch (In re Marsch)*, 36 F.3d 825, 828 (9th Cir.1994).

SUMMARY OF ARGUMENT

Bankruptcy courts possess broad discretion when determining whether to dismiss or convert a chapter 11 case. The Bankruptcy Division did not abuse that discretion in this case. In particular, the evidence of record supported the Bankruptcy Division's conclusions that 1) Prosser had failed either to schedule a potential IRS claim or to provide the IRS with written notice of the bar date in the case, 2) Prosser had failed to cooperate fully with the Examiner in providing access to his books and records, including bank account records, 3) Prosser had failed to demonstrate that he had the ability to propose a confirmable plan of liquidation, and 4) the cost of litigation would be substantially greater in chapter 11 than in chapter 7.

ARGUMENT

THE BANKRUPTCY DIVISION DID NOT ABUSE ITS DISCRETION IN CONVERTING THE CASE TO CHAPTER 7.

A. Legal Standards Governing Conversion.

The bankruptcy court has broad discretion in deciding whether to enter an order dismissing or converting a Chapter 11 case. *In re Lumber Exchange Bldg. Ltd. Partnership*, 968 F.2d 647, 648 (8th Cir.1992), citing *In re Gonic Realty Trust*, 909 F.2d 624, 626-27 (1st Cir.1990), and *In re Koerner,* 800 F.2d 1358, 1368 (5th Cir.1986). "This standard of review is supported by the legislative history of 11 U.S.C. § 1112(b); the applicable House and Senate reports both state that this section was intended to give 'wide discretion to the court to make an appropriate disposition of the case' and to allow the court 'to use its equitable powers to reach an appropriate result in individual cases.' Senate Comm. on the Judiciary, Bankruptcy Reform Act of 1978, S.Rep. No. 989, 95th Cong., 2d Sess. 117 (1978), *reprinted in* 1978

U.S.C.C.A.N. 5787, 5903 ('Senate Report'); House Comm. on the Judiciary, Bankruptcy Reform Act of 1978, H.Rep. No. 595, 95th Cong., 2d Sess. 405-06 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6361-32 ('House Report')." *Kates v. Mazzocone, supra*, 180 B.R. at 785.

The statutory requisite for dismissal or conversion of a chapter 11 case based on a motion by a party other than the debtor is set forth at 11 U.S.C. § 1112(b)(1), as follows:

> Except as provided in paragraph (2) of this subsection, subsection (c) of this section, and section 1104(a)(3),[7] on request of a party in interest, and

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[7] Paragraph (2) of subsection 1112(b), subsection (c), and section 1104(a)(3) provide, respectively, as follows:

> The relief provided in paragraph (1) shall not be granted absent unusual circumstances specifically identified by the court that establish that such relief is not in the best interests of creditors and the estate, if the debtor or another party in interest objects and establishes that –
> (A) there is a reasonable likelihood that a plan will be confirmed within the time frames established in sections 1121 (e) and 1129 (e) of this title, or if such sections do not apply, within a reasonable period of time; and
> (B) the grounds for granting such relief include an act or omission of the debtor other than under paragraph (4)(A) –
> (i) for which there exists a reasonable justification for the act or omission; and
> (ii) that will be cured within a reasonable period of time fixed by the court.

11 U.S.C. § 1112(b)(2).

> The court may not convert a case under this chapter to a case under chapter 7 of this title if the debtor is a farmer or a corporation that is not a moneyed, business, or commercial corporation, unless the debtor requests

> after notice and a hearing, absent unusual circumstances specifically identified by the court that establish that the requested conversion or dismissal is not in the best interests of creditors and the estate, the court *shall* convert a case under this chapter to a case under chapter 7 or dismiss a case under this chapter, whichever is in the best interests of creditors and the estate, if the movant establishes cause.

(emphasis supplied). *See In re 3 Ram, Inc.*, 343 B.R. 113, 117 (Bankr.E.D.Pa. 2006).

Paragraph (4) of section 1112(b) sets forth a list of examples of events or conduct that constitute cause within contemplation of subsection 1112(b)(1), including "substantial or continuing loss to or diminution of the estate and the absence of a reasonable likelihood of reorganization," "gross mismanagement of the estate," and "failure to comply with an order of the court."[8] "However, this list is not exhaustive,

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> such conversion.

11 U.S.C. § 1112(c).

> [T]he court shall order the appointment of a trustee –

...

> (3) if grounds exist to convert or dismiss the case under section 1112, but the court determines that the appointment of a trustee or an examiner is in the best interests of creditors and the estate.

11 U.S.C. § 1104(a).

[8] Paragraph (4) provides in its entirety as follows:

> (4) For purposes of this subsection, the term "cause" includes –
>
> (A) substantial or continuing loss to or diminution of the estate and the absence of a reasonable likelihood of rehabilitation;
>
> (B) gross mismanagement of the estate;
>
> (C) failure to maintain appropriate insurance that poses a risk to the estate or to the public;
>
> (D) unauthorized use of cash collateral substantially harmful to 1

and the court is free to consider other factors as they arise and to use its equitable powers to reach an appropriate result in individual cases." *In re All Denominational New Church*, 268 B.R. 536, 538 (8th Cir.BAP 2001), citing *Hatcher v. U.S. Trustee (In re Hatcher)*, 218 B.R. 441, 448 (8th Cir. BAP 1998), *aff'd*, 175 F.3d 1024 (8th Cir.1999). *See* 11 U.S.C. § 102(3) (" 'includes' and 'including' are not limiting"); *In re 3 Ram, Inc.*, *supra*, 343 B.R. at 117 ("While the enumerated examples of 'cause'

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or more creditors;

(E) failure to comply with an order of the court;

(F) unexcused failure to satisfy timely any filing or reporting requirement established by this title or by any rule applicable to a case under this chapter;

(G) failure to attend the meeting of creditors convened under section 341 (a) or an examination ordered under rule 2004 of the Federal Rules of Bankruptcy Procedure without good cause shown by the debtor;

(H) failure timely to provide information or attend meetings reasonably requested by the United States trustee (or the bankruptcy administrator, if any);

(I) failure timely to pay taxes owed after the date of the order for relief or to file tax returns due after the date of the order for relief;

(J) failure to file a disclosure statement, or to file or confirm a plan, within the time fixed by this title or by order of the court;

(K) failure to pay any fees or charges required under chapter 123 of title 28;

(L) revocation of an order of confirmation under section 1144;

(M) inability to effectuate substantial consummation of a confirmed plan;

(N) material default by the debtor with respect to a confirmed plan;

(O) termination of a confirmed plan by reason of the occurrence of a condition specified in the plan; and

(P) failure of the debtor to pay any domestic support obligation that first becomes payable after the date of the filing of the petition.

to convert or dismiss a chapter 11 case now listed in § 1112(b)(4) have changed under BAPCPA, the fact that they are illustrative, not exhaustive has not") (citing *In re TCR of Denver*, LLC, 338 B.R. 494, 500 (Bankr.D.Col.2006); 7 COLLIER ON BANKRUPTCY § 1112.01[2][a] at 1112-8-1112-9 (15th ed. rev.2005)).

> While no longer an enumerated ground under amended § 1112, conversion or dismissal of a Chapter 11 bankruptcy case is appropriate where the court finds that the proposed plan is not feasible and that a feasible plan is not possible ... If the Chapter 11 case cannot achieve a reorganization within the statutory requirements of the Code, then there is no point in expending estate assets on administrative expenses, or delaying creditors in the exercise of their nonbankruptcy law rights.

In re 3 Ram, Inc., *supra*, 343 B.R. at 117-8 (citations and footnote omitted).

B. The Bankruptcy Division Did Not Commit Clear Error in Finding That Cause to Convert Existed under Section 1112(b) of the Bankruptcy Code.

"Pursuant to Rule 8013 of the Federal Rules of Bankruptcy Procedure, on appeal, findings of fact by the bankruptcy court are set aside if clearly erroneous." *Schlumberger Resource Management Svcs. v. Cellnet Data Systems (In re CellNet Data Systems, Inc.)*, 327 F.3d 242, 244 (3d Cir. 2003). *See also Gen. Motors Acceptance Corp. v. Dykes (In re Dykes)*, 10 F.3d 184, 185 (3d Cir.1993). "The decision to convert the case to Chapter 7 is within the bankruptcy court's discretion [and] ...will be reversed only if based on an erroneous conclusion of law or when the record contains no evidence on which [the bankruptcy court] rationally could have based that decision." *Pioneer Liquidating Corporation v. U.S. Trustee (In re*

Consolidated Pioneer Mortg. Entities), 264 F.3d 803, 806-7 (9th Cir.2001) (Citations and internal quotation marks omitted).

As a debtor in possession, Prosser had a fiduciary obligation to place the economic interests of creditors above his own. *See Integrated Solutions, Inc. v. Service Support Specialties, Inc.*, 124 F.3d 487, 498 (3d Cir.1997) ("So long as the debtor remains in possession, [he] bears essentially the same fiduciary obligation to the creditors as does the trustee for the debtor out of possession."). As set forth in the Statement of Facts, *supra*, the evidence of record in this case shows that he violated this fiduciary obligation by continuing to pay himself over $1.5 million per year from the revenues of New ICC and its subsidiaries during a period when the unfunded pension liabilities of those companies were growing to in excess of $10 million. Furthermore, Prosser never filed a confirmable chapter 11 plan, nor has he otherwise disclosed what the terms of such a plan would be. The evidence of record in this case amply supports the Bankruptcy Division's decision to convert the case to chapter 7.

As he did in the District Court, Prosser focuses in his brief on appeal to this Court on four findings that he contends were not supported by the evidence.

1. <u>The Bankruptcy Division did not base its ruling on an erroneous finding regarding whether the IRS had a claim in the case.</u>

The Bankruptcy Division accurately observed in the Conversion Order that the Bankruptcy Code requires a debtor to list all claims, including contingent claims, yet

Prosser had failed to schedule the IRS as a creditor and, according to the case docket, had failed to provide the IRS with proper notice of the claims bar date "in the event that [it] has a claim." (Conversion Order, p. 4; JA-123, Vol.10, p.4928). These findings or conclusions are not subject to reasonable dispute. The Examiner reported that Prosser had received substantial sums of money from New ICC in the form of loans which New ICC "never expected him to repay" (Examiner's Report, p.18; JA-103, Vol.9, p.4124), but that he had neither scheduled these receipts as claims on his bankruptcy schedules, *Id.* at p.16, 4122, nor reported them as income on his income tax returns. *Id.* at pp.17-8, 4123-4.[9] In the Examiner Opinion, the Bankruptcy Division observed that "[t]he audited consolidated financial statements show 'net advances' to Prosser of approximately $13 million in 2005 and 2004 and of over $14 million in 2003, at a time when Prosser was personally indebted to New ICC in an amount in excess of $156 million." (Examiner Opinion, p. 25; JA-60, Vol.6, p.2548) (footnotes omitted). It is no surprise under these circumstances that the Examiner anticipated that "the Internal Revenue Service may have a substantial claim in the Debtor's bankruptcy." (Examiner's Report, p. 10; JA-103, Vol.9, p.4116).

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[9] The Examiner reported that "[f]rom 1998 through 2005, New ICC loaned an aggregate amount of $156,612,000 to the Debtor and ICC LLC, which is a single member limited liability company owned by the Debtor." (Examiner's Report, p. 13; JA-103, Vo.9, p.4119) (footnote omitted).

At page 14 of his brief on appeal, Prosser characterizes the Examiner's analysis of his potential income tax liability as "unsupported, unwarranted and careless speculation." Clearly, however, the Examiner articulated a detailed, well-grounded and convincing basis upon which Prosser could be assessed substantial tax liability for unreported income. Whether and/or to what extent such a claim is ultimately allowed is entirely beside the point. The point is that by failing to recognize this potential claim in his bankruptcy schedules and failing to serve the IRS with a written bar date notice, Prosser displayed a lack of candor inconsistent with his fiduciary responsibility to his creditors as a debtor in possession.

2. The record fully documents Prosser's lack of cooperation with the Examiner.

The duties of the Examiner in this case, as specified by the Bankruptcy Division in the Examiner Opinion, were "to investigate the income and expenses claimed and to prepare a report on the reasonable likelihood of rehabilitation." (Examiner Opinion, p.29; JA-60,Vol.6, p.2552). The Examiner Order specifically ordered Prosser to cooperate with the Examiner in this regard. (Examiner Order, p.2; JA-60, Vol.6, p.2561). The issue of Prosser's cooperation with the Examiner subsequently arose at a hearing held on May 16, 2007, at which time the Bankruptcy Division set a two-week deadline for Prosser to provide the Examiner certain information. (5/16/07 Transcript, pp.49-50; JA-77, Vol.7, pp.3066-7). Notwithstanding these directives, and notwithstanding Prosser's role as a fiduciary for creditors, the Examiner found it necessary to seek an order compelling Prosser to provide him with the information in question. On June 20, 2007, the Examiner filed a "Motion to Compel Debtor to Provide Examiner Access to Certain Personnel and Records" (the "**Motion to Compel**," JA-80, Vol.7, p.3301), alleging that despite his continued efforts to schedule a time to review Prosser's accounting and business records and those of his various business entities, including New ICC and its subsidiaries, Prosser had failed to make these records available to him. In a response to Prosser's opposition to that motion, the Trustee in the Corporate Cases asserted that Prosser had likewise failed to provide him with requested information. (JA-85, Vol.8, p.3592, ¶3).

On August 3, 2007, the Court entered an order granting the Motion to Compel and directing Prosser to provide the Examiner "immediate, full complete and unfettered access to any and all [of his] personnel, books, records, documents and accounts, including bank accounts" and those of any entities or organizations in which he had any interest or exercised any influence or control. (JA-93, Vol.8, p.3819). The Bankruptcy Division found in the Conversion Order that

> as of the hearing on September 21, 2007, Debtor still had not released to the Examiner his personal checking account statement and had not requested, or only recently requested, records from his bank and, although information was sought for a time period of 10 years, *no effort was made by Debtor to provide recent information*.

(Conversion Order, p.5; JA-123, Vol.10, p.4929) (emphasis supplied).

While Prosser maintains in his brief on appeal that he has "cooperated fully with the Trustee and Examiner" and that "[t]he record is replete with examples of [such] cooperation," he has cited to nothing in the record that is inconsistent with the Bankruptcy Division's conclusions to the contrary. His asserted cooperation in providing some requested information obviously does not excuse his failure to provide other information requested by the Examiner. As a debtor in possession, Prosser was not entitled to pick and choose what information he made available to the Examiner or his creditors. The Court's statement regarding the requested bank records was not directed to Prosser's delay in providing the Examiner with records for the past 10 years, as suggested in his brief, but to his delay in providing "recent information." The evidence of record amply supports the Bankruptcy Division's finding that Prosser made no effort to provide such information.

3. Prosser failed utterly to demonstrate that he has the ability to propose a confirmable plan of liquidation.

As noted in the Statement of Facts, *supra*, Prosser had ample opportunity to propose a chapter 11 plan prior to the entry of the Conversion Order but never did so. The obstacles to confirmation of any such plan would clearly have been formidable. In his analysis of Prosser's prospects for securing confirmation of a plan of liquidation pursuant to the "cramdown" option available under 11 U.S.C. § 1129(b)(2)(B), the

Examiner noted that because Greenlight and RTFC would control the unsecured creditor class and because they had announced their unwillingness to support any plan proposed by Prosser, Prosser would have to obtain the consenting vote of an impaired class consisting of a secured creditor in order to comply with 11 U.S.C. § 1129(a)(10).[10] (Examiner's Report, pp.34-5; JA-103, Vol.9, pp.4140-41). The Examiner questioned Prosser's ability to do this, stating that his secured creditors appeared to be "adequately collateralized" and that, "[a]lthough it is conceivable that one or more of [them] may be impaired by a Debtor plan, the Debtor has not sufficiently explained why his secured creditors would not be paid in full pursuant to the terms of their loan and security instruments." *Id.* at pp.35-6, 4141-2. Further, even assuming Prosser could obtain acceptance by an impaired class, the Examiner concluded that he could not meet the "best interest of creditors" requirement established by 11 U.S.C. § 1129(a)(7)(A)[11] without liquidating certain property that

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[10] Under 11 U.S.C. § 1129(a)(10), a plan can be confirmed only if "at least one class of claims that is impaired under the plan has accepted the plan, determined without including any acceptance of the plan by any insider."

[11] Section 1129(a)(7)(A) specifies that a plan can be confirmed only if, with respect to each impaired class of claims or interests –

> each holder of a claim or interest of such class –
> (i) has accepted the plan; or
> (ii) will receive or retain under the plan on account of such claim or interest property of a value, as of the effective date of the plan, that is not less than the amount that such holder would so receive or retain

he had expressed a lack of willingness to part with. *Id.* at pp. 38-9, 4141-5. Confirmation of any plan proposed by the Debtor would also have raised the issue of how to estimate his "projected disposable income" over the five year period beginning on the date the first payment was due under the plan, so as to determine the amount of plan payments needed to satisfy 11 U.S.C. § 1129(a)(15).[12] As the Bankruptcy Division noted in the Conversion Order, the Trustee for the Corporate Debtors had terminated Prosser's employment with New ICC (Conversion Order, pp.3-4; JA-123, Vol.10, pp.4927-8),[13] rendering any estimate of his projected disposable income over

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> if the debtor were liquidated under chapter 7 of this title on such date
> ...

[12] Section 1129(a)(15) establishes the following requirement for confirmation of a chapter 11 plan:

> In a case in which the debtor is an individual and in which the holder of an allowed unsecured claim objects to the confirmation of the plan –
>
> (A) the value, as of the effective date of the plan, of the property to be distributed under the plan on account of such claim is not less than the amount of such claim; or
>
> (B) the value of the property to be distributed under the plan is not less than the projected disposable income of the debtor (as defined in section 1325 (b)(2)) to be received during the 5-year period beginning on the date that the first payment is due under the plan, or during the period for which the plan provides payments, whichever is longer.

[13] On September 7, 2007, the Court entered an order in the ICC, LLC chapter 11 case (Case No. 06-30008, JA-104, Vol.9, p.4148) authorizing the Trustee to vote EmCom's shares of stock in New ICC to corporate action necessary to exercise control over that corporation. On October 3, 2007, the Bankruptcy Division directed the appointment of a trustee in New ICC's own chapter 11 case, *In re:*

the next five years a speculative endeavor at best.[14] Finally, the Court was entirely correct in its observation that, while conceding that his wife would have to contribute her interest in their jointly owned property in order for a plan to succeed, Prosser had produced no evidence of any agreement on her part to do so. (Conversion Order, p.3; JA-123, Vol.10, p.4927). Prosser's assertion at page 21 of his brief on appeal that his

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Innovative Communication Corporation, Case No. 07-30012 (JA-124, Vol.10, p.4933), and the Bankruptcy Division subsequently entered an order approving the appointment of Stanford Springel as chapter 11 trustee in that case, as well.

[14] In this regard, Prosser's counsel engaged in the following colloquy with the Court during the Conversion Hearing:

> THE COURT: But unless he's going to pay – well, I mean the test isn't that clear, but in all probability he's going to have to commit his post-petition earnings for five years to this plan. That's what –
> MR. CRAIG: Sure.
> THE COURT: Okay, so what are those earnings going to be? What are they coming from?
> MR. CRAIG: He may not have any, Your Honor.
> THE COURT: Well, then he's not too likely to confirm a plan.
> MR. CRAIG: Well, sure he can.
> THE COURT: I don't think so.
> MR. CRAIG: And, Your Honor, he has to be able to allocate whatever -- whatever his net disposal income is. And, Your Honor, the cases -- there aren't very many on this issue yet, but there are situations where it's acknowledged that may be a negative number, and if it is a negative number, the financial standard to be met is (a)(7), liquidation value. Okay?
> THE COURT: I understand. We're talking about a gentleman who ... makes a million to (sic) a year before all of this issue with the Trustee happened has an earning potential, which I still believe the courts will be looking at in Chapter 11 for the five years post-petition, that is very high.

(Conversion Hearing Transcript, pp. 58-9; JA-122, Vol.10, pp.4890-91).

wife had agreed to the sale of the Palm Beach property is obviously no substitute for her testimony or agreement to that effect. Furthermore, as the District Court pointed out, even if Prosser's wife was willing to participate in the sale of their jointly owned property, that does not equate to a willingness to contribute her portion of the proceeds from such sales to fund his hypothetical chapter 11 plan. (District Court Memorandum Opinion, pp. 8-9; JA-181, Vol.14, pp. 6830-1).

By the time the Bankruptcy Division entered the Conversion Order, over 14 months had transpired since Prosser filed his petition for relief under chapter 11. Prosser had the right, if he chose to do so, to file a plan of reorganization and disclosure statement at any time during this period. The Court found that "[g]rounds for conversion clearly exist[ed]" as early as February 13, 2007, when the Examiner Order was entered. (Examiner Opinion, p.35; JA-60, Vol.6, p.2558). Over six months later, at the Conversion Hearing, Prosser was asking for an additional two weeks to file a plan. The evidence clearly supported the Court's conclusion that Prosser could not propose a confirmable plan of liquidation and that there was consequently "no likelihood of a reasonable prospect of rehabilitation of [his] financial affairs in a Chapter 11." (Conversion Order, p.6; JA-123, Vol.10, p.4930).

4. The Bankruptcy Division had ample basis upon which to conclude that the cost of litigation would be greater in chapter 11 than chapter 7.

Prosser's two major creditors, RTFC and Greenlight, have made it clear that they will not support any plan proposed by him, and Prosser does not dispute that the only manner in which he could obtain confirmation of a plan would be pursuant to the "cram down," provisions of 11 U.S.C. § 1129(b). The correctness of the Examiner's conclusion that "any attempt by the Debtor to cramdown a plan would be rife with difficulties and costly to the estate" (Examiner's Report, p. 32; JA-103, Vol.9, p.4138) is not reasonably open to question. Among the issues that would have to be litigated would be Prosser's ability to create an accepting impaired class to satisfy 11 U.S.C. § 1129(a)(10),[15] whether the payments to non-accepting classes were at least equivalent to what such creditors would receive in a chapter 7 liquidation,[16] the validity of Prosser's as yet non-existent projections regarding his anticipated disposable income during the five year period beginning on the date the plan payments commenced,[17] whether he was committing all such projected disposable income to the plan so as to satisfy 11 U.S.C. § 1129(a)(15),[18] and whether he had

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[15] *See* footnote 10, *supra*.

[16] *See* footnote 11, *supra*.

[17] *See* footnote 12, *supra*.

[18] *See* footnote 13, *infra*.

satisfied the pre-confirmation disclosure requirements established by 11 U.S.C. § 1125. Prosser's counsel freely acknowledged that an attempt by Prosser to confirm a plan would entail litigation, stating,

> there's some other requirements under 1129, and when we get to confirmation, we'll have to fight over those ... We're just saying we will file that plan. There will be objections. We will have some debates, and Your Honor will resolve that. If it doesn't get confirmed, you can convert.

(Conversion Hearing Transcript, p. 53; JA-122, Vol.10, p.4885).

The Bankruptcy Division clearly did not abuse its discretion in concluding that the avoidance of such litigation was in the best interest of the bankruptcy estate and its creditors.

CONCLUSION

"'[A]n abuse of discretion exists where the district court's decision rests upon a clearly erroneous finding of fact, an errant conclusion of law, or an improper application of law to fact.' *In re SGL Carbon Corp.*, 200 F.3d [154], at 159 [(3d Cir.1999)] (quoting *ACLU v. Black Horse Pike Reg'l Bd. of Ed.*, 84 F.3d 1471, 1476 (3d Cir.1996))." *In re Integrated Telecom Express, Inc.*, 384 F.3d 108, 118 (3d Cir.2004). It is clear that the Bankruptcy Division's decision to convert this case from chapter 11 to chapter 7 was not predicated on any clearly erroneous finding of fact, errant conclusion of law, or improper application of law to fact. Any one of the numerous reasons articulated in the Conversion Order was sufficient by itself to support the decision to convert the case. Based on the foregoing arguments and authorities, the United States Trustee respectfully requests the Court to enter an order affirming the District Court's Order affirming the decision of the Bankruptcy Division.

Respectfully submitted this the 20th of April, 2009.

Of Counsel:

RAMONA ELLIOTT
General Counsel
P. MATTHEW SUTKO
WALTER W. THEUS, JR.
Office of the General Counsel

Executive Office for United States Trustees
United States Department of Justice
20 Massachusetts, Ave. NW, Ste 8100
Washington, D.C. 20530
Tel: (202) 307-1399

Prepared and submitted by:

By: ***/s/ Guy G. Gebhardt***
GUY G. GEBHARDT
Assistant United States Trustee

By: ***/s/ James H. Morawetz***
JAMES H. MORAWETZ
Trial Attorney

United States Department of Justice
Office of the United States Trustee
Suite 362, Russell Federal Building
75 Spring Street, SW
Atlanta, GA 30303
Tel: (404) 331-4437
Fax: (404) 331-4464

CERTIFICATE OF COMPLIANCE WITH FEDERAL RULE OF APPELLATE PROCEDURE 32(a) AND L.A.R. 31.1(c)

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Date: April 20, 2009.

/s/ ***James H. Morawetz***
JAMES H. MORAWETZ
Georgia Bar No. 521900
Attorney for Donald F. Walton,
United States Trustee, Region 21
E-mail: jim.h.morawetz@usdoj.gov
Tel: (404) 331-4437

CERTIFICATE OF SERVICE

I certify that I am over the age of 18 and that on this date I caused two copies of the foregoing Brief of Appellee Donald F. Walton, United States Trustee, Region 21, to be deposited in the U.S. Mail, first class postage prepaid, addressed to each of the following at the address shown herein:

Norman A. Abood, Esq.
203 Fort Industry Square
152 N. Summit Street
Toledo, OH 43604-2304

A. Jeffrey Weiss, Esq.
A. J. Weiss & Associates
6934 Vessup Lane
St. Thomas, USVI 00802-1001

Alex M. Moskowitz, Esq.
A.J. Weiss & Associates
6934 Vessup Lane
St. Thomas, USVI 00802-1001

Michaela C. Crocker, Esq.
Vinson & Elkins, LLP
2001 Ross Avenue
3700 Trammell Crow Center
Dallas, TX 75201-0000

Thomas S. Leatherbury, Esq.
Vinson & Elkins, LLP
2001 Ross Avenue
3700 Trammell Crow Center
Dallas, TX 75201-0000

Daniel C. Stewart, Esq.
Vinson & Elkins, LLP
2001 Ross Avenue
3700 Trammell Crow Center
Dallas, TX 75201-0000

J. Daryl Dodson, Esq.
Moore, Dodson & Russell, PC
5035 (14A) Norre Gade, Suite One
P.O. Box 310
St. Thomas, VI 00804

Toby L. Gerber, Esq.
Fulbright & Jaworski, LLP
2200 Ross Avenue
Suite 2800
Dallas, TX 75201-2784

Gregg M. Galardi, Esq.
Skadden, Arps, Slate, Meagher & Flom, LLP
One Rodney Square
P.O. Box 636
Wilmington, DE 19899-0636

Samuel H. Israel, Esq.
Fox Rothschild, LLP
2000 Market Street, 10th Floor
Philadelphia, PA 19103

Eric E. Reed, Esq.
Fox Rothschild, LLP
2000 Market Street, 10th Floor
Philadelphia, PA 1910

This the 20th day of April, 2009.

/s/ ***James H. Morawetz***
JAMES H. MORAWETZ
Georgia Bar No. 521900
Attorney for Donald F. Walton,
United States Trustee , Region 21
E-mail: jim.h.morawetz@usdoj.gov
Tel: (404) 331-4437

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In re Susan Kay Quigley (UST v. Quigley)

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Douglas A. Kilmer, W. Clarkson McDow, Thomas C. Kearns, P. Matthew Sutko
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***
• Whether the bankruptcy court erred in holding that the disposable income an above median income chapter 13 debtor must pay to creditors in her plan may include deductions for secured debt payments that the debtor would never make because she was surrendering the property to secured creditors.

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IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF WEST VIRGINIA

In re SUSAN KAY QUIGLEY,

Debtor.

HELEN M. MORRIS, Trustee

Appellant,

v.

SUSAN KAY QUIGLEY,

Appellee.

ON APPEAL FROM THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF WEST VIRGINIA
Bankruptcy Case No. 5:08-bk-00024

BRIEF FOR THE UNITED STATES TRUSTEE AS AMICUS CURIAE

OF COUNSEL

RAMONA D. ELLIOTT
General Counsel

P. MATTHEW SUTKO
THOMAS C. KEARNS
Executive Office for United States Trustees
Department of Justice
20 Massachusetts Avenue N.W.
Washington, D.C. 20530

W. CLARKSON McDOW, JR.
United States Trustee

DOUGLAS A. KILMER
Attorney for United States Trustee
Department of Justice
United States Courthouse, Room 2025
300 Virginia Street East
Charleston, West Virginia 25301
Telephone: (304) 347-3404

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INTEREST OF THE UNITED STATES

The United States Trustee submits this brief as *amicus curiae* supporting reversal of the decision of the bankruptcy court. *Cf.* Fed. R. App. P. 29(a)(permitting the United States to file an *amicus curiae* brief without the consent of the parties or leave of court).

This appeal calls upon this Court to examine certain statutes that affect chapter 13 and chapter 7 bankruptcy cases: 11 U.S.C. § 1325(b) and 11 U.S.C. § 707(b)(2)(A)(iii). The United States has a direct interest in the construction of these provisions. The Attorney General appoints United States Trustees to supervise the administration of chapter 7 and chapter 13 bankruptcy cases in nearly all federal judicial districts. 28 U.S.C. § 581(a). United States Trustees "serve as bankruptcy watch-dogs to prevent fraud, dishonesty, and overreaching in the bankruptcy arena." H.R. Rep. No. 595-595, at 88, *reprinted* in 1978 U.S.C.C.A.N. 5963, 6049.

This case involves a dispute over the interpretation of "projected disposable income" under 11 U.S.C. § 1325(b)(1) and interpretation of certain expense deductions under 11 U.S.C. § 707(b)(2)(A)(iii), in the context of confirmation of plans under chapter 13 of the Bankruptcy Code. This appeal affects the United States Trustee's interest for two reasons.

First, by interpreting section 1325(b), this Court will determine how much higher income chapter 13 debtors must repay their creditors in their chapter 13 plans. The United States Trustee has an interest in that question because United States Trustees supervise the administration of chapter 13 cases and trustees and monitor chapter 13 plans. 28 U.S.C. §586(a)(3)(C).

Second, by interpreting a provision of section 707(b)(2), the decision of this Court will impact what expenses higher income chapter 7 debtors can claim in determining their disposable income that can be paid to creditors. *See* 11 U.S.C. § 707(b)(1) and (2). The United States

Trustees are required to review all such cases and determine whether a case is abusive under the means test and should be dismissed. *See* 11 U.S.C. § 704(b). One of the allowed means test expenses that is the subject of this appeal - payments on secured debts under section 707(b)(2)(A)(iii) - is critical to the United States Trustee's analysis of whether there is a presumption of abuse.

In light of these interests, the United States Trustee respectfully submits this brief to offer this Court its views on the proper interpretation of sections 1325(b) and 707(b)(2)(A)(iii).

STANDARD OF REVIEW

A bankruptcy court's findings of fact are reviewed for clear error and but its conclusions of law are reviewed *de novo*. *In re White*, 487 F.3d 199,204 (4th Cir. 2007). In this case, the facts are undisputed and the bankruptcy court's interpretations of 11 U.S.C. § 1325 (b) and § 707(b)(2) are conclusions of law subject to *de novo* review.

STATEMENT OF THE ISSUE

Whether the bankruptcy court erred in holding that the disposable income an above median income chapter 13 debtor must pay to creditors in her plan may include deductions for secured debt payments that the debtor would never make because she was surrendering the property to secured creditors.

STATEMENT OF FACTS

I. Statutory Framework.

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA) [1] significantly altered how individual debtors obtain bankruptcy relief under chapter 7 and chapter 13 of the Bankruptcy Code. One of the innovations of BAPCPA was means-testing, a well-publicized change in bankruptcy law that involves calculation of a debtor's ability to pay debts.

In chapter 7 cases, where the debtor's primary objective is to receive a discharge of debts, BAPCPA amended section 707(b) of the Bankruptcy Code and established a new statutory presumption. A chapter 7 case is presumed to be an abuse (and subject to dismissal) if a mathematical formula, based on historical income and expenses allowed by statute, results in a certain level of disposable income. *See* 11 U.S.C. § 707(b)(2). In addition to establishing the presumption, the amendment changed the way expense deductions are computed. The prior law permitted debtors to use actual, reasonable and necessary expense amounts. Under BAPCPA, some of the allowed expenses continue to be actual expenses but other allowed expenses are either specified by statute or based on standards issued by the Internal Revenue Service for the debtor's area of residence. 11 U.S.C. § 707(b)(2)(A)(ii). The calculation of disposable income is made on Fed. R. Bankr. P. Official Form 22A (Statement of Current Monthly Income and Means Test Calculation). *See* 11 U.S.C. § 521 and § 707(b)(2)(C). If the calculation results in a certain level of disposable income, the case will be presumed abusive and subject to dismissal under section 707(b)(1) .

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[1] Pub L. No. 109-8, 119 Stat. 23 (2005)

Congress also applied means-testing to chapter 13 cases. In a chapter 13 case the objective is to pay creditors over time through a repayment plan, rather than by liquidating pre-petition assets as occurs in chapter 7. In chapter 13, the debtor's chapter 13 plan must provide that all the debtor’s "projected disposable income" will be used to pay creditors. *See* 11 U.S.C. § 1325(b)(1). The term “projected disposable income” has not been defined in the Bankruptcy Code and remains undefined after the BAPCPA amendments.

Prior to BAPCPA, “disposable income” was defined to mean “income which is received by the debtor and which is not reasonably necessary to be expended ... for the maintenance or support of the debtor.” 11 U.S.C. § 1325(b)(2)(2000 ed.). The disposable income was calculated from the debtor’s actual income and expenses shown on Schedules I and J filed by the debtor.

BAPCPA amended section 1325(b)(2) to change the definition of "disposable income" to mean "current monthly income [2] received by the debtor ... less amounts reasonably necessary to be expended ... for the maintenance or support of the debtor.” 11 U.S.C. § 1325(b)(2). This new definition of disposable income incorporated two changes: first, it defines "disposable income" based on an average of historical monthly income figures; and second, for debtors with higher income levels, it requires the debtor to use the same standard expenses allowed for chapter 7 debtors. Section 1325(b)(3) thus now directs that reasonable expenses be determined "in accord-

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[2] "Current monthly income," added to the Bankruptcy Code by BAPCPA, means the "average monthly income from all sources" that the debtor received during the six-month period ending the last calendar month before the debtor filed his bankruptcy petition. 11 U.S.C. § 101(10A).

ance with subparagraphs (A) and (B) of section 707(b)(2)" for above-median income debtors. 11 U.S.C. § 1325(b)(3).

Above-median income chapter 13 debtors determine disposable income by using Fed. R. Bankr. P. Official Form 22C (Chapter 13 Statement of Current Monthly and Disposable Income). On it, debtors list historical income. Because a debtor's income or expenses may change after the petition is filed, there is often a significant difference between the disposable income calculated under Form 22C and the debtor's actual disposable income.

This appeal involves the interpretation of a specific statutory expense deduction that BAPCPA provided for chapter 7 debtors but that is applicable in this case. Section 707(b)(2)(A)(iii) allows chapter 7 debtors to deduct "average monthly payments on account of secured debts" which are "scheduled as contractually due in each month of the 60 months following the date of the petition." 11 U.S.C. § 707(b)(2)(A)(iii). Although this deduction is found in chapter 7 of the Bankruptcy Code, it is made applicable to above median income chapter 13 debtors in the calculation of disposable income under section 1325(b)(3).

II. Factual Background

Susan Quigley filed her Chapter 13 petition on January 11, 2008. (Doc. 6-2, p.2). She also filed the following documents that are relevant to this appeal: Official Form 22C (Doc. 6-2, p.38); Chapter 13 Plan (Doc. 6-2, p.46); Schedules I and Schedule J (Doc. 6-2, p.29), which reflected her present employment, income, and expenses; and Schedules A and B (Doc. 6-2, p.17,18), which list all her assets. The debtor's Form 22C stated that her current monthly income was $3,339.33, or $40,071 annually. (Doc. 6-2, p.38). This is above the median income for a family size of one in West Virginia.[3]

The debtor's expenses included four deductions for debt payments on secured claims. (Form 22C, Line 47; Doc. 6-2, p.43). First, debtor deducted a secured payment of $45.83 for her 2003 Ford Ranger. The debtor indicated in her plan that she intended to retain this vehicle and continue to make the payments. (Doc. 6-3, p.3). This expense deduction is not at issue on appeal.

Second, debtor deducted monthly payments of $40.87 and $122.46 for two all terrain vehicles (ATVs). (Doc. 6-2, p.43). Debtor stated in her plan she was surrendering both ATVs to the secured creditors, HSBC Customer Service and Suzuki Retail Services, and did not provide for any payments on those vehicles in the plan. (Doc. 6-3, p.2). Debtor's Schedule J, listing projected expenses, also does not contain either of these payments. (Doc. 6-2, p.30. These expense deductions are at issue in this appeal.

Finally, debtor deducted a monthly payment of $307.83 for a Ford F-150 truck. (Doc. 6-2, p.43). On Schedule B, debtor stated that this truck "belongs to ex-boyfriend. He is making the payments on the vehicle." (Doc. 6-2, p.21). The bankruptcy court found while the ex-boyfriend is in possession of the truck and making payments on the truck, the debtor and her ex-boyfriend are co-owners of the truck and are co-obligated on its debt. (Doc. 6-3, p.27). Debtor's plan did not provide for any future payments on the truck (Doc. 6-2, p.46), and Schedule J does not list the truck payment as a monthly expense. (Doc. 6-2, p.30).

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[3] *See* http://www.usdoj.gov/ust/eo/bapcpa/20080101/bci_data/median_income_table.htm (table containing median family income data applicable to this case).

After accounting for the ATVs and truck expense deductions, debtor's Form 22C disposable income was <$48.08>. (Doc. 6-2, p.44). The Debtor's proposed chapter 13 repayment plan suggested bi-weekly payments of $122.77 (or $266 per month) for 60 months. (Doc. 6-2, p.46). The chapter 13 trustee objected to the plan, arguing that debtor failed to dedicate all of her disposable income to the plan because the debtor improperly deducted expense payments for the ATVs she was surrendering and the truck that was being paid by debtor's ex-boyfriend. (Doc. 6-3, p.9). *See* 11 U.S.C. § 1325(b)(1)(B)(if chapter 13 trustee objects to a proposed plan, debtor must dedicate all projected disposable income to repay unsecured creditors in order to have plan confirmed). The chapter 13 trustee objected because she believed that eliminating improper deductions claimed by the debtor would increase debtor's disposable income and monthly plan payments to $423.

In a Memorandum Opinion (Doc. 6-2, p.26) entered June 20, 2008, the bankruptcy court determined that the debtor's "projected disposable income" under section 1325(b)(1) may include expense deductions for payments on secured debt that the debtor would not be making in the future because she was surrendering the collateral.[4] The chapter 13 trustee timely appealed.

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[4] The bankruptcy court also held that the debtor could deduct the payments for the Ford F-150 truck that were being made by her ex-boyfriend, provided that the debtor included in her income the payments her ex-boyfriend was making on the truck. In its order, the bankruptcy court required the debtor to file an amended Form 22C that either (1) included in her income the payments the ex-boyfriend was making, or (2) instead of including the payments made by the ex-boyfriend in income, eliminated the contested truck payment from her Form 22C expenses. (Rec 54) The debtor filed an amended Form 22C which eliminated the truck payment as an expense deduction. This increased the debtor's stated disposable income from <$48.08> to $248.75. The amended Form 22C is not part of the record designated for this appeal. The United States Trustee raises this point because elimination of the truck payment expense is consistent with the position taken by the United States Trustee before the bankruptcy court. Accordingly, because deduction of a secured debt expense when payment is made by a third party is no longer an issue, the United States Trustee shall only address the surrender issue in this *amicus* brief.

SUMMARY OF ARGUMENT

This Court should reverse the decision of the bankruptcy court for three independent reasons. First, when a creditor or the chapter 13 trustee objects to confirmation of a chapter 13 plan, section 1325(b)(1) prohibits bankruptcy courts from confirming the plan unless the debtor provides all of his projected disposable income to repay unsecured creditors during the applicable commitment period. That did not occur here because the debtor artificially reduced her projected disposable income by claiming secured debt expenses on two ATVs that she was not going to be paying over the life of her chapter 13 plan because she was surrendering the vehicles to the secured creditors.

The bankruptcy court allowed the debtor to claim these non-existent expenses because the court failed to recognize projected disposable income is a forward-looking concept that requires the court to exclude expenses that the debtors do not or will not incur. By allowing a disposable income calculation in a chapter 13 plan that included deductions for payments on property that the debtor will surrender to secured creditors, the bankruptcy court did not compel the debtor to dedicate all her projected disposable income as section 1325(b)(1) requires.

Second, the bankruptcy court failed to appreciate that in calculating "disposable income" under section 1325(b)(2), debtors may only deduct from current monthly income “amounts reasonably necessary to be expended." The bankruptcy court should not have allowed the debtor to deduct payments on the two ATVs she was giving up because payments on that property was not going to be “expended" during the life of the plan, so it cannot be therefore be a “reasonably necessary” expense. To the contrary, it is a non-existent expense. Given this, the bankruptcy court erred in determining that the debtor could deduct as amounts "to be expended" payments the debtor will never make in the future on property being surrendered.

Third, and alternatively, the bankruptcy court misapplied section 707(b)(2)(A)(iii), which is incorporated into section 1325(b)(3) in above-median income chapter 13 cases by section 1325(b). It did so by excluding payments on surrendered property even though section 707(b)(2)(A)(iii) should be read as allowing deduction only for amounts that are "scheduled as contractually due" to secured creditors.

ARGUMENT

I. Section 1325(b)(1) Requires That Debtors Commit To Unsecured Creditors All Of Their "Projected Disposable Income" Over The Applicable Commitment Period

Under section 1325(b)(1), bankruptcy courts may not confirm chapter 13 plans over the chapter 13 trustee's objection unless "the plan provides that all of the debtor's projected disposable income to be received in the applicable commitment period. . .will be applied to make payments to unsecured creditors under the plan." 11 U.S.C. § 1325(b)(1). The chapter 13 trustee objected to the chapter 13 plan filed by the debtor. The bankruptcy court erred because it did not require payment of all the debtor's projected disposable income over the applicable commitment period.

A. "Projected Disposable Income" Is a Future Oriented Concept That Does Not Permit Debtors To Subtract Secured Debt Payments As Expenses When The Property At Issue Will Be Surrendered Under The Plan.

In considering "projected disposable income," this Court should adopt an interpretation that gives meaning to the definition of "disposable income" under section 1325(b)(2), by recognizing that the section's use of "projected" means that its expense analysis is forward looking. Under this construction, the debtor's historical income and expense deductions under section 707(b)(2)(A)(ii), (iii), and (iv) are a starting point, and should be carried forward throughout the term of the plan, absent evidence that the debtor's income or expenses are "projected" to change. When evidence demonstrates that the debtor is projected to have a significant change in income or expenses during the life of the chapter 13 plan, the Court should consider this evidence in its calculations of the debtor's projected disposable income.

This reading is based squarely upon section 1325(b)(1)'s text, which expressly requires that all of the debtor's projected disposable income "be applied to make payments to unsecured creditors. . ." 11 U.S.C. § 1325(b)(1).

1. <u>Courts have taken two principal approaches in interpreting "projected disposable income under section 1325(b).</u>

Two principal approaches have emerged in the interpretation of section 1325(b) "projected disposable income." One view is that section 1325(b) requires "projected disposable income" to be computed by taking the historical "disposable income" amount calculated on Form 22C and projecting it over the plan period, without any consideration of post-petition or future changes in income or expenses. The Ninth Circuit has adopted that interpretation. *See In re Kagenveama*, 527 F.3d 990 (9th Cir. 2008). The underlying rationale is that "disposable income" was defined for the first time in BAPCPA and is used nowhere other than in the phrase "projected disposable income" in section 1325(b)(1). Thus, the argument goes, "projected disposable income," while still undefined in the Code, must mean nothing more than historical "disposable income" that is projected out through the plan period. *In re Kagenveama,* 527 F.3d at 996 (to get from the statutorily defined 'disposable income' to 'projected disposable income, one simply takes the calculation . . . and does the math.); *see also In re Simms*, 2008 Bankr.LEXIS 224 at *38 (Bankr.N.D.W.Va., January 23, 2008)(debtor's projected disposable income is the disposable income calculation on Form 22C carried forward through the plan period, not based on any "actual" expenses of the debtor).

This definition of projected disposable income has been criticized because it ignores that the word “projected” in section 1325 requires courts to address projected changes to income and expenses over the life of the plan. For them, “projected” in section 1325(b) exists so that historical income and expenses will not necessarily be used when they will not be accurate during the plan period. While starting with the historical disposable income amount, they have read "projected disposable income" to permit the consideration of significant changes in income and expenses that are likely to occur over the life of the debtor's chapter 13 plan. *See, e.g., In re Lanning,* 380 B.R. 17, 24 (B.A.P. 10th Cir. 2007), *appeal pending*, No. 08-3009 (10th Cir.); *In re Kibbe*, 361 B.R. 302, 314 (B.A.P. 1st Cir. 2007); *In re Pak*, 378 B.R. 257 (B.A.P. 9th Cir. 2007), *overruled by In re Kagenveama*, 527 F.3d 990 (9th Cir. 2008) . These courts have noted that this reading of "projected disposable income" is consistent with a debtor's actual financial situation over the life of the chapter 13 plan.

2. The mechanical approach utilized in *Kagenveama* and *Simms* is flawed and should not be followed.

The bankruptcy court utilized the *Kagenveama* strict backward looking approach to “projected disposable income” in adopting a “mechanical calculation" for determining what must be paid to unsecured creditors. This backward looking approach is flawed and should not be followed.

First, this backward looking interpretation fails to consider the term "projected" in its proper context. *See Hibbs v. Winn*, 542 U.S. 88, 101 (2004) (statutory words must be construed in context). The use of the term "projected" in the economic and financial context of this statute suggests a forecast or estimate of an expected future financial reality.[5] While the calculation of "projected" financial data may well begin with historical data, it does not necessarily (or even usually) end there, nor does it entail a rigid and absolute assumption that projected income will be identical to past income when the available facts demonstrate otherwise. The backward looking test applied by the Ninth Circuit in *Kagenveama* and by the bankruptcy court here ignores the statutory language's context.

The backward looking approach utilized by the bankruptcy court also fails to reflect that section 1325(b)(1) explicitly requires chapter 13 plans to include all the debtor's projected disposable income "to be received" during the plan period. *(emphasis added)*. Only a forward-looking approach that takes into account significant changes in post-petition income and expenses results in the amount of projected disposable income "to be received" by the debtor during the plan period. The mechanical test fails to address cases in which historical disposable income calculated on Form 22C may be substantially more or less than the actual disposable income "to be received" by the debtor in the future.

Moreover, the backward looking approach fails to take into account another statutory phrase in section 1325(b)(1)(B), that the plan must provide that all the projected disposable income to be received "will be applied to make payments" under the plan. For reasons stated in connection with the "to be received" requirement, projected disposable income should include the disposable income that can "be applied to make payments" under the plan. In *Kagenveama*

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[5] See *The Random House Dict. of the English Lang.*, 1546 (2nd ed.1987)(defining to "project" as *inter alia* , "to set forth or calculate (some future thing); *They projected the building costs for the next five years."*); *Webster's Third New Int'l Dict.* 1813 (1993) (defining "projected" as *inter alia* "planned for future execution; contrived, proposed," as "[projected outlays for new plant and equipment").

the Ninth Circuit based its understanding of projected disposable income strictly on the historical “current monthly income” amount, minus expenses. But projecting forward this deemed or hypothetical income does not permit it to be "applied to make payments" simply because it does not exist.

It is well established that courts "must, if possible, construe a statute to give every word some operative effect." *Cooper Indus., Inc. v. Aviall Servs., Inc.,* 543 U.S. 157, 167 (2004) (*citing United States v. Nordic Village, Inc.*, 503 U.S. 30, 35-36 (1992)). The interpretation by the *Kagenveama* court and the court below ignores this statutory maxim.

B. Under Section 1325(b)(3), “Disposable Income” Is A Future-Oriented Concept That Does Not Permit Debtors To Subtract Amounts They Will Never “Expend” Because They Are Surrendering The Property Under The Plan.

Section 1325(b)(2) defines disposable income to include "current monthly income received by the debtor . . . less amounts reasonably necessary to be expended" for the maintenance or support of the debtor. For above-median debtors, section 1325(b)(3) provides that "amounts reasonably necessary to be expended . . . shall be determined in accordance with [section 707(b)(2)(A) and (B)]." 11 U.S.C. § 1325(b)(3).

The phrase "reasonably necessary to be expended" in section 1325(b)(2) also supports reading section 1325(b)(1) as allowing courts to factor in projected income and expense changes because the words “to be expended” are future-oriented. The term requires courts to look into the future to determine, inasmuch as possible, what expenses the debtor will have during the life of the plan." *In re Smith*, 383 B.R. 441, 454 (Bankr.E.D. Wis. 2008). Indeed, to give this phrase meaning, one must consider whether the debtor will actually "expend" a particular amount going forward. *Id. See also In re Renicker*, 342 B.R. 304, 309 (Bankr. W.D. Mo. 2006) (concluding that the "plain language of section 1325(b)(2) unambiguously indicates that prospective - not historical - expenses are to be used to calculate disposable income").

That term thus makes clear that the bankruptcy court should not have allowed the debtor to claim expenses she would not incur because she was surrendering the property securing the debt. Payments on property a debtor is surrendering, by definition, will never be "expended" and therefore cannot be "reasonably necessary" for the debtor's support. *In re McPhereson*, 350 B.R. 38, 45-46 (Bankr.W.D.Va. 2006) (payments the debtor does not propose to make, and is not required to make under the debtor's plan, cannot be reasonably necessary for debtor's support); *In re Coleman*, 382 B.R. 759, 763 (Bankr. W.D. Ark. 2008); *In re Koch*, 2008 WL 2910574, at *3 (Bankr. N.D.N.Y. July 25, 2008); *In re Hoss*, 2008 WL 3854448, at *6-7 (Bankr. D. Kan August 20, 2008)(rationale applied to eliminate expense deductions for second, third and fourth mortgage liens stripped off debtor’s residence, and to reduce allowed expense deduction to amount actually being paid by debtor where undersecured motor vehicle claim crammed down in chapter 13 case).

Because they will never be “reasonably necessary to be expended,” section 1325(b)(3) prohibits debtors such as Ms. Quigley from deducting from their disposable income secured debt payments on property they are surrendering. Thus, the bankruptcy court erred in holding that payments on the surrendered ATVs are allowed in determining debtor's disposable income. The bankruptcy court should be reversed and the case remanded with instructions to exclude from debtor’s Form 22C the expense deductions for payment on the surrendered ATVs.

II. Section 707(b)(2)(A)(iii) Does Not Allow Expense Deductions, As Future Payments on Secured Debt, For Collateral That Debtors Are Surrendering and Will Not Make Payments On Going Forward

The bankruptcy court's ruling should be reversed for a separate and distinct reason - section 707(b)(2)(A)(iii)(I), which section 1325(b)(3) incorporates in this case, independently prohibits chapter 13 debtors from claiming expenses associated with surrendered property. In determining disposable income for above-median income debtors, section 1325(b)(3) provides that the debtor's reasonably necessary expenses shall be determined "in accordance with subparagraphs (A) and (B) of section 707(b)(2)." 11 U.S.C. § 1325(b)(3). Under section 707(b)(2)(A)(iii)(I),[6] the bankruptcy court determined that the debtor could deduct payment on the ATVs notwithstanding that she would not actually be making any future payments because she was surrendering the collateral securing the debt. There are several reasons why this ruling is not correct.

First, the terms of section 707(b)(2)(A)(iii) contemplate that only <u>future</u> secured payments may be used to determine the debtors disposable income available to pay creditors. The statute provides: "[t]he debtor's average monthly payments on account of secured debts shall

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[6] 11 U.S.C. § 707(b)(2)(A)(iii) provides:

> The debtor's average monthly payments on account of secured debts shall be calculated as the sum of –
>
> (I) the total of all amounts scheduled as contractually due to secured creditors in each month of the 60 months following the date of the petition; and
>
> (II) any additional payments to secured creditors necessary for the debtor, in filing a plan under chapter 13 of this title, to maintain possession of the debtor's primary residence, motor vehicle, or other property necessary for the support of the debtor and the debtor's dependants, that serves as collateral for secured debts;
>
> divided by 60.

be calculated as the sum of ... the total of all amounts scheduled as contractually due to secured creditors in each month of the 60 months *following* the date of the petition." (Emphasis added). The court must begin with the statute's plain language and avoid constructions that render some words redundant or another part of the same statute superfluous. *United States v. Alaska*, 521 U.S. 1, 59 (1997). A fundamental canon of statutory construction requires that "unless otherwise defined, words will be interpreted as taking their ordinary, contemporary, common meaning. *United States v. Lehman*, 225 F.3d 426, 428-29 (4th Cir.2000); *see also* 2A Norman J. Singer, *429 *Sutherland Statutory Construction* § 46:01 (6th ed.2000).

The dictionary defines "following" as "subsequent to" or "next in the order of time" or in the future. *Merriam-Webster Online Dictionary* (2008).[7] This meaning should be imparted to the term "following" as it appears in section 707(b)(2)(A)(iii)(I), absent indication that Congress intended to give the term a different meaning. *Bailey v. United States*, 516 U.S. 137, 144-45 (1995)(using the dictionary definition of a term in order to determine it's statutory meaning). Using the common, ordinary meaning of "following" in section 707(b)(2)(A)(iii)(I) would only allow deduction for payments to secured creditors that will be made subsequent to or after the petition date. Payments for surrendered property that will never be made do not qualify under the statute. *See In re Naut*, 2008 WL 191297 at *9 (Bankr.E.D.Pa. Jan 22, 2008) (applying dictionary definition of "following" to conclude that secured payments must actually be due in the 60 months after the bankruptcy filing for the debtor to deduct the expense).

Second, the section requires that the debts be "scheduled as contractually due." Significantly, Congress has "used the phrase 'scheduled as' several times in the Bankruptcy Code

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[7] Available at: http://www.m-w.com/dictionary/following.

. . . to refer to whether a debt is identified on a debtor's bankruptcy schedules." The phrase “scheduled as contractually due” as used in that section and in conjunction with other sections of the Bankruptcy Code and Federal Rules of Bankruptcy Procedure demonstrate that secured debts must be included on a debtor's Schedule J to be deducted from income under section 707(b)(2)(A)(iii). *In re Skaggs,* 349 B.R. 594, 599 (Bankr. E.D. Mo. 2006); *In re Harris,* 353 B.R. 304, 308-10 (Bankr.E.D.Okla. 2006); *In re Naut*, 2008 WL 191297 at *9.[8] This use of the phrase "scheduled as contractually due" indicates Congress' intention that secured debts are permissible deductions under section 707(b)(2)(A)(iii) only to the extent they are legitimately on the debtor's schedules as a debt to be paid in the 60 months after the debtor filed bankruptcy.

"When Congress amends the bankruptcy laws, it does not write 'on a clean slate.'" *Dewsnup v. Timm*, 502 U.S. 410, 419 (1992). The prior bankruptcy law's ". . . longstanding meaning forms the background against which Congress legislates. . . [and] [t]he courts presume that Congress will use clear language if it intends to alter an established" meaning. *Skaggs*, 349 B.R. at 599 (citing *Firstar Bank v. Faul*, 253 F.3d 982, 988 (7th Cir. 2001). Accordingly, a debtor's “schedules and statements form the basis from which . . . [a] court should determine whether a debt is 'scheduled as contractually due. '" *Id.* The entire phrase "average monthly payments on account of secured debts scheduled as contractually due in each month of the 60

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[8] *See, e.g.*, 11 U.S.C. § 1111(a) ("wherein a claim or interest is not deemed filed if it is *scheduled as* disputed, contingent or unliquidated"). Other examples where the term "scheduled" is used to refer to a debtor's bankruptcy schedules include 11 U.S.C. § 523(a)(3)(individual debtor not discharged from debt "neither listed nor *scheduled* under section 521(1) of this title...") and 11 U.S.C. 554(c) ("Unless the court orders otherwise, any property *scheduled* under section 521(1) of this title not otherwise administered at the time of the closing of the case is abandoned to the debtor and administered for purposes of section 350 of this title.") (Emphases added).

months following the date of the petition" is best construed as contemplating a forward-looking calculation. *In re Ray,* 362 B.R.680, 685 (Bankr.D.S.C.2007).

The bankruptcy court rejected an interpretation of the term "scheduled as" in 707(b)(2)(A)(iii)(I) as referring to a debtors schedules required to be filed by the bankruptcy code, in part because a statement of intention or chapter 13 plan is not a "schedule" under the bankruptcy code. But the court did not consider that a debtor is required to file Schedule J and to list thereon all projected living expenses, including projected payments to secured and other creditors. *See In re Skaggs*, 349 B.R. at 599; *In re Harris*, 353 B.R. at 308-10 (Bankr.E.D.Okla. 2006); *In re Naut, supra*. Accordingly, Schedule J that shows the debtor has not listed future payments on the ATV debts, in conjunction with the statements in her chapter 13 plan that she is surrendering the vehicles and will not be making the payments, demonstrates that these debts have not been "scheduled."

Third, a comparison of section 707(b)(2)(A)(iii)(I) in context with its “conjunctive partner,” section 707(b)(2)(A)(iii)(II), “reinforces the conclusion that section 707(b)(2)(A)(iii)(I) applies only to payments on debts secured by collateral that a debtor intends to keep.” *In re Burden*, 380 B.R. 194, 202 (Bankr. W.D. Mo. 2007). While section 707(b)(2)(A)(iii)(I) allows secured debt payments scheduled as contractually due, the following section 707(b)(2)(A)(iii)(II) allows deductions for certain payments to secured creditors necessary for the debtor "to maintain possession of the debtor’s primary residence. . .” Allowing only debtors who intend to retain property to deduct secured debt expenses under section 707(b)(2)(A)(iii)(I) is consistent with the explicitly forward-looking nature of section 707(b)(2)(A)(iii)(II), which contemplates the debtor’s intent to maintain possession of property. *In re Burden,* 380 B.R. at 201-02.

Finally, the United States Trustee's approach is consistent with Congress' stated intent in enacting BAPCPA, which was to make certain that debtors "repay creditors the maximum they can afford." H.R. Rep. No. 109-31 (I) at 1 (2005), *reprinted in* 2005 U.S.C.C.A.N. 88,89. The disposable income test in chapter 13 and the means test in chapter 7 were intended to accomplish this objective, but mechanical interpretations of the statute that allow debtors such as Ms. Quigley to reduce their disposable income by deducting non-existent debt payments on property they intend to surrender conflicts with Congress' stated intent in enacting BAPCPA.

CONCLUSION

For all these reasons, the United States Trustee respectfully asks this Court to reverse the order of the bankruptcy court denying the chapter 13 trustee's objection to plan confirmation, and remand this case for further proceedings.

Respectfully submitted,

OF COUNSEL

RAMONA D. ELLIOTT
General Counsel

P. MATTHEW SUTKO
THOMAS C. KEARNS
Executive Office for United States Trustees
Department of Justice
20 Massachusetts Avenue N.W.
Washington, D.C. 20530

W. CLARKSON McDOW, JR.
United States Trustee

DOUGLAS A. KILMER
Attorney for United States Trustee
Department of Justice
United States Courthouse, Room 2025
300 Virginia Street East
Charleston, West Virginia 25301
Telephone: (304) 347-3404

Certificate of Service

I hereby certify that on this date I served the foregoing BRIEF FOR THE UNITED STATES TRUSTEE AS AMICUS CURIAE by electronic service on the following persons:

D. William Davis, Esq
Davis Law Offices
407 A Howard Street
Bridgeport, OH 43912

Susan Cannon-Ryan, Esq.
Office of the Chapter 13 Trustee
PO Box 8535
South Charleston, WV 25303

Date: August 26, 2008 /s/ Douglas A. Kilmer

BRIEF BANK — 'SUMMARY SHEET" *Printed Tue-5/22/07 14:24*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*
In Re: Ragle (Clippard v. Ragle)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*
United States District Court Eastern District of Kentucky

3. ("CCN") ***CURRENT*** CASE NO.
No.: Civil No. 3:07-cv-00026-KKC

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*
No.: 06-30208
Court: United States Bankruptcy Court for the Eastern District of Kentucky
(Identify judge & cite, if any)

5. ("SO") ***SOURCE***
U.S. TRUSTEES

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*
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Richard Clippard, John Daugherty, Joseph Golden, David Levine, P. Matthew Sutko
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") ● ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***
● Did the Bankruptcy court err in holding that the Ragles were eligible to claim the IRS standard vehicle financing expense allowance in calculating their disposable income under the Bankruptcy Code’s statutory means test 11 U.S.C. section 707 (b)(2 when they owned their car debt free and thus had no automobile vehicle financing expense
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UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF KENTUCKY

In re: MICHAEL J. RAGLE and TAMMY J. RAGLE, Debtors.	Bankr. No. 06-30208-jms Chapter 7
RICHARD F. CLIPPARD, United States Trustee, Appellant, v. MICHAEL J. RAGLE and TAMMY J. RAGLE, Appellees.	Civil No. 3:07-cv-00026-KKC

ON APPEAL FROM THE UNITED STATES BANKRUPTCY
COURT FOR THE EASTERN DISTRICT OF KENTUCKY, THE HONORABLE
JOSEPH M. SCOTT, JR., PRESIDING

BRIEF OF APPELLANT RICHARD F. CLIPPARD, UNITED STATES TRUSTEE

RICHARD F. CLIPPARD
UNITED STATES TRUSTEE
John L. Daugherty, Assistant U.S. Trustee
Joseph J. Golden, Assistant U.S. Trustee
Rachelle Williams, Trial Attorney
Department of Justice
Office of the U.S. Trustee
100 E. Vine Street, Suite 500
Lexington, KY 40507
(859) 233-2822

Of Counsel

Roberta DeAngelis, Acting General Counsel
P. Matthew Sutko, Associate General Counsel
David A. Levine, Trial Attorney
Executive Office for United States Trustees
Department of Justice
20 Massachusetts Ave., N.W., Suite 8000
Washington, D.C. 20530
(202) 307-1399

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UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF KENTUCKY

In re:

MICHAEL J. RAGLE and
TAMMY J. RAGLE,
Debtors.

Bankr. No. 06-30208-jms
Chapter 7

RICHARD F. CLIPPARD,
United States Trustee,
Appellant,

v.

MICHAEL J. RAGLE and
TAMMY J. RAGLE,
Appellees.

Civil No. 3:07-cv-00026-KKC

JURISDICTIONAL STATEMENT

The United States Bankruptcy Court for the Eastern District of Kentucky has jurisdiction over the underlying case, initiated by Michael J. Ragle and Tammy J. Ragle on August 16, 2006, by their filing of a voluntary petition under chapter 7 of the Bankruptcy Code,[1] title 11, United States Code. *See also* 28 U.S.C. §§ 157(b) and 1334(a).

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[1] As used herein, the term "Bankruptcy Code" refers to title 11, United States Code.

On March 23, 2007, the bankruptcy court entered a Memorandum of Opinion and Order denying the United States Trustee's motion to dismiss the Ragles' case for abuse. The United States Trustee filed a timely notice of appeal from that Order under section 158(c)(2) of title 28, United States Code, and Fed. R. Bankr. P. 8002(a) on April 2, 2007.[2] This Court has jurisdiction over this appeal under section 158(a)(1) of title 28, United States Code.

STATEMENT OF THE ISSUE

Did the bankruptcy court err in holding that the Ragles were eligible to claim the IRS Standard vehicle financing expense allowance in calculating their disposable income under the Bankruptcy Code's statutory means test, 11 U.S.C. § 707(b)(2), when they owned their car debt-free and thus had no automobile vehicle financing expense.

STANDARD OF REVIEW

In an appeal taken from a bankruptcy court order, a district court reviews the bankruptcy court's findings of fact under the clearly erroneous standard but reviews *de novo* the bankruptcy court's conclusions of law. *In re Isaacman*, 26 F.3d. 629, 631(6th Cir. 1994) (Citing *In re Zick*, 931 F.2d 1124, 1126 (6th Cir.1991)). The bankruptcy court's holding that the Ragles could

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[2] Congress has authorized the United States Attorney General to appoint 21 United States Trustees, each to serve in a specific geographic region of the United States. *See generally* 28 U.S.C. § 581, *et seq.* (establishing the United States Trustee Program). United States Trustees are senior officials of the Department of Justice. *Id.* United States Trustees "supervise the administration of cases and trustees" in all bankruptcy cases within his or her region through the exercise of a range of oversight responsibilities. 28 U.S.C. § 586(a)(3). *See generally Morganstern v. Revco D.C. Inc. (In re Revco D.S., Inc.)*, 898 F.2d 498, 500 (6th Cir. 1990) (explaining that United States Trustees oversee the bankruptcy process, protect the public interest, and ensure that bankruptcy cases are conducted according to law.). United States Trustees may raise, appear, and be heard on any issue in any case or proceeding under Title 11. 11 U.S.C. § 307; *See also Revco,* 898 F.2d at 499-500 (upholding broad appellate standing of United States Trustees).

deduct a vehicle ownership expense for their Honda Accord is a question of law and therefore subject to *de novo* review.

STATEMENT OF THE CASE

On August 16, 2006, Michael J. Ragle and Tammy J. Ragle (the "Ragles") filed a petition for relief under chapter 7 of the Bankruptcy Code. RA 1.[3] On October 30, 2007, the United States Trustee timely filed a Motion to Dismiss Case for abuse. RA 18.

The bankruptcy court on November 28, 2006 ordered the parties to enter into joint stipulations and stated that it would rule without further evidentiary hearing. RA 24. The Ragles and the United States Trustee entered into a Joint Stipulation of Facts on December 12, 2006, RA 26, and submitted the Motion to Dismiss to the Court for decision without an evidentiary hearing. The bankruptcy court concluded that the presumption of abuse did not arise and entered an Order overruling the motion to dismiss on March 23, 2007. RA 30. The United States Trustee timely filed a Notice of Appeal and an Election to Appeal to District Court on April 2, 2007. RA 32, 33.

STATEMENT OF THE FACTS

I. Statutory Framework

On October 17, 2005, most provisions of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA"), Pub. L. No. 109-8, 119 Stat. 23 (Apr. 20, 2005), took effect, implementing significant changes to the Bankruptcy Code. As part of this effort,

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[3] All references to "RA [number]" herein refer to the number of the Record on Appeal.

Congress significantly amended section 707(b) of the Bankruptcy Code, which governs dismissal of chapter 7 bankruptcy cases. The general goal of Congress in its complete overhaul of section 707(b) was to ensure "that those who can afford to repay some portion of their unsecured debts be required to do so...". 151 Cong. Rec. S2470 (March 10, 2005).

As it existed prior to BAPCPA, section 707(b) only authorized dismissal based on a finding that allowing the debtor relief (i.e., granting a discharge of debts) constituted a "substantial abuse" of chapter 7. Prior to its amendment by BAPCPA, section 707(b) also required courts to presume that a debtor was entitled to relief under chapter 7 of the Bankruptcy Code. Section 707(b) now authorizes dismissal where the court finds that the granting of relief would be an "abuse" of chapter 7. As amended by BAPCPA, section 707(b)(2) repealed the former presumption and replaced it with a new presumption: a case is an "abuse" of chapter 7 if a detailed mathematical formula set out in the statute, commonly referred to as the "means test," yields a minimum amount of monthly disposable income.

The means test uses a series of calculations to determine whether the section 707(b)(2) presumption of abuse arises. *See* 11 U.S.C. § 707(b)(2)(A). Specifically, the means test calculates a debtor's "current monthly income" ("CMI") based on the debtor's average income for the six calendar months preceding the month of the bankruptcy filing. *See* 11 U.S.C. § 101(10A). If a debtor's CMI is above the applicable state median family income, as is the case here, section 707(b)(2)(A) calculates the debtor's monthly disposable income available to repay creditors by reducing the CMI by certain enumerated categories of expenses. *See* 11 U.S.C. § 707(b)(2)(A)(ii), (iii), and (iv).

At issue in this appeal is whether the Ragles qualify for an expense allowance for vehicle ownership costs under Local Standards issued by the Internal Revenue Service. In determining expenses, section 707(b)(2)(A)(ii)(I) provides that a debtor's "monthly expenses shall be the debtor's *applicable* monthly expense amounts specified under the National Standards and Local Standards and the debtor's actual monthly expenses for the categories specified as Other Necessary Expenses issued by the Internal Revenue Service for the area in which the debtor resides . . . ." 11 U.S.C. § 707(b)(2)(A)(ii)(I) (emphasis added). The Local Standards issued by the Internal Revenue Service include transportation and housing related expenses, and apportion transportation expenses into two components. The first component includes costs associated with financing vehicle acquisition. The second component is associated with the costs of vehicle operation.

If the debtor's monthly disposable income, calculated by reducing CMI by allowed expenses, is less than $100 per month (or $6,000 over 60 months), the presumption of abuse does not arise. 11 U.S.C. § 707(b)(2)(A)(i).[4] If the debtor's monthly disposable income is equal to or exceeds $166.67 per month (or $10,000 over 60 months), the presumption of abuse does arise. *Id.* If the debtor's monthly disposable income is between $100 and $166.67 per month (between $6,000 and $10,000 over 60 months), the presumption of abuse arises if the disposable income, over 60 months, is sufficient to pay 25 percent of the debtor's nonpriority unsecured debt. *Id.*

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[4] Pursuant to section 104 of the Bankruptcy Code, dollar amounts set forth in Title 11 applicable to a determination of presumed abuse under the means test were adjusted by the Judicial Conference of the United States effective April 1, 2007. 72 Fed. Reg. 7082 (Feb. 14, 2007). This case is not subject to the recent dollar amount adjustments.

If the presumption of abuse under section 707(b)(2) arises after completion of the means test, the debtor may attempt to rebut the presumption by demonstrating special circumstances that justify income or expense adjustments for which there is no reasonable alternative. 11 U.S.C. § 707(b)(2)(B).

Each debtor with primarily consumer debts is required to file, in conjunction with the bankruptcy schedules and statement of financial affairs, a Statement of Current Monthly Income and Means Test Calculation, Official Form 22A ("Form 22A"). 11 U.S.C. §§ 521 and 707(b)(2)(C). The purpose of Form 22A is to calculate monthly disposable income following the formula set forth in section 707(b)(2), and determine whether the presumption of abuse arises.

II. Factual Background

The Ragles filed a Form 22A with the petition commencing their case on August 16, 2006. RA 1. Because the "Annualized Current Monthly Income" reported on Line 13 of Form 22A was above the applicable state median income for their household size, the Ragles completed the form to calculate monthly disposable income. The result of the Ragles' calculation was monthly disposable income of $136.28 and 60-month disposable income of $8,176.80. RA 1 (Form 22A, lines 50-51). Because this latter amount is less than the presumed abuse threshold of one quarter of their total non-priority unsecured debt, the Ragles checked the box at the top of the first page of the Form 22A indicating that the presumption of abuse did not arise. *Id*. (Form 22A).

The Ragles own a 1987 Honda Accord and a 2004 Jeep Liberty. *Id*. (Schedule B). While the Ragles scheduled a debt secured by the Jeep, the Debtors own their Honda free of any secured debt. *Id*. (Schedule D). On Line 23 of the Form 22A, the Ragles included a deduction of $471 for a "transportation ownership/lease expense" for the Honda, and on line 24 claimed a "transportation ownership/lease expense" in the amount of $338 for the Jeep.[5] *Id*. (Form 22A).

As required by 11 U.S.C. § 704(b)(1), the United States Trustee reviewed all of the documentation submitted by the Ragles and concluded that the presumption of abuse arose. RA 15. The United States Trustee filed a Motion to Dismiss Case on October 30, 2006, explaining that the presumption arose because the Ragles' monthly disposable income was $333.05 instead of $136.28. RA 18. This difference was due to (a) eliminating the ownership expense for the Honda and recalculating the ownership expense for the Jeep, (b) allowing the Ragles an additional vehicle operating expense of $200 for the Honda,[6] and (c) correctly calculating the average payment on the secured claim of Heights Finance. *Id*.

In response to the United States Trustee's Motion, the Ragles filed a Rebuttal of Presumption of Abuse which contended that the following "special circumstances" rebutted the presumption of abuse: (a) the Ragles incurred additional commuting expenses, and (b) the Ragles were in "dire need" of a more reliable automobile than the Honda. RA 20.

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[5] The vehicles were not expressly identified on lines 23 and 24 of Form 22A, but the calculations on Line 24 reference the secured debt payments (from Line 42) attributable to the Jeep.

[6] The United States Trustee allows an additional $200 operating expense under the means test for each debtor who owns a vehicle that is six year old or older or with more than 75,000 miles, based on the Internal Revenue Manual which allows such an additional vehicle operating expense. *See* Internal Revenue Manual, Part 5, (entitled Collecting Process), Chapter 8 § 5.8.5.5.2, Treatment of Non-Business Transportation Expenses, available at http://www.irs.gov/irm/part5/ch08s05.html.

On November 21, 2006, the Ragles filed an amended Form 22A. RA 21. Unlike the original Form 22A, the Ragles admitted on their amended Form 22A that their case was presumptively abusive after calculating monthly disposable income of $216.33. *Id*. The Ragles' amended Form 22A adopted the United States Trustee's position that they were not entitled to a vehicle ownership expense for the Honda, added the additional $200 vehicle operating expense for the Honda, corrected the amount of the average payment on the secured claim of Heights Finance, and added a childcare expense. *Id*. The Ragles also listed additional vehicle replacement and commuting expenses in Part VII of the amended Form 22A, which they contend should also be deducted from their CMI.. *Id.*

The Ragles and the United States Trustee filed Joint Stipulations of fact on December 12, 2006. RA 26. Stipulation 9 stated: "The debtors have two operating vehicles listed in Form 22A [sic], a 1987 Honda Accord, and a 2204 [sic] Jeep Liberty. Due to the unencumbered state of the 1987 Honda Accord, *the debtors only claimed an ownership/lease allowance for one vehicle* on line 23 and 24 of this Form." *Id.* (emphasis added). Stipulation 14 stated: "*There is no dispute as to the figures listed in parts I-VI* of the amended form B22A." *Id.* (emphasis added). Stipulation 18 stated: "The sole legal dispute before the Court is whether the debtors should be entitled to claim the additional expenses on form B22A that are listed in part VII." *Id.*

Pursuant to the bankruptcy court's scheduling order, RA 24, both parties filed Memoranda of Law. RA 27 (United States Trustee) and 28 (Ragles). The only issue briefed by the parties, per their joint stipulation, was whether the Ragles' claimed replacement vehicle cost and additional commuting expenses constituted "special circumstances" that rebutted the presumption of abuse. *Id*.

On March 23, 2007, the bankruptcy court entered a Memorandum Opinion and Order denying the United States Trustee's motion to dismiss. RA 30. The bankruptcy court, *sua sponte* and without providing the opportunity for briefing by the parties, revisited the issue of whether the Ragles' case was presumptively abusive. The court determined that section 707(b)(2)(A)(ii)(I) of the Bankruptcy Code allowed the Ragles to include a vehicle ownership expense for their Honda Accord and gave the Ragles ten days to prepare and file an amended Form 22A that included these expenses. *Id*. On April 2, 2007, the United States Trustee appealed to this court for relief. RA 32 (Notice of Appeal) and 33 (Election to Appeal to District Court).

SUMMARY OF ARGUMENT

The bankruptcy court erred in denying the United States Trustee's motion to dismiss by holding that the Ragles were entitled to deduct a vehicle ownership expense for their Honda Accord, even though the Ragles were not obligated to pay on a loan or lease for that vehicle.

The bankruptcy court's ruling was incorrect for three reasons. First, the Ragles could claim only "applicable" expenses under section 707(b)(2), and they had no applicable vehicle ownership expense for their Honda Accord because the vehicle was not subject to a loan or lease payment. By using the word "applicable," Congress limited eligibility for expenses under the Local Standards to debtors for whom the expenses apply. Because the vehicle acquisition/financing expense does not apply with respect to the Ragles' Honda Accord, the bankruptcy court erred in holding that they were eligible to deduct the expense under the means test.

Second, the bankruptcy court's failure to construe the word "applicable" in section 707(b)(2)(A)(ii)(I) as conditioning eligibility for the IRS Local Standard for vehicle ownership on the debtor having a monthly car payment is inconsistent with the Internal Revenue Service's longstanding application of this standard. Because the IRS does not allow taxpayers to claim vehicle ownership expenses absent a monthly car payment expense, courts should not allow debtors to do so when applying the same Standard for means testing purposes. Indeed, both case law and legislative history underscore that Congress intended that the IRS' application of the Standards be considered in applying these Standards under 11 U.S.C. § 707(b)(2).

Finally, the bankruptcy court's order conflicts with sound notions of public policy and the primary purpose of Congress in passing bankruptcy reform legislation in 2005 - including the amendments at issue in this appeal. The 2005 legislation was intended to ensure that debtors would repay their debts when they can. By allowing the Ragles to claim a phantom expense for their Honda Accord, the bankruptcy court subverted that purpose, and allowed debtors who had the ability to repay some of their debts to avoid doing so.

ARGUMENT

I. The bankruptcy court erred in holding that the Ragles were eligible to claim the IRS Local Standards for vehicle ownership for their Honda Accord because the expense was not applicable to them.

The bankruptcy court order denying the United States Trustee's motion to dismiss the Ragles' case as a presumed abuse of chapter 7 should be reversed because the Ragles were not entitled to deduct a vehicle ownership expense under the means test when they had no vehicle loan or lease payment. Although the bankruptcy court held that the Ragles could claim such an expense, the bankruptcy court's order fails to recognize that the Bankruptcy Code only allows debtors to claim "applicable" expenses, and the Ragles' claimed vehicle ownership expenses are not applicable because they do not have a monthly car payment obligation. 11 U.S.C. § 707(b)(2)(A)(ii)(I).

A. ***The vehicle ownership expense may be claimed only if such expense is "applicable" to a debtor***

Section 707(b)(2)(A)(ii)(I) of the Bankruptcy Code provides that a "debtor's monthly expenses shall be the debtor's *applicable* monthly expense amounts specified under the . . . Local Standards . . . issued by the Internal Revenue Service. . . ." 11 U.S.C. § 707(b)(2)(A)(ii)(I) (emphasis added). The statute expressly provides that before the specific IRS expense amounts may be included in the debtor's allowed monthly expenses, the expense must itself first be applicable to the debtor.

The Bankruptcy Code does not define the word "applicable," nor has the United States Trustee identified any Supreme Court decision that provides a definition. Where, as here, a statutory term is undefined, a basic principle of statutory construction provides that courts should give such terms their ordinary meanings. *E.g., Smith v. U.S.*, 508 U.S. 223, 228 (1993) ("When a word is not defined by statute, we normally construe it in accord with its ordinary or natural meaning.") The dictionary defines "applicable" to mean applying or capable of being applied; relevant; suitable; appropriate. *Random House Unabridged Dictionary* (2006). Accordingly, such a meaning should be imparted to the term "applicable" as it appears in section 707(b)(2)(A)(ii)(I) absent clear indication that Congress intended to give such term a different meaning. *See Clark Equipment Co. v. United States,* 912 F.2d 113,117 (6th Cir. 1990)(applying dictionary definition to ascertain common meaning of term not defined by statute) *cert. denied*, 500 U.S. 941 (1991); *see also Thompson v. Goetzmann*, 337 F.3d 489, 498 n.20 (5th Cir. 2003) ("dictionaries are a principal source for ascertaining the ordinary meaning of statutory language.")

The bankruptcy court's order is inconsistent with the word's ordinary, common sense definition because it allows debtors to deduct expenses that do not apply to them. By inserting the word "applicable" in section 707(b)(2)(A)(ii)(I), Congress limited eligibility for expenses under the Local Standards to debtors for whom such expenses are "relevant; suitable; appropriate." Since the Ragles did not have vehicle financing expenses for their Honda Accord, the IRS vehicle ownership expense did not apply to *them* for that vehicle. *See In re Devilliers*, 358 B.R. 849, 859 (Bankr. E.D. La. 2007) (debtor may claim IRS ownership expense only after "a determination is made as to the type of expenses allowed and applicable to the debtor"); *In re Wiggs*, 2006 WL 2246432, *2-3 (Bankr. N.D. Ill. 2006) (statute is "clear and unambiguous," and "term 'applicable' modifies the amounts specified to limit the expenses to only those that apply," such that debtors were not allowed ownership expense when they did not have a vehicle payment.).

By using the term "applicable" in this way, a determination of allowable expenses under the means test is a two-step process. The first step is eligibility – *i.e.*, does the debtor qualify for an expense allowance in the category at issue? If so, then the second step is to quantify the expense amount the eligible debtor is allowed by looking at the IRS Standard amounts that are specified for the number of vehicles owned by the debtor and where the debtor lives. *See*, *e.g.*, *In re Carlin*, 348 B.R. 795, 798 (Bankr. D. Or. 2006)("There is nothing absurd in Congress drawing the line for vehicle ownership expense eligibility at those debtors who are making payments on the vehicle."). The bankruptcy court's ruling skips the first step and proceeds directly to the second.

B. *The IRS definition of the vehicle ownership expense, which states that the expense may be claimed only when a taxpayer has a loan or lease payment for that vehicle, was incorporated in the Bankruptcy Code*

The bankruptcy court's order allowing a deduction of vehicle financing where the Ragles did not have a loan or lease payment on their Honda Accord is also supported by the Internal Revenue Service's longstanding application of its own Standards. In providing which deductions debtors may take under the means test, Congress specifically stated that debtors are permitted to deduct "the debtor's *applicable* monthly expense amounts specified under the . . .Local Standards . . .issued by the *Internal Revenue Service*." (emphasis added). 11 U.S.C. § 707(b)(2)(A)(ii)(I).

On page two of its Collection Financial Standards under the heading "Transportation" the IRS provides as follows:

> The transportation standards consist of nationwide figures for monthly loan or lease payments referred to as ownership costs, and additional amounts for monthly operating costs . . . . The ownership costs provided maximum allowances for the lease or purchase of up to two automobiles if allowed as a necessary expense . . . . If a taxpayer has a car payment, the allowable ownership cost added to the allowable operating cost equals the allowable transportation expense. **If a taxpayer has no car payment, or no car, the operating costs portion of the transportation standard is used to come up with the allowable transportation expense.**

See IRS Collection Standards (emphasis added), available at ww.irs.gov/individuals /article/0,,id=96543,00.html; see also Internal Revenue Manual, Financial Analysis Handbook, Pt. 5, ch. 15, § 5.15.1.7(4.B), available at www.irs.gov/irm/part5 /ch15s01.html.

The "ownership cost" was specifically calculated by the IRS based on the cost to finance the acquisition of a vehicle, and is not simply a cost associated with owning a car, such as repair or maintenance. Under the heading "Recent Revisions" to the Collection Financial Standards posted on the IRS website, the IRS notes that the "ownership cost" Standards are based on the "**five-year average of new and used car financing data compiled by the Federal Reserve Board of Governors**." *See id.* (emphasis added). As such, the "ownership cost" expense is not applicable if a debtor does not have a monthly expense related to financing a car. *See In re Devilliers*, 358 B.R. at 864 (The ownership allowance "is not the equivalent of an allowance for depreciation or an invitation for a debtor to 'save' for the ultimate replacement of an existing vehicle. Instead, the deduction is designed to assist with the acquisition of a vehicle on credit.").

The IRS recognizes that the vehicle "ownership cost" portion of the Local Transportation Standards is intended to apply *only* in situations where the debtor has a monthly vehicle acquisition financing expense, *i.e.*, has a monthly vehicle lease or loan payment. Accordingly, the Local Standard for vehicle ownership is an expense that is not necessarily "applicable" to every debtor. This stands in stark contrast to the National Standards for food, clothing, and other items, which the IRS allows to all debtors based on their family size and income level "without questioning amounts actually spent."[7] "Thus, if a debtor is not incurring expenses for the purchase or lease of a vehicle, the debtor cannot claim a vehicle ownership expense under the IRS standards."[8] *In re McGuire*, 342 B.R. 608, 613 (Bankr. W.D. Mo. 2006); *see also In re*

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[7] *See* Collection Financial Standards, published by the Internal Revenue Service on its website at http://www.irs.gov/individuals/article/0,,id=96543,00.html.

[8] Under the IRS Transportation Standards, in situations where the debtor has no loan or lease payment obligation on a vehicle that is over six years old and/or has reported mileage of

Ceasar, --- B.R. ---, 2007 WL 777821, *5 (Bankr. W.D. La. Mar. 6, 2007) (agreeing with the McGuire line of cases and noting that courts that disagree give too little weight to the critical qualifying word "applicable.").

How the Internal Revenue Service applies the Standards that it developed for its own internal debt collection purposes is relevant and should be considered by courts in applying the same Standards in analysis under section 707(b)(2). When Congress developed the means test, it "could have started from scratch, and created a system that was rigid but easy to administer, such as how many view workers' compensation or social security schemes." *In re Slusher*, 359 B.R. 290, 306 (Bankr. D. Nev. 2007). Instead, Congress "incorporated into the Bankruptcy Code an existing, administrative system that the IRS had long had in place." *Id.* This incorporation "strongly suggests that courts should look to how the IRS determined those standards; that is, as to how the IRS would have applied them in similar circumstances." *Id.* at 309.

In stating that the amounts "specified" by the IRS Standards may be deducted from current monthly income to yield a debtor's disposable income, Congress "essentially read[ ] into the Code not only the actual numbers contained in the IRS Standards, but also the Manual's context for their application." *In re Howell*, --- B.R. ---, 2007 WL 1237832 at *3 (Bankr. D. Kan. Apr. 26, 2007). Thus, "if guidance is sought on the meaning of the IRS standards that Congress incorporated into the Bankruptcy Code, practical reason would suggest that court should consider the full manner by which the IRS uses these standards." *In re Slusher*, 359 B.R. at 309; *see also Howell*, 2007 WL

75,000 or more miles, an additional operating expense of $200 may be allowable. See Internal Revenue Manual, Part 5 (entitled Collecting Process), Chapter 8, § 5.8.5.5.2, Treatment of Non-Business Transportation Expenses, which may be found on the IRS website at http://www/irs/gov/irm/part5/ch08s05.html. In this case, the United States Trustee factored in the additional $200 allowance in its means test analysis. RA 18.

1237832 at *3 ("It is unlikely that Congress intended the Statute to merely import the numbers without their attendant meaning and context"); *In re Oliver*, 350 B.R. 294, 301 (Bankr. W.D. Tex. 2006) (holding that debtor is not entitled to vehicle ownership expense because IRS Financial Analysis Handbook and Internal Revenue Manual limit expense to individuals that have loan or lease payment); *In re Hardacre*, 338 B.R. 718, 726 (Bankr. N.D. Tex. 2006) (same).

Finally, the court below expressed concern that the IRS Manual differs from section 707(b)(2)'s means test because the Manual lets taxpayers deduct the actual amount of their car payment - up to the cap set out in the IRS' Local Standards, but the means test allows debtors to claim the full amount of the Local Standard, even if their car payment is less. RA 30, p. 7-9. That is irrelevant. The relevant point is the IRS prohibits individuals from claiming a car payment when they have none. The exact same thing happens under the means test because a debtor without an "applicable" car expense cannot claim a car payment either.

Given the IRS' historic application of its National Standards and Local Standards up to the time of BAPCPA's enactment, "it would be quite odd if Congress intended to preclude courts from examining the context in which the authoring agency, the IRS, used and employed those standards." *Id.* Nothing compels such an odd reading. Consistent with IRS practice, this Court should hold that the IRS vehicle Ownership Standards do not apply to the Ragles' Honda Accord, and the bankruptcy court's order should be reversed.

II. The bankruptcy court's order should be reversed because it is inconsistent with the major goals of the 2005 amendments to the Bankruptcy Code.

The bankruptcy court's order also is inconsistent with Congress' goals and purpose in implementing bankruptcy reform. Congress amended the Bankruptcy Code in BAPCPA to rectify perceived abuses in the bankruptcy process. "Among the abuses identified by Congress was the easy access to chapter 7 liquidation proceedings by consumer debtors who, if required to file under chapter 13, could afford to pay some dividend to their unsecured creditors." *Hardacre*, 338 B.R. at 720 citing 151 Cong. Rec. S2459, 2469-70 (March 10, 2005). A "primary goal" of BAPCPA was to "ensure that debtors repay creditors the maximum they can afford." *In re Lenton*, 358 B.R. 651 (Bankr. E.D. Pa. 2006) *citing* H.R. Rep. No. 109-31, pt. 1, at 1 (2005), as reprinted in 2005 U.S.C.C.A.N. 88, 89. In cases such as this one, where the debtor has no loan or lease payment, Congress has established a system which does not provide her an expense deduction for vehicle financing. "Allowing debtors to deduct from their disposable income a fictional ownership allowance would give debtors with unencumbered vehicles a windfall at the expense of their unsecured creditors." *Howell*, 2007 WL 1237832 at *3.

CONCLUSION

For all of these reasons, the United States Trustee respectfully asks this Court to reverse the November 15, 2006 Order entered by the bankruptcy court denying the United States Trustee's motion to dismiss, and remand this case to the bankruptcy court for further proceedings.

Respectfully submitted,

RICHARD F. CLIPPARD
United States Trustee

By: /s/ Rachelle Williams
John L. Daugherty
Assistant U.S. Trustee
Joseph J. Golden
Assistant U.S. Trustee

Rachelle Williams
Trial Attorney
Department of Justice
Office of the U.S. Trustee
100 East Vine St., Suite 500
Lexington, KY 40507
(859) 233-2822
(859) 233-2834 fax
rachelle.c.williams@usdoj.gov

Of Counsel

Roberta DeAngelis
Acting General Counsel
P. Matthew Sutko
Associate General Counsel
David A. Levine
Trial Attorney
Executive Office for United States Trustees
Department of Justice
20 Massachusetts Ave., N.W.,
Suite 8000
Washington, D.C. 20530
(202) 307-1399

BRIEF BANK — 'SUMMARY SHEET" *Printed Wed-1/9/08 13:0*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*

In re: Ragle (UST v. Ragle)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*

E.D. Ky.

3. ("CCN") ***CURRENT*** CASE NO.

No.: 3:07-cv-00026-KKC

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*

No.: 06-30208

Court: Bankr. E.D.Ky.

(Identify judge & cite, if any)

5. ("SO") ***SOURCE***

U.S. TRUSTEES

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*

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P. Matthew Sutko, Sean E. Martin, John L. Daugherty, Rachelle C. Williams

(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***

BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s)

&

√ Any Miscellaneous ***BACKGROUND***

• UST moves for a rehearing on the issue of whether the order of the bankruptcy court overruling the UST's motion to Dismiss Case was a final order.

√ **Background:**

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UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF KENTUCKY
Central Division at Frankfort

In re:

Michael J. Ragle
Tammy J. Ragle

Debtors.

Case No. 06-30208-jms
Chapter 7

Richard F. Clippard,
United States Trustee,

Appellant,

v.

Michael J. Ragle and
Tammy J. Ragle,

Appellees.

Civil No. 3:07-cv-00026-KKC

MOTION FOR REHEARING

Richard F. Clippard, United States Trustee, by counsel, respectfully moves for a rehearing pursuant to Federal Rule of Bankruptcy Procedure 8015 on the issue of whether the order of the bankruptcy court overruling the United States Trustee's Motion to Dismiss Case was a final order, and in support states as follows:

Procedural History

On August 16, 2006, Michael J. Ragle and Tammy J. Ragle (the "Ragles") filed a petition for relief under chapter 7 of the Bankruptcy Code. On October 30, 2006, the United States Trustee timely filed a Motion to Dismiss Case for abuse. The United States Trustee's motion was grounded upon only the "presumed abuse" basis for dismissal. *See* 11 U.S.C. § 707(b)(2). On March 23, 2007, the bankruptcy court entered an order ("Bankruptcy Court Order") overruling the motion to dismiss, concluding that the presumption of abuse did not apply. The United States Trustee timely filed a Notice of Appeal and an Election to Appeal to District Court on April 2, 2007.

On December 3, 2007, this Court entered an order dismissing the instant appeal for lack of jurisdiction. The Court concluded, without briefing from the parties, that the Bankruptcy Court Order was not a final order for purposes of appeal. The United States Trustee files this Motion for Rehearing to provide the Court with the position of the Department of Justice that an order overruling or denying a motion to dismiss a bankruptcy case is "final" for purposes of appeal.

Argument

A. The Bankruptcy Court Order Finally Decided The Issue of the United States Trustee's Right to Dismiss For Abuse of Chapter 7.

1. The Bankruptcy Court Order is a final order from which immediate appeal can be taken as of right. A bankruptcy court order is final and appealable where, as here, it "finally dispose[s] of discrete disputes within the larger case." *In re Dow Corning Corp.*, 86 F.2d 482, 488 (6th Cir. 1996) (*quoting In re Saco Local Dev. Corp.*, 711 F.2d 411, 441 (1st Cir. 1983)). The United States Trustee's motion to dismiss instituted a contested matter under Federal Rule of Bankruptcy Procedure 9014[1], and the order denying the motion finally resolved that contested

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[1] Federal Rule of Bankruptcy Procedure 1017(f)(1) provides as follows: "Rule 9014 governs a proceeding to dismiss or suspend a case, or to convert a case to another chapter, except

matter. *See In re UAL Corp.*, 408 F.3d 847, 850 (7th Cir. 2005) (noting that an order resolving a contested matter is final if equivalent to the disposition of a stand-alone suit).

Here, the bankruptcy court denied the United States Trustee's motion. This is akin to entering judgment for the debtor. The order means the case filed by the Ragles will never be dismissed and instead must proceed to discharge.[2]

In this case, the court's order denying the motion to dismiss completely resolved the issue of the United States Trustee’s claim that granting relief to the debtor was a presumed abuse of chapter 7, and rejected the relief sought by the United States Trustee’s motion. The order was a formal adjudication of the section 707(b) proceeding and critically determined both the right of the debtor to proceed and that the United States Trustee could not dismiss the case for abuse. This is the epitome of a final order. *See In re Morse Electric Co.*, 805 F.2d 262, 265 (7th Cir.1986) (“Finality of the order comes from the fact that it resolves *all* of [the appellant’s] claims . . .”) (emphasis in original).

Bankruptcy court orders denying motions to dismiss brought under section 707(b) differ fundamentally from orders in district court civil cases that deny motions to dismiss complaints, because section 707(b) motions are, themselves, the functional equivalents of complaints.

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under §§ 706(a), 1112(a), 1208(a) or (b), or 1307(a) or (b).” Fed. R. Bankr. P. 9014 governs contested matters and provides, *inter alia*, that a motion initiating a contested matter “shall be served in the manner provided for service of a summons and complaint by Rule 7004.”

[2] Under the facts of this case, the court below can never revisit the dismissal issue because the United States Trustee’s deadline has run for filing a motion to dismiss for presumed abuse. *See* 11 U.S.C. § 704(b)(2).

In a civil case outside of bankruptcy, the denial of a motion to dismiss a complaint is not a final decision. *See, e.g., Simon v. Pfizer, Inc.*, 398 F.3d 765, 771 (6th Cir. 2005). Such an order is not final because it "ensures that litigation will continue in the District Court." *Gulfstream Aerospace Corp. v. Mayacamas Corp.*, 485 U.S. 271, 275 (1988).

In the section 707(b) context, however, the denial of a motion to dismiss operates as a judgment for the debtor ensuring the debtor's case will not be dismissed. The Federal Rules of Bankruptcy Procedure underscore why the denial of such a motion is final. Under the Rules, the filing of the 707(b) motion initiates a contested matter under Rule 9014. A motion to dismiss for abuse under section 707(b) is therefore the functional equivalent of a complaint commencing a cause of action, and an order either sustaining or overruling the motion is equivalent to a final judgment on the merits.

A denial of a section 707(b) motion conclusively determines the Rule 9014 contested matter, terminates it, and prevents the United States Trustee from asserting any claim under that section in the future. Thus, in cases like these, there is no litigation to "continue," so the denial order is final and appealable.

2. Significantly, the Bankruptcy Court Order finally denying the United States Trustee all relief in his contested matter is more final than most bankruptcy court orders determining contested matters. That is so because the Bankruptcy Code's statutory deadline for moving to dismiss this case for presumed abuse, set out in section 704(b)(2), has expired. *See* 11 U.S.C. § 704(b)(2). A motion brought under section 707(b)(1) for presumed abuse under section

707(b)(2) is not only the functional equivalent of a cause of action, but one that must be pled within the time specified by section 704(b).

Unlike a motion to dismiss predicated on other grounds, this section 707(b) motion cannot be renewed. Whereas a motion to dismiss a chapter 7 case under 11 U.S.C. § 707(a)(1) based on “unreasonable delay by the debtor that is prejudicial to creditors” has no statutory deadline and could be renewed if denied, *see* 11 U.S.C. § 707(a)(1), the bankruptcy court can no longer consider whether grounds exist for dismissal of a case for presumed abuse once the statutory deadline for filing such a motion has expired. Under section 704(b)(2), the United States Trustee’s deadline to file a motion to dismiss the debtor's case for presumed abuse expired on October 30, 2006. Thus, were there a question whether final rulings in contested matters are generally final, those concerns should evaporate given the Code’s filing deadline, which slams shut the door on any future trial court litigation concerning the right of the Ragles to bankruptcy relief.

Because the bankruptcy court denied the United States Trustee’s section 707(b) motion to dismiss in this case, and the deadlines have run for filing a motion to dismiss under section 707(b)(3) and for objecting to discharge,[3] the Ragles must be issued a discharge absent reversal by this Court. The Bankruptcy Court Order ended the section 707(b) contested matter on the

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[3] Under Interim Bankruptcy Rule 1017(e)(1) and Federal Rule of Bankruptcy Procedure 9006(1), the deadline for filing a motion to dismiss pursuant to section 707(b)(3) or the motion to extend the time to file such a motion expired on August 21, 2006, the first business day after the 60th day following the first date set for the meeting of creditors in the bankruptcy case. Under Federal Rule of Bankruptcy Procedure 4004(a), the deadline for filing a complaint objecting to discharge likewise expired on that date.

merits and left nothing further for the court to do with respect to the United States Trustee's motion to dismiss. Because the Bankruptcy Court Order constituted a final adjudication by the bankruptcy court of this controversy, it qualifies as a final order subject to appeal under 28 U.S.C. § 158(a)(1).

3. This Court's dismissal order indicates the Bankruptcy Court Order is not final because the bankruptcy court "must address the 'totality of the circumstances.'" Opinion and Order at 8. This is not correct. The United States Trustee's underlying motion was grounded only upon "presumed abuse," 11 U.S.C. § 707(b)(2), and does not allege, or present any evidence on, whether the underlying case was otherwise abusive under the "bad faith" or "totality of the circumstances" standards. *See* 11 U.S.C. § 707(b)(3). Nor is there any section 707(b)(3) proceeding before the bankruptcy court. *See* Bankruptcy Court Docket. Moreover, under Federal Rule of Bankruptcy Procedure 1017(e)(2), it is too late for the parties or the court to commence one. Put simply, there was no section 707(b)(3) claim for the court to adjudicate, and the parties presented no evidence to enable the bankruptcy court to make findings on these issues.[4]

4. Although the United States Supreme Court and the Sixth Circuit have not specifically addressed whether orders determining Rule 9014 contested matters triggered by the filing of section 707(b) motions are final, the clear weight of circuit law supports the conclusion that they are. Four United States courts of appeals–the Eighth, Third, Fifth, and Second–

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[4] In addition, insofar as neither party asserted any error in the bankruptcy court's (lack of) findings on the issues of "bad faith" and "totality of the circumstances," this issue is not before this Court on appeal.

adjudicated appeals under the prior law that emanated from bankruptcy court orders denying section 707(b) motions to dismiss. *See Stuart v. Koch (In re Koch)*, 109 F.3d 1285, 1289 (8th Cir. 1997) (holding that an order denying a section 707(b) motion to dismiss a chapter 7 case for substantial abuse is appealable); *In re Christian*, 804 F.2d 46, 47-48 (3d Cir. 1986) (same); *see also In re Cortez*, 457 F.3d 448, 453-54 (5th Cir. 2006) (treating as final for appeal purposes a bankruptcy court order denying the United States Trustee's motion to dismiss); *Schwartz v. Geltzer (In re Smith)*, — F.3d —, 2007 WL 3242846 (2d Cir. Nov. 5, 2007) (same).

5. Given the Sixth Circuit's finality jurisprudence, there is every reason to think it would follow the Second, Third, Fifth, and Eighth Circuits and treat orders denying section 707(b) motions as final. Indeed, the Sixth Circuit made clear that finality in the context of bankruptcy is broader than it is in ordinary civil litigation. In the case of *In re Dow Corning Corp.*, 86 F.3d 482 (6th Cir. 1996), it held that the denial of motions to transfer tort litigation to the bankruptcy forum constituted a final order. The Court reasoned:

> The finality requirement is considered in a more pragmatic and less technical way in bankruptcy cases than in other situations. In bankruptcy cases, a functional and practical application [of appellate jurisdiction] is to be the rule. . . . Therefore, where an order in a bankruptcy case finally dispose[s] of discrete disputes within the larger case, it may be appealed immediately.

Id. at 488 (citations and internal quotations omitted). The same reasoning applies equally in the instant case, where the bankruptcy court's denial of the motion to dismiss finally disposed of that discrete dispute.

The decision of the Bankruptcy Appellate Panel in the case of *In re V Companies*, 292 B.R. 290 (B.A.P. 6th Cir. 2003) ignores the pragmatic approach of finality set forth in *Dow Corning*. Without discussing the framework of *Dow Corning*, the panel merely stated without analysis that "the denial of a motion to dismiss is not a final order." 292 B.R. at 292. Ironically, the same panel in the case of *In re Morton*, 298 B.R. 301, 303 (B.A.P. 6th Cir. 2003), inconsistently held that a bankruptcy court's order *overruling* an objection to claim–itself a contested matter pursuant to Fed. R. Bankr. P. 9014–was a final order for purposes of appeal.

Not surprisingly, another panel of the Bankruptcy Appellate Panel ignored the crabbed reading of finality espoused by *V Companies* when deciding whether an order was final. In the case of *In re Geberegeorgis*, 310 B.R. 61 (B.A.P. 6th Cir. 2004), the panel explicitly followed the Sixth Circuit's practical view of finality set forth in *Dow Corning* and held that "an order that concludes a particular adversarial matter within the larger case should be deemed final and reviewable in a bankruptcy setting." *Id*. at 63 (citations omitted). In that case, the panel concluded that an order vacating a chapter 13 dismissal "concluded the dispute over dismissal" and was a final order immediately appealable without waiting for completion of the chapter 13 plan and the debtor's discharge. *Id*. at 64. An even stronger case for finality is present in the instant appeal. Unlike the chapter 13 case in *Geberegeorgis*, which would involve considerable future administration of plan payments and likely disputes over future defaults and issues of plan interpretations, the instant bankruptcy case absent appeal awaits only entry of a Final Decree.

B. The Bankruptcy Court Order Decided the Ultimate Issue of Whether the Debtors' Case is Actually Abusive.

Nothing in this Court's December 3, 2007, order changes the fact that the Bankruptcy Court Order, like other orders denying section 707(b) motions, is final. The Bankruptcy Court Order finally disposed of the abuse issue and the ultimate issue of whether the debtor's petition should be dismissed.

Although the United States Trustee filed a motion alleging presumptive abuse under section 707(b)(2), he did not file a motion alleging abuse under section 707(b)(3). Significantly, he is precluded now from doing so, because the deadline for filing a section 707(b)(3) motion was August 21, 2006. *See supra* n.3. And because the Bankruptcy Court Order held that the presumption of abuse did not arise under section 707(b)(2), there are no proceedings regarding "special circumstances" that must be undertaken.

The bankruptcy court completely adjudicated the issue of presumptive abuse under section 707(b)(2), and there are no further proceedings that remain regarding abuse under section 707(b)(3). Therefore, the Bankruptcy Court Order finally rejected dismissal of the Ragles' case under section 707(b). The order is final.[5]

C. Failure to Treat the Order as Final Will Adversely Impact the Administration of the Bankruptcy Case.

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[5] Even if there were pending motions to dismiss in this case from parties other than the United States Trustee, which there were not, the rights of the United States Trustee to seek dismissal under section 707(b) have been completely adjudicated by the Bankruptcy Court Order. The court's order conclusively determining the contested matter instituted by the United States Trustee's motion is therefore a final order. Moreover, even if the bankruptcy court should have considered the section 707(b)(3) factors itself after rejecting presumed abuse under section 707(b)(2), it did not, so that does not affect finality. The time for the court to consider this *sua sponte* has run. *See* Fed. R. Bankr. P. 1017(e)(2).

If the order denying the United States Trustee's motion to dismiss is not immediately appealable as a final order, review of the decision will be delayed. If the order is ultimately reversed, this will have resulted in a needless expenditure of time and resources by the bankruptcy court, the Ragles, the chapter 7 trustee, and the United States Trustee. Forcing such a delay is "[n]either desirable nor practical." *See Christian*, 804 F.2d at 48 ("If the order [denying the section 707(b) motion to dismiss] here is not now appealable the entire bankruptcy proceedings must be completed before it can be determined whether they were proper in the first place. We do not view such a resolution as either desirable or practical.").

Debtors should not endure longer periods of limbo, creditors should not be forced to wait longer for case closure, and judicial resources should not be expended on matters that would become irrelevant and unnecessary if the dismissal order were ultimately overturned. *See Koch*, 109 F.3d at 1288 ("Requiring trustees to complete Chapter 7 proceedings before appealing denial of their § 707(b) motions wastes debtor resources that should be used to pay creditors, and forces trustees and bankruptcy courts to expend their scarce institutional resources on abusive Chapter 7 petitioners.").

Deeming orders denying section 707(b) motions as interlocutory will also lead to the appeal of multiple orders. If orders denying section 707(b) motions are not final, the United States Trustee will have to appeal each subsequent order that may be final in a case, in order to preserve its ability to appeal this issue. Those would include discharge orders, case closure orders, and perhaps others. The United States Trustee will also need to continue appealing orders denying motions to dismiss under section 707(b) to preserve its rights, should the Sixth Circuit hold that such orders are final.

Finally, treating denial of section 707(b) motions as interlocutory could impede the development of case law interpreting the recent Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA"), Pub. L. No. 109-8, 119 Stat. 23 (Apr. 20, 2005). Because BAPCPA is a new statute, any number of important appeals over the meaning of its provisions will likely arise from rulings such as the one at issue in this case. Everyone will benefit if this Court and other appellate courts are able to resolve these issues expeditiously, thereby removing uncertainties not just in the cases being appealed but in future cases presenting the same issues.

Conclusion

For the reasons detailed above, the United States Trustee respectfully asks this Court to vacate its order dismissing this appeal, hold that the Bankruptcy Court Order is final order within the meaning of 28 U.S.C. § 158(a)(1), and rule on the merits[6] of this appeal.

Respectfully submitted,

Dated: December 12, 2007

Richard F. Clippard
United States Trustee, Region 8

By Counsel

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[6] During the pendency of this appeal, the only two appellate decisions that have been issued support the position of the United States Trustee that the Ragles are not entitled to claim the IRS vehicle ownership expense on Form 22A. *See In re Harwick*, 373 B.R. 645 (D. Minn. 2007); *In re Ross-Tousey*, 368 B.R. 762 (E.D. Wis. 2007). In both cases, the district courts treated bankruptcy court orders denying section 707(b) motions to dismiss as final orders for appeal.

Of Counsel

Roberta A. DeAngelis
Acting General Counsel

P. Matthew Sutko
Associate General Counsel
for Appellate Practice
Sean E. Martin
Trial Attorney
Executive Office
for United States Trustees
Department of Justice
20 Massachusetts Avenue, N.W.
Washington, DC 20530
(202) 307-1399

/s/ John L. Daugherty
John L. Daugherty
Assistant United States Trustee
Rachelle C. Williams
Trial Attorney
Department of Justice
100 East Vine St., Suite 500
Lexington, KY 40507
(859) 233-2822

Certificate of Service

This is to certify that this Motion was served electronically to Julie O'Bryan and Tracy L. Hirsch, attorneys for the Debtors; and to all parties requesting electronic notice on this 12th day of December, 2007.

/s/ John L. Daugherty
John L. Daugherty

BRIEF BANK — "SUMMARY SHEET" *Printed Wed-3/9/11 16:42*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE
[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]
Mahmoud S. Rahim, Raya H. Abdulhussain v. Pacifica Loan Four, LLC, David R. Bartley, Sr. and Bartley Realty Services

2. ("CO") ***CURRENT*** COURT
[E.g., "CTA9"]
E.D. Mich.

3. ("CCN") ***CURRENT*** CASE NO.
No.: 10-15123-SFC

4. ("PCN") ***PRIOR*** CASE NO. - & COURT
[IF ANY]
No.: 10-57577-SWR
Court: Bankr. E.D. Mich.
(Identify judge & cite, if any)

5. ("SO") ***SOURCE***
U.S. TRUSTEES

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF
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Richard A. Roble, Sean Cowley, Wendy Cox, P. Matthew Sutko, Ramona D. Elliott, Daniel M. McDermott
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") ● ***SUMMARY*** OF KEY ISSUE(s)
&
√ Any Miscellaneous ***BACKGROUND***

● Whether the bankruptcy court, in holding that Appellants' chapter 7 petition was filed in bad faith, abused its discretion in dismissing Appellants' chapter 7 petition under 11 U.S.C. § 707(a).

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UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF MICHIGAN

In re:	**Case No. 10-57577-SWR**
MAHMOUD S. RAHIM, **RAYA H. ABDULHUSSAIN,**	**Chapter 7**
Debtors.	**HON. STEVEN W. RHODES** **United States Bankruptcy Judge**
MAHMOUD S. RAHIM, **RAYA H. ABDULHUSSAIN,**	**Case No. 10-15123-SFC**
Appellants,	**HON. SEAN F. COX** **United States District Judge**
v.	
PACIFICA LOAN FOUR, LLC, **DAVID R. BARTLEY, SR. and** **BARTLEY REALTY SERVICES,**	
Appellees/Creditors.	

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE SUPPORTING AFFIRMANCE

RAMONA D. ELLIOTT
General Counsel

P. MATTHEW SUTKO
Associate General Counsel

WENDY COX
Trial Attorney
Executive Office for
United States Trustees
Department of Justice
20 Massachusetts Avenue, N.W.
Washington, D.C. 20530
Phone: (202) 307-1399
Fax: (202) 307-2397

DANIEL M. McDERMOTT
United States Trustee for Region 9

RICHARD A. ROBLE
Trial Attorney
Richard.A.Roble@usdoj.gov
Office of the United States Trustee
Department of Justice
221 West Fort St. - Suite 700
Detroit, Michigan 48226
Phone: (313) 226-6769
Fax: (313) 226-7952

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INTRODUCTION

Pursuant to Fed. R. App. P. 29 and Fed. R. Bankr. P. 8018(b), the United States submits this brief as *amicus curiae* urging affirmance of the bankruptcy court's ruling. The United States will address the following question presented upon appeal:

Did the bankruptcy court abuse its discretion in dismissing the Appellants' chapter 7 petition under 11 U.S.C. § 707(a)?

INTEREST OF THE UNITED STATES

The Attorney General appoints United States Trustees to supervise the administration of bankruptcy cases and trustees in regions comprising the vast majority of the federal judicial districts. 28 U.S.C. §§ 581-589a. United States Trustees "serve as bankruptcy watch-dogs to prevent fraud, dishonesty, and overreaching in the bankruptcy arena." H.R. Rep. No. 95-595, at 88 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6049. The United States Trustee Program thus acts in the public interest to promote the efficiency, and to protect and preserve the integrity, of the bankruptcy system. *Morganstern v. Revco D.S., Inc. (In re Revco D.S., Inc.)*, 898 F.2d 498, 500 (6th Cir. 1990) ("the U.S. trustees are responsible for 'protecting the public interest and ensuring that bankruptcy cases are conducted according to law.'") (quoting H.R. Rep. No. 95-595, at 109, *reprinted in* 1978 U.S.S.C.A.N. at 6070). To this end, Congress has provided that "[t]he United States trustee may raise and may appear and be heard on any issue in any case or proceeding. . . ." 11 U.S.C. § 307; *see also In re Revco*, 898 F.2d at 500 (Congress intended United States Trustees to have appellate standing); *In re Donovan Corp.*, 215 F.3d 929, 930 (9th Cir. 2000) (allowing the United States Trustee to intervene and appear "at any level of the proceedings from the bankruptcy court on . . . as either a party or an amicus").

In this brief, the United States respectfully offers this Court its views on the correct interpretation of 11 U.S.C. § 707(a). *See* 28 U.S.C. § 517 (authorizing the Department of Justice "to attend to the interests of the United States in a suit pending in a court of the

United States"). Section 707(a) authorizes bankruptcy courts at their discretion to dismiss cases pending under chapter 7 "for cause." 11 U.S.C. § 707(a). The statute is broad in scope and provides a critical mechanism by which bankruptcy courts can dispose of cases that should not proceed under chapter 7 for any number of reasons. The United States has not identified any case where debtors with such high incomes and lavish lifestyles have been permitted to discharge their debts through chapter 7 liquidation; the United States acts here to protect the integrity of the bankruptcy system by ensuring that such egregious cases may be dismissed for cause.

STATEMENT OF THE ISSUE

Whether the bankruptcy court, in holding that Appellants' chapter 7 petition was filed in bad faith, abused its discretion in dismissing Appellants' chapter 7 petition under 11 U.S.C. § 707(a).

STATEMENT OF THE CASE

A. Statute Involved.

The bankruptcy court dismissed the Appellants' cases under 11 U.S.C. § 707(a):

> The court may dismiss a case under this chapter [chapter 7] only after notice and a hearing *and only for cause*, including -
>
> > (1) unreasonable delay by the debtor that is prejudicial to creditors;
> > (2) nonpayment of any fees and charges required under chapter 123 of title 28; and
> > (3) failure of the debtor in a voluntary case to file, within fifteen days of such additional time as the court may allow after the filing of the petition commencing such case, the information required by paragraph (1) of section 521(a), but only on a motion by the United States trustee.

11 U.S.C. § 707(a) (2010) (emphasis added). Section 707(a) applies to all cases under chapter 7. 11 U.S.C. § 103(b).

B. Facts of the Case.

The Appellants, Dr. Mahmoud S. Rahim and Dr. Raya H. Abdulhaussain, (the "Doctors") are married, and are both medical doctors with separate practices. Slip Op. at 1. Their chapter 7 schedules establish they have approximately $39,400 in monthly income. Beyond that, the lower court found that additional income sources not disclosed by the Doctors raised their average monthly income to $42,446, corresponding with annual income of over $509,000. *Id.* at 1-2. On top of these income sources, the lower court found that the Doctors irregularly withdrew money from their medical practice "in varying but significant amounts" - though the amount of those withdrawals could not readily be determined at the time of the evidentiary hearing due to the "meager records" produced by the Doctors. *Id.* at 2 n.2. The Doctors' medical practices also paid $2,046 a month for their luxury vehicles - two Mercedes and a BMW.

The Doctors allege that all but $20.00 of their monthly income is consumed by their day-to-day expenditures. *Id.* at 3. These expenditures, which the lower court found "reflect[ed] a lifestyle that can only be described as extravagant and lavish[,]" *Id.* at 5, included $15,714 in expenses for their primary residence - including $14,503 in mortgage payments. *Id.* at 2. The Doctors also spend just shy of $5,000 per month on a second home in Florida, and an additional $2,600 per month on an unprofitable rental home. *Id.*

In addition to these considerable expenses, the lower court also noted that the Doctors spend over $1,800 per month on food and recreation, over $600 per month caring for the mother of one of the Doctors, $4,575 per month on private school for their two children, and $1,000 per month supporting a niece. *Id.* at 3. Thus, the lower court found that the Doctors make, and spend, over a half a million dollars each year. *Id.* at 1.

Against this income and these expenditures, the lower court noted that the Doctors' debts only totaled slightly more than ten million dollars - $3,417,423 in secured debts on real property, and $6,671,939 in unsecured claims, mostly on account of failed guaranties on failed real estate investments. *Id.* at 3. While these debts are, by any standard, a considerable sum, the lower court found that it would be possible for the Doctors to repay a considerable amount of these debts:

> If they would take the necessary steps to reduce their yearly expenses to, for example, half ($255,000 - still an extraordinary expense budget for a family of four in bankruptcy), they could commit the other half to a five year chapter 11 plan that would pay their creditors over $1,000,000. If they further reduced their yearly expenses to a more modest, but still comfortable, $150,000, the dividend to creditors might be $1,800,000.

Id. at 5.

Two of the Doctors' creditors, with claims of $329,485 and $3,815,352 each, respectively, filed a motion to dismiss the Doctors' chapter 7 petition pursuant to 11 U.S.C.

§ 707(a), arguing that the petition had been filed in bad faith.[1] The lower court held an evidentiary hearing on the matter which lasted an entire day, reviewed all the evidence presented and weighed the credibility of the witnesses presented, and issued a ten-page opinion dismissing the Doctors' case pursuant to § 707(a).

In that opinion, the lower court noted that the Doctors' "only substantial defense to the motion is that because their debts are business debts rather than consumer debts, ability to pay, on its own, is not sufficient to establish their bad faith." *Id.* at 6. While the lower court *did* consider the Doctors' ability to repay their creditors - finding that the Doctors had such an ability - the lower court also made other findings relevant to the motion, including that the Doctors had failed to make appropriate lifestyle adjustments, had not tried to meaningfully repay their creditors, and that the Doctors' use of chapter 7 was unfair. *Id.* at 5-6. The lower court also made findings that indicated the Doctors were paying expenses on behalf of insiders. *Id.* at 3. With all of these facts in mind, the lower court found that the Doctors' chapter 7 petition had been filed in bad faith, and dismissed the case. This appeal followed.

SUMMARY OF ARGUMENT

The bankruptcy court did not abuse its discretion in dismissing the Doctors' chapter 7 case for cause under 11 U.S.C. § 707(a) because it concluded that the Doctors had not filed their case in good faith. Although "cause" is not defined in the Bankruptcy Code, each operative chapter of the Bankruptcy Code contains a provision permitting the court to dismiss a case "for cause,"[2] and courts have interpreted the "for cause" language broadly to encompass reasons well beyond the examples enumerated in each statute.

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[1] The lower court noted that, as the Doctors' debts were not primarily consumer debts, 11 U.S.C. § 707(b) was not applicable in this action. Slip Op. at 3, n.5.

[2] *See* 11 U.S.C. §§ 707(a); 930(a); 1112(b); 1208(c) & 1307(c).

The Sixth Circuit has held expressly that bad faith filing constitutes cause for dismissal under section 707(a). *Industrial Ins. Servs. v. Zick*, 931 F.2d 1124, 1127 (6th Cir. 1991). Courts identify bad faith based on a multi-factored, *ad hoc* analysis of the facts of the individual case. Ultimately, the bad faith analysis depends on whether the case passes the "smell test" based on consideration of the debtor's need for bankruptcy relief and whether the debtor has treated his creditors fairly. *See Merritt v. Franklin Bank, N.A.*, No. 98-2399, 2000 WL 420681, at * 3 (6th Cir. Apr. 12, 2000) (unpublished).

The bankruptcy court made a number of factual findings that support its bad faith finding, none of which the Doctors challenge as clearly erroneous. Chief among those findings was that the Doctors made well over $500,000 annually, and spent essentially all of it living a lavish lifestyle. Those excessive expenditures continued, despite the Doctors' mounting debts. Instead of reducing their expenditures so they could pay their debts, the Doctors sought to discharge their debts through a chapter 7 liquidation. The bankruptcy court found that the Doctors could have paid their creditors as much as $1.8 million under chapter 11 or otherwise. Those findings establish this as an extraordinarily egregious case of debtors unfairly seeking relief the Bankruptcy Code was not intended to provide. The United States Trustee agrees with the bankruptcy court that the Bankruptcy Code does not envision chapter 7 liquidation relief under these circumstances; this case is more appropriately filed under chapter 11 where creditors would have some say in what they receive in return for a discharge of the Doctors' debts. Given its bad faith finding, the bankruptcy court did not abuse its discretion by dismissing this case for cause.

The Doctors argue that the bankruptcy court erred by relying solely on their ability to pay in dismissing the case. But this Court need not decide whether a debtor's ability to repay may be the sole basis for a finding of bad faith because the bankruptcy court made no less than five additional factual findings regarding the Doctors' conduct that constitute a sufficient basis for a bad faith dismissal, including (a) the Doctors' failure to disclose income on their schedules, (b) the Doctor's failure to disclose expenditures on their schedules, (c) their lavish lifestyle, (d) their continuing extravagant expenditures, and (e) their payment of expenses owed by family members, but not their own debts. All of these findings support the bankruptcy court's conclusion that the Doctors filed in bad faith.

The Doctors contend that their case may not be dismissed for bad faith under section 707(a) because the court did not find that they incurred their debts through misconduct. But it found facts that constitute misconduct. Even if it had not, that would not matter because there is no specific requirement as to how their debts were incurred. To the contrary, the bad faith inquiry is an ad hoc, multi-factored inquiry into the debtor's intent in filing.

Finally, the bankruptcy court did not, as the Doctors contend, improperly apply a section 707(b) analysis. The bankruptcy court cited and followed *Zick*. The Sixth Circuit contemplated some overlap between sections 707(a) and (b) in *Zick*. But the bankruptcy court's findings include indicia of the Doctors' bad faith beyond their prospective ability to pay their creditors – which is the primary focus of the abuse determination under section 707(b)(3)(B).

ARGUMENT

I. THE BANKRUPTCY COURT DID NOT ABUSE ITS DISCRETION IN DISMISSING THE DOCTORS' CHAPTER 7 PETITION.

A. The Court's Factual Findings Support Its Bad Faith Finding.

Section 707(a) of the Bankruptcy Code provides that bankruptcy courts may dismiss a case for "cause." 11 U.S.C. § 707(a). A bankruptcy court's decision to dismiss pursuant to 11 U.S.C. § 707(a) will be reversed only for abuse of discretion. *Zick,* 931 F.2d at 1126.

Section 707(a) enumerates three specific examples of cause, *see* 11 U.S.C. § 707(a)(1)-(3), but the Sixth Circuit has held that "the word 'including' was not meant to be a limiting word," *Zick*, 931 F.2d at 1126, and that other conduct could also establish "cause" for dismissal under § 707(a). *Accord* 11 U.S.C. § 102(3) (defining "including"). Each operative chapter of the Bankruptcy Code contains a similar provision authorizing the court to dismiss a case for cause. 11 U.S.C. §§ 707(a), 930(a), 1112(b)(1), 1208(c), 1307(c). In applying those provisions, courts have consistently applied "cause" broadly to permit courts to dismiss cases for various reasons beyond the examples specified in the provisions. For example, courts have dismissed cases under section 1112(b) for bad faith. *See, e.g., In re Trident Associates L.P.*, 52 F.3d 127, 131 (6th Cir. 1995); *In re McNallen*, 197 B.R. 215, 220 (Bankr. E.D. Va. 1995). And the Supreme Court has expressly held that "cause" under section 1307 includes bad faith. *Marrama v. Citizens Bank of Massachusetts*, 549 U.S. 365, 373-74 (2007).

"Under the *in pari materia* canon of statutory construction, statutes addressing the same subject matter generally should be read as if they were one law." *Wachovia Bank v. Schmidt,* 546 U.S. 303, 315-16 (2006) (internal citations and quotations omitted). The Sixth Circuit has acknowledged "the Bankruptcy Act as a detailed and calculated statutory scheme particularly appropriate to *in pari materia* construction." *Lynch v. Johns-Manville Sales Corp.,* 710 F.2d 1194, 1198 (6th Cir. 1983). This Court should therefore construe 11 U.S.C. § 707(a)'s "for cause" requirement in a similarly broad fashion.

The Sixth Circuit has long held that lack of good faith is a valid basis to dismiss a chapter 7 case for cause under § 707(a). *In re Zick*, 931 F.2d at 1126-27. Reasoning that the principal purpose of the Bankruptcy Code is to grant a "fresh start" to the "honest but unfortunate debtor," the Sixth Circuit concluded that a debtor who is not needy or who appears to be seeking a "head start" instead of dealing with his creditors on an equitable basis is not entitled to chapter 7 relief. *Zick*, 931 F.2d at 1128 (citing *In re Krohn*, 886 F.2d 123, 126, 127-28 (6th Cir. 1989)).

Under *Zick*, the Sixth Circuit held that "[t]he facts required to mandate dismissal based upon a lack of good faith are as varied as the number of cases," *Id*. at 1127, and that the inquiry is necessarily "ad hoc" in nature. *Id.* at 1129. This Court subsequently held that the bad faith "ad hoc determination" should be "evaluated under various flexible standards." *In re Laguna Assocs. L.P.*, 1993 WL 730746, at *3 (E.D. Mich. Apr. 12, 1993)(Edmunds, J.).

Over time, courts within the Sixth Circuit have developed a non-exhaustive list of facts that may support dismissal for cause under § 707(a) based on the debtor's lack of good faith, including but not limited to the following:

1. The debtor has reduced the creditor body to a single creditor immediately before filing;
2. The debtor has failed to make appropriate lifestyle adjustments;
3. There is an intent to avoid payment of a large single debt that has been reduced to judgment;
4. The debtor did not try to repay;
5. The use of chapter 7 is unfair;
6. The debtor has sufficient resources to pay debts;
7. The debtor is paying obligations to insiders;
8. The schedules inflate expenses;
9. The debtor transferred assets;
10. The debtor is abusing the protections of the Code;
11. The debtor showed a pattern to evade a single major creditor;
12. The debtor failed to make full disclosure;
13. The debts are modest in relation to assets and income;
14. There are multiple bankruptcy filings or other procedural "gymnastics"

In re Stump, 280 B.R. 208, 214 n.2 (Bankr. S.D. Ohio 2002) (internal citations omitted).

Not all these facts must be present. *See In re Lichtenstein*, 328 B.R. 513, 515 (Bankr. W.D. Ky. 2005) (". . .where a combination of the factors is present, courts have held that dismissal is warranted"). As the Sixth Circuit has held, a bad faith inquiry is ad hoc. *Zick*, 931 F.2d at 1129. Each case is determined on its unique facts.

The bankruptcy court has wide discretion in finding bad faith by the debtor. *Zick*, 931 F.2d at 1126 ("A bankruptcy court decision to dismiss pursuant to 11 U.S.C. § 707(a) will be reversed only for abuse of discretion"). That is because myriad factors can indicate bad faith. Indeed, in *Marrama*, the Supreme Court expressly declined to constrain "bad faith" with a single definition. 549 U.S. at 375 n.11. And the bankruptcy court is in the best position to evaluate the debtor's conduct and motives for seeking bankruptcy relief for two reasons. The bankruptcy court hears the debtor's testimony and evaluates the debtor's credibility. And it has a wide range of experience with debtors' reasons, both expressed and unexpressed for filing for bankruptcy.

Applying this law, the bankruptcy court did not clearly err in finding bad faith. The court termed this case "truly . . . egregious." Slip Op. at 5. The court found that with their yearly income of over $500,000, the Doctors could repay their creditors up to $1.8 million with moderate adjustments to their budget. *Id.* In addition to the Doctors' prospective ability to pay their creditors in another chapter or outside of bankruptcy, the court made several findings concerning the Doctors' conduct that support its finding of bad faith:

- It found that the Doctors failed to disclose certain income and expenditures on their schedules. Slip Op. at 1-3.

- It found that the Doctors continued to live an "extravagant and lavish" lifestyle that was unprecedented in chapter 7 cases in the Court's experience, spending over $40,000 a month on themselves instead of paying their creditors. *Id*. at 5.

- It implicitly found that the Doctors did not try to repay their creditors, finding they had made "no effort whatsoever to reduce their expenses" and stating:

> It is significant that the debtors did not attempt to argue that they are unable to repay a meaningful portion of their debts through a chapter 11 plan or otherwise.

Id. at 5-6.

- It found that the Doctors supported their niece, and paid unspecified expenses for their mother as well as their mother-in-law's cable bills. *Id.* at 3. That amounts to preferring insiders over their creditors.

- The court also found that the Doctors' use of chapter 7 was "extraordinarily unfair" to their creditors and that "allowing bankruptcy relief to these debtors would also be unfair to every other debtor in bankruptcy." *Id.* at 5 & n.6.

These findings concerning both the Doctors' misconduct and their prospective ability to repay their creditors are sufficient to support the lower court's determination that the Doctors filed their case in bad faith. For these reasons, the court was well within its discretion to dismiss the case for cause under section 707(a).

B. This Court Need Not Address the Question of Whether Ability to Repay, Alone, Can Justify Dismissal Under Section 707(a) Because the Bankruptcy Court Found Additional Facts That Support Its Finding of Bad Faith.

While the Doctors concede, as they must, that a debtor's ability to repay his debts is relevant to a good faith inquiry,[3] (Appellants' Brief, Doc. No. 15, p. 9) they argue that the

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[3] *Merritt*, 2000 WL 420681 at *3. *Accord Novak v. Wagnitz*, 2004 WL 626821, at *10 (N.D. Ill. Mar. 29, 2004) ("Under any version of this test, one factor in particular is of key relevance: the debtor's ability to pay"); see also *In re Spagnolia,* 199 B.R. 362, 366 (Bankr. W.D. Ky. 1995) (listing post-petition ability to repay as a factor); *In re Collins,* 250 B.R. 645, 654-55 (Bankr. N.D.Ill. 2000) (present ability to pay is the "most important factor"); *In re Cappuccetti,* 172 B.R. 37, 40 (Bankr. E.D. Ark. 1994) (finding bad faith in part based upon debtor's ability to pay); *In re Studdard*, 159 B.R. 852, 856 (Bankr. E.D. Ark. 1993) (ability to repay debts by lowering expenses justified bad faith dismissal under § 707(a)); *In re Remember Enterprises, Inc.,* 425 B.R. 757, 762 (Bankr. M.D.N.C. 2010); *In re Tallman,* 417 B.R. 568, 577 (Bankr. N.D. Ind. 2009).

bankruptcy court erred by relying solely on their prospective ability to repay their creditors.[4] *Id.* at 19. Although the United States believes that finding alone might be sufficient in some cases,[5] this Court need not reach that argument because as demonstrated above, many other factual findings - including the Doctors' prepetition misconduct - supported the bankruptcy court's finding that the Doctors filed their chapter 7 petition in bad faith. On these facts, the Court should affirm the finding of the lower court that the Doctors filed their case in bad faith, and hold that the bankruptcy court did not abuse its discretion in dismissing their petition under § 707(a).

C. The Bankruptcy Court Was Not Required to Find Misconduct in the Doctors' Incurrence of Their Debts.

The Doctors argue that dismissal for bad faith requires a finding of misconduct by the debtors in the occurrence of their debts, relying on *Zick*. Appellants' Brief, Doc. No. 15, pp. 12-19. In *Zick*, by way of example, the Sixth Circuit relied upon the following facts as establishing "cause" for dismissal:

> In this case, the court based its decision on (1) the debtor's manipulations which reduced the creditors in this case to one; (2) the debtor's failure to make significant lifestyle adjustments or efforts to repay; (3) the fact that the petition was filed clearly in response to [a creditor] obtaining a mediation award; and (4) the unfairness of the debtor's use of Chapter 7 under the facts of this case. We believe that the factors noted by the bankruptcy court may be sufficient to support its findings of bad faith.

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[4] *See, e.g.*, Appellants' Brief, Doc. No. 15, p. 3 ("The Court's holding was based upon the lone belief that the Appellants['] income was sufficient to warrant some form of meaningful repayment to their creditors"); *id.* at 18 ("The Bankruptcy Court in its Order to Dismiss relied exclusively on the Appellants' income and expenses, the Appellants' perceived ability to pay, in ruling that the Appellants filed their case in bad faith").

[5] The Sixth Circuit quoted *Collier on Bankruptcy* for the proposition that "when a debtor capable of at least partial repayment has made every effort to avoid payment of an obligation, lack of good faith sufficient to justify dismissal may be found." *Zick*, 931 at 1127 (quoting 4 Collier on Bankruptcy, ¶ 707.03 (15th ed. 1989)).

Zick, 931 F.2d at 1128. The Sixth Circuit found that those factors supported the bankruptcy court's finding of lack of good faith and noted that, "generally[,]" bad faith dismissal is used in "egregious cases" that involve similar factors. *Id* at 1129. While *Zick* articulated a list of non-exhaustive factors which were relevant *to the appeal before it at that time*, it did not specify any mandatory *prerequisites* to a court finding bad faith under § 707(a). *See, e.g.*, Appellants' Brief, Doc. No. 15, pp.13-17. The Sixth Circuit merely observed that certain factors "generally" are present in cases that have been dismissed for bad faith under section 707(a); it did not hold that any or all of those factors *must* be present to warrant dismissal. *Zick,* 931 F.2d at 1129.[6] That would be contrary to *Zick's* other pronouncements that § 707(a) analyses are necessarily "ad hoc," and that "[t]he facts required to mandate dismissal based upon a lack of good faith are as varied as the number of cases," under which dismissal is appropriate. *Id.* at 1127, 1129.

Further, the specific criterion upon which the Doctors contend is required for a bad faith finding – debtor misconduct in incurring debts – is not even among the factors identified in *Zick* as generally present in cases dismissed under section 707(a). And the Doctors have cited no authority for the proposition that a finding of bad faith under section 707(a) must be based on evidence of debtor misconduct in the incurrence of a debt.

The Doctors' reliance upon cases in which courts have cited such wrongdoing in support of a bad faith finding is misplaced. It simply does not follow from the fact that specific misconduct *can be* indicative of bad faith that the same misconduct *is required* to justify dismissal for bad faith.

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[6] *Cf. Merritt*, 2000 WL 420681 (affirming section 707(a) dismissal for bad faith despite absence of 1) a single large debt and 2) a finding of intent to avoid debt based on conduct akin to fraud, misconduct, or gross negligence - both of which are factors supporting bad faith as identified in *Zick)*.

D. The Bankruptcy Court's Decision Does Not Circumvent Section 707(b).

Both section 707(a) and section 707(b) permit a bankruptcy court to dismiss a chapter 7 case. There is some overlap between section 707(a), which broadly authorizes dismissal "for cause," and section 707(b), which is targeted specifically at abusive cases, because both allow the court to dispose of cases that are in some sense unfair. *Compare* 11 U.S.C. § 707(a) *with* 11 U.S.C. § 707(b). Section 707(a) applies to all cases filed under chapter 7 of the Bankruptcy Code. In contrast, 11 U.S.C. § 707(b) is applicable *only* in cases where a debtor's debts are primarily "consumer debts." *See* 11 U.S.C. § 707(b)(1).[7]

Under section 707(b), the court may dismiss a case brought by a consumer debtor if the totality of the debtor's financial situation indicates that he has a meaningful ability to repay his creditors. 11 U.S.C. § 707(b)(3)(B); *cf. In re Krohn*, 886 F.2d at 126 (interpreting predecessor statute).

In their brief, the Doctors argue that the bankruptcy court erred by using a section 707(b) analysis to dismiss their case under section 707(a). They contend that:

> The Bankruptcy Court's ruling in the present case, if affirmed, would permit creditors and other parties in interest to use § 707(a) to circumvent the limitations in the application of a § 707(b) analysis, which strictly limits such a review of a debtor's financial situation and ability to pay for signs of abuse to consumer debt cases, and assert abuse claims against a debtor in a non-consumer debt case. This is a slippery slope that contradicts Congress' intent when it enacted BAPCPA.

Appellants' Brief, Doc. No. 15, p. 23. That argument is unpersuasive for several reasons.

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[7] "Consumer debts" are defined in the Bankruptcy Code as "debt incurred by an individual primarily for a personal, family, or household purpose." 11 U.S.C. § 101(8). Debts outside the scope of "consumer debts," for example, would include debts incurred for a business purpose or with a profit motive in mind. *See, e.g., In re Westberry*, 215 F.3d 589, 593 (6th Cir. 2000). It was undisputed in the proceedings below that the Doctors' debts were not primarily consumer debts, and that § 707(b) therefore did not apply to their case.

First, review of a debtor's financial situation and ability to pay is not limited to section 707(b); case law from both inside and outside the Sixth Circuit demonstrates that bankruptcy courts may consider a debtor's ability to repay creditors in the context of a § 707(a) motion. *See, e.g., In re Merritt*, 2000 WL 420681, at *3; *In re Perlin*, 497 F.3d 364, 371 (3d Cir. 2007).

Second, the bankruptcy court did not apply the standard for abuse under section 707(b)(3)(B) to dismiss the Doctors' case under section 707(a). An abuse analysis under section 707(b)(3)(B) focuses primarily on the debtor's post-petition financial situation and analyzes the debtor's ability to make meaningful payments to his creditors. *Cf. In re Krohn,* 886 F.2d at 126 (6th Cir.1989) (interpreting predecessor statute). But the bankruptcy court's bad faith analysis under section 707(a) also examines the debtor's prepetition conduct and seeks to ascertain the debtor's motive in filing for bankruptcy. To that end, the court considered much more than the Doctors' substantial prospective ability to repay their creditors under chapter 11 or outside of bankruptcy. The bankruptcy court was particularly offended by the fact that despite having accrued enormous debt, the Doctors made no effort to "tighten their belts," but continued to spend their $500,000 annual income on extravagant expenditures and a lavish lifestyle. Instead of paying some of what they owed, the Doctors chose to put their substantial resources beyond the reach of their creditors.

Third, the Doctors' assertion that allowing ability to repay considerations within § 707(a) would somehow contravene Congressional intent in enacting BAPCPA is entirely without merit. In enacting BAPCPA in 2005, *Congress did not speak at all about non-consumer debtors*. Rather, the primary change pertinent to this appeal in the BAPCPA amendments to the Bankruptcy Code was to lower the § 707(b) threshold showing from "substantial abuse" to simple "abuse." That Congress sought to make it *easier* to dismiss *consumer* debtors' chapter 7 petitions says nothing about the review given to *non-consumer* debtors' chapter 7 filings.

If anything, the BAPCPA amendments would counsel *against* the Doctors' current arguments. Congress enacted BAPCPA "to correct perceived abuses of the bankruptcy system." *Milavetz, Gallop & Milavetz, P.A. v. United States*, 130 S.Ct. 1324, 1329 (2010). Such "perceived abuses" included a general intent to "push more debtors toward paying their creditors[.]" *In re Cavanaugh*, 2007 WL 6363170, at *3 (Bankr. E.D. Mich. Aug. 24, 2007) (Shapero, J.). It is inconceivable, that, in enacting provisions designed to increase payments to creditors, Congress could have intended non-consumer debtors to evade review on something as fundamental to the bankruptcy process as an ability to repay creditors. As noted by the lower court:

> If Congress fully intended to allow chapter 7 relief to a debtor with primarily business debt regardless of income, expenses, ability to pay or lack of need, surely it would have stated so explicitly in the code.

Slip Op. at 9. A contrary holding by this - or any - Court would judicially insulate non-consumer filers from review under the overwhelming majority of circumstances, with absolutely no Congressional authority upon which to base such a holding.

Finally, both the Supreme Court and the Sixth Circuit have ruled that "cause" in a dismissal statute includes bad faith. *Marrama*, 549 U.S. at 393-94; *Zick*, 931 F.2d at 1126-27. The fact that section 707(b)(3)(A) alternatively allows courts to dismiss for bad faith does not change the fact that section 707(a) permits dismissal on that ground too. Here the trial court did not clearly err in finding bad faith under section 707(a), so its order merits affirmance.

CONCLUSION

For the foregoing reasons, the order of the bankruptcy court should be affirmed.

Respectfully submitted,

RAMONA D. ELLIOTT
General Counsel

P. MATTHEW SUTKO
Associate General Counsel

WENDY COX
Trial Attorney
Executive Office for
United States Trustees
Department of Justice
20 Massachusetts Avenue, N.W.
Washington, D.C. 20530
Phone: (202) 307-1399
Fax: (202) 307-2397

Date: March 3, 2011

DANIEL M. McDERMOTT
United States Trustee for Region 9

/s/ RICHARD A. ROBLE
Trial Attorney
Office of the United States Trustee
Department of Justice
221 West Fort St. - Suite 700
Detroit, Michigan 48226
Phone: (313) 226-6769
Fax: (313) 226-7952
Richard.A.Roble@usdoj.gov
P51429

UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF MICHIGAN

In re:

MAHMOUD S. RAHIM,
RAYA H. ABDULHUSSAIN,

Debtors.

Case No. 10-57577-SWR

Chapter 7

HON. STEVEN W. RHODES
United States Bankruptcy Judge

MAHMOUD S. RAHIM,
RAYA H. ABDULHUSSAIN,

Appellants,

v.

PACIFICA LOAN FOUR, LLC,
DAVID R. BARTLEY, SR. and
BARTLEY REALTY SERVICES,

Appellees/Creditors.

Case No. 10-15123-SFC

HON. SEAN F. COX
United States District Judge

INDEX OF EXHIBITS

Exhibit	**Description**
A	*Industrial Ins. Servs. v. Zick*, 931 F.2d 1124 (6th Cir. 1991)
B	*Merritt v. Franklin Bank, N.A.*, No. 98-2399, 2000 WL 420681 (6th Cir. Apr. 12, 2000) (Unpublished)
C	*In re Stump*, 280 B.R. 208 (Bankr. S.D. Ohio 2002)
D	*In re Lichtenstein*, 328 B.R. 513 (Bankr. W.D. Ky. 2005)

BRIEF BANK — 'SUMMARY SHEET" *Printed Tue-5/22/07 15:27*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*

In Re: Randle (Randle v. Neary)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*

United States District Court for the District of Illinois

3. ("CCN") ***CURRENT*** CASE NO.

No.: 07 C 00631

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*

No.: 06 B 5929

Court: UNITED STATES BANKRUPTCY COURT FROM THE NORTHERN DISTRICT OF ILLINOIS *(Identify judge & cite, if any)*

5. ("SO") ***SOURCE***

U.S. TRUSTEES

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*

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7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*

P. Matthew Sutko, Thomas Kearns, Roman L. Sukley, M. Gretchen Silver

(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***

BANKRUPTCY

9. ("SU") ● ***SUMMARY*** OF KEY ISSUE(s)

&

√ Any Miscellaneous ***BACKGROUND***

● Whether a debtor may claim a secured mortgage deduction on means test when debtor has announced an intent to abandon, foreclosure has begun and the mortgage
has not been paid in 16 months?

√ **Background:**

10. PATH TO FILE LOCATION:
(e.g., S:\OGC\BRFBANK\etc...)

11. DO YOU RECOMMEND POSTING IN UST BRIEFBANK?

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UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ILLINOIS

ERNESTINE RANDLE,)
) Case No. 07 C 00631
Appellee.)
) Hon. James F. Holderman
v.)
)
WILLIAM T. NEARY,)
United States Trustee,)
)
Appellant.)
)
)
In Re) Chapter 7 Proceeding
)
ERNESTINE RANDLE,) Case No. 06 B 5929
)
Debtor.) Hon. Carol A. Doyle

ON APPEAL FROM THE UNITED STATES BANKRUPTCY COURT
FROM THE NORTHERN DISTRICT OF ILLINOIS

REPLY BRIEF OF THE APPELLANT, UNITED STATES TRUSTEE

Of Counsel

ROBERTA A. DeANGELIS
Acting General Counsel

P. Matthew Sutko
Thomas C. Kearns
United States Department of Justice
Executive Office for United States Trustees
20 Massachusetts Avenue, NW
Washington, D.C. 20530
(202) 307-1399

United States Trustee
WILLIAM T. NEARY

Roman L. Sukley
M. Gretchen Silver
Attorneys for United States Trustee
Office of the United States Trustee
227 W. Monroe Street, Suite 3350
Chicago, Illinois 60606
(312) 886-3324

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ARGUMENT

In his opening brief, the United States Trustee established the Debtor's chapter 7 case should have been dismissed because her disposable income exceeded the statutory maximum under 11 U.S.C. 707(b)(2). Open br. at 5, 6. That is so because the Debtor improperly sought to reduce her disposable income by claiming a secured debt mortgage expense under section 707(b)(2)(A)(iii) for her house even though she was surrendering the house, the house was in foreclosure, and the Debtor had not made any mortgage payments for the 16 months prior to filing for bankruptcy. Open br. at 4.

On appeal, the Debtor advances two justifications for claiming a mortgage expense she will not have: (1) the plain meaning of section 707(b)(2)(A)(iii) compels the expense deduction notwithstanding her surrender of her house; and (2) excluding the mortgage expense payment from the means test for property surrendered or to be surrendered by debtors would frustrate the mechanical nature of the means test. Both arguments lack merit.

First, the Debtor's plain meaning argument misreads section 707(b)(2)(A)(iii). Under the Debtor's construction, a debtor could claim a mortgage deduction so long as the mortgage was on the books at the time the debtor sought bankruptcy - even if, as here, the debtor was in the process of abandoning the property, had long ceased making mortgage payments, and freely admitted no more would ever be made. Not only does that reading produce arbitrary and unfair results, it conflicts with two phrases in section 707(b)(2)(A)(iii): **(a)** the requirement that debts "shall be calculated" as "scheduled as contractually due," and **(b)** that debt be determined as due "in each month of the 60 months following the date of the petition." 11 U.S.C. 707(b)(2)(A)(iii). *See In re Skaggs*, 349 B.R. 594, 600 (Bankr.E.D.Mo. 2006) (adopting the reading suggested here). Given that these phrases are forward looking, section 707(b)(2)(A)(iii) is best read as contemplating a *forward looking* calculation that factors in "the debtors' intention to surrender the collateral and make no future payments to the creditor." *In re Ray*, 2007 WL 690131, *5 (Bankr.D.S.C. Feb. 28, 2007).

Applying this forward looking reading of section 707(b)(2)(A)(iii) to this Debtor's case makes clear that the mortgage expense she seeks to claim under section 707(b)(2)(A)(iii) is improper. The Debtor concedes she is in the process of surrendering her residence (R. 15). She has acquiesced in the secured creditor's motion for relief from stay so the property can be foreclosed upon (R. 20 / R. 25). Upon foreclosure, the Debtor will receive a discharge from her personal liability on the mortgage debt and creditor will obtain a foreclosure decree through its *in rem* proceeding against the real property. *See First Federal Sav. Bank of Proviso Tp. v. Drovers Nat'l Bank of Chicago*, 237 Ill.App.3d 340, 606 N.E.2d 1253, 1258. (Ill.App. 2 Dist.1992)(bankruptcy discharge extinguishes creditor's right to proceed in personam against defaulting debtor, not right to proceed in rem in mortgage foreclosure action.) This means the secured creditor is taking title to the property and the Debtor will no longer have a mortgage payment. *Id.* Because the Debtor will have no payments due on the residence's secured debt in any of the 60 months following the date of the petition, in calculating the maximum amount the debtor has available going forward to repay her unsecured debt, these prior payment obligations cannot be deducted.

Second, the Debtor argues the United States Trustee's approach is inconsistent with the mechanical nature of the means test. Response br. at 10-11. The United States Trustee's interpretation does not alter the mechanical nature of the means test because conditioning the secured debt expense deduction on having a monthly payment obligation is applied in the same mechanical fashion as other allowed expenses under the means test. Under the United States

Trustee's interpretation, debtors deduct either **(a)** their mortgage expense when the debtor is making a mortgage payment, or **(b)** the IRS Housing and Utility Standard, when the debtor is not. This simple election is as mechanical as other parts of the means test.

CONCLUSION

For these reasons, as well as those reasons stated in his opening brief, the United States Trustee respectfully asks this Court to reverse the order entered below and remand this case with instructions to the bankruptcy court to correctly apply the means test under 11 U.S.C. section 707(b)(2).

Dated: May 15, 2007

Respectfully submitted,
United States Trustee
WILLIAM T. NEARY

OF COUNSEL

ROBERTA A. DEANGELIS
Acting General Counsel

Attorneys for United States Trustee
P. Matthew Sutko
Thomas C. Kearns
United States Department of Justice
Executive Office for United States Trustees
20 Massachusetts Avenue, NW
Washington, D.C. 20530
(202) 307-1399

/S/ M. Gretchen Silver
Roman L. Sukley
M. Gretchen Silver
Office of the United States Trustee
227 W. Monroe Street, Suite
Chicago, Illinois 60606
(312) 886-3324

BRIEF BANK — "SUMMARY SHEET"

Printed Wed-4/9/08 10:19

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]* — Ransom v. MBNA America Bank, N.A. (In re Ransom)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]* — 9th Cir.

3. ("CCN") ***CURRENT*** CASE NO. — No.: 08-15066

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]* — No.: 07-01254-DBaMo

Court: B.A.P. 9th Cir.

(Identify judge & cite, if any)

5. ("SO") ***SOURCE*** — **U.S. TRUSTEES**

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]* — Filed: April 4, 2008

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7. **("AU") *PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]* — P. Matthew Sutko, Sean E. Martin

(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC*** — **BANKRUPTCY**

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND*** — •Whether the lower courts correctly ruled debtors cannot claim a vehicle ownership deduction under section 707(b)(2)(A)(ii)(I) of the bankruptcy code when they have no vehicle ownership expenses.

10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)

11. DO YOU RECOMMEND POSTING IN UST BRIEFBANK? | x | YES | | NO

NAME: Linda Figueroa

DATE:

COURT OF APPEALS DOCKET NO. 08-15066

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

In re JASON RANSOM,
Debtor.

JASON RANSOM,
Debtor-Appellant,

v.

MBNA AMERICA BANK, N.A.,
Appellee.

ON APPEAL FROM
THE UNITED STATES BANKRUPTCY APPELLATE PANEL
FOR THE NINTH CIRCUIT

BRIEF FOR THE UNITED STATES AS *AMICUS CURIAE* SUPPORTING APPELLEE

ROBERTA A. DEANGELIS
Acting General Counsel

P. MATTHEW SUTKO
Associate General Counsel
SEAN E. MARTIN
Executive Office for United States Trustees
Department of Justice
20 Massachusetts Avenue, N.W.
Washington, D.C. 20530

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INTEREST OF THE UNITED STATES

This appeal calls upon this Court to examine a statutory provision affecting chapter 13 bankruptcy cases, 11 U.S.C. 1325(b)(3). Section 1325(b)(3) makes two chapter 7 provisions – 11 U.S.C. 707(b)(2)(A) and (B) – applicable to chapter 13 cases.

The United States has a direct interest in the proper construction of these provisions because United States Trustees, who are Justice Department officials appointed by the Attorney General, supervise the administration of chapter 7 and chapter 13 bankruptcy cases in all federal judicial districts within this circuit. 28 U.S.C. 581-589a. See also H.R. Rep. No. 95-595, at 88 (1977) (United States Trustees "serve as bankruptcy watch-dogs to prevent fraud, dishonesty, and overreaching in the bankruptcy arena."); Curry v. Castillo (In re Castillo), 297 F.3d 940, 950 (9th Cir. 2002) (citing this legislative history).

This appeal affects the United States' interests for two distinct reasons:

First, by applying section 1325(b)(3), this Court will determine how much above-median-income chapter 13 debtors must repay their creditors in their chapter 13 repayment plans. The United States has an interest in that question because United States Trustees "supervise the administration of [chapter 13] cases and trustees," monitor chapter 13 plans, and file comments with the court regarding such chapter 13 plans in connection with plan confirmation hearings under section 1324 of the Code. 28 U.S.C. 586(a)(3)(C).

Second, because section 1325(b)(3) incorporates two parts of the chapter 7 means test, sections 707(b)(2)(A) and (B), this appeal will also determine what expenses above-median-income chapter 7 debtors can claim on the means test. The means test determines whether an above-median-debtor's chapter 7 case should be dismissed as abusive. See 11 U.S.C. 707(b)(1) and (2).

United States Trustees play a unique role in chapter 7 means test cases because section 704(b) requires them to review all such cases and, whenever a case is deemed presumptively abusive under the statute, either (a) seek its dismissal, or (b) file a statement declining to seek dismissal. See 11 U.S.C. 704(b). In fiscal year 2007, United States Trustees filed 3,370 motions to dismiss under section 707(b)(2) and 1,441 statements declining to seek dismissal when a presumption of abuse existed in a case.

In light of these interests, the United States submits this brief to share its views on the application of sections 1325(b)(3) and 707(b)(2)(A) in cases like Mr. Ransom's. See 28 U.S.C. 517 (authorizing the Department of Justice "to attend to the interests of the United States in a suit pending in a court of the United States"). See also 11 U.S.C. 307 ("The United States trustee may raise and may appear and be heard on any issue in any case or proceeding."); In re Donovan Corp., 215 F.3d 929, 930 (9th Cir. 2000) (interpreting section 307).

STATEMENT OF THE ISSUE

The Bankruptcy Code allows debtors to claim a vehicle ownership expense, in a set amount, when "applicable." 11 U.S.C. 707(b)(2)(A)(ii)(I). In this case, Mr. Ransom claimed such an expense even though he had no vehicle ownership expenses.

Did the bankruptcy court and the Bankruptcy Appellate Panel of the Ninth Circuit err in ruling Mr. Ransom could not claim that expense because it was not "applicable" in his case?[1]

STATUTORY BACKGROUND

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("Reform Act")[2] significantly altered how chapter 13 debtors obtain chapter 13

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[1] This Court reviews de novo the proper interpretation of a statute. United States v. Johal, 428 F.3d 823, 826 (9th Cir. 2005).

[2] Pub. L. No. 109-8, 119 Stat. 23 (2005). The Reform Act applies to Mr. Ransom's case, because the act's general effective date is for cases filed on or after October 17, 2005.

bankruptcy relief.

In a chapter 13 case, a debtor's unsecured creditors or trustee may insist the debtor devote all of his "projected disposable income" to repay unsecured creditors. See 11 U.S.C. 1325(b)(1). Disposable income is a net number: income less expenses.

Under the Reform Act, an above-median-income debtor, like Mr. Ransom, determines disposable income by first calculating his gross income.[3] Next, the debtor deducts his permitted expenses. See 11 U.S.C. 1325(b)(2).

Above-median-income chapter 13 debtors determine their permissible expenses by employing the formula found in 11 U.S.C. 707(b)(2)(A) and (B). 11 U.S.C. 1325(b)(3) (incorporating those provisions). Section 707(b)(2)(A)(ii)(I) permits debtors to deduct (a) certain prescribed "actual" expenses, and (b) other "applicable" expense amounts. Applicable expense amounts are determined under the Internal Revenue Service's Local and National Standards. Id. Last, a debtor

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[3] The Bankruptcy Code provides that income is "current monthly income received by the debtor (other than child support payments, foster care payments, or disability payments for a dependent child made in accordance with applicable nonbankruptcy law to the extent reasonably necessary to be expended for such child)." 11 U.S.C. 1325(b)(2).

The term "current monthly income" itself is defined in the Code. 11 U.S.C. 101(10A).

may deduct additional expenses identified in other subsections of section 707(b)(2)(A). That yields a net number – disposable income, which establishes the minimum an above-median-income debtor must pay to unsecured creditors under a chapter 13 plan. 11 U.S.C. 1325(b)(1)(B).

This appeal involves one part of the expense-side calculation of disposable income – whether a vehicle ownership deduction under an IRS Local Standard is "applicable" under section 707(b)(2)(A)(ii)(I) to a particular debtor. The IRS Local Standard allows debtors to claim an expense amount to cover monthly vehicle loan or lease payments. See IRS Collection Financial Standards, Local Standards: Transportation (explaining that the vehicle ownership Local Standard is a "figure[] for monthly loan or lease payments").[4] In calculating disposable income, if an IRS Local Standard is applicable to a debtor, the debtor may deduct the precise dollar amount the standard sets out as the reasonable amount. See 11 U.S.C. 707(b)(2)(A)(ii)(I).

In this case, Mr. Ransom has no loan or lease payments on his vehicle, so

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[4] We attach the IRS Collection Financial Standards in our addendum. Because Mr. Ransom filed his case on July 5, 2006, the Collection Financial Standards in effect prior to October 1, 2007, are applicable. See 11 U.S.C. 707(b)(2)(A)(ii)(I) (stating that the IRS standards will be those "as in effect on the date of the order for relief").

this appeal requires this Court to determine whether he may nonetheless claim the IRS Local Standard amount expense of $471 for each month of his 60-month plan.

STATEMENT OF FACTS

On July 5, 2006, Mr. Ransom filed a voluntary petition under chapter 13 of the Bankruptcy Code. His means test form claimed monthly disposable income of $210.55.[5] In making this calculation, Mr. Ransom claimed on his means test form a $471 monthly vehicle ownership expense deduction under the IRS Local Standard, although he owns his vehicle free and clear of any loan or lease obligation. Mr. Ransom's chapter 13 repayment plan proposed to pay $500 monthly to unsecured creditors over 60 months.

The chapter 13 trustee and an unsecured creditor, MBNA America Bank, objected to confirmation of Mr. Ransom's plan, alleging the plan violated 11 U.S.C. 1325(b)(1)(B). They argued that Mr. Ransom had monthly disposable income of $681.55 available to repay unsecured creditors, because Mr. Ransom was ineligible to claim the $471 vehicle ownership expense amount. Mr. Ransom

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[5] The chapter 13 means test form, Form 22C, is a new form developed after the enactment of the Reform Act. This form provides for the computation of a chapter 13 debtor's income and expenses under the Reform Act.

The means test form was approved by the Judicial Conference of the United States and is a part of the Federal Rules of Bankruptcy Procedure.

countered that he was entitled to claim the expense amount regardless of whether his car was paid in full.

The United States Bankruptcy Court for the District of Nevada sustained the objections of the trustee and MBNA. Bankr. Op. at 7. It read 11 U.S.C. 707(b)(2)(A)(ii)(I) as allowing Mr. Ransom "[to] only deduct a vehicle ownership expense if he is currently making loan or lease payments on that vehicle." Id. at 4. The court denied confirmation of Mr. Ransom's plan, because Mr. Ransom incorrectly deducted his phantom vehicle payments when calculating his disposable income available to pay unsecured creditors under 11 U.S.C. 1325(b)(1). Id. at 7.

The Bankruptcy Appellate Panel for the Ninth Circuit affirmed. Ransom v. MBNA America Bank, N.A. (In re Ransom), 380 B.R. 799 (B.A.P. 9th Cir. 2007). The panel held that debtors may not claim vehicle ownership expense amounts under section 707(b)(2)(A)(ii)(I) for vehicles owned free and clear of any liens and encumbrances. Id. at 801.

The same day it affirmed the bankruptcy court, the appellate panel *sua sponte* certified the bankruptcy court's decision to this Court under 28 U.S.C. 158(d)(2). Ransom v. MBNA America Bank, N.A.(In re Ransom), 380 B.R. 809 (B.A.P. 9th Cir. 2007).

SUMMARY OF ARGUMENT

The lower courts ruled Mr. Ransom has no “applicable” vehicle ownership expense amount that he can claim under section 707(b)(2)(A)(ii)(I) because he has no loan or lease expense obligation on his vehicle. This interpretation best reads this section because it (1) uses the ordinary dictionary meaning of “applicable,” and does so in a way that gives meaning to each word in the section; (2) fulfills Congress’ stated reasons for enacting the section; (3) determines expense eligibility like the Internal Revenue Service does “under” the IRS standards referenced in section 707(b)(2)(A)(ii)(I); and (4) treats all debtors fairly, while treating creditors fairly as well.

1. Giving “applicable” its ordinary definition in section 707(b)(2)(A)(ii)(I) validates the lower courts’ interpretation of the statute. That ordinary definition yields a statute that allows debtors who have an expense to claim the IRS expense amount, while simultaneously preventing those who lack one from artificially reducing payments to their creditors by claiming phantom expenses. It avoids conflating two words in the section – “applicable” and “actual,” a flaw inherent in Mr. Ransom’s reading. It also yields a statute that gives meaning to every word in the section, something Mr. Ransom’s proffered construction does not. Given this, it is no surprise that all eight appellate courts to

interpret the meaning of "applicable" in section 707(b)(2)(A)(ii)(I) – six United States district courts and two bankruptcy appellate panels – have rejected the construction of "applicable" that Mr. Ransom advances before this Court.[6]

2. The Reform Act's legislative history supports the lower courts' interpretation of section 707(b)(2)(A)(ii)(I). It reveals Congress enacted the new law to (a) ensure that debtors would repay their debts when they could, and (b) eliminate loopholes and incentives for abuse. The lower courts' construction fulfills these congressional goals. Mr. Ransom's does not.

3. The lower courts interpreted a debtor's eligibility to claim a vehicle ownership expense amount under section 707(b)(2)(A)(ii)(I) like the IRS determines eligibility under the IRS standards that section 707(b)(2)(A)(ii)(I) references. This harmonious application is not the product of mere coincidence.

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[6] Grossman v. Sawdy (In re Sawdy), __ B.R. __, 2008 WL 789116 (E.D. Wis. March 17, 2008); Wieland v. Thomas (In re Thomas), __ B.R. __, 2008 WL 597586 (D. Kan. March 4, 2008); Meade v. McVay (In re Meade), __B.R. __, 2008 WL 792060 (W.D. Tex. Jan. 24, 2008); United States Trustee v. Deadmond (In re Deadmond), 2008 WL 191165 (D. Mont. Jan. 22, 2008); Fokkena v. Hartwick (In re Hartwick), 373 B.R. 645 (D. Minn. 2007); Neary v. Ross-Tousey (In re Ross-Tousey), 368 B.R. 762 (E.D. Wis. 2007); Babin v. Wilson (In re Wilson), __ B.R. __, 2008 WL 681102 (B.A.P. 8th Cir. March 14, 2008); Ransom v. MBNA America Bank, N.A.(In re Ransom), 380 B.R. 799 (B.A.P. 9th Cir. 2007).

Section 707(b)(2)(A)(ii)(I)'s text and its legislative history indicate Congress wanted courts to employ the IRS's methodology in determining whether debtors are eligible to claim standards expense amounts in particular cases.[7] The lower courts' interpretation achieves that; Mr. Ransom's does not.

4. The lower courts' interpretation also comports with sound notions of public policy. Barring above-median-income debtors like Mr. Ransom from claiming phantom ownership expenses is fair. It simply prevents them from claiming expenses they do not have. This interpretation does not hurt lower-income debtors, because they are not subject to section 707(b)(2)(A)(ii)(I) in the first place. See 11 U.S.C. 1325(b)(3). The lower courts' interpretation is also fair to creditors because they will receive payments on their debts when debtors have the financial ability to repay.

Finally, the bankruptcy system has two safety valves to ensure that higher-income debtors without loan or lease payments will not suffer by being denied phantom vehicle expenses. First, if they have older vehicles, they are entitled to an additional $200 monthly expense allowance to fund operating their older vehicles. Second, above-median-income chapter 13 debtors can modify their court-

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[7] As we explain in footnote 12, the IRS and the statute determine threshold eligibility to claim an expense identically, although the expense amounts eligible individuals can claim may differ.

confirmed repayment plan under section 1329(a) if they require a new car during the course of repaying their creditors.

ARGUMENT

THE LOWER COURTS CORRECTLY RULED DEBTORS CANNOT CLAIM A VEHICLE OWNERSHIP DEDUCTION UNDER SECTION 707(b)(2)(A)(ii)(I) OF THE BANKRUPTCY CODE WHEN THEY HAVE NO VEHICLE OWNERSHIP EXPENSES.

The United States asks this Court to affirm the lower courts' rulings that section 707(b)(2)(A)(ii)(I) of the Bankruptcy Code does not allow Mr. Ransom to reduce his disposable income available to repay creditors by claiming an inapplicable vehicle ownership expense. Those courts ruled Mr. Ransom cannot claim such a vehicle expense amount in his case because Mr. Ransom has no vehicle ownership expenses.

I. The lower courts' interpretation is the best reading of section 707(b)(2)(A)(ii)(I).

A. Vehicle ownership expense amounts are only applicable if a debtor is making loan or lease payments on a vehicle.

The Bankruptcy Code permits above-median-income debtors like Mr. Ransom to claim a vehicle ownership expense amount when that expense is "applicable." 11 U.S.C. 707(b)(2)(A)(ii)(I). Section 707(b)(2)(A)(ii)(I), which section 1325(b)(3) incorporates into Mr. Ransom's chapter 13 case, provides that a "debtor's monthly expenses shall be the debtor's applicable monthly expense amounts specified under the . . . Local Standards . . . issued by the Internal Revenue Service. . . ." 11 U.S.C. 707(b)(2)(A)(ii)(I) (emphasis added). The statute thus expressly provides that before a specific expense amount may be claimed by a debtor under the IRS Local Standards, the expense amount must first be applicable to the debtor. Id.

"Applicable" is not defined in the Bankruptcy Code, so the word should be given its ordinary meaning. Smith v. United States, 508 U.S. 223, 228 (1993) ("When a word is not defined by statute, we normally construe it in accord with its ordinary or natural meaning."); United States v. TRW Rifle 7.62 x 51 mm Caliber, One Model 14 Serial 593006, 447 F.3d 686 (9th Cir. 2006) (same); United States v. Hursh, 217 F.3d 761, 769 (9th Cir. 2000) (recognizing that when a word is not defined by statute or case law, a court "must look to the dictionary for the ordinary, common meaning of this word").

The dictionary defines "applicable" to mean "applying or capable of being applied; relevant; suitable; appropriate." Random House Unabridged Dictionary (2006).[8]

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[8] Even though this Court has not defined "applicable" in a bankruptcy context, it has interpreted it in the Federal Rules of Civil Procedure as meaning "capable of being applied." Fong v. Glover, 197 F.2d 710, 711 (9th Cir. 1952).

The courts below applied this ordinary meaning in concluding Mr. Ransom could not claim a vehicle expense amount when he had no vehicle expenses. The point here is simple – a debtor has no "applicable" section 707(b)(2)(A)(ii)(I) vehicle ownership "expense amounts "capable of being applied to the debtor if he does not make any lease or loan payments." Ransom v. MBNA America Bank, N.A.(In re Ransom), 380 B.R. 799, 807-08 (B.A.P. 9th Cir. 2007). Unsurprisingly, all the appellate courts agree on this point, and all reject Mr. Ransom's contrary interpretation. Grossman v. Sawdy (In re Sawdy), __ B.R. __, 2008 WL 789116 (E.D. Wis. March 17, 2008); Wieland v. Thomas (In re Thomas), __ B.R. __, 2008 WL 597586 (D. Kan. March 4, 2008); Meade v. McVay (In re Meade), __B.R. __, 2008 WL 792060 (W.D. Tex. Jan. 24, 2008); United States Trustee v. Deadmond (In re Deadmond), 2008 WL 191165 (D. Mont. Jan. 22, 2008); Fokkena v. Hartwick (In re Hartwick), 373 B.R. 645 (D. Minn. 2007); Neary v. Ross-Tousey (In re Ross-Tousey), 368 B.R. 762 (E.D. Wis. 2007); Babin v. Wilson (In re Wilson), __ B.R. __, 2008 WL 681102 (B.A.P. 8th Cir. March 14, 2008).

This definition coincides with the lower courts' construction of "applicable" in section 707(b)(2)(A)(ii)(I).

B. Mr. Ransom's interpretation of section 707(b)(2)(A)(ii)(I) suffers from three flaws the lower courts' interpretation avoids: (a) conflating "applicable" with "actual," (b) rendering the word "applicable" superfluous, and (c) misinterpreting the official means test form.

Mr. Ransom does not read "applicable" as an eligibility requirement. Instead, he suggests "applicable" merely refers to "the region of the country where a debtor resides as well as the number of vehicles a debtor owns." Appellant's Br. at 5. Under Mr. Ransom's reading, he can claim the amount under the IRS Local Standard for each car he owns even if he does not have any loan or lease payments.[9] Id.

Mr. Ransom's interpretation suffers from at least three flaws:

First, Mr. Ransom's reading confuses the distinction between the words "actual" and "applicable" in section 707(b)(2)(A)(ii)(I). See Appellant's Br. at 6. He argues the lower courts equate "applicable" with "actual" and that cannot be because Congress used both words in the statute, and the words therefore must

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[9] Two of the bankruptcy court decisions Mr. Ransom relies upon heavily in his opening brief have been reversed. See Appellant's Br. at 9 (citing In re Sawdy, 362 B.R. 898 (Bankr. E.D. Wis. 2007), since rejected, and vacated for further proceedings by Grossman v. Sawdy, __ B.R. __, 2008 WL 789116 (E.D. Wis. March 17, 2008)); Appellant's Br. at 12 (citing In re Wilson, 373 B.R. 638 (Bankr. W.D. Ark. 2007), since reversed by Babin v. Wilson, __ B.R. __, 2008 WL 681102 (B.A.P. 8th Cir. March 14, 2008)).

have different meanings. Id. Therefore, he argues that he need not have any actual expense for the ownership expense amount to be applicable. Id.

This argument fails to recognize that “expense amounts” – the words following “applicable” in the statute – do not refer to “actual” costs. Hartwick, 373 B.R. at 650 (recognizing that a debtor’s “actual” expense does not control the amount of the vehicle ownership deduction” under section 707(b)(2)(A)(ii)(I)). To the contrary, section 707(b)(2)(A)(ii)(I) uses numbers under the IRS Local and National Standards as fixed amounts regardless of the debtor’s “actual” expenses. Id. In calculating disposable income, so long as a debtor incurs some vehicle ownership expense, i.e., the expense is applicable to the debtor, the debtor is entitled to list the amount specified under the IRS Local Standard. See 11 U.S.C. 707(b)(2)(A)(ii)(I) (providing that the applicable expense amount “shall be” the amount “specified” under the IRS Local Standard). See also Hartwick, 373 B.R. at 650 (recognizing that any vehicle ownership expense will make a debtor eligible for the full IRS standard amount).

Under the better reading, the IRS standard expense amounts are not applicable to a debtor if the debtor lacks any costs in the first place. This reading “gives meaning to the distinction between ‘applicable’ and ‘actual’ without taking a further step to conclude that ‘applicable’ means ‘nonexistent’ or ‘fictional.’”

Ross-Tousey, 368 B.R. at 765. Accord Thomas, __ B.R. __, 2008 WL 597586 at *4 (rejecting Mr. Ransom's applicable-actual argument); Meade, __B.R. __, 2008 WL 792060 at *3 (same).

As the lower appellate courts have concluded, "applicable" and "actual" have distinct meanings in section 707(b)(2)(A)(ii)(I). But the Supreme Court has recognized that different words within a single section can be synonyms. Wachovia Bank v. Schmidt, 546 U.S. 303, 314 (2006) (noting "Congress may well have comprehended the words 'located' and 'established,' as used in [28 U.S.C.] § 1348, not as contrasting, but as synonymous or alternative terms"). Therefore, should this Court conclude that "applicable" is synonymous with "actual" in section 707(b)(2)(A)(ii)(I), Mr. Ransom would remain ineligible for a vehicle ownership expense amount because he has no "actual" ownership expenses.

Second, Mr. Ransom's reading of "applicable" renders it superfluous. Under Mr. Ransom's reading, section 707(b)(2)(A)(ii)(I) would have the same meaning without the word "applicable" in it. Mr. Ransom suggests the word simply instructs debtors to go to the IRS standards referenced in section 707(b)(2)(A)(ii)(I) and locate the standard dollar figure it allows in a debtor's locality for the number of vehicles the debtor has. Appellant's Br. at 5. But debtors would do the same thing if the word applicable were not in the statute because the statute would still provide "[t]he debtor's monthly expense shall be the debtor's ~~applicable~~ monthly expense amounts" in the IRS standards. 11 U.S.C. 707(b)(2)(A)(ii)(I). That would still lead the debtor to the same line under the Local Standard that Mr. Ransom suggests the word "applicable" exists to accomplish. Ransom, 380 B.R. at 808 (Mr. Ransom's construction would "read[] 'applicable' right out of the Bankruptcy Code"); Ross-Tousey, 368 B.R. at 765 (E.D. Wis. 2007) ("Had Congress intended to indiscriminately allow all expense amounts specified in the National and Local Standards, it would have written 707(b)(2)(A)(ii)(I) [without using the word 'applicable.']"); Deadmond, 2008 WL 191165 at *4 ("The word ['applicable'] must mean something, and if some monthly expenses are applicable, then other monthly expenses are not applicable.").

Because Mr. Ransom's reading renders "applicable" superfluous, the word must have a different meaning. See generally Cooper Indus., Inc. v. Aviall Servs., Inc., 543 U.S. 157, 167 (2004) (courts "must, if possible, construe a statute to give every word some operative effect. (citation omitted)); United States v. Vidal, 504 F.3d 1072, 1081 (9th Cir. 2007) ("We presume that a legislature does not employ redundant language in crafting a statute . . ."). As we explain above – it does. Under its dictionary meaning, the word exists to allow debtors to claim a standard vehicle expense amount that is applicable to them because they have a loan or lease expense.

Third, Mr. Ransom misinterprets the significance of the official means test form when he suggests the form dictates that "applicable" in section 707(b)(2)(A)(ii)(I) must mean the number of vehicles a debtor owns and their location, rather than meaning that the vehicles must be encumbered by a loan or lease expense. Appellant's Br. at 16-17. See also Fed. R. Bankr. P. Official Form 22C, line 28 (the portion of the chapter 13 means test form that permits debtors to "claim" vehicle ownership expenses).

The form merely instructs debtors to "check the number of vehicles for which you **claim** an ownership/lease expense." Official Form 22C, line 28 (emphasis added). It does not define what ownership expense amounts debtors may lawfully deduct under section 707(b)(2)(A)(ii)(I). Nor does it purport to define "applicable."

Section 707(b)(2)(A)(ii)(I) determines which "applicable" expense amounts debtors may deduct – not the form. See In re Lasowski, __ B.R. __, 2008 WL 833971 (B.A.P. 8th Cir. March 31, 2008) (noting that the Bankruptcy Code, not the chapter 13 means test form, controls the calculation of amounts to be excluded from disposable income). The form makes that clear by merely instructing debtors to enter the expenses they "claim," not the expenses to which they are entitled.

See, e.g., Sawdy, __ B.R. __, 2008 WL 789116 at *4 (rejecting the argument that the means test form contemplates ownership expense amount deductions regardless of the existence of ownership costs).

And federal law prohibits an official form from being interpreted as altering the meaning of "applicable" in section 707(b)(2)(A)(ii)(I). 28 U.S.C. 2075 (providing that the Federal Rules of Bankruptcy Procedure "shall not abridge, enlarge, or modify any substantive right"); In re Beaty, 306 F.3d 914, 924 (9th Cir. 2002) ("[A] Bankruptcy Rule cannot create an exception to the Bankruptcy Code . . .") (internal quotation omitted). Instead, "national or local forms are only valid to the extent that they conform to the substantive provisions of the Bankruptcy Code," and "it is axiomatic that guidelines in a form cannot stand as independent authority in opposition to the Bankruptcy Code itself." Ransom, 380 B.R. at 805 n.13.[10]

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[10] Mr. Ransom also suggests that section 707(b)(2)(A)(ii)(I)'s proviso that monthly expenses may not include any "payments for debts" means it is irrelevant whether or not a debtor is making loan or lease payments on a vehicle. Appellant's Br. at 7-8. This suggestion misunderstands the statute. Debtors for whom the ownership expense is applicable do **not** deduct their "payments" for debts. Instead, they receive a fixed standard allowance that is the dollar amount of the IRS Local Standard.

The "payment for debts" language ensures that debtors do not deduct their actual payments for debts under section 707(b)(2)(A)(ii)(I) for categories in the IRS's Other Necessary Expenses. Other Necessary Expenses categories include secured debt payments, repayments of delinquent tax debts, and student loans. See IRS Internal Revenue Manual, Financial Analysis Handbook, Pt. 5, ch. 15, §

II. The lower courts' interpretation of section 707(b)(2)(A)(ii)(I) fulfills two goals Congress expressed in enacting the Reform Act: (a) to ensure above-median-income debtors repay their debts when they can, and (b) to eliminate abuse.

A. Congress passed the Reform Act to maximize debtor repayment to creditors and to eliminate opportunities for bankruptcy abuse.

In interpreting "applicable" in 707(b)(2)(A)(ii)(I), this Court may consider whether the lower courts' reading is "most harmonious with [the Code's] scheme and with the general purposes that Congress manifested." United States v. Alghazouli, __ F.3d __, 2008 WL 564986 (9th Cir. March 4, 2008) (internal quotation omitted).

The Reform Act's legislative history confirms that the lower courts' interpretation of section 707(b)(2)(A)(ii)(I) is fully consistent with the intent of the act. See, e.g., American Fed'n of Gov't Employees, AFL-CIO Local 2152 v. Principi, 464 F.3d 1049, 1056 (9th Cir. 2006) (examining legislative history "to ensure that our reading comports with Congress' intent" and to demonstrate that alternative readings "are inconsistent with the logical meaning of the language").

The "heart" of the Reform Act is the means test, which seeks to "ensure that

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5.15.1.10, available at http://www.irs.gov/irm/part5/ch15s01.html#d0e195695. Secured debt payments may be deducted under section 707(b)(2)(A)(iii), and repayments of delinquent tax debts may be deducted under section 707(b)(2)(A)(iv). Student loan payments, however, may not be deducted under the means test for above-median debtors.

debtors repay creditors the maximum they can afford." H.R. Rep. No. 109-31 (I), at 1 (2005), reprinted in 2005 U.S.C.C.A.N. 88, 89. Cf. Thomas, 2008 WL 597586 at *5 ("If a debtor were permitted a car ownership allowance when he actually incurs no such expense, application of the means test would not accurately reflect the debtor's ability to repay creditors, and the purpose of the statute would be frustrated."). The Reform Act also seeks to eliminate "loopholes and incentives" in the system "that allow and – sometimes – even encourage opportunistic personal filings and abuse." H.R. Rep. No. 109-31 (I), at 5, 2005 U.S.C.C.A.N. at 92.

Ensuring that above-median-income debtors are eligible to claim standardized deductions for vehicle ownership expenses only when they have ownership expenses honors congressional intent that such debtors repay their debts when they can. See Ransom, 380 B.R. at 807 ("[W]hat is important is the payments that debtors actually make, not how many cars they own, because the payments that debtors make are what actually affect their ability to make payments to their creditors."); Wilson, __ B.R. __, 2008 WL 681102 at *3 ("[T]here can be no doubt that the purpose of these amendments to [sections] 707(b) and 1325(b) was to require above-median income debtors to make more funds available to their unsecured creditors, and to do so by limiting the court's authority to allow expenses."); Ross-Tousey, 368 B.R. at 766 ("The statute is only concerned about protecting the debtor's ability to continue owning a car, and if the debtor already owns the car, the debtor is adequately protected."); Hartwick, 373 B.R. at 652 (same).

B. Mr. Ransom's interpretation of section 707(b)(2)(A)(ii)(I) would yield results that conflict with congressional intent.

Mr. Ransom's interpretation of section 707(b)(2)(A)(ii)(I) would frustrate the Reform Act's goals by unnecessarily reducing payments to creditors by allowing above-median-income debtors to claim phantom expenses that do not apply to them. In Mr. Ransom's case, for example, $28,260 of his income would be shielded from unsecured creditors over his five-year repayment plan, although none of this money applies to an applicable expense.[11]

Under Mr. Ransom's reading of section 707(b)(2)(A)(ii)(I), higher-income debtors "who own two unusable cars rusting in their back yard would be entitled to the windfall benefit of both ownership and operating expense deductions although they, in fact, incur no expenses by owning the vehicles." Hartwick, 373 B.R. at 652 (citations omitted). This statutory reading has been rejected by appellate courts because it "defies common sense." Deadmond, 2008 WL 191165 at *4.

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[11] By incorrectly deducting $471 in monthly ownership expense amounts for nonexistent costs in calculating disposable income, Mr. Ransom's interpretation of section 707(b)(2)(A)(ii)(I) would reduce payments to creditors by $28,260 over his 60-month plan (60 months x $471 = $28,260).

III. The lower courts' interpretation of section 707(b)(2) (A)(ii)(I) coincides with the IRS's refusal to allow parties to claim nonexistent vehicle ownership expenses under its Local Standard.

Mr. Ransom suggests the bankruptcy court "erred in consulting the IRS manuals" in examining the proper application of the IRS standards identified in section 707(b)(2)(A)(ii)(I). Appellant's Br. at 15-16.

This suggestion is incorrect for two reasons.

First, section 707(b)(2)(A)(ii)(I)'s text requires that expense amounts be those established "under" the IRS standards. 11 U.S.C. 707(b)(2)(A)(ii)(I). This textual "reference to amounts specified 'under' the Standards indicates that one should use the numbers that result when the Standards are applied as they usually are . . ." Thomas, 2008 WL 597586 at *4. Given the text of the statute, "the most logical resource to consult is the IRS" to determine whether the IRS's Local Standard is "applicable" to a particular debtor. Hartwick, 373 B.R. at 650-51.

Under its Local Standard for vehicle ownership, the IRS prohibits vehicle ownership deductions if an individual has no loan or lease payments.[12] See IRS

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[12] For individuals with existing vehicle ownership costs, the IRS applies the expense deduction as a "cap," under which an individual may take the lower of his actual expense or the standardized expense amount. See addendum, IRS Collection Financial Standards (stating that under the Local Standards, "the taxpayer is allowed the amount actually spent or the standard, whichever is less").

The Bankruptcy Code prescribes a different application for debtors with

Internal Revenue Manual, Financial Analysis Handbook, Pt. 5, ch. 15, § 5.15.1.7(4.B) (providing that if a taxpayer has no vehicle loan or lease payments, the Local Standard ownership cost cannot be claimed by the taxpayer); id., § 5.15.1.7(4.B), available at www.irs.gov/irm/part5/ch15s01.html.

The lower courts correctly applied section 707(b)(2)(A)(ii)(I) in denying Mr. Ransom's nonexistent expenses, just as the IRS does under the Local Standard.[13] Accord Sawdy, 2008 WL 789116 at *4 (finding it "logical to look at the actual IRS Collection Financial Standards in determining the applicable expense Standards in bankruptcy actions"); Thomas, 2008 WL 597586 at * 4 ("[I]t does not appear that Congress intended to adopt only the numbers contained in the Standards without the context and meaning provided by the IRS in creating the Standards and in its normal application of those numbers . . .").

Second, Congress was interested in more than the mere numbers found in the IRS Local Standards in crafting section 707(b)(2)(A)(ii)(I). The House Report to

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existing ownership costs: in calculating disposable income, it permits debtors the entire expense amount. See 11 U.S.C. 707(b)(2)(A)(ii)(I) (providing that the applicable expense amount "shall be" the amount "specified" under the IRS Local Standard).

[13] Were Mr. Ransom correct, Congress would have worded the statute so debtors could deduct expenses in the amount set out "in" the standards rather than "under" them.

the legislation provides that the debtor's monthly expenses "must be the applicable monthly amounts set forth in the [IRS] Financial Analysis Handbook as Necessary Expenses under the National and Local Standards categories. . ." H.R. Rep. No. 109-31(I), at 99-100(2005).[14] The Financial Analysis Handbook provides that the Local Standard ownership cost cannot be claimed if a taxpayer has no vehicle loan or lease payments.[15] See IRS Internal Revenue Manual, Financial Analysis Handbook, Pt. 5, ch. 15, § 5.15.1.7(4.B), available at www.irs.gov/irm/part5/ch15s01.html.

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[14] Mr. Ransom argues that language from an unenacted version of bankruptcy legislation from a prior session of Congress reveals that the Reform Act meant to forbid courts from consulting the IRS methodology. Appellant's Br. at 9. Mr. Ransom attaches special importance to the fact that section 707(b)(2)(A)(ii)(I) of the Reform Act defines allowable expenses differently than the proposed 1998 legislation, which included a specific reference to the IRS's Financial Analysis Handbook.

This argument has three weaknesses. First, the language of the Reform Act does not indicate any intent to preclude reference to the IRS's application of its own expense standards and requires that deductions be taken "under" the Local Standards. Second, the legislative history of the Reform Act specifically references the IRS Financial Analysis Handbook in describing "applicable" expense amounts. See H.R. Rep. 109-31 (I), at 99-100 (2005). Third, Mr. Ransom's citation to Russello v. United States, 464 U.S. 16, 23-24 (1983) is unavailing, because that addressed a situation – unlike here – where "limiting language" is deleted from otherwise-identical prior legislation.

[15] For the other reasons advanced by the lower courts and in this brief, the lower court rulings should be affirmed even if they relied incorrectly upon the IRS application.

IV. The lower courts' construction of section 707(b)(2)(A)(ii)(I) implements sound bankruptcy policy.

1. The lower courts' interpretation of section 707(b)(2)(A)(ii)(I) is fair to all debtors, because it establishes a threshold – the existence of vehicle loan or lease payments – for claiming an ownership deduction that is consistent for all chapter 13 debtors. Just as below-median-income debtors must incur an expense before claiming a deduction, see 11 U.S.C. 1325(b)(2) (allowing such debtors only "reasonably necessary" expenses), above-median-income debtors must also meet this threshold by claiming "applicable" expenses before shielding income from creditors.

The lower courts' interpretation does not hurt below-median-income debtors – those most likely to file bankruptcy petitions – because such debtors are not subject to section 707(b)(2)(A)(ii)(I) in the first place. See 11 U.S.C. 1325(b)(3). The approximately 73% of chapter 13 debtors with below-median incomes are not subject to the vehicle ownership expense requirement because their ability to fund chapter 13 payments is calculated in a different way.[16] Similarly, in chapter 7

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[16] There were 307,521 non-business chapter 13 cases filed in fiscal year 2007. See U.S. Courts, Bankruptcy Statistics, 2007 Fiscal Year by Chapter, available at http://www.uscourts.gov/bnkrpctystats/sept2007/f2table.xls. Of these cases, the United States estimates that 83,030 cases may have filed by above-median debtors. The United States' estimate is based on a 2006 survey conducted by RAND across a sample of 9 judicial districts that estimated that 27% of chapter

bankruptcies, section 707(b)(2)(A)(ii)(I) only applies to the 10% of debtors with above-median incomes.[17]

The lower courts' interpretation is also fair to creditors because they will receive payments on their debts when above-median-income debtors have the financial ability to repay. See In re Mann Farms, Inc., 917 F.2d 1210 (9th Cir. 1990) (stating that proposed chapter 13 plans "are reviewed for fundamental fairness in dealing with one's creditors"). In enacting the Reform Act, Congress was concerned that under the prior system, "some bankruptcy debtors are able to repay a significant portion of their debts" but are not required to do so. H.R. Rep. No. 109-31 (I), at 5 (2005), reprinted in 2005 U.S.C.C.A.N. 88, 92. The proper reading of section 707(b)(2)(A)(ii)(I) is fair to creditors because it ensures that above-median-income debtors significantly repay their debts in chapter 13 plans

---

13 cases were filed by above-median debtors. See The Bankruptcy Abuse and Consumer Protection Act of 2005: Evaluation of the Effects of Using IRS Expense Standards to Calculate a Debtor's Monthly Disposable Income, RAND Institute for Civil Justice at x, 23, available at http://www.usdoj.gov/ust/eo/public_affairs/reports_studies/index.htm.

[17] During fiscal year 2007, according to data collected by the United States Trustee Program (USTP), 451,012 non-business chapter 7 cases were filed nationwide, excluding the judicial districts in Alabama and North Carolina which are not part of the USTP. Of these chapter 7 cases, according to USTP data, only 10% had above-median incomes and were thereby subject to the means test and the requirements of section 707(b)(2)(A)(ii)(I).

when they are able.

2. Mr. Ransom's interpretation is unfair, by contrast, because it would allow above-median-income debtors to deduct nonexistent expenses, something section 1325(b)(2) prevents below-median-income debtors from claiming. See Wilson, 2008 WL 681102 at *2 (observing that below-median income chapter 13 debtors, who are not subject to section 707(b)(2)(A)(ii)(I), are not entitled to deduct ownership costs for unencumbered vehicles in determining projected disposable income).

Prior to the Reform Act, above-median-income chapter 13 debtors, like Mr. Ransom, could not deduct vehicle payments when they had no ownership costs in the first place. See 11 U.S.C. 1325(b)(2) (2004) (previously requiring that expenses for all chapter 13 debtors be "reasonably necessary") (subsequently amended in 2005). To read the Reform Act as loosening the expense requirements for above-median-income debtors would benefit the very group of debtors that Congress enacted the Reform Act to scrutinize more closely.

3. Mr. Ransom nonetheless argues that requiring expenses to exist before expense amounts are "applicable" somehow discriminates against above-median-income debtors who cannot afford newer cars that are more likely to involve loan or lease payments. See Appellant's Br. at 17-18.

This argument has been uniformly rejected by the lower appellate courts and is incorrect for two reasons.[18] First, where any debtors do have older or higher-mileage vehicles, those debtors are shielded from potential harm. Debtors who own an unencumbered vehicle that is over 6 years old or with 75,000 or more miles are entitled to an additional $200 in monthly operating expenses. See IRS Internal Revenue Manual, Pt. 5, ch. 8, § 5.8.5.5.2 ("Treatment of Non-Business Transportation Expenses"), available at http://www.irs.gov/irm/part5/ch08s05.html. See also Ransom, 380 B.R. at 808 (recognizing $200 additional allowance); Hartwick, 373 B.R. at 652 (same); Wilson, 2008 WL 681102 at *4 (same).

Second, if any debtor needs a new vehicle during the course of his chapter 13 plan, the debtor can move to modify his plan to reduce payments to creditors to account for the new expense. See 11 U.S.C. 1329(a); Wilson, 2008 WL 681102 at *4 ("[I]n the event a debtor needs a new car during the course of a case, the debtor can move to modify the plan based on changed circumstances."). For debtors who require a new vehicle, plan modification is appropriate because financing the vehicle usually indicates a substantial change in a debtor's ability to pay that was

---

[18] See Wilson, 2008 WL 681102 at *4; Thomas, 2008 WL 597586 at *5; Ransom, 380 B.R. at 808; Hartwick, 373 B.R. at 652.

not already taken into account at the time of plan confirmation. See In re Anderson, 21 F.3d 35, 358 (9th Cir. 1994).

CONCLUSION

For these reasons, the United States respectfully asks this Court to affirm the decision of the Bankruptcy Appellate Panel for the Ninth Circuit, affirming the decision of the United States Bankruptcy Court for the District of Nevada.

Respectfully submitted,

ROBERTA A. DEANGELIS
Acting General Counsel

P. MATTHEW SUTKO
Associate General Counsel
SEAN E. MARTIN
Executive Office for United States Trustees
Department of Justice
20 Massachusetts Avenue, N.W.
Washington, D.C. 20530

CERTIFICATE OF COMPLIANCE

I certify that this brief is proportionately spaced, using Times Roman font, 14 point type. Based on a word count under Corel Word Perfect 12, this brief contains 6953 words, excluding the table of contents, table of authorities, addenda, and certificates of counsel.

Sean E. Martin

Sean E. Martin
Attorney for the United States
as Amicus Curiae

CERTIFICATE OF SERVICE

I hereby certify that on April 4, 2008, I served the foregoing Brief for the United States as *Amicus Curiae* in Support of Appellee on the following by sending two copies of the brief by First-Class Mail, to:

Christopher P. Burke, Esq.
218 S. Maryland Parkway
Las Vegas, NV 89101

Jeremy T. Bergstrom, Esq.
Miles, Bauer, Bergstrom & Winters, LLP
2200 Paseo Verde Parkway, Suite 250
Henderson, NV 89052

Tara Twomey, Esq.
National Association of Consumer Bankruptcy Attorneys
1501 The Alameda
San Jose, CA 95126

I also certify that I filed the brief by sending an original and fifteen copies to the Clerk, United States Court of Appeals for the Ninth Circuit, by First-Class Mail at the following address:

Clerk, United States Court of Appeals for the Ninth Circuit
Post Office Box 193939
San Francisco, CA 94119-3939

Sean E. Martin

Sean E. Martin
Attorney for the United States
as Amicus Curiae

ADDENDUM

11 U.S.C. 707(b)(2)(A)(ii)(I)

The debtor's monthly expenses shall be the debtor's applicable monthly expense amounts specified under the National Standards and Local Standards, and the debtor's actual monthly expenses for the categories specified as Other Necessary Expenses issued by the Internal Revenue Service for the area in which the debtor resides, as in effect on the date of the order for relief, for the debtor, the dependents of the debtor, and the spouse of the debtor in a joint case, if the spouse is not otherwise a dependent. Such expenses shall include reasonably necessary health insurance, disability insurance, and health savings account expenses for the debtor, the spouse of the debtor, or the dependents of the debtor. Notwithstanding any other provision of this clause, the monthly expenses of the debtor shall not include any payments for debts. In addition, the debtor's monthly expenses shall include the debtor's reasonably necessary expenses incurred to maintain the safety of the debtor and the family of the debtor from family violence as identified under section 309 of the Family Violence Prevention and Services Act, or other applicable Federal law. The expenses included in the debtor's monthly expenses described in the preceding sentence shall be kept confidential by the court. In addition, if it is demonstrated that it is reasonable and necessary, the debtor's monthly expenses may also include an additional allowance for food and clothing of up to 5 percent of the food and clothing categories as specified by the National Standards issued by the Internal Revenue Service.

11 U.S.C. 1325(b)(1), (2), (3)

(b)(1) If the trustee or the holder of an allowed unsecured claim objects to the confirmation of the plan, then the court may not approve the plan unless, as of the effective date of the plan--

> (A) the value of the property to be distributed under the plan on account of such claim is not less than the amount of such claim; or
>
> (B) the plan provides that all of the debtor's projected disposable income to be received in the applicable commitment period beginning on the date that the first payment is due under the plan will be applied to make payments to unsecured creditors under the plan.

(2) For purposes of this subsection, the term "disposable income" means current monthly income received by the debtor (other than child support payments, foster care payments, or disability payments for a dependent child made in accordance with applicable nonbankruptcy law to the extent reasonably necessary to be expended for such child) less amounts reasonably necessary to be expended--

> (A)(i) for the maintenance or support of the debtor or a dependent of the debtor, or for a domestic support obligation, that first becomes payable after the date the petition is filed; and
>
> (ii) for charitable contributions (that meet the definition of "charitable contribution" under section 548(d)(3) to a qualified religious or charitable entity or organization (as defined in section 548(d)(4)) in an amount not to exceed 15 percent of gross income of the debtor for the year in which the contributions are made; and
>
> (B) if the debtor is engaged in business, for the payment of expenditures necessary for the continuation, preservation, and operation of such business.

(3) Amounts reasonably necessary to be expended under paragraph (2), other than subparagraph (A)(ii) of paragraph (2), shall be determined in accordance with subparagraphs (A) and (B) of section 707(b)(2), if the debtor has current monthly income, when multiplied by 12, greater than--

> (A) in the case of a debtor in a household of 1 person, the median family

income of the applicable State for 1 earner;

(B) in the case of a debtor in a household of 2, 3, or 4 individuals, the highest median family income of the applicable State for a family of the same number or fewer individuals; or

(C) in the case of a debtor in a household exceeding 4 individuals, the highest median family income of the applicable State for a family of 4 or fewer individuals, plus $575 per month for each individual in excess of 4.

(3) Amounts reasonably necessary to be expended under paragraph (2), other than subparagraph (A)(ii) of paragraph (2), shall be determined in accordance with subparagraphs (A) and (B) of section 707(b)(2), if the debtor has current monthly income, when multiplied by 12, greater than--

(A) in the case of a debtor in a household of 1 person, the median family income of the applicable State for 1 earner;

(B) in the case of a debtor in a household of 2, 3, or 4 individuals, the highest median family income of the applicable State for a family of the same number or fewer individuals; or

(C) in the case of a debtor in a household exceeding 4 individuals, the highest median family income of the applicable State for a family of 4 or fewer individuals, plus $575 per month for each individual in excess of 4.

IRS Collection Financial Standards

Internal Revenue Service
United States Department of the Treasury

Collection Financial Standards

General

Collection Financial Standards are used to help determine a taxpayer's ability to pay a delinquent tax liability.

Allowances for food, clothing and other items, known as the National Standards, apply nationwide except for Alaska and Hawaii, which have their own tables. Taxpayers are allowed the total National Standards amount for their family size and income level, without questioning amounts actually spent.

Maximum allowances for housing and utilities and transportation, known as the Local Standards, vary by location. Unlike the National Standards, the taxpayer is allowed the amount actually spent or the standard, whichever is less.

Food, Clothing and Other Items

National Standards for reasonable amounts have been established for five necessary expenses: food, housekeeping supplies, apparel and services, personal care products and services, and miscellaneous.

All standards except miscellaneous are derived from the Bureau of Labor Statistics (BLS) Consumer Expenditure Survey (CES). The miscellaneous standard has been established by the IRS.

Alaska and Hawaii

Due to their unique geographic circumstances and higher cost of living, separate standards for food, clothing and other items have been established for Alaska and Hawaii .

Housing and Utilities

The housing and utilities standards are derived from Census and BLS data, and are provided by state down to the county level.

Transportation

The transportation standards consist of nationwide figures for monthly loan or lease payments referred to as ownership costs, and additional amounts for monthly operating costs broken down by Census Region and Metropolitan Statistical Area (MSA). Public transportation is included under operating costs. A conversion chart has been provided with the standards which shows which IRS districts fall under each Census Region, as well as the counties included in each MSA. The ownership cost portion of the transportation standard, although it

applies nationwide, is still considered part of the Local Standards.

The ownership costs provide maximum allowances for the lease or purchase of up to two automobiles if allowed as a necessary expense. The operating costs are derived from BLS data.

If a taxpayer has a car payment, the allowable ownership cost added to the allowable operating cost equals the allowable transportation expense. If a taxpayer has no car payment, or no car, only the operating costs portion of the transportation standard is used to come up with the allowable transportation expense.

Recent Revisions

The Local Standards for housing and utilities and transportation were revised on 02/01/06 to:

- add family size to the housing and utilities allowances (two or less, three, and four or more);
- base automobile ownership/leasing costs on the five-year average of new and used car financing data compiled by the Federal Reserve Board of Governors; and,
- reflect updated information from the Bureau of Labor Statistics.
- Housing and Utility Standards have been established in 2006 for U.S. Territories

The revised Local Standards for housing and utilities and transportation are effective for financial analysis conducted on or after January 1, 2006.

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United States Supreme Court

3. ("CCN") ***CURRENT*** CASE NO.

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(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***

BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s)

&

√ Any Miscellaneous ***BACKGROUND***

• Whether a Chapter 13 debtor who is not making any loan or lease payments on his vehicle may claim a vehicle ownership expense deduction in calculating the projected disposable income he has available to pay unsecured creditors.

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No. 09-907

In the Supreme Court of the United States

JASON M. RANSOM, PETITIONER

v.

MBNA, AMERICA BANK, N.A.

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE SUPPORTING RESPONDENT

RAMONA D. ELLIOTT
General Counsel

P. MATTHEW SUTKO
Associate General Counsel

JOHN P. SHEAHAN
CATHERINE B. SEVCENKO
Attorneys
Executive Office for United States Trustees
Washington, D.C. 20530-0001
(202) 514-2217

NEAL KUMAR KATYAL
Acting Solicitor General
Counsel of Record

MICHAEL F. HERTZ
Acting Assistant Attorney General

MALCOLM L. STEWART
Deputy Solicitor General

NICOLE A. SAHARSKY
Assistant to the Solicitor General

WILLIAM KANTER
JEFFRICA JENKINS LEE
Attorneys

Department of Justice
Washington, D.C. 20530-0001
SupremeCtBriefs@usdoj.gov
(202) 514-2217

QUESTION PRESENTED

In a Chapter 13 bankruptcy proceeding, if a trustee or unsecured creditor objects to the confirmation of a debtor's plan, and the plan does not provide for all unsecured creditors to be paid in full, the bankruptcy court may confirm the plan only if all of the debtor's "projected disposable income" will be used to pay unsecured creditors. 11 U.S.C. 1325(b)(1)(B). The Bankruptcy Code defines the debtor's "disposable income" as his current monthly income less certain "reasonably necessary" expenses. 11 U.S.C. 1325(b)(2)(A)(i). For an above-median-income debtor like petitioner, those reasonably necessary expenses are determined using the means test set forth in 11 U.S.C. 707(b)(2). See 11 U.S.C. 1325(b)(3). That means test allows deductions for a variety of expenses, including the "debtor's applicable monthly expense amounts specified under the National Standards and Local Standards" issued by the Internal Revenue Service (IRS). 11 U.S.C. 707(b)(2)(A)(ii)(I). As relevant here, the IRS Local Standards include expense amounts for vehicle ownership expenses. The question presented is as follows:

Whether a Chapter 13 debtor who is not making any loan or lease payments on his vehicle may claim a vehicle ownership expense deduction in calculating the projected disposable income he has available to pay unsecured creditors.

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In the Supreme Court of the United States

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ON WRIT OF CERTIORARI
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BRIEF FOR THE UNITED STATES AS AMICUS CURIAE SUPPORTING RESPONDENT

INTEREST OF THE UNITED STATES

This case presents the question whether a Chapter 13 debtor who makes no car loan or lease payments may deduct a vehicle ownership expense in calculating the disposable income he will have available to pay unsecured creditors. The United States has a direct interest in the resolution of that question because United States Trustees—who are Department of Justice officials appointed by the Attorney General—supervise the administration of bankruptcy cases. See 28 U.S.C. 581-589a (2006 & Supp. II 2008); H.R. Rep. No. 595, 95th Cong., 1st Sess. 88 (1977). In Chapter 13 cases, United States Trustees are authorized to review proposed repayment plans and submit comments about them to the bankruptcy courts. 28 U.S.C. 586(a)(3)(C). Congress has provided that "[t]he United States trustee may raise and may appear and be heard on any issue in any [bankruptcy] case or proceeding." 11 U.S.C. 307.

STATEMENT

1. a. Chapter 13 of the Bankruptcy Code permits an individual with regular income whose debts fall within statutory limits to obtain a discharge of those debts while retaining possession of his assets. 11 U.S.C. 1301 *et seq*. The debtor must agree to a court-approved plan under which he will repay his creditors a portion of his future income. 11 U.S.C. 1306(b), 1321, 1322, 1325. The debtor typically receives a discharge of debts only after he pays creditors in accordance with the terms of the plan. 11 U.S.C. 1325-1328.

Chapter 13 establishes several prerequisites to confirmation of the debtor's plan. See 11 U.S.C. 1325. If the trustee or an unsecured creditor objects to confirmation of the plan, and the plan does not provide for payment of all unsecured claims in full, the court may not confirm the plan unless "all of the debtor's projected disposable income to be received" during the plan period "will be applied to make payments to unsecured creditors under the plan." 11 U.S.C. 1325(b)(1)(B). The question in this case concerns the manner in which a Chapter 13 debtor's "projected disposable income" is calculated.

b. Determining the debtor's "projected disposable income" is a two-step process. First, the bankruptcy court must calculate the debtor's "disposable income," based on his current income and expenses. 11 U.S.C. 1325(b)(2). Second, to determine the debtor's "projected disposable income" during the plan period, the court should account for "known or virtually certain information about the debtor's future income or expenses" that makes the initial calculation of disposable income a demonstrably unreliable predictor of the debtor's financial condition during the plan period. *Hamilton* v. *Lanning*, 130 S. Ct. 2464, 2474-2475 (2010); see 11 U.S.C. 1325(b)(1).

i. The Bankruptcy Code defines the term "disposable income" as the debtor's "current monthly income" minus the debtor's "reasonably necessary" expenses for "maintenance or support," qualifying charitable contributions, and business expenditures. 11 U.S.C. 1325(b)(2). For an above-median-income debtor like petitioner, the amounts that are "reasonably necessary" for support or maintenance are determined using the methodology (commonly known as the "means test") set forth in Section 707(b)(2). See 11 U.S.C. 1325(b)(3).[1]

Under the means test, certain allowed monthly expenses are deducted from the debtor's income to determine what funds he has available to pay creditors. As relevant here, the allowed monthly expenses include "the debtor's applicable monthly expense amounts specified under the National Standards and Local Standards, and the debtor's actual monthly expenses for the categories specified as Other Necessary Expenses issued by the Internal Revenue Service [IRS]." 11 U.S.C. 707(b)(2)(A)(ii)(I).

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[1] Because the Section 707(b)(2) means test is also used to determine whether an individual is eligible for bankruptcy relief under Chapter 7, see 11 U.S.C. 707(b)(2)(A)(i), the Court's decision in this case may affect the disposition of Chapter 7 bankruptcy proceedings as well as cases under Chapter 13.

Section 707(b)(2) was amended in respects not relevant here in 2008. This brief refers to the 2006 version, which was in effect when petitioner filed his bankruptcy petition.

The IRS has established Local Standards for vehicle "ownership costs" and vehicle "operating costs." Resp. Br. App. 2a-3a.[2] For the vehicle ownership expense deduction, which is at issue here, the Local Standards identify amounts of $471 per month for a debtor's first car and $332 per month for his second. *Id.* at 5a. Those dollar amounts are based on the average cost of financing a vehicle as determined annually by the Federal Reserve Board. *Id.* at 3a; see *In re Meade*, 384 B.R. 132, 136 (Bankr. W.D. Tex. 2008). The IRS Collection Financial Standards state that "[t]he transportation standards consist of nationwide figures for loan or lease payments referred to as ownership costs, and additional amounts for monthly operating costs broken down by" geographic area. Resp. Br. App. 2a (italics omitted). They further explain that "[i]f a taxpayer has no car payment, or no car, only the operating costs portion of the transportation standard is used to come up with the allowable transportation expense." *Id.* at 3a.[3]

---

[2] In connection with its own tax-collection efforts, the IRS uses the National and Local Standards "to help determine a taxpayer's ability to pay a delinquent tax liability." Resp. Br. App. 1a; see 26 U.S.C. 7122(d)(2). This brief generally cites the National and Local Standards in place at the time petitioner filed for bankruptcy, because those are the standards that apply to this case. See 11 U.S.C. 301(b), 707(b)(2)(A)(ii)(I).

[3] The Collection Financial Standards explain that, for IRS tax-collection purposes, "[t]axpayers are allowed the total National Standards amount for their family size and income level, without questioning amounts actually spent." Resp. Br. App. 1a. Under the Local Standards, by contrast, "the taxpayer is allowed the amount actually spent or the standard, whichever is less." *Ibid.* The Collection Financial Standards note that "[t]he ownership cost portion of the transportation standard, although it applies nationwide, is still considered part of the Local Standards." *Id.* at 2a.

ii. As this Court explained in *Lanning*, calculating a Chapter 13 debtor's "disposable income" is only the first step in determining the amount of "projected disposable income" the debtor will have available to repay unsecured creditors. 130 S. Ct. at 2471. The bankruptcy court also must "project" the debtor's disposable income over the life of the plan and "account for changes in the debtor's income or expenses that are known or virtually certain at the time of confirmation." *Id.* at 2471-2472, 2478; see 11 U.S.C. 1325(b)(1)(B). In so doing, the court tailors the results of the mathematical calculation of "disposable income" to account for circumstances that will affect the debtor's ability to repay creditors. *Lanning*, 130 S. Ct. at 2471-2472.

2. Petitioner filed a voluntary Chapter 13 bankruptcy petition in July 2006. Pet. App. 3, 17. Among his assets, he listed a 2004 Toyota Camry. *Id.* at 3. Petitioner owns that vehicle outright and therefore does not make any loan or lease payments. *Ibid.*; see J.A. 38, 44. Petitioner reported liabilities of $82,542.93 in general unsecured claims, including a $32,896.73 claim held by respondent. Pet. App. 3; J.A. 40-41. Petitioner reported a current monthly income of $4248.56, which qualified him as an above-median-income debtor. Pet. App. 3; J.A. 45-48.

In calculating his monthly disposable income, petitioner claimed the $471 vehicle ownership expense deduction. Pet. App. 3; J.A. 49. With that deduction, petitioner's total monthly expenses would be $4038.01, making his monthly disposable income $210.55. Pet. App. 3; J.A. 53. If petitioner's plan had been confirmed, the vehicle ownership deduction would have allowed petitioner to shield approximately $28,000 from unsecured creditors over the five-year life of his plan.

Petitioner proposed to pay $500 per month over the life of the plan, $389 per month of which would be paid to unsecured creditors, resulting in repayment of approximately 25% of the unsecured claims. Pet. App. 3, 45; J.A. 53, 56. The Chapter 13 trustee, respondent, and another unsecured creditor objected to confirmation of petitioner's plan on the ground that the plan did not provide for all of petitioner's projected disposable income to be used to pay unsecured claims, as required by 11 U.S.C. 1325(b)(1). J.A. 60, 71. They contended that petitioner had understated his projected disposable income by taking a vehicle ownership expense deduction that was not "applicable" to him because he has no loan or lease payment. J.A. 60, 67-71.

3. The bankruptcy court denied confirmation of the plan. Pet. App. 36-47. Relying on its prior decision in *In re Slusher*, 359 B.R. 290 (Bankr. D. Nev. 2007), the court determined that, under the "plain language" of 11 U.S.C. 707(b)(2), a debtor "may only deduct a vehicle ownership expense if he is currently making loan or lease payments on that vehicle." Pet. App. 40-41.

4. The bankruptcy appellate panel affirmed. Pet. App. 15-35. The panel determined that Congress's use of the word "applicable" in Section 707(b)(2)(A)(ii)(I) evidenced its intent to limit the vehicle ownership deduction to debtors who are actually making loan or lease payments. *Id.* at 30-33. The panel explained that the vehicle ownership deduction "becomes relevant to the debtor (i.e., appropriate or applicable to the debtor)" only "when he or she in fact has such an expense." *Id.* at 32.

5. The court of appeals affirmed. Pet. App. 1-14. The court concluded that the "statutory language, plainly read" does not allow a debtor "to deduct an 'own-

ership cost' that the debtor does not have." *Id.* at 11. The court explained that, because the ordinary meaning of "applicable" is "capable of or suitable for being applied," the vehicle ownership expense deduction is "applicable" only if the debtor actually has an expense associated with vehicle ownership. *Id.* at 12 (internal quotation marks omitted). To allow the debtor to "assert a deduction for an expense he does not have," the court stated, would "read[] 'applicable' right out of the" statute. *Ibid.* (internal quotation marks omitted). The court of appeals further concluded that allowing a debtor to "diminish payments to unsecured creditors * * * on the basis of a fictitious expense not incurred by [him]" would be contrary to the statute's main objective, which is "to ensure that debtors repay as much of their debt as reasonably possible." *Id.* at 11, 13 (internal quotation marks omitted).

SUMMARY OF ARGUMENT

I. Because petitioner owns his vehicle outright and does not make loan or lease payments on the car, he is not entitled to deduct vehicle ownership expenses in calculating his "disposable income."

A. In calculating petitioner's monthly disposable income, the bankruptcy court was required to deduct, *inter alia*, "the debtor's applicable monthly expense amounts specified under the National Standards and Local Standards." 11 U.S.C. 707(b)(2)(A)(ii)(I); see 11 U.S.C. 1325(b)(3) (incorporating Section 707(b)(2) means test to calculate the disposable income of an above-median-income Chapter 13 debtor). A deduction for a particular type of expense is not "applicable" if the debtor will not pay that expense during the plan period. That reading of the statute is strengthened by Congress's reference to "the debtor's" applicable expenses, which suggests that the applicability of a particular deduction depends in part on the debtor's own circumstances.

Petitioner's reading of Section 707(b)(2)(A)(ii)(I), under which any debtor with a car may claim a vehicle ownership expense deduction, disserves the purposes for which the debtor's expenses are calculated. A debtor's "applicable monthly expense amounts" are deducted from his monthly income in order to ascertain what resources are available to pay his creditors. Allowing petitioner to deduct $471 per month in vehicle ownership expenses, notwithstanding the fact that petitioner owes no car loan or lease payments, would make that calculation demonstrably less accurate. Petitioner's approach also ignores the fact that the IRS Local Standards provide separate deductions for vehicle ownership and vehicle operating expenses. That distinct treatment of ownership and operating expenses would be superfluous if every debtor with a vehicle could claim both deductions.

B. Other provisions of the Bankruptcy Code confirm that a debtor who has no loan or lease payments is not entitled to a vehicle ownership expense deduction. In several places, Congress used the word "applicable" to require a threshold finding that an action or procedure is justified based on the individual debtor's specific circumstances, and "applicable" should have the same meaning here. Contrary to petitioner's contention, requiring such a threshold showing would not equate "applicable" with "actual." If a debtor qualifies for a vehicle ownership expense deduction because he has loan or lease payments, then the IRS Local Standard prescribes a standard amount to be used. Petitioner is likewise mistaken in relying on the statute's exclusion of "payments for debts." That provision excludes certain deductions that otherwise would be allowed; it cannot authorize a deduction for an expense that is not "applicable" to the debtor.

C. In enacting Section 707(b)(2)(A)(ii)(I)'s means test, and in directing that the test be used to calculate the disposable income of an above-median-income Chapter 13 debtor, Congress sought to ensure that such a debtor would pay as much as reasonably possible to his unsecured creditors during the life of his plan. Restricting the vehicle ownership deduction to debtors who will make vehicle loan or lease payments furthers that objective, while petitioner's approach would allow him to shield more than $28,000 in income from creditors during the plan period. Moreover, although Congress took steps in 2005 to scrutinize and circumscribe the expenses of above-median-income debtors, petitioner's approach would give such individuals a windfall not available to below-median-income debtors.

II. Even if a debtor without vehicle loan or lease payments could claim a vehicle ownership deduction under Section 707(b)(2)(A)(ii)(I)'s means test, no such deduction would be appropriate in calculating a Chapter 13 debtor's "projected disposable income" under 11 U.S.C. 1325(b)(1)(B). As this Court explained in *Hamilton* v. *Lanning*, 130 S. Ct. 2464 (2010), a bankruptcy court may account for "known or virtually certain information about the debtor's future income or expenses" that makes the initial calculation of disposable income an unreliable predictor of the debtor's available resources during the plan period. *Id.* at 2475. Here, allowing petitioner to claim a vehicle ownership expense would "deny creditors payments the debtor could easily make," a result that Congress sought to avoid. *Id.* at 2476.

ARGUMENT

WHEN CALCULATING HIS PROJECTED DISPOSABLE INCOME, AN ABOVE-MEDIAN-INCOME CHAPTER 13 DEBTOR WHO HAS NO VEHICLE LOAN OR LEASE PAYMENTS TO MAKE MAY NOT DEDUCT VEHICLE OWNERSHIP EXPENSES

A debtor who seeks Chapter 13 bankruptcy relief and who cannot satisfy all of his unsecured claims must propose a plan in which all of his "projected disposable income" will be used to pay unsecured creditors. 11 U.S.C. 1325(b)(1)(B). As part of the calculation of "disposable income," an above-median-income Chapter 13 debtor may deduct his "*applicable* monthly expense amounts specified under the National Standards and Local Standards." 11 U.S.C. 707(b)(2)(A)(ii)(I) (emphasis added); see p. 3, *supra*. Because the IRS Local Standard for vehicle ownership expenses covers loan and lease payments alone, the "expense amounts specified under" that Standard are not "applicable" to debtors who do not make such payments. Limiting the vehicle ownership expense to debtors who actually incur loan or lease payments directly furthers Congress's efforts "to ensure that debtors repay creditors the maximum they can afford." H.R. Rep. No. 31, 109th Cong., 1st Sess. Pt. 1, at 2 (2005) (*House Report*).

I. THE VEHICLE OWNERSHIP EXPENSE DEDUCTION IS NOT "APPLICABLE" TO A DEBTOR WHO WILL NOT MAKE ANY LOAN OR LEASE PAYMENTS DURING THE PLAN

Under the means test contained in 11 U.S.C. 707(b)(2), petitioner may deduct the vehicle ownership expense only if it is "applicable" to him. The word "applicable" is naturally construed to require a threshold showing that the debtor will pay the expense over the life of the plan. That understanding is firmly rooted in the context of the statute, and it furthers the statute's primary purpose, which is to ensure that Chapter 13 debtors pay as much as they can reasonably afford before obtaining a discharge of their debts.

A. Section 707(b)(2)(A)(ii)(I) Allows Deduction Of Vehicle Ownership Expenses Only If Such Expenses Are "Applicable"

"As with any case of statutory construction, [this Court's] analysis begins with the language of the statute." *Hughes Aircraft Co.* v. *Jacobson*, 525 U.S. 432, 438 (1999) (internal quotation marks omitted). Congress provided that only "applicable" expense amounts under the National and Local Standards may be deducted from an above-median-income debtor's income. The vehicle ownership expenses expense amounts contained in the relevant IRS Local Standard are not "applicable" to a debtor who will not be making any loan or lease payments on his vehicle.

1. Under the Bankruptcy Code, a debtor's "disposable income"—*i.e.*, the presumptive amount he has available to pay unsecured creditors—is calculated by subtracting from the debtor's income his "reasonably necessary" expenses for "maintenance or support," qualifying charitable contributions, and business expenditures. 11 U.S.C. 1325(b)(2). For an above-median-income debtor like petitioner, the means test contained in Section 707(b)(2) is used to determine the amounts that are "reasonably necessary" for maintenance and support. 11 U.S.C. 1325(b)(3).

The means test provides, in pertinent part:

> The debtor's monthly expenses shall be the debtor's applicable monthly expense amounts specified under the National Standards and Local Standards, and the debtor's actual monthly expenses for the categories specified as Other Necessary Expenses issued by the Internal Revenue Service for the area in which the debtor resides.

11 U.S.C. 707(b)(2)(A)(i)(I). This language identifies two categories of allowable expenses: "applicable" expense amounts specified in the IRS's National and Local Standards, which establish schedules for expenses such as food, clothing, health care, housing, and transportation; and "actual" amounts for certain other necessary expenses, such as legal and accounting fees, child-care expenses, and education expenses. See Resp. Br. App. 21a-27a.

Because the Bankruptcy Code does not define the word "applicable," that term should be given its ordinary meaning. See, *e.g.*, *Hamilton* v. *Lanning*, 130 S. Ct. 2464, 2471 (2010); *Smith* v. *United States*, 508 U.S. 223, 228 (1993). In ordinary use, "applicable" means "relevant," "appropriate," or "suitable." See *The New Oxford American Dictionary* 74 (2d ed. 2005) ("applicable" is "relevant or appropriate"); 1 *The Oxford English Dictionary* 405 (1978) ("applicable" is "[c]apable of being applied" or "fit or suitable for its purpose, appropriate"); *Webster's Third New International Dictionary of the English Language* 105 (1993) ("appropriate" is "capable of being applied; having relevance" or "[f]it, suitable, or right to be applied: appropriate"). This Court has used that common definition, see *Patterson* v. *Shumate*, 504 U.S. 753, 758-759 (1992) (equating "applicable" with "relevant" in the phrase "applicable nonbankruptcy law"), as did the court of appeals below, see Pet. App. 12 ("applicable" is "capable of or suitable for being applied" (internal quotation marks omitted)).

In Section 707(b)(2)(A)(ii)(I), "applicable" modifies "monthly expense amounts," which are the dollar amounts listed in the National and Local Standards. That structure evidences the purpose of the word "applicable," which is to identify those expenses that are relevant to the particular debtor. Congress did not say that the debtor may deduct *all* expense amounts listed in the National and Local Standards; it limited the deduction to "applicable" expense amounts. Congress thus required a threshold determination, based on the debtor's circumstances, that a particular expense category is "appropriate" or "suitable." Section 707(b)(2)(A)(ii)(I)'s reference to "*the debtor's* applicable monthly expense amounts" (emphasis added) reinforces that understanding and confirms that the applicability of a particular amount depends in part on the debtor's own expenses. See *In re Slusher*, 359 B.R. 290, 309 (Bankr. D. Nev. 2007).

2. To determine whether the vehicle ownership expense deduction listed in the Local Standards is "applicable" to petitioner, the courts below correctly sought to identify the types of expenses that are covered by the deduction and to ascertain whether petitioner will have those expenses. The vehicle ownership expense deduction accounts for the debtor's monthly expenses associated with acquiring use of the vehicle, *i.e.*, it is for "monthly loan or lease payments." Resp. Br. App. 2a. A table in the IRS Local Transportation Standards gives two standard nationwide amounts for vehicle ownership costs, one for a debtor's first car and the other for the

debtor's second car. *Id.* at 5a. As the court of appeals recognized, those expense amounts are "relevant to the debtor (i.e., appropriate or applicable to the debtor)" only if "he or she in fact has such an expense." Pet. App. 12 (internal quotation marks omitted).

This understanding of the term "applicable" is consistent with the word's usage in other contexts. For example, one dictionary provides the example of "add[ing] the applicable sales tax." *The American Heritage Dictionary of the English Language* 87 (4th ed. 2006) (italics omitted). No sales tax would be "applicable" if an individual did not purchase any items, just as no vehicle ownership expense would apply if the debtor did not have a car. But a sales tax similarly would not be "applicable" to a purchased item that was exempt from tax under the relevant law. By the same token, the vehicle ownership expense amounts specified in the Local Standards are not "applicable" to a debtor who owns a vehicle free and clear and therefore incurs no loan or lease payments.

3. Petitioner acknowledges (Br. 33) that bankruptcy courts must make a threshold determination—that the debtor has a car—before allowing the vehicle ownership deduction. He contends (Br. 14, 51), however, that the vehicle ownership expense is "applicable" to every debtor who owns a vehicle, regardless of whether he even has any loan or lease payments to make. In his view, "an applicable expense is one set down for a category, such as vehicle ownership expense, according to geographic region and number of cars." Br. 14; see NACBA Amicus Br. 9.

Petitioner's argument disregards the purposes that the means test is intended to serve. As the court of appeals explained, "what is important is the payments that debtors actually make, not how many cars they own, because the payments that debtors make are what actually affect their ability to make payments to their creditors." Pet. App. 11 (internal quotation marks omitted). Petitioner's approach also cannot be reconciled with the IRS's decision to establish two separate vehicle expense deductions—one for ownership costs and one for operating costs. Resp. Br. App. 2a-3a, 5a-6a. That separate treatment of ownership and operating costs would be superfluous if every debtor with a vehicle were allowed both expenses. The distinction between the two deductions in the IRS Standards reflects the real-world fact that debtors who are making car payments have less income available to pay creditors than those who are not making such payments, even if both have vehicle operating expenses.

4. Petitioner suggests (Br. 3, 43, 45-48) that the court of appeals improperly gave precedence to the IRS's tax-collection guidelines rather than following the "plain language" of the Bankruptcy Code. That argument is misconceived.

Section 707(b)(2)(A)(ii) incorporates by reference the "National Standards and Local Standards" issued by the IRS, and it allows the debtor to deduct his "applicable monthly expense amounts specified under" those Standards. That provision directs bankruptcy courts to look to certain aspects of IRS tax-collection practice in identifying the expenses that particular debtors may deduct. To determine whether a particular Local Standard is "applicable" to a particular debtor, the court must identify the categories of expenses that the Standard is intended to cover. Although the Bankruptcy Code does not incorporate every aspect of the IRS's tax-collection practices, the IRS's authoritative explanation of the National and Local Standards may assist the court in properly applying those Standards.

In its Collection Financial Standards, the IRS explained that "[t]he transportation standards consist of nationwide figures for loan or lease payments referred to as ownership costs, and additional amounts for monthly operating costs broken down by" geographic area. Resp. Br. App. 2a (italics omitted); see *id.* at 16a; see also IRS, *Local Standards: Transportation* (Mar. 18, 2010), http://www.irs.gov/businesses/small/article/0,,id=104623,00.html (current version).[4] The Collection Financial Standards further provide that "[i]f a taxpayer has no car payment, or no car, only the operating costs portion of the transportation standard is used to come up with the allowable transportation expense." Resp. Br. App. 3a.

In giving weight to those statements by the IRS (see Pet. App. 10), the court of appeals did not improperly disregard the text of the Bankruptcy Code. Rather, the court appropriately treated those statements as relevant to the proper interpretation of the pertinent statutory language. The court correctly understood the IRS's explication of the Local Standards governing transportation expenses to establish that the "expense amounts specified under the" vehicle ownership Local Standard

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[4] Petitioner contends (Br. 15, 53) that the vehicle ownership expense is also designed to cover expenses such as taxes and depreciation. That is incorrect. Taxes, including personal property taxes associated with a vehicle, are considered "Other Necessary Expenses" by the IRS; they are not part of the National Standards and Local Standards. See Resp. Br. App. 20a-27a. Depreciation is not an expense but a way to measure the change in a car's value over time. See, *e.g.*, *Black's Law Dictionary* 506 (9th ed. 2009). The transportation expenses in the Local Standards do not account for depreciation of a vehicle; they are designed to determine monthly cash flow, not to measure the value of assets over time.

are not "applicable" to petitioner's own circumstances because those expense amounts pertain to a category of costs that petitioner does not incur.

B. The Statutory Context Confirms That "Applicable" Expenses Are Those The Debtor Will Actually Pay

In interpreting a statutory term, the Court considers not only "the language itself [and] the specific context in which that language is used," but also "the broader context of the statute as a whole." *Robinson* v. *Shell Oil Co.*, 519 U.S. 337, 341 (1997). Here, other provisions of the Bankruptcy Code confirm that a debtor who has no loan or lease payments is not entitled to a vehicle ownership expense deduction.

1. In the subclause immediately following the one at issue here, Congress provided that a "debtor's monthly expenses may include, *if applicable*, the continuation of actual expenses paid by the debtor" to care for an elderly, ill, or disabled household or family member. 11 U.S.C. 707(b)(2)(A)(ii)(II). In that context, the word "applicable" requires a threshold finding that the expense is one the debtor expects to continue paying during the plan period. It would be anomalous to interpret "applicable" to require that showing in Subclause (II), but to preclude it in the portion of Subclause (I) at issue here, when both provisions are designed to determine allowable expenses in bankruptcy. See, *e.g.*, *NASA* v. *FLRA*, 527 U.S. 229, 235 (1999) (word or phrase "should ordinarily retain the same meaning wherever used in the same statute").

Other provisions of the Bankruptcy Code similarly use the term "applicable" to denote rules or procedures that are triggered by the specific factual circumstances of the bankruptcy case. One such provision requires a debtor to file a statement of intention to retain or surrender property and, "if applicable, specify[] that such property is claimed as exempt, that the debtor intends to redeem such property, or that the debtor intends to reaffirm debts secured by such property." 11 U.S.C. 521(a)(2)(A). The word "applicable" is used to signify that the debtor should take only the actions that are justified by his own circumstances.

Similarly, the bankruptcy court may enter a Chapter 11 or 13 discharge only if it finds that 11 U.S.C. 522(q)(1) is not "applicable" to the debtor. 11 U.S.C. 1141(d)(5)(C), 1328(h). Section 522(q)(1) concerns a debtor who has been convicted of a felony that demonstrates the bankruptcy filing is abusive, or who owes a debt arising from certain securities law violations and torts. Here again, determining whether a particular restriction on dischargeability is "applicable" requires an inquiry into the debtor's individual circumstances—*i.e.*, whether he has a conviction or debt of the type specified in Section 522(q)(1).

2. Section 707(b)(2)(A)(ii)(I) refers separately to the debtor's "applicable monthly expense amounts" under the National and Local Standards and his "actual monthly expenses" for the other necessary expense categories allowed by the IRS. 11 U.S.C. 707(b)(2)(A)(ii)(I). Petitioner suggests (Br. 26, 39-42) that, by restricting the vehicle ownership expense deduction to debtors with loan or lease payments, the court of appeals improperly disregarded the statutory distinction between "applicable" and "actual" expenses. That argument misconceives the manner in which the vehicle ownership expense deduction is calculated under the relevant Local Standard.

The IRS Local Standard for vehicle ownership expenses prescribes an amount of $471 for a first car and $332 for a second car. See Resp. C.A. Br. 5a. Although the applicability of that Local Standard depends on the debtor's actual circumstances (*i.e.*, whether the debtor has vehicle loan or lease payments, and if so on how many vehicles), the "expense amounts specified under the National Standards and Local Standards," 11 U.S.C. 707(b)(2)(A)(ii)(I), are standardized amounts that are determined without reference to a particular debtor's actual monthly payments. See, *e.g.*, *Fokkena* v. *Hartwick*, 373 B.R. 645, 650 (D. Minn. 2007). That approach to determining the allowed expense amount is different from Congress's approach to "Other Necessary Expenses." The IRS has not promulgated any table of standardized amounts for those expenses, and the statute requires that "actual" costs be used. 11 U.S.C. 707(b)(2)(A)(ii)(I). This approach "gives meaning to the distinction between 'applicable' and 'actual' without taking a further step to conclude that 'applicable' means 'nonexistent' or 'fictional.'" *In re Ross-Tousey*, 368 B.R. 762, 765 (Bankr. E.D. Wis. 2007), rev'd, 549 F.3d 1148 (7th Cir. 2008).

3. The Collection Financial Standards explain that, when the IRS uses the Local Standards in its tax-collection efforts, "the taxpayer is allowed the amount actually spent or the standard, whichever is less." Resp. Br. App. 1a; see note 3, *supra*. Respondent contends (Br. 12, 45-46) that bankruptcy courts should apply the same methodology in calculating the debtor's monthly expenses under Section 707(b)(2)(A)(ii)(I). Under that approach, a debtor who makes car loan or lease payments that are less than the standardized amounts reflected in the governing IRS table (here, $471 per

month, see Resp. Br. App. 5a), could deduct only his actual monthly payments rather than the standardized amounts.

That argument is not without force, since use of a debtor's actual vehicle ownership expenses (when they are less than the standardized amounts) would more fully accomplish Congress's purpose of making the debtor's entire resources available to unsecured creditors. In the government's view, however, Section 707(b)(2)(A)(ii)(I) is better read to allow a debtor with a car loan or lease payment to deduct the standardized amount even when it is greater than his actual payment. As applied to vehicle ownership expenses, Section 707(b)(2)(A)(ii)(I) thus strikes a balance between precision and ease of administration by requiring a debtor who invokes that deduction to establish the existence, but not the exact amount, of a vehicle loan or lease payment. See pp. 25-26, *infra*.

Section 707(b)(2)(A)(ii)(I) does not incorporate by reference every feature of the IRS's tax-collection methodology, but rather allows the debtor to deduct his "applicable monthly expense amounts specified under the National Standards and Local Standards." Although the IRS in collecting delinquent taxes considers the taxpayer's actual loan or lease payments, those actual "expense amounts" are not "specified" either in the Local Standards themselves or in any accompanying statements, but are instead derived from evidence unique to the particular debtor involved. The only vehicle ownership "expense amounts" that are "specified under the * * * Local Standards," 11 U.S.C. 707(b)(2)(A)(ii)(I), are the standardized amounts ($471 per month for a first car and $332 per month for a second, Resp. Br. App. 5a) listed in the relevant IRS table. The IRS's statement that "the taxpayer is allowed the amount actually spent or the standard, whichever is less," *id.* at 1a, supports this reading of the Bankruptcy Code, since that statement *contrasts* the "standard" with the "amount actually spent" and presumes that the former term refers to the standardized amounts set out in the IRS tables. This reading of Section 707(b)(2)(A)(ii)(I) also accords with the consensus view among the bankruptcy courts, see, *e.g.*, *In re Briscoe*, 374 B.R. 1, 6-7 (Bankr. D.D.C. 2007), and with the view of the Advisory Committee on the Federal Rules of Bankruptcy Procedure (Advisory Committee), see Official Bankr. Forms 22A, 22B & 22C advisory committee's note C.1 (2005-2008). In any event, the Court in this case need not decide the proper deduction for a debtor with vehicle loan or lease payments of less than the standardized amounts, since petitioner has no vehicle loan or lease payments at all.

4. Petitioner also contends (Br. 21, 27-28, 44-45) that he may claim the vehicle ownership expense deduction, even though he has no vehicle loan or lease payments, because 11 U.S.C. 707(b)(2)(A)(ii)(I) further provides that, "[n]otwithstanding any other provision of this clause, the monthly expenses of the debtor shall not include payments for debts." Petitioner's reliance on that sentence is misplaced.

By its terms, the sentence in question operates to *exclude* "payments for debts" from the debtor's "monthly expenses," even when such payments are encompassed by the remaining sentences of Section 707(b)(2)(A)(ii)(I). Under no circumstances can the "notwithstanding" sentence have the effect of authorizing a deduction for an expense that the remainder of Section 707(b)(2)(A)(ii)(I) does not cover. Thus, if the court of appeals' analysis is otherwise sound—*i.e.*, if the amounts specified in the Local Standards for vehicle ownership expenses are not "applicable" to a debtor who has no loan or lease payments—the "notwithstanding" sentence provides no basis for allowing an ownership expense deduction.

Properly understood, the "notwithstanding" sentence serves to ensure that the bankruptcy court does not include unsecured debt payments in the calculation of the debtor's monthly expenses. In addition to forward-looking expenses such as child care and education expenses, the IRS standards for "Other [Necessary] Expenses" include a category for "unsecured debts" and for student loan payments (which are unsecured debts). Resp. Br. App. 21a, 25a-26a. Although the IRS treats these unsecured debts as expenses in determining a taxpayer's ability to pay delinquent taxes, that approach would be inappropriate in the means test calculation under the Bankruptcy Code, since the purpose of that calculation is to determine the amount of money the debtor has available to pay unsecured debts after accounting for his living expenses. Congress therefore excluded "payments for debts" from the list of other expenses the IRS otherwise would allow. See, *e.g.*, *In re Knight*, 370 B.R. 429, 436-437 (Bankr. N.D. Ga. 2007) (applying this reasoning to student loan debts).

The exclusion of "payments for debts" also can serve to avoid double-counting of expenses that could fall within two different expense provisions of the means test. Under 11 U.S.C. 707(b)(2)(A)(iii), a debtor may deduct as monthly expenses certain "payments on account of secured debts." Section 707(b)(2)(A)(ii)(I)'s exclusion of "payments for debts" helps to ensure that a debtor who makes vehicle loan payments may not deduct both the standardized amount set forth in the vehicle ownership Local Standard (under Clause (ii)(I)) and his actual monthly payment (under Clause (iii)). See, *e.g.*, *In re Hardacre*, 338 B.R. 718, 726-727 (Bankr. N.D. Tex. 2006); see also Pet. Br. 33-34 (accepting this view).[5]

C. Allowing Debtors Without Loan Or Lease Payments To Deduct Vehicle Ownership Expenses Would Disserve Congress's Purposes In Enacting BAPCPA And Would Lead To Inequitable Results

Congress enacted the provision at issue here in the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA), Pub. L. No. 109-8, 119 Stat. 23. Congress's overarching objectives in enacting BAPCPA were to ensure that debtors pay as much of their debts as reasonably possible and to eliminate opportunities for abuse. Treating the standardized vehicle ownership expense amounts as "applicable" to debtors who have no loan or lease payments would subvert those goals.

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[5] A vehicle loan payment typically is secured by the vehicle and thus would qualify as a secured debt. There is some uncertainty about how the "notwithstanding" sentence operates in this context. It could be read to allow the debtor to deduct his car loan payment under Clause (iii), but not to claim any amount under Clause (ii), on the theory that the Clause (ii) standardized amount is intended to compensate him for a debt payment. Or it could be read to allow the debtor to deduct his car loan payment under Clause (iii), and claim the portion of the standard amount in Clause (ii) that exceeds his actual debt payment, on the theory that the Clause (ii) amount is an allowance to which the debtor is entitled so long as he has car ownership expenses, and that the "notwithstanding" sentence simply requires him to subtract out any amounts he will actually pay for debts. This is the approach taken on Form 22C, which was developed by the Advisory Committee for use in determining disposable income in Chapter 13 cases. See J.A. 49, 52-53. This debate is far afield from the dispute in this case, however, because petitioner has no loan or lease payments whatsoever.

1. As the House Judiciary Committee report explained, a primary goal of BAPCPA is "to ensure that debtors repay creditors the maximum they can afford." *House Report* 2. The report explained that consumer bankruptcy filings were having significant "adverse consequences for our nation's economy," with creditors passing on to other consumers the substantial losses associated with bankruptcy. *Id.* at 4. The report concluded that those "bankruptcy debtors [who] are able to repay a significant portion of their debts" should do so, and that Congress should eliminate the "loopholes and incentives" in the current bankruptcy system that permit "opportunistic personal filings and abuse." *Id.* at 5.

In order to achieve those objectives, Congress changed the way in which bankruptcy courts would ascertain debtors' ability to repay their creditors. See *House Report* 2 (defining this change as "the heart of [BAPCPA's] consumer bankruptcy reforms"). Before BAPCPA was enacted, a Chapter 13 debtor's "disposable income" was defined as the debtor's current income less the amounts that were "reasonably necessary" for the debtor's "maintenance or support," "charitable contributions," or "business * * * expenditures." 11 U.S.C. 1325(b)(2)(A)-(B) (2000). Because the Bankruptcy Code provided no additional guidance for determining when an expense was "reasonably necessary," bankruptcy courts addressed that question on a case-specific basis. See, *e.g.*, *Hebbring* v. *United States Trustee*, 463 F.3d 902, 907-908 (9th Cir. 2006). In BAPCPA, Congress established a means test to determine whether a debtor seeking Chapter 7 bankruptcy relief has sufficient ability to repay creditors that he should instead be required to proceed under Chapter 13. BAPCPA § 102(a)(1)(C), 119 Stat. 27 (enacting 11 U.S.C.

707(b)(2)). Congress also incorporated that means test into Chapter 13 in order to cabin the amounts that above-median-income debtors may shield from creditors. *Id.* § 102(h)(2), 119 Stat. 33 (enacting 11 U.S.C. 1325(b)(2)-(3)).

2. In revising the method of calculating a debtor's "reasonably necessary" expenses, Congress sought, *inter alia*, to effectuate the Bankruptcy Code's requirement that a Chapter 13 debtor repay creditors to the maximum extent possible before obtaining a discharge. See 11 U.S.C. 1325(b)(1)(B). If petitioner were allowed to claim a vehicle ownership expense deduction that is unrelated to any expense he will actually incur, he would be able to shield approximately $28,000 from creditors over the lifetime of his plan. See p. 5, *supra*. That is precisely the type of "senseless result" Congress wanted to avoid. *Lanning*, 130 S. Ct. at 2475-2476.

Indeed, petitioner's argument suggests that BAPCPA opened rather than closed a loophole for above-median-income debtors. Prior to BAPCPA, petitioner could have deducted from his income only those expenses that he demonstrated were "reasonably necessary." See 11 U.S.C. 1325(b)(2)(A)-(B) (2000). Under that standard, petitioner would not have been allowed to deduct a vehicle ownership expense he did not have. In petitioner's view, however, the changes worked by BAPCPA allow him to deduct such an amount. Such a perverse reading of the statute "flies in the face of all Congress intended to accomplish" in BAPCPA. *In re Washburn*, 579 F.3d 934, 943 (8th Cir. 2009) (Magnuson, J., dissenting).

3. Petitioner's amicus observes (NACBA Br. 22) that "BAPCPA moved bankruptcy courts from a system of case-by-case determinations of reasonableness to a

more uniform approach, based on standardized deductions listed in IRS tables." The amicus is correct that, by incorporating the "expense amounts specified under the National Standards and Local Standards," 11 U.S.C. 707(b)(2)(A)(ii)(I), Congress obviated the need for an individualized determination of all the debtor's actual expenses. But by limiting permissible deductions to the "applicable" expense amounts, Congress made clear that, even with respect to types of expenses for which the IRS Standards prescribe a standardized deduction, the debtor's own circumstances remain relevant to the expense calculation. Allowing a debtor with no loan or lease payments to deduct vehicle ownership expenses would disserve the balance struck by Congress between precision and ease of administration.

The amicus further contends (NACBA Br. 23) that, "[g]iven the inherent uncertainties of predicting a debtor's expenses several years into the future," Congress could reasonably eschew any inquiry into "the particular mix of a debtor's actual vehicle expenses at the time the case is commenced." Petitioner himself concedes (Br. 33), however, that a debtor who claims a vehicle ownership expense must at least make the threshold showing that he owns a car. There is no reason to believe that requiring bankruptcy courts to make the additional determination whether the debtor is making loan or lease payments will meaningfully increase the administrative burden on the courts. And there is likewise no reason to believe that a debtor who owns a vehicle free and clear when his bankruptcy petition is filed is more likely to incur loan or lease payments during the plan period than a debtor who at the time of filing owns no car at all.

4. In addition to furthering the important goal of ensuring that debtors pay their debts to the extent possible, disallowing a vehicle ownership expense deduction under the circumstances presented here fosters equitable treatment of debtors under the Bankruptcy Code. Not only would petitioner's view create a new loophole in the Bankruptcy Code, but it would do so for only one class of Chapter 13 debtors—those with above-median incomes. Under petitioner's view, an above-median-income debtor could shield income from creditors by claiming expenses he will never incur, while a below-median-income debtor would have to prove that each of his expenses—including vehicle ownership expenses—are reasonably necessary under 11 U.S.C. 1325(b). Such a result would loosen expense requirements for the very class of Chapter 13 debtors that Congress wished to scrutinize more closely. Under the court of appeals' approach, by contrast, above-median and below-median debtors are both entitled to deductions only for those types of automobile expenses they actually pay.

Petitioner (Br. 55) and his amicus (NACBA Br. 24-25) suggest that the court of appeals' approach will penalize thrifty debtors who continue to drive old vehicles and encourage debtors to take on additional debt to purchase new cars. The Bankruptcy Code, however, takes the debtor as he is on the date he files his petition. Based on the debtor's financial circumstances at that time, the court determines what amounts he requires for living expenses and what amounts he will be able to pay creditors. *Lanning*, 130 S. Ct. at 2471. As one court explained, "[t]he statute is only concerned about protecting the debtor's ability to continue owning a car, and if the debtor *already* owns the car, the debtor is adequately protected. * * * When the debtor has no monthly ownership expenses, it makes no sense to deduct an ownership expense to shield it from creditors." *In re Ross-Tousey*, 368 B.R. at 766.

Rather than assume that Congress was trying to further policy goals far afield of what the means test was designed to accomplish, this Court should faithfully apply the BAPCPA provisions by which Congress sought to ensure that Chapter 13 debtors—particularly those with higher monthly incomes—will repay creditors as much as they reasonably can afford. In any event, debtors who drive older cars will not in fact be worse off than those who buy new cars, since the former will have less overall debt than the latter. And a thrifty debtor who needs to buy a new car during the life of the plan may seek a plan modification to account for that expense. See 11 U.S.C. 1329(a).

5. Petitioner contends (Br. 17, 60-61) that disallowing a vehicle ownership deduction in the circumstances presented here would deny Chapter 13 bankruptcy relief to himself and to other honest debtors. Petitioner is mistaken. As a general matter, a debtor like petitioner who has a positive monthly disposable income, so that he is able to make regular payments to creditors, should be able to propose a confirmable Chapter 13 plan. See 11 U.S.C. 1325(b) (listing requirements for plan confirmation). In most cases, the debtor's monthly income will be the same during the plan period as it was during the six months before he filed his petition, and his expenses will be the same during the plan period as at the time of filing. See *Lanning*, 130 S. Ct. at 2474-2475; see 11 U.S.C. 707(b)(2) (means test). If it is known or reasonably certain that a debtor's income or expenses will change in a manner that will affect his ability to pay

creditors, the bankruptcy court may account for that prospect in projecting his disposable income over the life of the plan. *Lanning*, 130 S. Ct. at 2471.

Petitioner's belief that he cannot obtain confirmation of a Chapter 13 plan absent a deduction for a vehicle ownership expense appears to rest on errors in his calculation of income and expenses. For example, on Form 22C, the form for calculating Chapter 13 debtors' disposable income, petitioner failed to claim a $70.00 health care expense and a $247.50 retirement deduction expense, even though he identified those expenses on his Schedule J, which lists current expenditures. See J.A. 43, 44, 53, 56; 11 U.S.C. 707(b)(2)(A)(ii)(I) (authorizing deduction of "Other Necessary Expenses," which include health care); 11 U.S.C. 541(b)(7), 1306(a)(1) (authorizing deduction for contributions to qualified retirement plans). Petitioner also listed different income amounts for his income and for taxes on Schedule I (which shows current income) and on Form 22C. See J.A. 43, 45, 50. When these discrepancies are resolved, petitioner's monthly disposable income will be known and he should be able to obtain confirmation of a Chapter 13 plan.

Petitioner is also mistaken in contending (Br. 28, 34) that Form 22C authorizes him to deduct vehicle ownership expenses he will not pay. The form instructs debtors to "[c]heck the number of vehicles for which you *claim* an expense," J.A. 49 (emphasis added), leaving it to the debtor and his attorney to determine whether that expense category is applicable to him. Contrary to petitioner's suggestion (Br. 28-31), the Advisory Committee has not taken the position that debtors who have no loan or lease payments may deduct vehicle ownership expenses. Instead, recognizing the disagreement in the lower courts on this issue, the Committee recently clarified that "[t]he forms take no position on the question of whether the debtor must actually be making payments on a vehicle in order to claim the ownership/lease allowance." Official Bankr. Forms 22A, 22B & 22C advisory committee's note C.1 (2005-2008). In any event, even if the form or the Committee's note supported petitioner's view, they could not trump the text of the statute, which requires the vehicle ownership expense to be "applicable" to the debtor. See, *e.g.*, *Schwab* v. *Reilly*, 130 S. Ct. 2652, 2660 & n.5 (2010).

II. A DEBTOR'S "PROJECTED" DISPOSABLE INCOME SHOULD NOT EXEMPT VEHICLE OWNERSHIP EXPENSES THE DEBTOR WILL NOT INCUR

Even if this Court determines that a debtor without loan or lease payments may deduct a vehicle ownership expense under the means test used to calculate "disposable income," that does not end the matter. As this Court explained in *Lanning*, the Bankruptcy Code requires that all of a Chapter 13 debtor's "projected disposable income" be dedicated to repaying unsecured creditors. In determining the debtor's projected disposable income, the bankruptcy court should take account of the fact that funds claimed as vehicle ownership expenses are in fact available to pay secured creditors.

1. Calculating a Chapter 13 debtor's "disposable income" under the means test in Section 707(b)(2) is only the first step in determining what funds the debtor has available for his repayment plan. In order to confirm the plan, the bankruptcy court must ensure that the amount the debtor proposes to repay uses all the disposable income that the debtor is "projected" to receive over the plan's five-year life span. 11 U.S.C. 1324,

1325(b)(1)(B). As this Court explained in *Lanning*, that two-step process ensures that, in determining the debtor's ability to repay creditors, the court will take account of "known or virtually certain information about the debtor's future income or expenses." 130 S. Ct. at 2475.

2. Even if the means test would mechanically allow every debtor with a vehicle to claim a vehicle ownership expense deduction, the bankruptcy court should take account of the fact that some debtors will not pay those expenses. Here, where it is known that petitioner has no vehicle loan or lease payments, the bankruptcy court should ensure that the amounts petitioner claims under the Local Standard for vehicle ownership expenses are available to creditors as part of his "projected disposable income." That step is necessary so that all of petitioner's available funds can be used to pay unsecured creditors; without it, he will be able to shield more than $28,000 over the lifetime of the plan.

Although the facts of this case are slightly different from those in *Lanning*, the Court's holding and rationale apply equally here. Shortly before filing her bankruptcy petition, the debtor in *Lanning* had received a one-time buyout that made her pre-petition monthly income a demonstrably poor predictor of the income that she could expect to receive during the plan period. 130 S. Ct. at 2470. The Court explained that a "forward-looking approach" was necessary to ensure that the debtor would not be required, as a condition of plan confirmation, to commit to pay more during the plan period than she could actually afford. *Id.* at 2474-2475. Here, deducting vehicle ownership expenses in calculating petitioner's "projected disposable income" would be inappropriate, not because any change in the relevant circumstances has occurred or is expected to occur, but because petitioner currently has no vehicle loan or lease payments and has identified no reason to believe that he will make such payments during the plan period.

The Court in *Lanning* did not limit its holding to changed circumstances; it stated that the bankruptcy court could account for "known or virtually certain *information* about the debtor's future income or expenses" that makes the initial calculation of disposable income a demonstrably unreliable predictor of the debtor's financial condition during the plan period. 130 S. Ct. at 2474-2475 (emphasis added). And the concern that led the Court to the forward-looking approach is directly applicable here. If this Court rejects the construction of Section 707(b)(2)(A)(ii)(I) advocated by the government and by respondent, and holds that the IRS Local Standard for vehicle ownership expenses is "applicable" to petitioner, use of the "mechanical approach" in projecting petitioner's disposable income "would deny creditors payments the debtor could easily make." *Id.* at 2476. Here, as in *Lanning*, there is no reason to "throw[] out undisputed information bearing on how much a debtor can afford to pay." *In re Turner*, 574 F.3d 349, 355 (7th Cir. 2009); accord *In re Wentzel*, 415 B.R. 510, 517-518 (Bankr. D. Kan. 2009) (relying on this reasoning to deny vehicle ownership deduction for individual who had no car loan or lease payments). Accordingly, the fact that petitioner is not "projected" to have any vehicle ownership expenses provides an independent basis for affirming the judgment below.

CONCLUSION

The judgment of the court of appeals should be affirmed.

Respectfully submitted.

NEAL KUMAR KATYAL
Acting Solicitor General

MICHAEL F. HERTZ
Acting Assistant Attorney General

MALCOLM L. STEWART
Deputy Solicitor General

NICOLE A. SAHARSKY
Assistant to the Solicitor General

WILLIAM KANTER
JEFFRICA JENKINS LEE
Attorneys

RAMONA D. ELLIOTT
General Counsel

P. MATTHEW SUTKO
Associate General Counsel

JOHN P. SHEAHAN
CATHERINE B. SEVCENKO
Attorneys
Executive Office for United States Trustees

AUGUST 2010

APPENDIX

1. 11 U.S.C. 707 provides:

Dismissal of a case or conversion to a case under chapter 11 or 13

(a) The court may dismiss a case under this chapter only after notice and a hearing and only for cause, including—

(1) unreasonable delay by the debtor that is prejudicial to creditors;

(2) nonpayment of any fees or charges required under chapter 123 of title 28; and

(3) failure of the debtor in a voluntary case to file, within fifteen days or such additional time as the court may allow after the filing of the petition commencing such case, the information required by paragraph (1) of section 521, but only on a motion by the United States trustee.

(b)(1) After notice and a hearing, the court, on its own motion or on a motion by the United States trustee, trustee (or bankruptcy administrator, if any), or any party in interest, may dismiss a case filed by an individual debtor under this chapter whose debts are primarily consumer debts, or, with the debtor's consent, convert such a case to a case under chapter 11 or 13 of this title, if it finds that the granting of relief would be an abuse of the provisions of this chapter. In making a determination whether to dismiss a case under this section, the court may not take into consideration whether a debtor has made, or continues to make, charitable contributions (that meet the definition of "charitable contribution" under section 548(d)(3)) to any qualified religious or charitable entity or organization (as that term is defined in section 548(d)(4)).

(2)(A)(i) In considering under paragraph (1) whether the granting of relief would be an abuse of the provisions of this chapter, the court shall presume abuse exists if the debtor's current monthly income reduced by the amounts determined under clauses (ii), (iii), and (iv), and multiplied by 60 is not less than the lesser of—

(I) 25 percent of the debtor's nonpriority unsecured claims in the case, or $6,000, whichever is greater; or

(II) $10,000.

(ii)(I) The debtor's monthly expenses shall be the debtor's applicable monthly expense amounts specified under the National Standards and Local Standards, and the debtor's actual monthly expenses for the categories specified as Other Necessary Expenses issued by the Internal Revenue Service for the area in which the debtor resides, as in effect on the date of the order for relief, for the debtor, the dependents of the debtor, and the spouse of the debtor in a joint case, if the spouse is not otherwise a dependent. Such expenses shall include reasonably necessary health insurance, disability insurance, and health savings account expenses for the debtor, the spouse of the debtor, or the dependents of the debtor. Notwithstanding any other provision of this clause, the monthly expenses of the debtor shall not include any payments for debts. In addition, the debtor's monthly expenses shall include the debtor's reasonably necessary expenses incurred to maintain the safety of the debtor and the family of the debtor from family violence as identified under section 309 of the Family Violence Prevention and Services Act,[1] or other applicable Federal law. The expenses included in the debtor's monthly expenses described in the preceding sentence shall be kept confidential by the court. In addition, if it is demonstrated that it is reasonable and necessary, the debtor's monthly expenses may also include an additional allowance for food and clothing of up to 5 percent of the food and clothing categories as specified by the National Standards issued by the Internal Revenue Service.

(II) In addition, the debtor's monthly expenses may include, if applicable, the continuation of actual expenses paid by the debtor that are reasonable and necessary for care and support of an elderly, chronically ill, or disabled household member or member of the debtor's immediate family (including parents, grandparents, siblings, children, and grandchildren of the debtor, the dependents of the debtor, and the spouse of the debtor in a joint case who is not a dependent) and who is unable to pay for such reasonable and necessary expenses.

(III) In addition, for a debtor eligible for chapter 13, the debtor's monthly expenses may include the actual administrative expenses of administering a chapter 13 plan for the district in which the debtor resides, up to an amount of 10 percent of the projected plan payments, as determined under schedules issued by the Executive Office for United States Trustees.

(IV) In addition, the debtor's monthly expenses may include the actual expenses for each dependent child less than 18 years of age, not to exceed $1,500 per year

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[1] See References in Text note below.

per child, to attend a private or public elementary or secondary school if the debtor provides documentation of such expenses and a detailed explanation of why such expenses are reasonable and necessary, and why such expenses are not already accounted for in the National Standards, Local Standards, or Other Necessary Expenses referred to in subclause (I).

(V) In addition, the debtor's monthly expenses may include an allowance for housing and utilities, in excess of the allowance specified by the Local Standards for housing and utilities issued by the Internal Revenue Service, based on the actual expenses for home energy costs if the debtor provides documentation of such actual expenses and demonstrates that such actual expenses are reasonable and necessary.

(iii) The debtor's average monthly payments on account of secured debts shall be calculated as the sum of—

> (I) the total of all amounts scheduled as contractually due to secured creditors in each month of the 60 months following the date of the petition; and
>
> (II) any additional payments to secured creditors necessary for the debtor, in filing a plan under chapter 13 of this title, to maintain possession of the debtor's primary residence, motor vehicle, or other property necessary for the support of the debtor and the debtor's dependents, that serves as collateral for secured debts;

divided by 60.

(iv) The debtor's expenses for payment of all priority claims (including priority child support and alimony claims) shall be calculated as the total amount of debts entitled to priority, divided by 60.

(B)(i) In any proceeding brought under this subsection, the presumption of abuse may only be rebutted by demonstrating special circumstances, such as a serious medical condition or a call or order to active duty in the Armed Forces, to the extent such special circumstances that justify additional expenses or adjustments of current monthly income for which there is no reasonable alternative.

(ii) In order to establish special circumstances, the debtor shall be required to itemize each additional expense or adjustment of income and to provide—

(I) documentation for such expense or adjustment to income; and

(II) a detailed explanation of the special circumstances that make such expenses or adjustment to income necessary and reasonable.

(iii) The debtor shall attest under oath to the accuracy of any information provided to demonstrate that additional expenses or adjustments to income are required.

(iv) The presumption of abuse may only be rebutted if the additional expenses or adjustments to income referred to in clause (i) cause the product of the debtor's current monthly income reduced by the amounts determined under clauses (ii), (iii), and (iv) of subparagraph (A) when multiplied by 60 to be less than the lesser of—

(I) 25 percent of the debtor's nonpriority unsecured claims, or $6,000, whichever is greater; or

(II) $10,000.

(C) As part of the schedule of current income and expenditures required under section 521, the debtor shall include a statement of the debtor's current monthly income, and the calculations that determine whether a presumption arises under subparagraph (A)(i), that show how each such amount is calculated.

(D) Subparagraphs (A) through (C) shall not apply, and the court may not dismiss or convert a case based on any form of means testing, if the debtor is a disabled veteran (as defined in section 3741(1) of title 38), and the indebtedness occurred primarily during a period during which he or she was—

(i) on active duty (as defined in section 101(d)(1) of title 10); or

(ii) performing a homeland defense activity (as defined in section 901(1) of title 32).

(3) In considering under paragraph (1) whether the granting of relief would be an abuse of the provisions of this chapter in a case in which the presumption in subparagraph (A)(i) of such paragraph does not arise or is rebutted, the court shall consider—

(A) whether the debtor filed the petition in bad faith; or

(B) the totality of the circumstances (including whether the debtor seeks to reject a personal services contract and the financial need for such rejection as sought by the debtor) of the debtor's financial situation demonstrates abuse.

(4)(A) The court, on its own initiative or on the motion of a party in interest, in accordance with the procedures described in rule 9011 of the Federal Rules of

Bankruptcy Procedure, may order the attorney for the debtor to reimburse the trustee for all reasonable costs in prosecuting a motion filed under section 707(b), including reasonable attorneys' fees, if—

(i) a trustee files a motion for dismissal or conversion under this subsection; and

(ii) the court—

(I) grants such motion; and

(II) finds that the action of the attorney for the debtor in filing a case under this chapter violated rule 9011 of the Federal Rules of Bankruptcy Procedure.

(B) If the court finds that the attorney for the debtor violated rule 9011 of the Federal Rules of Bankruptcy Procedure, the court, on its own initiative or on the motion of a party in interest, in accordance with such procedures, may order—

(i) the assessment of an appropriate civil penalty against the attorney for the debtor; and

(ii) the payment of such civil penalty to the trustee, the United States trustee (or the bankruptcy administrator, if any).

(C) The signature of an attorney on a petition, pleading, or written motion shall constitute a certification that the attorney has—

(i) performed a reasonable investigation into the circumstances that gave rise to the petition, pleading, or written motion; and

(ii) determined that the petition, pleading, or written motion—

(I) is well grounded in fact; and

(II) is warranted by existing law or a good faith argument for the extension, modification, or reversal of existing law and does not constitute an abuse under paragraph (1).

(D) The signature of an attorney on the petition shall constitute a certification that the attorney has no knowledge after an inquiry that the information in the schedules filed with such petition is incorrect.

(5)(A) Except as provided in subparagraph (B) and subject to paragraph (6), the court, on its own initiative or on the motion of a party in interest, in accordance with the procedures described in rule 9011 of the Federal Rules of Bankruptcy Procedure, may award a debtor all reasonable costs (including reasonable attorneys' fees) in contesting a motion filed by a party in interest (other than a trustee or United States trustee (or bankruptcy administrator, if any)) under this subsection if—

(i) the court does not grant the motion; and

(ii) the court finds that—

(I) the position of the party that filed the motion violated rule 9011 of the Federal Rules of Bankruptcy Procedure; or

(II) the attorney (if any) who filed the motion did not comply with the requirements of clauses (i) and (ii) of paragraph (4)(C), and the motion was made solely for the purpose of coercing a debtor into waiving a right guaranteed to the debtor under this title.

(B) A small business that has a claim of an aggregate amount less than $1,000 shall not be subject to subparagraph (A)(ii)(I).

(C) For purposes of this paragraph—

(i) the term "small business" means an unincorporated business, partnership, corporation, association, or organization that—

(I) has fewer than 25 full-time employees as determined on the date on which the motion is filed; and

(II) is engaged in commercial or business activity; and

(ii) the number of employees of a wholly owned subsidiary of a corporation includes the employees of—

(I) a parent corporation; and

(II) any other subsidiary corporation of the parent corporation.

(6) Only the judge or United States trustee (or bankruptcy administrator, if any) may file a motion under section 707(b), if the current monthly income of the debtor, or in a joint case, the debtor and the debtor's spouse, as of the date of the order for relief, when multiplied by 12, is equal to or less than—

(A) in the case of a debtor in a household of 1 person, the median family income of the applicable State for 1 earner;

(B) in the case of a debtor in a household of 2, 3, or 4 individuals, the highest median family income of the applicable State for a family of the same number or fewer individuals; or

(C) in the case of a debtor in a household exceeding 4 individuals, the highest median family income of the applicable State for a family of 4 or fewer individuals, plus $525 per month for each individual in excess of 4.

(7)(A) No judge, United States trustee (or bankruptcy administrator, if any), trustee, or other party in interest may file a motion under paragraph (2) if the current monthly income of the debtor, including a veteran (as that term is defined in section 101 of title 38), and the debtor's spouse combined, as of the date of the order for relief when multiplied by 12, is equal to or less than—

(i) in the case of a debtor in a household of 1 person, the median family income of the applicable State for 1 earner;

(ii) in the case of a debtor in a household of 2, 3, or 4 individuals, the highest median family income of the applicable State for a family of the same number or fewer individuals; or

(iii) in the case of a debtor in a household exceeding 4 individuals, the highest median family income of the applicable State for a family of 4 or fewer individuals, plus $525 per month for each individual in excess of 4.

(B) In a case that is not a joint case, current monthly income of the debtor's spouse shall not be considered for purposes of subparagraph (A) if—

(i)(I) the debtor and the debtor's spouse are separated under applicable nonbankruptcy law; or

(II) the debtor and the debtor's spouse are living separate and apart, other than for the purpose of evading subparagraph (A); and

(ii) the debtor files a statement under penalty of perjury—

(I) specifying that the debtor meets the requirement of subclause (I) or (II) of clause (i); and

(II) disclosing the aggregate, or best estimate of the aggregate, amount of any cash or money payments received from the debtor's spouse attributed to the debtor's current monthly income.

(c)(1) In this subsection—

(A) the term "crime of violence" has the meaning given such term in section 16 of title 18; and

(B) the term "drug trafficking crime" has the meaning given such term in section 924(c)(2) of title 18.

(2) Except as provided in paragraph (3), after notice and a hearing, the court, on a motion by the victim of a crime of violence or a drug trafficking crime, may when it is in the best interest of the victim dismiss a voluntary case filed under this chapter by a debtor who is an individual if such individual was convicted of such crime.

(3) The court may not dismiss a case under paragraph (2) if the debtor establishes by a preponderance of the evidence that the filing of a case under this chapter is necessary to satisfy a claim for a domestic support obligation.

2. 11 U.S.C. 1325 provides:

Confirmation of plan

(a) Except as provided in subsection (b), the court shall confirm a plan if—

(1) the plan complies with the provisions of this chapter and with the other applicable provisions of this title;

(2) any fee, charge, or amount required under chapter 123 of title 28, or by the plan, to be paid before confirmation, has been paid;

(3) the plan has been proposed in good faith and not by any means forbidden by law;

(4) the value, as of the effective date of the plan, of property to be distributed under the plan on account of each allowed unsecured claim is not less than the amount that would be paid on such claim if the estate of the debtor were liquidated under chapter 7 of this title on such date;

(5) with respect to each allowed secured claim provided for by the plan—

(A) the holder of such claim has accepted the plan;

(B)(i) the plan provides that—

(I) the holder of such claim retain the lien securing such claim until the earlier of—

(aa) the payment of the underlying debt determined under nonbankruptcy law; or

(bb) discharge under section 1328; and

(II) if the case under this chapter is dismissed or converted without completion of the plan, such lien shall also be retained by such holder to the extent recognized by applicable nonbankruptcy law;

(ii) the value, as of the effective date of the plan, of property to be distributed under the plan on account of such claim is not less than the allowed amount of such claim; and

(iii) if—

(I) property to be distributed pursuant to this subsection is in the form of periodic payments, such payments shall be in equal monthly amounts; and

(II) the holder of the claim is secured by personal property, the amount of such payments shall not be less than an amount sufficient to provide to the holder of such claim adequate protection during the period of the plan; or

(C) the debtor surrenders the property securing such claim to such holder;

(6) the debtor will be able to make all payments under the plan and to comply with the plan;

(7) the action of the debtor in filing the petition was in good faith;

(8) the debtor has paid all amounts that are required to be paid under a domestic support obligation and that first become payable after the date of the filing of the petition if the debtor is required by

a judicial or administrative order, or by statute, to pay such domestic support obligation; and

(9) the debtor has filed all applicable Federal, State, and local tax returns as required by section 1308.

For purposes of paragraph (5), section 506 shall not apply to a claim described in that paragraph if the creditor has a purchase money security interest securing the debt that is the subject of the claim, the debt was incurred within the 910-day preceding the date of the filing of the petition, and the collateral for that debt consists of a motor vehicle (as defined in section 30102 of title 49) acquired for the personal use of the debtor, or if collateral for that debt consists of any other thing of value, if the debt was incurred during the 1-year period preceding that filing.

(b)(1) If the trustee or the holder of an allowed unsecured claim objects to the confirmation of the plan, then the court may not approve the plan unless, as of the effective date of the plan—

(A) the value of the property to be distributed under the plan on account of such claim is not less than the amount of such claim; or

(B) the plan provides that all of the debtor's projected disposable income to be received in the applicable commitment period beginning on the date that the first payment is due under the plan will be applied to make payments to unsecured creditors under the plan.

(2) For purposes of this subsection, the term "disposable income" means current monthly income received

by the debtor (other than child support payments, foster care payments, or disability payments for a dependent child made in accordance with applicable nonbankruptcy law to the extent reasonably necessary to be expended for such child) less amounts reasonably necessary to be expended—

> (A)(i) for the maintenance or support of the debtor or a dependent of the debtor, or for a domestic support obligation, that first becomes payable after the date the petition is filed; and
>
> (ii) for charitable contributions (that meet the definition of "charitable contribution" under section 548(d)(3)[1] to a qualified religious or charitable entity or organization (as defined in section 548(d)(4)) in an amount not to exceed 15 percent of gross income of the debtor for the year in which the contributions are made; and
>
> (B) if the debtor is engaged in business, for the payment of expenditures necessary for the continuation, preservation, and operation of such business.

(3) Amounts reasonably necessary to be expended under paragraph (2), other than subparagraph (A)(ii) of paragraph (2), shall be determined in accordance with subparagraphs (A) and (B) of section 707(b)(2), if the debtor has current monthly income, when multiplied by 12, greater than—

> (A) in the case of a debtor in a household of 1 person, the median family income of the applicable State for 1 earner;

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[1] So in original. Probably should be followed by a second closing parenthesis.

(B) in the case of a debtor in a household of 2, 3, or 4 individuals, the highest median family income of the applicable State for a family of the same number or fewer individuals; or

(C) in the case of a debtor in a household exceeding 4 individuals, the highest median family income of the applicable State for a family of 4 or fewer individuals, plus $525 per month for each individual in excess of 4.

(4) For purposes of this subsection, the "applicable commitment period"—

(A) subject to subparagraph (B), shall be—

(i) 3 years; or

(ii) not less than 5 years, if the current monthly income of the debtor and the debtor's spouse combined, when multiplied by 12, is not less than—

(I) in the case of a debtor in a household of 1 person, the median family income of the applicable State for 1 earner;

(II) in the case of a debtor in a household of 2, 3, or 4 individuals, the highest median family income of the applicable State for a family of the same number or fewer individuals; or

(III) in the case of a debtor in a household exceeding 4 individuals, the highest median family income of the applicable State for a family of 4 or fewer individuals, plus $525 per month for each individual in excess of 4; and

(B) may be less than 3 or 5 years, whichever is applicable under subparagraph (A), but only if the plan provides for payment in full of all allowed unsecured claims over a shorter period.

(c) After confirmation of a plan, the court may order any entity from whom the debtor receives income to pay all or any part of such income to the trustee.

BRIEF BANK — “SUMMARY SHEET” *Printed Fri-3/14/08 10:41*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	In Re Real Estate Partners, Inc. (UST v. Real Estate Partners, et al.)
2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	C.D. Cal.
3. ("CCN") ***CURRENT*** CASE NO.	No.: SACV07-1440-AG
4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*	No.: 8:07-13239-TA Court: Bankr. CA *(Identify judge & cite, if any)*
5. ("SO") ***SOURCE***	**U.S. TRUSTEES**
6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	Filed: March 7, 2008 Type: Appellant’s Opening Brief
7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*	P. Matthew Sutko, Walter W. Theus, Jr. and Michael Hauser *(UST/OGC: 202-307-1399/FAX-2397)*
8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	• Did the bankruptcy court err by finding that cause did not exist for the appointment of a Chapter 11 trustee pursuant to 11 U.S.C. § 1104(a)(1), even though the debtors’ pre-bankruptcy management had abdicated their management responsibilities, leaving a void in management that could be filled only by the appointment of an independent fiduciary? √ **Background:**
10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)	
11. DO YOU RECOMMEND POSTING IN UST BRIEFBANK?	☒ YES ☐ NO ***NAME:*** Linda Figueroa ***DATE:***

CASE NO. SACV07-1440-AG

UNITED STATES DISTRICT COURT
FOR THE CENTRAL DISTRICT OF CALIFORNIA

In re:

REAL ESTATE PARTNERS, INC.,
and its related entities,

Affects:
ALL DEBTORS

PETER C. ANDERSON,
UNITED STATES TRUSTEE

Appellant

v.

REAL ESTATE PARTNERS, INC.,
and its related entities,

Affects:
ALL DEBTORS

Appellees

District Court Case Number
SACV07-1440-AG

Bankruptcy Court Case Number
8:07-13239-TA
(Jointly Administered with Case
Nos. 8:07-13239-TA through
8:07-13246-TA)

Adversary Case Number
N/A

Appeal From an Order of the United States Bankruptcy
Court for the Central District of California
Honorable Theodor Albert, Presiding

APPELLANT'S OPENING BRIEF

PETER C. ANDERSON
UNITED STATES TRUSTEE

Michael Hauser (sb# 140165)
Attorney for the U.S. Trustee
OFFICE OF THE UNITED STATES TRUSTEE
411 West 4TH Street, Suite 9041
Santa Ana, CA 92701
Telephone: (714) 338-3400
Facsimile: (714) 338-3421

Of Counsel
ROBERTA A. DeANGELIS
General Counsel

Walter W. Theus, Jr.
U.S. Dept. of Justice
Executive Office for
United States Trustees
20 Massachusetts Ave., NW
Washington, D.C. 20530
Telephone: (202) 307-1399

PETER C. ANDERSON
UNITED STATES TRUSTEE
Michael Hauser (sb# 140165)
Attorney for the U.S. Trustee
OFFICE OF THE UNITED STATES TRUSTEE
411 West 4TH Street, Suite 9041
Santa Ana, CA 92701
Telephone: (714) 338-3400
Facsimile: (714) 338-3421

UNITED STATES DISTRICT COURT
FOR THE CENTRAL DISTRICT OF CALIFORNIA

In re: REAL ESTATE PARTNERS, INC., and its related entities, Affects: ALL DEBTORS	**District Court Case Number** **SACV07-1440-AG** **Bankruptcy Court Case Number** **8:07-13239-TA** (Jointly Administered with Case Nos. 8:07-13239-TA through 8:07-13246-TA) Adversary Case Number **N/A**
PETER C. ANDERSON, UNITED STATES TRUSTEE Appellant v. REAL ESTATE PARTNERS, INC., and its related entities, Affects: ALL DEBTORS Appellees	**APPELLANT'S OPENING BRIEF**

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I.

STATEMENT OF JURISDICTION

The bankruptcy court had jurisdiction under 28 U.S.C. §§ 157(a) and (b) to issue its final order denying the United States Trustee's motion seeking the appointment of a chapter 11 trustee.[1] Pursuant to 28 U.S.C. § 158(a), any final judgment, order, or decree of a bankruptcy court can be appealed to the District Court.

II.

STATEMENT OF ISSUES ON APPEAL

Did the bankruptcy court err by finding that cause did not exist for the appointment of a Chapter 11 trustee pursuant to 11 U.S.C. § 1104(a)(1), even though the debtors' pre-bankruptcy management had abdicated their management responsibilities, leaving a void in management that could be filled only by the appointment of an independent fiduciary?

III.

STANDARD OF REVIEW

On appeal, a bankruptcy court's findings of fact are reviewed for clear error, and its

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[1] The United States Trustee prosecuted the motion for the appointment of a trustee under 11 U.S.C. § 1104(a)(1). Pursuant to 28 U.S.C. § 582 *et seq.*, the United States Attorney General has appointed United States Trustees in 21 geographic regions throughout the United States. United States Trustees are senior officials of the Department of Justice who "supervise the administration of cases and trustees" in all bankruptcy cases within their respective regions through the exercise of a range of oversight responsibilities. 28 U.S.C. § 586(a)(3). *See generally In re Castillo*, 297 F.3d 940, 950 (9th Cir. 2002) (explaining that the United States Trustee is the "watchdog" of the bankruptcy system). United States Trustees may raise, appear, and be heard on any issue in any case or proceeding under title 11. 11 U.S.C. § 307; *See also In re Donovan Corp.*, 215 F.3d 929, 930 (9th Cir. 2000) (upholding broad appellate standing of United States Trustees).

conclusions of law are reviewed *de novo*. *See In re Bibo*, 76 F.3d 256, 258 (9th Cir. 1996). Because the facts underlying this appeal are not in dispute, the *de novo* standard of review applies to this Court's review of the bankruptcy court's conclusions of law.

IV.

STATEMENT OF THE CASE

A. Statutory Framework

A "debtor" is a person who commences a case under the United States Bankruptcy Code. 11 U.S.C. § 101(13). Corporations are persons, making them eligible for chapter 11 bankruptcy relief. 11 U.S.C. § 101(41) (definition of "person"); 11 U.S.C. § 109(b) and (d) (collectively making corporations eligible for chapter 11 relief).

When a debtor files a petition under chapter 11 of the Bankruptcy Code, the debtor ordinarily becomes a "debtor in possession." 11 U.S.C. § 1107(a). The debtor in possession has virtually all of the rights, powers, and duties of a trustee, and accordingly serves as a fiduciary for the bankruptcy estate. *Id.*; *see also Commodity Futures Trading Comm'n v. Weintraub,* 471 U.S. 343, 355 (1985) ("[T]he willingness of courts to leave debtors in possession 'is premised upon an assurance that the officers and managing employees can be depended upon to carry out the fiduciary responsibilities of a trustee.'") (*quoting Wolf v. Weinstein*, 372 U.S. 633, 651 (1963)).

Under § 1104(a)(1) of the Bankruptcy Code, the bankruptcy court "shall" order the appointment of a trustee upon a finding of "cause." The Bankruptcy Code sets forth a non-exclusive list of examples of what can constitute cause, "including fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor . . . ." Because the list of examples is introduced by the word "including," the list is not limiting. 11 U.S.C. § 102(3). The appointment of a chapter 11 trustee is the sole statutory remedy set out in the Bankruptcy Code by which a bankruptcy court may direct the appointment of a fiduciary to replace management of a debtor that is unable or unwilling to fulfill its fiduciary obligations to the estate.

The Bankruptcy Code authorizes bankruptcy courts to issue any order necessary or appropriate to carry out the provisions of the Bankruptcy Code, 11 U.S.C. § 105(a), but specifically prohibits bankruptcy courts from appointing receivers in bankruptcy cases. 11 U.S.C. § 105(b). Nothing in the Bankruptcy Code or Rules authorizes a court to appoint a "responsible person" to exercise the duties of a § 1104(a) trustee.

B. Factual Background

On September 6, 2007, the Securities and Exchange Commission (the "SEC") filed a complaint in the United States District Court for the Central District of California against Real Estate Partners, Inc., seven related entities, Dawson Davenport, and other individuals. This case is now pending as Case No. 8:07-cv-10122-AG-RNB. The SEC alleges that the defendants committed securities fraud in connection with raising $50 million from investors between January 2003 and August 2006. The complaint seeks disgorgement and civil penalties against the defendants. Shortly after filing its complaint, the SEC filed a motion for the appointment of a receiver which the defendants opposed. A hearing on the matter was set for October 9, 2007.

One day before the receiver hearing, on October 8, 2007, Real Estate Partners, Inc., a California Corporation ("REP") and its seven related entities (collectively, the "debtors") filed petitions under chapter 11 of the Bankruptcy Code in the United States Bankruptcy Court for the Central District of California. II ROA at 1032, 1057, 1061, 1066, 1071, 1076, 1080 and 1084.

These cases are being jointly administered as 8:07-13239-TA through 8:07-13246-TA. I ROA at 52-54.

REP purports to be in the business of acquiring, managing and disposing of real estate properties. I ROA at 43. REP is the operating entity for all of the debtors. I ROA at 47. The debtors' primary assets are the interests held by seven debtor entities in real estate projects. As of the petition date, the debtors had approximately $3.7 million in cash on hand along with $150,000 worth of office equipment. The debtors' unsecured claims total approximately $33,141.28, exclusive of the SEC's claims. I ROA at 46-47.

On the first day of the debtors' bankruptcy case, the debtors filed motions seeking an order from the bankruptcy court approving the hiring of a "responsible person" by REP's board of directors and majority shareholder, Davenport. I ROA at 258-360. These first day motions disclosed that REP had entered into an engagement letter with Richard Kipperman on October 5, 2007 to hire him as "responsible person."[2]

On October 12, 2007, the bankruptcy court held a hearing on the debtors' responsible person motions. I ROA at 506. The United States Trustee presented the court with a written opposition before the hearing. I ROA at 65-69. At the hearing, counsel for the SEC made an oral request that the court direct the appointment of a chapter 11 trustee *sua sponte*, which the bankruptcy court denied. I ROA at 530.

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[2] Before the filing of the cases, Dawson Davenport resigned as the CEO of REP, but he retained ultimate control of the debtors as REP's majority shareholder. I ROA at 43. At the time of filing, REP's board of directors consisted of its president, Mr. Thompson, and Mr. Itzel. II ROA at 606-607.

The United States Trustee stated at the hearing that he would be filing a motion for the appointment of a trustee for cause under § 1104(a)(1) of the Bankruptcy Code. The court stated that the debtors' responsible person motions, in and of themselves, established cause and, therefore, the United States Trustee need not submit further evidence to establish cause for the appointment of a trustee. Instead, the court viewed the United States Trustee's upcoming trustee motion as an opportunity for the parties to brief the issue of whether the appointment of the responsible person in lieu of a chapter 11 trustee was appropriate where "cause" exists for the appointment of a chapter 11 trustee under 11 U.S.C. § 1104(a). I ROA at 562-566.

At the conclusion of the hearing the court entered an interim order (the "October 12 order") appointing Mr. Kipperman to serve as a "responsible person" for the period between October 12 and a hearing scheduled for November 19 while the court considered whether to order the appointment of a chapter 11 trustee. I ROA at 556-557. The October 12 order effectively fired the debtors' officers and directors and put a responsible person in place who would act until the November 19 hearing.[3] While the appointment of the responsible person was interim, the removal of management was permanent. The court stated, "There is no scenario under which former management is to return to authority whatsoever. I want to make that very

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[3] The October 12 Order states:

> The Responsible Person shall have (i) the authority, responsibilities, rights, duties and obligations to make all decisions that would otherwise be made by the board of directors, officers, members, and/or trustee of each respective Debtor *and all persons who are presently directors and/or officers of any of the Debtors are accordingly hereby terminated*, and (ii) the authority, responsibilities, rights, duties and obligations to make all decisions associated with the conducting the day to day operations of the Debtors' business.

I ROA at 62. (emphasis added).

clear." I ROA at 559. Between the two hearings, the remaining officers and directors submitted formal letters of resignation, thereby establishing beyond any doubt that the "responsible person" was in complete control of the debtors. II ROA 606-607.

On October 26, 2007, the United States Trustee filed his § 1104(a) motion for appointment of a chapter 11 trustee with the Court. I ROA at 70. The SEC filed pleadings supporting the United States Trustee's motion. II ROA at 781.

The debtors opposed the United States Trustee's motion, claiming that the court-appointed responsible person could constitute "new" management of the debtors who was not tainted by prior management's misconduct, and that, therefore, "cause" would not exist under § 1104(a)(1) to appoint a chapter 11 trustee. II ROA at 568, 580-590. The United States Trustee filed a reply to the opposition, pointing out that because the responsible person was not properly empowered under applicable non-bankruptcy law to manage the debtors, the debtors had no current management. II ROA at 817-818. Accordingly, the United States Trustee asserted that the appointment of a § 1104(a) trustee was necessary to fill the management vacuum created by the wholesale resignation of the debtors' prior management.

On November 19, 2007, the bankruptcy court entertained oral argument on the United States Trustee's Motion and took the matter under submission. II ROA at 957, 1020-1021. On November 20, 2007, the bankruptcy court issued its order (the "November 20 order") denying the United States Trustee's § 1104(a) motion. The November 20 order appointed Mr. Kipperman to serve as a "responsible person" in all eight bankruptcy cases, thus making final the October 12 order. II ROA at 905. The court vested Mr. Kipperman with all of the rights, powers, and duties of a chapter 11 trustee.[4] It is from these orders that the United States Trustee filed his timely notice of appeal.

VI.

SUMMARY OF ARGUMENT

Section 1104(a)(1) of the Bankruptcy Code makes the appointment of a trustee mandatory if "cause" exists. 11 U.S.C. § 1104(a)(1) (the court "shall" order the appointment of a trustee). In this case, the debtors' management abdicated their management responsibilities and the bankruptcy court itself, at the October 12 hearing and in the October 12 order, made it clear that under no circumstances would prior management be permitted to regain control of the companies. This utter absence of management to carry out the duties of a debtor in possession constituted cause under § 1104(a)(1). Given that cause existed, the court below erred in refusing to order the appointment of a § 1104(a) trustee.

The bankruptcy court erred in finding that it could avoid the statutory mandate of § 1104(a) by appointing a "responsible person." The Bankruptcy Code and Rules nowhere

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[4] The October 12 Order also vests Mr. Kipperman with the following powers:

> The authority, responsibilities, rights, powers, duties, and obligations of the Debtors' Responsible Person shall include those set forth in 11 U.S.C. §§ 1106(a), 1107 and 1108, including but not limited to investigating the acts, conduct, assets, liabilities, and, financial affairs of the Debtors, the operation of the debtors' business and the desirability of the continuance of such business, and any other matter relevant to the case or to the formulation of a plan. The Responsible Person shall also have the authority to bring, on behalf of the bankruptcy estate(s), such actions as may be appropriate to recover funds and/or property.

I ROA at 62-63.

recognize the concept of a responsible person. To the contrary, the mandatory nature of a § 1104(a)(1) appointment – that statute uses "shall" – underscores that bankruptcy courts must appoint a trustee when cause exists.

Although the bankruptcy court cited §§ 105(a) and 1107(a) of the Bankruptcy Code in support of its decision to appoint a "responsible person" to perform the duties of a trustee, neither statute empowers the bankruptcy court to refuse to order a trustee appointment in the face of cause. First, it is hornbook law that § 105(a) does not permit a bankruptcy court to exercise its equitable powers to override other explicit mandates of other sections of the Bankruptcy Code such as § 1104(a)(1). Second, the court's power under § 105(a) is specifically limited by § 105(b), which expressly prohibits bankruptcy courts from appointing receivers. The responsible person in this case is a receiver in all but name. Finally, the court's authority to limit a debtor in possession's powers under § 1107(a) cannot fairly be read to authorize the court to appoint replacement management instead of ordering the appointment of a chapter 11 trustee.

The bankruptcy court's apparent reliance on California Corporations Code § 1400 as a source of the court's authority to appoint replacement management for the debtors was also misplaced. Section 1400 is not a corporate governance provision. That statute merely provides that a California corporation that files a chapter 11 petition may amend its articles of incorporation or bylaws to effectuate the terms of a confirmed plan of reorganization without board or shareholder approval. The statute does not empower bankruptcy courts to appoint a "responsible person" during the pendency of the bankruptcy case to supplant management or to fill a management vacuum. Under these circumstances the court's sole remedy is to order the appointment of a chapter 11 trustee.

Finally, the clear weight of authority supports the appointment of § 1104(a) trustees when cause exists and does not support recourse to the non-statutory alternative of a responsible person to appoint or replace the management of a debtor in possession. If management must be appointed or replaced, and if such appointment or replacement cannot be effectuated pursuant to state law, the proper remedy is the appointment of a chapter 11 trustee.

VII.

ARGUMENT

A. Because the debtors' utter absence of management constituted cause under 11 U.S.C. § 1104(a)(1), the appointment of a trustee for these cases was mandatory.

A.1. The appointment of a trustee is mandatory when cause exists under § 1104(a)(1)

Section 1104(a) of the Bankruptcy Code provides as follows:

> (a) At any time after the commencement of the case but before confirmation of a plan, on request of a party in interest or the United States trustee, and after notice and a hearing, the court *shall* order the appointment of a trustee –
>
> (1) for cause, including fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor by current management, either before or after the commencement of the case, or similar cause, but not including the number of holders of securities of the debtor or the amount of assets or liabilities of the debtor . . . .

11 U.S.C. § 1104(a)(1) (emphasis added).

The use of the word "shall" in § 1104(a) mandates the appointment of a trustee when "cause" exists. *See Escoe v. Zerbst*, 295 U.S. 490, 493 ("shall" is the language of command; its use in a statute indicates congressional intent that the statute be mandatory). "The willingness of Congress to leave a debtor-in-possession is premised on an expectation that current management can be depended upon to carry out the fiduciary responsibilities of a trustee. And if the debtor-in-possession defaults in this respect, Section 1104(a)(1) commands that the stewardship of the reorganization effort must be turned over to an independent trustee." *In re Marvel Entertainment Group, Inc.*, 140 F.3d 463, 474 (3rd Cir. 2000), *quoting In re V. Savino Oil & Heating Co., Inc.*, 99 B.R. 518, 526 (Bankr. E.D.N.Y. 1989). *See also In re Oklahoma Refining Company*, 838 F.2d 1133, 1136 (10th Cir.1988).

A.2. The debtors' lack of properly constituted management constituted "cause" for the appointment of a trustee

Although § 1104(a)(1) of the Bankruptcy Code lists a number of examples of what can constitute cause for the appointment of a trustee, that list is not exhaustive. Section 1104(a)(1)'s use of the word "including" to preface the list indicates that the list is not limiting. 11 U.S.C. § 102(3) (rule of construction establishing that "including" is "not limiting"). *See also In re Savino Oil & Heating Co., Inc.*, 99 B.R. 518 (Bankr. E.D.N.Y. 1989).

The total absence of duly empowered management is "cause" for the appointment of a § 1104(a) chapter 11 trustee. The usual presumption in favor of allowing a debtor's management to remain in the case vanishes completely when management does not or cannot perform its fiduciary duties. *See Commodity Futures Trading Comm'n v. Weintraub,* 471 U.S. 343, 355 (1985) ("[T]he willingness of courts to leave debtors in possession 'is premised upon an assurance that the officers and managing employees can be depended upon to carry out the fiduciary responsibilities of a trustee.'") (*quoting Wolf v. Weinstein*, 372 U.S. 633, 651 (1963)).

In this case, the debtors' prepetition officers and board of directors sought in the responsible person motions to completely get out of the business of running these debtors. They agreed to turn over their state law management duties to a person who would answer only to the bankruptcy court. By their motions, they demonstrated their unwillingness to manage the debtors in possession and acknowledged their lack of fitness to perform the necessary tasks. Indeed, the bankruptcy court's October 12 order expressly terminated all officers and directors of the debtors who were serving on that date. As the court stated at the October 12 hearing, "[t]here is no scenario under which former management is to return to authority whatsoever. I want to make that very clear." I ROA at 559. As of that date, therefore, the debtors had no management. This lack of management, in and of itself, constituted clear cause for the appointment of a chapter 11 trustee.

Rather than relying upon § 1104(a)(1) by ordering the appointment of a trustee, the federal bankruptcy court sought to replace the debtors' state law officers and directors by appointing a "responsible person" who would be answerable only to the court. The court then went on to analyze the case as if Mr. Kipperman was "new management."

Once the bankruptcy court effectively fired the debtors' officers and directors, the court had no choice but to order the appointment of a § 1104(a) trustee. The court's error was in concluding that it was not required to order the appointment of a § 1104(a) trustee to effectuate a change in management. In a case with quite analogous facts to those at bar, the Bankruptcy Appellate Panel for the First Circuit concluded that, if a debtor's duly authorized management must be displaced, the court's only alternative is to order the appointment of a chapter 11 trustee.

In *In re Casco Bay Lines, Inc.*, 17 B.R. 946 (B.A.P. 1st Cir. 1982), the bankruptcy judge to whom the case was originally assigned barred the debtor's principal stockholders, directors, and officers from any participation in or control of the debtor in possession. The court ordered that a former owner of the debtor's business be hired as the debtor's sole operating officer. *Id.* at 949.

Upon the death of the former owner, the control of the debtor's case was assumed by the debtor's attorney. *Id.* The original bankruptcy judge was later appointed to the district court. The bankruptcy judge to whom the case was reassigned raised issues about the management of the debtor in possession, and convened a hearing to consider whether a chapter 11 trustee should be appointed. Relying upon the dearth of properly constituted corporate management, the bankruptcy court found that cause existed for the appointment of a trustee and ordered the appointment of a chapter 11 trustee.

On appeal, the Bankruptcy Appellate Panel affirmed. The court found that the following undisputed facts mandated the trustee appointment: "(1) The principal officers had been barred from any participation in the management of the debtor; (2) new "management" had been installed by the court; and (3) no trustee had been appointed." *Id.* Affirming the bankruptcy court, the Bankruptcy Appellate Panel observed that in a chapter 11, there is either a debtor in possession or a trustee. Because the owners and officers of the debtor had been "ordered not in any way to have anything further to do with management of the company, that is the usual grounds for appointment of a Trustee, both under law and simple logic." *Id.* at 951. The court further held that

> . . . a Chapter 11 reorganization contemplates only two possible scenarios for control of the debtor's business operations: a debtor in possession, or a debtor out of possession. The latter situation contemplates and mandates the appointment of a trustee. . . . [E]ither the debtor must be in control, or the court will authorize the appointment of a trustee to take control of the debtor's affairs. Furthermore, the phrase "in possession" not only means physical possession, but actual control over decisions regarding conduct of the business. In sum, the debtor, to be in possession, must have some form of control over its business destiny and be able to make the day to day business decisions required of its operation.

Id. The court observed that "the appointment of a trustee is the only statutorily authorized alternative to a debtor in possession. The bankruptcy court is specifically prohibited from appointing a receiver. 11 U.S.C. § 105(b)." *Id.* at 952. The court concluded:

> Because a corporation is an inanimate legal entity, it acts only through its officers and agents. In this case, the court removed those agents from control and in effect replaced them with "new management". The court had no authority under the Bankruptcy Code to do so. Once it removed the debtor's agents from control, it had no alternative but to authorize those agents to be replaced with a trustee.

Id.

This case is factually indistinguishable from *Casco Bay Lines*. Just as the bankruptcy court in *Casco Bay Lines* had removed that debtor's managers from power and attempted to replace them with its designated representative, the court here sought to remove the debtors' management and replace them with Mr. Kipperman.

Worse, the alleged "management structure" used in this case, as imposed by the October 12 order and as confirmed by the November 20 order, is in derogation of California law. Under California law, "the business and affairs of the corporation shall be managed and all corporate powers shall be exercised by or under the direction of the board [of directors]." California Corporations Code § 300(a). Corporate officers, who are agents of the corporation, are "chosen by the board and serve at the pleasure of the board . . . ." California Corporations Code § 312(b). Mr. Kipperman clearly does not serve at the pleasure of the board of directors, as all pre-petition officers and directors have been terminated by order of the bankruptcy court. The October 12 order appointing Mr. Kipperman as the responsible person states that he answers only to the court. I ROA at 62-63. Mr. Kipperman is therefore not properly empowered under California corporate law to manage these debtors. Because Mr. Kipperman is not "current management" of the debtors, the debtors suffer from a management vacuum.

B. Because cause existed, the bankruptcy court was required by § 1104(a) to order the appointment of a chapter 11 trustee.

B.1. Neither § 105(a) nor § 1107(a) empowers a court to appoint a responsible person instead of ordering the appointment of a § 1104(a) trustee.

(a) 11 U.S.C. § 105(a)

When "cause" exists for the appointment of a trustee, Congress has established only one remedy that can supplant management while allowing the case to remain in chapter 11 – the appointment of a trustee pursuant to 11 U.S.C. § 1104(a). Because § 1104(a) expressly and specifically sets forth a mechanism for the appointment of an independent fiduciary to replace management of a debtor in possession, debtors and bankruptcy courts cannot ignore this provision by writing alternative remedies into the Code, such as the employment of a "responsible person" who would act as quasi-trustee. The court must be faithful to the plain meaning of the Bankruptcy Code's provisions, as drafted by Congress, and read them narrowly. *See, e.g., Lamie v. United States Trustee,* 540 U.S. 526, 533 (2004) (strictly interpreting 11 U.S.C. § 330(a)(1)). There is no "quasi-trustee" provision in the Code, and Congress has provided for no such entity. Any such alternative remedy would nullify the mandatory nature of trustee appointments as expressed in § 1104(a). See H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 402 (1977).

The bankruptcy court relied on 11 U.S.C. § 105(a) in holding that it had the authority to appoint a responsible person in lieu of a trustee. Section 105(a) of the Bankruptcy Code provides, in relevant part, that "[t]he court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of [the Bankruptcy Code]." 11 U.S.C. § 105(a). While this provision does grant bankruptcy courts broad equitable powers, it does not create substantive rights that would otherwise be unavailable under the Bankruptcy Code. *See In re Continental Airlines*, 203 F.3d 203, 211 (3d Cir. 2000); *United States v. Sutton,* 786 F.2d 1305, 1308 (5th Cir. 1986).

And it is universally accepted that a court cannot employ § 105(a) to ignore, supersede, misconstrue any bankruptcy statute or rule. *GAF Corp. v. Johns-Manville Corp. (In re Johns-Manville Corp.*), 26 B.R. 405, 414-18 (Bankr. S.D.N.Y.). As the Supreme Court has held, "Whatever equitable powers remain in the bankruptcy courts must and can be exercised within the confines of the Bankruptcy Code." *Northwest Bank Worthington v. Ahlers*, 485 U.S. 197, 206 (1988).

Accordingly, a court may not use § 105(a) to disregard specific Code sections addressing an issue and cannot use it to achieve a result not contemplated by the Code, such as the substitution of a so-called "responsible person" for a § 1104 trustee. *See In re Fesco Plastics Corp.*, 996 F.2d 152 (7th Cir. 1993). Thus, § 105(a) can only be used to carry out provisions of the Bankruptcy Code, not to engraft new provisions onto the statute that Congress neither enacted nor intended. *See Southern Ry. Co. v. Johnson Bronze Co.*, 758 F. 2d 137, 141 (3d Cir. 1985).

While the bankruptcy court's decision cited to its general equitable power under § 105(a), neither the court nor the debtors addressed the specific limitation on that power contained in § 105(b): "Notwithstanding subsection (a) of this section, a court may not appoint a receiver in a case under this title." 11 U.S.C. § 105(b). Legislative history underlying this prohibition could not be more clear: "[T]he bankruptcy judge is prohibited from appointing a receiver in a case under title 11 under any circumstances. The Bankruptcy Code has ample provision for the appointment of a trustee when needed. Appointment of a receiver would simply circumvent the established procedures." S. Rep. No. 989, 95th Cong., 2d Sess. 29 (1978). While the responsible person in this case is not called a "receiver" by name, he clearly is exercising the types of powers and performing the duties traditionally performed by receivers. *See Casco Bay Lines,* 17 B.R. at 952 ("[T]he appointment of a trustee is the only statutorily authorized alternative to a debtor in possession. The Bankruptcy Court is specifically prohibited from appointing a receiver. 11 U.S.C. § 105(b)").

Significantly, a recent decision from the United States Bankruptcy Court for the Southern District of New York rebuffed efforts by parties in interest to have the court rely on § 105(a) to appoint a non-trustee fiduciary. *In re Adelphia Comm. Corp.*, 336 B.R. 610 (Bankr. S.D.N.Y. 2006). The court made short shrift of the argument, pointing out that § 1104 calls for only two kinds of fiduciaries – trustees and examiners. *Id. at* 664. The movant had not shown grounds for a trustee appointment, and had not sought an examiner appointment. The bankruptcy court held that "[a]ppointing a trustee equivalent, under these circumstances, would be doing exactly what the Second Circuit told the lower courts *not* to do: using section 105(a) 'to create substantive rights that are otherwise unavailable under applicable law' and to 'invent remedies that overstep statutory limitations.'" *Id.* at 664 (footnotes omitted)(emphasis in original). The *Adelphia* court's analysis is compelling and should be followed here.

(b) 11 U.S.C. § 1107(a)

The bankruptcy court also cited § 1107(a) of the Bankruptcy Code as a source of its power to appoint a responsible person. Section 1107(a) provides that the debtor in possession will have most of the rights, powers, and duties of a chapter 11 trustee, "subject . . . to such limitations or conditions as the court prescribes. . . ." 11 U.S.C. § 1107(a). The bankruptcy court relied on § 1107(a) in its November 20 order: "Under 11 U.S.C. § 1107(a) the corporate debtor in possession has all of the powers and duties of a trustee *subject to such limitations or conditions as the court prescribes.* In effect, not only the assets of the estate but its governance as well are *in custodia legis.*" II ROA at 913 (emphasis in original). This reliance on § 1107 to support an order supplanting corporate management with a court-appointed quasi-trustee is plainly wrong.

The court in *Adelphia* extensivly analyzed § 1107(a) and declined to rely on that statute as a legal basis to circumvent § 1104(a) and to appoint non-statutory fiduciaries. The court observed that the circumstances under which a bankruptcy court exercises its discretion to prescribe conditions and limitations on normal debtor in possession status should be relatively limited, and that the court's power to prescribe additional conditions and limitations restricting normal debtor in possession rights and powers should be exercised with restraint. *Adelphia,* 336 B.R. at 665. The court expressed considerable doubt over whether § 1107(a) may be read as a license for a court to circumvent or displace more specific sections of the Code any more than § 105(a) may. *Id.* The court concluded that it might be "altogether forbidden" from using § 1107(a) to impose limitations on the rights of a debtor in possession that circumvented other sections of the Bankruptcy Code. *Id.* at 666.

The *Adelphia* court correctly recognized that bankruptcy courts may not properly rely on § 1107(a) as a source of authority to appoint or supplant estate fiduciaries. Section 1107(a) cannot be fairly read as an appointment statute. The drafters of the Bankruptcy Code knew how to create a power to appoint a person to serve in an office in a bankruptcy case. *See, e.g.*, 11 U.S.C. § 701 (appointment of interim Chapter 7 trustees); 11 U.S.C. § 1104(d) (appointment of Chapter 11 trustees and examiners); 11 U.S.C. § 1202 (appointment of Chapter 12 trustees); and 11 U.S.C. § 1302 (appointment of Chapter 13 trustees). While § 1107(a) clearly enables a court to place some limitations on the duties of a debtor in possession, it does not even implicitly authorize the court to appoint a person to perform those duties.

In point of fact, the Bankruptcy Code already specifically states who should perform duties the debtor in possession is ordered not to perform. If the court believes that a debtor should not perform some of the ordinary duties of a trustee that should nevertheless be performed, the proper course of action is to order the appointment of an examiner under 11 U.S.C. § 1104(c) to perform those duties. Section 1106(b), which sets out the duties of an examiner, states that an examiner shall, in addition to conducting an investigation and filing a report, perform, "except to the extent that the court order otherwise, any other duties of the trustee that the court orders the debtor in possession not to perform." The remedy is not, however, to appoint a responsible person pursuant to no express statutory authority.

B.2. California Corporations Code § 1400 does not empower the bankruptcy court to appoint an independent fiduciary

In its November 20 order, the bankruptcy court also relied on California Corporations Code § 1400 as additional authority for its appointment of the responsible person. That section provides in pertinent part:

> (a) Any domestic corporation with respect to which a proceeding has been initiated under any applicable statute of the United States, as now existing or hereafter enacted, relating to reorganizations or arrangements of corporations, has full power and authority to put into effect and carry out any plan of reorganization or arrangement and the orders of the court or judge entered in such proceeding and may take any proceeding and do any act provided in the plan or directed by such orders, without further action by its board or shareholders. Such power and authority may be exercised and such proceedings and acts may be taken, as may be directed by such orders, by the trustee or trustees of such corporation appointed in the reorganization or arrangement proceeding (or a majority thereof), or if none is appointed and acting, by officers of the corporation designated or a master or other representative appointed by the court or judge, with like effect as if exercised and taken by unanimous action of the board and shareholders of the corporation.
>
> (b) Such corporation may, in the manner provided in subdivision (a), but without limiting the generality or effect of subdivision (a), alter, amend or repeal its bylaws; constitute or reconstitute its board and name, constitute or appoint directors and officers in place of or in addition to all or some of the directors or officers then in office...

California Corporations Code § 1400.

This statute is not a corporate governance provision. Instead, it "merely provides that an existing corporation which files for reorganization under the Bankruptcy Code may amend its articles of incorporation or bylaws to effectuate the terms of a plan of reorganization without board or shareholder approval." *In re Mahoney*, 80 B.R. 197, 202 (Bankr. S.D. Cal. 1987); *see also* R. Franklin Balotti & Jesse A. Finklestein, *Delaware Law of Business Corporations and Business Organizations* § 11.15 (2007) (virtually identical Delaware statute intended to enable a corporation to effectuate a confirmed plan without further action by the directors or stockholders). When viewed properly, therefore, section 1400 has no bearing on the power of the bankruptcy court to enter an order; it simply provides that California corporations may implement lawful orders of the bankruptcy court. The bankruptcy court's holding that section

1400 creates an independent source of power under which it may approve the appointment of an independent fiduciary in a bankruptcy case must therefore be rejected.[5] *See Mahoney* at 202 (nothing in section 1400 authorizes the bankruptcy court to enter an order creating an entity violative of existing California corporations law).[6]

B.3. The great weight of case law does not support the appointment of responsible persons in lieu of chapter 11 trustees when cause exists.

In its November 20 order, the bankruptcy court cited to two older cases, *In re Gaslight Club, Inc.*, 782 F.2d 767 (7th Cir. 1986) and *In re FSC Corp.*, 38 B.R. 346 (Bankr. W.D. Penn.1983), in support of the appointment of the responsible person. These decisions are neither

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[5] Seven of these eight debtors are either Nevada Limited Liability Companies or Nevada Business Trusts. I ROA at 62. California Corporations Code § 1400 could therefore not possibly grant the Court authority to appoint a responsible person for them. In changing management of these entities, the debtors must comply with Nevada state laws.

[6] If section 1400 is properly interpreted to simply direct California corporations to implement lawful orders of bankruptcy courts, the statute could in no way be considered to be inconsistent with federal law. If, on the other hand, section 1400 is construed to provide bankruptcy courts with the power to appoint estate fiduciaries, serious questions of federal preemption might arise. The Ninth Circuit Court of Appeals has pointed out that

> [t]here can be no doubt that federal bankruptcy law is "pervasive" and involves a federal interest "so dominant" as to "preclude enforcement of state laws on the same subject"-much like many other areas of congressional power listed in Article I, Section 8, of the Constitution, such as patents, copyrights, currency, national defense and immigration. The Bankruptcy Clause, which grants Congress the power to make bankruptcy laws, U.S. Const. art. I, § 8, cl. 4, stresses that such rules must be "uniform." Bankruptcy law occupies a full title of the United States Code. It provides a comprehensive system of rights, obligations and procedures, as well as a complex administrative machinery that includes a special system of federal courts and United States Trustees.

Sherwood Partners, Inc. v. Lycos, Inc., 394 F.3d 1198, 1201 (9th Cir. 2005). In light of this broad preemption by the federal Bankruptcy Code of inconsistent state statutes, the enforceability of a state statute that purports to enable a bankruptcy court to enter orders inconsistent with clear provisions of the Bankruptcy Code is questionable.

controlling nor persuasive, and the great weight of authority since those cases were decided rejects the notion that a bankruptcy court may appoint a responsible person in lieu of appointing a trustee.

Both *Gaslight* and *FSC* relied exclusively on § 105(a), §1107(a), and state corporate statutes to justify their decisions upholding the power of the bankruptcy court to appoint a responsible person in a chapter 11 case instead of ordering the appointment of a chapter 11 trustee. The analyses in sections B.1 and B.2 of this brief demonstrate that none of these justifications are legally sound. The flawed legal reasoning of *Gaslight* and *FSC* cannot serve to support the flawed legal reasoning of the bankruptcy court in this case.

While *Gaslight* was decided over twenty years ago, it has not been widely followed. Reported decisions almost universally reject its underlying premises or limit its holding to cases where all parties consent to the "responsible person" appointment. *See, e.g., In re 1031 Tax Group, LLC,* 2007 WL 2085384 at * 3 fn. 4 (Bankr. S.D.N.Y. , July 17, 2007) ("Sections 105(a) and 1107(a) may empower a bankruptcy court to prevent a debtor from removing a manager, officer or director, but they do not provide the Court with an independent power of appointment."); (*In re Adelphia Comm. Corp.*, 336 B.R. 610, 668 (Bankr. S.D.N.Y. 2006) (A request for the appointment of an "independent fiduciary" "that is in substance if not name a trustee, and represents a back-door means of circumventing the statutory requirements, and case law, applicable to the appointment of trustees under section 1104 . . . . is not the type of relief that, in this Court's view, it should exercise its discretion to grant."); *In re Suncruz Casinos, LLC*, 298 B.R. 821, 832 (Bankr. S.D. Fla. 2003) ("[T]he Committee recommends that the Court appoint a "responsible Person" in lieu of a trustee, in the event the Court determines that Debtors' management should be replaced. . . . The Bankruptcy Code expressly provides for appointment of a trustee when a debtor's management is replaced. The Code does not contemplate appointment of a 'responsible Person' to perform the duties of a trustee."); *In re National Century Financial Enterprises, Inc.*, 292 B.R. 850 (Bankr. S.D. Ohio 2003) (Court rejected request to vest crisis manager with exclusive rights and powers of a debtor in possession); *In re Freedlander, Inc., The Mortg. People*, 86 B.R. 66, 68 (Bankr. E.D. Va. 1988) (adoption of "responsible person" rationale would enable every debtor to defeat a trustee motion by nominating its own successor; this result is not contemplated by the Bankruptcy Code); *but cf. In re United Press Int'l, Inc.*, 60 B.R. 265 (Bankr. D.D.C. 1986) (court relied on *Gaslight* to support order vesting CEO with management powers over the debtor).

In light of this near unanimity in post-*Gaslight* reported decisions, it is not surprising that *Collier On Bankruptcy,* perhaps the most frequently cited bankruptcy treatise, treats responsible person appointments with barely-disguised disdain:

> *It is really unnecessary to misinterpret the Code and look for ways to circumvent its provisions.* In an appropriate case, section 1104 can be utilized to provide the proper persons to run the business and assist in the reorganization. *When a court finds that management should be replaced, that should be sufficient cause under section 1104(a)(1) to order the appointment of a trustee.*

7 Collier On Bankruptcy ¶ 1104.03[6][a], at 1104-50 (15th Ed. Rev.) (footnotes omitted) (emphasis added).

Thus, the bankruptcy court's decision to appoint a responsible person instead of directing the appointment of a chapter 11 trustee cannot withstand scrutiny under either the governing sections of the Bankruptcy Code or under the great weight of case law and other authorities that have considered the issue. The decision must be reversed.

VIII.

CONCLUSION

For the foregoing reasons, the United States Trustee respectfully requests that this Court reverse the decisions of the bankruptcy court and vacate the order appointing Mr. Kipperman as the responsible person and grant the United States Trustee's motion for the appointment of a chapter 11 trustee.

Respectfully submitted,

OFFICE OF THE UNITED STATES TRUSTEE

Dated: 3/6/08

Michael Hauser

Michael J. Hauser
Attorney for the United States Trustee
Department of Justice

STATEMENT OF RELATED CASES

Pursuant to Ninth Circuit Rule 28-2.6, Appellant hereby identifies the following related case. On September 6, 2007, the Securities and Exchange Commission (the "SEC") filed a complaint in the United States District Court for the Central District of California against Real Estate Partners, Inc., seven related entities, Dawson Davenport, and other individuals. This case is now pending as Case No. 8:07-cv-10122-AG-RNB. The SEC alleges that the defendants committed securities fraud in connection with raising $50 million from investors between January 2003 and August 2006. The complaint seeks disgorgement and civil penalties against the defendants. Shortly after filing its complaint, the SEC filed a motion for the appointment of a receiver which the defendants opposed. A hearing on the matter was set for October 9, 2007.

One day before the receiver hearing, on October 8, 2007, Real Estate Partners, Inc., and its seven related entities filed petitions under chapter 11 of the Bankruptcy Code in the United States Bankruptcy Court for the Central District of California.

Respectfully submitted,

OFFICE OF THE UNITED STATES TRUSTEE

Dated: 3/6/08

Michael Hauser

Michael J. Hauser
Attorney for the United States Trustee
Department of Justice

CERTIFICATE OF SERVICE

I am employed in the County of Orange, State of California, in the Office of the United States Trustee under the supervision of a member of the bar of this Court at whose direction the service was made; I am over the age of 18 and not a party to the within action; and my business address is 411 W. Fourth Street, Suite 9041, Santa Ana, California 92701-8000.

On March 7, 2008, I served the document described as **APPELLANTS OPENING BRIEF** on the following parties at their last known address in this action by placing a true and correct copy thereof in a sealed envelope with postage thereon fully in the U.S. mail at Santa Ana, California, addressed as follows:

APPELLANTS' COUNSEL:
WINTHROP COUCHOT
ATTN: GARRICK HOLLANDER, ESQ.
660 NEWPORT CENTER DRIVE, 4TH FL.
NEWPORT BEACH, CA 92660

ATTORNEY FOR JOINT COMMITTEE OF EQUITY HOLDERS:
JEFFREY K. GARFINKLE, ESQ.
RICHARD P. ORMOND, ESQ.
BUCHALTER NEMER
18400 VON KARMAN AVE., #800
IRVINE, CA 92612-0514

OTHER INTERESTED PARTIES:
KAREN MATTESON, ESQ.
U.S. SECURITIES AND EXCHANGE COMMISSION
5670 WILSHIRE BLVD., 11TH FL.
LOS ANGELES, CA 90036

I declare under penalty of perjury under the laws of the United States of America that the foregoing is true and correct.

Dated: 3/7/08

Tari King
TARI KING
Legal Clerk

BRIEF BANK — "SUMMARY SHEET" *Printed Wed-5/28/08 12:4*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*
In re real Estate Parnter, Inc. (UST v. Real Estate Partners, Inc.)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*
D. Cal.

3. ("CCN") ***CURRENT*** CASE NO.
No.: SACv07-1440-AG

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*
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Court: Bankr. Cal.
(Identify judge & cite, if any)

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Michael Hauser, Walter W. Theus, P. Matthew Sutko, Peter c. Andersen, Roberta A. DeAngelis
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***
• Whether the absence of duly constituted management constitutes cause for the appointment of a trustee under 11 U.S.C. § 1104(a)(1). Whether a court can avoid appointing a trustee by appointing management in violation of state corporate governance law.

10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)

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CASE NO. SACV07-1440-AG

UNITED STATES DISTRICT COURT
FOR THE CENTRAL DISTRICT OF CALIFORNIA

In re: REAL ESTATE PARTNERS, INC., and its related entities, Affects: ALL DEBTORS	**District Court Case Number SACV07-1440-AG** **Bankruptcy Court Case Number 8:07-13239-TA** (Jointly Administered with Case Nos. 8:07-13239-TA through 8:07-13246-TA) Adversary Case Number **N/A**
PETER C. ANDERSON, UNITED STATES TRUSTEE Appellant v. REAL ESTATE PARTNERS, INC., and its related entities, Affects: ALL DEBTORS Appellees	

Appeal From an Order of the United States Bankruptcy
Court for the Central District of California
Honorable Theodor Albert, Presiding

APPELLANT'S REPLY BRIEF

PETER C. ANDERSON
UNITED STATES TRUSTEE

Michael Hauser (sb# 140165)
Attorney for the U.S. Trustee
OFFICE OF THE UNITED STATES TRUSTEE
411 West 4TH Street, Suite 9041
Santa Ana, CA 92701
Telephone: (714) 338-3400
Facsimile: (714) 338-3421

Of Counsel
ROBERTA A. DeANGELIS
General Counsel

Walter W. Theus, Jr.
U.S. Dept. of Justice
Executive Office for
United States Trustees
20 Massachusetts Ave., NW
Washington, D.C. 20530
Telephone: (202) 307-1399

PETER C. ANDERSON
UNITED STATES TRUSTEE
Michael Hauser (sb# 140165)
Attorney for the U.S. Trustee
OFFICE OF THE UNITED STATES TRUSTEE
411 West 4TH Street, Suite 9041
Santa Ana, CA 92701
Telephone: (714) 338-3400
Facsimile: (714) 338-3421

UNITED STATES DISTRICT COURT
FOR THE CENTRAL DISTRICT OF CALIFORNIA

In re:

REAL ESTATE PARTNERS, INC.,
and its related entities,

Affects:
ALL DEBTORS

PETER C. ANDERSON,
UNITED STATES TRUSTEE

Appellant

v.

REAL ESTATE PARTNERS, INC.,
and its related entities,

Affects:
ALL DEBTORS

Appellees

District Court Case Number
SACV07-1440-AG

Bankruptcy Court Case Number
8:07-13239-TA
(Jointly Administered with Case
Nos. 8:07-13239-TA through
8:07-13246-TA)

Adversary Case Number
N/A

APPELLANT'S REPLY BRIEF

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I.
INTRODUCTION

When stripped to its essence, the appellees' position is that a chapter 11 debtor should be able to name its own bankruptcy fiduciary pursuant to an extra-statutory procedure in lieu of the appointment of a bankruptcy trustee under established statutory procedures. Their arguments in favor of this extraordinary proposition lose sight of the following:

(1) The United States Trustee sought the appointment of a trustee in these cases because the debtors have no legally constituted management, and this absence of management constitutes cause for the appointment of a trustee under 11 U.S.C. § 1104(a)(1);

(2) This case has nothing to with any conduct engaged in by the debtor's former management, with the sole exception of their decision to abdicate their authorities as officers, directors, shareholders, and interest holders, which is a matter of record;

(3) This case has nothing to do with any misconduct by Mr. Kipperman;

(4) What matters in this case is the end result of the process by which Mr. Kipperman acquired complete control over these bankruptcy estates, not whether he was first retained by the debtors and then approved by the bankruptcy court, or whether he was appointed by the bankruptcy court; and

(5) It is uncontroverted that Mr. Kipperman has, since the entry by the bankruptcy court of the October 12 order, completely controlled the affairs of the debtors free from any supervision by a board of directors, the debtors' equity holders, with this control being subject only to further orders of the bankruptcy court.

In light of the foregoing, the issue in this appeal case can be restated simply: Is Mr. Kipperman "new management" of the debtors? While the appellees' brief describes Mr. Kipperman as new management as if this were a given, they do not address the fact that Mr. Kipperman occupies a position *vis-a-vis* the debtor California corporation that cannot be described as management under any reading of California corporate law. If Mr. Kipperman were truly an officer of the debtors duly elected by and answerable to an independent board of directors untainted by prepetition fraud and abuse, the United States Trustee would not have sought the appointment of a trustee in the absence of other grounds. Because he is not, federal law mandates that a chapter 11 trustee must be appointed.

The appellees' brief is replete with content that is either irrelevant, inaccurate or both. In the limited space available here, the United States Trustee will address those points that are crucial to this Court's determination of this appeal.

II.
ARGUMENT

A. Mr. Kipperman is not management of the debtor California corporation.

While the appellees' entire argument hinges off of the proposition that Mr. Kipperman is "new management" of the debtors, they assiduously avoid any mention of the corporate governance provisions of the California Corporations Code discussed in the United States Trustee's brief. Appellant's Brief at 13-14. Mr. Kipperman is not a member of the debtor's board of directors, whose duty under California law is to manage the business and affairs of the debtor and to exercise or to direct the exercise of all corporate powers. California Corporations Code § 300(a). The bankruptcy court's October 12 order disbanded the board of directors. To be an officer of the corporate debtor, Mr. Kipperman must have been chosen by and serve at the pleasure of the board of directors. California Corporations Code § 312(b). While Mr. Kipperman may have been originally brought on board by the corporate debtor's former board of directors, he no longer serves at the pleasure of a board of directors, as no such board exists. In fact, the October 12 order states categorically that Mr. Kipperman answers only to the bankruptcy court. I ROA at 62-63.

The appellees seek solace in the *1031 Tax Group* decisions, but they are plainly distinguishable. There the court ultimately concluded that the debtors had taken appropriate steps under applicable state laws to remove a tainted former manager and to have the selected turnaround manager assume complete control as the sole manager, sole director, or partner of the entities, which were corporations, limited liabilities, and partnerships. *In re The 1031 Tax Group, LLC,* 374 B.R. 78, 89 (Bankr. S.D.N.Y. 2007). In other words, the court concluded as a matter of applicable non-bankruptcy law that the debtors had new management that was untainted by connections to old management. It is noteworthy that the court in *1031 Tax Group* rejected out of hand the proposition that it could appoint or approve the appointment of a "responsible person." It stated that the only manner in which the bankruptcy court may impose upon state law corporate governance is by directing the appointment of a chapter 11 trustee under § 1104(a) of the Bankruptcy Code. *In re The 1031 Tax Group*, 2007 WL 2085384 (Bankr. S.D.N.Y.) at *3 fn. 4. Here, Mr. Kipperman cannot be found to be management, because the California corporation has no board of directors.

The appellees seek a lifeline in California Corporations Code § 1400. As the United States Trustee discussed in his opening brief, this statute is not a corporate governance provision. Appellant's brief at 18-20. Instead, it empowers a corporation to put into effect corporate changes mandated by a confirmed plan of reorganization or court orders implementing such a plan without board or shareholder approval. The appellees seek to distinguish *In re Mahoney*, 80

B.R. 197 (Bankr. S.D. Cal. 1987), where the bankruptcy court concluded that § 1400 did not empower the court to confirm a plan of reorganization that would impose upon a reorganized debtor a non-cumulative shareholder voting structure that ran afoul of California corporate law. *Id.* at 202. This was a holding, not *dictum* as stated by the appellees. While the appellees claim that *Mahoney* "narrowly" construes § 1400, the secondary source cited by the appellees itself recognizes that the amendments, changes or other authorizations ordered by the bankruptcy court must be "authorized under the General Corporation Law." 9 *Witkin Summary of California Law*, Corp § 191, 963 (2005) (quoted by Appellees' brief at 29). Just as the court in *Mahoney* recognized that it could not dispense with cumulative voting when such voting is required by California law, a bankruptcy court cannot through the appointment of a "responsible person" dispense with the California law requirement that a corporation be managed by a board of directors elected by the shareholders of the corporation. Because § 1400 provided the bankruptcy court with no independent authority to appoint Mr. Kipperman to serve as management of these estates, the estates had no duly constituted corporate management from and after the entry by the court of the October 12 order relieving the board of directors of all power.

B. The absence of duly constituted management constitutes cause for the appointment of a trustee under 11 U.S.C. § 1104(a)(1)

The appellees assert that cause exists for the appointment of a trustee under § 1104(a)(1) only if current management has committed misconduct. This is incorrect. While § 1104(a)(1) lists various types of misconduct by current management as being examples of cause, the use of the word "including" demonstrates that this list is not exhaustive. 11 U.S.C. § 102(3); Appellant's Brief at 10. The Supreme Court has held that the willingness of courts to leave debtors in possession is dependent upon an assurance that corporate management can be depended upon to carry out the fiduciary responsibilities of a trustee. *Commodity Futures Trading Comm'n v. Weintraub*, 471 U.S. 343, 355 (1985). In the absence of a board of directors properly constituted and operating under California law, the debtor cannot remain in possession. Cause therefore exists and a trustee must be appointed.

The decision of the first circuit bankruptcy appellate panel in *In re Casco Bay Lines, Inc.*, 17 B.R. 946 (B.A.P. 1st Cir. 1982), discussed in Appellant's Brief at pages 11-13, is directly on point here. The appellees seek to distinguish the decision based upon factual differences between these cases and the *Casco Bay Lines* case. While the facts of *Casco Bay Lines* and these cases differ, not one difference is a legally cognizable distinction. The appellees expend much paper and ink discussing the fact that Poulos, the person in charge of the debtor in *Casco Bay Lines,* suffered from conflicts of interest while Mr. Kipperman does not. The *Casco Bay Lines* court specifically discounted these conflicts of interest as a reason for its decision, however: "[T]he question of whether Poulos is a disinterested party is superfluous in view of what we conclude was the judge's real reason for authorizing the appointment of a trustee." *Id.* at 951. The court found that the bankruptcy court's "real reason" for authorizing the appointment of a trustee was that a chapter 11 estate could be operated only by a debtor in possession or a trustee, and that if a corporate debtor's owners and officers have been removed from control of the debtor, the debtor is no longer "in possession" and cause necessarily exists for the appointment of a trustee. *Id.* at 951-52. This holding is equally applicable to the present cases.

C. Whether Mr. Kipperman was chosen by the debtors' prior management or appointed by the court is irrelevant. He is now serving as a receiver in violation of § 105(b) of the Bankruptcy Code.

Because cause exists for the appointment of a trustee, the bankruptcy court erred in failing to direct such an appointment without regard to whether Mr. Kipperman is a receiver appointed in violation of § 105(b) of the Bankruptcy Code. Any rational interpretation of the Bankruptcy Code will, however, establish that Mr. Kipperman is in fact serving as such a receiver.

The appellees cannot seem to decide whether it best suits their case for Mr. Kipperman to have been employed by the debtors' prior management or appointed by the bankruptcy court. They attempt to resolve this problem by seeking to have it both ways. They argue that Mr. Kipperman cannot be a receiver appointed by the court in violation of § 105(b) of the Bankruptcy Code because he was employed by the debtors. Appellee's Brief at 18. They seek to distinguish *Casco Bay Lines* based upon the fact that Mr. Kipperman was chosen by the debtors, while the responsible person in *Casco Bay Lines* was chosen by the court. Appellees' Brief at 15. Elsewhere in the brief, they assert that Mr. Kipperman is untainted by the debtors' prepetition conduct because he "was not selected by prior management . . . ." Appellees' brief at 13. They also argue that California Corporations Code § 1400 "clearly provides an independent basis for the bankruptcy court to appoint a representative on behalf of the corporation . . . ." Appellees' brief at 29.

This semantic exercise is necessitated by the appellees' efforts to show that Mr. Kipperman is not a receiver appointed by the bankruptcy court in violation of the express statutory prohibition found in § 105(b) of the Bankruptcy Code. They claim that Mr. Kipperman cannot be a receiver prohibited by § 105(b) because he was not involuntarily foisted upon them by the court and because his duties extend beyond the mere preservation of property pending litigation. Appellees' brief at 18-19. They cite *In re Madison Avenue Ltd. Partnership*, 213 B.R. 888 (Bankr. S.D.N.Y. 1997) in support of their very limited definition of "receiver." But the bankruptcy court in *Madison Avenue Ltd. Partnership* itself distinguished between two types of receivers. First is the ordinary receiver appointed pre-bankruptcy by a non-bankruptcy court to preserve property pending litigation, such as a receiver appointed to operate mortgaged property pending a foreclosure. Such a receiver may be permitted to retain possession and control of property of a debtor after a bankruptcy filing, 11 U.S.C. § 543(d), but the receiver will not have any of the rights, powers, and duties of a trustee or a debtor in possession. 213 B.R. at 894.

The second type of receiver identified by the *Madison Avenue Ltd. Partnership* court is a receiver appointed *in a bankruptcy case*. The court noted that while receiver appointments were common in cases under the Bankruptcy Act of 1898, such appointments are expressly prohibited by § 105(b) of the Bankruptcy Code. *Id.* at 894 n. 13. Two circuit courts have also recognized the distinction between equity receivers and bankruptcy receivers. *See Cassidy Land and Cattle Co., Inc. v. Craig*, 836 F.2d 1130, 1133 (8th Cir. 1987) (§ 105(b) precludes a bankruptcy court from appointing a receiver in lieu of a trustee, but does not limit authority of court to appoint a receiver to take possession of mortgaged property of a third party pending a foreclosure instituted by the bankruptcy trustee); *In re Memorial Estates, Inc.*, 797 F.2d 516, 519 (7th Cir. 1986) (distinguishing between bankruptcy receiver and equity receiver; appointment of bankruptcy receiver in lieu of a trustee prohibited by § 105(b)). That § 105(b) prohibits the appointment of bankruptcy receivers is made clear by the legislative history of that provision. "[T]he bankruptcy judge is prohibited from appointing a receiver in a case under title 11 under any circumstances. The Bankruptcy Code has ample provision for the appointment of a trustee when needed. Appointment of a receiver would simply circumvent the established procedures." S. Rep. No. 989, 95th Cong., 2d Sess. 29 (1978).

The appellees argue that Mr. Kipperman cannot be a receiver prohibited by § 105(b) because they consented to his appointment. But the consent of a debtor, or of all parties to a bankruptcy case for that matter, cannot vest the bankruptcy court with power expressly denied it by the Bankruptcy Code. No legally cognizable difference exists between a situation where a debtor consents to a court order vesting all of the debtor's rights as debtor in possession in a person selected by the debtor and one where the court vests all of the debtor's rights as a debtor in possession in a person over the objection of the debtor. The end result is the same. The debtor's estate is subject to the complete control of a person who is neither a true debtor in possession nor a trustee. Either process "circumvents the procedures" established by the Bankruptcy Code for the selection of independent fiduciaries. Under those procedures, the United States Trustee appoints chapter 11 trustees after consultation with parties in interest, subject to the right of creditors to elect a candidate of their choice. *See* 11 U.S.C. § 1104(d), (b).

That Mr. Kipperman is not just a representative of the debtor in possession is clear from the court's October 12 order, which substantially expanded his authority. While the debtors granted Mr. Kipperman broad control over their operations under his Engagement Letter, he remained subject to termination by the board of directors. I ROA at 268. The October 12 order gave Mr. Kipperman exceedingly broad control over the affairs of the debtors. It also terminated "all person who are presently directors and/or officers of any of the Debtors." I ROA at 62. This termination was effectuated by the court, not by the debtors themselves. Even more tellingly, the October 12 order vested in Mr. Kipperman all of the authority, responsibilities, rights, powers, duties and obligations set forth in 11 U.S.C. §§ 1106(a), 1107, and 1108, including but not limited to the obligation to investigate the debtors under § 1106(a)(3). This obligation cannot have derived from the debtors in possession, as § 1107(a) specifically excludes the trustee's duty to investigate from the duties vested in a debtor in possession. Because Mr. Kipperman's legal powers and obligations under the October 12 order exceed those of a debtor in possession, he cannot be a debtor in possession. As he clearly is not a trustee, the inescapable conclusion is that he is a receiver appointed in violation of § 105(b).

D. *Gaslight, FSC,* and the only two reported cases that followed them were incorrectly decided.

The appellees rely heavily on *In re Gaslight Club, Inc.*, 782 F.2d 767 (7th Cir. 1986) and *In re FSC Corp.*, 38 B.R. 346 (Bankr. W.D. Penn. 1983) to support their arguments. They claim that there is "substantial federal case law" following these cases.

It is telling that the appellees are able to marshal precisely two reported decisions following these cases in the last 21 years. *See In re United Press International, Inc.*, 60 B.R. 265 (Bankr. D.C. 1986) and *In re Communications Options*, 299 B.R. 481 (Bankr. S.D. Ohio 2003). The other post-*Gaslight* cases cited by the appellees are inapposite. As was discussed above, the court in *1031 Tax Group* expressly found that it did not have the authority to appoint a responsible person. Furthermore, while the Ninth Circuit bankruptcy appellate panel noted in *In re Guy F. Atkinson Co. of Cal.,* 242 B.R. 497 (B.A.P. 9th Cir. 1999) that a responsible person had been appointed to manage and represent the estates, the propriety of such an appointment was not the issue before the court.[1]

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[1] Similarly, the Ninth Circuit court of appeals cannot be said to have implicitly approved the appointment of responsible persons in *In re Boileau*, 736 F.2d 503 (9th Cir. 1984). The propriety of such an appointment was not before the court on appeal. Instead the issue was whether the responsible person had the authority to waive the debtor's attorney-client privilege.

The United States Trustee's opening brief discusses at length the fallacies in the legal rationale of *Gaslight* and *FSC*. Appellant's Brief at 14-20. The limited reported authority that follows these cases suffers from the same shortcomings. One additional point should be made. The appellees cite *Gaslight* for the incorrect proposition that Fed. R. Bankr. P. 9001(5) authorizes a responsible person appointment. Appellee's Brief at 23. By its very terms, this rule applies to only two situations involving debtors who are not natural persons. The first is when an action is required *by the rules* to be performed *by the debtor*. An example of such an action would be the filing of schedules and statements of affairs under Fed. R. Bankr. P. 1007. The second is when it is necessary to compel attendance of a debtor for examination, such as an examination under Fed. R. Bankr. P. 2004. The rule does not, and indeed cannot, enable the court to designate the person to exercise the powers and perform the duties of a debtor in possession. Those powers and duties arise under the Bankruptcy Code, not under the rules. Under 28 U.S.C. § 2075, bankruptcy rules may not "abridge, enlarge, or modify any substantive right." The Bankruptcy Code substantively requires that the fiduciary duties of a trustee be performed by either a trustee or by the debtor in possession, and this requirement cannot be changed by rule.

The appellees struggle mightily to distinguish each of the numerous cases cited by the United States Trustee in his opening brief that held that responsible person appointments are not appropriate. Space does not permit the United States Trustee to refute each of these purported distinctions; suffice it to say that each represents an immaterial factual difference that was not germane to the court's decision.

Finally, the appellees cannot distinguish *Collier on Bankruptcy*, because it is a treatise, albeit the most authoritative in the bankruptcy field. As was noted in the United States Trustee's opening brief, the *Collier* editors reject the "responsible person" out of hand. Appellant's Brief at 22.

E. Because the facts in this case are undisputed and establish that cause exists, the United States Trustee has met the burden of proof.

One fact is salient to the determination of the legal issue presented by this appeal, and that fact is not in dispute. Since the entry by the bankruptcy court of the October 12 order, Mr. Kipperman, a person with no ownership interest in or prior relationship with the debtors, has been in complete control of the debtor's estates, vested with all of the rights, powers, and duties of a chapter 11 trustee, and only subject to supervision by the bankruptcy court. As was discussed above, this fact alone establishes cause for the appointment of a trustee, without regard to whether the burden of proof is clear and convincing or preponderance of the evidence.

The appellees nevertheless assert that the United States Trustee seeks an "extraordinary remedy" against which there is a "strong presumption" and grounds for which must be proven with "clear and convincing evidence." Appellee's brief at 8. While the United States Trustee acknowledges that cases can be found to support each of these propositions, these decisions are not well-grounded in the statutory language of the Bankruptcy Code or in its legislative history.[2] For instance, nothing in the language of § 1104 warrants the requirement that the proponent of a trustee appointment present the court with clear and convincing evidence. *See In re Tradex Corp.*, 339 B.R. 823 (D. Mass. 2006) (relying on *Grogan v. Garner*, 498 U.S 279 (1991) to hold

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[2] For a full discussion of the development of these propositions, *see* Clifford J. White III & Walter W. Theus, Jr., *Chapter 11 Trustees and Examiners After BAPCPA*, 80 Am. Bank. L.J. 289, 314-18 (2006)

that proper burden of proof for appointment of chapter 11 trustee is preponderance of the evidence). This Court need not address these issues to decide this appeal, however.

F. Even if the standard of review is "abuse of discretion," the bankruptcy court abused its discretion because it had no legal discretion to refuse to direct the appointment of a trustee in the face of clear cause.

The appellees' discussion of the standard of review is confusing. Appellees' Brief at 1-2. They appear to posit a two part test. They first cite several Ninth Circuit cases for the general proposition that an appellate court will apply an abuse of discretion standard in reviewing a lower court's decision to order the appointment of a chapter 11 trustee. *See, e.g.*, *In re Lowenschuss*, 171 F.3d 673 (9th Cir. 1999).[3] They then say that factual determinations are to be reviewed under a clearly erroneous standard. The appellees do not address the standard for reviewing conclusions of law.

The United States Trustee stands by his position that the bankruptcy court's determinations of fact should be reviewed for clear error and its conclusions of law should be reviewed *de novo*. In point of fact, these two standards, when combined, comprise the "abuse of discretion" standard advanced by the appellees. A trial court abuses its discretion if it basis its ruling on an erroneous view of the law or on a clearly erroneous assessment of facts. *See*

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[3] It should be noted that *In re San Joaquin Roast Beef*, 7 F.3d 1413 (9th Cir. 1993), cited by the appellees, had nothing whatsoever to do with whether grounds existed for the appointment of a trustee under § 1104(a). In that case the trustee himself, having failed to bring a cause of action within the statute of limitations period, sought an order vacating the order approving his appointment and the reentry of an order on a later date so that he could bring the action. The circuit court held that the bankruptcy court did not abuse its discretion by refusing to engage in this sleight of hand with the trustee. *Id.* at 1418. The appellees' citation to this decision is misleading at best.

Coughlin v. Tailhook Ass'n, 112 F.3d 1052, 1055 (9th Cir. 1997); *U.S. v. Plainbull,* 957 F.2d 724, 725 (9th Cir. 1992).

The proper application of the abuse of discretion standard does not grant a court discretion to enter relief contrary to statutory mandates. *See Cann v. Carpenters' Pension Trust Fund for Northern California,* 989 F.2d 313, 318 (9th Cir. 1993) (district court did not abuse its discretion in refusing to apply a multiplier to damages, as it had no statutory discretion to do so); *Mississippi Power & Light Co. v. United Gas Pipe Line Co.*, 760 F.2d 618, 629 (5th Cir. 1985) (although the grant of a preliminary injunction is reviewed under an abuse of discretion standard, the court has no discretion to grant such relief absent an adequate showing of likely irreparable harm).

Once a court determines that cause exists for the appointment of a trustee under § 1104(a)(1) of the Bankruptcy Code, the court has no discretion; a trustee must be appointed. *See In re V. Savino Oil & Heating Co., Inc.*, 99 B.R. 518, 525 (Bankr. E.D.N.Y. 1989); *In re Oklahoma Refining Company*, 838 F.2d 1133, 1136 (10th Cir. 1988). The bankruptcy court's failure to direct the appointment of a trustee in the face of the cause resulting from the debtors' absence of management is therefore reversible error, without regard to whether it is treated as an error of law or an abuse of discretion.

G. The U.S. Trustee is not "judicially estopped" from contesting the validity of responsible person appointments.

At pages 20-21 of their brief, the appellees assert that the United States Trustee is judicially estopped from opposing the appointment of a responsible person because the United States Trustee has previously either consented to or failed to object to responsible person appointments. Leaving aside for the moment whether this is an appropriate case for judicial estoppel, it should be noted that the United States Trustee for the Central District of California has very recently opposed the appointment of a responsible person. In May of 2006, in a case styled *In re National Consumer Mortgage* (SA 06-10429-TA) the United States Trustee successfully moved for the appointment of a chapter 11 trustee while opposing the appointment of a responsible person. That case factually paralleled these cases, as it arose in the wake of an SEC investigation of investment fraud by one of the debtor's insiders, Sam Favata. II ROA at 825, 839, and 862. Even more recently, in June of 2007, in the case of *In re Branford Partners, LLC* (SV 06-12551-KT) the United States Trustee opposed the appointment of a responsible person. II ROA at 874-81.

"Judicial estoppel" is an equitable doctrine that precludes a party from gaining an advantage by asserting one position in litigation, and then later seeking an advantage by taking a clearly inconsistent position. *Hamilton v. State Farm Fire & Cas. Co.*, 270 F.3d 778, 782 (9th Cir. 2001). As a matter of law, judicial estoppel only applies when a party takes a position, generally on a factual issue, in a case for its benefit and then takes a contrary position in the same case or in a related case with the same party when it suits its needs. *New Hampshire v. Maine*, 532 U.S. 742, 749 (2001). Contrary to the appellee's assertion, the Ninth Circuit has never held that a party, having taken a position on a legal issue in one case, is judicially estopped from taking a contrary position in all future cases, whether related or not. The appellees have cited no case holding that a party, having merely acquiesced in a legal position taken by parties in a case, was later estopped from taking a contrary legal position in a different case involving different parties. The court of appeals has held that judicial estoppel will not prevent a government agency from changing its interpretation of a statute; "public policy considerations allow the government to change its position in ways that might be inappropriate if merely a matter of private interest." *New Edge Network, Inc. v. F.C.C.* , 461 F.3d 1105, 1114 (9th Cir. 2006). Yet this is the result that the appellees ask this court to reach. If the appellees' argument were to be accepted, the U.S. Department of Justice, merely by consenting to or not objecting to relief sought in one or more bankruptcy cases, would be deemed to have foresworn for all time its right to argue that the relief is not appropriate under the Bankruptcy Code. This Court should reject the appellees' argument in favor of an unwarranted and radical expansion of the equitable doctrine of judicial estoppel that would threaten the ability of the Department of Justice and other federal agencies to continually refine their views of the statutes they deal with on a daily basis.

III.

CONCLUSION

For these reasons, the United States Trustee asks this Court to reverse the bankruptcy court's orders and remand with instructions that the bankruptcy court enter an order directing the appointment of a chapter 11 trustee.

Respectfully submitted,

OFFICE OF THE UNITED STATES TRUSTEE

Dated: 5/20/08

Michael Ha

Michael J. Hauser
Attorney for the United States Trustee
Department of Justice

CERTIFICATE OF SERVICE

I am employed in the County of Orange, State of California, in the Office of the United States Trustee under the supervision of a member of the bar of this Court at whose direction the service was made; I am over the age of 18 and not a party to the within action; and my business address is 411 W. Fourth Street, Suite 9041, Santa Ana, California 92701-8000.

On May 20, 2008, I served the document described as **APPELLANT'S REPLY BRIEF** on the following parties at their last known address in this action by placing a true and correct copy thereof in a sealed envelope with postage thereon fully in the U.S. mail at Santa Ana, California, addressed as follows:

APPELLANTS' COUNSEL:
WINTHROP COUCHOT
ATTN: GARRICK HOLLANDER, ESQ.
660 NEWPORT CENTER DRIVE, 4TH FL.
NEWPORT BEACH, CA 92660

ATTORNEY FOR JOINT COMMITTEE OF EQUITY HOLDERS:
JEFFREY K. GARFINKLE, ESQ.
RICHARD P. ORMOND, ESQ.
BUCHALTER NEMER
18400 VON KARMAN AVE., #800
IRVINE, CA 92612-0514

OTHER INTERESTED PARTIES:
KAREN MATTESON, ESQ.
U.S. SECURITIES AND EXCHANGE COMMISSION
5670 WILSHIRE BLVD., 11TH FL.
LOS ANGELES, CA 90036

I declare under penalty of perjury under the laws of the United States of America that the foregoing is true and correct.

Dated: 5/20/08

Tari King
TARI KING
Legal Clerk

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2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]* C.D. Cal.

3. ("CCN") ***CURRENT*** CASE NO. No.: 07-04357

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*
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Court: Bankr. C.D. Cal.
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(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC*** **BANKRUPTCY**

9. ("SU") ● ***SUMMARY*** OF KEY ISSUE(s)
● Did the Bankruptcy Court err in dismissing the debtor's case under 11 U.S.C.§ 707(b)?

&

√ Any Miscellaneous ***BACKGROUND***
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PETER C. ANDERSON
UNITED STATES TRUSTEE
Jennifer L. Braun, No. 130932
Assistant United States Trustee
OFFICE OF THE UNITED STATES TRUSTEE
21051 Warner Center Lane, Suite 115
Woodland Hills, California 91367
Telephone: (818) 716-8800; Fax: (818) 716-1576

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UNITED STATES DISTRICT COURT

CENTRAL DISTRICT OF CALIFORNIA

In re **PETER AND ANDREA REED,** **Debtors.**	**District Court Case No.** **CV 07-04357-MMM** **Bankruptcy Court Case No.** **ND 06-10901-RR**
PETER AND ANDREA REED, **Appellant,** **v.** **UNITED STATES TRUSTEE,** **PETER C. ANDERSON,** **Appellee.**	**Chapter 7** **APPELLEE'S OPENING BRIEF**

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STATEMENT OF APPELLATE JURISDICTION

The bankruptcy court had jurisdiction under 28 U.S.C. §§ 157(a) and (b), and 1334(a) to issue its final order granting the United States Trustee's motion to dismiss the Reeds' chapter 7 bankruptcy case[1]. That order was entered on the docket on May 29, 2007, from which the Reeds filed a timely notice of appeal under 28 U.S.C. § 158(c)(2) and Fed. R. Bankr. P. 8002(a). This Court has appellate jurisdiction under 28 U.S.C. § 158(a)(1).

STATEMENT OF ISSUE PRESENTED

Did the bankruptcy court err in dismissing the Reeds' bankruptcy case under 11 U.S.C. § 707(b)?

STATEMENT OF APPLICABLE STANDARD OF REVIEW

This Court "reviews a bankruptcy court order dismissing a chapter 7 case for abuse of discretion; legal conclusions are reviewed de novo, and factual findings are reviewed for clear error." *In re Hebbring* 463 F.3d 902, 905 (9th Cir. 2006).

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[1] The United States Trustee prosecuted the motion to dismiss under 11 U.S.C. § 707(b). Pursuant to 28 U.S.C. § 581, *et seq.* the United States Attorney General has appointed United States Trustees in 21 geographic regions throughout the United States. United States Trustees are senior officials of the Department of Justice who "supervise the administration of cases and trustees" in all bankruptcy cases within his or her region through the exercise of a range of oversight responsibilities. 28 U.S.C. § 586(a)(3). *See generally In re Castillo*, 297 F.3d 940, 950 (9th Cir. 2002) (explaining that the United States Trustee is the "watchdog" of the bankruptcy system). United States Trustees may raise, appear, and be heard on any issue in any case or proceeding under title 11. 11 U.S.C. § 307; *See also In re Donovan Corp.*, 215 F.3d 929, 930 (9th Cir. 2000) (upholding broad appellate standing of United States Trustees).

Whether the bankruptcy court properly interpreted the Bankruptcy Code provisions is an issue of law subject to *de novo* review.

STATEMENT OF THE CASE

On November 30, 2006, Peter and Andrea Reed filed a petition for relief under chapter 7 of the Bankruptcy Code. (Excerpt of Record ("ER") at 1). On February 15, 2007, the United States Trustee filed a motion to dismiss the Reeds' case, asserting that their chapter 7 case was abusive under 11 U.S.C. § 707(b). (ER at 77).

The United States Trustee sought dismissal under two different theories. First, that a statutory presumption of abuse arose in the Reeds' case which mandated its dismissal as a matter of law under 11 U.S.C. § 707(b)(2). In the alternative, the United States Trustee asserted that the Reeds' case should be dismissed because the totality of their financial circumstances demonstrated that their use of chapter 7 was abusive, as prescribed by 11 U.S.C. § 707(b)(3)(B) .

On May 29, 2007, the bankruptcy court entered an order granting the United States Trustee's motion to dismiss on both grounds. (ER at 247). This appeal followed. (ER at 273 - 279).

STATEMENT OF THE FACTS

A. Statutory Framework

1. Overview of 11 U.S.C. § 707(b)

On October 17, 2005, most provisions of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (the "2005 Reform Act"), S. 256, Pub. L. No. 109-8, 119 Stat. 23, took effect implementing significant changes to the Bankruptcy Code. In it, Congress made sweeping changes "to improve bankruptcy law and practice by restoring personal responsibility and integrity in the bankruptcy system and ensure that the system is fair to both debtors and creditors." H.R. Rep. No. 31(I), at 2, 109 Cong., 1st Sess. (2005), reprinted in 2005 U.S.C.C.A.N. 88, 97.

As part of this effort, Congress made significant changes to section 707(b) of the Bankruptcy Code, which polices the system for abuse, to ensure "that those who can afford to repay some portion of their unsecured debts be required to do so . . . ." 151 Cong. Rec. S2470 (March 10, 2005). First, Congress lowered the legal standard for dismissal from "substantial abuse" to mere "abuse." Likewise, Congress eliminated a statutory presumption that debtors were entitled to relief, and replaced it with a statutory presumption of abuse mandating dismissal or, with the debtor's consent, conversion to a chapter 13 debt repayment case. This presumption is identified and arises via a "means test," which contains specific objective criteria for the calculation of debtors' "disposable income" in an effort to identify those debtors who have the ability to repay. 11 U.S.C. § 707(b)(2)(A).

The means test calculates a debtor's current monthly income, as defined under 11 U.S.C. § 101(10A) (hereafter "CMI"), based on the debtor's average income for the six calendar months preceding the month of the bankruptcy filing.

Under the first part of the means test, if the debtor's CMI is below the applicable state median family income, no presumption arises and the case is reviewed for "abuse" under a totality of circumstances analysis. 11 U.S.C. § 707(b)(2)(A) and (b)(3).

When, as is the case here, a debtor's CMI is above the applicable state median family income, their monthly disposable income must be calculated to determine their ability to repay creditors. This is completed by reducing the debtor's CMI by certain categories of expenses identified in 11 U.S.C. § 707(b)(2)(A)(ii), (iii), and (iv). If the debtor's monthly disposable income is equal to or exceeds $167 per month (or $10,000 over 60 months), the presumption of abuse arises.[2] *Id.* If the presumption of abuse arises under section 707(b)(2) based on the means test, the debtor may attempt to rebut it by demonstrating special circumstances that justify income or expense adjustments for which there is no reasonable alternative. 11 U.S.C. § 707(b)(2)(B)

Each debtor with primarily consumer debts is required to file, in conjunction with his or her bankruptcy schedules and statement of financial affairs, Official Form 22A, titled "Statement of Current Monthly Income and Means Test Calculation" (the "Means Test Form"). 11 U.S.C. § 521 and § 707(b)(2)(C). In

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[2] Under 11 U.S.C. § 104, the dollar amounts set forth in title 11 and applicable to the threshold amounts for determining when the presumption of abuse arises under the means test were adjusted based on the consumer price index for cases filed on or after April 1, 2007. This case was filed in November 2006,

chapter 7 cases the main purpose of the Means Test Form is to calculate monthly disposable income (ability to pay) following the formula set forth under 11 U.S.C. § 707(b)(2), and determine whether the presumption of abuse arises.

2. Under the 2005 Reform Act, United States Trustees first file initial statements regarding the presumption of abuse and thereafter file motions to dismiss for abuse.

Under the 2005 Reform Act, United States Trustees analyze the Means Test Form and other materials filed by debtors to enforce section 707(b)(2). Section 704(b)(1)(A) specifies that United States Trustees review all materials filed by the debtor and then file a statement with the bankruptcy court as to whether the debtor's case should be presumed to be an abuse (the "10-Day Statement"). The 10-Day Statement is filed "not later than 10 days *after the date of the first meeting of creditors*," which is convened between 20 and 40 days after the case is commenced. 11 U.S.C. § 704(b)(1)(A) (emphasis added); Fed. R. Bankr. P. 2003(a). If the presumption arises, as it did here, section 704(b)(2) requires the United States Trustee to file either a motion to dismiss or a statement indicating why the United States Trustee does not believe that a motion to dismiss is appropriate "not later than 30 days after the date of filing" the 10-Day Statement.

3. The "first" meeting of creditors.

The "meeting of creditors," which is the event that establishes the filing dates set forth in section, is defined and mandated by section 341 of the

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and is therefore not subject to the dollar amount adjustments.

Bankruptcy Code. However, the Code does not define the specific phrase "first meeting of creditors," which is the precise language used by section 704. Historically, the Bankruptcy Act that preceded the modern Bankruptcy Code, Bankruptcy Act of July 1, 1898, c. 541, ss 301-99, 30 Stat. 544 (formerly codified at 11 U.S.C. ss 701-99), repealed, Act of Nov. 6, 1978, Pub.L.No. 95-598, s 401(a), 92 Stat. 2549 (hereinafter "Bankruptcy Act") provided for a "first" meeting of creditors early in the progress of each bankruptcy case. Bankruptcy Act § 55(a). That proviso also contained authority for optional interim meetings after the "first meeting," and for a "final" meeting in some cases. Bankruptcy Act §§ 55(d) and (e).

The "first meeting" under the Bankruptcy Act was designed as an occasion for creditors to meet, establish their claims, and elect a trustee to administer a debtor's bankruptcy estate. 3 Collier on Bankruptcy (14th ed. 1977) ¶ 55.01; *In re Vance*, 120 B.R. 181, 184 (Bankr. D. Okla. 1990). By contrast, under modern bankruptcy practice, creditors make claims by filing proofs with the clerk and litigating any disputes with the debtors. 11 U.S.C. §§ 501-502; Fed. R. Bankr. P. 3001-3008. Although trustees may still be elected, chapter 7 trustees are now generally appointed by the United States Trustee or the court. 11 U.S.C. §§ 701, 702(d), 703(c).

Therefore, the "first" meeting of creditors has lost the legal significance it once had under the old Bankruptcy Act. *Vance*, 120 B.R. at 184. Nevertheless, the initial meeting of creditors under section 341 of the Bankruptcy Code still often is loosely referred to as the "first meeting of creditors" as a vestige of pre-Code practice under the Bankruptcy Act, and still provides an opportunity for parties in interest (the trustee, creditors, and any others) to meet and question the debtor regarding his or her financial affairs. It is still required by statute that the meeting be held, 11 U.S.C. § 341(a)[3], and that the debtor "submit to interrogation under oath." 11 U.S.C. § 343.

In addition to the mandatory initial – or first – meeting, the Bankruptcy Code and the Bankruptcy Rules also allow "final" meetings and "special meetings" under section 341. 11 U.S.C. § 341(a) (meeting of creditors); 341(b) (meeting of equity security holders); 341(c) (referencing "any" final meeting of creditors). *Cf. In re Duplante*, 204 B.R. 49 (Bankr. S.D. Cal. 1996) *rev'd*, 215 B.R. 444 (B.A.P. 9th Cir. 1997) (creditor did not attend the section 341 "final" meeting of creditors).

Adjournment or continuation of an initial meeting of creditors required under section 341 of the Code is governed by Bankruptcy Rule 2003(e). It provides that the meeting may "be adjourned from time to time." Fed. R. Bankr. P. 2003(e).

4. Dismissal for abuse under section 707(b)(3) when the presumption does not arise or the debtor rebuts the presumption.

If no presumption of abuse arises under section 707(b)(2) or if the

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[3] *See also* Fed. R. Bankr. P. 2003(a)(requiring the United States Trustee to "call" the

presumption is rebutted under 11 U.S.C. § 707(b)(2)(B), the court must then consider whether the case should be dismissed as an "abuse" of chapter 7. 11 U.S.C. § 707(b)(3). In particular, the court "shall consider" whether the case was filed in "bad faith," 11 U.S.C. § 707(b)(3)(A), or whether "the totality of the circumstances of the debtor's financial situation . . . demonstrates abuse." 11 U.S.C. § 707(b)(3)(B).

Thus, sections 707(b)(2) and (b)(3) provide distinct and separate bases upon which the court may determine that a chapter 7 case is abusive; first, by application of an un-rebutted statutory presumption of abuse arising from the means test, then by a finding of abuse based upon bad faith or from the totality of the circumstances of the debtor's financial situation.

B. Factual Background

1. Mr. and Mrs. Reed's Bankruptcy Filing

On November 30, 2006, the Reeds jointly filed for bankruptcy protection under chapter 7 of the Bankruptcy Code. (ER at 1). The Reeds had $36,676.42 in unsecured debt. (ER at 21). They enjoyed stable income because Mr. Reed is employed as a supervisor at Aerospace Dynamics. (ER at 24).

Although Mrs. Reed was unemployed as of the date of the bankruptcy filing (ER at 24), she had operated a hair salon from December 2004 until it closed in August 2006. Mrs. Reed reported receiving no income from the business or

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meeting within 20 to 40 days after the commencement of the case).

otherwise in the six months before the bankruptcy filing (ER at 30, 37, 63, 67).

The Reeds' Means Test Form reflected average gross monthly income for the six months prior to filing of $5,947.57 ($71,370.84 annually). (ER at 37 - 38). Using this amount, the Reeds calculated they had no monthly disposable income available to repay their creditors. (ER at 41). In their schedules of current income (Schedule I) and expenses (Schedule J) filed with the bankruptcy court, the Reeds admitted, however, that Mr. Reed's gross monthly income was actually $7,645, and that they enjoyed $186.46 in monthly disposable income, available to repay creditors. (ER at 24 - 25).

2. The Meeting of Creditors Begins on January 8, 2007

The Bankruptcy Clerk noticed the Reeds' section 341 meeting of creditors for January 8, 2007. (ER at 47). However, because the gross income reported on the Reeds' Means Test Form was almost $1,700 lower than that reported on their Schedule I, the United States Trustee contacted the Reeds' attorney, Janet Lawson, prior to the January 8 meeting and asked her to explain and correct the discrepancy. (ER at 324, Line 21 - ER 326, Line 5). Notwithstanding this request, the Reeds failed to address the income discrepancy prior to or during the January 8 meeting of creditors. (ER at 322 - 328). Instead, the Reeds' attorney agreed to make appropriate corrections (ER at 325, Lines 3-4) to Schedule I and Means Test Form regarding their income, and the chapter 7 trustee appropriately sought to continue the meeting to January 29, 2007. (ER at 326, Line 20 - ER 327, Line 8). The

Reeds' attorney rejected this date and asked that the meeting be continued until the next available date, which was February 20, 2007. *Id.*

3. The United States Trustee's Motion to Dismiss

On January 17, 2007, ten days after the January 8 meeting, the United States Trustee filed a 10-Day Statement under section 704(b)(1) stating he could not determine whether the presumption of abuse arose in the Reeds' bankruptcy case.[4] (ER at 77). On January 25, 2007, the United States Trustee sent a letter to Ms. Lawson, again requesting evidence to verify the Reeds' income included on their Means Test Form. (ER at 146).

On February 15, 2007, after further evaluating materials the Reeds filed with the bankruptcy court, the United States Trustee filed a supplemental statement stating that the presumption of abuse arose.[5] (ER at 80 - 82). The next day, the United States Trustee filed a motion to dismiss the Reeds' bankruptcy case under 11 U.S.C. §§ 707(b)(2) and (b)(3). (ER at 83 - 165). The United States Trustee

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[4] The 10-Day Statement provides: Having reviewed the documents, if any, filed by the Debtor and any additional documents provided to the United States Trustee, the United States Trustee is currently unable to determine whether the Debtor's case would be presumed to be an abuse under Section 707(b) of the Bankruptcy Code." (ER at 77).

[5] The supplemental statement provides, in relevant part: ". . .the United States Trustee originally declared that a determination could not be made as to whether the Debtors' case is presumed abusive under 11 U.S.C. § 707(b). The United States Trustee filed a 'statement of inability to determine presumed abuse' on January 17, 2007. Based on the information the Debtors have provided to date, the United States Trustee has determined that a presumption of abuse arises in the

calculated that the Reeds had $576.51 in monthly disposable income, which exceeded the $167 threshold necessary to trigger the statutory presumption of abuse under 11 U.S.C. § 707(b)(2). *Id.* Alternatively, the United States Trustee asserted that the Reeds' use of chapter 7 was abusive under 11 U.S.C. § 707(b)(3)(B) because their schedules listed monthly disposable income that was available to repay creditors. (ER at 92).

4. The Meeting of Creditors continues; Reeds file two more Means Test Forms

The continuation of the 341 meeting occurred on February 20, 2007. At it the chapter 7 trustee noted the Reeds had filed a second Means Test Form that morning, and that neither he nor the United States Trustee had an opportunity to review it. (ER at 330). The second Means Test Form purported to increase the Reeds' CMI, decrease their tax withholding expense, and increase their health care expenses from $318 to $611.54. (*Compare* ER at 37 - 41 with ER at 167 - 171). In light of the different data just submitted by the Reeds, the chapter 7 trustee felt "obligat[ed]" to adjourn the meeting until March 12. (ER at 330, Lines 11-14). The Reeds did not appear at their March 12 meeting, so the chapter 7 trustee continued their meeting again until April 2 to allow them an opportunity to appear and explain their newest Means Test Form. (ER at 331 - 332]. The Reeds attorney appeared at the adjourned meeting on April 2, but the Reeds did not, so the chapter

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present case.

7 trustee continued the meeting again until May 14, 2007. (ER at 333).

On April 17, 2007, the Reeds filed a third Means Test Form containing a third set of gross income and income tax figures, adjusting health care and health insurance expenses, and adding a new monthly child care expense in the amount of $333.66. (ER at 219 - 223). Given these changes, the United States Trustee filed a motion to continue the hearing on his motion to dismiss, which was scheduled for April 25, 2007, so that he could examine the Reeds under oath at the May 14 creditors meeting, and obtain documentation to support the Reeds' third set of income and expense calculations. The bankruptcy court granted the United States Trustee's request, and continued the hearing on the motion to dismiss until May 16, 2007. *See* Bankruptcy Case Docket Entry No. 24.

On May 14, 2007, the United States Trustee examined the Reeds under oath at their section 341 meeting of creditors. (ER at 335 - 345). He asked Mrs. Reed to document the child care expenses contained in the Reeds' third Means Test Form. (ER at 337, Lines 6 - 24). The Reeds could not present any evidence that they actually incurred child care at the meeting, but promised to do so later. (ER at 294, Line 21 - ER 295, Line 2). Two days later, on May 16, 2007, at the hearing on the motion to dismiss, the Reeds gave the United States Trustee a statement reflecting the Reeds incurred day care expenses through September 6, 2006, which was approximately two months before the bankruptcy filing. *Id.* They provided no evidence that the expense was continuing now that Mrs. Reed had stopped working. *Id.*

5. Hearing on the Motion to Dismiss

The bankruptcy court heard the motion to dismiss on May 16, 2007. (ER at 284 - 306). At the hearing, the court rejected the Reeds' argument that the United States Trustee's initial 10-Day Statement did not satisfy the requirements of 11 U.S.C. § 704(b)(1). For that reason, the court rejected the Reeds' argument that the motion to dismiss under § 707(b)(2) was time-barred. (ER at 297, Line 15 - ER 299, Line 6).

Turning to the merits of the section 707(b)(2) portion of the dismissal motion, the bankruptcy court ruled that the childcare expenses claimed by the Reeds for $333.66 were neither reasonable nor necessary because Mrs. Reed was unemployed and the Reeds' only child attended school. (ER at 300 Lines 4 - 13; ER at 305, Lines 10 - 16). The court concluded this meant the Reeds had between $500 and $770 in monthly disposable income to pay creditors, so a presumption of abuse arose under 11 U.S.C. § 707(b)(2). (ER at 304, Line 14 - ER 305, Line 3). Alternatively, the bankruptcy court found that even if the presumption of abuse did not arise under section 707(b)(2), the case should be dismissed under 11 U.S.C. § 707(b)(3) based on the totality of the circumstances of the Reeds' financial situation. (ER at 294, Lines 6 - 17; ER 300 Lines 2 - 22; ER at 304, Line 14 to ER 305, Line 3). In support of this finding, the bankruptcy court cited to the Reeds' admission in their schedules that they enjoyed at least $186 in disposable income to pay creditors. The court reiterated the Reeds' childcare expenses were not reasonable or necessary, and accordingly under the totality of the circumstances, the Reeds' financial situation demonstrated that that their chapter 7 case was abusive. *Id.*

SUMMARY OF ARGUMENT

The bankruptcy court properly dismissed the Reeds' chapter 7 case under two alternative theories, first as presumptively abusive under section 707(b)(2), and second because the totality of the circumstances of the Reeds' financial situation under section 707(b)(3)(B) demonstrated abuse. The first ground, section 707(b)(2), raises pure legal issues, including interpretation of the United States Trustee's duties to file required statements under section 704(b), and is reviewed under a *de novo* standard. The second ground, section 707(b)(3)(B), is reviewed under the more deferential abuse of discretion standard. Because this Court may affirm on either theory, it may be simplest to affirm the bankruptcy court's abuse of discretion, totality of the circumstances, ruling under section 707(b)(3)(B).

ARGUMENT

I. The Bankruptcy Court Did Not Abuse its Discretion in Dismissing the Reeds' Case Under 11 U.S.C. § 707(b)(3)(B).

A. The bankruptcy court did not err in finding that Reeds' financial situation demonstrated abuse under a totality of the circumstances analysis provided for in 11 U.S.C. § 707(b)(3)(B). Under section 707(b)(3), the court must consider whether "the totality of the circumstances . . .of the debtor's financial situation . . . demonstrates abuse" *Id.*

The plain language of section 707(b)(3) requires the bankruptcy court to consider a debtor's ability to pay his or her debts in determining whether the case is an abuse of the provisions of chapter 7. *See Duncan v. Walker*, 533 U.S. 167, 172 (2001)(plain language).

Given section 707(b)(3)'s command that courts look at all financial circumstances, the Reeds are wrong in arguing "financial circumstances" cannot be considered when debtors pass section 707(b)(2)'s means test. *See* Reeds' Open. Br. at 11 – 25. First, their argument conflicts with the statute's text. Section 707(b)(3), by its express terms, applies to all debtors subject to section 707(b). Nowhere does it exclude debtors who pass section 707(b)(2)'s means test.

Not surprisingly, then, bankruptcy courts have rejected the Reeds' argument in other cases. *See In re Mestemaker*, 359 B.R. 849, 853-56 (Bankr. N.D. Ohio 2007); *In re Lenton*, 358 B.R. 651, 663 (Bankr. E.D. Pa. 2006) ("The broad language 'totality of the circumstances' and 'financial situation' clearly encompasses a debtor's ability to pay."); *In re Mundy*, 363 B.R. 407, 414 (Bankr. M.D. Pa. 2007) (decreased expenses due to surrender of collateral securing a debt allowed by the court under the means test "may be a factor . . .under the totality of the circumstances test under § 707(b)(3). . . ."). This is how the court below applied the means test here, so its section 707(b)(3) ruling merits affirmance.

Considering the Reeds' ability to pay under section 707(b)(3) is consistent with the 2005 Reform Act's legislative history. In adopting section 707(b)(3), Congress codified judicial decisions interpreting the old version of section 707(b) as giving courts discretion to dismiss cases when debtors' financial circumstances demonstrated they could make some payments to creditors. *See, e.g.*, *In re Lamanna*, 153 F.3d 1, 4 (1st Cir. 1998)(totality of the circumstances test "demands a comprehensive review of the debtor's current and potential financial situation"). *Cf.* 146 Cong. Rec. S11683-11729 (explaining the proposed Reform Act would codify cases like *Lamanna* that give courts "additional discretion" to dismiss based on debtors' financial circumstances), Dec. 7, 2000.

Finally, this construction of section 707(b)(3) is consistent with the Ninth Circuit's construction of pre-Reform Act law. In those cases, the Ninth Circuit held that, in considering motions to dismiss under 11 U.S.C. § 707(b), a debtor's ability to pay was the primary factor in evaluating the totality of the circumstances, and that such ability to pay alone warranted dismissal. *See In re Kelly*, 841 F.2d 908, 941 (9th Cir. 1988)("debtor's ability to pay his debts will, standing alone, justify a section 707(b) dismissal"); *In re Price*, 353 F.3d 1135, 1138-40 (9th Cir. 2004)(principal factor in determining "substantial abuse" is debtor's ability to pay his or her debts).

B. Given this, the bankruptcy court did not abuse its discretion in holding that the Reeds' demonstrated ability to pay a meaningful portion of their debt constituted abuse under 11 U.S.C. § 707(b)(3). *See* 11 U.S.C. § 707(b)(3); *see also Kelly*, 841 F.2d at 941; *Price*, 353 F.3d at 1138-40. Nor did the court commit clear error in finding the Reeds' child care expenses were not reasonably necessary for the Reeds' support. (ER at 294, lines 6 – 17). Mrs. Reed was unemployed and had not worked since before the Reeds' bankruptcy filing. Their son was six and attending school. *Id.* Given that, this finding was not clearly erroneous. *In re Hebbring*, 463 F.3d 902, 905 (9th Cir. 2006)(court reviews "for clear error a bankruptcy court's fact-intensive determination that an expense or property interest is not reasonably necessary for a debtor's support").

Nor did the bankruptcy court abuse its discretion in concluding that the Reeds have the ability to pay a substantial portion of their unsecured debts. *Hebbring*, 463 F.3d at 905, 908-09 (upholding the bankruptcy court's dismissal where the debtor had the ability to pay creditors a portion of their debts).

Even without removing the Reeds' claimed child care expenses, the Reeds admitted on their bankruptcy schedules that they have $186.46 in monthly disposable income, which is more than the debtor had in *Hebbring*. Removing the day care expense further increases their monthly disposable income to $520.12, or $31,207.20 over 60 months. This would be sufficient to repay approximately 85% of the Reeds' $36,676.42 in scheduled unsecured debt.

II. The bankruptcy court correctly held that the Reeds' bankruptcy case was presumptively abusive under 11 U.S.C. § 707(b)(1) and (2).

Alternatively, the bankruptcy court's ruling under section 707(b)(2) should be affirmed because the bankruptcy court correctly concluded an unrebutted presumption of abuse in the arose in the Reeds' bankruptcy case. As discussed below, none of the Reeds' procedural or substantive challenges to the bankruptcy court's ruling warrants reversal.

A. The bankruptcy court correctly ruled that the United States Trustee's initial 10-Day Statement is a valid "statement as to whether" the Reeds' bankruptcy case would be presumed to be an abuse under 11 U.S.C. § 707(b).

1. Section 704(b)(1)(A) requires the United States Trustee to file "a statement **as to whether** the debtor's case would be presumed to be an abuse under section 707(b)." (emphasis added). The Reeds assert that the statutory requirement is not satisfied when the United States Trustee's statement explains the United States Trustee cannot determine whether the presumption of abuse arises because the debtor has failed to adequately explain the debtor's financial circumstances. Open. Br. at 9-10. The Reeds' argument fails for at least two separate and independent reasons.

2. First, that is not what the statute requires. Instead, the 10-Day Statement filed by the United States Trustee is merely a "statement *as to whether*" the Reeds' case "would be presumed to be an abuse under section 707(b)," as required by the statute. 11 U.S.C. § 704(b)(1)(A)(emphasis added).

Congress' use of the words "as to whether" and "statement" make clear that all the statement must say is whether the United States Trustee can determine at the time if the presumption of abuse arises. The dictionary defines the phrase "as to" to mean "about," *e.g.*, "Melissa was at a loss as to how to explain the error." Merriam Webster Online Dictionary, available at www.m-w.com. Courts also "generally avoid restricting 'whether' to a binary choice. Thus, words or phrases following 'whether' in a statute will generally not limit the statute's meaning." *In re Cadwallder*, 2007 WL 1864154 at *15 (Bankr. S.D. Tex. June 28, 2007) *citing Galbreath v. Gulf Oil Corp.*, 294 F.Supp. 817, 824 (D. Ga. 1968) (stating that "[t]he cases hold without exception that words following 'whether' do not restrict the meaning to any following terms; rather they enlarge upon it"), *aff'd*, 413 F.2d 941 (5th Cir. 1969); *see also State ex rel. Berra v. Sestrict*, 349 Mo. 182, 159 S.W.2d 786, 789 (1942) (stating that "the word whether, neither in common parlance, nor in legal phraseology, has ever had the force of a videlicet.").

Further, Congress could have, but did not dictate the language of the "statement" required. Had Congress intended section § 704(b)(1)(A) to require the United States Trustee to make an unequivocal, final determination that the presumption either does or does not arise, it could easily have done so. *See BFP v. Resolution Trust Corp.*, 511 U.S. 531, 537 (1993) (courts presume that Congress acts intentionally and purposely when it omits particular language from a statute). Accordingly, the bankruptcy court correctly ruled that the United States Trustee's 10-Day Statement satisfied the requirements of 11 U.S.C. § 704(b)(1)(A).

3. Alternatively, the United States Trustee's second, February 15, 2007, statement also was timely, and it independently satisfied section 704(b)(1)(A). Section 704(b)(1)(A) requires the United States Trustee to file a statement "not later than 10 days ***after the date*** of the ***first meeting of creditors***. . ." 11 U.S.C. § 704(b)(1)(A) (emphasis added). The first meeting is a single event that may be adjourned from time to time, as it was in this case, and the United States Trustee was not required to file his 10-Day Statement until "after" that meeting, *i.e.*, after the meeting "concluded." By timely filing his supplemental 10-Day Statement – that expressly found abuse - **before the conclusion** of the adjourned meeting, the United States Trustee cured any possible defect in his original 10-Day Statement.

The text of section 341 supports this reading because it provides for a single "meeting of creditors" that may be continued, and the United States Trustee filed a definitive statement <u>before</u> that meeting ended. 11 U.S.C. §§ 341(a) and 341(d); Fed. R. Bankr. P. 2003(e) - (g). Thus, a *single* "meeting of creditors," also called the "first meeting of creditors," may take place on more than a single date. *Cf. In re Barnard*, 40 F. 3d 1028, 1031 (9th Cir. 1994) (noting that Bankruptcy Rule 2003(e) contemplates that the "first meeting" under section 341 "can't always be completed in one session [and] thus authorizes the trustee to adjourn the meeting to enable the debtor to give additional testimony or to enable creditors to conduct additional examination.") *Id.*[6]

The Bankruptcy Code and Rules also support this reading because they make clear the term "first" in section 341 is used to distinguish it from the discretionary "special" or "final" meetings that they also allow. *See* 11 U.S.C. § 341(c) (discussing "*any* final meeting"); Fed. R. Bankr. P. 2003(f) and (g) (special meetings).

Section 704's legislative history also supports the conclusion that the 10-Day Statement can be filed any time within 10 days of the end of the 341 meeting because it says that the statement is filed "following" the meeting. Specifically, it states that the United States Trustee must file the 10-Day Statement "within ten days following the meeting of creditors held pursuant to section 341 of the Bankruptcy Code. . . ." House Report No. 31, Pt. 1, 109th Cong., 1st Sess. 52 (2005). The reference to the section 341 meeting of creditors being "held" indicates that the meeting has been concluded. *Cf. In re Stewart*, 2006 WL 4043319, *4 (Bankr. E.D. Va. 2006) (deadline in statute that ran from the date that the section 341 meeting is "held" meant the conclusion of the meeting, not the first day on which the meeting was commenced), and *In re Shelton*, 343 B.R. 545

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[6] Many courts have similarly acknowledged that the first meeting may not be completed on the date first set. *See In re Spenler*, 212 B.R. 625, 627 (B.A.P. 9th Cir. 1997); *In re Burrell*, 289 B.R. 109, 110 (Bankr. C.D. Ill. 2002); *In re Lake States Commodities, Inc.*, 173 B.R. 642, 644 (Bankr. N.D. Ill. 1994); *In re Grand Jury Proceedings*, 497 F.Supp. 979, 980 (E.D. Pa. 1980); *In re Young*, 1 B.R. 387, 389 (Bankr. M.D. Tenn. 1979).

(Bankr. W.D. Va. 2006)(same). *See also* 6 Collier on Bankruptcy ¶704.17[1], p. 704-36 to 704-37 (rev. 15th ed. 2006)(stating that the "first meeting of creditors" refers to section 341(a) meeting of creditors and that reading the deadline as running from the conclusion of the meeting of creditors makes the most logical sense.)

Finally, the United States Trustee's interpretation finds further support in the Bankruptcy Code's Rules of Construction, which provide that "[i]n this title – . . . the singular includes the plural." 11 U.S.C. § 102(7). Viewed through the lens of section 102(7), section 704(b)(1)(A) should be read as providing "the United States Trustee . . .shall. . ., not later than 10 days after the date *or dates* of the first meeting of creditors, file with the court a statement as to whether the debtor's case would be presumed to be an abuse under section 707(b)." Since the language allows the "first meeting of creditors" to occur over multiple dates, the only correct reading of section 704(b)(1) is that the 10-Day Statement deadline is ten days after the last of these dates.[7]

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[7] The legislative history to section 102(7) supports this reading, by noting that "[t]he bill uses only the singular, even when the item in question most often is found in plural quantities. . ." House Report No. 95-595, 95th Cong. 1st Sess. (1977) 316; Senate Report No. 95-989, 95th Cong., 2nd Sess. (1978). Further, courts routinely apply section 102(7) to read singular terms in the Code as including the plural, even though the plural is not specifically enumerated. *See, e.g., Universal Church v. Geltzer*, 463 F.3d 218, 223 (2d Cir. 2006) (construing the term "transfer" in 11 U.S.C. § 548(a)(2) to include multiple "transfers" and noting that section 102(7) is a "significant provision of the Bankruptcy Code."); *see also In re Hailes*, 77 F.3d 873, 875 (5th Cir. 1996)("transfer" in section 547(c)(8)

Here, there is no dispute that the meeting of creditors was suspended on January 8, 2007, February 20, 2007, April 2, 2007, and May 14, 2007, and was never concluded. (ER at 322 – 345). The United States Trustee filed his initial 10-Day Statement on January 17, 2007, and his supplemental 10-Day Statement on February 15, 2007, before the conclusion of the meeting of creditors. (ER at 77, 80 – 82). Therefore, the United States Trustee timely filed his motion to dismiss because his second, unequivocal statement, was filed within the time specified by section 704.

B. The Reeds have waived any challenge to the bankruptcy court's substantive ruling that the presumption of abuse arose under section 707(b)(2) because they failed to present argument on any issues other than the court's ruling on child care expenses in their opening brief.

The bankruptcy court specifically found that after disallowing child care expenses claimed by the Reeds, the Reeds had sufficient monthly disposable income to trigger 11 U.S.C. § 707(b)(2)'s presumption of abuse. The Reeds have not challenged the bankruptcy court's calculation of "current monthly income" or expenses other than child care expenses under the means test. The Reeds' failure to present any argument challenging the bankruptcy court's finding regarding these issues in their opening brief waives any such arguments. *See Arpin v. Santa Clara Valley Transp. Agency*, 261 F3d 912, 919 (9th Cir. 2001) (stating that "issues which are not specifically and distinctly argued and raised in a party's opening brief are

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means "more than one transfer").

waived") (citation omitted).

C. The bankruptcy court correctly determined that the Reeds' claimed child care expenses were not allowed expenses under 11 U.S.C. § 707(b)(2)(A)(ii).

Under the means test, debtors may deduct their "actual monthly expenses for the categories specified as Other Necessary Expenses issued by the Internal Revenue Service . . ." except to the extent the IRS's categories of "Other Necessary Expenses" permit repayment of debts. 11 U.S.C. § 707(b)(2)(A)(ii)(I).

The Reeds contended below that their child care expenses were allowed as "Other Necessary Expenses." (ER at 221, Line 30). But section 5.15.1.10 of the IRS's Internal Revenue Manual[8] allows only "reasonable and necessary" expenses for child care, and considers the age of the child and whether both parents work in assessing whether an expense meets that standard. The Reeds bore the burden of proving this. *In re Lara*, 347 B.R. 198, 203 (Bankr. S.D. Tex. 2006). *See also In re Crittendon*, 2006 WL 2547102 at *4 n.4 (Bankr. M.D.N.C. Sept. 1, 2006) ("The enumerated 'other necessary expenses' must be 'necessary' in order to be deductible ...."); *In re Demonica*, 345 B.R. 895, 905 (Bankr. N.D. Ill. 2006) (debtor's claim for Other Necessary Expenses must "must itemize, document and provide a detailed" showing that such expenses are reasonable and necessary.).

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[8] Available at http://www.irs.gov/irm/part5/ch15s01.html#d0e187963.

Here, they did not meet that burden and the bankruptcy court specifically found that the Reeds' claimed child care expenses were not necessary or reasonable because Mrs. Reed was unemployed, their son was six years old and Mrs. Reed had "a half day to herself every day at least even if [her son was] in kindergarten. . ." (ER at 294, Line 6 to ER 295, Line 14; ER at 300, Lines 2 - 13). In addition, the Reeds neither presented any evidence that they actually continue to incur child care expenses.

III. The bankruptcy court did not commit any procedural errors in dismissing the Reeds' case.

In their opening brief, the Reeds raise procedural matters that they claim require reversal. The Reeds' claims are without merit.

The Reeds claim the bankruptcy court should have granted their oral request for a continuance at the hearing on the motion to dismiss because (1) an "accurate" Means Test Form "was not on file" and (2) the Reeds needed additional time to address "new issues" purportedly raised by the United States Trustee as to child care expenses claimed by the Reeds in their Third Means Test Form filed on April 17, 2007. (Open. Br. at 26 - 27). Because the Reeds have not demonstrated diligent preparation for the hearing, the bankruptcy court did not abuse its discretion in denying their request. *United States v. Flynt*, 756 F.2d 1352, 1358-59 (9th Cir. 1985)(setting forth factors for reviewing denials of motion for continuance). In addition, the Reeds failed to prove that they were prejudiced by the bankruptcy court's denial of their motion. *Id.* at 1359 ("[A]ppellant must show at a minimum that he has suffered prejudice as a result of the denial of his request") 756 F.2d at 1359.

Finally, the Reeds' contend that they were denied due process or a proper hearing because they did not receive proper notice of "new issues." (Open. Br. at 2, 27). Their complaints as to notice lack merit. A case may be dismissed under section 707(b) only "[a]fter notice and a hearing." 11 U.S.C. § 707(b). Section 102(1) of the Bankruptcy Code explains that "notice and a hearing" means whatever notice and hearing "as is appropriate in the particular circumstances." Such circumstances do not require a full-blown evidentiary hearing. *In re Zick*, 931 F.2d 1124, 1128-29 (6th Cir. 1991). In this case, the Reeds were given a full and fair "opportunity to present pleadings or an affidavit in opposition and to respond to the court through his counsel." *Id.* at 1129.

CONCLUSION

For these reasons, the United States Trustee respectfully asks this Court to affirm the order entered below.

Dated: November 14, 2007

Respectfully Submitted,

Of Counsel

ROBERTA A. DeANGELIS
General Counsel

P. Matthew Sutko
David A. Levine
United States Department of Justice
Executive Office for United States Trustee

PETER ANDERSON
United States Trustee

By:____________________
JENNIFER BRAUN
Assistant United States Trustee
United States Department of Justice
Office of the U.S. Trustee
21051 Warner Center Lane, Suite 115
Woodland Hills, CA 91367

PROOF OF SERVICE BY MAIL

STATE OF CALIFORNIA
COUNTY OF LOS ANGELES

I am employed in the County of Los Angeles, state of California, in the Office of the United States Trustee under the supervision of a member of the bar of this Court at whose direction the service hereinafter described was made; I am over the age of 18 and not a party to the within action; and my business address is: 21051 Warner Center Lane, Suite 115, Woodland Hills, California.

On November 14, 2007, I served the foregoing document described as: on the interested parties at their last known addresses by placing a true and correct copy thereof in a sealed envelope with sufficient postage thereon fully prepaid, in the United States Mail at Woodland Hills, California, addressed as follows:

DEBTOR:
Peter and Andrea Reed
229 N. Ashwood Avenue
Ventura, CA 93003

DEBTOR'S COUNSEL:
Janet A. Lawson, Esq.
3810 W Channel Islands Blvd, Suite F
Oxnard, CA 93035

CHAPTER 7 TRUSTEE:
David Y. Farmer, Esq.
1254 Marsh Street
P.o. Box 1443
San Luis Obispo, CA 903406

I declare under penalty of perjury that the foregoing is true and correct.

Dated: November 14, 2007

Veronica Hernandez
Legal Secretary, Office of the United States Trustee

BRIEF BANK — 'SUMMARY SHEET"

Printed Wed-7/26/06 10:19

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	In re Renaissance Corp.
2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	CTA 3
3. ("CCN") ***CURRENT*** CASE NO.	No.: 06-2342
4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*	Bankr NJ- 83-05545 D NJ- 05-04879 *(Identify judge & cite, if any)*
5. ("SO") ***SOURCE***	**U.S. TRUSTEES**
6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	Filed: July 6, 2006 Type: Motion for Summary Affirmance under this Court's Rule 27-4 and Internal Operating Procedure 10.6
7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*	Deborah Ruth Kant, Esq., Civil Division Appellate Staff *(UST/OGC: 202-307-1399/FAX-2397)*
8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	• The debtor attempts to undo the appointment of a bankruptcy trustee in order to regain the broadcast license it lost in the 1983 bankruptcy. Grounds for summary affirmance: 1) the attempt to vacate the appointment of the trustee are barred by *res judicata*, 2) debtor's motion to withdraw reference of 1983 bankruptcy case under28 USC 157(d) is barred by *res judicata*, 3) debtor's motion for a mandatory withdrawal of reference under 157(d) is meritless and untimely, and 4) any challenge to the sale of the broadcast license is foreclosed under 11 USC 363(m).
10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)	Y:\seggert\My Files\BriefBank-Web\Renaissance\RenaCorp01.wpd
11. DO YOU RECOMMEND POSTING IN UST BRIEFBANK?	| X | YES | | NO ***NAME:*** Steven Eggert ***DATE:*** Wed-7/26/06 10:6

IN THE UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

IN RE RENAISSANCE CORPORATION,	)	
RENAISSANCE BROADCASTING CORP.,	)	
Appellant-Debtor,	)	
UNITED STATES TRUSTEE,	)	No. 06-2342
Appellee.	)	

MOTION FOR SUMMARY AFFIRMANCE UNDER THIS COURT'S RULE 27-4 AND INTERNAL OPERATING PROCEDURE 10.6

Pursuant to this Court's Rule 27-4, and Internal Operating Procedure 10.6, the appellee, the United States Trustee,[1](“US Trustee”) respectfully moves for an order summarily affirming the district court's order of April 3, 2006. There is no substantial question presented in this appeal. Summary action will avoid the needless expenditure of this Court's and appellee's resources, and avoid unnecessary briefing in the above-referenced appeal.

This case marks yet another attempt by the debtor (“Renaissance”) in its 23-year odyssey to undo the appointment of a bankruptcy trustee in a bankruptcy case that has been closed for over 19 years. To that end, the debtor has filed several lawsuits.

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[1] The United States Trustee is an official of the United States Department of Justice, charged by statute with the duty to oversee and supervise the administration of bankruptcy cases. *See* 28 U.S.C. 586(a).

The present appeal arises from a series of confusing pleadings filed in the district court, including motions to: (i) withdraw the reference of the 1983 bankruptcy case to the bankruptcy court under 28 U.S.C. 157(d); (ii) withdraw the reference of Renaissance's motion to reopen the 1983 bankruptcy case; (iii) vacate the 1983 order appointing the bankruptcy trustee; and (iv) strike the U.S. Trustee's memorandum of law opposing such motions. Dkt #1, 6.[2]

By these motions, the ultimate relief Renaissance seeks is to vacate the appointment of the bankruptcy trustee and regain the broadcast license it lost in the 1983 bankruptcy. Because debtor's various claims are plainly barred by res judicata and are untimely after 23 years, this case is appropriate for summary affirmance. Moreover, summary affirmance will put an end to the debtor's continuous attempts in various guises, including two trips to this Court, to vacate the appointment of the trustee over 20 years ago. Finally, the debtor's pleadings are unintelligible, and as the district court noted, confusingly captioned. For this reason also, summary affirmance is warranted.

A. Background and Proceedings Below.

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[2] References to the district court record will be to the docket entry and corresponding exhibits filed by the US Trustee or debtor, "Dkt. #_ (Exh. _)." Because of the numerous exhibits associated with the debtor's lawsuits, we have not attached any of the exhibits. We will of course do so, should the Court request any of them.

1. On September 28 1983, Renaissance Broadcasting Corporation, which owned and operated a television station in Vineland New Jersey, filed a Chapter 11 petition in bankruptcy. Dkt. #4 (Exh. 2). After the US Trustee filed a motion to appoint a trustee under 11 U.S.C. 1104, the bankruptcy court held a hearing at which Renaissance's objections were considered. Dkt. # 4 (Exh. 5). On October 7, 1983, the bankruptcy court entered an order directing the appointment of a Chapter 11 trustee.[3] Dkt. # 4 (Exh. 6).

Under Federal Communications Commission (FCC) regulations, 47 C.F.R. 73.3541, the debtor became legally disabled once the Chapter 11 trustee was appointed, and the bankruptcy trustee acquired control of the broadcast license through an involuntary transfer. Renaissance appealed the trustee's appointment to the district court, and the district court affirmed the appointment. Dkt. # 4 (Exh. 10).

In 1984, the trustee negotiated a sale of the debtor's assets under 11 U.S.C. 363, including the broadcast license, for $3.5 million. Dkt. # 4 (Exh. 13). The bankruptcy court denied Renaissance's objections to the sale. *Ibid.* In April of 1985, the FCC approved the trustee's request for a voluntary transfer of the

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[3] Subsequently, on July 10, 1984, the bankruptcy case was converted to a case under Chapter 7, and the US Trustee appointed the former Chapter 11 trustee to serve as a Chapter 7 trustee under 11 U.S.C. 701(a)(1) and (c) and Fed. R. Bankr. P. 1019(4). Dkt. # 4 (Exh. 11).

broadcast license to the purchaser of the estate’s assets under 47 C.F.R. 73.3540(a). Dkt. # 4 (Exh. 16). Thereafter, on November 6, 1987, the bankruptcy court closed the debtor’s bankruptcy case. Dkt. # 4 (Exh. 18).

2. In 1985, the debtor ‘s principal and owner, Mr. Donald C. McMeans, filed a civil rights lawsuit in the United States District Court for the District of New Jersey against several defendants, including the bankruptcy trustee and US Trustee personnel. Dkt. #4 (Exh. 14). McMeans alleged, *inter alia*, that appointment of a trustee was part of a vast racially-motivated conspiracy against Renaissance. The district court dismissed the claims against the bankruptcy trustee and the US Trustee personnel, ruling that claims attendant to the appointment of the bankruptcy trustee had been fully aired in bankruptcy court and either had been or should have been raised in the appeal of the trustee's appointment. Dkt. # 4 (Exh. 17 at 13). In 1990, the civil rights action went to trial against other defendants, and the district court ruled against McMeans, in a directed verdict. Dkt. # 4 (Exh. 21). McMeans appealed to this Court, which affirmed without opinion. McMeans v. Twp. of Waterford, 924 F.2d 417 (3d Cir. 1991), *cert. denied*, 502 U.S. 854.

In 1995, McMeans filed a 60(b) motion seeking to resurrect his civil rights case by vacating, *inter alia*, the order appointing the trustee in the 1983 bankruptcy case. Dkt. # 4 (Exh. 25). The district court found that McMeans had not shown fraud upon the Court and that his allegations were "mere restatements of earlier contentions that have been litigated fully or could have been litigated fully." Dkt. # 4 (Exh. 26 at 4). The district court dismissed the claims with prejudice. *Ibid*. McMeans appealed to this Court, which summarily affirmed. Dkt. # 4 (Exh. 29).

3. On October 29, 2004, the debtor filed a motion to reopen the 1983 case and vacate the appointment of the trustee.
Dkt. # 4 (Exh. 30 & 31). On October 3, 2005, the day of the hearing of the motions (after several delays), the debtor filed another series of motions, *see, supra,* p.2. The district court, on April 3, 2006, ruled that Renaissance's various and "confusingly captioned" motions were efforts to reopen, and as such, were untimely and without merit.

B. Grounds for summary affirmance.

1. Renaissance's attempts to vacate the appointment of the bankruptcy trustee are barred by *res judicata*.

Renaissance's ultimate goal is to undo the appointment of the bankruptcy trustee in the 1983 bankruptcy case, and regain its broadcast license. It unsuccessfully attempted to achieve this goal in 1983, by directly seeking to challenge the appointment in the 1983 bankruptcy proceeding and taking an appeal to the district court which affirmed the appointment. The debtor later challenged the conversion of the Chapter 11 case to a Chapter 7 case in bankruptcy court, which conversion, under 11 U.S.C. 701(a)(1), automatically gives rise to the appointment of a Chapter 7 trustee. *See, supra,* n.3 (chapter 11 case converted to chapter 7 case). The debtor never took an appeal of this conversion. Renaissance then continued its efforts by filing a civil rights action in 1985 through its principal, and a subsequent 60(b) motion to reopen the civil rights lawsuit in 1995. In both instances, McMeans appealed to this Court, which affirmed the district court's decisions without opinion. In this present case, under the guise of several confusing motions, the debtor seeks the same result – to undo the appointment of the trustee in the 1983 bankruptcy case.

Any challenge to the appointment of the trustee is plainly barred by res judicata. Under the doctrine of *res judicata,* "a final judgment on the merits of an action precludes the parties or their privies from re-litigating a claim that was or could have been raised in that action." <u>Federated Dep't Stores, Inc</u>. v. <u>Moitie</u>, 452 U.S. 394, 398 (1981). *See also* <u>Nanavati</u> v. <u>Burdette Tomlin Memorial Hospital</u>, 857 F.2d 96, 111 (3d Cir. 1988), *cert. denied,* 489 U.S. 1078 (1989). Here the debtor plainly had the opportunity in 1983 and 1984 to challenge the appointments of the bankruptcy trustees under Chapters 11 and 7. In fact, it actually litigated these issues in bankruptcy court and, during the case, never appealed the Chapter 7 trustee's appointment (the final trustee in the 1983 bankruptcy case) to this Court.

2. The debtor’s motion to withdraw reference of the 1983 bankruptcy case under 28 U.S.C.157(d) is likewise barred by *res judicata*.

Under 28 U.S.C. 1334(b), district courts have “original but not exclusive jurisdiction of all civil proceedings arising under title 11, or arising in or related to cases under title 11.” 28 U.S.C. 157(a) provides in turn that a district court may refer to a bankruptcy court “any or all cases under title 11, and any or all proceedings arising under title 11 .” By standing order of July 23, 1984, the United States District Court for the District of New Jersey referred all such cases and proceedings to the bankruptcy court. Dkt. # 4 (Exh. 36). Title 28 also provides that a district court “shall, on timely motion of a party”, withdraw any case or proceeding, in whole or in part, referred to a bankruptcy court “if the court determines that resolution of the proceeding requires consideration of both title 11 and other laws of the United States regulating organizations or activities of interstate commerce.” 28 U.S.C. 157(d).[4] The debtor below asserted that because Federal Communications law governing broadcast licenses were implicated in the bankruptcy proceeding, section 157(d) mandates the withdrawal of reference of the 1983 case from the bankruptcy court.

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[4] The second sentence of 157(d) refers to a mandatory withdrawal of reference. The first sentence of this section refers to a discretionary withdrawal of reference for cause shown.

However, by filing a new motion seeking to withdraw reference of the long-closed 1983 bankruptcy case under 157(d), the debtor is in reality attempting once again to undo the appointment of the trustee appointed over 20 years earlier. The debtor's claim, however styled, is barred by *res judicata* for the reasons stated above. Moreover, as soon as the US Trustee filed the motion to appoint a Chapter 11 trustee, the debtor was on notice that the potential involuntary transfer of its broadcast license could, and did occur, in the bankruptcy proceeding. Thus, Renaissance had ample opportunity to raise the issue of a 157(d) withdrawal of reference from the bankruptcy court. In fact it could have raised this issue at any point in the bankruptcy proceeding but Renaissance chose not to do so. For this reason also, its motion to withdraw reference is barred by *res judicata*.

Nor does framing the motion to withdraw reference as a challenge to the subject-matter jurisdiction of the bankruptcy court in 1983 alter the application of *res judicata* principles to this case. It is well settled that even where "non-waivable subject matter jurisdiction is lacking but not raised, a final judgment has *res judicata* effect in a subsequent proceeding , and a collateral attack in a subsequent proceeding on the want of subject matter jurisdiction is barred." Chemical Leaman Tank Lines v. Aetna Cas. Sur., 177 F.3d 210, 219-220 (3d Cir. 1999). *See also* Insurance Corp. of Ireland v. Compagnie Des Bauxtes, 456 U.S. 694, 702 n.9 (1982); Hodge v. Hodge, 621 F.2d 590, 592-93 (3d Cir. 1980). This rule applies whether or not the claim was actually litigated, Chemical Leaman Lines, *supra*, at 220. In the 1983 bankruptcy proceeding, Renaissance had plenty of opportunity to assert the lack of subject-matter jurisdiction. Furthermore, filing a motion under Fed. R. Civ. P. 60(b)(4) does not overcome the principles of *res judicata*; final judgments are not rendered "void" under this provision because of a lack of subject matter jurisdiction. Hodge v. Hodge, 621 F.2d at 593. Moreover, the absence of jurisdiction was not so clear "that its assumption 'was a manifest abuse of authority.'" Hodge, *supra,* at 593, such that the normal rule of *res judicata* would not apply.

To be sure, there is another exception to the general rule of *res judicata* – namely that the assumptions of jurisdiction "'would substantially infringe the authority of another tribunal or [governmental] agency.'" Hodge, *supra*, at 593. Here, however, the bankruptcy trustee's acquisition of the broadcast license from the debtor by operation of federal law does not substantially infringe on the FCC's authority.

Federal communications law recognizes two kinds of license transfers: voluntary and involuntary. Voluntary transfers, such as when a licensee wishes to sell the license to another party, require prior FCC approval and are governed by 47 C.F.R. 73.3540. Involuntary transfers take place by operation of law upon death or legal disability of the license holder such as when a receiver or bankruptcy trustee is appointed, and is governed by 47 C.F.R. 73.3541. Involuntary transfers do not require prior FCC approval; rather the new holder created by operation of law has 30 days to seek FCC approval.

The appointment of the Chapter 11 trustee does not by itself substantially interfere with these regulations, or non-title ll law under 157(d). In the context of bankruptcy, the FCC has “consistently held that the [FCC] will not generally question the appointment of a bankruptcy trustee or receiver where a court is seeking to protect the creditors of a financially disabled licensee.” In Re Application of D.H. Overmyer Telecasting Co., Inc., 1983 WL 182836, at ¶9. *See also* LaRose v. FCC, 494 F.2d 1145, 1147-48 (D.C. Cir. 1974) (in a case under the Bankruptcy Act of 1898, “[t]he [FCC’s] regular practice is to approve an involuntary assignment of the license to a receiver in bankruptcy[.]”). The FCC’s long-held view is that the appointment of trustees under title 11 does not interfere with the regulation of broadcast licenses, and there is no Commission requirement that bankruptcy court’s orders appointing trustees be contingent upon the Commission’s approval of broadcast licenses.

In any event, the FCC approved the involuntary transfer of the broadcast license upon the appointment of the trustee, and it also approved the trustee’s voluntary transfer of the license when the estate’s assets were subsequently sold. Had the FCC thought the bankruptcy court’s appointment of a trustee substantially infringed upon its authority over license transfers, it would presumably have raised that issue over twenty years ago rather than approve these transfers.

Thus, for all the above reasons, the motion to withdraw reference under 157(d) is barred by *res judicata*.

3. In any event, the debtor’s motion for a mandatory withdrawal of reference under 157(d) is on its face meritless as well as untimely.

The mandatory withdrawal of reference provision under 28 U.S.C. 157(d) requires an existing case or proceeding before a district court can withdraw the reference. *See* In Re Pruitt, 910 F.2d 1160, 1169 (3d Cir. 1990) (holding that there was no cause for discretionary withdrawal of reference when the bankruptcy court had entirely disposed of the case). Here, there is no pending bankruptcy case or proceeding. The bankruptcy proceeding has been closed for almost two decades. The terms of 157(d) foreclose a withdrawal where, as here, there is no case.[5]

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[5] The debtor’s motions apparently do not ask the district court to reopen the 1983 bankruptcy case in the first instance, but rather seek a withdrawal of the reference of the motion to reopen filed in the bankruptcy court by Renaissance in 2004. The debtor’s motions regarding a case closed in 1987 are unintelligible, and for this reason also, summary affirmance is warranted. Moreover, the debtor cannot offer a substantial and compelling reason for reopening the case 19 years after it was closed, especially when the former estate assets have likely passed through at least a few subsequent purchasers. Finally, with respect to the bankruptcy court’s appointment of the

Moreover, the mandatory withdrawal of reference provision expressly requires a “timely motion by a party”. 28 U.S.C. 157(d). The bankruptcy case was closed in 1987. Filing a motion for withdrawal of reference 19 years later is by no stretch of the imagination “timely.”

The district court thus properly denied mandatory withdrawal of reference under 157(d).

4. Any challenge to the sale of the broadcast license is foreclosed under 11 U.S.C. 363(m).

One further consideration warrants summary affirmance. At the end of the day, the debtor is really seeking to overturn the sale of the broadcast license in the 1983 bankruptcy case under 11 U.S.C. 363(b). Section 363(m), however, forecloses such a challenge, and under this section, as this Court has held, any such appeal would be moot. Cinciola v. Scharffenberger, 248 F.3d 110,123 (3d Cir. 2001); Krebs Chrysler-Plymouth Inc. v. Valley Motors, Inc. 141 F.3d 490, 498-499 (3d Cir. 1998) (an appeal seeking the reversal or modification of the sale of the estate’s property is moot if it would affect the sale’s validity and there is no stay pending appeal).

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trustee, the court was well within its discretion to decide that an appointment was justified to protect the interests of the creditors of a financially disabled debtor/licensee. *See* 11 U.S.C. 1104 (grounds for the appointment of a trustee).

CONCLUSION

For the foregoing reasons, the US Trustee, respectfully moves for summary affirmance of the district court's order of April 3, 2006.

Respectfully submitted,

____
WILLIAM KANTER
(202)514-4575

____
DEBORAH RUTH KANT
(202) 514-3518
Attorneys, Appellate Staff
Civil Division, Room 7270
950 Pennsylvania Ave., NW
Department of Justice
Washington, D.C. 20530

Michael A. Artis
Robert J. Schneider
Trial Attorneys
Office of the United States Trustee
One Newark Center, Suite 2100
Newark, New Jersey 07102

CERTIFICATE OF SERVICE

I hereby certify that on this 6th day of July, I served the foregoing Motion For Summary Affirmance under Local Rule 27-4 and Internal Operating Procedure 10.6 upon opposing counsel by causing a copy to be mailed, postage prepaid, to:

Michael L. Block
22 Treebark Terrace
Voorhees, New Jersey 08043

DEBORAH RUTH KANT
Attorney

BRIEF BANK — 'SUMMARY SHEET" *Printed Mon-3/13/06 12:6*

WESTLAW CODES

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Repurchase v UST (In re Repurchase Corp.)

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Bank. ND Ill

3. ("CCN") ***CURRENT*** CASE NO.
No.: 05-7075

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(Identify judge & cite, if any)

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Kathryn Gleason, AUST
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***
• 1. Whether the bankruptcy court abused its discretion when it granted the U.S. Trustee's Motion to Dismiss the Bankruptcy Case pursuant to 11 U.S.C. §1112(b). 2. Whether the bankruptcy court was clearly erroneous when it denied confirmation of the First Amended Plan of Reorganization pursuant to 11 U.S.C. §1129(a)(11), based on its finding that the Amended Plan was not feasible. 3.Whether the bankruptcy court abused its discretion when it denied the Debtor's Motion to Amend Order Denying Confirmation of Amended Plan and Motion to Vacate Dismissal Order, declining to reopen the evidence in the confirmation hearing on the Amended Plan, based on its finding that: (a) such evidence was not newly discovered or unknown at the time of such hearing; and (b) there was no error of law in the rendering of each decision.

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UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

REPURCHASE CORPORATION,	)	
	)	Case No. 05 C 7075
Appellant.	)	
	)	Hon. David H. Coar
v.	)	
	)	
IRA BODENSTEIN, et al.,	)	
	)	
Appellees.	)	
	)	
	)	
In Re:	)	Chapter 11 Proceeding
	)	
REPURCHASE CORPORATION,	)	Case No. 04 B 32933
	)	
Debtor.	)	Hon. Jack B. Schmetterer
	)	

APPELLEE, UNITED STATES TRUSTEE'S OPENING BRIEF

Kathryn Gleason
Cameron M. Gulden
Office of the U.S. Trustee
227 West Monroe Street, Suite 3350
Chicago, Illinois 60606
Telephone (312) 886-3327
Facsimile   (312) 886-5794

Attorneys for Appellee,
Ira Bodenstein, United States Trustee

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BASIS OF APPELLATE JURISDICTION

Appellee, Ira Bodenstein, the United States Trustee for the Northern District of Illinois (the "U.S. Trustee") agrees with Appellant, Repurchase Corporation (the "Debtor") that this Court has jurisdiction over this appeal under 28 U.S.C. §158(a).

ISSUES PRESENTED

1. Whether the bankruptcy court abused its discretion when it granted the U.S. Trustee's Motion to Dismiss the Bankruptcy Case pursuant to 11 U.S.C. §1112(b).

2. Whether the bankruptcy court was clearly erroneous when it denied confirmation of the First Amended Plan of Reorganization pursuant to 11 U.S.C. §1129(a)(11), based on its finding that the Amended Plan was not feasible.

3. Whether the bankruptcy court abused its discretion when it denied the Debtor's Motion to Amend Order Denying Confirmation of Amended Plan and Motion to Vacate Dismissal Order, declining to reopen the evidence in the confirmation hearing on the Amended Plan, based on its finding that: (a) such evidence was not newly discovered or unknown at the time of such hearing; and (b) there was no error of law in the rendering of each decision.

APPLICABLE STANDARD OF REVIEW

The U.S. Trustee agrees with the Debtor that the decision to dismiss a case pursuant to 11 U.S.C. §1112(b) is within the sound discretion of the bankruptcy court. *See In re Woodbrook Assoc.*, 19 F.3d 312, 322 (7th Cir. 1994). This Court reviews the bankruptcy court's findings of fact with the clearly erroneous standard. Conclusions of law are reviewed de novo. *Id.* at 316.

STATEMENT OF THE CASE

The Debtor appeals five orders issued by the bankruptcy court for the Northern District of Illinois: (1) the Order Granting the U.S. Trustee's Motion to Dismiss, dated July 25, 2005; (2) the Order Denying Confirmation of Chapter 11 Plan, dated July 25, 2005; (3) the Order denying Debtor's Motion to Amend Order Denying Confirmation of Amended Plan, dated October 31, 2005; (4) the Order Denying Debtor's Motion to Vacate Dismissal Order, dated October 31, 2005; and (5) the Memorandum Opinion Denying Debtor's (a) Motion to Amend Order Denying Confirmation of Amended Plan and (b) Motion to Vacate Dismissal, dated October 31, 2005 (the "Opinion"). An evidentiary hearing on confirmation of the First Amended Plan of Reorganization (the "Amended Plan") was held on July 12, 2005, and, a hearing on the U.S. Trustee's Motion to Dismiss the bankruptcy case was held on July 25, 2005. A hearing on the Motion to Amend Order Denying Confirmation of Amended Plan and the Motion to Vacate Dismissal Order (collectively, the "Motions to Reconsider") was held on August 23, 2005. The Debtor appeals from the bankruptcy court's decisions to deny confirmation of the Amended Plan and to dismiss the chapter 11 case, which decisions the bankruptcy court declined to reconsider.

STATEMENT OF THE FACTS

The Debtor filed a voluntary petition for relief under Chapter 11 of the Bankruptcy Code on September 3, 2004. [Docket #140, p.2]. At the time of the filing, it was not an operating business. [Docket #69, p.7]. The sole asset of any value was net operating loss carryovers for federal income tax purposes. [Docket #69, p.1].

On December 30, 2004, the Debtor filed its Disclosure Statement for Repurchase Corporation's Plan of Reorganization (the "Original Disclosure Statement") and Plan of

Reorganization (the "Original Plan"). [Docket #s 34 and 35]. Under the Original Plan, Leon Greenblatt ("Greenblatt"), who currently owns and/or controls all of the outstanding shares of the Debtor, was to pay to the estate $100,000 and receive in consideration a minimum of 20% of the equity of the Debtor post-confirmation. [Docket #35, p.1]. Unsecured creditors were to receive a pro-rata distribution of the $100,000, as well as the option to purchase a pro-rata share of 800 shares of new stock. [Docket #35, pp. 1-2, 13]. The Original Disclosure Statement provided that the issuance and distribution of the new stock was exempt from the securities laws pursuant to 11 U.S.C. §1145. [Docket #35, p.17].

Both the U.S. Trustee and the Securities and Exchange Commission filed objections to the Original Plan in that it contemplated issuing the new stock in violation of 11 U.S.C. §1145, and, that it discharged the Debtor in violation of 11 U.S.C. §1141(d)(3).[1] The Debtor responded by arguing, *inter alia*, that whether the Original Plan violates securities laws is irrelevant to whether the plan is confirmable pursuant to 11 U.S.C. §1129(a). [Docket #51, pp. 3-4].

The bankruptcy court found as a matter of law the Debtor could not rely on 11 U.S.C. §1145 to exempt the issuance of the new stock from the securities laws. The bankruptcy court granted leave to the Debtor to amend the Original Plan and Original Disclosure Statement to provide for the exact legal exemption it intended to rely upon when issuing the new stock. [Docket #75]. The only material change the Debtor made in its Amended Disclosure Statement and the Amended Plan was to suggest it would attempt to rely on §4(2) of the Securities Act of 1933 to issue the new stock. [Docket #69, p.17].

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[1] James Stephenson, the Trustee of MJK Clearing, Inc. ("MJK"), also filed an objection to the Original Disclosure Statement alleging certain inaccuracies relating to the equity security holders and to Greenblatt contributing $100,000 to the Estate. [Docket #44].

The U.S. Trustee, MJK, and, Credit Suisse First Boston LLC ("CSFB"), an unsecured creditor which the Debtor listed in its Schedules of Assets and Liabilities as owed $702,443.61 [Docket #84, p.2], all filed objections to the Amended Disclosure Statement and the Amended Plan. [Docket #s 75, 77 and 84]. The Debtor filed its Report of Balloting on the Debtor's First Amended Plan of Reorganization which showed that the Amended Plan was accepted by the two creditors who timely voted.[2] The two creditors who voted were Robinson Curley & Clayton, PC, a law firm that holds a claim against the Debtor and continues to represent affiliates of the Debtor, and, Loop Properties, an affiliate of the Debtor. [Docket #81, footnote #1].

The bankruptcy court held an evidentiary hearing on confirmation of the Amended Plan on July 12, 2005. [Docket #118]. The Debtor offered the testimony of Greenblatt in support of confirmation. Greenblatt testified that the Debtor's business was investments in securities and in the oil business, however, the Debtor had not purchased a single security since 2001. [Docket #118, pp. 24 and 34-35]. He further testified that as of the date of the hearing, he had: (1) no source of employment income; (2) no cash and no demand deposit accounts; and (3) he had not filed any tax returns for the years 2001, 2002, 2003 or 2004, because, amongst other reasons, he had no taxable income. [Docket #118, pp. 36-37]. Shareholder contributions by his wife in the amount of $500,000 would provide the source of capital to start up the investment business, however, Greenblatt did not have a written commitment to contribute that amount or a current balance sheet showing her assets and liabilities. [Docket #118, pp. 52-53]. Greenblatt also testified that another source was to "...enter into the tax-type sharing agreements in which we would benefit cash in exchange for the

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[2] CSFB filed a motion to file a late ballot rejecting the Amended Plan. [Docket #118, p.4]. As the bankruptcy court denied confirmation, it did not decide the motion.

utilization of our NOLs through either leasing or other– some other mechanism.” [Docket #118, p.54]. Greenblatt, however, had “absolutely not” entered into such agreements yet. [Docket #118, p.54]. After Debtor’s counsel represented to the bankruptcy court that,

> [t]he only other piece of evidence that the debtors were going to offer was with respect to the funding of the $100,000 in the plan. And we had planned to have with us today a certified check...[but] we don’t have that right at this moment...,

the Debtor rested its case. [Docket #118, pp. 58 and 61].

Based on the record before it, the bankruptcy court denied confirmation of the Amended Plan. In reaching this decision, the bankruptcy court noted that,

> You [the debtor] have a burden to show me feasibility and legality, and in this case they are about the same. You have to show me that engaging in business is feasible...you would have to show me that you could engage in business and would engage in business both in terms of feasibility and in terms of 1141(d)(3).

[Docket #118, p.7-8]. Feasibility, the court stated, “...is something that we take into account seriously” in Chapter 11 [Docket #118, p.77].

The U.S. Trustee then filed the Motion to Dismiss Pursuant to 11 U.S.C. §1112(b) (“Motion to Dismiss”). [Docket #116]. The Motion requested dismissal because the Debtor had been in bankruptcy for almost a year, and, had twice attempted unsuccessfully to confirm a plan. Continuation of this case would only serve to further delay and prejudice the creditors. [Docket #116, p.2]. After notice, and, a hearing on July 25, 2005, the bankruptcy court dismissed the case. [Docket #119].

Thereafter, the Debtor filed the Motions to Reconsider the dismissal order and to the order denying confirmation of the Amended Plan. [Docket #s 125 and 126]. The Debtor alleged that there was clear error of law in denying confirmation. Further, the Debtor claimed that,

> ...it has reached an agreement for funding of the plan, and will have evidence of available funds. The Debtor's agreement with another entity will allow the Debtor to engage in business and utilize the NOLs post-confirmation.

[Docket #126, p.8]. The Debtor also stated that prior to the hearing on the Motions to Reconsider, it would present a second amended plan and second amended disclosure statement.[3] [Docket #126, p.7]. The Debtor did not allege that this evidence existed but was unavailable when confirmation was denied. [Docket #140, p.5].

A hearing on the Motions to Reconsider was held on August 23, 2005 whereby the Debtor, the U.S. Trustee, MJK and CSFB orally argued their respective positions.[4] At the hearing, the Debtor attempted to offer evidence of a merger agreement to fund the capital requirements of the reopened business. [Docket #135, p.17]. At the conclusion of the hearing, the bankruptcy court stated that it intended to write an opinion on the Motions to Reconsider. The court did indicate that it disagreed with the Debtor that it made a legal error, and, further, it would decline to exercise its discretion to reopen the proofs. [Docket #135, pp. 48-49]. On October 31, 2005, the bankruptcy court issued the Opinion denying the Motions to Reconsider. [Docket #140].

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[3] The Debtor did not tender a second amended plan and second amended disclosure statement at or prior to the hearing. [Docket #135, p.31].

[4] MJK also filed a written objection to the Motions. [Docket #130].

SUMMARY OF ARGUMENT

The bankruptcy court properly exercised its discretion when it dismissed the Debtor's Chapter 11 case. The case had pended for almost one year, and, the Debtor made two unsuccessful attempts at confirming a plan of reorganization. Without addressing the other grounds for dismissal, the Debtor argues that the bankruptcy court erred when it denied confirmation of the Amended Plan as not feasible. The Debtor, as the proponent of the Amended Plan, had the burden of proving by a preponderance of the evidence that the Amended Plan complies with the statutory requirements for confirmation, including feasibility. The Debtor did not meet this burden. The Amended Plan is premised upon outside financing. At the confirmation hearing, the Debtor introduced no written commitment to provide such financing. The bankruptcy court properly found that the availability of such financing was sheer speculation, and, denied confirmation. After the debtor rested its case, and, during the hearing on the Motions to Reconsider, the Debtor attempted to introduce evidence of a purported merger agreement that would provide the financing for the Amended Plan. The bankruptcy court properly declined to consider such evidence, finding that the Debtor was essentially requesting a 'do-over'. As the bankruptcy court noted, if the debtor did indeed now have the financing necessary to fund a plan, the proper course would be to file a new case. Instead, the Debtor filed this appeal.

ARGUMENT

I. The Bankruptcy Court Properly Exercised Its Discretion When It Dismissed the Bankruptcy Case

11 U.S.C. §1112(b) governs conversion or dismissal of a Chapter 11 case. Section 1112(b) provides, in pertinent part,

> ...on request of a party in interest or the United States trustee...and after notice and a hearing, the court may convert a case under this chapter to a case under chapter 7 of this title or may dismiss a case under this chapter, whichever is in the best interest of creditors and the estate, for cause, including — ...
>
> (2) inability to effectuate a plan;
>
> (3) unreasonable delay by the debtor that is prejudicial to creditors...

11 U.S.C. §1112(b). A bankruptcy court has broad discretion to dismiss or convert a Chapter 11 case for cause, and, its decision is reviewed for an abuse of discretion. *In re Woodbrook Assocs.*, 19 F.3d 312, 316 (7th Cir. 1994); *In re Han*, 2002 WL 31049846 at *4 (N.D.Ill. Sept. 12, 2004).

In the Motion to Dismiss, the U.S. Trustee alleged that cause existed in that there was an inability to effectuate a plan, and, unreasonable delay by the Debtor that was prejudicial to creditors. [Docket #116]. The bankruptcy case had pended for almost a year. Further, the Debtor had two unsuccessful attempts to confirm a plan. As the bankruptcy court noted in the Opinion, bankruptcy judges are given great discretion in determining when a Chapter 11 case that is otherwise floundering should be dismissed. *See* Docket #140, p.14 *quoting In re Woodbrook Assocs.,* 19 F.3d 312, 322 (7th Cir. 1994) ("Chapter 11 provides reasonable opportunity for corporate reorganization [;] it does not guarantee reorganization nor does it permit an indefinite suspension of creditors' rights and remedies pending the unsuccessful attempts of any party to effect a reorganization of debt...[B]ankruptcy courts are given a great deal of discretion to say when enough is enough.")[5] The bankruptcy court properly exercised its discretion when it said enough and dismissed the bankruptcy case.

II. The Bankruptcy Court Correctly Found that the Amended Plan was not Feasible

The Debtor complains that the bankruptcy court initially denied confirmation on the sole basis that the Amended Plan violated 11 U.S.C. §1141(d)(3) by providing a discharge to a liquidating chapter 11 debtor, and, only upon reconsideration, stated new grounds for denial as not feasible in violation of 11 U.S.C. §1129(a)(11). The Debtor misconstrues what occurred at the July 12, 2005 Hearing on Confirmation. At the Hearing, the bankruptcy court noted that feasibility is something that is seriously taken into account in Chapter 11. [Docket #118, p.77]. The Debtor had the burden to show to the bankruptcy court feasibility and legality, which the bankruptcy court found to be about the same thing in this case. [Docket #118, p.78]. As the bankruptcy court amplified in the Opinion,

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[5] Just as in *Woodbrook Assocs.*, the Debtor was afforded an opportunity to amend the Original Plan. The Amended Plan was substantially similar to the Original Plan, the only material change being to provide the exact legal exemption it intended to rely upon when issuing stock under the Amended Plan. *Id.*

confirmation was denied for two reasons, with the overriding one being lack of plan feasibility. [Docket #140, p.8].[6] This finding that the Amended Plan was not feasible is correct.[7]

The Debtor, as the plan proponent, had the burden of proving by a preponderance of the evidence that the Amended Plan complies with the statutory requirements for confirmation, including feasibility. *In re Arnold & Bakers Farms*, 177 B.R. 648, 654-53 (BAP 9th Cir. 1994), *aff'd*, 85 F.3d 1415 (9th Cir. 1996), *cert. denied*, 519 U.S. 1054 (1997). Section 1129(a)(11) of the Bankruptcy Code mandates that "[c]onfirmation of the plan is not likely to be followed by the liquidation, or the need for further financial reorganization, of the debtor or any successor to the debtor under the plan, unless such liquidation or reorganization is proposed in the plan." 11U.S.C. §1129(a)(11).[8] Feasibility must be established regardless of whether a plan is accepted by creditors. *See In re M & S Associates, Ltd.*, 138 B.R. 845, 848-49 (Bankr. W.D.Tex. 1992) (where the court found that "[a] bankruptcy court has an affirmative obligation to scrutinize a reorganization plan to

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[6] Specifically, the bankruptcy court held that "[e]ven if Debtor is correct that inclusion of the discharge provision in its Amended Plan was not illegal since the Plan did not expressly provide for 'liquidation' of the NOLs, it overlooks the overriding issue determined at confirmation– lack of plan feasibility. Under evidence heard at the confirmation hearing, Debtor's Amended Plan was not feasible." [Docket #140, pp. 8-9].

[7] In the Appellant's Opening Brief (the "Brief"), the Debtor suggests that the bankruptcy court erred in denying confirmation of the Amended Plan because it did so based upon a misinterpretation of 11 U.S.C. §1141(d)(3). [Brief, pp. 6-9]. This argument is wrong on the merits, but, more significantly, it is irrelevant. As previously discussed, the bankruptcy court was clear that confirmation of the Amended Plan alternatively was denied because the Plan was not feasible. [Docket #140, pp. 8-9]. Lack of feasibility formed a separate and independent basis for denial of confirmation that merits affirmance of the order entered below.

[8] In the Brief, the Debtor attempts to minimize the importance of feasibility, arguing that if the $100,000 contribution by Greenblatt did not arrive, creditors would have options under the Bankruptcy Code. [Brief, p.11]. The burden, however, does not shift to creditors to assure payment under a plan. The purpose of confirmation is to end litigation, not be the basis of further disagreement.

determine whether it is feasible. In order to confirm a plan, the court must make a specific finding that the plan, as proposed, is feasible").[9]

A reorganization plan under chapter 11 must be more than a nebulous speculative venture and must have a realistic chance of success which would lead to rehabilitation, and if outside financing is needed, it must be clearly in sight. *In re Original IFPC Shareholders, Inc.*, 317 B.R. 738, 744 (Bankr. N.D.Ill. 2004) (*citing In re K.C. Marsh Co., Inc.*, 12 B.R. 401 (Bankr. D.Mass. 1981)). The Amended Plan is premised upon a $100,000 contribution to be made by Greenblatt to the Debtor (the "Contribution"). [Docket #67, p.3]. The Contribution is the sole source of funding of any distribution to unsecured creditors under the Amended Plan. The Amended Disclosure Statement itself admits that "...the [Amended] Plan's feasibility is based on the payment of the Contribution." [Docket #69, p.25].

At the July 12, 2005 Hearing on confirmation, the Debtor provided no evidence that the Contribution would be available to fund the distribution to unsecured creditors. Greenblatt testified that as of the date of the hearing he had: (1) no source of employment income; (2) no cash and no demand deposit accounts; and (3) he had not filed any tax returns for the years 2001, 2002, 2003, or 2004, because, amongst other reasons, he had no taxable income. [Docket #118, pp. 36-37]. Instead, Greenblatt testified that his wife would be the contributing source for the Contribution, but, the Debtor provided no corroborating evidence that his wife had agreed to provide such funding,

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[9] In the Brief, the Debtor suggests that the bankruptcy court erred by just not accepting the creditors' vote on the Amended Plan. [Brief, p.11]. That is not the law. *Id.* at 848-49. Further, while it is true that the Amended Plan was accepted by the two creditors who timely voted, one of which was an affiliate of the Debtor, CSFB filed a motion to file a late ballot rejecting the Amended Plan, and, CSFB and MJK filed objections to confirmation. There was no overwhelming creditor support of the Amended Plan.

and, that she had the financial ability. Greenblatt had no balance sheet for his wife showing her assets and liabilities. [Docket #118, pp. 52-53].[10]

The bankruptcy court found that Mr. Greenblatt's testimony amounted to nothing more than wishful thinking. [Docket #140, p.10]. Specifically, the bankruptcy court found that,

> We have nothing but sheer speculation from the witness without the slightest corroboration as to plans to raise a half a million dollars from his wife, without even a piece of paper from his wife making a promise to undertake to do that, and without the slightest evidence as to her resources.

[Docket #118, p.84]. The bankruptcy court correctly found that the Debtor had failed to prove by a preponderance of the evidence that the Amended Plan was feasible, as required by 11 U.S.C. §1129(a)(11). As such, the bankruptcy court properly denied confirmation of the Amended Plan.

III. The Bankruptcy Court Properly Exercised Its Discretion When It Denied the Motions to Reconsider

As shown above, there was no mistake of law or fact in the bankruptcy court's decisions to grant the U.S. Trustee's Motion to Dismiss, and, to deny confirmation of the Amended Plan. Accordingly, the bankruptcy court properly denied the Motions to Reconsider pursuant to F.R.Civ.P. 59(e). *See Gendron v. United States*, 154 F.3d 672, 674 (7th Cir. 1998) (where the court held that motions to alter or amend a judgment based on Rule 59(e) of the Federal Rules of Civil Procedure will only be granted if there has been a mistake of law or fact to which the judgment is based upon or where there is newly discovered evidence that was not previously available).

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[10] Greenblatt similarly testified, without any corroborating evidence, that his wife would contribute the $500,000 required to restart the business. [Docket #118, p.53].

The Debtor, however, complains that the bankruptcy court refused to consider evidence of a purported written merger agreement between the Debtor and another entity at the August 23, 2005 Hearing on the Motions to Reconsider. [Brief, p.13].[11] A bankruptcy court has broad discretion in ruling on motions to reopen a judgment pursuant to F.R.Civ.P. 59(a). *Sellers v. Baisier*, 792 F.2d 690, 693 (7th Cir. 1986). Under F.R.Civ.P. 59(a), a "court may open the judgment once one has been entered, take additional testimony, amend findings of fact and conclusions of law or make new findings and conclusions, and direct the entry of a new judgment." F.R.Civ.P. 59(a). A motion premised on Rule 59(a) "is not intended to secure a forum for the relitigation of old matters or to afford the parties the opportunity to present the case under new theories; instead, the motion is a device properly used to correct manifest errors of law or fact or to present newly discovered evidence." *Fort Howard Paper Co. v. Standard Havens, Inc.*, 901 F.2d 1373, 1380 n.4 (7th Cir. 1990).

In the Opinion, the bankruptcy court clearly sets forth its reasons for declining to reopen the judgment to consider evidence of the purported merger agreement. July 12, 2005 was the date set for the hearing on confirmation of the Amended Plan. Necessary evidence should have been prepared and presented at that time. [Docket#140, p.13]. The bankruptcy court found that,

> What the Debtor is essentially requesting is a 'do-over' so that it can correct glaring deficiencies in its initial attempt to satisfy its burden of proof. Furthermore, the newly created evidence should have been prepared and presented during the confirmation hearing. (citations omitted).

[Docket #140, p.13]. As the bankruptcy court noted, if the Debtor did indeed now have such

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[11] The Debtor does not allege that this agreement had existed but was not available at the time of the hearing on confirmation of the Amended Plan. [Docket #140, p.5]. In fact, Greenblatt testified at the confirmation hearing that he had "absolutely not" entered into any agreement. [Docket #118, p.54].

funding available to it, it could have simply filed a new Chapter 11 case. [Docket #140, p.15]. The bankruptcy court did not abuse its discretion when it declined to consider the evidence, and, denied the Motions to Reconsider.

CONCLUSION

For these reasons, the U.S. Trustee respectfully asks this Court to affirm the orders entered below.

RESPECTFULLY SUBMITTED:
IRA BODENSTEIN
UNITED STATES TRUSTEE

DATED: January 17, 2006

BY: /S/ Cameron M. Gulden
Cameron M. Gulden, an attorney for the
United States Trustee

Kathryn Gleason (ARDC #06196518)
Cameron M. Gulden (ARDC # 0310931)
Office of the U.S. Trustee
227 West Monroe Street, Suite 3350
Chicago, Illinois 60606
(312) 886-2614

BRIEF BANK — "SUMMARY SHEET" *Printed Wed-4/2/08 17:7*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*
In re: Repurchase Corporation (Repurchase v. UST, et al.)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*
Bankr. Ill.

3. ("CCN") ***CURRENT*** CASE NO.
No.: 05 C 7075

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*
No.: 04 B 32933
Court:
(Identify judge & cite, if any)

5. ("SO") ***SOURCE***
U.S. TRUSTEES

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7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*
Kathryn Gleason, Cameron M. Gulden, P. Matthew Sutko
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***

• Whether the bankruptcy court abused its discretion when it granted the U.S. Trustee's Motion to Dismiss the Bankruptcy Case pursuant to 11 U.S.C. §1112(b).

Whether the bankruptcy court was clearly erroneous when it denied confirmation of the First Amended Plan of Reorganization pursuant to 11 U.S.C. §1129(a)(11), based on its findings that the Amended Plan was not feasible. Whether the bankruptcy court abused its discretion when it denied the Debtor's Motion to Amend Order Denying Confirmation of Amended Plan and Motion to Vacate Dismissal Order, declining to reopen the evidence in the confirmation hearing on the Amended Plan, based on its findings that: (a) such evidence was not newly discovered or unknown at the time of such hearing; and (b) there was no error of law in the rendering of each decision.

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UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

REPURCHASE CORPORATION,	)	
	)	Case No. 05 C 7075
Appellant.	)	
	)	Hon. David H. Coar
v.	)	
	)	
IRA BODENSTEIN, et al.,	)	
	)	
Appellees.	)	
	)	
	)	
In Re:	)	Chapter 11 Proceeding
	)	
REPURCHASE CORPORATION,	)	Case No. 04 B 32933
	)	
Debtor.	)	Hon. Jack B. Schmetterer
	)	

APPELLEE, UNITED STATES TRUSTEE'S OPENING BRIEF

Kathryn Gleason
Cameron M. Gulden
Office of the U.S. Trustee
227 West Monroe Street, Suite 3350
Chicago, Illinois 60606
Telephone (312) 886-3327
Facsimile (312) 886-5794

Attorneys for Appellee,
Ira Bodenstein, United States Trustee

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BASIS OF APPELLATE JURISDICTION

Appellee, Ira Bodenstein, the United States Trustee for the Northern District of Illinois (the "U.S. Trustee") agrees with Appellant, Repurchase Corporation (the "Debtor") that this Court has jurisdiction over this appeal under 28 U.S.C. §158(a).

ISSUES PRESENTED

1. Whether the bankruptcy court abused its discretion when it granted the U.S. Trustee's Motion to Dismiss the Bankruptcy Case pursuant to 11 U.S.C. §1112(b).

2. Whether the bankruptcy court was clearly erroneous when it denied confirmation of the First Amended Plan of Reorganization pursuant to 11 U.S.C. §1129(a)(11), based on its finding that the Amended Plan was not feasible.

3. Whether the bankruptcy court abused its discretion when it denied the Debtor's Motion to Amend Order Denying Confirmation of Amended Plan and Motion to Vacate Dismissal Order, declining to reopen the evidence in the confirmation hearing on the Amended Plan, based on its finding that: (a) such evidence was not newly discovered or unknown at the time of such hearing; and (b) there was no error of law in the rendering of each decision.

APPLICABLE STANDARD OF REVIEW

The U.S. Trustee agrees with the Debtor that the decision to dismiss a case pursuant to 11 U.S.C. §1112(b) is within the sound discretion of the bankruptcy court. *See In re Woodbrook Assoc.*, 19 F.3d 312, 322 (7th Cir. 1994). This Court reviews the bankruptcy court's findings of fact with the clearly erroneous standard. Conclusions of law are reviewed de novo. *Id.* at 316.

STATEMENT OF THE CASE

The Debtor appeals five orders issued by the bankruptcy court for the Northern District of Illinois: (1) the Order Granting the U.S. Trustee's Motion to Dismiss, dated July 25, 2005; (2) the Order Denying Confirmation of Chapter 11 Plan, dated July 25, 2005; (3) the Order denying Debtor's Motion to Amend Order Denying Confirmation of Amended Plan, dated October 31, 2005; (4) the Order Denying Debtor's Motion to Vacate Dismissal Order, dated October 31, 2005; and (5) the Memorandum Opinion Denying Debtor's (a) Motion to Amend Order Denying Confirmation of Amended Plan and (b) Motion to Vacate Dismissal, dated October 31, 2005 (the "Opinion"). An evidentiary hearing on confirmation of the First Amended Plan of Reorganization (the "Amended Plan") was held on July 12, 2005, and, a hearing on the U.S. Trustee's Motion to Dismiss the bankruptcy case was held on July 25, 2005. A hearing on the Motion to Amend Order Denying Confirmation of Amended Plan and the Motion to Vacate Dismissal Order (collectively, the "Motions to Reconsider") was held on August 23, 2005. The Debtor appeals from the bankruptcy court's decisions to deny confirmation of the Amended Plan and to dismiss the chapter 11 case, which decisions the bankruptcy court declined to reconsider.

STATEMENT OF THE FACTS

The Debtor filed a voluntary petition for relief under Chapter 11 of the Bankruptcy Code on September 3, 2004. [Docket #140, p.2]. At the time of the filing, it was not an operating business. [Docket #69, p.7]. The sole asset of any value was net operating loss carryovers for federal income tax purposes. [Docket #69, p.1].

On December 30, 2004, the Debtor filed its Disclosure Statement for Repurchase Corporation's

Plan of Reorganization (the "Original Disclosure Statement") and Plan of Reorganization (the "Original Plan"). [Docket #s 34 and 35]. Under the Original Plan, Leon Greenblatt ("Greenblatt"), who currently owns and/or controls all of the outstanding shares of the Debtor, was to pay to the estate $100,000 and receive in consideration a minimum of 20% of the equity of the Debtor post-confirmation. [Docket #35, p.1]. Unsecured creditors were to receive a pro-rata distribution of the $100,000, as well as the option to purchase a pro-rata share of 800 shares of new stock. [Docket #35, pp. 1-2, 13]. The Original Disclosure Statement provided that the issuance and distribution of the new stock was exempt from the securities laws pursuant to 11 U.S.C. §1145. [Docket #35, p.17].

Both the U.S. Trustee and the Securities and Exchange Commission filed objections to the Original Plan in that it contemplated issuing the new stock in violation of 11 U.S.C. §1145, and, that it discharged the Debtor in violation of 11 U.S.C. §1141(d)(3).[1/] The Debtor responded by arguing, *inter alia*, that whether the Original Plan violates securities laws is irrelevant to whether the plan is confirmable pursuant to 11 U.S.C. §1129(a). [Docket #51, pp. 3-4].

The bankruptcy court found as a matter of law the Debtor could not rely on 11 U.S.C. §1145 to exempt the issuance of the new stock from the securities laws. The bankruptcy court granted leave to the Debtor to amend the Original Plan and Original Disclosure Statement to provide for the exact legal exemption it intended to rely upon when issuing the new stock. [Docket #75]. The only material change the Debtor made in its Amended Disclosure Statement and the Amended Plan was to suggest it would

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[1/] James Stephenson, the Trustee of MJK Clearing, Inc. ("MJK"), also filed an objection to the Original Disclosure Statement alleging certain inaccuracies relating to the equity security holders and to Greenblatt contributing $100,000 to the Estate. [Docket #44].

attempt to rely on §4(2) of the Securities Act of 1933 to issue the new stock. [Docket #69, p.17].

The U.S. Trustee, MJK, and, Credit Suisse First Boston LLC ("CSFB"), an unsecured creditor which the Debtor listed in its Schedules of Assets and Liabilities as owed $702,443.61 [Docket #84, p.2], all filed objections to the Amended Disclosure Statement and the Amended Plan. [Docket #s 75, 77 and 84]. The Debtor filed its Report of Balloting on the Debtor's First Amended Plan of Reorganization which showed that the Amended Plan was accepted by the two creditors who timely voted.[2/] The two creditors who voted were Robinson Curley & Clayton, PC, a law firm that holds a claim against the Debtor and continues to represent affiliates of the Debtor, and, Loop Properties, an affiliate of the Debtor. [Docket #81, footnote #1].

The bankruptcy court held an evidentiary hearing on confirmation of the Amended Plan on July 12, 2005. [Docket #118]. The Debtor offered the testimony of Greenblatt in support of confirmation. Greenblatt testified that the Debtor's business was investments in securities and in the oil business, however, the Debtor had not purchased a single security since 2001. [Docket #118, pp. 24 and 34-35]. He further testified that as of the date of the hearing, he had: (1) no source of employment income; (2) no cash and no demand deposit accounts; and (3) he had not filed any tax returns for the years 2001, 2002, 2003 or 2004, because, amongst other reasons, he had no taxable income. [Docket #118, pp. 36-37]. Shareholder contributions by his wife in the amount of $500,000 would provide the source of capital to start up the investment business, however, Greenblatt did not have a written commitment to contribute that amount or a current balance sheet showing her assets and liabilities. [Docket #118, pp. 52-53].

[2/] CSFB filed a motion to file a late ballot rejecting the Amended Plan. [Docket #118, p.4]. As the bankruptcy court denied confirmation, it did not decide the motion.

Greenblatt also testified that another source was to "...enter into the tax-type sharing agreements in which we would benefit cash in exchange for the utilization of our NOLs through either leasing or other– some other mechanism." [Docket #118, p.54]. Greenblatt, however, had "absolutely not" entered into such agreements yet. [Docket #118, p.54]. After Debtor's counsel represented to the bankruptcy court that,

> [t]he only other piece of evidence that the debtors were going to offer was with respect to the funding of the $100,000 in the plan. And we had planned to have with us today a certified check...[but] we don't have that right at this moment...,

the Debtor rested its case. [Docket #118, pp. 58 and 61].

Based on the record before it, the bankruptcy court denied confirmation of the Amended Plan. In reaching this decision, the bankruptcy court noted that,

> You [the debtor] have a burden to show me feasibility and legality, and in this case they are about the same. You have to show me that engaging in business is feasible...you would have to show me that you could engage in business and would engage in business both in terms of feasibility and in terms of 1141(d)(3).

[Docket #118, p.7-8]. Feasibility, the court stated, "...is something that we take into account seriously" in Chapter 11 [Docket #118, p.77].

The U.S. Trustee then filed the Motion to Dismiss Pursuant to 11 U.S.C. §1112(b) ("Motion to Dismiss"). [Docket #116]. The Motion requested dismissal because the Debtor had been in bankruptcy for almost a year, and, had twice attempted unsuccessfully to confirm a plan. Continuation of this case would only serve to further delay and prejudice the creditors. [Docket #116, p.2]. After notice, and, a hearing on July 25, 2005, the bankruptcy court dismissed the case. [Docket #119].

Thereafter, the Debtor filed the Motions to Reconsider the dismissal order and to the order denying confirmation of the Amended Plan. [Docket #s 125 and 126]. The Debtor alleged that there was clear error of law in denying confirmation. Further, the Debtor claimed that,

> ...it has reached an agreement for funding of the plan, and will have evidence of available funds. The Debtor's agreement with another entity will allow the Debtor to engage in business and utilize the NOLs post-confirmation.

[Docket #126, p.8]. The Debtor also stated that prior to the hearing on the Motions to Reconsider, it would present a second amended plan and second amended disclosure statement.[3/] [Docket #126, p.7]. The Debtor did not allege that this evidence existed but was unavailable when confirmation was denied. [Docket #140, p.5].

A hearing on the Motions to Reconsider was held on August 23, 2005 whereby the Debtor, the U.S. Trustee, MJK and CSFB orally argued their respective positions.[4/] At the hearing, the Debtor attempted to offer evidence of a merger agreement to fund the capital requirements of the reopened business. [Docket #135, p.17]. At the conclusion of the hearing, the bankruptcy court stated that it intended to write an opinion on the Motions to Reconsider. The court did indicate that it disagreed with the Debtor that it made a legal error, and, further, it would decline to exercise its discretion to reopen the proofs. [Docket #135, pp. 48-49]. On October 31, 2005, the bankruptcy court issued the Opinion denying the Motions to Reconsider. [Docket #140].

[3/] The Debtor did not tender a second amended plan and second amended disclosure statement at or prior to the hearing. [Docket #135, p.31].

[4/] MJK also filed a written objection to the Motions. [Docket #130].

SUMMARY OF ARGUMENT

The bankruptcy court properly exercised its discretion when it dismissed the Debtor's Chapter 11 case. The case had pended for almost one year, and, the Debtor made two unsuccessful attempts at confirming a plan of reorganization. Without addressing the other grounds for dismissal, the Debtor argues that the bankruptcy court erred when it denied confirmation of the Amended Plan as not feasible. The Debtor, as the proponent of the Amended Plan, had the burden of proving by a preponderance of the evidence that the Amended Plan complies with the statutory requirements for confirmation, including feasibility. The Debtor did not meet this burden. The Amended Plan is premised upon outside financing. At the confirmation hearing, the Debtor introduced no written commitment to provide such financing. The bankruptcy court properly found that the availability of such financing was sheer speculation, and, denied confirmation. After the debtor rested its case, and, during the hearing on the Motions to Reconsider, the Debtor attempted to introduce evidence of a purported merger agreement that would provide the financing for the Amended Plan. The bankruptcy court properly declined to consider such evidence, finding that the Debtor was essentially requesting a 'do-over'. As the bankruptcy court noted, if the debtor did indeed now have the financing necessary to fund a plan, the proper course would be to file a new case. Instead, the Debtor filed this appeal.

ARGUMENT

I. The Bankruptcy Court Properly Exercised Its Discretion When It Dismissed the Bankruptcy Case

11 U.S.C. §1112(b) governs conversion or dismissal of a Chapter 11 case. Section 1112(b) provides, in pertinent part,

> ...on request of a party in interest or the United States trustee...and after notice and a hearing, the court may convert a case under this chapter to a case under chapter 7 of this title or may dismiss a case under this chapter, whichever is in the best interest of creditors and the estate, for cause, including — ...
>
> (2) inability to effectuate a plan;
>
> (3) unreasonable delay by the debtor that is prejudicial to creditors...

11 U.S.C. §1112(b). A bankruptcy court has broad discretion to dismiss or convert a Chapter 11 case for cause, and, its decision is reviewed for an abuse of discretion. *In re Woodbrook Assocs.*, 19 F.3d 312, 316 (7th Cir. 1994); *In re Han*, 2002 WL 31049846 at *4 (N.D.Ill. Sept. 12, 2004).

In the Motion to Dismiss, the U.S. Trustee alleged that cause existed in that there was an inability to effectuate a plan, and, unreasonable delay by the Debtor that was prejudicial to creditors. [Docket #116]. The bankruptcy case had pended for almost a year. Further, the Debtor had two unsuccessful attempts to confirm a plan. As the bankruptcy court noted in the Opinion, bankruptcy judges are given great discretion in determining when a Chapter 11 case that is otherwise floundering should be dismissed. *See* Docket #140, p.14 *quoting In re Woodbrook Assocs.*, 19 F.3d 312, 322 (7th Cir. 1994) ("Chapter 11 provides reasonable opportunity for corporate reorganization [;] it does not guarantee reorganization nor does it permit an indefinite suspension of creditors' rights and remedies pending the unsuccessful attempts of any party to effect a reorganization of debt...[B]ankruptcy courts are given a great deal of discretion to say when enough is enough.")[5/] The bankruptcy court properly exercised its discretion when it said enough and dismissed the bankruptcy case.

II. The Bankruptcy Court Correctly Found that the Amended Plan was not Feasible

The Debtor complains that the bankruptcy court initially denied confirmation on the sole basis that the Amended Plan violated 11 U.S.C. §1141(d)(3) by providing a discharge to a liquidating chapter 11 debtor, and, only upon reconsideration, stated new grounds for denial as not feasible in violation of 11 U.S.C. §1129(a)(11). The Debtor misconstrues what occurred at the July 12, 2005 Hearing on Confirmation. At the Hearing, the bankruptcy court noted that feasibility is something that is seriously taken into account in Chapter 11. [Docket #118, p.77]. The Debtor had the burden to show to the bankruptcy court feasibility and legality, which the bankruptcy court found to be about the same thing in this case. [Docket #118, p.78]. As the bankruptcy court amplified in the Opinion,

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[5/] Just as in *Woodbrook Assocs.*, the Debtor was afforded an opportunity to amend the Original Plan. The Amended Plan was substantially similar to the Original Plan, the only material change being to provide the exact legal exemption it intended to rely upon when issuing stock under the Amended Plan. *Id.*

confirmation was denied for two reasons, with the overriding one being lack of plan feasibility. [Docket #140, p.8].[6/] This finding that the Amended Plan was not feasible is correct.[7/]

The Debtor, as the plan proponent, had the burden of proving by a preponderance of the evidence that the Amended Plan complies with the statutory requirements for confirmation, including feasibility. *In re Arnold & Bakers Farms*, 177 B.R. 648, 654-53 (BAP 9th Cir. 1994), *aff'd*, 85 F.3d 1415 (9th Cir. 1996), *cert. denied*, 519 U.S. 1054 (1997). Section 1129(a)(11) of the Bankruptcy Code mandates that "[c]onfirmation of the plan is not likely to be followed by the liquidation, or the need for further financial reorganization, of the debtor or any successor to the debtor under the plan, unless such liquidation or reorganization is proposed in the plan." 11U.S.C. §1129(a)(11).[8/] Feasibility must be established regardless of whether a plan is accepted by creditors. *See In re M & S Associates, Ltd.*, 138 B.R. 845, 848-49 (Bankr. W.D.Tex. 1992) (where the court found that "[a] bankruptcy court has an affirmative

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[6/] Specifically, the bankruptcy court held that "[e]ven if Debtor is correct that inclusion of the discharge provision in its Amended Plan was not illegal since the Plan did not expressly provide for 'liquidation' of the NOLs, it overlooks the overriding issue determined at confirmation– lack of plan feasibility. Under evidence heard at the confirmation hearing, Debtor's Amended Plan was not feasible." [Docket #140, pp. 8-9].

[7/] In the Appellant's Opening Brief (the "Brief"), the Debtor suggests that the bankruptcy court erred in denying confirmation of the Amended Plan because it did so based upon a misinterpretation of 11 U.S.C. §1141(d)(3). [Brief, pp. 6-9]. This argument is wrong on the merits, but, more significantly, it is irrelevant. As previously discussed, the bankruptcy court was clear that confirmation of the Amended Plan alternatively was denied because the Plan was not feasible. [Docket #140, pp. 8-9]. Lack of feasibility formed a separate and independent basis for denial of confirmation that merits affirmance of the order entered below.

[8/] In the Brief, the Debtor attempts to minimize the importance of feasibility, arguing that if the $100,000 contribution by Greenblatt did not arrive, creditors would have options under the Bankruptcy Code. [Brief, p.11]. The burden, however, does not shift to creditors to assure payment under a plan. The purpose of confirmation is to end litigation, not be the basis of further disagreement.

obligation to scrutinize a reorganization plan to determine whether it is feasible. In order to confirm a plan, the court must make a specific finding that the plan, as proposed, is feasible").[9/]

A reorganization plan under chapter 11 must be more than a nebulous speculative venture and must have a realistic chance of success which would lead to rehabilitation, and if outside financing is needed, it must be clearly in sight. *In re Original IFPC Shareholders, Inc.*, 317 B.R. 738, 744 (Bankr. N.D.Ill. 2004) (*citing In re K.C. Marsh Co., Inc.*, 12 B.R. 401 (Bankr. D.Mass. 1981)). The Amended Plan is premised upon a $100,000 contribution to be made by Greenblatt to the Debtor (the "Contribution"). [Docket #67, p.3]. The Contribution is the sole source of funding of any distribution to unsecured creditors under the Amended Plan. The Amended Disclosure Statement itself admits that "...the [Amended] Plan's feasibility is based on the payment of the Contribution." [Docket #69, p.25].

At the July 12, 2005 Hearing on confirmation, the Debtor provided no evidence that the Contribution would be available to fund the distribution to unsecured creditors. Greenblatt testified that as of the date of the hearing he had: (1) no source of employment income; (2) no cash and no demand deposit accounts; and (3) he had not filed any tax returns for the years 2001, 2002, 2003, or 2004, because, amongst other reasons, he had no taxable income. [Docket #118, pp. 36-37]. Instead, Greenblatt testified that his wife would be the contributing source for the Contribution, but, the Debtor provided no corroborating evidence that his wife had agreed to provide such funding, and, that she had the

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[9/] In the Brief, the Debtor suggests that the bankruptcy court erred by just not accepting the creditors' vote on the Amended Plan. [Brief, p.11]. That is not the law. *Id.* at 848-49. Further, while it is true that the Amended Plan was accepted by the two creditors who timely voted, one of which was an affiliate of the Debtor, CSFB filed a motion to file a late ballot rejecting the Amended Plan, and, CSFB and MJK filed objections to confirmation. There was no overwhelming creditor support of the Amended Plan.

financial ability. Greenblatt had no balance sheet for his wife showing her assets and liabilities. [Docket #118, pp. 52-53].[10]

The bankruptcy court found that Mr. Greenblatt's testimony amounted to nothing more than wishful thinking. [Docket #140, p.10]. Specifically, the bankruptcy court found that,

> We have nothing but sheer speculation from the witness without the slightest corroboration as to plans to raise a half a million dollars from his wife, without even a piece of paper from his wife making a promise to undertake to do that, and without the slightest evidence as to her resources.

[Docket #118, p.84]. The bankruptcy court correctly found that the Debtor had failed to prove by a preponderance of the evidence that the Amended Plan was feasible, as required by 11 U.S.C. §1129(a)(11). As such, the bankruptcy court properly denied confirmation of the Amended Plan.

III. The Bankruptcy Court Properly Exercised Its Discretion When It Denied the Motions to Reconsider

As shown above, there was no mistake of law or fact in the bankruptcy court's decisions to grant the U.S. Trustee's Motion to Dismiss, and, to deny confirmation of the Amended Plan. Accordingly, the bankruptcy court properly denied the Motions to Reconsider pursuant to F.R.Civ.P. 59(e). *See Gendron v. United States*, 154 F.3d 672, 674 (7th Cir. 1998) (where the court held that motions to alter or amend a judgment based on Rule 59(e) of the Federal Rules of Civil Procedure will only be granted if there has been a mistake of law or fact to which the judgment is based upon or where there is newly discovered

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[10] Greenblatt similarly testified, without any corroborating evidence, that his wife would contribute the $500,000 required to restart the business. [Docket #118, p.53].

evidence that was not previously available).

The Debtor, however, complains that the bankruptcy court refused to consider evidence of a purported written merger agreement between the Debtor and another entity at the August 23, 2005 Hearing on the Motions to Reconsider. [Brief, p.13].[11/] A bankruptcy court has broad discretion in ruling on motions to reopen a judgment pursuant to F.R.Civ.P. 59(a). *Sellers v. Baisier*, 792 F.2d 690, 693 (7th Cir. 1986). Under F.R.Civ.P. 59(a), a "court may open the judgment once one has been entered, take additional testimony, amend findings of fact and conclusions of law or make new findings and conclusions, and direct the entry of a new judgment." F.R.Civ.P. 59(a). A motion premised on Rule 59(a) "is not intended to secure a forum for the relitigation of old matters or to afford the parties the opportunity to present the case under new theories; instead, the motion is a device properly used to correct manifest errors of law or fact or to present newly discovered evidence." *Fort Howard Paper Co. v. Standard Havens, Inc.*, 901 F.2d 1373, 1380 n.4 (7th Cir. 1990).

In the Opinion, the bankruptcy court clearly sets forth its reasons for declining to reopen the judgment to consider evidence of the purported merger agreement. July 12, 2005 was the date set for the hearing on confirmation of the Amended Plan. Necessary evidence should have been prepared and presented at that time. [Docket#140, p.13]. The bankruptcy court found that,

> What the Debtor is essentially requesting is a 'do-over' so that it can correct glaring deficiencies in its initial attempt to satisfy its burden of proof. Furthermore, the newly created evidence should have been

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[11/] The Debtor does not allege that this agreement had existed but was not available at the time of the hearing on confirmation of the Amended Plan. [Docket #140, p.5]. In fact, Greenblatt testified at the confirmation hearing that he had "absolutely not" entered into any agreement. [Docket #118, p.54].

> prepared and presented during the confirmation hearing. (citations omitted).

[Docket #140, p.13]. As the bankruptcy court noted, if the Debtor did indeed now have such funding available to it, it could have simply filed a new Chapter 11 case. [Docket #140, p.15]. The bankruptcy court did not abuse its discretion when it declined to consider the evidence, and, denied the Motions to Reconsider.

CONCLUSION

For these reasons, the U.S. Trustee respectfully asks this Court to affirm the orders entered below.

RESPECTFULLY SUBMITTED:
IRA BODENSTEIN
UNITED STATES TRUSTEE

DATED: January 17, 2006

BY: /S/ Cameron M. Gulden
Cameron M. Gulden, an attorney for the
United States Trustee

Kathryn Gleason (ARDC #06196518)
Cameron M. Gulden (ARDC # 0310931)
Office of the U.S. Trustee
227 West Monroe Street, Suite 3350
Chicago, Illinois 60606
(312) 886-3327

BRIEF BANK — "SUMMARY SHEET" *Printed Tue.-6/15/4 (10:14)*

WESTLAW CODES

1. **("TI")** ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*
Reishcel v. US Trustee

2. **("CO")** ***CURRENT*** COURT *[E.g., "CTA9"]*
CTA7

3. **("CCN")** ***CURRENT*** CASE NO.
No.: 03-4128

4. **("PCN")** ***PRIOR*** CASE NO. & COURT *[IF ANY]*
No.:
Court: E D WI
(Identify judge & cite, if any)

5. **("SO")** ***SOURCE***
U.S. TRUSTEES

6. **("DA")** ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*
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Type: Brief for the Appellee

7. **("AU")** ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*
Joshua Waldman, Esq, Appellate Staff/DOJ
(UST/OGC: 202-307-1399/FAX-2397)

8. **("TO")** ***TOPIC***
BANKRUPTCY

9. **("SU")** ! ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***

! Whether the bankruptcy court properly imposed a statutory 180 day prohibition on re-filing appellant's petition for bankruptcy after appellant willfully failed to appear at a creditors' meeting and willfully failed to appear in court for a hearing on a motion to dismiss his case.

√ **Background:** Appellant voluntarily filed a petition under the debt liquidation provision of the Bankruptcy Code, 11 USC §701, et seq. When he failed to appear at a creditors' meeting, the case trustee moved to dismiss his case under 11 USC § 707 (a). Appellant then failed to appear at the hearing on the motion to dismiss. In Sept 2002, the bankruptcy court dismissed appellant's case for failure to appear at the hearing and imposed a 180 day re-filing bar under §109 (g) (1) for the same reasons.

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No. 03-4128

IN THE UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

BENEDICT J. REISCHEL,

Debtor-Appellant,

v.

UNITED STATES TRUSTEE,

Appellee.

ON APPEAL FROM THE
UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF WISCONSIN

BRIEF FOR APPELLEE

OF COUNSEL:

MATTHEW SUTKO
Office of the General Counsel
Executive Office for United States Trustees
Department of Justice

PETER D. KEISLER
Assistant Attorney General

ROBERT M. LOEB
(202) 514-4332
JOSHUA WALDMAN
(202) 514-0236
Attorneys, Appellate Staff
Department of Justice
Civil Division, Room 9133
601 D Street N.W.
Washington, D.C. 20530

IN THE UNITED STATES COURT OF APPEALS
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No. 03-4128

BENEDICT J. REISCHEL,

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v.

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ON APPEAL FROM THE
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BRIEF FOR APPELLEE

JURISDICTIONAL STATEMENT

The bankruptcy court had jurisdiction under 28 U.S.C. §§ 157, 1334. On September 5, 2002, the bankruptcy court issued a final order dismissing Benedict Reischel's case under 11 U.S.C. § 707(a) and imposing a 180-day bar prohibiting the filing of a new bankruptcy petition under 11 U.S.C. § 109(g)(1). Appellant timely filed a notice of appeal to the district court on September 16, 2002, within the 10-day period required under Federal Rule of Bankruptcy Procedure 8002(a) and 9006(a). The district court had jurisdiction under 28 U.S.C. § 158(a)(1). The district court entered a final order affirming the bankruptcy court's order on September 17, 2003 and an order denying reconsideration on September 30, 2003. Appellant filed a timely notice of appeal on November 26, 2003, within the 60-day period permitted by Federal Rule of Appellate Procedure 4(a)(1)(B). This Court has jurisdiction under 28 U.S.C. § 158(d). As we explain below, however, because the issue raised by appellant is now moot, there is no longer Article III jurisdiction over this appeal.

STATEMENT OF THE ISSUES PRESENTED FOR REVIEW

Whether the bankruptcy court properly imposed a statutory 180-day prohibition on re-filing appellant's petition for bankruptcy after appellant willfully failed to appear at a creditors' meeting and willfully failed to appear in court for a hearing on a motion to dismiss his case.

STATEMENT OF THE CASE

Appellant voluntarily filed a petition under the debt liquidation provision of the Bankruptcy Code, 11 U.S.C. § 701 et seq. When he failed to appear at a creditors' meeting, the case trustee moved to dismiss his case under 11 U.S.C. § 707(a). Appellant then failed to appear at the hearing on the motion to dismiss. In September 2002, the bankruptcy court dismissed appellant's case for failure to appear at the creditors' meeting and failure to appear at the hearing, and imposed a 180-day re-filing bar under 11 U.S.C. § 109(g)(1) for the same reasons.

Appellant appeals the imposition of the 180-day bar on filing a new bankruptcy petition.

STATEMENT OF FACTS

I. STATUTORY BACKGROUND

1. In 1978, Congress established the United States Trustee Program "to aid in the administration of bankruptcy cases." Morgenstern v. Revco D.S., Inc., 898 F.2d 498, 500 (6th Cir. 1990). Under the program, the Attorney General appoints twenty-one United States Trustees to oversee bankruptcy cases within specified geographic areas, 28 U.S.C. § 581(a), who serve, in part, as "'watchdogs . . . prevent[ing] fraud, dishonesty, and over-reaching in the bankruptcy arena,'" In re A-1 Trash Pickup, Inc., 802 F.2d 774, 775 (4th Cir. 1986). U.S. Trustees "may raise and may appear and be heard on any issue in any case or proceeding under [Title 11]." 11 U.S.C. § 307; see also Morgenstern, 898 F.2d at 500 (discussing trustee as a proper party on appeal). Those U.S. Trustees, in turn, establish panels of individuals eligible to serve as case trustees in bankruptcy cases, 28 U.S.C. § 586(a), and the U.S. Trustee may then appoint a case trustee to oversee a particular case, 11 U.S.C. §§ 701, 702(d).

2. A bankruptcy court may dismiss a debtor's chapter 7 case "for cause," including an "unreasonable delay by the debtor that is prejudicial to creditors." 11 U.S.C. § 707(a)(1). If a

debtor's case is dismissed because of a "willful failure of the debtor to abide by orders of the court, or to appear before the court in proper prosecution of the case," then the debtor is barred for 180 days from filing another petition for bankruptcy. 11 U.S.C. § 109(g)(1).

II. FACTS AND PROCEEDINGS BELOW

1. On January 28, 2002, appellant Benedict J. Reischel filed in the Eastern District of Wisconsin a voluntary petition under Chapter 13 of the Bankruptcy Code. See 11 U.S.C. § 1301 et seq. Upon Reischel's motion, the petition was converted into a Chapter 7 proceeding. Supplemental Appendix ("App.") 25.[1] See also Black v. United States Postal Serv., 115 F.3d 521, 522 (7th Cir. 1997) ("The Chapter 13 debtor proposes a plan for the payment of creditors over time, in lieu of liquidation of the debtor's estate as in Chapter 7.").

The U.S. Trustee appointed a case trustee to represent the bankruptcy estate and oversee the bankruptcy case. The case trustee convened a meeting of creditors on June 10, 2002, at which Reischel was required to attend and cooperate. See 11 U.S.C. §§ 341(a), 343, 521(3). See App. 25. At that meeting,

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[1] Because Appellant's Appendix omits certain relevant documents and is un-paginated, pursuant to Seventh Circuit Rule 30(e), the Government has bound with this brief a Supplemental Appendix with the relevant contents as specified in Seventh Circuit Rule 30(a) and (b) and with pagination to permit citation thereto. All of the Government's Appendix citations are to the Supplemental Appendix bound with this brief.

Reischel was unable to answer the trustee's questions and did not provide his social security verification information. App. 25. The trustee adjourned the meeting until June 19, sending Reischel notice by certified mail. Reischel failed to claim the letter and it was returned to the trustee. Reischel then failed to appear at the June 19 meeting. App. 8, 25-26. Reischel has never explained his failure to attend the meeting.

2. The case trustee then moved to dismiss Reischel's action for failure to appear. App. 26; see 11 U.S.C. § 707(a)(1) ("The court may dismiss a case . . . for cause, including . . . unreasonable delay by the debtor that is prejudicial to creditors."). Reischel requested that the hearing be conducted by telephone or postponed until August 15, 2002; the bankruptcy court scheduled the hearing for the date Reischel requested. Reischel then asked to defer that hearing date, and the bankruptcy court once again accommodated him by rescheduling the hearing for September 5, 2002. On August 27, 2002, Reischel admitted that he was aware of the September 5 hearing date, but for the third time asked the court to defer the hearing. The court retained its hearing date of September 5, 2002. App. 26.

Reischel failed to appear at the September 5 hearing. App. 2, 26. On the motion to dismiss, the trustee explained that Reischel "did not appear" at the creditors' meeting on June 19, and the court therefore "dismissed for failure to appear." App. 3; see also App. 7.

The bankruptcy court also barred Reischel from filing a new bankruptcy petition for 180 days. Under 11 U.S.C. § 109(g)(1), "no individual . . . may be a debtor . . . who has been a debtor in a case pending . . . at any time in the preceding 180 days if . . . the case was dismissed by the court for willful failure of the debtor to abide by orders of the court, or to appear before the court in proper prosecution of the case." The bankruptcy court explained:

> [T]he 180 days [bar] applies if the case was dismissed by the Court for willful failure of the debtor to abide by order of the Court [or] to appear before the Court in proper prosecution of the case. That is true here. He has not appeared before this Court in proper prosecution of the case.

App. 4-5. The bankruptcy court subsequently amended its finding in a September 11 minute order, finding that Reischel failed to cooperate at the June 10 creditors' meeting, "did not appear at the adjourned meeting" on June 19, and "further failed to appear for [the September 5] hearing." App. 8. Accordingly, the bankruptcy court "dismissed the case due to the debtor's failure to appear at the adjourned § 341 meeting of creditors, as well as the willful failure of the debtor to appear before the court in proper prosecution of the case," and imposed the 180-day bar under § 109(g)(1). Ibid.

Reischel subsequently moved the bankruptcy court to stay its orders pending an appeal. Reischel failed to appear at that hearing as well, and the bankruptcy court denied his motion. App. 14.

3. Reischel appealed the bankruptcy court's order imposing a 180-day re-filing bar to the district court.[2] Reischel filed his brief to the district court on June 23, 2003, and the trustee filed his brief on July 8, 2003, within the 15-day limit required under Federal Rule of Bankruptcy Procedure 8009(a)(2). See App. 11 (District Court docket number 21). Reischel then had 10 days (until July 18) to file his reply brief, see F.R.B.P. 8009(a)(3), but rather than do so, he sent a fax on July 31 to the district court claiming that the trustee had not timely filed or properly served his brief, pointing out that the file stamp stated that the trustee's brief was filed "'after hours'" on July 8 (specifically, at 4:36 PM). App. 20. The trustee responded that a brief filed "'after hours'" is still timely, and attached an affidavit of service establishing timely service. App. 21-23. Reischel subsequently withdrew his argument that the brief was not timely served. App. 24.

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[2] Reischel originally appealed both the order dismissing his case and the order imposing a 180-day bar on his filing a new petition. The district court subsequently permitted him to voluntarily dismiss the former. App. 15; Br. at 5 ¶ 4.

4. On September 17, 2003, the district court entered an order affirming the decision of the bankruptcy court. The district court sustained the bankruptcy court's finding that Reischel's failure to appear in proper prosecution of the case was "'willful,'" holding that his repeated misconduct supported the bankruptcy court's conclusion. Specifically, the district court cited Reischel's failure to cooperate with the trustee at the June 10 creditors' meeting; Reischel's failure to appear at the June 19 creditors' meeting; and Reischel's failure to appear at the bankruptcy court's September 5 hearing despite that court's repeated scheduling of the hearing at Reischel's own request. App. 28-30.

Reischel also argued that once the bankruptcy court dismissed his case, it had no authority to then impose upon him a 180-day bar under § 109(g)(1). App. 30. In support of that argument, he cited the bankruptcy court's September 11 minute order relating to the 180-day bar, and pointed out that this came 6 days after the bankruptcy court's September 5 dismissal. App. 30; see also App. 8 (September 11, 2002 Minute Order). The district court rejected that argument as well, holding that the bankruptcy court made its finding imposing a 180-day bar at the September 5 hearing at the same time that it dismissed Reischel's case, and that the September 11 order "merely amended the September 5, 2002, oral order to reflect that finding." App. 30.

5. On September 30, 2003, the district court denied Reischel's motion to reconsider. Although Reischel argued that he had been denied an opportunity to submit a reply brief, the district court observed that "the court has endeavored to accommodate Reischel's incessant requests for more time to file an initial brief and a reply brief," that Reischel never submitted a reply brief, and that "over the course of almost a year, it has become more than clear to the court that Reischel has no intention of briefing the merits of his appeal." App. 32-33. "Indeed," continued the district court, "to have delayed the resolution of this matter any longer would have rewarded what can best be described as perpetual obfuscatory tactics on the part of Reischel. More to the point, the succinct factual and legal analysis addressed in the court's September 17, 2003 order make it equally clear that, on the merits of his appeal, Reischel is entitled to no relief whatsoever." App. 33. Thus, the district court denied his motion for reconsideration.

6. On November 26, 2003, Reischel filed a timely notice of appeal to this Court. Reischel was ordered to file his opening brief by January 30, 2004, and subsequently granted an extension until March 1, 2004. Rather than file a brief, however, one day after this Court's deadline expired, Reischel filed a motion for "summary disposition." This Court ordered Reischel to show cause why his appeal should not be dismissed for want of prosecution.

Reischel responded on March 31 that, as a pro se plaintiff, he misunderstood the applicable rules and required additional time to file his brief. This Court subsequently ordered him to file his brief by May 17, 2004.

SUMMARY OF ARGUMENT

Reischel's appeal of the imposition of a 180-day bar on re-filing a bankruptcy petition is moot. That bar was imposed on September 5, 2002, and has long since expired. Accordingly, he suffers no injury and this Court can grant no relief that would benefit him. The appeal should therefore be dismissed as moot.

On the merits, the bankruptcy court correctly imposed the 180-day statutory prohibition. There is no dispute that Reischel's case was properly dismissed, and Reischel does not appeal his dismissal. Nor is there any dispute that Reischel failed to appear at the June 19 creditors' meeting and failed to appear at the September 5 hearing before the bankruptcy court. And Reischel's repeated misconduct amply supports the bankruptcy court's finding that his conduct was "willful." Accordingly, he falls squarely within 11 U.S.C. § 109(g)(1), which imposes a 180-day bar on re-filing when a debtor's "case was dismissed by the court for willful failure of the debtor to abide by orders of the court, or to appear before the court in proper prosecution of the case."

The bankruptcy court was under no obligation, contrary to Reischel's argument, to permit him to appear by telephone at the September 5 hearing, especially after that court had twice scheduled the hearing date at Reischel's specific request. In any event, Reischel's failure to appear at the June 19 creditors' meeting was alone sufficient to impose a 180-day bar under § 109(g)(1).

Although Reischel has waived the argument on appeal, the bankruptcy court's dismissal did not deprive it of jurisdiction to subsequently impose the 180-day prohibition. That argument is factually and legally mistaken: it is factually wrong because the court simultaneously dismissed the case and imposed the bar; it is legally incorrect because the court retained jurisdiction, even after dismissing the case, to decide collateral issues unrelated to the merits of Reischel's bankruptcy petition, such as imposing the bar at issue.

Finally, Reischel's argument that the district court erred in failing to rule on whether the trustee's brief was timely filed is meritless. The record is entirely clear that the trustee's brief was both timely filed and served. Equally meritless is Reischel's complaint that he never had an opportunity to file a reply brief. The failure is his own, not the district court's. And in any event, as the district court pointed out, Reischel's arguments on the merits were so frivolous that a reply brief would not have changed the analysis or outcome.

STANDARD OF REVIEW

In an appeal of the district court's affirmance of a bankruptcy court's decision, this Court upholds the bankruptcy court's factual findings unless clearly erroneous and reviews its conclusions of law de novo. In re Crivello, 134 F.3d 831, 835 (7th Cir. 1998).

ARGUMENT

I. REISCHEL'S APPEAL OF THE EXPIRED 180-DAY FILING BAR IS MOOT

"Article III of the United States Constitution limits the jurisdiction of the federal courts to actual cases or controversies." Jordan v. Indiana High Sch. Athletic Ass'n, 16 F.3d 785, 787 (7th Cir. 1994). An actual case or controversy "must exist at all stages of appellate review," and if it does not, the appeal is moot and must be dismissed. Id.

Reischel's appeal is moot. He does not appeal the dismissal of his bankruptcy case, but only appeals the imposition of a 180-day re-filing bar. The bankruptcy court imposed that bar on September 5, 2002. The bar has long since expired and no longer precludes him from re-filing a bankruptcy petition. Compare 11 U.S.C. § 349(a) (authorizing bankruptcy court to bar all future discharge of debts in a dismissed case); Colonial Auto Ctr. v. Tomlin, 105 F.3d 933, 936-38 (4th Cir. 1997) (discussing difference between § 109(g)(1) and § 349(a)). Consequently his appeal is moot and should be dismissed. Orion Sales, Inc. v. Emerson Radio Corp., 148 F.3d 840, 842 (7th Cir. 1998) ("injunction entered by the district court in this case is patently moot" because it "expired by its own terms on March, 31, 1998, over two months prior to the oral argument of this appeal" and thus any relief sought "would have no effect, as the injunction has expired"); Jordan v. Indiana High Sch. Athletic Ass'n, 16 F.3d 785 (7th Cir. 1994) (dismissing as moot a challenge to an expired permanent injunction).[3]

II. THE BANKRUPTCY COURT CORRECTLY IMPOSED THE 180-DAY STATUTORY BAR

Because the appeal here is moot, there is no need or jurisdiction to address the merits of Reischel's claims. They are, in any event, without merit.

A. As noted above, if a debtor's case is dismissed because of a willful failure to follow the court's orders or a willful failure to prosecute the case, then the debtor is barred for 180 days from filing another petition for bankruptcy. 11 U.S.C.

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[3] The mootness exception for cases "capable of repetition, yet evading review" applies "only if there is a reasonable expectation that the same complaining party would be subjected to the same action again." Orion Sales, 148 F.3d at 842 (internal quotation marks and citation omitted). In this case, there is no reasonable expectation that Reischel will again engage in willful behavior leading to the dismissal of a future bankruptcy petition, and thus the imposition of another 180-day re-filing bar.

§ 109(g)(1) ("no individual . . . may be a debtor under this title who has been a debtor in a case pending under this title at any time in the preceding 180 days if . . . the case was dismissed by the court for willful failure of the debtor to abide by orders of the court, or to appear before the court in proper prosecution of the case."). Here, Reischel failed to appear at a creditors' meeting mandated by 11 U.S.C. §§ 341(a), 343, and then failed to appear at a bankruptcy court hearing that was specifically set to accommodate his schedule. As a result, the bankruptcy court properly imposed a 180-day re-filing bar.

Reischel does not appeal the dismissal of his bankruptcy case. See supra note 2; Br. at 5 ¶ 1. Nor is there any dispute that his case was dismissed for "failure of the debtor to abide by orders of the court," namely, failing to appear at the June 19 creditors' meeting. See Colonial Auto Ctr. v. Tomlin, 105 F.3d 933, 940 (4th Cir. 1997) (when a debtor "fail[s] to appear at the initial creditors' meeting," the "usual remedy . . . is the § 109(g) temporary bar to filing"); id. at 941 (debtor's "failure to attend the initial creditors' meeting . . . is the very behavior for which Congress formulated § 109(g)"); Montgomery v. Ryan, 37 F.3d 413, 414 (8th Cir. 1994) ("Failure to attend a creditors meeting is a failure to obey a court order within the meaning of section 109(g)(1)."). Nor, finally, is there any dispute of Reischel's "failure. . . to appear before the Court in proper prosecution of the case” at the September 5 hearing. App. 4-5 (Reischel “has not appeared before the Court in proper prosecution of the case”); App. 8 (“The debtor further failed to appear for this hearing.”).

While he does not challenge the dismissal of his bankruptcy case, Reischel appears to argue on appeal that his failure to appear at the September 5, 2002 hearing could not properly be a basis for imposing a 180-day re-filing bar under § 109(g)(1), because he requested, but was not granted, permission to appear by telephone. Br. at 4. Reischel appears to claim that the bankruptcy court could not therefore deem his conduct “willful” under § 109(g)(1).

A finding of willfulness, however, is subject to review for clear error. As the district court noted, the bankruptcy court had ample evidence to support willfulness: Reischel’s failure to cooperate with the trustee at the June 10 creditors’ meeting; his failure to appear at the June 19 creditors’ meeting; and his failure to appear at the bankruptcy court’s September 5 hearing despite that court’s repeated scheduling of the hearing at Reischel’s own request. See supra at 8. Moreover, Reischel was sent notice of the June 19 meeting and September 5 hearing, but never provided an explanation for his failure to attend.

Accordingly, the finding of willfulness was not clearly erroneous.[4]

As to Reischel's argument that the bankruptcy court should have allowed him to appear by telephone, Reischel can cite no authority suggesting that the bankruptcy court had an obligation to permit appearance by telephone – especially after it had already accommodated Reischel's two requests to schedule the hearing at a date of his choice. Nor does the court's declining to permit appearance by telephone excuse Reischel's failure to appear in person despite having notice of the hearing. In any event, even if his failure to appear at the September 5 hearing were not an adequate basis for the 180-day re-filing bar, Reischel's failure to appear at the June 19 creditors' meeting surely was, see supra at 14, and Reischel does not even discuss that basis for imposing the bar.

B. Although not pursued on appeal to this Court, Reischel argued below that once the bankruptcy court dismissed his case, it was without jurisdiction to impose a 180-day re-filing bar.

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[4] Reischel's subsequent conduct only reinforce the bankruptcy court's correct finding of willfulness: Reischel moved the bankruptcy court to stay its orders, but then failed to appear at the hearing on that motion. See supra at 7. Before the district court, Reischel failed to properly prosecute his case by failing to submit any reply brief, leading the district court to comment that "over the course of almost a year, it has become more than clear to the court that Reischel has no intention of briefing the merits of his appeal." App. 33. And in this Court, Reischel failed to timely file an opening brief, but instead filed a one page motion for "summary disposition."

Because Reischel has not raised the argument in his brief, he has waived the issue. See, e.g., Duncan v. Wisconsin Dep't of Health & Family Servs., 166 F.3d 930, 934 (7th Cir. 1999). In any event, as the district court correctly noted, Reischel's factual premise is mistaken: the two orders were imposed simultaneously at the September 5, 2002 hearing. While Reischel points to the subsequent September 11, 2002 minute order, that order "merely amended the September 5, 2002, oral order to reflect that finding." App. 30.

Even if the bankruptcy court had first dismissed the case, that would not have deprived it of jurisdiction to impose a § 109(g)(1) re-filing bar. "It is well established that a federal court may consider collateral issues after an action is no longer pending." Cooter & Gell v. Hartmarx Corp., 496 U.S. 384, 395 (1990). For example, a court may impose Rule 11 sanctions even after dismissal of the underlying action. Id. This is because imposing Rule 11 sanctions is "not a judgment on the merits of an action" but "requires the determination of a collateral issue," namely, "whether the attorney has abused the judicial process, and, if so, what sanction would be appropriate. Such a determination may be made after the principal suit has been terminated." Id. at 396. Likewise, "even after the [underlying] action . . . has been terminated," a court may award costs or attorney's fees, or consider a criminal contempt charge, because such orders are "not part of the original action" but are "'independent proceeding[s] supplemental to the original proceeding.'" Id. at 395-96. Similarly, even if the bankruptcy court had first dismissed Reischel's case, that would not deprive the court of jurisdiction to subsequently impose a 180-day re-filing bar, because that order would not be a judgment on the merits of Reischel's bankruptcy petition, but simply a collateral issue to determine whether Reischel had abused the legal process in prosecuting his petition.[5]

III. THE DISTRICT COURT DID NOT ERR IN DECLINING TO RULE ON THE TIMELINESS OF THE TRUSTEE'S BRIEF

Reischel argues that the district court erred in failing to rule on his argument that the trustee's district court brief was belatedly filed. Br. at 9. As noted above, however, the record is perfectly clear that the brief was timely filed and served. Furthermore, Reischel did file an opening brief, and it was considered by the district court, as is evident in the fact that the district court considered and rejected the arguments made in Reischel's brief. App. 25-30. While Reischel did not file a reply brief, that failure was his own doing, not the district

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[5] Rule 11 sanctions do not generally "preclude the refiling of a complaint," or if they do, it is not as "a consequence of the dismissal," 496 U.S. at 396-97. But those characteristics are relevant to whether Rule 11 sanctions are consistent with a voluntary dismissal under Federal Rule of Civil Procedure 41 (one of the issues considered in Cooter & Gell); they do not relate to whether a court has jurisdiction to impose Rule 11 sanctions post-dismissal.

court’s. And as the district court noted, App. 33, his arguments were so meritless that a reply brief would not have changed the analysis or outcome. Accordingly, the district court committed no error.

* * * *

This Court should dismiss Reischel’s appeal of the 180-day re-filing bar as moot, because the bar has expired and imposes no on-going consequences for Reischel. On the merits, the bankruptcy court properly imposed the bar as a result of Reischel’s failure to attend a creditors’ meeting and his failure to appear at a court hearing. The bankruptcy court did not err in finding Reischel’s conduct to be willful, was under no obligation to permit Reischel to appear by telephone, and had jurisdiction to impose the bar. Finally, the district court did not err in failing to rule on Reischel’s patently meritless claim that the U.S. trustee’s brief was untimely, and any missed opportunity to file a reply brief was Reischel’s own doing, not the district court’s.

CONCLUSION

For the foregoing reasons, this Court should affirm.

Respectfully submitted,

PETER D. KEISLER
Assistant Attorney General

ROBERT M. LOEB
(202) 514-4332
JOSHUA WALDMAN
(202) 514-0236
Attorneys, Appellate Staff
Department of Justice
Civil Division, Room 9133
601 D Street N.W.
Washington, D.C. 20530

OF COUNSEL:

MATTHEW SUTKO
Office of the General Counsel
Executive Office for United States Trustees
Department of Justice

JUNE 2004

STATUTORY ADDENDUM

11 U.S.C. § 109.

(a) Notwithstanding any other provision of this section, only a person that resides or has a domicile, a place of business, or property in the United States, or a municipality, may be a debtor under this title.

(b) A person may be a debtor under chapter 7 of this title only if such person is not--

(1) a railroad;

(2) a domestic insurance company, bank, savings bank, cooperative bank, savings and loan association, building and loan association, homestead association, a New Markets Venture Capital company as defined in section 351 of the Small Business Investment Act of 1958, a small business investment company licensed by the Small Business Administration under subsection (c) or (d) of section 301 of the Small Business Investment Act of 1958, credit union, or industrial bank or similar institution which is an insured bank as defined in section 3(h) of the Federal Deposit Insurance Act, except that an uninsured State member bank, or a corporation organized under section 25A of the Federal Reserve Act, which operates, or operates as, a multilateral clearing organization pursuant to section 409 of the Federal Deposit Insurance Corporation Improvement Act of 1991 may be a debtor if a petition is filed at the direction of the Board of Governors of the Federal Reserve System; or

(3) a foreign insurance company, bank, savings bank, cooperative bank, savings and loan association, building and loan association, homestead association, or credit union, engaged in such business in the United States.

(c) An entity may be a debtor under chapter 9 of this title if and only if such entity--

(1) is a municipality;

(2) is specifically authorized, in its capacity as a municipality or by name, to be a debtor under such chapter by State law, or by a governmental officer or organization empowered by State law to authorize such entity to be a debtor under such chapter;

(3) is insolvent;

(4) desires to effect a plan to adjust such debts; and

(5) (A) has obtained the agreement of creditors holding at least a majority in amount of the claims of each class that such entity intends to impair under a plan in a case under such chapter;

(B) has negotiated in good faith with creditors and has failed to obtain the agreement of creditors holding at least a majority in amount of the claims of each class that such entity intends to impair under a plan in a case under such chapter;

(C) is unable to negotiate with creditors because such negotiation is impracticable; or

(D) reasonably believes that a creditor may attempt to obtain a transfer that is avoidable under section 547 of this title.

(d) Only a railroad, a person that may be a debtor under chapter 7 of this title (except a stockbroker or a commodity broker), and an uninsured State member bank, or a corporation organized under section 25A of the Federal Reserve Act, which operates, or operates as, a multilateral clearing organization pursuant to section 409 of the Federal Deposit Insurance Corporation Improvement Act of 1991 may be a debtor under chapter 11 of this title.

(e) Only an individual with regular income that owes, on the date of the filing of the petition, noncontingent, liquidated, unsecured debts of less than $250,000 and noncontingent, liquidated, secured debts of less than $750,000, or an individual with regular income and such individual's spouse, except a stockbroker or a commodity broker, that owe, on the date of the filing of the petition, noncontingent, liquidated, unsecured debts that aggregate less than $250,000 and noncontingent, liquidated, secured debts of less than $750,000 may be a debtor under chapter 13 of this title.

(f) Only a family farmer with regular annual income may be a debtor under chapter 12 of this title.

(g) Notwithstanding any other provision of this section, no individual or family farmer may be a debtor under this title who has been a debtor in a case pending under this title at any time in the preceding 180 days if--

(1) the case was dismissed by the court for willful failure of the debtor to abide by orders of the court, or to appear before the court in proper prosecution of the case; or

(2) the debtor requested and obtained the voluntary dismissal of the case following the filing of a request for relief from the automatic stay provided by section 362 of this title.

11 U.S.C. § 707.

(a) The court may dismiss a case under this chapter only after notice and a hearing and only for cause, including–

(1) unreasonable delay by the debtor that is prejudicial to creditors;

(2) nonpayment of any fees or charges required under chapter 123 of title 28; and

(3) failure of the debtor in a voluntary case to file, within fifteen days or such additional time as the court may allow after the filing of the petition commencing such case, the information required by paragraph (1) of section 521, but only on a motion by the United States trustee.

(b) After notice and a hearing, the court, on its own motion or on a motion by the United States trustee, but not at the request or suggestion of any party in interest, may dismiss a case filed by an individual debtor under this chapter whose debts are primarily consumer debts if it finds that the granting of relief would be a substantial abuse of the provisions of this chapter. There shall be a presumption in favor of granting the relief requested by the debtor. In making a determination whether to dismiss a case under this section, the court may not take into consideration whether a debtor has made, or continues to make, charitable contributions (that meet the definition of "charitable contribution" under section 548(d)(3)) to any qualified religious or charitable entity or organization (as that term is defined in section 548(d)(4)).

CERTIFICATE OF COMPLIANCE WITH FED. R. APP. P. 32(a)

Pursuant to Federal Rule of Appellate Procedure 32(a)(7), I certify that the attached Brief for Appellee complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B) because this brief does not exceed 30 pages.

I also certify that this brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5), the type style requirements of Fed. R. App. P. 32(a)(6), and Seventh Circuit Rule 32(b), because this brief has been prepared in a monospaced typeface using Word Perfect 9 with Courier New type style, with 10 characters per inch.

____
Joshua Waldman
Counsel for Appellee

CERTIFICATE OF SERVICE

I hereby certify that on June 14, 2004, I served two copies of the foregoing Brief for Appellee and one electronic copy of the Brief by causing them to be sent by first class United States mail postage prepaid to:

BENEDICT J. REISCHEL
8221 West Imperial Drive
Franklin, WI 53132

I also hereby certify, pursuant to Fed. R. App. P. 25(d)(2), 30(a)(3), and 31(b), and pursuant to Seventh Circuit Rule 31(b), that on June 14, 2004, I filed an original and 15 copies of the foregoing Brief for Appellee by causing them to be sent by first class United States mail postage prepaid to:

Mr. Gino J. Agnello
Clerk, United States Court of Appeals
for the Seventh Circuit
U.S. Courthouse and Federal Office Bldg.
Room 2722
219 South Dearborn Street
Chicago, IL 60604

____
Joshua Waldman
Counsel for Appellee

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BRIEF BANK — "SUMMARY SHEET"

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WESTLAW CODES

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Jacques H. Geisenberger, Jr. PC v. Roberta A. DeAngelis United States Trustee (In re Ressler Hardwoods and Flooring, Inc.)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*
M.D. Pa.

3. ("CCN") ***CURRENT*** CASE NO.
No.: 1:10-cv-01660-CCC

4. ("PCN") ***PRIOR*** CASE NO. - & COURT *[IF ANY]*
No.: 1:08-bk-01878-MDF
Court: Bankr. M.D. Pa.
(Identify judge & cite, if any)

5. ("SO") ***SOURCE***
U.S. TRUSTEES

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*
Filed: November 1, 2010
Type: Brief of United States Trustee

7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*
Gregory R. Lyons, Anne W. Stukes, P. Matthew Sutko, Ramona D. Elliott, Anne K. Fiorenza, Roberta D. DeAngelis
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***
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IN THE UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF PENNSYLVANIA

IN RE RESSLER HARDWOODS AND :
FLOORING, INC. : BANKR. CASE NO. 1:08-bk-01878-MDF
Debtor :

JACQUES H. GEISENBERGER, JR., PC: CASE NO. 1:10-cv-01660-CCC
Appellant :
:
v. :
:
ROBERTA A. DeANGELIS :
UNITED STATES TRUSTEE :
Appellee :

ON APPEAL FROM THE UNITED STATES BANKRUPTCY COURT
FOR THE MIDDLE DISTRICT OF PENNSYLVANIA

BRIEF OF UNITED STATES TRUSTEE

Ramona D. Elliott
General Counsel

P. Matthew Sutko
Associate General Counsel

Anne W. Stukes
Trial Attorney
States Department of Justice
Executive Office for United States Trustees
20 Massachusetts Ave., NW
Room 8100
Washington, DC 20530
(202) 307-1399

ROBERTA A. DeANGELIS
UNITED STATES TRUSTEE

Anne K. Fiorenza
Assistant United States Trustee

By: /s Gregory R. Lyons
Gregory R. Lyons, Attorney United
Department of Justice
Office of the United States Trustee
P.O. Box 969
Harrisburg, PA 17108-0969
(717) 221-4515

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JURISDICTIONAL STATEMENT

On June 8, 2010, the United States Bankruptcy Court for the Middle District of Pennsylvania entered a final order granting the Amended Motion of the United States Trustee to disqualify Jacques H. Geisenberger, Jr., P.C. (referred to herein as "Geisenberger")[1] from acting as debtor's counsel, and seeking denial of compensation. The bankruptcy court had jurisdiction over the proceeding pursuant to 28 U.S.C. §§ 157 and 1334. On June 21, 2010 Geisenberger filed a motion asking the bankruptcy court to extend the time to file a notice of appeal. The motion was granted by Order dated June 22, 2010 and Geisenberger filed a timely notice of appeal on July 12, 2010. See 28 U.S.C. § 158(c)(2); Fed. R. Bankr. P. 8002. This Court has jurisdiction pursuant to 28 U.S.C. § 158(a)(1). See generally In re BH & P , Inc., 949 F.2d 1300, 1307 (3d Cir. 1991) (holding that an order disqualifying counsel in a bankruptcy case is final and appealable for purposes of 28 U.S.C. § 158).

COUNTERSTATEMENT OF ISSUES

A. Did the bankruptcy court clearly err by finding that Geisenberger failed to comply with the disclosure requirements of 11 U.S.C. § 329(a) and Federal Rule of Bankruptcy Procedure 2016(b)?

B. Did the bankruptcy court clearly err by finding that Geisenberger failed to comply with the disclosure requirements of 11 U.S.C. § 327 and Federal Rule of Bankruptcy Procedure 2014?

C. Did the bankruptcy court clearly err by finding that Geisenberger held an interest that was adverse to the bankruptcy estate?

D. Did the bankruptcy court abuse its discretion in concluding that disqualification of Geisenberger and denial of fees were appropriate

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[1] The bankruptcy court found no reason to distinguish between Mr. Geisenberger and his law firm, simply using the term "Geisenberger" to mean both. See Bankr. Docket no. 505 at p. 1, n.1. The United States Trustee adopts the same convention here.

remedies for Geisenberger's failure to meet the requirements of 11 U.S.C. §§ 327 and 329 and Federal Rules of Bankruptcy Procedure 2014 and 2016?

STANDARD OF REVIEW

The bankruptcy court's findings of fact are reviewed for clear error; its conclusions of law, *de novo*, and its exercise of discretion, for abuse. In re O'Brien Envtl. Energy, Inc., 188 F.3d 116, 122 (3d Cir. 1999). A bankruptcy court's factual determination of an attorney's disinterestedness or conflict of interest is reviewed for clear error. See, e.g., Federal Ins. Co. v. Grace, Nos. 04-844, 04-845, 2004 WL 5517843, *4 n.8 (D. Del. Nov. 22, 2004); In re Ponce Marine Farm, Inc., 259 B.R. 484, 491 (D. Puerto Rico 2001); Beal Bank, S.S.B. v. Waters Edge Ltd. Partnership, 248 B.R. 668, 696 (D. Mass. 2000). The bankruptcy court's decision to disqualify counsel is reviewed for abuse of discretion. In re BH & P, Inc., 949 F.2d 1300, 1321 (3d Cir. 1991). Likewise, the bankruptcy court's decision to deny or return attorney fees is reviewed for abuse of discretion. See, e.g., Hale v. U.S. Trustee, 509 F.3d 1139, 1147 (9th Cir. 2007); In re Robinson, 189 Fed. Appx. 371, 374, 2006 WL 1716702, *2 (6th Cir. June 22, 2006); In re Clark, 223 F.3d 859, 863 (8th Cir. 2000).

STATEMENT OF THE CASE

This is an appeal from a contested matter heard by the United States Bankruptcy Court for the Middle District of Pennsylvania. Ressler Hardwoods and Flooring, Inc. ("Ressler") filed the underlying chapter 11 case on May 27, 2008. On the same date, Ressler filed an application under 11 U.S.C. § 327(a) seeking the court's permission to employ Geisenberger as its bankruptcy counsel. (Bankr. Docket no. 4).[2] Based on the representations in the debtor's

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[2] Citations to the "Bankr. Docket" in this brief refer to the underlying Case No. 1:08-bk-01878-MDF. Citations to documents from the docket of the Little adversary proceeding

application and Geisenberger's declaration in support, and in the absence of any objections, the bankruptcy court entered an Order approving the application on June 26, 2008. (Bankr. Docket no. 76).

On March 31, 2009, the United States Trustee filed a motion to disqualify Geisenberger and to compel the return of fees. (Bankr. Docket no. 187). On May 13, 2009, the United States Trustee filed an amended motion. (Bankr. Docket no. 202). On July 30, 2009, Geisenberger filed a response to the amended motion (Bankr. Docket no. 252) and, after several continuances, the bankruptcy court conducted a hearing on December 10, 2009. (Bankr. Docket no. 363).

On June 8, 2010, the bankruptcy court entered an order granting the United States Trustee's motion, disqualifying Geisenberger and directing him to return $17,500 in fees to the bankruptcy estate. (Bankr. Docket no. 504). This appeal followed.

STATUTORY FRAMEWORK

Section 329(a) of the Bankruptcy Code governs the employment of attorney(s) by a debtor-in-possession. It states that "[a]ny attorney representing a debtor . . . shall file with the court a statement of the compensation paid or agreed to be paid, if such payment or agreement was made after one year before the date of the filing of the [bankruptcy] petition, for services rendered or to be rendered in contemplation of or in connection with the case by such attorney, and the source of such compensation." 11 U.S.C. § 329(a). If the reported compensation exceeds the reasonable value of any such services, the court may cancel the agreement and/or order the return of any excessive amount. 11 U.S.C. § 329(b).

In addition to section 329, Bankruptcy Rule 2016(b) provides that "every attorney for a

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refer to Adversary Case No. 1:08-ap-109.

debtor whether or not the attorney applies for compensation shall file and transmit to the United States Trustee . . . the statement required by § 329 . . . .”

Employment of a professional person by a debtor in possession is also governed by 11 U.S.C. § 327. Section 327(a) provides in relevant part:

> (a) Except as otherwise provided in this section, the trustee, with the court’s approval, may employ one or more attorneys . . . or other professional persons, that do not hold or represent an interest adverse to the estate, and that are disinterested persons . . .

Although by its terms section 327(a) applies only to professionals employed by the “trustee,” 11 U.S.C. § 1107(a) provides that a “debtor in possession” has “all the rights . . . of a trustee serving in a case under this chapter.”

The term “disinterested person” is defined at 11 U.S.C. § 101(14) as a person that -

> (A) is not a creditor, an equity security holder, or an insider;
>
> (B) is not and was not, within two years before the date of the filing of the petition, a director, officer, or employee of the debtor; and
>
> (C) does not have an interest materially adverse to the interest of the estate or any class of creditors or equity security holder, by reason of a direct or indirect relationship to, connection with, or interest in, the debtor, or for any other reason.

Federal Rule of Bankruptcy Procedure 2014 is designed to assist the court in implementation of section 327. Rule 2014 requires that an application seeking approval to employ a professional must state, among other things, any proposed arrangement for compensation, as well as the professional’s connections with the debtor, creditors, and any other party in interest. In addition, the application must be accompanied by an affidavit from the professional which also sets forth the professional’s connections with the debtor, creditors, and any other party in interest. Fed. R. Bankr. P. 2014. The purpose of Rule 2014 is to provide the court with information necessary to determine whether the professional’s employment meets the requirements of section 327.

Section 328(c) of the Bankruptcy Code authorizes the bankruptcy court to deny compensation to an attorney who has been employed if it comes to light that the attorney is not disinterested or holds an interest adverse to the estate. That section provides, in pertinent part:

> the court may deny allowance of compensation for services and reimbursement of expenses of a professional person employed under section 327 or 1103 of this title if, at any time during such professional person's employment under section 327 or 1103 of this title, such professional person is not a disinterested person, or represents or holds an interest adverse to the interest of the estate with respect to the matter on which such professional person is employed.

11 U.S.C. § 328(c).

COUNTERSTATEMENT OF FACTS

A. Geisenberger's Pre-petition Connections with Ressler.

Ressler was a flooring manufacturer owned and operated by Kenneth and Karen Ressler and their son, Keith Ressler (collectively the "Resslers"). On or about March 6, 2006, Ressler suffered fire damage that "totally destroyed" its place of business. Nt. 37.[3] On October 23, 2006, the Resslers had an initial conference with Jacques H. Geisenberger, Jr., the sole principal of Jacques H. Geisenberger, Jr., P.C. (collectively referred to herein as "Geisenberger"), to discuss the "financial and operational problems" caused by the failure of Erie Insurance Company to compensate Ressler for business interruption. Nt. 36, 37; UST trial Exhibit 1. During the ensuing months, Geisenberger represented Ressler in connection with the Erie insurance dispute as well as matters involving a lease of Ressler's place of business (Nt. 40), a loan default with Sovereign Bank (Nt. 38, 39), a sale of stock to CQ (one of debtor's vendors)

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[3] The designation "Nt" refers to the transcript of the hearing conducted by the bankruptcy court on December 10, 2009. The transcript can be found at Bankr. Docket no. 415.

(Nt. 42-45), and an aborted sale of a majority interest in Ressler to James Little (Nt. 44, 45, 46).

Despite the breadth of Geisenberger's work for Ressler, the terms of the attorney/client relationship were not documented until May 7, 2007, when Geisenberger sent Ressler a letter to "confirm several of the things which we discussed during our several meetings since our initial conference back on October 23, 2006." The "engagement letter" referenced unpaid fees for the first six months of representation and noted that future invoices would be submitted on a monthly basis. The letter listed as its subject "Various Problems," but specifically referenced only one matter: "the recent legal action commenced by Sovereign Bank."[4]

"Shortly after" the date of the engagement letter, Ressler paid Geisenberger the past-due fees. Nt. 41. The only other record of payments is found in an attachment to Ressler's Statement of Financial Affairs (Bankr. Docket no. 35; UST Trial Exhibit 3).[5] The attachment titled "Account Register" is intended to reflect all payments made by Ressler during the 90 days preceding the commencement of the bankruptcy case. The following payments to Geisenberger are reported, each of which was confirmed by Geisenberger during his trial testimony (Nt. 56-60):

Date	Check no.	Amount
02/06/08	1035	$7,033.17
03/07/08	1086	$7,897.96

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[4] A copy of the engagement letter is attached as Exhibit A to Ressler's application to employ Geisenberger. The application was admitted into evidence as United States Trustee's Exhibit 1.

[5] The Statement of Financial Affairs is one of the official bankruptcy forms (Form 7) that must be completed by all debtors. See Fed. R. Bankr. P. Official Form 7. It consists of 25 questions that seek historical financial information.

04/04/08	1144	$5,819.81
04/30/08	1197	$7,952.37
05/21/08	1002	$27,622.50
TOTAL		**$56,355.81**

B. Geisenberger's Involvement in the Little Litigation.

On or about January 14, 2008, James Little ("Little") filed a complaint against Ressler in the United States District Court for the District of Maryland alleging a violation of the Maryland Securities Act. Little claimed that Ressler and its principals issued stock to him and that the stock was neither registered nor exempt from registration under the Maryland Securities Act and that, therefore, he was entitled to a judgment against the defendants in the sum of $400,000. In Counts II and III of his complaint, Mr. Little sought relief based on securities fraud and assumpsit, respectively. The Little complaint was transferred to the Bankruptcy Court for the Middle District of Pennsylvania on July 22, 2008, and was assigned adversary number 1-08-ap-109. (Bankr. Docket no. 97; UST Trial Exhibit no. 4).

In support of his claims, Little alleged that during the spring of 2007, he began negotiating with Kenneth, Keith and Karen Ressler for a controlling interest in Ressler. (Bankr. Docket no. 97; UST Trial Exhibit no. 4 at ¶ 9). According to Little, the agreed purchase price for a 51% share was $1.2 million. (Id. at ¶ 10). A final sale agreement was contingent on the negotiation of, among other items, employment and non-compete agreements with the Resslers. (Id. at ¶ 9).

Little further alleged that in early July 2007 the Resslers asked him to make two advance deposits, each in the amount of $200,000, so that the business could meet various financial obligations. (Id. at ¶ 11). Little paid the money. Unfortunately, negotiations broke down and

Little demanded the return of both deposits. (Id. at ¶¶ 13, 14; Nt. 46). Instead of returning the money, Ressler issued Little a stock certificate for 26,021 shares of its stock. (UST Trial Exhibit no. 5).

The Ressler board of directors authorized the issuance of the stock certificate at a meeting held on December 10, 2007 (UST Trial Exhibit 5; Nt. 64, 66). Geisenberger attended the meeting and prepared and mailed the certificate that contained the following legend:

> These shares represented by this certificate are subject to restrictions upon transfer contained in the bylaws of the corporation. These securities have not been registered . . . They may not be sold or offered for sale in the absence of an effective registration . . . or an opinion of counsel satisfactory to the corporation that such registration is not needed.

(Id.). Geisenberger did not provide an opinion of counsel in connection with the issuance of the certificate and, at the time, did not know whether the certificate was exempt from registration. (Nt. 67, 68).

Upon receipt of the stock certificate, Little's counsel sent a letter to Geisenberger asserting that issuance of the stock to Little was contrary to the laws of the State of Maryland (Little's place of residence). (UST Exhibit 7; Nt. 72-76). Little's counsel offered to return the certificate in exchange for the funds advanced. Ressler refused and Little filed the above-described action in the United States District Court for the District of Maryland.

After the Little complaint was transferred to the bankruptcy court, Ressler and the individual defendants filed a motion for summary judgment. (Adversary Case 1-08-ap-109 Docket no. 40). On March 31, 2009, the bankruptcy court entered an order granting the defendants summary judgment on Little's claim that they had violated the Maryland Securities Act ("MSA"). The bankruptcy court denied summary judgment on Counts II and III.

In connection with the dismissed count, the court found that the shares issued to Little were “covered” securities and, therefore, exempt from registration under the MSA. (Adversary Case 1-08-ap-109 Docket no. 53 - Opinion at 14). The court opined, however, that Ressler was required to file a Form D with the Securities and Exchange Commission (“SEC”) and to satisfy the notice filing requirements of the MSA. Opinion at 16. It had not done either.[6] Opinion at 17. The court conducted a trial on the two remaining counts and judgment was entered in favor of Little. (Adversary 1-08-ap-109 Docket no. 111).

C. The Application to Employ Counsel and Geisenberger’s Declaration in Support.

Ressler filed an application under 11 U.S.C. § 727(a) to employ Geisenberger as its bankruptcy counsel on May 27, 2008, the day it filed for bankruptcy. (Bankr. Docket no. 4). As Fed. R. Bankr. P. 2014 requires, Geisenberger supplied a “Declaration of Disinterestedness” in support. In the declaration, Geisenberger affirmed that he did not represent an interest that was adverse to Ressler as debtor-in-possession. He also affirmed that he was a disinterested person who did not represent or hold an interest adverse to the bankruptcy estate. (Bankr. Docket no. 4 at Exhibit A).

At paragraph 4 of its application to employ Geisenberger, Ressler stated that it had consulted with and employed Geisenberger pursuant to a written engagement letter beginning in early 2007. (Bankr. Docket no. 4). Ressler also represented that it had paid a pre-petition retainer of $17,500 for future services and $2,000 as advanced costs including the bankruptcy

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[6] The debtor’s failure to file a Form D with the SEC may disqualify the debtor from making future offerings in reliance on Regulation D, <u>Chanana’s Corporation v. Gilmore</u>, 539 F.Supp.2d 1299, 1304 (W.D. Wash. 2003) and exposes the debtor and its principals to the possibility of criminal sanctions under 15 U.S.C. §77x. In addition, the failure of the debtor to meet the noticing requirements of the MSA exposes debtor to a variety of enforcement actions including a civil penalty up to $5,000, the appointment of a receiver, a freeze of the debtor’s assets and restitution. Md.Stat.Ann., Corps & Ass’ns § 11-702(b).

filing fee. The "engagement letter" described above was attached to the application as Exhibit A, along with the "Declaration of Disinterestedness" signed by Geisenberger.

Neither the section 327(a) application nor Geisenberger's declaration disclosed the scope of Geisenberger's prior representation of Ressler other than general references to "various problems," "problems caused by Erie's failure to pay you what you claimed" and "the recent legal action commenced by Sovereign." There was no mention of Geisenberger's role in the issuance of a stock certificate to Little. There was no reference to his work regarding lease negotiations. And there was no mention of his work regarding the sale of stock to CQ.

Based on the representations in the application and declaration, the bankruptcy court approved Geisenberger's employment on June 26, 2008. (Bankr. Docket no. 76).

D. The Statement of Attorney Compensation

On June 6, 2008, Geisenberger filed the mandatory Statement of Attorney Compensation as required by 11 U.S.C. § 329 and Bankruptcy Rule 2016(b) (Bankr. Docket no. 36). Geisenberger stated that he had been paid for all pre-petition services and that he had accepted a pre-petition retainer in the amount of $19,500. No other pre-petition payments were disclosed.

E. The United States Trustee's Reasons for Seeking Review of Geisenberger's Employment as Counsel.

Based upon a review of the Little adversary record, the United States Trustee[7] determined that Geisenberger may have acted negligently in the issuance of the stock certificate to Little and that Ressler might hold a claim against Geisenberger for losses incurred as a result of that

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[7] United States Trustees are Department of Justice Officials appointed by the Attorney General to supervise the administration of bankruptcy cases. See 28 U.S.C. § 581-589(a). See also H.R. Rep. No. 95-595, at 88 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 6049 (United States Trustees "serve as bankruptcy watch-dogs to prevent fraud, dishonesty, and overreaching in the bankruptcy arena."). "The United States trustee may raise and may appear and be heard on any issue in any case or proceeding under this title [11]." 11 U.S.C. § 307.

negligence. The United States Trustee also determined that Ressler's application and Geisenberger's declaration failed to properly disclose: 1) Geisenberger's role in the issuance of stock to Little; 2) that Geisenberger was a potential fact witness in the Little litigation; and 3) that he received fees totaling $49,290 during the 90 day preference period.

The United States Trustee raised her concerns to Geisenberger by letter dated March 20, 2009 and requested that he either respond to the concerns or immediately withdraw as counsel. (Geisenberger's Trial Exhibit 1). Geisenberger chose to respond by letter dated March 28, 2009. UST Exhibit 9. On the second page of his correspondence, Geisenberger opined that the United States Trustee's conclusions were unfounded. He acknowledged, however, that at the conclusion of his subsequent deposition (held on October 28, 2008 - Nt. 77-80), that Little's counsel, Richard Magid, asserted that Geisenberger had a conflict of interest.[8]

Not satisfied with Geisenberger's response, the United States Trustee filed the subject motion to disqualify and deny fees.

SUMMARY OF ARGUMENT

The bankruptcy court's denial of fees and disqualification of counsel can be affirmed on three separate and independent bases.

First, it can be upheld under section 329(a) of the Bankruptcy Code. That section requires an attorney employed by a debtor-in-possession to disclose all compensation received during the year preceding the commencement of the bankruptcy case for services rendered or to be rendered in connection with or in contemplation of the case. Bankruptcy Rule 2016(b) provides that "every attorney for a debtor whether or not the attorney applies for compensation shall file and

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[8] At trial, Geisenberger claimed that Mr. Magid actually opined that Geisenberger had committed malpractice. Nt. 81-82.

transmit to the United States Trustee . . . the statement required by § 329 . . ..” Here, the bankruptcy court did not clearly err in finding that Geisenberger failed to disclose payments totaling at least $36,855.

Second, section 327(a) of the Bankruptcy Code states that in order to be employed by a debtor-in-possession, a professional must not hold or represent an interest adverse to the bankruptcy estate and must be disinterested. To assist the court in making those determinations, Bankruptcy Rule 2014 requires that an application seeking approval to employ a professional must be accompanied by a verified statement of the professional’s connections with the debtor, its creditors or other parties in interest. Here, Geisenberger failed to disclose his prior representation of Ressler in a variety of matters including the sale of stock to Little. Moreover, as counsel to Ressler, Geisenberger had a duty to evaluate the merits of the Little litigation. Based on Geisenberger’s admitted failure to provide adequate legal guidance on the underlying issues, it was impossible for Geisenberger to evaluate the merits with disinterest. Accordingly, the bankruptcy court did not clearly err in finding that Geisenberger did not meet the requirements of 11 U.S.C. § 327.

Third, based on the record, the bankruptcy court did not abuse its discretion in disqualifying Geisenberger and ordering return of his fees. 11 U.S.C. § 328(c). An appropriate remedy for an attorney’s failure to comply with the requirements of sections 327 and 329 and Bankruptcy Rules 2014 and 2016 is denial of all compensation and disqualification of the professional, and section 328(c) authorizes the bankruptcy court to effectuate this remedy.

ARGUMENT

In an ordinary civil case, a party typically can pick the counsel of its choice. But in bankruptcy, the situation is different. Under 11 U.S.C. § 327 and § 1107, a bankruptcy chapter 11 debtor in possession cannot employ the counsel of its choice without court approval. Court approval can be obtained only if counsel satisfies two criteria: (1) that counsel is "disinterested" under 11 U.S.C. § 101(14); and (2) that counsel holds no interest adverse to the bankruptcy estate. Independent of these requirements, 11 U.S.C. § 329 requires bankruptcy attorneys to disclose all agreements to be paid by the debtor and all fees that they may have collected from the debtor within one year prior to the bankruptcy filing.

The Bankruptcy Code imposes these rigid requirements because a debtor in possession is a fiduciary of its creditors. See generally Commodity Futures Trading Com'n v. Weintraub, 471 U.S. 343, 355 (1985) (observing that a debtor in possession owes "the same fiduciary obligation to creditors and shareholders as would the trustee for a debtor out of possession"). A chapter 11 debtor proceeds through bankruptcy in order to protect its creditors, and the bankruptcy court determines what attorney can best help accomplish that goal. See 11 U.S.C. § 327(a) (the court "may" appoint the attorney recommended by the debtor).

Courts take a dim view of any failure by the debtor or nominated counsel to fully disclose all business relationships and fees, and courts consistently uphold the bankruptcy courts' power to deny an application for employment and deny all fees when attorney disclosures fall short of the mark. See, e.g., In re Kisseberth, 273 F.3d 714, 721 (6th Cir. 2001) (upholding denial of all fees where counsel failed to disclose fees pursuant to section 329); In re Park-Helena Corp., 63 F.3d 877, 882 (9th Cir. 1995) ("Even a negligent or inadvertent failure to disclose fully relevant information may result in a denial of all requested fees"); Rome v. Braunstein, 19 F.3d 54, 62 (1st Cir. 1994) (finding that counsel "can lay no claim of right to a lesser sanction" than disgorgement of all fees when counsel fails to disclose all material facts relevant to a conflict of interest under section 327(a)); In re Interwest Business Equipment, Inc., 23 F.3d 311, 317 (10th Cir. 1994) (upholding bankruptcy court's denial of application for employment even where bankruptcy court raised the issue sua sponte, because the "bankruptcy judge the responsibility and power to oversee professionals involved in a bankruptcy case without any requirement that the issues be raised by a party in interest").

A. The Bankruptcy Court Did Not Clearly Err in Finding that Geisenberger Failed to Comply With the Disclosure Requirements of 11 U.S.C. § 329(a) and Federal Rule of Bankruptcy Procedure 2016(b).

Section 329 of the Bankruptcy Code "was enacted because 'payments to a debtor's attorney provide serious potential for evasion of creditor protection provisions of the bankruptcy laws, and serious potential for overreaching by the debtor's attorney, and should be subject to careful scrutiny.'" In re Campbell, 259 B.R. 615, 625 (Bankr. N.D. Ohio 2001) (quoting H.R.Rep. No. 95-595 at 329 (1977)). See also In re Halbert, 225 B.R. 336, 346 (E.D. Mich. 1998). Compliance is, therefore, mandatory. In re Investment Bankers, Inc., 4 F.3d 1556, 1565 (10th Cir. 1993). Moreover, the disclosures made pursuant to section 329 must be "precise and complete." In re Berg, 356 B.R. 378, 381 (Bankr. E.D. Pa. 2006). "Coy or incomplete disclosures" that force the court "to ferret out pertinent information" are unacceptable. In re Park-Helena Corp., 63 F.3d 877, 881 (9th Cir. 1995) (quoting In re Saturely, 131 B.R. 509, 517 (Bankr. D. Me. 1991)), aff'd in part and rev'd in part 165 B.R. 339 (9th Cir. 1993).

Disclosure of pre-petition payments in a debtor's statement of financial affairs is not adequate to meet an attorney's obligations under section 329. In re Smitty's Truck Stop, 210 B.R. 844, 848 (B.A.P. 10th Cir. 1997). Nor are an attorney's obligations under section 329 vitiated by negligence or inadvertence, In re Maui 14K, Ltd., 133 B.R. 657, 660 (Bankr. D. Haw. 1991), and sanctions may be imposed even in the absence of harm to the estate. Id.

Here, Ressler's Statement of Financial Affairs admitted that Geisenberger received pre-petition payments totaling $56,355 during the 4 months preceding the commencement of the bankruptcy case. (Bankr. Docket no. 35; UST Trial Exhibit 3). But Geisenberger misrepresented in his Statement of Attorney Compensation the receipt of only $19,500. (Bankr. Docket no. 36). And at no time since the facts came to light did Geisenberger argue either that he did not receive an additional $36,855 or that this amount did not have to be disclosed. Accordingly, on this record, the bankruptcy court did not clearly err in finding that Geisenberger failed to meet the requirements of section 329 and Bankruptcy Rule 2016(b). See, e.g., In re Downs, 103 F.3d 472, 477 (6th Cir. 1996) (upholding disgorgement of all fees due to counsel's failure to "obey the mandate of § 329 and Rule 2016 concerning disclosure").

B. The Bankruptcy Court Did Not Clearly Err in Finding that Geisenberger Failed to Comply With the Disclosure Requirements of 11 U.S.C. § 327 and Federal Rule of Bankruptcy Procedure 2014.

As with section 329, the disinterestedness requirements of section 327 are strictly enforced. In re Hot Tin Roof, Inc. 205 B.R. 1000, 1003 (1st Cir. 1997); Beal Bank, S.S.B. v. Waters Edge Ltd. Partnership, 248 B.R. 668, 695 (D. Mass. 2000) ("These disinterestedness requirements [of 11 U.S.C. § 327] must be strictly enforced"); accord In re Greystone on Payette, LLC, 410 B.R. 900, 904 (Bankr. D. Idaho 2009) ("strict enforcement of the ethical rules to which estate professionals are subject under the Code is required in order to protect the integrity of the bankruptcy system"). The purpose of section 327 and Bankruptcy Rule 2014 is to shine a light on a professional's connections with the bankruptcy estate and to ensure that professionals "tender undivided loyalty and provide untainted advice and assistance in furtherance of their fiduciary responsibilities." In re Leslie Fay Companies, Inc., 175 B.R. 525, 532 (Bankr. S.D.N.Y. 1994) (quoting Rome v. Braunstein, 19 F.3d 54, 58 (1st Cir. 1994)). Sufficient information must be disclosed "so that the bankruptcy court may preserve the integrity of the judicial process, guard against potential conflicts, address actual conflicts, and ensure that the debtor's counsel is primarily concerned with the estate's best interest." In re Halbert, 225 B.R. 336, 346 (E.D. Mich. 1998).

It is the professional's responsibility to make a full, candid and complete disclosure. In re B.E.S. Concrete Products, Inc., 93 B.R. 228, 237 (Bankr. C.D.Cal. 1988). A professional cannot pick and choose which connections are irrelevant or trivial, In re EWC, Inc., 138 B.R. 276, 280 (Bankr. W.D. Okla. 1992), and cannot withhold information because it is not apparent to the professional that a conflict exists, In re Condor Systems, Inc., 302 B.R. 55, 69-70 (Bankr. N.D. Cal. 2003) (citing In re Park-Helena Corp., 63 F.3d at 880)). Moreover, the good faith or negligence of a professional does not excuse a failure to disclose. In re Halbert, 225 B.R. at 346; In re B.E.S. 93 B.R. at 237.

The disclosures must be made in the application for employment and/or the accompanying affidavit of the professional. As with section 329, neither the United States Trustee nor the court, nor any other party in interest, should be required to ferret out facts which the Bankruptcy Rules require that the lawyer plainly, openly, and timely disclose. See In re TJN, Inc., 194 B.R. 400, 403 (Bankr. D.S.C. 1996). "It is not the bankruptcy judge's responsibility to examine all the documents in the file to determine if the statements . . . are true . . . ." In re Chestnut Hill Mort., Corp., 158 B.R. 547, 551, n.3 (Bankr. D. Mass.1993).

Here, the record reflects that Geisenberger represented Ressler for approximately 18 months before the bankruptcy case was commenced. During that time, he represented Ressler in a variety of matters that related to Ressler's financial distress including the failed stock sale transaction involving Little. When the deal with Little fell through, Geisenberger prepared a stock certificate to deliver to Little, but admitted he did not know whether the issuance was an exempt transaction. (UST Trial Exhibit 5; Nt. 64, 66, 67, 68). By the time the bankruptcy case was filed, Geisenberger knew or should have known that he was a fact witness in a matter that was pivotal to Ressler's reorganization and that his role in the issuance of the stock certificate was being questioned.

But these problematic "connections" with Ressler were not disclosed in the application for employment or Geisenberger's "Declaration of Disinterestedness." (Bankr. Docket no. 4 & Exh. A thereto). Geisenberger suggested that he omitted the information because he believed it was of no consequence and did not create a conflict. (UST Exhibit 9; Geisenberger Deposition Nt. 77-80). As noted, however, it is not the role of the professional to pick and choose which connections are irrelevant or trivial. All connections must be disclosed so that the bankruptcy court and other parties in interest can evaluate the professional's qualifications to serve.

In rebuttal to the bankruptcy court's finding, Geisenberger notes that the Little litigation was discussed during the meeting of creditors and suggests that, therefore, the duties imposed on him by section 327 of the Bankruptcy Code and Bankruptcy Rule 2014 were satisfied. In making his argument, Geisenberger ignores the clear weight of legal authority that neither the bankruptcy court nor parties in interest should be forced to ferret out facts which the Bankruptcy Rules require that the lawyer plainly, openly, and timely disclose. See In re Park-Helena Corp., 63 F.3d at 881; In re TJN, Inc., 194 B.R. at 403; In re Chestnut Hill Mort., Corp., 158 B.R. at 551, n.3.

Based on all of the above law and facts, this Court can conclude that Geisenberger's inadequate disclosures were not an innocent mistake, and that the bankruptcy court did not clearly err in finding that Geisenberger failed to satisfy section 327 and Rule 2014. Disclosure of "[a]ll of these facts" was required in Geisenberger's "Declaration of Disinterestedness." See In re

Tomczak, 283 B.R. 730, 735 (Bankr. E.D.Wisc. 2002) (where the court ruled that special counsel to Chapter 7 trustee should have disclosed that a member of the firm might be called as a witness for the party named as defendant in litigation that counsel was retained to pursue). And, as discussed in more detail below, because Geisenberger's disclosures were inadequate, the bankruptcy court did not abuse its discretion by disqualifying counsel and denying all fees.

C. The Bankruptcy Court Did Not Clearly Err in Finding that Geisenberger Held an Interest That Was Adverse to the Bankruptcy Estate.

Section 327 of the Bankruptcy Code requires the bankruptcy court to deny employment of a professional if it finds that the employment creates an actual conflict of interest. Disqualification is mandatory if the conflict is "actual" and discretionary if the conflict is potential. In re BH & P, 949 F.2d 1300, 1315-16 (3d Cir. 1991). In BH & P, the Third Circuit found no error in the following articulation of the standard governing conflicts of interest:

> [t]he court should generally disapprove employment of a professional with a potential conflict, with certain possible exceptions. First of all, ... there may occasionally be large cases where every competent professional in a particular field is already employed by a creditor or a party in interest....
>
> The other exception is where the possibility that the potential conflict will become actual is remote, and the reasons for employing the professional in question are particularly compelling. This court will not attempt here to define the parameters of this exception, which necessarily will depend upon the facts of a particular case. I will, however, note that even in such situations, employment of a professional with a potential conflict is disfavored.

949 F.2d at 1316 (quoting In re BH & P, Inc., 103 B.R. 556, 564 (Bankr. D.N.J. 1989)) (emphasis added).

The record of this case reflects that Geisenberger played a pivotal role in the issuance of stock to Little which led to a lawsuit by Little alleging stock fraud. (UST Trial Exhibit 5; Nt. 64, 66, 67, 68). Geisenberger was present when Ressler's board of directors approved the issuance of stock, but did not offer any caution or advice regarding the need to meet the registration requirements of either federal or state law. (Id.). When the bankruptcy was filed and Geisenberger sought approval of the bankruptcy court to represent Ressler, Geisenberger knew or should have known that he may have fallen short of his professional duty to provide his client with competent representation and that he may face personal liability for any losses occasioned by Little's lawsuit.

As the attorney for Ressler, Geisenberger had the responsibility to decide whether to continue defense of the litigation. That decision would require, however, that Geisenberger reevaluate his own conduct. The bankruptcy court noted the conflicting interests as follows:

> It is difficult to see how Geisenberger could approach this decision objectively. To justify his prepetition legal advice, Geisenberger would be inclined to recommend defending [Ressler's] decision to transfer the shares as consideration for the $400,000 Little advanced. However, an objective review of Geisenberger's actions would disclose that he failed to investigate one of the pivotal issues in the suit — whether the stock offering was subject to state or federal security laws. . . . As counsel for a debtor-in-possession Geisenberger had an obligation to reevaluate the decisions that were made leading up to the bankruptcy filing. As a participant in those decisions, it was impossible for him to review those decisions with disinterestedness.

(Bankr. Docket no. 505 at pp. 13-14). Geisenberger has pointed to no fact in the record that would render the bankruptcy court's findings on this point clearly erroneous. To the contrary, the record supports the bankruptcy court's findings that Geisenberger held an interest that was adverse to the bankruptcy estate and was not qualified to represent Ressler in the bankruptcy case.

D. The Bankruptcy Court Did Not Abuse its Discretion in Concluding that Disqualification of Geisenberger and Denial of Fees Were Appropriate Remedies for Geisenberger's Failure to Meet the Requirements of 11 U.S.C. §§ 327 and 329 and Federal Rules of Bankruptcy Procedure 2014 and 2016.

The bankruptcy court is authorized to disqualify counsel when the facts establish that counsel is not disinterested or has an interest adverse to the bankruptcy estate. See, e.g., Pierce v. Aetna Life Insurance Company (In re Pierce), 809 F.2d 1356, 1362 (8th Cir. 1987) ("Although framed conjunctively, the conditions [in 11 U.S.C. § 327] are applied disjunctively; failure to meet either will result in disqualification."). These requirements "are congressionally established per se rules that a bankruptcy court must apply in exercising its approval power over the appointment of professionals." In re Harold & Williams Dev. Co., 977 F.2d 906, 909 (4th Cir. 1992). Accordingly, in this case, counsel's interest adverse to the bankruptcy estate, found without clear error, required the bankruptcy court to disqualify Geisenberger. The bankruptcy court did not abuse its discretion in doing so.

Moreover, 11 U.S.C. § 328(c) expressly authorizes the bankruptcy court to deny all compensation to an attorney that has been appointed under section 327 if it comes to light that counsel is not disinterested or holds or represents an interest adverse to the estate at any time during the representation. 11 U.S.C. § 328(c); In re Crivello, 134 F.3d 831 (7th Cir. 1998).[9] In Crivello, as in this case, the bankruptcy court had approved the debtor-in-possession's application to employ counsel and then revoked the employment order after learning of counsel's conflicts. Id. at 833-34. Under those circumstances, the Seventh Circuit held that the bankruptcy court had

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[9] A debtors cannot waive a conflict of interest because the requirement that counsel be disinterested is mandatory. See 11 U.S.C. § 327(a) (requiring that a professional employed by a debtor-in-possession must not hold or represent an interest adverse to the bankruptcy estate and must be disinterested).

discretion under section 328(c) to deny the law firm's fees in whole or in part. Id. at 837. This Court may reach the same conclusion on parallel facts. Here, after approving Geisenberger's employment, the bankruptcy court found that Geisenberger had an interest adverse to the bankruptcy estate. As discussed above, this finding was not clearly erroneous. Therefore, the bankruptcy court was within its discretion under section 328(c) to deny compensation.[10]

Moreover, courts have found that the failure to provide adequate disclosures under either section 327 or 329 is grounds for denial of compensation. See In re Waldo, 417 B.R. 854, 894 (Bankr. E.D. Tenn. 2009); In re Smitty's Truck Stop, 210 B.R. at 848; In re Vann, 136 B.R. 863, 873 (D.Colo 1992); In re Maui 14K, Ltd., 133 B.R. at 660. In addition, a failure by the professional to disclose any facts that may influence the court's determination of employment may result not only in the forfeiture of all compensation, but the removal of counsel. In re Halbert, 225 B.R. at 357; In re Hot Tin Roof, Inc. 205 B.R. at 1003; In re EWC, Inc., 138 B.R. 276, 280 (Bankr. W.D.Okla. 1992); In re Marine Outlet, Inc. 135 B.R. 154, 156 (Bankr. M.D.Fla. 1991).

As noted, the bankruptcy court found that Geisenberger failed to disclose four payments received from Ressler preceding the commencement of the bankruptcy case. Geisenberger has not argued that he did not receive the payments or that the payments were not required to be disclosed pursuant to section 329 or Bankruptcy Rule 2016(b). The bankruptcy court also found

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[10] This Court, sitting as an appellate court, can affirm on the basis of 11 U.S.C. § 328(c) even though the bankruptcy court did not cite it. See generally Oss Nokalva, Inc. v. European Space Agency, 617 F.3d 756, 761 (3d Cir. 2010) ("It is an accepted tenet of appellate jurisdiction that we 'may affirm a judgment on any ground apparent from the record, even if the [lower] court did not reach it.'") (quoting Kabakjian v. United States, 267 F.3d 208, 213 (3d Cir. 2001)).

that Geisenberger failed to meet the requirements of section 327 of the Bankruptcy Code and Bankruptcy Rule 2014 when he failed to disclose his extensive connections with Ressler including Geisenberger's involvement in the Little stock transaction. Given these findings, the bankruptcy court acted well within the limits of its discretion to disqualify counsel and require return by Geisenberger of his pre-petition retainer.

CONCLUSION

For all of the foregoing resasons, the United States Trustee respectfully requests that this Court affirm the decision below.

Date: November 1, 2010

ROBERTA A. DeANGELIS
UNITED STATES TRUSTEE

Anne K. Fiorenza
Assistant United States Trustee

By: /s Gregory R. Lyons
Gregory R. Lyons, Trial Attorney
Department of Justice
Office of the United States Trustee
228 Walnut Street, P.O. Box 969
Harrisburg, PA 17108-0969
(717) 221- 4515

Ramona D. Elliott
General Counsel

P. Matthew Sutko
Associate General Counsel

Anne W. Stukes
Trial Attorney
Department of Justice
Executive Office for United States Trustees
20 Massachusetts Ave., NW
Room 8100
Washington, DC 20530
(202) 307-1399

IN THE UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF PENNSYLVANIA

IN RE RESSLER HARDWOODS AND :
FLOORING, INC. : BANKR. CASE NO. 1:08-bk-01878-MDF
Debtor :

JACQUES H. GEISENBERGER, JR., PC: CASE NO. 1:10-cv-01660-CCC
Appellant :
:
v. :
:
ROBERTA A. DeANGELIS :
UNITED STATES TRUSTEE :
Appellee :

CERTIFICATE OF SERVICE

I hereby certify that on November 1, 2010, I electronically filed the foregoing with the Clerk of the District Court using the CM/ECF system which sent notification of such filing to the following Filing Users at the following e-mail address:

Jacques H. Geisenberger, Jr. Esq.
Email: jacques@geiscoop.com

ROBERTA A. DeANGELIS
UNITED STATES TRUSTEE

Anne K. Fiorenza
Assistant United States Trustee

By: /s Gregory R. Lyons
Gregory R. Lyons, Trial Attorney
Department of Justice
Office of the United States Trustee
228 Walnut Street, P.O. Box 969
Harrisburg, PA 17108-0969
(717) 221- 4515

(Cite as: 1989 WL 624990 (USTBRIEFS))

[*1] Title (TI): IN RE REVCO D.S., INC. (CONRAD MORGENSTEM, UST v. REVCO D.S., INC.) — REPLY BRIEF FOR APPELLANT, U.S. TRUSTEE
Court (CO): CTA6. U.S. Court of Appeals (6th Cir.)
Current-Case (CCN): No. 89-3545
Previous-Case (PCN): No. N/A
Source (SO): U.S. TRUSTEES
Date-of-Filing (DA): August 24, 1989
Author (AU): Martha L. Davis (202-307-1399)
Topic (TO): BANKRUPTCY — U.S. Trustee has standing to appeal from order denying his motion for the appointment of an examiner under 11 U.S.C. § 1104(b)(2).

Summary (SU): The U.S. Trustee has standing to challenge an order denying his motion to appoint an examiner, by virtue of 11 U.S.C. §§ 307 & 1104. Also, case is not "moot." Accord: In re Revco, 898 F.2d 498 (6th Cir. 1990) (Sec. 307 grants UST the right to raise, appear, and be heard on any Issue, & there is no limitation on the UST's right to appeal, either in the statute or in the legislative history).

No. 89-3545

IN THE UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

IN RE: REVCO D.S., INC., et al., Debtors

CONRAD J. MORGENSTERN, U.S. TRUSTEE, Appellant
v.
REVCO D.S., INC., et al., Appellees

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF OHIO, EASTERN DIVISION

REPLY BRIEF FOR THE APPELLANT

STUART E. SCHIFFER
Acting Asst. Atty General
WILLIAM KANTER
FTS/ (202) 633-1597
BRUCE G. FORREST
FTS/ (202) 633-2496
Attorneys, Appellate Staff
Civil Division, Room 7416-C
Department of Justice
Washington, D.C. 20530

Of counsel:
EDWARD I. GOLD
Office of the United States Trustee
Region IX (Ohio/Michigan)
JOHN LOGAN, General counsel
MARTHA L. DAVIS, Attorney
Executive Office of the U.S. Trustee
Department of Justice
Washington, D.C. 20530

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  Rule 11

Legislative History Materials:
124 Cong. Rec. 32403 (1978)
124 Cong. Rec. 34003 (1978)
House Report No. 595, 95th Cong., 1st Sess
House Bill, H.R. 8200
Senate Bill, S.2266

Miscellaneous Authorities:
DeNatale, The Creditors' Committee Under the Bankruptcy Code -- A Primer, 55 Am. Bankr. L.J. 43 (1981)
Resnick, Alan N. and Wypyski, Eugene M., Bankruptcy Reform Act of 1978: A Legislative History, William S. Hein & Co., 1979
Sutherland, Statutory Construction, §57.03

IN THE UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

No. 89-3545
IN RE: REVCO D.S., INC., et al., Debtors

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF OHIO, EASTERN DIVISION

REPLY BRIEF FOR THE APPELLANT

[*3]

ARGUMENT

I. THE DISTRICT COURT ERRED IN DISMISSING THE UNITED STATES TRUSTEE'S APPEAL FOR LACK OF STANDING.

1. The dismissal decision of the district court cannot be justified as a bringing forward of the pre-reform doctrine of bankruptcy standing. There never was a "pecuniary interest rule" for standing in bankruptcy law even under the 1898 Bankruptcy Code. Notwithstanding appellees' repetition of the "directly and adversely affected pecuniarily" formulation of the "persons aggrieved" requirement (appellees' merits brief, at 11-14), those case decisions do not hold that a monetary stake was a sine qua non to confer appellate standing in bankruptcy cases under the 1898 Code (appellant's initial brief, at 11-14). The Supreme Court so held in Securities and Exchange Comm'n v. United States Realty & Improvement Co., 310 U.S. 434, 459-60 (1940). In that case the SEC's interest "in the maintenance of its statutory authority and the performance of its public duties" rendered the Commission a "party aggrieved." That interest of the United States trustee here is the same, and appellees are unable to reconcile the United States Realty decision with the district court's dismissal on standing grounds.

It was necessary for Congress to amend the Bankruptcy Code and add a specific provision, 11 U.S.C. 1109(a), to preclude the SEC from taking appeals. Section 1109(a) is agency-specific; it has no effect upon other government agencies not precluded. See, In re Co Petro Marketing Group, Inc., 680 F.2d 566, 572-73 (7th Cir. 1982). Needless to say, the SEC rarely, if ever, has a pecuniary interest in the bankruptcy proceedings in which it becomes involved. Unless 11 U.S.C. 1109(a) is meaningless surplusage, government law enforcement entities enjoy standing to appeal in bankruptcy cases, based upon their interest in law enforcement, unless otherwise prohibited. Any other view would squarely conflict with the rule of in pari materia construction employed with respect to the Bankruptcy Code. Lynch v. Johns-Manville Corp., 710 F.2d 1194, 1198 (6th Cir. 1983).1

2. Appellees' analysis of the office of the United States trustee (appellees' merits brief, at 18-23) does not provide convincing arguments for concluding that a United States trustee lacks standing to appeal from an adverse order denying his request for an examiner pursuant to 11 U.S.C. 1104(b)(2). The supervisory and law enforcement duties of the United States trustee are indeed adversely affected by an erroneous failure of a bankruptcy court to appoint an independent examiner, [**FN**2] and the United States trustee has the same standing as any other federal regulatory agency not expressly barred from taking an appeal when its statutory authority has been impaired.

More importantly, appellees' analysis diverts attention from the substance of the central provision in dispute in this appeal, 11 U.S.C. 1104(b)(2). That statute adds, to the traditional parties in interest, the United States trustee as a person who may insist upon the appointment of an independent examiner in certain large public debt bankruptcies. A law enforcement official, who can seek the appointment of an examiner on the same basis as a "party in interest," must be accorded the same entitlement to an appeal, when his motion is denied, on the same basis as any other person enjoying the identical rights under the statute.

[*4] 3. Appellees note that the United States trustee has appealed in other cases where he enjoyed no pecuniary interest in the proceeding, citing In re Lathrop Mobile Investors, 55 B.R. 766 (Bankr. 9th Cir. 1985), and In re Kontaratos, 15 B.R. 298 (Bankr. 1st Cir. 1981). (Appellees' merits brief, at 22-23). Appellees would distinguish those cases by acknowledging an adverse effect to the United States trustee's right in those cases, while contesting it here. In doing so, appellees would have the court seriously misapply standing doctrine with this argument.

The question, for purposes of standing analysis, is not the ultimate determination of the United States trustee's rights; the question is whether the United States trustee raises matters arguably in the zone of the United States trustee's interest. Association of Data Processing Serv. Org. v. Camp, 397 U.S. 150, 153 (1970). [**FN**3] Hence the United States trustee, without any standing controversy, was allowed to seek appellate review of his asserted duty to conduct an investigation (Kontaratos) or the refusal of a bankruptcy judge to appoint a particular trustee (Lathrop Mobile Investors). The United States trustee had a right to appeal regardless of whether the merits of his appeal were abundantly clear, or highly argumentative.

The logical extension of appellees' standing argument is that, in every case where the United States trustee has (in retrospect) misconstrued his rights, he lacked standing to appeal. Or, stated differently, the appellees would have this Court hold that the United States trustee has standing to appeal on a question of his legal rights, but only when the bankruptcy court erred on the merits of the underlying issue. This cannot be a correct expression of standing doctrine.

4. Appellees' argument that policies of sound judicial administration support the district court's standing decision (appellees' merits brief, at 23-24) is ill-founded. Appellees can point to no unnecessary delay of the proceedings in this case. Their abstract arguments for the maintenance of an appellate standing rule for bankruptcy cases is no different from appellant's (appellant's initial brief, at 9-10).

But appellees' perspective is too simple. The courts allow appeals in bankruptcy cases from decisions that might otherwise be classified as interlocutory outside of the bankruptcy context because an error could prejudice and unravel many months of work. A bankruptcy standing decision that erroneously eliminates a district court from considering the merits of an appeal, as here, can compound the impact of the bankruptcy court's error.

The United States trustee's responsibilities in bankruptcy cases are all directed to promote the just and expeditious resolution of bankruptcy cases. Neither he, nor his attorneys, have any incentive for delay. Artificial standing rules are not needed to discipline his office. In this case, it is the erroneous standing dismissal, not the United States trustee's appeal, that is most likely to cause costly and unnecessary delay in these proceedings.

II. THE BANKRUPTCY COURT ERRED IN REFUSING TO APPOINT AN EXAMINER UNDER 11 U.S.C. 1104(b)(2).

[*5] 1. Appellees (merits brief at 31-34) propose a bizarre reading of 11 U.S.C. 1104(b)(2). They contend that the party seeking the appointment of an examiner must prove that the proposed investigation would be "appropriate" by providing evidence, in advance, of matters such as fraud, dishonesty, incompetence, etc. Unless we are to conclude that the draftsmen of section 1104 were extraordinarily inept, appellees' explanation of the plain language of the statute cannot be adopted. Any fair reading of this statute demonstrates that it was meticulously constructed. Congress may often provide us with frustratingly ambiguous, or hopelessly complex, statutory provisions. Section 1104 of the Bankruptcy Code suffers from no drafting infirmities. Congress knows the difference between "shall" and "may," and Congress meant what it said with such care.

The provision directs the appointment of trustees or examiners when certain conditions are met. Section 1104(a), respecting the possible appointment of a trustee to displace a debtor-in-possession, expressly sets forth matters that require findings of "cause, including fraud, dishonesty, incompetence, or gross mismanagement, *** or [that] such appointment is in the interests of creditors, any equity security holders, and other interests of the estate ***." Section 1104(b)(1) too, requires similar, highly discretionary findings findings that must precede the appointment of an examiner; in those cases where the unsecured public debts are less than $5 million, the mandatory appointment is triggered by "the interests of creditors, any equity security holders, and other interests of the estate[.]"

But, section 1104(b)(2) sets forth only an objective, jurisdictional requirement to trigger the mandatory appointment of an examiner: "the debtor's fixed, liquidated, unsecured debts, other than debts for goods, services, or taxes, or owing to an insider, exceed $5,000,000." [**FN**4] Because of the broader social and economic impact of these larger corporate reorganization cases, Congress decided that when either the United States trustee, or a party in interest, could insist upon the appointment of an examiner. No showing, beyond meeting the statutory debt amount, is necessary. [**FN**5]

If section 1104(b)(2) is construed to require an evidentiary showing of "cause," or that the appointment of an independent examiner is in the "best interests" of one of the parties, then section 1104(b)(2) becomes totally redundant to section 1104(b)(1). An entire, carefully crafted paragraph of the statute becomes meaningless surplusage, [**FN**6] and the Congressional deliberations that led to the compromise dividing paragraphs (1) and (2) [**FN**7] were a sort of senseless theater.

2. The bankruptcy court below confused the decision to utilize an independent examiner as an aid to the proceedings with the control over the scope and direction of his or her examination. This Court should reject appellees' proposal to perpetuate this confusion. (Appellees' merits br., at 32).

[*6] Appellant certainly agrees that the bankruptcy judge maintains the authority to direct an investigation of a type and scope that is "appropriate." But this in no way alters the obligation of the bankruptcy court to commence an independent investigation with an appointment of an examiner. Section 1104(b)(2) does not permit the refusal to appoint an examiner on the essentially discretionary grounds relied upon by the bankruptcy court in this case. Here, everyone agrees that some investigation of the leveraged buy-out is appropriate, and the dispute is about who (an examiner or the committees' accountants) should perform it. The statute answers the question when the United States trustee requests an examiner.

3.a. Appellees' discussion of the legislative history of section 1104(b)(2) (appellees' merits brief, at 29-31) is erroneous. The quotation appellees select (id. 29-30) from House Report No. 595 [**FN**8] admittedly would appear to describe a permissive, rather than a mandatory, legislative provision. However, the House Report was not describing 11 U.S.C. 1104(b)(2). Instead, in this passage, the House Report was describing language from its Bill, H.R. 8200, that was never enacted. Section 1104(b) of H.R. 8200 would have provided (emphasis added):

> If the court does not order the appointment of a trustee under this section, that at any time before the confirmation of a plan, on request of a party in interest of the United States trustee, and after notice and a hearing, the court may order the appointment of an examiner to conduct such an investigation of the debtor as is appropriate, including an investigation of any allegations of fraud, dishonesty, incompetence, or gross mismanagement of the debtor of or by current or former management of the debtor, if --
>
> (1) the protection afforded by an examiner is needed; and
> (2) the costs and expenses of an examiner would not be disproportionately higher than the value of the protection afforded. [**FN**9]

b. Proposed section 1104 of the Senate Bill was at the opposite extreme from the House Bill. As noted above, the House Bill, H.R. 8200, supra, left the matter of an independent examiner within the bankruptcy court's discretion, subject to that judge's cost/benefit analysis. Section 1104 of the Senate Bill, S.2266, [**FN**10] would have made the appointment of a trustee to run the affairs of the firm pending reorganization mandatory in every "case of a public company." [**FN**11] The compromise, so carefully wrought by Congress, allowed "public companies" to remain in the hands of the debtor-in- possession in the absence of misconduct; it permitted any party in interest or the United States trustee to obtain an independent examiner if the debtor- in-possession remained in charge; and it allowed the bankruptcy court to exercise control over the "appropriate" scope of the independent investigator's conduct.

Hence, as we explained in our initial brief (at 27-30), this is not a case where Congress stumbled accidentally into mandatory language, the application of which produces absurd results. In this instance, Congress considered various formulations and carefully crafted the shared decision- making provisions with respect to the appointment of an examiner set forth in 11 U.S.C. 1104(b). The language is precise and absolutely deliberate. Because the plain language is unambiguous, there should be no occasion to resort to the legislative history. E.g., Burlington Northern R. Co. v. Oklahoma Tax Com'n, 107 S.Ct. 1855, 1859-60 (1987). In any event, the legislative history confirms that this Court may order the appointment of an examiner under 11 U.S.C. 1104(b)(2) with the full confidence that this is exactly what Congress wanted.

[*7] 4.a. Appellees' rhetorical flourish, that their interpretation is supported by "overwhelming authority" (appellees' merits brief, at 26), is somewhat overstated. Not a single court of appeals, so far as counsel of either side of this appeal can determine, has addressed the statutory construction issue at bar. As appellant indicated in his initial brief (at 26 n.12), the reported lower court decisions are roughly divided on the matter. Several bankruptcy court decisions adopt the straightforward view that the statute means what it says. In re Lenihan, 4 B.R. 209 (Bankr. D. R.I. 1980); In re 1243 20th St., Inc., 6 B.R. 683, 685 n.3 (Bankr. D.C. 1980); In re the Bible Speaks, 74 B.R. 511, 514 (Bankr. D. Mass. 1987); cf. In re San Juan Hotel Corp., 71 B.R. 413, 418 n.3 (Bankr. D. P.R. 1987), affirmed in part and reversed in part, 847 F.2d 931 (1st Cir. 1988). Contra, in addition to the bankruptcy court below, see, In re Shelter Resources Corp., 35 B.R. 304, 305 (N.D. Ohio 1983) and In re GHR Companies, Inc., 43 Bankr. 165 (D. Mass. 1984), aff'd after transfer of venue on other grounds sub nom. Matter of GHR Energy Group, 792 F.2d 476 (5th Cir. 1986). None of these judicial pronouncements on the duty to appoint an examiner under section 1104(b)(2) is controlling here, and, appellant submits, none of these decisions provide the Court with useful guidance, let alone overwhelming authority.

b. The general rule is that "shall" means "shall," not "might," or "may." See, e.g., Escoe v. Zerbst, 295 U.S. 490, 493 (1935) (Cardozo, J.). "The form of the verb used *** is the single most important textual consideration ***." Sutherland, Statutory Construction, §57.03.

Appellees point to several bankruptcy court decisions, cited by the bankruptcy court below, where the word "shall," appearing elsewhere in the Bankruptcy Code, was not perceived as a mandatory instruction. (Appellees' merits brief, at 30 n.8). In re General Oil Distributors, Inc., 42 B.R. 402, 409 (Bankr. E.D.N.Y. 1984), simply holds that any finding of incompetence or dishonesty must consider whether the misconduct has risen to such a level as to constitute cause for the appointment of a trustee under section 1104(a)(1), i.e., where there is "cause." The court recognized that "the word 'shall' *** circumscribes the court's discretion," once the criteria of the particular paragraph section 1104(a)(1) are met. In contrast, section 1104(b)(2) has no "cause" or "interests" criteria, and its physical, objective conditions have been met by the parties' stipulation.

The two remaining cases, relating to the requirements for a debtor's personal appearance in 11 U.S.C. 343 and 542(d), illustrate the rarity and extreme judicial reluctance to ignore the mandatory statutory command. In re Garber, 4 Bankr. 684, 685 (Bankr. C.D. Cal. 1980) (citing, First National Bank of Helena v. Neill, 13 Mont. 377, 34 P.180 (S.Ct. Mont., 1893), poses that the command may be waived, "when no advantage is lost, when no right is destroyed, when no benefit is sacrificed, either to the public or to the individual ***." The court in In re Stewart, 14 B.R. 959, 960-61 (Bankr. N.D. Ohio 1981), required a showing of "extreme hardship" or "defeat of the statute's purpose" to overcome the literal language of the statute. If those cases were correctly decided, then they would fall within a narrow category of very rare cases. The bankruptcy court below lost sight of the extremely strong showing required and overruled the command of the statute without justification.

III. THIS APPEAL IS NOT MOOT AND THE COURT SHOULD EXERCISE ITS DISCRETION TO REACH THE MERITS OF THE UNDERLYING DISPUTE.

[*8] On June 23, 1989, the bankruptcy court allowed the Trade Creditor's committee to retain the accounting firm of Touche Ross & Co. for the limited purpose of assisting the Trade Creditors' Committee to conduct an investigation of the LBO. Appellees contend that this order has mooted the United States trustee's appeal (appellees' merits brief, at 38-39). Appellee's analysis is based upon the assumption that, because the Touche Ross accountants will likely cover the same territory as the independent examiner sought by the United States trustee, the retention of Touche Ross will serve the "same purpose" as the appointment of the examiner. This assumption is incorrect.

1. The Committee's accountants and the examiner proposed by the United States trustee do not perform the same functions. An examiner appointed pursuant to section 1104 must, unless affirmatively ordered by the bankruptcy court to the contrary, "investigate the acts *** of the debtor *** and the desirability of the continuation of such business, and any other matter relevant to the formulation of a plan" (11 U.S.C. 1106(a)(3), incorporated by reference in 1106(b)). The examiner must also,

> *** as soon as practicable *** file a statement of any investigation conducted under paragraph (3) of this subsection, including any fact ascertained pertaining to fraud, dishonesty, incompetence, misconduct, mismanagement, or irregularity in the management of the affairs of the debtor, or to a cause of action available to the estate ***.

11 U.S.C. 1106(a)(4).

The accounting firms retained by the committees pursuant to 11 U.S.C. 1103(c)(2) are different. They aid the voluntary investigation of the committee that retains them. The independent examiner's role is thus legally distinct from that of the committee's accountants in crucial respects: The accounting firm retained pursuant to section 1103(c)(2) will serve, and report to, the committee. The examiner, appointed under 1104(b)(2) and 1104(c), serves the Court. [**FN**12] Because the accountants serve the committee, the information they obtain is shared with the committee's lawyers, but not necessarily with anyone else. The examiner files a report with the bankruptcy court setting forth the results of any investigation [**FN**13]; there is no parallel obligation on the part of the committee.

2. There is, naturally, a potential overlap in the factual territory explored by the committee's accountants and the examiner. Congress was completely aware that, to some extent, as very frequently happens in complex litigation of all sorts, each of the parties might wish to investigate, with the assistance of their own experts, the same subject matter as another party. Here, once again, the legislative history proves that the statute was carefully considered. In the Senate Bill, S.2266, section 1103(c)(2) would have allowed a committee to conduct an investigation only "if no trustee or examiner is appointed ***." In enacting the Bankruptcy Reform Act, Congress deleted those words from the Senate Bill. Section 1103(c)(2) of the Bankruptcy Code thus permits a committee to conduct an investigation that may overlap the subject matter of a trustee or an independent examiner appointed pursuant to section 1104. However, the bankruptcy judge may refuse a committee's proposed employment of "attorneys, accountants, or other agents, to represent or perform services for such committee." 11 U.S.C. 1103(a). Through this device, rather than through the elimination of the independent examiner, the bankruptcy court can control undue duplication. [**FN**14]

[*9] 3. The scheme contemplated by Congress is that, in a reorganization proceeding brought under Chapter 11 by a large public company, where no case trustee has been appointed, and no party in interest has requested an examiner, a responsible United States trustee will evaluate whether an independent examiner should nevertheless conduct an investigation. If the United States trustee perceives that an independent examiner is needed, "the court shall order the appointment of an examiner to conduct such an investigation of the debtor as is appropriate ***." No showing of cause, or cost effectiveness is required: "In order to insure that adequate investigation of the debtor is conducted to determine fraud or wrongdoing on the part of present management, an examiner is required to be appointed in all cases in which the debtors' fixed, liquidated, and unsecured debt, other than debts for goods, services, or taxes, or owing to an insider, exceed $5 million." [**FN**15]

Thus, when an independent examiner is appointed pursuant to section 1104(b)(2), the bankruptcy court should then evaluate the committees' requests for accountants, lawyers, and other agents, for the conduct of their investigation, in light of the anticipated activities of the independent examiner whose appointment is mandatory.

But, in this case, the Congressional plan has been turned upside down. The United States trustee's early application for an examiner, to avoid duplication and waste, was deemed "premature." He has been directed to justify the appointment of an examiner in terms of the activities of the committees' investigations, rather than vice-versa. Appellant asks this Court to reset the proceedings to conform with the Congressional plan.

The failure of the bankruptcy court to follow the statutory road map has compromised the efficiency of the process, and threatens to compromise its integrity. Nevertheless, an examiner, appointed at this juncture, may be able to utilize the data collected by the parties' accountants and attorneys, as well as any reports that can be shared. The appellant strongly desires the examiner to minimize duplication to the greatest extent possible. [**FN**16] But the report by the independent examiner is crucial if the United States trustee is to perform his proper role under the Bankruptcy Reform Act. [**FN**17] Thus, this appeal will certainly not be moot at any time prior to the final confirmation of a reorganization plan. Since a proposed plan has not yet been submitted, and this Court has granted the United States trustees' motion to expedite the proceedings, there is ample time for meaningful participation by an examiner, without disruption or delay. [**FN**18]

Every day that this case proceeds without the appointment of an independent examiner, and the committees proceed without regard to the conduct of an examiner's investigation, the potential for wasteful duplication increases. The dispute regarding the United States trustee's request for the appointment of an examiner ought to be resolved as soon as possible. Appellant submits that this court should exercise its appellate discretion to correct the error of the bankruptcy court, as well as that of the district court.

CONCLUSION

[*1]0 For the foregoing reasons, the judgment of the district court dismissing the appeal of the United States Trustee should be vacated. The case should be remanded to the district court with instructions to reinstate the United States Trustee's appeal. This Court should also hold that the appointment of an examiner pursuant to 11 U.S.C. 1104(b)(2) should have been ordered by the bankruptcy court, and the district court should proceed consistent with that holding.

Respectfully submitted,
STUART E. SCHIFFER
Acting Asst. Atty General

WILLIAM KANTER
FTS/(202) 633-1597
BRUCE G. FORREST
FTS/(202) 633-2496
Attorneys, Appellate Staff
Civil Division, Room 7416-C
Department of Justice
Washington, D.C. 20530

Of counsel:
EDWARD I. GOLD
Office of the United States Trustee
Region IX (Ohio/Michigan)

JOHN LOGAN, General counsel
MARTHA L. DAVIS, Attorney
Executive Office of the U.S. Trustee
Department of Justice
Washington, D.C. 20530

CERTIFICATE OF SERVICE

I hereby certify that I have caused a copy of the foregoing reply brief for appellant to be served by first class mail this 24th day of August, 1989, upon the counsel listed below:

John Silas Hopkins, III
Baker & Hostetler
3200 National City Center
Cleveland, OH 44114

Michael J. Crames
Nancy L. Kourland
Levin & Weintraub & Crames
225 Broadway
New York, New York 10007

Harry W. Greenfield

Javotch & Eisen Co, LPA
1050 Statler Office Tower
1127 Euclid Ave.
Cleveland, Ohio 44115

Stuart E. Hertzberg
Hertzberg, Jacob & Weingarten
1530 Buhl Building
Detroit, Michigan 48226

Nancy Guller Hayt
Brad Eric Scheler
Madlyn B. Gleich
Freid, Frank, Harris, Shriver & Jacobson
One New York Plaza
New York, New York 10004

Robert J. White
O'Melveny & Myers
400 South Hope Street
Los Angeles, California 90071

Richard Lieb
Kronish, Lieb, Weiner & Hellman
1345 Avenue of the Americas
New York, New York 10105

Joseph F. Hutchison, Jr.
Brouse & McDowell
500 First National Tower
Akron, Ohio 44308

Edward A.C. Sutherland
Weil, Gotshal & Manges
767 Fifth Avenue
New York, New York 10153

Sec. & Exchange Commission
C/O John R. Lee
219 S. Dearborn, Room 1204
Chicago, Illinois 60604

BRUCE G. FORREST

FOOTNOTES

FN1. Appellees suggest that Congress did not prohibit the United States trustee from taking appeals in order to preserve his appellate rights for the rare occasions when the United States trustee serves as a case trustee. (Appellees' merits brief, at 17-18). This would be a very strange and unlikely explanation of Congress's silence, and it does bear scrutiny.
If the United States trustee is serving as a case trustee, and determines that a decision should be appealed, it necessarily follows that the pecuniary interest of the estate would be at stake. In that instance, the United States trustee would not be appealing as a United States trustee, but only in his capacity as the trustee and on behalf of the estate he represents. 11 U.S.C. 323. A United States trustee is not acting as a governmental entity when he serves as a case trustee. 11 U.S.C. 101(26). Thus, a statute precluding appeals by the United States trustee, written in terms parallel to those 11 U.S.C. 1109(a) or 11 U.S.C. 1164, would not bar his capacity to appeal as a case trustee on behalf of an estate.

FN2. For example, the United States trustee is directed to take such action as he deems appropriate "to ensure that all reports, schedules, and fees *** are properly and timely filed[.]" 28 U.S.C. 586(a)(3)(D). The United States trustee must also notify "the appropriate United States attorney of matters *** which may constitute a crime" and assist "in carrying out prosecutions *** [.]" 28 U.S.C. 586(a)(3)(F). Perhaps most pertinent here, the United State trustee is responsible for "monitoring plans and disclosure statements in cases file under chapter 11 of title 11 and filing with the court, in connection with hearings under section 1125 and 1128 of such title, comments with respect to such plans and disclosure statements[.]" 28 U.S.C. 586(a)(3)(B).

FN3. See, also, Chrysler Corp. v. Fedders Corp., 643 F.2d 1229, 1235 (6th Cir. 1981) (admonishing against making a determination on the merits under the guise of assessing claimant's standing); Stone v. William Beaumont Hospital, 782 F.2d 609, 616 (6th Cir. 1986) (Holschuh, D.J., concurring in the judgment).

FN4. Of course, a controversy could, in many cases, arise with respect to whether the $5 million statutory cutoff level had been met, and a hearing might be necessary to permit findings of fact on the matter. For such disputes, section 1104(b) provides for notice, hearing, and court approval. In this case, the facts underlying the jurisdictional level were stipulated by the parties. (Stipulation of October 7, 1988).

FN5. A very close parallel to this statutory structure is found in Fed. R. Civ. Pro. 11, which states in part (emphasis added): "If a pleading, motion, or other paper is signed in violation of this rule, the court, upon motion or upon its own initiative, shall impose *** an appropriate sanction ***." The district court judges enjoy very wide discretion in selecting what sanction might be appropriate, but, "[t]he mandatory word "shall" is intended to remove the exercise of discretion by the court in imposing Rule 11 sanctions once it has found a violation." Davis v. Crush, 862 F.2d 84, 88 (6th Cir. 1988).

FN6. Such a construction would, of course, be extremely disfavored. See, e.g., Reiter v. Sonotone Corp., 442 U.S. 330, 339 (1979); Colautti v. Franklin, 439 U.S. 379, 392 (1979).

FN7. Appellant's initial merits brief, at 27-30.

FN8. 95th Cong., 1st Sess. 402, reprinted in 1978 U.S. Code Cong. & Admin. News 6359.

FN9. Resnick, Alan N. and Wypyski, Eugene M., Bankruptcy Reform Act of 1978: A Legislative History, William S. Hein & Co., 1979, Document 41. A copy of the House version of section 1104 is attached for the convenience of the parties and the Court.

FN10. Resnick and Wypyski, supra, document 53, also reproduced in pertinent part in the Addendum to this brief.

FN11. Section 1101(3) of the Senate Bill would have defined a "public company" as "a debtor who *** had outstanding liabilities of $5,000,000 or more, exclusive of liabilities for goods, services, or taxes and not less than 1,000 security holders.

FN12. Compare, Matter of Hamiel & Sons, Inc., 20 B.R. 830, 832 (Bankr. S.D. Ohio 1982) (examiner is a "court fiduciary and is amenable to no other purpose or interested party") with In re Toledo Equipment Co., 35 B.R. 315, 318 (Bankr. N.D. Ohio 1983) (the purpose of a committee is to "protect [] the rights of its constituents and those creditors similarly situated"); Matter of Enduro Stainless, Inc., 59 B.R. 603, 605 (Bankr. N.D. Ohio 1986) (member's of creditors' committee act as fiduciaries); and Matter of Proof of the Pudding, Inc., 3 B.R. 645, 647 (Bankr. S.D. N.Y. 1980) (professionals hired by the creditors' committee represent the committee's interest), 3 B.R. 645, 647 (Bankr. S.D. N.Y. 1980) (professionals hired by the creditors' committee represent the committee's interests).

FN13. As noted above, the examiner's report must "includ[e] any fact ascertained pertaining to fraud, dishonesty, incompetence, misconduct, mismanagement, or irregularity[.]" The examiner's discoveries cannot, for example, become bargaining chips to be used in confidential negotiations among financially interested parties.

FN14. As one scholar explained:

> The appointment of a trustee or examiner should not supercede the investigation function of a committee inasmuch as the purposes of the investigations may differ. The committee's primary concern is determining, from the viewpoint of the class it represents, the advisability of permitting the debtor to continue operating its business and gathering information with which to negotiate a plan on behalf of its class. To the extent that the trustee or examiner may be developing similar information, it may be inappropriate to duplicate these efforts. Therefore, the various committees and the trustee or examiner should coordinate their efforts in the exercise of the investigation function as much as possible.

DeNatale, The Creditors' Committee Under the Bankruptcy Code -- A Primer, 55 Am. Bankr. L.J. 43, 53 (1981) (footnote omitted).

FN15. 124 Cong. Rec. 32403 (1978) (statement of Rep. Edwards); 124 Cong. Rec. 34003 (1978) (statement of Sen. DeConcini) (emphasis added.) As sponsors, these lawmakers' views are entitled to special consideration. Woodwork Mfrs. v. NLRB, 386 U.S. 612, 640 (1967).

FN16. When Touche Ross was authorized to aid in the investigation of the leveraged buy-out on behalf of the Trade Creditor's Committee, the accounting firm was admonished to seek assistance from the previously-authorized accounting firms. Order of June 26, 1989, authorizing retention of Touche Ross, etc., at 2 ¶2. The bankruptcy court could impose the same requirement upon the examiner as well within the bankruptcy court's power to insure that the examiner's investigation is appropriate.

FN17. Comments by the United States trustee on any proposed disclosure statement or reorganization plan are proper and expressly authorized under 11 U.S.C. 307, which accords the United States Trustee authority to "raise and appear and be heard on any issue in any case or proceeding ***." Indeed, "whenever the United States trustee considers it to be appropriate," the United States trustee is directed to "monitor[] plans and disclosure statements filed under chapter 11 *** and fil[e] *** comments with respect to such plans and disclosure statements[.]" 28 U.S.C. 586(a)(3)(B).

Appellees' assertion (merits brief, at 34 n.9), that an examiner is being sought for the "improper purpose" of providing advice to the United States trustee, is devoid of merit. Since an examiner is disinterested, it is difficult to fathom how he could act for only one party. See In re Baldwin United Corp., 46 B.R. 314, 316 (Bankr. S.D. Ohio 1985).

FN18. As the appellant indicated in his motion to expedite proceedings (at 3- 4), he has refrained from seeking a stay of bankruptcy court proceedings.

1989 WL 624990 (USTBRIEFS)

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REVCO I

(Cite as: 1989 WL 624991 (USTBRIEFS))

[*1] Title (TI): IN RE REVCO D.S., INC. (CONRAD MORGENSTERN, UST v. REVCO D.S., INC.) — OPENING BRIEF FOR APPELLANT, U.S. TRUSTEE
Court (CO): U.S. Court of Appeals (6th Cir.)
Current-Case (CCN): No. 89-3545
Previous-Case (PCN): No. N/A
Source (SO): U.S. TRUSTEES

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Author (AU): Martha L. Davis (202-307-1399)
Topic (TO): BANKRUPTCY — U.S. Trustee has standing to appeal from order denying his motion for the appointment of an examiner under 11 U.S.C. § 1104(b)(2).

Summary (SU): The U.S. Trustee has standing to challenge an order denying his motion to appoint an examiner, by virtue of 11 U.S.C. §§ 307 & 1104. Accord: In re Revco, 898 F.2d 498 (6th Cir. 1990) (Sec. 307 grants UST the right to raise, appear, and be heard on any issue, & there is no limitation on the UST's right to appeal, either in the statute or in the legislative history).

No. 89-3545

IN THE UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

IN RE: REVCO D.S., INC., et al., Debtors

CONRAD J. MORGENSTERN, U.S. TRUSTEE, Appellant
v.
REVCO D.S., INC., et al., Appellees

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF OHIO, EASTERN DIVISION

BRIEF FOR APPELLANT

STUART E. SCHIFFER
Acting Asst. Atty General
WILLIAM KANTER
FTS/ (202) 633-1597
BRUCE G. FORREST
FTS/ (202) 633-2496
Attorneys, Appellate Staff
Civil Division, Room 7416-C
Department of Justice
Washington, D.C. 20530

Of counsel:
EDWARD I. GOLD
Office of the United States Trustee
Region IX (Ohio/Michigan)
JOHN LOGAN, General counsel
MARTHA L. DAVIS, Attorney
Executive Office of the U.S. Trustee
Department of Justice
Washington, D.C. 20530

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cert. denied sub nom., Rothman v. New York State Dep't of Transp., 474 U.S. 1032 (1985)
In re El San Juan Hotel, 809 F.2d 151 (1st Cir. 1987)
In re Fulghum Construction Corporation, 706 F.2d 171 (6th Cir. 1983)
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[*3] IN THE UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

No. 89-3545
IN RE: REVCO D.S., INC., et al., Debtors
ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF OHIO, EASTERN DIVISION

BRIEF FOR CONRAD J. MORGENSTERN, UNITED STATES TRUSTEE, Appellant

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STATEMENT OF THE ISSUES PRESENTED FOR REVIEW

1. Whether the district court erred in holding that the United States Trustee lacked standing to appeal from an adverse bankruptcy court ruling on the United States Trustee's motion for the appointment of an examiner pursuant to 11 U.S.C. 1104(b)(2).

2. Whether the bankruptcy court erred in denying the United States Trustee's motion to appoint an examiner pursuant to 11 U.S.C. 1104(b)(2).

STATEMENT OF THE CASE

1. Nature Of The Case And Dispositions By The Courts Below.

Debtors are seeking reorganization relief under Chapter 11 of the Bankruptcy Code. The United States Trustee moved for the appointment of an examiner, pursuant to 11 U.S.C. 1104(b)(2), to investigate the facts surrounding the leveraged buy-out (sometimes referred to as the "LBO") transactions that preceded the bankruptcy petitions, but his motion was denied. The United States Trustee was permitted by the district court to take an interlocutory appeal to the district court pursuant to 28 U.S.C. 158(a) and (d). Thereafter, however, the district court dismissed the United States Trustee's appeal on the ground that the US Trustee lacked standing.

2. The Revco Reorganization Petitions And The United States Trustee's Request For The Appointment Of An Examiner.

Revco D.S., Inc. ("Revco") is a large discount drug store chain. In late 1986, a holding company acquired, through a subsidiary, all of the Revco common stock by means of a leveraged buy-out ("LBO"). In July, 1988, the holding company, Revco, and its operating subsidiaries filed for reorganization under Chapter 11 of the Bankruptcy Code. (Bankruptcy Court opinion 5-6). [**FN**1] The U.S. Trustee moved for the appointment of an examiner pursuant to 11 U.S.C. 1104(b)(2) to investigate the facts and circumstances surrounding the pre-petition LBO. On October 24, 1988, the bankruptcy court (Hon. H.F. White) held that, contrary to the U.S. Trustee's position, the term "shall" in section 1104(b)(2) does not impose a mandatory duty to appoint the examiner. (Bankruptcy court opinion 11-15). The bankruptcy judge denied the motion in the belief that the appointment "would burden the Debtors with administrative expenses and possibly hinder its merchandise activity at this crucial time." (Id. 16). The bankruptcy court therefore denied the U.S. Trustee's motion, without prejudice to the possible refiling of a similar motion by a party in interest at a later date.

3. The US Trustee's Appeal And The District Court's Dismissal.

The U.S. Trustee appealed to the district court. On December 29, 1988, district court (Hon. Sam H. Bell) ruled that, in its discretion, the U.S. Trustee should be permitted to pursue an interlocutory appeal on this matter. (R 18: Order of December 28, 1988). Thereafter, the Noteholders' Committee moved to dismiss the U.S. Trustee's appeal on the ground that the U.S. Trustee lacked standing to pursue the matter (R 24) and, by order entered April 25, 1989, the district court granted this motion (R 33). Prior to amendment in 1978, the Bankruptcy Code provided for the appeal of an order of the bankruptcy court by "a person aggrieved." As amended, the "person aggrieved" language was deleted, but, the district court observed, other courts have nevertheless continued applying this requirement. (R 33: slip op. 2-3). Under these "person aggrieved" decisions, the district court held, the courts require an appellant to have a direct, pecuniary interest in the matter. (Id. 3). The district court indicated the U.S. Trustee, as his role was contemplated by Congress, should be a disinterested party, one who will not be "aggrieved" in the pecuniary sense. (Id. 5). Although, virtually by definition, the United States Trustee will never have a pecuniary interest in an 1104(b) motion, the district court disclaimed any holding that the U.S. Trustee could never appeal. "There may, indeed, be circumstances or situations posed which would [give] standing to the Trustee for that purpose" (R 33; slip op. 5):

> **[*4]** Contrary to his protest that to foreclose his appeal of an adverse ruling by the bankruptcy court is to render him a watchdog without teeth, the simple fact is that his function is to be a neutral administrator and not an advocate. This appeal in fact illustrates precisely why the standing doctrine is required. Here, all of the interested parties opposed the action proposed by the U.S. Trustee and ultimately denied by the bankruptcy court. To allow the U.S. Trustee to appeal the ruling would permit a party with no pecuniary interest to delay the resolution of the case and involve the interested parties in a needless appeal. This is especially true in this case where all interests are represented by committees.

Id. 5-6.

STATUTE INVOLVED

11 U.S.C. 1104. Appointment of trustee or examiner

> (a) At any time after the commencement of the case but before confirmation of a plan, on request of a party in interest or the United States trustee, and after notice and a hearing, the court shall order the appointment of a trustee

> > (1) for cause, including fraud, dishonesty, incompe tence, or gross mismanagement, either before or after the commencement of the case, or similar cause, but not including the number of holders of securities of the debtor or the amount of assets or liabilities of the debtor; or
> >
> > (2) if such appointment is in the interests of creditors, any equity security holders, and other interests of the estate, without regard to the number of holders of securities of the debtor or the amount of assets or liabilities of the debtor.
>
> (b) If the court does not order the appointment of a trustee under this section, then at any time before the confirmation of a plan, on request of a party in interest or the United States trustee, and after notice and hearing, the court shall order the appointment of an examiner to conduct such an investigation of the debtor as is appropriate, including an investigation of any allegations of the debtor as is appropriate, including an investigation of any allegations of fraud, dishonesty, incompetence, misconduct, mismanagement, or irregularity in the management of the affairs of the debtor of or by current or former management of the debtor, if-
>
> > (1) such appointment is in the interests of creditors, any equity security holders, and other interests of the estate; or
> >
> > (2) the debtor's fixed, liquidated, unsecured debts, other than debts for goods, services, or taxes, or owing to an insider, exceed $5,000,000.

INTRODUCTION AND SUMMARY OF ARGUMENT

I.

The question of whether the United States Trustee has standing to appeal to the district court from a bankruptcy court's adverse ruling is a matter of very great importance to the administration of bankruptcy proceedings. Although the district court speculated that there "may" be some circumstances where the United States Trustee will be permitted to appeal, none readily come to mind. Cutting off the right to appeal will undermine the autonomy of the United States Trustee as contemplated by Congress.

[*5] Under the Bankruptcy Act of 1898, the district courts were required to sift out appeals of those who were not "persons aggrieved" by the order of the bankruptcy court. 11 U.S.C. 67(c) (1976) (repealed). Although Congress deleted the "persons aggrieved" test in the 1978 Act, the courts have continued to apply it. Appellant United States Trustee agrees that an appellate standing rule should be retained in bankruptcy cases. The error of the district court was not so much in accepting the premise of the "persons aggrieved" standard. Rather, the district court erred in the specific application of that requirement to the United States Trustee's appeal in this case.

A "person aggrieved" may ordinarily refer to a person whose financial stake has been irrevocably reduced. But injury to a pecuniary interest did not describe all "persons aggrieved" recognized by the courts under the 1898 Bankruptcy Code. A person may be "aggrieved" by an order that diminishes property, increases, or detrimentally affects a person's rights, Matter of Fondiller, 707 F.2d 441, 443 (9th Cir. 1983), or by impairment of "an interest which the Bankruptcy Act seeks to protect or regulate," In re Harwald Co., 497 F.2d 443, 444 (7th Cir. 1974). The district court erred in imposing an improbable pecuniary interest test to the appeal of the United States Trustee.

To the extent that the district court's dismissal was based upon a holding that the United States Trustee's non-pecuniary interests were not injured by the order of the bankruptcy court, the holding would also be incorrect. The district court defined the United States Trustee's interest as his right to bring the motion for the appointment of the examiner in the bankruptcy court. But the United States Trustee's interest, for purposes of standing analysis in this case, is the appointment itself. The district court's inverted analysis confuses the issue of statutory construction raised by the United States Trustee's appeal with the resolution of that issue. This type of standing analysis is erroneous. Association of Data Processing Serv. Org. v. Camp, 397 U.S. 150, 153 (1970).

Any doubt on this issue should have been resolved in favor of the United States Trustee in view of 11 U.S.C. 307, which accords the United States Trustee authority to "raise and appear and be heard on any issue in any case or proceeding ***." By this provision, Congress intended that the United States Trustee should be "given standing to raise, appear, and be heard on any issue in any case***. In this manner, the U.S. Trustee is given the same right to be heard as a party in interest ***." H.R. Rep. No. 764, 99th Cong., 2d Sess. 27, reprinted in 1986 U. S. Code Cong. & Admin. News 5227, 5240 (emphasis added).

In addition, other governmental entities are given statutory authority to proceed in bankruptcy cases. See 11 U.S.C. 1109(a) (SEC); 11 U.S.C. 1164 (ICC, DOT, "and any State or local commission having regulatory jurisdiction over the debtor). But those agencies "may not appeal from any judgment, order, or decree entered in the case." The United States Trustee's power to appear and be heard on any matter is subject to no similar restriction. The district court's decision violates the rule of pari materia construction, which is especially strong with respect to the "detailed and calculated scheme" of the Bankruptcy Code. Lynch v. Johns-Manville Corp., 710 F.2d 1194, 1198 (6th Cir. 1983).

II.

[*6] Should this Court agree that the district court erred in dismissing the United States Trustee's appeal, we ask this Court to also adjudicate the underlying dispute respecting the interpretation of 11 U.S.C. 1104(b). The issue is a straightfoward legal question and there is good cause to expedite the resolution of this dispute. E.g., Pinney Dock & Transp. v. Penn Cent. Corp., 838 F.2d 1445, 1461 (6th Cir.), cert. denied, 109 S.Ct. 196 (1988).

The plain language of section 1104(b)(2) says that, if the jurisdictional requirements are met, [**FN**2] the bankruptcy court "shall order the appointment of an examiner" "on request of *** the United States trustee ***." Only with the very strongest showing of an absurd result, utterly at odds with legislative intent, should the courts refuse to give force and effect to such unambiguously mandatory language. A search through the legislative history proves that, in fact, Congress meant exactly what it said. The Statute juxtaposes a permissive appointment, when the moving party shows cause (section 1104(b)(1)), against a mandatory provision for appointment in relatively large public bankruptcies (section 1104(b)(2)). The line was drawn as a result of extensive negotiation and legislative compromise: "In order to insure that adequate investigation of the debtor is conducted to determine fraud or wrongdoing on the part of present management, an examiner is required to be appointed in all cases in which the debtors' fixed, liquidated, and unsecured debt, other than debts for goods, services, or taxes, or owing to an insider, exceed $5 million." 124 Cong. Rec. 32403 (1978) (statement of Rep. Edwards). As the leading commentator summarized the matter:

> [T]he court must appoint an examiner under Sec. 1104(b)(2). In such case, the party requesting the appointment is not required to prove that the interests of creditors or equity security holders are well served by such appointment.

5 Collier on Bankruptcy, § 1104.03[4][a] (15th ed. 1988) (emphasis added) (footnotes omitted).

Accordingly, the decision of the bankruptcy court, as well as the decision of the district court, should be reversed, and the investigation by the independent examiner should commence with celerity.

ARGUMENT

I. THE UNITED STATES TRUSTEE HAS STANDING TO APPEAL FROM THE ORDER DENYING HIS MOTION FOR THE APPOINTMENT OF AN EXAMINER.

A. THE DISTRICT COURT ERRED IN APPLYING A PECUNIARY INTEREST TEST TO THE APPEAL OF THE UNITED STATES TRUSTEE.

1. Appellant does not, in this appeal, seek to eliminate or even curtail an appropriate standing rule for appeals from the bankruptcy courts to the district courts. Bankruptcy cases, especially the larger corporate bankruptcy cases, frequently include a large number of parties, and present many junctures where the financial interests of a debtor or creditor may become permanently impaired. To prevent the proceedings from becoming bogged down in a mire of frivolous interlocutory appeals, section 39(c) of the Bankruptcy Act of 1898 limited appeals to "persons aggrieved." 11 U.S.C. 67(c) (1976). [**FN**3] This "persons aggrieved" requirement was frequently referred to as the "appellate standing" rule in bankruptcy proceedings.

[*7] The 1978 Bankruptcy Reform Act [**FN**4] revisions repealed 11 U.S.C. 67(c). However, the courts have perceived that the bankruptcy appellate standing rule remains "necessary to insure that bankruptcy proceedings are not unreasonably delayed by protracted litigation that does not serve the interests of either the bankrupt's estate or its creditors." In re El San Juan Hotel, 809 F.2d 151, 154 (1st Cir. 1987). Accordingly, the courts have continued to require that bankruptcy appeals may be brought to the district court only by "persons aggrieved." E.g., In re San Juan Hotel, supra; In re Cosmopolitan Aviation Corp., 763 F.2d 507, 513-14 (2d Cir. 1985), cert. denied sub nom., Rothman v. New York State Dep't of Transp., 474 U.S. 1032 (1985); In re Fondiller, 707 F.2d 441, 442-43 (9th Cir. 1983).

The United States Trustee does not dispute the desirability of an appellate standing rule in bankruptcy cases. The bankruptcy "standing" doctrine is salutary; properly employed, it eliminates unnecessary appeals by debtors or other persons whose material interests would not be advanced even if the appeal were successful. The United States Trustee, whose role is to promote the efficiency and integrity of the bankruptcy process, would encourage the district courts to continue to weed out unnecessary bankruptcy appeals.

2. In this case, however, the district court misapprehended and misapplied the bankruptcy standing doctrine.

The district court's central holding was: "It is clear that the U.S. Trustee has no pecuniary interest in this case and is thus not a 'person aggrieved' to enable him to appeal." (R 33: slip op. 5). However, the appellate standing rule for bankruptcy cases never required a direct pecuniary interest for every party in every case.

Ordinarily, "persons aggrieved" are those parties "directly and adversely affected pecuniarily." In re San Juan Hotel, supra; Fondiller, supra; In re Cosmopolitan Aviation Corp., supra. The vast majority of parties in a bankruptcy proceeding -- the debtor and creditor interests -- are there for money. To determine whether such a party has standing to appeal, one would logically look to the "direct pecuniary interest" of such a party in the possible outcome of the appeal. For example, a bankrupt whose assets are substantially exceeded by his debts, so that debtor will received no net proceeds, has no standing to appeal from the attorneys fees awarded by the bankruptcy court. In re J.M. Wells Inc., 575 F.2d 329 (1st Cir. 1978). For parties whose interests are defined in terms of net financial recovery in the aftermath of the bankruptcy process the search for a direct pecuniary interest provides a valid test for determining whether an appellant has been "aggrieved."

However, the bankruptcy appellate standing requirement that appeals may be taken only by "persons aggrieved" has never meant the application of a universal direct-pecuniary-interest test to every party in every case.

[*8] Prior to the Bankruptcy Reform Act of 1978, which repealed the "persons aggrieved" language of 11 U.S.C. 67(c), the generally-valid application of a direct-pecuniary-interest test to "persons aggrieved" was not utilized to foreclose the valid appeals of others whose non-pecuniary interests were substantially impaired. Because of its relevance in the vast majority of bankruptcy cases, the courts often set forth the direct- pecuniary-interest test as if it were an alternative expression for "persons aggrieved." Those decisions, however, do not purport to define "persons aggrieved" for every case.

The possibility that persons without a direct pecuniary interest might nevertheless be aggrieved is recognized in other judicial formulations which, if applied here, would readily establish the United states Trustee's standing to pursue his appeal to the district court below. For example, a person would be "aggrieved" by an order that "diminish[ed] her property, increase[d] her burdens, or detrimentally affect[ed] her rights." Matter of Fondiller, 707 F.2d at 443 (emphasis added). See, also, In Re El San Juan Hotel, 809 F.2d at 155; In re J.M. Wells Inc., 575 F.2d F.2d at 331. A "person aggrieved" under former section 39(c) was one who incurred "injury in fact" to "an interest which the Bankruptcy Act seeks to protect or regulate." In re Harwald Co., 497 F.2d 443, 444 (7th Cir. 1974) (emphasis added). In sum, "persons aggrieved" was "broadly construed, but required generally that the appellant [had] a direct and substantial interest in the decision from which he appealed." [**FN**5] As the instant case illustrates so well, an interest can be direct and substantial without being pecuniary. [**FN**6]

The Supreme Court has expressly upheld the government's standing to appeal on the basis of a non-pecuniary interest in a bankruptcy proceeding in Securities and Exchange Comm'n v. United States Realty & Improvement Co., 310 U.S. 434, 459-60 (1940) (emphasis added):

> This interest of the [SEC] does not differ from that of a liquidator under a state statutory proceeding who may, in a proper case, intervene in an equity receivership in a federal court to ask the court to relinquish its jurisdiction in favor of the state proceeding. *** Neither the liquidator not the state has any personal, financial or pecuniary interest in the property in the custody of the federal court. Their interest, like that of the Commission, is a public one, to maintain the state authority and to secure a liquidation in conformity to state property. *** The Commission was *** a party aggrieved by the court's order refusing to dismiss and was entitled to appeal ***.[[**FN**7]]

3. In any event, even if there had ever been an inflexible pecuniary interest rule, to be applied without exception to government administrative agencies, such a rule could no longer be valid. Congress deleted the "persons aggrieved" requirement in 1978, an action that might best be viewed as a fully deliberate decision to eliminate the bankruptcy appellate standing doctrine. Levin, Bankruptcy Appeals, 58 N.C.L. Rev. at 976-77 (1980). [**FN**8] At a minimum, the use of any continued rule of appellate standing in bankruptcy cases would have to accommodate the new non-pecuniary interests of the United States Trustee whose position was created simultaneously with the repeal of 11 U.S.C. 67(c) in the Bankruptcy Act of 1978.

[*9] B. THE INTEREST OF THE UNITED STATES TRUSTEE IN THE APPOINTMENT OF AN EXAMINER IS CONFERRED BY 11 U.S.C. 1104(b).

As noted above, the district court dismissed the United States Trustee's appeal solely because he had no pecuniary interest in the proceeding. The district court's decision continues (R 33: slip op. 5):

> *** The bankruptcy order from which he appeals neither diminishes his property nor impairs his rights. The U.S. Trustee argues that his burden is significantly increased due to the refusal to appoint an examiner. This facet of the test, however, does not apply to the scope of his workload as an administrator. He has been given the opportunity to appear, raise and be heard in the bankruptcy court in relation to the appointment of an examiner as authorized by statute. 11 U.S.C. §1104(b).

To the extent that the district court intended to dismiss the appeal on the alternative ground that the bankruptcy court's decision had no substantial impact upon the United States Trustee's rights under the statute, this analysis is also erroneous. The appraisal completely misunderstands the United States Trustee's interest in this matter. The United States Trustee's interest is in the appointment of the examiner under 11 U.S.C. 1104(b); his rights are not limited to filing a motion and being heard.

The district court's reasoning is thus not a proper standing analysis. The district court's statement [**FN**9] erroneously conflates the assertion of an interest, which creates an issue, with the resolution of the issue on the merits. As the Supreme Court explained in Association of Data Processing Serv. Org. v. Camp, 397 U.S. 150, 153 (1970) (emphasis added):

> The "legal interest" test goes to the merits. The question of standing is different. It concerns . . . the question whether the interest sought to be protected by the complainant is arguably within the zone of interests to be protected or regulated by the statute ***.

See, also, In re Harwald Company, 497 F.2d at 444 (7th Cir. 1974).

The United States Trustee suffered "injury-in-fact"; his claimed right to the examiner appointment has been destroyed by the decision of the bankruptcy court. The United States Trustee is a statutory party expressly authorized to bring on the motion for the appointment of an examiner under 11 U.S.C. 1104(b). Under any reasonable rule of bankruptcy appellate standing, the United States Trustee's assertion of a statutory requirement of the examiner's appointment falls well within the zone of interest protected by the Bankruptcy Code.

C. THE UNITED STATES TRUSTEE'S STANDING TO PURSUE APPEALS MAY ALSO BE INFERRED FROM SECTION 307 OF THE BANKRUPTCY CODE.

With the nationwide expansion of the United States Trustee program in 1986, Congress made many important changes to the Bankruptcy Code to reflect the expanded United States Trustee's role, including section 307, which states:

> The United States trustee may raise and appear and be heard on any issue in any case or proceeding under this title but may not file a plan pursuant to section 1121(c) of this title.

[*1]0 The statute confers broad authority for the United States Trustee to act in bankruptcy matters in any court. The legislative history of section 307 confirms that Congress intended the United States Trustee to have the same procedural rights as a party in interest, notwithstanding his lack of pecuniary interest.

> Section 208 creates a new section 11 U.S.C. 332 [later codified as 307] setting forth the authority of the U.S. Trustee. The U.S. Trustee is given standing to raise, appear, and be heard on any issue in any case or proceeding under title 11, U.S. Code -- except that the U.S. Trustee may not file a plan in a chapter 11 case. In this manner, the U.S. Trustee is given the same right to be heard as a party in interest, but retains the discretion to decide when a matter of concern to the proper administration of the bankruptcy laws should be raised. By not designating the U.S. Trustee as a party in interest, the legislation ensures that there is no confusion over the U.S. Trustee's role in a case. A party in interest normally has a pecuniary interest in a case; the U.S. Trustee has no pecuniary stake in any case, and functions only as an impartial administrator.

H.R. Rep. No. 764, 99th Cong., 2d Sess. 27, reprinted in 1986 U. S. Code Cong. & Admin. News 5227, 5240 (emphasis added).

D. THE UNITED STATES TRUSTEE'S AUTHORITY TO APPEAL FROM THE DENIAL OF HIS SECTION 1104(b)(2) MOTION IS PROVED BY OTHER PROVISIONS OF THE BANKRUPTCY CODE EXPRESSLY PRECLUDING APPEALS.

This perspective becomes compelling when one reads section 307 in pari materia with other provisions of the Bankruptcy Code. Section 1109(a) of the Code confers the right to raise and be heard on any issue upon the Securities and Exchange Commission, "but the Securities and Exchange Commission may not appeal from any judgment, order, or decree entered in the case." Similarly, in section 1164 of the Code, the Interstate Commerce Commission, the Department of Transportation, and any State or local commission having jurisdiction over a chapter 11 railroad debtor may appear and be heard on any issue, but cannot appeal any judgment, order or decree. Congress' failure to impose a similar restriction on the United States Trustees in section 307 is extremely strong evidence of intentional differentiation.

> It is a fundamental rule of statutory construction that inclusion in one part of a congressional scheme of that which is excluded in another part reflects a congressional intent that the exclusion was not inadvertent. See: Equal Employment Opportunity Commission v. Kimberly Clark Corp., 511 F.2d 1352 (6th Cir.), cert. denied, 423 U.S. 994 (1975). In particular, this Court has acknowledged that Bankruptcy Act as a detailed and calculated scheme particularly appropriate to in pari materia construction. See: In re Bell, 700 F.2d 1053 (6th Cir. 1983) (constructing Chapter 7 and 13 in pari materia); In re Fulghum Construction Corporation, 706 F.2d 171 (6th Cir. 1983) (construing subsections of 11 U.S.C. § 547 in pari

> materia). ***

[*1]1 Lynch v. Johns-Manville Corp., 710 F.2d 1194, 1197-98 (6th Cir. 1983). More generally, see, e.g., Russello v. United States, 464 U.S. 16, 21, 23 (1983); Kyle v. Director, Office of Workers' Compensation, 819 F.2d 139, 143 (6th Cir. 1987).

E. THE DENIAL OF STANDING TO TAKE APPEALS IS INCONSISTENT WITH THE ENFORCEMENT FUNCTIONS OF THE UNITED STATES TRUSTEE AS CONTEMPLATED BY CONGRESS.

The office of the United States Trustee is new to the bankruptcy system. [**FN**10] No similar office existed under the Bankruptcy Act of 1898. The program was created to address historical problems that were uniquely associated with the bankruptcy process.

Of particular importance here, Congress recognized that there is a public interest in the proper administration of bankruptcy cases; that, unlike other, more conventional litigation, the adversary process could not be relied upon; and, therefor, bankruptcy cases require special, close supervision:

> [T]here is a public interest in the proper administration of bankruptcy cases. Bankruptcy is an area where there exists a significant potential for fraud, for self-dealing, and for diversion of funds. In contrast to general civil litigation, where cases affect only two or a few parties at most, bankruptcy cases may affect hundreds of scattered and ill-represented creditors. In general civil litigation, a default by one party is relatively insignificant, and though judges do attempt to protect parties' rights, they need not be active participants in the case for the protection of the public interest in seeing disputes fairly resolved. In bankruptcy cases, active supervision is essential. Bankruptcy affects too many people to allow it to proceed untended by an impartial supervisor.

H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 88 (1977), reprinted in 1978 U.S. Cong. Code & Admin. News 5963, 6050 (footnotes omitted).

This supervision was undertaken by the bankruptcy judges prior to the establishment of the United States Trustee program, but Congress found the administrative duties compromised the bankruptcy judge's ability to be impartial in hearing disputes. Furthermore, between the judge's role in appointing trustees and supervising cases, close working relationships developed between the judge with "his" trustee. The whole structure of the system created an institutional bias and the appearance that disputes were not being fairly resolved by the court. "The law must be changed to afford bankruptcy litigants the fair and impartial justice to which all other litigants in the federal courts are entitled." Id. at 91, 1978 U.S. Code Cong. & Admin. News 6053.

Congress also recognized that bankruptcy cases were controlled more by professionals receiving lucrative compensation, than by the creditors they represented:

> Creditor control in bankruptcy cases is a myth ***. In practice, creditor control has become attorney control, and the bankruptcy system operates more for the benefit of attorneys than for the benefit of creditors. The practices *** often work to the detriment of both debtors and creditors. They benefit only those administering bankruptcy cases. [Id. at 92, 1978 U.S. Code Cong. & Admin. News 6053 (footnote omitted).]

[*1]2 Congress had to confront the manner by which case trustees were compensated by the judges who appointed them. This contributed to an apparent and, oftentimes, real appearance of cronyism between the judges and the trustees. The feeling existed that a "bankruptcy ring" operated the bankruptcy system. The unusually close relationship between bankruptcy judges, trustees and the bankruptcy bar contributed to an appearance of favoritism that was viewed with suspicion and distrust. Id. 95-96, 1978 U.S. Code Cong. & Admin. News 6056-57.

Against this historical backdrop, Congress created the United States Trustee program to supervise bankruptcy cases and trustees, to protect the public interest and to ensure bankruptcy cases are conducted according to the law. The United States Trustees were to

> *** serve as enforcers of the bankruptcy laws by bringing proceedings in the bankruptcy courts in particular cases in which a particular action taken or proposed to be taken deviates from the standards established by the proposed bankruptcy code. [Id. 109 (emphasis added), 1978 U.S. Code Cong. & Admin. News 6070].

The United States Trustee sought to enforce the bankruptcy laws in this case by moving for the appointment on an independent examiner. Congress envisioned that the United States Trustees would take an active part in the proposed bankruptcy system and "serve as bankruptcy watch-dogs to prevent fraud, dishonesty, and overreaching in the bankruptcy arena." (Id. at 88, 1978 U.S. Code Cong. & Admin. News 6049).

The United States Trustee, emphatically, is not an adjudicator. Congress deliberately rejected placing United States Trustees under the supervision and control of the Administrative Office of the U.S. Courts. The contemplated active participation in bankruptcy litigation would have been inconsistent with the traditional role of the judiciary, and Congress recognized that the responsibility for execution of the bankruptcy laws should be vested with the executive rather than the judicial branch of the government. (Id. at 112).

The United States Trustee's lack of standing to appeal would very significantly impair the independence and effectiveness of that office, compromise its supervisory capacity, and would be inconsistent with the active executive branch enforcement role contemplated by Congress. The district court's decision would, contrary of Congress's intent, relegate the office to the status of an administrative appendage or advisor to the bankruptcy judge.

F. CONSIDERATIONS OF JUDICIAL ADMINISTRATION DO NOT JUSTIFY THE CURTAILING THE UNITED STATES TRUSTEE'S RIGHT TO APPEAL.

The district court also indicated that its decision was influenced by considerations of administrative judicial policy (R 33: slip op. 6):

> *** Here, all of the interested parties opposed the action proposed by the U.S. Trustee and ultimately denied by the bankruptcy court. To allow the U.S. Trustee to appeal the ruling would permit a party with no pecuniary interest to delay the resolution of the case and involve the interest parties in a needless appeal. This is especially true in this case where all interests are represented by committees.

[*1]3 The overarching legal error of this distressing passage is that these matters are irrelevant to the question of the United States Trustee's standing. The fact that the United States Trustee sought an appointment that no other party was interested in does not mean that his motion was inappropriate. Contrary to the district court's reaction, this episode proves only that the United States Trustee was, in this case, doing his job. As explained above, Congress established the role of the United States Trustee in bankruptcy proceedings to provide a public interest independent of both the traditional financial interests and the bankruptcy court itself. If it were appropriate to rely upon the creditors' interests, there would be no purpose in permitting the United States Trustee to make the motion. Congress added the United States Trustee's authority to section 1104(b)(2) for a reason. It should come as no surprise that such a motion receives no support from any creditors.

The district court's fears of delay are misplaced. The United States Trustee, unlike the other parties in a bankruptcy proceeding, is there to maintain the fairness and efficiency of the system, and there is no basis for the district court to have concluded that the United States Trustee, by exercising his intended role, will create unnecessary protraction. No delay was contemplated by the request for an examiner in this case. No stay or other delay of the proceedings has been sought, thus far, pending the United States Trustee's appeals. More importantly, this potential problem, if it exists, is not properly solved by partially immobilizing the United States Trustee program.

Thus, we agree that "an adverse ruling does not always necessitate an appeal." (R 33: slip op. 6). But there is no reason to believe that the United States Trustee will bring on unnecessary or frivolous appeals in a bankruptcy case. [**FN**11] On those occasions where the United States Trustee's appeal is truly "unnecessary," the district courts will surely utilize the usual arsenal of procedures to dispose of the matter.

The presence of the United States Trustee, and his potential role in bankruptcy cases, is perhaps novel. However, whether or not an appeal by the United States Trustee seems somehow awkward or inconvenient is a matter that might be addressed to Congress. The perception of the district court that the United States Trustee ought have no concern with respect to the outcome of his motion for the appointment of an examiner is totally contrary to the thrust of the United States Trustee program. Just as one would expect the United States Trustee to be a forceful advocate for the rulings he seeks in the bankruptcy courts, he must also be expected to appeal in suitable cases.

II. THE BANKRUPTCY COURT ERRED IN REFUSING TO APPOINT AN EXAMINER PURSUANT TO 11 U.S.C. 1104(b)(2).

A. THIS COURT SHOULD EXERCISE ITS DISCRETION TO REACH THE MERITS OF THE UNDERLYING DISPUTE.

Because the United States Trustee's appeal was erroneously dismissed on standing grounds, the district court never reached the merits of this dispute. Appellant would nevertheless urge this Court, in the exercise its appellate discretion, to resolve the underlying dispute as to whether the bankruptcy court should have appointed an examiner pursuant to 11 U.S.C. 1104(b)(2).

[*1]4 Under section 1104(b)(2), the examiner must be appointed before a reorganization plan is confirmed. As of this writing, the parties anticipate that a reorganization plan will be proposed by January 1, 1990. In order that an examiner can perform his task, and for his or her work product to be of use to the United States Trustee, the parties, and/or the bankruptcy court in considering the proposed plan, the appointment should occur as soon as possible. The merits issue presents a pure question of law, fully briefed by the parties below and fully addressed by the bankruptcy court. As the previous discussion indicates, there is considerable overlap between the standing and merits questions, and the issues can become confused, as we believe they were by the district court below. Complete appellate adjudication by this Court at this juncture would serve to advance the resolution of the dispute and would be in the interests of justice. Pinney Dock & Transp. v. Penn Cent. Corp., 838 F.2d 1445, 1461 (6th Cir.), cert. denied, 109 S.Ct. 196 (1988). See, also, e.g., Quinn v. Robinson, 783 F.2d 776 (9th Cir.), cert. denied, 479 U.S. 882 (1986).

B. THE PLAIN LANGUAGE OF THE ACT MANDATES THE APPOINTMENT OF AN EXAMINER UNDER 11 U.S.C. 1104(b)(2). [FN12]

Section 1104(b) of the Bankruptcy Code provides that (emphasis added), "If the court does not order the appointment of a trustee under this section, then *** on request of a party in interest or the United States trustee the court shall order the appointment of an examiner to conduct such an investigation of the debtor as is appropriate ***." The appointment is mandatory if either --

> (1) such appointment is in the interests of creditors, any equity security holders, and other interests of the estate; or
>
> (2) the debtor's fixed, liquidated, unsecured debts, other than debts for goods, services, or taxes, or owing to an insider, exceed $5,000,000.

It is undisputed that the Debtor, Revco D.S., Inc., owes more than $5,000,000 of the type of unsecured debt set forth in Section 1104(b)(2). The clear meaning of Section 1104(b)(2) is that the statute confers a mandatory duty upon the bankruptcy court to order the appointment of an examiner under these circumstances. This express mandate is not within the bankruptcy court's discretion to second-guess.

The search for congressional intent begins with the language of the statute. Mississippi Bank of Choctaw Indians v. Holyfield, 109 S.Ct. 1597, 1607-08 (1989); Steadman v. SEC, 450 U.S. 91, 97 (1981). In examining the language of a statute, "the fundamental canon of statutory construction [is] *** that *** words will be interpreted as taking their *** ordinary common meaning." Perrin v. United States, 444 U.S. 37, 42 (1979). The criteria set forth in Section 1104(b)(2) for ordering the appointment of an examiner are clear and direct. A more focused statement is difficult to comprehend.

C. A REVIEW OF THE LEGISLATIVE HISTORY OF 11 U.S.C. 1104(b) SHOWS THAT CONGRESS MEANT EXACTLY WHAT IT SAID.

[*1]5 The courts are not super-legislatures. As the Court stated in TVA v. Hill, 437 U.S. 153, 194-195 (1978):

> Our individual appraisal of the wisdom or unwisdom of a particular course consciously selected by the Congress is to be put aside in the process of interpreting a statute. Once the meaning of an enactment is discerned and its constitutionality determined, the judicial process comes to an end. We do not sit as a committee of review.

In this case the Court is spared the task of deciding between the literal and the rational result. The language of 11 U.S.C. 1104(b)(2) need not be tortured to correct some legislative "mistake." This not a case where the plain language of a statute, literally applied, works some absurd result, inconsistent with legislative intent. To the contrary, the legislative history of section 1104(b) reaffirms that the statute means exactly what it so bluntly says. The mandatory language of section 1104(b)(2) was no accident.

The provision was a compromise between those interests supporting the mandatory appointment of a trustee and those favoring a more discretionary standard of appointment. The House bill, H.R. 8200, would have restricted the appointment of a trustee to those circumstances where the need for a trustee would outweigh the costs and expenses. H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 402 (1977), reprinted in 1978 U.S. Code Cong. & ad. News 6358. In contrast, the Senate bill, S. 2266, provided that the appointment of a trustee would be mandatory for a public company defined as one that had $5 million in liabilities, excluding tax and trade obligations, and 1,000 security holders. S. Rep. No. 95-989, 95th Cong., 2d Sess. 115, reprinted in 1978 U.S. Code Cong. & Admin. News 5901 (1978).

When the floor managers of both Houses met to resolve the differences between their bills, the compromise bill that resulted contained the final version of Section 1104 at issue here. In exchange for making the appointment of a trustee discretionary, the floor managers acceded to the concerns raised by the Senate bill and made the appointment of an examiner mandatory under certain circumstances. The joint explanatory statement of the floor managers, which both Houses published following their floor debates on the compromise bill, states that the appointment of an examiner is required when the circumstances set forth in the Section 1104(b)(2) are presented. It also makes it clear that the two standards for appointing a trustee or examiner, i.e., for cause or the best interests of creditors, do not apply in the Section 1104(b)(2) situation.

> The new consolidated chapter 11 contains no special procedure for companies with public debt or equity security holders. *** In order to insure that adequate investigation of the debtor is conducted to determine fraud or wrongdoing on the part of present management,

> an examiner is required to be appointed in all cases in which the debtors' fixed, liquidated, and unsecured debt, other than debts for goods, services, or taxes, or owing to an insider, exceed $5 million. This should adequately represent the needs of public security holders in most cases. ***.

[*1]6 124 Cong. Rec. 32403 (1978) (statement of Rep. Edwards); 124 Cong. Rec. 34003 (1978) (statement of Sen. DeConcini) (emphasis added.)

The floor managers' statements also confirm that Congress intended Section 1104(b)(2) to be mandatory.

> In large cases, an examiner is appointed to investigate the affairs of the debtor, but there is never a mandatory appointment of a trustee. The examiner's investigation will not slow down the reorganization in any way.

124 Cong. Rec. 32419 (1978) (statement of Rep. Butler).

> In the business reorganization chapter the Senate succeeded in obtaining special protection for the large cases having great public interest. There will be automatically appointed an examiner in those cases, but not a trustee as in the Senate passed bill. I am convinced that debtor and creditor interests, as well as the public interest, will be preserved and enhanced by these provisions.

124 Cong. Rec. 33990 (1978) (statement of Sen. DeConcini) (emphasis added). [**FN**13]

CONCLUSION

For the foregoing reasons, the judgment of the district court dismissing the appeal of the United States Trustee should be vacated. The case should be remanded to the district court with instructions to reinstate the United States Trustee's appeal. This Court shpould also hold that the appointment of an examiner pursuant to 11 U.S.C. 1104(b)(2) should have been ordered by the bankruptcy court, and the district court should proceed consistent with that holding.

Respectfully submitted,
STUART E. SCHIFFER
Acting Asst. Atty General

WILLIAM KANTER
FTS/ (202) 633-1597
BRUCE G. FORREST
FTS/ (202) 633-2496
Attorneys, Appellate Staff
Civil Division, Room 7416-C
Department of Justice
Washington, D.C. 20530

Of counsel:
EDWARD I. GOLD
Office of the United States Trustee
Region IX (Ohio/Michigan)

JOHN LOGAN, General counsel
MARTHA L. DAVIS, Attorney
Executive Office of the U.S. Trustee
Department of Justice
Washington, D.C. 20530

CERTIFICATE OF SERVICE

I hereby certify that I have caused a copy of the foregoing brief for appellant to be served by first class mail this 12th day of July, 1989. 1989, upon the counsel listed below:

John Silas Hopkins, III
Baker & Hostetler
3200 National City Center
Cleveland, OH 44114

Myron Trepper
Levin & Weintraub & Crames
225 Broadway
New York, New York 10007

Harry W. Greenfield
Javotch & Eisen Co, LPA
1050 Statler Office Tower
1127 Euclid Ave.
Cleveland, Ohio 44115

Stuart E. Hertzberg
Hertzberg, Jacob & Weingarten
1530 Buhl Building
Detroit, Michigan 48226

Brad Eric Scheler
Madlyn B. Gleich
Freid, Frank, Harris, Shriver & Jacobson
One New York Plaza
New York, New York 10004

Robert J. White
O'Melveny & Myers
400 South Hope Street
[*1]7 Los Angeles, California 90071

Richard Lieb
Kronish, Lieb, Weiner & Hellman
1345 Avenue of the Americas
New York, New York 10105

Joseph F. Hutchison, Jr.
Brouse & McDowell
500 First National Tower
Akron, Ohio 44308

Edward A.C. Sutherland
Weil, Gotshal & Manges
767 Fifth Avenue
New York, New York 10153

Securities & Exchange Commission
C/O John R. Lee
219 S. Dearborn, Room 1204
Chicago, Illinois 60604

BRUCE G. FORREST

FOOTNOTES

FN1. Altogether, including later-filed petitions, there are now 67 Revco- related petitions pending in the Bankruptcy Court. Revco employs 28,000 persons and operates about 2,000 retail outlets. The debtors have over $610 million in assets and $1.3 billion in liabilities.

FN2. I.e., "the debtor's fixed, liquidated, unsecured debts, other than debts for goods, services, or taxes, or owing to an insider, exceed $5,000,000." These conditions are undisputedly met in the instant case.

FN3. A person aggrieved by an order of a referee may, within ten days after the entry thereof or within such extended time as the court upon petition filed within such ten-day period may for cause shown allow, file with the referee a petition for review of such order by a judge ***."

FN4. Pub. L. No. 95-598, 92 Stat. 2549-2688 (1978).

FN5. Levin, Bankruptcy Appeals, 58 N.C. L. Rev. 967, 976 (1980) (emphasis added, footnote omitted).

FN6. It is worth at least passing note that Congress used the same concept of an aggrieved person in setting forth the standing requirements for seeking judicial review of an administrative decision rendered under the Administrative Procedure Act, 5 U.S.C. 702. "That interest, at times, may reflect ' aesthetic, conservational, and recreational' as well as economic values. A person or family may have a spiritual stake in First Amendment values sufficient to give standing to raise issues concerning the Establishment Clause and the Free Exercise Clause. We mention these noneconomic values to emphasize that standing may stem from them as well as from *** economic injury ***." Association of Data Processing Serv. Org., v. Camp, 397 U.S. 150, 154 (1970) (citations omitted).

FN7. Summarizing the pre-1978 law, the leading bankruptcy treatise observed that a "personal, financial or pecuniary interest is not always necessary." 1 Collier on Bankruptcy (14th ed. 1979) ¶ 25.08[1] at 931.

FN8. The author suggests that new standards should be developed based upon the "extent of the interest of appellant, need for accountability of the officers of the estate, and economy and efficiency of the system." Id. at 977.

FN9. The district court's holding that the United State's Trustee could not be a "person aggrieved" because he lacked a pecuniary interest completely disposed of his appeal. It is not clear whether the analysis rejecting the United States Trustee's interest in the proper administration of section 1104(b) of the Bankruptcy Code is dictum or an alternative holding.

FN10. After operating seven years as a pilot program in 14 judicial districts, the United States Trustees became a permanent, nationwide program in 1986. Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1986, Pub. L. No. 99-554, 100 Stat. 3088 (1986) ("1986 Act").

FN11. A proposed appeal by the United States Trustee to a district court must be reviewed and approved by the General Counsel of the Executive Office of the United States Trustees. A United States Trustee's appeal to a circuit court must be reviewed and approved by the Solicitor General. It is arguable that there will be relatively fewer unnecessary appeals brought by the United States Trustee than there will be by the traditional parties to bankruptcy proceedings.

FN12. This issue has not, to our knowledge, been addressed by a circuit court of appeals. The lower courts have issued a smattering of brief comments on section 1104(b)(2). The bankruptcy court cited in In re Shelter Resources Corp., 35 Bankr. 304 (N.D. Ohio 1983) and In re GHR Companies, Inc., 43 Bankr. 165 (D. Mass. 1984), aff'd, 792 F.2d 476 (5th Cir. 1986). (Bankruptcy court op. 12-15). Other courts have adopted the view advocated by appellant here: In re The Bible Speaks, 74 Bankr. 511, 514 (Bankr, D. Mass. 1987); In re Lenihan, 4 Bankr. 209, 211 (D. R.I. 1980); In re 1243 20th St., Inc. 6 Bankr. 683, 685 n. 3 (D.D.C. 1980).

The Fifth Circuit in GHR expressly stated that the lower court's decision was not to be regarded as a decision on the merits interpreting section 1104(b). 792 F.2d at 478. Indeed, most, perhaps all, of the pronouncements in these cases are dicta.

FN13. This perspective of congressional intent is supported by the commentators.

> [T]he court must appoint an examiner under Sec. 1104(b)(2). In such case, the party requesting the appointment is not required to prove that the interests of creditors or equity security holders are well served by such appointment.

5 Collier on Bankruptcy, § 1104.03[4][a] (15th ed. 1988) (emphasis added) (footnotes omitted). See, also, Cowans Bankruptcy Law and Practice 1987, § 2.13, p. 126. 1989 WL 624991 (USTBRIEFS)

1989 WL 624991 (USTBRIEFS)

BRIEF BANK — 'SUMMARY SHEET" *Printed Wed-1/2/08 14:27*

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In re: Reyes (UST v. Reyes)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*
S.D. Fla.

3. ("CCN") ***CURRENT*** CASE NO.
No.: 07-20689

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*
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Court: Bankr. S.D. Fla.
(Identify judge & cite, if any)

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Felicia Turner, Ariel Rodriguez
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") ● ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***

● Did bankruptcy court lack jurisdiction to issue an advisory ruling on whether pro bono counsel is a debt relief agency when no actual controversy has been raised by parties involved?
Did the bankruptcy court err by raising sua sponte and ruling on issue of constitutionality of 11 U.S.C. §§526-528?
Did the bankruptcy court err by raising sua sponte and ruling that the issue of whether an attorney who provides bankruptcy assistance to assisted persons in return
for a fee is a debt relief agency as defined by 11 U.S.C. §101(12A)?

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UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF FLORIDA
Case No. 07-20689-CIV-GOLD

IN RE:

GLORIA REYES,

Debtor.
_______________________________/

UNITED STATES TRUSTEE,

Appellant,

v.

GLORIA REYES,

Appellee.
_______________________________/

APPEAL FROM THE UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF FLORIDA

CASE NO. 06-15957-BKC-AJC

INITIAL BRIEF OF APPELLANT, UNTIED STATES TRUSTEE

(ORAL ARGUMENT REQUESTED)

FELICIA S. TURNER
United States Trustee, Region 21

ARIEL RODRIGUEZ, Trial Attorney
Florida Bar No. 160253
U.S. Trustee’s Office
51 S.W. 1st Ave. #1204
Miami, Florida 33130
Phone (305) 536-7275
Fax (305) 536-7360
ariel.rodriguez@usdoj.gov

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PRELIMINARY STATEMENT

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REQUEST FOR ORAL ARGUMENT

Appellant United States Trustee requests oral argument. The challenged order declared the "debt relief agency" provisions of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA"), 11 U.S.C. §§ 526-528, unconstitutional as applied to attorneys and interpreted the definition of a "debt relief agency," 11 U.S.C. § 101(12A), to exclude attorneys licensed to practice law.

STATEMENT OF THE BASIS OF APPELLATE JURISDICTION

This Court has jurisdiction over this appeal pursuant to 28 U.S.C. § 158(a).

STATEMENT OF ISSUES PRESENTED FOR APPELLATE REVIEW

The Bankruptcy Code imposes certain restrictions and obligations on those entities that qualify as a “debt relief agency,” 11 U.S.C. §§ 526-528, and under section 101(12A) of the Bankruptcy Code, a “debt relief agency” only includes those persons who provide bankruptcy assistance “in return for payment of money or other valuable consideration.”

1. Did the Bankruptcy Court lack jurisdiction to issue an advisory ruling on whether *pro bono* counsel is a debt relief agency when no actual controversy has been raised by the parties involved?

2. Did the Bankruptcy Court err by raising *sua sponte* and ruling on the issue of the constitutionality of 11 U.S.C. §§ 526-528?

3. Did the Bankruptcy Court err by raising *sua sponte* and ruling that the issue of whether an attorney who provides bankruptcy assistance to assisted persons in return for a fee is a debt relief agency as defined by 11 U.S.C. § 101(12A)?

APPLICABLE STANDARD OF APPELLATE REVIEW

This appeal raises only issues of law. The standard of review on appeal is *de novo* as to conclusions of law. In re New Power Co., 438 F.3d 1113 (11th Cir. 2006); In re Empire for Him, Inc., 1 F.3d 1156 (11th Cir. 1993); In re Verola, 336 B.R. 547 (S.D. Fla. 2004).

STATEMENT OF THE CASE

I. Statutory Background

The BAPCPA is "a comprehensive package of reform measures" designed "to improve bankruptcy law and practice by restoring personal responsibility and integrity in the bankruptcy system and ensure that the system is fair for both debtors and creditors." H.R. Rep. No. 109-31, 109th Cong., 1st Sess. 2 (2005), reprinted at 2005 U.S.C.C.A.N. 88, 89. After conducting a series of hearings, Congress found that one of the problems was "misconduct by attorneys and other professionals." Id. at 92.[1]

For example, the evidence before Congress indicated that some bankruptcy attorneys were failing to provide clients with sufficient information regarding their options and the consequences of bankruptcy. The Honorable Edith Hollan Jones, United States Court of Appeals Judge for the Fifth Circuit and member of the National Bankruptcy Review Commission, testified as follows:

> Most debtors never see a judge. Many bankruptcy lawyers never

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[1] The BAPCPA is the product of nearly eight years of proposals and hearings on reform of bankruptcy law and practices.

> talk to their clients. The first time they see their clients often is when they are in a herd of people in bankruptcy courts and the lawyer raises a hand, and says, "Anyone's who's my client needs to step forward right now."

Bankruptcy Reform Act of 1998: Part I, Hearing on H.R. 3150 before House Judiciary Comm., 105th Cong., 2d Sess. 15 (1998). In this same vein, a study conducted by Tahira K. Hira, a Professor at Iowa State University, revealed that the two most common complaints of people who had their debts discharged in a bankruptcy proceeding were a lack of information and concern about the practices of their lawyers. The Consumer Bankruptcy Reform Act: Seeking Fair and Practical Solutions to Consumer Bankruptcy Crisis, Hearing on S. 1301 before Senate Judiciary Comm., 105th Cong., 2d Sess. 29 (1998).

Congress also found problems with advertisements by attorneys for debt relief. The House Judiciary Committee took note of a consumer alert issued by the Federal Trade Commission, which warned that some advertisers promising debt relief may actually use bankruptcy as the method for such relief. Bankruptcy Reform Act of 1998: Part III, Hearing on H.R. 3150 before House Judiciary Comm., 105th Cong., 2d Session 90-92 (1998). See also Bankruptcy Reform Act of 1999 (Part II), Hearing on H.R. 833 before House Judiciary Committee, 106th Cong., 1st Sess. 122-23 (1999) (creditor describing examples of customers misled by such advertisement into thinking that they had consolidated their loans and "didn't even realize that they filed" for bankruptcy).

To correct these problems, Congress included in BAPCPA "provisions strengthening professional standards for attorneys and other who assist consumer debtors with their bankruptcy cases." 2005 U.S.C.A.A.N. at 103. These standards are known as the "debt relief agency provisions." 11 U.S.C. §§ 526-528. The BAPCPA defines the term "debt relief agency," with certain exceptions not applicable here, as "any person who provides any bankruptcy assistance to an assisted person in return for the payment of money or other valuable consideration." 11 U.S.C. § 101(12A). "Bankruptcy assistance" includes "providing information, advice, counsel . . . [and] legal representation with respect to a case or proceeding under this title." 11 U.S.C. § 101(4A).

Section 526 prohibits a debt relief agency from (1) failing to perform any service that it informed the assisted person it would provide in connection with a bankruptcy case, (2) advising an assisted person to make untrue or misleading statements in bankruptcy filings, (3) misrepresenting the services it would provide or the benefits or risks of filing for bankruptcy, and (4) advising an assisted person to incur more debt in contemplation of filing for bankruptcy or for the purpose of paying an attorney or bankruptcy petition preparer for bankruptcy services. 11 U.S.C. § 526(a).

Section 527 requires that debt relief agencies provide certain disclosures and notices to an assisted person, including (1) a description of the various types of bankruptcy proceedings and the costs and benefits of proceeding under each chapter, (2) an explanation of the information that the debtor is to provide during the bankruptcy proceeding (e.g., an accurate accounting of assets and liabilities), and (3) a warning that the assisted person's failure to provide such information may result in the dismissal of the case or other sanction, including a criminal sanction. 11 U.S.C. § 527(a). A debt relief agency must also provide an assisted person with a separate specified notice explaining, inter alia, that the assisted person may proceed pro se or hire an attorney or a bankruptcy petition preparer, and that the attorney or preparer must furnish the person with "a written contract specifying what the attorney or bankruptcy petition preparer will do for you and how much it will cost." 11 U.S.C. § 527(b). In addition, a debt relief agency must provide an assisted person with reasonably sufficient information regarding valuation of assets and determining liabilities, income, and other information required to be provided in the proceeding (except to the extent that the debt relief agency itself completes the relevant forms on behalf of the debtor). 11 U.S.C. § 527(c).

Section 528 provides that a debt relief agency shall execute a written contract with the assisted person explaining the agency's services and fees. 11 U.S.C. § 528(a)(1). It also requires a debt relief agency to insert in any advertisements of "bankruptcy assistance services" the following statement or a substantially similar one: "We are a debt relief agency. We help people file for bankruptcy relief under the Bankruptcy Code." 11 U.S.C. §§ 528(a)(4), (b).

The BAPCPA establishes various remedies for violations of these debt relief provisions. First, a debt relief agency shall be liable to an assisted person for (a) "any fees or charges" paid to him or her by the debtor-client, (b) "actual damages," and (c) "reasonable attorneys' fees," if the debt relief agency is found, after notice and a hearing, to have "intentionally" or "negligently" violated any requirement imposed on it by §§ 526-528. 11 U.S.C. § 526(c)(2)(A). Second, in addition to such other remedies as are provided by State law, the BAPCPA authorizes state attorneys general to bring actions to enjoin violations of Section 526 and recover damages for debtors. 11 U.S.C. § 526(c)(3). Finally, "notwithstanding any other provisions of Federal law and in addition to any other remedy provided by Federal or State law, the court, on its own motion or on the motion of the United States trustee or debtor" may enjoin violations or impose an appropriate civil penalty, if the court "finds that a person intentionally violated [Section 526] or engaged in a clear and consistent pattern or practice of violating this section." 11 U.S.C. § 526(c)(5).

II. Procedural History

On November 17, 2006, Gloria Reyes ("Debtor") filed a voluntary petition under Chapter 7 of the Bankruptcy Code with the assistance of an attorney, Heather Yonke. R. 1. On December 19, 2006, the Debtor filed a motion seeking an order "determining and/or clarifying" that the Debtor's counsel is not a debt relief agency as defined in 11 U.S.C. § 101(12A) because she is representing the Debtor on a *pro bono* basis. R. 16. The motion noted that while Debtor's counsel will not accept any compensation for her services, she will attribute the hours spent on representation of the Debtor towards the annual *pro bono* requirement of the Florida Bar. Id. The motion, thus, raised two narrow statutory issues: (1) whether an attorney who provides bankruptcy assistance on a *pro bono* basis fits within the definition of a "debt relief agency," and (2) whether receipt of credit from the Florida Bar for such *pro bono* services constituted "other valuable consideration" under 11 U.S.C. § 101(12A).

On January 4, 2007, the United States Trustee filed a response stating that the motion should be denied as unnecessary because there was no dispute between any parties given that the plain language of 11 U.S.C. § 101(12A), which defines a "debt relief agency," includes only individuals who provide bankruptcy for a fee or other valuable consideration. R. 29.

On January 16, 2007, the Bankruptcy Court held a hearing on the motion. Instead of limiting the focus to the two narrow issues raised by the Debtor's motion, the Bankruptcy Court raised two other issues *sua sponte*: (1) whether the debt relief agency provisions were unconstitutional as applied to attorneys and (2) if they were constitutional, whether the provisions apply to attorneys. R. 35, at 4. The trial attorney explained that he was not prepared to address these new issues and requested that the proceeding be continued if the Bankruptcy Court was going to entertain those issues. Id. at 4-5. The court refused to continue the hearing but indicated that it would allow the United States Trustee to make an additional submission if he were to submit it before the Court made its ruling. Id. at 5-6.

Debtor's counsel then addressed the two issues raised by her motion. Id. at 8. Debtor's counsel did not address the new issues raised *sua sponte* by court. The trial attorney responded by stating that while the United States Trustee agreed that attorneys who provide *pro bono* services were not debt relief agencies, the motion should not be granted because there was no disagreement on the narrow issues raised by the Debtor in her motion. Id.

The Bankruptcy Court concluded the hearing by stating that "the simplest thing to do would be to then grant the debtor's motion" on the narrow issues raised by the debtor in her motion because "that's the scope of the motion" and "we don't have to go further than that." Id. at 10. The court stated, however, that it might "include some dicta" on the two other issues that he had raised *sua sponte*. Id. Based on that representation, the United States Trustee did not request to file a brief on those issues.

The next day, January 17, 2007, the Bankruptcy Court issued an order. R. 30. In its order, the court acknowledged that the only issues raised by the Debtor were (1) whether an attorney who provides bankruptcy assistance to an assisted person but who receives no money or other valuable consideration for the assistance is a debt relief agency, and (2) whether "attributing the hours on such representation to the annual *pro bono* requirement set forth by the Florida Bar Association constitute[s] 'other valuable consideration' under 11 U.S.C. § 101(12A)." Id. at 3.

The court, however, stated that two other issues "should be addressed before reaching the issues raised by the Motion[:]" (1) "If Debtor's counsel is a 'debt relief agency' pursuant to 11 U.S.C. § 101(12A), are the provisions of 11 U.S.C. §§ 526, 527 and 529 unconstitutional as applied to attorneys?" and (2) "If 11 U.S.C. §§ 526, 527, and 528 are constitutional, do those sections apply to attorneys who are licensed to practice law . . . ?" Id. at 4.

The Bankruptcy Court summarily concluded that the provisions were unconstitutional as applied to attorneys. Id. at 4. The Bankruptcy Court then stated that "the Court does not believe Congress intended the scope of the statute to include attorneys." Id. at 5. After addressing the issues not raised by the motion, the Bankruptcy Court turned to the narrow issues raised by the Debtor in her motion. Id. at 6-8. The Bankruptcy Court found that under the plain language of the provision, attorneys who provide *pro bono* services were not debt relief agencies. Id. at 7. The Bankruptcy Court further found that "receipt of credit toward the fulfillment of state bar requirement" did not "constitute 'valuable consideration' as the term is used in 11 U.S.C. § 101(12A)." Id. Although the Bankruptcy Court acknowledged that courts should "attempt to resolve the issues raised in a motion on other than constitutional grounds" (id. at 6) and that it was possible to resolve the motion without reaching the issues raised by the court *sua sponte*, the court included its findings on those issues in its order. Id. at 8-9. Specifically, the court issued an order finding that "the application of 11 U.S.C. §§ 526, 527, and 528 to Debtor's counsel is unconstitutional" and that "Sections 526, 527 and 528 of the Bankruptcy Code do not apply to an attorney licensed to practice law by the state, regulated by the laws of the state wherein the attorney is admitted and admitted to practice in United States Bankruptcy Courts." Id.

ARGUMENT

The Bankruptcy Court did not have jurisdiction to consider Debtor's motion seeking a clarification that attorneys who provide bankruptcy assistance on a *pro bono* basis are not debt relief agencies. Article III of the Constitution limits courts to the resolution of actual "cases and controversies." In this case, there was no disagreement between the Debtor and the United States Trustee with respect to the legal question presented by the motion. Moreover, even if there were a disagreement, the Debtor lacked standing to raise the issue because she has not alleged any injury to herself. Instead, the Debtor sought such an order because she alleges that other attorneys may be reluctant to provide *pro bono* services to other debtors. The Debtor has no standing to raise the rights of other attorneys or other debtors.

Even if the Bankruptcy Court, however, had jurisdiction to consider the two statutory issues raised in the motion, the Bankruptcy Court's finding that 11 U.S.C. §§ 526-528 are unconstitutional as applied to attorneys should be vacated on three jurisdictional and procedural grounds. First, the Debtor did not challenge the constitutionality of the provisions, not did she have standing to do so since the court found (and the parties agreed) that the provisions did not apply to attorneys, such as Debtor's counsel, who provided bankruptcy services on a *pro bono* basis. Accordingly, the court had no jurisdiction to consider the constitutionality of the debt relief provisions. Second, even if the Bankruptcy Court had jurisdiction to consider the constitutionality of the provisions, the Bankruptcy Court violated the doctrine of constitutional avoidance by reaching the issue since, as the court itself found, it was possible to resolve the Debtor's motion on the two statutory grounds raised in her motion. Third, even if the Bankruptcy Court could raise and resolve the constitutional issue, it improperly failed to provide the United

States Trustee adequate notice and a meaningful opportunity to address the constitutionality of the provisions.

The Bankruptcy Court's finding that an attorney who provides bankruptcy assistance for a fee is not a debt relief agency should also be vacated. Like the constitutional issue, this was not an issue raised by the Debtor in her motion. Nor was it an issue that the Debtor had standing to raise because her counsel did not receive a fee or other valuable consideration in return for providing bankruptcy assistance to the Debtor. Thus, like the constitutional issue, the Bankruptcy Court had no jurisdiction to consider the issue of whether attorneys who provide bankruptcy assistance for a fee are debt relief agencies. Moreover, even if the court had jurisdiction, its decision on this issue should be reversed. Under the plain language of the statute, attorneys fall within the definition of the term "debt relief agency," as defined by 11 U.S.C. § 101(12A).

I. THE BANKRUPTCY COURT DID NOT HAVE JURISDICTION TO CONSIDER DEBTOR'S MOTION BECAUSE THERE WAS NO CASE OR CONTROVERSY.

"[I]t is well settled that the jurisdiction of the bankruptcy courts to hear cases related to bankruptcy is limited initially by statute and eventually by Article III." In re Lemco Gypsum, Inc., 910 F.2d 784, 787 (11th Cir. 1990). Although a bankruptcy court is not itself an Article III court, see Northern Pipeline Constr. Co. v. Marathon Pipeline Co., 458 U.S. 50, 60-61 (1982), it is a "unit of the district court" and therefore bound by Article III. See 28 U.S.C. § 151; In re Goerg, 930 F.2d 1563, 1565 (11th Cir. 1991); In re Nunez, Nos. 98-CV-7077 and 98-CV-7078, 2000 WL 655983 (E.D.N.Y. March 17, 2000).

Article III of the Constitution limits the federal courts to the resolution of live "cases and controversies." Lujan v. Defenders of Wildlife, 504 U.S. 555, 559-60 (1992); Diamond v. Charles, 476 U.S. 54, 61-62 (1986); Allen v. Wright, 468 U.S. 737, 750 (1984). This limitation encompasses several related principles. It prohibits a court from issuing an advisory opinion on a legal issue upon which there is no actual dispute. Preiser v. Newkirk, 422 U.S. 395, 401 (1975). It also prohibits a court from considering an issue that a party has no standing to raise. Allen v. Wright, 468 U.S. at 750. In this case, the motion filed by the Debtor falls within both of these prohibitions.

A. The Debtor's Motion Did Not Present A Justiciable Case or Controversy.

The Supreme Court has held that the term "controversies" in Article III "implies the existence of present or possible adverse parties." Muskrat v. United States, 219 U.S. 346, 357 (1911). Thus, judicial power under Article III is limited "to determin[ing] actual controversies arising between adverse litigants." Id. at 361. It does not include the power to issue "advisory opinions not founded upon the facts of a controversy between truly adverse parties." Scott v. Pasadena Unified School District, 306 F.3d 646, 654 (9th Cir. 2002). Accord Preiser v. Newkirk, 422 U.S. 395, 400 (1975) (noting a federal court "has neither the power to render 'advisory opinions' nor 'to decide questions that cannot affect the rights of the litigants in the case before them'"); United States v. Johnson, 319 U.S. 302, 305 (1943) (dismissing as non-justiciable a suit brought at the request of the defendant because "it [was] not in any real sense adversary."). Based on this Article III limitation, courts have denied motions seeking advisory opinions in bankruptcy proceedings. See, e.g., In re Nunez, 2000 WL 655983, * 6; In the Matter of Hamlin's Landing Joint Venture, 81 B.R. 651, 653 (Bankr. M.D. Fla. 1987) (denying motion by debtor seeking clarification of whether automatic stay applied to non-debtor guarantors).

In this case, there has been no controversy between the parties regarding the narrow issues presented by the Debtor's motion. The United States Trustee agrees with Debtor that her counsel is not a debt relief agency, when, as here, she is providing bankruptcy assistance on a *pro bono* basis. R. 29, at 2-4. See also http://www.usdoj.gov/ust/eo/trustees_faqs.htm#dra_issue. Thus, the Debtor's motion did not raise an issue upon which there is an actual dispute or disagreement regarding the proper interpretation of the term "debt relief agency." Because there was no such disagreement, the Bankruptcy Court lacked jurisdiction to consider the motion.

B. The Debtor Lacked Standing to Raise the Issues Presented by Her Motion.

Even if there were an actual disagreement between the Debtor and the United States Trustee with regard to the issue of whether an attorney providing *pro bono* services fits within the definition of "debt relief agency," 11 U.S.C. § 101(12A), the Bankruptcy Court lacked jurisdiction because the Debtor had no standing to raise the issue. As the Supreme Court has stressed, "[t]he presence of a disagreement, however sharp and acrimonious it may be, is insufficient by itself to meet Art. III's requirements." Diamond v. Charles, 476 U.S. at 62. Instead, Article III's standing doctrine requires a plaintiff

> to "show that he personally has suffered some actual or threatened injury as a result of the putatively illegal conduct of the defendant," . . . and that the injury "fairly can be traced to the challenged action" and "is likely to be redressed by a favorable decision. . . ."

Valley Forge Christian College v. Americans United for Separation of Church and State, Inc., 454 U.S. 464, 472 (1982) (citations omitted). Accord Harris v. Evans, 20 F.3d 1118, 1121 (11th Cir. 1994).[2]

Based on these criteria, courts have dismissed motions by debtors or their attorneys

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[2] See also Baron & Budd, P.C. v. Unsecured Asbestos Claimants Comm., 321 B.R. 147, 160-61(D.N.J. 2005) (using the Lujan standard to determine whether standing exists in a bankruptcy case); In re Park South Securities, LLC, 326 B.R. 505, 511 (Bankr. S.D.N.Y. 2005) (using same criteria to determine whether standing exists in a bankruptcy case).

seeking declarations that attorneys who practice before a bankruptcy court are not debt relief agencies, ruling that the debtor has no real, actual or direct harm or injury, and thus cannot establish standing. In re David Cantor on Behalf of Himself and Members of the Bar Practicing Before the U.S. Bankruptcy Courts for the Western District of Kentucky, Case No. 05-2005 (Bankr. W.D.Ky. May 23, 2006) (Appendix A); In re Ella Srymanske, Case No. 05-60519 (Bankr. D. N.J. April 7, 2006) (Appendix B); In re Michelle Moore, No. 05-24651 (Bankr. W.D. Wash. Feb. 23, 2006) (Appendix C); In re McCartney, 336 B.R 588 (Bkrtcy. M.D. Ga. 2006); In re Harvey Beaver, No. 05-04080 (Bankr. W.D.N.C. Nov. 15, 2005) (Appendix D).

The motion here suffered from the same defect because the Debtor did not allege that she had personally suffered any injury as a result of the purported confusion over whether a *pro bono* attorney fits within the definition of debt relief agency. Instead, the Debtor's counsel stated that she sought a declaratory order because "there are a lot of law firms refusing to take *pro bono* cases" because of the purported ambiguity of whether receipt of credit constituted "valuable consideration." R. 30, at 8. But, even if this allegation were true, the Debtor had no standing to seek relief based on that alleged injury because she has counsel.

Nor did she have standing to file the motion on the behalf of other attorneys or individuals who seek such *pro bono* services. As courts have stressed, the usual rule is that an individual must "'assert his own legal rights and interests, and cannot rest his claim to relief on the legal rights or interests of third parties." Kowalski v. Tesmer, 543 U.S. 125, 129 (2004) (quoting Warth v. Seldin, 422 U.S. 490, 499 (1975)). Courts have recognized exceptions to this rule only where the individual can show that (1) he or she has suffered some injury in fact, (2) he or she has a "close" relationship with the person who possesses the right, and (3) there is a "hindrance" to that person's ability to protect his own interest. Id. at 129-130. Accord Singleton v. Wulff, 428 U.S. 106, 116 (1976); Harris v. Evans, 20 F.3d at 1122; Corey v. Dallas, 492 F.2d 496, 497 (5th Cir. 1974).

Applying these standards, courts have rejected similar attempts by attorneys to adjudicate the rights of others where there is no obstacle to the individual's ability to protect his or her own rights. Kowalski v. Tesmer, 543 U.S. at 131-34 (attorney lacked standing to assert the rights of indigent defendants denied appellate counsel); Conn v. Gabbett, 526 U.S. 286, 292-93 (1999) (rejecting an attorney's attempt to adjudicate the rights of a client); Juvenile Matters Trial Lawyers Ass'n v. Judicial Department, 363 F. Supp. 2d 239, 249 (D. Conn. 2005) (plaintiffs lacked standing to assert that low rates paid to attorneys representing indigent children violated their right to effective representation).

In this case, the Debtor has not alleged that she suffered any injury. She also has not alleged that she has a close relationship with either the attorneys who are reluctant to accept *pro bono* cases or their potential clients. Nor has she alleged that there is any barrier preventing them from protecting their own rights.

Accordingly, because the Debtor cannot show any injury to herself, the decision should be vacated because the Bankruptcy Court lacked jurisdiction to consider the motion.

II. THE BANKRUPTCY COURT'S FINDING THAT 11 U.S.C. §§ 526, 527 AND 528 ARE UNCONSTITUTIONAL AS APPLIED TO ATTORNEYS SHOULD BE VACATED.

Even if the Bankruptcy Court had jurisdiction to reach the two statutory issues raised by the Debtor, the Bankruptcy Court's finding that the debt relief provisions are unconstitutional as applied to attorneys should be vacated on at least three jurisdictional and/or procedural grounds:

(1) The Bankruptcy Court lacked jurisdiction to consider the constitutionality of Sections 526, 527 and 528 because it found (and the parties agreed) that the provisions did not apply to Debtor's counsel; (2) even if the Bankruptcy Court had jurisdiction to consider the constitutionality of the provisions, it violated the doctrine of constitutional avoidance because, as the court itself acknowledged, it was possible to resolve the narrow issues raised by the Debtor without reaching the constitutional issue, and (3) even if the court could raise and resolve the constitutional issue, the court improperly failed to provide the United States Trustee adequate notice and a meaningful opportunity to address the constitutionality of the provisions. The United States Trustee also contends that the court's finding that the provisions are unconstitutional as applied to attorneys is incorrect on the merits.[3] However, because the case can be resolved on narrower, non-constitutional issues, there is no need for this Court to consider that constitutionality of the provisions.

A. The Bankruptcy Court Lacked Jurisdiction to Consider the Constitutionality of the Debt Relief Provisions Because They Do Not Apply to Debtor's Counsel.

As explained supra at 10-11, a court only has jurisdiction to consider to claims which present an "actual case or controversy." This limitation prohibits a court from considering an issue that a party has no standing to raise. Allen v. Wright, 468 U.S. at 750. In this case, the

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[3] The Bankruptcy Court based its finding that Sections 526, 527 and 528 were unconstitutional as applied to attorneys on Milavetz, Gallop & Milavetz v. United States, 355 B.R. 758 (D. Minn. 2006). The court's reliance on Milavetz is, however, misplaced because the district court in Milavetz in fact only found Sections 526(a)(4) and 528(a)(4) and (b) unconstitutional. It did not address the constitutionality of Section 527 or any of the other subsections of Sections 526 and 528. Moreover, two other district courts have specifically held Sections 527 and 528(a)(4) and (b) to be constitutional. Hersh v. United States, 347 B.R. 19, 25-27 (N.D. Tex. 2006), appeals pending, Nos. 07-10226 and 07-10265 (5th Cir.); Olsen v. Gonzales, 350 B.R. 906, 917-921 (D. Ore. 2006).

Debtor had not challenged the constitutionality of the debt relief provisions. Indeed, she had no standing to raise the issue. The Bankruptcy Court concluded (and all parties agreed) that Debtor's counsel was not a debt relief agency since she did not accept any fee or other valuable consideration in return for her services. Accordingly, since the requirements placed on debt relief agencies under 11 U.S.C. §§ 526-528 do not apply to Debtor's counsel, the constitutionality of the provisions was a purely abstract issue in the context of this case. As the Supreme Court has held a court "has no jurisdiction to pronounce any statute, either of a state or of the United States, void, because irreconcilable with the constitution, except as it is called to adjudge legal rights of litigants to actual controversies." Liverpool, New York & Philadelphia Steam Ship Co. v. Emigration Commissioners, 113 U.S. 33, 38 (1885). The Bankruptcy Court's finding regarding the constitutionality of the debt relief provisions should, therefore, be vacated because the Bankruptcy Court lacked jurisdiction to consider the constitutionality of the debt relief agency provisions.

B. The Bankruptcy Court Failed To Comply With The Doctrine of Constitutional Avoidance.

Even if the Bankruptcy Court had jurisdiction to consider the constitutional issue, it violated the doctrine of constitutional avoidance by reaching that issue. It is well-established that a court will not "anticipate a question of constitutional law in advance of the necessity of deciding it." Liverpool , N.Y. & Philadelphia Steamship Co. v. Emigration Commissioners, 113 U.S. at 355. Indeed, even where a constitutional question is properly presented by the parties, a court should not "pass upon a constitutional question . . . if there is also present some other ground upon which the case may be disposed of." Ashwander v. Tennessee Valley Authority, 297 U.S. 288, 347 (1936) (Brandeis, J., concurring). In short, "if the case can be decided on either of two grounds, one involving a constitutional question, the other a question of statutory construction or general law, the Court will decide only the later." Id. (emphasis added). Accord United States v. $38,000/00 in U.S. Currency, 816 F.2d 1538, 1547 n.21 (11th Cir. 1987) (court decided issues on statutory grounds "in order to avoid unnecessarily deciding the constitutional issues"); State of Texas v. Daniel Grundstrom, 404 F.2d 644, 648 (5th Cir. 1968) ("courts do not anticipate questions of serious constitutional import but wait until a case is presented which requires a decision of the constitutional issue.")

Applying these principles, the Supreme Court has vacated decisions reaching constitutional issues when it may be possible to resolve the case on other grounds. See, e.g., Escamba County, Florida v. McMillian, 466 U.S. 48, 51 (1984); Alma Motor Co. v. Timken-Detroit Axel Co., 329 U.S. 129, 136-141 (1946).

This Court should vacate the findings made by the Bankruptcy Court on the constitutionality of the debt relief agency provisions for the same reason. In this case, while the Bankruptcy Court recognized the doctrine of constitutional avoidance, it did not follow the doctrine. The Debtor has not raised the issue of the constitutionality of the debt relief provisions as applied to attorneys in her motion. Instead, the Bankruptcy Court raised the issue *sua sponte*. R. 30, at 4. Then, instead of deferring the constitutional issue to determine whether it was possible to resolve the motion on the limited issues raised by the Debtor, the Court proceeded to address and decide the constitutional issue first. Id. Only after addressing the constitutional issue and the broader statutory issue that it raised *sua sponte* did the Bankruptcy Court consider the narrow statutory issues raised by the Debtor. Id. When the court considered the narrow statutory issues, it concluded that Debtor's counsel was not a debt relief agency under the plain language of the 11 U.S.C. § 101(12A) because she had not received a fee or other valuable consideration for her service. Id. Despite the fact that the court found that it could resolve the case without reaching the constitutional issue, the Bankruptcy Court issued an order which specifically found that the application of the debt relief agency provisions to Debtor's counsel was unconstitutional.

In short, instead of avoiding a constitutional issue, the Bankruptcy Court took every step possible to reach the constitutional issue. The court (1) inserted the constitutional issue into the case, (2) proceeded to decided the constitutional issue without first determining whether the motion could be resolved on other grounds, and (3) issued an order finding the provision unconstitutional even though it had specifically found that the motion could be resolved on narrow statutory grounds. Accordingly, the findings made by the Bankruptcy Court on the constitutionality of the debt relief provisions should be vacated.

C. The Bankruptcy Court Should Have Provided The United States Trustee Adequate Notice And A Meaningful Opportunity To Address The Constitutionality Of The Provisions.

Even if it were appropriate for the Bankruptcy Court to raise and consider the constitutional issue, the Bankruptcy Court erred by failing to provide the United States Trustee adequate notice and an opportunity to address the issue. As the Supreme Court has stressed, '[n]otice of issues to be resolved by the adversary process is a fundamental characteristic of fair procedure." Lankford v. Idaho, 500 U.S. 110, 126 (1991) (state court violated a defendant's due process rights by failing to provide notice that it was considering the death penalty after the state had indicated that it was not seeking the death penalty). Because of the fundamental importance of notice and opportunity to be heard, courts have repeatedly held that making a ruling without providing the adversely affected party with adequate notice and an opportunity to heard is "itself grounds for reversal." Snider v. Melindez, 199 F.3d 108, 113 (2d Cir. 1999)(quoting Square D Co. v. Niagara Frontier Tariff Bureau, Inc., 760 F.2d 1347, 1365). As the court in Snider explained in reversing a *sua sponte* dismissal of a complaint:

> providing the adversely affected party with notice and an opportunity to be heard plays an important role in establishing the fairness and reliability of the order. It avoids the risk that a court may overlook valid answers to its perception of defects the plaintiff's case. Furthermore, denying a plaintiff an opportunity to be heard "may tend to produce the very effect [the court] seek[s] to avoid – a waste of judicial resources – by leading to appeals and remands."

199 F.3d at 113 (quoting Perez v. Ortiz, 849 F.2d 793, 797 (2d Cir. 1988). Accord Jefferson Fourteenth Assoc. v. Wometco De Puerto Rico, 695 F.2d 524 (11th Cir. 1983)(reversing a district court's *sua sponte* dismissal of third party claim because the court failed to provide adequate notice and opportunity to respond). Cf. Massey v. Congress Life Ins. Co., 116 F.3d 1414 (11th Cir. 1997) (a court must provide sufficient notice before granting summary judgment *sua sponte*).

In this case, the Bankruptcy Court failed to provide the United States Trustee adequate notice and an opportunity to address the constitutionality of the debt relief provisions. The Bankruptcy Court raised the constitutional issue *sua sponte* at the hearing without any prior notice. Although the trial attorney explained that he was not prepared to address the constitutional issue and requested a continuance if the Bankruptcy Court was going to consider the issue, the Bankruptcy Court denied the request. Moreover, while the court stated that the trial attorney could file make a supplemental filing if he did so "expeditiously" before the court ruled, it later made comments which suggested that a supplemental brief would not be necessary. The Bankruptcy Court stated that while he might "include some dicta on the other two points," he would issue an order on the two issues raised by the Debtor since "that's the scope of the motion."

R. 35, at 10. The very next day, however, the Bankruptcy Court entered an order which specifically held that Sections 526, 527 and 528 were unconstitutional. In short, the United States Trustee had no meaningful opportunity to defend the constitutionality of the provisions before the Bankruptcy Court issued its ruling.

Accordingly, the Bankruptcy Court's findings regarding the constitutionality of the debt relief provisions should be vacated.

III. THE BANKRUPTCY COURT'S FINDING THAT AN ATTORNEY WHO PROVIDES BANKRUPTCY ASSISTANCE TO ASSISTED PERSONS FOR A FEE IS NOT A DEBT RELIEF AGENCY SHOULD BE VACATED.

The Bankruptcy Court's finding that an attorney who provides bankruptcy assistance to assisted persons for a fee is not a debt relief agency should also be vacated. Like the constitutional issue, it was not necessary for the Court to raise and resolve this broader statutory question. As the Bankruptcy Court itself acknowledged, the Debtor had not raised the issue and the Debtor's motion could be resolved without reaching broader statutory issue. Moreover, the Debtor had no standing to raise that issue in this case because the court found (and all parties agreed) that Debtor's counsel did not receive a fee or other valuable consideration in return for providing bankruptcy assistance to the Debtor. Therefore, the court's finding on this issue should be vacated because it is an advisory opinion regarding an issue that the Debtor had not raised and had no standing to raise.

However, even if the Bankruptcy Court had jurisdiction and authority to raise and resolve this new issue, the court's conclusions on this issue are erroneous. The plain language of this provision supports the proposition that attorneys fall within the purview of the “debt relief agency” provisions. The BAPCPA defines the term "debt relief agency," with certain exceptions not applicable here, as "any person" that, for a fee, "provides any bankruptcy assistance to an assisted person." 11 U.S.C. § 101(12A). "Bankruptcy assistance" includes "providing information, advice, counsel . . . [and] legal representation." 11 U.S.C. § 101(4A). Thus, while the definition of "debt relief agency" does not specifically mention attorneys, its plain language, when coupled with the definition of the term "bankruptcy assistance," clearly covers attorneys who provide "advice," "counsel," or "legal representation" to consumer debtors with respect to a bankruptcy proceeding. Hersh v. United States, 347 B.R. 19, 22 (N.D. Tex. 2006), appeals pending, Nos. 07-10226 and 07-10265 (5th Cir.) ("[a] reading of the text for plain meaning indicates that the term 'debt relief agency' includes bankruptcy attorneys such as Hersh"); Olsen v. Gonzales, 350 B.R. 906, 912 (D. Or. 2006) ("the plain language of the Act . . leads to the conclusion that attorneys are to be included in the definition of 'debt relief agency'").[3] As the court in Hersh explained, "as only attorneys are authorized to provide legal advice and '. . . providing legal advice' is part of the definition of bankruptcy assistance, it seems clear that bankruptcy attorneys such as Hersh fit within the definition of 'persons providing bankruptcy assistance.'" Hersh, 347 B.R. at 22-23.

Aside from the statutory language used to define "debt relief agency" and "bankruptcy assistance," other provisions of the BAPCPA also demonstrate that Congress intended to include

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[3] Contra Milavetz, Gallop & Milavetz v. United States, 355 B.R. 758, 767-68 (D. Minn. 2006); In re Attorneys at Law and Debt Relief Agencies, 332 B.R. 66, 69 (Bankr. S.D. Ga. 2005). The decision in Milavetz was issued in the context of denying defendant's motion to dismiss. Based on that decision, plaintiffs filed a motion for summary judgment, and the United States opposed on the grounds that plaintiffs were not entitled to judgment as a matter of law. The district court granted plaintiffs' motion for summary judgment and issued a final judgment on April 19, 2007. The decision by Bankruptcy Court for the Southern District of Georgia in In re Attorneys as Law and Debt Relief Agency was made *sua sponte,* without benefit of briefing by any party.

attorneys within the definition of "debt relief agency." For example, § 527(b) specifically requires the written notice to also contain the following statements:

> IMPORTANT INFORMATION ABOUT BANKRUPTCY ASSISTANCE SERVICES FROM AN ATTORNEY OR BANKRUPTCY PETITION PREPARER. . . . THE LAW REQUIRES AN ATTORNEY OR BANKRUPTCY PETITION PREPARER TO GIVE YOU A WRITTEN CONTRACT SPECIFYING WHAT THE ATTORNEY OR BANKRUPTCY PETITION PREPARER WILL DO FOR YOU AND HOW MUCH IT WILL COST.

11 U.S.C. § 527(b) (emphasis in the form of underlining added). The reference to an attorney in connection with one of the specific obligations imposed on a debt relief agency (i.e., the provision of a written contract) shows that an attorney falls within the definition of a debt relief agency. Indeed, the reference to the law requiring an attorney to provide a written contract to the debtor would make little sense unless an attorney were a debt relief agency.[4]

Thus, the term "debt relief agency" clearly encompasses an attorney who provides bankruptcy assistance to an assisted person. Where, as here, the plain language of an Act is broad enough to encompass attorneys, the courts have refused to imply an exception. For example, in Heintz v. Jenkins, 514 U.S. 291, 297 (1995), the Supreme Court held that lawyers who regularly engaged in litigation to collect consumer debts fell within the definition of "debt-collector" under the Fair Debt Collection Practices Act even though the definition did not mention "lawyers" or

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[4] Even if the plain language of the statute left any room for doubt, the legislative history of the provision likewise demonstrates that Congress intended the term "debt relief agency" to encompass attorneys. Hersh, 347 B.R. at 23. In the House Report, Congress specifically found that there was "misconduct by attorneys and other professionals" in the bankruptcy system. H.R. Rep. No. 109-31, 109th Cong., 1st Sess. at 4, reprinted in 2005 U.S.C.C.A.N. at 92. Congress also described that debt relief provisions as "provisions strengthening professionalism standards for attorneys and others who assist consumer debtors with their bankruptcy cases." Id. at 103.

the "practice of law." Similarly, in Goldfarb v. Virginia State Bar, 421 U.S. 773, 786 (1975), the Supreme Court refused to imply an exemption for attorneys in the Sherman Act, which prohibits those engaged in a "trade or commerce" from price fixing. As the Supreme Court emphasized, "our cases have repeatedly established that there is a heavy presumption against implicit exemptions." Id. at 787. That presumption applies with particular force here because BAPCPA expressly excepted from the definition of "debt relief agencies" certain other types of persons or organizations (i.e., nonprofit organizations). See 11 U.S.C. § 101(12A). As the Hersh court stressed, since the provision contains certain exemptions, "if Congress had wanted attorneys excluded from the term 'debt relief agency' (and as a result, the requirements of BAPCPA at issue here) it surely would have taken this opportunity to exclude them from what otherwise they are so plainly within." Hersh, 347 B.R. at 23. Accord Detweiler v. Pena, 38 F.3d 591, 594 (D.C. Cir. 1994) ("Where a statute contains explicit exceptions, the courts are reluctant to find other implicit exceptions.").

The Bankruptcy Court also tried to find some support for its interpretation in 11 U.S.C. § 526(d)(2). R. 30, at 6. But that provision demonstrates the opposite, namely that the debt relief agency provisions do cover attorneys. Section 526(d)(2) states that no language in Sections 526, 527, or 528 shall . . .

> (2) be deemed to limit or curtail the authority or ability –
>
> (A) of a State or subdivision or instrumentality thereof to determine and enforce qualifications for the practice of law under the laws of the State; or
>
> (B) of a Federal Court to determine and enforce the qualifications for the practice of law before that court.

11 U.S.C. § 526(d)(2). If the debt relief provisions did not apply to attorneys, this provision

would be rendered meaningless. As the Supreme Court has recognized, courts are reluctant to treat statutory provisions as "surplusage." TRW Inc. v. Andrews, 534 U.S. 19, 31 (2001); Duncan v. Walker, 533 U.S. 167, 174 (2001); United States v. Mandhai, 375 F.3d 1243, 1248 (11th Cir. 2004); United States v. Canals-Jimenz, 943 F.2d 1284, 1287 (11th Cir. 1991).

Moreover, the Bankruptcy Court's reliance on Section 526(d)(2) ignores the difference recognized by the BAPCPA between restrictions on conduct and qualifications to practice law. Compare 11 U.S.C. §§ 526(d)(1) and (d)(2). The debt relief provisions at issue here do not relate to bar admission or other "qualifications for the practice of law" imposed by State or Federal courts. Instead, they are standards of conduct setting forth the notices and other requirements that attorneys must follow in representing clients in bankruptcy proceedings. Thus, while Section 526(d)(2) specifically provides that nothing in the debt relief agency provisions limits or curtails the power of the State or Federal court to determine the "qualifications" for practicing law, the BAPCPA treats state law governing conduct differently. State laws governing conduct are preempted "to the extent that such law is inconsistent with [Sections 526, 527 and 528], and then only to the extent of the inconsistency." 11 U.S.C. § 526(d)(1).

Accordingly, the Bankruptcy Court's finding that an attorney who provides advice and legal representation to an assisted person with regard to filing for bankruptcy for a fee is not a debt relief agency should be vacated because it was not necessary for the Bankruptcy Court to reach that issue or, alternatively, should be reversed because the finding is erroneous.

CONCLUSION

The Court should reverse the order of the Bankruptcy Court because it did not have jurisdiction to consider the Debtor's motion. In the alternative, even if the Bankruptcy Court had jurisdiction to consider Debtor's motion, the findings made by the Bankruptcy Court regarding the constitutionality of Sections 526, 527 and 528 and the broader statutory issue of whether attorneys who provide bankruptcy assistance for a fee fit within the definition of a debt relief agency should be vacated for the reasons stated herein.

Respectfully submitted,

FELICIA S. TURNER
United States Trustee, Region 21

ARIEL RODRIGUEZ, Trial Attorney
Florida Bar No. 160253
U.S. Trustee's Office
51 S.W. 1st Ave. #1204
Miami, Florida 33130
Phone (305) 536-7285
Fax (305) 536-7360
ariel.rodriguez@usdoj.gov

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the foregoing Motion has been served on the following parties on May 2, 2007, electronically through CM/ECF, on parties having appeared electronically in the instant matter and that a copy hereof shall be served by U.S. Mail, postage prepaid, on parties not appearing electronically:

Heather Yonke, Esq..**

/s/______________________________
Ariel Rodriguez, Trial Attorney

BRIEF BANK — 'SUMMARY SHEET"

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WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*: In re: Reyes (UST v. Reyes)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*: S.D. Fla.

3. ("CCN") ***CURRENT*** CASE NO.: No.: 07-20689

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*:
No.: 06-15951
Court: Bankr. S.D. Fla.
(Identify judge & cite, if any)

5. ("SO") ***SOURCE***: **U.S. TRUSTEES**

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*:
Filed: July 2007
Type: Apply Brief of Appellant, United States Trustee

7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*: Felicia Turner, Ariel Rodriguez
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***: **BANKRUPTCY**

9. ("SU") ● ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***:

●Did the Bankruptcy Court have jurisdiction to consider the debtor's motion when it did not present a case or controversy?
Did the court err in its sua sponte ruling regarding the constitutionality of the statutes debt relief provisions and their application to attorneys who provide bankruptcy assistance for a fee?

√ **Background:**

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UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF FLORIDA
Case No. 07-20689-CIV-GOLD

IN RE:

GLORIA REYES,

Debtor.
__________________________________/

UNITED STATES TRUSTEE,

Appellant,

v.

GLORIA REYES,

Appellee.
__________________________________/

APPEAL FROM THE UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF FLORIDA

CASE NO. 06-15957-BKC-AJC

REPLY BRIEF OF APPELLANT, UNTIED STATES TRUSTEE

FELICIA S. TURNER
United States Trustee, Region 21

ARIEL RODRIGUEZ, Trial Attorney
Florida Bar No. 160253
U.S. Trustee’s Office
51 S.W. 1st Ave. #1204
Miami, Florida 33130
Phone (305) 536-7285
Fax (305) 536-7360
ariel.rodriguez@usdoj.gov

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INTRODUCTION

In this action, the Debtor sought a declaration upon a matter in which there was no dispute, namely that the definition of a "debt relief agency," 11 U.S.C. § 101(12A), does not include the Debtor's attorney, who did not receive a fee or other valuable consideration for her services. Although the court had no jurisdiction to consider the motion because it did not present a "case" or "controversy," the Bankruptcy Court compounded its error by raising *sua sponte* issues regarding the constitutionality of the statute's debt relief provisions and their application to attorneys who provide bankruptcy assistance for a fee, and then by addressing those broader issues first. Although the Bankruptcy Court later found that it had been unnecessary to reach those broader issues to resolve the narrower statutory issue raised by the Debtor, the Bankruptcy Court nevertheless included its findings on the broader issues in its order. None of the arguments presented by the Debtor supports the actions taken by the Bankruptcy Court.

I. THE BANKRUPTCY COURT DID NOT HAVE JURISDICTION TO CONSIDER DEBTOR'S MOTION BECAUSE THERE WAS NO CASE OR CONTROVERSY.

As explained in our initial brief, the Bankruptcy Court did not have jurisdiction to consider Debtor's motion seeking a declaration that attorneys who provide bankruptcy assistance on a *pro bono* basis are not debt relief agencies for two reasons. Initial Brief of Appellant, United States Trustee ("UST Br.") at 10-14. First, there was no actual "case" or "controversy" because there was no disagreement between the Debtor and the United States Trustee ("UST") with respect to the narrow statutory question presented by the motion. Second, even if there were a disagreement, the Debtor lacked standing to raise the issue because she has not alleged any injury to herself. Instead, the Debtor sought such an order because she alleges that other attorneys may be reluctant to provide *pro bono* services to other debtors. R. 30, at 8. The Debtor has no standing to raise the rights of other attorneys or other debtors. None of the arguments presented by the Debtor provide a basis for finding that the Bankruptcy Court had jurisdiction.

A. The Debtor's Motion Did Not Present A Justiciable Case or Controversy.

In her brief, the Debtor makes no attempt to show that there is any actual controversy between the Debtor and UST on the narrow issue raised by her motion. Instead, she seeks to avoid this fundamental jurisdictional defect by recasting the issue as a question of ripeness. Appellee's Answer Brief ("Debtor Br.") at 7-12. She then argues her motion is ripe for judicial review because she contends that the scope of the statute is unclear and, as a result, her attorney faces the threat of being prosecuted for violating debt relief provisions. Id. at 8.

This attempt to create a justiciable controversy is unpersuasive. As the Supreme Court has emphasized, in order for an action to be ripe, the threat of prosecution must be "credible," not merely "imaginary." Babbitt v. United Farm Workers Nat'l Union, 442 U.S. 289, 298 (1979). In this case, the purported threat of prosecution is not credible. Indeed, none has ever been alleged. As the Bankruptcy Court itself found, nothing in the definition of "debt relief agency" even remotely suggests that a *pro bono* attorney is a "debt relief agency." R. 30, at 7. Section 101(12A) "states clearly that the term 'debt relief agency' means 'any person who provides any bankruptcy assistance to an assisted person *in return for the payment of money or other valuable consideration*.'" Id. (emphasis added). As the Bankruptcy Court emphasized:

> [t]he use of the words "in return for" clearly imply an exchange. Under the circumstances described herein, there is no exchange between the Debtor and the attorney. The Debtor is receiving the pro bono services and is giving nothing in return for the same.

Id. (emphasis added). Moreover, the UST has explicitly stated that she agrees that *pro bono* attorneys are not debt relief agencies. R. 29, at 2-1.[1] Thus, any fear that the Debtor's attorney may have of being prosecuted for violation of the debt relief agency provisions in connection with her representation of the Debtor is purely imaginary.[2]

The Debtor also seeks to create a "controversy" by alleging for the first time that the debt relief provisions violate her First Amendment right to receive legal advice while her bankruptcy case is pending and being administrated. Debtor Br. at 9-11. This claim is misguided. First, her motion did not make any reference to any infringement of her First Amendment rights. Her motion was based solely on her statutory claim that *pro bono* attorneys did not fit within the definition of a debt relief agency, 11 U.S.C. § 101(12A). The issue of the constitutionality of debt relief provisions was raised *sua sponte* by the Bankruptcy Court at the hearing. R. 35, at 4. Indeed, even after the Court raised the issue, the Debtor's counsel never provided argument on that issue, but confined her remarks to the narrow statutory issue of whether *pro bono* attorneys were included in the definition of debt relief agency. Id. at 7-10. Second, her new First Amendment claim, like her "ripeness argument," is predicated on the erroneous assumption that the definition of debt relief agency could be read to include her *pro bono* attorney. But as explained above, *pro bono* attorneys do not fall within the plain language of the statute. She thus has no standing to challenge the constitutionality

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[1] See http://www.usdoj.gov/ust/eo/trustees_faqs.htm#dra_issue.

[2] The facts here are readily distinguishable from the facts in the cases cited by the Debtor. In those cases, the threats of prosecution were credible. See, e.g., Secretary of State of Md. v. Joseph H. Munson, Inc., 467 U.S. 947, 951 (1984) (plaintiff alleged that the State "had informed it that it was subject" to the challenged statute and "would be prosecuted if it failed to comply with the provisions"); Dombrowski v. Pfister, 380 U.S. 479, 487 (1965) (plaintiff had been arrested for violation); New Mexicans for Richardson v. Gonzales, 64 F.3d 1495, 1502-1505 (10th Cir. 1995) (finding that the threat of prosecution was credible because the State had "not affirmatively disavowed any intention of bringing criminal prosecution against Congressman Richardson").

of the debt relief agency provisions. See UST Br. at 5-6; infra at 4-6.

Debtor also cannot rely on 11 U.S.C. § 105 to avoid this jurisdictional defect. Section 105 addresses the court's authority to grant relief; it does not serve as a basis for the Court's jurisdiction. Matter of Zale Corp., 62 F.3d 746, 751 (5th Cir. 1995); United States Dep't of Air Force v. Carolina Parachute Corp., 907 F.2d 1469, 1475 (4th Cir. 1990); American Hardwoods, Inc. v. Deutchse Credit Corp., 885 F.2d 621, 624 (9th Cir. 1989); In re Nunez, Nos. 98-CV-7077 and 98-CV-7078, 2000 WL 655983, at *8 (E.D.N.Y. March 17, 2000).

In short, no matter how the Debtor tries to frame the issue, she cannot escape the fact that her motion sought an advisory opinion on a statutory issue on which there was no dispute.

B. The Debtor Lacked Standing to Raise the Issues Presented by Her Motion.

Even if there were an actual disagreement between the Debtor and the United States Trustee with regard to the issue of whether an attorney providing *pro bono* services fits within the definition of "debt relief agency," 11 U.S.C. § 101(12A), the Debtor had no standing to raise the issue. The "injury in fact" prerequisite for standing "requires that the party seeking review be himself among the injured." Lujan v. Defenders of Wildlife, 504 U.S. 555, 563 (1992). Therefore, in order to have standing to raise the issues presented by her motion, the Debtor had to establish that she personally suffered an injury as a result of the purported confusion over whether a *pro bono* attorney fits within the definition of debt relief agency. In this case, the Debtor failed to alleged any personal injury in her motion or at the hearing.

The Debtor now tries to meet this prerequisite for standing by alleging in her brief that she suffers an actual injury as a result of the debt relief provisions. Debtor's Br. at 13. This belated attempt to show injury is misguided because the debt relief provisions are directed at attorneys, not debtors. For that reason, as noted in our initial brief, courts have consistently found that debtors have no standing to challenge the application of the debt relief agency provisions. See In re Ella Srymanske, Case No. 05-60519 (Bankr. D. N.J. April 7, 2006); In re Michelle Moore, No. 05-24651 (Bankr. W.D. Wash. Feb. 23, 2006); In re McCartney, 336 B.R 588 (Bkrtcy. M.D. Ga. 2006); In re Harvey Beaver, No. 05-04080 (Bankr. W.D.N.C. Nov. 15, 2005).[3]

The Debtor nevertheless attempts to demonstrate an injury by suggesting that the legal advice that she receives "is currently distorted by confusing 'debt relief agency' BAPCPA provisions." Debtor Br. at 13. See also id. at 8 ("as Appellee's bankruptcy is pending and being administrated, she is denied her constitutional right to have informed *pro bono* legal advice"). Nowhere in her brief, however, does she identify which specific debt relief provisions allegedly limit the advice which she would otherwise receive during the pendency of her bankruptcy proceeding or what type of advice she otherwise would receive. Indeed, she cannot. The only two restrictions on advice are 11 U.S.C. §§ 526(a)(2) and (4). Section 526(a)(2) prohibits a debt relief agency from advising a debtor "to make a statement in a document filed in a case or proceeding under this title, that is untrue and misleading." Surely, the Debtor is not suggesting that her attorney would otherwise advise her to make a statement which is untrue or misleading. Section 526(a)(4) only prohibits advising a debtor to "incur more debt in contemplation of such person filing" a petition for bankruptcy. That provision does not limit any current advice from her attorney because it relates only to advice prior to filing for bankruptcy.

Accordingly, because the Debtor cannot show any injury to herself, the decision should be

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[3] The above unpublished decisions were cited by the UST in the UST Br. and attached thereto as appendixes.

vacated because the Bankruptcy Court lacked jurisdiction to consider the motion.[4]

II. THE BANKRUPTCY COURT'S FINDING THAT 11 U.S.C. §§ 526, 527 AND 528 ARE UNCONSTITUTIONAL AS APPLIED TO ATTORNEYS SHOULD BE VACATED.

Even if the Bankruptcy Court had jurisdiction to reach the narrow statutory issue raised by the Debtor's motion, the Bankruptcy Court's finding that the debt relief provisions are unconstitutional as applied to attorneys should be vacated on at least three jurisdictional and/or procedural grounds: (1) The Bankruptcy Court lacked jurisdiction to consider the constitutionality of Sections 526, 527 and 528 because it found (and the parties agreed) that the provisions did not apply to Debtor's counsel; (2) it violated the doctrine of constitutional avoidance because, as the court itself acknowledged, it was possible to resolve the narrow issues raised by the Debtor without reaching the constitutional issue, and (3) the court improperly failed to provide the UST adequate notice and a meaningful opportunity to address the constitutionality of the provisions. See UST Br. at 14-20. None of the arguments made by the Debtor demonstrate otherwise.

First, as explained supra, the Bankruptcy Court and all parties agreed that the Debtor's

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[4] In her brief, the Debtor tries to turn the fact that her motion did not establish a case or controversy into an advantage by suggesting that if there was no "case" or "controversy" presented by her initial motion, the UST has no standing to prosecute this appeal. Debtor Br. at 12 n. 3. In re Attorney at Law and Debt Relief Agencies, 353 B.R. 318, 312 (S.D. Ga. 2006), which she cites as support for this position, has no application here. In that case, the challenged order was not issued in connection with an actual bankruptcy case or proceeding. Therefore, although 11 U.S.C. § 307 provides that the UST "may raise and may appear and be heard on any issue in any case or proceeding under this title," the district court found that this provision did not apply in that case because there was no underlying bankruptcy case or proceeding. In this case, the challenged order was issued in the Debtor's bankruptcy case.

Moreover, unlike here, the order by the Bankruptcy Court in Georgia did not declare any provisions of the BAPCPA unconstitutional. It is clear that the United States has standing to challenge a decision declaring a federal statute unconstitutional. See 28 U.S.C. § 2403(a). A UST is a senior Department of Justice official. 28 U.S.C. § 581(a)(21).

attorney was not a debt relief agency since she did not accept any fee or other valuable consideration in return for her services. Accordingly, in this case, the constitutionality of these provisions was a purely abstract issue, which the Bankruptcy Court had no jurisdiction to consider.

Second, even were a constitutional question properly presented by the Debtor, the Bankruptcy Court's decision should be vacated because it violated the doctrine of constitutional avoidance regarding the order in which legal issues should be addressed. The doctrine is often referred to as the "last resort rule." It provides that court should not "pass upon a constitutional question . . . if there is also present some other ground upon which the case may be disposed of." Ashwander v. Tennessee Valley Authority, 297 U.S. 288, 347 (1936) (Brandeis, J., concurring). In short, "if a case can be decided on either of two grounds, one involving a constitutional question, the other a question of statutory construction or general law, the Court will decide only the latter." Id. (emphasis added). Accord Brooks v. Central Bank of Birmingham, 717 F.2d 1340, 1342-43 (11th Cir. 1983).

In this case, the Bankruptcy Court did just the opposite. See UST Br. at 17-18. Instead of addressing the narrow statutory issue raised by the Debtor's motion first, the Bankruptcy Court addressed the constitutional issue first. R. 30, at 4. When the Court finally considered the narrow statutory issues, it concluded that Debtor's counsel was not a debt relief agency under the plain language of the 11 U.S.C. § 101(12A) because she had not received a fee or other valuable consideration for her service. Id. at 7-8. Despite the fact that the Court found that it could resolve the case without reaching the constitutional issue, it issued an order which specifically found that the application of the debt relief agency provisions to Debtor's counsel was unconstitutional. Id. at 8-9. In short, it made a finding on a constitutional issue it should never have reached had it followed the "last resort rule."

In her brief, the Debtor seeks to obscure this point by confusing the "last resort rule" with a related but different rule – a rule for "choosing between two plausible interpretations of a statutory text." Debtor Br. at 15 (quoting Clark v. Martinez, 543 U.S. 371, 381 (2005).[5] Unlike the "last resort rule," this rule does not deal with the order in which constitutional and statutory issues are resolved. Instead, it is a rule of statutory construction, which provides that "where an otherwise acceptable construction of a statute would raise serious constitutional problems, the Court will construe the statute to avoid such problems unless such construction is plainly contrary to the intent of Congress." Edward J. DeBartolo Corp. v. Fla. Gulf Coast Bldg. & Constr. Trades Council, 485 U.S. 568, 575 (1988). As the Debtor acknowledges, this statutory construction "comes into play only when, after the application of ordinary textual analysis, the statute is found to be susceptible of more than one construction." Debtor Br. at 18 (quoting Clark v. Martinez, 543 U.S. at 385).

Contrary to the Debtor's suggestion, this rule of statutory construction has no application in this case. Unlike the Supreme Court cases cited by the Debtor, the statutory issue raised by the Debtor did not require the Bankruptcy Court to choose between two plausible interpretations of the statute. In this case, there was only one plausible interpretation of the statute: the Bankruptcy Court found (and all parties agreed) that *pro bono* attorneys did not fall within the plain language of the definition of a debt relief agency. R. 30, at 7-8. Indeed, the Court's decision demonstrates that it

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[5] As noted in Ashwander v. Tennessee Valley Authority, 297 U.S. 288, 346 (1936) (Brandeis, J., concurring), there are in fact "a series of rules under which [the Supreme Court] has avoided passing upon a large part of all the constitutional questions pressed upon it for decision." While each rule serves to avoid constitutional issues, each rule is distinct and should not be confused with the others. The "last resort rule" is the fourth rule listed by Justice Brandeis (id. at 347), and the statutory construction rule is the seventh rule listed. Id. at 348.

did not rely on this tool of statutory construction to resolve the statutory question presented by the Debtor's motion. In the portion of the decision in which the Court addressed the statutory question of whether *pro bono* attorneys fit within the statutory definition of a debt relief agency, the Court stated that is was "assuming . . . that 11 U.S.C. §§ 526-528 are both constitutional and applicable to attorneys." R. 30, at 6-7. Likewise in its concluding paragraph, the Court found that "even if 11 U.S.C. §§ 526, 527 and 528 pass constitutional muster," they "do not apply to attorneys providing *pro bono* representation to debtors and who receive no payment whatsoever, whether money or other valuable consideration, in return for their representation." Id. at 8. Accordingly, the Debtor's attempt to suggest that Bankruptcy Court complied with the doctrine of constitutional avoidance is based on a misunderstanding of both the doctrine and the Court's findings.

Finally, even if it were appropriate for the Bankruptcy Court to raise and consider the constitutional issue, the Bankruptcy Court erred by failing to provide the United States Trustee adequate notice and an opportunity to address the issue. UST Br. at 18-20. The Debtor's suggestion that the Bankruptcy Court provided the UST with an opportunity to file a supplemental brief ignores two critical points. First, while the Court stated that the trial attorney could file a supplemental brief if he did so "expeditiously" before the Court ruled (R. 35, at 6), it later made comments which suggested that a supplemental brief would not be necessary. When the trial attorney for the UST started to explain to the Court that he was not sure how long he would need to file a supplemental brief, the Court interrupted and said that it would later determine what further needs to be done after he heard the arguments. Id, at 7. After hearing argument on the narrow statutory issue, the Bankruptcy Court stated that while it might "include some dicta on the other two points," he would issue an order on the two issues raised by the Debtor since "that's the scope of the motion." Id. at

10. Second, the Bankruptcy Court did not provide the UST a realistic time to file a brief because it signed its order on the very next day. Thus, the Debtor's suggestion that UST had a meaningful opportunity to address the constitutional issue is not correct.

Accordingly, the Bankruptcy Court's findings regarding the constitutionality of the debt relief provisions should be vacated on each of these independent grounds.

III. THE BANKRUPTCY COURT'S FINDING THAT AN ATTORNEY WHO PROVIDES BANKRUPTCY ASSISTANCE TO ASSISTED PERSONS FOR A FEE IS NOT A DEBT RELIEF AGENCY SHOULD BE VACATED.

The Bankruptcy Court's finding that an attorney who provides bankruptcy assistance for a fee is not a debt relief agency should also be vacated. Like the constitutional issue, this was not an issue raised by the Debtor in her motion. Nor was it an issue that the Debtor had standing to raise because her counsel did not receive a fee or other valuable consideration in return for providing bankruptcy assistance to the Debtor. But even if the Court had jurisdiction of this broader statutory issues, its decision on this issue should be reversed because under the plain language of the statute, attorneys fall within the definition of the term "debt relief agency," as defined by 11 U.S.C. § 101(12A). Hersh v. United States, 347 B.R. 19, 22 (N.D. Tex. 2006), appeals pending, Nos. 07-10226 and 07-10265 (5th Cir.); Olsen v. Gonzales, 350 B.R. 906, 912 (D. Ore. 2006), appeal pending, No. ___ (9th Cir.) (filed July 24,2007). As the Court in Hersh explained, "as only attorneys are authorized to provide legal advice and 'providing legal advice' is part of the definition of bankruptcy assistance, it seems clear that bankruptcy attorneys . . . fit within the definition of 'persons providing bankruptcy assistance.'" 347 B.R. at 22-23. See also UST Br. at 20-25.

In her brief, the Debtor cites Milavetz, Gallop & Milavetz v. United States, 355 B.R. 758, 768 (D. Minn. 2006), appeal pending, No. 07-2405 (8th Cir.), as support for the Bankruptcy Court's contrary reading of the statute. Debtor's Br. at 20.[6] In that decision, the court acknowledged that BAPCPA's definition of a debt relief agency "might include attorneys" but suggested that 11 U.S.C. § 526(d)(2)(A) created an ambiguity on this point. 355 B.R. at 768. Citing to this purported ambiguity, the court then held that the definition should be read to exclude attorneys because including attorneys under BAPCPA's restrictions would unconstitutionally infringe "on the state's traditional role of regulating attorneys." Id. (citing Leis v. Flynt, 439 U.S. 438, 442 (1979)).

The analysis used by the Milavetz court is flawed. First, contrary to the Milavetz court's conclusion, 11 U.S.C. § 526(d)(2) actually demonstrates that the debt relief agency provisions do cover attorneys. See UST Br. at 23-25. If the debt relief provisions did not apply to attorneys, there would be no need for a provision stating that the debt relief provisions do not limit the authority or ability of the state "determine and enforce qualifications for the practice of law under the laws of that State." 11 U.S.C. § 526(d)(2)(A).[7] Nowhere in her brief does the Debtor address this point.

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[6] The Debtor also tries to find some support for the Bankruptcy Court's interpretation by noting that the words "attorney" or "lawyer" do not appear in the definition of debt relief agency. But where, as here, the plain language of a statute is broad enough to encompass attorneys, the fact that attorneys are not mentioned is irrelevant. See Heintz v. Jenkins, 514 U.S. 291, 296-97 (1995)(the Supreme Court held that lawyers who regularly engaged in litigation to collect consumer debts fell within the definition of "debt collector" under the Fair Debt Collection Practices Act even though the definition did not mention "lawyers" or the "practice of law").

[7] The Milavetz court's reliance on Section 526(d)(2) also ignores the difference recognized by the BAPCPA between restrictions on conduct and qualifications to practice law. Compare 11 U.S.C. §§ 526(d)(1) and (d)(2). The debt relief provisions do not relate to bar admission or other "qualifications for the practice of law" imposed by State or Federal courts. Instead, they are standards of conduct setting forth the notices and other requirements that attorneys must follow in representing clients in bankruptcy proceedings. Thus, while Section 526(d)(2) specifically provides that nothing in the debt relief agency provisions limits or curtails the power of the State or Federal court to determine the "qualifications" for practicing law, the BAPCPA treats state law governing conduct differently. State laws governing conduct are preempted "to the extent that such law is inconsistent with [Sections 526, 527 and 528], and then only to the extent of the inconsistency." 11 U.S.C. § 526(d)(1).

Second, there is no legal support for the Milavetz court's conclusion that application of the debt relief provision to attorneys would unconstitutionally infringe on the state's tradition role to regulate attorneys. While the Supreme Court in Leis v. Flynt acknowledged the traditional role of the states in regulating the practice of law in their boundaries in its dicta, nothing in that decision suggested that the Constitution precludes the federal government from regulating the conduct of attorneys when an attorney practices federal law in a federal forum. Indeed, that case did not involve a challenge to any federal statute or regulation. Instead, in Leis v. Flynt, plaintiff's claim was that a state could not preclude an attorney licensed in another state from representing a defendant in a state criminal proceeding.

The Supreme Court has specifically recognized that the federal government can regulate the conduct of attorneys. Heinz v. Jenkins, 514 U.S. 291, 298 (1995) (Supreme Court held that lawyers who regularly engage in litigation to collect consumer debts fell within the definition of debt collector under Fair Debt Collection Act even though the term "lawyer" or "practice of law" is not explicitly mentioned); Goldfarb v. Virginia State Bar, 421 U.S. 773, 792-93 (1975) (Supreme Court refuses to imply an exception for attorney in the Sherman Act); see also Sperry v. State of Fla. ex rel. Fla. Bar, 373 U.S. 379 (1963) (Florida may not "enjoin a nonlawyer registered to practice before the United States Patent Office from preparing and prosecuting patent applications in Florida"). Moreover, the Bankruptcy Clause authorizes Congress "to establish . . . uniform Laws on the subject of Bankruptcies throughout the United States." U.S. Const., art. I, § 8, cl. 4. The provisions at issue clearly come within that power. Thus, contrary to the finding of the Milavetz court, there is no reason to construe the provisions so as not to apply to attorneys.

The Bankruptcy Court's finding on the broader statutory issue should, therefore, also be vacated.

CONCLUSION

The Court should reverse the order of the Bankruptcy Court because it did not have jurisdiction to consider the Debtor's motion. In the alternative, even if the Bankruptcy Court had jurisdiction to consider Debtor's motion, the findings made by the Bankruptcy Court regarding the constitutionality of Sections 526, 527 and 528 and the broader statutory issue of whether attorneys who provide bankruptcy assistance for a fee fit within the definition of a debt relief agency should be vacated for the reasons stated herein.

Respectfully submitted,

FELICIA S. TURNER
United States Trustee, Region 21

ARIEL RODRIGUEZ, Trial Attorney
Florida Bar No. 160253
Office of the U.S. Trustee
Department of Justice
51 S.W. 1st Ave. #1204
Miami, Florida 33130
Phone (305) 536-7285
Fax (305) 536-7360
ariel.rodriguez@usdoj.gov

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the foregoing Motion has been served on the following parties on July 30, 2007, electronically through CM/ECF, on parties having appeared electronically in the instant matter and that a copy hereof shall be served by U.S. Mail, postage prepaid, on parties not appearing electronically:

Heather Yonke, Esq.**

/s/____________________________
Ariel Rodriguez, Trial Attorney

BRIEF BANK — 'SUMMARY SHEET" *Printed Tue-4/5/05 12:56*

WESTLAW CODES

1. **("TI")** *TITLE* OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]* Iherjirika v. Neary, UST, In re Reynoso

2. **("CO")** *CURRENT* COURT *[E.g., "CTA9"]* 9th Cir.

3. **("CCN")** *CURRENT* CASE NO. No.: 04-17190

4. **("PCN")** *PRIOR* CASE NO. & COURT *[IF ANY]*
No.:
Court: BAP 9th Cir.
(Identify judge & cite, if any)

5. **("SO")** *SOURCE* U.S. TRUSTEES

6. **("DA")** *DATE* OF FILING *& TYPE* OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*
Filed: February 9th, 2005
Type: Brief for the Appellee, UST

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I Glenn Cohn, Appellate Staff Attny
P. Matthew Sutko, EOUST
Minnie Loo, AUST *(UST/OGC: 202-307-1399/FAX-2397)*

8. **("TO")** *TOPIC* BANKRUPTCY

9. **("SU")** ● *SUMMARY* OF KEY ISSUE(s) & √ Any Miscellaneous *BACKGROUND*

● I. Whether Frankfort could re-litigate whether it was a bankruptcy petition preparer when it had been previously litigated in previous cases. II. Whether Frankfort was a bankruptcy petition preparer and engaged in the unauthorized practice of law. III. Whether Frankfort's conduct was fraudulent, unfair, or deceptive.

√ Background:

10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...) H:\seggert\My Files\BriefBank-Web\Reynoso\Reynoso1.wpd

11. DO YOU RECOMMEND POSTING IN UST BRIEFBANK?
| X | YES | | NO
NAME: Steven Eggert
DATE: Tue-4/5/05 12:48

No. 04-17190

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

In re: JAYSON REYNOSO,

Debtor.

HENRY IHERJIRIKA, FRANKFORT DIGITAL SERVICES, LTD.,

Appellants,

v.

WILLIAM T. NEARY, United States Trustee,

Appellee.

ON APPEAL FROM THE UNITED STATES BANKRUPTCY APPELLATE PANEL OF THE NINTH CIRCUIT

APPELLEE BRIEF FOR THE UNITED STATES TRUSTEE

Of Counsel:

P. MATTHEW SUTKO
Executive Office for
United States Trustee
U.S. Department of Justice
20 Massachusetts Ave., N.W.
Washington, D.C. 20530

MINNIE LOO
Assistant United States Trustee
Office of the U.S. Trustee
1301 Clay St, Ste 690 N.
Oakland, CA 94612-5217

PETER D. KEISLER
Assistant Attorney General

ROBERT M. LOEB
(202) 514-4332
I. GLENN COHEN
(202) 514-2498

Attorneys, Appellate Staff
Civil Division, Room 7226
Department of Justice
950 Pennsylvania Avenue, N.W.
Washington, D.C. 20530-0001

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IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

No. 04-17190

In re: JAYSON REYNOSO,
Debtor.

HENRY IHERJIRIKA, FRANKFORT DIGITAL SERVICES, LTD.,
Appellants,

v.

WILLIAM T. NEARY, United States Trustee,[1]
Appellee.

ON APPEAL FROM THE UNITED STATES BANKRUPTCY APPELLATE PANEL OF THE NINTH CIRCUIT

BRIEF FOR APPELLEE UNITED STATES TRUSTEE

STATEMENT OF JURISDICTION

This appeal arises from an adversary proceeding filed in the bankruptcy case of Jayson Reynoso against the preparer of his bankruptcy petition, Mr. Henry Ihejirika doing business as Frankfort Digital Services, Ltd. and Ziinet.com

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[1] William T. Neary recently resigned as the United States Trustee for the region. Sara L. Kistler is now Acting United States Trustee for the region. Therefore, Ms. Kistler should be substituted for Mr. Neary, pursuant to Fed. R. App. P. 43(c)(2).

(hereinafter collectively "Frankfort Digital"). The United States Trustee[2] filed a complaint seeking the assessment of fines, disgorgement of funds, injunctive relief, certification to the district court for damages, sanctions, fees, and costs, 11 U.S.C. §§ 110 (b),(c),(h),(i),(j), 329 , against Frankfort Digital. ER[3] 54-67. The bankruptcy court had jurisdiction over the adversary proceeding under 28 U.S.C. § 1334 and § 157(b)(1) and (b)(2)(A). The bankruptcy court entered judgment against Frankfort Digital on April 25, 2003. ER 12. Frankfort Digital filed a timely notice of appeal to the Bankruptcy Appellate Panel ("BAP") on April 25, 2003, which had jurisdiction under 28 U.S.C. § 158(b), (c). ER 1. On September 20, 2004, the BAP affirmed the judgment. In re Reynoso, 315 B.R. 544, 554 (B.A.P. 9th Cir. 2004).

On October 19, 2004, Frankfort Digital filed a timely notice of appeal. ER

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[2] United States Trustees are officials of the Department of Justice appointed by the Attorney General to supervise the administration of bankruptcy cases and trustees. See 28 U.S.C. §§ 581-589; In re Columbia Gas Sys., Inc., 33 F.3d 294, 296 (3d Cir. 1994) (explaining that United States Trustees oversee the bankruptcy process, protect the public interest, and ensure that bankruptcy cases are conducted according to law) (citing H.R. Rep. No. 95-595, 109 (1977)). "The United States Trustee is the 'watchdog' of the bankruptcy system, charged with preventing fraud and abuse and with 'fill[ing] the vacuum' caused by possible creditor inactivity." In re Castillo, 297 F.3d 940, 950 (9th Cir. 2002) (alteration in original) (citations omitted). Section 307 of the Bankruptcy Code authorizes the United States Trustee to appear and be heard in this case. See 11 U.S.C. § 307; In re Donovan Corp., 215 F.3d 929, 930 (9th Cir. 2000) (The United States Trustee may "intervene and appear at any level of the proceedings from the bankruptcy court on, 11 U.S.C. § 307, as either a party or an amicus.") (quoting Bernard v. Coyne, 31 F.3d 842, 844 (9th Cir. 1994)).

[3] All references to "ER" are to the Appellants' Excerpts of Record. References to Appellee's Supplemental Excerpts of Record will be referred to as "Supp. ER".

A-1. This Court has jurisdiction under 28 U.S.C. § 158(d).

STATEMENT OF THE ISSUES PRESENTED

I. Whether the bankruptcy court erred in holding that Frankfort Digital cannot relitigate the issues of whether it was acting as a bankruptcy petition preparer and engaged in the unauthorized practice of law when those issues were already fully litigated and decided on the merits against Frankfort Digital.

II. Whether the bankruptcy court clearly erred, in its alternative holding, in finding that Frankfort Digital was a bankruptcy petition preparer and had engaged in the unauthorized practice of law, given the overwhelming evidence that Frankfort Digital prepared bankruptcy documents for filing for compensation and was not an attorney or employee of an attorney, and where the evidence showed that Frankfort Digital solicited information from debtors which was then entered into a bankruptcy schedule, and advised debtors of exemptions from which to choose, or actually chose exemptions for debtors without explanation.

III. Whether the bankruptcy court abused its discretion in determining that Frankfort Digital's conduct was fraudulent, unfair, or deceptive, and granting appropriate relief.

STATEMENT OF THE CASE

I. NATURE OF THE CASE

This appeal challenges a judgment by the United States Bankruptcy Court for the Northern District of California which determined after a trial that Frankfort Digital was a bankruptcy petition preparer within the meaning of 11 U.S.C § 110(a)(1) and had engaged in the unauthorized practice of law, and in fraudulent, unfair, or deceptive conduct. The bankruptcy court ordered Frankfort Digital to pay fines and disgorge fees, enjoined it from acting as a bankruptcy petition preparer or otherwise assisting in the preparation of documents to be filed in a bankruptcy case, and certified the facts to the district court for entry of an order for damages under 11 U.S.C. § 110(i). The judgment and order was reviewed and sustained by the Ninth Circuit BAP.

II. STATUTORY FRAMEWORK

When enacting the Bankruptcy Reform Act, Pub. L. No. 103-394, 108 Stat. 4106 (1994), in 1994, Congress recognized the "growing problem of bankruptcy preparers who abuse the system in the course of preparing documents for debtors to file in bankruptcy court." 140 Cong. Rec. S4504, S4506 (daily ed. Apr. 20, 1994) (statement of Senator Metzenbaum). Congress found that there was an urgent need to regulate petition preparers, noting that "Bankruptcy petition preparers not employed or supervised by any attorney have proliferated across the country" and "[w]hile it is permissible for a petition preparer to provide services solely limited to typing, far too many of them also attempt to provide legal advice and legal services to debtors." H.R. Rep. No. 103-835, 56 (1994), reprinted in 1994 U.S.C.C.A.N. 3340, 3365. Recognizing that "[t]hese preparers often lack the necessary legal training and ethics regulation to provide such services in [an] adequate and appropriate manner," Congress feared that "[t]hese services may take unfair advantage of persons who are ignorant of their rights both inside and outside the bankruptcy system." Ibid.

Negligence and fraud were widespread, with "[h]undreds of typing mills * * * luring customers with vague promises of solving their credit problems, charging the customers hundreds of dollars while inducing them to sign bankruptcy petitions they often do not understand, and then improperly filing bankruptcy on their behalf." 140 Cong. Rec. S14597, S14597 (daily ed. Oct. 7, 1994) (Senator Metzenbaum). Moreover, there was concern in Congress that most of the "petition mills" were located in poor and minority communities and "prey[ed] on the poor and unsophisticated." Ibid.

Congress responded to this widespread problem by enacting the protections now codified at 11 U.S.C. § 110.[4] That section defines as a bankruptcy petition preparer ("BPP") any "person, other than an attorney or an employee of an attorney,

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[4] The statute is reproduced as an addendum to this brief.

who prepares for compensation a document for filing" in a bankruptcy case. 11 U.S.C. § 110(a)(1). A "document for filing" is a "petition or any other document prepared for filing by a debtor in a United States bankruptcy court or a United States district court in connection with a case under this title." Id. § 110(a)(2).

The statute requires bankruptcy petition preparers to sign each document filed in the bankruptcy, and to include on each document the preparer's name, address and social security number. Id. § 110 (b),(c). Petition preparers must also supply the debtor with copies of each document filed. Id. § 110(d). Section 110 prohibits petition preparers from executing documents on behalf of debtors (id. § 110(e)), from advertising their services as "legal" services or using a similar term (id. § 110(f)), and from collecting payment from the debtor for court fees (id. § 110(g)). The statute also requires petition preparers to file a declaration disclosing all fees received from or charged to the debtor. Id. § 110(h)(1). In addition, Section 110 also provides remedies for the victims of negligence, or any "fraudulent, unfair, or deceptive act." Id. § 110(i).

In terms of remedies, Section 110 authorizes bankruptcy courts to impose fines for non-compliance with its requirements. See, e.g., 11 U.S.C. § 110(b)(2), (c)(3), (d)(2), (e)(2), (f)(2), (g)(2), (h)(4) (establishing fines for the violation of specific provisions of the statute). The statute grants the bankruptcy court specific authority to review the fees of bankruptcy petition preparers and also authorizes the court to disallow and order the disgorgement of fees found to be in excess of the value of services rendered. Id. § 110(h)(1), (2). See also 11 U.S.C. § 329. In addition, if a bankruptcy court finds that a bankruptcy petition preparer's negligence causes a bankruptcy case or related proceeding to be dismissed, or it finds that the preparer has committed "any fraudulent, unfair, or deceptive act," it must certify that fact to the district court, which, after a hearing can impose damages. Id. § 110(i).

Section 110 also includes two provisions that authorize injunctive relief against petition preparers. First, specified types of conduct may be enjoined (1) where a petition preparer's conduct might be subject to a criminal penalty; (2) where the preparer has "misrepresented [his or her] experience or education as a bankruptcy petition preparer"; or (3) where the preparer has "engaged in any other fraudulent, unfair, or deceptive conduct", if "injunctive relief is appropriate to prevent the recurrence of such conduct." 11 U.S.C. § 110(j)(1)-(2)(A). Second, the statute provides that a court "may enjoin [a] person from acting as a bankruptcy petition preparer." Id. § 110(j)(2)(B). An injunction prohibiting a person from acting as a petition preparer is available to restrain a petition preparer who has "continually engaged in" conduct that may be enjoined under Subsection (j)(2)(A) if "an injunction prohibiting such conduct would not be sufficient to prevent such person's interference with the proper administration of" the bankruptcy code. Id. § 110(j)(2)(B). In addition, injunctive relief under Subsection (j)(2)(B) is also available in cases where a petition preparer "has not paid a penalty imposed under this section." Ibid.

III. FACTS AND PRIOR PROCEEDINGS.

A. Henry Ihejirika owns and operates Frankfort Digital Services, Ltd., a Bahamian corporation. ER 209-10. Frankfort Digital does business under at least 16 different names, including "www.ziinet.com" and "www.700law.com." Ibid. In December 2001, Ihejirika applied on behalf of Frankfort Digital for registration of a trademark with the United States Patent and Trademark Office. Id. at 210. Frankfort Digital described itself as providing "Internet based computer software for preparing legal documents" and sought to protect its "ziinet power" mark, representing that it was first used in August 2000. Ibid.

Frankfort Digital advertised its internet-based software, Ziinet, on its websites on the world wide web and advised prospective users that it was "an expert system and knows the law." ER 185, 237. The website explained that "[u]nlike most bankruptcy programs which are little more than customized word processors the Ziinet engine is an expert system. It knows bankruptcy laws right down to those applicable to the state in which you live. Now you no longer need to spend weeks studying bankruptcy laws." ER 185, 237 (emphasis in original). The website claimed that it could "automatically select bankruptcy exemptions for you" and that a user would merely have to "enter your information and Ziinet automatically figures where to put the data." ER 185, 238 (emphasis in original). Among the many "loopholes" and "little known techniques" on which the website promised to advise debtors, included: "You have heard that if you are married and have joint debts that you both must file to get rid of debts. Right? * * * Find out how to throw your creditors off your spouse's trail when you file alone", "[h]ow would you like to file bankruptcy and keep 3, 4 or even 5 cars with two little known techniques that are perfectly legal in all 50 states," and "[l]earn how to legally keep your secured furniture, big screen TV and much more without making payments." ER 229-30.

Ihejirika created an account with the internet-payment company known as Pay Pal, Inc., on April 5, 2001, to allow payments for Ziinet use to be made via Pay Pal for providing "access to barnkuptcy {sic} engine - for filing" by "ziinet.com bk engine - frankfort Digital[.]" ER 210. As of March 27, 2003, payments totaling more than $1,760,000 had been made to this account for preparing bankruptcy documents for filing. Id. at 211.

B. On October 28, 2002, the United States Bankruptcy Court for the Central District of California entered a judgment against Frankfort Digital in which Frankfort Digital was held to be a bankruptcy petition preparer, to have violated various parts of 11 U.S.C. § 110, and to have engaged in the unauthorized practice of law. In re Pillot, 286 B.R. 157, 163 (Bankr. C. D. Cal. 2002). Frankfort Digital did not appeal from the Pillot judgment.

C. 1. This particular litigation arises out of a chapter 7 bankruptcy filed by

Jayson Reynoso on February 28, 2002. ER 188. Tevis Thompson, the chapter 7 trustee, conducted the first meeting of creditors relating to that case on March 27, 2002. Ibid. When Thompson asked Reynoso if he had assistance preparing his bankruptcy papers, Reynoso responded that he had paid for the assistance of an online bankruptcy engine. Ibid. Thompson asked about certain errors in the documents, for example the fact that Reynoso's schedule B showed no "household goods" or "wearing apparel," and Reynoso responded that the website had not asked for such information. Ibid. Reynoso was required to amend his schedules and statement of financial affairs to correctly reflect his financial condition. Ibid.

On October 2, 2002, the U.S. Trustee filed a complaint against Frankfort Digital in the United States Bankruptcy Court for the Northern District of California, which was later superceded by an amended complaint and a second amended complaint, ER 9-10, 54-67. The second amended complaint sought the assessment of fines, disgorgement of funds, injunctive relief, certification to the district court for damages, sanctions, fees, and costs, 11 U.S.C. §§ 110 (b),(c),(h),(i),(j), 329, against Frankfort Digital. ER 54-67. The second amended complaint was based on allegations as to debtor Reynoso and a number of other debtors who had used Frankfort Digital's services. ER 58-60.

2. The bankruptcy court held a trial on April 7, 2003, on the issues of whether

Frankfort Digital was a bankruptcy petition preparer, had violated Section 110, had charged unreasonable fees, had engaged in the unauthorized practice of law and had engaged in fraudulent, unfair, or deceptive conduct. At trial, Reynoso and three other debtors who had used Frankfort Digital's services (Laurie Coggins, Lewis Martin and Diane Amaral) testified on behalf of the U.S. Trustee. See Transcript 14, 31, 45, 49. Trustee Thompson also testified. Transcript, 38:25-44:18. Frankfort Digital offered no witnesses and did not cross-examine witnesses Thompson, Martin, or Amaral. Although the U.S. Trustee was prepared to present several more witnesses, see ER 134, Frankfort Digital and the U.S. Trustee met during a recess at trial in which they shortened the trial by stipulating to most of the findings of fact, see Transcript, 13:19-25; 43:2-18; 44:9-13.

Reynoso testified at trial to the following facts: He searched the internet for a way to file for bankruptcy. Transcript, 14:7-15:1; ER 184-85. Reynoso paid Frankfort Digital $219 to assist in preparing his bankruptcy papers for which Reynoso ultimately received a printed and filled out voluntary petition, schedules, statement of financial affairs and statement of intention. Transcript 14:7-16:23; ER 185; In re Reynoso, 315 B.R. at 248. Frankfort Digital's website,[5] Ziinet, prompted

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[5] For the sake of simplicity, we refer to Ziinet as a website though it might also be described as web-based software. Nothing turns on the nomenclature.

Reynoso to respond to certain questions through the use of dialog boxes that solicited various information such as personal identification, assets, debts, income, etc. Transcript 17:18-20:2; ER 185-88; In re Reynoso, 315 B.R. at 548. The website advised Reynoso of various items for which he might claim exemptions including cars, boats, and apparel. Transcript, 18:10-17, 20:14-22:7. The website advised him "you don't need to enter certain things, if it's certain things that may seem complicated, as far as when you file your bankruptcy." Transcript, 21:15-21:18. This advice led Reynoso not to list any "Wearing Apparel" or "Household Goods" in Schedule B. Transcript, 21:9-22:6, 24:2-25:2; ER 188. Reynoso also testified that the website presented available exemptions for him to claim and selected exemptions for him which were not specifically chosen or typed by him but instead tied in automatically. Transcript, 18:7-20:20, 30:2-18. This included the website entering in specific code numbers into Schedule C under the column calling for "Specific Law Providing Each Exemption." Transcript, 18:7-19:3, 30:3-18; ER 186.

Additional evidence established that in response to question number 9 (payments related to debt counseling or bankruptcy), the software automatically inserted into Reynoso's statement of financial affairs a paragraph reading:

> Realizing that this document is signed under penalty of perjury, I declare that I prepared my own bankruptcy by myself using a computer and that I as not assisted by an attorney, paralegal or bankruptcy preparer. I downloaded the software into my computer's browser as a web page,

> typed in my bankruptcy information and printed my bankruptcy documents on my printer in the privacy of my home without any human intervention other than mine. The software printed the official Federal bankruptcy forms with the information I typed in within a few seconds of my pressing the print button and no one other than myself inputted, edited or reviewed my bankruptcy information or handled my bankruptcy documents at any point in the process. The contents of my documents are based entirely on my own research and no one gave me legal advice or told me to include or omit any information from my documents.

In re Reynoso, 315 B.R. at 548; ER 187. After Reynoso entered his responses to the questions posed by the website, a set of bankruptcy documents were revealed for the first time with Reynoso's responses appearing in certain portions of the documents. ER 187; In re Reynoso, 315 B.R. at 548. Reynoso took his printed documents and filed for bankruptcy on February 28, 2002. ER 188. Similar testimony was offered by the three other debtors who testified at trial. See Transcript, 31:18-38:10 (Laurie Coggins), 45:12-48:15 (Lewis Martin), 49:14-51:6 (Diane Amaral). The evidence showed that those debtors' experience with Frankfort Digital's website was similar to Reynoso's, and that neither Frankfort Digital's involvement in the document preparation nor the fees it charged were disclosed in the documents. See id. ER 198-99 (Laurie Coggins), 203-05 (Lewis Martin), 205 (Diane Amaral). In all cases, fees charged for use of the software were in excess of the $125 authorized under the Northern District of California's Bankruptcy Petition Preparer Guidelines ("BPP

Guidelines"). E.g., In re Reynoso, 315 B.R. at 549; ER 185, 198, 203, 205.

Evidence was also offered as to a portion of Frankfort Digital's website known as "The Bankruptcy Vault" or "the Vault." This portion of the website provided advice on "[h]ow to hide your bankruptcy from the credit bureaus", Supp. ER. 25, including "[i]f you do not put your social security number on your initial bankruptcy papers, they cannot match you," ibid., and "you can file a partial bankruptcy and the court clerk will dismiss your case in just 15 days. Filing a partial bankruptcy means leaving off some of the documents when you file the first time," id. at 33. Reynoso testified and the bankruptcy court found that Reynoso received an email providing more information on "the Vault." Reynoso testified he accessed "the Vault" and read through it, but that he declined to use the techniques contained in "the Vault" because he had serious concerns about their legality. See ER 185; Transcript, 20:14-21:4; In re Reynoso, 315 B.R. at 548. It is undisputed that "the Vault" was up and running when Reynoso used the website. ER 185; In re Reynoso, 315 B.R. at 551. No testimony was offered as to whether the other representative debtors viewed "the Vault."

3. On April 11, 2003, the bankruptcy court found that Frankfort Digital was a bankruptcy petition preparer within the meaning of 11 U.S.C § 110, had continually and intentionally violated Section 110, had engaged in the unauthorized practice of law, and had engaged in fraudulent, unfair, or deceptive conduct. ER 11, 213-16. The bankruptcy court ordered Frankfort Digital to pay fines and to disgorge fees to each Northern District of California debtor who was Frankfort Digital's customer. Id. at 214-18. The bankruptcy court also enjoined Frankfort Digital from acting as a bankruptcy petition preparer or otherwise assisting in the preparation of documents to be filed in a bankruptcy case in the Northern District of California, and certified the facts to the district court to allow for entry of an order for damages under 11 U.S.C. § 110(i). Id. at 216-20.

Although the bankruptcy court certified the facts to the district court, none of the creditors, debtors nor trustees moved in the district court for an entry of an order for damages pursuant to 11 U.S.C. § 110(i), and no damages were imposed. ER 11; Supp. ER 150-52.

On May 9, 2003, Frankfort Digital moved for a Partial Stay Pending Appeal. On June 4, 2003, the bankruptcy court denied the motion for a partial stay, making clear that it intended the fines to be assessed only as to Reynoso's case, but that it intended to require Frankfort Digital to disgorge fees as to all the debtors which had used its service in the Northern District of California. ER 14; Supp. ER 154-55; Appellants' Revised Br. 8 & n.2.

4. Frankfort Digital appealed to the Bankruptcy Appellate Panel on the same grounds it marshals in this appeal. The BAP sustained the Bankruptcy Court judgment in all respects. In re Reynoso, 315 B.R. 544 (B.A.P. 9th Cir. 2004). Frankfort Digital filed this appeal on October 19, 2004. ER A-1.

SUMMARY OF ARGUMENT

Frankfort Digital is paradigmatic of the type of entity that motivated Congress to enact 11 U.S.C. § 110, a business that targets desperate and poor debtors, promises more than the law allows, delivers less than what it promises, and leaves debtors high and dry when problems in their filings are noticed.

The bankruptcy court and BAP were presented with an overwhelming amount of evidence that Frankfort Digital not only acted as a bankruptcy petition preparer but engaged in conduct outside the permissible bounds of that role and engaged in the unauthorized practice of law. This was, in fact, how Frankfort Digital advertised its service to prospective customers, representing it to be an "expert system" that "knows bankruptcy laws right down to those applicable to the state in which you live" and could "automatically select bankruptcy exemptions for you," such that a user need only enter his data and the system "automatically figures where to put the data." ER 185 (emphasis in original).

The bankruptcy court's findings were well-supported by the record. Testimony by debtors proved that Frankfort Digital's website solicited information such as personal identification, assets, debts, income which it then transformed into a set of bankruptcy documents, with the only task left for the debtor to do was printing. But Frankfort Digital's service did not merely transform information it solicited from debtors into completed bankruptcy documents, which would alone be enough to constitute the preparing of bankruptcy documents for filing, but automatically selected exemptions for debtors. For example, Frankfort Digital inserted statute numbers in portions of Schedule C calling for "Specific Law Providing Each Exemption." E.g., ER 186. It also automatically inserted text into bankruptcy documents without debtors' permission including a statement "signed under penalty of perjury" that the debtor had prepared his or her own document and "was not assisted by an attorney, paralegal or bankruptcy preparer." In re Reynoso, 315 B.R. at 548; ER 187.

The bankruptcy court and BAP were not clearly erroneous in finding this evidence sufficient to prove that Frankfort Digital was a bankruptcy petition preparer, defined by statute as "person, other than an attorney or an employee of an attorney, who prepares for compensation a document for filing." 11 U.S.C. § 110(a)(1). Frankfort Digital does not dispute that it is not an attorney or employee of an attorney nor that it was compensated for its services. Frankfort Digital only disputes whether it prepared documents for filing, but the evidence that it did so was overwhelming.

Frankfort Digital's claims that it is not liable under Section 110 because its services are limited to licensing software which allows debtors to fill out their own bankruptcy petitions was correctly rejected by the bankruptcy court and BAP and has no basis in fact or law.

The bankruptcy court and BAP also did not clearly err in finding the evidence proved that Frankfort Digital engaged in the unauthorized practice of law in California because it (1) solicited information from a debtor which was then entered into a bankruptcy schedule, and/or (2) advised a debtor of exemptions from which to choose, or actually chose an exemption for the debtor without explanation.

In any event, that Frankfort Digital was a bankruptcy petition preparer under Section 110 and had engaged in the unauthorized practice of law was determined in a previous litigation from which Frankfort Digital did not appeal, In re Pillot, 286 B.R. 157 (Bankr. C.D. Cal. 2002), and the bankruptcy court and BAP did not clearly err in the alternative holding that those determinations be given issue preclusive (collateral estoppel) effect.

The bankruptcy court also did not abuse its discretion in finding Frankfort Digital's conduct was fraudulent, unfair, or deceptive, entering an injunction and certifying the case to the district court for entry of damages. Case law establishes that engaging in the unauthorized practice of law is itself sufficient to constitute fraudulent, unfair, or deceptive conduct, and, in any event, the bankruptcy court had ample evidence of other conduct that supported its determination. The bankruptcy court also did not abuse its discretion in ordering Frankfort Digital to disgorge fees it charged to all customers in the Northern District of California, including those who were not parties to the case, given its finding that the value of the services provided by Frankfort Digital was negligible.

Frankfort Digital has not really disputed any of the facts in this case, but instead attempts to avoid their significance by suggesting that they were merely a "mass adoption" of the suggested findings of the U.S. Trustee which the court "simply signed" without examination. Appellants' Revised Br. 26. This baseless accusation ignores the bankruptcy court judge's statement on the record that it had "reviewed each line and phrase," Transcript, 67:8-12, and the numerous changes to the proposed findings of fact made by the court. Any similarity between the U.S. Trustee's proposed findings of fact and the court's findings of fact are better explained by the fact that Frankfort Digital's counsel stipulated to most of the findings, offered no witnesses of his own, and engaged in very limited cross-examination of the Trustee's witnesses. In any event, Frankfort Digital has pointed to nothing in the findings that are clearly erroneous.

STANDARD OF REVIEW

This Court applies the same standard of review as the BAP did. In re Morrissey, 349 F.3d 1187, 1190 (9th Cir. 2003). In conducting this review, a bankruptcy court's findings of fact are upheld unless clearly erroneous while its conclusions of law are reviewed de novo. In re Bevan, 327 F.3d 994, 997 (9th Cir. 2003) (citing Figter Ltd. v. Teachers Ins. & Annuity Ass'n of Am. (In re Figter Ltd.), 118 F.3d 635, 637-38 (9th Cir. 1997)). A bankruptcy court's decision to impose discretionary penalties for a violation 11 U.S.C. § 110 is reviewed for abuse of discretion, In re Agyekum, 225 B.R. 695, 698 (B.A.P. 9th Cir. 1998). Under this standard, a court "must have a definite and firm conviction that the court below committed a clear error of judgment in the conclusion it reached, before reversal is proper." In re Crowe, 243 B.R. 43, 47 (B.A.P. 9th Cir. 2000), aff'd, 246 F.3d 673 (9th Cir. 2000) (quoting In re Tong Seae (U.S.A.), Inc., 81 B.R. 593, 597 (B.A.P. 9th Cir. 1988)).

ARGUMENT

I. THE BANKRUPTCY COURT DID NOT CLEARLY ERR IN DETERMINING THAT FRANKFORT DIGITAL WAS A BANKRUPTCY PETITION PREPARER AND HAD ENGAGED IN THE UNAUTHORIZED PRACTICE OF LAW

Section 110 of the Bankruptcy Code establishing numerous requirements and restrictions on the acts of bankruptcy petition preparers. A bankruptcy petition preparer is defined by statute as a "person, other than an attorney or an employee of an attorney, who prepares for compensation a document for filing[.]" 11 U.S.C. § 110(a)(1). Frankfort Digital conceded that it was not an attorney or an employee of an attorney, Appellants' Revised Br. 10, and there is no dispute that it had received compensation. The only thing that it contested was whether it "prepare[d] any 'document for filing'." Id. (emphasis added).

In this case the bankruptcy court had two alternative bases for concluding that Frankfort Digital was a bankruptcy petition preparer within the meaning of Section 110. First, it gave issue preclusive effect to the decision in an earlier case that Frankfort Digital was a bankruptcy petition preparer. ER 212. Second, it concluded on the merits that, based on the ample evidence before it, Frankfort Digital was a bankruptcy petition preparer within the meaning of Section 110. Id. at 213. Similarly, it had two alternative bases for concluding that Frankfort Digital was engaged in the unauthorized practice of law. First, it gave issue preclusive effect to the decision in an earlier case that Frankfort Digital was engaged in the unauthorized practice of law. Id. at 212. Second, it concluded on the merits that, based on the ample evidence before it, Frankfort Digital was engaged in the unauthorized practice of law. Id. at 216.

The BAP affirmed as to both issues on both the issue preclusion and merits grounds. In re Reynoso, 315 B.R. at 550-53. The bankruptcy court did not clearly err as to either ground, and sustaining its decision on either ground would be sufficient to affirm the judgment below.

A. The Bankruptcy Court Did Not Clearly Err in Applying Issue Preclusion Where Previous Adjudications Had Determined Frankfort Digital to Be a Bankruptcy Petition Preparer and Engaged in the Unauthorized Practice of Law.

The doctrine of issue preclusion (sometimes referred to as "collateral estoppel") forecloses the relitigation of matters that have already been actually litigated. Federal law governs the issue preclusive effects of a case decided by a federal court, including a bankruptcy court. Grogan v. Garner, 498 U.S. 279, 285 n.11 (1991); Fireman's Fund Ins. Co. v. Int'l Mkt. Place, 773 F.2d 1068, 1069 (9th Cir. 1985); In re Berr, 172 B.R. 299, 305 (B.A.P. 9th Cir. 1994). Under federal law, issue preclusion is appropriate when

> (1) there was a full and fair opportunity to litigate the issue in the previous action;
> (2) the issue was actually litigated in that action;

> (3) the issue was lost as a result of a final judgment in that action; and
> (4) the person against whom collateral estoppel is asserted in the present action was a party or in privity with a party in the previous action.

Pena v. Gardner, 976 F.2d 469, 472 (9th Cir. 1992). In In re Pillot, 286 B.R. 157 (Bankr. C.D. Cal. 2002), the U.S. Trustee filed a motion in the bankruptcy court for the Central District of California against Frankfort Digital alleging that it was a bankruptcy petition preparer under 11 U.S.C. § 110(a)(1), had violated Section 110(b)(1), (c)(1), and (h)(1), and had engaged in the unauthorized practice of law. The Bankruptcy court determined that "Henry Ihejirika, Ziinet.com, and Frankfort Digital Services, Ltd. are bankruptcy petition preparers, as that term is defined under 11 U.S.C. § 110(a)(1)" and ordered them to pay fines and disgorge fees. Id. at 162-63.

As the BAP concluded, all the elements of issue preclusion are met here and the Bankruptcy Court was correct to determine that the Pillot decision ought to be given issue preclusive effect, and find Frankfort Digital precluded from arguing it was not a bankruptcy petition preparer. In re Reynoso, 315 B.R. at 551. Frankfort Digital has not disputed that it was party to the Pillot case, that there was a full and fair opportunity to litigate these issues, that these issues were actually litigated and that they were essential to the final judgment. See Appellants Revised Br. 24-25. Its argument instead is that the issues at stake in this case were not identical to the ones in Pillot, because after the injunction in the Pillot case Frankfort Digital allegedly altered its website by removing "the Vault," and that the U.S. Trustee did not make a showing that the website viewed by Jayson Reynoso was the same as the one viewed by debtor in the Pillot case. Appellants' Revised Br. 24-25.

1. Frankfort Digital Waived Its Argument Against Issue Preclusion by Failing to Raise it Before the BAP.

As a threshold matter, this Court should find that, as the BAP noted, Frankfort Digital waived any argument against issue preclusion by failing to raise it before the BAP. In re Reynoso, 315 B.R. at 550. The same rules as to the preservation of arguments that apply to appeals from a district court proceeding apply when the appeal is from a bankruptcy proceeding. In re Bishop, Baldwin, Rewald, Dillingham & Wong, Inc., 104 F.3d 1147, 1148 (9th Cir. 1997) ("[O]ur case law on the preservation of issues from a district court's judgment also controls appeals from bankruptcy proceedings.") Frankfort Digital waived this argument by failing to raise any challenge to issue preclusion in its briefing before the BAP or even mentioning the Pillot case. See e.g., Med. Lab. Mgmt. Consultants v. Am. Broad. Cos., 306 F.3d 806, 820 n.8 (9th Cir. 2002) (finding argument waived because appellant "failed to raise them in its opening brief"); Laboa v. Calderon, 224 F.3d 972, 981 n.6 (9th Cir. 2000) (claims not specifically and distinctly argued in an appellant's opening brief are waived on appeal).

2. In Any Event, Frankfort Digital's Argument Against Issue Preclusion Is Utterly Without Support in Fact or Law.

Assuming, arguendo, that Frankfort Digital has not waived its argument against issue preclusion, the bankruptcy court and BAP nevertheless correctly determined that issue preclusion applied. Contrary to Frankfort Digital's suggestion, Appellants' Revised Br. 24-25, the BAP found that "the Vault" was available through Frankfort Digital's websites at the time Reynoso used the software, In re Reynoso, 315 B.R. at 551, a finding amply supported by the bankruptcy court's own findings of fact and Reynoso's own testimony, see ER 185-86; Transcript, 20:14-21:4.

Moreover, most of the facts relied on by the Pillot court to support its determination that Frankfort Digital was a bankruptcy petition preparer had nothing to do with the information available in "the Vault." The Pillot court determined that, as in this case, Frankfort Digital prepared documents for filing by transforming information it solicited from the debtor into completed bankruptcy documents, did so for compensation, and was not an attorney or an employee of an attorney. See In re Pillot, 286 B.R. at 159-60. The Pillot court also determined, again just as in this case, that Frankfort Digital itself inserted a response to question number 9 in the statement of financial affairs that was not the work of debtor, and concealed that it had assisted in preparing the documents including by failing to sign the documents as required by Section 110. Id. at 159.

Similarly, most of the facts relied on by the Pillot court to support its determination that Frankfort Digital was engaged in the unauthorized practice of law had nothing to do with the information available in "the Vault." The court noted that a number of statements on the website advised debtors that the website could automatically select exemptions for them, which constituted unauthorized practice of law. Id. at 160. As is discussed below, the bankruptcy court in this case explicitly found that the website automatically chose exemptions for debtors. Furthermore, the court noted that certain statements on the website "created an aura of expertise," statements such as "[a]ll you do is answer a few questions and leave the rest to Ziinet," "[i]f you cannot afford a trained bankruptcy attorney, then use Ziinet. Ziinet is an expert system * * * In fact Ziinet has a leg up on them [attorneys]" and "[i]f you use Ziinet, you answer a few questions and Ziinet takes care of the statement of intentions. You do not even need to know that there is such a thing as the statement of intentions." Id. at 160-61.

Therefore, the issues in the Pillot case were identical to the ones here, and Pillot ought to be given issue preclusive effect as to the issue of whether Frankfort Digital was a bankruptcy petition preparer and had engaged in the unauthorized practice of law.

3. Frankfort Digital Had Been Found to Be A Bankruptcy Petition Preparer and Engaged in the Unauthorized Practice of Law in A Number of Other Cases Where it Did Not Even Bother to Contest the Matter.

Pillot represents only one in a string of decisions finding that Frankfort Digital violated Section 110 and sanctioning it. In September 2002, the Bankruptcy Court for the Eastern District of Pennsylvania found Frankfort Digital Services, Ltd., Ziinet.com, and 700law.com to be bankruptcy petition preparers and enjoined them from acting as such. ER 211; Supp. ER 62-67. In November 2002, Frankfort Digital Services, Ltd., Ziinet.com, and 700law.com were enjoined from engaging in bankruptcy petition preparer activities by the bankruptcy court for the Western District of Tennessee. ER 212; Supp. ER 71-74. In February 2003, Frankfort Digital was found to have engaged in unauthorized practice of law and enjoined from engaging in bankruptcy petition preparer activities by the Bankruptcy Court in the Southern District of Iowa. ER 212 ; Supp. ER 75-78. In March 2003, this same bankruptcy court again found Frankfort Digital to have violated Section 110 and engaged in unauthorized practice of law, levied fines, and certified its conduct to the United States District Court for the district for an award of damages. ER 212; Supp. ER 79-84. In March 2003, Frankfort Digital was fined for violations of Section 110, found to have engaged in the unauthorized practice of law, and enjoined from engaging in bankruptcy petition preparer activities by the Bankruptcy Court for the District of Minnesota. ER 212; Supp. ER 85-109.

Although no one disputes that Frankfort Digital was given adequate notice, it nonetheless never appeared to defend itself in any of these cases, each of which resulted in a default judgment against it.

While the bankruptcy court and BAP did not rely on these cases for issue preclusion, relying instead on the Pillot case, this Court could also affirm on this ground. E.g., United States v. Smith, 389 F.3d 944, 955 (9th Cir. 2004). In the cases heard in the Eastern District of Pennsylvania and the Western District of Tennessee it appears that Henry Iherijika himself was not a named party. Nevertheless, issue preclusion is appropriate when a party in the current action was in privity with a party in the previous action, e.g., Pena, 976 F.2d at 472, and no one has disputed that Iherijika was in privity with Frankfort Digital Services, Ltd., Ziinet.com or 700law.com. Moreover, Iherijika was a named party in the cases before the Southern District of Iowa and the District of Minnesota.

Unlike Pillot, each of these four decisions was the product of a default judgment. As this Court has recognized, under California law a default judgment can form the basis for issue preclusion so long as (1) the party against which issue preclusion is being asserted has been personally served with summons or has actual knowledge of the existence of the litigation, and (2) the issue for which preclusion is asserted was properly raised by a party's pleadings or otherwise, was submitted to the court for determination, and actually determined by the court. E.g., In re Harmon, 250 F.3d 1240, 1247 (9th Cir. 2001). Neither of these prerequisites are in dispute here. That said, as noted, this case depends on the federal law of issue preclusion because it is a bankruptcy court decision which is asserted to have preclusive effect. It is not clear from this Court's precedents whether the federal law of issue preclusion follows California law in allowing default judgments to form the basis of issue preclusion. While dictum from a case decided more than twenty years ago in this Circuit suggests it may not, see In Re Gottheiner, 703 F.2d 1136, 1140 (9th Cir. 1983), a more recent decision by the Eleventh Circuit suggests that in certain circumstances federal issue preclusive effect can be given to a default judgment, In re Bush, 62 F.3d 1319, 1323-25 (11th Cir. 1995).

In any event, this Court need not reach this question if it determines that the Pillot decision itself should be given issue preclusive effect or it finds that the bankruptcy court did not clearly err in concluding that Frankfort Digital was a bankruptcy petition preparer and engaged in the unauthorized practice of law.

B. The Bankruptcy Court Did Not Clearly Err in Its Alternate Holding that Frankfort Digital Was a Bankruptcy Petition Preparer Within the Meaning of Section 110, Where the Only Contested Issue Was Whether it "Prepared" Documents for Filing and There Was Overwhelming Evidence to That Effect.

1. The Bankruptcy Court Had Overwhelming Evidence That Frankfort Digital Prepared for Compensation Documents for Filing.

Even if the Court determines that the Pillot case should not be given issue preclusive effect, the BAP correctly concluded that the bankruptcy court was not clearly erroneous in its alternative holding that Frankfort Digital was a bankruptcy petition preparer under Section 110. In re Reynoso, 315 B.R. at 551.

The Bankruptcy Code defines a "bankruptcy petition preparer" as "a person, other than an attorney or an employee of an attorney, who prepares for compensation a document for filing." 11 U.S.C. § 110(a)(1). "Document for filing" is defined as "a petition or any other document prepared for filing by a debtor in a United States bankruptcy court or a United States district court in connection with a case under this title." Id. § 110(a)(2).

Frankfort Digital does not dispute that it received compensation for preparing voluntary bankruptcy petitions, schedules, statements of financial affairs and statements of intention, which debtors filed in the United States bankruptcy courts. Frankfort Digital also admits that it is neither "an attorney or an employee of an attorney." Appellants' Revised Br. 10. There appears to be no dispute that the documents produced by Frankfort Digital for the debtors in this case were "document[s] for filing" that were in fact filed. E.g., ER 188, 200, 205, 206. Thus, the only dispute on appeal is whether they prepared a "document for filing". See Appellants' Revised. Br. 10 (describing this issue as "the crux of this case.")

As the bankruptcy court and the BAP recognized, however, the evidence on this element was overwhelming.

In its filing for trademark protection, Frankfort Digital described itself as providing "Internet based computer software for preparing legal documents." ER 210 (emphasis added). Frankfort Digital advertised its internet-based software, Ziinet, on its websites on the world wide web as "an expert system and knows the law. Unlike most bankruptcy programs which are little more than customized word processors the Ziinet engine is an expert system. It knows bankruptcy laws right down to those applicable to the state in which you live. Now you no longer need to spend weeks studying bankruptcy laws." ER 185, 237 (emphasis in original). The site claimed that it could "automatically select bankruptcy exemptions for you," and that a user would merely have to "enter your information and Ziinet automatically figures where to put the data." ER 185, 238 (emphasis in original).

At trial Reynoso testified that he searched the internet for a way to file for bankruptcy. Transcript, 14:7-15:1. Reynoso paid Frankfort Digital $219 to assist in preparing his bankruptcy papers for which Reynoso ultimately received a printed and filled out voluntary petition, schedules, statement of financial affairs and statement of intention. Transcript 14:7-16:23; ER 185; In re Reynoso, 315 B.R. at 248.

Frankfort Digital's website prompted Reynoso to respond to certain questions through the use of dialog boxes that solicited various information such as personal identification, assets, debts, income, etc. In re Reynoso, 315 B.R. at 248; ER 185-86.

After Reynoso entered his responses to the questions posed by the website, a set of bankruptcy documents were revealed for the first time with Reynoso's responses appearing in certain portions of the documents. In re Reynoso, 315 B.R. at 248; ER 186. Various portions of Reynoso's bankruptcy documents were filled out without Reynoso having offered any information and without his prompting or typing, including the insertion of statute numbers in a portion of Schedule C calling for "Specific Law Providing Each Exemption." In re Reynoso, 315 B.R. at 548; ER 186-87. As the BAP and bankruptcy court noted, the website also inserted a statement "signed under penalty of perjury" into Reynoso's statements of financial affairs that the debtor had prepared his own document and "was not assisted by an attorney, paralegal or bankruptcy preparer." In re Reynoso, 315 B.R. at 548; ER 187. Similar evidence was provided as to other debtors. Transcript, 31:18-38:10 (Laurie Coggins), 45:12-48:15 (Lewis Martin), 49:14-51:6 (Diane Amaral); ER 198-99 (Laurie Coggins), 203-05 (Lewis Martin), 205-06 (Diane Amaral).

In formatting and translating information the debtor provided (by responding to the website's prompts) into bankruptcy forms which were then filed, Frankfort Digital was acting as a bankruptcy petition preparer. All steps to produce the debtor's bankruptcy papers, other than the ministerial printing of the documents, were completed by Frankfort Digital. As such, Frankfort Digital "prepare[d] for compensation a document for filing" in bankruptcy court under Section 110(a)(1).

2. The Bankruptcy Court Correctly Rejected Frankfort Digital's Claim That it Was Immunized from Liability Because it Was Only "Licensing" Software.

Frankfort Digital does not actually dispute these key findings of fact by the bankruptcy court, which were affirmed by the BAP. Instead, its argument is that it is not liable under Section 110 because its services are limited to licensing software which allows debtors to fill out their own bankruptcy petitions. As the BAP held, the bankruptcy court did not clearly err in rejecting this argument. In re Reynoso, 315 B.R. at 552-53. The bankruptcy court soundly rejected Frankfort Digital's argument that it was merely a software licensor, noting it was "thoroughly unconvinced" by the argument "that someone can set up a website and have it sponsored by a particular entity or individual and then claim that it isn't them that's providing assistance." Transcript, 43:20-43:24. Observing that several other courts had rejected such an argument, the court noted that "websites don't just grow out of thin air and aren't maintained out of thin air. They're put together by people; they're put on the Internet; and it's not the website that provides the assistance. It's the people who develop the website that provide the assistance." Transcript, 44:1-8. This determination was amply supported by statute and case law.

To begin with, the law clearly establishes that if Frankfort Digital had engaged in the same behavior not by way of a website, but instead through mail or some other means, it would be a bankruptcy petition preparer, notwithstanding the claim that the charge was for licensing a product. For example, in In re Crowe, 243 B.R. 43 (B.A.P. 9th Cir. 2000), aff'd, 246 F.3d 673 (9th Cir. 2000), Appellant Ferm sold a book for a large fee entitled "Do It Yourself Bankruptcy", which guaranteed to its readers that "[i]f you buy my book and can't complete the forms yourself, I will do it for free." Id. at 49. Defendant claimed he was not a bankruptcy petition preparer but instead merely an author. Ibid. The panel correctly rejected his claim, noting that Ferm's "characterization of himself as an author is a disingenuous attempt to sidestep the 'for compensation' component of the definition of petition preparer under § 110(a)." Id. at 50. Instead, the panel concluded that "the book is a mere front for his services" and "[b]ecause what he really sells are his services, Ferm is subject to the court's jurisdiction for violations of § 110." Ibid. By the same token, Frankfort Digital's claim in this case that it was merely "licensing software" is a "mere front" for its services, what it is really selling is its services of preparing bankruptcy petitions.

Similarly, in In re Agyekum, 225 B.R. 695 (B.A.P. 9th Cir. 1998), Appellant Hastings charged a "$135 fee [,which] included $15 in costs and a nonrefundable $25 'document license fee' for the use of 'copyrighted intellectual property' prepared by Hastings. The pre-printed materials consisted of literature entitled 'Fast Facts Guide' and 'InfoForm Questionnaire.'" Id. at 697. The Guide "provided information about the bankruptcy process, and the Questionnaire functioned to obtain a client's pertinent information for the completion of a bankruptcy petition." Ibid. For the debtor in question, Hastings reviewed the debtors' completed Questionnaire and determined that she had omitted 15 items of information necessary for the proper completion of the petition, and sent a multi-page form detailing the omissions and requesting that the debtor furnish the missing information. Ibid. After the debtor filled in the missing information, Hastings mailed her a completed bankruptcy petition. Ibid. The court concluded that Hastings was a bankruptcy petition preparer within the meaning of Section 110 and was engaged in unauthorized practice of law. See id. at 701-02. Specifically, the court rejected the claim that charging a "document license fee" for the use of Hastings' "copyrighted intellectual property" was a service not covered by Section 110, id. at 701-02.

Obviously, the mere fact that Frankfort Digital engaged in the same behavior by way of its website rather than through the mails makes no difference. See In re Jolly, 313 B.R. 295, 300 (Bankr. S.D. Iowa 2004) (the fact that a person provides computerized bankruptcy preparation services and does not place data directly on the forms does not excuse that person's failure to reveal that role in the preparation of documents for filing under Section 110).

3. The Bankruptcy Court Did Not Clearly Err in Rejecting Frankfort Digital's "Turbo Tax" Defense Given That Bankruptcy Petition Preparers and Income Tax Return Preparers Are Regulated Through Two Entirely Different Regimes.

Frankfort Digital makes a final attempt to avoid liability by offering what might be characterized as a "Turbo Tax defense." It argues that it is not a bankruptcy petition preparer because it offers a service similar to the one offered by many online tax preparation software packages. Appellants' Revised Br. 10-11. Frankfort Digital complains that "[t]he court would not allow any testimony at trial regarding use of a computerized tax program to prepare tax returns." Id. at 11. The BAP properly regarded this argument as "irrelevant". In Re Reynoso, 315 B.R. at 552. Tax law does have restrictions on tax return preparers like the ones set forth in Section 110. The language of Section 110, however, imposes specific restrictions and disclosure requirements only upon bankruptcy petition prepares and in no way incorporates the rules applicable to tax preparers under the federal tax laws. Compare 11 U.S.C. § 110 (defining bankruptcy petition preparer), with 26 U.S.C. 7701(a)(36) (defining income tax return preparer). Thus, there is no dissonance in the fact that the same behavior might be lawful as to tax preparation when it is unlawful as to bankruptcy preparation.

As discussed above, in enacting Section 110 Congress was moved by the reality of widespread negligence and fraud disproportionately targeting minorities with "[h]undreds of typing mills * * * luring customers with vague promises of solving their credit problems, charging the customers hundreds of dollars while inducing them to sign bankruptcy petitions they often do not understand, and then improperly filing bankruptcy on their behalf." See 140 Cong. Rec. S14597 (daily ed. Oct. 7, 1994) (Senator Metzenbaum). Different concerns moved Congress in the tax context, resulting in a different regime.

It may in fact be the case that a website that offered services comparable to Frankfort Digital's in the tax context would be an income tax return preparer. See Rev. Rul. 85-189, 1985-2 C.B. 341(discussing computerized tax preparation software); see also Reynolds v. Commissioner, 296 F.3d 607, 619 (7th Cir. 2002) (noting the question of whether Turbo Tax is a "tax preparer" without deciding the matter); Ohrman v. Commissioner, 86 T.C.M. (CCH) 499 (2003) (describing Turbo Tax as a "a tax preparation program.") But the more important point is that rules governing tax return preparation are different from the ones governing bankruptcy petition preparation and are not relevant in this case.

C. The Bankruptcy Court Did Not Clearly Err in Its Alternate Holding That Frankfort Digital Was Engaged in the Unauthorized Practice of Law Where There Was Overwhelming Evidence That Frankfort Digital Solicited Information From Debtors it Transferred Into Bankruptcy Documents and Chose Exemptions for Debtors.

Bankruptcy courts have the power to regulate the activities of bankruptcy petition preparers under 11 U.S.C. § 110, but preparers may also be subject to sanctions beyond those of Section 110. Section 110(k) states that nothing in the Section shall be construed to permit "the unauthorized practice of law," 11 U.S.C. § 110(k), and bankruptcy courts generally look to state law for guidance when determining whether a person has engaged in the unauthorized practice of law. Taub v. Weber, 366 F.3d 966, 968 (9th Cir. 2004); In re Kangarloo, 250 B.R. 115, 123 (Bankr. C.D. Cal. 2000). See also 2 Collier on Bankruptcy, ¶ 110.12 (15th ed. 2004) ("Section 110(k) provides that the ability of nonlawyers to practice before bankruptcy courts in a given jurisdiction will be governed by '[relevant state] law, including rules and laws that prohibit the unauthorized practice of law,' as well as by section 110 itself.")(alteration in original).[6]

Under California law, the state law relevant in this case, the practice of law "includes legal advice and counsel and the preparation of legal instruments and contracts by which legal rights are secured although such matter may or may not be

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[6] Because determining whether a bankruptcy petition preparer engaged in the unauthorized practice of law depends on the jurisdiction in which that practice took place, Frankfort Digital's discussion of what constitutes unauthorized practice of law in Texas, Appellants' Revised Br. 19-22, is simply not relevant. Moreover, even under Texas law bankruptcy courts have found conduct similar to Frankfort Digital's to constitute the unauthorized practice of law. In re Guttierez, 248 B.R. 287, 296 (Bankr. W.D. Tex. 2000) (advising clients about exemptions or determining which exemptions apply to client's property is unauthorized practice of law).

pending in a court." In re Agyekum, 225 B.R. 695, 701 (B.A.P. 9th Cir. 1998); In re Glad, 98 B.R. 976, 977 (B.A.P. 9th Cir. 1989); Birbrower, Montalbano, Condon & Frank v. Superior Court, 949 P.2d 1, 5 (1998); People v. Sipper, 142 P.2d 960, 962 (1943), overruled on other grounds by, Murgia v. Municipal Court, 540 P.2d 44 (1975). Frankfort Digital agrees that this is the relevant definition under California law. Appellants' Revised Br. 16.

In the bankruptcy context, two types of conduct relevant in this case have been singled out as constituting the unauthorized practice of law under California law: (1) "Soliciting information from a debtor which is then typed into [bankruptcy] schedules," In re Agyekum, 225 B.R. at 702; see In re Glad, 98 B.R. at 978; In re Nieves, 290 B.R. 370, 379 (Bankr. C.D. Cal. 2003); In re Farness, 244 B.R. 464, 471 (Bankr. D. Idaho 2000); In re Kaitangian, 218 B.R. 102, 110 (Bankr. S.D. Cal. 1998) ("Plugging in solicited information from questionnaires and personal interviews to a pre-packaged bankruptcy software program constitutes the unauthorized practice of law."). (2) "[A]dvising of available exemptions from which to choose, or actually choosing an exemption for the debtor with no explanation." In re Kaitangian, 218 B.R. at 110; see In re Agyekum, 225 B.R. at 702; In re Glad, 98 B.R. at 978.[7] The

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[7] Although, as discussed earlier, only California law is directly relevant on the question of what constitutes unauthorized practice of law in California, we note that a number of bankruptcy courts in a number of other states have found that advising

bankruptcy court had overwhelming evidence before it that Frankfort Digital engaged in both of these types of prohibited conduct, though its finding that they engaged in either type of conduct would itself be sufficient to uphold a determination that Frankfort Digital engaged in the unauthorized practice of law.

1. The Bankruptcy Court Had Overwhelming Evidence Before it That Frankfort Digital Solicited Information From Debtors Which Was Then Transferred Into Bankruptcy Documents.

The bankruptcy court had overwhelming evidence before it that Frankfort Digital solicited information from debtors which was then transferred into bankruptcy documents. Reynoso testified that as he navigated through Frankfort Digital's website he was prompted by a series of dialogue boxes. ER 185-86. Transcript, 17:15-24, 22:22-23:2. Through these dialogue boxes, Frankfort Digital's software solicited such information as Reynoso's name, his property and its value, his

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debtors about available exemptions or simply choosing exemptions for debtors is unauthorized practice of law in that state. See, e.g., In re Bush, 275 B.R. 69, 76-78 (Bankr. D. Idaho 2002) (identifying possible exemptions found to be unauthorized practice of law even where the identification is done by bankruptcy software); In re Moffett, 263 B.R. 805, 814 (Bankr. W.D. Ky. 2001) ("advising clients about exemptions, or determining which exemptions apply to a client's property, is the unauthorized practice of law"); In re Guttierez, 248 B.R. 287, 296 (Bankr. W.D. Tex. 2000) (advising clients about exemptions or determining which exemptions apply to client's property is unauthorized practice of law).

automobile and its value, as well as other types of financial information. ER 185-86; Transcript, 17:15-19:3, 22:22-24:9. Once Reynoso had given his information, the software automatically placed the information into various places throughout the petition, schedules, and statements. ER 186. In so doing the website was delivering on the representations it made to Reynoso and other users which described it as an "expert system," where "[y]ou just enter your information and Ziinet automatically figures where to put the data." ER 185 (emphasis in original). Reynoso printed the bankruptcy documents which had been prepared reflecting not only the solicited information that Reynoso had provided but also additional information not provided by Reynoso. Other debtors in the Northern District of California who were assisted by Frankfort Digital testified to similar facts.[8] Given this uncontroverted evidence, the Bankruptcy Court did not clearly err in finding that Frankfort Digital engaged in the unauthorized practice of law.

2. The Bankruptcy Court Had Overwhelming Evidence Before it

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[8] As to debtor Laurie Coggins, see ER 198-200; Transcript 35:18-36:23; id. at 35:25-36:3 ("they asked me to list the property and the value, and then they figured the exemption number for me, according to what I put in that box.") As to debtor Lewis Martin, see ER 203-05; Transcript 47:1-48:14; id. at 47:19-22 ("It asked me a basic question about the assets * * *. And on the basis of that answer, it then fills in the exemption.") As to debtor Diane Amaral, see ER 205-07; Transcript 50:3-51:5; id. at 50:13-17 ("it would tell you to fill in certain things, and when you filled in those certain things, then you would go into the forms, and that would automatically then show up on the forms, unless you ask about it.")

That Frankfort Digital Advised Debtors About Available Exemptions From Which to Choose or Actually Selected Exemptions for Them.

As the BAP noted, In re Reynoso, 315 B.R.at 552, the bankruptcy court also had overwhelming evidence before it that Frankfort Digital advised debtors about available exemptions from which to choose or actually selected exemptions for them. Frankfort Digital's website advised users that it was "an expert system and knows the law. Unlike most bankruptcy programs which are little more than customized word processors the Ziinet engine is an expert system. It knows bankruptcy laws right down to those applicable to the state in which you live. Now you no longer need to spend weeks studying bankruptcy laws." ER 185, 237. The website promised that Ziinet could "automatically select bankruptcy exemptions for you" and "eliminate[] the need to choose which schedule to use for each piece of information. You just enter your information and Ziinet automatically figures where to put the data." ER 185, 238.

Debtor Reynoso testified that the website advised him of various items for which he might claim exemptions including cars, boats, and apparel. Transcript, 18:10-17, 20:14-22:7. The website advised him "you don't need to enter certain things, if it's certain things that may seem complicated, as far as when you file your bankruptcy." Transcript, 21:15-21:18. This advice lead Reynoso not to list any

"Wearing Apparel" or "Household Goods" in Schedule B. ER 188; Transcript, 21:9-22:6, 24:2-25:2. Reynoso also testified that the website presented available exemptions for him to claim as well as advice on how to file for bankruptcy and selected exemptions for him which were not specifically chosen or typed by him but instead tied in automatically, including printing in specific code numbers into Schedule C under the column calling for "Specific Law Providing Each Exemption." ER 186; Transcript, 18:7-20:20, 30:2-18.[9]

For these reasons, the bankruptcy court made no error in finding that Frankfort Digital had engaged in the unauthorized practice of law.

3. Whether Similar Conduct in the Tax Context Would Constitute Unauthorized Practice of Law Is Irrelevant Given That Bankruptcy Petition Preparers and Income Tax Return Preparers Are Regulated Through Two Entirely Different Regimes.

Although it does not develop any sustained argument to this effect, Frankfort Digital's brief hints that its actions do not constitute the unauthorized practice of law because tax preparation software offers similar assistance. Any such argument should be deemed waived for failure to develop it, Laboa, 224 F.3d at 981 n.6, but in any

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[9] Once again, several other debtors offered similar testimony that the bankruptcy court credited in its findings of fact. E.g., ER 198-99; Transcript, 35:18-36:23 (debtor Laurie Coggins); ER 203-05; Transcript, 47:13-48:14 (debtor Lewis Martin); ER 205-07; Transcript 50:3-51:5 (debtor Diane Amaral).

event, such a comparison is utterly wrong-headed. For one thing, unlike the statute defining "income tax return preparer", 26 U.S.C. § 7701(a)(36), Section 110 explicitly reserves that "[n]othing in this section shall be construed to permit activities that are otherwise prohibited by law, including rules and laws that prohibit the unauthorized practice of law." 11 U.S.C. § 110(k). This difference is an outgrowth of different congressional purposes in establishing each regulatory regime. As discussed above, in enacting Section 110 Congress was moved by the reality of widespread negligence and fraud disproportionately targeting minorities with "[h]undreds of typing mills * * * luring customers with vague promises of solving their credit problems, charging the customers hundreds of dollars while inducing them to sign bankruptcy petitions they often do not understand, and then improperly filing bankruptcy on their behalf." 140 Cong. Rec. S14597 (daily ed. Oct. 7, 1994) (Senator Metzenbaum). Different concerns moved Congress in the tax context, resulting in a different regime.

More importantly, it is well understood that tax return preparation, even when done by an attorney, is not regarded as the practice of law. See,e.g., United States v. Frederick, 182 F.3d 496, 500 (7th Cir. 1999). The same cannot be said in the bankruptcy context. See, e.g., In re Guttierez, 248 B.R. at 295; In re Farness, 244 B.R. at 467.

D. Frankfort Digital's Unsubstantiated Allegation That the Bankruptcy Court Committed Clear Error in Making a "Mass Adoption" of the U.S. Trustee's Proposed Findings of Fact is Without Any Support in Law or Fact.

Frankfort Digital failed to challenge almost any of the factual allegations at trial. It has been unable to identify on appeal any findings of fact that were clearly erroneous. Instead, it now desperately attempts to challenge the method by which the findings were adopted, contending that the bankruptcy court's findings of fact were simply a "mass adoption" of the suggestions of the U.S. Trustee and that "the court simply signed the Judgment and the Findings of Fact that were place in front of him by" the U.S. Trustee. Appellants' Revised Br. 26. As the BAP recognized, the bankruptcy court did not commit clear error in its findings of fact since each finding was carefully reviewed and supported by the evidence. In re Reynoso, 315 B.R. at 551.

As the BAP noted, the bankruptcy court made the following comment at the conclusion of trial: "I'm prepared to sign off on the U.S. Trustee's proposed findings, [of] which I have reviewed each line and phrase, and it appears quite – really without any controverting – that those facts are as they've been stated. The documents are all here." In re Reynoso, 315 B.R. at 550; Transcript, 67:8-12 (emphasis added). Frankfort Digital's position amounts to the suggestion that the bankruptcy court judge was lying when he made this statement, but they have presented nothing to substantiate this serious accusation. On the contrary, other statements by the bankruptcy court judge in the hearing demonstrate that he had thoroughly examined the proposed findings of fact and was familiar with them. See, e.g., Transcript, 43:2-18 (colloquy on proposed finding of fact number 142), 64:20-65:13 (colloquy on the request for a nationwide injunction in the proposed findings).

Moreover, Frankfort Digital's opening brief ignores the fact that Appellants and the U.S. Trustee met during a recess at trial in which they shortened the trial by stipulating to most of the findings of fact, Transcript, 13:19-25; 43:2-18; 44:9-13, although, as the BAP noted, there was no clear written stipulation in the record. In re Reynoso, 315 B.R. at 548. This left only a few proposed findings to be litigated related to various debtors' payments to Frankfort Digital for assistance (e.g., ER 185 at ¶ 9, ER 198 at ¶ 103, ER 203 at ¶ 145, and ER 205 at ¶ 163) and the debtors' responses to Frankfort Digital's queries and how those were reflected in their schedules (e.g., ER 186 at ¶ 17, ER 188 at ¶ 29, ER 189 at ¶ 40, ER 198 at ¶ 109, ER 203 at ¶ 146, and ER 205 at ¶ 164). Frankfort Digital did not produce any testimony to dispute the facts presented at trial, engaged in very little cross-examination of the U.S. Trustee's witnesses, and did not make evidentiary objections other than to relevance, objections which the court overruled. Transcript, 32:2-3, 67:2-6. None of the evidentiary rulings have been challenged on appeal. These facts better explain whatever similarities there are between the court's findings of fact and the ones proposed by the U.S. Trustee.

The proposed findings of fact that were originally submitted to the court appear in the record, and are clearly different from the findings of fact ultimately adopted by the court. To assist the panel in making the comparison, we include a "redlined" document from the BAP record that compares the proposed findings of fact with the ones settled on by the court. See Supp. ER. 111-49. Changes made by the court include the addition of several case citations, id. at 140, 143, the issuing of an injunction for the Northern District of California rather than the national one initially sought by the U.S. Trustee, id. at 145-47, and a host of smaller changes, id. at 130, 139, 140, 149. Thus, this is not a case of "verbatim adoption" meriting "careful scrutiny." L.K. Comstock & Co. v. United Eng'rs & Constructors Inc., 880 F.2d 219, 222 (9th Cir. 1989).

Even if, arguendo, the bankruptcy court's Findings of Fact were merely a verbatim adoption of the Trustees proposed findings, that in and of itself would not constitute reversible error. While this Circuit regards the practice of wholesale adoption of the prevailing party's findings as "disapproved" it also regards it as "permissible" in certain cases. Ibid. Indeed, "[t]he verbatim adoption of findings suggested by a party is not automatically objectionable * * * so long as those findings are supported by the record." Ibid. (quoting Unt v. Aerospace Corp., 765 F.2d 1440, 1444-45 (9th Cir. 1985)). Even in the case of findings adopted verbatim, contrary to what Frankfort Digital's brief suggests, Appellants' Revised Br. 26, although "the appellate court is to engage in 'careful scrutiny,' the 'clearly erroneous' standard still applies." L.K. Comstock & Co., Inc., 880 F.2d at 222 (quoting Photo Elecs. Corp. v. England, 581 F.2d 772, 777 (9th Cir. 1978)). Frankfort Digital has said nothing as to why specific findings are clearly erroneous but essential to the court's ruling. Even assuming dubitante that there was an error, this Court should find that any error was harmless. See 28 U.S.C. § 2111; Fed. R. Civ. P. 61, incorporated by Fed. R. Bankr. P. 9005; In re Maximus Computers, Inc., 278 B.R. 189, 194 (B.A.P. 9th Cir. 2002).

II. THE BANKRUPTCY COURT DID NOT ABUSE ITS DISCRETION IN FINDING FRANKFORT DIGITAL TO HAVE ENGAGED IN FRAUDULENT, UNFAIR, OR DECEPTIVE CONDUCT AND GRANTING APPROPRIATE REMEDIES.

Under 11 U.S.C. § 110(i), if a bankruptcy court finds a bankruptcy petition preparer to have violated section 110 or committed "any fraudulent, unfair, or deceptive act," it must certify that fact to the district court, which, after a hearing can impose damages. 11 U.S.C. § 110(i). Similarly, under 11 U.S.C. § 110(j), a bankruptcy court may "enjoin a bankruptcy petition preparer from engaging in any conduct in violation of this section or from further acting as a bankruptcy petition preparer" if the Court finds that a bankruptcy preparer has inter alia engaged in "fraudulent, unfair, or deceptive conduct" and "injunctive relief is appropriate to prevent the recurrence of such conduct." 11 U.S.C. § 110(j)(1)-(2)(a). In order to "enjoin the person from acting as a bankruptcy petition preparer" the court must further find that "the bankruptcy petition preparer has continually engaged in" this conduct "and that an injunction prohibiting such conduct would not be sufficient to prevent such person's interference with the proper administration of this title." Id. § 110(j)(2)(b). Section 110 also provides for a remedy of disgorgement in Subsection (h), which requires a bankruptcy petition preparer to "file a declaration under penalty of perjury disclosing any fee received from or on behalf of the debtor within 12 months immediately prior to the filing of the case, and any unpaid fee charged to the debtor" and provides that the "court shall disallow and order the immediate turnover to the bankruptcy trustee of any fee" that is "found to be in excess of the value of services rendered for the documents prepared." Id. § 110(h). See also 11 U.S.C. § 329; In re Glad, 98 B.R. at 977-78 (allowing disgorgement under 11 U.S.C. § 329 for fees for services provided by non-attorneys).

In the present case, the bankruptcy court certified the fact of Frankfort Digital's violations of Section 110 and its "fraudulent, unfair, or deceptive" acts to the district court. ER 12, 216, 221. However, no party moved in the district court for damages, see 11 U.S.C. § 110(i)(1), so no damages were imposed. The bankruptcy court entered an injunction against Frankfort Digital from acting as a bankruptcy petition preparer or otherwise assisting in the preparation of documents to be filed in a bankruptcy case in the Northern District of California. ER 237. The bankruptcy court also ordered Frankfort Digital to disgorge all fees collected by Frankfort Digital from every debtor in the Northern District of California who was its customer. ER 216-17.

Although there are a few stray sentences in Frankfort Digital's brief devoted to these three remedies, it is not clear Frankfort Digital offered an argument, much less a sustained and developed argument, either here or before the BAP, which would be necessary to preserve these issues for review. Thus, any such argument should be deemed waived. Laboa, 224 F.3d at 981 n. 6. But in an abundance of caution we will set out why the bankruptcy court in no way abused its discretion in granting these remedies.[10]

A. The Bankruptcy Court Did Not Abuse its Discretion in Finding That Frankfort Digital Repeatedly Engaged in

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[10] As to the certifying of facts to the district court under 11 U.S.C. § 110(i), Frankfort Digital's argument faces still another stumbling block. No party ever moved for damages so no damages were ever imposed. Thus even assuming, dubitante, that the bankruptcy court abused its discretion in certifying this fact to the district court, any error was harmless, and it is not clear Frankfort Digital even contends otherwise.

Fraudulent, Unfair, or Deceptive Conduct and Violated Section 110.

The bankruptcy court did not abuse its discretion in finding Frankfort Digital engaged in fraudulent, unfair, or deceptive conduct in this case. ER 216-17. The bankruptcy court is given wide latitude in this regard, and a court "must have a definite and firm conviction that the court below committed a clear error of judgment in the conclusion it reached, before reversal is proper." In re Crowe, 243 B.R. at 47 (internal quotation marks omitted). Frankfort Digital says nothing that comes even remotely close to meeting that high standard. Except for repeating its assertion that it is not a bankruptcy petition preparer, Frankfort Digital does not seem to even challenge the bankruptcy court's decision on this ground much less suggest why it is an abuse of discretion. In any event, the bankruptcy court had multiple separate bases for determining that Frankfort Digital committed fraudulent, unfair, or deceptive conduct, each of which would have been sufficient on its own.

First, as the BAP recognized, the unauthorized practice of law is itself sufficient to support the bankruptcy court's conclusion that Frankfort Digital's conduct was fraudulent, unfair, or deceptive. In re Reynoso, 315 B.R. at 553. Accord In re Bush, 275 B.R. 69, 83 (Bankr. D. Idaho 2002); In re Dunkle, 272 B.R. 450, 456 (Bankr. W.D. Pa. 2002); In re Moffett, 263 B.R. 805, 813 (Bankr. W.D. Ky. 2001); In re Gomez, 259 B.R. 379, 386-88 (Bankr. D. Colo. 2001); In re Guttierez, 248 B.R.

287, 294 (Bankr. W.D. Tex. 2000); In re Moore, 232 B.R. 1, 8 (Bankr. D. Me. 1999).

The bankruptcy court also had a number of other grounds for concluding that Frankfort Digital had engaged in conduct that was fraudulent, unfair, or deceptive. The bankruptcy court noted that Frankfort Digital (1) repeatedly concealed their involvement as bankruptcy petition preparers, (2) repeatedly violated the court's guidelines with respect to bankruptcy petition preparer activities by not giving debtors copies of those guidelines and (3) repeatedly failed to disclose the compensation they received in violation of the statute. Transcript, 67:14-68:7. See also In re Kaitangian, 218 B.R. at 117 ("the intentional failure * * * to disclose all fees paid by the debtors under penalty of perjury constitutes an unfair and deceptive act within the meaning of § 110(i)(1).")

Far from offering a "low-cost" solution to filing bankruptcy as Frankfort Digital's website suggested, the bankruptcy court found that the website charged an excessive fee without delivering the valuable service it claimed to deliver. Transcript, 68:8-69:13.

The court also concluded that Frankfort Digital repeatedly failed to sign the disclosure of the identity of the petition preparer as required by Section 110(b) and to sign or provide social security numbers in various places throughout the bankruptcy petitions prepared by Frankfort Digital. See, e.g., In re Reynoso, 315

B.R. at 548; ER 186-87, 198-99, 203-05; Transcript, 31:18-38:10, 45:12-48:15, 49:14-51:6.

Frankfort Digital's advice to debtors not to "complicate" their bankruptcies by disclosing too much resulted in Reynoso's schedule stating "none" where he was supposed to list "wearing apparel" and "household goods" he had. Transcript, 21:9-22:6, 24:2-25:2.

Frankfort Digital's website automatically inserted a statement "signed under penalty of perjury" into Reynoso's statements of financial affairs that the debtor had prepared his own document and "was not assisted by an attorney, paralegal or bankruptcy preparer." In re Reynoso, 315 B.R. at 548; ER 187. Reynoso did not write or authorize this passage. Id. A similar statement was inserted into the text of other debtors and not authorized by them. ER 199. See also In re Stacy, 193 B.R. 31, 37 (Bankr. D. Or. 1996) (bankruptcy petition preparer's insertion of information on the schedules that was not based on information provided by debtor constitutes fraudulent, unfair, or deceptive conduct).

Given all this uncontroverted evidence, the bankruptcy court did not abuse its discretion in finding Frankfort Digital had engaged in fraudulent, unfair, or deceptive conduct.

While the above-mentioned facts are more than sufficient to show the bankruptcy court did not abuse its discretion in finding fraudulent, unfair, or deceptive conduct, the portion of the website called "the Vault" provides still more of this type of conduct. "The Vault" promised debtors advice on "[h]ow to hide your bankruptcy from the credit bureaus," Supp. ER. 25, including "[i]f you do not put your social security number on your initial bankruptcy, they cannot match you," ibid., and "you can file a partial bankruptcy and the court clerk will dismiss your case in just 15 days. Filing a partial bankruptcy means leaving off some of the documents when you file the first time," id. at 33. Reynoso testified and the bankruptcy court found that Reynoso received an email providing more information on "the Vault," accessed and read the information in "the Vault," but that Reynoso declined to use the techniques contained in "the Vault" because he had serious concerns about their legality. See ER 185-86; Transcript, 20:14-21:4; In re Reynoso, 315 B.R. at 548.

There is a very brief and cryptic suggestion by Frankfort Digital, not developed by any argument, that the bankruptcy court somehow erred because the U.S. Trustee "offered no evidence that Appellants engaged in any fraudulent, unfair or deceptive conduct (Conclusion of Law # 232 1ER216) much less to every single person or entity who used the software to prepare his or her schedules." Appellants' Revised Br. 15. The first part of this assertion is flatly refuted by the voluminous evidence as to fraudulent, unfair, or deceptive conduct reviewed above. The second part of the assertion is also in error. In order to certify a case to the district court for damages or enter an injunction, there is no requirement in the statutory text or case law that the United States Trustee prove that defendants' conduct was fraudulent, unfair, or deceptive as to each and every debtor who used the service. To the extent that Appellant means instead to challenge the bankruptcy court's determination under 11 U.S.C. § 110 (j)(2)(B) that Frankfort Digital has "continually engaged" in this conduct, the court's determination is amply supported by the existence of evidence as to multiple debtors in this case as well as "appellants' history of § 110 violations, established in other districts," In re Reynoso, 315 B.R. at 554; In re Pillot, 286 B.R. 157.

B. The Bankruptcy Court Did Not Abuse its Discretion in Ordering Disgorgement of All Fees as to Every Debtor Who Had Used Frankfort Digital's Services in the Northern District of California.

Without developing the argument, Frankfort Digital contends that it "was error to order disgorgement to every person who used the software in the Northern District in the twelve months prior to Jayson Reynoso without any evidence of the value of the services to any other individuals." Appellants' Revised Br. 8. The argument should be deemed waived for lack of development. Laboa, 224 F.3d 972, 981 n.6. In any event, the BAP correctly rejected this argument, noting that "Appellants have not challenged, much less shown clearly erroneous, the bankruptcy court's finding that the value of the services provided by appellants was negligible. It was not an abuse of discretion to predicate an order of disgorgement on this finding." In re Reynoso, 315 B.R. at 553. In this appeal, Frankfort Digital does not even challenge the authority of the bankruptcy court to order disgorgement. As to Frankfort Digital's challenge to the valuation of the services it provided to debtors, it does not even address the bankruptcy court's finding that the value of the services provided by them was negligible, ER 216, much less show it to be clearly erroneous.

CONCLUSION

For the foregoing reasons, the judgment of the Bankruptcy Appellate Panel should be affirmed.

Respectfully submitted,

PETER D. KEISLER
Assistant Attorney General

ROBERT M. LOEB
(202) 514-4332
I. GLENN COHEN
(202) 514-2498

Attorneys, Appellate Staff
Civil Division, Room 7226
Department of Justice
950 Pennsylvania Avenue, N.W.
Washington, D.C. 20530-0001

Of Counsel:

P. MATTHEW SUTKO
Executive Office for
United States Trustee
U.S. Department of Justice
20 Massachusetts Ave., N.W.
Washington, D.C. 20530

MINNIE LOO
Assistant United States Trustee
Office of the U.S. Trustee
1301 Clay St, Ste 690 N.
Oakland, CA 94612-5217

FEBRUARY 2005

STATEMENT OF RELATED CASES

Counsel for the United States Trustee are not aware of any pending related cases, as defined in Ninth Circuit Rule 28-2.6.

CERTIFICATE OF COMPLIANCE

Counsel for the United States Trustee hereby certifies that the foregoing Brief for Appellee United States of America satisfies the requirements of Federal Rule of Appellate Procedure 32(a)(7) and Ninth Circuit Rule 32-1. The brief was prepared in monospace typeface using a 14-point font, Times New Roman, and contains 13,417 words.

I. Glenn Cohen
Counsel for the United States Trustee

CERTIFICATE OF SERVICE

I hereby certify that on this 9th day of February, 2005, I filed and served the foregoing Brief for Appellee United States Trustee by causing the original and 15 copies to be sent to this Court by Federal Express overnight, and by causing two copies to be sent Federal Express overnight to:

M. Jonathan Hayes
21800 Oxnard St., Suite 840
Woodland Hills, CA 91367
(818) 710-3656

____
I. Glenn Cohen
Counsel for the United States Trustee

BRIEF BANK — "SUMMARY SHEET" *Printed Fri-5/29/09 10:11*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*
In re Ritchie Special Credit Investment, LTD, et al. (Ritchie Special Credit Investment, LTD, et al. v. United States Trustee, et al.)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*
D. Minn.

3. ("CCN") ***CURRENT*** CASE NO.
No.: 09-cv-00680-ADM

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*
No.: 08-45257
Court: Bankr. Minn..
(Identify judge & cite, if any)

5. ("SO") ***SOURCE***
U.S. TRUSTEES

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*
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Type: Brief of Appellee United States Trustee

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Michael E. Ridgway, Walter W. Theus, P. Matthew Sutko, Robert B. Raschke, Habbo G. Fokkena
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***
• Did the bankruptcy court err in appointing Douglas A. Kelley as chapter 11 trustee for affiliated debtors?

10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)

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IN THE UNITED STATES DISTRICT COURT
DISTRICT OF MINNESOTA
09-680

RITCHIE SPECIAL CREDIT INVESTMENTS, LTD., ET AL.,

Appellants,

v.

UNITED STATES TRUSTEE, ET AL.,

Appellees.

ON APPEAL FROM THE UNITED STATES BANKRUPTCY COURT FOR THE DISTRICT OF MINNESOTA, BANKRUPTCY COURT FILE NO. 08-45257
HONORABLE GREGORY F. KISHEL

BRIEF OF APPELLEE UNITED STATES TRUSTEE

Of Counsel:

Ramona D. Elliott
General Counsel

P. Matthew Sutko
Walter W. Theus, Jr.
United States Department of Justice
Executive Office for United States Trustees
20 Massachusetts Avenue, NW
Washington, D.C. 20530
(202) 307-1399

Habbo G. Fokkena
United States Trustee

Michael E. Ridgway
Robert B. Raschke
Department of Justice
Office of the United States Trustee
300 South Fourth Street, Suite 1015
Minneapolis, MN 55415
(612) 664-5500

ATTORNEYS FOR APPELLEE
UNITED STATES TRUSTEE

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UNITED STATES DISTRICT COURT
DISTRICT OF MINNESOTA

IN THE MATTER OF:

Ritchie Special Investments, Ltd., et al.,

Civil No. 09-cv-680-ADM

v.

United States Trustee, et al.

Bky No. 08-45257

BRIEF OF APPELLEE UNITED STATES TRUSTEE

PRELIMINARY STATEMENT

Ritchie Special Credit Investments, Ltd., Rhone Holdings II, Ltd., Yorkville Investments I, L.L.C., Ritchie Capital Structure Arbitrage Trading, Ltd., and Ritchie Capital Management, L.L.C. (collectively "Ritchie") have appealed the order of the bankruptcy court[1] overruling their objection to the appointment of Douglas A. Kelley ("Kelley") as chapter 11 trustee, and approving his appointment in the jointly administered cases of Petters Company, Inc., et al. (Bankruptcy Court No. 08-45257) ("Trustee Order"). The United States Trustee[2] appointed

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[1] The Honorable Gregory F. Kishel presiding. The decision can be found at 401 B.R. 391 (Bankr. D. Minn. 2009).

[2] United States Trustees are Department of Justice Officials appointed by the Attorney General to supervise the administration of chapter 11 bankruptcy cases. *See* 28 U.S.C. § 581-589(a). *See also* H.R. Rep. No. 95-595, at 88 (1977), *as reprinted in* 1978 U.S.C.C.A.N. 5963, 6049 (United States Trustees "serve as bankruptcy watch-dogs to prevent fraud, dishonesty, and overreaching in the bankruptcy arena.") Their express statutory powers include authorization to move for the appointment of a trustee, 11 U.S.C. § 1104(a), and the naming of a trustee if the court orders a trustee's appointment, 11 U.S.C. § 1104(d).

Kelley pursuant to the bankruptcy court's Order for Appointment of Trustee(s) entered December 17, 2008. Kelley's appointment as trustee was supported by the Unsecured Creditors' Committee for the Petters cases ("the Petters Committee"), Ronald R. Peterson, Esq., Chicago, as trustee for the bankruptcy estates of Lancelot Investors Fund, L.P., et al. ("Lancelot trustee")[3] and the Unsecured Creditors' Committee in *In re Polaroid Corporation, et al.*, Bky 08-46617) ("the Polaroid Committee").

BASIS FOR APPELLATE JURISDICTION

Jurisdiction for this appeal is premised upon 28 U.S.C. § 158(a)(1) which grants "district courts of the United States . . . jurisdiction to hear appeals from final judgments, orders, and decrees" of bankruptcy judges. Ritchie has appealed the order of the bankruptcy court overruling its objection to the appointment of Douglas A. Kelley as the chapter 11 trustee in these cases. Although the Eighth Circuit has not yet specifically ruled on this issue, other courts have held that such an order appointing (or denying) a trustee is a final order for appeal purposes. *In re Marvel Entertainment Group*, 140 F.3d 463, 470 (3d Cir. 1998) ("Using the liberal finality rules which apply in bankruptcy matters of this nature, we believe that jurisdiction is proper over the order appointing a trustee here."); *In re Cajun Elec. Power Coop. Inc.*, 69 F.3d 746, 748 (5th Cir. 1995) (appointment of bankruptcy trustee is an immediately appealable final order); *In re Plaza de Diego Shopping Ctr., Inc.*, 911 F.2d 820, 826 (1st Cir. 1990) (same); *Committee of Dalkon Shield Claimants v. A.H. Robins Co.*, 828 F.2d 239, 241 (4th Cir. 1987) (same). Applying the factors enunciated by the Eighth Circuit in *In re Koch*, 109 F.3d 1285,

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[3] Lancelot is a group of Chicago-based hedge funds which filed for chapter 7 relief. Lancelot claims a loss in excess of $1.3 billion.

1287 (8th Cir. 1997),[4] it

appears that jurisdiction in the district court is proper.

STATEMENT OF ISSUES AND STANDARD OF REVIEW

THE BANKRUPTCY COURT DID NOT ERR IN APPOINTING KELLEY AS TRUSTEE FOR BOTH PGW & PCI

A. No disqualifying conflict of interest prevents Kelley from serving as a common trustee for these Debtors.

B. Kelley's pre-petition status as court-appointed Receiver for the Debtor entities did not disqualify him from serving as trustee for PGW.

C. The bankruptcy court's denial of Ritchie's request for expedited discovery is not properly before this Court on appeal, because Ritchie did not appeal the bankruptcy court's order of January 23, 2009.

Standard of Review

The district court sits as a court of review in bankruptcy matters; accordingly, the bankruptcy court's factual findings are reviewed for clear error and its conclusions of law *de novo*. *In re Loop Corp.*, 379 F.3d 511, 515 (8th Cir. 2004), *cert. denied* 543 U.S. 1055 (2005). However, in matters pertaining to the appointment or removal of a trustee, the bankruptcy court is given broad discretion. *In re Reagan*, __ B.R. __, 2009 WL 805144 (B.A.P. 8th Cir. March 30, 2009), *citing Contractors, Laborers, Teamsters & Eng'rs Health & Welfare Plan v. M & S Grading, Inc. (In re M & S Grading, Inc.)*, 541 F.3d 859, 867 (8th Cir. 2008). *See also, In re Farmland Indus., Inc.*, 397 F.3d 647, 651 (8th Cir. 2005) ("The bankruptcy court abuses its

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[4] The three factors are: "the extent to which (1) the order leaves the bankruptcy court nothing to do but execute the order; (2) the extent to which delay in obtaining review would prevent the aggrieved party from obtaining effective relief; (3) the extent to which a later reversal on that issue would require recommencement of the entire proceeding." *Id.* citing *In re Olson*, 730 F.2d 1109 (8th Cir. 1984).

discretion when it fails to apply the proper legal standard or bases its order on findings of fact that are clearly erroneous."); *Kim v. Cox*, 130 F.2d 721, 733 (8th Cir. 1942) (abuse of discretion standard applied in reviewing bankruptcy court's appointment or removal of trustee) (decided under Bankruptcy Act of 1898).

As indicated in the Trustee Order, most of the findings of fact were based on various state and federal court proceedings involving many of the same parties, and so are not in dispute. Trustee Order, 401 B.R. at 395, n. 6.

STATEMENT OF THE CASE

The petitions commencing the Chapter 11 cases of Petters Company, Inc. ("PCI") and Petters Group Worldwide, LLC ("PGW") were filed on October 11, 2008. Within one week following, the petitions commencing the Chapter 11 cases of PC Funding, LLC; Thousand Lakes, LLC; SPF Funding, LLC; PL Ltd., Inc.; Edge One, LLC and MGC Finance, Inc., PAC Funding, LLC and Palm Beach Finance Holdings were filed. All the cases were filed by Douglas A. Kelley in his capacity as the federal court-appointed receiver of these entities. An order for joint administration of the above-entitled cases was entered on October 22, 2008.

On December 2, 2008, the United States Trustee filed his motion under 11 U.S.C. § 1104(a) seeking an order directing the appointment of a chapter 11 trustee. UST App. 91-115. Ritchie filed its motion requesting the appointment of two trustees: one for PCI and one for PGW. The bankruptcy court held a hearing on the motion on December 16, 2008. The Court granted the United States Trustee's motion and also "held that the issue of whether a trustee should be appointed for Debtor Petters Group Worldwide, LLC, with a different person or persons to be appointed as trustee(s) for the other Debtors, was not ripe until the United States

Trustee had first exercised his authority under 11 U.S.C. § 1104(a), as to all of the Debtors." App. A-65, 66. On December 24, 2008, the United States Trustee, acting under the authority of 11 U.S.C. § 1104(d) and Fed. R. Bankr. P. 2009(c)(2), appointed Douglas A. Kelley ("Kelley") as Chapter 11 Trustee of these jointly administered cases, and filed a motion under Fed. R. Bankr. P. 2007.1(c) seeking approval of his appointment with the bankruptcy court. UST App. 151-167.

On January 7, 2009, Ritchie timely filed its objections[5] to the United States Trustee's appointment of Kelley, alleging disqualifying conflicts of interest arising from Kelley's status as pre-petition receiver for the Debtor entities as well as conflicts of interest arising from Kelley's role as trustee for both PCI and PGW. Ritchie also sought to conduct expedited discovery into certain of Kelley's actions in that regard. Kelley opposed the requests for discovery. A hearing was held on January 22, 2009 regarding Ritchie's motion to compel discovery. The bankruptcy court denied the request and quashed all such discovery attempts. UST App. 149-150. Ritchie did not appeal this order.

The United States Trustee's motion seeking approval of Kelley's appointment was heard on January 27, 2009. The Petters Committee, the Polaroid Committee and the Lancelot trustee appeared in support of the United States Trustee's appointment. Ritchie was the only creditor that opposed the motion.[6] At the hearing, no evidence was taken; the parties presented oral

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[5] In its order entered December 17, 2008, the bankruptcy court set deadlines regarding the appointment process. App. A-65, 66.

[6] In a colloquy with the bankruptcy court, Ritchie appears to have "backed off" its initial request to disqualify Kelley as trustee for all the Debtor entities, stating its "primary objective is to have a separate trustee appointed for PGW" and leaving Kelley in place for the other nine Debtor entities. Trustee Order, 401 B.R. at 403; UST App. 42. This position is consistent with

argument regarding their respective positions.

On February 26, 2009, the bankruptcy court issued its order approving the appointment of Kelley as common trustee for all of the Debtor entities. App. 344-378. Pursuant to the court's order, Kelley, on March 5, 2009, filed his acceptance of appointment as Chapter 11 Trustee and in the same pleading attached his turnover of assets. UST App. 168-172.

Ritchie timely filed its Notice of Appeal from the bankruptcy court's order on March 9, 2009. Docket Entry # 1.

STATEMENT OF THE FACTS

PCI and PGW[7] are both privately held limited liability companies owned 100% by Thomas J. Petters ("Petters"). PCI is the sole member and owns 100% of the membership interests of PC Funding, Thousand Lakes, SPF Funding, PL Ltd., Edge One, MGC Finance, PAC Funding and Palm Beach Holdings. PCI was utilized as the venture capital arm of the Petters enterprises. It utilized single purpose entities to obtain billions of dollars of funding, purportedly to acquire merchandise for sale to wholesalers and retailers nationwide. PGW has investments in companies across the globe; however, its principal asset was 100% ownership of the stock of Polaroid Corporation. UST App. 117-118.

As a result of a federal criminal investigation, Petters, PCI and PGW were indicted on charges

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Ritchie's prayer for relief "that the Court reverse the Trustee Order and direct the Bankruptcy Court to order the United States Trustee to appoint a separate trustee for PGW, and that the Trustee not be Kelley." Ritchie Brief at 24.

[7] PCI was formed in Minnesota and PGW was formed in Delaware, although both companies operate from the same location in Minnetonka, Minnesota.

of mail fraud, wire fraud, money laundering and conspiracy to commit those offenses.[8] Other Petters executives implicated in this Ponzi scheme had also been arrested and have since pled guilty to certain crimes. According to the government, more than 20 lenders and investors had been defrauded out of more than $3.45 billion as a result of this alleged scheme.

On October 6, 2008, pursuant to 18 U.S.C. § 1345(a)(2), the United States District Court for the District Court of Minnesota appointed Douglas A. Kelley, Esq., as a Receiver for PCI, PGW and all of their affiliates and subsidiaries except for MN Airlines, LLC dba Sun Country Airlines (the "Receiver").[9] From October 11, 2008 to October 19, 2008, the Receiver filed bankruptcy petitions for the various Debtors. By its order of October 22, 2008, the bankruptcy court ordered these cases to be jointly administered. UST App. 173-174.

Pursuant to the authority granted to him as Receiver, Kelley sought relief under Chapter 11 "to reorganize and/or preserve their operations, sell assets and preserve potential avoidance [actions] and claims." UST App. at 83. At the time of filing the petitions in bankruptcy, the Receiver was: (i) operating the Debtors' businesses, (ii) preserving the Debtors' assets, and (iii) based on the district court's order appointing him as a receiver, purporting to act as a debtor-in-possession under §§ 1107 and 1108 of the Bankruptcy Code. In point of fact, the only entities conducting any business operations at the time of filing were PCI and PGW.[10] UST App. at 80-90.

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[8] *See United States of America v. Thomas Joseph Petters, et al., United States District Court, District of Minnesota*, Criminal No. 08-364. Indictment, A - 293 - 305.

[9] *See United States of America v. Thomas Joseph Petters, et al.*, United States District Court, District of Minnesota, Civil No. 08-5348.

[10] PCI and PGW had a combined 28 employees, while the remaining Debtors' estates had no direct operations, no employees and no direct payroll costs. UST App. at 84-85.

The United States Trustee filed his motion under 11 U.S.C. § 1104(a) seeking the appointment of a chapter 11 trustee. The United States Trustee's motion was premised on two considerations – 1) the Bankruptcy Code did not recognize the authority of a "receiver" continuing on as a debtor in possession and 2) the Debtor entities had no management structure in place to operate the businesses since those individuals had either been indicted and/or plead guilty to certain federal crimes. UST App. 91-111. The bankruptcy court granted the motion and directed the United States Trustee to appoint a trustee or trustees for the debtors' estates. *See* 11 U.S.C. § 1104(d). The United States Trustee appointed Kelley to serve as trustee for the jointly administered estates, Fed. R. Bankr. P. 2009(c)(2), and filed an Application for Order Approving the Appointment of Trustee. Fed. R. Bankr. 2007.1(c).

The bankruptcy court held a hearing on the United States Trustee's Application for Order Approving the Appointment of Trustee. The Petters Committee, the Polaroid Committee[11] and the Lancelot Trustee supported the appointment of Kelley, while Ritchie continued its opposition. UST App. at 33-58.

The bankruptcy court issued its order on February 26, 2009. The court ruled that Kelley could serve as trustee for both the PCI estate and the PGW estate, overruling Ritchie's argument that he could not serve as trustee for both. The bankruptcy court cited Fed. R. Bankr. P. 2009(d), stating that "Ritchie (has) not made a prima facie showing that, at present their interests, or the interests of the creditors of any particular debtor, are actually prejudiced at present by the

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[11] Polaroid Corporation and nine affiliated companies ("Polaroid entities") filed petitions under Chapter 11 of the Bankruptcy Code on December 18, 2008. By order of the bankruptcy court dated December 23, 2008, the Polaroid cases were ordered to be jointly administered bearing Case No. 08-4661, Docket Entry # 21. The United States Trustee appointed the Official Unsecured Creditors' Committee on January 8, 2009, Docket Entry # 44.

existence of conflicts of interest that arise out of the configuration of the Debtors' rights against each other, pre- or post-petition. At this time, there is no 'internal conflict' that prevents Kelley from serving as trustee for all of the Debtors, pursuant to the U.S. Trustee's appointment." Trustee Order, 401 B.R. at 414.

The court also held that Kelley's pre-petition status as the court-appointed receiver for Tom Petters and several of his business entities (including all the Debtors) did not prevent Kelley from serving as a common trustee in these cases. "In sum, Kelley's past status as trustee (sic) does not make him not disinterested so as to bar his appointment as trustee for these cases. Any such status he may technically retain after a full effectuation of his appointment as trustee will not do so either. The 'external conflict' urged by the Ritchie Parties is not a ground for disapproving the United States Trustee's appointment." Trustee Order, 401 B.R. at 410.

SUMMARY OF ARGUMENT

A trustee for multiple estates with claims against one another need not be automatically removed. Removal must be based on some evidence of an actual conflict which prejudices the creditors of one of the estates. Ritchie has failed to meets its burden of establishing that it will suffer actual prejudice if Kelley is allowed to serve as a common trustee.

The selection of a common trustee in these jointly administered cases would be economical, would avoid unnecessary duplication of actions and would provide for an orderly administration of the cases. As the trustee, he acts in a fiduciary capacity and must act in conformity with the mandates of the Bankruptcy Code. His duties are to identify potential assets, prosecute avoidance claims and to monetize the same. Contrary to the assertions of Ritchie, Kelley does not have the power to pursue forfeiture actions, nor is he an "agent" of the federal government in its criminal action against Petters, PCI and PGW.

Ritchie did not appeal from the bankruptcy court's order denying its discovery requests. Accordingly, this Court lacks jurisdiction to consider this argument. Even if the issue was properly preserved, Ritchie still is unable to show that the bankruptcy court abused its discretion in denying its request.

ARGUMENT

THE BANKRUPTCY COURT DID NOT ERR BY APPROVING KELLEY'S APPOINTMENT AS TRUSTEE FOR BOTH PGW & PCI

A. No disqualifying conflict of interest prevents Kelley from serving as a common trustee for these Debtors.

1. Ritchie has not met its burden under Fed. R. Bankr. P. 2009(d).

Ritchie argues that an appointment of a separate trustee for PGW is mandated because of a conflict of interest between PGW and PCI. As the party challenging the appointment of a common trustee in these cases, the burden rests upon Ritchie to establish actual prejudice to them arising from any conflict of interest the common trustee may have *vis a vis* the other jointly administered entities. Fed. R. Bankr. P. 2009 (d) states: "[o]n a showing that creditors . . . of the different estates will be prejudiced by conflicts of interest of a common trustee **who has been . . . appointed**, the court shall order the selection of separate trustees for estates being jointly administered." (emphasis added). Fed. R. Bankr. P. 2009(d). If the appointment is that of a single trustee, a party in interest may challenge such appointment upon a showing of prejudice to creditors arising from conflicts of interest of a common trustee. *Id*. For the following reasons, Ritchie's assertion that Kelley cannot serve as a common trustee for all Debtors falls short of the mark.

Ritchie's sole basis for arguing that prejudice will result if Kelley serves as trustee for both PGW and PCI and its subsidiaries is that claims are likely to exist among those entities.[12] The existence of interdebtor claims is not, however, automatic grounds for removal of a trustee for multiple estates and accordingly does not constitute grounds to mandate the appointment of separate trustees. Removal must be based on evidence of an actual conflict which prejudices the creditors of one of the estates. The court in *In re BH&P, Inc.*, 949 F.2d 1300 (3d Cir. 1991), rejected the notion that a trustee who, in a jointly administered case, asserts a claim on behalf of one estate against another, becomes a "creditor" as defined under 11 U.S.C. § 101(14)(A). The court held that section 101(14) should not be read to disqualify a trustee because of actions taken by the trustee in his representative capacity. Any trustee appointed under 11 U.S.C. § 1104 must be disinterested as defined under section 101(14). The appointment of a separate trustee requires a showing that creditors will suffer actual prejudice by conflicts held by a common trustee. "Before a trustee may be removed, some actual injury must be shown." *Id*. at 1311.

The cases cited by Ritchie contain facts which established an identifiable conflict between two or more entities. Such is not the case here. The interrelatedness of these Debtor entities and affiliates of other Petters entities is obviously complex. "Upon reviewing the

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[12] This position is inconsistent with the one Ritchie took when it sought the appointment of a single receiver for both PGW and PCI in the Circuit Court of Cook County, Illinois. In that proceeding, Ritchie sought the appointment of a "William Procida as Receiver for the Collateral, including PGW and PCI and all its operations, with all of the usual powers of a receiver, . . ." *See Appointed Trustee's Response to Objection to Appointment of Douglas A. Kelley as Trustee for All of the Debtors in these Jointly Administered Proceedings*, UST App. 116-132. The state court granted Ritchie's request and appointed William Procida "Receiver of the Petters Entities," which was defined to include PGW and PCI. *Id.* at 119-120. Ultimately, however, the Illinois state court deferred to this Court's Receivership Order and suspended further proceedings. Trustee Order, 401 B.R. at 398.

schedules, it becomes immediately obvious that the Debtor Entities, along with the dozens of other subsidiary entities of these Debtor Entities, and affiliates of other entities owned by Thomas J. Petters, have accrued inter-company obligations, engaged in extensive transferring of funds between PCI, PGW and subsidiary entities of each, and incurred inter-company obligations on behalf of other entities at hundreds of million dollar levels." *Appointed Trustee's Response to Objection to Appointment of Douglas A. Kelley as Trustee for all of the Debtors in these Jointly Administered Proceedings*, UST App. 125. The response of Kelley outlined his proposed "plan of action" — to recover and liquidate assets, pursue avoidance claims and fraudulent transfers, and then to distribute the proceeds in accordance with the statutory priorities envisioned by the Bankruptcy Code.[13] *Id*. at 127.

The selection of a common trustee in these jointly administered cases will be economical, will avoid unnecessary duplication of actions and will provide for an orderly administration of the cases. "[I]t has long been recognized that joint administration, and the appointment of a common trustee, are favored means to save expense." *In re Ben Franklin Retail Stores, Inc.*, 214 B.R. 852, 858 (Bankr. N.D. Ill. 1997). Appointing a single trustee to investigate and locate all available assets is in the collective best interest of the creditors, and it does not present a conflict of interest. *See In re International Oil Co.*, 427 F.2d 186, 187 (2d Cir. 1970); *In re H&S Transp. Co.*, 55 B.R. 786, 791-92 (Bankr. M.D. Tenn. 1982).

The bankruptcy court recognized these considerations of economy and efficiency in declining to accept Ritchie's argument regarding this so-called "internal conflict." The additional expenditure of time and professional expense weighs heavily against appointing

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[13] All of these functions are contemplated by 11 U.S.C. § 1106(a).

another trustee for PGW. “The Ritchie Parties have not even made a squawk about economy or efficiency supporting or ultimately vindicating the appointment of a second trustee, and there is no credible way they can.” Trustee Order, 401 B.R. at 413.

Based on the foregoing, the bankruptcy court correctly held that Ritchie has not met its burden under Fed. R. Bankr. P. 2009(d). “The structure of Rule 2009(d) imposes a burden of proof on the party that asserts a disqualifying prejudice - both a burden of production of evidence if the existence of the prejudice is fact-dependent, and burden of persuasion if the arguments pro and con are in equipoise. The Ritchie Parties have not carried that burden(.)” Trustee Order at 414.

2. No inherent difference between Ritchie and other creditors, or between PGW and PCI, mandates the appointment of a separate trustee for PGW.

In an effort to support its contention that PGW is “different” and therefore must have a separate trustee, Ritchie seeks to differentiate between “regular creditors” and victims of Petters’ fraud. Ritchie claims “regular creditor” status for itself. Furthermore, it seeks to draw a line between PGW and the remaining Debtor entities, claiming that PGW was a legitimate business enterprise and that PCI and its subsidiaries were engaged in unrelated fraudulent activities. These are distinctions without a difference. Victims of fraud and commercial creditors are treated the same in bankruptcy cases, and whatever relationships existed between PGW and the remaining Debtors, including PCI, will be sorted out during the administration of the bankruptcy cases. In any event, the record does not support Ritchie’s attempted distinctions.

Ritchie’s characterization of its relationship with PGW as being that of a “true creditor” is belied by the underlying documentation (as reflected in Exhibit A to *Debtor's Response to United States Trustee's Motion to Appoint a Chapter 11 Trustee and Motion of the Ritchie Group for Appointment of a Chapter 11 Trustee in the Bankruptcy Case of Petters Worldwide, LLC*). A - 324-326. According to the financial history of the money "loaned" to PGW, the entire $146 million was wired directly by Ritchie into the bank account of PCI at M&I Bank. "This demonstrates how loosely funds were distributed around the various Petters companies, although notably no funds appear to have gone to PGW. Virtually all of these funds went immediately to pay other investors." A - 316. In this sense, Ritchie is most likely not a true creditor as it suggests, but instead another victim of Petters' vast Ponzi scheme. In such cases, appellate courts have consistently determined that innocent victims should share equally in any recovered funds because equity demands equal treatment.[14] *See generally United States Securities and Exchange Commission v. The Infinity Group Company*, 226 Fed. Appx. 217 (3d Cir. 2007) (*per curiam*) (*unpublished*) (collecting cases).

Ritchie also contends that "PCI was the vehicle for the fraud — not PGW." However, the indictment returned by the grand jury charges both entities with a variety of federal offenses. "From at least in or about 1995 and continuing through in or about September 2008, in the State of Minnesota and elsewhere, the defendants, THOMAS JOSEPH PETTERS, PETTERS COMPANY, INC., AND PETTERS GROUP WORLDWIDE, LLC, aided and abetted by persons and affiliated business entities, . . . did knowingly and unlawfully devise and participate in a scheme and artifice to defraud and to obtain billions of dollars in money and

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[14] Ritchie is attempting to bootstrap itself into a better position *vis a vis* other similarly situated parties. Such manipulation to Ritchie's benefit at this early stage of these cases would result in an inequitable and inefficient administration of these bankruptcy estates.

property by means of materially false and fraudulent pretenses, representations, and promises." *Indictment,* ¶ *4,* A - 293-394. In fact, counts 1 through 7 of the indictment charge both PCI and PGW with aiding and abetting mail fraud in violation of 18 U.S.C. Sections 1341 and 2. *Id.* at ¶ 10, A - 297-298. Counts 8 through 10 of the indictment charge both PCI and PGW with aiding and abetting wire fraud in violation of 18 U.S.C. Sections 1343 and 2. *Id.* at ¶ 13, A - 298-299. Count 11 alleges that Thomas Joseph Petters, PCI and PGW "**did knowingly and willfully combine, conspire, and agree with each other and with** . . . **others known and unknown to the Grand Jury**, to commit offenses against the United States, that is, mail fraud and wire fraud as described in Counts 1 through 10 above, in violation of Title 18, United States Code, Sections 1341 and 1343." (emphasis added) *Id.* at ¶ 15, A - 300. Count 12 of the Indictment alleges that Petters individually, along with both PCI and PGW, were involved in a money laundering conspiracy in violation of 18 U.S.C. § 1956(h). *Id.* at ¶20, A - 301-302.

Ritchie's attempt to minimize the role of PGW in the fraudulent scheme stands in stark contrast to the allegations in the indictment. According to the indictment, the actions of PGW and PCI were intertwined in this complex criminal scheme to defraud victims. The Grand Jury found probable cause to believe that both entities were instrumentalities in Petters' criminal enterprise.

B. Kelley's pre-petition status as court-appointed Receiver for the Debtor entities did not disqualify him from serving as trustee for PGW.

As the trustee for these bankruptcy cases, Kelley is obligated to follow the mandates of Title 11 of the United States Code. The district court who appointed him receiver recognized this requirement when it amended the Receivership Order to require "(a)ny bankruptcy cases . . . shall during their pendency be governed by and administered pursuant to the requirements of the

United States Bankruptcy Code, 11 U.S.C. section 101 *et seq.*, and the applicable Federal Rules of Bankruptcy Procedure." *Second Amended Order for Entry of Preliminary Injunction, Appointment of Receiver, and other Equitable Relief,*[15] *, Section IV,* ¶ *B. 2. c*, UST App. 73. The bankruptcy court's order also recognizes this obligation: ". . . Kelley has committed to proceeding with the administration of the estates in these cases in accordance with the values and priorities of bankruptcy law. Kelley acknowledges that this will entail maximizing the value of all assets collected, and then distributing them to the holders of all allowed claims against the Debtors, pursuant to statutory priorities and *pro rata* if necessary, all as the Bankruptcy Code envisions." Trustee Order, 401 B.R. at 409. (footnote omitted). In no event, however, would Kelley's obligations as trustee of these bankruptcy estates be materially adverse to his obligations as receiver in the district court.

In short, Kelley as trustee is duty-bound to administer these estates according to the dictates of the Bankruptcy Code. He is no longer a "receiver" and, contrary to the assertion of Ritchie, is not placed "in the untenable position of having to advance the interests of two distinct groups seeking recovery from the same assets."[16] Kelley is not a "receiver" over these

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[15] Docket Entry # 127, Civ. No. 08-5348, *United States of America v. Thomas Joseph Petters, et al.*, United States District Court, District of Minnesota ("Receivership Order"). UST App. 59-79.

[16] Ritchie's objection also misapprehends Kelley's role as receiver in the district court action, suggesting that he owes a fiduciary duty to the victims of Petters' fraud and serving as "an agent for the Government." In this regard, it is incorrect — "a receiver is the agent only of the court appointing him; he represents the court rather than the parties. He is the custodian of property which is under the control of the court." *Ledbetter v. Farmers Bank & Trust Co.*, 142 F.2d 147, 150 (4th Cir. 1944). *Greenleaf Apartments, Ltd. v. Soltesz (In re Greenleaf Apartments, Ltd.)*, 158 B.R. 456, 459 (Bankr. S.D. Ohio 1993) ("[A] receiver is a court appointed officer who is controlled exclusively by the court . . . [H]e is not to be regarded as an agent or representative of either party to an action.") (citations omitted).

bankruptcy cases or their respective estates.

Ritchie's objection to the appointment of Kelley as trustee for all of these Debtor entities totally misstates his role. The entire premise for the United States Trustee's motion for the appointment of a chapter 11 trustee in these cases centered on the inherent tension between the traditional duties of a court-appointed equity receiver and a trustee (or debtor-in-possession) in bankruptcy. As was explained in his motion seeking the appointment of a trustee, a bankruptcy court cannot order the appointment of a receiver under the Bankruptcy Code. "A court may not appoint a receiver under . . . title [11]." *11 U.S.C. § 105(b).* Although it may be conceded that Kelley, as receiver under the District Court's order, had the authority to file the petitions initiating these bankruptcy cases, once they were filed, the United States Trustee contends that his authority as receiver terminated by operation of law. Although the bankruptcy court did not wholly adopt the United States Trustee's position that Kelley's role as receiver terminated by *operation of law*, it recognized the effect of the District Court's receivership order "that these Chapter 11 cases will go ahead fully governed by the substantive law of bankruptcy." Trustee Order, 401 B.R. at 408. The bankruptcy court, citing the mandates of 11 U.S.C. § 543(b)(2),[17] ordered the turnover of all property Kelley had as receiver to himself as chapter 11 trustee. Trustee Order, 401 B.R. at 408-409.

The mandate of the Receivership Order[18] that Kelley "(c)oordinate with representatives

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[17] 11 U.S.C. § 543(b)(1) provides: "A custodian shall — deliver to the trustee any property of the debtor held by or transferred to such custodian, or proceeds, product, offspring, rents or profits of such property that is in such custodian's possession, custody, or control on the date that such custodian acquires knowledge of the commencement of the case(.)"

[18] *Section IV, ¶ 6*, UST App. 74-75.

of the United States Attorney's office and Court personnel as needed to ensure that any assets subject to the terms of this Order are available for criminal restitution, forfeiture, or other legal remedies . . ." does not create any materially adverse conflicts *vis a vis* Kelley's obligations to these bankruptcy estates. The mere allegation of forfeiture in the indictment against Petters, PCI and PGW does not mandate the appointment of a separate trustee for PGW. Kelley, in his role as Receiver, is not empowered to pursue restitution or forfeiture. The power to prosecute any forfeiture against any asset rests exclusively with the United States Attorney.[19] Contrary to the assertion of Ritchie, Kelley is not "an agent for the Government." "The notion of having the assets in Kelley's hands 'available for criminal restitution, forfeiture,' and the like signifies a duty to fully disclose their form and whereabouts and to maintain transparency that our legal system makes incumbent on any entrusted officer of a court, in the performance of obligations **to the appointing court**. It reflects no more than that." Trustee Order, 401 B.R. at 407. (emphasis in original).

Kelley's status as Receiver of any Petters entities does not conflict with his status as trustee of these Debtor entities. His fiduciary duties are mandated by Title 11 of the United States Code. In this regard, Kelley must collect and preserve all available assets, and make them available for distribution to the creditors of these estates according to the priorities set forth under the Bankruptcy Code. Kelley is powerless to determine what assets, if any, may be subject to forfeiture and/or restitution. Those decisions are left to the discretion of the United States Attorney and the district court. Accordingly, his current or former status as a receiver does not

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[19] The statutory authority of the United States Attorney to seek forfeiture of assets does not *ipso facto* make the United States a creditor in these bankruptcy cases.

disqualify him from serving as trustee in these cases.

C. The bankruptcy court's denial of Ritchie's request for expedited discovery is not properly before this Court on appeal, because Ritchie did not appeal the bankruptcy court's order of January 23, 2009.

Prior to the hearing on the United States Trustee's appointment of Kelley as trustee, Ritchie sought to compel discovery from him. The bankruptcy court conducted a hearing on Ritchie's requests on January 22, 2009. Kelley and the United States Trustee resisted such efforts. The bankruptcy court concluded that "there (wasn't) any basis for the discovery in the first instance here. So I'm certainly not going to either order the expediting of the responses nor am I going to delay the hearing. I'm going to address the issues as have been framed . . . next Tuesday for the formal hearing addressing these questions as matters of law." UST App. 30. The court entered its order denying Ritchie's request and further quashed all such discovery requests. UST App. 149-150.

Ritchie has not appealed the bankruptcy court's order denying its discovery requests. The only order Ritchie has appealed is the bankruptcy court's order entered February 26, 2009. Docket Entry # 1. As such, this Court does not have jurisdiction to entertain Ritchie's claim of error. *Powers v. Mesaba Aviation, Inc., d/b/a Mesaba Airlines*, ___ F.Supp.2d ___, 2007 WL 2261690 (D. Minn. Aug. 3, 2007) ("Under Rule 8002(a), a notice of appeal must be filed 'within 10 days of the date of the entry of the judgment, order, or decree appealed from.'") (citation omitted); *Accord*, *Veltman v. Whetzal*, 93 F.3d 517, 520 (8th Cir. 1996) (failure to timely file a notice of appeal "deprives the district court of jurisdiction to review that [appealed-from] order"), *affirming Veltman v. Whetzal*, 192 B.R. 201 (D.S.D. 1996) .

Even if Ritchie argues that the discovery issue is part and parcel of the bankruptcy court's order approving Kelley's appointment as trustee, Ritchie must show an abuse of discretion. Such matters are soundly left to the discretion of the court. *Pleasants v. Am Express Co.*, 541 F.3d 853, 859 (8th Cir. 2008) ("We review the district court's order for an abuse of discretion, allowing the court 'great latitude' in discovery matters") (citing *Executive Air Taxi Corp. v. City of Bismarck*, 518 F.3d 562, 570 (8th Cir. 2008)). *See also, Miscellaneous Docket Matter #1 v. Miscellaneous Docket Matter #2*, 197 F.3d 922, 925 (8th Cir. 1999) (abuse of discretion standard applies in discovery matters in proceeding ancillary to principal action). The bankruptcy court correctly concluded that disposition of the matter of approving Kelley's appointment as common trustee could be determined as a matter of law. Accordingly, Ritchie's claim of error concerning its discovery requests falls short.

[End of Document]

CONCLUSION

For these reasons, the United States Trustee hereby respectfully requests this Court affirm the bankruptcy court's order overruling Ritchie's objection to Kelley's appointment as trustee for these jointly administered chapter 11 cases and approving his appointment.

Respectfully submitted,

Dated: May 20, 2009

HABBO G. FOKKENA
United States Trustee
Region 12

Of Counsel:

RAMONA D. ELLIOTT
General Counsel
P. MATTHEW SUTKO
Associate General Counsel
WALTER W. THEUS, JR.
Executive Office for
United States Trustees
Department of Justice
20 Massachusetts Ave., N.W.
Washington, DC 20530
TELE: (202) 307-1399

By: /e/ Michael E. Ridgway
Michael E. Ridgway
Trial Attorney, SD Atty. No. 1456
Robert B. Raschke
Assistant U.S. Trustee, MN 161081
Department of Justice
Office of the U.S. Trustee
U.S. Courthouse, Suite 1015
300 South Fourth Street
Minneapolis, MN 55415
TELE: (612) 664-5500
FACS: (612) 664-551

IN THE UNITED STATES DISTRICT COURT
DISTRICT OF MINNESOTA
09-680

RITCHIE SPECIAL INVESTMENTS, LTD., ET AL.,

Appellants,
v.

UNITED STATES TRUSTEE, ET AL.,

Appellees.

ON APPEAL FROM THE UNITED STATES BANKRUPTCY COURT FOR THE DISTRICT OF MINNESOTA, BANKRUPTCY COURT FILE NO. 08-45257
HONORABLE GREGORY F. KISHEL

UNSWORN CERTIFICATE OF SERVICE

I, Audrey Williams, declare under penalty of perjury that on May 20, 2009, I served copies of the Brief of Appellee United States Trustee, United States Trustee's Appendix and Certificate of Compliance with Local Rule 7.1, electronically by Notice of Electronic Filing, and upon all parties who have requested service in these cases by filing the same via ECF with the United States District Court, District of Minnesota, and/or upon the following by first class mail postage pre-paid:

Ronald R. Peterson, Esq.
Jenner & Blck, LLP
330 North Wabash Avenue
Chicago, IL 60611-4603

David E. Runck
Fafinski, Mark & Johnson, PA
Eden Prairie, MN 55344

Richard A. Chesley
Paul, Hastings, Janofsky & Walker LLP
191 North Wacker Drive, 30th Floor
Chicago, IL 60606

Executed on: May 20, 2009

/e/Audrey Williams
Audrey Williams
Office of the United States Trustee

BRIEF BANK — "SUMMARY SHEET" *Printed Wed-2/3/10 17:4*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*

Ritchie Special Credit Investments, LTD., Rhone Holdings II, LTD., Ritchie Capital Structure Arbitrage Trading, LTD., Yorkville Investment I, L.L.C., and Ritchie Capital Management, L.L.C.,

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*

8th Cir.

3. ("CCN") ***CURRENT*** CASE NO.

No.: 09-3271

4. ("PCN") ***PRIOR*** CASE NO. - & COURT *[IF ANY]*

No.: 09-cv-00680-AMD

Court: D. Minn.

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U.S. TRUSTEES

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Michael E. Ridgway, Robert B. Raschke, Anne Stuke, P. Matthew Sutko, Ramona D. Elliott, Habbo G. Fokkena

(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***

BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***

• Did the bankruptcy court abuse its discretion in approving the appointment of a receiver as chapter 11 trustee for ten debtors, despite alleged conflicts of interest?

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10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)

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NAME: Linda Figueroa

DATE:

Appeal No. 09-3271

UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

RITCHIE SPECIAL CREDIT INVESTMENTS, LTD.,
RHONE HOLDINGS II, LTD., RITCHIE CAPITAL
STRUCTURE ARBITRAGE TRADING, LTD.,
YORKVILLE INVESTMENT I, L.L.C., and
RITCHIE CAPITAL MANAGEMENT, L.L.C.,

Appellants,

v.

UNITED STATES TRUSTEE and
OFFICIAL COMMITTEE OF UNSECURED CREDITORS,

Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MINNESOTA
Honorable Ann D. Montgomery, United States District Judge

BRIEF OF APPELLEE UNITED STATES TRUSTEE

Ramona D. Elliott
General Counsel

P. Matthew Sutko
Associate General Counsel

Anne W. Stukes
United States Department of Justice
Executive Office for United States Trustees
20 Massachusetts Avenue, NW
Washington, D.C. 20530
(202) 307-1399

Habbo G. Fokkena
United States Trustee

Michael E. Ridgway
Robert B. Raschke
United States Department of Justice
Office of the United States Trustee
300 South Fourth Street, Suite 1015
Minneapolis, MN 55415
(612) 664-5500

Attorneys for Appellee United States Trustee

SUMMARY OF THE CASE AND REQUEST FOR ORAL ARGUMENT

This appeal concerns the appointment of a chapter 11 trustee in ten jointly administered chapter 11 cases.[1] The United States Trustee sought the appointment.[2] He did that because pre-petition management had been replaced by a district court-appointed equity receiver who then filed chapter 11 petitions on behalf of the Petters debtors. Under 11 U.S.C. § 543, the receiver as a custodian was obligated to turn property of the estate over to a trustee or debtor in possession. Because old management was not qualified to serve as fiduciaries, the appointment of a trustee was necessary to assure that the debtors' estates were administered in conformity with the Bankruptcy Code.

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[1] They are: (1) Petters Company, Inc. (Case No. 08-45257); (2) Petters Group Worldwide (Case No. 08-45258); (3) PC Funding, LLC (Case No. 08-45326); (4) Thousand Lakes, LLC (Case No. 08-45327); (5) SPF Funding, LLC (Case No. 08-45328); (6) PL Ltd., Inc. (Case No. 08-45329); (7) Edge One LLC (Case No. 08-45330); (8) MGC Finance, Inc. (Case No. 08-45331); (9) PAC Funding, LLC (Case No. 08-45371); and (10) Palm Beach Finance Holdings, Inc. (Case No. 08-45392) (collectively, the "Petters debtors").

[2] United States Trustees are Department of Justice Officials appointed by the Attorney General to supervise the administration of chapter 11 bankruptcy cases. *See* 28 U.S.C. § 581-589(a). *See also* H.R. Rep. No. 95-595, at 88 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6049 (United States Trustees "serve as bankruptcy watch-dogs to prevent fraud, dishonesty, and overreaching in the bankruptcy arena.") Their express statutory powers include authorization to move for the appointment of a trustee, 11 U.S.C. § 1104(a), and the naming of a trustee if the court orders a trustee's appointment, 11 U.S.C. § 1104(d).

While the United States Trustee sought the appointment of a single trustee for all of the Petters debtors, the Appellants, collectively referred to herein as "Ritchie,"[3] sought the appointment of a separate trustee for one of the debtors, Petters Group Worldwide ("PGW"), because they have claimed that PGW is indebted to them for more than $200 million. After adjudicating that request, the bankruptcy court ruled that the United States Trustee was allowed to appoint one trustee for all of the Petters entities.

The United States Trustee then appointed Douglas A. Kelley ("Kelley") to serve as trustee for all of the Petters debtors, and the bankruptcy court approved the appointment, overruling Ritchie's subsequent objections to the common appointment of Kelley as chapter 11 trustee for the Petters debtors. *See Petters Co., Inc.*, 401 B.R. 391 (Bankr. D. Minn. 2009). Jt. App. 151-167.

Ritchie then appealed the bankruptcy court's order to the district court, which affirmed.[4] *Ritchie Special Credit Investments, Ltd. v. U. S. Trustee*, 415 B.R. 391 (D. Minn. 2009). The district court agreed with the bankruptcy court's

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[3] The appellants are: Ritchie Special Credit Investments, Ltd., Rhone Holdings II, Ltd., Yorkville Investments I, L.L.C., Ritchie Capital Structure Arbitrage Trading, Ltd., and Ritchie Capital Management, L.L.C. (collectively "Ritchie").

[4] Ritchie's appeal did not question the necessity for a trustee, but only whether the appointment of a common trustee was appropriate.

analysis on each primary issue presented on appeal. The district court found no justification for multiple trustees, and concluded that the appointment of a single trustee for all of the Petters debtors resulted in an economical, cost-efficient, and orderly administration of those estates. The district court also found that no materially adverse interest precluded Kelley's dual status as pre-petition receiver and bankruptcy trustee.

The United States Trustee requests oral argument in this case.

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STATEMENT OF JURISDICTION

The bankruptcy court had jurisdiction to decide the trustee-related disputes involved in this appeal under 11 U.S.C. § 157(d). On March 9, 2009, Ritchie filed a notice of appeal from the bankruptcy court's February 26, 2009 trustee order. It was timely under 11 U.S.C. § 158(c)(2) and FED. R. BANKR. P. 8002(a). The district court had jurisdiction under 28 U.S.C. § 158(a)(1) or (2). On September 23, 2009, Ritchie timely filed its notice of appeal from the district court's September 9, 2009 order affirming the bankruptcy court. FED. R. APP. P. 4(a)(1)(B). This Court has jurisdiction under 28 U.S.C. §§ 158(d)(1) and 1291 (authorizing appeals from district courts to circuit courts).

On October 14, 2009, a fellow appellee, the official committee of unsecured creditors, filed a motion to dismiss this appeal for lack of jurisdiction on the ground that the bankruptcy court's order was interlocutory. On November 9, 2009, this Court denied the motion to dismiss in a summary order in which it adopted the reasoning of *In re Marvel Entertainment Group, Inc.*, 140 F.3d 463, 470-471 (3d Cir. 1998).

STATEMENT OF THE ISSUES

I.

I. Did the bankruptcy court abuse its discretion in approving Kelley's appointment as chapter 11 trustee for Petters Group Worldwide ("PGW") and the other nine Petters debtors?
Most apposite cases and/or statutory provisions:

- 11 U.S.C. § 1104(a)

- 11 U.S.C. § 101(14)(C)

- *In re BH&P, Inc.*, 949 F.2d 1300 (3d Cir. 1991)

II. Did the bankruptcy court abuse its discretion in denying Ritchie's motion for expedited discovery?
Most apposite cases and/or statutory provisions:

- *Pleasants v. Am. Express Co.*, 541 F.3d 853 (8th Cir. 2008)

STATEMENT OF THE CASE

The petitions commencing the chapter 11 cases of Petters Company, Inc. ("PCI") and Petters Group Worldwide, LLC ("PGW") were filed on October 11, 2008.[5] Jt. App. 50. Within one week following, the petitions commencing the chapter 11 cases of the other eight Petters debtors were filed. *Id.* All the cases were filed by Douglas A. Kelley in his capacity as the federal court-appointed receiver of these entities. App. A47, A346. An order for joint administration of the above-entitled cases was entered on October 22, 2008. Jt. App. 103-104. The joint administration order meant that the procedural aspects of the debtors' cases would be treated as though there was one debtor. *See* FED. R. BANKR. P. 1015(b).

Shortly after the cases were filed, the United States Trustee filed his motion under 11 U.S.C. § 1104(a) seeking an order directing the appointment of a chapter 11 trustee. Jt. App. 105-129. Ritchie filed its own motion requesting the appointment of two trustees: one for PGW (the debtor against whom the Ritchie creditors had claims), and one for the other nine debtors — although at times Ritchie has cast its argument as seeking one trustee for PGW and one for PCI,

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[5] References to the record as contained in the respective appendices will made as follows: Ritchie's appendix - "App." followed by the appropriate page number; the joint appendix of the official committee of unsecured creditors of the Petters debtors and the United States Trustee - "Jt. App." followed by the appropriate page number.

which owns and controls all of the debtors aside from PGW. App. A8-A9, A12-A22, A51-A52.

After conducting a hearing, the court granted the United States Trustee's motion. App. A1-A64. It also granted Ritchie's motion, but only "to the extent of ordering the United States Trustee to appoint [one] trustee or [multiple] trustees for these cases, one or more in number as the United States Trustee's judgment dictated." App. A65-A66. The court found "the issue of whether a trustee should be appointed for debtor Petters Group Worldwide, LLC, with a different person or persons to be appointed as trustee(s) for the other debtors, was not ripe until the United States Trustee had first exercised his [statutory] authority under 11 U.S.C. § 1104(a), as to all of the debtors" "to name a specific person, or persons, as trustee." *Id.*; 11 U.S.C. § 1104(a).

Subsequently, the United States Trustee, acting under the authority of 11 U.S.C. § 1104(d) and FED. R. BANKR. P. 2009(c)(2), appointed Douglas A. Kelley ("Kelley") as chapter 11 trustee for all ten Petters debtors. Jt. App. 151-167. He next filed an application under FED. R. BANKR. P. 2007.1(c) seeking approval of that appointment with the bankruptcy court. *Id*.

Ritchie timely filed its objections[6] to the United States Trustee's appointment of Kelley as a trustee for all ten debtors; it alleged disqualifying conflicts of interest arising from Kelley's status as pre-petition receiver for the ten Petters entities as well as conflicts of interest arising from Kelley's role as trustee for both PCI and PGW. App. A67-A83. Ritchie contended that Kelley could serve as trustee for nine of the debtors, but a different trustee needed to be appointed to serve for PGW. Jt. App. 317-318. Ritchie also sought to conduct expedited discovery into certain of Kelley's actions. *Id.* at 209-221. Kelley opposed Ritchie's request for discovery. *Id.* at 221-229. A hearing was held regarding Ritchie's motion to compel discovery. *Id.* at 207-259. The bankruptcy court denied Ritchie's request and quashed all such discovery attempts. *Id.* at 260-261.

The bankruptcy court next held a hearing on the United States Trustee's Rule 2007.1(c) application seeking approval of Kelley's appointment. *Id.* at 278-388. The Official Committee of Unsecured Creditors for the Petters debtors, who represented the creditor body,[7] appeared in support of the United States Trustee's

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[6] The bankruptcy court set deadlines regarding the appointment process. App. A65- 66.

[7] 11 U.S.C. § 1103(c)(5) (committees provide "services . . . in the interest of those represented").

appointment. *Id.* at 335-345. Ritchie was the sole party to oppose the motion.[8] *Id.* at 285-318. Ritchie expressed its desire to have a separate trustee appointed for PGW, but indicated it had no objection if Kelley remained in place as trustee for PCI and the other eight Petters debtors. *In re Petters Co., Inc.,* 401 B.R. at 403, Jt. App. 312, 318. At the hearing the bankruptcy court allowed the parties time to present their arguments regarding their respective positions. *Id.* at 278-388.

The bankruptcy court issued a memorandum opinion approving the appointment of Kelley as common trustee for all of the debtor entities. App. A344-A378. The bankruptcy court held that there was no actual conflict of interest created by Kelley's pre-petition role as federal equity receiver and his role as bankruptcy trustee. *In re Petters Co., Inc.,* 401 B.R. at 410. The court also held that under the present circumstances, there was no actual conflict of interest which precluded Kelley from serving as trustee for both PCI and PGW. But the court also left open the possibility for Ritchie (or any party in interest) to come forward at some future point to establish an actual conflict had ripened. *Id.* at 414.

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[8] In a colloquy with the bankruptcy court, Ritchie"backed off" its initial request to disqualify Kelley as trustee for all the debtor entities, stating its "primary objective is to have a separate trustee appointed for PGW" and leaving Kelley in place for the other nine debtor entities. *In re Petters Co., Inc.,* 401 B.R. at 403; Jt. App. 317-318. This position is consistent with Ritchie's prayer for relief "the Trustee Order should be reversed, and a new trustee should be appointed for PGW." Ritchie Brief at 47.

Pursuant to the court's order, Kelley filed his acceptance of appointment as chapter 11 trustee and in the same pleading attached his turnover of assets. Jt. App. 401-405.

STATEMENT OF THE FACTS

PCI and PGW[9] are both privately held limited liability companies owned 100% by Thomas J. Petters ("Petters"). Jt. App. 51, 171. PGW has investments in companies across the globe; however, its principal asset was 100% ownership of the stock of Polaroid Corporation. *Id.* PCI was the venture capital arm of the Petters enterprises. *Id.* PCI owns 100% of the membership interests of eight out of the ten Petters debtors.[10] *Id.* It utilized single purpose entities to obtain billions of dollars of funding, purportedly to acquire merchandise for sale to wholesalers and retailers nationwide. *Id.*

On October 3, 2008, prior to the bankruptcy filings, Mr. Petters was arrested on federal charges of mail and wire fraud, money laundering, and conspiracy as a result of a federal criminal investigation into a Ponzi scheme. Jt. App. 1-8, 51, 172. On December 1, 2008, a federal grand jury returned a 20-count indictment against Petters, PCI and PGW.[11] App. A293-305. Other Petters executives

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[9] PCI was formed in Minnesota and PGW was formed in Delaware, although both companies operate from the same location in Minnetonka, Minnesota. Jt. App. 51, 171.

[10] They are: PC Funding, Thousand Lakes, SPF Funding, PL Ltd., Edge One, MGC Finance, PAC Funding and Palm Beach Holdings. Jt. App. 51, 171.

[11] *See United States of America v. Thomas Joseph Petters, et al., United States District Court, District of Minnesota,* Criminal No. 08-364. Indictment, App. A293 - A305.

implicated in this Ponzi scheme were also charged and have since pled guilty to certain crimes.[12] According to the government, more than 20 lenders and investors were defrauded out of more than $3.65 billion as a result of this alleged scheme. Jt. App. 9-16. On December 2, 2009, a federal jury convicted Mr. Petters of all counts of the superseding indictment. Jt. App. 502-508. PCI and PGW have yet to plead or be tried.

The United States Attorney for the District of Minnesota also initiated a civil action under the Anti-Fraud Injunction Statute, 18 U.S.C. § 1345, in which he sought the appointment of a receiver to take control over all the assets of Petters and all his related businesses. *Id.* at 9-16. The district court named Douglas A. Kelley, Esq. (the "Receiver") to serve as a federal receiver for PCI, PGW and all of their affiliates and subsidiaries except for MN Airlines, LLC dba Sun Country Airlines.[13] *Id.* at 17-31.

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[12] *See United States of America v. Deanna Lynn Coleman, United States District Court, District of Minnesota,* Criminal No. 08-304; *United States of America v. Robert Dean White, United States District Court, District of Minnesota,* Criminal No. 08-299; *United States of America v. Michael Alan Catain, United States District Court, District of Minnesota,* Criminal No. 08-302; and *United States of America v. Larry Reynolds, United States District Court, District of Minnesota,* Criminal No. 08-320.

[13] *See United States of America v. Thomas Joseph Petters, et al.,* United States District Court, District of Minnesota, Civil No. 08-5348.

The Receiver is a well-known and reputable attorney in the Twins Cities area. *Id.* at 153. None of the parties to these proceedings disputes Kelley's professional qualifications to serve. In fact, counsel for Ritchie noted for the record "that we are not in this proceeding attacking Mr. Kelley personally or professionally." *Id.* at 286.

From October 11, 2008 to October 19, 2008, the Receiver filed bankruptcy petitions for the various debtors. *Id.* at 50. Pursuant to the authority granted to him as Receiver, Kelley sought relief under chapter 11 "to reorganize and/or preserve their operations, sell assets and preserve potential avoidance [actions] and claims." *Id.* at 52. The bankruptcy court ordered these cases to be jointly administered. *Id.* at 103-104. At the time of filing the petitions in bankruptcy, the Receiver was preserving the debtors' assets and, based on the district court's order appointing him as a receiver, purporting to act as a debtor-in-possession under sections 1107 and 1108 of the Bankruptcy Code. *In re Petters Co., Inc.,* 401 B.R. at 400.

The only entities conducting any business operations at the time of filing were PCI and PGW.[14] Jt. App. 49-82. After the filing, only PGW continued to employ

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[14] PCI and PGW had a combined 28 employees, while the remaining debtors' estates had no direct operations, no employees and no direct payroll costs. Jt. App. at 53-54.

people.[15] "Except for PGW, PCI and the remaining Debtors' operations will be, for the most part, limited to reconstructing accounting records and analyzing and pursuing potential claims. PGW will conduct these activities as well, but will also be involved in the ongoing management, operations and sales (as the case may be) of its subsidiaries and their respective assets." Jt. App. 429-430.

Shortly after the bankruptcy cases were filed, the United States Trustee filed his motion under 11 U.S.C. § 1104(a) seeking the appointment of a chapter 11 trustee. *Id.* at 105-129. The United States Trustee's motion was premised on two considerations – 1) the Bankruptcy Code did not recognize the authority of a "receiver" continuing on as a debtor in possession and 2) the debtor entities had no management structure in place to operate the businesses since those individuals had either been indicted and/or plead guilty to certain federal crimes. *Id.* The bankruptcy court granted the motion and directed the United States Trustee to appoint a trustee or trustees for the debtors' estates. *See* 11 U.S.C. § 1104(d). App. A65-A66. The United States Trustee appointed Kelley to serve as trustee for the jointly administered estates, FED. R. BANKR. P. 2009(c)(2), and filed, under

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[15] According to Kelley, as of April 20, 2009, PGW employed 11 people. Jt. App. 414.

FED. R. BANKR. P. 2007.1(c), an Application for Order Approving the Appointment of Trustee. Jt. App. 151-167.

The bankruptcy court held a hearing on the United States Trustee's application for order approving the appointment of Kelley as trustee. *Id.* at 278-388. The Petters debtors' committee, the official committee of unsecured creditors for Polaroid Corporation[16] and the chapter 7 trustee for Lancelot Investors Fund, LP[17] supported the appointment of Kelley. *Id.* Only the Ritchie entities — who have filed four proofs of claim against PGW totaling $209,400,314.20 — opposed Kelley's appointment. *Id.*; *see* Jt. App. 441, 552-553 (claim nos. 31-34).

In its order rejecting Ritchie's objections, the bankruptcy court observed that ". . . the Ritchie Parties do not come forward as neutral, distanced friends of the abstract value of integrity in the administration of bankruptcy estates, as their rhetorical rectitude would suggest. Rather, they project a powerful self-interest onto the strategic plane." *In re Petters Co., Inc.,* 401 B.R. at 401. Ritchie sought

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[16] Polaroid Corporation and nine affiliated companies ("Polaroid entities") filed petitions under chapter 11 of the Bankruptcy Code on December 18, 2008. By order of the bankruptcy court dated December 23, 2008, the Polaroid cases were ordered to be jointly administered bearing Case No. 08-46617.

[17] Lancelot is the collective name given to a group of Chicago-based hedge funds which filed for chapter 7 relief in the Northern District of Illinois. Lancelot claims a loss in excess of $1.3 billion and is the largest unsecured creditor of the Petters debtors. Jt. App. 364, 517-519 (claim nos. 28-33).

a separate trustee for PGW to resist substantive consolidation of the estates, piercing of the corporate veil, or any other theoretical attempt at a future date to reduce the distribution of assets from the estate of PGW on its $209 million claims. App. A67-A83; Jt. App. 285-318, 371-380.

In ruling that Kelley could serve as trustee for both the PCI estate and the PGW estate, the bankruptcy court relied on FED. R. BANKR. P. 2009(d)[18] and found that "Ritchie (has) not made a prima facie showing that, at present their interests, or the interests of the creditors of any particular debtor, are actually prejudiced at present by the existence of conflicts of interest that arise out of the configuration of the debtors' rights against each other, pre- or post-petition. At this time, there is no 'internal conflict' that prevents Kelley from serving as trustee for all of the debtors, pursuant to the U.S. Trustee's appointment." *In re Petters Co., Inc.*, 401 B.R. at 414. The bankruptcy court noted, however, that a showing of prejudice need not

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[18] Rule 2009(d) applies when a trustee is alleged to have conflicts arising from jointly administered estates. It provides:

> (d) Potential conflicts of interest.
> On a showing that creditors or equity security holders of the different estates will be prejudiced by conflicts of interest of a common trustee who has been elected or appointed, the court shall order the selection of separate trustees for estates being jointly administered.

FED. R. BANKR. P. 2009(d).

“be made once and for always”, leaving the opportunity open for any party in interest to come back for a judicial determination of such prejudice. *Id.*

The court also held that Kelley’s pre-petition status as the court-appointed receiver for Tom Petters and several of his business entities (including all the debtors) did not prevent Kelley from serving as a common trustee in these cases. “In sum, Kelley’s past status as trustee [sic] does not make him not disinterested so as to bar his appointment as trustee for these cases. Any such status he may technically retain after a full effectuation of his appointment as trustee will not do so either. The ‘external conflict’ urged by the Ritchie Parties is not a ground for disapproving the United States Trustee’s appointment.” *In re Petters Co., Inc.*, 401 B.R. at 410.

Ritchie timely appealed the bankruptcy court’s order to the United States District Court, District of Minnesota. On appeal, the district court affirmed the bankruptcy court’s exercise of discretion. In ruling, the district court found no justification for multiple trustees, and concluded that appointment of a single trustee for all of the Petters debtors resulted, at present, in an economical, cost-efficient, and orderly administration of those estates. *Ritchie*, 415 B.R. at 400-401. The district court also found that Kelley was not precluded from serving. Ritchie had alleged that Kelley could not serve as trustee because he had a materially adverse interest arising from his dual status as pre-petition receiver and bankruptcy trustee. The district court disagreed. *Id.* at 399-400. Thus, the district court agreed with the bankruptcy court's analysis on each primary issue on appeal. This appeal followed.

STANDARD OF REVIEW

"On appeal from a district court's review of a bankruptcy proceeding, [this Court] sit[s] as a second court of review, reviewing the bankruptcy court's conclusions of law de novo and any factual findings for clear error." *Wells Fargo Home Mortgage, Inc. v. Lindquist,* No. 08-3442, 2010 WL 58946, at *2 (8th Cir. Jan. 11, 2010) (citations omitted). *See also In re Loop Corp.*, 379 F.3d 511, 515 (8th Cir. 2004), *cert. denied* 543 U.S. 1055 (2005) (the bankruptcy court's factual findings are reviewed for clear error and its conclusions of law *de novo*).

Matters pertaining to the appointment or removal of a trustee are within the bankruptcy court's discretion. *Contractors, Laborers, Teamsters & Eng'rs Health & Welfare Plan v. M & S Grading, Inc. (In re M & S Grading, Inc. II),* 541 F.3d 859, 867 (8th Cir. 2008) (finding that the bankruptcy court did not abuse its discretion by denying the motion to remove a trustee without a hearing). *See also In re Farmland Indus., Inc.*, 397 F.3d 647, 651 (8th Cir. 2005) ("The bankruptcy court abuses its discretion when it fails to apply the proper legal standard or bases its order on findings of fact that are clearly erroneous."); *Kim v. Cox,* 130 F.2d 721, 733 (8th Cir. 1942) (abuse of discretion standard applied in reviewing bankruptcy court's appointment or removal of trustee) (decided under Bankruptcy Act of 1898).

As indicated in the Trustee Order, most of the findings of fact were based on various state and federal court proceedings involving many of the same parties, and so are not in dispute. *In re Petters Co., Inc.*, 401 B.R. at 395, n. 6.

SUMMARY OF THE ARGUMENT

No party in this case opposed the appointment of a trustee for the ten Petters debtors. Only one party, Ritchie, believed two trustees were necessary. It unsuccessfully sought one trustee for nine related debtors, and a different trustee for the tenth — PGW. Under the law, a single trustee can represent multiple estates unless the bankruptcy court finds, based on the evidence before it, that an actual conflict prejudices one of the estates. The bankruptcy court did not commit clear error in finding Ritchie's assertions failed to demonstrate that multiple trustees must be appointed here.

First, the bankruptcy court did not commit clear error in finding the selection of a common trustee in these jointly administered cases presented no actual conflict and would be economical, would avoid unnecessary duplication of actions and would provide for an orderly administration of the cases. A trustee acts in conformity with the mandates of the Bankruptcy Code. His duties are to identify potential assets, prosecute avoidance claims and to monetize the same. Contrary to the assertions of Ritchie, Kelley does not have the power to pursue forfeiture actions, nor is he aligned with or biased in favor of the federal government in its criminal action against Petters, PCI and PGW.

Second, the district court did not commit clear error in finding that the facts surrounding Kelley's status as pre-petition receiver for the Petters debtors did not create an actual conflict with his proposed status as chapter 11 trustee of those entities. Therefore, the court did not err in finding Kelley was a "disinterested person"as that term is defined under the provisions of 11 U.S.C. § 101(14).

Third, the absence of reversible error in the bankruptcy court's findings is underscored by the court's statement that any party in interest could raise an objection to the trustee's appointment if an actual conflict ever arises in the future.

Finally, Ritchie is unable to show that the bankruptcy court abused its discretion in denying its discovery requests. There was no error in the district court's determination that the bankruptcy court did not abuse its discretion in denying Ritchie's discovery request as overbroad and irrelevant.

ARGUMENT

I. THE BANKRUPTCY COURT DID NOT ERR BY APPROVING KELLEY'S APPOINTMENT AS TRUSTEE

A. Statutory Framework

Chapter 11 bankruptcy cases are run either by debtors in possession or trustees. *Compare* 11 U.S.C. § 1107 (debtors in possession), *and* 11 U.S.C. § 1104 (trustees) . Under section 1104 of the Bankruptcy Code, the court is required to order the appointment of a chapter 11 trustee for "cause," including fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor by current management either before or after the filing of the petition. 11 U.S.C. § 1104(a)(1).

Once the court orders the appointment of a trustee, the United States Trustee, after consulting with parties in interest, appoints, subject to the court's approval, a "disinterested person" to serve as trustee. 11 U.S.C. § 1104(d). The definition of a "disinterested person" is set out in section 101(14) of the Bankruptcy Code.[19]

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[19] 11 U.S.C. § 101(14) provides:

(14) The term "disinterested person" means a person that –

(A) is not a creditor, an equity security holder, or an insider;

(B) is not and was not, withing 2 years before the date of the filing of the petition, a director, officer, or employee of the debtor; and

Further, the Bankruptcy Rules contemplate that while a common trustee may be appointed for jointly administered chapter 11 bankruptcy estates, the court shall order the selection of separate trustees when creditors or equity security holders demonstrate that the different estates will be prejudiced by a common trustee's conflicts of interest. FED. R. BANKR. P. 2009(c)(2), (d).

As an alternative, a party in interest may, within 30 days after the order requiring the appointment of a trustee, request that a trustee election be held, and the United States Trustee will convene a meeting of creditors for the purpose of holding such an election. 11 U.S.C. § 1104(b). The election must be held pursuant to procedures established in sections 702(a), (b), and (c) of the Bankruptcy Code, and the person elected must be disinterested. *Id.* The ability of creditors to demand a trustee election provides them with a means to select, as a group, a disinterested person to serve as chapter 11 trustee if they are not satisfied with the person appointed to serve as trustee by the United States Trustee.[20]

> (C) does not have an interest materially adverse to the interest of the estate or of any class of creditors or equity security holders, by reason of any direct or indirect relationship to, connection with, or interest in, the debtor, or for any other reason.

[20] Ritchie invoked its rights under these provisions of the Bankruptcy Code. Jt. App. 168-169. On April 22, 2009, the United States Trustee convened a meeting of creditors in the PGW case. App. A339. The United States Trustee filed his report of disputed election, concluding that the voting quorum threshold

B. The bankruptcy court did not commit clear error in finding that creditors of Petters Group Worldwide were not prejudiced by Kelley's common appointment as chapter 11 trustee in the Petters debtors' cases.

1. The bankruptcy court did not commit clear error in finding no actual conflict existed at the time of appointment and stating that it would revisit the issue if an actual conflict ever arose.

The bankruptcy court did not commit clear error in finding Ritchie's assertion that Kelley cannot serve as a common trustee for all the Petters debtors falls short of the requirements of FED. R. BANKR. P. 2009(d). App. A67-A83. Ritchie's sole basis for arguing an impermissible actual conflict would have arisen from Kelley's appointment as trustee for PGW, PCI, and PCI subsidiaries is that claims are likely to exist among those entities.[21]

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was not met for holding a trustee election, and alternatively, the votes did not meet the 50 percent statutory threshold for electing a new trustee. Ritchie objected. Jt. App. 439-461, 462-483. A hearing was held on July 15, 2009, before the bankruptcy court. The matter remains under advisement. *Id.*

[21] This position is inconsistent with the one Ritchie took when it sought the appointment of a single receiver for both PGW and PCI in the Circuit Court of Cook County, Illinois. In that proceeding, Ritchie sought the appointment of a "William Procida as Receiver for the Collateral, including PGW and PCI and all its operations, with all of the usual powers of a receiver, . . ." *See Appointed Trustee's Response to Objection to Appointment of Douglas A. Kelley as Trustee for All of the Debtors in these Jointly Administered Proceedings*, Jt. App. 170-186. The state court granted Ritchie's request and appointed William Procida "Receiver of the Petters Entities," which was defined to include PGW and PCI. *Id.* at 173-174. Ultimately, however, the Illinois state court deferred to the district court's Receivership Order, suspended further proceedings, and expressly relegated the Ritchie parties to "their rights on appeal or otherwise with respect to the Minnesota

But, as other courts have recognized, the existence of such interdebtor claims is not automatic grounds for removal of a trustee for multiple estates, and accordingly does not constitute grounds to mandate the appointment of separate trustees. Removal must be based on evidence of an actual conflict which prejudices the creditors of one of the estates.

In *In re BH&P, Inc.*, 949 F.2d 1300 (3d Cir. 1991), for example, the Third Circuit rejected the notion that a trustee who, in a jointly administered case, asserts a claim on behalf of one estate against another, becomes a "creditor" as defined under 11 U.S.C. § 101(14)(A). The *BH&P* court instead held that section 101(14) does not disqualify a trustee because of actions taken by the trustee in his representative capacity. As the Third Circuit explained, the appointment of a separate trustee requires a showing that creditors will suffer actual prejudice by conflicts held by a common trustee. "Before a trustee may be removed, some actual injury must be shown." *BH&P*, 949 F.2d at 1311.

The cases cited by Ritchie contain facts which established an identifiable conflict between two or more entities. Appellants' Br. at 26. Such is not the case here. The interrelatedness of the Petters debtors and affiliates of other Petters entities is obviously complex. "Upon reviewing the schedules, it becomes

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District Court's order." Trustee Order, 401 B.R. at 398.

immediately obvious that the debtor entities, along with the dozens of other subsidiary entities of these debtor entities, and affiliates of other entities owned by Thomas J. Petters, have accrued inter-company obligations, engaged in extensive transferring of funds between PCI, PGW and subsidiary entities of each, and incurred inter-company obligations on behalf of other entities at hundreds of million dollar levels." *Appointed Trustee's Response to Objection to Appointment of Douglas A. Kelley as Trustee for all of the Debtors in these Jointly Administered Proceedings*, Jt. App. 179. Kelley's response outlined his proposed "plan of action" to recover and liquidate assets, pursue avoidance claims and fraudulent transfers, and then to distribute the proceeds in accordance with the statutory priorities envisioned by the Bankruptcy Code.[22] *Id*. at 181-182.

Finally, the trial court recognized that conflicts are not necessarily static. As the bankruptcy court found, Ritchie (or any party in interest) is free to challenge Kelley's appointment at some future point to if an actual conflict arises. 401 B.R. at 414. Perhaps it is telling that well into these cases, Ritchie has never sought to do so. Under these circumstances, the bankruptcy court did not commit clear error.

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[22] All of these functions are contemplated by 11 U.S.C. § 1106(a).

II. The bankruptcy court did not commit clear error in finding that Ritchie's arguments did not establish prejudice under FED. R. BANKR. P. 2009(d).

The Bankruptcy Rules expressly contemplate that a common trustee may be appointed for jointly administered chapter 11 bankruptcy estates. FED. R. BANKR. P. 2009(c)(2). Indeed, "[j]oint administration by a single trustee is commonplace in the scheme of bankruptcy administration and its positives outweigh any negatives." *BH&P*, 949 F.2d at 1310-1311. Nevertheless, if different estates will be prejudiced by a common trustee's conflicts of interest, the appointment of separate trustees is permissible. FED. R. BANKR. P. 2009(d).

The subjective nature of this inquiry requires a case-by-case analysis, and a court should intervene only upon a showing that the conflicts of interest are serious, and only "in case of special and peculiar necessity for the protection of rights which cannot be adequately protected by a common trustee or by creditors directly." *See* 9 ALAN N. RESNICK & HENRY J. SOMMER, COLLIER ON BANKRUPTCY ¶ 2009.04, at 2009-6-7 (15th ed. rev. 2006) (quoting *In re Wood*, 248 F. 246 (6th Cir. 1918), *cert. denied*, 247 U.S. 512 (1918)). "'Horrible imaginings alone cannot be allowed to carry the day. Not every conceivable conflict must result in sending [the trustee] away to lick his wounds.'" *BH&P*, 949 F.2d at 1313 (quoting *In re Martin*, 817 F.2d 175, 183 (1st Cir. 1987)).

The bankruptcy court employed these principles when considering whether the selection of separate trustees in these cases was required under FED. R. BANKR. P. 2009(d), and in particular whether the creditors of PGW were prejudiced by Kelley's common appointment. As articulated by the bankruptcy court:

> The real issue is whether the conflicts bode actual and particularized prejudice — real detriment — to the creditors of one of the debtors, or to a particular creditor-constituency of one of the debtors, as the estates go through administration under the control of a single person, and that administration passes through the procedural and substantive permutations that that one person elects.

In re Petters Co., Inc., 401 B.R. at 412. While the bankruptcy court acknowledged that such conflicts could *potentially* emerge during the joint administration of these cases, it concluded that those conflicts were *not presently ripe*. *Id.* at 412-414 (noting, *inter alia*, that Kelley's activities as trustee would "not entail any action or process that would pit the distribution rights of Petters Group Worldwide's creditors directly against those of the creditors of any of the other debtors until most or all recoverable assets [had been marshaled]."). That finding was not clearly erroneous and should be affirmed.

Further, the bankruptcy court did not commit clear error in finding that the particular circumstances associated with these cases "powerfully support the concentration of attention and effort into one fiduciary steward." *Id.* at 413; *see* *also Ritchie*, 415 B.R. at 402 (district court opinion, quoting extensively from bankruptcy court's decision and concluding that "[t]he bankruptcy court properly engaged in a case-specific analysis and concluded that at this stage of the bankruptcy proceedings, the present, palpable, and substantial benefits of economy and efficiency prevail over concerns of future, abstract, and unripened conflicts that have yet to or may not materialize."). Thus, the bankruptcy court did not commit clear error in finding that Kelley could adequately serve as common trustee in each of these cases, and that the creditors of Petters Group Worldwide were not prejudiced by that common appointment.

Moreover, the selection of a common trustee in these jointly administered cases will be economical, will avoid unnecessary duplication of actions and will provide for an orderly administration of the cases. "[I]t has long been recognized that joint administration, and the appointment of a common trustee, are favored means to save expense." *In re Ben Franklin Retail Stores, Inc.*, 214 B.R. 852, 858 (Bankr. N.D. Ill. 1997). Appointing a single trustee to investigate and locate all available assets is in the collective best interest of the creditors, and it does not present a conflict of interest. *See In re International Oil Co.*, 427 F.2d 186, 187 (2d Cir. 1970); *In re H&S Transp. Co.*, 55 B.R. 786, 791-92 (Bankr. M.D. Tenn. 1982).

The bankruptcy court recognized these considerations of economy and efficiency. *In re Petters Co., Inc.*, 401 B.R. at 412. The additional expenditure of time and professional expense weighs heavily against appointing another trustee for PGW. Indeed, as the court found, the " Ritchie Parties have not even made a squawk about economy or efficiency supporting or ultimately vindicating the appointment of a second trustee, and there is no credible way they can." *Id.* at 413.

Based on the foregoing, the bankruptcy court did not commit clear error in finding that there was no conflict under FED. R. BANKR. P. 2009(d). *Id.* at 414.

3. No inherent difference between Ritchie and other creditors, or between PGW and PCI, mandates the appointment of a separate trustee for PGW.

In an effort to support its contention that PGW is "different" and therefore the court below abused its discretion in not giving it a separate trustee, Ritchie seeks to differentiate between "regular creditors" and victims of Petters' fraud. Ritchie claims "regular creditor" status for itself. *See, e.g.*, Appellants' Br. at 25. Furthermore, it seeks to draw a line between PGW and the remaining debtor entities, claiming that PGW was a legitimate business enterprise and that PCI and its subsidiaries were engaged in unrelated fraudulent activities. *Id.*

First, these are assertions. The bankruptcy court never made such factual findings. Second, these are distinctions without a difference. Victims of fraud are not given higher priority than commercial creditors in bankruptcy cases,[23] and whatever relationships existed between PGW and the remaining debtors, including PCI, will be sorted out during the administration of the bankruptcy cases. If Ritchie thinks it has special rights, it can assert those rights, and appeal if it loses.

In any event, Ritchie's attempt to distinguish between itself as a "creditor" and the "victims of PCI's diverting business fraud," *e.g.*, Appellants' Br. at 28, is belied by the underlying documentation (as reflected in Exhibit A to *Debtor's Response to United States Trustee's Motion to Appoint a Chapter 11 Trustee and Motion of the Ritchie Group for Appointment of a Chapter 11 Trustee in the Bankruptcy Case of Petters Worldwide, LLC*). App. A322-A326. According to the financial history of the money "loaned" to PGW, the entire $146 million was wired directly by Ritchie into the bank account of PCI at M&I Bank. "This demonstrates how loosely funds were distributed around the various Petters companies, although notably no funds appear to have gone to PGW. Virtually all of these funds went immediately to pay other investors." App. A316. In this sense, Ritchie is most likely not a true creditor as it suggests, but instead another

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[23] Section 507 of the Bankruptcy Code, which sets forth the priorities of expenses and claims in bankruptcies, does not prioritize victims of fraud over unsecured claims. *See* 11 U.S.C. § 507.

victim of Petters' vast Ponzi scheme.[24] In such cases, appellate courts have consistently determined that innocent victims should share equally in any recovered funds because equity demands equal treatment.[25] *See generally United States Securities and Exchange Commission v. The Infinity Group Company*, 226 Fed. Appx. 217 (3d Cir. 2007) (*per curiam*) (*unpublished*) (collecting cases).

Ritchie also contends that PCI, not PGW, was the vehicle for the fraud. Appellants' Br. at 20. However, the indictment returned by the grand jury charges both entities with a variety of federal offenses. "From at least in or about 1995 and continuing through in or about September 2008, in the State of Minnesota and elsewhere, the defendants, THOMAS JOSEPH PETTERS, PETTERS COMPANY, INC., AND PETTERS GROUP WORLDWIDE, LLC, aided and abetted by persons and affiliated business entities, . . . did knowingly and

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[24] Indeed, in Ritchie's complaint against Petters, PCI and PGW, filed in the state court of Illinois, it acknowledges this role, alleging that "Plaintiffs are the 'last in' to what the participants in the fraud called a 'Ponzi scheme', meaning that their funds likely were used to pay prior creditors in hopes of perpetuating the scheme. Defendants fraudulently omitted this information when inducing Plaintiffs to sign the Note Purchase Agreement and the Ritchie Lenders to purchase Notes - actions that would not have been taken absent the fraudulent omissions." Jt. App. 187-200.

[25] Ritchie is attempting to bootstrap itself into a better position *vis a vis* other similarly situated parties. Such manipulation to Ritchie's benefit would result in an inequitable and inefficient administration of these bankruptcy estates.

unlawfully devise and participate in a scheme and artifice to defraud and to obtain billions of dollars in money and property by means of materially false and fraudulent pretenses, representations, and promises." *Indictment*, ¶ *4*, App. A293-A294; *Superseding Indictment*,[26] ¶ *4*, Jt. App. 484-485. In fact, counts 1 through 7 of the indictment charge both PCI and PGW with aiding and abetting mail fraud in violation of 18 U.S.C. §§ 1341 and 1342. *Id.* at ¶ 10, A297-A298. Counts 8 through 10 of the indictment charge both PCI and PGW with aiding and abetting wire fraud in violation of 18 U.S.C. §§ 1343 and 1342. *Id.* at ¶ 13, A298-A299. Count 11 alleges that Thomas Joseph Petters, PCI and PGW "did knowingly and willfully combine, conspire, and agree with each other and with . . . others known and unknown to the Grand Jury, to commit offenses against the United States, that is, mail fraud and wire fraud as described in Counts 1 through 10 above, in violation of Title 18, United States Code, Sections 1341 and 1343." *Id*. at ¶ 15, A300. Count 12 of the Indictment alleges that Petters individually, along with both PCI and PGW, were involved in a money laundering conspiracy in violation of 18 U.S.C. § 1956(h). *Id*. at ¶ 20, A301-A302.

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[26] On June 3, 2009, the Grand Jury issued a Superseding Indictment against Petters, PCI and PGW; the same underlying offenses were charged, however, some changes were made in the specific counts. *See* Jt. App. 484-499.

Ritchie's attempt to minimize the role of PGW in the fraudulent scheme stands in stark contrast to the allegations in the indictment. At most, these are allegations, not factual bases for reversing a trial court's exercise of discretion. And, according to the Indictment and the Superseding Indictment, the actions of PGW and PCI were intertwined in this complex criminal scheme to defraud victims. The Grand Jury found probable cause to believe that both entities were instrumentalities in Petters' criminal enterprise. Against this backdrop, the bankruptcy court did not abuse its discretion in rejecting Ritchie's assertion that the differences in the alleged criminal culpability of PGW and PCI warranted appointment of a separate trustee for PGW.

C. The bankruptcy court did not commit clear error in finding that Kelley did not have an actual conflict from serving as the pre-petition Receiver and the trustee.

Once a court orders the appointment of a trustee, the United States Trustee, after consulting with parties in interest, is directed to appoint, subject to the court's approval, a "disinterested person" to serve as trustee. 11 U.S.C. § 1104(d). The requirements of a "disinterested person" as set out in 11 U.S.C. § 101(14), have been liberally construed. *See In re BH&P, Inc.*, 949 F.2d 1300, 1309 (3d Cir. 1991). In this appeal, Ritchie asserts that Kelley is not a "disinterested person" under subsection (C) of section 101(14). *See* 11 U.S.C. § 101(14)(C) (defining "disinterested person," in part, as someone who "does not have an interest materially adverse to the interest of the estate or of any class of creditors or equity security holders, by reason of any direct or indirect relationship to, connection with, or interest in, the debtor, or for any other reason.").

As the trustee for these bankruptcy cases, Kelley is obligated to follow the mandates of Title 11 of the United States Code. The district court who appointed him receiver recognized this requirement when it amended the receivership order to require "(a)ny bankruptcy cases . . . shall during their pendency be governed by and administered pursuant to the requirements of the United States Bankruptcy Code, 11 U.S.C. section 101 *et seq.*, and the applicable Federal Rules of Bankruptcy Procedure." *Receivership Order, Section IV, ¶ B. 2. c.* Jt. App. 144. The bankruptcy court's order also recognizes this obligation: ". . . Kelley has committed to proceeding with the administration of the estates in these cases in accordance with the values and priorities of bankruptcy law. Kelley acknowledges that this will entail maximizing the value of all assets collected, and then distributing them to the holders of all allowed claims against the debtors, pursuant to statutory priorities and *pro rata* if necessary, all as the Bankruptcy Code envisions." Trustee Order, 401 B.R. at 409. (footnote omitted). In no event, however, would Kelley's obligations as trustee of these bankruptcy estates be materially adverse to his obligations as receiver in the district court.

In short, Kelley as trustee is duty-bound to administer these estates according to the dictates of the Bankruptcy Code. The district court recognized this fiduciary obligation in affirming the order of the bankruptcy court. "As receiver, Kelley must adhere to the mandates of the bankruptcy forum for which he opted, but remains the receiver nevertheless." *Ritchie*, 415 B.R. at 399, n. 7. Indeed, the bankruptcy court, as part of its order approving Kelley's appointment, required him, as Receiver, to turnover all of the assets of the Petters debtors' bankruptcy estates to the appointed trustee. *In re Petters Co., Inc.* 401 B.R. at 415, UST App. 168-172.

Contrary to Ritchie's assertions, however, Kelley is not placed in an untenable position with conflicting loyalties.[27] Ritchie's objection to the appointment of

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[27] Ritchie's objection also misapprehends Kelley's role as Receiver, suggesting that he owes a fiduciary duty to the victims of Petters' fraud and serving as an agent for the government. The rights, powers and duties of a federal equity receiver are governed by 28 U.S.C. § 959(b). A receiver's primary duty is as an officer of the court in which he was appointed; he is not an employee of any party to the litigation. *See* FED. R. CIV. P. 66. *Smallwood v. Lay*, 443 F.2d 535, 539 (8th Cir. 1971); *Culhane v. Anderson*, 17 F.2d 559, 561 (8th Cir. 1927). "A receiver is the agent only of the court appointing him; he represents the court rather than the parties. He is the custodian of property which is under the control of the court." *Ledbetter v. Farmers Bank & Trust Co.*, 142 F.2d 147, 150 (4th Cir. 1944).

Kelley as trustee for all of these debtor entities misstates his role. The entire premise for the United States Trustee's motion for the appointment of a chapter 11 trustee in these cases centered on the fact that bankruptcy cases must be administered by trustees when "cause" exists because a bankruptcy court cannot order the appointment of a receiver under the Bankruptcy Code. 11 U.S.C. § 105(b) ("a court may not appoint a receiver under . . . title [11]."). But the Code nowhere provides that a pre-petition receiver can never be appointed to act as a chapter 11 trustee. If no actual conflict exists, he can. And, as the bankruptcy court correctly observed, "these chapter 11 cases will go ahead fully governed by the substantive law of bankruptcy." *In re Petters Co., Inc.*, 401 B.R. at 408. Acting in conformity with this law, the bankruptcy court, citing the mandates of 11 U.S.C. § 543(b)(2),[28] ordered the turnover of all property Kelley had as Receiver to himself as chapter 11 trustee. *In re Petters Co., Inc.*, 401 B.R. at 408-409.

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[28] 11 U.S.C. § 543(b)(1) provides: "A custodian shall — deliver to the trustee any property of the debtor held by or transferred to such custodian, or proceeds, product, offspring, rents or profits of such property that is in such custodian's possession, custody, or control on the date that such custodian acquires knowledge of the commencement of the case(.)"

Likewise, the mandate of the receivership order[29] that Kelley "(c)oordinate with representatives of the United States Attorney's office and Court personnel as needed to ensure that any assets subject to the terms of this Order are available for criminal restitution, forfeiture, or other legal remedies . . ." does not create any materially adverse conflicts *vis a vis* Kelley's obligations to these bankruptcy estates. Appellants' Br. at 36-37, 40-41. The mere allegation of forfeiture in the indictment against Petters, PCI and PGW does not mandate the appointment of a separate trustee for PGW. Kelley, in his role as Receiver, is not empowered to pursue restitution or forfeiture. The power to prosecute any forfeiture against any asset rests with the United States Attorney acting through the Department of Justice.[30] Contrary to the assertion of Ritchie, Kelley is not aligned with or biased in favor of the Government. *E.g.*, Appellants' Br. at 19, 20, 36-37, 40-41. "The notion of having the assets in Kelley's hands 'available for criminal restitution, forfeiture,' and the like signifies a duty to fully disclose their form and

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[29] *Section IV,* ¶ *6.* Jt. App. 145-146.

[30] "The authority to decide against whom federal indictments shall be sought lies almost exclusively with the United States Attorneys or the Justice Department, and their decisions in this regard are not generally subject to judicial review." *Massey v. Smith*, 555 F.2d 1355, 1356 (8th Cir. 1977); s*ee* 18 U.S.C. § 982(a)(2)(A) (criminal forfeiture in connection with violation of wire and mail fraud statutes).

whereabouts and to maintain transparency that our legal system makes incumbent on any entrusted officer of a court, in the performance of obligations **to the appointing court**. It reflects no more than that." *In re Petters Co., Inc.*, 401 B.R. at 407. (emphasis in original).[31]

Kelley's status as Receiver of any Petters entities does not conflict with his status as trustee of the Petters debtors. His fiduciary duties are mandated by title 11 of the United States Code. In this regard, Kelley must collect and preserve all available assets, and make them available for distribution to the creditors of these estates according to the priorities set forth under the Bankruptcy Code. Kelley is powerless to determine what assets, if any, may be subject to forfeiture and/or restitution. Those decisions are left to the discretion of the United States Attorney and the district court. *See* 18 U.S.C. § 982(a)(2)(A) (criminal forfeiture). Accordingly, his current or former status as Receiver does not disqualify him from serving as trustee in these cases.[32]

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[31] For these reasons, Ritchie's reliance on *In re Big Rivers Elec.*, 355 F.3d 415 (6th Cir. 2004) is unavailing. Appellants' Br. at 34. Kelley has no personal stake in the outcome of the Petters debtors' bankruptcies, in contrast to the bankruptcy examiner in *Big Rivers*, who improperly sought to arrange a side-deal that would tie his personal compensation to one creditor's recovery. *Big Rivers* has no bearing on this case.

[32] In addition, both the Second and Third Circuits have held that, for the purposes of section 101(14), in order for an individual to be considered not

THE BANKRUPTCY COURT DID NOT ABUSE ITS DISCRETION IN DENYING RITCHIE'S REQUEST FOR EXPEDITED DISCOVERY.

Prior to the hearing on the United States Trustee's appointment of Kelley as trustee, Ritchie sought to compel expedited discovery from him. Kelley and the United States Trustee objected to such efforts. Jt. App. 207-259. Ritchie had

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"disinterested" that individual "personally must 'have' the prohibited interest." *See Bank Brussels Lambert v. Coan (In re Arochem Corp)*, 176 F.3d 610, 629 (2d Cir. 1999); *BH&P*, 949 F.2d at 1310 n.12 ("Where section 327 explicitly applies to persons who hold *or represent* adverse interests, disqualifying both, section 101(14)(E) refers only to those who *have* disqualifying interests. We do not think that this difference in terminology was accidental."). *See also BFP v. Resolution Trust Corp.*, 511 U.S. 531, 537 (1994) ("[i]t is generally presumed Congress acts intentionally and purposely when it includes particular language in one section of a statute but omits it in another").

Both *Arochem* and *BH&P* construed section 101(14)(E) of the Bankruptcy Code, as in effect prior to October 17, 2005. On October 17, 2005, the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 became effective. *See* Pub. L. No. 109-8, 119 Stat. 23. Under the 2005 Act, section 101(14)(E) was re-codified at section 101(14)(C) of the Bankruptcy Code, although no change was made to its language. Thus, both *Arochem* and *BH&P* are instructive with respect to how section 101(14)(C) should be construed.

Under this construction, the bankruptcy court did not commit clear error in finding Kelley could not possibly be disqualified from serving as a common trustee in the Petters debtors' cases because his engagement as a pre-petition receiver for those entities occurred solely while acting in a *representative* capacity. *See BH&P*, 949 F.2d at 1310 (*citing In re O.P.M. Leasing Services, Inc.*, 16 B.R. 932, 938 (Bankr. S.D.N.Y. 1982) for the proposition that actions which individual undertakes as a fiduciary do not cause that individual to be ineligible for the purposes of section 101(14)). Accordingly, both the bankruptcy and district courts below properly concluded that Kelley's status as a pre-petition receiver did not bar his appointment as a trustee.

served Kelley's counsel with interrogatories, requests for production and a notice of deposition, the subject matter of which revolved around Kelley's role as the court-appointed federal receiver. *Id.* at 241.

Ritchie asserted that it needed the discovery for its argument that Kelley, because of his status as Receiver, was precluded from being disinterested as required by 11 U.S.C. § 101(14)(C). The bankruptcy court ruled that discovery was not necessary on this point because it could determine the question of Kelley's disinterestedness by reviewing Kelley's duties as Receiver as set forth in the district court's receivership order and Kelley's duties as trustee as set forth in the Bankruptcy Code. Jt. App. 250.

As to Ritchie's alternative argument that Kelley could not serve as common trustee of the Petters debtors because of competing interests as between the estates, the bankruptcy court opined that issue could be "measured by the content of statements in schedules and other documents that are available of public record." *Id.* at 252. The bankruptcy court further ruled that Ritchie's request for discovery was overbroad and was not necessary for a determination of the ultimate determination of whether Kelley's appointment as common trustee for the Petters debtors should be approved. *Id.* Thus, the court denied the request for expedited discovery in all respects. *Id.* at 260-61.

Discovery matters are soundly left to the discretion of the trial court — or in this case, the bankruptcy court. *See, e.g., Pleasants v. Am. Express Co.*, 541 F.3d 853, 859 (8th Cir. 2008) ("We review the district court's order for an abuse of discretion, allowing the court 'great latitude' in discovery matters") (citing *Executive Air Taxi Corp. v. City of Bismarck*, 518 F.3d 562, 570 (8th Cir. 2008)). *See also, Miscellaneous Docket Matter #1 v. Miscellaneous Docket Matter #2*, 197 F.3d 922, 925 (8th Cir. 1999) (abuse of discretion standard applies in discovery matters in proceeding ancillary to principal action).

To prevail on its argument, Ritchie must show an abuse of discretion. This it cannot do. The bankruptcy court correctly concluded that disposition of the matter of approving Kelley's appointment as common trustee could be determined without the need for discovery. Indeed, as established above, the bankruptcy court did not err in basing its approval of Kelley's appointment as trustee upon the receivership order, schedules and other matters appearing on the public record. *In re Petters Co., Inc.*, 401 B.R. at 395, n. 6. The district court agreed. *Ritchie*, 415 B.R. at 403. Accordingly, Ritchie's claim of error concerning its discovery requests falls short.

CONCLUSION

For these reasons, the United States Trustee respectfully asks this Court to enter an order affirming the bankruptcy court's order overruling Ritchie's objection to Kelley's appointment as trustee for these jointly administered chapter 11 cases and approving his appointment.

CERTIFICATE OF COMPLIANCE

The undersigned attorney for the United States certifies this brief complies with the type-volume limitation of Federal Rule of Appellate Procedure 32. The brief has 8,660 words of proportional spacing. The brief was prepared using WordPerfect X3. The undersigned attorney also certifies that the computer diskette containing the full text of the Brief of Appellee has been scanned for viruses and to the best of our ability and technology, believes it is virus-free.

Dated: January 25, 2010

HABBO G. FOKKENA
United States Trustee
Region 12

By: /s/ Michael E. Ridgway
Michael E. Ridgway
Trial Attorney, SD Atty. No. 1456
Robert B. Raschke, MN Atty. No.161081
Assistant U.S. Trustee
Department of Justice
Office of the U.S. Trustee
U.S. Courthouse, Suite 1015
300 South Fourth Street
Minneapolis, MN 55415
TELE: (612) 664-5500
FACS: (612) 664-5516

RAMONA D. ELLIOTT
General Counsel

P. MATTHEW SUTKO
Associate General Counsel

ANNE W. STUKES
Executive Office for
United States Trustees
Department of Justice
20 Massachusetts Ave., N.W.
Washington, DC 20530
TELE: (202) 307-1399
FACS: (202) 307-2397

UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

No: 09-3271

Ritchie Special Credit Investments, Ltd., et al.,

Appellants

v.

United States Trustee and Official Committee of Unsecured Creditors,

Appellees

Appeal from U.S. District Court for the District of Minnesota - Minneapolis
(0:09-cv-00680-ADM)

CERTIFICATE OF SERVICE

I hereby certify that I have served two copies of the foregoing brief and one CD-ROM (certified virus-free) containing an electronic file of the brief on the following parties by Federal Express on January 25, 2010:

James Jorissen
LEONARD O'BRIEN SPENCER, GALE & SAYRE, Ltd.
100 South Fifth Street, Ste. 2500
Minneapolis, Minnesota 55402
(612) 332-1030

Bryan Krakauer
Thomas K. Cauley, Jr.
Brian A. McAleenan
SIDLEY AUSTIN LLP
One South Dearborn Street

Chicago, Illinois 60603
(312) 853-7000

Counsel for Appellants

Connie A. Lahn
David Runck
FAFINSKI & MARK
775 Prairie Center Drive
Suite 400
Eden Prairie, MN 55344-0000
(952) 995-9500

Counsel for Appellee Official Committee of Unsecured Creditors

/s/ Michael E. Ridgway
Michael E. Ridgway

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3. ["CCN"] CURRENT CASE NO.	No.: 04-1281
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IN THE UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

No. 04-1281

IN RE CHANDLIER

Allan J. Rittenhouse,

Appellant,

v.

Saul Eisen,

United States Trustee,

Appellee.

On Appeal From The United States District Court
For The Western District Of Michigan

BRIEF FOR THE APPELLEE

SAUL EISEN
United States Trustee

DANIEL J. CASAMATTA,
Assistant United States Trustee

MICHAEL MAGGIO
Attorney for the United States Trustee

DONALD F. WALTON
Acting General Counsel

PAUL W. BRIDENHAGEN
P. MATTHEW SUTKO
Executive Office for United States Trustees
U.S. Department of Justice
901 E Street, N.W., Suite 780
Washington, D.C. 20530
(202) 307-1399

CORPORATE DISCLOSURE

Pursuant to 6th Circuit Rule 28(a)(1), the United States Trustee makes the following disclosure:

1. Is a party a subsidiary or an affiliate of a publicly owned corporation? NO.

2. Is there a publicly-owned corporation, not a party to the appeal, that has a financial interest in the outcome? NO.

Date	Paul W. Bridenhagen

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MISCELLANEOUS

IN THE UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

No. 04-1281

IN RE CHANDLIER

Allan J. Rittenhouse,

Appellant,

v.

Saul Eisen,

United States Trustee,

Appellee.

On Appeal From The United States District Court
For The Western District Of Michigan

BRIEF FOR THE APPELLEE

STATEMENT OF JURISDICTION

The bankruptcy court had subject matter jurisdiction under 28 U.S.C. sections 1334 and 157. The district court had jurisdiction over the appeal pursuant to 28 U.S.C. section 158(a). This Court has appellate jurisdiction under 28 U.S.C. section 158(d). The bankruptcy court's June 16, 2003, Final Order Pursuant to the Opinion and Order of April 16, 2003, which prohibited Allan J. Rittenhouse (hereinafter, "Mr. Rittenhouse" or "Appellant") from collecting any unpaid fees for pre-petition bankruptcy counseling was entered on the docket on June 20, 2003. (District Court Docket ("R.") 2, Notice of Transmittal, Appendix ("Apx.") ___ (Bankruptcy Court Docket ("Bankr. Dkt.") #57)) Mr. Rittenhouse filed a timely notice of Appeal on June 26, 2003. (R.2, Notice of Transmittal, Apx ___ (Bankr. Dkt. # 32)) The district court entered an opinion and final judgment affirming the bankruptcy court's judgment on February 11, 2004. (R. 15 (opinion) and 16 (order), Apx. ___) The district court's judgment was a final order, resolving the only outstanding claims between the parties. Mr. Rittenhouse filed a timely notice of appeal to this Court on February 26, 2004. (R.17, Notice of Appeal, Apx. ___)

STATEMENT OF THE ISSUE PRESENTED FOR REVIEW

Whether the bankruptcy court properly held that 11 U.S.C. sections 523 and 727(b) discharged any unpaid pre-petition attorneys' fees that were owed by the debtor prior to the filing of the bankruptcy petition.

STANDARD OF APPELLATE REVIEW

The district court factual findings are examined for clear error, while all conclusions of law are reviewed de novo. *City of Baltimore v. State of West Virginia (In re Eagle-Pitcher Industries, Inc.)*, 285 F.3d 522, 527 (6th Cir. 2002); Federal Rule of Bankruptcy Procedure 8013. The district court's decision that 11 U.S.C. section 727(b) discharged all unpaid pre-petition attorneys' fees that were owed prior to the filing of the bankruptcy petition was a conclusion of law, which is reviewed *de novo.*

STATEMENT OF THE CASE

This appeal addresses whether a debt owed to a chapter 7 debtor's attorney for legal services performed before the bankruptcy case was filed is discharged under sections 523 and 727(b). Mr. Rittenhouse alleges that he owns an account receivable for pre-petition work performed by Michael K. Pepin, Esq., on behalf of the debtor, Sara L Chandlier (the "debtor"). The United States Trustee took the position that the debt was discharged in the debtor's case, and requested the imposition of sanctions against Mr. Rittenhouse for attempting to collect a discharged debt. On April 16, 2003, the bankruptcy court issued an opinion holding that the attorneys' fees claimed by Mr. Rittenhouse were discharged pursuant to sections 523 and 727(b) during the debtor's bankruptcy case. (R.2, Notice of Transmittal, Apx. ___ (Bankr. Dkt. # 41)) In so holding, the bankruptcy court followed the substantial weight of authority and rejected Mr. Rittenhouse's argument that 11 U.S.C. section 329(b) operated as an additional, implied exception to discharge beyond those set forth in 11 U.S.C. sections 523 and

727(b). (R.2, Notice of Transmittal, Apx. ___ (Bankr. Dkt #41)) On June 16, 2003, the bankruptcy court issued a final order, based on the April 16, 2003, opinion that prohibited Mr. Rittenhouse from collecting any unpaid, pre-petition attorneys' fees. (R.2, Notice of Transmittal, Apx. ___ (Bankr. Dkt. # 57)) On appeal, in a decision entered on February 11, 2004, the district court affirmed the ruling of the bankruptcy court. (R.16, Order affirming order of bankruptcy court, Apx. ___) This appeal followed.

STATEMENT OF FACTS

On April 17, 2000, in the case of *In re Ernest J. Desilets*, Case No. GM99-90364, the United States Bankruptcy Court for the Western District of Michigan, entered an opinion and order finding that Mr. Rittenhouse was not authorized to practice in that court because he was not a member of the Michigan bar. *Rittenhouse v. Delta Home Improvement, Inc.*, 255 B.R. 294, 296 (W.D. Mich. 2000), *rev'd* 291 F.3d 295 (6th Cir. 2002). Mr. Rittenhouse appealed that order. On September 26, 2000, while the order was on appeal, Mr. Rittenhouse consented before the bankruptcy court, sitting *en banc,* to the entry of an order suspending him from the roll of attorneys and enjoining him from practicing law in the Bankruptcy Court for the Western District of Michigan, pending resolution of his appeal of the order of April 17, 2000. *Rittenhouse v. Delta Home Improvement, Inc.*, 255 B.R. at 296 n.2.

Approximately two months later, on November 6, 2000, while Mr. Rittenhouse was suspended from practice, Sara L. Chandlier (the "debtor") filed a petition for relief under chapter 7 of the Bankruptcy Code. The petition listed the attorney for the debtor as Michael Pepin, Esq. (R. 2, Notice of Transmittal, Apx. ___ (Bankr. Dkt. #1)) According to the response to Question 9 of the Statement of Affairs, and the Statement Filed Under Rule 2016(b), prior to the filing of the petition, the debtor paid Mr. Pepin nothing for his pre-petition bankruptcy counseling services as attorney for the debtor. Instead, the petition disclosed only that the debtor agreed to pay Mr. Pepin an $800 attorneys' fee in the future. (R. 2, Notice of Transmittal, Apx ___ (Bankr. Dkt. #1))

The debtor's meeting with the chapter 7 trustee and the creditors, required under 11 U.S.C. section 341, was scheduled for December 7, 2000, but was adjourned to December 21, 2000, because no attorney appeared on behalf of the debtor at either meeting. The debtor appeared on December 21, 2000, and was examined; her attorney did not represent her at that meeting. (R. 2, Notice of Transmittal, Apx ___ (Bankr. Dkt. No. 8 and 9; Transcript of Hearings Held on December 7 and 21, 2000, Bankr. Dkt No. 34; Bankruptcy Court Opinion of April 16, 2003, at 2, Bankr. Dkt. No. 41))

The bankruptcy court granted the debtor a discharge of all pre-petition debts on May 3, 2001, under 11 U.S.C. § 727(a). (R. 2, Notice of Transmittal, Apx ___ (Bankr. Dkt. No. 23)) That discharge has never been set aside, nor has any motion been filed for an exception of any particular debt from the discharge. (R. 2, Notice of Transmittal, Apx ___ (Bankruptcy Docket))

On June 3, 2002, a divided panel of the United States Court of Appeals for the Sixth Circuit reversed the order of April 17, 2000, which prohibited Mr. Rittenhouse from practicing in the United States Bankruptcy Court for the Western District of Michigan. *Rittenhouse v. Delta Home Improv., Inc. (In re Desilets)*, 291 F.3d 925 (6th Cir. 2002). The majority held that Mr. Rittenhouse did not need Michigan state bar licensure to practice before the United States Bankruptcy Court for the Western District of Michigan. The Sixth Circuit issued its mandate on September 11, 2002. Thereafter, the bankruptcy court rescinded the orders, suspension and injunction of April 17, 2000, and

September 26, 2000. Mr. Rittenhouse was restored to the bar for the Bankruptcy Court for the Western District of Michigan, effective on September 19, 2002.

On or about November 19, 2002, Mr. Rittenhouse wrote to the debtor claiming to have been her attorney in her 2000 bankruptcy filing, demanding payment of the $800 attorneys' fee to him as attorney for the debtor, and threatening to sue in order to collect. (R. 2, Notice of Transmittal, Apx ___ (Attachment to the United States Trustee's Motion Requesting Review and Disgorgement, Bankr. Dkt. No. 28)) Mr. Rittenhouse attached a draft state court complaint to the letter, along with six pages of proposed document requests, requests for admissions, and interrogatories.

The interrogatories referenced a motion for contempt for violation of the automatic stay of 11 U.S.C. section 362, and were apparently form interrogatories which bore no relationship to the debtor's situation. In the draft complaint, Mr. Rittenhouse alleged that the debtor contracted with him to act as her attorney and that the debtor agreed to pay him $800 in attorneys' fees. (R. 2, Notice of Transmittal, Apx ___ (Attachment to the United States Trustee's Motion Requesting Review and Disgorgement, Bankr. Dkt. No. 28)) The complaint did not explain how Mr. Rittenhouse was able to continue practicing bankruptcy law during a time he had been suspended voluntarily from practicing before the bankruptcy court, or why the attorney listed as the debtor's attorney on the petition had not been the attorney in the debtor's bankruptcy case.

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On December 17, 2002, the United States Trustee[1] filed a Motion Requesting Review and Disgorgement of Attorney Compensation Under 11 U.S.C. section 329(b) and Rule 2017, and Sanctions Under 11 U.S.C. section 362. (R. 2, Notice of Transmittal, Apx ___ (Bankr. Dkt. No. 28)) The motion asserted that: 1) Mr. Rittenhouse was not the debtor's attorney, although he might have acted as Mr. Pepin's paralegal around the time this case was filed; 2) Mr. Rittenhouse had not proven that he had any right to collect the fees from the debtor; 3) the services performed for the debtor did not justify a fee of $800; and 4) that all of the debtor's pre-petition obligations, including the agreement to pay $800 in attorneys' fees, were discharged in bankruptcy under 11 U.S.C. section 727(b).

The United States Trustee's motion was argued on January 16, 2003. During that hearing, Mr. Rittenhouse did not explain the inconsistency between the debtor's bankruptcy petition, which represented that Mr. Pepin was debtor's counsel, and the draft complaint, which asserted that Mr. Rittenhouse had been the attorney for the debtor. Instead, he told the bankruptcy court that he had purchased this account receivable from Mr. Pepin. Mr. Rittenhouse put no documents into evidence establishing this claim, and provided no testamentary evidence regarding who was actually the debtor's counsel, who did the work, or what arrangement, if any, Mr. Rittenhouse had with Mr. Pepin regarding this particular debtor during the time Mr. Rittenhouse was suspended from practice. Mr. Rittenhouse admitted at the January 16, 2003, hearing that he had no documentary evidence to prove his alleged

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[1] The United States Trustee is an officer of the United States Department of Justice, charged with the duty and authority to monitor the progress of cases under Title 11 and to supervise the administration of bankruptcy cases. 28 U.S.C. section 586(a)(3) and (a)(3)(G).

purchase of the accounts receivable from Mr. Pepin. (R. 2, Notice of Transmittal, Apx ___ (Bankr. Dkt. No. 37, page 13))

On April 16, 2003, the bankruptcy court issued an order and opinion, holding that the debtor's pre-petition obligation to pay the attorneys' fees was discharged by the filing of the bankruptcy petition. The April 16, 2003, order scheduled a hearing for May 16, 2003, to determine the sanctions that should be levied upon Mr. Rittenhouse for attempting to collect a discharged debt. (R. 2, Notice of Transmittal, Apx ___(Bankr. Dkt. No. 41)) The bankruptcy court's decision addressed the discharge issue only and did not resolve the identity of the debtor's counsel in the bankruptcy proceeding, or whether Mr. Rittenhouse had purchased this "account receivable."

Following the May 16, 2003, hearing on sanctions, the bankruptcy court held that the only sanction to be imposed upon Mr. Rittenhouse would be to prohibit him from collecting the $800 fee from the debtor, until and unless the bankruptcy court opinion and order of April 16, 2003, were reversed upon appeal. (R. 2, Notice of Transmittal, Apx ___(Bankr. Dkt. No. 55)) The bankruptcy court's Final Order Pursuant to the Opinion and Order of April 16, 2003, was entered on the docket on June 20, 2003. (R. 2, Notice of Transmittal, Apx ___ (Bankr. Dkt. No. 57)) Mr. Rittenhouse filed his notice of appeal from the Final Order on June 26, 2003. (R. 2, Notice of Transmittal, Apx ___ (Bankr. Dkt. No. 58)) The district court's order affirming the bankruptcy court's June 16, 2003, order was entered on the docket on February 11, 2004. (R.16, District Court Order, Apx. ___)

SUMMARY OF ARGUMENT

As of the filing of this bankruptcy case, the debtor owed her attorney an unpaid debt of $800 for attorneys' fees incurred for pre-petition work. By operation of law, the filing of this bankruptcy case stayed any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case. 11 U.S.C. section 362(a)(6) (creating an automatic stay, which is a mandatory injunction, prohibiting such collection efforts post-petition). In her bankruptcy case, the debtor received a discharge under 11 U.S.C. section 727(b) from "all debts that arose before" the filing of her bankruptcy petition. Under the Bankruptcy Code, the only debts that were not discharged were those specifically excluded from the discharge under 11 U.S.C. section 523(a).

Although section 523(a) excepts nineteen specifically enumerated debts from discharge under section 727(b), there is no exception for pre-petition attorneys' fees owed to the debtor's attorney. Once the debtor's discharge was granted, therefore, section 524(a)(2) operates as a permanent injunction, thereby enjoining Mr. Rittenhouse from commencing or continuing to collect, recover or offset any discharged debt against the debtor. Since unpaid pre-petition attorneys' fees owed to debtor's counsel were not excepted from the discharge, the debtor's obligation to Mr. Rittenhouse was discharged and Mr. Rittenhouse was enjoined from taking any steps to collect that debt from the debtor.

These statutory provisions plainly prohibit the fee recovery Mr. Rittenhouse sought post-discharge. Given that, it is not surprising that the Second, Seventh and Ninth Circuits have squarely rejected attempts by others to collect fees post-discharge. These well-reasoned circuit decisions are indistinguishable and this Court should apply the Bankruptcy Code's discharge provisions in the same way they have.

Not surprisingly, Mr. Rittenhouse does not assert that pre-petition attorneys' fees are one of the nineteen specific exceptions to discharge set forth in section 523. Instead, he seeks to avoid the consequences of that discharge, by invoking what is essentially a consumer protection statute for debtors, section 329 of the Bankruptcy Code. The Second, Seventh and Ninth Circuits also squarely rejected this argument, because section 329 is a disclosure provision that requires attorneys to disclose all fees they have charged and will charge debtors. Nothing in section 329's language or legislative history supports any contention that it either awards attorneys' fees or guarantees attorneys that any pre-petition attorneys' fees will be paid. To the contrary, nothing in that provision purports to give attorneys any rights to fees beyond the express provisions of sections 727(b), 524(a)(2) and 523.

I. ARGUMENT

A primary purpose of the Bankruptcy System is to allow honest debtors to unburden themselves of the weight of oppressive indebtedness and start afresh. *Local Loan Co. v. Hunt*, 292 U.S. 234, 244 (1934). A fresh start is made available to debtors by the discharge of all or a portion of a debtor's debts. *In re Krohn*, 886 F.3d 123, 125 (6th Cir. 1989). By operation of law, the filing of a bankruptcy case stays any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case. 11 U.S.C. section 362(a)(6) (creating an automatic stay, which is a mandatory injunction, prohibiting any collection efforts post-petition). In chapter 7, in exchange for liquidation of the debtor's assets for the benefit of creditors, a discharge is awarded pursuant to section 727(b) of the Bankruptcy Code, which provides as follows:

> Except as provided in section 523 of this title, a discharge under subsection (a) of this section discharges the debtor from *all debts that arose before the date of the order of relief under this chapter . . . and any liability on a claim* . . . as if it had arisen before the commencement of the case . . . except as provided under § 523.

11 U.S.C. 727(b) (emphasis added).

By its express terms, section 727(b) discharges all debts other than those listed in section 523 of the Bankruptcy Code. In turn, section 523(a) creates nineteen specific exceptions to the discharge, none of which apply to a debtor's pre-petition obligation to pay attorneys' fees. Given that plain language, the only three circuits to address the issue have prohibited attorneys from pursuing pre-petition fees from a debtor who has received a discharge in a case. *Fickling v. Flower, Medalie & Markowitz (In re Fickling)*, 361 F.3d 172, 175 (2d Cir. 2004) (pre-petition attorneys fees are not among the debts excepted from discharge by section 523); *Bethea v. Robert J. Adams & Assoc. (In re Bethea)*, 352 F.3d 1125, 1127(7th Cir. 2003) (same); *Hessinger and Associates v. United States Trustee (In re Biggar)*, 110 F.3d 685, 687 (9th Cir. 1997) (same).

Those decisions were correctly decided. Once a debtor's discharge is granted, section 524(a)(2) of the Bankruptcy Code operates as a permanent injunction, thereby enjoining a creditor from commencing or continuing to collect, recover or offset any discharged debt against a debtor. Thus, the stay and discharge provisions of the Bankruptcy Code are integral in providing a debtor with a fresh start.

A. Pursuant To The Plain Language Of Section 727(a), Unpaid Pre-Petition Attorneys' Fees Are Not Excepted From Discharge.

The Supreme Court has repeatedly made clear that exceptions to discharge are to be limited to those expressly set forth in section 523(a) of the Bankruptcy Code. *Federal Communications Comm'n v. Nextwave Personal Communications, Inc.*, 537 U.S. 293, 304 (2003) ("A preconfirmation debt is dischargeable unless it falls within an express exception to discharge.");[2] *Ohio v. Kovacs*, 469 U.S. 274 (1985) ("[e]xcept for the . . . kinds of debts saved from discharge by 11 U.S.C. section 523(a), a discharge in bankruptcy discharges the debtor from all debts that arose

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[2] *Nextwave* dealt with a discharge in chapter 11 case pursuant to 11 U.S.C. section 1141(d)(1)(A) which, like section 727(d), discharges "any debt" except those expressly listed in section 523.

before bankruptcy. "); and *Kawaauhau v. Geiger*, 523 U.S. 57, 62 (1998) (exceptions to discharge "should be confined to those plainly expressed.") (*quoting Gleason v. Thaw*, 236 U.S. 558, 562 (1915)). *See also, In re Meyers*, 196 F.3d 622, 624 (6th Cir. 1999) (exceptions to discharge narrowly construed consistent with the policy of providing the debtor with a "fresh start").

Contrary to Mr. Rittenhouse's argument, the plain language of sections 727(b) and 523 is dispositive of the issue in this appeal. Because pre-petition attorneys' fees are not among the nineteen debts excepted from the discharge under section 523(a), a debtor's pre-petition obligation to pay such fees does not survive discharge. *United States v. Turkette*, 452 U.S. 576, 580,(1981) (unambiguous statutory language, in the absence of a clearly expressed legislative intent to the contrary, must ordinarily be regarded as conclusive). Consequently, the attorneys' fees that Mr. Rittenhouse seeks to collect did not survive discharge and he violated section 524(a)(2) of the Bankruptcy Code by threatening to sue the debtor unless she paid them.

B. Section 329 Does Not Create Any Implicit Exception To Discharge For Pre-Petition Attorneys' Fees.

Mr. Rittenhouse does not contest that the debtor was granted a discharge. Instead, he argues that an agreement to pay pre-petition attorneys' fees post-petition is controlled by section 329 of the Bankruptcy Code, and the bankruptcy rules that implement it. Appellant's Brief at 7- 9. In this regard, he relies on the untenable argument that there is a conflict between section 329, on the one hand, and sections 727(b) and 523 on the other, which conflict must be resolved in favor of allowing payment of the fees. Appellant's Brief at 7-11. This argument is incorrect. There is no direct conflict between the discharge provisions and section 329. The plain language of section 329[3/] states that an attorney for a debtor "shall file with the court a statement of the compensation paid or agreed to be paid," and that "the court may cancel any such agreement, or order the return of any such payment, to the extent excessive." 11 U.S.C. section 329.

The effect of this language is to require a debtor's attorney to report all compensation paid or agreed to be paid within a year prior to the filing of bankruptcy. It also authorizes the bankruptcy court to review those payments or agreements, to modify them and to order disgorgement if fees are found to be excessive. Contrary to Mr. Rittenhouse's argument that it is intended to guarantee payment of attorney compensation, the true purpose of section 329 is to prevent overreaching by debtor's counsel. *See, In re Bethea*, 352 F.3d at 1127; H.R.Rep. No. 595, 95th Cong., 1st Sess. 329 (1977)("some

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[3/] section 329 of the Bankruptcy Code provides as follows:

> (a) Any attorney representing a debtor in a case under this title, or in connection with such a case, whether or not such attorney applies for compensation under this title, shall file with the court a statement of the compensation paid or agreed to be paid, if such payment or agreement was made after one year before the date of the filing of the petition, for services rendered or to be rendered in contemplation of or in connection with the case by such attorney, and the source of such compensation.
>
> (b) If such compensation exceeds the reasonable value of any such services, the court may cancel any such agreement, or order the return of any such payment, to the extent excessive, to-
> (1) the estate, if the property transferred-
> (A) would have been property of the estate; or
> (B) was to be paid by or on behalf of the debtor under a plan under chapter 11, 12, or 13 of this title; or
> (2) the entity that made such payment.

attorneys may be tempted to divert . . . funds to themselves by charging excessive fees."). *See also,* S.Rep. No. 989, 95th Cong., 2d Sess. 39 (1978) U.S.Code Cong. & Admin.News 1978, pp. 5787, 5825, 5963, 6285 ("[p]ayments to a debtor's attorney provide serious potential for evasion of creditor protection provisions of the bankruptcy laws, and serious potential for overreaching by the debtor's attorney, and should be subject to careful scrutiny.").

Section 727(b), in contrast, establishes the substantive rights of debtors to a discharge of "all debts" that arise prior to the filing of bankruptcy, limiting that discharge only by reference to the specific list of nineteen exceptions found in

section 523. It is grounded in the most fundamental goals of the Bankruptcy Code: providing a fresh start for debtors and ensuring equal treatment for creditors. *See In re Meyers*, 196 F.3d at 624.

Nothing in the language or effect of section 329 creates an exception to discharge for pre-petition attorneys' fees, or even guarantees the payment of such fees. Absent such an express provision, Mr. Rittenhouse's request that this Court should craft an implied exception to discharge that justifies ignoring the plain language of sections 727(b) and 523 must be rejected. *See Nextwave,* 537 U.S. at 304; *Kawaauhau v. Geiger*, 523 U.S. at 62; *Ohio v. Kovacs*, 469 U.S.at 277; *Gleason v. Thaw*, 236 U.S. at 562. *In re Meyers*, 196 F.3d at 624 (exceptions to discharge should be narrowly construed consistent with the policy of providing the debtor with a "fresh start"). *See also, In re Juzwiak*, 89 F.3d 424, 427 (7th Cir. 1996) ("Consistent with the 'fresh start' policy underlying the Code, these exceptions to discharge [in section 523] should be construed strictly against the creditor and liberally in favor of the debtor").

Section 329 simply does not support the expansive reading Mr. Rittenhouse would give it. Significantly, the three circuit courts that have been presented with this construct of section 329 have rejected it. *Fickling*, 361 F.3d at 175-76 ("there is no basis for . . . asserting that § 329 conflicts with § 727(b)"); *Bethea*, 352 F.3d at 1127 ("the structure of the Bankruptcy Code does not support treating § 329 as an implicit exception to § 727"); *Biggar*, 110 F.3d at 688 ("Because there is no conflict between the discharge and disclosure provisions [in section 329], the plain meaning of the discharge rules must be given effect.").[4/]

In further support of his argument that there is a conflict between section 329 and sections 727 and 523, Mr. Rittenhouse contends that the discharge of pre-petition attorneys' fees would render section 329 review meaningless. Appellant's Brief at 10. In *Biggar*, however, the Ninth Circuit demonstrated that this argument is unpersuasive, noting that section 329 would continue to have force in chapter 11 and 13 cases, because in those types of cases a plan might call for review of post-petition payments to an attorney. *Biggar,* 110 F.3d at 688. The court also found that even if pre-petition attorneys' fees were subject to discharge, section 329 had continued applicability in a chapter 7 case, observing that a court could review post-petition payments if a chapter 7 debtor re-affirms an obligation

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[4/] In addition to the three circuit court decisions cited above, the vast majority of courts to address this issue have held that pre-petition attorneys' fees are discharged pursuant to section 727(b). *See, e.g., Gordon v. Hines (In re Hines)*, 147 F.3d 1185 (9th Cir. 1998); *Sanchez v. Gordon (In re Sanchez)*, 241 F.3d 1148 (9th Cir. 2001); *In re Jastrem*, 253 F.3d 438 (9th Cir. 2001); *In re McNickle*, 274 B.R. 477 (Bankr. S.D. Ohio 2002); *In re Nieves*, 246 B.R. 866 (E.D. WI 2000); *In re Toms*, 229 B.R. 646 (Bankr. E.D. Pa. 1999); *In re Voglio*, 191 B.R. 420 (D.Ariz. 1996); *In re Symes*, 174 B.R. 114 (Bankr. D. Ariz. 1994); *In re Haynes*, 216 B.R. 440 (Bankr. D. Colo. 1997).

to an attorney. Id.[5] Because the two statutes were capable of co-existing, the court held that there was no conflict between section 329 and sections 727(b) and 523, and that the plain language of section 523 must be given effect. Id. at 688 (*citing Ruckelshaus v. Monsanto co.*, 467 U.S. 986, 1018 (1984) ("statutory provisions should be given effect where capable of coexistence").

The Seventh Circuit *In re Bethea*, also dismissed this argument: "§ 329 has plenty to do in Chapter 7 cases, even if debts for legal fees are subject to discharge." The court noted several applications section 329 under such a circumstance, including assessing : whether pre-paid fees exceed the "reasonable" value of and could be recovered for the benefit of creditors; whether post-petition fees are reasonable; and, whether the fees are reasonable if the debt is reaffirmed during the proceeding. Bethea, 352 F.3d at 1127. *See also Fickling*, 361 F.3d at 175-76 (agreeing with Seventh and Ninth Circuits that the discharge of pre-petition attorneys' fees does not render section 329 superfluous),

As the reasoning of the circuit courts demonstrate, section 329[6] and the discharge provisions

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[5] A debtor may, under prescribed conditions and with court approval, re-affirm a pre-petition debt pursuant to 11 U.S.C. section 524(c).

[6] Mr. Rittenhouse makes the insubstantial argument that Federal Rules of Bankruptcy Procedure, Rules 1006, 2016 and 2017 support his section 329 argument. Rules 2016 and 2017 are reporting and disallowance provisions, drafted to implement section 329, among others. Mr. Rittenhouse appears to contend that Rule 2017(b) will be rendered null in chapter 7 cases if pre-petition fees are discharged. For the reasons discussed above in the text, section 329 has continued applicability. Consequently the rules implementing it will likewise not be rendered null. Rule 1006(b)(3) specifically provides any installment payment of the filing fee must be completed before payment of any attorneys' fees
or fees to other persons retained in connection with the case may be paid. Even if pre-petition fees are discharged, this rule would still prohibit payment of post-petition attorneys' fees until the filing fee is completely paid. It thus continues to

serve different purposes and are not in conflict. Consequently, Mr. Rittenhouse's contention that the plain language in sections 727(b) and 523 should not be given effect is insupportable.

Finally, Mr. Rittenhouse asserts that the discharge of pre-petition attorneys' fees may prevent indigent debtors from access to counsel, because competent counsel will be unwilling to represent chapter 7 debtors who might seek to discharge the fees owed. Appellant's Brief at 34-36. This is an inappropriate policy argument and should be rejected. *Bethea*, 352 F.3d at 1127-28 (rejecting the same argument and stating "[t]hat argument about what makes for good public policy should be directed to Congress; the judiciary's job is to enforce the law Congress enacted, not write a different one the judges think superior.") (*citing Banrhart v. Sigmon Coal Co.* 534 U.S. 438, 460 - 62 (2002) and *United States v. Kras*, 409 U.S. 434 (1973). *See also Nat'l Life and Accident Ins. Co. v. United States*, 524 F.2d 559, 560 (6th Cir.1975) ("The Courts . . . do not have the power to repeal or amend the enactments of the legislature even though they may disagree with the result; rather it is

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provide an incentive for debtors to complete the payment of all filing fees and is not rendered ineffective by the discharge of pre-petition fees.

Mr. Rittenhouse's arguments concerning these rules are, therefore, without merit. Further, these rules cannot provide an independent basis for an exception to discharge, because the Federal Rules of Bankruptcy Procedure cannot "abridge, enlarge, or modify any substantive right." 28 U.S.C. 2075. Indeed, any construction of the bankruptcy rules that purports to create an implicit exception to the discharge over and above those granted under section 727(b) must be rejected as abridging the debtor's substantive right to a discharge granted under the express terms of section 727(b). Finally, any such construction would also be contrary to the Supreme Court's mandate that exceptions to discharge are narrowly construed. *Nextwave,* 537 U.S. at 304; *Kawaauhau v. Geiger*, 523 U.S. at 62; *Ohio v. Kovacs*, 469 U.S.at 277; *Gleason v. Thaw*, 236 U.S. at 562.

their function to give the natural and plain meaning effect to statutes as passed by Congress."). Moreover, as the bankruptcy court below recognized, this issue rarely arises because there are a number of creative solutions available to debtors that enable them to pay their attorneys fees before the case is filed. (R.2, Notice of Transmittal, Apx ___ (Bankr. Dkt. # 41, at 6))

C. The Legislative History Of Section 329 Does Not Support The Existence Of An Implicit Exception To Discharge

"[W]here as here, the statute's language is plain, 'the sole function of the courts is to enforce it according to its terms.'" *U.S. v. Ron Pair Enterprises, Inc.*, 489 U.S. 235, 240 (1989) (*quoting Caminetti v. U.S.* 242 U.S. 470, 485 (1917)). As discussed above, nothing in the plain language of section 329 provides for an exception to discharge for unpaid attorneys' fees earned prior to the filing of the petition. *Fickling*, 361 F.3d at 175-76; *Bethea*, 352 F.3d at 1127; *Biggar,* 110 F.3d at 688. Consequently, it is inappropriate to resort to an examination of its legislative history to construe that provision. *See In re Comshare, Inc.*, 183 F.3d 542, 549 (6th Cir.1999) (resort to a review of congressional intent or legislative history only when the language of the statute is not clear) (*citing Consumer Prod. Safety Comm'n v. GTE Sylvania, Inc*., 447 U.S. 102, 108 (1980)).

Nonetheless, nothing in Mr. Rittenhouse's discussion of section 329's legislative history supports his argument that section 329 creates an implicit exception to the discharge provided for by section 727(b). Mr. Rittenhouse argues that section 60d[7/] of the Bankruptcy Act of 1989 (the

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[7/] Former section 60d provided:

> d. If a debtor shall, directly or indirectly, in contemplation of the filing of a petition by or against him, pay money or transfer property to an attorney at law, for services rendered or to be rendered, the transaction may be

predecessor of section 329) was a discrete, exclusive regulation of debtors' attorneys' fees that was enacted to protect a debtor's right to competent counsel by controlling the compensation of counsel. Appellant's Brief at 12-13. This, Mr. Rittenhouse contends, was the prior practice for three-quarters of a century and Congress evidenced no intention in the Bankruptcy Code or its legislative history to change prior practice. *Id.* at 13-14. Mr. Rittenhouse argues, therefore, that section 60d's successor, section 329, should also be construed similarly. In response to this argument, it must be noted that section 60d did not except from discharge the pre-petition obligation to pay for pre-petition services. Section 60d authorized the bankruptcy court to review any payment or promise of payment of attorney fees, no matter whether it was made pre-petition or post-petition, and that such payments or promises were valid only to the extent reasonable, with any excess to be recovered by the estate.

Further, appellant's brief (at 13-14) cites various Bankruptcy Act opinions in support the proposition that the courts recognized the importance of safeguarding a debtor's right to choose counsel: *In re Wood*, 210 U.S. 246 (1908), *In re Cummins*, 196 F. 224 (S.D.N.Y. 1912),

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> examined by the court on its own motion or shall be examined by the court on the petition of the trustee or any creditor and shall be held valid only to the extent of a reasonable amount to be determined by the court, and the excess may be recovered by the trustee for the benefit of the estate.
>
> If, whether before or after the filing, a debtor shall agree orally or in writing to pay money or transfer property to an attorney at law after the filing, the transaction may be examined by the court on its own motion or shall be examined by the court on petition of the bankrupt made prior to discharge and shall be valid only to the extent of a reasonable amount to be determined by the court, and any excess obligation shall be cancelled, or if excess payment or transfer has been made, returned to the bankrupt.

Michelbacher v. Haar (In re Falk), 30 F.2d 607 (2d Cir. 1929), and *Caldwell v. Valley National Bank of Phoenix*, 208 F.2d 645 (10th Cir. 1953). Upon close review, however, those decisions did not confront the issue of whether unpaid attorneys' fees for pre-petition work are dischargable. These decisions merely state that if an attorney did receive a pre-petition payment for pre-petition services, that payment could not be recovered by the bankruptcy estate as a preference.[8/]

Finally, even if there were an implicit exception from the discharge under section 60d of the Bankruptcy Act for debtors' attorneys' fees, if the drafters of the Bankruptcy Code had wanted such an exception to continue under the Bankruptcy Code it is logical to conclude that they would have thought such a provision important enough to make it explicit along with the other explicit exceptions to the discharge found at section 523(a). For all these reasons, Mr. Rittenhouse's reliance upon section 60d is misplaced.

[8/] A preference payment made shortly before the filing of the petition to a specific creditor is recoverable by the estate for the benefit of all creditors. The right to pursue such a claim is currently set forth in section 547 of the Bankruptcy Code.

Conclusion

For all the above reasons, the United States Trustee asks this Court to affirm the order of the district court.

DONALD F. WALTON
Acting General Counsel

____
PAUL W. BRIDENHAGEN
P. MATTHEW SUTKO
Executive Office for United
States Trustees
U.S. Department of Justice
20 Massachussets Ave, N.W.
Washington, D.C. 20530
(202) 307-1399

CERTIFICATE OF COMPLIANCE

Pursuant to 6th Cir. Rule 32(a)(7)(C), the undersigned certifies this brief complies with the type-volume limitations of 6th Cir. Rule 32 (a)(7)(B) and that the foregoing proof brief contains _6146_ words. The proof brief was prepared in WordPerfect, Times Ne Roman 14 pt. font.

______ ________________________

Date Paul W. Bridenhagen

CERTIFICATE OF SERVICE

I hereby certify that 1 copy of the foregoing Proof Brief has been served on the following by first class U.S. mail, postage pre-paid, on May 27, 2004:

Allan J. Rittenhouse, Esq.
Norman P. Moore, Jr.
220 E. B Street
P.O. Box 62
Iron Mountain, MI 49801-0062

______ ____________________
Date Paul W. Bridenhagen

APPELLEE’S JOINT APPENDIX DESIGNATION

The United States Trustee hereby designates for inclusion in the Joint Appendix only those same parts of the record previously designated in the **Appellant’s Designation of Joint Appendix Contents**, which is contained in Appellant’s Brief, at 40.

______ ________________________
Date Paul W. Bridenhagen

ADDENDUM

INDEX TO ADDENDUM

Federal Statutes

Statutes and Federal Rules of Bankruptcy Procedure relevant to this appeal appear in the addendum in the following order:

28 U.S.C. section 158

28 U.S.C. section 586

28 U.S.C. section 2075

11 U.S.C. section 329

11 U.S.C. section 341

11 U.S.C. section 362

11 U.S.C. section 523

11 U.S.C. section 524(c)

11 U.S.C. section 727(b)

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Federal Rules of Bankruptcy Procedure, Rule 2017

Federal Rule of Bankruptcy Procedure 8013

BRIEF BANK — "SUMMARY SHEET" Printed Thu.-10/9/3 (9:14)

WESTLAW CODES

1. **("TI")** TITLE OF CASE
[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]

Rittenhouse v. Eisen, UST
(In re Chandlier)

2. **("CO")** CURRENT COURT
[E.g., "CTA9"]

WDMI
Chief Judge Bell

3. **("CCN")** CURRENT CASE NO.

No.: 2:03-cv-00160

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[IF ANY]

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Judge Stevenson (Identify judge & cite, if any)

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Michael V. Maggio, UST

(UST/OGC: 202-307-1399/FAX-2397)

8. **("TO")** TOPIC

BANKRUPTCY

9. **("SU")** • SUMMARY OF KEY ISSUE(s)
&
√ Any Miscellaneous BACKGROUND

• The bankruptcy court properly held that 11 U.S.C. §727(b) discharged all unpaid prepetition attorney fees that were owed as of the filing of the bankruptcy petition.

√ **Background:**

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UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF MICHIGAN

In re:

Sara L. Chandlier,

Case No. SM00-90786
Chapter 7
Honorable Jo Ann C. Stevenson

Debtor./

Allan J. Rittenhouse,

Appellant,

v.

District Court Case No.
2:03-cv-00160
Honorable Robert Holmes Bell
Chief Judge

Saul Eisen, United States Trustee,

Appellee.

/

APPELLEE UNITED STATES TRUSTEE'S BRIEF

Counsel for Appellee
Michael V. Maggio
Trial Attorney
Office of the U.S. Trustee
United States Department of Justice
330 Ionia NW, Suite 202
Grand Rapids, Michigan 49503
Tel: (616) 456-2002, ext. 14

Of Counsel
Joseph A. Guzinski
P. Matthew Sutko
Office of the General Counsel
Executive Office for United States Trustees
United States Department of Justice
20 Massachusetts Avenue NW
Washington, D.C. 20530

(202) 307-1399

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STATEMENT OF THE BASIS OF APPELLATE JURISDICTION

The appellant appeals as of right under 28 U.S.C. 158(a)(1) from the Bankruptcy Court's June 16, 2003 Final Order Pursuant to the Opinion and Order of April 16, 2003, prohibiting the appellant from collecting postpetition any unpaid fees for prepetition bankruptcy counseling services. (Bankruptcy Court Docket Sheet Document No. 57)[1] This was a final order of the Bankruptcy Court. The Bankruptcy Court had jurisdiction over this issue under 28 U.S.C. Section 157(b)(1).

STATEMENT OF THE ISSUE PRESENTED

The bankruptcy court properly held that 11 U.S.C. Section 727(b) discharged all unpaid prepetition attorney fees that were owed as of the filing of the bankruptcy petition.

STANDARD OF APPELLATE REVIEW

"The bankruptcy court's factual findings are examined for clear error (i.e., 'the most cogent evidence of mistake of justice'), while all conclusions of law are reviewed *de novo*." *City of Baltimore v. State of West Virginia (In re Eagle-Pitcher Industries, Inc.)*, 285 F.3d 522, 527 (6th Cir. 2002); Federal Rule of Bankruptcy Procedure 8013. The

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[1] Hereinafter, this brief cites documents by the Bankruptcy Court docket sheet entry number as follows: "(Docket Sheet Document No. __.)"

Bankruptcy Court's decision that 11 U.S.C. Section 727(b) discharged all unpaid prepetition attorney fees that were owed as of the filing of the bankruptcy petition was a conclusion of law.

STATEMENT OF THE CASE

On April 17, 2000, in the case of *In re Ernest J. Desilets*, Case No. GM99-90364, the Honorable James D. Gregg, Chief Judge of the United States Bankruptcy Court for the Western District of Michigan[2], entered an opinion and order finding that Allan J. Rittenhouse (hereinafter, "the appellant"), was not authorized to practice in that court because he was not a member of the Michigan bar. Mr. Rittenhouse filed an appeal of the order of April 17, 2000. On September 26, 2000, Mr. Rittenhouse consented before the Bankruptcy Court *en banc* to the entry of an order suspending Mr. Rittenhouse from the roll of attorneys and enjoining him from practicing law in the Bankruptcy Court for the Western District of Michigan, pending a resolution of his appeal of the order of April 17, 2000.

Sara Chandlier, the debtor, filed a petition for relief under Chapter 7 of the Bankruptcy Code on November 6, 2000. The petition listed the attorney for the debtor as

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[2] At that time Judge Gregg was responsible for the Marquette docket. Since that time, under the Bankruptcy Court's normal schedule, Judge Gregg has rotated out of Marquette and the Honorable Jo Ann C. Stevenson now sits in Marquette and rendered the decision upon appeal.

Michael Pepin, Esq. (Docket Sheet Document No. 1.)

According to the response to Question 9 of the Statement of Affairs, and the Statement Filed Under Rule 2016(b), prior to the filing of the petition, the debtor paid Mr. Pepin nothing for his debt or bankruptcy counseling services as attorney for the debtor. Instead, the debtor agreed to pay $800 to Mr. Pepin as his fee, with a balance due of $800. (Docket Sheet Document No. 1.)

The debtor's meeting with the chapter 7 trustee and the creditors, required under 11 U.S.C. Section 341, was scheduled for December 7, 2000, and adjourned to December 21, 2000. No attorney appeared on behalf of the debtor at either meeting. The debtor appeared on December 21, 2000 and was examined without her attorney present, with the debtor's consent. (Docket Sheet Document No. 8 and 9; Transcript of Hearings Held on December 7 and 21, 2000, Docket Sheet Document 34; Bankruptcy Court Opinion of April 16, 2003, page 2, Docket Sheet Document No. 41.)

The Bankruptcy Court granted the debtor a discharge of all prepetition debts on May 3, 2001. (Docket Sheet Document No. 23.) That discharge has never been set aside, nor has any motion been filed to except any particular debt from the discharge. (Bankruptcy Court Docket Sheet.)

On June 3, 2002, a divided panel of the United States Court of Appeals for the Sixth Circuit reversed the order of April 17, 2000 prohibiting Mr. Rittenhouse from practicing in the Bankruptcy Court for the Western District of Michigan. *Rittenhouse v. Delta Home Improv., Inc. (In re Desilets)*, 291 F.3d 925 (6th Cir. 2002). The majority held that Mr. Rittenhouse did not need Michigan state bar licensure to practice before the United States Bankruptcy Court for the Western District of Michigan. Pursuant to the mandate of the Sixth Circuit, on September 19, 2002 the Bankruptcy Court rescinded the orders, suspension and injunction of April 17, 2000 and September 26, 2000. Mr. Rittenhouse was restored to the bar for the Bankruptcy Court for the Western District of Michigan.

On or about November 19, 2002 Allan J. Rittenhouse, Esq., wrote to the debtor claiming to have been her attorney in her bankruptcy filing, demanding payment of the $800 attorney fee to him as attorney for the debtor, and threatening to sue the debtor to collect the $800. (Attachment to the United States Trustee's Motion Requesting Review and Disgorgement, Docket Sheet Document No. 28.) Mr. Rittenhouse attached to the letter a draft state court complaint, and six pages of proposed document requests, requests for admissions, and interrogatories. (The interrogatories reference a motion for contempt for violation of the automatic stay of 11 U.S.C. Section 362, and are apparently form interrogatories which bear no relationship to the debtor's situation.) In the complaint Mr. Rittenhouse alleges that the debtor contracted with Mr. Rittenhouse to act as attorney for the debtor and the debtor further agreed to pay Mr. Rittenhouse $800 as an attorney fee. (Attachment to the United States Trustee's Motion Requesting Review and Disgorgement, Docket Sheet Document No. 28.) The complaint did not explain how Mr. Rittenhouse was able to continue practicing bankruptcy law during a time he had been suspended voluntarily from practicing before the bankruptcy court, or why the attorney listed on the debtor's petition as the debtor's attorney actually had not been the attorney in the debtor's bankruptcy case.

On December 17, 2002, the United States Trustee[3] filed the Motion Requesting Review and Disgorgement of Attorney Compensation Under 11 U.S.C. Section 329(b) and Rule 2017, and Sanctions Under 11 U.S.C. Section 362. (Docket Sheet Document No. 28.) The motion alleged: 1) that Mr. Rittenhouse was not the debtor's attorney, although he may have acted as Mr. Pepin's paralegal when this case was filed; 2) Mr. Rittenhouse had not proven he had any right to collect the fees from the debtor; 3) that the services performed for the debtor did not justify a fee of $800; and 4) that the filing of the bankruptcy petition had discharged all of the debtor's prepetition obligations, including the debtor's prepetition agreement to pay the $800 attorney fee.

The Bankruptcy Court heard argument on the motion on January 16, 2003. (Docket Sheet Document No. 37.)

On April 16, 2003 the Bankruptcy Court issued the Opinion and Order holding that the debtor's prepetition obligation to pay the attorney fee was discharged by the filing of the bankruptcy petition. The order of April 16, 2003 scheduled a hearing for May 16, 2003 to determine the sanctions that should be levied upon Mr. Rittenhouse for

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[3] The United States Trustee is an officer of the United States Department of Justice. 28 U.S.C. Section 581 *et seq.* The United States Trustee is charged with the duty and authority to, *inter alia*, monitor the progress of cases under Title 11 and to supervise the administration of cases under chapters 7, 11, 12 and 13 of Title 11. 28 U.S.C. Section 586(a)(3) and (a)(3)(G). The United States Trustee may raise and may appear and be heard on any issue in any case or proceeding under Title 11, except that the United States Trustee may not file a plan of reorganization in a Chapter 11 case. 11 U.S.C. Section 307.

attempting to collect a discharged debt. (Docket Sheet Document No. 41.) The bankruptcy court did not resolve the factual question regarding who had been the debtor's counsel in the bankruptcy proceeding, or whether the appellant had purchased this account receivable.

On April 21, 2003 Mr. Rittenhouse filed an interlocutory appeal of the Bankruptcy Court's interim order of April 16, 2003. (The District Court dismissed that interlocutory appeal, *see* File No. 2:03-CV-86, on August 11, 2003.)

On May 16, 2003 the Bankruptcy Court held a hearing on sanctions and concluded at the end of the hearing that the only sanction to be imposed upon Mr. Rittenhouse was to prohibit him from collecting postpetition any unpaid fees owed for prepetition services, until and unless the Bankruptcy Court opinion and order of April 16, 2003 were reversed upon appeal. (Docket Sheet Document No. 55.) The Bankruptcy Court entered the Final Order Pursuant to the Opinion and Order of April 16, 2003 on June 16, 2003. (Docket Sheet Document No. 57.) Mr. Rittenhouse filed his notice of appeal of the Final Order on June 26, 2003. (Docket Sheet Document No. 58.)

ARGUMENT

I. Summary of Argument

As of the filing of this bankruptcy case, the debtor owed her attorney an unpaid debt of $800 for attorney fees incurred in the filing of this case.[4] By operation of law, the filing of this bankruptcy case stayed any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case. 11 U.S.C. Section 362(a)(6) (creating an automatic stay, which is a mandatory injunction, prohibiting such collection efforts post-petition). The debtor subsequently received her discharge under 11 U.S.C. Section 727(a); under Section 727(b) that discharged the debtor from "all debts [of hers] that arose before" the filing of her bankruptcy petition, except for debts which are specifically listed under 11 U.S.C. Section 523(a) as excluded from the discharge.

Section 523(a) excepts eighteen specifically enumerated debts from discharge under Section 727(b); there is no exception for prepetition attorney fees owed to the attorney for the debtor. Once Sara Chandlier's discharge was granted, Section 524(a)(2) enjoined Mr. Rittenhouse from commencing or continuing to collect, recover or offset

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[4] Although the debtor's bankruptcy petition represented that another attorney, Mr. Pepin, was debtor's counsel, Mr. Rittenhouse's draft complaint asserted that he had been the attorney for the debtor. Mr. Rittenhouse did not explain this to the bankruptcy court. Instead, he told the bankruptcy court that he had purchased this account receivable from Mr. Pepin. Mr. Rittenhouse put no documents into evidence establishing this, and provided no testamentary evidence regarding who was actually the debtor's counsel, who did the work, or what arrangement, if any, Mr. Rittenhouse had with Mr. Pepin regarding this particular debtor during the time Mr. Rittenhouse was suspended from practice. Mr. Rittenhouse admitted at the January 16, 2003 hearing that he had no documentary evidence to prove his alleged purchase of the accounts receivable from Mr. Pepin. (Docket Sheet Document No. 37, page 13.)

any discharged debt against the debtor. Since prepetition attorney fees owed to Mr. Rittenhouse were not excepted from the discharge, Ms. Chandlier's obligation to the appellant, if she ever in fact actually had one, was discharged and the appellant was enjoined from taking any steps to collect that debt from the debtor.

Rather than abiding by the law, Mr. Rittenhouse sought to intimidate Ms. Chandlier, a person of limited means, by bombarding her with a dunning letter, a draft complaint, and an onerous set of interrogatories. This was wrong. Ms. Chandlier had followed the rules in bankruptcy and she had a right not to be pursued, much less hectored, over discharged debts.

Mr. Rittenhouse does not contest that Ms. Chandlier's discharge wiped away her dischargeable debts. Mr. Rittenhouse does not contest that pre-petition attorney fees are not one of the eighteen specific exceptions to discharge. Instead, he seeks to side-step those statutory prohibitions, which deal specifically with the effect of Ms. Chandlier's discharge, by invoking, of all things, a consumer protection statute, Section 329 of the Bankruptcy Code. Section 329 serves two purposes. First, it requires attorneys to disclose all fee arrangements with clients, both legal and illegal ones. Second, it allows a bankruptcy court to review all fee arrangements between a debtor and the debtor's attorney, and reduce fees as appropriate.

It is dispositive of Mr. Rittenhouse's appeal that Section 329 is not an authorization provision. Neither its language nor its legislative history even hint that Section 329 authorizes attorneys to charge anything, supercedes provisions of the

Bankruptcy Code that limit or prohibit compensation, or preempts state law restrictions upon attorneys' ability to represent and charge fees to clients.

Even Mr. Rittenhouse concedes that the majority of cases that have considered this issue have held that Section 727(b) discharges all prepetition debts, including attorney fees. Faced with Section 727(b)'s plain inclusion of his fees within the scope of Ms. Chandlier's discharge, Mr. Rittenhouse seizes upon a single aberrant case, *Bethea v. Adams (In re Bethea)*, 275 B.R. 284, 292 (Bankr. N.D. Ill. 2002), *aff'd*, 287 B.R. 906 (N.D. Ill. 2003)[5], that erroneously concluded that Section 329 creates an implicit exception to the discharge of debts found in Section 727(b).

Bethea diverges from the weight of authority and its reasoning is flawed. First, Section 329 is not a provision that creates an entitlement to fees; it's a fee disclosure and fee reduction provision. Fees must be otherwise appropriate and allowable under applicable law. Second, under accepted canons of statutory construction Section 329 cannot overrule Section 727(b) and therefore Section 329 is not an implicit exception to Section 727(b).

Only the explicit exceptions created by Congress in 11 U.S.C. Section 523(a) survive discharge. Properly understood then, Section 329 does not conflict with Section 727(b), and in fact confers no independent right to compensation upon the appellant.

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[5] An appeal of this decision is pending before the Seventh Circuit Court of Appeals. The appeal was filed on February 6, 2003 and bears the case number 03-1303.

II. There Are No Implicit Exceptions To The Section 727(b) Discharge

Section 727(b) of the Bankruptcy Code provides as follows:

> Except as provided in section 523 of this title, a discharge under subsection (a) of this section discharges the debtor from all debts that arose before the date of the order of relief under this chapter, and any liability on a claim that is determined under section 502 of this title as if such claim had arisen before the commencement of the case, whether or not a proof of claim based on any such debt or liability is filed under section 501 of this title, and whether or not a claim based on any such debt or liability is allowed under section 502 of this title.

11 U.S.C. Section 727(b). By its express terms, Section 727(b) discharges all debts other than those listed in Section 523. In turn, 11 U.S.C. Section 523(a) creates eighteen explicit exceptions to the discharge.

A debtor's pre-petition obligation to pay attorney fees therefore does not survive discharge because such fees are not among the eighteen debts excepted from the discharge under Section 523. Equally significantly, Section 523 does not except from discharge a fee reviewed, or even theoretically approved, under Section 329 of the Code. For these reasons, Mr. Rittenhouse's fees did not survive discharge and he should not have threatened to sue Ms. Chandlier for fees after she received her discharge and successfully completed her bankruptcy.

Mr. Rittenhosue relies heavily upon an aberrant decision, *Bethea v. Adams (In re Bethea)*, 275 B.R. 284, 292 (Bankr. N.D. Ill. 2002), *aff'd*, 287 B.R. 906 (N.D. Ill. 2003), which held that Section 329 creates an implicit but necessary exception to the discharge of debts found in Section 727(b). The *Bethea* bankruptcy court wrote, "this Court reads sections 362(a)(6), 727(b), and 524(a)(2) in a manner that will preserve the right that Section 329(b) implicitly, but necessarily, grants to chapter 7 debtors and their attorneys to agree to the payment of fees after the order for relief." *Id*. The *Bethea* bankruptcy court and district court opinions do not cite any authority which expressly holds that there are implicit exceptions to the discharge other than the express exceptions found in Section 523.

The *Bethea* decisions were entered before the Supreme Court issued its decision in *Federal Communications Commission v. Nextwave Personal Communications, Inc.*, - U.S. -, 123 S.Ct. 832 (2003). In *Nextwave*, the Supreme Court forcefully rejected the idea that there are implicit or unwritten exceptions to the discharge other than the express exceptions to the discharge set forth in 11 U.S.C. Section 1141(d), which restricts exceptions to the discharge in Chapter 11 cases to those set forth in Section 523 in the same way that Section 727(b) does in Chapter 7. In interpreting Section 1141(d), the discharge provision of Chapter 11, *Nextwave* held, " [a] preconfirmation debt is dischargeable unless it falls within an express exception to discharge. Section 1141(d) of the Bankruptcy Code states that, except as otherwise provided therein, the 'confirmation of a plan [of reorganization]...discharges the debtor from *any debt* that arose before the date of such confirmation,' 11 U.S.C. 1141(d)(1)(A)(emphasis added), and the only debts it excepts from that prescription are those described in Section 523, see 1141(d)(2). Thus, '[e]xcept for the nine[6] kinds of debts saved from discharge by 11 U.S.C. Section 523(a), a discharge in bankruptcy discharges the debtor *from all debts that arose before bankruptcy*. Section 727(b). *Ohio v. Kovacs*, 469 U.S. 274, 278 (1985)." 123 S.Ct. 840. (Emphasis as in *Nextwave.*)

Thus, Section 1141(d)(1)(A) discharges a debtor from "any debt" except those expressly listed in Section 523; and Section 727(b) discharges a debtor from "any debt" except those expressly listed in Section 523. The Supreme Court's reasoning in *Nextwave* is equally applicable to Section 727(b).

In the case relied upon by *Nextwave*, *Ohio v. Kovacs*, 469 U.S. 274, 105 S. Ct. 705 (1985), the Supreme Court held that even a Chapter 7 debtor's obligation under a state court injunction to clean up a hazardous waste cite pursuant to state law was a debt discharged by Section 727(b) in the debtor's subsequent bankruptcy filing. "Except for the nine [at that time] kinds of debts saved from the discharge by 11 U.S.C. Section 523(a), a discharge in bankruptcy discharges the debtor from all debts that arose before the bankruptcy. 727(b)." 105 S.Ct. 708. At the end of the *Kovacs* opinion the Supreme Court makes it clear that the debtor might still be prosecuted for the violation of the state environmental laws or for criminal contempt.

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[6] At the time that *Ohio v. Kovacs*, 469 U.S. 274 (1985) was decided, there were only nine exceptions to the discharge listed in Section 523(a). Subsequent amendments to the Bankruptcy Code have increased the number of enumerated exceptions to the discharge to eighteen. Although Congress has amended Section 523(a) several times to add new exceptions to the discharge, it has never included pre-petition fees owed to the debtor's attorney among the listed exceptions.

The Supreme Court also noted that had a fine or a monetary penalty for violating the state law been imposed prior to the bankruptcy, that would have been excepted from discharge under Section 523(a)(7). It is interesting to note that even though there is an express exception under Section 523(a)(7) for fines and penalties, the Supreme Court did not attempt to base an unwritten or even expanded exception to the discharge for violation of environmental laws upon the text of Section 523(a)(7). Instead, *Kovacs* concluded, "As the case comes to us, however, Kovacs has been dispossessed and the State seeks to enforce his cleanup obligation by a money judgment," which was discharged. 105 S. Ct. at 712.

The Supreme Court has also addressed this issue in *Kawaauhau v. Geiger*, 523 U.S. 57, 118 S. Ct. 974 (1998). The issue in *Kawaauhau* was whether a debt arising from a medical malpractice judgment, attributable to negligent or reckless conduct, fell within the Section 523(a)(6) exception to the discharge. (Section 523(a)(6) expressly excepts from discharge a debt for "willful and malicious injury by the debtor to another.") The debtor physician's decision to discontinue all antibiotics because he incorrectly believed the patient's infection to have subsided caused the eventual amputation of the patient's right leg below the knee. The patient obtained a malpractice judgment, and the physician filed a bankruptcy petition.

The bankruptcy court held that the malpractice judgement was nondischargeable under Section 523(a)(6), and the district court affirmed. The court of appeals reversed, holding that Section 523(a)(6) was limited to intentional torts. The Supreme Court agreed, holding that “the ‘well-known’ guide that exceptions to discharge ‘should be confined to those plainly expressed.’ *Gleason v. Thaw*, 236 U.S. 558, 562, 35 S.Ct. 287, 289 (1915)” prevented every intentional act which results in an unintended injury from being held non-dischargeable under Section 523(a)(6). 118 S. Ct. 977. The malpractice judgment was therefore discharged under Section 727(b).

Nextwave, Kovacs and *Kawaauhau* are both controlling and persuasive. By prohibiting exceptions other than those set forth in the Code they prohibited Mr. Rittenhouse from pursuing Ms. Chandlier after she received her discharge.

These Supreme Court decisions consistently hold that a court may not add exceptions to a statute that already contains express exceptions: “exceptions to the discharge ‘should be confined to those plainly expressed.’” *Kawaauhau*, 118 S.Ct. at 977. Because Section 727(b) limits exceptions to those contained in Section 523, no other exceptions, including those Mr. Rittenhouse seeks to squeeze into Section 329, are appropriate.

The appellant cites *Citizens Bank of Maryland v. Strumpf*, 516 U.S. 16, 116 S.Ct. 286 (1995) and *Kelly v. Robinson*, 479 U.S. 36, 107 S.Ct. 353 (1986), in support of his argument that an explicit exception to the discharge for debtors’ attorneys fees is not required. Appellant’s Brief, page 24. However, neither case is applicable here. In *Strumpf,* the Supreme Court considered whether a “the creditor of a debtor in bankruptcy may, in order to protect its setoff rights, temporarily withhold payment of a debt that it owes to the debtor in bankruptcy without violating the automatic stay imposed by 11 U.S.C. Section 362(a)." Section 553 of the Bankruptcy Code provides that, except as provided in Section 362 and 363, nothing in the Bankruptcy Code affects the right of a creditor to offset mutual debts with the debtor. Section 362(a)(7) stays any offset until and unless the bankruptcy court grants relief from the automatic stay.

In *Strumpf*, a bank had placed an administrative freeze on a Chapter 13 debtor's account while the bank's motion for relief from stay was pending. In deciding *Strumpf*, the Supreme Court did not find any conflict between Section 362(a) and Section 553, nor did the Supreme Court then create an implicit exception to either section of the Code. Instead, the Supreme Court held that imposing an administrative freeze was not an act of set off, and therefore it did not violate Section 362(a)(7), for the reason that accomplishing a set off requires three steps to effect the set off which are not present in an administrative freeze. The Supreme Court further held that the administrative freeze was not an act of dominion over property of the debtor, but merely a temporary refusal to pay a debt. None of this reasoning is applicable to this case. Nor does *Strumpf* even mention Section 727(b), let alone construe its reach, as the Supreme Court opinions cited above have.[7]

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[7] Interestingly, neither the *Bethea* bankruptcy court nor the district court opinions see as much support for their position in *Strumpf* and *Kelly* as does the appellant. The *Bethea* bankruptcy court opinion cites *Strumpf* for the proposition that the Supreme Court merely narrowed the scope of Section 362(a)(7), 275 B.R. at 292, and it cites *Kelly* for a general rule of statutory construction, 275 B.R. at 288. The *Bethea* district court opinion cites *Strumpf* and *Kelly* only for general rules of statutory construction. 287 B. R. at 909. If these opinions were

Kelly v. Robinson does not authorize the creation of an implicit exception to Sections 727 and 523. The issue in *Kelly* was whether restitution obligations, imposed as probation conditions in criminal proceedings, are dischargeable. As noted above, Section 523(a)(7) excepts from the discharge fines and penalties payable to a government unit. *Kelly* did discuss extensively the history of the current Bankruptcy Code of 1978 and the prior Bankruptcy Act of 1898, how the Code and the Act treated fines and penalties, and the federal relationship to state court criminal penalties in general, and that discussion did inform the consideration of the issue. Ultimately however, *Kelly* held that restitution obligations were not dischargeable because they are imposed as a remedy for wrongdoing, and payable to the state directly, and to the victim only indirectly, and that therefore they are fines or penalties and are excepted from the Section 727(b) discharge by Section 523(a)(7). *Kelly* thus did nothing more than interpret specific provisions of Sections 727 and 523 as themselves creating an exception to discharge based upon the facts of that case. No such provisions in those statutes apply in Mr. Rittenhouse's case.

III. Section 329 Does Not Conflict With Section 727(b), Creates No Right To Compensation, And Sections 727 And 523 Would Trump Section 329 Even If It Did

Section 329 of the Bankruptcy Code provides as follows:

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compelling authority for the proposition that there are implicit exceptions to the Section 727(b) discharge, then the *Bethea* opinions would certainly have cited them for that proposition.

> (a) Any attorney representing a debtor in a case under this title, or in connection with such a case, whether or not such attorney applies for compensation under this title, shall file with the court a statement of the compensation paid or agreed to be paid, if such payment or agreement was made after one year before the date of the filing of the petition, for services rendered or to be rendered in contemplation of or in connection with the case by such attorney, and the source of such compensation.
>
> (b) If such compensation exceeds the reasonable value of any such services, the court may cancel any such agreement, or order the return of any such payment, to the extent excessive, to-
> (1) the estate, if the property transferred-
> (A) would have been property of the estate; or
> (B) was to be paid by or on behalf of the debtor under a plan under chapter 11, 12, or 13 of this title; or
> (2) the entity that made such payment.

11 U.S.C. Section 329. The appellant's argument depends upon finding in Section 329 some implicit authorization for postpetition payments by the debtor of a prepetition debt owed to the debtor's attorney. For this point, Mr. Rittenhouse relies principally upon both *Bethea* opinions, which read Section 329 as a fee granting provision, not as a fee reporting and fee limiting provision.

First, even if the *Bethea* courts' readings of Section 329 were correct, their holdings would still be in error. Section 727(b) excepts from discharge only those things contained in Section 523. Even if Section 329 could be read as both approving fees and excepting those fees from the discharge, that exception to the discharge would still not be effective because Section 727(b) references only those exceptions to the discharge found in Section 523; Section 727(b) does not refer to any exceptions found in Section 329.

More fundamentally, Section 329 does not award fees. It merely requires the disclosure of fees obtained under other provisions of the Code, or state law, or private contract, and allows bankruptcy courts to order those fees to be returned if they are excessive. Like all statutory provisions, a construction of Section 329 must begin with its words. *Pennsylvania Department of Public Welfare v. Davenport*, 495 U.S. 552, 557-58, 110 S. Ct. 2126 (1990)(main holding superceded by statute). Section 329(a) states in part that any attorney for the debtor "shall file with the court a statement of the compensation paid or agreed to be paid," and Section 329(b) states that "the court may cancel any such agreement, or order the return of any such payment, to the extent excessive."

Section 329 differs fundamentally from the two sections of the Bankruptcy Code which do authorize compensation of attorneys, Sections 330 and 331. Section 330 states in various places that the "court may award ...to a professional person...reasonable compensation," (a)(1)(A); "the court may...award compensation that is less..." (a)(2); "In determining the amount of reasonable compensation to be awarded..."(a)(3)(A); "In a chapter 12 or chapter 13 case...the court may allow reasonable compensation to the debtor's attorney..." (a)(4)(B); "The Court shall reduce the amount of compensation awarded..." (a)(5); and "Any compensation awarded..." (a)(6)." Section 331 provides in part that "A trustee, an examiner, a debtor's attorney[8], or any professional person employed under section 327 or 1103 of this title may apply to the court...for such

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[8] Sections 330 and 331 concern the awarding of compensation from the estate. Although the appellant is a debtor's attorney, as a Chapter 7 debtor's attorney he is not entitled to compensation from the estate under the terms of Section 330, and therefore cannot seek interim compensation under Section 331.

compensation for services..."

Sections 330 and 331 use terms such as "award compensation," "may allow reasonable compensation," and "may apply to the court." By contrast, Section 329(a) requires that any attorney representing a debtor "shall file with the court a statement of compensation paid or agreed to be paid." Section 329 states that if the compensation reported pursuant to Section 329(a) is excessive, "the court may cancel any such agreement, or order the return of any such payment." Section 329 speaks in terms of requiring that the attorney for the debtor "shall file" and the court "may cancel." Section 329 has no terms like "may award compensation" or "may apply to the court." "[W]here as here, the statute's language is plain, 'the sole function of the courts is to enforce it according to its terms.'" *U.S. v. Ron Pair Enterprises, Inc.*, 489 U.S. 235, 240, 109 S.Ct. 1026, 1030, (1989) (quoting *Caminetti v. U.S.* 242 U.S. 470, 485, 37 S.Ct. 192 (1917)).

The language of Section 329 plainly does not approve the payment of compensation at all; Section 329 requires the debtor's attorney to report all compensation paid or agreed to be paid, and Section 329 further authorizes the bankruptcy court to review those payments or promises and to cancel those that are excessive. If payments have been promised, Section 329 merely requires the reporting of those promises; it does not authorize the honoring of those promises. This language should be enforced by the courts.

Given the clarity of the language of Section 329, it is not necessary to refer to the legislative history. Nonetheless, nothing in the legislative history of Section 329 supports the appellant's argument that Section 329 creates an implicit exception to the discharge of Section 727(b). The legislative history provides in part, "Payments to a debtor's attorney provide serious potential for evasion of creditor protection provisions of the bankruptcy laws, and serious potential for overreaching by the debtor's attorney, and should be subject to careful scrutiny." H.R. Rep. 595, 95th Cong. , 1st Sess. 329 (1977); S.Rep. 989, 95th Cong., 2d Sess. 39 (1978). As the Sixth Circuit has held concerning Section 329, "[t]he provisions of the Bankruptcy Code and the Bankruptcy Rules that regulate attorney fees are designed to protect both creditors and the debtor against overreaching attorneys." *Henderson v. Kisseberth (In re Kisseberth)*, 273 F.3d 714, 721 (6th Cir. 2001). Far from giving attorneys an implicit exception to the discharge afforded to no other prepetition creditor, Congress intended Section 329 to be a limit and a restraint upon attorneys for the debtor.

The appellant's argument stands upon Section 329(a)'s requirement that all attorneys for the debtor "shall file with the court a statement of the compensation paid or agreed to be paid..." The appellant sees in this language an implicit grant of an exception to the discharge for prepetition promises to pay fees due to a debtor's attorney. However, viewed in light of the Congressional purpose to scrutinize all fees paid to the debtor's attorney, it is clear that this language was made as broad as possible in order to insure that debtors' attorneys did not evade the reporting requirements by trying to restructure the payment schedule to avoid having to disclose payments, or by characterizing payments as mere promises to pay that did not have to be reported.[9]

The appellant, and the *Bethea* opinions, also argue that since Section 60d of the former Bankruptcy Act, which was superceded by the Bankruptcy Code in 1979, was a discrete, exclusive regulation of debtors' attorneys' fees, then Section 60d's successor, Section 329, should also be construed as a discrete, exclusive regulation of debtors'

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[9] When Section 329 was drafted and enacted, the Bankruptcy Code did allow postpetition payments to debtors' attorneys for prepetition services. As originally drafted, 11 U.S.C. Section 330(a) allowed compensation to, among others, "the debtor's attorney" from the bankruptcy estate. Therefore, a debtor's attorney who was not paid in full prepetition could petition the bankruptcy court for a payment of the balance due from the bankruptcy estate. Under those circumstances, Section 329 had to be drafted in order to make it clear that these promises of future payment from the bankruptcy estate had to be reported to the bankruptcy court and explicitly made subject to the bankruptcy court's review. Otherwise, debtors, creditors and estates would not be protected from the overreaching that Congress was determined to prevent. The Bankruptcy Reform Act of 1994, Pub. L. No. 103-394, enacted on October 22, 1994, deleted the reference to "the debtor's attorney" from Section 330(a). In the place of the former language, the current and controlling version of Section 330(a)(1), allows compensation only to trustees, examiners, and professional persons employed under Sections 327 and 1103. The current Section 330(a)(4)(B) allows compensation to the attorney for a debtor only in Chapter 12 or Chapter 13. Therefore, apparently an attorney for the debtor in Chapter 7 is no longer entitled to compensation from the estate under the current and controlling version of Section 330(a)(1). *United States Trustee v. Equipment Services, Inc. (In re Equipment Services, Inc.)*, 290 F.3d 739 (4th Cir. 2002); *Ingelsby, Falligant v. Moore (In re American Steel Product, Inc.)*, 197 F.3d 1354 (11th Cir. 1999); *but see*, *Vergos v. Hilburn's Paint and Body Shop, Inc. (In re Hilburn's Paint and Body Shop, Inc.)*, 268 B.R. 127 (6th Cir.BAP 2001)(appeal to the Sixth Circuit pending). Be that as it may, the appellant cannot argue that the deletion of debtors' attorneys from the list of those entitled to compensation from the estate somehow created an implicit exception to the discharge for debtors' attorneys' fees. The appellant notes in his brief that the cases holding that debtors' attorney fees are discharged were not decided until 1994 and thereafter, even though the Bankruptcy Code was enacted in 1978. Appellant's Brief, page 17. Although the 1994 appeals were filed before the amendment of the Bankruptcy Code, it is interesting to note the coincidence of the amendment of Section 330 in 1994 to delete the reference to "the debtor's attorney" and the increase in the number of opinions that now address the issue of whether debtor's attorney's fees are discharged. Before the 1994 amendment, the issue may not have been so pressing because debtor attorneys could look to the estate in at least some of the cases for compensation.

attorneys' fees. *In re Bethea*, 275 B.R. at 292-93, and 287 B.R. at 910-11. Since Section 329 is a discrete, exclusive regulation of debtors' attorneys fees, the *Bethea* opinions argue, the debtors' attorneys' fees must be implicitly exempt from the discharge of Section 727(b), as that was the prior practice and Congress evidenced no intention in the Bankruptcy Code or its legislative history to change prior practice.

In response to this argument, it must be noted that nothing in the text of Section 60d of the former Bankruptcy Code provided that a debtor's obligation to pay prepetition attorney fees was excepted from the bankruptcy discharge.[10] The second half of Section 60d addressed payments made after the filing of the petition, but did not except from the discharge the prepetition obligation to pay for prepetition services.

The *Bethea* opinions do not cite a single case decided under Section 60d that held that the prepetition agreement to pay for prepetition services was excepted from the discharge. The Bankruptcy Act opinions cited by the *Bethea* opinions, *In re Wood*, 210

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[10] Former Section 60d provided:
d. If a debtor shall, directly or indirectly, in contemplation of the filing of a petition by or against him, pay money or transfer property to an attorney at law, for services rendered or to be rendered, the transaction may be examined by the court on its own motion or shall be examined by the court on the petition of the trustee or any creditor and shall be held valid only to the extent of a reasonable amount to be determined by the court, and the excess may be recovered by the trustee for the benefit of the estate.

If, whether before or after the filing, a debtor shall agree orally or in writing to pay money or transfer property to an attorney at law after the filing, the transaction may be examined by the court on its own motion or shall be examined by the court on petition of the bankrupt made prior to discharge and shall be valid only to the extent of a reasonable amount to be determined by the court, and any excess obligation shall be cancelled, or if excess payment or transfer has been made, returned to the bankrupt.

U.S. 246, 28 S.Ct. 621, 52 L.Ed. 1046 (1908), *In re Cummins*, 196 F. 224 (S.D.N.Y. 1912), *Michelbacher v. Haar (In re Falk)*, 30 F.2d 607 (2d Cir. 1929), and *Caldwell v. Valley National Bank of Phoenix*, 208 F.2d 645 (10th Cir. 1953), do at times use the phrase that attorneys for the debtor do not have to take chances as a general creditor. However, upon reading those opinions, it is clear that in those cases the attorney for the debtors had received a prepetition payment for services already performed and also yet to be performed. A general creditor who received such a payment would be subject to a suit to recover that payment as a preference. (A preference is a payment from a debtor to a creditor on an antecedent debt which may be recovered by the bankruptcy trustee if the payment was made within a certain period of time prior to the bankruptcy filing.) Just as any general creditor in the same position would be subject to a suit to recover the preference, the question in the Act cases cited by the *Bethea* cases was whether the attorney for the debtor had therefore received a preference that could be recovered since the attorney had received payment upon an antecedent debt. The opinions hold that the payment was not a preference, but they do not hold that the debt, if it had not been paid, was not dischargeable.[11]

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[11] Indeed, if there was an implicit exception from the discharge for debtors' attorneys' fees under the Bankruptcy Act which has survived under the Bankruptcy Code, it seems to have escaped the notice of the United States Supreme Court, which has held in *Federal Communications Commission v. Nextwave Personal Communications, Inc.*, 123 S.Ct. 832 (2003); *Ohio v. Kovacs*, 469 U.S. 274, 105 S. Ct. 705 (1985); *Kawaauhau v. Geiger*, 523 U.S. 57, 118 S. Ct. 974 (1998); and *Gleason v. Thaw*, 236 U.S. 558, 35 S.Ct. 287 (1915) that exceptions to the discharge should be confined to those plainly expressed in the statute. If the prior practice under the Bankruptcy Act was to except debtors' attorneys' fees from the discharge and that practice was continued under Section 329 of the Bankruptcy Code, then all those

Even if the Bankruptcy Act did except debtors' attorneys's fees from the discharge, that does not mean that the exception can continue under the Bankruptcy Code. The Bankruptcy Code definition of what constitutes a "claim" under 11 U.S.C. Section 101(5), and therefore the scope of the discharge under the Bankruptcy Code, is much broader than the definition of a claim under the Bankruptcy Act and represented a significant departure from the Act. The legislative history for the definition of "claim", which was originally found at 11 U.S.C. Section 101(4), but is now found at 11 U.S.C. Section 101(5), states:

> The effect of the [Bankruptcy Code definition of 'claim'] is a significant departure from present law. Under present law, 'claim' is not defined in straight bankruptcy. Instead, it is simply used, along with the concept of provability in section 63 of the Bankruptcy Act, to limit the kinds of obligations that are payable in a bankruptcy case. The term is defined in the debtor rehabilitation chapters of present law far more broadly. The definition in paragraph 4 [now paragraph 101(5)] adopts an even broader definition of claim than is found in the present debtor rehabilitation chapters....By this broadest possible definition, and by use of the term throughout the title 11, especially in subchapter I of chapter 5, the bill contemplates that all legal obligations of the debtor, *no matter how remote or contingent*, will be able to be dealt with in the bankruptcy case. It permits the broadest possible relief in the bankruptcy court.

H.R. Rep. No. 595, 95th Cong., 1st Sess. 309 (1977), S.Rep. 989, 95th Cong., 2d Sess. 21 (1978)(emphasis added). "In fashioning a single definition of 'claim' for the 1978 Bankruptcy Code, Congress intended to 'adop[t] an *even broader* definition of claim than [was] found in the [pre-1978 Act's] debtor rehabilitation chapters." *Johnson v. Home State Bank*, 501 U.S. 78, 111 S.Ct. 2150, 2155 (1991)(emphasis as in opinion, quoting

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Supreme Court opinions are mistaken.

H.R.Rep. No. 95-595, at 309, U.S.Code Cong. & Admin.News 1978, p. 6266), see also, *Pennsylvania Dept. of Public Welfare v. Davenport*, 495 U.S. 552, 558, 110 S.Ct. 2126, 2130, 109 L.Ed.2d 588 (1990)(Congress intended the "broadest possible" definition of the term "claim": "A 'claim" is a '*right to payment*, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured or unsecured,'" citing then 11 U.S.C. Section 101(4)(a), now cited as 101(5)(a)(emphasis as in opinion)). The Bankruptcy Code defines "debt" as "liability on a claim," 11 U.S.C. Section 101(12), and 11 U.S.C. Section 727(b) provides that a discharge under chapter 7, such as the discharge the debtor here received, "discharges the debtor from all debts that arose before the date of the order for relief." Therefore, the Bankruptcy Code may discharge debts that may not have been discharged under the Act, there may not be a perfect analogy between the provisions of the Act and the Code, and there may be no correlation between the debts that are excepted from the discharge under the Code and those that were excepted from the discharge under the Act.

The theory of the appellant's argument, and the *Bethea* cases, is that Section 60d created an implicit exception to the discharge and that when the Bankruptcy Code and Rules superceded the Bankruptcy Act, no one thought to make that unwritten, implicit exception an explicit statement in Section 523(a), Section 329(b), Section 727(b) or anywhere else in the Bankruptcy Code or Rules. At best this is wild conjecture based neither upon one word in the Bankruptcy Code or even a single statement in its legislative history. Moreover, such reasoning must be rejected, for it would lead to a situation where no one could possibly know what the law is. Even if there were an implicit exception from the discharge under the Bankruptcy Act for debtors' attorney fees, one would assume that if the drafters of the Bankruptcy Code wanted such an exception to continue under the Bankruptcy Code they would have thought such a provision important enough to make it explicit along with the other explicit exceptions to the discharge found at Section 523(a). Otherwise, the law becomes whatever we think it might once have been. For all these reasons, the appellant's reliance upon Section 60d is misplaced.

The intent of Section 329 was to protect creditors and debtors from overreaching and evasion by attorneys for the debtor. The appellant's argument, if endorsed by this court, would strike down that protection and make all debtors' attorney fees nondischargeable. It would be highly ironic if Section 329, which was meant to be a restraint upon debtors' attorneys and to protect debtors and creditors from the debtors' attorneys, were to instead be construed as a special benefit for debtors' attorneys only, and as sanctioning the practices Mr. Rittenhouse employed against Ms. Chandlier in this case.

IV. Section 103 And The Bankruptcy Rules Do Not Support The Argument That There Is An Implicit Exception To The Discharge.

The appellant argues that the United States Trustee's construction of Section 329 will destroy that section, and violate 11 U.S.C. Section 103. In support of his interpretation of Section 329 the appellant also cites Federal Rules of Bankruptcy Procedure 2016, 2017 and 1006. That argument is flawed.

The debtor cites 11 U.S.C. Section 103(a), which states "Except as provided in section 1161 of this title, chapters 1, 3, and 5 of this title apply in a case under chapter 7, 11, 12, or 13 of this title." The appellant argues that the United States Trustee's construction of Section 329 (which is found in chapter 3 of title 11) will make Section 329 inapplicable in Chapter 7. Such a construction, it is argued, will destroy Section 329, making it a nullity, at least in Chapter 7. The appellant's argument assumes that if Section 727(b) is applied as written, there will be no fees for the Bankruptcy Court to review under Section 329. That is incorrect. If the debtor had paid the attorney fee of $800 in full prepetition to secure both prepetition and postpetition services, the appellant would have had to disclose that payment under Section 329(a) and Rule 2016(b) and the Bankruptcy Court could have reviewed the reasonableness of that fee under Section 329(b).[12]

Thus, Section 329 would have worked in this case, just as it works in hundreds of thousands of chapter 7 cases, year in and year out. If the appellant required debtors to pay

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[12] Contrary to the appellant's argument, there are other payments a Chapter 7 debtor might make to an attorney postpetition beside payment for prepetition services, such as a debtor who files the bankruptcy petition pro se and who then decides postpetition that they need to retain an attorney, perhaps to defend their discharge if an objection to discharge or dischargeability is filed. These payments would be captured by the disclosure requirements of the Code and Rules and would be subject to review under Section 329(b). Of course, the impermissible postpetition payment of discharged prepetition attorney fees would be subject to disclosure and review, as in this case. Therefore, the United States Trustee's reading of Section 329(b) does not deprive that section of all meaning, as the appellant argues, but in fact fully reflects that Section's meaning.

his fee in full before the filing of the bankruptcy petition, there would be no violation of Section 727(b), the appellant would be able to disclose his compensation as required by Section 329(a), and the bankruptcy court could review that compensation as allowed by Section 329(b). Requiring debtors to pay the attorney fee in full before the filing of the bankruptcy case is a simple solution that entails no violations of Section 727(b) or Section 329, yet preserves the function of Section 329.

Indeed, this appeal disproves the appellant's argument. The United States Trustee was proceeding under Section 329 of the bankruptcy court when the motion was filed which gave rise to this appeal. In filing the motion for review and disgorgement under Section 329 against the appellant, the United States Trustee was using Section 329 as it was meant to be used, to allow the bankruptcy court to prohibit an attorney from receiving compensation he should not receive, and to prohibit overreaching by a debtor's attorney. It is the appellant's construction of Section 329 that would destroy Section 329 by transforming its protection of the creditors, debtors and estates into an implicit exception to the discharge which would benefit only attorneys for the debtor.

The appellant also cites Federal Rules of Bankruptcy Procedure 2016, 2017 and 1006 for the proposition that the Rules reveal an understanding of the Code as allowing postpetition services for prepetition work, which understanding of the Code was contemporaneous with the drafting of the Code. The Rules do not and cannot support that proposition.

Before reviewing the individual rules cited by the appellant it is important to review 28 U.S.C. Section 2075, which grants the United States Supreme Court the power to prescribe general rules, forms and procedures in cases under title 11. Section 2075 provides in part, “Such rules shall not abridge, enlarge, or modify any substantive right.” Therefore, any construction of the bankruptcy rules that creates a implicit exception to the discharge granted under Section 727(b) must be rejected as abridging the debtor’s substantive right to a discharge granted under the express terms of Section 727(b).

Rule 2016(b) requires every attorney for the debtor to file within fifteen days after the filing of a case an initial statement of all compensation paid or agreed to be paid, and to file a supplemental statement within fifteen days after any payment or agreement not previously disclosed. Rule 2017(a) permits the bankruptcy court to review transfers from the debtor to the attorney for the debtor before filing, and Rule 2017(b) permits the bankruptcy court to review transfers from the debtor to the attorney for the debtor made after the filing. Rule 1006(b)(1) allows a debtor to apply for permission to pay the bankruptcy filing fee in installments; the application must state that the debtor is unable to pay the filing fee except in installments, the proposed terms of the installment payments, and that the debtor has not paid any money or transferred any property to the debtor’s attorney. Rule 1006(b)(3) provides that the filing fee must be paid in full before the debtor may pay the attorney for the debtor. The appellant argues that these rules make sense only if the Code permits Chapter 7 debtors to make postpetition payments for prepetition legal services.

However, these rules do make sense even though the Code does not permit debtors to make postpetition payments for prepetition legal services. Rules 2016 and 2017 are reporting and disallowance provisions, drafted to help implement Section 329, among others. As such, they are drafted as broadly as possible. The inclusion of a transfer or payment within their scope does not indicate that the transfer is authorized, merely that it is subject to review. It would make little sense to prohibit a transfer, and then not to require the disclosure of that transfer to the bankruptcy court.

For example, Rule 2016(b) also requires every attorney for a debtor to disclose whether that attorney has agreed to share the compensation paid for services in the case with any other entity, and if such a sharing agreement has been entered into, to disclose the particulars of the sharing agreement. By the appellant's reasoning, the express inclusion of fee sharing agreements within the scope of Rule 2016(b)'s disclosure requirement should mean that all fee sharing agreements are authorized. However, 11 U.S.C. Section 504 strictly limits the situations in which fees may be shared, and in some instances prohibits fee sharing altogether. Indeed, some fee sharing agreements may be violations of criminal law. 18 U.S.C. Section 155. The inclusion of an act in a reporting requirement or in a disallowance provision does not and cannot mean that every act included within the scope of the reporting requirement is thereby authorized.

Rule 1006(b) requires debtors to state that they are unable to pay the filing fee except in installments, and that they have not yet paid any fees due to their attorney. Rule 1006(b)(3) states that the filing fee must be paid in full before the debtor may pay the attorney fees. Preliminarily, it should be noted that Rule 1006(b)(3) does not contain any language expressly authorizing the payment of prepetition attorney fees postpetition. Even if Rule 1006(b)(3) expressly provided that the debtors' attorney's fee were excepted from the Section 727(b) discharge when the debtor pays the filing fee in installments, 28 U.S.C. Section 2075 would require that the discharge prevail. However, the language of Rule 1006(b)(3) does not contain an express exception to the discharge; if there is an exception to Section 727(b) here, it is, again, implied, not express. As the Ninth Circuit has noted,

> The language [of Rule 1006(b)(3)] does not indicate that fees for pre-petition services are appropriate, let alone that an obligation to pay such fees must be exempt from automatic stay and discharge. Even if such an exemption were an arguable implication of the rule's language, a Bankruptcy Rule cannot create an exception to the Bankruptcy Code.

In re Jastrem, 253 F.3d 438, 441 (9th Cir. 2001). The appellant's argument fails to explain how the alleged implicit exception to the discharge in Rule 1006(b)(3) can prevail when an express exception to the discharge in Rule 1006(b) would not prevail over the express terms of Section 727(b).

It is true that federal rules are strongly presumed to be valid under both constitutional and statutory constraints, *In re Zimmerman*, 156 B.R. 192, 196 (Bankr. W.D. Mich. 1993)(*en banc* opinion)(citing *Burlington Northern Railroad v. Woods,* 480 U.S. 1, 6, 107 U.S. 967, 970, 94 L.Ed.2d 1 (1987)), but there is no conflict here. Even if there were, and the statute and the rules implementing that statute conflict, then 28 U.S.C. Section 2075 requires that the statute prevail over the rules. "'[A]ny conflict between the Bankruptcy Code and the Bankruptcy Rules must be settled in favor of the

Code.'" *In re Jastrem*, 253 F.3d 438, 441- 442 (9th Cir. 2001)(quoting, *United States v. Towers (In re Pacific Atlantic Trading Co.)*, 33 F.3d 1064, 1066 (9th Cir. 1994)).

Furthermore, the presumed validity of the rules also argues for the rejection of any construction of the rules, such as the appellant's, that would create a conflict with the express bankruptcy discharge of Section 727(b). "The Bankruptcy Code and Rules must be harmonized unless it is impossible to do so." *Zimmerman*, 156 B.R. at 199 (Judge Gregg, concurring opinion).

Similarly, compliance with Rule 1006(b)(3) does not require the creation of an implicit exception to the discharge and the express terms of Sections 727(b) and 523(a). Rather, the appellant can require all debtors who are able to pay both the filing fee and the attorney fee in full to pay him both sums before the filing of the case so that the appellant may pay the filing fee for his client at filing. As to those who are truly and deeply unable to pay the filing fee and the attorney fee before filing, the appellant may decline to represent such debtors, or he may accept the case on a pro bono basis or he may refer them to an attorney who will. This may restrict the number of cases filed in which the filing fee is paid in installments. However, that is consistent with the terms of Rule 1006(b)(1), which limits the request for permission to pay the filing fee in installments to only those who are "unable to pay the filing fee except in installments"; those who would find paying the filing fee in full at filing merely inconvenient or difficult are not allowed to request permission to pay the filing fee in installments.

V. The Weight of Authority Is Unified In Holding That Section 727(b) Discharges All Prepetition Debts, Including Unpaid Prepetition Attorney Fees.

The appellant and the *Bethea* opinions concede that theirs is a minority position. The majority of the opinions that have considered this question have held that the filing of the bankruptcy petition discharges all unpaid prepetition obligations, including unpaid attorney fees. *See, e.g., Hessinger and Associates v. United States Trustee (In re Biggar)*, 110 F.3d 685 (9th Cir. 1997); *Gordon v. Hines (In re Hines),* 147 F.3d 1185 (9th Cir. 1998); *Sanchez v. Gordon (In re Sanchez)*, 241 F.3d 1148 (9th Cir. 2001); *In re Jastrem*, 253 F.3d 438 (9th Cir. 2001); *In re McNickle*, 274 B.R. 477 (Bankr. S.D. Ohio 2002); *In re Nieves*, 246 B.R. 866 (E.D. WI 2000); *In re Toms,* 229 B.R. 646 (Bankr. E.D. Pa. 1999); *In re Voglio,* 191 B.R. 420 (D.Ariz. 1996); *In re Symes,* 174 B.R. 114 (Bankr. D. Ariz. 1994); *In re Haynes*, 216 B.R. 440 (Bankr. D. Colo. 1997).

The appellant criticizes these cases, pointing out that some of these cases construe the discharged "prepetition debt" as including all of the agreement to provide services and make payment, while others construe the discharged "prepetition debt" as including only the prepeptition agreement to pay for prepetition services, and exclude postpetition payment for postpetition services from the discharged debt. It is true that these cases disagree as to some details of the extent of the debtors' attorney fee discharged. However, it is important to note that none of these cases have repudiated the basic principle that the discharge discharges a debtor from all <u>prepetition</u> debts, which is the question presented by this appeal. Nor is the degree of their disagreement important;

even if every case that had considered this issue had held that there was an implicit exception to the discharge for prepetition attorney fees, the correct answer based upon the Bankruptcy Code would still be that there is no implicit exception for prepetition attorney fees which are discharged by the bankruptcy discharge granted under Section 727(b).

Bethea is not merely a minority position, it is an anomaly. To address a simple problem, *Bethea* proposes a solution that does all of the following: violates Section 727(b); distorts the meaning of Section 329; has no support in the legislative history, the caselaw, or the prior Bankruptcy Act; and awards debtors' attorneys fees in chapter 7 an extraordinary unwritten exception from the discharge.

There is a simple solution to this problem: the appellant should require that all clients pay their filing fee and their attorney fee in full prior to the filing of the bankruptcy petition. The vast majority of chapter 7 debtors who retain counsel apparently pay their attorney a flat fee prior to the filing of the bankruptcy petition. *See*, Teresa A. Sullivan, et al., *As We Forgive Our Debtors* 23 (1999)("Because most attorneys insist on being paid in advance, the debtor must find some money for fees and filing before bankruptcy is possible. Some people are literally saving up for their bankruptcies."); Amy L. Good and Dean P. Wyman, *Representing Consumer Debtors: Fiduciary Duties of Counsel*, Prac. Law., Mar. 1999, at 33 ("Chapter 7 attorneys are generally paid a one-time fee immediately before the filing of the bankruptcy petition."); Stanley B. Bernstein, et al., *Collier Compensation, Employment and Appointment of Trustees and Professionals* *in Bankruptcy* Para. 3.02[1], at 3-2 (2001)("In the majority of [chapter 7] cases, the debtor's counsel will accept an individual or a joint consumer chapter 7 case only after being paid a retainer that covers the 'standard fee' ...and the cost of filing the petition.")

Paying the debtor's attorney before the filing of the case also makes sense because that is when the bulk of the attorney's work must be done. "Proceedings under Chapter 7 differ from cases under other Chapters of the Code in that the bulk of the legal and fact-finding work is done *before* the petition is filed." Rosemary E. Williams, *Bankruptcy Practice Handbook* Section 5:1, at 5-4 (2d ed. 2002); accord *United States Trustee v. Garvey, Schubert & Barer (In re Century Cleaning Services, Inc.)*, 195 F.3d 1053, 1064 (9th Cir. 1999)(Thomas, J., dissenting)("In many Chapter 7 cases, there is little for the debtor's attorney to do after the petition is filed.")

Compared with other chapters, the Bankruptcy Code imposes very limited duties upon a chapter 7 debtor. The debtor must complete a bankruptcy petition, schedules of assets and debts, a statement of financial affairs, a statement of intentions as to secured debts, and supporting documents. 11 U.S.C. Sections 521(1) and (2); Federal Rule of Bankruptcy Procedure 4002; 11 U.S.C. App. Official Forms 1, 6 and 7. Those duties may generally be performed before the debtor files for bankruptcy. The debtor must also cooperate with the chapter 7 trustee, surrender all property of the estate to the chapter 7 trustee, and appear at any discharge hearing in the rare event the bankruptcy court convenes such a hearing. 11 U.S.C. Sections 521(3)-(5); Federal Rule of Bankruptcy Procedure 4002(2) and (3).

After the filing of the bankruptcy petition the chapter 7 debtor must submit to examination by the chapter 7 trustee and any creditors who appear. 11 U.S.C. Sections 341 and 343. The chapter 7 debtor's attorney typically analyzes the debtor's financial position, advises the debtor whether to file bankruptcy at all, and if so, whether to file under chapter 13 or chapter 7, prepares the schedules, statement of affairs and other supporting documents, and appears at the 341 meeting with the client. *Representing Consumer Debtors*, supra, at 40. Other than attending the meeting with the chapter 7 trustee, the rest of the services can be performed before filing the chapter 7 petition, and some, such as analyzing the debtor's finances and advising the debtor whether to file, *must* be preformed before the filing of the bankruptcy petition. Therefore, not only does requiring the debtor to pay the filing fee and the attorney fee in full before the bankruptcy filing avoid having to take post petition payments on the attorney fee in violation of the Section 727(b) discharge, it also makes practical sense.

As of filing, this debtor owed her attorney a prepetition debt of $800 for the filing of the bankruptcy case. The attorney for the debtor should have seen to it that this fee was paid in full before the bankruptcy case was filed. The appellant demanded that the debtor pay the $800 prepetition debt even though it was discharged. This is the kind of attorney overreaching which Congress intended to prevent by enacting Section 329. The parties asked the bankruptcy court if that debt was discharged under Section 727(b). The bankruptcy court properly held that the debt was discharged, and should be affirmed.

CONCLUSION

For all the above reasons, the United States Trustee asks this Court to affirm the order of the Bankruptcy Court.

Respectfully submitted,
SAUL EISEN
United States Trustee
Michigan/Ohio Region IX

Date:____________________ By:__________________________
Michael V. Maggio
Trial Attorney
Office of the United States Trustee
United States Department of Justice
330 Ionia NW, Suite 202
Grand Rapids, Michigan 49503
Tel: (616) 456-2002, ext. 14

BRIEF BANK — 'SUMMARY SHEET"

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1. ("TI") TITLE OF CASE [E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]
Ringgold v. UST (In re Ringgold)

2. ("CO") CURRENT COURT [E.g., "CTA9"]
9th Cir.

3. ("CCN") CURRENT CASE NO.
No.: 04-56147, 04-56401

4. ("PCN") PRIOR CASE NO. & COURT [IF ANY]
No.:
Court: CD CA
(Identify judge & cite, if any)

5. ("SO") SOURCE
U.S. TRUSTEES

6. ("DA") DATE OF FILING & TYPE OF BRIEF [E.g., "Opening Brief," "Reply," "Amicus," etc.]
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Eric D. Miller, Civil Div. & P. Matthew Sutko, EOUST/OGC
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") TOPIC
BANKRUPTCY

9. ("SU") • SUMMARY OF KEY ISSUE(s) & √ Any Miscellaneous BACKGROUND

•The UST filed a motion to dismiss under section 707(b) after receiving a suggestion from a creditor. The question presented by appeal is whether the Bankr. Ct. may consider the UST's motion; and the question on cross-appeal is whether the UST must show that he conducted an "independent investigation" before he filed the the motion.

√ **Background:**

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Nos. 04-56147, 04-56401

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

In re PATRICIA A. RINGGOLD,
Debtor.

PATRICIA A. RINGGOLD,
Appellant/Cross-Appellee,

v.

STEVEN J. KATZMAN, UNITED STATES TRUSTEE,
Appellee/Cross-Appellant

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE CENTRAL DISTRICT OF CALIFORNIA

BRIEF FOR APPELLEE/CROSS-APPELLANT

Of Counsel:

DONALD F. WALTON
Acting General Counsel

P. MATTHEW SUTKO
Executive Office for
United States Trustees
U.S. Department of Justice
20 Massachusetts Ave., N.W.
Washington, D.C. 20530_

PETER D. KEISLER
Assistant Attorney General

DEBRA W. YANG
United States Attorney

WILLIAM KANTER
(202) 514-4575
ERIC D. MILLER
(202) 514-5735
Attorneys, Appellate Staff
Civil Division, Room 7256
U.S. Department of Justice
950 Pennsylvania Ave., N.W.
Washington, D.C. 20530-0001

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IN THE UNITED STATES COURT OF APPEALS
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Appellant/Cross-Appellee,

v.

STEVEN J. KATZMAN, UNITED STATES TRUSTEE,
Appellee/Cross-Appellant.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE CENTRAL DISTRICT OF CALIFORNIA

BRIEF FOR APPELLEE/CROSS-APPELLANT

STATEMENT OF JURISDICTION

1. The bankruptcy court had jurisdiction under 28 U.S.C. §§ 157(b) and 1334. After that court entered a final order, the United States Trustee filed a timely notice of appeal to the district court. The district court had jurisdiction under 28 U.S.C. § 158(a).

2. As we explain below, see pages 11-14, although the district court remanded the case to the bankruptcy court for further proceedings, its order is nevertheless final. This Court therefore has jurisdiction under 28 U.S.C. §§ 158(d) and 1291.

3. The district court entered judgment on June 14, 2004. See Appellant's Excerpts of Record ("E.R.") 331. Ringgold filed a notice of appeal in No. 04-56147 on June 25, 2004, see E.R. 332, and the United States Trustee filed a notice of cross-appeal in No. 04-56401 on August 13, 2004, see E.R. 335. Both appeals are timely under Federal Rule of Appellate Procedure 4(a)(1)(B).

STATEMENT OF THE ISSUE PRESENTED FOR REVIEW

The Bankruptcy Code provides that "the court, on its own motion or on a motion by the United States trustee, but not at the request or suggestion of any party in interest, may dismiss a case" if it finds that granting relief would be a "substantial abuse" of the Code. 11 U.S.C. § 707(b). In this case, the United States Trustee filed a motion to dismiss after receiving a suggestion from a creditor.

The question presented by the appeal is whether the bankruptcy court may consider the United States Trustee's motion. The question presented by the cross-appeal of the United States Trustee is whether the United States Trustee must show that he conducted an "independent investigation" before he filed the motion.

STATEMENT OF THE CASE

Patricia Ringgold sought relief under Chapter 7 of the Bankruptcy Code. After a creditor noted that Ringgold appeared to have sufficient income to pay her debts, the United States Trustee moved to dismiss the case under 11 U.S.C. § 707(b), which permits the bankruptcy court to dismiss a case for "substantial abuse" either "on its own motion or on a motion by the United States trustee, but not at the request or suggestion of any party in interest." The bankruptcy court held that the United States Trustee's motion was improper because it had been made at the suggestion of a party in interest. The district court reversed, but it held that the motion could be proper only if the United States Trustee had conducted an "independent investigation," and it remanded to the bankruptcy court to determine whether such an investigation had occurred. Ringgold appealed, and the United States Trustee cross-appealed.

STATEMENT OF FACTS

A. Statutory Background

The United States Trustee is an official of the Executive Branch of the federal government and is responsible for "protecting the public interest and ensuring that bankruptcy cases are conducted according to the law." H.R. Rep. No. 95-595, at 109 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 6070. United States Trustees have a statutory responsibility to "supervise the administration of cases" under Chapter 7, 11, 12, or 13 of the Bankruptcy Code. 28 U.S.C. § 586(a)(3). Congress expected them to "serve as bankruptcy watch-dogs to prevent fraud, dishonesty, and overreaching in the bankruptcy arena." H.R. Rep. No. 95-595, at 88, 1978 U.S.C.C.A.N. at 6049; see also In re Castillo, 297 F.3d 940, 950 (9th Cir. 2002) ("The United States Trustee is the 'watchdog' of the bankruptcy system, charged with preventing fraud and abuse and with 'fill[ing] the vacuum' caused by possible creditor inactivity.") (citations omitted). Congress therefore provided that "[t]he United States trustee may raise and may appear and be heard on any issue in any case or proceeding" under the Bankruptcy Code. 11 U.S.C. § 307; see also In re Donovan Corp., 215 F.3d 929, 930 (9th Cir. 2000).

Of particular relevance to this case, a United States Trustee may move to dismiss a Chapter 7 case for "substantial abuse":

> After notice and a hearing, the court, on its own motion or on a motion by the United States trustee, but not at the request or suggestion of any party in interest, may dismiss a case filed by an individual debtor under this chapter whose debts are primarily consumer debts if it finds that the granting of relief would be a substantial abuse of the provisions of this chapter.

11 U.S.C. § 707(b).

B. Facts and Prior Proceedings

1. Patricia Ringgold filed a petition under Chapter 7 of the Bankruptcy Code. See E.R. 38. Her petition listed two creditors: Harvey Baker, who had won a judgment against her in state-court litigation, and David Dimitruk, who had represented

her in that litigation and was owed attorney's fees. See E.R. 52.

About a month after Ringgold filed her petition, Baker's attorney wrote a letter to the Office of the United States Trustee. See E.R. 216. The letter suggested that Ringgold's petition was "fraudulent, and should be dismissed," because Ringgold, an attorney employed by the State of California, "has plenty of discretionary income to pay" her debts. E.R. 216-17.

Thereafter, the United States Trustee moved to dismiss Ringgold's case under 11 U.S.C. § 707(b). See E.R. 32. The motion noted that Ringgold had a disposable income of $2,710 per month that was available to pay creditors, making it possible for her to pay off 75% of her debts within three years, and to more than pay off her debts within five years. See E.R. 33. Since "a finding that a debtor is able to pay his debts, standing alone, supports a conclusion of substantial abuse" under section 707(b), the United States Trustee argued that dismissal under that provision was appropriate. In re Kelly, 841 F.2d 908, 915 (9th Cir. 1988).

2. The bankruptcy judge denied the United States Trustee's motion to dismiss the case. See E.R. 221. The court did not consider the merits of the motion. Instead, it found that the United States Trustee's motion "was requested and suggested by" a creditor and therefore was improper under section 707(b). E.R.

244. In its view, section 707(b) prohibits the United States Trustee from acting “at the request or suggestion of any party in interest.” And as the court explained in denying a motion for reconsideration, “the communication by this creditor to the United States Trustee . . . constitutes a request or suggestion within the meaning of Section 707(b).” E.R. 298.

3. The United States Trustee appealed to the district court, which reversed and remanded to the bankruptcy court. See E.R. 316. The district court held that section 707(b) “bars a party in interest from bringing a motion to dismiss directly to the court,” but does not prohibit the United States Trustee from bringing such a motion, “even where a creditor initially suggested the substantial abuse.” E.R. 326. When the United States Trustee files a motion under section 707(b) after receiving a suggestion from a creditor, “it must demonstrate that it has independently investigated any allegations of substantial abuse prior to filing the motion.” E.R. 327 (quoting In re Morris, 153 B.R. 559, 563 (Bankr. D. Or. 1993)). “Failure to make this showing,” the court explained, “may result in the dismissal of the motion without a hearing on the merits.” Id. (quoting Morris, 153 B.R. at 563). The district court remanded the case to the bankruptcy court to determine whether the United States Trustee had conducted the requisite investigation.

Ringgold appealed, and the United States Trustee cross-appealed.

SUMMARY OF ARGUMENT

This Court has jurisdiction over both the appeal and the cross-appeal in this case. The bankruptcy court's order denying the United States Trustee's motion to dismiss was final. And although the district court remanded to the bankruptcy court for further factual findings, its order is also final under the "pragmatic approach to determining finality" that this Court applies in bankruptcy cases. In re Saxman, 325 F.3d 1168, 1171 (9th Cir. 2003). The issues presented by the appeal and cross-appeal are purely legal, and resolving them now could eliminate the need for the factfinding ordered by the district court.

On the merits, the district court's judgment should be affirmed insofar as it held that the United States Trustee may move to dismiss a case under 11 U.S.C. § 707(b) even after receiving a suggestion from an interested party. The statute provides that "the court, on its own motion or on a motion by the United States trustee, but not at the request or suggestion of any party in interest, may dismiss a case" for substantial abuse. The only logically and gramatically permissible interpretation of this provision is that the clause "but not at the request or suggestion of any party in interest" governs what the court may do, not what the United States Trustee may do. All three courts of appeals that have considered the issue have determined that section 707(b) does not prohibit the United States Trustee from filing a motion after receiving a suggestion from an interested party. See In re Stewart, 175 F.3d 796, 803-05 (10th Cir. 1999); In re Kornfield, 164 F.3d 778, 784 (2d Cir. 1999); In re Clark, 927 F.2d 793, 797 (4th Cir. 1991).

The legislative history supports the plain text of the statute. Congress prohibited interested parties from filing motions to dismiss because it was concerned that debtors would be harassed by creditors. There is no need to fear such harassment from the United States Trustee, who is a neutral and disinterested official. So there is no reason that the statute should restrict the United States Trustee's ability to file a section 707(b) motion.

The district court erred, however, in holding that the United States Trustee must show that he conducted an "independent investigation" before filing a motion under section 707(b). Because the statute limits only what the court may do, it imposes no obligation at all on the United States Trustee. Indeed, it would be very surprising if the statute did require proof of an investigation. Judicial enforcement of such a requirement would make it necessary for the bankruptcy court to conduct an intrusive examination of the internal decisionmaking processes of an agency in the Executive Branch. Nor would an "independent investigation" requirement serve any practical purpose. The

Bankruptcy Rules already require that the United States Trustee, like any other party, have evidentiary support for the factual assertions in any motion. And since the United States Trustee is a government official, his actions enjoy a presumption of regularity.

STANDARD OF REVIEW

Because this Court "is in as good a position as the district court to review the findings of the bankruptcy court, [it] independently review[s] the bankruptcy court's decision." In re Emery, 317 F.3d 1064, 1069 (9th Cir. 2003). The only issues in this appeal are questions of law, and the bankruptcy court's legal conclusions are reviewed de novo. See id.

ARGUMENT

I. This Court Has Appellate Jurisdiction Because Both the Bankruptcy Court and the District Court Entered Final Orders.

This Court has jurisdiction over "appeals from all final decisions, judgments, orders, and decrees" entered by district courts in bankruptcy cases. 28 U.S.C. § 158(d); see also id. § 1291. To determine whether a decision is final, the Court must look first to whether the bankruptcy court's order is final, and then to whether the district court's decision is final. See In re Kelly, 841 F.2d 908, 911 (9th Cir. 1988). In this case, both finality requirements are satisfied.

The bankruptcy court entered a final order when it denied the United States Trustee's motion to dismiss the case under 11 U.S.C. § 707(b). That order left no unresolved issues in the case, and it meant that Ringgold could obtain a discharge of her debts. See E.R. 245-46 (bankruptcy court ordered that entry of a discharge order would be stayed pending appeal). Courts have determined that a bankruptcy court's denial of a section 707(b) motion is a final appealable order. See In re Koch, 109 F.3d 1285 (8th Cir. 1997); In re Brown, 916 F.2d 120 (3d Cir. 1990).

The district court's decision is also final, even though it remanded the case to the bankruptcy court for further proceedings. This Court applies "a pragmatic approach to determining finality" in bankruptcy cases. In re Saxman, 325 F.3d 1168, 1171 (9th Cir. 2003); see also In re Olshan, 356 F.3d 1078, 1082 (9th Cir. 2004) ("In recent cases we have employed a more liberal approach to determining finality."). The Court examines four factors in determining whether a district court's decision is final: "(1) the need to avoid piecemeal litigation; (2) judicial efficiency; (3) systemic interest in preserving the bankruptcy court's role as factfinder; and (4) whether further delay would cause either party irreparable harm." Saxman, 325 F.3d at 1171.

In the context of a district court order remanding a case to a bankruptcy court, this Court has asked whether the "matters on remand concern primarily factual matters about which there is no dispute." In re Bankruptcy Estate of Markair, Inc., 308 F.3d 1057, 1060 (9th Cir. 2002) (citation and internal quotation marks omitted). If so, "the policies of judicial efficiency are best served by [this Court's] resolving the question." Id. (citation and internal quotation marks omitted). Even if the factfinding on remand relates to a "central issue" in the appeal, appellate jurisdiction is still appropriate if the issue "is legal in nature and its resolution either (1) could dispose of the case or proceedings and obviate the need for factfinding; or (2) would materially aid the bankruptcy court in reaching its disposition on remand." Id. (citation omitted).

Under this standard, the Court has appellate jurisdiction over the United States Trustee's cross-appeal. The district court has directed the bankruptcy court to determine whether the United States Trustee conducted an "independent investigation" before filing a motion under section 707(b). The argument presented in the cross-appeal is that this inquiry is unnecessary, because the statute does not require an independent investigation. The cross-appeal therefore poses "an independent question of law," and there is no need for "factual development to clarify a central legal issue." Saxman, 325 F.3d at 1172; see also In re Dawson, ___ F.3d ___, No. 02-16903, 2004 WL 2827663, at *3 (9th Cir. Dec. 10, 2004) (finding jurisdiction to review a remand order because "this appeal concerns primarily a question of law, and indeed a question of first impression in the Ninth Circuit"). And if the United States Trustee prevails, this Court's decision would "dispose of the . . . proceedings and obviate the need for factfinding." Markair, 308 F.3d at 1060.

Other factors also favor resolution of the cross-appeal. Hearing the cross-appeal now would not result in piecemeal litigation; this Court can conclusively resolve the issue raised in the cross-appeal, so there is no danger that the Court will be required to "review the same issues in the same case a second time." In re Lakeshore Village Resort, Ltd., 81 F.3d 103, 107 (9th Cir. 1996). And resolution of the issue is necessary in order to prevent irreparable harm to the United States Trustee. As we explain in Part III.B, the factfinding contemplated by the district court's order will require an inappropriate intrusion into the internal decisionmaking processes of the Executive Branch. The harm caused by this intrusion could not be fully redressed in a subsequent appeal.

The Court also has jurisdiction to consider Ringgold's appeal. Ringgold argues that the United States Trustee's dismissal motion in this case was improper regardless of whether there was an independent investigation. Therefore, if she were to prevail, further factfinding by the bankruptcy court would be unnecessary. Cf. Markair, 308 F.3d at 1060. In addition, since the appeal and cross-appeal present such closely related issues -- both concern the interpretation of the same clause in the same statute -- the interests of judicial economy would be served by considering them together.

II. Section 707(b) Allows the United States Trustee to Move to Dismiss a Case for Substantial Abuse Even After Receiving a Suggestion from a Party in Interest.

The district court correctly held that the United States Trustee may move to dismiss a case under 11 U.S.C. § 707(b) even after receiving a suggestion from an interested party. The statutory language makes clear that it is the court, and not the United States Trustee, that may not act upon the request or suggestion of an interested party. All three courts of appeals to consider the question have concluded that an interested party's suggestion does not disable the United States Trustee from filing a motion under section 707(b). Because the statute is clear, there is no need to consider legislative history, but here the legislative history is fully consistent with this interpretation of the statute.

A. The plain text of section 707(b) shows that it restricts what the bankruptcy court may do, not what the United States Trustee may do.

Section 707(b) provides that "the court, on its own motion or on a motion by the United States trustee, but not at the request or suggestion of any party in interest, may dismiss a case" for substantial abuse. The statutory phrase "but not at the request or suggestion of any party in interest" modifies "may dismiss" and not the intervening phrase "on a motion by the United States trustee." Accordingly, all three courts of appeals to consider the question have determined that the statute limits requests to the court, not requests to the United States Trustee. See In re Stewart, 175 F.3d 796, 803-05 (10th Cir. 1999); In re Kornfield, 164 F.3d 778, 784 (2d Cir. 1999); In re Clark, 927 F.2d 793, 797 (4th Cir. 1991).

The conclusion reached by the courts of appeals is plainly correct. The subject of the first sentence in section 707(b) is "the court," and the verb is "may dismiss." In between the subject and the verb, there are two clauses: "on its own motion or on a motion by the United States trustee," and "but not at the request or suggestion of any party in interest." The only logical reading of these clauses is that both of them modify "may dismiss," so they therefore govern what the court may do. See Clark, 927 F.2d at 797 ("The phrase 'but not at the request or suggestion of any party in interest' modifies what the court can do, since 'the court' is the subject of the sentence."). While the court may not act at the request or suggestion of an interested party, the United States Trustee is under no such disability. See Kornfield, 164 F.3d at 684 ("Section 707(b) does not bar the U.S. Trustee from using information obtained from . . . parties in interest in deciding whether to file a substantial abuse motion.”).

Ringgold does not explain exactly how she would parse the statutory language, and neither did the Bankruptcy Court for the District of South Dakota -- the only court, other than the bankruptcy court here, to have adopted her position. See In re Restea, 76 B.R. 728 (Bankr. D.S.D. 1987). But for Ringgold to be correct, the clause “but not at the request or suggestion of any party in interest” would have to modify all or part of the clause that precedes it. Reading the clause to modify both parts of the preceding clause creates a redundancy, because a court acting “on its own motion” is by definition not acting “at the request or suggestion of any party,” so the modifying clause would add nothing. An interpretation that makes part of a statute redundant is disfavored. See Sierra Club v. Babbitt, 65 F.3d 1502, 1509 n.10 (9th Cir. 1995).

On the other hand, reading the clause to modify only the phrase “on a motion by the United States trustee” would create two anomalies. First, it would mean that the statute contained no explicit prohibition on the court’s acting at the request of a party. It is difficult to see why Congress would have wanted to prevent interested parties from making requests of the United States Trustee while leaving them free to make requests of the court directly. Second, such a reading would require, at least implicitly, filling in missing words in the statute: “on a motion of the United States trustee, but not on one that is made at the request or suggestion of any party in interest." Cf. Lamie v. United States Trustee, 124 S. Ct. 1023, 1032 (2004) (rejecting an interpretation of a statute that "would have us read an absent word into the statute," producing not "'a construction of [the] statute, but, in effect, an enlargement of it by the court.'") (quoting Iselin v. United States, 270 U.S. 245, 251 (1926)).

If Congress had intended to prevent the United States Trustee from making a motion under section 707(b) based on a "request or suggestion of any party in interest," it could hardly have chosen a more obscure and ungrammatical formulation. There are several more coherent ways of expressing such an intent. In addition to the example suggested above, Congress could have said, "on the motion of the United States trustee, who shall not act at the request or suggestion of any party in interest;" or "on the motion of the United States trustee, but such motion shall not be made at the request of suggestion of any party in interest." Alternatively, Congress could have omitted the phrase and inserted a new sentence between the two sentences currently in section 707(b): "No such motion may be made at the request of suggestion of any party in interest."

The district court was therefore correct when it held that section 707(b) prevents only the court from acting at the request or suggestion of a creditor. If the United States Trustee decides to make a motion to dismiss, it is irrelevant what might have motivated the decision, and the court may consider the motion on the merits.

B. The legislative history supports this interpretation of the statute.

Because the text of section 707(b) is clear, it is unnecessary for the Court to consider the legislative history. See United States v. Meek, 366 F.3d 705, 719 (9th Cir. 2004). But in any event, the legislative history is entirely consistent with the plain language of the statute.

When first enacted in 1984, section 707(b) provided: "[T]he court, on its own motion and not at the request or suggestion of any party in interest, may dismiss a case" for substantial abuse. Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, § 312(2), 98 Stat. 333, 355 (1984). The statute reflected a legislative compromise. On the one hand, the possibility of dismissals for substantial abuse prevented consumers from "using the bankruptcy system, not to extricate themselves from an unfortunate situation, but rather as a method of avoiding debts even though they were not suffering economic hardship and possessed future income sufficient to meet their obligations." In re Padilla, 222 F.3d 1184, 1194 (9th Cir. 2000) (citation omitted). On the other hand, the restriction on motions by creditors helped "to prevent creditors from harassing the debtor or unnecessarily increasing the debtor's litigation costs." In re Joseph, 208 B.R. 55, 60 (B.A.P. 9th Cir. 1997) (quoting 4 Collier on Bankruptcy § 707.05, at 707-18 (15th ed. 1996)). As Senator Metzenbaum explained, by "prohibit[ing] creditors from filing motions attempting to deny bankruptcy relief to individuals," the statute "preclude[d] creditors from making bankruptcy too expensive for the debtor by filing harassing motions." 130 Cong. Rec. 17,158 (1984).

In 1986, Congress amended the statute to its present form to make clear that United States Trustees could bring motions to dismiss. See Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1986, Pub. L. No. 99-554, § 219(b), 100 Stat. 3088, 3101 (1986). The report of the Conference Committee noted that Congress "anticipate[d] that the panel trustee will work closely in conjunction with the United States Trustee to assist in the discharge of the specific authority granted under Section 707(b)." H.R. Conf. Rep. No. 99-958, at 47 (1986), reprinted in 1986 U.S.C.C.A.N. 5227, 5248. Specifically, Congress expected that the Chapter 7 trustee would "brin[g] to the United States trustee's attention any information or evidence of fraud or abuse which may provide the basis for dismissal of a case under Section 707(b)." Id.

This legislative history supports the district court's holding in two ways. First, Congress's concerns about creditor harassment have no application to a motion brought by the United

States Trustee, a neutral and disinterested party who acts as an independent watchdog over the bankruptcy system. Even when creditors are permitted to communicate requests and suggestions to the United States Trustee, a motion brought by the United States Trustee is not brought at the behest of creditors; it is brought in the interest of the proper administration of the bankruptcy system.

Ringgold’s interpretation would extend the statutory prohibition well beyond Congress’s purpose. It also would impede the United States Trustee’s ability to fulfill his responsibilities. As the district court noted, “should a well-meaning (or even not so well-meaning but nevertheless correct) creditor make the unfortunate mistake of bringing abuse to the [United States Trustee’s] attention,” the United States Trustee would then be disabled from investigating the matter and carrying out the statutory mandate to “supervise the administration of [the] cas[e].” E.R. 330; 28 U.S.C. § 586(a)(3).

Second, Congress contemplated that Chapter 7 trustees could deliver suggestions to the United States Trustee in cases of substantial abuse. But under Ringgold’s interpretation of section 707(b), this would be impossible, since a Chapter 7 trustee is a party in interest. <u>See</u> <u>In re Edmonston</u>, 107 F.3d 74, 77 (1st Cir. 1997); <u>In re Christian</u>, 51 B.R. 118, 119 (Bankr.

D.N.J. 1985), aff'd, 804 F.2d 46 (3d Cir. 1986). That interpretation should be rejected.

III. The District Court Erred in Requiring the United States Trustee to Show That He Conducted an "Independent Investigation" Before Filing a Motion Under Section 707(b).

The district court directed the bankruptcy court to determine whether the United States Trustee had conducted an "independent investigation" before filing the section 707(b) motion in this case. This was error. A requirement that the United States Trustee demonstrate an "independent investigation" is not contained in the statute, would be inconsistent with principles of prosecutorial discretion, and would create serious practical problems.

A. The text of section 707(b) contains no "independent investigation" requirement.

Nothing in 11 U.S.C. § 707(b) requires the United States Trustee to conduct an investigation before filing a motion to dismiss for substantial abuse. The statute provides that "the court, on its own motion or on a motion by the United States trustee, but not at the request or suggestion of any party in interest, may dismiss a case." As we have explained, the clause "but not at the request or suggestion of any party in interest" governs what the court may do, not what the United States Trustee may do. The district court erred in subjecting the United States Trustee to an obligation that has no basis in the statute.

The district court's holding is inconsistent with the decisions of the Fourth and Second Circuits. In In re Clark, the Fourth Circuit explained that the statute's "request or suggestion" clause "modifies what the court can do" and does not restrict the actions of the United States Trustee. 927 F.2d 793, 797 (4th Cir. 1991). Although the court did observe that "the trustee must make an independent judgment about whether it is appropriate to file a § 707(b) motion," it said nothing to suggest that the United States Trustee is legally obligated to conduct any particular kind of investigation. Id. (emphasis added).

Likewise, the Second Circuit held in In re Kornfield that "Section 707(b) does not bar the U.S. Trustee from using information obtained from . . . parties in interest in deciding whether to file a substantial abuse motion." 164 F.3d 778, 784 (2d Cir. 1999). But under the district court's theory, the provision sometimes does bar the United States Trustee from using information from interested parties, at least when the United States Trustee is unable to show that there has been an "independent investigation."

The district court cited the Tenth Circuit's decision in In re Stewart, but that case provides little support for the district court's reading of the statute. See E.R. 322-23; 175 F.3d 796 (10th Cir. 1999). In Stewart, the bankruptcy petitioner argued that section 707(b) requires the United States Trustee to prove, before filing a "substantial abuse" motion, that there has been an independent investigation of the facts underlying the motion. See 175 F.3d at 805. Perhaps because it was clear in that case that the United States Trustee had conducted an investigation, no party argued that an investigation was not required at all. The court, in turn, simply noted that the record showed that an investigation had occurred, adding that "[i]t is sufficient for the Trustee to make such a showing after filing his or her § 707(b) motion to dismiss." Id. The court had no occasion to address the issue presented here.

B. An "independent investigation" requirement would be inconsistent with principles of prosecutorial discretion.

Even if the statute were ambiguous, any ambiguity should be resolved so as to make the statute consistent, rather than inconsistent, with the general rule that courts will not inquire into the exercise of prosecutorial discretion. Cf. Astoria Fed. Sav. & Loan Ass'n v. Solimino, 501 U.S. 104, 108 (1991) ("[W]here a common-law principle is well established . . . the courts may take it as given that Congress has legislated with an expectation that the principle will apply except 'when a statutory purpose to the contrary is evident'") (quoting Isbrandtsen Co. v. Johnson, 343 U.S. 779, 783 (1952)). The district court's ruling disregards that principle and threatens to create an intrusive and impractical regime of bankruptcy-court supervision of executive-branch decisionmaking.

The Supreme Court has held that "[w]hether to prosecute and what charge to file . . . are decisions that generally rest in the prosecutor's discretion." United States v. Batchelder, 442 U.S. 114, 124 (1979); see also Reno v. American-Arab Anti-Discrimination Comm., 525 U.S. 471, 489 (1999) (noting that prosecutorial discretion is "a special province of the Executive"). As this Court has explained, "[i]t would raise serious separation of powers questions -- as well as a host of virtually insurmountable practical problems -- for the district court to inquire into and supervise the inner workings of the United States Attorney's Office." United States v. Redondo-Lemos, 955 F.2d 1296, 1299 (9th Cir. 1992).

Although the United States Trustee is not a criminal prosecutor in this case, he is an official of the Executive Branch who exercises responsibilities similar to those of a prosecutor. As the Eighth Circuit has recognized, a "United States Trustee 'may be compared with . . . a prosecutor.'" In re Charges of Unprof'l Conduct, 249 F.3d 821, 824 (8th Cir. 2001) (quoting H.R. Rep. No. 95-595, at 110 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 6071). In deciding "to place the United States trustee system in the Department of Justice," Congress observed that the United States Trustee, like a prosecutor, "has an independent executive duty to pursue" and does not serve "as an arm of the court or as a service agency for the courts." H.R. Rep. No. 95-595, at 110-11, 1978 U.S.C.C.A.N. at 6072; see also In re Revco D.S., Inc., 898 F.2d 498, 500 (6th Cir. 1990) ("Congress specified that the U.S. Trustees were to be independent of direct court supervision . . .; it likened the U.S. Trustee's relation to that of a prosecutor.").

It is unclear precisely what kind of inquiry the bankruptcy court would conduct in order to determine whether the United States Trustee had undertaken an "independent investigation" before filing a section 707(b) motion. But in a case where the debtor disputes the adequacy of the investigation, it might be necessary for the United States Trustee's counsel to testify as a witness and to describe how he or she decided to file a motion. Cf. Redondo-Lemos, 955 F.2d at 1299-1300 (noting that judicial inquiry into a prosecutor's charging decisions "would require that the government divulge minute details about the process by which scores, perhaps hundreds, of charging decisions are made"). And the United States Trustee might be asked to disclose sensitive information about pre-litigation investigations -- information that could well be protected by the deliberative process privilege. See Assembly of the State of Cal. v. Department of Commerce, 968 F.2d 916 (9th Cir. 1992). In the absence of a clear statement from Congress, this Court should not read the statute to require such an inquiry.

C. Requiring proof of an "independent investigation" would be impractical and would serve little purpose.

The district court's "independent investigation" requirement is not only contrary to the statute; it also would serve little practical purpose. Instead, it would be a time-consuming waste of judicial resources. This is especially so because the inquiry that the bankruptcy court would have to conduct is entirely standardless. The statute does not even mention investigations, let alone provide criteria for evaluating their adequacy, so it would be necessary for courts to develop some test for when an investigation is sufficiently inadequate to justify dismissal of an otherwise meritorious section 707(b) motion.

So far as we are aware, there is no other context in which a movant is required to show affirmatively how he or she obtained and reviewed the evidence supporting the motion. Nor is there anything about this context that creates a special need for such a showing. After all, the United States Trustee already bears the burden of proof when filing a motion to dismiss. See Stewart, 175 F.3d at 805 n.7. And the bankruptcy rules require, on pain of sanctions, that all motions be signed and that the factual representations they contain be supported by evidence. See Fed. R. Bankr. P. 9011.

Unlike the other parties in a bankruptcy proceeding, the United States Trustee is a disinterested official with a duty to "prevent fraud, dishonesty, and overreaching." H.R. Rep. No.

95-595, at 88, 1978 U.S.C.C.A.N. at 6049. And since the United States Trustee is a government official, his actions are entitled to a presumption of regularity. See United States Postal Serv. v. Gregory, 534 U.S. 1, 10 (2001). So even if the United States Trustee receives information from creditors, there is no reason to believe that he would mindlessly rubber-stamp their suggestions of "substantial abuse." Cf. Sosa v. Alvarez-Machain, 124 S. Ct. 2739, 2763 (2004) (noting that "the check imposed by prosecutorial discretion" is present when a statute is enforced by government officials rather than by private parties). An affirmative showing of an independent investigation is therefore unnecessary.

CONCLUSION

The judgment of the district court should be affirmed in part and reversed in part, and the case should be remanded to the district court with instructions to remand to the bankruptcy court for an evaluation of the merits of the United States Trustee’s motion to dismiss the case under 11 U.S.C. § 707(b).

Respectfully submitted,

Of Counsel:

DONALD F. WALTON
Acting General Counsel

P. MATTHEW SUTKO
Executive Office for
United States Trustees
U.S. Department of Justice
20 Massachusetts Ave., N.W.
Washington, D.C. 20530_

PETER D. KEISLER
Assistant Attorney General

DEBRA W. YANG
United States Attorney

WILLIAM KANTER
(202) 514-4575
ERIC D. MILLER
(202) 514-2754
Attorneys, Appellate Staff
Civil Division, Room 7256
U.S. Department of Justice
950 Pennsylvania Ave., N.W.
Washington, D.C. 20530-0001

DECEMBER 2004

CERTIFICATE OF SERVICE

I certify that on December 20, 2004, I filed and served this brief by causing an original and fifteen copies to be sent by Federal Express to the Clerk of the Court, and by causing two copies to be sent by Express Mail to:

Patricia A. Ringgold
P.O. Box 1073
Claremont, CA 91711-1073
(909) 624-0215

____
Eric D. Miller

CERTIFICATE OF RELATED CASES

Counsel is aware of no pending related cases.

____
Eric D. Miller

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1. **("TI")** *TITLE* OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*
Ringgold v. UST (In re Ringgold)

2. **("CO")** *CURRENT* COURT *[E.g., "CTA9"]*
9th Cir.

3. **("CCN")** *CURRENT* CASE NO.
No.: 04-56147, 04-56401

4. **("PCN")** *PRIOR* CASE NO. & COURT *[IF ANY]*
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Court: CD CA
(Identify judge & cite, if any)

5. **("SO")** *SOURCE*
U.S. TRUSTEES

6. **("DA")** *DATE* OF FILING *& TYPE* OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*
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7. **("AU")** *PRINCIPAL AUTHORS & OFFICE [E.g.,"UST/OGC"]*
Eric D. Miller, Civil Div. & P. Matthew Sutko, EOUST/OGC
(UST/OGC: 202-307-1399/FAX-2397)

8. **("TO")** *TOPIC*
BANKRUPTCY

9. **("SU")** ● *SUMMARY* OF KEY ISSUE(s) & √ Any Miscellaneous *BACKGROUND*
●The UST filed a motion to dismiss under section 707(b) after receiving a suggestion from a creditor. The question presented by appeal is whether the Bankr. Ct. may consider the UST's motion; and the question on cross-appeal is whether the UST must show that he conducted an "independent investigation" before he filed the the motion.
√ Background:

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Nos. 04-56147, 04-56401

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

In re PATRICIA A. RINGGOLD,
Debtor.

PATRICIA A. RINGGOLD,
Appellant/Cross-Appellee,

v.

STEVEN J. KATZMAN, UNITED STATES TRUSTEE,
Appellee/Cross-Appellant

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE CENTRAL DISTRICT OF CALIFORNIA

REPLY BRIEF FOR CROSS-APPELLANT

Of Counsel:

DONALD F. WALTON
Acting General Counsel

P. MATTHEW SUTKO
Executive Office for
United States Trustees
U.S. Department of Justice
20 Massachusetts Ave., N.W.
Washington, D.C. 20530

PETER D. KEISLER
Assistant Attorney General

DEBRA W. YANG
United States Attorney

WILLIAM KANTER
(202) 514-4575
ERIC D. MILLER
(202) 514-5735
Attorneys, Appellate Staff
Civil Division, Room 7256
U.S. Department of Justice
950 Pennsylvania Ave., N.W.
Washington, D.C. 20530-0001

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Appellee/Cross-Appellant.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE CENTRAL DISTRICT OF CALIFORNIA

REPLY BRIEF FOR CROSS-APPELLANT

INTRODUCTION

Both the appeal and the cross-appeal in this case turn on the interpretation of section 707(b) of the Bankruptcy Code, which provides that "the court, on its own motion or on a motion by the United States trustee, but not at the request or suggestion of any party in interest, may dismiss a case" if it finds that granting relief would be a "substantial abuse" of the Code. 11 U.S.C. § 707(b). In our opening brief, we explained that this provision prohibits the court from dismissing a case based on a request or suggestion from a party, but that it imposes no limit on the ability of the United States Trustee to file a motion. Therefore, the United States Trustee may move to dismiss a case even after receiving a request or suggestion from a party. All three courts of appeals to consider the issue have reached the same conclusion. See In re Stewart, 175 F.3d 796, 803-05 (10th Cir. 1999); In re Kornfield, 164 F.3d 778, 784 (2d Cir. 1999); In re Clark, 927 F.2d 793, 797 (4th Cir. 1991).

The specific issue presented by the cross-appeal is whether the United States Trustee must prove that he conducted an "independent investigation" before being allowed to prosecute a motion to dismiss under section 707(b). Ringgold claims that the United States Trustee has conceded the existence of such a requirement, but this is incorrect. Far from conceding the issue, the United States Trustee has consistently urged a plain-language interpretation of section 707(b) that is irreconcilable with an "independent investigation" requirement.

On the merits, the district court's "independent investigation" requirement should be rejected. Because section 707(b) limits only what the court may do, it imposes no obligations on the United States Trustee. Ringgold asserts that other courts have required a showing of an independent investigation, but the cases she cites do not support this claim. And Ringgold does not address the presumption of regularity that attaches to the actions of government officials. That presumption makes it inappropriate to impose on the United States Trustee the unusual -- and, so far as we are aware, unique -- burden of explaining the decisionmaking process that led him to file a motion.

ARGUMENT

I. The United States Trustee Has Not Waived the Argument That Section 707(b) Contains No "Independent Investigation" Requirement.

Ringgold asserts that the United States Trustee has waived the issue raised by the cross-appeal. In her view, "[h]aving argued below the existence of an implied investigation requirement, the [United States Trustee] on cross-appeal, may not now take the opposite position." Br. 11. Specifically, she asserts that the United States Trustee "conceded the applicability of the 'independent investigation' requirement in the present case." Br. 16; <u>see also</u> <u>id.</u> at 8 ("The [United States Trustee] conceded throughout his reply papers, that an 'independent investigation' showing is required in those jurisdictions permitting a hearing on the merits for dismissal motions brought by the [United States Trustee] at a creditor's request.").

Tellingly, Ringgold's claim of waiver is not supported by any quotation from any of the United States Trustee's filings in this case. Indeed, the United States Trustee has never argued, either explicitly or implicitly, that section 707(b) requires the

United States Trustee to prove that he conducted an "independent investigation" as a condition precedent to prosecuting a section 707(b) motion. On the contrary, he has consistently maintained that section 707(b) restricts only what the bankruptcy court may do, and that it in no way limits the ability of the United States Trustee to file a motion to dismiss after receiving a suggestion from a creditor. As we explained in our opening brief, since the statute does not restrict the activities of the United States Trustee, it cannot be read to require that he conduct an independent investigation. See Opening Br. 22. Far from endorsing an "independent investigation" requirement, the United States Trustee has consistently taken a position that is irreconcilable with the existence of such a requirement.

Before the bankruptcy court, the United States Trustee argued that section 707(b) does not restrict his ability to move to dismiss a case. The two sections of the argument in his filing were entitled "THE U.S. TRUSTEE'S MOTION IS NOT TAINTED BY A CREDITOR OR OTHER PARTY-IN-INTEREST REFERRAL," Appellant's Excerpts of Record ("E.R.") 210, and "STATUTORY LANGUAGE PERMITS THE U.S. TRUSTEE TO PROPERLY BRING § 707(b) MOTIONS EVEN IF A PARTY-IN-INTEREST REQUESTS THAT SUCH A MOTION BE FILED," id. at 212. In support of this second point, the United States Trustee explained that the statute "modifies what the Court can do and does not limit the U.S. Trustee." Id. Nowhere in his filings, or in his motion for reconsideration, see id. at 223, did the United States Trustee suggest that section 707(b) imposes an requirement of an independent investigation when a party in interest suggests that he file a dismissal motion.

Likewise, before the district court, the United States Trustee renewed his argument that section 707(b) limits only the bankruptcy court, not the United States Trustee. See Appellee/Cross-Appellant's Supplemental Excerpts of Record 19 ("[T]he prohibitive language [of section 707(b)] applies to the court's sua sponte motions to dismiss and not § 707(b) motions brought by the United States Trustee."); id. at 37 ("The overwhelming weight of authority interprets section 707(b) as permitting a court to hear a United States Trustee's motion to dismiss a debtor's case even when a party in interest makes a 'request or suggestion' to the United States Trustee."). Again, the United States Trustee nowhere suggested that affirmative proof of an adequate independent investigation was required. And the brief requested that the district court "reverse the order denying the dismissal of this case and remand the case with a direction to the bankruptcy court to rule on the merits." Id. at 32. It did not request a remand for determination whether there was an adequate independent investigation.

Ringgold maintains (Br. 15) that because the United States Trustee relied on In re Clark and In re Stewart, he necessarily accepted the "independent investigation" requirement which, in her view, those cases adopted. But as we explained in our opening brief, neither case held that such a requirement exists. See Opening Br. 22-24.

To be sure, the United States Trustee did point out that, in this particular case, he conducted his own investigation before filing the motion to dismiss. See, e.g., E.R. 213, 262. But this was simply an argument in the alternative; the United States Trustee nowhere suggested that an investigation was required by the statute. Instead, he urged an interpretation of a statute that forecloses any such requirement. Accordingly, Ringgold's claim of waiver should be rejected.

II. Section 707(b) Does Not Require the United States Trustee to Show That He Conducted an "Independent Investigation" Before Filing a Motion to Dismiss.

Nothing in 11 U.S.C. § 707(b) requires that the United States Trustee establish that he conducted an investigation as a condition precedent to filing a motion to dismiss for substantial abuse. The statute's qualifying language -- "but not at the request or suggestion of any party in interest" -- governs what the court may do, not what the United States Trustee may do. There is therefore no statutory basis for imposing any investigatory requirement on the United States Trustee.

A. In our opening brief, we noted that Ringgold had not explained exactly how she would parse the language of the statute. See Opening Br. 16. She still has not done so. In particular, Ringgold does not explain where in the statute she finds an "independent investigation" requirement. Instead, she asserts (Br. 17-18) that "[a]ll of the courts" that have permitted the United States Trustee to bring a section 707(b) motion after receiving a suggestion from a party in interest have required "a proper showing that the [United States Trustee] conducted an independent investigation." This is incorrect.

As we explained in our opening brief, all three courts of appeals that have considered the issue have determined that section 707(b) does not restrict the United States Trustee from bringing a motion to dismiss after receiving a suggestion from an interested party. See In re Stewart, 175 F.3d 796, 803-05 (10th Cir. 1999); In re Kornfield, 164 F.3d 778, 784 (2d Cir. 1999); In re Clark, 927 F.2d 793, 797 (4th Cir. 1991). In none of these cases did the court hold that the United States Trustee must prove that he conducted an independent investigation. In Clark, for example, the court noted that the United States Trustee would exercise "independent judgment," but it did not even mention the possibility of an "independent investigation" requirement. 927 F.2d at 797. In Kornfield, the court stated flatly that "Section 707(b) does not bar the U.S. Trustee from using information obtained from . . . parties in interest in deciding whether to file a substantial abuse motion." 164 F.3d at 784. It said nothing to suggest that the United States Trustee could use such information only after proving that he had conducted an independent investigation. And in Stewart, although the court mentioned the United States Trustee's investigation, it did not state that one was required -- indeed, since it was clear that an investigation had occurred, any such statement would have been dicta. See 175 F.3d 805.[*]

B. Application of an "independent investigation" requirement is inappropriate for the additional reason that it would be inconsistent with principles of prosecutorial discretion. Ringgold correctly observes (Br. 22-23) that this case does not involve a criminal prosecution. But as we have

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[*] In our opening brief, we stated that in Stewart, "no party argued that an investigation was not required at all." Opening Br. 24. We based this statement on the Stewart court's description of the parties' arguments. We have since learned, however, that the brief for the United States Trustee in Stewart did assert, albeit in a footnote: "[T]here is no requireement that the U.S. Trustee prove he has conducted an independent investigation under the statute. The suggestion to the contrary in In re Morris, 153 B.R. 559, 563 (Bankr. D. Ore. 1993), is mistaken." Brief for Appellee at 31 n.12, In re Stewart, 175 F.3d 796 (10th Cir. 1999) (No. 98-5000). Nevertheless, the opinion in Stewart suggests that the court did not consider this issue, no doubt because it was clear that an investigation had in fact occurred. See Stewart, 175 F.3d at 805 ("As the Panel noted, and we agree, the record demonstrates the Trustee undertook an independent investigation concerning Dr. Stewart's possible abuse of the provisions of Chapter 7 prior to filing the motion to dismiss."). For this reason, Stewart cannot be read as holding that an investigation is required.

explained, the United States Trustee's decision to bring a motion under section 707(b) is in many respects analogous to a United States Attorney's decision to seek an indictment, and judicial supervision of either decision is equally inappropriate.

In response, Ringgold asserts (Br. 23) that in this case, "[t]he [United States Trustee]'s motives and decision-making were not subjected to outside inquiry -- or judicial supervision." But such "inquiry" and "supervision" are precisely what the district court has called for. Ringgold suggests (Br. 26-27) that no further factual inquiry would be necessary in this case, but under the district court's order, the bankruptcy court must make a factual determination on remand. See E.R. 327. The bankruptcy court may well conclude that compliance with the district court's remand order requires holding a hearing and obtaining additional evidence concerning the nature of the investigation that the United States Trustee conducted.

In any event, whether or not further factual development would be necessary in this case, the district court's approach would surely require an extensive inquiry in many other cases. If a debtor challenged the adequacy or the independence of the investigation, the United States Trustee might well be asked to describe the investigation that he conducted. Depending on the facts of the case, the United States Trustee could be asked to identify the witnesses he interviewed and the documents he reviewed, as well as to explain the basis for his investigatory decisions. As we have observed, much of this material could be protected by the deliberative-process privilege, and requiring its disclosure would be inappropriate.

C. As Ringgold acknowledges (Br. 19-20), the United States Trustee already bears the burden of proof when filing a motion to dismiss. And like all litigants, he must certify that the factual representations in his motion are supported by evidence. See Fed. R. Bankr. P. 9011. Ringgold does not address the presumption of regularity that attaches to the actions of government officials. See United States Postal Serv. v. Gregory, 534 U.S. 1, 10 (2001). But in light of that presumption, there is no reason why the United States Trustee should bear the unique additional burden of explaining how he obtained and evaluated the evidence supporting his motion.

CONCLUSION

The judgment of the district court should be affirmed in part and reversed in part, and the case should be remanded to the district court with instructions to remand to the bankruptcy court for an evaluation of the merits of the United States Trustee’s motion to dismiss the case under 11 U.S.C. § 707(b).

Respectfully submitted,

PETER D. KEISLER
Assistant Attorney General

DEBRA W. YANG
United States Attorney

WILLIAM KANTER
(202) 514-4575
ERIC D. MILLER
(202) 514-2754
Attorneys, Appellate Staff
Civil Division, Room 7256
U.S. Department of Justice
950 Pennsylvania Ave., N.W.
Washington, D.C. 20530-0001

Of Counsel:

DONALD F. WALTON
Acting General Counsel

P. MATTHEW SUTKO
Executive Office for
United States Trustees
U.S. Department of Justice
20 Massachusetts Ave., N.W.
Washington, D.C. 20530

FEBRUARY 2005

CERTIFICATE OF SERVICE

I certify that on February 7, 2005, I filed and served this brief by causing an original and fifteen copies to be sent by Federal Express to the Clerk of the Court, and by causing two copies to be sent by Express Mail to:

Patricia A. Ringgold
P.O. Box 1073
Claremont, CA 91711-1073
(909) 624-0215

Eric D. Miller

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WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*
In re Ted Hopkins Roberts and Mary Ann Roberts (Ted Hopkins Roberts and Mary Ann Roberts v. Charles F. McVay, United States Trustee Region 7)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*
W. D. Tex.

3. ("CCN") ***CURRENT*** CASE NO.
No.: 5:07-cv-00583-XR

4. ("PCN") ***PRIOR*** CASE NO. - & COURT *[IF ANY]*
No.: 04-55897-rbk

Court: Bankr. W.D. Tex.

(Identify judge & cite, if any)

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U.S. TRUSTEES

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7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*
Nancy Ratchford, Sean E. Martin, P. Matthew Sutko, Ramona D. Elliott, Roberta A. DeAngelis, Charles F. McVay

(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s)

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√ Any Miscellaneous ***BACKGROUND***

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IN THE UNITED STATES DISTRICT COURT
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SAN ANTONIO DIVISION

In re TED HOPKINS ROBERTS and
MARY ANN ROBERTS,
Civil No. SA-07-CA-0583-XR

TED HOPKINS ROBERTS and
MARY ANN ROBERTS

Appellants

v.

CHARLES F. MCVAY,
UNITED STATES TRUSTEE, REGION 7,

Appellee

On Appeal from the United States Bankruptcy Court
for the Western District of Texas
San Antonio Division

BRIEF OF THE APPELLEE CHARLES F. McVAY UNITED STATES TRUSTEE , REGION 7

CHARLES F. McVAY **UNITED STATES TRUSTEE** **REGION 7** **Nancy Ratchford** Assistant U.S. Trustee Department of Justice Office of the U.S. Trustee 615 E. Houston St., Room 533 P.O. Box 1539 San Antonio, Texas 78295-1539 (210) 472-4640 Ext. 223 (210) 472-4649 Fax	**Of Counsel** **Roberta A. De Angelis** **Acting General Counsel** **Ramona D. Elliot** **Deputy General Counsel** **P. Matthew Sutko** **Associate General Counsel** **Sean E. Martin** **Trial Attorney** Executive Office for United States Trustees Department of Justice 20 Massachusetts Avenue, N.W. Suite 8000 Washington, D.C. 20530 (202) 307-1399

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RULES

STATEMENT OF APPELLATE JURISDICTION

This Court has jurisdiction over Ted and Mary Roberts' appeal from the judgment and other orders entered in the Adversary (Case No. 06-05121) under 28 U.S.C. § 158(a)(1) granting the United State Trustee's Complaint to deny the Roberts' discharge under 11 U.S.C. §§727(a)(2), (a)(3) and (a)(4) **.** The debtors also appeal from the following orders entered in their bankruptcy case, Case No. 04-55897 (the "Main Case"): 1) order allowing employment of counsel for John Patrick Lowe, Chapter 7 Trustee, entered on January 23, 2007 (Case Doc. No. 197) and 2) order overruling the debtors' objection to the application to employ counsel entered on March 6, 2007 (Case, Doc. No. 201) (collectively, the "Employment Orders"). The debtors failed to timely appeal, and this court is without jurisdiction to review the Employment Orders. *See Texas Gulf Trawling Co. v. Don Vincente Macias,* 168 F.3d 209 (5th Cir. 1999) *cert. denied* 528 U.S. 986 (1999)[1]. 28 U.S.C. 158(c)(2); and Fed. R Bankr. P. 8002(a)

STATEMENT OF ISSUES PRESENTED

Appellants designated thirty six issues on appeal. In their brief, Appellants identify five (5) issues. Appellee, the United States Trustee, pursuant to Fed. R. Bankr. P. 8010(a) (2), presents the following issues:[2]

1. Did the Bankruptcy Court err in denying the debtors' discharge?
2. Did the Bankruptcy Court err in its pre-trial discovery rulings?
3. Did the Bankruptcy Court err in denying the debtors' first amended motion for sanctions?

STATEMENT OF APPLICABLE STANDARD OF APPELLATE REVIEW

On appeal conclusions of law are reviewed *de novo* and findings of fact are reviewed for clear error. *In re National Gypsum Company,* 208 F. 3d. 498, 504 (5th Cir. 2000). "A bankruptcy

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[1] See Notice of Appeal. However, not only is the court without jurisdiction to review the Employment Orders on appeal, the issues are waived because the Appellants failed to include the issues in their statement of issues in the brief and do not argue them. *In re GGM, P.C. 165 F. 3d 1026,1031-1032(5th Cir. 1999).*

[2] The United States Trustee is not addressing the Employment Orders since Appellants' brief does not address them; and it appears Appellants have abandoned appeal of the Employment Orders.

court's determination that a debtor should be denied a discharge is reviewed only for abuse of discretion." *In re Jones*, 966 F. 2d 169, 172 (5th Cir. 1992); *In re Powers*, 979 F. 2d 1533 at *2 (5th Cir. 1992)(unpublished). The "discharge can only be denied if one or more of the statutory grounds of objection are proved." *In re Andrews*, 98 Fed. Appx. 290, 293 (5th Cir. 2004). The debtors' intent under §727 is a fact question. *In re Andrews*, 98 Fed. Appx. at 294. . The court's finding that the debtors made knowing and false statements is a question of fact. *Id.* The court's determination of the adequacy or lack of adequacy of the debtors' excuse or explanations of their omissions or mistakes is a factual finding. *First Sav. Ass'n., Inc. v. Reed (In re Reed),* 700 F. 2d 986, 993 (5th Cir. 1983). A court's factual finding is clearly erroneous "only if on the entire evidence, the court is left with the definite and firm conviction that a mistake has been committed." *Robertson v. Dennis (In re Dennis)*, 330 F.3d 696, 701 (5th Cir. 2003) [citations omitted]. A "factual finding is not clearly erroneous if it is plausible in the light of the record as a whole." *In re Ramba, Inc.*, 416 F.3d 394, 402 (5th Cir. 2005). On appeal the reviewing court gives deference to a bankruptcy court's opportunity to evaluate the credibility of the witnesses. *In re Dennis,* 330 F.3d at 701; Fed. R. Bankr. P. 8013. "[W]hen the bankruptcy court's findings of fact are based on determinations regarding the credibility of witnesses, they should be awarded even greater deference." *In re Andrews,* 98 Fed. Appx. at 293 [citation omitted]. "As long as there are two permissible views of the evidence," the bankruptcy court's "choice between competing views" is not clearly erroneous. *In re Acosta*, 406 F.3d 367, 373 (5th Cir. 2005) *citing Anderson v. Bessemer City*, 470 U.S. 564, 574 (1985). "A clearly erroneous finding of fact does not constitute reversible error if there is other sufficient evidence to support the bankruptcy court's ruling." *Jacobson v. Ormsby,* 2006 WL 2796672 (D. W.D. Tex. 2006) [citation omitted]. The standard of review for the court's discovery rulings is abuse of discretion. *Beattie v. Madison County School District*, 254 F.3d 595, 605 (5th Cir. 2001).

The issue concerning whether the debtors were entitled to sanctions is a mixed question of fact and law reviewed for abuse of discretion. *Merriman v. Security Ins. Co,* 100 F. 3d 1187, 1191 (5th Cir. 1996) (Fed. R. Civ. P. 11).

STATEMENT OF THE CASE

On October 13, 2004, Ted Roberts and Mary Roberts filed a petition for relief under Chapter 11 of the Bankruptcy Code (Adv. Doc. Nos. 1, 151).[3] On March 29, 2005 the debtors voluntarily converted their case to a Chapter 7 liquidation. (Adv. Doc. Nos. 1, 151). Mr. John Patrick Lowe was appointed as the Chapter 7 trustee. On July 11, 2006, the United States Trustee[4] timely filed a Complaint pursuant to 11 U.S.C. §727 seeking denial of the debtors' discharge for multiple false oaths and statements in the debtors' bankruptcy schedules, transfers and concealment of assets, and the debtors' failure to keep complete financial records. (Adv. Doc. No. 1, the "Complaint"). On May 4, 2007, after a three (3) day bench trial, held on April 3 through 5, 2007, the bankruptcy court denied the debtors' discharge. The court denied the debtors' discharge: (a) under §727(a) (4) finding that they had made multiple material false oaths by failing to disclose assets such as businesses, (Counts I and II of the Complaint), a bank account, (Count III of the Complaint) an escrow deposit (Count IV of the Complaint), stock (Count V of the Complaint) and claims against their professional corporation (Count VII of the Complaint); (b) under §727(a) (2) finding they concealed and transferred assets, (Counts IX, X and XIV of the Complaint); and (c) under §727(a)(3) finding they failed to maintain records (Count IIIA of the Complaint). (Adv. Doc. No. 179). The debtors appeal from the bankruptcy court's judgment denying their bankruptcy discharge. (Adv. Doc. No. 190). The debtors also appeal from pre and post trial orders relating to procedure and discovery and the order denying their first amended

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[3] All references are to the record on appeal.

[4] See Appellee's brief at p. 5 on the role of the United States Trustee.

motion for sanctions. (Adv. Doc. No. 190).

STATEMENT OF THE FACTS

I. The Bankruptcy Case, Schedules, Statements of Financial Affairs, and Creditors' Meetings

On October 13, 2004, the debtors filed a voluntary Chapter 11 bankruptcy case (the "Main Case." (Adv. Doc. Nos. 1, 151) and later voluntarily converted the case to a Chapter 7 liquidation. The debtors are attorneys, licensed in Texas since 1991 for Ted Roberts and since 1993 for Mary Roberts. (Trial Tr., Vol. 1, p. 224, L. 8-10, Vol. 3, p. 518, L. 12-16). According to the State Bar of Texas website, Ted Hopkins Roberts is currently indefinitely suspended from the practice of law starting June 15, 2007. www.texasbar.com Public Disciplinary History. Prior to his suspension, Ted Roberts was an experienced litigation attorney certified by the Texas Board of Legal Specialization in Civil Trial and Personal Injury Law. (Trial Tr., Vol. 1, p. 220, L. 5-7). The United States Court of Appeals for the Fifth Circuit has described the debtors as "prominent local attorneys". *Lowe v. Hearst Communications Inc.*, 487 F.3d 246, 249 (5th Cir. 2007).[5] Ted Roberts also held a Masters Degree in Business Administration. (Trial Tr., Vol. 1, p. 224, L. 14-16). The debtors were represented in their bankruptcy case by Jerome Brown, a board certified attorney in business and consumer bankruptcy law. (Trial Tr., Vol. 1, p. 221, L. 6-11, Vol. 3, p. 519, L. 12-15, Case Doc. No. 24). The debtors testified their bankruptcy counsel was competent and qualified to represent them. (Trial Tr., Vol. 1, p. 221, L. 12-25, p. 222, L. 1-20; Vol. 3 p. 519, L. 5-19). At the time they commenced their bankruptcy case the debtors filed signed sworn bankruptcy

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[5] "While at the time the article was published the Roberts had not yet been charged with any criminal activity, the article did mention the district attorney's response, which at the time was seeming disinterest. Maro Robbins & Joseph S. Stroud, *Sex, Lawyers, Secrets at Heart of Sealed Legal Case*, San Antonio Express-News, June 13, 2004, at A1. Given the broad interpretation of newsworthiness, particularly with regards to alleged criminal activity, an article describing the use of the legal system by prominent local lawyers in a way that could be described as blackmail is a matter of public concern." *Lowe v. Hearst, Id*.

schedules and financial statements, containing a declaration the signatures were under penalty of perjury. During the case, the debtors signed and filed amended schedules six (6) times and amended statements of financial affairs two (2) times (each containing a declaration under penalty of perjury) (collectively "Schedules" Case Doc. Nos. 20, 27, 30, 49, 93, 143, 195; and collectively "Statements of Financial Affairs" Case Doc. Nos. 19, 29, 94; Pl.'s Ex. 3-12, 3A-12A). The debtors appeared on November 15, 2004 and December 1, 2004 for creditor meetings (as adjourned) in the Chapter 11 case. The debtors testified under penalty of perjury at the creditor meetings they read the Schedules and Statements of Financial Affairs **before** they signed them; and they testified that, subject to minor corrections stated by their counsel, the Schedules and Statements of Financial Affairs were true and correct. (Trial Tr., Vol. 1, p. 246, L. 19 – 25, p. 247 L. 1-3; Vol. 3, p. 522, L. 4-25, Defs.' Ex. 3, p. 12-14). The debtors also testified they understood all their assets and property were to be disclosed in the Schedules and Statements of Financial Affairs. (Trial Tr., Vol. 1, p. 249, L. 10-15, Vol. 3 p. 522 L. 4-7, Defs.' Ex. 3, p. 14). As licensed attorneys the debtors knew the meaning of signing documents under penalty of perjury. (Trial Tr., Vol. 1, p. 248, L.25, p. 249, L. 1-3, Vol. 3, p. 523, L. 13-19).

II. The United States Trustee's Role in Bankruptcy Cases

United States Trustees are officials of the Department of Justice appointed by the Attorney General, charged with appointing private trustees in bankruptcy cases and supervising the administration of bankruptcy cases. 28 U.S.C. §581. *See generally* 28 U.S.C. §586 (specifying some of the powers and duties of the United States Trustee). *See also In re Castillo*, 297 F. 3d 940, 950 (9th Cir. 2002)("The United States Trustee is the 'watchdog' of the bankruptcy system . . . charged with preventing fraud and abuse and 'fill[ing] the vacuum' caused by possible creditor inactivity.")[6] United States Trustees "supervise the administration of cases and trustees" in all bankruptcy cases within their region through a range of oversight responsibilities. 28 U.S.C. §586(a) (3). *See generally Morganstern v. Revco D.S. Inc., (In re Revco D.S., Inc.),* 898 F. 2d 498, 500 (6th Cir. 1990)(explaining United States Trustees oversee the bankruptcy process, protect the public interest, and ensure that bankruptcy cases are conducted according to law). The United States Trustee may raise and may appear and be heard on any issue in any case or proceeding under the Bankruptcy Code. 11 U.S.C. §307; *see also Revco*, 898 F. 2d at 499-500 (affirming the appellate standing of United States Trustees).

III. The Debtors' Compliance with the Debtor in Possession Guidelines

These debtors received the United State's Trustee's written Debtor-in-Possession Guidelines, which govern the conduct of Chapter 11 cases, and reviewed them with their counsel before their creditor meeting. (Trial Tr., Vol. 1, p. 251, L. 4-6, p. 255, L. 5-9, Vol. 3, p. 531-532, Pl.'s Ex. 13). Both debtors signed statements certifying they understood and would comply with the DIP Guidelines, advising them to close all pre-petition bank accounts and open new DIP bank accounts. (Trial Tr., Vol. 3, p. 532, L. 18-23, Pl.'s Ex. 13). The debtors also signed a sworn statement given to the United States Trustee that they had closed all their pre-petition bank accounts. (Trial Tr., Vol. 1, p. 255, L. 20-24, Vol. 3, p. 533, L. 3-9, Pl.'s Ex. 14). However, the statement the debtors gave to the United States Trustee in early November 2004 about their bank accounts was false because the debtors had another undisclosed pre-petition bank account they did not close and continued to use. (Trial Tr., Vol. 1, p. 257, L. 12-15, Vol. 3 p. 532 L. 24-25, p. 533 L. 1-13).

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[6] *See also In re Donovan Corp.*, 215 F. 3d 929, 930 (9th Cir. 2000)(United States Trustee may intervene and appear at any level of the proceedings, from the bankruptcy court on, as a party or an amicus).

IV. Debtors' Omissions, Concealment, Failure to Disclose on Their Schedules and the Statements of Financial Affairs; and Their Failure to Maintain Records

The United States Trustee filed the Complaint seeking denial of the debtors' discharge under 11 U.S.C. §§727(a)(2), (a)(3) and (a)(4) after reviewing the debtors' conduct in their bankruptcy case and after questioning the debtors at their creditor meetings. The Complaint included fourteen (14) fact specific Counts[7] for the denial of the debtors' discharge pursuant to 11 U.S.C. §§727(a) (2) (A) and (B), 727(a) (3), and 727(a) (4). (Adv. Doc. No. 1). The denial of a debtor's discharge means the debtor remains liable for their debts after their bankruptcy case terminates. The debtors in their Amended Answer (Adv. Doc. No. 151) admitted they made omissions on the Schedules and Statements of Financial Affairs; and argued they lacked fraudulent intent or that the omissions were not material. The debtors also admitted to other omissions on their sworn Schedules and Statements of Financial Affairs not addressed in the Complaint including the: 1) sale of certain items of furniture; 2) ownership of stock in Simtrol Corp.; 3) existence of a co-debtor; 4) existence of a sanctions motion (relating to Hearst Corp.); 5) an additional signatory on a safe deposit box; 6) source of the filing fee; 7) a stamp collection; and 8) a $1,400 credit card rebate. (Adv. Doc. No. 151, pp. 14-15, Trial Tr., Vol. 3 p. 712, L. 14-23).

A. Ezekiel I and Roberts Foundation For Children

On the Statement of Financial Affairs the debtors failed to disclose their interests in and roles as general partners and directors of two entities, Ezekiel I and Roberts Foundation for Children ("RFC"). Question 18 of the Statement of Financial Affairs[8], signed by the debtors under oath,

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[7] The Statement of Facts will only address the Counts of the Complaint on which the bankruptcy court found for the United States Trustee.

[8] Question No. 18 on the Statement of Financial Affairs asked the debtors to list "the names, addresses, taxpayer identification numbers, nature of the businesses, and beginning and ending dates of all businesses in which the debtor was an officer, director, partner, or managing executive of a corporation, partnership, sole proprietorship or was a self employed individual within the six years immediately preceding the commencement of the case, or in which the debtor owned 5 percent or more of the voting or equity securities within the six years immediately

asks the debtors to disclose information concerning businesses in which they were involved during the six years prior to the bankruptcy filing. During the six years prior to the bankruptcy filing, the debtors were partners in the Texas general partnership, Ezekiel I. Ted Roberts was a general partner of Ezekiel I through at least 2002, and the managing general partner of Ezekiel I though 2003. (Trial Tr., Vol. 2, p. 344, L. 10-18). Mary Roberts was a general partner in Ezekiel I at least through 2002. (Trial Tr., Vol. 2, p. 344, L. 16-18). On June 15, 2000, Ted Roberts executed an Assumed Name Certificate for Ezekiel I and filed the certificate with the Bexar County Clerk. (Trial Tr., Vol. 2, p. 344, L. 24-25, p. 345, L. 1-23, Pl.'s Ex. 47). Ezekiel I was never formally dissolved. (Trial Tr., Vol. 2, p. 357, L. 10-12). The debtors failed to disclose both their positions as general partners and their partnership interests in Ezekiel I in response to question 18 of their initial Statement of Financial Affairs. (Pl's Ex. 3).

The debtors were also directors of RFC within six years before the bankruptcy case. The RFC Articles of Incorporation filed with the Texas Secretary of State on December 28, 2001, named both debtors as directors. (Trial Tr., Vol. 2, p. 371, L. 17-24, Vol. 3, p. 575, L. 1-2, Pl.'s Ex. 62). Ted Roberts received monies as described in a criminal case. *The State of Texas v. Ted H. Roberts*, Case No. 2006-CR-6404B (District Court 226th District, Bexar County; (Pl.'s Ex. 82 Charge of Court and Jury Verdict). He deposited those funds, relating to the criminal case, into RFC bank and investment accounts sometime in 2002. (Trial Tr., Vol. 1 pp. 218-220, Vol. 2 pp. 423-429; Pl.'s Exs. 82, 64, 65). Ted H. Roberts, P.C. (the "P.C.") borrowed these funds, no less that $69,000, from RFC, for the P.C.'s overhead. (Trial Tr.,Vol. 2, p. 373, L. 17-20, p. 374, L. 8-12, Vol. 3, p. 578, L. 3-6, p. 579, L. 22-25; Pl.'s Exs. 66, 67). The P.C. never repaid RFC. (Trial Tr., Vol. 1 p.241, L. 12-15, Vol. 3, p. 578, L. 12-15, p. 579, L. 22-25 p. 580 L. 1-4) RFC's Articles of Dissolution, filed with the Texas Secretary of State on January 22, 2004, less than ten months before the debtors filed bankruptcy, were signed

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preceding the commencement of the case."(Pl's Ex. 3).

by Mary Roberts as Chairman of the Board of Directors. (Trial Tr., Vol. 3, p. 575, L. 18-25, p. 576, L. 1-3, Pl.'s Ex. 63). Despite their involvement in the RFC, the debtors failed to disclose both their positions as directors and their interests in RFC in response to question 18 of the Statement of Financial Affairs filed on November 8, 2004. (Pl's Ex. 3).

B. <u>Lawyers' Title Deposit/Broadway Bank Account</u>

The debtors failed to disclose a bank account they owned and used both before and after they filed the bankruptcy case. The debtors did not disclose this asset on their bankruptcy Schedules until required by court order to do so in January 2007. (Case Doc. No. 193, Pl.'s Ex. 12). Mary Roberts, on June 12, 2004, paid $1,000.00 to Lawyers' Title to hold as earnest money (the "Lawyers' Title Deposit"). (Trial Tr., Vol. 3, p. 538, L. 12-16, Pl.'s Ex. 21). The debtors failed to disclose the Lawyers' Title Deposit on their Schedules. (Pl.'s Ex. 4).

The Chapter 7 trustee could not fully determine the disposition of the Lawyers' Title Deposit until sometime after the Complaint was filed. The Chapter 7 trustee made repeated requests to the debtors in 2005 for additional supporting documentation concerning the disposition of the Lawyers' Title Deposit. (Trial Tr., Vol. 1, p. 94, L. 8-24, p. 99, L. 4-7). On May 25, 2006, the Chapter 7 trustee filed a motion to compel the debtors to provide the requested documentation concerning the Lawyers' Title Deposit. (Case Doc. No. 165, Trial Tr. Vol. 1, p. 96, L. 24-25, p. 97, L. 1-4). The Chapter 7 trustee also demanded the return of what he considered estate assets. (Trial Tr., Vol. 1, p. 96, L. 14-17, Pl.'s Ex. 20). The debtors and the Chapter 7 trustee entered in an agreed order on the motion to compel on August 14, 2006 (Case Doc. No. 178, Trial Tr., Vol. 1, p. 99, L. 11-14); and the debtors finally produced a copy of a $1,000 check from Lawyers' Title (the "Refund Check") payable to the debtors showing a refund of the Lawyers' Title Deposit on August 23, 2004. (Trial Tr., Vol. 1, p. 100, L. 1-8, Pl.'s Ex. 24).

Despite producing a copy of the Refund Check, the debtors failed to disclose into which financial account they deposited the Refund Check. The Chapter 7 trustee made additional inquiries to the debtors concerning the identity of the account into which the Refund Check was deposited. (Trial Tr., Vol. 1, p. 102, L. 1-5; Pl.'s Exs. 23, 24, 25). On November 2, 2006, over two years after the bankruptcy filing, the debtors, through their bankruptcy counsel, admitted to the Chapter 7 trustee that the Refund Check was deposited, in August 2004, into the Broadway Bank Account,[9] a bank account not disclosed on the Schedules and Statements of Financial Affairs. (Trial Tr., Vol. 1, p. 102, L. 14-23, Pl.'s Ex. 25). The debtors further stated that they would amend the Schedules to include the undisclosed Broadway Bank Account. (Pl.'s Ex. 25)

On December 15, 2006, the United States Trustee filed a motion to compel the debtors to disclose the Broadway Bank Account (Case Doc. No. 190); and on January 11, 2007, the bankruptcy court entered an order granting the United States Trustee's motion to compel. (Case Doc. No. 193). On January 15, 2007, the debtors filed their sixth amended Schedules finally disclosing the Broadway Bank Account. (Pl.'s Ex. 12).

C. Martinez Deposit

The debtors did not disclose an earnest money deposit of $5,000.00 or that their funds, used for the deposit, were later credited and thus transferred for the "benefit" of a relative. On or about August 3, 2004, the debtors and Ernest and Mary Ann Martinez executed an earnest money contract wherein the debtors agreed to lease, with a purchase option, 9514 Burwick, San Antonio, Texas (the "Burwick Property"). (Trial Tr., Vol. 3, p. 583, L. 10-16, Pl.'s Ex. 70). Mary Roberts, on August 3, 2004, paid $5,000.00 to the Martinez to hold as a deposit (the "Martinez Deposit") pursuant to the earnest money contract. (Trial Tr., Vol. 3, p. 584, L. 3-7, Pl.'s Ex. 22).

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[9] Broadway Bank Account is Account No. 1393277 , a multiparty account with right of survivorship owned by Daniel F. Schorlemer, or Mary S. Roberts, or Ted Roberts (Pl.'s Ex. Nos. 12, 16, 30 through 38).

After the debtors filed bankruptcy, they filed Schedule G stating their intention to assume the earnest money contract. (Pl.'s Ex. 4, Trial Tr., Vol. 3, p. 586, L. 5-12). The debtors continued to make rent payments to the Martinez after the bankruptcy filing both from the Debtor in Possession account and the Broadway Bank Account. (Trial Tr., Vol. 3, p. 545-546, p. 552-553, p. 572-573, Pl.'s Ex. 31A, 32B, Defs.'Ex. D-1/D-5).

In May 2005, the debtors executed an Assignment assigning their rights in the earnest money contract and Martinez Deposit to Daniel and Caroline Schorlemer (the "Schorlemers"), Mary Roberts' parents. (Trial Tr., Vol. 3, p. 586, L. 15-22, p. 587, L. 13-20, Pl.'s Ex. 71). Also, the debtors, on May 12, 2005, corresponded with the Chapter 7 trustee to determine whether he opposed the Schorlemers' purchase of the Burwick Property. On May 13, 2005, the Chapter 7 trustee responded and clearly stated that bankruptcy estate was not relinquishing any rights in the Martinez Deposit. (Trial Tr., Vol. 1, p. 103, L. 19-25, p. 104, L. 1-2, Pl.'s Ex. 26). The debtors never returned the Martinez Deposit to the Chapter 7 trustee and never amended their Schedules and Statements of Financial Affairs to disclose the Martinez Deposit. (Trial Tr., Vol. 1, p. 96, L. 21-23, Pl.'s Exs. 4,5, 7, 8, 9, 9A, 11, 12,).

On or about June 1, 2005, the Schorlemers purchased the Burwick Property (Trial Tr., Vol. 3, p. 587, L. 21-24, Pl.'s Ex. 72) and received a credit for the undisclosed Martinez Deposit to fund their purchase despite the Chapter 7 trustee's claim to the deposit. (Trial Tr., Vol. 1, p. 109, L. 4-18, Pl.'s Exs. 23 and 27). The debtors, who reside at the Burwick Property, also effectively retained the benefit of the Martinez Deposit. (Trial Tr., Vol. 3, p. 546, L. 6-8).

D. <u>ACIS, Inc. Stock</u>

The debtors did not disclose stock they owned. The debtors owned the ACIS Stock, 4,500 shares in ACIS, a privately held company. The debtors valued the stock at $1,500 in July 2003 on their financial statement (the “Financial Statement”) (Pl.’s Ex. 39). When they filed their bankruptcy the debtors failed to disclose the stock on the Schedules, or as part of the contents of their safe deposit box on the Statement of Financial Affairs filed on November 8, 2004. (Pl.’s Exs. 3, 4). The debtors later admitted the ACIS Stock was in a safe deposit box at Compass Bank (Pl.’s Ex. 6); but they failed to examine the contents of the safe deposit box prior to filing the Schedules and Statement of Financial Affairs on November 8, 2004. (Trial Tr., Vol. 2, p. 394, L. 2-9, Vol. 3, p. 582, L. 10-25, p. 583, L. 1-4). Although the ACIS Stock was listed on their Financial Statement, the debtors testified they did not review the Financial Statement before preparing the Schedules and Statement of Financial Affairs filed November 8, 2004. (Trial Tr., Vol. 1, p. 225, L. 9-18, p. 228, L. 6-16,Vol. 2, p. 392 L. 10-20; Vol. 3, p. 580, L. 21-25, p. 581, L. 1-2, L. 10-21, Pl.’s Ex. 39). Ted Roberts testified he prepared the Financial Statement, which both debtors signed, and that he remembered the ACIS Stock in July 2003 without the need to review the contents of the safe deposit box. (Trial Tr., Vol. 2, p. 393 L. 4-9). The debtors amended the Statement of Financial Affairs and the Schedules in late November 2004, disclosing the ACIS Stock as part of the contents of their safe deposit box, and as personal property, valued at $100.00. (Pl.’s Exs. 5, 6 and 7).

E. Claim Against Ted H. Roberts, P.C.

The debtors did not disclose claims they owned against their P.C. The debtors owned a $35,625 claim (the “PC Claim”) against the P.C., which was wholly owned by the debtors, when they filed their bankruptcy. (Trial Tr., Vol. 2, p. 501, L. 1-20, Vol. 3, p. 596, L. 4-10, Pl.’s Ex. 8). But they failed to disclose the claim on the Schedules filed on November 8, 2004. (Trial Tr., Vol. 3, p. 597, L. 12-23, Pl.’s Ex. 4). Although the debtors listed they owed the P.C. $154,930.00 on Schedule F, this amount was a gross amount not including any set off or reduction for the PC Claim. (Trial Tr. Vol. 2, p. 503, L. 14-17, Pl.’s Ex. 4). They listed the value of the P.C. as unknown. (Pl.’s Ex. 4; Trial Tr., Vol. 2 pp. 399-400). The source of the monies for their PC Claim was advances made by the debtors mostly from their own credit cards. (Trial Tr., Vol. 2, p. 501, L. 21-25).

F. Debtors' Failure To Maintain Records

The debtors did not keep complete financial records relating to a deposit of their monies into the undisclosed Broadway Bank Account. The debtors admit in paragraphs 20 and 74 of their Amended Answer that they either failed to maintain or discarded the records concerning the disposition of the Lawyers' Title Deposit. (Adv. Doc. No. 151). The debtors admitted they did not keep the deposit records for the Refund Check. (Pl.'s Ex. 23). The Chapter 7 trustee did not get complete records from the debtors for the Broadway Bank Account; and the other bank records he got from the debtors were not complete. (Trial Tr., Vol. 1, p. 100, L. 14-21, p. 93, L. 13-18). (See Appellee's brief at, pp. 9-10 concerning the Chapter 7 trustee's efforts to obtain bank accounts and information concerning the Lawyers' Title Deposit). The debtors' admission of the Broadway Bank Account to the Chapter 7 trustee was **after** they responded to the United States Trustee's discovery requests when they first disclosed the account on November 1, 2006. The Chapter 7 trustee testified he did not receive all the records he was seeking regarding the Lawyers' Title monies when he filed his motion to compel turnover in May 2006. (Case Doc. 165, Trial Tr., Vol. 1pp. 181-182, L. 10-25, 1-4). Only on November 2, 2006, over two years after the bankruptcy filing, did the debtors produce to the Chapter 7 trustee an incomplete copy of an August-September 2004 Broadway Bank Account statement and say the statement showed the deposit of the Refund Check (Trial Tr., Vol. 1, p. 102, L. 14-23, Pl.'s Ex. 25). As customers and account holders the debtors could have obtained all the Broadway Bank documents for the account they were listed as owners of, according to the bank's representative. (Trial Tr., Vol. 1, p. 35 L. 1-4). Furthermore, the debtors had access to the Broadway Bank Account records not only from the bank, but from Mr. Schorlemer. (Trial Tr., Vol. 3, p. 543). Despite having access to account records for the Broadway Bank Account they were owners of, (Trial Tr., Vol. 1, p. 35, L. 1-4, Vol. 3, p. 543, L. 4-15), the debtors failed and refused to produce complete bank records for the account to the Chapter 7 trustee.[10] (Trial Tr., Vol. 1, p. 102, L. 24-25, p. 103, L. 1-3, Pl.'s Ex. 25).

V. Trial on the Complaint

After a three (3) day bench trial on April 3, 4, and 5, 2007, the bankruptcy court ruled in favor of the United States Trustee, holding that the debtors were not entitled to a bankruptcy discharge under ten separate counts, including three separate and independent legal grounds, in the Complaint. The court denied the discharge under 11 U.S.C. §727(a) (4) by granting judgment on Counts I, II, III, IV, V and VII of the Complaint. The court denied the discharge under 11 U.S.C. §727(a) (2) by granting judgment on Counts IX, X and XIV of the Complaint. And the court denied the discharge under 11 U.S.C. §727(a) (3) granting judgment on Count III A of the Complaint.[11] (Trial Ruling Tr. 5/4/07, p. 3, L. 7-11). The court found the debtors' failure to list the Broadway Bank Account, put into issue by the Lawyers' Title Deposit, Ezekiel I, Roberts Foundation for Children, the ACIS stock, the Martinez Deposit, and the claims against the P.C. were material omissions. The court found some of the debtors' omissions were not material: not listing their CPA and not disclosing a children's trust for which Ted Roberts, is trustee, and in his trustee capacity holds title to real property. (Trial Ruling Tr.5/4/07 pp. 3-4). The court found these false oaths and errors and omissions in the Schedules and Statements of Financial Affairs were "not corrected until the Debtors were prompted to do so". (Trial Ruling Tr. 5/4/07 p. 6-7). The court found the debtors' material false oaths, errors and omissions were "made with reckless indifference to their truth and accuracy." (Trial Ruling Tr. 5/4/07 p. 7). This appeal followed.

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[10] Mary Roberts testified she did not know what happened to the Broadway Bank Account records. (Trial Tr. Vol. 3 p. 543 L. 16-19).

[11] The court denied relief on Counts VI, VIII, XI, XII and XIII.

VI. Pretrial Discovery Matters

The debtors appeal from various discovery rulings. To aid it in ruling on discovery matters, the court had two hearings on discovery disputes. The court properly denied some of the parties' discovery requests controlling discovery by the debtors and the United States Trustee and enforced its own Scheduling Order[12]. (Adv. Doc. Nos. 58, 65, 67, 129, 130, 131, 132, 133, 134, 135).

A. The Written Discovery

On September 8, 2006, the United States Trustee served written discovery requests on the debtors. On November 1, 2006, the debtors responded and objected to the discovery requests, and, subject the restrictions imposed by the bankruptcy court, (Adv. Doc. Nos. 58, 65 67), the debtors finally produced documents to the United States Trustee on December 31, 2006.

In response to the debtors' multiple discovery requests, the United States Trustee, on October 30 and November 30 of 2006, timely served his objections and responses. (Adv. Doc. No. 113, 114, 115, 116). The United States Trustee produced relevant non-privileged documents to the debtors on October 30, 2006 and November 30, 2006. (Tr. 1/24/07, p. 62, L. 1-3, Adv Doc. Nos. 115, 116). The United States Trustee, subject to his objections, also produced documents to the debtors which they requested; and among the many documents the United States Trustee produced were letters from Ms. Lemler-Clark to the United States Trustee, with enclosures, which enclosures were publicly available documents or research from public data. (Defs.' Record on Appeal Nos. 52 and 53, Defs' Exs. D-2/D-1 and D-2/D-2)[13]

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[12] On August 16, 2006, the bankruptcy court entered a Scheduling Order in the Adversary setting an October 30, 2006 discovery deadline and a trial docket call on January 9, 2007. (Adv. Doc. No. 9). After a number of requests for continuances, the bankruptcy court, on November 16, 2006, entered orders extending the discovery deadline to January 31, 2007 and setting the trial on April 3, 2007[12]. (Adv. Doc. Nos. 55 and 56),

[13] These documents were not admitted as evidence below and are incomplete copies of documents the United States Trustee produced. The Appellee objects to the Appellants including in the record on appeal documents they neither offered, nor did the court admit, as evidence at trial. The court should not consider these documents as part of the record on appeal for multiple reasons. Since the debtors raised no issues on appeal about the court's evidentiary rulings excluding their Exhibits, the issues are waived. *GGM, P.C., v. Jenkins (In re GGM, P.C.)*, 165 F. 3d 1026, 1031-1032 (5th Cir. 1999); *Martin v. Sanderson Farms, Inc.*, 222 Fed. Appx. 360,362 (5th Cir. 2007) ("If an issue is

B. The Debtors' Motions to Limit Discovery And The Motions to Compel

On October 16, 2006 and On October 17, 2006, the debtors asked the court to limit the United States Trustee's discovery. On November 9, 2007, the United States Trustee filed a motion to compel. The bankruptcy court held hearings on the various discovery disputes on November 15, 2006. On November 16, 17, 21 and December 1, 2006, the bankruptcy court entered orders limiting the scope and controlling the United States Trustee's discovery.[14] (Adv. Doc. Nos. 56, 58, 65, and 67). On December 31, 2006, the debtors produced records to the United States Trustee. On January 19, 2007, the debtors filed motions to compel, without requesting expedited hearings, concerning the United States Trustee's responses, made in October and November 2006, to the debtors' discovery requests to which the United States Trustee timely responded. (Adv. Doc. Nos. 86, 87, 89, 90, 113, 114, 115, 116).[15] On March 6, 2007, the bankruptcy court entered orders denying each of the debtors' motions to compel. (Adv. Doc. Nos. 129, 130, 131, 132, 134). The debtors appeal from these discovery orders.

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not included in this statement, even if it was raised in and decided by the bankruptcy court, it is not preserved for appeal and is waived."); *Id.; Trevino v. First National Bank,* 2005 WL 1473966 (D. W.D. Tex. 2005); Fed. R. Bankr. P. 8006. The bankruptcy court specifically ruled the extraneous documents the debtors cite in their brief and include in the record on appeal were not relevant and excluded from evidence below. (Tr. 1/24/07 p. 34, L. 14-20). And, the debtors never offered or moved to admit Defs. Exs. D-2/D-1 through D-2/D-6, debtors' Amended Designation Nos. 52, 53, 54, 55 and 56 at trial. (Trial Tr. Vol 1 – 3; Adv. Doc. No. 191). Moreover, since these extraneous documents were both excluded evidence in hearings, and not offered by the debtors, or admitted at trial, the court should not consider the documents as evidence on appeal since they were not considered by the bankruptcy court. The extraneous documents are simply not proper grounds for attack of the bankruptcy judge's rulings.

[14] The United States Trustee complied with the court's discovery orders obtaining documents from the Chapter 7 trustee, and by subpoena to non-parties, Broadway Bank, the CPA and the real estate agent on the Burwick Property, instead of from the debtors.

[15] As part of his responses to the motions to compel, the United States Trustee supplemented his responses to interrogatories (Adv. Doc. Nos. 113, 114). On February 11, 2007, the debtors filed a motion to compel further responses to which the United States Trustee timely responded. (Adv. Doc. No. 122, 124).

C. The Debtors' Subpoenas and Resulting Motions to Quash And For Protective Orders

On December 13, and 15, 2006, the debtors delivered Notices of Deposition, and several Subpoenas, requesting the testimony of the Assistant U.S. Trustee, the Trial Attorneys of the United States Trustee (James W. Rose, Jr. and Kevin Epstein), and the United States Trustee's designated representative. (Adv. Doc. No. 69, attached Exs. 1,2,3,4,5,6). The debtors sought deposition testimony and production of documents from the Assistant U.S. Trustee and the Trial Attorneys, all employees of the United States Trustee, who have been acting as counsel to the United States Trustee in this action. (*Id.* Adv. No. 69). Also in December 2006, the debtors served Subpoenas seeking deposition testimony and documents on non-parties Rochel Lemler-Clark[16] and the Chapter 7 trustee. (Adv. Doc. Nos. 70,75, attached Exs. A, B). On December 20, 2006, the United States Trustee filed his motion for protective orders and to quash subpoenas. (Adv. Doc. No. 69). On January 2 and 5, 2007, Lemler-Clark and the Chapter 7 trustee filed motions to quash and for protective orders. (Adv. Doc. Nos. 70, 75). On January 24, 2007, the bankruptcy court held hearings on the motions to quash subpoenas and for protective orders. (Tr. 1/24/07, p. 1-2; Adv. Doc. Nos. 71, 78). At the hearings, the debtors stated to the bankruptcy court that the purpose of the discovery sought from Ms. Lemler-Clark and the Chapter 7 trustee related solely to the debtors' motion for sanctions, not the Complaint. (Tr. 1/24/07, p. 9, L. 6-17). The bankruptcy court held that the information sought from Ms. Lemler-Clark and the Chapter 7 trustee was not relevant to either the Complaint or the motion for sanctions and granted Ms. Lemler-Clark's and the Chapter 7 trustee's motions to quash and for protective orders.[17] (Tr. 1/24/07, p. 34, L. 14-20, p. 37, L. 18-25, P.

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[16] The debtors assert, without any competent evidence, the United States Trustee acted at the behest and direction of Ms. Lemler-Clark. Ms. Lemler-Clark is not a creditor in the case, and receives no direct benefit by the denial of the debtors' discharge.

[17] On January 24, 2007, the bankruptcy court entered orders granting Lemler-Clark's and the Chapter 7 trustee's motions to quash subpoenas and for protective orders. (Adv. Doc. No. 99 and 100).

38, L. 1-9). The court reasoned a free flow of information was elemental for the bankruptcy system to function.[18]

The bankruptcy court granted in part and denied in part the United States Trustee's motion to quash and for protective orders and allowed the debtors to take a deposition of the United States Trustee's designated representative on eight (8) of the thirteen (13) matters the debtors designated (the "Protective Order"). (Tr. 1/24/07, p. 93, L. 10-24, Adv. Doc. No. 104). The bankruptcy court also denied the debtors' request for a privilege log from the United States Trustee. (Tr. 1/24/07, p. 99, L. 10-15). The United States Trustee did not agree to extend or waive the discovery cut off of January 31, 2007; and the court did not extend the discovery cut off during the hearings.[19] (Tr. 1/24/07, p. 119, L. 2-3).

The United States Trustee complied[20] with the Protective Order (Adv. Doc. No. 104) and provided the debtors with proposed dates to depose the United States Trustee's authorized representative. Rather than scheduling or taking the deposition of the United States Trustee's representative within the discovery cut off, Ted Roberts, on January 30, 2007, filed a motion to extend the discovery period to which the United States Trustee objected on February 1, 2007. (Adv. Doc. No. 119, 121). On January 30, 2007, Ted Roberts also filed a motion for an order denying his request for a privilege log. (Adv. Doc. No. 120). On March 6, 2007, the bankruptcy court entered orders denying the debtors' motions to extend the discovery period and for an order denying the privilege log (Adv. Doc. Nos. 135,133). The debtors appeal from these discovery orders.

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[18] "If the flow of information is inhibited by going back and questioning and suing people for providing information to the trustee and the U.S. Trustee, then we are not going to get any more information about misconduct or alleged misconduct in bankruptcy cases." (Tr. 1/24/07 pp. 35-36).

[19] Rather, the bankruptcy court advised the parties the court would rule on pending discovery motions without further hearings; and the court would consider requests, if any, by the debtors to extend the deadlines, if they did not complete the deposition of the United State's Trustee's designated representative by January 31, 2007. (Tr. 1/24/07, p. 118 L. 2-24, p. 121 L. 8-20),

[20] After obtaining a copy of the Protective Order, the United States Trustee, at 11:47 a.m. on January 26, 2007, sent a letter, via facsimile, to the debtors stating that the United States Trustee's designated representative was available for a deposition on January 29, 30, or 31, 2007. (Adv. Doc. No. 121, p. 4, Para. 13).

VII. Debtors' Motions For Sanctions

A. Initial And Reissued Motions For Sanctions

On September 29, 2006, the debtors filed a motion for sanctions claiming among other things that the United State's Trustee's §727 Complaint was frivolous and filed for an improper purpose in violation of Fed. R. Bank. P. 9011. (Adv. Doc. No. 11).[21] On October 6, 2006, the United States Trustee filed a motion to strike the debtor's procedurally defective motion for sanctions and a response. (Adv. Doc. Nos. 12, 13). The court set the motion for sanctions for a hearing on November 15, 2006 (Adv. Doc. Nos. 18, 25) along with hearings on various discovery motions. On October 18, 2006, the debtors withdrew the motion for sanctions saying they were "profoundly committed to the development and presentation of their motion For sanctions." (Adv. Doc. Nos. 23, p., 2, Para. 5, 27). On October 23, 2006, the bankruptcy court entered an order dismissing the motion for sanctions as withdrawn. (Adv. Doc. No. 32).

During the November 15, 2006 hearings on discovery matters the debtors argued the substance of their withdrawn motion for sanctions.

On January 4, 2007, the debtors, pursuant to Fed. R. Bankr. P. 9011, filed their reissued motion for sanctions, a pleading identical to the withdrawn motion except for the filing date. (Adv. Doc. No. 72) On January 19, 2007, the United States Trustee filed his response denying the allegations in the reissued motion for sanctions. (Adv. Doc. No. 83). The court set the hearing on the reissued motion for sanctions on January 24, 2007. The debtors asked to continue the hearing. The United States Trustee opposed a continuance of the January 24, 2007 hearing on the debtors' motion for sanctions, suggesting the sanctions motion should not be heard at the same time as the trial on his Complaint. (Tr. 1/24/07 pp. 102-108). The court continued the hearing to April 3, 2007,

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[21] The debtors stated in the motion that "[b]ased upon investigation by Movants and others, the Complaint was prepared, presented, and filed for an improper purpose." (Adv. Doc. No. 11, p. 2, Para. 9).

at the debtors' request. (Adv. Doc. No. 74, Tr. 1/24/07, p. 116, L. 15-25).

B. First Amended Motion For Sanctions

On February 21, 2007, the debtors filed their first amended motion for sanctions pursuant to Fed. R. Bankr. P. 9011 (the "amended motion for sanctions"). (Adv. Doc. No. 123). The debtors alleged, again, the Complaint was unsupported, without evidentiary or legal support, the United States Trustee did not conduct a reasonable inquiry before filing the Complaint, and the Complaint was filed for an "improper purpose". (Adv. Doc. No. 123). The debtors identify their alleged improper purpose as shown by a "lengthy history of animosity" by Ms. Lemler-Clark and Bankruptcy Judge Clark toward the debtors, and a "vendetta". (Adv. Doc. No. 123). On February 28, 2007, the United States Trustee filed his response denying the allegations in the amended motion for sanctions. (Adv. Doc. No. 125).

C. Motion to Sever and Denial of Amended Motion For Sanctions

On March 21, 2007, the United States Trustee filed a motion to sever for trial the amended motion for sanctions asking the court to try the issues on the Complaint prior to considering the amended motion for sanctions. (Adv. Doc. No. 150). The United States Trustee asked the court to consider the evidence at trial of the Complaint in connection with the amended motion for sanctions. However, the United States Trustee alleged if he prevailed at trial on his Complaint there might be no need to litigate the amended motion for sanctions. (Adv. Doc. No. 150, p. 4). The debtors agreed with the motion to sever, as they said at trial.

The trial on the Complaint took place April 3 through April 5, 2007. During trial the court did not enter any orders either granting or denying the motion to sever. Both the Appellants and the Appellee rested on evidence presented and made closing arguments. (Trial Tr., Vol. 3, pp. 651, L. 1-8; p. 656, L. 6-21). At the end of the trial, the court continued the trial for a ruling on April 26, 2007, (Trial Tr., Vol. 3, p. 721, L. 14-17) and subsequently to May 4, 2007 (Adv. Doc. 170). Also, the court continued the amended motion for sanctions stating that the motion may or may not go forward after the ruling on the Complaint. (Trial Tr., Vol. 3, p. 724, L. 22-25, p. 725).

On May 4, 2007, the court entered a judgment denying the debtors' discharge, an order dismissing the motion to sever as moot, and an order denying the amended motion for sanctions. (Adv. Doc. Nos. 176, 178, 179).The debtors also appeal from these orders.

SUMMARY OF ARGUMENT

The bankruptcy court's judgment denying these debtors a discharge merits affirmance under 11 U.S.C. §§ 727(a)(4), (a)(2)(A) and (B) and (a)(3). The court denied the discharge on ten separate and independent grounds. Unless this court concludes all of these rulings were erroneous, this court may affirm the judgment below on any of them. The court below had ample and sufficient evidence to support its findings. Although this brief is necessarily long because the Appellants appeal from sixteen orders, the issues are simple: did the court below commit clear error in denying the debtors a bankruptcy discharge? It did not.

Nor did the court err in determining the debtors were not entitled to sanctions against the United States Trustee. The court held two hearings, before trial and even during trial in which the debtors argued for sanctions, namely denial of the Complaint and as a sanction against the United States Trustee an award of money damages of $50,000 for the debtors' attorneys' fees in defending the Complaint. The court properly denied the debtors' requested sanctions based upon the debtors' own pleadings, arguments and their testimony during the case. The United States Trustee's positions were based upon the facts; and the court's ruling in support of the United States Trustee on the Complaint seeking to deny a discharge demonstrates the Complaint was not brought for an improper purpose.

Finally, the court did not err in denying the debtors' attempted discovery from the United States Trustee after the court ordered discovery cut-off. The bankruptcy court did not abuse its discretion in the other rulings in multiple procedural and discovery orders. The bankruptcy court properly applied the correct legal standards.

ARGUMENT

I. <u>The Bankruptcy Court Did not Abuse its Discretion in Denying Discharge Under 11 U.S.C. §727</u>

A. <u>The Bankruptcy Court Did not Abuse its Discretion Under §727(a)(4)</u>

The bankruptcy court properly denied the debtors a discharge under 11 U.S.C. §727(a)(4). In doing so, it weighed the evidence and the credibility of the witnesses[22] concluding the debtors had made multiple material[23] misstatements and false oaths in their Schedules and Statements of Financial Affairs. Section 727(a) (4) (A) provides that a debtor's discharge shall be denied if the debtor "knowingly and fraudulently, in or in connection with the case ... made a false oath or account." The United States Trustee proved by a preponderance of the evidence that (1) the debtors made statements under oath, (2) the statements were false, (3) the debtors knew that the statements were false, (4) the debtors made the statements with fraudulent intent, and (5) the statements related materially to the bankruptcy case. *Beaubouef v. Beaubouef (In re Beaubouef),*

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[22] "The San Antonio Express News, a Hearst subsidiary, published an article [the June 13, 2004 article referred to in Appellants' brief at p. 7] describing a blackmail scheme carried out by two married attorneys, Ted and Mary Roberts. . . . Under threat of litigation, as many as five men entered into settlement agreements with Ted, who received between $75,000 and $155,000 in total as a result. . . . Ted Roberts has since been tried and convicted on charges of theft related to the allegations in the article." *Lowe v. Hearst Communications, Inc.* 487 F.3d 246, 249 (5th Cir.2007); "Maro Robbins & Joseph S. Stroud, *Sex, Lawyers, Secrets at Heart of Sealed Legal Case,* San Antonio Express –News, June 13, 2004, at A1." <u>*Id.*</u>; Pl.'s Ex. 82. Ted Roberts testified during the trial on the §727 Complaint he caused the monies related to the guilty counts in Pl.'s Ex. 82, the Verdict and Charge of the Court, to be placed in RFC accounts. (Trial Tr. Vol. 1, pp. 219-220, L. 15-25, L.1; Vol. 2, pp. 426).

[23] The Fifth Circuit has held: "[t]he subject matter of a false oath is material, and thus sufficient to bar discharge, if it bears a relationship to the bankrupt's business transactions or estate, or concerns the discovery of assets, business dealings, or the existence of disposition of his property." *In re Beaubouef*, 966 F.2d at 178-79 (holding that the debtor's failure to disclose a company was material even though the company no longer did business and had no assets).

966 F.2d 174, 178 (5th Cir. 1992). The court below found the debtors' multiple material false oaths, errors and omissions in the debtors' Schedules and Statements of Financial Affairs were sufficient to deny their discharge. Moreover, the court found although the debtors, after prompting, eventually disclosed most, but not all of the assets and interests they made unilateral decisions not to disclose certain assets and interests establishing their intent or reckless indifference. (Trial Ruling Tr. 5/4/07, pp. 5-7).

The court also found the debtors' material false oaths on the Schedules and Statements of Financial Affairs were their: (a) failure to disclose that the debtors were general partners of and owned interests in Ezekiel I through 2002 or 2003 (Count I of the Complaint) and that the debtors were owners, stockholders, directors or officers of the RFC (Count II of the Complaint) on the Statement of Financial Affairs filed on November 8, 2004; (b) failure to disclose the Broadway Bank Account into which the $1,000 Refund Check, property of the debtors, was deposited (Count III of the Complaint); (c) failure to disclose the Martinez Deposit on the Schedules (Count IV of the Complaint); (d) failure to disclose the ACIS, Inc. stock on the Schedules and the Statement of Financial Affairs filed on November 8, 2004 (Count V of the Complaint); and (e) failure to disclose the claim against Ted H. Roberts, P.C. on the Schedules filed on November 8, 2004 (Count VII of the Complaint). (Trial Ruling Tr. 5/4/2007 p.3). The court was not clearly erroneous. Finally, the court considered and implicitly found the debtors' explanations of their errors and omissions and argument they lacked fraudulent intent were not sufficiently credible. (Trial Ruling Tr. 5/4/07, p. 7).

The court granted judgment under 11 U.S.C. §§727(a)(4) finding the debtors acted with reckless indifference to the truth and accuracy of their Schedules and Statements of Financial Affairs and thus made false oaths. (Trial Ruling Tr. 5/4/07 p. 7). The debtors argue on appeal the court failed to specifically find "knowing false oaths" were made under §727(a)(4). (Appellants' brief, p. 13).

The debtors fail to appreciate that the court's express "reckless indifference" finding fully satisfied section 727(a)(4)'s intent requirement as the Fifth Circuit and other courts have held. In *Beaubouef* the Fifth Circuit expressly held that a finding of reckless indifference is "the requisite intent to deceive." 966 F.2d at 178; *Accord*, *Sholdra v. Chilmark Financial LLP (In re Sholdra)*, 249 F. 3d 380, 383 (5th Cir. 2001) *cert. den.* 534 U.S. 1042 (2001)("cumulative effect of all the falsehoods together evidences a pattern of reckless and cavalier disregard for the truth [to support] fraudulent intent [citations omitted]"); *In re Dupre*, 145 Fed. Appx. 855, 856 (5th Cir. 2005).

Thus, under Fifth Circuit law the lower court's reckless indifference finding satisfied the requirements of §727(a) (4). See also, *In re Dupre*, 145 Fed. Appx. at 856; *The Cadle Company v. Mitchell (In re Mitchell)*, 102 Fed. Appx. 860, 862 (5th Cir. 2004) ("Fraudulent intent may be proved by showing either actual intent to deceive or a reckless indifference to the truth."). Courts in other circuits also expressly hold reckless indifference is the equivalent of fraud. *Boroff v. Tully*, 818 F.2d 106, 112 (1st Cir. 1987); *In re Kaiser*, 722 F. 2d 1574, 1584 fn. 4 (1st Cir. 1983) "See *In re Diorio*, 407 F. 2d 1330, 1331 (2d Cir.1969) (per curiam) ("reckless indifference to the truth . . . is the equivalent of fraud.")[citation omitted]; *In re Chavin*, 150 F.3d 726, 728 (7th Cir. 1998)(Reckless disregard is, for the purposes of the provisions of the Bankruptcy Code governing discharge, the equivalent of knowing that the representation is false and material.) [citations omitted]. "An intent to deceive may be inferred from reckless disregard for the truth or falsity of a statement combined with the sheer magnitude of the resultant misrepresentation." *In re Acosta*, 406 F.3d 367, 372 (5th Cir. 2005)(§523(a)(2)(A) dischargeability standard for false representation or actual fraud).

The court did not commit clear error in finding that the debtors' unilateral decisions[24] about what they did not need to disclose were not the full complete and honest upfront disclosure required in the bankruptcy system. Since a bankruptcy discharge is a privilege and not a right, only debtors who play by the rules and make "a good faith effort in producing an entire picture of their financial affairs" are entitled to a bankruptcy discharge. *In re Hobbs*, 333 B.R 751, 755 (Bankr. N. D. Tex. 2005)[citations omitted]; *Grogan v. Garner*, 498 U.S. 279, 286 (1991). Each of the debtors' omissions and non-disclosures was integral to understanding their financial picture.

Nor did the court commit clear error by relying upon the evidence (See Appelle's brief at pp. 6-14) in finding the debtors did not deserve a discharge under §727(a)(4). When the debtor amends bankruptcy schedules after errors and omissions are brought to light but fails to clear up all inconsistencies and omissions at the first chance, or there is more than one false oath, this evidences intent, particularly when the errors and omissions would be obvious to the debtors from a careful review of their schedules. *Beaubouef*, 966 F. 2d at 178; *In re Sholdra*, 249 F.3d at 382-83 (debtors' false oaths in schedules are not excused merely by amendment); *In re Acosta*, 406 F. 3d at 372; *In re Dreyer*, 127 B.R. 587, 593-94 (Bankr. N.D. Tex. 1991); *Buckeye Investment Col, v. Bullough, (In re Bullough)*, 358 B.R. 261, 281,282, (Bankr. N.D. Tex. 2007). The paramount duties of the debtors to fully disclose all relevant information without being asked, compelled or confronted defeats typical explanations that the undisclosed property was of no value or the debtor believed the information was not necessary.

Contrary to the debtors' suggestion that at any point the Chapter 7 trustee or the United States Trustee could ask the court to compel the debtors to amend their Schedules every time a party

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[24] Trial Tr., Vol. 2 p. 361 L. 3-15, p. 364 L. 18-23 (Ted Roberts relied on his understanding of a business and did not recall consulting with bankruptcy counsel on his understanding of a business); Trial Tr., Vol. 3 p. 528, L. 13-19 Trial Tr., Vol. 3 p. 536 (Mary Roberts answered "No" to the question "Did I consult with anybody on what my impression of a business was?" Trial Tr., Vol. 3 p. 536 L. 10-15;L. 10-15; (Mary Roberts did not recall but she presumed she did not consult with bankruptcy counsel about whether to disclose the Broadway Bank Account).

believed it was necessary, the bankruptcy process is not designed as a debate or a "laborious tug-of-war to drag the simple truth into the glare of daylight." *Boroff v. Tully*, 818 F.2d at 110. "Full disclosure of assets and liabilities in the schedules [under federal law] required to be filed by one seeking relief under Chapter 7 is essential, because the schedules 'serve the important purpose of insuring that adequate information is available for the Trustee and creditors without need for investigation to determine whether the information provided is true.'" *In re Beaubouef*, 966 F.2d at 178-179 [citations omitted]; *In re Sholdra*, 249 F.3d at 383 (negative inference raised by debtor's failure to amend until after errors and omissions are brought to his attention); *In re* Gartner, 326 B.R. 357, 373 (Bankr. S.D. Tex. 2005).

The court in *In re Dreyer*, confronted a debtor's assertion in a §727 complaint that a Chapter 7 trustee can file a motion and obtain a court order (Trial Tr., Vol. 1 p. 140, L. 9-15) to make the debtors amend the schedules, and prove the Chapter 7 trustee is correct something must be disclosed in bankruptcy schedules when a debtor disagrees or has a difference of opinion. That court explained: "[t]he bankruptcy system relies on a debtor to deal honestly with his creditors by making full, complete and honest disclosure in his statements and schedules [citations omitted]. Instead, Mr. Dreyer took a course of action designed to furnish only the information he wished to furnish. Other matters were revealed only when he got caught. The bankruptcy court cannot tolerate such an approach." *In re Dreyer*, 127 B.R. at 593.

The debtors highlight in their brief that no creditor asked them to amend the Schedules or Statements of Financial Affairs. (Appellants' brief p. 15). However, both the Chapter 7 trustee and the United States Trustee did move to compel the debtors to amend their Schedules; and the Chapter 7 trustee moved to compel them to turn over the Lawyers' Title Deposit, the Martinez

Deposit and records showing "where the money is now" relating to the Lawyers' Title Deposit. (Trial Tr., Vol. 1 p. 142 L. 7-25; Case Doc. Nos. 165,190) Moreover, the debtors' disclosed Ezekiel I and RFC **after** being asked at the creditor meeting, information not among their voluntary amendments on November 8, 2004. (Trial Tr., Vol. 2, p. 357, L. 19-24, p. 365, L. 16-25, p. 366, L. 1-21). The debtors disclosed the ACIS stock **after** the United States Trustee asked them to provide full details about the contents of their Compass Bank safe deposit box. (Defs' Ex. 3 pp. 120-121). The debtors disclosed the PC Claims **after** being asked about them. (Defs' Ex. 4, p. 23-24)

Also, the court properly weighed the debtors' defenses of their errors and omissions, and reasons for the multiple amendments to the Schedules and Statements of Financial Affairs and found them not credible. (Trial Ruling Tr. 5/4/2007 pp. 5-7). Not only did the court conclude the debtors did not provide full complete and honest disclosure, the court discounted their explanations, considering their obvious level of education, sophistication and that they were assisted by board certified counsel. (Trial Ruling Tr. 5/4/2007 pp. 5-6). For example, the Chapter 7 trustee testified on cross examination that someone with a higher education was held to a "higher standard of care" under the "sophisticated debtor line of cases."[25] (Trial Tr. Vol. 1 p. 150 L. 1-11).

Thus, the bankruptcy court, applying the case law, did not commit clear error finding creditors were entitled to have complete and truthful information from the debtors in the first instance in order to make decisions. (Trial Ruling Tr. 5/4/07, pp. 5-7). Nor did the court commit clear error inferring fraudulent intent from the evidence showing the debtors' Schedules and Statements of Financial Affairs were false in multiple material areas. Omissions of information in schedules or the statement of financial affairs are affirmative oaths the undisclosed information does not exist, and therefore may be false oaths. *In re Gartner*, 326 B.R. at 367. The court properly applied the

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[25] *In re Slocombe*, 344 B.R. 529, 535 (Bankr. W.D. Mich. 2006); *In re Tan*, 350 B.R. 488, 495-496 (Bankr. N.D. Cal. 2006).

legal standards when analyzing the facts and evidence relying on what is commonly termed in the case law as “reckless indifference”. The finding of reckless indifference is sufficient to support the judgment and the court should be affirmed. Contrary to well established Fifth Circuit authority, the debtors ask the court to reverse and render the judgment and grant them a discharge. (Appellants’ brief, pp. 8, 15, 48).

1. Ezekiel I and Roberts Foundation for Children

The court did not commit clear error finding the debtors made false oaths omitting their positions and interests in these two businesses. The court weighed the debtors’ explanations of their omission of these assets: because the entities were not businesses in the debtors’ opinion, the use of an outdated worksheet, that the debtors did not read the question, only the answer to Statement of Financial Affairs, (Trial Tr. Vol. 2, p. 438 L. 17-25; p. 439 L. 1-4, Vol. 3, p.525, L. 3-14) and that they amended the Statement of Financial Affairs after being asked at the creditor meeting. (Trial Tr., Vol. 2, p. 357, L. 19-24, p. 365, L. 16-25, p. 366, L. 1-21). The debtors’ admitted they did not disclose these entities. (Trial Tr. Vol. 2, pp. 358-359, pp. 361-362, p. 462; Vol. 3 p.528 L. 13-25, p. 615). The debtors’ counsel agreed Ezekiel I should have been disclosed. (Trial Tr., Vol. 2, pp. 358-359; p. 499, L. 2-6; Defs. Ex. 3 p.71-72). The Chapter 7 trustee testified while Ezekiel I in his view was a business, “at first blush” he could see why someone would leave [RFC] out. (Trial Tr., Vol. 1, p. 146 L.22-25, p. 147, L. 1-10). The Chapter 7 trustee also testified that ultimate determinations about what is correct or wrong in bankruptcy schedules are made by the court. (Trial Tr., Vol. 1, p.182, L. 12-24). The evidence showed Ezekiel I was never formally dissolved and therefore remained in existence both within six years prior to October 13, 2004 and within two years prior to the date of filing. (Trial Tr., Vol. 2, p. 357, L. 10-12, Vol. 3 p. 614, L. 19-25, p. 615 L. 1-14 [Ezekiel I “still exists today.”]). The testimony of the debtors at trial showed Ezekiel I was the focus of litigation they were involved in during 2001 and 2002. (Trial Tr., Vol. 2, pp. 411-416). Ted Roberts, as managing partner pledged Ezekiel's collateral for loans from Compass Bank for the benefit of the debtors' P.C. (Pl.'s Ex. 48). Ezekiel I and RFC had financial and/or legal activity controlled and directed by the debtors during the two year period prior to bankruptcy. RFC remained in existence until its formal dissolution on January 22, 2004 when the Articles of Dissolution signed by Mary Roberts, as the Chairman of the Board of Directors, were filed. Mary Roberts later filed corporate tax information documents for RFC in April 2004. (Pl.'s Ex. 63). Money in RFC financial accounts from 2002 had in part, as its source, actions of Ted Roberts, described in the State of Texas v. Roberts, resulting in his criminal conviction (Trial Tr., Vol. 1, pp. 218-220; Vol. 2 pp. 423-429; Pl.'s Ex. 82). Some of the same monies from RFC were lent to the P.C. and never repaid. (Trial Tr. Vol 1 p. 241 L. 12-15, Vol. 2, p. 373 L. 17-20, p. 374 L. 8-12; Vol. 3, p. 578 L. 3-6, p. 579, L. 22-25). The Statement of Financial Affairs the debtors actually signed under the penalty of perjury (as opposed to the outdated worksheet they claimed to rely upon) and filed on November 8, 2004 clearly stated on question 18 that the debtors were providing information for the period beginning six years prior to October 13, 2004, during which Ezekiel I and RFC were in existence. Given that, the debtors' response to question 18 was clearly false.

The court properly applied the law to the debtors' defenses that Ezekiel I and RFC were not businesses. The Fifth Circuit has rejected similar explanations of non-disclosure in response to question 18 of the Statement of Financial Affairs holding: "[s]uch a straightforward question obviously calls for a direct answer..." *In re Beaubouef*, 966 F.2d at 179; *see also In re Dreyer*, 127 B.R. at 593-94 (debtors have a duty to read each question and answer and respond fully and completely). The court properly applied the law. The debtors' defenses that Ezekiel I and RFC were not both businesses, using their understanding of a business have failed in the Fifth Circuit.

Beaubouef, *Id.* at 178-179 (entity "did no business" failed or the company was worthless).

The court also properly weighed the debtors' defenses concluding they did not effectively mitigate the debtors' own non-disclosure even though Ezekiel I and RFC were later disclosed in an amended Statement of Financial Affairs. (Trial Ruling Tr. 5/4/2007 pp. 5-7). The court here appropriately analyzed the debtors' defense of lack of fraudulent intent shown by their amendments to the Statements of Financial Affairs to include Ezekiel I and RFC **after** the United States Trustee asked about Ezekiel I and RFC at the November 15, 2004 creditors' meeting and asked the debtors to amend their Schedules and Statements of Financial Affairs. Under applicable Fifth Circuit law, the debtors' amendments to their Schedules only after being questioned at a creditors' meeting creates a negative implication from which the court can infer fraudulent intent. *Sholdra*, 249 F.3d at 382-83; *In re Gartner*, 326 B.R. at 373-374. Given that, the court did not abuse its discretion in denying the debtors' discharge 11 U.S.C. §727(a) (4).

2. <u>Lawyers' Title Deposit/Broadway Bank Account</u>

Independent of that, the court also did not commit clear error by finding the debtors made a false oath through their omission of the Lawyers' Title Deposit and Refund Check which they deposited into the Broadway Bank Account. (Ruling Tr. 5/4/2007 p. 3). The evidence showed the debtors were owners of the Broadway Bank Account on the date they filed their bankruptcy. The debtors signed the signature card with Broadway Bank along with Mary Roberts' father, Mr. Schorlemer, although they both testified they did not recall signing, or signing as owners, but did not dispute they did so. The court implicitly found the debtors' claims that they did not recall or know they were "owners" of the Broadway Bank Account, and could not recall being signatories on the account or they "didn't think of it" when they completed their Schedules were less than credible when weighed against their ongoing use of the Broadway Bank Account before the bankruptcy filing and after, through March 2005. (Trial Tr., Vol. 2, p. 335 L. 12-22, Vol. 3, pp. 540-543, 627-628; Pl.'s Exs. 30-38). The evidence showed the debtors exercised continuing ownership and control over the Broadway Bank Account. (Pl.'s Exs. 30-38). The debtors used the Broadway Bank Account before and after the bankruptcy case filing on October 13, 2004. The debtors used the Broadway Bank Account during the Chapter 11 to pay the same types of personal expenses they used their Debtor in Possession bank account for. (Def's Ex. D-1/D-5; Pl.'s Exs. 30-38) The evidence also showed not only the Refund Check was deposited by the debtors into the account, other property belonging to the debtors was deposited, the $1,800 proceeds from the sale of the pool table and possibly proceeds from sale of other furniture and deposit of other funds of the debtors. (Trial Tr., Vol. 2, p. 494 L. 1-19, pp. 495-496; Vol. 3 p. 549, L. 10-12).

The Chapter 7 trustee testified the Broadway Bank account was property of the bankruptcy estate. (Trial Tr., Vol. 1, p. 180, L. 21-25; p. 181). Ted Roberts testified the Broadway Bank account was property of the debtors on October 13, 2004. (Trial Tr. Vol. 2, p. 336, L. 11-21). Although the debtors appeared to claim they lacked access to the Broadway Bank account records, the bank's representative testified as customers and account holders the debtors could obtain the records for the Broadway Bank account. (Trial Tr. Vol. 1, p. 35, L. 1-4). The court properly discounted the debtors' assertions they lacked access to information about the Broadway Bank Account because the bank statements were mailed to Mr. Schorlemer, not to the debtors, considering the debtors' use of the bank account, and Mary Roberts' own testimony that she would "ask Daddy is there money in the account to cover it" if she was uncertain about funds in the bank account when she was writing checks. (Trial Tr. Vol. 1, p. 137, L. 11-16; Vol. 3 p. 542, L. 13-25, p. 543, L. 1-3). Moreover, Mary Roberts testified she had access to the Broadway Bank Account records at her parents' home, the same Milldale address where the Broadway Bank statements were sent, where she had "most of her stuff" and took most of her meals during some portion of 2004. (Trial Tr., Vol. 3, p. 543, L. 1-15).

The Chapter 7 trustee testified he asked for and did not receive all the original bank account records from the debtors. (Trial Tr., Vol. 1, p. 93, L. 13-18). The Chapter 7 trustee further testified he did not receive complete records from the debtors regarding the Broadway Bank Account. (Trial Tr., Vol. 1, p. 100, L. 14-21). Only when compelled by court order, and in the course of discovery on the Complaint, the debtors' disclosed the Broadway Bank Account in November 2006, and on their Schedules in January 2007.

The evidence also showed the Broadway Bank Account with a balance of $3,962.46 on October 15, 2004, $4,048.00 on the date the case was filed, and $3,325.80 on the Schedules, was the largest dollar balance for financial accounts the debtors' listed on their Schedule B of personal property. (Trial Tr., Vol. 1, p.263, L. 18-23; Pl.'s Exs. 4, 12).

The court also did not commit clear error by finding the Lawyers' Title Deposit/Refund Check/Broadway Bank Account was material. (Trial Ruling Tr. 5/4/2007 pp. 3, 6). The Chapter 7 trustee testified why bank accounts like the Broadway Bank Account mattered, as assets, leading to assets or avoidance actions, and confirming other financial information about the debtors. (Trial Tr., Vol. 1, p. 105, L. 24-25, p. 106-107). "Few, if any, assets are more material to a consumer debtor's financial affairs than a bank account, for it is from that kind of assets that the creditors can discern not only an overall picture of the debtor's financial affairs, but also detail of the debtor's finances." *In re Pratt*, 411 F.3d 561, 567 (5th Cir. 2005)(now deceased debtor with chronic drug problems lacked intent regarding multiple omissions); *see also In re Guenther*, 333 B.R. 759, 768 (Bankr. N.D. Tex. 2005) (holding that bank accounts are included in the "basic matters about which creditors and the Court are most concerned."); *In re Bullough*, 358 B.R. at

271-272, 283.

Nor did the court commit clear error by rejecting debtors' assertion the Refund Check was expended pre-petition against their non-disclosure of the Broadway Bank Account with a balance in excess of $4,048. on the day the case was filed. (Trial Tr., Vol. 1, p. 137, L. 24-25; p. 138, L. 1-6, p. 178, L. 11-17; p. 180, L. 2-20) The debtors' own testimony showed the Broadway Bank Account contained other proceeds from their property, not just the Refund Check. (Trial Tr. Vol. 2 p. 494-496, Vol. 3, pp. 549-550). Furthermore, in considering a false oath regarding a bank account, the court need not engage in a First In First Out (FIFO) or Last In First Out (LIFO) analysis. *In re Post*, 347 B.R. 104, 113 (Bankr. M.D. Fla. 2006). In *Bullough*, for example, the court analyzed similar defenses a debtor asserted regarding belatedly disclosed bank accounts finding a debtor could not "forget" a bank account he used to pay personal and household expenses; and his omission of a third account because he did not think he needed to disclose it "makes no sense". Moreover, the debtor's omission of the accounts he used compared to the date he filed his original schedules showed "reckless indifference" when he did not correct the omission for six weeks. *Bullough*, 358 B.R. at 271-272, 283. Here the debtors failed to disclose the Broadway Bank Account they used on an ongoing basis for more than two (2) years. Because the debtors' failure to disclose the Broadway Bank account into which they deposited the Lawyers' Title Refund was a false oath made with fraudulent intent the court properly denied their discharge. 11 U.S.C. §727(a) (4).

3. Martinez Deposit

In the same way the court did not commit clear error finding the debtors made a false oath through their failure to disclose the Martinez Deposit on the Schedules and Statements of Financial Affairs. The court did not engage in clear error rejecting the debtors' preferred defenses the Martinez Deposit was forfeited and was not required to be disclosed. The evidence showed the Martinez Deposit was not forfeited; instead it was used as a credit for the Schorlemers, Mary Roberts' parents, to purchase of the Burwick Property, where the debtors currently reside. (Trial Tr., Vol. 1, p. 109, L. 13-18; p. 169, L. 12-19). The Chapter 7 trustee also asserted the Martinez Deposit was property of the bankruptcy estate and never returned to him. The Chapter 7 trustee also testified he might counsel the debtors to disclose the Martinez Deposit, even if it was forfeited; and in his view the transaction was a constructively fraudulent transfer. (Trial Tr., Vol. 1, p.173, L. 20-25; p. 174, L. 1-2, 13-21).

The court did not commit clear error rejecting the debtors' defenses of disclosure of the contract on Schedule G, that there was no place on the Schedules to disclose the Martinez Deposit, finding they still failed to make proper disclosure. Arguments, such as not knowing where on the schedules to list assets, that disclosure in another part of the schedules is enough, that a question does not call for the disclosure, or the information can be found in documents the debtor produced to the Chapter 7 trustee, generally fail. *E.g., In re Mitchell*, 102 Fed. Appx. at 863 (holding that the availability of correct information elsewhere in the petition did not cure the debtors' omissions on the schedules). Because the debtors made false oaths concerning the Martinez Deposit with fraudulent intent or at least reckless indifference to the truth, their discharge was properly denied under 11 U.S.C. §727(a)(4)(A).

4. <u>ACIS Stock</u>

The evidence showed the debtors failed to disclose the ACIS Stock on the Schedules or in response to Statement of Financial Affairs question 12. Again, the court did not commit clear error concluding the evidence and testimony that the debtors included and remembered the same ACIS stock on their Financial Statement which they prepared and signed and gave to the IRS in 2003, without having to locate the stock in their safe deposit box and that the debtors did not review the Financial Statement in preparing their Schedules. (Trial Tr., Vol. 1, p. 225, L. 9-18, p. 228, L. 6-16, Vol. 2, p. 392, L. 10-20, Vol. 3, p. 580, L. 21-25, p. 581). The court properly considered the debtors' defenses and explanations that the ACIS stock was later disclosed after they looked in their safe deposit box at Compass Bank after the first creditor meeting and found the stock in a manila envelope. The court considered the debtors' defense that their subsequent amendment to the Schedules showed their lack of intent. However, disclosure after the fact does not negate fraudulent intent in a discharge complaint but is a factor that the court can and did weigh here. *In re Sholdra*, 249 F. 3d at 382-383.

The debtors admitted they did not review the contents of their safe deposit box in preparing the Schedules and Statement of Financial Affairs. Only after the United States Trustee asked the debtors to review the contents of their safe deposit box at the November 15, 2004 creditors' meeting did the debtors' locate the ACIS stock. (Defs.' Ex. 3, p. 120-121). The debtors' failure to undertake even a modicum of review of their own prior Financial Statement, or inventory the contents of the safe deposit box are evidence of the debtors' "pattern of disregard for the truth that supports fraudulent intent." *In re Dupre*, 145 Fed. Appx. at 856; *In re Bullough*, 358 B.R. at 285-286 ("At some point errors and omissions in schedules and SOFAs leave the realm of honest mistakes and enter the realm of purposeful deceit or, at the very least, reckless indifference to the truth."). Given all this, the court did not err in denying the debtors' discharge for their false oath through their non-disclosure of the ACIS stock under 11 U.S.C. §727(a) (4) (A).

5. Claim Against Ted H. Roberts, P.C.

Finally the court did not err in concluding the debtors made a false oath by failing to disclose their $35,625 claim against their own P.C. and such non-disclosure was material even if had a net "zero" result. The evidence showed the P.C. was their largest personal asset valued at $8.1

million dollars on their July 2003 Financial Statement. (Trial Tr., Vol. 1, p. 227, L. 4-8; Pl.'s Ex. 39). In valuing the P.C., Ted Roberts deducted the P.C.'s liabilities from its assets. (*Id.;* Trial Tr. Vol. 1 p. 227, L. 4-16; Pl.'s Ex. 39). The debtors admitted they advanced the P.C. monies which the debtors borrowed over time.[26] (Trial Tr., Vol. 1, p. 79, L. 1-25; Vol. 2, p. 501, L. 21-25). The debtors argued their claim against the P.C. was either hard to determine and so they could not disclose the claim without an accounting, and/or subject to offset by loans the P.C. made to them. (Trial Tr., Vol. 2, p. 489, L. 1-18). The debtors listed the value of the P.C. as "unknown" throughout the case (Pl.'s Exs. 4,5,7,8,10,11,12; Trial Tr. Vol. 2 pp 399-400). The Chapter 7 trustee testified a claim by the debtors against the P.C. might be something he would pursue, or might affect whether the P.C. would get a distribution for the claim it filed in the case. (Trial Tr., Vol. 1, p. 124, L. 21-25, p. 125, L. 15-22). When the Chapter 7 trustee abandoned the P.C., he required the P.C. to subordinate its claim in the case and reserved certain potential litigation recoveries owed to the P.C. for the bankruptcy estate. (Trial Tr., Vol. 1, p. 126, L. 1-18; Case Doc. Nos. 125, 140, 146). Ted Roberts testified the P.C.'s $154,000 claim in the case was a "gross amount" and that the $35,000 claim against the P.C. could possibly reduce or set off the P.C.'s claim. (Trial Tr., Vol. 2, p. 503, L. 14-17, p. 501).

The court was well within its discretion finding the debtors' failure to list the PC Claim, even if the net result would have been zero, was a material misstatement made with intent or reckless indifference to the truth. (Trial Ruling Tr. 5/4/2007 pp. 3, 6). With respect to the set-off, the debtors decided for themselves that the disclosure of the PC Claim was not necessary; and they argue this supports their belief they did not have a "claim" against the P.C. when they filed the

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[26] The evidence also showed the P.C. had listed loans to shareholders on its year 2003 and 2004 federal income tax returns in the amount of $146,531 with no change. (Pl.'s Exs. 45, 46). The evidence also showed Mr. McElroy, who prepared the P.C.'s tax returns, would have had some information to make the line item entry for the P.C. loans to shareholders; and Ted Roberts, who signed the tax returns, expected the line item information in the P.C.'s tax returns he signed has some basis in documents or facts. (Trial Tr., Vol. 1, p. 236-237).

bankruptcy case. However, the debtors now acknowledge "technically" they have a claim against their P.C. (Trial Tr., Vol. 1, p. 501, L. 9-19). In *Gartner*, the court, confronted with a similar argument, held that it is without merit for a debtor to omit assets because he believes the asset has no value, for it is for the creditors to judge for themselves "what will benefit, and what will prejudice them." *In re Gartner*, 326 B.R. at 372 (citation omitted). The debtors' material false oaths concerning the PC Claim were made with at least reckless indifference to the truth supporting the denial the debtors' discharge pursuant to 11 U.S.C. §727(a)(4)(A).

B. The Court Should Allow a Limited Remand for More Specific Findings and Conclusions Under §§727(a)(2) and (3).

The court below granted judgment on the United State's Trustee's counts in his Complaint alleging the debtors should be denied a discharge under 11 U.S.C. §727 (a)(2)(Counts IX, X and XIV of the Complaint) and under §727 (a)(3)(Count III A of the Complaint) (Trial Ruling Tr. 5/4/2007). Unfortunately the court below issued few findings regarding why it reached those rulings. Thus, out of an abundance of caution, and to ensure fairness to the Roberts, the United States Trustee has on this same date filed a separate Motion for Stay and Limited Remand. Contrary to the debtors' request that this court reverse and render, granting them a bankruptcy discharge (Appellants' brief at pp. 8, 15, 48), relief for which they include no legal authority, the appropriate remedy under long standing Fifth Circuit authority is for this court to grant a specific limited remand. *See In re Texas Extrusion Corp.*, 836 F.2d. 217, 221 (5th Cir. 1988) *cert. den'd* 488 U.S. 926 (1988) (When a trial court fails to make findings, the appellate court normally remands for appropriate findings. Further, findings are not a jurisdictional requirement of appeal and cursory findings and conclusions or even the complete lack of findings and conclusions do not require reversal or remand of the judgment if a full understanding of the issues on appeal can be determined by the appellate court.); *Chandler v. City of Dallas*, 958 F.2d 85, 88-89 (5th Cir. 1992)(The Fifth Circuit ordered remand to the trial court for additional findings of fact and conclusions of law, but noted that the failure to meet the technical requirements if Fed. R. Civ. P. 52 does not warrant reversal or remand as long as the purposes behind rule are effectuated and that that the rule requires "neither punctilious detail nor slavish tracing of the claims by issue and witness and witness."); *Sample v. Miles*, 2007 WL 486770 (5th Cir. 2007) (The Circuit Court, in rejecting a challenge to the sufficiency of findings, stated that the trial court's findings need not be in great detail, but must be sufficient for appellate court review.); *Matter of Luce*, 960 F.2d 1277, 1284-1285 (5th Cir. 1992) (The Fifth Circuit held that the bankruptcy court's findings were incomplete and remanded for additional findings.).

C. Alternatively, The Court Did Not Abuse its Discretion in Denying the Debtors' Discharge Under 11 U.S.C. §727(a) (2) (A) and (B) Given its Reasonable Conclusion They Concealed Or Transferred Assets Thereby Hindering, Delaying, and Defrauding Creditors And the Trustee

Section 727(a) (2) (A) and (B) require a denial of discharge when there is: (1) a transfer [or concealment] of property; (2) belonging to the debtor; (3) within one year of the filing of the petition [or after the date of the filing of the petition]; and with intent to hinder, delay, or defraud a creditor or officer of the estate. *In re Pratt*, 411 F.3d at 565-566. While intent must be actual, the court can properly infer intent from the debtors' actions considering circumstantial evidence. *Id. citing In re Chastant*, 873 F.2d 89, 91 (5th Cir. 1989)("Because a debtor is unlikely to testify directly that his intent was fraudulent, the courts may deduce fraudulent intent from the facts and circumstances of a case." *Id.*, 873 F. 3d at 90. There are factors or "badges of fraud" that may be used to show actual intent to defraud.[27] Moreover, there is a presumption of fraudulent intent when a debtor transfers property to relatives. *In re Pratt*, 411 F.3d at 565-566. Once this presumption attaches, the burden shifts to the debtor to demonstrate that he lacked fraudulent intent. *In re Pratt*, 411 F.3d at 565-566. Further, section 727(a) (2) reads in the disjunctive – hinder, delay, **or** defraud. Accordingly, a transfer or concealment made with intent to hinder or delay a creditor or an officer of the estate is sufficient for denial of discharge, even if there is no fraudulent intent. *NCNB Texas Nat'l Bank v. Bowyer (In re Bowyer)*, 916 F.2d 1056, 1059 (5th Cir. 1990), *rev'd on other grounds*, 932 F.2d 1100 (5th Cir. 1991).

Here, the bankruptcy court acted within its discretion finding by a preponderance of the evidence that the debtors with the intent to hinder, delay or defraud creditors concealed and transferred their assets, the Broadway Bank Account into which the Refund Check was deposited and the Martinez Deposit and the transfer and credit of the deposit to relatives. In making that conclusion the court considered the same facts and evidence described in the Appellee's brief at pp. 9-11, regarding the Lawyers' Title Deposit/Refund Check – Broadway Bank Account and Martinez Deposit in granting Judgment on Counts IX, X and XIV of the Complaint. (See also Appellee's brief at pp. 30-34). The court found it had ample and sufficient evidence to deny the debtors' discharge and to conclude their concealment of the Lawyers' Title Deposit, the transfer of the Refund Check, and the concealment of the Broadway Bank Account, involving a relative, Mr. Schorlemer, was a transfer made by the debtors of their property within a year prior to filing the bankruptcy or property of the estate after filing bankruptcy made with the intent to hinder delay or defraud creditors or the estate. (Trial Ruling Tr. 5/4/2007 p.6). (See Appellee's brief at pp. 9-11).

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[27] The "badges of fraud" are: (1) The lack or inadequacy of consideration; (2) the family, friendship or close associate relationship between the parties; (3) the retention of possession, benefit or use of the property in question; (4) the financial condition of the party sought to be charged both before and after the transaction in question; (5) the existence or cumulative effect of the pattern or series of transactions of course of conduct after the incurring or debt, onset of financial difficulties, or pendency or threat of suits by creditors; and (6) the general chronology of the events and transactions under inquiry. *Id.; see also In re Dennis*, 330 F.3d at 701-02.

Similarly, the court had sufficient evidence to conclude the debtors' concealment and transfer of the Martinez Deposit coupled with the post-petition transfer of the Martinez Deposit as a credit for the Schorlemer's purchase of the Burwick Property was a transfer of the debtors' property within a year before bankruptcy or of property of the estate after bankruptcy made with intent to hinder delay or defraud the creditors or the estate. 11 U.S.C. §727(a)(2)(A) and (B). (See Appellee's brief at pp. 10-11). Indeed, the Chapter 7 trustee testified in his view this was a constructively fraudulent transfer. Further, the debtors ultimately retained the benefit of the Martinez Deposit because it was used to purchase the Burwick Property where they currently reside. (Pl.'s Exs. 27, 72; Trial Tr., Vol. 1, p. 174, L. 13-21). The debtors retention of the benefit of the concealed Martinez Deposit is one of the badges of fraud discussed in *Pratt* and *Dennis*. *In re Pratt*, 411 F.3d at 565-566*; In re Dennis*, 330 F.3d at 701-702. The court properly determined the debtors concealment and subsequent post-petition transfer of the Martinez Deposit to the Schorlemers were done with the intent to hinder, delay, or defraud creditors and the Trustee, and the denied the debtors' discharge pursuant to 11 U.S.C. §727(a)(2)(A) and (B). The debtors failed to meet their burden of proof under U.S.C. §727(a) (2) (A) and (B) to demonstrate they have acted without the requisite intent regarding the Broadway Bank Account and the Martinez Deposit. *In re Chastant*, 873 F.2d at 91 (affirming the denial of discharge of a debtor who set up trust for his children under section 727(a)(2)(A)). The debtors' argument that the court "received no evidence" supporting its finding under 11 U.S.C. §727(a)(2) is without merit. (Appellants' brief, p. 13), Because the appropriate remedy is a limited remand for more specific findings, the court should not reverse and render on this separate legal ground. (Appellants' brief, pp. 8, 15, 48).

D. Alternatively, the Court Did Not Abuse its Discretion By Denying The Debtors' Discharge Under 11 U.S.C. §727(a) (3) Given Their Failure To Maintain Records From Which Their Financial Condition Or Business Transactions Could Be Ascertained.

A discharge should be denied under 11 U.S.C. §727(a)(3) if the debtor fails to keep or adequately maintain financial records that could assist any creditors or trustee in ascertaining the debtors' financial condition. *In re Dennis*, 330 F.3d at 703; *In re Gartner*, 326 B.R. at 375-76. The United States Trustee established by a preponderance of the evidence under section 727(a)(3) that: (1) the debtors failed to maintain and preserve adequate records; and (2) such failure makes it impossible to ascertain the debtors' financial condition and material business transactions. *Id.* Once the United States Trustee established a *prima facie* case, the debtors had the burden of establishing their failure to keep adequate records was justified under all circumstances. *Id*. Under 11 U.S.C. §727(a) (3), the United States Trustee did not have to show intent or recklessness of the debtors. *In re Gartner*, 326 B.R.at 375; *see also In re Jones*, 327 B.R. 297, 303 (Bankr. S.D. Tex. 2005). The debtors' negligence in failing to keep or produce records is sufficient to deny their discharge. *In re Jones, Id.* "Creditors are entitled to written evidence of the debtor's financial situation and past transactions; maintenance of such records is a prerequisite to a discharge." *Pher Partners v. Womble (In re Womble)*, 289 B.R. 836, 856 (Bankr. N.D. Tex. 2003) *aff'd* 108 Fed, Appx. 993 (5th Cir. 2004). The records produced by debtors must be sufficient so that creditors need not be forced to undertake an independent investigation of the debtor's affairs. *See In re Juzwiak*, 89 F.3d 424, 428-429 (7th Cir. 1996). Further, the standard for disclosure of records of sophisticated debtors is higher than that of an unsophisticated debtor. *In re Gartner*, 326 B.R. at 375. Attorneys, such as the debtors, are held to a higher standard of disclosure of records. *See Meridian Bank v. Alten*, 958 F.2d 1226, 1231 (3rd Cir. 1992).

Just as the debtors' concealed the Broadway Bank Account, they failed to keep or maintain typical bank records, such as proof of the deposit of the Refund Check. While the Broadway Bank Account statements were mailed to Mr. Schorlemer, the debtors had access to them from the bank, or through relatives; and they either failed to obtain records for the bank account they owned, failed to keep records, and/or failed to timely turn over records when asked. The court properly denied their discharge for their failure to keep or maintain adequate financial records.

In this case the debtors not only admitted they either failed to maintain or discarded the records concerning the disposition of the Lawyers' Title Deposit, they had no reasonable justification or explanation. The court was well within its discretion concluding "I don't know what happened to them [the Broadway Bank Account records]" was not a reasonable justification for why the debtors did not have or keep records for the Broadway Bank Account. (Trial Tr., Vol. 3 p. 543). The debtors admitted they did not keep the deposit ticket showing the deposit of the Refund Check into the Broadway Bank Account. (Pl.'s Ex. 23). In making the conclusions under §727 (a) (3) the court considered the same facts described about concerning the Broadway Bank Account. (See Appellee's brief at pp. 9-10, and at pp. 30-33). The United States Trustee, like the Chapter 7 trustee, asked the debtors for copies of records all bank accounts to which debtors had access, which included the Broadway Bank account. (Case Doc. Nos. 165, 168, 178, 190, 193, Adv. Doc. Nos. 56, 58, 65, 67, Trial Tr. Vol. 1, p. 92-93, 102-103, 181-182, Pl.'s Exs. 19, 20, 23, 24, 25, Defs.' Ex 22). The debtors responded to the United States Trustee this was overly burdensome for them and he should get the records from Broadway Bank, which he did, pursuant to a subpoena to the bank. (Adv. Doc. Nos. 58, 65, 67; Pl.'s Exs. 15, 16). Although the Chapter 7 trustee may have subsequently concluded he had adequate financial records, after receiving documents in his response to compel, and after the Complaint was filed, this does not relieve the debtors of their obligations, or excuse their failure to keep or maintain the most basic of financial records, for the Broadway Bank Account. Given that, the court did not abuse its discretion concluding the debtors failure to cooperate in producing the Broadway Bank Account records violated section 727(a)(3) and justified the denial of their discharge. *See In re Gartner*, 326 B.R. at 377 (holding that debtors failure to fully open his records and allow free access to information that could assist in ascertaining the debtor's financial position was a violation of section 727(a)(3) supporting denial of discharge.). The debtors' argument that the court "received no evidence" supporting its findings under 11 U.S.C. §727(a)(3) is without merit. (Appellants' brief, p. 13). Because the appropriate remedy is a limited remand for more specific findings the court should not reverse and render on this separate legal ground. (Appellants' brief, pp. 8, 15, 48).

II. The Bankruptcy Court Did Not Abuse its Discretion in its Pre-Trial Discovery Rulings And, Even if They Had Been Erroneous, the Rulings Constitute Harmless Error

The bankruptcy court properly limited both the scope and timing of discovery resolving both the debtors' requests to limit discovery from them and the debtors' motions to compel discovery during the course of the case. (Adv. Doc. Nos. 58, 65, 129, 130, 131, 132, 134). Moreover, the bankruptcy court properly enforced its own scheduling order by denying the debtors' request to depose the United States Trustee's designated representative outside the court ordered deadline. (Adv. Doc. No. 135). Moreover, as the Fifth Circuit explained, "vague assertions that additional discovery will produce needed, but unspecified facts" will not meet the "for cause" standard justifying continuances of scheduling order and pre trial order deadlines. *Beattie v. Madison County School District*, 254 F. 3d. 595, 606 (5th Cir. 2001). [citations omitted].

Because the court properly concluded the objections to the debtors' discovery and assertions of various privileges by the United States Trustee were appropriate, the court also properly denied the debtors' request for a privilege log (Adv. Doc. No. 91) and the motion for a separate order denying request for privilege log. (Adv. Doc. Nos. 120, 133, Tr. 1/24/07, p. 99, L. 10-15).

The court acted within its discretion because the United State's Trustee asserted the attorney client, attorney work product and investigative files privileges, supported by its offer to the court for an *in camera* inspection of privilege logs in the court room during hearings on January 24, 2007. (Tr. 1/24/2007 pp. 58-59). The court may, but need not, order the exchange of the privilege logs or their filing with the court, particularly if the court sustains an assertion of attorney client privilege. *United States of America v. Philip Morris Inc.*, 347 F.3d 951, 954 (D.C. Cir. 2003)(court can first decide asserted privilege and rule on objection before party needs to include document in a privilege log). [28]

Even if the bankruptcy court erred in restricting or allowing discovery, errors made concerning allowance of discovery do not require reversal unless the result in "substantial prejudice" to a party's case. *Leatherman v. Tarrant County Narcotics Intelligence & Coordination Unit*, 28 F.3d 1388, 1394 (5th Cir. 1994). The bankruptcy court restricted both the debtors' and the United States Trustees' pre-trial discovery; but, the debtors received responses to their written discovery, access to the documents in the United States Trustee's possession, and opportunity to depose the United States Trustee's designated representative. Although the debtors were not permitted to take the depositions of Ms. Lemler-Clark and the Chapter 7 trustee, the debtors were not prevented from calling them as witnesses at trial. Consequently, the bankruptcy court's pre-

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[28] *See also LaSalle Bank N.A., v. Mobile Hotel Properties , LLC,* 2004 WL 902169 (D. E.D. La. 2004)(court denied defendants' motion to compel after reviewing privileged documents and privilege log in camera); *Kansas City Southern Railway Co. v. Nichols Construction Co., LLC,* 2007 WL 1792352 (D. E.D. La. 2007)(party may be required to compile privilege log and exchange it only after court orders exchange); *BG Real Estate Services Inc. v. American Equity Insurance Co.*, 2005 WL 1309048 (D. E.D. La. 2005)(court denies production request of privileged documents, in part and considers substantial burden of compiling privilege log, not requiring a privilege log, when denying some requests for clearly protected materials).

trial discovery rulings did not prejudice the debtors in the presentation of their defense to the Complaint or their amended motion for sanctions; and any errors by the court were harmless.

III. The Bankruptcy Court Did Not Abuse its Discretion in Denying the Debtors' Amended Motion for Sanctions Against the United States Trustee And Did Not Abuse Its Discretion in its Procedural Rulings on the Motion to Sever.

The debtors presented both pleadings, their own testimony at trial, and arguments in multiple hearings prior to trial why they were entitled to sanctions against the United States Trustee. (Adv. Doc. Nos. 11, 72, 123, Tr. 1/24/2007 pp. 9-19, 34, 63-70, 73, 88-90, Trial Tr., Vol. 3, p. 710-711, 713-714). So, they cannot properly claim, nor does the record support, the court "summarily denied" them any relief to which they were entitled. The court scheduled hearings on the debtors' motions for sanctions on November 15, 2006 and January 24, 2007. (Tr. 1/24/2007, Adv. Doc. Nos. 25, 26, 74). The debtors asked for and were given a continuance of the hearing on their motion for sanctions from January 24, 2007 to April 3, 2007. (Adv. Doc. Nos. 11, 72, 84, 94, 105). Contrary to their suggestion, (Appellants' brief at pp. 40-41) the bankruptcy court did not "summarily" deny their motion for sanctions after granting the United States Trustee's motion to sever. First, the debtors agreed to the motion to sever, in which the United States Trustee asserted if he prevailed on his Complaint there may be no need to litigate further the motion for sanctions. (Adv. Doc. No. 150 p. 4). Second, during trial the court did not enter an order granting of denying the motion to sever; rather the court stated after both the debtors and the United States Trustee rested and made closing arguments: "And the motion for sanctions, we'll decide what to do after the ruling on this, - - . . . . - - whether that goes forward or whether it does not." (Trial Tr., Vol. 3, pp. 724-725). The debtors also suggest they did not receive a separate evidentiary hearing[29] on their amended

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[29] The debtors cite no authority that they were entitled to a separate evidentiary hearing. Rather, Rule 9011 requires only that a party or attorney be given a "reasonable opportunity to respond" to the alleged violation prior to the imposition of sanctions. Fed. R. Bankr. P. 9011(c)(1)(A); *Merriman v. Security Insurance Co. of Hartford*, 100 F.3d 1187, 1191-1192 (5th Cir. 1996)("In the Rule 11 context, due process demands only that the sanctioned party be

motion for sanctions. (Appellants' brief, pp. 40-41). This was something they never asked for, and something they did not pursue in January 2007, when a hearing on their motion for sanctions was scheduled. (Tr. 1/24/2007, Adv. Doc. Nos. 84, 94, 105). Rather, a complete review of the court proceedings below shows the court allowed the debtors adequate discovery,[30] a number of hearings, and the opportunity to present their arguments in support of why they were entitled to sanctions against the United States Trustee. The debtors did not produce testimony from Ms. Lemler-Clark, their stated "key fact witness" for the alleged improper purpose at trial. (Tr., 1/24/07, p. 73). Although the debtors complain the court did not allow them to depose Ms. Lemler-Clark on their motion for sanctions, they presented no evidence showing why they did not present her at trial as a witness by subpoena.[31] Moreover, the court's holding sustaining the United States Trustee's positions on multiple counts of his Complaint refutes the Appellants' allegations the United States Trustee pursued the Complaint for an "improper purpose"[32] or

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afforded notice and an opportunity to be heard." {citations omitted]). The 1993 Advisory Committee Note to Fed. R. Civ. P. 11 states: "[w]hether the matter should be decided solely on the basis of written submissions or should be scheduled for oral argument (or, indeed, for evidentiary presentation) will depend on the circumstances." *See Travelers Insurance Co. v. St. Jude Hosp. of Kenner, La.*, 38 F.3d 1414, 1418 (5th Cir. 1994)(The circuit court held that a hearing on a motion for sanctions is necessary only when a hearing would assist the court in its decision.).

[30] The United States Trustee timely responded to the debtors' discovery requests aimed at their theory of the alleged "improper purpose" by denials. Although the United States Trustee objected to many of the requests, he produced documents received from non-parties Ms. Lemler-Clark and the trustee and responded, subject to his asserted objections. The United States Trustee also produced documents filed by Mr. Mays seeking recusal of Bankruptcy Judge Clark, and Judge Clark's opinions in the *Moerbe* and *Valles* cases, as responsive to the debtors requests for admissions that the United States Trustee was "familiar with" a State Bar disciplinary proceeding regarding Ms. Lemler-Clark in which Mr. Mays was the complaining attorney and in which Ted Roberts testified as a witness against Ms. Lemler-Clark. These documents are available on PACER as public documents; and decisions of the court appear on the court's web page. The United States Trustee denied the alleged "improper purpose" and further denied that U.S. Bankruptcy Judge Clark had a role in the Plaintiff's prosecution of the Adversary, or that the Plaintiff had provided documents about the debtors to Judge Clark. (Adv. Doc. Nos. 113 Ex. 1 pp. 9-11; 114 Ex. 1 pp. 6-7; 115 Ex. 1 pp. 5-6; 116 Ex. 1 pp. 3 – 5). The United States Trustee denied soliciting information from Lemler-Clark and denied speaking to Judge Clark about the debtors, or speaking to U.S. Bankruptcy Judge Ronald B. King (except in court hearings) about the debtors. (debtors' Amended Designation No. 49, United States Trustee's Response to motion to compel – admissions, Defs.' Ex. D-2/D-11 not admitted at trial, Adv. Doc. No. 112).

[31] Nor did the debtors produce at trial testimony from their own expert, Mr. Mays, designated as an expert on "statistical analysis" of the "relative frequency" of United States Trustee §727 complaints, or their "not yet designated" expert witness on whether the United States Trustee conducted a reasonable inquiry regarding his §727 Complaint. (Ted H. Roberts First Amended Initial Disclosures - DR #34 p. 15).

[32] The Fifth Circuit has held that: the filing of a complaint that is well grounded in fact and warranted by existing law cannot, as a matter of law, constitute harassment for purposes of Rule 11, "regardless of the plaintiff's

without a reasonable inquiry into the facts.

The debtors claim they were "singled out" and "received special attention". (Appellants' brief at p. 7; Adv. Doc. No. 123, Tr. 1/24/07 pp. 16-19).[33] When asked by the court if Ms. Lemler Clark had "commandeered the U.S. Trustee", Mr. Roberts responded "No'. (Tr. 1/24/07, p. 66, L. 2-23). The court also asked if Mr. Roberts thought this was the first time someone with a "vendetta" contacted the U.S. Trustee; and Mr. Roberts responded "No, I don't." (Tr. 1/24/07, p. 64). The court considered and weighed all the facts and evidence both denying the debtors' discharge and then finding their amended motion for sanctions against the United States Trustee was without merit. Merely taking and prevailing in adverse positions to the debtors in this case is not sufficient evidence of the alleged improper purpose. (See Appellee's brief, pp. 19-20)

The debtors argue in their brief that documents they received in discovery from the United States Trustee (Appellants' brief p. 7; DR #52, 53, 54, 55, and 56) should be weighed by this Court to support their theory of the alleged improper purpose. The debtors claim these documents were "noteworthy" such as the "scurrilous newspaper article;"[34] and the article was not relevant to their bankruptcy. (Appellants' brief at p. 7). Had the Chapter 7 trustee prevailed in the Hearst litigation, Mr. Roberts testified it was possible a substantial dollar recovery would result in payment of all the debtors' total scheduled debt of over $3,654,000 and resulted in a surplus distribution to the debtors. (Trial Tr., Vol. 2 p. 499 L. 7-21). Therefore, it is neither "noteworthy" nor

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subjective intent." *Jennings v. Joshua Independent School District*, 877 F.2d 313, 320 (5th Cir. 1989) *cert. denied* 496 U.S. 935 (1990). Likewise, in the underlying case, the United States Trustee's well grounded complaint cannot constitute harassment of the debtors under Fed. R. Bankr. P. 9011(b)(1).

[33] The debtors argue the statement of Trial Attorney James W. Rose, an employee of the United States Trustee, made at their creditor meeting, about debtor mistakes in bankruptcy schedules demonstrates the court committed clear error. (Appellants' brief, at p. 8) Yet, Mr. Rose was not a witness at trial. The debtors did not provide any expert witness testimony on the proper functioning of the bankruptcy system or completion of bankruptcy schedules on their behalf at trial. The bankruptcy court did not clearly err based on the evidence in this case.

[34] The published newspaper article they refer to in the brief related to an asset of their bankruptcy estate, and formed the basis for the Chapter 7 trustee's lawsuit in federal court against Hearst Corporation. (Trial Tr., Vol. 2 pp. 416-429; Pl.'s Ex. 5 Schedule B, Potential Causes of Action and/or Sanctions Against Hearst Corp./San Antonio Express News).

surprising the United States Trustee's file would contain the June 2004 Hearst article or that the U.S. Trustee would provide the Hearst article to the Chapter 7 trustee when the case was converted in March 2005, as it formed the basis for an asset, the causes of action, the debtors put on their Schedules and resulted in litigation the Chapter 7 trustee pursued to the Fifth Circuit. It is unclear to the United States Trustee why the debtors conclude the newspaper article was not "relevant" to the bankruptcy based on the debtors' own Schedules, Mr. Roberts' testimony, and the litigation concluded at the Fifth Circuit. (Appellants' brief at p. 7).

Even if the United States Trustee had engaged in misconduct, which he denies, the remedy the debtors sought was total denial of the Complaint, and granting their discharge. Indeed in their brief they ask the Court to reverse the court's judgment and grant them a discharge. (Appellants' brief, pp. 8, 48). The only remedy the debtors sought in their motions for sanctions was the most draconian, possible denial of the United States Trustee's Complaint and an award of money damages. The relief the debtors seek, a grant of a discharge and remand of the motion for sanctions, would penalize their creditors, since $1.2 million dollars of unsecured creditor claims would be released and unpaid. These creditors include individuals, the debtors owed money to: Zenaida Oliva, Ronny and Wade Petty, the estate of Erin Kent, the bankruptcy estate of Ruth Langston Daniels, and various entities, including Bank of America, Chase Visa, Ethan Allen, and Southwestern Bell Yellow Pages. (Pl.'s Ex. 4, Schedule F). Even if the United States Trustee had not pursued factually well grounded legally supportable adversarial litigation and a sanction was merited, which he denies, only the least restrictive sanction to deter inappropriate conduct would have been appropriate. *Spallone v. United States,* 493 U.S. 265,280 (1990); *Krim v. First City Bancorporation of Texas, Inc.,* 282 F. 3d 864, 867 (5th Cir. 2002). The debtors never asked for any lesser sanctions. So, the court properly denied their inappropriate and draconian amended motion for sanctions that would hurt innocent creditors. The bankruptcy court acted well within its discretion[35] in the context of the litigation, denying the amended motion for sanctions. The court properly applied the fact-dependent legal standard mandated by Fed. R. Bankr. P. 9011. The bankruptcy court properly entered the judgment, denied the sanctions, and properly mooted the motion to sever. None of this was wrong much less an abuse of discretion.

CONCLUSION

For these reasons, the United States Trustee respectfully asks this court to affirm the judgment denying the debtors' discharge under 11 U.S.C. §727(a)(4), grant a limited remand for additional findings under 11 U.S.C. §§727(a)(2) and (a)(3), or in the alternative affirm the judgment under §§727 (a)(2) and (a)(3), affirm the court on pre-trial discovery orders and post-trial procedural orders and affirm the court's order denying the debtors' motion for sanctions.

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[35] The court also did not abuse its discretion in declining to allow the debtors to the depose the United States Trustee's counsel litigating the complaint, or obtain his file containing privileged documents, including attorney work product and attorney client privileged materials. (Tr. 1/24/2007, p. 35-36) The court found the debtors' purported evidence of the alleged "improper purpose" was not relevant or admissible regarding either the Complaint or their motion for sanctions. (Tr. 1/24/2007, p. 34, L. 14-20). The court explained that the bankruptcy system required a free flow of information from interested persons both to the Chapter 7 trustee and the United States Trustee. (Tr. 1/24/2007, p. 35, L. 15-25, p. 36, L. 1-4).

Respectfully submitted,

CHARLES F. McVAY
UNITED STATES TRUSTEE
REGION 7

By: **/s/ Nancy Ratchford**
NANCY RATCHFORD
Assistant U.S. Trustee
Texas Bar No. 16558500
Department of Justice
Office of the U.S. Trustee
615 E. Houston St., Room 533
P.O. Box 1539
San Antonio, Texas 78295-1539
(210) 472-4640
(210) 472-4649 Fax

Of Counsel
Roberta A. DeAngelis
Acting General Counsel
Ramona D. Elliot
Deputy General Counsel
P. Matthew Sutko
Associate General Counsel
Sean E. Martin
Trial Attorney
Executive Office for the United States Trustees,
Department of Justice
20 Massachusetts Avenue, N.W., Suite 8000
Washington, D.C. 20530
(202) 307-1399

CERTIFICATE OF SERVICE

I hereby certify that on the 14th day of August, 2007, I electronically filed the foregoing with the Clerk of Court using the CM/ECF system which will send notification of such filing to the following:

Leslie Werner De Soliz
Soliz Law Group
108 S. Main
Victoria, TX 77901

Jerome A. Brown
Brown & Associates
121 S. Main
Victoria, TX 77901

And I certify that on the 14th day of August, 2007, I have mailed by United States Postal Service the document to the following non-CM/ECF participants:

Ted Hopkins Roberts
Attorney at Law
10004 Wurzbach, #111
San Antonio, TX 78230

Fred Hagans
Hagans Burdine et al.
3200 Travis
4th Floor
Houston, TX 77006

Rochel Lemler-Clark
1920 Nacogdoches
Suite 100
San Antonio, TX 78209

John Patrick Lowe
318 E. Nopal
Uvalde, TX 78801

James S. Wilkins
Willis & Wilkins, LLP
100 W. Houston St.
Suite 1275
San Antonio, TX 78205

/s/Nancy Ratchford
Assistant U.S. Trustee

BRIEF BANK — "SUMMARY SHEET" *Printed Wed-12/23/09 14:45*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE
[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]

In re Dr. R.C. Samanta Roy Institute of Science and Technology, Inc., et al. (Dr, R.C. Samanta Roy Institute of Science and Technology, Inc., et al. v. United States Trustee)

2. ("CO") ***CURRENT*** COURT
[E.g., "CTA9"]

D. Del.

3. ("CCN") ***CURRENT*** CASE NO.

No.: 09-789 (GMS)

4. ("PCN") ***PRIOR*** CASE NO. - & COURT
[IF ANY]

No.: 09-10876

Court: Bankr. Del.

(Identify judge & cite, if any)

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William K. Harrington, Joseph J. McHahon, Thomas P. Tinker, Anne W. Stukes, P. Matthew Sutko, Ramona D. Elliott, Roberta A. DeAngelis

(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***

BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s)

&

√ Any Miscellaneous ***BACKGROUND***

- Whether the bankruptcy court abused its discretion in finding "cause" that required dismissal of the debtors' bankruptcy cases under 11 U.S.C. § 1112(b)(1).

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UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF DELAWARE

:
In re
:
DR. R.C. SAMANTA ROY INSTITUTE OF SCIENCE AND TECHNOLOGY, INC., *et al.*, : Bankr. Case No. 09-10876

Debtors. :

DR. R.C. SAMANTA ROY INSTITUTE OF :
SCIENCE AND TECHNOLOGY, INC., *et al.*,
:
Appellants,
:
v. : Civil Action No. 09-789 (GMS)
:
UNITED STATES TRUSTEE,
:
Appellee.
:

APPELLEE'S BRIEF

ROBERTA A. DEANGELIS,
ACTING UNITED STATES TRUSTEE
FOR REGION THREE

WILLIAM K. HARRINGTON, ESQUIRE (# 4051)
ASSISTANT UNITED STATES TRUSTEE
JOSEPH J. MCMAHON, JR., ESQUIRE (# 4819)
THOMAS P. TINKER, ESQUIRE
TRIAL ATTORNEYS
UNITED STATES DEPARTMENT OF JUSTICE
OFFICE OF THE UNITED STATES TRUSTEE
J. CALEB BOGGS FEDERAL COURTHOUSE
844 KING STREET, SUITE 2207, LOCKBOX 35
WILMINGTON, DE 19801
(302) 573-6491
(302) 573-6497 (FAX)

Date: December 7, 2009

OF COUNSEL:

RAMONA D. ELLIOTT, ESQUIRE
GENERAL COUNSEL
P. MATTHEW SUTKO, ESQUIRE
ASSOCIATE GENERAL COUNSEL
ANNE W. STUKES, ESQUIRE
TRIAL ATTORNEY
UNITED STATES DEPARTMENT OF JUSTICE
EXECUTIVE OFFICE FOR
UNITED STATES TRUSTEES
20 MASSACHUSETTS AVENUE, N.W.,
SUITE 8217
WASHINGTON, D.C. 20530
(202) 307-1399
(202) 307-2397 (FAX)

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STATEMENT OF APPELLATE JURISDICTION

This appeal is taken from a final order entered by the United States Bankruptcy Court for the District of Delaware. This Court has appellate jurisdiction under 28 U.S.C. § 158(a)(1).

COUNTER-STATEMENT OF ISSUE PRESENTED

The issue on appeal is whether the bankruptcy court abused its discretion in finding "cause" that required dismissal of the Debtors' bankruptcy cases under 11 U.S.C. § 1112(b)(1), where the record clearly established that: (i) the Debtors neglected to respond to an offer to purchase one of the Debtors' properties; (ii) the Debtors failed to file tax returns since 2004; (iii) the Debtors' estates were losing money and the Debtors did not demonstrate the viability of their businesses; (iv) the Debtors mismanaged cash that was arguably property of the Debtors' estates by storing it in a safe located at a gas station; and (v) the Debtors failed to prepare a business plan.

STATEMENT OF APPROPRIATE STANDARD OF APPELLATE REVIEW

This appeal presents a question of whether the bankruptcy court abused its discretion in finding "cause" that required dismissal of the Debtors' bankruptcy cases under 11 U.S.C. § 1112(b)(1). A bankruptcy court abuses its discretion when its decision is based on "a clearly erroneous finding of fact, an errant conclusion of law, or an improper application of law to fact." *In re Marvel Entertainment Group, Inc*., 140 F.3d 463, 470 (3d Cir. 1998). A bankruptcy court's legal conclusions are subject to plenary review, while factual findings are subject to review for clear error. *See In re Sharon Steel Corp.*, 871 F.2d 1217, 1222-23 (3d Cir. 1989).

STATEMENT OF THE CASE

On March 16, 2009, the Debtors filed voluntary petitions for relief under chapter 11 of the Bankruptcy Code. R.4 (Docket entries) at D.I. 1.[1] On September 16, 2009, the bankruptcy court issued an order directing the Debtors to appear at a hearing on September 21, 2009 to show cause why the Debtors' cases should not be dismissed or a chapter 11 trustee should not be appointed in the cases. R.3 (9/16/09 "show cause" order). The bankruptcy court's "show cause" order followed (and was prompted by) a hearing on a secured creditor's motion for relief from the automatic stay held on September 14 and 15, 2009. R.3.

Roberta A. DeAngelis, Acting United States Trustee for Region 3 (the "United States Trustee")[2] and certain of the Debtors' creditors appeared at the September 21, 2009 "show cause" hearing. R.3 (Tr. 9/21/09). On September 22, 2009, the bankruptcy court issued an order dismissing the cases. R.2 (9/22/09 dismissal order). On October 2, 2009, the Debtors filed a notice of appeal from the September 22 dismissal order. R.21 (Notice of appeal).

On October 13, 2009, the Debtors filed a motion for a stay pending appeal. R.4 at D.I. 303. By order dated October 19, 2009, the bankruptcy court observed that, while the Debtors had not made out a case for a stay pending appeal, a limited stay was appropriate given the workload of this Court. D.I. 2 (Emergency stay motion) at Ex. F (10/19/09 stay order). Accordingly, the bankruptcy

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[1] References to items designated as part of the record are made with reference to the cumulative index filed by the United States Trustee with this Court on December 7, 2009 in the following form: R.[Index number]. Each record item is briefly described in a parenthetical accompanying the initial citation to the item.

[2] The United States Trustee is an official of the United States Trustee Program, an agency of the United States Department of Justice. The United States Trustee is charged with responsibility for supervising the administration of bankruptcy cases. *See generally* 28 U.S.C. § 586(a) (describing responsibilities); 11 U.S.C. § 307 (describing broad standing to raise issues).

court ordered a limited stay which was set to expire on October 26, 2009 or upon a ruling by this Court on a stay motion, whichever occurred first. D.I. 2 at Ex. F.

On October 21, 2009, the Debtors filed an emergency motion for a stay pending appeal with this Court. D.I. 2. By order dated October 26, 2009, this Court directed that the Bankruptcy Court's October 19, 2009 order remain in effect until further notice. D.I. 12 (10/26/09 stay order).

On October 26, 2009, the Debtors filed a "response" to the United States Trustee's designation of the record that sought to strike nearly all of the designated items. D.I. 10 (Debtors' response to U.S. Trustee designation). On November 5, 2009, the United States Trustee responded to the Debtors' filing. D.I. 17 (U.S. Trustee reply). To the extent that the Debtors' filing is properly characterized as a motion, it remains pending.

STATEMENT OF THE FACTS

On March 16, 2009, the Debtors filed voluntary petitions under chapter 11 of the Bankruptcy Code (R.4 (Docket entries) at D.I. 1) and, upon doing so, became debtors in possession.[3] The Debtors' operations are based in Shawano, Wisconsin, a town with less than 10,000 residents located approximately thirty-five miles northwest of Green Bay. R.5 (Isaacson affidavit) at 1. In their filings with the Bankruptcy Court, the Debtors described themselves as being in the business of "property acquisition and management, sales of gasoline and petroleum products, and funding for charitable activities." R.5 at 1. One Debtor, Midwest Oil of Shawano, LLC, is an operating entity. R.3 at 22:8-12. The remainder of the Debtors are holding companies that own real estate which is

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[3] A chapter 11 debtor is a "debtor in possession" unless a trustee has been appointed. *See* 11 U.S.C. § 1101(1). Pursuant to 11 U.S.C. § 1107, most of the rights, powers, and duties of a trustee in a chapter 11 case are conferred upon the debtor in possession. *See also* FED. R. BANKR. P. 9001(11) ("'Trustee' includes a debtor in possession in a Chapter 11 case.").

leased to the Debtors' wholly-owned, non-debtor subsidiaries. R.3 at 22:8-12. Two hotels, gas stations, an amusement park/racetrack for motorized carts, and a fudge shop are operated by the Debtors' non-debtor subsidiaries at the Debtor-owned locations. R.3 at 22-25. Other properties owned by the Debtors are leased to entities with no connection to the Debtors. R.3 at 40-42.

Under the Bankruptcy Code, the filing of the Debtors' bankruptcy petitions gave rise to an "automatic stay." The automatic stay assists the equitable administration of bankruptcy cases by preventing a race for estate assets; the stay generally prohibits a creditor from commencing or pursuing civil action against the Debtors and/or their assets unless the creditor obtains a bankruptcy court order permitting the creditor to act. *See* 11 U.S.C. § 362. In order to obtain "relief" from the automatic stay, a creditor must file a motion and demonstrate grounds for such relief. *See* 11 U.S.C. § 362(d). In the case of property, relief may be granted if, *inter alia*, the creditor's interest in the property is not adequately protected, if the debtor does not have equity in the property, or if the property is not necessary to an effective reorganization. *See id.*

On May 14, 2009, Vermillion State Bank ("Vermillion") sought relief from the automatic stay with respect to real property located at 3355 Hadley Avenue, Oakdale, Minnesota ("the subject property"). R.4 at D.I. 109. The Debtors had entered into a loan agreement with Vermillion in 2005 whereby the Debtors granted Vermillion a mortgage on the subject property in exchange for a loan in the approximate amount of $1.3 million. R.6 (Vermillion amended motion) at ¶ 5. The purposes of the loan were to refinance existing debt and to rehabilitate certain aspects of the subject property; the subject property had been operated as a gas station, and the Debtors were seeking to refurbish the property after they lost the gas pumps in a commercial dispute with the prior owner. R.11 (Tr. 9/14/09) at 269:24 - 270:23. From May 2005 through July 2006, the Debtors operated a convenience store at the subject property. R.11 at 273:13-16. At the time of the Debtors' bankruptcy filings, the subject property had been vacant since October, 2008, when it was burglarized. R.11 at 275:13-19.

In its motion for relief, Vermillion averred that it had foreclosed on the subject property prior to the Debtors' bankruptcy filings, and that a sheriff's sale of the subject property was scheduled for April 7, 2009, but was stayed by the Debtors' bankruptcy filings. R.6 at ¶¶ 16, 18. Vermillion asserted a secured claim of approximately $1.9 million. R.6 at ¶ 15.

The Debtors objected to Vermillion's motion for relief. R.4 at D.I. 155. On September 14 and 15, a contested evidentiary hearing was held on the Vermillion motion for relief from the automatic stay. R.4 at D.I. 281-82. At the hearing, Naomi Isaacson (the Debtors' Chief Executive Officer) testified that there were approximately $42,000 of unpaid real estate taxes on the property, R.11 at 18:20-23. Isaacson also testified that the Debtors had failed to make post-petition mortgage payments and tax payments related to the Minnesota property. R.11 at 18:24 - 19:9. Additionally, both Vermillion and the Debtors offered expert testimony regarding the value of the subject property at the hearing. R.11. The Debtors' expert witness, Steven T. Hosch, testified that the land value of the subject property was $2.55 million. R.11 at 90:13-18. He acknowledged that the Debtors had received an offer of $2.5 million from the "development arm" of Walgreens, a retail pharmacy chain (R.11 at 124:17-24) for the subject property, which he believed established a "floor to value for the subject property" ranging between $2 million and $2.7 million for its highest and best use, net of costs. R.11 at 121:21 - 122:18. Isaacson, however, testified that the Debtors' board of directors had decided that it wanted $7 million for the subject property, so she did not respond to the offeror. R. 11 at 278:18 - 279:4.

At the close of the hearing, the bankruptcy court made the following observations:

> Before we talk about the specifics of this case, it relates, obviously, to Vermillion's issue, but, frankly, I'm very disturbed with the testimony that I heard here today or yesterday, I should say, and it leads me to do something somewhat unusual.
>
> You know, we have a nonoperating property here. It has been nonoperating for a very long time. And there has been testimony that there is a party that is chomping at the bit to purchase this property at a price which, by the debtors' own admission, is a price which reflects the value of this property.
>
> There is not even a response to repeated calls from this party that is interested in making this purchase, and there is testimony yesterday from Ms. Isaacson that management would not even consider selling this property for seven million dollars.
>
> Well, to me that is a, at least prima facie, a situation which represents gross mismanagement and a breach of fiduciary duty to the creditors of these debtors. And under these circumstances, I don't see, where there are substantial and continuing losses, I don't see any reasonable prospects for rehabilitation of these debtors.
>
> So, I am sua sponte going to issue an order for a rule to show cause why I should not dismiss these cases or appoint a Chapter 11 trustee. And we will have that hearing on the 21st.
>
> I will also note that I very carefully reviewed our docket last night in this case, and in the six months that we have been in this case, there is virtually no activity in advancing toward a confirmation or resolution of these cases.
>
> Now, I recognize that the debtors have been busy defending motions to lift the automatic stay. But those motions to lift the automatic stay, frankly, are the result of the debtors' continuing non-payments, non-paying taxes [sic], and in effect using their creditors as their debtor-in-possession lenders, and that just isn't going to happen.
>
> So on the 21st I would like to know why, what specific plans for rehabilitation of these debtors are in play, whether they are reasonable, and how they are going to turn around these businesses, because I'm not going to have these cases continue with continuing losses and motions to lift automatic [sic] stay which, frankly are – it has just been too long.

R.12 (Tr. 9/15/09) 93:8 - 95:13.

On September 16, 2009, the bankruptcy court issued an "order on rule to show cause" which memorialized the court's September 15 comments and scheduled the "show cause" hearing for September 21, 2009 at 9:00 A.M. R.1 at 1. The bankruptcy court directed the Debtors to appear in court on September 21, 2009, at which time they "must show cause why the Court should not dismiss the cases or appoint a Chapter 11 Trustee." R.1 at 2.

The Debtors appeared at the September 21 "show cause" hearing and offered the testimony of two witnesses, Issacson and Howard Brod Brownstein of NachmanHaysBrownstein, the Debtors' proposed financial advisor. R.3. The Debtors did not seek a continuance of the "show cause" hearing or otherwise indicate on September 21 that they were not prepared to address the issues raised by the court order. R.3.

With regard to the potential sale of the subject property, Isaacson acknowledged that an entity that purchased land for Walgreens was interested in the property prior to the Debtors' bankruptcy filings. R.3 at 17:13-22. However, Isaacson testified that she did not want to respond post-petition because she thought that disclosing the Debtors' bankruptcy filings would weaken the Debtors' negotiating power. R.3 at 17:13 - 18:15.

Isaacson testified that, notwithstanding the fact that the Debtors' secured creditors had refused to discuss refinancing or other restructuring alternatives without reviewing the Debtors' business plan, the Debtors had not formulated a business plan as of the time of the "show cause" hearing. R.3 at 45:2 - 47:3.

The bankruptcy court specifically questioned Isaacson regarding the Debtors' continuing losses as reflected in the Debtors' July 2009 monthly operating reports. R.3 at 21:21 - 22:3. Isaacson admitted that Debtors Midwest Properties and R.C. Samanta Roy Institute of Science and Technology, Inc. were not paying all of their secured lenders post-petition. R.3 at 23:25 - 24:18;

14:24 - 15:4. The Debtors' proffered reason for not paying certain of their secured lenders was that they believed there was equity in those properties.[4] R.3 at 15:6-12. With regard to the amusement part/racetrack operations, Isaacson testified that the Debtors were not able to pay the operating expenses; employees worked without pay and board members paid certain expenses (including event-related insurance) out-of-pocket as "contributions." R.3 at 25:24 - 26:11; 27:5-8, 13-14.

On the subject of the filing of tax returns, Issacson testified that Debtor Dr. R.C. Samanta Roy Institute of Science and Technology, Inc. is a charitable, not-for-profit entity that had not filed tax returns since 2004 and was being audited by the Internal Revenue Service. R.3 at 30:15 - 31:8; 52:7-11. Isaacson further testified that the other Debtors were not charitable entities and that, with a couple of exceptions, they filed a combined tax return with Dr. R.C. Samanta Roy Institute of Science and Technology because they were wholly-owned, single member entities. R.3 at 32:10-13.

With regard to cash management, Isaacson testified that approximately $60,000 of proceeds from the amusement park/racetrack operations were stored in a safe located at one of the gas stations. R.3 at 57:21 - 62:8. In closing, Debtors' counsel acknowledged that there was "a question . . . as to whether or not it is debtor or non-debtor money." R.3 at 71:3-4. The bankruptcy court directed, and the Debtors agreed, to move the funds in the safe to a bank account. R.3 at 70:12 - 71:09.

At the September 21 hearing, the Debtors did not ask the bankruptcy court to find that there were "unusual circumstances" which established that dismissal of their cases was not in the best interests of creditors and the Debtors' estates. *See* 11 U.S.C. § 1112(b)(1).

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[4] Implicit in the Debtors' conclusion that the Debtors should not pay these lenders is a bet that the bankruptcy court would not permit them to foreclose on their collateral in state court because the collateral had an equity cushion protecting their respective interests.

After the close of the evidence, counsel to the United States Trustee orally moved for conversion of the cases to cases under chapter 7 or, alternatively, for appointment of a chapter 11 trustee. Counsel to the United States Trustee based the oral motion on (i) the Debtors' continuing losses and the absence of a reasonable likelihood of rehabilitation and (ii) the Debtors' failure to properly manage the funds that were parked in the safe. R.3 at 73:20 - 76:16. The Debtors did not object, procedurally or otherwise, to the United States Trustee's motion at the September 21 hearing. R.3.

On September 22, 2009, the bankruptcy court issued an order dismissing the cases. R.2. The dismissal order does not mention the United States Trustee's oral motion for dismissal or appointment of a chapter 11 trustee. R.2. In the dismissal order, the bankruptcy court noted that the Debtors "belatedly responded to the interested purchaser but only in the face of the Show Cause Order" and that the court "was left to its concern regarding other lost or delayed opportunities and, moreover, to Debtors [sic] inattention to actions it could or should be taking to market its assets." R.2 at 3.

The bankruptcy court also found that the Debtors had failed to file tax returns since 2004, including the 2008 return. R.2 at 2.

With respect to the Debtors' monthly operating reports, the bankruptcy court found that the "Debtors [sic] Monthly Operating Reports reveal that they are suffering continuing losses. Despite those losses, they do not have a business plan and were unable at the hearing to meet their burden of proving a reasonable likelihood of rehabilitation." R.2 at 2, 3.

Finally, the bankruptcy court noted the Debtors' admission that they were holding approximately $60,000 in a safe at one of the Debtors' gas stations and that the Debtors had failed to disclose to "creditors, the Court or the Office of the United States Trustee where or the manner in which they were holding the funds." R.2 at 3. The court found that "such 'cash management' constitutes not only gross mismanagement but, as well, a lack of candor." R.2 at 3.

SUMMARY OF ARGUMENT

The bankruptcy court acted within its discretion when it found "cause" that required dismissal of the Debtors' bankruptcy cases under 11 U.S.C. § 1112(b)(1). In its dismissal order, the bankruptcy court properly identified five separate bases for dismissing the cases:

- *Failure to Consider Purchase Offer* – The testimony of the Debtors' own witnesses established that they failed to give due consideration to an offer to purchase one of the Debtors' properties at a market price.

- *Failure to File Tax Returns* – The Debtors admitted that Dr. R.C. Samanta Roy Institute of Science and Technology, Inc. and certain of its Debtor-affiliates failed to file tax returns for 2005 forward.

- *Continuing Loss to/Diminution of the Debtors' Estates, Absence of a Reasonable Likelihood of Rehabilitation* – The Debtors' CEO testified that the Debtors were not making mortgage payments with respect to certain properties – in other words, the Debtors were not current with respect to their post-petition expenses related to administration of their estates. That fact alone establishes a continuing loss to, and diminution of, the Debtors' estates. As noted previously, it was also undisputed that the Debtors did not have a business plan in place at the time of the September 21 hearing.

- *Cash Mismanagement* – The record detailed an inappropriate system of handling cash that was arguably estate property (specifically, storing same in a safe located at a gas station) that is inconsistent with standards that both companies outside of bankruptcy proceedings and debtors in possession in bankruptcy proceedings are typically held to.

- *Failure to Prepare Business Plan* – The Debtors did not have a business plan prepared six months after they filed for bankruptcy protection.

Additionally, none of the Debtors' remaining arguments warrant reversal of the bankruptcy court's dismissal order.

ARGUMENT

Section 1112(b)(1) of the Bankruptcy Code provides that a bankruptcy court "shall"[5] convert or dismiss a case, whichever is in the best interests of creditors, if "cause" is established, absent "unusual circumstances . . . ." 11 U.S.C. § 1112(b)(1). Section 1112(b)(4) sets out examples of "cause" sufficient to justify conversion or dismissal. *See* 11 U.S.C. § 1112(b)(4) ("[f]or purposes of this subsection, the term 'cause' *includes* . . .") (emphasis added). Because the list in section 1112(b)(4) is not exclusive, the bankruptcy court may convert or dismiss a case for reasons other than the examples set forth in the statute. *See* 11 U.S.C. § 102(3) (establishing the rule of construction that "'includes' or 'including' are not limiting"); *In re SGL Carbon Corp.*, 200 F.3d 154, 160 (3d Cir. 1999) ("Section 1112(b), by its terms, therefore, does not preclude consideration of unenumerated factors in determining 'cause.'"); 7 COLLIER ON BANKRUPTCY ¶ 1112.04[1] (15th ed. rev. 2008) ("[T]he court may also convert or dismiss a case for reasons that are not specifically enumerated in the section, provided that these reasons are sufficient to demonstrate the existence of cause.").

The Debtors contend that the bankruptcy court erred in dismissing their cases for two general reasons. First, the Debtors contend that the bankruptcy court erred in dismissing the cases prior to the expiration of their exclusive period to file a disclosure statement and plan of reorganization. Appellants' Br. at 7, 8. In order to facilitate the reorganization process, the Bankruptcy Code gives debtors in possession the exclusive right to file a plan (and solicit votes thereon) for a period of 120

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[5] Prior to the enactment of The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. 109-8, 119 Stat. 23 (Apr. 20, 2005) (the "BAPCPA"), bankruptcy courts had greater discretion to deny relief under section 1112(b) following a determination that there was "cause" for dismissal or conversion. The Debtors do not appear to realize that the BAPCPA curtailed that discretion. Appellants' Br. at 7 ("A bankruptcy matter may be dismissed or converted pursuant to §1112 of the Bankruptcy Code if the movant establishes cause.").

days (filing) and 180 days (solicitation) after the inception of their cases. *See* 11 U.S.C. § 1121(b, c). These "exclusive" periods to file a plan and solicit votes thereon may be extended by the bankruptcy court for "cause," subject to certain limitations. *See* 11 U.S.C. § 1121(d). At the time of the September 21 hearing, the Debtors' exclusive periods had been extended by prior court order(s) and had not expired. Appellants' Br. at 8.

The Debtors' argument that their exclusive periods preclude dismissal of their cases conflicts with the plain language of the statute. The statute does not establish the Debtors' exclusive periods as a "safe harbor" from conversion or dismissal of their cases." To the contrary, the "failure to file a disclosure statement, or to file or confirm a plan, within the time fixed by this title or by order of the court" is but one of at least sixteen independent grounds for dismissal of the Debtors' cases. None of the cases cited by the Debtors stand for the proposition that, as a matter of law, the court cannot dismiss or convert a case until the plan exclusivity period has expired. All of the cases cited by the Debtors in their brief pre-date the BAPCPA amendment which curtailed the bankruptcy court's discretion. In addition, the express language of section 1112(b)(1) requires the bankruptcy court to grant relief if "cause" is established, absent "unusual circumstances."

Second, the Debtors contend that they were not given sufficient notice of the September 21 "show cause" hearing. Appellants' Br. at 9-11. The Debtors' contention is incorrect, as notice of the "show cause" hearing was sufficient. The requirement that there be "notice and a hearing" in section 1112(b)(1) "means after such notice as is appropriate in the particular circumstances, and such opportunity for hearing as is appropriate in the particular circumstances." 11 U.S.C. §

102(1)(A).[6] Here, the bankruptcy court properly set the "show cause" hearing for September 21 in light of its concerns regarding the Debtors' apparent mismanagement of their chapter 11 cases. Further, the Debtors' contention that notice was insufficient is curious, as the Debtors did not object to going forward at any time at or prior to the hearing on grounds that notice was inadequate.[7] The Debtors waived their notice objection by failing to claim inadequate notice before the bankruptcy court. *See Kirk v. Raymark Indus., Inc.*, 61 F.3d 147, 156 (3d Cir. 1995) ("'[I]t is well established that failure to raise an issue in the district court constitutes waiver of that argument.'") (internal citation(s) omitted).

The bankruptcy court found at least five grounds for dismissal, and the Debtors' remaining arguments are unavailing.

A. The Debtors' Failure to Consider the Purchase Offer for the Subject Property Constitutes Gross Mismanagement of Their Estates and Unreasonable Delay That Is Prejudicial to Creditors.

At the September 14-15 hearing, Isaacson testified that the Debtors had not pursued the sale of the subject property because they were concerned that tipping the potential purchaser off about the existence of the Debtors' bankruptcy filings would scare the bid away. R.3 at 17:13 - 18:15. In the September 22 order dismissing the cases, the bankruptcy court found that the Debtors' explanation did not excuse their failure to pursue the purchase offer. R.2 at 3.

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[6] While notice of a motion to convert or dismiss a chapter 11 case is ordinarily subject to a twenty-day notice requirement, *see* FED. R. BANKR. P. 2002(a)(4), "the court for cause shown may in its discretion with or without motion or notice order the period reduced." FED. R. BANKR. P. 9006(c)(1).

[7] In contrast to the Debtors' silence regarding the bankruptcy court's "show cause" order, the Debtors did respond in writing to papers filed by certain of the Debtors' secured lenders on procedural grounds. In their response, the Debtors asserted that they "have not had adequate notice of the relief sought by the Lenders, nor the opportunity to prepare therefor." R.17 (Debtors' Response to Carlyle Financial, LLC, *et al.*) at 2.

"Gross mismanagement of the estate" and unreasonable delay that is prejudicial to creditors are both grounds for relief under section 1112(b). "Gross mismanagement of the estate" is an enumerated example of "cause." *See* 11 U.S.C. § 1112(b)(4). Additionally, prior to the BAPCPA, section 1112(b) expressly listed "unreasonable delay by the debtor that is prejudicial to creditors" as an example of "cause." A leading treatise observes that, while the "unreasonable delay" example of "cause" is no longer expressly listed in section 1112(b), it still has vitality. *See* 7 COLLIER ON BANKRUPTCY ¶ 1112.04[5][c] (15th ed. rev. 2008) ("If it appears that a debtor has engaged in unreasonable delay that is prejudicial to creditors, this may justify a finding of cause to convert or dismiss the case regardless of whether the specific instance is not enumerated in revised section 1112(b).").

The bankruptcy court's conclusion that the Debtors had done too little, too late to pursue the purchase offer is supported by the record and does not constitute clear error. The Debtors did not advance discussions with the potential purchaser of the subject property for six months. The Debtors' proffered justification was fear that the potential purchaser might discover that the Debtors were bankrupt. R.3 at 17:13 - 18:15. The bankruptcy court acted within its discretion in concluding that the six-month delay constituted "unreasonable delay" under 11 U.S.C. § 1112(b)(4); the bankruptcy court properly refused to credit the Debtors' proffered justification for the delay, as it was an unacceptable excuse for a fiduciary charged with maximizing estate value. R.2 at 3.

B. The Debtors' Failure to File Tax Returns Constitutes Gross Mismanagement of Their Estates.

The Debtors' failure to file tax returns for pre-petition periods constitutes "gross mismanagement" of their estates. *See In re Evans*, 48 B.R. 46, 48 (Bankr. W.D. Tex. 1985); *see also In re Euro-American Lodging Corp.*, 365 B.R. 421, 426 (Bankr. S.D.N.Y. 2007) ("'Gross mismanagement' includes the chronic failure to pay taxes, particularly where the failure leads to liability for interest and penalties."). Here, Debtor Dr. R.C. Samanta Roy Institute of Science and Technology is a not-for-profit, 501(c)(3) organization that, along with its subsidiaries, has not filed tax returns for the past four tax years (2005 - 2008). R.3 at 30:23 - 31:8, 32:9-25. Accordingly, the bankruptcy court's dismissal of the Debtors' cases due to their failure to discharge their tax reporting obligations was well within the bankruptcy court's discretion.

In their opening brief, the Debtors suggest that they were excused from filing tax returns because they had been subject to audit by the Internal Revenue Service since 2004. Appellants' Br. at 8. The Debtors introduced no evidence at the "show cause" hearing to support this suggestion. R.3. Further, the Debtors contend that, because Debtor Dr. R.C. Samanta Roy Institute of Science and Technology is a not-for-profit, 501(c)(3) organization, "the [Debtors] have no tax liability; the obligation to file the return is merely a reporting requirement." Appellants' Br. at 9. Again, nothing in the record supports the Debtors' assertion in this regard; to the contrary, there are penalties associated with the failure by a 501(c)(3) organization to timely file returns (*Internal Revenue Service, Tax Information for Charitable Organizations, Filing Requirements*, (Nov. 23, 2009) < http://www.irs.gov/charities/article/0,,id=96103,00.html>), and the Debtors did not establish that they have no tax liability. R.3.

Finally, the Debtors argue that dismissal under section 1112(b)(1) is not warranted because the failure to fulfill post-petition obligations to file tax returns or pay taxes – not pre-petition obligations – alone constitutes "cause" for dismissal. Appellants' Br. at 8. The cases cited by the Debtors do not support their argument. *In re Pittsfield Weaving Co.*, 393 B.R. 271 (Bankr. D.N.H. 2008) is silent on the issue of whether a pre-petition failure to file tax returns or pay taxes constitutes "cause" for relief under section 1112(b)(1). *In re Berryhill*, 127 B.R. 427 (Bankr. N.D. Ind. 1991)[8] supports the United States Trustee's position. In *Berryhill*, the Debtors' cases were dismissed because the Debtors violated a court order requiring them to file past-due tax returns for pre-petition periods. *See id.* at 428.

C. There Is a Continuing Loss to/Diminution of the Debtors' Estates and the Absence of a Reasonable Likelihood of Rehabilitation.

Continuing loss to or diminution of the Debtors' estates and the absence of a reasonable likelihood of rehabilitation constitutes "cause" for relief under section 1112(b). Continuing negative cash flow is sufficient to establish a continuing loss to the Debtors' estates. *See Loop Corp. v. United States Trustee (In re Loop Corp.)*, 379 F.3d 511, 515-16 (8th Cir. 2004). Isaacson admitted that Debtors Midwest Properties and R.C. Samanta Roy Institute of Science and Technology, Inc. were not paying all of their secured lenders post-petition. R.3 at 23:25 - 24:18; 14:24 - 15:4. The Debtors' failure to make the post-petition mortgage payments on all of their properties evidences negative cash flow sufficient to establish a continuing loss to, or a diminution of, the Debtors' estates.

Further, as the bankruptcy court found, a reasonable likelihood of rehabilitation is absent here because the Debtors did not carry their burden on this point at the September 21 "show cause" hearing. R.2 at 4. The Debtors did not have a business plan to share with the bankruptcy court to prove their viability. R.2 at 3.

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[8] The citation to *Berryhill* in the Debtors' brief at page 8 (189 B.R. 483 (N.D. Ind. 1995)) is incorrect.

D. The Mismanagement of Funds That Were Arguably Estate Property Constitutes "Cause" for Dismissal.

The storage of funds that are arguably estate funds in a combination safe at a gas station constitutes an inadequate cash management practice. Courts have found "cause" to order the appointment of a chapter 11 trustee under section 1104(a)(1) of the Bankruptcy Code where current management is responsible for a failure to "institute formal internal accounting controls and effective, responsible management practices." *In re State Capital Corp.*, 51 B.R. 400, 403 (Bankr. M.D. Fla. 1985); *see In re New Orleans Paddlewheels, Inc.*, 350 B.R. 667, 679-80 (Bankr. E.D. La. 2006) (holding that the debtor's failure to properly maintain books and records, among other factors, warranted appointment of a trustee); *In re McCorhill Publ'g., Inc.*, 73 B.R. 1013, 1017 (Bankr. S.D.N.Y. 1987) ("[W]hen a debtor fails to maintain complete and accurate financial records, or fails to substantiate undocumented transactions, so that there appears to be a confusion in the debtor's accounting system, the courts have viewed these facts as gross mismanagement and have directed the appointment of a Chapter 11 trustee."). The bankruptcy court acted within its discretion when it found that the Debtors' unorthodox cash management practice warranted dismissal of the Debtors' cases.

The Debtors suggest that, because there was a temporary restraining order prohibiting the use of cash against which certain secured creditors asserted a lien, the storage of the cash in a safe at one of their gas stations was permissible. Appellants' Br. at 18-19. The Debtors' position is a *non sequitur*. The bankruptcy court identified the cash mismanagement as "cause" for dismissal because the chosen manner for holding the cash did not comport with standard cash management practices outside of bankruptcy and fell woefully short of the conduct expected of fiduciaries in bankruptcy. R.2 at 3, 4. Further, several of the Debtors, their principals and/or employees are subject to the temporary restraining order and had actual custody of the cash. Finally, Debtors' counsel conceded at the "show cause" hearing that there was a "question" as to whether the funds were estate property. R.3 at 70:25 - 71:4. Under these circumstances, the bankruptcy court did not abuse its discretion in determining that there was a failure to properly safeguard the cash and that such failure warranted dismissal of the Debtors' cases.

E. The Debtors' Failure to Prepare a Business Plan Constitutes Unreasonable Delay That Is Prejudicial to Creditors.

At the September 21 "show cause" hearing, approximately six months into the Debtors' bankruptcy cases, the Debtors had not prepared a business plan. The Debtors' failure in this regard constituted an unreasonable delay that was prejudicial to creditors; by Isaacson's own admission, the Debtors were not going to make any progress negotiating with their various secured creditors without having completed a business plan. R.3 at 45:2 - 47:3; s*ee* 7 COLLIER ON BANKRUPTCY ¶ 1112.04[5][c] (15th ed. rev. 2008) ("If the debtor's failure to timely take some other important step in the reorganization process results in prejudice to creditors, such as the failure to timely formulate a business plan, the court may conclude that cause exists to convert or dismiss the case."). The bankruptcy court properly identified the Debtors' failure to timely prepare the business plan as "cause" warranting relief under section 1112(b).

F. The Debtors' Remaining Arguments Do Not Warrant Reversal.

The Debtors contend that the bankruptcy court erred by basing its decision upon alleged assertions not of record in the Debtors' cases. The Debtors' contention rests upon several erroneous premises. First, the Debtors erroneously posit that the bankruptcy court was obligated to adjudicate two motions for relief from the automatic stay that it had taken under advisement before it could consider whether relief under section 1112(b) was warranted. Appellants' Br. at 12. The bankruptcy court was free to rely upon the Debtors' admissions made during the course of the stay relief proceedings in addressing whether the Debtors' cases should remain in chapter 11. Further, the Debtors erroneously assume that the bankruptcy court relied upon the alleged assertions in rendering its decision.

Next, the Debtors argue that the bankruptcy court improperly relied upon the United States Trustee's oral motion to convert. Appellants' Br. at 16-18. The Debtors' argument lacks merit. First, the United States Trustee's oral motion in open court was properly tendered. *See* Fed. R. Bankr. P. 9013. Second, the Debtors did not lodge a procedural objection to the United States Trustee's oral motion at the September 21 hearing. R.3. Third, nothing in the dismissal order indicates that the bankruptcy court ruled upon the United States Trustee's motion; the dismissal order does not mention the motion. R.2.

Finally, the Debtors claim that the bankruptcy court erred in interpreting the Debtors' monthly operating reports. Appellants' Br. at 14-15. The Debtors assert that the bankruptcy court "only had before it the Monthly Operating Reports for July 2009." Appellants' Br. at 14. That assertion is incorrect; in issuing the "show cause" order, the bankruptcy court indicated that it had reviewed the Debtors' monthly operating reports without specifying a particular month. R.1 at 1. Regardless, even if the bankruptcy court had only examined the July 2009 reports, the inference that the Debtors want this Court to draw from that assertion – namely, that the bankruptcy court did not examine the Debtors' operating results for other, post-bankruptcy filing months – is incorrect. In addition to reporting on the month in question, the Debtors' monthly operating reports contain cumulative income statements which enabled evaluation of a particular month's results in light of the Debtors' overall operating performance during the bankruptcy cases. When the information on the Debtors' income statements is evaluated in the context of (i) the Debtors' admission that they had not paid certain of their secured lenders (R.3 at 23:25 - 24:18; 14:24 - 15:4) and (ii) the fact that the bankruptcy court had not approved any applications for compensation by estate professionals (R.4), it is clear that the bankruptcy court did not err in concluding that the monthly operating reports "show" continuing losses.

CONCLUSION

WHEREFORE the United States Trustee requests that this Court issue an order affirming the bankruptcy court's September 22, 2009 order.

Respectfully submitted,

ROBERTA A. DeANGELIS
ACTING UNITED STATES TRUSTEE

BY: /s/ Joseph J. McMahon, Jr.
William K. Harrington, Esquire (# 4051)
Assistant United States Trustee
Joseph J. McMahon, Jr., Esquire (# 4819)
T. Patrick Tinker, Esquire
Trial Attorneys
United States Department of Justice
Office of the United States Trustee
J. Caleb Boggs Federal Building
844 King Street, Room 2207, Lockbox 35
Wilmington, DE 19801
(302) 573-6491
(302) 573-6497 (Fax)

Date: December 7, 2009

ADDENDUM – TEXT OF 11 U.S.C. § 1112(b)

(b)(1) Except as provided in paragraph (2) of this subsection, subsection (c) of this section, and section 1104(a)(3), on request of a party in interest, and after notice and a hearing, absent unusual circumstances specifically identified by the court that establish that the requested conversion or dismissal is not in the best interests of creditors and the estate, the court shall convert a case to a case under chapter 7 or dismiss a case under this chapter, whichever is in the best interests of creditors and the estate, if the movant establishes cause.

(2) The relief provided in paragraph (1) shall not be granted absent unusual circumstances specifically identified by the court that establish that such relief is not in the best interests of creditors and the estate, if the debtor or another party in interest objects and establishes that –

(A) there is a reasonable likelihood that a plan will be confirmed within the timeframes established in sections 1121(e) and 1129(e) of this title, or if such sections do not apply, within a reasonable period of time; and

(B) the grounds for granting such relief include an act or omission of the debtor other than under paragraph 4(A) –

(i) for which there exists a reasonable justification for the act or omission; and

(ii) that will be cured within a reasonable period of time.

(3) The court shall commence the hearing on a motion under this subsection not later than 30 days after filing of the motion, and shall decide the motion not later than 15 days after commencement of such hearing, unless the movant expressly consents to a continuance for a specific period of time or compelling circumstances prevent the court from meeting the time limits established by this paragraph.

(4) For purposes of this subsection, the term ‘cause’ includes –

(A) substantial or continuing loss to or diminution of the estate and the absence of a reasonable likelihood of rehabilitation;

(B) gross mismanagement of the estate;

(C) failure to maintain appropriate insurance that poses a risk to the estate or the public;

(D) unauthorized use of cash collateral substantially harmful to 1 or more creditors;

(E) failure to comply with an order of the court;

(F) unexcused failure to satisfy timely any filing or reporting requirement established by this title or by any rule applicable to a case under this chapter;

(G) failure to attend the meeting of creditors convened under section 341(a) or an examination ordered under rule 2004 of the Federal Rules of Bankruptcy Procedure without good cause shown by the debtor;

(H) failure timely to provide information or attend meetings reasonably requested by the United States trustee (or the bankruptcy administrator, if any);

(I) failure timely to pay taxes owed after the date of the order for relief or to file tax returns due after the date of the order for relief;

(J) failure to file a disclosure statement, or to file or confirm a plan, within the time fixed by this title or by order of the court;

(K) failure to pay any fees or charges required under chapter 123 of title 28;

(L) revocation of an order of confirmation under section 1144;

(M) inability to effectuate substantial consummation of a confirmed plan;

(N) material default by the debtor with respect to a confirmed plan;

(O) termination of a confirmed plan by reason of the occurrence of a condition specified in the plan; and

(P) failure of the debtor to pay any domestic support obligation that first becomes payable after the date of the filing of the petition.

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF DELAWARE

:
In re
:
DR. R.C. SAMANTA ROY INSTITUTE OF SCIENCE AND TECHNOLOGY, INC., *et al.*, : Bankr. Case No. 09-10876

Debtors. :

DR. R.C. SAMANTA ROY INSTITUTE OF SCIENCE AND TECHNOLOGY, INC., *et al.*, :
:
Appellants,
:
v. : Civil Action No. 09-789 (GMS)
:
UNITED STATES TRUSTEE,
:
Appellee.
:

CERTIFICATE OF SERVICE

I certify that, on December 7, 2009, I caused to be served a copy/copies of the Appellee's Brief, along with the related Index of Items Designated as Part of the Record on Appeal, via first class United States mail and electronic mail to the following persons:

Robert K. Beste, Esquire
Steven D. Usdin, Esquire
Nella M. Bloom, Esquire
COHEN, SEGLIAS, PALLAS,
GREENHALL & FURMAN, P.C.
Nemours Building, 1007 Orange Street,
Suite 1130
Wilmington, DE 19801
rbeste@cohenseglias.com
susdin@cohenseglias.com
nbloom@cohenseglias.com

William F. Taylor, Jr., Esquire
Katharine L. Mayer, Esquire
McCARTER & ENGLISH LLP
Renaissance Centre
405 North King Street, 8th Floor
Wilmington, DE 19801
wtaylor@mccarter.com
kmayer@mccarter.com

Susan E. Kaufman, Esquire
COOCH AND TAYLOR, P.A.
1000 West Street, 10th Floor
The Brandywine Building
Wilmington, DE 19899
skaufman@coochtaylor.com

Kevin S. Mann, Esquire
CROSS & SIMON, LLC
913 North Market Street, 11th Floor
P.O. Box 1380
Wilmington, DE 19899-1380
kmann@crosslaw.com

Glenn A. Brown, DMD, Esquire
REAL WORLD LAW, PC
916 North Union Street, No. 2
Wilmington, DE 19805
glenn.brown@realworldlaw.com

/s/ Joseph J. McMahon, Jr.
Joseph J. McMahon, Jr.
Trial Attorney

BRIEF BANK — "SUMMARY SHEET" *Printed Tue-11/16/10 16:10*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	Dr. R.C. Samanta Roy Institute of Science & Technology, Inc., et al. v. Roberta A. DeAngelis, United States Trustee for Region 3 (In re: Dr. R.C. Samanta Roy Institute of Science & Technology, Inc., et al.)
2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	3rd. Cir.
3. ("CCN") ***CURRENT*** CASE NO.	No.: 10-2535
4. ("PCN") ***PRIOR*** CASE NO. - & COURT *[IF ANY]*	No.: 09-789 Court: D. Del. *(Identify judge & cite, if any)*
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8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	• Whether the district court erred in determining that the bankruptcy court did not abuse its discretion in finding that cause existed under 11 U.S.C. § 1112(b)(1) to dismiss the debtor's bankruptcy cases, when such finding was supported by ample evidence in the record.
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No. 10-2535

IN THE UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

In re: DR. R.C. SAMANTA ROY INSTITUTE OF SCIENCE & TECHNOLOGY, INC., *et al*.,
Debtors.

DR. R.C. SAMANTA ROY INSTITUTE OF SCIENCE & TECHNOLOGY, INC., *et al*.,
Appellants,

v.

ROBERTA A. DeANGELIS, United States Trustee for Region 3,

Appellee.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF DELAWARE
Case No. 09-789, Chief Judge Gregory M. Sleet

BRIEF FOR APPELLEE, ROBERTA A. DeANGELIS, UNITED STATES TRUSTEE

Ramona D. Elliott
General Counsel
P. Matthew Sutko
Associate General Counsel
Department of Justice
Executive Office for U.S. Trustees
20 Massachusetts Ave, N.W.
Washington, DC 20530
(202) 307-1399

T. Patrick Tinker
Acting Assistant United States Trustee
Juliet Sarkessian
Robert J. Schneider
Trial Attorneys
Department of Justice
Office of the United States Trustee
844 King St, Rm 2207, Lockbox 35
Wilmington, DE 19801
(302) 573-6491

Attorneys for Appellee Roberta A. DeAngelis, United States Trustee

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STATEMENT OF JURISDICTION

This appeal is taken from a final order entered by the United States District Court for the District of Delaware, which affirmed a final order of the United States Bankruptcy Court for the District of Delaware. The bankruptcy court had jurisdiction over this chapter 11 proceeding under 28 U.S.C. § 157(a). The district court had appellate jurisdiction over the bankruptcy court's final order under 28 U.S.C. § 158(a)(1). This appeal was timely filed on May 28, 2010. This Court has jurisdiction over the district court's final order entered May 25, 2010, under 28 U.S.C. §§ 158(d) and 1291.

STATEMENT OF THE ISSUE PRESENTED

The sole issue on appeal is whether the district court erred in determining that the bankruptcy court did not abuse its discretion in finding that cause existed under 11 U.S.C. § 1112(b)(1) to dismiss the debtors' bankruptcy cases, when such finding was supported by ample evidence in the record.

STATEMENT OF THE CASE

On March 16, 2009, the Dr. R.C. Samanta Roy Institute of Science and Technology, Inc., and certain of its subsidiaries (collectively the "Debtors") filed voluntary petitions for relief under chapter 11 of the

Bankruptcy Code. Bankr. Ct. Dkt. 1.[1] On September 14 and 15, 2009, the bankruptcy court held a hearing on a secured creditor's motion for relief from the automatic stay. J.A. 0073-478 (transcript); *See* 11 U.S.C. § 362. The day following the hearing, September 16, 2009, the bankruptcy court issued an order directing the Debtors to appear at a hearing on September 21, 2009, to show cause why the court should not either dismiss the Debtors' cases or order the appointment of a chapter 11 trustee. J.A. 0899-90.

The September 21, 2009 hearing was attended by counsel for Roberta A. DeAngelis, the United States Trustee for Region 3, who was then the Acting United States Trustee for Region 3 (the "United States Trustee"),[2] counsel for the Debtors, and counsel for certain of the Debtors' creditors,.

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[1] Citations to documents included in the Joint Appendix will be referenced by "J.A. ____ [i.e., page of Joint Appendix on which cited matter appears]." Citations to documents not included in the Joint Appendix will be referenced by "Bankr. Ct. Dkt. ___ [i.e., docket number]" for documents appearing on the docket of Case No. 09-10876 before the Bankruptcy Court for the District of Delaware, by "Dist. Ct. Dkt. ____" for documents appearing on the docket of Case No. 09-789 before the District Court for the District of Delaware, and by "Ct. App. ___" for documents appearing on the docket in this appeal.

[2] The United States Trustee is an official of the United States Trustee Program, an agency of the United States Department of Justice. The United States Trustee is responsible for supervising the administration of bankruptcy cases. *See generally* 28 U.S.C. § 586(a) (describing responsibilities); 11 U.S.C. § 307 (describing broad standing to raise and be heard on issues).

J.A. 0984-1073 (transcript). After the close of the evidence, counsel to the United States Trustee orally moved “for the relief that’s cited in [the] Show Cause Order.” J.A. 1056 (Tr. 73:20-22). On September 22, 2009, the bankruptcy court issued an order dismissing the cases. J.A. 0006-10. On October 2, 2009, the Debtors filed a notice of appeal to the District Court for the District of Delaware. J.A. 980-83.

On May 25, 2010, after the appeal was fully briefed, the district court entered an order affirming the bankruptcy court’s order. J.A. 0004-5. On May 28, 2010, the Debtors filed a notice of appeal to this Court. J.A. 0001-3.

The bankruptcy court’s dismissal order was stayed through the district court appeal process. *See* Bankr. Ct. Dkt. 306 (order of 10/19/09); Dist. Ct. Dkt. 12 (order of 10/26/09). However, both the district court and this Court denied the Debtors’ motions for a stay pending resolution of the appeal to this Court. *See* Dist. Ct. Dkt. 50 (6/7/10 Order); Ct. App. 7/1/10 Order.

On July 26, 2010, the Debtors Midwest Oil of Minnesota LLC and Midwest Properties of Shawano, LLC withdrew their appeal to this Court. On that same date, Midwest Oil of Minnesota LLC filed a new bankruptcy case in the Bankruptcy Court for the District of Minnesota.[3] Midwest Properties of Shawano, LLC had filed a new bankruptcy case in the Bankruptcy Court for the Eastern District of Wisconsin on July 13, 2010, prior to withdrawing its appeal.[4] The remaining Debtors continue to be Appellants in this appeal.

STATEMENT OF APPROPRIATE STANDARD OF APPELLATE REVIEW

This appeal presents a question of whether the bankruptcy court abused its discretion in finding cause that required dismissal of the Debtors' bankruptcy cases under 11 U.S.C. § 1112(b)(1). *See In re SGL Carbon Corp*., 200 F.3d 154, 159 (3d Cir. 1999) (dismissal of chapter 11 case "is committed to the sound discretion of the bankruptcy or district court"). A bankruptcy court abuses its discretion when its decision is based on "a clearly erroneous finding of fact, an errant conclusion of law, or an improper

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[3] The Minnesota case was dismissed on August 18, 2010, upon the motion of the United States Trustee for Region 12. *See In re Midwest Oil of Minnesota LLC*, Case No. 10-35450, Dkt. 21. On September 1, 2010, Midwest Oil of Minnesota LLC filed a new case in the Bankruptcy Court for the District of Delaware, Case No. 10-12771.

[4] The Wisconsin case (Case No. 10-31515) was transferred to the Bankruptcy Court for the District of Delaware, Case No. 10-12481, on August 2, 2010.

application of law to fact." *In re Marvel Entertainment Group, Inc*., 140 F.3d 463, 470 (3d Cir. 1998).

The bankruptcy court's findings of fact will not be set aside unless they are either "completely devoid of minimum evidentiary support displaying some hue of credibility or bear[ ] no rational relationship to the supportive evidentiary data." *See Fellheimer, Eichen & Braverman P.C. v. Charter Technologies, Inc*., 57 F.3d 1215, 1223 (3d Cir. 1995) (*quoting Hoots v. Pennsylvania,* 703 F.2d 722, 725 (3d Cir. 1983)); *see also* Fed. R. Bankr. P. 8013 ("[F]indings of fact, whether based on oral or documentary evidence, shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the bankruptcy court to judge the credibility of the witnesses.").

STATUTORY FRAMEWORK

The relevant statute in this appeal is 11 U.S.C. § 1112(b) ("Section 1112(b)"), which provides:

> (b)(1) Except as provided in paragraph (2) of this subsection, subsection (c) of this section, and section 1104(a)(3), on request of a party in interest, and after notice and a hearing, absent unusual circumstances specifically identified by the court that establish that the requested conversion or dismissal is not in the best interests of creditors and the estate, the court shall convert a case under this chapter to a case under chapter 7 or dismiss a case under this chapter, whichever is in the best interests

of creditors and the estate, if the movant establishes cause.

(2) The relief provided in paragraph (1) shall not be granted absent unusual circumstances specifically identified by the court that establish that such relief is not in the best interests of creditors and the estate, if the debtor or another party in interest objects and establishes that - -

  (A) there is a reasonable likelihood that a plan will be confirmed within the timeframes established in sections 1121(e) and 1129(e) of this title, or if such sections do not apply, within a reasonable period of time; and

  (B) the grounds for granting such relief include an act or omission of the debtor other than under paragraph (4)(A) –

    (i) for which there exists a reasonable justification for the act or omission; and

    (ii) that will be cured within a reasonable period of time fixed by the court.

(3) The court shall commence the hearing on a motion under this subsection not later than 30 days after filing of the motion, and shall decide the motion not later than 15 days after commencement of such hearing, unless the movant expressly consents to a continuance for a specific period of time or compelling circumstances prevent the court from meeting the time limits established by this paragraph.

(4) For purposes of this subsection, the term ‘cause’ includes --

  (A) substantial or continuing loss to or diminution of the estate and the absence of a reasonable likelihood of rehabilitation;

(B) gross mismanagement of the estate;

(C) failure to maintain appropriate insurance that poses a risk to the estate or to the public;

(D) unauthorized use of cash collateral substantially harmful to 1 or more creditors;

(E) failure to comply with an order of the court;

(F) unexcused failure to satisfy timely any filing or reporting requirement established by this title or by any rule applicable to a case under this chapter;

(G) failure to attend the meeting of creditors convened under section 341(a) or an examination ordered under rule 2004 of the Federal Rules of Bankruptcy Procedure without good cause shown by the debtor;

(H) failure timely to provide information or attend meetings reasonably requested by the United States trustee (or the bankruptcy administrator, if any);

(I) failure timely to pay taxes owed after the date of the order for relief or to file tax returns due after the date of the order for relief;

(J) failure to file a disclosure statement, or to file or confirm a plan, within the time fixed by this title or by order of the court;

(K) failure to pay any fees or charges required under chapter 123 of title 28;

(L) revocation of an order of confirmation under section 1144;

(M) inability to effectuate substantial consummation of a confirmed plan;

(N) material default by the debtor with respect to a confirmed plan;

(O) termination of a confirmed plan by reason of the occurrence of a condition specified in the plan; and

(P) failure of the debtor to pay any domestic support

> obligation that first becomes payable after the date of the filing of the petition.

11 U.S.C. § 1112(b).

STATEMENT OF FACTS

On March 16, 2009, the Debtors filed voluntary petitions under chapter 11 of the Bankruptcy Code and, upon doing so, became debtors in possession.[5] Bankr. Ct. Dkt. 1 (petition). The Debtors' operations are based in Shawano, Wisconsin. J.A. 0030 (Isaacson Aff.) In their filings with the bankruptcy court, the Debtors described their business as "property acquisition and management, sales of gasoline and petroleum products, and funding for charitable activities." *Id.* One Debtor, Midwest Oil of Shawano, LLC, is an operating entity. J.A. 1005 (9/21/10 Tr. 22:8-12). The other Debtors are holding companies that own real property, which they lease to the Debtors' wholly-owned, non-debtor subsidiaries, as well as to entities with no connection to the Debtors. J.A. 1005, 1023-25 (9/21/10 Tr. 22:8-12; 40:10-42:5). Affiliates of the Debtors operated two hotels, gas stations,

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[5] A chapter 11 debtor is a "debtor in possession" unless a trustee has been appointed. *See* 11 U.S.C. § 1101(1). Pursuant to 11 U.S.C. § 1107, most of the rights, powers, and duties of a trustee in a chapter 11 case are conferred upon the debtor in possession. *See also* Fed. R. Bankr. P. 9001(11) (for purposes of the Federal Rules of Bankruptcy Procedure, "'Trustee' includes a debtor in possession in a chapter 11 case").

an amusement park/racetrack for motorized carts, and a fudge shop on Debtor-owned properties. J.A. 1005-08 (9/21/10 Tr. 22-25).

Vermillion's Lift-Stay Motion

On May 14, 2009, Vermillion State Bank ("Vermillion"), a secured creditor of the Debtor Midwest Oil of Minnesota LLC, sought relief from the automatic stay with respect to real property located at 3355 Hadley Avenue, Oakdale, Minnesota (the "Oakdale Property").[6] Bankr. Ct. Dkt. 109. That motion was amended on June 8, 2009 (the "Lift-Stay Motion"). J.A. 003747. In its Lift-Stay Motion, Vermillion stated that it had foreclosed on the Oakdale Property, but a sheriff's sale scheduled for April 7, 2009 was stayed by the Debtors' bankruptcy filings. J.A. 0038-39, at ¶¶ 16, 18.

The Hearing on Vermillion's Lift-Stay Motion

The Debtors objected to the Lift-Stay Motion. J.A. 0048-64. On September 14 and 15, 2009, a contested evidentiary hearing was held (the "Lift-Stay Hearing"). J.A. 0073-0478. At the Lift-Stay Hearing on

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[6] Under the Bankruptcy Code, the filing of the Debtors' bankruptcy petitions gave rise to an "automatic stay" in each case, which generally prohibits creditors from commencing or pursuing civil actions against the Debtors or their assets. *See* 11 U.S.C. § 362. Relief from the automatic stay may be granted with respect to property, if, *inter alia*, the creditor's interest in the property is not adequately protected, if the debtor does not have equity in the property, or if the property is not necessary to an effective reorganization. *See* 11 U.S.C. § 362(d).

September 14, 2009, the Debtors' Chief Executive Officer, Naomi Isaacson, testified that the Debtors had operated the Oakdale Property as a gas station and convenience store. J.A. 0341-42, 0345 (Tr. 269:24–270:23; 273:13-16). The property had been vacant since it was burglarized in October 2008. J.A. 347 (Tr. 275:13-19). In addition, the gas pumps on the property had been removed due to a dispute with the prior tenant, who had leased the pumps. J.A. 0341-42 (Tr. 269:24–270:9). Ms. Isaacson further testified that approximately $42,000 in unpaid real estate taxes was due on the Oakdale Property, and that the Debtors had failed to make any post-petition tax payments or mortgage payments related to the property. J.A. 0090-91 (Tr. 18:20–19:9).

An expert witness produced by the Debtors at the Lift-Stay Hearing, Steven T. Hosch, testified that the market value of the Oakdale Property was $2.55 million, after subtracting delinquent taxes. J.A. 0164 (Tr. 92:12-24). Mr. Hosch further testified that the Debtors had received an offer from the "development arm" of the Walgreens retail pharmacy chain to purchase the Oakdale Property for $2.5 million (J.A. 0193-94, 196 (Tr. 121:21- 122:2; Tr. 124:3-24)), which he believed established a "floor to value" ranging between $2 million and $2.7 million for the Oakdale Property's highest and best use. J.A. 0159, 0193-94 (Tr. 87:11-22; 121:21–122:18). Even though

Walgreens' offer fell within the Debtors' own expert's value range, Ms. Isaacson testified that she did not respond to the offer because the Debtors' board of directors had decided it wanted $7 million for the Oakdale Property. J.A. 0350-51 (Tr. 278:18–279:4).

At the close of the hearing on September 15, 2009, the bankruptcy court remarked that it was "disturbed with the testimony" with respect to, *inter alia*, the Debtors' failure to respond to the offer to purchase the long vacant, non-operating Oakdale Property "at a price which, by the debtors' own admission, is a price which reflects the value of this property." J.A. 0467-68 (Tr. 93:8–94:6). The bankruptcy court also noted that the Debtors had been in chapter 11 for six months with "virtually no activity in advancing toward confirmation or resolution of these cases." J.A. 0468 (Tr. 94:16-21). The bankruptcy court further expressed concern over the Debtors' continuing non-payment of taxes. J.A. 468-69 (Tr. 94:22-95:5). The bankruptcy court indicated that the facts presented at the Lift-Stay Hearing indicated, at least on a prima facie basis, "gross mismanagement and a breach of fiduciary duty to the creditors of these debtors," "substantial and continuing losses," and the lack of "any reasonable prospects for rehabilitation of these debtors." J.A. 0468 (Tr. 94:3-10). Therefore, the bankruptcy court stated that it would issue an order for a rule to show cause why it should not dismiss the Debtors' cases or appoint a chapter 11 trustee. *Id*. (Tr. 94:11-15).

The Bankruptcy Court's Show-Cause Order

The following day, September 16, 2009, the bankruptcy court issued an "order on rule to show cause" directing the Debtors to appear in court on September 21, 2009, at which time they "must show cause why the Court should not dismiss the cases or appoint a Chapter 11 Trustee." J.A. 899-90 (the "Show-Cause Order"). The Show-Cause Order also provided explicit notice to the Debtors as to certain particular issues that prompted the September 21 hearing:

- The Debtors' "refus[al] to even consider" the offer to purchase the Oakdale Property;
- The fact that the "Monthly Operating Reports indicate that Debtors are operating at a continuing loss;"
- A concern that the "Debtors' substantial or continuing loss to or diminution of the estate maybe [sic] the result of gross mismanagement and breach of fiduciary duty;" and
- The Debtors' "prospects for rehabilitation."

Id.

The Debtors did not seek to adjourn the September 21, 2009 hearing due to insufficient notice, nor did their witnesses or counsel indicate at the September 21, 2009 hearing that they were not prepared to fully address the issues raised by the Show-Cause Order. *See* J.A. 0984-1073 (9/21/09 Transcript).

<u>The September 21, 2009, Show-Cause Hearing</u>

At the September 21, 2009, hearing on the Show-Cause Order (the "Show-Cause Hearing"), the Debtors' Chief Executive Officer, Ms. Isaacson, testified that she did not respond to Walgreen's offer to purchase the Oakdale Property because she thought that the Debtors' negotiating power would be weakened if Walgreen's learned that the Debtors had filed for bankruptcy protection. J.A. 1000-01 (Tr. 17:13–18:15). She also testified that, subsequent to the Lift-Stay Hearing, she had finally responded to Walgreens and advised them that the Debtors were now willing to sell the Oakdale Property for $2.7 million. J.A. 1001 (Tr. 18:16-19).

Ms. Isaacson further testified that, at the outset of the bankruptcy cases, she had approached a number of potential lenders to seek financing for the Debtors in their bankruptcy cases, but the potential lenders all refused to consider lending money until the Debtors had formulated a business plan. J.A. 1028-29, 1037 (Tr. 45:2–46:14; 54:13-24). Nevertheless, as of the Show-Cause Hearing six months into the case, the Debtors still had not formulated the business plan that would be required to obtain post-petition financing. J.A. 1029-30 (Tr. 46:15–47:3). The Debtors had an application pending to retain a financial advisor to assist with preparing a business plan, but that application had not been filed until August 18, 2009, after the bankruptcy cases had been pending for five months. *See* Bankr. Ct. Dkt. No. 235; J.A. 1047-49 (Tr. 64: 20-66:10).

The bankruptcy court questioned Ms. Isaacson regarding the Debtors' operations as reflected in the Debtors' monthly operating reports,[7] and stated that the July reports, which were the most recent ones filed, "show losses for virtually each of the operations." J.A. 1004-05 (Tr. 21:21–22:3). Neither Ms. Isaacson nor any other witness called by the Debtors during the Show-Cause Hearing challenged or disagreed with the court's assertion that the monthly operating reports showed that the Debtors were incurring losses; indeed, Ms. Isaacson admitted that, of 23 loans secured by liens on the Debtors' property, the Debtors were only making post-petition payments on 14 or 17 of them. J.A. 0997-98 (Tr. 14:24–15:5). The Debtors' proffered reason for incurring continuing unpaid post-petition obligations on the remaining properties was that the Debtors believed there was equity in those

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[7] Chapter 11 debtors in possession are required to file "periodic reports" of the operation of their business. *See* 11 U.S.C. § 704(a)(8) (made applicable to debtors in possession by 11 U.S.C. §§ 1106(a)(1) and 1107(a)); *see also* Fed. R. Bankr. P. 2015(a)(3).

properties.[8] J.A. 0998 (Tr. 15:9-12). Moreover, as to the properties on which the Debtors received rent, Ms. Isaacson testified that the rents received exceeded the mortgage payments only “slightly,” if at all. J.A. 1021 (Tr. 38:4-8).

Ms. Isaacson also testified that the Debtors were unable to pay the ongoing operating expenses of their amusement park/racetrack operations. J.A. 1008-10 (Tr. 25:13-27:20). Employees worked without pay, and board members made “contributions” to pay certain expenses out-of-pocket, including event-related insurance, utilities, and food costs. *Id.* The Debtors even had to turn down potentially profitable opportunities for the racetrack due to insufficient funds to cover the cost of insuring large events. J.A. 1009 (Tr. 26:11-22)**.**

Ms. Isaacson further testified that the Debtors had not filed tax returns since 2004, and were in the midst of being audited by the Internal Revenue Service. J.A. 1013-14, 1035 (Tr. 30:15–31:8; 52:7-11). Although the Dr. R.C. Samanta Roy Institute of Science and Technology, Inc. is a not-for-profit entity, the other Debtors are not; with a couple of exceptions, the other Debtors filed a combined tax return with the Dr. R.C. Samanta Roy Institute

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[8] A secured creditor may not obtain relief from the automatic stay so as to proceed with foreclosure on real property if the debtor has equity in the property in question. *See* 11 U.S.C. § 362(d)(2)(A).

of Science and Technology because they were wholly-owned, single member entities. J.A. 1014, 1015 (Tr. 31:24-25; 32:9-13).

With regard to the Debtors' cash management, Ms. Isaacson disclosed for the first time in her testimony at the Show-Cause Hearing that approximately $60,000 of cash proceeds from the amusement park/racetrack operations were being stored in a safe located at one of the gas stations owned by the Debtors. J.A. 1040-45 (Tr. 57:14–62:8). Ms. Isaacson testified that she saw "no reason" to deposit the money rather than store it in a safe. J.A. 1041-42 (Tr. 58:19 – 59:2). Ms. Isaacson also testified that no ledger was kept for the monies in the safe, nor were the monies regularly inventoried. J.A. 1041(Tr. 59:13-18). In addition, Ms. Isaacson testified that, while the gas station was open 24 hours a day, it had no security. J.A. 1044-45 (Tr. 61:19–62:5).

Debtors' counsel acknowledged at the Show-Cause Hearing that there was "a question . . . as to whether or not [the money in the safe at the gas station] is debtor or non-debtor money." J.A. 1054 (Tr. 71:3-4). The bankruptcy court directed the Debtors to move the funds from the safe to a bank account, and the Debtors agreed to do so. J.A. 1053-54 (Tr. 70:12–71:09).

After the close of the evidence, counsel to the United States Trustee orally moved “for the relief that’s cited in [the] Show Cause Order.” J.A. 1056 (Tr. 73:20-22). The oral motion was based on Ms. Isaacson’s testimony, and highlighted (i) the Debtors’ continuing loss to or diminution of the estate, (ii) the Debtors’ failure to establish a reasonable likelihood of rehabilitation, and (iii) the Debtors’ failure to previously disclose the cash being held in the safe. J.A. 1056-59 (Tr. 73:20–76:16). The Debtors did not object, procedurally or otherwise, to the United States Trustee’s oral motion at the Show-Cause Hearing. J.A. 1056-59 (Tr. 73:8-76:20).

<u>The Bankruptcy Court’s Dismissal Order</u>

On September 22, 2009, the bankruptcy court issued an order dismissing the Debtors’ cases (the “Dismissal Order”). J.A. 0006-10. In the Dismissal Order, the bankruptcy court set forth a number of factual findings of “cause” to dismiss the cases under Section 1112(b), including the following:

- The “Debtors have, beyond cavil, abused the bankruptcy process” (J.A. 0009);

- The Debtors “belatedly responded to the interested purchaser but only in the face of the Show Cause Order,” which caused the bankruptcy court “concern regarding other lost or delayed opportunities and . . . Debtors inattention to actions [they] could or should be taking to market its assets” (J.A. 0008);

- The Debtors "have not filed tax returns since 2004, including the return for 2008 which was due after the petition date" (J.A. 0007);

- The "Debtors Monthly Operating Reports reveal that they are suffering continuing losses. Despite those losses, they do not have a business plan and therefore were unable at the hearing to meet their burden of proving a reasonable likelihood of rehabilitation" (J.A. 0007-8); and

- The Debtors' previously undisclosed storage of approximately $60,000 in cash in a gas station safe constituted "not only gross mismanagement but, as well, a lack of candor" (J.A. 0008).

The District Court's Order

On October 2, 2009, the Debtors filed a notice of appeal of the Dismissal Order to the District Court for the District of Delaware. J.A. 0980-83. After the parties fully briefed the appeal (J.A. 1094-1135), the district court affirmed the Dismissal Order by order entered on May 25, 2010. J.A. 0004-05. The district court's order expressly found that "dismissal was not an abuse of discretion and was appropriate for the reasons stated in the Bankruptcy Court's Order of Dismissal." J.A. 0004. The district court's order further held that the bankruptcy court "properly found gross mismanagement" warranting dismissal "based upon, among other things: 1) the debtors' failure to consider the purchase offer for the property located in Oakdale, Minnesota; 2) the debtors' failure to file tax returns both before and after the filing of their petition; and 3) the debtors' failure to report and account for nearly $60,000 in cash they were holding in a gas station safe." *Id.*, n.1. The district court further found the Debtors' assertions that the bankruptcy court committed legal error "are without merit." *Id.*

SUMMARY OF ARGUMENT

Under Section 1112(b), a bankruptcy court "shall" convert or dismiss a case, whichever is in the best interests of creditors and the estate, if cause is established, unless the debtor can show "unusual circumstances." 11 U.S.C. § 1112(b). Here, the bankruptcy court found that the following grounds constituted cause to dismiss the Debtors' cases: (i) the Debtors were experiencing continuing loss or diminution of their estates; (ii) the Debtors had still not obtained post-petition financing six months after filing for chapter 11 because they still had not prepared a business plan, and so had no reasonable likelihood of rehabilitation; (iii) the Debtors had not considered Walgreens' offer to purchase the Oakdale Property, and so had engaged in gross mismanagement, unreasonable delay prejudicial to creditors, and a breach of their fiduciary duties; (iv) the Debtors engaged in further gross mismanagement by storing approximately $60,000 in a gas station safe, which money was potentially estate funds but had not been disclosed to the court or the United States Trustee; and (v) the Debtors had failed to file tax returns since 2004, including the post-petition return due for 2008.

All of the bankruptcy court's findings were based on the testimony of the Debtors' Chief Executive Officer at a hearing on a motion for automatic-stay relief filed by a secured creditor and the hearing on the bankruptcy court's ensuing Show-Cause Order. The bankruptcy court's findings, therefore, were not clearly erroneous. As the Debtors were unable to prove the "unusual circumstances" required to avoid dismissal under Section 1112(b)(1) and (2), the bankruptcy court's dismissal of the Debtors' cases was not an abuse of discretion.

None of the Debtors' arguments on appeal support reversal of the bankruptcy court's decision. First, the Debtors argue that the bankruptcy court's interpretation of their monthly operating reports was erroneous, but ignore that at the Show-Cause Hearing the Debtors' own witness did not disagree with the bankruptcy court's characterization and admitted that the Debtors were not paying their post-petition obligations every month. Second, while the Debtors claim that they chose not to market the Oakdale Property and to keep the prospective purchaser ignorant of their chapter 11 status for strategic reasons, the Debtors' decision to hold out for a price three times the value assessed by the Debtors' own expert constitutes gross mismanagement, unreasonable delay, and a breach of fiduciary duty. Third, the Debtors assert that the money in the gas station safe might not be estate property, but until the court determine ownership of the money, the Debtors should have safeguarded it and disclosed the amount and location to the court and the United States Trustee. Fourth, the Debtors introduced no evidence at the Show-Cause Hearing to support their current claim that they were not yet required to file a 2008 federal tax return, and therefore their failure to file that return constitutes cause to dismiss. Fifth, contrary to the Debtors' argument, there is nothing in the Bankruptcy Code that precludes a court from dismissing a case before the expiration of a debtor's exclusive period to file a plan of reorganization, if it is in the best interests of creditors and the estate to do so. Sixth, the Debtors assert that the bankruptcy court erred by considering facts learned during Lift-Stay Hearing in making its finding of cause, but there is no evidence that the court based its decision on anything other than the testimony provided by the Debtors' own witnesses. Seventh, the United States Trustee's oral motion at the Show-Cause Hearing was properly interposed, and, in any event, there is no evidence that the court relied on the United States Trustee's oral motion.

The Debtors also argue that they did not receive adequate notice of the Show-Cause Hearing, but that argument is misguided. As an initial matter, the Debtors never raised the issue at the bankruptcy court, they expressed a readiness to proceed, and they provided considerable testimony. As a result, the Debtors waived the issue of the reasonableness of notice. In any event, the Show-Cause Order on its face was very clear that dismissal under Section 1112(b) would be considered at the hearing, in light of the Debtors' continuing losses, questionable prospects for rehabilitation, failure to consider Walgreens' offer to purchase the Oakdale Property, gross mismanagement and breach of fiduciary duty. As the Debtors had sufficient notice of the matters to be considered, their due process arguments are groundless.

As the bankruptcy court's findings of fact were based on the record and the Debtors have not shown that dismissal was not in the best interests of creditors and the estate, the bankruptcy court's decision to dismiss the Debtors' cases was not an abuse of discretion, and should be affirmed.

ARGUMENT

I. THE BANKRUPTCY COURT'S FINDING OF CAUSE TO DISMISS WAS NOT AN ABUSE OF DISCRETION.

A. Section 1112(b) Requires Conversion or Dismissal Once Cause is Established, Unless the Debtor Shows "Unusual Circumstances."

Section 1112(b)(1) provides that a bankruptcy court "shall" convert or dismiss a case, whichever is in the best interests of creditors and the estate, if "cause" is established. Although Section 1112(b)(4) provides a list of findings that may constitute cause, that list is nonexclusive. *See* 11 U.S.C. § 1112(b)(4) ("[f]or purposes of this subsection, the term 'cause' *includes* . . .") (emphasis added). As a result, the bankruptcy court may, at its discretion, find cause to convert or dismiss a case for reasons other than those set forth in the statute. *See* 11 U.S.C. § 102(3) (in the Bankruptcy Code, the terms "'includes' or 'including' are not limiting"); *In re SGL Carbon Corp.*, 200 F.3d 154, 160 (3d Cir. 1999) ("Section 1112(b), by its terms, therefore, does not preclude consideration of unenumerated factors in determining 'cause.'"); 7 Alan N. Resnick & Henry J. Sommer, *Collier on Bankruptcy* ¶ 1112.04[1] at 1112-20 (16th ed. rev. 2009) ("[T]he court may also convert or dismiss a case for reasons that are not specifically enumerated in the section, provided that these reasons are sufficient to demonstrate the existence of cause.").

The statutorily-enumerated factors constituting cause to convert or dismiss include "substantial or continuing loss to or diminution of the estate and the absence of a reasonable likelihood of rehabilitation" (Section 1112(b)(4)(A)), "gross mismanagement of the estate" (Section 1112(b)(4)(B)), and "failure timely to pay taxes owed after the date of the order for relief or to file tax returns due after the date of the order for relief" (Section 1112(b)(4)(I)).

In addition, a debtor's unreasonable delay may constitute cause to convert or dismiss. *See* 7 Alan N. Resnick & Henry J. Sommer, *Collier on Bankruptcy* ¶ 1112.04[5][c] at 1112-43 (16th ed. rev. 2009)("If it appears that a debtor has engaged in unreasonable delay that is prejudicial to creditors, this may justify a finding of cause to convert or dismiss the case regardless of whether the specific instance is not enumerated in revised section 1112(b).").

Furthermore, a chapter 11 debtor in possession is charged with certain powers and duties of a trustee, including "the trustee's fiduciary duty to maximize the value of the bankruptcy estate" and "the duty to protect and conserve property in its possession for the benefit of creditors." *See Official Committee of Unsecured Creditors of Cybergenics Corp. v. Chinery*, 330 F.3d 548, 573 (3d Cir. 2003) (*en banc*) (duty to maximize value of estate); *In re Marvel Entertainment Grp., Inc.*, 140 F.3d 463, 474 (3d Cir. 1998) (duty to protect and conserve property in its possession); *see also* 11 U.S.C. § 1107 (duties of a debtor in possession); 11 U.S.C. § 1106 (duties of chapter 11 trustee); 11 U.S.C. § 704 (duties of a trustee). The failure to comply with the fiduciary duties of a debtor in possession constitutes cause to convert or dismiss under Section 1112(b). *See, e.g.*, *In re Nugelt, Inc.*, 142 B.R. 661, 666 (Bankr. D. Del. 1992) ("The court finds section 1112(b) cause based on misuse of estate funds and other breaches of the debtor-in-possession's fiduciary duty to the estate and its creditors."); *In re Wells*, 71 B.R. 554, 557 (Bankr. N.D. Ohio 1987) ("A chapter 11 debtor as debtor in possession has certain fiduciary duties, a dereliction of which will subject the case to dismissal.").

Once the bankruptcy court finds cause, the burden shifts to the debtor to prove under Section 1112(b)(1) "unusual circumstances" establishing that conversion or dismissal is not in the best interests of creditors and the estate, or to prove under Section 1112(b)(2) that "there is a reasonable likelihood that a plan will be confirmed . . . within a reasonable period of time" and that the debtor's failures other than "substantial or continuing loss to or diminution of the estate and the absence of a reasonable likelihood of rehabilitation" are subject to "a reasonable justification" and "will be cured within a reasonable period of time." *See, e.g.*, *In re Van Eck*, 425 B.R. 54, 63 (Bankr. D. Conn. 2010) ("Once the movant has established 'cause' . . . , the burden shifts to the Debtor to establish the exceptions provided for by Section 1112(b)."); *In re Gateway Access Solutions, Inc.*, 374 B.R. 556, 561 (Bankr. E.D. Pa. 2007) ("If the Movants establish 'cause,' then the burden shifts to the Debtor to prove it falls within the § 1112(b)(2) 'unusual circumstances' exception to § 1112(b)(1)'s mandatory conversion.").

B. <u>The Bankruptcy Court's Finding of Cause to Dismiss Was Supported by the Record Developed at the Lift-Stay Hearing and Show-Cause Hearing</u>.

1. **The Evidence Before the Bankruptcy Court Supported the Finding of a Continuing Loss to or Diminution of the Debtors' Estates and the Absence of a Reasonable Likelihood of Rehabilitation.**

Under Section 1112(b)(4)(A), "substantial or continuing loss to or diminution of the estate and the absence of a reasonable likelihood of rehabilitation" constitutes cause to dismiss a chapter 11 case. The bankruptcy court found that that the Debtors were "suffering continuing losses," "were unable at the hearing to meet their burden of proving a reasonable likelihood of rehabilitation," and "have been unable to obtain necessary financing without a business plan." J.A. 0007-08 (Dismissal Order). As the record before the bankruptcy court supported these factual findings, the dismissal of the Debtors' cases was not an abuse of discretion and should be affirmed.

a. The Debtors' Testimony Reveals Continuing Loss to or Diminution of Estate Assets.

When a debtor in possession cannot meet its post-petition obligations, the ensuing accumulation of unpaid expenses exemplifies a negative cash flow, which is sufficient to establish a continuing loss to or diminution of the estate. *See Loop Corp. v. United States Trustee (In re Loop Corp.)*, 379 F.3d 511, 515-16 (8th Cir. 2004), *cert. denied*, 543 U.S. 1055 (2005).

The bankruptcy court found, based on the evidence introduced at the Lift-Stay Hearing, that the Debtors had a "precarious cash flow status" and "continuing operational loss," and based on the evidence introduced at the Show-Cause Hearing that "Debtors['] Monthly Operating Reports reveal that they are suffering continuing losses." J.A. 0006-07 (Dismissal Order). As a result, the bankruptcy court held that under Section 1112(b) "dismissal is mandatory." J.A. 0007.

The bankruptcy court's findings regarding the Debtors' cash flow and continuing losses were consistent with the evidence presented by the Debtors. At the Lift-Stay Hearing, the Debtors' Chief Executive Officer, Naomi Isaacson, testified that Debtor Midwest Oil of Minnesota LLC had not made any post-petition mortgage or real estate tax payments on the Oakdale Property. J.A. 0090-91 (9/14/09 Tr. 18:20–19:9). At the Show-Cause Hearing, the Debtors' Chief Executive Officer testified that Debtors Midwest Properties of Shawano LLC and R.C. Samanta Roy Institute of Science and Technology, Inc. were not paying all of their secured lenders post-petition. J.A. 0997-98, 1007-08 (Tr. 14:19–15:8; 23:25–24:18).

In addition, at the Show-Cause Hearing the bankruptcy court stated that the Debtors' July monthly operating reports "show losses for virtually each of the operations" and asked the Debtors' Chief Executive Officer to explain. J.A. 1004 (Tr. 21:21–22:3). In response, Ms. Isaacson did not disagree with the court's characterization of the content of the monthly reports, and she certainly did not testify that each of the Debtors was actually showing a net profit every month. To the contrary, she testified that Midwest Oil of Shawano "had kind of an unusual month in July due to some competition in the marketplace so hence the loss." J.A. 1007 (Tr. 24:1-3). Ms. Isaacson also testified that the Debtors had a decrease in rental income. *Id*. (Tr. 24:13-15). She further confirmed that the Debtors were only making mortgage payments to two-thirds of their lenders. *Id*. (Tr. 24:15-17). In addition, Ms. Isaacson testified that the Debtors did not have sufficient cash flow to fund their amusement park/racetrack operations, causing them to turn business away. J.A. 1008 (Tr. 25:18–27:12).

The Debtors argue in their opening brief that the bankruptcy court's interpretation of the monthly operating reports was inaccurate, and that at the Show-Cause Hearing the court only considered July 2009 reports rather than all of the reports filed through the entirety of the Debtors' cases. Appellants' Brief at 32. The Debtors' belief that the bankruptcy court viewed only the July 2009 operating reports appears to be based on the court's specific mention of those reports in its questioning of Ms. Isaacson at the Show-Cause Hearing. *See* Appellants' Brief at 32, citing J.A. 1004 (Tr. 21). But in the Show-Cause Order itself, the bankruptcy court indicated that it had reviewed the monthly operating reports in identifying the "continuing loss" that caused the court concern, without specifying a particular month or months. J.A. 0899. The Debtors had ample opportunity to present evidence that they were operating profitably – if such evidence exists – but they did not do so. As a result, the record before the bankruptcy court reflected only Ms. Isaacson's testimony acknowledging continued losses and diminution of the Debtors' estates, with no evidence to the contrary.

Ms. Isaacson's testimony at the Lift-Stay Hearing and Show-Cause Hearing indicates that the Debtors' cash flow problems were such that they were unable to pay post-petition obligations as they became due, which constitutes a continuing loss. In addition, her testimony regarding "competition in the marketplace," the decrease in rental income, and the turning away of business all indicate a diminution of the Debtors' estates. As a result, the bankruptcy court's decision to dismiss the Debtors' cases was supported by the record, and should be affirmed.

b. The Debtors' Testimony Reveals the Absence of a Reasonable Likelihood of Rehabilitation.

The second element of "cause" under Section 1112(b)(4)(A) is "the absence of a reasonable likelihood of rehabilitation." The bankruptcy court found that the Debtors still did not have a business plan and could not show a reasonable likelihood of rehabilitation. J.A. 0007-08 (Dismissal Order). The court's findings are supported by the admission of the Debtors' Chief Executive Officer that, six months after filing for bankruptcy, the Debtors still did not have a business plan, despite the fact that all potential post-petition lenders had insisted that they would not even consider lending to the Debtors in the absence of a business plan. J.A. 1-28-30, 1038 (9/21/09 Tr. 45:2-47:3; 55:13-24). The bankruptcy court acknowledged that the Debtors had recently hired a financial advisor to help develop a business plan, but found that they had waited too long to do so, and during the interim their businesses continued to falter. J.A. 0008.

In light of the testimony, it was not clear error for the bankruptcy court to find that the Debtors' continuing losses, "when joined with the absence of a plan to rehabilitate and lengthy inaction in obtaining financing or bringing efforts to the Court for maximizing the value of their assets for the benefit of creditors," necessitated dismissal. J.A. 0009.

2. **The Debtors' Failure to Consider Walgreen's Offer for the Oakdale Property Constitutes Gross Mismanagement, Unreasonable Delay Prejudicial to Creditors, and Breach of Fiduciary Duties.**

Under Section 1112(b)(4)(B), "gross mismanagement of the estate" constitutes cause to dismiss a chapter 11 case. In addition, unreasonable delay prejudicial to creditors and breach of fiduciary duty may constitute cause to dismiss. The bankruptcy court found that the Debtors had initially "not responded to a party interested in purchasing valuable real property which was vacant and therefore a financial drain rather than an income producing asset," and had "belatedly responded to the interested purchaser but only in the face of the Show Cause Order." J.A. 0007-08 (Dismissal Order). This caused the bankruptcy court "concern about other lost or delayed opportunities and, moreover, to Debtors['] inattention to actions [they] could or should be taking to market [their] assets." J.A. 0008. The bankruptcy court held that the Debtors' "lengthy inaction in . . . bringing efforts to the Court for maximizing the value of their assets," combined with its other factual findings, necessitated dismissal as they were "at odds with the requirements for maintaining a Chapter 11 case." J.A. 0009.

At the Lift-Stay Hearing, the Debtors' Chief Executive Officer testified that she had not pursued an offer from Walgreens to purchase the Oakdale Property – a vacant, non-operating gas station on which the Debtors were not making mortgage or real estate tax payments**.** J.A. 0090-91, 0347, 0350-51 (9/14/09 18:20-19:19, 275:13-19, 278:18 – 279:4). The testimony further established that the rejected offer price of $2.5 million was within the range of reasonableness established by the Debtors' own expert. *See* J.A. 0164, 0193-94 (9/14/09 Tr. 92:8-24; 121:21-122:18). Nevertheless, Walgreens' offer was not pursued because, for some unknown reason, the Debtors' board of directors was holding out for $7 million – an amount nearly three times what their own expert determined the property was worth. *See* J.A. 0350-51 (9/14/09 Tr. 278:18-279:4). The Debtors also did not pursue Walgreens' offer because they were concerned that their negotiating power would weaken once Walgreens learned they were in bankruptcy. J.A. 1000-01 (9/21/09 Tr. 17:13–18:15). It was only after the Lift-Stay Hearing that the Debtors responded to Walgreens' offer. J.A. 1001 (9/21/10 Tr. 18:16-19).

As a fiduciary, the Debtors were charged with maximizing the value of their estates for the benefit of their creditors; since they did not pursue reasonable offers to purchase estate assets, they breached their fiduciary duty. In addition, the Debtors' failure to pursue Walgreens' offer constitutes both "gross mismanagement of the estate" and unreasonable delay that is prejudicial to creditors. And, at the Show-Cause Hearing, the Debtors were unable to prove that their failures as a fiduciary are subject to a "reasonable justification" and "will be cured within a reasonable period of time," as required by Section 1112(b)(2). As a result, the bankruptcy court's dismissal of the Debtors' cases was not an abuse of discretion. *See, e.g.*, *In re Robino*, 243 B.R. 472, 488 (Bankr. N.D. Ala. 1999) (case dismissed due to debtor's failure to market properties to "reap maximum benefits"); *In re Halpern*, 229 B.R. 67, 75 (Bankr. E.D.N.Y. 1999) (case dismissed where debtor was given ample opportunity to sell estate's real property but chose not to do so).

The Debtors argue in the Appellants' Brief at 34 that their reason for not responding to Walgreens' offer boils down to one word: "strategy." Of course, this is the problem – as a fiduciary for the estate, it was incumbent upon the Debtors to maximize the value of the estates, not to engage in gamesmanship. As any sale of the Oakdale Property would be subject to court approval under 11 U.S.C. § 363, there would have been no way to sell the property during the chapter 11 case without all parties involved being keenly aware that the Debtors were in bankruptcy.

As a result, Debtors' argument that they refused to market the Oakdale Property in order to increase its sale value makes no sense. *See* Appellants' Brief at 35. By refusing to negotiate with prospective purchasers while they were in bankruptcy, the Debtors ensured that they would never sell the Oakdale Property assets while they were in bankruptcy – so the bankruptcy estates never stood to benefit from the "strategic" inaction of their fiduciary. Either the Debtors planned to surreptitiously sell their assets outside of the knowledge of the bankruptcy court and creditors (to unwitting purchasers ignorant of the Debtors' bankruptcy filing), or they never actually planned to sell their assets for the benefit of creditors during the bankruptcy case. Either way, for six months they engaged in gross mismanagement, unreasonable delay, and breach of fiduciary duty.

As the bankruptcy court's finding that the Debtors had not timely responded to Walgreens' offer to purchase the Oakdale Property was supported by the record, it was not clearly erroneous. This finding led the bankruptcy court to understandable concern about other opportunities that may have been lost or delayed due to the Debtors' inattention to marketing its assets. J.A. 0008 (Dismissal Order). The Debtors did not carry their burden to show "unusual circumstances" that made it in the best interests of creditors and the estate to allow the cases to continue in chapter 11. In light of this record, the bankruptcy court's dismissal of the Debtors' case was not an abuse of discretion, and should be affirmed.

3. The Mismanagement of Funds That Were Arguably Estate Property Constitutes "Cause" for Dismissal.

In furtherance of its fiduciary duties, a debtor in possession must safeguard estate funds, or money that might ultimately be found to be estate funds, by "mak[ing] such deposit or investment of the money . . . as will yield the maximum reasonable net return on such money, taking into account the safety of such deposit or investment." 11 U.S.C. § 345(a). Thus, "safeguarding cash is important in every case, particularly when the debtor is a business of any sort." 3 Alan N. Resnick & Henry J. Sommer, *Collier on Bankruptcy* ¶ 345.02 at 345-4 (16th ed. rev. 2009). As a result, a debtor in possession "should not allow funds to remain in non-interest bearing accounts for any length of time." *Id*. ¶ 345.03 at 345-6; *cf. Judge v. Pincus, Verlin, Hahn & Reich, P.C. (In re J & J Record Distrib. Corp.)*, 84 B.R. 364, 369 (E.D. Pa. 1988) (counsel to debtor in possession has affirmative duty to deposit or invest funds when it appears they will remain idle for a long period of time).

The bankruptcy court found that the Debtors were holding approximately $60,000 in a gas station safe, which had not previously been disclosed to the court or the United States Trustee. J.A. 0008 (Dismissal Order). The court found that "[s]uch 'cash management' constitutes not only gross mismanagement but, as well, a lack of candor." *Id.* Indeed, the court found that the Debtors' nondisclosure of these funds and the way they were maintained constituted "malfeasance." J.A. 0009.

In her testimony at the Show-Cause Hearing, Ms. Isaacson testified that the money kept in the safe was not maintained in a ledger or inventoried, and the gas station where it was stashed had no security. J.A. 1040 (Tr. 59:13-18); J.A. 1045 (Tr. 62:4-5). In addition, Debtors' counsel at the Show-Cause Hearing acknowledged that there was "a question . . . as to whether or not [the money in the safe at the gas station] is debtor or non-debtor money." J.A. 1054 (Tr. 71:3-4).

The Debtors argue in the Appellants' Brief at 38 that the funds at issue were "not conclusively owned" by the Debtors, as the bankruptcy court "had not yet ruled on the issue" as to whether the money was owned by the Debtors or a non-debtor affiliate. As a result, the Debtors felt they "were under no obligation to report" the existence of these funds to the bankruptcy court or the United States Trustee. Appellants' Brief at 37. In addition, as Ms. Isaacson testified, the Debtors felt no imperative to deposit the money rather than stash it in a safe, because, until the bankruptcy court ruled on ownership, the Debtors "couldn't use it." Appellants' Brief at 39 (citing J.A. 1041 (Tr. 58:21-22)).

To the extent that there was any question about whether these funds could possibly belong to one of the Debtors, they had to be safeguarded in an appropriate manner, such as depositing them in a bank account – not keeping $60,000 in cash in a safe in a gas station open 24 hours a day with no security. The Debtors were also required to account for all funds that came into their possession by reporting them in their monthly operating reports and other court filings, even if accompanied by a notation that there was a question as to whether the funds were owned by the Debtors. *See* 11 U.S.C. § 704(a)(2) (trustee must "be accountable for all property received"); 11 U.S.C. § 1106(a)(1) (making § 704(a)(2) applicable to chapter 11 trustees); 11 U.S.C. § 1107 (making § 1106(a)(1) applicable to debtors in possession).

In addition, the Debtors did not make any showing of "unusual circumstances" that made it better for creditors to keep the case in chapter 11 rather than dismiss it, as would be required under Section 1112(b)(1) to avoid dismissal. Similarly, the Debtors did not make a sufficient showing that their cash management was subject to a "reasonable justification" or would be "cured within a reasonable period of time," as would be required under Section 1112(b)(2) to avoid dismissal.

In light of the record developed at the Show-Cause Hearing, the bankruptcy court's dismissal of the Debtors' cases was not an abuse of its discretion and should be affirmed.

4. The Debtors' Chronic Failure to File Tax Returns Constitutes Cause to Dismiss.

Under Section 1112(b)(4)(I), the failure to pay taxes owed after the Debtors' chapter 11 petitions were filed, or to file tax returns due post-petition, constitutes cause to dismiss. The bankruptcy court found that the Debtors had failed to file tax returns since 2004, including the returns for 2008 – which became due after the Debtors filed their bankruptcy petitions. J.A. 0007 (Dismissal Order). As the record before the bankruptcy court supported this finding of fact, such finding was not clearly erroneous and the bankruptcy court's dismissal of the Debtors' cases was not an abuse of discretion.

The Debtors' Chief Executive Officer testified at the Show-Cause Hearing that the Debtors had not filed federal tax returns since 2004 (which included the 2008 returns that were due post-petition). J.A. 1013-14, 1015 (Tr. 30:23 - 31:8, 32:9-25). The Debtors' failure to file the 2008 tax return is statutory cause to dismiss under Section 1112(b)(4)(I). Furthermore, although the failure to file pre-petition tax returns is not included in Section 1112(b)'s nonexclusive list, it may still constitute cause to dismiss when combined with a number of other failings of a faithless fiduciary. As a result, the bankruptcy court did not abuse its discretion in dismissing the Debtors' cases under Section 1112(b)(4)(I).

The Debtors assert at page 24 of the Appellants' Brief that Section 1112(b)(4)(I) applies only to tax returns and tax payments for post-petition "periods." The Debtors' interpretation finds no support in the statutory language – the Debtors' 2008 income taxes were "owed," and their 2008 tax returns "due," after their March 16, 2009, filing date. The statute makes no mention of the period in which the taxes were incurred.

The Debtors' interpretation also finds no support in the cases cited in the Appellants' Brief at 24, neither of which stands for the proposition that a case cannot be dismissed for the failure to file tax returns for pre-petition periods that are due to be filed with the taxing authorities after the petition filing date. In *In re Pittsfield Weaving Co*., 393 B.R. 271, 274 (Bankr. D.N.H. 2008), the case was dismissed for nonpayment of $180,000 in "unpaid post-petition taxes"; the court did not state that the taxes were all incurred during post-petition periods, nor did it specify whether the taxes in question were income taxes, real estate taxes, or other taxes. In addition, the *Pittsfield Weaving* court made no reference to pre or post-petition tax returns. In *In re Berryhill*, 189 B.R. 463 (N.D. Ind. 1995), the case was dismissed for nonpayment of post-petition federal income taxes for 1993, in a chapter 11 case filed in September 1993; the IRS's motion was filed in 1994, and the court did not state that the taxes were all incurred during post-petition periods. Thus, *Berryhill* actually supports the United States Trustee's position. Given the fiduciary duties of a chapter 11 debtor in possession, it is no surprise that the Debtors were unable to find a case that says a debtor in possession may flout the tax laws and still avoid having its case converted or dismissed.

In addition, the Debtors assert in the Appellants' Brief at 24 that their 2008 tax returns were not yet due at the time of the Show-Cause Order, as they had received an extension. But the Debtors introduced no evidence at the Show-Cause Hearing to support this alleged "fact," so it cannot be used in this appeal to assess whether the bankruptcy court's factual findings were clearly erroneous. *See* J.A. 1013-14 (9/21/09 Tr. 30:23-31:1)(testimony of Ms. Isaacson that the Debtors "have not filed the current returns," but providing no testimony that such return was not yet due). The Debtors' attempt to introduce facts on appeal that were not before the bankruptcy court is improper, as "[t]he only proper function of a court of appeals is to review the decision below on the basis of the record that was before the [bankruptcy] court." *Fassett v. Delta Kappa Epsilon (New York)*, 807 F.2d

1150, 1165 (3d Cir. 1986), *cert. denied sub nom. Turgiss v. Fassett*, 481 U.S. 1070 (1987). Filing a notice of appeal does not afford the Debtors a second chance to introduce evidence they never introduced at the Show-Cause Hearing.

Furthermore, the Debtors argue at page 24 of the Appellants' Brief that they had not filed tax returns since 2004 because they were in the midst of an IRS audit. But the Debtors cite no authority to support the theory that taxpayers under audit do not have to comply with their ongoing obligations to file tax returns and pay taxes.

The Debtors further assert at page 24 of their brief that they "have no income tax liability," and their "obligation to file the return is merely a reporting requirement," because Debtor Dr. R.C. Samanta Roy Institute of Science & Technology, Inc. is a not-for-profit organization under Internal Revenue Code section 501(c)(3) (26 U.S.C. § 501(c)(3)). This argument in misguided, as even a section 501(c)(3) organization may still be liable for tax on its unrelated business income, and it may still incur penalties for failing to timely file returns. *See* Internal Revenue Service, the Tax and Filing Requirements, http://www.irs.gov/publications/p598/ch02.html; Internal Revenue Service, Annual Exempt Organization Return: Penalties for Failure to File (page last reviewed or updated Nov. 13, 2009), http://www.irs.gov/charities/article/0,,id=152725,00.html. In any event, the Debtors have not established that they have no tax liability, and nothing in the record supports the Debtors' assertion in this regard.

As none of their explanations are satisfactory, the Debtors failed to demonstrate the "unusual circumstances" required by Section 1112(b)(1) to avoid dismissal. Similarly, the Debtors were unable to prove that their failures to pay taxes and file tax returns were subject to a "reasonable justification" and "will be cured within a reasonable period of time," as is required by Section 1112(b)(2) to avoid dismissal.

In sum, the bankruptcy court's dismissal of the Debtors' cases was not an abuse of the discretion in light of the Debtors' failure to file post-petition tax returns.

C. The Debtors' Remaining Arguments Do Not Support Reversal.

1. The Bankruptcy Court Did Not Err By Dismissing the Debtors' Cases Before the Expiration of the Exclusive Period to File a Plan.

The Debtors argue at pages 22 and 23 of the Appellants' Brief that the bankruptcy court erred as a matter of law by dismissing their cases before expiration of the exclusive period during which only the Debtors may file a plan of reorganization. Under 11 U.S.C. § 1121(b), "only the debtor may file a plan until after 120 days after the date of the order for relief." The exclusive period may be extended upon a showing of cause. *See* 11 U.S.C. § 1121(d). Nothing in this or any other section of the Bankruptcy Code, however, provides that a case cannot be dismissed during the exclusive period if, in the bankruptcy court's discretion, it finds that dismissal is in the best interests of creditors or the estate.

The Debtors' interpretation of 11 U.S.C. § 1121 as providing a "safe harbor" from dismissal in cases of continuing losses, gross mismanagement, and breach of fiduciary duty is untenable. All of the cases cited by the Debtors are distinguishable based on the grounds on which dismissal was sought, and none stand for the proposition that, as a matter of law, the bankruptcy court is prohibited from dismissing a case until the exclusive period has expired. *See In re Century/ML Cable Venture*, 294 B.R. 9, 36-37 (Bankr. S.D.N.Y. 2003) (dismissal sought for bad faith filing; § 1121(b) not analyzed by court); *In re Coleman Enterprises, Inc.*, 266 B.R. 423, 440-41 (Bankr. D. Minn. 2001)(debtor's motion to dismiss denied so that creditor could pursue its own plan); *In re Toyota of Yonkers, Inc.*, 135 B.R. 471, 476-77 (Bankr. S.D.N.Y. 1992) (dismissal sought for bad faith filing and failure to effectuate plan).[9] Each of the cases cited by the Debtors refers to

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[9] The Debtors' citation of *In re Coleman Enterprises, Inc.* is misleading at best. In that case, the debtor sought to dismiss its own case, the United States Trustee sought to convert the case to chapter 7, and a creditor asked

superseded Section 1112(b), which prior to the 2005 amendments to the Bankruptcy Code included "inability to effectuate a plan" in the nonexclusive list of factors that may constitute cause to dismiss. The bankruptcy court below, however, did not base dismissal on the Debtors' failure to file a plan of reorganization – it based dismissal on the Debtors' continuing losses, delay in formulating a business plan, failure to maximize the value of estate assets, mismanagement of funds, and failure to file post-petition tax returns.

As a result, the Debtors' argument that the bankruptcy court committed legal error by dismissing the cases before the expiration of the exclusive period "is without merit." *See In re McDonald*, No. 93-4176, 1994 WL 160484 at *2-3 (E.D. La. Apr. 22, 1994) (affirming dismissal of chapter 11 case during exclusive period; district court refused to "imply a mandatory waiting period before a party is granted access to [Section 1112(b)]").

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the court to invoke its equitable powers under 11 U.S.C. § 105(a) to keep the case in chapter 11 so that it could pursue its own plan. *See* 266 B.R. 423 (Bankr. D. Minn. 2001). Thus, the court in *Coleman Enterprises* did not, as the Debtors suggest, hold that dismissal during the debtor's exclusive period was inappropriate; instead, debtor's motion to dismiss was denied as "fundamentally inconsistent with the requirements and protections of the bankruptcy process," the United States Trustee's motion to convert was "held in abeyance," and it was the creditor, QAL, which the court thought should be "given a chance" to confirm its plan. *Id*. at 438, 440, 441.

2. The Bankruptcy Court Did Not Err By Considering Facts Learned During Lift Stay Proceedings.

The Debtors contend at pages 29 through 32 of the Appellants' Brief that the bankruptcy court erred by basing its finding of cause to dismiss on "assertions outside of the record." As the Dismissal Order gave no indication that the bankruptcy court's decision was based on anything other than the evidence developed at the Lift-Stay Hearing and the Show-Cause Hearing, it is not clear what point the Debtors are trying to make. The Appellants' Brief is all the more indecipherable as it is based on what the Debtors think "appeared" to be the basis for the bankruptcy court's decision, without any record or case citation to support their position.

The crux of the Debtors' argument seems to be that the bankruptcy court dismissed the Debtors' cases while motions for relief from the automatic stay were pending, and the court may have applied what it learned in those proceedings to its determination of whether the cases should be dismissed. There is no legal basis for the Debtors' suggestion that 11 U.S.C. § 362 provides a "safe harbor" whereby chapter 11 cases cannot be dismissed while there are pending motions for stay relief. To the contrary, Section 1112(b) affords the bankruptcy court the discretion to find cause and, absent unusual circumstances, requires dismissal or conversion upon the finding of cause.

It should come as no surprise that evidence presented by the Debtors at the Lift-Stay Hearing may have formed part of the basis of the bankruptcy court's decision to dismiss the cases, as it was the Debtors' Chief Executive Officer's testimony at the Lift-Stay Hearing that caused the bankruptcy court to enter the Show-Cause Order. The Debtors have cited no authority to suggest that the bankruptcy court cannot base a finding of cause to dismiss on the debtor's own sworn testimony. In any event, the same matters that caused concern at the Lift-Stay Hearing were fully developed at the Show-Cause Hearing.

Indeed, Ms. Isaacson's testimony at the Show-Cause Hearing introduced even more concern, as she disclosed that the Debtors were storing cash – which may or may not be estate funds – in a gas station safe. The Debtors acknowledge at page 30 of the Appellants' Brief that "the ownership of the cash was . . . still undecided" by the bankruptcy court. This admission does not support the Debtors' argument for reversal; to the contrary, it is an indictment of the Debtors' cash management and candor. If it was not clear before, it is certainly clear after reading the Appellants' Brief – the Debtors had no intention of disclosing, marketing, or doing anything unless they were forced to by the court. This was not in keeping with their fiduciary duty to creditors and the estate, so dismissal was appropriate.

As the bankruptcy court's decision was based on evidence presented by the Debtor at the Lift-Stay Hearing and Show-Cause Hearing, and the Debtors have presented no record or legal citation supporting their suggestion that the court's decision was based on "assertions not of record," the Debtors' arguments in this regard are unavailing.

3. The Bankruptcy Court Did Not Improperly Rely on the United States Trustee's Oral Motion.

The Debtors also argue at pages 36 through 37 of the Appellants' Brief that the bankruptcy court improperly relied upon the United States Trustee's oral motion made at the Show-Cause Hearing. The Debtors' argument lacks merit. As an initial matter, the hearing was a Show-Cause Hearing at which sua sponte dismissal was already to be considered, and the resulting Dismissal Order referenced only the Show-Cause Order and did not mention the United States Trustee's oral motion at all. Thus, there is no basis to assume that the Dismissal Order was based on anything other than the evidence adduced at the Show-Cause Hearing.

In any event, the United States Trustee's oral motion was properly tendered, and the Debtors did not lodge a procedural objection at the Show-Cause Hearing. *See* Fed. R. Bankr. P. 9013. Counsel to the United States Trustee did not "rely[ ] upon information not before" the court at the Show-Cause Hearing, as suggested by the Debtors at page 36 of their brief; instead, the motion was expressly based on "[the court's] questions directed to Ms. Isaacson and the responses thereto." J.A. 1057 at 74:5-6. Thus, the Debtors' due process argument is unavailing as it relates to the United States Trustee's oral motion – since the Debtors knew dismissal under Section 1112(b) and the appointment of a trustee under 11 U.S.C. § 1104 were to be considered at the Show-Cause Hearing, and the United States Trustee's motion was based on the testimony of the Debtors' own witness, the Debtors were not prejudiced in any way by the United States Trustee's oral motion.

And, as the oral motion was procedurally sound and the bankruptcy court's finding of cause to dismiss was supported by the facts developed at the Show-Cause Hearing, the Dismissal Order would not have been an abuse of discretion even if it had been based on the United States Trustee's oral motion.

II. THE NOTICE AND HEARING RECEIVED BY THE DEBTORS WERE ADEQUATE FOR PURPOSES OF SECTION 1112(b).

A. Debtors' Failure to Raise the Issue of Adequacy of Notice Before the Bankruptcy Court Constitutes a Waiver of the Issue.

The Debtors contend that they did not receive "sufficient notice of the subject matter" of the Show-Cause Hearing, were unprepared to make the required evidentiary showing, and thus "were deprived of their due process rights." Appellants' Brief at 25-28. But the Debtors never objected, either before or during the Show-Cause Hearing, that they had inadequate notice of the subject matter, inadequate time to prepare, or an inadequate opportunity to present all evidence relevant to a Section 1112(b) motion.[10] To the contrary, Debtors presented evidence that they clearly thought responsive to the bankruptcy court's concerns. Indeed, Debtors' counsel expressly stated at the Show-Cause Hearing that the Debtors "will be prepared to and can present the testimony to you to demonstrate that we have been moving this along." J.A. 0994 (Tr. 11:5-6).

By participating in the Show-Cause Hearing without objecting in bankruptcy court to the sufficiency of the notice, the Debtors waived the issue, so it is not properly before this Court on appeal. *See, e.g.*, *First Nat'l Bank of Peoria v. Muller (In re Muller)*, 851 F.2d 916, 919 (7th Cir. 1988), *cert. denied sub nom. Rogers v. First Nat'l Bank of Peoria*, 490 U.S. 1007 (1989) ("If, as Rogers argues to this court, the notice of trial was not adequate to alert him that it was a trial, then he should have revealed that

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[10] In contrast to the Debtors' silence regarding the Show-Cause Order, the Debtors did respond in writing to papers filed by certain of the Debtors' secured lenders on procedural grounds, asserting that they "ha[d] not had adequate notice of the relief sought by the Lenders, nor the opportunity to prepare therefor." Bankr. Ct. Dkt. 288 (Debtors' Response in Opposition to Statement of Southwest Guaranty, Ltd. and its Lender Affiliates in Support of Dismissal or Conversion of the Debtors' Chapter 11 Cases), at 2.

concern when he appeared, but before he actively participated."); 9 Alan N. Resnick & Henry J. Sommer, *Collier on Bankruptcy* ¶ 2002.02 [6][j] at 2002-25 (16th ed. rev. 2009); *see also Kirk v. Raymark Indus., Inc.*, 61 F.3d 147, 156 (3d Cir. 1995) ("[I]t is well established that failure to raise an issue in the district court constitutes waiver of that argument.") (internal citation(s) omitted).

B. The Notice and Hearing Afforded to the Debtors Were Adequate Under the Circumstances.

Even if the Debtors are not deemed to have waived the notice issue, the amount and extent of the notice and hearing provided to the Debtors was sufficient, and the dismissal of the Debtors' cases should be affirmed. While Section 1112(b) provides that a chapter 11 case may only be dismissed "after notice and a hearing," that phrase "means after such notice as is appropriate in the particular circumstances, and such opportunity for a hearing as is appropriate in the particular circumstances." *See* 11 U.S.C. § 102(1)(A). Thus, the determination of whether the Debtors received adequate notice and hearing is fact-sensitive, and the bankruptcy court's decision is merely reviewed for abuse of discretion.

In September 2009, Federal Rule of Bankruptcy Procedure 2002(a)(4) ("Rule 2002(a)(4)") generally required a Section 1112(b) motion to be made on at least 20 days' notice by mail to all parties in interest.[11] Rule 2002(a)(4) is subject to Federal Rule of Bankruptcy Procedure 9006(c)(1), however, which allows the bankruptcy court to reduce the required notice period "for cause shown."

Here, the bankruptcy court properly set the Show-Cause Hearing for September 21, 2009, in light of its concerns regarding the Debtors' apparent mismanagement of their chapter 11 cases, based on the testimony introduced at the Lift-Stay Hearings held on September 14 and 15, 2009. The potential harm to creditors and the estate from the Debtors' gross mismanagement and breaches of fiduciary duty was such that the bankruptcy court obviously determined that a hearing on the Show-Cause Order had to take place as soon as possible. This decision was not an abuse of discretion given the record developed at the Lift-Stay Hearing. Although they were afforded less than one week's notice, the Debtors nevertheless had sufficient time to put together the evidence required to carry their burden under Section 1112(b). They were unsuccessful because such evidence did not exist, not because of insufficient notice and hearing. Even now, the Debtors do not contend that they were deprived of an opportunity to present evidence that would have yielded a different result at the Show-Cause Hearing.

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[11] Rule 2002(a)(4) has since been amended to provide 21 days' notice.

The Debtors' argument that the Show-Cause Order did not provide sufficient notice of the subject matter of the Show-Cause Hearing is misguided. The Show-Cause Order on its face notified the Debtors that at the hearing they were to "show cause why the Court should not dismiss the cases or appoint a Chapter 11 Trustee." J.A. 0900. Indeed, the Show-Cause Order actually itemized the specific issues that would be addressed at the hearing, including the Debtors' failure to consider the offer to purchase the Oakdale Property, their failure to make post-petition payments, their continuing losses as reflected in their monthly operating reports, the gross mismanagement and breach of fiduciary duty suggested by such "substantial or continuing loss to or diminution of the estate," and their prospects for rehabilitation. J.A. 0899. The Show-Cause Order even cited Section 1112. *Id*. As a result, the Debtors clearly had sufficient notice that at the Show-Cause Hearing they would be required to make the showing necessary to overcome a Section 1112(b) motion.[12]

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[12] The only case cited by the Debtors in support of their due process argument, *Martin v. Brown*, 63 F.3d 1252 (3d Cir. 1995), is inapposite. That case dealt with attorney sanctions, not Section 1112(b) dismissal, and the sanctioned attorney had not received prior notice of the provision pursuant to which sanctions would be assessed. *Id*. at 1264. Here, on the other hand, the Show-Cause Order clearly identified dismissal under Section 1112(b) and appointment of a trustee under 11 U.S.C. § 1104 as the remedies that would be considered at the Show-Cause Hearing.

The only significant issue addressed at the Show-Cause Hearing that was not specified in the Show-Cause Order was the Debtors' placement of approximately $60,000 in cash in a gas station safe – which was not known to the bankruptcy court until it was disclosed by the Debtors' Chief Executive Officer at the Show-Cause Hearing, and so could not have been referenced in the Show-Cause Order. The Debtors knew about that money all along, however, so they cannot be heard to complain that they were caught by surprise by their own witness's testimony at a hearing at which dismissal under Section 1112(b) was being considered.

The same "inadequate notice" argument made by the Debtors here was rejected in *Argus Group 1700, Inc. v. Steinman (In re Argus Group 1700, Inc.*), 206 B.R. 757 (E.D. Pa. 1997). In that case, the debtors argued on appeal that they were not provided with adequate notice of and opportunity to respond to the bankruptcy court's *sua sponte* motion to dismiss. *Id*. at 763. The debtors "assured the bankruptcy court that they were prepared to present evidence" at the hearing, and the debtor's principal then provided testimony. *Id*. at 764. In light of these facts, the district court stated that "it is clear that the bankruptcy court provided the debtors with adequate notice and an opportunity to respond, and that the debtors actively participated in the proceedings, *fully aware that the bankruptcy court might* *dismiss their cases sua sponte*." *Id*. (emphasis added). The same is true here.

As the notice, albeit short, was warranted in light of the seriousness of the bankruptcy court's concerns and sufficient to enable the Debtors to prepare the necessary defense to a Section 1112(b) motion, the Debtors' due process arguments are unwarranted.

CONCLUSION

For the reasons set forth above, the United States Trustee respectfully asks this Court to affirm the district court's order affirming the bankruptcy court's Dismissal Order.

Respectfully submitted,

ROBERTA A. DeANGELIS
UNITED STATES TRUSTEE
REGION 3

BY: *<u>/s/ Juliet Sarkessian</u>*
T. Patrick Tinker (FL # 64874)
Acting Assistant United States Trustee
Juliet Sarkessian, Esquire (PA # 57952)
Robert J. Schneider, Esquire (PA# 54626)
Trial Attorneys
Department of Justice
Office of the United States Trustee
J. Caleb Boggs Federal Building
844 King Street, Room 2207, Lockbox 35
Wilmington, DE 19801
(302) 573-6491 (Phone)
(302) 573-6497 (Fax)

Ramona D. Elliott
General Counsel
P. Matthew Sutko
Associate General Counsel
Department of Justice
Executive Office for U.S. Trustees
20 Massachusetts Ave, N.W.
Washington, DC 20530

Date: November 15, 2010

CERTIFICATE PURSUANT TO LAR 28.3(D)

The attorneys whose names appear on the brief are exempted from Local Rule 28.3(d) of this Court because they are attorneys who represent an agency of the United States government. *See* LAR 28.3, Committee Comments.

/s/ Juliet Sarkessian
Juliet Sarkessian
(PA 57872)

CERTIFICATE PURSUANT TO LAR 31(c)

Pursuant to Local Rule 31(c) of this Court, counsel hereby certifies the following:

1. The text of the brief that is being filed electronically with the Court in PDF format is identical to the paper copies being filed.
2. The virus detection program Microsoft Forefront Client Security has been run on the PDF file and no virus has been detected.

/s/ Juliet Sarkessian
Juliet Sarkessian
(PA 57872)

CERTIFICATE OF COMPLIANCE WITH FRAP 32(a)(7)

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1. This brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B) because it contains 12,184 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii), as calculated by the word-processing software Microsoft Word 2003.

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/s/ Juliet Sarkessian
Juliet Sarkessian
(PA 57872)

CERTIFICATE OF SERVICE

I hereby certify that an exact copy of the foregoing Brief of Appellee the United States Trustee for Region 3 has been served on counsel for Appellants listed below, and other interested parties, on this 15th day of November, 2010, in the manner indicated below. All parties served solely by email have consented to such service.

/s/ Juliet Sarkessian
Juliet Sarkessian
(PA 57872)

Steven D. Usdin, Esq. Cohen Seglias Greenhill & Furman PC United Plaza, 19th Floor 30 South 17th St. Philadelphia, PA 19103 *Counsel for Appellants* By Email and First Class Mail susdin@cohenseglias.com	Susan Kaufman, Esquire Cooch & Taylor, PA 1000 West Street, 10th Floor The Brandywine Building Wilmington , DE 19899 *Counsel for City of Shawano* By Email Only, on Consent skaufman@coochtaylor.com
Glenn A. Brown, DMD, Esq. Real World Law, PC 916 North Union Street, No. 2 Wilmington, DE 19805 *Counsel for Vermillion State Bank, N.A.* By Email Only, on Consent glenn.brown@realworldlaw.com	William F. Taylor, Jr., Esq. Kate Roggion Buck, Esq. McCarter & English LLP Renaissance Centre 405 North King Street, 8th Floor Wilmington, DE 19801 *Counsel for Southwest Guaranty, Ltd.* *Green Mountain Finance Fund, LLC* *Carlyle Financial, LLC, and* *Southwest Guaranty Partners, LLC* By Email Only, on Consent wtaylor@mccarter.com

Kevin S. Mann, Esq. Cross & Simon, LLC 913 North Market Street, 11th Floor PO Box 1380 Wilmington, DE 19899 *Counsel for American Bank of St. Paul* By Email Only, on Consent kmann@crosslaw.com	Gary Seitz, Esquire Rawle & Henderson LLP 300 Delaware Avenue, Suite 1015 P.O. Box 588 Wilmington DE 19899 *Counsel for Integrity First Bank* By Email Only, on Consent gseitz@rawle.com
Ian Connor Bifferato, Esquire Kevin Collins, Esquire Bifferato LLC 800 North King Street, Plaza Level Wilmington, DE 19801 *Counsel for M&I Marshall & Ilsley Bank* By Email Only, on Consent cbifferato@bifferato.com kcollins@bifferato.com	

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1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*

Morse, UST v. Rudler

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*

Bankruptcy Appellant Panel for 1st Circuit

3. ("CCN") ***CURRENT*** CASE NO.

No.: BAP No. NH-07-015

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*

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(Identify judge & cite, if any)

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Phoebe Morse, P. Matthew Sutko, Anne Marie Dirsa

(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***

BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s)

&

√ Any Miscellaneous ***BACKGROUND***

●Whether, under 11 U.S.C. § 707(b)(2)(A)(iii), a debtor qualifies for an expense allowance for future payments on secured debts when no payments will be made because the debtor is surrendering the property securing the debt.

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BEFORE THE UNITED STATES BANKRUPTCY APPELLATE PANEL
FOR THE FIRST CIRCUIT

BAP NO. NH-07-015

GLEN H. RUDLER,
Debtor

PHOEBE MORSE, UNITED STATES TRUSTEE,
Appellant,

v.

GLEN H. RUDLER,
Appellee.

ON APPEAL FROM THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEW HAMPSHIRE,
CASE NO. 06-10982

BRIEF OF THE APPELLANT, THE UNITED STATES TRUSTEE

PHOEBE MORSE
United States Trustee

Geraldine Karonis
Assistant United States Trustee

By:

Ann Marie Dirsa
Attorney for United States Trustee
Office of the United States Trustee
66 Hanover Street, Suite 302
Manchester, NH 03101
Tel:(603) 666-7908
Fax:(603) 666-7913

Roberta A. DeAngelis
Acting General Counsel

P. Matthew Sutko
Associate General Counsel
United States Department of Justice
Executive Office for
United States Trustees
20 Massachusetts Avenue, NW
Washington, DC 20530
(202) 307-1399

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STATEMENT OF ISSUE PRESENTED

The issue to be decided in this appeal is whether the bankruptcy court erred in denying the United States Trustee's motion to dismiss Mr. Rudler's bankruptcy case under 11 U.S.C. § 707(b)(1) based on the presumption of abuse that arises under the means testing provisions of 11 U.S.C. § 707(b)(2). The bankruptcy court's interpretation of the means testing provisions of 11 U.S.C. § 707(b)(2) raises the following issue for resolution by this Court:

> Whether, under 11 U.S.C. § 707(b)(2)(A)(iii), a debtor qualifies for an expense allowance for future payments on secured debts when no payments will be made because the debtor is surrendering the property securing the debt.

STATEMENT OF APPELLATE JURISDICTION

The United States Bankruptcy Court for the District of New Hampshire (the "bankruptcy court") had jurisdiction under 28 U.S.C. §§ 157(b), 1334(a) over the bankruptcy case Glen H. Rudler ("Mr. Rudler") initiated by filing a voluntary chapter 7 petition on August 15, 2006. This appeal is taken from a final order of the bankruptcy court entered on February 20, 2007, interpreting 11 U.S.C. § 707(b)(2)(A)(iii) and denying the United States Trustee's motion for an order dismissing the case for abuse under 11 U.S.C. § 707(b)(2). On March 1, 2007, the United States Trustee filed a timely notice of appeal from that order under 28 U.S.C. § 158 and Fed. R. Bankr. P. 8002. This Court has jurisdiction over this appeal under 28 U.S.C. §§ 158(a) and 158(b)(1).[1]

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[1] The United States Trustee incorporates by reference the arguments set forth in her April 30, 2007 Response to this Court's Order to Show Cause regarding the finality of the bankruptcy court's February 20, 2007 order.

STANDARD OF REVIEW

Reviewing courts apply a clearly erroneous standard to findings of fact and a *de novo* standard to conclusions of law. *See T.I. Fed. Credit Union v. DelBonis*, 72 F.3d 921, 928 (1st Cir. 1995); *Western Auto Supply Co. v. Savage Arms, Inc. (In re Savage Indus., Inc.)*, 43 F.3d 714, 719-20 n.8 (1st Cir. 1994). "Accordingly, where the issue on appeal is essentially one of statutory interpretation, it will be subject to *de novo* review." *In re Kibbe*, 361 B.R. 302, 305 (B.A.P. 1st Cir. 2007). *See also McMullen v. Sevigny (In re McMullen)*, 386 F.3d 320, 331 (1st Cir. 2004). Here, there are no facts in dispute, and the bankruptcy court's denial of the motion to dismiss was premised on its interpretation of 11 U.S.C. § 707(b)(2). That interpretation of the Bankruptcy Code is a conclusion of law subject to *de novo* review.

STATEMENT OF THE CASE

Mr. Rudler is an above-median income debtor who stated his intention to surrender his homestead rather than affirming the mortgages thereon, which otherwise would have obligated him to make payments totaling $4,000 per month. Mr. Rudler subtracted the average monthly cost of these mortgages as future payments on secured debt as part of the means testing calculation required by section 707(b)(2). Before the bankruptcy court, the United States Trustee moved to dismiss Mr. Rudler's case on the ground that the presumption of abuse arose under section 707(b)(2). The United States Trustee argued that Mr. Rudler had sufficient disposable income to repay his creditors, because Mr. Rudler was not entitled to deduct payments on surrendered property as a future expense on account of secured debt.

The United States Trustee moved to dismiss Mr. Rudler's case under section 707(b)(2), asserting that it would be presumptive abuse of chapter 7 of the Bankruptcy Code to grant the debtor a discharge because he had sufficient disposable income to repay his unsecured creditors at least $166.67 per month. On February 20, 2007, the bankruptcy court denied the United States Trustee's motion to dismiss. This appeal followed.

STATEMENT OF FACTS

I. Statutory Framework -- Overview of 11 U.S.C. § 707(b)(2)

Under section 707(b)(1) of the Bankruptcy Code[2], an individual's chapter 7 case merits dismissal when the individual has primarily consumer debts, and the granting of relief would be an "abuse" of the provisions of chapter 7. *See* 11 U.S.C. § 707(b)(1). In the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA"), S. 256, Pub. L. No. 109-8, 119 Stat. 23, Congress significantly amended section 707(b) of the Code to establish a new statutory presumption: a case is presumptively abusive of chapter 7 if a detailed mathematical formula set out in the statute, commonly referred to as the "means test," yields more than a specified amount of monthly disposable income. *See* 11 U.S.C. §707(b)(2). Each debtor with primarily consumer debts is now required to file, in conjunction with his or her bankruptcy schedules and statement of financial affairs, a Statement of Current Monthly Income and Means Test Calculation, Official Form 22A of the Federal Rules of Bankruptcy Procedure ("Form 22A").[3] 11 U.S.C. § 521 and § 707(b)(2)(C).

The means test, as embodied in Form 22A, is calculated through a two-step analysis. The first step determines whether a debtor's annualized current monthly income is above the applicable state median family income. *See* 11 U.S.C. §§ 101(10A), 707(b)(7)(A). Generally, if a debtor's income is above the applicable state median family income, as is the

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[2] Unless otherwise noted, all references to the "Bankruptcy Code" or "Code" are to the Bankruptcy Code, as amended by BAPCPA, 11 U.S.C. § 101, *et seq.* (2005).

[3] At the time this case was filed, the Official Form filed by Mr. Rudler was called "Official Form B22A." We will use the Official Form's current name, "22A," throughout.

case here, the case will be presumed to be abusive unless under the second step of the means test, a deduction of allowed expenses, brings the debtor's net monthly income to less than $167.67 per month.[4] 11 U.S.C. §§ 101(10A), 707(b)(2)(A)(i).

Section 707(b)(2)(A)(iii) allows debtors to deduct payments on secured debt that will be "due in each month of the 60 months following the date of the petition." 11 U.S.C. 707(b)(2)(A)(iii). Accordingly, Line 42 of Form 22A provides for a reduction of current monthly income ("CMI") for average payments on secured debt, calculated as the total of "all amounts contractually due to each Secured Creditor in the 60 months following the bankruptcy case, divided by 60." Form 22A, Line 42.

If a case is presumed to be abusive, the presumption "may only be rebutted by demonstrating special circumstances." 11 U.S.C. § 707(b)(2)(B)(i). If the presumption of abuse does not arise or is rebutted, section 707(b)(3) provides that a case still may be dismissed if the debtor filed the petition in bad faith or if "the totality of the circumstances" demonstrates abuse.

II. Factual Background

Mr. Rudler filed his voluntary chapter 7 petition on August 15, 2006, and identified himself as an individual with primarily consumer debts. *See* Appendix (hereinafter "(A. ___)") at 5, 10 – 46. Mr. Rudler has three dependents and earns $106,241 per year.

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[4] The presumption does not arise if an above-median debtor's monthly disposable income is less than $100 per month (or $6,000 over 60 months). 11 U.S.C. §707(b)(2)(A)(i). If the debtor's monthly disposable income is equal to or exceeds $166.67 per month (or $10,000 over 60 months), the presumption of abuse arises. *Id*. If an above median debtor's monthly disposable income is between $100 and $167.67 per month, the presumption of abuse arises if that amount, over 60 months, is sufficient to pay at least 25% of the debtor's nonpriority unsecured debt. *Id*.

Under 11 U.S.C. § 104, the dollar amounts set forth in title 11 and applicable to the threshold amounts for determining when the presumption of abuse arises under the means test were adjusted based on the consumer price index for cases filed on or after April 1, 2007. This case is not subject to the dollar amount adjustments.

Form 22A, Lines 13, 14 (A. 14). Mr. Rudler's annual income exceeds the New Hampshire median family income for a family of four by $21,323. *Id.*

Along with his petition, Mr. Rudler filed schedules itemizing his assets and liabilities, Form 22A, and a Chapter 7 Individual Debtor's Statement of Intention indicating his intent to surrender his homestead property. (A. 13-46). Mr. Rudler's required schedules and statements disclosed the following:

- Mr. Rudler owned a residence located at 40 Dorothy Drive, Epping, New Hampshire (*see* schedule A) (A. 24);
- Mr. Rudler's homestead was encumbered by first and second mortgages totaling $418,670; the first mortgage on Mr. Rudler's homestead had a monthly payment of $3,076, and the second mortgage had a monthly payment of $924 (*see* Form 22A, Line 42) (A.17); and
- Mr. Rudler was surrendering his residence (*see* Debtor's Statement of Intention) (A. 39).

On December 21, 2006, Sovereign Bank, the holder of a first mortgage on Mr. Rudler's residence, filed a motion for relief from stay to foreclose on his house. *See* Docket #27 (A. 8). Mr. Rudler did not oppose the motion, and the bank was granted relief from the automatic stay by entry of an order on January 10, 2007. *See* Docket #29 (A. 8).

Mr. Rudler claimed a deduction of $4,000 at Line 42 on Form 22A for the average monthly amount of mortgage payments on the property he was surrendering, and on which the bank is foreclosing. Form 22A, Line 42 (A.17). After deducting all expenses on Form 22A on Line 42, including the mortgage payments on property he intended to surrender, Mr. Rudler calculated that he had disposable income of $-2,376 per month. Form 22A, Line 50 (A. 17).

Under 11 U.S.C. § 704, the United States Trustee reviewed all materials filed by Mr. Rudler and performed her own means test analysis ("UST 22A"). (A. 61). The United States

Trustee excluded Mr. Rudler's Line 42 mortgage payments of $4,000 per month on the residence he was surrendering, and instead based her means test analysis on a $1,439 standard mortgage/rent expense as specified by the Local Standards for housing and utilities issued by the Internal Revenue Service.[5] UST 22A, Line 20B. (A. 63). The United States Trustee concluded, based on Mr. Rudler's surrender of his homestead, that Mr. Rudler had monthly disposable income of $1,461. *Id.* at Line 50. Thus, the United States Trustee concluded that the presumption of abuse arose.[6]

III. Procedural History

After the first meeting of creditors was held on September 11, 2006 (A. 5), the United States Trustee moved to dismiss Mr. Rudler's case under 11 U.S.C. § 704(b)(2), asserting that it would be presumptive abuse of chapter 7 of the Bankruptcy Code to grant Mr. Rudler a discharge because he had sufficient disposable income to repay his creditors at least $166.67 per month.[7] (A. 47). In her motion, the United States Trustee argued that Mr. Rudler was not entitled to claim a deduction from his current monthly income on Line 42 of Form 22A for average monthly payments on his homestead because he intended to surrender it. (A. 47).

On February 20, 2007, the bankruptcy court denied the motion to dismiss, concluding the debtor could deduct payments for surrendered collateral on his means test and, therefore, the presumption of abuse did not arise. (A. 3). On March 1, 2007, the United States Trustee

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[5] On Line 20B of Form 22A, in addition to an IRS Standard amount for non-mortgage/rent related housing expenses, a debtor may deduct the IRS Housing and Utility Standard, which includes an average expense amount for rent or mortgage related expenses based on a debtor's county of residence and family size.

[6] Under the United States Trustee's calculations, Mr. Rudler had sufficient disposable income to repay his unsecured creditors $87,665, or more than 100% of the total scheduled unsecured claims, in a 60-month chapter 13 repayment plan.

[7] The United States Trustee did not move to dismiss Mr. Rudler's case based on the criteria set forth in section 707(b)(3).

filed a timely notice of appeal. (A. 1).

On April 12, 2007, this Court issued an order to show cause why the appeal should not be dismissed for lack of jurisdiction, ruling that the order on appeal was interlocutory. The United States Trustee responded, and shared her view that the bankruptcy court's order was final. On May 29, 2007, this Court issued an Order Regarding Order to Show Cause stating that it had reconsidered its initial ruling on the finality of the bankruptcy court's order and stating that the panel hearing argument on the merits of the case would also pass upon this jurisdictional question.

SUMMARY OF ARGUMENT

In applying the means test, the bankruptcy court interpreted 11 U.S.C. § 707(b)(2) as authorizing the deduction of expenses that Mr. Rudler will not incur on a monthly basis. The bankruptcy court's ruling was incorrect for two reasons. First, Mr. Rudler could only claim *future* expenses for secured debt under section 707(b)(2)(A)(iii), and he had no future expense on the mortgage because he had stated his intention to surrender the residence. Because Mr. Rudler will have no secured debt payments on account of his mortgage, the bankruptcy court erred in holding that he was eligible to deduct this expense under the means test.

Second, the bankruptcy court's order conflicts with sound notions of public policy and the primary purpose of Congress in passing bankruptcy reform legislation in 2005, including the amendments at issue in this appeal. The 2005 legislation was intended to ensure that debtors would repay their debts when they can. By allowing Mr. Rudler to claim phantom expense for payments on his mortgage, the bankruptcy court's order undercuts that purpose, and allowed a debtor who had the ability to repay his debts to avoid doing so.

ARGUMENT

I. Excluding Payments for Collateral Mr. Rudler Is Surrendering Is the Proper Interpretation of 11 U.S.C. § 707(b)(2)(A)(iii).

This appeal presents a single legal issue, whether the use of the words "as contractually due" and "following" in the phrase "the total of all amounts scheduled as contractually due to secured creditors in each month of the 60 months following the date of the petition" allow section 707(b)(2)'s means test to take into account cases, like this one, where secured payments are zero because the debtor is surrendering the underlying property. Section 707(b)(2)'s text does allow the means test to take these circumstances into account, for two reasons.

First, the terms of section 707(b)(2)(A)(iii) clearly contemplate that future expenses will be used to determine whether a debtor will have sufficient disposable income to fund a chapter 13 plan going forward. It provides: "[t]he debtor's average monthly payments on account of secured debts shall be calculated as the sum of ... the total of all amounts scheduled as contractually due to secured creditors in each month of the 60 months *following* the date of the petition."[8] 11 U.S.C. § 707(b)(2)(A)(iii) (*emphasis added*). The "time-honored tenet" of

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[8] 11 U.S.C. § 707(b)(2)(A)(iii) provides:

> [t]he Debtor's average monthly payments on account of secured debts shall be calculated as the sum of -
>
> > (I) the total of all amounts scheduled as contractually due to secured creditors in each month of the 60 months following the date of the petition; and
> >
> > (II) any additional payments to secured creditors necessary for the debtor, in filing a plan under chapter 13 of this title, to maintain possession of the debtor's primary residence, motor vehicle, or other property necessary for the support of the debtor and the debtor's dependents, that serves as collateral for secured debts;
>
> divided by 60.

statutory construction is that '[a]ll words and provisions of a statute are intended to have meaning and are to be given effect, and no construction should be adopted which would render statutory words or phrases meaningless, redundant or superfluous.'" *Kibbe,* 361 B.R. at 312 (quoting *Lopez-Soto v. Hawayek*, 175 F.3d 170, 174 (1st Cir. 1999)). Thus, any construction of section 707(b)(2)(A)(iii) must consider the word "following" as well as the phrase "scheduled as contractually due."

The dictionary defines "following" as "subsequent to," "next in the order of time" or in the future. *Merriam-Webster Online Dictionary* (2007), [http:www.m-w.com/dictionary/following]. Accordingly, this meaning should be imparted to the term "following" as it appears in section 707(b)(2)(A)(iii), absent clear indication that Congress intended to give the term a different meaning. *See Clark Equip. Co. v. United States,* 912 F.2d 113, 117 (6th Cir. 1990) (applying dictionary definition to ascertain common meaning of term not defined by statute); *United States v. Knott*, 256 F.3d 20, 28 (1st Cir. 2001) (courts typically read statutory terms to convey their ordinary meaning, including as reflected in dictionary definitions). Using the common, ordinary meaning of "following," therefore, section 707(b)(2)(A)(iii) would only allow deductions for mortgage payments to secured creditors that will be made "subsequent to" or "after" the petition date, and payments for surrendered property that will never be made would not qualify.

Second, the fact that Congress also has used the term "scheduled as contractually due" in the section is consistent with this reading of the term "following." Significantly, Congress has "used the phrase 'scheduled as' several times in the Bankruptcy Code . . . to refer to whether a debt is identified on a debtor's bankruptcy schedules." *In re Skaggs*, 349 B.R. 594, 599 (Bankr. E.D. Mo. 2006). The *Skaggs* court cited to 11 U.S.C. § 1111(a) as an example (“wherein a claim or interest is not deemed filed if it is scheduled as disputed, contingent or unliquidated”). *Skaggs*, 349 B.R. at 599. Other examples where the term “scheduled” is used to refer to a debtor’s bankruptcy schedules include 11 U.S.C. § 523(a)(3)(individual debtor not discharged from debt “neither listed nor scheduled under section 521(1) of this title…”) and 11 U.S.C. § 554(c)(“ Unless the court orders otherwise, any property scheduled under section 521(1) of this title not otherwise administered at the time of the closing of a case is abandoned to the debtor and administered for purposes of section 350 of this title”).

“When Congress amends a law, as it did with BAPCPA, the prior statute’s . . . longstanding meaning forms the background against which Congress legislates . . . [and] [t]he courts presume that Congress will use clear language if it intends to alter an established” meaning. *Skaggs*, 349 B.R. at 599 (citing *Firstar Bank v. Faul*, 253 F.3d 982, 988 (7th Cir. 2001)). Accordingly, a debtor’s “schedules and statements form the basis from which . . .[a] court should determine whether a debt is ‘scheduled as contractually due.’” *Id*. Mr. Rudler’s schedules and statements, including his Statement of Intention, form the basis from which the court should determine whether he will be making future payments “with respect to the property of the estate which secures those debts.”[9] Statement of Intention. (A. 39). The entire phrase “average monthly payments on account of secured debts scheduled as contractually due in each month of the 60 months following the date of the petition” is “best construed as contemplating a forward-looking calculation.” *In re Ray*, CA No. 06-03988-DD, 2007 WL 690131, at *5 (Bankr. D. S.C. Feb. 28, 2007).

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[9] Because he is surrendering the collateral, Mr. Rudler should not have listed his average monthly mortgage payment on Schedule J. (A. 37). Mr. Rudler is under a continuing duty to amend his schedules to accurately reflect his monthly expenses. Pursuant to 11 U.S.C. § 521, all debtors are obligated to complete bankruptcy schedules accurately and completely and to amend those schedules when necessary.

Two lines of cases take an opposite view of section 707(b)(2)(A)(iii), one holding that the words "contractually due" are controlling, and the other holding that the words "contractually due" control unless the collateral is actually surrendered. The "contractually due" courts read the phrase "scheduled as contractually due" as permitting debtors to reduce CMI for payments owed pursuant to the underlying contract when debtors are surrendering, or have surrendered, the property. *See e.g., In re Walker*, No. 05-15010, 2006 WL 1314125, at 4* (Bankr. N.D. Ga. May 1, 2006) (surrender of collateral does not change the fact that payments are contractually due); *see also In re Mundy*, No. 1-06-BK-00875, 2007 WL 620971, at *4-5 (Bankr. M.D. Pa. Mar. 1, 2007), and *In re Hartwick*, 352 B.R. 867, 870 (Bankr. D. Minn. 2006). The "contractually due unless actually surrendered" courts allow debtors to deduct payments on secured debt except when the collateral has actually been surrendered. *See e.g. In re Singletary*, 354 B.R. 455, 467 (Bankr. S.D. Tex. 2006); *see also In re Nockerts*, 357 B.R. 497 (Bankr. E.D.Wis. 2006); *c.f., In re Brandenburg*, No. 07-20244, 2007 WL 1459402 (Bankr. E.D. Wis. May 15, 2007) (finding mortgage debt not "scheduled as contractually due" as of date of state law foreclosure sale).

These lines of cases present no unified structure for the analysis of section 707(b)(2)(A)(iii). Their analyses are fundamentally irreconcilable – the first holds that the means test is designed to be a historic reading of a debtor's financial condition as of the petition date, while the second requires that events occurring after the petition date be considered. More importantly, neither line of cases is textually satisfying because each fails to take into account or give effect to "all words and provisions of" section 707(b)(2)(A)(iii) for the reasons just discussed. *Kibbe*, 361 B.R. at 312.

Section 707(b)(2)(A)(iii) "allows debtors to deduct their average monthly payments on secured debts based upon those amounts that will be contractually due during the 60 month period following the petition." *In re Edmunds*, 350 B.R. 636, 645 (Bankr. D. S.C. 2006). The method used to determine whether an expense for secured debt may be deducted under the means test must therefore consider the amount, if any, that will actually be paid by the debtor in the future. Moreover, "[i]n considering whether debtors are abusing chapter 7, it is proper to construe the statute in such a way as to determine whether [debtors] have an ability to repay their general unsecured creditors once they have carried out their stated intentions." *Ray*, 2007 WL 690131, at *5. Proper application of section 707(b)(2)(A)(iii) thus requires courts to credit a debtor's intent to surrender collateral and make no future payments to secured creditors.

Correct application of the means test would accurately reflect Mr. Rudler's true financial circumstances, namely that he had $1,461 in monthly disposable income presumptively available. In allowing Mr. Rudler to subtract future expenses that he will not incur on a monthly basis, the bankruptcy court below misconstrued the means testing provisions of section 707(b)(2) and eliminated disposable income otherwise disclosed on Mr. Rudler's schedules and statements and available to repay his creditors.[10] For that reason, this case should be remanded, so the court below can conduct additional proceedings to determine whether special circumstances exists to rebut the presumption of abuse under section 707(b)(2)(B).

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[10] The additional "phantom" mortgage expenses reduced Mr. Rudler's disposable income by $2,561 [the difference between his historical average monthly mortgage expense ($4,000) and the applicable Line 20B(a) IRS Housing Standard allowance for mortgage/rental expenses ($1,439)]. The United States Trustee's calculations show that Mr. Rudler had monthly disposable income of $1,461 (Line 50), an amount sufficient to yield plan payments totaling $87,665, or more than 100% of the total scheduled unsecured claims. (A. 65).

II. The United States Trustee’s Construction of Section 707(b)(2)(A)(iii) Is Superior because It allows the Means Test to Accomplish the Goal Congress Set for It: Ensuring Debtors like Mr. Rudler Who Can Repay Debts Do So.

Mr. Rudler has the ability to repay all of his unsecured debt. When the $1,439 standard IRS mortgage/rent expense is substituted on the means test for Mr. Rudler’s Line 42 mortgage payments of $4,000 per month to reflect the reality that Mr. Rudler will not have prospective mortgage payments, he has monthly disposable income of $1,461. This amount is sufficient to repay Mr. Rudler’s unsecured creditors $87,665, or more than 100% of his total scheduled unsecured claims, in a 60-month chapter 13 repayment plan.

Congress intended that debtors make such repayments when, as here, they can. The construction advanced by the United States Trustee is superior because it is the only one that accomplishes that goal in cases where debtors are surrendering mortgaged or encumbered property. The means test was intended to create a gatekeeping mechanism to identify debtors who have sufficient disposable income to fund a repayment plan and to direct them to either voluntarily proceed in chapter 13 or be dismissed out of bankruptcy entirely. *In re Barraza*, 346 B.R.724, 729 (Bankr. N.D. Tex. 2006). Allowing a debtor to deduct more than the IRS Standard for housing expenses, even though the debtor will not expend this higher amount, defeats the purpose of the means test. If debtors are permitted to deduct secured debt expenses on surrendered property, section 707(b)(2) will not operate as the gatekeeper to chapter 7 that Congress intended. Rather, many debtors would “pass” through the means test by being allowed expense deductions for non-existent payments on surrendered collateral; cases would be considered for dismissal only under the totality of the circumstances analysis set forth in section 707(b)(3)(B). *Mundy*, 2007 WL 620971, at *5.

The bankruptcy court’s interpretation of the means test conflicts with Congress’ stated intent to make certain “that those who can afford to repay some portion of their unsecured debts be required to do so....” 151 Cong. Rec. S2470 (Mar. 10, 2005). As the *Kibbe* court noted, quoting the legislative history surrounding the enactment of BAPCPA:

> The heart of [BAPCPA’s] consumer bankruptcy reforms consists of the implementation of an income/expense screening mechanism (“needs-based bankruptcy relief” or “means testing”) *which is intended to ensure that debtors repay creditors the* *<u>maximum</u>* *they can* *<u>afford</u>*.
>
> H.R. Rep. No. 109-31, pt 1, at 2 (2005) (*emphasis supplied*).

Kibbe, 361 B.R. at 314. Here the bankruptcy court reasoned that Congress’ intent in creating a “mechanical” formula for presuming abuse precluded it from looking to postpetition developments in applying the means test, because to do so would require an exercise of discretion reserved to the court only under section 707(b)(3). Op. at 1 (following *In re Hartwick*, 359 B.R. 16 (Bankr. D. N.H. 2007)) (A. 3). The means test is not entirely mechanical because debtors do not rely solely on standardized IRS allowances. Although much of the test works in that manner, other parts, including section 707(b)(2)(A)(iii)(I), require courts to look to a debtor’s actual expenses. Once those expenses are determined, they are applied as mechanically as the rest of the means test.

For the means test to have utility in cases where debtors are surrendering secured debt, debtors must estimate the residual income available to them each month after the deduction of the projected monthly expenses at the time the case is filed. There is no utility in permitting debtors to calculate their repayment ability by including past expense amounts that are not projected for future payment. Rather, a debtor who does not have a monthly mortgage payment is allowed to take as a monthly expense the amount set forth in the IRS Local Housing Standards for a family the size of the debtor’s located in the same county. Permitting Mr. Rudler to take secured debt expense deductions for collateral he surrendered frustrates the purpose of the mean test, and conflicts with Congress' intent in enacting the BAPCPA.

CONCLUSION

For these reasons, the United States Trustee respectfully asks this Court to reverse the order entered below and remand this case for further proceedings consistent with this Court's ruling.

Respectfully submitted,

PHOEBE MORSE
United States Trustee

By:

____

Roberta A. DeAngelis
P. Matthew Sutko
United States Department of Justice
Executive Office for
United States Trustees
20 Massachusetts Avenue, NW
Washington, DC 20530
(202) 307-1399

Ann Marie Dirsa
Geraldine Karonis
United States Department of Justice
Office of the United States Trustee
66 Hanover Street, Suite 302
Manchester, NH 03101
Tel: (603) 666-7908
Fax: (603) 666-7913

CERTIFICATE OF SERVICE

I certify that on June 20, 2007, true and correct copies of the Brief of Appellant, United States Trustee were served by Federal Express Overnight Service, pre-paid, upon the individuals listed below.

Scott W. LaPointe, Esquire,
Attorney for the Debtor
Brown & LaPointe, P.A.
128 Main Street
Epping, NH 03042

Brian R. Hachey, Esquire
Attorney for Sovereign Bank
Shectman Halperin Savage LLP
1080 Main Street
Pawtucket, RI 02860

Steven M. Notinger
Chapter 7 Trustee
Donchess & Notinger PC
402 Amherst St., Suite 204
Nashua, NH 03063

Ann Marie Dirsa

ADDENDUM

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WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	In re Glen H. Rudler (Morse, UST v Rudler)
2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	1st Cir.
3. ("CCN") ***CURRENT*** CASE NO.	No.: 08-9007
4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*	No.: 07-00015 Court: BAP 1st Cir. *(Identify judge & cite, if any)*
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8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") ● ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	● Whether section 707 (B)(2) allows a debtor to deduct mortgage payments that he will not make.
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No. 08-9007

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIRST CIRCUIT

IN RE GLEN H. RUDLER, DEBTOR.

PHOEBE MORSE, United States Trustee for the Districts of Maine,
Massachusetts, New Hampshire and Rhode Island, Appellant,

v.

GLEN H. RUDLER, Appellee.

ON APPEAL FROM THE UNITED STATES BANKRUPTCY
APPELLATE PANEL FOR THE FIRST CIRCUIT

BRIEF FOR THE APPELLANT

PHOEBE MORSE
United States Trustee
Districts of Maine, Massachusetts
New Hampshire and Rhode Island

RAMONA D. ELLIOTT
P. MATTHEW SUTKO
Executive Office for
United States Trustees
U.S. Department of Justice
20 Massachusetts Ave. N.W.
Washington, D.C. 20530-0001

Geraldine Karonis
Ann Marie Dirsa
Office of the United States Trustee
District of New Hampshire
1000 Elm St., Suite 605
Manchester, New Hampshire 03103

GREGORY G. KATSAS
Assistant Attorney General

WILLIAM KANTER
(202) 514-4575
TEAL LUTHY MILLER
(202) 514-5048
Attorneys, Appellate Staff
Civil Division, Room 7234
U.S. Department of Justice
950 Pennsylvania Ave., N.W.
Washington D.C. 20530-0001

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IN THE UNITED STATES COURT OF APPEALS
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No. 08-9007

IN RE GLEN H. RUDLER, DEBTOR.

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v.

GLEN H. RUDLER, Appellee.

ON APPEAL FROM THE UNITED STATES BANKRUPTCY
APPELLATE PANEL FOR THE FIRST CIRCUIT

BRIEF FOR THE APPELLANT

STATEMENT OF JURISDICTION

The bankruptcy court had jurisdiction under 28 U.S.C. § 157(a) and (b) to hear the underlying case, a voluntary petition under Chapter 7 of the Bankruptcy Code, 11 U.S.C. § 1101 *et seq.* *See also* 28 U.S.C. §§ 151, 1334(a). On February 20, 2007, the bankruptcy court denied the United States Trustee's motion to dismiss the petition for abuse of Chapter 7 under 11 U.S.C. § 707(b)(1). Addendum 7. As explained in Section I of the argument below, the bankruptcy court's decision was a final and immediately appealable order. *See Perry* v. *First Citizens Fed. Credit Union (In re Perry)*, 391 F.3d 282, 285 (1st Cir. 2004). The United States Trustee filed a timely notice of appeal from the order denying the motion to dismiss to the United States Bankruptcy Appellate Panel for the First

Circuit. Appendix ("App.") 5. The Bankruptcy Appellate Panel had jurisdiction to hear the appeal under 28 U.S.C. § 158(a). On May 22, 2008, that court affirmed the bankruptcy court's order denying the United States Trustee's motion to dismiss. App. 55. On July 16, 2008, the United States Trustee filed a timely notice of appeal to this Court. App. 55. This Court has jurisdiction to hear the appeal under 28 U.S.C. § 158(d).

STATEMENT OF THE ISSUE PRESENTED FOR REVIEW

Under 11 U.S.C. § 707(b)(2), a bankruptcy petition is presumptively abusive if, for the 60 months following the petition, the debtor's monthly income minus allowable expenses, as calculated by a statutory formula, would be equal to or greater than a specified threshold dollar amount. Section 707(b)(2)(A)(iii) defines the "debtor's average monthly payments on account of secured debts," which is one of the allowable expenses under the statutory formula, as "the sum of the total of all amounts scheduled as contractually due to secured creditors in each month of the 60 months following the date of the petition . . . divided by 60." 11 U.S.C. § 707(b)(2)(A)(iii). The debtor in this case included monthly payments on two mortgages in the calculation of his "average monthly payments on account of secured debts," even though his petition for bankruptcy was accompanied by a statement that he intended to surrender the home securing those mortgages.

The question presented is whether mortgage payments can be deducted as "amounts scheduled as contractually due to secured creditors in each month of the 60 months following the date of the petition" when the debtor has made clear that he will not make those payments because the debt is secured by a mortgage on a home that he intends to surrender.

STATEMENT OF THE CASE

The United States Attorney General appoints United States Trustees to supervise the administration of bankruptcy cases and trustees. *See* 28 U.S.C. §§ 581-589a. United States Trustees "serve as bankruptcy watchdogs to prevent fraud, dishonesty, and overreaching in the bankruptcy arena." H.R. Rep. No. 595, 95th Cong., 1st Sess. 88 (1977). Among the Unites States Trustees' duties is the duty to review petitions for bankruptcy filed under chapter 7 to determine whether a statutory presumption that the filing is an abuse of chapter 7 applies. *See* 11 U.S.C. § 704(b)(1)(A).

After debtor Glen H. Rudler filed his petition for bankruptcy, United States Trustee Phoebe Morse moved to dismiss the filing as an abuse of Chapter 7 on the ground that Rudler should not have deducted his monthly mortgage payments when he calculated his monthly income, because he intended to surrender the house securing those mortgages. The bankruptcy court denied the United States Trustee's motion to dismiss, concluding that the debtor properly deducted the mortgage payments under 11 U.S.C. § 707(b)(2)(A)(iii), which defines the "debtor's average monthly payments on account of secured debts" as "the sum of the total of all amounts scheduled as contractually due to secured creditors in each month of the 60 months following the date of the petition . . . divided by 60." The United States Trustee appealed to the United States Bankruptcy Appellate Panel for the First Circuit, and that court affirmed the bankruptcy court's decision. The United States Trustee then brought this appeal.

STATEMENT OF THE FACTS

I. Statutory Background

A. History of the Means Test

1. Before 1984, a bankruptcy court could dismiss a chapter 7 bankruptcy case only for "cause." *See* Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, § 707 (codified at 11 U.S.C. § 707); S. Rep. No. 95-989, at 94 (1978); H.R. Rep. No. 95-595, at 380 (1977). A bankruptcy court had "cause" to dismiss a case if, for example, the debtor had unreasonably delayed the proceedings in a manner that prejudiced his creditors. *See* Pub. L. No. 95-598, § 707(1) (codified at 11 U.S.C. § 707). Congress made clear, however, that "the ability of the debtor to repay his debts in whole or in part" did not "constitute[] adequate cause for dismissal." S. Rep. No. 95-989, at 94; H.R. Rep. No. 95-595, at 380 (same).

2. In the early 1980s, Congress became concerned about a "dramatic[]" rise in the number of consumer bankruptcy cases, and, as a result, it amended provisions of the Bankruptcy Code pertaining to consumer bankruptcies. *See* Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353 (1984); S. Rep. No. 98-65, at 3 (1983). As part of these reforms, Congress enacted 11 U.S.C. § 707(b), which gave a bankruptcy court, "on its own motion or on a motion by the United States Trustee," authority to "dismiss a case filed by an individual debtor under this chapter whose debts are primarily consumer debts if it

finds that the granting of relief would be a substantial abuse of the provisions of this chapter." 11 U.S.C. § 707(b) (2004); Pub. L. No. 98-353, § 312; S. Rep. No. 98-65, at 53. By enacting Section 707(b), Congress sought to ensure that bankruptcy courts would have the authority to dismiss bankruptcy cases in which debtors could repay a substantial portion of their debts. *See* S. Rep. No. 98-65, at 53-54; *In re Kornfield*, 164 F.3d 778, 781 (2d Cir. 1999) (Congress was "[c]oncerned that debtors who could over time easily pay their creditors might resort to chapter 7 to erase their legitimate obligations"); *In re Stewart*, 175 F.3d 796, 812-13 (10th Cir. 1999); *In re Lamanna*, 153 F.3d 1, 3 n.6 (1st Cir. 1998).

3. In 2005, again concerned about the rise in bankruptcy filings, Congress enacted the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (the "2005 Act"), Pub.L. No. 109-8, 119 Stat. 23 (2005). The 2005 Act removed the requirement that the party seeking dismissal show "substantial abuse," so that Section 707(b) now requires a showing of "abuse" rather than "substantial abuse," 11 U.S.C. § 707(b)(1), and eliminated a presumption in favor of discharge. The 2005 Act also added a means test to identify chapter 7 cases that are presumptively abusive. Under the means test, there is a presumption that the case is an abuse of chapter 7 if the formula set out in Section 707(b)(2)(A) reflects monthly disposable income equal to or greater than a specified threshold amount. *See* 11 U.S.C. § 707(b)(2)(A). In enacting these changes, Congress called "the implementation of an income/expense screening mechanism ('needs-based bankruptcy relief' or 'means testing')" the "heart of the [2005 Act's] consumer

bankruptcy reforms," and it explained that the means test "is intended to ensure that debtors repay creditors the maximum they can afford." *See* H.R. Rep. No. 109-31 (I) at 1 (2005), reprinted in 2005 U.S.C.C.A.N. 88, 89.

B. The Means Test

The first step of the means test is determining whether the debtor's monthly income exceeds the state median family income for his family size. A debtor's current monthly income, as defined in 11 U.S.C. § 101(10A)(A), is based on the debtor's average monthly income from all sources for the six full calendar months immediately preceding the bankruptcy filing. If the debtor's monthly income is equal to or below the state median family income for the same household size, a safe harbor exists and a presumption of abuse will not arise. *See* 11 U.S.C. § 707(b)(7). If the debtor's current monthly income exceeds the state median income for the same household size, however, the debtor is an "above-median income debtor." Above-median income debtors are subject to the means test.

Under the means test, net monthly disposable income is calculated by deducting statutorily prescribed monthly expenses from current monthly income. If the resulting net monthly disposable income is above the amount specified in the statute, the bankruptcy case is presumptively abusive: the means test requires courts "presume abuse exists if the debtor's current monthly income reduced by the amounts determined under" the statute exceeds a threshold dollar amount specified in the statute and periodically adjusted by the Judicial Conference of the United States. 11 U.S.C. § 707(b)(2)(A)(i). At the time relevant to this case, that threshold was $167.[1] The means test calls for the deduction of statutorily prescribed monthly expenses rather than actual expenses. Deductible expenses include living expenses as set forth in national and local standards prescribed by the Internal Revenue Service, *see, e.g.*, 11 U.S.C. § 707(b)(2)(A)(ii)(I); certain actual expenses subject the requirement that they be "reasonably necessary," *see, e.g., id.* (allowing deduction for "reasonably necessary" health insurance and disability insurance expenses); and other actual expenses capped by a maximum allowable deduction, *see id.* at 707(b)(2)(A)(ii)(IV)(allowing deduction for actual expenses for a minor child "not to exceed" $1650 a month).

In addition to the deduction of these monthly expenses, the means test also allows the deduction of projected monthly payments on account of secured debts and priority claims. *See* 11 U.S.C. § 707(b)(2)(A)(iii)-(iv). Section 707(b)(2)(A)(iii) defines the debtor's "average monthly payments on account of secured debts," the statutory term at issue in this case, as the sum of "the total of all amounts scheduled as contractually due to secured creditors in each month of the 60 months following the date of the petition" divided by 60. 11 U.S.C. §

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[1] The $167 threshold is the result of dividing $10,000 by 60 under the formula set out in 11 U.S.C. 707(b)(2)(A)(i). Under Section 104 of the Bankruptcy Code, this dollar amount was increased by the Judicial Conference of the United States effective April 1, 2007. *See Revision of Certain Dollar Amounts in the Bankruptcy Code Prescribed Under Section 104(b) of the Code*, 72 Fed. Reg. 7082, 7082-83 (Feb. 14, 2007). This increased dollar amount does not apply to this case.

707(b)(2)(A)(iii). The Code does not define the term "amounts scheduled as contractually due to secured creditors."

To facilitate application of the means test, all individual chapter 7 debtors must file Schedule J, *Current Expenditures of Individual Debtor*, and Federal Rules of Bankruptcy Procedure Official Form 22A, *Statement of Current Monthly Income and Means Test Calculation* ("Form 22A"), with their schedules and Statement of Financial Affairs. *See* 11 U.S.C. §§ 521(a)(1)(B)(ii) and § 707(b)(2)(C). Debtors must also file a statement of intention as to whether they will retain or surrender property secured by debt within 30 days of the earlier of the filing date and the date of the meeting of creditors. *See* 11 U.S.C. § 521(a)(2)(A), *see also* Interim Fed. R. Bankr. P. 1017(b)(2) (requiring individual debtors in chapter 7 cases to file a statement of intent on the appropriate Official Form). The statement must specify whether the debtor intends to claim the property as exempt, redeem the property, or reaffirm debts secured by the property. *Id.* Section 521(a)(2)(B) requires debtors to perform their expressed intention within 30 days after filing the statement of intention.

The United States Trustee reviews these forms and all other materials to determine whether a presumption of abuse arises. *See* 11 U.S.C. § 704(b)(1)(A). The United States Trustee has 10 days from the meeting of creditors to "review all materials" filed by the debtor (including the statement of intent to surrender) and file a statement as to whether the debtor's case is presumed abusive under Section 707(b). *Id.* When a chapter 7 bankruptcy case is presumptively abusive under the statute, the United States Trustee must either seek its dismissal or conversion, or file a statement declining to seek dismissal. *See* 11 U.S.C. § 704(b)(2). The United States Trustee has an additional 30 days after filing the statement regarding abuse to file a motion to dismiss for presumed abuse. *Id.* Because the meeting of creditors must be held "no fewer then 20 and no more than 40 days after the order for relief," *see* Federal Rule of Bankruptcy Procedure Rule 2003, which in a voluntary petition under chapter 7 is the date of the petition, *see* 11 U.S.C. 301(b), the United States Trustee should know whether a debtor intends to surrender real or personal property subject to a security interest before the United States Trustee's deadline to file a motion to dismiss for presumed abuse under Section 707(b)(2). *See* 11 U.S.C. §§ 521(a)(2), 704(b)(2). A debtor may attempt to rebut the presumption of abuse by showing "special circumstances" that justify an income adjustment or additional expenses. 11 U.S.C. § 707(2)(B)(i).

II. This Proceeding

Appellee Glen H. Rudler filed for chapter 7 bankruptcy relief in August 2006. App. 2 (bankruptcy court docket), App. 7 (petition). At the time of his filing, he earned $8,853 a month. App. 10. He owed a combined monthly payment of $4,000 on the two mortgages secured by his house. App. 14. He also owed roughly $20,000 for domestic support obligations and $70,000 for credit card debt. App. 28, 29-30.

Rudler filed a statement of intention with his petition stating that he intended to surrender the home securing the mortgages. App. 36. But when

Rudler calculated his monthly disposable income on Form 22A (Statement of Current Monthly Income and Means Test Calculation), he deducted the $4000 in monthly mortgage payments from his income. App. 14. This deduction, together with the deductions allowed under the means test for reasonable living expenses (as described above), resulted in monthly disposable income of negative $2,376.

If Rudler did not deduct the monthly mortgage payments, he could instead claim a statutorily prescribed housing allowance of $1439.[2] In that event, his monthly disposable income would be $1,461.[3] That amount is almost 9 times the

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[2] Rudler actually deducted both the mortgage payments *and* the statutory housing allowance. *See* App. 10 (Rudler's Form 22A). There is no basis for taking both deductions. In determining "net mortgage/rental expense" at Line 20B of Form 22A, the debtor is required to subtract the average monthly payment for the mortgage secured by the debtor's home from the IRS Standard. *See* Form 22A, Line 20B (instructing debtor to subtract "Average Monthly Payment for any debts secured by [debtor's] home…"). *See also In re Meek*, 370 B.R. 294, 311 -312 (Bankr. D. Idaho 2007) ("[B]ecause § 707(b)(2)(A)(ii)(I) provides that monthly expenses pursuant to the IRS Standards 'shall not include any payments for debts,' and debtors are permitted to deduct actual mortgage … amounts separately, debtors must deduct from the IRS Standard expenses for their monthly mortgage …payments to avoid double-dipping."); *In re Hardacre*, 338 B.R. 718, 726 -727 (Bankr. N.D. Tex. 2006) (11 U.S.C. § 707(b)(2)(A)(ii) requires that IRS standard allowances for housing costs be reduced by average monthly payments for debts secured by debtor's home in applying means test). This process allows a debtor whose actual mortgage expenses are less than the IRS Local Standard to claim those secured debt expenses plus the balance of the IRS standard. *See In re Meek*, 370 B.R. at 311-312. But when the debtor has mortgage payments greater than the IRS standard and can deduct those payments because he has reaffirmed the debt, the net mortgage/rent expense allowance properly calculated at Line 20B is $0.

[3] The United States Trustee filed with its motion to dismiss a side-by-side comparison of the deductions that Rudler took and the United States Trustee's own calculation of appropriate deductions. Addendum ("Add.") 17-22. The $1461 figure comes from the United States Trustee's calculation of appropriate deductions. Add. 21. The $162 discrepancy between the $1461 monthly disposable income figure arrived at by the United States Trustee and the $1621 figure that results when the

$167 monthly disposable income threshold for presumptive abuse set by 11 U.S.C. § 707(b)(2)(A). Indeed, if Rudler were to proceed under chapter 13, he would have roughly $87,000 to repay creditors.[4]

Because the presumption of abuse would apply if Rudler were to eliminate the secured debt payments on surrendered collateral from the means tests and, instead, claim only the statutory housing allowance, the United States Trustee moved to dismiss the case under Section 707(b)(2). The United States Trustee argued that Rudler should not have included the mortgage payments in his listing of monthly payments on account of secured debts because he did not intend to make those payments.

The bankruptcy court denied the motion to dismiss. That court concluded that "the means test includes a deduction from current monthly income for all scheduled contractual payments to secured creditors regardless of a debtor's intent with respect to . . . actual payment of the secured debt." Add. 7.

The United States Trustee appealed the case to the United States Bankruptcy Appellate Panel for the First Circuit. After concluding that it had

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$4000 in mortgage payments are added back in to Rudler's claimed negative $2376 in monthly disposable income reflects the United States Trustee's allowance for $162 in chapter 13 administrative expenses on line 45 of Form 22A. Add. 21.

[4] Chapter 13 effectively requires above-median income debtors to commit their projected disposable income to repaying creditors for the 60 month period following bankruptcy. *See* 11 U.S.C. §§ 1325(b)(1) and (b)(4)(A)(ii)(I) (prohibiting courts from approving a repayment plan proposed by an above median-income debtor where the plan does not commit all of the debtor's projected disposable income over 60 months to repay creditors). $1461 a month for 60 months is $87,665.

jurisdiction to review the order denying the United States Trustee's motion to dismiss, the appellate panel affirmed. The court concluded that Rudler properly included mortgage payments on Form 22A even though he had made clear that he intended to surrender the home securing the mortgages, because secured debt payments remain due regardless of whether the payments are made, the debt is reaffirmed, or the property is surrendered. *Morse v. Rudler (In re Rudler)*, 388 B.R. 433, 438 (1st Cir. BAP (N.H.) 2008). The court took the view that the Section 707(b)(2)(A)(iii) calculation is based on "a 'snap-shot' of the debtor's situation as of the petition date," not a forward-looking approach that takes account of whether the debtor will actually make the mortgage payments. *Id.* The court rejected the government's argument that interpreting the statute to allow deductions for payments that the debtor will never make would frustrate the statutory purpose of requiring those who can afford to repay some portion of their debts to do so. *Id.* at 438-439. Instead, the court determined that Congress's purpose was to "limit judicial discretion" using a "mechanical test," and that its interpretation furthered that interest. *Id.* at 439.

SUMMARY OF ARGUMENT

1. The bankruptcy court order denying the motion to dismiss was a final appealable order under the flexible standard of finality in 28 U.S.C. § 158. The order resolved the question whether the debtor's chapter 7 petition was abusive and left no opportunity for further consideration of whether the case should be dismissed as an abuse of chapter 7. It thus met the test for finality that it "finally

dispose of all the issues pertaining to a discrete dispute within the larger proceeding," *Perry* v. *First Citizens Fed. Credit Union (In re Perry)*, 391 F.3d 282, 285 (1st Cir. 2004), and this Court has jurisdiction to hear this appeal.

2. Section 707(b) of the Bankruptcy Code authorizes a bankruptcy court to dismiss a chapter 7 consumer bankruptcy case if the court "finds that the granting of relief would be an abuse of" chapter 7. 11 U.S.C. § 707(b). The provision thus requires bankruptcy courts to evaluate whether it would be appropriate to grant a debtor the relief offered by chapter 7 – a discharge of his past debts. In order to make that determination, a bankruptcy court must consider whether the debtor will have sufficient future income to repay his past debts. And to facilitate that inquiry, Congress has established a means test to identify cases that are presumptively abusive because the debtor has sufficient means to repay some of his debts.

The means test allows a debtor to deduct from his current monthly income his "average monthly payments on account of secured debt," and as relevant here it defines those payments as "the sum of the total of all amounts scheduled as contractually due to secured creditors in each month of the 60 months following the date of the petition . . . divided by 60." 11 U.S.C. § 707(b)(2)(A)(iii). The question in this case is whether the debtor correctly deducted $4000 in monthly mortgage payments from his income instead of taking the statutorily prescribed housing allowance, even though his petition made clear that he would never make the mortgage payments because the mortgage was secured by property that he intended to surrender. The question is significant, because if the debtor properly took those deductions, then all of his debts – including approximately $70,000 in unsecured credit card debt – will likely be discharged, but if the monthly mortgage payments were not properly deducted from his monthly disposable income, then his monthly disposable income would be $1461 and his petition would be presumptively abusive. Assuming he could not rebut the presumption of abuse (a question that the bankruptcy court did not need to reach, because it concluded that the presumption did not apply) and opted to proceed under chapter 13, this disposable income would give him roughly $87,000 to repay his creditors over the course of a 60 month plan.

The bankruptcy appellate panel concluded that the debtor was entitled to deduct his mortgage payments because the payments were and would remain "contractually due" even when the debtor surrendered his property. But the bankruptcy appellate panel erred by focusing in isolation on the phrase "contractually due." Read as a whole, the statute allows the deduction only of payments that the debtor actually intends to make.

By using the phrases "scheduled as contractually due" (rather than simply "contractually due") and "60 months following the date of the petition," the statute calls for a forward-looking assessment of which payments on secured debts will actually be made and are thus properly listed (or "scheduled") as "payments on account of a secured debt." Reading the means test this way makes it consistent with the mean's tests treatment of the debtor's other expenses, which are also forward looking.

Contrary to the reasoning of the bankruptcy appellate panel, a forward looking assessment of payments on account of secured debt cannot include payments that the debtor will never make. In many cases, when a debtor surrenders the collateral securing a debt, nothing remains "contractually due." Even in those situations where a debtor is liable for a deficiency, once title to the property securing the debt transfers, the remaining liability is not "contractually due to [a] *secured* creditor," as required by the statute. Accordingly, the debtor will not be liable for any payments that fit within the statutory terms.

Finally, allowing debtors to deduct only those payments that they actually will make best serves Congress's purpose in enacting the means test. The 2005 Act established a means test to ensure that those who can afford to repay some portion of their unsecured debts be required to do so. That purpose is best served by limiting the debtor to deductions that reflect his true financial circumstances rather than allowing him to shelter disposable income behind phantom payments on secured debt.

This court should reverse the decision of the bankruptcy appellate panel and rule that the means test does not allow Rudler to claim roughly $87,000 in mortgage payments that he will never make. In that event, Rudler's creditors will likely recover most – if not all – of what Rudler owes them, while Rudler will still be entitled to the standard IRS housing allowance provided by Section 707.

Conversely, if this Court accepts the views of the bankruptcy appellate panel, debtors who surrender property will be allowed to claim payments on that property that they will never make, and many debts will be discharged in bankruptcy based upon that fiction. That inequitable result is contrary to the better reading of Section 707(b)(2)(A), and it conflicts with Congress' stated purpose for enacting the 2005 Act.

STANDARD OF REVIEW

This Court reviews the legal conclusions of the Bankruptcy Appellate Panel *de novo*. *See In re Marrama*, 430 F.3d 474, 477 (1st Cir. 2005).

ARGUMENT

I. THIS COURT HAS JURISDICTION TO HEAR THIS APPEAL

Appeals to the United States Bankruptcy Appellate Panel for the First Circuit and to this Court are governed by 28 U.S.C. § 158 and 28 U.S.C. §§ 1291-1292. *See In re Northwood Properties, LLC*, 509 F.3d 15, 21 (1st Cir. 2007). The bankruptcy appellate panel, like a district court sitting in its appellate capacity in bankruptcy proceedings, has jurisdiction to review "final judgments, orders, and decrees" of the bankruptcy court. 28 U.S.C. § 158(a)(1). This Court has further appellate jurisdiction over "all final decisions, judgments, orders, and decrees" issued by the bankruptcy appellate panel. 28 U.S.C. § 158(d)(1); *see also* 28 U.S.C. § 1291. This limitation on this Court's appellate jurisdiction "recognizes that 'the 'finality' of a bankruptcy court's decision may be affected by the district court's disposition of the appeal,'" *Northwood Properties, LLC*, 509

F.3d at 21, *quotation omitted*; a remand by the bankruptcy appellate panel for purely ministerial action, however, does not deprive this Court of jurisdiction, *id.*

To be final, "a bankruptcy order need not resolve all of the issues in the proceeding, but it must finally dispose of all the issues pertaining to a discrete dispute within the larger proceeding." *Perry* v. *First Citizens Fed. Credit Union (In re Perry)*, 391 F.3d 282, 285 (1st Cir. 2004). Because "bankruptcy cases typically involve numerous controversies bearing only a slight relationship to each other, 'finality' is given a flexible interpretation in bankruptcy." *Northwood Properties*, 509 F.3d at 21, quoting *In re G.S.F. Corp.*, 938 F.2d 1467, 1473 (1st Cir. 1991), abrogated on different grounds by *Connecticut National Bank* v. *Germain*, 503 U.S. 249 (1992).

The bankruptcy court's decision denying the United States Trustee's motion to dismiss was a final and appealable order. A motion to dismiss under Section 707(b) is not akin to a motion to dismiss under 12(b)(6) of the Federal Rules of Civil Procedure, where the case proceeds if the motion is denied. A Section 707(b) motion institutes a cause of action – a "contested matter" – within the larger bankruptcy case, *see* Federal Rule of Bankruptcy Procedure 9014 (in "a contested matter not otherwise governed by these rules, relief shall be requested by motion"); *see also* Fed. R. Bankr. P. 1017(f)(1) (Rule 9014 governs proceedings to dismiss a case), alleging that the bankruptcy petition is an abuse of chapter 7. Unlike the denial of a 12(b)(6) motion, a bankruptcy court order denying a motion to dismiss for abuse finally settles the contested matter of whether the petition is abusive; denying the motion to dismiss means that the debtor's debts will be discharged unless some party files a separate action to block the discharge under 11 U.S.C. § 523 or 727. The bankruptcy court's order denying the motion to dismiss finally resolved the United States Trustee's claim that granting relief to Rudler would be an abuse of chapter 7. The order was thus a formal and final adjudication of the Section 707(b) proceeding.

Moreover, because the deadline for filing a motion to dismiss had passed when the court entered its order denying the motion to dismiss, the question whether the petition should be dismissed as an abuse of chapter 7 could not be reopened. *See* 11 U.S.C. § 704(b)(2) (establishing a 30-day deadline for the United States Trustee to file a motion to dismiss under Section 707(b)(2) measured from the date of the United States Trustee's filing an initial statement under Section 704(b)(1) regarding whether the case would be a presumed abuse under Section 707(b)(2)); Interim Fed. R. Bankr. P. 1017(e)(2) (establishing that a motion to dismiss for abuse under Section 707(b)(3) must be brought within 60 days after the first date set for the meeting of creditors).[5] The bankruptcy court's order thus "finally dispose[d] of all the issues pertaining to a discrete dispute

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[5] By contrast, other types of motions to dismiss bankruptcy cases are not subject to the time bar that restricts Section 707(b) motions. For example, a motion to dismiss a chapter 7 case for "cause" under Section 707(a) has no statutory or Bankruptcy Rule deadline and could be renewed if denied. *See also* 11 U.S.C. § 1112(b) (permitting dismissal of chapter 11 case for "cause" but establishing no deadlines for seeking such dismissal; the Bankruptcy Rules also set no relevant deadline); 11 U.S.C. 521(i) (setting grounds for "automatic []" dismissal but establishing no deadlines for seeking orders dismissing such cases; the Bankruptcy Rules also set no relevant deadline).

within the larger proceeding." *In re Perry*, 391 F.3d at 285. Likewise, the bankruptcy appellate panel's decision affirming the bankruptcy court's decision finally resolved the discrete issue raised by the motion.

Although the United States Supreme Court and this Court have not addressed whether orders denying Section 707(b) motions are final, three United States courts of appeals – the Eighth, Third, and Fifth – have adjudicated appeals from bankruptcy court orders denying Section 707(b) motions to dismiss under the "substantial abuse" standard in the pre-2005 version of the statute. Two expressly held such orders are final, *see Stuart v. Koch (In re Koch)*, 109 F.3d 1285, 1289 (8th Cir. 1997); *In re Christian*, 804 F.2d 46, 47-48 (3d Cir. 1986) (same), and the third treated as final a bankruptcy court order denying the United States Trustee's Section 707(b) motion to dismiss for substantial abuse, *see In re Cortez*, 457 F.3d 448, 453-54 (5th Cir. 2006).

While the Eleventh Circuit recently concluded in *In re Donovan*, 532 F.3d 1134 (11th Cir. 2008), that an order denying a motion to dismiss a chapter 7 case for substantial abuse was not appealable, that conclusion relied on cases concerning motions to dismiss under chapter 11, even though chapter 11 is distinguishable. Unlike a motion to dismiss for abuse under Section 707(b), nothing prevents a party in a chapter 11 case from filing multiple motions to dismiss while a case is open. *See* 11 U.S.C. § 1112(b) (permitting dismissal of chapter 11 case for "cause" but establishing no deadlines for seeking such dismissal; the Bankruptcy Rules also set no relevant deadline). An order denying a motion to dismiss in a chapter 11 case thus lacks the finality of the order denying the motion to dismiss here. This Court should follow the Eighth, Third, and Fifth Circuits and conclude that the bankruptcy court order at issue here is an final order subject to appeal under 28 U.S.C. § 158(a)(1).

II. SECTION 707(B)(2) DOES NOT ALLOW A DEBTOR TO DEDUCT MORTGAGE PAYMENTS THAT HE WILL NOT MAKE

Section 707(b) of the Bankruptcy Code authorizes a bankruptcy court to dismiss a chapter 7 case that involves "primarily consumer debts" (or with the debtor's consent, convert the case to chapter 13) if the court "finds that the granting of relief would be an abuse of the provisions of this chapter." 11 U.S.C. § 707(b). In the 2005 Act, Congress amended Section 707(b) to provide a means test to identify presumptively abusive filings. *See* 11 U.S.C. § 707(b)(2)(A). Congress called "the implementation of an income/expense screening mechanism ('needs-based bankruptcy relief' or 'means testing')" the "heart of the [2005 Act's] consumer bankruptcy reforms," and it explained that the means test "is intended to ensure that debtors repay creditors the maximum they can afford." *See* H.R. Rep. No. 109-31 (I) at 1 (2005), reprinted in 2005 U.S.C.C.A.N. 88, 89.

The means test requires the court to assess the debtor's current monthly income, reduced by projected allowable expenses for the period following the bankruptcy filing specified in 11 U.S.C. § 707(b)(2)(A)(ii)-(iv), and determine whether that income is above the threshold set out in the statute for presumptive abuse. Among these expenses is the debtor's "average monthly payments on account of secured debts." 11 U.S.C. 707(b)(2)(A)(iii). Section 707(b)(2)(A) defines "average monthly payments on account of secured debts" as the sum of "the total of all amounts scheduled as contractually due to secured creditors in each month of the 60 months following the date of the petition," divided by 60. 11 U.S.C. § 707(b)(2)(A)(iii). Contrary to the conclusion of the bankruptcy appellate panel, this definition of "average monthly payments on account of secured debt" does not include mortgage payments that the debtor will not make.

A. Read as a Whole, Section 707(b)(2)(A) Makes Clear That the Means Test Is Forward Looking

Section 707(b)(2)(A)(iii), like any statutory provision, must be read as a whole. *See Koons Buick Pontiac GMC, Inc.* v. *Nieh*, 543 U.S. 50, 60 (2004) (calling for a "holistic" approach to reading statutes). The phrases "scheduled as" and "following the date of the petition" call for a projection of what the debtor's payments on account of secured debt will be following bankruptcy. And in light of the means test's more general approach to identifying allowable expenses, the phrase "average monthly payments on account of secured debt" must be understood to include only payments on account of secured debt that the debtor actually will make.

1. While the bankruptcy appellate panel concluded that the phrase "scheduled as contractually due" required it to look at a current "snapshot" of the debtor's obligations on account of secured debt, *Morse v. Rudler (In re Rudler)*, 388 B.R. at 438, even read in isolation the phrase "scheduled as contractually due" is not best understood this way. Reading the phrase "scheduled as contractually

due” to include all current contractual obligations fails to give independent meaning to the words “scheduled as.”

If Congress meant for debtors to deduct all “contractually due” payments without regard to whether they would actually be made, it could have left out the phrase “scheduled as” and defined “payments on account of secured debts” as payments that are “contractually due . . . following the date of the petition” instead of “scheduled as contractually due . . . following the date of the petition.” Reading the phrase “scheduled as contractually due” to call for a forward-looking assessment of whether the payments will actually be made gives separate effect to the term “scheduled as” in the phrase “scheduled as contractually due,” and thus honors the rule that “whenever possible, every word and phrase in a statute should be given effect.” *Aguilar* v. *U.S. Immigration and Customs Enforcement Div. of Dept. of Homeland Sec.*, 510 F.3d 1, 10 (1st Cir. 2007). By contrast, the bankruptcy appellate panel’s reading gives no independent meaning to the phrase “scheduled as.” As one court explained, considering the phrase “scheduled as contractually due” from Section 707(b)(2)(A)(iii) in a chapter 13 case, the word “scheduled” is best understood to “contemplate[] a forward looking approach. That is, one schedules something which one expects to take place in the future and not an event which one plans to avoid.” *In re Love*, 350 B.R. 611, 613-14 (Bankr. M.D. Ala. 2006).

The phrase “scheduled as contractually due” should also be read to mean something more specific than “contractually due” because the phrase “scheduled as" is a term of art in the Bankruptcy Code – the Code refers to a claim or debt being "scheduled as" due if the debt is properly listed on a debtor's bankruptcy schedules. *See In re Skaggs*, 349 B.R. 594, 599 (Bankr. E.D. Mo. 2006). The only provision of the Code other than Section 707(b)(2)(A)(iii) that uses the phrase "scheduled as" is 11 U.S.C. § 1111(a). Section 1111(a) provides that a "proof of claim or interest is deemed filed under section 501 of this title for any claim or interest that appears in the schedules filed under . . . section 521(1) or 1106(a)(2) of this title, except a claim or interest that is *scheduled as* disputed, contingent, or unliquidated." (Emphasis added). The second part of the provision excepts claims that are "*scheduled as* disputed, contingent, or unliquidated." In context, "scheduled as" thus means "appears on the schedule" or "appended to" the schedule. Because of the "'normal rule of statutory construction,' *Sorenson* v. *Secretary of Treasury*, 475 U.S. 851, 860, 106 S.Ct. 1600, 1606, 89 L.Ed.2d 855 (1986), that 'identical words used in different parts of the same act are intended to have the same meaning,' *Atlantic Cleaners & Dyers, Inc.* v. *United States*, 286 U.S. 427, 433, 52 S.Ct. 607, 609, 76 L.Ed. 1204 (1932)," *Commissioner* v. *Keystone Consol. Industries, Inc.*, 508 U.S. 152, 159 (1993), "scheduled as contractually due" in Section 707(b)(2)(A) should be read to include contractual obligations on secured debts that are properly listed on a bankruptcy schedule because the debtor intends to honor them.

The bankruptcy appellate panel rejected this argument on the basis of *In re Nockerts*, 357 B.R. 497 (Bkrtcy. E.D. Wis. 2006). But *Nockerts* considered a broader argument about the word "scheduled," not the phrase "scheduled as." *Nockerts* reviewed each use of the term "scheduled" in the Code and concluded that the term sometimes refers to the placement of a claim or debt on a bankruptcy schedule but sometimes is used in a more general sense. *See Nockerts*, 357 B.R. at 502. *Nockerts* thus does not address the meaning of the narrower phrase "scheduled as," which appears only in Section 1111a and Section 707(b)(2)(A)(iii). Reading "scheduled as contractually due" to call for a forward looking assessment of whether a payment on a secured debt is properly listed on a bankruptcy schedule has the benefit of making the phrase "scheduled as" mean the same thing in Section 707(b)(2)(A)(iii) that it means in Section 1111(a).

2. Allowing a deduction for mortgage payments that will never be made on the basis that the payments remain "contractually due" also fails to take account of the phrase "*following* the date of the petition" in the statute. *See In re Naut*, 2008 WL 191297 at *9 (Bankr. E.D. Pa. Jan. 22, 2008) (unpublished disposition); *In re Harris*, 353 B.R. 304, 308-10 (Bankr. E.D. Okla. 2006); *In re Skaggs*, 349 B.R. 594, 599-600 (Bankr. E.D. Mo. 2006). The word "following," used as a preposition, means "subsequent to" or "after in time." *Webster's Third New International Dictionary*, 833 (1993). By requiring courts to look at payments due "subsequent to" or "after" the date of the petition, the statute makes clear that it contemplates a projection of future expenses rather than a snapshot of current expenses. Accordingly, the means test allows the debtor to deduct from his current monthly income only those payments on account of secured debt that he

actually will make after he files the petition. As the court explained in *Naut*, "[i]ncluding a loan payment as a deduction from income must be based on the loan payment actually being due in each of the 60 months after the bankruptcy petition is filed. Only this interpretation properly gives effect to every clause and word in the statute." *In re Naut*, 2008 WL 191297 at *9. *See also In re Ray*, 362 B.R. 680, 683 n.5 (Bankr. D. S.C. 2007).

3. The term "payments on account of secured debts" should also be read to call for a forward-looking assessment of what payments the debtor actually will make because that reading treats the deduction for payments on secured debts most consistently with the treatment of other expenses under the means test. It is a general rule of statutory construction that "'a word [in a statute] is known by the company it keeps,' a rule that 'is often wisely applied where a word is capable of many meanings in order to avoid the giving of unintended breadth to the Acts of Congress.' *Jarecki* v. *G.D. Searle & Co.*, 367 U.S. 303, 307, 81 S.Ct. 1579, 6 L.Ed.2d 859 (1961); *see also Dole* v. *Steelworkers*, 494 U.S. 26, 36, 110 S.Ct. 929, 108 L.Ed.2d 23 (1990) ('[W]ords grouped in a list should be given related meaning' (internal quotation marks and citations omitted))." *Dolan* v. *United States Postal Serv.*, 546 U.S. 481, 486-487 (2006).

The other deductions allowed by the means test are forward looking. Section 707(b)(2)(A)(ii) does not use actual expenses to define the expenses that the debtor may deduct from current monthly income. Rather, it requires the debtor to calculate and deduct only those expenses allowed under the statute. The statute sets allowable expenses using several different methods. For example, living expenses are based on Internal Revenue Service standards. *See* 11 U.S.C. § 707(b)(2)(A)ii)(I). The statute sets other expenses, such as health and disability insurance, as actual expenses subject to a "reasonably necessary" standard. *See id.* Finally, the statute sets expenses for a dependant child at actual expenses "not to exceed" a dollar amount specified in the statute and periodically adjusted. 11 U.S.C. § 707(b)(2)(A)(ii)(IV). By requiring the debtor to project his expenses as defined under these rules and deduct only those expenses, rather than allowing him to deduct actual expenses, the statute calls for a forward-looking assessment of the debtor's disposable income in the months following bankruptcy. In light of these forward-looking definitions of allowable expenses, the definition of "payments on account of secured debt" is best read to be forward looking as well.

By focusing on the single term "contractually due" without giving due consideration to the phrases "scheduled as" and the phrase "following the date of the petition," the bankruptcy appellate panel "miss[ed] the actual meaning and the intent of § 707(b)(2)." *Skaggs* at 600. Read as a whole and in light of the other deductions allowed under the means test, Section 707(b)(2)(A)(iii) requires a forward-looking assessment of the secured payments that the debtor actually will make.

B. Looking Forward, Payments That the Debtor Will Not Make Cannot Be Considered "Payments on Account of a Secured Debt"

The bankruptcy appellate panel reasoned that it ultimately did not matter whether the statute was forward looking, because "nothing the debtor does or does not do," including surrendering the secured property, "changes the fact that scheduled payments remain contractually due." *Morse v. Rudler (In re Rudler)*, 388 B.R. at 437. But that reasoning reflects a misunderstanding of the law of secured debts. Contrary to the bankruptcy appellate panel's conclusion, the surrender and transfer of title of collateral securing a debt changes the nature of the debt, so that any remaining obligation on the debt is not an obligation "on account of a secured debt" and any payment would not be made to a "secured creditor," as required by the statute. Accordingly, the forward looking nature of the means test is critically important; it means that payments that are due on a secured debt but the debtor will never make cannot be deducted from monthly income under the means test.

While a debtor's obligation on account of a secured debt after he surrenders the collateral varies under state law, surrender and transfer of title either eliminates the obligation or turns the debt into an unsecured debt. Some states are non-recourse states, in which a borrower may surrender property and will not be liable for any deficiency. *See* Baxter Dunaway, *State Laws and Practices Regarding Confirmation of Sale and Deficiency Judgments*, Appendix 19A, Law of Distressed Real Estate (2008). And even in recourse states, once the debtor surrenders the collateral and title transfers to the lender, the debt becomes an unsecured debt rather than a secured one, which means that any payment on a contractual obligation that follows would not be a "payment on account of [a] secured debt[]," and would not be made to a "secured creditor." *See In re Wright*, 492 F.3d 829 (7th Cir. 2007) (concluding that where debtors owed more on their purchase-money automobile loan than the car was worth, any shortfall had to be treated as an unsecured debt under the Bankruptcy Code, because the creditor was entitled only to an unsecured deficiency judgment after surrender of the car).

While the bankruptcy appellate panel in this case noted that surrendering the secured property would not change "the fact that scheduled payments remain contractually due," *Morse v. Rudler (In re Rudler)*, 388 B.R. at 437, the court failed to recognize that any obligation that remains "contractually due" would not be due to a "secured creditor," as specified in the statute. Once the surrender (or foreclosure) takes place and title is transferred to the lender, any obligations become *unsecured*, and that fact is relevant to the debtor's monthly expenses, and thus relevant to whether granting the debtor a chapter 7 discharge would be an abuse. As one court has explained, when "a debtor surrenders collateral, the debtor is no longer required to make the scheduled installment payments. If there is a deficiency after application of the collateral proceeds to the indebtedness, an unsecured claim remains, but a secured debt no longer exists and no payment is due except for an unsecured deficiency balance." *In re Harris*, 353 B.R. at 309. "'Indeed, debtors return collateral to secured parties for the express purpose of lowering their monthly living expenses.'" *Id., quoting In re Love*, 350 B.R. 611, 614-15 (Bankr. M.D. Ala. 2006). A court assessing a motion to dismiss a filing as presumptively abusive will know whether the debtor intends to make payments on the debt or forfeit the collateral. A debtor must file a statement of intention as to whether he intends to retain or surrender property secured by debt within 30 days of the earlier of the chapter 7 petition date and the date of the meeting of creditors. *See* 11 U.S.C. § 521(a)(2)(A); Interim Fed. R. Bankr. P. 1017(b)(2) (requiring individual debtors in chapter 7 cases to file a statement of intent on the appropriate form); *In re Burr*, 160 F.3d 843, 849 (1st Cir. 1998). This means that the latest possible date for the debtor to file the statement is 30 days after he files the chapter 7 petition. United States Trustees have 10 days from the meeting of creditors to "review all materials" filed by the debtor (including the statement of intent), and file a statement as to whether the debtor's case would be presumed abusive under Section 707(b), and 30 days to file a motion to dismiss for presumed abuse. 11 U.S.C. § 704(b)(1) and (2). Because the meeting of creditors must be held "no fewer then 20 and no more than 40 days after the order for relief," *see* Federal Rule of Bankruptcy Procedure Rule 2003, which in a voluntary petition under chapter 7 is the date of the petition, *see* 11 U.S.C. 301(b), the United States Trustee should know by the deadline for filing his statement on presumptive abuse whether the debtor intends to surrender property secured by debt.

In this case, Rudler not only stated his intent to forfeit the property, he actually failed to make mortgage payments prior to his bankruptcy filing. *See* App. 46 (Secured Creditor's Motion for Relief from Automatic Stay, noting a pre-petition arrearage of $21,259). Accordingly, allowing him to deduct his mortgage payments would not even provide an accurate snapshot of his *current* payments on account of secured debts as of the date of the petition. *See In re Naut*, 2008 WL 191297 at *8 ("debts must be included on a debtor's Schedule J [the statement of current expenses required by 11 U.S.C. § 521(a)(1)(B)(ii)] to be deducted from income through the means test.").[6] Rather, as explained above, it would allow him to shelter approximately $1461 a month in disposable income that otherwise could be used to pay his creditors. For all these reasons, a debtor's intent to surrender the collateral securing a debt means that payments due on that debt should not be deducted as "payments on account of a secured debt" under the means test.

C. Disallowing Deductions for Payments That Will Never Be Made Best Serves the Purpose of the Means Test

1. Allowing a deduction only for mortgage payments that actually will be made is not only compelled by the statutory text, but also best serves Congress's purpose in enacting the means test. The 2005 Act established the means test – the "heart of the [2005 Act's] consumer bankruptcy reforms," H.R. Rep. No. 109-31

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[6] Rudler filed for bankruptcy on August 15, 2006, but the record reflects that his mortgage was in arrears prior to the filing. App. 2 (petition date), 46 (Motion for Relief from Automatic Stay noting arrearage). Because Rudler had stopped making mortgage payments when he filed, his case does not present the question of how to account for mortgage payments made between the date of a bankruptcy filing and the date of the forfeiture of the property securing the mortgage. Moreover, Rudler's experience appears to be typical; other decisions note that the debtor had stopped making payments on the debt at least as soon as he stated an intent to forfeit, if not before, even though the actual forfeiture had not yet taken place. *See, e.g., In re Naut*, 2008 WL 191297 at *7 (Bankr. E.D. Pa. Jan. 22, 2008) (noting that the debtor "ceased making payments on the [secured] debt at least at the time he filed his petition in this case."); *In re Nockerts*, 357 B.R. at 500 (noting that the debtors testified at the meeting of creditors that they were "not making the monthly payment on the mortgages"). Accordingly, how to apply Section 707(b)(2)(A)(iii) where the debtor makes a mortgage payment after filing for bankruptcy but before forfeiting his property appears to be a purely theoretical question.

(I) at 1 (2005), reprinted in 2005 U.S.C.C.A.N. 88, 89 – to identify which debtors have the means to pay something to their creditors, and which do not. Congress intended the means test to ensure that those who can afford to repay some portion of their unsecured debts be required to do so. *See* H.R. Rep. No. 109-31 (I) at 1 (2005), reprinted in 2005 U.S.C.C.A.N. 88, 89 (stating intent to make certain that debtors "repay creditors the maximum they can afford."). That purpose is better served by allowing the debtor to include only those payments that the debtor actually will make. Reading the means test to allow the deduction of payments that the debtor has no intention of making would make the means test a less accurate picture of the debtor's "average monthly payments on account of secured debts." By contrast, reading the statute to allow only those payments that actually will be made gives a more accurate picture of what the debtor's resources will be in the period following the petition, which is the key fact for determining whether the petition is presumptively abusive. In this case, the difference is stark. If the ruling below stands, Rudler's debts will be discharged even though he has $1461 in disposable income and could repay his creditors roughly $87,000 over the course of a 60 month chapter 13 plan.

The bankruptcy appellate concluded that its interpretation of the statute served Congress's intent to create a "mechanical" means test. *See Morse v. Rudler (In re Rudler),* 388 B.R. at 439. The history of the 2005 Act makes clear, however, that Congress's primary intent in creating the means test was to decrease the number of abusive filings by ensuring that debtors "repay creditors the maximum they can afford," and its effort to make the means test a mechanical one was subsidiary to the effort to eliminate abuse. And in any event, the means test is more accurate, and no less mechanical, if it requires a court to take the debtor's intent to surrender property securing a debt into account when projecting the debtors payments on account of secured debt in the 60 months following the filing of the bankruptcy petition.

2. An analogy to this Court's interpretation of the factors for dismissing a chapter 7 petition prior to the 2005 Act also suggests that the means test should not be read to allow the deduction of payments on account of secured debt that will not be made. Prior to the 2005 Act, Section 707(b) provided a presumption in favor of discharging the debts of a chapter 7 debtor, and a party seeking dismissal under Section 707(b) was required to show that permitting the case to proceed under chapter 7 would be a "substantial abuse" of the provisions of chapter 7. The 2005 Act changed this statutory framework by removing both the presumption in favor of discharge and the term "substantial." A chapter 7 case may now be dismissed or converted upon a showing that the grant of relief under chapter 7 would be only an abuse (not a substantial abuse) of the provisions of chapter 7. 11 U.S.C. §§ 707(b)(1), 707(b)(2)(A). Interpreting the "substantial abuse" requirement that applied prior to the 2005 Act, this Court held that, to determine whether a petition would be a "substantial abuse" of chapter 7, bankruptcy courts should consider whether the debtor could repay a substantial portion of his past debts. *See In re Lamanna*, 153 F.3d 1, 4 (1st Cir. 1998). The other courts of

appeals agreed that the key question was whether the debtor could repay a substantial portion of his debts. *See In re Behlke*, 358 F.3d 429, 434, 437 (6th Cir. 2004); *In re Price*, 353 F.3d 1135, 1140 (9th Cir. 2004); *In re Stewart*, 175 F.3d 796, 809 (10th Cir. 1999); *In re Kornfield*, 164 F.3d 778, 781, 784 (2d Cir. 1999); *Fonder v. United States*, 974 F.2d 996, 999 (8th Cir. 1992); *In re Krohn*, 886 F.2d 123 (6th Cir. 1989).

Because Congress eliminated the presumption in favor of discharge and the requirement that the abuse of chapter 7 be "substantial," the standard for whether a bankruptcy petition should be dismissed under Section 707(b) must now be understood to be less demanding than it was before the 2005 Act. If "substantial abuse" requires the ability to repay a substantial portion of one's debts, then simple abuse must require the ability to repay something less than a substantial amount one's debts. But reading the means test to allow the deduction of payments on account of secured debt even though those payments will never be made would effectively allow the debtor to shelter a substantial portion of his income, which would make the standard for dismissal of a chapter 7 petition harder to meet, rather than easier. As one court has explained, the debtor "would be artificially reducing his current monthly income to defeat the purpose of the means test and to avoid paying his debts to his creditors, when he could in fact afford to pay." *In re Naut*, 2008 WL 191297, at *8.

CONCLUSION

The judgment of the Bankruptcy Appellate Panel should be reversed.

Respectfully submitted,

PHOEBE MORSE
United States Trustee
Districts of Maine, Massachusetts
New Hampshire and Rhode Island

RAMONA D. ELLIOTT
P. MATTHEW SUTKO
Executive Office for
United States Trustees
U.S. Department of Justice
20 Massachusetts Ave. N.W.
Washington, D.C. 20530-0001

Geraldine Karonis
Ann Marie Dirsa
Office of the United States Trustee
District of New Hampshire
1000 Elm St., Suite 605
Manchester, New Hampshire 03101

GREGORY G. KATSAS
Assistant Attorney General

WILLIAM KANTER
(202) 514-4575
TEAL LUTHY MILLER
(202) 514-5048
Attorneys, Appellate Staff
Civil Division, Room 7234
U.S. Department of Justice
950 Pennsylvania Ave., N.W.
Washington D.C. 20530-0001

SEPTEMBER 2008

CERTIFICATE OF SERVICE

I certify that on September 15, 2008 I filed and served the foregoing brief by causing nine copies together with a computer readable copy on diskette to be sent by overnight delivery to the Clerk of the Court, and by causing two copies and a diskette to be sent by overnight delivery to the following counsel:

Scott W. LaPointe, Esquire,
Brown & LaPointe, P.A.
128 Main Street
Epping, NH 03042

____
Teal Luthy Miller

CERTIFICATE OF COMPLIANCE

1. This brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B) because this brief contains 9394 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B) (iii).

2. This brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P 32(a)(6) because it has been prepared in a proportionally spaced typeface using Word Perfect 9 in 14 point Times New Roman.

TEAL LUTHY MILLER

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2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	1st Cir.
3. ("CCN") ***CURRENT*** CASE NO.	No.:08-9007
4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*	No.: 07-015 Court: BAP 1st Cir. *(Identify judge & cite, if any)*
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9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	• Whether, under 11 U.S.C, § 707(b)(2)(A)(iii), a debtor may claim an expense allowance for future payments on a secured debt when the property collateralizing the secured debt is being surrendered.
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No. 08-9007

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIRST CIRCUIT

IN RE GLEN H. RUDLER, DEBTOR.

PHOEBE MORSE, United States Trustee for the Districts of Maine,
Massachusetts, New Hampshire and Rhode Island, Appellant,

v.

GLEN H. RUDLER, Appellee.

ON APPEAL FROM THE UNITED STATES BANKRUPTCY
APPELLATE PANEL FOR THE FIRST CIRCUIT

REPLY BRIEF FOR THE APPELLANT

PHOEBE MORSE
United States Trustee
Districts of Maine, Massachusetts
New Hampshire and Rhode Island

RAMONA D. ELLIOTT
P. MATTHEW SUTKO
Executive Office for
United States Trustees
U.S. Department of Justice
20 Massachusetts Ave. N.W.
Washington, D.C. 20530-0001

Geraldine Karonis
Ann Marie Dirsa
Office of the United States Trustee
District of New Hampshire
1000 Elm St., Suite 605
Manchester, New Hampshire 03103

GREGORY G. KATSAS
Assistant Attorney General

WILLIAM KANTER
(202) 514-4575
TEAL LUTHY MILLER
(202) 514-5048
Attorneys, Appellate Staff
Civil Division, Room 7234
U.S. Department of Justice
950 Pennsylvania Ave., N.W.
Washington D.C. 20530-0001

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ON APPEAL FROM THE UNITED STATES BANKRUPTCY
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REPLY BRIEF FOR THE APPELLANT

This case concerns the proper treatment under the means test of approximately $87,000 in mortgage payments that the debtor acknowledges he will never make. The means test allows debtors to deduct "average monthly payments on account of secured debts," 11 U.S.C. § 707(b)(2)(A)(iii), from their monthly income when determining whether that income is above the threshold at which a bankruptcy filing is presumptively abusive. Section 707(b)(2)(A) defines "average monthly payments on account of secured debts" as the sum of "the total of all amounts scheduled as contractually due to secured creditors in each month of the 60 months following the date of the petition," divided by 60. 11 U.S.C. § 707(b)(2)(A)(iii). The United States Trustee understands these provisions to prohibit a debtor from deducting payments on secured debts that the debtor will never make, because a payment is not "scheduled as contractually due" following the petition, *i.e.*, properly listed on a bankruptcy schedule as a payment that will be made even after the bankruptcy, if the debtor has made clear that he will not make it. In concluding that a debtor can deduct mortgage payments that he will never make, the bankruptcy appellate panel reasoned that the means test is intended to provide a mechanical "snap shot" of the debtor's situation at filing. But that reasoning not only reflects an incorrect understanding of the statute, it does not even support the panel's decision. In any event, the United States Trustee's treatment of the test is no less mechanical than the panel's, and it provides a more accurate picture of whether a filing is presumptively abusive. This court should reverse the panel's decision.

Debtor William Rudler argues that he should be permitted to deduct mortgage payments that he will never make because those payments remained due at the time that he prepared his filing, even though he made clear that he would not make them. Rudler's reading of the statute misreads the term "scheduled as contractually due" and fails to take account of the phrase "following the date of the petition" that follows it. Rudler's brief also contains no response to our argument that the United States Trustee's reading of Section 707(b)(2)(A)(iii) treats payments on secured debts most consistently with other expenses deductible under the means test, and makes no attempt to reconcile his reading of the section with Congress's purpose in adopting the means test.

ARGUMENT

Section 707(b) of the Bankruptcy Code authorizes a bankruptcy court to dismiss a Chapter 7 case (or convert it to Chapter 13) if it finds that "the granting of relief would be an abuse of the provisions of this chapter." 11 U.S.C. § 707(b). In the 2005 Act, Congress added the means test to the Bankruptcy Code to identify presumptively abusive filings. *See* 11 U.S.C. § 707(b)(2)(A). Contrary to Rudler's arguments, the means test does not allow him to deduct mortgage payments that he will not make when calculating his current monthly income reduced by projected allowable expenses for the period following the bankruptcy filing.

I. Read as a Whole, Section 707(b)(2)(A) Is Forward Looking

A. Rudler argues for his interpretation of the statute on the ground that it is compelled by plain meaning. He suggests (Br. at 6) that the phrase "scheduled as contractually due" includes payments that will be contractually due after the filing, regardless of whether they will be made, because "[o]therwise, the word 'scheduled' would have no meaning." But it is his reading that fails to give any independent meaning to the phrase "scheduled as."

If Congress meant for debtors to deduct all "contractually due" payments without regard to whether they would actually be made, it could have left out the phrase "scheduled as" and defined "payments on account of secured debts" as payments that are "contractually due . . . following the date of the petition" instead of "scheduled as contractually due . . . following the date of the petition." Reading the phrase "scheduled as contractually due" to call for a forward-looking assessment of whether the payments will actually be made takes account of the debtor's intent to reaffirm or disavow a debt and thus gives separate effect to the term "scheduled as" in the phrase "scheduled as contractually due." That approach is consistent with the rule that "whenever possible, every word and phrase in a statute should be given effect." *Aguilar* v. *U.S. Immigration and Customs Enforcement Div. of Dept. of Homeland Sec.*, 510 F.3d 1, 10 (1st Cir. 2007).

As we explain in our opening brief (at 22-23), the phrase "scheduled as" is a term of art in the Bankruptcy Code. Something is "scheduled as" in the meaning of the Code when it is properly listed on a debtor's bankruptcy schedules. While Rudler contends (Br. at 12-13) that "scheduled as" does not have this special meaning in the Code, noting that the Code sometimes uses the term "scheduled" to refer to the placement of a claim or debt on a bankruptcy schedule but sometimes uses in a more general sense (Br. at 12-13, quoting *In re Nockerts*, 357 B.R. 497, 502 (Bankr. E.D. Wis. 2006)), that general contention misses the narrower point. *Nockerts* addresses the use of the term "scheduled" generally, not the meaning of the narrower phrase "scheduled as," which appears only in Section 1111a and Section 707(b)(2)(A)(iii). Accordingly, Rudler's reliance on *Nockerts* is unresponsive.

B. Allowing a deduction for mortgage payments that will never be made on the theory that the payments are contractually due even if the debtor will never make them also ignores the phrase "*following* the date of the petition." As we have explained, the word "following," used as a preposition, means "subsequent to" or "after in time." *Webster's Third New Int'l Dictionary*, 833 (1993). By requiring courts to look at payments contractually due “subsequent to” or “after” the date of the petition, the statute makes clear that it contemplates a projection of future expenses rather than a snapshot of current expenses. The means test thus allows the debtor to deduct only payments that he actually will make.

C. The term “payments on account of secured debts” should also be read to call for a forward-looking assessment of what payments the debtor actually will make because that reading treats the deduction for payments on secured debts most consistently with the treatment of other expenses under the means test. It is a general rule of statutory construction that “‘a word [in a statute] is known by the company it keeps.’” *Dolan* v. *United States Postal Serv.*, 546 U.S. 481, 486-487 (2006).

As our opening brief explained (at 25-26), the other deductions allowed by the means test are forward looking. Rudler makes no response to this point about the other provisions of the means test. Instead, he contends (Br. at 10) that Congress could have used more specific language in the means test to indicate that a debtor cannot deduct payments on secured debt that he will not make, pointing to the second clause of Section 707(b)(2)(A)(iii) as an example. But the second clause of Section 707(b)(2)(A)(iii) actually supports rather than undermines the United States Trustee’s position that the means test is forward looking, because the second clause provides that only payments that actually will be made should be factored in to the test.

As is now familiar, the first clause of Section 707(b)(2)(A)(iii) – the one at issue here – provides that the debtor’s average monthly payments on account of secured debts shall be calculated as the sum of the “total of all amounts scheduled as contractually due to secured creditors in each month of the 60 months following the date of the petition." The second clause also allows "any additional payments to secured creditors necessary for the debtor, in filing a plan under chapter 13 of this title, to maintain possession of the debtor's primary residence, motor vehicle, or other property necessary for the support of the debtor and the debtor's dependents, that serves as collateral for secured debts." The use of the word "additional" and the relationship of these two provisions is telling. The payments in the second clause can only be "*additional* payments" (as opposed to simply being "payments") if they are additional to the payments referred to in the first clause. By providing that only "*additional payments*" necessary to maintain possession of certain allowable items should be factored in under the means test, the second clause makes clear that the first clause also refers to *payments*, *i.e.*, amounts that actually will be paid.[1]

D. Contrary to Rudler's suggestion (Br. at 6), Sovereign Bank's Motion for Relief from Stay does not show that Rudler properly deducted the payments that he will never make, for two reasons. First, the bank's motion did not purport to interpret the provisions of the statute. Second, while the bank used the term "contractually due" at one point in its motion and separately referred to the "next scheduled payment," it never referred to a particular payment as being "scheduled as contractually due." That a payment might be commonly referred to as being due under a contract ("contractually due") even if it will not be made does not show that

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[1] The second clause excludes luxury items from cure calculations under a bankruptcy plan by making clear that only the primary residence and other items necessary for support should be reaffirmed and deducted as monthly expenses.

the payment is a "payment on account of a secured debt" that is "scheduled as contractually due" within the meaning of the Code. The United States's Trustee's argument does not depend on the "contractually due" language in isolation. Rather, it is the United States Trustee's position that, by using the phrases "scheduled as contractually due" (rather than simply "contractually due") and "60 months following the date of the petition," the statute calls for a forward-looking assessment of which payments on secured debts will actually be made and are thus properly listed (or "scheduled") as payments on account of a secured debt.

II. Contrary to Rudler's Arguments, Payments That the Debtor Will Not Make Cannot Be Considered "Payments on Account of a Secured Debt"

As our opening brief explains, the bankruptcy appellate panel was wrong to conclude that "nothing the debtor does or does not do," including surrendering the secured property, "changes the fact that scheduled payments remain contractually due." *Morse v. Rudler (In re Rudler)*, 388 B.R. 431, 437 (1st Cir. BAP (N.H.) 2008). The surrender and transfer of title of collateral securing a debt changes any remaining debt from a secured debt to an unsecured one *See In re Wright*, 492 F.3d 829, 833 (7th Cir. 2007). Once the debtor surrenders the collateral, any remaining obligation on the debt is not an obligation "on account of a secured debt" and any payment would not be made to a "secured creditor," as required by the statute. Because any remaining obligation would not be "on account of a secured debt" or to a "secured creditor," the bankruptcy appellate panel was wrong to conclude that surrender would not change the status of Rudler's remaining contractual obligations within the meaning of the statute.[2]

Rudler does not dispute that surrender and transfer of title changes the nature of the debt. Instead, he contends (Br. at 8) that the logical consequence of this point is that "all parties would have to wait until the debtor had surrendered his homestead and the bank had foreclosed on the homestead satisfying the debt, before the court could correctly determine the number of months that the debtor could be permitted to include payments on the secured debt." Rudler's contention misunderstands the significance of this point about the law of secured debts; the point is not that the means test requires parsing individual payments, but rather that the court below was incorrect when it concluded that the debtor should be permitted to deduct payments he was contractually obligated to make without regard to his intent to surrender because surrender and transfer of title does not change the fact "that scheduled payments remain contractually due" within the meaning of the statute. Contrary to the

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[2] Several Courts of Appeals have followed the Seventh Circuit's decision in *Wright*, which concerns the proper treatment of a debt secured by a vehicle under Chapter 13 when the debtor surrenders the vehicle. Like the Seventh Circuit, those courts have each recognized that, once a debtor surrenders secured property, any remaining obligation on the debt becomes unsecured. *See DaimlerChrsyler Financial Services Americas LLC* v. *Barrett (In re Barrett),* __ F.3d __, 2008 WL 4378739 *7 (11th Cir.) ("creditor may pursue an *unsecured* deficiency claim") (emphasis added); *Tidewater Financial Co. v. Kenney*, 531 F.3d 312, 318 (4th Cir. 2008) *(*"the creditor may pursue an *unsecured* deficiency claim under state law") (emphasis added); *DaimlerChrsyler Financial Services Americas LLC* v. *Ballard (In re Ballard)*, 526 F.3d 634, 638 (10th Cir. 2008) (A creditor may pursue an *unsecured* deficiency claim when the debtor surrenders the vehicle") (emphasis added); *Capital One Auto Finance* v. *Osborn*, 515 F.3d 817, 822 (8th Cir. 2008) (under state law, "an *unsecured* deficiency judgement is allowed when the creditor complies with [the] law governing disposition of collateral after default")(emphasis added); *see also AmeriCredit Financial Services, Inc.*, v. *Long (In re Long),* 519 F.3d 288 (6th Cir. 2008) (recognizing general principle but calling for national rule regarding deficiencies).

court's reasoning, the debtor's intent to surrender has significant implications for his contractual obligations and for the best estimate of the debtor's monthly disposable income following bankruptcy.

Congress added the means test to Chapter 7 as a safeguard against abusive filings. The means test is an estimate of the debtor's monthly disposable income for the 60 month period following bankruptcy, not an after-the-fact accounting of disposable income. The test estimates the debtor's monthly disposable income to determine whether the debtor would have sufficient means to repay some or all of his debts under a Chapter 13 plan. The means test provides a more accurate estimate if it disallows deductions of payments on secured debt where the debtor intends to surrender the property securing the debt and cease making payments on the debt than it is if it allows deductions for the life of the secured debt without regard to surrender, even if in some cases debtors end up making a few payments that are not factored into the estimate. Because Section 521(a)(2)(B) requires the debtor to surrender shortly after filing the statement of intention, *see* 11 U.S.C. § 521 (a)(2)(B) ("within 30 days after the first date set for the meeting of creditors under section 341(a), or within such additional time as the court, for cause, within such 30-day period fixes, the debtor shall perform his intention with respect to such property, as specified by subparagraph (A) of this paragraph."), debtors in any event should never make many post-statement of intention, pre-surrender payments.

More to the point, while Rudler is correct as a theoretical matter that a debtor might continue making payments until the surrender actually takes place, and that any such payments would be payments to a secured creditor, Rudler's case does not present the question how such payments should be treated under Section 707(b)(2)(A)(iii), because Rudler stopped making payments even before he filed for bankruptcy. *See* App. 46 (Secured Creditor's Motion for Relief from Automatic Stay, noting a pre-petition arrearage of $21,259). Moreover, his case appears to be typical; other decisions in this area also note that the debtor had stopped making payments on the debt prior to surrender. *See, e.g., In re Naut*, 2008 WL 191297 at *7 (Bankr. E.D. Pa. Jan. 22, 2008) (noting that the debtor "ceased making payments on the [secured] debt at least at the time he filed his petition in this case."); *In re Nockerts,* 357 B.R. at 500 (noting that the debtors testified at the meeting of creditors that they were "not making the monthly payment on the mortgages"). Rudler's argument that debtors should be allowed to deduct up to 60 months worth of mortgage payments that they will not make because otherwise the bankruptcy court "would have to wait" to determine the number of monthly payments that the debtor "could be permitted to include" depends on a purely theoretical scenario, and one that is in any event not presented by this case.

Rudler also contends (Br. at 6) that the debtor's intent to surrender property securing debt is irrelevant under the means test because "the means test does not make reference to the statement of intention filed by the Debtors pursuant to § 521(a)(2)(A)." But as our opening brief explains, Section 521(a)(2) requires the debtor to file the statement of intention at a point early enough in the proceedings to ensure that the United States Trustee will know whether the debtor intends to reaffirm secured debts or surrender the property securing those debts when evaluating whether the filing is presumptively abusive, and the debtor's intent to surrender is clearly relevant to the ultimate question addressed by the means test: whether the filing is presumptively abusive. The debtor must file the statement of intention within 30 days of the earlier of the Chapter 7 petition date and the date of the meeting of creditors. *See* 11 U.S.C. § 521(a)(2)(A); Interim Fed. R. Bankr. P. 1017(b)(2) (requiring individual debtors in Chapter 7 cases to file a statement of intent on the appropriate form). This means that the latest possible date for the debtor to file the statement is 30 days after he files the Chapter 7 petition. United States Trustees have 10 days from the meeting of creditors to "review all materials" filed by the debtor (including the statement of intent), and file a statement as to whether the debtor's case would be presumed abusive under Section 707(b), and 30 days to file a motion to dismiss for presumed abuse. 11 U.S.C. § 704(b)(1) and (2). Because the meeting of creditors must be held "no fewer then 20 and no more than 40 days after the order for relief," *see* Federal Rule of Bankruptcy Procedure Rule 2003, which in a voluntary petition under Chapter 7 is the date of the petition, *see* 11 U.S.C. § 301(b), the United States Trustee will know by the deadline for filing his statement on presumptive abuse whether the debtor intends to surrender property secured by debt.

Rudler also argues (Br. at 8) that the United States Trustee's position is "impractical and unreasonable" because it suggests that a formerly secured creditor would have to file an unsecured claim for any deficiency resulting from foreclosure. Contrary to Rudler's suggestion, there is nothing surprising about that suggestion –

as *Wright* and the cases that follow it explain, that is precisely the effect that would be expected from surrender and transfer of title of collateral securing a debt. *See In re Wright*, 492 F.3d at 833.

III. Rudler Offers No Argument That His Interpretation of the Statute Serves the Purpose of the Means Test

Prohibiting deductions for mortgage payments that will not be made best serves Congress's purpose in enacting the means test. The 2005 Act established the means test to make certain that debtors "repay creditors the maximum they can afford." *See* H.R. Rep. No. 109-31 (I) at 1 (2005), reprinted in 2005 U.S.C.C.A.N. 88, 89. That purpose is better served by allowing the debtor to deduct only those payments that the debtor actually will make. That way, the means test gives a more accurate picture of what the debtor's resources will be in the period following the petition, which is the key fact for determining whether the petition is presumptively abusive. In this case, the difference is stark. If the ruling below stands, Rudler's debts will be discharged even though he has $1461 in monthly disposable income and could repay his creditors roughly $87,000 over the course of a 60 month Chapter 13 plan.

Rudler argues (Br. at 4) that the means test was intended to "reflect the debtor's financial condition at the time of the filing of the petition." But Rudler's interpretation has the opposite effect. His intent to surrender the property means that he will no longer make payments on the property, and thus that he has additional funds to repay his creditors. The means test is best understood to reflect that reality. Rudler provides no explanation for how it is "more accurate" to deduct payments that the debtor has explicitly declared *at the time of the filing of the petition* that he will not make than it is to take account of the debtor's intention to surrender his home.

Ultimately, Rudler offers no argument that allowing him to deduct the payments that he will not make serves the goal of ensuring that those who can afford to repay some portion of their unsecured debts be required to do so. Rudler contends (Br. at 3) that the United States Trustee's statements as to "what amount of money . . . would be available to pay creditors under a Chapter 13 plan would seem to be an argument made pursuant to a Motion to Dismiss [] considering the totality of the circumstances." He does not deny, however, that he has claimed roughly $87,000 in mortgage payments that he will never make or explain why that information is not directly relevant to the question whether his petition is presumptively abusive. Without those deductions, Rudler's creditors would likely recover most of what Rudler owes them. Conversely, if this Court accepts the views of the bankruptcy appellate panel, Rudler will be allowed to deduct payments that he will never make, and his debts will likely be discharged in bankruptcy based upon that fiction. That result is contrary to Congress' stated purpose for enacting the 2005 Act.

CONCLUSION

The judgment of the Bankruptcy Appellate Panel should be reversed.

Respectfully submitted,

PHOEBE MORSE
United States Trustee
Districts of Maine, Massachusetts
New Hampshire and Rhode Island

RAMONA D. ELLIOTT
P. MATTHEW SUTKO
Executive Office for
United States Trustees
U.S. Department of Justice
20 Massachusetts Ave. N.W.
Washington, D.C. 20530-0001

Geraldine Karonis
Ann Marie Dirsa
Office of the United States Trustee
District of New Hampshire
1000 Elm St., Suite 605
Manchester, New Hampshire 03101

GREGORY G. KATSAS
Assistant Attorney General

WILLIAM KANTER
(202) 514-4575
TEAL LUTHY MILLER
(202) 514-5048
Attorneys, Appellate Staff
Civil Division, Room 7234
U.S. Department of Justice
950 Pennsylvania Ave., N.W.
Washington D.C. 20530-0001

NOVEMBER 2008

CERTIFICATE OF SERVICE

I certify that on November 6, 2008 I filed and served the foregoing brief by causing an original and nine copies together with a computer readable copy on diskette to be sent by overnight delivery to the Clerk of the Court, and by causing two copies and a diskette to be sent by overnight delivery to the following counsel:

Scott W. LaPointe, Esquire,
Brown & LaPointe, P.A.
128 Main Street
Epping, NH 03042

____
Teal Luthy Miller

CERTIFICATE OF COMPLIANCE

1. This brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B) because this brief contains 3680 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B) (iii).

2. This brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P 32(a)(6) because it has been prepared in a proportionally spaced typeface using Word Perfect 9 in 14 point Times New Roman.

____
TEAL LUTHY MILLER

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2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	D. Or.
3. ("CCN") ***CURRENT*** CASE NO.	No.: 6:08-cv-06250-HO
4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*	No.: 07-63072-aer-7 Court: Bankr. Or. *(Identify judge & cite, if any)*
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IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF OREGON

In re: WENDY McKENZIE RYAN, Debtor.	Civ. App. No. _____________
MUHLHEIM BOYD, LLP, Appellant, vs. ROBERT D. MILLER, JR., ACTING UNITED STATES TRUSTEE, REGION 18, Appellee.	Bk. Case No. 07-63072-aer7

Brief of Appellee, The United States Trustee
(ORAL ARGUMENT REQUESTED)

Ramona D. Elliott, General Counsel
P. Matthew Sutko, Associate General Counsel
Executive Office for United States Trustees
Department of Justice
20 Massachusetts Ave., N.W.
Washington, D.C. 20530
Phone: (202) 307-1399

Gail B. Geiger, Assistant United States Trustee
Ronald C. Becker, Trial Attorney
Office of the United States Trustee
Department of Justice
405 East 8th Ave., Suite 1100
Eugene , OR 97401-2706
Phone: (541) 465-6330
Counsel for Robert D. Miller, Jr.,
Acting United States Trustee, Region 18

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STATEMENT OF JURISDICTION

The bankruptcy court had jurisdiction, under 28 U.S.C. § 157(a) and (b), to hear the underlying voluntary case under Chapter 7 of the Bankruptcy Code, 11 U.S.C. § 701, et seq. This Court has jurisdiction over appeals from final bankruptcy orders. 28 U.S.C. §§ 158(a) and (b)(1); Interim Fed. R. Bankr. P. 8001(a) and (e); Fed. R. Bankr. P. 8002(a); U.S. District Court Local Rules 2200 .2(b) and 2200.6. "A bankruptcy court order is final and thus appealable 'where it 1) resolves and seriously affects substantive rights and 2) finally determines the discrete issue to which it is addressed." In re AFI Holding, Inc., — F.3d — , 2008 WL 2420706 p. 6 (9th Cir. June 17, 2008) (citing In re Lewis, 113 F.3d 1040, 1043 (9th Cir. 1997)).

STATEMENT OF ISSUES

1. Did the bankruptcy court abuse its discretion in ruling on the motion by Mulheim Boyd (**"MB"**) to withdraw as counsel for Debtor Wendy Ryan (**"Ryan"**)?

2. Did the bankruptcy court's rulings violate MB's due process rights by offering MB the option of waiving its fees as a condition of withdrawal, despite the fact that MB had the opportunity, in an evidentiary hearing, to justify its fees?

3. Would MB's continued representation of Ryan, pursuant to an order of the bankruptcy court, have violated Oregon Rule of Professional Conduct 1.16?

4. Should this Court remand this appeal so the bankruptcy court can conduct an 11 U.S.C. § 329 review to determine what attorney fees, if any, are appropriate under that section of the Bankruptcy Code?

STANDARD OF REVIEW

A bankruptcy court's legal conclusions are reviewed de novo, while its factual findings are reviewed for clear error. E.g., In re Myrvang, 232 F.3d 1116, 1120 (9th Cir. 2000).

Application of a rule of law to established facts is generally reviewed de novo if the question requires consideration of legal concepts in a mix of facts and law. United States v. McConney, 728 F.2d 1195, 1202-04 (9th Cir. 1984) (en banc), cert. denied, 469 U.S. 824 (1984).

A bankruptcy court's choice of remedies is reviewed for abuse of discretion, since it has broad equitable remedial powers. In re Straightline Investments, Inc., 525 F.3d 870, 882-83 (9th Cir. 2008) (citations omitted).

STATEMENT OF THE CASE

I. Nature of the case.

In this appeal, MB challenges a series of bankruptcy court orders that offered the choice of 1) waiving its fees as a condition of granting the firm's motion to withdraw as attorney for Ryan; or 2) not waiving its fees, resulting in denial of MB's motion to withdraw and leaving the firm's status as Ryan's attorney unaltered. MB substituted in as Ryan's attorney, in place of her initial attorney, Kimberly Covington (**"Covington"**), following the United States Trustee's filing of a motion to dismiss Ryan's case as an abuse of Chapter 7 of the Bankruptcy Code.[1] MB appeared on Ryan's behalf at a preliminary hearing on that dismissal motion. Thereafter, on February 12, 2008, just two days before Ryan's written response to the dismissal motion was due

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[1] United States Trustees are officials of the Department of Justice appointed by the Attorney General to supervise the administration of bankruptcy cases and trustees. See 28 U.S.C. §§ 581-589; In re Columbia Gas Sys., Inc., 33 F.3d 294, 296 (3rd Cir. 1994) (United States Trustees oversee the bankruptcy process, protect the public interest, and ensure that bankruptcy cases are conducted according to law) (citing H.R. Rep. No. 95-595, 109 (1977)). "The United States Trustee is the 'watchdog' of the bankruptcy system . . . charged with preventing fraud and abuse and with 'fill[ing] the vacuum' caused by possible creditor inactivity." In re Castillo, 297 F.3d 940, 950 (9th Cir. 2002). Section 307 of the Bankruptcy Code authorizes the United States Trustee to appear and be heard on the matters at issue in this appeal. See 11 U.S.C. § 307; In re Donovan Corp., 215 F.3d 929 (9th Cir. 2000) ("The United States trustee may . . . intervene and appear at any level of the proceedings from the bankruptcy court on . . . as either a party or an amicus.") (internal quotation marks omitted).

(and with discovery requests of Ryan pending, and with Ryan's deposition scheduled for February 20, 2008), MB moved for the bankruptcy court's permission to withdraw as Ryan's attorney. The United States Trustee opposed MB's motion to withdraw because of its timing.

An expedited hearing was held on the motion to withdraw, and the bankruptcy court's order resulting from that hearing constituted the first of the series of orders MB now appeals. The last of those orders required MB to file a declaration with the court, within ten days, stating it would not waive it's fees, if the firm so chose. If MB did not file such a declaration, it's motion to withdraw would be deemed granted and its fees deemed waived. MB has never filed a formal declaration as provided in that order, and the ten-day period has now passed. However, within the ten-day period, MB filed its notice of appeal.

II. Factual background.

A. Events preceding the February 20, 2008, hearing.

On October 30, 2007, Ryan filed a voluntary petition under Chapter 7 of the Bankruptcy Code. See Chapter 7 Voluntary Petition, Docket Entry #1, District of Oregon Bankruptcy Case No. 07-63072-aer7. Covington, as Ryan's initial attorney of record, prepared and filed Ryan's bankruptcy petition, schedules, Statement of Financial Affairs, and other related documents, and appeared with Ryan in a November 26, 2007, 11 U.S.C. § 341 meeting of creditors. Id.; ER 105.

On December 5, 2007, the United States Trustee filed a motion to dismiss Ryan's case as an abuse of the provisions of Chapter 7 of the Bankruptcy Code (**"§ 707(b) Motion"**), pursuant to 11 U.S.C. §§ 707(b)(1) and (2); or, alternatively, §§ 707(b)(1) and (3). ER 1. Section 707(b)(1) provides for dismissal of a consumer debtor's case if the court finds "granting relief would be an abuse of the provisions of" Chapter 7. As revised by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA"), § 707(b) provides for a statutory "means test," set forth under § 707(b)(2)(A) (applicable only to above median income debtors, and based on historic income and certain standardized expenses).[2] If a debtor "fails" the means test, a presumption of abuse arises which may only rebutted as specified under § 707(b)(2)(B) (providing for rebuttal if "special circumstances" warrant adjustment of debtor's income or expenses). Regardless of whether the presumption of abuse arises, a debtor's case may still be dismissed under § 707(b)(1) if granting Chapter 7 relief would be an abuse based on bad faith or the totality of the circumstances of the debtor's financial situation. §§ 707(b)(3)(A) and (B). The United States Trustee alleged that granting Ryan Chapter 7 relief would have constituted an abuse because she had sufficient disposable income under § 707(b)(2)(a)(i)(II) to trigger the presumption of abuse. Alternatively, the United States Trustee alleged that bad faith factors and the totality of the circumstances of Ryan's financial situation warranted dismissal of her case. See ER 3 (United States Trustee's memorandum supporting the § 707(b) Motion).

The United States Trustee's memorandum in support of the § 707(b) motion stated factual and legal bases supporting dismissal of Ryan's case. ER 3. On December 11, 2007, the bankruptcy court noticed a January 10, 2008, preliminary hearing on the § 707(b) Motion. See Docket Entry #28, Case No. 07-63072-aer7.

On January 10, 2008, the same date as the preliminary hearing on the § 707(b) Motion, MB attorney Loren Scott (**"Scott"**) substituted in as attorney of record for Ryan, in place of

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[2] *Former* § 707(b) provided for dismissal of cases found to be a *substantial* abuse of the provisions of Chapter 7. The BAPCPA reduced the requisite level of abuse to simply *abuse*. Under the means test, a presumption of abuse arises if a debtor's monthly disposable income calculates (based on § 707(b)(2) criteria) as at least $109.59, and over 60 months would provide for payment of at least 25 percent of the debtor's general unsecured debts; or, alternatively, if the debtor's monthly disposable income calculates as at least $182.50. § 707(b)(2)(a)(i)(I) and (II).

Covington.[3] ER 24. Scott appeared on Ryan's behalf at the preliminary hearing. ER 27. In that hearing, Scott stated to the bankruptcy court that:

> I've noted at the outset [Ryan's] clear ineligibility for Chapter 13 [due to her] exceeding the debt limits, and the question then becomes does [Ryan] want to make an effort to explore this in Chapter 11, dismiss the case, or fight the [United States Trustee's § 707(b) Motion].[4]

ER 31. Scott further stated:

> I think there are potential defenses to the presumption of abuse which I will probably certainly end up conceding arises, although I'm not exactly prepared to do that here today, both under [§ 707](b)(2) and (b)(3) defenses, but we would like a little bit of time to make sure that this is a fight worth fighting. . . .

ER. 32.

On January 15, 2008, the court entered a stipulated scheduling order for litigating the § 707(b) Motion (the "Scheduling Order"). ER 38. Ryan's written response to the § 707(b) Motion was due no later than February 14, 2008. Id. On January 31, 2008, the bankruptcy court noticed a March 6, 2008, evidentiary hearing on the § 707(b) Motion. ER 41.

U.S. District Court for the District of Oregon Local Rule 83.11(a) specifies that "[a]n attorney may withdraw as counsel of record only with leave of Court, if doing so leaves the party unrepresented. . . ." Local Bankruptcy Rule (LBR) 9010-1(A) of the Bankruptcy Court for the District of Oregon makes LR 83.11 applicable in bankruptcy cases. In accordance with LR 83.11, Scott "and" MB filed a Motion for Authority to Withdraw as Ryan's Counsel on February 12, 2008, (**the "Withdrawal Motion"**). ER 42. In a supporting declaration, Scott represented

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[3] References in this brief to "MB" include Scott, unless concurrent references are made separately to Scott and MB.

[4] If a case is found to be abusive, § 707(b)(1) provides for consensual conversion of a debtor's case to Chapter 11 or Chapter 13 as an alternative to dismissal.

that Ryan requested, on February 12, 2008, that Scott file a motion to withdraw as her counsel so she could finish the case *pro se*, including opposing the § 707(b) Motion. ER 43. In Scott's declaration, he characterized the Withdrawal Motion as urgent, because of pending Scheduling Order deadlines.

The day after the Withdrawal Motion was filed, Scott filed a Disclosure of Compensation of Attorney for Debtor (**"Scott's Disclosure"**). ER 45. In Scott's Disclosure, Scott represented he had agreed to provide legal services "[h]ourly" and that he had received $1,000 from Ryan. Id. Under paragraph 6, Scott certified his agreement with Ryan did not include "[a]dversary proceedings and contested matters, other than opposition to the U.S. Trustee's 707(b) motion." Id. He also represented that, subsequent to their agreement regarding compensation, Ryan instructed Scott to withdraw as Ryan's attorney. Id.

The United States Trustee objected to the Withdrawal Motion the same day that motion was filed, because of its timing. ER 52.[5] The United States Trustee's objection emphasized that the final evidentiary hearing on the § 707(b) motion was less than three weeks away (March 6th); the parties were to exchange witness and exhibits lists in just two days (February 14th); the parties' objections to exhibits were due in 9 days (February 21st), or the exhibits would be deemed admissible; and the parties were to provide the court with witness and exhibit lists and trial briefs within sixteen days (February 28th). ER 53-54. Additionally, the United States Trustee's objection noted the Debtor had not yet responded to a portion of discovery requests that had been presented to Scott. ER 54. The objection also noted that on January 14, 2008, the United States Trustee sent Scott a request to schedule Ryan's deposition, and followed that with

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[5] The United States Trustee filed a response and an amended response, which were not materially different in substance. Compare ER 47 and ER 52.

a February 4, 2008, reminder. Because Scott was unable to confirm a deposition date (and due to other impending Scheduling Order deadlines), the United States Trustee scheduled Ryan's deposition to occur in eight days (February 20th). ER 54-55. Failure to meet any of the deadlines cited in the United States Trustee's objection to the Withdrawal Motion could have resulted in substantial prejudice to Ryan's defense, and to the United States Trustee's ability to prepare its case.

On February 14, 2008, the bankruptcy court noticed a February 20, 2008, evidentiary hearing on the Withdrawal Motion. ER 57. Before the court ruled on the Withdrawal Motion, Scott filed a February 14, 2008, "response" to the § 707(b) Motion. ER 58. That response was merely a "cover sheet" for a narrative response Ryan drafted herself. ER 171. Specifically, Scott electronically filed the cover sheet, with Ryan's response attached, while still her attorney of record. He represented that he filed the document on Ryan's behalf because she intended to oppose the § 707(b) Motion *pro se*, and had requested that MB cease representing her. ER 58; ER 171.

B. February 20, 2008, hearing regarding the Withdrawal Motion.

In the February 20, 2008, hearing, Scott began by stating Ryan had discharged him. ER 67. Scott cited ORPC 1.16, which he characterized as stating "a lawyer shall not represent a client if among other things the lawyer is discharged." ER 68.

The bankruptcy court then asked Ryan whether her decision to terminate Scott was financial or whether she was dissatisfied with Scott's services. Ryan's response was: "Financial matter." Id. The bankruptcy court then commented regarding Scott's Disclosure, and Scott stated, in part, "when the [$1,000] retainer is exhausted, she will pay monthly bills as they are remitted by [MB]." ER 69. Ryan agreed with that characterization of the fee arrangement.

ER 70.

The bankruptcy court inquired of Ryan regarding Scott's substitution for Covington. Id. Ryan stated that Covington told her that she (Covington) did not have the expertise to continue with a § 707(b) defense; and Covington thus referred Ryan to other counsel, who ultimately referred Ryan to Scott. Id. The court asked whether Ryan had been informed, at the outset of their attorney-client relationship, that Covington's experience was limited. Id. Ryan stated Covington had not done so; rather, Ryan had understood Covington would handle her case from start to finish. Id.

The court then stated it was "loathe to force [Scott] to continue on the case if [he did not] want to continue." ER 73. The court went on to characterize Scott's representation (in the Withdrawal Motion) that he had been discharged as "somewhat misleading because your client is simply indicating she does not have the funds to pay you[,]" which the court did not equate with "discharging a lawyer, which . . . would normally mean to indicate that the client doesn't want [the lawyer] anymore." Id.

The court then stated Scott could either stay on or refund the $1,000 he had received, but that he could not do both. Id. Scott responded: "Your Honor, we'll refund the $1,000 to Ms. Ryan. She's indicated she doesn't want the money back from me but I will do so." Id. Scott then added:

> She has indicated that she does not have the financial wherewithal to continue to pay ongoing fees to my firm for services in the event I am to stay on as her attorney. So she continues to wish for me to withdraw and I will refund the money that I've received.

ER 73-74. Shortly thereafter, Ryan stated, "I would love to be represented but I can't afford it." ER 75. Ryan also stated she was "not sure how many hours Mr. Scott has put in. I was afraid to open his bill when I got it." Id. Ryan then stated:

> But for me to hire another attorney and to start from scratch, they're going to want a retainer. And they're going to want an hourly [fee]. And it's going to cost me a fortune and I don't have it. No one will want to take the case based on a set fee. . .

ER 75-76. In response, the court advised Ryan that, while the court could not change her financial situation, "Mr. Scott is going to be giving you money back." ER 76.

After subsequent discussion regarding Covington, the serious nature of Ryan's situation, and pending deadlines regarding the § 707(b) Motion, the following exchange occurred:

> [THE COURT]: Mr. Scott, since your motion was filed shortly before the deadline, I don't feel too much need to give you too much time to make the payment. So I'm going to give you three days to return the money to Ms. Ryan and to file an affidavit or declaration to the court indicating that's been done.
>
> MR. SCOTT: Will do, your Honor.
>
> THE COURT: And your motion is contingent upon that. If I don't receive that declaration within the next three business days, then your motion to withdraw is denied.

ER 78. Further on, the Court reiterated:

> As a result of today's hearing, Mr. Scott's motion to withdraw is allowed contingent on his refunding the retainer within the next three business days to Ms. Ryan and filing a certificate with the court to that effect.
>
> Again, failing that, the motion to withdraw is denied without further notice or hearing or action by this court.

ER 85.

That ruling was formalized in a Summary of Proceedings & Minute Order filed February 13, 2008 (**"Minute Order"**), which stated: "If Mr. Scott remits his $1,000 retainer to Ms. Ryan and files a declaration as to same, both within 3 business days of today's date, his motion to withdraw is granted. If he fails to timely remit and declare, the motion is denied. . . ." ER 98.

C. Interim events between February 20 and March 6, 2008, hearings.

On February 22, 2008, Scott filed a declaration stating: "On February 22, 2008, the $1,000 retainer was refunded to [Ryan]." ER 99. In his declaration Scott further represented "MB is issuing this refund to comply with the [Minute Order] and, notwithstanding the issuance of the refund, MB hereby reserves the right to appeal the entry of the [Minute Order]." Id.

On February 25, 2008, the United States Trustee filed a motion for clarification of the Minute Order. ER 101. Specifically, the United States Trustee asked the bankruptcy court to clarify "whether, after remittance of his retainer to [Ryan], Scott is precluded from billing [Ryan] for attorneys' fees incurred through the date of his withdrawal." ER 103.

On February 27, 2008, the United States Trustee filed a stipulated order disgorging $1,701 of Covington's attorneys' fees.[6]

An order supplementing and clarifying the Minute Order was filed February 29, 2008 (**"Clarifying Order"**). The Clarifying Order stated:

> IT IS HEREBY ORDERED AND ADJUDGED that Mr. Scott's withdrawal from representation of [Ryan] is conditioned on waiver of all fees in the case in addition to refund of his $1,000 retainer; and
>
> IT IS HEREBY FURTHER ORDERED AND ADJUDGED that unless Mr. Scott files a Declaration within 5 days of this Order's entry that he is not waiving his fees, his [withdrawal motion] is granted, and his fees are deemed waived. If such a declaration is filed, his [withdrawal motion] is denied, and he is permitted to require payment from [Ryan] for the $1,000 previously refunded.

ER 108-09.

On March 3, 2008, MB filed a motion to alter or amend the Minute Order and the

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[6] In the February 20th hearing, the United States Trustee reported that (based on circumstances described by Ryan during the hearing) the United States Trustee would be seeking disgorgement of Covington's fee. ER 74. On March 4, 2008, Covington filed a declaration affirming she had refunded $1,701 to Ryan on March 3, 2008. ER 124.

Clarifying Order (**"Motion to Alter or Amend"**) "and for findings." ER 110. In a supporting memorandum, MB argued that 1) its withdrawal was mandatory under ORPC 1.16 and "[t]he court should not have sidestepped that rule . . ." (ER 116); that 2) the bankruptcy court improperly exercised its authority under § 329 to require disgorgement of MB's retainer because a) the statute did not apply, and b), even if it did, the court failed to comply with applicable rules, by failing to give adequate notice and hold a hearing on the issue of MB's fees pursuant to § 329 and Fed. R. Bankr. P. 2017 (ER 119); and that 3) requiring MB to refund the retainer and denial of all fees without notice and a hearing violated MB's rights without due process of law. ER 121.

On March 5, 2008, the United States Trustee filed a response objecting to MB's Motion to Alter or Amend. ER 126.

D. March 6, 2008, hearing regarding the Motion to Alter or Amend.

On March 6, 2008 the bankruptcy court held a hearing on the Motion to Alter or Amend (**"March 6th hearing"**). Ryan did not personally appear. ER 146. In opening remarks, the court stated that, at the February 20th hearing, it "developed through representations made by [Ryan] and [Scott], that it was a stretch of the terminology to use the word 'discharged.' [Ryan] was in essence, quote, 'discharging [MB],' unquote, because she could not afford to pay the fees, and that's what was made clear to the Court." ER 151. The court added Ryan had "indicated . . . she was not dissatisfied. She did not indicate that this was a situation where she did not want to pay more legal fees. She indicated this was a situation where she could not pay any legal fees." ER 152. The court went on to state:

> I would agree that fees were not noticed for hearing. I would agree with the moving parties that the Court has not made any findings that the fees charged by [MB] were reasonable or unreasonable, or excessive; and the Court did not

> reach any issues, at least so far, under [§] 329.
>
> Frankly, the Court did not feel that the matter of a normal fee hearing to determine the reasonableness of fees was before the Court. What was before the Court was [the Withdrawal Motion]. The Court indicated to [MB] that if [it] wished to withdraw, that withdrawal was conditioned upon a refund and waiver of the fees. It was not an order denying fees, because [MB] could choose to remain on the case, in which case [MB] I suppose could continue to bill Ms. Ryan for its services. Whether or not she had the ability to pay that bill is a matter between [MB] and Ms. Ryan, but there were no fees denied. It was simply a choice that was provided to the firm.

ER 153-54. The court subsequently reiterated the February 20th hearing was not "a hearing to determine whether fees were excessive or reasonable, and this hearing is not such either. [The February 20th hearing] was a hearing on [the Withdrawal Motion]." ER. 157-58.

Under MB's direct examination, Scott testified he was Ryan's attorney in connection with opposing the United States Trustee's § 707(b) Motion. ER 159. MB then offered, as an exhibit, an engagement letter, sent to Ryan, dated December 27, 2007, (**"Engagement Letter").** Scott testified that he and Ryan proceeded in their attorney/client relationship based on that letter. ER 160. Scott further testified that at no time did he directly or indirectly suggest or state to Ryan that he would withdraw from representing her because she had not paid any sum of money. ER 162. Scott also testified he never asked Ryan for permission to withdraw; but, rather, she instructed him to withdraw. ER 163. Specifically, Scott testified Ryan "had instructed [him] to withdraw, and as her testimony in court on February 20th indicated, she did so because she did not wish to incur additional legal fees to [MB]." ER 164. Scott also testified that in the February 20th hearing, he "did not make a choice." Id.

Under cross examination, Scott testified that Ryan's "was the first [§] 707(b) motion [he] had ever defended" and that he had called the United States Trustee's attorney and asked her "what happens at the preliminary hearing" on such a motion . ER 171. He further testified he did not have anything to do with drafting Ryan's response to the § 707(b) Motion (*i.e.*, ER 59-63). ER 171. Scott also testified he had estimated to Ryan that his fees for services through trial on the § 707(b) Motion would total $5,000. Id. He also testified he had advised her of ways those fees might be reduced. ER 172.

After arguments, the court stated it would take the matter under advisement. ER 187. The court also observed that it had received a proposed stipulated order whereby Ryan and the United States Trustee agreed Ryan's case should be dismissed. ER 187-88. Regarding that proposed order, the court explained:

> My problem with that, so that you'll understand the Court is not sitting on it — my problem with that is that at the time that stipulation was entered into [Ryan] did not have the benefit of counsel. And if indeed for one reason or another [MB] continues to represent her, there should certainly be the opportunity for some input from counsel as to whether or not dismissal is in [Ryan's] best interest, or whether she should go forward with the hearing.

ER 188.

The Engagement Letter stated Ryan was considering MB "to represent [her] in matters related to opposing the [§ 707(b) Motion]." ER 194. The Engagement Letter further described MB's "mission as providing the finest legal services available to those who find themselves ensnared by the legal web surrounding commercial disputes and financially distressed businesses. We offer a broad range of experience in representing local and national clients in all phases of commercial law and business disputes. . . ." Id. The Engagement Letter further stated MB limited its "practice to what we do best. We accept clients and referrals only when the legal issues facing them require our fields of expertise. . . ." Id. The Engagement Letter further provided MB could "withdraw as your attorney at any time, so long as in doing so we comply with the Rules of Professional Responsibility for the Oregon State Bar. . . ." ER 195.

In a February 12, 2008, letter to Ryan, also entered into evidence at the March 6, 2008, hearing, Scott stated that Ryan had indicated she wanted to continue to oppose the United States Trustee's § 707(b) Motion *pro se*, because she did not want to incur legal fees necessary for MB to represent her. ER 202. Scott's letter also advised Ryan that MB remained her attorney of record until a court order approving MB's withdrawal was signed by the court. Id.

E. The bankruptcy court's ruling from the March 6th hearing.

In a March 20, 2008, letter opinion (**"Letter Opinion"**), the bankruptcy court denied MB's Motion to Alter or Amend. ER 210. The court held that MB had not shown manifest error such as would support altering or amending the Minute Order or entering a clarifying order under Fed R. Civ. P. 59 (incorporated by Fed. R. Bankr. P. 9023). ER 207-210. In reaching its decision, the court noted that even assuming MB had been discharged, ORPC 1.16(c) requires a discharged attorney to continue representation if ordered to do so. ER 208. The court added, however, that it had not ordered MB to continue representing Ryan; rather, the court had given MB "a choice." Id.

The court further explained that its duty was to balance all of the parties' interests. ER 209. The court also noted that, in exercising its discretion, it had appreciated Ryan's indication that she "would love to be represented" and that its ruling was an attempt to facilitate that representation, by giving Ryan a source of cash to retain new counsel, and by relieving her of the obligation of paying MB additional fees. ER 209-210.

The Letter Opinion concluded by noting MB had not yet filed a declaration stating the firm would not waive its fees, as provided for by the Clarifying Order. The court thus gave MB one more chance to do so — within ten days. If no declaration was filed, MB's Withdrawal Motion was denied; if the declaration was timely filed, the Withdrawal Motion would be granted and the fees deemed waived. ER 209. A separate order denying MB's motion to alter or amend was then filed March 20, 2008. ER 211.

Thereafter, on March 28, 2008 — within the additional 10 days the court allowed MB to file a declaration that it would not waive its fees — MB filed its Notice of Appeal of the Minute Order, Clarifying Order, and the order denying the Motion to Alter or Amend. ER 212.

F. Dismissal of Ryan's bankruptcy case.

On April 2, 2008, the bankruptcy court approved a stipulated order dismissing Ryan's case pursuant to the § 707(b) Motion and the parties' stipulations. ER 220. That same date, the court entered a separate Order of Dismissal and Administratively Closing [Ryan's] Case. ER 222. Dismissal of the case terminated MB's status as Ryan's attorney (because MB's role was limited to defending Ryan on the § 707(b) motion). Id.

SUMMARY OF ARGUMENT

The bankruptcy court had the authority and discretion to order MB to continue as Ryan's attorney. Yet, the court did not simply order MB to continue. Instead, it gave MB the choices of staying on as Ryan's attorney or, alternatively, withdrawing and waiving its fees. Although MB never filed a declaration objecting to a waiver of its fees, on appeal the firm contests wavier of its fees, and contends its withdrawal should not have been conditioned on such a waiver. At the initial hearing on the Withdrawal Motion, the firm had multiple opportunities to raise issues regarding reasonableness of its fees, but failed to do so. There thus has not been any determination regarding whether the fees MB seeks from Ryan are reasonable. Under those circumstances, the United States Trustee respectfully submits this Court should remand this appeal to the bankruptcy court, to allow for examination of MB's fees under § 329.[7]

ARGUMENT

I. The bankruptcy court had authority to order MB to continue as Ryan's counsel.

A. The decision to grant or deny a motion to withdraw is committed to the court's sound discretion, and trial courts are granted considerable deference in such decisions.

The decision to grant or deny a motion to withdraw is committed to the trial court's sound discretion. Whiting v. Lacara, 187 F.3d 317, 320 (2nd Cir. 1999); LaGrand v. Stewart, 133 F.3d 1253, 1269 (9th Cir. 1998); United States v. Gardner, 417 F.Supp. 703, 718 (D.Md. 2006) (citing United States v. Gallop, 838 F.2d 105, 107 (4th Cir. 1988)); Rusinow v. Kamara, 920 F.Supp. 69, 71 (D.N.J. 1996); Liang v. Cal-Bay International, Inc., 2007 WL 3144099 p. 1 (S.D.Cal. October 24, 2007) (citing LaGrand). A bankruptcy court abuses its discretion if it bases its decision on an erroneous view of the law or on clearly erroneous factual findings. AFI Holding, Inc., 2008 WL 2420706 p. 11 (Ninth Circuit Court of Appeals adopting, as its own opinion, In re AFI Holding, Inc., 355 BR 139 (9th Cir. BAP 2006)) (citation omitted).

Trial courts are due considerable deference in deciding whether to deny a motion for an attorney's withdrawal. Whiting, 187 F.3d, 320 (citing Washington v. Sherwin Real Estate, Inc., 694 F.2d 1081, 1087 (7th Cir. 1982)). "The trial judge is closest to the parties and the facts, and [appellate courts] are very reluctant to interfere with [trial] judges' management of their very busy dockets." Whiting, 187 F.3d at 320. See also Gallo v. U.S. District Court for the District of Arizona, 349 F.3d 1169, 1179 - 1180 (9th Cir. 2003) (federal courts have inherent and broad

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[7] Because the case closure order was entered after MB filed its notice of appeal, that order was ineffective. See In re Padilla, 222, F.3d.1184, 1190 (9th Cir.2000) (timely filing of notice of appeal divests court of control over those aspects of case involved in appeal).

regulatory authority to make rules respecting the admission, practice and discipline of attorneys in the federal courts) (citations omitted).

B. The bankruptcy court considered appropriate factors in ruling on MB's Withdrawal Motion.

Factors considered when ruling on a motion to withdraw include: 1) the reasons why withdrawal is sought; 2) the prejudice withdrawal may cause to other litigants; 3) the harm withdrawal may cause to the administration of justice; and 4) the degree to which withdrawal will delay the resolution of the case. Rusinow, 920 F. Supp at 71; Liang, 2007 WL 3144099 p. 1 (citing Irwin v. Mascott, 2004 U.S. Dist. LEXIS 28264 at 4 (N.D.Cal. December 1, 2007)). Even where an attorney is able to demonstrate good cause to withdraw, equitable factors may, at the trial court's discretion, preclude allowing withdrawal. Rusinow, 920 F.Supp. at 72 (citing Haines v. Ligget Group, Inc., 814 F.Supp 414, 425 (D.N.J. 1993)).

For example, failure to demonstrate availability of substitute counsel may preclude allowing an attorney to withdraw. Id.; In re Lands End Leasing, Inc., v. Blue Mack Transport, Inc., 220 B.R. 226, 235-36 (Bankr. D.N.J. 1998). See also Carter v. City of Philadelphia, 2000 WL 537380 (E.D.Pa. April 25, 2000) (in denying motion to withdraw, court found that compelling plaintiff to proceed *pro se*, when he would prefer to be represented by a qualified attorney, "must be considered prejudicial"). Similarly, where withdrawal would significantly impair a party's ability to maintain the action, courts have denied motions to withdraw. Rusinow, 920 F.Supp, 72 (citing Haines, 814 F. Supp. at 425) (additional citation omitted)).

In the February 20th hearing, the bankruptcy court queried Ryan regarding circumstances precipitating the Withdrawal Motion. ER 68; ER 70-72. The court also inquired of Scott regarding the nature of his fee arrangement (ER 68-70); and sought clarification regarding

Covington's prior involvement (*i.e.*, how much Covington was paid, and what services Ryan understood Covington would provide). ER 70-73. In so doing, the court elicited from Ryan that her decision to no longer have Scott/MB represent her was a "financial matter," rather than any dissatisfaction with legal services Scott or his firm provided. ER 68. Scott echoed that, telling the court that Ryan "[did] not have the financial wherewithal to continue to pay ongoing fees to [MB] for services in the event [MB was] to stay on as her attorney." ER 73-74.

The court also noted the serious nature of the § 707(b) Motion, and advised Ryan that it wanted to allow her an opportunity to be represented if she so desired. ER 75; ER 77. In response, Ryan stated she would "love to be represented but I can't afford it." Id. The court also heard and considered Ryan's concerns that "for [her] to hire another attorney and start from scratch, they're going to want a retainer. And they're gong to want an hourly [fee]. And it's going to cost a fortune and I don't have it." ER 75-76. The impending deadlines governing litigation of the § 707(b) Motion were also noted and were the subject of considerable discussion by the court. ER 71; ER 74; ER 77-87.

In the Letter Opinion, the court summarized that, in exercising its discretion, it considered the seriousness of Ryan's situation (*i.e.*, potential dismissal of her case). ER 209. The court further considered that scheduling deadlines and an evidentiary hearing were imminent. Id. A refund of MB's retainer and relief from having to pay additional MB fees (together with a potential refund by Covington) would provide Ryan with some flexibility in obtaining new counsel. ER 209-210. The bankruptcy court's summary of factors it considered in this case thus mirrors those described in Rusinow, 920 F. Supp at 71.

Specifically, the court considered 1) why withdrawal was sought (Ryan could not afford MB's fees); 2) the prejudice withdrawal might cause other litigants (impending discovery deadlines and a hearing regarding the § 707(b) Motion); 3) the harm withdrawal might cause the administration of justice (the court recognized, and warned Ryan, that the § 707(b) Motion was a serious matter); and 4) the court recognized resolution of the § 707(b) Motion would likely be delayed were Scott/MB to withdraw (deadlines might have to be extended, delaying action on the stipulated dismissal order the United States Trustee had submitted).

The bankruptcy court thus considered appropriate factors in ruling on MB's Withdrawal Motion.

C. The bankruptcy court's view of the law applicable to motions to withdraw was correct.

In the Letter Opinion, the bankruptcy court, citing Darby v. City of Torrance, 810 F.Supp. 275, 276 (C.D.Cal. 1992), correctly observed that an attorney may only withdraw with leave of court. ER 208. The court also correctly noted that LBR 9010-1.A (adopting LR 83.11(a)) implements that axiom.[8] Id. The court further correctly observed that ORPC 1.16(c) supercedes ORPC 1.16(a)(3), if a court orders a "discharged" attorney to continue representation. Id. Notwithstanding its hesitancy to construe the situation as one of attorney "discharge" (see ER 73 and ER 151), the court also correctly discerned that whether Ryan had or had not "discharged" MB was ultimately a "distinction without difference" because ORPC 1.16(c) supercedes *both* ORPC 1.16(a) and (b). ER 209. Finally, the court correctly cited factors to be considered in ruling on the Withdrawal Motion, including its duty to consider equitable factors (*i.e.*, "[court's] duty was to balance all of the parties interests"). Id.

In sum, the bankruptcy court's decisions were based on a correct interpretation of

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[8] The Letter Opinion cites "LBR 9011-1.A.1," but no such rule exists. Rather, LBR 9010-1.A.1(a) is the rule that adopts LR 83.11(a). The reference to "LBR 9011-1.A.1" in the Letter opinion thus appears to simply represent a scrivener's error.

applicable law. The record thus does not support a support a finding that the court abused its discretion, insofar as requiring MB to continue representing Ryan (if the firm chose, from the two options it was given, to object to waiver of its fees).

D. The bankruptcy court's factual findings were correct.

The bankruptcy court's factual findings were expressly stated in the Letter Opinion. ER 205-210. In pertinent part, those included: 1) that Scott's representation of Ryan was limited to opposing the § 707(b) Motion (ER 205-06); 2) that the United States Trustee had opposed the Withdrawal Motion on the basis that (because of the motion's timing) allowing Scott/MB to withdraw would prejudice Ryan and the administration of justice (ER 206); 3) that the notice of the February 20th hearing on the Withdrawal Motion stated testimony could be received (Id.); 4) that in the February 20th hearing, Ryan "confirmed she no longer wanted [Scott] to represent her" (ER 209); 5) that the basis for Ryan no longer wanting Scott to represent her was "financial," rather than any dissatisfaction with his/MB's services (Id.); 6) that Scott also said Ryan had stated she did not have "the financial wherewithal to continue to pay ongoing fees" to him or his firm (Id.); 7) that Ryan would "love to be represented but couldn't afford it" (Id.); and 8) that Ryan's "only reason for not wanting representation was 'financial.'" Id.

All findings summarized above are supported by the record. Accordingly, the court's findings were not "clearly erroneous," such as might support a finding of abuse of its discretion.

II. The bankruptcy court did not violate MB's due process rights by offering it the choice of waiving its fees as a condition of granting the Withdrawal Motion.

Generally speaking, some sort of hearing is required before a bankruptcy court materially reduces the amount of fees an attorney requests. In re Eliapo, 468 F.3d 592, 602 (9th Cir. 2006) (citing In re Busy Beaver Bldg. Centers, Inc., 19 F.3d 833, 846 n. 16 (3rd Cir. 1994)). For purposes of the Bankruptcy Code, however, the phrase "after notice and a hearing" is interpreted flexibly, pursuant to 11 U.S.C. § 102(1).[9] Id. at 603. The important point is that counsel be given a meaningful opportunity to be heard, by appraising counsel of the court's concerns, and by giving counsel a reasonable opportunity to argue or present evidence in support of counsel's position. Eliapo, 468 F.3d 603.

Here, the bankruptcy court did not unequivocally order disgorgement of any fees. Rather, any fee reduction as a result of the court's ruling was based on a choice (*i.e.*, waiver) that was entirely MB's to make. ER 208. Yet, notwithstanding that point, the February 20th hearing was prompted by the Withdrawal Motion. ER 42. After the United States Trustee's objection (ER 52), a notice apprised MB the hearing would concern the Withdrawal Motion and the United States Trustee's objection thereto, and that testimony could be received. ER 57.

During the hearing, the nature of Scott's fee agreement was almost immediately addressed. ER 68-70. When the court first offered Scott the choice of continuing to represent Ryan or refunding MB's retainer, Scott — without *any* qualification whatsoever — offered: "Your Honor, we'll *refund* the $1,000 to [Ryan]." ER 73 (emphasis added). Subsequently, Scott again — again without any qualification — reiterated he would *refund* the retainer. ER 74 Thereafter, the court apprised Ryan that "Scott is going to be giving you money back," which elicited no comment from Scott. ER 76. When subsequently informed he would be allowed three days to "return the money to [Ryan]," Scott yet again — again without qualification —

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[9] Section 102(1)(A) states that "after notice and a hearing" means "after such notice as is appropriate in the particular circumstances, and such opportunity for a hearing as is appropriate in the particular circumstances; . . . ." Moreover, "after notice and a hearing" also "authorizes an act without an actual hearing if such notice is given properly and if — (i) such a hearing is not requested timely by a party in interest; or (ii) there is insufficient time for a hearing to be commenced before such act must be done, and the court authorizes such act[.]" § 102(1)(B).

stated only: "Will do, Your Honor." ER 78. Finally, when the court more formally decreed that granting the Withdrawal Motion was contingent on Scott refunding the retainer within the next three days, Scott again failed to voice any objection. ER 85.

During the February 20th hearing Scott had, as characterized in Eliapo, "reasonable opportunity to present legal argument and/or evidence to clarify or supplement" why the retainer he received from Ryan should not be "refunded." Specifically, Scott had at least five opportunities during the hearing to explain or argue why MB should *not* have to refund the retainer. In every instance, however, Scott failed to do so. "So long as fair notice and an opportunity to be heard are afforded, the bankruptcy court has considerable freedom to fashion procedures for notice and a hearing that are 'appropriate in the particular circumstances.'" Eliapo, 468 F.3d at 603 (quoting and citing § 102(1)(A)).

Such was the case here, and MB failed to raise any issues regarding reasonableness of its fees during the February 20th hearing, despite having had multiple opportunities to do so.

III. The bankruptcy court's ruling did not impose any ethical dilemma.

A. Local U.S. District Court rules, applicable to bankruptcy proceedings, provide that attorneys may not withdraw without court approval.

District Court Local Rules 83.1 through 83.12 apply, generally, to attorneys appearing in the Bankruptcy Court for the District of Oregon. LBR 9010-1.A.1. When Scott substituted in as attorney for Ryan, he became Ryan's attorney of record. LBR 9010-1.A.1.b. After his appearance, Scott was required to obtain court approval to withdraw if withdrawal would leave Ryan unrepresented. LBR 83.11(a). That Scott's withdrawal would have left Ryan unrepresented is undisputed. See ER 43 (Scott's declaration supporting the Withdrawal Motion, citing Ryan's intent to proceed *pro se*). Moreover, by filing a *motion* to withdraw, MB acknowledged its withdrawal was contingent on the bankruptcy court's approval.

B. ORPC 1.16(a)(3) is expressly subject to local rules requiring leave of court to withdraw.

Oregon Rule of Professional Conduct 1.16 (as amended by the Oregon Supreme Court, effective December 1, 2006) governs both mandatory and permissive attorney withdrawals. Rusinow, 920 F.Supp. at 71 (construing analogous rule); Lands End Leasing, Inc., 220 B.R. at 235 (same). The rule provides, in pertinent part:

> (a) *Except as stated in paragraph (c)*, a lawyer shall not represent a client or, where representation has commenced, shall withdraw from the representation if:
>
> > (1) the representation will result in violation of the Rules of Professional Conduct or other law;
> >
> > ***
> >
> > (3) the lawyer is discharged.
> >
> > ***
>
> (c) A lawyer must comply with applicable law requiring notice to or permission of a tribunal when terminating representation. When ordered to do so by a tribunal, a lawyer shall continue representation notwithstanding good cause for terminating the representation.
>
> ***

ORPC 1.16 (emphasis added).

Application of subsection (a) of ORPC 1.16 is expressly limited by subsection (c). Subsection (c) requires a lawyer to continue representing a client when ordered to do so by a tribunal. Consequently, in its full context, ORPC 1.16 defers to the discretion of tribunals to order a lawyer to continue, even when the lawyer is "discharged."

Nonetheless, MB asserts "the text of ORPC 1.16 does not support a conclusion that subsection (c) applies to situations of mandatory withdrawal in subsection (a)" because "[g]ood cause [referred to in ORPC 1.16(c)] is only used in ORPC 1.16(b) . . . ." Appellant's Opening

Brief, p. 20 n. 6. That assertion, however, simply cannot withstand the express provision that ORPC 1.16(a) governs mandatory withdrawals "except as stated in paragraph (c) . . . ." Based on that, ORPC 1.16(c) "limits withdrawal pursuant to both [O]RPC 1.16(a) and (b)[.]" Lands End Leasing, Inc., 220 B.R. at 235; Rusinow, 920 F. Supp. at 71 (withdrawal pursuant to both RPC 1.16(a) and (b) limited by RPC 1.16(c)).

"'[E]ven if withdrawal is otherwise appropriate, other considerations must sometimes take precedence, such as maintaining fairness to litigants and preserving a court's resources and efficiency.'" Id. (citing Haines, 814 F.Supp at 423). Regarding the latter concern, "a *pro se* debtor presents often monumental problems of case administration." In re Cuddy, 322 B.R. 12, 17 (Bankr. D.Mass. 2005); see also In re Edsall, 89 B.R. 772, 775 (Bankr. N.D.Ind. 1988) (*pro se* litigants present the court with important concerns; more often than not they are unfamiliar with legal procedures or the formality of trial practice, and can be a danger to themselves). Rule 1.16(c) thus allows for "[t]he balance [to be] struck by the judge, and the lawyer must abide by that decision." Cherokee Nation of Oklahoma v. United States, 42 Fed. Cl. 15, 17 (Cl. Ct. 1998) (citing GEOFFREY C. HAZARD, JR., & W. WILLIAM HODES, THE LAW OF LAWYERING, § 1.16.401 (1998)).

Thus, regardless of whether cause for a lawyer's withdrawal is framed as mandatory or permissive, ORPC 1.16(c) defers to the authority of tribunals to order the lawyer to continue, notwithstanding any other of the rules provisions.

C. Neither MB nor Scott faced any ethical dilemma by continuing to represent Ryan if the Withdrawal Motion was denied.

An attorney who seeks to withdraw, but who is ordered to continue, is, relieved of any ethical conflict that might otherwise be perceived based on ORPC 1.16(a) or (b). Gardner, 417

F.Supp. at 718 (although defendant unequivocally stated he fired his lawyers, court deemed it in "best interests of justice" that lawyers continue); Securities and Exchange Commission v. Poirier, 2007 WL 2462173 p. 2 (D. Ariz August 24, 2007) (even where client did not wish attorney to continue, because local rule "require[d] an order of the Court to withdraw, [attorney] would not be in violation of his ethical obligations should the Court refuse to permit his withdrawal."). See also In re Lathen, 294 Or 157, 166, 654 P.2d 1110, 1114 (1982) (even though attorney was required, under former DR 5-102(A), to withdraw upon learning member of his firm ought to be called as a witness, attorney was not subject to discipline for continuing as his client's counsel, as required by trial judge's order).

As noted above, LR 83.11(a) and LBR 9010-1(A) unequivocally require that an attorney who has appeared for a debtor must obtain leave of the bankruptcy court to withdraw from representation "if doing so leaves the [debtor] unrepresented . . . ." See In re Covert, 16 DB Rptr 87, http://www.osbar.org/_docs/dbreport/dbr16.pdf (OR Disciplinary Board 2002) (order approving disciplinary stipulation stated lawyer "failed to obtain permission to withdraw from the bankruptcy proceeding, as provided by LR 83.11). Here, on January 10, 2008, Covington withdrew and MB substituted in as Ryan's attorney. ER 24. MB then complied with LR 83.11(a) and LBR 9010-1(A) when Scott filed the Withdrawal Motion. ER 42.

Via the Minute Order, the Clarifying Order, and the order denying the Motion to Alter or Amend, the bankruptcy court refused to unconditionally grant MB's Withdrawal Motion. ER 98; ER 108; ER 211. Instead, the court offered MB the alternative choices of 1) refunding the retainer Ryan paid, and waiving its fees; or 2) opposing waiver of its fees, in which instance MB's Withdrawal Motion would be denied and the firm would remain Ryan's attorney. ER 73; ER 78; ER 85; ER 98; ER 108; ER 152-53; ER 154; ER 210; ER 211.

In its opening brief, MB suggests the bankruptcy court's rulings were premised in part on the view "that [Ryan] had not 'really' discharged MB as her attorneys." Appellant's Opening Brief p. 20. The bankruptcy court did, initially, question whether MB was "discharged," given that Ryan testified she was not unhappy with Scott's services; but, rather, she simply could not afford continued fees. ER 73; ER 151-52. In the Letter Opinion, however, the court noted that whether Ryan discharged MB (such as would implicate the mandatory withdrawal provision of ORPC 1.16(a)(3)) or "simply could not afford to pay for past and future services" (such as would implicate the permissive withdrawal provisions of ORPC 1.16(b)) was "a distinction without a difference on the facts at bar" because Ryan's "only reason for not wanting further representation [by MB] was 'financial.'" ER 209. That finding was correct.

Specifically, whether MB was or was not discharged is irrelevant. Even, however, if the firm was "discharged," the bankruptcy court still had authority — pursuant to LBR 83.11(a) and the express language of ORPC 1.16(a) and (c) — to order the firm to continue, notwithstanding ORPC 1.16(a)(3).[10] The bankruptcy court's ruling thus posed no ethical dilemma for MB. Gardner, 417 F.Supp. 703 at 718; Poirier, 2007 WL 2462173 p. 2. See also Or Eth. Op. 2005-1 p. 2, http://wwwosbar.org/_docs/ethics/2005-1.pdf (Or.St.Bar.Assn. 2005) (if court refuses to permit lawyer to withdraw, lawyer must continue and provide competent representation) (citing Lathen); Or Eth Op. 1991-1 p. 2, 1991 WL 279142 (Or.St.Bar.Assn. 1991) (same).

IV. **Given that on appeal MB objects to waiver of its fees, remand for a determination of the reasonableness of the firm's fees is appropriate.**

When MB sought leave to withdraw discovery deadlines and an evidentiary hearing

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[10] Moreover, even if LR 83.11(a) conflicted with ORPC 1.16(a)(3), that would be irrelevant, because LR 83.11(a) controls in federal cases.

regarding the § 707(b) motion were imminent. The Withdrawal Motion was filed only 35 days after Scott substituted in as Ryan's attorney. In that time, Scott made one appearance (at the preliminary hearing on the § 707(b) Motion) on Ryan's behalf. The record thus does not show what, if any, benefit Ryan received for the fees MB seeks from her.

The ruling appealed by MB provided that, if the firm filed a declaration refusing to waive its fees, the Withdrawal Motion would be denied "without further notice or hearing or action" (ER 85). Arguably, MB would then have been free to bill Ryan as it continued to represent her. If MB did not file such a declaration, the bankruptcy court's ruling provided that the Withdrawal Motion would be granted, and MB's fees would be deemed waived. ER 108-09. The bankruptcy court's ruling was thus self-executing. The ten-day period ultimately granted by the Letter Opinion has expired, and MB has never filed a declaration objecting to waiver of its fees. Given, however, the position it has taken in this appeal, the firm clearly does object to waiving its fees. See Appellant's Opening Brief at 4 n. 2 (stating MB never filed a declaration refusing to waive its fees, but "took other action to contest being forced to waive its fees.").

Under those circumstances, to clarify the record, the United States Trustee submits it is appropriate to remand this case to allow for review of MB's fees, in the context of § 329(b), to determine whether, and to what extent, the firm should be allowed to seek payment from Ryan.

CONCLUSION

For the foregoing reasons, the United States Trustee respectfully asks this Court to remand this appeal to the bankruptcy court to consider the reasonableness of MB's fees in the context of a formal § 329(b) hearing.

Respectfully submitted,

ROBERT D. MILLER, JR.
ACTING UNITED STATES TRUSTEE

/s/ Ronald C. Becker
Ronald C. Becker, OSB #83151
Attorney for the United States Trustee

Ramona D. Elliott, General Counsel
P. Matthew Sutko, Associate General Counsel
Executive Office for United States Trustees
Department of Justice
20 Massachusetts Ave., N.W.
Washington, D.C. 20530
Phone: (202) 307-1399

Gail B. Geiger, Assistant United States Trustee
Office of the United States Trustee
Department of Justice
405 East 8th Ave., Suite 1100
Eugene , OR 97401-2706
Phone: (541) 465-6330

CERTIFICATE OF SERVICE

I certify, under penalty of perjury, as follows:

1. On July 18, 2008, the attached document was served on the persons shown below by depositing a true copy thereof, in a sealed envelope with First-Class postage prepaid and addressed as shown below, in the U.S. Mail, at Eugene, Oregon. To the best of my knowledge, information and belief, there is regular communication by First-Class mail between Eugene, Oregon, and the address shown below:

Wendy McKenzie Ryan
3520 Celeste Way
Eugene, OR 97408

Debtor

2. Based on the Bankruptcy Court for the District of Oregon's PACER online "Parties" records for Case No. 07-63072-aer7, as accessible on July 18, 2008, the following person(s) should (in addition to the U.S. Trustee) be served electronically via ECF when the attached document is filed with the Court:

Ronald R Sticka (Trustee)
ronaldrstickatrustee@rsticka.com

Kimberly S Covington (Former Attorney for Debtor)
kcovington@letusfightforyou.com

Thomas K Hooper (Attorney for Creditor FMCC)
bmail@hooplaw.com

William F McDonald (Attorney for Creditors GMAC Mortgage, LLC, & MERS)
ecforb@piteduncan.com

Loren S Scott, Natalie C Scott & Wilson C Muhlheim (Attys for Mulheim Boyd, LLP)
ecf@mb-lawoffice.com

Wilson C Muhlheim & Loren S Scott (Attorneys for Debtor)
ecf@mb-lawoffice.com

Marilyn R Podemski (Attorney for Creditor Wells Fargo Bank, NA)
mrp@podemski.com

//

Lance E Olsen (Attorney for Creditor Wells Fargo Bank, NA)
ecfor@rcflegal.com

Dated: July 18, 2008

/s/ Larry D. Eyre
Larry D. Eyre, Paralegal Specialist
Office of the U.S. Trustee

BRIEF BANK — "SUMMARY SHEET"

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WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]* — In re Wendy McKenzie Ryan (Muhlheim Boyd, LLP v. Robert D. Miller, Acting United States Trustee)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]* — 9th Cir.

3. ("CCN") ***CURRENT*** CASE NO. — No.: 08-36007

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]* — No.: 6:08-cv-06250-HO

Court: D. Or.

(Identify judge & cite, if any)

5. ("SO") ***SOURCE*** — **U.S. TRUSTEES**

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]* — Filed: February 11, 2009

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7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]* — Ronald C. Becker, Gail Geiger, Saleela Salahuddin, Matthew Sutko, Robert D. Miller, Jr.

(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC*** — **BANKRUPTCY**

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***

- Whether the district court's remand order is not a final order.

10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)

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Ronald C. Becker, OSB # 83151
Office of the United States Trustee
Department of Justice
Wayne L. Morse U.S. Courthouse
405 East Eighth Avenue, Suite 1100
Eugene, Oregon 97401
Telephone: (541) 465-6330

Attorneys for Appellee

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

In re: Wendy McKenzie Ryan, Debtor.	No. 08 - 36007 D.C. No. 6:08-cv-06250-HO District of Oregon, Eugene
Muhlheim Boyd, LLP, Appellant, v. Robert D. Miller, Jr. Acting United States Trustee, Region 18. Appellee.	APPELLEE'S MEMORANDUM IN SUPPORT OF ORDER TO SHOW CAUSE WHY APPEAL SHOULD NOT BE DISMISSED FOR LACK OF JURISDICTION

Facts and Procedural Background

For purposes of addressing Appellant, Mulheim Boyd's ("MB") response to this Court's order to show cause why this appeal should not be dismissed, Appellee, the United

States Trustee,[1] accepts Appellant's statement of facts as recited in MB's January 30, 2009, memorandum, except as follows.[2]

MB's representation of the debtor, Wendy Ryan ("Ryan") was limited to the defense of the United States Trustee's motion to dismiss her case pursuant to 11 U.S.C. § 707(b). MB filed its motion to withdraw on February 12, 2008. The bankruptcy court did not issue its order on MB's motion until March 20, 2008. Nevertheless, Ryan has been, in effect, proceeding *in pro per* ever since the February 12, 2008, motion to withdraw was filed. The only action MB has taken in this case, after February 12, 2008, has been to litigate and appeal its motion to withdraw. Ryan drafted and signed her own response to the United States Trustee's 11 U.S.C. § 707(b) motion to dismiss.[3] Ryan also signed, on her own behalf, a stipulated order granting the United States Trustee's motion to dismiss (the "Dismissal Order"). ER 9 - 10. Finally, MB did return the $1,000 retainer that Ryan paid MB. At this point, the bankruptcy case has been dismissed, and it appears that MB has not been paid anything for its services in representing Ryan up to the date MB moved to withdraw (except for the $1,000 retainer that

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[1] United States Trustees are officials of the Department of Justice appointed by the Attorney General to supervise the administration of bankruptcy cases and trustees. See 28 U.S.C. §§ 581-589; In re Columbia Gas Sys., Inc., 33 F.3d 294, 296 (3rd Cir. 1994) (United States Trustees oversee the bankruptcy process, protect the public interest, and ensure that bankruptcy cases are conducted according to law) (citing H.R. Rep. No. 95-595, 109 (1977)). "The United States Trustee is the 'watchdog' of the bankruptcy system . . . charged with preventing fraud and abuse and with 'fill[ing] the vacuum' caused by possible creditor inactivity." In re Castillo, 297 F.3d 940, 950 (9th Cir. 2002). Section 307 of the Bankruptcy Code authorizes the United States Trustee to appear and be heard on the matters at issue in this appeal. See 11 U.S.C. § 307; In re Donovan Corp., 215 F.3d 929 (9th Cir. 2000) ("The United States trustee may . . . intervene and appear at any level of the proceedings from the bankruptcy court on . . . as either a party or an amicus.") (internal quotation marks omitted).

[2] Additional excerpts of the record are attached hereto as necessary and are labeled "ER 1," "ER 2," etc.

[3] The response was, however, electronically docketed by MB on Ryan's behalf. However, the only input MB had on the response was to attach a "cover sheet" to the response Ryan drafted showing MB's signature. MB had nothing to do with the content of the response. ER 1 - 7; 8.

MB returned to Ryan).

Summary of Argument

MB's appeal should be dismissed on two alternative bases. First, the order MB appeals from is not a final order and, consequently, this Court lacks jurisdiction. Alternatively, the dismissal of the bankruptcy case renders MB's request to withdraw moot (because MB was hired solely to defend the United States Trustee's motion to dismiss which has now been resolved).

Argument.

The district court's remand order is not a final order.

In In re Lakeshore Village Resort, 81 F.3d 103 (9th Cir. 1996), this Court made clear that the four criteria set out in Vylene Enterprises, Inc. V. Naugles, Inc. (In re Vylene Enterprises, Inc.), 968 F.2d 887 (9th Cir. 1992) must be considered in determining whether an order is final for purposes of appellate jurisdiction under either 28 U.S.C. § 158(d) or 28 U.S.C. § 1291. Those four factors include:

1. The need to avoid piecemeal litigation;
2. Judicial efficiency;
3. The systemic interest in preserving the bankruptcy court's role as a finder of fact; and
4. Whether delaying review would cause irreparable harm.

All four factors favor of dismissal for lack of jurisdiction. First, conducting a hearing on the amount MB is owed will avoid piecemeal litigation. The district court astutely observed that MB's appeal of the bankruptcy court's order effectively demonstrated MB's refusal to waive its fees. What MB purports to seek (by its motion to withdraw and the ensuing appeals) is to be relieved of its obligation to represent of Ryan (on the United States Trustee's motion to dismiss) and to be allowed to bill Ryan for the work that it did before withdrawal.[4] The district court remanded for the bankruptcy court to hold a hearing on MB's fees under 11 U.S.C. § 329. Subsection (b) of that section provides that the court may cancel any fee agreement if the court finds that the compensation paid or agreed to be paid to the attorney is excessive. If, on remand, the bankruptcy court finds that MB is owed nothing (because MB's fees were excessive), then it would be likely that MB would appeal again to raise additional issues presented by the lower court's ruling on the reasonableness of the fees. Therefore, awaiting the adjudication of MB's fees until the remand proceeding is completed ensures the Court will not need to adjudicate two appeals concerning MB's fees (a) in this appeal and (b) a subsequent appeal from a § 329 order that cancels MB's contract with Ryan and orders the return of the same $1,000 at issue here.

The second consideration, judicial efficiency, also favors of dismissal. The bankruptcy court's withdrawal order was conditional. MB argues that this Court should, in essence, reverse the district court and order the bankruptcy court to grant MB's motion to withdraw without conditions. Even if this Court were to so rule, a remand would be appropriate so that the bankruptcy court could consider its prior ruling in that context. This is not a case where the bankruptcy court simply denied MB's motion. Nor did the bankruptcy court grant MB's motion outright. The bankruptcy court's order was conditional. ER 11-16. Ryan wanted MB to withdraw so as to avoid further expense associated with the litigation. Although the bankruptcy court declined to determine the reasonableness of MB's fees at that juncture, this Court's ruling on whether such a conditional order is appropriate might be different if the record regarding those expenses is more fully developed before this Court reviews the

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[4] As discussed in the mootness section, below, MB's representation ceased when Ryan's case was dismissed. All that is left to do is to collect its fees from Ryan (or for the bankruptcy court to find that no fees are owed).

decisions below. Moreover, should the bankruptcy court, on remand, determine that MB's fees were reasonable and should be paid, there may be no reason for MB to further appeal.

Third, the record thus far contains insufficient evidence or findings on the issue of whether and to what extent MB should be allowed compensation at all. See 11 U.S.C. § 329. The bankruptcy court is the proper forum for presenting and considering those matters. Dismissing this appeal preserve's the bankruptcy court's role as a fact finder by allowing the bankruptcy court to hear evidence on the fees issue under section 329 as directed by the district court.

Finally, delaying the review of this matter will not cause any party irreparable harm. If the bankruptcy court determines that MB is not entitled to any fees, MB could appeal that decision. On the other hand, if the bankruptcy court determines, on remand, that MB is entitled to full compensation, the need for any further appeal might be eliminated altogether. In other words, MB will still have the ability to seek review, albeit with a more complete record.

The remand involves factual issues necessary to a central issue on appeal.

One of the options given to MB under the bankruptcy court's conditional withdrawal order in this case was for MB to waive its fees. Additional fact finding as to whether, and to what extent, MB should be compensated for its services would lend context to the choices that MB was presented and is, therefore, central to the appeal of whether the bankruptcy court's order was proper. That evidence should, therefore, be developed prior to this Court hearing an appeal of those issues.

Appellant also relies on the collateral order doctrine in support of its contention that the bankruptcy court's orders it appeals are final orders. Appellant cites Law Offices of Nicholas A. Franke v. Tiffany (In re Lewis), 113 F.3d 1040, 1043 (9th Cir. 1997) and points out that, in order for an order to be final and appealable, it must "finally determine the discrete issue to which it is addressed." Appellant's Memorandum at p.13. The bankruptcy court's order, however, was conditional. MB never directly made one of the elections provided in the bankruptcy court's order. Rather than elect one option or the other, MB filed its notice of appeal to the district court. The bankruptcy court's order, therefore, did not finally determine whether MB was or was not Ryan's counsel. It was the eventual dismissal of Ryan's case (as more fully discussed below) that ultimately determined MB's status as Ryan's counsel (due to the limited terms of MB's engagement).

<u>Dismissal of Ryan's bankruptcy case renders MB's appeal moot.</u>

MB seeks an order reversing the district court's ruling that the bankruptcy court did not err in conditioning MB's withdrawal from the case on MB's agreement to waive the fees it billed. That issue has been rendered moot by a series of events that has occurred after MB filed its notice of appeal to the district court.

MB's representation of Ryan was limited to defending against the § 707(b) dismissal motion. Prior to dismissal of Ryan's case, the bankruptcy court gave MB two options: 1) to have its motion to withdraw granted, conditional upon the firm waiving its fees; or 2) to oppose waiving its fees, in which case MB's withdrawal motion would be denied, and MB could seek further payment from Ryan. MB was ultimately allowed until March 29, 2008, to file an opposition to waiving its fees. ER 11 - 16, at 16 (the "Letter Opinion").

The district court, on appeal, recognized that by its notice of appeal filed March 28, 2008 — one day prior to the 10-day deadline stated in the Letter Opinion — MB effectively opposed waiving its fees. Consequently, MB's withdrawal motion was, as a practical matter, denied as of its notice of appeal and MB remained Ryan's attorneys of record. Because MB had not waived its fees, and no order had been entered expressly denying MB's fees, MB remained free to seek payment from Ryan, unhindered by *any* order entered in Ryan's case.

MB, by moving to withdraw, sought leave of court to end its representation of Ryan without impediment to seeking payment from her. Although Ryan continued to act on her own, MB was still Ryan's attorneys of record at the time the case was dismissed. When, however, the dismissal occurred, MB's representation terminated, because 1) it never agreed to provide *any* services beyond opposing the § 707(b) Motion; and 2) the dismissal motion was granted by Ryan's *pro per* stipulation. Additionally, because MB's withdrawal motion was never granted — and because waiver of its fees was conditional upon withdrawal — MB remains free to seek payment from Ryan for services performed in opposing the § 707(b) motion pre-dismissal.

Under the unique facts of this case, it is impossible for any effective relief to be granted. MB has already received, in full, the result sought by its withdrawal motion (albeit for different reasons than those it has advanced here). Accordingly, because no effective relief can be fashioned, this appeal is moot. In re Di Giorgio, 134 F.3d 971, 974 (9th Cir. 1998) (doctrine of mootness precludes federal court decision of "questions that cannot affect the rights of litigants in the case before them" citing and quoting from North Carolina v. Rice, 404 U.S. 244, 246, 92 S.Ct. 402, 404, 30 L.Ed.2d 413 (1971)).

The dismissal of Ryan's bankruptcy case has never been an issue on appeal. MB is simply seeking a ruling allowing it to be formally released as Ryan's counsel and allowing it to bill Ryan for its fees. As a practical matter, the Dismissal Order did just that. Because, under the unique facts of this case, the Dismissal Order was not central to MB's appeal, the bankruptcy court had jurisdiction to enter that order notwithstanding the pending notice of appeal filed a few days prior to the entry of the Dismissal Order. In re Padilla, 222 F.3d 1184, 1190 (9th Cir. 2000).

Although MB's motion to withdraw is moot, its request for fees is not. While the case remained open, the bankruptcy court could have considered any issues presented under 11

U.S.C. § 329 involving the reasonableness of MB's compensation. MB initially sought remand for that purpose, and the district court ultimately ordered a remand for that purpose. On remand, the bankruptcy court will consider that matter and MB can appeal any order adversely affecting the fees it receives in this case.

Conclusion.

The district court's remand order is not a final order and this appeal should, as a consequence, be dismissed. Moreover, the relief MB is seeking – relief from acting as Ryan's counsel and ability to seek compensation – has already been granted by virtue of the dismissal of the case.

For the foregoing reasons, this appeal should be dismissed.

Respectfully submitted February 10, 2009.

ROBERT D. MILLER, JR.
Acting United States Trustee, Appellee

/s/Ronald C. Becker
RONALD C. BECKER, OSB # 83151
Attorney for the United States Trustee, Appellee
Department of Justice
Wayne L. Morse U.S. Courthouse
405 E. 8th Ave., Suite 1100
Eugene, OR 97401
(541) 465-6330
Email: ronald.becker@usdoj.gov

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Appellee's Memorandum in Support of Order to Show Cause Why Appeal Should Not Be Dismissed for Lack of Jurisdiction

Loren S. Scott, OSB #024502
MUHLHEIM BOYD, LLP
88 East Broadway
Eugene, OR 97401
Telephone: (541) 868-8005
Facsimile: (541) 868-8004
Email: scott@mb-lawoffice.com
Of Attorneys for Debtor

UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF OREGON

In re: Wendy McKenzie Ryan, Debtor.	Case No. 07-63072-aer7 RESPONSE TO UNITED STATES TRUSTEE'S MOTION TO DISMISS CASE PURSUANT TO 11 U.S.C. §§ 707(b)(1) AND (2); OR ALTERNATIVELY, §§ 707(b)(1) AND (3)

Attached as Exhibit A is the response drafted by Wendy McKenzie Ryan, debtor herein, to the U.S. Trustee's motion to dismiss her case. This response is filed on behalf of the debtor because, as indicated in the Motion for Authority to Withdraw as Counsel for Debtor, the debtor intends to oppose the U.S. Trustee's motion to dismiss pro se and has requested that Muhlheim Boyd, LLP cease its representation of her. A hearing on that Motion is set for February 20, 2008 at 10:00 a.m. Unless and until the court enters an order authorizing the withdrawal of Muhlheim Boyd, LLP as attorneys for the debtor, the debtor is prohibited from filing documents directly with the court.

DATED this 14th day of February, 2008.

MUHLHEIM BOYD, LLP

By: /s/ Loren S. Scott
Loren S. Scott, OSB #024502
Of Attorneys for Debtor

In re Wendy McKenzie Ryan

Debtor. Bankruptcy Case No. 07-63072-aer7

Written response to motion to dismiss

With regards to the presumption of abuse, the court has not been given true facts and correction of errors indicated in the 20 page memorandum in support of 707(b) motion.

*It is stated that there is unsecure debt of $166,652, "all described as credit card debt." In addition to the unsecured debt, the secured debt, although I previously quit claimed on 2 out of the 3 properties, creditors quickly began to pursue me as a co-debtor. A list of all mortgages was properly stated with my bankruptcy papers. I wish the court to note that the unsecured debt was allocated in my divorce decree to my ex-husband with exception of about $35-$39,000 of which up until I filed for bankruptcy, I was NEVER LATE. Although the debt was allocated in the divorce decree to my ex-husband, Jeffrey M. Ryan, he charged credit lines and credit cards weather in my name or his and the statements went to his home in California, so I never saw all the charges and became aware of all the debt when we separated in 2004, at which time I made it clear that he would pay these debts as he had been doing. When his earnings as a Mortgage Broker began to decline, he stopped paying on all credit cards and mortgages and the creditors quickly came to me for recourse. Although as stated above, the balances of credit cards in my possession of approximately $35-$39,000 were current with zero delinquencies, I was advised by legal counsel that when I file

Exhibit A
Page 1 of 5

for bankruptcy that I could not selectively pay the credit cards that were "mine." Looking back at my divorce decree the courts should shame themselves for issuing a decree and then that very 'LEGAL" document or judgment does nothing to protect the individual as it was so ordered by the court! He didn't close accounts, rather he charged more, and he didn't refinance and remove my name as also ordered by the court. Had he closed the accounts and paid as ordered by the court and removed my name on said real property, I wouldn't be in bankruptcy.

*Regarding the judgment that dissolved my prior marriage, my ex-husband, Jeffrey M. Ryan wages have decreased to under $300,000 according to him and he is indicating his need to lower child support. It is unknown to me at this time what the figure will be lowered to.

*An error in paragraph 6, pg. 3-20 indicates "the judgment provides that Debtor's ex-husband shall pay for the cost of Rosa Meza." For the courts records, Rosa Mesas' services were terminated when I moved to Oregon in 2006. Also noted, that I pay for all child care and out of pocket medical expenses.

*Paragraph 8, pg 3-20 should be noted to the court that I NEVER took spousal support, but could have taken a substantial amount at the time of my divorce in 2004. If my attorney indicated in my divorce decree that "spousal support is reserved," it would have been out of her wishes to protect me as her client who was married over 10+ years and declined spousal support. She strongly discouraged me from waiving my right to spousal support and my attorney at the time put the statement in my divorce decree. I told my ex-husband at the time of our separation that I didn't want any spousal support. Also noted, I am re-married and have been since 2006, so this statement in the "Motion to Dismiss" is clearly one of many errors that Ms.

Kamitsuka failed to note. Ms. Kamitsuka should have the legal knowledge that once re-married you lose any right to spousal support and I am clearly married and could not seek spousal support from my ex-husband that I have been separated from since 2004.

*Paragraph 9, pg 4-20 Please note to the court that my husband, Mr. Todd Kurilo is still unemployed at this time and any reference of my positive feedback to his soon becoming employed is simply trying to remain positive for him and our family. He has diligently been sending out his resume and applications and has yet to find employment in his field of home building. The housing industry as a whole is at our nations all time lowest with foreclosures and builders laying off many quality employees. This is what led to Hayden Homes terminating my husband in October 2007.

*Our current residence at 3520 Celeste Way, which we bought at the time of our relocating to the Eugene area in 9/06 for $550,000 is over the "standards" for Lane County (I realize), however at the time when my husband was hired at Hayden Homes, he was making I'm sure more than the "standards" for Lane county and our home, when we purchased it was not extravagant or out of our league by any means. We were financially fine up until my ex-husband filed for bankruptcy and all the creditors came looking to me. Having my husband out of work still, we have to consider the possibility of selling our home.

*Paragraph 11, pg. 5-20 refers to tuition to St. Paul School. This like many other items in the Motion to Dismiss is a way to waste time on items that are of unimportance. To go through mathematical analogies' to come down to a difference of $26.46/mo difference in tuition is our justice system wasting energy and not

#4285^{00}

focusing on true facts. With that being said, the tuition of ~~$428.50~~ plus an additional $400 per year a the end of the year, unless parents put in 40+ hours at the school, plus $200 registration, the actual total tuition is $4885 divided by 12 is $407.08 divided by 2 is $203.54/ea. per month. The calendar year of 10 months vs. 12 months is why I pay $428.50, but my ex-husband pays child support 12 months, so to keep payments the same we don't adjust it. This is the difference of $26.46/month. Again, to go on and on about a $20 something dollar error and to dismiss that I am in bankruptcy because of Mr. Ryan (my ex-husband) and that because of him I have lost my credit rating, which was impeccable, my dignity, my name as a good standing citizen and to top it off he has cost me thousands in legal fees because of a divorce and a divorce decree that didn't do what it was set out by our judicial system to do. I am a Girl Scout leader here in Eugene and my background check when they opened a checking account for our troop was degrading. Ms. Kamitsuka says that this bankruptcy has nothing to do with Mr. Jeff Ryan's but she is very wrong. I wouldn't be in bankruptcy if it wasn't for Mr. Ryan. In addition to the above, I was forced to file bankruptcy just after having a baby, who is just 4 months old. Mr. Ryan has caused undo stress in my life including stress to my husband, Todd Kurilo, who has nothing to do with the obligations of my ex-husband.

*Page 5, footnote 6 states incorrectly a $2509 payment. This payment is to Mr. Jeff Ryan's 1st wife, Rhonda Ryan, not to me.

*Page 6 indicates another error of an $18,000 deposit, which I gave copies to Kim Covington's office with other documentation all labeled, including all credit card statements, bank statements, my husbands earnings to date, insurance policies, etc. This $18,000 was done in May (I believe) of 2007, when I had no idea what was about to hit me by Mr. Ryan's bankruptcy. And during which time my husband was still employed and I consolidated my credit cards and paid off credit cards with the $18,000. This $18,000 was a check from a credit card company that I deposited and paid other credit cards off with. All documentation was previously provided back in December 2007. I have done more than my part in collecting, copying and giving all account information as ordered by the court. I regret that copies provided to Ms. Covingtons office either never made it to the UST office or that the UST office has the same filing system as Ms. Covington. To note, this $18,000 was not additional income to me as insinuated in the Motion to Dismiss by Ms. Kamitsuka.

*In close, had Mr. Ryan (my ex-husband) not filed for bankruptcy, I wouldn't be writing this document today. I have no financial means of taking care of the obligations either secured or unsecured that so unjustly landed on my lap. With my husband unemployed and worried about what the future brings, I ask the court to consider my very unusual situation and not try to fit me in a box that doesn't exist.

CERTIFICATE OF SERVICE

I hereby certify that on February 14, 2008, I directed my staff to serve the foregoing RESPONSE TO UNITED STATES TRUSTEE'S MOTION TO DISMISS CASE PURSUANT TO 11 U.S.C. §§ 707(b)(1) AND (2); OR ALTERNATIVELY, §§ 707(b)(1) AND (3) by depositing in the United States mail at Eugene, Oregon full and complete copies thereof, by first class mail, postage prepaid, or hand delivered, addressed to the following:

Wendy McKenzie Ryan
3520 Celeste Way
Eugene, OR 97408
Debtor

I hereby certify that on February 14, 2008, my staff determined from the United States Bankruptcy Court electronic case filing system that the following parties will be served electronically via ECF:

THOMAS K HOOPER bmail@hooplaw.com, csayles@hooplaw.com
WILLIAM F. MCDONALD ecforb@piteduncan.com
LANCE E OLSEN ecfor@rcflegal.com, ecfor@rcflegal.com
MARILYN R PODEMSKI mrp@podemski.com
LOREN S SCOTT ecf@mb-lawoffice.com
Ronald R Sticka ronaldrstickatrustee@rsticka.com, ssticka@rsticka.com
US Trustee, Eugene USTPRegion18.EG.ECF@usdoj.gov

MUHLHEIM BOYD, LLP

By: /s/ Loren S. Scott
Loren S. Scott, OSB #02450
Of Attorneys for Debtor

drafted; isn't that correct?

A On the deadline the response was due, my office filed a cover sheet attaching as an exhibit Ms. Ryan's response.

Q And Ms. Ryan wrote that response; isn't that correct?

A That's correct.

Q You didn't have anything to do with the drafting of that; is that correct?

A Correct.

Q And did you provide the debtor with any estimate of what it would cost to defend the 707(b) dismissal motion?

MR. MUHLHEIM: I believe you can answer that, but not the specifics of it.

A Yes, I did.

Q (By Ms. Geiger) And what was the amount --

MR. MUHLHEIM: Objection: invades territory of attorney-client privilege.

THE COURT: Overruled.

Q (By Ms. Geiger) What was the estimate, Mr. Scott?

THE WITNESS: The estimate for what again?

MS. GEIGER: Defending the motion to dismiss.

A Five thousand dollars through trial.

Q (By Ms. Geiger) Did you advise Ms. Ryan of any

U.S. BANKRUPTCY COURT
DISTRICT OF OREGON
F I L E D
April 02, 2008
Clerk, U.S. Bankruptcy Court

Below is an Order of the Court.

albert E Radcliffe
ALBERT E. RADCLIFFE
U.S. Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF OREGON

In re: Wendy McKenzie Ryan, Debtor.	)	Case No. 07-63072-aer7 STIPULATED ORDER DISMISSING CASE PURSUANT TO 11 U.S.C. § 707(b)(1)

Based on the motion of the United States Trustee, filed December 5, 2007; the stipulation of the parties (below); and good cause appearing, the court hereby FINDS as follows:

1. The Debtor's debts in this case are primarily consumer debts.
2. Dismissal of this case pursuant to 11 U.S.C. § 707(b)(1) is appropriate.

Based on the foregoing FINDINGS, it is hereby

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ORDERED that this case shall be, and hereby is, dismissed, pursuant to 11 U.S.C. § 707(b)(1).

# # #

It is so stipulated:

ROBERT D. MILLER, JR. Acting United States Trustee	WENDY McKENZIE RYAN Debtor
/s/ P. Rebecca Kamitsuka P. REBECCA KAMITSUKA, OSB #93326 Attorney for United States Trustee	*/s/ Wendy McKenzie Ryan* WENDY McKENZIE RYAN Debtor

Presented by:

/s/ P. Rebecca Kamitsuka
P. REBECCA KAMITSUKA, OSB #93326
Attorney for United States Trustee
Wayne L. Morse Courthouse
405 E. 8th Ave., Suite 1100
Eugene, OR 97401-2706
(541) 465-6330

cc: P. Rebecca Kamitsuka, Attorney for U.S. Trustee
William J. Critchlow, Attorney for Debtor
Ronald R. Sticka, Trustee
Loren S. Scott, Former Attorney for Debtor
Kimberly S. Covington, Former Attorney for Debtor
Thomas K. Hooper, Attorney for Creditor FMCC
William F. McDonald, Attorney for Creditors GMAC Mortgage; MERS/Greenpoint
Marilyn R. Podemski, Attorney for Creditor Wells Fargo Bank, NA
Lance E. Olsen, Attorney for Creditor Wells Fargo Bank, NA

Conventional Service List:

Wendy McKenzie Ryan
3520 Celeste Way
Eugene, OR 97408

(Debtor)

U.S. BANKRUPTCY COURT
DISTRICT OF OREGON
F I L E D
March 20, 2008
Clerk, U.S. Bankruptcy Court

United States Bankruptcy Court for the District of Oregon

Albert E. Radcliffe, Judge
Virginia H. Denney, Judicial Assistant
Howard J. Newman, Law Clerk

405 East Eighth Avenue, Suite 2600
Eugene, Oregon 97401

(541) 431-4050
FAX: (541) 431-4047

March 19, 2008

Ms Gail Geiger
Office of the U. S. Trustee
211 East 7th Avenue, Room 285
Eugene, OR 97401

Mr. Wilson C. Muhlheim
Muhlheim Boyd
88 East Broadway
Eugene, OR 97401

RE: RYAN, Wendy McKenzie; Case No. 07-63072-aer7
Muhlheim Boyd's Motion to Alter or Amend February 21, 2008 Minute Order and February 29, 2008 Order Supplementing and Clarifying Minute Order

Counsel:

This letter will announce my findings of fact and conclusions of law regarding the above-referenced motion.

History:

Debtor Wendy McKenzie Ryan filed her Chapter 7 petition, herein, on October 30, 2007, through attorney Kim Covington. On December 4, 2007, the United States Trustee (UST) filed a motion to dismiss under 11 U.S.C. § 707(b).[1] On January 10, 2008, Loren Scott of the Muhlheim Boyd firm (the firm) filed a substitution for Ms Covington as Debtor's counsel. That same day I conducted a hearing on the UST's motion. As a result of that hearing, a scheduling order was entered on January 15, 2008. The order gave Debtor 30 days to file a response to the UST's motion. The parties were to exchange witness and exhibit lists at least 21 days before the evidentiary hearing on the motion.[2] Objections to the exhibits needed to be served on the

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[1] Unless otherwise indicated, all subsequent statutory references are to Title 11 of the United States Code.

[2] On January 31, 2008, notice went out setting the evidentiary hearing for March 6, 2008.

opposing party at least 14 days before the hearing. Witness and exhibit lists, as well as trial memoranda were to be filed at least 7 days before the hearing. At least 11 days before the hearing the parties were required to meet and confer and file a certification as to such conference at least 7 days before the hearing.

On February 12, 2008, Mr. Scott moved to withdraw. The motion was supported by his declaration stating that Debtor had that day communicated to him that she no longer wanted him to represent her and that she wanted to proceed pro se. The declaration further states that Debtor had been notified of all pending deadlines, especially the February 14, 2008, deadline to file a response to the UST's motion. Mr. Scott requested an expedited hearing on the motion so that Debtor could file her response pro se. On February 13, 2008, Mr. Scott filed his own § 329 attorney fee disclosure statement, indicating the firm had been paid $1,000, and that any balance due was "hourly." As for services to be rendered, the statement excluded adversary proceedings and contested matters. Excluded from this exclusion was "opposition to the U.S. Trustee's 707(b) motion." The statement also indicated that "[s]ubsequent to the agreement w/the debtor regarding compensation, the debtor instructed me to withdraw from my representation of her in the case." The UST filed an opposition to the Motion to Withdraw, indicating that the Debtor's deposition was scheduled for February 20, 2008, arguing that withdrawal would be prejudicial to Debtor and to the administration of justice, particularly in view of the imminent scheduling deadlines.

On February 14, 2008, Mr. Scott filed a cover page, attaching Debtor's pro se response to the UST's Motion. On that same date, the court served notice of a hearing set for February 20, 2008 on Mr. Scott's motion to withdraw. The notice stated that testimony may be received.

On February 20, 2008, I conducted the hearing on the motion to withdraw. Mr. Scott and Debtor appeared as did Ms Kamitsuka of the UST's office. At the February 20 hearing, I orally announced my conclusions which were reduced to a minute order entered February 21, 2008 (the minute order). The minute order provided that if Mr. Scott refunded the $1,000 retainer and filed a declaration as to same within 3 business days, his motion to withdraw would be granted. If not, his motion would be denied. Mr. Scott then timely filed a declaration that he had refunded the $1,000, but that notwithstanding the issuance of the refund, the firm reserved the right to appeal entry of the order.

The UST and Mr. Scott then disagreed as to whether the minute order prohibited the firm from subsequently billing for its services after refund of the $1,000. The UST filed a motion to clarify the order. On February 29, 2008 an order was entered clarifying and supplementing the minute order (the supplemental order). The supplemental order provided that the grant of the motion to withdraw was conditioned on Mr. Scott waiving all fees in the case. If he did not want to waive fees, he could file a declaration within 5 days, upon which his motion to withdraw would be denied, he could then require repayment of the $1,000 previously refunded. If no declaration was filed, the fees were deemed waived and the motion would be granted.[3]

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[3] As the parties recall, at the February 20, 2008, hearing Ms Covington's fees were discussed at some length. It appeared from her § 329 disclosure statement that defense of a motion to dismiss was covered in her $1,701 flat fee. The UST advised it would file a § 329 motion to review her fees. Before

On March 3, 2008, the firm filed the present motion to alter or amend the minute and supplemental orders, which the UST opposed. On March 6, 2008, I conducted a hearing on the motion to alter or amend. Mr. Scott testified as to his representation of the Debtor. I also received several exhibits.

Discussion:

The issue before me is whether the firm has shown sufficient grounds to alter or amend the minute and supplemental orders.[4] The motion is under FRCP 59(a) and (e), and FRCP 52(b).[5]

Under Rule 59(e):

> [R]econsideration of a judgment after its entry is an extraordinary remedy which should be used sparingly. There are four basic grounds upon which a Rule 59(e) motion may be granted. First, the movant may demonstrate that the motion is necessary to correct manifest errors of law or fact upon which the judgment is based. Second, the motion may be granted so that the moving party may present newly discovered or previously unavailable evidence. Third, the motion will be granted if necessary to prevent manifest injustice.... Fourth, a Rule 59(e) motion may be justified by an intervening change in controlling law.

McDowell v. Calderon, 197 F.3d 1253, 1255, n.1 (9th Cir. 1999) (quoting, 11 Charles Alan Wright et al., Federal Practice and Procedure § 2810.1 (2d ed.1995)).

Under Rule 59(a), granting a motion for a new trial is appropriate if the moving party demonstrates 1) a manifest error of fact; 2) a manifest error of law; or 3) newly discovered evidence. Janas v. Marco Crane and Rigging Co. *(In re JWJ Contracting Co., Inc.)*, 287 B.R. 501, 514 (9th Cir. BAP (Az.) 2002), *aff'd.*, 371 F.3d 1079 (9th Cir. 2004) (internal citation omitted). The same standards apply to a motion to amend or for additional findings under FRCP 52(b). Weiner v. Perry, Settles & Lawson, Inc. *(In Re Weiner)*, 208 B.R. 69, 72 (9th Cir. BAP (N.D.Cal.) 1997), *rev'd on other grounds*, 161 F.3d 1216 (9th Cir. 1998).

The firm has not argued there has been an intervening change in controlling law, nor has it argued the motion should be granted to allow it to present newly discovered or previously unavailable evidence. This leaves the firm's contentions that I committed manifest errors of law

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doing so, Ms Covington and the UST stipulated to an order fully refunding Ms Covington's fees to the Debtor. Ms Covington has since filed a declaration that she has done so.

[4] As I announced at the March 6th hearing, the minute and supplemental orders do not constitute findings and conclusions under § 329 of the reasonableness of Mr. Scott's fees.

[5] FRCP 59 and FRCP 52(b) are made applicable by FRBP 9023 and FRBP 7052 respectively.

and fact or that altering or amending the minute and supplemental orders would prevent a "manifest injustice." I will discuss these grounds in turn.

For an error of law or fact to be "manifest," it must be "an error that is plain and indisputable, and that amounts to a complete disregard of the controlling law or the credible evidence in the record." In re Oak Park Calabasas Condominium Association, 302 B.R. 682, 683 (Bankr. C.D. Cal. 2003) (quoting, Blacks Law Dictionary 563 (7th ed. 1999)). The firm has not shown manifest error.

It is axiomatic that an attorney may not withdraw as counsel except by leave of court. Darby v. City of Torrance, 810 F.Supp. 275, 276 (C.D. Cal.1992). LBR 9011-1.A.1 implements this axiom.[6] The decision to grant or deny withdrawal is committed to my discretion. Liang v. Cal-Bay Intern., Inc., 2007 WL 3144099, *1 (S.D. Cal. 2007). Despite this general rule, the firm argues I had no discretion but to unconditionally allow withdrawal because it had been "discharged", citing Oregon Rule of Professional Conduct (ORPC) 1.16(a)(3).[7] This argument was raised at the February 20th hearing. Mere reiteration of duly considered and rejected arguments are inappropriate in a Rule 59 motion. Taylor. v. Knapp, 871 F.2d 803, 805 (9th Cir. 1988). Further, on the merits, the argument fails. Even assuming arguendo the firm was "discharged," the ethical rules allow even a "discharged" attorney to continue representation if ordered to do so.[8] ORCP 1.16(c);[9] see, also, SEC v. Poirier et. al., 2007 WL 2462173 (D. Az. 2007) (construing Arizona's analogous rule). In any event, I did not order the firm to continue its representation. I gave it a choice. The conditions I put on withdrawal were pecuniary. They did not put the firm in any sort of ethical bind.[10]

At bottom line, the firm objects to the conditions I put on withdrawal. It argues I committed manifest error in evaluating the evidence. It posits the evidence plainly indicated

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[6] LBR 9011-1.A.1 makes LR 83.11 applicable. LR 83.11 provides that an attorney may withdraw as counsel of record "only with leave of court, if doing so leaves the party unrepresented or without local counsel."

[7] ORPC 1.16(a)(3) provides: "Except as stated in paragraph (c), a lawyer shall not represent a client or, where representation has commenced, shall withdraw from the representation of a client if . . . the lawyer is discharged."

[8] LBR 9011-1.A.1 also incorporates LR 83.7 which requires lawyers practicing before the court to "comply with the standards of professional conduct required of members of the Oregon State Bar . . . ."

[9] By its terms, ORPC 1.16(a)(3) is expressly subject to ORPC 1.16(c). ORPC 1.16(c) states that: "A lawyer must comply with applicable law requiring notice to or permission of a tribunal when terminating a representation. When ordered to do so by a tribunal, a lawyer shall continue representation notwithstanding good cause for terminating the representation."

[10] The firm has noted that Debtor advised Mr. Scott at the February 20th hearing she did not want the $1,000 back. If this is true, she is free to gift it back to the firm. She is also free to voluntarily pay any outstanding fees. The minute and supplemental orders simply prohibit the firm from compelling such payment.

Debtor had "discharged" the firm because she no longer wanted to incur future legal fees, not that the firm was withdrawing because Debtor couldn't afford to pay fees. Again, these points were argued and duly considered at the February 20th hearing, and are not appropriate for reconsideration. Taylor, supra.

In any event, I have carefully reviewed the transcript of the February 20th hearing.[11] I believe the findings upon which I exercised my discretion by no means constituted a "complete disregard of the . . . credible evidence in the record." Oak Park, supra. At the hearing, Debtor confirmed she no longer wanted Mr. Scott to represent her. Upon my further questioning, she advised it was a "financial matter," not dissatisfaction with Mr. Scott's services. Tr. at 4:17-20. Mr. Scott later represented that Debtor indicated she did not have the financial wherewithal to continue to pay ongoing fees to his firm for services in the event he was to stay on as her attorney. Tr. at 9:23-10:1. Debtor stated at one point that she would love to be represented but couldn't afford it. Tr. at 11:10-11. Whether these representations indicated "discharge" or simply a client who wanted continued representation but could not afford to pay for past and future services is a distinction without a difference on the facts at bar. Debtor's only reason for not wanting further representation was "financial."

My duty was to balance all of the parties' interests. In exercising my discretion, I may consider (1) the reasons why withdrawal is sought; (2) the prejudice withdrawal may cause to other litigants; (3) the harm withdrawal might cause to the administration of justice; and (4) the degree to which withdrawal will delay the resolution of the case. Liang, supra 2007 WL 3144099 at *1 (citing, Irwin v. Mascott, 2004 U.S. Dist. LEXIS 28264 at 4 (N.D. Cal. December 1, 2004)).[12] Here, there were imminent scheduling deadlines and an imminent evidentiary hearing. Debtor had dismissal of her case at stake. She indicated she would love to be represented. My ruling was an attempt to facilitate that representation. The firm could either stay on or refund and waive its fees. The latter would facilitate Debtor retaining another attorney if she chose, by giving her a ready source of cash, as well as relief from the burden of paying the firm's accrued fees. I was also aware that it was highly probable Debtor would be getting some or all of Ms Covington's fees refunded, which would also facilitate employment of new counsel. In fact, this refund occurred soon after the February 20th hearing. See, f.n. 3, supra. I recognize

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[11] The evidence admitted at the March 6th hearing is not relevant to this issue. A motion to alter or amend is not an opportunity for a party to re-try its case. Rather, the only relevant new evidence on a motion to alter or amend is that which the moving party submits could not have reasonably been produced at the original hearing. Ponzar v. Cornerstone Mtg., Inc., 2007 WL 2048671 (E.D. Mo. 2007). The firm has proffered no such evidence.

[12] ORPC 1.16(c) acknowledges these concerns. As one court notes:

> RPC 1.16(c) recognizes the notion that even if withdrawal is otherwise appropriate, other considerations must sometimes take precedence, such as maintaining fairness to litigants and preserving a court's resources and efficiency. Criteria such as the proximity to trial and the possibility for a client to obtain substitute counsel are also relevant considerations.

Rusinow v. Kamara, 920 F.Supp. 69, 71 (D. N. J.1996) (construing New Jersey's analogous rule)(internal citations and quotations omitted).

Debtor stated at the February 20th hearing that she could not get new counsel because they would charge too high a fee. My order allowed Debtor at least some flexibility should she change her mind and seek such representation. Further, my order recognized the stage of the proceedings and the potential cost to Debtor to bring new counsel up to speed.

The last possible ground for reconsideration is to prevent a "manifest injustice," which has been held to be "an error in the trial court that is direct, obvious, and observable, such as a defendant's guilty plea that is involuntary or that is based on a plea agreement that the prosecutor rescinds." Oak Park, supra. For the reasons discussed above, the minute and supplemental orders do not memorialize a "manifest injustice."

The firm's motion to alter or amend will be denied. An order consistent herewith will be entered. The above constitute my findings of fact and conclusions of law under FRBP 7052. They shall not be separately stated.

I note that the firm has not filed a declaration that it is not waiving its fees per the supplemental order. Under the circumstances, I feel it is appropriate to give the firm further time to consider its election in this matter. Accordingly, I shall give the firm a period of 10 days from the date of this letter to file a declaration that it is not waiving its fees. In such event, the motion to withdraw will be denied and the firm shall remain as counsel for the debtor. If such a declaration has not been filed within the 10 day period, the firm's motion to withdraw is granted and its fees, relative to this matter, shall be deemed waived.

Very truly yours,

Albert E Radcliffe

ALBERT E. RADCLIFFE
Bankruptcy Judge

AER:vhd

cc: Ms Wendy Ryan, Debtor, pro se

CERTIFICATE OF SERVICE

I, Ronald C. Becker, hereby certify as follows:

1. On February 11, 2009, the foregoing APPELLEE'S MEMORANDUM IN SUPPORT OF ORDER TO SHOW CAUSE WHY APPEAL SHOULD NOT BE DISMISSED FOR LACK OF JURISDICTION was filed with the Clerk of the Court for the United States Court of Appeals for the Ninth Circuit by using the appellate CM/ECF system.

Participants in the case who are registered CM/ECF users will be served by the appellate CM/ECF system.

I further certify that I served on the persons shown below by depositing a true copy thereof, in a sealed envelope with First-Class postage prepaid and addressed as shown below, in the U.S. Mail, at Eugene, Oregon. To the best of my knowledge, information and belief, there is regular communication by First-Class mail between Eugene, Oregon, and the address shown below:

Wendy McKenzie Ryan
2530 Celeste Way
Eugene, OR 97408

Natalie C. Scott
Mulheim Boyd, LLP
88 E. Broadway
Eugene, OR 97401

/s/Ronald C. Becker
RONALD C. BECKER, OSB # 83151
Attorney for the Appellee,
United States Trustee

BRIEF BANK — "SUMMARY SHEET" *Printed Thu-3/17/11 11:54*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE
[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]

Sacramento Apartment Holdings, LLC v. JPMCC 2002-C1 Tuolumne Drive Limited (In re Sacramento Apartment Holdings, LLC)

2. ("CO") ***CURRENT*** COURT
[E.g., "CTA9"]

B.A.P. 9th Cir.

3. ("CCN") ***CURRENT*** CASE NO.

No.: 10-1294

4. ("PCN") ***PRIOR*** CASE NO. - & COURT
[IF ANY]

No.: 10-40200

Court: N.D. Cal.

(Identify judge & cite, if any)

5. ("SO") ***SOURCE***

U.S. TRUSTEES

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF
[E.g., "Opening Brief," "Reply," "Amicus," etc.]

Filed: February 23, 2011

Type: Brief of the United States Trustee for Region 17

7. **("AU") *PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*

Matthew R. Kretzer, Catherine B. Sevcenko, P. Matthew Sutko, Ramona D. Elliott, Barbara A. Matthews, August B. Landis

(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***

BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s)

&

√ Any Miscellaneous ***BACKGROUND***

• 1). Does this court have jurisdiction under 28 U.S.C. § 158(c)(2) and Fed. R. Bankr. P. 8002(a) to hear SAH counsel's appeal of the sanctions awarded to the United States Trustee although the notice of appeal is out-of-time? 2). If this court has jurisdiction, the issue becomes whether the bankruptcy court abused its discretion in awarding sanctions against SAH counsel for filing SAH's bankruptcy case in order to frustrate the bankruptcy court's lifting of the stay in the prior bankruptcy case of Gold River.

10. PATH TO FILE LOCATION:
(e.g., S:\OGC\BRFBANK\etc...)

11. DO YOU RECOMMEND POSTING IN UST BRIEFBANK?| x | | | ***NAME:*** Linda Figueroa

YES NO ***DATE:***

BARBARA A. MATTHEWS (SBN 195084), Assistant U.S. Trustee
MATTHEW R. KRETZER (SBN 157949), Trial Attorney
United States Department of Justice
Office of the United States Trustee
1301 Clay Street, Suite 690N
Oakland, California 94612-5231
Telephone: (510) 637-3200
e-mail: matt.r.kretzer@usdoj.gov

RAMONA D. ELLIOTT, General Counsel
P. MATTHEW SUTKO, Associate General Counsel
CATHERINE B. SEVCENKO, Trial Attorney
United States Department of Justice
Executive Office for United States Trustees
20 Massachusetts Ave, N.W.
Washington, DC 20530

Attorneys for AUGUST B. LANDIS,[1]
Acting United States Trustee

UNITED STATES BANKRUPTCY APPELLATE PANEL FOR THE NINTH CIRCUIT

In Re:

SACRAMENTO APARTMENT HOLDINGS, LLC,
Debtor.

Bankr. No. 10-40200
Chapter 11
Hon. Leslie Tchaikovsky
Bankruptcy Judge

SACRAMENTO APARTMENT HOLDINGS, LLC,
Appellant,
v.
JPMCC 2002-C1 TUOLUMNE DRIVE LIMITED PARTNERSHIP, a/k/a German American Capital Corporation, a/k/a LB-RPR Notes Holdings, LLC.;
AUGUST B. LANDIS, United States Trustee,
Appellees.

BAP No. NC-10-1294

On Appeal from the United States Bankruptcy Court for the Northern District of California

BRIEF OF THE UNITED STATES TRUSTEE FOR REGION 17

---

[1] Acting United States Trustee August B. Landis has replaced Acting United States Trustee Sara L. Kistler. See Fed. R. App. 43(c)(2) (allowing automatic substitution in such circumstances).

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TABLE OF AUTHORITIES

CASES

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JURISDICTIONAL STATEMENT

In its order of January 26, 2011, this Court stated that the sanctions order granting the United States Trustee attorney fees "appears to be a final order from which no timely notice of appeal was ever filed." Order at 2 (Doc. 9169625). The United States Trustee agrees.[2] For the reasons set out in Section I of the Argument section of this brief, the United States Trustee respectfully requests that this Court dismiss the appeal of Appellants Timothy Wilson and Ori Blumenfeld ("SAH Counsel") as it pertains to the United States Trustee. SAH Counsel did not file a timely appeal of the final order awarding sanctions to the United States Trustee, thereby failing to create a basis upon which this Court can assert jurisdiction. 28 U.S.C. § 158(c)(2); Fed. R. Bankr. P. 8002.

The United States Bankruptcy Court for the Northern District of California otherwise had subject matter jurisdiction over the underlying chapter 11 case and the proceedings for the determination of sanctions against SAH Counsel. 28 U.S.C. §§ 157(b) and 1334. The bankruptcy court's order imposing sanctions in favor of the United States Trustee were final, appealable orders. 28 U.S.C. § 158(a)(1); 28 U.S.C. § 158(c)(1).

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[2] Although this Court suggested that the parties address the issue of jurisdiction over the sanctions awarded to the United States Trustee in their briefs, Appellants Timothy Wilson and Ori Blumenfeld ("SAH Counsel") failed to do so. *See* SAH Br. at 2 (asserting this Court has jurisdiction because "all parties have consented to this Court's jurisdiction").

STATEMENT OF THE ISSUES

SAH Counsel has raised 22 issues on appeal, grouped into seven categories. SAH Br. at 2. However, the majority of those issues do not pertain to the United States Trustee or have not been properly raised.

Consequently, there are only two issues before this Court, as relate to the United States Trustee:

1. Does this Court have jurisdiction under 28 U.S.C. § 158(c)(2) and Fed. R. Bankr. P. 8002(a) to hear SAH Counsel's appeal of the sanctions awarded to the United States Trustee although the Notice of Appeal is out-of-time?

2. If this Court has jurisdiction, the issue becomes whether the bankruptcy court abused its discretion in awarding sanctions against SAH Counsel for filing SAH's bankruptcy case in order to frustrate the bankruptcy court's lifting of the stay in the prior bankruptcy case of Gold River.

FACTS

I. Prologue: Gold River Apartments LLC's Chapter 11 Case

In March 2009, Gold River Apartments LLC filed a chapter 11 petition in the United States Bankruptcy Court for the Northern District of California (Oakland Division). *In re Gold River Apartments, LLC*, No. 09-41589 LT (Bankr. N.D. Cal. filed Mar. 2, 2009). At that time, JPMCC 2002-C1 Tuolumne Drive

Limited Partnership, Gold River's secured lender, was in the process of foreclosing on the Gold River apartment complex. (Dkt. #31-2).[3] On December 2, while Mr. Blumenfeld and Mr Wilson – the appellants here – were counsel to Gold River, the bankruptcy court granted JPMCC's lift stay motion. No. 09-41589, Dkt. #142, SER 0006. Then JPMCC initiated foreclosure proceeding in the Superior Court of California (Sacramento County). Case No. 34-2009-00035774-CU-OR-GDS (Cal. Sup. Ct. filed Dec. 17, 2009) (Dkt. #31-3). While the state court proceedings were pending, the principals of Gold River transferred the apartment complex to a new corporation – Sacramento Apartment Holdings. (Dkt. #31-5 at 8-9) (corporation registration and quitclaim deed). The Bankruptcy Court did not authorize this transfer.

II. Sacramento Apartment Holdings's Chapter 11 Case

Counsel for Sacramento Apartment Holdings initiated a second chapter 11 case on December 22, 2009 in the San Francisco Division of the Bankruptcy Court of the Northern District of California. *In re Sacramento Holdings*, No. 09-34054 LT (Bankr. N.D. Cal. filed Dec. 22, 2009). They filed the petition the same day

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[3] As explained in the Appellee Secured Lender's brief (Doc. 9172441), the name of the secured lender has changed three times in the course of this litigation – from JPMCC 2002-C1 Tuolumne Drive Limited Partnership to German American Capital Corporation to LB-RPR Notes Holdings, LLC. Appellee Br. at 1 (Doc. 9172441). The United States Trustee will refer to the secured lender as "JPMCC" because that was the entity's name at the time the events in this case took place.

that they finalized the transfer of the apartment complex from Gold River to Sacramento Apartment Holdings. (Dkt. #31-15). This apartment complex is Sacramento Apartment Holdings' sole asset. It is the same property that JPMCC was authorized to foreclose upon in the *Gold River* case. This is also the same apartment complex at issue in the superior court foreclosure proceedings in Sacramento County.

On December 24, 2010, JPMCC filed a motion to transfer the case back to the Oakland Division, which was granted on January 7, 2010. *Sacramento Holdings*, No. 09-34054 (Dkt. #30). The next day, JPMCC filed a motion under 11 U.S.C. § 362(d)(4) to have the automatic stay in the *Sacramento Holdings* case lifted. *In re Sacramento Holdings*, No. 10-40200 (Bankr. N.D. Cal. filed Jan. 8, 2010) (Dkt. #31). The bankruptcy court lifted the automatic stay ordering that "[u]pon recordation, this [lift-stay] order shall be binding in any other case filed under Title 11of the United States Code not later than 2 (two) years after the date of entry of this order[.]" (Dkt. #60).

III. The United States Trustee Seeks Sanctions Against SAH Counsel, Mr. Blumenfeld and Mr. Wilson.

The United States Trustee filed a motion for sanctions against SAH Counsel under Federal Rule of Bankruptcy Procedure 9011 on January 12, 2010. (Dkt. #38). The United States Trustee alleged that they had filed the underlying bankruptcy case to delay foreclosure on the apartment complex first owned by Gold River and then by Sacramento Holdings. *Id.* at 3. JPMCC filed a joinder in the United States Trustee's motion the next day. (Dkt. #41). The SAH Counsel opposed the motion, arguing that its actions had been proper and therefore no basis existed to impose sanctions. (Dkt. #56).

At the February 16, 2010, hearing, when the bankruptcy court lifted the stay, it also considered the sanctions issue. At the outset, SAH Counsel withdrew all of their motions in both the Gold River and the Sacramento Apartment Holdings cases. Feb. 16 Tr. at 6. (Dkt. #121). SAH Counsel also agreed that their client would "participate in the foreclosure" and not "obstruct it." *Id.* SAH Counsel admitted that their litigation strategy "wasn't a good approach." *Id.* Finally, they asked "the Court to accept our apology for the kind of mess that we've created, but we're doing what we can to mitigate it, turn it over, and let everybody go on their way." *Id.* at 7.

On March 1, 2010, the bankruptcy court entered an order memorializing the February 16th hearing at which it granted the United States Trustee's motion for sanctions, in addition to lifting the stay to allow the foreclosure proceedings against the apartment complex to resume. (Dkt. #65). The order stated that the "Court shall determine the amount of sanctions." *Id.* It accordingly ordered the

United States Trustee and JPMCC to file declarations “indicating the fees and costs they incurred because of the sanctionable conduct.” *Id.*

The trial attorney representing the United States Trustee filed a declaration stating that he spent seven hours working on the motion for sanctions and requesting a rate of $350 per hour. (Dkt. #62). In addition, he requested compensation for 1 hour of a colleague’s time, at $400 per hour, for appearing at the February 16th hearing. *Id.*

The United States Trustee’s total fee request was $2,850. JPMCC filed a separate fee request for $69,195.88, reflecting the work of several attorneys at different hourly rates starting on December 22, 2009. (Dkt. #64).

SAH Counsel did not file an opposition to the United States Trustee’s request for $2,850 in sanctions. During the response period, SAH Counsel opposed neither the amount of sanctions requested by the United States Trustee nor the method by which the $2,850 was calculated.

SAH Counsel did oppose JPMCC’s $69,195.88 fee request. (Dkt. #67). In that document, SAH Counsel made two general statements that they should not have to pay sanctions to the United States Trustee because they had learned their lesson. *Id.* at 3, 4 (stating that the United States Trustee “has made their [sic] point regarding the Code”). Aside from averring that monetary sanctions were not necessary to deter similar action in the future, SAH Counsel did not challenge any aspect of the United States Trustee's motion or declaration asking for $2,850.

The bankruptcy court considered the fee requests and SAH Counsel's opposition to the JPMCC fee request before entering two separate orders. On March 22, 2010, the court docketed an order awarding JPMCC $50,000, payable in ten monthly installments of $5,000 each. (Dkt #70).

The order awarding the United States Trustee $2,850 was dated March 31 and entered on the docket on April 1, 2010. (Dkt #76).

In a filing dated and filed on March 31, 2010, SAH Counsel filed a motion to reconsider the "Order Granting Payment of Sanctions To Duane Morris and Office of the United States Trustee entered by this Court on March 22, 2010." (Dkt. #74). In this motion, SAH objected to the $2,850 amount awarded to the United States Trustee and to the method by which it was calculated. *Id.* at 3. The bankruptcy court denied the motion for reconsideration, and an order to that effect was entered on April 21, 2010. (Dkt # 81).

The SAH Counsel filed a second motion for reconsideration on April 30, 2010 (Dkt # 83). They filed third and fourth motions for reconsideration on June 12, 2010 and June 18, 2010, respectively. (Dkt #s 90, 91). The bankruptcy court did not rule on any of these motions because they did not raise new issues. Dkt.

#107 at 2, 3 (stating that "Wilson [SAH Counsel] has no right to require the Court to consider and rule on an unending series of motions for reconsideration, stating no new grounds"); *see also* July 6 Tr. at 4 (Dkt. #113).

JPMCC filed a motion for an order holding the SAH Counsel in civil contempt on May 18, 2010 because they had not made any sanction payments. (Dkt. #86). The United States Trustee did not join that motion. The bankruptcy court entered its order on July 15, 2010 granting JPMCC $200 for each day that SAH Counsel continued to be in arrears on their $5,000 monthly payments. (Dkt. #97). That order did not set a specific sanction amount. The final order awarding JPMCC $87,014.50 in sanctions, compensatory contempt sanctions, and civil contempt sanctions was entered on January 19, 2011. (Dkt. #151). That order did not mention the sanctions award made to the United States Trustee.

On July 29, 2010, the SAH Counsel filed a notice of appeal of 1) the original sanctions order of March 1, 2010; 2) the March 22 Order setting the amount of sanctions payable to JPMCC at $50,000; 3) the April 1 Order setting the United States Trustee's award at $2,850; and 4) the July 15 Order granting JPMCC's motion for contempt. (Dkt. #101).

STANDARD OF REVIEW

This Court reviews questions of law *de novo* and factual findings for clear error. *In re Ferrell*, 539 F.3d 1186, 1189 (9th Cir. 2008). A bankruptcy court's imposition of sanctions under Federal Rule of Bankruptcy Procedure 9011 is reviewed for abuse of discretion. *Valley Nat'l Bank of Arizona v. Needler (In re Grantham Bros.)*, 922 F.2d 1438, 1441 (9th Cir. 1991). A court abuses its discretion when the record contains no evidence to support its decision. *MGIC Indemnity Corp. v. Moore*, 952 F.2d 1120, 1122 (9th Cir. 1991).

ARGUMENT

I. The Appeal of the Sanctions Awarded to the United States Trustee Must be Dismissed Because SAH Counsel Filed Their Notice of Appeal Three Months Beyond the Statutory Deadline in 28 U.S.C. § 158(c)(2), so that this Court Does Not Have Jurisdiction to Hear it.

A. The deadline for filing a Notice of Appeal under 28 U.S.C. § 158(c)(2) is jurisdictional and therefore this Court does not have the power to hear this case as it pertains to the United States Trustee.[4]

This Court does not have jurisdiction to hear SAH Counsel's appeal of the sanction awarded to the United States Trustee because the July 15, 2010 Notice of Appeal is untimely. A litigant in bankruptcy has 14 days to file a notice of appeal of a final order. 28 U.S.C. § 158(c)(2) (stating that appeals are taken in the "time provided by Rule 8002 of the Bankruptcy Rules). This deadline is mandatory and

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[4] At this point in the litigation, the finality analysis regarding JPMCC differs from that pertaining to the United States Trustee. JPMCC filed a motion for civil contempt due to SAH Counsel's failure to obey the sanctions order. The United States Trustee did not join that motion. The bankruptcy court entered the contempt order on July 15, 2010. (Dkt. #97_____). SAH Counsel timely appealed the contempt order on July 29, 2010.

jurisdictional. *In re Wiersma*, 483 F.3d 933, 938 (9th Cir. 2007) ("[T]he failure to timely file a notice of appeal is a jurisdictional defect barring appellate review.") (citation and internal quotation marks omitted). SAH Counsel appealed the bankruptcy court's order awarding fees to the United States Trustee nearly three months late. Thus, this Court does not have jurisdiction to hear their appeal.

This case is governed by the Supreme Court case *Bowles v. Russell*, which held that if Congress established a time limit for taking an appeal in a statute, "that limitation is more than a simple 'claim-processing rule.'" *Bowles v. Russell*, 551 U.S. 205, 213 (2007). It is jurisdictional. *Id.* at 206; *Kingman Reef Atoll Invs., L.L.C. v. United States*, 541 F.3d 1189, 1196 (9th Cir. 2008) (quoting *Bowles*).

The *Bowles* holding applies to appeals in bankruptcy for two reasons. First, the Rule 8002(a) requirement that appeals be timely filed is incorporated into title 28. Section 158(c)(2) of title 28 provides that appeals in bankruptcy shall be taken "in the time provided by Rule 8002 of the Bankruptcy Rules." This reference to Rule 8002 is located in the same section of the statute that grants district courts jurisdiction to hear bankruptcy appeals. *See* 28 U.S.C. §§ 158(a)-(b). Because the time limitation is statutory, it is mandatory and jurisdictional.

Second, federal case law has for over 100 years treated time limits for filing a notice of appeal as jurisdictional. *Bowles*, 551 U.S. at 206 (stating that it has "long and repeatedly [been] held that the time limits for filing a notice of appeal are jurisdictional in nature"). The failure of SAH Counsel to file a timely notice of appeal deprives this Court of jurisdiction to review the bankruptcy court's award of $2,850 in sanctions to the United States Trustee. *Anderson v. Mouradick (In re Mouradick)*, 13 F.3d 326, 327 (9th Cir. 1994) (holding a court does not have jurisdiction to hear an untimely appeal).

B. SAH Counsel filed four motions for reconsideration but this does not change the fact that their appeal of the sanctions award to the United States Trustee was untimely.

SAH Counsel filed a timely motion for reconsideration of both sanctions orders on March 31, 2010. Fed. R. Bankr. P. 9023. (Dkt. #74).[5] An initial motion for reconsideration tolls the appeal period. Fed. R. Bankr. P. 8002(b)(2). The bankruptcy court denied the reconsideration motion on April 21, 2010. (Dkt. #81). The SAH Counsel therefore had 14 days from April 21, 2010 to file a notice of appeal. *Wages v. IRS*, 915 F.2d 1230, 1234, n.3 (9th Cir. 1990); *see In re Brewster*, 243 B.R. 51, 55 (B.A.P. 9th Cir. 1999) (citing cases). But they did not do so.

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[5] Although the order setting the sanction amount due to the United States Trustee was not entered until April 1, 2010, the motion for reconsideration filed the day earlier was also timely. *Calculators Hawaii, Inc. v. Brandt, Inc.*, 724 F.2d 1332, 1335 (9th Cir. 1983) (holding that a motion to reconsider filed before entry of judgment was timely for the purposes of calculating appeal period).

Instead of filing a notice of appeal, SAH Counsel filed three more motions for reconsideration in the bankruptcy court. (Dkt. #s 83, 90, 91). Additional motions for reconsideration do not toll the appeal period for the underlying judgment. *Ysais v. Richardson*, 603 F.3d 1175, 1178 (10th Cir. 2010) (holding that a second motion for reconsideration tolled the appeal period for the first motion of reconsideration but not the time to appeal the judgment itself).[6] Because SAH Counsel did not appeal the bankruptcy court's sanction orders within 14 days of its first denial of reconsideration, namely by May 5, 2010, their appeal is untimely and must be dismissed. *Anderson v. Mouradick (In re Mouradick)*, 13 F.3d 326, 327 (9th Cir. 1994).

II. The Bankruptcy Court's Award of Sanctions to the United States Trustee Became Final on April 21, 2010, Thus Starting the Appeal Period, Which Ended on May 5, 2010, Nearly Three Months Before SAH Counsel Filed Their Notice of Appeal.

An appeal of right from a bankruptcy court decision applies only to final "judgments, orders, and decrees." 28 U.S.C. §§ 158(a)(1) and (c). The bankruptcy court's order awarding sanctions to the United States Trustee became final on April 21, 2010, as described below.

Initially, the bankruptcy court's initial sanctions order, issued March 1,

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[6] Furthermore, the second and third motions for reconsideration were also untimely. Fed. R. Bankr. P. 9023.

2010, was not final because it did not establish the amount of sanctions. *Jensen Elec. Co. v. Moore, Caldwell, Rowland & Dodd, Inc.*, 873 F.2d 1327, 1329 (9th Cir. 1989) (holding that a sanctions order is final when the amount of sanctions is determined). Instead, the bankruptcy court ordered the parties to submit declarations so that it could determine the appropriate dollar amount. *Brown v. Wilshire Credit Corp. (In re Brown)*, 484 F.3d 1116, 1121 (9th Cir. 2007) (holding that an order that demonstrates court's intent for future action is not a final order).

The bankruptcy court entered the sanctions order as to the United States Trustee on April 1, but SAH Counsel filed a motion for reconsideration, thus continuing the litigation. Fed. R. Bankr. P. 8002. When the bankruptcy court denied the reconsideration motion on April 21, the order awarding the United States Trustee $2,850 was final and appealable because there was nothing else for the bankruptcy court to decide. *Catlin v. United States*, 324 U.S. 229, 233 (1945).

A. Although the underlying bankruptcy case is still pending, the order granting sanctions to the United States Trustee is final.

Cases holding that sanctions orders cannot be appealed until the litigation is complete do not apply in this case. In *Cunningham v. Hamilton County*, the Supreme Court held that a lawyer could not appeal discovery sanctions imposed upon her until the underlying case had been adjudicated. *Cunningham v. Hamilton County*, 527 U.S. 198, 200 (1999); *see also Markus v. Gschwend (In re Markus)*, 313 F.3d 1146, 1151 (9th Cir.) (stating that a sanctions motion in an adversary proceeding is not final until judgment has been entered). Even the *Cunningham* Court acknowledged, however, that sanctions orders are "conclusive." *Cunningham* 527 U.S. at 205. The applicability of *Cunningham* therefore depends upon the procedural posture of the underlying case. *In re Rimsat, Ltd.*, 212 F.3d 1039, 1044 (7th Cir. 2000) (stating it was "unclear" after *Cunningham* whether sanctions orders are final and appealable in bankruptcy because they resolve a discrete dispute within the bankruptcy case as a whole).

The reasoning in *Cunningham* does not apply in this case. The Supreme Court gave three reasons why a sanctions motion should not be final in civil litigation. First, an appeal while the case was pending could interfere with the independence of the district court judge. *Cunningham*, 527 U.S. at 203. Second, prohibiting an immediate appeal would prevent the interference with the litigants' interests and avoid the "cost of a succession of separate appeals." *Id.* Third, delaying the sanctions appeal to the end of the litigation would promote judicial efficiency. *Id.* at 204.

None of the grounds for the decision in *Cunningham* are implicated here. First, the bankruptcy court's independence is not at stake. Second, there is no danger of piecemeal appeals. Third, judicial efficiency would be undermined if this Court were to hear an untimely appeal.

Here, the merits of the case have been adjudicated, as *Cunningham* envisions. As the Seventh Circuit has held, the resolution of the issues in a bankruptcy case makes *Cunningham* inapplicable. *In re Rimsat, Ltd.*, 212 F.3d at 1044 (allowing the sanctions process to proceed because the dispute between the creditor and the debtor had been resolved, allowing for the final distribution of the bankruptcy estate).

Here, the bankruptcy court lifted the stay order on February 18, 2010, allowing the foreclosure of Sacramento Holding's sole asset and resolving the chapter 11 issue in the case. (Dkt. #60); *Cf.* SAH Resp. at 6 (filed Dec. 13, 2010) ("The legal proceedings in the SAH case are over except for the issues of sanctions and civil contempt."). Then the bankruptcy court resolved the sanctions issues. (Dkt #s 62, 64, 65, 70, 76, 81). Because the substantive bankruptcy issue had been decided, the order awarding sanctions to the United States Trustee was final. *See Rimsat*, 212 F.3d at 1044.

And this Court has also distinguished *Cunningham* to hold that it does not necessarily govern in bankruptcy cases. *Stasz v. Gonzalez (In re Stasz)*, 387 B.R. 271, 275 (B.A.P. 9th Cir. 2008) (stating that "neither *Cunningham* nor *Markus* directly addresses the procedural context of the case at hand"). Although *Stasz* was a contempt case under Rule 9020, rather than a sanctions case under Rule 9011, the reasoning in *Stasz* is apt here as well.

In *Stasz*, this Court reasoned that an "order entered resolving a contested matter has the status of a judgment under Federal Rule of Civil Procedure 58. Fed. R. Civ. P. 58, incorporated by Fed. R. Bankr. P. 9021. It follows that the court's award of sanctions was a final order that ended the particular contested matter." *Id.*; *accord In re Brown*, 484 F.3d at 1121 (stating that "We follow a 'pragmatic approach' to finality in bankruptcy – 'a complete act of adjudication need not end the entire case, but need only end any of the interim disputes from which an appeal would lie'") (citation omitted)).

The United States Trustee's motion for sanctions was a contested matter and was the sole issue before the court at the time the sanctions were awarded. Fed. R. Bankr. P. 9014; *Snyder v. Dewoskin (In re Mahendra)*, 131 F.3d 750, 754 (8th Cir. 1997) (stating that a motion for 9011 sanctions is a contested matter). Once the bankruptcy court denied reconsideration of the sanction award to the United States Trustee, the contested matter ended. *See Stasz* at 276 (stating if a sanctions award were not appealable even though it resolved the final issue in the case, "it is unclear when the order would become final and appealable").

III. Alternatively, To the Extent That SAH Counsel Have Asserted That this Court Has Jurisdiction over the United States Trustee's Sanctions

Order, Their Position Has No Merit.

In its January 26, 2011 order, this Court invited the parties to address whether SAH Counsel had timely appealed the order awarding sanctions to the United States Trustee. SAH Counsel did not address the issue in their brief other than to assert, without citation, that this Court can decide all aspects of this appeal because "all parties" have submitted to the jurisdiction of this Court. SAH Br. at 2. It is black-letter law, however, that if jurisdiction is improper, a court does not have power to hear a case. *United States v. Cotton*, 535 U.S. 625, 630 (2002). Therefore "jurisdiction can never be forfeited or waived." *Id.* Nor can it be created by mutual consent. *See Seminole Tribe of Florida v. Florida*, 517 U.S. 44, 127-128 (1996) (stating that consent of a private party is "wholly insufficient to create subject-matter jurisdiction where it would not otherwise exist").

In response to this Court's November 8, 2010 order questioning jurisdiction, SAH Counsel also argued that their failure to comply with the deadline to appeal should be excused on two grounds: 1) the "unique circumstances" doctrine and 2) "excusable neglect." SAH Resp. at 4-6 (filed Dec. 13, 2010). *Bowles* rejects both theories. First, federal courts have "no authority to create equitable exceptions to jurisdictional requirements, [therefore] use of the 'unique circumstances' doctrine is illegitimate."[7] *Bowles*, 551 U.S. at 214. Second, appeal deadlines in Federal Rule of Bankruptcy Procedure 8002 are incorporated into 28 U.S.C. 158(c)(2), making them jurisdictional; therefore, they cannot be mitigated by equitable principles such as "excusable neglect." [8] *Id.*

IV. Alternatively, The Bankruptcy Court Did Not Abuse its Discretion in Awarding Sanctions.

A. The bankruptcy court did not abuse its discretion when it sanctioned SAH Counsel for filing the Sacramento Apartment Holdings chapter 11 case to avoid the foreclosure action that had been authorized in the *Gold River* case.

SAH Counsel filed the chapter 11 bankruptcy case at issue here in order to delay foreclosure of the apartment complex their client owned, prompting the United States Trustee to file a motion for sanctions because the petition was filed for an "improper purpose" and to "cause unnecessary delay." Mot. at 1, 3 (Dkt. #38-1); Fed. R. Bankr. P. 9011(b)(1).[9] Filing a bankruptcy case to impede state court litigation constitutes an improper purpose. *Dressler v. Seely Co. (In re Silberkraus)*, 336 F.3d 864, 868 (9th Cir. 2003). Courts may also dismiss chapter

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[7] SAH Counsel cite only cases decided before *Bowles* for this argument.

[8] SAH Counsel cite cases involving late proofs of claim under Fed. R. Bankr. P. 9006 to support their argument. *See e.g., Pioneer Inv. Servs. Co. v. Brunswick Assoc. Ltd. P'ship*, 507 U.S. 380 (1993). These cases are inapposite because accepting a late proof of claim is irrelevant to the Court's jurisdiction.

[9] Because the United States Trustee sought sanctions for the filing of a petition to institute a case, the Rule 9011(c)(1)(A) safe harbor provision did not apply. *Id.*

11 petitions filed for “tactical reasons unrelated to reorganization.” *Marsch v. Marsch (In re Marsch)*, 36 F.3d 825, 828 (9th Cir. 1994). “The test is whether a debtor is attempting to unreasonably deter or harass creditors or attempting to effect a speedy, efficient reorganization on a feasible basis.” *Id.*

The actions taken by SAH Counsel are a classic example of “New Debtor Syndrome,” a pattern of conduct that indicates that there is cause to dismiss a chapter 11 case. *In re Duvan Apt. Inc.*, 205 B.R. 196, 200 (B.A.P. 9th Cir. 1996) (listing indicators). SAH Counsel transferred the distressed property from Gold River Holdings to a newly-created corporation, Sacramento Apartment Holdings. *Id.* The transfer occurred the same day that SAH Counsel filed the second chapter 11 case in another division of the bankruptcy court. *Id.* The apartment complex was Sacramento Apartment Holdings’ sole asset and the rents from the property were the only source of funds for servicing its debt. *Id.* At the very least, these facts were sufficient to create a prima facie case that SAH Counsel failed to rebut. *Id.*

The bankruptcy court did not abuse its discretion in finding that SAH Counsel filed this chapter 11 case for improper purposes. (Dkt. #65). In fact, SAH Counsel conceded as much. After the United States Trustee filed his sanctions motion, SAH Counsel attempted to withdraw all its filings rather than demonstrate that SAH could reorganize. *Marsch*, 36 F.3d at 828; Feb.16 Tr. at 6. SAH Counsel admitted that the procedure they followed was not "well-founded." Feb.16 Tr. at 5. They admitted that their actions were "not a good approach," *Id.* at 6, and that they had created a "mess." *Id.* at 7. The bankruptcy court did not abuse its discretion in deciding that the conduct of SAH Counsel warranted sanctions.

B. The other arguments of SAH Counsel have no merit.

1. Due Process

SAH Counsel have not been denied due process. SAH Br. at 8, 22. Three conditions must be met to satisfy due process in a sanctions proceeding. First, the party being sanctioned must receive notice. Second the party must be given an opportunity to respond. And third there must be a hearing. *Kirshner v. Uniden Corp. of Am.*, 842 F.2d 1074, 1082 (9th Cir. 1988). In this case, all the prerequisites have been met. The Court held a hearing. (Dkt. #58). It did not bar SAH Counsel from presenting witnesses or arguments. (Dkt. #121) (transcript). Therefore, due process rights were respected.

2. SAH Counsel are incorrect that the bankruptcy court ignored their arguments about mitigation and their financial situation.

Contrary to SAH Counsel's assertions, the bankruptcy court did consider their arguments 1) that they have mitigated the damage caused by their actions and 2) they cannot afford to pay sanctions. The bankruptcy court simply was not persuaded by their arguments.

In its opinion denying reconsideration, the bankruptcy court rejected SAH's claim that they had saved JPMCC money because they had withdrawn their appeal in the Gold River case because the Gold River can had been dismissed, thus "the appeal would have been dismissed as moot in any event." Mem. Op. at 11-12, n.2 (Dkt. #78). The bankruptcy court also instructed SAH Counsel "confer with Secured Creditor to substantiate their contentions concerning their limited finances and attempt to work out a reasonable payment plan." *Id.* at 12, n.3. SAH Counsel did not attempt to do so. July 6 Tr. at 5. The bankruptcy court did not abuse its discretion in rejecting SAH Counsel's claims they could not afford to pay the sanctions.[10]

CONCLUSION

The United States Trustee requests that this appeal be dismissed with respect

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[10] SAH Counsel's argument that the bankruptcy court abused its discretion in awarding sanctions in the amount of $2,850 to the United States Trustee has been waived. SAH counsel did not oppose the United States Trustee's motion that requested $2,850 in sanctions, nor did they object to the method the United States Trustee used to establish that amount, thus waiving their ability to do so now."It is a fundamental rule of federal appellate procedure that only such points as are made in the court below or such questions as are there raised will be reviewed on appeal[.]" *Kottemann v. Commissioner of Internal Revenue*, 81 F.2d 621, 623 (9th Cir. 1936). Furthermore, it is also black-letter law that a new argument may not be made in a motion for reconsideration, which was the first time that SAH Counsel questioned the methodology used to calculate the $2,850 fee request. *See Boardman v. Estelle*, 957 F.2d 1523, 1535 (9th Cir. 1992) (new arguments impermissible in petition for rehearing). Therefore, the fact that SAH Counsel first raised this issue in their motion for reconsideration did not preserve it.

to sanctions awarded to the United States Trustee. In the alternative, the United States Trustee requests that the bankruptcy court's sanctions orders in favor of the United States Trustee be affirmed.

Date: February 23, 2011

Respectfully Submitted,

AUGUST B. LANDIS, Acting United States Trustee, Region 17

BARBARA A. MATTHEWS
Assistant United States Trustee

By: /s/ *Matthew R. Kretzer*
MATTHEW R. KRETZER
Trial Attorney

Attorneys for Acting United States Trustee
August B. Landis

RAMONA D. ELLIOTT
General Counsel
P. MATTHEW SUTKO
Associate General Counsel
CATHERINE B. SEVCENKO
Trial Attorney
United States Department of Justice
Executive Office for United States Trustees
20 Massachusetts Ave, N.W.
Washington, DC 20530

BRIEF BANK — "SUMMARY SHEET"

Printed Thu-1/21/10 15:43

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE
[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]

Safeway Van Lines, Inc., v. W. Clarkson McDow, Jr., United States Trustee for Region Four (In re Safeway Van Lines, Inc.)

2. ("CO") ***CURRENT*** COURT
[E.g., "CTA9"]

D. Md.

3. ("CCN") ***CURRENT*** CASE NO.

No.: 8:09-cv-02378-MJG

4. ("PCN") ***PRIOR*** CASE NO. - & COURT
[IF ANY]

No.: 09-22579 PM

Court: Bankr. Md.

(Identify judge & cite, if any)

5. ("SO") ***SOURCE***

U.S. TRUSTEES

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF
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Jeanne M. Crouse, Anne Stukes, P. Matthew Sutko, W. Clarkson McDow, Jr.

(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***

BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s)

&

√ Any Miscellaneous ***BACKGROUND***

- Whether the bankruptcy court erred in entering an order granting the debtor's motion to convert this case to a liquidation under the provisions of chapter 7 of the bankruptcy code, 11 U.S. C. § 101.

10. PATH TO FILE LOCATION:
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IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MARYLAND
(Greenbelt Division)

SAFEWAY VAN LINES, INC. **Appellant,** **v.** **W. CLARKSON McDOW, JR., UNITED STATES TRUSTEE FOR REGION FOUR,** **Appellee.**	**Civil Case No.: 8:9-cv-02378-MJG**
In re: **SAFEWAY VAN LINES, INC.,** **Debtor.**	**Case No. 09-22579-PM** **Chapter 11**

REPLY MEMORANDUM IN SUPPORT OF UNITED STATES TRUSTEE'S MOTION TO DISMISS APPEAL

W. Clarkson McDow, Jr., the United States Trustee for Region Four, appellee herein ("United States Trustee"), by and through undersigned counsel, files this reply memorandum in support of his motion to dismiss the appeal filed by Simmons & Associates, Chartered (hereafter, "the Law Firm" or the "Appellant"), counsel for the Debtor, Safeway Van Lines, Inc. ("Debtor").

I. The Debtor Has No Standing to Pursue This Appeal.

On October 9, 2009, the United States Bankruptcy Court for the District of Maryland (Mannes, J.) entered an Order granting the Debtor's motion to convert this case to a liquidation under the provisions of Chapter 7 of the Bankruptcy Code, 11 U.S.C. § 101 *et seq.* (the

"Bankruptcy Code").[1] Michael M. Wolff has been appointed the Chapter 7 Trustee. As such, the Debtor is no longer in possession or control of its assets, its operations, or this appeal. The Debtor no longer has standing to pursue this appeal. The decision as to whether to continue the appeal rests solely with the Chapter 7 Trustee. Indeed, it was improper for the Law Firm to file its Opposition to the United States Trustee's Motion to Dismiss Appeal without first (1) being employed by the Chapter 7 Trustee, and (2) obtaining the Chapter 7 Trustee's consent. Given that this appeal does not benefit the bankruptcy estate, it most likely will not be pursued by the Chapter 7 Trustee.[2]

In view of these developments that strip the Debtor of standing, this Court may dismiss the appeal without ruling on the Law Firm's arguments about mootness. Nonetheless, if the Court elects to reach those arguments, it should not rule in favor of the Law Firm. Specifically, the Law Firm argues that the appeal is not moot because, if this Court reverses the Bankruptcy Court, the Law Firm will be entitled to file an application for compensation. The Law Firm cites *United States Trustee v. Equipment Services, Inc.*, 290 F.3d 739 (4th Cir. 2002), *aff'd, Lamie v. United States Trustee*, 540 U.S. 526 (2004), for the proposition that even after a case is converted to Chapter 7 from Chapter 11, debtor's counsel is entitled to payment for services performed pre-conversion. *Lamie* is distinguishable. In *Lamie*, unlike here, the Bankruptcy Court had approved counsel's application for employment before conversion to Chapter 7. Here, the Debtor converted to Chapter 7 after the application to employ the Law Firm was denied and while the

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[1] *See* Dkt. No. 56. A true and correct copy of the current Docket Sheet for the underlying bankruptcy case is attached hereto as Exhibit 1.

[2] When contacted, the Chapter 7 Trustee indicated his intent to take action to dismiss this appeal.

issue was on appeal. Thus, before its attorneys can submit a fee application for services rendered to this Debtor, the Debtor first must obtain approval to employ counsel. This critical step had been completed in *Lamie* before the appeal was taken. In this case, the Law Firm is seeking permission for the Debtor to continue to pursue its application to employ. However, because it has converted to Chapter 7, the Debtor is no longer authorized to seek employment of counsel. *Lamie*, 540 U.S. at 535. As such, this Court should dismiss.

II. The Order Appealed from Is Not Final, and Insufficient Grounds Exist for an Interlocutory Appeal under 28 U.S.C. § 158.

As noted in our original motion and as conceded by the Appellants, to hear this interlocutory appeal, this Court must find (1) the existence of a controlling question of law, (2) as to which there is substantial ground for a difference of opinion, and (3) immediate appeal would materially advance the termination of the litigation. *KPMG Peat Marwick, L.L.P. v. Estate of Nelco, Ltd.*, 250 B.R. 74 (E.D. Va. 2000). An order involves a controlling question of law when either (1) reversal of the bankruptcy court's order would terminate the action, or (2) determination of the issue on appeal would materially affect the outcome of the litigation. *In re Travelstead*, 250 B.R. 862 (Bankr. D. Md. 2000).

A. There is No Controlling Question of Law.

This case does not involve a controlling question of law because it does not deal with a question of "pure law." An issue is characterized as a controlling question of law if it deals with a question of "pure law, or deals with matters that can be decided quickly and cleanly without having to study the record." *McFarlin v. Conseco Servs., LLC*, 381 F.3d 1251, 1258 (11th Cir. 2004) (quoting *Ahrenholz v. Bd. of Tr. of Univ. of IL*, 219 F.3d 674, 677 (7th Cir. 2000)); *see also Allapattah Servs., Inc. v. Exxon Corp.,* 333 F.3d 1248, 1252-53 (11th Cir. 2003); *Pittway*

Corp. v. Fyrnetics, Inc. 9 F.3d 977 (Fed. Cir. 1993) (Table) (For proper certification of interlocutory appeals, "the order [must] involve a clear-cut question of law against a background of determined and immutable facts."). Questions of fact or matters for the discretion of the trial court are not appropriate issues for interlocutory appeals. *Garner v. Wolfinbarger*, 430 F.2d 1093, 1097 (5th Cir. 1970).

The decision below involved a matter of discretion for the bankruptcy court, not a question of "pure law." *See generally In re Lincoln Hosp. Med. Ctr., Inc*., 234 Fed.Appx. 426, 427 (9th Cir. 2007) (a bankruptcy court's decision to deny employment of counsel is reviewed for "abuse of discretion"). Furthermore, the appeal raises questions of fact — the Law Firm asserts that the fees in question were generated solely from work performed to prepare this bankruptcy case, but the record is not clear on that issue because appellant adduced no evidence — such as invoices — below. Thus, because the appeal involves matters of discretion and factual analysis, the issue presented is not one of "pure law," and this appeal cannot be heard as interlocutory.[3]

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[3] The Law Firm's argument that it is not a pre-petition creditor because the fees owed were for preparing the bankruptcy filing relies heavily on the case of *In re Roberts*, 46 B.R. 815 (Bankr. D. Utah 1985). The United States Trustee pointed out in his Motion to Dismiss that the *Roberts* case had been reversed by *In re Roberts*, 75 B.R. 402, 407 (D. Utah 1987). The Law Firm responded by claiming that *Roberts* was affirmed in part and reversed in part, which is correct. However, the issue upon which *Roberts* was reversed is the issue upon which the Law Firm is relying. In reversing the Bankruptcy Court, the United States District Court for the District of Utah unequivocally held: "A law firm which is a pre-petition creditor does not meet the 'disinterested person' criteria set forth in 11 U.S.C. § 101(13) and therefore is disqualified from representing a Chapter 11 debtor in possession." *In re Roberts*, 75 B.R. at 407. The law firm was therefore not eligible to represent the debtor, Roberts, Inc. *Id.* at 409.

B. There is No Substantial Ground for Difference of Opinion.

Even if the Law Firm could establish that the appeal involves a controlling question of law, there is no substantial ground for a difference of opinion as to the central legal question. Although there is no need for the Court to reach the underlying merits of the case to decide whether it has jurisdiction, the Court may note that, under 11 U.S.C. § 327(a), the overwhelming majority of courts have held that an attorney is ineligible to represent a debtor and not disinterested if that attorney is owed fees for pre-petition work. *See, e.g., United States Trustee v. Price Waterhouse,* 19 F.3d 138, 141 (3d Cir. 1994); *In re Patterson*, 53 B.R. 366 (Bankr. D. Neb 1985). The Court in *In re Eastern Charter Tours, Inc*., 167 B.R. 995 (Bankr. M.D. Ga. 1994), analyzed the construction of disinterestedness standards of the Bankruptcy Code and categorized the *Roberts* and *Martin* cases, upon which the Law Firm relies, as "caveat" positions to the majority view expressed by the *Price Waterhouse* case. Three rogue – or "caveat" – cases do not substantial disagreement make. *In re Eastern Charter Tours, Inc*., 167 B.R. 995, 997 (Bankr. M.D. Ga. 1994). *See also Oyster v. Johns-Manville Corp.*, 568 F.Supp. 83, 88 (D. Pa. 1983) (A "single case [in opposition] demonstrates that while there may be grounds for differences of opinion, they are not, however, *substantial*) (emphasis in original); *KPMG Peat Marwick*, 250 B.R. at 82 (citations omitted) ("'the difference of opinion must arise out of genuine doubt as to the correct legal standard'").

Against this backdrop, the Law Firm unconvincingly cites three cases, including one from the First Circuit. However, none of these cases is more recent than 1987 and one, *Roberts*, has been reversed.[4] Contrary to the authority cited by the Law Firm, there has been significant

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[4] *See* note 3 *supra*.

litigation --- and agreement --- on the question of statutory construction of the phrase "disinterested person" since 1987. The courts' analysis comports with Supreme Court holdings that, although bankruptcy courts retain significant discretion, that discretion "can only be exercised within the confines of the Bankruptcy Code" and cannot be used to eviscerate plain statutory language. *Norwest Bank of Washington v. Ahlers*, 485 U.S. 197, 206, 108 S. Ct. 963, 968-69, 99 L.Ed.2d 169 (1988). Under this analysis, the majority of courts now hold that Section 327(a) of the Bankruptcy Code bars a law firm-creditor from serving as counsel to the debtor in a bankruptcy case. *See, e.g., United States Trustee v. Price Waterhouse,* 19 F.3d 138, 141 (3d Cir. 1994); *Childress v. Middleton Arms, L.P. (In re Middleton Arms, L.P.)*, 934 F.2d 723, 724-25 (6th Cir. 1991). *See also United States Trustee v. Bloom (In re Palm Coast, Matanza Shores L.P)*, 101 F.3d 253 (2d Cir. 1996) (concluding that language in Section 327 prohibits case trustee from hiring his real estate firm). In short, it is well-settled that this Law Firm, which concedes that it is owed money for pre-petition services, is not disinterested and thus could not be employed as counsel.

C. Immediate Appeal Will Not Materially Advance the Termination of this Litigation.

Finally, the determination of the issue on appeal would not materially affect the outcome of the litigation. The Law Firm argues that the resolution of this appeal will terminate litigation between the Debtor and the United States Trustee. The Law Firm is mistaken – the resolution of this appeal will not necessarily terminate the litigation.[5] Any reversal on appeal would be the

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[5] The Law Firm advances two theories as to why its application for employment should be granted: (1) it claims that it is not a pre-petition creditor because its fees were generated for preparing the bankruptcy petition and accompanying papers, and (2) if it is considered a pre-petition creditor, then it will agree to waive its pre-petition fees. Contrary to its

first step in a longer process. If this Court reverses the lower court's decision and remands for further proceedings, the Law Firm first must obtain approval below of its application for employment. If that hurdle is cleared, the Law Firm must then prepare and file a request for compensation under Section 330 of the Bankruptcy Code before any fees can be awarded. At that juncture, the United States Trustee and other creditors and parties-in-interest would have an opportunity to object to the Law Firm's application for compensation. If an objection is filed, the Bankruptcy Court generally holds a hearing on the matter.[6] At this hearing, the Law Firm would bear the burden of proving that its fees were *inter alia* actual, necessary and reasonable. The Court could sustain any objections or could deny any and all fees *sua sponte*. *See In re Busy Beaver Bldg. Ctrs., Inc.*, 19 F.3d 833, 840-41 (3d Cir. 1994). Thus, contrary to the Appellant's assertions, if it is successful in this appeal, the litigation road will only get longer – not shorter. In other words, a determination now will not materially advance the litigation.

In conclusion, the Law Firm has not demonstrated that its motion for leave to appeal should be granted. Further, the Law Firm's prosecution of this appeal does not benefit the Debtor, who will never be required to pay this bill; the creditors, who are likely to receive only a

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assertions, the Law Firm never has agreed to waive its pre-petition fees to eliminate its conflict of interest. It has consistently stated that it will waive its outstanding pre-petition fees only if a court requires such waiver as a condition of employment. This is too little, too late. Professionals who seek to eliminate a conflict of interest caused by an outstanding amount due waive the amount due and owing long before any litigation on the issue in or conclusion reached by the bankruptcy court.

[6] The requirement for a hearing is governed by Section 102 of the Bankruptcy Code, which grants bankruptcy courts broad discretion to fashion the type of "hearing [that] is appropriate in the particular circumstances; . . ." 11 U.S.C. § 102(1)(A). Further, Section 102 empowers a bankruptcy court to take action without a hearing if "such a hearing is not timely requested by a party in interest" or if there is not sufficient time to hold a hearing. 11 U.S.C. § 102(1)(B).

small percentage, if any, of their claims, and will receive even less if the appeal succeeds; or the bankruptcy estate. This appeal benefits only one party – the Law Firm. This Court should dismiss.

WHEREFORE, for the foregoing reasons, the United States Trustee for Region Four, including the District of Maryland, respectfully requests that the Court deny the Appellant's Motion for Leave to Appeal, dismiss the appeal as interlocutory, and grant such other and further relief as is necessary and appropriate.

Dated: November 19, 2009

Respectfully submitted,

W. CLARKSON McDOW, JR.
United States Trustee for Region 4
By Counsel:

/s/ Jeanne M. Crouse
Jeanne M. Crouse, Bar No. 05329
Assistant United States Trustee
Lynn A. Kohen, Bar No. 10025
Trial Attorney
6305 Ivy Lane, Suite 600
Greenbelt, MD 20770
Tel: (301) 344-6216
Fax: (301) 344-8431
E-mail: jeanne.m.crouse@usdoj.gov;
lynn.a.kohen@usdoj.gov

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on this day, 19 November 2009, I caused to be served a true and correct copy of the foregoing REPLY MEMORANDUM IN SUPPORT OF UNITED STATES TRUSTEE'S MOTION TO DISMISS APPEAL, AND ATTACHED EXHIBIT 1, by ECF, by email at the at the email address provided below, and by first-class U.S. mail, postage prepaid, at the address given below:

Matthew H. Simmons
Simmons and Associates Chtd
4833 Rugby Ave Ste 100
Bethesda , MD 20814
Email: Matt@hoyalaw.com

/s/ Jeanne M. Crouse
Jeanne M. Crouse

BRIEF BANK — "SUMMARY SHEET" *Printed Thu-1/22/09 16:21*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*
In re: Jose Sanchez and Fanny Sanchez (Donald F. Walton, UST v. Countrywide Home Loans, Inc.)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*
S.D. Fla.

3. ("CCN") ***CURRENT*** CASE NO.
No.: 08-cv-23337-ASG

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*
No.: 08-01176-AJC
Court: Bankr. S.D. Fla.
(Identify judge & cite, if any)

5. ("SO") ***SOURCE***
U.S. TRUSTEES

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*
Filed: January 21, 2009
Type: Initial Brief of Appellant, the United States Trustee

7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*
John Sheahan, Zana M. Scarlett, P. Matthew Sutko, Donald F. Walton
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***
• Whether the bankruptcy court erred when it concluded that the United States Trustee lacks authority to request that the court impose civil sanctions against Countrywide and that the United States Trustee failed to state a claim for equitable relief.

10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)

11. DO YOU RECOMMEND POSTING IN UST BRIEFBANK?
| x | YES | | NO
NAME: Linda Figueroa
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UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF FLORIDA
Case No. 08-CV-23337-ASG

IN RE

JOSE SANCHEZ
and FANNY SANCHEZ,

Debtors.
_________________________________/

DONALD F. WALTON
United States Trustee,

Appellant,

v.

COUNTRYWIDE HOME LOANS, INC.,

Appellee.
_________________________________/

APPEAL FROM THE UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF FLORIDA

CASE NO. 01-042230-BKC-AJC
ADV. NO. 08-1176-BKC-AJC-A

INITIAL BRIEF OF APPELLANT, THE UNITED STATES TRUSTEE

(ORAL ARGUMENT REQUESTED)

DONALD F. WALTON
United States Trustee, Region 21

ZANA M. SCARLETT, Esq.
Office of the United States Trustee
Department of Justice
51 SW 1st Ave.
Miami, FL 33130
Phone: (305) 536-7285
Fax: (305) 536-7360
zana.scarlett@usdoj.gov

RAMONA D. ELLIOTT
General Counsel
P. MATTHEW SUTKO
Associate General Counsel
JOHN P. SHEAHAN
Trial Attorney
Executive Office for United States Trustees
Department of Justice
20 Massachusetts Avenue, N.W.
Washington, D.C. 20530

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REQUEST FOR ORAL ARGUMENT

Appellant United States Trustee requests oral argument. The challenged order dismissed the United States Trustee's complaint pursuant to Fed. R. Bankr. P. 7012(b)(1) on the grounds that the United States Trustee lacks authority to seek civil sanctions against a creditor in a bankruptcy case for abuse of the bankruptcy process, and on the grounds that the United States Trustee failed to state a claim for equitable relief.

STATEMENT OF THE BASIS OF APPELLATE JURISDICTION

The bankruptcy court had jurisdiction over the underlying chapter 13 bankruptcy case under 28 U.S.C. §§ 157(a) and (b) and 1334(a). The bankruptcy court dismissed the United States Trustee's adversary complaint by order entered on October 2, 2008. The United States Trustee timely appealed that order under 28 U.S.C. § 158(c)(2) and Fed. R. Bankr. P. 8002(a) on October 14, 2008. This Court has jurisdiction over this appeal under 28 U.S.C. § 158(a)(1).

STATEMENT OF ISSUES PRESENTED FOR APPELLATE REVIEW

In the adversary proceeding below, the bankruptcy court dismissed the United States Trustee's complaint, which requested that the bankruptcy court exercise its discretion to impose sanctions and appropriate equitable relief, pursuant to 11 U.S.C. § 105(a) and its inherent equitable powers, against Countrywide Home Loans, Inc. ("Countrywide") for Countrywide's misconduct in the bankruptcy case of Jose and Fanny Sanchez. This appeal raises the following issues:

1. Did the Bankruptcy Court err by holding that the United States Department of Justice, acting through one of its officers, the United States Trustee, lacks authority to request that the court exercise its discretion by imposing monetary sanctions under its inherent authority and 11 U.S.C. § 105(a) against a party that has abused the bankruptcy process?

2. Did the Bankruptcy Court rely on an incorrect legal standard when it held that the allegations of the United States Trustee's complaint were insufficient to state a claim for injunctive relief against Countrywide?

3. Did the Bankruptcy Court err by presuming that the only possible equitable relief it was empowered to grant pursuant to the United States Trustee's complaint is an injunction for Countrywide to obey the law?

APPLICABLE STANDARD OF APPELLATE REVIEW

This appeal raises only issues of law. The standard of review on appeal is de novo as to conclusions of law. In re New Power Co., 438 F.3d 1113 (11th Cir. 2006); In re Empire for Him, Inc., 1 F.3d 1156 (11th Cir. 1993); In re Verola, 336 B.R. 547 (S.D. Fla. 2004).

STATEMENT OF THE CASE

I. Countrywide's Abuse of the Bankruptcy System.

This appeal arises out of a series of abusive actions by Countrywide that the bankruptcy court, in the decision below, characterized as "reprehensible conduct by an apparently overreaching mortgage lender." (Op. at 11).[1] In 2001, the debtors, Jose and Fanny Sanchez, were the owners of a home on which Countrywide held a second mortgage. (Compl. at Exh. 1). On November 19, 2001, the Sanchezes filed a bankruptcy petition under chapter 13 of the United States Bankruptcy Code (Compl. at ¶ 7), and on January 17, 2002, they proposed a first amended chapter 13 plan. (Compl. at ¶ 8). With respect to Countrywide's second mortgage, that plan contained a "strip-down" provision, which alleged that the value of Countrywide's junior security interest was zero, and proposed to treat Countrywide's claim as a wholly unsecured claim. (Compl. at ¶ 9). Countrywide never objected to the Sanchez plan, and on January 17, 2002, the bankruptcy court entered an order confirming the plan. (Compl. at ¶ 10-11).

On February 19, 2002, Countrywide filed a proof of claim in the Sanchez bankruptcy case, in which it incorrectly characterized its claim as secured. (Compl. at ¶ 12). In response, the Sanchezes filed a motion for recordable order, requesting that the court confirm that Countrywide's lien had been stripped by the plan and that Countrywide's claims were unsecured. (Compl. at ¶ 13). Countrywide was served with a copy of the motion, but again filed no objection, and the bankruptcy court granted the motion for recordable order on April 24, 2003.

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[1] Citations herein to the decision of the bankruptcy court are referenced as (Op. _). Citations to the United States Trustee's adversary complaint are referenced as (Compl. __). Citations to pleadings contained in the docket of the underlying adversary proceeding are referenced as (Dkt. __).

(Compl. at ¶¶ 14-15).

Despite the entry of two bankruptcy court orders eliminating its security interest, in late 2003, Countrywide commenced a series of proceedings in which it sought to foreclose on the Sanchezes' property. On November 13, 2003, Countrywide filed a motion for relief from the automatic stay in the bankruptcy court, which the bankruptcy court subsequently denied for lack of prosecution. (Compl. at ¶ 16-17). On January 9, 2003, Countrywide filed a second motion for relief from the stay, which it later withdrew without prejudice. (Compl. at ¶¶ 18-19). Both of Countrywide's motions for relief from the stay falsely recited that Countrywide was the holder of a secured claim. (Compl. at ¶¶ 16-18).

The Sanchezes completed their chapter 13 plan and received a bankruptcy discharge on December 13, 2006. (Compl. at ¶ 20). Six months later, in apparent disregard of the Sanchezes' discharge and the bankruptcy court's orders regarding its claim, Countrywide commenced a foreclosure action against the Sanchezes in state court. In response, the Sanchezes moved to reopen their bankruptcy case and sought an order holding Countrywide in contempt of the bankruptcy discharge order. (Compl. at ¶ 23). Countrywide voluntarily dismissed its foreclosure complaint on October 29, 2007. (Compl. at ¶ 24). On October 30, 2007, the Sanchezes dismissed their contempt motion. (Compl. at ¶ 25). The Sanchezes did not otherwise settle or release their rights of action, if any, against Countrywide.

Countrywide's actions in the Sanchez case form part of a broader, nationwide pattern of misconduct, which recently has led to the imposition of sanctions against Countrywide and its representatives in several districts. See, e.g., In re Parsley, 384 B.R. 138 (Bankr. S.D. Tex. 2008) (sanctioning Countrywide's counsel and criticizing Countrywide for its failure to ensure the accuracy of its pleadings); In re Ennis, Case No. 05-11985 (Bankr. W.D. Pa. July 31, 2006) (sanctioning Countrywide and its counsel for failing to make reasonable inquiry prior to filing factually inaccurate motion for relief from the automatic stay); In re Allen, Case No. 06-60121, 2007 WL 1747018 (Bankr. S.D. Tex. Jan. 9, 2007) (sanctioning Countrywide's attorneys upon finding that Countrywide's objection to a chapter 13 plan "had no basis in fact or law and was materially disruptive to the efficient and effective operation of this Court"); In re Mann, Case No. 03-82973 (Bankr. M.D.N.C. March 8, 2004) (awarding punitive damages against Countrywide for repeated violations of the automatic stay and finding that Countrywide's conduct was "aggravated and egregious").

II. The United States Trustee's Complaint.

The plaintiff, the United States Trustee for Region 21, is a senior official of the United States Department of Justice who is charged with representing the interests of the United States and in overseeing the administration of the bankruptcy system in, among other jurisdictions, the Southern District of Florida. See 11 U.S.C. § 307; 28 U.S.C. §§ 581(a)(21), 586. By his complaint, the United States Trustee requested that the bankruptcy court exercise its discretion to impose appropriate sanctions against Countrywide pursuant to both the bankruptcy court's inherent equitable powers and its statutory power to "prevent an abuse of process," see 11 U.S.C. § 105(a). In particular, the United States Trustee's complaint requested two specific forms of relief. First, the complaint requested that the bankruptcy court "impos[e] appropriate monetary sanctions against Countrywide" to deter it from similar abuses of the bankruptcy system in the future. Second, the complaint requested that the bankruptcy court enter an order "enjoining and restraining Countrywide from engaging in bad faith and abusive practices" in connection with its filing of proofs of claim, pleadings, and foreclosure complaints.

On May 28, 2008, Countrywide moved to dismiss the United States Trustee's complaint. (Dkt. 24), and on June 30, 2008, the United States Trustee responded to the motion to dismiss. (Dkt. 42).

III. The Bankruptcy Court Decision.

On October 2, 2008, the bankruptcy court granted Countrywide's motion to dismiss the complaint. The bankruptcy court concluded that the United States Trustee had standing to assert his claims (Op. at 3), that the complaint was not moot (Id.), and that it had subject matter jurisdiction over the United States Trustee's claims. (Id.).

Nonetheless, the bankruptcy court dismissed the United States Trustee's complaint on three narrow grounds. First, with respect to the United States Trustee's claim for monetary relief, the bankruptcy court held that, although it had jurisdiction to impose a monetary sanction against Countrywide, and although the United States Trustee had standing to be heard on such a matter, the United States Trustee was not "authorized" to raise a request for civil sanctions on behalf of the public. (Op. at 5). Instead, the bankruptcy court held, without any explanation or support, that such action could only be taken by the United States Attorney, another officer of the Department of Justice. (Op. at 6).

Second, with respect to the United States Trustee's claims for non-monetary relief, the bankruptcy court held that the United States Trustee "failed to plead facts showing an imminent threat of future injury or any continuing, current injury warranting any sort of injunction." (Op. at 10). As a result, the bankruptcy court concluded that with respect to the United States Trustee's request for an injunction against future misconduct, "the 'injury' requirement of standing is not satisfied." (Op. at 9).

Third, the bankruptcy court dismissed the United States Trustee's non-monetary claims on the alternative grounds that any equitable relief obtained by the United States Trustee would take the form of an injunction against conduct already prohibited by other rules and law, and thus "would be an unnecessarily duplicative decree." (Op. at 10). As a result, the bankruptcy court held that the United States Trustee's claim for equitable relief would be denied on the grounds that it "lacks any degree of specificity and fails to provide any real guidance for Countrywide's future conduct." (Op. at 10).

SUMMARY OF ARGUMENT

The bankruptcy court erred when it concluded that the United States Trustee lacks authority to request that the court impose civil sanctions against Countrywide. As the officer of the United States Department of Justice responsible for overseeing the integrity of bankruptcy cases, the United States Trustee has been charged by Congress with the duty to investigate and prevent abuses of the bankruptcy system. The United States Trustee's request that the bankruptcy court exercise its discretion to sanction Countrywide for misconduct falls well within the scope of that duty.

In this case, by ruling that the United States Trustee lacked authority to bring an instance of party misconduct to the court's attention, the bankruptcy court relied on an erroneous statutory interpretation that is irreconcilable with the text of the Bankruptcy Code and Title 28, United States Code, and which also conflicts with well-established decisions of the Eleventh Circuit and other federal courts.

The bankruptcy court's determination that the United States Trustee failed to state an equitable claim for relief was also erroneous. By holding that the United States Trustee was required to plead a particularized injury to himself to obtain equitable relief, the bankruptcy court relied on a pleading standard that is inapplicable to governmental units seeking relief on behalf of the public interest. Furthermore, by basing its decision on speculation as to the form of the injunction that the United States Trustee would eventually request after the completion of discovery, the bankruptcy court improperly considered matters beyond the scope of a motion to dismiss under the notice-pleading standard set forth by Fed. R. Bankr. P. 7008 and Fed. R. Bankr. P. 7012. Finally, even if the issue of possible remedies were properly before the court, the bankruptcy court erred by presuming that its power to order injunctive relief against Countrywide is limited, at most, to an order requiring Countrywide to obey the law in the future.

ARGUMENT

I. THE UNITED STATES TRUSTEE STATED A CLAIM FOR MONETARY RELIEF AGAINST COUNTRYWIDE

The bankruptcy court correctly recognized that it has both inherent and statutory authority to sanction Countrywide for its abuse of the bankruptcy system, and further held that the United States Trustee "has standing." (Op. at 3).[2] Nevertheless, the bankruptcy court dismissed the

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[2] The bankruptcy court's sanctioning authority in this matter arises both from section 105(a) of the Bankruptcy Code, which authorizes courts to issue any order appropriate or necessary to "prevent . . . an abuse of process," as well as the inherent authority of all federal courts to punish bad faith conduct in litigation. The existence of a non-statutory, inherent source of sanctioning power has been settled law since the Supreme Court's decision in Chambers v. NASCO, Inc., 501 U.S. 32 (1991), which upheld the power of a district court to sanction bad faith conduct even where such conduct could not be sanctioned under Rule 11. Id. at 43. Although Chambers involved a sanction issued by a district court, the Eleventh Circuit subsequently recognized that the same powers are also inherent in federal bankruptcy courts. See In re Walker, 532 F.3d 1304, 1309-10 (11th Cir. 2008). The Eleventh Circuit has also held that the inherent power sanctions available to a federal court include, among other things, non-compensatory civil fines. See Kleiner v. First Nat. Bank of Atlanta, 751 F.2d 1193, 1209 (11th

United States Trustee's claims for monetary relief on the grounds that the United States Trustee is not "authorized" to seek such relief. (Id. at 5). The bankruptcy court opined that such relief could only be sought by the United States Attorney. (Id. at 6). The bankruptcy court did not explain its reasons for distinguishing between the standing and authority of the United States Trustee, and it cited no authority in support of its assertion that the United States Attorney, and not the United States Trustee, is vested with exclusive authority to request sanctions on behalf of the Department of Justice.

The bankruptcy court's holding is erroneous for at least three distinct reasons First, the bankruptcy court's decision misstates the purpose and statutory mandate of the United States Trustee program. The mission of the United States Trustee is not, as the bankruptcy court suggested, limited to the mere investigation of possible abuses. Rather, Congress provided the United States Trustee with a broad statutory mandate to commence appropriate litigation wherever abuses arise. The bankruptcy court's decision undermines this legislative purpose. Second, the bankruptcy court's ruling is based on an erroneous statutory interpretation. By suggesting that the United States Trustee lacks authority to perform duties not specifically enumerated by statute, the bankruptcy court's decision not only contradicted the plain terms of the statutory provisions on which it relied, but also failed to give effect to section 307 of the Bankruptcy Code. Third, the bankruptcy court's decision conflicts with more than two decades of rulings by federal appellate courts, which have uniformly recognized the broad nature of the United States Trustee's power to combat abuses of the bankruptcy system.

Cir. 1985) (affirming $50,000 noncompensatory fine imposed against counsel pursuant to trial court's inherent powers).

A. The United States Trustee Program was Created by Congress in Order to Litigate, as Well as Investigate, Misconduct in Bankruptcy Cases.

The United States Trustee Program has its genesis in the Commission on the Bankruptcy Laws of the United States, which was created by Congress in 1970 to study the structural problems inherent in the bankruptcy laws existing at the time. See Act of July 24, 1970, P.L. 91-354, 84 Stat. 468 (1970). Among the most longstanding and systemic of these problems was the lack of an effective administrative mechanism to protect against self-dealing, conflicts of interest, and other abuses in the bankruptcy process. These problems stemmed from the fact that bankruptcy is fundamentally different from typical litigation, which involves only a few parties who are actively motivated to defend their own self-interest. In contrast, a bankruptcy case often involves debtors who lack the sophistication or financial wherewithal to protect their own interests, and creditors whose small stake in proceedings or distance from the bankruptcy forum effectively denies them the ability to protect their rights. As a result, while courts recognized that "[t]he conduct of bankruptcy proceedings not only should be right but must seem right," In re Ira Haupt & Co., 361 F.2d 164, 168 (2d Cir. 1966), there was a widespread perception that in practice, bankruptcy proceedings fell well short of meeting this goal.[3]

In particular, the structural shortcomings of the former bankruptcy laws often meant that debtors and creditors would have no incentive to commence litigation to combat abuses. Moreover, because bankruptcy judges served in the dual role of administrator, which included

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[3] The severity of these problems was first exposed in a report submitted by William J. Donovan, a prominent New York attorney, to Congress in 1931, and was subsequently reiterated by then Solicitor General Thomas Thacher. See House Committee on the Judiciary, Administration of Bankrupt Estates, 71st Cong. 3d Sess. (Comm. Print 1931); Report to the President on the Bankruptcy Act and its Administration in the Courts of the United States, (1931), reprinted in S. Doc. No. 65, 72nd Cong. 1st Sess. (1932).

the duty to supervise the conduct of cases and investigate abuses, as well as the trier of law and fact in any proceedings to punish those abuses, the Commission expressed concern that "participation in administrative aspects of bankruptcy proceedings tends to impair the litigants' confidence in the impartiality of the tribunal's decision." Report of the Commission of the Bankruptcy Laws of the United States, H.R. Doc. No. 137, 93rd Cong. 1st Sess. (1973).

Echoing the recommendations of previous critics, the Commission concluded that it was essential to separate the administrative functions of the bankruptcy court from its judicial functions, and recommended the creation of an agency that would supervise bankruptcy cases. See Id. Congress carefully considered the Commission's suggestions, and in 1977, the United States House of Representatives issued a report that fully concurred in the Commission's determination and recommended the creation of the United States Trustee Program, a new entity to be located within the Department of Justice, to assume the administrative functions of the bankruptcy courts. See H.R. Rep. No. 595, 95th Cong. 1st Sess. (1977), reprinted in 1978 U.S.C.C.A.N. 5963. The House's recommendation was largely adopted in the legislation eventually enacted as the Bankruptcy Reform Act of 1978, which created the United States Trustee Program.[4] See P.L. 95-598, 92 Stat. 2549 (1978).

The legislative history relating to the creation of the United States Trustee Program reflects Congress's intention that the United States Trustees would not merely be a passive administrator, but would act as a "watchdog" whose role "may be compared with . . . a

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[4] The 1978 Reform Act initially created a pilot United States Trustee Program that served eighteen of ninety-four federal districts. See Reform Act § 224. However, just eight years later, the United States Trustee Program was expanded nation-wide as part of the Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1986. See P.L. 99-554, 100 Stat. 3088 (1986).

prosecutor." H.R. Rep. No. 95-595 at 109. Thus, one report described the proposed United States Trustee as the "enforcer[] of the bankruptcy laws," and noted that the United States Trustee would be responsible for bringing "proceedings in the bankruptcy courts in particular cases in which a particular action taken or proposed to be taken deviate[d] from the standards established by the . . . bankruptcy code." H.R. Rep. No. 989, 95th Cong., 2d Sess. 88, 109 (1977), quoted in A-1 Trash Pickup, Inc. v. United States Trustee (In re A-1 Trash Pickup), 802 F.2d 774, 775 (4th Cir. 1986). See also Morgenstern v. Recvo D.S, Inc. (In re Revco D.S., Inc.), 898 F.2d 498, 500 (6th Cir. 1990) (holding that United States Trustee could be likened to prosecutor with standing to litigate appeal on behalf of the public interest); In re Charges of Unprofessional Conduct Against 99-37, 249 F.3d 821, 825 (8th Cir. 2001) (comparing United States Trustee to federal prosecutor for purposes of sovereign immunity).

The United States Trustee's authority to enforce bankruptcy laws on behalf of the public further arises from the fact that, when creating the United States Trustee Program, Congress assigned to the United States Trustee many of the functions that previously had been performed in bankruptcy cases by the Securities and Exchange Commission. See H.R. Rep. 95-595 at 109 (stating that United States Trustees "operate much as the Securities and Exchange Commission operates under current chapter X of the Bankruptcy Act, protecting the public interest and ensuring that bankruptcy cases are conducted according to law"). As the Supreme Court held in an influential early decision, the SEC's functions included a broad authority, in addition to its prescribed statutory duties, to litigate in bankruptcy cases wherever the public policy of the bankruptcy laws was threatened. See Sec. & Exch. Comm'n v. U.S. Realty & Improvement Co., 310 U.S. 434, 459-60 (1940) (holding that SEC's "duty and its interest extends not only to the performance of its prescribed functions," but also to the prevention of any "violation of the public policy of the [Bankruptcy] Act"). The same principle is equally applicable under current law to the United States Trustee. See Revco, 898 F.2d at 499 (analyzing standing of United States Trustee under rule stated in U.S. Realty).

The present case provides a stark example of the policy Congress had in mind when it empowered the United States Trustees to litigate against abuses of the bankruptcy system. As a practical matter, few individual debtors will have the resources or sophistication to detect, or obtain redress for, abuses by large creditors. Even where debtors eventually resolve their disputes independently, as the Sanchezes appear to have done in this case, there is no incentive for those debtors or the creditor to resolve such abuses on a systemic basis. For this reason, as one bankruptcy court recently observed in another case involving Countrywide, the United States Trustee plays an essential role in combating creditor abuse. See Parsley, 358 B.R. at 145 (noting that "[b]ut for the extremely thorough investigation by the Office of the United States Trustee . . . the court may never have become aware of the numerous issues discussed herein").

Accordingly, the bankruptcy court erred when it held that Congress had not authorized the United States Trustee to act against bankruptcy abuses by requesting civil sanctions on behalf of the public.

B. The Bankruptcy Court Erroneously Construed the Statutes Defining the Scope of the United States Trustee's Powers.

In holding that the United States Trustee lacked authority to initiate a proceeding for sanctions, the Bankruptcy Court relied on the fact that pursuing sanctions is not among the United States Trustee's functions listed by 28 U.S.C. § 586 or set forth by a specific provision of the Bankruptcy Code. (Op. at 5-6). However, the bankruptcy court erred by concluding that the United States Trustee lacks authority to perform any functions not expressly mentioned in 28 U.S.C. § 586 or a specific Bankruptcy Code section.

In particular, the bankruptcy court's interpretation fails to account for section 307 of the Bankruptcy Code, which expressly authorizes the United States Trustee to raise and be heard on "any issue," except that the United States Trustee may not file a plan of reorganization. 11 U.S.C. § 307. The language of this provision is deliberately open-ended, and reflects a Congressional intent that the United States Trustee's standing is a rule, rather than the exception, in bankruptcy cases.[5] See United States Trustee v. Columbia Gas Sys., Inc. (In re Columbia Gas Sys., Inc.), 33 F.3d 294, 296 (3d Cir. 1994) (noting, with respect to section 307 of the Bankruptcy Code, that "[i]t is difficult to conceive of a statute that more clearly signifies Congress's intent to confer standing").

Furthermore, nothing in 28 U.S.C. § 586 limits the broad effect of 11 U.S.C. §307. Although 28 U.S.C. § 586 sets forth a list of examples of supervisory duties that the United States Trustee is authorized to perform, nothing in that statute limits the United States Trustee's power to perform duties other than those listed. Instead, the statute expressly authorizes the United States Trustee to assume all additional duties prescribed by titles 11 and 28, see 28 U.S.C. § 586(a)(5), including the power to "raise" issues relating to party misconduct pursuant to section 307. As a result, as every other court to have examined the issue has agreed, the structure of 28

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[5] Indeed, if the bankruptcy court were correct that the United States Trustee lacks authorization to act except where expressly permitted, the exception contained within section 307 would be meaningless, since no other provision of the Bankruptcy Code generally authorizes the United States Trustee to file plans.

U.S.C. § 586 is illustrative, not exclusive. See, e.g., In re Miles, 330 B.R. 848, 849-51 (Bankr. M.D. Ga. 2004) (noting that "nothing in the Code suggests that [the list contained in 28 U.S.C. § 586] is exclusive"); In re B&B Enterprises, Inc., 100 B.R. 982, 985 (Bankr. W.D. Tenn. 1989) (noting that section 586(a)(5) is intended as a "catchall" authorizing United States Trustee to perform duties not specifically listed elsewhere).

C. The Bankruptcy Court's Decision Conflicts With More Than Two Decades of Federal Appellate Precedent.

Contrary to the bankruptcy court's analysis, the question of whether the United States Trustee may perform duties absent specific statutory authorization was settled more than two decades ago. In A-1 Trash Pickup, a case decided prior to the enactment of section 307, the Fourth Circuit was faced with the question of whether the United States Trustee had the authority to commence a proceeding to combat bankruptcy abuse (in that case, by moving to dismiss an abusive bankruptcy filing) where, at the time, no provision of the Bankruptcy Code explicitly empowered the United States Trustee to do so. The Fourth Circuit found that the United States Trustee did have such authority, stating that Congress "expected the [United States Trustee] . . . to intervene whenever particular actions threatened an abuse of the bankruptcy system or its procedures." A-1 Trash Pickup, 802 F.2d at 776.

Courts in other jurisdictions have unanimously followed the holding of A-1 Trash Pickup. Thus, in Thompson v. Greenwood, 507 F.3d 416, 420 n.3 (6th Cir. 2007), the Sixth Circuit recognized the authority of the United States Trustee to file an objection to venue, even though the United States Trustee is not specifically authorized to file such a motion by Title 28, United States Code, the Bankruptcy Code, or the Federal Rules of Bankruptcy Procedure. In Columbia

Gas Systems., 33 F.3d at 295-96, the Third Circuit upheld the authority of the United States Trustee to object to a debtor's investment guidelines, rejecting the debtor's contention that the United States Trustee lacks enforcement powers except on matters where the Bankruptcy Code expressly authorizes him to intervene. Other appellate courts have also upheld the authority of the United States Trustee to file appeals despite the fact that appellate litigation is not among the functions of the United States Trustee specifically listed in 28 U.S.C. § 586. See Stanley v. McCormick (In re Donovan), 215 F.3d 929, 930 (9th Cir. 2000) (holding that United States Trustee had standing to appeal order); In re Clark, 927 F.2d 793, 796 (4th Cir. 1991) (same); In re Plaza de Diego Shopping Ctr., 911 F.2d 820, 824 (1st Cir. 1990) (same).

Additionally, courts in this circuit have upheld the authority of the United States Trustee to bring actions for disgorgement and injunctive relief, even though such proceedings are not specifically mentioned in the Bankruptcy Code. See Walton v. Watts (In re Swift), 185 B.R. 963, 970 (Bankr. N.D. Ga. 1995) (holding that "broad supervisory powers" under 28 U.S.C. § 586 authorized United States Trustee to file adversary complaint for disgorgement and injunctive relief against persons who engaged in unauthorized practice of law); Walton v. Jones (In re Shirley), 184 B.R. 613, 617 (Bankr. N.D. Ga. 1995) (noting that "ample authority exists" for the United States Trustee to file motion for sanctions and injunctive relief against party engaged in unauthorized practice of law).[6]

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[6] The Eleventh Circuit has not published any decision in which the issues raised by A-1 Trash Pickup were in dispute. In at least one case, however, the Eleventh Circuit has referenced the principle stated in A-1 Trash Pickup and its progeny as settled law. See also United States Trustee v. Fishback (In re Glados, Inc.), 83 F.3d 1360, 1361 n.1 (11th Cir. 1996) (noting, without discussion, that United States Trustee has standing to appeal order regarding compensation of chapter 7 trustee).

The bankruptcy court's decision not only represents a rejection of the long-settled principle stated in A-1 Trash Pickup, but would have grave consequences for the efficiency and integrity of the bankruptcy system as a whole. In order to combat abuse of the bankruptcy system, among other duties, United States Trustees regularly commence proceedings to disgorge funds improperly paid to professionals, see Quarles & Brady v. United States Trustee (In re Jennings), 199 Fed. Appx. 845 (11th Cir. 2006) (affirming order granting United States Trustee's motion for disgorgement against law firm); file motions to dismiss for improper venue, see Thompson, 507 F.3d at 420; and litigate appeals, see Glados, 83 F.3d 1360, 1361 n.1. The United States Trustee's power to take such actions, which has long been settled, rests on no greater or less statutory authority than its power to request that the bankruptcy court impose sanctions against Countrywide in the present case.

Even apart from the United States Trustee's broad authorization to combat bankruptcy abuse, the United States Trustee is authorized as an officer of the court to bring misconduct to the court's attention and to request that the court exercise its discretion to impose sanctions. See In re Gopman, 531 F.2d 262, 265 (5th Cir. 1976) (noting that whenever an officer of the court "discovers a possible ethical violation concerning a matter before the court, he is not only authorized but is in fact obligated to bring the problem to that court's attention"); In re Paradyne Corp., 803 F.2d 604, 608 n.7 (11th Cir. 1986) (same); see also Brown & Williamson Tobacco Corp. v. Daniel Int'l Corp., 563 F.2d 671, 673 (5th Cir. 1977) (holding that issue of attorney's disqualification could be raised by any other party before the court, regardless of whether that party was itself aggrieved by ethical violation).

Notwithstanding the weight of authority recognizing the United States Trustee's authority to take action to prevent an abuse of the bankruptcy process, the bankruptcy court held, without explanation or support, that only the United States Attorney is authorized to request that the court exercise its discretion to impose noncompensatory civil sanctions on behalf of the public. No other court has ever limited the sanctioning powers of federal courts in such a manner. Rather, courts regularly have affirmed sanctions orders pursuant to the court's inherent powers in proceedings initiated by parties other than the United States Attorney, including the United States Trustee. See, e.g., Methode Electronics, Inc. v. Adam Technologies, Inc., 371 F.3d 923, 928 (7th Cir. 2004) (holding that district court was "well within its authority" when it ordered noncompensatory fine, payable to clerk of court, upon motion of opposing party); Hale v. United States Trustee, 509 F.3d 1139, 1144 (9th Cir. 2007) (affirming sanction of disgorgement and monetary penalty payable to United States Trustee in proceeding initiated by United States Trustee).[7]

Accordingly, this Court should reverse the bankruptcy court's determination that the United States Trustee lacks authority under 28 U.S.C. § 586 and 11 U.S.C. § 105(a) to request civil monetary sanctions against Countrywide.

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[7] In distinguishing the Hale decision, the bankruptcy court incorrectly stated that "[t]he United States Trustee's actions in Hale, in contrast to the UST's here, involved a Rule 9011 motion - a remedy not sought by, nor available to the UST here." (Op. at 8, n. 4). In fact, as the Ninth Circuit's opinion makes clear, the United States Trustee expressly sought sanctions under 11 U.S.C. § 105(a) and the court's inherent powers as well as under Bankruptcy Rule 9011. See Hale, 509 F.3d at 1143 (stating that the United States Trustee's motion "argued that sanctions were authorized under 11 U.S.C. §§ 105(a) . . . 'and the inherent authority of the court to sanction bad faith conduct'")(citations omitted). Moreover, because the Ninth Circuit eventually concluded that the requirements of Rule 9011 were not met, the sanction in Hale was ultimately analyzed and affirmed solely as an exercise of the court's inherent powers. Id. at 1148.

II. THE UNITED STATES TRUSTEE STATED A CLAIM AGAINST COUNTRYWIDE FOR NON-MONETARY RELIEF

A. The United States Trustee Alleged All Facts Necessary to Sustain His Claim for Equitable Relief Under Eleventh Circuit Law.

Under the doctrine of notice pleading set forth by Fed. R. Civ. P. 8 and Bankruptcy Rule 7008, a complaint is not required to contain "heightened fact pleading of specifics," but must set forth "only enough facts to state a claim to relief that is plausible on its face." Bell Atlantic Corp. v. Twombly, 550 U.S. 544, 127 S. Ct. 1955, 1974 (2007). In this case, the United States Trustee's claim for equitable relief satisfies the four prima facie elements of a claim for equitable relief under federal law: (1) an irreparable harm; (2) the inadequacy of any legal remedy; (3) a showing that the balance of hardships favor an equitable remedy; and (4) a showing that the public interest would not be disserved by the injunction. See eBay, Inc. v. MercExchange, 547 U.S. 388, 391 (2006) (reciting "well-established" elements of claim for equitable relief).

The United States Trustee's complaint meets the pleading requirements set forth by Twombly because it contains plausible allegations that, if proven, would entitle the United States Trustee to permanent equitable relief. First, the complaint alleges a series of specific abuses that constitute an ongoing harm to the bankruptcy system. (Compl. ¶¶ 25-28). Second, the complaint alleges that Countrywide has continued to engage in such misconduct notwithstanding the imposition of non-injunctive sanctions. (Compl. ¶¶ 30-32). As such, the complaint contains allegations sufficient to conclude that a legal remedy would be inadequate. Finally, as the bankruptcy court itself observed, the allegations of the complaint describe "reprehensible conduct by an apparently overreaching mortgage lender." (Op. at 11). Such allegations are pertinent both to the balance of the equities and to the issue of the public interest.

The Eleventh Circuit has recognized that permanent injunctive relief is available under such circumstances. In Riccard v. Prudential Ins. Co., 307 F.3d 1277 (11th Cir. 2002), a litigant filed a series of frivolous lawsuits against his former employer. Based on the trial court's finding that the litigant was unlikely to be deterred by monetary sanctions and was likely to continue his abusive conduct in the future, the Eleventh Circuit upheld an injunction requiring the litigant to obtain leave of the court before filing future lawsuits. Id. at 1295. For similar reasons, in Cofield v. Ala. Pub. Serv. Comm'n, 936 F.2d 512 (11th Cir. 1991), the Eleventh Circuit upheld in part a permanent injunction against a prisoner-litigant based upon the district court's finding that the prisoner regularly filed meritless lawsuits for the purpose of extorting settlements. Id. at 516. See also Martin-Trigona v. Shaw, 986 F.2d 1384, 1387 (11th Cir. 1993) (listing cases in which courts have upheld permanent injunctions against abusive litigants); Procup v. Strickland, 792 F.2d 1069, 1072-73 (11th Cir. 1986) (same). Accordingly, the complaint alleges "enough facts to state a claim to relief that is plausible on its face" and satisfies the pleading standard set forth by Twombly.

B. The Bankruptcy Court Erred by Requiring the United States Trustee to Demonstrate an Individualized, Imminent Injury to Himself.

The bankruptcy court applied an incorrect legal standard when it dismissed the United States Trustee's claim on the grounds that the complaint "fails to suggest a specific imminent threat of future harm," and that "[w]ithout 'continuing present adverse effects,' the injury remains 'wholly inchoate,' and the 'injury' requirement of standing is not satisfied." (Op. at 9-10). In so holding, the bankruptcy court incorrectly relied on Elend v. Basham, 471 F.3d 1199 (11th Cir. 2006), a case involving a private litigant who sought to enjoin governmental action.

The rationale and holding of Elend, however, is wholly inapplicable to a request for injunctive relief brought by the United States Trustee acting on behalf of the public interest, and the bankruptcy court's reliance on this decision was in error.

Elend arose out an attempted challenge to the establishment of a "protest zone" at a presidential rally by a political protestor, whose complaint sought permanent injunctive relief prohibiting the United States Secret Service from engaging in "any further constitutional violations." Id. at 1203. The United States moved to dismiss on the grounds, among others, that the plaintiffs lacked standing to raise claims involving the rights of other protestors at future events. The Eleventh Circuit agreed. The Eleventh Circuit noted that the issues before the court could be "distilled to a single question: whether the Plaintiffs have sufficiently alleged an imminent and concrete threat of future injury by stating their intention to protest at an unspecified, prospective event supervised by the Secret Service?" Id. at 1205. Because there was no assurance that the plaintiffs would ever suffer such an injury in the future, the Eleventh Circuit held that the requirement of standing was not met. Id.

The rationale of Elend is inapplicable to the claims of the United States Trustee. First, the United States Trustee's standing does not depend on the existence of an injury to itself, but derives from its role as the representative of the public interest in bankruptcy cases. See Glados, 83 F.3d at 1361 n.1 (11th Cir. 1996) (noting that United States Trustee is "charged by statute with the duty to oversee and supervise the administration of bankruptcy cases"); United Artists Theater Co. v. Walton, 315 F.3d 217, 225 (3d Cir. 2003) (holding that United States Trustee was not required to demonstrate pecuniary interest or injury as prerequisite to standing); Revco, 898 F.2d at 499 (holding that "public interests" provided United States Trustee with standing even in the absence of pecuniary interests).

Second, as the complaint specifically alleges, Countrywide's abuses in the Sanchez case appear to form part of a systemic pattern of misconduct that has led to substantially similar abuses in other recent cases, and if unchecked will lead to similar abuses in future cases.(Compl. at ¶¶ 30-32). Accordingly, the bankruptcy court erred when it relied on Elend for the proposition that the United States Trustee's complaint was too speculative to warrant equitable relief.

C. The Bankruptcy Court Erred by Dismissing the Complaint on the Basis of its Speculation as to the Eventual Remedy.

The bankruptcy court additionally found that the United States Trustee failed to state a claim for injunctive relief because of its speculation that the terms of the eventual injunction would lack "specificity and clear guidance" and violate Bankruptcy Rule 7065. (Op. at 9). In so ruling, however, the bankruptcy court improperly relied on facts not in evidence and considered matters beyond the scope of a motion to dismiss under Bankruptcy Rule 7012.

No proposed injunction is yet before the bankruptcy court. As courts have long recognized, "the hallmark of equity is the ability to assess all relevant facts and circumstances and tailor appropriate relief on a case by case basis." Rosario-Torres v. Hernandez-Colon, 889 F.2d 314, 321 (1st Cir. 1989). In this case, no discovery has taken place, and there has been no evidence as to why or how Countrywide's abuses in the Sanchezes' bankruptcy case occurred. Until such discovery is taken and such evidence is heard, it is impossible to predict the exact terms that an appropriate injunction might take.

Moreover, the bankruptcy court's discussion of the perceived limitation of a hypothetical remedy, rather than on the United States Trustee's right to relief, was beyond the proper scope of a Bankruptcy Rule 7012 motion to dismiss. Such a motion "properly addresses the cause of action alleged, not the remedy sought. Only when that remedy has been determined may defendants contest its application on grounds of vagueness or some other violation of Rule 65(d) of the Federal Rules of Civil Procedure." City of New York v. A-1 Jewelry & Pawn, Inc., 247 F.R.D. 296, 353 (E.D.N.Y. 2007). Accordingly, the bankruptcy court erred when it required the United States Trustee's complaint to contain a statement as to the exact equitable remedy that the bankruptcy court would impose after discovery and trial. See In re GSSI Liquidation, Inc., 355 B.R. 691, 708 (Bankr. N.D. Ill. 2006) (holding that where adversary defendants were on notice that trustee would seek relief relating to violation of automatic stay, trustee was not required to plead specific remedy that would be sought).

D. The Bankruptcy Court Erroneously Presumed that the Only Equitable Remedy Available to it was an Injunction to Obey the Law.

Even assuming that the issue of the form of equitable remedy was properly before the bankruptcy court on a motion to dismiss, the bankruptcy court further erred by presuming, without explanation, that any injunctive remedy would consist only of an injunction to simply "obey the law." (Op. at 8-9).

It is well recognized that courts have the discretion to fashion remedies against litigation abuse that go beyond mere commands to obey the law. Thus, in Riccard and Cofield, the Eleventh Circuit affirmed case-specific injunctions designed to curb litigation abuses by vexatious litigants, notwithstanding that the misconduct targeted by those injunctions was already proscribed by Rule 11 and other rules. In those cases, the court fashioned effective equitable remedies by requiring the sanctioned parties to submit to procedural safeguards not otherwise required by federal law. See Cofield, 936 F.2d at 516; Riccard, 307 F.3d at 1295.

In addition, the bankruptcy court has both inherent power and broad statutory authority to issue appropriate injunctions to prevent illegal or sanctionable conduct on a preventative basis. See 11 U.S.C. § 105(a) (affirming power of bankruptcy court to "tak[e] any action . . . to prevent an abuse of process"). As a result, bankruptcy courts have traditionally crafted a broad range of injunctive remedies, other than simple commands to obey the law, to protect the integrity of the bankruptcy process. See, e.g., Hale, 509 F.3d at 1145 (upholding order requiring attorney to sign bankruptcy petitions which he helped to prepare and to formally advise clients of his ethical obligations); In re Williams, 226 Fed. Appx. 384 (5th Cir. 2007) (upholding bankruptcy court sanctions order enjoining creditors' attorney from filing future complaints under 11 U.S.C. §§ 523 or 707 without obtaining prior leave of court); In re Dragoo, 219 B.R. 460, 467 (Bankr. N.D. Tex. 1998) (requiring attorneys to undergo additional ethics training prior to appearing in future bankruptcy cases); In re Latanowich, 207 B.R. 326, 338 (Bankr. D. Mass. 1997) (permanently enjoining creditor from attempting to enforce security interest that was subject to invalid reaffirmation agreement); In re Palumbo Family Ltd. P'ship, 182 B.R. 447, 479 (Bankr. E.D. Va. 1995) (issuing admonition against attorneys responsible for inadvertent violation of court orders and requiring attorneys to prepare report outlining corrective measures).

At the present stage of this case, it is premature to predict which, if any, of the foregoing injunctive remedies will be appropriate safeguards to dissuade Countrywide from engaging in future misconduct. Nevertheless, it was error for the bankruptcy court to conclude, without any evidence, that no such remedies will be available.

CONCLUSION

For the foregoing reasons, this Court should reverse the bankruptcy court's order dismissing the United States Trustee's adversary complaint.

DATED: January 16, 2009.

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Donald F. Walton
Acting United States Trustee
Region 21

/s/ Zana M. Scarlett
Zana M. Scarlett, Trial Attorney
Florida Bar No.: 626031
U.S. Trustee's Office
51 SW 1st Ave.
Miami, FL 33130
Phone: (305) 536-7285
Fax: (305) 536-7360
Zana.M.Scarlett@usdoj.gov

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the foregoing has been served on the following parties on January 16, 2009, electronically through CM/ECF, on parties having appeared electronically in the instant matter and that a copy hereof shall be served by U.S. Mail, postage prepaid, on parties not appearing electronically:

Philip J. Landau, Esq.** Thomas A. Connop, Esq.

/s/ Zana M. Scarlett
Zana M. Scarlett, Trial Attorney

BRIEF BANK — 'SUMMARY SHEET" *Printed Thu-5/3/07 10:18*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*
Grossman v. Sawdy

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*
United States District Court for the District of Wisconsin

3. ("CCN") ***CURRENT*** CASE NO.
No.: 07-C-312

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*
No.: 2006-25130-PP
Court: THE UNITED STATES BANKRUPTCY COURT FOR THE EASTERN DISTRICT OF WISCONSIN
(Identify judge & cite, if any)

5. ("SO") ***SOURCE***
U.S. TRUSTEES

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*
Filed:
Type: BRIEF FOR THE UNITED STATES TRUSTEE AS AMICUS CURIAE SUPPORTING APPELLANT

7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*
P. Matthew Sutko, Thomas C. Kearns, William Neary, David Asbach
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***

- whether the court below erred by ruling as a matter of law that the Debtors could claim the IRS Standard expense allowance for vehicle financing in the calculation of their disposable income even though these Debtors had no automobile vehicle financing expense because they owned their cars debt-free.

√ **Background:**

10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)

11. DO YOU RECOMMEND POSTING IN UST BRIEFBANK?
☐ YES ☐ NO ***NAME:***
DATE:

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF WISCONSIN

In the Matter of:	Bkr. Case No. 2006-25130-PP
MICHAEL G. SAWDY, and JORI A. SAWDY,	
Debtors.	
MARY GROSSMAN, Chapter 13 Trustee,	
Appellant,	
v.	Appeal No. 07-C-312
MICHAEL G. SAWDY, and JORI A. SAWDY,	
Appellees.	

ON APPEAL FROM THE UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF WISCONSIN

THE HONORABLE PAMELA PEPPER, PRESIDING

BRIEF FOR THE UNITED STATES TRUSTEE AS AMICUS CURIAE SUPPORTING APPELLANT

Of Counsel	WILLIAM T. NEARY United States Trustee
ROBERTA A. DeANGELIS General Counsel	DAVID W. ASBACH Assistant United States Trustee United States Department of Justice Office of the U.S. Trustee 517 E. Wisconsin Avenue, Suite 430 Milwaukee, WI 53202
P. Matthew Sutko Thomas C. Kearns United States Department of Justice Executive Office for United States Trustees	

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20 Massachusetts Avenue, N.W.
Washington, D.C. 20530
(202) 307-1399

(414) 297-4499; Fax (414) 297-4478

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TABLE OF AUTHORITIES

FEDERAL CASES:

INTEREST OF THE UNITED STATES

The Court below held that in calculating the Debtors' disposable income on Form B22C, it was permissible for the Debtors to deduct the IRS Local Standard expense amount for vehicle financing costs even though they do not make monthly note or lease payments. Whether debtors in Chapter 13 cases may claim a deduction for vehicle financing costs under these circumstances is of substantial interest to the United States.

The Attorney General appoints United States Trustees to supervise the administration of bankruptcy cases and trustees in regions comprising the vast majority of federal judicial districts. 28 U.S.C. §§ 581-589a. United States Trustees "serve as bankruptcy watchdogs to prevent fraud, dishonesty, and overreaching in the bankruptcy arena." H.R. Rep. No. 595, 95th Cong., 1st Sess. 88 (1977). The United States Trustee Program thus "acts in the public interest to promote the efficiency and to protect and preserve the integrity of the bankruptcy system." U.S. Dep't of Justice, *United States Trustee program Strategic Plan FY 2005-2010*, at 2 (visited Sept. 28, 2006) <http://www.usdoj.gov/ust/eo/ust_org/StrategicPlanFY2005-2010.pdf>. United States Trustees "supervise the administration of cases and trustees" in all bankruptcy cases within their region through the exercise of a range of oversight responsibilities. 28 U.S.C. § 586(a)(3). *See generally Morganstern v. Revco D.C. Inc. (In re Revco D.S., Inc.)*, 898 F.2d 498, 500 (6th Cir. 1990) (explaining that United States trustees oversee the bankruptcy process, protect the public interest, and ensure that bankruptcy cases are conducted according to law.). By statute, "[t]he United States trustee may raise and may appear and be heard on any issue in any case or proceeding under this Title." 11 U.S.C. § 307. *See also In re Revco D.S., Inc.*, 898 F.2d at 499-500 (upholding broad appellate standing of United States trustees).

In this matter, the United States Trustee has two separate and distinct interests. First, the United States Trustee has the statutory duty to oversee the administration of Chapter 13 cases, which includes monitoring, and if necessary objecting to, Chapter 13 plans under 11 U.S.C. § 1324. 28 U.S.C. § 586(a)(3)(C). Second, the United States Trustee has an interest in this appeal because the issue on appeal directly implicates 11 U.S.C. § 707(b), which the United States Trustee oversees pursuant to duties set forth in 11 U.S.C. § 704(b), and under which United States Trustees regularly seek relief involving the same legal issue.[1]

The question of law involved in this appeal is not limited to the Sawdys. To the contrary, it will apply globally to thousands of debtors in a myriad of different financial circumstances who will file bankruptcy cases in this district and nationally. For this reason, the United States Trustee submits this brief as amicus in support of reversal.

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[1] The same issue is on appeal before Judge Griesebach in the context of a Chapter 7 case. See *In re Ross-Tousey (Neary v. Ross-Tousey)*, Case No. 07-C-0065. The United States Trustee is a party to that appeal.

STATEMENT OF ISSUES PRESENTED FOR REVIEW

The Chapter 13 Trustee objected to confirmation of the Debtors' modified plan on the grounds that it did not commit all of the Debtors' disposable income to the plan, as required under 11 U.S.C. § 1325(b)(1)(B). The Bankruptcy Court overruled the Chapter 13 Trustee's objection and confirmed the plan holding that the Debtors could properly claim the IRS Standard expense allowance for vehicle ownership notwithstanding that Debtors had no vehicle loan or lease payment, thereby reducing to zero the funds available to pay creditors under the plan.

Given this, the issue presented to this Court for determination is whether the court below erred by ruling as a matter of law that the Debtors could claim the IRS Standard expense allowance for vehicle financing in the calculation of their disposable income even though these Debtors had no automobile vehicle financing expense because they owned their cars debt-free.

STATUTORY FRAMEWORK & BACKGROUND

I. Statutory Framework

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA") altered the analysis bankruptcy courts must employ when determining whether to confirm proposed Chapter 13 repayment plans. When, as here, a trustee or holder of an allowed unsecured claim objects to plan confirmation, 11 U.S.C. § 1325(b)(1) conditions plan confirmation upon the debtor committing all of his or her "projected disposable income" to payments to unsecured creditors through the Chapter 13 plan. "Disposable income" is the current monthly income received by the debtor (other than child support payments, foster care payments, or disability payments for a dependant child) less amounts reasonably necessary to be expended. 11 U.S.C. § 1325(b)(2). The term "current monthly income" is the average monthly income from all sources that the debtor receives during the six-month period ending on the last day of the calendar month immediately preceding the date of the commencement of the case, including any amount paid by a third party on a regular basis for the household expenses of the debtor or the debtor's dependents but excluding benefits received under the Social Security Act. 11 U.S.C. § 101(10A). For above-median-income debtors the "amounts reasonably necessary to be expended" are determined "in accordance with" section 707(b)(2)(A)[2] and (B), which

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[2] As amended by the BAPCPA, Section 707(b)(2) repealed the former presumption in favor of the debtor, and replaced it with a new presumption: A case is an "abuse" of chapter 7 if a detailed mathematical formula set out in the statute, commonly referred to as the "means test," yields a minimum amount of monthly disposable income. The means test uses a series of calculations to determine whether the Section 707(b)(2) presumption

provides various specific expense categories from which debtors may reduce "current monthly income."[3] 11 U.S.C. § 1325(b)(3).

The "means test" provisions of sections 707(b)(2)(A) and (B) are used in determining the expenses of Chapter 13 debtors, like these debtors, whose income exceeds their state's family median income. 11 U.S.C. § 1325(b)(3). In determining expenses, section 707(b)(2)(A)(ii)(I) provides that a debtor's "monthly expenses shall be the debtor's *applicable* monthly expense amounts specified under the National Standards and Local Standards and the debtor's actual monthly expenses for the categories specified as Other Necessary Expenses issued by the Internal Revenue Service for the area in which the debtor resides . . . ." 11 U.S.C. § 707(b)(2)(A)(ii)(I) (emphasis added).

II. Factual Background

The Debtors own two vehicles, a 1996 Ford Explorer and 1993 Ford Escort. R. 7, p. 10.[4] They own them outright; neither vehicle is encumbered by debt. *Id*. In their original and amended Forms B22C, Debtors claimed the IRS Standard "transportation ownership/lease expense" for both vehicles in the amounts of $471 and $332, respectively,

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of abuse arises in chapter 7 cases. *See* 11 U.S.C. § 707(b)(2)(A).

[3] Form B22C, which debtors must file pursuant to Interim Federal Rule of Bankruptcy Procedure 1007(b)(6), serves, in part, to calculate debtor's "current monthly income."

[4] In this brief, "R." followed by a number refers to the record on appeal set forth in docket entry #1 of the district court docket for this case.

on lines 28 and 29 of the Form B22C.[5] R. 7, p. 41; R. 9.

The Debtors' modified Chapter 13 plan proposed paying nothing to unsecured creditors. R. 10. The Chapter 13 Trustee filed an objection to confirmation of the Debtors' modified plan, claiming that the modified plan failed to provide all of the Debtors' disposable income, contrary to 11 U.S.C. §§ 1325(a)(3) and (b)(1)(B). R. 12, ¶4. The Chapter 13 Trustee argued that the Debtors had more income to devote to paying creditors because they were improperly claiming that IRS Standard expense for vehicle financing expenses even though that expense deduction was not *applicable* because these debtors had no a vehicle loan or lease payments. R. 12, ¶¶ 4 and 5. The trustee noted that the Debtors could pay their unsecured creditors in full by excluding that inapplicable deduction. *Id*.

On February 20, 2007, the United States Bankruptcy Court for the Eastern District of Wisconsin entered its decision and order overruling the Chapter 13 Trustee's objection to the Debtors' modified plan. R. 15. On February 28, 2007, the Court issued its Order confirming the Debtors' modified plan. R. 16. The Court ruled that the Debtors were entitled to reduce their disposable income by the amount of an IRS Standard expense allowance for vehicle financing costs even though they had no vehicle financing costs. On

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[5] These amounts are in addition to the "vehicle operation expense" for two or more vehicles of $336 taken by the Debtors on Line 27. Because the vehicles are each over six years old, the Unites States Trustee would also allow the Debtors an additional $200 operating expense per vehicle, based on the Internal Revenue Manual which allows such an additional vehicle operating expense. *See* Internal Revenue Manual, Part 5 (entitled Collecting Process), Chapter 8, § 5.8.5.5.2, Treatment of Non-Business Transportation Expenses, which may be found on the IRS website at http://www/irs/gov/irm/part5/ch08s05.html.

March 1, 2007, the Chapter 13 Trustee filed a timely notice of appeal of the orders dated February 20, 2007, and February 28, 2007.

ARGUMENT

The court below allowed the Debtors to reduce their current monthly income by the IRS Standard for vehicle financing costs for two vehicles, a total of $803, even though they have no monthly loan or lease payment obligation associated with their vehicles. That ruling merits reversal because it misreads 11 U.S.C. § 707(b)(2)(A)(ii)(I), deviates from longstanding Internal Revenue Service practice, and conflicts with the legislative purposes underlying the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005.

I. Section 707(b)(2) of Title 11 does not allow debtors like the Sawdys, who have no monthly loan or lease payments, to claim an IRS local standard vehicle acquisition expense. That reading comports with section 707(b)(2)'s legislative purpose and draws substantial support from decisions interpreting it.

A. 11 U.S.C. § 707(b)(2) limits the IRS local standards, including the local standard referred to as vehicle ownership expense, to debtors for whom the expense is "applicable."

Section 707(b)(2)(A)(ii)(I) of the Bankruptcy Code provides that a debtor's monthly expenses "shall be the debtor's *applicable* monthly expense amounts specified under the . . . Local Standards . . . issued by the Internal Revenue Service." 11 U.S.C. § 707(b)(2)(A)(ii)(I) (emphasis added). The statute thus specifically provides that before the specific IRS expense amounts may be included in the debtor's allowed monthly expenses, the expense itself must first be *applicable* to the debtor.

The Bankruptcy Code does not define the word "applicable." Nor has the United States Trustee identified any Supreme Court decision that provides a definition. But the Seventh Circuit has made clear that "'Applicable' is a protean word that takes color from context; it lacks a single enduring meaning." *Sierra Club v. Environmental Protection Agency*, 375 F.3d 537, 541 (7th Cir. 2004). The dictionary defines "applicable" similarly: applying or capable of being applied; relevant; suitable; appropriate. *Random House Unabridged Dictionary* (2006).

The United States Trustee's construction of "applicable" in section 707(b)(2)(A)(ii)(I) comports with the Seventh Circuit's construction of the word and with its dictionary definition. By using the word "applicable" in section 707(b)(2)(A)(ii)(I), Congress limited eligibility for expenses under the Local Standards to debtors for whom the expenses actually apply. *In re Devilliers*, ---- B.R. ----, 2007 WL 92504, *6 (Bankr. E.D. La. January 9, 2007). Only after "a determination is made as to the type of expenses allowed and applicable to the debtor" may the debtor claim the amount set forth under the IRS Local Transportation Standards. *Id.; see also In re Wiggs,* ---- B.R. ----, 2006 WL 2246432, *2-3 (Bankr. N.D. Ill. 2006) (in applying Section 707(b)(2)(A)(ii)(I) in context of Section 1325, court finds that the statute is "clear and unambiguous," and that the "term 'applicable' modifies the amounts specified to limit the expenses to only those that apply," such that debtors were not allowed to include the standard ownership expense for transportation ownership when they did not have a payment on the vehicle). *Accord*, *In re Demonica*, 345 B.R. 895, 904 (Bankr. N.D. Ill. 2006).[6]

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[6] *Demonica* is relied on by the bankruptcy court in *In re Fowler*, 349 B.R. 414 (Bankr. D. Del. 2006), a case that is cited by the court below. The *Fowler* court misconstrues *In re Demonica*. In fact, *In re Demonica,* like the *In re Wiggs* decision, held that a loan or lease payment was required in order to qualify for the IRS Transportation Ownership Expense Standard. The *Demonica* court allowed the debtor to take an expense adjustment because the debtor in that case established that he actually made payments on the vehicle at issue, even though he did not have a contractual liability on the vehicle loan. *In re Demonica*, 345

Given this, the court below should have refused to confirm these Debtors' plan, which proposed to pay unsecured creditors nothing. Given these debtors had no ownership or lease payments on their car, the IRS Standard expense was not applicable to them. By excluding that inapplicable expense, the creditors in this case will receive full payment of their debts. The order entered below should be reversed and this case remanded so that can happen.

B. The Internal Revenue Service's application of its own local standard for vehicle acquisition costs, and interpretive case law, support the United States Trustee's reading of 11 U.S.C. § 707(b)(2)(A)(ii)(I).

Construing the word "applicable" in the IRS Standards like the Chapter 13 trustee and the United States Trustee does draw substantial support from the Internal Revenue Service's longstanding application of the IRS Standards. When Congress developed the means test, it "could have started from scratch, and created a system that was rigid but easy to administer, such as how many view workers' compensation or social security schemes." *In re Slusher*, ---- B.R. ----, 2007 WL 118009, *12 (Bankr. D. Nev. January 17, 2007). Instead, Congress "incorporated into the Bankruptcy Code an existing, administrative system that the IRS had long had in place." *Id.* This incorporation "strongly suggests that courts should look to how the IRS determined those standards; that is, as to how the IRS would have applied them in similar circumstances." *Id.* at *14. Thus, "if guidance is sought on the meaning of the IRS standards Congress incorporated into the Bankruptcy Code, practical reason would suggest that court should consider the full manner by which

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B.R. at 905.

the IRS uses these standards." *Id.*

Considering IRS practice in interpreting "applicable" expenses in section 707(b)(2)(A)(ii)(I) does not negate the section's later allowance of "actual" monthly expenses in the IRS categories of Other Necessary Expenses. Rather, "a natural reading" of Section 707(b)(2)(A)(ii)(I) indicates that the words "actual" and "applicable" limit the relevant expense deductions in different ways. *In re Slusher*, ---- B. R. ----, 2006 WL 118009 at *13. "Had Congress intended to indiscriminately allow all expense amounts specified in the National and Local Standards, it would have written section 707(b)(2)(A)(ii)(I) to read, 'The debtor's monthly expenses shall be the monthly amounts specified under the National Standards and Local Standards . . .' rather than 'The debtor's monthly expenses shall be *the debtor's applicable* monthly expenses amounts specified under the National and Local Standards.'" *In re Slusher*, 2007 WL 118009, *13 (Bankr. D. Nev. January 17, 2007) (emphasis in original). Given the IRS' historic application of its National Standards and Local Standards up to the time of BAPCPA's enactment, "it would be quite odd if Congress intended to preclude courts from examining the context in which the authoring agency, the IRS, used and employed those standards." *Id.* Nothing compels such an odd reading, and the court below erred by interpreting the term contrary to the IRS.

The IRS' construction fully supports the United States Trustee's construction of the term applicable. On page two of its Collection Financial Standards under the heading "Transportation" the IRS provides as follows:

> The transportation standards consist of nationwide figures for monthly loan

> or lease payments referred to as ownership costs, and additional amounts for monthly operating costs . . . . The ownership costs provide maximum allowances for the lease or purchase of up to two automobiles if allowed as a necessary expense . . . . If a taxpayer has a car payment, the allowable ownership cost added to the allowable operating cost equals the allowable transportation expense. **If a taxpayer has no car payment, or no car, the operating costs portion of the transportation standard is used to come up with the allowable transportation expense.**

See IRS Collection Standards (emphasis added), available at ww.irs.gov/individuals /article/0,,id=96543,00.html; *see also* Internal Revenue Manual, Financial Analysis Handbook, Pt. 5, ch. 15, § 5.15.1.7(4.B), available at www.irs.gov/irm/part5/ch15s01.html.

Thus, according to the IRS, if the debtor does not have a loan or lease payment obligation, then the Local Standard referred to as vehicle ownership deduction is not "applicable." If the debtor's vehicle is subject to a monthly loan or lease payment obligation, however, then in addition to the vehicle "operating cost" expense, the "ownership cost" is also "applicable" and shall be the dollar amount specified by the IRS. This application of the statute is supported by significant bankruptcy court authority. *See In re Barraza*, 346 B.R. 724, 728-29 (Bankr. N.D. Tex. 2006) (debtor not entitled to standard ownership allowance for vehicle without a loan or lease payment); *In re McGuire*, 342 B.R. 608, 613-14 (Bankr. W.D. Mo. 2006) (chapter 13 debtors not permitted standard ownership allowance for vehicle owned free and clear of liens); *In re Ceasar*, ---- B.R. ----, 2007 WL 777821, *5 (Bankr.W.D. La Mar. 6, 2007) (following *McGuire*, and noting that cases holding to the contrary place "undue emphasis [on] the term 'shall' in Section 707(b)(2)(A)(ii)(I)"). *See also*, *In re Harris*, 353 B.R. 304, 307-309 (Bankr. E.D. Okla. 2006); *In re Hardacre*, 338 B.R.

718, 723-24 (Bankr N.D. Tex. 2006); *In re Oliver*, 350 B.R. 294, 301 (Bankr. W.D. Tex. 2006); *In re Wiggs*, ---- B.R. ----, 2006 WL 2246432, at *2-3 (Bankr. N.D. Ill. August 4, 2006); *In re Carlin*, 348 B.R. 795 (Bankr. D. Or. 2006); *but see In re Fowler*, 349 B.R. 414 (Bankr. D. Del. 2006) (debtors may deduct ownership expenses for a vehicle for which they do not make car payments); *In re Haley*, 354 B.R. 340 (Bankr. D. N.H. October 18, 2006) (same); *In re Farrar-Johnson*, 353 B.R. 224 (Bankr. N.D. Ill. 2006) (debtors entitled to deduct IRS Local Standard for housing even though they had no actual housing expense); *In re Zak*, 2007 WL 143065 (Bankr. N.D. Ohio January 12, 2007).

In addition to the IRS Collection Financial Standards themselves, the IRS also publishes guidelines, including the Internal Revenue Manual. Those support a reading of Section 707(b)(2)(A)(ii)(I) that requires debtors to have an actual loan or lease payment obligation on a vehicle before the Local Standard referred to as ownership expense "applies." Recent revisions to the Collection Financial Standards also make clear that the "ownership cost" is calculated by the IRS based on the "**five-year average of new and used car financing data compiled by the Federal Reserve Board of Governors**." *See* IRS Collection Financial Standards, supra (emphasis added). As such, the "ownership cost" is intended to account for the reasonable expense of financing a vehicle over five years and is inapplicable if a debtor has no such acquisition financing expense. *See In re Devilliers*, 2007 WL 92504, *10 (Bankr. E.D. La. Jan. 9, 2007) (The ownership allowance "is not the equivalent of an allowance for depreciation or an invitation for a debtor to 'save' for the ultimate replacement of an existing vehicle. Instead, the deduction is designed to assist with the acquisition of a vehicle on credit.").

Accordingly, guidance in applying its expense standards published by the IRS makes clear that the vehicle "ownership cost" portion of the Local Transportation Standards is intended to apply only in situations where the debtor has a monthly vehicle acquisition financing expense, *i.e.*, has a monthly vehicle lease or loan payment. *Cf. McGuire*, 342 B.R. at 613 ("Thus, if a debtor is not incurring expenses for the purchase or lease of a vehicle, the debtor cannot claim a vehicle ownership expense under the IRS standards.") "Because the Local Standards are issued by the IRS, it is instructive to refer to publications of that organization for guidance as to the types of 'debt payments' that can reduce allowances under the Local Standards." *Hardacre*, 338 B.R. at 726.

Finally, the court below refused to accept the IRS' longstanding interpretation of its own standard because an unenacted 1998 predecessor to BAPCPA, H.R. 3150, included a specific reference to the IRS' financial analysis handbook, which is not found in BAPCPA. However, that is not significant given that the IRS' Financial Analysis Handbook "has been expressly adopted by Congress in Section 707(b)(2)(A)(ii)." *In re Lenton*, 358 B.R. 651, 658 n.15 (Bankr. E.D. Pa. 2006). To the extent the statute is not clear, BAPCPA's legislative history clarifies that "the debtor's monthly expenses--exclusive of any payments for debts (unless otherwise permitted)--must be the applicable monthly amounts set forth in the Internal Revenue Service Financial Analysis Handbook." *Id. (quoting* H.R. Rep. 109-31(I), at 13-14, *as reprinted in* 2005 U.S.C.C.A.N. 88, 100).

Moreover, the wording of the 1998 draft language highlighted by the Court below is not so markedly different as to evidence any special congressional intent to eliminate use of the IRS' application of its own expense standards. It is equally likely that the change in phrasing from "expense allowances under the applicable Local Standards as determined under the Internal Revenue Service financial analysis" in 1998 "to the debtor's applicable monthly expense amounts specified under the Local Standards" in 2005 merely restates the same methodology in a more summary fashion. The court's reliance on legislative history from a predecessor of BAPCPA is misplaced and should be rejected.

II. The bankruptcy court's interpretation of the vehicle ownership expense is contrary to the major goals of BAPCPA.

The Chapter 13 Trustee's and the United States Trustee's reading comports with the congressional policies underlying BAPCPA's enactment. Congress enacted BAPCPA to rectify perceived abuses in the bankruptcy process. "Among the abuses identified by Congress was the easy access to chapter 7 liquidation proceedings by consumer debtors who, if required to file under chapter 13, could afford to pay some dividend to their unsecured creditors." 151 Cong. Rec. S2459, 2469-70 (March 10, 2005); *Hardacre*, at 720. *See also, e.g.*, *Owner-Operator Independent Driver's Ass'n, Inc. v. New Prime, Inc.*, 192 F.3d 778, 785 (8th Cir. 1999) (while court's principal focus must be on the language of the relevant statute, court cannot ignore the broader perspective and may use legislative history to confirm most plausible construction of statute) (*citing Wisconsin Public Intervenor v. Mortier*, 501 U.S. 597, 610 (1991)).

Section 1325(b)(1)(B) requires that the above-median-income debtor's plan commit "all of the debtor's projected disposable income to be received in the applicable commitment period . . . to make payments to unsecured creditors under the plan." By authorizing every debtor who owns a car to take the vehicle financing expense deduction, in addition to the operating expense allowance, regardless of whether the debtors actually incur monthly vehicle acquisition finance expenses,[7] the bankruptcy court allowed these Debtors to reduce their monthly disposable income by a total of $803. By so ruling, this amount can be used indiscriminately by Debtors rather than to pay creditors. Instead of furthering BAPCPA's goal of providing that disposable income be paid to unsecured creditors, the Court's determination turns the BAPCPA on its head, and creates for the Debtors the very "slush fund" the Court said it was opposed to providing. *In re Sawdy*, ---- B.R. ----, 2007 WL 582535, *9 (Bankr. E.D. Wis. 2007).

Finally, the approach supported by the United States Trustee neither punishes those debtors who own vehicles without a current car payment, and thus cannot take the financing expense deduction, nor rewards those debtors who have only one or several payments left on their vehicle loan at the time of filing and thus are eligible to take the vehicle financing expense deduction on Form B22C. For cases involving the former, debtors may modify their plan under 11 U.S.C. § 1329 to account for the additional vehicle financing expense when such an expense is actually incurred. For cases involving the

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[7] The purpose of the ownership expense allowance "is not the equivalent of an allowance for depreciation or an invitation for a debtor to 'save' for the ultimate replacement of an existing vehicle. Instead, the deduction is designed to assist with the acquisition of a vehicle on credit." *In re Devilliers*, 2007 WL 92504 at *10.

latter, the change in financial circumstances may be examined by the court pre-confirmation with an appropriate adjustment made to the debtor's projected disposable income that is required to be committed to the plan, or post-confirmation through a plan modification. *See In re Jass*, 340 B.R. 411, 418-19 (Bankr. D. Utah 2006) (calculation of projected disposable income when changed circumstances exist); *In re Nowlin*, ---- B.R. ----, 2007 WL 1095449 (Bankr. S.D. Tex. Apr. 11, 2007) (when an event will occur that "will significantly alter the amount of [debtor's] disposible income . . . under Section 1325(b)[, the debtor's] plan must account for this change in circumstances); *In re Devilliers*, 2007 WL 92504 at *10 (trustee may challenge vehicle expenses under Section 1329 if actual expenses differ substantially from standard deduction) .

CONCLUSION

For these reasons, the United States Trustee respectfully asks this Court to reverse the orders entered below.

Respectfully submitted at Milwaukee, Wisconsin, this 18th day of April, 2007.

WILLIAM T. NEARY
UNITED STATES TRUSTEE

By: /s/
David W. Asbach
Assistant United States Trustee
David W. Asbach Bar Number: 1003651
Attorney for U.S. Trustee
Office of the United States Trustee
Eastern District of Wisconsin
517 East Wisconsin Avenue, Room 430
Milwaukee, WI 53202
Phone: (414) 297-4499; Fax: (414) 297-4478
E-Mail: dave.w.asbach@usdoj.gov

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2. ("CO") CURRENT COURT [E.g., "CTA9"]: CA6

3. ("CCN") CURRENT CASE NO.: No.: 03-6248

4. ("PCN") PRIOR CASE NO. & COURT [IF ANY]: No.:
Court:
(Identify judge & cite, if any)

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Anne Murphy, Esq., Appellate Staff
P. Matthew Sutko, Esq., Attorney EOUST
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") TOPIC: BANKRUPTCY

9. ("SU") ! SUMMARY OF KEY ISSUE(s) & √ Any Miscellaneous BACKGROUND:
! Whether the bankruptcy court abused it's discretion when it ordered the disgorgement of fees paid to counsel for the trustee in bankruptcy.

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No. 03-6248

IN THE UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

In Re Gerald Anthony Smith

J. BAXTER SCHILLING, Trustee, et. al.,

Appellants,

v.

GERALD ANTHONY SMITH, Debtor;
RICHARD CLIPPARD, United States Trustee,

Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF KENTUCKY

PROOF BRIEF FOR THE APPELLEE

STATEMENT OF SUBJECT MATTER AND APPELLATE JURISDICTION

This appeal arises from the Chapter 7 bankruptcy of Gerald Anthony Smith. The bankruptcy court had jurisdiction over the bankruptcy proceeding under 28 U.S.C. §§ 157 and 1334.

The bankruptcy court denied fees to the Law Firm of J. Baxter Schilling, counsel to J. Baxter Schilling, Esq., who was the Chapter 7 trustee in Mr. Smith's case. The bankruptcy court entered its final order denying fees and ordering the disgorgement of interim fees on December 6, 2002.

Mr. Schilling appealed to the district court, which had jurisdiction under 28 U.S.C. § 158(a). The district court affirmed the decision of the bankruptcy court in a final judgment entered on August 6, 2003. On October 3, Mr. Schilling filed a timely notice of appeal to this Court. See Fed. R. App. P. 4(a)(1). This Court has jurisdiction under 28 U.S.C. § 158(d).

STATEMENT OF THE ISSUE PRESENTED FOR REVIEW

Whether the bankruptcy court abused its discretion when it ordered the disgorgement of the fees paid to counsel for the trustee in bankruptcy.

STATEMENT OF THE CASE

This case is an appeal from an order of the district court, affirming the bankruptcy court's determination that the Law Firm of J. Baxter Schilling (whose sole member is J. Baxter Schilling, Esq.) should disgorge fees it received from acting as counsel to J. Baxter Schilling, debtor Gerald Smith's Chapter 7 Trustee. The bankruptcy court found, and the district court agreed, that Mr. Schilling's law firm was not “disinterested” within the meaning of 11 U.S.C. § 327(a), and that it therefore was ineligible to receive fees under the Bankruptcy Code.

FACTS AND PRIOR PROCEEDINGS

A. Statutes Principally At Issue.

i. The Appointment and Compensation of Professionals.

This appeal involves the provisions of the Bankruptcy Code that apply when the trustee in a Chapter 7 debt liquidation bankruptcy case employs legal counsel on behalf of the bankruptcy estate.

Several Code provisions work together to ensure that professionals who assist the bankruptcy trustee have certain characteristics that allow them to loyally perform their fiduciary obligations. First, the Code does not authorize the trustee to retain a professional at all unless that professional does not “hold or represent an interest adverse to the estate.” 11 U.S.C. § 327(a). A professional must also be a “disinterested person[]” to be eligible to serve the estate. *Ibid.* A disinterested person does not have “an interest materially adverse to the interest of the estate or of any class of creditors * * * by reason of any direct or indirect relationship to, connection with, or interest in, the debtor * * * or for any other reason.” 11 U.S.C. § 101(14)(E). The Code expressly provides that the bankruptcy court “may authorize the trustee to act as attorney or accountant for the estate if such authorization is in the best interest of the estate." *Id.*, § 327(d). In addition, and independently of any particular provisions of the Code, bankruptcy professionals are fiduciaries who owe fiduciary obligations to those whose interests they serve. See United States v. Schilling (In re Big Rivers Electric Corp.), 355 F.3d 415, 433 (6th Cir. 2004) (explaining that Congress in enacting the Bankruptcy Code "legislated against the backdrop of centuries of common-law decisions about the duties of trustees and other fiduciaries").

As well as requiring professionals to meet certain criteria of disinterestedness to be eligible for appointment, the Code also gives the bankruptcy courts broad authority over professionals' compensation. The Code generally authorizes professionals to be compensated "on any reasonable terms and conditions of employment" (11 U.S.C. § 328(a)), and to receive "reasonable compensation for actual, necessary services" and "reimbursement for actual, necessary expenses." *Id.*, § 330(a)(1). The Code, however, also authorizes a court to "deny allowance of compensation for services and reimbursement of expenses * * * if, at any time during such professional person's employment" authorized by the Bankruptcy Code, "such professional person is not a disinterested person, or represents or holds an interest adverse to the interest of the estate * * *." *Id.*, § 328(c).

In addition to authorizing the denial of all professional compensation, the Code also allows bankruptcy courts to "award compensation that is less than the amount" sought by the professional for his services. 11 U.S.C. § 330(a)(2). The Code further safeguards fee determinations by providing that professional compensation requests are subject to "notice to the parties in interest and the United States Trustee and a hearing" and that compensation must be awarded consistently with the requirements of Section 327, including the requirement of disinterestedness.[1] Finally, as part of the United States Trustees' oversight obligations, the Bankruptcy Code gives United States Trustees responsibility for "monitoring applications filed under section 327 of title 11 and, whenever the United States trustee deems it to be appropriate, filing with the court comments with respect to the approval of such applications." 28 U.S.C. § 586(a)(3)(H).[2]

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[1] A professional may apply for interim fees. See 11 U.S.C. § 331 (authorizing an award of interim fees "[a]fter notice and a hearing"). Interim fees are treated as an advanced portion of the final award under Section 330. See *id.*, § 330(a)(5) ("The court shall reduce the amount of compensation awarded under this section by the amount of any interim compensation awarded under section 331, and, if the amount of such interim compensation exceeds the amount of compensation awarded under this section, may order the return of the excess to the estate").

[2] Congress has authorized the Attorney General to appoint twenty-one United States Trustees ("U.S. Trustees"), each to serve in a specific geographic region of the United States. See generally 28 U.S.C. § 581 *et seq.* (establishing U.S. Trustee Program). The U.S. Trustee must "supervise the administration of cases and trustees"

(continued...)

ii. Chapter 7 Bankruptcy.

In a Chapter 7 bankruptcy, the debtor's assets are collected, liquidated and distributed according to priorities established by the Bankruptcy Code. See generally 11 U.S.C. §701-728. When an individual debtor files a voluntary Chapter 7 petition, that filing constitutes an "order for relief" under Chapter 7 (see 11 U.S.C. § 301), creates a bankruptcy estate, and triggers the automatic stay (see *id.*, § 362(a)), thus protecting the debtor and the estates from further collection activity.

After the order for relief, the United States Trustee appoints an interim trustee to administer the case. See *id.*, § 701. The debtor files schedules showing his financial assets and obligations, and may claim certain property as exempt from distribution under 11 U.S.C. § 522(b). The bankruptcy court sends notice of the case to the creditors, including notification of the deadline for filing proofs of claim. Collier On Bankruptcy, § 700.03, 700-3 (15th Ed. Rev. 2002 ed). A meeting of the creditors is held (see 11 U.S.C. § 341(a)), and if the creditors do not themselves elect

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[2] (...continued)
in all bankruptcy cases within his or her region through a range of oversight responsibilities. 28 U.S.C. § 586(a)(3). The U.S. Trustee's responsibilities include monitoring bankruptcy court filings, such as plans and disclosure statements, monitoring creditors' committees and the progress of bankruptcy cases, and bringing to the attention of the United States Attorneys any possible criminal activity occurring in the bankruptcy context. *Id.*, § 586(a)(3)(B), (C), (E), (F).

a trustee, then the interim trustee becomes the permanent trustee. See 11 U.S.C.§ 703(d).

The Bankruptcy Code requires the trustee to gather the assets of the estate, convert them to cash, and distribute them to creditors under the priority scheme established by Section 726. See Collier, *supra*, at 700-4. Secured creditors are "paid in satisfaction of their liens on property that has been liquidated to the extent of their interests in such property." *Ibid.* Unsecured creditors are generally paid in the order established under Section 507(a) of the Code. When the estate has been liquidated, the debtor is granted his discharge. See 11 U.S.C. § 727.

The Bankruptcy Code also explains how the Chapter 7 bankruptcy trustee's fee is generally to be calculated (see 11 U.S.C. § 330, discussed *supra* at 4-5), and imposes an upper limit upon the amount of that fee. A Chapter 7 trustee is eligible to be compensated up to a certain percentage of "all moneys disbursed or turned over in the case by the trustee to parties in interest * * *." *Id.*, § 326(a). Significantly for this case, however, money turned over to the debtor is excluded from the amount of disbursement used to calculate the cap upon the trustee's fees. *Ibid.* Thus, a trustee who turns over substantial sums to the debtor will be eligible for a smaller maximum fee than a trustee who distributes the estate to parties other than the debtor.

B. Facts and District Court Proceedings.

i. The Initial Bankruptcy Proceedings.

In February, 2001, Gerald Anthony Smith filed a voluntary petition for bankruptcy under Chapter 7 of the Bankruptcy Code. R. 73 (Bankr. Ct. Op. ("Op.") at 1). The next day, J. Baxter Schilling ("Mr. Schilling") was appointed interim trustee. *Ibid.* Mr. Schilling secured the appointment of his law firm, the Law Firm of J. Baxter Schilling (of which he is the sole member), to represent the trustee. *Ibid.*

Mr. Schilling informed the bankruptcy court after the creditors' meeting that there were assets in the estate for distribution. R. 73, Op. at 2. Accordingly, the bankruptcy court notified the debtor and creditors in March, 2001 of the "bar date," the deadline for filing proofs of claim, and of the deadline for filing objections to the debtor's discharge. *Ibid.* One creditor, MBNA America Bank NA, filed a timely claim before the bar date. *Ibid.*

ii. The First Fee Request.

In October 2001, Mr. Schilling timely filed a complaint against the debtor, Mr. Smith, objecting to the debtor's discharge. R. 73, Op. at 2. In November, he filed his first request for attorneys' fees, seeking approximately $16,500 in fees and $300 in expenses. *Id.* at 3. The debtor objected to the fees as excessive, and the bankruptcy court awarded Mr. Schilling the full amount of his expenses but $1,743.64 less in fees

– representing ten hours of work – than Mr. Schilling had requested. See *ibid.* The court disallowed the fees "because the Trustee spent excessive amounts of time researching" an issue that was "not novel to an experienced bankruptcy trustee." R. 73, Op. 8.

iii. The Adversary Proceeding And Settlement.

In February 2002, Mr. Schilling filed an adversary proceeding against Mr. Smith's brother, Robert Smith, alleging that the debtor's transfer of a mortgage to his brother should be set aside as a fraudulent transfer. R. 73, Op. 2. After negotiations with the debtor and his counsel, the parties agreed to settle all issues in the bankruptcy case for a payment of $50,000 from Mr. Smith, the debtor, into the bankruptcy estate.

Mr. Schilling assumed sole responsibility for drafting the settlement agreement. R. 66, U.S. Trustee's Report at 3. The settlement agreement provided, among other things, that neither the debtor nor his brother would have standing to object to the allowance of claims against the estate. It also provided that the $50,000 settlement amount, as well as previous payments from the debtor to the estate, were "non-exempt assets of the estate which will be used to pay administrative and unsecured claims of the estate," excluding any payments to the debtor himself. R. 56, para 4.

In addition, the settlement agreement included a non-negotiated provision relating to Mr. Schilling's fees as attorney. See R. 66, U.S. Trustee's Report at 3 (explaining that both parties agreed that Mr. Schilling's fees were not a topic of the settlement negotiations). The fee provision provided that Mr. Schilling would "request in his final fee application that the Court reconsider the disallowance of attorney fees for the ten (10) hours which were billed" to the estate, but disallowed by the bankruptcy court in response to Mr. Smith's objection. R. 56, para 5. The settlement agreement further provided that "[t]he Debtor shall support the aforestated application." *Ibid.*

Mr. Smith's lawyer, Jan Morris, first saw the fee provision when Mr. Schilling faxed him the settlement agreement for signature. Mr. Morris later explained to the United States Trustee that although "he was annoyed by the insertion of the provision," he "did not object to it since he thought it would not impact his client financially." R. 66, U.S. Trustee's Report at 3.

Mr. Schilling filed in the bankruptcy court a motion to approve the settlement agreement. R. 73, Op. at 2. No objections were filed, and the bankruptcy court approved the settlement on April 8, 2002. *Ibid.*

iv. The Second Fee Request.

In May 2002, Mr. Schilling submitted a second request for attorneys' fees, seeking approximately $10,300 in fees and $136 in expenses. R. 73, Op. 3; see also R. 33 (fee application). Among other things, Mr. Schilling asked the bankruptcy court to revisit the issue of his previously disallowed fees. *Ibid.* Mr. Schilling pointed out to the bankruptcy court that the settlement agreement included a provision expressly addressing the fees disallowed after the first fee application. *Ibid.*

Indeed, Mr. Schilling represented that "[t]he only objection to the prior attorney fee application was by the debtor, and pursuant to the settlement agreement filed in this case, and approved by the Court, the debtor has agreed to support the efforts of the Trustee to have this Court reconsider, and award, the previously disallowed $1743.64 in interim fees to Trustee's counsel." *Ibid.* (quoting Mr. Schilling's fee request).

Mr. Schilling also justified his fee request on the ground that the distribution to creditors would be "100% of the allowed timely filed claims, and a substantial percentage to all tardily filed claims." R. 33, p.3. At the time, there were no tardily filed claims, and MBNA's claim was the sole allowed timely claim. Mr. Schilling nonetheless told the bankruptcy court that "Trustee's counsel should be fully compensated for his legal services which provided this 100% distribution." *Ibid.*

Later, in June 2002, about a year after the bar date, Mr. Schilling filed seven proofs of claim on behalf of creditors listed on the debtor's schedules.

No objections were filed to the fee request. R. 73, Op. 3. The bankruptcy court, however, directed the United States Trustee to assess whether it was proper for the Trustee to include a provision regarding his fees in an agreement settling disputes over the assets of the estate. *Ibid.* The United States Trustee accordingly prepared his report recommending that the bankruptcy court disallow Mr. Schilling's fees, primarily because Mr. Schilling had filed the tardy claims not to benefit the creditors, but to justify his fee request. R. 66.

v. <u>The Bankruptcy Court's September 2002 Opinion and Order</u>.

On September 17, 2002, the bankruptcy court granted Mr. Schilling's fee request in part and explained why the remaining fees should be disallowed. R 73. The court warned that a trustee's decision to act as his own counsel should be treated with caution because "where the trustee uses his legal services to pursue [estate] assets while getting paid his/her counsel fees from the assets of the estate, the potential for overreaching and self-interest through pursuit of litigation is much greater than for the trustee who does not employ himself." R. 73, Op. 6. The bankruptcy court also pointed out that if it allowed the tardily filed claims and granted in full both Mr. Schilling's request for attorney's fees totaling $25,143 and his proposed request for a trustee's commission of $8,034.79,[3] then "the Trustee and his counsel would receive 46.15% of the total assets disbursed." *Id.* at 5-6.

Reviewing the facts and the United States Trustee's Report, the bankruptcy court held that Mr. Schilling "overreached and acted in his own self-interest during the course of preparing and tendering the executed Settlement Agreement to the Court

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[3] The commission of a trustee may be calculated as a percentage of disbursements from the estate, less disbursements to the debtor. See 11 U.S.C. § 326(a).

and filing the Tardy Trustee Claims." R 73, Op. 7. The court explained that Mr. Schilling's "use of the Settlement Agreement requiring the Debtor to support the Trustee's motion for attorney fees, including reconsideration of previously disallowed fees, evidences his self-interest in the outcome of the litigation and in the estate itself." *Id.* at 8. It concluded that "[t]he act of enlisting an agreement which has no purpose other than to inappropriately influence this Court's evaluation of the requested fees and which solely serves the self-interest of the Trustee is against public policy, constitutes overreaching and is insupportable." *Ibid.* Indeed, the court could see the fee agreement as nothing but "direct evidence of the Trustee's self-interest in his Trustee's attorney fees rather than the estate." *Ibid.*

The bankruptcy court also held that Mr. Schilling had acted improperly in including in the settlement agreement the provision depriving the debtor of standing to contest claims filed against the estate. R 73, Op. at 9. It determined that Mr. Schilling had erred in filing creditor claims long after the bar date when he had a duty to oppose procedurally improper claims. *Ibid.* Finally, the court concluded that "the Trustee overreached when he attempted to or believed he had the Debtor's waiver of a distribution from the estate." *Id.* at 10. Pointing out that the debtor has a statutory right to a distribution from the estate if there is a surplus after all claims are paid, the court held that "[n]o legitimate estate purpose could be served by a trustee seeking a debtor's waiver of a right to participate in a distribution of the surplus." *Ibid.*

Based upon these multiple findings of misconduct, the bankruptcy court held that "the Trustee and Trustee's counsel hold an interest adverse to the estate and are not disinterested persons pursuant to 11 U.S.C. § 327(a)." R. 73, Op. 11.

Exercising its authority under 11 U.S.C. § 330 to award an amount of fees lower than Mr. Schilling's request, the bankruptcy court performed a lodestar analysis to calculate an appropriate fee. R. 73, Op. 12. First, the court determined that Mr. Schilling had failed to supply any evidentiary justification for his contention that the prevailing rate in Kentucky for bankruptcy work was $205 per hour in 2001 and $210 per hour in 2002. *Ibid.* Instead, the bankruptcy court relied upon its own experience of bankruptcy fee requests and determined that an appropriate rate was $150 per hour.

Next, the bankruptcy court calculated how many of hours of legal work should properly be compensated from the funds of the estate. R. 73, Op. 13. The court carefully reviewed each of Mr. Schilling's time entries. *Ibid.* It disallowed the fees charged for preparing the settlement agreement because "the Settlement Agreement has been found to evidence the Trustee's counsel's lack of disinterestedness" and, for the same reason, held that "all fees thereafter[] are disallowed in their entirety." *Ibid.* Next, after identifying specific instances of charges for excessive time spent upon discovery in the fraudulent conveyance proceeding, legal research and the preparation of fee applications, the court disallowed a total of 13.8 of the 41 hours for which Mr. Schilling sought compensation. *Id.* at 14-15.

In calculating a reasonable rate of compensation for the 27.3 allowable hours of work by Mr. Schilling, the bankruptcy court determined after "considering the matter at great length" that "a substantial downward adjustment of the lodestar analysis" would be necessary to take account of Mr. Schilling's misconduct. R. 73, Op. 15. As the court explained, the "only mitigating factor in the Trustee's favor" was his collection of substantial assets for the estate. *Ibid.* Balancing Mr. Schilling's misconduct against his substantial work on the case, the court applied a 50% downward adjustment to the lodestar amount to reach a final award of $2,047.50 in fees. *Ibid.* In addition, the court allowed Mr. Schilling's claim for expenses in full.

vi. <u>The Bankruptcy Court's December 2002 Opinion</u>.

In December 2002, the bankruptcy court amended its order in response to the United States Trustee's motion explaining that the court's findings that "the employment of Trustee's counsel was not in the best interest of the estate, that he held an interest adverse to the estate and that he was not disinterested" required a denial of all compensation. R. 80, Op 2 at 1. Relying upon <u>Mapother & Mapother, P.S.C. v. Cooper (In re Downs)</u>, 103 F.3d 472, 479 (6th Cir. 1996), the bankruptcy court acknowledged that when a fee claimant exhibits a "callous disregard" for his fiduciary duties, it may be "an abuse of discretion for the Bankruptcy Court to allow the claimant to retain any fees." *Id.* at 3.

The bankruptcy court next found that Mr. Schilling's conduct "demonstrate[s] 'callous disregard' for [his] duties." R. 80, Op 2 at 3. It concluded that it would be an abuse of discretion to allow Mr. Schilling to retain any of his fees. *Ibid.* Rather, "[t]otal denial of the fees requested and previously allowed is a sanction commensurate with the egregiousness of the conduct set forth in the Court's prior factual findings." *Ibid.*

vii. The District Court's Opinion.

On Mr. Schilling's appeal to the district court (R. 85), the district court affirmed the bankruptcy court's judgment denying fees. The district court pointed out that"by procuring [debtor] Smith's support for his fee application, Schilling effectively silenced all objections to his fees, and then attempted to use the agreement to gain approval of his renewed fee application." R. 85, Op. at 6. The district court accordingly expressly agreed with the bankruptcy court's finding that the settlement agreement itself is "'direct evidence of the Trustee's self-interest * * *.'" *Id.* at 7 (quoting the opinion of the bankruptcy court). It also affirmed the bankruptcy court's determination that Schilling had breached his duty to the estate when he filed untimely claims against the estate. *Id.* at 9. The district court concluded that "[h]aving determined that Schilling was not disinterested, the bankruptcy court did not err in failing to approve his fee application." *Ibid.*

STATEMENT OF RELATED CASES AND PROCEEDINGS

Counsel is unaware of any cases or proceedings related to this case.

STATEMENT OF THE STANDARD OF REVIEW

In this appeal from a judgment of the district court, exercising its appellate jurisdiction over a judgment of the bankruptcy court, this Court reviews "directly the decision of the bankruptcy court." Brady-Morris v. Schilling (in re Kenneth Allen Knight Trust), 303 F.3d 671, 676 (6th Cir. 2002).

This Court reviews fee awards in bankruptcy for abuse of discretion. United States v. Schilling (In re Big Rivers Electric Corp.), 355 F.3d 415, 429 (6th Cir. 2004). In ascertaining whether the bankruptcy court abused its discretion, this Court will "adopt the [bankruptcy] court's underlying factual findings unless clearly erroneous" and will "review [the court's] underlying construction of the Bankruptcy Code *de novo*." *Ibid.*

SUMMARY OF THE ARGUMENT

This Court recently confirmed in United States v. Schilling (In re Big Rivers Electric Corp.), 355 F.3d 415, 429 (6th Cir. 2004), that bankruptcy professionals must exercise their fiduciary obligations with great loyalty to the entities they represent. Moreover, strict compliance with that obligation of fiduciary loyalty is a condition of receiving professional compensation under the Bankruptcy Code. As this Court pointed out, compensation simply is not "reasonable" within the meaning of 11 U.S.C. § 330 unless it represents payment for "'loyal and disinterested service in the interest of those for whom the claimant purported to act.'" Big Rivers, 355 F.3d 432.

Here, the bankruptcy court found that Mr. Schilling was not a proper person to receive fees under the Bankruptcy Code for two reasons; first, he was not a disinterested person as required by the Code, and second, he had acted in violation of his fiduciary obligations. The bankruptcy court therefore denied Mr. Schilling's fee request in full. The bankruptcy court's factual findings regarding Mr. Schilling's self-interested conduct were not clearly erroneous. Moreover, the court did not abuse its discretion when it held that a complete denial of fees was appropriate in light of those facts.

1. The bankruptcy court's finding that Mr. Schilling acted in his own self-interest when he inserted the fee provision into the settlement agreement between the debtor and the bankruptcy estate is fully supported by the facts. The fee provision, which provided that the debtor would support Mr. Schilling's request for reconsideration not only of the previously-disallowed fees, but future fee requests as well, obviously benefitted nobody but Mr. Schilling himself. Moreover, Mr. Schilling in the fee provision asserted a personal right to property of the bankruptcy estate by seeking an award of fees that the court had already held were not properly payable and should be retained by the estate. The bankruptcy court therefore did not err in holding that the fee provision was clear evidence that Mr. Schilling acted in self-interest, rather than as a fiduciary.

2. The bankruptcy court's two other findings of misconduct are also fully supported by the undisputed facts in the record. First, both the record evidence and Mr. Schilling's arguments in the bankruptcy court and this Court show that Mr. Schilling overreached when he sought to force the bankruptcy court to award him fees that had previously been disallowed. Mr. Schilling argues in this Court that the bankruptcy court was legally required to award him the previously disallowed fees because the court had granted Mr. Schilling's unopposed motion to approve the settlement agreement contemplating the award of those fees. In Mr. Schilling's view, when the bankruptcy court approved the settlement agreement, the agreement and each of its terms represented the court's "adjudication" of factual disputes and established the "law of the case" on legal matters. Under the circumstances, Mr. Schilling argues, the bankruptcy court was bound by the terms of the settlement agreement, including the agreement to reconsider and award the disallowed fees.

As the bankruptcy court held, however, not only is Mr. Schilling's view that a court's approval of a settlement agreement precludes it from adjudicating disputes implicating the terms of the settlement agreement mistaken, but both that view and Mr. Schilling's conduct violate a bankruptcy trustee's obligations of candor to the court. The bankruptcy court found that Mr. Schilling acted improperly when he sought to evade meaningful inquiry into his fee request by representing that the court had already ruled that it would reconsider and award the disallowed fees and by barring the debtor from objecting to the fee request. The bankruptcy court's finding of misconduct is fully supported by the record and it is not clearly erroneous.

Second, the bankruptcy court's finding that Mr. Schilling acted improperly in filing claims on behalf of creditors long after the bar date is not clearly erroneous. Although a trustee's decision to file tardy creditor claims is not necessarily a breach of the trustee's fiduciary obligations, nonetheless the Bankruptcy Code does not provide for the payment of late-filed claims fled by the trustee on behalf of creditors if other parties in interest object. Here, the settlement agreement waived the debtor's right to file further objections to claims against the estate. Moreover, the late-filed claims effectively cut out the debtor from sharing in the distribution of the estate's surplus funds and had the immediate and direct result of both increasing the potential amount of the trustee's fee (see 11 U.S.C. § 326(a) (capping the trustee's fee at a percentage of moneys disbursed to parties other than the debtor)) and producing a greater distribution that might justify a more substantial award of attorneys' fees. The bankruptcy court therefor did not err in finding that under the facts of this case, the trustee filed the late claims not as a fiduciary, but rather, in breach of his fiduciary duties.

3. In light of its findings that Mr. Schilling was not disinterested and that he breached his fiduciary obligations when he acted in his own self-interest, rather than in the interests of the estate, the bankruptcy court did not abuse its discretion in denying Mr. Schilling all fees in the Smith Chapter 7 bankruptcy. On the contrary, when a bankruptcy professional is not disinterested and violates his fiduciary duty, the court must deny compensation under the Bankruptcy Code. The bankruptcy court therefore did not abuse its discretion in applying that principle here.

ARGUMENT

I. The Bankruptcy Properly Exercised Its Discretion In Denying Mr. Schilling's Request For Fees Because Mr. Schilling Was Not A Disinterested Person, As The Bankruptcy Code Requires, And Mr. Schilling Breached His Fiduciary Obligations.

A. This Court's Decision In *Big Rivers* Confirms That Compensation Under The Bankruptcy Code Turns Upon A Fiduciary's Faithful And Disinterested Performance Of His Obligations.

This Court recently clarified in United States v. Schilling (In re Big Rivers Electric Corp.), 355 F.3d 415, 429 (6th Cir. 2004), ("Big Rivers"), the standards that govern awards of compensation for bankruptcy professionals. The legal principles set forth in Big Rivers are controlling here.[4]

This Court in Big Rivers emphasized that bankruptcy professionals' fiduciary obligations lie at the core of their responsibilities under the Bankruptcy Code. It explained that Congress required bankruptcy professionals to be "disinterested" because those professionals "must satisfy the unbending standards of fiduciary duty that the law and society long have come to expect of trustees in general and that the Supreme Court has required of bankruptcy trustees in particular." Big Rivers, 355 F.3d at 431. Moreover, this Court pointed out that the Code's compensation

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[4] Although this Court decided Big Rivers on January 8, 2004 and Mr. Schilling filed his opening brief on January 30, Mr. Schilling does not mention Big Rivers anywhere in his brief.

provisions grow out of Congress's understanding that bankruptcy professional must honor their fiduciary obligations as a condition of receiving compensation authorized by the Code. See *id.* at 432. As this Court explained, the statutory requirement that compensation be "reasonable" incorporates an ethical component; it "suggests that trustees * * * must remain loyal to all relevant parties in the bankruptcy and must act as fiduciaries in doing so." *Ibid.*

This Court in Big Rivers also clarified more specifically the scope and content of bankruptcy professionals' fiduciary duties in bankruptcy proceedings.[5] See generally Big Rivers, 355 F.3d at 433-434. Of particular relevance here, this Court emphasized that the statutory requirement of "disinterest" ensures that a trustee "may not have a 'material adverse' interest to any party to the bankruptcy 'for any * * * reason' either at the time of appointment or during the course of the bankruptcy." *Id.*, 355 F.3d at 433 (quoting the Bankruptcy Code). In addition, by acknowledging bankruptcy trustees' fiduciary obligations as an aspect of "reasonable

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[5] Although Big Rivers involved the compensation of a bankruptcy examiner, rather than of counsel to the trustee, this Court's analysis applies to this case despite "modest differences" between the duties of trustees and examiners. Big Rivers, 355 F.3d at 430. Indeed, the fundamental statutory requirements of disinterestedness and reasonable compensation apply equally to both trustees and examiners. See 11 U.S.C. § 1104(d) (examiners must be disinterested); *id.*, § 328(a) (counsel to the trustee must be disinterested); *id.*, § 330(a) (compensation for all professionals, including examiners and trustees' counsel, must be reasonable).

compensation," this Court recognized that "bankruptcy law 'seeks to avoid * * * delicate inquiries * * * into the conduct of its own appointees by exacting from them forbearance of all opportunities to advance self-interest.'" *Ibid.* (quoting Mosser v. Darrow, 341 U.S. 267, 271 (1951)). This Court's law is thus unmistakably clear – if a bankruptcy fiduciary wishes to receive compensation under the Bankruptcy Code, then he cannot develop interests adverse to the interests of parties to the bankruptcy, and, in particular, cannot act in his own self-interest.

This Court in Big Rivers also confirmed that a complete denial of fees is generally appropriate when an applicant for fees has acted in self-interest, rather than as a loyal fiduciary. See Big Rivers, 355 F.3d at 436. Recognizing that "'a fiduciary may not receive compensation for services tainted by disloyalty or conflict of interest'" (*ibid.*, quoting Wolf v. Weinstein, 372 U.S. 633, 642 (1963)), this Court reasoned that "[a]bsent 'peculiar and unique circumstances' * * * a court must deny all compensation when a party is not disinterested at the time of appointment." *Ibid.* (quoting Michel v. Federated Dep't Stores, Inc. (In re Federated Dep't Stores, Inc.), 44 F.3d 1310, 1319-20 (6th Cir. 1995)). And as this Court added in Big Rivers, the fact that a trustee "breache[s] these duties at some time *after* his appointment does not change matters." *Ibid.*

B. Based On The Fee Agreement Alone, The Bankruptcy Court's Determinations That Mr. Schilling Was Not Disinterested And That He Breached His Fiduciary Obligations Are Not Clearly Erroneous.

The bankruptcy court held that Mr. Schilling's "use of the Settlement Agreement requiring the Debtor to support [Mr. Schilling's] motion for attorney fees, including reconsideration of previously disallowed fees, evidences his self-interest in the outcome of the litigation and in the estate itself." R. 73, Op. 8. For this and other reasons, the court concluded that Mr. Schilling and his law firm "hold an interest adverse to the estate and are not disinterested persons pursuant to 11 U.S.C.§ 327(a)." *Id.* at 11. Far from being clearly erroneous, this finding is fully supported by the undisputed evidence.

The provision concerning Mr. Schilling's fees that Mr. Schilling inserted into the settlement agreement – representing that the debtor would support Mr. Schilling's efforts to recover the previously disallowed fees and support any application for future fees – was plainly an attempt to co-opt the debtor's objection to any fee request, and benefitted nobody but Mr. Schilling and his law firm, ultimately at the debtor's expense. Not only had the debtor previously objected to the disallowed fees as excessive, but the bankruptcy court had agreed that they were excessive and not properly compensable under the Bankruptcy Code. See R. 46 (fee disallowance). Despite the court's ruling, however, Mr. Schilling inserted into the settlement agreement the provision representing that Mr. Smith would support a motion for reconsideration of the disallowed fees. See R. 73, Op. at 5. This provision had nothing to do with the substance of the settlement (terminating the adversary proceedings), and nothing to do with furthering the interests of the estate or its creditors. On the contrary, as the bankruptcy court found, the fee provision can be interpreted only as "direct evidence of the Trustee's self-interest in his Trustee's attorney fees rather than the estate." *Id.* at 8.

Of course, it is improper for a bankruptcy trustee to promote his own self interest in settling disputes concerning the bankruptcy estate. As this Court carefully explained in Big Rivers, a trustee "'owes single-minded devotion to the interests of those on whose behalf the trustee acts.'" Big Rivers, 355 F.3d at 434. See also Op. 7 ("The Trustee must never 'perform as a self-serving party to himself'" (quoting In re Redman, 69 B.R. 27, 28 (Bankr. D. Haw. 1986)). Here, instead of looking to the interests of the bankruptcy estate and the creditors, Mr. Schilling unilaterally inserted a provision to bind the debtor and the estate to an agreement that included pursuit of legal fees previously disallowed by the bankruptcy court and therefore subject to retention by the estate. In so doing, Mr. Schilling violated his fiduciary obligations, asserted a personal interest in the property of the bankruptcy estate, and ceased to be disinterested. The bankruptcy court's finding that Mr. Schilling was not a "disinterested person" (Op. 11) accordingly was not clearly erroneous.

In his brief on appeal to this Court, Mr. Schilling makes no effort to justify his conduct in inserting the fee agreement into the settlement between Mr. Smith and the estate. Indeed, he nowhere argues either that he did not act in self-interest in drafting and inserting the fee provision into the settlement, or that the disallowance of fees would not be the appropriate consequence of such conduct.[6]

Rather, Mr. Schilling's sole argument touching on the fee issue is the contention that the bankruptcy court erred by denying fees for Trustee's counsel based upon findings that "the Trustee was not disinterested and held an interest

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[6] Mr. Schilling's representation that the United States Trustee's Report found no conflict of interest in the negotiation of the settlement agreement (Br. at 20, 54) is misleading. Although the Report concluded "[‘t]here was no conflict of interest in the sense that the trustee agreed to accept less than the $50,000.00 in exchange for the debtor's support of the second fee application" (Rpt. at 4), that statement merely acknowledges that Mr. Schilling did not include his fee request in the negotiations. The limited statement is a far cry from a blanket conclusion that the fee provision created no conflict of interest at all. Rather, in light of its finding that Mr. Schilling had a conflict because he "manipulated the court's record by filing unallowable proofs of claim so that he could justify his attorney fees" the Report had no reason to address other potential improprieties in Mr. Schilling's conduct. *Id.* at 5.

In any event, even if the United States Trustee's Report overlooked certain elements of Mr. Schilling's wrongdoing, the bankruptcy court's application of the law to the undisputed facts is nonetheless correct and it warrants affirmance.

adverse to the estate." Br. 52 (emphasis added). In Mr. Schilling's view, because the bankruptcy court "dealt solely with an award of attorney fees," it was improper for it even to consider the conduct of the trustee in evaluating the fee request. *Ibid.* Mr. Schilling attacks the bankruptcy court's decision in this regard on both substantive and procedural grounds. See Br. 52-55.

Contrary to Mr. Schilling's contentions, there is no substantive distinction in the context of the fee dispute between J. Baxter Schilling, Esq., Trustee, and J. Baxter Schilling, Esq., sole member of the Law Firm of J. Baxter Schilling. Rather, this Court expressly recognized in Big Rivers that malfeasance by an individual acting as bankruptcy examiner justified disallowing fees sought by the examiner's law firm, of which the examiner himself was the sole member. See Big Rivers, 355 F.3d at 437. Here, when J. Baxter Schilling, Trustee, inserted the fee provision into the settlement agreement, he did so, as the bankruptcy court correctly found, to benefit himself. As this Court in Big Rivers implicitly acknowledged, the fact that payment of the previously-disallowed funds would benefit him through a check paid to the Law Firm of J. Baxter Schilling, rather than through a check paid to himself personally as

Trustee, is simply immaterial to the question whether Mr. Schilling was pursuing his own interests, rather than the interests of the estate.[7]

Moreover, as this Court observed in Big Rivers, rejecting similar arguments based upon supposed distinctions between Mr. Schilling and his law firm, "Schilling in the end may not retain what Schilling must disgorge." Big Rivers, 355 F.3d at 443. The bankruptcy court's goal in ordering disgorgement – ensuring compliance with the Bankruptcy Code's command that only "disinterested person[s]" receive professional compensation – would be frustrated if trustees could benefit themselves without running afoul of the Code simply by arranging for estate funds to be diverted to their solely owned law firms, rather than to themselves as individuals.[8]

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[7] Of course, drawing a distinction in other contexts between the trustee and trustee's counsel might be both meaningful and consistent with the Bankruptcy Code. The case Mr. Schilling cites for that proposition (Br. 52), however, was reversed on appeal. See Connolly v. Harris Trust of California (In re Miniscribe Corp.), 309 F.3d 1234 (10th Cir. 2002), reversing Connolly v. Harris Trust of California (In re Miniscribe Corp.), 257 B.R. 56 (Bankr. D. Colo. 2000).

[8] Nor is there any merit to Mr. Schilling's complaints that his procedural rights were violated because the bankruptcy judge "had never advised Trustee or his counsel that she was contemplating entering an opinion in which she would conclude the Trustee and Trustee's Counsel had overreached the Debtor, were not disinterested and held an interest adverse to the estate." Br. 55. Certainly, both Mr. Schilling and his law firm were on notice of the dispute over his fee request from its inception and Mr. Schilling had the opportunity to be heard at all stages of the fee litigation. Mr. Schilling never even requested a hearing on his fee application. Contrary to Mr. Schilling's suggestions, therefore, the bankruptcy judge's failure to advise Mr.

(continued...)

C. The Bankruptcy Court's Findings That Mr. Schilling's Other Conduct Also Violated His Fiduciary Obligations Also Are Not Clearly Erroneous.

In addition to finding that Mr. Schilling had displayed self-interest in negotiating the fee provision, the bankruptcy judge also found that Mr. Schilling violated his fiduciary obligations when he "used the Settlement Agreement to silence objections to his actions in execution of his duties as Trustee in this case." R. 73, Op. 7. The bankruptcy judge found that Mr. Schilling "attempted to or believed he had effectively eliminated the Debtor as a potential beneficiary of the estate" and then, having sidelined the Debtor, used the fee provision in the settlement agreement "in an attempt to slide through not only the current fees requested but also to encourage the Court to reconsider its prior Order." *Id.* at 8. The bankruptcy court also found that Mr. Schilling had acted improperly in filing the "Tardy Trustee Claims." *Ibid.*[9]

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[8](...continued)
Schilling of the precise contents of her forthcoming opinion did not violate his procedural rights.

[9] As we explain in more detail below (*infra*, at 37), the bankruptcy court's broad legal conclusion that a trustee generally has a duty to the debtor that precludes him from assisting creditors by filing late claims (see R. 73, Op. at 8), is not fully consistent with the trustee's obligations under the Bankruptcy Code. Under the facts presented here, however, the bankruptcy court could have reached the same conclusion – that the Tardy Trustee Claims were filed for improper reasons – on the narrower grounds we discuss below.

As we now show, the bankruptcy court's findings are not clearly erroneous. There is ample support in the record for both the finding that Mr. Schilling improperly used the settlement agreement as a vehicle for forcing the court to reconsider the disallowed fees, and for the finding that Mr. Schilling violated his fiduciary obligations when he filed the Tardy Trustee Claims.

a. The Improper Use Of The Settlement Agreement As A Device To Force The Bankruptcy Court To Allow The Previously Disallowed Fees And To Shield Future Fee Requests From Scrutiny.

The bankruptcy court's finding that Mr. Schilling improperly used the settlement agreement as an indirect means of forcing reconsideration of the disallowance of fees is not clearly erroneous. Rather than straightforwardly asking the judge herself to reconsider the disallowance, Mr. Schilling sought to reinstate the fees indirectly by inserting the fee provision into the settlement agreement, obtaining approval of the settlement from the court, and then presenting the judge with her own order apparently endorsing the terms of the settlement, including the fee provision. In addition, obtaining the debtor's waiver of the right to object to future fee requests was a transparent device to shield Mr. Schilling's future fee requests from meaningful scrutiny by the bankruptcy court.

As the bankruptcy court pointed out, however, "an agreement by a party in interest to support a trustee's fee or establish such fee is not enforceable or binding on the Court." Op. 8. Rather, "[t]he act of enlisting an agreement which has no purpose other than to inappropriately influence this Court's evaluation of the requested fees and which solely serves the self-interest of the Trustee is against public policy" and inconsistent with the trustee's obligations under the Bankruptcy Code. *Ibid.*

The bankruptcy court similarly found that Mr. Schilling had acted improperly in negotiating the terms of the settlement agreement "which have the specific purpose of waiver of the Debtor's right to be heard on any matter or motion relating to the allowance of any claim filed in the estate * * *." R. 73, Op. 8-9. As the court pointed out, "absent comments or objections by interested parties," the court is unlikely to become aware of issues in the bankruptcy case. *Ibid.* The court accordingly concluded that Mr. Schilling "used the Settlement Agreement to silence objections to his actions in execution of his duties as Trustee" (*id.* at 7), and with the intent to "keep meaningful input from this Court" (*id.* at 10).

There is an ample factual and legal basis for the bankruptcy court's finding that Mr. Schilling acted improperly by inserting the fee provision into a settlement agreement and then trying to use the bankruptcy court's approval of the settlement as conclusive evidence that the court had agreed to reconsider and award the fees. Although the Bankruptcy Rules require court oversight of settlements if objections are filed (see Fed. R. Bankr. Pro. 9019), a settlement need not necessarily be approved by the court if there is no objection from interested parties. See 11 U.S.C. § 362(b)(1). No rational bankruptcy judge would devote the same resources to scrutinizing an unopposed motion for approval of a settlement agreement as to resolving an issue directly presented by motion, and a bankruptcy trustee accordingly ought not to bury important and controversial fee issues in uncontested settlement agreements, particularly not when the settlement agreement itself limits the debtor's standing to file objections. As the bankruptcy court pointed out, "shrouding matters involving the estate and the trustee's performance of his/her fiduciary duties * * * in the form of any agreement settling litigation" falls short of the trustee's obligation to be open and honest with the court. Op. 10. See also Big Rivers, 355 F.3d at 432 (explaining that trustees are also fiduciaries of the court). *C.f.* Downs, 103 F.3d at 478-79 (discussing a professional's deliberate failure to disclose compensation); In re Kisseberth, 273 F.3d 714, 721 (6th Cir. 2001) (explaining that even a negligent failure to disclose may justify disgorgement).

The undisputed facts are more than adequate to support the court's finding that Mr. Schilling acted improperly in this case by trying to use the settlement agreement to obtain indirectly what he had failed to obtain directly. Obviously, the parties to a bankruptcy proceeding should not be able to undermine a court order by reaching a private settlement inconsistent with that order, having the settlement approved by the bankruptcy court on an uncontested motion, and then raising the court's approval of the settlement as a bar to any further adjudication regarding matters related to the settlement.

Even in his brief in this Court, Mr. Schilling repeatedly invokes the bankruptcy court's approval of the settlement agreement as conclusive evidence of the propriety of his fee request and as a bar to the bankruptcy court's even considering the facts underlying the settlement agreement in resolving the fee dispute. See, *e.g.*, Br. at 26, 32 (bold typeface). Mr. Schilling argues that because the bankruptcy court approved the settlement agreement, approval of the agreement and all of its terms is "the law of the case" (*id.* 26), and to the extent that the bankruptcy judge's findings in the fee litigation are inconsistent with the terms of the settlement agreement they are "contrary to [the bankruptcy judge's] Order of April 8, 2002 [approving the settlement agreement], and are contrary to law." *Id.* 36. See also *id.* at 44 (mistakenly alleging that the money the debtor paid the estate was "adjudicated to be" nonexempt property that would be used to pay administrative and unsecured claims because the settlement agreement provided that the funds would be treated in that manner). And compare *id.* at 43-44 (arguing that "the plain language of" the Order approving the settlement agreement bars the debtor from receiving any distribution of surplus funds from the estate) with Op. 10 (reviewing the underlying facts and finding, contrary to the terms of the settlement agreement, that Mr. Schilling overreached the debtor in securing a waiver of any distribution from the estate because "[n]o legitimate estate purpose could be served by a trustee seeking a debtor's waiver of a right to participate in a distribution of the surplus" both because the Bankruptcy Code itself gives debtors a right to participate (11 U.S.C. § 726(a)), and because bankruptcy policy "favors the Debtor's fresh start with exempt assets").

Mr. Schilling's reliance upon the law of the case doctrine is misplaced. As this Court has explained, "[t]he law-of-the-case doctrine does not remove a [] court's jurisdiction to reconsider, or otherwise preclude a [] court from reconsidering, an issue previously decided in the case." United States v. Dunbar, 357 F.3d 582, 594 (6th Cir. 2004). Rather, despite the law of the case doctrine, "'[p]rejudgment orders remain interlocutory and can be reconsidered at any time.'" *Ibid.* Mr. Schilling's argument – that because of the law of the case doctrine, the bankruptcy court's approval of the settlement agreement bars any further examination of matters relating to agreement – is therefore mistaken. The bankruptcy court had the authority, and indeed the obligation, to look to the facts underlying Mr. Schilling's fee request and, because the request turned upon the Settlement Agreement, to investigate the circumstances of that Agreement. See R. 65 (bankruptcy court's Order requiring an investigation by the United States Trustee into "the propriety of the Trustee's fees as a material term of the Settlement Agreement").

Even if the law of the case doctrine were relevant, it would not prevent the bankruptcy court from looking to the substance of the settlement here because the court made no findings and issued no rulings about the substance of the settlement. See Rouse v. DaimlerChrysler Corporation UAW, 300 F.3d 711, 715 (6th Cir. 2002) (law of the case doctrine did not apply when the court had not decided the issues that were later claimed to be barred). Mr. Schilling is therefore mistaken in contending that the bankruptcy court's order approving the settlement "specifically determine[d]" that the underlying facts are as the agreement represents them to be. Br. at 35. Similarly, the order approving settlement does not represent the bankruptcy court's "adjudicat[ion]" of disputes settled under the agreement (*id.* at 44), or establish "law of the case" by accepting as binding the parties' agreement on legal issues (*id.* at 26).

Mr. Schilling's continued reliance in this Court upon the bankruptcy court's approval of the settlement agreement as a bar to review of his fee application only confirms that the bankruptcy court committed no error when it found that Mr. Schilling violated his obligations to the court when he used the court's approval of the settlement agreement as a shield against meaningful adjudication of the fee dispute. See Op. 10. The bankruptcy court's holding that Mr. Schilling improperly included the fee provision in the settlement agreement in an attempt to evade the order disallowing his fees is therefore not clearly erroneous, and it should be sustained.

b. The Tardy Trustee Claims.

The bankruptcy court also found that Mr. Schilling did not act in the best interests of the estate when he filed claims on behalf of creditors over eleven months after the bar date. Op. 9. The bankruptcy court suggested that the late filings were "in breach of [Mr. Schilling's] duty to the estate and the Debtor as a party in interest." *Id.* at 8.

Although the bankruptcy court's apparent view that a trustee necessarily breaches his or her duty by filing late claims on behalf of creditors is overbroad – a Chapter 7 trustee's primary fiduciary obligation is to the estate and the creditors, see Big Rivers, 355 F.3d at 431-32, and a filing outside the bar date will not necessarily undermine the interests of the estate – there is nonetheless ample evidentiary support for the court's finding that Mr. Schilling did not act in the best interests of the estate when he filed the tardy claims in Mr. Smith's Chapter 7 proceeding.

Although the Bankruptcy Code may sometimes authorize a trustee to file late claims on behalf of creditors without violating any fiduciary duty, nonetheless "[n]o provision is made for the payment of claims filed tardily under [11 U.S.C.] § 501(c)" by the trustee or the debtor. Drew v. Royal (In re Drew), 256 B.R. 799, 804 (10th Cir. B.A.P. 2001) (emphasis added). See also Op. 9 n.1 (pointing out that "while a tardy claim filed by a creditor is entitled to a distribution, a tardy claim filed by a debtor or the trustee on behalf of a creditor is not"). Accordingly, these claims may be disallowed if a party in interest objects to them. See *ibid.*

Here, Mr. Schilling engaged in a transparent scheme to use the tardily filed claims to increase both his fee as trustee and his attorney fees. With regard to the trustee fee, the settlement agreement included the provision barring the debtor from objecting to claims filed against the estate. See R. 73, Op. 9. Having silenced the debtor's objections, Mr. Schilling could thus be sure that even tardy claims in this case would effectively cut out the debtor from participating in the distribution of the surplus, because the tardy claims would account for the residue of the estate. The debtor thus would be ineligible for any distribution, despite his rights under the Bankruptcy Code to participate in that distribution and make his fresh start. See 11 U.S.C. § 726(a)(6). Cutting out the debtor, of course, would increase the fee available to Mr. Schilling as trustee, because his trustee fee is capped at a percentage of the funds distributed, excluding funds distributed to the debtor. See *id.*, 326(a). Under these circumstances, the bankruptcy court's finding that Mr. Schilling had acted improperly by filing procedurally invalid claims at the expense of the debtor, who had a legitimate interest under the Bankruptcy Code in the surplus distribution, was not clearly erroneous.

In addition to increasing his trustee fee, Mr. Schilling could use the tardily filed claims to increase his attorney fees. Mr. Schilling himself agrees that a trustee acts improperly if he files "proofs of claims solely for the purpose of increasing [his] trustee compensation." Br. 45. See also In re Nettles, 251 B.R. 899 (Bankr. M.D. Fla. 2000). The United States Trustee concluded in his Report, after interviewing Mr. Schilling and Mr. Morris and reviewing the documentary evidence (R. 66, United States Trustee's Report at 1), that Mr. Schilling "filed unallowable claims on behalf of those creditors who had failed to do so" because he was "unable to justify all of his attorney's fees" unless substantial additional funds came into the estate. *Id.*, 4. As the United States Trustee pointed out, Mr. Schilling's second fee application justified his request for fees – including the previously disallowed fees – by representing to the bankruptcy court that Mr. Schilling had secured a distribution of "'100% of the allowed timely filed claims and a substantial percentage to all tardily filed claims.'" *Id.* at 2 (quoting R. 63, Second Fee Application at 3). But at the time of the second fee application, there *were* no tardily filed claims; rather, only MBNA's timely claim had been filed. Mr. Schilling filed the seven claims on behalf of creditors after he filed his fee application, and over a year after the bar date. Because Mr. Schilling had justified his fee request to the bankruptcy court in reliance upon "tardily filed claims" that did not even exist, the United States Trustee concluded that Mr. Schilling's justifications for the fee request were unreliable.

Mr. Schilling's brief in this Court is almost entirely devoted to challenging the bankruptcy court's decision on the Tardy Trustee Claims, even though that decision in fact constitutes only one aspect of the bankruptcy court's analysis. See Br. at 36-52. Mr. Schilling makes two principal arguments, both of which are misplaced.[10]

First, Mr. Schilling's claim that the Bar Order in Mr. Smith's Chapter 7 bankruptcy should be ignored because of an order entered in Mr. Smith's earlier, Chapter 13 bankruptcy (Br. at 39-40), lacks any basis in law or fact. The Chapter 13 case was dismissed, rather than converted, and an order relating to creditor claims in the Chapter 13 case therefore has no relevance at all to creditors in the new Chapter 7 proceeding, which is an entirely separate bankruptcy case.

Second, there is no merit to Mr. Schilling's contention his late filings were in fact timely because the Chapter 7 Bar Order itself is invalid and "cannot stand." Br. 42. According to Mr. Schilling, the Bar Order is invalid because it provides broadly that creditor claims filed after the bar date "will be barred from receiving any

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[10] As we have explained, the United States Trustee, like Mr. Schilling, does not interpret the Bankruptcy Code to bar a trustee from filing late creditor claims in all circumstances.

distribution of assets." *Ibid.* (quoting the Bar Order). Mr. Schilling's argument assumes that the Bar Order is akin to a legal ruling or procedural rule that must be struck down if it is not fully consistent with the Bankruptcy Code. Compare United States v. Cardinal Mine Supply, Inc., 916 F.2d 1087 (6th Cir. 1990) (invalidating a Bankruptcy Rule that was inconsistent with the Bankruptcy Code).

Mr. Schilling's assumption is mistaken. The Bar Order is not a judicial ruling or a procedural rule, but rather a routine document sent out in a Chapter 7 case to notify creditors of the bankruptcy proceedings and inform them of the bar date for filing claims. Collier on Bankruptcy, § 700.03, 700-3 (15th Ed. Rev. 2002). There is no reason why a Bar Order should explain in intricate detail all of the classes of claims that might, perhaps, be payable in the unusual situation presented in this case, where surplus funds remain in the estate after distribution to all creditors who filed timely claims. In the mine run of Chapter 7 liquidations, it is true that a creditor who misses the bar date will, as a practical matter, be barred from receiving any distribution of assets. The Bar Order was accordingly not invalid because it warned creditors forcefully of the likely consequence of any failure to file timely claims.

Mr. Schilling is therefore mistaken in arguing that the Bar Order was facially invalid. His contention that his creditor claims filed over a year after the bar date were in fact timely, because the invalidity of the Bar Order meant that “no valid bar date for filing claims existed” in the Smith bankruptcy, is therefore meritless. Br. 42.

D. The Bankruptcy Court Did Not Abuse Its Discretion In Ordering Disgorgement.

“[T]he bankruptcy court is given a great deal of latitude in fashioning an appropriate sanction” for a professional’s wrongdoing. Mapother & Mapother, P.S.C. v. Cooper (In re Downs), 103 F.3d 472, 478 (6th Cir. 1996). As this Court reaffirmed in Big Rivers, therefore, a bankruptcy court’s decision regarding the appropriate sanction “‘should not be disturbed unless a clear abuse of discretion is found.’” Big Rivers, 355 F.3d at 436 (quoting Downs).

The bankruptcy court here did not abuse its discretion in ordering full disgorgement. It found, based upon undisputed facts, that Mr. Schilling had acted in his own self-interest when he inserted the fee provision into the settlement agreement had ceased to be “disinterested” within the meaning of the Bankruptcy Code, and had violated his fiduciary obligations. These are grounds enough for disgorgement. As this Court emphasized in Big Rivers, “a court must deny all compensation when a party is not disinterested at the time of appointment” and the fact that a fiduciary breaches his duty “at some point after his appointment does not change matters.” 355 F.3d at 436.

Moreover, the bankruptcy court found Mr. Schilling's conduct to be sanctionable in other ways as well. It found that Mr. Schilling had acted improperly when he tried to force the court to allow the previously disallowed fees by securing the debtor's agreement not to contest the renewed application for fees, and representing to the court itself that it had approved the fee request when it approved the filing of the settlement agreement. And the bankruptcy court found that Mr. Schilling had acted improperly in using the settlement agreement to take away the debtor's right to contest further fee applications, and to prevent the debtor from objecting to future claims against the estate. That agreement allowed Mr. Schilling to secure himself larger trustee and attorney fees by filing claims for creditors long after the bar date. These findings relating to Mr. Schilling's self-interest and breach of duty are also not clearly erroneous.

Mr. Schilling in his brief argues that disgorgement was inappropriate in this case because his efforts turned Mr. Smith's Chapter 7 bankruptcy from a no distribution case into a case with substantial assets. See, *e.g.*, Br. at 57. Certainly, Mr. Schilling was successful in identifying assets in the Smith bankruptcy and in securing those assets for the estate through adversary proceedings. But Mr. Schilling's obligations as trustee required no less. See 11 U.S.C. § 704(1) (requiring trustees to collect estate assets). Moreover, Mr. Schilling had every expectation of being compensated for his services; the Bankruptcy Code "neither expects nor requires [trustees] to volunteer their time." Big Rivers, 355 F.3d at 430.

Finally, even if the bankruptcy court had abused its discretion in ordering full disgorgement – and in light of Mr. Schilling's obvious self-interest in inserting the fee provision, it did not – there would nonetheless be no reason for this Court to award any more than the amount the bankruptcy court calculated under its lodestar analysis in its original opinion and order resolving Mr. Schilling's second fee application. See R. 73, Bankruptcy Court Opinion at 12-15. The bankruptcy court's careful analysis of each of the relevant factors (the hourly fee, the number of hours reasonably chargeable and the downwards adjustment for improper conduct), was supported both by reason and by the facts identified in the bankruptcy court's opinion.

The bankruptcy court's subsequent order requiring Mr. Schilling to disgorge his fees, however, is fully consistent with the law of this Court and based upon factual findings that are not clearly erroneous.

CONCLUSION

The judgment of the district court should be affirmed.

Respectfully submitted,

Of Counsel:

P. MATTHEW SUTKO
Attorney, Office of the General Counsel
Executive Office For U. S. Trustees
U.S. Department of Justice
901 E. Street, N.W.
Washington, D.C. 20530

PETER D. KEISLER
Assistant Attorney General

WILLIAM KANTER
(202) 514-4575
ANNE MURPHY
(202) 514-3688
Attorneys, Appellate Staff
Civil Division, Room 9104
U.S. Department of Justice
601 D. Street, N.W.
Washington, D.C. 20530-0001

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3. ("CCN") ***CURRENT*** CASE NO. — No.: 07-5618

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]* — No.:

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(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC*** — **BANKRUPTCY**

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***

•1. Whether plaintiffs have standing to challenge the constitutionality of the Abuse Prevention Act means test provisions establishing the presumption of abusive filing under Chapter 7; and

2. Whether the means tests created by the Abuse Prevention Act violate Article I, Section 8, Clause 4 of the U.S. Constitution, which vests in Congress the authority to establish “uniform Laws on the subject of Bankruptcies throughout the United States.”

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IN THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BERNARD FRANCIS SCHULTZ, ET AL.,

PLAINTIFFS-APPELLANTS,

V.

UNITED STATES OF AMERICA, ET AL.,

DEFENDANTS-APPELLEES.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF TENNESSEE

PROOF BRIEF FOR APPELLEES

PETER D. KEISLER
Assistant Attorney General

JAMES R. DEDRICK
United States Attorney

WILLIAM KANTER
LEWIS S. YELIN, (202) 514-3425
Attorneys, Appellate Staff
Civil Division, Room 7318
U.S. Department of Justice
950 Pennsylvania Ave., N.W.

Washington, D.C. 20530-0001

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STATEMENT CONCERNING ORAL ARGUMENT

THE UNITED STATES REQUESTS ORAL ARGUMENT, WHICH IT BELIEVES WILL BE HELPFUL TO THE COURT.

IN THE UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

NO. 07-5618

BERNARD FRANCIS SCHULTZ, ET AL.,

PLAINTIFFS-APPELLANTS,

V.

UNITED STATES OF AMERICA, ET AL.,

DEFENDANTS-APPELLEES.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF TENNESSEE

PROOF BRIEF FOR APPELLEES

JURISDICTIONAL STATEMENT

PLAINTIFFS INVOKED THE DISTRICT COURT'S JURISDICTION

UNDER 28 U.S.C. §§ 1331 AND 1334. OCTOBER 19, 2007 THE DISTRICT COURT GRANTED DEFENDANTS' MOTION FOR SUMMARY JUDGMENT AND DISMISSED PLAINTIFFS' COMPLAINT ON MAY 14, 2007. (R. 30 ORDER, APX. P. __; R. 31 JUDGMENT, APX. P. __.) PLAINTIFFS FILED A TIMELY NOTICE OF APPEAL ON MAY 16, 2007. (R. 33 NOTICE OF APPEAL, APX. P. __.) THIS COURT HAS JURISDICTION UNDER 28 U.S.C. § 1291.

STATEMENT OF THE ISSUES

TITLE I OF THE BANKRUPTCY ABUSE PREVENTION AND CONSUMER PROTECTION ACT OF 2005 (THE ABUSE PREVENTION ACT), PUB. L. NO. 109-8,

112 STAT. 23, CREATED A MEANS TEST FOR DETERMINING ELIGIBILITY FOR BANKRUPTCY UNDER CHAPTER 7 OF THE BANKRUPTCY CODE, WHICH PROVIDES FOR LIQUIDATION OF THE DEBTOR'S NON-EXEMPT PROPERTY AND DISCHARGE OF DEBTS. IT ALSO ESTABLISHED A MEANS TEST THAT DETERMINES WHETHER A DEBTOR'S REPAYMENT PERIOD WILL BE THREE OR FIVE YEARS FOR BANKRUPTCIES FILED UNDER CHAPTER 13, AND THE AMOUNTS TO BE REPAID.

THE QUESTIONS PRESENTED ARE:

1. WHETHER PLAINTIFFS HAVE STANDING TO CHALLENGE THE CONSTITUTIONALITY OF THE ABUSE

PREVENTION ACT MEANS TEST PROVISIONS ESTABLISHING THE PRESUMPTION OF ABUSIVE FILING UNDER CHAPTER 7; AND

2. WHETHER THE MEANS TESTS CREATED BY THE ABUSE PREVENTION ACT VIOLATE ARTICLE I, SECTION 8, CLAUSE 4 OF THE U.S. CONSTITUTION, WHICH VESTS IN CONGRESS THE AUTHORITY TO ESTABLISH "UNIFORM LAWS ON THE SUBJECT OF BANKRUPTCIES THROUGHOUT THE UNITED STATES."

STATEMENT OF THE CASE

IN NOVEMBER, 2006, PLAINTIFFS FILED FOR BANKRUPTCY UNDER CHAPTER 13, A PROVISION OF THE

BANKRUPTCY CODE REQUIRING SATISFACTION OF CREDITORS' CLAIMS FROM FUTURE INCOME. (R. 2 AMENDED COMPLAINT, P. 1, APX. P. __.) INDEPENDENTLY, PLAINTIFFS BROUGHT SUIT IN THE DISTRICT COURT. PLAINTIFFS' COMPLAINT ALLEGED THAT, BUT FOR THE ABUSE PREVENTION ACT'S AMENDMENTS TO THE BANKRUPTCY CODE, PLAINTIFFS WOULD HAVE FILED FOR BANKRUPTCY UNDER CHAPTER 7, WHICH DOES NOT REQUIRE REPAYMENT OF CREDITORS FROM FUTURE INCOME. (R. 2 AMENDED COMPLAINT, P. 9, APX. P. __.) THE COMPLAINT FURTHER ALLEGED

THAT, BUT FOR THE ABUSE PREVENTION ACT'S AMENDMENTS TO THE BANKRUPTCY CODE, PLAINTIFFS WOULD HAVE BEEN ELIGIBLE FOR A THREE-YEAR REPAYMENT PLAN UNDER CHAPTER 13 INSTEAD OF THE LONGER FIVE-YEAR PLAN AND THAT MORE OF THEIR INCOME WOULD HAVE BEEN EXEMPTED IN THE PLAN'S REPAYMENT CALCULATIONS. (*IBID.*)

THE COMPLAINT SOUGHT A DECLARATION THAT THE ABUSE PREVENTION ACT'S AMENDMENTS TO THE BANKRUPTCY CODE ESTABLISHING A MEANS TEST TO DETERMINE ELIGIBILITY FOR

DISCHARGE UNDER CHAPTER 7 AND FOR THE SHORTER REPAYMENT PERIOD AND INCOME CALCULATIONS UNDER CHAPTER 13 ARE UNCONSTITUTIONAL BECAUSE THEY VIOLATE THE REQUIREMENT THAT CONGRESS ENACT "UNIFORM LAWS ON THE SUBJECT OF BANKRUPTCIES." U.S. CONST. ART. I, § 8, CL. 4; (*SEE* R. 2 AMENDED COMPLAINT, P. 10, APX. P. __.) IT ALSO SOUGHT AN INJUNCTION PROHIBITING ENFORCEMENT OF THOSE PROVISIONS. (*IBID.*)

THE PARTIES FILED CROSS-MOTIONS FOR SUMMARY JUDGMENT. THE DISTRICT COURT GRANTED DEFENDANTS' MOTION, CONCLUDING

THAT THE ABUSE PREVENTION ACT AMENDMENTS SATISFY THE BANKRUPTCY CLAUSE'S UNIFORMITY REQUIREMENT. (R. 29 MEMORANDUM, APX. P. __.) ACCORDINGLY, THE DISTRICT COURT DISMISSED PLAINTIFFS' CLAIMS. (R. 30 ORDER, APX. P. __.) PLAINTIFFS NOW APPEAL THE DISTRICT COURT'S ORDER OF DISMISSAL.

STATEMENT OF THE FACTS

I. STATUTORY BACKGROUND

THE BANKRUPTCY CODE ESTABLISHES TWO BASIC FORMS OF BANKRUPTCY FOR INDIVIDUAL DEBTORS. UNDER CHAPTER 7, "AN INDIVIDUAL DEBTOR RECEIVES AN

IMMEDIATE UNCONDITIONAL DISCHARGE OF PERSONAL LIABILITY FOR CERTAIN DEBTS IN EXCHANGE FOR RELINQUISHING HIS OR HER NONEXEMPT ASSETS TO A BANKRUPTCY TRUSTEE FOR LIQUIDATION AND DISTRIBUTION TO CREDITORS." H.R. REP. 109-31(I), AT 10; *SEE* 11 U.S.C. §§ 701–727. BY CONTRAST, UNDER CHAPTER 13, "A DEBTOR COMMITS TO REPAY SOME PORTION OF HIS OR HER FINANCIAL OBLIGATIONS" OVER A SPECIFIED PERIOD "IN EXCHANGE FOR RETAINING NONEXEMPT ASSETS AND RECEIVING A BROADER DISCHARGE OF DEBT THAN IS AVAILABLE UNDER

CHAPTER 7." H.R. REP. 109-31(I), AT 10; *SEE* 11 U.S.C. §§ 1321–1330. UNDER THE BANKRUPTCY REFORM ACT OF 1978, PUB. L. NO. 95-598, 92 STAT. 2549, A DEBTOR COULD FREELY CHOOSE WHETHER TO FILE FOR BANKRUPTCY UNDER CHAPTER 7 OR CHAPTER 13. *SEE* H.R. REP. 109-31(I), AT 11.

IN 1984, CONGRESS AMENDED CHAPTER 7 TO PERMIT DISMISSAL OF A BANKRUPTCY PETITION FILED UNDER THAT CHAPTER IF A COURT FOUND "SUBSTANTIAL ABUSE." BANKRUPTCY AMENDMENTS AND FEDERAL JUDGESHIP ACT OF 1984, PUB. L. NO. 98-353, § 312, 98 STAT. 333, 335,

CODIFIED AS AMENDED AT 11 U.S.C. § 707(B)(1) (1988). CONGRESS ENACTED THIS AMENDMENT TO RESPOND "TO CONCERNS THAT SOME DEBTORS WHO COULD EASILY PAY THEIR CREDITORS MIGHT RESORT TO CHAPTER 7 TO AVOID THEIR OBLIGATIONS." H.R. REP. 109-31(I), AT 12 (QUOTATION MARKS OMITTED). TWO YEARS LATER, CONGRESS AGAIN AMENDED THIS PROVISION TO AUTHORIZE THE UNITED STATES TRUSTEE TO SEEK DISMISSAL OF CHAPTER 7 PETITIONS FOR "SUBSTANTIAL ABUSE." BANKRUPTCY JUDGES, UNITED STATES TRUSTEES, AND FAMILY FARMER BANKRUPTCY

ACT OF 1986, PUB. L. NO. 99-554, § 21, 100 STAT. 3088, 3101; *CODIFIED AT* 11 U.S.C. § 707(B)(1) (1988).

AFTER TWENTY-YEARS' EXPERIENCE, CONGRESS FOUND THAT THESE AMENDMENTS WERE INSUFFICIENT TO CONTROL ABUSE OF THE CHAPTER 7 BANKRUPTCY PROCESS. AMONG OTHER PROBLEMS, THE HOUSE REPORT ACCOMPANYING THE ABUSE PREVENTION ACT IDENTIFIED THE "INHERENT[] VAGUE[NESS]" OF THE "SUBSTANTIAL ABUSE" STANDARD, WHICH LED TO DISAGREEMENT IN THE COURTS ABOUT WHETHER A DEBTOR'S ABILITY TO REPAY A SIGNIFICANT

PORTION OF HIS OR HER DEBTS OUT OF FUTURE INCOME CONSTITUTES SUBSTANTIAL ABUSE, MERITING DISMISSAL. H.R. REP. 109-31(I), AT 12. ANOTHER PROBLEM WAS THAT CONGRESS HAD ESTABLISHED "A PRESUMPTION IN FAVOR OF GRANTING THE RELIEF REQUESTED BY THE DEBTOR," WHICH INFLUENCED COURTS' DECISIONS WHETHER TO FIND SUBSTANTIAL ABUSE. 11 U.S.C. § 707(B) (2000 SUPPL. 4); *SEE* H.R. REP. 109-31(I), AT 12.

RESPONDING TO THESE PERCEIVED SHORTCOMINGS OF THE BANKRUPTCY CODE, CONGRESS HELD HEARINGS OVER FIVE YEARS TO

DETERMINE WHAT MEASURES IT COULD ADOPT "TO ENSURE THAT DEBTORS REPAY CREDITORS THE MAXIMUM THEY CAN AFFORD." H.R. REP. 109-31(I), AT 2; *SEE ID.* AT 12. AS A RESULT OF THOSE HEARINGS, CONGRESS DETERMINED THAT IT SHOULD ADOPT "NEEDS-BASED REFORMS," WHICH WOULD LIMIT THE AVAILABILITY OF CHAPTER 7 RELIEF TO THOSE WHO CONGRESS BELIEVED COULD NOT AFFORD TO REPAY A PORTION OF THEIR DEBTS OUT OF FUTURE INCOME, AS IS REQUIRED UNDER CHAPTER 13. *ID.* AT 12.

THE ABUSE PREVENTION ACT IMPLEMENTED THESE NEED-BASED REFORMS. TO ADDRESS THE VAGUENESS OF THE "SUBSTANTIAL ABUSE" STANDARD, THE ACT AUTHORIZES THE BANKRUPTCY COURT TO DISMISS A PETITION FILED UNDER CHAPTER 7 OR, WITH THE DEBTOR'S CONSENT, TO CONVERT SUCH A PETITION TO A CASE UNDER CHAPTERS 11 OR 13 "IF IT FINDS THAT THE GRANTING OF RELIEF WOULD BE AN ABUSE OF THE PROVISIONS OF THIS CHAPTER." 11 U.S.C. § 707(B)(1). THE ACT THEN PROVIDES SPECIFIC CRITERIA WHICH, IF SATISFIED, REQUIRE A

COURT TO PRESUME THE EXISTENCE OF ABUSE, REQUIRING "DISMISSAL [OR CONVERSION TO CHAPTER 13] BASED ON A CHAPTER 7 DEBTOR'S ABILITY TO REPAY." H.R. REP. 109-31(I), AT 15.

FIRST, A COURT IS TO COMPARE THE DEBTOR'S ANNUALIZED "CURRENT MONTHLY INCOME" TO THE "MEDIAN FAMILY INCOME" OF A SIMILARLY SIZED FAMILY IN THE DEBTOR'S STATE. IF THE DEBTOR'S CURRENT MONTHLY INCOME IS BELOW THE MEDIAN, THEN THE PRESUMPTION OF ABUSE DOES NOT ARISE AND THE COURT MAY NOT DISMISS THE CHAPTER 7 PETITION

FOR ABUSE BECAUSE OF ABILITY TO REPAY DEBTS. 11 U.S.C. § 707(B)(7); *SEE* H.R. REP. 109-31(I), AT 15. BOTH "CURRENT MONTHLY INCOME" AND "MEDIAN FAMILY INCOME" ARE DEFINED TERMS. THE FORMER GENERALLY INCLUDES "THE AVERAGE MONTHLY INCOME FROM ALL SOURCES THAT THE DEBTOR RECEIVES" OVER A SPECIFIED SIX-MONTH PERIOD. 11 U.S.C. § 101(10A). "MEDIAN FAMILY INCOME" IS THE MEDIAN INCOME FOR A PARTICULAR FAMILY SIZE IN THE APPLICABLE STATE, AS REPORTED BY THE BUREAU OF THE CENSUS. *ID.* § 101(39A); *ID.* § 707(B)(7)(A).

IF THE DEBTOR'S ANNUALIZED CURRENT MONTHLY INCOME EXCEEDS THE MEDIAN FAMILY INCOME, THEN, TO DETERMINE WHETHER THE PRESUMPTION OF ABUSE ARISES, THE STATUTE DIRECTS THE COURT TO REDUCE THE DEBTOR'S INCOME BY SPECIFIED AMOUNTS AND TO COMPARE THE RESULT TO CERTAIN BENCHMARKS.[1] *ID.* § 707(B)(2)(A). THE AMOUNTS BY WHICH A DEBTOR'S CURRENT MONTHLY INCOME IS REDUCED FALL INTO THREE CATEGORIES: (1)

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[1] THE BENCHMARKS ARE ADJUSTED EVERY THREE YEARS "TO REFLECT THE CHANGE IN THE CONSUMER PRICE INDEX." 11 U.S.C. § 104(B)(1)(A).

NECESSARY EXPENSES UNDER NATIONAL STANDARDS; (2) NECESSARY EXPENSES UNDER LOCAL STANDARDS; AND (3) OTHER NECESSARY EXPENSES ACTUALLY INCURRED. THE ABUSE PREVENTION ACT DEFINES THOSE CATEGORIES, IN THE FIRST INSTANCE, BY REFERENCE TO THE INTERNAL REVENUE SERVICE'S FINANCIAL ANALYSIS HANDBOOK. *IBID.*; *SEE* INTERNAL REVENUE SERV., INTERNAL REVENUE MANUAL, FINANCIAL ANALYSIS HANDBOOK (IRS HANDBOOK), *AVAILABLE AT* HTTP://WWW.IRS.GOV/IRM/PART5/

CH15S01.HTML.[2] THE IRS HANDBOOK EXPLAINS THAT THESE THREE CATEGORIES TOGETHER COMPRISE "NECESSARY EXPENSES," THAT IS, "EXPENSES THAT ARE NECESSARY TO PROVIDE FOR A TAXPAYER'S AND HIS OR HER FAMILY'S HEALTH AND WELFARE AND/OR PRODUCTION OF INCOME." IRS HANDBOOK § 5.15.1.7.

THE NATIONAL STANDARDS DEFINE AMOUNTS FOR FIVE NECESSARY EXPENSES: "FOOD, HOUSEKEEPING SUPPLIES, APPAREL AND SERVICES, AND PERSONAL CARE

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[2] THE IRS USES THE FINANCIAL ANALYSIS HANDBOOK TO DETERMINE THE AMOUNTS THAT DELINQUENT TAXPAYERS MUST PAY. *SEE* IRS HANDBOOK, § 5.15.1.1.

PRODUCTS AND SERVICES," AND A FIXED "MISCELLANEOUS" AMOUNT. *ID.* § 5.15.1.7(3). AS APPLIED IN THE BANKRUPTCY CONTEXT, THE NATIONAL STANDARDS ARE GEOGRAPHICALLY UNIFORM AMOUNTS FOR THE CONTINENTAL UNITED STATES BUT VARY ACCORDING TO A DEBTOR'S GROSS MONTHLY INCOME AND FAMILY SIZE. *SEE* U.S. TRUSTEE, IRS NATIONAL STANDARDS FOR ALLOWABLE LIVING EXPENSES (CASES FILED BETWEEN OCTOBER 1, 2006, AND JANUARY 31, 2007, INCLUSIVE), *AVAILABLE AT* HTTP://WWW.USDOJ.GOV/UST/EO/BA

PCPA/20061001/BCI_DATA/NATIONAL_EXPENSE _STANDARDS.HTM. THE U.S. TRUSTEE EXPLAINS THAT, "[D]UE TO THEIR UNIQUE GEOGRAPHIC CIRCUMSTANCES AND HIGHER COST OF LIVING, SEPARATE STANDARDS HAVE BEEN ESTABLISHED FOR ALASKA AND HAWAII." *IBID*.

THE LOCAL STANDARDS DEFINE AMOUNTS FOR TWO NECESSARY EXPENSES: HOUSING AND TRANSPORTATION. IRS HANDBOOK § 5.15.1.7(4). HOUSING EXPENSES, WHICH INCLUDE UTILITIES (*SEE ID*. § 5.15.1.9(1)(A)), "ARE ESTABLISHED FOR EACH COUNTY WITHIN A STATE" (*SEE ID*. § 5.15.1.7(4)(A)).

TRANSPORTATION EXPENSES "CONSIST OF NATIONWIDE FIGURES FOR LOAN OR LEASE PAYMENTS REFERRED TO AS OWNERSHIP COST, AND ADDITIONAL AMOUNTS FOR OPERATING COSTS BROKEN DOWN BY CENSUS REGION AND METROPOLITAN STATISTICAL AREA." *ID*. § 5.15.1.7(4)(B). THUS, LOCAL STANDARDS INCLUDE SOME GEOGRAPHIC VARIATION. *SEE* U.S. TRUSTEE, MEANS TESTING: CENSUS BUREAU, IRS DATA AND ADMINISTRATIVE EXPENSES MULTIPLIERS (CASES FILED BETWEEN OCTOBER 1, 2006, AND JANUARY 31, 2007, INCLUSIVE), SEC. 2,

LOCAL STANDARDS, *AVAILABLE AT* HTTP://WWW.USDOJ.GOV/UST/EO/BAPCPA/20061001/ MEANSTESTING.HTM.

THE IRS HANDBOOK PROVIDES A NON-EXHAUSTIVE LIST OF OTHER NECESSARY EXPENSES, BUT INCLUDES WITHIN THIS CATEGORY ANY EXPENSE THAT "MEET[S] THE NECESSARY EXPENSE TEST," THAT IS, ACTUAL EXPENSES THAT "PROVIDE FOR THE HEALTH AND WELFARE OF THE TAXPAYER AND/OR HIS OR HER FAMILY OR [ARE] FOR THE PRODUCTION OF INCOME." IRS HANDBOOK § 5.15.1.10(1).

THE ABUSE PREVENTION ACT ALLOWS SOME DEVIATION FROM

THE NATIONAL AND LOCAL STANDARDS, BASED ON ACTUAL EXPENSES. THUS, IT PERMITS A DEBTOR TO INCLUDE "AN ADDITIONAL ALLOWANCE FOR FOOD AND CLOTHING OF UP TO 5 PERCENT OF THE FOOD AND CLOTHING CATEGORIES AS SPECIFIED BY THE NATIONAL STANDARDS," IF THE DEBTOR DEMONSTRATES THAT THE ADDITIONAL ALLOWANCE IS REASONABLE AND NECESSARY. 11 U.S.C. § 707(B)(2)(A)(II)(I). IT ALSO PERMITS A DEBTOR TO CLAIM "AN ALLOWANCE FOR HOUSING AND UTILITIES, IN EXCESS OF THE ALLOWANCE SPECIFIED BY THE

LOCAL STANDARDS * * * BASED ON THE ACTUAL EXPENSES FOR HOME ENERGY COSTS IF THE DEBTOR PROVIDES DOCUMENTATION OF SUCH ACTUAL EXPENSES AND DEMONSTRATES THAT SUCH ACTUAL EXPENSES ARE REASONABLE AND NECESSARY." *ID.* § 707(B)(2)(A)(II)(V). THE ABUSE PREVENTION ACT ENUMERATES CERTAIN SPECIFIC EXPENSES (WHICH WOULD FALL UNDER THE IRS HANDBOOK'S UNDEFINED "OTHER NECESSARY EXPENSE" CATEGORY) SUCH AS "REASONABLY NECESSARY HEALTH INSURANCE, DISABILITY INSURANCE, AND HEALTH SAVINGS ACCOUNT

EXPENSES FOR THE DEBTOR, THE SPOUSE OF THE DEBTOR, OR THE DEPENDENTS OF THE DEBTOR"; EXPENSES THAT ARE "REASONABLE AND NECESSARY FOR CARE AND SUPPORT OF AN ELDERLY, CHRONICALLY ILL, OR DISABLED HOUSEHOLD MEMBER OR MEMBER OF THE DEBTOR'S IMMEDIATE FAMILY"; AND CERTAIN ACTUAL EDUCATIONAL EXPENSES (UP TO A SPECIFIED AMOUNT) FOR A DEPENDANT'S EDUCATION. *ID.* § 707(B)(2)(A)(II)(I), (II), (IV).

AFTER THE COURT REDUCES THE DEBTOR'S CURRENT MONTHLY INCOME BY THESE NECESSARY

EXPENSES, THE ABUSE PREVENTION ACT DIRECTS THE COURT TO APPLY A MATHEMATICAL FORMULA AND DETERMINE WHETHER THE RESULT IS ABOVE OR BELOW CERTAIN BENCHMARKS. *ID.* § 707(B)(2)(A)(I). IF THE RESULTING NUMBER IS ABOVE THE BENCHMARKS, THE COURT "SHALL PRESUME ABUSE EXISTS." *IBID.* AND, UNLESS THE DEBTOR REBUTS THE PRESUMPTION, THE COURT MAY DISMISS THE CHAPTER 7 PETITION OR, WITH THE DEBTOR'S CONSENT, CONVERT IT TO A PETITION UNDER CHAPTER 11 OR CHAPTER 13. *ID.* § 707(B)(1). THE PRESUMPTION OF ABUSE CAN BE

REBUTTED ONLY IF THE DEBTOR ESTABLISHES "SPECIAL CIRCUMSTANCES, SUCH AS A SERIOUS MEDICAL CONDITION OR A CALL OR ORDER TO ACTIVE DUTY IN THE ARMED FORCES" AND DEMONSTRATES THAT NECESSARY EXPENSES ASSOCIATED WITH THOSE SPECIAL CIRCUMSTANCES REDUCE THE DEBTOR'S CURRENT MONTHLY INCOME BELOW SPECIFIED BENCHMARKS. *ID.* § 707(B)(2)(B).[3]

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[3] EVEN IF THE DEBTOR REBUTS THE PRESUMPTION OF ABUSE, OR IF THE PRESUMPTION NEVER ARISES, A COURT MAY NEVERTHELESS FIND ABUSE IF IT DETERMINES THAT THE DEBTOR FILED IN BAD FAITH, OR IF THE TOTALITY OF THE CIRCUMSTANCES DEMONSTRATE ABUSE. 11 U.S.C. § 707(B)(3).

CONGRESS ENACTED ENFORCEMENT PROVISIONS TO ENSURE THAT THESE REFORMS WOULD BE IMPLEMENTED. UNDER THE ABUSE PREVENTION ACT, THE U.S. TRUSTEE (OR THE BANKRUPTCY ADMINISTRATOR) REVIEWS A CHAPTER 7 DEBTOR'S PETITION AND FILES WITH THE COURT A STATEMENT EXPLAINING WHETHER THE PRESUMPTION OF ABUSE ARISES UNDER SECTION 707(B). *ID.* § 704(B)(1). IF THE U.S. TRUSTEE DETERMINES THAT THE PRESUMPTION OF ABUSE ARISES, THEN HE FILES EITHER A MOTION TO DISMISS OR CONVERT THE CHAPTER 7 PETITION, OR A

STATEMENT EXPLAINING WHY HE BELIEVES SUCH A MOTION IS NOT APPROPRIATE. *ID.* § 704(B)(2).

THE ABUSE PREVENTION ACT ALSO AMENDED TWO ASPECTS OF BANKRUPTCY PETITIONS UNDER CHAPTER 13, THE PROVISION OF THE BANKRUPTCY CODE UNDER WHICH A DEBTOR REPAYS CREDITORS OUT OF THE DEBTOR'S DISPOSABLE INCOME FOR A SPECIFIED PERIOD IN EXCHANGE FOR DISCHARGE OF DEBTS.

FIRST, THE ABUSE PREVENTION ACT DEFINES "DISPOSABLE INCOME" TO INCLUDE "CURRENT MONTHLY INCOME RECEIVED BY THE DEBTOR

* * * LESS AMOUNTS REASONABLY NECESSARY TO BE EXPENDED." 11 U.S.C. § 1325(B)(2). IF THE DEBTOR'S ANNUALIZED CURRENT MONTHLY INCOME IS BELOW THE MEDIAN FAMILY INCOME FOR A SIMILARLY-SIZED FAMILY IN THE APPLICABLE STATE, THE "AMOUNTS REASONABLY NECESSARY TO BE EXPENDED" INCLUDE AMOUNTS FOR "THE MAINTENANCE OR SUPPORT OF THE DEBTOR OR A DEPENDENT OF THE DEBTOR, OR FOR A DOMESTIC SUPPORT OBLIGATION, THAT FIRST BECOMES PAYABLE AFTER THE DATE THE PETITION IS FILED"; FOR CERTAIN CHARITABLE

CONTRIBUTIONS; AND FOR CERTAIN BUSINESS EXPENSES. *IBID*. IF THE DEBTOR'S ANNUALIZED CURRENT MONTHLY INCOME EXCEEDS THE MEDIAN FAMILY INCOME FOR A SIMILARLY-SIZED FAMILY IN THE APPLICABLE STATE, THE ABUSE PREVENTION ACT REQUIRES THE COURT TO DETERMINE THE "AMOUNTS REASONABLY NECESSARY TO BE EXPENDED" IN ACCORDANCE WITH 11 U.S.C. § 707(B)(2)(A) AND (B), THAT IS, IN ACCORDANCE WITH THE IRS HANDBOOK'S NATIONAL, LOCAL, AND OTHER STANDARDS, AS MODIFIED BY THE ABUSE PREVENTION ACT. 11 U.S.C. § 1325(B)(3).

SECOND, IF A DEBTOR'S ANNUALIZED CURRENT MONTHLY INCOME EXCEEDS THE APPLICABLE MEDIAN FAMILY INCOME, THE COURT MUST REQUIRE A REPAYMENT PERIOD OF "NOT LESS THAN 5 YEARS." *ID.* § 1325(B)(4)(A)(II). IF THE DEBTOR'S ANNUALIZED INCOME IS LESS THAN THE MEDIAN, THEN THE REPAYMENT PERIOD IS THREE YEARS. *ID.* § 1325(B)(4)(A)(I).

BY REPLACING THE BANKRUPTCY CODE'S "PRESUMPTION IN FAVOR OF THE DEBTOR" UNDER CHAPTER 7 "WITH A MANDATORY PRESUMPTION OF ABUSE THAT WOULD ARISE

UNDER CERTAIN CONDITIONS" (H.R. REP. 109-31(I), AT 13), BY MODIFYING THE DISPOSABLE INCOME AND REPAYMENT PERIOD CALCULATIONS UNDER CHAPTER 13, AND BY EMPLOYING MEANS TESTS TO EFFECT THESE CHANGES, CONGRESS ACTED "TO ENSURE THAT DEBTORS REPAY CREDITORS THE MAXIMUM THEY CAN AFFORD" (*ID.* AT 2).

II. THE PROCEEDINGS BELOW

A. PLAINTIFFS ARE A HUSBAND AND WIFE WHO FILED A CHAPTER 13 PETITION IN THE UNITED STATES BANKRUPTCY COURT FOR THE EASTERN DISTRICT OF TENNESSEE IN NOVEMBER 2006. PLAINTIFFS ALSO

BROUGHT A SEPARATE SUIT AGAINST THE UNITED STATES IN THE DISTRICT COURT TO ARGUE THAT THE ABUSE PREVENTION ACT'S MEANS TESTING VIOLATES THE BANKRUPTCY CLAUSE'S UNIFORMITY REQUIREMENT.

THE DISTRICT COURT COMPLAINT ALLEGES THAT PLAINTIFFS' ANNUALIZED CURRENT MONTHLY INCOME IS GREATER THAN THE MEDIAN FAMILY INCOME FOR THE STATE OF TENNESSEE, THE STATE IN WHICH PLAINTIFFS RESIDE, BUT BELOW THE MEDIAN FAMILY INCOME OF OTHER STATES. (R. 2 AMENDED COMPL., P. 4, APX. P. __.)

PLAINTIFFS ALLEGE THAT THEY WOULD HAVE BEEN SUBJECT TO A MOTION TO DISMISS BY THE U.S. TRUSTEE HAD THEY FILED A PETITION UNDER CHAPTER 7 BECAUSE THEY WOULD HAVE BEEN "SUBJECT TO THE PRESUMPTION OF ABUSE UNDER 11 U.S.C. § 707(B)(2)." (R. 2 AMENDED COMPL., P. 6, APX. P. __.) PLAINTIFFS FURTHER ALLEGE THAT, BECAUSE THAT PROSPECT HAD A "CHILLING EFFECT" UPON THEM, THEY FILED A PETITION UNDER CHAPTER 13 INSTEAD OF CHAPTER 7. *IBID*. PLAINTIFFS' COMPLAINT ALLEGES THAT THEIR CHAPTER 13 PLAN, WHICH WAS CONFIRMED IN

JANUARY 2007, IMPOSES A FIVE-YEAR REPAYMENT PERIOD AND THAT, BECAUSE OF THE MEANS TESTS, THEY WERE UNABLE TO TAKE ADVANTAGE OF MORE GENEROUS INCOME EXCLUSIONS THAT ARE AVAILABLE TO CHAPTER 13 FILERS WHOSE INCOME IS BELOW THE MEDIAN. (R. 2 AMENDED COMPL., PP. 1, 9, APX. PP. __, __.)

PLAINTIFFS' COMPLAINT ASSERTS THAT FIVE PROVISIONS ENACTED BY THE ABUSE PREVENTION ACT VIOLATE THE BANKRUPTCY CLAUSE'S UNIFORMITY PROVISION. PLAINTIFFS CONTEND THAT THE "SAFE HARBOR" CREATED BY 11 U.S.C.

§ 707(B)(7), UNDER WHICH THE PRESUMPTION OF ABUSE DOES NOT ARISE FOR DEBTORS WHOSE INCOME IS LESS THAN THE MEDIAN FAMILY INCOME FOR THE APPLICABLE STATE, IS NOT UNIFORM "BECAUSE IT IS BASED UPON THE APPLICABLE MEDIAN FAMILY INCOME FOR THE STATE OF THE DEBTORS RESIDENCE WHICH VARIES WIDELY FROM STATE TO STATE." (R. 2 AMENDED COMPL., P. 5, APX. P. __.) THEY CLAIM THAT 11 U.S.C. § 707(B)(2)(A)(II) IS NOT UNIFORM BECAUSE THE EXPENSES IT IDENTIFIES TO BE SUBTRACTED FROM A DEBTOR'S CURRENT MONTHLY INCOME "ARE

BASED UPON THE NATIONAL AND LOCAL STANDARDS ISSUED BY THE INTERNAL REVENUE SERVICE AND ARE NOT UNIFORM FOR DEBTORS WITH THE SAME ANNUALIZED [CURRENT MONTHLY INCOME] AMONG THE VARIOUS STATES AND AMONG THE VARIOUS COUNTIES OF THE SAME JUDICIAL DISTRICT." (R. 2 AMENDED COMPL., P. 5, APX. P. __.) AND BECAUSE THE U.S. TRUSTEE MAY FILE A MOTION TO DISMISS OR CONVERT UNDER 11 U.S.C. § 704(B) ANY TIME THE PRESUMPTION OF ABUSE ARISES, BUT NOT IF THE DEBTOR'S CURRENT MONTHLY INCOME IS BELOW THE FAMILY MEDIAN

INCOME FOR THE APPLICABLE STATE, PLAINTIFFS CLAIM THAT SECTION 704(B) ALSO VIOLATES THE UNIFORMITY REQUIREMENT. (R. 2 AMENDED COMPL., PP. 5-5, APX. PP. __.) FINALLY, PLAINTIFFS CONTEND THAT 11 U.S.C. § 1325(B)(3)'S DETERMINATION OF "AMOUNTS REASONABLY NECESSARY TO BE EXPENDED" AND 11 U.S.C. § 1325(B)(4)'S DETERMINATION OF THE REPAYMENT PERIOD FOR CHAPTER 13 PLANS BOTH LACK UNIFORMITY BECAUSE THEY TURN ON "THE APPLICABLE MEDIAN FAMILY INCOME FOR THE STATE OF THE DEBTORS RESIDENCE WHICH VARIES

WIDELY FROM STATE TO STATE." (R. 2 AMENDED COMPL., P. 5, APX. P. __.)

PLAINTIFFS'S COMPLAINT SOUGHT A DECLARATION THAT THESE FIVE PROVISIONS VIOLATE THE BANKRUPTCY CLAUSE'S UNIFORMITY REQUIREMENT AND AN INJUNCTION, PROHIBITING THE UNITED STATES FROM ENFORCING THOSE PROVISIONS. (R. 2 AMENDED COMPL., P. 10, APX. P. __.)

B. THE PARTIES FILED CROSS-MOTIONS FOR SUMMARY JUDGMENT. THE DISTRICT COURT GRANTED THE GOVERNMENT'S MOTION AND DISMISSED PLAINTIFFS' COMPLAINT. (R. 29 MEMORANDUM, APX. P. __.)

THE DISTRICT COURT BEGAN ITS ANALYSIS "WITH THE PROPOSITION THAT THERE IS A PRESUMPTION THAT BANKRUPTCY LAWS ARE CONSTITUTIONAL." (R. 29 MEMORANDUM, P. 4, APX. P. __.) IT EXPLAINED THAT "[T]HE ISSUE HERE IS VERY SIMPLE AND STRAIGHTFORWARD. IS [THE ABUSE PREVENTION ACT] A UNIFORM LAW ON THE SUBJECT OF BANKRUPTCY?" *IBID*. THE DISTRICT COURT THEN CANVASSED THE SUPREME COURT'S APPLICATION OF THE BANKRUPTCY CLAUSE OVER THE LAST HUNDRED YEARS. IT NOTED THAT THE SUPREME COURT UPHELD THE

INCORPORATION OF EXEMPTIONS DEFINED BY STATE LAW IN THE BANKRUPTCY ACT OF 1898 AS, "'IN THE CONSTITUTIONAL SENSE, UNIFORM THROUGHOUT THE UNITED STATES'" BECAUSE "'[T]HE GENERAL OPERATION OF THE LAW IS UNIFORM ALTHOUGH IT MAY RESULT IN CERTAIN PARTICULARS DIFFERENTLY IN DIFFERENT STATES.'" (R. 29 MEMORANDUM, P. 4, APX. P. __ (QUOTING *HANOVER NAT'L BANK V. MOYSES*, 186 U.S. 181 (1902).) THE DISTRICT COURT OBSERVED THAT THE SUPREME COURT UPHELD CONGRESS' INCORPORATION OF STATE FRAUDULENT CONVEYANCE

STATUTES ON THE SAME RATIONALE, "EVEN THOUGH THE OPERATION OF THOSE STATUTES VARIED FROM STATE TO STATE." (R. 29 MEMORANDUM, P. 5, APX. P. __ (DISCUSSING *STELLWAGEN V. CLUM*, 245 U.S. 605 (1918).) AND THE SUPREME COURT ALSO HELD THAT, IN THE ABSENCE OF POSITIVE FEDERAL LAW, "STATE TORT AND CONTRACT LAW DETERMINES THE VALIDITY OF CREDITORS' CLAIMS." (*IBID.* (DISCUSSING *VANSTON BONDHOLDERS PROTECTIVE COMM. V. GREEN*, 329 U.S. 156 (1946).) THE DISTRICT COURT DETERMINED THAT THIS PRECEDENT "MAKES IT CLEAR THAT

THE UNIFORMITY REQUIREMENT DOES NOT PROSCRIBE DIFFERENT RESULTS IN DIFFERENT STATES BECAUSE OF STATE LAW VARIATIONS." (*IBID.*)

THE PLAINTIFFS ARGUED THAT WHILE THE BANKRUPTCY CLAUSE PERMITS CONGRESS TO INCORPORATE STATE LAW CLASSIFICATIONS THAT PRODUCE DIFFERENT RESULTS, THE UNIFORMITY REQUIREMENT PROHIBITS CONGRESS FROM ENACTING FEDERAL STANDARDS THAT HAVE THE SAME EFFECT. (*IBID.*) THE DISTRICT COURT FOUND THIS ARGUMENT UNPERSUASIVE

"FOR SEVERAL REASONS." (*IBID.*) FIRST, "[P]LAINTIFFS HAVE SUPPLIED NO PRINCIPLED REASON FOR CONCLUDING THAT VARIATIONS RESULTING FROM FEDERAL STATISTICS CREATE UNCONSTITUTIONAL NON-UNIFORMITY, WHEREAS VARIATIONS RESULTING FROM STATE LAW DO NOT." (*IBID.*) IN ANY EVENT, "THE EXEMPTIONS THAT PRODUCE DIFFERENT RESULTS IN DIFFERENT STATES ARE ALSO THE RESULT OF FEDERAL LEGISLATION INCORPORATING THOSE EXEMPTIONS INTO BANKRUPTCY LAW." (*IBID.*) IN FACT, "[T]HE

SUPREME COURT HAS UPHELD CONGRESSIONAL LEGISLATION DEALING WITH RAILROAD REORGANIZATION IN A STATUTORILY DEFINED REGION[, EXPLAINING THAT] ‘[T]HE UNIFORMITY PROVISION DOES NOT DENY CONGRESS POWER TO TAKE INTO ACCOUNT DIFFERENCES THAT EXIST IN DIFFERENT PARTS OF THE COUNTRY.’” (R. 29 MEMORANDUM, PP. 5-6, APX. P. ___-___ (QUOTING *BLANCHETTE V. CONN. GEN. INS. CORP.*, 419 U.S. 102, 159 (1974).)

THE DISTRICT COURT NOTED THAT THE SUPREME COURT HAS ONLY ONCE HELD THAT A

BANKRUPTCY ACT VIOLATES THE UNIFORMITY REQUIREMENT, AND THAT WAS IN A CASE IN WHICH "THE LEGISLATION AT ISSUE APPLIED TO ONLY ONE REGIONAL BANKRUPT RAILROAD, WHEREAS [THE ABUSE PREVENTION ACT] APPLIES NATIONWIDE." (R. 29 MEMORANDUM, P. 6, APX. P. __ (DISCUSSING *RWY. LABOR EXECUTIVES ASS'N V. GIBBONS*, 455 U.S. 457 (1982).) AND EVEN IN THAT CASE, THE SUPREME COURT RECOGNIZED THAT BANKRUPTCY CLAUSE PERMITS CONGRESS "'TO DEFINE CLASSES OF DEBTORS AND TO STRUCTURE RELIEF ACCORDINGLY.'" (R. 29 MEMORANDUM, PP. 6, APX. P. __

(QUOTING *GIBBONS*, 455 U.S. AT 473).) AND THAT, THE DISTRICT COURT HELD, "IS PRECISELY WHAT CONGRESS HAS DONE IN THE [THE ABUSE PREVENTION ACT]." (*IBID.*) "DISPOSABLE INCOME MAY VARY FROM PLACE TO PLACE, BUT IT IS BASED ON UNIFORMLY CALCULATED NATIONAL STATISTICS." (*IBID.*) FOR THAT REASON, "[T]HE VARIATIONS IN THE RESULTS PRODUCED BY THESE STATISTICS ARE OF NO CONSTITUTIONAL CONSEQUENCE." (*IBID.*)

SUMMARY OF ARGUMENT

I. PLAINTIFFS CHALLENGE FIVE SEPARATE PROVISIONS ENACTED BY

THE ABUSE PREVENTION ACT, BUT PLAINTIFFS LACK STANDING TO CHALLENGE TWO OF THOSE PROVISIONS. 11 U.S.C. § 707(B)(2) ESTABLISHES A PRESUMPTION OF ABUSE, REQUIRING DISMISSAL OR CONVERSION, IF A DEBTOR'S ANNUALIZED CURRENT MONTHLY INCOME IS GREATER THAN THE APPLICABLE MEDIAN FAMILY INCOME *AND* IF THE DEBTOR'S CURRENT MONTHLY INCOME, WHEN REDUCED BY ALLOWABLE NECESSARY EXPENSES AND SUBJECT TO A MATHEMATICAL FORMULA, IS GREATER THAN A STATUTORY BENCHMARK. AND UNDER 11 U.S.C. §

704(B), THE U.S. TRUSTEE EVALUATES A DEBTOR'S PETITION AND INFORMS THE COURT WHEN HE BELIEVES THE PRESUMPTION OF ABUSE ARISES AND FILES A MOTION TO DISMISS OR CONVERT, WHEN APPROPRIATE.

PLAINTIFFS CHALLENGE SECTION 707(B)(2) BECAUSE, THEY SAY, THEY ARE SUBJECT TO THE PRESUMPTION OF ABUSE. BUT THEY POINT TO NO EVIDENCE IN THE RECORD TO SUBSTANTIATE THAT CLAIM. ALTHOUGH PLAINTIFFS HAVE ESTABLISHED THAT THEIR ANNUALIZED CURRENT MONTHLY INCOME IS ABOVE THE APPLICABLE MEDIAN FAMILY, THEY HAVE NOT

ALLEGED THAT THEIR CURRENT MONTHLY INCOME, WHEN REDUCED AND SUBJECT TO THE MATHEMATICAL FORMULA, IS ABOVE THE STATUTORY BENCHMARK. ACCORDINGLY, PLAINTIFFS HAVE NOT ADEQUATELY ALLEGED THE REQUISITE INJURY TO CHALLENGE EITHER SECTION 704(B) OR SECTION 707(B)(2).

PLAINTIFFS ARGUE THAT THEY HAVE STANDING TO CHALLENGE THESE PROVISIONS BECAUSE A PETITION FILED UNDER CHAPTER 7 THAT IS SUBJECT TO THE PRESUMPTION OF ABUSE CAN BE DISMISSED RATHER THAN

CONVERTED INTO A CHAPTER 13 PROCEEDING, AND BECAUSE THEIR ATTORNEY COULD BE SUBJECT TO FEES AND PENALTIES FOR FILING A PETITION GIVING RISE TO THE PRESUMPTION OF ABUSE. FOR THESE REASONS, THEY SAY SECTIONS 704(B) AND 707(B)(2) COERCED THEM INTO FILING A CHAPTER 13 PETITION. BECAUSE PLAINTIFFS HAVE NOT SHOWN THAT THE PRESUMPTION OF ABUSE WOULD APPLY TO THEIR PETITION, NEITHER OF THESE ARGUMENTS HAS MERIT. AND THEY LACK MERIT EVEN ON THEIR OWN TERMS. A DEBTOR WHO FILES UNDER CHAPTER 7 HAS A RIGHT TO

CONVERT TO A CHAPTER 13 PROCEEDING SO LONG AS THE DEBTOR HAS NOT FILED IN BAD FAITH OR OTHERWISE ACTED INAPPROPRIATELY. AND A DEBTOR'S ATTORNEY IS SUBJECT TO FEES AND PENALTIES ONLY IF HE FILES FRIVOLOUS OR INAPPROPRIATE DOCUMENTS, A SANCTION WHICH APPLIES IN CHAPTER 13 PROCEEDINGS AS WELL.

II. IN ANY EVENT, THE FIVE ABUSE PREVENTION ACT PROVISIONS PLAINTIFFS CHALLENGE ARE A VALID EXERCISE OF CONGRESS' BANKRUPTCY CLAUSE POWER.

A. PLAINTIFFS CONTEND THAT, BECAUSE THE ABUSE PREVENTION ACT PROVISIONS EMPLOY STANDARDS THAT TAKE INTO ACCOUNT REGIONAL ECONOMIC VARIATION, THIS COURT MUST ENGAGE IN SOME TYPE OF HEIGHTENED SCRUTINY, AND THEY SUGGEST THAT IT IS THE GOVERNMENT'S BURDEN TO ESTABLISH THE CONSTITUTIONALITY OF THE PROVISIONS. THAT IS MISTAKEN. ALL CONGRESSIONAL ACTS ARE ENTITLED TO A PRESUMPTION OF CONSTITUTIONALITY AND A PLAINTIFF ALWAYS BEARS THE

BURDEN OF ESTABLISHING INVALIDITY. CONGRESS' USE OF GEOGRAPHIC CLASSIFICATIONS IN A BANKRUPTCY STATUTE DOES NOT CHANGE A PLAINTIFF'S BURDEN. AND, CONTRARY TO PLAINTIFFS' SUGGESTION, WHEN EVALUATING A GEOGRAPHIC CLASSIFICATION USED IN A BANKRUPTCY ACT, THE SUPREME COURT DOES NOT ENGAGE IN HEIGHTENED SCRUTINY. AS IS CLEAR FROM THE COURT'S DECISION IN *BLANCHETTE* – A CASE INVOLVING AN EXPLICIT GEOGRAPHIC CLASSIFICATION – THE COURT SIMPLY EVALUATES THE TEXT OF THE LEGISLATION AND ANY

LEGISLATIVE HISTORY TO DETERMINE WHETHER THE CLASSIFICATIONS SATISFIES THE UNIFORMITY REQUIREMENT, AS THAT REQUIREMENT HAS BEEN INTERPRETED BY THE COURT.

B. THE SUPREME COURT AND THIS COURT'S PRECEDENT RECOGNIZE THAT THE BANKRUPTCY CLAUSE GIVES CONGRESS BROAD POWER TO FASHION BANKRUPTCY LEGISLATION THAT RESULTS IN REGIONAL VARIATION.

THE SUPREME COURT HAS UPHELD INCORPORATION INTO FEDERAL BANKRUPTCY LAW OF VARIOUS STATE LAWS, EVEN THOUGH THE APPLICATION OF THE

RESULTING LAW PRODUCES DIFFERENT OUTCOMES IN DIFFERENT STATES. THIS PRECEDENT FURTHER SHOWS THAT CONGRESS HAS EXTREMELY BROAD POWER TO DEFINE CLASSES OF DEBTORS AND TO PRESCRIBE DIFFERENT TREATMENT UNDER THE BANKRUPTCY LAWS FOR THE DIFFERENT CLASSES. AND THE SUPREME COURT HAS EXPRESSLY RECOGNIZED THAT CONGRESS HAS THE POWER, UNDER THE BANKRUPTCY CLAUSE, "TO TAKE INTO ACCOUNT DIFFERENCES THAT EXIST BETWEEN DIFFERENT PARTS OF THE COUNTRY." *BLANCHETTE*, 419

U.S. AT 159. INDEED, THE SUPREME COURT HAS ONLY ONCE INVALIDED A BANKRUPTCY LAW, AND THAT WAS WHEN CONGRESS CREATED A PRIVATE BANKRUPTCY BILL TO GOVERN THE BANKRUPTCY OF A SINGLE DEBTOR, AN ACTION THE BANKRUPTCY CLAUSE WAS MEANT TO PREVENT.

THE SUPREME COURT'S AND THIS COURT'S SETTLED PRECEDENT ESTABLISH THAT THE ABUSE PREVENTION ACT PROVISIONS ARE A VALID EXERCISE OF CONGRESS' BANKRUPTCY CLAUSE POWER. SECTIONS 707(B)(7), 1325(B)(3), AND 1325(B)(4) DISTINGUISH AMONG

CLASSES OF DEBTORS AND PRESCRIBE DIFFERENT TREATMENT FOR EACH CLASS OF DEBTORS. THE TREATMENT THE MEMBERS OF EACH CLASS RECEIVE IS UNIFORM THROUGHOUT THE UNITED STATES. THAT IS ALL THE BANKRUPTCY CLAUSE REQUIRES. SIMILARLY, CONGRESS WAS AUTHORIZED TO ADOPT THE MEANS TEST ESTABLISHED BY SECTION 707(B)(2)(A) AS A MECHANISM FOR ENSURING THAT DEBTORS REPAY CREDITORS TO THE MAXIMUM THEY CAN AFFORD. IN ADDRESSING THAT PROBLEM, CONGRESS WAS NOT REQUIRED TO IGNORE THE

VARIATIONS IN REGIONAL ECONOMIES THAT AFFECT DEBTOR'S ABILITY TO REPAY. AND BECAUSE THAT PROVISION IS WITHIN CONGRESS' AUTHORITY, SO TOO IS SECTION 704(B), WHICH CONGRESS ENACTED TO ENFORCE THE REQUIREMENTS OF SECTION 707(B)(2).

PLAINTIFFS' ARGUMENTS TO THE CONTRARY LACK MERIT. FIRST, THEY CONTEND THAT, WHILE CONGRESS MAY PERMISSIBLY INCORPORATE STATE LAW INTO BANKRUPTCY STATUTES, IT MAY NOT PERMISSIBLY EMPLOY REGIONAL CLASSIFICATIONS AS A MATTER OF FEDERAL LAW. THAT

CONTENTION IS FLATLY INCONSISTENT WITH THE BANKRUPTCY AND TAX CASES IN WHICH THE SUPREME COURT UPHELD FEDERAL STATUTES THAT EMPLOY REGIONAL CLASSIFICATIONS AGAINST UNIFORMITY CHALLENGES. THE ARGUMENT ALSO IGNORES THE COURT'S REPEATED HOLDING THAT CONGRESS MAY TAKE INTO ACCOUNT REGIONAL DIFFERENCES WHEN ENACTING BANKRUPTCY LEGISLATION.

NEXT, PLAINTIFFS ARGUE THAT THE ABUSE PREVENTION ACT PROVISIONS ARE INCONSISTENT

WITH THE SUPREME COURT'S TREATMENT OF UNIFORMITY IN ITS TAXATION CASES. BUT THAT, TOO, IS MISTAKEN. THE COURT HAS UPHELD FEDERAL TAXES THAT RESULT IN REGIONAL VARIATION WHEN IT DETERMINES THAT CONGRESS DID NOT ENACT THE TAX FOR REASONS OF FAVORITISM TOWARDS OR DISCRIMINATION AGAINST THE CITIZENS OF A STATE. PLAINTIFFS HAVE NOT ESTABLISHED THAT CONGRESS ACTED WITH THAT IMPROPER INTENTION IN ENACTING THE ABUSE PREVENTION ACT OR THAT THE STATUTE HAS

DISCRIMINATORY (AS OPPOSED TO DISPARATE) EFFECT.

FINALLY, PLAINTIFFS CONTEND THAT THE MECHANISM CONGRESS ADOPTED DOES NOT APPROPRIATELY REMEDY THE EVIL CONGRESS SOUGHT TO REMEDY. BUT WHETHER CONGRESS' CHOICE OF REMEDY WAS WISE HAS NO BEARING ON WHETHER THE CLASSIFICATION CONGRESS EMPLOYED SATISFY THE UNIFORMITY REQUIREMENT.

STANDARD OF REVIEW

THIS COURT REVIEWS DE NOVO A DISTRICT COURT'S GRANT OF SUMMARY JUDGMENT. *HELMS V.*

ZUBATY, 495 F.3D 252, 255 (6TH CIR. 2007).

ARGUMENT

I. BECAUSE THEY HAVE NOT ADEQUATELY ALLEGED THAT THEY ARE SUBJECT TO THE PRESUMPTION OF ABUSE, PLAINTIFFS LACK STANDING TO CHALLENGE 11 U.S.C. §§ 704(B) AND 707(B)(2).

PLAINTIFFS HERE CHALLENGE FIVE SEPARATE PROVISIONS OF THE ABUSE PREVENTION ACT. BUT THEY HAVE FAILED TO ESTABLISH THEIR STANDING TO CONTEST THE VALIDITY OF TWO OF THOSE PROVISIONS.

A. ARTICLE III, SECTION 2 OF THE CONSTITUTION LIMITS THE FEDERAL COURTS' JURISDICTION TO "CASES" AND "CONTROVERSIES." "ONE COMPONENT OF THE

CASE-OR-CONTROVERSY REQUIREMENT IS STANDING, WHICH REQUIRES A PLAINTIFF TO DEMONSTRATE THE NOW-FAMILIAR ELEMENTS OF INJURY IN FACT, CAUSATION, AND REDRESSABILITY." *LANCE V. COFFMAN*, 127 S. CT. 1194, 1196 (2007). TO ALLEGE INJURY IN FACT, A PLAINTIFF MUST ALLEGE "AN INVASION OF A LEGALLY PROTECTED INTEREST WHICH IS (A) CONCRETE AND PARTICULARIZED, AND (B) ACTUAL OR IMMINENT, NOT CONJECTURAL OR HYPOTHETICAL." *LUJAN V. DEFENDERS OF WILDLIFE*, 504 U.S. 555, 560 (1992).

"[A] PLAINTIFF MUST DEMONSTRATE STANDING FOR EACH CLAIM HE SEEKS TO PRESS * * * [AND] MUST DEMONSTRATE STANDING SEPARATELY FOR EACH FORM OF RELIEF SOUGHT." *DAIMLERCHRYSLER CORP. V. CUNO*, 126 S. CT. 1854, 1867 (2006). TO HAVE STANDING FOR FORWARD-LOOKING, INJUNCTIVE RELIEF, SUCH AS IS SOUGHT HERE, A PLAINTIFF MUST SHOW THAT HE FACES "A REAL AND IMMEDIATE THREAT" OF FUTURE INJURY. *ADARAND CONSTRUCTORS, INC. V. PENA*, 515 U.S. 200, 211 (1995).

"[S]TANDING CANNOT BE INFERRED ARGUMENTATIVELY FROM

AVERMENTS IN THE PLEADINGS, BUT RATHER MUST AFFIRMATIVELY APPEAR IN THE RECORD," AND "IT IS THE BURDEN OF THE PARTY WHO SEEKS THE EXERCISE OF JURISDICTION IN HIS FAVOR, CLEARLY TO ALLEGE FACTS DEMONSTRATING THAT HE IS A PROPER PARTY TO INVOKE JUDICIAL RESOLUTION OF THE DISPUTE." *SPENCER V. KEMNA*, 523 U.S. 1, 10-11 (1998) (QUOTATION MARKS OMITTED). MOREOVER, "ARTICLE III STANDING IS A JURISDICTIONAL REQUIREMENT THAT CANNOT BE WAIVED, AND SUCH MAY BE BROUGHT UP AT ANY TIME IN THE

PROCEEDING." *ZURICH INS. CO. V. LOGITRANS, INC.*, 297 F.3D 528, 531 (6TH CIR. 2002).

B. HERE, PLAINTIFFS HAVE FAILED TO SHOW THAT THEY HAVE BEEN INJURED BY 11 U.S.C. § 707(B)(2), THE ABUSE PREVENTION ACT MEANS TEST ESTABLISHING THAT A DEBTOR WITH AN ANNUALIZED CURRENT MONTHLY INCOME EXCEEDING THE APPLICABLE MEDIAN FAMILY INCOME IS NOT SUBJECT TO THE PRESUMPTION OF ABUSE.

PLAINTIFFS' COMPLAINT ALLEGES "THAT, BECAUSE THEIR ANNUALIZED [CURRENT MONTHLY INCOME]

EXCEEDS THE MEDIAN FAMILY INCOME FOR RESIDENTS OF THE STATE OF TENNESSEE, [PLAINTIFFS] ARE SUBJECT TO THE PRESUMPTION OF ABUSE UNDER 11 U.S.C. § 707(B)(2)." (R. 2 AMENDED COMPL., P. 9, APX. P. __.) AND, ON APPEAL, THE PRINCIPAL INJURY ON WHICH THE PLAINTIFFS RELY TO ESTABLISH THEIR STANDING TO CHALLENGE SECTION 707(B)(2) IS THE SUPPOSED APPLICATION OF THE PRESUMPTION OF ABUSE TO THEM. PLS.' BR. 35-37. BUT THE FACT THAT A DEBTOR'S ANNUALIZED CURRENT MONTHLY INCOME EXCEEDS THE MEDIAN FAMILY INCOME IS NOT ITSELF

SUFFICIENT TO CREATE THE PRESUMPTION OF ABUSE. AS EXPLAINED ABOVE, IN THAT CIRCUMSTANCE, A COURT MUST REDUCE THE DEBTOR'S CURRENT MONTHLY INCOME BY ALLOWABLE NECESSARY EXPENSES. 11 U.S.C. § 707(B)(2)(A)(I). AFTER THE COURT REDUCES THE DEBTOR'S CURRENT MONTHLY INCOME, THE ABUSE PREVENTION ACT REQUIRES IT TO APPLY A MATHEMATICAL FORMULA AND TO COMPARE THE RESULTING NUMBER TO SPECIFIED BENCHMARKS. *IBID*. IF THE RESULTING NUMBER IS BELOW THE BENCHMARKS, THEN THE

PRESUMPTION OF ABUSE DOES NOT ARISE. *IBID*.

AT NO POINT IN THE DISTRICT COURT DID PLAINTIFFS ALLEGED THAT, AFTER THE APPROPRIATE REDUCTIONS AND CALCULATIONS, THEY WOULD BE SUBJECT TO THE PRESUMPTION OF ABUSE. ON APPEAL, PLAINTIFFS STATE THAT "SECTION 707(B)(2) REQUIRES THE BANKRUPTCY COURT TO 'PRESUME ABUSE EXISTS' UNDER CERTAIN MATHEMATICAL CALCULATIONS, *WHICH THE APPELLANTS ADMITTEDLY EXCEED*." BR. 35 (EMPHASIS ADDED). BUT A PLAINTIFF MAY NOT ESTABLISH

STANDING BY "ADMITTING" INJURY, AS PLAINTIFFS ATTEMPT TO DO. HE OR SHE MUST, INSTEAD, AVER SPECIFIC FACTS TO ESTABLISH STANDING. *SEE, E.G., SPENCER*, 523 U.S. AT 11 ("[I]T IS THE BURDEN OF THE PARTY WHO SEEKS THE EXERCISE OF JURISDICTION IN HIS FAVOR, CLEARLY TO ALLEGE FACTS DEMONSTRATING THAT HE IS A PROPER PARTY TO INVOKE JUDICIAL RESOLUTION OF THE DISPUTE." (QUOTATION MARKS OMITTED)). PLAINTIFFS POINT TO NOTHING IN THE RECORD TO SUPPORT THEIR CLAIM THAT THEIR CURRENT MONTHLY INCOME, WHEN REDUCED

BY ALLOWABLE EXPENSES AND SUBJECT TO THE STATUTORY CALCULATION, WOULD EXCEED THE BENCHMARKS. ACCORDINGLY, THEY HAVE NOT ADEQUATELY ALLEGED THAT THEY ARE SUBJECT TO THE PRESUMPTION OF ABUSE, AND SO THEY LACK STANDING TO CHALLENGE SECTION 707(B)(2).[4]

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[4] PLAINTIFFS WERE CLEARLY ON NOTICE IN THE DISTRICT COURT THAT THEY HAD FAILED TO ADEQUATELY ALLEGE THAT THEY WOULD BE SUBJECT TO THE PRESUMPTION OF ABUSE. (*SEE, E.G.,* R. 15 DEFENDANTS' STATEMENT OF MATERIAL FACTS, P. 3, APX. P. __ ("[P]LAINTIFFS, AND DEBTORS GENERALLY, ARE NOT SUBJECT TO A PRESUMPTION OF ABUSE IN A CHAPTER 7 CASE MERELY BECAUSE THEIR ANNUALIZED CURRENT MONTHLY INCOME EXCEEDS THE MEDIAN FAMILY INCOME FOR THE

AND BECAUSE PLAINTIFFS HAVE NOT ESTABLISHED THAT THEY WOULD BE SUBJECT TO THE PRESUMPTION OF ABUSE, THEY ALSO LACK STANDING TO CHALLENGE 11 U.S.C. § 704(B), UNDER WHICH THE U.S. TRUSTEE INFORMS THE COURT WHEN HE BELIEVES THE PRESUMPTION OF ABUSE APPLIES.

C. ON APPEAL, PLAINTIFFS IDENTIFY TWO OTHER INJURIES THEY CONTEND THEY HAVE

STATE WHERE THEY RESIDE.").) PLAINTIFFS TOOK NO STEPS TO AMEND THEIR COMPLAINT IN LIGHT OF THIS OMISSION. IN ANY EVENT, WHETHER OR NOT THEY WERE ON NOTICE, THE BURDEN OF ESTABLISHING STANDING IS THE PLAINTIFFS'. *CUNO*, 126 S. CT. AT 1867.

SUFFERED AS A RESULT OF SECTIONS 704(B) AND 707(B)(2). FIRST, THE ARGUE THAT, HAD THEY FILED A PETITION UNDER CHAPTER 7 AND, HAD THE COURT FOUND ABUSE, THEIR ATTORNEY COULD POSSIBLY HAVE BEEN SUBJECT TO FEES AND CIVIL PENALTIES. PLS.' BR. 36. THEY ALSO ARGUE THAT, BECAUSE WERE THEY SUBJECT TO THE PRESUMPTION OF ABUSE, THE COURT COULD DISMISS THEIR CHAPTER 7 PETITION OUTRIGHT RATHER THAN CONVERT TO A CHAPTER 13 CASE BECAUSE THERE IS NO ABSOLUTE RIGHT TO CONVERT. PLS.' BR. 35-36. FOR THESE REASONS, PLAINTIFFS

CONTEND THEY WERE "COERCED" INTO FILING A CHAPTER 13 PETITION. *ID.* AT 36. AND THEY ARGUE THAT IT IS TO AVOID SUCH THREATENED INJURY THAT THE SUPREME COURT HAS RECOGNIZED THAT A PLAINTIFF NEED NOT VIOLATE THE LAW IN ORDER TO HAVE STANDING TO CHALLENGE IT, IF THE LAW EFFECTIVELY COERCED COMPLIANCE. *ID.* AT 32-33 (DISCUSSING *MEDIMMUNE, INC. V. GENETECH, INC.*, 127 S. CT. 764 (2007)).

BUT PLAINTIFFS HAVE NOT ESTABLISHED THAT THEY WERE COERCED INTO FILING A CHAPTER 13 PETITION. THE U.S. TRUSTEE MAKES

PUBLICLY AVAILABLE THE RELEVANT DATA UNDER THE NATIONAL AND LOCAL STANDARDS. *SEE, E.G.,* U.S. TRUSTEE, MEANS TESTING: CENSUS BUREAU, IRS DATA AND ADMINISTRATIVE EXPENSES MULTIPLIERS (CASES FILED BETWEEN OCTOBER 1, 2006, AND JANUARY 31, 2007, INCLUSIVE), *AVAILABLE AT* HTTP://WWW.USDOJ.GOV/UST/EO/BAPCPA/20061001/MEANSTESTING.HTM. AND THE REMAINING RELEVANT DATA – A DEBTOR'S OTHER NECESSARY EXPENSES ACTUALLY INCURRED – IS IN THE POSSESSION OF EACH DEBTOR. THUS,

PROSPECTIVE DEBTORS (OR THEIR ATTORNEYS) CAN DETERMINE FOR THEMSELVES WHETHER THEIR CURRENT MONTHLY INCOME WHEN REDUCED BY ALLOWABLE NECESSARY EXPENSES AND SUBJECT TO THE STATUTORY FORMULA WILL COME WITHIN THE BENCHMARKS, THUS ELIMINATING THE PRESUMPTION OF ABUSE. AS EXPLAINED, PLAINTIFFS HAVE NOT ALLEGED THAT THEIR REDUCED CURRENT MONTHLY INCOME WOULD PRODUCE THE PRESUMPTION OF ABUSE. ACCORDINGLY, THEY HAVE NOT ADEQUATELY ALLEGED THAT THEY

WERE "COERCED" INTO FILING A CHAPTER 13 PETITION.

NOR DOES THE ABSENCE OF AN "ABSOLUTE" RIGHT TO CONVERT A CHAPTER 7 PETITION INTO A CHAPTER 13 CASE DEMONSTRATE COERCION. PLAINTIFFS CANNOT DISPUTE THAT THE ABUSE PREVENTION ACT GIVES A DEBTOR THE RIGHT "[TO] CONVERT A CASE UNDER THIS CHAPTER TO A CASE UNDER CHAPTER 11, 12, OR 13 OF THIS TITLE AT ANY TIME" IF THE CASE HAS NOT PREVIOUSLY BEEN CONVERTED, PROVIDED THAT THE DEBTOR IS ELIGIBLE TO BE A DEBTOR UNDER THE NEW CHAPTER.

11 U.S.C. § 706(A), (D). RELYING ON THE SUPREME COURT'S RECENT DECISION IN *IN RE MARRAMA*, PLAINTIFFS SUGGEST THAT, HAD THEY FILED A CHAPTER 7 PETITION, AND HAD THE PRESUMPTION OF ABUSE APPLIED, "THERE IS NOTHING IN THE SECTION 707(B) THAT PREVENTS THE BANKRUPTCY COURT FROM SIMPLY DISMISSING THE CASE." PLS.' BR. 15; *SEE ID.* AT 16 (CITING *IN RE MARRAMA*, 127 S. CT. 1105 (2007)).

HOWEVER, IN *IN RE MARRAMA*, THE SUPREME COURT HELD THAT THE DEBTOR "FORFEITED HIS RIGHT" TO CONVERT HIS CHAPTER 7 PROCEEDING TO A CHAPTER 13

PROCEEDING BECAUSE THE DEBTOR'S REQUEST TO CONVERT WAS MADE IN BAD FAITH AND WOULD BE AN ABUSE OF THE BANKRUPTCY PROCESS. 127 S. CT. AT 1109. FOR THAT REASON, THE COURT HELD, THE DEBTOR WOULD NOT BE ELIGIBLE TO BE A DEBTOR UNDER CHAPTER 13. *ID.* AT 1109-1111. ACCORDINGLY, "THE TEXT OF § 706(D)," WHICH AUTHORIZES CONVERSION ONLY IF THE DEBTOR COULD BE A DEBTOR UNDER THE NEW CHAPTER, "PROVIDES ADEQUATE AUTHORITY FOR THE DENIAL OF HIS MOTION TO CONVERT." *ID.* AT 1111.

PLAINTIFFS CITE NO AUTHORITY TO SUPPORT THEIR SUGGESTION THAT, IN THE ABSENCE OF BAD FAITH OR OTHER IMPROPRIETY ON THE PART OF A DEBTOR, A COURT WOULD DISMISS A CHAPTER 7 PETITION RATHER THAN COVERT IT TO A CHAPTER 13 PROCEEDING, IF THE DEBTOR WOULD PREFER CONVERSION TO DISMISSAL. IN FACT, DISMISSAL IN THAT CONTEXT WOULD BE INCONSISTENT WITH THE STATUTORY TEXT. *COMPARE* 11 U.S.C. § 706(A), (D) (ESTABLISHING A RIGHT TO CONVERT A CHAPTER 7 PETITION INTO A CHAPTER 13 CASE "AT ANY TIME" IF THE DEBTOR IS ELIGIBLE

TO BE A DEBTOR UNDER CHAPTER 13 AND THE CASE HAS NOT PREVIOUSLY BEEN CONVERTED) *WITH ID*. § 707(B)(1) (AUTHORIZING A COURT TO "DISMISS A CASE FILED BY AN INDIVIDUAL DEBTOR UNDER [CHAPTER 7] WHOSE DEBTS ARE PRIMARILY CONSUMER DEBTS, OR, WITH THE DEBTOR'S CONSENT, CONVERT SUCH A CASE TO A CASE UNDER CHAPTER 11 OR 13 OF THIS TITLE, IF IT FINDS THAT THE GRANTING OF RELIEF WOULD BE AN ABUSE OF THE PROVISIONS OF THIS CHAPTER).

SIMILARLY, THE POSSIBILITY THAT PLAINTIFFS' ATTORNEY

COULD BE SUBJECT TO FEES AND CIVIL PENALTIES IF THE COURT DETERMINED THAT PLAINTIFFS' CHAPTER 7 PETITION WAS AN ABUSE DOES NOT SHOW THAT THEIR FILING UNDER CHAPTER 13 WAS COERCED. UNDER 11 U.S.C. § 707(B)(4), A COURT MAY IMPOSE FEES AND PENALTIES IF IT DETERMINES THAT THE DEBTOR'S ATTORNEY "VIOLATED RULE 9011 OF THE FEDERAL RULES OF BANKRUPTCY PROCEDURE." THAT RULE IS THE "BANKRUPTCY ANALOG TO FEDERAL RULE OF CIVIL PROCEDURE 11." H.R. REP. 109-31(I), AT 14 N.68. IT "AUTHORIZES A COURT TO IMPOSE

SANCTIONS AGAINST AN ATTORNEY OR PARTY WHO COMMENCES A FRIVOLOUS ACTION[] OR FILES OTHER INAPPROPRIATE DOCUMENTS IN VIOLATION OF THIS RULE'S REQUIREMENTS." *IBID*. IT IS UTTERLY MERITLESS TO SUGGEST, AS PLAINTIFFS DO, THAT A PARTY MAY BE COERCED INTO FILING UNDER CHAPTER 13 BECAUSE OF THE POSSIBILITY THAT THE PARTY'S ATTORNEY COULD BE SANCTIONED UNDER CHAPTER 7 FOR MAKING FRIVOLOUS OR OTHERWISE INAPPROPRIATE FILINGS. THAT IS ESPECIALLY SO BECAUSE AN ATTORNEY IS SUBJECT TO

SANCTIONS FOR MAKING INAPPROPRIATE FILINGS IN CHAPTER 13 PROCEEDINGS AS WELL. *SEE* FED. R. BANKRUPTCY 9011(C).

* * *

BECAUSE PLAINTIFFS HAVE NOT ESTABLISHED THAT THEIR REDUCED MONTHLY INCOME FALLS ABOVE THE STATUTORY BENCHMARKS, THEY HAVE NOT ESTABLISHED THAT 11 U.S.C. §§ 704(B) AND 707(B)(2) HAVE INJURED THEM OR WOULD CAUSE THEM FUTURE INJURY, SHOULD THEY SEEK TO CONVERT THEIR PETITION TO A CHAPTER 7 PROCEEDING. ACCORDINGLY, THEY LACK STANDING TO CHALLENGE

THOSE PROVISIONS AND TO SEEK AN INJUNCTION TO PROHIBIT THEIR ENFORCEMENT.[5]

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[5] WE DO NOT DISPUTE THAT PLAINTIFFS HAVE STANDING TO CHALLENGE 11 U.S.C. §§ 707(B)(7) AND 1325. PLAINTIFFS HAVE ALLEGED THAT THEIR ANNUALIZED CURRENT MONTHLY INCOME EXCEEDS THE MEDIAN FAMILY INCOME. THUS, IT "AFFIRMATIVELY APPEAR[S] IN THE RECORD" THAT PLAINTIFFS RECEIVE LESS FAVORABLE TREATMENT UNDER THOSE PROVISIONS THAN DO DEBTORS WHOSE CURRENT MONTHLY INCOME FALLS BELOW THE MEDIAN. *SPENCER*, 523 U.S. AT 11 (QUOTATION MARKS OMITTED).

II. THE ABUSE PREVENTION ACT AMENDMENTS SATISFY THE BANKRUPTCY CLAUSE'S UNIFORMITY REQUIREMENT.

A. THERE IS NO HEIGHTENED SCRUTINY FOR UNIFORMITY CHALLENGES TO BANKRUPTCY STATUTES EMPLOYING GEOGRAPHIC CLASSIFICATIONS.

As an initial matter, we address plaintiffs' contention that the court must employ some type of heightened scrutiny in reviewing the constitutionality of the Abuse Prevention Act amendments. Plaintiffs and their amicus attack the district court for "start[ing] with the proposition that there is a

PRESUMPTION THAT BANKRUPTCY LAWS ARE CONSTITUTIONAL." (R. 29 MEMORANDUM, P. 4, APX. P. __.) THEY ARGUE THAT THE DISTRICT COURT ERRED BY SUPPOSEDLY CONDUCTING A "DEFERENTIAL" REVIEW OF THE ABUSE PREVENTION ACT PROVISIONS CHALLENGED HERE. PLS.' BR. 30. INSTEAD, THEY CONTEND, THE DISTRICT COURT SHOULD HAVE ENGAGED IN A "CLOSE" (*ID.* AT 31) OR "PROBING" (AMICUS BR. 15) INQUIRY OF THE PROVISIONS TO DETERMINE WHETHER THEY VIOLATE THE BANKRUPTCY CLAUSE'S UNIFORMITY REQUIREMENT.

THAT ARGUMENT IS INCORRECT. THE SUPREME COURT HAS MANY TIMES STATED THAT "*[W]HENEVER* CALLED UPON TO JUDGE THE CONSTITUTIONALITY OF AN ACT OF CONGRESS * * * THE COURT ACCORDS GREAT WEIGHT TO THE DECISIONS OF CONGRESS." *ROSTKER V. GOLDBERG*, 453 U.S. 57, 63 (1981); *SEE ALSO UNITED STATES V. MORRISON*, 529 U.S. 598, 607 (2000). IT IS FOR THIS REASON THAT COURTS BEGIN, AS DID THE DISTRICT COURT HERE, WITH THE PRESUMPTION THAT A CONGRESSIONAL ENACTMENT IS CONSTITUTIONAL. *SEE, E.G., MORRISON*, 529 U.S. AT 607 ("WITH

THIS PRESUMPTION OF CONSTITUTIONALITY IN MIND, WE TURN TO THE QUESTION WHETHER § 13981 FALLS WITHIN CONGRESS' POWER UNDER ARTICLE I, § 8, OF THE CONSTITUTION."). AND COURTS INVALIDATE A STATUTE ONLY IF A PLAINTIFF ESTABLISHES THAT THE PRESUMPTION HAS BEEN OVERCOME. *SEE, E.G., WALTERS V. NAT'L ASS'N OF RADIATION SURVIVORS*, 473 U.S. 305, 366 (1985) (STEVENS, J., DISSENTING) ("THE COURT CORRECTLY NOTES THAT THE PRESUMPTION OF CONSTITUTIONALITY THAT ATTACHES TO EVERY ACT OF CONGRESS REQUIRES THE

CHALLENGER TO BEAR THE BURDEN OF DEMONSTRATING ITS INVALIDITY.").

PLAINTIFFS AND THEIR AMICUS CONTEND THAT WHEN CONGRESS EMPLOYS GEOGRAPHIC CLASSIFICATIONS IN A BANKRUPTCY STATUTE, COURTS MUST ENGAGE IN SOME UNSPECIFIED HEIGHTENED SCRUTINY. PLS.' BR. 30-31; AMICUS BR. 14. BUT THAT IS MISTAKEN, AS THE REGIONAL RAIL REORGANIZATION ACT CASE SHOWS. THERE, THE SUPREME COURT CONSIDERED A UNIFORMITY CHALLENGE TO A BANKRUPTCY STATUTE THAT, BY ITS TERMS, APPLIED ONLY TO

RAILROADS IN A SPECIFIED GEOGRAPHIC REGION. *SEE BLANCHETTE*, 419 U.S. AT 108 N.2, 156. IN EVALUATING THE STATUTE, THE COURT GAVE NO INDICATION THAT GEOGRAPHIC CLASSIFICATIONS ARE INHERENTLY SUSPECT. *SEE ID*. AT 158-61. INSTEAD, THE COURT UPHELD THE STATUTE AFTER DETERMINING THAT IT DID NOT VIOLATE THE UNIFORMITY REQUIREMENT, AS THAT REQUIREMENT HAS LONG BEEN CONSTRUED BY THE COURT. *IBID*.

PLAINTIFFS AND THEIR AMICUS RELY ON THE SUPREME COURT'S DECISION IN *UNITED STATES V. PTASYNSKI*, 462 U.S. 74 (1983), TO

SUPPORT THEIR CONTENTION THAT COURTS MUST ENGAGE IN HEIGHTENED SCRUTINY WHEN EVALUATING UNIFORMITY CHALLENGES TO GEOGRAPHIC CLASSIFICATIONS. PLS.' BR. 30-31; AMICUS BR. 14. BUT *PTASYNSKI* DOES NOT SUPPORT THEIR ARGUMENT. *PTASYNSKI* INVOLVED A STATUTE THAT GAVE FAVORABLE TAX TREATMENT TO CERTAIN ALASKAN OIL. PLAINTIFFS THERE ARGUED THAT THE TAX VIOLATED THE CONSTITUTION'S REQUIREMENT THAT TAXES BE "UNIFORM THROUGHOUT THE UNITED STATES." 462 U.S. AT 80 (QUOTING U.S. CONST.

ART. I, § 8, CL. 1). THE COURT EXPLAINED THAT THE UNIFORMITY CLAUSE DOES NOT PROHIBIT CONGRESS "FROM CONSIDERING GEOGRAPHICALLY ISOLATED PROBLEMS." *ID.* AT 84. BUT, WHEN CONGRESS "FRAME[S] A TAX IN GEOGRAPHIC TERMS, [THE COURT] WILL EXAMINE THE CLASSIFICATION CLOSELY TO SEE IF THERE IS ACTUAL GEOGRAPHIC DISCRIMINATION," THE EVIL MEANT TO BE AVOIDED BY THE UNIFORMITY REQUIREMENT. *ID.* AT 85; *SEE ID.* AT 81 (EXPLAINING THAT THE UNIFORMITY REQUIREMENT WAS ADOPTED TO PREVENT THE

NATIONAL GOVERNMENT FROM USING "ITS POWER OVER COMMERCE TO THE DISADVANTAGE OF PARTICULAR STATES"). IN ENGAGING IN THIS "CLOSE[]" EXAMINATION, THE COURT DID NOT SHIFT THE BURDEN OF PERSUASION TO THE GOVERNMENT OR ASSUME THE GEOGRAPHIC CLASSIFICATION WAS INHERENTLY SUSPECT. INSTEAD, IT SIMPLY EXAMINED THE STATUTORY TEXT AND LEGISLATIVE HISTORY FOR EVIDENCE "THAT CONGRESS SOUGHT TO BENEFIT ALASKA FOR REASONS THAT WOULD OFFEND THE PURPOSE OF THE

CLAUSE." *ID.* AT 85. FINDING NONE, THE COURT UPHELD THE PROVISION.

HERE, IT IS PLAINTIFFS' BURDEN TO SHOW THAT THE ABUSE PREVENTION ACT PROVISIONS THEY CHALLENGE ARE NOT CONSISTENT WITH "THE FLEXIBILITY INHERENT IN" THE UNIFORMITY REQUIREMENT. *ID.* AT 158. THE PROVISIONS' USE OF GEOGRAPHIC CLASSIFICATIONS IN NO WAY LESSENS OR SHIFTS PLAINTIFF'S BURDEN. AS THE DISTRICT COURT DETERMINED, AND AS WE EXPLAIN BELOW, PLAINTIFFS HAVE NOT ESTABLISHED THAT THE ABUSE PREVENTION ACT PROVISIONS THEY

CHALLENGE ARE UNCONSTITUTIONAL.

B. THE ABUSE PREVENTION ACT ESTABLISHES CLASSIFICATIONS THAT ARE UNIFORM WITHIN THE MEANING OF THE BANKRUPTCY CLAUSE.

1. THE CONSTITUTION AUTHORIZES CONGRESS TO ENACT "UNIFORM LAWS ON THE SUBJECT OF BANKRUPTCIES THROUGHOUT THE UNITED STATES." U.S. CONST. ART. I, § 8, CL. 4. PRIOR TO THE CONSTITUTION'S RATIFICATION, STATES WOULD RELIEVE INDIVIDUALS OF THEIR DEBTS BY ENACTING PRIVATE ACTS. *GIBBONS*, 455 U.S. AT 472. BUT GIVEN EACH

STATE'S SOVEREIGN STATUS, IT WAS UNCLEAR WHETHER ONE STATE HAD TO RECOGNIZE THE DEBT RELIEF GIVEN BY ANOTHER. *IBID.*; *SEE CENT. VA. CMTY. COLLEGE V. KATZ*, 546 U.S. 356, 377 (2006) ("[TH]E FRAMERS, IN ADOPTING THE BANKRUPTCY CLAUSE, PLAINLY INTENDED TO GIVE CONGRESS THE POWER TO REDRESS THE RAMPANT INJUSTICE RESULTING FROM STATES' REFUSAL TO RESPECT ONE ANOTHER'S DISCHARGE ORDERS."). FOR THIS REASON, "[U]NIFORMITY AMONG STATE DEBTOR INSOLVENCY LAWS WAS AN IMPOSSIBILITY AND THE PRACTICE OF PASSING PRIVATE

BANKRUPTCY LAWS WAS SUBJECT TO ABUSE IF THE LEGISLATORS WERE LESS THAN HONEST." *GIBBONS*, 455 U.S. AT 472. RESPONDING TO THIS PROBLEM, THE FRAMERS ADOPTED THE CONTRACT CLAUSE, WHICH "PROHIBITS THE STATES FROM ENACTING DEBTOR RELIEF LAWS WHICH DISCHARGE THE DEBTOR FROM HIS OBLIGATIONS." *ID*. AT 472 N.14. AND IT ADOPTED THE BANKRUPTCY CLAUSE "TO PROVIDE CONGRESS WITH THE POWER TO ENACT UNIFORM LAWS ON THE SUBJECT ENFORCEABLE AMONG THE STATES" AND "TO PROHIBIT

CONGRESS FROM ENACTING PRIVATE BANKRUPTCY LAWS." *ID.* AT 472.

IN LIGHT OF THIS PURPOSE, THE SUPREME COURT HAS CONSISTENTLY INTERPRETED THE BANKRUPTCY CLAUSE PRINCIPALLY AS A BROAD GRANT OF AUTHORITY TO CONGRESS RATHER THAN A RESTRICTION ON CONGRESSIONAL POWER. THUS, IN ONE OF THE EARLIEST CASES INTERPRETING THAT PROVISION, CHIEF JUSTICE MARSHALL EXPLAINED THAT: "THE PECULIAR TERMS OF THE GRANT CERTAINLY DESERVE NOTICE. CONGRESS IS NOT AUTHORIZED MERELY TO PASS LAWS, THE OPERATION OF WHICH

SHALL BE UNIFORM, BUT TO ESTABLISH UNIFORM LAWS ON THE SUBJECT THROUGHOUT THE UNITED STATES." *STURGES V. CROWNINSHIELD*, 17 U.S. (4 WHEAT.) 122, 193-94 (1819); *SEE IN RE DEHON, INC.*, 327 B.R. 38, 56 (BKRTCY. D. MASS. 2005) ("AS JUSTICE MARSHALL'S STATEMENT IN *STURGES* IMPLIES, THE USE OF THE WORD 'UNIFORM' IN THE BANKRUPTCY CLAUSE WAS NOT PRIMARILY INTENDED AS A RESTRICTION ON CONGRESSIONAL POWER, BUT AS A GRANT OF POWER TO CONGRESS.").

FOR THIS REASON, THE SUPREME COURT AND THIS COURT HAVE

REJECTED ALMOST EVERY UNIFORMITY CHALLENGE TO A BANKRUPTCY LAW. THUS, AT THE TURN OF THE TWENTIETH CENTURY, THE SUPREME COURT UPHELD THE BANKRUPTCY ACT OF 1898'S ALLOWANCE OF EXEMPTIONS THAT DEBTORS COULD CLAIM UNDER STATE LAW. THE COURT EXPLAINED THAT, ALTHOUGH CONGRESS MUST ENACT BANKRUPTCY LAWS THAT ARE "UNIFORM" THROUGH THE UNITED STATES, "THAT UNIFORMITY IS GEOGRAPHICAL, AND NOT PERSONAL." *MOYSES*, 186 U.S. AT 188. ELABORATING, THE COURT EXPLAINED THAT THE 1898 ACT'S

APPLICATION OF DIFFERENT STATE EXEMPTION LAWS TO DIFFERENT DEBTORS DID NOT VIOLATE THE UNIFORMITY REQUIREMENT BECAUSE "[T]HE GENERAL OPERATION OF THE LAW IS UNIFORM ALTHOUGH IT MAY RESULT IN CERTAIN PARTICULARS DIFFERENTLY IN DIFFERENT STATES." *ID.* AT 190. IN THAT CASE, THE "GENERAL OPERATION OF THE LAW" WAS UNIFORM BECAUSE "THE TRUSTEE TAKES IN EACH STATE WHATEVER WOULD HAVE BEEN AVAILABLE TO THE CREDITOR IF THE BANKRUPT LAW HAD NOT BEEN PASSED." *IBID.*

SEVENTEEN YEARS LATER, THE COURT UPHELD A DIFFERENT PROVISION OF THE 1898 ACT, WHICH INCORPORATED STATE FRAUDULENT CONVEYANCE STATUTES BY AUTHORIZING THE TRUSTEE TO AVOID ANY TRANSFER OF PROPERTY THAT A CREDITOR COULD HAVE AVOIDED. *CLUM*, 245 U.S. AT 613-614. IN SO HOLDING, THE COURT REITERATED THAT "[N]OTWITHSTANDING THIS REQUIREMENT AS TO UNIFORMITY THE BANKRUPTCY ACTS OF CONGRESS MAY RECOGNIZE THE LAWS OF THE STATE IN CERTAIN PARTICULARS, ALTHOUGH SUCH RECOGNITION MAY

LEAD TO DIFFERENT RESULTS IN DIFFERENT STATES." *ID.* AT 613; *SEE ALSO GREEN*, 329 U.S. AT 161 ("WHAT CLAIMS OF CREDITORS ARE VALID AND SUBSISTING OBLIGATIONS AGAINST THE BANKRUPT AT THE TIME A PETITION OF BANKRUPTCY IS FILED, IS A QUESTION WHICH, IN THE ABSENCE OF OVERRULING FEDERAL LAW, IS TO BE DETERMINED BY REFERENCE TO STATE LAW.").

THIS COURT REBUFFED A UNIFORMITY CHALLENGE TO A DIFFERENT PROVISION OF THE BANKRUPTCY ACT OF 1898. IN *LEIDIGH CARRIAGE CO. V. STENGEL*,

PLAINTIFFS CHALLENGED A PROVISION THAT DISTINGUISHED BETWEEN NATURAL AND ARTIFICIAL PERSONS, AND "BETWEEN CLASSES OF ARTIFICIAL PERSONS," AND PROVIDED FOR DIFFERENT TREATMENT FOR EACH CLASS. 95 F. 637, 646 (6TH CIR. 1899). UPHOLDING THE PROVISION, THIS COURT HELD THAT THE BANKRUPTCY CLAUSE

> IMPOSES NO LIMITATION UPON CONGRESS AS TO THE CLASSIFICATION OF PERSONS WHO ARE TO BE AFFECTED BY SUCH LAWS, PROVIDED ONLY THAT THE LAWS SHALL HAVE UNIFORM OPERATION THROUGHOUT THE UNITED STATES. THE OBJECT WHICH THE FRAMERS OF THE CONSTITUTION HAD WAS TO ENABLE CONGRESS TO PREVENT THE ENFORCEMENT OF AS

> MANY DIFFERENT BANKRUPTCY LAWS AS THERE WERE STATES. * * * [THE TEXT OF THE BANKRUPTCY CLAUSE] LEAVES NO DOUBT THAT THE UNIFORMITY REQUIRED IS GEOGRAPHICAL, AND NOT PERSONAL, IN THE SENSE OF BEING ALIKE APPLICABLE TO ALL MEMBERS OF THE COMMUNITY.

IBID.

MORE RECENTLY, IN *BLANCHETTE V. CONNECTICUT GENERAL INSURANCE CORPORATION,* THE SUPREME COURT EXPLAINED THAT THE UNIFORMITY REQUIREMENT DOES NOT LIMIT CONGRESS' ABILITY TO RESPOND TO REGIONAL DIFFERENCES THAT HAVE IMPLICATIONS FOR BANKRUPTCY. THE COURT'S DECISION IN

BLANCHETTE IS CRITICAL TO THIS CASE. THERE, THE COURT CONSIDERED A BANKRUPTCY STATUTE, THE REGIONAL RAIL REORGANIZATION ACT OF 1973, THAT, BY ITS EXPRESS TERMS, APPLIED TO RAILROADS IN REORGANIZATION IN A GEOGRAPHICALLY DEFINED REGION OF THE COUNTRY, PRINCIPALLY IN THE NORTHEAST AND MIDWEST. *SEE* 45 U.S.C. § 702(17).

THE STATUTE WAS ATTACKED ON UNIFORMITY GROUNDS, "BECAUSE THE RAIL ACT'S PROVISIONS APPLY ONLY TO RAILROADS IN REORGANIZATION IN THE 'REGION.'" *BLANCHETTE*, 419 U.S. AT 156. IN

REJECTING THAT ARGUMENT, THE COURT OBSERVED THAT "[T]HE PROBLEM DEALT WITH UNDER THE BANKRUPTCY CLAUSE MAY PRESENT SIGNIFICANT VARIATIONS IN DIFFERENT PARTS OF THE COUNTRY." *ID.* AT 159 (QUOTATION AND ALTERATION MARKS OMITTED). ACCORDINGLY, THE COURT HELD THAT "[T]HE UNIFORMITY PROVISION DOES NOT DENY CONGRESS POWER TO TAKE INTO ACCOUNT DIFFERENCES THAT EXIST BETWEEN DIFFERENT PARTS OF THE COUNTRY, AND TO FASHION LEGISLATION TO RESOLVE GEOGRAPHICALLY ISOLATED PROBLEMS." *IBID.* THE

CRISIS THAT GAVE RISE TO THE RAIL ACT "CENTERED IN THE PROBLEMS OF THE RAIL CARRIERS OPERATING IN THE REGION DEFINED BY THE ACT, AND THESE WERE THE PROBLEMS CONGRESS SOUGHT TO ADDRESS." *IBID*. BECAUSE NO RAILROAD REORGANIZATION PROCEEDING WAS PENDING OUTSIDE THE REGION, "THE RAIL ACT APPL[IED] EQUALLY TO ALL CREDITORS AND DEBTORS" AND THIS WAS ALL THE BANKRUPTCY CLAUSE REQUIRED. *ID*. AT 160.

THE COURT NOTED THAT THIS CONSTRUCTION OF THE BANKRUPTCY CLAUSE'S UNIFORMITY

REQUIREMENT WAS CONSISTENT WITH ITS CONSTRUCTION OF THE SIMILAR REQUIREMENT IN THE TAXATION CLAUSE. *IBID*. THUS, IN *THE HEAD MONEY CASES*, THE COURT UPHELD AGAINST A UNIFORMITY CHALLENGE A STATUTE THAT IMPOSED A TAX FOR NON-U.S. CITIZENS WHO WERE PASSENGERS ARRIVING AT U.S. PORTS FROM A FOREIGN PORTS BY STEAM OR SAIL VESSEL. *IBID*. (DISCUSSING 112 U.S. 580 (1884)). THE STATUTE WAS CHALLENGED BECAUSE IT DID NOT IMPOSES A SIMILAR TAX ON NON-U.S. CITIZENS ENTERING THE COUNTRY BY RAIL OR OTHER MEANS OF

INLAND TRANSPORTATION. *IBID.* THE COURT REJECTED THE CHALLENGE BECAUSE "'THE EVIL TO BE REMEDIED BY THIS LEGISLATION HAS NO EXISTENCE ON OUR INLAND BORDERS, AND IMMIGRATION IN THAT QUARTER NEEDED NO SUCH REGULATION.'" *ID.* AT 161 (QUOTING 112 U.S. AT 595). THE *BLANCHETTE* COURT HELD THAT THE RAIL ACT SIMILARLY "IS DESIGNED TO SOLVE 'THE EVIL TO BE REMEDIED,' AND THUS SATISFIES THE UNIFORMITY REQUIREMENT OF THE BANKRUPTCY CLAUSE." *IBID.*

THE SUPREME COURT AGAIN ADDRESSED THE BANKRUPTCY

CLAUSE IN *GIBBONS*, THE ONLY CASE IN WHICH THAT COURT HELD A BANKRUPTCY STATUTE VIOLATED THE UNIFORMITY REQUIREMENT. *GIBBONS* INVOLVED A BANKRUPTCY ACT, THE ROCK ISLAND RAILROAD TRANSITION AND EMPLOYEE ASSISTANCE ACT, THAT OVERRODE THE APPLICATION OF THE GENERAL BANKRUPTCY ACT AND IMPOSED CERTAIN REQUIREMENTS ON THE TRUSTEE OF A SINGLE BANKRUPT RAILROAD. 455 U.S. AT 461-63. WHILE RECOGNIZING THAT THE UNIFORMITY REQUIREMENT ALLOWS CONGRESS TO ADDRESS "DISTINCTIVE AND SPECIAL

PROBLEM[S]," AND ALLOWS IT "TO TAKE INTO ACCOUNT DIFFERENCES THAT EXIST BETWEEN DIFFERENT PARTS OF THE COUNTRY, AND TO FASHION" APPROPRIATE LEGISLATION, THE COURT HELD THAT THE STATUTE AT ISSUE VIOLATED THE BANKRUPTCY CLAUSE BECAUSE, "[B]Y ITS TERMS, [THE ACT] APPLIES TO ONLY ONE REGIONAL BANKRUPT RAILROAD." *ID.* AT 469-70. BECAUSE THE CHALLENGED PROVISIONS "COVER NEITHER A DEFINED CLASS OF DEBTORS NOR A PARTICULAR TYPE OF PROBLEM, BUT A PARTICULAR PROBLEM OF ONE BANKRUPT

RAILROAD," THE STATUTE WAS "NOTHING MORE THAN A PRIVATE BILL," WHICH THE FRAMERS SOUGHT TO PREVENT BY ADOPTING THE BANKRUPTCY CLAUSE. *ID.* AT 470-71; *SEE ID.* AT 472.

2. THE PURPOSE OF THE BANKRUPTCY CLAUSE AND THE SUPREME COURT'S AND THIS COURT'S SETTLED PRECEDENT MAKE IT CLEAR THAT THE FIVE PROVISIONS OF THE ABUSE PREVENTION ACT THAT PLAINTIFFS CHALLENGE DO NOT VIOLATE THE UNIFORMITY REQUIREMENT.[6]

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[6] WE HERE ADDRESS THE CONSTITUTIONALITY OF ALL THE PROVISIONS PLAINTIFFS CHALLENGE

CONGRESS AMENDED THE BANKRUPTCY CODE IN 2005 BECAUSE IT CONCLUDED THAT THE CODE WAS NOT ADEQUATELY CONTROLLING ABUSIVE CHAPTER 7 BANKRUPTCY CASES. AS EXPLAINED ABOVE, CHAPTER 7 PROVIDES FOR DISCHARGE OF DEBTS IN EXCHANGE FOR LIQUIDATION OF A DEBTOR'S PROPERTY, FOR DISTRIBUTION AMONG THE CREDITORS. *SEE* 11 U.S.C. §§ 541, 726. CHAPTER 13, BY CONTRAST, REQUIRES REPAYMENT OF CREDITORS WITH A DEBTOR'S FUTURE INCOME. *SEE* 11 U.S.C. §§ 1306,

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IN CASE THIS COURT DETERMINES THAT PLAINTIFFS HAVE STANDING TO ASSERT ALL OF THEIR CLAIMS.

1326. CONGRESS BELIEVED THAT, BECAUSE DEBTORS COULD FREELY CHOOSE TO FILE UNDER EITHER CHAPTER 7 OR CHAPTER 13, AND BECAUSE OF THE EXISTING PRESUMPTION IN FAVOR OF AFFORDING RELIEF UNDER CHAPTER 7, SOME DEBTORS WERE SEEKING DISCHARGE UNDER CHAPTER 7 RATHER THAN UNDER CHAPTER 13, EVEN THOUGH THEY "ARE ABLE TO REPAY A SIGNIFICANT PORTION OF THEIR DEBTS." H.R. REP. 109-31(I), AT 5. CONGRESS ENACTED THE MEANS TESTS PLAINTIFFS CHALLENGE IN ORDER TO REMEDY THE "LOOPHOLES AND INCENTIVES THAT ALLOW AND –

SOMETIMES – EVEN ENCOURAGE OPPORTUNISTIC PERSONAL FILINGS AND ABUSE." *IBID*.

AS THE PRECEDING DISCUSSION SHOWS (AND AS PLAINTIFFS RECOGNIZE (*SEE* PLS.' BR. 16)), THE SUPREME COURT AND THIS COURT HAVE REPEATEDLY RECOGNIZED THAT THE BANKRUPTCY CLAUSE PERMITS CONGRESS TO "DISTINGUISH AMONG CLASSES OF DEBTORS" AND TO TREAT DIFFERENT CATEGORIES OF DEBTORS DIFFERENTLY. *GIBBONS*, 455 U.S. AT 469; *SEE ALSO STENGEL*, 95 F. AT 646. THAT IS WHAT THREE OF THE FIVE CHALLENGED PROVISIONS DO. 11

U.S.C. §§ 707(B)(7), 1325(B)(3), AND 1325(B)(4) DISTINGUISH BETWEEN DEBTORS WHOSE ANNUALIZED CURRENT MONTHLY INCOME IS ABOVE THE FAMILY MEDIAN INCOME FOR THE APPLICABLE STATE AND THOSE WHOSE ANNUALIZED CURRENT MONTHLY INCOME IS BELOW THE MEDIAN. THESE PROVISIONS AFFORD DIFFERENT TREATMENT FOR THESE TWO CLASSES OF DEBTORS. THUS, UNDER SECTION 707(B)(7), CHAPTER 7 DEBTORS WHOSE INCOME IS BELOW THE MEDIAN ARE NOT SUBJECT TO THE PRESUMPTION OF ABUSE. BY CONTRAST, DEBTORS WITH INCOMES

ABOVE THE MEDIAN MUST APPLY THE MEANS TEST TO DETERMINE WHETHER THE PRESUMPTION ARISES. SIMILARLY, UNDER SECTION 1325(B)(3) AND (4), CHAPTER 13 DEBTORS WHOSE INCOME IS BELOW THE MEDIAN HAVE ONLY A THREE-YEAR INSTEAD OF A FIVE-YEAR REPAYMENT PERIOD AND ARE SUBJECT TO MORE FAVORABLE TREATMENT IN DETERMINING THEIR DISPOSABLE INCOME (FROM WHICH REPAYMENT IS MADE) THAN ARE THOSE WHOSE INCOME IS ABOVE THE MEDIAN.

THESE PROVISIONS ARE AN UNEXCEPTIONAL EXERCISE OF

CONGRESS' POWER UNDER THE BANKRUPTCY CLAUSE. THE CLASSIFICATIONS THEY MAKE AND THE TREATMENT THEY PRESCRIBE FOR DEBTORS IN EACH CLASS "HAVE UNIFORM OPERATION THROUGHOUT THE UNITED STATES." *STENGEL*, 95 F. AT 646. ALL DEBTORS WHOSE INCOME FALLS ABOVE THE MEDIAN FAMILY INCOME ARE TREATED ALIKE AS ARE DEBTORS WHOSE INCOME FALLS BELOW.[7] ACCORDINGLY, "[T]HE

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[7] AN EXCEPTION EXISTS FOR DEBTORS WHO ARE DISABLED VETERANS WHOSE INDEBTEDNESS OCCURRED PRIMARILY DURING A PERIOD OF ACTIVE DUTY OR HOMELAND DEFENSE ACTIVITY. THE PRESUMPTION OF ABUSE DOES NOT ARISE FOR SUCH DEBTORS, EVEN IF THEIR ANNUALIZED CURRENT

GENERAL OPERATION OF THE LAW IS UNIFORM ALTHOUGH IT MAY RESULT IN CERTAIN PARTICULARS DIFFERENTLY IN DIFFERENT STATES." *MOYSES*, 186 U.S. AT 190. AND THE LEGISLATIVE HISTORY DEMONSTRATES THAT CONGRESS ADOPTED THESE CLASSIFICATIONS IN ORDER "TO ENSURE THAT DEBTORS REPAY CREDITORS THE MAXIMUM THEY CAN AFFORD." H.R.

MONTHLY INCOME EXCEEDS THE APPLICABLE MEDIAN FAMILY INCOME, AND EVEN IF THEY WOULD OTHERWISE FAIL THE MEANS TEST. 11 U.S.C. § 707(B)(2)(D). THIS EXCEPTION IS ANOTHER EXAMPLE OF CONGRESS' DETERMINATION TO RECOGNIZE A DISTINCT CLASS OF DEBTORS AND PRESCRIBE A UNIFORM RULE THAT APPLIES TO THE CLASS.

REP. 109-31(I), AT 2. THAT IS A NEUTRAL PURPOSES THAT IS NOT GEOGRAPHICALLY DISCRIMINATORY AND THAT APPLIES UNIFORMLY TO DEBTORS THROUGHOUT THE COUNTRY.

SIMILARLY UNEXCEPTIONAL ARE THE MEANS TEST PROVISIONS IN 11 U.S.C. § 707(B)(2)(A), WHICH ARE USED FOR DETERMINING WHETHER THE PRESUMPTION OF ABUSE ARISES FOR CHAPTER 7 DEBTORS WHOSE ANNUALIZED CURRENT MONTHLY INCOME EXCEEDS THE MEDIAN FAMILY INCOME, AND FOR DETERMINING THE DISPOSABLE INCOME OF A CHAPTER 13 DEBTOR

WHOSE ANNUALIZED CURRENT MONTHLY INCOME IS ABOVE THE MEDIAN (*SEE* 11 U.S.C. § 1325(B)(3)). CONGRESS ENACTED THE ABUSE PREVENTION ACT "TO ENSURE THAT DEBTORS REPAY CREDITORS TO THE MAXIMUM THEY CAN AFFORD." H.R. REP. 109-31(I), AT 2. IN DECIDING HOW BEST "TO SOLVE 'THE EVIL TO BE REMEDIED,'" (*BLANCHETTE*, 419 U.S. AT 161), CONGRESS WAS NOT REQUIRED TO BLIND ITSELF TO THE FACT THAT THE COST OF LIVING AND RELATIVE PURCHASING POWER VARY ACROSS THE COUNTRY. RATHER, IT MAY CONSTITUTIONALLY ADOPT A

SOLUTION THAT "TAKE[S] INTO ACCOUNT DIFFERENCES THAT EXIST BETWEEN DIFFERENT PARTS OF THE COUNTRY" (*BLANCHETTE*, 419 U.S. AT 159) AND THAT ADDRESSES "A PARTICULAR TYPE OF PROBLEM" (*GIBBONS*, 455 U.S. AT 470).

IT BEARS NOTING THAT, OF THE THREE EXPENSE STANDARDS THAT ARE USED IN SECTION 707(B)(2), ONLY ONE – THE "LOCAL" STANDARDS – HAS ANY SIGNIFICANT REGIONAL VARIATION. AS EXPLAINED ABOVE, "NATIONAL" STANDARDS ARE UNIFORM THROUGHOUT THE CONTINENTAL UNITED STATES. AND THE "OTHER NECESSARY EXPENSES"

STANDARDS RELATE TO CERTAIN OF THE DEBTOR'S ACTUAL EXPENSES. PLAINTIFFS' COMPLAINT ALLEGES THAT THE NATIONAL STANDARDS VIOLATE THE BANKRUPTCY CLAUSE "[B]ECAUSE THE NATIONAL STANDARDS ARE HIGHER FOR RESIDENTS IN THE STATES OF ALASKA AND HAWAII." (R. 2 AMENDED COMPL., P. 7, APX. P. __.) BUT THE ABUSE PREVENTION ACT'S INCORPORATION OF THE NATIONAL STANDARDS TAKE INTO ACCOUNT THE "UNIQUE GEOGRAPHIC CIRCUMSTANCES AND HIGHER COST OF LIVING" OF THOSE TWO STATES. U.S. TRUSTEE, IRS NATIONAL

STANDARDS, *AVAILABLE AT* HTTP://WWW.USDOJ.GOV/UST/EO/BAPCPA/20061001/BCI_DATA/NATIONAL_EXPENSE_STANDARDS.HTM. THAT IS A PARADIGM EXAMPLE OF CONGRESS "FASHION[ING] LEGISLATION TO RESOLVE GEOGRAPHICALLY ISOLATED PROBLEMS." *BLANCHETTE*, 419 U.S. AT 159. IN ANY EVENT, PLAINTIFFS HAVE NOT PRESSED THIS ARGUMENT ON APPEAL AND SO HAVE ABANDONED IT. *SEE ENERTECH ELEC., INC. V. MAHONING COUNTY COMM'RS*, 85 F.3D 257, 259 (6TH CIR. 1996).

FINALLY, BECAUSE THESE PROVISIONS ARE WITHIN CONGRESS'

BANKRUPTCY CLAUSE POWER, SO TOO IS 11 U.S.C. § 704(B), WHICH DIRECTS THE U.S. TRUSTEE TO EVALUATE CHAPTER 7 PETITIONS TO DETERMINE WHETHER THE PRESUMPTION OF ABUSE ARISES, AND TO SUBMIT AN APPROPRIATE FILING IN THE BANKRUPTCY COURT.

3. PLAINTIFFS' VARIOUS ARGUMENTS TO THE CONTRARY LACK MERIT. FIRST, PLAINTIFFS ARGUE THAT, ALTHOUGH CONGRESS MAY PERMISSIBLY "INCORPORATE[ ] BY REFERENCE THE LAWS OF THE SEVERAL STATES" INTO FEDERAL BANKRUPTCY LAW, IT NEVERTHELESS VIOLATES THE

UNIFORMITY REQUIREMENT FOR CONGRESS TO ADOPT A FEDERAL STANDARD THAT TAKES INTO ACCOUNT DIFFERENCES AMONG DEBTORS THAT ARE THE PRODUCT OF REGIONAL ECONOMIES. PLS.' BR. 12; *SEE ID*. AT 18, 21.

PLAINTIFFS PROVIDE NO RATIONALE TO EXPLAIN THIS DISTINCTION, NOR DO THEY CITE ANY PRECEDENT ADOPTING IT. THEIR ONLY ARGUMENT APPEARS TO BE THAT THE SUPREME COURT HAS NOT ADDRESSED CLASSIFICATIONS SUCH AS THOSE IN THE ABUSE PREVENTION ACT AND HAS TO DATE ONLY UPHELD BANKRUPTCY LAWS

THAT INCORPORATE STATE LAW. *ID.* AT 12-13, 23. BUT THAT CONTENTION IS SIMPLY MISTAKEN. THE BANKRUPTCY LAW IN *BLANCHETTE* (AND THE TAX LAW IN *PTASYNSKI*) ESTABLISHED A REGIONAL CLASSIFICATION UNDER FEDERAL LAW. IN ADDITION, PLAINTIFFS' ARGUMENT IGNORES THE RATIONALES UNDERLYING THE SUPREME COURT'S UNIFORMITY CASES, UNDER WHICH CONGRESS MAY PERMISSIBLY ENACT BANKRUPTCY LEGISLATION THAT "TAKE[S] INTO ACCOUNT DIFFERENCES THAT EXIST BETWEEN DIFFERENT PARTS OF THE COUNTRY." *BLANCHETTE*, 419 U.S. AT

159. IT ALSO IGNORES THE FACT THAT THE SUPREME COURT HAS ONLY ONCE HELD THAT A STATUTE VIOLATES THE UNIFORMITY CLAUSE, AND THAT STATUTE WAS A PRIVATE BANKRUPTCY BILL, WHICH APPLIED TO ONE AND ONLY ONE DEBTOR.

PLAINTIFFS' AMICUS DOES EXPLAIN WHY, IN HIS VIEW, THE BANKRUPTCY CLAUSE PERMITS CONGRESS TO INCORPORATE STATE LAW BUT NOT TO ENACT FEDERAL BANKRUPTCY LAWS THAT TAKE REGIONAL VARIATIONS INTO ACCOUNT. ACCORDING TO HIM, CONGRESS CANNOT DISCRIMINATE

AGAINST THE CITIZENS OF PARTICULAR STATES BY INCORPORATING STATE LAW, "[B]ECAUSE A STATE CAN CHANGE ITS LAWS TO MATCH THOSE OF ANY OTHER STATE." AMICUS BR. 5. BUT BECAUSE STATES CANNOT SIMILARLY ADAPT TO FEDERAL LAW, PLAINTIFFS' AMICUS ARGUES THAT FEDERAL LAWS THAT TAKE REGIONAL VARIATIONS INTO ACCOUNT ARE IMPERMISSIBLE. *IBID*.

THAT THEORY IS NOT ONLY BEREFT OF PRECEDENTIAL SUPPORT, IT IS ALSO INCONSISTENT WITH THE SUPREME COURT'S UNIFORMITY

CASES IN BOTH THE BANKRUPTCY AND (AS WE EXPLAIN BELOW) TAX CONTEXTS. THE SUPREME COURT HAS UPHELD CONGRESS' POWER "TO TAKE INTO ACCOUNT DIFFERENCES THAT EXIST BETWEEN DIFFERENT PARTS OF THE COUNTRY," AND TO FASHION APPROPRIATE LEGISLATION. *BLANCHETTE*, 419 U.S. AT 159. WHEN A PLAINTIFF CHALLENGES A FEDERAL BANKRUPTCY OR TAX LAW THAT USES GEOGRAPHIC CLASSIFICATIONS AND ARGUES THAT THE CLASSIFICATIONS ARE DISCRIMINATORY, THE COURT REVIEWS THE STATUTE AND ANY

LEGISLATIVE HISTORY TO DETERMINE WHETHER "CONGRESS INTENDED TO GRANT [GIVE CITIZENS OF ONE STATE] AN UNDUE PREFERENCE AT THE EXPENSE OF OTHER" STATES. *PTASYNSKI*, 462 U.S. AT 86. THE ABUSE PREVENTION ACT'S STATUTORY TEXT AND THE LEGISLATIVE HISTORY DISCUSSED ABOVE DEMONSTRATE THAT CONGRESS MADE A DETERMINATION, "BASED ON NEUTRAL FACTORS" (*ID.* AT 85), THAT ELIGIBILITY FOR BANKRUPTCY RELIEF SHOULD BE BASED ON A DEBTORS' ABILITY TO REPAY CREDITORS, AND THAT ABILITY TO PAY IS AFFECTED BY

REGIONAL ECONOMIC VARIATIONS. THE ABUSE PREVENTION ACT'S PURPOSE AND EFFECT ARE CONSISTENT WITH THE BANKRUPTCY CLAUSE'S PROHIBITION AGAINST REGIONAL DISCRIMINATION.

NEXT, PLAINTIFFS ARGUE THAT CONSIDERATION OF THE UNIFORMITY REQUIREMENT UNDER THE TAXATION CLAUSE SHOWS THAT THE ABUSE PREVENTION ACT VIOLATES THE SIMILAR REQUIREMENT IN THE BANKRUPTCY CODE. PLS.' BR. 24. PLAINTIFFS ARE CORRECT THAT THE SUPREME COURT HAS LOOKED TO ITS

INTERPRETATION OF THE TAXATION CLAUSE'S UNIFORMITY REQUIREMENT TO AID IN ITS INTERPRETATION OF THE SIMILAR REQUIREMENT IN THE BANKRUPTCY CLAUSE (AND VICE VERSA). *SEE, E.G.*, *BLANCHETTE*, 419 U.S. AT 160 (DISCUSSING *THE HEAD MONEY CASES*). BUT PLAINTIFFS ERR IN SUGGESTING THAT THE SUPREME COURT'S TAXATION CASES CALL INTO DOUBT THE VALIDITY OF THE ABUSE PREVENTION ACT PROVISIONS THEY CHALLENGE.

PLAINTIFFS RELY HEAVILY ON THE SUPREME COURT'S DECISION IN *PTASYNSKI*. IN THAT CASE, THE

COURT CONSIDERED THE VALIDITY OF A TAX LAW THAT PROVIDED AN EXEMPTION FOR "ALASKAN OIL." 462 U.S. AT 77 (QUOTATION MARKS OMITTED). PLAINTIFFS SUGGEST THAT *PTASYNSKI* STANDS FOR THE PROPOSITION THAT A TAX SATISFIES THE UNIFORMITY REQUIREMENT ONLY WHEN THE TAX "'OPERATES WITH THE SAME FORCE AND EFFECT IN EVERY PLACE WHERE THE SUBJECT IS FOUND.'" PLS.' BR. 24. THAT IS MISTAKEN. THE QUOTED LANGUAGE IS ACTUALLY FROM *THE HEAD MONEY CASES*. *SEE* 112 U.S. AT 594. AND THE *PTASYNSKI* COURT EXPLAINED THAT IT WAS A

MISTAKE TO UNDERSTAND THAT PRECEDENT TO "PROHIBIT ALL GEOGRAPHICALLY DEFINED CLASSIFICATIONS." *PTASYNSKI*, 462 U.S. AT 84. RATHER, "[T]HE UNIFORMITY CLAUSE GIVES CONGRESS WIDE LATITUDE IN DECIDING WHAT TO TAX AND DOES NOT PROHIBIT IT FROM CONSIDERING GEOGRAPHICALLY ISOLATED PROBLEMS." *IBID*. BECAUSE THE COURT DETERMINED THAT, IN GRANTING THE EXEMPTION, CONGRESS DID NOT ENACT THE EXEMPTION TO GIVE ALASKA A PREFERENCE AT THE EXPENSE OF OTHER STATES – ONE OF

THE EVILS THE UNIFORMITY REQUIREMENT WAS ADOPTED TO PREVENT – THE COURT UPHELD THE STATUTE. *ID*. AT 85-86.

THUS PLAINTIFFS ARE FURTHER MISTAKEN IN SUGGESTING THAT THE UNIFORMITY REQUIREMENT PROHIBITS TAXES THAT HAVE DIFFERENT EFFECT IN DIFFERENT REGIONS OF THE COUNTRY. *SEE* PLS.' BR. 26. INDEED, THE SUPREME COURT HAS REPEATEDLY UPHELD SUCH TAXES AGAINST UNIFORMITY CHALLENGES. THUS, FOR EXAMPLE, IN *KNOWLTON V. MOORE*, THE SUPREME COURT UPHELD A PROVISION OF THE WAR REVENUE

ACT, UNDER WHICH "THE PRIMARY RATE OF TAXATION DEPENDS UPON THE DEGREE OF RELATIONSHIP OR WANT OF RELATIONSHIP TO A DECEASED PERSON." 178 U.S. 41, 107 (1900). THE PLAINTIFFS IN THAT CASE ARGUED THAT THE TAX VIOLATED THE UNIFORMITY REQUIREMENT, "INASMUCH AS TESTAMENTARY AND INTESTACY LAWS MAY DIFFER IN EVERY STATE." *ID.* AT 107-08. THE COURT REJECTED THAT CONTENTION BECAUSE "[I]T IS CERTAIN THAT THE SAME DEGREE OF RELATIONSHIP OR WANT OF RELATIONSHIP TO THE DECEASED,

WHEREVER EXISTING, IS LEVIED ON AT THE SAME RATE THROUGHOUT THE UNITED STATES. THE TAX IS HENCE UNIFORM THROUGHOUT THE UNITED STATES, DESPITE THE FACT THAT DIFFERENT CONDITIONS AMONG THE STATES MAY OBTAIN AS TO THE OBJECTS UPON WHICH THE TAX IS LEVIED." *ID.* AT 108.

THE ABUSE PREVENTION ACT PROVISIONS EASILY SATISFY THIS STANDARD. THEY DEFINE CLASSES OF DEBTORS, TAKING INTO ACCOUNT "DIFFERENT CONDITIONS AMONG THE STATES" AND AFFORD UNIFORM BANKRUPTCY RELIEF TO EACH DEBTOR WITHIN A CLASS. THAT IS

ALL THE BANKRUPTCY CLAUSE REQUIRES.

FINALLY, PLAINTIFFS CONTEND THAT THE ABUSE PREVENTION ACT'S COMPARISON OF ANNUALIZED CURRENT MONTHLY INCOME TO FAMILY MEDIAN INCOME IN THE APPLICABLE STATE AND THE STATUTE'S USE OF THE MEANS TEST DO NOT ACCURATELY REFLECT "THE COST OF LIVING EXPENSES FROM ONE PART OF THE COUNTRY TO ANOTHER." PLS.' BR. 29; *SEE ID.* AT 26-30. PLAINTIFFS EXPRESSLY DISCLAIM ANY CHALLENGE UNDER THE EQUAL PROTECTION CLAUSE "OR ANY OTHER CLAUSE OF THE

CONSTITUTION" OTHER THAN THE BANKRUPTCY CLAUSE. *ID.* AT 10. BUT WHETHER CONGRESS SELECTED THE BEST MEANS TO ADDRESS THE EVIL IT IDENTIFIED HAS NO BEARING ON WHETHER THE LAW APPLIES UNIFORMLY. ACCORDINGLY, EVEN IF PLAINTIFFS WERE CORRECT THAT THE ABUSE PREVENTION ACT'S CLASSIFICATIONS ARE "ARBITRARY," (PLS.' BR. 29) – A CONTENTION WE DISPUTE – THAT WOULD NOT ESTABLISH A VIOLATION OF THE BANKRUPTCY CLAUSE.

CONCLUSION

THIS COURT SHOULD AFFIRM THE DISTRICT COURT'S GRANT OF SUMMARY JUDGMENT TO DEFENDANTS.

RESPECTFULLY SUBMITTED,

PETER D. KEISLER
Assistant Attorney General

JAMES R. DEDRICK
United States Attorney

WILLIAM KANTER
LEWIS S. YELIN, (202) 514-3425
Attorneys, Appellate Staff
Civil Division, Room 7318
U.S. Department of Justice
950 Pennsylvania Ave., N.W.

Washington, D.C. 20530-0001

OCTOBER 22, 2007

CERTIFICATE OF COMPLIANCE

PURSUANT TO FED. R. APP. P. 32(A)(7)(C), I CERTIFY THAT THIS BRIEF USES PROPORTIONATELY SPACED FONT AND CONTAINS 11,084 WORDS, EXCLUDING THE PARTS OF THE BRIEF EXEMPTED BY FED. R. APP. P. 32(A)(7)(B)(III).

LEWIS S. YELIN
ATTORNEY FOR THE UNITED STATES

DATE: OCTOBER 22, 2007

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I CERTIFY THAT ON THIS 22D DAY OF OCTOBER, 2007, I CAUSED THE FOREGOING PROOF BRIEF FOR APPELLEES TO BE FILED WITH THE COURT AND SERVED ON COUNSEL BY CAUSING ONE ORIGINAL COPY TO BE DELIVERED VIA OVERNIGHT DELIVERY TO:

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CINCINNATI, OH 45202-3988
(513) 564-7000

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KNOXVILLE, TN
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ADVANTAGE, INC.
432 WALNUT
STREET, STE. 200
CINCINNATI, OH
45202
(513) 651-2252

LEWIS S. YELIN
ATTORNEY FOR THE UNITED STATES

APPELLEES' DESIGNATION OF APPENDIX

PURSUANT TO SIXTH CIRCUIT RULE 28(D), APPELLEES HEREBY DESIGNATES THE FOLLOWING FILINGS IN THE DISTRICT COURT'S RECORDS AS ITEMS TO BE INCLUDED IN THE JOINT APPENDIX IN ADDITION TO THOSE DESIGNATED BY APPELLANT:

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1. DEFENDANTS' STATEMENT OF MATERIAL FACTS	03/26/07	15

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2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	United States Supreme Court
3. ("CCN") ***CURRENT*** CASE NO.	No.: 08-538
4. ("PCN") ***PRIOR*** CASE NO. - & COURT *[IF ANY]*	No.: 06-4290 Court: 3rd Cir. *(Identify judge & cite, if any)*
5. ("SO") ***SOURCE***	**U.S. TRUSTEES**
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8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	• Whether a chapter 7 trustee is required by Federal Rule of Bankruptcy Procedure 4003(b) to object to a debtor's claimed exemption when the debtor is entitled to an exemption in the amount claimed, but the debtor incorrectly lists the market value of the property as equal to the amount of the exemption.
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No. 08-538

In the Supreme Court of the United States

WILLIAM G. SCHWAB, PETITIONER

v.

NADEJDA REILLY

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE SUPPORTING PETITIONER

ELENA KAGAN
Solicitor General
Counsel of Record

TONY WEST
Assistant Attorney General

MALCOLM L. STEWART
Deputy Solicitor General

JEFFREY B. WALL
Assistant to the Solicitor General

WILLIAM S. KANTER
MELISSA N. PATTERSON
Attorneys

Department of Justice
Washington, D.C. 20530-0001
(202) 514-2217

RAMONA D. ELLIOTT
General Counsel

P. MATTHEW SUTKO
Associate General Counsel

ERIC K. BRADFORD
CATHERINE B. SEVCENKO
Attorneys
Executive Office for United States Trustees
Washington, D.C. 20530

QUESTION PRESENTED

Whether a Chapter 7 trustee is required by Federal Rule of Bankruptcy Procedure 4003(b) or this Court's decision in *Taylor* v. *Freeland & Kronz*, 503 U.S. 638 (1992), to object to a debtor's claimed exemption when the debtor is entitled to an exemption in the amount claimed, but the debtor incorrectly lists the market value of the property as equal to the amount of the exemption.

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In the Supreme Court of the United States

No. 08-538

WILLIAM G. SCHWAB, PETITIONER

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ON WRIT OF CERTIORARI
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BRIEF FOR THE UNITED STATES AS AMICUS CURIAE SUPPORTING PETITIONER

INTEREST OF THE UNITED STATES

Respondent, a debtor in a Chapter 7 bankruptcy proceeding, filed a form (Schedule C) on which she claimed an exemption, in a specified amount, for property used in her business. On the same Schedule C, respondent also stated her belief that the actual value of the property was equal to the amount of the claimed exemption. Petitioner, the bankruptcy trustee, did not object to the claimed exemption. Petitioner determined, however, that the property was worth substantially more than the amount of the claimed exemption, and he proposed to sell the property and divide the proceeds, giving respondent the amount of the exemption and distributing the rest to creditors. The courts below found that petitioner was barred from selling the property because he had not objected to the claimed exemption within the 30-day period provided by Federal Rule of Bankruptcy Procedure 4003(b). That holding raises an issue of substantial importance to the United States.

The Attorney General appoints United States Trustees, who are Justice Department officials, to supervise the administration of bankruptcy cases and to oversee trustees in regions comprising the vast majority of the federal judicial districts. 28 U.S.C. 581-589a. By statute, "[t]he United States trustee may raise and may appear and be heard on any issue in any case or proceeding under this title." 11 U.S.C. 307. United States Trustees "serve as bankruptcy watchdogs to prevent fraud, dishonesty, and overreaching in the bankruptcy arena." H.R. Rep. No. 595, 95th Cong., 1st Sess. 88 (1977). The United States Trustee Program thus "acts in the public interest to promote the efficiency and to protect and preserve the integrity of the bankruptcy system." United States Dep't of Justice, *United States Trustee Program Strategic Plan FY 2005-2010*, at 2 (visited July 16, 2009) <http://www.usdoj.gov/ust/eo/ust_org/StrategicPlanFY2005-2010.pdf>. The United States therefore has a substantial interest in the effective implementation of the bankruptcy system and in the avoidance of unwarranted burdens on bankruptcy trustees' performance of their duties.

In addition, the United States is the largest creditor in the Nation. Numerous federal agencies frequently appear as creditors in Chapter 7 cases. Because a bankruptcy estate's assets are typically scarce, the United States has an interest in preventing and deterring Chapter 7 debtors from undervaluing assets in a way that might prevent their use to satisfy claims of the United States.

STATEMENT

1. A debtor commences a voluntary bankruptcy case by filing a petition in bankruptcy court. 11 U.S.C. 301. Individual debtors typically file for relief under Chapter 7 or Chapter 13 of the Bankruptcy Code. The present case arises under Chapter 7, which provides for a liquidation of a debtor's non-exempt pre-petition assets in exchange for a discharge of debts. 11 U.S.C. 701-727. Commencement of a Chapter 7 case creates an "estate" that includes all of the debtor's "legal or equitable interests * * * in property as of the commencement of the case." 11 U.S.C. 541(a). The debtor must surrender all non-exempt estate property to the Chapter 7 trustee, who takes custody of such property, liquidates it, and disburses the proceeds to creditors in accordance with their rights and priorities under the Code. 11 U.S.C. 507, 521(3) and (4), 704(1), 726.[1]

A debtor is entitled, however, to claim various statutory exemptions to prevent the distribution of specified categories of property. 11 U.S.C. 522. Generally speaking, "property exempted [from the estate] is not liable during or after the case for any debt of the debtor that arose * * * before commencement of the case." 11 U.S.C. 522(c). Section 522(d) specifies the types of

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[1] Congress enacted the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (Act), Pub. L. No. 109-8, 119 Stat. 23, on April 20, 2005, one day before respondent filed for bankruptcy, see Pet. App. 2a. Although the Act amended Title 11 in certain respects, virtually all of those amendments did not take effect until October 17, 2005, see Act § 1501(a), 119 Stat. 216, and would not affect this case in any event. Unless otherwise noted herein, references to the Bankruptcy Code and Rules are therefore to the versions in effect in April 2005.

property that a debtor may exempt from the estate under the Bankruptcy Code.[2]

Under Section 522(d), there are two basic types of exemptions. A few exemptions allow a debtor to exempt particular types of property regardless of their value. For instance, a debtor may fully exempt unmatured life insurance contracts (other than credit life insurance contracts), 11 U.S.C. 522(d)(7); professionally prescribed health aids, 11 U.S.C. 522(d)(9); some forms of public assistance, veterans' or disability benefits, 11 U.S.C. 522(d)(10)(A)-(C); and awards under a crime victim's reparation law, 11 U.S.C. 522(d)(11)(A).

Most of the Code's exemptions, however, allow a debtor to exempt only an "interest" in a type of property, typically up to a maximum dollar value.[3] For instance, a debtor may exempt an interest in a residence up to $18,450, 11 U.S.C. 522(d)(1); an interest in a motor vehicle up to $2,950, 11 U.S.C. 522(d)(2); an aggregate interest in household goods up to $9,850, 11 U.S.C. 522(d)(3); an aggregate interest in jewelry up to $1,225, 11 U.S.C. 522(d)(4); and an aggregate interest "in any implements, professional books, or tools, of the trade of the debtor" up to $1,850, 11 U.S.C. 522(d)(6). In addition, the so-called wild card exemption allows a debtor to exempt an aggregate interest "in any property" up to

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[2] States are permitted to opt out of the federal bankruptcy exemptions and thereby require debtors to claim exemptions under state and federal nonbankruptcy law. 11 U.S.C. 522(b)(1). Respondent resides and filed for bankruptcy in Pennsylvania, which has not opted out of the federal bankruptcy exemptions. J.A. 26a, 56a.

[3] Some exemptions are limited not to a maximum dollar value, but to the value "reasonably necessary for support of the debtor." 11 U.S.C. 522(d)(10)(D)-(E); see 11 U.S.C. 522(d)(11)(B), (C) and (E).

$975, plus up to $9,250 of any unused amount of the residence exemption. 11 U.S.C. 522(d)(5).[4]

2. Within 15 days after filing the petition, the debtor must file several schedules of assets and liabilities. 11 U.S.C. 521(1); Fed. R. Bankr. P. 1007(c); Fed. R. Bankr. P. Official Form 6, Schedules A-J. One of those schedules, Schedule C, requires the debtor to specify "a list of property that the debtor claims as exempt." 11 U.S.C. 522(*l*); see Fed. R. Bankr. P. 4003(a) (requiring, in tandem with Rule 1007(b)(1), that the debtor "list the property claimed as exempt" on Schedule C). For each claimed exemption, Schedule C contains four columns on which the debtor provides a "description of [the] property," the "law providing [the] exemption," the "value of [the] claimed exemption," and the "current market value of [the] property without deducting [the] exemption." Fed. R. Bankr. P. Official Form 6, Schedule C (capitalization omitted); see J.A. 57a-58a.

"Unless a party in interest objects" to the exemptions set forth by the debtor on Schedule C, "the property claimed as exempt on such list is exempt." 11 U.S.C. 522(*l*). A party in interest

> may file an objection to the list of property claimed as exempt only within 30 days after the meeting of creditors held under § 341(a) is concluded or within

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[4] The exemption amounts are adjusted every three years based on the Consumer Price Index. 11 U.S.C. 104(a). The exemption amounts were last adjusted in 2007. See 72 Fed. Reg. 7082 (2007) (11 U.S.C. 104 note). The pre-2007 amounts listed in the text apply to the present case because respondent filed her petition in April 2005. See 11 U.S.C. 104(b)(3); see also 11 U.S.C. 522(d); 69 Fed. Reg. 8482 (2004) (11 U.S.C. 104 note (Supp. IV 2004)).

> 30 days after any amendment to the list or supplemental schedules is filed, whichever is later.

Fed. R. Bankr. P. 4003(b). The bankruptcy court may extend the 30-day period for filing objections upon a showing of cause. *Ibid.* The objecting party bears the burden of proving that the challenged exemption has not been properly claimed. Fed. R. Bankr. P. 4003(c).

3. When a Chapter 7 petition is filed, the United States Trustee designates a private trustee to administer the bankruptcy estate. 11 U.S.C. 323, 701, 704; 28 U.S.C. 586(a)(1). The trustee is a fiduciary of the estate, charged with securing the estate's assets, defending the estate against improper claims or other adverse interests, and liquidating the estate for the benefit of creditors. 11 U.S.C. 704. That process generally begins with a required meeting of the debtor's creditors, held between 20 and 40 days after the petition is filed. 11 U.S.C. 341; Fed. R. Bankr. P. 2003(a). At that meeting, the trustee can verify the debtor's financial affairs, assets, and liabilities by questioning the debtor under oath. 11 U.S.C. 343.

Based on the debtor's schedules, the testimony at the creditors' meeting, and any factual investigation, the trustee may determine that the estate does not have sufficient non-exempt assets to liquidate for the benefit of creditors. 11 U.S.C. 341, 521(1), 704(4), and 704(9); Executive Office for United States Trustees, United States Dep't of Justice, *Handbook for Chapter 7 Trustees*, at 8-1 (July 2002) <http://www.usdoj.gov/ust/eo/private_trustee/library/chapter07/docs/7handbook1008/Ch7_Handbook.pdf>. Historically, approximately 95 to 97% of Chapter 7 cases yield no assets for creditors. United States Trustee Program, United States Dep't of Justice, *Preliminary Report on Chapter 7 Asset Cases:*

1994 to 2000, at 7 (June 2001) <http://www.usdoj.gov/ust/eo/private_trustee/library/chapter07/docs/assetcases/Publicat.pdf>. The trustee currently receives a $60 fee for the administration of a no-asset case. 11 U.S.C. 330(b).

In the remaining Chapter 7 cases, the trustee generally liquidates the estate property through either a private sale or a public auction. The trustee then typically prepares a report for the bankruptcy court that describes the disposition of the estate assets and proposes a plan for distribution of proceeds to creditors. 11 U.S.C. 704(9); Fed. R. Bankr. P. 2015(a)(2) and 5009. Through the trustee's distribution, the debtor receives the amount of her exemptions and creditors receive the remaining proceeds according to their statutory priority. 11 U.S.C. 726. In addition to the trustee's $60 fee, the trustee may move in such cases for additional "reasonable compensation." 11 U.S.C. 326(a).

4. Respondent owned a catering business in Conynham, Pennsylvania. Pet. Br. 14. In April 2005, she filed a petition for Chapter 7 relief. Pet. App. 2a. On her Schedule C, respondent invoked two Bankruptcy Code provisions as bases for exempting specified interests in kitchen equipment that respondent had previously used in her business. J.A. 58a.

First, respondent invoked 11 U.S.C. 522(d)(6), which allowed her to exempt an interest in "tools[] of the trade" of up to $1,850. J.A. 58a. Respondent listed the value of the claimed exemption as $1,850. *Ibid.* Second, respondent invoked 11 U.S.C. 522(d)(5), the wild card exemption, which allowed her to exempt an interest in "any property" of up to $10,225 (because she did not claim a residence exemption). J.A. 58a. Respondent listed the value of the claimed exemption as $8,868.

Ibid. In the fourth column of Schedule C, respondent identified the current market value of the business equipment as $10,718, an amount equal to the sum of the two claimed exemptions of $1,850 and $8,868. *Ibid.*

Petitioner was appointed trustee for respondent's estate. Believing that the kitchen equipment might be worth more than $10,718, petitioner obtained an appraisal indicating the equipment was worth approximately $17,000. Pet. Br. 15. On June 22, 2005, petitioner held the creditors' meeting required by 11 U.S.C. 341(a). J.A. 11a. Petitioner did not file within the next month an objection to the "list [of] property claimed as exempt," Fed. R. Bankr. P. 4003(a), including respondent's claimed interests in kitchen equipment, see J.A. 11a-13a.

Seven weeks after the creditors' meeting, on August 10, 2005, petitioner filed with the bankruptcy court a motion to sell the kitchen equipment. J.A. 13a, 141a-143a. By selling the equipment, petitioner could distribute $10,718 of the proceeds to respondent as her exempt interest, while distributing any remaining after-expense proceeds to creditors. See J.A. 142a-143a. Respondent objected to the proposed sale, contending that she had claimed an exemption for the kitchen equipment in its entirety and that petitioner's failure to object to the exemption foreclosed him from consummating the sale. See J.A. 145a-148a.

5. a. After a hearing, the bankruptcy court denied the motion to sell without written opinion. Pet. App. 27a-28a. On appeal, the district court affirmed. *Id.* at 19a-26a. The court stated that, because respondent had identified the same sum ($10,718) as both the amount of the claimed exemption and the value of the kitchen equipment, her clear intent was to exempt the entire

value of the asset. *Id.* at 24a-25a. Relying substantially on this Court's decision in *Taylor* v. *Freeland & Kronz*, 503 U.S. 638 (1992), the district court concluded that "[a]s [respondent] exempted the entire value, and the trustee never objected, she is entitled to the entire value, even if the trustee asserts it is worth more than she estimated." Pet. App. 25a.

b. The court of appeals affirmed. Pet. App. 1a-18a. Relying on *Taylor*, the court found it "important" that respondent had "valued the business equipment at $10,718 and claimed an exemption in the same amount." *Id.* at 11a. The court stated that "[s]uch an identical listing put [petitioner] on notice that [respondent] intended to exempt the property fully." *Ibid.* The court of appeals concluded that "once Rule 4003's 30-day period elapsed without [petitioner] filing an objection or a request for an extension, the property became fully exempt from the bankruptcy estate regardless of its ultimate market value." *Id.* at 12a.

SUMMARY OF ARGUMENT

1. a. Under Section 522(*l*) and Rule 4003(b), the Chapter 7 trustee must object to a claimed exemption within a specified period of time or the relevant property will be treated as exempt. To claim an exemption, a debtor must include on Schedule C, as on all its predecessor schedules, a description of the property, the legal basis for the exemption, and the value of the claimed exemption. Most of the statutory exemptions, including those (11 U.S.C. 522(d)(5) and (6)) that respondent invoked for the kitchen equipment at issue in this case, allow the debtor to exempt an "interest" in particular types of property up to a specified dollar amount. Where, as here, a debtor accurately describes an asset

that is exemptible in the claimed amount under applicable law, the debtor has stated a facially valid exemption that is not subject to any objection.

b. At various points in time, Schedule C and its predecessor schedules have required the debtor to supply the trustee with additional information, such as the property's location, use, or market value. In accord with the demands of the current Schedule C, respondent identified a supposed market value for the property in question. That additional information, however, has no bearing on the validity of a debtor's claimed exemption. A claim of exemption informs the trustee that, according to the debtor, she has an interest in property that does not belong to the estate. By contrast, a market valuation informs the trustee whether, according to the debtor, there is an additional interest in the same property that does belong to the estate. If the trustee doubts the accuracy of the debtor's valuation, he may seek to have the property appraised, but such doubt provides no basis for objecting to an otherwise valid exemption. For that reason, a trustee's failure to object to a claimed exemption in the manner or within the time period prescribed by Rule 4003 does not preclude the trustee from selling the asset and distributing to creditors any proceeds in excess of the debtor's exempt interest.

2. a. Contrary to the court of appeals' conclusion, respondent's Schedule C did not suggest an intent to exempt her kitchen equipment in its entirety regardless of the equipment's actual value. Rather, by claiming an exemption in a particular dollar amount, respondent indicated her intent to exempt only a definite, fixed interest in the property. Respondent might have indicated her intent to exempt the kitchen equipment in its entirety by using terms such as "unknown" or "100% of

its value" to describe the value of the claimed exemption, but she used no such terminology.

Respondent's use of a specific dollar figure to describe the claimed exemption distinguishes this case from *Taylor* v. *Freeland & Kronz*, 503 U.S. 638 (1992), in which the debtor claimed an indefinite interest by listing the value of her exemption as "unknown." Because the property at issue in *Taylor* (a claim for lost wages in a pending lawsuit) was not one of the assets that a Chapter 7 debtor may exempt in its entirety regardless of its value, that claimed exemption was invalid on its face. Although the Court in *Taylor* held that the trustee had forfeited his objection to that exemption by failing to object within Rule 4003(b)'s 30-day deadline, the Court did not suggest that a trustee who questions the debtor's separate market valuation must object to a facially valid exemption in order to preserve his right to obtain an appraisal, sell the property, and distribute any excess proceeds to creditors. Nothing in *Taylor*, moreover, supports the court of appeals' conclusion that respondent, by using the same dollar figure to identify both the amount of the claimed exemption and the market value of the property, had manifested an intent to exempt the kitchen equipment in its entirety regardless of its actual value.

Petitioner's contrary understanding—that respondent's use of specific dollar amounts in the third column of Schedule C reflected an intent to claim as an exemption the amounts stated—reflects a much more natural reading of the form. That interpretation of respondent's Schedule C also has other advantages: it places the responsibility on debtors, who know best what they intend to claim, to complete their schedules in a way that accurately communicates their intent; and it sensibly resolves any ambiguity in a way that renders claimed exemptions valid rather than invalid. Presuming that respondent intended to claim a valid exemption is particularly reasonable here because respondent invoked two statutory subsections (11 U.S.C. 522(d)(5) and (6)) that are limited by their terms to "interest[s]" in property up to specific dollar amounts, and the dollar amounts she listed as the value of the claimed exemption fell within the applicable statutory caps.

b. Contrary to the court of appeals' conclusion, the expiration of the objection period gave respondent no right to assume that she would be allowed to keep her kitchen equipment. To be sure, petitioner's failure to object within that period meant that the property respondent claimed as exempt would be treated as exempt. Properly understood, however, respondent's Schedule C claimed an exemption for an interest in the kitchen equipment in the amount of $10,718. Whether respondent would receive that amount in cash (if petitioner sold the property) or in physical property (if he did not) was left to petitioner to decide during the administration of the estate.

ARGUMENT

I. A TRUSTEE IS REQUIRED TO OBJECT ONLY TO THE PROPERTY CLAIMED AS EXEMPT, NOT TO THE DEBTOR'S MARKET VALUATION OF THAT PROPERTY

A. A Trustee Is Required To Object To A Debtor's Description Of The Property, Asserted Legal Basis For The Exemption, Or Claimed Value Of The Exemption

1. Section 522(*l*) of the Bankruptcy Code establishes the basic process by which debtors claim exemptions and trustees and other parties in interest object to those exemptions. Section 522(*l*) requires the debtor to file "a

list of property that the debtor claims as exempt." Section 522(*l*) does not specify, however, the precise manner in which debtors must claim their exemptions or trustees must file their objections.

Rule 4003 of the Federal Rules of Bankruptcy Procedure supplies those details. It requires that the debtor "list the property claimed as exempt under § 522 of the Code on the schedule of assets required to be filed by Rule 1007." Fed. R. Bankr. P. 4003(a). Rule 1007, in turn, requires the debtor to file "schedules of assets and liabilities, * * * prepared as prescribed by the appropriate Official Forms." Fed. R. Bankr. P. 1007(b)(1). Official Form 6 contains the schedules of assets and liabilities that a debtor must file, and Schedule C requires the debtor to list "property claimed as exempt." Fed. R. Bankr. P. Official Form 6, Schedule C (capitalization omitted).

Rule 4003 also provides that any party in interest, including a trustee,

> may file an objection to the list of property claimed as exempt only within 30 days after the meeting of creditors held under § 341(a) is concluded or within 30 days after any amendment to the list or supplemental schedules is filed, whichever is later.

Fed. R. Bankr. P. 4003(b). The bankruptcy court may extend the time for filing objections upon a showing of cause. *Ibid.* Absent a timely objection, "the property claimed as exempt on such list is exempt." 11 U.S.C. 522(*l*).

2. Under the Code, a debtor may exempt some types of property, regardless of their value. See 11 U.S.C. 522(d)(9) (professionally prescribed health aids); 11 U.S.C. 522(d)(10)(C) (disability benefits); 11 U.S.C.

522(d)(7) (unmatured life insurance contracts); 11 U.S.C. 522(d)(10)(A)-(C) (public assistance, veterans', illness, and unemployment benefits); 11 U.S.C. 522(d)(11)(A) (awards under a crime victim's reparation law). Most of the Code's exemptions, however, including the two exemptions that respondent invoked with respect to the kitchen equipment at issue, are limited to the debtor's "interest" in particular types of property up to a maximum dollar amount. See 11 U.S.C. 522(d)(5) and (6); J.A. 58a. When an asset is worth more than the interest that the debtor has exempted, the excess value belongs to the estate, not the debtor. Under those circumstances, the trustee may liquidate the debtor's exempt interest and the estate's non-exempt interest by selling the asset, and he may then distribute to the debtor and creditors their respective shares of the proceeds.

3. Because the nature of the asset determines whether the debtor can claim it in whole or only in part, "the list of property that the debtor claims as exempt" under Section 522(*l*) must include (a) a description of the asset, (b) the legal authority that provides the exemption, and (c) the value of the claimed exemption. See Fed. R. Bankr. P. Official Form 6, Schedule C. Those are the three pieces of information that a trustee needs in order to determine whether a claimed exemption is valid. So long as the debtor has an interest in property that is potentially exemptible; the debtor identifies the legal basis for her claimed exemption; and the debtor's claimed exemption does not exceed any applicable legal limit, then the debtor has asserted a valid exemption that the trustee has no reason to challenge. Conversely, a challenge to any of those three things—the property description, legal basis for the exemption, or value of the exemption—is an objection to the exemption itself, and

thus must be made within the 30-day time period provided by Rule 4003(b).

4. In the present case, petitioner had no valid basis for objecting to respondent's claimed exemptions for her interests in the kitchen equipment. With respect to that equipment, respondent claimed an exemption of $1,850 under 11 U.S.C. 522(d)(6) (the tools of the trade exemption) and an exemption of $8,868 under 11 U.S.C. 522(d)(5) (the wild card exemption). J.A. 58a. It is undisputed that respondent properly described the kitchen equipment; that the statutory subsections she invoked apply to the property at issue; and that the values of her claimed exemptions did not exceed the maximum values permitted by those subsections. Respondent therefore claimed two valid exemptions for her interests in the kitchen equipment.

Because respondent's exemptions had an adequate basis in law and fact, petitioner did not object to either exemption within the 30-day time period provided by Rule 4003(b). The absence of an objection from petitioner (or any other party in interest) means that "the property claimed as exempt on such list is exempt." 11 U.S.C. 522(*l*). The property claimed as exempt on respondent's Schedule C were two interests in kitchen equipment valued at $1,850 and $8,868. Because petitioner did not object within the 30-day time period provided by Rule 4003(b), respondent is entitled to receive the value of those property interests during the administration of the estate.

B. Because The Debtor's Estimated Market Valuation Is Not Part Of Her Claim Of Exemption, A Trustee's Disagreement With That Valuation Provides No Basis For Objecting To The Exemption

A claim of exemption informs the trustee that, according to the debtor, she has an interest in property that does not belong to the estate. A market valuation informs the trustee whether, according to the debtor, there is an additional interest in the same property that does belong to the estate. The market valuation provided by the debtor on the fourth column of Schedule C thus facilitates the trustee's administration of the estate by helping him to discern whether particular assets have sufficient non-exempt value to justify liquidation by sale or auction. The presence or absence of additional value belonging to the creditors, however, has no bearing on whether the interest that the debtor claims as exempt is in fact exempt under the applicable statutory provisions.

That understanding of the Code is confirmed by the history of the relevant provisions and schedules. Since the Bankruptcy Act was enacted in 1898, Schedule C and its predecessors (Schedules B-4 and B-5) have required the debtor to provide the information necessary to determine the validity of her claimed exemptions: namely, a description of the property, a specification of the legal basis for the exemption, and a statement of the value of the claimed exemption. Compare *General Orders and Forms in Bankruptcy*, 172 U.S. 653, 677 (1898) (Form 1, Schedule B.(5)), and Fed. R. Bankr. P. Official Form 6, Schedule B-4 (1973), with Fed. R. Bankr. P. Official Form 6, Schedule C (1991). At various points in time, however, Schedule C and its predecessors have required other types of information that do not bear on the validity of the debtor's claimed exemptions.

Prior to 1991, for example, Schedule B-4 required the debtor to state the location of the property and its present use, although it did not require the debtor to estimate the market value of the property. That was true even though then, as now, the debtor was required to file on Schedule B-4 "a list of property that the debtor claims as exempt." 11 U.S.C. 522(*l*) (1988); see Fed. R. Bankr. P. 4003(a) (1990) (requiring, in tandem with Rule 1007(b)(1), that the debtor "list the property claimed as exempt" on Schedule B-4). In 1991, Schedule B-4 was amended and retitled Schedule C. *Inter alia*, those amendments required the debtor to state the property's location on Schedule A (real property) and Schedule B (personal property) instead of Schedule C; eliminated the prior requirement that the debtor state the property's present use; and required the debtor to state the property's market value. See Fed. R. Bankr. P. Official Form 6 advisory committee's note (1991). The recency of the requirement that the debtor identify the market value of property for which exemptions are claimed reinforces the conclusion that such valuations do not bear on the propriety of a debtor's claimed exemptions.

In order to preserve his challenge to a claimed exemption, a trustee or other party in interest must "object[]" within a specified period to the "list of property that the debtor claims as exempt." 11 U.S.C. 522(*l*); see Fed. R. Bankr. P. 4003(b) (establishing 30-day time limit, subject to extension for cause, for "[o]bjecting to a claim of exemptions"). As explained above, the "list of property that the debtor claims as exempt" includes a description of (a) an interest in an asset (b) of a particular value (c) that is exempt from the bankruptcy estate under applicable law. So long as the interest for which the debtor claims an exemption is less than or equal to the relevant statutory cap, the trustee's belief that the debtor has understated the value of the asset provides no basis for objecting to the claimed exemption. That is because the claimed exemption—the interest that the debtor claims as hers under the applicable law—stands separate and apart from the value of the asset; the two bear no necessary, or even likely, relationship to each other. In deciding whether to object to a claimed exemption, the trustee naturally looks only to the claimed exemption—not to the independent statement of property value. For that reason, neither Section 523(*l*) nor Rule 4003 speaks to the time or manner in which the trustee may seek to determine (for purposes of possible liquidation) whether the debtor's statement of property value is correct.

II. RESPONDENT'S ARGUMENTS THAT PETITIONER WAS REQUIRED TO OBJECT TO HER MARKET VALUATION OF HER PROPERTY LACK MERIT

A. Respondent Did Not Indicate An Intention To Exempt The Full Value Of The Asset

1. Respondent's Schedule C is most naturally read as claiming exemptions only for a definite, fixed interest

On her Schedule C of property claimed as exempt, respondent identified kitchen equipment as one category of property; invoked 11 U.S.C. 522(d)(5) and (6) as the applicable statutory provisions; claimed exemptions of $8,868 and $1,850 respectively under those provisions; and stated the current market value of the equipment as $10,718. J.A. 58. Relying substantially on this Court's decision in *Taylor* v. *Freeland & Kronz*, 503 U.S. 638 (1992), the court of appeals concluded that, by claiming exemptions totaling $10,718 while valuing the kitchen equipment in the same amount, respondent had expressed her intent to claim an exemption for the full value of the equipment, whatever that value turned out to be. See Pet. App. 11a, 13a, 17a. Petitioner, by contrast, construed respondent's Schedule C as claiming a definite, fixed exemption of $10,718, while indicating respondent's belief that the kitchen equipment was worth precisely that sum. Pet. Br. 23. Petitioner's interpretation of the form is more natural, and this Court's decision in *Taylor* provides no support for the court of appeals' contrary view.

1. Where, as here, a debtor's Schedule C assigns a particular dollar amount to an exemption, the form is naturally read to claim an exemption limited to the specified amount, not an indefinite exemption in whatever value the property is ultimately determined to have. See, *e.g.*, *In re Barroso-Herrans*, 524 F.3d 341, 346 (1st Cir. 2008) ("[T]he trustee's reading of the exemptions as limited to [the claimed amount] of a $4,000 share of the proceeds from each law suit is objectively reasonable."); *In re Hyman*, 967 F.2d 1316, 1319 (9th Cir. 1992) ("[T]he [debtors] did not sufficiently notify others that they were claiming their entire homestead as exempt property; their schedule only gave notice that they claimed $45,000 as exempt, which is the proper amount of their homestead allowance.").

That is particularly true because respondent could have claimed an indefinite interest by listing the value of her claimed exemption as "unknown," "to be determined," or "100% of its value." Courts and commentators have recognized that such terms "'are red flags to trustees and creditors,' and therefore put them on notice that if they do not object, the whole value of the asset—whatever it might later turn out to be—will be exempt." *Barroso-Herrans*, 524 F.3d at 345 (quoting 1 *Collier on Bankruptcy* ¶ 8.06[1][c][ii], at 8-75 to 8-76 (Alan N. Resnick & Henry J. Sommer, eds., 15th ed. rev. 2007) (*Collier*)). Use of such terms may be unproblematic with respect to property that is exempt in full regardless of its value. But if respondent had used such terms in claiming exemptions under 11 U.S.C. 522(d)(5) and (6), which are limited to a debtor's "interest" in particular categories of property up to specified dollar amounts, petitioner would have been clearly placed on notice of the need to object because the exemptions would have been invalid if the value of the kitchen equipment exceeded the sum of the relevant statutory thresholds.

Respondent used none of those "red flag" terms, but instead claimed exemptions to which she assigned the definite and fixed values of $1,850 and $8,868, for a total of $10,718. Her Schedule C is most naturally read to indicate that she intended to claim an exempt interest limited to that amount *and* that she estimated $10,718 to be the actual market value of the property. Indeed, if a debtor believes that her exemptible interest is equal to the market value of a particular asset, but wishes to make clear that she is claiming only a specific dollar interest within the applicable statutory cap in the event that the property turns out to be worth more, the debtor has no other way to communicate that intent than by using the same dollar amount in the third and fourth columns of Schedule C.

2. This Court's decision in *Taylor* provides no support for the court of appeals' reading of respondent's Schedule C. In *Taylor*, a debtor listed the value of her claimed exemption in a pending lawsuit as "unknown," and the debtor's attorneys informed the trustee that the

suit had a potential value well in excess of any available exemption. See 503 U.S. at 640, 642. After the creditors' meeting (which triggered the 30-day objection period in Rule 4003(b)), the trustee informed the debtor that he considered the lawsuit's proceeds to be property of the estate, but he elected not to file a formal objection based on his belief that the lawsuit lacked sufficient value. *Id.* at 640-641. When the lawsuit settled for a substantial sum and the trustee belatedly demanded that the debtor turn over the proceeds, the debtor's counsel responded that the trustee's failure to file a timely objection meant that the lawsuit was fully exempt. *Id.* at 643-644.

The trustee in *Taylor* did not dispute that, by listing "unknown" as the value of the lawsuit proceeds, the debtor had claimed an exemption for the full value of the lawsuit, whatever that turned out to be. Rather, the trustee argued that, notwithstanding his failure to object to an exemption that was invalid on its face, "courts may invalidate a claimed exemption after expiration of the 30-day period if the debtor did not have a good-faith or reasonably disputable basis for claiming it." 503 U.S. at 643. The Court rejected that argument, explaining that, once Rule 4003(b)'s 30-day deadline expires without an objection, "Section 522(*l*) [makes] the property exempt," and the trustee "cannot contest the exemption * * * whether or not [the debtor] had a colorable statutory basis for claiming it." *Id.* at 643-644. While recognizing that Rule 4003(b)'s 30-day deadline "may lead to unwelcome results," the Court observed that the deadline also "prompt[s] parties to act" and "produce[s] finality." *Id.* at 644.

The decision in *Taylor* sheds no light on the question presented here. In *Taylor*, all agreed that the debtor had claimed an exemption for the full recovery in her discrimination suit, whatever that amount turned out to be. The parties in *Taylor* also "agree[d] that [the debtor] did not have a right to exempt more than a small portion of these proceeds either under state law or under the federal exemptions specified in § 522(d)." 503 U.S. at 642. The trustee in *Taylor* declined to object within Rule 4003(b)'s 30-day period, not because he reasonably construed the form submitted by the debtor to claim an exemption that was within an applicable statutory cap, but because he judged that the certain costs of objection outweighed the speculative benefits to the estate. *Id.* at 641.

Here, by contrast, respondent used specific dollar figures, totaling $10,718, to identify the value of the claimed exemption. J.A. 58a. Petitioner had no occasion to object to respondent's claimed exemption because he construed that exemption exactly as it was written, as limited to a $10,718 interest in the kitchen equipment—and that amount was within applicable statutory limits. Nothing in *Taylor* supports the court of appeals' view that, by using the same $10,718 figure as the market value of the kitchen equipment, respondent signaled her intent to exempt the full value of the equipment, whatever that value turned out to be. Indeed, *Taylor* cannot support that view, both because (a) the debtor in *Taylor* described the value of her claimed exemption as "unknown" rather than specifying an exact dollar amount, and (b) the Court in *Taylor* was not confronted with any interpretive question analogous to this one, given the parties' agreement in that case that the debtor had sought to exempt the full value of the lawsuit. See *Barroso-Herrans*, 524 F.3d at 344 ("*Taylor* does not tell us *what* has been claimed as exempt—only that *whatever* has been claimed as exempt is beyond the estate's grasp once the deadline has elapsed.").[5]

2. Related provisions of the Bankruptcy Code and Rules reinforce the conclusion that respondent's claimed exemption in her kitchen equipment was limited to a specific dollar amount

As explained above, respondent's Schedule C identified two dollar figures ($1,850 and $8,868), which totaled $10,718, in the column entitled "value of claimed exemption." Respondent's use of those specific figures is most naturally understood as claiming an exemption for a $10,718 interest in the equipment. Related provisions of the Bankruptcy Code and Rules reinforce that conclusion.

1. Under the Rules, a trustee has limited time to review a debtor's schedules and file objections to claims of exemption. The burden should therefore be placed on the debtor, who knows best what she intends to claim as exempt, to complete her schedules in a way that accurately communicates her intent. See *In re Hyman*, 967 F.2d at 1320 n.6. Specifically, Rule 4003(b) requires objections to exemptions within 30 days of the creditors' meeting, which generally must be held 20 to 40 days after a debtor files her petition. Fed. R. Bankr. P. 2003(a). Thus, absent an extension for cause, objections to claimed exemptions must be filed within 50-70 days

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[5] Indeed, the debtor in *Taylor* was not called upon to estimate the market value of her lawsuit because the forms used at that time did not require her to do so. The debtor in *Taylor* filed for bankruptcy in 1984, seven years before then-Schedule B-4 was amended to require any estimate of market valuation from the debtor. See 503 U.S. at 640; p. 17, *supra*; Pet. Br. 28. The interpretive question that the court of appeals addressed in this case therefore could not have arisen under the law in effect at the time of the bankruptcy petition in *Taylor*.

after receiving the debtor's Schedule C. In light of that "relatively short" objection period, "it is important that trustees and creditors be able to determine precisely whether a listed asset is validly exempt simply by reading a debtor's schedules." *In re Hyman*, 967 F.2d at 1319-1320 n.6; *In re Barroso-Herrans*, 524 F.3d at 345 ("[A]fter *Taylor*, a failure to object to a claimed objection exemption has very harsh consequences for the estate, and so it is most fair to place on the debtor the burden of claiming exemptions unambiguously.").

While the Rules' time frame for asserting objections allows a trustee to identify claimed exemptions that are invalid on their face, it will often be insufficient to conduct appraisals to determine whether particular assets are worth more than the applicable exemption caps. That practical consideration reinforces the view that the time limits for "object[ing]" to a claimed exemption do not apply to a trustee's reassessment and possible rejection of the debtor's valuation of listed property. To be sure, if petitioner had construed respondent's Schedule C to claim an exemption for the full value of her kitchen equipment, he might have objected (without first performing an appraisal) on the ground that the exemption was *potentially* invalid since the kitchen equipment *might* be worth more than the applicable exemption limits. A rule of construction that encouraged such objections, however, would engender needless litigation in cases where the debtor in fact intended to claim an exemption of a specific dollar amount.

Recognizing the debtor's responsibility to state her claimed exemptions accurately also accords with the larger purposes and structure of the federal bankruptcy system. That system is premised on the notion that an "honest but unfortunate debtor who surrenders for distribution the property which [s]he owns" deserves "a new opportunity in life and a clear field for future effort." *Local Loan Co.* v. *Hunt*, 292 U.S. 234, 244 (1934). For the system to function effectively, the debtor must honestly and accurately report her assets, liabilities, and exemptions so that the property can be divided between the debtor and her creditors in accordance with applicable Code provisions. See, *e.g.*, *In re An-Tze Cheng*, 308 B.R. 448, 458 (B.A.P. 9th Cir. 2004) ("The efficacy of the bankruptcy system depends in important respects on accurate self-reporting by debtors."), aff'd, 160 Fed. Appx. 644 (9th Cir. 2005) (mem.). When a debtor seeks to claim an exemption for a listed asset in its entirety, rather than for a specific monetary interest in that asset, the debtor can and should so indicate on her Schedule C.

2. To the extent that a particular Schedule C is ambiguous, the trustee should seek to resolve the ambiguity so as to render claimed exemptions valid rather than invalid. Respondent contends, and the court of appeals held, that petitioner should have interpreted her Schedule C to claim the full value of the kitchen equipment, whatever that value turned out to be. But respondent's kitchen equipment was not among the categories of property that may be exempted from the bankruptcy estate regardless of its value. Respondent thus argues in effect that petitioner should have presumed the worst—*i.e.*, that respondent was claiming an exemption potentially in excess of the Code's limits. The more usual and sensible presumption is that debtors are aware of the statutory limits and are attempting to claim exemptions to which they are legally entitled. See *United States* v. *Budd*, 144 U.S. 154, 163 (1892) ("[N]o man is

presumed to do wrong or to violate the law, and every man is presumed to know the law.").

That presumption is particularly sound in the circumstances of this case because respondent correctly identified 11 U.S.C. 522(d)(5) and (6) as the bases for the claimed exemption. J.A. 58a. The exemptions authorized by those provisions are limited to a debtor's "interest" in particular types of property up to specified dollar amounts. The amounts that respondent claimed as exempt under those provisions fell within the statutory caps. Given respondent's express reliance on statutory provisions that are limited by their terms to "interest[s]" having specified maximum values, and given her use of precise dollar figures falling within those statutory maxima, petitioner had no reason to conclude that respondent was claiming a potentially invalid exemption for the full value of the equipment.

3. The court of appeals' approach has the perverse effect of rewarding respondent for her inaccurate assessment of the market value of her kitchen equipment. If respondent had correctly listed that market value as $17,000, she would have had no basis for opposing petitioner's subsequent motion to sell, and she would have received a total exemption of $10,718. But the court of appeals held that by undervaluing her property, respondent had the opportunity to receive a greater exemption—in the amount of the actual value of the property, or $17,000.

As explained above (see p. 16, *supra*), requiring the debtor to identify the market value of the property listed on her Schedule C assists the trustee in determining whether the property has significant additional value, beyond the interest that the debtor claims as exempt under applicable Code provisions, that may feasibly be liquidated and distributed to creditors. The information currently required to be included in the fourth column of Schedule C thus facilitates the administration of the bankruptcy estate, even though it is irrelevant to the trustee's determination whether a claimed exemption is valid. A debtor who believes that an asset has significant non-exemptible value, however, might perceive an incentive to list on her Schedule C a market value at or very close to the claimed exemption, in order to dissuade the trustee from undertaking an appraisal and sale. Acceptance of the interpretive approach adopted by the court of appeals would create an additional incentive to such undervaluations of property.

4. Petitioner's approach entails no unfairness to debtors. If a debtor intends to exempt the full value of an asset, whatever that value may be, she may convey that intent by saying so explicitly or by using "unknown" or similar language to describe the value of the claimed exemption. See pp. 19-20, *supra*. In addition, a debtor may amend her Schedule C "as a matter of course at any time before the case is closed." Fed. R. Bankr. P. 1009(a). If a debtor claims as exempt a specific dollar interest that is beneath the applicable cap, based on the mistaken belief that the dollar figure represents the asset's true market value, nothing prevents her from claiming a larger exemption when she discovers her mistake (when, for example, the trustee moves to sell the property). The Rules therefore provide a straightforward solution for debtors who mistakenly undervalue property and who are entitled to claim larger exemptions: express amendment by debtors of those claimed

exemptions, not implied enlargement of those exemptions by courts.[6]

In the present case, there was little reason for respondent to amend because she was not entitled to claim a larger exemption.[7] Nevertheless, respondent had ample *opportunity* to claim a larger exemption if she believed that one was authorized under the Code. At the creditors' meeting, petitioner informed respondent's attorney that the likely value of the kitchen equipment was approximately $17,000, and that petitioner intended to sell the property in order to generate funds for unsecured creditors. Br. in Opp. 3-4 & n.1. That statement of intent strongly suggested that petitioner understood respondent to be claiming an exemption limited to a $10,718 interest in the equipment. At that point, if respondent had intended to claim an exemption for the kitchen equipment in its entirety, she could have amended her Schedule C to claim the full value of $17,000

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[6] Absent bad faith, a debtor could convert her case from Chapter 7 to Chapter 13, and her property would remain her own rather than being transferred to a bankruptcy estate. 11 U.S.C. 706(a), 1306(b); *Marrama* v. *Citizens Bank*, 549 U.S. 365 (2007). In addition, a Chapter 7 debtor could use her post-petition income to repurchase property given over to the bankruptcy estate.

[7] Indeed, respondent's total claimed exemptions under the Code's wild card provision actually exceeded the applicable statutory cap. Respondent invoked the wild card exemption for an interest of $8,868 in the kitchen equipment, as well as for interests totaling $26 in bank accounts and interests totaling $2,306 in food goods at her restaurant. J.A. 57a-58a. Thus, respondent claimed a total wild card exemption of $11,200, or $975 more than she was permitted at the time. 11 U.S.C. 522(d)(5). When petitioner did not object (apparently because the foodstuffs were perishable items that could not be readily sold), respondent received a windfall of the additional $975.

(to which petitioner presumably would have objected, as in excess of the wild card exemption limit of $10,225).

But respondent did not amend—which makes this case the flipside of *Taylor*. In *Taylor*, the debtor told the trustee that she intended to claim the asset's full value, and the trustee asserted no objection to that facially invalid exemption. Here, the trustee told the debtor that the asset was worth more than her exemption and that the trustee intended to liquidate the property, and the debtor neither amended her Schedule C nor informed the trustee that he had misunderstood the extent of the exemption that she intended to claim. Moreover, because trustees must apply to sell property and provide notice of that application to the debtor, 11 U.S.C. 725; Fed. R. Bankr. P. 2002, 6004, the Court need not be concerned that debtors in future cases will lack notice of any undervaluation.

B. Petitioner's Proposal To Liquidate The Kitchen Equipment And Divide The Proceeds Between Respondent And Her Creditors Did Not Undermine Any Legitimate Reliance Interest Created By Expiration Of The 30-Day Objection Period

The court of appeals asserted that its approach "accords with bankruptcy's promise of a fresh start," because "[o]nce the period for objection lapses, all parties know what property belongs to the bankruptcy estate and what remains with the debtor." Pet. App. 16a. That assertion is correct as far as it goes. Once Rule 4003(b)'s 30-day period expires, "the property claimed as exempt" on a debtor's Schedule C "is exempt." 11 U.S.C. 522(*l*). But the "property claimed as exempt" on Schedule C is not always or even typically an entire asset or tangible item. See pp. 4, 14, *supra*. The Code permits only a handful of in-kind exemptions for entire assets. Most of the Code's exemptions instead allow a debtor to exempt an "interest" in property, up to a maximum dollar value. Accordingly, the "property claimed as exempt" on Schedule C is often an interest worth a certain dollar amount, which the debtor will receive in cash if the trustee liquidates the asset by sale or auction.

By specifying precise dollar figures as the value of her claimed exemptions in the kitchen equipment, and by relying on statutory provisions (11 U.S.C. 522(d)(5) and (6)) that are limited by their terms to "interest[s]" in property up to a specified amount, respondent's Schedule C expressed an intent to claim as exempt an interest in kitchen equipment worth a total value of $10,718. Once the period for filing objections expired, respondent knew that she would be allowed to retain that interest, either in cash (if the trustee sold the equipment) or in physical property (if he did not). But the trustee's failure to object gave respondent no basis for assuming that she could retain the physical property rather than the dollar value of the interest claimed to be exempt. That choice is always the trustee's, and it is frequently made after the period to object has expired.

The court of appeals was therefore wrong in stating that, if respondent's "listing were construed to exempt only that portion of the property having the value stated[,] the provisions finalizing exemptions if no objections are filed would be rendered meaningless." Pet. App. 16a-17a n.4 (quoting 9 *Collier* ¶ 4003.02[1], at 4003-5). If respondent's Schedule C had identified $17,000 as the correct market value for the kitchen equipment, and the trustee had failed to object to her claimed $10,718 exemption, respondent would have known that the equipment was subject to liquidation, in which case she would receive her exempt interest in cash proceeds from the sale. On petitioner's approach, respondent will have precisely that same certainty when she undervalues property. What respondent actually seeks, and what the court of appeals granted her, was a different kind of certainty: the certainty that she could keep an asset's full value, which she had not claimed as exempt and to which she was not statutorily entitled.

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted.

ELENA KAGAN
Solicitor General

TONY WEST
Assistant Attorney General

MALCOLM L. STEWART
Deputy Solicitor General

JEFFREY B. WALL
Assistant to the Solicitor General

WILLIAM S. KANTER
MELISSA N. PATTERSON
Attorneys

RAMONA D. ELLIOTT
General Counsel

P. MATTHEW SUTKO
Associate General Counsel

ERIC K. BRADFORD
CATHERINE B. SEVCENKO
Attorneys
Executive Office for United States Trustees

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1. (“TI”) TITLE OF CASE [E.g., “SMITH v. U.S. TRUSTEE (IN RE SMITH)”]
Scott v. UST (In re Doser)

2. (“CO”) CURRENT COURT [E.g., “CTA9"]
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3. (“CCN”) CURRENT CASE NO.
No.: 03-35411

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7. (“AU”) PRINCIPAL AUTHORS & OFFICE [E.g.,“UST/OGC”]
R. Craig Green, Attorney Appellate Staff
P. Matthew Sutko, Attorney EOUST
(UST/OGC: 202-307-1399/FAX-2397)

8. (“TO”) TOPIC
BANKRUPTCY

9. (“SU”) ! SUMMARY OF KEY ISSUE(s) & √ Any Miscellaneous BACKGROUND
! 1) Did bankruptcy court abuse its discretion in holding that Appellant committed an "Unfair of deceptive act" under 11 USC 110 (i)? 2) Does 11 USC 110's prohibition of "fraudulent, unfair, and deceptive" acts by bankruptcy petition preparers exceeds Congress' authority under the Bankruptcy Clause? 3) Does 11 USC 110 (i) prohibition of "fraudulent, unfair, and deceptive" acts by bankruptcy petition preparers violates Appellant's First Amendment rights?
√ Background:

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No. 03-35411

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

IN RE: KEVIN J. DOSER & LAURA E. DOSER,

Debtors.

JUDITH M. SCOTT

Appellant,

v.

UNITED STATES TRUSTEE

Appellee.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF IDAHO

BRIEF FOR UNITED STATES TRUSTEE

PETER D. KEISLER
Assistant Attorney General

WILLIAM KANTER
(202) 514-4575
H. THOMAS BYRON, III
(202) 616-5367
R. CRAIG GREEN
(202) 514-2498
Attorneys, Appellate Staff
Civil Division, Room 9104
Department of Justice
601 D Street, N.W.
Washington, D.C. 20530

OF COUNSEL:

JOSEPH A. GUZINSKI
General Counsel
P. MATTHEW SUTKO
Attorney
Office of the General
Counsel, Executive Office
for U.S. Trustees
20 Massachusetts Ave., N.W.
Washington, D.C. 20530

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BRIEF FOR UNITED STATES TRUSTEE

STATEMENT OF JURISDICTION

Judith M. Scott, d/b/a We The People Forms and Service Center of Boise, appeals from a final decision of the United States District Court for the District of Idaho, which affirmed a final decision of the United States Bankruptcy Court for the District of Idaho. The bankruptcy court had jurisdiction under 28 U.S.C. § 157(b) and issued its final decision on July 3, 2002. On July 11, 2002, Scott filed a notice of appeal to the district court, which had appellate jurisdiction under 28 U.S.C. § 158(a). On March 31, 2003, the district court rendered its final decision. On May 7, 2003, Scott filed a notice of appeal to this Court, which has jurisdiction under 28 U.S.C. § 158(d).

STATEMENT OF THE ISSUES

1. Whether the bankruptcy court abused its discretion in holding that Scott committed an “unfair or deceptive act” under 11 U.S.C. § 110(i).

2. Whether 11 U.S.C. § 110’s prohibition of “fraudulent, unfair, and deceptive” acts by bankruptcy petition preparers exceeds Congress’s authority under the Bankruptcy Clause.

3. Whether 11 U.S.C. § 110(i)’s prohibition of “fraudulent, unfair, or deceptive” acts by bankruptcy petition preparers violates Scott’s First Amendment rights.

STATEMENT OF THE CASE

This case arises from the bankruptcy court’s determination that Scott violated 11 U.S.C. § 110 while preparing a Chapter 7 bankruptcy petition for Kevin and Laura Doser. The bankruptcy court found that Scott violated 11 U.S.C. § 110(g) by receiving and delivering payment of the Dosers’ court fees, that Scott’s fees were excessive under 11 U.S.C. § 110(h), and that Scott violated 11 U.S.C. § 110(i) by committing unfair and deceptive acts. The district court affirmed each of the bankruptcy court’s rulings.

STATEMENT OF FACTS

1. As part of the Bankruptcy Reform Act of 1994, Pub. L. 103-394, Congress enacted 11 U.S.C. § 110 to create "standards and penalties pertaining to bankruptcy petition preparers." H.R. Rep. 103-835, 103d Cong., 2d Sess. 40-41 (Oct. 4, 1994). The term "bankruptcy petition preparer" includes all persons, apart from attorneys and their employees, who are paid to prepare bankruptcy documents filed in court. 11 U.S.C. § 110(a)(1). By enacting Section 110, Congress sought to impose legal limits on preparers who "often lack the necessary legal training and ethics regulation" to provide debtors with legal advice and legal services. H.R. Rep. 103-834, at 40-41. Congress determined that when preparers try to provide an expansive range of services, they may mislead or "take unfair advantage of persons who are ignorant of their rights both inside and outside the bankruptcy system." Ibid.

Congress responded to such problems by enacting protections that are now codified in 11 U.S.C. § 110. In relevant part, Section 110 forbids bankruptcy preparers from committing any "fraudulent, unfair or deceptive" act. See 11 U.S.C. § 110(i). Section 110 also requires preparers to sign filed documents and disclose their Social Security number, to give debtors a copy of filed documents, and to disclose any fees charged within a year of the bankruptcy case's filing. See 11 U.S.C. § 110(b), (c), (d), & (h). Preparers are forbidden from executing documents on a debtor’s behalf, using the word “legal” in advertisements, or receiving the debtor’s court fees. See 11 U.S.C. § 110(e), (f), & (g). Bankruptcy courts must disallow a preparer’s fees to the extent that they are excessive. See 11 U.S.C. § 110(h)(2).

2. On December 4, 2001, Kevin and Laura Doser filed a bankruptcy petition under Chapter 7 of the Bankruptcy Code. The petition disclosed that it was prepared by Scott, and that the Dosers paid Scott $214.00, which included $199.00 for document preparation and $15.00 for photocopies.

On December 27, 2002, the bankruptcy court sua sponte ordered Scott to show cause that she did not violate 11 U.S.C. § 110 through her services and compensation concerning the Dosers’ petition. That order invited Scott, the Chapter 7 Trustee, and the United States Trustee to file written submissions.[1] On February 19, 2002, the bankruptcy court held an

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[1] United States Trustees are officials of the Department of Justice appointed by the Attorney General to supervise the administration of bankruptcy cases and trustees. See 28 U.S.C. §§ 581-589; In re Columbia Gas Sys., Inc., 33 F.3d 294, 296 (3d Cir. 1994) (explaining that United States Trustees oversee the bankruptcy process, protect the public interest, and ensure that bankruptcy cases are conducted according to law) (citing H.R. Rep. No. 95-595, 109 (1977)). “The United States Trustee is the ‘watchdog’ of the bankruptcy system * * * charged with preventing fraud and abuse and with ‘fill[ing] the vacuum’ caused by possible creditor inactivity.” In re Castillo, 297 F.3d 940, 950 (9th Cir. 2002). Section 307 of the Bankruptcy Code authorized the United States Trustee to appear and be heard on the propriety of Scott’s fee. See 11 U.S.C. § 307; In re Donovan Corp., 215 F.3d 929, 930 (9th Cir. 2000) (“The United States trustee may

evidentiary hearing attended by Scott, the Chapter 7 Trustee, and the United States Trustee.

3. On July 3, 2002, the bankruptcy court issued a decision outlining Scott's business methods, and holding that she violated 11 U.S.C. § 110. The bankruptcy court explained that Scott operates, under the name "We The People Forms and Service Center of Boise," an Idaho franchise of "We The People Forms and Service Centers USA, Inc.," a California-based corporation. Bankr. Op. 5. Scott informed the Dosers that she was not an attorney, directed them to sign a "purchase order," and collected a $214.00 fee. Id. at 6-8. Scott then gave the Dosers two documents: a "Bankruptcy Overview," and a "Workbook." Id. at 8-9.

a. The Overview is a twenty-page document that describes general concepts of Chapter 7 bankruptcy and offers "tips" on how customers should represent themselves in bankruptcy proceedings. Bankr. Op. 9. The Overview contains "detailed, substantive material," listing "all exemptions allowed under Idaho law" and recommending how such exemptions should be documented on a customer's bankruptcy schedule. Id. at 10. Furthermore, the Overview informs Scott's bankruptcy customers that:

> The bankruptcy law regarding the scope of a Chapter 7 discharge is complex. Know your rights. **Should you have any doubts about the appropriateness of bankruptcy**

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* * * intervene and appear at any level of the proceedings from the bankruptcy court on, * * * as either a party or an amicus.") (internal quotation marks omitted).

> **in your particular case, you should seek the advice of an attorney.**
>
> In addition, don't forget that you enjoy the right, as a WE THE PEOPLE customer, to chat with our Supervising Attorney, at no additional cost to you.

Overview 7. The "Supervising Attorney" is a lawyer retained by Scott's California-based franchisor and represents only the franchisor; the Overview does not inform customers that the attorney does not represent Scott or Scott's customers.[2] Bankr. Op. 11.

b. Scott's other document, the Workbook, is a questionnaire that her bankruptcy customers use to describe their assets, debts, and financial affairs. Bankr. Op. 9. Customers return the Workbook to Scott, and she checks the information for legibility and typographical errors. Then, she faxes the Workbook to the franchisor's office in California, and the franchisor's employees transfer information from the Workbook to official bankruptcy forms. The official forms are electronically transmitted to Scott, who prints them and asks debtors to sign the papers in her office. Id. at 8-9. After the Dosers signed

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[2] Scott pays the franchisor $200.00 per month for general assistance in bankruptcy and non-bankruptcy areas of her business. Scott's non-bankruptcy business includes services associated with divorce, wills, copyright, trademark, name changes, incorporation, and probate. See http://www.boisewethepeople.com (visited January 14, 2004). Scott pays her franchisor a portion of her gross revenues and a $200 monthly fee for the Supervising Attorney. Bankr. Op. 20 & n.13, 22-23.

their bankruptcy forms, Scott made three copies. The Dosers gave Scott a money order payable to the clerk of court, and Scott delivered the documents and the money order to the bankruptcy court. Id. at 9.

c. In her show-cause proceeding before the bankruptcy court, Scott argued that she did not receive adequate notice and hearing, and that she did not violate 11 U.S.C. § 110. The bankruptcy court disagreed, holding that the show-cause proceeding satisfied due process, and that Scott's business practices violated two provisions of 11 U.S.C. § 110.

Under 11 U.S.C. § 110(g), the bankruptcy court held that Scott illegally collected and received the Doser's money order for "the court fees in connection with filing the petition." See Bankr. Op. 34-39 (quoting 11 U.S.C. § 110(g)). The court fined Scott $10.00 for that misconduct. Id. at 40.

Under 11 U.S.C. § 110(i), the bankruptcy court held that Scott engaged in three "unfair or deceptive" acts. First, as to the Supervising Attorney, the bankruptcy court determined that although "this lawyer does not represent Ms. Scott's bankruptcy customers * * * , it is undisputed that Ms. Scott in person, and the [Overview] * * * , expressly instruct the customers to contact this lawyer for advice." Bankr. Op. 23. The bankruptcy court held that, by "hyp[ing] the availability of the supervising attorney as an advantage to customers who deal with We the

People," Scott risked misleading customers. Specifically, customers might adopt the "illusory" belief that, "because of the association of an attorney in the process, [Scott's] approach to processing bankruptcy forms is more beneficial and reliable than others providing similar services." Id. at 23-24. In fact, the bankruptcy court found, "customers gain no advantage because Ms. Scott has a lawyer available to 'review' and approve her blank forms." Id. at 24.

The bankruptcy court also held that "there is no real advantage to customers' having access to the lawyer to 'chat.'" Bankr. Op. 24-25. Rather, "Ms. Scott's customers are at risk if they think they are receiving reliable, personal guidance about bankruptcy law. By necessity, the information the lawyer provides them is no more customized or trustworthy than they could obtain consulting a book at the library." Id. at 25. The bankruptcy court found that Scott's layperson customers could be misled by undisclosed distinctions between, on the one hand, repeated offers to "chat" with an attorney about general bankruptcy "advice," and on the other, the hidden impossibility of that lawyer's representing them in their particular case. Id. at 25-26.

Second, as to the Overview, the bankruptcy court found that "Ms. Scott's practice of distributing her publication to her customers is fraught with the potential for confusion and damage.” Bankr. Op. 27. Specific shortfalls include the Overview’s failure to mention the option of Chapter 13 bankruptcy and its failure to explain evidentiary requirements for Chapter 7’s exceptions to discharge. Id. at 27-28. Also, the Overview omits discussion of certain exceptions from discharge, thereby jeopardizing debtors’ efforts to obtain anticipated relief under Chapter 7. Id. at 29. The bankruptcy court found one of the Overview’s “tips” about overzealous trustees “laughable,” id. at 29-30, and ultimately concluded that “[i]t is clear on this record that * * * Ms. Scott recommended, either expressly or impliedly, that her bankruptcy customers consult [the Overview] as accurate and reliable information for use in filing for bankruptcy and completing their forms.” Id. at 30. “[Preparers] may not make such suggestions consistent with their proper role as transcribers of bankruptcy forms. This is the sort of recommendation that constitutes prohibited legal advice in this context.” Ibid. (emphasis added).

Third, with respect to the Workbook, the bankruptcy court noted as a general matter that efforts to “simplify” questions in official bankruptcy forms often require preparers to exercise impermissible legal judgment when they transfer information from the Workbook to official bankruptcy documents. Bankr. Op. 32. The bankruptcy court then listed specific examples of ambiguities and errors from Scott’s Workbook, including the Workbook’s use of “quick-sale value,” analysis of “pets,” advice regarding government-guaranteed student loans, and treatment of “net income” from a debtor’s second job. Id. at 32-33. A debtor who followed the Workbook’s inaccurate instructions on those issues would, absent substantive correction or legal advice, be unable to complete official bankruptcy forms accurately. The bankruptcy court concluded that Scott’s substantively flawed Workbook risked “potential debtor prejudice, and represents a deceptive and unfair practice in violation of § 110.” Id. at 33.

Despite holding that Scott violated 11 U.S.C. § 110(i), the bankruptcy court in its discretion declined to impose any injunctive or monetary relief based on Scott’s “unfair or deceptive” acts. Bankr. Op. 39-40.

d. The bankruptcy court also found Scott’s $214.00 fee excessive under 11 U.S.C. § 110(h)(2), which directs courts to “disallow * * * any [preparer’s] fee * * * found to be in excess of the value of the services rendered.” Bankr. Op. 40. The bankruptcy court noted that other bankruptcy preparers typically charge $50-$60 for normal bankruptcy petitions. The bankruptcy court also stated that few Chapter 7 cases “could involve a simpler set of bankruptcy paperwork” than the Dosers’ case. Id. at 41-42. Moreover, the bankruptcy court in Idaho offers free bankruptcy forms on its website, allows forms to be completed on-line, and sells hard copies of such forms for $3.00. Id. at 42.

Given the simplicity of the Dosers' case, the bankruptcy court discredited Scott's documentation of four hours she allegedly spent on their petition, including one hour of photocopying and collation, but not including the word processing performed by Scott's franchisor. Bankr. Op. 44. Based on the bankruptcy court's experience in other cases, decisions from other jurisdictions, testimony at the hearing, and various case-specific circumstances, the bankruptcy court calculated Scott's reasonable compensation as three hours at $30.00 per hour and $10.00 for copying and postage expenses. Id. at 44-52. Thus, the court ordered Scott to surrender $114.00 of her fee to the Dosers' Chapter 7 trustee under 11 U.S.C. 110(h)(2). Id. at 52.

4. On July 11, 2002, Scott appealed to federal district court. She asserted for the first time that 11 U.S.C. § 110 is constitutionally invalid under Article I. Scott also argued that her conduct did not constitute unauthorized practice of law or an unfair or deceptive act, and that Section 110 violates the First Amendment.[3]

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[3] Scott further argued that Section 110 is unconstitutional under Article III, that the bankruptcy court failed to provide notice and hearing, that Section 110 did not authorize the show-cause order, that she did not violate Section 110(g) by accepting the Dosers' money order, and that her $214.00 fee was not excessive under 11 U.S.C. § 110(h). See Scott Dist. Ct. Br. i-iii. The district court rejected each of those arguments, and none of them appears in Scott's opening brief before this Court.

The district court affirmed the bankruptcy court's decision in all respects. The district court held that Section 110 does not violate the Constitution, and that Scott engaged in unfair and deceptive conduct. Noting that Scott did not challenge any of the bankruptcy court's operative factual conclusions, Dist. Op. 9-10, the district court affirmed the bankruptcy court's finding that to offer Scott's customers a "chat" with her franchisor's Supervising Attorney "misleads debtors into believing that the services offered by We The People are more reliable than those that do not offer attorneys. This is a deceptive and unfair act." Id. at 11. The district court also affirmed the bankruptcy court's finding that "information provided to potential debtors" in the Overview and Workbook is misleading. Id. at 11-12. The district court therefore determined that for Scott to give the Dosers such documents was a "fraudulent, unfair, or deceptive act" in violation of Section 110. Id. at 12.

5. On May 7, 2003, Scott filed a timely notice of appeal to this Court.

SUMMARY OF ARGUMENT

1. This case turns on three factual findings, each of which is reviewed for clear error. First, the bankruptcy court found that for Scott to "hype" her association with the franchisor's Supervising Attorney was deceptive and unfair because it risked

misleading customers about the value of that attorney's participation. Second, the bankruptcy court found that it was deceptive and unfair for Scott to recommend an erroneous Overview to her customers in connection with their bankruptcy filing because that risked misleading debtors about the operation of bankruptcy law. Third, the bankruptcy court found that Scott's Workbook inaccurately "simplified" Chapter 7 bankruptcy concepts, thereby implicitly rendering legal judgments, risking inaccurate bankruptcy filings, and causing unfair prejudice to potential debtors.

The district court affirmed each of those findings, and Scott makes no effort to refute them. Nor can Scott deny that her actions, as detailed by the bankruptcy court, qualify under federal bankruptcy law as "unfair or deceptive" conduct pursuant to 11 U.S.C. § 110(i). As the courts below determined, each of Scott's actions conveyed inaccurate information, risked misleading debtors, and inflated the perceived value of Scott's services.

Scott mistakenly focuses on whether her conduct constituted "unauthorized practice of law" under Idaho state law. See Appellant's Br. 35-43. Scott's arguments are dubious even on their own terms, but the dispositive legal question is whether Scott violated federal law, namely 11 U.S.C. § 110(i), by committing an "unfair or deceptive" act. Unauthorized practice of law often constitutes a violation of 11 U.S.C. § 110(i). But the Bankruptcy Code does not indicate that preparers only violate Section 110(i) if they also violate state authorized practice laws. Cf. 11 U.S.C. § 110(k) (noting that Section 110 neither codifies nor preempts such laws). The present appeal depends on the interpretation of Section 110(i) as a matter of federal bankruptcy law, not on details of Idaho state law.

2. a. Scott claims (Br. 19-29) that Section 110 exceeds Congress's power under the Bankruptcy Clause of the Constitution. Scott has waived that argument by failing to raise it in the bankruptcy court. Even if this Court opts to reach the issue, no court has found Section 110 invalid, and this Court should not either. Scott admits (Br. 2) that 11 U.S.C. § 110(i) provides important debtor protection from "scam artists and others [who were] * * * counter-productive and were charging their customers exorbitant fees." Without Section 110, such dishonest or incompetent preparers might mislead Chapter 7 debtors or extract undue fees, thereby dissipating assets that would otherwise be part of the bankruptcy estate. Because Section 110 is inextricably related to initiating a bankruptcy case, and because it safeguards assets of potential Chapter 7 debtors and the bankruptcy system's integrity, Section 110 represents a valid exercise of Congress's power under the Bankruptcy Clause.

b. Scott also argues that Section 110(i) violates her First Amendment rights. Section 110(i), however, does not target protected speech. Section 110 bars only fraudulent, unfair, and deceptive acts, without imposing any limitation on particular content or viewpoints. Moreover, Section 110 does not restrict any communication directed to the public at large. Instead, Section 110 only prevents bankruptcy preparers from engaging in “unfair or deceptive” acts that would undermine the heavily regulated relationship between preparers and their customers. Scott concedes (Br. 2) that protecting debtors is important and that Section 110 significantly protects against “scam artists” and incompetent preparers. Such interests do not target protected speech. Because any effect of Section 110 on communication is incidental to its valid regulation of unprotected conduct, the First Amendment allows Congress to regulate “misleading and unfair” conduct in the narrow context of preparers and their vulnerable customers.

Furthermore, Section 110 regulates only the efforts of paid bankruptcy preparers to promote and execute their commercial enterprise improperly. For example, Scott’s documents in this case were distributed as mere tools to help customers gather data for their paid petition preparation. Accordingly, any communication affected by Section 110 would constitute deceptive commercial speech. The First Amendment permits the government to “ban commercial expression that is fraudulent or deceptive without further justification.” Edenfield v. Fane, 507 U.S. 761, 768 (1993).

Finally, Scott claims that Section 110 suffers from unconstitutional vagueness and overbreadth. Scott fails, however, to argue that Section 110 is unconstitutionally vague as applied to the specific conduct condemned by the bankruptcy court. Nor can any facial challenge succeed. Because Section 110 does not impose any criminal sanction or implicate free speech concerns, a facial challenge would require Scott to “establish that no set of circumstances exists under which [Section 110] would be valid.” Hotel & Motel Ass’n of Oakland v. City of Oakland, 344 F.3d 959, 971 (9th Cir. 2003). Scott has not carried that burden.

STANDARD OF REVIEW

This Court reviews a district court’s appeal from a bankruptcy court using the same standards employed by the district court. Accordingly, this Court reviews the bankruptcy court’s factual findings for clear error and its legal conclusions de novo. In re Mantz, 343 F.3d 1207, 1211 (9th Cir. 2003). The bankruptcy court’s application of law to fact under Section 110 is reviewed for abuse of discretion, In re Agyekum, 225 B.R. 695, 698 (9th Cir. BAP 1998), and this Court “must have a definite and firm conviction that the court below committed a clear error of judgment * * * before reversal is proper." In re Crowe, 243 B.R. 43, 47 (9th Cir. BAP), aff'd 246 F.3d 673 (9th Cir. 2000); see Smith v. Jackson, 84 F.3d 1213, 1221 (9th Cir. 1996) (same).

ARGUMENT

I. The Bankruptcy Court Properly Held That Scott's Conduct In Preparing The Dosers' Bankruptcy Petition Violated 11 U.S.C. § 110(i)

Congress enacted Section 110 in 1994 to address the "growing problem of bankruptcy preparers who abuse the system in the course of preparing documents for debtors to file in bankruptcy court." 140 Cong. Rec. S4506 (daily ed. April 20, 1994) (Sen. Metzenbaum). The original need to regulate preparers derived from the fact that, in Congress's view, "far too many [bankruptcy petition preparers] * * * attempt to provide legal advice and legal services to debtors. These preparers often lack the necessary legal training and ethics regulation to provide such services in [an] adequate and appropriate manner." H.R. Rep. No. 103-835 at 56 (1994). Negligence and fraud were widespread, with "[h]undreds of typing mills * * * luring customers with vague promises of solving their credit problems, charging the customers hundreds of dollars while inducing them to sign bankruptcy petitions they often do not understand, and then improperly filing bankruptcy on their behalf." 140 Cong. Rec. S14597 (daily ed. Oct. 7, 1994) (Sen. Metzenbaum). Moreover, there was legislative concern that most of the “petition mills” were located in low-income, minority communities and “prey[ed] on the poor and unsophisticated.” Ibid.; see also Appellant’s Br. 2, 16 (admitting that Section 110 serves the important national policy of protecting debtors from abuse by preparers).

Congressional efforts to alleviate such harm to debtors and the bankruptcy system include 11 U.S.C. 110(i), which forbids bankruptcy petition preparers from committing any “fraudulent, unfair, or deceptive act.” In this case, the bankruptcy court held that Scott’s conduct violated Section 110(i) in three respects. The bankruptcy court’s factual analysis of that conduct is undisputed. Appellant’s Br. 18 (averring that all “issues presented by this appeal are issues of law”).

A. The Supervising Attorney

Scott “hype[d]” the fact that she cooperates with a “Supervising Attorney.” Bankr. Op. 23-24. She also informed customers that they should contact the Supervising Attorney for a “chat.” The bankruptcy court correctly found such conduct unfair and deceptive because customers might easily be misled about the Supervising Attorney’s practical value to them. Scott did not inform customers that the Supervising Attorney represents the franchisor, not the customers or herself.

The bankruptcy court held that neither the Supervising Attorney’s limited assistance to Scott nor the possibility of a "chat" provides any cognizable benefit to debtors like the Dosers. On the contrary, "this arrangement may lead her customers to believe that, because of the association of an attorney with the process, Ms. Scott's approach to processing their bankruptcy forms is more beneficial and reliable than others providing similar services. Any such reliance is illusory." Id. at 23-24. Explaining part of the problem at length, the bankruptcy court stated:

> While customers are encouraged [by Scott's Overview] to exercise their 'right' to 'chat' with the lawyer about their bankruptcy problems, no attempt is made to inform them that they cannot * * * rely upon the lawyer's advice in the traditional manner where a client seeks counsel from an attorney. Absent the existence of an attorney-client relationship, Ms. Scott's customers are at risk if they think they are receiving reliable, personal guidance about bankruptcy law. By necessity, the information the lawyer provides them is no more customized or trustworthy than they could obtain consulting a book at the library. The Court concludes Congress did not intend that a [preparer] require customers to attempt such complex distinctions.

Id. at 25-26.

Scott's brief never disputes the bankruptcy court's finding that her relationship to the Supervising Attorney is misleading. Cf. Appellant's Br. 8, 13, 35. In fact, Scott's Overview explains that customers should "seek the advice of an attorney" if there are "any doubts about the appropriateness of bankruptcy in your particular case." Overview 7. The Overview then states that customers "enjoy the right, as a WE THE PEOPLE customer, to chat with our Supervising Attorney, at no additional cost."

Ibid. The bankruptcy court was correct in finding that Scott's conduct and statements regarding the Supervising Attorney were incomplete, unfair, and self-serving. Such conduct falls within the prohibition of 11 U.S.C. § 110(i), and is precisely the kind of misleading activity that Congress sought to excise from the preparer-customer relationship.

B. The Overview

Scott gave her customers an alleged "Overview" of Chapter 7, which contained "tips" about how to complete bankruptcy schedules and how to represent oneself in bankruptcy proceedings. The bankruptcy court rightly held that conduct impermissible under Section 110, quoting other courts' warnings that lay bankruptcy preparers ought not to provide legal advice and that "[l]egal advice is legal advice whether it comes directly from the petition preparer or indirectly via * * * a bankruptcy treatise being recited by that preparer." Bankr. Op. 27 (quoting In re Bush, 275 B.R. 69, 78-79 (Bankr. D. Idaho 2002)). The particular harm caused by advice in the preparer-customer context is that "[p]ersons seeking legal assistance tend to place their trust in an individual purporting to have expertise in that area." Ibid.

In this case, the bankruptcy court explained that Scott's Overview was "fraught with the potential for confusion and damage," and the bankruptcy court listed the Overview's various omissions, ambiguities, and "laughable" misstatements. Id. at

27-31. "[B]y giving her customers a short, summary description of [Chapter 7 bankruptcy], Ms. Scott may lead them to believe that the decision whether to seek Chapter 7 relief is one they can effectively make without counsel, something which may be far from correct." Id. at 39. The bankruptcy court concluded:

> It is clear on this record that in giving them the Overview, Ms. Scott recommended * * * that her bankruptcy customers consult this publication as accurate and reliable information for use in filing for bankruptcy and completing their forms. [Preparers] may not make such suggestions consistent with their proper role as transcribers of bankruptcy forms. * * * Ms. Scott is in no position to know * * * whether a given publication is a reliable and accurate bankruptcy law resource, or whether the pamphlet contains enough information about the subject to answer her customers' critical questions.

Id. at 30-31. After detailing some of the Overview's errors, the bankruptcy court held that, "[e]ven were this book accurate and complete," it was "deceptive and unfair" for Scott implicitly to hold out herself and her Overview as adequate legal resources. Id. at 31. The bankruptcy court also found that, given Scott's role as a petition preparer, distributing the Overview to her customers constitutes unauthorized practice of law. Ibid.

Although Scott's brief (p. 38) states a "disagree[ment] that there are any material inaccuracies in the Overview," it offers no substantive analysis to contradict the bankruptcy court's holding. Similarly, Scott does not mention the bankruptcy court's determination that to offer legal information in the context of a preparer-customer relationship is inherently unfair and misleading because it lends undue credibility to the proffered “advice.” Cf. Appellants Br. 38-39. To distribute such written materials is particularly unfair and deceptive where — as the bankruptcy court found in this case — the relevant materials are oversimplified, incomplete, and inaccurate. Accordingly, Scott’s conduct regarding the Overview also constitutes a violation of 11 U.S.C. § 110(i).

C. The Workbook

Scott distributed to her customers a Workbook that, the bankruptcy court found, contained “deviations from the official forms” and a number of substantive “problems.” Bankr. Op. 32-33. The bankruptcy court properly held that Scott’s Workbook violates Section 110. The bankruptcy court determined that, although the Workbook asks for the “quick-sale value” of personal property, official bankruptcy forms require “current market value.” The Workbook instructs customers to list “farm animals” as assets, but not “pets,” even though official bankruptcy forms require disclosure of all assets without that distinction. The Workbook also erroneously advises customers not to disclose government-guaranteed student loans or gross income from a second job.

The bankruptcy court concluded that “depending on the facts of a particular case, the [preparer’s] attempts to ‘help’ customers complete the forms via the instructions in the Workbook, while arguably well-intentioned, can easily constitute prohibited legal advice." Id. at 33 (emphasis added). "In this case," the bankruptcy court held, Scott's "use of the Workbook in its present form may cause a potential debtor prejudice, and represents a deceptive and unfair practice in violation of § 110." Ibid. (emphasis added). The bankruptcy court advised that, "[i]f Ms. Scott * * * insist[s] on using a 'workbook' instead of the official forms in their business, in order to comply with the Bankruptcy Code such a tool must religiously adhere to the format and substance of the forms prescribed by the Rules." Ibid.

Scott's brief ignores all of the foregoing analysis and states, without explanation, that the Workbook "collects exactly the same information sought on the official bankruptcy forms." Appellant's Br. 39. Scott never disputes the bankruptcy court's holding that the Workbook's inaccuracies, ambiguities, and oversights make it unfair and deceptive for Scott to sell her services as though she were accurately "simplifying" official bankruptcy forms.

D. Unauthorized Practice

Instead of addressing the bankruptcy court's dispositive factual and legal analysis, Scott's brief focuses only on whether her conduct qualified as "unauthorized practice of law" under Idaho jurisprudence. Appellant's Br. 35-43. That issue is at most peripheral to this appeal. This Court sits to review the bankruptcy court’s decision, and all of the bankruptcy court’s rulings regarding 11 U.S.C. § 110(i) are supported by findings of “unfair or deceptive” conduct independent of any unauthorized practice of law. See supra.[4]

Scott mischaracterizes the bankruptcy court’s opinion in suggesting that its analysis depends on unauthorized practice. Appellant’s Br. 35. In fact, although the bankruptcy court’s opinion warns in dicta of unauthorized practice, the opinion held that Scott committed unauthorized practice only in one regard: distributing her Overview. That holding was correct in the context of bankruptcy preparers who provide legal advice. See infra. More importantly, the bankruptcy court found that distributing Scott’s Overview to customers was an “unfair and deceptive” practice under Section 110(i) because the Overview was “fraught with the potential for confusion and damage” and contained omissions, ambiguities, and “laughable” errors. The latter holding is not disputed in Scott’s opening brief, and Scott also fails to contest the factual finding that the Overview’s errors risked misleading, confusing, and damaging her customers. Thus, as a matter of federal bankruptcy law, Scott cannot unseat the bankruptcy court’s determination that the

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[4] Similarly irrelevant are Scott’s comments about general definitions of legal practice. Appellant’s Br. 4-5. Scott has not argued that she or other bankruptcy preparers are allowed to “practice law” under any definition of that term.

Overview violated Section 110(i) — much less the bankruptcy court's independent holdings about the Workbook and Supervising Attorney — regardless of whether her analysis of Idaho state law is correct.

Scott's brief seems to recognize that law concerning unauthorized practice and Section 110(i) prohibit types of misconduct that may overlap, but are not identical. For example, Scott (Br. 40) characterizes the district court's reasoning as having two independent "prongs": unfair and deceptive conduct under Section 110(i) and unauthorized practice under Idaho law. Scott then correctly criticizes any "restrictive interpretation" of Section 110(i) that would limit the term "unfair or deceptive" to encompass only acts that are also unauthorized practice. Id. at 41. The courts below, however, never adopted that sort of "restrictive interpretation," and Scott's own brief fails to answer the Section 110(i) "prong" of the case against her. See supra.

Section 110(k) confirms that section 110(i) is not limited to unauthorized practice. Section 110(k) states that nothing in Section 110 "shall be construed to permit activities that are otherwise prohibited by law, including rules or laws that prohibit the unauthorized practice of law." 11 U.S.C. 110(k). Section 110(k) thus recognizes that state law may, in some instances, be more restrictive than Section 110 and that Section

110 does not preempt such state-law restrictions. Regardless of whether a particular State's prohibitions against unauthorized legal practice in general are more or less restrictive than Section 110's provisions specific to bankruptcy, state law does not define what constitutes a violation of Section 110.

Although this Court need not address Scott's arguments concerning Idaho law, that analysis is also incorrect. As the Idaho Supreme Court explained, the practice of law includes "legal advice and counsel, and the preparation of instruments * * * by which legal rights are secured." Idaho State Bar v. Meservy, 80 Idaho 504, 508 (1959). In this case, although Scott was certainly permitted to prepare customers' bankruptcy forms and perform other ministerial functions, the bankruptcy court found that Scott's business methods went too far. See supra.

Similar facts were involved in In re Bush, 275 B.R. 69, (Bankr. D. Idaho), where the court found that:

> [The preparer] does not merely type what the debtors elect to provide. He assists them, and he steers them with his worksheets and "pro se" materials. He manipulates their raw data into a form he believes comports with the requirements of law. * * * [He] provides his customers with a worksheet which identifies for them exemptions which he believes are available under Idaho law. He identifies for them the Idaho Code sections which give rise to the exemptions. He identifies the amounts available under each exemption. * * * In doing all of this, he not only violates § 110, he engages in the unauthorized practice of law.

Id. at 83. The Bush court thus entered an injunction to prevent the preparer from, inter alia, “advising or assisting customers in the preparation of their bankruptcy forms, specifically including but not limited to provision of information regarding exemptions.” Id. at 84.

Scott does not quarrel with the result in Bush. Instead, she tries to distinguish the case on its facts. Scott maintains (Br. 41) that the Bush preparer gave customers more “specific information” than Scott did. Even if so, the Bush opinion makes quite clear that preparers cannot legally provide even “general” substantive advice concerning exemptions, other provisions of Chapter 7, or the litigation of pro se bankruptcy cases. And, as the bankruptcy court detailed at length (see supra), Scott’s Overview and Workbook offered advice very similar to that which Bush condemned as unauthorized practice.

Scott’s insistence that unauthorized practice means more “‘than the mere filling in of blank forms’” or “being a mere scrivener” is irrelevant because those are not the facts that the bankruptcy court found. See Appellant’s Br. 36 (quoting In re Matthews, 57 Idaho 75, 83 (1936)). In this case, the bankruptcy court found that Scott provided substantial legal assistance, and that the scope of such assistance exceeded the strictures of Idaho state law. Scott’s Overview, for example, offers general advice about Chapter 7 bankruptcy, including “detailed, substantive material" that purports to list "all exemptions allowed under Idaho law." Bankr. Op. 10. The Overview also recommends how Idaho's exemptions should be documented on a bankruptcy schedule, and offers "tips" about how customers should undertake their own representation. Id. at 9. Scott cites no case that has allowed bankruptcy preparers to offer such expansive, "general" advice. The Bush decision, and cases discussed therein, have found such conduct violative of unauthorized practice laws in Idaho and other States. The bankruptcy court was correct in applying that reasoning here.

Although the bankruptcy court did not explicitly find that the Workbook constituted unauthorized practice of law, it did note that "[a]ttempts through a questionnaire to 'simplify' the questions posed and information required in the official bankruptcy forms usually leads to the exercise of judgment by the [preparer] in how best to accomplish that result, which in turn inevitably crosses the line by giving potential debtors guidance and advice on how to fill out the forms." Bankr. Op. 37. Even though this case turns not on Idaho law governing unauthorized practice, but on the specific factual conduct identified by the bankruptcy court as unfair and deceptive under Section 110, it seems clear from Bush and related cases that bankruptcy preparers cannot insulate efforts to give customers legal advice simply by calling that advice "general" instead of "specific."

Scott's effort to compare her situation to a bookstore or an alleged "monopoly on every discussion of the law" is inapt. Appellant's Br. 38 & n.87. Nothing in this case, or in Section 110's application to bankruptcy preparers, has any necessary effect on people who are not bankruptcy preparers. Congress in enacting Section 110, and the lower courts in applying that provision, endeavor to protect potentially vulnerable debtors from potentially misleading preparers. It is obvious from the statutory text that Section 110(i) applies only to bankruptcy preparers and not to bookstore sales or ordinary interpersonal conversations. Cf. 11 U.S.C. 110(a)(1) (defining "bankruptcy petition preparer"). Courts that have addressed the unauthorized practice issue have limited their discussion to the context of a preparer-consumer relationship, see, e.g., In re Bush, 275 B.R. 69, and this Court need not prejudge the scope of unauthorized legal practice in other contexts. In fact, this appeal can be decided based on federal bankruptcy law alone, without reaching the issue of unauthorized practice at all.

II. Section 110(i) Is A Valid Exercise Of Congressional Power, And The Bankruptcy Court's Decision Did Not Violate Scott's Constitutional Rights

A. The Bankruptcy Clause

Scott's claim that Section 110 exceeds congressional power under the Bankruptcy Clause was not raised before the bankruptcy court. Thus, according to ordinary appellate practice, that argument was waived.[5] Scott's untimely interpretation of Article I does not affect the subject matter jurisdiction of this Court or of the courts below pursuant to 28 U.S.C. §§ 157 and 158. But cf. Appellant's Br. 28-29. Furthermore, Scott presents no "extraordinary circumstance" that would render normal waiver rules otherwise inappropriate.

If this Court were to reach the argument, Section 110(i) should be upheld pursuant to Congress's power "To establish * * * uniform laws on the subject of Bankruptcies" and as a "necessary and proper" measure for executing that power. U.S. Const. Art. I, § 8, cl. 4, 18; see also id. § 8, cl. 9 ("Tribunals inferior to the supreme Court"). As explained supra, Congress enacted Section 110 to curb prevalent and serious abuses by bankruptcy preparers concerning the filing of bankruptcy petitions.

Every aspect of Section 110 is integrally related to conventional goals and operations of bankruptcy law. Section 110 regulates permissible methods for filing and preparing bankruptcy petitions, and it does so by regulating preparers who seek to be paid for their commercial involvement in bankruptcy activities. The statute's purpose is to protect debtors from abuse that might

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[5] See, e.g., Edwards v. City of Coeur D'Alene, 262 F.3d 856, 862 n.14 (9th Cir. 2001) (constitutional challenge); In re Cybernetic Serv., 252 F.3d 1039, 1045 n.3 (9th Cir. 2001) (bankruptcy); In re Kieslich, 258 F.3d 968, 971 & n.4 (9th Cir. 2001) (bankruptcy); In re Slack, 187 F.3d 1070, 1075 (9th Cir. 1999) (bankruptcy); In re SPM Mfg. Corp., 984 F.2d 1305, 1316 (1st Cir. 1993) (bankruptcy).

otherwise siphon pre-petition assets out of the bankruptcy estate, and to protect the bankruptcy system from incorrect bankruptcy forms that might be prepared using fraudulent or deceptive means. Section 110 thus lies within Congress's power to control how bankruptcy litigation is pursued and operates, and is strikingly similar to other federal provisions that are ancillary to bankruptcy proceedings. See, e.g., 28 U.S.C. § 1930 (prescribing fees for filing bankruptcy petitions), 18 U.S.C. § 157 (condemning fraud in the filing of bankruptcy documents, or in statements about a proceeding falsely asserted to be pending). As the Supreme Court stated in United States v. Fox:

> There is no doubt of the competency of Congress to provide * * * for the enforcement of all legislation necessary or proper to the execution of powers with which it is intrusted. * * * [Congress's Bankruptcy Clause power] may embrace within its legislation whatever may be deemed important to a complete and effective bankrupt system. * * * Any act committed with a view of evading the legislation of Congress passed in the execution of any of its powers, or of fraudulently securing the benefit of such legislation, may properly be [regulated].

95 U.S. 670, 672 (1877) (emphasis added).

1. Scott cites no Supreme Court or appellate authority that has invalidated under the Bankruptcy Clause any congressional action similar to Section 110. Instead, Scott relies heavily on Northern Pipeline Co. v. Marathon Pipe Line Co., 458 U.S. 50 (1982). That case, however, analyzed judicial power under Article III, not congressional authority under Article I.

Neither Justice Brennan's plurality opinion nor that of the concurring Justices addressed Scott's asserted limits on the Bankruptcy Clause. See Northern Pipeline, 458 U.S. at 87 (Brennan, J., plurality); id. at 91 (Rehnquist, J., concurring).

Scott also relies on In re C.F. Foods, Inc., 2001 WL 1632272 (E.D. Pa. Dec. 20, 2001), cited in Appellant's Br. 23 & n.49, which rejected a Bankruptcy Clause claim partly because of Louisville Joint Stock Land Bank v. Radford, 295 U.S. 555 (1935). Nothing in C.F. Foods or Louisville Joint Stock Land Bank supports Scott's position here. Scott similarly errs in invoking Seminole Tribe of Florida v. Florida, 517 U.S. 44 (1996). Appellant's Br. 24-25. That case involved the scope of a State's Eleventh Amendment immunity, not Congress's Article I authority with respect to non-State entities. Contrary to Scott's suggestion (id. at 25), State and non-State creditors are not similarly situated with respect to the rule in Seminole Tribe, and that decision contains nothing to support Scott's constitutional argument regarding the Bankruptcy Clause.

Finally, Scott cites two bankruptcy court decisions. In re Bernier, 176 B.R. 976 (Bankr. D. Conn. 1995), rejected a constitutional challenge under the Bankruptcy Clause, and explained that bankruptcy laws are valid even when they affect rights and interests outside the confines of the debtor-creditor relationship. Id. at 985 (citing Wright v. Union Cent. Life Ins.

Co., 304 U.S. 502, 514 (1938)). Bernier also observed that "[t]he Supreme Court has characterized the Bankruptcy Clause as expansive," id. at 984, and limits on its scope are generally defined "in terms of other constitutional requirements, rather than * * * inherent limitations to the bankruptcy power," id. at 987. The result in Bernier undermines, rather than supports, Scott's constitutional analysis.

Scott's second bankruptcy court decision, In re Persky, 134 B.R. 81 (Bankr. E.D.N.Y. 1991), held unconstitutional a code provision that is vitally dissimilar to 11 U.S.C. § 110. Persky concerned 11 U.S.C. § 363(h), which allows a trustee to sell the interest of the estate and any co-owner of "property in which the debtor had * * * an undivided interest." The court's analysis of that provision does not contain any clear implications for code provisions like Section 110.

Moreover, Persky's holding on regarding 11 U.S.C. § 363(h) "is rarely cited and never * * * followed." Sapir v. Sartorius, 230 B.R. 650, 654 (S.D.N.Y. 1999). "[N]umerous cases decided in [the Second Circuit] and elsewhere since [Persky] have continued to apply Section 363(h)." Ibid. (citing In re Kahan, 28 F.3d 79 (9th Cir. 1994); In re Garner, 952 F.2d 232 (8th Cir. 1991); In re Rivera, 214 B.R. 50 (D.P.R. 1997); In re Grabowski, 137 B.R. 1 (S.D.N.Y. 1992)). Accordingly, even if Persky's analysis regarding 11 U.S.C. § 363(h) somehow applied to this case, that analysis is dubious and apparently has not been followed by any other court.

2. As discussed supra, Scott lacks support for her claim that Congress may only promulgate bankruptcy legislation if it is “related to the restructuring of the debtor-creditor relationship” and “bears upon the estate of a debtor.” Appellant’s Br. 19-20. Even if there were such a rule, however, Section 110 would pass muster because it protects debtors and the bankruptcy system from abuse, and it allows debtors to file accurate forms without exorbitant fees.

First, bankruptcy preparers who provide “unfair or deceptive” advice to their customers about the Bankruptcy Code can corrupt the integrity of bankruptcy proceedings from the very beginning. Faced with such preparer misconduct, some customers might file for bankruptcy when they ought not, or might fail to or wrongly apply particular code provisions. Second, bankruptcy preparers who commit “unfair or deceptive” acts to solicit business can divert pre-petition assets away from the estate. Just as with rules concerning pre-petition attorney’s fees (11 U.S.C. § 329(a)), one of Section 110’s legitimate functions is to prevent unscrupulous “assistants” from misdirecting debtors’ assets that should go to the bankruptcy estate. See In re Guttierez, 248 B.R. 287, 292 & n.13 (Bankr. W.D. Tex. 2000) (describing legislative history); cf. 11 U.S.C. § 541 (defining property of the bankruptcy estate). Congress's authority under Article I amply supports Section 110 as a means of addressing serious problems linked to "unfair or deceptive" bankruptcy preparers.

The foregoing conclusion is amplified by reference to the Necessary and Proper Clause. U.S. Const. Art. I, § 8, cl. 18. Congress may act to "carry into Execution" (ibid.) any enumerated power if the relevant statute is "conducive" and "plainly adapted" to that end. Jinks v. Richland County, 123 S. Ct. 1667, 1670 (2003) (quoting M'Culloch v. State of Maryland, 17 U.S. 316 (1819)). Section 110 satisfies those constitutional standards because it seeks to stem confusion and deception among debtors, and seeks to protect debtors' pre-petition assets for distribution as part of the estate.[6]

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[6] If this Court were to find Congress's authority inadequate under the Bankruptcy Clause and the Necessary and Proper Clause were inadequate to prohibit "unfair or deceptive" conduct by bankruptcy preparers, Section 110 should nonetheless be upheld under Article I's Commerce Clause. U.S. Const. Art. I, § 8, cl. 3. Although the Supreme Court suggested in Railway Labor Executives v. Gibbons, 455 U.S. 457 (1982), that Congress may not use its commerce power to circumvent the requirement that bankruptcy laws provide "uniform" rules, that is irrelevant here because uniformity is not at issue. Also, if Scott were right that regulating bankruptcy preparers lies "outside" the sphere of bankruptcy, it would similarly lie outside any "uniformity" requirement, and would thus be subject to legislation under Congress's enumerated non-bankruptcy powers.

B. The First Amendment

1. Scott's First Amendment argument misstates Section 110's scope and function. Section 110 neither "restrict[s] the information Scott can communicate to the public" at large, nor does it "depriv[e] her customers [of] the right to receive general information about the law." Appellant's Br. 33. On the contrary, Section 110 chiefly restricts the conduct of paid bankruptcy preparers, namely their "unfair or deceptive acts." The statute's terms do not target speech at all, much less speech of particular content or viewpoint.

Section 110's undisputed purpose is to protect debtors from abuse by paid bankruptcy preparers, regardless of whether such abuse occurs through speech or otherwise. See 11 U.S.C. § 110(a)(1) (limiting the statute's scope to persons who prepare bankruptcy documents "for compensation"); cf. Appellant's Br. 2. Even Scott admits the importance of regulating "scam artists" and incompetent bankruptcy preparers who mislead debtor-customers and charge them excessive fees. Ibid. And the category of acts prohibited by Section 110 is closely tailored to the precise harms Congress sought to remedy.

The fact that "unfair or deceptive acts" may involve words does not immunize such improper acts from regulation under Section 110, and any effect of Section 110 on communication is purely incidental to its goal of regulating illegal conduct. See

United States v. O’Brien, 391 U.S. 376, 376 (1968) (“[W]hen ‘speech’ and ‘nonspeech’ elements are combined in the same course of conduct, a sufficiently important governmental interest in regulating the nonspeech element can justify incidental limitations on First Amendment freedoms.”); cf. San Francisco Arts & Athletics, Inc. v. United States Olympic Comm., 483 U.S. 522, 536 (1987) (upholding “restrictions on expressive speech [that] are * * * incidental to the primary congressional purpose” concerning unprotected conduct).

It is also important that Section 110 does not impose any broad-based restriction on general public communications. As the statutory text makes clear, Section 110 limits only the “unfair or deceptive” conduct of paid bankruptcy preparers toward near-bankrupt clients who may be especially vulnerable to misdirection. 11 U.S.C. § 110(a)(1). As described supra, Congress sought to protect debtors by enacting numerous restrictions on the business practices of bankruptcy preparers. See 11 U.S.C. § 110(b)-(h). In such a highly regulated commercial context, preparers who seek profits by participating in the bankruptcy process are not protected from regulations that prohibit “deceptive or unfair” conduct. On the contrary, “[w]here the federal government extensively regulates a field of economic activity, communication of regulated parties often bears directly on the particular economic objectives sought by the government, and regulation of such communications has been upheld." SEC v. Wall St. Publ'g Inst., Inc., 851 F.2d 365, 372-73 (D.C. Cir. 1988) (citations omitted); see id. at 373 (noting limited judicial oversight where regulations "impinge upon communications occurring within the umbrella of an overall regulatory scheme").[7]

The unfair and deceptive conduct at issue here was wholly ancillary to Scott's being paid to prepare the Dosers' petition. Such commercial conduct is the precondition for applying Section 110, and the statute does not regulate any communication outside that limited context. Cf. Honolulu Weekly, Inc. v. Harris, 298 F.3d 1037, 1043 (9th Cir. 2002) ("[T]he First Amendment does not guarantee the right to communicate * * * at all times and places or in any manner that may be desired.'"). The Supreme Court has held that similar regulations of commercial conduct do not violate the First Amendment "merely because the conduct was in part initiated, evidenced, or carried out by means of language, either spoken, written, or printed." Ohralik v. Ohio St. Bar

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[7] Cf. Gentile v. State Bar of Nevada, 501 U.S. 1030, 1071-73 (1991) (plurality) (noting that speech rights are "extremely circumscribed" for attorneys who assist participants in judicial proceedings); Lowe v. SEC, 472 U.S. 181, 228-29 (1985) (Rehnquist, J., concurring) (observing that "[t]he power * * * to regulate the professions is not lost whenever the practice of a profession entails speech"; "the most obvious example of a 'speaking profession' * * * is the legal profession," even though it "is almost entirely devoted to the sort of communicative acts that, viewed in isolation, fall within the First Amendment's protection").

Ass'n, 436 U.S. 447, 456 (1978) (internal quotation marks omitted). Indeed, "[n]umerous examples * * * of communications * * * are regulated without offending the First Amendment, such as the exchange of information about securities, corporate proxy statements, the exchange of price and production information among competitors, and employers' threats of retaliation for the labor activities of employees." Ibid. (citations omitted). "Each of these examples illustrates that the State does not lose its power to regulate commercial activity deemed harmful to the public wherever speech is a component of that activity." Ibid.[8]

Like other consumer protection statutes, Section 110(i) governs only the "unfair and deceptive acts" of a commercial actor whose acts occur in the course of, or are integrally related to, business activities. See 15 U.S.C. § 45(a)(1) (authorizing the Federal Trade Commission to prohibit "unfair or deceptive acts"); 49 U.S.C. § 41712 (barring unfair or deceptive practices by air transporters). Because Section 110 does not target speech, but rather forbids illicit commercial "acts," 11 U.S.C. § 110(i), the First Amendment allows Congress through Section 110 to mitigate debtor abuse and confusion, and to

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[8] Cf. Pittsburgh Press Co. v. Pittsburgh Comm'n on Human Relations, 413 U.S. 376, 389 (1973) (prohibiting a newspaper from publishing sex-discriminatory employment advertisements); National Soc'y of Prof'l Eng's v. United States, 435 U.S. 679, 696-699 (1978) (enjoining the publication of a professional society's ethical canon that restrained trade).

safeguard the bankruptcy system's integrity. Cf. Nutritional Health Alliance v. Shalala, 144 F.3d 220, 227-28 (2d Cir. 1998) (upholding Food and Drug Administration's restraints on claims of health benefits); Harry & Bryant Co. v. FTC, 726 F.2d 993, 1002 (4th Cir. 1984) (upholding Federal Trade Commission regulations of "unfair and misleading" practices because such practices "are not 'speech' entitled to First Amendment protection"); Katherine Gibbs School, Inc. v. FTC, 612 F.2d 658, 666 (2d Cir. 1979) (holding that the First Amendment allows "reasonable latitude" for governmental efforts to prevent "unfair or deceptive acts").

2. At a minimum, because the communications regulated by Section 110 stem directly from Scott's commercial petition preparation, this Court should analyze any First Amendment interest under the rubric of "commercial speech." See In re Kaitangian, 218 B.R. 102, 107-108 (Bankr. S.D. Cal. 1998). As the Supreme Court explained in Ohralik, commercial speech warrants "a limited measure of protection, commensurate with its subordinate position in the scale of First Amendment values." 436 U.S. at 456; cf. id. at 459 ("A lawyer's procurement of remunerative employment is a subject only marginally affected with First Amendment concerns. It falls within the State's proper sphere of economic and professional regulation."). Although this Court has not created "bright-line rules" to distinguish commercial from non-commercial speech, Scott cannot

contest that the Overview and Workbook are distributed only as tools to assist customers in having their bankruptcy petitions prepared. United Reporting Publ'g Corp. v. California Highway Patrol, 146 F.3d 1133, 1137 (9th Cir. 1998), rev'd on other grounds, 528 U.S. 32 (1999). Such documents are purely functional aids to commercial conduct, and courts have applied commercial speech standards in analogous contexts. See Dun & Bradstreet, Inc. v. Greenmoss Builders, Inc., 472 U.S. 749, 762 (1985) (plurality) (applying commercial speech standards where communication "was speech solely in the interest of the speaker and its specific business audience"); Trans Union Corp. v. FTC, 245 F.3d 809, 818 (D.C. Cir. 2001) (same); cf. Friedman v. Rogers, 440 U.S. 1, 10 n.9 (1979) ("By definition, commercial speech is linked inextricably to commercial activity.").

Under commercial speech principles, Section 110 does not violate Scott's First Amendment rights because the statute affects only misleading or deceptive communications. As the Supreme Court explained in Edenfield v. Fane, 507 U.S. 761, 768 (1993), it is "clear that the State may ban commercial expression that is fraudulent or deceptive without further justification." See Virginia Pharmacy Bd. v. Virginia Citizens Consumer Council, 425 U.S. 748, 771 (1976) (finding "no obstacle" to restricting "deceptive or misleading" commercial speech); FTC v. Brown & Williamson Tobacco Corp., 778 F.2d 35, 43 (D.C. Cir. 1985) (noting that deceptive commercial speech "may be prohibited entirely") (internal quotation marks omitted); Harry & Bryant Co., 726 F.2d at 1001 (same).[9]

Similarly, although Scott invokes the First Amendment rights of her customers, she mistakenly cites cases concerning accurate representation by lawyers. See Appellant's Br. 33-34 & nn.72-74, 76. Contrary to Scott's suggestion (Br. 33-34), nothing in Section 110 restricts debtors' ability to retain an attorney, "access courts," or even represent themselves. On the facts of this case, Scott's customers have no identifiable interest in receiving misleading or deceptive materials, and, if they had full information, such customers certainly would not want the misinformation that the bankruptcy court condemned. Cf. Hill v. Colorado, 530 U.S. 703, 716 (2000) (recognizing governmental discretion to "protect listeners from unwanted communication"). Again, Section 110's only barrier is against "unfair or deceptive" acts by paid bankruptcy preparers, 11 U.S.C. § 110(a)(1), (i). In Section 110's exclusively commercial

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[9] Cf. Illinois ex rel. Madigan v. Telemarketing Assocs., Inc., 123 S. Ct. 1829, 1836 (2003) ("[T]he First Amendment does not shield fraud."); Donaldson v. Read Magazine, Inc., 333 U.S. 178, 192 (1948) ("[It] cannot be seriously considered * * * that freedom of the press includes a right to * * * deception of the public."); Young v. American Mini Theaters, Inc., 427 U.S. 50, 68 (1976) ("[Government] may prohibit businessmen from making statements which, though literally true, are potentially deceptive.").

context, that prohibition fully comports with the First Amendment.[10]

3. Scott's vagueness and overbreadth arguments depart from established case law in this Circuit and elsewhere. First, the Supreme Court has held that First Amendment overbreadth doctrine does not apply to commercial speech. "Commercial speech is not as likely to be deterred as noncommercial speech, and therefore does not require the added protection afforded by the overbreadth approach." Ohralik, 436 U.S. at 463 n.20. Moreover, as the district court noted, "laws that regulate economic activity not involving constitutionally protected conduct are subject to a quite lenient test for constitutional sufficiency." Dist. Op. 6 (quoting In re Kelly, 841 F.2d 908, 915 (9th Cir. 1988)); accord In re Stewart, 175 F.3d 796, 811 (10th Cir. 1999). Scott does not apply that "lenient" test, which Section 110 clearly satisfies.

Scott does not argue that Section 110 is vague or overbroad "as applied" to the misconduct found by the bankruptcy court. To mislead customers about the potential involvement of a Supervising Attorney satisfies any common-sense understanding of an "unfair or deceptive act." 11 U.S.C. § 110(i). So too does Scott's distribution of inaccurate documents that might mislead

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[10] The constitutional status of state laws, which may impose additional restrictions upon the conduct of bankruptcy petition preparers, is not presented by this appeal.

customers about their ability to file a bankruptcy petition, the proper manner of doing so, and the perceived need to employ a bankruptcy petition preparer.

The Supreme Court has held that, before invoking the “strong medicine” of overbreadth doctrine, a claimant bears the burden of showing, “from the text of [the law] and from actual fact,” that “a law’s application to protected speech be substantial, not only in an absolute sense, but also relative to the scope of the law’s plainly legitimate applications.” Virginia v. Hicks, 123 S. Ct. 2191, 2197-98 (2003). “Rarely, if ever, will an overbreadth challenge succeed against a law * * * that is not specifically addressed to speech or to conduct necessarily associated with speech.” Id. at 2199.

This Court has further explained that, in analyzing overbreadth claims, the “first task is to determine whether the enactment reaches a substantial amount of constitutionally protected conduct. If it does not, then the overbreadth challenge must fail. The court should then examine the facial vagueness challenge and, assuming the enactment implicates no constitutionally protected conduct, should uphold the challenge only if the enactment is impermissibly vague in all of its applications.” Hotel & Motel Ass’n of Oakland v. City of Oakland, 344 F.3d 959, 971 (9th Cir. 2003) (quoting Village of Hoffman Estates v. Flipside, Hoffman Estates, Inc., 455 U.S. 489, 494-95 (1982)). Under this Court's jurisprudence, it is dispositive that Section 110 does not impose criminal sanctions, involves only economic regulation, and does not infringe constitutional rights. See, e.g., Ohralik, 436 U.S. at 463 n.20 (holding overbreadth doctrine inapplicable to commercial speech); Craft v. National Park Serv., 34 F.3d 918, 922 (9th Cir. 1994); Go Leasing, Inc. v. NTSB, 800 F.2d 1514, 1525 (9th Cir. 1986); see also Nutritional Health Alliance, 144 F.3d at 226 (dismissing overbreadth challenge on ripeness grounds absent evidence that the provision "actually bars any truthful, non-misleading speech").

The cases Scott cites (Br. 30-31 & nn.61-65) concern, inter alia, loitering, criminal contempt, and vagrancy, none of which is anything like Section 110. Contrary to contexts where the Supreme Court has found statutory terms utterly standardless, the phrase "unfair and deceptive acts" is a cornerstone of Federal Trade Commission enforcement under 15 U.S.C. § 45(a)(1). The term was enacted into federal law in 1938, 52 Stat. 111, and has been incorporated within numerous federal regulations in various fields of commerce. See, e.g., 16 C.F.R. § 1.8 (general authority); 7 C.F.R. § 1150.161 (agricultural promotion); 12 C.F.R. § 227.11 (banking); 16 C.F.R. § 14.12 (marketing research); see also 49 U.S.C. § 41712 (proscribing "unfair or deceptive practice" by air transporters). We know of no court that has found the term “unfair or deceptive” facially invalid with respect to other federal laws. Against that backdrop, Scott cannot explain why that same term is facially unconstitutional with respect to Section 110.[11]

CONCLUSION

For the foregoing reasons, the district court’s judgment should be affirmed.

Respectfully submitted,

PETER D. KEISLER
Assistant Attorney General

WILLIAM KANTER
(202) 514-4575
H. THOMAS BYRON, III
(202) 616-5367
R. CRAIG GREEN
(202) 514-2498
Attorneys, Appellate Staff
Civil Division, Room 9104
Department of Justice
601 D Street, N.W.
Washington, D.C. 20530

OF COUNSEL:

JOSEPH A. GUZINSKI
General Counsel
P. MATTHEW SUTKO
Attorney
Office of the General Counsel, Executive Office for U.S. Trustees
20 Massachusetts Ave., N.W.
Washington, D.C. 20530

JANUARY 2004

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[11] Scott also suggests (Br. 31-32) that 11 U.S.C. 110(h) is vague because it orders courts to disallow any fee “in excess of the value of services rendered for the documents prepared.” Section 110(h) has no relation whatever to any free speech interest, and is a clear example of permissible regulation of economic activity.

STATEMENT OF RELATED CASES

The government is not aware of any related case, as defined in Ninth Circuit Rule 28-2.6, that is pending in this Court.

CERTIFICATE OF COMPLIANCE PURSUANT TO FED. R. APP. 32(a)(7)(C) AND CIRCUIT RULE 32-1 FOR CASE NUMBER 03-35411

I certify that pursuant to Fed. R. App. P. 32(a)(7)(C) and Ninth Circuit Rule 32-1, the attached Brief for Appellee is monospaced (in Courier New, 12 point font), has 10.5 or fewer characters per inch and contain 10153 words (excluding cover, tables, and certificates), according to the count of Corel WordPerfect 9.

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R. CRAIG GREEN
Attorney

CERTIFICATE OF SERVICE

I hereby certify that on this 28th day of January, 2004, I filed and served the foregoing Brief For United States Trustee by causing the original and fifteen copies to be sent to this Court by Federal Express overnight, and by causing two copies to be served upon the following counsel by Federal Express overnight:

Charles F. Vihon
4738 Howard Ave.
Western Springs, IL 60558
708-246-6565

____
R. CRAIG GREEN
Attorney

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WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE
[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]

In re Martin Brian Shat, Anjanette Shat (Martin Brian Shat, Anjanette Shat v. The United States Trustee, Las Vegas)

2. ("CO") ***CURRENT*** COURT
[E.g., "CTA9"]

BAP 9th Cir.

3. ("CCN") ***CURRENT*** CASE NO.

No.: NV 09-1092

4. ("PCN") ***PRIOR*** CASE NO. - & COURT
[IF ANY]

No.: 08-23136-BAM

Court: Bankr. Nev.

(Identify judge & cite, if any)

5. ("SO") ***SOURCE***

U.S. TRUSTEES

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Edward M. McDonald Jr., Catherine B. Sevcenko, P. Matthew Sutko, August B. Landis

(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***

BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s)

&

√ Any Miscellaneous ***BACKGROUND***

• Did the bankruptcy court abuse its discretion by 1) denying the debtor's applications to employ attorney Christopher Gellner and 2), refusing, in the alternative, to grant the application *nunc pro tunc* to the date of the filing of the petition?

10. PATH TO FILE LOCATION:
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NAME: Linda Figueroa

DATE:

AUGUST B. LANDIS, *Assistant U. S. Trustee* (IA PK9228)
EDWARD M. MCDONALD JR. (NY EM2209)
OFFICE OF THE U.S. TRUSTEE
300 Las Vegas Boulevard, So., Suite 4300
Las Vegas, Nevada 89101
Telephone: (702) 388-6600 Attorney Ext. 234
Facsimile: (702) 388-6658

RAMONA D. ELLIOTT, *General Counsel*
P. MATTHEW SUTKO, *Associate General Counsel*
CATHERINE B. SEVCENKO, *Trial Attorney*
United States Department of Justice
Executive Office for United States Trustees
20 Massachusetts Ave, N.W.
Washington, DC 20530

Attorneys for Appellee,
The Acting United States Trustee, SARA L. KISTLER

UNITED STATES BANKRUPTCY APPELLATE PANEL
FOR THE NINTH CIRCUIT

In re MARTIN BRIAN SHAT, ANJANETTE SHAT, Debtors.	Bankr. No. 08-23136-BAM Chapter 11 Bankruptcy Judge, Bruce A. Markell, presiding
MARTIN BRIAN SHAT, ANJANETTE SHAT, Appellants, v. THE UNITED STATES TRUSTEE, Las Vegas, Appellee.	BAP No.: NV-09-1092 On Appeal from the United Bankruptcy Court for the District of Nevada

BRIEF OF APPELLEE,

THE ACTING UNITED STATES TRUSTEE FOR REGION 17

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I. STATEMENT OF JURISDICTION

The United States Bankruptcy Court for the District of Nevada entered an interlocutory order denying appellant debtors' Application to Employ Attorney, filed by Martin Brian Shat and Anjanette Shat, ("Debtors") on March 5, 2009. [AA, T. 16][1] Debtors filed a timely notice of appeal under 28 U.S.C. § 158(c)(2) and FED. R. BANKR. P. 8002(a) on March 13, 2009. The Bankruptcy Appellate Panel of the Ninth Circuit has jurisdiction over this appeal pursuant to 28 U.S.C. §§ 158(a)(3), (b) and (c). This court granted leave to appeal this interlocutory order on June 25, 2009.

II. ISSUE PRESENTED ON APPEAL

Did the bankruptcy court abuse its discretion by 1) denying the Debtors' application to employ attorney Christopher Gellner and 2), refusing, in the alternative, to grant the application *nunc pro tunc* to the date of the filing of the Petition?

III. STANDARD OF APPELLATE REVIEW

A bankruptcy court's ruling whether to approve an application for the employment of a professional is reviewed for abuse of discretion. *In re Elias*, 215 B.R. 600 (B.A.P. 9th Cir. 1997). The bankruptcy court's findings of fact

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[1] AA, T. refers to a document tabbed in the Appellants' Appendix.

are reviewed for clear error and its conclusion of law are reviewed *de novo*. *In re Park-Helena Corp.*, 63 F.3d 877, 880 (9th Cir. 1995); FED R. BANKR. P. 8013.

IV. STATEMENT OF THE CASE

This appeal arises from the bankruptcy court's denial of an application under 11 U.S.C. § 327(a) to employ attorney Christopher G. Gellner as Debtors' counsel in their chapter 11 bankruptcy case. The Acting United States Trustee opposed the application because it, and the verified statement filed in support, failed to disclose the fact that Mr. Gellner concurrently represented another chapter 11 debtor, Steve Herbert Hofsaess, who held an interest adverse to the Debtors' estate.[2] Mr. Gellner had represented both the Debtors and his other client, Hofsaess, in a post-petition transaction conveying to Hofsaess, without consideration, legal title to real property held by the Debtors. Mr. Gellner did not disclose this information in his mandatory verified statement. FED. R. BANKR.P. 2014(a).

The Acting United States Trustee also opposed granting Mr. Gellner's retention *nunc pro tunc* on the ground Mr. Gellner submitted his application more than two months after the Debtors filed for bankruptcy. Mr. Gellner

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[2] Steve Herbert Hofsaess ("Hofsaess"), Chapter 11 Case No. Bk-S-08-23761 (D. Nev., filed Nov. 19, 2008).

argued the court below should waive this omission because 1) the December holidays, and 2) the displacement caused by office renovations prevented him from filing a timely application.

At the conclusion of the hearing on the United States Trustee's opposition, the court, exercising its discretion, ruled from the bench that Mr. Gellner was not qualified to serve as the Debtors' attorney because 1) his involvement in the real estate transaction constituted, at a minimum, a potential conflict of interest, and 2) Mr. Gellner had demonstrated that he was not qualified to handle a chapter 11 case. The bankruptcy court entered its order denying Debtors' application to retain Mr. Gellner on March 5, 2009. [AA, T. 16] This appeal followed.

A. Statement of the Facts and Prior Proceedings

In 2006, the Debtors, Martin and AnJanette Shat, and their friend Steven Herbert Hofsaess each owned several rental properties. [AA, T. 12, p. 74, para. 1 and p. 76, paras. 7-8]. At that time the Debtors held legal title to real property located at 6175 Smarty Jones Avenue. They gave their friend Mr. Hofsaess an equitable interest in the property but retained legal title. [AA, T. 12, p. 76, para. 8].

Approximately three years later, the friends all declared bankruptcy. Both parties opted to retain the Appellant, Mr. Gellner, to handle their bankruptcies. Mr. Gellner filed a chapter 11 bankruptcy petition for the Debtors on November 5, 2008, and for Mr. Hofsaess on November 19, 2008, both in the District of Nevada.[3] [AA, T. 11, p. 72, para. 5] The Debtors' petition identified Mr. Gellner as counsel, although they did not file an application to employ Mr. Gellner at that time. [AA, T. 1, p. 3] Nor had Mr. Gellner submitted the requisite verified statement establishing he was a disinterested person and therefore potentially qualified to serve .

The Debtors' bankruptcy schedules listed real property valued at $1,917,000, subject to $3,042,192 in secured claims. [AA, T. 1, p. 13] The real property consisted of six homes, including one at 6175 Smarty Jones Avenue in Las Vegas, Nevada. The scheduled value of that home is $340,000, subject to secured claims totaling $576,000. [AA, T. 1, pp. 15, 20, and 21]

Shortly after the Debtors and Mr. Hofsaess filed their bankruptcy petitions, Mr. Shat executed a quitclaim deed purporting to convey legal title of the Smarty Jones property to Mr. Hofsaess. [AA, T. 12, pp. 75-76, paras. 5-

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[3] 11 U.S.C. § 101 *et seq*. Unless otherwise indicated, the term "Code" as used in this brief refers to the United States Bankruptcy Code.

6]. The bankruptcy court did not receive prior notice of it and did not approve this transfer of property. Mr. Gellner handled the transaction, representing both parties. His paralegal notarized the deed. [AA, T. 13; *see also* AA, T. 22, pp. 126:22 – 127:17] Neither party received advice from independent counsel, although the Debtors and Mr. Hofsaess held adverse interests to the property. [AA, T. 22, pp. 128:14 - 129:8]

At approximately the same time Mr. Gellner was arranging the transfer of the Smarty Jones property, the bankruptcy court entered an order setting a status conference for December 16, 2008. [AA, T. 2] The order required Debtors to file a brief of not more than five pages by December 11, 2009, explaining their efforts to develop a plan of reorganization. [AA, T. 2, p. 43:15-22]

Mr. Gellner failed to appear at the December 16, 2008, status conference. [AA, T. 20, p. 111:2 - 112:22] The bankruptcy court rescheduled it for January 27, 2009, but stated in the order that if Mr. Gellner failed to appear, Mr. Gellner would face a $500 fine. [AA, T. 3, p. 45:21-22]

About two months after filing for bankruptcy, in mid-January 2009, the Debtors filed their application requesting the bankruptcy court approve Mr. Gellner as their lawyer pursuant to 11 U.S.C. § 327(a) and FED. R. BANKR. P.

2014. [AA, T. 5] Mr. Gellner declared under penalty of perjury that he and his firm were disinterested persons as defined in the Code and that they had no previous relationship with the Debtors. [AA, T. 5, pp. 50, para. 6, and AA, T. 6, p. 52, para. 2, and p. 53, para. 5]

The Acting United States Trustee filed an opposition to the Debtors' application to engage Mr. Gellner as their bankruptcy counsel on three grounds: neither the application, nor the Mr. Gellner's supporting declaration, disclosed 1) Mr. Gellner's representation of both the Debtors and Hofsaess; 2) his clients' competing interests in the Smarty Jones property; or 3) the potentially disqualifying conflict of interest arising from his involvement in both cases. [AA, T. 9, pp. 60 - 61, paras. 7 - 11] The Acting United States Trustee also opposed *nunc pro tunc* employment because neither the application, nor Mr. Gellner's supporting declaration, established exceptional circumstances sufficient to warrant employment on a such basis. [AA, T. 9, p. 61, paras. 12 - 14]

In their reply, the Debtors admitted Mr. Gellner represented both them and Mr. Hofsaess. [AA, T. 10, p. 66:11 - 14, and p. 68:18 - 23; *see also* AA, T. 11, p. 72, para. 5] The reply also stated that Mr. Shat had agreed to sell Mr. Hofsaess the property at 6175 Smarty Jones Avenue in December 2006, but

the Debtors conceded they had not legally transferred the property to Hofsaess until December 4, 2008, after both parties had declared bankruptcy. [AA, T. 10, pp. 66:15-67:6; AA, T. 12, pp. 75 - 76, paras. 5-6.; *see also* AA, T. 12, p. 76, paras. 7 - 8 and AA, T. 11, p. 72, para. 5] The reply also admitted that Debtors' application to retain Mr. Gellner as their attorney had been submitted to the court two months late. [AA, T. 11, p. 71,, para. 2] Mr. Gellner attributed the delay to the fact he had been busy filing numerous chapter 7, 11, and 13 cases. [AA, T. 10, p. 68:14 - 23; *see also* AA, T. 11, pp. 71 - 72, paras. 4 -5] He further blamed the timing: during the last two weeks of December 2008 and the first week of January 2009, the work flow of his firm slowed because of the holidays and employee vacations. [AA, T. 11, p. 72, para. 6] Mr. Gellner also claimed the delay was excusable because he had received notice in mid-December 2008 that he would have to vacate his offices within 30 days for renovations. [AA, T. 22, pp. 131:15 – 131:21]

On January 27, 2009, Mr. Gellner and counsel for the Acting United States Trustee appeared at the continued status hearing. [AA, T. 21, pp. 114 - 120] The bankruptcy court asked Mr. Gellner why he had not yet filed the status brief required by the court's November 10, 2009 order. [AA, T. 21, p. 116:11] Mr. Gellner replied that he had not read the order. [AA, T. 21, p.

117:2- 3] The bankruptcy then continued the status hearing to the date set for the hearing on the Debtors' application to employ Mr. Gellner and expressed concern that Mr. Gellner might not be competent to serve as counsel in individual chapter 11 bankruptcy case. [AA, T. 21, p. 118: 14- 25]

After the bankruptcy court heard argument, it denied the applications to employ Mr. Gellner as counsel in both the Shat and Hofsaess cases for two independent reasons. [AA, T. 22, pp. 142:2 - 145:3] In a decision from the bench, the bankruptcy court first decided that Mr. Gellner had at least a potential conflict of interest, if not an actual one, due to his representation of both the Debtors and Mr. Hofsaess. The court was troubled that the parties had not had independent legal advice: "it [the conflict] may not be actual but certainly potential" because there was not independent examination of the transaction. [AA, T. 22, p. 142:7-11]. Therefore, Mr. Gellner was not disinterested and could not serve.

Secondly, the bankruptcy court denied the applications because of doubts concerning Mr. Gellner's competence to handle a chapter 11 case. The court found it "astounding" that Mr. Gellner did not understand that debtors-in-possession were fiduciaries of their creditors and not simply individuals. [*See* AA, T. 22, pp. 136:5 -137:4; AA, T. 22, p. 140:9 - 18; AA, T.

22, p. 142:12 - 16] Furthermore, the court based its decision on Mr. Gellner's failure to prosecute the case in its early stages, in particular his failure to comply with the court's briefing schedule, and Mr. Gellner's attempt to blame his staff for the oversight. [AA, T. 22, p. 143:13 - 21] The bankruptcy court declared it "unacceptable" that Mr. Gellner tried to disavow participation in executing the unauthorized post-petition quitclaim deed. [AA, T. 22, p. 143:19 - 21] Finally, the bankruptcy court denied the *nunc pro tunc* employment request. [AA, T. 22, p. 144:2-13] The court concluded that denial of Mr. Gellner's retention applications was appropriate due to "serious concerns at least with respect to individual chapter 11s whether or not Mr. Gellner's office either can handle this on a case-management basis or even, potentially, on a legal basis." [AA, T.22, pp. 144:24-145:3] In the course of the hearing, the judge identified other causes of concern. [*See* AA, T. 22, p. 136:6 - 7 *and* AA, T. 22, p. 142:7 - 11 (discussion of Mr. Gellner's conflict); AA, T. 22, p. 138:22 – 139:3 and AA, T. 22, p. 143:3 - 5 (discussion of Mr. Gellner's lack of disinterestedness); AA, T. 22, p. 142:17 - 24 (discussion of failure to disclose facts giving rise to Mr. Gellner's conflict and lack of disinterestedness)].

The bankruptcy court entered its order on March 5, 2009, denying Mr. Gellner's employment application. [AA, T. 16] Debtors filed a timely notice of appeal on March 13, 2009. [AA, T. 17]

V. SUMMARY OF THE ARGUMENT

The order entered below constituted a sound exercise of the bankruptcy court's discretion. The court found there were two separate and independent grounds not to approve the Debtor's application to employ Mr. Gellner. First, Mr. Gellner had, at a minimum, a potential conflict of interest because he had represented the Debtors and another one of his bankruptcy clients in a post-petition transfer of property that arguably violated the Bankruptcy Code. *See* 11 U.S.C. § 549 (allowing a trustee to avoid post-petition transfers).[4] Second, the bankruptcy judge concluded that Mr. Gellner was not competent to act as counsel in this case on multiple grounds. Mr. Gellner demonstrated an ignorance of chapter 11 law in general and the responsibilities of a chapter 11 debtor as a fiduciary in particular. Mr. Gellner neglected for months to file the Debtor's application for employment and his verified statement and, when he did so, he stated under oath that he had no conflict, although he had been involved in a post-petition property transfer between the Debtors and another

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[4] It also was arguably conducted in violation of 11 U.S.C. § 363.

client. He missed two deadlines to file a status brief and blamed his shortcomings on his staff, rather than taking responsibility for them himself.

The Code gives bankruptcy courts broad discretion to assess a professional's suitability to participate in a bankruptcy case. The court may consider the totality of the circumstances, including the specific facts of each case and the overall objectives of the bankruptcy system, in deciding whether an applicant is suitable. In this case, the bankruptcy court had ample facts upon which to base its decision that Mr. Gellner was an unsuitable attorney for the Debtors' case: he represented both parties to a post-petition transfer of legal title to the Smarty Jones property from one of his clients (Martin Shat) to another (Steve Hofsaess). At a minimum, Mr. Gellner's participation in that transaction gave rise to a potential conflict of interest, sufficient grounds for the court to deny retention as counsel. In addition, the court did not abuse its discretion in deciding that Mr. Gellner's inattentive prosecution of the Debtors' disqualified him from service.

Finally, the bankruptcy court did not abuse its discretion in denying ***nunc pro tunc*** **employment given it findings that Gellner had not timely filed his applications and failed satisfactorily to explain why his proposed retention**

should be afforded *nunc pro tunc* status under applicable law, if it could have been granted at all.

VI. ARGUMENT

A. The Controlling Statutory Framework

1. <u>11 U.S.C. § 327</u>

This appeal is governed by section 327 of the Bankruptcy Code, which provides "the trustee, with the court's approval, may employ one or more attorneys . . . that do not hold or represent an interest adverse to the estate, and that are disinterested persons, to represent or assist the trustee in carrying out the trustee's duties under this title.[5] At a minimum a professional desiring to serve in a bankruptcy case must meet three criteria. First, the professional must "not hold or represent an interest adverse to the estate." A generally accepted definition of "adverse interest" is the (1) possession or assertion of an economic interest that would tend to lessen the value of the bankruptcy estate; or (2) possession or assertion of an economic interest that would create either an actual or potential dispute in which the estate is a rival claimant; or (3) possession of a predisposition under

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[5] As used in section 327(a), "trustee" also includes a debtor in possession in a chapter 11 bankruptcy case. 11 U.S.C. § 1107(a).

circumstances that create a bias against the estate. ***In re AFI Holding, Inc.*****, 530 F.3d 832, 845 (9th Cir. 2008) (citation omitted).**

Second, the applicant to serve in a bankruptcy case must be "disinterested." The Code defines "disinterested person" as one who "is not a creditor, an equity security holder, or an insider" and who "does not have an interest materially adverse to the interest of the estate . . . [because of] any direct or indirect relationship to, connection with, or interest in the debtor . . . or for any other reason." 11 U.S.C. §§ 101(14)(A) & (E). The requirement that a professional be disinterested is mandatory. Debtors cannot waive conflicts of interest. ***See In re S.S. Retail Stores Corp.*****, 211 B.R. 699, 703 (B.A.P. 9th Cir. 1997).**

Third, the statute provides that a trustee, with the "approval" of the bankruptcy court "may" appoint counsel who are disinterested and have no adverse interest, creating a third criterion, namely that the bankruptcy judge approve the person seeking appointment. The permissive language in the statute makes clear that courts can deny appointment on additional grounds; such decisions are reviewed on appeal on an abusive of discretion standard. Thus, the Code's language is broad enough that a bankruptcy court may exclude a professional with any connection that "would even faintly color the

independence and impartial attitude required by the Code." ***In re Crivello,*** **134 F.3d 831, 835 (7th Cir. 1998). These statutory requirements ensure that all professionals appointed under section 327(a) "tender undivided loyalty and provide untainted advice and assistance in furtherance of their fiduciary responsibilities."** ***Id. at*** **836 (7th Cir. 1998) (quotation omitted). In sum, determination that a professional is disinterested is the only first step. Creditors, parties in interest, and the United States Trustee may still object, and the court may deny the application if it is in the best interest of the estate.**

2. Federal Rule of Bankruptcy Procedure 2014

Section 327(a) establishes the standards for determining that a professional may serve in a bankruptcy case. Federal Rule of Bankruptcy Procedure 2014 outlines the procedures for seeking the necessary court approval. It requires that the proposed lawyer provide in a verified statement of "all the person's connections with the debtor, creditors, any other party in interest, their respective attorneys and accountants, the United States trustee, or any person employed in the office of the United States trustee." FED. R. BANKR. P. 2014. Accurate disclosure is mandatory. ***In re Mehdipour,*** **202 B.R. 474, 480 (B.A.P. 9th Cir. 1996). Failure to disclose is sufficient grounds to revoke an employment order and deny compensation.** ***Crivello,*** **134 F.3d at**

836; *Rome v. Braustein,* 19 F.3d 54, 59-60 (1st Cir. 1994); *cf. In re Futuronics Corp.,* 655 F.2d 463, 470 (2d Cir. 1981) (duty to disclose arises from fiduciary obligations as well as the Bankruptcy Rules).

The disclosure requirement is broad. The applicant-counsel "must disclose all connections and not merely those that rise to the level of conflicts." *In re Keller Fin. Serv. of Fla.,* 248 B.R. 859, 897-98 (Bankr. M. D. Fla. 2000) (citation omitted). The applicant cannot "usurp" the court's role to decide which connections are relevant to determining whether a professional is disinterested and which are not. *Id.*; *Park-Helena,* 63 F.3d at 882 (stating that an applicant cannot "pick and choose which connections are irrelevant or trivial"). The Ninth Circuit applies the disclosure requirements of Rule 2014 "strictly," even if the results "are sometimes harsh." *Park-Helena,* 63 F.3d at 881. Both the Code and the Rules are designed to ensure that bankruptcy cases are administered and adjudicated with the highest level of integrity.

B. The Bankruptcy Court Did Not Abuse Its Discretion in Declining to Appoint Mr. Gellner to Represent the Debtors.

1. <u>The bankruptcy court has broad discretion when deciding whether to approve appointments of proposed counsel.</u>

A bankruptcy court has broad discretion to deny appointment of a professional. Under the Code, a trustee "may" appoint a professional, but

only with "approval" of the bankruptcy judge. 11 U.S.C. § 327(a). And it is hornbook law that it is within a bankruptcy judge's broad discretion to approve, or disapprove the appointment of professionals chosen by the trustee or debtor. *In re Martin*, 817 F.2d 175, 182 (1st Cir. 1987) (describing wide discretion of bankruptcy courts to determine terms of engagement for professionals); *In re Harold & Williams Dev. Co.*, 977 F.2d 906, 909 (4th Cir. 1992). In order to protect the debtors or the estate, the bankruptcy court may disapprove an application for any reason that serves the best interests of the estate and creditors. *In re Vebeliunas*, 231 B.R. 181, 194-95 (Bankr. S.D.N.Y. 1999).

In this case, the bankruptcy judge denied Mr. Gellner's application on two separate grounds. First, Mr. Gellner's involvement in the Smarty Jones real estate transaction created at least a potential conflict of interest. Second, Mr. Gellner was not competent to represent the Debtors. The record supports both of these conclusions, as explained in detail below. The bankruptcy court did not abuse its discretion.

C. Mr. Gellner Had, at a Minimum, a Potential Conflict of Interest and Thus Could Not Represent the Debtors.

An actual conflict of interest mandates disqualification of a professional to serve in a bankruptcy case. 11 U.S.C. §§ 327(a) & (c). However, a potential conflict also provides sufficient grounds for a court to decline to appoint an attorney. *AFI Holding*, 530 F.3d at 851 (potential for materially adverse effect or appearance of impropriety sufficient grounds to deny appointment). *In re Pillowtext, Inc.*, 304 F.3d 246, 251 (3d Cir. 2002) (stating a court "may within its discretion-pursuant to § 327(a) and consistent with § 327(c)-disqualify an attorney who has a potential conflict of interest") (citing *In re Marvel Entertainment Gp., Inc.*, 140 F.3d 463, (3d Cir. 1998)). In fact, doubt as to whether a particular set of facts gives rise to a disqualifying conflict of interest should normally be resolved in favor of disqualification. *In re Angelika Films 57th Inc.*, 227 B.R. 29, 39 (Bankr. S.D.N.Y. 1998).

Therefore, Mr. Gellner's attempt to argue that his representation of multiple debtors in the Smarty Jones real estate transaction is proper because it does not constitute an "actual" conflict is irrelevant to the resolution of this case. [AA, T.22 pp. 126:4-6; 135:22-24; 138:10-11; 139:8-11]. Even if Mr. Gellner were correct that the transfer was a fair transaction, the bankruptcy court still had the discretion to disqualify him on the grounds of a potential conflict of interest. *Marvel*, 140 F.3d at 476. The court was troubled that Mr.

Gellner arranged a post-petition sale of property and then wanted to represent both parties in bankruptcy, although they had potentially competing claims to the one piece of property. [AA, T. 22, p. 139:1-7]. No one had independently analyzed the transaction. Nothing in the record confirmed its legitimacy. In a proper exercise of discretion, the bankruptcy judge refused to appoint Mr. Gellner because "there is a conflict here. It may not be actual, but it certainly is potential because there has been no independent examination of this." [AA, T.22, p. 142:7-11].

There was substantial support in the record to conclude Mr. Gellner had an adverse interest. First, Mr. Gellner failed to disclose the Smarty Jones property transaction to the creditors of both estates, something the bankruptcy judge could not understand. [AA, T.22, p. 142:17-24 (stating "why there was no consideration given to disclosing this to creditors is beyond me")]. Second, Mr. Gellner admitted in open court that he was aware of the potential conflict between the Debtors' and Mr. Hofsaess's estates when the Debtors filed their bankruptcy petition. [AA, T. 22, pp. 128:25-129:8]. Third, as a result, Mr. Gellner should have disclosed the potential conflict when he filed his application and declaration. *Rome,* 19 F.3d at 59 (requiring that counsel inform the court immediately after acquiring constructive knowledge

of a potential conflict). Counsel are required to make all the necessary disclosures. *Park-Helena*, 63 F.3d at 881-82.

As the circuit cases indicate, counsel too often fail to provide accurate rule 2014(a) verified statements. This was the case here. Mr. Gellner failed to disclose that 1) he represented both the Debtors and Mr. Hofsaess; 2) that the two parties had engaged in a post-petition transfer of real estate; and 3) that his law firm had executed that transaction; and 4) because of the transfer, the two debtors were adverse to each other.[6] Standing alone, this would justify denial of employment. Indeed, courts routinely order disgorgement of fees in such cases. *Crivello,* 134 F.3d at 836. At a minimum, this failure to disclose, when coupled with the potential conflict of interest gave the court below ample discretion to deny employment.

D. Mr. Gellner Could Not Represent the Debtors Because He Was Not Disinterested.

The Bankruptcy Code requires that a professional engaged in a bankruptcy proceeding be a disinterested person, namely someone who "does

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[6] Mr. Gellner claims he informed the Acting United States Trustee about the Smarty Jones transaction during the IDI meetings for the Debtors and Mr. Hofsaess. Appellant Br. at 7. This does not cure the 2014(a) violation. The Ninth Circuit has long held that such informal communication fails to satisfy the statutory requirement of attorney disclosure. *In re Haldeman Pipe & Supply Co.,* 417 F.2d 1302, 1304-05 (9th Cir. 1969).

not have an interest materially adverse to the interest of the estate . . . [because of] any direct or indirect relationship to, connection with, or interest in the debtor . . . or for any other reason." 11 U.S.C. §§ 101(14)(A) & (E). A finding that a person is not disinterested precludes approval of employment. *In re Middletown Arms Ltd. P'ship,* 934 F.2d 723, 725 (6th Cir. 1991) (holding that the court could not use its equitable powers to approve employment of a person who is not disinterested); *see also AFI,* 530 F.3d at 847.

The bankruptcy judge has discretion, however, to disqualify someone if the professional has a meaningful incentive to act contrary to the interest of the estate. *In re Interwest Bus. Equip., Inc.,* 23 F.3d 311, 316 (10th Cir. 1994); *In re Granite Part. L.P.,* 219 B.R. 22, 36 (Bankr. S.D.N.Y. 1998); *In re Leslie Fay Cos.,* 175 B.R. 525, 534 (Bankr. S.D.N.Y 1994); *Rome,* 19 F.3d at 59. In particular courts are skeptical when, as here, a lawyer proposes to represent two parties. Such an arrangement casts doubt on the ability of the professional to fulfill his or her role as an independent fiduciary. *Interwest,* 23 F.3d at 316. For instance, the *Interwest* Court affirmed a bankruptcy court's denial of a law firm's application for employment as counsel for the debtors because that firm represented multiple debtors in related chapter 11 cases. *Id.* at 318-19; *In re BH & P, Inc.,* 949 F.2d 1300, 1317-18 (3d Cir. 1991)

(disqualifying attorney because estates had claims against one another); *In re Lee*, 94 B.R. 172, 180 (Bankr. C.D. Cal. 1998) (same).

In this case, the Debtors and Mr. Gellner's other client, Mr. Hofsaess, engaged in a transfer of real estate after each party had declared bankruptcy. The parties claimed that the quitclaim deed simply memorialized an agreement that they had made several years before. [AA, T. 10, p. 66:15 - 67:6; *see also* AA, T. 12, p. 76, paras. 7 - 11]. The property, however, cannot belong to both estates. The trustee and/or the bankruptcy court will have to determine who properly owns the Smarty Jones property. Logically, Mr. Gellner will have to act against the interests of one estate as the ownership is adjudicated; at the end of the process, one of his clients will have the property and the other will be deprived of it. Accordingly, this dual representation cannot meet the standards of disinterest mandated by section 327(a).

E. The Bankruptcy Court Did Not Abuse its Discretion When it Disqualified Mr. Gellner Because He Lacked Competence to Represent the Debtors.

The bankruptcy judge denied Mr. Gellner's application on a second, independent ground. He found that Mr. Gellner was not competent to represent the debtors.

Under the Code, if proposed counsel is disinterested and does not hold an adverse interest, the court then considers the totality of the circumstances before deciding whether to approve an appointment. *AFI,* 530 F.3d at 847 (B.A.P. opinion adopted by Ninth Circuit). The discretion of the bankruptcy court to approve professional employment plays a particularly important role in chapter 11 cases. Chapter 11 debtors in possession differ substantially from non-debtors because a bankrupt's fiduciary duties run to the creditors' benefit, not the debtor's. *CFTC v. Weintraub,* 471 U.S. 343, 355 (1985); *In re McConville,* 110 F.3d 47, 50 (9th Cir. 1997). The bankruptcy judge must also provide for the "efficient expeditious, and economical resolution of the bankruptcy proceeding." *In re Harold,* 977 F.2d at 910. For that reason, bankruptcy courts, not debtors, exercise ultimate discretion and gate-keeping authority over who may be employed as bankruptcy counsel under 11 U.S.C. § 327(a).

In this case, even if Mr. Gellner were correct that he is disinterested, and he is not, the bankruptcy court still established ample grounds on which

to deny Mr. Gellner's application for employment. Specifically, at the hearing, Mr. Gellner demonstrated an "astounding" lack of knowledge about the fiduciary duties of a chapter 11 debtor. [AA, T.22, p. 142:16]. The following colloquy exemplifies the court's concern:

MR. GELLNER: And the only thing they [the Debtors and Mr. Hofsaess] didn't do, your Honor, is they didn't sign a deed, and the reason why they didn't do that is because they were friends, and it was no big deal to them.

THE COURT: Right. But as you've already established, you don't understand that it's not just them anymore. It's them and their creditors, and that's a fundamental distinction that if you don't acknowledge and recognize it's difficult for me –

MR. GELLNER: No.

THE COURT: – to approve –

MR. GELLNER: I understand that.

THE COURT: – your employment as a Chapter – well, you didn't when I asked you earlier.

[AA, T. 22, p. 140:5-19] The bankruptcy judge was convinced that Mr. Gellner did not have sufficient understanding of chapter 11 to represent the Debtors competently. Accordingly, he did not abuse his discretion by denying Mr. Gellner's application.

Nor was Mr. Gellner's weak understanding of chapter 11 law the only cause of the bankruptcy judge's concern. The court found him lacking in

basic case management skills. He had failed on two occasions to file a status brief that the court had requested. Instead of taking responsibility for that oversight, he blamed it on his staff. The bankruptcy court termed "unacceptable" his additional claim that the quitclaim deed was drafted when he was not in the office. Nor did the judge believe that Mr. Gellner's inability to file a timely application for employment boded well for his ability to manage the case. [AA, T. 22, pp. 143:9-145:3].

Finally, the Debtors' desire to retain Mr. Gellner cannot compensate for his conflict of interest and other short-comings. Mr. Gellner is incorrect that a debtor has an unfettered right to retain his or her attorney of choice. [Appellants' Br. at 10-11]. To the contrary, the Code's procedural and substantive protections limit the usual freedom to select one's preferred counsel. *See AFI,* 530 F.3d at 839 (stating that courts evaluate the totality of the circumstances before disqualifying counsel; *see also Harold,* 977 F.2d 910. Mr. Gellner's position cannot be squared with common sense or with section 327's text which gives the bankruptcy court power to approve a professional that the trustee "may" nominate. Nor can the use of "may" and "approval" be attributed to a slip of the pen. *Lamie v. United States Trustee,* 540 U.S. 526, 541 (2004) (court cannot re-write statute). Furthermore, the use of "shall" in

section 327(c) demonstrates that Congress knew how to distinguish between the two words in the section, so the use of "may" in sections 327(a), (b), (d), (e) and (f) should be given its dictionary meaning. There is simply no right for a debtor to retain the counsel of his choice. The court weighs the totality of the circumstances. If the court disqualifies its decision is reviewed for abuse of discretion. *AFI*, 530 F.3d at 852.

The claim that a debtor can choose any professional overlooks the Code's goal of ensuring that debtors retain impartial counsel who can be trusted to deal responsibly with the estate's assets and with the many fiduciary duties that arise in the course of a case. *In re Crivello*, 134 F.3d at 836. This is particularly important in chapter 11 cases; debtors in possession have a fiduciary obligation to their creditors. *Weintraub*, 471 U.S. at 355. A bankruptcy court's willingness to allow a chapter 11 debtors to remain in control of the estate is premised upon confidence that they will carry out their fiduciary responsibilities. *Id.* Under Mr. Gellner's interpretation, Chrysler could have chosen a sole practitioner to handle its multi-million dollar bankruptcy case if the lawyer was disinterested and had no adverse intent. That cannot be, and is not, correct. The bankruptcy court properly exercised its discretion to overrule the Debtors' wishes and disqualify Mr. Gellner in

order to protect the interest of the bankruptcy estate. Affirmance of that order is warranted.

F. There is No Basis for Approving Mr. Gellner's Retention *Nunc Pro Tunc* to the Petition Date.

Assuming, *arguendo*, that the bankruptcy court could have approved Mr. Gellner's retention application, such approval could not have been given on a *nunc pro tunc* basis. *In re Atkins*, 69 F.3d 970, 974 (9th Cir. 1995) (describing the grounds for granting a *nunc pro tunc* application). Such authorization can only be given in "extraordinary circumstances." *In re Gutterman*, 239 B.R. 828, 830 (Bankr. N.D. Cal. 1999) (citation omitted). In order to qualify, an applicant must satisfactorily explain the failure to receive prior judicial approval before beginning representation. The applicant must also demonstrate that he or she has benefitted the estate in some significant manner. *In re THC Fin. Corp.*, 837 F.2d 389, 392 (9th Cir. 1988) (citations omitted); *In re Atkins*, 69 F.3d 970, 974 (9th Cir. 1995).

In this case, Mr. Gellner did not adequately explain why his application was several months late. His explanation that he was busy does not constitute an "extraordinary circumstance," nor does the fact that his work flow slowed over the winter holidays. That is true of most, if not all, businesses. The fact

that he had to move his office temporarily in January 2009 does not explain why he did not file his application for employment with the court in November 2008 – when it was due. Mr. Gellner cannot meet the first element of the test for retroactive appointment. The bankruptcy court properly denied his request for *nunc pro tunc* employment.

VII. CONCLUSION

For these reasons, the Acting United States Trustee respectfully asks this court to affirm the order entered below.

DATED this _____ day of June, 2009.

SARA L. KISTLER, ACTING UNITED STATES TRUSTEE, REGION 17

By:_______________________________
Edward M. McDonald, Jr., Esq.
Attorney for the Acting United States Trustee

Ramona D. Elliott
General Counsel
P. Matthew Sutko
Associate General Counsel
Catherine B. Sevcenko
Trial Attorney
United States Department of Justice
Executive Office for United States Trustees
20 Massachusetts Ave, N.W.
Washington, DC 20530

BRIEF BANK — “SUMMARY SHEET” *Printed Mon-5/23/11 11:31*

WESTLAW CODES

1. ("TI") *TITLE* OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	In re: Michael R. Shemonsky (Shemonsky v. Atlantic Financial Federal)
2. ("CO") *CURRENT* COURT *[E.g., "CTA9"]*	3rd Cir.
3. ("CCN") *CURRENT* CASE NO.	No.: 08-3803
4. ("PCN") *PRIOR* CASE NO. & COURT *[IF ANY]*	No.: 4-08-cv-01094 Court: M.D. Pa. *(Identify judge & cite, if any)*
5. ("SO") *SOURCE*	U.S. TRUSTEES
6. ("DA") *DATE* OF FILING *& TYPE* OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	Filed: October 31, 2008 Type: Response of the United States Trustee as Amicus In Support of Dismissal or Summary Affirmance
7. ("AU") *PRINCIPAL AUTHORS & OFFICE [E.g.,"UST/OGC"]*	Ann McCormick, P. Matthew Sutko, Anne K. Fiorenza *(UST/OGC: 202-307-1399/FAX-2397)*
8. ("TO") *TOPIC*	BANKRUPTCY
9. ("SU") • *SUMMARY* OF KEY ISSUE(s) & √ Any Miscellaneous *BACKGROUND*	• Whether the bankruptcy court’s order denying remand was interlocutory and unappealable.
10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)	
11. DO YOU RECOMMEND POSTING IN UST BRIEFBANK?	☒ YES ☐ NO *NAME:* Linda Figueroa *DATE:*

No. 08-3803

IN THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

IN RE MICHAEL R. SHEMONSKY

MICHAEL R. SHEMONSKY,

Appellant.

**On Appeal from the United States District Court
for the District of Delaware**

RESPONSE OF THE UNITED STATES TRUSTEE AS AMICUS IN SUPPORT OF DISMISSAL OR SUMMARY AFFIRMANCE

Anne K. Fiorenza
Office of the United States Trustee
United States Department of Justice
228 Walnut Street
P.O. Box 969
Harrisburg, PA 17108
(717) 221-4515
Counsel for The United States Trustee

I. INTRODUCTION

The United States Trustee, pursuant to Rules 27(b) and 29(a) of the Federal Rules of Appellate Procedure, hereby responds to the Clerk of Court's September 18, 2008 letter advising the parties that the Court may dismiss this pro se appeal for lack of jurisdiction or take other summary action sua sponte under Chapter 10.6 of the Court's Internal Operating Procedures.

Acting as amicus, the United States Trustee[1/] supports the summary disposition of this appeal for two reasons. First, the order Mr. Shemonsky appeals is interlocutory and this Court lacks jurisdiction under 28 U.S.C. §158(d) and 28 U.S.C. §1291 to review it. Secondly, were this Court to consider the merits, it

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[1/] The United States Trustee is an official of the United States Department of Justice, charged by statute with the duty to oversee and supervise the administration of bankruptcy cases. See 28 U.S.C. §§ 581-589. The United States Trustee's Program within the Department of Justice was created by Congress to aid in the administration of bankruptcy cases. See, e.g., Morgenstern v. Revco D.S., Inc. (In re Revco D.S., Inc.), 898 F.2d 498, 500 (6th Cir. 1990). Each U.S. Trustee supervises the administration of bankruptcy cases as appropriate and maintains a panel of private trustees who are available to serve as trustees in bankruptcy cases. See 28 U.S.C. § 586. The U.S. Trustee has standing to raise any issue under the bankruptcy title and may appear and be heard on any bankruptcy issue, although a Trustee may not file a reorganization plan. See 11 U.S.C. § 307; Haden v. Pelofsky, 212 F.3d 466, 468 n.5 (8th Cir. 2000); U.S. Trustee v. Fishback, 83 F.3d 1360, 1361 n.1 (11th Cir. 1996); U.S. Trustee v. Columbia Gas Systems Inc. (In re Columbia Gas Systems Inc.), 33 F.3d 294, 295-299 (3d Cir. 1994); Morgenstern v. Revco D.S., Inc. (In re Revco D.S., Inc.), 898 F.2d at 499-500.

should affirm because Mr. Shemonsky presents no valid legal argument entitling him to relief on that point, and there is no substantial question for this Court's review.

II. PROCEDURAL BACKGROUND

This appeal arises from an involuntary petition filed under 11 U.S.C. § 303 on March 7, 2008, in the United States Bankruptcy Court for the Middle District of Pennsylvania, by three petitioning creditors, Michael R. Shemonsky ("Mr. Shemonsky"), Nicholas Shemonsky, and Sharon A. Gimbi, against alleged debtor Atlantic Financial Federal. Atlantic Federal was a federally chartered savings and loan that went out of business in or around 1990. Case No. 08-50640, Dkt. No. 1. Exhibit No. 1 at p. 55.

On April 1, 2008, Mr. Shemonsky, a frequent pro se litigant before the federal courts,[2/] filed a "Motion to Quash" in Atlantic's case, requesting that the bankruptcy court quash six federal statutes as leading to "fascism and a failed state." [3/] Case No. 08-50640, Dkt. No. 13. On May 8, 2008, after hearing oral

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[2/] See, e.g., In re Shemonsky, 2008 WL 4276974 (3d Cir. Sept. 18, 2008); Shemonsky v. Office of Thrift Supervision, 733 F.Supp. 892 (M.D. Pa.), aff'd 922 F.2d 833 (3d Cir. 1990).

[3/] The six federal statutes were: "(1) Judicial Act of 1790, (2) US Trustee and Magistrate Act of 1978, (3) 1985 Federal Court Improvement Act, (4) 1984 Federal Judgeship Act, (5) Patriot Act, (6) Bankruptcy Act of 2005." See Case No. 08-50640, Dkt. No. 13, p. 1.

argument from Mr. Shemonsky, the bankruptcy court denied the motion for lack of a justiciable case or controversy. Case No. 08-1094, Dkt. No. 3, Exh. 6.

The United States Trustee was not a party to the proceedings, did not appear or participate at the May 8, 2008 hearing, and took no position with respect to the motion to quash. Case No. 08-50640, Dkt. No. 25.

On May 12, 2008, Mr. Shemonsky appealed the denial of his motion to the United States District Court for the Middle District of Pennsylvania. Case No. 08-50640, Dkt. No. 20. In a May 19, 2008 pleading entitled "Joint Brief of the Appellant and Appellee," Mr. Shemonsky argued (in two sentences without explanation or support) that "[t]he Removal Act of 1790 (sic) had to be quashed due to abuse by the District Court."[4/] Case No. 08-1094, Dkt. No. 10, p. 4. Mr. Shemonsky sought "remand" of the case to the United States Bankruptcy Court in Wilkes-Barre, Pennsylvania "for trial on the illegal removal." Id. Although not without doubt, it appears Mr. Shemonsky objected to the removal of a state bankruptcy complaint filed in 1992 to the federal district court for the Eastern District of Pennsylvania, and sought remand of either the current bankruptcy case,

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[4/] Mr. Shemonsky provided no citation for the "Removal Act of 1790" and no such statute appears to exist.

or the prior case, to the state court. Compare Case No. 08-1094, Dkt. No. 10 at p. 3 with Case No. 08-1094, Dkt. No. 10 at p. 4.

On August 7, 2008, the district court entered an order suggesting it was inclined to dismiss Mr. Shemonsky's appeal and directing the United States Trustee to file a brief. Case No. 08-1094, Dkt. No. 12. On September 2, 2008, the United States Trustee filed a brief as amicus supporting affirmance. It argued the appeal should be dismissed as interlocutory and devoid of legal merit. Case No. 08-1094, Dkt. No. 17.

On August 20, 2008, the district court entered the order now appealed from, dismissing Mr. Shemonsky's appeal as interlocutory, devoid of legal merit, and lacking a justiciable case or controversy. Case No. 08-1094, Dkt. No. 20. Id. Mr. Shemonsky's timely appeal to this Court followed. Case No. 08-1094, Dkt. No. 21.

III. SUMMARY OF ARGUMENT

This Court lacks jurisdiction over this appeal because the bankruptcy court order denying the motion to quash was an interlocutory order. In addition, Mr. Shemonsky lacks appellate standing because he made no showing of pecuniary injury. Moreover, Mr. Shemonsky's motion to quash is clearly devoid of legal merit. Therefore, this Court should dismiss the appeal for lack of jurisdiction or summarily affirm the district court’s dismissal of the appeal on the ground that it presents no substantial question for review.

III. ARGUMENT

A. The Bankruptcy Court’s Order Denying Remand Was Interlocutory and Unappealable.

Under 28 U.S.C. § 1291 and 28 U.S.C. § 158 (d)(1), the United States Courts of Appeals have jurisdiction over appeals from “final decisions, judgments, orders, and decrees” entered by district courts sitting as appellate courts in bankruptcy cases.[5/] In order to be final and reviewable by this Court, both the bankruptcy court and the appellate court orders must be final.

District courts have jurisdiction to hear appeals from final judgments and orders of bankruptcy courts, 28 U.S.C. §158(a)(1), and, "with leave of the court," to hear appeals "from other interlocutory orders and decrees." 28 U.S.C. §158(a)(3). The courts of appeals have jurisdiction to hear "appeals from all final

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[5/] In addition, courts of appeals have jurisdiction over certain interlocutory district court orders under 28 U.S.C. § 1292 when such orders arise in a bankruptcy case. *See* Connecticut Nat’l Bank v. Germain, 503 U.S. 249, 252-54 (1992). These include interlocutory orders of the district courts “granting, continuing, modifying, refusing or dissolving injunctions, or refusing to dissolve or modify injunctions” (§ 1292(a)(1)), “appointing receivers, or refusing orders to wind up receiverships or to take steps to accomplish the purposes thereof” (§ 1292(a)(2)), “determining the rights and liabilities of the parties to admiralty cases” (§ 1292(a)(3)), and orders in which the district court expressly states that immediate appeal is needed to “materially advance the ultimate termination of the litigation” (§ 1292(b)).

decisions, judgments, orders, and decrees" entered by the district court or a bankruptcy appellate panel. 28 U.S.C. §158(d). This Court, like all the courts of appeals, holds that where the bankruptcy court ruling is not final, the district court order reviewing the interlocutory bankruptcy ruling is also not final for purposes of 28 U.S.C. §158(d), unless certain circumstances not present here obtain. Commerce Bank v. Mountain View Village, Inc., 5 F.3d 34, 36 (3d Cir. 1993); Sumy Stubbe v. Banco Central Corp. (In re Empresas Noroeste, Inc.), 806 F.2d 315, 316 (1st Cir. 1986); Flor v. BOT Fin. Group (In re Flor), 79 F.3d 281, 283 (2d Cir. 1996); Sumy v. Schlossberg, 777 F.2d 921, 922-923 (4th Cir. 1985); Andrews & Kurth v. Family Snacks, Inc. (In re Pro-Snax Distributors, Inc.), 157 F.3d 414, 420 (5th Cir. 1998); Marlow v. Rollins Cotton Co. (In re Julien Co.), 146 F.3d 420, 422 (6th Cir. 1998); In re Rimsat Ltd., 212 F.3d 1029, 1044 (7th Cir. 2000); Lewis v. United States, Farmers Home Administration, 992 F.2d 767, 768, 772 (8th Cir. 1993); Stanley v. S.S. Retail Stores Corp. (In re S.S. Retail Stores Corp.), 162 F.3d 1230, 1232 (9th Cir. 1998); Simons v. FDIC (In re Simons), 908 F.2d 643, 644 (10th Cir. 1990) (per curiam); Dzikowski v. Boomer's Sports & Recreation Ctr., Inc. (In re Boca Arena, Inc.), 184 F.3d 1285, 1286 (11th Cir. 1999); see also 1 Collier on Bankruptcy ¶ 5.09[2] (rev. 15th ed. 2001).

Because the bankruptcy court order is interlocutory, this appeal should be dismissed. This circuit applies a broad concept of “finality” with respect to bankruptcy appeals under § 1291. See In re Marvel Entm't Group, Inc., 140 F.3d 463, 470 (3d Cir. 1998). In determining whether an order is final for purposes of its appellate jurisdiction, this Court considers four factors: (1) the impact of the Order on the assets of the bankrupt estate; (2) the necessity for further fact-finding on remand; (3) the preclusive effect of the district court's decision on the merits of further litigation; and (4) the interest of judicial economy.” In re Owens Corning, 419 F.3d 195, 203 (3d Cir. 2005) (citing Buncher Co. v. Official Comm. of Unsecured Creditors of GenFarm Ltd. P'ship IV, 229 F.3d 245, 250 (3d Cir. 2000)). Here, the bankruptcy court order has no impact on the assets of the bankruptcy estate. And although no further fact-finding would be necessary on remand because the order presents only a question of law, the bankruptcy court’s decision has no preclusive effect on further litigation. Moreover, the interests of judicial economy are best served by not asserting jurisdiction here, given that the resolution of this appeal will not obviate the need for further proceedings in the bankruptcy court. Nor does Mr. Shemonsky contend that the bankruptcy court order is final. Rather, he refers to this order as “interlocutory” in both his notice of appeal and in his response to the Clerk of Court's September 18, 2008 letter. Case No. 08-3803, Dkt. Nos. 1 and 4.

That the bankruptcy court order is interlocutory and unreviewable on appeal is buttressed by the district court's reasonable interpretation of Mr. Shemonsky's request for relief. Broadly construing his concise but cryptic pleadings, the district court discerned that Mr. Shemonsky wished to "challeng[e] the statute that authorized removal of a state court bankruptcy complaint filed in 1992 in the United States District Court for the Eastern District of Pennsylvania." Case No. 08-01094, Dkt. No. 20. An order denying remand from federal court to state court is interlocutory. Cf., e.g. Murphy v. Fed'l Ins. Co., 206 Fed. Appx. 143, 144 (3rd Cir. 2006) (referencing the court's dismissal of a prior appeal in the same case – not in the bankruptcy context – on grounds that an order denying remand of a case to state court is "plainly" interlocutory). Thus, to the extent that Mr. Shemonsky seeks a remand to state court, this Court lacks jurisdiction over the appeal because the appeal of an order denying remand is interlocutory.

Because this Court lacks jurisdiction to hear Mr. Shemonsky's appeal, it should be dismissed.

B. Alternatively, the Court Should Summarily Affirm Because the Appeal is Clearly Without Merit and Presents No Substantial Question for Review

Both the bankruptcy court and the district court recognized that Mr. Shemonsky raised no legitimate basis for declaring six federal statutes invalid. Summary action affirming the decision of the district court to dismiss the appeal will avoid the needless expenditure of this Court's and appellee's resources and avoid unnecessary briefing and argument.

According to the reasoning of the bankruptcy court, with which the district court agreed, Mr. Shemonsky failed to present a justiciable case or controversy. Case No. 08-50640, Dkt. No. 40, pp. 4-6; Case No. 08-01094, Dkt. No. 20 at p. 3. To meet the Article III "case or controversy" requirement in a bankruptcy case, a person must be "aggrieved" by an order of the bankruptcy court. Gen'l Motors Acceptance Corp. v. Dykes (In re Dykes), 10 F.3d 184, 187 (3d Cir. 1993). A person is "aggrieved" in the bankruptcy context if his interests are "directly and adversely affected pecuniarily" by an order of the bankruptcy court. In re Dykes, 10 F.3d at 187 (citing In re Fondiller, 707 F.2d 441, 443 (9th Cir. 1983)). "[P]erson[s] aggrieved" must show the order of the bankruptcy court "diminishes their property, increases their burdens, or impairs their rights." In re PWS Holding

Corp., 228 F.3d at 249 (citing In re Dykes, 10 F.3d at 187). Mr. Shemonsky made no showing of pecuniary injury here, and thus lacks standing to appeal.

Even assuming Mr. Shemonsky had standing to appeal, he presented no discernible legal theory entitling any court to quash the six federal statutes and remand the current bankruptcy case to state court. In the words of the district court, "[i]t is impossible to discern any legal basis for Shemonsky's motion to quash and his exhibits shed no light on the question." Case No. 08-01094, Dkt. No. 20, p. 3. Because Mr. Shemonsky's arguments in favor of remand are devoid of legal merit, no substantial question is presented for the Court's review, and the decision of the district court dismissing his appeal should be summarily affirmed.

IV. CONCLUSION

For the foregoing reasons, the United States Trustee, as amicus, respectfully asks this Court to dismiss Mr. Shemonsky's appeal for lack of jurisdiction to review it, or in the alternative, summarily affirm the decision of the district court dismissing the district court appeal.

Respectfully submitted,

ROBERTA A. DeANGELIS
ACTING UNITED STATES TRUSTEE

By: ___________________________
Counsel for Appellee, The United States Trustee

CERTIFICATION OF BAR MEMBERSHIP (L.A.R. 46.1)

Pursuant to Third Circuit Local Appellate Rule 46.1, I hereby certify that I am a member of the bar of the United States Court of Appeals for the Third Circuit.

Dated: October___, 2008

____
Anne K. Fiorenza
Assistant United States Trustee
Office of the United States Trustee
United States Department of Justice
228 Walnut Street, P.O. Box 969
Harrisburg, PA 17108-0969
(717) 221-4515

Counsel for Appellee, The United States Trustee

CERTIFICATE OF SERVICE

I, Anne K. Fiorenza, Esquire, hereby certify that on October___, 2008, two (2) true and correct copies of the foregoing Response of the United States Trustee As Amicus In Support of Dismissal or Summary Affirmance were served upon the following parties by first class mail, postage pre-paid.

Michael R. Shemonsky
523 6th Street
Weatherly, PA 18255-0000
Counsel for Appellant

Atlantic Financial Federal
523 6th Street
Weatherly, PA 18255
Defendant

Dated: October __, 2008 ________________________________
Anne K. Fiorenza
Assistant United States Trustee
Office of the United States Trustee
United States Department of Justice
228 Walnut Street, P.O. Box 11754
Harrisburg, PA 17108-0969
(717) 221-4515

Counsel for Appellee, The United States Trustee

BRIEF BANK — "SUMMARY SHEET" Printed Fri.-2/2/1 (12:52)

WESTLAW CODES

1. ("TI") TITLE OF CASE [E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]	William F. Sherlock v. Alloy, Silverstein, et al. (In re Sherlock)
2. ("CO") CURRENT COURT [E.g., "CTA9"]	DNJ
3. ("CCN") CURRENT CASE NO.	No.: Civil No. 00-04631 (GEB) (Garrett E. Brown, Jr., District Judge)
4. ("PCN") PRIOR CASE NO. & COURT [IF ANY]	No.: Bankr. Case No. 00-54210 (Chapter 11) Court: Bankr. D.N.J. (Raymond T. Lyons, Bankruptcy Judge) (Identify judge & cite, if any)
5. ("SO") SOURCE	**U.S. TRUSTEES**
6. ("DA") DATE OF FILING & TYPE OF BRIEF [E.g., "Opening Brief," "Reply," "Amicus," etc.]	Filed: Oct. 26, 2000 Type: Brief for U.S. Trustee, Appellee
7. ("AU") PRINCIPAL AUTHORS & OFFICE [E.g.,"UST/OGC"]	Robert J. Schneider & Fran B. Steele Attorneys for U.S. Trustee for Region 3 (973-645-3014) (UST/OGC: 202-307-1399/FAX-2397)
8. ("TO") TOPIC	**BANKRUPTCY**
9. ("SU") ● SUMMARY OF KEY ISSUE(s) & √ Any Miscellaneous BACKGROUND	● Bankruptcy Court may convert case, sua sponte, from Chapter 11 to Chapter 7 pursuant to 11 U.S.C. 1112(b) & 105(a). And issues of allegedly inadequate notice are waived if not raised below, and in any event, notice need only be "reasonable" under "particular" circumstances. √ **Background:** The 1986 Amendment to 11 U.S.C. 105(a) overruled cases like In re Moog, 774 F.2d 1073, 1076-77 (11th Cir. 1985), which had held that Bankruptcy Courts lack power to convert a case sue sponte because they are not specifically listed in Sec. 1112(b) as an entity that may seek conversion or dismissal.
10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)	S:/General Counsel/Web Briefs/Sherloc1.wpd
11. DO YOU RECOMMEND POSTING IN UST BRIEFBANK?	| x | YES | | NO NAME: Anthony J. Ciccone DATE: Tue.-12/19/0 (16:58)

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF NEW JERSEY

--------------------------x	
In re:	Chapter 11
WILLIAM F. SHERLOCK,	Bankr. Case No. 00-54210 (GEB)
Debtor.	
--------------------------x	
WILLIAM F. SHERLOCK,	Civil No. 00-04631(GEB)
Appellant,	Hon. Garrett E. Brown, Jr.
v.	
ALLOY, SILVERSTEIN, et al,	Proceedings Regarding the Appeal of an Order Entered by Hon. Raymond T. Lyons, U.S.B.J.
Appellees.	
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RESPONSE BRIEF OF APPELLEE UNITED STATES TRUSTEE

PATRICIA A. STAIANO
UNITED STATES TRUSTEE
United States Department of Justice
Office of the United States Trustee
One Newark Center, Suite 2100
Newark, New Jersey 07102
(973) 645-3014

By: Robert J. Schneider
Trial Attorney
RS 0595

Fran B. Steele
Trial Attorney
FS 6336

October 26, 2000

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STATEMENT OF APPLICABLE STANDARD OF APPELLATE REVIEW

The District Court conducts a *de novo* review of the Bankruptcy Court's legal findings. *See, e.g.*, *Rode v. Dellarciprete*, 892 F.2d 1177, 1182 (3d Cir. 1990). A Bankruptcy Court's factual findings may be reversed only if they are clearly erroneous. *See, e.g.*, *Stendardo v. Federal Nat'l Mortgage Ass'n (In re Stendardo)*, 991 F.2d 1089, 1094 (3d Cir. 1993). In reviewing for clear error, "due regard shall be given to the opportunity of the bankruptcy court to judge the credibility of the witnesses." Fed. R. Bankr. P. 8013. The Bankruptcy Court's findings of fact are accepted unless they are either "completely devoid of minimum evidentiary support displaying some hue of credibility or bear[ ] no rational relationship to the supportive evidentiary data." *Fellheimer, Eichen & Braverman P.C. v. Charter Technologies, Inc.*, 57 F.3d 1215, 1223 (3d Cir. 1995).

"Whether conversion of a case from Chapter 11 to Chapter 7 is proper involves a question of fact." *Halvajian v. Bank of New York (In re Halvajian)*, 216 B.R. 502, 511 (D.N.J. 1998), *aff'd*, 168 F.3d 478 (3d Cir. 1998) (table). The determination of whether "cause" exists to convert a case is left to the bankruptcy court's discretion. *Id.* In reviewing a matters left by Congress to the Bankruptcy Court's discretion, "the district court may only determine whether the bankruptcy court did or did not abuse its discretion." *Id.* at 508.

STATEMENT OF FACTS

On April 20, 2000, William F. Sherlock ("Debtor") filed a voluntary petition under Chapter 11 of title 11, United States Code ("Bankruptcy Code"). *See* Docket No 1. As the Debtor did not file schedules and other supporting documentation with the petition as required by Federal Rule of Bankruptcy Procedure 1007(c), the Bankruptcy Court scheduled a deficiency hearing for Monday, May 15, 2000. *See* Docket No. 2. On Friday, May 12, 2000, the Debtor filed schedules of assets and liabilities and a statement of financial affairs. *See* Docket No. 8.

The Debtor's Schedule A reflects joint ownership with his wife, Patricia B. Sherlock, of real property located in Maple Shade, Mt. Laurel, Medford, and Stone Harbor, New Jersey. *Id.* The Debtor's Schedule B reflects the Debtor's 100% stock ownership of two corporations, Bi-Tech, Inc. and Bi-Tech Industries, Inc. *Id.*

Furthermore, Schedule I indicates that the Debtor's monthly income is only $15,500, while Schedule J indicates that his monthly household expenditures exceed $29,000, including monthly mortgage payments of $13,800. *Id.* The Schedules were accompanied by a Declaration Concerning Debtor's Schedules in which the Debtor attested to the accuracy of the information under penalty of perjury. *Id.* The Statement of Financial Affairs, also signed under penalty of perjury, indicates that the

Debtor earned $239,100 in 1999. *Id.* The Schedules and Statement of Financial Affairs, which were part of the record below, constitute an admission by the Debtor that his monthly expenses exceed his monthly income by $13,500, and when annualized his monthly expenses exceed his 1999 income by $108,900.

On June 15, 2000, the Debtor appeared at a meeting of creditors held pursuant to 11 U.S.C. § 341(a), at which he was examined under oath by counsel for the United States Trustee.[1/] *See* Docket No. 16; Transcript of August 25, 2000, Hearing Regarding Status Conference, Stay Relief, and Conversion ("Transcript") at 6, 38. The creditors' meeting was continued first to July 13, 2000, and again to July 20, 2000, on which date the Debtor was further examined under oath by another United States Trustee attorney. *See* Transcript at 6. On July 20, 2000, the Debtor also appeared at an initial debtor interview at which time a bankruptcy analyst employed by the Office of the United States Trustee advised the Debtor of his statutory duty to file monthly operating reports pursuant to 11 U.S.C. § 704(8) (made applicable to Chapter 11 debtors in possession by 11 U.S.C.

[1/] The United States Trustee Program is a unit of the Department of Justice charged by Congress to, *inter alia*, supervise the administration of Chapter 11 cases. *See* 28 U.S.C. § 586(a)(3). The United States Trustee's duties include presiding over the meeting of creditors and administering the oath to debtors in Chapter 11 cases. *See* 28 U.S.C. § 586(a)(5); 11 U.S.C. § 343; Fed. R. Bankr. P. 2003, 9012(a). In addition, 11 U.S.C. § 307 enables the United States Trustee to raise and be heard on any issue in any Chapter 11 case.

§§ 1106(a)(1) and 1107) and Federal Rule of Bankruptcy Procedure 2015(a)(3).[2] *Id.* at 39. At no time between July 20 and August 25, 2000 did the Debtor contact the Office of the United States Trustee to discuss any problems in meeting his statutory reporting obligation.[3] *Id.*

The Bankruptcy Court scheduled a status conference pursuant to 11 U.S.C. § 105(d) for June 26, 2000. *See* Docket No. 11. At the status conference the Bankruptcy Court instructed the Debtor to pay real estate taxes for the second quarter of 2000. *See* Transcript at 7-8. The status conference was carried first to August 16, 2000, and then to August 25, 2000. *See* Docket Nos. 23, 32.

The August 25, 2000, continued status conference was attended by the Debtor and his counsel, counsel to secured

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[2] Another of the United States Trustee's duties is to "tak[e] such action as the United States trustee deems to be appropriate to ensure that all reports, schedules, and fees required to be filed under title 11 and [title 28] by the debtor are properly and timely filed." *See* 28 U.S.C. § 586(a)(3)(D).

[3] By letter dated July 25, 2000, Debtor's counsel requested a copy of the Operating Guidelines for Chapter 11 Cases, to which the reporting forms recommended by the United States Trustee for Region 3 are attached. Region 3 encompasses New Jersey, Delaware, and Pennsylvania. Each Region has prepared its own Operating Guidelines and reporting forms. As Debtor's counsel and the Bankruptcy Court both know from years of experience with Chapter 11 cases, the Operating Guidelines are generally mailed to the debtor and its counsel as soon as the Office of the United States Trustee opens a file on the case; in the instant case, the United States Trustee's copy of the Operating Guidelines is stamped "May 4, 2000." Nevertheless, on August 1, 2000, another copy of the Operating Guidelines was mailed to Debtor's counsel.

creditor Hudson United Bank ("HUB"),[4] counsel to secured creditor Bridgeton Meat Co., and (via telephone) counsel to the United States Trustee. *See* Transcript at 4-5. At the status conference, Debtor's counsel admitted that, despite the Bankruptcy Court's direction at the June 26, 2000, status conference to pay post-petition real estate taxes, the Debtor had not done so. *See* Transcript at 15. Debtor's counsel also admitted that the Debtor had not made post-petition mortgage payments. *Id.* Debtor's counsel further stated that the Medford property, which serves as part of the collateral for HUB's lien, "is not productive to the debtor [or] to the Bi-Tech organization." *Id.* at 10. In addition, the United States Trustee's counsel informed the Bankruptcy Court that the Debtor

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[4] HUB's lien is secured by assets of the Debtor's business as well as the Debtor's real estate. *See* Transcript at 30-31. HUB's foreclosure proceeding was apparently the catalyst for the Debtor's filing, and HUB fears that the Debtor or his affiliates may file future petitions to stave off foreclosure. *Id.* at 8, 67-68. Indeed, a related entity, Bi-Tech Manufacturing, Inc., filed a Chapter 7 petition, Case No. 00-10090 (JHW), on January 5, 2000, the day before the first scheduled Sheriff's Sale. *See* Docket No. 5. The Sheriff's Sale was adjourned without date, likely to be rescheduled no sooner than 1½ months after the lifting of the automatic stay imposed by the Chapter 7 filing. *Id.* On March 1, 2000, the Honorable Judith H. Wizmur entered an order lifting the automatic stay in the *Bi-Tech Manufacturing, Inc.* case. *Id.* Little more than 1½ months later, the Debtor filed his petition. *See* Docket No. 1. The Bankruptcy Court below was well aware of the Debtor's history with HUB, stating that the Debtor "is fighting them every step of the way," and that HUB's counsel was "probably right" about future filings by Debtor affiliates intended to frustrate HUB's ability to foreclose on its collateral. *See* Transcript at 11, 68.

had not filed any monthly reports. *Id.* at 6.

The Bankruptcy Court determined that the Debtor's "gross failure . . . to do anything in Chapter 11" constituted cause to convert the case to Chapter 7. *Id.* Specifically, the Bankruptcy Court referred to the Debtor's failures to comply with its earlier direction to pay real estate taxes, make any progress in refinancing the HUB lien, make post-petition payments to secured creditors, file monthly reports, and file a plan of reorganization. *Id.* at 15-16.

After the Bankruptcy Court's ruling, Debtor's counsel asked the Court to reconsider its decision to convert the case, and the Bankruptcy Court inquired as to whether Debtor's counsel wished to present evidence regarding the Debtor's efforts in Chapter 11. *Id.* at 17. Debtor's counsel responded "Yes, Your Honor, ***I'd be prepared to do that***." *Id.* (emphasis added). The Bankruptcy Court asked further if Debtor's counsel wished to elicit testimony from the Debtor himself, to which Debtor's counsel replied "***I'd be prepared to do that***." *Id.* (emphasis added). The Bankruptcy Court then offered Debtor's counsel a "recess" of undetermined length to allow him to converse with his client regarding this testimony, to which Debtor's counsel responded "***I don't think I need to***, Your Honor." *Id.* (emphasis added).

The Debtor proceeded to testify under oath to a number of violations of his fiduciary duty as a debtor in possession. For example, the Debtor testified that he had expended approximately $7,000 in estate funds without Bankruptcy Court approval to pay loan application fees, but was unable to obtain any refinancing commitment due in part to the fact that he did not have enough money to pay approximately $10,000 in appraisal fees. *Id.* at 20-23. The Debtor also testified that he had entered into listing agreements with real estate brokers to sell estate assets without first obtaining Bankruptcy Court authorization as required by 11 U.S.C. § 327(a) and Federal Rule of Bankruptcy Procedure 2014(a). *Id.* at 24-26.

The Debtor also testified that his discussions with potential lenders hinged upon his obtaining "working capital." *Id.* at 28. Since the Debtor is not a business entity, he was presumably referring to working capital for his corporation, Bi-Tech Inc., which is not presently in bankruptcy. *Id.* at 28. In fact, the Debtor testified that he had "put all [his] best efforts, at least 12 hours a day, five and a half days a week," into Bi-Tech – not into his anticipated liquidation of estate assets, which Debtor's counsel alleged were being "marketed aggressively" and "diligently." *Id.* at 27; 10,17, 51. He further testified that to pay the monthly carrying charges on any loan he might obtain he would require the lender to either agree to "a moratorium" on repayment for six months or provide "additional monies to cover the first six months." *Id.*

Thus, the Debtor essentially testified that he would only enter into an agreement to refinance the estate's obligations if money was provided to fund a non-debtor corporation, because the Debtor did not "have the dollars" to fund this entity himself. *Id.* at 29. Indeed, the Debtor responded "Oh, absolutely, absolutely" to the following characterization made by the Bankruptcy Court: "[I]f I understand what you're saying, your projected source of cash flow to pay back a new lender for [refinancing the loan to HUB] would be if you could get working capital in your business, Bi-Tech, you think that in six months time Bi-Tech would be able to generate enough excess cash so you could use that money to service the new loan." *Id.* at 48.

The Debtor also acknowledged that he "made a mistake" in agreeing to give HUB a lien on not just his personal real property but also Bi-Tech's receivables, machinery, and equipment. *Id.* at 29-31. The Debtor testified that he sought to have Bi-Tech's assets removed as collateral. *Id.* at 30-32. The Debtor then hoped to place a new lien on Bi-Tech's assets, use the money to fund Bi-Tech, and perhaps someday be in a position to pay creditors in his individual Chapter 11 case. *Id.*

The Debtor also testified that while the post-petition mortgage and real estate tax payments for the Mt. Laurel property were current, they were being paid directly by the tenant – ***so the Debtor had nothing whatsoever to do with the fact that those***

payments were current. *Id.* at 34-35. The Debtor also testified that his entire effort at "marketing" the Mt. Laurel property, which he valued at approximately $600,000, was to ask the tenant if it wanted to buy the property. *Id.* at 34-37. As of the hearing date the Debtor had received no answer, but had not otherwise undertaken any efforts to liquidate the property. *Id.* at 37-38. The Debtor also disclosed that he had received unsolicited inquiries into purchasing his shore house in Stone Harbor for between $1.3 million and $1.5 million, but he never followed up on them. *Id.* at 27. The Debtor further testified that he had been unsuccessfully attempting to sell the Medford property for 1½ years, during which time Bi-Tech has not paid rent to the Debtor for its use of the property. *Id.* at 27-28.

In addition, the Debtor admitted that he had not filed the statutorily-mandated monthly financial reports for April, May, June, and July 2000 – but he blamed this failure on the fact that the Office of the United States Trustee had not provided him with reporting forms. *Id.* at 38-39. Despite his statutory and fiduciary duty to report on his financial condition, however, the Debtor admitted that he had made no effort to obtain these forms, nor did he attempt to provide the necessary information in any other form. *Id.* at 39-40. In fact, the Debtor testified that he had not requested the forms, which have been specifically created to assist Chapter 11 debtors in fulfilling their statutory and fiduciary reporting obligations, because he was too busy doing "***everything I can to take care of my obligations***." *Id.* at 39 (emphasis added).

The Debtor further testified that another reason he was over four months delinquent in filing his monthly reports was that he had only recently located an accountant that did not have a conflict of interest. *Id.* at 40. As of the hearing date, however, that accountant had still not been employed pursuant to Bankruptcy Court order as required by 11 U.S.C. § 327(a). *Id.* at 6-7. For some reason, rather than obtain a disinterested accountant before filing his petition or shortly thereafter, the Debtor waited for over four months because he "wanted someone to tell us was there a conflict" in hiring his prior accountants, to whom he owed $22,000 according to Schedule F filed in support of his petition. *Id.* at 40; Docket No. 8.

In addition, the Debtor testified that he had not remitted the quarterly fee required by 28 U.S.C. § 1930(a)(6) to be paid to the United States Trustee in every Chapter 11 case by the end of the month following a quarter. *Id.* As the Debtor filed his petition during April 2000 the first quarterly fee he owed was for the second quarter of 2000, which was due on or before July 31, 2000. *See* 28 U.S.C. § 1930(a)(6). Nevertheless, the Debtor never paid any fee for the second quarter of 2000 - not even the $250 statutory minimum. *See* Transcript at 40.

In his summation, Debtor’s counsel acknowledged that the Debtor “has been less than a conventional debtor in regards to immediately hiring an accountant and filing reports,” and he admitted that he had been unaware that the Debtor had actually entered into a listing agreement for the Medford property. *Id.* at 50. Debtor’s counsel also referred to a lack of “working capital available to ***this company***” – despite the fact that the Debtor, and not Bi-Tech, is the Chapter 11 debtor in possession. *Id.* at 51 (emphasis added). Debtor’s counsel also acknowledged that the Debtor’s intention was to liquidate assets and file a “liquidating plan” rather than a plan of reorganization. *Id.* at 51-52. In addition, Debtor’s counsel admitted that the Debtor had not personally made any post-petition real estate tax or mortgage payments. *Id.* at 51. According to Debtor’s counsel, the reason the Debtor had not made any payments was that “[t]here just hasn’t been a cash flow[.]” *Id.* at 52.

As for the Debtor’s admitted abject failure to comply with his statutory and fiduciary duties, Debtor’s counsel suggested that the Debtor had suddenly “gotten religion” and might finally comply with these duties if ordered to do so by the Bankruptcy Court by a date certain. *Id.* at 51-52. Indeed, Debtor’s counsel had earlier suggested that some modicum of “urgency” might at long last have been infused into the Debtor by his belated recognition that the failure to comply with his statutory and fiduciary obligations could result in the conversion of his case to Chapter 7. *Id.* at 13-14.

The Bankruptcy Court stated that after hearing the Debtor’s testimony he was “more convinced than ever that this case should be converted to Chapter 7.” *Id.* at 54. The Court noted that the Debtor’s failure to file monthly reports made it impossible to verify Debtor’s counsel’s assertion that no estate funds had been diverted. *Id.* In addition, the Court also referred to the lack of cash flow and limited number of checks written by the Debtor over four months, and concluded that “these monthly reports are not sophisticated things that require a certified public accountant. Anyone who keeps his or own checkbook should be able to fill out the monthly reports for an individual in Chapter 11.” *Id.* The Bankruptcy Court further based his decision to convert on the Debtor’s failure to pay statutorily-mandated quarterly fees, his intention to file a liquidating plan, and his failure to obtain court authorization for any of the appraisers, auctioneers, or real estate brokers he had hired and paid regarding the sale of his properties. *Id.* at 54-55.

The Bankruptcy Court rejected the Debtor’s attempt to blame the Office of the United States Trustee for his own failure to file monthly reports, stating that the Debtor’s failure to obtain the reporting forms “just indicates how little attention he has paid to his obligations as a debtor in possession.” *Id.* at 56.

The Court then went on to find that "there is serious concern that any value in [the Debtor's] properties are [sic] being eroded by the failure to pay taxes and the failure to pay interest on all of these secured loans." *Id.*

As for the Debtor's desire to obtain working capital for his business, the Bankruptcy Court questioned why the Debtor did not sell his shore home in Stone Harbor, which is valued at over $1 million. *Id.* at 56-57. Indeed, the Court noted that "it's hard to see how one can justify keeping a million dollar home and a million dollar plus second home, not paying the taxes or mortgages on that and yet keep creditors at bay." *Id.* at 58. Finally, the Court stated that appointing a Chapter 7 trustee "would probably be in [the Debtor's] best interests" in light of the Debtor's difficulty in marketing his properties or refinancing over the 1½ years preceding the filing of the Debtor's petition. *Id.* at 57.

The Bankruptcy Court then granted HUB relief from the automatic stay, as the conversion of the case made the Medford property no longer necessary for an effective reorganization.[5]

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[5] The United States Trustee takes no position on the propriety of the Bankruptcy Court's decision to grant relief from the automatic stay. If it is determined that the Bankruptcy Court did not err in lifting the stay, however, that would lend further support for the conversion of this case to Chapter 7, as any liquidating plan the Debtor might have filed would presumably have relied heavily on the Debtor's anticipated refinancing of the Medford property.

ARGUMENT

I. THE BANKRUPTCY COURT'S *SUA SPONTE* CONVERSION WAS NOT ERRONEOUS AS A MATTER OF LAW

A. The Bankruptcy Court Had the Power Under 11 U.S.C. § 105(a) to Convert This Case to Chapter 7 *Sua Sponte*

Conversion of a Chapter 11 case to one under Chapter 7 is governed by 11 U.S.C. § 1112(b) ("Section 1112(b)"). Section 1112(b) provides that a Bankruptcy Court may convert a case "on the request of a party in interest or the United States trustee[.]" Prior to the Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1986, Pub. L. No. 99-554 (1986) ("1986 Amendment"), some courts held that Bankruptcy Courts lacked the power to convert a case *sua sponte*, given that they are not listed in Section 1112(b) as an entity that may seek conversion or dismissal. *See, e.g.*, *In re Moog*, 774 F.2d 1073, 1076-77 (11th Cir. 1985); *Gusam Restaurant Corp. v. Speciner (In re Gusam Restaurant Corp.)*, 737 F.2d 274, 276-77 (2d Cir. 1984); *Warner v. Universal Guardian Corp. (In re Warner)*, 30 B.R. 528, 529 (Bankr. 9th Cir. 1983). *But see* *In re East Town Properties*, 31 B.R. 507, 507 (Bankr. E.D. Wisc. 1983); *In re Nikron, Inc.*, 27 B.R. 773, 777-78 (Bankr. E.D. Mich. 1983); *In re Missouri*, 22 B.R. 600, 602 (Bankr. E.D. Ark. 1982); *In re Coram Graphic Arts*, 11 B.R. 641, 644 (Bankr. E.D.N.Y. 1981); *Continental Ill. Nat'l Bank & Trust Co. of Chicago v. Century City, Inc. (In re Century City, Inc.)*, 8 B.R. 25, 29-30

(Bankr. D.N.J. 1980); *In re Stahl, Asano, Shigetomi & Assocs.*, 7 B.R. 181, 186 (Bankr. D. Haw. 1980).

As modified by the 1986 Amendment, however, 11 U.S.C. § 105(a) now reads as follows (emphasis added):

> The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title. ***No provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, sua sponte, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process.***

Since the 1986 Amendment, there is no longer any doubt that Bankruptcy Courts have the power to convert or dismiss a case *sua sponte* notwithstanding the fact that no party in interest has moved for such relief.[6] *See, e.g.*, *In re Finney*, 992 F.2d 43, 45 (4th Cir. 1993); *Hayes v. Production Credit Ass'n of Midlands*, 955 F.2d 49 (unpublished), 1992 WL 26785 *3 (10th Cir.); *Argus Group 1700, Inc. v. Steinman (In re Argus Group 1700, Inc.*), 206 B.R. 757, 763 (E.D. Pa. 1997); *In re 183 Lorraine Street Assocs.*, 198 B.R. 16, 32 (E.D.N.Y. 1996); *Pleasant Pointe Apartments, Ltd. v. Kentucky Housing Corp.*, 139 B.R. 828, 831 (W.D. Ky. 1992);

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[6] As under Section 1112(b) statutory cause to dismiss and statutory cause to convert are the same, cases that have held that the Bankruptcy Court may dismiss a case *sua sponte* are relevant to the Bankruptcy Court's ability to convert a case *sua sponte*.

Finstrom v. Huisinga, 101 B.R. 997, 999 (D. Minn. 1989); *In re A-1 Specialty Gasolines, Inc.*, 238 B.R. 876, 878 (Bankr. S.D. Fla. 1999); *In re Tornheim*, 181 B.R. 161, 164 n.4 (Bankr. S.D.N.Y. 1995), *appeal dismissed*, 1996 WL 79333 (S.D.N.Y. 1996); *In re Tax Shop, Inc.*, 173 B.R. 605, 607 n.1 (Bankr. E.D. Mich. 1994); *In re Great American Pyramid Joint Venture*, 144 B.R. 780, 789 (Bankr. W.D. Tenn. 1992); *In re 266 Washington Assocs.*, 141 B.R. 275, 288-89 (Bankr. E.D.N.Y. 1992), *aff'd sub nom.*, *In re Washington Assocs.*, 147 B.R. 827 (E.D.N.Y. 1992).

The only case cited by the Debtor that supports his bald assertion that Bankruptcy Courts lack the power to bring *sua sponte* motions to convert or dismiss is distinguishable. The decision of the Bankruptcy Appellate Panel of the Ninth Circuit (***not*** the Court of Appeals for the Ninth Circuit, as the Debtor suggests) in *Warner v. Universal Guardian Corp. (In re Warner)*, 30 B.R. 528 (Bankr. 9th Cir. 1983), was based primarily on the outdated pre-1986 Amendment theory that the Bankruptcy Court had no power to dismiss a case on its own motion. *Id.* at 529. The Bankruptcy Court in *Warner* had based its decision to dismiss on its belief that individual debtors cannot file Chapter 11 petitions, a position that is clearly incorrect. In addition, the debtor in *Warner* had not been afforded an opportunity to be heard as to why the case should not be dismissed. Thus, the

Warner decision is completely inapposite to the instant case because (i) the "individual as Chapter 11 debtor" issue had no basis on the Bankruptcy Court's decision to convert, (ii) after the 1986 Amendment there is no doubt that the Bankruptcy Court can convert *sua sponte*, and (iii) the instant Debtor ***was provided an opportunity to be heard.*** Indeed, Debtor's counsel was even provided an opportunity to have some time to prepare the Debtor before the Debtor gave testimony. Nevertheless, Debtor's counsel asserted that additional time was unnecessary as he was prepared to proceed with the hearing, knowing full well that the testimony would be instrumental in the Bankruptcy Court's decision regarding the conversion of the case to Chapter 7.

As the Bankruptcy Court was clearly authorized by statute to convert a case *sua sponte*, its decision should be affirmed.

II. THE NOTICE AND HEARING RECEIVED BY THE DEBTOR WERE ADEQUATE FOR PURPOSES OF SECTION 1112(b)

A. Debtor's Failure to Raise the Issue of Adequacy of Notice Before the Bankruptcy Court Constitutes a Waiver of the Issue

If the issue of alleged defective notice is not raised at the hearing before the Bankruptcy Court it is deemed waived. *See, e.g., First Nat'l Bank of Peoria v. Muller (In re Muller)*, 851 F.2d 916, 919 (7th Cir. 1988), *cert. denied sub nom., Rogers v. First Nat'l Bank of Peoria*, 490 U.S. 1007 (1989) ("If, as Rogers argues to this court, the notice of trial was not adequate to alert him that it was a trial, then he should have revealed that concern when he appeared, but before he actually participated.”); *9281 Shore Road Owners Corp. v. Seminole Realty Co. (In re 9281 Shore Road Owners Corp.)*, 187 B.R. 837, (E.D.N.Y. 1995); 9 Lawrence P. King, *Collier on Bankruptcy* ¶ 2002.02[6][3] at 2002-18 (15th ed. rev’d 2000).

In the instant case, Debtor’s counsel never expressed any concern to the Bankruptcy Court about the alleged inadequate notice. While Debtor’s counsel implied several times that the Debtor did not appreciate the importance of complying with his statutory and fiduciary duties, he never objected to the hearing proceeding in light of the allegedly inadequate notice. Debtor’s counsel could have raised the notice issue when the Bankruptcy Court asked if he wanted to present evidence. Instead of objecting to the lack of notice, Debtor’s counsel clearly asserted that he was ready to proceed with evidence regarding what the Debtor had done in Chapter 11 that might persuade the Bankruptcy Court to allow the case to remain in Chapter 11. Similarly, when the Bankruptcy Court offered additional time during which to prepare for the Debtor’s testimony, Debtor’s counsel stated that that would not be necessary. In addition, after the hearing the Debtor did not file a motion to reconsider based on facts he was unable to raise due to the alleged lack of notice.

In light of Debtor's counsel's failure to object at the Bankruptcy Court level to the adequacy of notice of the Bankruptcy Court's *sua sponte* motion to convert the case, the issue should not be considered on appeal.

B. The Notice Afforded the Debtor Was Adequate Under the Circumstances[7]

Even if this Court considers the notice issue, the Bankruptcy Court's decision should be affirmed. While Section 1112(b) provides that a Chapter 11 case may only be converted "after notice and a hearing," that phrase simply "means after ***such notice as is appropriate in the particular circumstances, and such opportunity for a hearing as is appropriate in the particular circumstances***." *See* 11 U.S.C. § 102(1)(A) (emphasis added). Similarly, Federal Rule of Bankruptcy Procedure 9014 provides for nothing more than "reasonable notice and opportunity for hearing." As a result, the determination of whether the

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[7] To the extent that the Debtor suggests that the Bankruptcy Court's decision should be reversed because creditors did not receive notice that conversion would be considered at the status conference, that argument must be rejected because the Debtor does not have standing to argue on behalf of the creditors. *See, e.g., Argus Group 1700, Inc. v. Steinman (In re Argus Group 1700, Inc.)*, 206 B.R. at 764. No creditors have come forward to file a motion for reconsideration, a motion to convert the case back to Chapter 11, or an appeal. Indeed, as the Debtor intended to liquidate his assets anyway, if he is correct about the amount of equity in his assets unsecured creditors stand to make out just as well in Chapter 7 as they would have in Chapter 11, if not better. In any event, the only creditors that have actively participated in this case were in attendance at the August 25, 2000 hearing and they have not objected to the conversion.

Debtor received adequate notice and a hearing is fact-sensitive, and the Bankruptcy Court's decision is merely reviewed for abuse of discretion.

Federal Rule of Bankruptcy Procedure 2002(a)(4) generally requires that a motion to convert a Chapter 11 case be made on at least 20 days' notice by mail to all parties in interest. This Rule is subject to Federal Rule of Bankruptcy Procedure 9006(c)(1), however, which allows the Bankruptcy Court to reduce the required notice period "for cause shown." There is no limit on how much the notice period may be reduced. Presumably, it may be reduced to zero days if the Bankruptcy Court, at its discretion, finds that cause exists to convert a case immediately without first providing notice.

The leading bankruptcy commentator has apparently adopted this position regarding notice and *sua sponte* conversion, as it states that ["t]he 20 day period may be shortened for cause shown. And, ***in appropriate circumstances, the court may act sua sponte, without notice or a hearing, and dismiss or convert the case***. . . ." *See* 9 Lawrence P. King, *Collier on Bankruptcy* ¶ 2002.02[6][d] at 2002-16 (15th ed. rev'd 2000) (emphasis added). This authority cites *In re Jephunneh Lawrence & Assocs. Chartered*, 63 B.R. 318 (Bankr. D.D.C. 1986), in which the Bankruptcy Court held as follows:

> Notwithstanding the general requirement for notice, where (as here) it is apparent on the

> face of the record that under no set of circumstances can the relief requested be granted, this Court, like any other, has inherent authority to dismiss a case, ***sua sponte and without notice***, as being irremediably defective.

Id. at 321 (emphasis added).

The instant Debtor's "inadequate notice" argument was rejected in *Argus Group 1700, Inc. v. Steinman (In re Argus Group 1700, Inc.*), 206 B.R. 757 (E.D. Pa. 1997).[8] In that case, the debtors argued that they were not provided with adequate notice of and opportunity to respond to the Bankruptcy Court's *sua sponte* motion to dismiss. *Id.* at 763. The Bankruptcy Court offered the debtors a choice of being heard or returning on another date, but the debtors "assured the bankruptcy court that they were prepared to present evidence" at the hearing, and the debtor's principal then provided testimony. *Id.* at 764. The District Court reviewed these facts and stated that "it is clear that the bankruptcy court provided the debtors with adequate notice and an opportunity to respond, and that the debtors actively participated in the proceedings, ***fully aware that the bankruptcy court might dismiss their cases sua sponte***." *Id.*

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[8] In light of the *Argus Group 1700, Inc.* decision, the Debtor's argument that "courts in the Third Circuit" require 20 days notice for all Section 1112(b) motions must be rejected. The sole case cited by the Debtor for that proposition, *In re Mead*, 28 B.R. 1000 (E.D. Pa. 1983), is inapposite as it predates that 1986 Amendment, which made it clear that Bankruptcy Courts may enter *sua sponte* orders to convert cases.

The Debtor is presumed to have understood since he filed his petition on April 20, 2000 that as a Chapter 11 debtor in possession he was assuming certain statutory and fiduciary duties. He is further presumed to have understood that failure to comply with these duties constitutes grounds for conversion, and that pursuant to 11 U.S.C. § 105(a) the bankruptcy Court has the power to enter *sua sponte* orders when necessary. In addition, the Debtor received adequate notice of the status conference, and 11 U.S.C. § 105(d) provides that at a status conference the Bankruptcy Court may "issue an order . . . prescribing such limitations and conditions as the court deems appropriate to ensure that the case is handled expeditiously and economically."

While 11 U.S.C. § 105(d) provides a list of possible orders that may be entered at a status conference, this list is not exclusive. *See* 11 U.S.C. § 102(3) (word "including" preceding a list is not limiting). A Bankruptcy Court may always enter "any order . . . that is necessary or appropriate to carry out the provisions of" the Bankruptcy Code. *See* 11 U.S.C. § 105(a). The Debtor is presumed to understand that if he testifies at a status conference (or any other proceeding) that he has not complied with his statutory or fiduciary duties, such testimony may be deemed by the Bankruptcy Court at its discretion to be cause for conversion under Section 1112(b) and thus could result in a *sua* *sponte* conversion pursuant to 11 U.S.C. § 105(a).

The case cited by the Debtor for the proposition that Section 1112(b) motions must be written rather than oral, *In re Bistrian*, 184 B.R. 678 (E.D. Pa. 1995), is distinguishable. In *Bistrian*, the Bankruptcy Court had refused to consider the oral voluntary dismissal motion of an abusive serial Chapter 13 filer who announced that she intended to immediately file another Chapter 13 petition if her case was dismissed. *Id.* at 680. The Bankruptcy Court refused to consider the motion because the very creditors who the debtor intended to frustrate by filing yet another petition had not received notice of the debtor's motion. *Id.* Instead, the Bankruptcy Court found that the case had been filed in bad faith and it granted a secured creditors' written motion to convert to Chapter 7, thereby thwarting the debtor's plan to continue frustrating the secured creditor's attempts to sell the debtor's house at sheriff's sale. *Id.* at 681.

Although the District Court in *Bistrian* held that the Bankruptcy Court had not abused its discretion in refusing to consider the oral motion, it expressly stated that "***[w]e do not hold that a bankruptcy court may never consider an oral motion for voluntary dismissal.***"[9] *Id.* at 683 (emphasis added). The

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[9] Oral motions are contemplated by Federal Rule of Bankruptcy Procedure 9013, which requires any request for an order to be "by written motion, ***unless made during a hearing***" (emphasis added).

District Court cited *Taragan v. Eli Lilly & Co.*, 838 F.2d 1337, 1341 (D.C. Cir. 1988), which in turn had held that the notice requirement "is satisfied when the oral motion has some connection to . . . the matter set for hearing." *Id.*

The teaching of the *Bistrian* court, therefore, is that oral motions that have a connection to the reason for a particular hearing ***may*** be considered, and that "the examination of the connection between an oral motion and a hearing, and of the need for written notice, are 'matter[s] in which ***the discretion and experience of the trial judge are paramount***.'" *In re Bistrian*, 184 B.R. at 684 n.11 (quoting *Taragan v. Eli Lilly & Co.*, 838 F.2d at 1341)) (emphasis added).

In the instant case the Bankruptcy Court applied his years of experience in the Chapter 11 field to determine that an oral motion to convert was sufficiently connected to the purposes behind a status conference – one of which, as 11 U.S.C. § 105(d)(2)(B) makes clear, is to facilitate the passage of a case through the shoals of Chapter 11. Indeed, Congress expressly added 11 U.S.C. § 105(d) to help Bankruptcy Courts "manage their dockets in a more efficient and expeditious manner." *See* H.R. Rep. No. 103-834, 103rd Cong., 2nd Sess. 4 (1994). Thus, Bankruptcy Courts must necessarily have the power to entertain oral motions without notice at a 11 U.S.C. § 105(d) status conference so as to weed out cases that cannot make it successfully through Chapter 11; otherwise Congress' goal of helping Bankruptcy Courts manage their cluttered dockets would not be obtained. *Cf. Finstrom v. Huisinga*, 101 B.R. 997, 999 (D. Minn. 1989) (Bankruptcy Court may dismiss *sua sponte* in exercising its inherent power to manage its own proceedings); *In re Jones*, 1990 WL 300922 * 1 (Bankr. N.D. Ind.) ("[I]t is appropriate to bring this [dismissal] before the court, ***on its own motion and without notice or hearing***, in order to enforce or implement this court's prior orders, to prevent abuse of process, and to perpetuate the proper use of the bankruptcy laws" (emphasis added)).

In the instant case, the Bankruptcy Court held that the value of estate assets was being compromised as long as the Debtor remained in possession. The Debtor admitted to having no cash flow, and the Schedules and Statement of Financial Affairs filed in support of his petition indicate an inability to met his monthly expenses based on income alone. The Debtor was accumulating post-petition debt to secured creditors and local taxing authorities, and every dollar of estate funds that goes to pay such administrative expenses is a dollar that creditors will never see. Likewise, the Debtor had employed real estate brokers and expended estate funds without Bankruptcy Court authorization, thereby adding to the administrative cost. The full extent of the damage to the estate cannot be ascertained, because the

Debtor never filed reports of his financial position. In view of the Bankruptcy Court's valid concern for the decreasing value of estate assets, and thus the decreasing possibility of recovery for creditors, the decision to "pull the plug" immediately rather than after another three week "notice period" had passed was not clearly erroneous.

C. Any Deficiency of Notice was not Prejudicial to the Debtor

Federal Rule of Civil Procedure 61, made applicable to bankruptcy cases by Federal Rule of Bankruptcy Procedure 9005, requires that a judgment that constitutes harmless error must not be disturbed. An error is "harmless" if it does not affect the substantial rights of the parties. *See* Fed. R. Civ. P. 61.

In *Hing Quan Lum v. United States Trustee (In re Hing Quan Lum)*, Civil No. 94-5312, slip op. at 7 (3d Cir. Jan. 19, 1995)(unpublished decision attached hereto as Exhibit A) the Bankruptcy Court had based its decision to convert on judicial notice of the Debtor's failure to file monthly reports, not on the grounds actually noticed as part of the United States Trustee's motion. Nevertheless, the Third Circuit held that the Bankruptcy Court's actions constituted harmless error, rather than an abuse of due process, because the Debtor had ***admitted*** before the Bankruptcy Court that he had not filed monthly reports. *Id.*, slip op. at 7.

In the instant case, the Debtor intended to liquidate his assets and pay creditors, so conversion does not affect any party’s substantial rights; the only change is that now a Chapter 7 trustee, rather than the Debtor, will liquidate the Debtor’s assets and pay his creditors. Although the Debtor’s brief was filed on October 11, 2000, the Debtor has not suggested what evidence he would have been able to scare up if he had been given until September 18, 2000. Indeed, it is difficult to imagine what evidence the Debtor could have presented, since he admitted on August 25, 2000 that he had breached his statutory and fiduciary duties. As a result, cause existed as of that day to convert the case, and cause would have continued to exist no matter how much time the Debtor was given.

Brooks v. Hussman Corp., 878 F.2d 115 (3d Cir. 1989), a case cited by the Debtor, is completely inapposite because it dealt with the notice required for a summary judgment motion, where the issue of whether facts are in dispute is paramount. In the instant case, of course, no amount of time could have enabled the Debtor to prove that monthly reports actually had been filed and quarterly fees and taxes had been paid, because ***by his own admission these obligations had not been met.*** There was no factual issue in dispute.

The Debtor’s only argument in favor of prejudice is essentially that if he had been told that his breaches of statutory and fiduciary duty were a problem, he would have "cured" the problem. As the Third Circuit made clear in *Lum*, however, the Debtor cannot "cure" such failures simply by showing up on the day of a hearing with reports and checks in hand.

For example, in *In re William Steiner, Inc.*, 139 B.R. 536 (Bankr. D. Md. 1992), the debtor facially "cured" the deficiencies raised in the United States Trustee's motion to dismiss or convert. *Id.* at 357-58. The United States Trustee raised additional grounds for dismissal at the hearing, however, and the Bankruptcy Court afforded the Debtor an opportunity to respond. *Id.* at 357. The Bankruptcy Court then dismissed the case, finding that the debtor was not prejudiced by the United States Trustee's raising of new issues at the hearing because "[a]ll facts upon which the U.S. Trustee relied were known to the debtor" and the debtor was afforded an opportunity to respond. *Id.* at 358. An additional reason for the court's decision was that, while the debtor had ostensibly "cured" the filing deficiency on its surface, the debtor's "unreasonable delay complying with administrative requirements" constituted cause for dismissal under Section 1112(b). *Id.*

The instant Debtor's "cure" argument is apparently predicated on the assumption that he need not comply with any of his obligations until someone files a motion to convert giving him a 20-day notice period. The law is to the contrary, however. As one Bankruptcy Court within the Eastern District of

Pennsylvania stated when faced with a debtor that refused to report unless forced to do so by threat of dismissal:

> The troubling aspect of this case is that debtor's counsel seems to believe that Bankruptcy Court is a legal playground where the debtor can indulge in an elaborate game of catch-me-if-you-can with her creditors. Such is not the case.

In re Bystrek, 17 B.R. 894, 895 (Bankr. E.D. Pa. 1982).

D. The Hearing Afforded the Debtor Was Adequate Under the Circumstances

The Debtor cannot say that he was denied a hearing, as he actually provided testimony regarding his activities as a debtor in possession which, after four months in Chapter 11, he certainly should have been able to do. Indeed, the Debtor testified to some length about what he had done in Chapter 11. Indeed, he received more of a hearing than is necessary, as an evidentiary hearing is not necessary when the record provides ample evidence of cause for purposes of Section 1112(b). *See In re Lease-a-Fleet, Inc.*, 1995 WL 743666 *6 (E.D. Pa.), *aff'd*, 101 F.3d 690 (3d Cir. 1996) (table). The problem is not that the Debtor was not afforded an opportunity to present his case; the problem is that everything he said pointed to conversion.

This is not a situation where a lack of notice and a hearing has led to an unjust result. The Debtor simply failed to comprehend both the possible dire consequences to a debtor in possession of its breach of fiduciary duty and the swiftness with which these consequences may be visited upon a faithless fiduciary. The Debtor's predicament is reminiscent of that of the debtor in *Turney v. F.D.I.C.*, 18 F.3d 865, 865 (10th Cir. 1994): "Although present and represented by counsel at all proceedings, Debtor insists he did not interpret the eventualities which arose from the particular hearings in the manner they played out." Just as in the instant case, in which the Bankruptcy Court's factual findings came directly from the Debtor's mouth, the debtor in *Turney* "[did] not challenge the factual findings underpinning the bankruptcy court's legal conclusions; but, instead, he ask[ed the court] to fabricate a new law of due process to relieve him of the process he indeed received." *Id.* at 868.

It is clear that the instant Debtor was not deprived of a hearing – he just does not like the result of the hearing. As the Tenth Circuit stated in *Turney*:

> That Debtor is disgruntled over the manner of his participation . . . does not negate the fact of his presence at those proceedings. . . . At best, Debtor's contentions reflect nothing more than a failure to comprehend what was set before him. No concept of due process can be invoked to protect him from that failure.

Turney v. F.D.I.C., 18 F.3d at 869.

III. THE BANKRUPTCY COURT'S DECISION THAT CAUSE EXISTED TO CONVERT THE CASE TO CHAPTER 7 WAS NOT CLEARLY ERRONEOUS

A. The Debtor's Admitted Failure to File Monthly Reports Constituted Cause to Convert

Section 1112(b) provides that the Bankruptcy Court may either convert or dismiss a case, "whichever is in the best interest of creditors and the estate, for cause[.]" While Section 1112(b) provides a list of things that can constitute "cause," this list is not exclusive. *See, e.g.*, *First Jersey Nat'l Bank v. Brown (In re Brown)*, 951 F.2d 564, 562 (3d Cir. 1991). Congress left to the Bankruptcy Court's discretion the determination of whether "cause" to convert exists in a particular case. *Halvajian v. Bank of New York (In re Halvajian)*, 216 B.R. 502, 511 (D.N.J. 1998), *aff'd*, 168 F.3d 478 (3d Cir. 1998) (table). Congress did, however, expressly include, among other things, "continuing loss to or diminution of the estate and absence of a reasonable likelihood of rehabilitation," "inability to effectuate a plan," "unreasonable delay by the debtor that is prejudicial to creditors," and "nonpayment of any fees or charges required under chapter 123 of title 28." *See* 11 U.S.C. § 1112(b)(1), (2), (3), and (10).

Filing monthly reports is one of the primary fiduciary duties of a debtor in possession. *See, e.g.*, *In re Tornheim*, 181 B.R. at 164; *In re Berryhill*, 127 B.R. 427, 433 (Bankr. N.D. Ind. 1991); *In re McClure*, 69 B.R. 282, 289 (Bankr. N.D. Ind. 1987).

As one court has stated:

> Timely and accurate financial disclosure is the life blood of the Chapter 11 process. Monthly operating reports are much more than busy work imposed upon a Chapter 11 debtor. . . . They are the means by which creditors can monitor a debtor's post-petition operations.

In re Tornheim, 181 B.R. at 164.

In light of the vital importance of timely monthly reports, there is no "cure period" such as the Debtor urges upon this Court. If a Bankruptcy Court finds that a debtor in possession is not fulfilling its statutory duty to report, the Court may convert or dismiss the case for lack of prosecution. *See, e.g.*, *In re McClure*, 69 B.R. 282, 289 (Bankr. N.D. Ind. 1987); *In re Missouri*, 22 B.R. 600, 604 (Bankr. E.D. Ark. 1982). Indeed, in one case in which a debtor in possession faced with a motion to convert sought to "cure" its admitted failure to file four month's worth of reports, the Bankruptcy Court held as follows:

> This case does not present a simple failure by the debtor to "dot the i's and cross the t's," as the debtor argues, ***nor does curing the defects cleanse the debtor of its initial wrongdoings***. The debtor simply failed to exercise its fiduciary duty as a debtor-in-possession. If this is not a case that establishes cause for conversion or dismissal for utter failure to comply with the Bankruptcy Rules and Code, then it is hard to imagine such a case.

In re Cloisters of Brevard, Inc., 117 B.R. 722, 723 (Bankr. M.D. Fla. 1990) (citation omitted) (emphasis added).

The Third Circuit addressed the relationship between timely, accurate monthly reports and conversion in *Hing Quan Lum v. United States Trustee (In re Hing Quan Lum)*, Civil No. 94-5312 (3d Cir. January 19, 1995)(unpublished decision attached hereto as Exhibit A). In *Lum*, an individual Chapter 11 debtor filed six delinquent monthly reports and paid two delinquent quarterly fees in response to the United States Trustee's motion to convert. *Id.*, slip op. at 3. The debtor then objected to the motion, arguing that he had "cured" his reporting and fee deficiencies. *Id.*, slip op. at 4. The case was nevertheless converted due to the debtor's failure to file a plan of reorganization and other violations disclosed in the recently-filed monthly reports. *Id.* The debtor appealed, arguing that he was denied due process in that he had been "blindsided" by the use of the ***contents*** of the monthly reports, whereas the United States Trustee's motion only put him on notice that the case could be converted for ***failure to file*** the reports. *Id.*, slip op. at 4-5. The District Court affirmed. *Id.*, slip op. at 5.

The Third Circuit held that the bankruptcy court had properly taken judicial notice of facts evident from the docket and case history, including the debtor's tardiness in filing monthly reports and paying quarterly fees. *Id.*, slip op. at 5-6. The Third Circuit noted that not only were these facts ascertainable by reference to court records, but the debtor had admitted to them at the hearings before the bankruptcy court. *Id.*, slip op. at 7.

As for the importance of monthly reports, the Third Circuit stated that "[m]onthly reports are a key feature of a Chapter 11 bankruptcy; they allow creditors to monitor the conduct of the debtor to prevent waste and help creditors formulate reorganization plans." *Id.*, slip op. at 8. Noting that the debtor's failure to file timely reports "deprived the creditors of their right to review his financial conditions and take actions necessary to protect their interests in the estate," the Third Circuit opined that "[t]he failure of the Debtor to file his monthly reports alone arguably provides a basis for conversion under § 1112(b)(3) [unreasonable delay that is prejudicial to creditors]." *Id.*, slip op. at 8-9. Thus, the Third Circuit affirmed the District Court. *Id.*, slip op. at 12.

The *Lum* decision is consistent with the large of courts that have held that the failure to file timely and accurate monthly reports constitutes cause to dismiss or convert a Chapter 11 case. *See, e.g., In re Tornheim*, 181 B.R. 161, 164 (Bankr. S.D.N.Y. 1995), *appeal dismissed* 1996 WL 79333 (S.D.N.Y. 1996); *In re Wilkins Inv. Group, Inc.*, 171 B.R. 194, 196-97 (Bankr. M.D. Pa. 1994); *In re Vallejo*, 77 B.R. 365, 367 (Bankr. D.P.R. 1987); *In re Security & Energy Sys., Inc.*, 62 B.R. 676, 678 (Bankr. W.D.N.Y. 1986); *In re Modern Office Supply, Inc.*, 28 B.R. 943, 945 (Bankr. W.D. Okla. 1983). As a result, the Bankruptcy Court's decision to convert a case for failure to file timely reports is not so far afield, either factually or legally, as to constitute an abuse of discretion.

The Debtor's attempt to foist responsibility for its failure upon the United States Trustee amounts to an equitable estoppel argument. The Debtor suggests that if only he had received the form report sooner he would have complied with his statutory reporting obligation. This argument must fail, however, as equitable estoppel normally may not be invoked against governmental entities. *See, e.g.*, *Heckler v. Community Health Servs. of Crawford Co., Inc.*, 467 U.S. 51, 60 (1984); *Schweiker v. Hansen*, 450 U.S. 785 (1981); *Federal Crop Ins. Corp. v. Merrill*, 332 U.S. 380, 385 (1947); *Utah Power & Light Co. v. United States*, 243 U.S. 389, 409 (1917). Thus, the Debtor cannot be heard to blame his failings on the actions of any federal government employee.

In light of the foregoing, the Bankruptcy Court's finding of cause to convert should be affirmed on the basis of the Debtor's failure to file monthly reports alone, regardless of any other violations of statutory or fiduciary duty.

B. The Debtor's Admitted Failure to Pay Post-Petition Real Estate Taxes Constituted Cause to Convert

The Debtor's failure to pay post-petition real estate taxes has increased the amount of administrative expenses that would have to be paid on the effective date of any plan. *See* 11 U.S.C. § 1129(a)(9)(A). By increasing the administrative expenses, the Debtor has created a concomitant decrease in the value of the estate to general creditors. *See In re 865 Centennial Ave. Assocs. L.P.*, 200 B.R. 800, 811 (Bankr. D.N.J. 1996). As one court stated when faced with a debtor accumulating post-petition taxes, "the Court finds no reason to allow this debt to increase and further harm the creditors while the Debtor continues its exercise in tire-kicking." *In re Moore Construction, Inc.*, 206 B.R. 436, 438 (Bankr. N.D. Tex. 1997).

The Debtor's nonpayment of real estate taxes constitutes cause to convert this case pursuant to Section 1112(b)(1). *See, e.g.*, *Berryhill v. United States (In re Berryhill)*, 189 B.R. 463, 466 n.4 (N.D. Ind. 1995); *In re Citi-Toledo Partners*, 170 B.R. 602, 606 (Bankr. N.D. Ohio 1994); *In re 865 Centennial Ave. Assocs. L.P.*, 200 B.R. at 811. As a result, the Bankruptcy Court's discretionary decision was not clearly erroneous and should be affirmed.

C. The Debtor's Admitted Failure to Pay Quarterly Fees Constituted Cause to Convert

Congress created the 28 U.S.C. § 1930(a)(6) quarterly fee requirement to fund the United States Trustee Program from fees paid by the users of Chapter 11 rather than from the public fisc. *See, e.g.*, *United States Trustee v. Prines (In re Prines)*, 867

F.2d 478, 480 (8th Cir. 1989). These fees are mandatory for as long as a case remains in Chapter 11. Congress obviously intended that these fees be paid, as it made plan confirmation contingent upon payment of all quarterly fees and it made non-payment of fees cause to convert. *See* 11 U.S.C. § 1129(a)(12); 11 U.S.C. § 1112(b)(10).

The Third Circuit and other courts within this Circuit have noted that nonpayment of quarterly fees in and of itself is cause to convert. *See, e.g., Hing Quan Lum v. United States Trustee (In re Hing Quan Lum)*, Civil No. 94-5312, slip op. at 9; *In re Nugelt, Inc.*, 142 B.R. 661, 668-70 (Bankr. D. Del. 1992); *In re Rose*, 86 B.R. 439, 442 (Bankr. E.D. Pa 1988). As a result, the instant Bankruptcy Court's decision to convert the case is supported by the Debtor's failure to pay quarterly fees. Thus, the bankruptcy Court's decision was not clearly erroneous, and should be affirmed.

D. The Totality of The Circumstances, Including the Record Before the Bankruptcy Court and the Entirety of the Debtor's Testimony, Constituted Cause to Convert

Even if no one factor by itself constitutes cause to convert the instant case, the Debtor admitted to numerous violations of his statutory and fiduciary duties, including: failure to file monthly reports; failure to pay post-petition real estate taxes; failure to pay other post-petition obligations; failure to pay quarterly fees; failure to obtain court authorization before entering into listing agreements and employing professionals; and failure to obtain court approval before expending estate funds on several loan applications. In addition, the Debtor clearly did not appreciate the importance of filing monthly reports on time rather than waiting until forced to do so. The Debtor also testified that the majority of his time was spent on his business, not his bankruptcy estate, and that he had unsuccessfully been trying to sell or refinance the estate's assets for over 1½ years. Finally, the Debtor has not filed a plan, and any plan he would file would be a liquidating plan by his counsel's own admission.

As one court has stated:

> It is clear from the history of this case that the Debtor has failed to take seriously the requirements of the Bankruptcy Code and this Bankruptcy Court and the guidelines of the Office of the United States Trustee. As a result, he has prejudiced his creditors. . . . The Debtor wants the benefits of the extraordinary rights and remedies provided by the Bankruptcy Code to protect him from his legitimate obligations to creditors, yet he has continually failed to comply with the requirements of the bankruptcy system he wants to take advantage of.

In re Cannon, 143 B.R. 805, 806 (Bankr. W.D.N.Y. 1992). The Debtor's actions have similarly prejudiced the rights of creditors and the bankruptcy system as a whole.

In light of the foregoing, the Bankruptcy Court's decision that the Debtor could not comply with court orders and his statutory and fiduciary duties was sound. Thus, the totality of the circumstances indicate that the Bankruptcy Court’s finding of cause to convert was reasonable, and should be affirmed.

CONCLUSION

For all of the foregoing reasons, the United States Trustee respectfully requests that the decision of the Bankruptcy Court to convert the case to Chapter 7 be affirmed.

Respectfully submitted,

PATRICIA A. STAIANO
UNITED STATES TRUSTEE

By: ________________________
Robert J. Schneider
Trial Attorney

Dated: October 26, 2000

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WESTLAW CODES

1. ("TI") TITLE OF CASE [E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]

PAUL S. ABLON & JASMINE FILMS, INC. v. WYNNE SPIEGEL ITKIN; GUMPORT, REITMAN & MONTGOMERY; WEINSTEIN & EISEN; & UST (IN RE PREAMBLE MUSIC, INC., D&D PRODUCTIONS, INC., AMBLE MUSIC, INC., & SHERWOOD PRODUCTIONS, INC.)

2. ("CO") CURRENT COURT [E.g., "CTA9"]

CTA9

3. ("CCN") CURRENT CASE NO.

No.: 98-56467

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No.: CC-96-2024 (Consolidated)

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Marjorie Lakin Erickson, Senior Attorney
Region 16 (213-894-3678/805-957-4104)
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") TOPIC

BANKRUPTCY

9. ("SU") ● SUMMARY OF KEY ISSUE(s) & / Any Miscellaneous BACKGROUND

● Whether the Bankruptcy Court abused its discretion by ordering sanctions under Rule 9011 (against Appellants Ablon & Jasmine) for filing a frivolous motion to "vacate and/or terminate" the appointment of Chapter 11 trustee Alfred Siegel in these cases.

/ **Background:**

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UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

Case Number 98-56467

BAP NOS. CC-96-2024, CC-96-2058, CC-96-2059 AND CC-96-2060
(Consolidated under BAP No. CC-96-2024)

In re Preamble Music, Inc., D and P Productions, Inc.; Amble Music, Inc.; and Sherwood Productions, Inc., Debtors.

PAUL S. ABLON and JASMINE FILMS, INC.,
Appellants.

v.

WYNNE SPIEGEL ITKIN; GUMPORT, REITMAN & MONTGOMERY; WEINSTEIN & EISEN; OFFICE OF UNITED STATES TRUSTEE
Appellees.

BRIEF OF APPELLEE UNITED STATES TRUSTEE

MAUREEN A. TIGHE
United States Trustee
MARJORIE LAKIN ERICKSON
Senior Attorney Advisor
OFFICE OF THE UNITED STATES TRUSTEE
221 N. Figueroa Street, Suite 800
Los Angeles, California 90012
(213) 894-3678; (805) 957-4101

March 23, 1999

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I.

STATEMENT OF JURISDICTION

The United States Trustee agrees with Appellant’s Statement of Jurisdiction.

II.

STATEMENT OF ISSUES

Whether the bankruptcy court abused its discretion when it ordered sanctions against Appellants Jasmine, Inc. and Paul S. Ablon for filing a frivolous motion to “vacate and/or terminate” the appointment of Alfred Siegel as Chapter 11 trustee in these bankruptcy cases.

III.

STANDARD OF REVIEW

An order imposing sanctions pursuant to either Federal Rule of Civil Procedure 11 (“Rule 11") or Federal Rule of Bankruptcy Procedure 9011 (“Rule 9011") is reviewed for an abuse of discretion. *Terran v. Kaplan*, 109 F.3d 1428, 1434 (9th Cir. 1997); *In re Grantham Brothers*, 922 F.2d 1438, 1441 (9th Cir. 1990).

To the extent that Jasmine and Ablon suggest any other standard of review, and rely on cases not involving Rule 11 sanctions, their suggestion is without merit. "[A]n appellate court should apply an abuse of discretion standard in reviewing all aspects of a district court's Rule 11 determination." *Cooter & Gell v. Hartmarx Corporation*, 496 U.S. 384, 405, 110 L.Ed.2d 359, 110 S.Ct. 2447, 2461 (1990).

IV.

STATEMENT OF THE CASE

This is an appeal from a Bankruptcy Appellate Panel decision affirming the bankruptcy court's order awarding Rule 11 sanctions against Appellant Jasmine Films, Inc. ("Jasmine") and its counsel, Paul S. Ablon ("Ablon"), because they filed a motion based on innuendo and unfounded and unsupported assumptions. Indeed, the bankruptcy court "found the motion so shockingly off base that it seemed to [it] [Jasmine] was trying to extract some sort of a benefit from these estates without any basis for receiving one." Appellants'

Amended Excerpts of Record ("AER") 2:277, lines 1-4.

The motion at issue was Jasmine's motion to "terminate and/or vacate" the appointment of Alfred Siegel ("Siegel") as Chapter 11 trustee in the four bankruptcy estates of D and P Productions, Inc., Amble Music, Inc., Sherwood Productions, Inc. ("Sherwood"), and Preamble Music, Inc.[1/] Sherwood is the parent corporation and the other three are wholly owned subsidiaries.

All of the companies are related to the bankruptcy of Bruce McNall, the former owner of the Los Angeles Kings hockey team. The motion was based on Jasmine's assertion that Siegel had an impermissible conflict of interest because his name was suggested to the United States Trustee as a possible candidate for trustee by

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[1/] While these cases began as Chapter 11 reorganizations, they were subsequently converted to Chapter 7, with Mr. Siegel remaining as a Chapter 7 trustee.

people associated with the McNall bankruptcy.[2] The motion further complains that although Jasmine's principal, Barry Goldin, expressed his opposition to Siegel's appointment, the United States Trustee did not list him as one of the parties consulted.

Jasmine and Ablon came forward with no evidence that Siegel had engaged in any misconduct. Neither did they supply the court with any evidence that he has been or would be influenced, much less unduly influenced by McNall or McNall's trustee. Based on the bare fact that Siegel's name had been suggested by McNall and McNall's trustee, Jasmine and Ablon asserted that Siegel was "beholden to them," "vetted" by them, that he would not pursue claims against them, that the procedure appointing him was "highly irregular," that "no trustee chosen by Bruce McNall or any successor to Bruce McNall . . .

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[2] The motion asserts that Mr. Siegel was nominated by R. Todd Neilson, the trustee for the estate of Bruce McNall, Mr. Neilson's counsel, Leonard Gumport, and Mr. McNall's counsel, Richard Wynne. This assertion is not true. The evidence is undisputed the Mr. Siegel was suggested by Gumport alone. AER 2:168 and 217.

can be truly expected to protect, or ever appear to be protecting, the Sherwood estate.” The court determined that all these allegations were completely without merit or factual support and are based on at best a thorough misunderstanding of the appointment process.

The bankruptcy court found that the motion was filed for an improper purpose. This improper purpose is reflected by the fact that Jasmine admittedly attempted to conceal its representation by an attorney who was a partner of the trustee Jasmine sought to have appointed.

Having found the motion to be without a basis in fact or law and that it had been brought for an improper purpose, the court properly ordered sanctions payable to the responding parties.

On March 28, 1998, 1½ years after the hearing on the motion for sanctions, Jasmine brought a second motion to remove Mr. Siegel as trustee, which was also denied by the bankruptcy court and which is currently on appeal to the district court. Jasmine and Ablon assert that the disputed facts alleged in the second motion for sanctions have some bearing on the order that is the subject of this appeal.

V.

STATEMENT OF FACTS[3]

These bankruptcy cases were initiated by the filing of bankruptcy petitions on June 13, 1996. They were filed by the principal of the Debtors, Bruce McNall.[4] Shortly after these cases were filed, McNall stipulated to the appointment of a Chapter 11 trustee for the corporate debtors. The order approving the stipulation was entered on July 12, 1996. AER 2:47, 60, 71, and 82. The United States Trustee consulted with parties in inter-

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[3] In the interests of avoiding repetition, The United States Trustee restricts her statement of facts to the facts of which she has direct knowledge. The facts setting forth in more detail the dealings between and among the various other parties to this appeal are contained in the statement of facts submitted by Weinstein, Eisen & Levine and Gumport, Reitman & Montgomery.

[4] Two years earlier, McNall's creditors had filed an involuntary proceeding against him. Within a short period of time, McNall consented to an order for relief and Chapter 11 trustee R. Todd Neilson was ordered appointed in his case.

est, McNall's counsel and Neilson's counsel, as contemplated by 11 U.S.C. §1104(d) and Federal Rule of Bankruptcy Procedure ("FRBP") 2007.1. The United States Trustee also consulted with Barry Goldin, who at the time of the consultation asserted he was an interested party because he expected to receive an interest in the parent of Sherwood. AER 2:238, lines 24-26. Because Goldin, on behalf of Jasmine, did not assert a current interest in any of the Debtors, either as principal or creditor, the United States Trustee did not list his name on her Application for Approval of the Appointment of Mr. Siegel.[5/] AER 3:238, line 24 - 239, line 1. The fact that his name was not listed, however, has no bearing on whether or not his views were considered. The uncontroverted evidence is that the United States Trustee considered Goldin's views but nonetheless decided to

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[5/] FRBP 2007.1 provides that the application to the court for approval of the United States Trustee's appointment of a trustee state the "name of the person appointed, [and] the names of the parties in interest with whom the United States Trustee consulted regarding the appointment . . .."

appoint Mr. Siegel. AER 2:239, lines 1-2. Jasmine’s assertion, at its opening brief page 12, that the United States Trustee attorney “paid little, if any, heed to Jasmine’s concerns” is unsupported in the record.

On July 30, 1996, after receiving Siegel’s statement of disinterestedness, the United States Trustee applied to the court for approval of her appointment of Alfred Siegel as trustee in these cases. AER 2:238, lines 13-19. The court entered the order approving the appointment on August 6, 1996. AER 2:48, 61, 72 and 83. Just nine days later, on August 15, 1996, Jasmine and Ablon filed their motion seeking to vacate or terminate Siegel’s appointment, supported by the Barry Goldin’s declaration. AER 2:91. The motion did not state what procedural rule or code section it was based on. *Id.*

The motion was opposed by Mr. Siegel, Mr. Neilson and the United States Trustee. AER 2:163-204, 205-226, and 228-240. Mr. Siegel also filed evidentiary objections to Goldin’s declaration. [AER 2:223-226 and Appellee’s Supplemental Excerpts of Record (“SER”), Exh. 1],[6] which were sustained with the court noting that the Goldin declaration contained “rank hearsay, pure speculation, [and] argument. . ..” In ruling on the motion, the court noted that it was “among the most outrageous I’ve entertained in 11 years on the bench.” AER 2:284, lines 13-22. No appeal has been taken the order sustaining Siegel’s objection to Goldin’s declaration. The United States Trustee requested sanctions in her opposition to the motion.[7] AER 2:228-235. On September 10, 1996, the court denied the motion and set a further hearing on the United States Trustee’s request for sanctions. AER 2:280, lines 11-17 and 283, line 22 - 284, line 12.

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[6] The evidentiary objection has been included in the Supplemental Excerpts because the second page on the objection is missing in Appellants’ Amended Excerpts of Record.

[7] Jasmine’s assertion at page 11 of its brief that the court *sua sponte* scheduled a hearing on sanctions is not accurate.

The hearing on the sanctions was held on September 24, 1996. AER 3:455. Sanctions were ordered against both Jasmine and its counsel, Paul Ablon, in the amount of $10,550 by order entered October 28, 1996. AER 3:504. The Bankruptcy Appellate Panel affirmed the sanctions order [AER 10], and this appeal followed.

On March 2, 1998, one and a half years after the sanctions order was entered, Jasmine brought a second motion to remove Mr. Siegel as trustee. AER 12:706. This motion alleged that Mr. Siegel was no longer disinterested and therefore ineligible to serve as trustee, because he had negotiated for a loan from the McNall estate to fund the running of the insolvent Sherwood estates. SER Exh. 7, Page 9. The motion was denied and is on appeal to the district court. Jasmine and Ablon assert that the disputed facts alleged in this motion, which facts did not even occur until after the hearing on sanctions, should be taken into account when considering whether the court abused its discretion by ordering sanctions based on its finding that there was no factual basis for the motion at issue here.

Appellants' Opening Brief, Page 28.[8/]

VI.

THE COURT DID NOT ABUSE ITS DISCRETION IN AWARDING RULE 9011 SANCTIONS AGAINST APPELLANTS

Pursuant to former FRBP 9011, as it read at the time of appellants' August 1996 motion,[9/] the signing and filing of a pleading constitutes a certification that the pleading is "well grounded in fact and is warranted by existing law or a good faith argument for the extension, modification, or reversal of existing law; and that is not interposed for any improper purpose, such as to harass or to cause unnecessary delay or

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[8/] A complete exposition of the facts regarding the second removal motion is set forth in the motion of Gumport, Reitman & Montgomery to dismiss this appeal. As discussed below, the United States Trustee believes that Jasmine's subsequent motion of March 2, 1998, has no legal bearing on the propriety of the sanctions imposed in response to Jasmine's unfounded motion of August 15, 1996, which is the only order currently on appeal here.

[9/] In December 1997, after the events that are the subject of this appeal, Rule 9011 was amended to more closely track Rule 11, which had been amended in 1993.

needless increase in the cost of litigation or administration of the case." FRBP 9011.

In determining whether Rule 9011 has been violated, "courts must consider both frivolousness and improper purpose on a sliding scale, where the more compelling the showing as to one element, the less decisive need be the showing as to the other." *In re Marsch*, 36 F.3d 825, 830 (9th Cir. 1994).

Here, Jasmine and Ablon filed a motion on August 15, 1996, that was devoid of factual or legal basis and did so for the purpose of trying to assert improper influence over these bankruptcy cases. Facts that occurred after the motion was filed, even if sufficient to warrant the removal of the trustee, cannot change the fact that Jasmine and Ablon filed the 1996 motion for an improper purpose, with no facts to support it.

A. THE MOTION HAD NO FACTUAL BASIS

Contrary to Jasmine and Ablon's assertions, the motion they filed was completely devoid of admissible factual support. Rather, their motion was based on supposition, innuendo and speculation. Suggesting that the bankruptcy court had improperly taken part in the selection of the trustee, the motion erroneously asserted in footnote 1 that the “procedure leading to the appointment of Siegel was highly irregular” because the “Order not only directed the appointment of a trustee by also appointed Siegel as trustee.” AER 2:94, footnote 1.

The motion also alleged that the selection of Mr. Siegel had been “vetted” by the felonious Mr. McNall, that Siegel was “beholden” to Wynne and Gumport, that because of that he would ignore his fiduciary duties and “not be likely to assert the claims of Sherwood against either Bruce McNall or the McNall Bankruptcy Estate.” AER 2:98. There was no factual basis for these allegations. Nonetheless, Jasmine and Ablon assert that based on these unsupported “facts,” Siegel had an impermissible conflict that Jasmine’s concerns should have been reported to the court.

Jasmine and Ablon have acknowledged the falsity of the allegation that the procedure leading to the appointment was irregular. AER 3:354-355. The very exhibits attached to Jasmine and Ablon's motion demonstrate the falsity of the allegation.[10] Jasmine and Ablon suggest that they bear no responsibility for the accusation in footnote 1 because it appears to have been added to the motion by outside counsel, Leslie Cohen (AER 3:355, lines 8-20; 420). Yet that claim does not relieve Jasmine and Ablon of their responsibility to investigate the accuracy of their motion, especially where, as here, a simple reading of their exhibits would have shown the unfounded allegations of footnote 1 to be false.

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[10] The order on Sherwood's stipulation for the appointment of a trustee was entered on July 12, 1996, and merely ordered the United States Trustee to appoint a chapter 11 trustee, but did not name a specific trustee. AER 2:115-118. The application for an order approving the appointment of Mr. Siegel was filed in August 6, 1996. AER 2:110. Both of these documents were attached to the motion to vacate and clearly demonstrate the falsity of the assertion in footnote 1 that "the Order not only directed the appointment of a trustee by also appointed Siegel at Trustee." AER 2:94, footnote 1.

The other allegations contained in the 1996 motion are similarly without merit. Although the motion purports to be supported by Goldin's declaration, a review of that declaration reveals no facts to support the allegations that Siegel was vetted by McNall, that Siegel was beholden to McNall or that he would not assert Sherwood's claims against McNall. As noted by the court, the declaration is "completely unsupported, hearsay and speculation." AER 2:276, lines 19-23. Indeed, the court sustained the evidentiary objections filed by counsel for Mr. Siegel, leaving the motion without even the unsupported allegations asserted in the Goldin declaration. That evidentiary ruling has never been appealed from. There is not one concrete piece of evidence to support these allegations of impropriety on behalf of any of the participants.[11/] Even a cursory

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[11/] Appellants' repeated invocation of Bruce McNall's criminal conduct is disingenuous. No one disputes that Mr. McNall is a convicted felon. However, despite Jasmine and Ablon's suggestions, McNall's criminal conduct cannot be imputed either to Mr. Wynne, McNall's counsel, or to Mr. Neilson, the trustee of his reading of the motion and declaration should have alerted Jasmine and Ablon to the lack of factual basis.

Notwithstanding the lack of evidence, this motion was filed alleging gross improprieties on the part of the court, the trustee, the United States Trustee, McNall, Wynne, Neilson and Gumport. Making such allegations without any factual basis or any investigation into their truth is at the very least reckless. Jasmine and Ablon were properly held accountable for their actions. Our judicial system does not allow participants to make wild, untrue and baseless allegations of improper conduct without suffering the consequences. Rule 11 was enacted for just this purpose in response to concerns that abusive litigation practices abounded in the federal courts. *Cooter & Gell v. Hartmarx Corporation*, 496 U.S. 384, 393, 110 L.Ed.2d 359, 110 S.Ct. 2447, 2454. "It is now clear that the

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bankruptcy estate, or to Mr. Gumport, Mr. Neilson's counsel. Whatever McNall may have done, proof of his misconduct does not constitute evidence of anyone else's misconduct.

central purpose of Rule 11 is to deter baseless filing in district court . . . .” *Id.*[12]

B. THE MOTION HAD NO LEGAL BASIS

The motion was styled as a motion to terminate or vacate the appointment of the trustee, but no supporting bankruptcy code section or procedural rule was cited.

Termination of a trustee appointment is governed by 11 U.S.C. §1105, which provides in relevant part that at the request of a party in interest the court “may terminate the trustee’s appointment and restore the debtor in possession and management of the property of the estate and of the operation of the debtor’s business.” If the trustee were terminated under this provision, the control of these estates would devolve to Mr. McNall. Clearly this is not the result intended by Jasmine and Ablon.

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[12] Federal Rule of Civil Procedure 11 was amended in 1993. The pre-amendment Rule is essentially the same as the version of Rule 9011 in effect at the time of the hearing. Cases construing the pre-1993 Rule 11 are relevant to construing Rule 9011. *In re Soll*, 181 B.R. 433, 446 footnote 37 (Bankr. D. Ariz. 1995).

Similarly, 11 U.S.C. §324 provides that a trustee can only be removed for cause. Jasmine and Ablon concede that Siegel had not engaged in any misconduct and that no cause existed for his removal. AER 3:353. Rather, Jasmine and Ablon assert that the United States Trustee omitted "material facts in the Application for the Order Approving Appointment of Trustee." AER 3:353. As noted, however, the claimed omission is not material and does not give rise to a legal basis for the motion.[13]

Jasmine and Ablon argue that FRBP 2007.1 required the United States Trustee to include Jasmine in the list of parties consulted and an exposition of Jasmine's opposition to Siegel. This argument ignores the plain language of Rule 2007.1, which requires only the names of the parties in interest consulted, not the substance

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[13] The fact that the court did not remove the trustee once it was aware of the "evidence" that Jasmine presented to the United States Trustee affirms the assertion that the information was not material to whether the court would have approved the appointment of Mr. Siegel as trustee.

of the consultation. Even if Jasmine had been listed,[14] its position regarding the trustee nominees would not have been set forth because the rule does not contemplate that sort of disclosure and it is the United States Trustee's practice to list only the names of "parties in interest consulted."[15]

In any event, even if such information is contemplated by Rule 2007.1, and such information was omitted, the omission is material only if it is true. As we have seen, allegations of Siegel's conflict were made of whole cloth and entirely without merit. Jasmine

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[14] It is not disputed that at the time of the discussions with Jasmine, the United States Trustee had not been informed that Jasmine claimed to be a creditor, but only that it hoped to obtain an equity interest in Sherwood. AER 2:238, paragraph 7. This expectancy does not make Jasmine a party in interest, even under the expansive definition urged by Jasmine and Ablon, and for that reason Jasmine was not listed among the parties consulted.

[15] See, e.g., 11 U.S.C. §1109(b): "A party in interest, including the debtor, the trustee, a creditor's committee, an equity security holders' committee, a creditor, an equity security holder, or any indenture trustee, may raise and may appear and be heard on any issue in a case under this chapter."

and Ablon can only have a colorable legal basis for their motion if it has a factual basis. Jasmine and Ablon apparently concede the motion as filed had no factual basis because they now insist that conduct that occurred <ins>after</ins> the 1996 motion was filed must be considered in determining whether their conduct is sanctionable.

Jasmine and Ablon assert that the award of sanctions was an abuse of discretion because they were entitled to bring their “legitimate” concerns about Mr. Siegel’s “conflicts” to the attention of the court. This argument fails because it is premised on the faulty assumptions that the concerns were legitimate and that there were in fact conflicts. This is the very assumption that the court determined was without any basis when it denied Jasmine’s motion and awarded opposing parties sanctions of $10,550. Failure of the factual basis necessarily results in failure of the legal basis as well.

C. THE MOTION WAS FILED FOR AN IMPROPER PURPOSE

Jasmine’s dealings with the United States Trustee are sufficient to demonstrate that the motion was filed for an improper purpose. Jasmine and Ablon purport to have been “astounded” that anyone nominated by McNall or Neilson would be appointed trustee. That position is wholly without merit and exhibits a fundamental misunderstanding of the trustee-appointment process. The parties in interest consulted regarding the appointment of a trustee are usually creditors and the debtors and often have their own concerns. If potential trustees were eliminated because the party suggesting them had a potential conflict, the consultation requirement would be a nullity and an absurdity. It is totally disingenuous for Jasmine and Ablon to express outrage at Siegel’s appointment.

While there is <u>no</u> evidence that any party engaged in improper manipulation regarding Siegel’s appointment, it is undisputed that Jasmine and Ablon manipulated the process by concealing the fact that Jasmine was represented by Leslie Cohen in order to attempt to convince the United States Trustee to appoint her partner, Larry Diamant, as trustee in these cases. AER 3:374. This evidence alone is sufficient for the court to find an improper purpose, warranting the sanctions imposed.

D. BOTH JASMINE AND ABLON FAILED TO UNDERTAKE A REASONABLE INQUIRY INTO THE FACTUAL OR LEGAL BASIS FOR THEIR MOTION

Neither Jasmine or Ablon undertook a reasonable inquiry into the truth of their allegations. Jasmine and Ablon defend their actions by arguing that they obtained as much information as they could, given the fact that the motion was filed so quickly. Even if the need to act quickly could justify the filing of a legally and factually unsupported motion, there was no such need here. There was no time sensitivity to the motion. There is no rule requiring that their motion be brought within any specified time frame.

Nonetheless, Jasmine and Ablon argue they needed to bring the motion quickly “before [Siegel] could take any action as the Sherwood Companies’ Trustee that would implicate the conflicts of interest that concerned Appellants.” Appellant’s Opening Brief, Page 36. Jasmine and Ablon do not and cannot explain what this action might be. In fact, this argument is disingenuous. The alleged conflict is that Siegel would fail to take actions against McNall and the McNall bankruptcy because he was “beholden” to McNall and Neilson. How could the threat of non-action create a time constraint for the motion? The argument is logically nonsensical at best.

Because of this manufactured time constraint, Jasmine and Ablon now assert that they necessarily had to move based on limited information. The information they decided was sufficient was that McNall engaged in fraud, Sherwood had claims against McNall and Siegel was “nominated and ‘vetted’ by McNall’s representatives.” Appellant’s Opening Brief, Page 14. They assert that was reasonable because of “extensive” information Goldin had obtained regarding McNall and his related entities during the course of other litigation. But all this information is irrelevant to the motion they brought accusing the judge, the United States Trustee, Neilson, Gumport, and Wynne of improper conduct. It is these false allegations that warranted sanctions, not anything the motion had to say about McNall himself. They do not even pretend to have made a reasonable inquiry regarding the allegations they made in the motion. It is clear from Jasmine and Ablon’s brief that the motion was based solely on the bare fact that Wynne and Gumport were listed as the parties consulted prior to the trustee appointment.[16/]

As noted above, the false allegation contained in footnote 1 was contradicted by Jasmine and Ablon’s own exhibits. It is patently unreasonable for them to have

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[16/] The fact that Jasmine and Ablon’s assumption that Siegel was suggested by the parties consulted was incorrect, and that Gumport alone suggested Mr. Siegel as trustee, means that McNall’s representative did not even suggest Mr. Siegel, much less “vet” him.

failed to read their own exhibits and thereby ascertain that the allegation was false.

The purpose of Rule 11 is to “bring home to the individual signer his personal, nondelegable responsibility . . . to validate the truth and legal reasonableness of the papers filed.” *Pavelic & LeFlore*, 493 U.S. 120, 126, 107 L.Ed.2d 438, 460, 110 S.Ct. 456 (1989). Similarly, “a represented party who signs his or her name bears a personal, nondelegable responsibility to certify the truth and reasonableness of the document.” *Business Guides, Inc. v. Chromatic Communications Enterprises, Inc.*, 498 U.S. 533,547, 112 L.Ed.2d 1140. 111 S.Ct 922, 931 (1990).

Jasmine and Ablon cannot escape this responsibility by asserting they were unfamiliar with bankruptcy proceedings and that it was reasonable for them therefore to delegate their personal responsibility to file truthful pleadings on a third party (Lesley Cohen) who did not sign the pleadings and who they do not even claim had done her own legal or factual investigation.

Indeed, a review of Ms. Cohen's notations on the draft motion reveals that she questioned whether there was more evidence to support the motion. AER 3:416-427.

Finally, Jasmine and Ablon assert that their own subjective intent was not to file a baseless motion for an improper purpose. This, however, is not the test. Rather, as Jasmine and Ablon themselves argue, the court imposes an objective standard with regard to both the question of frivolity and improper purpose. *In re Soll*, 181 B.R. 433, 447 (Bankr. Ariz. 1995). "Sanctions [should] be assessed if the paper . . . filed . . . [was] frivolous, legally unreasonable or without factual foundation, even though the paper was not filed in subjective bad faith." *Id.*, *quoting Zaldivar v. City of Los Angeles*, 780 F.2d 823 (9th Cir., 1986).

E. JASMINE AND ABLON'S DUE PROCESS ARGUMENT IS WITHOUT MERIT

Jasmine and Ablon also suggest that the court denied them due process and a forum to challenge Siegel's appointment. They assert that they had a due process right to bring their concerns to the court’s attention. And they are right. If that is all they had done, there would be no foul and no sanctions order. But that is not all they did. Their 1996 motion contained numerous untrue, unsupported allegations of misconduct that neither Jasmine or Ablon made any attempt to verify. That is why sanctions were ordered, and properly so.

It is not true that the court denied Jasmine and Ablon’s right to be heard. The court did nothing of the kind. The motion was heard and denied. It is clear from the transcript that the court considered the merits of the motion, determined the motion was unfounded and unsupported and denied the motion on the merits. The award of sanctions was not for filing the motion per se, but rather for filing a frivolous motion for an improper purpose. Jasmine and Ablon have cited no authority, nor can they, for the proposition that they have a due process right to file frivolous motions for an improper purpose.

F. THE QUESTION OF JASMINE’S STANDING IS NOT

RELEVANT

Jasmine and Ablon assert that the bankruptcy court was incorrect when it determined that Jasmine had no standing to object to the trustee appointment in the Preamble Music, Inc., D and P Productions, Inc., and Amble Music, Inc. cases. The court acknowledged that Jasmine had standing in the Sherwood case, and considered Jasmine's 1996 motion on the merits. The standing question, however, is irrelevant because it has no bearing on whether the court abused its discretion by ordering sanctions against Jasmine and Ablon. Irrespective of the standing issue, the dispositive issue on the sanctions order is the fact that Jasmine and Ablon filed a motion that was not properly researched and was full of misstatements of fact. In any event, it is clear from the record that the court did not decide the matter on the standing issue but rather considered the merits of the motion and found it to be baseless. AER 2:279; AER 3:465-470.

G. THE AMOUNTS OF THE SANCTIONS AWARDS ARE

APPROPRIATE

For the first time in this appeal, Jasmine and Ablon challenge the amount of the sanctions award or even whether monetary sanctions were appropriate. It is well settled that arguments raised for the first time on appeal are not properly before the appellate court. *United States v. Carlson*, 900 F.2d 1346, 1349 (9th Cir. 1990). Given that Jasmine and Ablon made unsupported allegations impugning the integrity of the court and the United States Trustee, the amount of sanctions awarded does not seem inappropriate to deter future improper conduct.[17/]

VII.

[17/] The amount of sanctions was not arbitrarily arrived at but was based on the amount that would serve as a deterrence and limited to the costs incurred by aggrieved parties. The total amount of the sanctions ordered was $10,630 payable jointly and severally by Jasmine and Ablon to the four appellees, pro rated over the four bankruptcy estates: $3,000 to the United States Trustee, $2,000 to Wynn Spiegel Itkin, $1,080 to Gumport, Reitman & Montgomery, and $4,550 to Weinstein & Eisen. The amount due to each appellee was based on their costs in defending the unfounded motion and is supported by declarations regarding those costs.

FACTS ALLEGED TO HAVE OCCURRED AFTER JASMINE AND ABLON FILED THEIR MOTION CANNOT PROVIDE FACTUAL SUPPORT FOR THE MOTION

Apparently recognizing that the 1996 motion that is the subject of this appeal was without factual support when it was filed, Jasmine and Ablon have made several attempts to convince the Bankruptcy Appellate Panel and this court that facts that occurred <u>after</u> they filed their motion can somehow remedy the lack of factual support for the motion. This argument fails because the question of whether a motion is frivolous is determined by the facts that existed as of the time the motion was signed. Even if the court could somehow bootstrap subsequent events to provide the factual basis for the motion, the facts alleged here provide no such support.

A. CONDUCT ALLEGED TO HAVE OCCURRED AFTER THE HEARING GRANTING SANCTIONS CANNOT BE CONSIDERED BY THIS COURT IN DETERMINING WHETHER THE BANKRUPTCY COURT ABUSED HER DISCRETION BY

AWARDING SANCTIONS

Pursuant to Federal Rule of Appellate Procedure 10 and Ninth Circuit Rule 10-2, record on appeal shall consist of the “original papers and exhibits filed in the district court, the transcript of proceedings, if any, and a certified copy of the docket entries prepared by the clerk of the district court. . . .” Numerous cases have held, in accordance with that rule, that the record on appeal cannot be augmented by evidence that was not before the court at the time it ruled on the order appealed from. *United States v. Walker*, 601 F.2d 1051, 1954-55 (9th Cir. 1979) (Rule 10(e) cannot be used to augment record on appeal to include material not before the district court); *Kirshner v. Uniden Corp. of America*, 842 F.2d 1074, 1077-78 (9th Cir. 1988) (evidence neither filed with the district court, considered by the district court, nor even before the court when it ruled was stricken from the record on appeal).

In judging whether a motion was frivolous when made, no other rule would make any sense. As Jasmine and

Ablon concede in their opening brief, at footnote 14 on page 27, in assessing whether a person signing a pleading has met the obligations imposed by Rule 11, the court applies the "snapshot" rule, measuring the complained of conduct "as of the time of the signing." *Federal Deposit Insurance Corporation*, 34 F.3d 1291, 1296 (5th Cir. 1994). Jasmine and Ablon do not attempt to present any legal argument to justify their assertion that this court should determine the propriety of the bankruptcy court's ruling on facts that were not before it and that had not occurred at the time the sanctions order was made.[18/] Jasmine and Ablon do not explain how facts that had not even occurred at the time the court ruled can supply support for the motion they filed almost two months earlier.

[18/] The assertion made by Jasmine and Ablon that Mr. Siegel's counsel contacted Mr. Neilson's counsel "well before the filing of the motion to vacate" [Appellant's Opening Brief, Page 16] is not true. The motion to vacate was filed on August 15, 1996, which is clearly not after October 4, 1996, the date the contact was made.

Jasmine and Ablon cite *In re Fegert, Inc.*, 887 F.2d 955 (9th Cir. 1989) for the proposition that "intermediate appellate courts may consider any issue supported by the record," including the file in the underlying case. *Id.* at 957-58. However, *Fegert* does not stand for the proposition that intermediate appellate courts are free to consider facts that did not exist at the time the lower court ruled. In *Fegert*, the issue was whether in an appeal of a decision in an adversary proceeding, the appellate court could decide an issue not decided by the bankruptcy court. The Ninth Circuit noted that the issue was before the bankruptcy court, even if not decided by it, and the factual basis to decide the issue was before the bankruptcy court, at least in the record of the underlying bankruptcy case. The case dealt only with facts and issues that existed at the time the bankruptcy court ruled. It does not provide support for Jasmine and Ablon's remarkable contention that Post hoc facts can be considered by this Court in determining whether the bankruptcy court abused its discretion in imposing sanctions for the unfounded 1996 motion.

B. EVEN IF THIS COURT CONSIDERS THE EVIDENCE PRESENTED IN THE SECOND MOTION TO REMOVE THE TRUSTEE, THE BANKRUPTCY COURT'S DECISION SHOULD BE AFFIRMED

Jasmine and Ablon try to convince this court to ratify their sanctionable conduct by proving that, although ungrounded at the time they filed their first motion, their suspicions proved to be true. But their suspicions did not, in fact, prove to be true. They assert that their suspicions were borne out by the "fact" that Mr. Siegel had "secretly" negotiated a loan from the bankruptcy estate of one of the principals of the debtor against whom the trustee had filed a $97 million proof of claim. That this negotiation provided proof that Mr. Siegel now had a conflict of interest is alleged to be inferred from the "fact" of the trustee's "failure to investigate the claims held by the Sherwood

Estates against the McNall Estates (proposed lender). . ..” Appellant’s Opening Brief, Page 28.

Again, these allegations are unsupported by the facts. First, the Sherwood estate never borrowed any money from the McNall estate; second, the contemplated loan was not secret because it would not have gone forward without the express approval of the court; third, as Appellant acknowledged to the court, there is no legal authority to support its contention that negotiations for the loan constituted a conflict of interest requiring Siegel to be removed as trustee; fourth, Appellants’ supposed proof that Mr. Siegel had a conflict of interest consisted of arguments already made to the court and a course of action already approved by the court. As a result, the court denied Jasmine’s 1998 motion to remove Siegel as trustee.

Most important is, of course, that none of these facts existed at the time Jasmine and Ablon filed its 1996 motion to terminate or vacate Siegel’s appointment as trustee.

VIII.

CONCLUSION

The court’s decision to order sanctions in this case was not a close call. Rather, as the court noted, she found “these motions among the most outrageous [she had] entertained in 11 years on the bench.” AER 2:284, lines 20-22. For this reason and the reasons cited above, the 1996 award of sanctions should be affirmed.

DATED: March 11, 1999

OFFICE OF THE UNITED STATES TRUSTEE

By: ____________________________________
Marjorie Lakin Erickson, Attorney
for the United States Trustee

PROOF OF SERVICE BY MAIL

STATE OF CALIFORNIA
COUNTY OF LOS ANGELES

I am employed in the County of Los Angeles, State of California, in the Office of the United States Trustee under the supervision of a member of the bar of this Court at whose direction the service was made; I am over the age of 18 and not a party to the within action; and my business address is 221 North Figueroa Street, Suite 800, Los Angeles, California 90012.

On March 23, 1999,I served the foregoing document described as: **CERTIFICATION PURSUANT TO FEDERAL RULE OF APPELLATE PROCEDURE 32(E)(4)** on parties at their last known address in this action by placing a true and correct copy thereof in a sealed envelope with postage thereon fully prepaid in the United States Mail at Los Angeles, California addressed as Follows:

ATTORNEYS FOR DEBTOR:
Richard L. Wynne
Wynne Spiegel Itkin
1901 Avenue of the Stars
Suite 1600
Los Angeles, CA 90067

ATTORNEYS FOR SHERWOOD TRUSTEE:
David R. Weinstein
Weinstein, Eisen & Levine
1925 Century Park East
Suite 1150
Los Angeles, CA 90067-2712

ATTORNEYS FOR McNALL TRUSTEE:
Leonard L. Gumport
Gumport, Reitman & Montgomery
550 South Hope Street
Suite 825

Los Angeles, CA 90071-2627

ATTORNEYS FOR APPELLANTS:
James A Hinds, Jr.
1801 Century Park East
Suite 900
Los Angeles, CA 90067

I declare under penalty of perjury that the foregoing is true and correct.

____
DARLENE S. THOMPSON

Dated: March 23, 1999

BRIEF BANK — “SUMMARY SHEET” *Printed Tue-9/14/10 15:54*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*
Robert E. Simmons v. The Hon. Stephen Raslavich

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*
E. D. Pa.

3. ("CCN") ***CURRENT*** CASE NO.
No.: 2:10-mc-00102-RBS

4. ("PCN") ***PRIOR*** CASE NO. - & COURT *[IF ANY]*
No.: 10-10989
Court: Bankr. E.D. Pa.
(Identify judge & cite, if any)

5. ("SO") ***SOURCE***
U.S. TRUSTEES

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*
Filed: September 10, 2010
Type: Brief for the United States as Amicus Curiae in Support of Defendant

7. **("AU") *PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*
Fred Baker, P. Matthew Sutko, Anne Stukes
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***
• Whether a pro se petition for TRO/preliminary injunction filed in the district court should be dismissed as moot or construed as a mandamus petition and dismissed because petitioner could have, but did not, appeal from bankruptcy court to the district court.

10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)

11. DO YOU RECOMMEND POSTING IN UST BRIEFBANK?
| x | YES | | NO
NAME: Linda Figueroa
DATE:

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA
PHILADELPHIA DIVISION

ROBERT E. SIMMONS)
)
Plaintiff,)
)
v.) Case No. 2:10-mc-00102-RBS
)
THE HON. STEPHEN RASLAVICH,)
)
Defendant.)
)

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE IN SUPPORT OF DEFENDANT

ROBERTA A. DEANGELIS
United States Trustee for Region 3

FREDERIC J. BAKER
Assistant United States Trustee
United States Department of Justice
Office of the United States Trustee
833 Chestnut Street, Suite 500
Philadelphia, PA 19107
Phone: 215-597-4411
Fax: 215-597-5795
frederic.j.baker@usdoj.gov
Attorney for Amicus Curiae the United States

COMES NOW, Roberta A. DeAngelis, the United States Trustee for Region 3 and a United States Department of Justice official, 28 U.S.C. § 581(a)(3), and respectfully submits this *amicus curiae* brief in support of defendant.[1] For the reasons set forth below, the United States has an interest in the outcome of this case and respectfully suggests that dismissal is the appropriate resolution of this matter.

INTEREST OF THE UNITED STATES AS *AMICUS CURIAE*

This case presents the question whether a chapter 7 debtor, whose bankruptcy case was dismissed in the bankruptcy court, may obtain substantive review of that dismissal in this Court by filing a "Motion for Temporary Restraining Order or in the Alternative a Preliminary Injunction / Order to Compel Response to Notice of Appeal from a Judgment of U.S. Bankruptcy Court" instead of a direct appeal under 28 U.S.C. § 158(a). The United States has a direct interest in the resolution of that question because United States Trustees — who are Department of Justice officials appointed by the Attorney General — supervise the administration of bankruptcy cases. *See* 28 U.S.C. §§ 581-589a; H.R. Rep. No. 595, 95th Cong., 1st Sess. 88 (1977). Congress has provided that "any officer of the Department of Justice[] may be sent by the Attorney General to any State or district in the United States to attend to the interests of the

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[1] Although the Federal Rules of Civil Procedure do not contain a Rule that addresses appearances of *amicus curiae*, the procedures in Rule 29 of the Federal Rules of Appellate Procedure provide helpful guidance. *See* Fed. R. App. P. 29. Under Fed. R. App. P. 29(a), the "United States or its officer or agency . . . may file an amicus-curiae brief without the consent of the parties or leave of court." If this Court should require a motion for leave for the United States to appear as amicus curiae, the United States respectfully requests that this brief be construed as a motion for leave to file and that such leave be granted — as this brief addresses the two requirements set forth in Fed. R. App. P. 29(b) for motions for leave, including "(1) the movant's interest; and (2) the reason why an amicus brief is desirable and why the matters asserted are relevant to the disposition of the case." Fed. R. App. P. 29(b).

United States in a suit pending in a court of the United States." 28 U.S.C. § 517. *See also* 28 U.S.C. § 516 ("Except as otherwise authorized by law, the conduct of litigation in which the United States, an agency, or officer thereof is a party, or is interested, and securing evidence therefor, is reserved to officers of the Department of Justice, under the direction of the Attorney General.").[2]

BACKGROUND

Mr. Simmons' Chapter 7 Bankruptcy

This case's procedural history began in the bankruptcy court. In February 2010, the plaintiff, Robert E. Simmons, filed a voluntary chapter 7 bankruptcy petition in the United States Bankruptcy Court for the Eastern District of Pennsylvania. *See In re Robert E. Simmons*, No. 10-10989-sr (Bankr. E.D. Pa. Feb. 9, 2010) (hereafter cited as "*Simmons Bankruptcy*") Dkt. 1 (attached hereto as Exhibit A). The case was assigned to Chief Bankruptcy Judge Stephen Raslavich.

Rule 1007 of the Federal Rules of Bankruptcy Procedure requires a bankruptcy debtor to file certain schedules, statements and documents. *See* Fed. R. Bankr. P. 1007(b). One such required document is a statement of compliance with 11 U.S.C. § 109(h), which requires

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[2] Indeed, this Court may determine that an appearance by the United States as *amicus curiae* is desirable because the defendant, the Chief United States Bankruptcy Judge for the Eastern District of Pennsylvania, would be under no obligation to appear in this action. That is, if plaintiff Simmons' petition to this Court is construed as a mandamus petition, the Third Circuit has long held that "the judge below, although named as a respondent, shall be deemed a nominal party only and the prevailing parties in the challenged decision shall be deemed to be respondents and permitted to answer the petition." *Rapp v. Van Dusen*, 350 F.2d 806, 812-13 (3d Cir. 1965). This holding is consistent with the current version of Fed. R. App. P. 21, governing writs of mandamus. *See, e.g.*, Fed. R. App. P. 21(b)(4) ("The trial-court judge may request permission to address the petition but may not do so unless invited or ordered to do so by the court of appeals.").

individual debtors to undergo pre-petition credit counseling. This district's Local Bankruptcy Rule 1007-2 also requires debtors to file a "matrix" listing creditors. The bankruptcy court ordered Mr. Simmons to file various missing documents — including various bankruptcy schedules and a statement of compliance with credit counseling. *See Simmons Bankruptcy* Dkt. 5 (attached hereto as Exhibit B). The court warned Mr. Simmons that if he did not file all missing documents, "this case may be dismissed without additional notice or hearing." *Id.* And, indeed, after Mr. Simmons did not file the missing documents, the bankruptcy court dismissed his case on February 18, 2010. *See Simmons Bankruptcy* Dkt. 9 (attached hereto as Exhibit C). The bankruptcy case was closed.

More than 14 days after the bankruptcy court entered its order of dismissal, Mr. Simmons filed a document styled as a "Notice of Appeal." *Simmons Bankruptcy* Dkt. 12 (attached hereto as Exhibit D).[3] In that document, Mr. Simmons emphasized that he was a *pro se* inmate in a state penal institution, without access to "bankruptcy information," and without the means to obtain credit counseling. *Id.* He pleaded with the bankruptcy court to "Reverse it's decision and allow my Bankruptcy Petition to Proceed and to not hold me to the same standards of one being represented by counsel, and not as a Prisoner." *Id.* at p. 2.

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[3] This timing is significant because, under 28 U.S.C. § 158(c)(2), an appellate court has jurisdiction to consider an appeal from a bankruptcy court only if the appeal is taken "in the time provided by Rule 8002 of the Bankruptcy Rules." 28 U.S.C. § 158(c)(2). Under Rule 8002(a), a notice of appeal must be filed within 14 days of the date of entry of the order appealed. When a time period for perfecting a timely notice of appeal is set forth in a statute — such as 28 U.S.C. § 158(c)(2)'s requirement of adherence to the time periods in Bankruptcy Rule 8002 — the time period is jurisdictional. *See Bowles v. Russell*, 551 U.S. 205, 213 (2007). Accordingly, Mr. Simmons' untimely notice of appeal could not have been effective to perfect an appeal from the first dismissal of his bankruptcy case. *Compare* Exhibit C (dismissal entered 02/18/2010), *with* Exhibit D ("notice of appeal" filed 03/17/2010).

The bankruptcy court construed Mr. Simmons' untimely "Notice of Appeal" as a motion for reconsideration and granted it. The court's order instructed Mr. Simmons to file a Matrix List of Creditors as required by Local Bankruptcy Rule 1007-2, and included instructions for how to format and file the matrix. *Simmons Bankruptcy* Dkt. 13 (attached hereto as Exhibit E). Further, the court warned Mr. Simmons to file the matrix no later than April 15, 2010. *Id.* When Mr. Simmons failed to file any additional documents, the bankruptcy court dismissed the case again on April 27, 2010. *Simmons Bankruptcy* Dkt. 15 (attached hereto as Exhibit F). Mr. Simmons did not file a notice of appeal from the second order of dismissal.

Mr. Simmons' Petition to This Court

Instead of filing a notice of appeal from the second dismissal of his bankruptcy case, Mr. Simmons initiated a new proceeding in this Court by filing a "Motion for Temporary Restraining Order or in the Alternative a Preliminary Injunction / Order to Compel Response to Notice of Appeal from a Judgment of U.S. Bankruptcy Court." Dkt. 1 (filed 05/28/2010). The petition named Chief Bankruptcy Judge Stephen Raslavich as defendant. Attached to the petition is the "Notice of Appeal" that Mr. Simmons filed in the bankruptcy court on March 17, 2010. *See* Dkt. 1 ("Plaintiff's Exhibit Marked A"). Mr. Simmons requests that the bankruptcy court be ordered to take action on the "Notice of Appeal." *See* Dkt. 1, ¶¶ 1, 4, 6, 7, 9.

As of the date of this filing, no other parties have appeared in this case, and no other documents have been filed on the docket.

ARGUMENT

As *amicus curiae*, the United States respectfully suggests that this case should be dismissed with prejudice for at least two reasons. First, this case is moot because Mr. Simmons has already been granted all the relief that he requests. Second, to the extent that — as the United States contends — Mr. Simmons' petition is construed as a mandamus petition, relief is unavailable because he could have, but did not, pursue a timely appeal.

A. This case is moot because the bankruptcy court already acted upon Mr. Simmons' "Notice of Appeal" and granted him the relief that he presently requests.

Based on the documents available on the bankruptcy court's docket, Mr. Simmons' substantive request is moot because the bankruptcy court already granted him the relief he seeks in his petition to this Court. The relief that Mr. Simmons seeks is found in paragraph one of his petition:

> Simmons submits this Motion for T.R.O./Preliminary Injunction/order to Compel Response that seeks to Compel the Hon. Stephen Raslavich, Chief Judge sitting in the U.S. Bankruptcy Court for the Eastern District of Penn., to Process and respond to Simmons' 'Notice of Appeal', filed with that court [o]n March 11th, 2010.

Dkt. 1 at p. 2, ¶ 1. But the bankruptcy court already did "process and respond to Simmons' 'Notice of Appeal.' " *Id.* The bankruptcy court construed the notice as a motion for reconsideration, reopened Mr. Simmons' bankruptcy case, and granted him more time to file the required documents — even enclosing instructions for how to fill out and submit the creditor matrix form required by local rule. *Simmons Bankruptcy* Dkt. 13 (attached hereto as Exhibit E). Although Mr. Simmons asks this Court to order the bankruptcy court to act upon his "notice of appeal," no further relief can be had when the only requested relief — that the bankruptcy court "process and respond to Simmons' 'Notice of Appeal' " — was granted already. Accordingly, Mr. Simmons' petition is moot and should be dismissed. *See, e.g., In re Huertas,* 322 F. App'x 174, 175, 2009 WL 1028044, *1 (3d Cir. April 17, 2009) (holding that a writ of mandamus seeking to compel the district court to rule upon certain motions was moot because the district court had ruled upon said motions); *In re Shemonsky,* 239 F. App'x 770, 771, 2007 WL 2510705, *1 (3d Cir. Sept. 6, 2007) (dismissing as moot appeals from the denial of motions to proceed *in forma pauperis* because the circuit court granted IFP status and therefore the appellant "has now been granted the relief he sought").

B. Alternatively, Mr. Simmons' pleading is properly construed as a mandamus petition, and mandamus relief cannot lie where appellate relief is available or could have been pursued.

Mr. Simmons' filing in this Court seeks an order compelling the bankruptcy court to take action on a particular pleading. The United States suggests that Mr. Simmons' petition is properly construed as a mandamus petition. *See, e.g., In re Simon,* 342 F. App'x 816, 817, 2009 WL 2526162, *1 (3d Cir. Aug. 13, 2009) (construing a pro se prisoner's letter complaining of "delay in the judicial system" as a petition for a writ of mandamus under 28 U.S.C. § 1651). The relief requested by Mr. Simmons — a request for a directive that a lower court rule on a motion or pleading — traditionally falls within the realm of mandamus. *See generally In re Huertas*, 322 F. App'x 174, 174, 2009 WL 1028044, *1 (3d Cir. April 17, 2009) (petition for a writ of mandamus seeking to compel the United States District Court for the District of New Jersey to decide several motions); *In re Porter,* 193 F. App'x 166, 167, 2006 WL 2560746, *1 (3d Cir. Sept. 6, 2006) (a mandamus petition seeking to compel the United States District Court for the Western District of Pennsylvania to direct the assigned magistrate judge to rule on a motion). Accordingly, by all appearances, Mr. Simmons' "Motion for Temporary Restraining Order or in the Alternative a Preliminary Injunction / Order to Compel Response to Notice of Appeal from a Judgment of U.S. Bankruptcy Court" is properly construed as a mandamus petition.

To the extent that Mr. Simmons' pleading is construed as a mandamus petition, it should be denied because mandamus relief is not available where appellate relief could have been pursued. As discussed above, the bankruptcy court acted upon Mr. Simmons' "Notice of Appeal" filing and reopened the bankruptcy case — giving Mr. Simmons another chance to file the required forms to enable the court to process his case. When Mr. Simmons persisted in not filing the required forms — despite the bankruptcy court's inclusion of an instruction sheet on how to correctly file — the bankruptcy court dismissed his case again. *Simmons Bankruptcy* Dkt. 15 (attached hereto as Exhibit F).

If, by his current petition, Mr. Simmons seeks more than just a ruling on his self-styled "Notice of Appeal," but instead reversal of the bankruptcy court's order of dismissal, reinstatement of his bankruptcy case, permission to forego filing the required forms, or some other remedy, relief is unavailable to him. Mr. Simmons could have perfected a timely appeal from the second order of dismissal, but he did not. Mandamus relief does not lie where appellate relief is available. *In re Chambers Development Co., Inc.*, 148 F.3d 214, 223 (3d Cir. 1998) ("Given its drastic nature, a writ of mandamus should not be issued where relief may be obtained through an ordinary appeal."). Nor can mandamus be a substitute for a properly perfected appeal or a cure for a missed appeal deadline. *In re Riviere*, 249 F. App'x 272, 274, 2007 WL 2859986, 1 (3d Cir. 2007) ("Any claim that the District Court misconstrued his motions should have been raised in an otherwise proper and timely appeal to this Court and not in a mandamus petition."). An order of dismissal is a final, appealable order under 28 U.S.C. § 158(a)(1). *See, e.g., Cadle Co. v. Zofko*, 380 B.R. 375, 377 (W.D. Pa. 2007) (concluding that a bankruptcy court's order dismissing a complaint in a chapter 7 bankruptcy case was final and appealable under 28 U.S.C. § 158(a)(1)). Because Mr. Simmons could have sought to appeal the second order of dismissal in his bankruptcy case, but did not, he cannot utilize mandamus as an end-run, and his petition can be denied on this ground.

CONCLUSION

For all of the foregoing reasons, the United States, as *amicus curiae*, respectfully suggests that dismissal is the appropriate resolution of this case.

Dated: September 10, 2010

Respectfully submitted,

/s/ Frederic J. Baker

ROBERTA A. DEANGELIS
United States Trustee for Region 3

FREDERIC J. BAKER
Assistant United States Trustee
United States Department of Justice
Office of the United States Trustee
833 Chestnut Street, Suite 500
Philadelphia, PA 19107
Phone: 215-597-4411
Fax: 215-597-5795
frederic.j.baker@usdoj.gov
Attorney for Amicus Curiae the United States

CERTIFICATE OF SERVICE

I hereby certify that on this 10th day of September, 2010, I served the foregoing Brief for the United States as Amicus Curiae in Support of Defendant by first-class mail, postage prepaid on the following:

Robert E. Simmons
3003 N. Water Street
Philadelphia, PA 19134

Robert E. Simmons
P.O. Box 256
Waymart, PA 18472-0256

Hon. Chief Bankruptcy Judge Stephen Raslavich
Robert N.C. Nix Sr. Federal Courthouse
900 Market Street, Suite 204
Philadelphia, PA 19107

/s/ Frederic J. Baker

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA
PHILADELPHIA DIVISION

ROBERT E. SIMMONS	)	
	)	
Plaintiff,	)	
	)	
v.	)	Case No. 2:10-mc-00102-RBS
	)	
THE HON. STEPHEN RASLAVICH,	)	
	)	
Defendant.	)	
	)	

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE IN SUPPORT OF DEFENDANT

EXHIBIT A

B 1 (Official Form 1) (1/08)

United States Bankruptcy Court EASTERN DISTRICT, Phila, PA,	**Voluntary Petition**
Name of Debtor (if individual, enter Last, First, Middle): Simmons, Robert E.	Name of Joint Debtor (Spouse) (Last, First, Middle):
All Other Names used by the Debtor in the last 8 years (include married, maiden, and trade names): na	All Other Names used by the Joint Debtor in the last 8 years (include married, maiden, and trade names):
Last four digits of Soc. Sec. or Indvidual-Taxpayer I.D. (ITIN) No./Complete EIN (if more than one, state all): 7316	Last four digits of Soc. Sec. or Indvidual-Taxpayer I.D. (ITIN) No./Complete EIN (if more than one, state all):
Street Address of Debtor (No. and Street, City, and State): 3003 N. Water Street Phila., PA. 19134 ZIP CODE 19134	Street Address of Joint Debtor (No. and Street, City, and State): ZIP CODE
County of Residence or of the Principal Place of Business: Philadelphia	County of Residence or of the Principal Place of Business:
Mailing Address of Debtor (if different from street address): P.O. Box 256 Waymart, PA. 18472-0256 ZIP CODE 18472	Mailing Address of Joint Debtor (if different from street address): ZIP CODE

Location of Principal Assets of Business Debtor (if different from street address above):

ZIP CODE

Type of Debtor (Form of Organization) (Check **one** box.)	**Nature of Business** (Check **one** box.)	**Chapter of Bankruptcy Code Under Which the Petition is Filed** (Check **one** box.)
☒ Individual (includes Joint Debtors) *See Exhibit D on page 2 of this form.* ☐ Corporation (includes LLC and LLP) ☐ Partnership ☐ Other (If debtor is not one of the above entities, check this box and state type of entity below.) ________________	☐ Health Care Business ☐ Single Asset Real Estate as defined in 11 U.S.C. § 101(51B) ☐ Railroad ☐ Stockbroker ☐ Commodity Broker ☐ Clearing Bank ☐ Other **Tax-Exempt Entity** (Check box, if applicable.) ☐ Debtor is a tax-exempt organization under Title 26 of the United States Code (the Internal Revenue Code).	☒ Chapter 7 ☐ Chapter 9 ☐ Chapter 11 ☐ Chapter 12 ☐ Chapter 13 ☐ Chapter 15 Petition for Recognition of a Foreign Main Proceeding ☐ Chapter 15 Petition for Recognition of a Foreign Nonmain Proceeding **Nature of Debts** (Check one box.) ☒ Debts are primarily consumer debts, defined in 11 U.S.C. § 101(8) as "incurred by an individual primarily for a personal, family, or household purpose." ☐ Debts are primarily business debts.

Filing Fee (Check one box.)	**Chapter 11 Debtors**
☐ Full Filing Fee attached. ☐ Filing Fee to be paid in installments (applicable to individuals only). Must attach signed application for the court's consideration certifying that the debtor is unable to pay fee except in installments. Rule 1006(b). See Official Form 3A. ☒ Filing Fee waiver requested (applicable to chapter 7 individuals only). Must attach signed application for the court's consideration. See Official Form 3B.	**Check one box:** ☐ Debtor is a small business debtor as defined in 11 U.S.C. § 101(51D). ☐ Debtor is not a small business debtor as defined in 11 U.S.C. § 101(51D). **Check if:** ☐ Debtor's aggregate noncontingent liquidated debts (excluding debts owed to insiders or affiliates) are less than $2,190,000. - **Check all applicable boxes:** ☐ A plan is being filed with this petition. ☐ Acceptances of the plan were solicited prepetition from one or more classes of creditors, in accordance with 11 U.S.C. § 1126(b).

Statistical/Administrative Information

☐ Debtor estimates that funds will be available for distribution to unsecured creditors.
☒ Debtor estimates that, after any exempt property is excluded and administrative expenses paid, there will be no funds available for distribution to unsecured creditors.

Estimated Number of Creditors

☒ 1-49	☐ 50-99	☐ 100-199	☐ 200-999	☐ 1,000-5,000	☐ 5,001-10,000	☐ 10,001-25,000	☐ 25,001-50,000	☐ 50,001-100,000	☐ Over 100,000

Estimated Assets

☒ $0 to $50,000	☐ $50,001 to $100,000	☐ $100,001 to $500,000	☐ $500,001 to $1 million	☐ $1,000,001 to $10 million	☐ $10,000,001 to $50 million	☐ $50,000,001 to $100 million	☐ $100,000,001 to $500 million	☐ $500,000,001 to $1 billion	☐ More than $1 billion

Estimated Liabilities

☒ $0 to $50,000	☐ $50,001 to $100,000	☐ $100,001 to $500,000	☐ $500,001 to $1 million	☐ $1,000,001 to $10 million	☐ $10,000,001 to $50 million	☐ $50,000,001 to $100 million	☐ $100,000,001 to $500 million	☐ $500,000,001 to $1 billion	☐ More than $1 billion

THIS SPACE IS FOR COURT USE ONLY

U.S. BANKRUPTCY COURT
2010 FEB -9 AM 9:35

B 1 (Official Form 1) (1/08) Page 2

Voluntary Petition *(This page must be completed and filed in every case.)*	Name of Debtor(s): Robert E. Simmons	
All Prior Bankruptcy Cases Filed Within Last 8 Years (If more than two, attach additional sheet.)		
Location Where Filed:	Case Number:	Date Filed:
Location Where Filed:	Case Number:	Date Filed:
Pending Bankruptcy Case Filed by any Spouse, Partner, or Affiliate of this Debtor (If more than one, attach additional sheet.)		
Name of Debtor:	Case Number:	Date Filed:
District:	Relationship:	Judge:

Exhibit A (To be completed if debtor is required to file periodic reports (e.g., forms 10K and 10Q) with the Securities and Exchange Commission pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 and is requesting relief under chapter 11.) ☐ Exhibit A is attached and made a part of this petition.	**Exhibit B** (To be completed if debtor is an individual whose debts are primarily consumer debts.) I, the attorney for the petitioner named in the foregoing petition, declare that I have informed the petitioner that [he or she] may proceed under chapter 7, 11, 12, or 13 of title 11, United States Code, and have explained the relief available under each such chapter. I further certify that I have delivered to the debtor the notice required by 11 U.S.C. § 342(b). X ____________________ Signature of Attorney for Debtor(s) (Date)

Exhibit C

Does the debtor own or have possession of any property that poses or is alleged to pose a threat of imminent and identifiable harm to public health or safety?

☐ Yes, and Exhibit C is attached and made a part of this petition.

☒ No.

Exhibit D

(To be completed by every individual debtor. If a joint petition is filed, each spouse must complete and attach a separate Exhibit D.)

☐ Exhibit D completed and signed by the debtor is attached and made a part of this petition.

If this is a joint petition:

☐ Exhibit D also completed and signed by the joint debtor is attached and made a part of this petition.

Information Regarding the Debtor - Venue
(Check any applicable box.)

☒ Debtor has been domiciled or has had a residence, principal place of business, or principal assets in this District for 180 days immediately preceding the date of this petition or for a longer part of such 180 days than in any other District.

☐ There is a bankruptcy case concerning debtor's affiliate, general partner, or partnership pending in this District.

☐ Debtor is a debtor in a foreign proceeding and has its principal place of business or principal assets in the United States in this District, or has no principal place of business or assets in the United States but is a defendant in an action or proceeding [in a federal or state court] in this District, or the interests of the parties will be served in regard to the relief sought in this District.

Certification by a Debtor Who Resides as a Tenant of Residential Property
(Check all applicable boxes.)

☐ Landlord has a judgment against the debtor for possession of debtor's residence. (If box checked, complete the following.)

____
(Name of landlord that obtained judgment)

____
(Address of landlord)

☐ Debtor claims that under applicable nonbankruptcy law, there are circumstances under which the debtor would be permitted to cure the entire monetary default that gave rise to the judgment for possession, after the judgment for possession was entered, and

☐ Debtor has included with this petition the deposit with the court of any rent that would become due during the 30-day period after the filing of the petition.

☐ Debtor certifies that he/she has served the Landlord with this certification. (11 U.S.C. § 362(l)).

B 1 (Official Form) 1 (1/08) **Page 3**

Voluntary Petition
(This page must be completed and filed in every case.)

Name of Debtor(s):
Robert E. Simmons

Signatures

Signature(s) of Debtor(s) (Individual/Joint)

I declare under penalty of perjury that the information provided in this petition is true and correct.
[If petitioner is an individual whose debts are primarily consumer debts and has chosen to file under chapter 7] I am aware that I may proceed under chapter 7, 11, 12 or 13 of title 11, United States Code, understand the relief available under each such chapter, and choose to proceed under chapter 7.
[If no attorney represents me and no bankruptcy petition preparer signs the petition] I have obtained and read the notice required by 11 U.S.C. § 342(b).

I request relief in accordance with the chapter of title 11, United States Code, specified in this petition.

X Robert E. Simmons
Signature of Debtor

X ______________________
Signature of Joint Debtor

Telephone Number (if not represented by attorney) n/a

Date 2/8/10

Signature of Attorney*

X ______________________
Signature of Attorney for Debtor(s)

Printed Name of Attorney for Debtor(s)

Firm Name

Address

Telephone Number

Date

*In a case in which § 707(b)(4)(D) applies, this signature also constitutes a certification that the attorney has no knowledge after an inquiry that the information in the schedules is incorrect.

Signature of Debtor (Corporation/Partnership)

I declare under penalty of perjury that the information provided in this petition is true and correct, and that I have been authorized to file this petition on behalf of the debtor.

The debtor requests the relief in accordance with the chapter of title 11, United States Code, specified in this petition.

X ______________________
Signature of Authorized Individual

Printed Name of Authorized Individual

Title of Authorized Individual

Date

Signature of a Foreign Representative

I declare under penalty of perjury that the information provided in this petition is true and correct, that I am the foreign representative of a debtor in a foreign proceeding, and that I am authorized to file this petition.

(Check only **one** box.)

☐ I request relief in accordance with chapter 15 of title 11, United States Code. Certified copies of the documents required by 11 U.S.C. § 1515 are attached.

☐ Pursuant to 11 U.S.C. § 1511, I request relief in accordance with the chapter of title 11 specified in this petition. A certified copy of the order granting recognition of the foreign main proceeding is attached.

X ______________________
(Signature of Foreign Representative)

(Printed Name of Foreign Representative)

Date

Signature of Non-Attorney Bankruptcy Petition Preparer

I declare under penalty of perjury that: (1) I am a bankruptcy petition preparer as defined in 11 U.S.C. § 110; (2) I prepared this document for compensation and have provided the debtor with a copy of this document and the notices and information required under 11 U.S.C. §§ 110(b), 110(h), and 342(b); and, (3) if rules or guidelines have been promulgated pursuant to 11 U.S.C. § 110(h) setting a maximum fee for services chargeable by bankruptcy petition preparers, I have given the debtor notice of the maximum amount before preparing any document for filing for a debtor or accepting any fee from the debtor, as required in that section. Official Form 19 is attached.

Printed Name and title, if any, of Bankruptcy Petition Preparer

Social-Security number (If the bankruptcy petition preparer is not an individual, state the Social-Security number of the officer, principal, responsible person or partner of the bankruptcy petition preparer.) (Required by 11 U.S.C. § 110.)

Address

X ______________________

Date

Signature of bankruptcy petition preparer or officer, principal, responsible person, or partner whose Social-Security number is provided above.

Names and Social-Security numbers of all other individuals who prepared or assisted in preparing this document unless the bankruptcy petition preparer is not an individual.

If more than one person prepared this document, attach additional sheets conforming to the appropriate official form for each person.

A bankruptcy petition preparer's failure to comply with the provisions of title 11 and the Federal Rules of Bankruptcy Procedure may result in fines or imprisonment or both. 11 U.S.C. § 110; 18 U.S.C. § 156.

Wed. Feb. 3rd. MMX

U.S. Bankruptcy Court/Eastern Distern
Clerk of Court
Robert N.C. Nix Bldg., Suite 400
900 Market Street
Phila., PA. 19107

Robert E. Simmons
#HH7348
P.O. Box 256
Waymart, PA. 18472-0256

RE: Additional Information.

Dear Sir/Ms.

This Petition is being filed by an Inmate currently housed in a State Prison here in Waymart, PA. I have been incarcerated since Dec., 2007.

This Petition was filled out without the benifit or access to any sources that would aid me in this process. This Petition is being submitted Pro Se and I do not have any financial papers with me or any means to get them. I have estimated what my house value is and the current amount of the debt(s).

I have no other assets other than my home that I am attempting to save. I have a prison job and make $42.00 a month. I have no other sources of income nor do I have access to any money, period. I am married but my wife and I are not together. She has no interest in the property.

Thank you for your understanding and consideration.

Sincerely, Robert E. Simmons
Robert E. Simmons #HH7348
S.C.I. Waymart, PA. 18472

B6 Summary (Official Form 6 - Summary) (12/07)

United States Bankruptcy Court

EASTERN District Of PENNSYLVANIA

In re Robert E. Simmons,
Debtor

Case No. ____

Chapter 7

SUMMARY OF SCHEDULES

Indicate as to each schedule whether that schedule is attached and state the number of pages in each. Report the totals from Schedules A, B, D, E, F, I, and J in the boxes provided. Add the amounts from Schedules A and B to determine the total amount of the debtor's assets. Add the amounts of all claims from Schedules D, E, and F to determine the total amount of the debtor's liabilities. Individual debtors also must complete the "Statistical Summary of Certain Liabilities and Related Data" if they file a case under chapter 7, 11, or 13.

NAME OF SCHEDULE	ATTACHED (YES/NO)	NO. OF SHEETS	ASSETS	LIABILITIES	OTHER
A - Real Property	Yes	1	$ 25,000.00		
B - Personal Property	Yes	3	$ 70.00		
C - Property Claimed as Exempt	yes	1			
D - Creditors Holding Secured Claims	Yes	1		$ 21,000.00	
E - Creditors Holding Unsecured Priority Claims (Total of Claims on Schedule E)	yes	1		$	
F - Creditors Holding Unsecured Nonpriority Claims	yes	1		$ 3,000.00	
G - Executory Contracts and Unexpired Leases	NO	0			
H - Codebtors	NO	0			
I - Current Income of Individual Debtor(s)					$
J - Current Expenditures of Individual Debtors(s)					$
TOTAL			$25,070.00	$	

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2010 FEB -9 AM 9:35
U.S. BANKRUPTCY COURT

Form 6 - Statistical Summary (12/07)

United States Bankruptcy Court
EASTERN District Of PENNSYLVANIA

In re Robert E. Simmons,
Debtor

Case No. ________

Chapter 7

STATISTICAL SUMMARY OF CERTAIN LIABILITIES AND RELATED DATA (28 U.S.C. § 159)

If you are an individual debtor whose debts are primarily consumer debts, as defined in § 101(8) of the Bankruptcy Code (11 U.S.C. § 101(8)), filing a case under chapter 7, 11 or 13, you must report all information requested below.

☐ Check this box if you are an individual debtor whose debts are NOT primarily consumer debts. You are not required to report any information here.

This information is for statistical purposes only under 28 U.S.C. § 159.

Summarize the following types of liabilities, as reported in the Schedules, and total them.

Type of Liability	Amount
Domestic Support Obligations (from Schedule E)	$ 0.00
Taxes and Certain Other Debts Owed to Governmental Units (from Schedule E)	$ 0.00
Claims for Death or Personal Injury While Debtor Was Intoxicated (from Schedule E) (whether disputed or undisputed)	$ 0.00
Student Loan Obligations (from Schedule F)	$ 0.00
Domestic Support, Separation Agreement, and Divorce Decree Obligations Not Reported on Schedule E	$ 0.00
Obligations to Pension or Profit-Sharing, and Other Similar Obligations (from Schedule F)	$ 0.00
TOTAL	$ 0.00

State the following:

Average Income (from Schedule I, Line 16)	$ 42.00
Average Expenses (from Schedule J, Line 18)	$ 42.00
Current Monthly Income (from Form 22A Line 12; **OR**, Form 22B Line 11; **OR**, Form 22C Line 20)	$ 42.00

State the following:

1. Total from Schedule D, "UNSECURED PORTION, IF ANY" column		$ .0
2. Total from Schedule E, "AMOUNT ENTITLED TO PRIORITY" column.	$ .0	
3. Total from Schedule E, "AMOUNT NOT ENTITLED TO PRIORITY, IF ANY" column		$,0
4. Total from Schedule F		$3,000.00
5. Total of non-priority unsecured debt (sum of 1, 3, and 4)		$3,000.00

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U.S. BANKRUPTCY COURT

B6A (Official Form 6A) (12/07)

In re Robert E. Simmons, Case No. ______
Debtor (If known)

SCHEDULE A - REAL PROPERTY

Except as directed below, list all real property in which the debtor has any legal, equitable, or future interest, including all property owned as a co-tenant, community property, or in which the debtor has a life estate. Include any property in which the debtor holds rights and powers exercisable for the debtor's own benefit. If the debtor is married, state whether the husband, wife, both, or the marital community own the property by placing an "H," "W," "J," or "C" in the column labeled "Husband, Wife, Joint, or Community." If the debtor holds no interest in real property, write "None" under "Description and Location of Property."

Do not include interests in executory contracts and unexpired leases on this schedule. List them in Schedule G - Executory Contracts and Unexpired Leases.

If an entity claims to have a lien or hold a secured interest in any property, state the amount of the secured claim. See Schedule D. If no entity claims to hold a secured interest in the property, write "None" in the column labeled "Amount of Secured Claim."

If the debtor is an individual or if a joint petition is filed, state the amount of any exemption claimed in the property only in Schedule C - Property Claimed as Exempt.

DESCRIPTION AND LOCATION OF PROPERTY	NATURE OF DEBTOR'S INTEREST IN PROPERTY	HUSBAND, WIFE, JOINT, OR COMMUNITY	CURRENT VALUE OF DEBTOR'S INTEREST IN PROPERTY, WITHOUT DEDUCTING ANY SECURED CLAIM OR EXEMPTION	AMOUNT OF SECURED CLAIM
2 Bedroom, brick rowhouse 3003 N. Water Street Phila., PA. 19134	Owner/resident		$25,000.00 -?	$21,000.00
		Total➤	$25,000.00	

(Report also on Summary of Schedules.)

B6B (Official Form 6B) (12/07)

In re Robert E. Simmons, Case No. ____________
Debtor (If known)

SCHEDULE B - PERSONAL PROPERTY

Except as directed below, list all personal property of the debtor of whatever kind. If the debtor has no property in one or more of the categories, place an "x" in the appropriate position in the column labeled "None." If additional space is needed in any category, attach a separate sheet properly identified with the case name, case number, and the number of the category. If the debtor is married, state whether the husband, wife, both, or the marital community own the property by placing an "H," "W," "J," or "C" in the column labeled "Husband, Wife, Joint, or Community." If the debtor is an individual or a joint petition is filed, state the amount of any exemptions claimed only in Schedule C - Property Claimed as Exempt.

Do not list interests in executory contracts and unexpired leases on this schedule. List them in Schedule G - Executory Contracts and Unexpired Leases.

If the property is being held for the debtor by someone else, state that person's name and address under "Description and Location of Property." If the property is being held for a minor child, simply state the child's initials and the name and address of the child's parent or guardian, such as "A.B., a minor child, by John Doe, guardian." Do not disclose the child's name. See, 11 U.S.C. §112 and Fed. R. Bankr. P. 1007(m).

TYPE OF PROPERTY	NONE	DESCRIPTION AND LOCATION OF PROPERTY	HUSBAND, WIFE, JOINT, OR COMMUNITY	CURRENT VALUE OF DEBTOR'S INTEREST IN PROPERTY, WITHOUT DEDUCTING ANY SECURED CLAIM OR EXEMPTION
1. Cash on hand.		$70.00		
2. Checking, savings or other financial accounts, certificates of deposit or shares in banks, savings and loan, thrift, building and loan, and homestead associations, or credit unions, brokerage houses, or cooperatives.	X			
3. Security deposits with public utilities, telephone companies, landlords, and others.	X			
④ Household goods and furnishings, including audio, video, and computer equipment.	X	unknown-?		
5. Books; pictures and other art objects; antiques; stamp, coin, record, tape, compact disc, and other collections or collectibles.	X			
6. Wearing apparel.	X			
7. Furs and jewelry.	X			
8. Firearms and sports, photographic, and other hobby equipment.	X			
9. Interests in insurance policies. Name insurance company of each policy and itemize surrender or refund value of each.	X			
10. Annuities. Itemize and name each issuer.	X			
11. Interests in an education IRA as defined in 26 U.S.C. § 530(b)(1) or under a qualified State tuition plan as defined in 26 U.S.C. § 529(b)(1). Give particulars. (File separately the record(s) of any such interest(s). 11 U.S.C. § 521(c).)	X			

B6B (Official Form 6B) (12/07) -- Cont.

In re Robert E. Simmons,
Debtor

Case No. ____________________
(If known)

SCHEDULE B - PERSONAL PROPERTY

(Continuation Sheet)

TYPE OF PROPERTY	NONE	DESCRIPTION AND LOCATION OF PROPERTY	HUSBAND, WIFE, JOINT, OR COMMUNITY	CURRENT VALUE OF DEBTOR'S INTEREST IN PROPERTY, WITHOUT DEDUCTING ANY SECURED CLAIM OR EXEMPTION
12. Interests in IRA, ERISA, Keogh, or other pension or profit sharing plans. Give particulars.	X			
13. Stock and interests in incorporated and unincorporated businesses. Itemize.	X			
14. Interests in partnerships or joint ventures. Itemize.	X			
15. Government and corporate bonds and other negotiable and non-negotiable instruments.	X			
16. Accounts receivable.	X			
17. Alimony, maintenance, support, and property settlements to which the debtor is or may be entitled. Give particulars.	X			
18. Other liquidated debts owed to debtor including tax refunds. Give particulars.	X			
19. Equitable or future interests, life estates, and rights or powers exercisable for the benefit of the debtor other than those listed in Schedule A – Real Property.	X			
20. Contingent and noncontingent interests in estate of a decedent, death benefit plan, life insurance policy, or trust.	X			
21. Other contingent and unliquidated claims of every nature, including tax refunds, counterclaims of the debtor, and rights to setoff claims. Give estimated value of each.	X			

B6B (Official Form 6B) (12/07) -- Cont.

In re Robert E. Simmons, Debtor

Case No. ______________ (If known)

SCHEDULE B - PERSONAL PROPERTY

(Continuation Sheet)

TYPE OF PROPERTY	NONE	DESCRIPTION AND LOCATION OF PROPERTY	HUSBAND, WIFE, JOINT, OR COMMUNITY	CURRENT VALUE OF DEBTOR'S INTEREST IN PROPERTY, WITHOUT DEDUCTING ANY SECURED CLAIM OR EXEMPTION
22. Patents, copyrights, and other intellectual property. Give particulars.	X			
23. Licenses, franchises, and other general intangibles. Give particulars.	X			
24. Customer lists or other compilations containing personally identifiable information (as defined in 11 U.S.C. § 101(41A)) provided to the debtor by individuals in connection with obtaining a product or service from the debtor primarily for personal, family, or household purposes.	X			
25. Automobiles, trucks, trailers, and other vehicles and accessories.	X			
26. Boats, motors, and accessories.	X			
27. Aircraft and accessories.	X			
28. Office equipment, furnishings, and supplies.	X			
29. Machinery, fixtures, equipment, and supplies used in business.	X			
30. Inventory.	X			
31. Animals.	X			
32. Crops - growing or harvested. Give particulars.	X			
33. Farming equipment and implements.	X			
34. Farm supplies, chemicals, and feed.	X			
35. Other personal property of any kind not already listed. Itemize.	X			

__________ continuation sheets attached Total ➤ $

(Include amounts from any continuation sheets attached. Report total also on Summary of Schedules.)

B6C (Official Form 6C) (12/07)

In re Robert E. Simmons,
Debtor

Case No. ____________
(If known)

SCHEDULE C - PROPERTY CLAIMED AS EXEMPT

Debtor claims the exemptions to which debtor is entitled under:
(Check one box)
☒ 11 U.S.C. § 522(b)(2) -?
☐ 11 U.S.C. § 522(b)(3)

☐ Check if debtor claims a homestead exemption that exceeds $136,875.

DESCRIPTION OF PROPERTY	SPECIFY LAW PROVIDING EACH EXEMPTION	VALUE OF CLAIMED EXEMPTION	CURRENT VALUE OF PROPERTY WITHOUT DEDUCTING EXEMPTION
2-Bedroom, Rowhouse 3003 N. Water St. Phila., PA.	unknown *	unknown	$25,000.00-?

*Note: This Petition is being filed by an Inmate Incarcerated in a State Prison, without access to Bankruptcy Codes or Statues and/or Internet service.

B6D (Official Form 6D) (12/07)

In re Robert E. Simmons, Debtor

Case No. ______________ (If known)

SCHEDULE D - CREDITORS HOLDING SECURED CLAIMS

State the name, mailing address, including zip code, and last four digits of any account number of all entities holding claims secured by property of the debtor as of the date of filing of the petition. The complete account number of any account the debtor has with the creditor is useful to the trustee and the creditor and may be provided if the debtor chooses to do so. List creditors holding all types of secured interests such as judgment liens, garnishments, statutory liens, mortgages, deeds of trust, and other security interests.

List creditors in alphabetical order to the extent practicable. If a minor child is the creditor, state the child's initials and the name and address of the child's parent or guardian, such as "A.B., a minor child, by John Doe, guardian." Do not disclose the child's name. See, 11 U.S.C. §112 and Fed. R. Bankr. P. 1007(m). If all secured creditors will not fit on this page, use the continuation sheet provided.

If any entity other than a spouse in a joint case may be jointly liable on a claim, place an "X" in the column labeled "Codebtor," include the entity on the appropriate schedule of creditors, and complete Schedule H – Codebtors. If a joint petition is filed, state whether the husband, wife, both of them, or the marital community may be liable on each claim by placing an "H," "W," "J," or "C" in the column labeled "Husband, Wife, Joint, or Community."

If the claim is contingent, place an "X" in the column labeled "Contingent." If the claim is unliquidated, place an "X" in the column labeled "Unliquidated." If the claim is disputed, place an "X" in the column labeled "Disputed." (You may need to place an "X" in more than one of these three columns.)

Total the columns labeled "Amount of Claim Without Deducting Value of Collateral" and "Unsecured Portion, if Any" in the boxes labeled "Total(s)" on the last sheet of the completed schedule. Report the total from the column labeled "Amount of Claim Without Deducting Value of Collateral" also on the Summary of Schedules and, if the debtor is an individual with primarily consumer debts, report the total from the column labeled "Unsecured Portion, if Any" on the Statistical Summary of Certain Liabilities and Related Data.

☐ Check this box if debtor has no creditors holding secured claims to report on this Schedule D.

CREDITOR'S NAME AND MAILING ADDRESS INCLUDING ZIP CODE AND AN ACCOUNT NUMBER (*See Instructions Above.*)	CODEBTOR	HUSBAND, WIFE, JOINT, OR COMMUNITY	DATE CLAIM WAS INCURRED, NATURE OF LIEN , AND DESCRIPTION AND VALUE OF PROPERTY SUBJECT TO LIEN	CONTINGENT	UNLIQUIDATED	DISPUTED	AMOUNT OF CLAIM WITHOUT DEDUCTING VALUE OF COLLATERAL	UNSECURED PORTION, IF ANY
ACCOUNT NO. 20-0051-028 1278 Citifinancial 4050 Regent Irving, Texas 75063			unknown VALUE $				$21,000.00	
ACCOUNT NO.			VALUE $					
ACCOUNT NO.			VALUE $					
____continuation sheets attached			Subtotal ► (Total of this page)				$ 21,000.00	$
			Total ► (Use only on last page)				$ 21,000.00	$
							(Report also on Summary of Schedules.)	(If applicable, report also on Statistical Summary of Certain Liabilities and Related Data.)

B6E (Official Form 6E) (12/07)

In re Robert E. Simmons, Debtor Case No.________ (if known)

SCHEDULE E - CREDITORS HOLDING UNSECURED PRIORITY CLAIMS

A complete list of claims entitled to priority, listed separately by type of priority, is to be set forth on the sheets provided. Only holders of unsecured claims entitled to priority should be listed in this schedule. In the boxes provided on the attached sheets, state the name, mailing address, including zip code, and last four digits of the account number, if any, of all entities holding priority claims against the debtor or the property of the debtor, as of the date of the filing of the petition. Use a separate continuation sheet for each type of priority and label each with the type of priority.

The complete account number of any account the debtor has with the creditor is useful to the trustee and the creditor and may be provided if the debtor chooses to do so. If a minor child is a creditor, state the child's initials and the name and address of the child's parent or guardian, such as "A.B., a minor child, by John Doe, guardian." Do not disclose the child's name. See, 11 U.S.C. §112 and Fed. R. Bankr. P. 1007(m).

If any entity other than a spouse in a joint case may be jointly liable on a claim, place an "X" in the column labeled "Codebtor," include the entity on the appropriate schedule of creditors, and complete Schedule H-Codebtors. If a joint petition is filed, state whether the husband, wife, both of them, or the marital community may be liable on each claim by placing an "H," "W," "J," or "C" in the column labeled "Husband, Wife, Joint, or Community." If the claim is contingent, place an "X" in the column labeled "Contingent." If the claim is unliquidated, place an "X" in the column labeled "Unliquidated." If the claim is disputed, place an "X" in the column labeled "Disputed." (You may need to place an "X" in more than one of these three columns.)

Report the total of claims listed on each sheet in the box labeled "Subtotals" on each sheet. Report the total of all claims listed on this Schedule E in the box labeled “Total” on the last sheet of the completed schedule. Report this total also on the Summary of Schedules.

Report the total of amounts entitled to priority listed on each sheet in the box labeled "Subtotals" on each sheet. Report the total of all amounts entitled to priority listed on this Schedule E in the box labeled “Totals” on the last sheet of the completed schedule. Individual debtors with primarily consumer debts report this total also on the Statistical Summary of Certain Liabilities and Related Data.

Report the total of amounts not entitled to priority listed on each sheet in the box labeled “Subtotals” on each sheet. Report the total of all amounts not entitled to priority listed on this Schedule E in the box labeled “Totals” on the last sheet of the completed schedule. Individual debtors with primarily consumer debts report this total also on the Statistical Summary of Certain Liabilities and Related Data.

☒ Check this box if debtor has no creditors holding unsecured priority claims to report on this Schedule E.

TYPES OF PRIORITY CLAIMS (Check the appropriate box(es) below if claims in that category are listed on the attached sheets.)

☐ **Domestic Support Obligations**

Claims for domestic support that are owed to or recoverable by a spouse, former spouse, or child of the debtor, or the parent, legal guardian, or responsible relative of such a child, or a governmental unit to whom such a domestic support claim has been assigned to the extent provided in 11 U.S.C. § 507(a)(1).

☐ **Extensions of credit in an involuntary case**

Claims arising in the ordinary course of the debtor's business or financial affairs after the commencement of the case but before the earlier of the appointment of a trustee or the order for relief. 11 U.S.C. § 507(a)(3).

☐ **Wages, salaries, and commissions**

Wages, salaries, and commissions, including vacation, severance, and sick leave pay owing to employees and commissions owing to qualifying independent sales representatives up to $10,950* per person earned within 180 days immediately preceding the filing of the original petition, or the cessation of business, whichever occurred first, to the extent provided in 11 U.S.C. § 507(a)(4).

☐ **Contributions to employee benefit plans**

Money owed to employee benefit plans for services rendered within 180 days immediately preceding the filing of the original petition, or the cessation of business, whichever occurred first, to the extent provided in 11 U.S.C. § 507(a)(5).

B6F (Official Form 6F) (12/07)

In re Robert E. Simmons, Case No. ______________
Debtor (if known)

SCHEDULE F - CREDITORS HOLDING UNSECURED NONPRIORITY CLAIMS

State the name, mailing address, including zip code, and last four digits of any account number, of all entities holding unsecured claims without priority against the debtor or the property of the debtor, as of the date of filing of the petition. The complete account number of any account the debtor has with the creditor is useful to the trustee and the creditor and may be provided if the debtor chooses to do so. If a minor child is a creditor, state the child's initials and the name and address of the child's parent or guardian, such as "A.B., a minor child, by John Doe, guardian." Do not disclose the child's name. See, 11 U.S.C. §112 and Fed. R. Bankr. P. 1007(m). Do not include claims listed in Schedules D and E. If all creditors will not fit on this page, use the continuation sheet provided.

If any entity other than a spouse in a joint case may be jointly liable on a claim, place an "X" in the column labeled "Codebtor," include the entity on the appropriate schedule of creditors, and complete Schedule H - Codebtors. If a joint petition is filed, state whether the husband, wife, both of them, or the marital community may be liable on each claim by placing an "H," "W," "J," or "C" in the column labeled "Husband, Wife, Joint, or Community."

If the claim is contingent, place an "X" in the column labeled "Contingent." If the claim is unliquidated, place an "X" in the column labeled "Unliquidated." If the claim is disputed, place an "X" in the column labeled "Disputed." (You may need to place an "X" in more than one of these three columns.)

Report the total of all claims listed on this schedule in the box labeled "Total" on the last sheet of the completed schedule. Report this total also on the Summary of Schedules and, if the debtor is an individual with primarily consumer debts, report this total also on the Statistical Summary of Certain Liabilities and Related Data..

☐ Check this box if debtor has no creditors holding unsecured claims to report on this Schedule F.

CREDITOR'S NAME, MAILING ADDRESS INCLUDING ZIP CODE, AND ACCOUNT NUMBER *(See instructions above.)*	CODEBTOR	HUSBAND, WIFE, JOINT, OR COMMUNITY	DATE CLAIM WAS INCURRED AND CONSIDERATION FOR CLAIM. IF CLAIM IS SUBJECT TO SETOFF, SO STATE.	CONTINGENT	UNLIQUIDATED	DISPUTED	AMOUNT OF CLAIM
ACCOUNT NO. unknown Citifinancial Services Inc. 11000 Roosvelt Blvd. Phila., PA. 19116-3961			unknown				$3,000.00-?
ACCOUNT NO.							
ACCOUNT NO.							
ACCOUNT NO.							

Subtotal➤	$ 3,000.00
Total➤ (Use only on last page of the completed Schedule F.) (Report also on Summary of Schedules and, if applicable, on the Statistical Summary of Certain Liabilities and Related Data.)	$ 3,000.00

_____continuation sheets attached

B7 (Official Form 7) (12/07)

UNITED STATES BANKRUPTCY COURT

EASTERN DISTRICT OF PENNSYLVANIA

In re: Robert E. Simmons, Debtor Case No. ______ (if known)

STATEMENT OF FINANCIAL AFFAIRS

This statement is to be completed by every debtor. Spouses filing a joint petition may file a single statement on which the information for both spouses is combined. If the case is filed under chapter 12 or chapter 13, a married debtor must furnish information for both spouses whether or not a joint petition is filed, unless the spouses are separated and a joint petition is not filed. An individual debtor engaged in business as a sole proprietor, partner, family farmer, or self-employed professional, should provide the information requested on this statement concerning all such activities as well as the individual's personal affairs. To indicate payments, transfers and the like to minor children, state the child's initials and the name and address of the child's parent or guardian, such as "A.B., a minor child, by John Doe, guardian." Do not disclose the child's name. See, 11 U.S.C. §112 and Fed. R. Bankr. P. 1007(m).

Questions 1 - 18 are to be completed by all debtors. Debtors that are or have been in business, as defined below, also must complete Questions 19 - 25. **If the answer to an applicable question is "None," mark the box labeled "None."** If additional space is needed for the answer to any question, use and attach a separate sheet properly identified with the case name, case number (if known), and the number of the question.

DEFINITIONS

"In business." A debtor is "in business" for the purpose of this form if the debtor is a corporation or partnership. An individual debtor is "in business" for the purpose of this form if the debtor is or has been, within six years immediately preceding the filing of this bankruptcy case, any of the following: an officer, director, managing executive, or owner of 5 percent or more of the voting or equity securities of a corporation; a partner, other than a limited partner, of a partnership; a sole proprietor or self-employed full-time or part-time. An individual debtor also may be "in business" for the purpose of this form if the debtor engages in a trade, business, or other activity, other than as an employee, to supplement income from the debtor's primary employment.

"Insider." The term "insider" includes but is not limited to: relatives of the debtor; general partners of the debtor and their relatives; corporations of which the debtor is an officer, director, or person in control; officers, directors, and any owner of 5 percent or more of the voting or equity securities of a corporate debtor and their relatives; affiliates of the debtor and insiders of such affiliates; any managing agent of the debtor. 11 U.S.C. § 101.

---

1. Income from employment or operation of business

None ☒

State the gross amount of income the debtor has received from employment, trade, or profession, or from operation of the debtor's business, including part-time activities either as an employee or in independent trade or business, from the beginning of this calendar year to the date this case was commenced. State also the gross amounts received during the **two years** immediately preceding this calendar year. (A debtor that maintains, or has maintained, financial records on the basis of a fiscal rather than a calendar year may report fiscal year income. Identify the beginning and ending dates of the debtor's fiscal year.) If a joint petition is filed, state income for each spouse separately. (Married debtors filing under chapter 12 or chapter 13 must state income of both spouses whether or not a joint petition is filed, unless the spouses are separated and a joint petition is not filed.)

AMOUNT	SOURCE

2. Income other than from employment or operation of business

None
☒

State the amount of income received by the debtor other than from employment, trade, profession, operation of the debtor's business during the **two years** immediately preceding the commencement of this case. Give particulars. If a joint petition is filed, state income for each spouse separately. (Married debtors filing under chapter 12 or chapter 13 must state income for each spouse whether or not a joint petition is filed, unless the spouses are separated and a joint petition is not filed.)

AMOUNT	SOURCE

---

3. Payments to creditors

Complete a. or b., as appropriate, and c.

None
☒

a. *Individual or joint debtor(s) with primarily consumer debts:* List all payments on loans, installment purchases of goods or services, and other debts to any creditor made within **90 days** immediately preceding the commencement of this case unless the aggregate value of all property that constitutes or is affected by such transfer is less than $600. Indicate with an asterisk (*) any payments that were made to a creditor on account of a domestic support obligation or as part of an alternative repayment schedule under a plan by an approved nonprofit budgeting and credit counseling agency. (Married debtors filing under chapter 12 or chapter 13 must include payments by either or both spouses whether or not a joint petition is filed, unless the spouses are separated and a joint petition is not filed.)

NAME AND ADDRESS OF CREDITOR	DATES OF PAYMENTS	AMOUNT PAID	AMOUNT STILL OWING

None
☒

b. *Debtor whose debts are not primarily consumer debts:* List each payment or other transfer to any creditor made within **90 days** immediately preceding the commencement of the case unless the aggregate value of all property that constitutes or is affected by such transfer is less than $5,475. If the debtor is an individual, indicate with an asterisk (*) any payments that were made to a creditor on account of a domestic support obligation or as part of an alternative repayment schedule under a plan by an approved nonprofit budgeting and credit counseling agency. (Married debtors filing under chapter 12 or chapter 13 must include payments and other transfers by either or both spouses whether or not a joint petition is filed, unless the spouses are separated and a joint petition is not filed.)

NAME AND ADDRESS OF CREDITOR	DATES OF PAYMENTS/ TRANSFERS	AMOUNT PAID OR VALUE OF TRANSFERS	AMOUNT STILL OWING

None
☒ c. *All debtors:* List all payments made within **one year** immediately preceding the commencement of this case to or for the benefit of creditors who are or were insiders. (Married debtors filing under chapter 12 or chapter 13 must include payments by either or both spouses whether or not a joint petition is filed, unless the spouses are separated and a joint petition is not filed.)

NAME AND ADDRESS OF CREDITOR AND RELATIONSHIP TO DEBTOR	DATE OF PAYMENT	AMOUNT PAID	AMOUNT STILL OWING

---

4. Suits and administrative proceedings, executions, garnishments and attachments

None
☒ a. List all suits and administrative proceedings to which the debtor is or was a party within **one year** immediately preceding the filing of this bankruptcy case. (Married debtors filing under chapter 12 or chapter 13 must include information concerning either or both spouses whether or not a joint petition is filed, unless the spouses are separated and a joint petition is not filed.)

CAPTION OF SUIT AND CASE NUMBER	NATURE OF PROCEEDING	COURT OR AGENCY AND LOCATION	STATUS OR DISPOSITION

None
☒ b. Describe all property that has been attached, garnished or seized under any legal or equitable process within **one year** immediately preceding the commencement of this case. (Married debtors filing under chapter 12 or chapter 13 must include information concerning property of either or both spouses whether or not a joint petition is filed, unless the spouses are separated and a joint petition is not filed.)

NAME AND ADDRESS OF PERSON FOR WHOSE BENEFIT PROPERTY WAS SEIZED	DATE OF SEIZURE	DESCRIPTION AND VALUE OF PROPERTY

---

5. Repossessions, foreclosures and returns

None
☐ -? List all property that has been repossessed by a creditor, sold at a foreclosure sale, transferred through a deed in lieu of foreclosure or returned to the seller, within **one year** immediately preceding the commencement of this case. (Married debtors filing under chapter 12 or chapter 13 must include information concerning property of either or both spouses whether or not a joint petition is filed, unless the spouses are separated and a joint petition is not filed.)

NAME AND ADDRESS OF CREDITOR OR SELLER	DATE OF REPOSSESSION, FORECLOSURE SALE, TRANSFER OR RETURN	DESCRIPTION AND VALUE OF PROPERTY

6. Assignments and receiverships

None ☒

a. Describe any assignment of property for the benefit of creditors made within **120 days** immediately preceding the commencement of this case. (Married debtors filing under chapter 12 or chapter 13 must include any assignment by either or both spouses whether or not a joint petition is filed, unless the spouses are separated and a joint petition is not filed.)

NAME AND ADDRESS OF ASSIGNEE	DATE OF ASSIGNMENT	TERMS OF ASSIGNMENT OR SETTLEMENT

None ☒

b. List all property which has been in the hands of a custodian, receiver, or court-appointed official within **one year** immediately preceding the commencement of this case. (Married debtors filing under chapter 12 or chapter 13 must include information concerning property of either or both spouses whether or not a joint petition is filed, unless the spouses are separated and a joint petition is not filed.)

NAME AND ADDRESS OF CUSTODIAN	NAME AND LOCATION OF COURT CASE TITLE & NUMBER	DATE OF ORDER	DESCRIPTION AND VALUE Of PROPERTY

7. Gifts

None ☒

List all gifts or charitable contributions made within **one year** immediately preceding the commencement of this case except ordinary and usual gifts to family members aggregating less than $200 in value per individual family member and charitable contributions aggregating less than $100 per recipient. (Married debtors filing under chapter 12 or chapter 13 must include gifts or contributions by either or both spouses whether or not a joint petition is filed, unless the spouses are separated and a joint petition is not filed.)

NAME AND ADDRESS OF PERSON OR ORGANIZATION	RELATIONSHIP TO DEBTOR, IF ANY	DATE OF GIFT	DESCRIPTION AND VALUE OF GIFT

8. Losses

None ☒

List all losses from fire, theft, other casualty or gambling within **one year** immediately preceding the commencement of this case **or since the commencement of this case**. (Married debtors filing under chapter 12 or chapter 13 must include losses by either or both spouses whether or not a joint petition is filed, unless the spouses are separated and a joint petition is not filed.)

DESCRIPTION AND VALUE OF PROPERTY	DESCRIPTION OF CIRCUMSTANCES AND, IF LOSS WAS COVERED IN WHOLE OR IN PART BY INSURANCE, GIVE PARTICULARS	DATE OF LOSS

9. Payments related to debt counseling or bankruptcy

None ☒

List all payments made or property transferred by or on behalf of the debtor to any persons, including attorneys, for consultation concerning debt consolidation, relief under the bankruptcy law or preparation of a petition in bankruptcy within **one year** immediately preceding the commencement of this case.

NAME AND ADDRESS OF PAYEE	DATE OF PAYMENT, NAME OF PAYER IF OTHER THAN DEBTOR	AMOUNT OF MONEY OR DESCRIPTION AND VALUE OF PROPERTY

---

10. Other transfers

None ☒

a. List all other property, other than property transferred in the ordinary course of the business or financial affairs of the debtor, transferred either absolutely or as security within **two years** immediately preceding the commencement of this case. (Married debtors filing under chapter 12 or chapter 13 must include transfers by either or both spouses whether or not a joint petition is filed, unless the spouses are separated and a joint petition is not filed.)

NAME AND ADDRESS OF TRANSFEREE, RELATIONSHIP TO DEBTOR	DATE	DESCRIBE PROPERTY TRANSFERRED AND VALUE RECEIVED

None ☒

b. List all property transferred by the debtor within **ten years** immediately preceding the commencement of this case to a self-settled trust or similar device of which the debtor is a beneficiary.

NAME OF TRUST OR OTHER DEVICE	DATE(S) OF TRANSFER(S)	AMOUNT OF MONEY OR DESCRIPTION AND VALUE OF PROPERTY OR DEBTOR'S INTEREST IN PROPERTY

---

11. Closed financial accounts

None ☒

List all financial accounts and instruments held in the name of the debtor or for the benefit of the debtor which were closed, sold, or otherwise transferred within **one year** immediately preceding the commencement of this case. Include checking, savings, or other financial accounts, certificates of deposit, or other instruments; shares and share accounts held in banks, credit unions, pension funds, cooperatives, associations, brokerage houses and other financial institutions. (Married debtors filing under chapter 12 or chapter 13 must include information concerning accounts or instruments held by or for either or both spouses whether or not a joint petition is filed, unless the spouses are separated and a joint petition is not filed.)

NAME AND ADDRESS OF INSTITUTION	TYPE OF ACCOUNT, LAST FOUR DIGITS OF ACCOUNT NUMBER, AND AMOUNT OF FINAL BALANCE	AMOUNT AND DATE OF SALE OR CLOSING

12. Safe deposit boxes

None ☒

List each safe deposit or other box or depository in which the debtor has or had securities, cash, or other valuables within **one year** immediately preceding the commencement of this case. (Married debtors filing under chapter 12 or chapter 13 must include boxes or depositories of either or both spouses whether or not a joint petition is filed, unless the spouses are separated and a joint petition is not filed.)

NAME AND ADDRESS OF BANK OR OTHER DEPOSITORY	NAMES AND ADDRESSES OF THOSE WITH ACCESS TO BOX OR DEPOSITORY	DESCRIPTION OF CONTENTS	DATE OF TRANSFER OR SURRENDER, IF ANY

13. Setoffs

None ☒

List all setoffs made by any creditor, including a bank, against a debt or deposit of the debtor within **90 days** preceding the commencement of this case. (Married debtors filing under chapter 12 or chapter 13 must include information concerning either or both spouses whether or not a joint petition is filed, unless the spouses are separated and a joint petition is not filed.)

NAME AND ADDRESS OF CREDITOR	DATE OF SETOFF	AMOUNT OF SETOFF

14. Property held for another person

None ☒

List all property owned by another person that the debtor holds or controls.

NAME AND ADDRESS OF OWNER	DESCRIPTION AND VALUE OF PROPERTY	LOCATION OF PROPERTY

15. Prior address of debtor

None ☒

If debtor has moved within **three years** immediately preceding the commencement of this case, list all premises which the debtor occupied during that period and vacated prior to the commencement of this case. If a joint petition is filed, report also any separate address of either spouse.

ADDRESS	NAME USED	DATES OF OCCUPANCY

16. Spouses and Former Spouses

None ☒ If the debtor resides or resided in a community property state, commonwealth, or territory (including Alaska, Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Puerto Rico, Texas, Washington, or Wisconsin) within **eight years** immediately preceding the commencement of the case, identify the name of the debtor's spouse and of any former spouse who resides or resided with the debtor in the community property state.

NAME

---

17. Environmental Information.

For the purpose of this question, the following definitions apply:

"Environmental Law" means any federal, state, or local statute or regulation regulating pollution, contamination, releases of hazardous or toxic substances, wastes or material into the air, land, soil, surface water, groundwater, or other medium, including, but not limited to, statutes or regulations regulating the cleanup of these substances, wastes, or material.

"Site" means any location, facility, or property as defined under any Environmental Law, whether or not presently or formerly owned or operated by the debtor, including, but not limited to, disposal sites.

"Hazardous Material" means anything defined as a hazardous waste, hazardous substance, toxic substance, hazardous material, pollutant, or contaminant or similar term under an Environmental Law.

None ☒ a. List the name and address of every site for which the debtor has received notice in writing by a governmental unit that it may be liable or potentially liable under or in violation of an Environmental Law. Indicate the governmental unit, the date of the notice, and, if known, the Environmental Law:

SITE NAME AND ADDRESS	NAME AND ADDRESS OF GOVERNMENTAL UNIT	DATE OF NOTICE	ENVIRONMENTAL LAW

None ☒ b. List the name and address of every site for which the debtor provided notice to a governmental unit of a release of Hazardous Material. Indicate the governmental unit to which the notice was sent and the date of the notice.

SITE NAME AND ADDRESS	NAME AND ADDRESS OF GOVERNMENTAL UNIT	DATE OF NOTICE	ENVIRONMENTAL LAW

None ☒ c. List all judicial or administrative proceedings, including settlements or orders, under any Environmental Law with respect to which the debtor is or was a party. Indicate the name and address of the governmental unit that is or was a party to the proceeding, and the docket number.

NAME AND ADDRESS OF GOVERNMENTAL UNIT	DOCKET NUMBER	STATUS OR DISPOSITION

---

18 . Nature, location and name of business

None ☒ a. *If the debtor is an individual*, list the names, addresses, taxpayer-identification numbers, nature of the businesses, and beginning and ending dates of all businesses in which the debtor was an officer, director, partner, or managing executive of a corporation, partner in a partnership, sole proprietor, or was self-employed in a trade, profession, or other activity either full- or part-time within **six years** immediately preceding the commencement of this case, or in which the debtor owned 5 percent or more of the voting or equity securities within **six years** immediately preceding the commencement of this case.

If the debtor is a partnership, list the names, addresses, taxpayer-identification numbers, nature of the businesses, and beginning and ending dates of all businesses in which the debtor was a partner or owned 5 percent or more of the voting or equity securities, within **six years** immediately preceding the commencement of this case.

If the debtor is a corporation, list the names, addresses, taxpayer-identification numbers, nature of the businesses, and beginning and ending dates of all businesses in which the debtor was a partner or owned 5 percent or more of the voting or equity securities within **six years** immediately preceding the commencement of this case.

NAME	LAST FOUR DIGITS OF SOCIAL-SECURITY OR OTHER INDIVIDUAL TAXPAYER-I.D. NO. (ITIN)/ COMPLETE EIN	ADDRESS	NATURE OF BUSINESS	BEGINNING AND ENDING DATES

None ☒ b. Identify any business listed in response to subdivision a., above, that is "single asset real estate" as defined in 11 U.S.C. § 101.

NAME	ADDRESS

The following questions are to be completed by every debtor that is a corporation or partnership and by any individual debtor who is or has been, within **six years** immediately preceding the commencement of this case, any of the following: an officer, director, managing executive, or owner of more than 5 percent of the voting or equity securities of a corporation; a partner, other than a limited partner, of a partnership, a sole proprietor, or self-employed in a trade, profession, or other activity, either full- or part-time.

(An individual or joint debtor should complete this portion of the statement ***only*** *if the debtor is or has been in business, as defined above, within six years immediately preceding the commencement of this case. A debtor who has not been in business within those six years should go directly to the signature page.)*

19. Books, records and financial statements

None ☒ a. List all bookkeepers and accountants who within **two years** immediately preceding the filing of this bankruptcy case kept or supervised the keeping of books of account and records of the debtor.

NAME AND ADDRESS	DATES SERVICES RENDERED

None ☒ b. List all firms or individuals who within **two years** immediately preceding the filing of this bankruptcy case have audited the books of account and records, or prepared a financial statement of the debtor.

NAME	ADDRESS	DATES SERVICES RENDERED

None
☒

c. List all firms or individuals who at the time of the commencement of this case were in possession of the books of account and records of the debtor. If any of the books of account and records are not available, explain.

NAME	ADDRESS

None
☒

d. List all financial institutions, creditors and other parties, including mercantile and trade agencies, to whom a financial statement was issued by the debtor within **two years** immediately preceding the commencement of this case.

NAME AND ADDRESS	DATE ISSUED

20. Inventories

None
☒

a. List the dates of the last two inventories taken of your property, the name of the person who supervised the taking of each inventory, and the dollar amount and basis of each inventory.

DATE OF INVENTORY	INVENTORY SUPERVISOR	DOLLAR AMOUNT OF INVENTORY (Specify cost, market or other basis)

None
☒

b. List the name and address of the person having possession of the records of each of the inventories reported in a., above.

DATE OF INVENTORY	NAME AND ADDRESSES OF CUSTODIAN OF INVENTORY RECORDS

21. Current Partners, Officers, Directors and Shareholders

None
☒

a. If the debtor is a partnership, list the nature and percentage of partnership interest of each member of the partnership.

NAME AND ADDRESS	NATURE OF INTEREST	PERCENTAGE OF INTEREST

None
☒

b. If the debtor is a corporation, list all officers and directors of the corporation, and each stockholder who directly or indirectly owns, controls, or holds 5 percent or more of the voting or equity securities of the corporation.

NAME AND ADDRESS	TITLE	NATURE AND PERCENTAGE OF STOCK OWNERSHIP

22 . Former partners, officers, directors and shareholders

None ☒ a. If the debtor is a partnership, list each member who withdrew from the partnership within **one year** immediately preceding the commencement of this case.

NAME	ADDRESS	DATE OF WITHDRAWAL

None ☒ b. If the debtor is a corporation, list all officers or directors whose relationship with the corporation terminated within **one year** immediately preceding the commencement of this case.

NAME AND ADDRESS	TITLE	DATE OF TERMINATION

23 . Withdrawals from a partnership or distributions by a corporation

None ☒ If the debtor is a partnership or corporation, list all withdrawals or distributions credited or given to an insider, including compensation in any form, bonuses, loans, stock redemptions, options exercised and any other perquisite during **one year** immediately preceding the commencement of this case.

NAME & ADDRESS OF RECIPIENT, RELATIONSHIP TO DEBTOR	DATE AND PURPOSE OF WITHDRAWAL	AMOUNT OF MONEY OR DESCRIPTION AND VALUE OF PROPERTY

24. Tax Consolidation Group.

None ☒ If the debtor is a corporation, list the name and federal taxpayer-identification number of the parent corporation of any consolidated group for tax purposes of which the debtor has been a member at any time within **six years** immediately preceding the commencement of the case.

NAME OF PARENT CORPORATION	TAXPAYER-IDENTIFICATION NUMBER (EIN)

25. Pension Funds.

None ☒ If the debtor is not an individual, list the name and federal taxpayer-identification number of any pension fund to which the debtor, as an employer, has been responsible for contributing at any time within **six years** immediately preceding the commencement of the case.

NAME OF PENSION FUND	TAXPAYER-IDENTIFICATION NUMBER (EIN)

* * * * * *

[If completed by an individual or individual and spouse]

I declare under penalty of perjury that I have read the answers contained in the foregoing statement of financial affairs and any attachments thereto and that they are true and correct.

Date 2/8/10 Signature of Debtor Robert E. Simmons

Date ______ Signature of Joint Debtor (if any) ______

[If completed on behalf of a partnership or corporation]

I declare under penalty of perjury that I have read the answers contained in the foregoing statement of financial affairs and any attachments thereto and that they are true and correct to the best of my knowledge, information and belief.

Date ______ Signature ______

______ Print Name and Title

[An individual signing on behalf of a partnership or corporation must indicate position or relationship to debtor.]

____ continuation sheets attached

Penalty for making a false statement: Fine of up to $500,000 or imprisonment for up to 5 years, or both. 18 U.S.C. §§ 152 and 3571

DECLARATION AND SIGNATURE OF NON-ATTORNEY BANKRUPTCY PETITION PREPARER (See 11 U.S.C. § 110)

I declare under penalty of perjury that: (1) I am a bankruptcy petition preparer as defined in 11 U.S.C. § 110; (2) I prepared this document for compensation and have provided the debtor with a copy of this document and the notices and information required under 11 U.S.C. §§ 110(b), 110(h), and 342(b); and, (3) if rules or guidelines have been promulgated pursuant to 11 U.S.C. § 110(h) setting a maximum fee for services chargeable by bankruptcy petition preparers, I have given the debtor notice of the maximum amount before preparing any document for filing for a debtor or accepting any fee from the debtor, as required by that section.

______ Printed or Typed Name and Title, if any, of Bankruptcy Petition Preparer

______ Social-Security No. (Required by 11 U.S.C. § 110.)

If the bankruptcy petition preparer is not an individual, state the name, title (if any), address, and social-security number of the officer, principal, responsible person, or partner who signs this document.

______

______
Address

X ______ Signature of Bankruptcy Petition Preparer

______ Date

Names and Social-Security numbers of all other individuals who prepared or assisted in preparing this document unless the bankruptcy petition preparer is not an individual:

If more than one person prepared this document, attach additional signed sheets conforming to the appropriate Official Form for each person

A bankruptcy petition preparer's failure to comply with the provisions of title 11 and the Federal Rules of Bankruptcy Procedure may result in fines or imprisonment or both. 18 U.S.C. § 156.

B4 (Official Form 4) (12/07)

United States Bankruptcy Court

EASTERN District Of PENNSYLVANIA

In re Robert E. Simmons,
Debtor

Case No. ______________

Chapter 7

LIST OF CREDITORS HOLDING 20 LARGEST UNSECURED CLAIMS

Following is the list of the debtor's creditors holding the 20 largest unsecured claims. The list is prepared in accordance with Fed. R. Bankr. P. 1007(d) for filing in this chapter 11 [*or* chapter 9] case. The list does not include (1) persons who come within the definition of "insider" set forth in 11 U.S.C. § 101, or (2) secured creditors unless the value of the collateral is such that the unsecured deficiency places the creditor among the holders of the 20 largest unsecured claims. If a minor child is one of the creditors holding the 20 largest unsecured claims, state the child's initials and the name and address of the child's parent or guardian, such as "A.B., a minor child, by John Doe, guardian." Do not disclose the child's name. See, 11 U.S.C. §112 and Fed. R. Bankr. P. 1007(m).

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(1) *Name of creditor and complete mailing address, including zip code*	(2) *Name, telephone number and complete mailing address, including zip code, of employee, agent, or department of creditor familiar with claim who may be contacted*	(3) *Nature of claim (trade debt, bank loan, government contract, etc.)*	(4) *Indicate if claim is contingent, unliquidated, disputed or subject to setoff*	(5) *Amount of claim [if secured also state value of security]*
Citifinancial Services, Inc. 11000 Roosevelt Blvd. #151 Phila., PA. 19116-3961		Credit Card- $3,000.00-?		

Date: 2/8/10

Robert E. Simmons
Debtor

[Declaration as in Form 2]

B6 Declaration (Official Form 6 - Declaration) (12/07)

In re Robert E. Simmons, Debtor

Case No. ______ (if known)

DECLARATION CONCERNING DEBTOR'S SCHEDULES

DECLARATION UNDER PENALTY OF PERJURY BY INDIVIDUAL DEBTOR

I declare under penalty of perjury that I have read the foregoing summary and schedules, consisting of 33 sheets, and that they are true and correct to the best of my knowledge, information, and belief.

Date 2/8/10

Signature: Robert E. Simmons
Debtor

Date ______

Signature: ______
(Joint Debtor, if any)

[If joint case, both spouses must sign.]

DECLARATION AND SIGNATURE OF NON-ATTORNEY BANKRUPTCY PETITION PREPARER (See 11 U.S.C. § 110)

I declare under penalty of perjury that: (1) I am a bankruptcy petition preparer as defined in 11 U.S.C. § 110; (2) I prepared this document for compensation and have provided the debtor with a copy of this document and the notices and information required under 11 U.S.C. §§ 110(b), 110(h) and 342(b); and, (3) if rules or guidelines have been promulgated pursuant to 11 U.S.C. § 110(h) setting a maximum fee for services chargeable by bankruptcy petition preparers, I have given the debtor notice of the maximum amount before preparing any document for filing for a debtor or accepting any fee from the debtor, as required by that section.

Printed or Typed Name and Title, if any, of Bankruptcy Petition Preparer

Social Security No. *(Required by 11 U.S.C. § 110.)*

If the bankruptcy petition preparer is not an individual, state the name, title (if any), address, and social security number of the officer, principal, responsible person, or partner who signs this document.

Address

X ______
Signature of Bankruptcy Petition Preparer

Date

Names and Social Security numbers of all other individuals who prepared or assisted in preparing this document, unless the bankruptcy petition preparer is not an individual:

If more than one person prepared this document, attach additional signed sheets conforming to the appropriate Official Form for each person.

A bankruptcy petition preparer's failure to comply with the provisions of title 11 and the Federal Rules of Bankruptcy Procedure may result in fines or imprisonment or both. 11 U.S.C. § 110; 18 U.S.C. § 156.

DECLARATION UNDER PENALTY OF PERJURY ON BEHALF OF A CORPORATION OR PARTNERSHIP

I, the ______ [the president or other officer or an authorized agent of the corporation or a member or an authorized agent of the partnership] of the ______ [corporation or partnership] named as debtor in this case, declare under penalty of perjury that I have read the foregoing summary and schedules, consisting of ___ sheets (*Total shown on summary page plus 1*), and that they are true and correct to the best of my knowledge, information, and belief.

Date ______

Signature: ______

[Print or type name of individual signing on behalf of debtor.]

[An individual signing on behalf of a partnership or corporation must indicate position or relationship to debtor.]

Penalty for making a false statement or concealing property: Fine of up to $500,000 or imprisonment for up to 5 years or both. 18 U.S.C. §§ 152 and 3571.

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA
PHILADELPHIA DIVISION

ROBERT E. SIMMONS	)	
	)	
Plaintiff,	)	
	)	
v.	)	Case No. 2:10-mc-00102-RBS
	)	
THE HON. STEPHEN RASLAVICH,	)	
	)	
Defendant.	)	
	)	

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE
IN SUPPORT OF DEFENDANT

EXHIBIT B

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF PENNSYLVANIA

In Re:	Chapter: 7
Robert E. Simmons	
Debtor(s)	Bankruptcy No: 10−10989−sr

O R D E R

AND NOW, this 9th day of February, 2010 , the debtor having failed to file or submit with the petition all of the documents required by Fed. R. Bankr. P. 1007,

And the following documents are missing

Certification Concerning Credit Counseling and/or Certificate of Credit Counseling due 2/16/2010
Matrix List of Creditors due 2/16/2010
Statement of Current Monthly Income due 2/23/2010
Schedule G due 2/23/2010
Schedule H due 2/23/2010
Schedule I due 2/23/2010
Schedule J due 2/23/2010

It is hereby ORDERED that, if the debtor has not filed the Matrix List of Creditors (as required by L.B.R. 1007−2) or the Certificate of Credit Counseling or a Request for a Waiver from the Credit Counseling Requirement, then those documents are due within 7 days of the filing of the petition or else this case may be dismissed without additional notice or hearing after that date.

It is further ORDERED that all other missing documents are due within 14 days of the date of the filing of the petition, unless an extension for cause, sought prior to the expiration of 14 days, is granted. If not, this case may be dismissed without additional notice or hearing after 2/23/10 .

By the Court

Stephen Raslavich
Chief Judge , United States Bankruptcy Court

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA
PHILADELPHIA DIVISION

ROBERT E. SIMMONS	)	
	)	
Plaintiff,	)	
	)	
v.	)	Case No. 2:10-mc-00102-RBS
	)	
THE HON. STEPHEN RASLAVICH,	)	
	)	
Defendant.	)	
	)	

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE
IN SUPPORT OF DEFENDANT

EXHIBIT C

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF PENNSYLVANIA

In re	:	Chapter 7
	:	
Robert E. Simmons	:	
Debtor	:	Bankruptcy No. 10-10989sr

ORDER

AND NOW, this 18th day of Feb, 2010, it is

ORDERED that since the debtor(s) have failed to timely file the documents required by the order dated February 9, 2010 this case be and the same is hereby DISMISSED.

Stephen Raslavich, Chief
United States Bankruptcy Judge

Missing Documents:

Certificate of credit counseling
Matrix

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA
PHILADELPHIA DIVISION

ROBERT E. SIMMONS	)	
	)	
Plaintiff,	)	
	)	
v.	)	Case No. 2:10-mc-00102-RBS
	)	
THE HON. STEPHEN RASLAVICH,	)	
	)	
Defendant.	)	
	)	

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE
IN SUPPORT OF DEFENDANT

EXHIBIT D

Chief Judge Stephen Raslavich
U.S. BANKRUPTCY COURT
EASTERN DISTRICT OF PENN. (Phila.,)
Bankruptcy Petition #: 10-10989-sr

Thurs. 3/11/10

Robert E. Simmons Pro Se
#HH7348
P.O. box 256
Waymart, PA. 18472-0256

NOTICE OF APPEAL

RE: #: 10-10989-sr

Appeal being taken from order of this Court to; Dismiss For Failure to File Information.

RELEVANT HISTORY

This Appeal is sought as a result of this Courts error in determining that I failed to 'File Information'.

However, I sent all the forms that were relevant to my case. I also sent a Cover Letter, making it Crystal Clear that I am and will continue to be a 'Prisoner', incarcerated in a State Prison here in Waymart, PA. Where I do not have access to Bankruptcy information, nore am I able to determine that I have not filed all the pertinent documentation.

To my knowledge, I had filed and sent the Court the, 'Waiver From The Credit Counseling Requirement'. Where on the form I clearly stated that I do not, will not, be able to comply with this requirement. Again, I AM AN INMATE, CURRENTLY INCARCERATED IN A STATE PENAL INSTITUTION, WHERE I DO NOT NOW OR WILL I IN THE NEAR FUTURE HAVE ACCESS TO OR BE ALLOWED TO ACCESS THOSE SERVICES-PERIOD!!

I sent a list of my Creditors with my filings, as well as a statement of my monthly income from my inmate employment here at the prison. (I have no other source of income).

I did not send Schedules G,H,I,J, because there are no Excutory Contracts and Unexpired Leases(G). No Codebtors(H). No Current Income of Individual Debtors(I). And No Current Expenditures of Individual Deptor(J). The information required on these forms do not pertain to me and they would be Blank Forms that I would send to you.

This Petition was filed with the hope that this Court would be Cognizance of the fact of my status (Pro Se, Prisoner) and act accordingly.

NOTICE OF APPEAL (con'ted)

Where I do not have any legal training or expertise, and if this Courts rules are so rigid/stringent where this prevents all but bankruptcy attorneys from it's utilization, how are ordinary citizens to access it? Do my status as a Prisoner bar my access to this Court?

THEREFORE I respectfully ask that this Honorable Court Reverse it's decision and allow my Bankruptcy Petition to Proceed and to not hold me to the same standards of one being represented by counsel, and not as a Prisoner.

Respectifully Submitted,
Robert E. Simmons
Robert E. Simmons
#HH7348
P.O.Box 256
Waymart, PA. 18472-0256

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA
PHILADELPHIA DIVISION

ROBERT E. SIMMONS Plaintiff, v. THE HON. STEPHEN RASLAVICH, Defendant.	Case No. 2:10-mc-00102-RBS

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE IN SUPPORT OF DEFENDANT

EXHIBIT E

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

IN RE: : CHAPTER 7
:
ROBERT E. SIMMONS :
DEBTOR(S) : BANKRUPTCY NO. 10-10989 SR

ORDER

AND NOW, upon consideration of the Debtor's *Pro Se* Motion to Reconsider Dismissal of Case for failure to file creditor matrix, it is hereby:

ORDERED, that the Motion be and hereby is Granted, and the Debtor's case is hereby reopened; and it is further **ORDERED** that the Debtor shall have until April 15, 2010 to file his matrix. A copy of Court's web page outlining Creditor Matrix Requirements is attached hereto.

By the Court:

Stephen Raslavich

Stephen Raslavich
Chief United States Bankruptcy Judge

Dated: March 18, 2010

Robert E. Simmons
P. O. Box 256
Waymart, PA 18472-0256

George Conway, Esquire
Office of the United States Trustee
833 Chestnut Street
Suite 500
Philadelphia PA 19106

United States Bankruptcy Court
Eastern District of Pennsylvania

Stephen Raslavich, Chief Judge
Timothy B. McGrath, Clerk of Court

Print Document

Creditors Matrix Format Requirements

In order to ensure that the cases you file can be properly read by the optical scanner, we ask that you observe the following guidelines:

Matrix must be typed in one of the following standard fonts, in a 10- or 12-point size:

- Courier
- Courier New
- CG Times
- Letter Gothic
- Times New Roman

Matrix should be typed in a single column, down the center of the page.

Each address should not exceed a total of (five) 5 lines.

Each line in the address should not exceed 40 characters.

Matrix should have at least one blank line between each address.

Use upper and lower case letters (capital and small letters). Do not use all capital letters.

Nine-digit ZIP codes should be typed with a hyphen separating the two groups of digits.

Things to Avoid:

The following will prevent your list from being read by the optical scanner, requiring you to resubmit your creditors list:

Non-address data:

- debtor
- joint debtor
- attorney for debtor(s)
- account number
- attention line
- page numbers

Extra marks: letterhead, dates, coffee stains, handwritten marks, lines, symbols, etc.

Non-standard paper: onion skin, half-sized paper, colored paper.

Poor quality type, unreadable fonts or print styles: photocopy, carbon, exotic fonts, proportionally-spaced fonts, script fonts, non-office quality printer (dot-matrix print with less than 360 dpi).

Misarranged list: paper incorrectly inserted into the printer causing list to be skewed.

Text attributes: bold, italics, underline.

Sample Fonts:

- Courier: The Quick Brown Fox Jumps Over the Lazy Dog.
- Courier New: The Quick Brown Fox Jumps Over the Lazy Dog.
- CG Times: The Quick Brown Fox Jumps Over the Lazy Dog.
- Letter Gothic: The Quick Brown Fox Jumps Over the Lazy Dog.
- Times New Roman: The Quick Brown Fox Jumps Over the Lazy Dog.

Sample Matrix:

Advanta
Credit Department
Suite 500
P. O. Box 15480
Wilmington, DE 19850

Boscovs
Credit Services
Box 4274
Reading, PA 19606

Citibank South Dakota NA
Citicorp Retail Services
Box 2050
Kansas City, MO 64153

Discover
c/o Greenwood Trust Company
P. O. Box 6011
Dover, DE 19903-6011

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Home Depot
Box 105981 Dept. 51
Atlanta, GA 30348-5981


Dr. John Smith
P. O. Box 123
Paoli, PA 19999


Chase Manhattan Bank
Card Member Services
P. O. Box 100
Matteson, IL 60443-8648

Beneficial Credit Management
P. O. Box 1220
Hartford, CT 06115-1220


Seventh Heaven
Membership Services
2500 Suitland Road
Greenbelt, MD 20233
```

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IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA
PHILADELPHIA DIVISION

ROBERT E. SIMMONS	)	
	)	
Plaintiff,	)	
	)	
v.	)	Case No. 2:10-mc-00102-RBS
	)	
THE HON. STEPHEN RASLAVICH,	)	
	)	
Defendant.	)	
	)	

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE
IN SUPPORT OF DEFENDANT

EXHIBIT F

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF PENNSYLVANIA

In re	:	Chapter 7
	:	
Robert E. Simmons	:	
Debtor	:	Bankruptcy No. 10-10989sr

ORDER

AND NOW, this 27th day of April, 2010, it is

ORDERED that since the debtor(s) have failed to timely file the documents required by the order dated March 18, 2010 extending time until April 15, 2010 this case be and the same is hereby DISMISSED.

Stephen Raslavich, Chief
United States Bankruptcy Judge

Missing Documents:

MATRIX LIST OF CREDITORS
CERTIFICATION CONCERNING CREDIT COUNSELING
STATEMENT OF CURRENT MONTHLY INCOME
SCHEDULES G,H, I, J,

BRIEF BANK — "SUMMARY SHEET"

Printed Thu-1/29/09 11:27

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*
In re Timothy J. Smith and Karrie A. Smith (Robert D. Miller Jr., Acting UST v. Timothy J. Smith, et al.)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*
B.A.P., 9th Cir.

3. ("CCN") ***CURRENT*** CASE NO.
No.: 08-1312

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*
No.: 07-43853
Court: W.D. Wash.
(Identify judge & cite, if any)

5. ("SO") ***SOURCE***
U.S. TRUSTEES

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*
Filed: January 26, 2009
Type: Brief of Appellant United States Trustee

7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*
Marjorie S. Raleigh, Thomas C. Kearns, P. Matthew Sutko, Robert d. Miller Jr.
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s)
& √ Any Miscellaneous ***BACKGROUND***

• Whether the bankruptcy court erred in holding that the calculation of disposable income that above-median chapter 13 debtors must pay to creditors in their plan may include deductions for secured debt payments that the debtors will never make, because they are surrendering the collateral to the secured creditors?

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UNITED STATES BANKRUPTCY APPELLATE PANEL OF THE NINTH CIRCUIT

In re

TIMOTHY J. SMITH and
KARRIE A. SMITH,
Debtors

BAP Case No. WW-08-1312

ROBERT D. MILLER JR.,
Acting United States Trustee,
Appellant
v.
TIMOTHY J. SMITH and
KARRIE A. SMITH,
Appellees

Bankr. Case No. 07-43853
Bankruptcy Court for the Western
District of Washington

BRIEF OF APPELLANT UNITED STATES TRUSTEE

RAMONA D. ELLIOTT
General Counsel
P. MATTHEW SUTKO
Associate General Counsel
Executive Office for
United States Trustees
Department of Justice
20 Massachusetts Ave., N.W.
Washington, DC 20530

ROBERT D. MILLER JR.
Acting United States Trustee, Region 18
MARJORIE S. RALEIGH
Attorney for the United States Trustee
Office of the United States Trustee
700 Stewart St., Suite 5103
206-553-2000, 206-553-2566 (fax)

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JURISDICTION

The bankruptcy court had jurisdiction over Timothy and Karrie Smith's ("Debtors") bankruptcy case under 28 U.S.C. §§ 151, 157(a) and (b), and 1334(a). On November 14, 2008, the bankruptcy court entered an order denying the objections of the chapter 13 trustee, creditor America Express Bank, and the United States Trustee to confirmation of the Debtor's chapter 13 plan. All three objecting parties filed timely notices of appeal under 28 U.S.C. § 158(c)(2) and Fed.R.Bankr.P. 8002(a).

This Court has appellate jurisdiction under 28 U.S.C. § 158(b)(1). A bankruptcy court's order confirming a chapter 13 plan is a final, appealable order. *In re Crown Vantage, Inc.* 421 F.3d 963, 971 (2005); *see also In re Robert L. Helms Construction & Development Co., Inc.*, 139 F.3d 702, 704 (9th Cir.1998). An order overruling objections to confirmation of a chapter 13 debtor's plan is treated as an order of confirmation for purposes of appeal. *In re Wolff*, 22 B.R. 510 (9th Cir. BAP (Cal.) 1982).

STATEMENT OF ISSUE ON APPEAL

Did the bankruptcy court err in holding that the calculation of disposable income that above-median chapter 13 debtors must pay to creditors in their plan may include deductions for secured debt payments that the debtors will never make, because they are surrendering the collateral to the secured creditors?

STANDARD OF REVIEW

A bankruptcy court's findings of fact are reviewed for clear error and but its conclusions of law are reviewed *de novo*. *In re Shook*, 278 B.R. 815, 820 (9th Cir. BAP (Nev.) 2002). Chapter 13 plan confirmation issues requiring only statutory interpretation are reviewed *de novo*. *In re Hull*, 251 B.R. 726, 730 (9th Cir. BAP (Wash.) 2000).

STATEMENT OF THE CASE

This case involves the interpretation of provisions added to the Bankruptcy Code by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub.L.No. 109-8, 119 Stat. 23 (2005) ("2005 Act"), and specifically § 1325(b) and § 707(b)(2). In chapter 13, a plan providing for payment of less than 100% to unsecured creditors must be confirmed if it commits all the debtor's "projected disposable income" to unsecured creditors for a commitment period of five years. This case involves the expense component of the "disposable income" calculation, and specifically whether the debtor is entitled to deduct payments on a secured debt the debtor will never pay, because the debtor is surrendering the property securing the claim.

Allowable expenses under § 1325(b)(3) are determined in accordance with §

707(b)(2), which contains a list of expenses also used in calculating disposable income for purposes of the chapter 7 means test. The chapter 7 means test creates a presumption of abuse for a debtor with above-median income, if the debtor has "disposable income" exceeding a statutory threshold. If the presumption arises, the court must dismiss the case or, with the debtor's consent, convert the case to chapter 11 or 13. If the presumption of abuse does not arise or is rebutted, the court may still find abuse and dismiss or convert the case based on the totality of the debtors' financial situation or bad faith.

Timothy and Karrie Smith ("Debtors") filed a voluntary chapter 7 petition. (*See* Appellants' Appendix, Tab A, pp. 1-43.) Because the Debtors had income above the State median and excess income that would enable them to fund a chapter 13 plan, the United States Trustee filed a motion to dismiss for abuse under § 707(b)(3). (*See* Appendix, Tab B, pp. 44-50, and Tab A, pp. 24-26.) The bankruptcy court agreed with the United States Trustee and found that, given the totality of the debtors' financial situation, it would be an abuse to grant them a chapter 7 discharge. (*See* Appendix, Tab F, pp. 71-72.)

Rather than allowing their case to be dismissed, the Debtors voluntarily converted to chapter 13. (*See* Appendix, Tab E, p. 70.) In chapter 13, they proposed a plan to pay unsecured creditors $889 per month for six months, representing a 4 percent dividend. (*See* Appendix, Tab G, pp. 73-76.) The Debtors justified their plan based on their calculation of negative ($1,749) in disposable income on Form 22C, "Chapter 13 Statement of Current Monthly Income and Calculation of Commitment Period and Disposable Income". (*See* Appendix, Tab I, pp. 81-87.) They obtained the negative result by deducting nearly $7,000 in monthly payments on account of surrendered property (*See* Appendix, Tab I, p. 85.)

The chapter 13 trustee, American Express Bank, and the United States Trustee all objected, asserting that the Debtors' disposable income calculation was incorrect, because they had improperly deducted secured debt payments that they would not in fact make because they were surrendering the collateral. (Appendix, Tab K, pp. 89-123; Tab L, pp. 124-134; Tab 0, pp. 182-194.) In a memorandum opinion, the bankruptcy court overruled the objections, holding that amounts due on account of surrendered property were properly deductible, even though the amounts would in fact never be paid. (Appendix, Tab Q, pp. 198-210; Tab R, p. 211.)

STATEMENT OF FACTS

I. Statutory Framework

The 2005 Act significantly altered how debtors obtain relief under chapters 7 and 13 of the Bankruptcy Code. In a chapter 13 case, a debtor's unsecured creditors or trustee may insist that the debtor devote all of his or her projected disposable income to pay creditors. *See* 11 U.S.C. § 1325(b)(1). Although "projected disposable income" is not defined, "disposable income" is defined as the net of historical income less prescribed expenses. *See* 11 U.S.C. § 1325(b)(2).

The first component in the disposable income calculation is "current monthly income," which is defined in § 101(10A) as the debtor's average monthly income over the six months prior to filing. From current monthly income the debtors deduct expenses in "amounts reasonably necessary to be expended" for maintenance or support or necessary business expenses. 11 U.S.C. § 1325(b)(2) and (3). Above-median-income chapter 13 debtors determine "amounts reasonably necessary to be expended . . . in accordance with" § 707(b)(2)(A) and (B) of the Bankruptcy Code. 11 U.S.C. § 1325(b)(3) (incorporating those provisions).[1]

Expenses allowed in the calculation of disposable income under § 707(b)(2) and § 1325(b)(3) include payments on secured debt. Specifically, § 707(b)(2)(A)(iii) permits the deduction of "the total of all amounts scheduled as contractually due to secured creditors in each month of the 60 months following

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[1] Prescribed expenses are contained in § 707(b)(2)(A)(I), (ii), and (iii). Section 707(b)(2)(B) may permit additional expenses for debtors who establish special circumstances.

the date of the petition" divided by 60. *Id.* Deducting all allowed expenses from a debtor's income yields a net number -- disposable income.

Disposable income is not the ending point, however, in determining how much a chapter 13 debtor must pay creditors over the life of a chapter 13 plan. Instead, § 1325(b)(1) requires "all of the debtor's projected disposable income" be paid to creditors when, as happened in this case, the chapter 13 trustee objects to a proposed plan. "Projected disposable income" is determined by multiplying disposable income by the "applicable commitment period," which for above-median debtors is 60 months. *Maney v. Kagenveama (In re Kagenveama*), 541 F.3d 868 (9th Cir. 2008).[2]

Disposable income is determined the same way in chapter 7 as it is in chapter 13. In chapter 7, the disposable income analysis is the centerpiece of the 2005 Act's means test. In the case of a debtor whose income exceeds the

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[2] The Eighth and Tenth circuits have expressly rejected the Ninth Circuit's approach to projected disposable income by concluding that the historically-based "disposable income" is a starting point for determination of "projected disposable income," but that the final calculation may take into consideration the debtor's actual income and expenses. *See Hamilton v. Lanning (In re Lanning)*, 545 F.3d 1269, 1278-82 (10th Cir. 2008); *Coop v. Frederickson (In re Frederickson*), 545 F.3d 652, 659-60 (8th Cir. 2008).

applicable median income,[3] abuse is presumed where the debtor's disposable income exceeds certain statutory levels.[4] 11 U.S.C. § 707(b)(2). Where the presumption of abuse arises, § 707(b)(1) mandates dismissal or, with the debtor's consent, conversion to chapter 11 or 13. Debtors may rebut the presumption of abuse by demonstrating "special circumstances" that justify adjustments to income and expenses for which there is no reasonable alternative. 11 U.S.C. § 707(b)(2)(B).

If abuse is not presumed or the presumption is rebutted, § 707(b)(3) provides that for dismissal or conversion where bad faith or the totality of the debtor's financial situation demonstrates abuse. 11 U.S.C. § 707(b)(3).

II. Factual Background

On November 14, 2007, the Debtors filed a voluntary chapter 7 petition (*See* Appendix, Tab A, pp. 1-43.), together with a Form 22A, "Statement of Current Monthly Income and Means Test Calculation" (*See* Appendix, Tab B, pp. 44-50.).

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[3] The applicable median income is the median income for the applicable State for a family the same size as the debtor's household. 11 U.S.C. § 707(b)(6).

[4] Under § 707(b)(2)(A)(i), a case is presumed abusive if projected monthly disposable income (i.e. monthly disposable income multiplied by 60), is at least $10,950 (i.e. $182.50 per month). If disposable income is less than $6,575 ($109.58 per month), the presumption does not arise. If projected disposable income is between $6,575 and $10,950, the presumption arises if the result is at least 25% of unsecured claims.

The United States Trustee moved to dismiss the case under § 707(b)(3). (*See* Appendix, Tab F, pp. 1-2.) By order dated June 13, 2008, the bankruptcy court granted the motion based on the totality of the Debtors' financial circumstances and, with the Debtors' consent, converted the case to chapter 13. (*See* Appendix, Tab F, pp. 1-2).

The Debtors' post-conversion Schedule I, "Current Income of Individual Debtor(s)" shows actual, projected gross income of $10,417, less payroll deductions of $2,810, for a net of $7,607. (*See* Appendix, Tab H, p. 77.) The Debtors' post-conversion Schedule J, "Current Expenditures of Individual Debtors," shows living expenses of $6,718, leaving a monthly excess of $889. (*See* Appendix, Tab H, p.78-79.) The Debtors' plan provides for monthly payments of $889 for a period of six months, with a total of $4,300 allocated to nonpriority unsecured creditors. (*See* Appendix, Tab G, pp. 73-76.) This is approximately four percent of the $101,256 in unsecured debts listed on Schedule F. (*See* Appendix, Tab 20, 21.)

The Debtors' "Chapter 13 Statement of Current Monthly Income and Calculation of Commitment Period and Disposable Income" ("Form 22C")[5] shows

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[5] The current monthly income and expenses are identical to the numbers contained on the means test form (Form 22A) filed in the chapter 7 case, except that Form 22C includes a chapter 13 administrative expense of $89. (Appendix,

current monthly income of $12,906 and annualized CMI of $154,872, which is above the applicable state median income.[6] (*See* Appendix, Tab I, p. 82.) From CMI the Debtors deducted expenses of $14,655, including $7,185 in monthly payments on two residences and a vehicle they had surrendered.[7] (*See* Appendix, Tab I, pp. 85-86.) The resulting disposable income is a negative ($1,749). (*See* Appendix, Tab I, p. 86.) If the mortgage and vehicle payments were not deducted, the Debtors would be entitled to a statutorily prescribed housing allowance of $1,245. In that event, their deductions would be $8,715, and monthly disposable income would be $4,191. This is sufficient to pay the $101,256 in scheduled unsecured debt in full over a period of 24 months. Alternatively, they could fund a 60-month 100% plan for approximately $1,700 per month.

The sole issue on appeal is whether the court properly applied §§ 1325(b)(2)

Tab B, p. 44-50.)

[6] The Debtors report a household size of 5. The median income in Washington for a household of this size is $82,040.

[7] The Schedules included the following items, which the Debtors surrendered post-petition: (1) a residence in Washington, valued at $499,000, with encumbrances of $450,232 and monthly payments of $3,364; (2) a former residence in Utah, valued at $450,000, subject to encumbrances of $413,514, and payments of $3,221; and (3) a 2007 Dodge Nitro, valued at $30,000 with $36,762 owed and payments of $600. The monthly payments on the surrendered items totals $7,185.

and (3) and 707(b)(2)(A)(iii) in permitting the deduction of payments on debt secured by surrendered property.

SUMMARY OF ARGUMENT

The bankruptcy court improperly allowed the Debtors to deduct secured debt payments they would never make because they had surrendered the collateral securing the debts. First, § 1325(b)(2) is forward looking, allowing expense deductions only for "amounts reasonably necessary to be expended," which expenditures will never occur on surrendered property. Second, by focusing on the single term "contractually due" in § 707(b)(2)(A)(iii) without giving due consideration to the phrases "scheduled as" and the phrase "following the date of the petition," the court missed the meaning and intent of the provision, which is to allow only those debts that the Debtors will actually pay. Third, read as a whole and in light of the other deductions allowed under the means test, § 707(b)(2)(A) requires a forward looking assessment of expenses, supporting the interpretation that § 707(b)(2)(A)(iii) limits the deduction to payments the Debtors will actually make. Finally, the bankruptcy court's ruling defies Congress' stated purpose in enacting the 2005 Act that debtors pay the maximum amount they can afford.

ARGUMENT

I. Under § 1325(b)(2) and (3), which the Ninth Circuit did not interpret in *Kagenveama*, the Debtors failed to commit all of their projected disposable

income to pay their unsecured creditors.

Section 1325(b)(2) permits the deduction from CMI of “amounts reasonably necessary to be expended” for maintenance and support of the debtor or debtor’s dependents. *See* 11 U.S.C. § 1325(b)(2). For debtors with above-median income, “amounts reasonably necessary to be expended” are to be determined “in accordance with” § 707(b)(2)(A) and (B). Notwithstanding the reference to § 707(b)(2), the phrase “reasonably necessary to be expended” must be given meaning.

Section 1325(b)(2) permits only those expenses that are “to be expended” and is therefore future oriented. *See In re Van Bodegom Smith*, 383 B.R. 441, 455 (Bankr. E.D. Wis. 2008). The phrase “requires debtors, and courts, to look into the future to determine, inasmuch as possible, what expenses the debtor will have during the life of the plan.” *Id.* Accordingly, to give this phrase meaning, one must consider whether the debtor will actually “expend” any amounts going forward. *Id.*; *see also In re Renicker*, 342 B.R. 304, 309 (Bankr. W.D. Mo. 2006) (concluding that “plain language of section 1325(b)(2) unambiguously indicates that prospective – not historical – expenses are to be used to calculate disposable income”).

It is axiomatic that payments on property that a debtor is surrendering will not be made in the future, and hence will never be "expended." Indeed, the Debtors did not include any payments for a mortgage, mortgage arrearage or property taxes on their post-conversion Schedule J, "Current Expenditures of Individual Debtors." *See In re Turner*, 384 B.R. 537, 539 (Bankr. S.D. Ind. 2008).

Accordingly, because § 1325(b)(3) only provides for the inclusion of "amounts reasonably necessary to be expended" as part of a disposable income calculation, the bankruptcy court erred in allowing the Debtors to deduct expenses for their two surrendered homes and vehicle in calculating disposable income, when these items have been surrendered and no future payments will be made on them.

II. Under § 707(b)(2)(A)(iii), which the Ninth Circuit did not interpret in *Kagenveama*, the Debtors cannot deduct secured debt obligations on collateral they are surrendering.

Section 707(b)(2)(A)(iii) provides as follows:

> The debtor's average monthly payments on account of secured debts shall be calculated as the sum of –
>
> (I) the total of all amounts scheduled as contractually due to secured creditors in each month of the 60 months following the date of the petition; and
>
> (II) any additional payments to secured creditors necessary for the debtor, in filing a plan under chapter 13 of this title, to maintain possession of the debtor's primary residence, motor vehicle, or other property necessary for the support of the

> debtor and the debtor’s dependents, that serves as collateral for
> secured debts;
> divided by 60.

Section 707(b)(2)(A)(iii), like any statutory provision, must be read as a whole. *See Koons Buick Pontiac GMC, Inc. v. Nieh*, 543 U.S. 50, 60 (2004) (calling for a “holistic” approach to reading statutes). The phrases “scheduled as” and “following the date of the petition” call for a projection of what the debtor’s payments on account of secured debt will be following bankruptcy. Further, in light of the means test’s more general approach to identifying allowable expenses, the phrase “average monthly payments on account of secured debt” must be understood to include only payments on account of secured debt that the debtor actually will make.

The bankruptcy court rejected this approach, noting that numerous courts have allowed debtors to deduct payments on secured debt, even though the debtor intends to surrender the collateral and therefore will never make the payments. *See*, e.g., *In re Maya, 374 B.R. 750, 753 (Bankr.S.D.Cal. 2007); In re Kelvie, 372 B.R. 56, 62 (Bankr.D.Idaho 2007); In re Wilkins, 370 B.R. 815, 819 (Bankr.C.D. Cal. 2007)*; *In re Rodriguez*, 2008 WL 372742 (Bankr.N.D.Cal. Feb. 11, 2008); *In re Chang*, 2007 WL 3034679 at *3 (Bankr.N.D.Cal. Oct. 16, 2007). However, allowing debtors to deduct obligations on surrendered property fails to give independent meaning to the phrases “scheduled as” and “following the date of the petition.”

If Congress meant for debtors to deduct all “contractually due” payments without regard to whether they would actually be made, it would have left out the phrase “scheduled as” and defined “payments on account of secured debts” as payments that are “contractually due . . . following the date of the petition” instead of “scheduled as contractually due . . . following the date of the petition.” The phrase “scheduled as contractually due” calls for a forward looking assessment of whether the payments will actually be made. Giving the phrase a future orientation gives separate effect to the term “scheduled as” in the phrase “scheduled as contractually due,” and thus honors the rule that “whenever possible, every word and phrase in a statute should be given effect.” *Negonsott v. Samuels*, 507 U.S. 99, 106, 113 S.Ct. 1119, 122 L.Ed.2d 457 (1993), cited in *Kagenveama*, 541 F.3d 868, 872 (9th Cir. 2008).[8] By contrast, the bankruptcy court’s reading gives no independent meaning to the phrase “scheduled as.” As one court explained,

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[8] The Eighth and Tenth circuits have expressly rejected the Ninth Circuit’s approach to projected disposable income by concluding that the historically-based “disposable income” is a starting point for determination of “projected disposable income,” but that the final calculation may take into consideration the debtor’s actual income and expenses. *See Hamilton v. Lanning (In re Lanning)*, 545 F.3d 1269, 1278-82 (10th Cir. 2008); *Coop v. Frederickson (In re Frederickson*), 545 F.3d 652, 659-60 (8th Cir. 2008).

considering the phrase “scheduled as contractually due” in a chapter 13 case, the word “scheduled” is best understood to “contemplate[ ] a forward looking approach. That is, one schedules something which one expects to take place in the future and not an event which one plans to avoid.” *In re Love*, 350 B.R. 611, 613-14 (Bankr. M.D. Ala. 2006).

The phrase “scheduled as contractually due” should also be read to mean something more specific than “contractually due” because the phrase “scheduled as” is a term of art in the Bankruptcy Code. The Code refers to a claim or debt being “scheduled as” due if the debt is properly listed on a debtor’s bankruptcy schedules. *See In re Skaggs* 349 B.R. 594, 599 (Bankr. E.D. Mo. 2006). The only provision of the Code other than Section 707(b)(2)(A)(iii) that uses the phrase “scheduled as” is 11 U.S.C. § 1111(a). Section 1111(a) provides that a “proof of claim or interest is deemed filed under section 501 of this title for any claim or interest that appears in the schedules filed under . . . section 521(1) or 1106(a)(2) of this title, except a claim or interest that is *scheduled as* disputed, contingent, or unliquidated.” (Emphasis added). The second part of the provision excepts claims that are “*scheduled as* disputed, contingent, or unliquidated.” In context, “scheduled as” thus means “appears on the schedule” or “appended to” the schedule. Because of the “‘normal rule of statutory construction,’ *Sorenson v.*

Secretary of Treasury, 475 U.S. 851, 860, 106 S.Ct. 1600, 1606, 89 L.Ed.2d 855 (1986), that 'identical words used in different parts of the same act are intended to have the same meaning,' *Atlantic Cleaners & Dyers, Inc. v. United States*, 286 U.S. 427, 433, 52 S.Ct. 607, 609, 76 L.Ed. 1204 (1932)," *Commissioner v. Keystone Consol. Industries, Inc.*, 508 U.S. 152, 159 (1993), "scheduled as contractually due" in Section 707(b)(2)(A) should be read to include contractual obligations on secured debts that are properly listed on a bankruptcy schedule because the debtor intends to honor them.

Allowing a deduction for mortgage payments that will never be made on the basis that the payments remain "contractually due" also fails to take account of the phrase "*following* the date of the petition" in § 707(b)(2)(iii)(I). *See In re Naut*, 2008 WL 191297 at *9 (Bankr. E.D. Pa. Jan. 22, 2008) (unpublished disposition); *In re Harris*, 353 B.R. 304, 308-10 (Bankr. E.D. Okla. 2006); *In re Skaggs*, 349 B.R. 594, 599-600 (Bankr. E.D. Mo. 2006). The word "following," used as a preposition, means "subsequent to" or "after in time." *Webster's Third New International Dictionary*, 833 (1993). By requiring courts to look at payments due "subsequent to" or "after" the date of the petition, the statute makes clear that it contemplates a projection of future expenses rather than a snapshot of current expenses. Accordingly, the means test allows the debtor to deduct from his current monthly income only those payments on account of secured debt that he actually will make after he files the petition. As the court explained in *Naut*, "[i]ncluding a loan payment as a deduction from income must be based on the loan payment actually being due in each of the 60 months after the bankruptcy petition is filed. Only this interpretation properly gives effect to every clause and word in the statute." *In re Naut*, 2008 WL 191297 at *9. *See also In re Ray*, 362 B.R. 680, 683 n.5 (Bankr. D. S.C. 2007).

III. Expense allowances under § 707(b)(2) are future-oriented, precluding deductions for debt payments the debtor will not make.

Giving a future orientation to the term "payments on account of secured debts" aligns § 707(b)(2)(A)(iii) with the treatment of other expenses under § 707(b)(2)(A) and (B), which by their terms are forward looking. It is a general rule of statutory construction that "'a word [in a statute] is known by the company it keeps,' a rule that 'is often wisely applied where a word is capable of many meanings in order to avoid the giving of unintended breadth to the Acts of Congress.' *Jarecki v. G.D. Searle & Co.*, 367 U.S. 303, 307, 81 S.Ct. 1579, 6 L.Ed.2d 859 (1961); *see also Dole v. Steelworkers*, 494 U.S. 26, 36, 110 S.Ct. 929, 108 L.Ed.2d 23 (1990) ('[W]ords grouped in a list should be given related meaning' (internal quotation marks and citations omitted))." *Dolan v. United States Postal Serv.*, 546 U.S. 481, 486-487 (2006).

First, the expense allowances in § 707(b)(2)(A)(ii) are forward looking. Unlike current monthly income, expenses allowances are not based on historical averages. Rather, allowances are either defined by IRS standards or determined by the debtor's actual expenses, subject to either statutory maximums or a "reasonably necessary" standard. The "reasonably necessary" standard necessitates a projection of the debtor's future needs.[9]

Additionally, a comparison of § 707(b)(2)(A)(iii)(I) in context with its "conjunctive partner," § 707(b)(2)(A)(iii)(II), "reinforces the conclusion that § 707(b)(2)(A)(iii)(I) applies only to payments on debts secured by collateral that a debtor intends to keep." *In re Burden*, 380 B.R. 194, 202 (Bankr.W.D.Mo. 2007). While § 707(b)(2)(A)(iii)(I) allows secured debt payments scheduled as contractually due, the following § 707(b)(2)(A)(iii)(II) allows deductions for cure

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[9] With minor exceptions, none of the expenses in § 707(b)(2)(A)(ii) are backward-looking. Included are standardized living expenses in amounts prescribed by the Internal Revenue Service's National Standards and Local Standards (e.g. housing, utilities, food, clothing, and transportation). All other expense allowances under clause (ii) must be actual and are subject to a "reasonably necessary" standard (e.g. mandatory payroll deductions, insurance, child care, educational expenses). Some reasonably necessary expenses are allowed but only if they are a continuation of actual, historical expenses paid by the debtor (e.g. care and support of elderly, chronically ill, or disabled household or family member). Certain other actual expenses are allowed up to a maximum amount (e.g. private school for minor dependent child "not to exceed $1,650 per year)." Thus, the "actual" and "reasonably necessary" standards each entail a projection of the debtor's future needs.

payments on encumbered property, but only as to items that are reasonably necessary for the support of the debtor and debtor's dependents. Limiting the § 707(b)(2)(A)(iii)(I) deduction for current obligations to payments for property the debtor seeks to retain is consistent with the explicitly forward looking nature of § 707(b)(2)(A)(iii)(II), which contemplates the debtor's intention to retain the property. *In re Burden*, 380 B.R. at 201-02.

The bankruptcy court disagreed with the United States Trustee on this point, concluding that the Ninth Circuit's use of a "backward-looking approach" defining projected disposable income in light of the text of a different statutory provision (§ 1325(b)(1)) in *Kagenveama* precludes a "forward-looking approach" to expenses of § 707(b)(2)(A)(iii)(I). The bankruptcy court reasoned that using projected expenses from historical income would be "similar to having a business employ two different accounting systems." Mem. Dec. p. 7, lines 3 - 6.

Kagenveama does not compel or support this conclusion. The income and expense components of disposable income are defined separately and, like *Kagenveama*, calls upon this Court to review the text of the statute before it. As we explain above, the text and context of § 707(b)(2)(A)(iii)(I) are forward looking and should be applied that way.

In contrast, in interpreting the language of a different provision, §

1325(b)(1), the Ninth Circuit concluded that current monthly income provides the income data for the disposable income calculation, and that “projected disposable income” is the product of current monthly income multiplied by the applicable commitment period. Concluding that the plain language of the statute mandated a historical approach to current monthly income, the Court rejected the lines of cases interpreting the term “projected” to introduce flexibility to the components of “projected disposable income.” *S*ee, *e.g., In re Hardacre*, 338 B.R. 718, 722 (Bankr.N.D.Tex. 2006) (allowing the court to consider evidence of anticipated income as opposed to historical current monthly income); and *In re Jass*, 340 B.R. 411, 415 (Bankr.D.Utah 2006) (treating the § 707(b)(2) calculation as a presumptive starting point, subject to rebuttal with evidence of more accurate income and expenses going forward). The issues in *Kagenveama* were driven by the income component of projected disposable income. The Court did not address any specific expense allowance, observing only generally as to expenses that “[t]he revised ‘disposable income’ test uses a formula to determine what expenses are reasonably necessary[,]” thereby eliminating judicial flexibility. *Kagenveama*, 541 F.3d at 874. The Court did not characterize expenses as either backward or forward looking, nor did it insist on a formula that complied with standard accounting methods. Thus, nothing in *Kagenveama* requires that §

707(b)(2)(A)(ii)(I) be read differently from its natural forward looking text.

IV. The 2005 Act's purpose that debtors repay the maximum amount they can afford is frustrated by allowing above-median income debtors to deduct non-existent secured debt payments.

Allowing a deduction only for secured debt payments that actually will be made is not only compelled by the statutory text, but also best serves Congress' purpose in enacting the means test and incorporating it into the chapter 13 definition of disposable income. The 2005 Act established the means test – the "heart of the [2005 Act's] consumer bankruptcy reforms," H.R. Rep. No. 109-31 (I) at 1 (2005), reprinted in 2005 U.S.C.C.A.N. 88, 89 – to identify which debtors have the means to pay something to their creditors, and which do not. Congress intended the means test to ensure that those who can afford to repay some portion of their unsecured debts be required to do so at the maximum level they can afford. *See Id.*

Just last week, in *Blausey v. United States Trustee (In re Blausey)*, 2009 WL 153241 (9th Cir. Jan. 23, 2009), the 9th Circuit reiterated the 2005 Act's overarching purpose of ensuring that "'debtors pay creditors the maximum they can afford.'" *In re Blausey*, 2009 WL 153241, at * 8, *quoting* H.R. Rep. No. 109-31 (I) at 1 (2005), reprinted in 2005 U.S.C.C.A.N. 88, 89. In *Blausey,* the 9th Circuit concluded that disability insurance benefits received by the debtors were included in current monthly income, because excluding the $4,000 received each month by the debtors “would result in a figure that does not accurately reflect the [debtors'] ability to repay their debts.” *Id.*

This Congressional purpose is served by allowing the debtor to deduct from income only those payments that the debtor actually will make. The bankruptcy court’s reading of § 1325(b)(2) and § 707(b)(2)(A)(iii) allows the deduction of payments that the debtor has no intention of making. The result is total expenses that are not grounded in reality, which manifestly defeats Congress’ stated purpose of maximum effort by all chapter 13 debtors.

Further, these imaginary deductions are available only to higher-income debtors,[10] with the inequitable result that those with greater means to repay their debt must actually pay less or none at all. The inequity is stark in this case, where the Debtors, with income substantially above the median,[11] were are allowed to deduct over $7,000 in non-existent payments on property that is admittedly not

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[10] Only above median debtors use the means testing provisions to determine “amounts reasonably necessary to be expended.” 11 U.S.C. § 1325(b)(3). For debtors with income below the median, expense deductions are determined consistent with pre-2005 Act law, i.e., using expense deductions from Schedule J.

[11] The Debtors’ current monthly income is 89 percent above the applicable state median income (see fn. 6, *supra* at 9), and their projected Schedule I income exceeds the median by 52 percent.

necessary for their support. If the Debtors are allowed to deduct the payments on surrendered property, the projected dividend to unsecured creditors is 4% – only a modest increase over zero repayment in chapter 7 which the court found would be an abuse. On the other hand, if the payments are disallowed, Debtors' projected disposable income would be sufficient to pay in full the $101,256 in scheduled unsecured creditors, plus U.S. Bank's deficiency claim on the surrendered Dodge Nitro.

The bankruptcy court acknowledged that its interpretation of § 1325 "may create what appears to be an unjust result in this case[,]" and further that "[s]uch result also may appear to be at odds with Congressional intent in enacting the [2005 Act], i.e. that debtors should pay the maximum amount they can afford." (Appendix, Tab Q, p. 209, lines 3 - 9.) At the same time, the court suggests that the disposable income test may, conversely, result in unfairness to the debtor, where the debtor's expenses may increase postpetition, requiring an unaffordable chapter 13 payment that would "jeopardiz[e] the ability of a debtor to reorganize and would be at odds with the bankruptcy goal of providing the debtor a fresh start." The court dismissed both scenarios, concluding that "'it is a rare occasion when a legislature's effort to establish specific guidelines is so refined that its application is guaranteed to be uniformly fair. . . . Nonetheless, the courts are bound to enforce what the legislature has enacted.'" Opinion at 12, *citing In re McGillis*, 370 B.R. 720 at 726 (Bankr.W.D.Mich. 2007)

The United States Trustee asserts that disposable income as defined by § 1325(b)(2) is neither unrefined nor unfair to debtors. The statute contains safeguards for debtors, so that they are not forced into unaffordable plans based on their disposable income. First, many of the expense allowances in § 707(b)(2)(A)(ii) are based on the debtor's actual expenses, within reasonable and necessary limits. Second, as to the standardized categories, some are subject to increase if the debtor can show actual expenses in excess of the IRS allotments (e.g. health care, telecommunication services, home energy, and food and clothing). Third, because § 1325(b)(3) references both § 707(b)(2)(A) and (B), adjustments of expenses are contemplated where the debtor establishes special circumstances "for which there is no reasonable alternative." *See, e.g. In re Crego*, 387 B.R. 225 (Bankr.E.D.Wisc. 2008) (§ 1325(b)(3) allows above-median-income chapter 13 debtors with two households to use § 707(b)(2)(B) to adjust expenses, just as it is used by chapter 7 debtors to rebut the presumption of abuse). Finally, debtors whose expenses increase postpetition are able to amend their plans, contrary to the bankruptcy court's statement that such debtors "will be required to pay more into a Chapter 13 plan than he or she can afford." (Appendix, Tab Q, p. 209, lines 11-12.)

This is not to negate the potential for harsh results for debtors flowing from the Ninth Circuit's mechanical approach to *projected disposable income*. *See In re Stansell*, 395 B.R. 457 (Bankr. D. Idaho 2008) (requiring non-recurring income received from debtor's deceased spouse to be included in projected disposable income calculation notwithstanding that deceased spouse's income would not be available during term of plan); *In re Featherstone*, No. 08-00016, 2008 WL 5217936 (D. Mont. Dec. 11, 2008) (affirming bankruptcy court's order denying confirmation of debtors' plan where debtors sought to exclude income received from one-time sale of livestock from projected disposable income calculation).

In sum, the United States Trustee's approach is consistent with Congress' stated intent to make certain that debtors "repay creditors the maximum they can afford." H.R. Rep. No. 109-31 (I) at 1 (2005), *reprinted in* 2005 U.S.C.C.A.N. 88, 89; *In re Blausey*, 2009 WL 153241, at * 8. The bankruptcy court's ruling defies Congressional intent by permitting debtors to deduct from their disposable income secured debt expenses for collateral they have surrendered or intend to surrender and on which they will never make payments.

CONCLUSION

For these reasons, the United States Trustee respectfully asks this Court to reverse the bankruptcy court's order overruling the United States Trustee's objection to confirmation.

Dated: January 26, 2009

Respectfully submitted,

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MARJORIE S. RALEIGH
Office of the United States Trustee
700 Stewart Street, Suite 5103
Seattle, WA 98101-1271
Telephone No.: (206) 553-2000
Facsimile No.: (206) 553-2566

Attorney for Appellant, United States Trustee

Certification Required by BAP Rule 8010(a)-1(c)

The undersigned certifies that the following are known related cases and appeals:

BAP Number	Debtor’s Name
08-1311	Timothy J. and Karrie A. Smith
08-1312	Timothy J. and Karrie A. Smith

______________________________ January 26, 2009

Marjorie S. Raleigh
Attorney for the United States Trustee

Certificate of Mailing

I certify that on this date I placed a copy of the following documents in the United States mail, postage prepaid, addressed to the following:

Karla Forsythe
Chapter 13 Trustee
P.O. Box 9804
Vancouver, WA 98666

Stanley F. Horak, Esquire
1104 Main Street, Suite 300
Vancouver, WA 98660

William Andrew McNeal, Esquire
Becket & Lee LLP
16 General Warren Boulevard
P.O. Box 3001
Malvern, PA 19355

Dated: January 23, 2009

Marjorie S. Raleigh
Attorney for the United States Trustee

BRIEF BANK — "SUMMARY SHEET" *Printed Wed-3/4/09 12:51*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*: In re Timothy J. Smith and Karrie A. Smith (Robert D. Miller Jr., Acting United States Trustee v. Timothy J. Smith and Karrie A. Smith)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*: B.A.P. 9th Cir.

3. ("CCN") ***CURRENT*** CASE NO.: No.: 08-1312

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*:
No.: 07-43853
Court: Bankr. W. D. Wash.
(Identify judge & cite, if any)

5. ("SO") ***SOURCE***: **U.S. TRUSTEES**

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*:
Filed: March 2, 2009
Type: Reply Brief of Appellant United States Trustee

7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g., "UST/OGC"]*: Marjorie S. Raleigh, Thomas Kearns, P. Matthew Sutko, Robert D. Miller, Jr.
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***: **BANKRUPTCY**

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***:
• Whether the statutory text, context, and purpose of §§ 1325(b)(2) and (3) and 707(b)(2)(A)(iii), which govern expense allowances for above-median-income debtors, preclude the deduction of secured debt payments that debtors will not make because they have surrendered the collateral.

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UNITED STATES BANKRUPTCY APPELLATE PANEL OF THE NINTH CIRCUIT

In re

TIMOTHY J. SMITH and
KARRIE A. SMITH,
Debtors

ROBERT D. MILLER JR.,
Acting United States Trustee,
Appellant
v.
TIMOTHY J. SMITH and
KARRIE A. SMITH,
Appellees

BAP Case No. WW-08-1312

Bankr. Case No. 07-43853
Bankruptcy Court for the Western
District of Washington

REPLY BRIEF OF APPELLANT UNITED STATES TRUSTEE

RAMONA D. ELLIOTT
General Counsel
P. MATTHEW SUTKO
Associate General Counsel
Executive Office for
United States Trustees
Department of Justice
20 Massachusetts Ave., N.W.
Washington, DC 20530

ROBERT D. MILLER JR.
Acting United States Trustee, Region 18
MARJORIE S. RALEIGH
Attorney for the United States Trustee
Office of the United States Trustee
700 Stewart St., Suite 5103
206-553-2000, 206-553-2566 (fax)

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INTRODUCTION

The United States Trustee, together with the chapter 13 trustee and American Express Bank, objected to the proposed chapter 13 plan of Timothy and Karrie Smith ("Debtors") on the grounds that it does not commit all of their projected disposable income to unsecured creditors for a commitment period of five years. The bankruptcy court overruled the objections, and the parties appealed on the grounds that the bankruptcy court erred in its calculation of the Debtors' disposable income, by allowing them to deduct $7,185 in secured debt payments that they will never make, on collateral they are surrendering.

The United States Trustee's opening brief explained that a proper interpretation of 11 U.S.C. § 1325(b)(2) and (3), and § 707(b)(2)(A)(iii), preclude the deduction of such payments in the calculation of disposable income. First, § § 1325(b)(2) and (3) compel the result by limiting deductions to amounts that will be expended in the future. Second, § 707(b)(2)(A)(iii) by its terms limits the deduction to secured debt payments that are identified in the debtor's schedules as contractually due following the date of the petition, thereby precluding payments that the debtor will not make because the collateral is being surrendered. Third, allowing the deduction produces an anomaly in the context of the statute as a whole, because all other allowances are limited to expenses that are actual and/or applicable to the debtor. Fourth, allowing the deductions produces a result which defeats the driving purpose of the legislation, which is to require debtors who have disposable income to pay the maximum they can afford.

The Debtors respond with three principal arguments. First, they assert that the United States Trustee's interpretation of the statutes violates the Ninth Circuit's ruling in *In re Kagenveama*, which they argue requires that income and expenses alike be viewed from a historical perspective. Second, they claim that this result is required to further Congress's purpose in enacting a rigid, formulaic disposable income test. Third, they allege that the United States Trustee's approach would defeat the mechanical means test by reinstating a flexible standard to the determination of disposable income.

The Debtors misconstrue the statute and mischaracterize the United States Trustee's argument. First, the *Kagenveama* court interpreted the language of a different provision, § 1325(b)(1), and Debtors' own interpretation requires that important terms be read out of § § 1325(b)(2) and 707(b)(2)(A)(iii). Second, Debtors' reading of the statute produces an anomaly within the statute by treating secured debt payments differently from all others. The Debtors' interpretation does not survive a holistic analysis, which limits deductions to those expenses that are applicable to or actually incurred by the debtor.

Finally, the United States Trustee does not dispute that the means test is mechanical, but rather asserts that installments on surrendered property are never an appropriate expense item. The United States Trustee's interpretation is compelled by the language of the statute and is the only interpretation that implements Congress's primary purpose of requiring that debtors who have the ability to pay creditors to do so to the maximum they can afford. The Debtors' interpretation of the statute is erroneous because it both ignores important terms and defeats the ultimate purpose of the means test, which is to require debtors to apply all of their disposable income to pay unsecured creditors.

ARGUMENT

I. The Debtors misapply the holding in *In re Kagenveama*, which addressed the income but not the expense component of "disposable income."

In defining "projected disposable income," the Ninth Circuit in *In re Kagenveama* addressed the income component of disposable income and the meaning of "projected disposable income" in the case of debtors with above-median income. *Maney v. Kagenveama* (*In re Kagenveama),* 541 F.3d 868 (9th Cir. 2008). The Court determined that "current monthly income" ("CMI") is derived historically, as the average of the debtor's six months' pre-filing income, a result compelled by the definition of the term in § 101(10A). "Disposable income" is CMI less expenses, which in turn are ascertained by a formula which "determine[s] what expenses are reasonably necessary," citing § 1325(b)(2) and (3). 541 F.3d at 874.

The Debtors misinterpret *Kagenveama* by suggesting that its interpretation of §1325(b)(1) requires or supports the use of historical expenses in determining disposable income. The debtor's expenses under § 1325(b)(2) were not at issue in *Kagenveama*. *See In re Gonzalez*, 388 B.R. 292, 304 (Bankr.S.D.Tex. 2008). To suggest that because the CMI figure is historical means that expenses must also be historical defies the plain language of § 1325(b)(2), which permits only those payments that are "to be expended," and § 707(b)(2)(A)(iii), which by its terms permits only secured debt payments that are "scheduled" as due over the sixty months "following the date of the petition." To include purely historical expenses in the calculation misses the point, which is that the statute be interpreted according to its terms and every phrase and clause be given meaning.

In support of their position that *Kagenveama* applies to expenses, the Debtors cite to the Court's observation that the new calculation presents a "deliberate departure from the old 'disposable income' calculation, which was bound up with the facts and circumstances of the debtor's financial affairs." *In re Kagenveama* 541 F.3d at 874. Repeatedly mischaracterizing the United States

Trustee's position, the Debtors assert that "[t]he Appellants now want the Court to ignore the Ninth Circuit decision in *Kagenveama,* and engage in an analysis of the factors and circumstances of the debtor's financial affairs, and restore judicial discretion to correct perceived errors in the drafting of the Bankruptcy code." Response Brief, p. 7, lines 15-19.

The Debtors confuse the exercise of discretion in ascertaining actual (as opposed to statutory) and projected income, a question of fact, with the purely legal interpretation of a statute. The United States Trustee does not ask for a case-by-case determination of debtors' actual income or expense amounts, except where the statute limits expense allowances to those which are actual, reasonable, and/or necessary.[1] Rather, the United States Trustee simply wants the Court to properly interpret the statute by prohibiting debtors as a matter of law from deducting nonexistent payments on surrendered collateral.

II. The statutory text, context, and purpose of § § 1325(b)(2) and (3) and 707(b)(2)(A)(iii), which govern expense allowances for above-median-income debtors, preclude the deduction of secured debt payments that debtors will not make because they have surrendered the collateral.

Where statutory text is plain, the court's sole function is to enforce it according to its terms, unless to do so would render an absurd result, *Lamie v. U.S.*

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[1] *See* discussion of expense allowances at § III below.

Trustee, 540 U.S. 526, 534 (1999); 157 L.Ed.2d 1024 (2004), or if a literal application "will produce a result demonstrably at odds with the intention of its drafters." *U.S. v. Ron Pair Enters., Inc.,* 489 U.S. 235, 242; 109 S.Ct. 1026 (1982). The United States Trustee asserts that the plain language of § § 1325(b)(2) and (3), as well as § 707(b)(2)(A)(iii), applied independently, do not allow the deduction of debt payments that will not actually be made in the future. However, some courts have found the provisions capable of more than one interpretation, in which case context helps determine whether statutory language is plain or ambiguous, and if ambiguous, context helps clarify its meaning. *See In re Ransom,* 380 B.R. 799, 807 (B.A.P 9th Cir. 2007), *appeal docketed,* No. 08-15066 (9th Cir. Apr. 8, 2008) ("To determine whether statutory language is plain or ambiguous, we refer to 'the language itself, the specific context in which that language is used, and the broader context of the statute as a whole.'").

A. Debtors ignore the phrase "to be expended" in 1325(b)(2) and (3), with the result that their chapter 13 plan fails to commit all projected disposable income to unsecured creditors.

Section 1325(b)(2) defines "disposable income" as "current monthly income received by the debtor . . . less amounts reasonably necessary *to be expended*" for the maintenance and support of the debtor and debtor's dependents. 11 U.S.C. § 1325(b)(2) (emphasis added). Section 1325(b)(3) provides that for debtors with above-median income, “amounts reasonably necessary *to be expended*” be determined in accordance with § 707(b)(2)(A) and (B). 11 U.S.C. § 1325(b)(3) (emphasis added).

The phrase “to be expended” plainly denotes actual, future expenditures. However, as to debtors with above- median income, the Debtors assert that § 1325(b)(3) supplants the whole of § 1325(b)(2), with the result that § 707(b)(2)(A) allowances are deemed “to be expended” in the future, whether or not in fact the debtor will pay the expense. With that premise, amounts that in fact *will not be expended* on secured debts because the collateral has been surrendered are nevertheless deductible in determining disposable income.

Under the Debtors’ interpretation, the use of “to be expended” in § 1325(b)(3) essentially cancels out the same phrase in § 1325(b)(2), thus reading the phrase out of the statute entirely, violating the rule of construction on which *Kagenveama* was based, i.e. that “[c]ourts must give meaning to every clause and word of a statute.” *See Kagenveama*, 541 F.3d at 873. The proper interpretation is that “[t]he [‘to be expended’] phrase is carried over to § 1325(b)(3),” indicating that “amounts to be deducted as secured debt payments are amounts that will be paid in the future as provided in the debtor’s plan.” *In re Hoss*, 392 B.R. 463, 472 (Bankr.D.Kan. 2008). *See also In re McPherson*, 350 B.R. 38, 45 (Bankr.W.D.Va.

2006) ("An amount, the payment of which is never contemplated, cannot be an amount that is to be paid in the future.")

Some courts hold that both conditions of § 1325(b)(2) are carried over to § 1325(b)(3), such that all expense allowances of above-median-income debtors in chapter 13 must be both "reasonably necessary" for specified purposes and "to be expended" in the future. *See In re Gonzalez*, 388 B.R. 292 (deduction for surrendered home not allowed as not being reasonably necessary for the debtors' future maintenance and support). *See also In re McGillis*, 370 B.R. 720, 730 (Bankr.W.D. Mich.2007) ("phantom payments" for surrendered timeshare and avoided second mortgage disallowed for same reason). This is the position of the Chapter 13 Trustee (*see* Chapter 13 Trustee's Opening Brief at pp. 7 -10), and the United States Trustee supports that analysis.

Section 707(b)(2) expense allowances are by their terms limited to amounts that are actual, necessary, and/or reasonably necessary, rendering it unnecessary to apply the *Gonzalez* court's two-part test. However, to the extent that § 707(b)(2)(A)(iii) may be interpreted to allow secured debt payments that are not in fact to be made in the future, a conclusion the United States Trustee vigorously disputes as discussed below, the "to be expended" requirement of § 1325(b)(2) and (3) supplies a factual, temporal limitation that can neither be ignored nor simply deemed to exist, as urged by the Debtors.

B. The Debtors misinterpret § 707(b)(2)(A)(iii) by failing to limit the deduction of secured debt installments to those that are *“scheduled as* contractually due . . . *following the date of the petition.”*

Section 1325(b)(3) requires that “amounts reasonably necessary to be expended” by above-median debtors be determined in accordance with § 707(b)(2)(A) and (B). Section 707(b)(2)(A)(iii) permits the deduction of the debtor’s average monthly payments on account of secured debt, calculated as the total of all amounts “scheduled as contractually due” to secured creditors in each of the 60 months “following the date of the petition.”

The United States Trustee asserts that “scheduled as” has independent significance in the context of a bankruptcy petition, where it references a debt that is included in the debtor’s schedules. *See In re Skaggs*, 349 B.R. 594, 599-600 (Bankr. E.D.Mo. 2006); *In re Naut*, 2008 WL 191297, *8 (Bankr.E.D.Pa. Jan. 22, 2008); *In re Allen*, 2008 WL 451053, *6 (Bankr.D.Kan. Feb. 15, 2008). Disregarding the words “scheduled as,” the Debtors assert that “scheduled as contractually due . . . following the date of the petition” simply means that the debts are contractually due following the petition date and not as of the effective date of the plan.

The Debtors mischaracterize the United States Trustee’s position as using "the actual future expenses of the debtors" reflected in Schedule J "in determining the applicable commitment period," thus "ignoring the specific language of § 707(b)(2)(A)(iii)(I)." *See* Appellees' Brief, p. 12, lines 4 - 8. The United States Trustee advocates referencing Schedule J only to confirm whether debtors actually have the expenses they are claiming on Official Form 22C, such as payments on secured debts, and whether the amounts on Schedule J are consistent with "actual" expenses claimed on Form 22C. Once disposable income is determined by deducting the appropriate expenses from CMI, the court can calculate "projected disposable income" by multiplying the result by the 60-month commitment period applicable to above-median-income debtors. *In re Kagenveama*, 541 F.3d at 872-875.

Debtors also argue that if Congress had intended to allow secured debt payments only if they are continuing, it would have used the term "continuation of actual expenses paid" as it did with expenses for the care and support of an elderly, chronically ill, or disabled household or family member. *See* 11 U.S.C. § 707(b)(2)(A)(ii)(II). However, the purpose served by the term "continuation" in the context of the family care expense is not to ensure that it continues into the future. The expense is allowed only "if applicable" and is limited to "actual" expenses. *See Id.* The "applicable" and "actual" modifiers denote expenses that will be made in the future, while "continuation of actual expenses paid," means that the expense continues from past practice. Debtors analogy is inapposite and should be rejected.

III. Allowing a deduction for secured debt payments that will not actually be made produces a result that is incompatible with the rest of the statute, which allows only those expenses that are "applicable" to the debtor or "actual".

To avoid giving unintended breadth to the secured debt payment allowance of § 707(b)(2)(A)(iii), it is instructive to compare it with the other expenses allowed in § 707(b)(2)(A). *See Ransom*, 380 B.R. at 807 ("To determine whether statutory language is plain or ambiguous, we refer to 'the language itself, the specific context in which that language is used, and the broader context of the statute as a whole,'"), quoting *Robinson v. Shell Oil Co.*, 519 U.S. 337, 341, 117 S.Ct. 843, 136 L.Ed.2d 808 (1997). The comparison will assist in determining whether § 707(b)(2)(A)(iii), as applied to nonexistent payments on surrendered collateral, is ambiguous or plain. If the comparison shows that allowance of the nonexistent payment is an anomaly, the court should interpret the item narrowly so as to create consistency with the rest of the law. *See Ransom*, 330 B.R. at 807 (where a statutory provision seems ambiguous, a holistic approach will clarify its meaning "because only one of the permissible meanings [of that provision] produces a substantive effect that is compatible with the rest of the law").

As explained in the United States Trustee's opening brief, all expenses allowed under § 707(b)(2)(A)(ii) are future-oriented, because they are allowed only if applicable to the debtor or actual in amount.[2] The Debtors acknowledge that most of the expense allowances must by their terms be reasonable and actual. However, they take issue when it comes to the IRS National and Local Standards, noting that "the IRS guidelines are taken from historical data of living expenses [and] do not attempt to project the future." *See* Appellees' Brief, p. 9, lines 11 - 14.

By adopting the IRS allowances for universal necessities of food, clothing, housing, and transportation, Congress limited the bankruptcy court's discretion to inquire into the actual amounts expended by debtors in these categories. The amounts are based on historical data reflecting the average cost to sustain a household nationally and in the debtor's locality. They bear no relation to and do not support the deduction of illusory amounts, representing acquisition costs for items the debtor elected to incur but has since abandoned.

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[2] The IRS National and Local Standards allow the debtor's "applicable" monthly expenses covering basic necessities: food, clothing, household supplies, personal care, and miscellaneous; housing and utilities; transportation. All other expenses, including IRS "Other Necessary Expenses" and additional expenses separately cataloged in § 707(b)(2)(A)(ii), must be "actual" and "reasonably necessary."

In further support of their argument that debtors should be allowed secured debt payments that they do not actually make, the Debtors cite *In re Farrar-Johnson*, 353 B.R. 224, 230-231, (Bankr.N.D.Ill.2006), in which the court permitted the IRS Local Standard housing expense even though the debtors lived on a military base and did not actually pay for their own housing. The court held that the expense was “applicable” to the debtors, even though it was not “actual”, a requirement of all other expense allowances, noting that the resulting disposable income was “divorced from the debtor’s actual circumstances,” producing a plan that was “‘based on a sort of parallel universe.’” 353 B.R. 224, 230-231 (citation omitted).

The Ninth Circuit BAP rejected *Farrar-Johnson* in *Ransom*, 380 B.R. 799, holding that the debtor could not deduct the IRS National Standard vehicle ownership expense, because the debtor owned his vehicle free and clear and therefore the expense did not apply. In reaching its result, the *Ransom* Court stressed the importance of consistency with the overall statute and furtherance of the statute’s purpose of maximizing payments to creditors, noting that “‘[w]hen the debtor has no monthly ownership expenses, it makes no sense to deduct an ownership expense to shield it from creditors.’” 380 B.R. at 807 (quoting *In re Ross-Tousey*, 368 B.R. 762, 766 (E.D.Wis. 2007); *rev’d*, 549 F.3d 1148 (7th Cir.

2008).[3]

IV. The 2005 Act's purpose that debtors repay the maximum amount they can afford is subverted by allowing above-median income debtors to deduct non-existent secured debt payments.

Where a statute is capable of more than one interpretation, it must be construed in a manner that is consistent with its purpose. *U.S. v. Ron Pair Enters., Inc.*, 489 U.S. 235, 242; 109 S.Ct. 1026 (1982) (a literal application is required unless it "will produce a result demonstrably at odds with the intention of its drafters.").

Many courts have concluded that § 1325(b) is plain on its face, yet the "opinions are uniform neither in result nor in reasoning." *In re Gonzalez*, 388 B.R. 292, 297 (Bankr.S.D.Tex. 2008); *see also In re Hoss*, 392 B.R. at 474 ("There can be no doubt that the drafters created a statutory jumble by incorporating § 707(b)(2) into § 1325(b)(3), . . . and that the unjumbling lends itself to numerous interpretations, all of which are defensible.") Whether this Court perceives the

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[3] *Ransom* is on appeal to the Ninth Circuit, and other courts addressing the issue have followed *Farrar-Johnson*, holding that "applicable" turns on the debtor's locality and household size rather than whether the debtor has the expense. *See, e.g. In re Ross-Tousey*, 549 F.3d 1148, 1158. Nevertheless the United States Trustee asserts that *Ransom* is the proper analysis of the statute. Moreover the alternative interpretation, that debtors are given an allowance for basic necessities whether or not they bear that expense, does not support an allowance for acquisition costs they do not have because they have surrendered the goods.

provisions to be clear or ambiguous either by their terms or within their broader context, to allow a deduction for payments the debtor will not make on secured debt that is ultimately discharged, on collateral the debtor has or intends to abandon, is demonstrably at odds with Congress's purpose in enacting the disposable income test. In either case, given two possible interpretations of the statutory language, the court must select the one that harmonizes the applicable provisions and implements the statute's overarching purpose of ensuring that "'debtors pay creditors the maximum they can afford,'" *In re Blausey*, 2009 WL 153241, at * 8, *quoting* H.R. Rep. No. 109-31 (I) at 1 (2005), reprinted in 2005 U.S.C.C.A.N. 88, 89. *See also* *Hoss*, 392 B.R. at 474.

The Debtors attempt to justify the deduction of non-existent mortgage and vehicle expenses by asserting that to do so satisfies congressional intent by promoting the mechanical test, citing *Kagenveama* and the Ninth Circuit's focus on the rigid test. The Debtors' argument elevates the mechanical test to a status that defeats the very goal it is meant to serve. Although *Kagenveama* recognized that use of CMI and application of the mechanical multiplier may result in a disposable income figure that does not accurately predict the future, the Court's reasoning and conclusion were driven by defined statutory terms. Although recognizing that the rigid income component of the calculation may produce inaccurate results in some cases, the fact remains that accuracy in determining disposable income is the goal that drives the analysis whenever possible. *See Blausey*, 2009 WL 153241 at *8 ($4,000 in disability insurance benefits received by the debtors were included in CMI, as excluding the payments "would result in a figure that does not accurately reflect the [debtors'] ability to repay their debts.")

Clearly inaccurate disposable income is an unfortunate, unintended consequence that occurs in cases where the debtor's actual projected income is inconsistent with CMI. The majority of courts have avoided this result in chapter 13 by disallowing payments on surrendered collateral. *See, e.g., In re Hoss,* 392 B.R. at 467-469 (cataloging chapter 7 and 13 cases, and noting that the majority disallows such payments in chapter 13). They reach the result by various routes, some by interpreting "projected disposable income," to require an inquiry into the debtor's actual and projected income, *see, e.g. In re Thomas*, 395 B.R. 914, 923 (B.A.P. 6th Cir. 2008),[4] and others by reasoning that the plan creates a new contract, eliminating the obligation under the original contract for purposes of §

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[4] The Debtor cites *Thomas* for its allowance of the deduction for surrendered collateral in calculating disposable income under both chapter 7 and 13. However, as noted in the text above, *Thomas* ultimately eliminates the expense when projecting the debtor's disposable income. Additionally, the *Thomas* court does not conduct a holistic analysis of § 707(b)(2)(ii), thus erroneously concluding that expense allowances are generally backward looking.

707(b)(2)(A)(iii), *see, e.g. In re McPherson,* 350 B.R. at 46.

Although *Kagenveama*'s interpretation of "projected disposable income" precludes the flexible approach represented by *Thomas*, the Debtors' theory of expense allowances impermissibly exaggerates the potential inaccuracy of disposable income by inserting nonexistent expenses into the analysis. Simply because courts have recognized that the result of a rigid test may be inaccurate in some cases does not justify an expansive, erroneous reading of the statute.

The Debtors promote their interpretation by asserting that "a mechanical test that cannot be varied by the courts will be uniformly applied to all the debtors and creditors. *It is this uniformity that will maximize payment to creditors*." (emphasis added.) *See* Response Brief p. 19, lines 22-25. Yet the mechanical test, no matter how uniformly it is applied, will not in and of itself maximize payment to creditors. The test has no inherent significance and exists only to further the goals of identifying chapter 7 debtors who have disposable income and urge them into chapter 13, and to ensure that chapter 13 debtors pay the maximum they can afford.

CONCLUSION

For these reasons, the United States Trustee respectfully asks this Court to reverse the bankruptcy court's order overruling the United States Trustee's objection to confirmation.

Dated: March 2, 2009

Respectfully submitted,

/s/ Marjorie S. Raleigh
MARJORIE S. RALEIGH
Office of the United States Trustee
700 Stewart Street, Suite 5103
Seattle, WA 98101-1271
Telephone No.: (206) 553-2000
Facsimile No.: (206) 553-2566

Attorney for Appellant, United States Trustee

Certificate of Mailing

I certify that on this date I placed a copy of the following documents in the United States mail, postage prepaid, addressed to the following:

Stanley F. Horak, Esquire
1104 Main Street, Suite 300
Vancouver, WA 98660

William Andrew McNeal, Esquire
Becket & Lee LLP
16 General Warren Boulevard
P.O. Box 3001
Malvern, PA 19355

Christine A. Ford, Esquire
7303 Lakewood Drive W., Suite 11
Lakewood, WA

Gerald R. Pederson, Esquire
P.O. Box 9804
Vancouver, WA 98666

David Howe
1551 Broadway, Suite 600
Tacoma, WA 98402

Dated: March 2, 2009

/s/ Marjorie S. Raleigh
Marjorie S. Raleigh
Attorney for the United States Trustee

Addendum

Statutory Authorities

Tab A

LEXSTAT 11 USCS § 707

UNITED STATES CODE SERVICE

*** CURRENT THROUGH PL 110-460, APPROVED 12/23/2008 ***

TITLE 11. BANKRUPTCY
CHAPTER 7. LIQUIDATION
SUBCHAPTER I. OFFICERS AND ADMINISTRATION

11 USCS § 707

§ 707. Dismissal of a case or conversion to a case under chapter 11 or 13

(a) The court may dismiss a case under this chapter [*11 USCS §§ 701* et seq.] only after notice and a hearing and only for cause, including--

(1) unreasonable delay by the debtor that is prejudicial to creditors;

(2) nonpayment of any fees [or] and charges required under chapter 123 of title 28; and

(3) failure of the debtor in a voluntary case to file, within fifteen days or such additional time as the court may allow after the filing of the petition commencing such case, the information required by paragraph (1) of section 521 [*11 USCS § 521*], but only on a motion by the United States trustee.

(b)

(1) After notice and a hearing, the court, on its own motion or on a motion by the United States trustee, trustee (or bankruptcy administrator, if any), or any party in interest, may dismiss a case filed by an individual debtor under this chapter whose debts are primarily consumer debts, or, with the debtor's consent, convert such a case to a case under chapter 11 or 13 of this *title [11 USCS §§ 1101* et seq. or *1301* et seq.], if it finds that the granting of relief would be an abuse of the provisions of this chapter [*11 USCS §§ 701* et seq.]. In making a determination whether to dismiss a case under this section, the court may not take into consideration whether a debtor has made, or continues to make, charitable contributions (that meet the definition of "charitable contribution" under section 548(d)(3) [*11 USCS § 548(d)(3)*]) to any qualified religious or charitable entity or organization (as that term is defined in section 548(d)(4) [*11 USCS § 548(d)(4)*]).

(2)

(A) (i) In considering under paragraph (1) whether the granting of relief would be an abuse of the provisions of this chapter [*11 USCS §§ 701* et seq.], the court shall presume abuse exists if the debtor's current monthly income reduced by the amounts determined under clauses (ii), (iii), and (iv), and multiplied by 60 is not less than the lesser of--

(I) 25 percent of the debtor's nonpriority unsecured claims in the case, or $ 6,575, whichever is greater; or

(II) $ 10,950.

(ii) (I) The debtor's monthly expenses shall be the debtor's applicable monthly expense amounts specified under the National Standards and Local Standards, and the debtor's actual monthly expenses for the categories specified as Other Necessary Expenses issued by the Internal Revenue Service for the area in which the debtor resides, as in effect on the date of the order for relief, for the debtor, the dependents of the debtor, and the spouse of the debtor in a joint case, if the spouse is not otherwise a dependent. Such expenses shall include reasonably necessary health insurance, disability insurance, and health savings account expenses for the debtor, the spouse of the debtor, or the dependents of the debtor. Notwithstanding any other provision of this clause, the monthly expenses of the debtor shall not include any payments for debts. In addition, the debtor's monthly expenses shall include the debtor's reasonably necessary expenses incurred to maintain the safety of the debtor and the family of the debtor from family violence as identified under section 309 [320] of the Family Violence Prevention and Services Act [*42 USCS § 10421*], or other applicable Federal law. The expenses included in the debtor's monthly expenses described in the preceding sentence shall be kept confidential by the court. In addition, if it is demonstrated that it is reasonable and necessary, the debtor's monthly expenses may also include an additional allowance for food and clothing of up to 5 percent of the food and clothing categories as specified by the National Standards issued by the Internal Revenue Service.

(II) In addition, the debtor's monthly expenses may include, if applicable, the continuation of actual expenses paid by the debtor that are reasonable and necessary for care and support of an elderly, chronically ill, or disabled household member or member of the debtor's immediate family (including parents, grandparents, siblings, children, and grandchildren of the debtor, the dependents of the debtor, and the spouse of the debtor in a joint case who is not a dependent) and who is unable to pay for such reasonable and necessary expenses.

(III) In addition, for a debtor eligible for chapter 13 [*11 USCS §§ 1301* et seq.], the debtor's monthly expenses may include the actual administrative expenses of administering a chapter 13 [*11 USCS §§ 1301* et seq.] plan for the district in which the debtor resides, up to an amount of 10 percent of the projected plan payments, as determined under schedules issued by the Executive Office for United States Trustees.

(IV) In addition, the debtor's monthly expenses may include the actual expenses for each dependent child less than 18 years of age, not to exceed $ 1,650 per year per child, to attend a private or public elementary or secondary school if the debtor provides documentation of such expenses and a detailed explanation of why such expenses are reasonable and necessary, and why such expenses are not already accounted for in the National Standards, Local Standards, or Other Necessary Expenses referred to in subclause (I).

(V) In addition, the debtor's monthly expenses may include an allowance for housing and utilities, in excess of the allowance specified by the Local Standards for housing and utilities issued by the Internal Revenue Service, based on the actual expenses for home energy costs if the debtor provides documentation of such actual expenses and demonstrates that such actual expenses are reasonable and necessary.

(iii) The debtor's average monthly payments on account of secured debts shall be calculated as the sum of--

(I) the total of all amounts scheduled as contractually due to secured creditors in each month of the 60 months following the date of the petition; and

(II) any additional payments to secured creditors necessary for the debtor, in filing a plan under chapter 13 of this *title [11 USCS §§ 1301* et seq.], to maintain possession of the debtor's primary residence, motor vehicle, or other property necessary for the support of the debtor and the debtor's dependents, that serves as collateral for secured debts;

divided by 60.

(iv) The debtor's expenses for payment of all priority claims (including priority child support and alimony claims) shall be calculated as the total amount of debts entitled to priority, divided by 60.

(B) (i) In any proceeding brought under this subsection, the presumption of abuse may only be rebutted by demonstrating special circumstances, such as a serious medical condition or a call or order to active duty in the Armed Forces, to the extent such special circumstances that justify additional expenses or adjustments of current monthly income for which there is no reasonable alternative.

(ii) In order to establish special circumstances, the debtor shall be required to itemize each additional expense or adjustment of income and to provide--

(I) documentation for such expense or adjustment to income; and

(II) a detailed explanation of the special circumstances that make such expenses or adjustment to income necessary and reasonable.

(iii) The debtor shall attest under oath to the accuracy of any information provided to demonstrate that additional expenses or adjustments to income are required.

(iv) The presumption of abuse may only be rebutted if the additional expenses or adjustments to income referred to in clause (i) cause the product of the debtor's current monthly income reduced by the amounts determined under clauses (ii), (iii), and (iv) of subparagraph (A) when multiplied by 60 to be less than the lesser of--

(I) 25 percent of the debtor's nonpriority unsecured claims, or $ 6,000, whichever is greater; or

(II) $ 10,000.

(C) As part of the schedule of current income and expenditures required under section 521 [*11 USCS § 521*], the debtor shall include a statement of the debtor's current monthly income, and the calculations that determine whether a presumption arises under subparagraph (A)(i), that show how each such amount is calculated.

(D) Subparagraphs (A) through (C) shall not apply, and the court may not dismiss or convert a case based on any form of means testing, if--

(i) the debtor is a disabled veteran (as defined in section 3741(1) of title 38 [*38 USCS § 3741(1)*]), and the indebtedness occurred primarily during a period during which he or she was--

(I) on active duty (as defined in section 101(d)(1) of title 10 [*10 USCS § 101(d)(1)*]); or

(II) performing a homeland defense activity (as defined in section 901(1) of title 32 [*32 USCS § 901(1)*]); or

(ii) with respect to the debtor, while the debtor is--

(I) on, and during the 540-day period beginning immediately after the debtor is released from, a period of active duty (as defined in section 101(d)(1) of title 10 [*10 USCS § 101(d)(1)*]) of not less than 90 days; or

(II) performing, and during the 540-day period beginning immediately after the debtor is no longer performing, a homeland defense activity (as defined in section 901(1) of title 32 [*32 USCS § 901(1)*]) performed for a period of not less than 90 days;

if after September 11, 2001, the debtor while a member of a reserve component of the Armed Forces or a member of the National Guard, was called to such active duty or performed such homeland defense activity.

(3) In considering under paragraph (1) whether the granting of relief would be an abuse of the provisions of this chapter [*11 USCS §§ 701* et seq.] in a case in which the presumption in subparagraph (A)(i) of such paragraph does not arise or is rebutted, the court shall consider--

(A) whether the debtor filed the petition in bad faith; or

(B) the totality of the circumstances (including whether the debtor seeks to reject a personal services contract and the financial need for such rejection as sought by the debtor) of the debtor's financial situation demonstrates abuse.

(4) (A) The court, on its own initiative or on the motion of a party in interest, in accordance with the procedures described in *rule 9011 of the Federal Rules of Bankruptcy Procedure*, may order the attorney for the debtor to reimburse the trustee for all reasonable costs in prosecuting a motion filed under section 707(b) [*11 USCS § 707(b)*], including reasonable attorneys' fees, if--

(i) a trustee files a motion for dismissal or conversion under this subsection; and

(ii) the court--

(I) grants such motion; and

(II) finds that the action of the attorney for the debtor in filing a case under this chapter [*11 USCS §§ 701* et seq.] violated *rule 9011 of the Federal Rules of Bankruptcy Procedure.*

(B) If the court finds that the attorney for the debtor violated *rule 9011 of the Federal Rules of Bankruptcy Procedure*, the court, on its own initiative or on the motion of a party in interest, in accordance with such procedures, may order--

(i) the assessment of an appropriate civil penalty against the attorney for the debtor; and

(ii) the payment of such civil penalty to the trustee, the United States trustee (or the bankruptcy administrator, if any).

(C) The signature of an attorney on a petition, pleading, or written motion shall constitute a certification that the attorney has--

(i) performed a reasonable investigation into the circumstances that gave rise to the petition, pleading, or written motion; and

(ii) determined that the petition, pleading, or written motion--

(I) is well grounded in fact; and

(II) is warranted by existing law or a good faith argument for the extension, modification, or reversal of existing law and does not constitute an abuse under paragraph (1).

(D) The signature of an attorney on the petition shall constitute a certification that the attorney has no knowledge after an inquiry that the information in the schedules filed with such petition is incorrect.

(5) (A) Except as provided in subparagraph (B) and subject to paragraph (6), the court, on its own initiative or on the motion of a party in interest, in accordance with the procedures described in *rule 9011 of the Federal Rules of Bankruptcy Procedure*, may award a debtor all reasonable costs (including reasonable attorneys' fees) in contesting a motion filed by a party in interest (other than a trustee or United States trustee (or bankruptcy administrator, if any)) under this subsection if--

(i) the court does not grant the motion; and

(ii) the court finds that--

(I) the position of the party that filed the motion violated *rule 9011 of the Federal Rules of Bankruptcy Procedure*; or

(II) the attorney (if any) who filed the motion did not comply with the requirements of clauses (i) and (ii) of paragraph (4)(C), and the motion was made solely for the purpose of coercing a debtor into waiving a right guaranteed to the debtor under this title.

(B) A small business that has a claim of an aggregate amount less than $ 1,100 shall not be subject to subparagraph (A)(ii)(I).

(C) For purposes of this paragraph--

(i) the term "small business" means an unincorporated business, partnership, corporation, association, or organization that--

(I) has fewer than 25 full-time employees as determined on the date on which the motion is filed; and

(II) is engaged in commercial or business activity; and

(ii) the number of employees of a wholly owned subsidiary of a corporation includes the employees of--

(I) a parent corporation; and

(II) any other subsidiary corporation of the parent corporation.

(6) Only the judge or United States trustee (or bankruptcy administrator, if any) may file a motion under section 707(b) [*11 USCS § 707(b)*], if the current monthly income of the debtor, or in a joint case, the debtor and the debtor's spouse, as of the date of the order for relief, when multiplied by 12, is equal to or less than--

(A) in the case of a debtor in a household of 1 person, the median family income of the applicable State for 1 earner;

(B) in the case of a debtor in a household of 2, 3, or 4 individuals, the highest median family income of the applicable State for a family of the same number or fewer individuals; or

(C) in the case of a debtor in a household exceeding 4 individuals, the highest median family income of the applicable State for a family of 4 or fewer individuals, plus $ 575 per month for each individual in excess of 4.

(7) (A) No judge, United States trustee (or bankruptcy administrator, if any), trustee, or other party in interest may file a motion under paragraph (2) if the current monthly income of the debtor, including a veteran (as that term is defined in section 101 of title 38 [*38 USCS § 101*]), and the debtor's spouse combined, as of the date of the order for relief when multiplied by 12, is equal to or less than--

(i) in the case of a debtor in a household of 1 person, the median family income of the applicable State for 1 earner;

(ii) in the case of a debtor in a household of 2, 3, or 4 individuals, the highest median family income of the applicable State for a family of the same number or fewer individuals; or

(iii) in the case of a debtor in a household exceeding 4 individuals, the highest median family income of the applicable State for a family of 4 or fewer individuals, plus $ 575 per month for each individual in excess of 4.

(B) In a case that is not a joint case, current monthly income of the debtor's spouse shall not be considered for purposes of subparagraph (A) if--

(i) (I) the debtor and the debtor's spouse are separated under applicable nonbankruptcy law; or

(II) the debtor and the debtor's spouse are living separate and apart, other than for the purpose of evading subparagraph (A); and

(ii) the debtor files a statement under penalty of perjury--

(I) specifying that the debtor meets the requirement of subclause (I) or (II) of clause (i); and

(II) disclosing the aggregate, or best estimate of the aggregate, amount of any cash or money payments received from the debtor's spouse attributed to the debtor's current monthly income.

(c)

(1) In this subsection--

(A) the term "crime of violence" has the meaning given such term in section 16 of title 18 [*18 USCS § 16*]; and

(B) the term "drug trafficking crime" has the meaning given such term in section 924(c)(2) of title 18 [*18 USCS § 924(c)(2)*].

(2) Except as provided in paragraph (3), after notice and a hearing, the court, on a motion by the victim of a crime of violence or a drug trafficking crime, may when it is in the best interest of the victim dismiss a voluntary case filed under this chapter [*11 USCS §§ 701* et seq.] by a debtor who is an individual if such individual was convicted of such crime.

(3) The court may not dismiss a case under paragraph (2) if the debtor establishes by a preponderance of the evidence that the filing of a case under this chapter [*11 USCS §§ 701* et seq.] is necessary to satisfy a claim for a domestic support obligation.

Tab B

LEXSTAT 11 USCS § 1325

UNITED STATES CODE SERVICE

*** CURRENT THROUGH PL 110-460, APPROVED 12/23/2008 ***

TITLE 11. BANKRUPTCY
CHAPTER 13. ADJUSTMENT OF DEBTS OF AN INDIVIDUAL WITH REGULAR INCOME
SUBCHAPTER II. THE PLAN

11 USCS § 1325

§ 1325. Confirmation of plan

(a) Except as provided in subsection (b), the court shall confirm a plan if--

(1) the plan complies with the provisions of this chapter [*11 USCS §§ 1301* et seq.] and with the other applicable provisions of this *title [11 USCS §§ 101* et seq.];

(2) any fee, charge, or amount required under chapter 123 of title 28 [*28 USCS §§ 1911* et seq.], or by the plan, to be paid before confirmation, has been paid;

(3) the plan has been proposed in good faith and not by any means forbidden by law;

(4) the value, as of the effective date of the plan, of property to be distributed under the plan on account of each allowed unsecured claim is not less than the amount that would be paid on such claim if the estate of the debtor were liquidated under chapter 7 of this *title [11 USCS §§ 701* et seq.] on such date;

(5) with respect to each allowed secured claim provided for by the plan--

(A) the holder of such claim has accepted the plan;

(B) (i) the plan provides that--

(I) the holder of such claim retain the lien securing such claim until the earlier of--

(aa) the payment of the underlying debt determined under nonbankruptcy law; or

(bb) discharge under section 1328 [*11 USCS § 1328*]; and

(II) if the case under this chapter is dismissed or converted without completion of the plan, such lien shall also be retained by such holder to the extent recognized by applicable nonbankruptcy law;

(ii) the value, as of the effective date of the plan, of property to be distributed under the plan on account of such claim is not less than the allowed amount of such claim; and

(iii) if--

(I) property to be distributed pursuant to this subsection is in the form of periodic payments, such payments shall be in equal monthly amounts; and

(II) the holder of the claim is secured by personal property, the amount of such payments shall not be less than an amount sufficient to provide to the holder of such claim adequate protection during the period of the plan; or

(C) the debtor surrenders the property securing such claim to such holder;

(6) the debtor will be able to make all payments under the plan and to comply with the plan;

(7) the action of the debtor in filing the petition was in good faith;

(8) the debtor has paid all amounts that are required to be paid under a domestic support obligation and that first become payable after the date of the filing of the petition if the debtor is required by a judicial or administrative order, or by statute, to pay such domestic support obligation; and

(9) the debtor has filed all applicable Federal, State, and local tax returns as required by section 1308 [*11 USCS § 1308*].

For purposes of paragraph (5), section 506 [*11 USCS § 506*] shall not apply to a claim described in that paragraph if the creditor has a purchase money security interest securing the debt that is the subject of the claim, the debt was incurred within the 910-day preceding the date of the filing of the petition, and the collateral for that debt consists of a motor vehicle (as defined in section 30102 of title 49 [*49 USCS § 30102*]) acquired for the personal use of the debtor, or if collateral for that debt consists of any other thing of value, if the debt was incurred during the 1-year period preceding that filing.

(b)

(1) If the trustee or the holder of an allowed unsecured claim objects to the confirmation of the plan, then the court may not approve the plan unless, as of the effective date of the plan--

(A) the value of the property to be distributed under the plan on account of such claim is not less than the amount of such claim; or

(B) the plan provides that all of the debtor's projected disposable income to be received in the applicable commitment period beginning on the date that the first payment is due under the plan will be applied to make payments to unsecured creditors under the plan.

(2) For purposes of this subsection, the term "disposable income" means current monthly income received by the debtor (other than child support payments, foster care payments, or disability payments for a dependent child made in accordance with applicable nonbankruptcy law to the extent reasonably necessary to be expended for such child) less amounts reasonably necessary to be expended--

(A) (i) for the maintenance or support of the debtor or a dependent of the debtor, or for a domestic support obligation, that first becomes payable after the date the petition is filed; and

(ii) for charitable contributions (that meet the definition of "charitable contribution" under section 548(d)(3) [*11 USCS § 548(d)(3)*] to a qualified religious or charitable entity or organization (as defined in section 548(d)(4) [*11 USCS § 548(d)(4)*]) in an amount not to exceed 15 percent of gross income of the debtor for the year in which the contributions are made; and

(B) if the debtor is engaged in business, for the payment of expenditures necessary for the continuation, preservation, and operation of such business.

(3) Amounts reasonably necessary to be expended under paragraph (2), other than subparagraph (A)(ii) of paragraph (2), shall be determined in accordance with subparagraphs (A) and (B) of section 707(b)(2) [*11 USCS § 707(b)(2)*], if the debtor has current monthly income, when multiplied by 12, greater than--

(A) in the case of a debtor in a household of 1 person, the median family income of the applicable State for 1 earner;

(B) in the case of a debtor in a household of 2, 3, or 4 individuals, the highest median family income of the applicable State for a family of the same number or fewer individuals; or

(C) in the case of a debtor in a household exceeding 4 individuals, the highest median family income of the applicable State for a family of 4 or fewer individuals, plus $ 575 per month for each individual in excess of 4.

(4) For purposes of this subsection, the "applicable commitment period"--

(A) subject to subparagraph (B), shall be--

(i) 3 years; or

(ii) not less than 5 years, if the current monthly income of the debtor and the debtor's spouse combined, when multiplied by 12, is not less than--

(I) in the case of a debtor in a household of 1 person, the median family income of the applicable State for 1 earner;

(II) in the case of a debtor in a household of 2, 3, or 4 individuals, the highest median family income of the applicable State for a family of the same number or fewer individuals; or

(III) in the case of a debtor in a household exceeding 4 individuals, the highest median family income of the applicable State for a family of 4 or fewer individuals, plus $ 575 per month for each individual in excess of 4; and

(B) may be less than 3 or 5 years, whichever is applicable under subparagraph (A), but only if the plan provides for payment in full of all allowed unsecured claims over a shorter period.

(c) After confirmation of a plan, the court may order any entity from whom the debtor receives income to pay all or any part of such income to the trustee.

BRIEF BANK — "SUMMARY SHEET"

Printed Mon.-1/11/99 (16:59)

WESTLAW CODES

1. ("TI") *TITLE* OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	**IN RE SMITH (SMITH v. BUTLER)**
2. ("CO") *CURRENT* COURT *[E.g., "CTA9"]*	CTA11
3. ("CCN") *CURRENT* CASE NO.	No.: 98-8190
4. ("PCN") *PRIOR* CASE NO. & COURT *[IF ANY]*	No.: 97-00250 Court: S.D.Ga. *(Identify judge & cite, if any)*
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8. ("TO") *TOPIC*	**BANKRUPTCY**
9. ("SU") ! *SUMMARY* OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	! Whether "bad faith" constitutes "cause" for dismissal under 11 U.S.C. 707(a); and what constitutes "substantial abuse" sufficient to warrant dismissal under 707(b). (The 707(b) issue was a matter of first impression before the 11th Circuit.) √ **Background:** Here, evidence of "bad faith" & "substantial abuse" included debtors' failure to reduce their expenses, and the fact that they could repay their unsecured creditors almost 80% of their claims.
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UNITED STATES COURT OF APPEALS
FOR THE ELEVENTH CIRCUIT

Case No. 98-8190

In re **DENNIS SMITH** and **VICKI SMITH**, Debtors.

DENNIS SMITH and **VICKI SMITH**, Appellants,

v.

C. DAVID BUTLER, United States Trustee,

Appellee.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF GEORGIA

BRIEF OF APPELLEE UNITED STATES TRUSTEE

C. DAVID BUTLER
UNITED STATES TRUSTEE

MARTHA L. DAVIS
General Counsel
JOHN L. DAUGHERTY
Attorney-Advisor
U.S. Department of Justice
Executive Office for United
States Trustees
901 E St. NW, Suite 780
Washington, DC 20530
(202) 307-1399
(202) 307-2397 (Fax)

OF COUNSEL:
JACK K. BERRY
Assistant United States Trustee
COLUMBUS GILMORE
Senior Attorney-Advisor
Office of the U.S. Trustee
222 W. Oglethorpe Ave. (#302)
Savannah, GA 31412
(912) 652-4112

September 17, 1998

CERTIFICATE OF INTERESTED PERSONS

The undersigned counsel certifies that the following is a complete list of interested persons identified in accordance with Eleventh Circuit Rule 26.1-1:

The Honorable Dudley H. Bowen

The Honorable John S. Dalis

Dennis Smith

Vicki Smith

Terrance P. Leiden, Esq.

Leiden and Leiden, a Professional Corporation

A. Stephenson Wallace, trustee

C. David Butler, United States Trustee

Donald Walton, Regional Assistant United States Trustee

Martha L. Davis, General Counsel, EOUST

John L. Daugherty, Attorney-Advisor, EOUST

Jack K. Berry, Assistant United States Trustee

Columbus Gilmore, Senior Attorney-Advisor

STATEMENT REGARDING ORAL ARGUMENT

The United States Trustee believes the instant appeal raises issues of first impression before this Court requiring oral argument.

CERTIFICATE OF TYPE SIZE AND STYLE

The type size and style used in this brief is 14 point Times New Roman.

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STATEMENT OF JURISDICTION

This case is an appeal from a final Order of the United States District Court for the Southern District of Georgia, which affirmed a decision of the United States Bankruptcy Court for the Southern District of Georgia. The United States Court of Appeals for the Eleventh Circuit has jurisdiction over this appeal pursuant to 28 U.S.C. § 158(d).

STATEMENT OF THE ISSUES

(1) Did the district court err in affirming the bankruptcy court's dismissal of the Smiths' case for bad faith pursuant to 11 U.S.C. § 707(a)?

(2) Did the district court err in affirming the bankruptcy court's dismissal of the Smiths' case for substantial abuse pursuant to 11 U.S.C. § 707(b)?

STATEMENT OF THE CASE

A. Course of Proceedings below

The United States Trustee adopts the statement of the Course of Proceedings set forth in the Brief of Appellants 2.

B. Statement of facts

On June 12, 1996, Dennis and Vicki Smith ("the Smiths") filed a petition for relief under the liquidation provisions of chapter 7 of the Bankruptcy Code. R-1-1(1)-1.[1] The Smiths reported combined monthly

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[1] The citation form "R-1-x-x" refers to the District Court Record contained in one volume, followed by document number and page number. Document 1 of the Record contains the Bankruptcy Court Record. The

income from trade or business of $4,197.00 ($50,364.00 annually), less payroll deductions of $1,332.92, plus other income of $200, for a total gross monthly income of $3,064.08. R-1-1(1)-23. The Smiths also reported monthly expenses of $4,064.57. R-1-1(1)-25. The Smiths scheduled secured debt of $207,806.00, priority tax debt of $19,300, and general unsecured debt of $79,156.96. R-1-1(1)-4. The majority of their debt was consumer debt. R-1-21.

A trial on the motion of the United States Trustee to dismiss the case was held on January 6, 1997. R-1-1.

At trial, Dennis Smith testified that he and his wife are currently self-employed real estate agents. R-1-13. Dennis Smith was formerly employed as a Vice President for manufacturing for Greenfield Industries, earning approximately $75,000 annually. R-1-14, 15. He was terminated from

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Bankruptcy Record document number is noted in parenthesis after the District Court Record document number. Page references to the Bankruptcy Record are to the individual Bankruptcy Record document. The transcript of the Bankruptcy Court does not have a document number and is referenced "R-1-xx", consisting of the volume number and page number.

employment in October of 1992, receiving six months' salary as part of his severance package. R-1-14. At that time, Vicki Smith was employed full-time as a real estate agent and Dennis Smith was employed part-time as a real estate agent in addition to his full-time employment. After his termination, Dennis Smith worked in real estate full time with his spouse. R-1-14, 15. Dennis Smith further testified that their annual household income in 1992 was approximately $133,000. R-1-15.

Since his departure from Greenfield industries in 1992, the Smiths' annual income declined. In 1994, the Smiths reported total income of $81,842. R-1-1(6)-1. The Smiths reported total income of $70,543 in 1995. R-1-1(7)-1. In 1995, the Smiths reported gross business income of $136,229 and total business expenses of $68,172. R-1-1(7)-6. In their schedules, the Smiths claimed monthly gross business income in 1996 of $9,600, which on an annualized basis totaled $115,200, and monthly business expenses of $5,403 ($64,836 annually). R-1-1(1)-27.

At trial, however, it was determined that gross business income for 1996 actually totaled $154,292.91, an average of $ 12,857.74 a month.[2]

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[2] Dennis Smith at one point testified that their 1996 gross income was $139,000, R-1-70, but the higher number was calculated from bank statements and Smith's own testimony for the period October to December 1996. Deposits from commissions totaled $42,355.11 for the period January 1 to June 12, 1996. R-1-1(8)-1; R-1-1(9)-1; R-1-50, 51. From June 28 to September 30, 1996, deposits totaled $71,013.30. R-1-1(10)-2, 4, 6, 8; R-1-35, 36. Finally, Dennis Smith testified that gross income for October 1996 totaled $15,514, November $12,070, and December $13,340.50. R-1-76. The bankruptcy court apparently made a computational error in the Smiths' favor, stating a lower figure of $152,635, or $12,719.50 monthly, an error of $138.24 monthly. R-1-1(17)-3. Throughout this Brief, the correct computations are used. The Smiths have waived any argument on this minor error because they have not raised it below or before this Court. *See United States v. Oakley*, 744 F.2d 1553, 1556 (11th Cir. 1984) (holding that arguments raised for first time in reply brief not properly before court). Furthermore, the computational error should be ignored on review because it

Dennis Smith also testified that business expenses were greater than scheduled, and averaged just less than $8,000 from October through December 1996. R-1-79. Dennis Smith admitted, however, that they were relatively unfamiliar with sound business accounting practices and failed to segregate business and personal expenses until the eve of filing. R-1-35, 40, 59. Based upon the contradictory evidence offered by the Smiths, the bankruptcy court concluded that the monthly business expenses of the Smiths averaged $6,000. R-1-1(17)-3, 4. In addition, the bankruptcy court found that a reasonable payroll deduction for taxes should total $2,000, versus the $1332.92 originally scheduled. R-1-1(17)-4. Based upon these adjustments, the bankruptcy court found that the Smiths' net after-tax income was $5057.74 ($12,857.74 + $200 - $6000 - $2000). Id.

The scheduled expenses of the Smiths also received scrutiny. Dennis Smith testified at trial that he leased a 1996 Lexus ES-300 luxury sedan three months prior to the filing of their bankruptcy petition for $571 a month. R-1-28, 29. The Smiths also owned a 1990 Buick LeSabre automobile subject to

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is *de minimis* and does not affect the substantial rights of the parties. 28 U.S.C. § 2111.

a monthly auto loan payment of $143. R-1-27. The Lexus lease was entered into by “rolling over” an existing $478 a month lease with one year remaining for a 1993 Lexus. R-1-28, 29, 63 to 65. Dennis Smith admitted that when entering into the new lease he and his wife were experiencing financial difficulties. R-1-28, 30. He also admitted that an adequate automobile could be obtained for $300 a month or less. R-1-30.

The Smiths scheduled $1695 as a monthly mortgage payment. R-1-1(1)-25. Dennis Smith testified that their residence in Columbia County, Georgia was valued between $212,000 and $215,000, and was subject to mortgages totaling $178,000. R-1-1(1)-1; R-1-23, 24. He agreed that the cost of an average house in the locality was approximately $100,000, less than half the value of their residence. R-1-26. Dennis Smith testified that he made no effort to sell the residence, would have suffered no loss in a sale, and could have reduced their housing expenses. R-1-25 to 27. Based upon the evidence, the bankruptcy court found that a reasonable housing expense would be $1,000. R-1-1(17)-10.

As mitigating factors, Dennis Smith testified that he sold his Bass Boat, eliminating a $230 monthly payment and netting approximately $700. R-1-18, 19. He testified that they did not carry health insurance, but he admitted that they had not carried health insurance since his termination from Greenfield Industries in October 1992. R-1-17. Dennis Smith let his life insurance expire, but this only resulted in a monthly savings of $80. Id. He also testified that they "substantially" cut back on credit card purchases, but they did not end credit card use entirely. R-1-61. Dennis Smith, however, never made any effort to analyze their credit card debt service. R-1-87. Finally, Dennis Smith testified that they took no vacations, delayed some home repairs, did not purchase any new clothing for themselves, and reduced their long distance telephone expenses. R-1-17, 18, 60.

The bankruptcy court also made findings of fact regarding the ability of the Smiths to pay their creditors in a hypothetical chapter 13 case by revising their monthly budget set forth in their bankruptcy petition. The bankruptcy court removed a scheduled $600 monthly payment to the Internal Revenue Service and the Georgia Department of Taxation because their claims would be addressed in a chapter 13 plan. R-1-1(17)-10. The bankruptcy court also found that their monthly expenses were $2,669.67 ($4,064.67 scheduled - $100 reduction in auto payment - $695 reduction in mortgage/rent payment - $600 payment to taxing authorities). R-1-1(17)-11. After subtracting the monthly expenses from monthly income of $5,057.74, disposable income of

$2,388.07 remains. Id. The bankruptcy court then assumed payment of this amount for 36 months yielding $85,970.52, less a 6% fee to the chapter 13 standing trustee of $3,438.82, for a total of $82,531.70 available for unsecured creditors. Id. After paying the scheduled priority tax claims of $19,300, the remaining unsecured creditors would receive $63,231.70, a 79.9% dividend on their claims totaling $79,165.96.[3] Id.

Finally, the bankruptcy court found that Dennis Smith's termination from Greenfield Industries in 1992, R-1-14, was not the calamity that caused the bankruptcy filing. R-1-1(17)-9, 10. This was contradicted by the

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[3] In addition to the computational error in the Smiths' favor noted in footnote 2, *supra*, the bankruptcy court made two other *de minimis* computational errors in calculating a hypothetical chapter 13 plan. Instead of reducing the mortgage payment to $1000 by subtracting $695 from expenses, the court subtracted $1000, an error of $305. R-1-1(17)-11. In addition, the court loses an additional $0.08 in monthly after tax income. R-1-1(17)-4. Based upon these errors, the bankruptcy court calculated the dividend to creditors to be 84.8% instead of 79.9%. As in footnote 2, the errors are harmless and the Smiths have waived any argument on this issue.

significant income earned by the Smiths from their real estate employment. R-1-1(17)-9. Instead, the bankruptcy court found that the filing was cause by the Smiths inability to reduce their expenses and live within their means. R-1-1(17)-9,10.

C. Standard of Review

This Court must accept the findings of fact of the bankruptcy court unless they are clearly erroneous. E.g., McMillan v. Joseph Decosimo and Company (In re Das A. Borden & Co.), 131 F.3d 1459, 1462 (11th Cir. 1997). A finding is clearly erroneous only when “the reviewing court on the entire evidence is left with the definite and firm conviction that a mistake has been committed.” United States v. United States Gypsum Co., 333 U.S. 364, 395 (1948). If the bankruptcy court's findings as trial court are plausible in light of the record viewed in its entirety, a reviewing court may not reverse even if convinced that it would have weighed the evidence differently as a trier of fact. Anderson v. City of Bessemer City, N.C., 470 U.S. 564, 574 (1985). This standard of review is applied with “particular rigor” if a bankruptcy court’s findings of fact are affirmed by the district court as in the present case. Jet Florida, Inc. v. American Airlines, Inc. (In re Jet Florida Sys., Inc.), 861 F.2d 1555, 1558 (11th Cir. 1988).

Conclusions of law are reviewed de novo. E.g., Das A. Borden, 131 F.3d at 1462. The decision of the district court may be affirmed on any basis supported by the record. Blum v. Bacon, 457 U.S. 132, 137 n.5 (1982).

SUMMARY OF ARGUMENT

The district court did not err in affirming the bankruptcy court's decision to dismiss the Smiths' chapter 7 bankruptcy case. The bankruptcy court's decision was based upon two independent statutory grounds: section 707(a) of the Bankruptcy Code, title 11 U.S.C., and section 707(b).

The bankruptcy court concluded correctly that a debtor's bad faith can constitute "cause" supporting dismissal under section 707(a). Bankruptcy relief is intended only for the "honest but unfortunate debtor," and the concept of good faith pervades the Bankruptcy Code. To hold otherwise, simply because good faith is not explicitly required in the Bankruptcy Code, creates an absurd result, and would allow dishonest and unneedy individuals to obtain a discharge in bankruptcy.

The bankruptcy court's finding that the Smiths filed their petition in bad faith is amply supported by the record. The Smiths, in spite of their financial difficulties, failed to take meaningful measures to reduce their expenses and pay their just debts. Instead, the Smiths remained in a residence subject to mortgages far in excess of what is reasonable in their locality. In addition, the Smiths leased a luxury automobile within three months of filing bankruptcy, even though they had more than one year remaining on an existing auto lease, and owned another automobile.

The evidence in this case amply supports the bankruptcy court's conclusion that the Smiths' filing for chapter 7 relief was a "substantial abuse." The Smiths could repay their unsecured creditors almost 80% of their claims, and they filed for chapter 7 relief in bad faith.   Although the issue of "substantial abuse" is a matter of first impression before this Court, the majority of other circuit courts that have considered this issue have concluded that an ability to pay debts may alone constitute substantial abuse. The majority also hold that a debtor's bad faith can constitute substantial abuse.

ARGUMENT

I. THE DISTRICT COURT CORRECTLY AFFIRMED THE BANKRUPTCY COURT'S DISMISSAL OF THE SMITHS' CASE FOR BAD FAITH PURSUANT TO 11 U.S.C. § 707(a)

A. A finding of bad faith can support dismissal under 11 U.S.C. § 707(a)

Section 707(a) of the Bankruptcy Code, title 11 U.S.C., provides that a court:

> may dismiss a case under this chapter only after notice and a hearing and only for cause, including
>
> (1) unreasonable delay by the debtor that is prejudicial to creditors;
>
> (2) nonpayment of any fees or charges required under chapter 123 of title 28; and
>
> (3) failure of the debtor in a voluntary case to file . . . the information required by paragraph (1) of section 521, but only on a motion by the United States Trustee.

The plain text states that a case may be dismissed upon any ground constituting "cause," and sets out some nonexclusive examples of what could constitute "cause." See 11 U.S.C. § 102(3) (term "including" not limiting).

Although this Court has not decided whether bad faith is a ground for dismissal under section 707(a), it has held that bad faith is a ground for dismissing a chapter 11 case. Albany Partners, Ltd. v. Westbrook (In re Albany Partners, Ltd.), 749 F.2d 670 (11th Cir. 1984). The court in Albany interpreted section 1112 of the Bankruptcy Code which permits a court to dismiss or convert a chapter 11 case for "cause," and this section, like section 707(a), contains nonexclusive examples of "cause." Id. at 674. Because of the equitable nature of determining whether to dismiss or convert a chapter 11 case for "cause," the Court in Albany concluded that a debtor's lack of good faith may constitute cause for dismissal. Id. The reasoning in Albany applies equally to a chapter 7 debtor who must appear before the same bankruptcy court.[4] Bankruptcy courts are courts of equity, and bankruptcy relief is only intended for "the honest but unfortunate debtor." Grogan v. Garner, 498 U.S. 279, 287 (1991) (quoting Local Loan v. Hunt, 292 U.S. 234, 244 (1934)).

One of the leading cases holding that a court can dismiss a chapter 7 case under section 707(a) for bad faith is Industrial Insurance Services, Inc. v.

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[4] It is also similar to a court's inherent power to sanction the bad faith litigant. *Cf. Chambers v. NASCO, Inc.*, 501 U.S. 32, 43-46 (1991).

Zick (In re Zick), 931 F.2d 1124 (6th Cir. 1990). In Zick, the Sixth Circuit held that good faith is a jurisdictional requirement for chapter 7 relief:

> good faith . . . is inherent in the purposes of bankruptcy relief. . . . Bankruptcy protection was not intended to assist those who, despite their own misconduct, are attempting to preserve a comfortable standard of living at the expense of their creditors. Good faith and candor are necessary prerequisites to obtaining a fresh start. The bankruptcy laws are grounded on the fresh start concept. There is no right, however, to a head start.

Id. at 1129-30 (quoting with approval In re Jones, 114 B.R. 917, 926 (Bankr. N.D. Ohio 1990)). Among other reasons supporting dismissal, the court in Zick concluded that "a failure to make significant lifestyle adjustments or efforts to repay" may be sufficient to support dismissal for bad faith. Zick, 931 F.2d at 1128. In other words, one factor in a bad faith analysis is whether the debtor has engaged in any "belt-tightening" before deciding to file for chapter 7 relief. In re Griffieth, 209 B.R. 823, 827 (Bankr. N.D.N.Y. 1996); In re Hammonds, 139 B.R. 535, 542 (Bankr. D. Colo. 1992). Reported lower court cases in the Eleventh Circuit also uniformly recognize that a chapter 7 case may be dismissed for bad faith. In re Sammons, 210 B.R. 197 (Bankr. N.D. Fla. 1997); In re Tanguay, 206 B.R. 575 (Bankr. M.D.

Fla. 1997); Turner v. United States, 195 B.R. 476 (Bankr. N.D. Ala. 1996); In re Davidoff, 185 B.R. 631 (Bankr. S.D. Fla. 1995); In re Ripley & Hill P.A., 176 B.R. 596 (Bankr. M.D. Fla. 1994); In re Creazzo, 172 B.R. 657 (Bankr. M.D. Fla. 1994).

The Eighth Circuit in Huckfeldt v. Huckfeldt (In re Huckfeldt), 39 F.3d 829, 832 (8th Cir. 1994), also recognizes that a bankruptcy court may deny chapter 7 relief to a person who is not an "honest but unfortunate debtor." Although the court in Huckfeldt was loath to use the term "bad faith," preferring merely to state that dismissal was "for cause," id., the result is consistent with the holding in Zick. In Huckfeldt, the debtor was using the bankruptcy to intentionally unload debt which he could shortly begin to repay in order to force his ex-spouse into bankruptcy.[5] Id. at 830. Although the court in Huckfeldt intimated that a mere ability to repay is not cause for

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[5] The bankruptcy court found that the debtor and his ex-spouse had incurred joint debt in part to pay for the debtor's college and medical school education. *Huckfeldt*, 39 F.3d at 830. The debtor filed his petition six months before he would complete his residency in surgery, and took steps to deliberately reduce his annual income. *Id*.

dismissal under section 707(a), the court recognized that it could be bad faith to attempt to discharge debt for an improper purpose. Id. at 832. In this regard, the holding in Huckfeldt is similar to the holding in Zick because Zick held that it is an improper purpose to discharge debt to “preserve a comfortable standard of living.” Zick, 931 F.2d at 1129.

Scattered lower courts have held that a debtor’s bad faith will not support dismissal. In re Etcheverry, 221 B.R. 524 (Bankr. D. Colo. 1998) (appeal pending); In re Landes, 195 B.R. 855 (Bankr. E.D. Pa. 1996); In re Latimer, 82 B.R. 354 (Bankr. E.D. Pa. 1988). These cases rely upon crabbed interpretations of the Bankruptcy Code. For example, the court in Etcheverry held that such a provision cannot be found in the plain terms of the Code. 221 B.R. at 525-26. This court ignores the fact that bankruptcy courts are courts of equity, and can only grant relief to those deserving of it, i.e., the “honest but unfortunate debtor.” The Etcheverry court’s purported reliance on the plain text of the Code, if followed to its logical extreme, would allow the “dishonest and fortunate” debtor to obtain a discharge of his unsecured debt. Such a conclusion is plainly an absurd result not intended by Congress. See generally Public Citizen v. U.S. Dep’t of Justice, 491 U.S. 440, 454-55

(1989) (plain language of statute not followed when it would compel an odd or absurd result).

In the face of this absurd construction, one commentator has attempted to argue that a chapter 7 debtor, unlike a chapter 11 debtor, need not exhibit good faith in seeking relief:

> When a debtor reorganizes, it is allowed to retain its assets . . . . In return for these benefits, Congress requires the debtor to [act] in good faith, for the mutually beneficial purpose of reorganization. On the other hand, when a debtor liquidates, it surrenders all of its nonexempt assets for distribution. . . . Since liquidation requires no ongoing relationship between the debtor and its creditors, the remedy of discharge should be made available to any debtor who wishes to pay the price . . . . This is true regardless of whether the debtor's motive in seeking such a remedy was grounded in good faith.

Katie T. Kimlinger & William P. Wassweiler, The Good Faith Fable of 11 U.S.C. § 707(a): How Bankruptcy Courts Have Invented a Good Faith Filing Requirement for Chapter 7 Debtors, 13 Bankr. Dev. J. 61, 65 (1996). Their argument is wanting. It ignores the real nature of a chapter 7 proceeding (for individuals), which is to obtain a discharge of indebtedness and not to liquidate assets. Over 90 percent of chapter 7 cases, like the instant case, involve no distribution to creditors. See Jean Braucher, Increasing

Uniformity in Consumer Bankruptcy: Means Testing as a Distraction and the National Bankruptcy Review Commission as a Starting Point, 6 Am. Bankr. L. Rev. 1, 24 (1998)(discussing estimates of percentage of no-asset cases). Given the real benefit provided to debtors -- a discharge of all indebtedness with limited exceptions -- and the countervailing total loss to creditors in the great majority of cases, the opportunity for bad faith by parties wishing to live comfortably at the expense of their creditors is great. For these reasons, the courts must not permit debtors lacking good faith to avail themselves of a discharge.

B. Dismissal of the Smiths' case under 11 U.S.C. § 707(a) for bad faith was proper

By filing bankruptcy, the Smiths attempted to use a chapter 7 discharge to maintain a lifestyle beyond their means by shedding their credit card debt. They acted in bad faith by failing to engage in a meaningful reduction of their lifestyle in an attempt to meet their financial obligations.

The Smiths were attempting to maintain a residence valued between $213,000 and $215,000, more than twice the value of the average house in their locality, by paying $1695 monthly on mortgages totaling $178,000. R-1-23, 24. Despite the fact that the Smiths were real estate agents (thereby eliminating or reducing real estate commissions), R-1-14, 15, and could have avoided any loss on the sale, R-1-25 to 27, the Smiths ignored this obvious avenue for reducing their expenses. The mortgage payment, their largest monthly expense, was excessive. The willingness of the Smiths to maintain these payments at the expense of their other creditors bears all of the marks of bad faith.

The conclusion that the Smiths acted in bad faith by blithely attempting to use a chapter 7 discharge to live beyond their means was driven home by their lease of a 1996 Lexus ES-300 luxury automobile on the eve of filing bankruptcy. R-1-28, 29. Dennis Smith admitted that they were in severe financial difficulties when he entered into the auto lease which called for monthly payments of $571, and further admitted that an adequate automobile could have been obtained for only $300 a month. R-1-28, 30. The lease was affected by a “roll over” of an existing Lexus lease that was approximately $100 cheaper and had one year remaining. R-1-63 to 65. Any rationale for leasing the Lexus was further weakened by the fact that the Smiths already possessed adequate transportation in a 1990 Buick LeSabre, and could have used the 1993 Lexus for another year. R-1-27, 29.

The evidence presented by Dennis Smith of their piecemeal and half-hearted attempts to reduce expenses fails to demonstrate that the bankruptcy court erred in dismissing the case. The only substantial reduction in the Smiths' expenses occurred when Dennis Smith sold his Bass boat, eliminating a $230 monthly payment and netting approximately $700. R-1-18, 19. Other reductions were minor or unquantifiable. Although the Smiths did not carry health insurance, they had not carried health insurance since Dennis Smith's termination from Greenfield Industries in October 1992. R-1-17. Dennis Smith let his life insurance expire, but this only resulted in a monthly savings of $80. Id. He also testified that they "substantially" cut back on credit card purchases, but they did not end credit card use entirely. R-1-61. The fact that at times the minimum credit card payments were made instead of paying secured creditors or taxing authorities does not evidence good faith but merely highlights the unwillingness of the Smiths to address their obligations by curtailing their comfortable lifestyle.

Finally, Dennis Smith testified that they took no vacations, delayed some home repairs, did not purchase any new clothing for themselves, and reduced their long distance telephone expenses. R-1-17, 18, 60. These minor reductions do not evidence the belt-tightening called for, but merely highlight their unwillingness to address their excessive mortgage and automobile lease expenses.

In conclusion, the district court's decision to affirm the bankruptcy court's dismissal for bad faith is amply supported by the record. The district and bankruptcy court's correctly interpreted section 707(a), and the Smiths have failed to show that the bankruptcy court's findings were clearly erroneous.[6]

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[6] The Smiths also argue that the motion of the United States Trustee to dismiss under section 707(a) was procedurally improper because entry of a discharge is not delayed even if a motion under section 707(a) is pending. Brief of Appellants 11-14. This argument is frivolous. No order of discharge was ever entered because a motion covered by Fed. R. Bankr. P. 1017(e) (the United States Trustee's 707(b) motion) was pending. Fed R. Bankr. P. 4004(c)(1)(d).

II. THE DISTRICT COURT CORRECTLY AFFIRMED THE BANKRUPTCY COURT'S DISMISSAL OF THE SMITHS' CASE FOR SUBSTANTIAL ABUSE PURSUANT TO 11 U.S.C. § 707(b)

A. An ability to repay is sufficient to support dismissal for substantial abuse

Section 707(b) of the Bankruptcy Code provides that a court

> on its own motion or on a motion by the United States trustee, but not at the request or suggestion of any party in interest, may dismiss a case filed by an individual debtor under this chapter whose debts are primarily consumer debts if it finds that the granting of relief would be a substantial abuse of the provisions of this chapter. There shall be a presumption in favor of granting the relief requested by the debtor.

This provision was added to the Bankruptcy Code by Title III of the Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, 98 Stat. 355 (1984). The term "substantial abuse" is not defined in the Bankruptcy Code. Committee reports for this act also were not issued, which would have been an authoritative expression of legislative intent. Garcia v. United States, 469 U.S. 70, 76 (1984). Statements by individual legislators discussing this section are divided, Zolg v. Kelly (In re Kelly), 841

F.2d 908, 914 n.6 (9th Cir. 1988), and are of negligible utility in determining Congressional intent. Garcia, 469 U.S. at 76.

However, the Senate Judiciary Committee issued a report in 1983 on S. 445, a predecessor of the 1984 Act. Kelly, 914 F.2d at 914. It states that dismissal for substantial abuse is intended to

> uphold[] creditors' interests in obtaining repayment where such repayment would not be a burden . . . . if a debtor can meet his debts without difficulty as they come due, use of Chapter 7 would represent a substantial abuse.

S. Rep. No. 65, 98th Cong., 1st Sess. 53, 54 (1983). One court also noted that the primary impetus for the 1984 enactment of 707(b) was the credit industry's concern over the increasing use of chapter 7 relief by consumer debtors who were able to repay their debts since enactment of the Bankruptcy Code in 1978. First USA v. Lamanna (In re Lamanna), --- F.3d ---, 1998 WL 514106 at *2 (1st Cir. Aug. 25, 1998).

This Court has not yet decided a case involving "substantial abuse" under section 707(b)[7]. While other Circuits espouse slightly differing

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[7] No clear consensus on "substantial abuse" exists among lower courts in the Eleventh Circuit. Some cases appear to adopt a general totality of

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circumstances. *In re Weber*, 208 B.R. 575 (Bankr. M.D. Fla. 1997) (based on ability to pay and totality of circumstances); *In re Woodhall*, 104 B.R. 544 (Bankr. M.D. Ga. 1989); *In re Tefertiller*, 104 B.R. 513 (Bankr. N.D. Ga. 1989); *In re Busbin*, 95 B.R. 240 (Bankr. N.D. Ga. 1989); *In re Strange*, 85 B.R. 662 (Bankr. S.D. Ga. 1988). Some cases appear based solely upon ability to pay without consideration of other factors. *In re Seager*, 211 B.R. 81 (Bankr. M.D. Fla. 1997) (follows 8th and 9th Circuits); *In re Matias*, 203 B.R. 490 (Bankr. S.D. Fla. 1996) (same); *In re Dickerson*, 193 B.R. 67 (Bankr. M.D. Fla. 1996); *In re Dickerson*, 166 B.R. 480 (Bankr. N.D. Ga. 1993); *In re Rushing*, 93 B.R. 750 (Bankr. N.D. Fla. 1988) (based upon ability to pay and debtor's intent to maintain lifestyle). Some cases appear to adopt the totality of circumstances test enunciated by the Fourth Circuit. *In re Gentri*, 185 B.R. 368 (Bankr. M.D. Fla. 1995); *In re Tindall*, 184 B.R. 842 (Bankr. M.D. Fla. 1994); *In re Blair*, 180 B.R. 656 (Bankr. N.D. Ala. 1995) (ability to pay most important factor; court should consider other factors); *In re Rogers*, 168 B.R. 806 (Bankr. M.D. Ga. 1993); *In re Lee*, 162 B.R. 31 (Bankr. N.D. Ga. 1993). Finally, the court in *In re Attanasio,* 218 B.R. 180 (Bankr. N.D. Ala. 1998), in a lengthy analysis declined to follow definitions of substantial abuse, they uniformly uphold a court's discretion to consider a range of factors, or the "totality of circumstances" in deciding whether to dismiss a case for substantial abuse. The primary factor, however, in deciding an issue of substantial abuse is the debtor's ability to repay.

The First and Sixth Circuits have adopted the predominant definition of substantial abuse that is based upon the "totality of circumstances":

> Substantial abuse can be predicated upon either lack of honesty or want of need.
>
> It is not possible, of course, to list all the factors that may be relevant to ascertaining a debtor's honesty. Counted among them, however, would surely be the debtor's good faith and candor in filing schedules and other documents, whether he has engaged in "eve of bankruptcy purchases," and whether he was forced into Chapter 7 by unforeseen or catastrophic events.
>
> Among the factors to be considered in deciding whether a debtor is needy is his ability to repay his debts out of future earnings. That factor alone may be sufficient to warrant dismissal.

<u>In re Krohn</u>, 886 F.2d 123, 126 (6th Cir. 1989); <u>Lamanna</u>, 1998 WL 514106 at *3 (quoting in part above language with approval). Under this definition, although a bankruptcy court should examine the equities of an individual

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any existing analysis of substantial abuse.

case, it may dismiss a case if the debtor is able to repay his debts out of future earnings. See also Lamanna, 1998 WL 514106 at *1 ("we don't require a court to look beyond the debtor's ability to repay if that factor warrants the result").

The Eighth and Ninth Circuits have adopted a similar approach to substantial abuse. These Circuits focus on whether a debtor is financially needy and hold that the primary factor evidencing substantial abuse is a debtor's ability to repay the debts for which a discharge is sought . In re Walton, 866 F.2d 984-85 (8th Cir. 1989) (quoting with approval Kelly, 841 F.2d at 914-915 (citations omitted)). While the Eighth and Ninth Circuit decisions have been labeled a "per se" test, e.g., In re Motaharnia, 215 B.R. 63, 70 n.10 (Bankr. C.D. Cal. 1997), a closer examination of these decisions reveals that they do not preclude use of the "totality of circumstances" set forth in the First and Sixth Circuits. The Eighth Circuit in Walton noted that "[c]ertainly the court may take the petitioner's good faith and unique hardships into consideration under section 707(b)." 866 F.2d at 983 (citation omitted). And the Ninth Circuit in Kelly stated that "[t]his is not to say that inability to pay will shield a debtor from section 707(b) dismissal where bad faith is otherwise shown." 841 F.2d at 915. See also In re Morse, 164 B.R.

651 (Bankr. E.D. Wash. 1994) (discussing ability to consider mitigating factors); In re Martin, 107 B.R. 247 (Bankr. D. Alaska 1989) (ability to pay outweighed by mitigating factors of debtors' residence in remote Alaskan village and uncertain and difficult future).

The Fourth Circuit is the only Circuit holding that ability to repay alone is not a sufficient basis to dismiss. Green v. Staples (In re Green), 934 F.2d 568, 572 (4th Cir. 1991). Green stated that a court should evaluate the following factors in addition to ability to repay:

> (1) Whether the bankruptcy petition was filed because of sudden illness, calamity, disability, or unemployment;
>
> (2) Whether the debtor incurred cash advances and made consumer purchases far in excess of his ability to repay;
>
> (3) Whether the debtor's proposed family budget is excessive or unreasonable;
>
> (4) Whether the debtor's schedules and statement of current income and expenses reasonably and accurately reflect the true financial condition; and
>
> (5) Whether the petition was filed in good faith.

Id. (citations omitted). These factors do not necessarily involve balancing all of the factors, however. In the case of In re Kestell, 99 F.3d 146, 150 (4th Cir. 1996), the Fourth Circuit affirmed a dismissal for substantial abuse solely upon a finding of bad faith.

The United States Trustee urges the Court to affirm the decision of the district court below. The bankruptcy court in a proper exercise of discretion decided that the bankruptcy filing of the Smiths was a substantial abuse of the provisions of chapter 7. The bankruptcy court did not dismiss the Smiths' case solely because of the Smiths' ability to repay their creditors, but only after considering any mitigating factors, and taking into account the bad faith of the Smiths. Such an analysis is consistent with the legislative intent of the statute and the application of substantial abuse adopted by the First, Fourth, Sixth, Eighth, and Ninth Circuits.

B. The record supports dismissal of the Smiths' case for substantial abuse

The bankruptcy court's decision that granting the Smiths a chapter 7 discharge would be a substantial abuse is supported by the evidence and consistent with predominant interpretations of substantial abuse. Contrary to the Smiths' assertion, the bankruptcy court did not engage in a "onedimensional" focus in evaluating whether the filing was a substantial abuse. The bankruptcy court reviewed whether the Smiths had an ability to pay their debts, considered any mitigating factors advanced by the Smiths, and considered any aggravating factors such as bad faith.

As discussed in section I.B supra, the Smiths' desire to maintain their lifestyle and continue to live beyond their means at the expense of their unsecured creditors constituted bad faith. The bankruptcy court did not err in dismissal because bad faith alone can support dismissal for substantial abuse.

Similarly, the bankruptcy court did not err in finding that the Smiths could pay a substantial portion of their debt in a hypothetical chapter 13 case. The court found that their gross business income for 1996 was $154,292.91, or on average $12,857.74 a month, based upon the Smiths' own bank statements and Dennis Smith's testimony regarding their income in the last three months of 1996. See footnote 2, supra. The bankruptcy court found that their business expenses averaged $6,000 monthly. R-1-1(17)-3, 4. The debtors only scheduled business expenses of $5,403. R-1-1(1)-27. Although Dennis Smith testified that his business expenses averaged $8,000, this was based upon the last three months of the year. R-1-79. In addition, Dennis Smith's latter-day estimates carried little weight in light of his admissions that they were relatively unfamiliar with sound business accounting practices and failed to segregate business and personal expenses until the eve of filing. R-1-35, 40, 59. After weighing the contradictory evidence presented by the Smiths, the bankruptcy court did not err in concluding that their average monthly business expenses were $6,000.

The bankruptcy court was not clearly erroneous in analyzing the ability of the Smiths to repay in the context of a hypothetical chapter 13 case. Courts often analyze the debtor using chapter 13 concepts. E.g., Stuart v. Koch (In re Koch), 109 F.3d 1285, 1288 (8th Cir. 1997); Walton, 866 F.2d at 984-85. Such an analysis utilizes the concept of "disposable income," 11 U.S.C. § 1325(b)(1)(B), which is defined in part as income reasonably necessary to be expended for the maintenance and support of the debtor, including certain charitable contributions. 11 U.S.C. § 1325(b)(2)(A). Contrary to the assertion of the Smiths, Brief of Appellants 43-51, courts determining a debtor's disposable income can and do review mortgage payments for reasonableness. See In re Kitson, 65 B.R. 615, 621 (Bankr. E.D.N.C. 1986) (chapter 13 - mortgage unreasonable); In re Jones, 55 B.R. 462, 467 (Bankr. D. Minn. 1985) (chapter 13 - "house payment" unreasonable).

The Smiths do not challenge the bankruptcy court's conclusion that the lease payment for the Lexus was not reasonable. In fact, the bankruptcy court reduced the amount budgeted for this by only $100, when Dennis Smith admitted that adequate transportation could be obtained for $300, a reduction of $271. R-1-30.

The bankruptcy court's finding that $1,000 is a reasonable monthly payment for mortgage or rent is also supported by the evidence and not clearly erroneous. Dennis Smith admitted that the value of an average house in his locality was $100,000. R-1-26. The mortgage on the average house would likely not exceed $588, assuming an $80,000 mortgage at 10% for 30 years[8], and the Smiths undoubtedly could have obtained more than adequate rental accommodations for $1000.[9]

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[8] Although the bankruptcy court did not explain the basis for the $1000 figure, it would service a 30 year mortgage of approximately $136,000 at 8%; $114,000 at 10%; and $97,000 at 12%.

[9] The reasonableness of the bankruptcy court's determination is highlighted by other data on housing in Columbia County, Georgia. The Bureau of the Census states that the 1990 median value of owner-occupied noncondominium housing units in Columbia County is $83,700. U.S.

The reasonableness of the bankruptcy court's conclusion is highlighted by the emotional but misguided argument made by the Smiths that "housing is a priority, and not just adequate housing but housing commensurate with an individual's station in life."[10] Brief of Appellants 48. The United States

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Department of Commerce, Bureau of the Census, *USA Counties 1996* (corrected edition), *available in* http://govinfo.library.orst.edu. With a value of between $213,000 and $215,000, the Smiths' residence is valued approximately 250% over the county median. The Internal Revenue Service also provides an allowance for housing and utilities when analyzing the ability of a taxpayer to repay a tax obligation. U.S. Department of the Treasury, Internal Revenue Service, *Internal Revenue Manual* §§ 5323.12, 5323.41. The allowance in Columbia County, Georgia is $1001. *Internal Revenue Manual* § 4323.433(a) and Exhibit 5300-50 (updated October 2, 1995).

[10] The Smiths also argue, without any citation to the Bankruptcy Code or case law, that any review of a debtor's mortgage expenses in the context of 11 U.S.C. § 707 is improper. Brief of Appellant 43-51. This argument is based upon the Fourth Amendment to the U.S. Constitution and "general housing policy" of the United States. The "general housing policy" referred to consists of scattered Congressional and Presidential statements and

Trustee cannot comment on the Smiths' subjective assertions about their "station in life." However, having made the affirmative decision to file bankruptcy, the Smiths have placed the financial affairs underpinning their "station in life" at issue. Nobody is forcing the Smiths to leave their home. The bankruptcy court merely concluded, based upon the application of neutral Bankruptcy Code standards, that the Smiths had an ability to repay their debt after making adjustments for their excessive expenses. In the context of the bankruptcy court's adjustment for housing, the Smiths cannot honestly say that an expenditure of $1,000 monthly for housing will force them into a slum or homeless shelter.[11]

Legislative History focusing primarily on providing incentives to home-loan lenders, and to low and moderate-income home buyers. The Fourth Amendment is not applicable because the Smiths cannot allege that their residence has been seized by the federal government or their reasonable expectation of privacy as been invaded. *United States v. Bachner*, 706 F.2d 1121, 1125 (11th Cir.), *cert. denied*, 464 U.S. 896 (1983) .

[11] The Smiths, however, do appear to have an irrational fear of becoming associated with the landless classes: "Nowhere in the policy of the Bankruptcy Code or the housing laws of the United States has Congress

Finally, the Smiths have failed to establish any countervailing considerations that would militate against dismissal. Although the Smiths attempt to argue that Dennis Smith's termination from Greenfield Industries in 1992, R-1-14, was an "unforeseen financial calamity" causing the bankruptcy filing, Brief of Appellants 24, the bankruptcy court correctly found that it did not lead to the filing. R-1-1(17)-9, 10. The Smiths continued to earn significant income from their real estate employment, as evidenced by their reported total income of $81,842 in 1994, R-1-1(6)-1, $70,542 in 1995, R-1-1(7)-1, and gross income of $152,635 in 1996. See footnote 2, supra. The Smiths also had sufficient income and time after Dennis Smith's termination to engage in meaningful "belt-tightening." This

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declared that people will be forced to move out of their homes, *become renters or even homeless*, for the purposes of paying credit card debt." Brief of Appellants 50 (emphasis added). Although this fear may have had some merit in the early days of our republic, *see* Chilton Williamson, *American Suffrage: From Property to Democracy 1760-1860* at 131-132 (1960)(stating that Georgia eliminated property ownership suffrage requirement in 1798), it has no place in our modern society.

failure to properly address their expenses, not any "unforeseen calamity," was the direct cause of their bankruptcy filing. See section I.A., supra.

In conclusion, the bankruptcy court's decision to dismiss the Smiths' case for substantial abuse is amply supported by the record. The Smiths have an ability to repay their creditors a significant dividend if they choose to file a chapter 13 proceeding, and have acted in bad faith in seeking chapter 7 bankruptcy relief. No other factors militate against these findings.[12]

CONCLUSION

For the foregoing reasons, this honorable Court should AFFIRM the judgment of the District Court.

Dated: September 17, 1998

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[12] The decision of the bankruptcy court is also proper under the *Green* test. Although factor 2 (excessive cash advances and purchases) is not present, all other factors in addition to an ability to pay support dismissal: factor 1 (the Smiths' filing is not caused by any calamity), factor 3 (the budget of the Smiths is excessive), factor 4 (the Smiths' scheduled income and expenses were not accurate), and factor 5 (the Smiths filed in bad faith).

Respectfully submitted,

MARTHA L. DAVIS
General Counsel

OF COUNSEL:
JACK K. BERRY
Assistant United States Trustee
COLUMBUS GILMORE
Attorney-Advisor
Office of the U.S. Trustee
222 W. Oglethorpe Ave.
Suite 302
Savannah, GA 31412
(912) 652-4112

____
John L. Daugherty
Attorney-Advisor
U.S. Department of Justice
Executive Office for United
States Trustees
901 E Street NW, Suite 780
Washington, DC 20530
(202) 307-1399
Counsel for C. David Butler
United States Trustee

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing brief was sent via FedEx, on the 17th day of September, 1998, to:

United States Court of Appeals for the
Eleventh Circuit
56 Forsyth St. NW
Atlanta, GA 30303
(original + 7 copies)

Terrance P. Leiden
Leiden & Leiden
330 Telfair St.
Augusta, GA 30901
(2 copies)

John L. Daugherty

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CASE NO. No. 10-2007

IN THE UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

In re

MATTHEW SCOTT SOOS,
Debtor.

KELLEY L. SKEHEN, Trustee
Appellant,

v.

MATTHEW SCOTT SOOS,
Appellee.

On Appeal from the United States Bankruptcy Court for the District of New Mexico, as Certified by the United States Bankruptcy Appellate Panel of the Tenth Circuit
The Honorable Bankruptcy Judge Mark B. McFeeley
Bankr. No. 09-10557-m13

BRIEF OF AMICUS CURIAE, UNITED STATES OF AMERICA

In Support of Reversal
Oral Argument Requested

RAMONA D. ELLIOTT
General Counsel
P. MATTHEW SUTKO
Associate General Counsel
CATHERINE B. SEVCENKO
Trial Attorney
Department of Justice
Executive Office for United States Trustees
20 Massachusetts Avenue, NW
Washington, DC 20530
Telephone: (202) 307-1399

RICHARD A. WIELAND
United States Trustee, Region 20
Office of the United States Trustee
Department of Justice
301 N. Main, Suite 1150
Wichita, KS 67202
Telephone: (316) 269-6161

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MISCELLANEOUS

INTEREST OF THE UNITED STATES

The United States submits this brief under Federal Rule of Appellate Procedure 29 as *amicus curiae* in support of reversal of the bankruptcy court's order below.

This appeal will determine whether chapter 13 debtors may shield almost $30,000 from their creditors over the five-year life of their chapter 13 repayment plans by claiming "phantom" vehicle expenses, expenses that are "phantom" because the debtors will never incur them.[1] Section 1325(b), which incorporates section 707(b)(2)(A), allows debtors to deduct $489 to cover car loan payments. In the United States' view, the text of sections 1325 and 707 each independently bars debtors from reducing creditor recoveries by claiming this expense when they have no loan or lease payment.

The United States has a direct interest in the construction of these two provisions and in ensuring debtors make fair payments to creditors. This is so because Justice Department officials, known as United States

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[1] *In re Turner*, 574 F.3d 349, 356 (7th Cir. 2009) (holding 11 U.S.C. § 1325(b) precludes debtors from claiming "phantom" expenses they will not actually pay over the life of their chapter 13 repayment plans).

Trustees, supervise the administration of bankruptcy cases in all federal judicial districts within this circuit. *See* 28 U.S.C. §§ 581-589a. *See also* H.R. Rep. No. 95-595 at 88 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6049 (explaining that United States Trustees "serve as bankruptcy watch-dogs to prevent fraud, dishonesty, and overreaching in the bankruptcy arena").

The Bankruptcy Code authorizes United States Trustees to review repayment plans that debtors propose under section 1325 and to submit comments about them to the bankruptcy courts. 28 U.S.C. § 586(a)(3)(C). United States Trustees also have a congressional charge to review chapter 7 cases and to file suit under section 707(b), the other section at issue in this appeal, when a chapter 7 debtor's case merits dismissal or conversion to chapter 13. *See* 11 U.S.C. §§ 707(b)(1), (2); 11 U.S.C. § 704(b); *In re Stewart*, 175 F.3d 796, 805 (10th Cir. 1999) (involving action taken by a United States Trustee under the pre-2005 version of section 707)).

Accordingly, the United States has devoted significant resources to addressing whether either section 707(b) or section 1325 prevents debtors from shielding hundreds of dollars each month from their creditors by claiming a vehicle loan or lease deduction they do not actually have. The issue is significant. Allowing chapter 13 debtors to claim such a deduction can result in a nearly $30,000 windfall shielded from creditors over a five-year repayment plan. It can also affect whether a chapter 7 debtor is eligible for chapter 7 relief.

Given these interests, the United States submits this *amicus* brief to share its views on the application of sections 707(b)(2) and 1325(b) in support of reversal.[2] This brief **(a)** explains why the United States has concluded that the better reading of the text of sections 1325 and 707(b) each independently prevent debtors from claiming phantom car expenses, and **(b)** suggests that this Court's recent interpretation of section 1325(b)(1)(B) in *Hamilton v. Lanning* mandates reversal in this case.

SUMMARY OF THE ARGUMENT

1. This case turns on the meaning of two words in the Bankruptcy Code: "applicable" in section 707(b)(2)(A)(ii)(I) and "projected" in section 1325(b)(1)(B). If this Court agrees with the United States' construction of either word, then it should reverse the bankruptcy's order confirming Mr. Soos' chapter 13 plan, which incorporates its earlier order allowing Mr.

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[2] *See* 28 U.S.C. § 517 (authorizing Department of Justice "to attend to the interests of the United States in a suit pending in a court of the United States"); 11 U.S.C. § 307 (United States Trustee "may raise and may appear and be heard on any issue in any case or proceeding").

Soos an allowance for car payments although there is no doubt his vehicle is paid in full.

2. Mr. Soos, like all chapter 13 debtors, was required to propose a repayment plan. 11 U.S.C. § 1321. Above-median-income debtors, like Mr. Soos, must develop this plan by calculating their monthly disposable income under sections 1325(b)(2) and (3).

Section 1325 required Mr. Soos to begin calculating his chapter 13 expenses by applying the rules set forth in section 707(b)(2)(A)(ii)(I). Section 707(b)(2) allows debtors to claim some "applicable" expenses and some actual expenses. The only "applicable" expenses debtors may claim are those set forth in the Internal Revenue Service's Local and National Standards. One of the expenses set out in the Standards is a fixed $489 monthly deduction to cover a car loan or lease.[3]

But section 707(b)(2)(A)(ii)(I) does not give debtors the unfettered right to claim every expense listed in the IRS Standards. It allows debtors to claim only expenses that are "applicable."

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[3] The ownership expense allowance under the IRS Standards is one amount for each vehicle that is based on the average cost of financing a vehicle as determined annually by the Federal Reserve Board. *In re Meade* 384 B.R. 132, 136 (W.D. Tex. 2008). It was $489 when Mr. Soos filed his bankruptcy petition in 2009.

Thus, the first question presented in this appeal is whether a $489 monthly car payment is an "applicable" expense for debtors who owe no money on their vehicles.

The answer is no. Section 707(b)(2)(A)(ii)(I) does not define "applicable," so it should be given its dictionary meaning. The dictionary defines "applicable," as capable of being applied, or as relevant. A nullity, in this case a phantom car payment, is not capable of being applied to anything or anyone. Because it is undisputed that Mr. Soos has no monthly expenses for vehicle ownership, section 707(b)(2)(A)(ii)(I) does not allow him artificially to reduce his payments to creditors by almost $30,000 over the life of his plan by claiming an expense he does not have.

The 2005 Act's legislative history confirms this. In it, Congress explained that the new law was enacted to establish a system under which debtors would repay creditors the maximum they can afford. Allowing Mr. Soos to claim $30,000 in fictional expenses over the life of his plan contravenes Congress' stated purpose in passing the 2005 Act.

Without question, courts are divided on this question. The Ninth Circuit agrees with the United States' reading of "applicable." The Fifth and Seventh Circuits do not. Nor did a divided Eighth Circuit panel.

Those courts that concluded they were constrained to allow a phantom expense did so because they read the word "applicable" in section 707(b)(2)(A)(ii)(I) as requiring courts to allow any expense set forth in the IRS Standards, even ones debtors do not have. They acknowledged that an IRS document, the IRS Manual, expressly precludes people from claiming that phantom $489 car loan expense when dealing with the IRS, but they concluded this IRS practice was not relevant in interpreting section 707 because section 707 references the IRS Standards, not that IRS Manual.

That reading was never right. It is not the IRS's practice in its Manual that prohibits chapter 13 debtors from claiming fictional expenses. It is the text of section 707 that does so by expressly limiting expenses to those that are "applicable," something a phantom expense is not.

And, were that reading ever right, it certainly is not correct now. That is so because by January 1, 2008, the IRS had amended the Standards themselves to expressly prohibit phantom payments. Thus, the very document that section 707(b)(2)(A)(ii)(I) mentions, "the National Standards and Local Standards," now expressly prohibits phantom payments. Given this, it is unclear whether the Fifth, and Seventh Circuits, or the divided Eighth Circuit panel, which allowed phantom payments, would do so if asked to construe section 707(b)(2)(A)(ii)(I) today.

Finally, reading “applicable” to require a corresponding loan or lease payment fosters sound public policy. Barring above-median-income debtors like Mr. Soos from claiming inapplicable ownership expense amounts is fair because it prevents them from sheltering money from creditors for an expense they do not have.

3. Mr. Soos could not claim nearly $30,000 in phantom car payments even if this Court were to agree with the bankruptcy court’s construction of “applicable” in section 707(b)(2)(A)(ii)(I).

That is so because the word “projected” in section 1325(b)(1)(B) independently bars Mr. Soos from claiming that nearly $30,000 fictional expense. Under section 1325(b)(1)(B), a bankruptcy judge must “project” a chapter 13 debtor’s monthly disposable income after the debtor performs his section 707(b)(2) calculations. And, this Court has held in *Hamilton v. Lanning* that the word “projected” in section 1325(b)(1)(B) means bankruptcy courts should adjust debtors’ monthly payment amounts up or down as warranted to reflect deviations between the means test calculation and reality.[4]

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[4] The bankruptcy appellate panel identified the relevance of *Lanning* in footnote 19 of its memorandum opinion regarding certification. *Skehen v. Soos (In re Soos)*, No. 09-035, mem. op. at 7, n.19 (B.A.P. 10th Cir. Oct. 21, 2009).

Although the facts of *Lanning* required a court to adjust the debtor's income, rather than her expenses, that difference is not significant. In *In re Turner*, for example, the Seventh Circuit recently applied the *Lanning* reading of "projected" in section 1325(b)(1)(B) to adjust an expense. The Seventh Circuit ruled the word "projected" prevented that debtor from claiming phantom mortgage payments because he was abandoning the property to the lender and would not be making those payments over the life of the plan. Under this *Lanning-Turner* approach, section 1325(b)(1)(B)'s projected requirement independently bars Mr. Soos from claiming upwards of $30,000 in similar phantom deductions over the life of his plan.

ARGUMENT

I. The Bankruptcy Court Erred in Ruling that Mr. Soos Could Claim a Deduction for a Phantom Vehicle Ownership Payment under Section 707(b)(2)(A)(ii)(I) of the Bankruptcy Code.

This is a statutory construction case, which calls upon this Court to determine whether the word "applicable" in section 707(b)(2)(A)(ii)(I) allows a chapter 13 debtor to claim a set monthly expense deduction to cover a car loan or lease payment if the debtor has none. The United States concedes debtors, such as Mr. Soos, may claim a set $489 each month to cover loan or lease payments under section 707(b)(2)(A)(ii)(I) when it is "applicable" to them. But the text of that statute is best read as not making the expense "applicable" to debtors who have no corresponding ownership expense. 11 U.S.C. § 707(b)(2)(A)(ii)(I).

The question whether debtors in Mr. Soos's situation may claim the IRS Local Standards expense amount for a car or lease payment, and thus shelter $489 a month from their creditors for each month of their five-year repayment plan, has divided the lower and circuit courts. *See In re Ransom*, 577 F.3d 1026, 1029 (9th Cir. 2009) (collecting cases). However, the Ninth Circuit recently reviewed the arguments on both sides of the issue and concluded that "[a]n 'ownership cost' is not an 'expense' - either actual or applicable - if it does not exist, period." *Id.* at 1030. *Ransom* relies on the words of the statute, congressional intent, and common sense to hold that a debtor such as Mr. Soos should not be allowed to keep $29,340 from his creditors for an expense it is certain he does not have. The United States respectfully asks this Court to consider the rationale of Part III of the *Ransom* decision as a basis for reversing the decision below.

A. Both the dictionary meaning of "applicable" and normal English usage demonstrate that a debtor may only claim a vehicle ownership expense under section 707(b)(2)(A)(ii)(I) when he is making a corresponding loan or lease payment.

1. "Applicable" is not defined in the Bankruptcy Code, so the word should be given its ordinary meaning. *Smith v. United States*, 508 U.S. 223, 228 (1993) (explaining "[w]hen a word is not defined by statute, we normally construe it in accord with its ordinary and natural meaning."); *United States ex rel. Holmes v. Consumer Ins. Group*, 318 F.3d 1199, 1208-09 (10th Cir. 2003) (same). Courts frequently turn to dictionaries to ascertain a word's ordinary meaning. *See e.g. United States v. Gonzales*, 456 F.3d 1178, 1182 (10th Cir. 2006) (applying a dictionary definition to determine the common meaning of a statutory term).

The dictionary defines "applicable" to mean "capable of being applied: having relevance . . . fit, suitable, or right to be applied: APPROPRIATE . . .

syn see RELEVANT" *Webster's Third New International Dictionary* at 105 (1981) (emphasis in the original).

The Ninth Circuit recently explained in *Ransom* that the dictionary meaning of "applicable" does not allow debtors to claim a vehicle ownership expense when they have no associated loan or lease payment. The *Ransom* panel asked rhetorically how a vehicle ownership expense allowance could be "capable of being applied to the debtor if he does not make any lease or loan payments on the vehicle?" *Ransom*, 577 F.3d at 1031. The United States agrees with the *Ransom's* answer – it cannot.

The dictionary meaning illustrates why debtors should be allowed to subtract ownership expenses specified under the IRS Standards only when they will be making payments on a car loan or lease over the course of their chapter 13 plans. Under Webster's definition, for an expense to be relevant, or capable of being applied, there must be a correlation between the expense and a loan or lease. Absent an ongoing loan or lease obligation, there is no nexus so that it is inappropriate for a debtor to claim the amount specified in the IRS Standards as an expense. But, for debtors who have a car loan, an ownership expense is "capable of being applied" and "appropriate" because they will have to remit a payment every month to their lenders – a payment for which the Bankruptcy Code allows them an expense allowance.

2. Reading section 707(b)(2)(A)(ii)(I) to allow phantom expenses not only ignores the dictionary meaning of "applicable;" it distorts the word's contextual meaning as well.

The United States reads "applicable" as telling debtors to claim only those expenses set out in the IRS Standards that they will pay during the life of their plans. In other words, the United States reads "applicable" as asking debtors to look at all the expense categories set out in the Standards and to select only the subset that is relevant, namely that affects their financial situation in a quantifiable way.

This is exactly how the word applicable in most commonly used. For example, a Louisiana public school health form asks parents to check all ailments applicable to their child.[5] By doing this, it asks parents to look at all the ailments, and pick those on a lengthy list that apply.

Apply, which is a synonymous adjective, serves the identical winnowing function. For example, question two of the 2010 Census form

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[5] *See, e.g.* Louisiana school health information form that asks parents to indicate which of a list of ailments applies to their child. http://www.louisianaschools.net/lde/scs/2582.html

has a box check-list naming categories of people, such as newborn babies, live-in nannies, or relatives living there on a temporary basis. The question asks citizens to "mark all the boxes that may apply" to indicate fully who in fact lives in the house.[6] The common application for college admission similarly asks highschool seniors to mark all the reasons that apply to explain interrupted secondary school attendance, such as transferring schools or taking time-off.[7]

The purpose on all three forms is to narrow down possible conditions or status to choose only those that pertain to the person completing the form in a definable way. It would make no sense for a mother to check the box next to an ailment that her child does not have simply because she has a child. Nor does it make sense for Mr. Soos to claim an ownership expense for a loan payment everyone agrees he does not have simply because he has a car.

Mr. Soos suggests "applicable" should be read in a far more unnatural way in section 707(b)(2)(A)(ii)(I). Mr. Soos believes "applicable" exists in section 707(b)(2)(A)(ii)(I) not to instruct debtors to claim relevant

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[6] 2010.census.gov/2010census/pdf/2010_Questionnaire_Info.pdf

[7] https://www.commonapp.org/CommonApp/DownloadForms.aspx

expenses, but solely to make sure debtors do not foolishly choose the wrong box. *See* Addendum at 3 (giving debtors the option to choose one or two cars). The Standards allow debtors to pick one car or two. Mr. Soos believes debtors inexplicably would pick the wrong number unless told to pick the "applicable" one. This reading is doubtful, as people normally do not have trouble discerning between one and two.

The Ninth Circuit's reading therefore is more natural than Mr. Soos's because it gives "applicable" a real purpose in section 707 - pick the box that corresponds to the number of cars (one car or two) for which a debtor will be making an ownership payment. Mr. Soos sees it merely as an unusual and unnecessary admonition to do the obvious, one car if you have just one. Like the word's dictionary meaning, the common usage of applicable supports reading the term as barring phantom car expenses.

B. The legislative history demonstrates that Congress did not intend for debtors to benefit from phantom vehicle payments.

Giving "applicable" its proper meaning, and thereby prohibiting phantom payments, fulfills two of Congress's goals in enacting the 2005 Act: 1) ensuring that above-median-income debtors repay their debts when they can and 2) eliminating abuse. Therefore, "[i]ronic it would be indeed to diminish payments to unsecured creditors in this context on the basis of a fictitious expense not incurred by a debtor." *Ransom*, 577 F.3d at 1030.

In interpreting "applicable" in section 707(b)(2)(A)(ii)(I), this Court may look to its legislative history. *In re Geneva Steel Co.*, 281 F.3d 1173, 1178 (10th Cir. 2002). "Ambiguous text can also be decoded by knowing the purpose behind the statute." *Id.* The heart of the 2005 Act is the means test, which seeks to "ensure that debtors repay creditors the maximum they can afford." H.R. Rep. No. 109-31(I), at 1 (2005), *reprinted in* 2005 U.S.C.C.A.N. 88, 89. *See also Schultz v. United States*, 529 F.3d 343, 347 (6th Cir. 2008) ("The centerpiece of the [2005 Act] is the imposition of a 'means test' for chapter 7 filers.").

Congress emphasized the importance of ensuring debtors repay what they can afford in the legislative history: in the very first paragraph of the House Report and in the discussion of the means test itself. H.R. Rep. No. 109-31(I), at 1 (2005), *reprinted in* 2005 U.S.C.C.A.N. 88, 89, 97-100. Congress aimed to eliminate "loopholes and incentives" in the system "that allowed and - sometimes - even encourage opportunistic personal filings and abuse." *Id.* at 5, *reprinted in* 2005 U.S.C.C.A.N. at 92.

It is hard to envision a more classic loophole than an interpretation of section 707(b)(2)(A)(ii)(I) that allows above-median-income debtors to claim a vehicle ownership expense for cars that are fully paid for. *See Hamilton v. Lanning (In re Lanning)*, 545 F.3d 1269, 1280-81 (10th Cir. 2008), *cert. granted in part*, 130 S. Ct. 487 (2009) (noting that the intent of Congress was for debtors to pay their creditors what they could afford – "no more, no less").[8]

As the Ninth Circuit explained in *In re Ransom*, "[t]o interpret the statute otherwise [to allow deductions for phantom payments] is counterintuitive to one of the main objectives of BAPCPA: to ensure that debtors repay as much of their debt as reasonably possible." *In re Ransom*, 577 F.3d at 1031; *see also In re Washburn*, 579 F.3d 934, 943 (8th Cir. 2009) (stating in dissent that "allowing a debtor to avoid paying more than $28,000 to his unsecured creditors flies in the face of all Congress intended to accomplish with BAPCPA"). Interpreting section 707(b)(2)(A)(ii)(I) to allow phantom payments cannot be squared with the legislative history of the 2005 Act.

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[8] *Lanning* is before the Supreme Court (Docket No. 08-998) and was argued on March 22, 2010. The United States submitted a brief *amicus curiae* in support of affirmance. *Hamilton v. Lanning*, No. 08-998, 2010 WL 383620 (Feb. 3, 2010).

C. The reading of the 2005 Act that prevents phantom expenses has been mislabeled the IRM approach, when it actually does nothing other than construe the word "applicable" in the text of section 707(b)(2)(A)(ii)(I).

The United States' reading of the 2005 Act, which prevents parties from reducing payments by claiming phantom expenses, has been mischaracterized as an "IRM Approach," referring to the Internal Revenue Service Manual. This is so "because the courts following it use the methodology of the IRM as an interpretive guide for applying the means test." *In re Tate*, 571 F.3d 423, 426 (5th Cir. 2009).

The IRS Manual is <u>not</u> the basis for the interpretation of the 2005 Act that prohibits phantom deductions. *See Ransom*, 577 F.3d at 1030 ("we decide this issue not on the IRS's manual but instead on the 'statutory language, plainly read.'") (citation omitted). To the contrary, the language of the 2005 Act itself – the dictionary meaning of the word applicable – is the foundation for denying the debtor phantom car payments. *Id.*

Moreover, the title some courts have used to describe Mr. Soos's interpretation allowing phantom deductions – the plain language approach – is equally inappropriate. *See e.g. Ross-Tousey v. Neary (In re Ross-Tousey)*, 549 F.3d 1148, 1157-58 (7th Cir. 2008) (using this terminology). The plain language of the 2005 Act does not demonstrate that debtors without car payments are entitled to ownership costs. Even the first federal appellate decision to call that approach a "plain language" one, *Ross-Tousey*, conceded that "courts which have differed from our present ruling should not be viewed as rejecting the 'plain language' of the statute." *Ross-Tousey*, 549 F.3d at 1157, n.6. Similarly, the Fifth Circuit acknowledged in *Tate* that "[b]oth approaches start from the text of the statute . . . ." *Tate*, 571 F.3d at 426; *accord Washburn*, 579 F.3d at 943 (referring to the split of authority "as to the proper reading of the dense and confusingly written Bankruptcy Code with respect to the deduction at issue here") (Magnuson, J., dissenting).

There is, however, a better reading of the 2005 Act: one based upon the dictionary meaning of "applicable" and adopted by the Ninth Circuit. This interpretation allows debtors to claim expenses that are capable of being applied to them, i.e. those they have, but not the sort of phantom expenses Mr. Soos wants to claim here. *Webster's Third New International Dictionary* at 105 (1981).

D. The January 2008 amendments to the IRS Local Standards, which added a prohibition against phantom expenses, cast doubt upon the continuing vitality of decisions such as *Ross-Tousey*, *Tate*, and *Washburn*.

Those courts finding that phantom car payments are allowable have justified their interpretation in part based on the fact that the Local Standards themselves did not prohibit debtors from claiming a deduction for payments they do not have. *See e.g., Washburn*, 579 F.3d at 938; *Tate*, 571 F.3d at 427*; Ross-Tousey*, 549 F.3d at 1156.

The National and Local Standards mentioned in section 707(b)(2)(A)(ii)(I) are found in the IRS's Financial Analysis Handbook which, in turn, is contained in the IRS's Internal Revenue Manual. *Ross-Tousey*, 549 F.3d at 1156.[9] Section 5.15.1.9 of the IRS Manual states "[i]f a taxpayer has a car, but no car payment, only the operating costs portion of the transportation standard is used to figure the allowable transportation expense."[10]

This appeal does not implicate the other car-associated expense, known as the operating expense.[11] The operating expense covers costs

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[9] The IRM, including the Financial Analysis Handbook, can be found on the IRS website, at http://www. irs. gov/irm.

[10] Available at: http://www.irs.gov/irm/part5/irm_05-015-001.html#d0e1087

[11] The addendum to this brief provides a copy of the text of both expenses, which is set forth in the IRS National and Local Standards. *See* 11 U.S.C. § 707(b)(2)(A)(ii)(I) (allowing debtors to claim expenses set forth in the Standards when "applicable.").

associated with running a car, things like repairs, insurance and gas. Addendum at 3. Any debtor who has an operating car may claim it. Mr. Soos claimed this operating expense in his case, and everyone agrees he had the right to do so.

All courts acknowledge that debtors may claim only expenses allowed in the Standards, and acknowledge that the Manual contains a general prohibition (which a revenue agent can ignore on a case by case basis) against claiming a loan payment when the taxpayer has no loan or lease. But some courts refused to treat debtors in the same way that the IRS treats taxpayers because the IRS's common sense prohibition against claiming phantom expenses was set out in the Manual. Section 707(b)(2)(2)(A)(ii)(I) does not reference the Manual. Instead, it only references the Standards. *See*, *e.g.*, *Ross-Tousey*, 549 F.3d at 1159 (stating that section 707(b)(2)(A)(ii)(I) "does not incorporate the IRM or the Financial Analysis Handbook, or even refer to them"); *Tate*, 571 F.3d at 427 (stating that the legislative history of section 707(b)(2)(A)(ii)(I) "confirms that the provision's silence with regard to the IRM and IRS methodology was deliberate"). Because the guidance was not expressly referenced in the standards, these courts held it did not apply.

Ironically, these courts might come to a different conclusion were they to consider how to interpret the word "applicable" in section 707(b)(2)(A)(ii)(I) today.

This is so because new IRS Local Transportation Standards went into effect in January 2008. Those add to the Standards themselves the IRS Manual prohibition against phantom expenses. Addendum at 3.

The revised introductory text for the Local Transportation Standards, which is expressly referenced in section 707(b)(2)(A)(ii)(I), now reads: "If a taxpayer has a car, but no car payment, only the operating costs portion of the transportation standard is used to figure the allowable transportation expense. The taxpayer is allowed the amount actually spent, or the standard, whichever is less."[12] Addendum at 3.

Thus, the Standards do prohibit phantom expense for cases filed after January 1, 2008. Mr. Soos' case was filed on February 18, 2009.

Finally, this change raises an obvious question: would the *Washburn*, *Ross-Tousey*, and *Tate* panels reach the opposite outcome now, given that the Standards directly prohibit claiming an ownership deduction for a vehicle that is paid for? And it raises a second - why authorize an expense

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[12] 2010 version available at: http://www.irs.gov/individuals/article/0,,id=104623,00.html (last visited Mar. 9. 2010).

the Standards themselves now oppose? We can identify no good reason for doing so.

E. Barring above-median-income debtors from claiming phantom vehicle ownership expenses implements sound bankruptcy policy.

Reading section 707(b)(2)(A)(ii)(I) as restricting vehicle ownership expenses to debtors who make loan or lease payments is fair to above-median-income debtors and to creditors. *In re Ransom*, 577 F.3d at 1031 ("When the debtor has no monthly ownership expenses, it makes no sense to deduct an ownership expense to shield it from creditors."); *In re Deadmond*, No. CV 07-15-H-CCL, 2008 WL 191165, at *4 (D. Mont. Jan. 22, 2008). This is so because it establishes a threshold – the existence of vehicle loan or lease payments – for claiming a standardized ownership expense amount that is consistent for all chapter 13 debtors.

It also is fair to below-median- income debtors. Section 1325(b)(2) allows only above-median debtors to claim set-amount applicable expenses. *See* 11 U.S.C. 1325(b)(2) (allowing such debtors only "reasonably necessary" expenses). Thus, under Mr. Soos's reading of section 707(b)(2)(A)(ii)(I), a higher-income debtor with an inoperable car could claim the ownership expense amount simply because the car is an automobile and he owns it. A lower-income debtor could not go to the junk yard and buy a wreck to get the same $489 per month advantage because an inoperable car does not produce any "reasonably necessary" expenses. Reading "applicable" as requiring above-median-income debtors to have an associated expense means they will not be able to claim phantom expenses that less wealthy debtors cannot.

Nor will above-median-income debtors like Mr. Soos be disadvantaged by this reading of the statute. Section 1329(a) provides a safety valve to ensure that such debtors without loan or lease payments will not be harmed by being denied a deduction for phantom vehicle payments. These chapter 13 debtors can modify their confirmed repayment plan if they require a new car during the course of repaying their creditors.

Finally, the facts of Mr. Soos's case underscore why it is unfair to allow above median income debtors to claim phantom expenses. Prior to bankruptcy Mr. Soos took out an unsecured loan and used that money to pay off his secured loan on his car. *In re Soos*, No. 13-09-10557, 2009 WL 2913226, at *1 (Bankr. D. N.M. May 6, 2009). He then sought to discharge the bulk of that unsecured debt through a chapter 13 repayment plan. In the plan, he sought to use his phantom expense to reduce recoveries by creating a fictionalized $29,340 five-year vehicle ownership expense. As the bankruptcy court explained, the ownership allowance for the phantom car payments will not only give Mr. Soos "excess monthly net income in his budget, [but] at the end of the plan term he will discharge a substantial balance of the unsecured debt that enabled him to obtain his car free and clear of any security interest." *Id.* at *2. Allowing Mr. Soos to pay pennies on the dollar for a new model Honda Coupe demonstrates why his reading of section 707(b)(2)(A)(ii)(I) contravenes the letter and the spirit of the 2005 Act.

II. Alternatively, Under the Rationale of this Court's Decision in *In re Lanning*, the Bankruptcy Court Erred in Allowing an Expense Allowance for a Non-existent Car Payment.

A. Under this Circuit's precedent, a debtor's chapter 13 repayment plan must reflect the reality of the debtor's financial situation, foreclosing anomalies such as giving debtors a $489 monthly credit for phantom car payments.

Calculating section 707(b)(2)(A)'s expense deductions is only the first step in determining a chapter 13 debtor's disposable income available for a feasible repayment plan. However, in every chapter 13 case, the bankruptcy court must next "project" the debtor's monthly net income over the life of the plan to make sure that the amount the debtor proposes to repay uses all the disposable income that the debtor is "projected" to receive over the plan's five-year life span. 11 U.S.C. § 1325(b)(1)(B); 11 U.S.C. § 1324.

In a recent decision, *In re Lanning*, this Court interpreted section 1325(b)(1)(B) as requiring adjustment of a debtor's monthly repayment amount, which had been calculated - like that of Mr. Soos - under section 707(b)(2), to reflect the debtor's actual income rather than the inaccurate figure yielded by the section 707(b)(2) calculation. *Lanning,* 545 F.3d at 1281-82.

In *Lanning*, this Court ruled the use of "projected" in section 1325(b)(1)(B) requires a court to look at a debtor's actual income when determining how much the debtor can pay over the life of a chapter 13 repayment plan. *Lanning*, 545 F.3d at 1282.

The Seventh Circuit read "projected" similarly, and it applied that reading to reject a chapter 13 debtor's attempt to claim phantom expenses. *In re Turner*, 574 F.3d at 356 (citing *Lanning* and prohibiting a debtor from using "a phantom deduction to reduce the recovery by his unsecured creditors without benefitting any other creditor"). Like this Court in *Lanning*, the Seventh Circuit ruled that the word "projected" in section 1325(b)(1)(B) does not require "throwing out undisputed information bearing on how much a debtor can afford to pay . . . ." *Turner*, 574 F.3d at 355. *Accord In re Wentzel*, 415 B.R. 510, 517 (Bankr. D. Kan. 2009) (analogizing *Lanning* to deny deduction for phantom car payments). *See also Washburn*, 579 F.3d at 943 (advocating reversal in dissent because the plan "did not provide that all projected disposable income would go to unsecured creditors").

Under the *Lanning-Turner* approach, this Court may hold that Mr. Soos cannot deduct $489 for a phantom car payment because that is almost $30,000 less than the amount he can actually pay creditors over the life of his plan. As the bankruptcy court itself recognized, "[by] allowing the Debtor [Mr. Soos] to take the vehicle ownership expense deduction and to contribute only $207.00 per month for the life of the plan[,] the Debtor will receive a windfall. . . ." *Soos*, 2009 WL 2913226, at *2. The *Lanning-Turner* approach provides a complete and sufficient independent basis for preventing such an inequitable result in this case – regardless of how this Court might construe the word "applicable" in section 707(b)(2)(A)(ii)(I).

CONCLUSION

For these reasons, the United States respectfully asks this Court to reverse the order entered below.

March 22, 2009

Respectfully submitted,

RAMONA D. ELLIOTT
General Counsel
P. MATTHEW SUTKO
Associate General Counsel
CATHERINE B. SEVCENKO
Trial Attorney
Department of Justice
Executive Office for United States Trustees
20 Massachusetts Avenue, NW
Washington, DC 20530
Telephone: (202) 307-1399

RICHARD A. WIELAND
United States Trustee, Region 20

/s/ Richard A. Wieland
Richard A. Wieland
Ronald E. Andazola
Assistant United States Trustee
Office of the United States Trustee
Department of Justice
301 N. Main, Suite 1150
Wichita, KS 67202
Telephone: (316) 269-6161
Email: ronald.andazola@usdoj.gov

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BRIEF FORMAT

1. This brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B) because this brief contains **5625** words, excluding the parts of the brief exempted by Federal Rule of Appellate Procedure 32(a)(7)(B)(iii).

2. This brief complies with the typeface requirements of Federal Rule of Appellate Procedure 32(a)(5) and the type style requirements of Federal Rule of Appellate Procedure 32(a)(6) because this brief has been prepared in a proportionally spaced typeface using WordPerfect version 12.0 in Georgia 14-point type.

UNITED STATES TRUSTEE,

By_s/Ronald E. Andazola
Ronald E. Andazola

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I certify that on March 22, 2010, I filed the foregoing pleading electronically through the CM/ECF system, which caused all other parties or counsel in this matter to be served by electronic means as more fully reflected on the Notice of Docket Activity.

UNITED STATES TRUSTEE,

By__s/Ronald E. Andazola
Ronald E. Andazola

ADDENDUM

IRS NATIONAL AND LOCAL STANDARDS
2008

Addendum - 1

Internal Revenue Service
United States Department of the Treasury

National Standards: Food, Clothing and Other Items

Disclaimer: *IRS Collection Financial Standards are intended for use in calculating repayment of delinquent taxes. These National Standards are effective on October 1, 2007 for purposes of federal tax administration only. Expense information for use in bankruptcy calculations can be found on the website for the U.S. Trustee Program. For bankruptcy purposes, the effective date for the standards will be January 1, 2008, to allow for the orderly administration of the bankruptcy laws.*

National Standards have been established for five necessary expenses: food, housekeeping supplies, apparel and services, personal care products and services, and miscellaneous.

The standards are derived from the Bureau of Labor Statistics (BLS) Consumer Expenditure Survey (CES).

Taxpayers are allowed the total National Standards amount monthly for their family size, without questioning the amounts they actually spend. If the amount claimed is more than the total allowed by the National Standards, the taxpayer must provide documentation to substantiate those expenses are necessary living expenses. Generally, the total number of persons allowed for National Standards should be the same as those allowed as exemptions on the taxpayer's most recent year income tax return.

Expense	**One Person**	**Two Persons**	**Three Persons**	**Four Persons**
Food	$270	$511	$615	$737
Housekeeping supplies	$28	$59	$61	$72
Apparel & services	$85	$150	$206	$239
Personal care products & services	$30	$53	$56	$64
Miscellaneous	$81	$152	$185	$219
Total	**$494**	**$925**	**$1,123**	**$1,331**

More than four persons	**Additional Persons Amount**
For each additional person, add to four-person total allowance:	$246

References/Related Topics

- Collection Financial Standards
- Local Standards: Transportation
- Local Standards: Housing and Utilities
- National Standards: Out-of-Pocket Health Care

Addendum - 2

Internal Revenue Service
United States Department of the Treasury

National Standards: Out-of-Pocket Health Care

Disclaimer: *IRS Collection Financial Standards are intended for use in calculating repayment of delinquent taxes. These Out-of-Pocket Health Care Standards are effective on October 1, 2007 for purposes of federal tax administration only. Expense information for use in bankruptcy calculations can be found on the website for the U.S. Trustee Program. For bankruptcy purposes, the effective date for the standards will be January 1, 2008, to allow for the orderly administration of the bankruptcy laws.*

The table for health care expenses, based on Medical Expenditure Panel Survey data, has been established for minimum allowances for out-of-pocket health care expenses.

Out-of-pocket health care expenses include medical services, prescription drugs, and medical supplies (e.g. eyeglasses, contact lenses, etc.). Elective procedures such as plastic surgery or elective dental work are generally not allowed.

Taxpayers and their dependents are allowed the standard amount monthly on a per person basis, without questioning the amounts they actually spend. If the amount claimed is more than the total allowed by the health care standards, the taxpayer must provide documentation to substantiate those expenses are necessary living expenses. Generally, the number of persons allowed should be the same as those allowed as exemptions on the taxpayer's most recent year income tax return.

The out-of-pocket health care standard amount is allowed in addition to the amount taxpayers pay for health insurance.

	Out-of-Pocket Costs
Under 65	$54
65 and Older	$144

References/Related Topics

- Collection Financial Standards
- Local Standards: Transportation
- Local Standards: Housing and Utilities
- National Standards: Food, Clothing and Other Items

Addendum - 3

Internal Revenue Service
United States Department of the Treasury

Local Standards: Transportation

***Disclaimer:** IRS Collection Financial Standards are intended for use in calculating repayment of delinquent taxes. These Transportation Standards are effective on October 1, 2007 for purposes of federal tax administration only. Expense information for use in bankruptcy calculations can be found on the website for the U.S. Trustee Program. For bankruptcy purposes, the effective date for the standards will be January 1, 2008, to allow for the orderly administration of the bankruptcy laws.*

The transportation standards consist of nationwide figures for monthly loan or lease payments referred to as ownership costs, and additional amounts for monthly operating costs. The operating costs include maintenance, repairs, insurance, fuel, registrations, licenses, inspections, parking and tolls (These standard amounts do not include personal property taxes).

The ownership costs provide maximum allowances for the lease or purchase of up to two automobiles, if allowed as a necessary expense. A single taxpayer is normally allowed one automobile.

If a taxpayer has a car payment, the allowable ownership cost added to the allowable operating cost equals the allowable transportation expense. The taxpayer is allowed the amount actually spent, or the standard, whichever is less.

If a taxpayer has a car, but no car payment, only the operating costs portion of the transportation standard is used to figure the allowable transportation expense. The taxpayer is allowed the amount actually spent, or the standard, whichever is less.

There is a single nationwide allowance for public transportation based on Bureau of Labor Statistics expenditure data for mass transit fares for a train, bus, taxi, ferry, etc. Taxpayers with no vehicle are allowed the standard amount monthly, per household, without questioning the amount actually spent.

If a taxpayer owns a vehicle and uses public transportation, expenses may be allowed for both, provided they are needed for the health and welfare of the taxpayer or family, or for the production of income. However, the expenses allowed would be actual expenses incurred for ownership costs, operating costs and public transportation, or the standard amounts, whichever is less.

If the amount claimed is more than the total allowed by the transportation standards, the taxpayer must provide documentation to substantiate those expenses are necessary living expenses.

Public Transportation

National	$163

Ownership Costs

	One Car	Two Cars
National	$478	$956

Operating Costs

	One Car	Two Cars
Northeast Region	$206	$412
Boston	$209	$418
New York	$268	$536
Philadelphia	$221	$442
Pittsburgh	$172	$344
Midwest Region	$173	$346
Chicago	$203	$406
Cleveland	$181	$362
Detroit	$248	$496
Minneapolis-St. Paul	$169	$338
St. Louis	$169	$338
South Region	$181	$362
Atlanta	$198	$396
Baltimore	$186	$372
Dallas-Ft. Worth	$206	$412
Houston	$240	$480
Miami	$236	$472
Washington, D.C.	$208	$416
West Region	$194	$388
Anchorage	$185	$370
Denver	$199	$398
Honolulu	$202	$404
Los Angeles	$251	$502
Phoenix	$225	$450
Portland	$170	$340
San Diego	$216	$432
San Francisco	$256	$512
Seattle	$173	$346

The Operating Costs section of the Transportation Standards are provided by Census Region and Metropolitan Statistical Area (MSA). The following table lists the states that comprise each Census Region. Once the taxpayer's Census Region has been ascertained, to determine if an MSA standard is applicable, use the definitions below to see if the taxpayer lives within an MSA (MSAs are defined by county and city, where applicable). If the taxpayer does not reside in an MSA, use the regional standard.

Northeast Census Region

Maine, New Hampshire, Vermont, Massachusetts, Rhode Island, Connecticut, Pennsylvania, New York, New Jersey		
MSA	**COUNTIES**	
New York	*in NY:*	Bronx, Dutchess, Kings, Nassau, New York, Orange, Putnam, Queens, Richmond, Rockland, Suffolk, Westchester
	in NJ:	Bergen, Essex, Hudson, Hunterdon, Mercer, Middlesex, Monmouth, Morris, Ocean, Passaic, Somerset, Sussex, Union, Warren
	in CT:	Fairfield, Litchfield, Middlesex, New Haven
	in PA:	Pike
Philadelphia	*in PA:*	Bucks, Chester, Delaware, Montgomery, Philadelphia
	in NJ:	Atlantic, Burlington, Camden, Cape May, Cumberland, Gloucester, Salem
	in DE:	New Castle
	in MD:	Cecil
Boston	*in MA:*	Bristol, Essex, Hampden, Middlesex, Norfolk, Plymouth, Suffolk, Worcester
	in NH:	Hillsborough, Merrimack, Rockingham, Strafford
	in CT:	Windham
	in ME:	York
Pittsburgh	*in PA:*	Allegheny, Beaver, Butler, Fayette, Washington, Westmoreland

Midwest Census Region

North Dakota, South Dakota, Nebraska, Kansas, Missouri, Illinois, Indiana, Ohio, Michigan, Wisconsin, Minnesota, Iowa		
MSA	**COUNTIES (unless otherwise specified)**	
Chicago	*in IL:*	Cook, DeKalb, DuPage, Grundy, Kane, Kankakee, Kendall, Lake, McHenry, Will
	in IN:	Lake, Porter
	in WI:	Kenosha
Detroit	*in MI:*	Genesee, Lapeer, Lenawee, Livingston, Macomb, Monroe, Oakland, St. Clair, Washtenaw, Wayne

Addendum - 6

Minneapolis-St. Paul	*in MN:*	Anoka, Carver, Chisago, Dakota, Hennepin, Isanti, Ramsey, Scott, Sherburne, Washington, Wright
	in WI:	Pierce, St. Croix
Cleveland	*in OH:*	Ashtabula, Cuyahoga, Geauga, Lake, Lorain, Medina, Portage, Summit
St. Louis	*in MO:*	Crawford, Franklin, Jefferson, Lincoln, St. Charles, St. Louis, Warren, St. Louis city
	in IL:	Clinton, Jersey, Madison, Monroe, St.Clair

South Census Region

Texas, Oklahoma, Arkansas, Louisiana, Mississippi, Tennessee, Kentucky, West Virginia, Virginia, Maryland, District of Columbia, Delaware, North Carolina, South Carolina, Georgia, Florida, Alabama		
MSA	**COUNTIES (unless otherwise specified)**	
Washington, D.C.	*in DC:*	District of Columbia
	in MD:	Calvert, Charles, Frederick, Montgomery, Prince George's, Washington
	in VA:	Arlington, Clarke, Culpepper, Fairfax, Fauquier, King George, Loudoun, Prince William, Spotsylvania, Stafford, Warren, Alexandria city, Fairfax city, Falls Church city, Fredericksburg city, Manassas city, Manassas Park city
	in WV:	Berkeley, Jefferson
Baltimore	*in MD:*	Anne Arundel, Baltimore, Carroll, Harford, Howard, Queen Anne's, Baltimore city
Atlanta	*in GA:*	Barrow, Bartow, Carroll, Cherokee, Clayton, Cobb, Coweta, DeKalb, Douglas, Fayette, Forsyth, Fulton, Gwinnett, Henry, Newton, Paulding, Pickens, Rockdale, Spalding, Walton
Miami	*in FL:*	Broward, Miami-Dade
Dallas-Ft. Worth	*in TX:*	Collin, Dallas, Denton, Ellis, Henderson, Hood, Hunt, Johnson, Kaufman, Parker, Rockwall, Tarrant
Houston	*in TX:*	Brazoria, Chambers, Fort Bend, Galveston, Harris, Liberty, Montgomery, Waller

West Census Region

New Mexico, Arizona, Colorado, Wyoming, Montana, Nevada, Utah, Washington, Oregon, Idaho, California, Alaska, Hawaii		
MSA	**COUNTIES (unless otherwise specified)**	
Los Angeles	*in CA:*	Los Angeles, Orange, Riverside, San Bernadino, Ventura

San Francisco	*in CA:*	Alameda, Contra Costa, Marin, Napa, San Francisco, San Mateo, Santa Clara, Santa Cruz, Solano, Sonoma
San Diego	*in CA:*	San Diego
Portland	*in OR:*	Clackamas, Columbia, Marion, Multnomah, Polk, Washington, Yamhill
	in WA:	Clark
Seattle	*in WA:*	Island, King, Kitsap, Pierce, Snohomish, Thurston
Honolulu	*in HI:*	Honolulu
Anchorage	*in AK:*	Anchorage borough
Phoenix	*in AZ:*	Maricopa, Pinal
Denver	*in CO:*	Adams, Arapahoe, Boulder, Denver, Douglas, Jefferson, Weld

References/Related Topics

- Collection Financial Standards
- Local Standards: Housing and Utilities
- National Standards: Food, Clothing and Other Items
- National Standards: Out-of-Pocket Health Care

IRS TRANSPORTATION STANDARDS

2009

Addendum - 8

IRS.gov

Local Standards: Transportation

Disclaimer: *IRS Collection Financial Standards are intended for use in calculating repayment of delinquent taxes. These Standards are effective on March 1, 2009 for purposes of federal tax administration only. Expense information for use in bankruptcy calculations can be found on the website for the U.S. Trustee Program.*

The transportation standards consist of nationwide figures for monthly loan or lease payments referred to as ownership costs, and additional amounts for monthly operating costs. The operating costs include maintenance, repairs, insurance, fuel, registrations, licenses, inspections, parking and tolls (These standard amounts do not include personal property taxes).

The ownership costs provide maximum allowances for the lease or purchase of up to two automobiles, if allowed as a necessary expense. A single taxpayer is normally allowed one automobile.

If a taxpayer has a car payment, the allowable ownership cost added to the allowable operating cost equals the allowable transportation expense. The taxpayer is allowed the amount actually spent, or the standard, whichever is less.

If a taxpayer has a car, but no car payment, only the operating costs portion of the transportation standard is used to figure the allowable transportation expense. The taxpayer is allowed the amount actually spent, or the standard, whichever is less.

There is a single nationwide allowance for public transportation based on Bureau of Labor Statistics expenditure data for mass transit fares for a train, bus, taxi, ferry, etc. Taxpayers with no vehicle are allowed the standard amount monthly, per household, without questioning the amount actually spent.

If a taxpayer owns a vehicle and uses public transportation, expenses may be allowed for both, provided they are needed for the health and welfare of the taxpayer or family, or for the production of income. However, the expenses allowed would be actual expenses incurred for ownership costs, operating costs and public transportation, or the standard amounts, whichever is less.

If the amount claimed is more than the total allowed by the transportation standards, the taxpayer must provide documentation to substantiate those expenses are necessary living expenses.

Public Transportation

National	$173

Ownership Costs

	One Car	Two Cars
National	$489	$978

Operating Costs

	One Car	Two Cars
Northeast Region	$235	$470
Boston	$225	$450
New York	$280	$560
Philadelphia	$235	$470
Midwest Region	$183	$366
Chicago	$217	$434
Cleveland	$186	$372
Detroit	$267	$534
Minneapolis-St. Paul	$187	$374
South Region	$201	$402
Atlanta	$226	$452
Baltimore	$217	$434
Dallas-Ft. Worth	$228	$456
Houston	$263	$526
Miami	$275	$550
Washington, D.C.	$230	$460
West Region	$211	$422
Los Angeles	$261	$522
Phoenix	$232	$464
San Diego	$244	$488
San Francisco	$261	$522

EXHIBIT

A

Addendum - 9

Seattle	$192	$384

The data for the Operating Costs section of the Transportation Standards are provided by Census Region and Metropolitan Statistical Area (MSA). The following table lists the states that comprise each Census Region. Once the taxpayer's Census Region has been ascertained, to determine if an MSA standard is applicable, use the definitions below to see if the taxpayer lives within an MSA (MSAs are defined by county and city, where applicable). If the taxpayer does not reside in an MSA, use the regional standard.

Northeast Census Region

Maine, New Hampshire, Vermont, Massachusetts, Rhode Island, Connecticut, Pennsylvania, New York, New Jersey		
MSA	**Counties**	
Boston	*in MA:*	Bristol, Essex, Hampden, Middlesex, Norfolk, Plymouth, Suffolk, Worcester
	in NH:	Hillsborough, Merrimack, Rockingham, Strafford
	in CT:	Windham
	in ME:	York
New York	*in NY:*	Bronx, Dutchess, Kings, Nassau, New York, Orange, Putnam, Queens, Richmond, Rockland, Suffolk, Westchester
	in NJ:	Bergen, Essex, Hudson, Hunterdon, Mercer, Middlesex, Monmouth, Morris, Ocean, Passaic, Somerset, Sussex, Union, Warren
	in CT:	Fairfield, Litchfield, Middlesex, New Haven
	in PA:	Pike
Philadelphia	*in PA*	Bucks, Chester, Delaware, Montgomery, Philadelphia
	in NJ:	Atlantic, Burlington, Camden, Cape May, Cumberland, Gloucester, Salem
	in DE:	New Castle
	in MD:	Cecil

Midwest Census Region

North Dakota, South Dakota, Nebraska, Kansas, Missouri, Illinois, Indiana, Ohio, Michigan, Wisconsin, Minnesota, Iowa		
MSA	**Counties (unless otherwise specified)**	
Chicago	*in IL:*	Cook, DeKalb, DuPage, Grundy, Kane, Kankakee, Kendall, Lake, McHenry, Will
	in IN:	Lake, Porter
	in WI:	Kenosh
Cleveland	*in OH:*	Ashtabula, Cuyahoga, Geauga, Lake, Lorain, Medina, Portage, Summit
Detroit	*in MI:*	Genesee, Lapeer, Lenawee, Livingston, Macomb, Monroe, Oakland, St. Clair, Washtenaw, Wayne
Minneapolis-St. Paul	*in MN:*	Anoka, Carver, Chisago, Dakota, Hennepin, Isanti, Ramsey, Scott, Sherburne, Washington, Wright
	in WI:	Pierce, St. Croix

South Census Region

Texas, Oklahoma, Arkansas, Louisiana, Mississippi, Tennessee, Kentucky, West Virginia, Virginia, Maryland, District of Columbia, Delaware, North Carolina, South Carolina, Georgia, Florida, Alabama		
MSA	**Counties (unless otherwise specified)**	
Atlanta	*in GA:*	Barrow, Bartow, Carroll, Cherokee, Clayton, Cobb, Coweta, DeKalb, Douglas, Fayette, Forsyth, Fulton, Gwinnett, Henry, Newton, Paulding, Pickens, Rockdale, Spalding, Walton
Baltimore	*in MD:*	Anne Arundel, Baltimore, Carroll, Harford, Howard, Queen Anne's, Baltimore city
Dallas-Ft. Worth	*in TX:*	Collin, Dallas, Denton, Ellis, Henderson, Hood, Hunt, Johnson, Kaufman, Parker, Rockwall, Tarrant

Houston	*in TX:*	Brazoria, Chambers, Fort Bend, Galveston, Harris, Liberty, Montgomery, Waller
Miami	*in FL:*	Broward, Miami-Dade
Washington, D.C.	*in DC:*	District of Columbia
	in MD:	Calvert, Charles, Frederick, Montgomery, Prince George's, Washington
	in VA:	Arlington, Clarke, Culpepper, Fairfax, Fauquier, King George, Loudoun, Prince William, Spotsylvania, Stafford, Warren, Alexandria city, Fairfax city, Falls Church city, Fredericksburg city, Manassas city, Manassas Park city
	in WV:	Berkeley, Jefferson

West Census Region

New Mexico, Arizona, Colorado, Wyoming, Montana, Nevada, Utah, Washington, Oregon, Idaho, California, Alaska, Hawaii		
MSA	**Counties**	
Los Angeles	*in CA:*	Los Angeles, Orange, Riverside, San Bernadino, Ventura
Phoenix	*in AZ:*	Maricopa, Pinal
San Diego	*in CA:*	San Diego
San Francisco	*in CA:*	Alameda, Contra Costa, Marin, Napa, San Francisco, San Mateo, Santa Clara, Santa Cruz, Solano, Sonoma
Seattle	*in WA:*	Island, King, Kitsap, Pierce, Snohomish, Thurston

References/Related Topics

- Collection Financial Standards
- Local Standards: Housing and Utilities
- National Standards: Food, Clothing and Other Items
- National Standards: Out-of-Pocket Health Care

Rate the Small Business and Self-Employed Web Site

Page Last Reviewed or Updated: February 25, 2009

BRIEF BANK — “SUMMARY SHEET”

Printed Wed-8/5/09 16:42

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	In re South Beach Securities Inc. (Scattered Corporation v. William T. Neary)
2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	N.D. Ill.
3. ("CCN") ***CURRENT*** CASE NO.	No.: 1:08-cv-01135 consolidated with 1:08-cv-01136
4. ("PCN") ***PRIOR*** CASE NO. - & COURT *[IF ANY]*	No.: 05-16679 Court: Bankr. N.D. Ill. *(Identify judge & cite, if any)*
5. ("SO") ***SOURCE***	**U.S. TRUSTEES**
6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	Filed: June 6, 2008 Type: Appellee, United States Trustee’s Opening Brief
7. **("AU")** ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*	Cameron M. Gulden, M. Gretchen Silver *(UST/OGC: 202-307-1399/FAX-2397)*
8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	• Did the bankruptcy court err in denying plan confirmation and dismissing the case when (1) the plan was not accepted by a non-insider creditor and (2) the plan’s principal purpose was tax avoidance?
10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)	
11. DO YOU RECOMMEND POSTING IN UST BRIEFBANK?	| x | YES | | NO ***NAME:*** Linda Figueroa ***DATE:***

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

IN RE:	)	CHAPTER 11
	)	
SOUTH BEACH SECURITIES, INC.	)	CASE NO. 08 C 1135
	)	
	)	(CONSOLIDATED
	)	WITH 08 C 1136)
	)	
DEBTOR.	)	HON. JOAN H. LEFKOW
	)	

APPELLEE, UNITED STATES TRUSTEE'S OPENING BRIEF

Cameron M. Gulden
M. Gretchen Silver
UNITED STATES DEPARTMENT OF JUSTICE
OFFICE OF THE UNITED STATES TRUSTEE
219 South Dearborn Street, Room 873
Chicago, Illinois 60604
Telephone (312) 886-5785
Facsimile (312) 886-5794

Attorneys for Appellee,
William T. Neary, United States Trustee

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TABLE OF AUTHORITIES

Other Authority

BASIS OF APPELLATE JURISDICTION

Appellee, William T. Neary, the United States Trustee for the Northern District of Illinois states that this Court has jurisdiction to hear the appeal from the bankruptcy court under 28 U.S.C. § 158(a).

STATEMENT OF THE ISSUES

South Beach Securities, Inc., the debtor in the bankruptcy case below, has one creditor, Scattered Corp., and that one creditor is an insider. South Beach has no ongoing business to reorganize, no employees, and no assets of alleged value other than $3.2 million in net operating losses it hoped to use to offset taxable income — the only purpose set forth by South Beach for its bankruptcy in its disclosure statement. Did the bankruptcy court err in denying plan confirmation and dismissing the case when (1) the plan was not accepted by a non-insider creditor and (2) the plan's principal purpose was tax avoidance?

APPLICABLE STANDARD OF REVIEW

A bankruptcy court's decision to dismiss a Chapter 11 case for cause is reviewed for an abuse of discretion. *In re Woodbrook Assocs.*, 19 F.3d 312, 316 (7th Cir. 1994); *In re Han*, 2002 WL 31049846 at *4 (N.D. Ill. Sept. 12, 2004). The District Court reviews the bankruptcy court's findings of fact with the clearly erroneous standard, and conclusions of law are reviewed *de novo*. *In re Woodbrook Assocs.*, 19 F.3d at 316.

STATEMENT OF THE FACTS

When it filed its Chapter 11 bankruptcy case on April 27, 2005, South Beach Securities, Inc. listed just one asset, stock in Health Risk Management ("HRM"), and just one creditor, Scattered Corp. Docket #6, Schedule B, #12. South Beach valued its sole listed asset at $0 and purported to owe Scattered $3,297,498. Docket #6, Schedule F. South Beach has had no income for at least two years, Docket #7, p.1, and has no employees or ongoing business operations of any kind. Docket #130, p. 1. Leon Greenblatt III was the Debtor's authorized agent who signed the petition and schedules on behalf of South Beach. Docket #1, 6, 7.

About three months after the case was filed, and before any plan or disclosure statement had been proposed, the bankruptcy court invited the parties to brief whether the case should be dismissed for bad faith under § 1112. A month later, the bankruptcy court dismissed the case, and South Beach appealed. Judge Kennelly found that although South Beach's sole creditor was likely an insider, that alone was an insufficient basis for a finding of bad faith under § 1112(b), reversing dismissal and remanding the case for further proceedings. Five months later, South Beach filed its plan, which was jointly proposed with Scattered, Docket #130, p. 9, and a short time later filed its disclosure statement.

In its disclosure statement, South Beach disclosed additional assets, including an account receivable owed from NOLA, its parent company, of the same amount that South Beach owed Scattered. Docket #106, p.12. According to South Beach, it "waived its $3,297,400 claim against NOLA for purposes of this bankruptcy case" without any explanation. *Id.* South Beach also disclosed certain Net Operating Losses ("NOLs") arising from the acquisition of the HRM stock. *Id.*, Docket #89, p. 6. South Beach argued that the NOLs were the only source of value from which it could compensate Scattered and that the value of the NOLs could only be preserved for the benefit of its creditor through a plan of reorganization. Docket #30, pp. 3-4. At confirmation, however, South Beach changed its position and stated it did not need bankruptcy to "monetize" its NOLs and that the purpose of the Chapter 11 case was actually to avoid litigation, though no evidence or explanation was provided regarding this new purpose. Docket #130, p. 9.

The U.S. Trustee objected to the proposed plan because (1) it had no impaired, non-insider creditors voting in favor and thus failed to satisfy § 1129(a)(10); (2) its principal purpose was tax avoidance in violation of § 1129(d); and (3) it provided for a discharge in a liquidating case in violation of § 1141(d)(3). The bankruptcy court conducted an evidentiary hearing and the only party to testify for South Beach was Leon Greenblatt III. Docket #130, p. 2. Greenblatt, an officer of Scattered, had signed South Beach's bankruptcy petition and had testified on behalf of the South Beach at the Meeting of Creditors. Docket #1, 6, 7. No party examined Greenblatt on behalf of Scattered, and after the U.S. Trustee and the bankruptcy court questioned Greenblatt, the bankruptcy court took the matter under advisement.

Later, the bankruptcy court issued a Memorandum Opinion, sustaining the U.S. Trustee's objections under § 1129(a)(10) and § 1129(d), while finding it unnecessary to address the § 1141(d)(3) discharge issue due to its ruling on the other two issues. Docket #130. Shortly after the bankruptcy court denied plan confirmation, the U.S. Trustee moved to dismiss South Beach's case under § 1112(b)(2), and that motion was granted.[1] Docket #134. South Beach, Scattered, and Greenblatt *pro se* appealed both the order denying confirmation and the order dismissing the case, but this Court later granted the U.S. Trustee's motion to dismiss Greenblatt's appeal for lack of standing. Scattered filed its brief, which South Beach adopted *in lieu* of filing a brief of its own.

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[1] South Beach, Scattered, and Greenblatt all filed interlocutory appeals from the order denying confirmation before a hearing was held on dismissal. To procedurally simplify the appeals, this Court dismissed the interlocutory appeals so the bankruptcy court could rule on the motion to dismiss. The motion to dismiss was granted without objection, except for the objections raised at the confirmation hearing.

I. BECAUSE THE DEBTOR'S SOLE CREDITOR WAS AN INSIDER, THE DEBTOR COULD NOT SATISFY § 1129(a)(10) AND DENIAL OF PLAN CONFIRMATION WAS THEREFORE NOT ONLY CORRECT, BUT REQUIRED

A. South Beach's Plan Did Not Meet All the Requirements of § 1129(a) so Confirmation Was Properly Denied

Every Chapter 11 debtor "has the burden of proving by at least a preponderance of the evidence that the plan satisfies all of the requirements of 11 U.S.C. § 1129(a)." *In re Rusty Jones, Inc.*, 110 B.R. 362, 373 (Bankr. N.D. Ill. 1990) (emphasis added); *In re Repurchase Corp.*, 332 B.R. 336, 342 (Bankr. N.D. Ill. 2005). This includes § 1129(a)(10), which requires that "[i]f a class of claims is impaired under the plan, at least one class of claims that is impaired under the plan has accepted the plan, determined without including any acceptance of the plan by an insider." Scattered was impaired and voted to accept the plan, so the only issue was whether Scattered was an insider. The bankruptcy court properly found that Scattered was an insider based on the evidence and testimony provided.

Appellants' assertion that the plan was "otherwise confirmable" is both irrelevant and incorrect. "Close enough" does not suffice. Appellants' argument is factually incorrect that the U.S. Trustee "addressed only the insider and tax avoidance issues of § 1129." Appellants' Brief ("Brief"), p. 10. Actually, the U.S. Trustee also objected to confirmation because the proposed plan provided for a discharge in violation of § 1141(d)(3), though the bankruptcy court found it unnecessary to rule on that issue because of the plan's other fatal flaws. Docket #130, Opinion, p. 2, fn. 1 (finding no need to address § 1141(d)(3) "given the outcome on the other objections"). Because the only creditor of South Beach was an insider, South Beach could not satisfy its burden under § 1129(a)(10) and the bankruptcy court properly denied plan confirmation and correctly exercised its discretion in dismissing the case.

B. South Beach's Sole Creditor Was an Insider so the Bankruptcy Court Properly Found the Plan Did Not Satisfy § 1129(a)(10)

There are two types of insiders: those specifically listed by way of example in 11 U.S.C. § 101(31) (most often referred to as "statutory" insiders), and those insiders not listed in the statute but that nonetheless have a close, less-than-arm's length relationship with a party (most often referred to as "extra-statutory" or "non-statutory" insiders). The bankruptcy court found that Scattered was both. Section 101(31)(B) defines "insider" for corporate debtors, including a "person in control of the debtor." However, the statutory definition is not exhaustive and § 101(31)(B) "is intended to be illustrative rather than exhaustive." *In re Krehl*, 86 F.3d 737, 741 (7th Cir. 1996) (referencing § 102(3)); *In re Kunz*, 489 F.3d 1072, 1075 (10th Cir. 2007) (noting that "[c]ourts have held that the use of the word 'includes' in this section [101(31)] indicates that Congress did not intend for the categories listed to be exclusive"). Therefore, the term "insider" also "encompasses anyone with 'a sufficiently close relationship with the debtor that his conduct is made subject to closer scrutiny than those dealing at arm's length with the debtor.'" *In re Krehl*, 86 F.3d at 741 (quoting S. Rep. No. 989, 95th Cong.2d Sess.).

1. Both Scattered and South Beach Concede That Scattered Is an Insider

The Appellants argue at length that Scattered is not in control of the debtor under § 101(31)(B), Brief, pp.6-8, but make no argument whatsoever that Scattered does not have a close relationship with South Beach, that the relationship does not merit closer scrutiny, or that the transactions between the two were conducted at arm's length. In other words, Appellants concede that Scattered is an extra-statutory insider. Although the Appellants state that "Scattered does not fall into any of the categories of 'insider,'" Brief, p.6, Scattered does not *need* to fall into any of the § 101(31)(B) categories, as the bankruptcy court held. Docket #130, p. 16-17. The bankruptcy court looked at the relationship between South Beach and Scattered and applied criteria established by case law to determine that the conduct between South Beach and Scattered was subject to closer scrutiny than a normal arm's length transaction. *See In re Krehl,* 86 F.3d at 742 (determining insider status by looking "to the closeness of the relationship between the parties and to whether any transactions between them were conducted at arm's length"). There was more than sufficient evidence to support the bankruptcy court's conclusion.[2]

In addition, Appellants chose not to appeal the bankruptcy court's finding that Scattered is an insider not specifically mentioned by way of example in § 101(31) (*i.e.* a non-statutory insider) and offered no evidence to the contrary in the hearing below. Docket #130, p. 16 (noting that "no evidence was adduced showing arm's length transactions between Scattered and South Beach"). In fact, to its credit since South Beach and Scattered are so intimately intertwined, South Beach did not even argue the point before the bankruptcy court. Docket #130, p. 16. Appellants have thus waived that issue and this Court need not re-visit it.

2. If the Court Revisits the Relationship Between South Beach and Scattered, it will Find the Parties did not Deal at Arm's Length and That Scattered is an Insider of South Beach

Though Appellants did not raise the issue before the bankruptcy court or argue Scattered's non-statutory insider status to this Court, a review of the uncontested facts reveal the

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[2] The standard of review to be applied to a bankruptcy court's finding on a party's insider status "has been the subject of some debate." *In re Krehl*, 86 F.3d at 743. But as in *Krehl*, whether this mixed question of law and fact is reviewed for clear error or de novo, "the bankruptcy court's conclusion survives scrutiny under either standard." *Id.*

insider relationship: (1) Greenblatt signed the petition on behalf of South Beach, testified at the Meeting of Creditors, and testified for South Beach at confirmation, Docket #130, p. 2; (2) Greenblatt is an officer and director of Scattered, Docket #130, p. 2; (3) South Beach and Scattered share the identical mailing address, Docket #130, p. 3, 6, 14; (4) Greenblatt executed the original loan agreement on behalf of South Beach, as the borrower, Docket #130, p. 5; (5) when the loan was assigned by the lender to Scattered, Greenblatt executed the agreement on behalf of Scattered, Docket #130, p. 6; and (6) Scattered is listed as the preparer on South Beach's tax returns, Docket #130, p. 9. These uncontested facts demonstrate that Scattered is both a statutory ("in control") insider and a non-statutory insider since "none of [the dealings between South Beach and Scattered] were remotely arm's length." Docket #130, p. 17. Because the dealings were not at arm's length and merited careful scrutiny, *see In re Three Flint Hill Ltd. Ptship.*, 213 B.R. 292, 298 (D. Md. 1997) (citing *Butler v. Shaw*, 72 F.3d 437, 443 (4th Cir. 1996)), the bankruptcy court was correct in finding that Scattered was an insider of South Beach.

C. The Bankruptcy Court Properly Applied the Plain Language of § 1129(a)(10)

Appellant's policy argument attempts to circumvent the plain language of § 1129(a)(10). If a statute's language is not ambiguous, the court should apply its plain meaning to the facts before it. *Lexington Ins. Co. v. Rugg & Knopp, Inc.*, 165 F.3d 1087, 1091 (7th Cir. 1999). Only if the statute is ambiguous should the court attempt to "discern legislative intent by looking beyond the language to the scope, history, context, subject matter and object of the statute." *Id.* at 1092 (citing *Kenison v. Wellington Ins. Co.*, 582 N.W.2d 69, 71 (1998)).

Section § 1129(a)(10) is not ambiguous. It is correct, as Appellants state, that § 1129(a)(10), at times, prevents "cramdown of a plan from being triggered unless a legitimate creditor finds the plan's treatment of its claim acceptable." Brief, p.8. The U.S. Trustee also agrees with Judge Kennelly's general statement that there is no *"blanket* prohibition on insider creditors collecting on their debts as part of a bankruptcy proceeding." Docket #52, p. 8 (emphasis added). True: as long as a plan satisfies § 1129(a)(10) by having at least one impaired class, not counting insiders, vote to accept the plan, and as long as the other requirements of § 1129(a) are met, insider creditors may (and often do) collect as part of a confirmed Chapter 11 plan.

But if § 1129(a)(10) somehow did not apply in cases where a debtor's only creditor was an insider, at least two questions arise: (1) why doesn't the statute say that? and (2) where is the body of case law supporting such a curious proposition? Certainly South Beach has not cited to a single case from any district where a bankruptcy court confirmed such a plan, and this Court should not be the first to approve such a scheme. As it asked the bankruptcy court, South Beach now asks this Court to rewrite the statute to help it accomplish its tax goals, and the Court should not so oblige. The bankruptcy court did not err in finding the language of § 1129(a)(10) unambiguous and applying it, as written, to the facts at hand in denying confirmation. Thus, since South Beach did not satisfy § 1129(a)(10), the bankruptcy court properly exercised its discretion in dismissing the case.

II. BECAUSE THE ONLY PURPOSE OF THE PLAN WAS TAX AVOIDANCE, THE BANKRUPTCY COURT PROPERLY FOUND THE PLAN VIOLATED § 1129(d)

The only purpose of South Beach's plan was tax avoidance, Docket #130, p. 8, 22-25, because the *only* purpose of this case is, and has always been, to use net operating losses to substantially offset some future taxable income, *i.e.* tax avoidance, despite the eleventh-hour invention at trial of the litigation avoidance purpose. It is not for this Court to decipher the tax maneuvers of South Beach but rather to determine whether the bankruptcy court erred in finding the plan's principal purpose was tax avoidance.

A. The Bankruptcy Court Correctly Discerned the Plan's Principal Purpose, Which South Beach Had Set Forth in its Disclosure Statement

As the bankruptcy court noted, "The disclosure statement explains the motivation behind the plan." Docket #130, p.7. The bankruptcy court was in the best position to determine the plan's principal purpose, considering the long-standing Disclosure Statement which was never amended, the credibility of Greenblatt, South Beach's sole witness, and the timing of the newly-claimed but detail-deficient purpose.[3] *See generally Luke v. C.I.R.,* 351 .F2d 568, 571-72 (7th Cir. 1965) (finding the determination of motivation "is essentially factual and entitled to great weight"). From the time of the § 341 Meeting in June 2005 to the confirmation hearing in January 2007, South Beach made it clear that its only purpose was to "monetize" its NOLs. Even if *a* purpose of the plan was to avoid "being lured" into litigation with creditors of Debtor's parent, nothing whatsoever in testimony or evidence indicates the *principal* purpose of the plan was anything other than tax avoidance, and the bankruptcy court thus properly found the proposed plan violated § 1129(d).

B. South Beach Created a New Purpose Only After the U.S. Trustee's § 1129(d) Objection

The new "litigation avoidance" purpose was mentioned nowhere in the 37-page Disclosure Statement, though lawsuits a debtor faces are virtually always set forth in disclosure

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[3] *See* Docket #130, p. 25, fn. 17 (discussing hazy details of alleged litigation avoidance purpose).

statements. *See* 9C Am.Jur. 2d Bankruptcy § 2895 (2008) (noting that "courts often require that a disclosure statement must include . . . the existence, likelihood, and possible success of nonbankruptcy litigation"); *In re Dakota Rail, Inc.*, 104 B.R. 138, 142 (Bankr. D. Minn. 1989). In addition, South Beach pointed to no action in which it is actually a defendant, Docket #130, p. 9, fn. 10.

South Beach created a new purpose only *after* the U.S. Trustee's § 1129(d) objection, Docket #130, p. 25-26, and South Beach has now completely changed its position on its need for bankruptcy. Compare the following statements:

> (1) "In light of the Debtor's financial condition and the restrictions contained in the Internal Revenue Code on transferring the NOLs, "the only way to monetize the sole valuable asset of the Debtor — the NOLS — is the[sic] for the Debtor to cancel its current stock, issue New Stock and allow its post-confirmation equity to utilize the tax benefits of the NOLs." Docket Entry #130, p.8.
>
> vs.
>
> (2) "A bankruptcy filing was simply not necessary in order for Debtor to maximize its NOLs." Brief, p.11.

The first statement is from the Disclosure Statement, followed by a seven-page discussion of tax consequences to the Debtor, while the second statement is from Appellant's Brief, followed by the new announcement that "[s]imply put, under applicable tax law, Debtor did not need to confirm a plan in order to maximize its NOLs." Brief, p.11. This sudden change and vague new assertion, of course, occurred only after the U.S. Trustee alleged the plan's only purpose was tax avoidance and the bankruptcy court properly gave the newly-created purpose little weight in determining the plan's principal purpose of tax avoidance. Because the plan violated § 1129(d), the bankruptcy court was correct to deny plan confirmation on that basis.

III. BECAUSE THE PRIOR APPEAL INVOLVED ONLY DISMISSAL UNDER §1112, NOTHING INVOLVING § 1129(a)(10) IS THE LAW OF THE CASE.

In an earlier appeal from an order of dismissal under § 1112(b), § 1129 was not and could not have been litigated by the parties because the case was not at the confirmation stage. Docket #130, p. 13 (finding that "[b]ecause the district court never suggested, let alone held, that a plan can be confirmed in a Chapter 11 case where the debtor's only creditor is an insider holding an impaired claim, the district court's decision is not the law of the case on that point . . ."). The law of the case doctrine means that "once an issue is litigated and decided," that same matter should be ended and not re-litigated. *Ienco v. Angarone*, 429 F.3d 680, 684 (7th Cir. 2005). The doctrine does not apply to issues that are similar but contain different elements, *In re Christopher K*, 841 N.E.2d, 945, 956-59 (Ill. 2005), or to dicta, *Ienco*, 429 F.3d at 684.

On appeal, the District Court held that the Debtor's case could not be dismissed for bad faith under § 1112(b) based only on the fact that the Debtor's sole creditor is an insider. The law the parties addressed was § 1112(b) and the issue litigated by the parties was whether the case should be dismissed as bad faith under that section. The issue stated by both the Debtor and the U.S. Trustee in the first appeal back in 2005 was whether the bankruptcy court abused its discretion in dismissing the case, and this was the issue addressed by the district court. Plan confirmation was not before the district court and thus nothing involving confirmation is — or could possibly be — the law of the case here. Section 1129 was never addressed by the U.S. Trustee and was referenced only once in a "*see also*" parenthetical by the Debtor. An issue never even *mentioned* by one party, much less an issue not litigated by the parties, cannot be the law of the case.

Appellants ask this Court to make a quantum leap in assuming that because Judge Kennelly found the case should not have been dismissed at an early stage based primarily on the fact that the case was filed to benefit an insider that, therefore, he was holding any proposed plan could meet the confirmation requirements of § 1129(a). It is difficult, if not impossible, to imagine the district court was attempting to rule on a confirmation issue in a case not at the confirmation stage, *and* that it did so in a novel way, unsupported by any accompanying case law, that changed the requirements of § 1129(a)(10). The proposed plan "was not even filed until five months after the case had been remanded ," Docket #130, p. 12, so the district court could not possibly have known whether at some point in the future South Beach could conceivably satisfy all the necessary provisions of § 1129(a). Therefore, because § 1129 was not litigated by the parties and thus not ruled on by the district court,[4] nothing involving confirmation is the law of the case here.

In January of 2008, however, the case was in an entirely different posture than it was during its prior appeal in 2005. A plan had been filed, a contested confirmation hearing was held, complete with testimony from South Beach's only witness, and confirmation was denied on two solid bases. South Beach was given a full and fair opportunity to present its plan and argue that it satisfied all the requirements of § 1129(a), while the bankruptcy court and the U.S. Trustee were likewise given an opportunity to examine the proposed plan, to examine the witness, and to determine whether the proposed plan met the statutory requirements for confirmation. After confirmation was denied, the bankruptcy court had ample basis to the dismiss the case under § 1112(b)(2), and did not abuse its discretion in so doing.

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[4] Judge Kennelly did note that "Scattered is likely an insider vis-à-vis South Beach . . . ." Docket #130, p. 2.

CONCLUSION

The bankruptcy court properly denied plan confirmation because the plan did not satisfy § 1129(a)(10) and the plan violated § 1129(d). The sole creditor of South Beach was an insider, so South Beach could not satisfy § 1129(a)(10) and the bankruptcy court was right to thus deny confirmation on that basis. Also, the plan's only purpose — right up to the confirmation stage, that is — was to use $3.2 million in NOLs to offset taxable income in hopes of avoiding significant taxes, which the bankruptcy court correctly found violates § 1129(d). Bankruptcy was not meant to be used for the sole purpose of helping an insider avoid taxes, and the U.S. Trustee asks this Court to affirm the bankruptcy court's denial of plan confirmation and dismissal of the case of South Beach.

Dated: June 6, 2008

Respectfully submitted,
WILLIAM T. NEARY
UNITED STATES TRUSTEE

By: s/ Cameron M. Gulden
Cameron M. Gulden, an attorney
for the U.S. Trustee

Cameron M. Gulden (ARDC #0310931)
M. Gretchen Silver (ARDC #6204419)
UNITED STATES DEPARTMENT OF JUSTICE
OFFICE OF THE UNITED STATES TRUSTEE
219 South Dearborn Street, Room 873
Chicago, Illinois 60604
Telephone (312) 886-5785
Facsimile (312) 886-5794

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1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	In re South Beach Securities (Scattered Corporation v. William T. Neary)
2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	7th Cir.
3. ("CCN") ***CURRENT*** CASE NO.	No.: 09-3079
4. ("PCN") ***PRIOR*** CASE NO. - & COURT *[IF ANY]*	No.: 1:08-cv-01135 consolidated with 1:08-cv-01136 Court: N. D. Ill. *(Identify judge & cite, if any)*
5. ("SO") ***SOURCE***	**U.S. TRUSTEES**
6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	Filed: November 13, 2009 Type: Brief of Appellee William T. Neary, United States Trustee
7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*	Cameron M. Gulden, M. Gretchen Silver, Anne W. Stukes, P. Matthew W. Sutko, Ramona D. Elliott *(UST/OGC: 202-307-1399/FAX-2397)*
8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	• Whether the lower courts erred in finding South Beach's plan of reorganization was unconfirmable under 11 U.S.C. § 1129(a)(10).
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NO. 09-3079

IN THE UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

In re SOUTH BEACH SECURITIES, INCORPORATED,
Debtor.

Appeal of:
SCATTERED CORPORATION,
Creditor-Appellant,

ON APPEAL FROM
THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS, EASTERN DIVISION
Hon. Joan H. Lefkow

BRIEF OF APPELLEE
WILLIAM T. NEARY, UNITED STATES TRUSTEE

RAMONA D. ELLIOTT
General Counsel

P. MATTHEW SUTKO
Associate General Counsel

ANNE W. STUKES
United States Department of Justice
Executive Office for United States Trustees
20 Massachusetts Avenue, N.W.
Washington, D.C. 20530
(202) 307-1399
Attorneys for Appellee

CAMERON M. GULDEN
M. GRETCHEN SILVER
United States Department of Justice
Office of the United States Trustee
219 South Dearborn St., Room 873
Chicago, Illinois 60604
(312) 886-5785

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JURISDICTIONAL STATEMENT

Pursuant to Circuit Rule 28(b) Appellee states that the jurisdictional statement in the appellant's brief was found by this Court to be incomplete in an order dated October 29, 2009.

A. This is an appeal from an order of the United States District Court for the Northern District of Illinois, affirming the bankruptcy court's denial of plan confirmation and dismissal of a case arising under chapter 11 of the Bankruptcy Code. The district court had jurisdiction under 28 U.S.C. § 158(a)(1), which confers jurisdiction on the district court to hear appeals from final judgments, orders and decrees of bankruptcy courts.

B. This Court has jurisdiction under 28 U.S.C. § 158(d)(1), which confers jurisdiction on the courts of appeals to hear bankruptcy appeals from final decisions, judgments, orders and decrees entered by district courts under 28 U.S.C. § 158(a).

C. The district court's order affirming the judgment of the bankruptcy court was entered on July 24, 2009. No motion was filed claiming to toll the time within which to appeal. Scattered Corporation and South Beach Securities, Inc. filed separate notices of appeal 28 days thereafter, on August 21, 2009, within the time limit set forth in Fed. R. App. P. 4(a)(1)(B). The United States Trustee did not cross-appeal. This Court dismissed South Beach Securities, Inc.'s appeal on

October 16, 2009 for non-compliance with Circuit Rule 3(c) after it failed to file a docketing statement.

D. The appeal in this case is from a final order. The district court's July 24, 2009 judgment disposed of all parties' claims, and nothing remains to be adjudicated by the lower courts.

ISSUES PRESENTED

1. Whether the district court correctly affirmed the bankruptcy court's judgment of dismissal where 11 U.S.C. § 1129(a)(10) provides that a chapter 11 bankruptcy plan of reorganization cannot be confirmed unless it is accepted by at least one impaired class of non-insiders, but that did not occur because the only accepting creditor in this case is an insider.

2. Alternatively, whether the district court correctly affirmed the bankruptcy court's judgment of dismissal where 11 U.S.C. § 1129(d) provides that a chapter 11 bankruptcy plan of reorganization cannot be confirmed if its principal purpose is the avoidance of taxes, and the sole purpose of filing bankruptcy in this case was to take advantage of the tax attributes of the debtor's net operating losses.

This Court may affirm if it determines the lower courts decided either of these issues correctly.

STATEMENT OF THE CASE

This is an appeal from a judgment of the district court affirming the bankruptcy court's denial of plan confirmation and dismissal of a case arising under chapter 11 of the Bankruptcy Code.

In April 2005, debtor South Beach Securities, Inc. ("South Beach") filed a voluntary petition for chapter 11 bankruptcy relief in the United States Bankruptcy Court for the Northern District of Illinois. *In re South Beach Securities, Inc.*, No. 05-16679 (Bankr. N.D. Ill. Apr. 27, 2005). Shortly thereafter, the bankruptcy court *sua sponte* made a preliminary finding that the case should be dismissed under 11 U.S.C. § 1112(b) because it appeared to have been filed in bad faith. *See* Order, *In re South Beach Securities, Inc.,* No. 05-16679 (Bankr. N.D. Ill. July 28, 2005) (Bankr. Doc. 29).[1] Following briefing — in which the United States Trustee[2]

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[1] Citations to the record are to the Supplemental Appendix (filed herewith), abbreviated "Supp. Appx.," or to the dockets of the bankruptcy court and district court. The abbreviation "Bankr. Doc." means a document on the bankruptcy court's docket. The abbreviation "D. Doc." means a document on the district court's docket.

[2] United States Trustees are officials of the Department of Justice appointed by the Attorney General and charged with appointing trustees in bankruptcy cases and supervising the administration of bankruptcy cases. 28 U.S.C. §§ 581-89. United States Trustees oversee the bankruptcy process, protect the public interest, and ensure that bankruptcy cases are conducted according to law. *See generally United States Tr. v. Columbia Gas Sys., Inc. (In re Columbia Gas Sys., Inc.),* 33 F.3d 294, 296 (3d Cir. 1994). To accomplish this objective, "the United States trustee may raise and may appear and be heard on any issue in any case or proceeding under this title . . . ." 11 U.S.C. § 307. The United States Trustee and his staff constitute an agency of the United States. *See Joelson v. United States*, 86 F.3d 1413, 1417 (6th Cir. 1996) ("parties . . . do not dispute that the U.S. Trustee's Office is an agency within the definition of the Administrative Procedure Act").

supported dismissal — the bankruptcy court dismissed the case. *See* Order of Dismissal, *In re South Beach Securities, Inc.*, No. 05-16679 (Bankr. N.D. Ill. Aug. 24, 2005) (Bankr. Doc. 38).

After dismissal of its case, South Beach appealed to the district court, which reversed and remanded so the chapter 11 case could go forward, concluding that the record as it existed did not support the bankruptcy court's finding of bad faith. *See* Supp. Appx. 000050 (Memorandum Op. at 8, *In re South Beach Securities, Inc.*, No. 1:05-cv-05957, 341 B.R. 853 (N.D. Ill. Apr. 6, 2006) (D. Doc. 14)).

On remand, the bankruptcy court, after briefing and an evidentiary hearing, denied confirmation of South Beach's proposed plan of reorganization. *See* Supp. Appx. 000001 (Memorandum Op., *In re South Beach Securities, Inc.*, No. 05-16679 (Bankr. N.D. Ill. Nov. 1, 2007) (Bankr. Doc. 130)). Subsequently, the bankruptcy court dismissed the case. *See* Supp. Appx. 000027a (Order Dismissing Bankr. Case, *In re South Beach Securities, Inc.*, No. 05-16679 (Bankr. N.D. Ill. Jan. 2, 2008) (Bankr. Doc. 173)).

The bankruptcy court's denial of plan confirmation was based on two alternate grounds. First, the bankruptcy court found South Beach was incapable of meeting the requirements of 11 U.S.C. § 1129(a)(10) — which requires denial of plan confirmation unless the plan is accepted by at least one "non-insider" class — because South Beach's only creditor is Scattered Corporation ("Scattered"), an "insider." Second, the bankruptcy court found South Beach's plan could not be confirmed under 11 U.S.C. § 1129(d) — which requires denial of confirmation where the principal purpose of the bankruptcy plan is avoidance of taxes — because South Beach's stated purpose in filing for bankruptcy relief was to "monetize" the tax attributes of its net operating losses for the benefit of its sole creditor, Scattered.

South Beach and Scattered appealed to the district court, which consolidated the appeals. *See* Minute Entry, *In re South Beach Securities, Inc.,* No. 1:08-cv-01135 (N.D. Ill. Mar. 6, 2008) (D. Doc. 5). After briefing, the district court affirmed the bankruptcy court, finding that the bankruptcy court's decision was correct in fact and law. *See* Supp. Appx. 000028 (Mem. Op. and Order, *In re South Beach Securities, Inc.,* No. 1:08-cv-01135 (N.D. Ill. July 24, 2008) (D. Doc. 51)).

South Beach and Scattered both appealed to this Court, but South Beach's appeal was dismissed, leaving only Scattered's appeal, which has been assigned case number 09-3079.

STATUTORY BACKGROUND

Every chapter 11 debtor has the burden of proving by at least a preponderance of the evidence that the plan satisfies all of the requirements of 11 U.S.C. § 1129(a). *See, e.g., In re Madison Hotel Assocs.*, 749 F.2d 410, 416 & n.7

(7th Cir. 1984); *In re Rusty Jones, Inc.*, 110 B.R. 362, 373 (Bankr. N.D. Ill. 1990); *see also In re Repurchase Corp.*, 332 B.R. 336, 342 (Bankr. N.D. Ill. 2005).

This case involves the requirement found in section 1129(a)(10), which states: "[i]f a class of claims is impaired under the plan, at least one class of claims that is impaired under the plan has accepted the plan, determined without including any acceptance of the plan by any insider." In other words, the debtor's plan of reorganization must be accepted by at least one impaired class of *non-insiders*. A class is "impaired" if the plan alters the legal, equitable, or contractual rights of the members of that class. *See* 11 U.S.C. § 1124. For example, a class comprised of general unsecured claims is impaired if the plan fails to pay the members of that class 100% of their claims plus interest.

The other statutory section relevant to this appeal is 11 U.S.C. § 1129(d), which prohibits confirmation of a chapter 11 plan if its principal purpose is the avoidance of taxes. Section 1129(d) provides as follows:

> (d) Notwithstanding any other provision of this section, on request of a party in interest that is a governmental unit, the court may not confirm a plan if the principal purpose of the plan is the avoidance of taxes or the avoidance of the application of section 5 of the Securities Act of 1933. In any hearing under this subsection, the governmental unit has the burden of proof on the issue of avoidance.

11 U.S.C. § 1129(d).

STATEMENT OF THE FACTS

A. General Background

The following facts are undisputed. Debtor South Beach is a Mississippi company incorporated in 1984. *See* Supp. Appx. 000235 (Exhibit G to Objection to Confirmation of Plan, *In re South Beach*, No. 05-16679 (Bankr. N.D. Ill. Jan. 12, 2007) (Bankr. Doc. 106-7)). Although it was once registered with the Securities and Exchange Commission as a broker-dealer, it relinquished that registration years ago. *See* Supp. Appx. 000156 (Exhibit A to Objection to Confirmation of Plan at pp. 21-22, *In re South Beach*, No. 05-16679 (Bankr. N.D. Ill. Jan. 12, 2007) (Bankr. Doc. 106-1)).

When it filed its chapter 11 bankruptcy petition and schedules in 2005, South Beach claimed no business operations and no income for the preceding two years. *See* Supp. Appx. 000068 (Exhibit D to Objection to Confirmation of Plan, *In re South Beach*, No. 05-16679 (Bankr. N.D. Ill. Jan. 12, 2007) (Bankr. Doc. 106-4)). South Beach had no business operations aside from attempting to have its chapter 11 plan confirmed. Supp. Appx. 000223-000224 (Confirmation Hrg. Tr. at pp. 62-63, *In re South Beach*, No. 05-16679 (Bankr. N.D. Ill. Jan. 17, 2007)). It built nothing. It marketed nothing. It sold nothing. It did nothing. *Id.* Its sole asset was comprised of net operating losses (“NOLs”), a tax attribute. *Id.* Supp. Appx. 000170, 000182, 000196 (Confirmation Hrg. Tr. at pp. 9, 21, 35).

South Beach's only creditor is an entity called Scattered Corporation, which claimed to be owed approximately $3.3 million. *See* Supp. Appx. 000054 (Exhibit D to Objection to Confirmation of Plan, *In re South Beach*, No. 05-16679 (Bankr. N.D. Ill. Jan. 12, 2007) (Bankr. Doc. 106-4)). South Beach and Scattered share the same business address. *See id.* Supp. Appx. 000052 and 000054 (listing 330 S. Wells St., Chicago, IL as the address for both South Beach and Scattered).

Leon A. Greenblatt, III is South Beach's authorized agent, and he signed its bankruptcy petition. *See id.* Supp. Appx. 000053. Mr. Greenblatt is also an officer and director of Scattered. Supp. Appx. 000243 (Exhibit E to Objection to Confirmation of Plan, *In re South Beach*, No. 05-16679 (Bankr. N.D. Ill. Jan. 12, 2007) (Bankr. Doc. 106-5)).

Scattered is South Beach's creditor by virtue of its purchase of a loan that South Beach obtained from an entity called Loop Corp.[3] *See* Supp. Appx. 000244, 000249 (Exhibits B and C to Objection to Confirmation of Plan, *In re South Beach*, No. 05-16679 (Bankr. N.D. Ill. Jan. 12, 2007) (Bankr. Docs. 106-2, 106-3)). Mr. Greenblatt signed the loan papers on behalf of South Beach when it received the

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[3] It appears that Mr. Greenblatt also controlled Loop Corp. *See Loop v. United States Trustee*, 379 F.3d 511 (8th Cir. 2004) (Loop and Mr. Greenblatt acting as co-appellants); *Loop v. United States Trustee*, 2003 WL 23332845 at *5 (Brief of the United States Trustee); *In re MJK Clearing, Inc.*, 408 F.3d 512, 513 (8th Cir. 2005) (referring to Loop as one of "the Greenblatt entities" and noting "Loop . . . [was] formed by Leon A. Greenblatt").

loan, and on behalf of Scattered when it purchased the loan. *See* Supp. Appx. 000248, 000250; *see also* Supp. Appx. 000195-000196 (Confirmation Hrg. Tr. at pp. 34-35, *In re South Beach*, No. 05-16679 (Bankr. N.D. Ill. Jan. 17, 2007)).

Shortly after South Beach filed its bankruptcy petition and schedules, the bankruptcy court *sua sponte* made a preliminary finding that the case should be dismissed under 11 U.S.C. § 1112(b) because it appeared to have been filed in bad faith.[4] *See* Order, *In re South Beach Securities, Inc.*, No. 05-16679 (Bankr. N.D. Ill. July 28, 2005) (Bankr. Doc. 29). After the parties briefed the issue, the bankruptcy court dismissed the case, concluding that Scattered was an insider and the point of the South Beach bankruptcy was to take advantage of South Beach's NOLs. *See* Order of Dismissal, *In re South Beach Securities, Inc.*, No. 05-16679 (Bankr. N.D. Ill. Aug. 24, 2005) (Bankr. Doc. 38).

This case does not require a determination of the applicability of federal tax law, but as a general matter, NOLs may be used to offset income taxes. *See generally* 26 U.S.C. § 172. An NOL can occur when tax deductions exceed gross income for a taxable year. *See* 26 U.S.C. § 172(c). In certain situations, 26 U.S.C. § 172 can allow a taxpayer to offset income in previous and future years with losses from other years.

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[4] 11 U.S.C. § 1112(b) allows for dismissal of a chapter 11 case for "cause."

After the 2005 dismissal of its case, South Beach appealed to the district court, which reversed and remanded. The district court held that, although Scattered was "likely an insider vis-à-vis South Beach," there is no "blanket prohibition on insider creditors collecting on their debts" in bankruptcy, so "more was needed" before the case could be dismissed. *See In re South Beach Securities, Inc.*, 341 B.R. 853, 857-58 (N.D. Ill. 2006).

On remand, South Beach filed a disclosure statement in which it asserted that the NOLs were its only valuable asset, and that the value of the NOLs could only be preserved for the benefit of its creditor, Scattered, through a plan of reorganization. *See* Supp. Appx. 000119-000120 (Disclosure Statement at pp. 7-8, *In re South Beach*, No. 05-16679 (Bankr. N.D. Ill. Oct. 18, 2006) (Bankr. Doc. 89)). South Beach stated:

> [T]he only way to monetize the sole valuable asset of the Debtor — the NOLs — is the [sic] for the Debtor to cancel its current stock, issue New Stock and allow its post-confirmation equity to utilize the tax benefits of the NOLs. In this regard, the Debtor and Scattered have agreed to allow Scattered the right to receive 1,000 shares of New Stock. The Plan sets forth the mechanics for the release of the New Stock to Scattered.
>
> *Id.*

South Beach's plan of reorganization was jointly proposed with its sole creditor, Scattered. The plan proposed two classes of claims and interests. Class 1 was described as general unsecured claims and was comprised of a single creditor, Scattered, with its $3.3 million claim. *See* Supp. Appx. 000086 (Debtor's Plan of

Reorganization at p. 13, *In re South Beach*, No. 05-16679 (Bankr. N.D. Ill. Sept. 21, 2006) (Bankr. Doc. 83)).

The only other class listed in the plan was described as "holders of interests" in the debtor, South Beach. *Id.* The plan identified no members of class 2, but described them as holders of South Beach stock, whose interests would be canceled upon confirmation of the plan. *Id.* As such, the members of class 2 were conclusively presumed to reject the plan. *See* 11 U.S.C. § 1126(g). Thus, the only impaired class eligible to vote for acceptance or rejection of the plan was Scattered, the sole creditor.

The United States Trustee objected to the plan of reorganization on the two grounds at issue in this appeal. First, because section 1129(a)(10) requires that, if there is an impaired class of claims under the plan, at least one impaired, non-insider class must vote in favor of the plan, South Beach was incapable of meeting this requirement because its only impaired class consisted of Scattered, an insider. Second, the plan's principal purpose was tax avoidance in violation of section 1129(d). *See* Objection to Confirmation of Plan, *In re South Beach*, No. 05-16679 (Bankr. N.D. Ill. Jan. 12, 2007) (Bankr. Doc. 106).[5]

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[5] The United States Trustee raised a third ground of objection, namely that the plan provided for a discharge in a liquidating case in violation of section 1141(d)(3). Section 1141(d)(3) provides:

The bankruptcy court conducted an evidentiary hearing on the proposed plan of reorganization. *See* Supp. Appx. 000162 (Confirmation Hrg. Tr., *In re South Beach*, No. 05-16679 (Bankr. N.D. Ill. Jan. 17, 2007)). Only one witness testified: Leon A. Greenblatt, III, the authorized agent of both South Beach and Scattered. Previously, Mr. Greenblatt had been examined under oath by the United States Trustee in a deposition-like proceeding pursuant to Fed. R. Bankr. P. 2004. *See* Supp. Appx. 000151 (Exhibit A to Objection to Confirmation of Plan at 16, 17, 20, *In re South Beach*, No. 05-16679 (Bankr. N.D. Ill. Jan. 12, 2007) (Bankr. Doc. 106-1)). During the Rule 2004 examination, Mr. Greenblatt stated that he could not recollect even the most basic information about himself, such as when he graduated from high school, what his occupation had been since 1990, and whether he signed South Beach's bankruptcy petition. *See id.* Supp. Appx. 000154-

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> The confirmation of a plan does not discharge a debtor if—
>
> > (A) the plan provides for the liquidation of all or substantially all of the property of the estate;
> >
> > (B) the debtor does not engage in business after consummation of the plan; and
> >
> > (C) the debtor would be denied a discharge under section 727(a) of this title if the case were a case under chapter 7 of this title.

Because the bankruptcy court sustained the United States Trustee's objections under sections 1129(a)(10) and 1129(d), it found it unnecessary to address the section 1141(d)(3) discharge issue.

000155. The bankruptcy court characterized Mr. Greenblatt as “taciturn and uncooperative.” *See* Supp. Appx. 000003 (Memorandum Op. at 3 (Bankr. N.D. Ill. Nov. 1, 2007) (Bankr. Doc. 130)).

At the evidentiary hearing, Mr. Greenblatt was asked how South Beach’s plan of reorganization would — to use the term from the disclosure statement — “monetize” the NOLs. He testified that, after confirmation of the plan, South Beach would use the NOLs to offset its income. *See* Supp. Appx. 000182-000183 (Confirmation Hrg. Tr. at pp. 21-22, *In re South Beach*, No. 05-16679 (Bankr. N.D. Ill. Jan. 17, 2007)). When asked how an entity with no business operations would generate income, Mr. Greenblatt said that South Beach’s new owner, Scattered, would make a capital contribution to South Beach — “enough capital to use up the NOL.” *See id.* Supp. Appx. 000224-000225 (Confirmation Hrg. Tr. at pp. 63-64). In addition, Mr. Greenblatt testified that Scattered had prepared South Beach’s tax returns for the preceding five years “for the purposes of confirming the plan” of reorganization. *See id.* Supp. Appx. 000217 (Confirmation Hrg. Tr. at p. 56).

Although South Beach’s disclosure statement stated that the purpose of the bankruptcy was to preserve the value of the NOLs, Mr. Greenblatt denied that the purpose of the plan was to avoid taxes. Rather, at the hearing, Mr. Greenblatt testified for the first time that the purpose of the plan was to "avoid litigation" with the creditors of South Beach's parent company. *See id.* Supp. Appx. 000170, 000180, 000182, 000183 (Confirmation Hrg. Tr. at pp. 9, 19, 21, 23). No evidence or explanation was provided regarding this new purpose, and no explanation was given for how South Beach — an entity that had no assets and had conducted no business for years — might somehow become embroiled in litigation. *See id.*

A ballot in which Scattered voted to accept the plan was entered into the record. *See* Supp. Appx. 000271 (Chapter 11 Ballot, *In re South Beach*, No. 05-16679 (Bankr. N.D. Ill. Jan. 9, 2007) (Bankr. Doc. 100)).

B. The Bankruptcy Court's Ruling

The bankruptcy court issued a memorandum opinion sustaining the United States Trustee's objections on the two alternate bases, section 1129(a)(10) and section 1129(d). *See* Supp. Appx. 000001 (Memorandum Op., *In re South Beach Securities, Inc.*, No. 05-16679 (Bankr. N.D. Ill. Nov. 1, 2007) (Bankr. Doc. 130)).

With respect to section 1129(a)(10), the bankruptcy court determined that under governing law, South Beach, as plan proponent, had failed to prove by a preponderance of the evidence that Scattered is not a "person in control of the debtor," and was, therefore, an "insider" of South Beach. *See* 11 U.S.C. § 101(31)(B)(iii). The court found that Scattered qualified as a "person in control of the debtor" in view of, *inter alia*: Scattered and South Beach's shared business address; Mr. Greenblatt's role as an officer and director of Scattered and his role as the sole officer and employee of the manager of South Beach's parent; and Mr. Greenblatt's dual role as an "authorized person" for both South Beach and Scattered. *See* Supp. Appx. 000013-000015 (Memorandum Op. at 13-15).

In addition, the bankruptcy court found that even if Scattered did not qualify as a person in control of the debtor under section 101(31)(B)(iii), because the list of insiders is nonexclusive, citing *In re Krehl*, 86 F.3d 737, 741 (7th Cir. 1996), Scattered was a non-statutory insider. The court was persuaded by the fact that Mr. Greenblatt directs the affairs of South Beach from his position as an officer and director of Scattered. *See* Supp. Appx. 000015-000017 (Memorandum Op. at 15-17). The court relied upon the fact that South Beach made no attempt to dispute that Scattered qualified as a non-statutory insider. *See id.*

The bankruptcy court concluded that all evidence suggested that Scattered was an insider of South Beach. Based on its findings that Scattered was an insider and the sole member of the only impaired class in the plan, the court held there was not at least one class of impaired claims, excluding insiders, voting in favor of the plan as required by section 1129(a)(10). Therefore, the court concluded the plan could not be confirmed.

Alternatively, the bankruptcy court found that the United States Trustee had proved by a preponderance of the evidence that the principal purpose of the plan was an improper one, avoidance of taxes, making the plan unconfirmable under section 1129(d). *See* Supp. Appx. 000022-000026 (Memorandum Op. at 22-26). The court stated that the "plan's principal purpose is to put Scattered in a position to inject money into South Beach, enabling South Beach to use the net operating losses to obtain a tax deduction." *Id.* at Supp. Appx. 000022. The bankruptcy court rejected the newly-stated purpose of litigation avoidance and denied confirmation under section 1129(d). *Id.* at Supp. Appx. 000025-000026.

Shortly after the bankruptcy court denied plan confirmation, the United States Trustee moved to dismiss South Beach's case for cause under section 1112(b). *See* Notice of Motion and Motion to Dismiss Case, *In re South Beach Securities, Inc.*, No. 05-16679 (Bankr. N.D. Ill. Nov. 5, 2007) (Bankr. Doc. 134). The United States Trustee asserted that cause for dismissal existed because confirmation of the plan was denied and South Beach was unable to effectuate a plan of reorganization given that its sole creditor was determined to be an insider. *Id*. The court granted the motion and dismissed the case. *See* Supp. Appx. 000027a (Order Dismissing Case, *In re South Beach Securities, Inc.,* No. 05-16679 (Bankr. N.D. Ill. Jan. 2, 2008) (Bankr. Doc. 173)).

South Beach, Scattered, and Mr. Greenblatt, *pro se,* filed notices of appeal from the order denying confirmation and the order dismissing the case. *See In re South Beach Securities, Inc.,* No. 05-16679 (Bankr. N.D. Ill.) (Bankr. Docs. 135, 139, 154, 177, 183, 185). The district court consolidated the appeals and granted the United States Trustee's motion to dismiss Mr. Greenblatt's appeal for lack of standing. *See In re South Beach Securities, Inc.,* No. 1:08-cv-01135 (N.D. Ill. Mar. 6 and May 16, 2008) (D. Docs. 5, 25).

C. The District Court's Ruling

On appeal to the district court, Scattered filed a brief, which South Beach adopted in lieu of filing a brief of its own. *See In re South Beach Securities, Inc.,* No. 1:08-cv-01135 (N.D. Ill. Apr. 11 and 17, 2008) (D. Docs. 14, 22).

With respect to the section 1129(a)(10) "insider" issue, the appellants disputed that Mr. Greenblatt's role in both South Beach and Scattered was sufficient to support the finding that Scattered was an insider. They further asserted that the orders denying plan confirmation and dismissing the case should be reversed because Scattered, the sole creditor, accepted the plan and therefore confirmation of the plan would prejudice no one. On the section 1129(d) "tax avoidance" issue, Scattered and South Beach reasserted that the plan's purpose was litigation avoidance, not tax avoidance.

The United States Trustee countered that the evidence supported the bankruptcy court's finding that Scattered is an insider, and the plain language of section 1129(a)(10) therefore forbade confirmation of the plan. *See* Appellee's Brief, *In re South Beach Securities, Inc.,* No. 1:08-cv-01135 (N.D. Ill. June 6, 2008) (D. Doc. 28). The United States Trustee further argued that tax avoidance was the principal purpose of the plan, as stated explicitly in South Beach's disclosure statement, and that the new claim of "litigation avoidance" was an unsupported and incredible eleventh-hour excuse.

On July 24, 2009, the district court affirmed the bankruptcy court's decision. Its memorandum opinion sustained the United States Trustee's objections under section 1129(a)(10) and section 1129(d). *See* Supp. Appx. 000028 (Mem. Op. and Order, *In re South Beach Securities, Inc.,* No. 1:08-cv-01135 (N.D. Ill. July 24, 2008) (D. Doc. 51)).

The district court's opinion closely mirrors the bankruptcy court's. On the section 1129(a)(10) issue, the district court noted the bankruptcy court's "elaborate findings" regarding the close interrelationships among Greenblatt-controlled entities, and the district court concluded that "Greenblatt was for all intents and purposes Scattered and South Beach. Greenblatt was a shareholder of Scattered, acted on behalf of Scattered, and 'managed' South Beach by making all decisions pertaining to it." Mem. Op. and Order at 13. The district court concluded that "the bankruptcy court's findings of historical facts are consistent with the record evidence and its conclusion that South Beach failed to prove that Scattered was not an insider is correct as a matter of law." *Id.*

The district court also found that the evidence supported the bankruptcy judge's alternative conclusion that the only purpose of the plan was to avoid taxes in violation of section 1129(d). Reviewing the bankruptcy court's findings, the district court determined that, whether South Beach or Scattered could have offset the NOLs without the plan (as they argued they could, contrary to their position taken before the bankruptcy court) was immaterial to the plan's actual purpose. The district court, therefore, found it unnecessary to analyze whether South Beach or Scattered could have taken deductions for the NOLs under the tax law. Mem. Op. and Order at 13-14.

South Beach and Scattered timely appealed the district court's order to this Court. On October 16, 2009, South Beach's appeal was dismissed for failure to comply with Circuit Rule 3(c). Therefore, only Scattered remains as an appellant.

SUMMARY OF ARGUMENT

This case involves the straightforward application of unambiguous statutory language. Under 11 U.S.C. § 1129(a)(10), a plan of reorganization cannot be confirmed if a class of claims is impaired under the plan unless at least one impaired class of *non-insiders* votes to accept it. In this case, there was only one impaired class, and it consisted of only one creditor, Scattered. Based on the record evidence establishing that Scattered controlled South Beach through its officer, director and owner, Mr. Greenblatt, there was no clear error in the bankruptcy court's finding that Scattered was indeed an "insider." Thus, under the plain language of section 1129(a)(10), South Beach's plan was unconfirmable, and the lower courts did not err in reaching this conclusion.

Likewise, South Beach's plan was unconfirmable under the plain language of 11 U.S.C. § 1129(d). Under that section, a plan cannot be confirmed if "the principal purpose of the plan is the avoidance of taxes." By South Beach's own admission, the entire point of its proposed plan was to "monetize" South Beach's net operating losses by using them to offset income tax. On the record of this case, the lower courts committed no error in concluding that section 1129(d) applied to prevent confirmation of the proposed plan.

This Court may affirm the judgment of the district court if it agrees with either basis under 11 U.S.C. § 1129.

ARGUMENT

I. STANDARD OF REVIEW

The standard of review in a case involving determinations under 11 U.S.C. § 1129 are well established. This court exercises *de novo* review of the district court's and the bankruptcy court's conclusions of law. Findings of fact made by the bankruptcy court are reviewed under a clearly erroneous standard. *In re Andreuccetti*, 975 F.2d 413, 419-20 (7th Cir. 1992).

II. THE LOWER COURTS DID NOT ERR IN FINDING SOUTH BEACH'S PLAN OF REORGANIZATION WAS UNCONFIRMABLE UNDER 11 U.S.C. § 1129(a)(10).

Under 11 U.S.C. § 1129(a)(10), if there is an impaired class under the plan, the plan cannot be confirmed unless it is accepted by at least one impaired class that has no "insider." South Beach's plan of reorganization was unconfirmable because its only impaired class consisted solely of Scattered, an "insider." There was not at least one class of "non-insiders" to accept the plan. Thus, South Beach was not capable of meeting the requirements of section 1129(a)(10). Moreover, South Beach did not even attempt to dispute the facts supporting the lower courts' findings that Scattered is an insider.

A. The Lower Courts Did Not Err in Determining That South Beach Could Not Satisfy § 1129(a)(10) Because its Sole Creditor, Scattered, is an Insider.

Section 1129(a) sets out the mandatory conditions that must exist before a bankruptcy court may confirm a chapter 11 plan of reorganization. One of these requirements is section 1129(a)(10), which requires that "[i]f a class of claims is impaired under the plan, at least one class of claims that is impaired under the plan has accepted the plan, determined without including any acceptance of the plan by an insider."

The bankruptcy court found that Scattered, as South Beach's only creditor, was an "impaired" class within the meaning of the Bankruptcy Code. *See* Supp. Appx. 000010 (Memorandum Op. at 10, *In re South Beach Securities, Inc.*, No. 05-16679 (Bankr. N.D. Ill. Nov. 1, 2007) (Bankr. Doc. 130)). The record more than adequately supports this conclusion. South Beach's plan would have altered Scattered's "legal, equitable, or contractual rights," *see* 11 U.S.C. § 1124, because it called for issuance of 1,000 shares of New Stock to Scattered in full satisfaction of the debt owed by South Beach, *see* Supp. Appx. 000086 (Debtor's Plan of Reorganization at p. 13, *In re South Beach*, No. 05-16679 (Bankr. N.D. Ill. Sept. 21, 2006) (Bankr. Doc. 83)).

Accordingly, if — as the lower courts correctly concluded — Scattered is an insider, Scattered's vote to accept the plan of confirmation could not satisfy section 1129(a)(10). Based on the evidence and testimony provided, the bankruptcy court properly found that Scattered was an insider, and the district court correctly affirmed that conclusion.

1. The Lower Courts Committed No Error in Concluding that Scattered Meets the Definition of "Statutory Insider."

Under the Bankruptcy Code, there are two types of insiders: those specifically listed by way of example in 11 U.S.C. § 101(31) (most often referred to as "statutory" insiders), and those insiders not listed in the statute but that nonetheless have a close, less-than-arm's length relationship with a party (most often referred to as "extra-statutory" or "non-statutory" insiders). Section 101(31)(B) defines what it means to be an "insider" of a corporate debtor. The definition includes such titles as officer, director, and general partner, but also includes a "person in control of the debtor." 11 U.S.C. § 101(31)(B)(iii).

A review of uncontested facts demonstrates that the lower courts correctly concluded that Scattered is a statutory insider of South Beach. Indeed, under the facts of this case, it is difficult to see how anyone *other than* Scattered could be "in control" of South Beach. As Mr. Greenblatt admitted, South Beach's "operations" during the relevant time period consisted of preparing the bankruptcy case. *See* Supp. Appx. 000224 (Confirmation Hrg. Tr. at pp. 63, *In re South Beach*, No.

05-16679 (Bankr. N.D. Ill. Jan. 17, 2007)). Scattered, via its officer and director Mr. Greenblatt, conducted all of those operations for South Beach. Mr. Greenblatt signed South Beach's bankruptcy petition as well as the accompanying schedules and monthly operating reports. *See* Supp. Appx. 000053; 000055, 000067, 000073 (Exhibit D to Objection to Confirmation of Plan, *In re South Beach*, No. 05-16679 (Bankr. N.D. Ill. Jan. 12, 2007) (Bankr. Doc. 106-4)). He participated in formulating the reorganization plan, testified at the meeting of creditors, and testified at the confirmation hearing. *See* Supp. Appx. 000206 (Confirmation Hrg. Tr. at p. 45, *In re South Beach*, No. 05-16679 (Bankr. N.D. Ill. Jan. 17, 2007)). Also in his hearing testimony Mr. Greenblatt stated — in his dual role as an authorized agent of both Scattered and South Beach — that Scattered had prepared South Beach's tax returns "for the purposes of confirming the plan." *See id.* Supp. Appx. 000217 (Confirmation Hrg. Tr. at p. 56); *see also* Supp. Appx. 000251-000270 (tax returns).[6]

Scattered's brief cites several bankruptcy cases and asserts that, to be "in control" of the debtor, there must be more than financial control, there should be

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[6] Although the photocopies of South Beach's tax returns for the years 2001 to 2005 are not the highest quality, it is undisputed that Scattered prepared South Beach's taxes for these years. *See* Supp. Appx. 000217(Confirmation Hrg. Tr. at p. 56). Scattered's name can clearly be seen in the field for "preparer" on the bottom of pages Supp. Appx. 000259, 000263, 000267.

instead day-to-day control over production, purchasing, personnel, management, *etc*. *See* Appellant's Br. at 7 (citing, *e.g.*, *In re Armstrong,* 231 B.R. 746 (Bankr. E.D. Ark. 1999); *In re Octagon Roofing,* 124 B.R. 522 (Bankr. N.D. Ill. 1991); *In re Technology For Energy Corp.*, 56 B.R. 307 (Bankr. E.D. Tenn. 1985)). This argument is wholly inapposite here, however, because South Beach is a holding company with no ongoing business. There is simply no going concern to manage. The type of control that Scattered exercises over South Beach goes far beyond "financial control incident to the creditor-debtor relationship." *In re Winstar Communications, Inc*. 554 F.3d 382, 399 (3d Cir. 2009). Scattered was conducting the only "operations" that South Beach had. Indeed, Scattered exercised over South Beach the only kind of control that could possibly be exerted, because South Beach conducted no operations other than preparing the bankruptcy case. Scattered's actions, carried out by Mr. Greenblatt, are thus the actions of a "person in control of the debtor," 11 U.S.C. § 101(31)(B)(iii), and the bankruptcy court did not commit clear error in so finding. As the district court aptly phrased it, "Scattered via its officer and director who is also South Beach's [parent company's] sole officer and employee, *i.e.*, Greenblatt, was in control of South Beach." *See* Supp. Appx. 000038 (Mem. Op. and Order at 11, *In re South Beach Securities, Inc.*, No. 1:08-cv-01135 (N.D. Ill. July 24, 2008) (D. Doc. 51)). This

Court should affirm the lower courts' conclusion that Scattered is a statutory insider within the meaning of 11 U.S.C. § 101(31)(B)(iii) and § 1129(a)(10).

2. Alternatively, This Court Should Affirm the Conclusion that Scattered Meets the Definition of "Non-Statutory Insider."

The statutory definition of "insider" is not exhaustive. As this Court has observed, the statutory list of insiders "is intended to be illustrative rather than exhaustive." *In re Krehl*, 86 F.3d 737, 741 (7th Cir. 1996) (referencing § 102(3)); *accord In re Kunz*, 489 F.3d 1072, 1075 (10th Cir. 2007) (noting that "[c]ourts have held that the use of the word 'includes' in this section [101(31)] indicates that Congress did not intend for the categories listed to be exclusive"). In addition to the roles set forth in the statutory definition, therefore, the term "insider" also "encompasses anyone with 'a sufficiently close relationship with the debtor that his conduct is made subject to closer scrutiny than those dealing at arm's length with the debtor.' " *In re Krehl*, 86 F.3d at 741 (quoting S. Rep. No. 95-989 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787).

In the district court, Scattered conceded that it was a "non-statutory insider" by offering no argument contesting the bankruptcy court's conclusion on this point. In this Court, Scattered does not assert separate "statutory" and "non-statutory" insider arguments, instead objecting generally to the "insider" finding.

Appellant's Br. at 7-8. Arguably, therefore, this Court could affirm on the grounds that South Beach and Scattered failed to preserve any challenge to the lower court's non-statutory insider findings. *See generally Houskins v. Sheahan,* 549 F.3d 480, 494 (7th Cir. 2008) (citing the fundamental principle that appellate review is precluded on arguments not made below).

Moreover, based on the facts and law, this Court can affirm the lower courts' conclusions that Scattered is a "non-statutory insider." As the bankruptcy court observed, "none of [the dealings between South Beach and Scattered] were remotely arm's length." Supp. Appx. 000017 (Memorandum Op. at 17, *In re South Beach Securities, Inc.,* No. 05-16679 (Bankr. N.D. Ill. Nov. 1, 2007) (Bankr. Doc. 130)). Scattered and South Beach share the same address and share Mr. Greenblatt as authorized agent. On the loan papers that gave rise to South Beach's debt to Scattered, Mr. Greenblatt executed the original loan agreement on behalf of South Beach as the borrower, and later, when the loan was assigned by the lender to Scattered, Greenblatt executed the agreement on behalf of Scattered, the creditor. *See* Supp. Appx. 000248, 000250; *see also* Supp. Appx. 000195-000196 (Confirmation Hrg. Tr. at pp. 34-35, *In re South Beach*, No. 05-16679 (Bankr. N.D. Ill. Jan. 17, 2007)).

Because the dealings between Scattered and South Beach were not at arm's length and merited careful scrutiny, *see In re Three Flint Hill Ltd. Ptship.*, 213 B.R. 292, 298 (D. Md. 1997) (citing *Butler v. Shaw*, 72 F.3d 437, 443 (4th Cir. 1996)), the district court was correct to affirm the bankruptcy court's finding that Scattered was an insider of South Beach. Both the bankruptcy court and district court looked at the relationship between South Beach and Scattered and applied criteria established by case law to determine that the conduct between South Beach and Scattered was subject to closer scrutiny than a normal arm's length transaction. *See In re Krehl,* 86 F.3d at 742 (determining insider status by looking "to the closeness of the relationship between the parties and to whether any transactions between them were conducted at arm's length"). Because the evidence was more than sufficient evidence to support these findings, this Court should affirm.

B. The Lower Courts Did Not Err in Rejecting Scattered's Law of the Case Assertions.

This Court should reject Scattered's argument that the lower courts erred by misapplying "law of the case." Appellant's Br. at 8-9. This flawed contention is premised on the district court's ruling in an earlier appeal from the bankruptcy court's dismissal for bad faith under 11 U.S.C. § 1112(b).

In 2006, in case number 1:05-cv-05957, the district court considered an appeal from the dismissal of South Beach's bankruptcy for bad faith under 11 U.S.C. § 1112(b). In that appeal, the district court concluded that South Beach's case could not be dismissed at that juncture for bad faith under section 1112(b) based on the fact that South Beach's sole creditor, Scattered, is an insider. *See* Supp. Appx. 000043 (Memorandum Op., *In re South Beach Securities, Inc.,* No. 1:05-cv-05957, 341 B.R. 853 (N.D. Ill. Apr. 6, 2006) (D. Doc. 14)). Scattered now asserts that the district court's prior holding that South Beach's case should not have been dismissed for bad faith under section 1112(b) foreclosed the court from later finding that South Beach's plan could not be confirmed under section 1129(a)(10).

Scattered is incorrect. The district court's conclusions under section 1112(b) did not consider whether South Beach's plan could be confirmed under section 1129(a)(10). Plan confirmation was not even before the district court in the first appeal. In fact, the proposed plan was not filed until five months after the case had been remanded. *See* Supp. Appx. 000074 (Debtor's Plan of Reorganization, *In re South Beach*, No. 05-16679 (Bankr. N.D. Ill. Sept. 21, 2006) (Bankr. Doc. 83)).

Although as a general matter under the law of the case doctrine, "once an issue is litigated and decided," that same matter should be ended and not re-litigated by the same court, *see Ienco v. Angarone*, 429 F.3d 680, 684 (7th Cir. 2005), the doctrine has its limits. Law of the case does not apply when the facts or circumstances have changed between the time of the two rulings in question, nor does it apply when the issues are not the same. *See, e.g., Sharp Electronics Corp. v. Metropolitan Life Ins. Co.*, 578 F.3d 505, 510 (7th Cir. 2009).

Here, the issues under consideration in the first appeal and the subsequent proceedings were not the same. In the 2006 appeal, the parties addressed only section 1112(b), not section 1129(a)(10). An issue that was not litigated by the parties and not determined by the district court cannot be the law of the case. As the bankruptcy court correctly observed and the district court correctly affirmed, "[b]ecause the district court never suggested, let alone held, that a plan can be confirmed [under 11 U.S.C. § 1129(a)(10)] in a Chapter 11 case where the debtor's only creditor is an insider holding an impaired claim, the district court's decision is not the law of the case on that point." *See* Supp. Appx. 000013 (Memorandum Op. at 13, *In re South Beach Securities, Inc.*, No. 05-16679 (Bankr. N.D. Ill. Nov. 1, 2007) (Bankr. Doc. 130)).[7] This Court should find no error.

Furthermore, it should go without saying that the law of the case doctrine cannot bind this Court to the district court's opinion in the first appeal. *See*

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[7] The district court's opinion in the first appeal actually cuts against Scattered on the "insider" issue. On that point, the district court stated, "We agree that Scattered is likely an insider vis-a-vis South Beach: the owners of Scattered — including Greenblatt — are the sons of South Beach's owners." *See* Supp. Appx. 000049 (Memorandum Op. at 7, *In re South Beach Securities, Inc.*, No. 1:05-cv-05957, 341 B.R. 853 (N.D. Ill. Apr. 6, 2006) (D. Doc. 14) (citing 11 U.S.C. § 101(31)(B)(vi) (insiders include "relative[s] of a general partner, director, officer, or person in control of the debtor")).

Marseilles Hydro Power LLC v. Marseilles Land & Water Co., 481 F.3d 1002, 1004 (7th Cir. 2007) (noting that law of the case "has no application to the review of rulings by a higher court"). "[T]he law of the case doctrine has little force when a higher court is reviewing decisions of a lower court." *Sharp Electronics*, 578 F.3d at 510; *see also* 8 FEDERAL PRACTICE & PROCEDURE § 4478, at 801 ("So long as a matter is properly preserved in the lower court, the fact that the lower court can properly refuse reconsideration as a matter of law of the case of course does not prevent subsequent review and reversal on appeal."). Accordingly, this Court should reject Scattered's law-of-the-case contentions.

C. The Lower Courts Correctly Applied the Plain Language of § 1129(a)(10), Notwithstanding Scattered's Assertions About How Its Vote Should Have Been Counted.

This Court should also reject Scattered's assertion that the bankruptcy court somehow miscalculated its vote accepting South Beach's proposed plan under 11 U.S.C. § 1126. Appellant Br. at 9-10. Notwithstanding Scattered's mathematical musings about denominators and dividing by zero, there is no dispute that, in this case, there was only one impaired class, and Scattered was the sole member of that class. There was also no dispute that Scattered cast its sole vote to accept the plan. *See* Supp. Appx. 000271 (Chapter 11 Ballot, *In re South Beach*, No. 05-16679 (Bankr. N.D. Ill. Jan. 9, 2007) (Bankr. Doc. 100)).

Thus, no matter how it was counted, there was only one vote, and it came from Scattered, an insider. And therein lies the reason that South Beach's plan of reorganization was unconfirmable. Regardless of how Scattered's vote was calculated, it came from an insider, and that factual circumstance rendered the plan unconfirmable under the plain and unambiguous language of 11 U.S.C. § 1129(a)(10). Under the statute, if a class of claims is impaired under the plan, there must be at least one accepting vote by an impaired class of non-insiders before a plan can be confirmed.

If a statute's language is not ambiguous, the court should apply its plain meaning to the facts before it. *See, e.g., Lexington Ins. Co. v. Rugg & Knopp, Inc.*, 165 F.3d 1087, 1091 (7th Cir. 1999). Application of that plain language here yields but one conclusion: Because the only creditor of South Beach was an insider, South Beach could not satisfy its burden under § 1129(a)(10) and the bankruptcy court properly denied plan confirmation and correctly dismissed the case. The district court properly affirmed. This Court should affirm, as well.

III. ALTERNATIVELY, THIS COURT SHOULD CONCLUDE THAT THE LOWER COURTS COMMITTED NO ERROR IN FINDING THE PLAN UNCONFIRMABLE UNDER 11 U.S.C. § 1129(d) BECAUSE ITS PRINCIPAL PURPOSE WAS TAX AVOIDANCE.

South Beach's own words in its disclosure statement admitted that the purpose of the plan was to use net operating losses to substantially offset some future taxable income, *i.e.*, to avoid taxes. Indeed, this was not merely a principal purpose of the plan, but its sole evident purpose, notwithstanding the eleventh-hour excuse given by Mr. Greenblatt at trial regarding the plan being merely for the purpose of "avoiding litigation." The bankruptcy court's factual determination that the principal purpose of the plan was tax avoidance is supported by the record and is not clearly erroneous. As a result, the bankruptcy court properly denied confirmation under 11 U.S.C. § 1129(d), and the district court properly affirmed.

A. Under 11 U.S.C. § 1129(d), a Plan Cannot Be Confirmed if its Principal Purpose is Tax Avoidance.

In pertinent part, 11 U.S.C. § 1129(d) provides that "the court may not confirm a plan if the principal purpose of the plan is the avoidance of taxes." Section 1129(d), by its plain terms, looks at the *purpose* of the plan, *not* at whether the avoidance of taxes purported by the plan would be permissible under tax law, and not whether a particular tax treatment is achievable with or without the plan. For this reason, it is immaterial whether — as Scattered asserts — the use of NOLs is "legal" or whether South Beach "needed" to confirm a chapter 11 plan to maximize its NOLs. Appellant's Br. at 5-6. If, as was the case here, the stated purpose of the plan is to avoid taxes, section 1129(d) applies.

Moreover, when a debtor such as South Beach has "no business" to reorganize, "no assets except a potential tax loss," and proposes a plan solely as a way to take advantage of the tax loss, a court is entitled to conclude that the purpose of the plan is tax avoidance. *See, e.g., In re Maxim Indus., Inc.,* 22 B.R. 611, 611 (Bankr. D. Mass. 1982) (denying confirmation under such facts). That was the case here, and as discussed further below, the lower courts were correct to apply 11 U.S.C. § 1129(d) on this record.

B. The Bankruptcy Court Did Not Clearly Err in Finding That Tax Avoidance Was the Plan's Principal Purpose.

From the outset, the record has left no doubt that the purpose of South Beach's proposed plan of reorganization was to take advantage of the tax benefits of its net operating losses ("NOLs"). South Beach's disclosure statement admitted this explicitly, stating that "the sole asset of any value of the Debtor was a net operating loss ("NOL") carryovers for U.S. federal income tax purposes," and

> the only way to monetize the sole valuable asset of the Debtor — the NOLs — is the for the Debtor to cancel its current stock, issue New Stock and allow its post-confirmation equity to utilize the tax benefits of the NOLs. In this regard, the Debtor and Scattered have agreed to allow Scattered the right to receive 1,000 shares of New Stock. The Plan sets forth the mechanics for the release of the New Stock to Scattered.

See Supp. Appx. 000113, 000019-000120 (Disclosure Statement at pp. 1, 7-8, *In re South Beach*, No. 05-16679 (Bankr. N.D. Ill. Oct. 18, 2006) (Bankr. Doc. 89)).

In addition to the disclosure statement, there was the testimony of Mr. Greenblatt at the confirmation hearing. Mr. Greenblatt explained that, after confirmation of the plan, South Beach would use the NOLs to “offset its income.” *See* Supp. Appx. 000182-000183 (Confirmation Hrg. Tr. at pp. 21-22, *In re South Beach*, No. 05-16679 (Bankr. N.D. Ill. Jan. 17, 2007)). Given that South Beach has no business operations, the income would be in the form of a capital contribution from South Beach’s new owner, Scattered, which would contribute “enough capital to use up the NOL.” *See id.* Supp. Appx. 000224-000225 (Confirmation Hrg. Tr. at pp. 63-64). Thus, Mr. Greenblatt confirmed that the “mechanics” of the plan, as described in the disclosure statement, were to engineer a circumstance in which the NOLs could be used to offset income taxes.

As for the purpose that Mr. Greenblatt offered for the first time at the confirmation hearing —“litigation avoidance” — it was most remarkable for its timing and lack of detail. The “litigation avoidance” purpose was offered two years after the bankruptcy petition was filed, only *after* the United States Trustee objected to the plan under section 1129(d). Denying that the plan was for the purpose of tax avoidance, Mr. Greenblatt asserted that the plan’s purpose was to avoid litigation with the creditors of South Beach’s pre-confirmation parent company. *See* Supp. 000182, 000183 (Confirmation Hrg. Tr. at pp. 21, 23, *In re South Beach*, No. 05-16679 (Bankr. N.D. Ill. Jan. 17, 2007)). Yet Mr. Greenblatt did not explain how such litigation could extend to South Beach.

Nothing in South Beach’s bankruptcy petition and accompanying schedules disclosed the existence or threat of litigation. *See* Supp. Appx. 000052-000073 (Exhibit D to Objection to Confirmation of Plan, *In re South Beach*, No. 05-16679 (Bankr. N.D. Ill. Jan. 12, 2007) (Bankr. Doc. 106-4)). The disclosure statement — which devoted multiple pages to a detailed discussion of "monetizing" the NOLs — did not contain a single mention of potential litigation with the creditors of South Beach's parent or otherwise. *See* Supp. Appx. 000119-000120, 000141-000149 (Disclosure Statement at pp. 7-8, 29-37, *In re South Beach*, No. 05-16679 (Bankr. N.D. Ill. Oct. 18, 2006) (Bankr. Doc. 89)). Lawsuits a debtor faces are virtually always set forth in disclosure statements. *See* 9C Am.Jur. 2d Bankruptcy § 2895 (2008) (noting that "courts often require that a disclosure statement must include . . . the existence, likelihood, and possible success of nonbankruptcy litigation"); *see also In re Dakota Rail, Inc.*, 104 B.R. 138, 142 (Bankr. D. Minn. 1989). Indeed, as the bankruptcy court observed, South Beach could point to no litigation in which it is actually a defendant. *See* Supp. Appx. 000009 (Memorandum Op. at 9, n.10, *In re South Beach Securities, Inc.*, No. 05-16679 (Bankr. N.D. Ill. Nov. 1, 2007) (Bankr. Doc. 130)).

As the court that heard the evidence firsthand, the bankruptcy court was in the best position to determine the plan's principal purpose, considering the long-standing disclosure statement that was never amended, the credibility of Mr. Greenblatt, South Beach's sole witness, and the timing and plausibility of the newly-claimed but detail-deficient “litigation avoidance” purpose. *See generally Luke v. C.I.R.,* 351 .F2d 568, 571-72 (7th Cir. 1965) (finding the determination of motivation “is essentially factual and entitled to great weight”). The bankruptcy court observed, “the disclosure statement makes no bones about” the sole purpose of the plan:

> [T]here is nothing here to reorganize, no business to resuscitate, no going concern to keep going. The whole point of the South Beach bankruptcy and the proposed plan is to make use of South Beach’s NOLs.

Supp. Appx. 000023 (Memorandum Op. at 23*, In re South Beach Securities, Inc.,* No. 05-16679 (Bankr. N.D. Ill. Nov. 1, 2007) (Bankr. Doc. 130) (citing *In re Maxim Indus., Inc.*, 22 B.R. 611, 611 (Bankr. D. Mass. 1982))).

Until the United States Trustee objected, South Beach made it clear that the plan’s only purpose was to “monetize” the NOLs. Even if *a* purpose of the plan was to avoid being lured into litigation with creditors of its parent, nothing whatsoever in testimony or evidence indicates the *principal* purpose of the plan was anything other than tax avoidance.[8] The bankruptcy court thus properly found the proposed plan was unconfirmable under section 1129(d), and the district court

---

[8] Perhaps if South Beach were genuinely concerned about the threat of litigation, it would have remained an active participant in this appeal. It may be telling that South Beach knowingly allowed its appeal in this Court to be dismissed, despite being advised that it could preserve its appeal merely by filing a docketing statement.

correctly affirmed. This Court likewise should find no clear error.

C. The United States Trustee Had Standing to Object Under 11 U.S.C. § 1129(d).

Scattered's brief states that "Scattered does not understand how the United States Trustee has standing to object here." Appellant's Br. at 4. This Court need not reach this question if it affirms under section 1129(a)(10). In addition, this Court need not reach this issue because Scattered has not adequately preserved it. Scattered offers no legal citations or argument to support a conclusion that the United States Trustee somehow lacks standing; rather, Scattered simply states that it "does not understand" standing. This is insufficient to preserve an argument. *See United States v. Dunkel*, 927 F.2d 955, 956 (7th Cir.1991) ("A skeletal 'argument,' really nothing more than an assertion, does not preserve a claim.") (citation omitted).

Should this Court consider the standing issue, however, it should readily conclude that the United States Trustee does have standing in this case. Indeed, 11 U.S.C. § 307 confers broad standing on the United States Trustee, providing: "The United States trustee may raise and may appear and be heard on any issue in any case or proceeding under this title [11]."

The United States Trustee's standing is broad because Congress created the United States Trustee Program to "supervise the administration of [bankruptcy] cases." 28 U.S.C. § 586(a)(3). In its report discussing the need for the Program, the House of Representatives determined that bankruptcy cases suffered from woefully inadequate administration. See H.R. Rep. No. 595, 95th Cong. 1st Sess. (1977), reprinted in 1978 U.S.C.C.A.N. 5963 (the "House Report"). The United States Trustee Program was created because "there is a public interest in the proper administration of bankruptcy." *Id*. at 88. United States Trustees "serve as bankruptcy watch-dogs to prevent fraud, dishonesty, and overreaching in the bankruptcy arena." *Id.*

Although the section 1129(d) objection may be raised only by a "governmental unit," the United States Trustee qualifies. In the Bankruptcy Code, the term "governmental unit" is defined in 11 U.S.C. § 101(27). Although the definition excludes "a United States trustee while serving as a trustee in a case under this title," in this case, the United States Trustee was not serving as a trustee of the bankruptcy estate. Rather, he was carrying out his duties under 28 U.S.C. § 586(a)(3)(B), which include "monitoring plans and disclosure statements filed in cases under chapter 11 of title 11 and filing with the court, in connection with hearings under sections 1125 and 1128 of such title, comments with respect to such plans and disclosure statements." As such, the United States Trustee had standing to object under section 1129(d).

As for Scattered's suggestion that creditors, not the United States Trustee, should “carry the day,” it is indeed the plain language of section 1129(d) that must “carry the day” in this case. And the statutory language required denial of South Beach’s proposed plan of reorganization.

IV. THIS COURT SHOULD AFFIRM THE DISMISSAL OF SOUTH BEACH’S BANKRUPTCY CASE.

The bankruptcy court’s order dismissing the case was based upon the rulings under 11 U.S.C. § 1129(a)(10) and § 1129(d). *See* Notice of Motion and Motion to Dismiss Case, *In re South Beach Securities, Inc.*, No. 05-16679 (Bankr. N.D. Ill. Nov. 5, 2007) (Bankr. Doc. 134); *see* Supp. Appx. 000027a (Order Dismissing Case, *In re South Beach Securities, Inc.*, No. 05-16679 (Bankr. N.D. Ill. Jan. 2, 2008) (Bankr. Doc. 173)). For all of the reasons discussed above, South Beach was unable to effectuate a plan of reorganization, and never will be able to do so. *See*, *e.g.*, 11 U.S.C. § 1112(b)(4)(M) (“inability to effectuate substantial confirmation of a confirmed plan” is cause for dismissal). Accordingly, the dismissal of its bankruptcy case was correct, and this Court should affirm.

CONCLUSION

For these reasons, the United States respectfully asks this Court to affirm the decision of the United States District Court for the Northern District of Illinois, which affirmed the decision of the United States Bankruptcy Court for the Northern District of Illinois.

Respectfully submitted,

____
RAMONA D. ELLIOTT
General Counsel

P. MATTHEW SUTKO
Associate General Counsel

CAMERON M. GULDEN
M. GRETCHEN SILVER
Office of the United States Trustee
United States Department of Justice
219 South Dearborn St., Room 873
Chicago, Illinois 60604
(312) 886-5785

ANNE W. STUKES
D.C. Bar No. 469446
Executive Office for United States Trustees
United States Department of Justice
20 Massachusetts Avenue, N.W.
Washington, D.C. 20530
(202) 307-1399

CERTIFICATE OF COMPLIANCE

Pursuant to the type-volume limitation in Fed. R. App. P. 32(a)(7)(B)(i), I certify that this brief is proportionately spaced, using Times Roman font, 14 point type. Based on a word count under Corel Word Perfect 12, this brief contains 9,656 words, excluding the table of contents, table of authorities, addendum, appendix, and certificates of counsel.

Anne W. Stukes
Attorney for the United States Trustee

REPRODUCTION OF STATUTES

11 U.S.C. § 1129(a)(10)

§ 1129. Confirmation of plan

(a) The court shall confirm a plan only if all of the following requirements are met:

[. . .]

(10) If a class of claims is impaired under the plan, at least one class of claims that is impaired under the plan has accepted the plan, determined without including any acceptance of the plan by any insider.

11 U.S.C. § 1129(d)

§ 1129. Confirmation of plan

(d) Notwithstanding any other provision of this section, on request of a party in interest that is a governmental unit, the court may not confirm a plan if the principal purpose of the plan is the avoidance of taxes or the avoidance of the application of section 5 of the Securities Act of 1933. In any hearing under this subsection, the governmental unit has the burden of proof on the issue of avoidance.

CERTIFICATE OF SERVICE

I hereby certify that on November 12, 2009, I served the foregoing brief on the following by sending two copies of the brief and one disk, by Federal Express Next Business Day Delivery to:

Colleen E. McManus
Much, Shelist, Freed, Denenberg, Ament, & Rubenstein
191 N. Wacker Drive, Suite 1800
Chicago, IL 60606-1615

I also certify that on November 12, 2009, I filed the brief by sending the original, fifteen copies, and one disk to the Clerk, United States Court of Appeals for the Seventh Circuit, by Federal Express Next Business Day Delivery at the following address:

Clerk of Court
United States Court of Appeals for the Seventh Circuit
219 South Dearborn Street, Room 2722
Chicago, IL 60604

____
Anne W. Stukes
Attorney for the United States Trustee

BRIEF BANK — "SUMMARY SHEET" *Printed Thu-8/19/10 16:34*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]* — In re South Beach Securities

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]* — 7yh Cir.

3. ("CCN") ***CURRENT*** CASE NO. — No.: 09-3079, 09-3177

4. ("PCN") ***PRIOR*** CASE NO. - & COURT *[IF ANY]* — No.: 08-cv-01135

Court: E. D. Ill.

(Identify judge & cite, if any)

5. ("SO") ***SOURCE*** — **U.S. TRUSTEES**

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]* — Filed: August 12, 2010

Type: Estimate of the United States Trustee's costs.

7. **("AU") PRINCIPAL AUTHORS & OFFICE** [E.g.,"UST/OGC"] — Cameron M. Gulden, Anne W. Stukes, Matthew Sutko, Ramona D. Elliott

(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC*** — **BANKRUPTCY**

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***

- The United States Trustee's estimate of the costs of his participation in this appeal.

10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)

11. DO YOU RECOMMEND POSTING IN UST BRIEFBANK?

| x | YES | | | NO

NAME: Linda Figueroa

DATE:

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COURT OF APPEALS DOCKET NO. 09-3079, 09-3177

IN THE UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

In re SOUTH BEACH SECURITIES, INCORPORATED,
Debtor.

Appeal of:
SCATTERED CORPORATION,
Creditor-Appellant,

ON APPEAL FROM
THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS, EASTERN DIVISION

ESTIMATE OF THE UNITED STATES TRUSTEE'S COSTS

AUG 12 2010
FILED COPY

U.S.C.A. — 7th Circuit
RECEIVED
AUG 1 2 2010 ~~SK~~ cop
GINO J. AGNELLO
CLERK

DATE OF DECISION
MAY 2 5 2010

U.S.C.A. — 7th Ci
FILED
AUG 1 2 2010
GINO J. AGNELLO
CLERK

This Court has invited the appellee, United States Trustee William T. Neary, to submit an estimate of the costs of his participation in this appeal. Accordingly, the United States Trustee sets forth the following estimated costs:

1. *Attorney Time.* Department of Justice attorney Anne W. Stukes, who works at the Executive Office for United States Trustees in Washington, D.C., represented the appellee on the brief and at oral argument. She expended approximately 174 hours on this appeal at an estimated cost of $92.73 per hour, for a subtotal of $16,134.67. Department of Justice attorney Cameron M. Gulden, who works at the

Office of United States Trustee in Chicago, entered an appearance in this appeal and assisted in the briefing and preparation for oral argument. He expended approximately 64 hours on this appeal at an estimated cost of $83.00 per hour, for a subtotal of $5,311.98.

2. *Attorney Travel*. The cost of airfare, food and lodging for the United States Trustee's counsel to travel to Chicago to present oral argument was $650.83.

3. *Photocopies*. The United States Trustee filed 10 copies and served 2 copies of a 279-page supplemental appendix. The United States Trustee filed 25 copies and served 4 copies of a 51-page brief. Two non-attorney employees of the Executive Office for United States Trustees in Washington, D.C. spent approximately 12 hours photocopying and binding the materials. Estimated costs are $25.10 in paper and $439.93 in labor, for a total of $465.03.

TOTAL ESTIMATED COSTS: $22,562.51

Support for these amounts is set forth in the accompanying declarations of Anne W. Stukes, Cameron M. Gulden, and Joni E. Reilly.

Respectfully Submitted,

CAMERON M. GULDEN
Office of the United States Trustee
Department of Justice
219 South Dearborn Street, Room 873
Chicago, IL 60604
(312) 886-2614

RAMONA D. ELLIOTT
General Counsel
P. MATTHEW SUTKO
Associate General Counsel
ANNE W. STUKES
Executive Office for United States Trustees
Department of Justice
20 Massachusetts Avenue, N.W.
Washington, D.C. 20530
(202) 307-1399

CERTIFICATE OF SERVICE

I hereby certify that on August 12, 2010, I served the foregoing Estimate of United States Trustee's Costs and the Declarations of Anne W. Stukes, Cameron M. Gulden, and Joni E. Reilly in support of same on the following by U.S. Mail:

Colleen E. McManus
Much, Shelist, Freed, Denenberg, Ament, & Rubenstein
191 N. Wacker Drive, Suite 1800
Chicago, IL 60606-1615

Jonathan T. Mann
222 N. LaSalle Street, Suite 200
Chicago, IL 60601

Louis D. Bernstein
Bernstein Law Firm, LLC
350 N. Clark St., Suite 400
Chicago, IL 60654

Cameron M. Gulden
Attorney for the United States Trustee

COURT OF APPEALS DOCKET NO. 09-3079, 09-3177

IN THE UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

In re SOUTH BEACH SECURITIES, INCORPORATED,
Debtor.

Appeal of:
SCATTERED CORPORATION,
Creditor-Appellant,

ON APPEAL FROM
THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS, EASTERN DIVISION

DECLARATION OF ANNE W. STUKES IN SUPPORT OF ESTIMATE OF THE UNITED STATES TRUSTEE'S COSTS

I, Anne W. Stukes, do declare and affirm as follows:

1. My name is Anne W. Stukes. I am employed as an attorney by the United States Department of Justice in the Office of the General Counsel, Executive Office for United States Trustees. I have been a member in good standing of the Georgia bar since 1997 and the District of Columbia bar since 2000. I am admitted to practice before numerous federal courts across the country. As part of my job responsibilities, I appear on behalf of United States Trustees in federal appeals.

2. In this appeal, I appeared as counsel for the appellee, United States Trustee William T. Neary. I prepared the appellee's brief and presented oral argument.

3. As an attorney in the Office of the General Counsel, Executive Office for United States Trustees, I do not maintain contemporaneous time records, nor do my weekly time sheets reflect task-based descriptions of the matters on which I work.

4. Upon receipt of this Court's July 28, 2010, order inviting the United States Trustee to submit an estimate the costs of his participation in this appeal, I endeavored to assess a reasonable estimate of my time spent on the case. I reviewed my calendar, internal files and e-mails to approximate the days and hours that I devoted to this appeal. When in doubt, I underestimated the time spent. In good faith, I estimate that I devoted at least 174 hours to this case from August 21, 2009 to July 28, 2010.

5. My colleague, attorney Cameron M. Gulden in the Office of the United States Trustee in Chicago, also in good faith estimated the time he spent on this appeal. According to his declaration submitted herewith, Mr. Gulden devoted 64 hours to this appeal.

6. In estimating my time, I did not include the time of other attorneys

and supervisory staff with the United States Trustee Program who reviewed the brief or otherwise spent time on the case.

7. Because I am a government attorney, I do not bill by the hour. Nonetheless, an hourly cost can be estimated using the my annual base salary plus benefits. The calculated hourly cost to the Department of Justice for an hour of my time is $92.73 per hour.

8. Accordingly, based on an estimate of 174 hours, the total cost estimate of my time in this case is $16,134.67.

9. In addition, the United States Trustee Program incurred costs for my travel from Washington, D.C. to Chicago for oral argument in this case. The total in airfare, lodging, and meals for my round-trip travel on February 18-19, 2010 was $650.83.

10. Finally, the United States Trustee Program incurred photocopying expenses in submitting the brief and appendix in this case. At least twelve copies of the appellee's 279-page appendix were made (ten filed with the court; two served on the appellants). At least 29 copies of the appellee's 51-page brief were made (25 filed with the court; four served on the appellants). Under my supervision, two non-attorney employees of the Executive Office for United States Trustees in Washington, D.C. spent at least 12 hours photocopying and binding

the materials. Estimated costs are $25.10 in paper and $439.93 in labor, for a total of $465.03.

11. Based on calculations performed at my request by Joni E. Reilly, Deputy Assistant Director, Budget and Travel Division in the Executive Office for United States Trustees, the total, good-faith estimate the costs of the United States Trustee Program's participation in this appeal, including personnel costs, travel, and photocopying, is $22,562.51. Further support for this total is contained in the declaration of Joni E. Reilly and the spreadsheet that she prepared, submitted herewith.

I hereby affirm under penalty of perjury that the foregoing is true and correct to the best of my knowledge.

Dated this 11th day of August, 2010.

Anne W. Stukes
Executive Office for United States Trustees
Department of Justice
20 Massachusetts Avenue, N.W.
Washington, D.C. 20530
(202) 307-1399

COURT OF APPEALS DOCKET NO. 09-3079, 09-3177

IN THE UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

In re SOUTH BEACH SECURITIES, INCORPORATED,
Debtor.

Appeal of:
SCATTERED CORPORATION,
Creditor-Appellant,

ON APPEAL FROM
THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS, EASTERN DIVISION

DECLARATION OF CAMERON M. GULDEN IN SUPPORT OF ESTIMATE OF THE UNITED STATES TRUSTEE'S COSTS

I, Cameron M. Gulden, do declare and affirm as follows:

1. My name is Cameron M. Gulden. I am a Department of Justice attorney employed in the Office of the United States Trustee in Chicago since 2003. As part of my job responsibilities, I appear on behalf of United States Trustees in federal appeals. I have been a member in good standing of the Minnesota bar since 2001. I am also admitted to practice before the District Court for the Northern District of Illinois and before the Seventh Circuit Court of Appeals. I represented the United States Trustee when this case was before the

bankruptcy court and the district court. I have entered an appearance before this Court and assisted in the drafting and editing of the United States Trustee's brief.

2. As an attorney employed by the Department of Justice, I do not record my time for billing purposes. I do, however, keep and submit weekly time sheets through our Professional Timekeeping System.

3. Upon receipt of this Court's July 28, 2010, order inviting the United States Trustee to submit an estimate the costs of his participation in this appeal, I reviewed my weekly time sheets dated August 21, 2009, to July 28, 2010. In good faith, I estimate that I devoted at least 64 hours to this case.

4. This estimate does not include time spent on this appeal by other attorneys and supervisory staff with the United States Trustee Program who reviewed the brief or otherwise spent time on the case.

5. As a government attorney, I do not bill by the hour. Nonetheless, an hourly cost can be estimated using my annual base salary plus benefits. Based upon information provided to me by Joni E. Reilly, the Chief of Budget and Travel for the Executive Office of United States Trustees, I understand that the calculated hourly cost to the Department of Justice for my time is $83.00 per hour.

6. Accordingly, the total cost estimate of attorney time for the undersigned in this case is $5,311.98.

I hereby affirm under penalty of perjury that the foregoing is true and correct to the best of my knowledge.

Dated this 11th day of August, 2010.

CAMERON M. GULDEN
Office of the United States Trustee
Department of Justice
219 South Dearborn Street, Room 873
Chicago, IL 60604
(312) 886-2614

COURT OF APPEALS DOCKET NO. 09-3079, 09-3177

IN THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

In re SOUTH BEACH SECURITIES, INCORPORATED,
Debtor.

Appeal of:
SCATTERED CORPORATION,
Creditor-Appellant,

ON APPEAL FROM
THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS, EASTERN DIVISION

DECLARATION OF JONI E. REILLY IN SUPPORT OF ESTIMATE OF THE UNITED STATES TRUSTEE'S COSTS

I, Joni E. Reilly, do declare and affirm as follows:

1. My name is Joni E. Reilly. I am employed by the United States Department of Justice as the Deputy Assistant Director, Budget Execution and Travel Division in the Executive Office for United States Trustees. I have been head of the budget division for the United States Trustee Program since 1995.

2. As part of my job responsibilities, I maintain information about the budget of the United States Trustee Program, including information about the costs of payroll, travel, and office supplies. Specifically, I have access to

information about the salaries and benefits of all employees in the United States Trustee Program, the travel expenses of employees in the United States Trustee Program, and the cost of office supplies like paper.

3. When it is necessary to do so, I am responsible for calculating the costs of United States Trustee Program's participation in court cases. I have performed such a calculation in this case.

4. To calculate the cost-per-hour of the time an employee of the United States Trustee Program has devoted to a particular case, I retrieve information about the employee's salary and benefits from the Department of Justice's financial system, and then divide the annual salary and benefits by 2,080, the number of hours a full-time employee is paid to work per year. This calculation yields an hourly rate that serves as an approximation of the cost to the United States Trustee Program for the employee's time. I multiply the hourly rate by the number of hours that the employee devoted to a particular case, which yields a dollar amount for the employee's time devoted to that case.

5. For this case, I ran reports from the Department of Justice financial system for attorneys Anne Stukes and Cameron Gulden and performed the calculation in paragraph 4. The hourly cost to the Department of Justice for attorney Anne Stukes' salary and benefits is $92.73 per hour, and for attorney

Cameron Gulden is $83.00 per hour.

6. I was informed that Ms. Stukes devoted 174 hours to this case, and Mr. Gulden devoted 64 hours. Using these amounts, I calculated the total cost estimate of attorney time in this case to be $21,446.65 ($16,134.67 for Ms. Stukes and $5,311.98 for Mr. Gulden).

7. In addition, the United States Trustee Program incurred costs for attorney Anne Stukes' travel from Washington, D.C. to Chicago for oral argument in this case. The United States Trustee Program's official travel records indicate that the total in airfare, lodging, and meals for counsel's round-trip travel on February 18-19, 2010 was $650.83.

8. To calculate the cost to the United States Trustee Program of producing briefs and appendices, I retrieve information on the cost of paper and the hourly cost of employee(s) who photocopy and bind the material.

9. In this case, I was informed that at least twelve copies of the appellee's 279-page appendix were made (3,348 pages), and at least 29 copies of the appellee's 51-page brief were made (1,479 pages), for a total of 4,827 pages. I was further informed that two employees of the Executive Office for United States Trustees in Washington, D.C. spent at least 12 hours photocopying and binding the materials. Thus, the estimated costs for the briefs and appendices are $25.10

in paper and $439.93 in labor, for a total of $465.03.

10. Based on the foregoing, the total, good-faith estimate the costs of the United States Trustee Program's participation in this appeal, including personnel costs, travel, and photocopying, is $22,562.51. Calculations of this total are contained on the attached spreadsheet that I prepared.

I hereby affirm under penalty of perjury that the foregoing is true and correct to the best of my knowledge.

Dated this 11th day of August, 2010.

Joni E. Reilly

Joni E. Reilly
Deputy Assistant Director, Budget
Execution and Travel Division
Executive Office for United States Trustees
Department of Justice
20 Massachusetts Avenue, N.W.
Washington, D.C. 20530
(202) 616-1069

Appellate Cost Calculations

Attorney Time	Hours	Hourly Rate*	Total
Anne Stukes	174	92.73	$16,134.67
Cameron Gulden	64	83.00	$5,311.98
Travel Voucher for Anne Stukes			$650.83

Paper Cost	Pages	Reams of Paper	Total
12 copies of 279-page appendix	3,348	7	$17.41
29 copies of 51-page brief	1,479	3	$7.69

Non-Attorney Time Copying and Binding	Hours	Hourly Rate*	Total
Support Staff 1	6	32.13	$192.76
Support Staff 2	6	41.20	$247.17
Total Appellate Costs			$22,562.51

*includes base salary and benefits

BRIEF BANK — "SUMMARY SHEET" Printed Thu.-11/20/3 (11:09)

WESTLAW CODES

1. ("TI") TITLE OF CASE [E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]	Specker Motor Sales, Co., v. Eisen, UST (In re Specker Motor Sales, Co.)
2. ("CO") CURRENT COURT [E.g., "CTA9"]	CTA6
3. ("CCN") CURRENT CASE NO.	No.: 03-1893
4. ("PCN") PRIOR CASE NO. & COURT [IF ANY]	No. & Court: 97-90180-jcs U.S. Bankr. Court, W.D. MI No. & Court: 2:03-CV-79 U.S. District Court, W.D. MI, Southern Division (Identify judge & cite, if any)
5. ("SO") SOURCE	**U.S. TRUSTEES**
6. ("DA") DATE OF FILING & TYPE OF BRIEF [E.g., "Opening Brief," "Reply," "Amicus," etc.]	Filed: Nov. 17, 2003 Type: Proof Brief of Appellee
7. ("AU") PRINCIPAL AUTHORS & OFFICE [E.g.,"UST/OGC"]	P. Matthew Sutko & Michele Mansfield UST/OGC (UST/OGC: 202-307-1399/FAX-2397)
8. ("TO") TOPIC	**BANKRUPTCY**
9. ("SU") • SUMMARY OF KEY ISSUE(s) & √ Any Miscellaneous BACKGROUND	• Under section 727(a) of the Bankruptcy Code, Payments to classes of people who are owed chapter 11 expenses in chapter 7 cases converted from chapter 11 "shall be made pro rata" among everyone in that class whenever there is too little money to pay them fully. May a bankruptcy court prefer a former chapter 11 debtors' counsel by paying him more than his pro rata share under section 727(b), thereby necessarily give everyone else in his class less than their pro rata share? **Background:** After conclusion of a bankruptcy case that was converted from ch 11 to ch 7 the court required Specker former ch 11 attorney Bays to return a portion of the interim compensation under the pro rata distribution requirement of section 727(b). The district court confirmed the bankruptcy court's decision.
10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)	C:\WINNT\Profiles\rschnell\Desktop\post web files\Specker01.wpd
11. DO YOU RECOMMEND POSTING IN UST BRIEFBANK?	☒ YES ☐ NO NAME: Steven Eggert DATE: Wed.-11/19/3 (12:02)

No. 03-1893

In the
United States Court of Appeals
for the Sixth Circuit

In re Specker Motor Sales Co.,
Debtor.

Specker Motor Sales Co. dba Choice Motor,
Appellant,

v.

Saul Eisen, United States Trustee,
Appellee.

On Appeal from the United States District Court
for the Western District of Michigan at Marquette

Proof Brief of Appellee

JOSEPH A. GUZINSKI,
General Counsel

P. MATTHEW SUTKO
MICHELE M. MANSFIELD
United States Department of Justice
Executive Office for United States Trustees
20 Massachusetts Ave., N.W., Suite 8000
Washington, D.C. 20530
(202) 307-1399

Counsel for Appellee,
Saul Eisen, United States Trustee

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TABLE OF AUTHORITIES

Federal Cases

Federal Statutes

Federal Rules

Fed. R. App. P. 3(c)..5

Fed. R. Bankr. P. 2014 . . . . 13, 15

Fed. R. Bankr. P. 2016...13

Statement Regarding Oral Argument

We believe that, due to the nature of the issues involved in this case, oral argument will materially aid the Court in deciding the case.

No. 03-1893

In the
United States Court of Appeals
for the Sixth Circuit

In re Specker Motor Sales Co.,
Debtor.

Specker Motor Sales Co. dba Choice Motor,
Appellant,

v.

Saul Eisen, United States Trustee,
Appellee.

On Appeal from the United States District Court
for the Western District of Michigan at Marquette

STATEMENT OF JURISDICTION

As a threshold issue, this Court must determine whether defects in the notice of appeal divest the Court of jurisdiction. A difficult jurisdictional issue was created in this case when attorney Donald Bays filed the notice of appeal on behalf of Specker Motor Sales Company ("Specker Motors"), rather than on behalf of himself. Specker Motors, the named appellant, lacks standing, and Mr. Bays has standing but lacks authority to appeal on behalf of Specker Motors and is not named as an appellant.

By way of background, in March 1997, Specker Motors filed a petition for reorganization under chapter 11 of the Bankruptcy Code and Mr. Bays was appointed by the court as its chapter 11 attorney. (R.1.1, Voluntary Petition, Apx. pg. __; R.1.67, Order Granting Application to Employ Donald Bays, Apx. pg. __). This appeal is related to the distribution of estate property in payment of Mr. Bays' attorney fees incurred during the chapter 11 bankruptcy. On September 24, 1997, Specker Motors' case was converted to chapter 7 under 11 U.S.C. 1112(b), and an independent trustee was appointed as its representative and to manage its bankruptcy estate. (R.1.168, Order Granting Motion to Convert Case from Chapter 11, Apx. pg. __). Under 11 U.S.C. 323, the trustee became the representative of the debtor with the capacity to sue and be sued on its behalf. *See also* 11 U.S.C. 704 (enumerating essential duties of trustee). As a result, as of March 24, 1997, Mr. Bays lost his authority to act on behalf of debtor Specker Motors. Most significantly, Mr. Bays no longer had the authority to appeal future bankruptcy court orders on behalf of Specker Motors, because in a chapter 7 proceeding related to the bankruptcy estate, the chapter 7 trustee alone has standing to prosecute an appeal of a bankruptcy court order. *See Spenlinhauer v. O'Donnell*, 261 F.3d 113, 118 (1st Cir. 2001); *Richman v. First Woman's Bank* (*In re Richman*), 104 F.3d 654, 657 (4th Cir. 1997)*; In re El San Juan Hotel*, 809 F.2d 151, 155 (1st Cir. 1987).

Nevertheless, on July 1, 2003, Mr. Bays filed a notice of appeal to this Court on behalf of Specker Motors. The notice of appeal states:

> Notice is hereby given that *Specker Motor Sales Company, Debtor/Appellant* in the above captioned matter*, hereby appeals* to the United States Court of Appeals for the Sixth Circuit from a Final Judgment Affirming the Bankruptcy Court's Order Determining Administrative Insolvency and Disgorgement of Fees entered on the 23rd Day of June, 2003.

(R.16, Notice of Appeal, Apx. pg. __) (emphasis added). The notice was signed by Donald W. Bays as "Attorney for the Debtor/Appellant." (R.16, Notice of Appeal, Apx. pg. __). There is no specification of anyone other than Specker Motors as appellant in the notice of appeal.

Specker Motors, however, lacks standing because the outcome will not affect its pecuniary interest, property, or rights. "To appeal from an order of the bankruptcy court, [an] appellant[] must have been directly and adversely affected pecuniarily by the order . . . [and] only when the order directly diminishes a person's property, increases his burdens, or impairs his rights will he have standing to appeal." *Marlow v. Rollins Cotton Co.* (*In re The Julien Co.*), 146 F.3d 420, 423 (6th Cir. 1998). This appeal involves Mr. Bays' personal pursuit of his attorney fees. Moreover, a chapter 7 debtor generally lacks standing to appeal an order of the bankruptcy court, except where a successful appeal would create an estate that has assets in excess of liabilities or unless the appeal is taken from orders affecting a debtor's discharge. *See Cult Awareness Network, Inc. v. Martino* (*In re Cult Awareness Network, Inc.*), 151 F.3d 605, 607 (7th Cir. 1998);

McGuirl v. White, 86 F.3d 1232 (D.C. Cir. 1996); *Weston v. Mann* (*In re Weston*), 18 F.3d 860, 863-864 (10th Cir. 1994); *In re El San Juan Hotel*, 809 F.2d 151, 155 (1st Cir. 1987). In this case, Specker Motors will not receive any money from the estate regardless of the outcome of this appeal, and this appeal is unrelated to discharge. (R.1.244, Order for Payment of Dividends, Apx. pg. __). Specker Motors' lack of standing divests this court of jurisdiction over this appeal. *See In re Troutman Enters., Inc.*, 286 F.3d 359, 364 (6th Cir. 2002) (standing is a jurisdictional requirement); *Zurich Ins. Co. v. Logitrans, Inc.*, 297 F.3d 528, 531 (6th Cir. 2002) (party seeking relief must have standing in order for court to exercise jurisdiction).

Although Specker Motors lacks standing as an appellant, and only the trustee could appeal on its behalf, Mr. Bays has standing to bring this appeal on his own behalf because he has a direct pecuniary interest in the outcome of his personal request for fees. However, further difficulty arises because Mr. Bays is not named as an appellant, and a court may not exercise jurisdiction over an unnamed party after the time for filing a notice of appeal has passed. *See Torres v. Oakland Scavenger Co.*, 487 U.S. 312, 314-315 (1988). The requirement under Fed. R. App. P. 3(c) that a notice of appeal " specify the party or parties taking the appeal," is jurisdictional, and cannot be waived by the court, and consequently, the failure to name a party in a notice of appeal constitutes a failure of that party to appeal. *Torres,* 487 U.S. at 314-315.

Although this Court cannot waive a jurisdictional deficiency, it may exercise jurisdiction over this appeal if it finds the "functional equivalent" of the specification of Mr. Bays as the appellant so as to meet the jurisdictional requirement of Fed. R. App. P. 3(c). *See id.* at 312 (use of *et al.* in notice of appeal is not functional equivalent of specifying parties). "In order for a litigant's acts to be considered as the functional equivalent [of a jurisdictional requirement], they must be such that the document affords notice to the appellee of the litigant's intent to seek appellate review." *Mattingly v. Farmers State Bank*, 153 F.3d 336, 337 (6th Cir. 1998) (citations omitted).

The United States Trustee does not assert insufficient notice of Mr. Bays' intent to bring this appeal in his capacity as the former counsel for a former chapter 11 debtor. Indeed, the subjective understanding of the United States Trustee throughout the relevant proceedings is that Mr. Bays has been pursing this appeal on his own behalf.[1] This Court, however, must make the final determination as to jurisdiction. *See Troutman,* 286 F.3d at 364 (court is under continuing obligation to verify its jurisdiction over a particular case).

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[1] Neither the United States Trustee nor Mr. Bays previously raised or took steps to correct issues related to the notice of appeal. However, since the United States Trustee has identified this potential jurisdictional issue he raises it now, as a jurisdictional requirement cannot be waived. *See Torres v. Oakland Scavenger Co.*, 487 U.S. 312, 317 (1988) (jurisdictional requirements of Fed. R. App. P. 3 cannot be waived); *Zurich Ins. Co. v. Logitrans, Inc.*, 297 F.3d 528, 531 (6th Cir. 2002) (standing may not be waived and can be brought up at any time in the proceeding); *Adland v. Russ*, 307 F.3d 471, 477 (6th Cir. 2002) (court must verify standing even if issue not raised on appeal).

Assuming this Court finds that the notice of appeal contains no jurisdictional deficiencies, the Court has jurisdiction over this appeal under 28 U.S.C. 158(d). The United States Bankruptcy Court for the Western District of Michigan had jurisdiction over the bankruptcy case under 28 U.S.C. 157(b)(1). The United States District Court for the Western District of Michigan had jurisdiction over the appeal from the bankruptcy court under 28 U.S.C. 158(a) and 1334, assuming that similar defects in the notice of appeal from the bankruptcy court do not deprive that court of jurisdiction.[2] (R.1.267, Notice of Appeal by Specker Motor Sales Company, Apx. pg.__). The appeal to this Court is taken from the final order of the district court entered on June 20, 2003, affirming the bankruptcy court's final judgment entered February 26, 2003, requiring the counsel for the former chapter 11 debtor to return interim fees exceeding the

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[2] Some of the confusion with respect to the notice of appeal to this Court may emanate from the notice of appeal of the bankruptcy court's order. (R.1.267, Notice of Appeal, Apx. pg. __). That notice of appeal stated "Donald W. Bays, attorney for the Debtor, appeals under 28 U.S.C. § 158 . . ." and noted that Mr. Bays was "Appellant/Attorney for Debtor," but was signed by Mr. Bays as "Attorney for Appellant." *Id.* Bays also filed a Designation of Record and Statement of Issues that was ambiguous as to the identity of the appellant(s), stating "[n]ow comes the Attorney for Debtor/Appellant, Donald W. Bays, by and through his attorneys, Osstyn, Bays, Ferns and Quinnell, by Donald W. Bays, and submits the following as his Designation of Record ...." (R.1.268, Appellant Designation of Record and Statement of Issues, Apx. pg. __). The Designation was signed by Mr. Bays as "Attorney for Appellant." *Id.* The bankruptcy and district courts logically assumed that Specker Motors, as the debtor, was the appellant, and styled the appeal accordingly.

amount of the *pro rata* payment he was entitled to receive under 11 U.S.C. 726(b). The notice of appeal to the district court was timely filed on March 12, 2003, and the notice of appeal from the district court's order was timely filed on July 22, 2003.

STATEMENT OF THE ISSUE

Under section 726(b) of the Bankruptcy Code, payments to classes of people who are owed chapter 11 expenses in chapter 7 cases converted from chapter 11 "shall be made *pro rata*" among everyone in that class whenever there is too little money to pay them all fully. May a bankruptcy court prefer a former chapter 11 debtors' counsel by paying him more than his *pro rata* share under section 726(b), and thereby necessarily give everyone else in his class less than their *pro rata* share?

STATEMENT OF THE CASE

This appeal arose when, at the conclusion of a bankruptcy case that was converted from chapter 11 to chapter 7, the bankruptcy court required Specker Motors' former chapter 11 attorney Donald Bays to return a portion of interim compensation to the estate because the amount of the interim compensation was more than the amount Bays was entitled to receive at the conclusion of the case. The court ordered the return of the difference because, under the *pro rata* distribution requirement of section 726(b), that money was owed to Carroll Motor

Supply, the State of Michigan Treasury Department ("Michigan Treasury"), the State of Michigan Unemployment Agency ("Michigan Unemployment Agency"), and the Internal Revenue Service ("IRS"). Mr. Bays filed a motion for reconsideration and a motion for determination of administrative insolvency and disgorgement, and was opposed by the United States Trustee, the State of Michigan and the IRS.[3] On appeal, the United States Trustee, the State of Michigan, and the IRS supported the bankruptcy court's decision. The district court affirmed the bankruptcy court's decision, and this appeal ensued.

STATEMENT OF FACTS

1. Statutory Background.

This appeal primarily involves section 726 of the Bankruptcy Code, the provision governing the division of estate property in a liquidation case under chapter 7. Specifically, this appeal involves the distribution of estate property in

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[3] *See* (R.1.245, Motion by Debtor Specker Motor Sales Company for Reconsideration, Apx. pg.__; R.1.247, United States Trustee's Objection to Motion for Reconsideration, Apx. pg.__; R.1.250, United Stats of America's Concurrence (on behalf of Creditor Internal Revenue Service) in the United States Trustee's Objection, Apx. pg.__; R.1.254, Debtor's Motion for Determination, Apx. pg.__); R.1.258, United States Trustee's Response to Debtor's Motion for Determination, Apx. pg.__; R.1.261, United States of America's Concurrence with the United States Trustee's Response to Debtor's Motion for Determination, Apx. pg.__; R.1.263, Brief for Creditor Michigan Employment Security Agency and Creditor Michigan Department of Treasury in Support of Trustee's Determination to Disgorge, Apx. pg.__).

payment of administrative expenses allowed under 11 U.S.C. 503(b), including attorney fees awarded under 11 U.S.C. 330. Relevant to the arguments raised in this appeal are the overall employment and compensation of attorneys under the Bankruptcy Code and the determination of prepetition and postpetition claims and expenses in a case converted from chapter 11 to chapter 7. Finally, the statutory basis for the United States Trustee's oversight of the distribution of estate assets is also relevant because the appeal is brought by the United States Trustee as part of his oversight of bankruptcy matters in Michigan.

a. Priority and Distribution of Bankruptcy Estate Property.

Congress established a system of priorities to govern the allocation of bankruptcy estate assets in a liquidation bankruptcy case under the chapter 7 of the Bankruptcy Code, 11 U.S.C. 701 *et seq*. Section 726(a) lists in rank order six categories to which property of the estate is to be distributed. The first category is of "claims of a kind specified in" 11 U.S.C. 507(a), which consists of a group of nine types of expenses and claims that Congress deemed entitled to top priority for distribution. 11 U.S.C. 726(a)(1). Section 507(a) prioritizes those elite groups of expenses and claims. 11 U.S.C. 507(a). First priority under section 507(a) is given to "administrative expenses allowed under section 503(b) [of the Bankruptcy Code], and any fees and charges assessed against the estate under chapter 123 of title 28." 11 U.S.C. 507(a)(1). Notwithstanding certain unpaid secured claims given "superpriority" under section 507(b), and fees under chapter 123 of title 28, administrative expenses allowed under section 503(b) ("allowed administrative expenses") ultimately enjoy top priority for payment out of property of the estate at the conclusion of a bankruptcy case.

Beginning with the category of allowed administrative expenses, pursuant to section 726 payments are made to each category in the order established by sections 726 and 507, until all estate assets are distributed. If there is insufficient property in the estate to pay in full all expenses or claims in the last category of expenses or claims to receive any payment, then, pursuant to section 726(b), payment to that group of expenses or claims is made *pro rata*. *See* 11 U.S.C. 726(b). Once all property of the estate is distributed in this manner, expenses and claims in any subordinate categories, unfortunately, receive nothing.

This mandatory *pro rata* distribution applies to all chapter 7 cases. Section 726(b) includes one additional provision with respect to allowed administrative expenses that is applicable only to certain cases that have been converted to chapter 7 after originally being filed under chapters 11, 12, or 13 of the Bankruptcy Code. *See* 11 U.S.C. 726(b). In those converted cases, allowed administrative expenses incurred postconversion under chapter 7 have priority over preconversion allowed administrative expenses incurred under chapter 11, 12, or 13. *Id.* Since allowed administrative expenses as group are paid prior to all other classes of claims, practically speaking this exception is relevant only in converted cases that are "administratively insolvent," where the estate contains insufficient funds at the conclusion of the chapter 7 case to cover both chapter 7 *and* chapter 11 allowed administrative expenses. Specker Motors is such a case.

b. Attorney Employment and Compensation.

The importance of attorneys to the bankruptcy system is underscored by the *per se* high priority administrative expenses status granted to attorney fees awarded under section 330. 11 U.S.C. 503(b)(2) (compensation and reimbursement awarded under section 330(a) allowed as administrative expenses). On the other hand, the potential for the abuse of the power afforded to bankruptcy attorneys is recognized by the number of provisions regulating the employment and compensation of attorneys and other professionals. Under the Bankruptcy Code, the retention, employment, and award of compensation to professionals working for the bankruptcy estate or debtor in possession, including debtor's counsel, are highly supervised by the bankruptcy court, and the courts must disqualify attorneys or reduce or disgorge fee awards as a sanction for failure to comply with statutory requirements.

Prior to approving the employment of a professional employed by a trustee or debtor in possession, the court must first ensure that such professional does "not hold or represent an interest adverse to the estate" and is a disinterested person. 11 U.S.C. 327(a); *see also* 11 U.S.C. 101(14) (definition of "disinterested person"). At the outset of employment, the court reviews and approves "reasonable terms and conditions of employment," which may include a retainer, hourly payment, or contingent fees. 11 U.S.C. 328(a). Once a professional has rendered services, the court determines, using prescribed criteria, the amount to award as "reasonable compensation for actual necessary services rendered" and "reimbursement for actual, necessary expenses." 11 U.S.C. 330(a).

The bankruptcy court retains a great deal of discretion in making such determinations, and also to make modifications during the pendency of a case or at the conclusion of a case. *See, e.g.,* 11 U.S.C. 328(c) (court may deny compensation if professional becomes disinterested or has adverse interest). The court has the discretion to authorize the interim disbursement of compensation to professionals under 11 U.S.C. 331, although the court is required to reduce the final compensation it awards by any interim compensation and is authorized to order the return of compensation to the estate if the interim amount awarded is in excess of the final amount awarded. *See* 11 U.S.C. 330(a)(5).

The Bankruptcy Code and the Bankruptcy Rules impose strict demands on professionals employed in bankruptcy cases. Rule 2014 dictates the requirements of an application for employment. *See* Fed. R. Bankr. P. 2014. Rule 2016 sets forth the requirements for filing an application for interim or final fees, including disclosures that must be made. *See* Fed. R. Bankr. P. 2016. Failure to comply with the demands may result in the denial or reduction of fees or the disgorgement of interim or final compensation received, at the court's discretion.

c. Oversight Responsibilities of the United States Trustee.

Congress has authorized the Attorney General to appoint twenty-one United States Trustees, each to serve in a specific geographic region of the United States. *See generally* 28 U.S.C. § 581 *et seq.* (establishing United States Trustee Program). The United States Trustees are employees of the Department of Justice. *Id.* The United States Trustee must "supervise the administration of cases and trustees" in all bankruptcy cases within his or her region through a range of oversight responsibilities. 28 U.S.C. § 586(a)(3). *See generally Morganstern v. Revco D.S. Inc.* (*In re Revco D.S., Inc.*), 898 F.2d 498, 500 (6th Cir 1990) (explaining that Unites States Trustees oversee the bankruptcy process, protect the public interest, and ensure that bankruptcy cases are conducted according to law).

The United States Trustee's responsibilities include monitoring bankruptcy court filings, such as plans and disclosure statements, monitoring creditors' committees and the progress of bankruptcy cases, and bringing to the attention of the United States Attorneys any possible criminal activity occurring in the bankruptcy context. *Id.*; § 586(a)(3)(B), (C), (E), (F). The United States Trustee may raise and may appear and be heard on any issue in any case or proceeding under Title 11. 11 U.S.C. 307; *see also In re Revco D.S., Inc.*, 898 F.2d at 499-500 (appellate standing of United States Trustee).

2. Factual Background.

Specker Motors filed a petition for relief under the debt reorganization provisions of chapter 11 of the Bankruptcy Code on March 18, 1997. (R.1.1, Voluntary Petition, Apx. pg. __), and on March 26, 1997, it filed an application with the court requesting permission to employ Donald Bays as its chapter 11 counsel. (R.1.17, Application to Employ Counsel, Apx. pg. __); *see* 11 U.S.C. 327(a) and Fed. R. Bankr. 2014 (requirements for obtaining court permission to retain counsel). Specker Motors requested that Mr. Bays perform work on an hourly basis "at the compensation rate of $125.00 per hour plus out of pocket expenses." (R.1.17, Application to Employ Counsel, Apx. pg. __). Specker Motors also sought permission to give Mr. Bays a "general retainer" of $10,000, which Specker Motors indicated would represent eighty hours of work at the hourly rate of $125.00 per hour. *Id.* The Application did not seek permission to transfer title to the $10,000 to Mr. Bays. Instead, it acknowledged that Mr. Bays' right to use the $10,000 as a source of payment for the work he performed in the case "shall be subject to the final approval of the Court at the conclusion of the case." *Id.*

Along with the application, Specker Motors filed an Affidavit of Donald W. Bays as required by Fed. R. Bankr. P. 2014(a) ("affidavit") (R.1.18, Affidavit of Donald Bays, Apx. pg. __). In his affidavit, Mr. Bays represented that Specker Motors "[w]as not indebted to [Bays] for pre-petition services or otherwise rendered to the Debtor." *Id.* Bays then disclosed that Specker Motors had given him $800 for the filing fee and "a general retainer of $10,000." *Id.* Mr. Bays affirmatively represented to the court, however, that "compensation paid or promised to [Bays] for services rendered or to be rendered in connection with the case is as follow [sic]: Debtor will pay an hourly rate of $125 per hour for services rendered." *Id.*

The bankruptcy court reviewed the application and authorized Specker Motors[4] to employ Mr. Bays at the "compensation rate of $125.00 per hour plus out of pocket expenses" by order entered April 21, 1997. (R.1.67, Order Granting Application to Employ Donald Bays, Apx. pg. __). The order neither approved Mr. Bays retention of the retainer nor authorized him to draw upon it without court order. *See* 11 U.S.C. 331 and Fed R. Bankr. P. 2016 (specifying procedures counsel must follow if they wish to obtain interim compensation in a bankruptcy case); *see also* 11 U.S.C. 330(a)(5) (making such interim compensation non-final and subject to reduction at the time of the final fee award).

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[4] The order authorizing Mr. Bays employment by Specker Motors identifies "E & L Enterprises, Inc." as the Debtor and Debtor-In-Possession. (R.1.67, Order Granting Application to Employ Donald Bays, Apx. pg. __). E & L Enterprises, Inc. was a debtor in the United States District Court for the Western District of Michigan, Case No. 97-90179 (petition filed March 18, 1997). This is presumably a typographical error.

For a short period of time after filing its petition, Specker Motors continued to operate its business, but on May 22, 1997, less than sixty days after filing its bankruptcy petition, Specker Motors filed a motion for an auction sale of its assets free and clear of liens. (R.1.88, Motion for Auction Sale, Apx. pg. __). On June 24, 1997, the court authorized and confirmed the sale of all of the assets of Specker Motors for $500,000. (R.1.123, Order Authorizing and Confirming Sale, Apx. pg. __). Specker Motors never filed a chapter 11 disclosure statement or plan as contemplated by 11 U.S.C. 1121 through 1129 (specifying plan and disclosure requirements).

As a result of the sale of all of the assets of Specker Motors, combined with the fact that it had not filed mandatory monthly financial reports and had failed to pay certain postpetition debts such as contributions to the health and retirement funds for Specker Motors' employees, the United States Trustee filed a motion to convert under 11 U.S.C. 1112(b). (R.1.144, Motion to Convert, Apx. pg. __). Specker Motors' case was converted to a chapter 7 liquidation case on September 24, 1997, and James Boyd, Esq. was appointed as the chapter 7 trustee ("trustee"). (R.1.168, Order Granting Motion to Convert, Apx. pg. __). Under 11 U.S.C. 542(a), Mr. Bays had an express duty to turn over the retainer, which was property of the estate, to the chapter 7 trustee, who is the representative of the estate. *See* 11 U.S.C. section 323(a); 11 U.S.C. 542(a). Mr. Bays did not do so.

Approximately four years later,[5] on October 9, 2001, Mr. Bays filed an application seeking $17,343.10 in compensation, accompanied by an invoice detailing his activities and calculating payment based on the authorized rate of $125 per hour. (R.1.235, Application for Professional Fees, Apx. pg. __). The court awarded Mr. Bays fees totaling $17,343.10, and approved taking of $10,000 of the fees by order entered February 4, 2002. (R.1.241, Order for Approval of Retainer Paid and Fees, Apx. pg. __). Such compensation was "interim." *See* (R.1.244 Order for Payment of Dividends, Apx pg.__; R.1.241, Order For Approval of Attorney Retainer Paid, Apx. pg. ___); *see* 11 U.S.C. 330(a)(5), 331 (codifying allowance of interim compensation). Total fees in the amount of $17,343.10 were awarded pursuant to 11 U.S.C. 330 on August 5, 2002. *Id.*

The bankruptcy court also approved the trustee's final report and ordered payment as proposed by the trustee's report on August 5, 2002. *Id*. In compliance with the Bankruptcy Code, the trustee proposed distribution in full to chapter 7 allowed administrative claimants, and *pro rata* distribution of the remaining money to the chapter 11 allowed administrative claimants. (R.1.242, Notice of

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[5] From the time of conversion on September 24, 1997 until the trustee's final report in June, 2002, activity in the case consisted of valuation and distribution of sale proceeds, the trustee's efforts to obtain certain documents, matters pertaining to claims, and matters pertaining to administration by the trustee. *See generally* Bankruptcy Court Docket Report.

Trustee Report and Final Account to Creditors, Apx. pg. __). All remaining allowed claims, totalling $653,457.73, unfortunately, would receive no payment because the case was administratively insolvent, which means that the cost of administering the case in bankruptcy was greater than all the assets of the estate. *Id.*

Mr. Bays was one of five chapter 11 allowed administrative expense claimants entitled to payment of a *pro rata* share of estate property toward their respective claims. *Id.* Mr. Bays was the only one of these five that had already received interim payment out of property of the estate. *Id.* As a result, his *pro rata* share was less than the interim compensation he already received. The *pro rata* distribution to these claimants is summarized below:

Chapter 11 Allowed Administrative Expense Claimant	**Allowed Claim Amount**	**Interim Payment as of date of Final Report**	***Pro Rata* Share**	**Payment**
Internal Revenue Service	$128,094.19	$0.00	$7,189.46	$7189.46
Michigan Treasury	$52,695.18	$0.00	$2,957.59	$2,957.59
Donald W. Bays	$17,343.10	$10,000	$973.41	$-9026.59
Michigan Unemployment Agency	$5,724.86	$0.00	$321.32	$321.32
Carroll Motor Supply	$942.41	$0.00	$52.89	$52.89

See id.

To ensure that Carroll Motor Supply, Mr. Bays, the Michigan Treasury, the Michigan Unemployment Agency, and the IRS shared the estate property equally, Mr. Bays was required to return a portion of the interim compensation so that this amount could be fairly distributed to the other four claimants. (R.1.244, Order for Payment of Dividends, Apx. Pg. __; R.1.266, Court's Opinion and Order Determining Administrative Insolvency and Disgorgement, Apx. pg.__). However, Mr. Bays opposed returning the difference to the trustee so that Carroll Motor Supply, the Michigan Treasury, the Michigan Unemployment Agency, and the IRS could receive payment. (R.1.245, Motion by Debtor Specker Motor Sales Company for Reconsideration of Trustee's Final Account and Report, Apx. pg. __; R.1.254, Debtor's Motion for Determination re: Administrative Insolvency and Disgorgement, Apx. pg. __). Following several motions and hearings the bankruptcy court found that Mr. Bays must "disgorge interim fees paid to him in the Chapter 11 so that they can be distributed *pro rata* among all Chapter 11 administrative claimants," and that disgorgement was mandatory to ensure compliance with 11 U.S.C. 726(b). (R.1.266, Opinion Determining Administrative Insolvency and Disgorgement ("Opinion"), Apx. pg. __).

The bankruptcy court first noted that

> The rule provided in [section] 726(b) is a simple one. When a Chapter 11 case is converted to one under Chapter 7, the Chapter 7 administrative expenses have a priority of payment over the Chapter 11 administrative

> expenses." Once the Chapter 7 expenses have been paid in full, Chapter 11 administrative expenses are paid. If the estate cannot pay all Chapter 11 administrative expenses in full, they are paid *pro rata*.

Id. Because he held himself out as a bankruptcy professional, the bankruptcy court found that Mr. Bays was on notice that he might have to return interim compensation if there was not enough money to pay all chapter 11 allowed administrative claimants at the conclusion of the case as required by section 726(b). *Id.* Further, the order of disgorgement was fair because "all administrative expenses [accrued in the same chapter] are on parity as to payment," in accord with the policy of equality of distribution, and "[t]here is no priority among administrative claimants." *Id.*

The bankruptcy court rejected Mr. Bays' argument that disgorgement is discretionary, holding that while disgorgement of interim compensation is discretionary because "the allowance of compensation is always discretionary," section 726(b) requires "disgorgement of interim compensation in every case of administrative insolvency in order to achieve the '*pro rata*' disbursement described in [section 726(b)]." (R.1.266, Opinion, Apx. pg. __). Finally, the court noted that "interim allowances are interlocutory in nature and are always subject to the court's re-examination and adjustment during the course of a case," and accordingly "the amount of fees subject to review at the end of a case are not only the balance due at the end but all compensation sought including the interim fees and the retainer already received." *Id.*

On appeal,[6] the district court affirmed the order of the bankruptcy court. (R.14, Opinion, Apx. pg. __). The district court noted "[t]here is no dispute that the retainer [Mr. Bays] received was not a final payment and was subject to disgorgement," and Mr. Bays "acknowledged this potential and now cannot claim surprise when such an event occurs." *Id.* Not only did the district court reject Mr. Bays argument that the risk of disgorgement renders him a "guarantor of the estate," stating that Mr. Bays "is no more a guarantor of the estate than any other creditor incurring post-petition debt who must await resolution of the bankruptcy proceedings before hoping to collect," and is a "gambler in such proceedings like every other administrative creditor," but the court noted the sound policy reasons for delaying final payment of debtors' counsel until the conclusion of the case. *Id.*

The district court found that efficient administration of a bankruptcy case is ensured by "diminishing counsel's incentive to incur large fees," and that delaying final compensation until the end of a case "keeps the attorney alert to the on-going reorganization chances of the debtor" because "attorneys are less likely to allow a

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[6] Pending resolution of the appeals, the parties agreed and the court ordered to stay the disgorgement order upon deposit by Mr. Bays of $9,200 into the Bankruptcy Court Registry Fund. (R.1.292, Order to Stay Order to Disgorge Attorney Fees Pending Appeal, Apx. pg. __).

Chapter 11 business to continue when [the attorneys] are amassing large fee bills which may go unpaid." *Id.* (citation omitted). Further, the court noted that interim payments are not final, but are intended only to "relieve the economic burden on professionals providing services," and to treat them as final would mean that sections 330 and 331 could not be given effect "as the court would be denied the opportunity to correct" improprieties. (R. __, Opinion, Apx. pg. __).

The district court emphasized that failure to disgorge the interim compensation received by Mr. Bays would dishonor the intent of the Code and violate the "ultimate aim" of bankruptcy law of equality between like creditors by creating a "superpriority" for debtors' counsel because in a group otherwise considered equal under the Code, professionals are the only ones eligible to receive interim compensation. *Id.* Distinguishing between disgorgement under 330 and 331 as a "harsh remedy" which for the purpose of sanctions should be employed with discretion, and disgorgement necessary to effect compliance with *pro rata* distribution, which requires no discretion, the district court noted that the courts are not free exercise discretion when not authorized by Congress. *Id.* (noting use of word "may" in sections 330 and 331 and use of "shall" in section 726(b)).

Finally, the district court countered Mr. Bays argument that mandatory disgorgement when necessary to comply with *pro rata* distribution will discourage the involvement of attorneys in bankruptcy cases. The district court observed that "[l]awyers regularly get involved in legal matters without knowing if they will be compensated. It is the potential payout that makes it worthwhile and which the Court is confident will continue in this line of business." *Id.*

Following the district court's affirmance of the decision of the bankruptcy court, Mr. Bays initiated the appeal to this Court.

SUMMARY OF THE ARGUMENT

Mr. Bays cannot keep money that legally and equitably belongs to Carroll Motor Supply, the Michigan Treasury, the Michigan Unemployment Agency, and the IRS. These are the claimants with whom Mr. Bays is similarly situated under 11 U.S.C. 503(b) and with whom he shares estate assets *pro rata* under 11 U.S.C. 726(b). The position that Mr. Bays advances results in a fundamentally unfair result because it prefers himself to the detriment of other claimants who are equally deserving and equally entitled to payment, and there is simply no way around the fact that allowing Mr. Bays to keep the interim fees in his possession in excess of his *pro rata* share means that the other claimants will receive significantly less than the *pro rata* shares to which they are entitled under the Bankruptcy Code.

By its order of disgorgement, the bankruptcy court not only ensured equitable treatment of Carroll Motor Supply, Mr. Bays, the Michigan Treasury, the

Michigan Unemployment Agency, and the IRS, but it also ensured compliance with the plain language of the section 726(b) that payment “shall be made *pro rata*.” The bankruptcy and district courts correctly recognized that there is nothing that allows the courts to create a unique superpriority for Mr. Bays (or any other claimant), unless authorized by Congress to do so. An unavoidable and unfortunate fact of bankruptcy is that there is rarely enough money to pay all persons who should receive payment. For this reason, Congress established a system of priorities and distribution. Under the facts of this appeal, Mr. Bays should receive no more than his fair share.

ARGUMENT

1. Standard of Review.

This court “review[s] a bankruptcy appeal differently than a typical appeal from the district court. The bankruptcy court makes findings of fact and conclusions of law. The district court then reviews the bankruptcy court's findings of fact for clear error and the bankruptcy court's conclusions of law de novo.” *Wesbanco Bank Barnesville v. Rafoth* (*In re Baker & Getty Fin. Servs. Inc.*), 106 F.3d 1255, 1259 (6th Cir. 1997) (citations omitted). This Court reviews the decision of the bankruptcy court directly, reviewing its factual findings for clear error and its legal conclusions de novo. *Suhar v. Burns (In re Burns*), 322 F.3d 421, 425 (6th Cir. 2003). The factual findings relevant to this appeal are not disputed. This Court conducts a de novo review of the bankruptcy court's legal conclusion that "[11 U.S.C.] 726(b) requires mandatory disgorgement of $9,026.59 from Specker Motors' counsel so that the administrative claimants can be paid *pro rata*." (R.1.266, Order and Opinion, Apx. pg. ___).

2. Mr. Bays Cannot Keep Money That Equitably and Legally Belongs to Carroll Motor Supply, the Michigan Treasury, the Michigan Unemployment Agency, and the IRS.

Allowing Mr. Bays the interim compensation he received in excess of his *pro rata* share means that the other four claimants will each receive less than their respective *pro rata* shares in violation of both 11 U.S.C. 726(b) and the fundamental bankruptcy principle of equality of distribution. Mr. Bays does not dispute that he received interim compensation that was conditioned on the court's final award of fees, nor does he dispute that section 726(b) requires *pro rata* distribution among similarly situated creditors. Nevertheless, Mr. Bays advocates a position that he should be allowed to receive a distribution that is 57.9% of his claim while Carroll Motor Supply, the Michigan Treasury, the Michigan Unemployment Agency, and the IRS receive 0.7% of their respective claims. The court below correctly refused to allow such an inequity of distribution in violation of the Bankruptcy Code.

In drafting the Bankruptcy Code, Congress weighed policy considerations with respect to giving deference to certain claims and expenses with the need for fair and equitable distribution of bankruptcy estate assets. The result was a system for liquidating cases under chapter 7 of the Bankruptcy Code which ranks expenses and claims by class and systematically distributes estate funds by such class in order of priority, but provides for payment within each class *pro rata*. 11 U.S.C. 726. “Equality of distribution among creditors is a central policy of the Bankruptcy Code [and] according to that policy, creditors of equal priority should receive *pro rata* shares of the debtor's property.” *Begier v. Internal Revenue Service*, 496 U.S. 53, 58 (1990). In its simplest terms, *pro rata* means that each claimant within a class must have an equal percentage of his or her claim paid. Carroll Motor Supply, Mr. Bays, the Michigan Treasury, the Michigan Unemployment Agency, and the IRS each hold claims incurred under chapter 11 and allowed under section 503(b) and are each entitled to payment of an equal percentage of 5.6% of their claims. *See* 11 U.S.C. 726(b) (payment on claims of a kind specified in 507(a) shall be made *pro rata*); 11 U.S.C. 507(a) (priority class of administrative claims allowed under section 503(b)). If the court allows Mr. Bays to retain the award as interim compensation, he would receive far too much and the other claimants would receive far too little. This result would be a clear violation of the *pro rata* distribution rule of section 726(b) and would be a subversion of the core bankruptcy principle of equality of distribution.

3. Carroll Motor Supply, Mr. Bays, the Michigan Treasury, and the Michigan Unemployment Agency are "Similarly Situated" Claimants Entitled to *Pro Rata* Distribution.

The five chapter 11 administrative claimants in this case, Carroll Motor Supply, Mr. Bays, the Michigan Treasury, the Michigan Unemployment Agency, and the IRS, are "similarly situated" for purposes of distribution of estate property because they enjoy the same priority of distribution by virtue of their status under 503(b). Moreover, they share the same priority status because their claims share the characteristics of each being incurred post-petition under chapter 11 of the Bankruptcy Code but preconversion to chapter 7; of each meeting the definition of a specific administrative expense under section 503(b), *see* 503(b)(1)(A) (Carroll Motor Supply); 503(b)(2) (Mr. Bays); 503(b)(1)(B) (Michigan Treasury, Michigan Unemployment Agency, and IRS); and each being "allowed" under 503(b).

The bankruptcy court, pursuant to the Bankruptcy Code, made a correct determination with respect to "similarly situated" claims, and Mr. Bays' current arguments with respect to the issue are meritless. Courts do not treat administrative expense status lightly, because "these claims are the first priority unsecured claims . . . and are paid before all other unsecured creditors." *United States v. Ginley* (*In re Johnson*), 901 F.2d 513, 516 (6th Cir. 1990) (superceded by Fed. R. Bankr. P. 1019 on other grounds). The bankruptcy court in the instant case considered and rejected requests for chapter 11 administrative expenses from entities other than the five that were ultimately allowed. *See, e.g.*, Bankruptcy Court Docket Nos. 130, 131,151, 163, 164, 180 (claim of United States Department of Labor); Nos. 154, 155, 160, 165, 170 (claim of Halron Oil Co.).

Mr. Bays does not even dispute the status of any of the allowed chapter 11 administrative expense claims now. His sole argument that his is not "similarly situated" with the other claimants is based on his former position as Specker Motors' chapter 11 lawyer. *See* App. br. at 10. His prior relationship with Specker Motors, however, is irrelevant to the classification of his claim for purposes of distribution.[7]

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[7] Mr. Bays raises a second argument related to the fiduciary relationship between himself and Specker Motors: That enforcement of *pro rata* distribution under 726(b) creates "an insurmountable conflict of interest" that destroys the attorney-client relationship because the attorney's pecuniary interest may be better served by advising Specker Motors not to pay certain administrative expenses during the pendency of the case. App. br. at 10-12. However, in a successful reorganization under chapter 11, funds will exist to pay allowed attorney fees in full. It is only when the chapter 11 case converts to a case under chapter 7 and is administratively insolvent that the attorney's fees will be affected.

Mr. Bays' fiduciary duty compels him to advise his clients how to deal with claims fairly. Any attorney would do nothing less than breach his fiduciary duty if he advised his client to engage in misconduct so the attorney could receive a fee greater than allowed by federal law. Moreover, Mr. Bays' policy argument on this point cannot be reconciled with the plain language of the section 726(b) and that plain language controls the outcome of this appeal. *See United States v. Ron Pair Enters., Inc.*, 489 U.S. 235, 242 (1989) (plain language and meaning of legislation conclusive unless literal meaning demonstrably at odds with drafters' intention).

4. There is Nothing in the Bankruptcy Code that Allows A Court to Disregard the Plain Language of Section 726(b) and Create a Superpriority for Professionals.

There is no basis in the law for excepting Mr. Bays from the plain language of section 726(b) requiring *pro rata* distribution.[8] That 726(b) requires *pro rata* distribution is not disputed by Mr. Bays. Section 726(b) states that "payment *shall* be made *pro rata* . . ." 11 U.S.C. 726(b) (emphasis added). The statutory use of the term "shall" normally "creates an obligation impervious to judicial discretion." *Lexecon, Inc. v. Milberg Weiss Bershad Hynes & Lerach*, 523 U.S. 26, 35 (1998) (citations omitted). Because the language of 726(b) is plain and there is nothing absurd about the result of similar claimants sharing equally, the sole function of

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[8] Mr. Bays alleges incorrectly that he should be allowed to keep more than his *pro rata* share because he lacked notice that he might have to disgorge his interim fee award. App. br. at 8. It is enough of a general response to note that parties are presumed to know the law. *Accord* (R.1.266, Opinion Determining Administrative Insolvency and Disgorgement, Apx. pg. __). Indeed, this issue had been litigated in courts, and courts had ruled against Mr. Bays' substantive position, prior to the inception of the Specker Motors bankruptcy case. *See, e.g., In re Wilson-Seafresh, Inc.*, 263 B.R. 624 (Bankr. N.D. Fla. 2001); *In re Kingston Turf Farms, Inc.*, 176 B.R. 308 (Bankr. D.R.I. 1995). Alternatively, the debtor and Mr. Bays acknowledged in the original application to employ him that his compensation would be set by final order. (R.1.17, Application to Employ Counsel, Apx. pg. __; R.1.18, Affidavit of Donald Bays, Apx. pg. __). That happened here and Mr. Bays cannot complain that his final compensation was determined in compliance with federal law. Finally, Mr. Bays had notice and an opportunity to defend his position below. There were a flurry of motions and hearings before the bankruptcy court prior to its ruling against Mr. Bays on the merits.

the court is to enforce section 726(b) according to its terms. *See Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A.*, 530 U.S. 1, 6 (2000) (citations omitted).

In order to enforce section 726(b) according to its terms and ensure *pro rata* distribution in this case, the bankruptcy court properly ordered Mr. Bays to return $9,026.59 the estate to be paid to Carroll Motor Supply, the Michigan Treasury, the Michigan Unemployment Agency, and the IRS. The court's power to order the disgorgement arises from the authority granted by 11 U.S.C. 105(a) to "issue any order, process or judgment necessary or appropriate to carry out the provisions" of the Bankruptcy Code, and authority that "must and can only be exercised within the confines of the Bankruptcy Code." *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 206 (1988); *see also* 11 U.S.C. 330(a)(5) (courts can require return of interim compensation).

There is no explicit provision in the Bankruptcy Code that permits a court to use its equitable power to except Mr. Bays from its enforcement of the terms of 726(b). A search for a similar implied exception in the Bankruptcy Code provisions is equally in vain. The most likely section from which to imply such an exception would be section 331. The fact that Mr. Bays received interim compensation, however[9] does not assist Mr. Bays in this appeal, since interim compensation is always subject to final approval at the conclusion of a case. *See* 11 U.S.C. 330(a)(5); *see e.g., In re Regan*, 135 B.R. 216, 218 (Bankr. E.D.N.Y. 1992) (only at conclusion of case is thorough analysis possible). Interim compensation is often reduced or disgorged prior to or at the time of final approval, for example, on the merits, *see, e.g., In re Taxman Clothing Co.*, 49 F.3d 310 (7th Cir. 1995), or as a sanction, or to satisfy superpriority claims under section 507(b). *See, e.g., In re Wilson-Seafresh, Inc.*, 263 B.R. 624, 631 (Bankr. N.D. Fla. 2001). Other courts have held that interim compensation must be reduced or disgorged to effectuate *pro rata* distribution. *See, e.g., In re Wabash Valley Power Assoc., Inc.*, 69 B.R. 471, 475 (Bankr. S.D. Ind. 1987).

Even if the court were to find justification in section 331 to prefer Mr. Bays over the other four claimants, to do so would impermissibly create a priority between allowed administrative expenses. In drafting section 726(a), Congress ranked the categories for distribution of property of the estate: "[p]roperty of the estate shall be distributed . . . first . . . second . . . third . . ." 11 U.S.C. 726(a). In

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[9] Even if the interim compensation paid to Mr. Bays was still part of the retainer, this would not except him from *pro rata* distribution and allow him to keep the $9,026.59. Retainers paid to counsel for the debtor are held in trust for the debtor and debtor's equitable interest in the trust is estate property. *See Mapother & Mapother, P.S.C. v. Cooper* (*In re Downs*), 103 F.3d 472, 478 (6th Cir. 1996).

drafting section 507(a), Congress established the order of priority of categories of expenses and claims: “The following expenses and claims have priority in the following order . . .” 11 U.S.C. 507(a). Noticeably absent in section 503(b), however is any ranking or order of priority of among allowed administrative expenses. Section 503(b) simply states that “there shall be allowed, administrative expenses . . . including . . .” 11 U.S.C. 503(b). As previously noted, the sole provision in the Code establishing priority among any type of allowed administrative expenses is the priority granted by section 726(b) to chapter 7 allowed administrative expenses in a case converted to chapter 7 over any preconversion allowed administrative expenses.

Clearly, any priority granted to an allowed administrative expense held by Mr. Bays cannot arise by statute, but must instead be authorized by the court in deviation from the statute. However, as this Court has held, “if the claims of a class of creditors are to receive preferential treatment from the courts, the right to such treatment must have been authorized by Congress in clear and precise terms.” *Travelers Prop. Cas. Corp., v. Birmingham-Nashville Express, Inc. (In re Birmingham-Nashville Exp., Inc.*), 224 F.3d 511, 515 (6th Cir. 2000). There are no “clear and precise” terms in the Code or legislative history granting Mr. Bays priority over Carroll Motor Supply, the Michigan Treasury, the Michigan Unemployment Agency, or the IRS, nor are there even ambiguous or imprecise terms granting such priority. In fact, there is clear and precise language, in section 726(b), that ensures that neither debtors' attorneys nor any holder of an allowed administrative expense claim has priority over the others. "Payment on claims [for allowed administrative expenses] *shall be made pro rata* among claims of the kind . . . 11 U.S.C. 726(b) (emphasis added).

5. Reliance on *Unitcast* is Misplaced Because *Unitcast* Fails to Distinguish Between Disgorgement as a Sanction and Disgorgement to Ensure Equal Distribution.

This appeal does not involve the remedy of disgorgement as a sanction for misconduct or noncompliance. *Compare Mapother & Mapother, P.S.C. v. Cooper* (*In re Downs*), 103 F.3d 472 (6th Cir. 1996). That type of disgorgement is a discretionary remedy, one that should be applied when mandated by the equities of a case, determined at the court's discretion. *Id*. This appeal involves disgorgement as a means to ensure a fair division of estate assets as expressly mandated by federal statute. 11 U.S.C. 726(b). The division of estate property under section 726 allows no discretion, and when disgorgement is necessary to comply with the statutory mandate of section 726, the court simply may not exercise discretion. For this reason, the court's analysis in *United States v. Schottenstein, Zox, & Dunn* (*In re Unitcast*), 219 B.R. 741 (6th Cir. B.A.P. 1998) is flawed because it rests on an assumption that disgorgement cannot be both discretionary and mandatory, failing to recognize that disgorgement is merely a remedy whose nature depends upon the context within which it is used. The sole similarity between "disgorgement" used as a sanction originating from an attorney's misconduct and the "disgorgement" of funds previously received in excess of the amount of the attorney's *pro rata* share is that both "disgorgements" involve the order of return of money to the estate. This similarity is insufficient justification to yoke the court's duty to enforce a non-discretionary statute like section 726(b) with discretionary punitive disgorgement.

The court in *Unitcast* reasoned that disgorgement is discretionary even when necessary to comply with section 726 because "disgorgement is a remedy within the discretion of bankruptcy judges as the final arbiters of professional fee requests under §§ 330 and 331." 219 B.R. at 753. True, the bankruptcy court is the final arbiter of the *award* of professional fee requests under sections 330 and 331 by virtue of the discretion granted to the courts by Congress under those sections. *Unitcast* is correct that disgorgement is a discretionary remedy. But even that exercise of discretion has limits. *See Mapother & Mapother, P.S.C. v. Cooper* (*In re Downs*), 103 F.3d 472 (6th Cir. 1996) (bankruptcy court erred in not requiring complete disgorgement for intentional misconduct). Further, the *Unitcast* court assumes, without any authority, that disgorgement can *only* be discretionary, and can *only* be used as a remedy under 330 or 331. The court's faulty assumption stems from the failure to distinguish between the award of professional fees and the distribution of estate property in payment of such fees.

The discretion granted to the bankruptcy court to award, and hence to reduce or disgorge the amount of fees, pursuant to section 330 and 331 is utterly lacking with respect to the distribution of estate property under section 726. Sections 330 and 331 are fraught with discretionary language. *See* 11 U.S.C. 330, 331 ("after notice and hearing," "the court may award,""the court shall consider,""the court may allow,""the court may allow and disburse"). In contrast, there is not a single reference to the court, nor a hint of discretionary language in section 726. *See* 11 U.S.C. 726. Section 726(b), in particular affords no discretion. To the contrary, it uses the word "shall." *Id.*

The court in *Unitcast* tried to avoid the mandatory language of 726(b) by stating that "[s]ection 726(b) contemplates distribution based on the requests for payment of administrative expenses allowable at the time of distribution." *Unitcast,* 219 at 753. However, in doing so, the court arbitrarily excluded retainers and interim fees from the definition of claims allowable at distribution, and excluded retainers and fees from final distribution and review. To do so is not only contradictory to the tentative nature of interim fee awards, *see* 11 U.S.C. 330(a)(5), but also has the effect of silently depriving the *pro rata* distribution requirement of enforcement or meaning. A *pro rata* distribution at the conclusion of a case that ignores retainers and interim fee awards would not be *pro rata* distribution, but an exaggeration of an already unequal distribution.

Courts must give effect to sections 330, 331 and 726(b), as the courts below correctly did. When two statutes are capable of coexistence, it is the duty of the courts, absent a clearly expressed congressional intention to the contrary, to regard each as effective." *Fed. Communications Comm'n v. Nextwave Personal Communications, Inc.*, 537 U.S. 293, 303 (2003) (citations omitted). The simplest way to give effect to all three sections is to acknowledge that compensation awards under section 331 really are "interim," and that under section 330(a)(5) all professional fee final awards are clearly subject to review, and to disgorge interim fees when necessary to ensure *pro rata* distribution.

6. No Remand Is Necessary.

No remand is necessary if the Court determines that disgorgement is mandatory when required to ensure compliance with section 726(b). Mr. Bays asserts that this matter must be remanded to the bankruptcy court even if this Court requires him to disgorge his interim fees because the bankruptcy court "must determine what other Administrative Expenses were paid and then recover those payments . . . to be distributed *pro rata* to all Administrative Expense creditors." App. br. at 20. Such a remand is wholly unnecessary because the record reflects that no other allowed administrative expense claims subject to disgorgement received interim payment other than Mr. Bays' claim. (R.1.242, Notice of Trustee Report and Final Account to Creditors, Apx. pg. __; R.1.244, Order for Payment of Dividends, Apx. pg. __).

At issue in this appeal is the provision of section 726(b) under which Mr. Bays is entitled to distribution, which states that "[p]ayment of claims of a kind specified in paragraph (1) . . . of section 507(a) . . . shall be made *pro rata* among claims the kind specified in [such] paragraph," except that "a claim allowed" under section 503(b) incurred under chapter 7 "has priority over a claim under section 503(b)" incurred prior to conversion. 11 U.S.C. 726(b). Unquestionably, under section 726(b), the chapter 7 administrative expense claims paid by the trustee had priority and were entitled to payment, and no determination of payment on those claims is necessary.[10] (R.1.242, Notice of Trustee Report and Final Account to Creditors, Apx. pg. __; R.1.244, Order for Payment of Dividends, Apx. pg. __); 11 U.S.C. 726(b). The only claims subject to *pro rata* distribution, and therefore disgorgement of payments made if necessary to ensure *pro rata*

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[10] The statutory fees paid to the United States Trustee pursuant to 28 U.S.C. 1930(a)(6) are entitled to priority under 11 U.S.C. 507(a), and in a case converted from chapter 11 to chapter 7, share *pro rata* with chapter 7 administrative expenses. (R.1.242, Notice of Trustee Report and Final Account to Creditors, Apx. pg. __; R.1.244, Order for Payment of Dividends, Apx. pg. __).

distribution, are "administrative expenses allowed under [section] 503(b)" incurred under chapter 11 prior to conversion to chapter 7. *See* 11 U.S.C. 726(b).

In this case, there were five administrative expenses allowed under section 503(b) that were incurred under chapter 11 prior to conversion. First, Carroll Motor Supply in the amount of $942.41; second, Donald Bays in the amount of $17,343.10; third, the Michigan Unemployment Agency in the amount of $5,724.86; fourth, the Michigan Treasury in the amount of $52,695.18; and fifth, the IRS in the amount of $128,094.19. (R.1.242, Notice of Trustee Report and Final Account to Creditors, Apx. pg. __; R.1.244, Order for Payment of Dividends, Apx. pg. __). The only one of the five to receive any payments toward their allowed administrative expense claims under section 503(b) was Mr. Bays, who received $10,000 interim compensation. *Id.* The record is clear and undisputed as to these facts and Mr. Bays states no foundation for his assertion of the necessity of a remand.

Although Mr. Bays' brief is far from clear on this point, he may be implying that the "ordinary course of business expenses" Specker Motors may have paid during the short pendency of the chapter 11 case should also be subject to disgorgement. Such an assertion would contravene the Bankruptcy Code, and would radically upset the manner in which chapter 11 cases are administered.

Unlike Mr. Bays' claim, ordinary course of business expenses that are paid during a chapter 11 case are not "allowed" under section 503(b). Instead, sections 363(c)(1), 1107 and 1108 authorize a chapter 11 trustee or debtor in possession to pay ordinary course of business claims as they go. 11 U.S.C. 363(c)(1) (debtor may use estate property in the ordinary course of business without prior court approval); 11 U.S.C. 1108 (trustee authorized to operate debtor's business); 11 U.S.C. 1107 (chapter 11 debtor in possession has rights of trustee). In every chapter 11 case, debtors and/or trustees use this power to operate the business. Those costs never become claims under section 503(b) because they are fully satisfied upon payment. No hearing is required, no court approval is necessary, no additional review occurs.[11] Thus, paid ordinary course of business transaction may not be disgorged to be distributed *pro rata* to allowed administrative expense claimants because they have been paid fully under section 363(c)(1), 1107 and 1108, and never become an administrative expense claim subject to *pro rata* payment under section 503(b). This is so because expenses paid in the ordinary

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[11] Sometimes, a chapter 11 ordinary course of business expense is incurred but not paid prior to conversion to chapter 7. Under section 348(d), the unpaid portion only, not the paid portion, becomes a general unsecured claim unless it is an administrative expense claim, in which case it would be lumped with other section 503(b) administrative claims. *See* 11 U.S.C. 348(d). The record does not establish there were any such unpaid section 348(d) administrative claims in the Specker Motors case.

course of business are paid (1) under sections 363(c)(1) and 1108 - not 503(b), and (2) without notice and a hearing unlike 503(b), which requires notice and a hearing for expenses to be "allowed" and entitled to the resulting priority status. Thus, these two classes of claims are mutually exclusive.

The preconversion payment of ordinary course of business expenses is distinct from Mr. Bays' situation, because compensation awarded under 330 is specifically designated as an administrative expense, and because section 330 awards are specifically required to be paid under section 503(b)(2). Conversely, ordinary course of business expenses are paid without notice and hearing pursuant to sections 363(c)(1), 1107, and 1108, and are not subject to section 503(b). They are simply paid by the debtor in possession during the pendency of the chapter 11 case under the debtor's power to make such payments under sections 363(c)(1), 1107 and 1108.

CONCLUSION

For the foregoing reasons, the United States Trustee respectfully requests that the judgment of the district court be affirmed.

Respectfully Submitted,

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Michele M. Mansfield

JOSEPH A.GUZINSKI,
General Counsel

P. MATTHEW SUTKO
MICHELE M. MANSFIELD
United States Department of Justice
Executive Office for United States Trustees
20 Massachusetts Ave., N.W., Suite 8000
Washington, D.C. 20530
(202) 307-1399

Counsel for Appellee,
Saul Eisen, United States Trustee

CERTIFICATE OF COMPLIANCE

I certify that in compliance with the Federal Rules of Appellate Procedure and the Sixth Circuit Rules of Appellate Procedure, this brief is typed in proportionally spaced typeface in 14 point font and that, based on WordPerfect 9.0, this brief contains 11,194 words.

Michele M. Mansfield

CERTIFICATE OF SERVICE

I certify that on November 17, 2003, I filed and served the foregoing brief, including Appellee's Cross-Designation of Joint Appendix Contents, by causing one copy to be sent by First Class Mail to the Clerk of the Court, and by causing one copy to be sent by First Class Mail to the following counsel:

Donald Wayne Bays
Osstyn, Bays, Ferns, & Quinnell
419 W. Washington Street
Marquette, MI 49855

Steven B. Flancher
Assistant Attorney General
Revenue Division, First Floor
Treasury Building
Lansing, MI 48922

Francesca Ugolini
United States Department of Justice
601 D. Street, N.W. Room 7921

Thomas B. Johnson
Assistant Attorney General
350 Ottawa NW, Ste. 4C
Grand Rapids, MI 49503

____
Michele M. Mansfield

Addendum

APPELLEE'S CROSS-DESIGNATION OF JOINT APPENDIX CONTENTS

In addition to the items listed by the Appellant in its Designation of Joint Appendix Contents, the Appellee, pursuant to the Sixth Circuit Local Rule 30(b), hereby designates the following to be included in the joint appendix:

Description of Item	**Filing Date**	**Record #**
Application by Debtor Specker Motor Sales Company to Employ Donald Bays	3/26/97	R.1.17
Affidavit of Donald W. Bays	3/26/97	R.1.18
Order Granting Motion to Convert	9/24/97	R.1.168
Application for Professional Fees	10/9/01	R.1.235
Notice of Trustee Report& Final Account	8/5/02	R.1.244
Order for Payment of Dividends	8/8/02	R.1.244
Motion by Debtor Specker Motor Sales Company for Reconsideration	8/16/02	R.1.245
United States Concurrence (On Behalf of IRS) in United States Trustee's Objection	9/18/02	R.1.250
Debtor's Motion for Determination	12/16/02	12/16/02
United States Trustee's Response to Debtor's Motion for Determination	2/13/03	R.1.258
United States of America's Concurrence with the United States Trustee's Response	2/18/03	R.1.261
Brief for Michigan Employment Security Agency, Michigan Department of Treasury	2/19/03	R.1.263
Appellant Designation of Record and Statement of Issues	3/13/03	R.1.267
Order to Stay Order Pending Appeal	6/20/03	R.1.292

BRIEF BANK — "SUMMARY SHEET" Printed Fri.-11/5/99 (10:35)

WESTLAW CODES

1. ("TI") TITLE OF CASE [E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]	STANLEY v. S.S. RETAIL STORES CORP. (In re S.S. Retail Stores Corp.)
2. ("CO") CURRENT COURT [E.g., "CTA9"]	CTA9
3. ("CCN") CURRENT CASE NO.	No.: 99-16413
4. ("PCN") PRIOR CASE NO. & COURT [IF ANY]	No.: C 98-3794 CRB Court: N.D. Cal. (Breyer, D.J.) (Identify judge & cite, if any)
5. ("SO") SOURCE	**U.S. TRUSTEES**
6. ("DA") DATE OF FILING & TYPE OF BRIEF [E.g., "Opening Brief," "Reply," "Amicus," etc.]	Filed: October 14, 1999 Type: Opening Brief for Appellant, U.S. Trustee Linda Ekstrom Stanley
7. ("AU") PRINCIPAL AUTHORS & OFFICE [E.g.,"UST/OGC"]	Daniel L. Kaplan (Civil/Appellate Staff) Of Counsel: Jeanne M. Crouse (UST/OGC) (UST/OGC: 202-307-1399/FAX-2397)
8. ("TO") TOPIC	**BANKRUPTCY**
9. ("SU") • SUMMARY OF KEY ISSUE(s) & / Any Miscellaneous BACKGROUND	(1) Whether a law firm with an "interested" partner (who served as an officer of the debtor corporation until less than 2 weeks pre-petition) may nevertheless qualify as a "disinterested person" under 11 U.S.C. 327(a) and serve as counsel to the debtor-in-possession. (2) Whether the district court properly dismissed the U.S. Trustee's appeal on the ground that the law firm had an equitable entitlement to retain all fees, even if it was never eligible to receive them. / **Background:** See prior decision: Stanley v. S.S. Retail Stores Corp., 162 F.3d 1230 (9th Cir. 1998)
10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)	S:\General Counsel\Brief Bank-Web\To-West-Net\SSRetail\ss-re-2-toPDF.wpd
11. DO YOU RECOMMEND POSTING IN UST BRIEFBANK?	☒ YES ☐ NO NAME: Jeanne M. Crouse DATE: Fri.-11/5/99 (10:35)

No. 99-16413

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

LINDA EKSTROM STANLEY, United States Trustee,

Appellant,

v.

S.S. RETAIL STORES CORPORATION and
OFFICIAL UNSECURED CREDITORS COMMITTEE,

Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF CALIFORNIA

BRIEF FOR THE APPELLANT

OF COUNSEL:

MARTHA L. DAVIS
General Counsel

JEANNE M. CROUSE
Attorney

Executive Office for
United States Trustees

DAVID W. OGDEN
Acting Assistant Attorney General

JACOB M. LEWIS
(202) 514-5090
DANIEL L. KAPLAN
(202) 514-5083
Attorneys, Appellate Staff
Civil Division, Room 9134
Department of Justice
601 D Street, N.W.
Washington, D.C. 20530-0001

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ARTICLE

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

LINDA EKSTROM STANLEY, United States Trustee,

Appellant,

v.

S.S. RETAIL STORES CORPORATION and
OFFICIAL UNSECURED CREDITORS COMMITTEE,

Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF CALIFORNIA

BRIEF FOR THE APPELLANT

STATEMENT OF JURISDICTION

The bankruptcy court (Jellen, C. Bankr. J.) had jurisdiction over the underlying bankruptcy case pursuant to 28 U.S.C. §§ 157 and 1334. The district court (Breyer, J.) had jurisdiction over the United States Trustee's appeal from the bankruptcy court pursuant to 28 U.S.C. § 158(a)(1).[1] The district court entered an order dismissing the

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[1] Although it granted appellees' motion to dismiss as moot the United States Trustee's appeal, the district court stated that its dismissal was not based on a finding of "mootness." Excerpts of Record 66-67 n.3. It is thus unclear whether the district court may properly be said to have concluded that it lacked jurisdiction over the appeal. At any rate, as we show *infra* in argument II, the district court's analysis was improper.

United States Trustee's appeal on April 30, 1999. Excerpts of Record (ER) 64-68. The United States Trustee filed a notice of appeal from the district court's order on June 28, 1999 (ER 68-69); this notice was timely pursuant to Federal Rule of Appellate Procedure 4(a)(1)(B). This Court has jurisdiction over this appeal pursuant to 28 U.S.C. § 158(d).

STATEMENT OF THE ISSUES

1. Whether a law firm with an "interested" partner who served as Assistant Secretary of the debtor corporation until less than two weeks prior to the filing of the debtor corporation's chapter 11 petition may nevertheless qualify as a "disinterested person" eligible to serve as counsel to the debtor-in-possession.

2. If not, whether the district court properly dismissed the United States Trustee's appeal on the ground that the firm had an equitable entitlement to retain all of its fees even if it was never eligible to collect them.

STATEMENT OF THE CASE

A. Nature of the Case, Course of Proceedings, and Disposition in the Courts Below

This case arises out of proceedings commenced by S.S. Retail Stores Corporation (the debtor) for reorganization under chapter 11 of the Bankruptcy Code. Lawrence Calof, a partner of the law firm Gibson, Dunn & Crutcher (Gibson, Dunn) applied, on the debtor's behalf, for the bankruptcy court's authorization to retain Gibson, Dunn as counsel to the debtor-in-possession in the chapter 11 case. Calof had served as the debtor's Assistant Secretary until less than two weeks prior to the bankruptcy filing. The United States Trustee objected, arguing that the firm was ineligible to serve as counsel to the debtor-in-possession because it could not qualify as a "disinterested person" as required by the Bankruptcy Code. The bankruptcy court authorized the debtor-in-possession to employ the firm over the United States Trustee's objection. The United States Trustee appealed to the bankruptcy appellate panel, which affirmed. This Court dismissed the United States Trustee's appeal from the bankruptcy appellate panel's decision, holding that the order authorizing the employment of the firm was not a final, appealable order.

Back in the bankruptcy court, the United States Trustee again pressed her argument that Gibson, Dunn's employment contravened the Bankruptcy Code, through objections to the bankruptcy court's orders approving the firm's final fee application and issuing a final decree in the case. The bankruptcy court denied the United States Trustee's objections, and the district court dismissed the United States Trustee's appeal. The district court held that even if the firm's employment contravened the Bankruptcy Code, a disgorgement remedy would be impermissibly inequitable. The United States Trustee now appeals the district court's order.

B. The Bankruptcy Code's "Disinterested Person" Requirement

The Bankruptcy Code requires a chapter 11 debtor-in-possession[2] to obtain the bankruptcy court's authorization to employ certain types of "professional persons" to represent or assist it in carrying out its duties under the Code:

> Except as otherwise provided in this section, the trustee, with the court's approval, may employ one or more attorneys, accountants, appraisers, auctioneers, or other professional persons, that do not hold or represent an interest adverse to the estate, and that are disinterested persons, to represent or assist the trustee in carrying out the trustee's duties under this title.

11 U.S.C. § 327(a). The Code further provides that a "disinterested person" must be a person who (*inter alia*) "is not and was not, within two years before the date of the filing of the petition, a director, officer, or employee of the debtor." 11 U.S.C. § 101(14)(D).

This "disinterested person" requirement originated in the Chandler Act of 1938. In 1937, then-Chairman of the Securities and Exchange Commission William O. Douglas testified to Congress that insiders of debtor corporations had all too often

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[2] When a debtor corporation is permitted to retain control of its property during a chapter 11 reorganization, rather than having to turn its property over to a trustee, the corporation is referred to as a "debtor-in-possession." Although § 327(a) refers only to trustees, the Bankruptcy Code provides that (with exceptions not relevant here) a debtor in possession "shall have all the rights * * * and powers, and shall perform all the functions and duties * * * of a trustee," 11 U.S.C. § 1107(b), and thus the limitations on employment of professional persons imposed by § 327(a) apply equally to trustees and to debtors-in-possession. See S. Rep. No. 95-989, at 116 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5902 ("[section 1107] places a debtor in possession in the shoes of a trustee in every way").

exercised "absolute control" over corporate reorganizations, and had sacrificed the financial well-being of investors and the public to "the insiders' desires for protection and for further profit." H.R. Rep. No. 75-1409 (House Report), at 37 (1937). Douglas laid particular stress upon the fact that, under the existing system, "one of [the debtor corporation's] officials may be appointed trustee for the debtor," which he thought "a strange and novel privilege for debtors in a bankruptcy proceeding" because it permitted insiders to evade any meaningful scrutiny from, or responsibility to, interests other than their own. *Id*. at 37-38. He accordingly urged that "something must be done to provide impartial, capable control over reorganizations." *Id*. at 37.

Congress acted upon Commissioner Douglas's recommendation by mandating that corporate reorganizations involve persons free of any substantial connection to the debtor corporation's insiders. The Chandler Act of 1938 provided that trustees would be appointed to participate in corporate reorganizations involving debts of $250,000 or more, and that these trustees, as well as any attorneys appointed to represent them, would be "disinterested" — meaning that they could not have been officers of the debtor corporation during the two years preceding the filing of the bankruptcy petition. Chandler Act §§ 156-158, 52 Stat. 840, 888. A House Report noted that the role of these "disinterested persons" was "difficult to overemphasize" (House Report at 43), since "[t]he central problem in reorganization is to see to it that power is not exploited by reorganizers but appropriated for the benefit of investors" (*id*. at 44).

The federal law of bankruptcy has since been amended several times, most extensively by the Bankruptcy Reform Act of 1978, Pub. L. No. 95-598 (1978) (codified as amended in scattered sections of Title 11 of the United States Code) (1978 Act). But from 1938 to the present Congress has retained the requirement that a "disinterested person" — *i.e.*, someone sufficiently detached from the debtor corporation's insiders to provide a safeguard against insider manipulation — must be involved in corporate reorganizations. Thus, while the 1978 Act authorized debtor corporations to remain in possession of their property while reorganizing, Congress required these debtors-in-possession to hire only "disinterested persons" to assist them in the reorganization process (11 U.S.C. § 327(a)) and excluded from this category persons who have served as officers of the debtor corporation during the two years preceding the filing of the bankruptcy petition (*id*. § 101(14)(D)).

C. Statement Of Facts And Prior Proceedings

In connection with the filing of the debtor corporation's voluntary chapter 11 petition, Gibson, Dunn partner Lawrence Calof filed a request, on the debtor corporation's behalf, for the bankruptcy court's authorization to employ his firm as attorney for the debtor-in-possession in the chapter 11 case. ER 1-6. Calof also filed a declaration in support of the application, in which he disclosed that he had served as Assistant Secretary of the debtor corporation from an unspecified point in time until thirteen days prior to the filing of the bankruptcy petition. ER 9; see also ER 13-14.

The United States Trustee[3] objected to the firm's employment, on the ground that the representation would contravene the Bankruptcy Code. ER 11-12. The United States Trustee argued that, since Calof had been an officer of the debtor corporation well within the two-year period preceding the filing of the debtor's bankruptcy petition, neither he nor Gibson, Dunn could qualify as "disinterested persons" eligible to represent the debtor-in-possession.

After two hearings on the matter, the bankruptcy court issued a four-sentence order in which it "assum[ed]" that Calof was disqualified for "interest," but nevertheless authorized the employment of Gibson, Dunn as counsel for the debtor-in-possession. ER 40-41.

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[3] The United States Trustees are "bankruptcy watch-dogs" charged with "prevent[ing] fraud, dishonesty, and overreaching in the bankruptcy arena." H.R. Rep. No. 95-595, at 88 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6049. They are authorized to raise "any issue in any case or proceeding under [the Bankruptcy Code]," 11 U.S.C. § 307, and are directed to participate in bankruptcy cases in a variety of ways, including by monitoring applications for the employment of professional persons filed under § 327 of the Bankruptcy Code. See 28 U.S.C. § 586(a)(3)(H); see also *St. Angelo* v. *Victoria Farms, Inc.*, 38 F.3d 1525, 1530 (9th Cir. 1994), *amended*, 46 F.3d 969 (1995); *In re A-1 Trash Pickup, Inc.*, 802 F.2d 774, 775-76 (4th Cir. 1986).

The United States Trustee appealed to the bankruptcy appellate panel (Hagan, Ryan, and Ollason, Bankr. JJ.), which affirmed. Although the panel held that Calof was not a "disinterested person," it went on to hold that his law firm could nevertheless be considered a "disinterested person" and could represent the debtor-in-possession. The panel reasoned that, because the Bankruptcy Code included no "vicarious disqualification" provision "despite the legislative opportunity to include the disqualification," the "attribution" of Calof's disqualification to his firm "should not occur in this instance." ER 52-53.

While the United States Trustee's appeal from the bankruptcy appellate panel was pending, Gibson, Dunn filed a motion to dismiss the appeal as moot. The firm stated that the reorganization plan had been fully consummated, and argued that any disgorgement remedy for the firm's unlawful representation of the debtor-in-possession would be impermissibly inequitable. This Court (through its Appellate Commissioner) denied Gibson, Dunn's motion. (The Appellate Commissioner is authorized to dispense with plainly meritless motions without referring them to a motions panel, merits panel, or individual judge. See Ninth Circuit General Orders (January 1999) 51-52.)

A panel of this Court subsequently held that it lacked jurisdiction over the appeal because the order authorizing the employment of Gibson, Dunn was not a "final" order appealable pursuant to 28 U.S.C. § 158(d). *In re S.S. Retail Stores Corp.*, 162 F.3d 1230 (9th Cir. 1998).

Meanwhile, the underlying bankruptcy case proceeded to completion in the bankruptcy court, and Gibson, Dunn filed its final fee application and asked the bankruptcy court to issue a final decree in the case. The United States Trustee opposed both requests, reiterating her argument that the firm's employment contravened the Bankruptcy Code. ER 55-59. The bankruptcy court entered the requested final orders over the United States Trustee's objections. ER 60-63.

The district court dismissed the United States Trustee's appeal from the final orders in the bankruptcy case. The court reasoned that "equity favor[ed]" Gibson, Dunn's request to dismiss the appeal, because no competing claims to the firm's fees had been made, the firm disclosed Calof's service as Assistant Secretary of the debtor corporation when it applied to represent the debtor-in-possession, "no harm or prejudice to creditors was proved," the United States Trustee had not alleged any "actual wrongdoing or misfeasance on the part of [Gibson, Dunn]," the fee was found to be appropriate, and "perhaps most importantly," Gibson, Dunn "can hardly be expected to abandon its representation of the debtor for fear that it was legally disqualified * * * after both the Bankruptcy Court and the [bankruptcy appellate panel] had issued legal rulings to the contrary." ER 67. The district court held that "[i]t would not be equitable to order the disgorgement of [Gibson, Dunn's] fees," and accordingly dismissed the appeal. ER 68.

The United States Trustee now appeals from the district court's order.

SUMMARY OF ARGUMENT

Permitting a law firm to qualify as a "disinterested person" despite not being composed of "disinterested persons" violates the plain language of the Bankruptcy Code, and is fundamentally contrary to the "disinterested person" requirement's essential purpose of guarding against insider manipulation of the corporate reorganization process. The Code provides that a "disinterested person" must not have served as an officer of the debtor corporation within the two years preceding the chapter 11 filing, and insofar as only natural persons (and not law firm "persons") may serve as corporate officers, the plain language of this requirement must be read to disqualify firms which — like Gibson, Dunn in this case — are subject to the "interest" created by their members' service as officers of the debtor.

The bankruptcy court's contrary holding creates a loophole in the "disinterested person" requirement through which law firm "persons" may easily pass, regardless of the "interest" of the attorneys of which they are composed. In carving out this loophole, the bankruptcy court undermined the "disinterested person" requirement's essential purpose, because law firms that are not composed of "disinterested" individuals cannot be relied upon to act like "disinterested" individuals. To the contrary, a firm's "interest" (created by the "interest" of its former-officer partner) by its nature erodes the firm's inclination aggressively to pursue the interests of the bankruptcy estate — the true "client" of counsel to a debtor-in-possession.

The district court's holding, that the firm has an equitable entitlement to retain all of its fees even if they were all collected in violation of the Bankruptcy Code, is insupportable. Bankruptcy courts enjoy broad discretion to order appropriate remedies for Code violations, and this Court's controlling precedent, as well as ample precedent from other courts, establishes that a disgorgement remedy would be an entirely permissible exercise of that discretion in this case. Indeed, this Court's precedents not only establish that a disgorgement remedy would be consistent with equitable principles, but also indicate that the district court's equitable analysis was fundamentally improper. This Court has made plain that the bankruptcy courts' equitable powers may be used only to further the Bankruptcy Code's purposes, and permitting a firm to leapfrog a strict disqualification provision set forth in the Code can hardly be thought to further the Code's purposes. Furthermore, even if the equitable concerns cited by the district court could properly be thought to bar the bankruptcy court from ordering *full* disgorgement, the district court erred in refusing to consider the equitability of a *partial* disgorgement remedy.

This Court should eliminate the loophole in the "disinterested person" requirement that the bankruptcy court created, reject the district court's holding that the firm is equitably entitled to keep all of its fees even if none of the fees were lawfully collected, and remand the case so that an appropriate remedy may be provided.

ARGUMENT

Statement Of The Applicable Standard Of Review

This appeal presents only pure questions of law, which this Court reviews *de novo*. *Committee of Dental Amalgam Mfrs. and Distribs.* v. *Stratton*, 92 F.3d 807, 810 (9th Cir.), *cert. denied*, 519 U.S. 1084 (1997).

I. GIBSON, DUNN'S APPOINTMENT AS COUNSEL TO THE DEBTOR-IN-POSSESSION VIOLATED THE BANKRUPTCY CODE.

A. Permitting A Law Firm That Is Not Composed Of "Disinterested Persons" To Qualify As A "Disinterested Person" Contravenes The Plain Language Of The Bankruptcy Code.

It has long been recognized that "professionals engaged in the conduct of a bankruptcy case should be free of the slightest personal interest which might be reflected in their decisions concerning matters of the debtor's estate or which might impair the high degree of impartiality and detached judgment expected of them during the course of administration." *In re Philadelphia Athletic Club, Inc.*, 20 B.R. 328, 334 (E.D. Pa. 1982) (quoting 1 Collier Bankruptcy Manual § 101.13 (1981)). The loophole through which the bankruptcy court permitted Gibson, Dunn to evade the "disinterested person" requirement flies in the face of this important principle.

By defining the term "person" to include "individual, partnership, and corporation" (11 U.S.C. § 101(41)), the Bankruptcy Code provides that a law firm must be treated as a "person," and the Code draws no distinction between the "disinterest" requirement it imposes upon a law-firm "person" and that which it imposes upon a natural "person" (*id.* § 327(a)). Thus, the plain language of the "disinterest" requirement must be "rigidly applied" to law firm "persons," just as it is to natural persons. *In re Jartran, Inc.*, 78 B.R. 524, 526 (Bankr. N.D. Ill. 1987); accord *In re TMA Assocs.*, 129 B.R. 643, 646 (Bankr. D. Colo. 1991). Gibson, Dunn plainly could not meet this standard, because the firm's partner Lawrence Calof was an officer of the debtor corporation until less than two weeks before the debtor's bankruptcy petition was filed. ER 9.

The bankruptcy court's refusal to apply the "disinterested person" requirement to the firm cannot be squared with the Code's plain language. Whereas the Code makes all aspects of the "disinterested person" requirement applicable to law firms, the bankruptcy court's construction would introduce a "law firm exception," at least for the provision ascribing "interest" to recent service as an officer of the debtor corporation, that is nowhere to be found in the statute. This innovation upon the plain language of the statute must be rejected.

B. Permitting A Law Firm That Is Not Composed Of "Disinterested Persons" To Qualify As A "Disinterested Person" Would Severely Undermine The Purpose Of The "Disinterested Person" Requirement.

Even if it could be thought consistent with the relevant language of the Bankruptcy Code considered *in vacuo*, the bankruptcy court's construction of this language must be rejected as fundamentally contrary to the purposes for which the "disinterested person" requirement was created. The Supreme Court has stressed "[o]ver and over" that "[i]n expounding a statute, [courts] must not be guided by a single sentence or member of a sentence, but look to the provisions of the whole law, and to its object and policy." *Regions Hosp.* v. *Shalala*, 522 U.S. 448, 460 n.5 (1998) (internal quotation marks and citations omitted).

The bankruptcy court's conclusion that a law firm "person" may be considered "disinterested" despite the "interest" of its former-officer partner severely undermines the "object and policy" underlying the "disinterested person" requirement, because a firm partly composed of "interested persons" cannot be relied upon to act in the thoroughly detached fashion in which a "disinterested" individual would act. For example, if a "disinterested" individual serving as counsel to the debtor-in-possession were to uncover evidence indicating that the officers of the debtor corporation were legally liable for wrongdoing committed before the bankruptcy filing, she would not hesitate to initiate a lawsuit against the officers to recover money and property which rightfully belongs to the bankruptcy estate — the true "client" of counsel to a debtor-in-possession (*In re Perez*, 30 F.3d 1209, 1219 (9th Cir. 1994)). See, *e.g*., *Trone* v. *Smith*, 621 F.2d 994, 996 (9th Cir. 1980) (trustee initiated legal action against officers of the debtor corporation); *In re Sally Shops, Inc.*, 50 B.R. 264, 265 (Bankr. E.D. Pa. 1985) (same).

But if counsel for the debtor-in-possession is a law firm with a partner or partners who are, or recently were, officers of the debtor, the firm's loyalty to the bankruptcy estate is impaired. The detachment and vigilance of the "interested" attorney's partners would be undermined by a natural resistance to initiating a legal action that might subject their own former-officer partner to liability. They would be less motivated to seek out evidence of wrongdoing by the debtor corporation's officers than "disinterested" counsel would be. The "interested" attorney's partners would also be inclined to exercise less vigilant scrutiny over the debtor corporation's business plans than would "disinterested" counsel, because they would think it possible that their former-officer partner had a hand in creating the plans, or could in any case be held legally responsible for them by virtue of his former position.

Although the threat to the estate posed by these factors will vary from case to case, Congress expressly declined to leave determinations as to whether recent service as an officer of the debtor corporation gives rise to disqualifying "interest" to case-by-case inquiry, choosing instead to create a categorical rule of disqualification. See 11 U.S.C. §§ 101(14)(D), 327(a). The preferability of such a prophylactic rule over a case-by-case inquiry was a legislative judgment well within Congress's authority to make, and courts are bound to respect it. See *In the Matter of Consolidated Bancshares, Inc.*, 785 F.2d 1249, 1256 n.6 (5th Cir. 1986) ("The standards for the employment of professional persons are strict, for Congress has determined that strict standards are necessary in light of the unique nature of the bankruptcy process").

In a steady stream of decisions beginning as far back as the early 1980s, courts have recognized these principles, and have steadfastly refused to create a loophole in the "disinterested person" requirement for law firm "persons." See *In re Michigan Interstate Ry. Co.*, 32 B.R. 327, 330 (Bankr. E.D. Mich. 1983) ("this Court is of the opinion that the 'insider' characteristics of one lawyer associated with the firm * * * are sufficient to strip the firm of its claim to disinterestedness"); *In re Wells Benrus Corp.*, 48 B.R. 196, 199 (Bankr. D. Conn. 1985) ("The disqualification of any attorney pursuant to Code § 327(a) causes every attorney in that attorney's firm to be disqualified as well"); *In re SIS Corp.*, 97 B.R. 361, 362 (Bankr. N.D. Ohio 1989) (because, among other reasons, a member of the law firm served as corporate secretary of the debtor during the two years preceding the filing of the bankruptcy petition, the firm could not qualify as a "disinterested person"); *In re Tinley Plaza Assocs.*, 142 B.R. 272, 277 (Bankr. N.D. Ill. 1992) ("If an attorney who is a member of a law firm is disqualified from employment by the debtor-in-possession because he or she does not meet [the criteria set out in §§ 327(a) and 101(14)(D)], then all the members of the attorney's law firm are also disqualified"); *In re Envirodyne Indus.*, 150 B.R. 1008, 1017 (Bankr. N.D. Ill. 1993) ("[I]f one attorney with a law firm is ineligible to represent a debtor-in-possession, then that firm is disqualified from such representation"); *In re Weibel, Inc.*, 161 B.R. 479, 483 (Bankr. N.D. Cal. 1993) ("If a partner is disqualified, the firm is disqualified"), *aff'd*, 176 B.R. 209 (9th Cir. B.A.P. 1994).

C. The Bankruptcy Court And Bankruptcy Appellate Panel Fundamentally Misunderstood The "Disinterested Person" Requirement.

The record demonstrates that, in overruling the United States Trustee’s objections to the firm’s employment, the bankruptcy court fundamentally misunderstood the "disinterested person" requirement’s purpose. As explained above, Congress created the "disinterested person" requirement in order to ensure that counsel to a debtor-in-possession is completely *detached* from the debtor corporation's insiders. Yet the bankruptcy judge reasoned that the requirement should not be applied to Gibson, Dunn because the firm's "interested" partner was "not the enemy" of the debtor corporation. ER 25 ("[Mr. Calof has] been on the Debtor's team all along, *remains* on the Debtor's team * * * he's not the enemy") (emphasis added). The very closeness to the debtor corporation's insiders that the bankruptcy court believed rendered the representation lawful was in fact the basis for Congress's concern in adopting the Code's prophylactic "disinterested person" requirement.

In affirming the bankruptcy court, the bankruptcy appellate panel likewise misconstrued the functioning of the "disinterested person" requirement. The panel relied primarily upon the proposition that the disqualification of a firm for "interest" should not be available because § 327(a) includes no language specifically providing for the "vicarious" disqualification of law firm "persons." See ER 52 ("[n]o vicarious disqualification is provided for in the applicable sections of the Bankruptcy Code, despite the legislative opportunity to include the disqualification"). But the panel's reasoning was misguided. Law firms are clearly incorporated into the definition of "persons" in § 101(41) of the Code, and are just as clearly required to be "disinterested" in order to be employed as "professional persons" under § 327(a). Thus, the Code disqualifies "interested" law firms directly, and no inquiry into whether these firms may also be disqualified "vicariously" is necessary.

Even if it were correct in thinking "vicarious disqualification" necessary to the United States Trustee's objection, the panel's "negative pregnant" reasoning for concluding that § 327(a) cannot provide for this type of disqualification was mistaken. The panel did not explain its reasons for concluding that there was a "negative pregnant" in § 327(a) with regard to "interested" law firm "persons," but it did offer a clue by citing the Missouri bankruptcy court's decision in *In re Creative Restaurant Management, Inc.*, 139 B.R. 902 (Bankr. W.D. Mo. 1992). See ER 52. The *Creative Restaurant* court's rationale for its "negative pregnant" theory was that, because Rule 5002(a) of the Federal Rules of Bankruptcy Procedure (Bankruptcy Rules) expressly provides that another type of disqualification must apply to a disqualified individual's law firm, this rule injects a "negative pregnant" into § 327(a) of the Bankruptcy Code regarding a firm's disqualification based on its partner's "interest." *Creative Restaurant*, 139 B.R. at 913; see also *Vergos* v. *Timber Creek, Inc.*, 200 B.R. 624 (W.D. Tenn. 1996) (following *Creative Restaurant*); *In re Capen Wholesale, Inc.*, 184 B.R. 547 (N.D. Ill. 1995) (same); *In re Timber Creek, Inc.*, 187 B.R. 240 (Bankr. W.D. Tenn. 1995) (same).

The *Creative Restaurant* court's reasoning is fatally flawed. The rationale of the "negative pregnant" principle of statutory construction is that "[w]here Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion." *Bates* v. *United States*, 522 U.S. 23, 29-30 (1997) (internal quotation marks and citation omitted). But the language that the *Creative Restaurant* court used to insert a "negative pregnant" into § 327(a) does not appear in the "same Act," nor does it appear in any other Act, and in fact it was not even drafted by Congress. Rule 5002 was drafted by an advisory committee, which referred its draft to the Committee on Rules of Practice and Procedure of the United States Judicial Conference, which approved the draft and submitted it to the Supreme Court, which in turn transmitted the proposed Rules to Congress. Congress took no action to disapprove or amend the Rule within the time period specified by the Court and, in this fashion, Rule 5002 took effect by congressional default. See 9 King *et al.*, Collier on Bankruptcy ¶ 5002RH[1], at 5002-9; ¶ 1001.02[2], at 1001-4 - 1001-5 (15th ed. & 1998 Supp.). Sound inferences as to Congress's intent may not be drawn by comparing the language that Congress placed in a statute to the language that an advisory committee placed in a rule.

Furthermore, using the Bankruptcy Rules to inject "negative pregnants" into the Bankruptcy Code runs counter to the Rules Enabling Act, which bars any use of the Federal Rules of Bankruptcy Procedure to "abridge, enlarge, or modify any substantive right," 28 U.S.C. § 2075, and thereby "requires that procedural rules be consistent with bankruptcy law as contained in titles 11 and 28 of the United States Code." 9 King *et al.*, Collier on Bankruptcy ¶ 1001.01[1], at 1001-2 (15th ed. & 1997 Supp.).

These flaws in the *Creative Restaurant* court's reasoning compound that court's fundamental failure to understand the purpose and significance of the "disinterested person" requirement. As Professor Warner observed in a recent article in the American Bankruptcy Institute Law Review, *Creative Restaurant* and its progeny "lose sight of the prophylactic nature of [the Code's disqualification of former officers of the debtor corporation] and effectively read it out of the statute." G. Ray Warner, *Of Grinches, Alchemy And Disinterestedness: The Commission's Magically Disappearing Conflicts Of Interest*, 5 Am. Bankr. Inst. L. Rev. 423, 433 n.52 (1997). It is "simply inconsistent" with the premise of the Code's disqualification of officers of the debtor corporation "to adopt a rule permitting the employment of a two-person firm, where one of the partners is the corporate secretary," and "[m]oving to a 100-member firm is merely a change in the extent of the relationship, not in its type." *Ibid*.

This Court should reject the notion that the position held by the United States Trustee, and supported by overwhelming precedent, may be discarded pursuant to the use of a Bankruptcy Rule to read a "negative pregnant" into § 327(a) of the

Bankruptcy Code, and should eliminate the loophole that the bankruptcy court carved out of the "disinterested person" requirement.

II. THE DISTRICT COURT ERRED IN HOLDING THAT GIBSON, DUNN IS EQUITABLY ENTITLED TO RETAIN ALL OF ITS FEES EVEN IF IT WAS NEVER ELIGIBLE TO COLLECT THEM.

A. This Court's Precedent, And Other Pertinent Caselaw, Strongly Supports The Availability Of A Disgorgement Remedy In This Case.

There is no serious doubt that the bankruptcy court can order a disgorgement remedy if this Court holds that Gibson, Dunn's service as counsel to the debtor-in-possession was void *ab initio* under the Bankruptcy Code. Indeed, bankruptcy courts enjoy "considerable equitable discretion in fashioning an appropriate bankruptcy remedy" (*In re Reeves*, 65 F.3d 670, 674 (8th Cir. 1995)), and disgorgement is the standard remedy when an attorney or law firm has collected fees for professional services in a chapter 11 case despite the fact that the attorney or firm was not eligible under § 327(a) to provide the services. See, *e.g.*, *Occidental Fin. Group, Inc.*, 40 F.3d 1059, 1062-63 (9th Cir. 1994) (affirming an order requiring a law firm to disgorge the full $140,000 in fees it had collected for its services in a chapter 11 case because the firm was ineligible to serve under § 327(a)); *In re B.E.T. Genetics, Inc.*, 35 B.R. 269 (Bankr. E.D. Cal. 1983) (ordering full disgorgement by a law firm in a chapter 11 case because the firm was ineligible — due in part to the fact that one of its partners had served as Assistant Secretary of the debtor corporation within the two years preceding the chapter 11 filing — to serve under § 327(a)).

This Court has clearly stated that the line of cases originating in *In re Roberts Farms, Inc.*, 652 F.2d 793 (9th Cir. 1981), which the district court cited in support of its dismissal (ER 67 n.3), is simply "inapplicable" when, as in this case, the Court may fashion effective monetary relief that does not infringe upon the rights of persons not before the court. *In re Baker & Drake, Inc.*, 35 F.3d 1348, 1351 (9th Cir. 1994). Ordering the firm to disgorge unlawfully-collected fees would provide effective relief for the Bankruptcy Code violation, would not injure individuals not before the Court, and would be entirely consistent with the relevant equities articulated in this Court's decisions.

This Court has explained that the question of whether equity weighs against a requirement that a professional disgorge unlawfully-collected funds turns upon whether the professional had early notice that its ability to collect those funds was under challenge. In this case, as in several cases in which this Court affirmed the appropriateness of a disgorgement remedy, the potentially-disgorging party has known from the very beginning that its right to collect the funds was under challenge. See *In re Cascade Roads, Inc.*, 34 F.3d 756, 761 (9th Cir. 1994) (observing that "[t]he trustee is a party to this appeal and has been aware at all times that the United States would seek appellate review," and concluding that "[g]iven the trustee's notice and participation in this appeal, it would not be inequitable to [order the trustee to disgorge money erroneously disbursed]"); *In re Spirtos*, 992 F.2d 1004, 1007 (9th Cir. 1993) (concluding that, because the "[d]ebtor knew at the time he received and spent his plan distribution that [a creditor] had appealed the bankruptcy court's decision [that the debtor's interest in pension plans was exempt]," it would not be "inequitable" to order disgorgement); *In re International Envtl. Dynamics, Inc.*, 718 F.2d 322, 326 (9th Cir. 1983) (holding that, since counsel for certain creditors "has known since [the fees were disbursed] that [the trustee] contests the bankruptcy court's order that he be paid from the certificate of deposit," it would not be "inequitable" to order disgorgement).

This Court's precedents not only establish that a bankruptcy court could, consistently with equitable principles, provide a disgorgement remedy in this case, but also demonstrate that the equitable analysis that the district court considered mandatory was actually fundamentally improper. This Court has repeatedly observed that a bankruptcy court's equitable powers "may not be invoked to defeat clear statutory language, nor to reach results inconsistent with the statutory scheme established by the [Bankruptcy] Code." *In re Powerine Oil Co.*, 59 F.3d 969, 973 (9th Cir.), *cert. denied*, 516 U.S. 1140 (1996); see also *In re Futoran*, 76 F.3d 265, 267 (9th Cir. 1996) ("The bankruptcy court's equitable powers may only be exercised in furtherance of the goals of the Bankruptcy Code") (internal quotation marks and citations omitted). Authorizing a law firm to escape a strict disqualification provision set forth in the Code can hardly be thought to be "consistent with" — much less to "further" — the Code's goals.

The district court does not appear to have consulted any of these controlling decisions of this Court. Instead, the district court opted to rely upon broad equitable considerations (such as the lack of evidence that the bankruptcy estate was actually harmed by the unlawful representation) and decisions of a bankruptcy appellate panel and the Sixth Circuit. ER 67-68. Neither of these bases of the district court's decision is sound.

In addition to contravening this Court's precedents discussed above, the district court's reference to broad equitable principles was wholly inappropriate to the particular context of this case. As Justice Douglas (whose testimony as Chairman of the Securities and Exchange Commission inspired the creation of the "disinterested person" requirement (see *supra* at 4-6)) observed for the Supreme Court in *Woods* v. *City National Bank & Trust Co.*, 312 U.S. 262, 268 (1941), when a fiduciary's ability to provide "loyal and disinterested service" was impaired by that professional's interests, "[i]t is no answer to say that fraud or unfairness were not shown to have resulted." The remedy of denying compensation to a fiduciary who was unqualified to collect it is designed to eradicate "not only actual evil results" but also the "tendency to evil in other cases," and a bankruptcy court should not have to "speculate" as to whether a particular statutory ground for disqualification might have caused harm to the bankruptcy estate. *Ibid*. (internal quotation marks and citations omitted).

The decisions of the Sixth Circuit and a bankruptcy appellate panel from which the district court derived its equitable analysis are likewise unavailing. See ER 67-68 (relying upon *In re CIC Investment Corp.*, 192 B.R. 549 (B.A.P. 9th Cir. 1996), and *In re Federated Department Stores, Inc.*, 44 F.3d 1310 (6th Cir. 1995)). The bankruptcy appellate panel's conclusion in *CIC Investment* that a professional should be able to retain compensation for work performed pursuant to a bankruptcy court order through the time that the panel reversed the order (see 192 B.R. at 553) directly contradicts this Court's precedent. The potentially-disgorging parties in *Cascade Roads*, *Spirtos*, and *Environmental Dynamics* had all collected money in reliance upon bankruptcy court orders authorizing them to do so, and in none of these cases did this Court suggest that this fact would vest them with an equitable entitlement to keep the money they had collected in violation of the Code. See *Cascade Roads*, 34 F.3d at 759; *Spirtos*, 992 F.2d at 1006; *Environmental Dynamics*, 718 F.2d at 324.

Nor may the Sixth Circuit's *Federated Department Stores* decision provide a sound basis for the district court's holding. In that case, the Sixth Circuit rejected a mootness argument very similar to the one that Gibson, Dunn pressed before the district court. Like Gibson, Dunn, the professional whose "disinterestedness" was challenged in *Federated Department Stores* claimed an equitable entitlement to retain all of the fees it had collected from the challenged representation, and argued that even if its employment had violated the Bankruptcy Code, the violation therefore could not be remedied. *Federated Dep't Stores*, 44 F.3d at 1317. The court disagreed, held that the professional's appointment had contravened the Bankruptcy Code, and required it to disgorge the fees it had collected for close to eight months of work on the bankruptcy case. See *id*. at 1314, 1320. Although the court permitted the unlawfully-appointed professional to retain *some* of its fees, it did so only in recognition of the case's "peculiar and unique circumstances" and applied an *ad hoc* equitable rationale (based on the issuance of a controlling court of appeals decision establishing the professional's ineligibility (*id*. at 1320)), that departs from the equitable principles articulated in this Court's precedents.

B. The District Court Erred In Failing To Consider The Equitability Of A Partial Disgorgement Remedy.

Furthermore, even if the district court's equitable entitlement theory could properly be applied to bar the bankruptcy court from ordering *full* disgorgement, the district court erred in failing to consider the equitability of *partial* disgorgement. As explained above, the general rule calls for the disgorgement of all fees collected in violation of the Code, but even in a case in which a bankruptcy court adjusted a firm's forfeiture of fees in light of equitable factors similar to those that animated the district court below, the bankruptcy court — rather than simply turning a blind eye to the Code violation — nevertheless required *partial* disgorgement. See *In re Kendavis Indus. Int'l, Inc.*, 91 B.R. 742, 762 (Bankr. N.D. Tex. 1988) (accepting the general rule that a professional's ineligibility to collect fees under the Bankruptcy Code requires a disallowance of all fees, but holding that in light of the fact that the law firm had "committed a great deal of time and labor" to the cases, in reliance upon court orders authorizing it to undertake the representation while the final determination of the issue of the firm's lack of disinterestedness was postponed, the law firm should forfeit only half of the over $4,000,000 in fees it had been awarded for its services).

C. The Application Of The District Court's Equitable Entitlement Theory Would Undermine The Bankruptcy Process.

Acceptance of the district court's theory that a law firm is equitably entitled to keep all of the fees it collects in bankruptcy cases regardless of the unlawfulness of the representation could have any of several effects, each of which would undermine the efficiency and fairness of the bankruptcy system.

First, the holding could undermine the effective enforcement of types of statutory disqualification that the courts of appeals have not yet addressed. Confident that they will be able to collect all of their fees before a court of appeals can rule on a challenge to their eligibility, attorneys will feel free to engage in representations that appellate courts would, given the opportunity, declare unlawful. By the same token, the district court's rule would provoke undue haste on the part of professionals who are aware of, or who foresee, challenges to their eligibility to collect fees: If they can win the race against the challenger's appeals, they will be rewarded with an equitable entitlement to retain their fees notwithstanding the possible unlawfulness of their employment. The district court's approach could also force United States Trustees to seek to stay bankruptcy cases pending review of their challenges to professional persons' eligibility to collect fees. Such a result would burden the other parties affected by bankruptcy cases, and would conflict with this Court's observation that no stay of a bankruptcy case should be required when the effective remedy of disgorgement is available. *Environmental Dynamics*, 718 F.2d at 326.

The equitable entitlement theory upon which the district court's dismissal rested would substantially interfere with the purposes of the Bankruptcy Code and the interests of other parties involved in bankruptcy cases. This Court should correct the district court's failure to implement the applicable principles of order and fairness set forth in its controlling precedent.

CONCLUSION

For the foregoing reasons, this Court should hold that the bankruptcy court erred in rejecting the United States Trustee's objections to Gibson, Dunn's employment as counsel to the debtor-in-possession, reverse the district court's dismissal of the United States Trustee's appeal, and remand the case either for the issuance of a specified remedy, or for the lower courts' determination of the appropriate remedy.

Respectfully submitted,

DAVID W. OGDEN
Acting Assistant Attorney General

JACOB M. LEWIS
(202) 514-5090
DANIEL L. KAPLAN
(202) 514-5083
Attorneys, Appellate Staff
Civil Division, Room 9134
Department of Justice
601 D Street, N.W.
Washington, D.C. 20530-0001

OF COUNSEL:

MARTHA L. DAVIS
General Counsel

JEANNE M. CROUSE
Attorney

Executive Office for
United States Trustees

OCTOBER 14, 1999

CERTIFICATE OF COMPLIANCE WITH NINTH CIRCUIT RULE 32-1

I certify that, pursuant to Federal Rule of Appellate Procedure 32(a)(7)(C) and Ninth Circuit Rule 32-1, the attached opening brief is proportionately spaced, has a typeface of 14 points and contains 6,924 words.

____
DATE

____
DANIEL L. KAPLAN
Attorney for Appellant

STATEMENT OF RELATED CASES

Counsel for appellant hereby certify that they are unaware of any cases that qualify as "related cases" within the meaning of Ninth Circuit Rule 28-2.6.

DANIEL L. KAPLAN
Attorney for Appellant

ADDENDUM

11 U.S.C. § 327

Employment of professional persons

(a) Except as otherwise provided in this section, the trustee, with the court's approval, may employ one or more attorneys, accountants, appraisers, auctioneers, or other professional persons, that do not hold or represent an interest adverse to the estate, and that are disinterested persons, to represent or assist the trustee in carrying out the trustee's duties under this title.

(b) If the trustee is authorized to operate the business of the debtor under section 721, 1202, or 1108 of this title, and if the debtor has regularly employed attorneys, accountants, or other professional persons on salary, the trustee may retain or replace such professional persons if necessary in the operation of such business.

(c) In a case under chapter 7, 12, or 11 of this title, a person is not disqualified for employment under this section solely because of such person's employment by or representation of a creditor, unless there is objection by another creditor or the United States trustee, in which case the court shall disapprove such employment if there is an actual conflict of interest.

(d) The court may authorize the trustee to act as attorney or accountant for the estate if such authorization is in the best interest of the estate.

(e) The trustee, with the court's approval, may employ, for a specified special purpose, other than to represent the trustee in conducting the case, an attorney that has represented the debtor, if in the best interest of the estate, and if such attorney does not represent or hold any interest adverse to the debtor or to the estate with respect to the matter on which such attorney is to be employed.

(f) The trustee may not employ a person that has served as an examiner in the case.

11 U.S.C. § 101(14)

"disinterested person" means person that--

(A) is not a creditor, an equity security holder, or an insider;

(B) is not and was not an investment banker for any outstanding security of the debtor;

(C) has not been, within three years before the date of the filing of the petition, an investment banker for a security of the debtor, or an attorney for such an investment banker in connection with the offer, sale, or issuance of a security of the debtor;

(D) is not and was not, within two years before the date of the filing of the petition, a director, officer, or employee of the debtor or of an investment banker specified in subparagraph (B) or (C) of this paragraph; and

(E) does not have an interest materially adverse to the interest of the estate or of any class of creditors or equity security holders, by reason of any direct or indirect relationship to, connection with, or interest in, the debtor or an investment banker specified in subparagraph (B) or (C) of this paragraph, or for any other reason[.]

11 U.S.C. § 101(41)

"person" includes individual, partnership, and corporation, but does not include governmental unit, except that a governmental unit that—

(A) acquires an asset from a person--

(i) as a result of the operation of a loan guarantee agreement; or

(ii) as receiver or liquidating agent of a person;

(B) is a guarantor of a pension benefit payable by or on behalf of the debtor or an affiliate of the debtor; or

(C) is the legal or beneficial owner of an asset of--

(i) an employee pension benefit plan that is a governmental plan, as defined in section 414(d) of the Internal Revenue Code of 1986; or

(ii) an eligible deferred compensation plan, as defined in section 457(b) of the Internal Revenue Code of 1986; shall be considered, for purposes of section 1102 of this title, to be a person with respect to such asset or such benefit[.]

CERTIFICATE OF SERVICE

I hereby certify that on October 14, 1999, I dispatched the requisite number of copies of the foregoing Brief for the Appellant to the Clerk of this Court by First Class Mail. On the same date, and by the same manner of delivery, I served two copies of the Brief on each of the following counsel:

Jonathan M. Landers, Esq.
Desmond Cussen, Esq.
GIBSON, DUNN & CRUTCHER LLP
Telesis Tower
One Montgomery Street
San Francisco, CA 94104-4505

Thomas C. Given, Esq.
MURPHY, WEIR & BUTLER
101 California Street, 39th Floor
San Francisco, CA 94111-6822

DANIEL L. KAPLAN
Attorney for Appellant

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(IN RE S.S. RETAIL STORES CORP.)

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Daniel L. Kaplan (Civil/Appellate Staff)
Of Counsel: Jeanne M. Crouse (EOUST/OGC)
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") TOPIC

BANKRUPTCY

9. ("SU")
- SUMMARY OF KEY ISSUE(s)

&

/ Any Miscellaneous BACKGROUND

(1) Whether a law firm with an "interested" partner (who served as an officer of the debtor corporation until less than 2 weeks pre-petition) may nevertheless qualify as a "disinterested person" under 11 U.S.C. 327(a) and serve as counsel to the debtor-in-possession.
(2) Whether the district court properly dismissed the U.S. Trustee's appeal on the ground that the law firm had an equitable entitlement to retain all fees, even if it was never eligible to receive them.

/ **Background:** See prior decision: Stanley v. S.S. Retail Stores Corp., 162 F.3d 1230 (9th Cir. 1998)

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No. 99-16413

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

LINDA EKSTROM STANLEY, United States Trustee,

Appellant,

v.

S.S. RETAIL STORES CORPORATION and
OFFICIAL UNSECURED CREDITORS COMMITTEE,

Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF CALIFORNIA

REPLY BRIEF FOR THE APPELLANT

OF COUNSEL:

MARTHA L. DAVIS
General Counsel

JEANNE M. CROUSE
Attorney

Executive Office for
United States Trustees

December 16, 1999

DAVID W. OGDEN
Acting Assistant Attorney General

JACOB M. LEWIS
(202) 514-5090
DANIEL L. KAPLAN
(202) 514-5083
Attorneys, Appellate Staff
Civil Division, Room 9134
Department of Justice
601 D Street, N.W.
Washington, D.C. 20530-0001

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REPLY BRIEF FOR THE APPELLANT

In her opening brief, the United States Trustee explained that she has from the beginning objected to Gibson, Dunn's employment as general counsel in this chapter 11 case because the firm had a statutorily-impermissible connection to the debtor corporation's insiders. She also explained that, in holding that this Bankruptcy Code violation could not be remedied, the district court overlooked controlling precedent establishing that a disgorgement remedy would fall well within the bankruptcy court's remedial discretion.

S.S. Retail's response is, for the most part, not to respond. Rather than attempting to identify any flaw in the United States Trustee’s arguments, S.S. Retail simply adopts the lower courts' reasoning. Her essential points unrebutted, the United States Trustee reiterates her request that the decisions below be overturned and the Bankruptcy Code violation inherent in the firm's employment remedied.

I. GIBSON, DUNN WAS NOT A "DISINTERESTED PERSON" ELIGIBLE TO REPRESENT THE ESTATE UNDER THE BANKRUPTCY CODE.

A. S.S. Retail Ignores The "Disinterested Person" Requirement's Plain Language And Purpose.

In her opening brief, the United States Trustee showed that a properly strict application of the "disinterested person" requirement’s plain language requires that a law firm "person" subject to the "interest" of its former-officer partner must be disqualified. She also noted that this result would further the requirement's purpose, which is to ensure that counsel representing bankruptcy estates in chapter 11 cases are completely detached from the debtor corporations' insiders.

S.S. Retail does not attempt to argue that the firm's employment was consistent with a strict application of the "disinterested person" requirement's plain language. Nor does S.S. Retail's brief include any discussion of the "disinterested person" requirement's purpose, except insofar as it dismisses the relevant concerns raised by the firm's participation in the case as "gremlins and goblins." Br. Appellee 14. S.S. Retail even embraces the bankruptcy court's statement that Gibson, Dunn should be thought "disinterested" because the firm’s former-officer partner was always "on the debtor's team." Br. Appellee 37. Indeed, under S.S. Retail's understanding of the "disinterest" requirement, Gibson, Dunn would have been even better suited to represent the bankruptcy estate if *all* of its partners had recently been officers of the debtor corporation — that would create even *more* reason to believe that the firm would be "on the debtor's team." As the United States Trustee explained, this gets the matter exactly backwards, because the "disinterest" requirement exists to guarantee that counsel for the bankruptcy estate is completely *detached* from the debtor corporation's insiders. Br. Appellant 17-18.

S.S. Retail also appears to assume that Gibson, Dunn represented *the debtor* in this case, and that what is at issue is the debtor’s ability to select "its own" counsel. Br. Appellee 29. S.S. Retail thus steadfastly refuses to heed this Court’s exhortation that counsel for the estate in chapter 11 cases must "keep firmly in mind that [their] client is the *estate* and not the debtor individually." *In re Perez*, 30 F.3d 1209, 1219 (9th Cir. 1994) (emphasis added); cf. Br. Appellant 15 (citing this portion of *Perez*); see also *In re First Jersey Securities, Inc.*, 180 F.3d 504 (3d Cir. 1999) (overruling order authorizing the employment of "interested" law firm which the bankruptcy court had justified by, *inter alia*, the premise that there is "a presumption that a party should be entitled to the professionals of the party's choice" (187 B.R. 135, 145 (Bankr. D.N.J. 1995))).

B. S.S. Retail's Arguments Amount To Efforts To Rewrite The Code.

Rather than addressing the "disinterested person" requirement's purpose or attempting to show that the firm's employment did not thwart that purpose, S.S. Retail essentially urges that the requirement should be ignored, speculating that "there is no indication * * * that Congress considered the peculiar application of [the "disinterested person" requirement] to the debtor in possession structure of the Code." Br. Appellee 33 n.30. To the contrary, however, as the National Bankruptcy Review Commission ("Commission") observed in its 1997 report, "[t]he history of the bankruptcy system during the period 1890-1939, together with the legislative history of the 1978 Code, tends to show that Congress consciously implemented broader application [*sic*] of disinterestedness" that applies to both debtor-in-possession and non-debtor-in-possession cases. I Report of the National Bankruptcy Review Commission 880 (October 20, 1997) ("Commission Report") (available at www.nbrc.gov/report/).

Moreover, Congress received the specific recommendation of the Commission (which it created by statute (Pub. L. No. 103-394, tit. VI, 108 Stat. 4106, 4147-50

(1994))) that the "disinterested person" requirement should remain fully applicable in debtor-in-possession cases. In making this recommendation, the Commission noted that all of the policies supporting the strict application of this rule in non-debtor-in-possession cases also support its strict application in debtor-in-possession cases. See Commission Report at 873-77, 881. (S.S. Retail's speculation would of course be irrelevant in any event, insofar as the assertion that Congress failed to "consider" a statutory mandate's application to a particular type of situation creates no license for a court to refuse to apply the statute as written. *United States* v. *Wells*, 519 U.S. 482, 497 (1997) (factor suggesting that Congress may have "overlooked" an issue "does nothing to muddy the ostensibly unambiguous provision of the statute as enacted by Congress").)

The logic of S.S. Retail's contrary theory appears to be that, because Congress in the Bankruptcy Reform Act of 1978 permitted chapter 11 debtors to retain possession and control of their assets during bankruptcy cases, it could not have intended for the "disinterested person" requirement to deter manipulation of the reorganization process by the debtor's insiders. Br. Appellee 29. In other words, because it created a system that raised certain recognized dangers of insider manipulation, Congress must have intended to remove from the Code any protections against these dangers. This makes no sense. As the Commission aptly noted, the concerns favoring the application of the strict "disinterest" requirement are even *stronger* in debtor-in-possession cases than in non-debtor-in-possession cases. See Commission Report at 875 ("because the debtor in possession has inherent conflicts of interest and is by definition not disinterested, an even *stricter* adherence to disinterestedness may be appropriate for the debtor in possession's professionals than for those of a disinterested trustee"); *id*. at 876 ("requiring disinterestedness is probably even *more* important when the estate is being administered by a debtor in possession; arguably, the debtor in possession and any creditors' committee lack the same incentives and ability to monitor the performance of counsel that a trustee has") (emphases added).

S.S. Retail also makes much of the fact that the Code permits a debtor's prepetition counsel to continue as counsel after the debtor becomes a debtor-in-possession (11 U.S.C. § 1107(b)). Br. Appellee 29. But the plain language of the Code demonstrates that Congress drew a line between a corporation's former officers and its former counsel, and the rationale underlying this line is clear and compelling. The relationship between the non-officer attorney and the attorney's corporate client is generally conducted at "arm's-length." A corporation's officers, by contrast, are part of the corporation. The importance of this difference is well-recognized in the law of professional responsibility. See 1 GEOFFREY C. HAZARD, JR. & W. WILLIAM

HODES, THE LAW OF LAWYERING § 1.13:110, at 402 ("a lawyer who must give detached legal advice and at the same time be mindful of his or her own potential liability as a corporate office[]-holder cannot blink the possibility that the quality of the representation may suffer"). (Further, S.S. Retail's argument once again misperceives the role of courts in applying statutes. Even when its rationale is less evident, courts may not second-guess Congress's line-drawing unless a line has been placed "'very wide of any reasonable mark.'" *Schweiker* v. *Wilson*, 450 U.S. 221, 238-39 n.23 (1981) (quoting *Louisville Gas & Electric Co.* v. *Coleman*, 277 U.S. 32, 41 (1938) (Holmes, J., dissenting)).)

S.S. Retail cites four recent lower-court cases (among which is one of the very decisions being challenged here) as "overwhelming case law" (Br. Appellee 9) in its favor, and asserts that the United States Trustee has cited no authority for the proposition that "every single partner must be disinterested" in order for a law firm to qualify as a "disinterested person" (*id*. at 32) (emphasis removed). These assertions are perplexing, given the fact that the United States Trustee cited six cases in support of her position, and quoted language from each of these cases clearly setting forth this very proposition. Br. Appellant 16-17. S.S. Retail's assertion that the decisions upon which it relies did not apply a "negative pregnant" theory (Br. Appellee 32) is equally perplexing, given that its own summary of these decisions' reasoning confirms that they did. See *id*. 35 (observing that these decisions reasoned that "Congress could have imputed a person's disqualification to his/her firm if it wanted to," and citing Bankruptcy Rule 5002(a)).

S.S. Retail's persistent stress upon the fact that the debtor's creditors did not object to the firm's employment (Br. Appellee 8, 23, 25) is similarly misplaced. One of the foremost concerns underlying Congress's decision to create the United States Trustees and empower them to monitor compliance with the Bankruptcy Code was its finding that "[t]he notion of creditor control [wa]s a myth." H.R. Rep. No. 95-595, ch. 2, at 92 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6053 (footnote omitted); see also Commission Report at 876 (noting that creditors' committees lack sufficient incentive and ability to monitor counsel's performance). And S.S. Retail's assertion that the application of the "disinterested person" requirement's plain language could be unreasonably burdensome in cases in which a law firm's partner owns a single share of stock in the debtor (Br. Appellee 32) is mistaken. Congress declined to impose on equity holders the "two-years-back" requirement that it placed upon former officers. 11 U.S.C. § 101(14)(A) (compare *id*. § 101(14)(D)). Thus, the hypothetical share-owning partner need only sell her share in order to render her firm immediately eligible to undertake the representation.

In short, S.S. Retail has failed to explain why Gibson, Dunn deserved to be exempted from the Code's strict "disinterest" requirement. Because a law firm with an "interested" partner lacks the complete detachment from the debtor corporation's insiders that the Code requires, the bankruptcy court should have accepted the United States Trustee's objection to the firm's employment.

C. This Court Can And Should Address The Issue Of Whether Gibson, Dunn's Employment Violated The Bankruptcy Code.

S.S. Retail suggests that the fact that the district court declined to decide whether Gibson, Dunn's employment violated the Bankruptcy Code precludes this Court from addressing the issue. Br. Appellee 28. This suggestion is incorrect. While this Court *could* confine itself to the district court's "mootness" holding and direct the district court on remand to address the legality of the firm's employment, it is under no *obligation* to do so. To the contrary, this Court enjoys the discretion to address even issues that were never *raised* before the district court, and commonly does so when the issues involve only pure questions of law and considering them would prejudice neither party. See, *e.g.*, *United States* v. *Roberts*, 5 F.3d 365, 368 n.2 (9th Cir. 1993); see also 28 U.S.C. § 2106 (vesting courts of appeals with power to affirm, modify, vacate, set aside or reverse any judgment, decree, or order lawfully brought before them, and to remand causes with directions to enter such judgments, decrees, or orders, or to engage in such further proceedings, as are "just under the circumstances").

All of the pertinent factors strongly recommend that this Court address the propriety of Gibson, Dunn's employment in the instant appeal. This issue not only was briefed and argued before the district court below, it was also briefed and argued twice in the bankruptcy court, was briefed, argued, and decided in the bankruptcy appellate panel, and has now been briefed in this Court twice. It involves a pure question of law that this Court is "equally if not better suited than the district court" to decide, *United States* v. *Real Property Known as 22249 Dolorosa Street*, 190 F.3d 977, 981 (9th Cir. 1999), and far from prejudicing any party, deciding the issue now would spare the parties the burden of litigating a wholly unnecessary further round of appeals (for which Gibson, Dunn evidently would not be compensated (see Br. Appellee 28)). Under these circumstances, there is no compelling reason for this Court not to address the issue at this stage.

II. GIBSON, DUNN HAS NO EQUITABLE ENTITLEMENT TO RETAIN ALL OF ITS FEES.

A. There Is No Equitable Bar To A Disgorgement Remedy In This Case.

In her opening brief, the United States Trustee demonstrated that the district court erred in concluding that no remedy is available and dismissing her appeal from the bankruptcy court's final orders. This Court has noted that it "may only dismiss an appeal if it is impossible to fashion 'relief that is both effective and equitable.'" *St. Angelo v. Victoria Farms, Inc.*, 38 F.3d 1525, 1533 (9th Cir. 1994); *amended*, 46 F.3d 969 (9th Cir. 1995) (quoting *In re Spirtos*, 992 F.2d 1004, 1007 (9th Cir. 1993)). S.S. Retail has failed to show that this is the case. To the contrary, this Court's precedents establish that where, as here, the effective remedy of disgorgement may be applied against a party that has had notice that disgorgement might be ordered, and disgorgement would not impair the interests of third parties not before the Court, equity supports the bankruptcy court's discretion to order a disgorgement remedy.[1] S.S. Retail's brief fails to obscure the clear application of this controlling precedent.

S.S. Retail argues that a bankruptcy appeal becomes "equitably moot" when an appellant has not sought to stay the challenged bankruptcy court order, and the money which would form the basis for the disgorgement remedy has already been transferred. But this is precisely the theory that this Court rejected in *In re International*

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[1] The United States Trustee notes that 11 U.S.C. § 328(c) authorizes bankruptcy courts to deny compensation to "professional person[s] employed under section 327" if the persons were, at any time during their service, not "disinterested." The United States Trustee does not believe that this provision applies when a professional's employment was void *ab initio*, and thus the professional was never validly "employed under section 327." The courts of appeals have divided on this question. Compare *In re Federated Department Stores*, 44 F.3d 1310, 1320 (6th Cir. 1995) with *In re Crivello*, 134 F.3d 831, 837 (7th Cir. 1998). This Court need not decide the issue, however, because even if § 328(c) were applicable here, it clearly could not support the district court's conclusion that no remedy is available in this case.

Environmental Dynamics, Inc., 718 F.2d 322, 325-26 (9th Cir. 1983) and *Spirtos*, 992 F.2d at 1006-07. In each of these decisions, this Court held that it could fashion relief that was both effective and equitable by ordering the disgorgement of erroneously-disbursed funds. See also *In re Cascade Roads, Inc.*, 34 F.3d 756, 759-61 (9th Cir. 1994) (rejecting litigant's argument that the payment to the estate of the money sought to be recovered mooted the appeal).

S.S. Retail does not attempt to deny that the effective relief of disgorgement is likewise available here. Instead, S.S. Retail argues only that any disgorgement remedy would be impermissibly inequitable. Br. Appellee 10-28. But as in *Environmental Dynamics*, *Spirtos*, and *Cascade Roads*, Gibson, Dunn has known from the beginning that its right to collect the fees that would underlie any disgorgement remedy was under challenge. Thus, as in those cases, equity supports the availability of the remedy here. See *Environmental Dynamics*, 718 F.2d at 326; *Spirtos*, 992 F.2d at 1007; *Cascade Roads*, 34 F.3d at 761.

Indeed, S.S. Retail does not deny that the equities articulated in these precedents support the availability of a disgorgement remedy in this case. Rather, S.S. Retail seeks to distinguish these decisions, claiming that each of them dealt with situations in which there were "competing claimants" to "particular funds." Br. Appellee 21. If S.S. Retail means to refer to situations in which multiple parties compete for the assets of a limited fund, the assertion is incorrect. Only one of these cases dealt with such a situation, and in that case the Court found the existence of competing claimants relevant only to the question of whether the (private-party) appellant qualified as an "aggrieved person" under the (pre-1978) Bankruptcy Act. *Environmental Dynamics*, 718 F.2d at 326; cf. *Spirtos*, 992 F.2d at 1005-07 (Court examined whether Debtor would be required to reimburse estate for money that was placed into pension plans and then distributed); *Cascade Roads*, 34 F.3d at 758-60 (Court examined whether estate would be required to return money judgment awarded in contract action).

If S.S. Retail instead means to refer to situations in which other entities with an interest in the bankruptcy estate would receive the disgorged funds, the instant case also involves such "competing claimants." Should this Court find that Gibson, Dunn's employment contravened the Bankruptcy Code and remand the case for the provision of a remedy, the bankruptcy court presumably would reopen the case pursuant to 11 U.S.C. § 350(b), order Gibson, Dunn to disgorge funds, and distribute the disgorged funds to the unsecured creditors — who received only nineteen cents for each dollar they were owed, pursuant to the plan. Br. Appellee 3-4; see also *First Jersey*, 180 F.3d at 514 (reversing order authorizing the employment of an "interested" law firm and remanding the case to the district court with directions to remand to the

Bankruptcy Court with instructions to disqualify the "interested" law firm and "take such further action as is consistent with this opinion").

S.S. Retail's assertion that this appeal is rendered moot by a "comprehensive change of circumstances" (Br. Appellee 13) is likewise unavailing. The "comprehensive changes" to which S.S. Retail refers cannot render this appeal moot, for the simple reason that they have nothing whatever to do with the effective remedy of disgorgement. The decisions to which S.S. Retail refers deal with litigants seeking remedies that would require the Court to "unscramble the eggs" of a largely-completed reorganization. *In re Baker & Drake, Inc.*, 35 F.3d 1348, 1351 (9th Cir. 1994). When the Court can fashion effective relief by ordering a party to disgorge money, there is no need to undo "transactions that are * * * complex or difficult to unwind," *In re Lowenschuss*, 170 F.3d 923, 933 (9th Cir. 1999), and those decisions are inapplicable. *Ibid.*; accord *Baker & Drake*, 35 F.3d at 1351; *Cascade Roads*, 34 F.3d at 759-60; *Spirtos*, 992 F.2d at 1006; *Environmental Dynamics*, 718 F.2d at 326.

S.S. Retail's heavy reliance upon the Sixth Circuit's decision in *In re Federated Department Stores, Inc.*, 44 F.3d 1310 (6th Cir. 1995) (Br. Appellee 16-19) is curious, since in that case the Sixth Circuit applied the very principles set forth above to reject "mootness" arguments virtually identical to those pressed by S.S. Retail here. The Sixth Circuit was unpersuaded by the professional's argument that the United States

Trustee's failure to seek a stay of the bankruptcy proceeding, pending appeal of his challenge to the professional's employment order, required dismissal of the United States Trustee's appeal. The court observed that, pursuant to this Court's *Environmental Dynamics* decision, equity did not require dismissal of the appeal on this ground, because the professional had known "[f]rom the outset" that the United States Trustee objected to its appointment and that the challenged retention order "would be subject to reversal." *Federated Dep't Stores*, 44 F.3d at 1317 (citing *Environmental Dynamics*). The Court also rejected the professional's argument that the appeal had been mooted by the completion of the reorganization, noting that even when the completion of a reorganization has mooted "issues directly involving the reorganization of the estate," the "collateral or ancillary" issues raised by a challenge to the lawfulness of an employment order may remain alive. *Id*. at 1316 (quoting *In re Dahlquist*, 751 F.2d 295, 298 (8th Cir. 1985)). Having determined that the United States Trustee's appeal was neither constitutionally nor "equitably" moot, the Sixth Circuit proceeded to review — and to reverse — the challenged employment order. *Id*. at 1318-19.

Still more curious is S.S. Retail's refusal even to address the Supreme Court’s decision in *Woods* v. *City National Bank & Trust Company*, 312 U.S. 262 (1941), which the United States Trustee discussed at some length in her opening brief (at 25-

26). In *Woods*, the Supreme Court stated that, because "'reasonable compensation for services rendered' necessarily implies loyal and disinterested service," a fiduciary whose ability to provide such service was impaired should be denied compensation, notwithstanding his assertion that "fraud or unfairness were not shown to have resulted." *Id*. at 268. The *Woods* decision has been widely cited for its entire 58-year history, and is recognized as "[t]he seminal conflict of interest case" in the bankruptcy context. *In re Florida Peach Corp.*, 110 B.R. 589, 592 (Bankr. M.D. Fla. 1990); see also *Matter of York Int'l Bldg., Inc.*, 527 F.2d 1061, 1075 (9th Cir. 1975) ("In *Woods*, the Supreme Court said that a fiduciary who represents several masters may not perfect a claim for compensation by insisting that his primary loyalty was not weakened by the pull of his secondary one"). Significantly, the Commission relied upon *Woods* in disapproving proposals to replace the Code's strict "disinterestedness" requirement with a "less rigorous showing of materially adverse conflict," noting that conflicts "can cripple public confidence in the bankruptcy system even if their magnitude cannot be quantified." Commission Report at 876 (citing *Woods*).

The governing principles set forth in this seminal decision foreclose S.S. Retail’s persistent argument (Br. Appellee 6, 8, 9, 14, 21, 35) that no disgorgement remedy may be provided unless the United States Trustee can prove that Gibson, Dunn’s "interest" gave rise to specific, identifiable shortcomings in its representation.

By its very nature, an attorney's "interest" reduces the value of the attorney's services, *In re Coastal Equities, Inc.*, 39 B.R. 304, 312 (Bankr. S.D. Cal. 1984), and thus the bankruptcy court would be well within its discretion in retroactively reducing the firm's compensation in light of its "interest," even if it could not conclusively determine that the firm's "interest" actually impaired its representation or harmed the estate.[2]

B. Even If This Court Were To Adopt S.S. Retail's Generalized Equitable Analysis, Affirmance Of The District Court's Dismissal Would Not Be Proper.

Even if this Court were to adopt S.S. Retail's suggested broad equitable analysis of the remedial issue, this analysis cannot support the district court's conclusion that equity bars the provision of *any* remedy in this case.

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[2] In any event, neither the United States Trustee nor this Court would be in any position to make such a determination at this stage. This would require a factual inquiry necessitating intimate knowledge of the details of the case, and would therefore be a question that would have to be addressed in the first instance by the bankruptcy court. (Because it concluded that Gibson, Dunn was "disinterested," the bankruptcy court did not reach or consider the question.) Thus, the bankruptcy appellate panel in the *CIC Investment* decision (upon which S.S. Retail relies (Br. Appellee 15, 16)) remanded the case to the bankruptcy court for its determination of "whether [the professional person's] failure to be disinterested negatively interfered with its efforts" in the case. *In re CIC Investment Corp.*, 192 B.R. 549, 554 (B.A.P. 9th Cir. 1996). S.S. Retail's attempt to distinguish this aspect of *CIC Investment* (Br. Appellee 16 n.22) is unavailing. The burden of proof in regard to a professional's compensation rests upon the professional, and not (as S.S. Retail appears to assume) on the United States Trustee. *Zolfo, Cooper & Co.* v. *Sunbeam-Oster Co., Inc.*, 50 F.3d 253, 261 (3d Cir. 1995); *In re Vann*, 136 B.R. 863, 871 (D. Colo. 1992), *affirmed*, 986 F.2d 1431 (10th Cir. 1993) (Table). (Indeed, the bankruptcy court would have the duty of determining whether this burden has been carried even if the United States Trustee had never objected to the firm's employment. *Zolfo*, 50 F.3d at 262.) Moreover, this matter would not necessarily have to be resolved on the basis of the current record, since the bankruptcy court on remand could well decide that its examination of the role the firm's "interest" may have played in the case required further record development.

Although portions of S.S. Retail's brief appear to take the position that there are *no* relevant concerns weighing in favor of the relief sought by the United States Trustee, S.S. Retail does acknowledge that the "systemic harms" the United States Trustee described in her brief constitute relevant "equities." Br. Appellee at 13 n.21. Inexplicably, however, S.S. Retail asserts that "[i]t is not suggested that these equities apply here." *Ibid*. These equities self-evidently do apply here, and if they are to be accorded even minimal weight, the district court's conclusion that equity bars the provision of *any* remedy cannot stand.

A broad systemic harm that would result from an affirmance of the district court's dismissal would be the creation of a "catch-22" system of review, whereby it will generally be impossible for a United States Trustee to obtain this Court's review of a bankruptcy court's unlawful employment order. See Br. Appellant 29-30. Because this Court has held that an initial employment order is not "final" and appealable, *In re S.S. Retail Stores Corp.*, 162 F.3d 1230 (9th Cir. 1998), a United States Trustee must wait for the final orders in a chapter 11 case before appealing the denial of her objection to a professional's employment. An affirmance of the district court's "mootness" holding would turn this Court's finality doctrine into a "catch-22" trap, whereby pre-final-order appeals are dismissed as premature, and post-final-order appeals are dismissed as "equitably moot." The net result would be that the power to object to an unlawful employment order, which Congress expressly conferred upon the United States Trustees, 28 U.S.C. § 586(a)(3)(H), would be partially nullified. Such a review framework has no basis in this Court's precedents, and would severely undermine the orderliness and fairness of the bankruptcy review process.

Finally, it is important to reiterate that the district court's dismissal cannot stand unless S.S. Retail establishes that the firm has an equitable entitlement to retain *every penny* of its fees — *i.e.*, that an order requiring the disgorgement of *any* sum, however small, would be outside the boundaries of the bankruptcy court's broad remedial discretion. Given the extreme nature of this proposition, it is notable that S.S. Retail makes so serious effort to defend it. Instead, S.S. Retail offers only an unelaborated assertion that "any disgorgement remedy would be inequitable." Br. Appellee 24. Yet S.S. Retail cites no case in which any court has held that equity entitled a professional whose employment contravened the Bankruptcy Code from the beginning to retain *all* of its fees.

In summary, S.S. Retail's proffered equitable analysis contradicts controlling precedent, and the equitable entitlement to retain all of its fees to which Gibson, Dunn lays claim does not exist. The governing law establishes that this Court should address the merits of the United States Trustee's objection to the firm's employment, and remand the case to the bankruptcy court for the provision of an appropriate remedy.

CONCLUSION

For the foregoing reasons, and for the reasons set forth in the United States Trustee's opening brief, this Court should hold that the bankruptcy court erred in rejecting the United States Trustee's objections to Gibson, Dunn's employment as counsel to the debtor-in-possession, reverse the district court's dismissal of the United States Trustee's appeal, and remand the case either for the issuance of a specified remedy, or for the lower courts' determination of the appropriate remedy.

Respectfully submitted,

DAVID W. OGDEN
Acting Assistant Attorney General

JACOB M. LEWIS
(202) 514-5090
DANIEL L. KAPLAN
(202) 514-5083
Attorneys, Appellate Staff
Civil Division, Room 9134
Department of Justice
601 D Street, N.W.
Washington, D.C. 20530-0001

OF COUNSEL:

MARTHA L. DAVIS
General Counsel

JEANNE M. CROUSE
Attorney

Executive Office for
United States Trustees

DECEMBER 1999

CERTIFICATE OF COMPLIANCE WITH NINTH CIRCUIT RULE 32-1

I certify that, pursuant to Federal Rule of Appellate Procedure 32(a)(7)(C) and Ninth Circuit Rule 32-1, the foregoing Reply Brief for the Appellant is proportionately spaced, has a typeface of 14 points, and contains 4,737 words.

____
DATE

____
DANIEL L. KAPLAN
Attorney for Appellant

CERTIFICATE OF SERVICE

I hereby certify that on December 16, 1999, I dispatched the requisite number of copies of the foregoing Reply Brief for the Appellant to the Clerk of this Court by First Class Mail. On the same date, and by the same manner of delivery, I served two copies of the brief on each of the following counsel:

Jonathan M. Landers, Esq.
Desmond Cussen, Esq.
GIBSON, DUNN & CRUTCHER LLP
Telesis Tower
One Montgomery Street
San Francisco, CA 94104-4505

Thomas C. Given, Esq.
MURPHY, WEIR & BUTLER
101 California Street, 39th Floor
San Francisco, CA 94111-6822

DANIEL L. KAPLAN
Attorney for Appellant

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In re Nicholas Stamat and Penny Stamat (Nicholas Stamat and Penny Stamat v. William T. Neary)

2. ("CO") ***CURRENT*** COURT
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N. D. Ill.

3. ("CCN") ***CURRENT*** CASE NO.
No.: 08–C-06543

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M. Gretchen Silver, Saleela Khanum Salahuddin, P. Matthew Sutko, William T. Neary
(UST/OGC: 202-307-1399/FAX-2397)

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BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s)
&
√ Any Miscellaneous ***BACKGROUND***

• Whether the bankruptcy court abused its discretion by denying the debtors' discharge under 11 U.S.C. §§ 727(a)(2), (a)(4), and (a)(5), which allow courts to deny granting a discharge where there is evidence that required bankruptcy documents are not truthful.

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IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

WILLIAM T. NEARY, **UNITED STATES TRUSTEE,**	)	Case No. 08 C 06543
Plaintiff-Appellee.	)	
	)	Honorable Joan B. Gottschall
v.	)	
NICHOLAS STAMAT ***and*** **PENNY STAMAT,**	)	
Defendants-Appellants	)	Appeal from: Adv.Pro.No. 07 A 01278 Honorable Jack B. Schmetterer, Presiding

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BRIEF FOR THE APPELLEE UNITED STATES TRUSTEE

WILLIAM T. NEARY,
UNITED STATES TRUSTEE, REGION 11

M. Gretchen Silver
Office of the United States Trustee
219 South Dearborn Room 873
Chicago, Illinois 60604
Telephone (312) 886-5785
Facsimile (312) 886-5794

<u>Of Counsel</u>

Ramona D. Elliott
General Counsel
P. Matthew Sutko
Associate General Counsel
Saleela Khanum Salahuddin
Trial Attorney
United States Department of Justice
Executive Office for United States Trustees
United States Department of Justice
20 Massachusetts, Ave. NW, Suite 8000
Washington, D.C. 20530
(202) 307-1399

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I. JURISDICTION

The United States Trustee, as appellee, adopts the jurisdictional statement of the appellants, Nicholas Stamat and Penny Stamat ("the Debtors"). This Court has appellate jurisdiction under 28 U.S.C. § 158(a)(1) and Fed. R. Bankr. P. 8001(a) over the bankruptcy court's final order entered in favor of the United States Trustee on September 24, 2008.

II. ISSUE PRESENTED FOR REVIEW[1]

Whether the bankruptcy court abused its discretion by denying the Debtors' discharge under 11 U.S.C. §§ 727(a)(2), (a)(4), and (a)(5), which allow courts to deny granting a discharge where there is evidence that required bankruptcy documents are not truthful.

III. STATEMENT OF THE CASE

On July 26, 2007, the Debtors filed a voluntary bankruptcy petition under chapter 7 of the Bankruptcy Code, 11 U.S.C. § 701 *et seq*. On December 21, 2007, the United States Trustee[2] filed

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[1] The Debtors raised eight issues in their notice of appeal but their brief raises sixteen issues. The Debtors do not individually address each issue and it is unclear whether the issues raise challenges to finding of fact or mixed findings of fact and conclusions of law. As noted in the brief, *supra*, the standard of review varies.

[2] United States Trustees "serve as bankruptcy watch-dogs to prevent fraud, dishonesty, and overreaching in the bankruptcy arena." H.R. Rep. No. 95-595, at 88 (1977). The United States Trustee Program therefore acts in the public interest to promote and preserve the efficiency and integrity of the bankruptcy system. Congress has provided that "[t]he United States trustee may raise and may appear and be heard on any issue in any case or proceeding . . . ." 11 U.S.C. § 307. *See, e.g.*,*Thompson v. Greenwood*, 507 F.3d 416, n.3 (6th Cir. 2007) (stating "[t]he United States Trustee is an interested party by statute"); *In re South Beach Sec., Inc.*, 376 B.R. 881, 892-893 (Bankr.N.D. Ill. 2007) (stating "the U.S. Trustee is the watchdog that guards the public interest . . . [and] protects the integrity of the system.").

a complaint objecting to the discharge of debts under 11 U.S.C. §§ 727(a)(2), (4) and (5). On September 24, 2008, the bankruptcy court agreed with the United States Trustee and entered a final judgment order denying the Debtors' discharges. The Debtors filed a timely notice of appeal on October 4, 2008.

IV. STANDARD OF REVIEW

An appellate court reviews a bankruptcy court's legal interpretations and mixed questions of law and fact *de novo*. *Mungo v. Taylor*, 355 F.3d 969, 974 (7th Cir. 2004). An appellate court reviews findings of fact entered by the bankruptcy court for clear error. *In re Scott*, 172 F.3d 959, 966 (7th Cir. 1999).

In reviewing a bankruptcy court's decision to deny discharge, neither an appellate court nor a district court will overturn the decision unless it is clearly erroneous. *In re D'Agnese,* 86 F.3d 732, 734 (7th Cir. 1996) (*citing In re Martin*, 698 F.2d 883, 886 (7th Cir. 1983)); *see also* Fed. R. Bankr. P. 8013 and Fed. R. Civ. P. 52(a).

A finding is clearly erroneous when the appellate court is left with the definite and firm conviction that the lower court has made a mistake. *In re Thirtyacre*, 36 F.3d 697, 700 (7th Cir. 1994) (*citing Anderson v. Bessemer City*, 470 U.S. 564, 573 (1985)).

Since proof of conduct satisfying any one of section 727(a)'s sub-sections is enough to deny discharge, (*In re Krehl*, 86 F.3d 737, 744 (7th Cir. 1996) (*citing Farouki v. Emirates Bank Int'l, Ltd.*, 14 F.3d 244, 250 (4th Cir. 1994)), appellate courts grant great deference to bankruptcy courts under the clearly erroneous standard of review. *Green Bay Packaging, Inc. v. Oscarson*, 2007 U.S. Dist. LEXIS 84057 (N. D. Ill. 2007) (*citing In re Yonikus*, 974 F.2d 901, 903 (7th Cir. 1992)).

V. STATEMENT OF FACTS

The Debtors are Nicholas Stamat, a medical doctor with his own medical practice, and his wife, Penny Stamat, who holds a bachelor's degree in math and accounting, and has worked as a business controller. (Adv. Dkt. 36, ¶¶ 3, 15, 16)[3] Before filing for bankruptcy, Mrs. Stamat formed a medical billing company, On Time Billing, LLC, and managed the couple's business and personal finances. (Id. at ¶ 19 and Tr. P. 22 lines 5-11). The Debtors filed a voluntary chapter 7 bankruptcy petition on July 26, 2007. (Plf. Ex. 1)

Debtors filed the required official bankruptcy Schedules and Statement of Financial Affairs ("SOFA"), which they signed under penalty of perjury.[4] The Debtors' original schedules disclosed the following:

- Schedule A disclosed two homes valued at $1,475,000;
- Schedule B identified personal assets, excluding real property, worth $16,420.67;[5] and,
- Schedule D identified secured liabilities of $1,227,491.38, most of which is secured by Debtors' two houses; and Schedule F identified unsecured liabilities of $364,114.87. *(Id.)*

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[3] Cites to Dkt. refer to the docket number in case 07 B 13379; Adv. Dkt. refers to the docket number in Adversary 07 A 1278; Plf. Ex. refers to Plaintiff's Exhibits; Def. Ex. refers to Defendants' Exhibits and Tr. refers to the Trial Transcript.

[4] The Schedules and SOFA are official forms that debtors must complete. *See* Fed. R. Bankr. P. Official Form 6 (Schedules) and Form 7 (Statement of Financial Affairs). The Schedules require disclosure of a debtor's assets and liabilities as of the date of the bankruptcy filing. The SOFA requires disclosure of financial information over a longer time period before bankruptcy.

[5] Debtors valued their interests in the medical practice and On Time Billing, LLC at zero.

At the Debtors' first meeting of creditors (the section 341 meeting) on November 14, 2007, the chapter 7 trustee and the Debtors' creditors questioned the Debtors about the completeness and accuracy of their Schedules and SOFA. (Plf. Ex. 11)

At the meeting, the creditors revealed information that the Debtors should have disclosed, but had not: (1) transfers of property that occurred within two years of filing; (2) numerous business interests that the Debtors owned within 6 years of filing; and, (3) Dr. Stamat's position as a part-time police officer and two revolvers that he owned. (*Id.*)

In early December, 2007, the Debtors amended their Schedule B personal property disclosure to include the revolvers. (Plf. Ex. 2, Dkt. 52) The Debtors did not make any other disclosures despite their testimony at the section 341 meeting that acknowledged other omissions.

On December 21, 2007, the United States Trustee filed his complaint to deny discharge under Bankruptcy Code §§ 727(a)(2), (4) and (5). (Adv. Dkt. 1)

On April 16, 2008, the United States Trustee conducted a sworn oral examination of both Debtors. (Plf. Ex. 12) The United States Trustee questioned the Debtors about omissions from the Schedules and SOFA discovered at the section 341 meeting and during the United States Trustee's review of the Debtors' subpoenaed documents.

Included in the documents produced by the Debtors and introduced as evidence at trial were:

- tax returns for the Debtors and their businesses, which revealed that, in 2006, Dr. Stamat's income from his medical practice was $265,012; (Def. Ex. 16-20)
- a November 2005 closing statement from a refinancing of the Debtors' Michigan home and an October 2006 closing statement from a later refinancing for which the Debtors received a total of more than $90,000; (Plf. Ex. 10)
- a cancelled check in the amount of $10,000 the Debtors had written to settle litigation; (Plf. Ex. 9)

- acknowledgment of prior ownership of business interests; (Plf. Ex. 5) and,
- bank statements and copies of cancelled checks for the Debtors' personal and business accounts. (Plf. Ex. 7-8; Def. Ex. 1-12)

During the section 341 meeting (Plf. Ex. 11), the U.S. Trustee examination (Plf. Ex. 12) and at trial, the Debtors acknowledged that they had failed to disclose on their Schedules and SOFA: (1) their business income; (2) the refinancings of their Michigan home; (3) the settlement payment they had paid; and, (4) their prior ownership of numerous business interests. (Adv. Dkt. 36, Finding ¶¶ 11, 32, 36, and 38)

On May 8, 2008, the last day for filing pre-trial documents, the Debtors filed an amended Schedule I, adding Dr. Stamat's additional income from working as a police officer and an amended SOFA. (Dkt. 60, 61) The Debtors amended their SOFA to disclose their two home refinances, and their $10,000 settlement payment. The Debtors also amended their SOFA to reflect their ownership in their business interests, including interest in Stamat Pediatrics, LLC; On Time Billing, LLC; Meyer Medical Physicians Group; 4425 West 63rd Medical Center; and, Hoffman/Elk Grove Physicians Group.[6]

At trial, the Debtors conceded that their amended disclosures should have been previously disclosed. (Adv. Dkt. 36, Finding ¶¶ 31-41)

Despite the last minute amendments, the Debtors still failed to disclose other omissions

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[6] Each of the disclosed businesses are related to Dr. Stamat's practice: Stamat Pediatrics LLC and On-Time Billing LLC are 100 % debtor-owned; Meyer Medical was a medical partnership of which Dr. Stamat was a partner with approximately six other individuals; 4425 W. 63rd was an entity that owned the building in which Meyer Medical operated; and Hoffman/ElkGrove was another pediatric medical practice, now no longer operational, in which Dr. Stamat was a partner.

identified during the section 341 meeting and the U.S. Trustee examination. For example, the Debtors did not disclose: (1) their income from the medical practice; (2) their ownership in four other business interests, which included two limited partnerships and two stock positions; or, (3) their counterclaims against a bank. (Adv. Dkt. 36, Concl. ¶13, 14, and 25)

At trial, the Debtors did not provide the bankruptcy court with factual or legal support for their non-disclosures. With respect to the undisclosed income, the Debtors argued that they did not have to disclose the medical practice's gross income because the medical practice is an LLC and has its own tax identification number. (Tr. p. 136, line 9 - p. 138, line 6) Mrs. Stamat could not explain how she determined the disclosed income on either the original SOFA ($53,309) (Tr. p. 35 line 22 - p. 36, line 10) or the amended SOFA ($53,309 + $5330) (Tr. p. 41, line 1; p. 42 line 6). The Debtors could not tie the disclosed amount to any particular line from the LLCs' tax returns, nor could the Debtors explain where the disclosed income figure came from, other than basing it on an estimate of the Debtors' monetary withdrawals from the LLCs. (Tr. p. 81, line 23 - p. 83, line 6.)

The Debtors originally failed to disclose any business interests, despite the instructions given on the SOFA form to disclose business interests owned in the six years prior to filing the bankruptcy petition. (Pl. Ex. 1)

The Debtors acknowledged that they had ownership interests in entities that should have been initially disclosed on their Schedules and SOFA. (Tr. p. 65, lines 17-22) At trial, Mrs. Stamat testified that she did not know why she did not disclose business interests in the medical practice and the billing company. (Tr. p. 105, lines 6-18) Mrs. Stamat also testified that, during the six years before filing her bankruptcy petition, the Debtors owned several different partnership and limited partnership interests,[7] including a membership interest in an LLC, a less than 5% interest in a corporation, and an unknown position in another entity, Hoffman/ElkGrove Physicians Group, Ltd. (Tr. p. 62, line 1 - p. 64, line 15)

The Debtors argued that the United States Trustee failed to prove that the Debtors had a counterclaim that should have been disclosed. Although no documents from the litigation were introduced into evidence at trial, Mrs. Stamat acknowledged that the Debtors have been suing Standard Bank since 2001 and that the Debtors likely possessed information about the lawsuit. (Tr. p. 69, line 25 - p. 71, line 3)

The Debtors did not explain the loss of their assets and inability to repay their debts, especially with respect to their $90,000 home refinancing proceeds, which they received within two years of filing their bankruptcy petition. Mrs. Stamat testified that she deposited the $90,000 into her and Dr. Stamat's personal bank account and they used the money for living expenses and the medical practice. (Tr. p. 73, line 11 - p. 74, line 18) Mrs. Stamat, who is the bookkeeper for the household and the medical practice, did not specifically detail how she and Dr. Stamat used the money, nor did she explain how she accounted for the proceeds between the practice and the individuals.

A review of the bank statements revealed numerous checks made payable to cash with no indication on the face of the check regarding how the $90,000 was used. (Def. Ex. 1-12) Although the Debtors testified that they produced the checking account information as their explanation of loss, the bankruptcy court found that their records were "disjointed and fragmented." (Adv. Dkt. 36,

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[7] The Debtors also owned interests in 4425 W. 63rd Medical Center; Trailhead Land Investment Limited Partnership; Eagle Crest Golf Club; and Windy City Investors, LLC.

Finding 56)

On September 24, 2008, the bankruptcy court issued its order denying the Debtors' discharge. The bankruptcy court concluded that the Debtors' inability to explain the basis of their non-disclosures exhibited a reckless disregard for the truth in completing the SOFA. (Adv. Dkt. 36, Concl. ¶¶ 12-14) With respect to the non-disclosures, the bankruptcy court concluded that the Debtors exhibited a reckless disregard for the truth, especially in connection with their Schedules and SOFA and denied their discharge under section 727(a)(2). (*Id.*) The bankruptcy court found that the Debtors signed their Schedules and SOFA under penalty of perjury and that they knew or should have known that they were inaccurate and incomplete (*Id.*, Concl. ¶ 25(a)) and that the cumulative effect of their misrepresentations and omissions clearly establish the Debtors' pattern of reckless indifference to the truth. (*Id.*) Therefore, the bankruptcy court concluded that the Debtors' discharge should be denied under section 727(a)(4). Finally, the bankruptcy court found that the Debtors failed to meet their burden to offer a satisfactory explanation for the unavailability of the substantial and identifiable assets. (*Id.*, Concl. ¶ 36) The bankruptcy court concluded that the Debtors explanation was vague, indefinite and uncorroborated and required the court, creditors and the U.S. Trustee to speculate as to what actually happened to the Debtor's assets. (*Id.*) Therefore, the bankruptcy court concluded that the Debtors' discharge should be denied under section 727(a)(5).

Pursuant to 28 U.S.C. § 158(a), the Debtors timely filed a notice of appeal to this Court on October 4, 2008.

VI. SUMMARY OF THE ARGUMENT

The bankruptcy court did not abuse its discretion in denying the Debtors' discharge. The testimony and evidence show that the Debtors did not make full disclosures on their Schedules and SOFA and support the bankruptcy court's denial of the Debtors' discharge under sections 727(a)(2), (4) and (5). The Debtors do not identify any of the bankruptcy court's findings of fact as being in error. Rather, they merely identify findings of fact with which they are displeased.

VII. ARGUMENT

A. Discharge Standards

When objecting to discharge, the United States Trustee must establish each element of an objection by a preponderance of the evidence. *In re Scott*, 172 F.3d 959, 966-67 (7th Cir. 1999). Once the United States Trustee establishes each element, the burden of production shifts to the debtors to provide a "credible explanation" of their actions. *In re Costello*, 299 B.R. 882, 894 (Bankr. N.D. Ill. 2003). Discharge in bankruptcy is limited to the "honest but unfortunate" debtors. *Scott*, 172 F.3d at 966. If a debtor violates any provision of section 727, this completely bars a bankruptcy court from entering a discharge. *Costello*, 299 B.R. at 894. Here, the bankruptcy court found that the Debtors violated three subsections of 727. This Court can affirm on any of those three grounds.

B. 11 U.S.C. § 727(a)(2)

1.

Section 727(a)(2) denies a discharge of debts to a debtor who, with intent to delay, hinder or defraud creditors transfers or conceals property of the bankruptcy estate within one year of filing the bankruptcy petition or anytime post-petition. *See* 11 U.S.C.§ 727(a)(2). Section 727(a)(2) requires a denial of discharge where a court finds (1) a transfer or concealment of property of the estate and (2) a subjective intent to hinder, delay or defraud creditors, (3) within the year before filing or post-petition. *Id*. *See also In re Self*, 325 B.R. 224, 237 (Bankr. N.D. Ill. 2005). Concealment includes "failing or refusing to divulge information to which creditors were entitled." *In re Holstein*, 299 B.R 211, 229 (Bankr.N.D. Ill.2003) (citations omitted). Transfer or concealment may occur even if creditors are not harmed by it. *In re Costello*, 299 B.R. at 894.

Intent may be proved by circumstantial evidence or inferences from a debtor's conduct. *Id* at 895. Where a debtor does not care about the truth or falsity of a statement, this satisfies the intent requirement of section 727(a)(2). *In re Chavin*, 150 F. 3d 726, 728 (7th Cir. 1998).

2.

The bankruptcy court found that the Debtors concealed assets by failing to disclose required information to which creditors were entitled. (Adv. Dkt. 36, Concl. ¶¶ 13-14) The bankruptcy court relied on the evidence and testimony to conclude that the Debtors failed to disclose personal property, personal business income, business interests, two home refinances, and ongoing litigation against a bank. (*Id.*) The bankruptcy court found that the Debtors were obligated to disclose information requested in the Schedules and SOFA, and the Debtors did not do so. (*Id.*) The bankruptcy court also found that the Debtors attempted to rectify their omissions by filing last minute amendments before trial, but even those last minute amendments were incomplete. (*Id.*)

Based on its findings, the bankruptcy court did not commit clear error when it concluded that the Debtors intentionally concealed property of the estate through their failure to make required disclosures and denied discharge under section 727(a)(2). (*Id.*, Concl. ¶ 15)

C. 11 U.S.C. § 727(a)(4)

1.

Section 727(a)(4) requires denial of a discharge if the debtor knowingly and fraudulently, in connection with the filing of a bankruptcy petition, makes a false oath or account, among other actions. The party objecting to discharge "has the burden of proof to establish five elements: (1) the debtor made a statement under oath; (2) the statement was false; (3) the debtor knew the statement was false; (4) the debtor made the statement with intent to defraud; and (5) the statement related to the bankruptcy case in a material way." *In re Costello*, 299 B.R. at 899 (*citing In re Bailey*, 145 B.R 919, 926). Although the burden of proof rests on the plaintiff at all times, the debtor cannot prevail if he is unable to offer credible evidence after the plaintiff has established a *prima facie* case. *Id.* (citing *In re Sapru*, 127 B.R. 306, 314 (Bankr. E.D.N.Y. 1991)).

The purpose of section 727(a)(4) is to "enforce the debtor's duty of disclosure and to ensure that the debtors provide reliable information to those who have an interest in the administration of the estate." *In re Broholm*, 310 B.R. 864, 879 (Bankr.N.D.Ill. 2004) (*citing In re Bostrom*, 286 B.R. 352, 359 (Bankr. N.D. Ill. 2002)). For purposes of section 727(a)(4), a debtor's bankruptcy petition and schedules, statement of financial affairs, statements made at a section 341 meeting and testimony at a Rule 2004 examination all constitute statements that are made under oath. *Id.* Filing schedules with material omissions or representations with an intent to mislead creditors as to the debtor's financial condition constitutes a false oath under section 727(a)(4). *Id.*

A debtor must disclose all ownership interests he holds in property. *In re Costello*, 299 B.R. at 899 ("It is not the debtor's responsibility to decide which assets are to be disclosed to creditors; rather, his job is simply to address each question and answer it accurately and completely.")

(citations omitted). "Complete financial disclosure is 'a condition precedent to the privilege of discharge.'" *In re Olbur*, 314 B.R. 732, 745 (Bankr. N.D. Ill. 2004) (*citing Glucoma Am., Inc. v. Ardisson (In re Ardisson)*, 272 B.R. 346, 359 (Bankr. N.D. Ill. 2001)).

It is not enough to allow a debtor to file amended schedules and SOFA once caught in a pattern of non-disclosure. "Allowing a debtor to submit false schedules and then, on discovery, avoid the negative consequences of his dishonesty by amending those schedules is contrary to the spirit of the law which aims to relieve honest debtors only . . . ." *In re Costello*, 299 B.R. at 899-900 (citations omitted).

Fraudulent intent must be inferred from circumstantial evidence or by a debtor's conduct. *In re Costello*, 299 B.R. at 900 (*citing In re Bailey*, 145 B.R. at 928). Moreover, if a debtor's schedules and statements indicate that the debtor is recklessly indifferent to the truth, an objecting creditor or other party does not have to offer any additional evidence of fraud. *Id*. The cumulative effect of a number of false oaths by a debtor establishes a pattern of reckless and cavalier disregard for the truth by the debtor. *Id*. (*citing In re Calisoff*, 92 B.R. 346, 355 (Bankr. N.D. Ill. 1988)). "[T]here comes a point when the aggregate errors and omissions cross the line past which a debtor's discharge should be denied." *In re Costello*, 299 B.R. at 899 (*citing In re Bostrom*, 286 B.R. 352, 360-61 (Bankr. N.D. Ill. 2002)).

A party objecting to discharge must show that the false statements made by the debtor relate materially to the bankruptcy case. For purposes of section 727(a)(4), a statement is material if it relates to the debtor's estate, involves the discovery of assets, or concerns the disposition of the debtor's property or his entitlement to discharge. *Id*. (citations omitted).

2.

The bankruptcy court ruled that the Debtors knowingly did not include material disclosures in their Schedules and SOFA, which they signed under penalty of perjury. (Adv. Dkt. 36, Concl. ¶ 25) The bankruptcy court's ruling was not clearly erroneous. It was supported by substantial evidence. (*Id.*) The Debtor's omissions directly relate to the Debtors' estate, and their material non-disclosures included undisclosed assets and the disposition of property, such as the disappearance of equity from their second home during the two years before the bankruptcy. (*Id.*) The Debtors' misrepresentations and omissions were material to their bankruptcy petition and establish the Debtors' reckless indifference to the truth.

The Debtors' subsequent amendments to their Schedules and SOFA, which only partially corrected previous omissions, do not erase or excuse the falsity of their prior oaths. *See, e.g.*, *Stathopoulos v. Bostrom*, 2003 U.S. Dist. LEXIS 2470 (N.D. Ill. 2003) (stating "[i]f debtors could omit assets at will, with the only penalty that they had to file an amended claim once caught, cheating would be altogether too attractive") (*citing Payne v. Woods*, 775 F.2d 202, 205 (7th Cir. 1985); *In re Costello*, 299 B.R. at 899-900 ("[A] debtor cannot excise a false oath by making subsequent corrections to his bankruptcy petition . . . .") (citations omitted).

The bankruptcy court did not commit clear error when it denied the Debtors' discharge under section 727(a)(4).

D. <u>11 U.S.C. § 727(a)(5)</u>

1.

Section 727(a)(5) denies a debtor a discharge if a debtor does not "satisfactorily" explain any loss of assets or deficiency of assets to meet the debtor's liabilities. *See* 11 U.S.C. § 727(a)(5).

Section 727(a)(5) is one of several Bankruptcy Code provisions meant to "relieve [ ] creditors and courts of the full burden of reconstructing the debtor's financial history and condition, placing it instead upon the debtor." *In re Olbur*, 314 B.R. at 740 (Bankr. N.D. Ill. 2004) (*quoting In re Hermanson*, 273 B.R. 538, 545 (Bankr. N.D. Ill. 2002)). Under section 727(a)(5), the bankruptcy court has "broad power to decline to grant a discharge . . . where the debtor does not adequately explain a shortage, loss, or disappearance of assets." *Id.* (*quoting In re D'Agnese*, 86 F.3d 732, 734 (7th Cir. 1996).

To make the case for why a debtor should be denied discharge under section 727(a)(5), the moving party bears the burden of showing that the debtor "at one time owned substantial and identifiable assets that are no longer available to his creditors." *In re Olbur*, 314 B.R. at 740 (*citing In re Bostrom*, 286 B.R. at 359 (Bankr. N.D. Ill. 2002) and *In re Hermanson*, 273 B.R. at 545). Once this showing is made, the burden falls on the debtor to offer a "satisfactory explanation" for the unavailability of those assets. *Id.* A court exercises its discretion to determine whether an explanation is satisfactory. *In re Olbur*, 314 B.R. at 741 (*citing In re Bostrom*, 286 B.R. at 364). A court focuses on "the completeness and truth of the debtor's explanation." *In re Costello*, 299 B.R. at 901.

A debtor's explanation must meet two criteria to be deemed "satisfactory." *In re Mantra*, 314 B.R. 723, 730 (Bankr. N.D. Ill. 2004) (*citing In re Bryson*, 187 B.R. 939, 955 (Bankr. N.D. Ill. 1995)). First, the debtor's explanation must be supported by documentation. *In re Costello*, 299 B.R. at 901. Second, the supporting documentation must be sufficient to "eliminate the need for the Court to speculate as to what happened to all the assets." *Id.* (*citing In re Bostrom*, 286 B.R. at 364-65); *see also In re Hansen*, 325 B.R. at 763 (noting the intertwined relationship between the documentation required by section 727(a)(3) and the adequacy of the explanation under section 727(a)(5)). The debtor must explain in good faith "what really happened to the assets in question." *In re Olbur*, 314 B.R. at 740 (*citing In re Bailey*, 145 B.R. at 925). The debtor's explanation must amount to more than a "vague, indefinite, and uncorroborated hodgepodge of financial transactions." *In re Olbur*, 314 B.R. at 741 (*citing In re Costello*, 299 B.R. 882, 901 (Bankr. N.D. Ill. 2003)).

A debtor "cannot abuse the bankruptcy process by obfuscating the true nature of his affairs and then refusing to provide a credible explanation." *In re Mantra*, 314 B.R. at 730 (*citing In re Johnson*, 98 B.R. 359, 366 (Bankr.N.D.Ill. 1988). A "satisfactory" explanation about an asset's disappearance depends on the subjective nature or honesty of the debtor's explanation and the objective adequacy of the explanation. *In re Mantra*, 314 B.R. at 730 (*citing In re D'Agnese*, 86 F.3d at 734-35). A debtor's failure to satisfactorily justify a substantial loss of assets, however, does not have to be the product of fraudulent intent. *In re Mantra*, 314 B.R. at 730 (*citing In re Gannon*, 173 B.R. 313, 317 (Bankr. S.D.N.Y. 1994)).

2.

The bankruptcy court did not commit clear error by finding that the Debtors at one time owned substantial and identifiable assets that are no longer available to their creditors. (Adv. Dkt. 36, Concl. ¶¶ 35-36) The Schedules state, under penalty of perjury, that the Debtors have only $16,620.67 in personal property and that their homes are subject to mortgages. (*Id.*) However, the section 341(a) meeting and review of the Debtors' subpoenaed documents revealed that, prior to filing their bankruptcy petition, they had received $90,000 from home refinances within two years of filing their bankruptcy petition. (Plf. Ex. 10) Also, in 2006, the year before filing, the Debtors received $265,012 in gross income from Dr. Stamat's medical practice. (Def. Ex. 19)

The bankruptcy court did not commit clear error in ruling that the Debtors failed to offer a satisfactory explanation for the unavailability of the substantial and identifiable assets, especially the $90,000 of equity in their Michigan home. (Adv. Dkt. 36, Concl. ¶36) Although the Debtors produced a collection of bank statements and cancelled checks and testified about their general financial demise, the Debtors could not explain how their personal and professional bank accounts reconciled, how their income was determined or what happened to all of the cash removed from their accounts. (*Id.*) Although they stated that the funds were spent on their personal expenses and Dr. Stamat's medical practice, no documents were identified that corroborate their explanation. (*Id.*)

The bankruptcy court did not abuse its discretion when it found that the Debtors failed to adequately explain their loss or deficiency of assets to meet their liabilities, and a denial of discharge was required under section 727(a)(5).

VIII. CONCLUSION

For the foregoing reasons, the United States Trustee respectfully asks this Court to affirm the order entered below.

Dated: March 13, 2009

Respectfully submitted,
WILLIAM T. NEARY
UNITED STATES TRUSTEE

By: /s/ *M. Gretchen Silver*
M. Gretchen Silver, an attorney
for the U.S. Trustee

M. Gretchen Silver
UNITED STATES DEPARTMENT OF JUSTICE
OFFICE OF THE UNITED STATES TRUSTEE
219 South Dearborn Street, Room 873
Chicago, Illinois 60604
Telephone (312) 886-5785
Facsimile (312) 886-5794

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[E.g., "CTA9"]

7th Cir.

3. ("CCN") ***CURRENT*** CASE NO.

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(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***

BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s)

&

√ Any Miscellaneous ***BACKGROUND***

• Whether the bankruptcy court abused its discretion by denying the Stamats' discharge under section 727(a)(4) because the Stamats made false oaths in connection with their bankruptcy case.

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IN THE UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

NICHOLAS STAMAT and
PENNY STAMAT,

Appellants,

v.

WILLIAM T. NEARY,
UNITED STATES TRUSTEE,

Appellee.

On Appeal from the United States District Court
for the Northern District of Illinois
The Honorable Joan B. Gottschall

BRIEF OF THE APPELLEE
WILLIAM T. NEARY, UNITED STATES TRUSTEE

Of Counsel

Ramona D. Elliott
General Counsel
P. Matthew Sutko
Associate General Counsel

M. Gretchen Silver
Office of the United States Trustee
Department of Justice
219 South Dearborn, Room 873
Chicago, Illinois 60604

Wendy Cox
Trial Attorney
Department of Justice
Executive Office for United States Trustees
20 Massachusetts Ave., N.W.
Suite 8000
Washington, DC 20530
Telephone (202) 307-1399

Attorneys for the Appellee

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I. JURISDICTIONAL STATEMENT

The jurisdictional statement in the Stamats' Brief is not complete and correct. The bankruptcy court had jurisdiction to enter the order denying the Appellants' discharge in the core adversary proceeding arising in Appellants' chapter 7 bankruptcy case under 28 U.S.C. § 157(a), (b)(1) & (b)(2)(J). That order was a final order and was entered on September 24, 2008. (Adv. Doc. 38).[1] The Appellants timely filed a notice of appeal to the district court under 28 U.S.C. § 158(c)(2) and Fed. R. Bankr. P. 8002 on October 4, 2008. (Adv. Doc. 41).

The district court had jurisdiction under 28 U.S.C. § 158(a)(1) to review the bankruptcy court's order. The district court entered its judgment affirming the bankruptcy court's order on September 2, 2009. (D.Ct. Doc. 38). The Appellants timely filed their notice of appeal under 28 U.S.C. § 158(a)(1) and Fed. R. App. P. 4(a)(1) to this Court of the district court's judgment on October 2, 2009. (D.Ct. Doc. 39). This Court has jurisdiction to review the final judgment of the district court under 28 U.S.C. § 158(d)(1) and 28 U.S.C. § 1291.

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[1] Documents filed in the Stamats' bankruptcy case (No. 07-13379) are cited herein as "Bankr. Doc. __." Documents filed in the adversary proceeding (No. 07-01278) arising out of that case are cited herein as "Adv. Doc. __." Documents filed in the district court appeal (No. 08-06543) are cited herein as "D.Ct. Doc. __."

II. STATEMENT OF THE ISSUES

The bankruptcy court denied the Stamats a discharge of their debts on three independent statutory grounds, 11 U.S.C. §§§ 727(a)(2), 727(a)(4), and 727(a)(5), so the bankruptcy court's decision merits affirmance unless the bankruptcy court's decision to deny the discharge is clearly erroneous as to each of the three grounds. Therefore, the issue presented by in this appeal is whether:

(a) the bankruptcy court's determination under 11 U.S.C. § 727(a)(4) that the Stamats fraudulently made false statements under oath is clearly erroneous; and

(b) the bankruptcy court's determination under 11 U.S.C. § 727(a)(5) that the Stamats failed to satisfactorily explain the loss of assets is also clearly erroneous; and

(c) the bankruptcy court's determination under 11 U.S.C. § 727(a)(2) that the Stamats concealed estate assets with the intent to defraud their creditors is also clearly erroneous.

III. STATEMENT OF THE CASE

The Stamats filed their voluntary Chapter 7 bankruptcy petition on July 27,

2007. (Supp.App. 1).[2] On December 21, 2007, the United States Trustee filed his complaint objecting to the discharge of the Stamats' debts on three statutory grounds: concealing property with the intent to defraud creditors, making false oaths with fraudulent intent, and failing to satisfactorily explain the loss of substantial assets or deficiency of assets to meet their liabilities. (Adv. Doc. 1). *See* 11 U.S.C. §§ 727(a)(2), (4) and (5). The bankruptcy court tried the matter on May 22, 2008. (Supp.App. 49). On September 24, 2008, the bankruptcy court entered its judgment denying the Stamats' discharge on each of the three grounds. (Adv. Doc. 38).

The Stamats appealed the judgment to the district court on October 4, 2008. (Adv. Doc. 41). On September 2, 2009, the district court entered an order affirming the bankruptcy court's decision to deny discharge pursuant to Section 727(a)(4) for fraudulently making a false oath, without reaching the two other grounds. (App. 1-13). This appeal followed.

IV. STATUTORY FRAMEWORK

Under chapter 7 of the Bankruptcy Code, "a debtor [typically] receives an immediate unconditional discharge of personal liability for certain debts in

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[2] Citations to "App." refer to the Appendix submitted by the Stamats with their brief. Citations to "Supp.App." refer to the supplemental appendix submitted by the United States Trustee.

exchange for relinquishing his or her nonexempt assets to a bankruptcy trustee for liquidation and discharge to creditors." H.R. Rep. 109-31(I) at 10 (2005), *reprinted in* 2005 U.S.C.C.A.N. 88, 97; *see* 11 U.S.C. §§ 701-727. A discharge under section 727(a) releases the debtor from liability for debts that arose before the case was filed, with limited exceptions. *See* 11 U.S.C. § 727(b). However, the chapter 7 trustee, a creditor, or the United States Trustee[3] may object to the granting of a discharge on the basis of any of the grounds set forth in 11 U.S.C. § 727(a). 11 U.S.C. § 727(c)(1). Specifically, a court may deny a discharge to a debtor if the debtor knowingly and fraudulently made a false oath in the case. 11 U.S.C. §§ 727(a)(4)(A). In addition, it may do so if the debtor failed to explain satisfactorily any loss of assets or deficiency of assets to meet his liabilities. 11 U.S.C. § 727(a)(5).   A debtor's concealment of property to hinder his creditors is also grounds to deny a discharge. 11 U.S.C. § 727(a)(2).

A denial of discharge means the independent chapter 7 trustee continues to liquidate the debtor's non-exempt assets for distribution to creditors, but those

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[3] The United States Trustee Program is a unit of the Department of Justice charged by Congress to, among other things, appoint trustees and supervise the administration of Chapter 7 cases. *See* 28 U.S.C. § 586. United States Trustees "serve as bankruptcy watch-dogs to prevent fraud, dishonesty, and overreaching in the bankruptcy arena." H.R. Rep. No. 95-595, at 88 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6049.

creditors are free to pursue the debtors after bankruptcy for the unpaid balance. *See* 11 U.S.C. § 727(b) (regarding effect of discharge).

V. STATEMENT OF FACTS

A. Relevant Facts

The bankruptcy court found the following facts based on the parties' stipulations and the evidence adduced at trial.

1. Background

The debtors are Nicholas Stamat, a medical doctor with his own medical practice, and his wife, Penny Stamat, who holds a bachelor's degree in math and accounting and has worked as a business comptroller. (App. 24 - 25, ¶¶ 3, 15, 16); (Supp.App. 78, 176). Mrs. Stamat owned and operated a medical billing company, On Time Billing, LLC, and managed the couple's business and personal finances. (App. 25, ¶ 19); (Supp.App. 80, 164, 178). When they filed their petition, the Stamats owned two homes, which they valued together at $1,475,000. (Supp.App. 4).

2. Omissions and Misrepresentations in the Stamats' Schedules and Statement of Financial Affairs

The Stamats filed a voluntary chapter 7 bankruptcy petition on July 26, 2007 seeking relief from over $1.5 million in secured and unsecured debt. (App.

24, ¶¶ 1, 5, 6); (Supp.App. 1, 25). Shortly thereafter, the Stamats filed the required official bankruptcy schedules and Statement of Financial Affairs ("SoFA"), which they signed under penalty of perjury.[4] (App. 24 at ¶ 1); (Supp.App. 26, 34). The Stamats testified at trial that they understood their obligation to provide complete and accurate information in those documents. (App. 30 at ¶ 12); (Supp.App. 85-86, 183). They were represented by experienced bankruptcy counsel when they prepared and filed those documents. (App. 30 at ¶ 12); (Supp.App. 81-82).

a. Income

In response to Question 1 of their original SoFA,[5] the Stamats listed gross income they received from their businesses in 2006 as $53,309 (Supp.App. 27), although Dr. Stamat's medical practice had grossed $265,012 in 2006 and Mrs.

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[4] The schedules and SoFA are official forms that debtors must complete. 11 U.S.C § 521(a)(1)(B). The schedules require disclosure of a debtor's assets and liabilities as of the date of the bankruptcy filing. *See* Fed. R. Bankr. P. Official Form 6. The SoFA requires disclosure of financial information over a longer time period before bankruptcy. *See* Fed. R. Bankr. P. Official Form 7.

[5] Question 1 of their SoFA read in pertinent part:

> State the gross amount of income the debtor has received from employment, trade, or profession, or from operation of the debtor's business, including part-time activities either as an employee or in independent trade or business . . . during the **two years** immediately preceding this calendar year." (Supp.App. 27) (emphasis in original); (App. 27, ¶ 41(b)).

Stamat's business had grossed $22,188. (App. 27 at ¶ 41(a) & App. 31 at ¶ 14(c)); (Supp.App. 87); (Supp.App. 54, 56). At the first meeting of creditors in the Stamats' case (the "§ 341 meeting")[6] on November 14, 2007, the chapter 7 trustee and the Stamats' creditors questioned the Stamats about the completeness and accuracy of their schedules and SoFA and identified specific information that the Stamats had not disclosed in those documents. (App. 25-26 at ¶¶ 26-32); (Adv. Doc. 31 at ¶¶ 27-32, Doc. 33 at ¶¶ 27-32). After the § 341 meeting, the Stamats filed amended schedules to disclose two previously unreported guns (App. 26 at ¶ 33); (Supp.App. 36), but still did not change their SoFA to reflect the $287,200 in gross income from Dr. Stamat's medical practice and Mrs. Stamat's billing business.

The United States Trustee subsequently subpoenaed the Stamats' tax returns. (App. 26 at ¶ 34). On April 16, 2008, he conducted an oral examination of the Stamats pursuant to Rule 2004 of the Federal Rules of Bankruptcy Procedure ("Rule 2004 examination") (App. 26 at ¶ 34), and questioned them about omissions from their schedules and SoFA discovered at the § 341 meeting and as a result of the United States Trustee's review of the Stamats' subpoenaed

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[6] Section 341 directs the United States Trustee to hold and preside over a meeting of creditors within a reasonable time after a bankruptcy case is filed. 11 U.S.C. § 341(a).

documents. Although given an opportunity to complete the record, the Stamats still did not volunteer that Dr. Stamat's medical practice had grossed $265,012, nor did they include that amount in their gross income when they amended their SoFA on the eve of trial.[7] (Supp.App. 41). They did amend their Schedule I, however, to separately indicate Dr. Stamat's $80 monthly income from his part-time position with the Village of Thornton. (App. 25-26 at ¶¶ 27-28; App. 24 at ¶ 4); (Supp.App. 40).

Although the Stamats' tax return was completed on June 26, 2007, the Stamats' response to Question 1 in their original SoFA did not correspond to any particular line from those returns. (App. 31-32, at ¶ 41(c)-(d)); (Supp.App. 49-57); (Supp.App. 138-42). Mrs. Stamat testified that the income figures in the SoFA's were estimates of the amounts the Stamats had taken from the business in 2006. (Supp.App. 138-42). The SoFA, however, did not indicate that the gross income figure was an estimate. (Supp.App. 27).

b. Business interests

The Stamats originally failed to disclose in their SoFA any business

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[7] The Stamats filed an amended schedule I and an amended SoFA on May 8, 2008, the last day for filing documents before trial. (Supp.App. 40, 41).

interests owned in the six years prior to filing the bankruptcy petition.[8] (App. 25 at ¶ 11; App. 26 at ¶¶ 37 - 38); (Supp.App. 34). At the § 341 creditors meeting, the Stamats were asked about and acknowledged that they had ownership interests in numerous entities that were not initially disclosed on their schedules and SoFA. (App. 26 at ¶¶ 37-38; App. 29 at ¶ 70); (Supp.App. 164-65). However, they did not immediately amend their SoFA to correct the omission. (App. 29, ¶¶ 70-73).

At their Rule 2004 examination, the Stamats acknowledged they currently or formerly had ownership interests in: 1) Stamat Pediatrics, L.L.C., 2) On Time Billing, LLC, 3) Meyer Medical Physician Group Ltd., 4) 4425 E. 63rd Medical Center, 5) Hoffman/Elk Grove Physicians Group Ltd., 6) Trailhead Land Investment L.P., and 7) Eagle Crest Golf Club, Ltd. Partnership, none of which had been disclosed in their SoFA. (App. 25 at ¶¶ 21-25; App. 26 at ¶¶ 37-38); (Supp.App. 170-71). Still, they did not amend their Schedules and SoFA to add those disclosures.

Immediately before trial, the Stamats finally amended their SoFA to reflect

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[8] Question 18 of the SoFA required the Stamats to list specific information about "all businesses in which the debtor was an officer, director, partner, or managing executive of a corporation, partner in a partnership, sole proprietor, or was self-employed in a trade, profession, or other activity either full- or part-time within **six years** immediately preceding the commencement of this case . . . ." (Supp.App. 34) (emphasis in original).

their ownership in five of the businesses: Stamat Pediatrics, LLC; On Time Billing, LLC; Meyer Medical Physicians Group; 4425 West 63rd Medical Center; and, Hoffman/Elk Grove Physicians Group. (App. 29, ¶ 72); (Supp.App. 48). Even then, the Stamats did not disclose their ownership interest in Trailhead Land Investment L.P. and Eagle Crest Golf Club, Ltd. Partnership in their amended SoFA. (Supp.App. 48).

c. Counterclaim

The Stamats failed to disclose on their original Schedule B they had a counterclaim pending against Standard Bank and Trust seeking to invalidate a lien against their home.[9] (App. 26-27 at ¶40); (Supp.App. 6).   Mrs. Stamat testified at trial that the Stamats had been suing Standard Bank since 2001, though the value of the claim was not proved. (App. 26-27, ¶ 40); (Supp.App. 128-29). The Stamats never amended their Schedule B to disclose their counterclaim. (App. 30-31, ¶¶ 13, and 14).

d. Transfers

Question 10 of the SoFA required the Stamats to list all property transferred

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[9] Line 21 of Schedule B directs the debtor to list "[o]ther contingent and unliquidated claims of every nature, including . . . counterclaims of the debtor . . . ." (Supp.App. 6).

within the two years before they filed bankruptcy.[10] (Supp.App. 31). The Stamats' original SoFA does not list any transfers of assets in response to Question 10. (*Id.*); (App. 25 at ¶ 11). At the § 341 meeting, the Stamats were questioned about and acknowledged a transfer of assets within two years before filing for bankruptcy that they had not disclosed on their SoFA. (App. 26 at ¶ 31); (Supp.App. 158). Dr. Stamat confirmed that he had transferred $10,000 in September 2005 to Financial Group of Oak Brook to settle pending litigation against the Stamats, but the Stamats did not immediately amend their response to Question 10. (App. 26 at ¶ 31); (Supp.App. 158). The Stamats did not correct their sworn SoFA, until months later on the eve of trial. (Supp.App. 45).

At the Rule 2004 examination, Mrs. Stamat acknowledged that the Defendants had refinanced their Michigan home twice in the two years before filing the petition, receiving total cash in excess of $90,000. (App. 26 at ¶ 35); (Adv. Doc. 31 at ¶ 35, Doc. 33 at ¶ 35). Neither of those transfers had been disclosed in their SoFA. The Stamats did not immediately amend their SoFA to add the omitted transfers, but waited until May 8, 2008, the last day for filing pre-

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[10] Question 10 requires the debtors to "[l]ist all other property, other than property transferred in the ordinary course of the business or financial affairs of the debtor, either absolutely or as security within **two years** immediately preceding the commencement of this case." (Supp.App. 31) (emphasis in original).

trial documents. (Supp.App. 45).

e. Assets

Line 8 of Schedule B required the Stamats to disclose all of their firearms. (App. 25 at ¶ 8); (Supp.App. 5). The Stamats initially failed to disclose two service revolvers owned by Dr. Stamat. (App. 26 at ¶ 30); (Supp.App. 5). At the § 341 meeting of creditors, Dr. Stamat admitted he owned two guns. (App. 26 at ¶ 29); (Adv. Doc. 31 at ¶ 29, Doc. 33 at ¶ 29). The Stamats amended their Schedule B on December 7, 2007 to disclose their ownership of the revolvers, but failed to correct other omissions on their schedules and SoFA. (App. 25 at ¶ 10); (Supp.App. 36).

3. Failure to explain loss of assets

The Stamats did not explain the loss of their assets and inability to repay their debts, especially the $90,000 home refinancing proceeds they had received within two years of filing their bankruptcy petition. The Stamats owned only $16,420.67 in personal property when they filed for bankruptcy according to their schedules. (App. 24 at ¶ 7); (Supp.App. 7). Mrs. Stamat, who is the bookkeeper for the household and the medical practice, testified that she deposited the $90,000 into the Stamats' personal bank account and they used the money for living expenses and the medical practice. (Supp.App. 158-61). She did not specifically detail how she and Dr. Stamat used the money, nor did she explain how she accounted for the proceeds between the practice and the individuals. (*Id.*).

The Stamats produced bank statements and copies of cancelled checks for their personal and business accounts. (App. 28 at ¶ 56, App. 36 at ¶ 36); (Supp.App. 159-160); (Plaintiff's Exs. 7-8).[11] The bankruptcy court found the Stamats' records "disjointed and fragmented " and insufficient to corroborate their vague testimony. (App. 28 at ¶ 56).

B. Summary Chart

In response to:	Initial disclosure:	When discrepancy uncovered by third parties:	When corrected:
SoFA Q1 (Gross income)	$53, 309 (Did not include over $200,000 in gross income from businesses)	Before trial	Never

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[11] Plaintiff's Exhibits 7 and 8, produced by the Stamats pursuant to subpoena and as an explanation of their loss of assets, are bank statements from 2005 through 2007 (including copies of cancelled checks) for their medical practice, Stamat Pediatrics, and their personal checking account. The two exhibits total over 200 pages and were too voluminous to be scanned into the district court's electronic record. They have been transmitted in paper form to this Court as part of the appellate record. In deference to Circuit Rule 30(e)'s directive that appendices should not be lengthy, the United States Trustee has not included those exhibits in its supplemental appendix, but will amend its supplemental appendix to add them should if Court wishes.

SoFA Q10 (Transfers of property)	None	•$10,000 payment to settle claim discovered at §341 meeting on 11/14/07 •Two home refinancings discovered at Rule 2004 exam on 4/16/08	•Amended to include settlement just before trial on 5/8/08 •Amended to include refinancings just before trial on 5/8/08
Schedule B Ln 21 (Other contingent and unliquidated claims including counterclaims)	None	Counterclaim discovered before trial	Never
SoFA Q18 (Business interests owned within six years before filing for bankruptcy)	None	•Stamat Pediatrics and On Time Billing were listed elsewhere in schedules •Interests in five other businesses were uncovered at § 341 meeting on 11/14/07	•Amended just before trial on 5/8/08 to include those businesses •Amended just before trial on 5/8/08 to include three, two others were never disclosed
Schedule I	$3,333 net income (failed to separately indicate P/T employment)	Discovered at §341 meeting on 11/14/07	Amended just before trial on 5/8/08 to separately indicate P/T employment

Schedule B Ln 8 (Firearms and collections)	Train collection, but no firearms	Discovered at §341 meeting on 11/14/07	Amended on 12/7/07 to add two guns

C. Decisions Below

1. Bankruptcy Court

On December 21, 2007, the United States Trustee filed a complaint seeking a denial of the Stamats' discharge based on the numerous false oaths in their schedules and SoFA, their failure to explain the loss of substantial assets including the money they pulled out of their house and the income from Dr. Stamat's medical practice, and their concealment of assets. (App. 24 at ¶ 2). The bankruptcy court held a trial in which the parties offered evidence and the Stamats testified about the reasons for their omissions and what had happened to their assets. (App. 14-37).

The bankruptcy court, after a detailed analysis of the evidence, denied the Stamats' discharge under sections 727(a)(2), (4), and (5). (App. 37). With respect to the denial under sections 727(a)(4), the bankruptcy court found that the Stamats signed their schedules and SoFA under penalty of perjury and that they knew or should have known that they were inaccurate and incomplete, and that such omissions were false oaths. (App. 34-35 at ¶ 25). The cumulative effect of their misrepresentations and omissions established the Stamats' pattern of reckless indifference to the truth. (App. 30-31 at ¶13, 14). Therefore, the bankruptcy court concluded that the Stamats' discharge should be denied under section 727(a)(4). (App. 37).

In addition, the bankruptcy court found that the Stamats' non-disclosures and reckless disregard for the truth in connection with completing their schedules and SoFA also constituted the concealment of assets of the estate with intent to defraud creditors, warranting a denial of discharge under section 727(a)(2). (App. 29-32).

Finally, the bankruptcy court found that the Stamats failed to meet their burden to offer a satisfactory explanation for the unavailability of the substantial and identifiable assets, specifically the $90,000 in proceeds from their home refinancings. (App. 36). The bankruptcy court concluded that the Stamats' explanation was vague, indefinite and uncorroborated and required the court, creditors and the United States Trustee to speculate about what happened to the Stamats' assets. (*Id.*). Therefore, the bankruptcy court concluded that the Stamats' discharge should be denied under section 727(a)(5) as well. (*Id.*).

2. District Court

On September 2, 2009, the district court affirmed the bankruptcy court's denial of discharge under section 727(a)(4) on the briefs. (App. 1 n.1 & 13). The district court agreed with the bankruptcy court's extensive findings of fact and its conclusion that the United States Trustee proved each of the elements of section 727(a)(4). (App. 4-13). The district court affirmed the denial of discharge under that section. (App. 13). Because a denial of discharge under one part of section 727(a) was sufficient to affirm the bankruptcy court's judgment, the district court did not address the denial of discharge under either section 727(a)(2) or (5). (*Id.*). The Stamats appealed the district court decision to this Court.

VI. SUMMARY OF ARGUMENT

The bankruptcy court denied the Stamats' discharge of their debts on three separate and independent grounds: 11 U.S.C. §§§ 727(a)(2), 727(a)(4) and 727(a)(5). (App. 37). This court can affirm on any of these bases.

There were substantial factual bases to deny their discharge under each ground. The Stamats, sophisticated, well-educated debtors, filed a chapter 7 bankruptcy case seeking to be relieved of over $1.5 million in secured and unsecured debt. In return, they were required to provide specific financial information under penalty of perjury on official bankruptcy schedules and statements to allow the bankruptcy trustee to identify and collect non-exempt assets for distribution to the Stamats' creditors.

The Stamats were better positioned than most chapter 7 debtors to complete those forms given their education and experience. They had owned no less than seven businesses. Nevertheless, the United States Trustee, upon investigation, discovered at least fourteen misstatements and omissions in those documents, some quite substantial. Those errors included the failure to disclose:

- over $200,000 in gross income from Dr. Stamat's medical practice,
- multiple business interests,
- a pending counterclaim against a bank,
- a $10,000 payment to settle a claim against them, and
- two recent home refinancings resulting in at least $90,000 in proceeds.

The private chapter 7 trustee in their case, the Stamats' creditors and United States Trustee had to root out that information at the § 341 meeting of creditors, at the Stamats' examination and by subpoenaing documents.

Although the Stamats filed amended schedules shortly after the § 341 meeting to disclose some guns, they did not correct more substantial omissions until the eve of trial on the United States Trustee's complaint objecting to their discharge, six months after the § 341 meeting and a month after the Rule 2004 examination. Even then, they did not correct all of their errors. That response, which was insufficient under the Code, together with the cumulative number of misstatements and omissions in their statements and schedules established a reckless indifference by the Stamats to the accuracy of those documents. In this Circuit, as in at least four other circuits, reckless indifference to the truth is the equivalent of fraudulent intent. *In re Chavin*, 150 F.3d 726, 728 (7th Cir. 1998); *In re Yonikus*, 974 F.2d 901, 905 (7th Cir. 1992). *Accord In re Duncan*, 562 F.3d 688, 695 (5th Cir. 2009); *In re Keeney*, 227 F.3d 679, 686 (6th Cir. 2000); *In re Tully*, 818 F.2d 106, 112 (1st Cir. 1987); *In re Kaiser*, 722 F.2d 1574, 1584 n.4 (2d Cir. 1983).

The bankruptcy court rejected the Stamats' explanation that they had misunderstood the questions on the schedules and SoFA and the district court agreed that the Stamats' explanations for their errors were not credible.

The bankruptcy court found that the Stamats' omissions and inaccuracies on their schedules and SoFA were material because they related to the Stamats' assets or the disposition of those assets. The United States Trustee was not required to prove that the false oaths harmed the creditors.

Full and accurate disclosure in a debtor's original schedules is essential to the success of the bankruptcy process because without it, the trustee can not identify potential preferential and fraudulent transfers and maximize estate assets available for distribution to creditors, the creditors cannot make an informed choice about their level of participation in the case, the bankruptcy court cannot properly oversee its cases, and the United States Trustee cannot fulfill its statutory role as “watchdog” over the bankruptcy process. The Stamats invaded the provinces of all of those entities by choosing which information to disclose instead of disclosing all responsive information. This Court should not condone that conduct.

Alternatively, this Court should affirm because the record supports the bankruptcy court’s finding that Stamats failed to satisfactorily explain what happened to the $90,000 they received from the two refinancings of their home, warranting the denial of their discharge under section 727(a)(5).

As a third alternative, this Court should affirm the denial of discharge because the Stamats, by failing to disclose financial information on their schedules and SOFA, concealed assets of the estate with the intent to defraud creditors justifying the denial of their discharge under section 727(a)(2).

VII. ARGUMENT

A. Standard of Review

When considering an appeal from a district court order affirming a bankruptcy court decision, this Court reviews the bankruptcy court decision and applies the same standard of review as the district court did: the clear error standard applies to the bankruptcy court's findings of fact and its conclusions of law are reviewed *de novo*. *Ojeda v. Goldberg,* 599 F.3d 712, 716 (7th Cir. 2010). A finding is clearly erroneous when the appellate court is left with the definite and firm conviction that the lower court has made a mistake. *In re Thirtyacre*, 36 F.3d 697, 700 (7th Cir. 1994) (*citing Anderson v. Bessemer City*, 470 U.S. 564, 573 (1985)). "Where there are two permissible views of the evidence, the fact finder's choice between them cannot be clearly erroneous." *Anderson*, 470 U.S. at 574.

An appellate court should not overturn a bankruptcy court's decision to deny discharge unless it is clearly erroneous. *In re D'Agnese*, 86 F.3d 732, 734 (7th Cir. 1996). Moreover, whether a debtor acted with fraudulent intent is a question of fact reviewed for clear error. *In re Yonikus*, 974 F.2d at 905 & n. 10; *Carini v. Matera*, 592 F.2d 378, 380 (7th Cir. 1979). The intent determination often will depend upon a bankruptcy court's assessment of the debtor's credibility, making deference to that court's finding particularly appropriately. *In re Krehl*, 86 F.3d 737, 743 (7th Cir. 1996).

B. The Bankruptcy Court Did Not Abuse Its Discretion By Denying The Stamats' Discharge Under Section 727(a)(4) Because The Stamats Made False Oaths In Connection With Their Bankruptcy Case.

A bankruptcy court may deny a debtor's discharge if the debtor knowingly and fraudulently makes a false oath in or in connection with his bankruptcy case. 11 U.S.C. § 727(a)(4).[12] The party objecting to discharge must prove by a preponderance of the evidence that: (1) the debtor made a statement under oath; (2) the statement was false; (3) the debtor knew the statement was false; (4) the debtor made the statement with intent to defraud; and (5) the statement related to the bankruptcy case in a material way. *In re Hudgens*, No. 03-3153, 149 Fed. Appx. 480, 487, 2005 WL 2077288, at *6 (7th Cir. Aug. 26, 2005) (unpublished); *Clean Cut Tree Svc., Inc. v. Costello (In re Costello)*, 299 B.R. 882, 899 (Bankr. N.D. Ill. 2003). *See Peterson v. Scott (In re Scott)*, 172 F.3d 959, 966-67 (7th Cir. 1999) (grounds for denial of discharge must be proved by preponderance of evidence).

It is undisputed that the original schedules and statement filed by the Stamats constitute statements made under oath for the purposes of 11 U.S.C. §

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[12] The pertinent portion of section 727(a)(4) provides:

(a) The court shall grant the debtor a discharge, unless–

> (4) the debtor knowingly and fraudulently, in or in connection with the case–
>
> > (A) made a false oath or account;

11 U.S.C. § 727(a)(4).

727(a)(4)(A)[13] and that those document contained numerous misstatements and omissions.[14] (App. 32). *See* 6 Alan N. Resnick & Henry J. Sommer, Collier on Bankruptcy ¶ 727.04[1][a] (15th ed. 2009).

1. The bankruptcy court did not clearly err in finding the Stamats acted with reckless indifference to the truth based on their cumulative errors and conduct.

The bankruptcy court correctly found that the Stamats acted with fraudulent intent.[15] (App. 30-31). In this Circuit as in numerous others, reckless indifference to or reckless disregard for the truth is the equivalent of fraudulent intent for the purpose of section 727(a). *In re Chavin,* 150 F.3d at 728; *In re Yonikus,* 974 F.2d

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[13] Bankruptcy Rule 1008 requires all schedules and statements to be verified or contain an unsworn declaration as provided in 28 U.S.C. § 1746. Fed. R. Bankr. P. 1008.

[14] Omissions in a debtor's schedules and other bankruptcy filings constitute false denials for the purposes of section 727(a). *In re Chavin,* 150 F.3d at 727. *Accord* 6 Alan N. Resnick & Henry J. Sommer, Collier on Bankruptcy ¶ 727.04[1][c] (15th ed. 2009). Such false oaths can not be cured by the debtor's subsequent amendment to his schedules and SoFA. *Payne v. Wood (In re Payne),* 775 F.2d 202, 205 (7th Cir. 1985) ("If debtors could omit assets at will, with the only penalty that they had to file an amended claim once caught, cheating would be altogether too attractive."), *cert. denied,* 475 U.S. 1085 (1986); *Mazer v. U.S.,* 298 F.2d 579, 582 (7th Cir. 1962) (rejecting debtor's argument that amendment cured false oath).

[15] A debtor must act "knowingly and fraudulently" to be denied a discharge under section 727(a)(4)(A). Both are encompassed within a finding of fraudulent intent. *See, e.g., In re Chavin,* 150 F.3d at 728; *In re Yonikus,* 974 F.2d at 905.

at 905. *Accord In re Duncan*, 562 F.3d at 695; *In re Keeney*, 227 F.3d at 686; *In re Tully*, 818 F.2d at 112; *In re Kaiser*, 722 F.2d at 1584 n.4. To establish fraudulent intent under section 727(a), "the court must find the debtor knowingly intended to defraud the trustee, or engaged in such reckless behavior as to justify the finding of fraud. *In re Yonikus*, 974 F.2d at 905. Not caring whether some representation is true or false, the state of mind known as "reckless disregard," satisfies the fraudulent intent element. *In re Chavin*, 150 F.3d at 728.

Fraudulent intent may be inferred from circumstantial evidence or by a debtor's conduct. *In re Yonikus*, 974 F.2d at 905. The cumulative effect of a number of false oaths by a debtor establishes a pattern of reckless disregard for the truth by the debtor, warranting a denial of discharge under section 727(a)(4). *See In re Chavin*, 150 F.2d at 728-29 (affirming denial of discharge on the basis of seventeen false statements and omissions in bankruptcy schedules and filings where debtor offered no credible explanation). *Accord Sholdra v. Chilmark Fin. LLP (In re Sholdra)*, 249 F.3d 380, 383 (5th Cir. 2001), *cert. denied*, 534 U.S. 1042 (2001); *In re Costello*, 299 B.R. at 900; *Guardian Indus. Prods. v. Diodati (In re Diodati)*, 9 B.R. 804, 808-09 (Bankr. D. Mass. 1981).

The bankruptcy court found that the Stamats made numerous false oaths in their original schedules and SoFA, including the omissions of:

- over $200,000 in gross income from their businesses,
- multiple business interests,
- a pending counterclaim against a bank,
- a $10,000 payment to settle a claim against them, and
- two recent home refinancings resulting in $90,000 in proceeds.

(App. 31). The Stamats do not dispute that they failed to accurately disclose the gross income they received from Dr. Stamat's medical practice and Mrs. Stamat's business and they do not dispute that they were required, but failed, to disclose much of the omitted information.[16] Moreover, as explained in section VII.B.2. *infra*, their arguments that they were not required to disclose other omitted information were rejected by the bankruptcy court and the district court. (App. 6, 9, 31-32, 34-35).

As the district court observed, "there comes a point when the aggregate errors and omissions cross the line past which a debtor's discharge should be denied." (App. 3). The bankruptcy court concluded the Stamats had crossed that line, finding that the Stamats had acted with reckless indifference. (App. 34).

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[16] Specifically, the Stamats do not dispute that were required, but failed to disclose their interests in at least five businesses in response to Question 18 of their original SoFA. They also do not dispute that they failed to separately report Dr. Stamat's part-time job on their original Schedule I and to include his guns on their original Schedule B.

That finding was not clear error. The numerous errors and omissions in the Stamats' schedules, the Stamats' failure to correct those errors on their own even after they were identified by the creditors, private trustee and United States Trustee, and the Stamats' lack of credible explanations for the deficiencies all established the Stamats' reckless disregard for the accuracy of their statements and schedules. That satisfies the fraudulent intent element. *See In re Chavin*, 150 F.3d at 728; *In re Yonikus*, 974 F.2d at 905. *Accord In re Duncan*, 562 F.3d at 695; *In re Keeney*, 227 F.3d at 686; *In re Tully*, 818 F.2d at 112; *In re Kaiser*, 722 F.2d at 1584 n.4.

The Stamats' contention that fraudulent intent was not established for specific omissions (Appellants' brief at 13, 24) ignores the bankruptcy court's finding that the Stamats completed their schedules with a reckless indifference to the truth. (App. 34). In light of that finding, no further proof of fraudulent intent was necessary. *In re Chavin*, 150 F.3d 726. *Accord In re Sholdra*, 249 F.3d at 383; *In re Costello*, 299 B.R. at 900; *In re Diodati*, 9 B.R. at 808-09.

2. The bankruptcy court did not clearly err in rejecting the Stamats' excuses for the numerous deficiencies in their schedules and statements.

The Stamats continue to assert that they were not required to disclose certain information in response to three questions on their SoFA, but their strained interpretations of those questions do not excuse their failure to answer them truthfully. The bankruptcy court and the district court not only disagreed with the Stamats' interpretations, they rejected them as credible explanations for the Stamats' errors.[17] (App. 6, 9, 31, 34-35).

First, Question 18 of the SoFA required the Stamats to list all businesses and partnerships in which they were partners within the six year prior to filing for bankruptcy.[18] The Stamats contend that they were not required to report their interests in two limited partnerships because limited partners are not "partners" within the meaning of the question. Appellants' brief at 14-15. But the plain meaning of the term "partner" encompasses both general partners and limited partners. Moreover, the instructions for Questions 19-25 of the SoFA expressly excepts limited partnerships from the reach of those questions.[19] Therefore,

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[17] This Court should defer to the bankruptcy court's credibility determination. Fed. R. Bankr. P. 8013; *In re D'Agnese*, 86 F.3d at 734.

[18] Question 18 requires individual debtors to list specific information about "all businesses in which the debtor was an officer, director, partner, or managing executive of a corporation, partner in a partnership, sole proprietor, or was self-employed in a trade, profession, or other activity, either full or part-time within **six years** immediately preceding the commencement of this case . . . ." (Supp.App. 34) (emphasis in original).

[19] Those instructions state:

The following questions are to be completed by every debtor that is a

Question 18, which has no express exception for limited partnerships, includes them. The Stamats further contend that it would be absurd to require disclosure of limited partnerships (Appellants' brief at 15-16), but it is not the debtor's province to decide which information is useful to the trustee and creditors; the debtor must answer the questions accurately and completely. *In re Chavin*, 150 F.3d at 729.

Second, the Stamats contend they did not have to report their $10,000 settlement payment and their two home refinancings in response to Question 10 of their SoFA because those transactions were not outside the ordinary course of their business.[20] Appellants' brief at 18-22. Neither the SoFA, nor the Bankruptcy Code defines the phrase "in the ordinary course of business," so that phrase should

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corporation or partnership and by any individual debtor who is or has been, within six years immediately preceding the commencement of this case, any of the following: an officer, director, managing executive, or owner of more than 5 percent of the voting or equity securities of a corporation; a partner, *other than a limited partner*, of a partnership, a sole proprietor, or self-employed . . . ."

Fed. R. Bankr. P. Official Form 7 (emphasis added).

[20] Question 10 requires the debtors to "[l]ist all property, other than property transferred in the ordinary course of business or financial affairs of the debtor, transferred either absolutely or as security within **two years** immediately preceding the commencement of this case." (Supp.App. 31) (emphasis in original). It is undisputed that the Stamats paid $10,000 to Oak Brook Financial Group in settlement of pending litigation against Dr. Stamat and twice refinanced their second home, receiving $90,000 in proceeds, during the relevant period. (App. 26 at ¶¶ 31, 35).

be given its ordinary meaning. *See Asgrow Seed Co. v. Winterboer*, 513 U.S. 179, 187 (1995) (undefined terms in statutes are given their ordinary meaning). Black's Law Dictionary defines "ordinary" as "normal" or "usual"; it defines "course of business" as "the normal routine in managing a trade or business." Black's Law Dictionary (8th ed. 2004). There is nothing usual or routine about an individual paying thousands of dollars to settle a claim or pulling nearly $100,000 out of her home. Those are extraordinary transactions about which the trustee and the Stamats' creditors would want to know. Moreover, the Stamats' argument that the refinancings were in the ordinary course of their business because they used the funds to pay their personal bills and expenses of Dr. Stamat's medical practice also fails because the Stamats have not shown how they spent the money.[21] (App. 36).[22]

Third, the Stamats contend that they actually overstated their gross income

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[21] The bankruptcy court separately denied the Stamats' discharge under section 727(a)(5) because they failed to satisfactorily explain the loss of those proceeds. (App. 36).

[22] Appellants also contend that the bankruptcy court found that the refinancings were made in the ordinary course of the Stamats' business. Appellants' brief at 20-21. That contention is wrong because, as the district court observed, it relies on a statement in the opinion that the Stamats have taken out of context; the statement refers to what the Stamats testified to at trial, not to what the court found. (App. 8-9).

in response to Question 1 of the SoFA because they did not have to report the nearly $300,000 their businesses grossed, but only the amount they netted from those businesses.[23] Appellants' brief at 22-23. The bankruptcy court correctly held that federal tax law concerning single member limited liability corporations compelled the disclosure of the full amount of their businesses' 2006 gross income. (App. 31). The Stamats had a duty to report their businesses' gross income of $287,200. Their disclosure of $53,309, whether or not it overstates their *net* income does not change the fact that they failed to report their businesses' entire *gross* income or excuse that failure. Moreover, as the bankruptcy court observed, the figure reported by the Stamats did not match their reported net income either. (App. 31).

The bankruptcy court did not credit the Stamats' explanations for good reason. The questions in the schedules and SoFA are the result of years of work by the Judicial Conference and Committee on Rules of Practice and Procedure. *See Report of the Advisory Committee on Bankruptcy Rules* (May 8, 2007) (describing process of drafting and vetting new official forms for the 2005

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[23] Question 1 asks the debtor to "[s]tate the gross amount of income the debtor has received from employment, trade, or profession, or from operation of the debtor's business, including part-time activities either as an employee or in independent trade or business . . ." (Supp.App. 27).

amendments to the Bankruptcy Code) (available in Alan M. Resnick, Henry J. Sommer, 2009 Bankruptcy Rules at T-12-T-23 (Collier pamphlet ed.)). They are open to public comment for 6 months, approved by the Judicial Conference and the Supreme Court and then sent to Congress. *Id*. at T-1-T-23. Given that level of review, and the Stamats' education and experience and resources, they should not have had to struggle to understand the forms. The Stamats' interpretations of the questions are not in keeping with the proverbial "honest debtor" who acts in good faith to provide required information, particularly an honest debtor who has as much business savvy as the Stamats. *See In re Scott*, 172 F.3d at 966 (discharge in bankruptcy is limited to the "honest but unfortunate" debtors); *In re Yonikus,* 974 F.2d at 906 (discharge in bankruptcy is privilege granted only to "the honest debtor").

In addition, the Stamats assert that there was insufficient proof of the counterclaim that they were required to list on their schedule of assets. Appellants' brief at 16-18. The bankruptcy court found that the Stamats had an undisclosed counterclaim based on Mrs. Stamat's testimony that the Stamats had been suing their lender for years to invalidate their mortgage and the district court affirmed the finding.[24] (App. 39-40); (Supp.App. 127-29). Although Mrs. Stamat also testified that she was unaware of a counterclaim, the apparent inconsistency in Mrs. Stamat's testimony did not negate her testimony but created a credibility issue that the bankruptcy court as factfinder resolved. This Court should not disturb that finding. *See* Fed. R. Bankr. P. 8013; *In re Krehl*, 86 F.3d at 743 (deference to bankruptcy court's finding particularly appropriate where based on credibility findings); *In re D'Agnese*, 86 F.3d at 734.

Given the Stamats' education, business experience and representation, they have not provided an explanation for all of the deficiencies in their schedules as they are required to do. Fourteen errors, including understating gross income by over $200,000 demonstrates they acted with reckless indifference to the truth.

3. The bankruptcy court correctly found that the Stamats' omissions were material because they related to the Stamats' assets and their disposition of those assets.

The bankruptcy court correctly found based on the evidence that the Stamats' false oaths were material. For purposes of section 727(a)(4), a statement is sufficiently material to bar discharge if it relates to the debtor's business transactions or estate, involves the discovery of assets, or concerns the existence

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[24] The Stamats cited no authority for their contention that the United States Trustee was required to introduce the actual pleading into evidence. Appellants' brief at 18.

and disposition of the debtor's property. *In re Pratt*, 411 F.3d 561, 566 (5th Cir. 2005); *In re Keeney*, 227 F.3d at 686; *In re Chalik*, 748 F.2d 616, 618 (11th Cir. 1984). Each of the Stamats' false oaths were material because it related to the Stamats' estate or business dealings or the existence or disposition of the Stamats' property. The omissions concerned income they had received the year prior to filing for bankruptcy, business interests that they still owned or had disposed of within six years of filing, a counterclaim against their lender that the Stamats might recover on, and recent transfers of money or property. All of this information is important to the chapter 7 trustee because the trustee has the duty to search out, gather, and liquidate estate assets for distribution to creditors. 11 U.S.C. § 704. The trustee can also unwind preferential transfers and fraudulent conveyances and bring the transferred assets back into the estate for distribution to creditors. 11 U.S.C. § 547.

The Stamats assert that their omissions were not material because they involved assets the Stamats no longer owned or were worthless, or because they disclosed the information elsewhere, so their creditors were not harmed by their omissions. Appellants' brief at 11-14, 24-25. However, many of the false statements concerned the receipt or disposition of substantial assets. For example, the Stamats failed to report their businesses grossed over $250,000 in 2006. They also failed to disclose the depletion of $90,000 in equity from their Michigan home. Certainly, the trustee has an interest in determining where that money went.

There is no legal requirement that omitted assets have value as of the date of the filing in order to be material. *In re Pratt*, 411 F.3d at 566-67; *In re Chalik*, 748 F.3d at 618 (false oaths regarding worthless assets can still bar discharge of debts). Nor is proof of harm to creditors required. *In re Smiley*, 864 F.2d 562, 569 (7th Cir. 1989). Complete transparency is the price a debtor must pay for a discharge, because complete and accurate disclosure is essential in a bankruptcy case. *Ross v. RJM Acquisitions Funding LLC*, 480 F.3d 493, 498 (7th Cir. 2007) (Bankruptcy Code hinges on debtor's veracity and full disclosure); *In re Payne,* 775 F.2d at 205 (proper operation of the bankruptcy system depends on honest reporting by the debtor); *In re Broholm*, 310 B.R. 864, 880 (Bankr.N.D.Ill. 2004) (purpose of section 727(a)(4) is to "enforce the debtor's duty of disclosure and to ensure that the debtors provide reliable information to those who have an interest in the administration of the estate."). Without full disclosure, the chapter 7 trustee, the bankruptcy court, and the United States Trustee can not do their jobs effectively. The chapter 7 trustee has a duty to collect the assets of the estate for liquidation and distribution. 11 U.S.C. § 704. Information regarding worthless assets, such as empty bank accounts may lead to the discovery of existing assets of value, and information about former assets and the disposition of those assets may enable the trustee to identify fraudulent or preferential payments that can be recovered for the benefit of the creditors. The creditors need full and accurate disclosure to make an informed decision about what resources to devote to the case, which depends on whether they believe that their efforts in the case can significantly increase their distribution. The bankruptcy courts need full disclosure to fulfil their statutory obligations such as evaluating repayment plans. *See United Student Aid Funding, Inc. v. Espinosa*, __ U.S. __, 130 S. Ct. 1367, 1381 (2010). And the United States Trustee requires full disclosure to ensure that the debtor is not abusing the bankruptcy process and that only honest debtors receive a discharge. *See* 11 U.S.C. § 707(b) & 727(a).

It is essential that a debtor's original schedules and statements are accurate and complete because those documents are filed with the court and in the public record. The trustee, the creditors, the bankruptcy court and the United States Trustee all must be able to rely on the information in those documents. Rejecting a similar "no-harm, no foul" argument, one court explained:

> The critical time for disclosure is at the time of the filing of a petition and the Debtor has the responsibility to do so. Bankruptcy law requires debtors to be honest and to take seriously the obligation to disclose all matters. The bankruptcy schedules and statements of affairs are carefully designed to elicit certain information necessary to

> the proper administration and adjudication of the case. To allow the debtor to use his discretion in determining the relevant information to disclose would create an end-run around this strictly crafted system.

Siegel v. Weldon (In re Weldon), 184 B.R. 710, 715 (Bankr. D.S.C. 1995). The Stamats did not take seriously their obligation to fully and accurately disclose all matters at the beginning of their case. They did not care about the truth of the information they provided. And the Stamats decided what information the trustee, the creditors, the court and the United States Trustee should receive instead of fully and accurately reporting the required information as required. By doing so, the Stamats invaded the province of the trustee, the United States Trustee, the creditors and the court. The bankruptcy court did not allow that conduct and neither should this Court.

C. Alternatively, This Court Should Affirm The Denial Of The Discharge Under 11 U.S.C. § 727(a)(5) Because The Bankruptcy Court's Finding That The Stamats Failed To Satisfactorily Explain The Loss Of The Proceeds From Their Refinancings Is Not Clearly Erroneous.

Although the district court affirmed the denial of discharge under section 727(a)(4) without reaching the two alternative grounds cited by the bankruptcy court, this Court can affirm on any ground passed on by the bankruptcy court.[25] It

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[25] If this Court does not agree that a denial of discharge is warranted under 11 U.S.C. §727(a)(4) and chooses not to consider the alternate grounds cited by the bankruptcy court for denying the Stamats' discharge, the United States Trustee

is well established that a reviewing court may affirm the judgment of a lower court on any grounds supported by the record. *In re Volpert*, 110 F.3d 494, 500 (7th Cir. 1997) (citing *Schweiker v. Hogan*, 457 U.S. 569, 585 & n. 24 (1982)). The appellate record shows that the bankruptcy court did not err in concluding that denial of the Stamats' discharge was warranted under section 727(a)(5) for their inability to satisfactorily explain the loss of substantial assets including $90,000 in proceeds they received by refinancing their house.

Under section 727(a)(5),[26] the bankruptcy court has "broad power to decline to grant a discharge . . . where the debtor does not adequately explain a shortage, loss, or disappearance of assets." *See* 11 U.S.C. § 727(a)(5); *In re D'Agnese*, 86 F.3d at 734. Section 727(a)(5) is one of several Bankruptcy Code provisions meant to "relieve [ ] creditors and courts of the full burden of

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requests that this Court remand this appeal to the district court with instructions for that court to review the propriety of the bankruptcy court's denial of discharge pursuant to 11 U.S.C. §§727(a)(2) and (a)(5).

[26] Subsection 727(a)(5) provides: (a) The court shall grant the debtor a discharge, unless–

* * *

> (5) the debtor has failed to explain satisfactorily, before determination of denial of discharge under this paragraph, any loss of assets or deficiency of assets to meet the debtor's liabilities;

11 U.S.C. § 727(a)(5).

reconstructing the debtor's financial history and condition, placing it instead upon the debtor." *In re Olbur*, 314 B.R. 732, 740 (Bankr. N.D. Ill. 2004). Whether a debtor has satisfactorily explained a loss of assets is a question of fact that will not be overturned on review unless clearly erroneous. *In re D'Agnese*, 86 F.3d at 734.

The bankruptcy court's inquiry focuses on "the completeness and truth of the debtor's explanation." *In re Costello*, 299 B.R. at 901. However, fraudulent intent is not required for denial of discharge under section 727(a)(5). *See In re D'Agnese*, 86 F.3d at 734 (explanation need not be a lie to be unsatisfactory). A debtor's explanation must be supported by documentation sufficient to "eliminate the need for the Court to speculate as to what happened to all the assets." *In re Costello*, 299 B.R. at 901. Vague, indefinite, and uncorroborated assertions by the debtor of what happened to the assets are not adequate under section 727(a)(5). *In re D'Agnese*, 86 F.3d at 734; *Baum v. Earl Millikin, Inc.*, 359 F.2d 811, 814 (7th Cir. 1966).

The bankruptcy court found that the Stamats at one time owned substantial and identifiable assets that are no longer available to their creditors. (App. 36 at ¶¶ 34-35). The schedules state, under penalty of perjury, that the Stamats had only $16,620.67 in personal property and that their homes were subject to mortgages. (*Id.*); (Supp.App. 4, 7). However, the Stamats acknowledged they had received

$90,000 from home refinances within two years of filing their bankruptcy petition. (App. 26 at ¶ 35). Also, the year before they filed for bankruptcy, Dr. Stamat's medical practice grossed $265,012. (Supp.App. 54).

The Stamats failed to offer a satisfactory explanation for the unavailability of those assets, especially the $90,000 the took out of their Michigan home. (App. 36). Although the Stamats produced a collection of bank statements and cancelled checks and testified about their general financial challenges, the Stamats could not explain how their personal and professional bank accounts reconciled, how their income was determined or what happened to all of the cash removed from their accounts. (*Id.*); (Supp.App. 158-63). The Stamats asserted that the funds were spent on their personal expenses and Dr. Stamat's medical practice, but they offered no specific details or documents to corroborate their explanation. (App. 36); (Supp.App. 158-63). Under the circumstances, it was not clearly erroneous for the bankruptcy court to find that the Stamats failed to satisfactorily explain a loss of assets and deny their discharge on that basis. *See In re D'Agnese*, 86 F.3d at 735 (affirming denial of discharge where debtor failed to provide documentation or adequate explanation for missing assets).

D. Alternatively, This Court Should Affirm The Denial Of The Discharge Under 11 U.S.C. § 727(a)(2) Because The Bankruptcy Court's Finding That The Stamats Concealed Assets With The Intent To Defraud Their Creditors Was Not Clearly Erroneous.

As a third alternative, this Court should affirm the bankruptcy court's decision to deny the Stamats' discharge under section 727(a)(2) because the appellate record supports the bankruptcy court's finding that the Stamats concealed property with the intent to defraud creditors warranting a denial of their discharge on that ground as well. It is well established that a reviewing court may affirm the judgment of a lower court on any grounds supported by the record. *In re Volpert*, 110 F.3d at 500.

Section 727(a)(2) denies a discharge of debts to a debtor who, with intent to delay, hinder or defraud creditors transfers or conceals property of the bankruptcy estate within one year of filing the bankruptcy petition or anytime post-petition. *See* 11 U.S.C.§ 727(a)(2).[27] Section 727(a)(2) requires a denial of discharge where

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[27] Section 727(a)(2) provides:

(a) The court shall grant the debtor a discharge, unless–

* * *

(2) the debtor, with intent to hinder, delay, or defraud a creditor or an officer of the estate charged with custody of property under this title, has transferred, removed, destroyed, mutilated, or concealed, or has permitted to be transferred, removed, destroyed, mutilated, or concealed–

(A) property of the debtor, within one year before the date of a court finds (1) a transfer or concealment of property of the estate by the debtor and (2) a subjective intent to hinder, delay or defraud creditors, (3) within the year before filing or post-petition. 11 U.S.C. § 727(a)(2). *See Village of San Jose v. McWilliams*, 284 F.3d 785, 791 (7th Cir. 2002).

"Debtors have an absolute duty to report whatever interests they hold in property, even if they believe their assets are worthless . . . ." *In re Yonikus*, 974 F.2d at 904. Concealment includes failing or refusing to divulge information to which creditors were entitled. *See In re Scott*, 172 F.3d at 967. Transfer or concealment may occur even if creditors are not harmed by it. *In re Smiley*, 864 F.2d at 569.

Intent may be proved by circumstantial evidence or inferences from a debtor's conduct. *In re Yonikus*, 974 F.2d at 905. Where a debtor does not care about the truth or falsity of a statement, this satisfies the intent requirement of section 727(a)(2). *In re Chavin*, 150 F. 3d at 728.

The bankruptcy court found that the Stamats concealed assets by failing to

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> the filing of the petition; or
>
> (B) property of the estate, after the date of the filing of the petition;

11 U.S.C. § 727(a)(2).

disclose required information to which creditors were entitled. (App. 30-31 at ¶¶ 8, 13-14). The bankruptcy court relied on the evidence and testimony to conclude that the Stamats failed to disclose personal property, business income, business interests, two home refinances, and ongoing litigation against a bank. (*Id.*). The bankruptcy court found that the Stamats were obligated to disclose information requested in the schedules and SoFA, and the Stamats did not do so. (*Id.*). Based on its findings, the bankruptcy court did not commit clear error when it concluded that the Stamats concealed property of the estate through their failure to make required disclosures with the intend to defraud creditors and denied discharge under section 727(a)(2). (App. 32 at ¶ 15).

VIII. CONCLUSION

For the foregoing reasons, the United States Trustee respectfully requests this Court to affirm the judgment of the bankruptcy court.

Dated: June 16, 2010	Respectfully submitted, WILLIAM T. NEARY UNITED STATES TRUSTEE
Of Counsel	By: /s/
Ramona D. Elliott General Counsel P. Matthew Sutko Associate General Counsel M. Gretchen Silver Office of the United States Trustee Department of Justice 219 South Dearborn, Room 873 Chicago, Illinois 60604	Wendy Cox DC Bar No. 429918 Trial Attorney Department of Justice Executive Office for United States Trustees 20 Massachusetts Ave., N.W., Ste. 8000 Washington, DC 20530 Telephone (202) 307-1399 Attorneys for the Appellee

CERTIFICATE OF COMPLIANCE WITH FED. R. APP. P. 32(a)(7)

Pursuant to the type-volume limitation in Fed. R. App. P. 32(a)(7)(B), I certify that this brief is proportionately spaced, using Times New Roman font, 14 point type. Based on a word count under Corel Word Perfect 12, this brief contains 9661 words, excluding the Table of Contents, Table of Authorities and certifications of counsel.

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Wendy L. Cox
Attorney for the United States Trustee

CERTIFICATE OF SERVICE

I hereby certify that on June 16, 2010, I served the foregoing brief on the following by sending two copies of the brief and one disk, by Federal Express Next Business Day Delivery to:

David R. Herzog
Herzog & Schwartz PC
77 W. Washington Street #1717
Chicago, Illinois 60602
ATTORNEY FOR APPELLANTS

I also certify that on June 16, 2010, I filed the brief by sending the original, and fifteen copies to the Clerk of the United States Court of Appeals for the Seventh Circuit by Federal Express Next Business Day Delivery at the following address:

Clerk of Court
United States Court of Appeals for the Seventh Circuit
219 Dearborn Street, Room 2772
Chicago, IL 60604

and by submitting the brief electronically.

____
Wendy L. Cox
Attorney for the United States Trustee

BRIEF BANK — “SUMMARY SHEET”

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WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*

In re Donald Standiferd and Betty Ann Standiferd (Ronald Standiferd and Betty Ann Standiferd v. United States Trustee)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*

D. N.M.

3. ("CCN") ***CURRENT*** CASE NO.

No.: 1:09-cv-00083-RB-RLP

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*

No.: 00-16958-m7

Court: Bankr. N.M.

(Identify judge & cite, if any)

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U.S. TRUSTEES

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Leonard K. Martinez-Metzgar, Ron E. Andazola, Diarmuid Gorham, P. Matthew Sutko

(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***

BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s)

&

√ Any Miscellaneous ***BACKGROUND***

• Whether the bankruptcy court property applied 11 U.S.C. § 727(a)(6)(A), and, if so, whether it committed clear error in finding that the appellants’ disobeyed a lawful order of the court.

10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)

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UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF NEW MEXICO

IN RE:

RONALD STANDIFERD and
BETTY ANN STANDIFERD

Debtor(s). **No. 00-16958 m7**

RONALD STANDIFERD and
BETTY ANN STANDIFERD,

Appellants

v. **1:09-cv-00083-RB-RLP**

UNITED STATES TRUSTEE,
Appellee.

<u>ON APPEAL FROM A FINAL ORDER OF</u>
<u>THE UNITED STATES BANKRUPTCY COURT</u>
<u>FOR THE DISTRICT OF NEW MEXICO</u>
<u>THE HONORABLE MARK B. McFEELEY</u>

BRIEF FOR APPELLEE
UNITED STATES TRUSTEE

RICHARD A. WIELAND
United States Trustee

Ron E. Andazola
Assistant United States Trustee

Leonard K. Martinez-Metzgar
Trial Attorney
United States Department of Justice
P. O. Box 608
Albuquerque, NM 87103
(505) 248-6548

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JURISDICTIONAL STATEMENT

On December 17, 2008, the bankruptcy court entered Findings of Fact and Conclusions of Law and a separate Judgment sustaining the United States Trustee's objections to discharge under 11 U.S.C. §§ 727(a)(2)(B), and (6)(A) and accordingly denied the Standiferds' discharge.[1] The Standiferds filed their Notice of Appeal of the Judgment on December 24, 2008. This Court has appellate jurisdiction over the bankruptcy court's entry of a judgment in favor of the United States Trustee pursuant to 28 U.S.C. § 158(a)(1) and Federal Bankruptcy Rule 8001(a).

STATEMENT OF ISSUES TO BE PRESENTED

(1) The bankruptcy court denied the Standiferds' discharge under section 727(a)(6)(A) because the Standiferds refused to obey a lawful order of the court. The question on appeal is whether the bankruptcy court properly applied 11 U.S.C. §727(a)(6)(A), and, if so, whether it committed clear error in finding that the Standiferds' disobeyed a lawful order of the Court.

(2) The bankruptcy court also denied the Standiferds' discharge under section 727(a)(2) because the Standiferds concealed property of the chapter 13 estate after the petition date with the intent to hinder, delay, or defraud creditors. The question on appeal is whether:

(a) As the Standiferds suggest, the bankruptcy court must, as a matter of law, ignore their misconduct while their bankruptcy case was pending in chapter 13, when denying their discharge under section 727(a); and

(b) If the bankruptcy court properly considered that misconduct, whether the bankruptcy court committed clear error in finding that the Standiferds converted their case in bad faith and concluding that their concealed assets are property of the chapter 7 estate.

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[1] The Court alternatively held that the Standiferds' bad acts during the pendency of their bankruptcy proceeding warranted dismissal of their case without discharge pursuant to 11 U.S.C. § 707(a)

This Court can affirm the denial of the Standiferd's discharge on either ground.

STATEMENT OF STANDARD OF REVIEW

This Court reviews the bankruptcy court's conclusions of law *de novo*. *See Mathai v. Warren (In re Warren)*, 512 F.3d 1241, 1248 (10th Cir. 2008). Findings of fact, whether based on oral or documentary evidence, shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the bankruptcy court to judge the credibility of witnesses."[2] Fed. R. Bankr. P. 8013; *See also*, *In re Branding Iron Motel, Inc.*, 798 F.2d 396, 399 (10th Cir. 1986); *In re Mullett*, 817 F.2d 677, 678 (10th Cir. 1987). "In reviewing the factual findings, an appellate court may not weigh the evidence or reverse a finding because it would have decided the case differently." *Id. See also, Bartmann v. Maverick Tube Corp.*, 853 F.2d 1540, 1543 (10th Cir. 1988). A bankruptcy court's factual findings should not be disturbed absent "the most cogent reasons appearing in the record." *Kansas Federal Credit Union v. Wiemeier*, 227 F.2d 287, 291 (10th Cir. 1955). *See also*, *In re Pikes Peak Water Co.*, 779 F.2d 1456, 1458 (10th Cir. 1985); *In re Reid*, 757 F.2d 230, 233-34 (10th Cir. 1985); *See Connolly v. Harris Trust Company of Calif. (In re Miniscribe Corp.)*, 309 F.3d 1234, 1240 (10th Cir. 2002). A finding of fact is clearly erroneous if it is without factual support in the record or if, after reviewing all of the evidence, the reviewing court is left with the definite and firm conviction that a mistake has been made. *In re Miniscribe Corp.*, 309 F.3d at 1240. The facts are to be reviewed in the light most favorable to the trial judge's factual findings. *See Gillman v. Ford (In re Ford)*, 492 F.3d 1148, 1154 (10th Cir. 2007). Any inferences, deductions and conclusions to be drawn from the evidence are left to the sound discretion of the trial judge. *See id.* A bankruptcy court

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[2] FED. R. BANKR. P. 7052 requires a bankruptcy court to make findings of fact and conclusions of law. This requirement is satisfied as long as the court's findings clearly show an appellate court the basis for the bankruptcy court's decision. *See Bell v. AT & T*, 946 F.2d 1507, 1510 (10th Cir. 1991).

determination of fraud regarding discharge is reviewed for clear error. *Williamson v. Fireman's Fund Ins. Co.*, 828 F2d 249, 251 (4th Cir. 1987); *Dean v. McDow*, 299 B.R, 133,139 (E. D. Va. 2003); Fed. R. Bankr. P. 8013.

STATEMENT OF FACTS

The Standiferds filed a chapter 13 petition on December 28, 2000. *See* 11 U.S.C. § 1301, *et seq.* and (Exhibit 1)[3] In a chapter 13 case, the debtor must file a plan that provides for the contribution of all or such portion of a debtor's future earnings necessary to the execution of the plan. 11 U.S.C. §§ 1321, 1322. The debtor's post-petition earnings for services performed by the debtor become property of the bankruptcy estate. *See* 11 U.S.C. § 1306.

A bankruptcy court may only confirm a plan that has been proposed in good faith. *See* 11 U.S.C. § 1325(a). The proposed plan must also comply with the provisions of 11 U.S.C. § 1301, *et seq.* as well as all other applicable provisions of Title 11. *Id.* If the proposed plan meets the requirements of 11 U.S.C. § 1325, the bankruptcy court shall confirm the plan. *Id.* The provisions of the confirmed plan bind the debtor. 11 U.S.C. § 1327. The order confirming the plan may affect the rights and obligations of a debtor in connection with the plan. For example, the confirmation order may dictate the timing and manner of payments under the plan or may provide for, or limit, the re-vesting of estate property in the debtor. 11 U.S.C. §§ 1326 and 1327.

In this case, the Standiferds filed a proposed plan on January 12, 2001, (UST Exhibit 4) and later an amended plan February 8, 2001 (UST Exhibit 5). Both plans proposed to use the Standiferds tax refunds and other income to repay creditors. (UST Exhibits 4 and 5) The amended plan proposed to repay the Standiferds' debts over 36 months through monthly

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[3] For brevity, references to the record with respect to exhibits introduced by the respective parties at the hearing on the United States Trustee's objections to discharge shall be referred to as "Exhibit" or "UST Exhibit" respectively.

payments of $470 derived from earnings. (UST Exhibit 5) In order to adequately fund the plan, the Standiferds proposed to supplement these payments by the contributing their tax refunds and any proceeds from pending litigation against Mr. Standiferds' former business partners. (UST Exhibits 1 and 5)

In their original schedules and statements filed on January 12, 2001, under the penalty of perjury, the Standiferds disclosed a total of $229,217.93 in unsecured debt. (UST Exhibit 1)

On January 15, 2002, the bankruptcy court entered an order confirming the amended chapter 13 plan. (UST Exhibit 6) The order directed the Standiferds to do four things:[4]

(a) If the Standiferds began engaging in business they were required to file monthly operating reports. (UST Exhibit 6, ¶ 7)

(b) The Standiferds were required to timely file all tax returns and provide copies thereof to the chapter 13 trustee throughout the duration of the plan. The Standiferds were also to pay all federal and state tax refunds into the plan for distribution to creditors. (UST Exhibit 6, ¶ 11)

(c) The Standiferd were not to incur any additional debt outside the ordinary course of business without further order of the court. (Exhibit 6, ¶ 4)

(d) If the Standiferds received any bonuses, they were required to notify the chapter 13 trustee of the receipt of said bonuses with documentation showing the exact amount received. The Standiferds were further required to pay 60 percent of the gross amount of any bonuses they received to the chapter 13 trustee, in addition to the regular monthly plan payment of $470.00. (UST Exhibit 6, ¶ 12)

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[4] It should be noted that the order contained other provisions affecting the rights and obligations of the Standiferds, for example with respect to specific creditors or claims, and also contained various administrative directives, i.e., that the Standiferds report any change of address to the chapter 13 trustee. (UST Exhibit 6)

In addition, the confirmation order also preserved the chapter 13 trustee's right to object to any discharge of a plan which paid less than 100 percent to unsecured creditors. (UST Exhibit 6, ¶ 10)

The Standiferds' attorney was served with a copy of the confirmation order (UST Exhibit 6). The Standiferds understood that they were required to provide copies of their tax returns to the chapter 13 trustee and file monthly operating reports. (Debtors' Exhibit C and D - as shown in the U. S. Trustee's Supplemental Findings and Conclusions, Docket No. 35, Exhibit "E"),[5] (UST Exhibit 43, p.11, line 16-17, Transcript pp. 30-31)

During their case, each of the four requirements of the confirmation order was triggered: the requirement that they file operating reports, the requirement that they account for bonuses, the requirement that they not incur additional debt, and the requirement that they provide tax returns to the trustee. However, the Standiferds did nothing. In June, 2002, Mr. Standiferd began working for STX Construction Inc. (STKX) (Transcript pp. 86-87)

Shortly after going to work for STKX, Mr. Standiferd approached the owner of STKX, Deke Noftsker, about the possibility of forming a partnership. (Transcript p. 88, lines 1-7) On July 10, 2002 STKX and Ron Standiferd, d/b/a Standiferd & Sons Company formed a new partnership called S & S Joint Venture.[6] (UST Exhibit 8, Transcript p. 89) The S & S Joint

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[5] Debtors' Exhibits C and D as introduced at trial were voluminous and were not paginated. At the conclusion of trial, the Court directed the United States Trustee to file an addendum referring to the specific pages of Debtors' Exhibits C and D. (8/19/08 Transcript p.27). In this brief, reference will be made both to Debtors exhibits and to the United States Trustee's Supplemental Findings and Conclusions with separate documents attached thereto and separately labeled alphabetically (Exhibit UST A, B, C etc.).

[6] Mr. Standiferd also operated a sole proprietorship known as Standiferd & Sons Company since approximately 2000. (Transcript p. 23, line 6) Mr. Standiferd never opened a bank account in the name of Standiferd & Sons Company. (Transcript, p. 23, line 17) Mr. Standiferd also testified that he reported any revenues he received as sole proprietor of Standiferd & Sons Company on the Standiferds' individual income tax returns. (Transcript p. 24, lines 13-19)

Venture partnership agreement spelled out the means for the distribution of profits, ownership percentages, and procedures for resolving disputes. (UST Exhibit 8) All check writing authority would be with the certified public accountant for STKX and Deke Noftsker. (Transcript p. 97, line 1)

On November 8, 2004, Mr. Standiferd incorporated Standiferd & Sons, Inc.[7] (UST Exhibit 20) In June 2005, Standiferd and Sons, Inc. substituted as a partner for Standiferd and Sons Company in the S & S Joint Venture. (UST Exhibit 8, p.5) Standiferd & Sons, Inc. owned no vehicles or equipment or any other assets (Transcript p. 43, lines 13-15) except the right to receive bonuses from S & S Joint Venture. (Transcript p. 44, lines 6-8) Mr. Standiferd told Deke Noftsker that he sought the substitution to shield his assets and income. (Transcript p. 96, lines 17-22) Standiferd & Sons, Inc. did not have a bank account of any kind until August 2006. (Transcript p. 44, lines 17-19)

During the course of the chapter 13 bankruptcy proceeding, the partnership entered into several construction contracts which generated a profit. (UST Exhibits 9, 12, 15, 16) In 2003, Mr. Standiferd made $52,000 in wages from his employment with STKX. (UST Exhibit 10) In addition, Mr. Standiferd also received checks written from the S & S Joint Venture account which totaled $15,000 in bonuses. (UST Exhibit 11) The Standiferds deposited all revenues received from S & S Joint Venture into their personal account at Wells Fargo. (Transcript p. 29, lines 1-10)

Despite the requirements of the confirmation order, the Standiferds never disclosed these funds to the chapter 13 trustee in monthly operating reports, because they never filed any.

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[7] Mr. Standiferd was a 70 percent owner and Betty Standiferd was a 30 percent owner. (Transcript p. 43, line 8).

(Transcript p. 28, lines 2-5) Needless to say, the Standiferds also failed to turn over any portion of the bonus to the chapter 13 trustee, despite the directive of the confirmation order. (Transcript p. 28, lines 1-10) The Standiferds also failed to provide tax returns, which would have disclosed these amounts, and were also required to be turned over to the chapter 13 trustee pursuant to the confirmation order. (UST Exhibit 6)

In 2004, Mr. Standiferd reported wages in the amount of $48,000.00 according to his W-2. (UST Exhibit 13) In addition, he received bonus checks from S & S Joint Venture totaling $100,000.00. (UST Exhibit 14) Once again, in violation of the requirements of the confirmation order, the Standiferds failed to disclose the bonuses received in 2004 from S & S Joint Venture to the chapter 13 trustee, failed to file monthly operating reports and again failed to provide their tax returns to the chapter 13 trustee as required under the confirmation order. (Transcript p. 28-29)

According to Mr. Standiferd's W-2 for 2005, Mr. Standiferd made wages in the amount of $52,000. (UST Exhibit 17) In addition, he received bonus checks totaling $20,000 from S & S Joint Venture. (UST Exhibit 14) None of the bonus funds were reported in monthly operating reports and none of the bonuses were disclosed to the chapter 13 trustee because Standiferds never provided tax returns to the chapter 13 trustee as required by the confirmation order. (Transcript p. 30, lines 11-13) Over the course of the three year plan term, the Standiferds ignored the three requirements of the confirmation order that they provide tax returns, report and provide 60 percent of bonuses received, and file operating reports to the extent they engaged in any business. Mr. Standiferd admitted that he never voluntarily told the chapter 13 trustee about S & S Joint Venture or the bonuses he received from it, nor did he amend his schedules to reflect his interest in S & S Joint Venture. (Transcript p. 50, lines 11-22)

The Standiferds were given every opportunity to comply with the requirements of the confirmation order. The chapter 13 trustee sent letters to the Standiferds reminding them of their obligation to submit tax returns to the chapter 13 trustee. (Transcript p. 59, lines 3-7) The chapter 13 trustee also sent end of the year reports to the Standiferds, reminding them of their obligation to submit tax returns to the trustee. (Debtors' Exhibit C and D - as shown in the United States Trustee's supplemental findings and conclusions, Docket No. 35, exhibit "A") The chapter 13 trustee never received tax returns for the years 2003, 2004, and 2005. (Transcript, p. 57, lines 13-15) Mr. Standiferd falsely testified at his Fed. R. Bankr. P. 2004 examination that the income he received from S & S Joint Venture was reported to the trustee in his personal tax returns though not in monthly operating reports.[8] (UST Exhibit 44, p. 30-33)

Rather than comply with the confirmation order, the Standiferds instead spent all of the unreported bonuses they received, with the majority of being spent on home improvements.[9] (Transcript p. 29, lines 11-13)

After failing to receive the Standiferds 2003 tax return, on May 16, 2003, the chapter 13 trustee filed a motion to dismiss alleging the Standiferds' failure to provide copies of tax returns and/or failure to contribute tax refunds to the plan as required by the confirmation order. (*See* No. 00-16958, Docket No. 102) On June 5, 2003, the Standiferds filed a motion to modify their plan by waving the requirement to contribute tax refunds for 2001 and 2002, due to Mr. Standiferd's unemployment between April to July 2002. (*See* Case No. 00-16958, Docket No.

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[8] A Fed. R. Bankr. P. 2004 examination is generally a deposition which is limited to acts, conduct, or property of the debtor, the debtor's liabilities and financial condition, the administration of the bankruptcy estate, or to the debtor's right to a discharge. Rule 2004 examinations are conducted when there are no pending motions or other litigation against debtors.

[9] Betty Standiferd handled the Standiferds' finances**.** (Transcript p. 19, lines 2-6)

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The chapter 13 trustee's first motion to dismiss was denied. (Case No. 00-16958, Docket No. 116) The motion to waive the tax refund requirement was granted by stipulation between the parties. (Case No. 00-16958, Docket No. 116) The stipulation provided that payment of $3,907.00 in tax refunds, which the Standiferds had received in 2001 and 2002 would be deferred until the end of the plan term in the event that 100 percent of unsecured claims were not paid. (*See* No. 00-16958, Docket No. 116)

The chapter 13 trustee filed a second motion to dismiss on October 16, 2006, alleging *inter alia*, the Standiferds' failure to provide accounting of bonus income, failure to provide copies of tax returns, and failure to contribute tax refunds to the plan. (*See* No. 00-16958, Docket No. 123) The bankruptcy court held a hearing on the motion to dismiss on November 16, 2006. Several days later, on November 22, 2006, the Standiferds voluntarily filed a notice of conversion of their chapter 13 proceeding to one under chapter 7. (*See* No. 00-16958, Docket No. 129)

After conversion, the Standiferds amended their schedules. Despite the mandate of the confirmation order that they not incur debt outside the ordinary course without court approval, in their amended Schedule F filed on December 15, 2006, the Standiferds disclosed a total of $653,153.98 in unsecured debt. (UST Exhibit 3, p. 13; *see also*, No. 00-16958, Docket No. 134) During the course of the chapter 13 proceeding, the Standiferds' unsecured debt had nearly tripled from the amount set forth in their schedules at the outset of the case. (UST Exhibit 1) In their Amended Schedule B filed on May 8, 2007, the Standiferds also disclosed, for the first time, their 100 percent ownership of Standiferd & Sons, LLC and 100 percent ownership of Sands Construction, LLC, but still failed to disclose their interest in S & S Joint Venture. (UST Exhibit 16; *see also*, No. 00-16958, Docket No. 162)

The Standiferds never filed monthly operating reports (Exhibit 7) nor did they provide the chapter 13 trustee with copies of tax returns for 2003, 2004, or 2005. (Transcript p. 57 lines 13-15) The Standiferds never informed the chapter 13 trustee about the formation or operation of S & S Joint Venture, nor their ownership interest in it. (Transcript p. 50, lines 11- 22) Finally, the Standiferds never disclosed their business profits or bonuses from S & S Joint Venture to the chapter 13 trustee. (Transcript p. 50, lines 19- 22)

On May 21, 2007, the United States Trustee filed a complaint objecting to the Appellants' discharge under 11 U.S.C. §727 (a)(2)(B), 11 U.S.C. §727 (a)(4)(D), 11 U.S.C. §727(a)(6)(A), and 11 U.S.C. §727 (a)(5). (Adv. No. 07-01076, Docket No. 1)

After a two day trial, the bankruptcy court entered judgment in favor of the United States Trustee on December 17, 2008 and issued its findings of fact and conclusions of law that same day. (Case No. 07-01076, Docket Nos. 41 and 42) The Court denied the Standiferds' discharge under 11 U.S.C. § 727(a)(6)(A) and/or 11 U.S.C. § 727(a)(2)(B) (Case No. 07-01076, Docket Nos. 41 and 42) The bankruptcy court found that the Standiferds willfully failed to comply with the confirmation order, and further found that the Standiferds had concealed assets of the bankruptcy estate with the intent to hinder delay or defraud their creditors. (Case No. 07-01076, Docket No. 42) On December 24, 2008, the Standiferds timely appealed the bankruptcy court's judgment. (Case No. 07-01076, Docket No. 44)

SUMMARY OF ARGUMENT

The bankruptcy court found that denial of the Standiferds discharge was warranted under either 11 U.S.C. § 727(a)(6)(A) or 11 U.S.C. § 727(a)(2)(B). This Court can affirm under either basis. Denial was proper under section 727(a)(6)(A). The Standiferds willfully refused to comply with the terms of the bankruptcy court's order confirming their chapter 13 plan by failing to report and contribute business income, file operating reports and provide tax returns to the chapter 13 trustee. The confirmation order was a valid and enforceable order of the bankruptcy court and, thus, the court properly applied the plain meaning of section 727(a)(6) in determining that the Standiferds' willful and intentional conduct in disobeying that order supported denial of discharge.

Alternatively, Section 726(a)(2)(B) also warranted denial of the Standiferds' discharge because the Standiferds' concealed assets during their chapter 13 proceeding with the intent to, hinder, delay or defraud their creditors. The bankruptcy court properly considered the Standiferds' pre-conversion conduct in concluding that denial of discharge was warranted and in determining that the Standiferds converted their case in bad faith under section 348, which meant that the concealed assets became property of the chapter 7 estate upon conversion.

This Court may affirm the bankruptcy court's decision if the bankruptcy court's findings of fact and conclusions of law supported denial of discharge under <u>either</u> 11 U.S.C. § 727(a)(6)(A) or 11 U.S.C. § 727(a)(2)(B).

ARGUMENT

I. THE BANKRUPTCY COURT DENIED THE STANDIFERDS' DISCHARGE UNDER SECTION 727(a)(6)(A) BECAUSE THE STANDIFERDS REFUSED TO OBEY A LAWFUL ORDER OF THE COURT.

The United States Trustee filed his objection to discharge based, in part, on the Standiferds' admitted violation of their obligations under the confirmation order, to report bonus income to the trustee and contribute that income to their plan, file operating reports if they engaged in any business, and provide tax returns to the chapter 13 trustee. Section 727(a)(6)(A), provides that the Court shall deny the debtor a discharge when the debtor, as here, refuses to obey a lawful order of the Court.[10]

The requirements of 11 U.S.C. § 727(a)(6) are straightforward. Discharge is denied if "1) the Court issued an order directed at the debtor; 2) the order was lawful; 3) the order did not require the debtor to respond to a material question or to testify; and 4) the debtor refused to obey the order." *In re Green*, 335 B.R. 181,183 (Bankr. D. Utah 2005) Under 11 U.S.C. § 727(a)(6) some degree of willfulness or volition on the part of the debtor not to obey the order must be present. *Id*. at 184.

The initial burden is on the plaintiff to demonstrate that the debtor received the order and failed to comply with its terms. *Smith v. Jordan (In re Jordan)*, 521 F.3d 430, 434 (4th Cir. 2008) The burden then shifts to the debtor who must then explain the reasons for non-compliance. *Id.*

As an initial matter, there is no question that the order confirming the chapter 13 plan is a valid order of the bankruptcy court. The Tenth Circuit has confirmed that a confirmation order is a valid order, noting that "'[u]pon becoming final, the order confirming the chapter 13 plan represents a binding determination of the rights and liabilities of the parties as ordained by the plan. Absent timely appeal the confirmed plan is res judicata and its terms are not subject to collateral attack.'" *In re Talbot* 124 F.3d 1201, 1209 (10th Cir. 1997) (quoting 8 Collier on Bankruptcy ¶ 1327.02 (Lawrence P. King 15th ed.1996)) See also *In re Dial Business Forms* 341 F.3d 738, 744 (8th Cir. 2003) (holding a confirmed chapter 11 plan is a contract and order of the court).

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[10] Section 727(a)(6)(A) provides, in relevant part:

> The court shall grant the debtor a discharge unless–
> (6) the debtor has refused, in the case–
> (A) to obey any lawful order of the court, other than an order to respond to a material question or to testify;

11 U.S.C. § 727(a)(6).

The Standiferds violated the confirmation order in this case. The confirmation order required that they (1) timely file tax returns and provide copies to the chapter 13 trustee, (2) file operating reports if the Standiferds engaged in business, and (3) provide documentation to the chapter 13 trustee of all bonuses that the Standiferds received together with a payment of 60 percent of any such bonuses. (UST Exhibit 6) The Standiferds received the confirmation order and were aware of its terms. (Defendant's Exhibit C and D - itemized in United States Trustee's Supplemental Findings and Conclusions, Docket No. 35, Exhibit "UST E" and Exhibit 43) Six months after confirmation of their chapter 13 plan, in July 2002, the Standiferds formed S & S Joint Venture. (Exhibit 8) The purpose in forming the joint venture was to make money as a business venture. (Transcript p. 25, lines 9-12) During the next three years, the Standiferds received bonuses from their operation of a business totaling $135,000. (Exhibits 11, 14, 18) Not only did they fail to file monthly operating reports reflecting their operation of a business (Exhibit 7, Transcript p. 56, lines 6-8), they failed to report any of their bonus income or pay any portion thereof to the chapter 13 trustee. (Transcript, pp. 61-62, Exhibit 40) The Standiferds flagrantly disregarded the requirements of the confirmation order.[11]

The Standiferds' failure to provide tax returns also violated the confirmation order, and conveniently furthered their efforts to hide their income from bonus payments from the chapter 13 trustee. In fact, the Standiferds only provided their 2002 tax return to the chapter 13 trustee in response to the trustee's motion to dismiss for failing to provide her with tax returns.

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[11] Not only did the Standiferds refuse to obey the confirmation order in failing to account for income, and providing tax returns, the Standiferds also ignored the provision of the order directing them not to incur additional debt outside the ordinary course without further order of the court. In their original schedules filed on January 12, 2001, the Standiferds disclosed unsecured claims totaling $229,217.93. (UST Exhibit 1, p.19) In an Amended Schedule F filed on December 15, 2006, the Standiferds disclosed unsecured debt totaling $653,153.98. While the Standiferds' case was pending in chapter 13, they virtually tripled their debt. (UST Exhibit 3, p.13) It is self evident that this is not the case of an unfortunate debtor, but an abuse of the chapter 13 process by debtors who believed they could ignore the order of the bankruptcy court and then avoid the consequences of their conduct by converting their case to one under chapter 7.

(Transcript pp. 56-57) At this point, there can be no argument that the Standiferds were unaware of their obligation to provide tax returns. Yet they continually failed to do so, which resulted in the chapter 13 trustee filing another motion to dismiss on October 16, 2006. (Exhibit 40) Although Mr. Standiferd testified under oath at his meeting of creditors on March 5, 2007, that he had provided tax returns "every year," (Exhibit 43, p.11, lines 11-16) it is clear he did not provide tax returns for the years 2003, 2004 and 2005 as testified by the chapter 13 trustee. (Transcript p. 57 lines 13-15)

A. THE BANKRUPTCY COURT PROPERLY APPLIED 11 U.S.C. §727(a)(6)(A).

Ample evidence in the record supports the bankruptcy court's finding that the Standiferds willfully disobeyed an order of the Court within the meaning of section 727(a)(6)(A). The Standiferds do not contest the evidence supporting this finding. (Appellants' Brief at 15-19) Instead, they argue that the bankruptcy court failed to apply the "plain meaning" of section 727, which they claim requires the conclusion that section 727(a)(6) is not applicable to orders issued while a case is pending in chapter 13. (Appellants' Brief at 8) However, Section 727(a)(6)(A) says no such thing. The Standiferds' seek to amend section 727(a)(6)(A) by adding words to the statute that are not there and then use those words to avoid the natural consequences of their misconduct. The bankruptcy court refused to allow the Standiferds to rewrite section 727 to achieve such an inequitable result. The court in doing so, applied the text of the relevant statute. The court's result, which is both just and lawful, merits affirmance.

Section 727(a)(6)(A) reads: "[t]he court shall grant the debtor a discharge unless . . . (6) the debtor has refused in the case– to obey any lawful order of the court . . .." 11 U.S.C. § 727(a)(6)(A) The Standiferds seek to amend it to add "in the [chapter 7] case" to the phrase "in the case." (Appellants' Brief at 15-16) The Standiferds do not cite even one case justifying the qualification "chapter 7" to the word "case" in section 727(a)(6)(A). Courts apply statutes as written. *Lamie v. U.S. Trustee,* 540 U.S. 526, 534 (2004) Here the Standiferds willfully violated a "lawful order of the court." As a result, denial of discharge was justified.

The Standiferds suggest that 11 U.S.C. § 1307(a) merits a different result. Section 1307(a) provides that "[t]he debtor may convert a case under this chapter to a case under chapter 7 of this title at any time." The Standiferds argue that because section 1307 does not read that the debtor may convert "the case from chapter 17 (sic) to chapter seven," the reference in section 1307(a) is to two separate cases. (Appellants' Brief at 16) The Standiferds therefore contend that upon conversion, the chapter 13 case is separate from the chapter 7 case. As a result, the Standiferds argue that 11 U.S.C. § 727(a)(6) applies only to orders issued by the court while a chapter 7 case is pending. This argument is wrong as a matter of statutory construction because the Standiferds' argument ignores 11 U.S.C. § 348(a) which provides:

> Conversion of the case from a case under one chapter of this title to a case under another chapter of this title constitutes an order for relief under the chapter to which the case is converted but, except as provided in subsections (b) and (c) of this section, does not effect a change in the date of the filing of the petition, the commencement of the case, or the order for relief.

11 U.S.C. § 348(a). The Standiferds reading of section 727 is similarly unsupported by case law See *In re Lyons*, 162. B.R. 242, 243 (Bankr. E.D. Mo. 1993) (interpreting section 348(a) in connection with an objection to discharge under 11 U.S.C. § 727(a)(8), and finding that where a chapter 13 case converted to chapter 7, the chapter 7 was deemed to have commenced on the date the original chapter 13 petition was filed); *In re Sours* 350 B.R. 261, 268 (Bankr. E.D. Va. 2006) (converted case deemed filed as of the date of the original petition); *In re Capers* 347 B.R. 169 (Bankr. D.S.C. 2006); *Shaw v. Ehrlich* 294 B.R. 260 (W.D. Va.2003); *In re Canganelli* 132 B.R. 369 (Bankr. N.D. Ind.1991); *In re Burrel*, 148 B.R. 820 (Bankr. E.D. Va. 1992); *In re*

Marshall, 74 B.R .185 (Bankr. N.D.N.Y. 1987).[12]

Nor could the general provisions of section 348 overturn section 727(a)(6)'s more specific rule that the court shall grant the debtor a discharge unless– "the debtor has refused, *in the case*- to obey any lawful order of the court. . ..." 11 U.S.C. § 727(a)(6) (emphasis added) Here the Standiferds violated multiple provisions of a court order. *See supra,* pp. 5-10. The bankruptcy court was well within its discretion in denying discharge given their misconduct.

B. THE STANDIFERDS DISOBEYED A LAWFUL ORDER OF THE COURT.

The Standiferds also contend that denial of discharge was improper under section 727(a)(6) because the confirmation order was not a "lawful order." (Appellants' Brief at 16) They argue that, "in a chapter 13 case, the confirmation order is, in fact, and can lawfully be no more than an approval of a proposal by the debtor to the creditors." (Appellants' Brief at 19) Therefore, they contend that the bankruptcy court had no authority to order that they file monthly operating reports, provide tax returns to the chapter 13 trustee, turnover tax refunds, or document bonuses and pay 60 percent of those proceeds to the chapter 13 trustee.

The Standiferds cite no support for this proposition. The Bankruptcy Code does not support their reading. *See* 11 U.S.C. §§ 1306 (b) (referring to the "order confirming a plan"); 1326(c) (referring to the "order confirming a plan"); 1327(b) (same); 1327(c) (same); 1330(a) (which provides for the revocation "of an order of confirmation"); and 1330(b) (which discusses

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[12] The Standiferds quibble with *In re Sharp,* 305 B.R. 571 (Bankr. M.D. Fla.2003), a case cited by the bankruptcy court, suggesting it is inapplicable to this case because it was decided under section 727(a)(7) and not section 727(a)(6). That is not significant here, because section 727(a)(7) is even broader than (a)(6) in that it allows denial of discharge based on conduct occurring outside the bankruptcy or in an entirely different proceeding, let alone in a converted case. And, in *Sharp,* the denial of discharge under (a)(7) was based on a violation of a (6) because of the individual chapter 7 debtor's failure to obey an order entered in the chapter 11 case. More importantly, *Sharp* is not determinative here. Section 726(a)(6)'s text is, and, it allows denial of discharge when, as here, the debtors violate and order "in the case."

the effect of revocation of "an order of confirmation.")

Given these repeated references to orders of confirmation, which occur in a debtor's case, it is clear that Congress intended confirmation orders to be exactly what they purport to be– an order "in the case." Beyond question, a confirmation order issued in this case. (No. 00-16958, Docket No. 71) The Standiferds violated it. (Findings of Fact and Conclusions of Law, Docket No. 42, p. 20) Given this, the bankruptcy court did not abuse its discretion in by denying discharge under section 726(a)(6).

The Standiferds next argue (again, without citing a single case) that chapter 13 is entirely voluntary, and thus a debtor may willfully and with impunity choose to ignore the confirmation order.[13] (Appellants' Brief at 18) According to the Standiferds' the only remedy for this conduct is to file a motion under 11 U.S.C. § 1307(c) to convert or dismiss the proceeding. (Appellants' Brief at 18) The problem with the Standiferds' argument is that no statute even remotely suggests this, and the plain language of section 726(a)(6) refutes it. Moreover, there is nothing improper in the confirmation order.[14] The Standiferds fail to explain why any provisions of the confirmation order were unnecessary or inappropriate to the confirmation process. In fact, such provisions were necessary and appropriate given that the Standiferds' plan proposed a 100 percent payment to unsecured creditors. (UST Exhibit 5) As listed in Schedule F of their schedules, the Standiferds owed $229,217.93 in unsecured debt (UST Exhibit 1, p.19) and clearly could not pay such debt with proposed monthly payments of $470.00 for a period of 36 months. (UST Exhibit 5) The confirmation order thus included provisions requiring the contribution of bonus proceeds and tax refunds. In support of their novel suggestion that the

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[13] The issue in this instance is not whether the Standiferds' could fail to comply with the bankruptcy court's direction that certain payments be made. Rather, the issue is the Standiferds' failure to disclose their finances which allowed them to conceal estate property.

[14] Even if there were, the Standiferds would have had to appeal that order. The did not, so they are collaterally estopped from challenging it here. *See, e.g., In re Otasco*, 18 F.3d 841 (10th Cir. 1994).

confirmation order was not an order but merely some sort of amorphous stipulation between the Standiferds, the chapter 13 trustee, and certain creditors, the Standiferds cite *In re Jefferson*, 323 B.R. 767 (Bankr. D. Colo. 2005), a case which was also cited by the bankruptcy court. The *Jefferson* case is clearly distinguishable from these circumstances, because it involved an order that simply approving a stipulation and the debtors in that case had no obligation to do anything under the terms of the order. 323 B.R. at 768. However, in this case, the last 12 paragraphs of the confirmation order entered on January 15, 2002, are preceded by the words, "IT IS FURTHER ORDERED, ADJUDGED AND DECREED . . .." (UST Exhibit 6) Clearly, the Standiferds were required to take certain actions and the confirmation order was not a simple stipulation. Further, as stated by one court, "An order confirming the chapter 13 plan is res judicata as to all justiciable issues which were or could have been decided at the confirmation hearing ." *In re Patterson*, 107 B.R. 576, 578 (Bankr. S.D. Ohio 1989) The confirmation order is far more than simply a rubber stamp of an agreement between the parties.

II. THE BANKRUPTCY COURT DENIED THE STANDIFERDS' DISCHARGE UNDER SECTION 727(a)(2) BECAUSE THE STANDIFERDS CONCEALED PROPERTY OF THE CHAPTER 13 ESTATE AFTER THE PETITION DATE WITH THE INTENT TO HINDER, DELAY, OR DEFRAUD CREDITORS

The bankruptcy court's denial of discharge pursuant to 11 U.S.C. § 727(a)(2) is supported by the record. Section 727(a)(2) provides for the denial of discharge where a debtor "with intent to hinder, delay, or defraud a creditor or an officer of the estate charged with custody of property *under this title*, has transferred, removed, destroyed, mutilated, do or concealed, or has permitted to be transferred, removed, destroyed, mutilated, or concealed" property of the estate, after the date of the filing of the petition. 11 U.S.C. § 727(a)(2) (emphasis added) To prevail in an adversary proceeding under this section, the plaintiff must prove that: (1) the debtor transferred or concealed; (2) property of the estate after the date of the filing of the petition; (3) with the intent to hinder, delay, or defraud creditors. *In re Milano*, 35 B.R.89, 91 (Bankr. S. D. N. Y. 1983); *Hunter v Sowers (In re Sowers)*, 229 B.R. 151 (Bankr. N.D. Ohio 1998), *In re Bostick*, 400 B.R. 348 (Bankr. D. Conn. 2009) Denial of discharge under section 727(a)(2)(B) requires actual intent to hinder, delay, or defraud a creditor or officer of the estate. *Johnson v Johnson (In re Johnson)*, 387 B.R. 728, 749 (Bankr. S. D. Ohio 2008)

Concealment within the meaning of 11 U.S.C. §727(a)(2)(B) means simply withholding knowledge of an asset by the failure or refusal to divulge required information. *Sowers* at 229 B.R. at 156 (citing *In re Martin*, 698 F. 2d 883 (7th Cir. 1983))

Fraudulent intent may be inferred based upon the surrounding facts and circumstances. *In re Searles*, 317 B.R. 368,369 (B.A.P. 9th Cir. 2004), *aff'd* 212 Fed. Appx. 589 (9th Cir. 2006) ("intent to hinder, or to delay, or to defraud the trustee . . . is a question of fact that requires the trier of fact to delve into the mind of the debtor and may be inferred from surrounding circumstances.") Just one wrongful act may be sufficient to show actual intent under section 727(a)(2) but a continuing pattern of wrongful behavior is a stronger indication of actual intent. *Hunter v Sowers (In re Sowers)*, 229 B.R. 151,157 (Bankr. N. D. Ohio 1998) Evidence tending to show oversight or ignorance in his actions will tend to negate the actual intent to defraud as long as the debtor did not act in a manner constituting a reckless indifference to the truth. *Id* at157. See *Retirement Company, LLC v Heil (In re Heil)*, 289 B.R. 897, 908 (Bankr. E. D. Tenn. 2003) (concluding that the cumulative evidence established fraudulent intent, or at a minimum reckless indifference for the truth, "which is a requisite for each section [§ 727(a)(2)(A), § 727(a)(2)(B), and § 727(a)(4)(A)].) Another strong factor tending to indicate a debtor's fraudulent intent under §727(a)(2)(B) involves examining the general chronology of the events and transactions under inquiry. *Sowers* at 157. The underlying purpose of 11 U.S.C. § 727(a)(2)(B) is "to deny discharge to a debtor who 'fails to disclose transactions regarding his assets subsequent to filing his petition for bankruptcy.'" *Johnson*, 387 B.R. at 749 (quoting *Sicherman v Rivera (In re Rivera*), 338 B.R. 318,328 (Bankr. N. D. Ohio 2006) (quoting *In re Caserta*, 182 B.R. 599, 606 (Bankr. S. D. Fla. 1995))

In this case, there is substantial evidence supporting the bankruptcy court's findings of concealment of property with the intent to hinder, delay, or defraud creditors, all of which supports the denial of discharge. The confirmation order required that the Standiferds take several actions. First, the order required that the Standiferds file monthly operating reports if they engaged in business. (Exhibit 6, p 3, ¶ 7) On July 10, 2002, S & S Joint Venture (hereafter S & S) was formed (Exhibit 8). Mr. Standiferd testified that S & S was formed as a money making venture. (Trans p. 25, lines 9-12)

In 2003, the Standiferds received bonus checks from S & S totaling $15,000. (UST Exhibit 11), (Findings of Fact and Conclusions of Law, Case No. 07-01076, Docket No. 42 at p. 5)

In 2004, the Standiferds received bonus checks from the S & S totaling $100,000 (UST Exhibit 14), (Findings of Fact and Conclusions of Law, Case No. 07-01076, Docket No. 42 at pp. 5-6)

Finally, in 2005 the Standiferds received bonus checks from S & S totaling $20,000. (UST Exhibit 18), (Findings of Fact and Conclusions of Law, Case No. 07-01076, Docket No. 42 at p. 6)

The Standiferds actively concealed these bonuses from the chapter 13 trustee by not filing operating reports and failing to provide tax returns to the chapter 13 trustee. (Findings of Fact and Conclusions of Law, Case No. 07-01076, Docket No. 42 at 18) Not a single monthly operating report is reflected in the case docket. (UST Exhibit 7) The bankruptcy court found that by not filing monthly operating reports and failing to provide tax returns as required by the plan, the Standiferds were intentionally concealing the bonuses received from S & S. (Findings of Fact and Conclusions of Law, Case No. 07-01076, Docket No. 42 at 18) This factual finding was not clearly erroneous. Indeed, the chapter 13 trustee never knew about the bonuses the Standiferds had received. (Transcript, p. 61, lines 15-25) At his creditors meeting in the converted chapter 7 case held on January 18, 2007, Mr. Standiferd admitted that he had agreed to report any business income outside of salary (Exhibit 42, p. 10, lines 2-10). But the unrebutted testimony of the chapter 13 trustee established that the Standiferds did not filed operating reports reflecting this income, which came from a business operated by the Standiferds. (Transcript pp. 55-56) Had the Standiferds filed such reports they would have disclosed the bonuses received from S & S.

The Standiferds' actual intent to defraud is further borne out by the record, which clearly demonstrates that the bankruptcy court's findings were not erroneous and ultimately support the bankruptcy court's conclusion that the Standiferds concealed estate assets with the intent to hinder, delay or defraud creditors. First, the confirmation order required that the Standiferds provide a copy of their tax returns to the Trustee. However, the Standiferds provided her a copy of the 2002 tax return only after the chapter 13 trustee filed her first motion to dismiss in 2002, and failed to provide returns for subsequent years through conversion. (Transcript p. 57, lines 10-12) Moreover, the chapter 13 trustee testified that she sends out requests twice a year reminding debtors to file their tax returns and provide copies to the chapter 13 trustee. (Transcript p. 57, lines 16-24) However, despite these requests, the chapter 13 trustee never received copies of tax returns from the Standiferds for 2003, 2004, and 2005. (Transcript p. 57, lines 13-15)

The chapter 13 trustee again alleged the Standiferds' failure to provide tax returns in her second motion to dismiss filed on October 16, 2006. (Exhibit 40) These tax returns would likely have disclosed the Standiferds concealed assets. When the chapter 13 trustee sought dismissal (UST Exhibit 40), the Standiferd's response was not to provide the tax returns, but instead to file a voluntary notice of conversion to chapter 7. (Exhibit 41) The bankruptcy court found that the failure to file operating reports or provide tax returns that would have revealed the Standiferds income under the facts and circumstances established that the Standiferds acted with the intent to hinder, delay or defraud their creditors. (Findings of Fact and Conclusions of Law, Case No. 07-01076, Docket No. 42 at 18)

This conclusion is further supported in the record by the testimony of Deke Noftsker, Mr. Standiferd's former business partner. Mr. Noftsker was a partner in S & S with Mr. Standiferd. He testified that Mr. Standiferd stated that he was going to use the profits from S & S to pay his creditors. (Transcript p. 101, lines 10-14) The Standiferds never did. Instead, they deposited all the bonuses received from S & S into their personal account (Transcript pp. 19-20) and used the funds to refurbish their home. (Transcript p. 20, lines 3-5)

Finally, the Standiferds' amended schedules, filed after the case was converted to chapter 7 (Exhibit 3) substantially support the bankruptcy court's finding of actual intent to hinder, delay or defraud. The amended schedules show their 100 percent interest in Standiferd and Sons, LLC and their 100 percent interest in Sands Construction LLC. However, the Standiferds still omitted their ownership interest in S & S. In response to the question regarding interests in partnerships or joint ventures, the Standiferds indicated they had none. (Exhibit 3, p. 16) There is also nothing in the amended schedules regarding the bonuses received from S & S. (Exhibit 3) Not only did the chapter 13 trustee never know about the bonuses, but by not disclosing them in the amended schedules, the Standiferds continued their ongoing concealment by preventing the chapter 7 trustee from making any inquiry at the chapter 7 section 341 meeting of creditors.

Thus, the bankruptcy court had ample support to find each element of a section 727(a)(2) violation. For that reason, denial of discharge merits affirmance.

A. SECTION 727 (a) IS APPLICABLE TO THE STANDIFERDS' ACTIONS AND OMISSIONS WHILE THEIR CASE WAS PENDING IN CHAPTER 13

The Standiferds do not contest the bankruptcy court's findings of fact in their brief. Instead, the Standiferds contend that section 727(a) does not apply to pre-conversion proceedings in the chapter 13 case. The Standiferds argue that under 11 U.S.C. § 103(b), section 727 applies only in chapter 7 cases and under 11 U.S.C. § 103(i), chapter 13 applies only in chapter 13 cases. Section 130(b) provides that subchapters "I and II of chapter 7 of this title apply only in a case under such chapter," while section 103(i) provides that chapter "13 of this title applies only in a case under such chapter." 11 U.S.C. § 103 (b) and (i) The Standiferds argument is incorrect on its face because it is not necessary to apply any provision of chapter 13 in finding that denial of discharge is proper under the facts and circumstances of this case. The Standiferds incorrectly equate the language of 103 to mean that their pre-conversion conduct cannot have any implication in connection with a denial of discharge under section 727. This is simply wrong.

The Standiferds' argument is unsupported by case law. In fact, the Fifth Circuit has held that sections 348(a) and (b), taken together, specifically incorporate 11 U.S.C. §727(b) and permit objections to discharge in converted cases. *In re Baker* 154 F.3d 534, 538 (5th Cir. 1998. While the Standiferds argue that *Baker* is not applicable since it dealt with facts which arose prior to the 1994 amendment to section 348, the 1994 amendment only added 11 U.S.C. § 348(f). *In re Baker*, 154 F.3d at 536, n. 2. The 1994 amendments made no changes to sections 348(a) and (b), so the Fifth Circuit's holding that section §727(b) has been incorporated by section 348 has not been overruled and remains valid.

In addition to *Baker*, a plain reading of section 727(a)(2) supports the applicability of objections to discharge in converted cases. As noted above, a discharge should be denied to a debtor who "with intent to hinder, delay, or defraud a creditor or an officer of the estate charged with custody of the property *under this title* has transferred, remove, destroyed, mutilated or concealed . . . property of the estate . . .." 11 U.S.C. 727(a)(2)(emphasis added) The phrase "under this title" makes clear that a discharge action may be pursued for the stated malfeasance committed while a case was pending under another chapter of Title 11.

Moreover, the Standiferds argument that 11 U.S.C. § 103(b) precludes the applicability of section 727(a) defies the rules of statutory construction. It is a well-settled rule of construction that statutory provisions should be interpreted so as to be in harmony with each other. *Jones v. St. Louis-San Francisco Ry Company* 728 F 2d. 257, 262 (6th Cir.1984); *Matter of Robison* 166 F.2d 166, 171 (7th Cir.1981); *In re Wilson*, 305 B.R. 4 (N.D. Iowa, 2004) But, sections 103(b) and section 727(a) harmonize easily, and in a common sense way. Section 103(b) states that "[s]ubchapters I and II of chapter 7 of this title apply only in a case under such chapter." 11 U.S.C. § 103(b) Section 727(a) is part of subchapter II of chapter 7. Section 103(b) certainly stands for the proposition that while a case is pending in chapter 13, statutory provisions under chapter 7 are not applicable. However, once a chapter 13 case is converted to chapter 7, statutory provisions such as section 727(a) are applicable to actions while the case was pending in chapter 13 in order to preserve the benefits of a chapter 7 discharge to honest debtors. Such an interpretation would also be in harmony with section 348(a) which, as stated above, provides that conversion from one chapter of title 11 to another does not effect a change in the date of the filing of the petition, the commencement of the case, or the order for relief. Indeed, as cited above, there are numerous cases which hold that in situations where cases are converted from chapter 13 to chapter 7, the chapter 7 is deemed to have been filed on the date of the original chapter 13. *E.g., In re Lyons* 162 B.R. 242 (Bankr. E.D. Mo. 1993)

B. THE STANDIFERDS INCORRECTLY ARGUE THAT SECTION 727(a) REQUIRES THAT (1) THE ACTS COMPLAINED OF MUST RELATE TO THE CHAPTER 7 CASE IN SPECIFIC WAYS AND (2) THAT THEIR CONCEALED ASSETS ARE NOT PROPERTY OF THE ESTATE.

While the Standiferds have argued that section 727(a) does not apply to pre-conversion proceedings in the chapter 13 case, they have at the same time admitted that section 727(a) does apply where the acts complained of relate to the chapter 7 case in specific ways. (Appellants' Brief at 11) The Standiferds contend that the property of the chapter 13 estate revested in the Standiferds during the chapter 13 and therefore, there was no estate property at the time of conversion. (Appellants' Brief at 13) As a consequence, the Standiferds argue they concealed no property of the estate within the meaning of section 727(a)(2)(B). The Standiferds seem to think that a debtor who conceals assets, but then dissipates those assets prior to conversion, cannot be held accountable post-conversion.

They are wrong. 11 U.S.C. § 1306(a) provides that property of a chapter 13 estate includes that property specified in section 541 as well as (1) all property of the kind specified in such section that the debtor acquires after the commencement of the case but before the case is closed, dismissed, or converted . . . and (2) earnings from services performed by the debtor after the commencement of the case but before the case is closed, dismissed, or converted . . ." 11 U.S.C. § 1306. The Standiferds' confirmed First Amended Plan mandated that property of the chapter 13 estate would only revest in the Standiferds "at the time of completion of the plan." (UST Exhibit 5 p.6) The plan further provided that should their case be "converted to a case under chapter 7 or 11 of Title 11, United States Code, property of the estate shall vest in accordance with applicable law. " (UST Exhibit 5 p. 6) It is clear that the Standiferds' unreported bonuses were property of the chapter 13 estate.

In this case, the Standiferds did not complete their plan and the property of the chapter 13 estate never revested in them. Because they converted their case to one under chapter 7, section 348(f) governs the subsequent disposition of property of their estate. Section 348(f) provides in relevant part:

> (f)(1) Except as provided in paragraph (2), when a case under chapter 13 of this title is converted to a case under another chapter under this title –
>
> > (A) property of the estate in the converted case shall consist of property of the estate, as of the date of the petition, that remains in the possession of or is under control of the debtor on the date of conversion...
>
> (2) If the debtor converts a case under chapter 13 of this title to a case under another chapter under this title in bad faith, the property of the estate in the converted case shall consist of the property of the estate as of the date of conversion.

11 U.S.C. §§ 348(f)(1)(A) and (f)(2) The purpose of section 348(f)(1)(A) is to "avoid penalizing debtors for their chapter 13 efforts by placing them in the same economic position they would have occupied if they had filed chapter 7 originally." *In re Fobber*, 256 B.R. 268, 277-278 (Bankr. E. D. Tenn. 2000) (citing *In re Pearson*, 214 B.R. 156,164 (Bankr. N.D. Ohio 1997)) Section 348(f)(1)(A) "was designed to mitigate the effect of §1306(a) [which provides that assets acquired post-petition are property of the estate] in cases converted from chapter 13 by excluding from property of the estate in the converted case property brought in to the estate under § 1306(a)." *In re Fobber*, 256 B.R. at 278; *see also Warren v. Peterson*, 298 B.R. 322, 326 (N.D. Ill. 2003) (the purpose of Section 348(f)(1) is to prevent debtors from losing additional property in a chapter 7 case after they have already made payments to creditors in an attempt to reorganize their debts through a chapter 13 plan).

In this case, the bankruptcy court found that the Standiferds failed to fully and accurately disclose their financial affairs before converting their case, therefore section 348(f)(1)(A) was not applicable. (Findings of Fact and Conclusions of Law, Case No. 07-01076, Docket No. 42 at

11-13) They do not contest this finding on appeal and their failure to provide monthly operating reports, tax returns and disclose their bonuses, clearly supports this finding. Conversion under such circumstances constitutes bad faith within the meaning of section 348(f)(2). *In re Siegfried* 219 B.R. 581 (Bankr. D. Colo. 1998) As a result, the bankruptcy court did not commit clear error in finding that the Standiferds converted their case in bad faith and the property of the chapter 7 estate comprised the property of the estate on the date of conversion. (Adv. No. 07-1076, Docket No. 42)

As of conversion though, the Stanidferds concealed income could not become property of the chapter 7 estate because the Standiferds spent it prior to conversion. The United States Trustee elicited testimony from Mr. Standiferd that the S & S profits were used to make home improvements. (Transcript p. 29, lines 11-13) Having established that the S & S profits were converted in form to improvements on the Standiferds' residence, it is clear that the appreciation in value of the Standiferds' home as a result of the improvements is property of the chapter 7 estate. The widely accepted rule is that, "[t]he conversion in form of property of the estate does not change its character as property of the estate." *Bradt v. Woodlawn Auto Workers, F.C.U.* 757 F.2d 512 (2nd Cir.1985); *see also In re Sayre* 321 B.R. 430 (Bankr. N.D. Ohio 2004) The improvements were property of the estate within the meaning of section 348(f)(2) on the date of conversion. For purposes of section 727(a)(2)(A), property of the estate, namely the S & S profits, were concealed in the form of improvements to the Standiferds' residence. Having established the other elements of section 727(a)(2)(A), the United States Trustee met the requirements for denial of the Standiferds' discharge.

C. WHILE CHAPTER 13 IS VOLUNTARY, CHAPTER 13 DEBTORS ARE BOUND BY THE REQUIREMENTS OF GOOD FAITH AND IN THE EVENT OF CONVERSION TO CHAPTER 7, ARE SUBJECT TO SECTION 727(A)

The Standiferds argue that chapter 13 is strictly voluntary and that the only remedies for their conduct in this case were either conversion to chapter 7 or dismissal of the chapter 13 case under 11 U.S.C. §1307(c). (Appellants' Brief at 5-6) They further argue that chapter 13 is designed "as something of a 'flea bath' for dishonest and unaccountable debtors." (Appellants' Brief at 10-11) First, this is legally irrelevant here. Second, it is wrong. The Standiferds contentions are at odds with the good faith requirement in filing a chapter 13 petition. 11 U.S.C. §1325(a)(7) In making an inquiry as to a debtor's good faith, consideration must be made "whether the debtor came to bankruptcy court seeking a fresh start under chapter 13 protection with an intent that is consistent with the spirit and purpose of that law-rehabilitation through debt repayment-or with an intent that contrary to its purposes-debt avoidance through manipulation of the Code." *In re Paley*, 390 B.R. 53 (Bankr. N.D.N.Y. 2008) (quoting *In re McGovern*, 297 B.R. 650, 660 (S.D. Fla. 2003))

In this case, the Standiferds filed their chapter 13 with $229,217.93 in unsecured debt. (UST Exhibit 1, p. 19) Upon conversion to chapter 7, the Standiferds listed $653,153.98 in unsecured debt. (UST Exhibit 3, p.13) They incurred this debt in violation of the confirmation order. (UST Exhibit 6) During the chapter 13, they withheld disclosure of $135,000 in bonuses they received. (UST Exhibits 11, 14) Nothing about the voluntary nature of chapter 13 allows the violation of the confirmation order or the manipulation of the Bankruptcy Code to allow the Standiferds to increase their unsecured indebtedness by nearly $424,000, while concealing property of the estate that would otherwise have been available to creditors.

III. THE BANKRUPTCY COURT DID NOT ERR IN CONSIDERING DISMISSAL OF THE CASE PURSUANT TO 11 U.S.C. SECTION 707(a) NOR DID THE COURT ABUSE ITS DISCRETION BY NOT DISMISSING THE CASE.

Finally, the Standiferds argue that they were somehow harmed by the bankruptcy court's dicta, that dismissal under section 707(a) would be an appropriate alternate ground for the decision. However, the the bankruptcy court did not base its ruling on section 707(a). (Appellants' Brief at 19) Thus, the Standiferds' argument is irrelevant. It is irrelevant because the bankruptcy court did not dismiss their case and because the bankruptcy court's ruling denied the Standiferds their discharge based on section 727(a) and not section 707(a). Moreover, even assuming, for the purposes of argument, that the bankruptcy court incorrectly considered dismissal under section 707(a), it was harmless error since the decision was not based on that ground. In this case, after considering the totality of the circumstances, the bankruptcy court did not abuse its discretion in ruling that the denial of discharge was the better resolution of the matter rather than the dismissal of the case. Given the Standiferds' scheme to hide in excess of $100,000 in income and their other misconduct, there was no error in the bankruptcy court's decision.

CONCLUSION

For these reasons, the United States Trustee respectfully requests that this court affirm the order entered below.

Respectfully submitted,

RICHARD A. WIELAND
United States Trustee

Electronically submitted
RONALD E. ANDAZOLA
LEONARD K. MARTINEZ-METZGAR
Trial Attorney(s)
United States Department of Justice
P. O. Box 608
Albuquerque, NM 87103
(505) 248-6548

I HEREBY CERTIFY that a true copy of the foregoing Appellee United States Trustee Brief together with the Addendum has been sent to the following counsel on this 15th day of June, 2009.

/s/ Leonard Martinez-Metzgar
LEONARD K. MARTINEZ-METZGAR
Trial Attorney

GEORGE M. MOORE , Esq.
Counsel for the Appellants
P.O. Box 216
Albuquerque, NM 87103
(505) 242-1218

APPENDIX

11 U.S.C. § 103(b), (h) &(i)

(b) Subchapters I and II of chapter 7 of this title apply only in a case under such chapter.

(h) Subchapter IV of chapter 11 of this title applies only in a case under such chapter concerning a railroad.

(i) Chapter 13 of this title applies only in a case under such chapter.

11 U.S.C. § 348(a) & (f)

(a) Conversion of a case from a case under one chapter of this title to a case under another chapter of this title constitutes an order for relief under the chapter to which the case is converted, but, except as provided in subsections (b) and (c) of this section, does not effect a change in the date of the filing of the petition, the commencement of the case, or the order for relief.

(f)(1) Except as provided in paragraph (2), when a case under chapter 13 of this title is converted to a case under another chapter under this title--

> (A) property of the estate in the converted case shall consist of property of the estate, as of the date of filing of the petition, that remains in the possession of or is under the control of the debtor on the date of conversion;
>
> (B) valuations of property and of allowed secured claims in the chapter 13 case shall apply only in a case converted to a case under chapter 11 or 12, but not in a case converted to a case under chapter 7, with allowed secured claims in cases under chapters 11 and 12 reduced to the extent that they have been paid in accordance with the chapter 13 plan; and
>
> (C) with respect to cases converted from chapter 13--
>
>> (i) the claim of any creditor holding security as of the date of the petition shall continue to be secured by that security unless the full amount of such claim determined under applicable nonbankruptcy law has been paid in full as of the date of conversion, notwithstanding any valuation or determination of the amount of an allowed secured claim made for the purposes of the case under chapter 13; and
>>
>> (ii) unless a prebankruptcy default has been fully cured under the plan at the time of conversion, in any proceeding under this title or otherwise, the default shall have the effect given under applicable nonbankruptcy law.

(2) If the debtor converts a case under chapter 13 of this title to a case under another chapter under this title in bad faith, the property of the estate in the converted case shall consist of the property of the estate as of the date of conversion.

11 U.S.C. § 707 (a)

(a) The court may dismiss a case under this chapter only after notice and a hearing and only for cause, including –

> (1) unreasonable delay by the debtor that is prejudicial to creditors;
>
> (2) nonpayment of any fees and charges required under 123 of title 28; and;
>
> (3) failure of the debtor in a voluntary case to file, within fifteen days or such additional time as the court may allow after the filing of the petition commencing such case, the information required by paragraph (1) of section 521, but only on a motion by the United States trustee.

11 U.S.C. § 727(a)(2), (4), (5), (6), (7) and (8)

(a) The court shall grant the debtor a discharge, unless–

> (2) the debtor, with intent to hinder, delay, or defraud a creditor or an officer of the estate charged with custody of property under this title, has transferred, removed, destroyed, mutilated, or concealed, or has permitted to be transferred, removed, destroyed, mutilated, or concealed–
>
> > (A) property of the debtor, within one year before the date of the filing of the petition; or
> >
> > (B) property of the estate, after the date of the filing of the petition;

(4) the debtor knowingly and fraudulently, in or in connection with the case–

> (A) made a false oath or account;
>
> (B) presented or used a false claim;
>
> (C) gave, offered, received, or attempted to obtain money, property, or advantage, or a promise of money, property, or advantage, for acting or forbearing to act; or
>
> (D) withheld from an officer of the estate entitled to possession under this title, any recorded information, including books, documents, records, and papers, relating to the debtor's property or financial affairs;

(5) the debtor has failed to explain satisfactorily, before determination of denial of discharge under this paragraph, any loss of assets or deficiency of assets to meet the debtor's liabilities;

(6) the debtor has refused, in the case--

> (A) to obey any lawful order of the court, other than an order to respond to a material question or to testify;
>
> (B) on the ground of privilege against self-incrimination, to respond to a material question approved by the court or to testify, after the debtor has been granted immunity with respect to the matter concerning which such privilege was invoked; or
>
> (C) on a ground other than the properly invoked privilege against self-incrimination, to respond to a material question approved by the court or to testify;

(6) of this subsection, on or within one year before the date of the filing of the petition, or during the case, in connection with another case, under this title or under the Bankruptcy Act, concerning an insider;

(7) the debtor has committed any act specified in paragraph (2), (3), (4), (5), or

(8) the debtor has been granted a discharge under this section, under section 1141 of this title, or under section 14, 371, or 476 of the Bankruptcy Act, in a case commenced within 8 years before the date of the filing of the petition;

11 U.S.C. § 727(b)

(b) Except as provided in section 523 of this title, a discharge under subsection (a) of this section discharges the debtor from all debts that arose before the date of the order for relief under this chapter, and any liability on a claim that is determined under section 502 of this title as if such claim had arisen before the commencement of the case, whether or not a proof of claim based on any such debt or liability is filed under section 501 of this title, and whether or not a claim based on any such debt or liability is allowed under section 502 of this title.

11 U.S.C. § 1306(a)

(a) Property of the estate includes, in addition to the property specified in section 541 of this title.

> (1) all property of the kind specified in such section that the debtor acquires after the commencement of the case but before the case is closed, dismissed, or converted to a case under chapter 7, 11, or 12 of this title, whichever

occurs first; and

(2) earnings from services performed by the debtor after the commencement of the case but before the case is closed, dismissed, or converted to a case under chapter 7, 11, or 12 of this title, whichever occurs first.

11 U.S.C. § 1307(a) & (c)

(a) The debtor may convert a case under this chapter to a case under chapter 7 of this title at any time. Any waiver of the right to convert under this subsection is unenforceable.

(c) Except as provided in subsection (e) of this section, on request of a party in interest or the United States trustee and after notice and a hearing, the court may convert a case under this chapter to a case under chapter 7 of this title, or may dismiss a case under this chapter, whichever is in the best interests of creditors and the estate, for cause, including--

(1) unreasonable delay by the debtor that is prejudicial to creditors;

(2) nonpayment of any fees and charges required under chapter 123 of title 28;

(3) failure to file a plan timely under section 1321 of this title;

(4) failure to commence making timely payments under section 1326 of this title;

(5) denial of confirmation of a plan under section 1325 of this title and denial of a request made for additional time for filing another plan or a modification of a plan;

(6) material default by the debtor with respect to a term of a confirmed plan;

(7) revocation of the order of confirmation under section 1330 of this title, and denial of confirmation of a modified plan under section 1329 of this title;

(8) termination of a confirmed plan by reason of the occurrence of a condition specified in the plan other than completion of payments under the plan;

(9) only on request of the United States trustee, failure of the debtor to file, within fifteen days, or such additional time as the court may allow, after the filing of the petition commencing such case, the information required by paragraph (1) of section 521;

(10) only on request of the United States trustee, failure to timely file the information required by paragraph (2) of section 521; or

(11) failure of the debtor to pay any domestic support obligation that first becomes payable after the date of the filing of the petition.

11 U.S.C 1325(a)(7)

(a) Except as provided in subsection (b), the court shall confirm a plan if--

(7) the action of the debtor in filing the petition was in good faith;

28 U.S.C. § 158(a)(1)

(a) The district courts of the United States shall have jurisdiction to hear appeals.

(1) from final judgments, orders, and decrees;

FED. R. BANKR. P. 7052

Rule 52 F. R. Civ. P. applies in every adversary proceeding.

FED. R. CIV. P. 52

(a) Findings and Conclusions.

(1) *In General.* In an action tried on the facts without a jury or with an advisory jury, the court must find the facts specially and state its conclusions of law separately. The findings and conclusions may be stated on the record after the close of the evidence or may appear in an opinion or a memorandum of decision filed by the court. Judgment must be entered under Rule 58.

(2) *For an Interlocutory Injunction.* In granting or refusing an interlocutory injunction, the court must similarly state the findings and conclusions that support its action.

(3) *For a Motion.* The court is not required to state findings or conclusions when ruling on a motion under Rule 12 or 56 or, unless these rules provide otherwise, on any other motion.

(4) Effect of a Master's Findings. A master's findings, to the extent adopted by the court, must be considered the court's findings.

(5) *Questioning the Evidentiary Support.* A party may later question the sufficiency of the evidence supporting the findings, whether or not the party requested findings, objected to them, moved to amend them, or moved for partial findings.

> (6) *Setting Aside the Findings.* Findings of fact, whether based on oral or other evidence, must not be set aside unless clearly erroneous, and the reviewing court must give due regard to the trial court's opportunity to judge the witnesses' credibility.

(b) Amended or Additional Findings. On a party's motion filed no later than 10 days after the entry of judgment, the court may amend its findings--or make additional findings--and may amend the judgment accordingly. The motion may accompany a motion for a new trial under Rule 59.

(c) Judgment on Partial Findings. If a party has been fully heard on an issue during a nonjury trial and the court finds against the party on that issue, the court may enter judgment against the party on a claim or defense that, under the controlling law, can be maintained or defeated only with a favorable finding on that issue. The court may, however, decline to render any judgment until the close of the evidence. A judgment on partial findings must be supported by findings of fact and conclusions of law as required by Rule 52(a).

FED.R.BANKR. P. 2004

(a) Examination on motion.

On motion of any party in interest, the court may order the examination of any entity.

(b) Scope of examination.

The examination of an entity under this rule or of the debtor under § 343 of the Code may relate only to the acts, conduct, or property or to the liabilities and financial condition of the debtor, or to any matter which may affect the administration of the debtor's estate, or to the debtor's right to a discharge. In a family farmer's debt adjustment case under chapter 12, an individual's debt adjustment case under chapter 13, or a reorganization case under chapter 11 of the Code, other than for the reorganization of a railroad, the examination may also relate to the operation of any business and the desirability of its continuance, the source of any money or property acquired or to be acquired by the debtor for purposes of consummating a plan and the consideration given or offered therefor, and any other matter relevant to the case or to the formulation of a plan.

(c) Compelling attendance and production of documents.

The attendance of an entity for examination and for the production of documents, whether the examination is to be conducted within or without the district in which the case is pending, may be compelled as provided in Rule 9016 for the attendance of a witness at a hearing or trial. As an officer of the court, an attorney may issue and sign a subpoena on behalf of the court for the district in which the examination is to be held if the attorney is admitted to practice in that court or in the court in which the case is pending.

(d) Time and place of examination of debtor.

The court may for cause shown and on terms as it may impose order the debtor to be examined under this rule at any time or place it designates, whether within or without the district wherein the case is pending.

(e) Mileage

An entity other than a debtor shall not be required to attend as a witness unless lawful mileage and witness fee for one day's attendance shall be first tendered. If the debtor resides more than 100 miles from the place of examination when required to appear for an examination under this rule, the mileage allowed by law to a witness shall be tendered for any distance more than 100 miles from the debtor's residence at the date of the filing of the first petition commencing a case under the Code or the residence at the time the debtor is required to appear for the examination, whichever is the lesser.

FED.R.BANKR. P. 8013

On an appeal the district court or bankruptcy appellate panel may affirm, modify, or reverse a bankruptcy judge’s judgment, order, or decree or remand with instructions for further proceedings. Findings of fact, whether based on oral or documentary evidence, shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the bankruptcy court to judge the credibility of the witnesses.

Federal Bankruptcy Rule 8001(a)

(a) Appeal as of right; how taken

An appeal from a judgment, order, or decree of a bankruptcy judge to a district court or bankruptcy appellate panel as permitted by 28 U.S.C. § 158(a)(1) or (a)(2) shall be taken by filing a notice of appeal with the clerk within the time allowed by Rule 8002. An appellant's failure to take any step other than timely filing a notice of appeal does not affect the validity of the appeal, but is ground only for such action as the district court or bankruptcy appellate panel deems appropriate, which may include dismissal of the appeal. The notice of appeal shall (1) conform substantially to the appropriate Official Form, (2) contain the names of all parties to the judgment, order, or decree appealed from and the names, addresses, and telephone numbers of their respective attorneys, and (3) be accompanied by the prescribed fee. Each appellant shall file a sufficient number of copies of the notice of appeal to enable the clerk to comply promptly with Rule 8004.

BRIEF BANK — "SUMMARY SHEET" *Printed Wed-2/16/11 13:16*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE
[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]

Stetler Cross Ministries, Inc. v. Daniel M. McDermott, United States Trustee (In re Stetler Cross Ministries, Inc.)

2. ("CO") ***CURRENT*** COURT
[E.g., "CTA9"]

W. D. Ky.

3. ("CCN") ***CURRENT*** CASE NO.

No.: 10-183

4. ("PCN") ***PRIOR*** CASE NO. - & COURT
[IF ANY]

No.: 09-11332

Court: Bankr. W.D. Ky.

(Identify judge & cite, if any)

5. ("SO") ***SOURCE***

U.S. TRUSTEES

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF
[E.g., "Opening Brief," "Reply," "Amicus," etc.]

Filed: February 10, 2011

Type: Brief for the Appellee, United States Trustee

7. **("AU")** ***PRINCIPAL AUTHORS & OFFICE*** *[E.g., "UST/OGC"]*

Scott J. Goldberg, Noah M. Schottenstein, P. Matthew Sutko, Joseph J. Golden, Ramona D. Elliott, Daniel M. McDermott

(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***

BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s)

&

√ Any Miscellaneous ***BACKGROUND***

• Did the bankruptcy court abuse its discretion when it held that Mr. Yates must return the $2,000 in compensation he received for representing Stetler in this chapter 11 bankruptcy case without first obtaining authorization from the bankruptcy court under 11 U.S.C. 330?

10. PATH TO FILE LOCATION:
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YES NO ***DATE:***

UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF KENTUCKY

CASE NO. 1:10-cv-183

In re STETLER CROSS MINISTRIES, INC.,
Debtor.

STETLER CROSS MINISTRIES, INC.,
Appellant,

v.

DANIEL M. McDERMOTT, UNITED STATES TRUSTEE,
Appellee.

ON APPEAL FROM THE UNITED STATES BANKRUPTCY COURT
FOR THE WESTERN DISTRICT OF KENTUCKY
BANKRUPTCY CASE NO. 09-11332

BRIEF FOR THE APPELLEE, UNITED STATES TRUSTEE

RAMONA D. ELLIOTT
General Counsel
P. MATTHEW SUTKO
Associate General Counsel
NOAH M. SCHOTTENSTEIN
Trial Attorney

United States Department of Justice
Executive Office for United States Trustees
20 Massachusetts Ave., N.W., Ste 8100
Washington, D.C. 20530
Telephone: (202) 307-1399

DANIEL M. McDERMOTT
United States Trustee for Region 8
JOSEPH J. GOLDEN
Assistant United States Trustee
SCOTT J. GOLDBERG
Trial Attorney

United States Department of Justice
Office of the United States Trustee
601 W. Broadway, Ste 512
Louisville, KY 40202
Telephone: (502) 582-6000

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INTRODUCTION

Stetler Cross Ministries voluntarily filed a petition for relief under chapter 11 of the Bankruptcy Code on August 3, 2009. Stetler engaged Mr. Frank Yates, Jr. to file that petition and to serve as bankruptcy counsel for the estate. But Stetler never received bankruptcy court approval to employ Mr. Yates, as required by 11 U.S.C. § 327(a).

Almost a year later, the bankruptcy court converted Stetler's chapter 11 case to one under chapter 7. The appointment of the chapter 7 trustee automatically terminated Stetler's status as the debtor-in-possession and so terminated Mr. Yates's de facto representation. Lamie v. U.S. Trustee, 540 U.S. 526, 532 (2004).

The bankruptcy court then ordered Mr. Yates to return the money he took from his retainer. That was because he (1) had never been employed under section 327(a) and (2) neither received, nor was he eligible to receive, court authorization to pay himself out of the funds of the estate, as required by 11 U.S.C. § 330(a). Mr. Yates filed a notice of appeal from that order, but did so in Stetler's name, rather than his own. This appeal followed.

STATEMENT OF APPELLATE JURISDICTION

This Court has jurisdiction over this appeal under 28 U.S.C. § 158(a)(1). The United States Bankruptcy Court for the Western District of Kentucky had jurisdiction over Stetler Cross Ministries, Inc.'s chapter 11 bankruptcy case under 28 U.S.C. §§ 157 and 1334. The bankruptcy court's final order requiring Mr. Yates to return $2,000 in attorney's fees was entered on July 7, 2010. Mr. Yates timely filed a motion to reconsider that order on July 19, 2010, which the bankruptcy court denied on October 1, 2010.

Mr. Yates timely filed a notice of appeal from both orders on October 15, 2010, under 28 U.S.C. § 158(c)(2) and Fed. R. Bankr. P. 8002(a). Mr. Yates's notice of appeal listed Stetler as the appellant. That was incorrect for two reasons. First, the order on appeal concerns only Mr. Yates's personal obligation to return the $2,000 he took for his attorney's fees. Second, Mr. Yates does not currently represent Stetler. Its chapter 11 bankruptcy case was converted to one under chapter 7, and Mr. Yates was not retained as chapter 7 counsel after the conversion. <u>See</u> <u>Lamie v. United States</u>, 540 U.S. 526, 532 (2004). Currently, only the chapter 7 trustee may represent Stetler. <u>See</u> 11 U.S.C. § 704 (listing the trustee's duties).

Mr. Yates should have listed himself as the appellant, rather than Stetler. But this error is not fatal to Mr. Yates's appeal. Under Fed. R. Bankr. P. 8001(a), "[a]n appellant's failure to take any step other than timely filing a notice of appeal does not affect the validity of the appeal, but is ground only for such action as the district court . . . deems appropriate." Fed. R. Bankr. P. 8001(a).

The Sixth Circuit has previously held that under Fed. R. Bankr. P. 8001(a), an appellant's failure to name correctly the parties to an appeal, in an otherwise timely filed notice of appeal, does not prevent the district court from hearing the appeal. French v. Phoenix Corp. (In re Phoenix Corp.), No. 95-6679, 121 F.3d 709, 1997 WL 415315 (6th Cir. July 22, 1997) (unreported) (stating that "mere technicalities should not stand in the way of consideration of a case on its merits") (citation omitted); accord Fadayiro v. Ameriquest Mortg. Co., 371 F.3d 920, 922 (7th Cir. 2004) (observing the importance of potential confusion when evaluating whether a defective notice of appeal divests an appellate court of jurisdiction under Fed. R. Bankr. P. 8001(a)); but see Groetken v. Davis (In re Davis), No. 00-4071, 35 F. App'x 826, 2002 WL 1044832 (10th Cir. 2002) (unpublished) (holding that the district court lacks jurisdiction over a party not specifically designated as an appellant in the notice of appeal under Fed. R. Bankr. P. 8001(a)).

Here, Mr. Yates timely filed his notice of appeal. He has a direct, financial interest in the appeal. There has been no ambiguity that — as the only person subject to the order on appeal — he is prosecuting the appeal in his own interest. Therefore, the government does not believe that this Court lacks jurisdiction to consider his appeal on the merits. Phoenix Corp., 1997 WL 415315 at *2.

STATEMENT OF THE ISSUE

Did the bankruptcy court abuse its discretion when it held that Mr. Yates must return the $2,000 in compensation he received for representing Stetler in its chapter 11 bankruptcy case without first obtaining authorization from the bankruptcy court?

STANDARD OF REVIEW

An order requiring a bankruptcy professional to return compensation is reviewed for abuse of discretion. United States v. Schilling (In re Big Rivers Elec. Corp.), 355 F.3d 415, 429 (6th Cir. 2004). Findings of fact are reviewed for clear error and legal conclusions are reviewed de novo. Id.

STATEMENT OF THE CASE

I. Statutory Framework

A. The Retention, Compensation, and Payment of Professionals in a Chapter 11 Bankruptcy Case

When a debtor commences a bankruptcy case, a separate legal entity known as the "estate" is created. 11 U.S.C. § 541(a). That estate contains all of the debtor's property, subject to exceptions not applicable here. Id. Under the Bankruptcy Code, all third parties that possess property of the estate must return it. 11 U.S.C. § 542(a).

When a debtor files a case to reorganize under chapter 11 of the Bankruptcy Code, the debtor becomes a "debtor-in-possession" of the estate. 11 U.S.C. § 1101. The debtor-in-possession maintains control over the estate's property, but also obtains the rights, obligations, and fiduciary duties of a trustee. 11 U.S.C. §§ 1106-08. This includes the ability to ask the bankruptcy court for permission to employ professionals, including attorneys, to assist the debtor-in-possession with the reorganization of the bankruptcy estate. 11 U.S.C. § 327.

Such court-authorized attorneys are subject to strict regulations governing their retention, compensation, and payment. First, under section 327(a), the bankruptcy court must authorize the debtor to employ the attorney. 11 U.S.C.

§ 327(a). Then, under section 330(a), an attorney employed under section 327(a) may request "reasonable compensation for actual, necessary services rendered." 11 U.S.C. § 330(a). Indeed, employment under section 327(a) is a necessary prerequisite for an attorney to receive any compensation in the case. Lamie v. U.S. Trustee, 540 U.S. 526, 538 (2004).

Furthermore, even after an attorney (1) is employed under section 327(a), (2) requests reasonable compensation under section 330(a), and then (3) receives a section 330(a) fee award from the bankruptcy court, payment is not self-executing. Rather, section 503(b)(2) provides an attorney only with a claim against the estate for administrative expenses. 11 U.S.C. § 503(b)(2). At that point, an attorney's claim may then be paid by a distribution from the estate, which must be made in accord with the Bankruptcy Code's system of priorities. 11 U.S.C. § 507(a)(2) (giving attorneys for the estate second priority in a distribution from the estate).

B. The United States Trustee's statutory duty to monitor bankruptcy professionals and object to improper fees under 28 U.S.C. §§ 581-589.

The United States Trustee is an official of the United States Department of Justice appointed by the Attorney General to supervise the administration of bankruptcy cases. 28 U.S.C. §§ 581-589. The United States Trustee has a statutory obligation to review applications for compensation under section 330(a) and to object to applications the United States Trustee considers to be inappropriate. 28 U.S.C. § 586(a)(3)(A). The United States Trustee is also required to review applications for employment under section 327(a) and, "whenever the United States Trustee deems it to be appropriate, fil[e] with the court comments with respect to the approval of such applications." 28 U.S.C. § 586(a)(3)(H).

Furthermore, "[t]he United States trustee may raise and may appear and be heard on any issue in any case or proceeding under this title but may not file a plan pursuant to section 1121(c) of this title." 11 U.S.C. § 307. Courts have repeatedly held that the United States Trustee has standing under section 307 to appear and be heard on any issue in any bankruptcy case, despite the lack of pecuniary interest in the outcome. See Morgenstern v. Revco D.S., Inc. (In re Revco D.S., Inc.), 898 F.2d 498, 500 (6th Cir. 1990); see also Adams v. Zarnel (In re Zarnel), 619 F.3d 156, 161 (2d Cir. 2010); Stanley v. McCormick (In re Donovan Corp.), 215 F.3d 929, 930 (9th Cir. 2000) ("The United States trustee may . . . intervene and appear at any level of the proceedings from the bankruptcy court on . . . as either a party or an amicus.").

II. Statement of the Facts

Mr. Yates, the appellant, acted as de facto counsel for the corporate debtor, Stetler Cross Ministries, while its case proceeded under chapter 11 of the Bankruptcy Code. Chapter 11 Voluntary Petition dated 08/03/2009, B.C. Dkt. No. 1 at 3.[1] After filing Stetler's petition for chapter 11 bankruptcy relief, Mr. Yates disclosed the existence of a $2,000 fee agreement pursuant to 11 U.S.C. § 329(a) and Fed. R. Bankr. P. 2016 on August 17, 2009. Disclosure of Fee of Attorney dated 08/17/2009, B.C. Dkt. No. 13.

Mr. Yates, however, did not file an application to be employed as Stetler's counsel under 11 U.S.C. § 327. Nor did he apparently intend to. At a hearing regarding the conversion of Stetler's case on April 29, 2010, the bankruptcy court asked Mr. Yates about his $2,000 fee agreement. Transcript dated 04/29/2010, B.C. Dkt. No. 88 at 7. Mr. Yates admitted that he paid himself out of this retainer without providing notice or obtaining authorization from the bankruptcy court. Id. at 8.

The bankruptcy court recalled how it had warned Mr. Yates "at the very

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[1] Stetler's chapter 11 bankruptcy case was subsequently converted to one under chapter 7 on May 19, 2010. Conversion Order dated 05/19/2010, B.C. Dkt. No. 41. The conversion is irrelevant to Mr. Yates's appeal because he only is seeking attorney's fees for representing Stetler while its case was proceeding under chapter 11.

beginning of this case, that it all had to be done right . . . But if you have pulled that [$2,000] out of your escrow account and applied that to the bills of your office then you are in violation of Chapter 11." Id. at 13. "Where is that fee? . . . Why hasn't he filed an application to be paid?" Id. at 14. The court instructed Mr. Yates to file something with respect to his fee agreement and how he utilized the retainer. Id. at 16.

Two weeks later, Stetler filed an application under section 327(a) to employ Mr. Yates as counsel. Application to Employ Frank Yates, Jr. as Attorney dated 05/13/2010, B.C. Dkt. No. 37. That application, which was filed 10 months after Stetler initiated its bankruptcy case, included a copy of Mr. Yates's legal services agreement. Id at Attach. No. 2 (Agreement for Legal Services).

That agreement was never approved by the bankruptcy court under section 327(a). Yet it was signed almost two weeks after the commencement of the case, on August 15, 2009. Id. It provided that Mr. Yates would receive, as compensation for "any legal services to be provided herein," a retainer of $2,000, and a billable rate of $150 per hour. Id. It also contained a clause stating that it "supersedes all prior agreements, arrangements and understanding relating to the subject matter hereof." Id.

III. Statement of the Proceedings Below

The United States Trustee moved the bankruptcy court for an order requiring Mr. Yates to return any fees he drew from his retainer without prior court authorization in violation of sections 327(a) and 330(a). Motion of the U.S. Trustee for Disgorgement of Attorney Fees dated 05/04/2010, B.C. Dkt. No. 32. In response, Mr. Yates argued that he was not required to comply with the Bankruptcy Code's rules governing attorney compensation because (1) he allegedly received the retainer pre-petition, and thus it was not property of the estate, and (2) the "mechanical application of the rule" should not be applied since he disclosed his fees, they were not a large amount of money, and he had not overbilled his client. Response to Motion of the U.S. Trustee for Disgorgement of Attorney Fees dated 06/03/2010, B.C. Dkt. No. 48 at 5-6. Mr. Yates also requested that the bankruptcy court authorize nunc pro tunc his employment under section 327(a) and fee request under section 330(a). Id. at 7.

The bankruptcy court agreed with the United States Trustee and on July 7, 2010, ordered Mr. Yates to return the fees that he took without prior court authorization under sections 327(a) and 330(a). Mem. and Order dated 07/07/2010, B.C. Dkt. No. 52. The court held that the Bankruptcy Code and Rules "strictly regulate the compensation of professionals" and regardless of how small the fee, "[f]ailure to follow these rules . . . cannot be overlooked by this Court." Id. at 2. It also held that Mr. Yates's disclosure statement did "not alleviate the need for counsel's employment to be approved and prior approval before drawing on any retainer." Id. at 3.

The court found that Mr. Yates had drawn on the retainer without court approval, based on Mr. Yates's admission at the earlier hearing, which was never contradicted by any later statements. Id. It also noted that even if Mr. Yates's conduct was "an inadvertent or negligent failure to disclose . . . the failure to seek Court approval by Debtor's counsel prior to accepting the fee and having his employment approved by the Court is serious enough to require disgorgement." Id.

Mr. Yates then moved the bankruptcy court to set aside its order. Motion to Set Aside Order dated 07/19/2010, B.C. Dkt. No. 53. The bankruptcy court took the motion under consideration and on October 1, 2010, denied Mr. Yates's motion to set aside the order. Mem. and Order dated 10/01/2010, B.C. Dkt. No. 77. The court ruled that Mr. Yates must return the money because he (1) took it from the bankruptcy estate without authorization under the Bankruptcy Code, (2) was not eligible for compensation under the Bankruptcy Code, and (3) failed to demonstrate that he deserved nunc pro tunc relief. Id. at 2-3.

On October 15, 2010, Mr. Yates timely filed a notice of appeal from both orders. Amended Notice of Appeal dated 10/15/2010, B.C. Dkt. No. 79.

SUMMARY OF THE ARGUMENT

In Lamie v. U.S. Trustee, 540 U.S. 526, 539 (2004), the Supreme Court held that employment under 11 U.S.C. § 327(a) is a necessary prerequisite for a debtor's attorney to receive a fee award under 11 U.S.C. § 330(a). And the only way for a debtor's attorney to be compensated for fees earned in a chapter 11 bankruptcy case is to obtain a fee award under section 330(a). Thus, Mr. Yates violated federal law when he took a $2,000 retainer provided by his client — a chapter 11 debtor at the time — because he had never been employed under section 327(a) and never obtained a fee award under section 330(a).

After the bankruptcy court discovered what Mr. Yates had done, it ordered him to return the money to his client. That order was appropriate for two reasons. First, Mr. Yates had no right to take money from the estate for his attorney's fees. Section 330(a) is the only way a debtor's attorney may obtain compensation for services performed in a chapter 11 bankruptcy case. Because Mr. Yates had not been employed under section 327(a) and had never received a fee award under section 330(a), he was prohibited from receiving that compensation. Furthermore, because his failure to obtain bankruptcy court authorization for his employment and fee payment was due to mere negligence, he cannot show the existence of any extraordinary circumstances that would warrant nunc pro tunc relief.

Second, Mr. Yates had an independent statutory duty to return the $2,000 retainer because it was property of the estate. The legal services agreement under which Mr. Yates received the retainer was entered into after Stetler's bankruptcy case had been commenced and was for ongoing representation in Stetler's bankruptcy case. That means Mr. Yates had no pre-petition interest in the money when Stetler filed for bankruptcy. Therefore, it was property of the estate under 11 U.S.C. § 541(a) and subject to turnover under 11 U.S.C. § 542(a).

On appeal, Mr. Yates argues that he should be allowed to keep the money because it was provided as a general retainer for pre-petition services under Kentucky law. But this argument is without merit because there is no evidence in the record or legal authority to support Mr. Yates's argument. In fact, under the terms of his legal services agreement, it was impossible for him to have received such an interest as a matter of Kentucky law.

In addition, Mr. Yates's argument must fail because Kentucky law cannot provide Mr. Yates with compensation prohibited by the Bankruptcy Code. His proposed application of Kentucky law would undermine the "intended purpose and natural effect" of the Bankruptcy Code's comprehensive scheme for regulating attorney's fees in bankruptcy cases. Should this Court find that a conflict of law exists, Kentucky law would then be preempted under the Supremacy and Bankruptcy Clauses of the Constitution.

Accordingly, the bankruptcy court did not abuse its discretion when it required Mr. Yates to return the $2,000 retainer and its order should be affirmed.

ARGUMENT

I. The bankruptcy court correctly ordered Mr. Yates to return the $2,000 he took for his attorney's fees because it violated federal law.

A. Mr. Yates was ineligible to receive any compensation from the bankruptcy estate because he was not employed under section 327(a) and did not receive a fee award under section 330(a).

Section 330(a) does not authorize compensation to a debtor's attorney from estate funds unless that attorney's employment has been approved under section 327(a). Lamie v. U.S. Trustee, 540 U.S. 526, 538 (2004). Under Sixth Circuit law, "section 330 establishes the exclusive means of allowing a claim for professional fees in a bankruptcy proceeding." Dery v. Cumberland Cas. & Sur. Co. (In re 5900 Assoc., Inc.), 468 F.3d 326, 328 (6th Cir. 2006). It "is the sole mechanism by which fees may be enforced" in a bankruptcy case. Id. at 330.

Without a fee award under section 330(a), an attorney has no right to receive payment from a chapter 11 debtor. "Court approval under section 330(a) is what creates the liability, not performance of the services." Id. at 331 (citation omitted). "An attorney who extracts payments from debtors other than pursuant to proper disclosure, or to allowance under section 330, stands in violation of the provisions of the Bankruptcy Code, and may be properly stripped of all fees." Id. (citation omitted). Other circuits agree. See In re Milwaukee Engraving Co., 219 F.3d 635, 636 (7th Cir. 2000) (holding that attorneys may not receive compensation under the Bankruptcy Code when they have not been employed under section 327(a)); accord In re Albrecht, 233 F.3d 1258, 1260 (10th Cir. 2000); Cushman & Wakefield of Conn., Inc. v. Keren Ltd. P'ship (In re Keren Ltd. P'ship), 189 F.3d 86, 88 (2d Cir. 1999); F/S Airlease II, Inc. v. Simon (In re F/S Airlease II, Inc.), 844 F.2d 99, 109 (3d Cir.1988).

So too here. Mr. Yates took $2,000 as compensation pursuant to a post-petition legal services agreement with Stetler, which was a chapter 11 debtor at the time. Application to Employ Frank Yates, Jr. as Attorney dated 05/13/2010, B.C. Dkt. No. 37 at Attach. No. 2 (Agreement for Legal Services). That agreement, signed 12 days after Stetler filed its petition for bankruptcy relief, gave Mr. Yates a $2,000 retainer for "any legal services to be provided herein," billed at $150 per hour. Id. The agreement also contained a clause stating that it "supersedes all prior agreements, arrangements and understanding relating to the subject matter hereof." Id.

Stetler, however, was the "debtor-in-possession" of the estate under the Bankruptcy Code at the time the agreement was signed. See 11 U.S.C. § 1101. That means Mr. Yates's contract is with Stetler's bankruptcy estate, for services to be performed in the course of Stetler's bankruptcy case, with payment from the property of that bankruptcy estate. See 11 U.S.C. §§ 327(a), 541, 1106(a)(3).

Consequently, Mr. Yates was statutorily barred from taking that $2,000 for his attorney's fees. Without being employed under section 327(a), Mr. Yates could not receive a compensation award under section 330(a). Lamie, 540 U.S. at 538. Without a compensation award under section 330(a), Mr. Yates had no legal right to receive any fees for any services performed under the legal services agreement in connection with the bankruptcy case. 5900 Assoc., 468 F.3d at 330.

The same is still true even if Mr. Yates had been employed under section 327(a), or whether his failure to seek bankruptcy court authorization for his employment and fees was due to mere negligence. Section 330(a) is the sole method for a debtor's attorney to receive compensation for fees earned during a chapter 11 bankruptcy case. Id. Mr. Yates did not have authorization under section 330(a) prior to taking the fees for himself. Because he took that compensation in violation of these provisions of the Bankruptcy Code, "his fees are unenforceable" and he "may be properly stripped of all fees." Id. at 331.

B. Mr. Yates cannot show that the bankruptcy court abused its discretion by refusing to grant him nunc pro tunc relief.

The Sixth Circuit has recognized that a bankruptcy court may enter relief nunc pro tunc in some circumstances, but it has not addressed what standard should be used in deciding whether an application for employment under section 327(a) should be approved nunc pro tunc. Cf. In re Mitan, 573 F.3d 237, 245-46 (6th Cir. 2009) (holding that a bankruptcy court "did not err by entering a nunc pro tunc order" retroactively converting a case from chapter 11 to chapter 7 due to the presence of "extraordinary circumstances"). Lower courts within the Sixth Circuit appear to agree that — with some variation in how that test is articulated — a party requesting nunc pro tunc relief under section 327(a) must demonstrate "extraordinary circumstances." See,e.g., Farinash v. Vergos (In re Aultman Enter.), 264 B.R. 485, 489 (E.D. Tenn. 2001) (reviewing the case law among Sixth Circuit jurisdictions and adopting the nine-factor test of In re Twinton Prop. P'ship, 27 B.R. 817, 819-20 (Bankr. M.D. Tenn. 1983)).

Other circuits also require extraordinary circumstances. F/S Airlease II, 844 F.2d at 109 (Third Circuit); accord Albrecht, 233 F.3d at 1260 (Tenth Circuit);

Keren Ltd. P'ship, 189 F.3d at 88 (Second Circuit); Atkins v. Wain, Samuel & Co. (In re Atkins), 69 F.3d 970, 974 (9th Cir. 1995) (adopting the Twinton test for the Ninth Circuit); but see In re Singson, 41 F.3d 316, 319 (7th Cir. 1994) (adopting "excusable neglect" standard).

Generally, this test requires that a section 327(a) applicant affirmatively demonstrate compelling reasons that justify nunc pro tunc approval of the employment application See Aultman, 264 B.R. at 493 (comparing the circuit court authority); see also Twinton, 27 B.R. at 819 (requiring clear and convincing evidence). Simple negligence or mere oversight can never constitute a satisfactory explanation for failure to comply with section 327(a). Aultman, 264 B.R. at 493.

On appeal, as a matter of law or as a matter of fact, Mr. Yates cannot show that the bankruptcy court abused its discretion by refusing to grant him nunc pro tunc relief. First, this Court need not consider this argument because it has been waived. An appellate court may summarily affirm a lower court's decision when a litigant fails to include supporting argument. Inge v. Rock Fin. Group, 388 F.3d 930, 937 (6th Cir. 2004); see, e.g., Garrett v. Selby Connor Maddux & Janer, 425 F.3d 836, 841 (10th Cir. 2005) (stating that conclusory allegations with no citations to the record or supporting legal authority is not considered adequate briefing and results in waiver). This Court "cannot fill the void by crafting arguments" for the appellant. Garrett, 425 F.3d at 841.

Here, although Mr. Yates has observed that nunc pro tunc relief is available "in proper circumstances" and "upon proper showing," he has never articulated what in the record supports his conclusion that he deserves nunc pro tunc relief. See Appellant's Br. at 18 (concluding, without providing explanation, that his request for employment and fees should be approved nunc pro tunc). Therefore, his argument has been waived. Inge, 388 F.3d at 937.

Second, there is nothing in the record to support Mr. Yates's request for nunc pro tunc relief. He never explained to the bankruptcy court why he failed to request court authorization for his employment under section 327(a). See Mem. and Order dated 07/07/2010, B.C. Dkt. No. 52 at 2. He never explained why he failed to request compensation under section 330(a), or an interim compensation award under section 331 to draw against his retainer. See id. And he never submitted the accounting of his time and expenses that the bankruptcy court ordered. Compare Transcript dated 04/29/2010, B.C. Dkt. No. 88 at 16 (requesting Mr. Yates "file something" explaining how he "utilized that retainer") with Response to Motion of the U.S. Trustee for Disgorgement of Attorney Fees dated 06/03/2010, B.C. Dkt. No. 48 at 5-6 (alleging that he did not "overbill" his client, but failing to provide any evidence in support).

Despite having an opportunity to present argument and facts to support his request for the bankruptcy court to approve his employment and fees nunc pro tunc, Mr. Yates never offered anything except for a conclusory statement that it should be given. Id. at 7. Therefore, the bankruptcy court did not abuse its discretion by denying that request.

II. Alternatively, Mr. Yates must return the payment under 11 U.S.C. § 542(a) because the money is property of the estate under 11 U.S.C. § 541(a).

The bankruptcy court was also correct to order Mr. Yates to return the $2,000 he took for his attorney's fees because that money was property of the estate.

A. Money held by an attorney as a retainer still constitutes property of the estate and is subject to turnover.

Section 541(a) defines the property of the estate. Under that section, the commencement of a case "creates an estate" and "all" of the debtor's property — subject to narrow exceptions not relevant here — becomes part of that estate. § 541(a). This property remains "subject to the same restrictions that existed at the time the debtor filed the petition." Demczyk v. Mut. Life Ins. Co. of New York (In re Graham Square, Inc.), 126 F.3d 823, 831 (6th Cir. 1997). Section 541(a) does not define property, but instead leaves that determination to state law. Butner v. United States, 440 U.S. 48, 55 (1979).

Under Section 542(a), individuals in possession of property of the estate "shall deliver" that property to the estate and account for its value. § 542(a). This equally applies to property held by a debtor's attorney in the form of an unearned retainer. Indian Motocycle Assoc. III Ltd. P'ship v. Mass. Housing Fin. Agency, 66 F.3d 1246, 1254-55 (1st Cir. 1995).

The record shows that Mr. Yates entered into a post-petition legal services agreement to represent Stetler in the course of its bankruptcy case. Application to Employ Frank Yates, Jr. as Attorney dated 05/13/2010, B.C. Dkt. No. 37 at Attach. No. 2 (Agreement for Legal Services). Pursuant to that agreement, the retainer was "to be paid" for "legal services to be provided herein," billed at the rate of $150 per hour. Id. Those services were to "provide legal counseling and services in relationship to her Business Bankruptcy and to perform all necessary Legal Services required to pursue the aforesaid Bankruptcy." Id.

Accordingly, Mr. Yates's legal right to compensation for those post-petition, bankruptcy-related services vested only if that employment agreement was authorized under section 327(a) and those fees were approved under section 330. 5900 Assoc., 468 F.3d at 331 ("Court approval under section 330(a) is what creates the liability, not performance of the services."). Neither occurred. Thus, he had no right to the money he took from the estate. Graham Square, 126 F.3d at 831. As such, the bankruptcy court was also justified in requiring Mr. Yates to return the money he took for his attorney's fees under section 542(a). Indian Motocycle, 66 F.3d at 1254-55.

B. Lamie does not allow chapter 11 attorneys to avoid the requirements of sections 327(a) and 330(a) by taking a pre-petition retainer for post-petition services.

Mr. Yates states that he received his retainer pre-petition and suggests that dicta in Lamie indicates that a pre-petition retainer is not property of the estate. Appellant's Br. at 13 (citing Lamie, 540 U.S. at 537-38). This, he believes, allowed him to take the money for his post-petition services without having to obtain bankruptcy court approval under section 327(a) and 330(a). Id. Even assuming that Mr. Yates received the retainer pre-petition — and there is no evidence of that in the record — Lamie would still not support Mr. Yates's position.

In Lamie, the Supreme Court held that when a chapter 11 bankruptcy case is converted to one under chapter 7, counsel previously employed by the chapter 11 debtor-in-possession must be separately employed by the chapter 7 trustee under section 327(a) and obtain a section 330(a) fee award to receive compensation for post-conversion services to the estate. Lamie, 540 U.S. at 538. In the dicta that Mr. Yates cites, the Lamie Court states that section 330(a) does not prevent an individual chapter 7 debtor from paying, pre-petition, a consumer bankruptcy attorney an advance fee for pre-petition work to prepare a chapter 7 bankruptcy filing. Id. at 537-38.

That is not the case here. Mr. Yates took money for post-petition work from the debtor in violation of sections 327(a) and 330(a), under Sixth Circuit and Supreme Court law. Furthermore, it makes no sense to extend Lamie's generalized approval of pre-petition payments for pre-petition services in chapter 7 cases to validate pre-petition retainers for post-petition services outside of the chapter 7 context. After all, chapter 7 cases are fundamentally different from chapter 11 cases.

This is because in a chapter 7 case the vast majority of the work is completed before the petition is filed and the debtor's non-exempt assets become part of the estate under section 541. See Brief of Resp't in Lamie v. U.S. Trustee, 2003 WL 21839367 at 39-40. As the Court observed in Lamie, chapter 7 attorney's fees are paid in advance "to ensure that the filing is in order." Id. at 538. The post-petition services paid through the pre-petition flat fee are typically limited because individual chapter 7 debtors can pay for post-petition legal services out of their current salary, as the property of the estate does not include post-petition income earned by individual debtors for services. 11 U.S.C. § 541(a)(6).

In contrast, under chapter 11, the debtor-in-possession's administration of the estate is co-extensive with the reorganization efforts. United States v. Schilling (In re Big Rivers Elec. Corp.), 355 F.3d 415, 431 (6th Cir. 2004). That requires the debtor-in-possession to engage in substantial post-petition activities vital to the administration of the estate, such as recovering property of the estate, avoiding transactions, and proposing and confirming a reorganization plan that includes post-petition assets for distribution to creditors. 11 U.S.C. §§ 1106-1108, 1122-1129.

The significance of these responsibilities gives rise to the "the unbending standards of fiduciary duty that the law and society long have come to expect of trustees in general . . . and bankruptcy trustees in particular," which section 327(a)'s requirements seek to ensure. Big Rivers, 355 F.3d at 431. Not one word of Lamie's dicta impliedly approves of a way for chapter 11 attorneys to circumvent such an important rule, particularly because at the very same time the Court held that an attorney must be employed under section 327(a) to receive compensation from the estate. Lamie, 540 U.S. at 539.

<u>III. Mr. Yates's reliance on Kentucky law is without merit.</u>

Mr. Yates asserts that the $2,000 he took for his services in Stetler's chapter 11 bankruptcy case was his property because it was taken from a pre-petition "general" retainer, i.e., a flat fee, under Kentucky law. Appellant's Br. at 13-14. Therefore, he argues the money was not property of the estate and was not subject to Bankruptcy Code's regulations. <u>Id.</u>

This argument is without merit, as nothing in the record supports Mr. Yates's position that he took the money pre-petition or received a pre-petition property right in that money. But even if this Court decides that Kentucky law did provide Mr. Yates with a right to compensation, he still must return the money. That is because Kentucky law would conflict with the Bankruptcy Code's comprehensive scheme for regulating attorney's fees in bankruptcy cases. In such circumstances, state law must give way to federal law under the Supremacy and Bankruptcy Clauses of the Constitution.

A. Mr. Yates did not have a property right in the retainer as a matter of law or fact.

Under Kentucky law, a "fee may be designated as a non-refundable retainer." Ky. Sup. Ct. R. 3.130(1.5)(f). "A non-refundable retainer fee agreement shall be in writing." Id. And to be valid, the non-refundable nature of the fee agreement must be in a writing signed by the client. Ky. Bar Ass'n, Ethics Opinion KBA E-380 (1995), available at http://www.kybar.org/30.

Kentucky law presumes that a retainer provides a security interest for fees to be earned in the future. The default expectation "is that the lawyer will perform the particular services requested and draw on the prepaid fees as services are rendered and then considered earned according to . . . the lawyer's hourly rate." Id.

A lawyer may designate an amount of a client's written fee payment as a non-refundable retainer "to make it clear to the client that a portion of the fee is earned at the time of payment." Id. This may occur when there has been initial work and responsibility in the process of accepting the matter, or when it is necessary to secure the future services of the lawyer. Id. But "[i]f a lawyer obtains an advance fee payment, and the arrangement is not a valid non-refundable retainer agreement," the funds must be held in the lawyer's trust account and treated like a traditional security retainer. Id.

Here, Mr. Yates entered into a post-petition agreement for legal services with Stetler. See Application to Employ Frank Yates, Jr. as Attorney dated 05/13/2010, B.C. Dkt. No. 37 at Attach. No. 2 (Agreement for Legal Services).

The terms of that agreement state that the $2,000 retainer was "to be paid" for "legal services to be provided herein," billed at the rate of $150 per hour. Id. Those services were to "provide legal counseling and services in relationship to her Business Bankruptcy and to perform all necessary Legal Services required to pursue the aforesaid Bankruptcy." Id.

The legal services agreement does not state that any portion of the payment was non-refundable. It does not state that any portion of the payment was for pre-petition or other services not listed under the terms of the contract. Instead, it states that Stetler would provide a $2,000 retainer and that Mr. Yates would bill for his services at $150 per hour. And although Mr. Yates argues differently, he does not show any evidence in the record that would support a different reading of the facts or explain how the legal services agreement complies with Kentucky law. Compare Transcript dated 04/29/2010, B.C. Dkt. No. 88 at 16 (requesting Mr. Yates "file something" explaining how he "utilized that retainer") with Response to Motion of the U.S. Trustee for Disgorgement of Attorney Fees dated 06/03/2010, B.C. Dkt. No. 48 (failing to provide such an explanation).

Thus, even assuming Mr. Yates took the $2,000 payment pre-petition, which is a proposition the evidence in the record contradicts, it was still impossible for Mr. Yates receive a pre-petition property interest in the fees he took from Stetler. His post-petition legal services agreement did not conform to SCR 3.130(1.5)(f) and therefore could not validly convey a non-refundable retainer. Ethics Opinion KBA E-380. As a result, Mr. Yates received only a security retainer. Id.

Security retainers, like this one, remain the client's property "until applied by counsel in payment of legal services actually performed" and become property of the estate on the date the petition for bankruptcy relief is filed. Indian Motocycle, 66 F.3d at 1254-55. As such, Mr. Yates cannot support his claim that the bankruptcy court erroneously ordered him to return the $2,000 he took because it was allegedly his property.

B. The Bankruptcy Code comprehensively governs the compensation of bankruptcy professionals and preempts state law.

Additionally, Mr. Yates may not rely on Kentucky law as a basis for taking the $2,000 retainer. The Supremacy and Bankruptcy clauses prohibit him from utilizing Kentucky law in a manner inconsistent with the Bankruptcy Code.

Federal law is the "supreme law of the land." U.S. Const. art. VI, § 2. Under the Supremacy Clause, federal law preempts inconsistent state law when Congress enacts a federal statute within the realm of its constitutional authority. Barnett Bank of Marion County, N.A. v. Nelson, 517 U.S. 25, 30 (1996).

When explicit preemption language does not appear in a statute, inconsistent state law must yield to federal law in at least two circumstances. Crosby v. Nat'l Foreign Trade Council, 530 U.S. 363, 372 (2000). The first circumstance is field preemption. When "congress intends federal law to occupy the field, state law in that area is preempted." Id. (citations omitted). The second circumstance is conflict preemption. That exists (1) when it is impossible to comply with both state and federal law, or (2) when state law stands as an obstacle to "the full purposes and objectives of Congress." Id. at 373. Whether state law is a sufficient obstacle is determined by examining the entirety of the federal statutory scheme and identifying its purpose and intended effects. Id.

Both of these tests are met in the instance of bankruptcy law. Under the Bankruptcy Clause, Congress has the power to establish "uniform laws on the subject of bankruptcies throughout the United States." U.S. Const. art. I, § 8, cl. 4. Congress has exercised that power by enacting the Bankruptcy Code. 11 U.S.C. § 101, et seq.

There is no doubt that the Bankruptcy Code is the exclusive law governing bankruptcy proceedings. Pertuso v. Ford Motor Credit Co., 233 F.3d 417, 425 (6th Cir. 2000). "The pervasive nature of Congress's bankruptcy regulation can be seen just by glancing at the Code." Id. The Bankruptcy Code occupies a full title of the United States Code and provides a comprehensive system of rights and responsibilities, its own set of procedures under the Federal Rules of Bankruptcy Procedure, and a "complex administrative machinery that includes a special system of federal courts and United States Trustees." Sherwood Partners, Inc. v. Lycos, Inc., 394 F.3d 1198, 1201 (9th Cir. 2005). Although bankruptcy law may reference state law at many points, it does not "permit the superimposition of state remedies on the many activities that might be undertaken in the management of the bankruptcy process." Pertuso, 233 F.3d at 425 (citation omitted).

C. Mr. Yates's attempt to obtain compensation under Kentucky law improperly circumvents the Bankruptcy Code's statutory framework governing professional compensation.

Mr. Yates may not rely on Kentucky law to justify retaining the fees he took for representing Stetler in its chapter 11 bankruptcy case. That is because "[f]ees in a bankruptcy proceeding are governed by federal, not state, law." Dery v. Cumberland Cas. & Sur. Co. (In re 5900 Assoc., Inc.), 468 F.3d 326, 329 (6th Cir. 2006). The professional compensation provisions of the Bankruptcy Code — 11 U.S.C. §§ 327-331, 503, 507 — collectively "reveal a clear, but implicit, preemptive intent," and "create a scheme of federal regulation so pervasive as to make reasonable the inference that Congress left no room for the States to supplement it." Crosby, 530 U.S. at 372-73 (citations omitted).

The Supreme Court has long held that the federal statutory scheme governing the compensation of bankruptcy professionals in bankruptcy cases is a pervasive scheme of regulation that provides centralized control over compensating professionals, and therefore preempts inconsistent state laws. Brown v. Gerdes, 321 U.S. 178, 183 (1944) (holding, under the Bankruptcy Act of 1898, that federal law governs compensation for attorneys representing the estate). The same is true today under the modern Bankruptcy Code. 5900 Assoc., 468 F.3d at 328. Federal law "establishes the exclusive means of allowing a claim for professional fees in a bankruptcy proceeding." Id.

In the Bankruptcy Code, Congress has enacted a comprehensive set of rules providing a cradle-to-grave scheme for retaining, compensating, and paying attorneys employed by the estate. It regulates (1) when attorneys may be employed by the estate, § 327(a); (2) the amount such attorneys may be compensated, §§ 328-330; (3) how they may receive that compensation from the estate, §§ 330-331, 503(b)(2); and (4) in what priority they may be paid. § 507(a)(1). This even includes oversight of all compensation, including for non-bankruptcy matters, received up to a year before the commencement of the bankruptcy case. § 329. The Bankruptcy Code requires courts to review those transactions, and may order the return of unreasonable fees. Id.

Significantly, these provisions are interdependent. Section 327(a) authorizes the estate to retain professionals, including attorneys, subject to bankruptcy court approval. § 327(a). This ensures that such professionals (1) do not have an adverse interest in the estate and (2) are disinterested persons, as defined under the Bankruptcy Code. Id. Strict enforcement of this provision is essential to ensuring fair and equitable bankruptcy proceedings. See Big Rivers, 355 F.3d at 429 (reviewing the history and significance of the fiduciary obligations imposed upon bankruptcy professionals).

In turn, sections 328 and 329 limit compensation to attorneys employed under section 327(a). Once authorized under section 327(a), the estate may employ attorneys on "reasonable terms and conditions." § 328. And section 329 requires the court to review compensation for pre-petition services "rendered in contemplation of or in connection with" the bankruptcy case, and allows the court to return any compensation received that "exceeds the reasonable value of any such services." § 329.

Sections 330(a) and 331 then allow a court to award compensation based on such services. Under section 330(a), a court may then award fees to a debtor's attorney, but only if the attorney has been employed under section 327(a). § 330(a)(1); see Lamie v. U.S. Trustee, 540 U.S. 526, 538 ("[W]e hold that section

330(a)(1) does not authorize compensation awards to debtors' attorneys from estate funds, unless they are employed as authorized by section 327."). Furthermore, a court may award "compensation that is less than the amount of compensation that is requested" by the attorney, § 330(a)(2), or grant an attorney the right to receive interim compensation throughout the pendency of the bankruptcy case. § 331.

Once a fee has been awarded, an attorney is not given a self-executing judgment in the amount approved by the bankruptcy court. Under section 503(b)(2), a fee award under section 330(a) only provides an attorney with a claim against the estate for administrative expenses. § 503(b)(2). At that point, an attorney's claim may then be paid from a distribution from the estate, which must be made in accord with the Bankruptcy Code's system of priorities. § 507(a)(2) (giving attorneys for the estate second priority in a distribution from the estate).

Mr. Yates may not circumvent this comprehensive process. The Bankruptcy Code exclusively governs attorney compensation in bankruptcy cases. And it does not allow Mr. Yates to retain the $2,000 he took for his bankruptcy fees. Any Kentucky law, or use thereof, allowing for the contrary is preempted because it would undermine the "intended purpose and natural effect" of the Bankruptcy Code's comprehensive regulatory scheme. Crosby, 530 U.S. at 373; see 5900

Assoc., 468 F.3d at 331 (holding that bankruptcy fees are not enforceable under state law because it is court approval under section 330(a) that creates the attorney's right to payment, not performance of the services); see also Pertuso, 233 F.3d at 425 (holding that state law cannot provide remedies for activities already governed by the Bankruptcy Code).

CONCLUSION

For these reasons, the United States Trustee respectfully asks this Court to affirm the order entered below.

Respectfully submitted,

DANIEL M. McDERMOTT
United States Trustee for Region 8

Dated: February 10, 2011

BY: /s/ Scott J. Goldberg
Scott J. Goldberg
Trial Attorney

United States Department of Justice
Office of the United States Trustee
601 West Broadway, Suite 512
Louisville, Kentucky 40202
Telephone: (502) 582-6000

/s/ Noah M. Schottenstein
Noah M. Schottenstein
Trial Attorney

United States Department of Justice
Executive Office for United States Trustees
20 Massachusetts Ave., N.W., Ste 8100
Washington, D.C. 20530
Telephone: (202) 307-1399

CERTIFICATE OF SERVICE

I certify that a copy of this brief was sent by first class U.S. Mail, postage prepaid, on February 10, 2011 to Frank Yates, 4602 Southern Parkway, Suite B2, Louisville, Kentucky 40214.

/s/ Scott J. Goldberg
Scott J. Goldberg

BRIEF BANK — "SUMMARY SHEET" *Printed Fri-3/19/10 9:46*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	Ronald Hugh Standifered and Betty Ann Standiferd v. Richard Wieland, United States Trustee for Region 20
2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	10th Cir.
3. ("CCN") ***CURRENT*** CASE NO.	No.: 09-2238
4. ("PCN") ***PRIOR*** CASE NO. - & COURT *[IF ANY]*	No.: 1-09-cv-00083-RB-RLP Court: D. N.M. *(Identify judge & cite, if any)*
5. ("SO") ***SOURCE***	**U.S. TRUSTEES**
6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	Filed: February 9, 2010 Type: Brief for Appellee, Richard Wieland, United States Trustee
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8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") ● ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	● Whether the bankruptcy court properly denied the Standiferds a discharge under § 727(a)(6)(A) and (a)(2)(B) when all the conduct supporting the denial occurred in the chapter 13 portion of their case before they converted to chapter 7.
10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)	
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No. 09-2238

IN THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

RONALD HUGH STANDIFERD and
BETTY ANN STANDIFERD,
Appellants,
v.
RICHARD WIELAND, United States Trustee for Region 20,
Appellee.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF NEW MEXICO
The Honorable Robert C. Brack

BRIEF FOR APPELLEE, RICHARD WIELAND, UNITED STATES TRUSTEE

Oral Argument Requested

Ramona D. Elliott
General Counsel
P. Matthew Sutko
Associate General Counsel
Wendy Cox
Trial Attorney
Executive Office for U.S. Trustees
20 Massachusetts Ave, N.W.
Washington, DC 20530
(202) 307-1399

Richard Wieland
United States Trustee
Ronald E. Andazola
Assistant United States Trustee
U. S. Department of Justice
Office of the United States Trustee
P.O. Box 608
Albuquerque, NM 87103
(505) 248-6549

Attorneys for Richard Wieland,
United States Trustee

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STATEMENT OF RELATED CASES

There are no prior or related appeals.

STATEMENT OF JURISDICTION

The final order initially appealed from was entered by the Bankruptcy Court in a core proceeding that arose under title 11. The Bankruptcy Court had jurisdiction under 28 U.S.C. §§ 1334 and 157(a) and (b)(2)(J) over that proceeding. The Standiferds timely appealed the order to the United States Bankruptcy Appellate Panel of the Tenth Circuit on December 24, 2008 and the United States Trustee elected to have the appeal heard by the United States District Court for the District of New Mexico. The District Court had appellate jurisdiction over the Bankruptcy Court's final order under 28 U.S.C. § 158(a)(1). The District Court entered a final order on September 4, 2009 affirming the Bankruptcy Court's order. The Standiferds timely filed this appeal from the District Court's order on October 1, 2009. This Court has jurisdiction over this appeal under 28 U.S.C. §§ 158(d)(1) and 1291.

STATEMENT OF THE ISSUES PRESENTED

1. Whether the Bankruptcy Court erred by denying a discharge under 11 U.S.C. § 727(a)(6)(A) to debtors who willfully refused to obey the confirmation order issued by the court in the Chapter 13 portion of their bankruptcy case.

This issue was raised and decided in the Bankruptcy Court's Opinion at 8-19. Aplts. App. at 42-53.

2. Whether the Bankruptcy Court erred in denying a discharge under section 727(a)(2)(B) to debtors who fraudulently concealed over $100,000 in business profits with the intent to hinder their creditors during the Chapter 13 portion of their bankruptcy case.[1]

This issue was raised and decided in the Bankruptcy Court's Opinion at 19-22. Aplt. App. at 53-56.

STATEMENT OF THE CASE

This is an appeal from a final order of the United States District Court for the District of New Mexico ("District Court"), affirming a final order entered by the United States Bankruptcy Court for the District of New Mexico ("Bankruptcy Court"), denying the debtors, Ronald Hugh Standiferd and Betty Ann Standiferd, a discharge of their debts in a bankruptcy case that they initially filed under Chapter 13 of the Bankruptcy Code, but voluntarily converted over five years later to

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[1] The Standiferds raise two additional issues on appeal concerning dicta in the Bankruptcy Court's opinion that the Standiferds' conduct would have justified dismissal of their case for cause under 11 U.S.C. § 707(a). The District Court did not consider those issues on appeal because the Bankruptcy Court did not dismiss their case under that section. Aplt. App. at 67. For the same reason, the United States Trustee will not address those issues in this brief.

Chapter 7. After the conversion, the United States Trustee objected to the discharge of the Standiferds' debts, alleging that the Standiferds had concealed property during the bankruptcy case with the intent to hinder creditors, refused to obey a lawful order of the Bankruptcy Court, failed to explain satisfactorily a loss of assets, and knowingly and fraudulently made a false oath while their bankruptcy case was pending. See 11 U.S. C. § 727(a). The Bankruptcy Court denied the discharge on two of the independent grounds advanced by the United States Trustee, finding that the Standiferds had fraudulently concealed property from their creditors within the meaning of section 727(a)(2)(B) and had intentionally refused to obey a court order within the meaning of section 727(a)(6)(A).

The District Court affirmed the judgment of the Bankruptcy Court on appeal on both grounds and the Standiferds appealed the decision to this Court.

STATEMENT OF APPROPRIATE STANDARD OF APPELLATE REVIEW

A bankruptcy court's findings of fact are reviewed for clear error and its conclusions of law are reviewed de novo. Gullickson v. Brown (In re Brown), 108 F.3d 1290, 1292 (10th Cir. 1997). A finding of fact is clearly erroneous when the appellate court is left with the definite and firm conviction that the lower court has made a mistake. United States v. U.S. Gypsum Co., 333 U.S. 364, 395 (1948). Mixed questions consisting of legal conclusions drawn from the facts are reviewed de novo. In re Brown, 108 F.3d at 1292. In addition, this Court must construe the Bankruptcy Code liberally in favor of the debtor. Id.

The Standiferds do not contest any of the Bankruptcy Court's findings of fact on appeal. The first issue involves the Bankruptcy Court's interpretation of 11 U.S.C. § 727(a)(6)(A), which is reviewed de novo. The second issue involves the Bankruptcy Court's interpretation of 11 U.S.C. §§ 727(a)(2)(B) and is also subject to de novo review.

STATUTORY FRAMEWORK[2]

Under Chapter 7, "a debtor [typically] receives an immediate unconditional discharge of personal liability for certain debts in exchange for relinquishing his or her nonexempt assets to a bankruptcy trustee for liquidation and discharge to creditors." H.R. Rep. 109-31(I) at 10 (2005), reprinted in 2005 U.S.C.C.A.N. 88,

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[2] The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. 109-8, 119 Stat. 23 (codified in scattered sections of title 11) ("BAPCPA") significantly amended many provisions of the Bankruptcy Code. Because this case was filed prior to the October 17, 2005 effective date of the BAPCPA, all references and citations herein are to the pre-BAPCPA version of title 11 unless otherwise indicated.

98; see 11 U.S.C. §§ 701-727.[3] However, the Chapter 7 trustee, a creditor, or the United States Trustee[4] may object to the granting of a discharge on the basis of any of the grounds set forth in 11 U.S.C. § 727(a). 11 U.S.C. § 727(c)(1). Specifically, in Chapter 7, a court may deny a discharge to a debtor if the debtor refuses to obey a court order in the bankruptcy case or if the debtor transfers or conceals property to hinder his creditors. 11 U.S.C. §§ 727(a)(6)(A), 727(a)(2). A discharge under section 727(a) releases the debtor from liability for debts that arose before the case was filed, with limited exceptions. See 11 U.S.C. § 727(b). If the case was converted from Chapter 13, the debtor is discharged from all debts that arose prior to the time of conversion, with limited exceptions. See id.; 11 U.S.C. § 348(d).

While a bankruptcy case may begin in one chapter, it may not necessarily remain there. The Bankruptcy Code provides for conversions, both voluntary and involuntary between various chapters. See, e.g., 11 U.S.C. § 1307 (conversion from Chapter 13 to Chapter 7, 11 or 12); § 1112 (conversion from Chapter 11 to

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[3] The Bankruptcy Code is divided into various chapters. All cases are filed under Chapter 7, 9, 11, 12 or 13, which are the operative chapters. Provisions set forth in Chapter 7 of the Code apply in Chapter 7 cases. See 11 U.S.C. § 103(b).

[4] The United States Trustee Program is a unit of the Department of Justice charged by Congress to, among other things, appoint trustees in Chapter 7 and Chapter 13 cases, and supervise the administration of Chapter 7 and Chapter 13 cases. See 28 U.S.C. § 586.

Chapter 7, 12 or 13). A debtor proceeding under Chapter 13 has the right to convert his case to Chapter 7 at any time.[5] 11 U.S.C. § 1307(a).

The conversion of a case from one chapter to another does not affect the date of the filing of the petition or the commencement of the case or the order for relief (11 U.S.C. § 348(a)), but it may change the composition of the bankruptcy estate. The estate of a debtor proceeding under Chapter 13 includes all property that the debtor has an interest in when the case is filed plus earnings and other property acquired by the debtor during the Chapter 13 case. 11 U.S.C. §§ 541, 1306(a). When a debtor's case is converted from Chapter 13 to Chapter 7, the Chapter 7 bankruptcy estate includes all of the debtor's interest in property as of the time the Chapter 13 petition was filed that the debtor still has at the time of conversion, but usually does not include property that the debtor acquired during the Chapter 13 proceeding. 11 U.S.C. § 348(f)(1)(A). If the debtor is found to have converted his case in bad faith, however, the property of the estate in the converted case includes all of the debtor's property at the time of conversion, including property and earnings that the debtor acquired while in Chapter 13. 11 U.S.C. § 348(f)(2).

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[5] The debtor converts his case by filing a notice with the court. Fed. R. Bankr. P. 1017(f)(3).

STATEMENT OF FACTS

The Standiferds filed a voluntary petition under Chapter 13 of the Bankruptcy Code on December 28, 2000.[6] At the time, the Standiferds listed a total of $229,217.93 in unsecured debt on their bankruptcy schedules. Aplee Supp. App. at 13-19.

The Standiferds filed a plan for repaying their debts and subsequently amended their proposed plan. The Standiferds' filed their First Amended Plan ("Plan") on February 8, 2001. Aplee Add. at 1-7. The Plan proposed to pay 100% of the unsecured creditors' claims. Id. at 5. The Plan provided that the Standiferds would pay $470 per month from their earnings for a minimum of thirty-six months to their unsecured creditors. Id. at 1-2. It also provided that they would supplement the fixed monthly payments with variable amounts consisting of any tax refunds and proceeds from receivables to make up the shortfall of over $200,000 between the unsecured creditors' claims and the fixed monthly payments. Id. at 2.

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[6] The Standiferds do not challenge the factual findings of the Bankruptcy Court in this appeal. Therefore, many of the record citations in the Statement of Facts are to the findings of fact set forth in the Bankruptcy Court's opinion. [Aplt. App. at 35-59]. Other citations herein are to the Appellants' Appendix [Aplt. App.], the Appellee's Supplemental Appendix [Aplee. Supp. App.] and the Appellee's Addendum [Aplee. Add.].

The Bankruptcy Court entered an order confirming the Standiferds' Plan on January 25, 2002. Aplee. Supp. App. at 31-35. As relevant here, the Confirmation Order directed the Standiferds to do two things:

- The Standiferds had to file all their tax returns on time, send copies of the returns to the Chapter 13 trustee, and pay any tax refunds they received into the Plan. Id. at 35, ¶ 11.
- If they engaged in business, they had to file monthly operating reports. Id. at 34, ¶ 7.

The tax returns and operating reports were intended to notify the trustee of the receipt of funds committed to the repayment of creditors under the Plan and alert the trustee to any increase in the Standiferds' income so she could seek to modify the Plan to increase payments to creditors under 11 U.S.C. § 1329(a). In addition, the Standiferds were ordered not to incur any additional debt outside the ordinary course of business without the Bankruptcy Court's approval. Aplee. Supp. App. at 34, ¶ 4. The trustee expressly was permitted to object to a discharge if plan paid less than 100 percent to the Standiferds' creditors. Id. at 35, ¶ 10.

The Standiferds' attorney signed the Confirmation Order. Id. at 35. The Standiferds received a copy of the Confirmation Order and understood that they had to give the trustee copies of their tax returns, file operating reports if they engaged in business and turn over their tax refunds to the trustee. Aplt. App. at 38;

Aplee. Supp. App. at 125(copy of order mailed to Standiferds by their attorney). See also Aplee. Supp. App. at 171-172, 181 (testimony of Ronald Standiferd).

In May or June of 2002, Mr. Standiferd obtained a job with STKX Construction, Inc. Aplee. Supp. App. at 227-228, 275.

Shortly thereafter, Mr. Standiferd, began engaging in business. Using the name Standiferd and Sons Company, he formed a business partnership with STKX Construction, Inc. called S & S Joint Venture. Id. at 228-229, 276. Through the joint venture, Mr. Standiferd engaged in the business of handling construction projects for Native Americans. Id. at 279-281. The Standiferds did not file an operating report as required by the Confirmation Order. Aplt. App. at 42, 54; Aplee. Supp. App. at 197.

The Standiferds received tax refunds for 2001 and 2002, but did not pay them into the Plan and did not give the trustee copies of their tax returns, despite annual reminders from the trustee requesting the tax returns. Aplee. Supp. App. at 198-199, See, Aplee. Supp. App. at 38. This violated the Confirmation Order.

On May 16, 2003, the Chapter 13 trustee filed a motion to dismiss the Standiferds' Chapter 13 bankruptcy case based on their failure to provide copies of their 2001 and 2002 tax returns and to contribute tax refunds to the Plan as required by the Confirmation Order. Aplt. App. at 26.

To avoid dismissal, the Standiferds agreed to pay the tax refunds at the end of their Plan, unless they had already paid their creditors in full; in turn, the trustee withdrew the May 2003 dismissal motion. See Aplt. App. at 29-31. The Standiferds belatedly provided a copy of their 2002 tax return to the trustee in connection with the motion to dismiss. Aplt. App. at 41; Aplee. Supp. App. at 197-198.

The Standiferds continued to engage in the construction business without reporting it as the order required. In 2003, Mr. Standiferd received profits from his business venture. Over the course of the year, he received three checks that year from his joint venture totaling $15,000. Aplt. App. at 39; Aplee. Supp. App. at 168-169; Aplee. Add. at 9-12. Although, paragraph seven of the order required reporting, the Standiferds did not file monthly operating reports for the joint venture. Aplt. App. at 42, 54; Aplee. Supp. App. at 191, 197. And they did not provide the trustee with a copy of their 2003 tax return on which they reported the income from the joint venture and that would have alerted the trustee to the fact that the Standiferds had started a business and were making money. Aplt. App. at 42, 54; Aplee. Supp. App. at 197-198.

Over the course of 2004, Mr. Standiferd received seven more checks from engaging in business through his joint venture; these totaled $80,000. [Aplt. App.

at 39-40]; Aplee. Supp. App. at 169-170; Aplee. Add. at 13-20. Those checks represented profits from the joint venture. [Aplt. App. at 39-40]; Aplee. Supp. App. at 169-170. The Standiferds did not notify the trustee of the receipt of any of that money. Aplee. Supp. App. at 202. They did not file monthly operating reports disclosing that Mr. Standiferd was engaging in business or that he received $80,000 in profits as required by the Confirmation Order. Aplt. App. at 42, 54; Aplee. Supp. App. at 168-169, 197. And, in violation of the Confirmation Order, they did not provide the trustee with a copy of their 2004 tax return that shows their income from the joint venture. Aplt. App. at 42,54; Aplee. Supp. App. at 198.

In November of 2004, Mr. Standiferd formed a corporation called Standiferd and Sons, Inc. to substitute for him as a partner in the joint venture and to receive the profits from the joint venture. Aplee. Supp. App. at 184-816. In 2005, the Standiferds received a check for $20,000 representing their profits from the joint venture. Aplt. App. at 40; Aplee. Supp. App. at 170-171; Aplee Add. at 21-24. Still, they filed no operating reports disclosing that they were engaging in business. Aplt. App. at 42, 54; Aplee. Supp. App. at 170-171, 197. That violated paragraph seven of the Confirmation Order. They did not give the trustee a copy of their 2005 tax return on which they reported their business profits as required by the order. Aplt. App. at 42, 54; Aplee. Supp. App. at 198. Instead, the Standiferds spent most of the $100,000+ in undisclosed profits that they had received from their business to renovate their home, which they retained throughout the Chapter 13 portion of their bankruptcy case. Aplt. App. at 52; Aplee. Supp. App. at 161, 168-169, 320, 333-334.

On October 16, 2006, the Chapter 13 trustee filed a second motion to dismiss the Standiferds' bankruptcy case on the ground that the Standiferds had failed to provide an accounting of bonus income, had failed to provide copies of their tax returns and had failed to contribute tax refunds to the Plan. Aplt. App. at 32. In response, on November 22, 2006, the Standiferds converted their proceeding to Chapter 7. Aplee. Supp. App. at 41. At the time of the conversion, the Standiferds' bankruptcy case had been pending for nearly six years. For the entire period, the Standiferds' creditors had been subject to an automatic stay of their claims against the Standiferds, which means they could look only to the money the Standiferds paid through the bankruptcy in satisfaction of their claims. See 11 U.S.C. § 362; Aplee. Supp. App. at 211. That stay remained in effect following the Standiferds conversion to Chapter 7.

Over the life of the Chapter 13 proceeding, the Standiferds paid $32,640 on their debt of $469,303.99, plus interest,[7] and did not disclose over $100,000 in business income. Aplee. Supp. App. at 2; Aplee. Supp. App. at 73.

The Standiferds filed amended schedules following their conversion to Chapter 7. Schedule F filed on December 15, 2006 showed that the Standiferds' unsecured debts had nearly trebled to $653,153.98 since they filed their bankruptcy petition. Aplee. Supp. App. at 42-48.

The first time the Standiferds disclosed their interest in S& S Joint Venture, the 2002 joint venture they created, was at the Chapter 7, section 341 meeting of creditors in January of 2007. Aplee. Supp. App. at 191-192. At a continuation of that meeting on March 5, 2007, the Standiferds also for the first time disclosed their interest in Standiferd & Sons LLC, years after they formed it. Aplee. Add. at 34. Subsequently, on May 8, 2007, the Standiferds filed an amended Schedule B formally listing their interest in Standiferd & Sons LLC, but still omitting their interest in S & S Joint Venture. See Aplee. Supp. App. at 51.

After conducting an investigation, the United States Trustee filed a complaint seeking to deny the Standiferds a discharge of their debts. The Complaint alleged a discharge should be denied on four separate grounds.

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[7] That amount includes secured debt of $229,885.06, priority tax debt of $10,201, and unsecured debt of $229,217.93.

~~Complaint~~ Aplee. Supp. App. at 56-66. The United States Trustee's complaint alleged that the Standiferds: 1) knowingly and fraudulently had withheld recorded information relating to their property and financial affairs from the Chapter 13 trustee, which justified a denial of discharge under 11 U.S.C. § 727(a)(4)(D); 2) had failed to satisfactorily explain the loss of $140,000 received in distributions from S & S Joint Venture, which justified a denial of discharge under 11 U.S.C. § 727(a)(5); 3) had failed to file monthly operating reports and turn over any portion of the distributions from their joint venture to the Chapter 13 trustee as required by the Confirmation Order, which justified a denial of discharge under 11 U.S.C. § 727(a)(6)(A); and 4) had concealed and transferred the distributions from their joint venture with the intent to hinder, delay and defraud the trustee and their creditors, which justified a denial of discharge under 11 U.S.C. § 727(a)(2)(B). Id.

On December 17, 2008, after a two-day trial, the Bankruptcy Court issued a twenty-five page opinion and entered judgment in favor of the United States Trustee denying the Standiferds a discharge of their debts. Aplt. App. at 35-59, 60. The Bankruptcy Court found that the Standiferds had willfully failed to comply with the Confirmation Order, justifying a denial under section 727(a)(6)(A) and the Standiferds had concealed assets of the estate to hinder their creditors, justifying a denial under section 727(a)(2)(B). Aplt. App. at 52-56. In so holding, the

Bankruptcy Court determined based on evidence of the Standiferds' fraudulent conduct and the timing of their conversion, they had converted their case to Chapter 7 in bad faith. Aplt. App. at 45. Therefore, their Chapter 7 estate included all of the assets of their Chapter 13 estate. Id. The Bankruptcy Court also squarely rejected the Standiferds' argument that their discharge could not be denied because section 727(a) did not apply to misconduct in Chapter 13. Aplt. App. at 42-50. Having determined denial was warranted on two independent grounds, the Bankruptcy Court indicated that section 727(a)(5) was not an appropriate ground for a denial of discharge and declined to address the fourth ground - section 727(a)(4)(D). Aplt. App. at 56.

In dicta, the Bankruptcy Court opined that the Standiferds' bankruptcy case could be dismissed for cause without the entry of a discharge pursuant to 11 U.S.C. § 707(a). Aplt. App. at 57-58. However, the Bankruptcy Court did not do that, but denied the Standiferds' discharge under section 727(a) instead. Aplt. App. at 59.

On December 24, 2008, the Standiferds timely appealed the Bankruptcy Court's judgment to the United States Bankruptcy Appellate Panel of the Tenth Circuit. Aplee. Supp. App. at 138. The appeal was transferred to the United States District Court for the District of New Mexico at the election of the United States

Trustee, where the appeal was referred to a magistrate judge. On August 17, 2009, the magistrate judge issued his recommendation that the decision of the Bankruptcy Court be affirmed on both independent grounds. Aplt. App. at 61-67. The Standiferds objected to the magistrate judge's recommendation. On September 4, 2009, the district court, following a de novo review of the record, adopted the magistrate judge's recommendation and denied the Standiferds' appeal. Aplt. App. at 70.

The Standiferds filed a timely notice of appeal to the Tenth Circuit on October 1, 2009. Aplee. Supp. App. at 140-141].

SUMMARY OF ARGUMENT

This is a garden variety denial of discharge case. The Bankruptcy Court denied the Standiferds' discharge on two independent grounds under 11 U.S.C. § 727(a) and this Court can affirm on either of those grounds. The Bankruptcy Court found that the Standiferds willfully refused to obey the Confirmation Order and fraudulently concealed their business profits during their bankruptcy case, warranting the denial of their discharge under 11 U.S.C. §§ 727(a)(6)(A) and (a)(2)(B), respectively. Those findings are not clearly erroneous; there is ample evidence in the record supporting them. The Standiferds do not dispute the Bankruptcy Court's factual findings. Instead, they raise several legal challenges based on the fact their case did not originate in Chapter 7, seeking to avoid the consequences of their misconduct. There is no merit to their arguments. The first two pertain to the Bankruptcy Court's dismissal under section 727(a)(6)(A). If the Court affirms on the first ground, section 727(a)(6)(A), it need not reach the remaining issues.

The Standiferds allege the Bankruptcy Court erred in denying their discharge under section 727(a)(6)(A) because: 1) the Confirmation Order was not a lawful order that the parties had to obey, but only a stipulation; and 2) the Confirmation Order was not an order "in the case" within the meaning of section 727(a)(6)(A) because it was entered in the Chapter 13 part of their bankruptcy case. In addition, they allege the Bankruptcy Court erred in denying their discharge under section 727(a)(2)(B) because section 727 does not apply to fraudulent conduct in Chapter 13 and the fraudulently diverted proceeds were not part of their postconversion estate. The Bankruptcy Court did not clearly err in finding that the Confirmation Order was a court order the Standiferds were required to obey. That order unambiguously directed the Standiferds to pay any tax refunds into the Plan, and provide tax returns and monthly operating reports to the trustee. The Standiferds never challenged the legality of the Confirmation Order and they are foreclosed from doing so now.

Nor did the Bankruptcy Court err in concluding the Standiferds' willful disregard of the confirmation order was a refusal "in the case" to obey a court order. The Standiferds filed and participated in only one bankruptcy case. The Bankruptcy Court entered the Confirmation Order and the Standiferds intentionally disregarded it during that case. Therefore, the Bankruptcy Court properly denied the Standiferds' discharge under section 727(a)(6)(A).

The Standiferds' challenges to denial under section 727(a)(2)(B) are equally unpersuasive. The Standiferds' contention section 727 did not apply to their fraudulent conduct because it occurred during the Chapter 13 part of their case is wrong for two reasons. First, section 727 applies to fraudulent conduct that occurs during any part of the bankruptcy case. The language and the purpose of the statute support that reading. Further corroborating that reading is a recent Supreme Court decision that rejected a debtor's attempt to avoid the consequences of his fraudulent conduct by converting his case, recognizing that preconversion conduct can support postconversion remedies under a different chapter. And under strikingly similar facts, the Fifth Circuit affirmed a decision denying a discharge under section 727(a)(2)(B) to debtors who, like the Standiferds, had fraudulently spent funds belonging to the bankruptcy estate during the Chapter 13 part of their case and then converted their case to Chapter 7.

Interpreting Section 727(a) as the Standiferds would, as applying only to fraud committed in the Chapter 7 part of converted cases would allow dishonest debtors to obtain debt relief through bankruptcy in contravention of Congress' express intent to the contrary. It also would provide a perverse incentive for debtors to abuse the bankruptcy process, knowing that they can convert to a new chapter and still obtain a discharge of their debts if they are caught.

Even if the Standiferds were right, and section 727 applies only to fraud committed in the Chapter 7 part of their case or that affected the assets of the Chapter 7 estate, it applies here because they put the money they diverted into their house, which became part of the Standiferds' Chapter 7 estate when they converted in bad faith. The Standiferds do not challenge the factual basis of the Bankruptcy Court's bad faith finding, which was amply supported by the evidence and not clearly erroneous. And it was not error for the Bankruptcy Court to consider the circumstances of the Standiferds' case conversion because the Standiferds, themselves, implicitly raised the issue of the scope of their Chapter 7 estate in response to the United States Trustee's objection to their discharge.

ARGUMENT

I. The Bankruptcy Court Properly Denied the Discharge under Section 727(a)(6)(A).

A. The Bankruptcy Court's Finding That the Standiferds Had Refused to Obey A Lawful Order in the Bankruptcy Case Was Not Clearly Erroneous.

A bankruptcy court may deny a debtor a discharge if he has refused to obey a lawful order of the court. 11 U.S. C. § 727(a)(6)(A); Martinez v. Los Alamos Nat'l Bank (In re Martinez), No. 04-2040, 126 Fed. Appx. 890, 896, 2005 WL 648218, at *4 (10th Cir. Mar. 22, 2005) (unpublished).[8] Discharge will be denied under § 727(a)(6)(A) if "1) the Court issued an order directed at the debtor; 2) the order was lawful; 3) the order was not one requiring a response to a material question or to testify; and 4) the debtor refused to obey the order." Gillman v. Green (In re Green), 335 B.R. 181, 183 (Bankr. D. Utah 2005). See 11 U.S.C. § 727(a)(6)(A).

There must be some degree of willfulness or volition on the part of the debtor not to obey the order. Martinez, 126 Fed. Appx. at 896, 2005 WL 648218, at *4; Smith v. Jordan (In re Jordan), 521 F.3d 430, 433 (4th Cir. 2008). The initial burden is on the plaintiff to demonstrate that the debtor received the order and failed to comply with its terms. Smith, 521 F.3d at 433. The burden then shifts to the debtor who must explain the reasons for non-compliance. Id.

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[8] Section 727(a)(6) is intended to give the bankruptcy court a means to ensure the debtor is straightforward in dealing with creditors and complies with its orders. Id.

Ample evidence in the record supports the Bankruptcy Court's finding that the Standiferds willfully disobeyed a court order within the meaning of section 727(a)(6)(A). The Bankruptcy Court issued the Confirmation Order in the Standiferds' bankruptcy case and directed it to the parties in that case. Aplee. Supp. App. at 31-36. The Confirmation Order specifically directed the Standiferds to timely file tax returns and provide copies of the returns to the Chapter 13 trustee, to pay any tax refunds they received into the Plan, and to file operating reports if they engaged in business, presumably to enable the trustee to ensure that the Standiferds made all the required contributions to the Plan and to notify the trustee of any additional income the Standiferds received.[9] Id. at 34-35.

The Bankruptcy Court found that the Standiferds had received the Confirmation Order and had failed to comply with its terms. Aplt. App. at 38, 54-55. Specifically, the Bankruptcy Court found that the Standiferds formed S & S Joint Venture in 2002 and "engaged in business" thereafter for years, but never filed a monthly operating report regarding the Joint Venture. Aplt. App. at 54. The Bankruptcy Court further found that from 2003 - 2005, the Standiferds received 11 checks from their business representing their share of profits from the Joint Venture in an aggregate amount of $135,000. Aplt. App. at 39-40. Still, the

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[9] The Confirmation Order did not require the Standiferds to respond to a material question or testify.

Standiferds never filed a single monthly operating report. Aplt. App. at 42. They also failed to provide copies of their tax returns for the years, 2003, 2004, and 2005 to the trustee that would have alerted the trustee to the fact that the Standiferds had received thousands of dollars in business profits. Aplt. App. at 42. These omissions were in direct derogation of the terms of the Confirmation Order.

The Bankruptcy Court found based on the evidence adduced at trial, and the Standiferds did not dispute, they were aware of their obligations under the Confirmation Order and were able to comply with the Order. Aplt. App. at 55. They provided a copy of their 2002 tax return to the trustee when faced with a motion to dismiss. The Standiferds offered no explanation for their noncompliance with the Order. The Bankruptcy Court properly concluded therefore, that their refusal to obey was willful. Id.

The Standiferds do not dispute that they willfully disobeyed the Confirmation Order, but argue that the Confirmation Order was not a "lawful order" within the meaning of section 727(a)(6)(A), characterizing the Order as a court approval of a voluntary stipulation between the parties the Standiferds were free to disregard. They further contend the Bankruptcy Court had no authority to order them to do anything in the Confirmation Order. Those assertions are contrary to both the facts in this case and the relevant law.

It was not clearly erroneous for the Bankruptcy Court to determine that the Confirmation Order was, in fact, a court order and not merely a stipulation between the parties.[10] The Supreme Court recently upheld the enforceability of a confirmation order and incorporated insurance settlement order in Travelers Indem. Co. v. Bailey, concluding those final court orders were not subject to collateral attack and should be enforced according to their unambiguous terms. 129 S. Ct. 2195, 2204 (2009).[11] A confirmation order is recognized in this Circuit as a valid, binding order. United States v. Richman (In re Talbot), 124 F.3d 1201, 1209 (10th Cir. 1997). The Confirmation Order bore all of the hallmarks of a court order. It was appropriately designated "Order Confirming." It purported to "order[], adjudge[] and decree[]" specific things. See Aplee. Supp. App. at 31-36. Most importantly, the Confirmation Order clearly and directly required the Standiferds to take certain specified actions under certain specified circumstances. Id.

The Standiferds were required to obey the Confirmation Order. A court order "must be obeyed by the parties until it is reversed by orderly and proper proceedings." Maness v. Meyers, 419 U.S. 449, 459 (1975) (citation omitted). See

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[10] This Court reviews a bankruptcy court's finding of fact for clear error. Gullickson, 108 F.3d at 1292.

[11] The Supreme Court also noted that most federal Courts of Appeals give substantial deference to a bankruptcy court's interpretation of its own orders. Id., n.4.

Martinez, 126 Fed. Appx. at 897, 2005 WL 648218, at * 5 (affirming denial of discharge under section 727(a)(6)); NCNB Tex. Nat'l Bank v. Jones (In re Jones), 966 F.2d 169, 174 n. 3 (5th Cir. 1992) ("The bankruptcy court entered an order that was within its equitable power. The debtors could have appealed the order, but absent a withdrawal of the order on appeal, the debtors were obligated to obey it."). The Standiferds never objected to or appealed the Confirmation Order as being beyond the authority of the Bankruptcy Court. Therefore, they were bound to follow its terms.

B. The Standiferds' Refusal Was "In The Case" Because There Was Only One Bankruptcy Case.

The Standiferds' refusal to obey the Confirmation Order was a refusal "in the case" to obey a lawful court order within the plain meaning of section 727(a)(6)(A). The Standiferds argue that because the Confirmation Order was entered (and disregarded by the Standiferds) during the Chapter 13 phase of their bankruptcy case, it is not an order in the Chapter 7 case as they incorrectly assert the statute requires. That argument is wrong for two reasons. First, the plain language of that section 727(a)(6)(A) includes no such limitation. Second, the Standiferds' construction requires the Chapter 13 and Chapter 7 proceedings to have been separate cases. They were not.

According to the statute, a denial of discharge is warranted when a debtor has refused to obey a court order "in the case."[12] The plain meaning of the phrase "in the case" is in the debtor's bankruptcy case.

The Chapter 13 proceeding and the Chapter 7 proceeding are both part of the single bankruptcy case filed by the Standiferds.[13] Section 301 of the Bankruptcy Code states that a voluntary case under any chapter is commenced by filing a petition with the bankruptcy court. 11 U.S.C. § 301(a). That case then continues until it is dismissed or closed. Thus, a case can only be commenced by filing a petition.[14]

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[12] Section 727(a)(6)(A) provides:

> (a) The court shall grant the debtor a discharge, unless –
>
> * * *
>
> (6) the debtor has refused, in the case–
>
> (A) to obey any lawful order of the court, other than an order to respond to a material question or to testify;

[13] The Standiferds take the position that the proceeding under Chapter 13 and the proceeding under Chapter 7 in their bankruptcy case are separate cases, citing 11 U.S.C. § 1307(a). Appellants' Brief at 22-23. Section 1307(a) provides that "[t]he debtor may convert a case under this chapter to a case under chapter 7 of this title at any time. . . ." That argument is wrong because section 1307(a) does not govern or even address whether the conversion of a case from Chapter 13 to Chapter 7 begins a new, separate case.

[14] A voluntary conversion under section 1307(a), by contrast, is accomplished by filing a notice. <u>See</u> Fed R. Bankr. P. 1017(f)(3).

The conversion of a case to a new chapter does not begin a new case. See 11 U.S.C. § 348(a); Finney v. Smith (In re Finney), 992 F.2d 43, 45 (4th Cir. 1993) (conversion creates no break in a case); Calder v. Job (In re Calder), 973 F.2d 862, 866 (10th Cir. 1992) (". . . [a] proper reading of § 348 indicates that it is not a source of disruption but, instead, preserves the continuity of the bankruptcy proceedings.") (internal quotation omitted). Section 348, which governs the effect of conversion explains that conversion does not affect the date of the filing of the petition or the commencement of the case. By its terms, section 348(a) recognizes that in a converted case there is only one petition and one commencement of the case. 11 U.S.C. § 348(a) ("Conversion of a case . . . does not effect a change in the date of the filing of *the* petition, the commencement of *the* case, or the order for relief.") (emphasis added).

Rule 1019 of the Federal Rules of Bankruptcy Procedure, which implements section 348, was amended in 1997 to delete the phrase "superseded case" in subsection 3 specifically to dispel any misconception that conversion to a new chapter results in a new case. Advisory Committee Note to 1997 Amendment to Fed. R. Bankr. P. 1019 (explaining that the prior version of the rule "create[d] the erroneous impression that conversion of a case results in a new case that is distinct from the original case.").

When the Standiferds converted their case to Chapter 7, the existing Chapter 13 case was not dismissed or closed, and the Standiferds did not file a second petition with the Bankruptcy Court seeking relief under Chapter 7.[15] Therefore, they have commenced only a single bankruptcy case, one they converted to Chapter 7 after a portion of their misconduct was uncovered by the Chapter 13 trustee. Finally, the Bankruptcy Court's administrative handling of the Standiferds' case buttresses this conclusion. The Standiferds' Chapter 7 proceeding continued on the same docket report under the same case number as the Chapter 13 proceeding.

The Standiferds want this Court to read the phrase "in the case" as "in the Chapter 7 case." Appellants' Brief at 22 ("For the same reasons that § 727(a)(2)(B) cannot apply to property of the chapter 13 estate, orders in a chapter 13 case are not orders 'in the [chapter 7] case."). That construction of section 727(a)(6)(A) makes no sense because it relies on the erroneous premise that the Standiferds participated in two separate bankruptcy cases–one under Chapter 13 and one under Chapter 7. Further, it is not what the statute says. The Standiferds' attempt to construe the statute contrary to its plain meaning for policy reasons runs

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[15] The Standiferds had the option of dismissing their Chapter 13 proceedings and filing a petition to commence a new case under Chapter 7, but they chose to convert their existing case instead. In fact, they converted their case to avoid dismissal.

afoul of two basic tenets of statutory construction. First, where the statute's language is plain, the court must enforce it according to its terms. Lamie v. United States Trustee, 540 U.S. 526, 534 (2004). Second, a court may not read an absent word into a statute to change the reach of the statute. Id. at 538. The Supreme Court noted in Lamie that its unwillingness to soften the import of Congress' chosen words even if it believed the words lead to a harsh outcome is longstanding and results from deference to the supremacy of the Legislature and the recognition that Congressmen typically vote on the language of a bill. Id. In short, the statute plainly says a debtor who intentionally refuses to obey a court order issued in his bankruptcy case may be denied a discharge in Chapter 7. That is exactly what the Standiferds did, and the Bankruptcy Court did not err by denying their discharge.

II. Alternatively, the Bankruptcy Court Properly Denied the Discharge Under Section 727(a)(2)(B).

A. The Bankruptcy Court's Finding That the Standiferds Had Concealed Business Profits with the Intent to Hinder Their Creditors Was Not Clearly Erroneous.

Although this Court need not reach the remainder of the issues addressed in this brief if it affirms on the first ground, the Bankruptcy Court's denial of discharge on the alternate ground of 11 U.S.C. § 727(a)(2)(B) is also amply supported by the record evidence. To prevail under this section, the plaintiff must prove that: 1) the debtor transferred or concealed 2) property of the estate, 3) after the date of the filing of the petition, 4) with the intent to hinder, delay, or defraud creditors. Balaber-Strauss v. Milano (In re Milano), 35 B.R. 89, 91 (Bankr. S. D. N. Y. 1983). See Mathai v. Warren (In re Warren), 512 F.3d 1241, 1249 (10th Cir. 2008) (interpreting section 727(a)(2)(A)). Denial of discharge under this section requires actual intent to hinder, delay, or defraud a creditor or officer of the estate. Warren, 512 F.3d at 1249 (citing Marine Midland Bus. Loans, Inc. v. Carey (In re Carey), 938 F.2d 1073, 1077 (10th Cir. 1991)); Weston v. Goss, Nos. 94-4140, 94-4202, 94-4254, 69 F.3d 549 (table), 1995 WL 628125 at *1 (10th Cir. Oct. 26, 1995) (unpublished). Fraudulent intent may be established by circumstantial evidence, or by inferences drawn from a course of conduct. Warren, 512 F.3d at 1249; Weston, 1995 WL 628125, at *1; Farmers Coop. Ass'n of Talmadge, Kan. v. Strunk, 671 F.2d 391, 395 (10th Cir. 1982).

The Bankruptcy Court found that the Standiferds received over $100,000 in bonuses or profits from their business ventures during the Chapter 13 case. Aplt. App. at 52. That money was property of their bankruptcy estate pursuant to 11 U.S.C. §§ 541 and 1306, and the court-approved repayment plan.[16] Id. The Confirmation Order required the Standiferds to notify the trustee of the receipt of

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[16] The Plan provided that the Standiferds' property did not revest in the Standiferds until payments under the Plan had been completed. Am. Plan [Aplee. Add. at 6, ¶ 8].

that money by filing monthly operating reports and providing copies of their tax returns. Id. The Standiferds never notified the trustee that they had received those funds. Id. Instead, they used the money to make improvements to their home. Id. In addition, the Bankruptcy Court inferred from the Standiferds' failure to provide the trustee with copies of their tax returns, which would have revealed their business income, that the Standiferds concealed the profits from their business with intent to hinder, delay, or defraud their creditors. Id. The Standiferds' failure to file monthly operating reports for their business as required further supports that finding. Id. Thus, it was not clearly erroneous for the Bankruptcy Court to find the Standiferds had fraudulently concealed the profits with the intent to hinder their creditors.

B. The Standiferds' Contention They Cannot Be Held Accountable For Their Fraud Under Section 727 Because They Committed It During the Chapter 13 Part of Their Case Is Wrong For Two Reasons.

1. Section 727 Applies To Fraudulent Conduct That Occurs During Any Part of a Bankruptcy Case.

The language and purpose of the section 727(a)(2), case law and the necessary consequences of an alternate construction, all support the conclusion that section 727(a) applies to fraudulent conduct that occurs during any part of a debtor's bankruptcy case. Section 727(a)(2) by its terms authorizes a denial of discharge if a debtor fraudulently conceals or diverts assets that should be distributed to their creditors, within a year before or during his bankruptcy case. It provides:

(a) The court shall grant the debtor a discharge, unless –

> (2) the debtor, with intent to hinder, delay, or defraud a creditor or an officer of the estate charged with custody or property under this title, has transferred, removed, destroyed, mutilated, or concealed, or has permitted to be transferred, removed, destroyed, mutilated, or concealed–
>
>> (A) property of the debtor, within one year before the date of the filing of the petition;
>>
>> (B) property of the estate, after the date of the filing of the petition;

The statute attempts to cover all methods by which a debtor may attempt to defeat the intent and effect of the bankruptcy process through efforts to keep his property from being equitably distributed to creditors. Subsection A covers fraudulent behavior prior to filing the bankruptcy case and subsection B covers fraudulent behavior during the bankruptcy case. The reference to “property of the estate” in subsection B, as opposed to “property of the debtor” in subsection A merely reflects the fact that postpetition, the debtor’s assets are no longer property of the debtor, but belong to the bankruptcy estate.[17] See 11 U.S.C. § 541 (broadly defining property of the estate).

The construction of the statute advocated by the Standiferds would create a temporal gap in the statute's reach. Under the Standiferds' construction of the statute, debtors like the Standiferds who file under Chapter 13 and subsequently convert to Chapter 7 could have their discharge denied on the basis of fraudulent conduct before they filed (under section 727(a)(2)(A)) and fraudulent conduct after they converted (under 727(a)(2)(B)), but would not be subject to denial of discharge for fraudulent conduct during the Chapter 13 portion of their case. That simply makes no sense.

The Standiferds' fraudulent concealment of their business profits during their bankruptcy case to prevent them from being distributed to their creditors is precisely the type of behavior section 727(a)(2)(B) is intended to punish and deter. Section 727 makes complete financial disclosure a condition precedent to the privilege of discharge. United States v. Ellis, 50 F.3d 419, 424 (7th Cir. 1995). The underlying purpose of 11 U.S.C. § 727(a)(2)(B) is to deny discharge to a debtor who fails to disclose transactions regarding his assets subsequent to filing

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[17] The Bankruptcy Code recognizes that a word may have different meanings in different sections of the Code. See 11 U.S.C. § 102(8). Therefore, the Court's interpretation of section 727(a)(2)(B) need not affect or be constrained by its interpretation of the word "estate" in other sections of the Code.

his petition for bankruptcy. Sicherman v. Rivera (In re Rivera), 338 B.R.318, 328 (Bankr. N.D. Ohio 2006); Caserta v. S. Nat'l Bank of N.C. (In re Caserta), 182 B.R. 599, 606 (Bankr. S.D. Fla. 1995). The Standiferds did not fully and honestly disclose their assets in their bankruptcy case; they failed to disclose the receipt of over one hundred thousand dollars. Therefore, they were not entitled to a discharge of their debts.

The Supreme Court's recent decision in Marrama v. Citizens Bank of Mass., 549 U.S. 365 (2007) sheds light on this case. In both cases, the debtors fraudulently concealed or transferred assets to protect them from creditors and then when caught, converted their cases in bad faith to a different chapter to avoid the consequences of their conduct. Id. at 368-69. The Supreme Court refused to construe bankruptcy statutes to limit a court's authority to take appropriate action in response to fraudulent conduct by the atypical debtor who has demonstrated that he is not entitled to relief available to the typical debtor. Id. at 374-75. Marrama established that a dishonest debtor cannot escape the consequences of his conduct by converting his case to a different chapter; after conversion a debtor is subject to the sanctions and remedies available under the chapter to which he has converted and such sanctions may be based solely on fraudulent and bad faith conduct committed in the preconversion proceeding and prepetition. Id. at 373-74 (individual's Chapter 13 case could be dismissed or converted under 11 U.S.C. § 1307(c) on the basis of prepetition bad faith including fraudulent acts committed in an earlier Chapter 7 proceeding).

In a case strikingly similar to this one, the Fifth Circuit affirmed the denial of a discharge under section 727 against debtors who fraudulently spent money on a trip while they were in Chapter 13 bankruptcy and then converted their case to Chapter 7. Baker v. Rank (In re Baker), 154 F.3d 534 (5th Cir. 1998). The Fifth Circuit squarely rejected the notion that the debtors could not be denied a discharge because section 727 does not apply to Chapter 13, concluding "[b]ecause Debtors' conduct occurred after the date they filed for Chapter 13, and because the court expressly found that this conduct hindered their creditors, it is relevant for consideration under § 727(a)(2)(B) and justified a denial of discharge." Id. at 538-39.[18]

Policy considerations also argue in favor of construing section 727 to apply to fraudulent conduct committed during every part of a debtor's bankruptcy case. As this Court has long recognized, the twin goals at the core of the federal bankruptcy system are giving the honest but unfortunate debtor a fresh start and

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[18] Baker has been superseded by 11 U.S.C. § 348(f) as to the issue of which assets become part of the Chapter 7 estate after conversion from Chapter 13. That does not affect its conclusion that section 727(a) applies to preconversion misconduct.

ensuring the maximum possible equitable distribution to creditors. See, e.g., Stellwagen v. Clum, 245 U.S. 605, 617 (1918); Williams v. United States Fid. & Guar. Co., 236 U.S. 549 (1915). First, the Standiferds are not honest debtors. They did not simply fail to make their Plan payments. Over a period of years, they fraudulently concealed over $100,000 worth of assets that could have been used to pay to their creditors, spent those funds on home improvements instead, and racked up hundreds of thousands of dollars of additional debt, all the while keeping their creditors from pursuing their assets by means of the automatic stay. They avoided dismissal of their case by making the minimal $470 fixed monthly payments, leading the other parties to believe the Standiferds were complying with the Plan. When they got caught, they converted their case to Chapter 7 to avoid a dismissal without a discharge. Congress did not intend for dishonest debtors like the Standiferds to obtain relief from their debts through the bankruptcy process and this Court should not interpret section 727(a) to permit that result. See Marrama, 549 U.S. at 373-74 (because of bad faith conduct prepetition and in Chapter 7, debtor could not proceed under Chapter 13 because he was not a member of the class of honest, but unfortunate debtors that the bankruptcy laws were enacted to protect).

Second, the Standiferds' contention that neither Chapter 13 remedies,[19] nor section 727(a) sanctions can be imposed on a dishonest Chapter 13 debtor postconversion not only would not maximize the equitable distribution to creditors, it would create a perverse incentive for unscrupulous debtors to try to cheat the system. The unavoidable consequence of the Standiferds' view is a debtor can attempt to exploit the bankruptcy system by diverting assets committed to repayment of his creditors risk-free because if the dishonest debtor is caught, he can use his absolute right to convert his case to a new chapter and still receive a discharge. It strains credulity to believe that Congress intended that result.

2. Even If the Standiferds Were Right And Section 727 Applies Only To Fraud Committed In the Chapter 7 Part of the Case, It Applies Here Because They Put the Money They Diverted Into Their House, Which Became Property of Their Chapter 7 Estate Upon Conversion.

Even if the Court accepts the Standiferds' narrow construction of section 727(a)(2)(B) that in cases converted from other chapters, the fraudulently concealed assets must be part of the debtor's Chapter 7 estate upon conversion, the Standiferds' conduct still falls within the reach of section 727(a)(2)(B) because the Standiferds' bad faith conversion brought the concealed profits into their Chapter 7 estate. Property of the Chapter 7 estate following a bad faith conversion from

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[19] Once a debtor converts from Chapter 13 to Chapter 7, the remedies available under Chapter 13 no longer apply. <u>See</u> 11 U.S.C. § 103(i).

Chapter 13 is defined by 11 U.S.C. § 348(f)(2), which provides that "[i]f the debtor converts a case under chapter 13 of this title to a case under another chapter under this title in bad faith, the property in the converted case shall consist of the property of the estate as of the date of conversion." The Bankruptcy Court found that the Standiferds had converted their Chapter 13 case to a Chapter 7 case in bad faith, relying on its finding they had failed to fully or accurately disclose their financial affairs prior to converting the case. Aplt. App at 45. See In re Siegfried, 219 B.R. 581, 585-87 (Bankr. D. Colo. 1998) (finding bad faith conversion under 11 U.S.C. § 348(f)(2) based on cumulative effect of debtor's failures to disclose assets and debts during his Chapter 13 proceedings and his eleventh hour conversion to avoid hearings that might raise bad faith issues).[20] That finding was not clearly erroneous and the Standiferds do not challenge it except on limited procedural grounds. Therefore, the Standiferds' Chapter 7 estate included all of the assets of their Chapter 13 estate on the date of conversion, including the business profits.

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[20] Contrary to the Standiferds' allegation, the Bankruptcy Court's finding they converted their case in bad faith, while based on much of the same fraudulent conduct, is not, in and of itself, a ground for denial of their discharge. Appellants' Brief at 29. The finding of bad faith simply means the scope of their bankruptcy estate after conversion is governed by section 348(f)(2) instead of section 348(f)(1).

At the time of the conversion, the business profits no longer existed as cash, but because the Standiferds had spent them on improvements to their home, which became part of their Chapter 7 estate, the business profits became part of the Chapter 7estate. Aplee. Supp. App. at 320, 333-334. It is widely accepted that, "[t]he conversion in form of property of the estate does not change its character as property of the estate." Bradt v. Woodlawn Auto Workers, F.C.U., 757 F.2d 512, 515 (2d Cir. 1985) (quoting H.R. Rep. No. 595, 95th Cong., 1st Sess. 368 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 6324). Therefore, the Bankruptcy Court properly found that all of the elements needed to deny the Standiferds a discharge pursuant to 11 U.S.C. § 727(a)(2)(B) had been established.

Finally, the Bankruptcy Court committed no procedural error by considering whether the Standiferds had converted their case in bad faith when it ruled in the adversary proceeding to deny the Standiferds' discharge. Contrary to the Standiferds' allegations, the Bankruptcy Court did not give them the option to convert their case, and then unfairly find their conversion to have been in bad faith and deny their discharge on that basis. See Appellants' Brief at 29. In fact, at the hearing on the trustee's second motion to dismiss, the Standiferds' attorney requested additional time to allow the Standiferds to come up with fees to convert the case, so it would not be dismissed, and the Bankruptcy Court granted that request. See Aplee. Supp. App. at 40.

The issue of whether the Standiferds were converting their case in good faith was not raised at the time of conversion, because the Standiferds had an absolute statutory right under 11 U.S.C. § 1307(a) to convert to Chapter 7 even while the motion to dismiss was pending, and no one had the right to object to the conversion. The Standiferds subsequently raised that issue, themselves, when they contended section 727 did not apply to their fraudulent conduct because the money they hid from their creditors was not property of the Chapter 7 estate, the scope of which depended on whether the Standiferds converted their case in good faith. See Aplee. Supp. App. at 136. Compare 11 U.S.C. § 348(f)(1)(defining estate after good faith conversion) with § 348(f)(2)(defining estate after bad faith conversion). In any event, the Standiferds' discharge was not denied because they converted the case in bad faith; it was denied under 11 U.S.C. § 727 because they refused to obey a court order and fraudulently concealed assets during their bankruptcy case. The bad faith issue has no bearing on the first ground and is relevant to the second ground only if the Court finds the Standiferds were right and section 727 applies only when the fraudulently diverted assets are part of the Chapter 7 estate.

CONCLUSION

For these reasons, the United States Trustee respectfully asks this Court to affirm the district court's order. If the Court does not affirm the order, the Court should remand the case to the Bankruptcy Court for a finding whether a denial of discharge is warranted under 11 U.S.C. § 727(a)(4)(D) in this case.

ORAL ARGUMENT STATEMENT

Oral argument is requested in this case to assist the Court in addressing novel issues and interpreting complex provisions of the Bankruptcy Code.

Respectfully submitted,

RICHARD WIELAND
UNITED STATES TRUSTEE

By: /s/ Ronald E. Andazola
Ronald E. Andazola
Assistant United States Trustee
U.S. Department of Justice
Office of the United States Trustee
P.O. Box 608
Albuquerque, NM 87103
Email: ronald.andazola@usdoj.gov
Telephone: (505) 248-6549

Dated: February 9, 2010

CERTIFICATE OF COMPLIANCE WITH F.R.A.P. 32(a)

As required by Fed. R. App. P. 32(a)(7)(a), I certify that this brief is proportionally spaced and contains 11349 words.

I relied on my word processor to obtain the count and it is Corel WordPerfect 12.

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By: /s/ Ronald E. Andazola
Ronald E. Andazola
Attorney for Appellee

CERTIFICATE OF DIGITAL SUBMISSION AND PRIVACY REDACTIONS

I hereby certify that a copy of the foregoing BRIEF FOR APPELLEE, RICHARD WIELAND, UNITED STATES TRUSTEE, as submitted in digital Form via the court's ECF system, is an exact copy of the written document filed with the /clerk and has been scanned for viruses with the Microsoft Forefront Client Security and, according to the program is free of viruses. In addition, I certify all required privacy redactions have been made.

By: /s/ Ronald E. Andazola
Ronald E. Andazola
Attorney for Appellee

Dated: February 9, 2010

CERTIFICATE OF SERVICE

I certify that on February 9, 2010, I caused to be served a copy of the Brief for Appellee Richard Wieland, United States Trustee via this Court's electronic filing system (ECF) and by first class mail. I also caused to be served a copy of Appellee's Supplemental Appendix and a copy of Appellee's Addendum by first class mail only to the persons listed below:

George M. Moore
Moore, Berson & Gandarilla, P.C.
P.O. Box 7459
Albuquerque, NM 87194
Email: gmm11usc@swcp.com

Attorney for Appellants

/s/ Ronald E. Andazola
Ronald E. Andazola
Attorney for Appellee

ATTACHMENT

(Relevant portions of 11 U.S.C. § 727(a) and 11 U.S.C. § 348)

§ 727. Discharge

(a) The court shall grant the debtor a discharge, unless –

(2) the debtor, with intent to hinder, delay, or defraud a creditor or an officer of the estate charged with custody or property under this title, has transferred, removed, destroyed, mutilated, or concealed, or has permitted to be transferred, removed, destroyed, mutilated, or concealed–

(A) property of the debtor, within one year before the date of the filing of the petition;

(B) property of the estate, after the date of the filing of the petition;

(4) the debtor knowingly and fraudulently, in or in connection with the case-

* * *

(D) withheld from an officer of the estate entitled to possession under this title, any recorded information, including books, documents, records, and papers, relating to the debtor's property or financial affairs;

(5) the debtor has failed to explain satisfactorily, before determination of denial of discharge under this paragraph, any loss of assets or deficiency of assets to meet the debtor's liabilities;

(6) the debtor has refused, in the case–

(A) to obey any lawful order of the court, other than an order to respond to a material question or to testify;

§ 348. Effect of conversion

(a) Conversion of a case from a case under one chapter of this title to a case under another chapter of this title constitutes an order for relief under the chapter to which the case is converted, but, except as provided in subsections (b) and (c) of this section, does not effect a change in the date of the filing of the petition, the commencement of the case, or the order for relief.

(b) Unless the court for cause orders otherwise, in sections 701(a), 727(a)(10), 727(b), 728(a), 728(b), 1102(a), 1110(a)(1), 1121(b), 1121(c), 1141(d)(4), 1146(a), 1146(b), 1201(a), 1221, 1228(a), 1301(a), and 1305(a) of this title, "the order for relief under this chapter in a chapter to which a case has been converted under section 706, 1112, 1208, or 1307 of this title, other than a claim specified in section 503(b) of this title, shall be treated for all purposes as if such claim had arisen immediately before the date of the filing of the petition.

* * *

(f) (1) Except as provided in paragraph (2), when a case under chapter 13 of this title is converted to a case under another chapter under this title –

(A) property of the estate in the converted case shall consist of property of the estate, as of the date of filing of the petition, that remains in the possession of or is under the control of the debtor on the date of conversion;

* * *

(2) If the debtor converts a case under chapter 13 of this title to a case under another chapter under this title in bad faith, the property in the converted case shall consist of the property of the estate as of the date of conversion.

BRIEF BANK — "SUMMARY SHEET" *Printed Wed-5/12/10 15:19*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	In re Dorothy Chase Stewart (Wells Fargo Bank, N.A. v. Dorothy Chase Stewart)
2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	5th Cir.
3. ("CCN") ***CURRENT*** CASE NO.	No.: 09-30832
4. ("PCN") ***PRIOR*** CASE NO. - & COURT *[IF ANY]*	No.: 08-cv-3225, 08-cv-3669, 08-cv-3852, 08-cv-3853 Court: E.D. La. *(Identify judge & cite, if any)*
5. ("SO") ***SOURCE***	**U.S. TRUSTEES**
6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	Filed: March 1, 2010 Type: Brief for the United States as *Amicus Curiae* in Support of Affirmance.
7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*	John P. Sheahan, Noah M. Schottenstein, P. Matthew Sutko, *(UST/OGC: 202-307-1399/FAX-2397)*
8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	• Whether the bankruptcy court's audit order was authorized as an exercise of its statutory power to "Prevent Abuse" under 11 U.S.C. § 105(a).
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Case No. 09-30832

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

In the Matter of: DOROTHY CHASE STEWART
Debtor

WELLS FARGO BANK, N.A.
Appellant

v.

DOROTHY CHASE STEWART
Appellee

In the Matter of: IRBY FITCH; BRITTANY FITCH
Debtors

WELLS FARGO BANK, N.A., doing business as, America's Servicing Company
Appellant

v.

IRBY FITCH; BRITTANY FITCH
Appellees

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF LOUISIANA

BRIEF FOR THE UNITED STATES AS *AMICUS CURIAE* IN SUPPORT OF AFFIRMANCE

RAMONA D. ELLIOTT
General Counsel
P. MATTHEW SUTKO
Associate General Counsel
JOHN P. SHEAHAN
United States Department of Justice
Executive Office for United States Trustees
20 Massachusetts Avenue, NW
Washington, DC 20530
Telephone: (202) 307-1399
Facsimile: (202) 307-2397
email: john.sheahan@usdoj.gov

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PRELIMINARY STATEMENT

In a bankruptcy case, a creditor may present its claims to the court by filing a proof of claim. 11 U.S.C. § 501(a). A proof of claim sets forth the amount and basis of the creditor's claim, and must be signed by the creditor or the creditor's authorized agent. Fed. R. Bankr. P. 3001(a), Official Form 10. A properly filed proof of claim creates a *prima facie* presumption that the creditor's claim is valid in the amount stated, and such claims generally are allowed automatically in the absence of an objection. 11 U.S.C. § 502(a), Fed. R. Bankr. P. 3001(f).

The filing of an inaccurate proof of claim undermines the integrity of the bankruptcy process in several ways. In a chapter 13 bankruptcy, such as the case below, debtors and trustees ordinarily rely on the accuracy of proofs of claim when calculating the amount of the payments that must be distributed to creditors under the debtor's plan. 11 U.S.C. § 1325, 1326. The allowance of an inflated claim ultimately may reduce the assets available to other creditors, and may make it difficult for a deserving individual debtor to achieve the fresh start that bankruptcy is intended to provide. In addition, as the history of this case illustrates, the task of untangling an error-riddled or incomprehensible proof of claim can impose a heavy administrative burden on the bankruptcy courts and other parties in the bankruptcy case.

These problems are particularly heightened in the case of claims filed by mortgage servicers. The amounts stated in those claims often represent a bundle of unpaid principal, interest, escrow charges, penalties, and other assorted fees. Absent clear documentation, it is often difficult, if not impossible, for the debtor or the court to disentangle these charges and verify whether the amounts claimed as owed are correct. Because the mortgage often represents the largest single claim in an individual bankruptcy, an error in the mortgage servicer's proof of claim may make it impossible for the debtor to successfully complete a bankruptcy plan, and may lead to foreclosure and the loss of the debtor's residence. *See* Katherine Porter, *Misbehavior and Mistake in Bankruptcy Mortgage Claims*, 87 Tex. L. Rev. 121 (Nov. 2008).

A federal bankruptcy court possesses statutory, inherent, and rule-based authority to remedy abusive conduct by creditors. Section 105 of the United States Bankruptcy Code authorizes bankruptcy courts to issue "any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title," and also recognizes the authority of bankruptcy courts to "tak[e] any action or mak[e] any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process." 11 U.S.C. § 105(a).

Federal Rule of Bankruptcy Procedure 9011 provides that any pleading submitted to a court (including a proof of claim) constitutes a representation that, among other things, "after an inquiry reasonable under the circumstances," the allegations and factual contentions of the pleading have evidentiary support. Fed R. Bankr. P. 9011(b), (b)(3).

This appeal raises important questions concerning the ability of a bankruptcy court to protect its proceedings from abusive proofs of claim. In this case, Wells Fargo filed a proof of claim that was so insufficiently documented and incomprehensible that it took the bankruptcy court four months and three hearings to unravel the basis for Wells Fargo's computations. After the bankruptcy court finally managed to reconcile Wells Fargo's account history, it became clear that Wells Fargo's claim included so many errors and invalid fees that the true amount of its claim had been overstated by more than ten thousand dollars. *See* Case No. 07-1113, Dkt. 61 at 44 ("*Stewart I"*).[1]

More troublingly, the bankruptcy court's investigation revealed that many of the errors in *Stewart* were not based on factors unique to this case, but instead arose from Wells Fargo's corporate practice of preparing proofs of claim through a heavily automated process that leaves little room for human oversight before the claim is filed. *Stewart I* at 22. The bankruptcy court's findings also revealed that Wells Fargo had done little to correct its practices in the wake of *In re Jones*, 366 B.R. 584 (Bankr. E.D. La. 2007), an earlier decision by the same judge that had

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[1] The bankruptcy court's opinion in *Stewart I* is reported at 391 B.R. 327 (Bankr. E.D. La. 2008).

detected similar problems. *Stewart I* at 48. Thus, the evidence in *Stewart* not only revealed serious deficiencies in Wells Fargo's proof of claim in the immediate case, but also led the court to infer that similar problems existed, undetected, in countless other cases involving Wells Fargo mortgages.

Among other remedies, the bankruptcy court addressed the systemic nature of Wells Fargo's deficiencies by requiring it to conduct an audit of the claims it had filed in other cases in the Eastern District of Louisiana since the entry of the *Jones* decision. *Id.* In cases where errors were detected, the court ordered Wells Fargo to amend its claims "where necessary." *Id.* at 49. In a subsequent decision denying a motion by Wells Fargo to stay the judgment, the bankruptcy court clarified its order by stating that "[a]ssuming, after audit, Wells Fargo believes that every charge assessed against its borrowers is appropriate, no amendment to the proof of claim would be necessary." Case No. 07-11113, Dkt. 116 at 10 ("*Stewart II*").[2]

INTEREST OF THE UNITED STATES

This appeal is of interest to the United States because it involves the construction of 11 U.S.C. § 105(a) and other sources of authority that permit federal courts to regulate the conduct of parties appearing before them. The

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[2] The bankruptcy court's decision in *Stewart II* is unreported, but is published online at 2008 WL 5096011 (Bankr. E.D. La. 2008).

United States has a direct interest in the proper construction of these provisions because United States Trustees, who are Justice Department officials appointed by the Attorney General, supervise the administration of chapter 13 bankruptcy cases in this circuit. 28 U.S.C. §§ 586(a)(3)(A)-(H), (s). United States Trustees also are responsible for "prevent[ing] fraud, dishonesty, and overreaching in the bankruptcy arena." H.R. Rep. No. 95-595 at 88 (1977). The United States submits this brief pursuant to 28 U.S.C. § 517 (authorizing the Department of Justice to "attend to the interests of the United States in a suit pending in a court of the United States").

SUMMARY OF ARGUMENT

The United States files this *amicus* brief in order to address Wells Fargo's contention that the bankruptcy court lacked authority to order it to perform an audit of the proofs of claim it filed in certain unrelated cases, and to correct any claims which it determines to be erroneous as a result of that audit.[3] That remedy

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[3] The United States limits its argument to the issue of whether it was permissible for the bankruptcy court to order non-monetary relief against Wells Fargo, a private party, under the facts of this particular case. The United States takes no position as to the appropriateness of the monetary relief ordered against Wells Fargo in this proceeding. In addition, because Wells Fargo is a private actor, it is unnecessary for this Court to reach the issue of whether, and to what extent, section 105 relief, or relief under the court's inherent powers, may be ordered against governmental creditors under the doctrine of sovereign immunity. *See United States v. Nordic Village, Inc.,* 503 U.S. 30, 38 (1992) (narrowly construing waiver of sovereign immunity in bankruptcy cases).

was based on the bankruptcy court's findings, which largely are not in dispute, that Wells Fargo's proof of claim contained numerous and substantial errors, and that those errors resulted from systemic deficiencies in Wells Fargo's claims-preparation practices.

Under these circumstances, the bankruptcy court's requirement that Wells Fargo investigate whether it had also made similar errors in other pending cases was reasonable, necessary, and narrowly tailored to the purpose of protecting the integrity of the bankruptcy system in the Eastern District of Louisiana. That remedy falls well within the statutory authority granted to the bankruptcy court by Congress under section 105(a) to "prevent abuse." It also is appropriate under the broad equitable power of federal courts to control the conduct of litigants, which this Court has long upheld under comparable circumstances.

The second part of the bankruptcy court's order, which requires Wells Fargo to amend claims in the event that errors are discovered, does nothing more than reiterate Wells Fargo's general duties as a claimant in a bankruptcy case. Because that order is limited by its own terms to claims which Wells Fargo itself believes to be defective, it does not preemptively resolve any issues that are in genuine dispute, nor does it prevent Wells Fargo from defending its accounting methods in other cases. Indeed, Wells Fargo's argument against the order to amend rests entirely on the false premise that without such order, it would be permissible for it to continue to maintain an erroneous proof of claim even after it had actual knowledge of the claim's inaccuracy. Wells Fargo does not, and cannot, provide any authority or justification for such a result.

ARGUMENT

1. The Undisputed Findings Below Demonstrate that Wells Fargo Engaged in a Systemic Abuse of the Bankruptcy System.

Although Wells Fargo disputes the exact amount by which it inflated its claim against Ms. Stewart, it does not dispute the underlying conclusion that its proof of claim contained numerous errors. In particular, it is undisputed that Wells Fargo's proof of claim contained, among other charges and fees, charges for property inspections that were performed without notice, that were never actually relied on by Wells Fargo, and that in some cases were performed on the wrong property (*Stewart I* at 25); charges for at least seven broker price opinions (BPOs) that Wells Fargo was unable to produce (*Id.* 26); duplicative charges for BPOs, and in two cases, charges for BPOs that could not possibly have been performed on the dates stated due to the occurrence of Hurricane Katrina (*Id.* 27); one charge for a BPO that was performed after Wells Fargo had already foreclosed on Ms. Stewart's property (*Id.* 29); charges for attorney's fees and foreclosure costs that overstated the expenses actually incurred by Wells Fargo (*Id.* 37); charges for various invalid bankruptcy-related fees in Ms. Stewart's prior bankruptcy cases that had never been disclosed to, or approved by, the bankruptcy court in those cases (*Id.* 36-37); and a charge for a title insurance policy that Wells Fargo acquired for itself after it had already foreclosed on Ms. Stewart's home, which the bankruptcy court characterized as a cost of ownership rather than collection. (*Id.* 38).

None of these findings are discussed by Wells Fargo in its brief. Thus, even were this Court to accept as true every one of the arguments raised by Wells Fargo, there would be no basis to disturb the bankruptcy court's conclusion that Wells Fargo filed a substantially inaccurate proof of claim.

Wells Fargo likewise does not challenge the bankruptcy court's finding that these errors were caused, in part, by general deficiencies in its policies and procedures for preparing proofs of claim. These deficiencies include Wells Fargo's practice of filing claims through counsel who are not provided with the debtor's loan history or with information necessary to explain or defend the amounts stated on the claim (*Id.* 14), as well as its practice of generating proofs of claim through a highly automated process under which no Wells Fargo employee actually reviews the claim until after it has already been filed and an objection to the claim is received. (*Id.* 15). In addition, the bankruptcy court found that Wells Fargo had a "corporate practice" of failing to notify debtors when fees, costs, or charges were assessed against their accounts. (*Id.* 22). As a result, the undisputed record supports the bankruptcy court's finding that the same errors that occurred in Ms. Stewart's case were likely occurring in many other cases in which Wells Fargo is a creditor.

2. The Bankruptcy Court's Audit Order was Authorized as an Exercise of its Statutory Power to "Prevent Abuse" Under 11 U.S.C. § 105(a)

The bankruptcy court's response to Wells Fargo's deficient practices was to order it to take a simple corrective action: it ordered Wells Fargo to review its recently-filed proofs of claim in other cases in the Eastern District of Louisiana for errors– an action that Wells Fargo should have performed, but apparently did not, before those claims were filed. *See* Fed. R. Bankr. P. 9011(b) (requiring that pleadings filed in bankruptcy cases, including proofs of claim, be based on a reasonable inquiry); *see also Cash-n-Advance v. Dansereau*, 64 Fed. Appx. 417 (5th Cir. 2003) (upholding sanctions under Rule 9011 against party that filed proof of claim without inquiry as to whether claim had legal or factual basis).

The bankruptcy court's remedy was within the Court's power, expressly authorized under section 105(a), to take "any action . . . necessary or appropriate to enforce or implement court orders or rules, or *to prevent an abuse of process*." 11 U.S.C. § 105(a) (emphasis added). As this Court has previously recognized, the grant of remedial authority under section 105(a) is broad. *In re Sadkin*, 36 F.3d 473, 478-79 (5th Cir. 1994) (stating that section 105(a) "provides equitable powers for the bankruptcy court to use at its discretion").

It is equally well established that section 105(a) may be invoked to protect the bankruptcy process from abuse. *See Campbell v. Countrywide Home Loans, Inc.*, 545 F.3d 348, 356 n.1 (5th Cir. 2008) (noting that section 105 is available to discipline parties who "attempt to abuse the procedural mechanisms within the bankruptcy court"). In this respect, section 105(a) expands upon the traditional equitable power of federal courts to protect their proceedings by enjoining abusive litigants. *See Balawajder v. Scott*, 160 F.3d 1066, 1067-68 (5th Cir. 1998) (recognizing inherent power of federal courts to enjoin party from filing vexatious pleadings); *Farguson v. MBank Houston, N.A.*, 808 F.2d 358, 360 (5th Cir. 1986) (holding that order enjoining abusive litigant from filing further suits against certain defendants "was well within the court's range of authority").

The record below supports the conclusion that the audit remedy ordered by the bankruptcy court is reasonable and necessary to prevent an abuse of process. In light of the significant errors discovered by the bankruptcy court, the requirement that Wells Fargo investigate other potential errors in recently-filed cases within the same district can only be described as mild. By contrast, in both *Farguson* and *Balawajder*, this Court upheld the far more drastic remedy of restricting a litigant's right to file future pleadings, a form of relief that has not been imposed against Wells Fargo in this case. *Balawajder*, 160 F.3d at 1067;

Farguson, 808 F.2d at 360.

Moreover, where a court is confronted with evidence of a pattern of abuse by a single party extending across many cases, it is reasonable for the court to enter a single order in one case to remedy the totality of that abuse. *See, e.g., In re John Richards Home Bldg. Co., LLC*, 404 B.R. 220, 226-27 (E.D. Mich. 2009) (holding that section 105(a) could be used to remedy misconduct that took place in other forums, and rejecting argument that movant was required to commence a separate proceeding in each and every court in which misconduct occurred). Particularly in a case such as this, the bankruptcy court's remedy is reasonable because the only alternative would be to commence a separate proceeding in each of the countless other cases in which Wells Fargo is a creditor, a procedure that would impose a substantial and unnecessary administrative burden on the court.

Wells Fargo nonetheless offers three unpersuasive arguments for why section 105(a) cannot support the bankruptcy court's remedy in this case. First, without citing to any authority, Wells Fargo argues that section 105(a) may only be invoked in cases where the court has explicitly found that a party has acted in bad faith. Br. 51. No such limitation, however, is present in the text of section 105(a). Moreover, where Congress has intended to make a remedy conditional on a finding of bad faith, it has done so explicitly. *Compare* 11 U.S.C. § 303(i)(2) (authorizing sanctions against creditors who file involuntary petition in bad faith);

§ 707(b)(3) (expressly providing that court may consider bad faith in determining whether to dismiss bankruptcy petition as abusive). As a result, as every court to have considered the matter has concurred, bad faith is not a prerequisite for relief under section 105(a). *See In re Hardy*, 97 F.3d 1384, 1389 (11th Cir. 1996) (holding that, for purposes of civil contempt proceedings under section 105(a), no showing of bad faith was required); *In re Crayton*, 192 B.R. 970, 976-77 (B.A.P. 9th Cir. 1996) (holding that bankruptcy court was not required to make explicit finding of bad faith prior to ordering non-monetary relief against attorney under section 105(a)).

Wells Fargo cites no cases decided under section 105(a) in support of its proposition that the bankruptcy court was required to make a finding of bad faith, instead relying on several decisions in which courts imposed sanctions for bad faith conduct under their inherent equitable powers. *See Chambers v. NASCO, Inc.*, 501 U.S. 32, 34 (1991) (discussing "inherent powers" as independent basis for sanctioning power of federal court). However, although section 105(a) and the court's inherent powers are similar in some respects, they are distinct sources of authority. *See Hardy*, 97 F.3d at 1389 (noting that by enacting section 105(a), Congress created a source of sanction authority that is "distinct" from the court's inherent powers).

The court's inherent power to punish misconduct, as recognized in

Chambers, also differs from its section 105(a) powers in several other fundamental respects. Inherent powers provide a mechanism for punishing misconduct, while section 105(a) includes the power to "prevent" abuse. Therefore, it is unsurprising that Congress did not put a bad faith prerequisite in section 105(a). An order to prevent abuse under section 105(a) is designed to protect parties and the bankruptcy system. It does not hinge on the culpability of the parties, but on the harm that is to be prevented. For that reason, there is no good reason to graft a bad faith limitation onto section 105(a) that Congress did not see fit to include.

Second, Wells Fargo misreads section 105(a) when it suggests that the bankruptcy court erred because section 105(a) may only be invoked in order to enforce another specific section of the Bankruptcy Code. Br. 52. Although one function of section 105(a) is to provide an enforcement mechanism for other sections of the Bankruptcy Code, that is far from its only purpose. *See Marrama v. Citizens Bank of Mass.*, 549 U.S. 365, 375 (2007) (holding that "broad authority" of bankruptcy judge to prevent abuse under section 105(a) was sufficient basis for it to deny abusive motion to convert case). In particular, the clause of section 105(a) that permits courts to "prevent abuse" is separate from the clause that permits them to enforce other provisions of the Bankruptcy Code, and as a result section 105(a) may be invoked to prevent abuse even if no specific violation of another section of the Bankruptcy Code has occurred. *Cf. Marrama*, 549 U.S. at 383 (Alito, J., dissenting) (listing examples of remedies authorized under section 105(a)).

It is true that the bankruptcy court's equitable authority "must be exercised in a manner that is consistent with the Bankruptcy Code." *In re Oxford Management, Inc.*, 4 F.3d 1329, 1334 (5th Cir. 1993). However, as one court has observed, "the scope of that restriction should not be exaggerated to the point at which bankruptcy courts feel powerless to act unless a party can present a specific textual quotation which precisely identifies the availability of a specific remedy." *In re Barron*, 264 B.R. 833, 844 (Bankr. E.D. Tex. 2001).

Moreover, even if Wells Fargo's narrow reading of section 105(a) were correct, the bankruptcy court did not err because the remedy in this case does operate to enforce specific provisions of the Bankruptcy Code and Rules. In particular, the bankruptcy court's decision ensures the proper functioning of 11 U.S.C. § 501 (regulating the filing of proofs of claim), Rule 3001(a) (contents of proof of claim), Rule 3001(f) (evidentiary effect of proof of claim) and Rule 9011 (requiring reasonable inquiry before filing of proof of claim). As a result, there is no merit to Wells Fargo's suggestion that the remedy in this case is somehow untethered to any other statutory provision.

Third, Wells Fargo argues that section 105(a) may not be used in a manner that affects other pending cases. Br. 53. Here again, nothing in the text of section

105(a) or in any authority cited by Wells Fargo supports such a limitation. Indeed, courts have regularly upheld orders under section 105(a) that have a much greater impact on other pending cases than the audit order at issue in this case. *See, e.g., In re Davis*, 730 F.2d 176, 184 (5th Cir. 1984) (upholding bankruptcy court order under section 105(a) that stayed litigation pending in other courts). In addition, in non-bankruptcy cases, this Court has rejected the argument that the effect of orders directed at abusive litigants should be confined to the court that issued the order. *See Balawajder*, 836 F.2d at 1067 (holding that pre-filing injunction issued by one district court was enforceable in other districts within the Fifth Circuit). Accordingly, the bankruptcy court did not exceed its authority by ordering Wells Fargo to amend its claims in other pending cases.

3. Wells Fargo's Objections to the Bankruptcy Court's Order to Amend Lack Merit.

Wells Fargo directs the bulk of its remaining arguments to the specific portion of the bankruptcy court's order that requires Wells Fargo to amend claims that it discovers to be in error as a result of the audit. Br. 35. Wells Fargo's arguments appear to be based on the misconception that this order preemptively resolves disputed legal issues in numerous unrelated cases to which Wells Fargo is a party. *Id.* The bankruptcy court's order has no such effect. Rather, as the bankruptcy court clarified, the obligation to amend is triggered only where Wells

Fargo itself believes that a proof of claim is incorrect, and therefore it is inapplicable to any claims that may be in *bona fide* dispute. *Stewart II* at 10.[4]

Contrary to Wells Fargo's argument, the amendment portion of the order neither interferes with the administration of other cases, nor does it materially alter Wells Fargo's rights or duties. As a claimant in a bankruptcy case, Wells Fargo is already under an ongoing duty to correct its proofs of claim once it discovers, through the audit, that they are erroneous. As lower courts consistently have recognized, once an error is discovered in a proof of claim, "it is the claimant's duty to amend in order to ensure accuracy." *In re Hence*, No. 06-32451-H4-13, 2007 WL 4333834 at *5 (Bankr. S.D. Tex. Dec. 5, 2007); *see also In re Hannon*, 421 B.R. 728, 733 (Bankr. M.D. Pa. 2009) (citing cases). By ordering Wells Fargo to amend claims it believes to be defective, the bankruptcy court has simply reiterated Wells Fargo's existing duties.

This result is consistent with this Court's jurisprudence under Fed. R.

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[4] Wells Fargo's brief characterizes the order to amend as one that preemptively resolves various legal and contractual disputes that might arise in other cases involving Wells Fargo mortgages. Br. 33-34. As discussed, the United States construes the bankruptcy court's order more narrowly, and submits that the subsequent decision in *Stewart II* conclusively demonstrates that such order is applicable only to undisputed factual errors. Nevertheless, to the extent the issue is relevant, the United States concurs with Wells Fargo's view that the validity of Wells Fargo's accounting and collection actions should be determined according to the particular facts, contractual terms, and applicable regulatory framework of each case, and that the bankruptcy court's rulings on these issues in *Stewart* should not be dispositive of any other case.

Bankr. P. 9011 and Fed. R. Civ. P. 11.[5] Although this Court has recognized that compliance with Rule 11 is normally measured at the moment a pleading is filed, *see Thomas v. Capital Sec. Services, Inc.*, 836 F.2d 866, 874 (5th Cir. 1987), in this case the record indicates that Wells Fargo never complied with Rule 9011 by making a reasonable inquiry into its proofs of claim in the first instance. As a result, to the extent that Wells Fargo has filed any erroneous claims for which no reasonable inquiry was ever made, it is already under a continuing obligation under Rule 9011 to verify and correct those claims. *Cf. Skidmore Energy, Inc. v. KPMG*, 455 F.3d 564 (5th Cir. 2006) (holding that *Thomas* did not preclude imposition of sanctions where party "never satisfied Rule 11 to begin with").

In addition, the bankruptcy court's order is not invalid because of a lack of specificity. Although Wells Fargo suggests that the bankruptcy court erred by requiring it "to comply with the principles established in this case and *Jones*," without separately defining those principles, Br. 29, any ambiguity in that order was cured by the court's subsequent decision in decision in *Stewart II*, which clarifies that Wells Fargo is required to correct only those claims that Wells Fargo itself believes to be inaccurate. *Stewart II* at 10.

The order to audit and amend claims also did not violate Wells Fargo's due

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[5] Because Rule 9011 is "substantially identical" to Rule 11, on which it is based, this Court has relied on Rule 11 jurisprudence when construing Rule 9011. *In re Pratt*, 524 F.3d 580, 586 (5th Cir. 2008).

process rights. Wells Fargo does not contend that it lacked notice of the conduct for which it was being held accountable, but rather contends that its due process rights were violated because the court did not provide it with notice that it was considering the specific remedy of a "broad injunction" involving other cases. Br. 40. Contrary to Wells Fargo's suggestion, however, there is no bright-line rule that a party must be given notice of the exact terms of an equitable remedy before such a remedy can be imposed. As courts have noted, "[t]he precise procedural protections of due process vary, depending upon the circumstances, because due process is a flexible concept unrestricted by any bright-line rules." *Steinert v. Winn Group, Inc.*, 440 F.3d 1214 1222 (10th Cir. 2006). In particular, where a party is sanctioned for its litigation misconduct, this Court has not hesitated to hold that due process was satisfied merely upon a general warning to the party that sanctions might be imposed. *See Henderson v. Dept. of Public Safety & Corrections*, 901 F.2d 1288, 1294 (5th Cir. 1990) (warnings by district judge and magistrate judge that future frivolous motions may result in Rule 11 sanctions satisfied due process).

In any event, the record of this case demonstrates that Wells Fargo received ample due process before the bankruptcy court ordered it to audit and amend its claims. As Wells Fargo admits, it was given three evidentiary hearings to explain its conduct. Br. 9-11. Moreover, the order in *Stewart I* was preceded by the same bankruptcy judge's decision in *Jones*, which imposed equitable and injunctive relief against Wells Fargo based on deficiencies similar to those that occurred in *Stewart*. *Stewart I* at 18 n. 23. Consequently, even if Ms. Stewart's counsel did not specifically request non-monetary relief, Wells Fargo had actual notice that such remedies were a possibility. Finally, Wells Fargo offers no explanation for how it would have altered its trial strategy had it known that the court was considering equitable as well as monetary remedies.

Finally, there is also no merit to Wells Fargo's contention that the bankruptcy court lacked subject matter jurisdiction to remedy Wells Fargo's deficient claims-filing practices. Br. 35. The statutory subject matter jurisdiction of the bankruptcy courts includes, among other things, all matters "arising in a case under title 11." 28 U.S.C. § 157(b)(1). As this Court has observed, this jurisdictional grant includes proceedings to remedy misconduct occurring in a bankruptcy case. *See In re TByrd Enterprises LLC*, No. 08-41104, 2009 WL 3199593 (5th Cir. Oct. 7, 2009) (holding that "the imposition of sanctions on litigants in a bankruptcy case is clearly a matter 'arising in'" a bankruptcy case for purposes of 28 U.S.C. § 157). Moreover, there is no jurisdictional obstacle to a court imposing a form of discipline against a party that has the effect of regulating that party's conduct in other proceedings. *See In re Martin-Trigona*, 737 F.2d 1254, 1261 (2d Cir. 1984) (rejecting argument that district court lacked jurisdiction to impose nationwide, prospective injunction against vexatious litigant); *Farguson*, 808 F.2d at 360 (citing *Martin-Trigona* with approval). Accordingly, the bankruptcy court had subject matter jurisdiction to order Wells Fargo to audit and amend its claims.

CONCLUSION

For these reasons, the United States respectfully requests that this Court affirm the orders of the bankruptcy court and the district court.

CERTIFICATE OF COMPLIANCE WITH FED. R. APP. P. 32(a)

I hereby certify that the foregoing brief complies with the typeface requirements in Fed. R. App. P. 32(a)(5) and the page and type-volume limitation in Fed. R. App. P. 32(a)(7). I also certify that the foregoing brief is proportionately spaced, using Times New Roman font, 14 point type. Based on a word count under Corel Word Perfect 12, this brief contains 5,177 words excluding the table of contents, table of authorities, statutory appendix, and certificates of counsel.

/s/ John P. Sheahan
John P. Sheahan
Attorney for the United States
as Amicus Curiae

CERTIFICATE OF SERVICE

I hereby certify that on March 1, 2010, I served the foregoing Brief for the United States as *Amicus Curiae* in Support of Reversal on the following by sending two copies of the brief by overnight mail to:

Michael H. Rubin
Anthony Rollo
McGlinchey Stafford, PLLC
One American Place, 14th Floor
Baton Rouge, LA 70825

Rudy J. Cerone
Eric J. Simonson
McGlinchey Stafford, PLLC
601 Poydras Street, 12th Floor
New Orleans, LA 70130

Elisabeth D. Harrington
Kirk L. Myers
Harrington & Myers
2901 N. Causeway Blvd.
Suite 303
Metarie, LA 70002

DATED, this 1st day of March, 2010

/s/ John P. Sheahan
John P. Sheahan
Attorney for the United States
as Amicus Curiae

BRIEF BANK — "SUMMARY SHEET" *Printed Thu-12/9/10 15:1*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE
[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]

Wells Fargo Bank, N.A. v Dorothy Chase Stewart (In the Matter of: Dorothy Chase Stewart) and Wells Fargo Bank, N.A., doing business as, America's Servicing Company v. Irby Fitch; Brittany Fitch (In the Matter of: Irby Fitch; Brittany Fitch)

2. ("CO") ***CURRENT*** COURT
[E.g., "CTA9"]

5th Cir.

3. ("CCN") ***CURRENT*** CASE NO.

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[IF ANY]

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Johb P. Sheahan, P. Matthew Sutko

(UST/OGC: 202-307-1399/FAX-2397)

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9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s)

&

√ Any Miscellaneous ***BACKGROUND***

• Whether the bankruptcy court had power to order the audit because it was a recognized collateral proceeding and because it had statutory power to prevent abuse.

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THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

In the Matter of: DOROTHY CHASE STEWART
Debtor

WELLS FARGO BANK, N.A.
Appellant
v.

DOROTHY CHASE STEWART
Appellee

In the Matter of: IRBY FITCH; BRITTANY FITCH
Debtors

WELLS FARGO BANK, N.A., doing business as, America's Servicing Company
Appellant
v.

IRBY FITCH; BRITTANY FITCH
Appellees

SUPPLEMENTAL BRIEF OF THE UNITED STATES, AS *AMICUS CURIAE*, IN RESPONSE TO COURT DIRECTIVE DATED OCTOBER 15, 2010

PRELIMINARY STATEMENT

On May 1, 2010, the United States filed a brief in this appeal as *amicus curiae* in support of partial affirmance. The United States did not take a position on the merits of the dispute between Ms. Stewart and Wells Fargo regarding the interpretation of Ms. Stewart's mortgage. Instead, the United States argued that the bankruptcy court appropriately required that Wells Fargo to conduct an audit and take certain other actions in bankruptcy cases not involving Ms. Stewart. This Court heard argument on the appeal, in which the United States participated, on October 5, 2010.

On October 15, 2010, the Court issued a directive inviting the United States to submit a supplemental brief "addressing whether there exists an Article III case or controversy regarding injunctive relief when the debtor has not personally asserted a likelihood of future injury from the allegedly unlawful conduct." The United States submits this brief in response to that invitation.

ARGUMENT

I. The audit order presents a "case or controversy" because it is amenable to judicial resolution and because it arose in an adversarial context.

The grant of subject matter jurisdiction to a federal court is limited to actual "cases" or "controversies." U.S. Const. Art. III, Sec. 2. As this Court has observed, the case or controversy doctrine imposes two basic requirements before a federal court may exercise its jurisdiction: the question must be "presented in an adversary context," and it must be "amenable to resolution through the judicial process." *Dailey v. Voight Aircraft Co.*, 141 F.3d 224, 227 (5th Cir. 1998).

Both requirements are met here. The Supreme Court has construed the "amenable to resolution" test as meaning that the court must have the practical ability to order relief, and that the relief must be something that is "historically viewed" as a judicial function. *GTE Sylvania, Inc. v. Consumers Union of U. S., Inc.*, 445 U.S. 375, 382 (1980). Here, the audit remedy is amenable to resolution through the judicial process because it obligates Wells Fargo to take actions that it would not have been required to take absent the order, and because the court has the ability to monitor and enforce Wells Fargo's compliance with that order. *Cf. In re Stewart*, Case No. 07-11113, 2008 WL 5096011 (Bankr. E.D. La. Oct. 15, 2008) (establishing procedure for enforcement of audit remedy). In addition, the remedy of ordering an audit is a traditional function of bankruptcy courts. *See Marrama v. Citizens Bank of Massachusetts*, 549 U.S. 365, 383 (2007) (Alito, J., dissenting) (noting the historical equitable power of bankruptcy courts to "requir[e] accountings"). Furthermore, the extensive litigation record in this Court and in the proceedings below also reflects that the audit has been presented in an adversary context.

II. The bankruptcy court had power to order the audit because it was a recognized collateral proceeding and because it had statutory power to prevent abuse.

Although the basic jurisdictional requirement of a case or controversy is met, the United States understands the Court's directive to raise a related issue: does the bankruptcy court's subject matter jurisdiction over the audit terminate once there is no longer a case or controversy which affects Ms. Stewart personally? The United States submits that it does not, for two reasons: first, under the analysis adopted by the Supreme Court, the audit is a "collateral issue" over which the bankruptcy court could exercise jurisdiction independently of its jurisdiction in the underlying case. Secondly, because the bankruptcy court was authorized to order the audit on its own authority, and for the purpose of preventing abuse in the bankruptcy system as a whole, Ms. Stewart's participation was never necessary to the audit at all, and the resolution of all remaining issues affecting her cannot terminate the bankruptcy court's authority to enforce that order.

A. The audit order is a collateral order.

As the Supreme Court has noted, "[i]t is well established that a federal court may consider collateral issues after an action is no longer pending." *Cooter & Gell v. Hartmarx Corp.*, 496 U.S. 384, 395-96 (1990). A "collateral issue," in turn, is one that "does not signify a[n] . . . assessment of the legal merits" of the underlying complaint, but which may be resolved independently of the main dispute. *Id.* at 396. Notably, the Supreme Court has described "the determination of . . . whether [an] attorney has abused the judicial process" as a prototypical example of a collateral issue. *Id.*; *see also Willy v. Coastal Corp.,* 503 U.S. 131, 138 (1992) (same).

The audit remedy in this case differs from the remedies in *Cooter* and *Willy* in that was directed not at an attorney, but at a party. However, since the principal sources of authority for the remedies in both *Cooter* and *Willy* (Rule 11) and in this case (11 U.S.C. § 105(a)) are applicable to both attorneys and represented parties, there is no reason to distinguish *Cooter* and *Willy* on that basis.

A principal consequence of the collateral issue doctrine is that a court evaluates its subject matter jurisdiction over the collateral issue without regard to whether it also has subject matter jurisdiction in the underlying case. Thus, in *Cooter*, the Supreme Court upheld the jurisdiction of the trial court to enter a Rule 11 sanctions order even after the case in which the sanction arose had been voluntarily dismissed. *Cooter*, 496 U.S. at 398. In *Willy*, the underlying case was one over which the district court never had proper subject matter jurisdiction at all. *Willy*, 503 U.S. at 133. The Supreme Court nevertheless upheld the district court's jurisdiction to issue a sanction for misconduct that occurred before the case was dismissed, rejecting the petitioner's contention that the lack of underlying subject matter jurisdiction meant that there was no "case or controvers[y]" regarding the sanction. *Id.* at 135-36; *see also Chambers v. NASCO, Inc.*, 501 U.S. 32 (1991) (affirming order that sanctioned party for misconduct occurring over the entire course of a lawsuit, where sanctions proceeding commenced after the lawsuit was decided).

In this case, the dispute over the audit is collateral to Ms. Stewart's bankruptcy case. The bankruptcy court's decision reflects that the audit was ordered not solely in response to the errors in Ms. Stewart's case, but was based on the court's determination that Wells Fargo was engaged in deficient practices in a wide range of other cases as well. *See In re Stewart*, 391 B.R. 327, 342 (Bankr. E.D. La. 2008) (attributing abuses to Wells Fargo's "corporate practice"). As the United States discussed in its brief, the principal findings underlying the determination of abuse are undisputed, and the audit can be affirmed even if Wells Fargo prevails on every other argument which it has raised on appeal. *See* U.S. Amicus Br. 8.

This Court recently applied the collateral issue doctrine to a case presenting a jurisdictional scenario virtually indistinguishable from the audit issue in this case. In *Qureshi v. United States*, a district court enjoined an abusive litigant from filing papers in Texas federal courts without prior written permission from the judge. *Qureshi v. United States*, 600 F.3d 523, 524 (5th Cir. 2010). Notably, like the audit remedy in this case, the *Qureshi* injunction was not limited to proceedings before the same judge, and by its terms it also extended to cases having nothing to do with the United States, the adverse party in the case in which the injunction was issued. *Id.*

Although this Court eventually vacated the injunction on other grounds, it specifically rejected Qureshi's claim that the injunction exceeded the district court's jurisdiction because the underlying case had been resolved. *Id.* at 525. Noting that there was no reason to distinguish between the equitable remedy imposed by the district judge and the Rule 11 sanctions discussed in *Cooter* and *Willy*, this Court held that the equitable remedy presented a "collateral issue." As a result, this Court concluded that the holdings of *Cooter* and *Willy* were directly applicable, and that the trial court's jurisdiction to impose the equitable remedy did not depend on it having continued subject matter jurisdiction over the underlying case. *Id.* at 526. The same reasoning applies here.

B. The bankruptcy court had the authority to order the audit *sua sponte*.

Indeed, the bankruptcy court's actions here are even more appropriate because it was acting under a federal statute that allowed it to act *sua sponte*. *See* 11 U.S.C. § 105(a) (authorizing bankruptcy court to "sua sponte [take] any action . . . necessary or appropriate to enforce or implement court orders or rules or to prevent an abuse of process"). The jurisdiction of courts to enter *sua sponte* orders to protect their own proceedings is well-established in this circuit, and is unremarkable in the bankruptcy context. *See, e.g., In re Thomson*, 48 Fed. Appx. 918 (5th Cir. 2002) (holding that district court had subject matter jurisdiction to open a proceeding captioned as "Thomson v. No Defendant Named" and to simultaneously issue a *sua sponte* order barring attorney from courthouse, independent of any pending case or controversy).

Furthermore, in addition to section 105(a), numerous provisions of the Bankruptcy Code give bankruptcy court express statutory authority to act *sua sponte*. *See, e.g.,* 11 U.S.C. § 107 (bankruptcy court may enter protective order on court's own motion); § 110(h)(4) (court may initiate proceeding against bankruptcy petition preparer); § 526(c)(5) (authorizing *sua sponte* injunction against debt relief agency); § 707(b)(1) (authorizing *sua sponte* dismissal of consumer bankruptcy case).

In this case, section 105(a) expressly authorizes the bankruptcy court to enter *sua sponte* orders to prevent abuse, and not merely remedy abuse after the fact. The bankruptcy court's actions here fell well within its Congressional authorization, and should be upheld.

III. The bankruptcy court's power to prevent abuse is not limited to cases involving Ms. Stewart.

As the United States stated in its *amicus* brief, the audit remedy was an exercise of the bankruptcy court's statutory power under section 105 of the Bankruptcy Code, which authorizes bankruptcy courts to enter orders to "prevent an abuse of process." 11 U.S.C. §105(a); U.S. Amicus Br. 9. This authorization to prevent abuse is "broad." *In re Marrama*, 549 U.S. at 379. In particular, as numerous courts have recognized, section 105(a) does not merely authorize courts to protect particular parties from abuse in a single case. Rather, it also authorizes courts to take action on a global basis to protect the bankruptcy system as a whole. *See, e.g., In re Morgan*, 573 F.3d 615, 626 (8th Cir. 2009) (holding that section 105(a) authorized bankruptcy court to issue order removing private trustee from all cases in which she was appointed, even absent showing of actual harm to estate or creditors); *In re Casse*, 198 F.3d 327, 340 (2d Cir. 1999) (holding that section 105(a) authorized bankruptcy court to enjoin abusive litigant from filing future bankruptcy petitions).

For these reasons, the question of whether Ms. Stewart personally will suffer a future injury is not relevant to an analysis of the bankruptcy court's jurisdiction. The audit remedy is designed to protect the entire bankruptcy system, not solely Ms. Stewart. *See In re Nosek*, 544 F.3d 34 (1st Cir. 2008) (noting that purpose of section 105(a) is to "preserve the integrity of the bankruptcy system") (internal citation omitted). Thus, for purposes of evaluating the availability of injunctive relief in this case, it is the bankruptcy system, and not Ms. Stewart personally, that must be exposed to the threat of future injury. As the district court noted, to the extent that it is even applicable, that requirement was satisfied by the bankruptcy court's extensive findings regarding the systemic nature of Wells Fargo's misconduct. *See In re Stewart*, 2009 WL 2448054 at *15 (E.D. La. Aug. 7, 2009) (summarizing relevant bankruptcy court findings). Those findings have not been challenged on appeal.

IV. The bankruptcy court has independent authority to protect the integrity of its own proceedings, which it may exercise even in the absence of Ms. Stewart's participation.

Finally, as noted above, it is unnecessary for this Court to find that Ms. Stewart had standing to request the audit, because, as the text of section 105(a) itself provides, such relief could be ordered by the bankruptcy court on its own initiative. *See* 11 U.S.C. §105(a) (recognizing authority of court to prevent abuse sua sponte). Indeed, the authority of bankruptcy courts to enter *sua sponte* relief under section 105(a) is well established in this circuit. *See In re Thomas*, 223 Fed. Appx. 310, 314 (5th Cir. 2007) (affirming *sua sponte* order of bankruptcy court that vacated confirmed plan pursuant to section 105(a)); *In re Beard*, 84 F.3d 431 (5th Cir. 1996) (affirming *sua sponte* order denying confirmation of plan on grounds of bad faith); *In re Hammers*, 988 F.2d 32, 35 (5th Cir. 1993) (affirming sua sponte order of dismissal).

Nothing in this case is particularly novel. Court-initiated inquiries under 11 U.S.C. § 105(a) and other provisions into systemic abuses by national mortgage lenders and their attorneys have become common in bankruptcy cases in recent years. *See, e.g., In re Parsley*, 384 B.R. 138 (Bankr. S.D. Tex. 2008) (bankruptcy court issued order to show cause against lender and attorneys under 11 U.S.C. § 105(a) where factual errors in pleading were caused, in part, by corporate policy that prohibited direct communication between attorney and client); *In re Cabrera-Mejia*, 402 B.R. 335 (Bankr. C.D. Cal. 2008) (*sua sponte* proceeding under 11 U.S.C. § 105(a) and Fed. R. Bankr. P. 9011 to consider sanctions against law firm that persistently filed and withdrew inaccurate pleadings in multiple cases); *In re Porcheddu*, 338 B.R. 729 (Bankr. S.D. Tex. 2006) (order to show cause under Fed.

R. Bankr. P. 9011 directed against attorneys for lender who systemically falsified fee statements)

In some cases, court-initiated remedies may be not only permissible, but even mandatory. In *Espinosa v. United Student Aid Funds*, 130 S.Ct. 1367 (2010), for example, the Supreme Court considered the issue of an abusive chapter 13 plan that was confirmed by the bankruptcy court after no creditor objected. Reversing the judgment of the Ninth Circuit, the Supreme Court held that section 105(a), among other provisions, required the court to *sua sponte* deny confirmation. As a result, the Supreme Court concluded that "the Code makes plain that bankruptcy courts have the authority - *indeed, the obligation* - to direct a debtor to conform his plan" to the Bankruptcy Code, even when no party objects. *Id.* at 1381 (emphasis added).

In the context of creditor abuse litigation, there are also important public policy reasons why courts should be empowered to act to prevent abuse independently of the debtor. Individual debtors typically have little or no financial incentive to seek to curb a lender's abuses outside of their own cases. Moreover, such debtors almost invariably lack the legal resources required to fully investigate a lender's systemic conduct. Any rule that prohibited entities other than the debtor from investigating systemic creditor abuse could create perverse results, since any creditor could escape scrutiny of its conduct if the debtor agred to settle or lost the ability to continue his litigation efforts. *Cf. In re Hill*, 437 B.R. 503, 517 (Bankr. W.D. Pa. 2010) (attributing mortgage lender's desire to quickly settle case with debtor to desire to quash further investigation of its alleged abusive activities); *see also Porcheddu*, 338 B.R. at 729 (noting that death of debtor did not terminate court's inquiry into lender's misconduct).

These same principles apply here. Once the bankruptcy court determined that Wells Fargo's conduct constituted an abuse of the bankruptcy system, it had the authority, if not the obligation, to order relief to remedy that abuse. No action by Ms. Stewart was required in order to trigger that authority, and for the same reason, the termination of any continuing dispute involving Ms. Stewart does not deprive the court of its jurisdiction to protect the bankruptcy system against abuse.

CONCLUSION

For the foregoing reasons, the judgment of the courts below should be affirmed.

Respectfully submitted:

By: /s/ John P. Sheahan

JOHN P. SHEAHAN
United States Department of Justice
20 Massachusetts Ave., NW
Washington, DC 20530
Telephone no. (202) 307-1399
Facsimile no. (202) 307-2397

CERTIFICATE OF COMPLIANCE WITH WORD-COUNT LIMITATIONS

I hereby certify that the foregoing brief complies with the typeface requirements in Fed. R. App. P. 32(a)(5). I also certify that the foregoing brief is proportionately spaced, using Times New Roman font, 14 point type. Based on a word count under Corel Word Perfect 12, this brief contains 3,766 words excluding certificates of counsel.

/s/ John P. Sheahan
JOHN P. SHEAHAN

CERTIFICATE OF SERVICE

I certify that a copy of the above has been served to:

Michael H. Rubin
Anthony Rollo
McGlinchey Stafford, PLLC
One American Place, 14th Floor
Baton Rouge, LA 70825

Rudy J. Cerone
Eric J. Simonson
McGlinchey Stafford, PLLC
601 Poydras Street, 12th Floor
New Orleans, LA 70130

Attorneys for appellee,
Wells Fargo Bank, N.A.

Elisabeth D. Harrington
Kirk L. Myers
Harrington & Myers
P.O. Box 13127
New Orleans, LA 70185
Attorneys for appellees,
Dorothy Chase Stewart, Irby Fitch and Brittany Fitch

Done this 6th day of December 2010.

/s/ John P. Sheahan
JOHN P. SHEAHAN

BRIEF BANK — "SUMMARY SHEET"

Printed Wed.-5/5/4 (16:23)

WESTLAW CODES

1. ("TI") TITLE OF CASE [E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]	Stewart v. UST, (In re Stewart)
2. ("CO") CURRENT COURT [E.g., "CTA9"]	CA8
3. ("CCN") CURRENT CASE NO.	No.: 98-5000
4. ("PCN") PRIOR CASE NO. & COURT [IF ANY]	No.: Court: BAP 10 (Identify judge & cite, if any)
5. ("SO") SOURCE	**U.S. TRUSTEES**
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8. ("TO") TOPIC	**BANKRUPTCY**
9. ("SU") • SUMMARY OF KEY ISSUE(s) & √ Any Miscellaneous BACKGROUND	• Whether granting Ch 7 relief to debtor would be substantial abuse of the provisions of that chapter, in light of his ability to repay debts, the circumstances surrounding the petition, and other facts found by the BAP. Whether Debtor's debts were "primarily consumer debts" under §707(b) and whether §707(b) is consistent with equal protection and is not unconstitutionally vague. √ **Background:** The bankruptcy court dismissed the petition for "substantial abuse" (§707(b)). Debtor appealed and the BAP 10th Circuit affirmed the dismissal. Debtor now appeals again.
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ORAL ARGUMENT IS DESIRED

No. 98-5000

IN THE UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

IN RE JEFFREY D. STEWART,

Debtor.

JEFFREY D. STEWART,

Plaintiff-Appellant,

v.

UNITED STATES TRUSTEE,

Defendant-Appellee.

ON APPEAL FROM THE
UNITED STATES BANKRUPTCY APPELLATE PANEL
OF THE TENTH CIRCUIT

BRIEF FOR THE APPELLEE

FRANK W. HUNGER
Assistant Attorney General

WILLIAM KANTER
(202) 514-4575
EDWARD HIMMELFARB
(202) 514-3547
Attorneys, Appellate Staff
Civil Division, Room 9145
Department of Justice
601 "D" Street, N.W.
Washington, D.C. 20530-0001

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STATEMENT OF PRIOR OR RELATED APPEALS

There are no prior appeals in this case and no appeals related to it.

IN THE UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

No. 98-5000

IN RE JEFFREY D. STEWART,

Debtor.

JEFFREY D. STEWART,

Plaintiff-Appellant,

v.

UNITED STATES TRUSTEE,

Defendant-Appellee.

ON APPEAL FROM THE
UNITED STATES BANKRUPTCY APPELLATE PANEL
OF THE TENTH CIRCUIT

BRIEF FOR THE APPELLEE

STATEMENT OF SUBJECT MATTER AND APPELLATE JURISDICTION

The bankruptcy court had jurisdiction over this case under 28 U.S.C. 151 and 28 U.S.C. 1334. The court entered an order dismissing the debtor's petition (subject to the debtor's right to raise a constitutional challenge to 11 U.S.C. 707(b)) on October 31, 1996, App. 854-82, and entered an order finally dismissing the petition on January 31, 1997, App. 936-41. The debtor filed a timely notice of appeal on February 7, 1997. App. 943-45. The Bankruptcy Appellate Panel of the Tenth Circuit had jurisdiction over that appeal under 28 U.S.C. 158(c). The Panel entered an order affirming the order of the bankruptcy court on December 9, 1997. App. 1842-61. The debtor filed a timely notice of appeal on January 6, 1998. App. 1894-95. This Court has jurisdiction under 28 U.S.C. 158(d).

STATEMENT OF THE ISSUES

1. Whether granting chapter 7 relief to Stewart would be a substantial abuse of the provisions of that chapter, in light of his ability to repay his debts, the circumstances surrounding the filing of his chapter 7 petition, and other facts found by the bankruptcy court.

This issue was raised in Stewart's response to the U.S. Trustee's motion to dismiss, App. 193, and was ruled upon by the bankruptcy court, App. 877-82, and the Bankruptcy Appellate Panel, App. 1859-61.

2. Whether Stewart's debts were "primarily consumer debts" under 11 U.S.C. 707(b).

This issue was raised in Stewart's response to the U.S. Trustee's motion to dismiss, App. 193, and was ruled upon by the bankruptcy court, App. 870-77, and the Bankruptcy Appellate Panel, App. 1854-59.

3. Whether section 707(b) is consistent with equal protection and is not unconstitutionally vague.

This issue was raised in Stewart's response to the U.S. Trustee's motion to dismiss, App. 194, and was ruled upon by the bankruptcy court, App. 936-41, and the Bankruptcy Appellate Panel, App. 1851-54.

STATEMENT OF THE CASE

A. Nature of the Case.

This case arises out of a chapter 7 petition filed by Dr. Jeffrey D. Stewart, an obstetrician-gynecologist. Stewart sought to discharge his debts, which consisted in large part of alimony and child support to his ex-wife and children under a divorce settlement, amounts owing to his former in-laws, and student loan obligations. On motion of the U.S. Trustee pursuant to 11 U.S.C. 707(b), the bankruptcy court dismissed the petition for "substantial abuse." The debtor appealed, but the Bankruptcy Appellate Panel of the Tenth Circuit affirmed the dismissal. The debtor now appeals again.

B. Statutory Background.

1. The U.S. Trustees Program was created by Congress in 1978 in order to "separate the administrative duties in bankruptcy from the judicial tasks, leaving the bankruptcy judges free to resolve disputes untainted by knowledge of administrative matters unnecessary and perhaps prejudicial to an impartial judicial determination." H.R. Rep. No. 764, 99th Cong., 2d Sess. 18, reprinted in 1986 U.S.C.C.A.N. 5227, 5230. Until the Bankruptcy Reform Act was passed in 1978, administration of individual bankruptcy cases was the responsibility of bankruptcy judges.

Because of the bankruptcy judges' "dual responsibilities — administrative and judicial," there was a "close relationship between bankruptcy judges, trustees, trustees' attorneys, and the bankruptcy bar that led to the perception that there was a 'bankruptcy ring' that had the inside track on all bankruptcy matters." General Accounting Office, Bankruptcy Administration: Justification Lacking for Continuing Two Parallel Programs, Sept. 1992 (GAO/GGD-92-133), at 4; see H.R. Rep. No. 595, 95th Cong., 2d Sess. 95, reprinted in 1978 U.S.C.C.A.N. 5963, 6056-57 (discussing "bankruptcy ring").

Congress, accordingly, created the U.S. Trustees Program as an agency within the Department of Justice to take over the administrative responsibilities for bankruptcy cases. In doing so, Congress "likened the U.S. trustee's relation to that of a prosecutor." In re Revco D.S., Inc., 898 F.2d 498, 500 (6th Cir. 1990). But the U.S. Trustee was designed to serve not only as a prosecutor but also as a "watchdog." A "good watchdog guards the interests of those for whom it watches; the roles are not incompatible." Id.; see In re A-1 Trash Pickup, Inc., 802 F.2d 774, 775 (4th Cir. 1986) (legislative history "indicates that Congress expected for United States Trustees to oversee administration of bankruptcy cases and act as 'watchdogs . . . prevent[ing] fraud, dishonesty, and overreaching in the bankruptcy arena'") (citation omitted).

The duties of the U.S. Trustees are set forth in 28 U.S.C. 586(a). Principally, the U.S. Trustee is to "establish, maintain, and supervise a panel of private trustees that are eligible and available to serve as trustees in cases under chapter 7 of title 11," and to "supervise the administration of" chapter 7, 11, or 13 bankruptcy cases in numerous respects. 28 U.S.C. 586(a)(1) & (3)(A)-(H). In addition, the U.S. Trustee is authorized to serve as a bankruptcy trustee when required under title 11. 28 U.S.C. 586(a)(2), (4) & (5).

2. When Congress created the U.S. Trustees program, "it expected the trustees to actively oversee the administration of bankruptcy cases and to intervene whenever particular actions threatened an abuse of the bankruptcy system or its procedures." In re A-1 Trash Pickup, 802 F.2d at 775-76. Thus, in 1986,

Congress gave the U.S. Trustees the authority to file a motion to dismiss a chapter 7 petition for "substantial abuse":

> (b) After notice and a hearing, the court, on its own motion or on a motion by the United States trustee, but not at the request or suggestion of any party in interest, may dismiss a case filed by an individual debtor under this chapter whose debts are primarily consumer debts if it finds that the granting of relief would be a substantial abuse of the provisions of this chapter. There shall be a presumption in favor of granting the relief requested by the debtor.

11 U.S.C. 707(b).

C. Statement of Facts.

Stewart married Barbara Teichner in 1978 while they were enrolled in college and, after leaving college, had four children between 1980 and 1987. App. 854. During this time Stewart had a variety of jobs, including cook, baker, delivery truck driver, and ice skating teacher. "His family's standard of living was minimal." Id. Stewart took college classes from time to time. App. 855.

Stewart's in-laws, the Teichners, lent them money, which was used partly to cover the cost of Stewart's education but "largely to pay for his and his family's normal living expenses during his long period of part-time and/or low-paying employment." App. 871. Stewart also took loans from commercial lenders under "government-sponsored educational loan programs." Stewart obtained a Bachelor of Science degree. App. 855.

In 1988, Stewart went to medical school, enrolling at the University of Oklahoma at Norman. At medical school Stewart met Patricia Hill, and "[d]omestic difficulties ensued." Stewart moved his family to Tulsa and transferred to the medical school at the University of Oklahoma at Tulsa. Stewart and Barbara separated at some time between April and July 1990, and Stewart "promptly commenced a 'romantic liaison' and 'conjugal relationship' with Patricia." Id.

In September 1990, Barbara filed for divorce, which Stewart did not contest. Their Marital Settlement Agreement required Stewart to pay alimony (which it referred to as "support alimony") of $500 a month until he finished his residency or became a licensed physician, and after that $25,000 a year up to a total of $2 million. The $2 million total, however, would be reduced to $250,000 if Barbara remarried. In addition, Stewart agreed to pay $2000 a month in child support and some additional child-related expenses, including college and post-graduate tuition, room, and board. The agreement required Stewart to obtain a residency that would enable him to earn income to provide the child support. App. 855-56. A divorce decree, which approved the agreement, was entered in October 1990. App. 856-57.

Stewart graduated from medical school in 1992 and began his internship and residency at the University of Oklahoma at Tulsa. At about that time, he stopped paying support to Barbara, moved to modify his child support payments, and moved to vacate the divorce decree on the ground of duress (Barbara's alleged threat to make public Stewart's extramarital affair).[1] Barbara agreed

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[1] Between November 1995 and January 1996, Stewart's motion to vacate the divorce decree was tried in state court and denied. His motion for a new trial was also denied, with the court explaining that Stewart's duress claim "makes no sense" since the extramarital affair had previously been disclosed. App. 859 (quoting state court order). The state court noted that Stewart

to a 70% reduction in child support but not to modification or vacation of the divorce decree. App. 857. Barbara married Larry Rose in May 1993. App. 857-58.

D. Proceedings Below.

1. In May 1996, Stewart filed his chapter 7 petition. Stewart scheduled assets valued at $23,066 and debts totaling $2,548,440.37, which included $2,000,000 owed to Barbara, $272,133 in student loans (plus an unknown amount in additional student loans), and $230,000 owed to the Teichners. App. 1845. The $2 million owed to Barbara did not take into account the provision of the marital settlement reducing Stewart's obligation to $250,000 if Barbara remarried. Id. Stewart explained that he had set the alimony debt at $2 million because he was unsure what would happen to his obligation if Barbara's second husband died or if they divorced. App. 1848.

In June 1996, Stewart completed his residency in obstetrics-gynecology. He also filed an adversary proceeding against Barbara seeking discharge of his debts under the marital agreement on the ground that those debts "are not true alimony or support but merely property division" and are excessively hard for him to repay. App. 862. Before the bankruptcy court could

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was "intent on leaving the marriage and the problems of raising the four children born of it," and that Barbara was "in ill health, virtually bedridden and saddled with children reacting adversely to the separation and impending divorce." App. 859-60. The state court concluded: "The pressure on him was internal and of his own making. He wanted a divorce 'bad' and he got one — a bad divorce. [He] made a bad bargain but with eyes open, fully informed and under no threat other than dealing with his own conscience." App. 860.

rule, "another matter intervened": the U.S. Trustee filed a motion under 11 U.S.C. 707(b) to dismiss the petition for substantial abuse. Id. The U.S. Trustee's motion argued that Stewart was currently employed, had completed his OB/GYN residency, and had an earning potential of $100,000 to $250,000 a year. It also argued that upon completion of his fellowship, he would have an earning potential of $250,000 to $500,000 a year. Finally, it asserted that Stewart's sole purpose in filing a chapter 7 petition was to discharge marital and family obligations when Stewart was able to repay a substantial portion of his debts.[2] App. 862-63.

The same day Stewart responded to the U.S. Trustee's motion, he amended his bankruptcy schedules. He reduced slightly the value of his assets and increased his liabilities to about $2.6 million. He switched his purported $2 million debt to Barbara from Schedule F (unsecured nonpriority claims) to Schedule E (unsecured priority claims); he increased his debt to the Teichners to about $320,000, claimed student loan debts of about $218,000, and listed a total unsecured debt of $582,509. App. 1845. Stewart claimed that his monthly take-home pay was $2,556 and projected his average monthly take-home pay for 1996 at

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[2] The U.S. Trustee also pointed out that Stewart had failed to report the income of Patricia, his second wife, "who is a practicing physician and contributes to the payment of the monthly expenses." App. 863, quoting motion. The bankruptcy court concluded that by failing to include Patricia's income Stewart had presented a "seriously misleading picture of his actual financial status." App. 879. The Bankruptcy Appellate Panel disagreed, App. 1848-49, and we do not pursue this point here.

$3,403. He listed monthly expenses of $7,966. App. 1845-46.

2. The bankruptcy court held an evidentiary hearing on the U.S. Trustee's motion. There was testimony that in 1995 perinatology program graduates without board certification had estimated starting salaries of $100,000 to $140,000.[3] The U.S. Trustee introduced evidence that between 1991 and 1995 OB/GYN specialists earned salaries between $175,000 and $325,000 and that the highest salaries were in excess of $500,000. Stewart himself testified that if he were in private practice, instead of having accepted a perinatology fellowship, he could have been earning $80,000 to $100,000 a year. App. 866-67.

The bankruptcy court concluded that Stewart's chapter 7 petition should be dismissed for substantial abuse, applying a "totality of the circumstances" analysis: "All relevant circumstances should be considered, including but not limited to the debtor's ability to repay his debts." App. 877. The court relied primarily on Stewart's "considerable earning potential." Id. "By his own admission, he could be making $80,000-$100,000 per year right now, fresh out of medical school," and his own witnesses suggested he could "soon" earn up to $140,000 — a figure that could double or triple, according to the U.S. Trustee. App. 877-78. Stewart's reported expenses were "improvidently high" and he did not "tighten his belt." App. 880, quoting In re Goodson, 130 B.R. 897, 901 (Bankr. N.D. Okla.

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[3] The published version of the opinion gives this range as $100,000 to $150,000. In re Stewart, 201 B.R. 996, 1001 (Bankr. N.D. Okla. 1996), aff'd, 215 B.R. 456 (B.A.P. 10th Cir. 1997).

1991). The court noted that Stewart's excuse — the need to maintain two houses — made no sense, since the second house was "kept to facilitate his travel to work at a new job that pays him less (very much less) than he is capable of earning." App. 880. Moreover, Stewart's effort to undo his divorce settlement, the timing of his bankruptcy petition, and "other circumstances (such as buying an expensive recreational vehicle while refusing to pay his children's medical bills)" indicate that he "has no intention of honoring the notes he gave Mr. and Mrs. Teichner, the marital agreement with Barbara, or his legal and moral obligation to support his own children." App. 878.

The bankruptcy court also held that Stewart's debts were "primarily consumer debts," — i.e., debts "incurred by an individual primarily for a personal, family, or household purpose." 11 U.S.C. 101(8). The student loans were not taken with a "profit motive," since a significant part of the proceeds went to pay the family's living expenses and Stewart himself disclaimed an interest in high income. App. 874. Similarly, the debts to Barbara and the Teichners were consumer debts because they, too, were for a personal, family, or household purpose. App. 876.

Noting that Stewart has the means to meet his financial obligations and that chapter 11 is, in any event, available to him and not unduly burdensome, the court held that granting relief under chapter 7 would be a substantial abuse. It would "amount to a reward for Stewart's own financial improvidence and judicial blessing of an unconscionably one-sided, opportunistic adjustment of Stewart's relationship with his domestic creditors." App. 882. The bankruptcy court, however, withheld action on the dismissal pending Stewart's briefing of his constitutional challenge to section 707(b).

On January 31, 1997, the bankruptcy court rejected the constitutional challenge. First, the court held that section 707(b)'s provision for dismissal of cases involving primarily consumer debts was not meant to imply a right to abuse chapter 7 by business debtors. Section 707(b)'s singling out of consumer debtors for special attention was rational, because it addresses "a type of bankruptcy case which is especially liable to abuse and especially deserving of review" — a case involving an individual debtor who "takes advantage of modern easy-credit practices to accumulate debts, for the immediate purpose of satisfying his private appetites and maintaining or enhancing his personal qualities and lifestyle, or those of his dependents — often in circumstances which offer creditors little security . . . ." App. 939, quoting App. 872-73.

The court also rejected Stewart's argument that the terms of the statute — "primarily," "consumer debt," "substantial," and "abuse" — were unconstitutionally vague, relying on its earlier decision in <u>In re Higginbotham</u>, 111 B.R. 955 (Bankr. N.D. Okla. 1990). App. 940.

3. Stewart appealed to the Bankruptcy Appellate Panel of the Tenth Circuit, which affirmed the bankruptcy court's dismissal for substantial abuse. The Panel first held that section 707(b) did not prohibit an action by the U.S. Trustee following Barbara's request or suggestion that one be commenced.

The statutory language "not at the request or suggestion of any party in interest" limits "who may file the motion[;] it does not limit the source of information or factual basis on which the United States Trustee or the court may initiate a § 707(b) motion." App. 1850. In any event, the U.S. Trustee in this case undertook an independent investigation and relied on information beyond that provided by Barbara. App. 1851.

Second, the Panel agreed that section 707(b) is constitutional. By using a "totality of the circumstances" test for substantial abuse, the courts are acting essentially the same as they act with regard to business debtors under 11 U.S.C. 105(a) and 11 U.S.C. 707(a). Because there was no practical distinction between consumer debtors and business debtors, it was not even necessary to reach the equal protection claim. App. 1852-52. The Panel also agreed that the terms in section 707(b) were not unconstitutionally vague. App. 1853.

Third, the Panel found that the debts to Barbara and the Teichners were consumer debts. The Teichner loans were made mostly to enable Stewart, Barbara, and their family to meet ordinary living expenses, App. 1856-57, and Stewart admitted that there was no authority for treating marital obligations as a business debt. App. 1858. The Panel held that student loans were not per se consumer debts, but it found no clear error in the bankruptcy court's determination that they were on the facts of this case. Even if they were not, however, Stewart's debts were primarily — that is, more than half, App. 1858 — consumer debts based on the marital debt and the debt to the Teichners.

Evidence at trial showed that the marital debt was $250,000, the Teichner debt was $320,000, and the student loan debt was $218,000. The $250,000 and the $320,000 amounts together ($570,000) represented more than half of Stewart's total of $837,009 in total debt, even without adding in the student loans. App. 1859.

Finally, the Panel concluded that the bankruptcy court properly dismissed the petition for substantial abuse. The Panel adopted the "totality of the circumstances" approach, including among the relevant factors:

> (1) circumstances surrounding the bankruptcy filing (i.e., was it induced by emergency, sudden illness, disability, unemployment, etc.); (2) whether the debtor incurred cash advances and made consumer purchases far in excess of his or her ability to pay; (3) whether the debtor's budget is excessive or unreasonable; (4) whether the debtor's schedules and statement of income and expenses reasonably and accurately reflect his or her true financial condition; (5) whether the petition was filed in good faith; and (6) whether the debtor has the ability to repay.

App. 1859-60. The Panel found that the record supported the bankruptcy court's determination that the chapter 7 proceeding constituted a substantial abuse. The petition had been filed shortly after the divorce but not after a sudden emergency. Although deeply in debt, Stewart has the "genuine ability to earn significant income" and he agrees that Patricia's income may be considered under section 707(b). App. 1860. Stewart has not earned significantly higher income only because he chose to enter a lower-paying fellowship. He has deferred income at a time when his monthly expenses exceeded his monthly income by about $4,500 and after living on institutional and family loans for 20 years.

He has tried to discharge some or all of the marital debt and all of the family loans, asking his family and his former in-laws once again to "bear the financial consequences of his personal ambition." App. 1861.

Because Stewart "has the current ability to pay, and in the near future his income prospects will increase significantly," and because of the circumstances surrounding the filing of the petition and the purpose for which the debts were used, the Panel found that this case presented a substantial abuse of chapter 7. Id.

SUMMARY OF ARGUMENT

I. The bankruptcy court found that granting relief to Stewart under chapter 7 would be a substantial abuse, and the Bankruptcy Appellate Panel agreed. Stewart accepts the "totality of the circumstances" approach to substantial abuse but disagrees with its application here. Nothing Stewart argues in this Court indicates that any fact finding or the conclusion that there was substantial abuse was wrong.

The bankruptcy court dismissed Stewart's petition for substantial abuse based on several findings of fact. It found that Stewart had "considerable earning potential," App. 877, and could soon earn up to $140,000 a year, but that he had chosen a low-paying fellowship, which made it difficult for him to pay his debts. It found that he filed for bankruptcy shortly after his divorce without any emergency or immediate need. The bankruptcy court also found that Stewart had no intention of making good on his obligations to his ex-wife, his children, and his former in-laws and that the main effect of permitting discharge would be to discharge those very obligations. It found that Stewart's expenses were also excessive. Finally, the bankruptcy court found that granting Stewart chapter 7 relief would "result in little or no dividend to creditors, and would amount to a reward for Stewart's own financial improvidence and judicial blessing of an unconscionably one-sided, opportunistic adjustment of Stewart's relationship with his domestic creditors." App. 882. These facts are sufficient to support dismissal under section 707(b).

Stewart argues that section 707(b) does not apply to him because his debts are not "primarily consumer debts." He does not dispute the meaning of that phrase but merely disagrees with the bankruptcy court's findings of fact regarding that issue. The bankruptcy court found that Stewart's debt to his ex-wife and his debt to his former in-laws were consumer debts because they were incurred "primarily for a personal, family, or household purpose." 11 U.S.C. 101(8). Stewart merely disputes the weight that the bankruptcy court gave to the testimony on this issue. He agrees that "primarily" means more than half, and the bankruptcy court found that the debts to his ex-wife and former in-laws were over half of his total debts. It is not necessary to decide here whether Stewart's student loans were also consumer debt, because his other consumer debts already are more than half the amount of his total debt.

Stewart is also mistaken in claiming that the U.S. Trustee's motion under section 707(b) was tainted because it was based on the suggestion of his ex-wife, a party in interest. The language of section 707(b) is clear that the court may not dismiss a case on the "request or suggestion of any party in interest," but that the U.S. Trustee is not precluded from making a motion based on such a request or suggestion. As the Bankruptcy Appellate Panel put it, the statutory language "limits who may file the motion, [but] it does not limit the source of information or factual basis on which the United States Trustee or the court may initiate a § 707(b) motion." App. 1850. The two canons of construction Stewart invokes do not support Stewart's position.

II. Stewart's two constitutional challenges to section 707(b) are wholly without merit. His vagueness challenge boils down to the observation that different courts have applied the terms of that provision differently. But this happens all the time, and it often requires a Supreme Court decision to bring uniformity to the case law. Stewart's equal-protection challenge is essentially a claim of underinclusiveness — that, while Congress may properly have covered consumer debtors under section 707(b), it was constitutionally required to include business debtors as well. This argument is without basis. Congress could rationally have concluded that abuse of chapter 7 by consumer debtors was a more serious problem. It is well established that under rational-basis review, it does not violate equal protection to address one portion of a problem without also addressing all other aspects of the problem.

ARGUMENT

Standard of Review. The Court reviews de novo the meaning of the terms used in section 707(b), United States v. Diaz, 989 F.2d 391, 392 (10th Cir. 1993), and the constitutional validity of the statute, United States v. Wilks, 58 F.3d 1518, 1519 (10th Cir. 1995). However, the bankruptcy court's findings of fact may be rejected only if they are clearly erroneous. In re Taylor, 133 F.3d 1336, 1340 (10th Cir. 1998). The bankruptcy court's ultimate conclusion that, based on the facts found, discharge would be a "substantial abuse" of chapter 7 is reviewed de novo. Fonder v. United States, 974 F.2d 996, 999 (8th Cir. 1992); In re Green, 934 F.2d 568, 570 (4th Cir. 1991).

I. THE BANKRUPTCY COURT AND THE BANKRUPTCY APPELLATE PANEL CORRECTLY FOUND THAT STEWART'S PETITION WAS A "SUBSTANTIAL ABUSE" OF CHAPTER 7.

The bankruptcy court concluded that granting relief to Stewart would be a substantial abuse of chapter 7. This conclusion was correct, and the Bankruptcy Appellate Panel properly affirmed.

A. "Substantial Abuse" Is Determined On The Totality Of Circumstances, With Ability To Repay Debts The Primary Factor.

This Court has not yet decided a case involving "substantial abuse" under section 707(b), and other circuits have not been completely uniform in their understanding of that provision. In our view, the proper approach is found in the Fourth Circuit's "totality of the circumstances" analysis, which the Bankruptcy Appellate Panel adopted, App. 1859-60. Stewart more or less agrees with this approach (Br. 19), although he disagrees with its application here.

1. Prior to enactment of section 707(b) in 1984 and its

amendment in 1986 to permit dismissal on motion of the U.S. Trustee, chapter 7 debtors were subject to dismissal for cause under 11 U.S.C. 707(a), dismissal for various types of wrongdoing under 11 U.S.C. 727(a), and exceptions to discharge under 11 U.S.C. 523(a), but they otherwise "enjoyed an unfettered right to a 'fresh start' under Chapter 7, in exchange for liquidating their nonexempt assets for the benefit of their creditors." In re Krohn, 886 F.2d 123, 126 (6th Cir. 1989). Section 707(b), which permits dismissal of a chapter 7 case for "substantial abuse," was intended to "deny Chapter 7 relief to the dishonest or non-needy debtor." Id. (citing In re Walton, 866 F.2d 981, 983 (8th Cir. 1989). The goal was to "promote fairness to creditors, and thereby increase the flow of consumer credit." In re Koch, 109 F.3d 1285, 1288 (8th Cir. 1997).

Congress did not define "substantial abuse" in section 707(b), choosing instead to leave the standard "flexible," In re Krohn, 866 F.2d at 983; see In re Kelly, 841 F.2d 908, 914 (9th Cir. 1988), in order to enable courts to respond to a wide range of fact situations. All four courts of appeals to address the "substantial abuse" standard agree that the "primary" or "principal" factor is the debtor's ability to repay his debts. In re Green, 934 F.2d at 572; In re Krohn, 886 F.2d at 126; In re Walton, 866 F.2d at 984; In re Kelly, 841 F.2d at 914. "The primary factor that may indicate a substantial abuse is the ability of the debtor to repay the debts out of future disposable income." 6 Lawrence P. King, Collier on Bankruptcy ¶ 707.04[4], at 707-20 (15th ed. rev. 1997).

The principal difference among the circuits concerns whether the ability to repay debts is merely the primary factor or, rather, standing alone, supports dismissal under section 707(b). Both the Ninth Circuit, In re Kelly, 841 F.2d at 915, and the Eighth Circuit, United States v. Harris, 960 F.2d 74, 77 (8th Cir. 1992), have held that ability to repay is enough (although they recognize that other factors may be relevant). The Sixth Circuit agrees, at least in those cases in which the debtor has the ability to repay "with relative ease." In re Krohn, 886 F.2d at 126.

We are aware that if the ability to repay debts is sufficient, without more, to support dismissal under section 707(b), that would make it considerably easier for the U.S. Trustee, but we do not believe such a holding is justified. As the Fourth Circuit pointed out in In re Green, while the debtor's relative solvency may "raise an inference" that he is abusing the bankruptcy process and taking advantage of creditors, the statutory presumption in favor of granting chapter 7 relief suggests that solvency alone is not a basis for a finding of substantial abuse. 934 F.2d at 572.

The Fourth Circuit, accordingly, has applied a "totality of the circumstances" approach and has required that the "substantial abuse" determination be made on a case-by-case basis. Id. The Fourth Circuit has enumerated as the relevant factors not only the debtor's ability to repay but also "factors such as the following": (1) whether the petition was filed "because of sudden illness, calamity, disability, or unemployment"; (2) whether the debtor "incurred cash advances and made consumer purchases far in excess of his ability to pay"; (3) whether the debtor's "proposed family budget is excessive or unreasonable"; (4) whether the debtor's schedules and statement of current income and expenses "reasonably and accurately reflect [his] true financial condition"; (5) whether the petition "was filed in good faith." Id. A court need not analyze all these factors in every case, since substantial abuse is a case-specific and fact-based determination. See, e.g., In re Kestell, 99 F.3d 146, 150 (4th Cir. 1996) (focusing on lack of good faith of debtor who "sought to avoid paying what he owes to his former wife while making good on his other financial obligations").

The Sixth Circuit employs a similar "totality of the circumstances" approach (although the court is willing to allow dismissal based on ability to repay alone). In In re Krohn, the court offered a nonexclusive list of possibly relevant factors: "the debtor's good faith and candor in filing schedules and other documents, whether he has engaged in 'eve of bankruptcy purchases,' and whether he was forced into Chapter 7 by unforeseen or catastrophic events." 886 F.2d at 126. These factors are comparable to factors (1), (2), (4), and (5) under In re Green.

As we will now show, the bankruptcy court properly dismissed Stewart's petition as a substantial abuse under a totality of the circumstances, and the Bankruptcy Appellate Panel's affirmance was also correct.[4]

B. Stewart's Petition Was Properly Dismissed As A "Substantial Abuse" In Light Of Stewart's Ability To Repay His Debts, The Circumstances Surrounding The Filing Of His Petition, And Other Factors.

Dismissal of Stewart's petition for substantial abuse was proper under a totality of the circumstances. The bankruptcy court dismissed Stewart's petition for substantial abuse based on eight factors.[5] App. 1846-47. In affirming, the Bankruptcy Appellate Panel focused on three of those factors: Stewart's ability to pay his debts, the circumstances surrounding the filing of his chapter 7 petition, and the purpose and use of the debts incurred. App. 1859-61. The combination of these factors supports the bankruptcy court's dismissal of this case.

1. The bankruptcy court's dismissal of Stewart's petition was highly fact-based. First, and most important, the bankruptcy court found that Stewart, with his "considerable earning potential," App. 877, had the ability to repay his debts:

> By his own admission, he could be making $80,000-$100,000 per year right now, fresh out of medical school. According to his own witnesses, he will soon be capable of earning up to $140,000 per year. According to the [U.S. Trustee], as Stewart gains experience over the next few years his earning potential could rise much higher — the figure of $140,000 per year could double, or even triple. His current wife is also a doctor, and their combined earning potential is enormous — from ten times to

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[4] Because one of those circumstances is that Stewart has the ability to repay his debts, dismissal also would have been proper under a rule that an ability to repay debts, standing alone, is enough to support dismissal.

[5] We do not challenge the Bankruptcy Appellate Panel's rejection of two of the bankruptcy court's findings of fact. App. 1848-49.

> twenty times what the average American makes in a year, perhaps even more.

App. 877-78. As the Bankruptcy Appellate Panel noted, Stewart had not realized this income because he had chosen to enter a low-paying fellowship, and to "defer[] income despite living on family and institutional loans for the last 20 years." App. 1861. Stewart's claim that the courts below did not make any determination of his ability to pay (Br. 21) is mistaken.

Second, Stewart's chapter 7 petition was filed soon after his divorce, and the bankruptcy court found that there was no "emergency, disaster or untenable situation to be remedied" by - the filing of the petition. App. 881. Stewart concedes this point. (Br. 23)

Third, the bankruptcy court found, on the basis of Stewart's conduct, that he had "no intention of honoring the notes he gave Mr. and Mrs. Teichner, the marital agreement with Barbara, or his legal and moral obligation to support his own children." App. 878. The main effect of permitting Stewart's chapter 7 case to proceed would be to discharge those debts. Id. This finding was upheld by the Bankruptcy Appellate Panel. App. 1847-48.

Fourth, Stewart failed to "tighten his belt" and lived an extravagant lifestyle; he himself claimed to be spending $4,500 more than he took home each month. App. 880. The bankruptcy court found that this was "certainly unnecessary" in that Stewart "maintains two households in two different cities, and drives back and forth between them — but the second home in Oklahoma City is kept to facilitate his travel to work at a new job that pays him less (very much less) than he is capable of earning." Id. The Bankruptcy Appellate Panel agreed that Stewart's monthly expenses were excessive. App. 1849.

Finally, the bankruptcy court found that chapter 7 relief would "result in little or no dividend to creditors, and would amount to a reward for Stewart's own financial improvidence and judicial blessing of an unconscionably one-sided, opportunistic adjustment of Stewart's relationship with his domestic creditors." App. 882. Stewart did not dispute this finding before the Bankruptcy Appellate Panel, App. 1847, and he does not dispute it here.

Based on the combination of these factors, the bankruptcy court properly dismissed Stewart's petition.

2. Stewart objects to dismissal for substantial abuse on four grounds, each of which is without merit.

His first objection is that the bankruptcy court "should have first determined whether or not Stewart had an 'ability to pay' before engaging in the rest of the substantial abuse analysis." (Br. 21) But, in fact, the court did precisely that. We quoted the relevant portion of the opinion above, in which the bankruptcy court discussed the evidence about the income Stewart could earn "right now, fresh out of medical school," App. 877, if he had taken into account his obligation to his creditors instead of deferring income by pursuing a low-paying fellowship. The bankruptcy court went on to state that Stewart "can afford to pay what he owes, to them and to all his other creditors — if not all at once, then certainly over time, within the near and foreseeable future, entirely from his own earnings if need be, but certainly with the help of his current wife, whose own considerable earnings can support them while Stewart pays his just debts." App. 881.

Along these same lines, Stewart contends that the court failed to consider whether all secured and unsecured debt, a portion of that debt, or "a significant dollar amount" could be paid in a chapter 13 or chapter 11 plan. (Br. 21) Again, the court did precisely that. It explained that while Stewart owed too much to be eligible for chapter 13, he was still eligible for chapter 11, adding that "[t]o whatever extent Stewart needs relief from his creditors' collection efforts, he can achieve it in Ch. 11, without heedless discharge of debts which can and should be repaid." App. 881. Contrary to Stewart's apparent position (Br. 23), future income may be considered as part of a debtor's ability to pay. Fonder, 974 F.2d at 998 ("essential inquiry remains whether the debtor's ability to repay creditors with future income" shows a substantial abuse); In re Krohn, 886 F.2d at 127 ("Krohn's ample future income" and other factors supported dismissal); 6 Collier on Bankruptcy, ¶ 707.04[4], at 707-20 (primary factor for substantial abuse is ability to repay debts out of "future disposable income").[6] Stewart's argument

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[6] In In re Carlton, 211 B.R. 468 (Bankr. W.D.N.Y.), aff'd sub nom. Kornfield v. Schwartz, 214 B.R. 705 (W.D.N.Y.), appeal pending, No. 97-5080 (2d Cir.), on which Stewart relies (Br. 21-22), the bankruptcy judge cited as a factor supporting dismissal under section 707(b) the debtors' unwillingness to consider chapter 11, which "raise[d] concerns as to their honesty and good faith." 211 B.R. at 482.

that the legislative history precludes reliance on future income (Br. 23-24 & n. 16) is mistaken. See In re Walton, 866 F.2d at 983; In re Kelly, 841 F.2d at 914.

Stewart's second objection is that there are actually 15 factors to be evaluated in determining substantial abuse and that only two of them operated against him. (Br. 22-23) He is mistaken about the number: Ability to repay — the primary factor — also operates against him. But in any event, the number is irrelevant. Those courts applying a "totality of the circumstances" analysis do not simply count the number of factors operating for and against a debtor. To the contrary, the court's decision whether granting relief would be a substantial abuse is merely guided by the enumerated factors and depends on a case-specific analysis of all the facts. See, e.g., In re Kestell, 99 F.3d at 149-50 (dismissal proper simply because petition filed with goal of favoring certain creditors over debtor's ex-wife).

Third, Stewart objects that since he is ineligible for chapter 13 and there was "no evidence that [he] could have made meaningful debt payments in a Chapter 11 case," dismissal of his chapter 7 petition means that there was "nowhere else in the Bankruptcy courthouse to go." (Br. 24) This argument lacks merit. Not only was there indeed such evidence, as discussed above, but Stewart's "nowhere to go" argument was persuasively rejected in In re Krohn. There, the Sixth Circuit concluded that an "inability to qualify under Chapter 13 should not be dispositive" under section 707(b), explaining that allowing debtors to avoid dismissal because their unsecured indebtedness is too high for chapter 13 eligibility "would be rewarding outrageous abusers of consumer credit, while denying to those with more moderate consumer debt the benefits of Chapter 7." 886 F.2d at 127. The court was concerned that debtors would be encouraged by such a rule to "run up [their] unsecured debts in excess of $100,000" to avoid dedicating their future earnings to debt reduction under chapter 13. Id. Moreover, the "nowhere to go" argument also fails because there is no constitutional right to a discharge, and Congress can deny access to a "fresh start" in bankruptcy to certain debtors based on policy concerns. Id. To put it another way, Congress has decided that "[a] fresh start is not the same thing as a 'free ride.'" Kornfield v. Schwartz, 214 B.R. 705, ___ (W.D.N.Y. 1997), appeal pending, No. 97-5080 (2d Cir.).

Finally, Stewart objects that there was no showing of "bad faith." (Br. 25) But bad faith is not a prerequisite to dismissal under a totality of the circumstances. As the Bankruptcy Appellate Panel explained, App. 1860, it is simply one factor. See In re Green, 934 F.2d at 572 (listing "good faith" as one factor); In re Krohn, 886 F.2d at 126 (one factor is debtor's "good faith and candor in filing schedules and other documents").

3. The bankruptcy court properly applied the "totality of the circumstances" analysis on these facts. The dismissal of Stewart's petition for substantial abuse was appropriate.

C. Stewart's Debts Were "Primarily Consumer Debts."

Stewart's debts were "primarily consumer debts" within the meaning of section 707(b). His claim to the contrary is based on his disagreement with the bankruptcy court's findings of fact that his debts were "consumer debts." (Br. 9-17) He agrees with us about the meaning of the term "primarily" in section 707(b). (Br. 17-18)

1. The Bankruptcy Code defines "consumer debt" to mean a "debt incurred by an individual primarily for a personal, family, or household purpose." 11 U.S.C. 101(8). A debt incurred with a profit motive is not consumer debt, because it is not incurred "primarily" for a personal, family, or household purpose under section 101(8). In re Burns, 894 F.2d 361, 363 (10th Cir. 1990); see In re Runski, 102 F.3d 744, 747 (4th Cir. 1996); In re Booth, 858 F.2d 1051, 1054 (5th Cir. 1988); In re Kelly, 841 F.2d at 908. The primary purpose of the debt controls; that is, if the debt was incurred not only for personal, family, or household purposes but also with a profit motive, the debt is consumer debt if the former purposes predominate over the profit motive. See 2 Lawrence P. King, Collier on Bankruptcy ¶ 101.08, at 101-47 (15th ed. rev. 1997); App. 1855-56.[7]

Whether the debtor has "primarily" consumer debts within the meaning of section 707(b) depends on whether the amount of those debts is more than half of the debtor's entire debt. In re

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[7] It follows from the definition of "consumer debt" in section 101(8), in which a debt is either a consumer debt or not, depending on its primary purpose, that a debt cannot be divided into consumer-debt and non-consumer-debt parts. But see In re Booth, 858 F.2d at 1055 (when less than half of a debt was for consumer purposes, and more than half for a business venture, Fifth Circuit treated the consumer portion of the debt as consumer debt).

Kelly, 841 F.2d at 913 ("when 'the most part' — i.e., more than half — of the dollar amount owed is consumer debt, the statutory threshold is met"). This is the ordinary sense of the word "primarily." Stewart agrees here (Br. 18) that "primarily" means more than 50% of total debt.[8]

2. The Bankruptcy Appellate Panel correctly held that there was no clear error in the bankruptcy court's finding that Stewart's debt was "primarily consumer debt[]." App. 1859; see App. 876-77. The Panel noted that "[w]hen the marital obligation [of $250,000] is added to the $320,000 in debt to the former in-laws, the sum ($570,000) exceeds half of the $837,009 in total debt." App. 1859.

The bankruptcy court's finding was based on trial testimony. Stewart himself testified at trial that the money borrowed from the Teichners was "used for anything Stewart's family needed to pay, including vacation bills." App. 867. Barbara Stewart testified that her parents had loaned money to Stewart's family "to facilitate Stewart's education while maintaining his family in a 'certain life style' that would otherwise have been beyond their reach." Id. The bankruptcy court found that Stewart had borrowed this money partly for educational purposes but "largely

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[8] Another circuit appears to consider, in addition to amount, the number of individual debts, In re Booth, 858 F.2d at 1055, but that additional requirement makes little sense. One does not file for bankruptcy protection based on the number of debts one has but rather on their overall amount. It introduces an element of arbitrariness to decide whether a debtor's debts are primarily consumer debts based on how many individual consumer debts he has, when that may depend entirely on whether or not he has chosen to consolidate them on a single credit card.

to pay for his and his family's normal living expenses during his long period of part-time and/or low-paying employment." App. 871. Because "a significant part of the funds from Stewart's so-called student loans went to pay living expenses, vacation expenses, and the like for Stewart and his family, during the long period of his education as a doctor," App. 874, and because it believed in any event that education was "intimately 'personal,'" App. 875, the bankruptcy court held that the Teichner loans (and the institutional student loans) were consumer debt.

Based on the testimony cited by the bankruptcy court, that court's finding that the Teichner loans were primarily for a personal, family, or household purpose was not clearly erroneous. It is not necessary to decide whether the institutional student loans are also consumer debt, because, as the Bankruptcy Appellate Panel observed, the Teichner debt plus the marital debt exceeds half of Stewart's total debt. App. 1859.

3. Stewart admits that his marital debt is "probably" a consumer debt (Br. 17), see In re Kestell, 99 F.3d at 149 (lump sum owed to ex-wife from divorce judgment is consumer debt), but he otherwise disputes the bankruptcy court's findings of fact.

First, he disputes the court's description of his testimony, and he claims that the loans from the Teichners were not consumer debt, because they were primarily for his medical education. (Br. 12) But he adduces nothing to show that the bankruptcy court's evaluation of his testimony was clearly erroneous. He also admits that there was contrary trial testimony on this point from his ex-wife, yet he argues that the bankruptcy court "should have accorded Mrs. Stewart's testimony no weight in view of her conveniently shifting recollection" of the purpose of the loans. (Br. 13) Because Stewart's argument is merely a dispute over fact findings predicated on the court's evaluation of trial testimony, it does not support a showing of clear error. Miles v. Dorsey, 61 F.3d 1459, 1473 (10th Cir. 1995), cert. denied, 516 U.S. 1062 (1996)(quoting United States v. Frank, 956 F.2d 872, 875 (9th Cir. 1991), cert. denied, 506 U.S. 932 (1992) ("Clear error is not demonstrated by pointing to conflicting evidence in the record.")). Nor does his characterization of the court's reasoning as "non-sensical" (Br. 14) equate with proof of clear error.[9]

Second, Stewart argues that the institutional student loans are non-consumer debt. But the Bankruptcy Appellate Panel properly held that, while these loans are not per se consumer debt, their purpose may show that they are consumer debt. App. 1856. In any event, as we explained above, it is not necessary to reach this question, given that the Teichner loans and the alimony debt add up to over 50% of Stewart's total debt.

In short, Stewart's debts were "primarily consumer debts"

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[9] The principal case he relies on, In re Frisch, 76 B.R. 801, 803 (Bankr. D. Colo. 1987), merely says that "First Trust has failed to provide any authority for the proposition that intra-family loans constitute consumer debt." It provides no analysis of the issue, other than the assertion that Congress, in enacting section 707(b), was interested in protecting the consumer credit industry. Id. Contrary to Frisch, intra-family loans may be consumer debt to the extent that they fit the statutory definition in 11 U.S.C. 101(8).

under section 707(b).

D. The U.S. Trustee's Motion Under 707(b) Was Not "Tainted."

Stewart argues that the U.S. Trustee's motion under section 707(b) was "tainted" because it was brought at the suggestion of an interested party, his ex-wife. (Br. 26-35) His argument is based upon a flawed reading of the statute. Under section 707(b), the court — but not the U.S. Trustee — is barred from proceeding "at the request or suggestion of any party in interest." Both the bankruptcy court and the Bankruptcy Appellate Panel correctly rejected Stewart's statutory argument.

1. Section 707(b) provides that "the court, on its own motion or on a motion by the United States trustee, but not at the request or suggestion of any party in interest, may dismiss" a chapter 7 petition for substantial abuse. The only court of appeals to address the issue has held that the phrase "but not at the request or suggestion of any party in interest" modifies "the court" and not the intervening phrase "on its own motion or a motion by the United States trustee." <u>In re Clark</u>, 927 F.2d 793, 797 (4th Cir. 1991).

That interpretation is clearly the right one. In section 707(b), the subject of the first sentence is "the court" and the corresponding verb is "may dismiss." Between the subject and the verb, section 707(b) describes three possible litigation events that might prompt the court to dismiss the case — the court's own motion, the U.S. Trustee's motion, and a "request or suggestion" of an interested party. The language of section 707(b) permits the court to dismiss based on either the first or second event, and it bars the court from dismissing based on the third. As the Bankruptcy Appellate Panel concluded, the language "limits who may file the motion, [but] it does not limit the source of information or factual basis on which the United States Trustee or the court may initiate a § 707(b) motion." App. 1850.

Congress's intent was that motions to dismiss under section 707(b) should come only from neutral and disinterested parties; thus, it expressly prohibited motions by "any party in interest." The goal was to prevent harassment of debtors by creditors. In re Joseph, 208 B.R. 55, 60 (B.A.P. 9th Cir. 1997). Indeed, in using the phrase "request or suggestion," Congress chose language broader than the term "motion" to prevent the court from entertaining "any motion to dismiss under § 707(b), however disguised, which is brought before the Court by anyone other than the [U.S. Trustee]." App. 869 (emphasis added). The effect of this language is prevent creditors from evading the statutory limitation by acting without a formal motion.

These concerns about creditor harassment have no application to a motion brought by the U.S. Trustee, a neutral and disinterested party who acts as an independent watchdog over the bankruptcy system. In re Revco D.S., Inc., 898 F.2d at 500; In re A-1 Trash Pickup, Inc., 802 F.2d at 775. A motion brought by the U.S. Trustee is not brought at the behest of creditors; it is brought in the interest of the proper administration of the bankruptcy system. As the bankruptcy court noted, creditor allegations that are brought to the attention of the U.S. Trustee are "reviewed and 'filtered' by the [U.S. Trustee] before being filed." App. 869. Section 707(b) requires no more.[10]

2. Stewart argues that section 707(b) bars the U.S. Trustee from seeking dismissal of the petition for substantial abuse if any of the information was brought to his attention by a creditor. That cannot possibly be the correct interpretation.

If Congress had intended to prevent the U.S. Trustee from making a motion under section 707(b) based on a "request or suggestion of any party in interest," as Stewart claims, it could hardly have chosen a more obscure and ungrammatical formulation. There are numerous more coherent ways of expressing such an intent, of which we will suggest four. First, the phrase could have been written thus: "who shall not act at the request or suggestion of any party in interest." The word "who" then would plainly have referred to the U.S. Trustee. Second, Congress could have used the phrase "which shall not be at the request or suggestion of any party in interest." The word "which" would have referred to the motion of the U.S. Trustee (or the court's own motion). Third, Congress could have used the phrase "but <u>such motion shall not be</u> at the request of suggestion of any party in interest." The underlined words would have made the referent clear. Finally, Congress could have omitted the phrase

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[10] The Bankruptcy Appellate Panel stated that the U.S. Trustee conducts an "independent investigation" of the allegations before bringing a motion under section 707(b). App. 1851. This is almost always the case, given the U.S. Trustee's institutional function, but there is no requirement that the U.S. Trustee prove he has conducted an independent investigation under the statute. The suggestion to the contrary in <u>In re Morris</u>, 153 B.R. 559, 563 (Bankr. D. Ore. 1993), is mistaken.

and inserted a new sentence between the two sentences currently in section 707(b): "No such motion may be made at the request of suggestion of any party in interest."

Stewart tries to justify his interpretation of section 707(b) by referring to two canons of statutory construction, which he admits are in conflict with each other. (Br. 34) Neither is sufficient to alter the plain sense of section 707(b).

Stewart first adverts to the "last antecedent doctrine" of interpretation. (Br. 29-31) Under that doctrine, a qualifying phrase qualifies the last antecedent — the term that immediately precedes it in the sentence. Use of this canon, however, is "not compelled," Nobleman v. American Savings Bank, 508 U.S. 324, 330 (1993), and is appropriate only if it appears to result in the most reasonable reading of the statute. As we have shown, that is not the case here. Indeed, a half century ago, this Court admonished that the "last antecedent doctrine" should not "be indulged to confuse that [which] is otherwise manifestly plain." Hughes v. Samedan Oil Corp., 166 F.2d 871, 873 (10th Cir. 1948). This admonition remains equally valid today.

Stewart also invokes the doctrine of reddendo singula singulis (Br. 31-34) to suggest that the phrase "but not at the request or suggestion of any party in interest" should be read "distributively" to modify both "on its own motion" and "on a motion by the United States trustee." This Latin canon is another way of saying that "[w]here a sentence contains several antecedents and several consequents they are to be read distributively." 2A Sutherland, Statutes and Statutory

Construction § 47.26, at 240 (5th ed. 1992). Since there is only one consequent in section 707(b), it is not clear why Stewart thinks this canon applies. But, more to the point, the canon simply requires a court to "interpret a passage in which antecedents and consequents are unclear by reference to the context and purpose of the statute as a whole." Go-Video, Inc. v. Akai Electric Co., 885 F.2d 1406, 1412 (9th Cir. 1989). As we have already explained, the context and purpose of this statute do not support Stewart's interpretation.

II. THE BANKRUPTCY COURT AND THE BANKRUPTCY APPELLATE PANEL CORRECTLY REJECTED STEWART'S CONSTITUTIONAL CHALLENGE TO 11 U.S.C. 707(b).

Stewart contends that section 707(b) is unconstitutionally vague and violates equal protection. Both the bankruptcy court and the Bankruptcy Appellate Panel properly rejected these contentions.

A. Section 707(b) Is Not Unconstitutionally Vague.

Stewart contends that section 707(b) is unconstitutionally vague because different courts have analyzed the statute in different ways. (Br. 47-50) His contention is meritless.

First, Stewart is making a facial vagueness challenge to section 707(b) in arguing that "[t]he statute as written fails to impart notice to this debtor (or to any other Chapter 7 debtor) of the kind of conduct that may cause the debtor to be shown the Bankruptcy Courthouse door." (Br. 49) But facial vagueness challenges are unavailable when First Amendment rights are not at stake. United States v. Powell, 423 U.S. 87, 92 (1975); United States v. Mazurie, 419 U.S. 554, 550 (1975).

Second, when First Amendment rights are not involved, the requirements of the vagueness doctrine are minimal. Even in the case of a statute that imposes criminal liability, which section 707(b) does not, the vagueness doctrine requires only that the language "be sufficiently definite to give notice of the required conduct to one who would avoid its penalties, and to guide the judge in its application and the lawyer in defending one charged with its violation." Boyce Motor Lines, Inc. v. United States, 342 U.S. 337, 340 (1952); see Village of Hoffman Estates v. The Flipside, Hoffman Estates, Inc., 455 U.S. 489, 503 (1982) ("In reviewing a business regulation for facial vagueness, . . . the principal inquiry is whether the law affords fair warning of what is proscribed.").[11] These standards are even less strict when the statute is civil in nature and the penalty is merely a refusal to confer a bankruptcy discharge. Id. at 498-99 (Court has "expressed greater tolerance of enactments with civil rather than criminal penalties because the consequences of imprecision are qualitatively less severe").

Third, the statutory terms Stewart says are unconstitutionally vague are not. The term "consumer debt" is defined in 11 U.S.C. 101(8). While Stewart says the term

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[11] See Boyce Motor Lines, 342 U.S. at 340 ("But few words possess the precision of mathematical symbols, most statutes must deal with untold and unforeseen variations in factual situations, and the practical necessities of discharging the business of government inevitably limit the specificity with which legislators can spell out prohibitions. Consequently, no more than a reasonable degree of certainty can be demanded. Nor is it unfair to require that one who deliberately goes perilously close to an area of proscribed conduct shall take the risk that he may cross the line.").

"primarily" in the phrase "primarily consumer debts" is vague, he also believes it indicates a clear test — whether the ratio of consumer debt to total debt exceeds 50%. (Br. 18) That is clarity enough. As for "substantial abuse," while that term is undefined in the statute, it no more unconstitutionally vague than the terms "substantial evidence" and "abuse of discretion," which are applied every day in administrative law. See In re Kelly, 841 F.2d at 916 ("the Supreme Court has upheld statutes that contain equally undefined standards of decision"); In re Heller, 160 B.R. 655, 661 (D. Kan. 1993); In re Higginbotham, 111 B.R. 955, 966 (Bankr. N.D. Okla. 1990) ("substantial abuse" provides a standard, "even though the details must be worked out by judicial decisions," as with "fraud," "good faith," and "due process").[12]

Section 707(b), in sum, is not unconstitutionally vague.

B. Section 707(b) Does Not Violate Equal Protection.

Nor does section 707(b) violate equal protection. The distinction between debtors with primarily consumer debts and all other debtors is rational.

1. Congress's distinction between debtors with primarily consumer debt and all other debtors is reviewed for rational

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[12] The fact that different courts have interpreted section 707(b) differently hardly shows that it is unconstitutionally vague; the Supreme Court grants certiorari in numerous cases each year to resolve conflicting statutory interpretations in the lower courts. See also The Federalist, No. 37, at 229 (J. Madison) (Clinton Rossiter ed.) ("All new laws, though penned with the greatest technical skill . . ., are considered as more or less obscure and equivocal, until their meaning be liquidated and ascertained by a series of particular discussions and adjudications.").

basis, because the distinction implicates no fundamental right, United States v. Kras, 409 U.S. 434, 446 (1973) ("no constitutional right to obtain a discharge of one's debts in bankruptcy"), and affects no suspect classification.

The rational-basis test is highly deferential, and the question for the court is only whether there is a "rational relationship between the disparity of treatment and some legitimate governmental purpose." Heller v. Doe, 509 U.S. 312, 320 (1993). The court may consider "any reasonably conceivable state of facts that could provide a rational basis for the classification." FCC v. Beach Communications, Inc., 508 U.S. 307, 313 (1993). Since the Supreme Court "never require[s] a legislature to articulate its reasons for enacting a statute, it is entirely irrelevant for constitutional purposes whether the conceived reason for the challenged distinction actually motivated the legislature." Id. at 315; see United States Railroad Retirement Bd. v. Fritz, 449 U.S. 166, 179 (1979). "In other words, a legislative choice is not subject to courtroom fact-finding and may be based on rational speculation unsupported by evidence or empirical data." Beach Communications, 508 U.S. at 315.

The limits on rational-basis review "have added force 'where the legislature must necessarily engage in a process of line-drawing.'" Id. (quoting Fritz, 449 U.S. at 179). In those circumstances, "the legislature must be allowed leeway to approach a problem incrementally." Id. at 316. "Evils in the same field may be of different dimensions and proportions, requiring different remedies." Williamson v. Lee Optical of

Oklahoma, Inc., 348 U.S. 483, 489 (1955). Thus, Congress "may take one step at a time, addressing itself to the phase of the problem which seems most acute to the legislative mind" and "may select one phase of one field and apply a remedy there, neglecting the others." Id. "Particularly with respect to social welfare programs, so long as the line drawn by the State is rationally supportable, the courts will not interpose their judgment as to the appropriate stopping point." Geduldig v. Aiello, 417 U.S. 484, 495 (1974). Equal protection "does not require that a State must choose between attacking every aspect of a problem or not attacking the problem at all." Dandridge v. Williams, 397 U.S. 471, 486-87 (1970).[13]

Congress's goal in enacting section 707(b) appears to have been — and, certainly, could rationally have been — to give the courts, and the U.S. Trustees as watchdogs, the power to dismiss one class of chapter 7 cases that were particularly subject to abuse. As the bankruptcy court explained, the statute addresses

> a type of bankruptcy case which is especially liable to abuse and especially deserving of review. That type of case involves an individual debtor who . . . takes advantage of modern easy-credit practices to accumulate debts, for the immediate purpose of satisfying his private appetites and maintaining or enhancing his personal qualities and lifestyle, or those of his dependents — often in circumstances which offer creditors little security, because the benefits acquired by the debts are used up ("consumed") by the debtor himself and assimilated to his person — and who effectively avoids repayment by keeping his unconsumed property and his income from wages or professional

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[13] Contrary to Stewart's suggestion (Br. 40-41), there is only one rational-basis test. See Heller v. Doe, 509 U.S. at 321 (in earlier cases, Court did not "purport to apply a different standard of rational-basis review from that just described").

> earnings to himself and from his creditors, despite even bankruptcy . . . .

App. 872-73; see App. 939. While Congress surely could have provided for dismissal of any bankruptcy petition for substantial abuse, and not just ones filed by debtors with primarily consumer debts, it was not required to do so. Congress could permissibly address the most serious concern without addressing all concerns. See Williamson v. Lee Optical, 348 U.S. at 489.

2. Modeling his argument on In re Keniston, 85 B.R. 202, 205-12 (Bankr. D.N.H. 1988), Stewart contends that section 707(b) violates equal protection. (Br. 36-47) His argument is based almost entirely on a claim of underinclusiveness — that is, he argues that while it may be permissible for Congress to permit dismissal of consumer-debt cases under section 707(b), Congress is constitutionally required to include business debtors. (Br. 42-46) This simply is not the law.

When enacting social or economic legislation that is subject to rational-basis review, Congress may address one part of a problem at a time. It is not required to "choose between attacking every aspect of a problem or not attacking the problem at all." Dandridge v. Williams, 397 U.S. at 487. The only question is whether there is a rational basis for the classification. As we have explained, Congress rationally could have been concerned about the particular abuse of bankruptcy by consumer debtors, and that is all that is necessary to satisfy equal protection here.

3. A few words are necessary here about the Bankruptcy

Appellate Panel's effort to avoid the constitutional question by interpreting section 707(b) as requiring a "totality of the circumstances" analysis. App. 1853. The idea is that if a "totality of the circumstances" analysis is applied, courts use section 707(b) to review consumer-debt cases for dismissal "in much the same manner" that they use section 105(a), regarding abuse of process, and section 707(a), regarding dismissal for cause, to review business-debt cases for dismissal. Id.

We agree that the "totality of the circumstances" analysis is the correct approach to section 707(b), but we do not find the Panel's argument for avoiding the constitutional question persuasive, and we do not think this Court should follow that road. First, the equal-protection question is not a difficult one to resolve, and there is no need to avoid it. See, e.g., Almendarez-Torres v. United States, 118 S. Ct. ____, ____, 1998 WL 126904, at *10 (1998) (courts should not use doctrine of "constitutional doubt" to avoid "a constitutional difficulty that, upon analysis, will evaporate"). Second, even after adopting a "totality of the circumstances" approach to section 707(b), there remain differences between the treatment of consumer debtors under that section and the treatment of all debtors, including business debtors, under sections 105(a) and 707(a), which permit dismissal on specified grounds. Section 707(b), which applies only to debtors with primarily consumer debts, confers a broader authority on the court and the U.S. Trustee than those other provisions, while at the same time expressly creating a presumption that the debtor is entitled to chapter 7 relief.[14]

In short, the constitutional question cannot be avoided, but it is not a difficult question to resolve.

CONCLUSION

For the foregoing reasons, the judgment of the Bankruptcy Appellate Panel should be affirmed.

STATEMENT REGARDING ORAL ARGUMENT

Pursuant to Tenth Circuit Rule 28.2(f), the appellee desires oral argument. The appellant has raised two challenges to the constitutionality of a federal statute, only one of which has been addressed by any court of appeals. Furthermore, this Court has not yet interpreted the provision for dismissal for "substantial abuse" under 11 U.S.C. 707(b), and the matter is of great importance to the United States Trustees Program.

Respectfully submitted,

FRANK W. HUNGER
Assistant Attorney General

WILLIAM KANTER
(202) 514-4575
EDWARD HIMMELFARB
(202) 514-3547
Attorneys, Appellate Staff
Civil Division, Room 9145
Department of Justice
601 "D" Street, N.W.
Washington, D.C. 20530-0001

APRIL 1998

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[14] If section 707(b) conferred the same authority as sections 707(a) and 105(a), it would not have been needed. See In re Walton, 866 F.2d at 983 (such an interpretation "would needlessly duplicate other provisions of the Code"); In re Snow, 185 B.R. 397, 400 (Bankr. D. Mass. 1995).

CERTIFICATE OF SERVICE

I hereby certify that on this 29th day of April, 1998, I served the foregoing Brief for the Appellee by causing two copies to be sent by first-class U.S. mail, postage prepaid to the following counsel:

Richard A. Shallcross, Esq.
Brewster, Shallcross & DeAngelis
2021 S. Lewis Ave., Suite 675
Tulsa, OK 74104

I also certify that I filed the brief by causing an original and seven copies to be sent by first-class U.S. mail, postage prepaid to the Clerk, U.S. Court of Appeals for the Tenth Circuit.

____
EDWARD HIMMELFARB
Attorney for the Appellee

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WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*
In re Douglas W. Weiderhold and Kelly L. Weiderhold (Roberta A. DeAngelis, Acting United States Trustee) and In re Karen D. Stipe (Charles J. DeHart, III, Standing Trustee Chapter 13 Trustee v. Karen D. Stipe)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*
M. D. Pa.

3. ("CCN") ***CURRENT*** CASE NO.
No.: 1:08-cv-00549-wwc consolidated with 1:07-cv-02325-wwc

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*
No.: 1:07-bk-02691 and 1:07-bk-02464
Court: Bankr. Pa.
(Identify judge & cite, if any)

5. ("SO") ***SOURCE***
U.S. TRUSTEES

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Anne Fiorenza, David I. Gold, P. Matthew Sutko, Roberta A. DeAngelis
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***
• Whether 11 U.S.C. § 707(b)(2)(A)(ii)(I) allows debtors to reduce their payments to creditors by claiming an expense for a car loan or car lease payment when the debtor has no such payments. Additionally, at issue is whether section 1325(b)'s additional requirements that expenses be for actual "support or maintenance," and that the courts project real expenses over the life of a chapter 13 plan, independently bar phantom loan expenses even if they are authorized under the chapter 7 means test.

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IN THE UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF PENNSYLVANIA

IN RE:	:	
	:	
DOUGLAS W. WEIDERHOLD and	:	**Case No. 1:08-CV-549**
KELLY L. WEIDERHOLD	:	
Debtors	:	**(Judge Caldwell)**
	:	
ROBERTA A. DeANGELIS	:	
ACTING UNITED STATES TRUSTEE	:	
Appellant	:	
	:	
v.	:	
	:	
DOUGLAS W. WEIDERHOLD and	:	
KELLY L. WEIDERHOLD	:	
Appellees	:	

* * * * * * *

IN RE:	:	
	:	
KAREN D. STIPE	:	**Case No. 1:07-CV-2325**
Debtor	:	
	:	**(Judge Caldwell)**
	:	
CHARLES J. DeHART, III	:	
STANDING CHAPTER 13 TRUSTEE,	:	
Appellant	:	
	:	
v.	:	
	:	
KAREN D. STIPE	:	
Appellee	:	

ON APPEALS FROM THE UNITED STATES BANKRUPTCY COURT
FOR THE MIDDLE DISTRICT OF PENNSYLVANIA

CONSOLIDATED BRIEF OF THE UNITED STATES

RAMONA D. ELLIOTT
General Counsel
P. MATTHEW SUTKO
Associate General Counsel
DAVID I. GOLD
Trial Attorney
Executive Office for United States Trustees
Department of Justice
20 Massachusetts Avenue, N.W.
Washington, D.C. 20530

ROBERTA A. DeANGELIS
Acting United States Trustee

Anne K. Fiorenza
Assistant United States Trustee
228 Walnut Street
P.O. Box 969
Harrisburg, PA 17108-0969
(717) 221-4515
Fax No. (717) 221-4554
E-mail: Anne.Fiorenza@usdoj.gov
License No. PA41818

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INTEREST IN THESE CONSOLIDATED APPEALS

I. The *Weiderhold* Appeal.

The United States Trustee for Region 3, as the appellant in the *Weiderhold* chapter 7 appeal, has a direct interest in its outcome. United States Trustees are Department of Justice Officials appointed by the Attorney General, who supervise the administration of chapter 7 and 13 bankruptcy cases in all federal judicial districts other than those located in Alabama and North Carolina. *See* 28 U.S.C. § 581-589(a). *See also* H.R. Rep. No. 95-595, at 88 (1977) *as reprinted in* 1978 U.S.C.C.A.N. 5963 (United States Trustee's "serve as bankruptcy watch-dogs to prevent fraud, dishonesty, and overreaching in the bankruptcy arena.").

By interpreting 11 U.S.C. § 707(b)(2)(A)(ii)(I), this appeal will determine the expenses above-median-income chapter 7 debtors may claim when completing their bankruptcy means test. This is significant because the means test determines whether an above-median-income chapter 7 debtor's case should be dismissed as abusive. *See* 11 U.S.C. § 707(b)(1) and (2). United States Trustees play a unique role in this process because 11 U.S.C. § 704(b) requires them to review all such cases and, whenever a case is deemed presumptively abusive under the means test, either: (a) seek its dismissal, or (b) file a statement declining to seek dismissal. *See* 11 U.S.C. § 704(b). *See also Schultz v. United States*, 529 F.3d 343, 348 (6th Cir. 2008) (describing the United States Trustees' enforcement of the Chapter 7 means test). Thus, United States Trustees have a direct interest in the proper construction of section 707(b)(2)(A)(ii)(I). Here, the United States Trustee for Region 3 filed a motion to dismiss the Weiderhold's case under 11 U.S.C. § 707(b)(1). The bankruptcy court denied the United States Trustee's motion, and the United States Trustee timely appealed.

II. The *Stipe* Appeal.

The United States, acting as *amicus curiae*, has a direct interest in the outcome of the *Stipe* chapter 13 appeal. In addition to determining what expenses above-median-income chapter 7 debtors may claim under section 707(b)(2)(A)(ii)(I), this consolidated appeal will also determine, by interpreting 11 U.S.C. § 1325(b), the amount above-median-income chapter 13 debtors must pay their creditors under their chapter 13 plans. The United States has an interest in this question because United States Trustees "supervise the administration of [Chapter 13] cases and trustees," monitor Chapter 13 plans, and file comments with the court regarding such plans in connection with plan confirmation hearings under section 1324 of the Bankruptcy Code. 28 U.S.C. § 586(a)(3)(C). Accordingly, the United States shares its views on the application of sections 707(b)(2)(A)(ii)(I) and 1325(b) as *amicus curiae* in the *Stipe* appeal. *See* 28 U.S.C. § 517 (authorizing the Department of Justice "to attend to the interests of the United States in a suit pending in a court of the United States"). *See also* 11 U.S.C. § 307 ("The United States trustee may raise and may appear and be heard on any issue in any case or proceeding.").

JURISDICTIONAL STATEMENT

I. The *Weiderhold* Chapter 7 Appeal.

On February 11, 2008, the United States Bankruptcy Court for the Middle District of Pennsylvania entered a final order denying the United States Trustee's motion to dismiss Douglas W. Weiderhold's and Kelly L. Weiderhold's (the "Weiderholds") chapter 7 bankruptcy case under 11 U.S.C. § 707(b)(1) and (2). (Weiderhold R. at Dkt. 25)[1] The bankruptcy court had jurisdiction

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[1] "Weiderhold R." denotes a citation to the United States Trustee's "Designation of Contents for Inclusion of Record and Statement of Issues on Appeal" filed in Case No. 1:08-CV-549 at Dkt. No. 2.

over that proceeding under 28 U.S.C. §§ 157 and 1334. On February 21, 2008, the United States Trustee timely filed a notice of appeal from that order to this Court under 28 U.S.C. § 158(a) and Fed. R. Bankr. P. 8002(a). This Court has jurisdiction pursuant to 28 U.S.C. § 158(a)(1).

II. The *Stipe* Chapter 13 Appeal.

On November 21, 2007, the United States Bankruptcy Court for the Middle District of Pennsylvania entered a final order overruling chapter 13 trustee Charles J. DeHart, III's, objection to confirmation of Karen Stipe's ("Stipe") chapter 13 plan case under 11 U.S.C. §§ 1324 and 1325. (Stipe R. at Dkt. 17)[2] The bankruptcy court had jurisdiction over that proceeding under 28 U.S.C. §§ 157 and 1334. On November 30, 2007, the chapter 13 trustee timely filed a notice of appeal from that order to this Court under 28 U.S.C. § 158(a) and Fed. R. Bankr. P. 8002(a). This Court has jurisdiction pursuant to 28 U.S.C. § 158(a)(1).

STATEMENT OF THE ISSUES

These appeals involve two different types of bankruptcy, chapter 7 and 13. Because chapter 13 incorporates certain chapter 7 provisions, both appeals involve interpretation of chapter 7 provisions. But, chapter 13 imposes additional statutory obligations on debtors. For that reason, both the *Weiderhold* chapter 7 appeal and the *Stipe* chapter 13 appeal invite the interpretation of 11 U.S.C. § 707(b)(2)(A)(ii)(I), but the *Stipe* appeal also invites the interpretation of three subsections of 11 U.S.C. § 1325(b).

At issue in both of these consolidated appeals is whether section 707(b)(2)(A)(ii)(I) allows debtors to reduce their payments to creditors by claiming an expense for a car loan or car lease payment when the debtor has no such payment.

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[2] "Stipe R." denotes a citation to the United States Trustee's "Designation of Items to be Included in the Record on Appeal" filed in Case No. 1:07-CV-2325 at Dkt. No. 2.

Additionally, at issue in the *Stipe* chapter 13 appeal is whether section 1325(b)'s additional requirements that expenses be for actual "support or maintenance," and that courts project real expenses over the life of a chapter 13 plan, independently bar phantom loan expenses even if they are authorized under the chapter 7 means test.

STATEMENT OF THE CASE

On August 29, 2007, the Weiderholds sought chapter 7 bankruptcy relief in the United States Bankruptcy Court for the Middle District of Pennsylvania. *See* 11 U.S.C. § 701 et seq. On November 14, 2007, the United States Trustee filed a motion to dismiss the Weiderhold's case for abuse under 11 U.S.C. § 707(b)(1) because a presumption of abuse arose as a matter of law under 11 U.S.C. § 707(b)(2)'s means test. On February 11, 2008, the bankruptcy court entered an order denying the United States Trustee's motion. The *Weiderhold* appeal followed.

On August 10, 2007, Ms. Stipe sought chapter 13 bankruptcy relief in the United States Bankruptcy Court for the Middle District of Pennsylvania. *See* 11 U.S.C. § 1301 et seq. That same day, Ms. Stipe filed her proposed chapter 13 repayment plan with the bankruptcy court. On October 19, 2007, Ms. Stipe's chapter 13 trustee, Charles J. DeHart, III, objected to Ms. Stipe's plan because it violated 11 U.S.C. § 1325. On November 21, 2007, the bankruptcy court entered an order overruling the chapter 13 trustee's objection. The *Stipe* appeal followed.

On May 12, 2009, the United States Trustee filed her motion with this Court seeking to consolidate the *Weiderhold* and *Stipe* appeals. That same day, this Court entered an order granting the motion to consolidate. These consolidated appeals are now ripe for decision.

STATEMENT OF THE FACTS

I. Statutory Background.

On April 20, 2005, Congress enacted the Bankruptcy Abuse Prevention and Consumer

Protection Act of 2005. *See* Pub. L. No. 109-8, 119 Stat. 23 (2005). The 2005 Act significantly altered how debtors obtain relief under chapters 7 and 13 of the Bankruptcy Code.

A. The 2005 Chapter 7 Amendments.

1. Prior to the enactment of the 2005 Act, there was a presumption in favor of granting the relief requested by a debtor. *See* 11 U.S.C. § 707(b) (2004). This presumption could be overcome only if a court found that the "granting of relief would be a *substantial* abuse" of chapter 7. *Id* (emphasis added). "[The 2005 Act] produced a sea change." *Egebjerg v. United States Trustee (In re Egebjerg)*, – F.3d –, 2009 WL 1492138, at *2 (9th Cir. May 29, 2009). Now, "section 707(b)(2) provides a means test by which bankruptcy courts determine whether a case is presumed to be an abuse of chapter 7. If the case is presumed abusive, it will be dismissed unless the debtor shows 'special circumstances' rebutting the presumption. If the presumption does not arise, the bankruptcy court may still find abuse under § 707(b)(3) based on the totality of the circumstances." *Blausey v. United States Trustee (In re Blausey)*, 552 F.3d 1124, 1127 n.1 (2009) (internal citation omitted). *See also Ross-Tousey v. Neary*, 549 F.3d 1148, 1161-62 (7th Cir. 2008) (discussing use of section 707(b)(3)'s totality of the circumstances analysis where presumption of abuse does not apply under section 707(b)(2)'s means test).

2. The means test lies at the "heart" of the 2005 Act's consumer bankruptcy reforms and acts "to ensure that debtors repay creditors the maximum they can afford." H.R. Rep. 109-31 at 1 (I) (2005), *as reprinted in* 2005 U.S.C.C.A.N. 88, 89. Under prior law, "some bankruptcy debtors [were] able to repay a significant portion of their debts," but were not doing so because the law contained "no clear mandate requiring these debtors to repay their debts." *Id.* at 5 and n.18, 2005 U.S.C.C.A.N. at 92. Congress enacted the means test to ensure that debtors repay creditors the maximum they can afford. *Id.* at 1, 2005 U.S.C.C.A.N. at 89.

3. Under the means test, debtors first determine their average income for the six calendar months preceding the month of their bankruptcy filing. *See* 11 U.S.C. § 101(10A). If this averaged amount, multiplied by twelve, is below the median income for the debtor's state and household size, the debtor's case cannot be dismissed under the means test. *See* 11 U.S.C. § 707(b)(7). However, if this averaged amount exceeds the median income for the debtor's state and household size – as in the Weiderhold's case – section 707(b)(2)(A) prescribes a statutorily mandated calculation that yields an amount a debtor is presumed to be able to repay his creditors. This presumptive amount, commonly referred to as a debtor's monthly disposable income, is obtained by reducing a debtor's historic averaged income by certain enumerated categories of expenses. *See* 11 U.S.C. § 707(b)(2)(A)(ii), (iii) and (iv). After subtracting permitted expenses, an above-median-income debtor's case is presumed abusive as a matter of law when his historic averaged income reduced by prescribed expense amounts yields a net income that exceeds $182.50 per month. *See* 11 U.S.C. § 707(b)(2)(A)(i).

4. These consolidated appeals pose a question about a debtor's expense-side calculation under the means test. Section 707(b)(2)(A)(ii) of the Bankruptcy Code permits all above-median-income debtors in chapters 7 and 13 to deduct, among other things:

(a) certain prescribed "actual" expenses; and

(b) other "applicable" expense amounts.

See 11 U.S.C. § 707(b)(2)(A)(ii)(I). "Applicable" expense amounts are not the debtor's actual expenses. Instead, they are the static amounts listed in the Internal Revenue Service's Local and National Standards. *See* 11 U.S.C. § 707(b)(2)(A)(ii)(I).

The IRS's Local Standards include expenses for transportation. *See* Addendum "A" to this consolidated brief.[3] Transportation expenses are authorized in two standardized amounts. *Id.* They are: (1) monthly expenses for costs associated with operating vehicles; and (2) monthly expenses for costs associated with purchasing or leasing vehicles. *Id.* All debtors, including the Weiderholds and Ms. Stipe, receive monthly transportation expenses based on either public transportation costs or the costs associated with operating a vehicle. *See* Addendum "B" to this consolidated brief.[4] The standard operating expense includes amounts for vehicle maintenance, fuel, state and local registration, required inspection, parking fees, tolls, and driver's license fees. *Id.* Ownership expenses, when applicable, include allowances based on the average cost of financing a vehicle. *Id.* Both operating and ownership expenses are limited to no more than two vehicles. *Id.*

B. The 2005 Chapter 13 Amendments.

In section 1325(b) of the Bankruptcy Code – which addresses confirmation of a chapter 13 debtor's repayment plan – Congress implemented the means test by incorporating sections 101(10A) and 707(b)(2)(A)(ii), (iii), and (iv) of the Bankruptcy Code into what is commonly known as the "projected disposable income test." *See* 11 U.S.C. § 1325(b)(2) and (3). In a chapter 13 case, a debtor's unsecured creditors or trustee may insist the debtor devote all of his projected disposable income to pay creditors. *See* 11 U.S.C. § 1325(b)(1). Although "projected disposable income" is not defined, "disposable income" is defined as a net number: historic averaged income less prescribed expenses. *See* 11 U.S.C. § 1325(b)(2). Under the 2005 Act, above-median-income

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[3] Addendum "A," which the United States hereby incorporates by reference, represents a true and correct copy of the Local Standards for transportation applicable to this case.

[4] Addendum "B," which the United States hereby incorporates by reference, represents a true and correct copy of the IRS Collection Financial Standards applicable to this case.

debtors, like Ms. Stipe, determine disposable income by first calculating their historic averaged income. *See* 11 U.S.C. § 1325(b)(2) (dictating that "current monthly income"[5] be used as part of disposable income calculation). Next, they deduct permitted expenses, which include "amounts reasonably necessary to be expended." *See* 11 U.S.C. § 1325(b)(2). Above-median-income chapter 13 debtors determine "amounts reasonably necessary to be expended . . . in accordance with" sections 707(b)(2)(A)(ii), (iii), and (iv) of the Bankruptcy Code. 11 U.S.C. § 1325(b)(3) (incorporating those provisions).

However, these expenses are limited to only those amounts "reasonably necessary to be expended" for "maintenance or support," domestic support obligations, charity, or business purposes. 11 U.S.C. § 1325(b)(2). Deducting all allowed expenses from a debtor's current monthly income yields a net number – projected disposable income.

II. The Facts and Proceedings Below.

A. Weiderhold.

On August 29, 2007, the Weiderholds filed a joint voluntary petition for relief under the liquidation provisions of chapter 7 of the Bankruptcy Code. (Weiderhold R. at Dkt. No. 1) The Weiderholds own three vehicles – a Chevy Cavalier, a Buick LeSabre, and a Jeep Wrangler. (Weiderhold R. at Dkt. No. 11) They own these vehicles free and clear of liens, which means the Weiderholds have no monthly payments on them. (Weiderhold R. at Dkt. No. 11)

The Weiderhold's have $6,508.38 in average monthly income, or $78,100.56 per year. (Weiderhold R. at Dkt. No. 11) The Weiderhold's income is substantially greater than the

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[5] The term "current monthly income" is a defined term. *See* 11 U.S.C. § 101(10A) (defining "current monthly income" as the debtor's average monthly income for the six-month period preceding the month of the filing of the debtor's petition).

$48,612.00 annual median income for the Weiderhold's household size in Pennsylvania. (Weiderhold R. at Dkt. No. 11)

Because, the Weiderhold's income was well above the Pennsylvania median, they are subject to chapter 7's means test. *See* 11 U.S.C. § 707(b)(2) and (7). That required them to determine whether their case had to be dismissed or converted because they can pay creditors at least $182.50 per month. (Weiderhold R. at Dkt. No. 11)

The Weiderholds claimed monthly expense of $6,865.82. (Weiderhold R. at Dkt. No. 11) In making this calculation, the Weiderholds claimed the IRS Local Standard transportation ownership expense for two vehicles in the amounts of $471.00 and $332.00, respectively.[6] (Weiderhold R. at Dkt. No. 11) This resulted in claimed monthly disposable income on their means test form in the amount of negative $357.44 which was below the $182.50 required for the presumption of abuse to arise. (Weiderhold R. at Dkt. No. 11)

On November 14, 2007, the United States Trustee, pursuant to section 704(b)(2) of the Bankruptcy Code, filed his section 707(b)(2) motion to dismiss the Weiderhold's case for abuse. (Weiderhold R. at Dkt. No. 18) The motion claimed the Weiderholds miscalculated their claimed expenses on the means test. (Weiderhold R. at Dkt. No. 18) The United States Trustee also alleged that the Weiderholds failed the means test when their expenses were calculated correctly, and that their case therefore constituted an abuse of the provisions of chapter 7 of the Bankruptcy Code. (Weiderhold R. at Dkt. No. 18)

The crux of the dispute concerned the Weiderhold's attempt to claim expenses for vehicles

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[6] In addition, the Weiderholds claimed a $393.00 deduction for the IRS Local Standard "transportation, vehicle operation/public transportation expense" for two or more vehicles. (Weiderhold R. at Dkt. No. 11)

for which they had no loan or lease payments. (Weiderhold R. at Dkt. No. 18) The United States Trustee argued section 707(b)(2)(A)(ii)(I) did not allow them to claim vehicle payments as expenses because they had no vehicle payments. (Weiderhold R. at Dkt. No. 18) The Weiderhold's claimed they could.

Under the United States Trustee's interpretation, the Weiderhold's failed the means test and their case needed to be dismissed. (Weiderhold R. at Dkt. No. 18) Under the Weiderhold's interpretation, they were eligible for bankruptcy relief.

On February 11, 2008, the bankruptcy court denied the United States Trustee's motion to dismiss the Weiderhold's case pursuant to 11 U.S.C. § 707(b)(1). (Weiderhold R. at Dkt. No. 25)

On February 21, 2008, the United States Trustee timely filed a notice of appeal to this Court under 28 U.S.C. § 158(a) and Fed. R. Bankr. P. 8002(a).

B. Stipe.

On August 10, 2007, Ms. Stipe filed a voluntary petition for relief under the reorganization provisions of chapter 13 of the Bankruptcy Code. (Stipe R. at Dkt. No. 1) That same day, Ms. Stipe filed her bankruptcy Schedules A through J, means test form, and proposed chapter 13 repayment plan. (Stipe R. at Dkt. No. 1, 3) Ms. Stipe's Schedules I and J reflect that her current net monthly income totals $535.68. (Stipe R. at Dkt. No. 1) Ms. Stipe's Schedule A reflects that she owns a Mercury Grand Marquis. (Stipe R. at Dkt. No. 1) This vehicle is owned free and clear of liens, which means that Ms. Stipe has no monthly payments on it.[7] (Stipe R. at Dkt. No. 1)

Ms. Stipe's income is greater than the $41,706.00 annual median income for Ms. Stipe's

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[7] For unknown reasons, Ms. Stipes Schedule J reflects a $200 auto installment payment. (Stipe R. at Dkt. No. 1) This cannot be accurate given the lack of any secured debts or leases listed on her Schedules D and G. (Stipe R. at Dkt. No. 1) Thus, Ms. Stipe's current net monthly income should total $735.68.

household size in Pennsylvania. (Stipe R. at Dkt. No. 1) Because, Ms. Stipe's income was above the Pennsylvania median, section 1325(b)(3) of the Bankruptcy Code required her to complete her means test form in full to determine her "projected disposable income" as a matter of law. (Stipe R. at Dkt. No. 1)

Ms. Stipe listed monthly expense deductions of $3,6214.13 on her means test form. (Stipe R. at Dkt. No. 1) In making these calculations, Ms. Stipe claimed a monthly ownership expense for one vehicle in the amount of $471.00.[8] (Stipe R. at Dkt. No. 1) This resulted in claimed monthly projected disposable income on her means test form in the amount of $179.69. (Stipe R. at Dkt. No. 1)

Based on that number, and notwithstanding that her Schedules I and J reflect a monthly net surplus after expenses of $535.68, Ms. Stipe's chapter 13 repayment plan proposed to pay her chapter 13 trustee only $180 per month over 60 months for a total of $10,800. (Stipe R. at Dkt. No. 3) From that amount, Ms. Stipe's chapter 13 trustee will distribute $3,574 to her bankruptcy attorney, leaving approximately $6,794[9] for distribution to Ms. Stipe's general unsecured creditors.[10] (Stipe R. at Dkt. No. 3)

On October 19, 2007, Ms. Stipe's chapter 13 trustee, pursuant to sections 1324(a) of the Bankruptcy Code, filed his objection to confirmation of Ms. Stipe's proposed repayment plan.

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[8] In addition, Ms. Stipe claimed a $311.00 monthly operating expense for her vehicle. (Stipe R. at Dkt. No. 1)

[9] This number accounts for the costs of administering Ms. Stipe's bankruptcy estate, which equals 4% of the $10,800 to be distributed under Ms. Stipe plan, or $432. *See* http://www.usdoj.gov/ust/eo/bapcpa/20070201/bci_data/ch13_exp_mult.htm#PA.

[10] Ms. Stipes Schedule F reflects $83,708 in general unsecured debts. (Stipe R. at Dkt. No. 1) Thus, based on the record before this Court, it appears that the dividend to unsecured creditors in Ms. Stipe's case should total approximately eight cents on the dollar (*i.e.,* $6,794 / $83,708).

(Stipe R. at Dkt. No. 15) The trustee alleged that Ms. Stipe's proposed repayment plan failed to commit all of her projected disposable income to her plan as required under section 1325(b)(1) of the Bankruptcy Code. (Stipe R. at Dkt. No. 15) And, the trustee alleged that Ms. Stipe's deduction of a vehicle ownership expense on her Form 22 was improper because absent that deduction she was able to fund a repayment plan in a substantially higher amount than the $180 per month proposed. (Stipe R. at Dkt. No. 15)

On November 21, 2007, the bankruptcy court overruled the trustee's objection to Ms. Stipe's chapter 13 plan. (Stipe R. at Dkt. No. 17)

On November 30, 2007, the trustee timely filed a notice of appeal to this Court under 28 U.S.C. § 158(a) and Fed. R. Bankr. P. 8002(a).

STANDARD OF REVIEW

These consolidated appeals involve questions of law, which this Court reviews *de novo*. *See In re O'Brien Envtl. Energy, Inc.*, 188 F.3d 116, 122 (3d Cir. 1999).

SUMMARY OF ARGUMENT

I. Section 707(b)(2)(A)(ii)(I).

Neither basic notions of fairness nor the text of the Bankruptcy Code allow the Weiderholds and Ms. Stipe to reduce the amount they have to pay creditors by claiming expenses they do not have. They do that based upon an argument that section 707(b)(2)(A)(ii)(I) of the Bankruptcy Code allows them to claim $803 and $471 respectively in monthly vehicle loan or lease expenses even though they have no loan or lease payments on their vehicles.

Under the better reading of the Bankruptcy Code, neither the Weiderholds or Ms. Stipe can claim phantom vehicle ownership expenses because section 707(b)(2)(A)(ii)(I) only allows a debtor to claim such expenses when they are "applicable" to the debtors' vehicles. Here, they are not. Under the ordinary dictionary definition of "applicable" a debtor must have a loan or lease payment to claim a loan or lease expense. Because these debtors do not, they cannot claim such expenses on their means test form.

II. Section 1325(b).

The *Stipe* ruling fails to properly apply section 1325 of the Bankruptcy Code for two independent reasons. This Court can reverse the lower court's order in *Stipe* on either ground.

First, under section 1325(b)(1) of the Bankruptcy Code, a bankruptcy court may not confirm a chapter 13 plan over the chapter 13 trustee's objection unless "the plan provides that all of the debtor's *projected* disposable income *to be received* in the applicable commitment period . . . *will be applied to make payments* to unsecured creditors under the plan." 11 U.S.C. § 1325(b)(1) (emphasis added). Each of these phrases anticipates future action during the life of a debtor's chapter 13 plan. Therefore, each precludes a debtor, like Ms. Stipe, from deducting a vehicle ownership expense she will not have over the life of her chapter 13 plan.

Second, under section 1325(b)(2) of the Bankruptcy Code, the types of expenses a debtor may deduct in calculating projected disposable income are limited to those "reasonably necessary to be expended" for: (a) the maintenance or support of the debtor or a dependent of the debtor; (b) domestic support obligations; (c) charitable contributions; and (d) the continuation, preservation, and operation of a business. *See* 11 U.S.C. § 1325(b)(2)(A) and (B). Phantom vehicle expense deductions, such as those allowed by the bankruptcy court in Ms. Stipe's case, do not qualify.

III. Other Bases for Reversal.

The rulings below should also be reversed because they are unfair and fail to fulfill congressional goals related to the 2005 Act. Congress passed the 2005 Act to maximize debtor repayment to creditors and to eliminate opportunities for bankruptcy abuse. Allowing above-median-income debtors, like the Weiderholds and Ms. Stipe, from claiming inapplicable ownership expense amounts impairs these goals. Moreover, such a result is unfair because: (a) it allows above-median-income debtors to claim expenses they do not have; and (b) provides creditors with smaller payments on their debts notwithstanding a debtors financial ability to repay.

ARGUMENT

I. A Vehicle Ownership Expense is "Applicable" Under Section 707(b)(2)(A)(ii)(I) of the Bankruptcy Code Only When Debtors Make Corresponding Loan or Lease Payments on their Vehicles.

A. Section 707(b)(2)(A)(ii)(I) does not let debtors claim loan or lease expenses that are not "applicable" to them because they make no loan or lease payments.

1. The Bankruptcy Code permits above-median-income debtors, like the debtors here, to claim a vehicle ownership expense amount in a set amount when that expense is "applicable." *See* 11 U.S.C. § 707(b)(2)(A)(ii)(I). Section 707(b)(2)(A)(ii)(I) provides that a debtor's "monthly expenses shall be the debtor's *applicable* monthly expense amounts specified under the . . . Local Standards . . . issued by the Internal Revenue Service. . . ." 11 U.S.C. § 707(b)(2)(A)(ii)(I) (emphasis added).

The Bankruptcy Code does not define the term "applicable." The word should therefore be given its ordinary meaning. *Smith v. United States*, 508 U.S. 223, 228 (1993) ("When a word is not defined by statute, we normally construe it in accord with its ordinary or natural meaning."); *Galloway v. United States*, 492 F.3d 219, 223 (3d Cir. 2007) ("in interpreting statutes, the literal meaning of the statute is most important, and we are always to read the statute in its 'ordinary and natural sense.'").

The dictionary defines "applicable" to mean "capable of being applied: having relevance . . . fit, suitable, or right to be applied: APPROPRIATE." *Webster's Third New Int'l Dict.*, at 105

(1981) (emphasis in original). Such a meaning should therefore be imparted to the term "applicable" used in Section 707(b)(2)(A)(ii)(I). *See Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A.*, 530 U.S. 1, 6 (2000) ("when the statute's language is plain, the sole function of the courts-at least where the disposition required by the text is not absurd-is to enforce it according to its terms.") (internal quotations omitted); *Bailey v. United States*, 516 U.S. 137, 144-45 (1995) (turning to dictionary definition of a term to define its statutory meaning).

The lower courts' interpretation of section 707(b)(2)(A)(ii)(I) is inconsistent with applicable's dictionary meaning because it allows debtors to claim a monthly vehicle ownership expense amount when they do not have associated monthly loan or lease expenses. As articulated by the Ninth Circuit bankruptcy appellate panel in *Ransom*, "[g]iven the ordinary sense of the term 'applicable,' how is the vehicle ownership expense allowance *capable of being applied* to [a] debtor if he does not make any lease or loan payments on the vehicle?" *Ransom v. MBNA America Bank, N.A. (In re Ransom)*, 380 B.R. 799, 807-08 (B.A.P. 9th Cir. 2007), *appeal pending* Case No. 08-15066 (9th Cir. Jan. 4, 2008) (emphasis in original). The answer is, it is not. If a debtor, like those before this Court, does not have a loan or lease payment on their vehicle, then there is no expense capable of being applied. For this reason alone, the lower courts' orders should be reversed.

2. If there was ever any doubt regarding what Congress intended the term "applicable" to mean under Section 707(b)(2)(A)(ii)(I), it would be answered in the next subsection of the Bankruptcy Code: subsection 707(b)(2)(A)(ii)(II). That subsection states, in relevant part, that a "debtor's monthly expenses may include, *if applicable*, the continuation of *actual* expenses paid by the debtor . . . for care and support of an elderly, chronically ill, or disabled household member or member of the debtor's immediate family. . . ." 11 U.S.C. § 707(b)(2)(A)(ii)(II) (emphasis added).

Thus, Congress used the term "applicable" under Section 707(b)(2)(A)(ii)(II) to only allow those expenses that literally apply to that particular debtor.

Because it is a basic rule of statutory construction that "'identical words used in different parts of the same act are intended to have the same meaning[,]'" *Commissioner of Internal Revenue v. Lundy*, 516 U.S. 235, 250 (1996) (citations omitted), the same meaning of the term "applicable" in Section 707(b)(2)(A)(ii)(II) should be given to the term "applicable" in Section 707(b)(2)(A)(ii)(I).

B. The lower courts' reading of Section 707(b)(2)(A)(ii)(I) renders the word "applicable" superfluous.

The interpretation of section 707(b)(2)(A)(ii)(I) offered by the lower courts suggests that the term "applicable" modifies the phrase "amounts specified under the . . . Local Standards" not the debtor's "monthly expense." *See, e.g., In re Weiderhold*, 381 B.R. 626, 630 (Bankr. M.D. Pa. 2008). However, the lower courts' reading cannot be right because even if the word "applicable" were stricken from section 707(b)(2)(A)(ii)(I), the remaining words in section 707(b)(2)(A)(ii)(I) still lead debtors to the same line under the IRS Local Standards as follows:

> a "debtor's monthly expenses shall be the debtor's **~~applicable~~** monthly expense amounts specified under the . . . Local Standards . . . issued by the Internal Revenue Service. . . ."

See Ransom, 380 B.R. at 808 (concluding that such a construction would "read 'applicable' right out of the Bankruptcy Code."). Accordingly, the lower courts' reading makes the word "applicable" superfluous.

Congress deliberately chose to include the term "applicable" in section 707(b)(2)(A)(ii)(I). Because "courts should strive to give operative meaning to every word in a statute," *see Cooper*

Indus., Inc. v. Aviall Servs., Inc., 543 U.S. 157, 167 (2004), *Rosenberg v. XM Ventures*, 274 F.3d 137, 141 (3d Cir. 2001), the word "applicable" must be read as adding something to the statute. *See United States Trustee v. Deadmond (In re Deadmond)*, Case No. 07-15-H-CCL, 2008 WL 191165, at *4 (D. Mont. Jan. 22, 2008) ("The word ['applicable'] must mean something, and if some monthly expenses are applicable, then other monthly expenses are not applicable."). The United States' construction does that. The lower courts' construction does not.

Moreover, contrary to the lower courts' belief, *see Weiderhold*, 381 B.R. at 630, the United States' construction of section 707(b)(2)(A)(ii)(I) does not equate "applicable" with "actual." Rather, its construction gives the words "applicable" and "actual" entirely *different* meanings. Vehicle expense amounts under section 707(b)(2)(A)(ii)(I) are not the debtor's "actual," or literal, vehicle ownership expenses. Rather, they are static, fixed amounts, drawn from the IRS Standards, used *regardless* of the debtor's "actual" expenses. *See Fokkena v. Hartwick (In re Hartwick)*, 373 B.R. 645, 650 (D. Minn. 2007) (recognizing that a debtor's "actual" expense does not control the amount of the vehicle ownership deduction under section 707(b)(2)(A)(ii)(I)). Debtors receive $471.00 for the first vehicle that has an associated loan or lease payment, and $332.00 for the second. These are the opposite of "actual" expenses.[11] *See Wieland v. Thomas (In re Thomas)*, 382 B.R. 793, 798 (D. Kan. 2008) (finding that "the juxtaposition of 'applicable . . . amounts' and 'actual . . . expenses' in the statute is not inconsistent with the Court's interpretation" that vehicle ownership expense amounts are only applicable if a debtor is making loan or lease payments on a

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[11] Even if the terms "applicable" and "actual" meant the same thing in section 707(b)(2)(A)(ii)(I), the Supreme Court has recognized that there is nothing wrong with two different words within a single section of a statute being synonymous. *See Wachovia Bank v, Schmidt*, 546 U.S. 303, 314 (2006) ("Congress may well have comprehended the words 'located' and 'established,' as used in [28 U.S.C.] § 1348, not as contrasting, but as synonymous or alternative terms.").

vehicle); *Meade v. McVay (In re Meade)*, 384 B.R. 132, 136 (W.D. Tex. 2008) (explaining how the terms "applicable" and "actual" have different meanings under 707(b)(2)(A)(ii)(I)).

C. The lower courts' interpretation of Section 707(b)(2)(A)(ii)(I) yields inequitable results not contemplated by Congress.

According to its legislative history, the 2005 Act seeks to "ensure that debtors repay creditors the maximum they can afford." H.R. Rep. No. 109-31 (I), at 1, 2005 U.S.C.C.A.N. at 89.[12] A contrary interpretation of section 707(b)(2)(A)(ii)(I) would frustrate the 2005 Act's goal of proper repayment by allowing above-median-income debtors to claim phantom expenses that do not apply to them. Under the lower courts' reading of section 707(b)(2)(A)(ii)(I), a higher-income debtor with an inoperable car could claim the ownership expense amount simply because the car is an automobile and he owns it. This statutory reading has been rejected because it "defies common sense." *Deadmond*, 2008 WL 191165, at *4.

D. Although there is a divergence of opinion on this issue, those courts allowing debtors a vehicle ownership expense under Section 707(b)(2)(A)(ii)(I) do not articulate a valid basis for doing so.

Among those appellate courts to have considered the vehicle ownership expense within the context of section 707(b)(2)(A)(ii)(I), there is a split with respect to whether the expense should be allowed.[13]

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[12] There is no Senate Report or Conference Report to the 2005 Act.

[13] Indeed, there is even a divergence of opinion on this issue among the bankruptcy judges in this district depending on the bankruptcy chapter involved. For example, in the chapter 7 context, Judge Opel has held that debtors may take the vehicle ownership allowance without a concomitant ownership expense, while Chief Judge Thomas has held the opposite. *Compare In re Weiderhold*, 381 B.R. at 626, *with In re Talmadge*, 371 B.R. 96 (Bankr. M.D.Pa. 2007). Similarly, in the chapter 13 context, Judge France has held that debtors may take the vehicle ownership allowance without a concomitant ownership expense, while Judge Opel has held the opposite. *Compare In re Vaughn*, Case No. 06-00788 (entered June 8, 2007) (unpublished decision), *with In re Ponce*, Case No. 08-

(continued...)

Some courts have found that the expense should not be allowed. *See Babin v. Wilson (In re Wilson)*, 383 B.R. 729 (B.A.P. 8th Cir. 2008); *Grossman v. Sawdy (In re Sawdy)*, 384 B.R. 199 (E.D. Wis. 2008), *overruled sub nom. Ross-Tousey v. Neary*, 549 F.3d at 1148; *Thomas*, 382 B.R. at 793; *Meade*, 384 B.R. at 132; *Deadmond*, 2008 WL 191165; *Ransom*, 380 B.R. at 799, *appeal pending* Case No. 08-15066 (9th Cir. Jan. 4, 2008); *Fokkena v. Hartwick*, 373 B.R. at 645.

Other courts, including the United States Courts of Appeal for the Fifth and Seventh Circuits, have found that the expense should be allowed. *See Ross-Tousey*, 549 F.3d at 1148; *Tate v. Bolen (In re Tate)*, – F.3d –, 2009 WL 1608890 (5th Cir. Jun. 10, 2009); *Hildebrand v. Kimbro (In re Kimbro)*, 389 B.R. 518 (B.A.P. 6th Cir. 2008)*, appeal pending* Case No. 08-5871 (6th Cir. Aug. 24, 2008); *Clippard v. Ragle (In re Ragle)*, 395 B.R. 387 (E.D. Ky. 2008); *Brunner v. Armstrong (In re Armstrong)*, 395 B.R. 127 (E.D. Wash. 2008); *Musselman v. eCast Settlement Corp.*, 394 B.R. 801 (E.D.N.C. 2008).

Because the United States believes the decisions in *Ross-Tousey*, *Tate, Kimbro*, and the cases that follow them fail to articulate a valid basis for allowing the vehicle ownership expense under section 707(b)(2)(A)(ii)(I), it urges this Court to follow the line of decisions denying the expense.

Ross-Tousey primarily relied on interpretive conclusions reached by a divided Sixth Circuit bankruptcy appellate panel in *Kimbro*, whose decision was entered *after* briefing was completed in *Ross-Tousey*. *See Ross-Tousey*, 549 F.3d at 1155-60 (*citing* and *quoting* extensively from *Kimbro*, 389 B.R. at 518). *Tate* relied almost exclusively on the factual and legal reasoning used in *Ross-Tousey* and *Kimbro*. *See Tate*, –F.3d –, 2009 WL at 1608890 (*citing* and *quoting* extensively from

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[13](...continued)
04048 (entered June 22, 2009) (unpublished decision).

Ross-Tousey, 549 F.3d at 1148, and *Kimbro*, 389 B.R. at 518). Accordingly, the government's concerns regarding *Kimbro*, each of which are discussed below*,* are equally applicable to *Ross-Tousey*, *Tate*, and the cases that follow them.

First, while the panels in *Ross-Tousey* and *Tate*, like the majority in *Kimbro*, concluded that the government's construction of section 707(b)(2)(A)(ii)(I) improperly gives the same meaning to the words "applicable" and "actual" in section 707(b)(2)(A)(ii)(I), the government's reading actually gives them different ones. *Compare Kimbro*, 389 B.R. at 523-24 *with* United States' Brief, *supra.* at 17. Indeed, this juxtaposition of terms was explained by the dissent in *Kimbro* when it stated that "Congress intended and used the phrases 'applicable monthly expense amounts' . . . and 'actual expenses' . . . simply in recognition of the differing ways in which the IRS uses the National Standards and Local Standards versus the Other Necessary Expense Categories." *Kimbro*, 389 B.R. at 533 (Fulton, J., dissenting).

Second, while the panels in *Ross-Tousey* and *Tate*, like the majority in *Kimbro*, erroneously concluded that the vehicle ownership amount was necessary to cover operating costs, a separate IRS expense standard governs those types of vehicle expenses. *Compare Kimbro*, 389 B.R. at 531 (referencing "depreciation, insurance, licensing fees and taxes") *with* United States' Brief, *supra.* at 6-7 (discussing vehicle ownership and *operating* expenses).

Third, while the panels in *Ross-Tousey* and *Tate*, like the majority in *Kimbro*, ruled that the phrase "monthly expenses of the debtor shall not include any payments for debts" justifies an ownership expense allowance, *see, e.g., Kimbro*, 389 B.R. at 523, it does not. Rather, debtors for whom the ownership expense is applicable receive a fixed standard allowance, not the dollar amount associated with a "payment for a debt." *See* United States' Brief, *supra.* at n.17.

Fourth, the panels in *Ross-Tousey* and *Tate*, like the majority in *Kimbro*, relied upon the legislative history of a statute never enacted in order to support their conclusions. *See, e.g., Kimbro*, 389 B.R. at 525-27. Such an approach has been rejected by the Supreme Court and at least three circuit courts of appeal presumably because it opens the door to the potential subversion of statutory language actually voted on by Congress and signed into law by the President. *See, e.g., Mead Corp. v. Tilley*, 490 U.S. 714, 723 (1989) ("We do not attach decisive significance to the unexplained disappearance of one word from an unenacted bill because 'mute intermediate legislative maneuvers' are not reliable indicators of congressional intent."); *Interstate Natural Gas Co. v. Federal Power Comm.*, 156 F.2d 949, 952 (5th Cir. 1946) ("the legislative history of a bill that was not adopted cannot be resorted to construe a bill that was."), *aff'd.* 331 U.S. 682 (1947); *United States v. Lincoln Rochester Trust Co.*, 297 F.2d 891, 893 (2d Cir. 1962) (finding that portion of House report referring to language not included in Technical Amendments Act of 1958, as finally adopted, may not be relied on in interpreting Act), *cert. denied*, 369 U.S. 887 (1962); *Com. of Puerto Rico v. Blumenthal*, 642 F.2d 622, 635 n.23 (D.C. Cir. 1980) ("[Appellant's] argument that we should not consider the legislative history of a bill that was never enacted represents a correct statement of the law.").

Fifth, the panels in *Ross-Tousey* and *Tate*, like the majority in *Kimbro*, erroneously declined to apply the dictionary meaning of the word "applicable." *See, e.g., Kimbro*, 389 B.R. at 522-23. Had they done so, it would have had to question how the vehicle ownership expense allowance is "capable of being applied" to a debtor if the debtor does not make any lease or loan payments. *See, e.g., Ransom*, 380 B.R. at 807-808. Accordingly, because the panels in *Ross-Tousey* and *Tate*, like the majority in *Kimbro*, failed to take this fundamental step as part of their statutory analysis, their construction of section 707(b)(2)(A)(ii)(I) is suspect and should not be followed by this Court.

II. As a Separate, Independent, and Alternative Basis for Reversal in the *Stipe* Case, this Court Should Reverse Because Section 1325(b)(1) of the Bankruptcy Code is Forward-Looking and Excludes Phantom Expenses.

A. *Frederickson*, the only circuit court decision to interpret the expense side of Section 1325(b)(1), as this Court is tasked with doing in the *Stipe* case, has concluded that Section 1325(b)(1) is forward-looking.

On October 27, 2008, the United States Court of Appeals for the Eighth Circuit decided *Coop v. Frederickson*. *Coop v. Frederickson (In re Frederickson*), 545 F.3d 652, 659-60 (8th Cir. 2008), *pet. for cert. denied* No. 08-950 (Mar. 23, 2009). *Frederickson* is the only circuit court decision to interpret section 1325(b)(1) with respect to both claimed income *and* expenses.[14] In doing so, *Frederickson* articulated a forward-looking approach to section 1325(b)(1). *See Frederickson*, 545 F.3d at 659.

Under this approach, a court looks to whether a debtor has, and will continue have, certain expenses going forward when determining projected disposable income under section 1325(b)(1). *Id.* If a debtor does not have a current expense, or will not have the expense in the future, *Frederickson* dictates that such information should be considered as part of the projected disposable income calculation. *Id.* The lower court's ruling in *Stipe* conflicts with this forward-looking approach because it refused to consider, as part of the projected disposable income calculation in Ms. Stipe's case, that Ms. Stipe does not, and will not, make payments on her vehicle. (Stipe R. at 1) Accordingly, this court should reverse the lower court's ruling in favor of

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[14] Other circuit courts have considered section 1325(b)(1) with respect to income only. *See Hamilton v. Lanning (In re Lanning)*, 545 F.3d 1269, 1278-82 (10th Cir. 2008), *pet. for cert. filed* No. 08-998 (Feb. 3, 2009) (adopting forward-looking approach to income under section 1325(b)); *Maney v. Kagenveama (In re Kagenveama*), 541 F.3d 868 (9th Cir. 2008) (rejecting forward-looking approach to income under section 1325(b)). *See also Kibbe v. Sumski (In re Kibbe)*, 361 B.R. 302, 314-15 (B.A.P. 1st Cir. 2007) (*per curium*) (adopting forward-looking approach to income under section 1325(b)).

the forward-looking approach to section 1325(b)(1) articulated in *Frederickson*.

B. Because Section 1325(b)(1) is forward-looking, it precludes debtors, like Ms. Stipe, from including phantom vehicle ownership expenses on their means test that they will not incur during the life of their chapter 13 plans.

Under section 1325(b)(1) of the Bankruptcy Code, a bankruptcy court may not confirm a chapter 13 plan over the chapter 13 trustee's objection unless "the plan provides that all of the debtor's *projected* disposable income *to be received* in the applicable commitment period . . . *will be applied to make payments* to unsecured creditors under the plan."[15] 11 U.S.C. § 1325(b)(1) (emphasis added). Thus, the use of the terms "projected," "to be received," and "will be applied to make payments" in section 1325(b)(1) makes that section forward-looking.

Although the word "projected" is not defined under the Bankruptcy Code, the dictionary defines "projected" as forward-looking. *See The Random House Dict. of English Lang.*, 1546 (2d ed. 1987) (defining to "project" as *inter alia*, "to set forth or calculate (some future thing); *They projected the building costs for the next five years*."); *Webster's Third New Int'l Dict.*, 1813 (1993) (defining "projected" as *inter alia*, "planned for future execution: contrived, composed," as "[projected] outlays for new plant and equipment."). This forward-looking meaning should therefore be imparted to the term "projected" in section 1325(b)(1) absent a clear indication that Congress intended to give that term a different meaning. *See Bailey v. United States*, 516 U.S. at 137 (turning to dictionary definition of a term to define its statutory meaning). *Accord Kibbe*, 361 B.R. at 302; *Lanning*, 545 F.3d at 1269; *Frederickson*, 545 F.3d at 652. There is no such indication.

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[15] Section 1325(b)(4) defines the term "applicable commitment period," with certain exceptions, as 3 years for below-median-income chapter 13 debtors, and not less than 5 years for above-median-income chapter 13 debtors like Ms. Stipe. *See* 11 U.S.C. § 1325(b)(4).

The statutory requirements that: (a) a chapter 13 plan include all of a debtor's projected disposable income "to be received" during the plan period; and that (b) these amounts "will be applied to make payments" to unsecured creditors, both support this forward-looking reading of section 1325. *See* 11 U.S.C. § 1325(b)(1)(B). A court must interpret a statute as a symmetrical and coherent regulatory scheme and fit, if possible, all parts into a harmonious whole. *See Food & Drug Admin. v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 1301 (2000). Each of these phrases anticipate future action during the life of a debtor's plan. Thus, they reinforce the forward-looking nature of section 1325. *See, e.g., In re Coffin*, 396 B.R. 804, 809 (Bankr. D. Me. 2008).

C. This forward-looking construction of Section 1325(b)(1) is consistent with *Ross-Tousey*.

The forward-looking construction of section 1325(b)(1) advocated by the United States is consistent with the Seventh Circuit's ruling in *Ross-Tousey*. *See Ross-Tousey*, 549 F.3d at 1148. While *Ross-Tousey* ruled that chapter 7 cases are initially evaluated for dismissal under section 707(b)(2),[16] it went on to find that: (a) merely passing section 707(b)(2)'s means test does not guarantee chapter 7 relief; (b) section 707(b)(3)(B) of the Bankruptcy Code requires the dismissal of cases that pass the means test when the totality of a debtor's financial situation establishes abuse; and (c) abuse is evaluated based on a debtor's "actual income and expenses." *Id.* at 1157-62.

Ross-Tousey's construction of section 707(b)(3)(B) supports the United States' reading of section 1325(b) in this case. Just as section 707(b)(3)(B) mandates the dismissal of a chapter 7 debtor's case based upon an evaluation of a debtor's actual income and expenses, and regardless of

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[16] As previously discussed, section 707(b)(2) evaluates a debtor's historical income and statutorily prescribed expense amounts. *See* United States' Brief, *supra.* at 5-6.

a contrary result under section 707(b)(2)'s means test, *id.* at 1161-62; so too does section 1325(b)(1) require that a chapter 13 debtor make plan payments based upon their actual income and expenses (as projected over the life of their plan), and regardless of section 1325(b)(3)'s incorporation of section 707(b)(2)'s means test. Indeed, a contrary reading would transform section 707(b)(2)'s means test – which is merely a stage-one "screening mechanism" in chapter 7, H.R. Rep. 109-31 at 1 (I) (2005), *reprinted* in 2005 U.S.C.C.A.N. 88, 89 – into the final arbiter of chapter 13 plan payments.

III. As a Separate, Independent, and Alternative Basis for Reversal in the *Stipe* Case, this Court Should Reverse Because Section 1325(b)(2) of the Bankruptcy Code Limits a Debtor's Expense Deductions, and the Phantom Vehicle Expense Deductions Allowed by the Bankruptcy Court in Ms. Stipe's Case Do Not Qualify.

Section 1325(b)(2) of the Bankruptcy Code defines disposable income to include "current monthly income received by the debtor . . . less amounts reasonably necessary to be expended" for: (a) the maintenance or support of the debtor or a dependent of the debtor; (b) domestic support obligations; (c) charitable contributions; and (d) the continuation, preservation, and operation of a business. *See* 11 U.S.C. § 1325(b)(2)(A) and (B). Thus, section 1325(b)(2) expressly and independently limits the types of expenses a debtor may deduct in calculating projected disposable income.

Ms. Stipe's claimed vehicle expense deduction does not qualify under section 1325(b)(2) because it is not necessary for her or her dependents "maintenance and support." *See* 11 U.S.C. § 1325(b)(2)(A). "Payments that a debtor does not propose to make during the pendency of the plan and that a debtor is not required to make under the plan cannot be said to be reasonably necessary *for the [maintenance or] support of that debtor*." *In re McPherson*, 350 B.R. 38, 44-45 (Bankr. W.D. Va. 2006) (emphasis added). *See also In re Rahman*, 400 B.R. 362, 370 (Bankr. E.D.N.Y.

2009) (stating that "the Court must look at a debtor's stated intentions of record as they exist on the date of confirmation to determine what expenses are 'reasonably necessary to be expended *for the maintenance or support* of the debtor or a dependent of the debtor' during the Chapter 13 plan.") (emphasis added). Because Ms. Stipe has no loan or lease payments associated with her vehicle, her claimed expense deduction for the vehicle cannot be said to be reasonably necessary for maintenance or support.[17] *See McPherson*, 350 B.R. at 44-45; *Rahman*, 400 B.R. at 370. Accordingly, the lower court's order in *Stipe* should be reversed as violating section 1325(b)(2) of the Bankruptcy Code.

IV. Limiting the Vehicle Ownership Expense to Debtors With Loan or Lease Payments Fulfills Two Goals Congress Expressed in Enacting the 2005 Act.

In interpreting sections 707(b)(2)(A)(ii)(I) and 1325, this Court may consider relevant legislative history to determine the statute's objectives and illuminate its text. *See Almendarez-Torres v. United States*, 523 U.S. 224, 228 (1998) ("We therefore look to the statute before us and ask what Congress intended. . . . In answering this question, we look to the statute's language, structure, subject matter, context, and history-factors that typically help courts determine a statute's objectives and thereby illuminate its text."); *Crandon v. United States*, 494 U.S. 152, 158 (1990) ("In determining the meaning of the statute, we look not only to the particular statutory language, but to the design of the statute as a whole and to its object and policy.").

The purpose of the 2005 Act was to "ensure that debtors repay creditors the maximum they can afford." H.R. Rep. No. 109-31 (I), at 1, 2005 U.S.C.C.A.N. at 89. *See also Schultz*, 529 F.3d at 347 ("The centerpiece of the [2005 Act] is the imposition of a 'means test' for chapter 7 filers.").

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[17] The claimed expense deductions are also not necessary for a domestic support obligation, or for charitable or business purposes. *See* 11 U.S.C. § 1325(b)(2)(A) and (B).

Cf. Thomas, 382 B.R. at 798 ("If a debtor were permitted a car ownership allowance when he actually incurs no such expense, application of the means test would not accurately reflect the debtor's ability to repay creditors, and the purpose of the statute would be frustrated.").

Congress felt this aspect of bankruptcy reform legislation was so important that it included this language in the first paragraph of the first page of the 2005 Act's legislative history. *See* H.R. Rep. No. 109-31 (I), at 1, 2005 U.S.C.C.A.N. at 89 ("The heart of the bill's consumer bankruptcy reforms consists of the implementation of an income/expense screening mechanism ('needs-based bankruptcy relief' or 'means testing'), which is intended to ensure that debtors repay creditors the maximum they can afford.").

Congress saw fit to reiterate this point when it addressed the legislative history to section 707(b).[18] *Id.* at 97-100. Given how important this was to Congress, sections 707(b)(2)(A)(ii)(I) and 1325 should be interpreted in accordance with the overarching goal that underpins the 2005 Act.

Further, the 2005 Act also sought to eliminate "loopholes and incentives" in the system "that allow and – sometimes – even encourage opportunistic personal filings and abuse." H.R. Rep. No. 109-31 (I), at 5, 2005 U.S.C.C.A.N. at 92.

Ensuring that above-median-income debtors are eligible to claim standardized deductions for vehicle ownership expenses only when they have such expenses honors congressional intent that debtors repay their debts when they are able. *See Ransom*, 380 B.R. at 807 ("[W]hat is important is the payments that debtors actually make, not how many cars they own, because the payments that debtors make are what actually affect their ability to make payments to their

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[18] As previously noted, section 1325 incorporates large portions of section 707(b). *See* 11 U.S.C. § 1325(b)(3) (incorporating sections 707(b)(2)(A)(ii), (iii), and (iv) of the Bankruptcy Code).

creditors."); *Wilson*, 383 B.R. at 733 (noting that for above-median-income chapter 13 debtors, the "purpose" of the 2005 Act was to "require" such debtors "to make more funds available to their unsecured creditors"); *Hartwick*, 373 B.R. at 652.

V. The Lower Courts' Construction of Sections 707(b)(2)(A)(ii)(I) and 1325 Fails to Implement Sound Bankruptcy Policy Because it is Unfair to Debtors and Creditors Alike.

The lower courts' interpretation of sections 707(b)(2)(A)(ii)(I) and 1325 is unfair to all debtors because it fails to establish a threshold – the existence of vehicle loan or lease payments – for claiming an ownership deduction that is consistent for all debtors under chapters 7 and 13.

First, it discriminates in favor of better off debtors.[19] While below-median-income debtors must actually incur an expense before claiming a deduction, *see* 11 U.S.C. § 1325(b)(2) (allowing such debtors only "reasonably necessary" expenses), above-median-income debtors may claim a deduction regardless of whether they have an actual expense capable of being applied. *See Wilson*, 383 B.R. at 729 (observing that below-median-income Chapter 13 debtors, who are not subject to section 707(b)(2)(A)(ii)(I), are not entitled to deduct the ownership costs for unencumbered vehicles in determining projected disposable income).

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[19] Conversely, the argument that requiring the existence of an expense in order to claim the ownership deduction somehow discriminates against above-median-income debtors fails for two reasons. First, debtors who own an unencumbered vehicle that is over 6 years old or with 75,000 or more miles are entitled to an additional $200.00 expense deduction to cover increased monthly operating expenses associated with the vehicle's age. *See* Internal Revenue Manual, Offer in Compromise Financial Analysis Section at 5.8.5.6.3 (09-23-2008) (providing for additional $200 vehicle operating expense in cases of aged and/of high mileage vehicles). *See also Ransom*, 380 B.R. at 808 (recognizing $200.00 additional allowance); *Hartwick*, 373 B.R. at 652 (same); *Wilson*, 383 B.R. at 732 (same). Second, if a debtor needs a new vehicle during the course of his chapter 13 plan, plan modification is permitted to reduce payments to creditors to account for the new expense. *See* 11 U.S.C. § 1329(a); *Wilson*, 383 B.R. at 734 ("[I]n the event a debtor needs a new car during the course of a case, the debtor can move to modify the plan based on changed circumstances.").

Second, the lower courts' interpretation is unfair to creditors because they will receive smaller payments on their debts notwithstanding an above-median-income debtors financial ability to repay. For example, Ms. Stipe's bankruptcy schedules indicate that she has the present ability to repay *at least* $535.68 per month to her general unsecured creditors over a sixty month repayment plan. (Stipe R. at Dkt. 1) However, the lower court would require her to repay only $180 per month. (Stipe R. at Dkt. 3, 17) In enacting the 2005 Act, Congress was concerned that under the prior system, "some bankruptcy debtors are able to repay a significant portion of their debts" but are not required to do so. H.R. Rep. No. 109-31 (I), at 5, 2005 U.S.C.C.A.N. at 92. To read the 2005 Act as loosening the expense requirements for above-median-income debtors would benefit the very group of debtors that Congress enacted the 2005 Act to scrutinize more closely.

CONCLUSION

For these reasons, the United States respectfully asks the Court to reverse the decisions below.

Dated: June 24, 2009

Respectfully submitted,

RAMONA D. ELLIOTT
General Counsel
P. MATTHEW SUTKO
Associate General Counsel
DAVID I. GOLD
Trial Attorney
Executive Office for United States Trustees
P.O. Box 969
Department of Justice
20 Massachusetts Avenue, N.W.
Washington, D.C. 20530

ROBERTA A. DeANGELIS
Acting United States Trustee

BY: /s Anne K. Fiorenza
Anne K. Fiorenza
Assistant United States Trustee
228 Walnut Street
Harrisburg, PA 17108-0969
(717) 221-4515
Fax No. (717) 221-4554
E-mail: Anne.Fiorenza@usdoj.gov
License No. PA41818

CERTIFICATE OF SERVICE

I hereby certify that on June 24, 2009, I electronically filed a true and correct copy of the foregoing Consolidated Brief of the United States with the Clerk of the United States District Court using the CM/ECF system, and that each of the following parties were served via the CM/ECF system:

James K. Jones
jjones@pamd13trustee.com

John P. Neblett
jpn@neblettlaw.com

Lawrence V. Young
lyoung@cgalaw.com

ROBERTA A. DeANGELIS
Acting United States Trustee

Anne K. Fiorenza
Assistant United States Trustee

BY: /s Anne K. Fiorenza
Anne K. Fiorenza
Assistant United States Trustee
228 Walnut Street
P.O. Box 969
Harrisburg, PA 17108-0969
(717) 221-4515
Fax No. (717) 221-4554
E-mail: Anne.Fiorenza@usdoj.gov
License No. PA41818

BRIEF BANK — "SUMMARY SHEET" *Printed Tue-4/20/10 16:23*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	In re: John Patrick Stokes (John Patrick Stokes v. United States Trustee)
2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	D. Mont.
3. ("CCN") ***CURRENT*** CASE NO.	No.: 09-162-M-DWM
4. ("PCN") ***PRIOR*** CASE NO. - & COURT *[IF ANY]*	No.: 09-60265-RBK Court: Bankr. Mont. *(Identify judge & cite, if any)*
5. ("SO") ***SOURCE***	**U.S. TRUSTEES**
6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	Filed: January 28, 2010 Type: Response Brief of Appellee, The United States Trustee
7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*	Neal G. Jensen, Anne W. Stukes, Sean C. Day *(UST/OGC: 202-307-1399/FAX-2397)*
8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	• Did the bankruptcy court abuse its discretion under 11 U.S.C. § 1112(b) when it converted Mr. Stokes' chapter 11 bankruptcy case to a chapter 7 bankruptcy case?
10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)	
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NEAL G. JENSEN
Assistant United States Trustee
United States Department of Justice
Office of United States Trustee
Liberty Center, Suite 204
301 Central Avenue
Great Falls, MT 59401
Phone (406) 761-8777
Fax (406) 761-8895
neal.g.jensen@usdoj.gov
State Bar I.D. No. 738

Attorney for United States Trustee/Appellee

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MONTANA
BUTTE DIVISION

In re JOHN PATRICK STOKES,	Cause No. CV 09-162-M-DWM
JOHN PATRICK STOKES, Appellant, vs. UNITED STATES TRUSTEE, et al., Appellees.	RESPONSE BRIEF OF APPELLEE, THE UNITED STATES TRUSTEE

ON APPEAL FROM THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF MONTANA

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JURISDICTIONAL STATEMENT

On September 21, 2009, the United States Bankruptcy Court for the District of Montana issued an order under 11 U.S.C. § 1112(b) converting Appellant John Patrick Stokes' chapter 11 bankruptcy case to a case under chapter 7 (the "conversion order"). (Bankr. Dkt. 97, 98). On October 1, Mr. Stokes timely filed a motion to have the bankruptcy court reconsider the conversion order, which stayed his time to file a notice of appeal. (Bankr. Dkt. 140). *See* Fed. R. Bankr. P. 8002(b). On October 8, the bankruptcy court denied Mr. Stokes' motion to reconsider. (Bankr. Dkt. 150). Mr. Stokes timely filed a notice of appeal on October 16, 2009, under 28 U.S.C. § 158(c)(2) and Fed. R. Bankr. P. 8002(a) and (b). (Bankr. Dkt. 154). The appeal of the conversion order and the motion to reconsider the conversion order is a timely appeal of a final order of the bankruptcy court. This Court has jurisdiction to hear the appeal pursuant to 28 U.S.C. § 158(a)(1).

STATEMENT OF THE ISSUES[1]

1. Did the bankruptcy court abuse its discretion under 11 U.S.C. § 1112(b)

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[1] Mr. Stokes also appeals the bankruptcy court's September 21, 2009 order denying, without prejudice, his motion to modify the automatic stay under 11 U.S.C. § 362(a) to permit the Montana Supreme Court to hear an appeal by Mr. Stokes of a judgment against him. (Bankr. Dkt. 97, 99). Although Mr. Stokes devotes the majority of his appellate brief to this issue (App. Br. at 1-21), the United States Trustee took no position on this issue when it was before the bankruptcy court, and therefore takes no position on it in this appeal.

when it converted Mr. Stokes' chapter 11 bankruptcy case to a chapter 7 bankruptcy case?

2. Did the bankruptcy court abuse its discretion under 11 U.S.C. § 1112(b) by finding various objections that Mr. Stokes now alleges were "constitutional" violations were insufficient to prevent the conversion of his bankruptcy case?

STANDARD OF REVIEW

A bankruptcy court's decision to convert a case to chapter 7 pursuant to 11 U.S.C. § 1112(b) is reviewed for an abuse of discretion. *In re Consol. Pioneer Mortg. Entities*, 264 F.3d 803, 806 (9th Cir. 2001). The bankruptcy court's decision "'will be reversed only if based on an erroneous conclusion of law or when the record contains no evidence on which [the bankruptcy court] rationally could have based that decision.'" *Id.* at 806-07 (quoting *In re Conejo Enter., Inc.*, 96 F.3d 346, 351 (9th Cir.1996)).

STATEMENT OF THE CASE

Mr. Stokes filed a voluntary bankruptcy petition under chapter 11 of the United States Bankruptcy Code.[2] (Bankr. Dkt. 4). Shortly thereafter, the United

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[2] Mr. Stokes filed a petition and an amended petition on March 4, 2009. References to the petition in this brief will be to the amended petition.

States Trustee filed a motion with the bankruptcy court to have Mr. Stokes' case converted to a chapter 7 case pursuant to 11 U.S.C. § 1112(b)(1). (Bankr. Dkt. 24). In support of the motion, the United States Trustee noted that Mr. Stokes' Schedules and Statement of Financial Affairs ("SOFA") were incomplete and inaccurate.[3] As set forth in more detail below: Mr. Stokes' description of his interest in real property is inaccurate; Mr. Stokes' recitation of his household property failed to disclose several thousand dollars worth of household items, a number of vehicles, an FCC radio license with an estimated value (according to Mr. Stokes) of $1.5 million, and two radio towers with an estimated value (according to Mr. Stokes) of $625,000; Mr. Stokes provided inaccurate information concerning the value of secured claims; Mr. Stokes failed to acknowledge priority claims including personal state and federal income taxes; and Mr. Stokes failed to list a number of unsecured creditors.

Mr. Stokes filed a response to the motion requesting conversion. (Bankr. Dkt. 29). In his response Mr. Stokes acknowledged inaccuracies in his SOFA but argued that conversion would not be in the best interests of Mr. Stokes' creditors and that efforts were underway to correct and amend the SOFA. (*Id.*) A hearing

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[3] Mr. Stokes filed his original SOFA on April 3, 2009 and an amended SOFA on July 24, 2009. (Bankr. Dkt. 17, 70).

was held on the motion to convert on August 13 and 14, 2009. ("Hearing Tr." at Bankr. Dkt. 164, 165). All of Mr. Stokes' creditors who have made appearances, with the exception of his daughter, joined the United States Trustee's motion in support of conversion. (Bankr. Dkt. 30, 97 at p.32, 164, 165).

On September 21, 2009, the bankruptcy court entered the conversion order accompanied by an opinion supporting the order. In that opinion, the bankruptcy court found that sufficient "cause" required by 11 U.S.C. § 1112(b)(1) existed for the conversion of the case. (Bankr. Dkt. 97, Op. at 35). The bankruptcy court also found "the best interests of the creditors and estate clearly are served with conversion to Chapter 7, and appointment of a trustee and qualified and objective counsel to investigate and evaluate the Debtor's assets and lawsuits." (Bankr. Dkt. 97, Op. at 33).

In the same order, the bankruptcy court also denied, without prejudice, Mr. Stokes' motion to modify the automatic stay under 11 U.S.C. § 362(a) to permit the Montana Supreme Court to hear an appeal by Mr. Stokes from a judgment of $3.8 million. (Bankr. Dkt. 97, Op. at 36-37). Mr. Stokes argued that judgment was the basis for his decision to file for bankruptcy and that, "[l]iability cannot be established if any until the Supreme Court reviews to affirm or remand or dismiss." (Bankr. Dkt. 58, Stay Mot. at 1).

The bankruptcy court denied the motion to modify the stay, without prejudice, based on its finding that "it [is] premature to lift the stay to allow the Debtor's appeal of the Gardners' judgment to proceed in the Montana Supreme Court. With conversion of this case, a trustee will be appointed in the Chapter 7 case who must be permitted reasonable time to evaluate the Debtor's appeal along with the other assets and claims." (Bankr. Dkt. 97, Op. at 36). In the bankruptcy court, the United States Trustee took no position on Mr. Stokes' motion to modify the automatic stay, and takes no position on it now.

SUMMARY OF ARGUMENT

The bankruptcy court did not abuse its discretion when it converted this case from chapter 11 to chapter 7. The conversion order was supported by the bankruptcy court's findings of facts, which in turn were supported by the evidence, including Mr. Stokes' own documents, filed and subscribed under penalty of perjury, and his testimony. Because Mr. Stokes failed to show a reasonable justification for the deficiencies in filing and reporting and failed to show that there was a reasonable likelihood that a plan would be confirmed, the bankruptcy court acted within its discretion by converting the case to chapter 7.

Furthermore, the bankruptcy court did not abuse its discretion in ordering conversion of this case to chapter 7 notwithstanding the list of objections that Mr.

Stokes sets out in his brief as alleged violations of his Fourth and Fifth Amendment rights. Several of these objections are factually wrong. Moreover, Mr. Stokes did not establish in the bankruptcy court how any of these alleged violations required a different outcome on the issue of conversion, nor does he do so on appeal. Accordingly, this Court should affirm.

ARGUMENT

A. The Bankruptcy Court Did Not Abuse Its Discretion in Ordering This Case Converted to Chapter 7.

"[A]bsent unusual circumstances specifically identified by the court," 11 U.S.C. § 1112(b)(1) requires a bankruptcy court, upon a the request of a party in interest, to convert a bankruptcy case under another chapter to a chapter 7 case or dismiss the case, "whichever is in the best interests of creditors and the estate, if the movant establishes cause." 11 U.S.C. § 1112(b)(1). The United States Trustee "is a recognized party in interest with standing to request after notice and a hearing the dismissal or conversion of a Chapter 11 case." *In re Johnston*, 149 B.R. 158, 161 (B.A.P. 9th Cir. 1992). *See* 28 U.S.C. § 586(a)(8) (authorizing United States Trustees to file motions under section 1112(b)).

Subsection 1112(b)(4) of the Bankruptcy Code provides a list of what constitutes "cause" to convert or dismiss a case. 11 U.S.C. § 1112(b)(4). This list is non-exhaustive. *In re Gonic Realty Trust*, 909 F.2d 624, 627 (1st. Cir. 1990); *In re Milford Connecticut Assocs., L.P.*, 404 B.R. 699, 707 (D. Conn. 2009). That is so because the section uses the term "including," which the Bankruptcy Code construes as being non-limiting. 11 U.S.C. § 102(3).

A debtor (or another party in interest) can successfully object to a motion to convert or dismiss under section 1112(b)(1) if the debtor can establish:

> (A) there is a reasonable likelihood that a plan will be confirmed within the timeframes established in sections 1121(e) and 1129(e) of this title, or if such sections do not apply, within a reasonable period of time; and
>
> (B) the grounds for granting such relief include an act or omission of the debtor other than under paragraph (4)(A) –
>
> > (i) for which there exists a reasonable justification for the act or omission; and
> >
> > (ii) that will be cured within a reasonable period of time fixed by the court.

11 U.S.C. § 1112(b)(2).

In his brief, Mr. Stokes states that this is an appeal of the conversion order. (App. Br. at 5). Over the course of twenty-nine pages of his brief, however, he devotes only two paragraphs to his claim of error regarding the conversion order. (App. Br. at 22-23). Mr. Stokes provides no legal authorities in support of his appeal of the conversion order and does not provide this Court with any basis upon which it could find that the bankruptcy court abused its discretion in converting Mr. Stokes' case to a chapter 7 case.[4]

Mr. Stokes' brief sets out no adequate basis for reversing the bankruptcy court's conversion order. To the contrary, the court below did not abuse its discretion in finding that ample cause existed for the conversion of Mr. Stokes' chapter 11 case to a chapter 7 case. Put succinctly, Mr. Stokes repeatedly failed to give the bankruptcy court an adequate statement of his financial affairs. His testimony and filings were routinely in conflict. At every turn, Mr. Stokes failed to provide the bankruptcy court, the United States Trustee, and his creditors with a complete and accurate picture of his assets.

For example, in his original schedules, Mr. Stokes failed to list under several of the required schedules assets that, *according to Mr. Stokes*, are valued at several million dollars. On Schedule A, Mr. Stokes was required to list "all real

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[4] This Court might be able to dismiss Mr. Stokes' appeal pursuant to Bankruptcy Rule 8010, which provides, *inter alia*, that a brief must include "contentions of the appellant with respect to the issues presented, and the reasons therefor, with citations to the authorities, statutes and parts of the record relied on." Fed. R. Bankr. 8010(a)(1)(E). Mr. Stokes' brief does not contain these items with respect to his appeal of the conversion order. *Cf. In re Morrissey*, 349 F.3d 1187, 1189 (9th Cir. 2003) (affirming B.A.P dismissal of an appeal where appellant's brief "lacked a statement of appellate jurisdiction; there was no intelligible statement of the issues presented or the applicable standard of appellate review; there was no statement of the case in the form required; and the argument sections omitted essential citations to the authorities, statutes and parts of the record relied on.") (internal citations omitted). But, as further review might be sought, it may be most prudent to address the merits, as the record fully supports affirmance.

property in which the debtor has any legal, equitable, or future interest[.]" (Bankr. Dkt. 17 at p.3). At a creditor's meeting held pursuant to 11 U.S.C. § 341 (a "section 341 meeting") Mr. Stokes acknowledged that he failed to list easement rights to property on which he maintains two radio towers that he estimated to be worth $6.6 million. (Bankr. Dkt. 81, Exh. 2 at 72-73). Mr. Stokes confirmed this failure in the hearing on the conversion motion. (Hearing Tr. at 47).

On Schedule B, Mr. Stokes was required to list "[l]icenses, franchises, and other general intangibles." (Bankr. Dkt. 17 at p.4). At his section 341 meeting, Mr. Stokes acknowledged he failed to list a radio license issued by the FCC which he estimates has a fair market value of $1.5 million. (Bankr. Dkt. 81, Exh. 2 at 66-67, 71). Mr. Stokes was also required to list on Schedule B, "contingent and unliquidated claims of every nature[.]" (Bankr. Dkt. 17 at p.4). Mr. Stokes listed none. At his section 341 meeting, Mr. Stokes identified several claims he valued at more than $5.4 million. (Bankr. Dkt. 81, Exh. 2 at 57-60).

On Schedule D, Mr. Stokes was required to list creditors holding claims secured against his property, the value of the secured property, and the amount of the claim. (Bankr. Dkt. 17 at p.8). Mr. Stokes listed a 2002 Dodge truck with a value of $2,075. (*Id.*). Yet in his section 341 meeting, Mr. Stokes averred the value was close to $12,000. (Bankr. Dkt. 81, Exh. 2 at 66). Mr. Stokes listed

Questa Resources as a secured creditor with a claim amount of $1.3 million. (Bankr. Dkt. 17, at p.8). In his section 341 meeting, Mr. Stokes acknowledged that Questa is no longer a secured creditor, having assigned its interest to other parties in 2000. (Bankr. Dkt. 81, Exh. 2 at 78-79). These parties are not listed on Mr. Stokes' original schedules.

On Schedule E, Mr. Stokes was required to list unsecured priority claims. (Bankr. Dkt. 17 at p.9). Included on the Schedule is a check box to indicate "[t]axes, customs duties, and penalties owing to federal, state, and local governmental units[.]" (*Id*.). Mr. Stokes checked the box indicating he was subject to no unsecured priority claims. In his section 341 meeting, however, Mr. Stokes testified that this was not true. (Bankr. Dkt. 81, Exh. 2 at 81). Mr. Stokes testified he had never filed a Montana income tax return since moving to the state in 1994 and had not filed federal income tax returns since 1985 and that he likely owed income taxes to both Montana and the United States. (*Id*. at 82-83).

These are but some of the problems with Mr. Stokes' original schedules and SOFA. In his amended schedules and SOFA, filed almost five months after he filed his bankruptcy petition and three months after the United States Trustee sought conversion, Mr. Stokes did belatedly correct some of the problems. (Bankr. Dkt. 69, 70). For example, Mr. Stokes' original Schedule A listed $3.1

million in interests in real property; his amended Schedule A listed $10.7 million. (Bankr. Dkt. 97, Op. at 15). But problems remained with Mr. Stokes' amended schedules and SOFA, and as the bankruptcy court properly noted, the amended schedules and SOFA "continue[] to reflect serious errors and omissions." (*Id.*).

Specifically, Mr. Stokes omitted from his amended schedules approximately $65 million in litigation claims for which he provided inaccurate numbers or failed to disclose at all. In his Amended Schedule B, Mr. Stokes lists a claim of $12 million in litigation against Davar and Todd Gardener. (Bankr. Dkt. 69 at p.13). Mr. Stokes complaint against the Gardeners, by his own admission, seeks closer to $50 million. (Hearing Tr. at 61-62). Mr. Stokes also listed in his Amended Schedule B a litigation claim against Wade Dahood at $410,000. (Bankr. Dkt. 69, at p.14). In the hearing on the conversion motion, Mr. Stokes admitted his complaint against Mr. Dahood seeks well over $12 million. (Hearing Tr. at 65).

Mr. Stokes also failed to list in his Amended Schedule B a lawsuit he had filed against, *inter alia*, Questa Resources and Boone Karlberg Employee Profit Sharing Trust. In the hearing on the conversion motion, Mr. Stokes admitted that he filed such a lawsuit and was seeking $2.7 million. (Hearing Tr. at 68-69).

Mr. Stokes' failure to file even reasonably accurate schedules and SOFA constitutes sufficient cause for conversion. *In re Cohoes Indus. Terminal, Inc.*, 65

B.R. 918, 921 (Bankr. S.D.N.Y.1986) ("A debtor's failure to file proper schedules of assets and liabilities; a failure to file accurate monthly operating statements of assets and liabilities; an inability to obtain adequate insurance to protect its property; a failure to pay post-petition rent and mortgage charges, and the absence of a plan of reorganization or any forward movement during the more than five months after the filing of a Chapter 11 petition constitute sufficient cause for either dismissing the case or converting it for liquidation pursuant to 11 U.S.C. § 1112(b)."); *see In re Charfoos*, 979 F.2d 390 (6th Cir. 1992) (Chapter 11 case dismissed for, inter alia, factual misrepresentations and omissions on financial statements and bankruptcy pleadings).

Moreover, as the bankruptcy court noted in its decision supporting the conversion order, cause supporting conversion existed for a number of additional reasons. (Bankr. Dkt. 97, Op. at 30). At the hearing on the motion to convert Mr. Stokes' case, Larry Rezentes, the bankruptcy analyst and CPA for the United States Trustee, testified that Mr. Stokes failed to file satisfactory monthly operating reports as required by the United States Trustee. (Hearing Tr. at 15-18). According to Mr. Rezentes, the financial documents Mr. Stokes did file did not meet the United States Trustee's requirements, and Mr. Rezentes could not evaluate Mr. Stokes' financial condition. (Hearing Tr. at 19-20).

As a result of Mr. Stokes' failure to file satisfactory operating reports, the bankruptcy court did not abuse its discretion in finding cause for conversion under two of the categories listed at section 1112(b)(4). Mr. Stokes failed to "satisfy timely any filing or reporting requirement established by this title or by any rule applicable to a case under this chapter." 11 U.S.C. § 1112(b)(4)(F); *In re Tucker,* 411 B.R. 530, 535 (Bankr. S.D. Ga. 2009) ("cause" existed for conversion where "[d]ebtor's monthly operating reports [were] incomplete, misleading, and materially false in some respects."); *In re Tornheim*, 181 B.R. 161, 164 (Bankr. S.D.N.Y.1995) ("Refusal or inability to provide financial disclosure sounds the death knell of a chapter 11 case. The failure to file monthly operating statements required by the Trustee's operating guidelines, 'whether based on inability to do so or otherwise, undermines the chapter 11 process and constitutes cause for dismissal or conversion of the chapter 11 proceedings.'") (quoting *In re Roma Group, Inc.*, 165 B.R. 779, 780 (S.D.N.Y.1994)); *In re Wilkins Inv. Group, Inc.*, 171 B.R. 194, 196-97 (Bankr. M.D. Pa. 1994) (dismissal warranted in chapter 11 case, though not filed in bad faith, for failure to file monthly operating reports with trustee). Mr. Stokes also failed "to provide information . . . reasonably requested by the United States trustee." 11 U.S.C. § 1112(b)(4)(H). Accordingly, the bankruptcy court did not abuse its discretion in ordering the conversion Mr.

Stokes' case on these additional grounds.

Rather than contradict or deny any of these shortcomings, Mr. Stokes argues that the United States Trustee treated "every failure by Mr. Stokes . . . . as if he was represented by the best law firm in Montana instead of being forced to act *pro se*, having been abandoned by his lawyer (after the lawyer failed to properly do his job) in the middle of the proceedings." (App. Br. 22-23).[5] This is not so. And Mr. Stokes' omissions and his inaccuracies constitute material discrepancies. By Mr. Stokes' own account, he failed to include in his SOFA and amended schedules *several million dollars* worth of assets and failed to list a number creditors and claims. (Bankr. Dkt. 81, Exh. 2 at 57-60, 66-67, 71, 72-73, 78-79, 81, 82-83; Hearing Tr. at 47, 61-62, 65, 68-69). Mr. Stokes' case is precisely the type in which a trustee is necessary to examine a debtor's finances and arrive at an accurate picture of his assets and liabilities. *See In re McCorhill Pub., Inc.*, 73

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[5] The United States Trustee filed its motion to convert on April 22, 2009. At that time, and when Mr. Stokes prepared and filed his original schedules and SOFA, he was represented by counsel. (Bankr. Dkt. 17) (filed by counsel G. Duncan). Mr. Stokes' response to the motion was also filed on his behalf by counsel. (Bankr. Dkt. 28) (filed by counsel G. Duncan). Mr. Stokes's first counsel did not file a motion to withdraw until June 5, 2009. (Bankr. Dkt. 48).

Moreover, whether or not Mr. Stokes was represented by counsel is irrelevant in this circuit. While some leeway may be given to a *pro se* litigant in certain circumstances, no such leeway can extend to filing wholly inaccurate and misleading schedules of assets. Mr. Stokes has an obligation to prepare and submit accurate filings no matter if he is a *pro se* litigant or in fact represented by the best law firm in Montana. *In re Glass*, 60 F.3d 565, 570 (9th Cir. 1995) (the fact that a debtor proceeds *pro se* is no excuse for filing inaccurate or incomplete schedules).

B.R. 1013, 1017 (Bankr. S.D.N.Y. 1987) (noting the value of a trustee "when a debtor fails to maintain complete and accurate financial records, or fails to substantiate undocumented transactions, so that there appears to be a confusion in the debtor's accounting system"). Mr. Stokes admission that he failed to provide accurate information to the bankruptcy court underscores that the order converting this case to chapter 7 should be affirmed.

Once cause is established, a court must next decide whether to convert or dismiss a chapter 11 case is the "best interests of the creditors." 11 U.S.C. § 1112(b)(1) (requiring that "the court shall convert a case under this chapter to a case under chapter 7 or dismiss a case under this chapter, *whichever is in the best interests of creditors and the estate*, if the movant establishes cause.") (Emphasis added). Every one of Mr. Stokes' creditors who appeared at the hearing joined the United States Trustee's motion to convert this case to a chapter 7 case. (Bankr. Dkt. 30, 97 at p.32, 164, 165). There is perhaps no better evidence of how the creditors view their own interests. *See Loop Corp. v. U.S. Trustee*, 290 B.R. 108, 115 (D. Minn. 2003) (bankruptcy court did not abuse its discretion in converting to a chapter 7 case where creditor's committee favored conversion and noting that "these creditors were in the best position to determine their own best interests"). And the bankruptcy court specifically found conversion was in the creditors' best interest. (Bankr. Dkt. 97, Op. at p.33).

Accordingly, the bankruptcy court did not abuse its discretion when it converted Mr. Stokes' case to a chapter 7 case. As the bankruptcy court noted, "overwhelming evidence establishes the 'cause' identified under § 1112(b)(2) and (b)(4) that is necessary for conversion to chapter 7." (Bankr. Dkt. 97 at p.32). The decision of the bankruptcy court should be affirmed.

B. The Bankruptcy Court Did Not Abuse Its Discretion by Ordering Conversion Notwithstanding the Issues that Mr. Stokes Now Alleges as "Constitutional" Violations.

Finally, Mr. Stokes appears to assert that the bankruptcy court should not have converted his bankruptcy to a chapter 7 case because the United States Trustee allegedly violated his rights protected by the Fourth and Fifth Amendments to the United States Constitution. (App. Br. 23-27). Each of Mr. Stokes' allegations is a mere conclusory statement that his constitutional rights were violated. He provides no record support for his allegations. He provides no legal authorities to support his claims.[6] Mr. Stokes' allegations are without merit, and none provides a basis for concluding that the bankruptcy court abused its discretion in converting Mr. Stokes' case to one under chapter 7.

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[6] *See* Fed. R. Bankr. P. 8010(a)(1)(E) (requiring the brief of an appellant to "contain the contentions of the appellant with respect to the issues presented, and the reasons therefor, with citations to the authorities, statutes and parts of the record relied on.").

Although Mr. Stokes lists seven allegations against "the US Trustee," (App. Br. at 25-27), not all of his allegations bear a connection to actions that were in fact undertaken by the United States Trustee. For instance, Mr. Stokes alleges the United States Trustee created a "perjury trap" by requesting that Mr. Stokes file amended schedules but still holding him accountable during the section 341 meeting for his answers in the original schedules and SOFA. (App. Br. at 25). This Court should not reverse the bankruptcy court based on Mr. Stokes' allegation of a "perjury trap." Mr. Stokes filed sworn statements setting forth the condition of his financial affairs. (Bankr. Dkt. 1, 4, 17, 70). He makes no effort to explain why holding him accountable for the filing of these statements or questioning their contents amounts to either a "perjury trap" or a violation of constitutional rights. Indeed, it is hard to imagine how it could be unconstitutional to require a debtor to provide truthful and accurate information in his bankruptcy schedules.

Second and third, Mr. Stokes alleges that the United States Trustee violated the bankruptcy court's order that he submit a witness list three days prior to the hearing on the motion to convert, (Bankr. Dkt. 77), and the United States Trustee "endorsed" a "violation of the three-day rule" when he "allowed" Mr. Stokes' creditors "to not provide their witness list until the day after" the August 13 hearing, (App. Br. at 25-26). Notwithstanding Mr. Stokes' allegations, the United States Trustee in fact filed a copy of his witness list with the bankruptcy court on August 10, 2009, three days before the hearing, and served the witness list on Mr. Stokes by mailing it the same day. (Bankr. Dkt. 83). Likewise, the record reflects that Mr. Stokes' creditors did the same. (Bankr. Dkt. 80). Even assuming the record established that the United States Trustee failed to comply with the bankruptcy court's scheduling order, Mr. Stokes' brief does not allege that his ability to prepare for or present his case at the hearing was prejudiced. In light of the record, this Court should find that the bankruptcy court did not abuse its discretion by converting this case to one under chapter 7 and overruling Mr. Stokes' objections, which do not rise to the level of constitutional violations. (Bankr. Dkt. 164, Hrg. Tr. at 6). *See generally In re Finney*, 992 F.2d 43, 45 (4th Cir. 1993) (finding that notice and a hearing in a proceeding to convert a case to a chapter 7 case satisfies due process).

Fourth, Mr. Stokes claims the United States Trustee "endorsed" a violation of "the rules of evidence" by an attorney for one of Mr. Stokes' creditors when Mr. Stokes allegedly "was not permitted to explain an answer in the critical August 13th Hearing." (App. Br. at 26). In that hearing, Mr. Stokes was asked by counsel for the creditor a yes-or-no question — whether a statement Mr. Stokes had made in his section 341 meeting was correct. (Bankr. Dkt. 164, at 129). Mr. Stokes fails to provide any legal or factual explanation for how the actions of third parties not under the control, nor acting at the direction, of the United States Trustee should be imputed to the United States Trustee. And Mr. Stokes does not allege that he was prejudiced or otherwise precluded from stating his position to the bankruptcy court after the creditor's counsel had finished his questions. This Court should not conclude that the bankruptcy court abused its discretion in any way related to this objection.

In his fifth allegation, Mr. Stokes seems to have confused the United States Trustee with the chapter 7 trustee, who is not a government official. *Compare* 28 U.S.C. § 581(a)(18) (the United States Trustee for this district is a Justice Department employee), *with* 11 U.S.C. §§ 326, 701, 702(d), and 704 (appointment, duties, and compensation of non-governmental chapter 7 trustees). Mr. Stokes alleges that the United States Trustee violated the Fourth Amendment by seizing personal papers, without a warrant or probable cause, from a radio station that he owned and operated. (App. Br. at 26). The chapter 7 trustee, Richard J. Samson, took possession of estate assets in furtherance of an order of the bankruptcy court that is not before the Court in this appeal. (Bankr. Dkt. 120). Moreover, the United States Trustee took no part in the enforcement of this order.

On this record, therefore, there is no basis to conclude that the United States Trustee committed any violation of the Fourth Amendment.[7]

Sixth, Mr. Stokes alleges that the United States Trustee "violated the principle of attorney-client privilege" between Mr. Stokes and his first bankruptcy counsel by allegedly ordering counsel to "hand over Stokes file." (App. Br. at 26). As alleged by Mr. Stokes on appeal and in the bankruptcy court, this is not an objection grounded in any right guaranteed by the constitution. If Mr. Stokes believes his former counsel erred in producing materials, Mr. Stokes' quarrel is with him. In any event, the record reflects that Mr. Stokes objected — not on constitutional grounds — to the admission into evidence of his proposed plan of reorganization and disclosure statement, and the bankruptcy court overruled this objection. (Bankr. Dkt. 164, Hrg. Tr. at 104-06). There was no abuse of discretion in this ruling, because a debtor's disclosure of his assets and liabilities to his attorney for the purpose of preparing bankruptcy petitions and schedules is not protected by the attorney-client privilege. *See United States v. Bauer*, 132 F.3d 504, 509 (9th Cir. 1997) ("When information is disclosed for the purpose of

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[7] Furthermore, it is unclear that Mr. Stokes properly preserved this issue. At the hearing on his motion for reconsideration, Mr. Stokes did not assert any Fourth Amendment violations related to the securing of his assets, but instead presented the issue as a request for a continuance of the hearing. (Bankr. Dkt. 163, Tr. at 5-7, 11).

assembly into a bankruptcy petition and supporting schedules, there is no intent for the information to be held in confidence because the information is to be disclosed on documents publicly filed with the bankruptcy court.") (quoting *United States v. White*, 950 F.2d 426, 430 (7th Cir.1991)).

Seventh and last, Mr. Stokes alleges the United States Trustee "failed to determine" the "actual value" of certain land associated with Mr. Stokes' estate by failing to get an appraisal or "by acquiring certain knowledge of the City of Kalispell's airport expansion plans." (App. Br. at 27). The United States Trustee had no role in the valuation of property associated with Mr. Stokes' estate. It is the responsibility of the chapter 7 trustee to evaluate the assets of the estate. *See* 11 U.S.C. § 704(a) (setting forth the duties of the chapter 7 trustee). Thus, there is no basis to conclude that the United States Trustee has violated any of Mr. Stokes' rights — constitutional or otherwise — in regard to this claim.

Even if Mr. Stokes had supported his allegations of "constitutional" violations with record evidence or legal authorities, he has not explained how or why these allegations were related to the subject of this appeal: the bankruptcy court's decision to convert Mr. Stokes bankruptcy case to a chapter 7. As demonstrated above, the bankruptcy court's decision was amply supported by the record. Mr. Stokes repeatedly failed to provide an accurate picture of his financial affairs and he failed to cooperate with the routine requirement of the United States Trustee that he submit monthly operating reports. Cause existed to support the conversion of the case to a chapter 7 case and it was in the best interests of the creditors to do so. 11 U.S.C. § 1112(b). The bankruptcy court did not abuse its discretion.

CONCLUSION

For all of the foregoing reasons, the bankruptcy court's order converting Mr. Stokes' case to a chapter 7 case should be affirmed.

DATED this 28th day of January, 2010 Respectfully submitted,

By: /s/ Neal G. Jensen

NEAL G. JENSEN
United States Department of Justice
Assistant United States Trustee
Office of United States Trustee
Liberty Center, Suite 204
301 Central Avenue
Great Falls, MT 59401
Phone (406) 761-8777
Fax (406) 761-8895
neal.g.jensen@usdoj.gov
State Bar I.D. No. 738

Attorney for United States Trustee

CERTIFICATE OF COMPLIANCE

The undersigned hereby certifies that the foregoing Appellee's Response Brief contains 22 pages with 5,385 words, exclusive of the caption and certificates of service and compliance, and is typewritten in 14 point font size without erasures or materially defacing interlineations, with page size of 8.5x11 inches.

/s/ Neal G. Jensen
Neal G. Jensen

CERTIFICATE OF MAILING

I, the undersigned, Neal G. Jensen, Assistant United States Trustee, do hereby certify under penalty of perjury that on January 28, 2010, or as soon as possible thereafter, copies of the foregoing Notice of Appearance was served electronically by the Court's ECF notice to all persons/entities requesting special notice or otherwise entitled to the same, and that in addition service by mail was made to the following persons/entities who are not ECF registered users: None.

/s/ Neal G. Jensen
Neal G. Jensen

BRIEF BANK — "SUMMARY SHEET" Printed Mon.-2/5/1 (10:37)

WESTLAW CODES

1. ("TI") TITLE OF CASE [E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]
Attorney 99-37 v. Barbara G. Stuart, U.S. Trustee
(In re Charges of Unprofessional Conduct against Attorney 99-37)

2. ("CO") CURRENT COURT [E.g., "CTA9"]
CTA8

3. ("CCN") CURRENT CASE NO.
No.: 00-3030 MN

4. ("PCN") PRIOR CASE NO. & COURT [IF ANY]
No.:
Court: Minnesota Office of Lawyers Professional Responsibility
(Identify judge & cite, if any)

5. ("SO") SOURCE
U.S. TRUSTEES

6. ("DA") DATE OF FILING & TYPE OF BRIEF [E.g., "Opening Brief," "Reply," "Amicus," etc.]
Filed: Nov. 9, 2000
Type: Brief for U.S. Trustee, Appellee

7. ("AU") PRINCIPAL AUTHORS & OFFICE [E.g.,"UST/OGC"]
Roylene A. Champeaux, Assistant U.S. Attorney (612-664-5600)
Anthony J. Ciccone, Executive Office for U.S. Trutees (202-307-0003)
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") TOPIC
BANKRUPTCY

9. ("SU") • SUMMARY OF KEY ISSUE(s)
&
√ Any Miscellaneous BACKGROUND

- Appeal of quashed state court subpoena per Touhy Rules (28 CFR 16.21). Propriety of removal of state court subpoena to federal court (28 USC 1442(a)(1))

√ **Background:** U.S. Trustee referred attorney to Minnesota Office of Lawyers Professional Responsibility, and attorney sought to depose U.S. Trustee. Per Touhy rules, DOJ allowed deposition of subordinate USTP attorney, but declined to make UST available for deposition. Respondent issued state court subpoena; DOJ removed to federal court & quashed; respondent appealed.

10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)
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11. DO YOU RECOMMEND POSTING IN UST BRIEFBANK?
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In The

UNITED STATES COURT OF APPEALS

For the Eighth Circuit

No. 00-3030 MN
Civil

IN RE CHARGES OF UNPROFESSIONAL CONDUCT
AGAINST ATTORNEY 99-37, an Attorney,
at Law of the State of Minnesota,

APPELLANT,

v.

BARBARA G. STUART, U.S. TRUSTEE,

APPELLEE.

Appeal from the United States District Court for the

District of Minnesota

BRIEF OF APPELLEE BARBARA G. STUART

B. TODD JONES
United States Attorney

BY: ROYLENE A. CHAMPEAUX
Assistant United States Attorney
District of Minnesota
Attorney I.D. No. 154805
600 United States Courthouse
300 South Fourth Street
Minneapolis, MN 55415
(612) 664-5600

Attorneys for Appellee

SUMMARY OF THE CASE AND STATEMENT REGARDING ORAL ARGUMENT

In October, 1998 United States Trustee Barbara G. Stuart forwarded to the Minnesota Office of Lawyers Professional Responsibility (hereinafter "OLPR") findings of the United States Bankruptcy Court regarding the apparent attorney misconduct of Attorney 99-37. The Minnesota OLPR later commenced an Attorney disciplinary proceeding against Attorney 99-37.

Attorney 99-37 obtained a subpoena from Ramsey County District Court directing the United States Trustee to appear at a deposition. Attorney 99-37 sought the consent of the United States Department of Justice to the deposition. The United States Department of justice refused to allow the United States Trustee to be deposed, but did consent to the deposition of the subordinate Departmental attorney assigned to the case.

After the United States Trustee did not appear for the deposition, Attorney 99-37 brought an action in Ramsey County District Court, the court issuing the subpoena, to compel the United States Trustee's testimony and to have the United States Trustee found in contempt of a state court subpoena. The United States Trustee removed the subpoena and motion to compel from state court to federal court. The United States Trustee then moved to quash the subpoena and dismiss the action. Attorney 99-37 moved the District Court to remand the case to State Court or alternatively to compel the United States Trustee's testimony and for an award of attorney's fees and costs.

The District Court, the Honorable James M. Rosenbaum reviewed the merits of the case, quashed the subpoena and granted the United States Trustee’s dismissal motion.

Counsel for Appellee do not believe oral argument will assist the court appreciably in its consideration of the case.

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III. WHETHER ATTORNEY 99-37 HAS A CONSTITUTIONAL RIGHT TO CROSS EXAMINE TRUSTEE STUART IN THE CONTEXT OF THE MINNESOTA ATTORNEY DISCIPLINARY PROCEEDING.

Fifth Amendment to the Constitution of the United States

Fourteenth Amendment to the Constitution of the United States

STATEMENT OF THE CASE

Attorney 99-37 obtained a subpoena from Ramsey County District Court directing the United States Trustee, Barbara G. Stuart, to appear at a January 25, 2000 deposition. Ms. Stuart is the United States Trustee for Region 12 covering the Districts of Minnesota, North Dakota, South Dakota and Iowa. The U.S. Trustee Program ("USTP") is a component of the Department of Justice responsible for overseeing the administration of bankruptcy cases and private trustees. 28 U.S.C. § 586; 11 U.S.C. § 101, et seq.[1/]

Attorney 99-37 obtained the state court subpoena pursuant to Rule 9(d), Minnesota Rules on Lawyers Professional Responsibility. Earlier the Minnesota Office of Lawyers Professional Responsibility had commenced a disciplinary proceeding against Attorney 99-37. Neither the United States nor U.S. Trustee Stuart were a party to this proceeding. Attorney 99-37 sought to take Ms. Stuart's deposition in conjunction with that disciplinary procedure.

[1/] Congress established the office of the United States Trustee in the Bankruptcy Reform Act of 1978 to "protect[] the public interest and ensur[e] that bankruptcy cases are conducted according to the law." H. Rep. No. 95-595, 95th Cong., 2d Sess. at 109 (Sept. 8, 1977), reprinted in 1978 U.S. Code Cong. & Admin. News 5787, 5963, 6070. Congress declared that the United States Trustee "may be compared with . . . a prosecutor," and stated in no uncertain terms that United States Trustees "serve as bankruptcy watch-dogs to prevent fraud, dishonesty, and overreaching in the bankruptcy arena." Id. at 6071 and 6049; accord In Re Clark, 927 F.2d 793, 795-96 (4th Cir. 1991) ("The trustee serves the role of 'protecting the public interest and ensuring that bankruptcy cases are conducted according to law'"); In Re Revco D.S. Inc., 898 F.2d 498, 499-500 (6th Cir. 1990); In Re Columbia Gas Sys. Inc., 33 F.3d 294, 296-97 (3d Cir. 1994).

Counsel for Attorney 99-37 applied to the United States Department of Justice (hereinafter "Department" or "DOJ") pursuant to the DOJ Touhy Regulations to depose United States Trustee Stuart.[2] DOJ refused to allow the United States Trustee to testify, but did allow the deposition and hearing testimony of a subordinate attorney in the United States Trustee's office, Sarah J. Fagg. Ms. Fagg's deposition had already been completed at the time Attorney 99-37 sought to depose United States Trustee Stuart.

After thorough review of the supplemental deposition request under the Department's Touhy rules, DOJ refused to allow the deposition of the United States Trustee because her testimony would, at most, be duplicative of the testimony of Ms. Fagg -- who was the attorney assigned to the case and most knowledgeable of the underlying facts and Bankruptcy Court findings of impropriety -- and because there is no waiver of sovereign immunity compelling the appearance of senior Federal officials in state court proceedings. In addition, the United States Trustee's deposition would be unduly burdensome and disruptive of the operation of her office, and wholly superfluous in light of the prior deposition of a subordinate. Accordingly, the United States Trustee did not appear at the deposition.

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[2] These rules are codified in the Code of Federal Regulations at 28 C.F.R. 16.21-16.29 (Subpart B, "Production or Disclosure in Federal and State Proceedings"). These regulations are sometimes referred to as the "Touhy" rules, after the seminal case of United States ex rel. Touhy v. Ragen, 340 U.S. 462 (1951), which is cited at 28 C.F.R. 16.28.

Attorney 99-37 then brought an action in State Court to compel the United States Trustee's testimony and to have Trustee Stuart found in contempt. Counsel for the United States Trustee removed the contempt action to Federal Court. The United States Trustee then moved to quash the subpoena and dismiss the action pursuant to Rule 12, Federal Rules of Civil Procedure, on the basis that the State Court lacked subject matter jurisdiction and that the Plaintiff had failed to state a claim upon which relief could be granted.

The District Court, the Honorable James Rosenbaum, reviewed the merits of the case, quashed the subpoena and granted the United States Trustee's dismissal motion.

Attorney 99-37 then filed this appeal.

STATEMENT OF THE FACTS

On October 21, 1998 United States Trustee Barbara G. Stuart made a referral to the Minnesota Office of Lawyers Professional Responsibility (hereinafter “OLPR”) involving the possible attorney misconduct of Attorney 99-37. The referral was based on pleadings filed by Attorney 99-37 and on the findings made by a federal bankruptcy judge. (See Parties Joint Appendix at 14 - 17.) The OLPR opened an investigation of Attorney 99-37. (App. at 18.)

Attorney 99-37 sought to depose the United States Trustee. (App. at 29 - 33.) The United States Department of Justice declined to allow the United States Trustee's testimony because a subordinate attorney in Trustee Stuart’s office had already been deposed by Attorney 99-37, because the United States was not a party to the OLPR litigation and because of the burden on the United States Trustee’s time and office. (App. at 36.)

Attorney 99-37 then brought an action in Ramsey County District Court to enforce the subpoena, to have the United States Trustee found in contempt of the state court subpoena, and for costs and attorneys fees. (App. at 48 - 49.)

The United States Trustee removed the subpoena and related contempt proceedings to Federal District Court. (App at 5 - 54.) Trustee Stuart did not remove the OLPR complaint against Attorney 99-37. (App. at 5 - 54.)

SUMMARY OF THE ARGUMENTS

1. Removal was proper under Title 28, United States Code, Section 1442(a)(1) as the United States Trustee while acting under color of office was named as a defendant in a contempt proceeding in State Court. (Appellee's Brief at Pgs 5 - 7.)
2. The Jurisdiction of a Federal Court upon removal pursuant to Title 28, United States Code, Section 1442 is derivative of that of the State Court. (Appellee's Brief at Pgs 8 - 9.)
3. The subpoena and contempt proceeding are barred by sovereign immunity. (Appellee's Brief at Pgs 10 - 16.)
4. Any Constitutional rights available to Attorney 99-37 in the context of the Minnesota disciplinary proceeding are not implicated in this subpoena case. (Appellee's Brief at Pg 17.)

ARGUMENTS

I. REMOVAL WAS PROPER UNDER TITLE 28, UNITED STATES CODE, SECTION 1442(a)(1).

Removal pursuant to Title 28, United States Code, Section 1442(a)(1) is proper where a federal officer has been named in a show cause proceeding, contempt proceeding, or other proceeding commenced within a pending state court case. See, e.g., Edwards v. United States Dep't of Justice, 43 F.3d 312, 314 (7th Cir. 1994)(removal pursuant to 28 U.S.C. § 1442(a)(1) where show cause proceeding were commenced against federal officials directing them to "show cause" why documents were not produced); Nationwide Investors v. Miller, 793 F.2d 1044, 1044-1046 (9th Cir. 1986) (removal pursuant to 28 U.S.C. § 1442(a)(1) upheld where state court issued "Order to Appear" to federal official in garnishment proceeding); DeTienne v. DeTienne, 815 F.Supp. 394, 395 (D. Kan. 1993) (removal pursuant to 28 U.S.C. § 1442(a)(1) where state court ordered federal agency official to appear and show cause why agency should not be held in contempt.)

A federal officer may remove even if not a party to the underlying state court proceeding. Louisiana v. Sparks, 978 F.2d 226, 231 (5th Cir. 1992)(contempt proceedings "need not be against parties in the underlying state case in order to fall within the ambit of the removal statute"); see Nationwide Investors, 793 F.2d at 1044-1046 (federal personnel employee's removal of Order to Appear for purposes of judgment creditor's garnishment in landlord tenant action); DeTienne, 815 F.Supp. at 395 (Social Security Administration's removal of garnishment proceeding in divorce action.)

Here, the Ramsey County District Court pursuant to Rule 9(a), Minn. R.L.P.R. issued a deposition subpoena to the United States Trustee. When the United States Trustee, pursuant to the instructions of the United States Department of Justice, failed to appear at the deposition, Attorney 99-37 brought an action in Ramsey County District Court to compel the United States Trustee's testimony and for a finding of civil contempt. Accordingly, the subpoena and contempt proceedings were removed as an action against a federal officer pursuant to 28 U.S.C. § 1442(a)(1). Only the deposition subpoena and related proceedings were removed from Ramsey County District Court. The underlying Office of Lawyers Professional Responsibility complaint was not removed from the jurisdiction of the Minnesota Supreme Court.

Attorney 99-37 argues that removal is improper because the entire attorney disciplinary proceeding was removed. He argues that this proceeding is neither a civil or criminal action but sui generis and as such not covered by 28 U.S.C. § 1442(a)(1). While it is clear from the record that only the subpoena and related proceeding were removed, the issue is not the exact nature of the proceedings but whether the action falls within the language and intent of the removal Statue. North Carolina v. Carr, 386 F.2d 129, 131 (4th Cir. 1967). In accord, Wisconsin v. Schaffer, 565 F.2d 961, 963 (7th Cir. 1977). The United States Trustee submits that a State Court contempt action against a federal officer falls within the language of 28 U.S.C. § 1442(a)(1).

Although Attorney 99-37 argues differently, the record below shows that the subpoena and contempt proceedings were a distinct action against the United States Trustee that were separate from the attorney disciplinary case and thus validly removed without removing the disciplinary case. United States v. Penney, 310 F.Supp. 1396, 1397 (D.C. 1970) and Wisconsin v. Schaffer, 565 F.2d at 964.

II. THE SUBPOENA AND MOTION TO COMPEL AND FOR A FINDING OF CIVIL CONTEMPT AGAINST THE UNITED STATES TRUSTEE ARE BARRED BY SOVEREIGN IMMUNITY.

A. The Jurisdiction of a Federal Court Upon Removal Pursuant to 28 U.S.C. § 1442 Is Essentially Derivative of That of the State Court.

An action against a federal officer may be removed even if there is no original federal subject matter jurisdiction over the action:

> [U]nlike removal pursuant to 28 U.S.C. § 1441 . . . a district court has jurisdiction to hear an action removed pursuant to 28 U.S.C. § 1442a even if the initial action could not have been commenced by the plaintiff in a federal forum.

Mir v. Fosburg, 646 F.2d 342, 344 (9th Cir. 1980); Johnson v. Showers, 747 F.2d 1228, 1229 (8th Cir. 1984)("Section 1442 'itself grants independent jurisdictional grounds over cases involving federal officers where a district court otherwise would not have jurisdiction.'")(quoting IMFC Professional Services, Inc. v. Latin American Home Health, Inc., 676 F.2d 152, 156 (5th Cir. 1982)); compare 28 U.S.C. § 1441(a), (b) (providing for removal of certain types of actions of which district courts have "original jurisdiction") with 28 U.S.C. § 1442(a)(1) (providing for removal of actions against federal officers without regard to existence of "original jurisdiction".)

Rather than being based on a grant of federal jurisdiction, "[t]he jurisdiction of the federal court upon removal, pursuant to 28 U.S.C. § 1442, is essentially derivative of that of the state court." Edwards, 43 F.3d at 316 (citing Arizona v. Manypenny, 451 U.S. 232, 242 n.17 (1981); As a "'purely derivative form of jurisdiction,'" Section 1442(a)(1) removal jurisdiction "'neither enlarg[es] nor contract[s] the rights of the parties.'" See, e.g., Guidry v. Durkin, 834 F.2d 1465, 1468 (9th Cir. 1987)(quoting Manypenny, 451 U.S. at 242, 101 S.Ct. at 1664 (footnote omitted.) "Thus, the net effect of Section 1442(a)(1) is to provide a federal officer with a federal forum in which the federal rules of procedure will be applied without changing the substantive law relevant to the plaintiff's claims." Guidry, 834 F.2d at 1468.

"However, because of the derivative nature of the jurisdiction conferred on the district court by [Section 1442(a)(1)], the federal court may not exercise jurisdiction over the removed action unless the state court initially had subject matter jurisdiction." Id. Accordingly, if the state court had no jurisdiction over the removed action, the action must be dismissed by the federal court for lack of jurisdiction. See, e.g., id. (removed state court action dismissed where state court "lacked subject matter jurisdiction over . . . claims . . . and, a fortiori, the district court acquired no subject matter jurisdiction over those claims upon removal"); Johnson, 747 F.2d at 1229 (dismissal of third-party complaint where state court had no jurisdiction.) Therefore, because, in this case, the federal court's jurisdiction is derivative of the state court's jurisdiction, if the state court had no jurisdiction over the federal Defendant, the subpoena was properly dismissed.

B. No Jurisdiction Exists Over the Subpoena And Related Proceedings Unless Authorized By Federal Statute.

A suit against federal defendants in their official capacities is a suit against the United States which is barred by the doctrine of sovereign immunity, unless the United States has waived immunity. Coleman v. Espy, 986 F.2d 1184, 1189 (8th Cir. 1993), cert. denied, Dye v. Espy, 510 U.S. 913, 114 S.Ct. 301 (1993); and Lukovsky v. Herstad, 748 F.2d 499, 500 (8th Cir. 1984).

Here, the motion to compel and for a finding of civil contempt does not assert any actions by the Federal Defendant in her individual capacities. Rather the motion and Subpoena assert actions by the Federal Defendant taken under color of office. Therefore, the motion to compel and for a finding of civil contempt based on the underlying State Court subpoena is an action against the United States that is barred by sovereign immunity unless there has been a waiver.

It is, of course, axiomatic, that waivers of sovereign immunity cannot be inferred; rather, any waiver of sovereign immunity of the United States from suit must be explicit, and should be strictly construed in favor of the United States. Ruckelshaus v. Sierra Club, 463 U.S. 680, 685 (1983); Lehman v. Nakshian, 453 U.S. 156, 160-161 (1981)(quoting Soriano v. United States, 352 U.S. 270, 276 (1957)); United States v. Kubrick, 444 U.S. 111, 117-118 (1979). A suit against the United States cannot be brought unless it can be shown that an act of Congress specifically authorizes the court to entertain his particular claim. McNutt v. General Motors Acceptance Corp., 298 U.S. 178 (1936); Lehigh Mining and Mfg. Co., v. Kelly, 160 U.S. 327, 337 (1895). "'Waiver of sovereign immunity is a jurisdictional prerequisite in the nature of . . . subject matter jurisdiction, in that unless sovereign immunity is waived, there may be no consideration of the subject matter.'" Louisiana v. Sparks, 978 F.2d 226, 235 (5th Cir. 1992) (quoting J.C. Driskill, Inc. v. Abdnor, 901 F.2d 383, 385 n.4 (4th Cir. 1990)).

Attorney 99-37 argues that the United States Trustee's actions in sending a referral letter to the OLPR constitute a waiver of sovereign immunity. The facts show that United States Trustee Stuart made a referral to the Office of Lawyers Responsibility solely in her official capacity as U.S. Trustee. Such referral was based on pleadings filed by Attorney 99-37 with the United States Bankruptcy Court for the District of Minnesota and on findings of apparent impropriety entered by the Honorable Dennis D. O'Brien, Chief United States Bankruptcy Judge. The referral contains no information based on any personal knowledge of United States Trustee Stuart.

The disclosure of factual information of this nature does not constitute a waiver of sovereign immunity as to other related matters. Smith v. Cromer, 159 F.3d 875, 880 (4th Cir. 1998); see also, Swett v. Schenk, 792 F.2d 1447, 1452 (9th Cir. 1986), (Permitting a federal employee to testify on certain matters which are not violative of the regulations at issue cannot be construed as an intent to waive immunity.)

After receiving the referral, the Minnesota Office of Lawyers Professional Responsibility chose to bring a disciplinary proceeding against Attorney 99-37. Attorney 99-37 argues that the United States Trustee brought the disciplinary proceeding against him/her. That is incorrect; the United States Trustee did not bring the proceeding. Rather, the United States Trustee simply brought the Bankruptcy Court's findings to the attention of the Office of Lawyers Professional Responsibility which then proceeded to act against Attorney 99-37. See Referral Letter dated October 21, 1998, at page 2 ("this referral [is] based on Judge O'Brien's findings that the transfer of real estate and the transfer of money were intentionally concealed from the Bankruptcy Court") (App. at 14-17).

Further, there is no merit to any suggestion that, by allowing Ms. Fagg's deposition, the Department waived sovereign immunity as a defense to the deposition of other DOJ officials, such as the United States Trustee. To the contrary, the Touhy regulations, 28 C.F.R. § 16.24 et seq., serve the salutary goal of minimizing the dissipation of scarce Federal resources by allowing the Department to determine which, if any, employees should testify in state court proceedings as to which sovereign immunity has not been waived. Nothing in these regulations provides that if DOJ allows the testimony of a certain employee, the Department must allow the testimony of any other DOJ employee, let alone a senior Departmental official.

Accordingly, no waiver exists for the deposition of the United States Trustee, and the subpoena and contempt proceedings were properly dismissed by the U.S. District Court because those state court proceedings do not fall within any exception to the doctrine of sovereign immunity expressly set forth in a federal statute. No such exception exists here.

C. The State Court Lacked Jurisdiction To Require Testimony From a Federal Employee Who Has Been Instructed, Pursuant to **Touhy** Regulations, Not To Testify In A State Court Matter.

The head of an executive department, such as the Department of Justice, may regulate the conduct of his employees and "the custody, use, and preservation of its records, papers, and property." 5 U.S.C. § 301. In United States ex rel. Touhy v. Ragen, 340 U.S. 462, 467-68 (1951), the Supreme Court validated this position by determining that the Attorney General of the United States could, by regulation, take from his subordinates the discretion to determine whether documents in their custody should be disclosed. See also Boron Oil Co. v. Downie, 873 F.2d 67, 69 (4th Cir. 1989) and Swett v. Schenk, 792 F.2d 1447, 1451-52 (9th Cir. 1986).

Accordingly, the Department of Justice has adopted regulations prohibiting the disclosure of "any information relating to or based upon material contained in the files of the Department ... without prior approval of the proper Department official...." 28 C.F.R. § 16.21-16.29[3]. The Department of Justice regulations at issue here,

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[3] Section 16.21(a) provides in pertinent part:

> (a) This subpart sets forth procedures to be followed with respect to the production or disclosure of any material contained in the files of the department, any information relating to material contained in the files of the Department, or any information acquired by a person while such person was an employee of the Department as part of the performance of that person's official duties or because of that person's official status: ....
>
> (2) In all ... state proceedings in which the United States is not a party, including any proceedings in which the Department is representing a government employee solely in

28 C.F.R. §§ 16.21-16.29, are valid and should be accorded the force of law. North Carolina v. Carr, 264 F.Supp. 75, 80 (W.D. N.C.), appeal dismissed 386 F.2d 129 (4th Cir. 1967) (upholding Department of Justice Order No. 324-64 (predecessor to 28 C.F.R. § 16.21, et seq.))[4]; see also United States v. Allen, 554 F.2d 398, 406 (10th Cir.), cert. denied, 434 U.S. 836 (1977). In Touhy, the

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that employee's individual capacity, when a subpoena, order, or other demand ... of a court ... is issued for such material or information....

Section 16.22 provides in pertinent part:
(a) In any ... state case ... in which the United States is not a party, no employee ... shall, in response to a demand, produce any material contained in the files of the Department, or disclose any information relating to or based upon material contained in the files of the Department, or disclose any information or produce any material acquired as part of the performance of that person's official duties or because of that person's official status without prior approval of the proper Department of Justice official in accordance with §§ 16.24 and 16.25 of this part....

(c) If oral testimony is sought by demand in any case or matter in which the United States is not a party, an affidavit, or, if that is not feasible, a statement by the party seeking the testimony or by his attorney, setting forth a summary of the testimony sought and its relevance to the proceeding must be furnished to the responsible U.S. Attorney. Any authorization for testimony by a present ... employee of the Department, shall be limited to the scope of the demand as summarized in such statement.

[4] Order no. 324-64, formerly 28 C.F.R. § 16.1, provided in part:

"No officer or employee of the Department of Justice shall produce or disclose, in response to a subpoena, order, or other demand ... of a court or other authority any information or material contained in the files of the Department of Justice or any other information or material acquired as part of the performance of his official duties or because of his official status, without the prior approval of the Attorney General."

Supreme Court upheld another predecessor of the regulations involved in this case and ordered the release from jail of a special agent of the F.B.I. who had been incarcerated on contempt charges. Touhy, 340 U.S. at 470. Petitioner Touhy, in a habeas corpus proceeding, demanded that an agent of the FBI produce certain records pertinent to his case. The subpoena required the production of certain records which, petitioner Touhy claimed, established that his conviction was brought about by fraud. Id. at 464-65. The agent requested instructions from his superiors, and was jailed for contempt of court when he declined to produce the files on orders from the Attorney General. Id. at 465.

The Supreme Court notes that it was appropriate for the Attorney General to prescribe regulations and procedures governing the custody, use, release, and preservation of records pertaining to the Department of Justice. Id. The Court held that the refusal of the official was proper and that the Attorney General may withdraw from his subordinates the power to release department papers. Id. at 467. The Court noted that employees of the Department of Justice have no discretion to honor subpoenas for official information and that they are bound to follow the lawful orders of the Attorney General. Id. This observation follows a judicial policy against holding a subordinate responsible for the discretionary acts of his superiors. N.L.R.B. v. Capitol Fish Co., 294 F.2d 868, 874 n.13 (5th Cir. 1961); Marcoux v. Mid-States Livestock, 66 F.R.D. 573, 579 (W.D.Mo. 1975).

_____Following the receipt of the request for testimony, which is required to be produced, the Department of Justice must consider whether or not disclosure of information through the oral testimony of the employee is appropriate under various factors listed in 28 C.F.R. § 16.26(a) and (b).

The Assistant Attorney General of the United States or his designee is charged with determining whether the requested materials should be produced. 28 C.F.R. §§ 16.22, 16.24. Here, after making the United States Trustee's subordinate available for deposition, the Director of the Executive Office for United States Trustees and the United States Attorney determined that United States Trustee Stuart’s testimony was not authorized, as previously explained. Attorney 99-37 then moved to compel and for a finding of civil contempt in Ramsey County District Court. The United States District Court properly determined that the State Court lacked jurisdiction to compel the United States Trustee's testimony in the underlying state court matter.

III. ATTORNEY 99-37 DOES NOT HAVE A CONSTITUTIONAL RIGHT TO CROSS EXAMINE TRUSTEE STUART IN THE CONTEXT OF THE MINNESOTA ATTORNEY DISCIPLINARY PROCEEDING.

The United States Trustee did not bring the attorney disciplinary complaint. Rather, that complaint was filed by the Minnesota Office of Lawyers Professional Responsibility based upon its independent review of the facts of record, including the findings of apparent impropriety by Attorney 99-37 before the Bankruptcy Court. Nor did the United States Trustee remove the underlying state attorney disciplinary proceedings to federal court or otherwise purport to subject those uniquely state matters of "attorney discipline" to federal jurisdiction.

Rather, the sole issue on appeal stems from the United States Trustee's exercise of her right, under 28 U.S.C. § 1442(a)(1), to remove the state court subpoena and related contempt proceedings filed against her by Attorney 99-37 from state court to U.S. District Court, which properly dismissed them for lack of federal jurisdiction.

Whatever constitutional rights Attorney 99-37 is guaranteed under the Constitution of the United States or the Minnesota Constitution are not implicated here. No response is required to the arguments contained in Part III of Appellant’s brief (Appellant’s brief at pgs. 17-22) because sovereign immunity controls the outcome.

CONCLUSION

For all these reasons Appellee Stuart requests that the judgment of the District Court be affirmed in all respects.

CERTIFICATE OF COMPLIANCE

The undersigned attorney for the United States certifies this brief complies with the type-volume limitation of Federal Rule of Appellate Procedure 32. The brief has 905 lines of monospaced type. The brief was prepared using WordPerfect 8.1. The undersigned attorney also certifies that the computer diskette containing the full text of the Brief of Appellee has been scanned for viruses and to the best of our ability and technology, believes it is virus-free.

Dated: November 9, 2000

B. TODD JONES
United States Attorney

BY: ROYLENE A. CHAMPEAUX
Assistant United States Attorney
District of Minnesota
Attorney I.D. No. 154805
600 United States Courthouse
300 South Fourth Street
Minneapolis, MN 55415
(612) 664-5600

Attorneys for Appellee
Barbara G. Stuart, U.S. Trustee

ADDENDUM OF APPELLEE

CERTIFICATE OF SERVICE BY MAIL

IN RE CHARGES OF UNPROFESSIONAL)
CONDUCT AGAINST 99-37, AN ATTORNEY)
AT LAW OF THE STATE OF MINNESOTA,)
) APPEAL NO. 00-3030 MN
Appellant,)
)
v.)
)
BARBARA G. STUART, UNITED STATES)
TRUSTEE FOR THE DISTRICT OF)
MINNESOTA,)
)
Appellee.)

The undersigned hereby certifies that she is an employee in the Office of the United States Attorney for the State and District of Minnesota and is a person of such age and discretion as to be competent to serve papers.

That on November 9, 2000 she served two copies of the attached: BRIEF OF APPELLEE

and a 3½ inch computer disk containing the full test of the Brief of Appellee by placing said copies in a postpaid envelope addressed to the person hereinafter named, at the place and address stated below which is the last known address, and by depositing said envelope and contents in the United States Mail at Minneapolis, MN 55415.

Addressee(s):

Richard J. Harden, Esq.
RICHARD J. HARDEN, P.A.
6053 Hudson Road, Suite 120
Woodbury, MN 55125-1015

CARLA R. KOHL

U.S. Department of Justice

United States Attorney
District of Minnesota

600 United States Courthouse *(612)664-5600*

300 South Fourth Street
Minneapolis, MN 55415

November 9, 2000

VIA FEDERAL EXPRESS
Mr. Michael Gans, Clerk
U.S. Court of Appeals for
the Eighth Circuit
Thomas F. Eagleton Court House
Room 24.329
111 S. 10th Street
St. Louis, MO 63102

Re: In Re Charges of Unprofessional Conduct Against Attorney 99-37, an Attorney at Law of the State of Minnesota v. Barbara G. Stuart, U.S. Trustee
Appeal No. 00-3030 MN

Dear Mr. Gans:

Enclosed for filing, together with a Certificate of Service, are the original and nine copies of the **Brief of Appellee** in the above-referenced matter. Also enclosed for filing is a 3½ inch computer diskette containing the full text of the Brief of Appellee. The diskette has been scanned for viruses and to the best of our ability and technology, we believe it is virus-free.

Opposing counsel is being served by copy of this letter and enclosures.

Sincerely,

B. TODD JONES
United States Attorney

BY: ROYLENE A. CHAMPEAUX
Assistant U. S. Attorney

Enclosure
c: (w/enclosure)
Richard J. Harden, Esq.
Anthony J. Ciccone, Esq. - OGC, EOUST
Robert Raschke, Assistant U.S. Trustee
Timothy M. Burke, Esq. - OLPR

BRIEF BANK — "SUMMARY SHEET" *Printed Tue-6/8/10 16:32*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*

In re: Sugar Hill Residential Development, Inc. (Richard L. Fuqua v. Charles F. McVay, United States Trustee for Region 7)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*

S.D. Tex.

3. ("CCN") ***CURRENT*** CASE NO.

No.: 08-cv-2796

4. ("PCN") ***PRIOR*** CASE NO. - & COURT *[IF ANY]*

No.: 08-31459

Court: Bankr. S.D. Tex.

(Identify judge & cite, if any)

5. ("SO") ***SOURCE***

U.S. TRUSTEES

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*

Filed: June 1, 2010

Type: Brief for the United States Trustee as Appellee

7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*

Kevin M. Epstein, John P. Sheahan, P. Matthew Sutko, Ramona D. Elliott, Charles F. McVay

(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***

BANKRUPTCY

9. ("SU") ● ***SUMMARY*** OF KEY ISSUE(s)

&

√ Any Miscellaneous ***BACKGROUND***

● Whether bankruptcy court's determination that Mr. Fuqua engaged in sanctionable conduct is supported by the record and is not clearly erroneous.

10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)

11. DO YOU RECOMMEND POSTING IN UST BRIEFBANK?

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NAME: Linda Figueroa

DATE:

Case No. 08-cv-2796

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF TEXAS

In the Matter of: SUGAR HILL RESIDENTIAL DEVELOPMENT, INC.

Debtor

RICHARD L. FUQUA,

Appellant

v.

CHARLES F. McVAY, UNITED STATES TRUSTEE FOR REGION 7

Appellee

ON APPEAL FROM THE UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF TEXAS

BRIEF FOR THE UNITED STATES TRUSTEE AS APPELLEE

RAMONA D. ELLIOTT
General Counsel
P. MATTHEW SUTKO
Associate General Counsel
JOHN P. SHEAHAN
Department of Justice
20 Massachusetts Avenue, NW
Washington, DC 20530
Telephone: (202) 307-1399
Facsimile: (202) 307-2397

CHARLES F. MCVAY
United States Trustee
KEVIN M. EPSTEIN
Attorney-in-Charge
Texas Bar No. 00790647
Southern District No. 437129
Office of the U.S. Trustee
615 E. Houston St., Room 357
P.O. Box 1539
San Antonio, TX 78295-1539
Telephone: (210) 472-4640
Facsimile: (210) 472-4649

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STATEMENT OF THE STANDARD OF REVIEW

This Court reviews the factual findings of the bankruptcy court for clear error, and reviews its conclusions of law de novo. *In re San Patricio Cty. Comm. Action Agency*, 575 F.3d 553, 557 (5th Cir. 2009). Where a bankruptcy court determines that sanctionable conduct has occurred, the resulting sanction is reviewed for abuse of discretion. *In re Dragoo*, 186 F.3d 614, 616 (5th Cir. 1999).

STATUTORY BACKGROUND

The decision below involves three separate sources of the bankruptcy court's disciplinary authority: Rule 9011 of the Federal Rules of Bankruptcy Procedure (the "Bankruptcy Rules"); 11 U.S.C. § 105(a); and the inherent powers of federal courts.

Rule 9011 provides that by filing, signing, or advocating a pleading, an attorney is deemed to have represented that, "to the best of the person's knowledge, information, and belief," and after "an inquiry reasonable under the circumstances," the pleading is not being presented for an improper purpose, its legal contentions are warranted by existing law, and the factual allegations have evidentiary support. Fed. R. Bankr. P. 9011(b). Where an attorney violates his Rule 9011 obligations, the court may impose both monetary and non-monetary sanctions, in an amount "sufficient to deter repetition of such conduct or comparable conduct by others similarly situated." Fed. R. Bankr. P. 9011(c).

Section 105(a) of the Bankruptcy Code authorizes bankruptcy courts to take "any action . . . necessary or appropriate to enforce or implement court orders or rules, or *to prevent an abuse of process*." 11 U.S.C. § 105(a) (emphasis added). The Fifth Circuit has construed Section 105(a) as providing an independent statutory basis for sanctions and remedial relief against litigants who abuse the bankruptcy system. *Campbell v. Countrywide Home Loans, Inc.*, 545 F.3d 348, 356 n.1 (5th Cir. 2008); *see also In re Sadkin*, 36 F.3d 473, 478-79 (5th Cir. 1994) (stating that section 105(a) "provides equitable powers for the bankruptcy court to use at its discretion"). The bankruptcy court's Section 105(a) authority does not require a finding of bad faith. *See In re Hardy*, 97 F.3d 1384, 1389 (11th Cir. 1996) (holding that, for purposes of civil contempt proceedings under section 105(a), no showing of bad faith was required).

The bankruptcy court also possesses inherent authority to issue sanctions against attorneys and litigants who engage in misconduct before the court. *See Chambers v. NASCO, Inc.*, 501 U.S. 32, 45-48 (1991); *In re Yorkshire, LLC*, 540 F.3d 328, 332 (5th Cir. 2008) (affirming sanctions under bankruptcy court's inherent powers). The fact that such conduct may arguably fall afoul of, or be governed by other rules and statutes does not deprive the court of its inherent power to sanction bad faith conduct. *Chambers*, 501 U.S. at 46-47. To invoke its inherent powers, the court must find that the party being sanctioned acted in bad faith. *Yorkshire*, 540 F.3d at 332 (citing *Elliot v. Tilton*, 64 F.3d 213, 217 (5th Cir. 1995)); *see also Fink v. Gomez*, 239 F.3d 989, 993-94 (9th Cir. 2001) (reckless statements made to the court coupled with an improper purpose, such as the manipulation of proceedings, was tantamount to bad faith and sufficient to impose sanctions under court's inherent authority).

STATEMENT OF THE CASE

On September 3, 2008, the United States Bankruptcy Court for the Southern District sanctioned Mr. Richard Fuqua, an attorney, for his role in filing a misleading bankruptcy petition for an entity that lacked any legitimate reorganization purpose, as well as for his subsequent actions in which he misrepresented facts to both the court and to the United States Trustee[1] in an effort to avoid judicial scrutiny of his behavior. That sanction consisted of a referral to the state bar of Texas, as well as a fine in the

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[1] The United States Trustee Program is the component of the Department of Justice that enforces federal bankruptcy law. *See* H.R. Rep. No. 95-595 at 110 (1977) (describing United States Trustees' "obligation to execute and enforce the bankruptcy laws"). Among other duties, United States Trustees are authorized to commence "proceedings in the bankruptcy courts in particular cases in which a particular action taken or proposed to be taken deviate[d] from the standards established by the . . . bankruptcy code." H.R. Rep. No. 95-989 at 88, 109 (1977), *quoted in In re A-1 Trash Pickup*, 802 F.2d 774, 775 (4th Cir. 1986). The United States Trustee may raise and be heard on any issue in a chapter 11 case. *See* 11 U.S.C. § 307; *In re Clark*, 927 F.2d 793, 796 (4th Cir. 1991) (recognizing appellate standing of United States Trustee); *In re Plaza de Diego Shopping Ctr.*, 911 F.2d 820, 824 (1st Cir. 1990) (same).

amount of $15,000, pursuant to Fed. R. Bankr. P. 9011, 11 U.S.C. § 105(a), and the inherent powers of the court. (Dkt. 28).[2]

On September 11, 2008, Mr. Fuqua filed a timely notice of appeal from the bankruptcy court's sanctions order. (Dkt. 32). On August 28, 2009, this Court dismissed the appeal for failure to prosecute. (Dist. Ct. Dkt. 4). On September 4, 2009, Mr. Fuqua moved for reconsideration of this Court's dismissal order. (Dist. Ct. Dkt. 5). On October 22, 2009, this Court granted Mr. Fuqua's motion and reinstated this appeal. (Dist. Ct. Dkt. 10).

STATEMENT OF THE FACTS

1. Background.

The debtor, Sugar Hill Residential Development, Inc. ("Sugar Hill"), was a special-purpose entity whose only business activity was to act as general partner for SHRD Partners, LP (the "Limited Partnership"). *See* Transcript of June 16, 2008 Evidentiary Hearing (Dkt. 20) (hereinafter "Tr. _") at 27 (testimony of Mr. Easley). Apart from a small partnership interest in the Limited Partnership, Sugar Hill had minimal assets and no full-time employees. (Tr. 27). The Limited Partnership, in turn, was also a special-purpose entity, whose sole asset was an undeveloped 137-acre

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[2] Unless otherwise indicated, all docket references are to the docket of the bankruptcy court case of In re Sugar Hill Residential Development, Inc., Case No. 08-31459 (Bankr. S.D. Tex.).

parcel of land in Harris County, Texas (the "Property"). (Tr. 51) (testimony of Mr. Fuqua). At the time of the Sugar Hill's bankruptcy filing, the Real Property had been posted for foreclosure by the Limited Partnership's secured creditor, Olympic Coast Investments ("Olympic"). (Tr. 53).

In addition to serving as the attorney for Sugar Hill, Mr. Fuqua controls the Fuqua Family Limited Partnership, which was the former owner of one of the parcels comprising the Property, and which at the time of the Sugar Hill bankruptcy owned an interest of between 15 and 20 percent of the Limited Partnership. (Tr. 95) (testimony of Mr. Fuqua). The bankruptcy court found that Mr. Fuqua "has been familiar with the ownership of the [Property] since at least 2001." (Dkt. 28 at 9). Mr. Fuqua did not file any pleading disclosing the relationship between the Fuqua Family Limited Partnership and the Limited Partnership.[3]

2. Mr. Fuqua files a bankruptcy petition on behalf of Sugar Hill, which the bankruptcy court finds to be incomplete and misleading.

Following the failure of workout negotiations, Olympic posted the Property for a foreclosure sale scheduled for March 4, 2008. (Tr. 23) (testimony of Mr. Easley).

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[3] In a chapter 11 bankruptcy case, the attorney for the debtor is required to file a disclosure of compensation promised or received from the debtor, as well as a certification listing the attorney's connection with the debtor or other parties in the bankruptcy case. 11 U.S.C. § 329; Fed. R. Bankr. P. 2014, 2016. Mr. Fuqua did not file the documents disclosing connections required by Fed. R. Bankr. P. 2014 in the Sugar Hill case.

On about February 29, 2008, Thomas L. Easley, the president of Sugar Hill, directed Mr. Fuqua to prepare a chapter 11 bankruptcy petition in response to the foreclosure. (Tr. 52) (testimony of Mr. Fuqua). Although the owner of the Property was the Limited Partnership, and not Sugar Hill, Mr. Fuqua filed a bankruptcy petition on behalf of Sugar Hill alone. (Tr. 57).[4]

On March 3, 2008, Mr. Fuqua filed a chapter 11 bankruptcy petition on behalf of Sugar Hill. (Dkt. 1). The bankruptcy court found this petition to be incomplete and misleading in several respects. Although 11 U.S.C. § 521 and Fed. R. Bankr. P. 1007 require a chapter 11 debtor to file a complete set of financial schedules along with its bankruptcy petition, Sugar Hill's petition includes only a single schedule, Schedule A, which sets forth a debtor's interests in real property. That schedule, in turn, contained an entry for the Property, which was described without elaboration as a "3%

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[4] According to the testimony of both Mr. Easley and Mr. Fuqua, this was done at the direction of Mr. Easley, who believed that a chapter 11 filing by Sugar Hill would be "less complicated." (Tr. 27) (testimony of Mr. Easley); (Tr. 57) (testimony of Mr. Fuqua). The bankruptcy court found that the testimony of Mr. Easley and Mr. Fuqua was not credible. (Dkt. 28 at 4). The bankruptcy court found that the actual motive for filing a petition on behalf of Sugar Hill and not the Limited Partnership was to avoid a disqualification of Mr. Fuqua under 11 U.S.C. § 327, which requires attorneys for the debtor-in-possession to be "disinterested." 11 U.S.C. § 327(a). Had the Limited Partnership filed a bankruptcy petition, Mr. Fuqua would likely have been unable to satisfy the disinterestedness requirement of section 327, and therefore would have been ineligible to serve as the bankruptcy attorney for the Limited Partnership, due to his control of the Fuqua Family Limited Partnership.

Interest." Sugar Hill did not initially file a Schedule B, which sets forth a debtor's interests in personal property. *See* Fed. R. Bankr. P. Official Form 6.

The bankruptcy court found that Mr. Fuqua's failure to file Schedule B with Schedule A was misleading under the circumstances of the case. Although Sugar Hill's Schedule A referenced a "3% interest," Sugar Hill did not actually have a direct ownership interest in the Property. Rather, Sugar Hill had a 3% interest in the Limited Partnership, not the Property. If Schedule B had been completed accurately, Mr. Fuqua would have been required to disclose that Sugar Hill's 3% interest was actually an interest in a partnership. The bankruptcy court found that timely filing of Schedule B would have removed any ambiguity concerning the nature of Sugar Hill's interest in the Property, and further found that the reason Mr. Fuqua did not file Schedule B with Schedule A was that he intended to create a false impression that Sugar Hill, rather that the Limited Partnership, was the actual owner of the Property. (Dkt. 28 at 9).

Mr. Fuqua denied having filed Sugar Hill's bankruptcy pleadings with an intent to deceive. Instead, he attributed the ambiguity of the Sugar Hill petition and schedules to the hurried manner in which the Sugar Hill bankruptcy was filed. In particular, Mr. Fuqua testified that prior to drafting Sugar Hill's bankruptcy petition, he "glanced" at the file provided to him by Mr. Easley but did not review the actual deed to the Property or any public documents. (Tr. 55). Mr. Fuqua further testified that at the time of the bankruptcy filing, he “really didn’t know either way” whether Sugar Hill or the Limited Partnership was the owner of the Property. (Id.).

The bankruptcy court found that Mr. Fuqua was not credible when he claimed not to know whether Sugar Hill owned the Property. (Dkt. 28 at 8). The bankruptcy court found it significant that Mr. Fuqua’s other testimony revealed that he “was very familiar with title to the [Property] and how the [Property] came to be owned by the Limited Partnership.” (Dkt. 28 at 2) (citing Tr. at 50-51). The bankruptcy court found further that even if title to the Property was unclear, Mr. Fuqua had three days between his engagement and the bankruptcy filing to determine ownership of the Property. (Dkt. 28 at 3). As a result, the bankruptcy court concluded that at the time Sugar Hill filed for bankruptcy, “he knew or should have known that [Sugar Hill] did not have an interest” in the Property. (Id. at 8).

Mr. Fuqua testified that the purpose of the bankruptcy filing was to delay foreclosure. This tactic was unsuccessful. On the morning of March 4, 2008, Mr. Fuqua contacted counsel for Olympic to advise them of Sugar Hill’s bankruptcy filing the previous evening. (Tr. 64) (testimony of Mr. Fuqua). Olympic’s counsel, however, concluded that the skeletal bankruptcy petition filed by Sugar Hill did not affect its ability to foreclose on an asset owned by the Limited Partnership.[5] As a result, Olympic proceeded with the foreclosure as scheduled on March 4. (Tr. 67). Sugar Hill did not contest the foreclosure. As a result of this foreclosure, Sugar Hill was left with no assets or business to reorganize. (Tr. at 74).

3. Mr. Fuqua files a motion for an extension of time for Sugar Hill to file its bankruptcy schedules, based on a representation that Sugar Hill's management was burdened by bankruptcy-related duties.

On March 18, 2008, nearly two weeks after the foreclosure of the Limited Partnership's only asset, Mr. Fuqua signed and filed the Debtor's Motion to Extend Time to File Schedules and Statement of Financial Affairs (Dkt. 6). That motion represented, among other things, that since the date of its bankruptcy petition, Sugar Hill "has maintained possession of its property, and remains in control of its ongoing business affairs." (Id. ¶ 1). The motion further represented that an extension of time to file the full schedules required by 11 U.S.C. § 521 was necessary because "the bankruptcy filing has placed additional burdens upon the Debtor's accounting staff, which has been working extremely hard to perform its normal duties while complying

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[5] Section 362 of the Bankruptcy Code provides that the filing of a bankruptcy petition acts as an automatic stay of, among other things, a pending foreclosure proceeding against property owned by the estate. 11 U.S.C. § 362(a)(1), (3), (4), (5). As Olympic's counsel correctly realized, however, the automatic stay normally does not stay actions against property owned by non-debtor affiliates of the debtor. *See Arnold v. Garlock, Inc.*, 278 F.3d 426, 436 (5th Cir. 2001).

with the requirements of the Office of the United States Trustee and requests for information from various creditors." (Id. ¶ 3).

The bankruptcy court granted Sugar Hill a ten-day extension of time, through March 28, 2008, to file its schedules. (Dkt. 9). Sugar Hill did not comply with the extended deadline. (Dkt. 28 at 6). Instead, Sugar Hill took no action to file its schedules until the bankruptcy court expressly raised the issue of sanctions against Mr. Fuqua. (Dkt. 28 at 8). Sugar Hill's schedules eventually were filed on May 27, 2008. (Dkt. 15).

The bankruptcy court found that the factual representations in Sugar Hill's initial motion for an extension of time were false, or at the very least, seriously misleading. (Dkt. 28 at 5). It did so based on its finding that as of March 18, 2008, Sugar Hill had no "ongoing business affairs," due to the Limited Partnership's loss of its only asset. There was also no evidence that Sugar Hill's "staff" (consisting of a single shared employee) was being overtaxed by bankruptcy duties, or, for that matter, performing any duties at all. (Id.).

4. Acting on Mr. Fuqua's advice, Sugar Hill's president fails to attend two Initial Debtor Interviews as well as the Meeting of Creditors pursuant to 11 U.S.C. § 341.

In chapter 11 cases, United States Trustees conduct Initial Debtor Interviews ("IDIs") immediately after the bankruptcy petition is filed in order to ensure the accuracy of the debtor's schedules and ensure the debtor's compliance with its various administrative obligations. *See* United States Trustee Manual ¶ 3-3.1 (http://www.justice.gov/ust/eo/ust_org/ustp_manual/volume3/vol3ch03.htm); *In re Stuart*, Case No. 05-95809, 2005 WL 3953894 (Bankr. N.D. Ga. Dec. 19, 2005) (holding that debtor's failure to attend IDI may constitute cause for dismissal of bankruptcy petition). In addition, section 341 of the Bankruptcy Code requires that, within a reasonable time after the filing of the petition, the United States Trustee shall convene a meeting of creditors. 11 U.S.C. § 341(a). An officer of the debtor is required to attend the meeting of creditors and be examined under oath. 11 U.S.C. § 343.

In this case, the United States Trustee initially scheduled the IDI for March 19, 2008. Although Mr. Fuqua was present, Mr. Easley, the president of Sugar Hill, was not. Mr. Easley later testified that he failed to attend because "I was advised that it would not be a necessity." (Tr. at 38).[6] As a result, the United States Trustee rescheduled the IDI for April 4, 2008. Mr. Easley again did not appear. According

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[6] Mr. Easley testified that he could not specifically recall who advised him not to attend the IDI, explaining that "I would have probably gotten this through someone in our office, Mrs. Lefler perhaps, that would have probably spoken to someone on Mr. Fuqua's staff. But I don't want to speculate on that." (Tr. at 38). Based on Mr. Easley's testimony, the bankruptcy court concluded that the source of this advice was Mr. Fuqua. (Dkt. 28 at 9).

to Mr. Easley's testimony, his failure to attend the April 4 IDI "would have had to have been for similar reasons to the previous one." (Id.).

Mr. Easley also failed to attend the Meeting of Creditors, held on April 8, 2008. As before, Mr. Easley testified that his failure to attend was based on advice that his "presence was not specifically required." (Tr. 39).

5. At the Section 341 Meeting, Mr. Fuqua represents to counsel for the United States Trustee that Sugar Hill had reached an out-of-court settlement with Olympic.

No person attended the April 8, 2008 Section 341 meeting apart from Mr. Fuqua and Mr. Hector Duran, an attorney for the United States Trustee. Because no creditor or representative of the debtor was present, the proceedings were not recorded. (Tr. at 77) (testimony of Mr. Fuqua). It is undisputed that in the conversation that ensued, Mr. Fuqua urged the United States Trustee to seek dismissal of the Sugar Hill bankruptcy case. However, Mr. Duran and Mr. Fuqua offered conflicting testimony as to the exact content of that conversation. Mr. Duran testified that Mr. Fuqua informed him that "this case was filed due to a pending foreclosure by [Olympic], and that an out-of-court settlement had been reached by and between the Debtor and [Olympic]." Mr. Duran further testified that he was not informed of the foreclosure of the Property. (Id. at 106). In actuality, no settlement between Olympic and Sugar Hill or the Limited Partnership was ever reached. (Tr. 78) (testimony of

Mr. Fuqua).

Mr. Fuqua denied that he had told Mr. Duran that a settlement existed. (Tr. 69). Instead, Mr. Fuqua testified that he told Mr. Duran only "that there was no ambition to file any other -- any further or other pleadings, foreclosure had occurred, that I thought a dismissal would be appropriate, there was nothing left." (Id.).

The bankruptcy court found Mr. Duran's account of the discussion to be credible, and Mr. Fuqua's testimony to be not credible. (Dkt. 28 at 7). In particular, the bankruptcy court noted that immediately after the Section 341 meeting, the United States Trustee filed a motion to dismiss the Sugar Hill bankruptcy case. (Dkt. 7). That motion stated that "[a]t the meeting of creditors, Debtor's counsel stated . . . that an out-of-court settlement had been reached by and between the Debtor and [Olympic]." (*Id.*). In addition, although Mr. Fuqua as served with a copy of the motion, he never filed any responsive pleading contradicting the allegations of Mr. Duran's motion. Based on this evidence, the bankruptcy court concluded that, contrary to Mr. Fuqua's testimony, he had affirmatively represented the existence of a settlement to Mr. Duran. (Dkt. 28 at 7).

On May 14, 2008, the bankruptcy court issued a memorandum-decision which ordered further proceedings in order to determine whether to dismiss or convert the

Sugar Hill bankruptcy case, and to consider sanctions.[7] (Dkt. 12). As one of the factors relevant to its decision to convert or dismiss, the bankruptcy court mentioned the alleged settlement between Olympic and Sugar Hill reported in Mr. Duran's motion, unaware that such settlement did not exist. (Dkt. 28 at 7-8).

6. At a hearing on sanctions, Mr. Fuqua represents to the Court that recent changes in Texas law justified his filing of a bankruptcy petition on behalf of Sugar Hill.

The bankruptcy court held a hearing on the motion to dismiss and sanctions on June 16, 2008, at which Mr. Fuqua testified as a witness. When questioned about the misleading content of Schedule A, which classified Sugar Hill's partnership interest in the Limited Partnership as a real property interest, Mr. Fuqua alleged that under Texas law, Sugar Hill's partnership interest was considered a "fee interest" in real property. (Tr. 62-63). Mr. Fuqua further represented that, according to his research, "Texas Limited Partnership law, until a year and a half ago, would have -- if they would have filed -- if the general partner in a partnership would file, the stay would be effective because it was recognized as an interest in real property." (Tr. 66).

In response to Mr. Fuqua's assertions regarding Texas law, the bankruptcy

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[7] Section 1112 of the Bankruptcy Code provides that, on request of a party and interest and for cause, the bankruptcy court may dismiss a chapter 11 case or convert the case to a liquidation under chapter 7. 11 U.S.C. § 1112(b). In determining whether to convert or dismiss, the bankruptcy court must consider which form of relief would be in the best interests of creditors and the estate. *Id.*

court issued an order requiring Mr. Fuqua to file a supplemental memorandum setting forth the citations and authority on which he based his analysis, as well as a memorandum identifying the change in Texas law to which Mr. Fuqua referred during his testimony. (Dkt. 21). Mr. Fuqua filed a memorandum in response to the bankruptcy court's order on July 7, 2008. (Dkt. 24). The bankruptcy court determined that Mr. Fuqua's memorandum did provide any support for his legal contentions and did not identify any changes in law.[8] As a result, the bankruptcy court concluded that Mr. Fuqua had intentionally misled the court concerning his legal research. (Dkt. 28 at 8).

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[8] The bulk of Mr. Fuqua's memorandum was devoted to the argument that Mr. Fuqua had reasonably relied on the representations of Sugar Hill and had acted in good faith. Mr. Fuqua's discussion of Texas law consisted, in its entirety, of the following statement:

> This Court is correct in its understanding that Texas follows an entity theory of ownership whereby partnership property is owned by the partnership itself and not by the individual partners. However, under well-established partnership principles, ownership of property intended to be a partnership asset is not determined by legal title, but rather by the intention of the parties as supported by the evidence. Property acquired in the name of one or more of the partners, without an indication in the instrument transferring title to the property of the person's capacity as a partner or of the existence of a partnership, and without the use of partnership property, is presumed to be the partner's property, regardless of whether the property is used for partnership purposes.

(Dkt. 24 at 1-2).

SUMMARY OF ARGUMENT

Based on a full consideration of the evidence and the testimony of witnesses, the bankruptcy court found that Mr. Fuqua had engaged in several specific instances of deceptive conduct, which abused the bankruptcy process. Those factual findings are reviewed deferentially, and Mr. Fuqua offers no persuasive argument for why this Court should conclude that those findings were clearly erroneous. In addition, those findings are sufficient to support the imposition of sanctions under any of three alternative legal theories: Bankruptcy Rule 9011, 11 U.S.C. § 105(a), and the bankruptcy court's inherent powers.

Mr. Fuqua's principal substantive argument is that the bankruptcy court did not find that he had acted in bad faith by "clear and convincing" evidence. Mr. Fuqua's argument lacks merit, for two reasons: first, although the bankruptcy court did not expressly identify the standard of proof it was applying when it concluded that he had acted in bad faith, the weight of the evidence would support a finding of bad faith even under a clear and convincing standard. Second, under the facts of this case, a clear and convincing finding of bad faith is not necessary to support the judgment below. Two of the three sources of authority relied on by the bankruptcy court, Fed. R. Bankr. P. 9011 and 11 U.S.C. § 105(a), do not require a showing of bad faith at all. Although the Fifth Circuit has suggested that the third source of authority, the court's inherent powers, does require bad faith, none of the authorities cited by Mr. Fuqua stand for the proposition that a clear and convincing standard would be applicable to the bankruptcy court's bad faith finding in this case.

Finally, in an argument raised for the first time on appeal, Mr. Fuqua contends that the judgment below should be reversed because of judicial bias. Because Mr. Fuqua did not seek recusal of the bankruptcy judge in the proceedings below, this argument has not been preserved for appeal.

ARGUMENT

1. The bankruptcy court's determination that Mr. Fuqua engaged in sanctionable conduct is supported by the record and is not clearly erroneous.

In this case, based on the evidence presented at trial, the bankruptcy court identified numerous distinct instances of sanctionable conduct by Mr. Fuqua. These include: (1) Mr. Fuqua's filing of a bankruptcy petition that was filed without any real hope of reorganization; (2) Mr. Fuqua's filing of the Sugar Hill bankruptcy petition when he knew or should have known that Sugar Hill lacked an ownership interest in the Property; (3) Mr. Fuqua's failure to conduct a reasonable investigation prior to drafting and filing Sugar Hill's bankruptcy petition; (4) Mr. Fuqua's filing of an intentionally vague and misleading Schedule A in order to create a false impression that Sugar Hill had an ownership interest in the Property; (5) Mr. Fuqua's false representation to the court that there had been “changes” in Texas law; (6) Mr. Fuqua’s false representation to counsel for the United States Trustee that Sugar Hill and Olympic had reached a settlement; and (7) Mr. Fuqua’s direction to his client not to appear for the IDI or Section 341 meeting. (Dkt. 28 at 8-9).

Significantly, the majority of these factual findings are unchallenged by Mr. Fuqua. Indeed, the only factual conclusion with which Mr. Fuqua appears to take issue is the bankruptcy court’s determination that Mr. Fuqua knew or should have known that Sugar Hill did not have an ownership interest in the Property at the time he prepared the Sugar Hill bankruptcy petition. (Br. 8-9). As he argued in the proceedings below, Mr. Fuqua contends that the bankruptcy court should have credited his own testimony that he “reasonably relied” on what turned out to be false information provided by his client. (Br. 10).

The bankruptcy court, after weighing the evidence at trial and considering the demeanor and credibility of Mr. Fuqua, found otherwise, and concluded that Mr. Fuqua did not reasonably rely on his client’s representations. Dkt. 28 at 8-9. The bankruptcy court based this determination on, among other evidence, testimony that revealed that Mr. Fuqua was “exceptionally familiar” with the history of the Property prior to the Sugar Hill bankruptcy (Dkt. 28 at 2 n. 3), as well as Mr. Fuqua’s admitted failure to examine review such basic documents as the deed before he filed the bankruptcy petition (Id. n. 2). Although Mr. Fuqua may disagree with the bankruptcy court's weighing of the evidence, he falls well short of his burden of demonstrating clear error. *See In re Morrison*, 555 F.3d 473, 480 (5th Cir. 2009) (holding that, under clearly erroneous standard, appellate court should reverse trial court's findings only where it is "left with the definite and firm conviction that a mistake has been made") (internal citations omitted).

2. The bankruptcy court did not err by failing to apply a "clear and convincing" standard of proof to Mr. Fuqua's misconduct.

Although the bankruptcy court found that Mr. Fuqua acted in bad faith, it did not expressly state whether it made that finding under the normal preponderance of the evidence standard, or under a heightened "clear and convincing" standard. Mr. Fuqua argues that the correct standard in this case was clear and convincing, and argues further that the bankruptcy court's failure to apply that standard was error. (Br. 20).

Mr. Fuqua's argument is misplaced, for two reasons. First, a clear and convincing finding of bad faith was not essential under the facts of this case. The bankruptcy court sanctioned Mr. Fuqua under three alternative and independent sources of authority. Only one of these, the court's inherent powers, requires a showing of bad faith at all. The bankruptcy court did not need to find that Mr. Fuqua acted in bad faith in order to sanction him under Fed. R. Bankr. P. 9011, *see In re DeVille*, 361 F.3d 539, 548 (9th Cir. 2004) (in contrast to inherent power sanctions, sanctions under Rule 9011 do not require showing of bad faith); *Fellheimer, Eichen & Braverman, P.C. v. Charter Tech., Inc.*, 57 F.3d 1215, 1225 (3rd Cir. 1995) (same), or under 11 U.S.C. § 105(a). *See In re Dempsey*, 247 Fed. Appx. 21, 25 (7th Cir. 2007) (court's use of section 105(a) to impose a one-year filing bar was justified despite absence of bad faith finding); *In re Dyer*, 322 F.3d 1178, 1191 (9th Cir. 2003) (holding that a court's use of its contempt power under section 105 does not require bad faith). Thus, even though the bankruptcy court made an express finding of bad faith in this matter, that finding was not essential to support the sanctions under Rule 9011 and 11 U.S.C. § 105.

In addition, the bankruptcy court did not err by failing to expressly apply a clear and convincing standard when it sanctioned Mr. Fuqua under its inherent powers. Although Mr. Fuqua is correct that inherent power sanctions are applied sparingly, the Fifth Circuit has never held that such sanctions require proof of bad faith by clear and convincing evidence, rather than the preponderance of evidence standard that is generally applicable in civil actions. *See, e.g., In re OCA, Inc.*, 551 F.3d 359, 372 n.41 (5th Cir. 2008) (noting that preponderance of the evidence is the "fundamental civil case standard" and holding that the bankruptcy court erred by requiring willfulness to be proven by clear and convincing evidence on motion to set aside default judgment).

Even if a clear and convincing standard were applicable here, moreover, the evidence at trial is sufficient to meet such a standard. Under the clear and convincing standard, the finder of fact must be satisfied that the factual allegations in question are "highly probable." *Colorado v. New Mexico*, 367 U.S. 310, 316 (1984). The evidence below meets this standard. The bankruptcy court found that Mr. Fuqua acted in bad faith based on testimony that was either undisputed, or for which the bankruptcy court determined that Mr. Fuqua's version of events was not credible, or based on events for which Mr. Fuqua did not explain or justify his behavior. *See. e.g.*, Dkt. 28 at 8-9 ¶ 1 (Mr. Fuqua filed bankruptcy petition for bad faith purpose of delaying foreclosure); ¶ 3 (Mr. Fuqua acted in bad faith by giving no meaningful thought to the purposes of chapter 11); ¶ 4 (finding that Mr. Fuqua intentionally chose vague and misleading language when drafting petition and finding alternative explanation offered by Mr. Fuqua not credible); ¶ 7 (concluding that various actions by Mr. Fuqua served no purpose except to delay case and avoid scrutiny of his own behavior). As the Fifth Circuit has observed, where a trial court makes an evidentiary determination based on its weighing of the credibility of witnesses, that determination may satisfy the clear and convincing standard. *See OCA*, 551 F.3d at 372 n. 42 (noting that application of clear and convincing standard does not permit court to ignore "he said, she said" evidence).

3. Mr. Fuqua's conclusory allegations of judicial bias are not grounds for overturning the sanctions below.

Lastly, Mr. Fuqua devotes the bulk of his brief to a discussion of other cases in which he was the subject of sanctions or adverse rulings by the bankruptcy court, and argues on the basis of those cases that the present sanctions should be overturned because of judicial bias. (Br. 13-20). Although Mr. Fuqua appears to believe that the bankruptcy judge should have recused himself under 28 U.S.C. § 455(a), Mr. Fuqua never filed a motion for recusal in the bankruptcy court, and consequently he has not preserved such issue for appeal. *Taylor Acquisitions, L.L.C. v. City of Taylor*, 313 Fed. Appx. 826, 838 (6th Cir. 2009) (appellate court may not consider allegation of judicial bias, where party did not first raise issue before trial court through motion to recuse); *United States v. DiPina*, 230 F.3d 477, 486 (1st Cir. 2000) (same); *United States v. Mathison*, 157 F.3d 541, 545-46 (8th Cir. 1998) (same). In any event, even if Mr. Fuqua had preserved this issue, the mere fact that he has been the subject of adverse decisions in the bankruptcy court in the past does not, without more, demonstrate judicial bias. *See Taylor*, 313 Fed. Appx. at 838 (holding that "[j]udicial bias must be predicated on a personal bias as distinguished from a judicial one, arising out of the judge's background and association and not from the judge's view of the law") (internal citations omitted).

CONCLUSION

For the foregoing reasons, the United States Trustee respectfully asks this Court to affirm the order of the bankruptcy court.

Dated: June 1, 2010

Respectfully submitted,
CHARLES F. McVAY
UNITED STATES TRUSTEE
REGION 7

By: **/s/ Kevin M. Epstein**
KEVIN M. EPSTEIN
Trial Attorney
Department of Justice
Attorney-in-Charge
Texas Bar No. 00790647
Southern District No. 437129
Office of the U.S. Trustee
615 E. Houston St., Room 357
P.O. Box 1539
San Antonio, Texas 78295-1539
(210) 472-4640
(210) 472-4649 Fax

Ramona D. Elliott, General Counsel
P. Matthew Sutko, Assoc. General Counsel
John Sheahan, Trial Attorney
Executive Office for United States Trustees
Department of Justice
20 Massachusetts Avenue, N.W.
Suite 8000
Washington, D.C. 20530
(202) 307-1399

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing **BRIEF FOR THE UNITED STATES TRUSTEE AS APPELLEE** was served upon the party listed below through the Notice of Electronic Filing from the Court's Electronic Filing System or by United States Mail, first class, postage prepaid on this the 1st day of June 2010.

/s/ Kevin M. Epstein
KEVIN M. EPSTEIN
Trial Attorney

BRIEF BANK — 'SUMMARY SHEET"

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WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	In re: Mark A. Sullivan (Mark Sullivan, et al. v. UST)
2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	9th Cir. BAP
3. ("CCN") ***CURRENT*** CASE NO.	No.: 07-1273
4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*	No.: 06-60618 Court: Bankr. Mont. *(Identify judge & cite, if any)*
5. ("SO") ***SOURCE***	**U.S. TRUSTEES**
6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	Filed: January 16, 2008 Type: Response Brief of Appellee, The United States Trustee
7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*	Daniel P. McKay and Melissa Burgess *(UST/OGC: 202-307-1399/FAX-2397)*
8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	• Whether the bankruptcy court abused its discretion in dismissing Mr. and Mrs. Sullivan's bankruptcy case as an abuse based on either the presumption of abuse that arose under 11 U.S.C. § 707(b)(2) or the totality of the circumstances of Mr. and Mrs. Sullivan's financial situation under 11 U.S.C. § 707 (b)(3). √ **Background:**
10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)	
11. DO YOU RECOMMEND POSTING IN UST BRIEFBANK?	| x | YES | | NO ***NAME:*** Linda Figueroa ***DATE:***

Daniel P. McKay
Office of the United States Trustee
Department of Justice
301 Central Avenue, Suite 204
Great Falls, MT 59401
Phone: (406) 761-8777
Fax: (406) 761-8895
e-mail: dan.p.mckay@usdoj.gov
State Bar I.D. No. 2422
(Attorney for the United States Trustee)

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MONTANA
BUTTE DIVISION

In re	)	Cause No. CV-07-45-BU-RFC
MARK A. SULLIVAN, and DIANA M. SULLIVAN,	)	Bankruptcy No. 06-60618-7
Debtors.	)	
MARK SULLIVAN, and DIANA SULLIVAN,	)	
Appellants,	)	
vs.	)	RESPONSE BRIEF OF APPELLEE, THE UNITED STATES TRUSTEE
UNITED STATES TRUSTEE,	)	
Appellee.	)	

ON APPEAL FROM THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF MONTANA

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JURISDICTIONAL STATEMENT

The bankruptcy court had jurisdiction under 28 U.S.C. §§ 157(a) and (b), and 1334(a) to issue its final order granting the United States Trustee's motion to dismiss the Sullivans' chapter 7 bankruptcy case.[1] The order was entered on the docket on June 27, 2007, and the Sullivans filed a timely notice of appeal under 28 U.S.C. § 158(c)(2) and Fed. R. Bankr. P. 8002(a). This Court has appellate jurisdiction under 28 U.S.C. § 158(a)(1).

STATEMENT OF THE ISSUES

Whether the bankruptcy court abused its discretion in dismissing Mr. and Mrs. Sullivan's bankruptcy case as an abuse based on either the presumption of abuse that arose under 11 U.S.C. § 707(b)(2) or the totality of the circumstances of Mr. and Mrs. Sullivan's financial situation under 11 U.S.C. § 707(b)(3).

STANDARD OF REVIEW

In an appeal taken from a bankruptcy court order, a district court "reviews the bankruptcy court order dismissing a chapter 7 case for abuse of discretion; legal conclusions are reviewed de novo, and factual findings are reviewed for clear error." In re Hebbring, 463 F.3d 902, 905 (9th Cir. 2006). The bankruptcy court's holding that the facts did not support allowing the Sullivans to claim certain expenses in full is a factual finding reviewed for clear error. The bankruptcy court's holding that the Sullivans' case should be dismissed for abuse based on the totality of the circumstances of the Sullivans' financial situation under 11 U.S.C. § 707(b)(3) is also a factual finding subject to review for clear error.

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[1] Congress has authorized the United States Attorney General to appoint 21 United States Trustees, each to serve in a specific geographic region of the United States. See generally 28 U.S.C. § 581, *et seq.* (establishing the United States Trustee Program). United States Trustees are senior officials of the Department of Justice. Id. United States Trustees "supervise the administration of cases and trustees" in all bankruptcy cases within his or her region through the exercise of a range of oversight responsibilities. 28 U.S.C. § 586(a)(3). See generally In re Castillo, 297 F.3d 940, 950 (9th Cir. 2002) (explaining that the United States Trustee is the "watchdog" of the bankruptcy system). United States Trustees may raise, appear, and be heard on any issue in any case or proceeding under title 11. 11 U.S.C. § 307; See also In re Donovan Corp., 215 F.3d 929, 930 (9th Cir. 2000) (upholding broad appellate standing of United States Trustees).

STATEMENT OF THE CASE

On July 31, 2006, Mark and Diana Sullivan (the "Sullivans") filed a petition for relief under chapter 13 of the Bankruptcy Code. (Exh. 17, Exh. 15, docket no. 1). On November 8, 2006, the bankruptcy court entered an order converting the Sullivans' case to chapter 7. (Exh. 14). On January 25, 2007 the United States Trustee filed a motion to dismiss the Sullivans' case (Exh. 1), asserting that their chapter 7 case was abusive under 11 U.S.C. § 707(b). (Exh. 1, pg. 5).

The United States Trustee sought dismissal under two different theories. First, that a statutory presumption of abuse arose in the Sullivans' case that mandated its dismissal as a matter of law under 11 U.S.C. § 707(b)(2). (Exh. 1, pgs. 3, 4). In the alternative, the United States Trustee asserted that if the presumption of abuse did not arise, or was rebutted by the Sullivans, the case should be dismissed because the totality of their financial circumstances demonstrated that their use of chapter 7 was abusive under 11 U.S.C. § 707(b)(3). (Exh. 1, pgs. 4, 5).

On June 27, 2007, the bankruptcy court entered an order granting the United States Trustee's motion to dismiss on both grounds and issued a Memorandum of Decision (Exh. 2) containing its findings of fact and conclusions of law. This appeal followed.

STATEMENT OF THE FACTS

I. Statutory Framework

On October 17, 2005, most provisions of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (the "2005 Reform Act"), S. 256, Pub. L. No. 109-8, 119 Stat. 23, took effect, implementing significant changes to the Bankruptcy Code. 11 U.S.C. §§ 101 - 1532. As part of this effort, Congress amended section 707(b) of the Bankruptcy Code, which governs dismissal of chapter 7 bankruptcy cases for abuse. Analysis of the "means test," as contained within section 707(b)(2), is underpinned by Congress' general goal behind the complete overhaul of section 707(b), ensuring "that those who can afford to repay some portion of their unsecured debts be required to do so...". 151 CONG. REC. S2470 (March 10, 2005).

As it existed prior to the 2005 Reform Act, section 707(b) only authorized dismissal based on a finding that allowing the debtor relief constituted a “substantial abuse” of chapter 7. Further, section 707(b) prior to its amendment required courts to presume that a debtor was entitled to relief under chapter 7 of the Bankruptcy Code. Section 707(b) now authorizes dismissal where the court finds that the granting of relief would be an “abuse” of chapter 7. As amended by the 2005 Reform Act, section 707(b)(2) repealed the former presumption and replaced it with a new presumption: a case is an “abuse” of chapter 7 if a detailed mathematical formula set out in the statute, commonly referred to as the “means test,” yields a minimum amount of monthly disposable income.

The means test uses a series of calculations to determine whether the section 707(b)(2) presumption of abuse arises. See 11 U.S.C. § 707(b)(2)(A). Specifically, the means test calculates a debtor’s current monthly income, as defined under 11 U.S.C. § 101(10A) (hereafter “CMI”), based on the debtor’s average income for the six calendar months preceding the month of the bankruptcy filing. If the debtor’s CMI is above the applicable state median family income, as is the case here, 11 U.S.C. § 707(b)(2)(A) calculates the debtor’s monthly disposable income available to repay creditors by reducing the CMI by certain categories of expenses identified in 11 U.S.C. § 707(b)(2)(A)(ii), (iii), and (iv). If a debtor's monthly disposable income, calculated by reducing the CMI by allowed expenses under 11 U.S.C. § 707(b)(2)(A)(ii) - (iv), is less than $100 per month (or $6,000 over 60 months), the presumption of abuse does not arise. 11 U.S.C. § 707(b)(2)(A)(I).[2] If the debtor's monthly disposable income is equal to or exceeds $167 per month (or $10,000 over 60 months), the presumption of abuse does arise. Id. If the debtor's monthly disposable income is between $100 and $167 per month (between $6,000 and $10,000 over 60 months), the presumption of abuse arises if the disposable income, over 60 months, is sufficient to pay 25 percent of the debtor's nonpriority unsecured debt. Id.

If the presumption of abuse arises under section 707(b)(2) based on the means test, the

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[2] Pursuant to 11 U.S.C. § 104, the dollar amounts set forth in Title 11 and applicable to the threshold amounts for determining when the presumption of abuse arises under the means test were adjusted based on the consumer price index for cases filed on or after April 1, 2007. The amounts discussed herein are those in effect on the date of the filing of the Sullivans’ petition, July 31, 2006.

debtor may attempt to rebut the presumption under 11 U.S.C. § 707(b)(2)(B) by demonstrating special circumstances that justify income or expense adjustments for which there is no reasonable alternative.

Even if the presumption of abuse does not arise in a chapter 7 case, or is rebutted, the court may nonetheless dismiss a case if it finds that the case was (1) filed in bad faith, or (2) the totality of the debtor's financial situation demonstrates abuse. 11 U.S.C. § 707(b)(3).

Each chapter 7 debtor with primarily consumer debts is required to file, in conjunction with his or her bankruptcy schedules and statement of financial affairs, a Statement of Current Monthly Income and Means Test Calculation, Official Form 22A of the Federal Rules of Bankruptcy Procedure ("Form 22A" or the "Means Test Form"). 11 U.S.C. §§ 521 and 707(b)(2)(C). In chapter 7 cases the main purpose of Form 22A is to calculate monthly disposable income following the formula set forth in 11 U.S.C. § 707(b)(2), and determine whether the presumption of abuse arises. Chapter 13 debtors are required to calculate their "disposable income" on Official Form 22C. The methodology for calculating monthly disposable income for above median income debtors in chapter 13 is similar to that used to calculate whether a presumption of abuse arises under 11 U.S.C. § 707(b)(2)(A). In fact, section 1325(b)(2) requires such debtors to subtract from their CMI the expenses set out in subparagraphs (A) and (B) of section 707(b)(2).[3]

II. Factual Background.

The Sullivans are a married couple residing in Montana. (Exh. 2, p. 2). They both are employed by the State of Montana and have four dependents. (Exh. 2 p. 3). They originally filed their bankruptcy case under chapter 13 of the Bankruptcy Code on July 31, 2006.

On September 26, 2006, chapter 13 trustee Robert G. Drummond (the "chapter 13 trustee") filed an objection (Exh. 12) to the Sullivans' proposed second amended chapter 13 plan.

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[3] There also are several expenses that an above median income chapter 13 debtor is allowed to deduct from CMI that are not deductible for purposes of the chapter 7 "means test." Those are payments on certain retirement plan loans (11 U.S.C. § 1322(f)) and contributions to certain retirement plans (11 U.S.C. § 541(b)(7)). Chapter 7 debtors may only deduct retirement plan contributions if such contributions are mandatory, <u>i.e.</u> a condition of employment, as in the Sullivans' case.

(Exh. 7). That plan proposed bi-weekly payments of $35.00 over a period of 36 months, totaling $2,730.00, to be made to the trustee for disbursement to creditors. (Exh. 7, pg. 1). The chapter 13 trustee's objection alleged, among other things, that the plan failed to commit all of Mr. and Mrs. Sullivans' disposable income to fund the plan as required by 11 U.S.C. § 1325(b)(1); that the calculation of disposable income on their Form 22C was incorrect; and that the Sullivans were required to make payments over 60 months. (Exh. 12, pgs. 1, 2). On November 7, 2006, the bankruptcy court held a hearing on confirmation of the Sullivans' second amended chapter 13 plan. (Exh. 15, minute entry 11/7/06). Just a few days prior to the hearing, on November 3, 2006, the chapter 13 trustee moved to convert Mr. and Mrs. Sullivans' case to chapter 7 (Exh. 13), and the Sullivans consented. (Exh. 11, pg. 6, ll. 2 -7, pg. 36, ll. 12, 13). The bankruptcy court, in its order dated November 8, 2006, granted the motion to convert. (Exh. 14). The court based its order on the Sullivans' consent to the trustee's motion and its finding that Mr. and Mrs. Sullivan had intentionally omitted pre-petition debt from their bankruptcy schedules. (Exh. 14, pg. 2).

After the Sullivans' case was converted to chapter 7, the United States Trustee undertook an investigation to ascertain whether their bankruptcy case should be dismissed as an abuse under 11 U.S.C. § 707(b). Based on her review of the amended Form 22C filed in the Sullivans' chapter 13 case,[4] the U.S. Trustee determined that the presumption of abuse arose under 11 U.S.C. § 707(b)(2) and filed a statement of presumed abuse as required by 11 U.S.C. § 704(b)(1)(A). (Exh. 15, docket no. 44). On January 25, 2007, the United States Trustee timely filed her motion to dismiss the Sullivans' case under 11 U.S.C. § 704(b)(2) and 707(b)(1). (Exh. 1).

In her motion to dismiss, the United States Trustee alleged that the presumption of abuse arose under 11 U.S.C. § 707(b)(2). (Exh. 1, pgs. 3, 4). In particular, the United States Trustee alleged that the Sullivans overstated expenses for taxes, childcare, healthcare, and telecommunications and understated expenses for health insurance on their chapter 13 Means

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[4] The Sullivans did not file an Official Form 22A immediately upon conversion; they filed Official Form 22A concurrently with their post-hearing brief on June 8, 2007, 2007. (Exh. 4).

Test Form. Id. After adjusting for these errors, the United States Trustee alleged in her motion to dismiss that a properly completed Means Test Form would result in monthly disposable income of $1,107.46, which is sufficient to trigger a presumption of abuse. (Exh. 1, pgs. 4, 5). The motion also alleged that the totality of the circumstances of the Sullivans' financial situation demonstrated abuse under 11 U.S.C. § 707(b)(3). Id.

Mr. and Mrs. Sullivan filed a response to the United States Trustee's motion to dismiss on February 5, 2007. (Exh. 16). Their response did not refute any of the allegations in the motion to dismiss but simply set the matter for hearing. Id.

A hearing on the United States Trustee's motion was held on May 8, 2007. (Exh. 15, minute entry 5/8/07). Debtor Mark A. Sullivan and a bankruptcy analyst employed by the Office of the United States Trustee testified under oath regarding various aspects of the Sullivans' income and expenses. (Exh. 8). The parties presented legal arguments in briefs filed after the hearing. (Exh. 3; Exh. 9).

In her post-hearing brief, the United States Trustee argued, based on the evidence adduced at the hearing, that a properly completed Means Test Form would result in monthly disposable income at Line 50 of $492.67. (Exh. 9, pg. 7; Exh. 10, Line 50). The United States Trustee based her conclusion on adjustments to the Sullivans' claimed expenses on their amended Form 22C. (Exh. 6). These adjustments included a reduction of taxes (Line 30 of Form 22C - Line 25 of Form 22A) to $1,187.28; childcare (Line 34 of Form 22C - Line 30 of Form 22A) to $411; and telecommunications (Line 37 of Form 22C - Line 32 of Form 22A) to $66. (Exh. 9, pgs. 3-6). The United States Trustee accepted the Sullivans' claim of $414 for healthcare expenses (Line 36 of Form 22C - Line 31 of Form 22A) and increased the Sullivans' amount for "Health Insurance, Disability Insurance, and Health Savings Account Expenses" (Line 39 of Form 22C - Line 34 of Form 22A) to $1,068.38.[5] (Exh. 9, pg. 6).

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[5] The Court will note also that the U.S. Trustee increased the second vehicle ownership expense (Line 29 of Form 22C - Line 24 of Form 22A) from $200 to $332. This is based on the Montana bankruptcy court's ruling that a debtor that owns a vehicle outright, i.e. free of loan or lease payments, is entitled to the full IRS ownership expense under the IRS National Standards. In re Naslund, 359 B.R. 781, 792 (Bankr. D. Mont. 2006).

In their post-hearing brief, the Sullivans conceded that all of the expense amounts asserted by the United States Trustee were correct. (Exh. 3, pgs. 2, 3). However, the Sullivans, for the first time, claimed that they were entitled to an expense of $450 at Line 21 of their Means Test Form for additional home repairs and $285 at Line 38 of Form 22A for "Education expenses for dependent children less than 18." (Exh. 3, pgs. 3, 4). According to the Sullivans, this would result in monthly disposable income at Line 50 of Form 22A of negative $175.95 and the presumption of abuse would not arise. (Exh. 4, Line 50).

The bankruptcy court, in its June 27, 2007 Memorandum of Decision, dismissed the Sullivans' chapter 7 case under section 707(b)(2) and (3). (Exh. 2, pg. 15). Under section 707(b)(2), it allowed the Sullivans education expenses of only $25 per month on Line 38 and additional home repair expenses of $95. (Exh. 2, pg. 14). Based on these findings, the court determined (a) that the Sullivans had $406.12 in monthly disposable income; (b) the presumption of abuse arose; and (c) the Sullivans failed to rebut the presumption. Id. The court alternatively determined that the totality of the Sullivans' financial situation demonstrated abuse under section 707(b)(3). (Exh. 2, pgs. 14, 15). This appeal followed.

SUMMARY OF ARGUMENT

The bankruptcy court dismissed the Sullivans' chapter 7 case on two alternate bases – as a statutorily presumed abuse under 11 U.S.C. § 707(b)(2) and as an abuse under 11 U.S.C. § 707(b)(3)(B) based on the totality of the circumstances of the Sullivans' financial situation. This Court can affirm under either theory.

First, this Court can affirm under 11 U.S.C. § 707(b)(2) because the bankruptcy court did not commit clear error in ruling the Sullivans failed the means test. Although the bankruptcy court allowed the Sullivans increased education and home repair expenses, it did so in amounts less than the Sullivans requested. That ruling was supported by substantial evidence. If this Court concludes the evidence was insufficient to support the bankruptcy court's expense findings, this Court should remand, but only if the Court first rules the bankruptcy court erred in alternatively dismissing the Sullivans' case under 11 U.S.C. § 707(b)(3).

The bankruptcy court's section 707(b)(3) holding constitutes a separate basis for affirmance. In dismissing the Sullivans' case on that ground, the bankruptcy court did not commit clear error in determining that the totality of the circumstances of the Sullivans' financial situation demonstrated they could make reasonable payments to creditors. The record before the bankruptcy court contained ample evidence to support the bankruptcy court's conclusion that the Sullivans' financial situation demonstrated abuse because they have the ability to pay amounts to their unsecured creditors.

ARGUMENT

I. The Bankruptcy Court's Dismissal Under 11 U.S.C. § 707(b)(2) Should be Affirmed Because the Factual Findings Supporting Dismissal Were Not Clearly Erroneous.

In their Opening Brief, the Sullivans suggest that, in calculating whether the presumption of abuse arose, the bankruptcy court should have allowed them to claim an additional $450 per month for housing and utilities expenses (Debtors' Br., pgs. 8, 9) and an additional $285 per month for educational expenses. Id., pg. 10. If the Sullivans are correct and should have been allowed either of those expense deductions in full, the presumption of abuse would not arise. Because the court below instead determined that the facts supported deductions for these expenses in amounts significantly *less* than those claimed by the Sullivans, they seek further review from this Court.

The bankruptcy court's factual findings are entitled to deference on appeal. See Anderson v. City of Bessemer City, N.C., 470 U.S. 564, 574 (1985) (because trial judge has expertise in fact determination, "review of factual findings under the clearly-erroneous standard-with its deference to the trier of fact-is the rule, not the exception"); Granfinanciera, S.A. v. Nordberg, 492 U.S. 33, 50 (1989) (district courts may set aside clearly erroneous factual findings by bankruptcy courts); Fed. R. Bankr. P. 8013 ("[f]indings of fact...shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the bankruptcy court to judge the credibility of the witnesses).

On appeal, the Sullivans contest the bankruptcy court's factual findings. To be clearly erroneous, those findings "must strike [the Court] more than just maybe or probably wrong; [they] must ... strike us as wrong with the force of a five-week-old, unrefrigerated dead fish." U.S. v. Bussell, 504 F.3d 956, 962 (9th Cir. 2007) (*quoting* Hayes v. Woodford, 301 F.3d 1054, 1067 n. 8 (9th Cir.2002)). Because the bankruptcy court's factual findings were supported by the evidence, "[n]o such stench lingers here." Id.

A. The Bankruptcy Court's finding that Mr. and Mrs. Sullivan failed to justify education expenses of more than $25 was not clearly erroneous.

In calculating whether the presumption of abuse arose under section 707(b)(2), the bankruptcy court found that the Sullivans had established they were entitled to an expense deduction of only $25 per month on Line 38 of their Means Test Form for "Education expenses for dependent children less than 18." (Exh. 2, pg. 14). This finding was amply supported by the evidence and should be affirmed.

Debtors are allowed to claim education expenses on Line 38 of the Means Test Form under 11 U.S.C. 707(b)(2)(A)(ii)(IV). That section provides, in pertinent part, that:

> ... the debtor's monthly expenses may include the actual expenses for each dependent child less than 18 years of age, not to exceed $1,500 per year per child, to attend a private or public elementary or secondary school if the debtor provides documentation of such expenses and a detailed explanation of why such expenses are reasonable and necessary, and why such expenses are not already accounted for in the National Standards, Local Standards, or Other Necessary Expenses referred to in subclause (I).

Accordingly, this section allows debtors a deduction of up to $1,500 per child on the Means Test Form for expenses to attend a private or public school if the debtor provides: (1) documentation; (2) a detailed explanation of the reasonableness and necessity of the expense; and (3) a detailed explanation of why the expense is not accounted for elsewhere on the Means Test Form in the IRS standards. Id.

The Sullivans failed to introduce any admissible evidence that they met the criteria in section 707(b)(2)(A)(IV). First, although the bankruptcy court noted that Mr. Sullivan testified that "the expenses ... pertain to daycare, school lunches, school supplies, extracurricular activities and the such" (Exh. 2, p. 13), Mr. Sullivan did not actually offer any testimony regarding any of those expenses except for daycare. (Exh. 8). Moreover, the Sullivans already received a deduction for those daycare expenses on Line 30 of their Means Test Form as an Other Necessary Expense, so those expenses clearly did not meet the criteria for inclusion on Line 38. See 11 U.S.C. § 707(b)((2)(A)(ii)(IV) (requiring debtors to establish, as a prerequisite to allowance of education expenses, that such expenses are not otherwise accounted for in the Other Necessary

Expenses established by the IRS).[6] Based on Mr. Sullivan's testimony, the court was justified in finding that they failed to establish that they had allowable expenses under section 707(b)(2)(A)(ii)(IV). (Exh. 2, pg. 13). Likewise, although the Sullivans claimed they were entitled to $285 in education expenses on Line 38 based upon affidavits filed with their post-hearing brief, (Exh. 3, pg. 4), the court properly rejected those affidavits "on grounds they are hearsay, not subject to cross examination, and were filed after the close of testimony." (Exh. 2, pg. 4).

Given that, the bankruptcy court did not err when it limited the Sullivans' education expense deduction to $25. Indeed, the Sullivans themselves previously filed documents with the court indicating that their education expense totaled only $25 per month. (Exh. 2, pg. 5; Exh. 5; Exh. 6). Accordingly, the bankruptcy court's finding that Mr. and Mrs. Sullivan were entitled to deduct only $25 per month for education expenses on their Means Test Form should be affirmed.

B. The Bankruptcy Court's allowance of an adjustment of $95 per month for home repair was not clearly erroneous.

Mr. and Mrs. Sullivan also argue that the bankruptcy court erred because they were entitled to additional expenses for home repairs of $450 per month on Line 21 of Form 22A, instead of the $95 allowed by the bankruptcy court. Debtors' Br., pg. 9. They are wrong. The bankruptcy court's findings were not clear error because the court exercised proper discretion in weighing the evidence before it.

Section 707(b)(2)(A)(ii)(I) provides in relevant part that debtors are allowed to claim on their Means Test Form "applicable expense amounts specified under the ... Local Standards ... issued by the Internal Revenue Service...." 11 U.S.C. § 707(b)(2)(A)(ii)(I). The Local Standards issued by the IRS as of the date the Sullivans filed their bankruptcy case, as referred to in section

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[6] In fact, the U.S. Trustee elicited extensive testimony regarding Mr. and Mrs. Sullivans' daycare expenses (Exh. 8, pgs. 16-23) and asserted that they had average monthly daycare expenses of $411 that were allowable as an Other Necessary Expense on Line 30 of the Means Test Form. (Exh. 9, pg. 5; Exh. 10, Line 30). The Sullivans conceded this amount in their post-hearing brief and the Form 22A they filed with it. (Exh. 3, p. 2; Exh. 4, Line 30).

707(b)(2)(A)(ii)(I), are found in the Collection Financial Standards published by the IRS.[7]

At issue in this case is whether the Sullivans are entitled to adjust their Means Test form to account for home repair costs that exceed the amount allowed in the Local Standard for Housing and Utilities, Debtors' brief, pgs. 8, 9, which includes expenses for: mortgage or rent, property taxes, interest, insurance, maintenance, repairs, gas, electric, water, heating oil, garbage collection, telephone and cell phone. See http://www.irs.gov/irm/part5/ch15s01.html#d0e193592 (defining housing and utilities standards). On the Means Test Form, these expenses are represented on two lines: Line 20A includes the non-mortgage expenses included in the Standard, and Line 20B includes the mortgage or rent portion of the Standard. Id. See also Official Form 22A, Lines 20A and 20B. Because they are not part of a mortgage or rent, home repair costs may be accounted for on line 20A as part of the non-mortgage expenses.

On their Means Test Form, the Sullivans claimed not only the full allowance of $403 on Line 20A for non-mortgage housing and utilities expenses,[8] but also claimed additional expenses of $450 per month to complete repairs to their home. (Exh. 2, pgs 11, 12; Exh. 4, Line 21).[9]

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[7] The IRS revised its Collection Financial Standards, effective October 1, 2007, see IRS Collection Financial Standards, at http://www.irs.gov/irm/part5/ch15s01.html#d0e193592 , and such revisions are applicable to bankruptcy cases filed as of January 1, 2008. See http://www.usdoj.gov/ust/eo/bapcpa/meanstesting.htm. Because the Sullivans' case was filed on July 31, 2006, only the Collection Financial Standards in effect prior to October 1, 2007, are applicable to their case. It is important to note, however, that the revisions made by the IRS effective October 1, 2007 do not change any result in this case.

[8] The Sullivans also claimed the full amount of the Mortgage/Rent expense available to them under the Standard. Because their actual mortgage expense exceeded the amount of the mortgage/rent standard expense on Line 20A, they were instead allowed the full amount of their mortgage in lieu of the Standard. (Exh. 10, Lines 20A and 42). Accordingly, Line 20A reflects an amount of $0, while the applicable deduction of $$1,570.86 for their mortgage is reflected at Line 42. Id.

[9] The Sullivans argued that they were entitled to this adjustment on Line 21 of their Means Test Form, and the bankruptcy court mistakenly allowed the reduced adjustment on this Line. (Exh. 2, pg. 13). However, the proper method of allowing this expense would be as a special circumstance to potentially rebut the presumption under 11 U.S.C. § 707(b)(2)(B). Line 21 is available only where a debtor claims that the process of separating the single IRS Housing and Utilities Standard into the mortgage and non-mortgage components on Lines 20A and 20B does not "accurately compute the allowance to which you are entitled under the ... Standards." Line 21 cannot be used to increase a debtor's housing and/or utility expenses simply because the debtor

However, the bankruptcy court found that the Sullivans failed to establish that $450 per month for home repairs was warranted under the circumstances because many of the repairs allegedly required were elective cosmetic repairs that “would be nice to do if a person could afford such repairs,” but were “certainly not necessary for the maintenance and support of the Debtors’ household.” (Exh. 2, pgs. 12, 13). As set forth below, the bankruptcy court carefully weighed the evidence before it and its factual findings should therefore be given deference by this Court.

In its opinion, the bankruptcy court carefully considered testimony offered by Mr. Sullivan. (Exh. 2, pgs. 11, 12, 13, 15). Based on Mr. Sullivan’s testimony, the bankruptcy court determined that many of these repairs were unnecessary and “should not be completed at the detriment of Debtors’ creditors.” Id. at 13. These included finishing the downstairs bathroom; improving the laundry room; adding a wall to the master bedroom; repairing a fence; resurfacing their driveway; and repairing kitchen cabinets. Id. at 11. The Sullivans have not identified any clear error in the bankruptcy court’s finding or the court’s analysis of Mr. Sullivan’s testimony in their Opening Brief, but simply disagree with the court’s factual conclusion that many of the claimed repairs would be “nice if you can afford them.” Debtors’ Br., pg. 9.

As further evidence that the bankruptcy court used proper discretion in weighing the evidence before it, the court did not flatly reject all of the home repairs sought by the Sullivans. Instead, it carefully considered the nature of the requested repairs, and allowed those that it considered necessary for the health and welfare of the Sullivans and their children. For example, the court allowed additional monthly expenses to fund replacement of a furnace because Mr. Sullivan had witnessed “flames shooting out of the side,” (Exh. 2, pg. 12), and to repair a deck that was suffering from rot and falling away from the house. Id. at 13. After averaging the costs for these two repairs over 60 months, as some other expenses on the Means Test Form are

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has higher expenses than allowed by the Standard. In re Sudhaker Rajender, No. 07-21945, 2007 WL 2345018, *1, 2 (Bankr. E.D. Cal. Aug. 7, 2007) (unpublished). See also In re Skaggs, 349 B.R. 594, 597 (Bankr. E.D. Mo. 2006) ("Neither party has argued that Lines 20A and 20B together do not set out the maximum allowance under the IRS Housing and Utilities Standards...."). Instead, those must be raised as “special circumstances” under 11 U.S.C. § 707(b)(2)(B). It is not, however, necessary for this Court to reach this issue. Whether allowed on Line 21 or as a special circumstance, the bankruptcy court was well within its discretion to limit the adjustment to $95.

averaged,[10] the court allowed an additional deduction of $95 per month for those repairs. Id.

Accordingly, even allowing the Sullivans to claim expenses over and above the Local Standards to perform necessary home repairs, the bankruptcy court concluded that the Sullivans nevertheless had over $400 per month in disposable income. Because this triggered the presumption of abuse, the court granted the United States Trustee's motion to dismiss. The Sullivans have not asserted any clear error in this analysis, and it should be affirmed.

C. The Sullivans failed to establish special circumstances below to rebut the presumption of abuse that the bankruptcy court found arose under 11 U.S.C. § 707(b)(2).

The Sullivans argue in their Opening Brief, for the first time, that this Court should find that they can establish special circumstances under 11 U.S.C. § 707(b)(2)(B) to rebut the presumption of abuse that arose under section 707(b)(2). Their proposed new special circumstance is the fact that the Sullivans purportedly would be unable to fund a chapter 13 plan. Debtors' Br., pgs. 7, 11, 13. As a preliminary matter, the Sullivans did not present any evidence at trial to rebut the presumption, (Exh. 2, pg. 14) ("Debtors failed to present evidence to rebut the presumption of abuse"), and so they have waived this argument. See Smith v. Marsh, 194 F. 3d 1045, 1052 (9th Cir. 1999) (appellate courts will not consider arguments raised for the first time on appeal because such arguments are waived). In fact, the Sullivans concede their failure to present evidence to the bankruptcy court on the issue of rebuttal of the presumption of abuse, and instead complain that the United States Trustee failed to elicit testimony at trial to establish their burden for them. Debtors' Br., pg. 7. Because it was the *Sullivans'* burden to rebut the presumption, and not the United States Trustee's, their attempt to litigate rebuttal of the presumption at this juncture should be rejected by this Court. See, e.g., In re Martin, 371 B.R. 347, 352 (Bankr. C.D. Ill. 2007) (burden of rebutting the presumption of abuse under section 707(b)(2) is on the debtor).

Should this Court consider this new issue, the Sullivans' contentions should be rejected because they fail to show that the bankruptcy court committed clear error in finding that they

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[10] See, e.g., 11 U.S.C. § 707(b)(2)(A)(iii) (allowing expenses for secured debt payments when averaged over 60 months); 11 U.S.C. § 707(b)(2)(A)(iv) (allowing payments for priority claims averaged over 60 months) See also Official Form 22A, Lines 42 and 44.

failed to rebut the presumption of abuse.

To demonstrate special circumstances, a debtor must itemize and document each adjustment of income or expenses, provide a detailed explanation of each adjustment under oath, demonstrate that there is no reasonable alternative to the adjustments, and the adjustments must cause the presumption of abuse to no longer arise. 11 U.S.C. § 707(b)(2)(B)(ii)-(iv); In re Batzkiel, 349 B.R. 518, 586 (Bankr. N.D. Iowa 2006).

On appeal, the Sullivans suggest that they have "special circumstances" because they cannot make any payments in a chapter 13 plan. Debtors' Br., pgs. 7, 11, 13. At trial, however, the Sullivans did not submit any documentation to support such a claim and have even admitted in their Opening Brief that they have the ability to repay 7 percent of their unsecured claims. Id. at 11. Further, the Sullivans' "special circumstances" claim is inconsistent with the bankruptcy court's finding that they have the ability to make payments on their unsecured debt, which finding was supported by substantial evidence. Finally, as other bankruptcy courts have found, "[t]he potential payback of zero percent to unsecured creditors in a Chapter 13[plan] is not a special circumstance contemplated under § 707(b)(2)(B)." In re Johns, 342 B.R. 626, 629 (Bankr. E.D. Okla. 2006).

Accordingly, the bankruptcy court's finding that the Sullivans failed to establish special circumstances to rebut the presumption under 11 U.S.C. § 707(b)(2)(B) is not clearly erroneous and should be affirmed.

II. The Bankruptcy Court's Finding that the Totality of the Circumstances of the Sullivans' Financial Situation Demonstrated Abuse Under 11 U.S.C. § 707(b)(3) was Not Clearly Erroneous.

The bankruptcy court dismissed the Sullivans' case on two independent grounds. In addition to the section 707(b)(2) dismissal, the court independently dismissed the case under section 707(b)(3)(B) of the Code. If this Court agrees with either of the two bases relied upon by the court below, that dismissal should be affirmed.

On appeal, the Sullivans suggest the bankruptcy court erred in finding that their case should also be dismissed under 11 U.S.C. § 707(b)(3). Debtors' Br., pgs. 11, 12. This argument lacks merit. The record is replete with evidence to support the bankruptcy court's conclusion that the Sullivans had the ability to repay their unsecured debt. See, e.g., Hebbring, 463 F.3d at 907 (holding, under pre-Reform Act section 707(b), that bankruptcy courts have broad discretion to evaluate facts that support dismissal based on the totality of the circumstances of a debtor's financial situation).

First, Schedules I and J filed by the Debtors indicate that the Debtors have $6,554.31 of monthly income and $6,477.79 of monthly expenses, leaving a surplus of $76.52 per month. (Exh. 17, Schedules I and J). However, the Sullivans included in that calculation the full $450 per month in home repairs that they requested in connection with their claim on the Means Test Form. (Exh. 17, Schedule J, l. 3). (As set forth above, the bankruptcy court used its discretion to determine that $450 per month in home repair costs was excessive, and properly reduced the home repair expenses claimed by the Sullivans to $95 per month to allow only for those repairs that are necessary. (Exh. 2, pg. 13). Accordingly, if the Sullivans' scheduled expenses were reduced to allow only $95 per month for home repair, without adjusting any of their other claimed expenses, their net monthly income would increase to $431.52 ($76.52 plus $355, which is the difference between the claimed $450 in repairs and the $95 allowed). Over the course of a 60 month plan, this would repay over $25,000 of the Sullivans' scheduled unsecured debt. (Exh. 17, Schedule F). See, e.g., Hebbring, 463 F.3d at 908 (affirming dismissal based on totality of the circumstances where debtor could repay $172 per month to unsecured creditors in a chapter 13 plan); In re Behlke, 358 F.3d 429, 437 (6th Cir. 2004) (affirming dismissal where debtor could repay 14% of unsecured debt in a chapter 13 plan).

Moreover, on Schedule J, the Sullivans scheduled expenses for school lunches twice, including an expense for "daycare and school lunches" in the amount of $610 and an expense for "school lunches" of $90. (Exh. 17, Schedule J, l. 17). Elimination of the redundant entry for "school lunches" of $90 alone would increase the Sullivans' net disposable income to $166.52 ($76.52 plus $90). If both the school lunch redundancy and home repair reduction were factored in, the Sullivans would have more than $521 per month in net monthly income ($76.52 plus $355 for disallowed home repairs plus $90 for disallowed redundant school lunch expenses).

Finally, the Sullivans admit in their Opening Brief that they can repay at least 7 percent of their accrued unsecured debt in a chapter 13 plan. Debtors' Br., pg. 11. Accordingly, their argument that they have no ability to repay creditors is disingenuous and does not render the bankruptcy court's contrary finding clearly erroneous.

CONCLUSION

For these reasons, the United States Trustee respectfully asks this Court to affirm the order entered below.

Respectfully submitted this 16th day of January, 2008.

/s/ Daniel P. McKay
DANIEL P. McKAY
Office of the United States Trustee
Department of Justice
Attorney for the United States Trustee

UNITED STATES DISTRICT COURT
DISTRICT OF DELAWARE

In re : Chapter 11
:
SUMMIT METALS, INC., : Bankr. Case No. 98-2870 (KJC)
:
Debtor. :
:
AMBROSE M. RICHARDSON, III, :
:
Appellant, :
: Civ. Action 1:08-cv-00005 (SLR)
v. :
:
ROBERTA A. DEANGELIS, :
ACTING UNITED STATES TRUSTEE, :
AND FRANCIS A. MONACO, JR., :
CHAPTER 11 TRUSTEE, :
:
Appellees. :
:

BRIEF FOR APPELLEE, ROBERTA A. DEANGELIS, ACTING UNITED STATES TRUSTEE

Roberta A. DeAngelis, Acting General Counsel
Ramona D. Elliott
P. Matthew Sutko
John Sheehan
Robert J. Schneider
U.S. Department of Justice
Executive Office for United States Trustees
20 Massachusetts Ave, N.W.
Washington, DC 20530

Andrew R. Vara, Assistant U.S. Trustee
Richard L. Schepacarter
U.S. Department of Justice
Office of the United States Trustee
844 King Street, Room 2207, Lockbox 35
Wilmington, DE 19801
(302) 573-6491

Attorneys for Appellee

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STATEMENT OF ISSUE PRESENTED

Under section 503(b) of the Bankruptcy Code, certain post-petition expenditures may be granted administrative expense priority treatment, which allows them to be paid from the bankruptcy estate ahead of other claims. Appellant Ambrose Richardson III, a creditor in the bankruptcy case of Summit Metals, Inc., sought administrative expense priority treatment for $768,921.71 in hourly time he spent on various matters in Summit's bankruptcy case and other cases, and $107,826.96 for reimbursement of out-of-pocket expenses he incurred. The bankruptcy court only allowed administrative expense priority treatment for $2,533.65 in out-of-pocket expenses that Richardson had proven were incurred in his capacity as a member of the official committee of unsecured creditors in Summit's bankruptcy case. Did the bankruptcy court err in finding that Richardson had not made the requisite showing under section 503(b) to support an entitlement to administrative expense priority treatment for the remainder of his out-of pocket expenses and his entire request for hourly compensation?

STATEMENT OF APPROPRIATE STANDARD OF APPELLATE REVIEW

This Court conducts a *de novo* review of the bankruptcy court's legal findings. *See, e.g.*, *Rode v. Dellarciprete*, 892 F.2d 1177, 1182 (3d Cir. 1990); *In re Hechinger Inv. Co. of Del., Inc.*, 276 B.R. 43, 45 (D. Del. 2002). The bankruptcy court's findings of fact, however, will not be set aside unless they are either "completely devoid of minimum evidentiary support displaying some hue of credibility or bear [ ] no rational relationship to the supportive evidentiary data." *Fellheimer, Eichen & Braverman P.C. v. Charter Technologies, Inc.*, 57 F.3d 1215, 1223 (3d Cir. 1995); *see also* Fed. R. Bankr. P. 8013 ("[F]indings of fact, whether based on oral or documentary evidence, shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the bankruptcy court to judge the credibility of the witnesses.").

STATEMENT OF THE CASE

I. Statutory Framework

The assets in a bankruptcy case must be distributed to claimants in the order established by 11 U.S.C. § 507(a).[1] First priority is afforded to administrative expenses allowed under 11 U.S.C. § 503(b). *See* 11 U.S.C. § 507(a)(1). The statutory administrative expense provisions are interpreted narrowly "so as to keep fees and administrative costs at a minimum." *See Burlington N. R.R. v. Dant & Russell, Inc. (In re Dant & Russell, Inc.)*, 853 F.2d 700, 706 (9th Cir. 1988).

Section 503(b) contains a nonexclusive list of items that may be afforded administrative expense priority. Each subparagraph of section 503(b) refers to a separate kind of administrative expense. This appeal implicates subparagraphs (b)(1)(A), (b)(3), and (b)(4) of section 503.

A. Section 503(b)(1)(A)

Section 503(b)(1)(A) provides administrative expense priority treatment to "the actual, necessary costs and expenses of preserving the estate, including wages, salaries, or commissions for services rendered after the commencement of the case." Bankruptcy courts have broad discretion in determining whether to grant or deny administrative expense requests under section 503(b)(1)(A). *See Burlington*, 853 F.2d at 707.

An applicant under section 503(b)(1)(A) must prove three things: (i) that his costs and expenses were actually incurred (i.e., they are out-of-pocket expenses rather than "opportunity costs" or "services rendered"); (ii) that the estate received an actual benefit (i.e., not a conjectural, contingent, or potential benefit); and (iii) that there is a demonstrable causal

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[1] As this case was filed prior to the October 17, 2005, effective date of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA"), all references and citations herein are to the pre-BAPCPA version of title 11.

connection between the applicant's actual expenses and a specific actual benefit received by the estate (i.e., the expenses were "necessary" to "preserving the estate"). *See Calpine Corp. v. O'Brien Envtl. Energy, Inc. (In re O'Brien Envtl. Energy, Inc.)*, 181 F.3d 527, 532 (3d Cir. 1999) (applicant must prove connection between actual expense and actual benefit); *Burlington*, 853 F.2d at 706 (benefit to estate must be actual, not potential). The Third Circuit has stated that an applicant under section 503(b)(1)(A) bears a "heavy burden." *Id.*

In addition, as the "estate" to be preserved did not exist before the filing of the petition, a claimant seeking priority treatment under subparagraph (b)(1)(A) must show that his request is based on a post-petition transaction with the debtor in possession. *See, e.g.*, *Former Employees of Builders Square Retail Stores v. Hechinger Inv. Co. of Del. (In re Hechinger Inv. Co. of Del.)*, 298 F.3d 219, 226 (3d Cir. 2002); *O'Brien*, 181 F.3d at 532. If the transaction that gave rise to the claim predates the filing of the petition, the claim is a pre-petition unsecured claim that cannot be afforded section 503(b)(1)(A) administrative expense priority treatment.

B. Section 503(b)(3)

Section 503(b)(3) allows certain claimants to receive administrative expense priority for their "actual, necessary expenses" other than the compensation and reimbursement of professionals specified in subparagraph (b)(4). Thus, a creditor may never receive administrative expense priority under subparagraph (b)(3) for attorney compensation and expenses; attorney compensation and expenses may only receive administrative expense priority, if at all, under subparagraph (b)(4) (discussed below). In addition, subparagraph (b)(3) only allows for the reimbursement of a creditor's "actual" out-of-pocket "expenses," not the recovery of the value of the hours the creditor has put into the case.

1. Section 503(b)(3)(C)

Subparagraph (b)(3)(C) refers to out-of-pocket expenses incurred by "a creditor in connection with the prosecution of a criminal offense relating to the case or to the business or property of the debtor." Under this provision, a creditor must prove two things: (i) a direct relationship between the expenses sought and the prosecution of a criminal offense; and (ii) a direct relationship between the criminal offense and the debtor's bankruptcy case, business, or property. *See Lebron v. Mechem Financial Inc.*, 27 F.3d 937, 943 n.1 (3d Cir. 1994). If a creditor cannot prove either of these connections, he cannot receive a section 503(b)(3)(C) claim.

2. Section 503(b)(3)(D)

Subparagraph (b)(3)(D) refers to out-of-pocket expenses incurred by a creditor "in making a substantial contribution in a case under chapter 9 or 11[.]" In determining whether he has made a "substantial contribution," the applicant bears an "especially difficult" burden. *See In re U.S. Lines, Inc.*, 103 B.R. 427, 430 (Bankr. S.D.N.Y. 1989). To carry this burden, a creditor must prove three things: (i) that his expenses were actually incurred; (ii) that the estate received an "actual and demonstrable benefit"; and (iii) that the benefit is "more than an incidental one arising from activities the applicant has pursued in protecting his or her own interests." *Lebron*, 27 F.3d at 944. Essentially, creditors seeking section 503(b)(3)(D) treatment must show a causal connection between their services and the benefit, just like applicants under section 503(b)(1)(A). *See In re Worldwide Direct, Inc.*, 334 B.R.112, 121 (Bankr. D. Del. 2005). Creditors are "presumed to be acting in their own interests"; the presumption is rebutted only if they "satisfy the court that their efforts have transcended self-protection." *Lebron*, 27 F.3d at 944. Unless the court finds that the creditor's actions "were designed to benefit others" rather than himself, the creditor cannot obtain administrative expense priority under subparagraph 503(b)(3)(D) even if there was a benefit to the estate. *Id.* at 946. The Third Circuit has held that "[t]he inquiry concerning the existence of a substantial contribution is one of fact, and it is the bankruptcy court that is in the best position to perform the necessary fact finding task." *Id.* As a result, the bankruptcy court has broad discretion to determine whether an applicant has carried his burden of proof.

3. Section 503(b)(3)(F)

Section 503(b)(3)(F) allows a member of an official committee of unsecured creditors to receive administrative expense priority for out-of-pocket expenses incurred in the performance of the duties of the committee.[2] A committee member cannot receive administrative expense priority for everything he does during the case, however; only out-of-pocket expenses proven to be incurred as a member of the committee may receive priority treatment under subparagraph (b)(3)(F). Specifically, a committee member cannot obtain hourly compensation for services he renders during the case. *See In re County of Orange*, 179 B.R. 195, 201 (Bankr. C.D. Cal. 1995).

C. Section 503(b)(4)

Section 503(b)(4) refers to "reasonable compensation for professional services rendered by an attorney or accountant of an entity whose expense is allowable under paragraph (3)[.]"

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[2] Under the pre-BAPCPA version of section 503(b) applicable to this case, the Third Circuit had held that official committee members could also receive administrative expense priority treatment for reimbursement of out-of-pocket expenses constituting fees paid to attorneys. *See First Merchants Acceptance Corp. v. J.C. Bradford & Co.*, 198 F.3d 394, 396 (3d Cir. 2000). This interpretation was superseded by the BAPCPA's amendment of subparagraph (b)(4) to expressly clarify that it does not apply to creditors specified in subparagraph (b)(3)(F). The *First Merchants* decision applied to a reimbursement of the out-of-pocket expenses of a committee member who had actually paid an attorney; it did not apply to compensation for hours spent on the case by the committee member itself.

This provision only provides for compensation for services rendered by the "attorney of" a creditor; it does not provide for the hourly compensation for services rendered by the creditor himself. Indeed, a creditor must actually have paid an attorney before he can obtain a subparagraph (b)(4) claim, as the Third Circuit "do[es] not read subsection (b)(4) to authorize a payment to a creditor in excess of the amount he or she was required to pay for those services." *See Lebron*, 27 F.3d at 947 n.5. In addition, subparagraph (4) only applies to attorney services rendered for a creditor who is himself entitled to administrative expense priority under subparagraph (b)(3); attorney services rendered for a creditor who does not meet the subparagraph (b)(3) requirements cannot receive priority treatment under subparagraph (b)(4). *See Xifaras v. Morad (In re Morad)*, 328 B.R. 264, 269 (B.A.P. 1st Cir. 2005).

II. Statement of Facts

A. Background

Summit Metals, Inc. ("Summit") filed a petition for relief under chapter 11 of title 11 of the United States Code ("Bankruptcy Code") on December 30, 1998. D.I. 1.[3] Richard E. Gray ("Gray") is Summit's controlling shareholder and sole director. D.I. 320.

On March 4, 1999, the United States Trustee appointed an official committee of unsecured creditors ("Committee") under 11 U.S.C. § 1102(a). D.I. 37. The Committee's chairman, Ambrose R. Richardson, III ("Richardson"), was a creditor because of an indemnification claim for fees and expenses incurred in defending against litigation that

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[3] Pursuant to D. Del. L.R. 7.1.3(a)(F), all references herein to docket entries shall be in the form "D.I. [docket item number]."

implicated his actions as a former officer of Summit's predecessor, The Chariot Group, Inc. ("Chariot").[4] D.I. 599 (Transcript of April 4, 2006, Hearing ("Apr. Tr.") 130:16-21).

B. Summit Ligation Against Richardson

On May 3, 1999, Summit sued Richardson in bankruptcy court to recover, as an alleged preferential transfer, a pre-petition payment made on Richardson's indemnification claim. D.I. 82; D.I. 599 (Apr. Tr. 102:6-13; 143:5-144:4; 145:16-19). This adversary proceeding continued for several years, during which time Richardson, in defense of the action against him, conducted discovery regarding Summit and related entities. *See* Docket for Adv. Pro. No, 99-126. The parties ultimately agreed to resolve the adversary proceeding by an agreed stipulation of dismissal dated January 31, 2005, in which counsel to Richardson and counsel to the chapter 11 trustee in Summit's bankruptcy case[5] stipulated that "th[e] action is hereby dismissed, *each party to bear its own fees and costs*." *See* Adv. Pro. No. 99-126, D.I. 44 (emphasis added).

In addition, on August 3, 1999, Summit filed a RICO action against Richardson (among others). D.I. 133. This adversary proceeding was dismissed after only 10 days. Adv. Pro. No. 99-257 D.I. 1 (complaint), 3 (dismissal order).

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[4] *Gray v. Richardson*, 251 A.D. 2d 268, 675 N.Y.S. 2d 57 (1st Dept. 1998), *leave to appeal denied*, 92 N.Y.2d 815, 706 N.E. 2d 747, 683 N.Y.S. 2d 759 (1998).

[5] On September 13, 2004, the bankruptcy court entered an order granting the United States Trustee's motion for the appointment of a chapter 11 trustee, which was grounded in part on Gray's self-dealing and gross mismanagement of Summit. D.I. 329 (motion), 334 (order). The United States Trustee subsequently appointed Francis A. Monaco to serve as chapter 11 trustee. D.I. 338, 343.

C. Committee Litigation Against Gray

The Committee submitted an application under 11 U.S.C. § 1103(a) to employ Silverman, Harnes, Harnes, Prussin & Keller as special counsel on August 20, 1999; an order authorizing the employment was entered on August 27, 1999. D.I. 148, 155. A partner in that firm, H. Adam Prussin ("Prussin"),[6] had represented shareholders in pre-petition litigation in New York State in which it was alleged that Gray had looted Chariot for his own benefit. D.I. 599 (Apr. Tr. at 187:5-24.); *see also* Appellant's Appendix at A56-A71.

On September 21, 1999, the bankruptcy court entered an order authorizing the Committee to prosecute actions of Summit's estate against Gray and Gray-related entities. D.I. 168. Thereafter, on October 29, 1999, the Committee filed a complaint on behalf of Summit to recover property from Gray and several of his affiliated entities including Riverside Millwork Company, Inc. ("Rivco") and Jenkins Manufacturing, Inc. ("Jenkins"). D.I. 172. The complaint alleged that Gray breached his fiduciary duties owed to Summit and Chariot by engaging in unfair and fraudulent self-dealing transactions, including: (i) looting Chariot from 1991 to 1995; (ii) transferring Chariot's assets to Energy Savings Products ("ESP"); (iii) merging Chariot into Summit, and (iv) using ESP's money to acquire Rivco and Jenkins. *Id.*

On August 6, 2004, the Honorable Kent Jordan, United States District Judge,[7] issued post-trial findings of fact and conclusions of law in which he awarded a $48 million judgment in

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[6] Later, after Prussin moved to Pomerantz Haudek Block Grossman & Gross, LLP, the Committee obtained an order authorizing the employment of that firm as special counsel. D.I. 237.

[7] On April 6, 2000, the reference to the bankruptcy court was withdrawn pursuant to 28 U.S.C. § 157(d). The District Court Civil Action number for the adversary proceeding is 1:00-cv-00387-SLR.

favor of Summit and directed Gray and his affiliated entities to transfer to Summit their interests in Rivco and Jenkins.[8] D.I. 320, Ex. A; District Court D.I. 221-22. Summit's chapter 11 trustee later sold Rivco's assets for over $9 million and Jenkins' assets for $6.7 million. D.I. 538, 562.

D. ESP Litigation Against Committee and Richardson in Tennessee

On October 13, 2000, an involuntary petition under chapter 11 of the Bankruptcy Code was filed against ESP in the Middle District of Tennessee. M.D. Tenn. Bankr. Case No. 00-09273, D.I.1. ESP then filed a complaint against the Committee, its counsel, and Richardson personally, in which it sought to stay the adversary proceeding pending in Delaware against Gray and Gray-related entities as well as monetary damages against the defendants and punitive damages against Richardson. *See* Docket for M.D. Tenn Bankr. Case No. 00-09273, D. I. 149. The ESP adversary proceeding was closed on April 29, 2005, after over three years of inactivity. *See* Docket for M.D. Tenn Adv. Pro. No. 01-00676.

E. Richardson's Application for Administrative Expense Priority Treatment

On February 15, 2005, Richardson filed his initial application ("Initial Application") under 11 U.S.C. §§ 507(a)(1) and 503(b) seeking the allowance of fees and expenses totaling $877,752.59[9] as an administrative expense. D.I. 403. The chapter 11 trustee and United States Trustee both objected to the Initial Application. D.I. 421, 427.

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[8] Judge Jordan's decision is reported at 2004 WL 1812700.

[9] As a point of comparison, special counsel to the Committee received $1 million in fees and expenses, and counsel for the Committee received $770,300.25 in fees and $73,757.01 in expenses and. D.I. 580 (special counsel), 797 (counsel).

Thereafter, on March 13, 2006, Richardson filed an amended application ("Amended Application") reducing his total request to $869,631.50 and citing Sections 503(b)(1)(A), 503(b)(3)(B), (C), (D), and (F), and 503(b)(4) for legal authority. D.I. 587. In his Amended Application, Richardson provided a "Quantitative Summary of Claims" that divided his request into thirteen discrete tasks. *Id.*

Richardson filed a supplement to his Amended Application on April 3, 2006 ("Supplemental Application"), in which he provided an additional "Quantitative Summary of Claims II" that divided his request among the statutory provisions under which he sought administrative expense priority treatment.[10] D.I. 591. In his Supplemental Application, Richardson removed Section 503(b)(3)(B) as legal authority for his request, but he increased his total claim to $876,748.67. *Id.* Of the amount requested, a total of $768,921.71 was in the form of "fees" calculated by taking the number of hours worked by Richardson or an associate of his law firm and multiplying them by the corresponding hourly rate ($250 to $275 for Richardson). *Id.* (attached invoices). The remaining $107,826.96 was classified as "Expenses." *Id.*

Richardson's Amended Application seeks administrative expense priority treatment for services such as the following:

- defending against post-petition litigation brought against Richardson by Summit and ESP, on the theory that Summit is required to indemnify Richardson for all costs attendant to all litigation with Gray-related entities

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[10] The division is as follows: $561,380.81 in fees and $81,816.65 under a combination of sections 503(b)(1)(A), (b)(3)(D), and (b)(4); $118,614.59 in fees and $23,638.17 in expenses under a combination of sections 503(b)(3)(D) and (b)(4); $57,615.06 in fees and $541.55 in expenses under section 503(b)(1)(A) only; $19,864.58 in fees and $1,827.59 in expenses under a combination of sections 503(b)(3)(C), (b)(3)(D), and (b)(4); and $11,466.67 in fees and $3.00 in expenses under section 503(b)(3)(C) only. D.I. 591.

(including the cost of post-petition efforts to collect his pre-petition indemnification claim);

- allegedly laying the factual and legal groundwork for virtually every asset collected during Summit's bankruptcy case, as well as other cases in other jurisdictions;
- taking actions in other jurisdictions that, as a matter of conjecture, might possibly have staved off actions adverse to Summit;
- taking measures in other jurisdictions that, while unsuccessful, nonetheless "did sow seeds of distrust against Gray"; and
- providing information that led to Gray's incarceration, in Missouri, for bankruptcy and tax fraud in a Missouri bankruptcy case.[11]

In addition, Richardson alleged that if he had not drafted pleadings, reviewed evidence, and formulated theories and strategies "there would have been no possibility of recover [sic] for himself or for the Estate." D.I. 587 at 7. Richardson also stated that his services in allegedly creating the Committee were vital because, without the results obtained by the Committee, "Richardson could not have recovered the indemnification due to him." *Id*. at 9.

On the other hand, Richardson acknowledged that Prussin "was active in this case," and that he and Prussin "worked closely" on the proceedings in which Gray was found to be in contempt of a pre-petition preliminary injunction obtained in New York state court by shareholders Prussin represented. *Id*. at 13 Indeed, Richardson acknowledged that "[t]he in court work was done by Prussin" in obtaining the preliminary injunction which, according to Richardson, laid the groundwork for all of the assets subsequently brought into Summit's estate. *Id*. at 19.

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[11] Gray was incarcerated for fraud committed in the bankruptcy case of HomeStar Industries, Case No. 97-51831, which was filed in the District of Missouri on December 2, 1997.

With regard to the criminal proceedings in Missouri, Richardson stated that he provided authorities with "extensive background" and "the overall big picture," and the benefit derived from the incarceration was "the collapse of [Gray's] house of cards." *Id.* at 27.

In support of Richardson's claims connecting his services in this and other cases to great results in this case, the Amended Application supplied time records indicating that he put in the time – but provided no additional evidence to connect the time spent to the alleged resulting benefit to the estate. *Id.*

The United States Trustee, chapter 11 trustee, and Committee objected to the Amended Application arguing that (i) Richardson's efforts were duplicative of other parties' services, (ii) Richardson's section 503(b)(1)(A) claim failed because his fees and expenses did not arise from a post-petition transaction with the Debtor or provide an actual benefit to the estate; (iii) Richardson's section 503(b)(3)(C) claim failed because the criminal matters in which he assisted do not relate to the Debtor's case, business, or property; (iv) Richardson's section 503(b)(3)(D) claim failed because he did not make a substantial contribution to the Debtor's estate or creditors; and (v) Richardson could not recover his fees under section 503(b)(4) because the mere fact that he is an attorney does not entitle him to recover professional fees as he was not employed by an entity entitled to recover under subsection 503(b)(3). D.I. 421, 427.

F. Trial

The hearing on Richardson's administrative expense request spanned two days, March 16, 2006, and April 4, 2006, and featured testimony from both Richardson and Prussin. D.I. 589, 599. Relevant highlights of the testimony are as follows:

- Richardson admitted that, in the pre-petition New York shareholder lawsuits which he claimed laid the groundwork for most of the beneficial results obtained in this case, he was neither a plaintiff nor counsel to the plaintiffs. D.I. 599 (Apr. Tr. 91:9-14; 92:20-94:1;125:5-10). He also admitted that no assets were brought into Summit's bankruptcy estate through the pre-petition New York litigation. D.I. 589 (Transcript of March 16, 2006, Hearing ("Mar. Tr.") 19: 11-18); D.I. 599 (Apr. Tr. 126:1-4).

- Richardson admitted that his actions in defending against the short-lived RICO action provided no benefit to the estate. D.I. 599 (Apr. Tr. 151:3-9).

- Richardson admitted that the only benefit derived from Gray's incarceration in Missouri was "psychic gratification." D.I. 599 (Apr. Tr. 158:24-160:12).

- Richardson testified that James Kelly was the key witness in the adversary brought by the Committee against Gray, and that "it would have been impossible to go to trial" without him. D.I. 599 (Apr. Tr. 252:12).

- Prussin testified that Richardson did not participate in the trial in which Gray was originally jailed for contempt of the preliminary injunction entered in the New York shareholder litigation. D.I. 599 (Apr. Tr. at 188:24-189:15).

- Prussin testified that the majority of the facts and theories behind the various causes of action in the Committee's complaint against Gray were developed through the efforts of many different persons and were not solely the result of Richardson's exploits. D.I. 599 (Apr. Tr. 194-208).

On May 18, 2006, Richardson filed a post-hearing brief in which he stated, *inter alia*, that he was entitled to be indemnified by the Debtor and that his indemnification allowed him to collect his "costs of collection" under 11 U.S.C. § 503(b)(1)(A). D.I. 610 at 2. The United States Trustee filed a response, and the chapter 11 trustee and Committee filed a joint response.[12] D.I. 622, 620.

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[12] The chapter 11 trustee and Committee sought leave to file a brief in excess of the page limits as the post-trial brief was joint in nature and addressed not only Richardson's Amended Application but that of Jepsco, another section 503(b) applicant.

G. Bankruptcy Court Decision

On December 4, 2007, the bankruptcy court issued an opinion and order.[13] D.I. 793, 795. The Bankruptcy Court found that Richardson failed to meet his burden of proof under section 503(b)(1)(A), (b)(3)(C), (b)(3)(D), and (b)(4). *Id.* The bankruptcy court denied all hourly compensation requested, and all but $2,533.62 of the out-of-pocket expenses requested.

On December 13, 2007, Richardson filed a timely notice of appeal. D.I. 809.

SUMMARY OF ARGUMENT

The only relief sought anywhere in Richardson's Memorandum of Law is "remand for rehearing with fair procedures." The procedures followed by the bankruptcy court were eminently fair, however. Richardson was allowed to amend and supplement his initial request for an administrative expense claim, he then had a two-day plenary hearing, and finally he was afforded to opportunity to submit a post-hearing brief. As Richardson received an eminently fair and thorough hearing, remand is not necessary, and the bankruptcy court's decision should be affirmed.

In addition, Richardson's request for hourly compensation was properly denied by the bankruptcy court. Neither section 503(b)(1)(A), 503(b)(3)(C), nor 503(b)(3)(D) allow administrative expense priority treatment for a creditor's time spent. In addition, section 503(b)(4) only applies to an attorney employed by a creditor, and not the creditor itself – and it only applies if the creditor may obtain administrative expense priority treatment under section 503(b).

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[13] The Bankruptcy Court's decision is reported at 379 B.R. 40.

Furthermore, the bankruptcy court properly denied Richardson's request for administrative expense treatment of certain expenses pursuant to section 503(b)(1)(A), 503 (b)(3)(C), and 503(b)(3)(D). Richardson was not able to carry his burden of proving that he actually rendered services, that those services benefitted the estate, and that he could prove a causal connection between his services and the benefit. As Richardson could not carry the heavy burden attendant to section 503(b) claims, the bankruptcy court's denial of his request was not clearly erroneous, and should be affirmed.

ARGUMENT

I. The Procedures Followed by the Bankruptcy Court Were Fair, So Remand is Not Necessary

Federal Rule of Bankruptcy Procedure 8010(a)(1)(F) requires an appellant's brief to contain a conclusion "stating the precise relief sought." The only relief requested in the conclusion of Richardson's Memorandum of Law (or elsewhere, for that matter) is the request, at page 35, that "[t]he appropriate relief would be a remand for rehearing with fair procedures." As the conclusion and the paragraph immediately preceding it contain the only suggestion in Richardson's Memorandum of Law of procedural infirmity, it is difficult to discern precisely what he is complaining about. It would appear that Richardson thinks this matter should be remanded for further proceedings because he was not afforded the opportunity to file a reply to the responses filed to his post-hearing brief. *See* Richardson Memorandum of Law at 1, 35.

The only procedural requirement contained in section 503(b) is that administrative expense requests be subject to "notice and a hearing." Under 11 U.S.C. § 102(1)(A), "after notice and a hearing" means "such notice as is appropriate in the particular circumstances, and such opportunity for a hearing as is appropriate in the particular circumstances."

In this case, Richardson filed his Initial Application in February 2005 and the hearing did not take place until March and April of 2006, so there are presumably no notice issues. D.I. 403, 589, 599. As for the adequacy of the hearing his request received, Richardson filed not only his Initial Application, but also an Amended Application and a Supplement Application. He then received a plenary hearing with two full days of testimony, during which he not only testified but also presented documentary evidence that had not been provided with his application. Then, after the hearing, he was allowed to file an extensive post-hearing brief. Far from being "unfair" to Richardson, the bankruptcy court went out of its way to provide him with the opportunity to carry his burden of proof.

It is difficult to imagine how much more "fair" the proceedings would have been had Richardson been allowed to file a post-hearing reply brief. In addition, nothing in the record below remotely supports Richardson's allegations that the bankruptcy court was "misled" (page 18 of Richardson's Memorandum of Law), suffered from a "fundamental misconception" (page 19), was "unfamiliar with Judge Jordan's findings" (page 23), did not read Richardson's document submission (page 34), had a "predisposition that makes a fair hearing impossible" (page 34), had "fundamental misconceptions of the underlying facts and proceedings [that] taint the entire analysis" (page 34-35), or was "confused about . . . factual matters that were viewed in a distorted context" (page 35). Contrary to his belief that the bankruptcy court was either duped, predisposed, or grossly negligent, the record shows that Richardson received a thorough and fair hearing on his request during which all of his evidence and arguments were considered – he simply failed to carry his burden of proof, and he does not like the result. *See* Bankruptcy Court Decision at 23, 25, 27, 31, 37, 38, 39, 40. Given the extensive hearing Richardson has already received, there is no need for a remand that would only provide Richardson with yet another opportunity to attempt to carry his burden of proof.

As there is no need for a remand on this record, Richardson's request for remand should be denied. As Richardson's Memorandum of Law requests no relief other than remand, the bankruptcy court's decision should be affirmed.

II. The Bankruptcy Court Properly Denied Richardson's Request for Hourly Fees

The bulk of Richardson's administrative expense request consists of $768,921.71 in compensation for hourly time spent by Richardson and employees of his law firm in various matters attendant to this and other cases. As (i) sections 503(b)(1)(A) and (b)(3) do not allow administrative expense priority treatment to requests for compensation for services rendered, and (ii) section 503(b)(4) only allows administrative expense priority treatment to compensation for services rendered by an attorney employed by a creditor (but not to the creditor himself), the bankruptcy court did not err in denying Richardson's request to be paid for his time spent on this and other cases.

A. Section 503(b)(1)(A) Does Not Allow Administrative Expense Priority For Services Rendered

Of his total request, Richardson seeks to have hourly time valued at $643,197.46 afforded administrative expense priority treatment under section 503(b)(1)(A), either under that provision alone or "bootstrapped" with other provisions of section 503(b).[14] Under section 503(b)(1)(A), a

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[14] It is inappropriate to "bootstrap" a request by seeking administrative expense treatment under myriad provisions of section 503(b) in the hope that if the request is denied under one

party may obtain administrative expense priority treatment for his attorney fees only if he can carry what the Third Circuit has called "the heavy burden of demonstrating that the costs and fees for which [he] seeks payment provided an actual benefit to the estate and that such costs and expenses were necessary to preserve the value of estate assets." *See Calpine Corp. v. O'Brien Environmental Energy, Inc. (In re O'Brien Environmental Energy, Inc.)*, 181 F.3d at 533.

As an initial matter, Richardson cannot prove that his hourly time spent is an "actual" cost or expense. He has not gone "out of pocket" to pay an attorney to provide these services; instead, he has rendered them himself. What he seeks to recover is not the reimbursement of an "actual" expense capable of being objectively proven, but the payment of a theoretical "opportunity cost" to which he has affixed a value. This is not the kind of "cost and expense" for which section 503(b)(1)(A) is intended.

Unlike other provisions of section 503(b), section 503(b)(1)(A) makes no mention of "compensation." *Compare* 11 U.S.C. § 503(b)(2), (4), & (5). Thus, applicants cannot obtain a section 503(b)(1)(A) claim in the amount of compensation for their services rendered. If Congress had so intended, it would have written "compensation" into subparagraph (b)(1)(A) like it did into other subparagraphs of section 503(b). Thus, subparagraph (b)(1)(A) only allows for reimbursement of the claimant's out-of-pocket "costs and expenses," but not for the hourly time spent by the claimant.

Even if he were entitled to request section 503(b)(1)(A) administrative expense priority treatment for services rendered, to carry his burden Richardson must do more than show that he

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provision it may be granted under another. *Cf. F/S Airlease II, Inc. v. Simon*, 844 F.2d 99, 108-09 (3d Cir. 1988), *cert. denied*, 488 U.S. 852 (1988) (professional may not use § 503(b)(1)(A) when he cannot meet requirement for § 503(b)(2) claim).

spent time on a matter in which the estate wound up with a good result; he must prove that his services were necessary to obtain the result – essentially, that he alone was the "catalyst" for the result. *O'Brien*, 181 F.3d at 533 (participation must be "necessary to accord the estate an actual benefit"), 537 (applicant must show not just benefit, but that he was the catalyst for benefit). In reviewing the denial of a section 503(b)(1)(A) request on appeal, this Court must "consider whether the record evidence supports the Bankruptcy Court's implicit conclusion that awarding [the requested] fees was not necessary to preserve the value of [the] estate." *Id.* at 536.

The record indicates that on most of the significant actions taken by Richardson, Prussin and others were involved, at least enough that Richardson cannot prove that he is the catalyst for the benefits received by the estate. D.I. 599 (Apr. Tr. 91:9-14, 92:20-94:1, 125:5-10). For example, Prussin testified that he was a principal draftsman of the Committee's complaint against Gray. D.I. 599 (Apr. Tr. 199:25, 200:1-8). In addition, matters filed in other courts were so attenuated that Richardson was not able to prove that they produced a demonstrable asset to the estate. D.I. (Apr. Tr. 151:3-9). As a result, even if compensation for services rendered was available under section 503(b)(1)(A), Richardson did make the necessary showing.

On the record before the bankruptcy court, it was not clear error to deny Richardson's request for section 503(b)(1)(A) administrative expense priority treatment for his hourly time spent. As a result, the bankruptcy court's decision should be affirmed.

B. Section 503(b)(3)

Of his total request, Richardson seeks to have hourly time valued at $711,326.65 afforded administrative expense priority treatment under section 503(b)(3)(C) and (D), either under those provisions alone or "bootstrapped" with other provisions of section 503(b). Due to the existence of section 503(b)(4), however, no hourly charges for legal services may ever be compensated under section 503(b)(3). The statutory construct expressly requires creditors to first prove that their actual out-of-pocket expenses, "other than compensation and reimbursement specified in [section 503(b)(4)]," may be afforded administrative expense priority under section 503(b)(3); only if they first make that showing can they seek administrative expense priority treatment for the fees incurred by their attorney. *See In re Worldwide Direct, Inc*., 334 B.R. at 120.

In addition, section 503(b)(3) only allows administrative expense priority treatment for "actual" expenses. As Richardson's hourly time spent is not an actual out-of-pocket expense, it is not subject to administrative expense priority treatment under section 503(b)(3).

Also, section 503(b)(3) requires proof that the expenses were "necessary" to achieve a benefit to the estate. To carry his burden, Richardson needed to not only produce time records and his own glowing account of his deeds – he needed to provide "corroborating testimony from a disinterested party." *See Derivative Plaintiffs v. Columbia Gas Sys. (In re Columbia Gas Sys.)*, 2000 WL 1456298 (D. Del. Sept. 20, 2000). As he did not provide disinterested corroborating evidence, Richardson did not make the requisite showing to carry his burden of proof. D.I. 599 (Apr. Tr. 252:1-12).

Furthermore, section 503(b)(3)(C) applies only to criminal prosecution "relating to the case or to the business or property of the debtor." The fact that the prosecution was of Summit's principal, who may or may not have looted Summit, means that there is some question whether the prosecution was too attenuated. In any event, however, Richardson did not supply sufficient information to enable the bankruptcy court to determine that the prosecution implicated either Summit, its business, or its assets. D.I. 589 (Mar. Tr. 30:15-25).

As a result, the bankruptcy court's denial of Richardson's request to have his hourly services afforded administrative expense priority treatment under sections 503(b)(3)(C) and (D) was not erroneous, and the bankruptcy court's decision should be affirmed.

C. Section 503(b)(4)

Of his total request, Richardson seeks to have hourly time valued at $699,859.98 afforded administrative expense priority treatment under section 503(b)(4), either under that provision alone or "bootstrapped" with other provisions of section 503(b).

Section 503(b)(4) provides for the administrative expense priority treatment of the legal fees of the attorney for a creditor whose expenses are entitled to section 503(b)(3) priority treatment. Thus, unless a creditor has first received a section 503(b)(3) administrative expense, he cannot obtain section 503(b)(4) priority for his legal fees.

As has been addressed previously, Richardson was faced with a steep burden under section 503(b)(3)(D) – he had to rebut the presumption that everything he did in this case was done to benefit his own self-interest, such that every benefit that resulted was incidental and not a "substantial contribution." *See Lebron v. Mechem Financial Inc.*, 27 F.3d at 944. Richardson was unable to rebut that presumption, so his section 503(b)(3)(D) request was properly denied. As a result, he cannot obtain section 503(b)(4) administrative expense treatment for his attorney fees, regardless of whether he actually paid for them or rendered them *pro se*.

Even if section 503(b)(4) was not inexorably linked to section 503(b)(3), Richardson would still not be entitled to receive administrative expense treatment for the *pro se* legal fees he alleges to have racked up in this case. The Third Circuit has noted that it reads section 503(b)(4) as only allowing a creditor to obtain an administrative expense claim equal to the amount he "was required to pay for [legal] services." *Lebron*, 27 F.3d at 947 n.5. As a result, Richardson could only recover attorney fees if he could prove that he had to pay for them, and then he would only receive the actual amount he had to pay. As he has not paid an attorney, but instead rendered the services himself, Richardson cannot receive administrative expense treatment under section 503(b)(4).

In any event, section 503(b)(4) applies to the attorney "of" a creditor, not the creditor himself (even if the creditor just so happens to be an attorney). As a result, even an attorney-creditor cannot obtain compensation for his own legal services under section 503(b)(4). *See, e.g.*, *In re Patriot Aviation Services, Inc.*, ___ B.R. ___, 2008 WL 506260 (Bankr. S.D. Fla. Feb. 21, 2008); *In re Gimelson*, 2004 WL 2713059 * 22 (E.D. Pa. Nov. 23, 2004); *In re Pappas*, 277 B.R. 171, 177-78 (Bankr. E.D.N.Y. 2002).[15]

Richardson argues at page 30-31 of his Memorandum of Law that he was awarded *pro se* legal fees in his indemnification, and so should be awarded his *pro se* legal fees here. This argument is unavailing, however. The Delaware indemnification law (pursuant to which Richardson obtained his claim) and the Bankruptcy Code are different statutes, with different purposes. It may very well be good public policy to award *pro se* legal fees in indemnification actions, but the overarching policy in bankruptcy cases is to limit the amount of administrative claims. *See Burlington*, 853 F.2d at 706 ("[K]eeping costs to a minimum serves the overwhelming concern of the Code: Preservation of the estate."). As section 503(b) is to be

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[15] Richardson did not attempt to prove that he had a contractual relationship with anyone in his capacity as an attorney.

applied strictly, and Richardson's desired result would require a lax application, the bankruptcy court's denial of Richardson's *pro se* counsel fees were not clearly erroneous.

As a result, the bankruptcy court's denial of Richardson's request for his hourly time spent in this and other cases to be treated as legal fees under section 503(b)(4) was not erroneous, and should be affirmed.

III. <u>The Bankruptcy Court's Denial of Richardson's Out-of-Pocket Expenses Was Not Clearly Erroneous</u>

A. <u>Denial of Richardson's Section 503(b)(1)(A) Request Was Not Clearly Erroneous</u>

The bulk of Richardson's section 503(b)(1)(A) request is related to his attempts to collect the pre-petition indemnification award of $46,331.98 that he received after successfully defending himself in a suit by Gray alleging a violation of Richardson's fiduciary duty as an officer of Chariot, Summit's predecessor. *See Gray v. Richardson*, 251 A.D.2d 268, 675 N.Y.S.2d 57 (1st Dept. 1998), *leave to appeal denied*, 92 N.Y.2d 815, 706 N.E. 2d 747, 683 N.Y.S. 2d 759 (1998). Richardson seeks administrative expense priority for expenses he incurred in the Summit bankruptcy case, the RICO and preference actions brought against him by Summit, and several other cases in other venues in which he attempted to bring assets into the estate to increase the likelihood that he would collect on his indemnification award. *See* Bankruptcy Court Decision at 19. The bankruptcy court denied Richardson's entire indemnification-related request because, even if Richardson is entitled to an indemnification claim for his collection efforts, the claim would still not be entitled to section 503(b)(1)(A) administrative expense priority treatment because it would be a pre-petition claim. *See* Bankruptcy Court Decision at 20-21.

Under section 503(b)(1)(A), an applicant must show that the claim "arise[s] from a transaction with the debtor in possession," rather than a pre-petition transaction with the debtor (or its predecessor). *See O'Brien*, 181 F.3d at 532. Although the Richardson Memorandum of Law states at page 26 that each post-petition contested matter with Summit was a new post-petition "transaction," the actual transaction that gave rise to Richardson having any indemnification claim at all was his pre-petition employment transaction with Chariot, Summit's predecessor. D.I. 599 (Apr. Tr. 99:9-101:19). As the bankruptcy court correctly held, indemnification claim grounded on a claimant's pre-petition employment status is a form of pre-petition compensation, and thus is part of the claimant's pre-petition unsecured claim rather than a post-petition administrative claim subject to section 503(b)(1)(A) priority. *See, e.g.*, *In re Overland Park Fin. Corp.*, 240 B.R. 402, 405-06 (Bankr. D. Kan. 1999); *In re Highland Group, Inc.*, 136 B.R. 475, 481 (Bankr. N.D. Ohio 1992). As a result, the bankruptcy court's denial of Richardson's request for administrative expense treatment for his indemnification claim was not clearly erroneous.

Richardson's analogy at page 27 and 28 of his Memorandum of Law to the Supreme Court's decision in *Reading Co. v. Brown* and similar cases is unavailing. In those cases, an administrative expense claim was awarded because an estate fiduciary was affirmatively found to have engaged in wrongdoing that harmed the applicant. *See, e.g.*, *Reading Co. v. Brown*, 391 U.S. 471, 485 (1968) ("We hold that damages resulting from the negligence of a receiver acting within the scope of his authority as receiver gives rise to 'actual and necessary costs' of a Chapter XI arrangement."); *Spunt v. Charlesbank Laundry, Inc. (In re Charlesbank Laundry, Inc.)*, 755 F.2d 200, 202 (1st Cir. 1985) (harm caused by debtor's violation of injunction during proceedings for nuisance damages afforded administrative expense priority). In the instant case, while Richardson has certainly accused Gray and his entities (including Summit) of causing him harm, there has been no affirmative determination that Richardson is owed any damages for any post-petition action taken against him by Summit. *See* Bankruptcy Court Decision at 19 (Richardson's reliance on *Reading* "is misplaced, as he has not accused [Summit] of committing a tort."). Indeed, the only actions taken by Summit against Richardson were a short-lived RICO claim that caused Richardson no harm and a preference action that, in the stipulation that dismissed the adversary proceeding, expressly stated that the parties would each pay their own costs. Adv. Pro. 99-126 D.I. 44. And of course, actions taken by any entity other than Summit could never justify a *Reading* administrative expense in Summit's case, barring a finding that Summit itself had engaged in wrongdoing. Without an affirmative finding of wrongdoing by Summit that caused Richardson to incur damages, there is simply no basis for a *Reading* administrative expense claim in this case.

The remainder of Richardson's section 503(b)(1)(A) claim is comprised of expenses incurred on various Committee matters that, according to Richardson, enabled the estate to recover assets. D.I. 610 at 2. Although Richardson's writings have continuously argued that his actions benefitted the estate, Richardson has not provided any separate evidence to corroborate the causal connection between his services and an actual specific benefit to the estate. Section 503(b)(1)(A) claims cannot simply be had for the asking; Richardson had the admittedly "heavy burden" of proving that his expenses were necessary to achieve an identifiable actual benefit to the estate, but he was unable to carry that burden, producing only unsupported conclusory statements but no real evidence. Given the broad discretion provided the bankruptcy court in this area, and especially given the deference accorded the bankruptcy court's ability to observe the witnesses, it cannot be said that the bankruptcy court's denial of Richardson's section 503(b)(1)(A) claim was clearly erroneous on the record before it. As a result, the bankruptcy court's decision should be affirmed.

B. Denial of Richardson's Section 503(b)(3)(D) Request Was Not Clearly Erroneous

Most of the expenses for which Richardson seeks section 503(b)(3)(D) administrative expense priority treatment were generated during Richardson's defense against litigation filed against him. Although Richardson's writings extol the benefits of his actions in these matters, the fact remains that at virtually every turn in this case Richardson was attempting to either defend himself against attack or collect on his indemnification claim.

The Third Circuit presumes that creditors are acting on their own behalf, unless they can rebut the presumption with proof that their actions were "designed to benefit others." *Lebron*, 27 F.3d at 946. The record below contained ample evidence that Richardson's actions were borne of an intent to benefit himself, and no evidence of altruistic intent. As a result, he did not rebut the presumption of self-interest, so any benefit to the estate from his actions must be deemed to be purely incidental. D.I. 599 (Apr. Tr. 151:3-9, 164:23-165:2, 132:3-14, 144:13-17).

In addition, many of Richardson's actions did not produce a demonstrable benefit to the estate. For example, on pages 25-26 of his Memorandum of Law Richardson posits a tenuous daisy chain linking (i) the pre-petition injunction against Gray in the New York shareholder litigation, (ii) Richardson's correspondence with the United States Trustee in Tennessee, (iii) Gray's federal indictment in Missouri, and (iv) the granting of a motion over Richardson's objection in a Tennessee bankruptcy court – all of which somehow, by Richardson's reckoning, led to a benefit to the Summit estate caused solely by Richardson. If this is a benefit, it is exactly the kind of benefit that the Third Circuit deems insufficient for section 503(b)(3)(D) purposes.

In order to carry his burden of proof under section 503(b)(3)(D), Richardson was required to introduce "'[s]omething more than mere conclusory, self-serving statements regarding [his] involvement in [the] case.'" *See Derivative Plaintiffs v. Columbia Gas Sys. (In re Columbia Gas Sys)*, 2000 WL 1456298 (D. Del. Sept, 20, 2000) (quoting *In re Buckhead Am. Corp*., 161 B.R. 11, 15 (Bankr. D. Del. 1993). Indeed, he should have introduced "'[c]orroborating testimony [from] a disinterested party attesting to [his] instrumental acts.'" *Id*. (quoting *In re U.S. Lines, Inc*., 103 B.R. 427, 430 (Bankr. S.D.N.Y. 1989)). But he introduced no such evidence, relying instead on his time records and glowing narratives. Given the evidence that Prussin, as special counsel to the Committee, was intimately involved in most of the actions that produced value to the Summit estate, Richardson's failure to produce corroborating evidence is fatal to his section 503(b)(3)(D) request.

Even when Richardson was involved in a matter that produced a benefit to the estate – such as the Committee's complaint against Gray, which brought in over $48 million – he has failed to prove that his services were the necessary bridge to the benefit. While Richardson's writings certainly trumpet his services as the font from which all benefits sprung, the record placed before the bankruptcy court was devoid of any corroborating evidence to that effect, and no one – not the court, not the United States Trustee, not the chapter 11 trustee, and not the Committee – agreed with him on that point. All Richardson has shown is that he filed documents, responded to documents, and corresponded with people in this and other cases – but he has not proven the causal connection between these actions and the benefit received by the estate. Richardson has apparently fallen victim to the logical fallacy of "*post hoc, ergo propter hoc*" – essentially, "after this, therefore because of this." By focusing solely on his early actions and the ultimate result, he failed to prove the causal connection between his services and the result. *See* Bankruptcy Court Decision at 30 (Richardson provided no additional evidence to support assertions that he developed facts and theories regarding New York preliminary injunction and contempt proceedings against Gray), 32 (Richardson did not sow causal connection between his actions and Gray incarceration in Missouri), 33 (Richardson merely argues with no proof regarding alleged substantial contribution form actions in Tennessee proceedings).

As Richardson did not carry his burden of proof, the bankruptcy court's denial of his section 503(b)(3)(D) claim was not clear error. Thus, the bankruptcy court's decision should be affirmed.

C. Denial of Richardson's Section 503(b)(3)(C) Request Was Not Clearly Erroneous

Richardson's request for administrative expense treatment under section 503(b)(3)(C) for his expenses attendant to Gray's prosecution for bankruptcy and tax fraud in Missouri is not as large as his other requests, but it suffers from most of the same failings. As the bankruptcy court stated at page 26 of its decision, although a request under section 503(b)(3)(C) need not show a benefit to the estate, Richardson still must show a direct relationship between his expenses and Gray's prosecution, and he must show a connection between Gray's prosecution and Summit's bankruptcy case, business, or property. As the record below did not make these connections, the bankruptcy court properly denied Richardson's request. D.I. (Apr. Tr. 83:6-25, 84:1-5, 158:24-159:25).

The record only reflects that Richardson corresponded with the authorities; there is no indication from the FBI, IRS, or other governmental authorities that Richardson's information was instrumental in prosecuting Gray. Indeed, as the bankruptcy court stated at page 27 of its decision, it is not clear how Gray's criminal proceeding, or even the underlying Missouri bankruptcy case, had anything more than a tangential relation to Summit's case, property, or business. It is not enough to say that any criminal proceeding against Summit's principal, who looted Summit, is related to Summit's case, business, or property. Some quantum of proof was required, and none was provided by Richardson.

As Richardson failed to carry his burden of proof under section 503(b)(3)(C), the bankruptcy court's denial of his request was not clearly erroneous. Thus, the bankruptcy court's decision should be affirmed.

CONCLUSION

For these reasons, the Acting United States Trustee respectfully asks this Court to affirm the bankruptcy court's order.

Respectfully submitted,

ROBERTA A. DEANGELIS
ACTING UNITED STATES TRUSTEE
REGION 3

By: P. Matthew Sutko
John Sheehan
Robert J. Schneider
United States Department of Justice
Executive Office for United States Trustees
20 Massachusetts Ave, N.W.
Washington, DC 20530

Andrew R. Vara, Assistant U.S. Trustee
Richard L. Schepacarter
/s/Richard L. Schepacarter
United States Department of Justice
Office of the United States Trustee
844 King Street, Room 2207, Lockbox 35
Wilmington, DE 19801
(302) 573-6491

Dated: May 16, 2008

BRIEF BANK — "SUMMARY SHEET"

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WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*
In re Summit Metals, Inc. (Ambrose M. Richardson, III v. Roberta A. DeAngelis, Acting United States Trustee for Region 3, and Francis A. Monaco, Jr., Esq., Chapter 11 Trustee)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*
3rd Cir.

3. ("CCN") ***CURRENT*** CASE NO.
No.: 08-4879

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*
No.: 1-08-cv-00005
Court: D. Del.
(Identify judge & cite, if any)

5. ("SO") ***SOURCE***
U.S. TRUSTEES

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*
Filed: June 5, 2009
Type: Brief for Appellee, Roberta A. DeAngelis, Acting United States Trustee

7. **("AU") *PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*
Richard L. Schepacarter, Robert J. Schneider, John P. Sheahan, P. Matthew Sutko, William K. Harrington
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***
• Did the bankruptcy court err when it held that the appellant was not entitled to compensation from the bankruptcy estate of Summit Metals, Inc. under section 503 of the United States Bankruptcy Code, where appellant sought to be paid for his time and expenses litigating in his personal capacity in various proceedings against the principal shareholder of Summit and his related entities?

10. PATH TO FILE LOCATION:
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No. 08-4879

IN THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

In re: SUMMIT METALS, INC.,
Debtor.

AMBROSE M. RICHARDSON, III,
Appellant,

v.

ROBERTA A. DeANGELIS, Acting United States Trustee for Region 3,
and FRANCIS A. MONACO, JR., ESQ., Chapter 11 Trustee,

Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF DELAWARE

BRIEF FOR APPELLEE, ROBERTA A. DeANGELIS, ACTING UNITED STATES TRUSTEE

Ramona D. Elliott
General Counsel
P. Matthew Sutko
Associate General Counsel
John P. Sheahan
Department of Justice
Executive Office for U.S. Trustees
20 Massachusetts Ave, N.W.
Washington, DC 20530

William K. Harrington
Assistant United States Trustee
Richard L. Schepacarter
Robert J. Schneider
Department of Justice
Office of the United States Trustee
844 King Street, Room 2207, Lockbox 35
Wilmington, DE 19801
(302) 573-6491

Attorneys for Appellee Roberta A. DeAngelis,
Acting United States Trustee

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STATEMENT OF JURISDICTION

The bankruptcy court had jurisdiction over this chapter 11 proceeding under 28 U.S.C. § 157(a). The district court had appellate jurisdiction over the bankruptcy court's final order under 28 U.S.C. § 158(a)(1). This appeal was timely filed on December 21, 2008. This Court has jurisdiction over the district court's final order dated October 7, 2008, under 28 U.S.C. §§ 158(d) and 1291.

STATEMENT OF THE ISSUE PRESENTED

Did the bankruptcy court err when it held that the appellant, Ambrose Richardson, was not entitled to compensation from the bankruptcy estate of Summit Metals, Inc. under section 503 of the United States Bankruptcy Code, where Richardson sought to be paid for his time and expenses litigating in his personal capacity in various proceedings against the principal shareholder of Summit and his related entities?

STATEMENT OF THE CASE

Around 1995, Ambrose Richardson, a director of The Chariot Group, Inc. ("Chariot"), caused the filing of a lawsuit in New York state court against Richard E. Gray, Chariot's controlling shareholder. Br. 6.[1] Gray counter-sued

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[1] Citations to items in the record contained in Richardson's Appendix are indicated as "A __." Citations to Richardson's Opening Brief are indicated as "Br. _." Citations to items on the electronic docket of the bankruptcy case below are

Richardson, accusing him of violating his own fiduciary duties to Chariot. *Id.* These lawsuits began a protracted legal battle between Gray and Richardson, which has so far resulted in numerous lawsuits, claims, and criminal proceedings in multiple state and federal courts.

Since 1999, some of these legal battles have taken place within the chapter 11 bankruptcy case of Summit Metals, Inc. ("Summit"), a company into which Chariot merged. The present appeal involves Richardson's efforts to recoup the costs of his legal battle against Gray from the creditors and bankruptcy estate of Summit. In 2005, Richardson filed an application in the bankruptcy court for an award of $876,748.67 as an administrative expense. Under the provisions of the Bankruptcy Code, this expense, if allowed, would be required to be paid in full before any distribution could be made to Summit's unsecured creditors. *See* 11 U.S.C. §§ 503(b), 507(a). The greater part of this claim represents the alleged value of the personal time spent on Gray-related matters by Richardson, who is an attorney, despite the fact that the bankruptcy court never authorized Richardson to represent the Summit bankruptcy estate.

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indicated as "B.D.I.[docket item number]." Citations to the electronic dockets and docket items in other cases or proceedings before the bankruptcy court below or other bankruptcy courts are indicated by specifying the court, case or proceeding number, and docket item number.

The bankruptcy court denied Richardson's claim, except for approximately $2,533.62 of expenses that Richardson had incurred in his capacity as a member of the Summit Creditors' Committee.[2] The district court subsequently affirmed the bankruptcy court's order. This appeal raises the questions of whether the bankruptcy court applied an incorrect legal standard, or made clearly erroneous findings of fact, in disallowing the balance of Richardson's administrative claim.

STATEMENT OF APPROPRIATE STANDARD OF APPELLATE REVIEW

This Court exercises the same review over the bankruptcy court's decision as did the district court. *See Fellheimer, Eichen & Braverman P.C. v. Charter Technologies, Inc.*, 57 F.3d 1215, 1223 (3d Cir. 1995). As a result, this Court conducts a *de novo* review of the bankruptcy court's legal findings, but reviews the bankruptcy court's factual findings for clear error. *Id.* In particular, the bankruptcy court's findings of fact will not be set aside unless they are either "completely devoid of minimum evidentiary support displaying some hue of credibility or bear[ ] no rational relationship to the supportive evidentiary data."

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[2] The bankruptcy court awarded Richardson compensation under section 503(b)(3)(F) of the Bankruptcy Code, which pertains to claims for reimbursement for out-of-pocket expenses incurred by a member of a creditors' committee in the course of their official duties. Richardson's section 503(b)(3)(F) fees are not at issue in this appeal.

Id.; *see also* Fed. R. Bankr. P. 8013 ("[F]indings of fact, whether based on oral or documentary evidence, shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the bankruptcy court to judge the credibility of the witnesses.").

STATUTORY FRAMEWORK

The United States Bankruptcy Code classifies certain expenses of the bankruptcy estate as "administrative expenses," which are paid in full before any distribution is made to unsecured creditors. *See* 11 U.S.C. §§ 503(b), 507.[3] In this circuit, the Bankruptcy Code's provisions authorizing payment of administrative expenses are interpreted narrowly in light of the Bankruptcy Code objective to "keep[ ] fees and administrative costs at a minimum so as to preserve as much of the estate as possible for creditors." *Lebron v. Mechem Financial Inc.*, 27 F.3d 937, 944 (3d Cir. 1994).

Section 503(b) sets out a nonexclusive list of items that may be afforded administrative expense priority. In this case, Richardson bases his claim on subparagraphs (b)(1)(A), (b)(3)(C), (b)(3)(D), and (b)(4) of section 503. Br. 14,

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[3] As this case was filed prior to the October 17, 2005, effective date of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA"), all references and citations herein are to the pre-BAPCPA version of title 11.

15, 18, 23.

Section 503(b)(1)(A) provides administrative expense priority treatment to "the actual, necessary costs and expenses of preserving the estate, including wages, salaries, or commissions for services rendered after the commencement of the case." Section 503(b)(3) provides administrative expense priority for "actual, necessary expenses" of the estate, other than professional fees. Under subparagraph (b)(3)(C), these expenses include the out-of-pocket expenses incurred by "a creditor in connection with the prosecution of a criminal offense relating to the case or to the business or property of the debtor." Subparagraph (b)(3)(D) provides administrative priority to expenses incurred by a creditor "in making a substantial contribution in a case under chapter 9 or 11[.]" Lastly, section 503(b)(4) provides administrative priority for "reasonable compensation for professional services rendered by an attorney or accountant of an entity whose expense is allowable under paragraph (3)[.]"

In the proceedings below, the United States Trustee was authorized to object to Richardson's administrative expense application by 11 U.S.C. §§ 503(b) and 307 and 28 U.S.C. § 586(a)(3). The United States Trustee Program is a unit of the Department of Justice charged by Congress to, among other things, appoint official committees of unsecured creditors in chapter 11 cases, appoint trustees in chapter 11 cases, and supervise the administration of chapter 11 cases. *See* 11 U.S.C. §§ 1102(a) & 1104(a), 28 U.S.C. § 586(a)(3). In addition, 11 U.S.C. § 307 enables the United States Trustee to raise and be heard on any issue in any chapter 11 case.

STATEMENT OF FACTS

I. Summit's Chapter 11 Bankruptcy Case

On December 30, 1998 Summit filed a petition for relief under chapter 11 of the Bankruptcy Code. B.D.I. 1. At the time of Summit's bankruptcy filing, Richardson was a creditor of Summit by virtue of a partially-uncollected indemnity judgment that Richardson had obtained against Gray and Summit (as successor-in-interest to Chariot) in state court. A678 (Transcript of April 4, 2006, Hearing ("Apr. Tr.") 102:18-22).

On March 4, 1999, pursuant to section 1102(a) of the Bankruptcy Code, the United States Trustee appointed an official committee of unsecured creditors in the Summit chapter 11 case (the "Committee"). B.D.I. 37. Richardson was elected chairman of the Committee, and has continued to serve as chairman at all times relevant to this appeal.

On September 13, 2004, the bankruptcy court ordered the appointment of a chapter 11 trustee to assume control of Summit. B.D.I. 334. Under sections 1104 and 1106 of the Bankruptcy Code, chapter 11 trustees are independent fiduciaries appointed to manage the chapter 11 debtor in the place of the debtor's prior management. Chapter 11 trustees may be appointed for cause, including mismanagement or misconduct by a debtor's current management. *See* 11 U.S.C. §§ 1104(a)(1), 1104(e), 1106. The United States Trustee subsequently appointed Francis A. Monaco to serve as chapter 11 trustee. B.D.I. 338, 343.

II. Litigation Involving Gray, Richardson, and Summit

Richardson's alleged administrative claims arise from the numerous lawsuits and collection actions which Gray and Richardson have litigated against one another, some (but not all) of which have also involved Summit as a party. Although there appear to be numerous other proceedings between Richardson and Gray that are not pertinent to this appeal, Richardson specifically bases his claim on five of these legal proceedings: the Chariot litigation pending in state court prior to the Summit bankruptcy; certain bankruptcy adversary proceedings filed by Gray, on behalf of Summit, against Richardson; a bankruptcy adversary proceeding filed against Gray by the Committee; the bankruptcy case of ESP, another company controlled by Gray; and various criminal proceedings against Gray.

A. State Court Derivative Litigation and Indemnity Judgment

In about 1995, Richardson caused the filing of a state court lawsuit against Gray on behalf of the shareholders of Chariot. A56. In response, Gray filed a complaint against Richardson for breaching his fiduciary duties as a director of Chariot. A61. In 1997, Richardson was granted summary judgment on Gray's claims against him. A84. As part of that judgment, the court also awarded Richardson indemnification under Chariot's bylaws. A86; *see also Gray v. Richardson*, 251 A.D.2d 268, 675 N.Y.S.2d 57 (1st Dept. 1998). This judgment was only partially paid prior to Summit's bankruptcy. Br. 6.

B. Bankruptcy Adversary Proceedings Against Richardson

On May 3, 1999, Summit, then still controlled by Gray, filed a complaint against Richardson in bankruptcy court, which sought to recover Summit's pre-petition partial payment of Richardson's indemnity judgment on the grounds that the payment was a preferential transfer voidable under section 547 of the Bankruptcy Code.[4] B.D.I. 82; A678, 719-21 (Apr. Tr. 102:6-13; 143:5-144:4;

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[4] Section 547of the Bankruptcy Code provides that, under certain circumstances, the debtor may sue to recover payments made to a creditor "on account of an

145:16-19). In 2005, after the appointment of the chapter 11 trustee, Richardson and Summit stipulated to the dismissal of the preferential transfer complaint, with each party agreeing to bear its own costs. *See* Del. Adv. Pro. No. 99-126, D.I. 44.

On August 3, 1999, Summit filed an action under the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. § 1961 *et seq*. ("RICO") alleging that Richardson and others engaged in a scheme to defraud Summit's predecessor, Chariot. B.D.I. 133. On August 13, 1999, just ten days after it was filed, this action was dismissed. *See* Del. Adv. Pro. No. 99-257, D.I. 3.

C. Bankruptcy Adversary Proceeding Against Gray

On October 29, 1999, the Committee filed a complaint on behalf of Summit alleging that Gray had breached his fiduciary duties, engaged in self-dealing transactions, and otherwise misappropriated assets belonging to Chariot and Summit. A97. The factual basis for this lawsuit appears to have been similar to that of the New York derivative litigation. To represent its interests in this lawsuit, the Committee retained H. Adam Prussin, the same attorney who had earlier represented the plaintiffs in the New York litigation. B.D.I. 148, 155, 237. Richardson was not retained, and did not seek to be retained, as an attorney for the

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antecedent debt" shortly before the commencement of the bankruptcy case. 11 U.S.C. § 547(b).

Committee or the estate. On August 6, 2004, the United States District Court for the District of Delaware granted Summit a $48 million judgment against Gray and directed Gray and his affiliates to return certain assets to Summit. A134, 175. Summit's chapter 11 trustee later sold those assets for an aggregate of $15.7 million. B.D.I. 538, 562.

D. ESP Bankruptcy Case

On October 13, 2000, an involuntary petition under chapter 11 of the Bankruptcy Code was filed against ESP, another company controlled by Gray, in the Middle District of Tennessee. M.D. Tenn. Bankr. Case No. 00-09273, D.I. 1. ESP then filed a complaint against the Summit Committee, its counsel, and Richardson personally, in which it sought to stay the adversary proceeding pending in Delaware against Gray and Gray-related entities as well as monetary damages against the defendants and punitive damages against Richardson. *See* Docket for M.D. Tenn Bankr. Case No. 00-09273, D.I. 149. The ESP adversary proceeding was closed on April 29, 2005, after over three years of inactivity. *See* Docket for M.D. Tenn Adv. Pro. No. 01-00676.

E. Criminal Proceedings

In 2001, Gray pled guilty to bankruptcy fraud and tax fraud relating to the bankruptcy case of HomeStar Industries ("HomeStar"), Case No. 97-51831, which was pending in the bankruptcy court for the Eastern District of Missouri. A7, A34, A159. The charges arose from Gray's misappropriation of HomeStar's insurance proceeds and providing false testimony during HomeStar's bankruptcy case. A29-30.

III. Richardson's Administrative Expense Claim

On February 15, 2005, Richardson filed his initial application under Bankruptcy Code sections 507(a)(1) and 503(b) seeking the allowance of fees and expenses totaling $877,752.59[5] as an administrative expense. B.D.I. 403.

Thereafter, on March 13, 2006, Richardson filed an amended application ("Amended Application") reducing his total request to $869,631.50, citing Bankruptcy Code sections 503(b)(1)(A), 503(b)(3)(B), (C), (D), and (F), and 503(b)(4) as the statutory basis for his application. A490.

Richardson filed a supplement to his Amended Application on April 3, 2006 ("Supplemental Application"), in which he removed section 503(b)(3)(B) as legal

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[5] As a point of comparison, special counsel to the Committee received $1 million in fees and expenses, and counsel for the Committee received $770,300.25 in fees and $73,757.01 in expenses. B.D.I. 580 (special counsel), 797 (counsel).

authority for his request, but he increased his total request to $876,748.67. A518. Of the amount requested, a total of $768,921.71 was in the form of “fees” calculated by taking the number of hours worked by Richardson or an associate of his law firm and multiplying them by the corresponding hourly rate ($250 to $275 for Richardson). *Id*. (attached invoices). The remaining $107,826.96 was classified as “Expenses.” *Id*.

Richardson’s Amended Application (A490-517) sought administrative expense priority treatment for, among other things:

- defending post-petition lawsuits brought against Richardson by Summit and ESP, on the theory that Summit is required to indemnify Richardson for all costs attendant to all litigation with Gray-related entities (including the cost of post-petition efforts to collect his pre-petition indemnification claim);
- allegedly laying the factual and legal groundwork for virtually every asset collected during Summit’s bankruptcy case, as well as in cases in other jurisdictions;
- taking actions in other jurisdictions that, as a matter of conjecture, might possibly have staved off actions adverse to Summit;
- taking measures in other jurisdictions that, while unsuccessful, nonetheless “did sow seeds of distrust against Gray”; and
- allegedly providing information that led to Gray’s incarceration, in Missouri, for bankruptcy and tax fraud in HomeStar’s Missouri bankruptcy case.

The United States Trustee, chapter 11 trustee, and the Committee each independently objected to the Amended Application on the grounds that (i) Richardson's efforts were duplicative of other parties' services, (ii) Richardson's section 503(b)(1)(A) request was improper because his fees and expenses did not arise from a post-petition transaction with Summit as debtor in possession and did not provide an actual benefit to the estate; (iii) Richardson's section 503(b)(3)(C) request was improper because the criminal matters in which he assisted do not relate to Summit's bankruptcy case, business, or property; (iv) Richardson's section 503(b)(3)(D) request was improper because he did not make a substantial contribution to Summit's bankruptcy estate or creditors; and (v) Richardson could not recover his fees under section 503(b)(4) because he was not employed by an entity entitled to recover under subsection 503(b)(3). B.D.I. 421, 427.

On May 18, 2006, Richardson filed a post-hearing brief in which he stated, among other things, that he was entitled to be indemnified by Summit and that his indemnification allowed him to collect his "costs of collection" under Bankruptcy Code section 503(b)(1)(A). B.D.I. 610 at 2. The United States Trustee filed a response, and the chapter 11 trustee and Committee filed a joint response. B.D.I. 622, 620.

IV. The Bankruptcy Court Decision

The bankruptcy court held evidentiary hearings on Richardson's administrative expense application on March 16, 2006, and April 4, 2006. A524, A577. On December 4, 2007, the bankruptcy court issued an opinion and order denying the majority of the fees and expenses sought by Richardson.[6] A4, A51. In pertinent part, the bankruptcy court found that, even assuming that Richardson had a right to recover his litigation and collection expenses pursuant to his indemnification agreement with Chariot (an issue the bankruptcy court did not reach), Richardson's claim was not entitled to administrative status in the Summit bankruptcy, because he failed to demonstrate that his indemnification claim arose from a transaction with Summit as debtor in possession. A24. The bankruptcy court further found that Richardson's legal fees and expenses incurred during the bankruptcy case were not compensable under section 503(b)(1)(A), because Richardson had not met his burden of demonstrating that those fees and expenses were necessary to preserve the value of estate assets. A26. Similarly, the bankruptcy court found that Richardson had not met his evidentiary burden with respect to his section 503(b)(3)(C) request, because he had not demonstrated that

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[6] The bankruptcy court's decision is reported at 379 B.R. 40.

the criminal prosecution of Gray related to the business or property of Summit. A30.

The bankruptcy court also found that Richardson had failed to prove any "substantial contribution" to the bankruptcy estate as a result of his various litigation activities against Gray, and was therefore ineligible to be compensated under section 503(b)(3)(D). A31-A43. In particular, based on the evidence and testimony before it, the bankruptcy court found that: (1) Richardson had provided no actual benefit to the estate through his litigation efforts; (2) to the extent that any of those proceedings did benefit the estate, such benefit was attributable to other professionals and not Richardson; (3) Richardson's primary motivation was to benefit himself, and not the Summit estate; and (4) many of Richardson's efforts were duplicative of those of the retained professionals in the Summit case. *Id.*

Lastly, the bankruptcy court denied Richardson's request for compensation under section 503(b)(4), on two grounds. First, the bankruptcy court found that by its plain terms, that section only authorized reimbursement to an attorney of a party who is eligible for compensation under section 503(b)(3), which Richardson was not. Second, the bankruptcy court alternatively held that section 503(b)(4) is inapplicable to attorneys, such as Richardson, who perform legal services on behalf on themselves. A27-A28.

Based on its findings of fact and legal conclusions, the Bankruptcy Court allowed Richardson an administrative expense of $ 2,533.65, representing certain incidental out-of-pocket expenses he had incurred while serving as a member of the Committee, and denied the remainder of his application. A2. On December 13, 2007, Richardson filed a timely notice of appeal of the bankruptcy court's order. A1.

V. The District Court Decision

On October 7, 2008, the district court entered an order affirming the bankruptcy court's decision, holding that the bankruptcy court's findings of fact and conclusions of law were not erroneous. Aiv. Among other conclusions, the district court found that Richardson had been afforded a "full and fair opportunity" to present his factual theories to the bankruptcy court, and that Richardson had failed to demonstrate that the bankruptcy court's weighing of the evidence was clearly erroneous. *Id.*

On October 17, 2008, Richardson filed a timely motion for reconsideration. Del. District Court Case No. 08-005, D.I. 23. The motion was denied on November 22, 2008. Aii.

On December 21, 2008, Richardson filed a timely notice of appeal. Ai.

SUMMARY OF ARGUMENT

Richardson challenges the bankruptcy court's decision denying his administrative expense application on five grounds. First, Richardson argues that the bankruptcy court erred by rejecting his contention that Richardson's pre-petition activities in the New York derivative litigation, which occurred long before any Summit bankruptcy was even contemplated, provided a "substantial contribution" to the Summit bankruptcy estate under section 503(b)(3)(D). The bankruptcy court, however, found that Richardson's actions did not benefit the estate, were intended to benefit himself, and were duplicative, and also found that any positive results were primarily due to Prussin and not Richardson. As recognized by the Third Circuit, each of these findings is an independent basis for denying Richardson's section 503(b)(3)(D) request. *See Lebron*, 27 F.3d at 944. Each of these factual findings, moreover, is amply supported by the evidentiary record, and Richardson cannot meet the stringent burden of demonstrating that they were clearly erroneous.

Second, Richardson argues that his claims arising from the defense of various actions brought against him by Gray should be deemed "actual, necessary costs and expenses of preserving the estate" under section 503(b)(1)(A). The bankruptcy court did not err when it rejected this argument, for at least two independent reasons. First, apart from his alleged Chariot indemnity rights, Richardson did not identify any contractual or legal right that would allow him to recoup his personal legal expenses from another party. The bankruptcy court found, however, that the Richardson's indemnity rights did not provide an actual benefit to the estate, and that finding was not clearly erroneous. Second, even assuming that Richardson's expenses during the bankruptcy case were somehow recoverable under his former indemnity rights as a director of Chariot, any such indemnity claim would be paid as an unsecured pre-petition claim. The bankruptcy court did not err by concluding that such claim could not be recharacterized as a first-priority, administrative obligation of the Summit bankruptcy estate.

Third, Richardson suggests that the bankruptcy court committed clear error when it found that Richardson's actions in the ESP case, a separate bankruptcy proceeding, did not create a substantial contribution to the estate of Summit. The bankruptcy court's findings were supported by the evidence and are not clearly erroneous. The bankruptcy court found, based on a full consideration of the evidence before it, that Richardson failed to meet his burden of demonstrating that his actions in Tennessee produced a direct benefit to the Summit estate, and was unable to rebut the presumption that his services were designed to benefit himself rather than others.

Fourth, Richardson argues that the bankruptcy court erred by denying his request for first-priority payment of his fees under section 503(b)(3)(C) for his alleged services in connection with the criminal prosecutions of Gray. The bankruptcy court denied this request on the grounds that Richardson had failed to show any connection between these criminal prosecutions and the Summit bankruptcy. The bankruptcy court's conclusion was not clearly erroneous, and as a result, it correctly determined that Richardson was ineligible to seek fees under section 503(b)(3)(C).

Fifth, Richardson argues that the bankruptcy court erroneously applied a "double standard" in denying fees for Richardson under section 503(b)(3), while allowing fees for the Committee counsel and other retained professionals under section 503(b)(2). That "double standard," however, is expressly mandated by the Bankruptcy Code. Section 503(b) differentiates between the administrative expense applications made by professionals who have been officially retained in the case, which are governed by section 503(b)(2), and other types of administrative expense claims, which are governed principally by section 503(b)(1)(A) and section 503(b)(3). In this case, Richardson is not a retained professional, and cannot rely on section 503(b)(2) in support of his request to be compensated. Moreover, because the criteria for compensation under section 503(b)(3) are far more stringent than those of section 503(b)(2), the fact that other professionals may have been compensated under section 503(b)(2) has no bearing on whether Richardson should be compensated under section 503(b)(3).

ARGUMENT

I. The Bankruptcy Court Did Not Err in Denying Section 503(b)(3)(D) Treatment to Richardson's Pre-Petition Actions in New York State Court

Bankruptcy Code section 503(b)(3)(D) allows for the administrative expense treatment of "the actual, necessary expenses, other than compensation and reimbursement specified in [section 503(b)(4)], incurred by . . . a creditor . . .in making a substantial contribution in a case under chapter 9 or 11 of [the Bankruptcy Code]." Under this provision, only actual, out-of-pocket "expenses" may be recovered, not hourly attorney services (which are recoverable, if at all, only under section 503(b)(4)).[7]

A decision to grant a claimant administrative status is significant. Because

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[7] Section 503(b)(4) authorizes "reasonable compensation for professional services by an attorney or an accountant of an entity whose expense is allowable under subparagraph (A), (B), (C), (D), or (E) of paragraph (3) of this subsection[.]" 11 U.S.C. § 503(b)(4).

administrative claimants enjoy priority over all unsecured creditors, the allowance of an administrative claim will normally reduce the amount that will be paid to all unsecured creditors in the case. *See City of White Plains v. A&S Galleria-Real Estate, Inc. (In re Federated Dept. Stores, Inc.)*, 270 F.3d 994, 1000 (6th Cir. 2001) ("[c]laims for administrative expenses under § 503(b) are strictly construed because priority claims reduce the funds available for creditors and other claimants").

For these reasons, to receive administrative expense priority under section 503(b)(3)(D), a claimant must prove three things: (i) that expenses were actually incurred; (ii) that the estate received an "actual and demonstrable benefit"; and (iii) that the benefit is "more than an incidental one arising from activities the applicant has pursued in protecting his or her own interests." *Lebron*, 27 F.3d at 944. To be reimbursable under section 503(b)(3)(D), a creditor's services must have "***directly*** and materially contributed to the reorganization." *Id*. at 943 (emphasis added) (internal quotations omitted). Creditors seeking administrative claimant status are "presumed to be acting in their own interests," and such presumption is rebutted only if they "satisfy the bankruptcy court that their efforts have transcended self-protection." *Id*; *see also Haskins v. United States (In re Lister)*, 846 F.2d 55, 57 (10th Cir.1988) ("Efforts undertaken by a creditor solely to further his own self-interest . . . will not be compensable, notwithstanding any incidental benefit accruing to the bankruptcy estate.”). Unless the bankruptcy court finds that the creditor’s actions “were ***designed*** to benefit others who would foreseeably be interested in the estate,” rather than “in pursuit of his own interests,” the creditor cannot obtain administrative expense priority under subparagraph 503(b)(3)(D) “even though there may have been an incidental benefit to the chapter 11 estate.” *Lebron,* 27 F.3d at 946 (emphasis added).

Richardson argues that he was solely responsible for the results of the preliminary injunction proceedings initiated against Gray in New York state court in October 1996, over two years before Summit’s bankruptcy petition in this case was filed. Br. 13-14. Based on his contention that many of the findings that arose from these pre-petition actions were later used successfully by the Committee in Summit’s bankruptcy case, Richardson argues that his services should be afforded section 503(b)(3)(D) treatment on the theory that they provided a “substantial contribution” in Summit’s bankruptcy case.

Although the bankruptcy court found that discovery from the pre-petition New York state court preliminary injunction aided the Committee in its successful litigation against Gray in bankruptcy court, it also noted that the materials produced in that state court proceeding had been sealed, and it was the Committee

– not Richardson – that succeeded in obtaining and using the confidential documents in the Delaware adversary proceeding. A33-34. As a result, the bankruptcy court held that it could not find that Richardson's efforts in New York state court in 1996 and 1997 had ***directly*** benefitted the Summit estate in 2004 (when the Delaware adversary proceeding was successfully concluded) and 2005 (when the trustee sold the estate's interests in assets recovered in the Delaware Adversary proceeding). A34.

The bankruptcy court's decision finds support in the record, which demonstrates that "the participation of many led to the[ ] results" obtained in the successful Delaware adversary proceeding. A41. Richardson's self-serving, unsubstantiated statements to the contrary do not rise to the level of evidence required to prove that his pre-petition actions led ***directly*** to the ultimate benefit derived years later from the Committee's litigation efforts. In any case, although Richardson's proposed factual conclusions are different from those adopted by the bankruptcy court, Richardson cannot demonstrate that the bankruptcy court's findings were clearly erroneous.

In addition, Richardson does not rebut the bankruptcy court's finding that the New York litigation took place long before any bankruptcy filing by Summit was contemplated. *See Lebron*, 27 F.3d at 946 (expenses not reimbursable when incurred in litigation "initiated many months before a reorganization was anticipated by anyone"). Indeed, even after the Summit filed for bankruptcy, Richardson unsuccessfully sought to have its bankruptcy case dismissed. B.D.I. 24. Moreover, the record below contains ample evidence to support the bankruptcy court's conclusion that Richardson's actions were intended to benefit himself, not others. *See, e.g.,* A720 (Apr. Tr. 144: 16-18) ("Q: And the actions you undertook in [Summit's preference suit] were taken with the intent of proving that you weren't liable? A: Yes."); A740-41 (Apr. Tr. 164:23-165:2) ("Q: And the actions that you undertook in connection with [ESP's suit against Richardson] were taken with the intent of proving that you weren't liable or otherwise responsible for any wrongdoing, isn't that right? A: Yes.").

Thus, even if the bankruptcy court erred when it held that Richardson's actions did not benefit the estate, Richardson offers no argument to rebut the bankruptcy court's findings that those actions were done out of self-interest. This fact alone precludes Richardson from seeking section 503(b)(3)(D) administrative priority. *See Lebron*, 27 F.3d at 946.

Stated differently, in order to meet his burden of establishing a "substantial contribution," Richardson must do more than merely allege that he spent time on a matter in which the estate wound up with a good result. Rather, he must prove that his services led directly to an actual and demonstrable benefit, and that the benefit was more than an incidental one arising from Richardson's pursuit of his own interests. *Lebron*, 27 F.3d at 943-44. As the record developed at trial did not prove any essential connection between Richardson's services and a specific benefit to the estate, the bankruptcy court's finding that Richardson had failed to demonstrate a substantial contribution was not clearly erroneous.

II. The Bankruptcy Court's Finding That Richardson's Defense Costs Were Not "Actual Necessary Expenses" of the Summit Estate is Supported by the Record and is Not Clearly Erroneous

Bankruptcy Code section 503(b)(1)(A) allows administrative expense priority treatment to "the actual, necessary costs and expenses of preserving the estate, including wages, salaries, or commissions for services rendered after the commencement of the case." In addition to demonstrating that the request is comprised of out-of-pocket "costs and expenses," an applicant under section 503(b)(1)(A) must prove three things: (i) that his request is based on a transaction with the debtor in possession that arose "after the commencement of the case"; (ii) that the estate received an actual benefit; and (iii) that there is a demonstrable causal connection between the applicant's actual expenses and a specific actual benefit received by the estate (i.e., the expenses were "necessary" to "preserving the estate”). *See, e.g.*, *Former Employees of Builders Square Retail Stores v. Hechinger Inv. Co. of Del. (In re Hechinger Inv. Co. of Del.)*, 298 F.3d 219, 226 (3d Cir. 2002) (request must be based on post-petition transaction with debtor in possession); *Calpine Corp. v. O’Brien Envtl. Energy, Inc. (In re O’Brien Envtl. Energy, Inc.)*, 181 F.3d 527, 532 (3d Cir. 1999) (applicant must prove connection between actual expense and actual benefit). As this Court has stated, an applicant under section 503(b)(1)(A) bears a “heavy burden.” *O’Brien*, 181 F.3d at 532.

The bankruptcy court found that Richardson failed to demonstrate any of these three elements. A23. First, the bankruptcy court found that Richardson could not demonstrate that his claim was based on a post-petition transaction, rather than his pre-petition collection efforts. A24. As for the remainder of Richardson’s request, the bankruptcy court found that Richardson had not met his burden of proof under section 503(b)(1)(A) since, “although Richardson argues extensively that he conferred an actual benefit to the estate, he failed to establish that his costs and expenses were necessary to preserve the value of estate assets.” A25-26.

These findings were not clearly erroneous. Although Richardson appears to characterize each of the lawsuits filed against him by Gray as a post-petition “transaction” with Summit, with respect to at least two of the lawsuits on which

Richardson bases his argument, this characterization is incorrect. The New York fiduciary duty lawsuit by Gray against Richardson was resolved long before the Summit bankruptcy, and served as the basis for Richardson's pre-petition indemnification claim. *See Gray v. Richardson*, 251 A.D.2d 268. Richardson also seeks compensation for defending the lawsuit against him in Tennessee. That lawsuit, however, was filed by ESP, not by Summit. None of the expenses rendered in either of those actions is recoverable under section 503(b)(1)(A), as they were not based on post-petition transactions with Summit.

At most, the only two lawsuits that can even plausibly be characterized as a post-petition "transaction" involving Summit are the RICO lawsuit and the preferential transfer litigation. The RICO lawsuit was dismissed ten days after it was filed, however, and Richardson does not identify any actual expenses that he was forced to incur during the brief time this lawsuit was pending. With respect to the preferential transfer adversary proceeding, moreover, Richardson cannot identify any legal basis for shifting his costs of litigation to Summit. Indeed, as part of the stipulation resolving that adversary proceeding, Richardson expressly waived his right to seek any such costs. *See* Del. Adv. Pro. No. 99-126, D.I. 44.

Although Richardson's argument appears to assume that he is entitled to force the plaintiffs to bear the costs of the various lawsuits he has defended,[8] the only apparent basis for such fee-shifting would be Richardson's alleged indemnification rights as a director of Chariot. Even assuming that Richardson's indemnity agreement was still effective, it would provide him with, at most, a pre-petition unsecured claim in Summit's bankruptcy case. That is so because it is impermissible to grant administrative status to a indemnification claims where "the claim for indemnity arose from prepetition services . . . provided to the corporation," even if "some of the litigation expenses did not accrue until after the petition was filed." *In re Overland Park Fin. Corp.*, 240 B.R. 402, 405-06 (Bankr. D. Kan. 1999). *Accord In re ANC Rental Corp.*, 341 B.R. 178, 179-80 (Bankr. D. Del. 2006); *In re Pinnacle Brands, Inc.*, 259 B.R. 46, 50-51 (Bankr. D.Del. 2001); *In re Mid-American Waste Sys., Inc.*, 228 B.R. 816, 821 (Bankr. D. Del. 1999); *In re Pennsylvania Truck Lines, Inc.*, 189 B.R. 331, 334 (Bankr. E.D. Pa. 1995); *In re Highland Group, Inc.*, 136 B.R. 475, 481 (Bankr. N.D. Ohio 1992).

Despite his failure to demonstrate any right to reimbursement or benefit to the estate as a result of his defense of lawsuits in which he was sued personally,

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[8] Richardson's brief argues that his claims for legal fees and costs might also be "styled as tort claims for frivolous litigation or abuse of process." Br. 16. Richardson cannot identify any evidence in the proceedings below demonstrating that he would prevail against the Summit bankruptcy estate on any such tort theory.

Richardson argues that his fees are nevertheless entitled to administrative payment under the Supreme Court's decision in *Reading Co. v. Brown*, 391 U.S. 471 (1968). Br. 15-16. Richardson's reliance on *Reading* is misplaced. *Reading* considered the availability of tort damages under a provision of the 1898 Bankruptcy Act, which like section 503(b)(1)(A) provided payment for "the actual and necessary costs and expense of preserving the estate subsequent to filing the petition."[9] *Reading*, 391 U.S. at 475. In *Reading*, a building owned by the debtor burned while the debtor was under the protection of a bankruptcy receivership. *See id*. at 473. The owner of a building that neighbored the debtor's building claimed the damages that he suffered in the fire as administrative expenses. *See id.* For purposes of deciding whether his claim would receive administrative priority, the court stated that it "would be assumed that the damage to petitioner's property resulted from the negligence of the receiver and a workman he employed." *Id.* at 474.

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[9] As relevant here, section 64a provided that

> The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be (1) the costs and expenses of administration, including the actual and necessary costs and expenses of preserving the estate subsequent to filing the petition . . . .

11 U.S.C. § 104(a)(1) (repealed 1978).

Reading held that the claim for damages was allowable as an "actual and necessary" expense of preserving the estate even though the negligence that led to the fire did not benefit the estate, because the receiver's operation of the business was an essential element of the debtor's rehabilitation. *Reading*, 391 U.S. at 485. But *Reading* did not recognize a freestanding right to payment under the 1898 Act. Instead, the Court assumed that the tort creditor in that case had a valid negligence claim against the trustee; the question was whether that claim qualified as an administrative expense entitled to priority. *Id.* at 482. In this case, as noted above, Richardson failed to demonstrate that any similar valid claim exists.

There has been no affirmative determination by the bankruptcy court that Richardson is owed any damages for any post-petition action taken against him by Summit or its estate fiduciaries. Also, although Richardson alleges that he incurred costs due to meritless actions, the bankruptcy court has not affirmatively determined that either of Summit's two actions against Richardson lacked merit. And, of course, no *Reading* claim could be imposed on Summit's bankruptcy estate due to actions, meritless or otherwise, taken by Gray pre-petition or by a different entity – ESP – in a different bankruptcy case. *Reading*, 391 U.S. at 482 ("tort claims arising ***during an arrangement*** [are] actual and necessary expenses of the arrangement") (emphasis added); *Kadjevich v. Kadjevich (In re Kadjevich)*, 220 F.3d 1016, 1019-20 (9th Cir. 2000) (pre-petition debts may not be granted *Reading* administrative expense award). As a result, there is simply no basis for a *Reading* administrative expense award in this case.

Even if Richardson had stated a valid tort claim against Summit, moreover, *Reading* is distinguishable because Summit, unlike the debtor in *Reading*, is a liquidating company that is not engaged in any business. B.D.I. 671 (plan of liquidation), 672 (disclosure statement). An important rationale for the decision in *Reading*, by contrast, was that the debtor was operating when the damages were inflicted by the fire. *See Reading*, 391 U.S. at 475 ("[T]he words 'preserving the estate' include the larger objective, common to arrangements, of operating the debtor's business with a view of rehabilitating it."); *id.* at 478 ("[T]he question is whether the fire claimants should be subordinated to, should share equally with, or should collect ahead of those creditors for whose benefit the continued operation of the business . . . was allowed."); *id.* at 479 ([T]he "business [was] operating . . . for the benefit of the creditors and with the hope of rehabilitation. That benefit and that rehabilitation are worthy objectives. But it would be inconsistent with . . . the rule of fairness in bankruptcy to seek these objectives at the cost of excluding tort creditors. . . ."); *id.* at 483 ("[A]nalogous cases suggest that 'actual and necessary costs' should include costs ordinarily incident to operation of a business, and not be limited to costs without which rehabilitation would be impossible."); and *id.* at 485 n.12 ("Among other expenses incident to conducting a business and therefore allowable as an administrative expenditure may be . . . payments on claims for personal injuries inflicted in the operation of a business[.]").

These statements make clear that the continuing operation of a business was integral to *Reading's* holding. As the First Circuit has noted, moreover, applying *Reading* in an ordinary, nonoperating liquidation proceeding "appears extremely problematic, as one fundamental justification for the priority is that general creditors stand to benefit from the post-petition operation of the debtor's business, either through the immediate generation of operating profits or through the ultimate reorganization of the debtor as a viable business entity." *Woburn Assoc. v. Kahn (In re Hemingway Transport, Inc.)*, 954 F.2d 1, 5 n.5 (1st Cir. 1992). Regardless of the merits of Gray's various lawsuits against Richardson, the creditors of Summit (other than Richardson) did not benefit from the fact that they were successfully defended. Similarly, Richardson does not suggest any Summit creditors benefitted from Gray's initial decision to commence such litigation. Accordingly, *Reading's* rationale that tort creditor's damages were administrative expenses because the general creditors stood to benefit from the trustee's operation of the debtor's business, and the damages were caused by the operation of the business, does not apply to this case.

III. The Bankruptcy Court Did Not Err in Denying Administrative Expense Priority Treatment in This Case to Richardson's Services Rendered in ESP's Bankruptcy Case in Tennessee

Equally without merit is Richardson's contention that his actions in the ESP bankruptcy case in the Middle District of Tennessee made a substantial contribution to the Summit bankruptcy case. Br. at 19. The bankruptcy court found that Richardson did not prove that his services rendered in ESP's case resulted in a benefit to the Summit bankruptcy estate, and denied his request. A36-38. The bankruptcy court's factual finding was supported by the record and is not clearly erroneous.

Richardson's request for "substantial contribution" fees in connection with the ESP litigation is improper for the same reasons as his request for such fees in connection with the New York litigation. In particular, Richardson again has failed to meet his burden of demonstrating that such services rendered in the ESP case resulted in a ***direct*** benefit to the Summit bankruptcy estate. *Lebron*, 27 F.3d at 943. In addition, Richardson's services are presumed to have been designed to benefit himself and not others, particularly since similar services were already being performed on behalf of the Summit estate by Committee counsel. A41. As Richardson did not present sufficient evidence to rebut the presumption of self-interest, the bankruptcy court did not err in denying section 503(b)(3)(D) priority for his services in the ESP case.

Richardson's request for fees relating to the ESP litigation is also improper under section 503(b)(1)(A). Richardson's services in the ESP case do not constitute a "transaction" with Summit as debtor in possession, but rather involved ESP, which was a separate legal entity in its own chapter 11 case in Tennessee. Also, Richardson has shown neither that his services in the ESP case were "necessary to accord the [Summit] estate an actual benefit," nor that his services were the "catalyst" for any benefit the Summit estate derived. *See O'Brien*, 181 F.3d 533, 537.

In addition, even if the ESP litigation was considered as a necessary cost of doing business for Summit, Richardson was never retained as Summit's attorney, and he cannot rely on section 503(b)(1)(A) to circumvent the Bankruptcy Code's procedures for the appointment and compensation of estate professionals. *See Lamie v. United States Trustee*, 520 U.S. 526, 533 (2004) (stating that a "debtor's attorney not engaged as provided by § 327 is simply not included within the class of persons eligible for compensation"); *F/S Airlease II, Inc. v. Simon*, 844 F.2d 99, 108-09 (3d Cir. 1988), *cert. denied*, 488 U.S. 852 (1988) (allowing section 503(b)(1)(A) treatment to an unretained professional "would contravene Congress' intent in providing for prior approval").

IV. The Bankruptcy Court Did Not Err in Denying Section 503(b)(3)(C) Treatment to Richardson's Services Rendered in Gray's Criminal Proceedings in Missouri

Bankruptcy Code section 503(b)(3)(C) allows for the administrative expense priority treatment of the "actual, necessary expenses, other than compensation and reimbursement specified in [section 503(b)(4)], of "a creditor in connection with the prosecution of a criminal offense relating to the case or to the business or property of the debtor." As with any section 503(b)(3) request, only actual, out-of-pocket "expenses" may be recovered, not hourly attorney services. In addition, a claimant seeking section 503(b)(3)(C) administrative expense priority must prove not only that he incurred actual, necessary out-of-pocket expenses, but also (i) a direct relationship between the expenses sought and the prosecution of a criminal offense, and (ii) a direct relationship between the criminal offense and the debtor's bankruptcy case, business, or property. *See Lebron*, 27 F.3d at 943 n.1. Unless a claimant demonstrates that both of these criteria are present, he cannot receive a section 503(b)(3)(C) award.

The bankruptcy court did not clearly err when it found that Richardson satisfied neither of the requirements for section 503(b)(3)(C) compensation. A29. Gray's tax fraud apparently occurred before the Summit case was even filed. Br. 22. His bankruptcy fraud occurred in a Missouri bankruptcy case. *Id.* As the bankruptcy court found below, Richardson did not meet his burden of explaining how Gray's criminal proceedings, or even the underlying Missouri bankruptcy case, had anything more than a tangential relation to Summit's case, property, or business. A29.

V. The Bankruptcy Court Did Not Err in Denying Section 503(b)(3) and (b)(4) Treatment to Richardson's Hourly Time Spent Rendering Legal Services, Despite its Having Authorized Section 503(b)(2) Treatment to Services Rendered by Estate and Committee Professionals

Finally, Richardson suggests that the bankruptcy court improperly imposed a "double standard" by allowing section 503(b)(2) administrative expense treatment for the compensation requests of estate and Committee professionals while denying Richardson's request for administrative expense treatment under sections 503(b)(3) and (4) for similar hourly legal services. Br. 23. The bankruptcy court, however, was correct to distinguish between these two provisions. Section 503(b)(2) grants administrative expense priority to "***compensation*** and reimbursement awarded under section 330(a) of [the

Bankruptcy Code]" (emphasis added). Section 330(a)(1), in turn, allows the bankruptcy court to award "reasonable compensation for actual, necessary services rendered" as well as "reimbursement for actual, necessary expenses" to estate professionals employed under Bankruptcy Code section 327 and committee professionals employed under Bankruptcy Code section 1103. Under section 330(a)(3)(A), in determining an award for reasonable compensation the bankruptcy court "shall" consider "the time spent on such services." Thus, compensation for hourly services rendered is expressly authorized by section 503(b)(2).

Unlike section 503(b)(2), however, section 503(b)(3) does not allow for "compensation for services rendered" – it only allows for recovery of "actual, necessary expenses." Indeed, section 503(b)(3) by its express terms excludes compensation for creditors' attorney services, which may only be recovered, if at all, under section 503(b)(4). *See Xifaras v. Morad (In re Morad)*, 328 B.R. 264, 269 (B.A.P. 1st Cir. 2005) ("As a stand-alone provision, § 503(b)(3) has no bearing upon a request for legal fees and costs.").

Section 503(b)(4) allows for the administrative expense priority treatment of "reasonable compensation for professional services rendered by an attorney or accountant of an entity whose expense is allowable under [section 503(b)(3)]."[10] This section only provides for compensation for services rendered by the "attorney of" a creditor; it does not provide for the hourly compensation for services rendered by the creditor himself. Indeed, a creditor must actually have paid an attorney before he can obtain a section 503(b)(4) claim, as this Court "do[es] not read subsection (b)(4) to authorize a payment to a creditor in excess of the amount he or she was ***required to pay*** for those services." *See Lebron*, 27 F.3d at 947 n.5 (emphasis added). In addition, section 503(b)(4) only applies to attorney services rendered for a creditor who is himself entitled to administrative expense priority under section 503(b)(3); attorney services rendered for a creditor who does not meet the section 503(b)(3) requirements cannot receive priority treatment under section 503(b)(4).

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[10] Under the pre-BAPCPA version of section 503(b) applicable to this case, the Third Circuit had held that official committee members could receive administrative expense priority treatment for reimbursement of out-of-pocket expenses constituting fees paid to attorneys. *See First Merchants Acceptance Corp. v. J.C. Bradford & Co.*, 198 F.3d 394, 396 (3d Cir. 2000). This interpretation has been superseded by the BAPCPA's amendment of subparagraph (b)(4) to expressly clarify that it does not apply to creditors specified in subparagraph (b)(3)(F). The *First Merchants* decision applied to a reimbursement of the out-of-pocket expenses of a committee member who had actually paid an attorney; it did not apply to compensation for hours spent on the case by the committee member itself.

Like all other creditors, Richardson is ineligible to compensate himself out of the estate for the alleged value of his hourly services personally rendered under section 503(b)(3). In addition, because Richardson did not make the requisite showing under any subparagraph of section 503(b), he is not entitled to recover attorney compensation under section 503(b)(4) regardless of whether the attorney services were rendered by Richardson himself or by someone else.

In any event, section 503(b)(4) applies to the attorney "of" a creditor, not the creditor himself (even if, as here, the creditor is also an attorney). As a result, the bankruptcy court's denial of administrative expense priority treatment under section 503(b)(3) and (4) for *pro se* legal services was consistent with other reported decisions. A27-28; *see, e.g.*, *In re Gimelson*, 2004 WL 2713059 * 22 (E.D. Pa. Nov. 23, 2004) (denying section 503(b)(4) priority to creditor/attorney who represented himself and did not incur attorney fees); *In re Patriot Aviation Services, Inc.*, 384 B.R. 649, 652 (Bankr. S.D. Fla. 2008) (denying section 503(b)(3)(D) and (b)(4) priority to creditor/law firm "seeking opportunity costs for services provided while representing itself"); *In re Pappas*, 277 B.R. 171, 177 (Bankr. E.D.N.Y. 2002) (denying section 503(b) priority to creditor/attorney for his own personal time devoted to case where his billable time, although valuable, was not an "actual expense").

Richardson attempts at page 18 of his brief to distinguish the *Gimelson* and *Pappas* decisions as being rendered in chapter 7 cases to which section 503(b)(3)(D) does not apply. But, the lawyer/creditors in *Gimelson* and *Pappas* sought compensation under section 503(b)(3)(B), which ***is*** applicable to chapter 7 cases, so the decisions in those cases are not "dictum" [sic] as stated by Richardson. Rather, *Gimelson* and *Pappas* stand for the proposition that a lawyer/creditor cannot obtain administrative expense priority treatment under ***any*** subsection of 503(b). *See Gimelson*, 2004 WL at * 22 ("'Section 503(b) provides that "actual" "expenses" may be afforded administrative expense status. [The creditor's] time, although valuable, was not an "actual expense" to him.'") (quoting *Pappas*, 277 B.R. at 177). In any event, the subsequent decision in *In re Patriot Aviation Services, Inc*., which did arise in the chapter 11 context, nevertheless relied on *Gimelson* and *Pappas* in holding that "[t]he record overwhelmingly supports the position that the time spent by [the lawyer/creditor] was in a personal capacity, which precludes administrative compensation under section 503(b)(3)(D) or section 503(b)(4)." *Patriot Aviation*, 384 B.R. at 653.

In addition, Richardson argues that his services could not have "duplicated" those of Committee counsel since Richardson's services were rendered first. Br. 23-24. However, Richardson's services did duplicate those of Committee counsel, regardless of the timing of when services were rendered, to the extent both the Committee's counsel and Richardson rendered comparable services. Committee counsel was authorized under section 1103 to render legal services on behalf of its client, the Committee, and its legal services were compensable under sections 330 and 503(b)(2). Richardson either rendered unauthorized concurrent, duplicative legal services on behalf of the Committee (which would not be compensable, as he was not employed to render such services) or he rendered services on behalf of himself (which would not be reimbursable from the estate unless he made the showing required under section 503(b)(3)(D)). *See First Merchants*, 198 F.3d at 396. The estate cannot be burdened with authorized Committee counsel's necessary hourly compensation plus the hourly compensation request of every creditor who chooses to shadow Committee counsel throughout the case.

Richardson also argues that, since the New York state court held that Delaware corporate law allowed him to recover *pro se* attorney fees as part of his indemnification claim, the bankruptcy court was required, under either a "law of the case" or comity theory, to allow administrative expense priority treatment for all of the hours he has personally rendered. Br. 17. This argument is unavailing, however. The New York state court's decision may be "law of the case" in the New York state court case in which it was rendered, but it is not "law of the case" in a completely different case, filed in federal bankruptcy court in Delaware. *See Christianson v. Colt Indus. Operating Corp.*, 486 U.S. 800, 816 (1988) (under "law of the case" doctrine, "when a court decides upon a rule of law, that decision should continue to govern the same issues in subsequent stages ***in the same case***") (emphasis added).

Similarly, while state law determines whether a creditor has a pre-petition claim against a debtor, it does not determine the relative priorities afforded various claims in a bankruptcy case, which are established by sections 503 and 507 of the Bankruptcy Code. Thus, the New York state court may determine whether Richardson has an indemnification claim and whether that claim includes compensation for *pro se* legal services, but only the bankruptcy court can determine whether that indemnification claim is entitled to administrative priority status under section 503(b).

In addition, Richardson's reliance on *Jones v. Lujan*, 883 F.2d 1031, 1034-35 (D.C. Cir. 1989), in support of his request for administrative expense priority for his *pro se* legal fees is unavailing as that case is inapposite. Br. 18. *Jones v. Lujan* was decided under the Equal Access to Justice Act ("EAJA") which by its own terms allows for the recovery of "***fees*** and other expenses" incurred. *See* 28 U.S.C. § 2412(d)(1)(A) (emphasis added). Section 503(b)(3), by comparison, does not allow for the recovery of "fees" – only out-of-pocket "expenses." Thus, unlike actions under the EAJA, requests for section 503(b)(3) priority cannot include an attorney fee component.

CONCLUSION

For these reasons, the Acting United States Trustee respectfully asks this Court to affirm the district court's order.

Respectfully submitted,

ROBERTA A. DEANGELIS
ACTING UNITED STATES TRUSTEE
REGION 3

By: /s/ Richard L. Schepacarter
Richard L. Schepacarter
Robert J. Schneider
United States Department of Justice
Office of the United States Trustee
844 King Street, Room 2207, Lockbox 35
Wilmington, DE 19801
(302) 573-6491

P. Matthew Sutko
John P. Sheahan
United States Department of Justice
Executive Office for United States Trustees
20 Massachusetts Ave, N.W.
Washington, DC 20530

Dated: June 5, 2009

CERTIFICATION OF ADMISSION TO BAR

I, Richard L. Schepacarter, Esquire, certifies as follows:

1. I am a member in good standing of the bar of the United States Court of Appeals for the Third Circuit.

2. Pursuant to 28 U.S.C. § 1746, I certify under penalty of perjury that the foregoing is true and correct.

/s/Richard L. Schepacarter
Richard L. Schepacarter, Esquire

Dated: June 5, 2009

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/s/Richard L. Schepacarter
Richard L. Schepacarter
Attorney for Appellee

Dated: June 5, 2009

CERTIFICATE OF SERVICE

I certify that on June 5, 2009, I caused to be served a copy of the Brief for Appellee, Roberta A. Deangelis, Acting United States Trustee via email and/or USPS, first class mail to the persons listed below:

Ambrose M. Richardson, III, Esquire
40 Wall Street
35th Floor
New York, NY 10005
Email: ArichIII@aol.com

Kevin J. Mangan, Esquire
Womble Carlyle Sandridge & Rice
PLLC
222 Delaware Avenue, Suite 1501
Wilmington, DE 19801
Email: Kmangan@wcsr.com

/s/Richard L. Schepacarter
Richard L. Schepacarter
Attorney for Appellee

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2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]* — DC MD Ga

3. ("CCN") ***CURRENT*** CASE NO. — No.: 03-41707

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]* — No.:

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(Identify judge & cite, if any)

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(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC*** — **BANKRUPTCY**

9. ("SU") ! ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***

! Whether the bankruptcy court erred in transferring this case to the Bankruptcy Court for the Middle District of Alabama pursuant to 28 U.S.C. § 1406(a) for lack of jurisdiction.

√ **Background:**

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UNITED STATES DISTRICT COURT
MIDDLE DISTRICT OF GEORGIA
COLUMBUS DIVISION

	)	
In re Wayne A. Swinney and	)	Bankruptcy N0. 03-41707
Phoebe G. Swinney	)	
	)	
Debtors.	)	
	)	
	)	
Wayne A. Swinney and	)	
Phoebe G. Swinney,	)	
	)	
Appellants,	)	
vs.	)	District Ct. No. 4:03CV-189-3 (CDL)
	)	
Felicia S. Turner,	)	
United States Trustee,	)	
Appellee.	)	
	)	

BRIEF OF APPELLEE

Felicia S. Turner
UNITED STATES TRUSTEE

Mark Roadarmel
ASSISTANT UNITED STATES TRUSTEE

Donald F. Walton
ACTING GENERAL COUNSEL

Paul W. Bridenhagen
TRIAL ATTORNEY
Executive Office for U.S. Trustees
20 Massachusettes Ave., N.W., 8th Floor
Washington, D.C. 20530
(202) 307-1399
(202) 307-2397 (fax)

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Bankruptcy Amendments and Federal Judgeship Act, Pub. L. 98-353, 98 Stat. 333 (1984), *Pub L. 98-353*, title I, §§ 102 and 114. 9-10

UNITED STATES DISTRICT COURT
MIDDLE DISTRICT OF GEORGIA
COLUMBUS DIVISION

In re Wayne A. Swinney and
Phoebe G. Swinney
Debtors.

Bankruptcy N0. 03-41707

Wayne A. Swinney and
Phoebe G. Swinney,

Appellants,

vs.

District Ct. No. 4:03CV-189-3 (CDL)

Felicia S. Turner,
United States Trustee, Appellee.

BRIEF OF APPELLEE

STATEMENT OF JURISDICTION

The bankruptcy court had jurisdiction over this matter pursuant to 28 U.S.C. §§ 157(b) and 1334. On October 14, 2004, the bankruptcy court's Order Granting Change of Venue was entered on the docket. Bankruptcy Docket ("B. Doc..")[1] #16. On October 22, 2003, Wayne A. Swinney and Phoebe G. Swinney (hereinafter the "Debtors") filed a timely notice of appeal from that order with this Court, in accordance with Rule 8002 of the Federal Rules of Bankruptcy Procedure ("Fed. R. Bankr. P."). This Court possesses jurisdiction over the appeal by virtue of 28 U.S.C. § 158(a).

The United States Trustee believes this is a final order under the flexible approach to finality followed by this Circuit. *In re F.D.R. Hickory House, Inc.*, 60 F.3d 724, 727 (11th Cir.1995)

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[1] The United States Trustee will utilize the same method of citing the record as set forth by the Appellants. *See* Appellant's Brief at 1.

(discussing the more flexible standard of finality in appeals in bankruptcy orders). However, the United States Trustee also notes that this Circuit has held, in the non-bankruptcy context, that orders of transfer on grounds of *forum non conveniens* are non-appealable, interlocutory orders. *Grayson v. K Mart* Corp., 79 F.3d 1086, 1094 (11th 1996)(*citing Dobard v. Johnson*, 749 F.2d 1503, 1506 (11th Cir. 1985)("courts have fairly consistently held that transfer orders brought . . . are not generally final orders for the purpose of appeal")).

The United States Trustee further notes that even if the transfer order at issue here is not final, this Court may exercise jurisdiction over this matter pursuant to 28 U.S.C. 158(a)(3). *See, e.g., In re Sorrells*, 218 B.R. 580, 583-584 (10 Cir. BAP 1998) (exercising jurisdiction pursuant to 28 U.S.C. 158(a)(3)).

STATEMENT OF THE ISSUE

Whether the Bankruptcy Court erred in transferring this case to the Bankruptcy Court for the Middle District of Alabama pursuant to 28 U.S.C. § 1406(a) for lack of proper venue.

STANDARD OF APPELLATE REVIEW

Findings of fact are reviewed for clear error, while conclusions of law are reviewed *de novo*. The decision of the bankruptcy court insofar as it concerns the application of 28 U.S.C. § 1406(a) and Rule 1014 of the Fed. R. Bankr. P. constitutes an interpretation of a statute and a rule. It therefore involve conclusions of law, which are subject to *a de novo* standard of review. *Pierce v. Underwood*, 487 U.S. 552, 558 (1988). To the extent that this Court were to reach the bankruptcy court's alternative holding that it would not have retained the case, that decision should be reviewed under an abuse of discretion standard. *See Christo v. Padgett*, 223 F.2d 1335, 1335-1336 (11th Cir. 2000)

STATEMENT OF THE CASE AND STATEMENT OF THE FACTS

A. Nature of the Case and Procedural History

The Debtors challenge the bankruptcy court's decision to transfer this case to the Bankruptcy Court for the Middle District of Alabama pursuant to 28 U.S.C. § 1406. The Debtors filed their chapter 7 petition in bankruptcy in the Middle District of Georgia on July 10, 2003.[2] The United States Trustee timely objected to the Debtors' filing of their petition by filing a Motion for Change of Venue. B. Doc. # 3. On September 17, 2003, the Debtors responded to the UST's motion. B. Doc. #11 (Memorandum of Authorities In Opposition to Motion of U.S. Trustee to Dismiss Case or Transfer Venue). On September 18, 2003, a hearing was held on the United States Trustee's motion. The bankruptcy court issued its Order Granting Change of Venue on October 14, 2003. B. Doc. #16.

The Debtors perfected this appeal by filing a Notice of Appeal on October 22, 2003. B. Doc. #17

B. Statement of Facts

The facts in this matter are uncontested. The Debtors' petition disclosed that they reside at 3911 26th Ave, Phenix City, Alabama 36867, a city located in Federal judicial district for the Middle District of Alabama, Opelika Division. Appellants' Brief, at 2. The Debtors' did not check the "venue" box on their petition, which states: "place of business or principal assets in this District for 180 days immediately preceding the date of this petition or for a longer part of such 180 days than in any other District." B. Doc. #1 (Bankruptcy Petition) at 1. Instead they conceded that venue was not proper, by writing on the face of the Petition as follows: "Wrong, More Convenient Forum Filing!" Id.; Appellants' Brief at 2. On the Debtors' schedules, they claim exemptions under the statutes of Alabama. B. Doc #1 (Schedule C) pp. 1-2. Further, the

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[2] . 28 U.S.C. § 81(b) (Alabama is divided into three judicial districts). Phenix City is included in the Middle District).

schedules list 12 national credit card companies, none of which have a Georgia address. B. Doc #1 (Schedule F), pp. 1-2. The schedules do not disclose any tangible assets located in the Middle District of Georgia. B. Doc #1 (Schedule A) at 1. Indeed, the only nexus between the Debtors and Georgia are two small unsecured debts that represent a minuscule percentage of their total debts, B. Doc #1 (Schedule F) p. 1, and the fact that the Debtors are both employed in Columbus, Georgia. Hrg. Transcript (9/18/03) p. 22, ln. 17-21, p. 29 ln 25-p.30, ln 14.
Finally, if the Debtors' case were transferred to the seat of the Opelika Division of the Middle District of Alabama, they will only have to travel an additional 20 miles to court: the Debtors live within 10 miles of the courthouse for the Middle District of Georgia, Columbus Division, and withing 30 miles of courthouse for the Opelika Division of the Middle District of Alabama. Hrg. Transcript (9/18/03) p. 22, lns 2, 5-9. The Debtors assert in their brief that Mr. Swinney underwent surgery for the replacement of a heart defibulator. Appellants' Brief, at 4. The Debtors indicate in their brief that Mr. Swinney 's health concerns had made it difficult for him to travel. *Id.* Mr. Swinney plainly testified, however, that he was capable of driving to Opelika at the time his petition was filed. Hrg. Transcript (9/18/03) p. 20, lns 17-19. He further testified that he expected, after a sufficient recovery period, that he would again be capable of driving to Opelika. Hrg. Transcript (9/18/03) p. 22, lns 17-19. Finally, he testified that his wife was also capable of making that drive. Hrg. Transcript (9/18/03) p. 22, ln 17 to p. 23, ln 2.

ARGUMENT

I.PURSUANT TO 28 U.S.C. § 1406 AND BANKRUPTCY RULE 1014 CASES FILED IN THE WRONG VENUE ARE TO BE DISMISSED OR TRANSFERRED.

A statutory analysis begins with an examination of the language of the statutes involved. *United States v. Ron Pair Enters., Inc.* 489 U.S. 235, 241-41 (1989). Venue for bankruptcy cases is derived from 28 U.S.C. § 1408 which provides in relevant part that:

a case under title 11 may be commenced in the district court for the district—

(1) in which the domicile, residence, principal place of business in the United States, or principal assets in the United States, of the person, or entity that is the subject of such case have been located for the one-hundred-and-eighty days immediately preceding such commencement or for a longer portion of such one-hundred-and-eighty-day period than the domicile, residence, or principal assets in the United States, of such person were located in any other district; or....

Application of this statute to the facts found in the record in this matter clearly identifies the only proper venue is in the Middle District of Alabama, Opelika Division. The Debtors' place of residence is in the Middle District of Alabama, and; by their admission, they do not conduct business in the Middle District of Georgia. Appellants' Brief, at 6 (conceding jurisdiction lies the Middle District of Alabama). Further, the Debtors' schedules do not disclose any tangible assets located in the Middle District of Georgia. B. Doc #1 (Schedule A) p. 1

Cases discussing improper venue issues can be divided into a majority rule and a minority rule. The majority rule holds that a bankruptcy court may not retain improperly venued cases, but instead must either dismiss or transfer them pursuant to 28 U.S.C. 1406(a).[3] *See*, *In re Sorrells*,

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[3] 28 U.S.C. § 1406(a) provides as follows:

Cure or waiver of defects

The district court of a district in which is filed a case laying venue in the wrong division or district shall dismiss, or if it be in the interest of justice, transfer such case to any district or division in which it could have been brought.

218 B.R. 580 (10th Cir. BAP 1998). *See also* In *re Micci,* 188 B.R. 697 (S.D. Fla. 1995); *In re Columbia Western, Inc.,* 183 B.R. 660 (Bankr. Mass. 1995); *In re Washington, Perito & Dubuc,* 154 B.R. 853 (Bankr.S.D.N.Y. 1993); *In re Great Lakes Hotel Associates,* 154 B.R. 667 (E.D. Va. 1992); *In re Petrie,* 142 B.R. 404 (Bankr.D.Nev. 1992); *In re Sporting Club,* 132 B.R. 792 (Bankr. S.D. 1989); *ICMR, Inc. v. Tri-City Foods, Inc.,* 100 B.R. 51 (D. Kan. 1989); *In re Dorval,* 1994 WL 228653 (Bankr. R.I. May 11, 1993).

The minority view, in contrast, holds that a bankruptcy court may retain a case filed in an improper venue pursuant to 28 U.S.C. 1412[4], if such retention is "in the interest of justice or for the convenience of the parties." The minority view, however, is represented only by those cases following the holding of *In re Lazaro*, 128 B.R. 168 (Bankr. W.D. Tex. 1991). *See also In re Leonard*, 55 B.R. 106, 108-09 (Bankr. D.C. 1985); *In re Boeckman*, 54 B.R. 110 (Bankr. S.D. 1985)

The bankruptcy court correctly followed those cases constituting the weight of authority, and held that a bankruptcy court may not retain a case where venue is improper. B. Doc. #15 (Memorandum Opinion), pp. 9-10. The Debtors' arguments that the bankruptcy court may retain an improperly venued case appears to be built on the premise that section 1412 implicitly allows retention of an improperly venued case. Appellants' Brief, at 6 n.1. The Debtors' argument in this regard, however, is without merit because section 1412's plain language neither makes it expressly applicable to improperly venued cases, nor states that a court has the option of

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[4] 28 U.S.C. § 1412 provides as follows:

> Change of Venue
>
> A district court may transfer a case or proceeding under title 11 to a district court for another district, in the interest of justice or for the convenience of the parties.

retaining such a case. *In re Sorrells*, 218 B.R. 580, 587 (10th Cir. BAP 1998). Thus the Debtor's premises is unsupportable and should be rejected on the basis of the statute's plain language.

Next, the Debtors' assert that section 1406(a) is not applicable to bankruptcy courts, but only to the district courts. As the bankruptcy court correctly recognized, that argument is without merit, as is evident from a review of the Supreme Court's decision in *Connecticut National Bank v. Germain*, 503 U.S. 249, (1992). B. Doc. #15 (Memorandum Opinion) pp. 9-10. In *Connecticut National Bank*, 503 U.S. at 251-52, the Supreme Court addressed two statutes concerning appellate jurisdiction in the circuit courts of appeal. *Id.,* at 251-252. The first statute, 28 U.S.C. § 158(d), afforded court of appeal jurisdiction over final, but not interlocutory, bankruptcy appeals from a district court. The second statute, 28 U.S.C. § 1292, which is not bankruptcy specific, provided for court of appeal jurisdiction from interlocutory injunctive orders originating in bankruptcy court. *Id.* The Supreme Court expressly rejected the notion that jurisdictional grant in section 1292 was somehow limited by section 158(d), stating that "each section confers jurisdiction over cases that the other section does not reach." *Id., at 253.*

The bankruptcy court below correctly held that the *Connecticut National Bank* case was controlling. B. Doc. #15 (Memorandum Opinion) pp. 9-10. It noted that in this case, as in the *Connecticut National Bank* case, there is a bankruptcy specific statute (section 1412) that is silent on the issue before it (i.e. the disposition of improperly venued cases), as well as a non-bankruptcy specific statute (section 1406(a)) that does address the issue. *Id.* Following the reasoning of the Supreme Court, the bankruptcy court determined that section 1406(a) applied to bankruptcy court cases and gave effect to each, concluding that "28 U.S.C. §1406(a) applies to cases that are not addressed in 28 U.S.C. § 1412, namely cases filed in the wrong venue." B. Doc. #15 (Memorandum Opinion) pp. 9-10. It therefore concluded that it had no discretion to retain cases filed in the wrong venue, but that it may only dismiss a case, or if the interests of justice or the convenience of the parties so dictate, transfer an improperly filed case to a district or division in which it could have properly filed in the first instance. B. Doc. #15 (Memorandum Opinion) at 10.

As discussed above, the statutory language of section 1412 plainly does not grant bankruptcy courts the authority to retain a case filed in an improper venue. Even if there were ambiguity concerning the meaning of section 1412, the legislative history of sections 1406 and 1412 further undermine the Debtors' claim. As the bankruptcy court correctly noted, pursuant to the Bankruptcy Amendments and Federal Judgeship Act, Pub. L. 98-353, 98 Stat. 333 (1984), Congress revised the bankruptcy venue statutes in 1984. B. Doc. #15 (Memorandum Opinion), p. 7 (citing *In re Sorrells*, 218 B.R. at 586). Prior to these amendments, venue of bankruptcy cases was governed by 28 U.S.C. sections 1475 and 1477 (repealed 1984). *In re Sorrells*, 218 B.R. at 586. Section 1475 had provided, in relevant part, as follows:

> **Change in Venue**
>
> A bankruptcy court may transfer a case under title 11 . . . to a bankruptcy court for another district, in the interest of Justice and for the convenience of the parties.

28 U.S.C. 1475 (repealed 1984).

In contrast, section 1477 had expressly allowed for the retention by bankruptcy courts of improperly venued cases. Section 1477 had provided as follows:

> **Cure or Waiver of Defects**
>
> The bankruptcy court of a district in which is filed a case or proceeding laying venue in the wrong division or district may, in the interest of justice and for the convenience of the parties, **retain such case or proceeding, or may transfer**, under section 1475 of this title, such case or proceeding to any other district or division.

28 U.S.C. 1477 (repealed 1984)(emphasis added).

Section 1477, along with section 1475, were repealed in the 1984 legislation. *Pub L. 98-353*, title I, §§ 102 and 114. Section 1412 was substituted for section for section 1475, bearing the same caption and the same standard for transfer as former section 1475. *In re Sorrells*, 218 B.R. at 587. In light of the similarities between former section 1475 and section 1412, it is clear that section 1412 should be construed as having the same scope of former section 1475. *See In re Sorrells*, 218 B.R. at 587 (nothing in the legislative history of section 1412 suggests that it should be expanded beyond the scope of former section 1475). Consequently, the Debtor's argument that section 1412 should be construed as implicitly allowing the retention of an improperly venued case should be rejected and the bankruptcy court's holding affirmed.

Finally, the bankruptcy court's statutory analysis is further supported by Rule 1014 of the Fed. R. Bankr. Procedure, and the Advisory Committee Note to that rule. Fed R. Bankr. P. 1014, which recognizes the attributes of both section 1406(a) and 1412. Rule 1014(a) of the Federal Rules of Bankruptcy Procedure provides:

> (a) *Dismissal and Transfer of Cases.*
>
> (1) *Cases Filed in Proper District.* If a petition is filed in a proper district, on timely motion of a party in interest, and after hearing on notice to the petitioner, the United States trustee, and other entities as directed by the court, the case may be transferred to any other district if the court determines that the transfer is in the interest of justice or for the convenience of the parties.
>
> (2) *Cases Filed in Improper District.* If a petition is filed in an improper district, on timely motion of a party in interest and after hearing on notice to the petitioners, the United States trustee, and other entities as directed by the court, the case may be dismissed or transferred to any other district if the court determines that transfer is in the interest of justice or for the convenience of the parties.[5]

Rule 1014 therefore reinforces the bankruptcy court's interpretation of section 1406(a) by providing that an improperly filed case may be either dismissed or transferred as set forth in sub-part (a)(2) of the Rule. The Rule also gives effect to section 1412 pursuant to sub-part Rule 1014(a)(1). Rule 1014(a)(1), however, says nothing about retention of an improperly venued case. This conclusion is further supported by the Advisory Committee Note to Rule 1014, which provides as follows:

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[5]. The annotated statute is followed by the following commentary; "Section 1406 of Title 28 is addressed to a case in which venue has been laid in an improper district. It authorizes either a dismissal on that ground, or, if the court finds that the interest of justice would be served by a transfer, then a transfer instead. (A transfer from one proper district to another, based on the convenience of witnesses and the needs of justice, is governed by § 1404.)"

Advisory Committee Note (1987) to Fed. R. Bankr. P.

> Both paragraphs 1 and 2 of subdivision (a) are amended to conform to the standard for transfer in 28 U.S.C. § 1412. Formerly, 28 U.S.C. § 1477 authorized a court either to transfer or retain a case which had been commenced in a district where venue was improper. However, 28 U.S.C. § 1412, which supersedes 28 U.S.C. § 1477, authorizes only the transfer of a case. The rule is amended to delete the reference to retention of a case commenced in the improper district. Dismissal of a case commenced in the improper district as authorized by 28 U.S.C. § 1406 has been added to the rule. If a timely motion to dismiss for improper venue is not filed, the right to object to venue is waived.

Thus, contrary to the Debtors' argument, it is plain under both the statutes and the unambiguous language of Rule 1014 that only a **properly filed** case can be transferred for the "convenience of the parties" or retained by the court.

II. THE BANKRUPTCY COURT'S ALTERNATE HOLDING THAT THIS CASE SHOULD NOT BE RETAINED IN THE MIDDLE OF GEORGIA IS NOT AN ABUSE OF DISCRETION

The bankruptcy court below made an alternative holding, as follows:

> Even if the Court were to have found that it had discretion to retrain the case, the Court would have transferred the case to the United States Bankruptcy Court in the Middle District of Alabama given the equities involved. Respondents live in Alabama, their assets are in Alabama, and all of their creditors are either national or are located in Alabama. Therefore, other than the convenience of Respondents and their attorney, no interest would be served by keeping the case in Georgia. Further, Opelika is approximately 35 miles from Phenix City. This distance is not so far as to create an undue burden on Respondents.

B. Doc. #15 (Memorandum Opinion), pp. 10-11.

As discussed above, supra at 3, this alternative holding should be reviewed, if at all, under an abuse of discretion standard. *See Christo v. Padgett*, 223 F.2d 1335, 1335-1336 (11th Cir. 2000). Under this standard, a reviewing court should not overturn an exercise of discretion unless it is "left with a definite and firm conviction that the court below committed a clear error of judgment in the conclusion it reached upon a weighing of relevant factors." *BankAtlantic v. Blythe Eastman Paine Webber, Inc., et al*, 12 F.3d 1045, 1048 (11th Cir. 1994). In light of the factors discussed by the bankruptcy court in this regard, its alternate holding is not an abuse of discretion.

CONCLUSION

For the foregoing reasons, this Court should affirm the bankruptcy court's decision transferring this case to the Middle District of Alabama.

Respectfully submitted,

Felicia S. Turner
UNITED STATES TRUSTEE

Mark Roadarmel
ASSISTANT UNITED STATES TRUSTEE

Donald F. Walton
ACTING GENERAL COUNSEL

____
Paul W. Bridenhagen
TRIAL ATTORNEY
Executive Office for U.S. Trustees
20 Massachusettes Ave., N.W., 8th Floor
Washington, D.C. 20530
(202) 307-1399
(202) 307-2397 (fax)

CERTIFICATE OF SERVICE

I hereby certify that the foregoing Appellee's Brief has been served this 17th day of February, 2004 by U.S. mail, first class, pre-paid upon the following persons:

Fife M Whiteside
Attorney for Appellants
P.O. Box 5383
Columbus, GA 31906

Ms. Joy K. Webster
Akin & Webster
P.O. Box 1773
Macon, GA 31202-1773

____

BRIEF BANK — 'SUMMARY SHEET" *Printed Tue-6/22/04 8:45*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*
Tarbox v. UST (In re Tarbox)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*
CTA5

3. ("CCN") ***CURRENT*** CASE NO.
No.: 04-10298

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*
No.:
Court: USDC ND Tex.
(Identify judge & cite, if any)

5. ("SO") ***SOURCE***
U.S. TRUSTEES

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*
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Michele Mansfield, Esq. UST/OGC
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") ! ***SUMMARY*** OF KEY ISSUE(s)

&

√ Any Miscellaneous ***BACKGROUND***

! Whether the lower courts erred in declining to approve post-petition interest on the compensation to be paid to the trustee under 11 U.S.C. sections 330(a) and 503(b)(2) Of the Bankruptcy Code, where 11 U.S.C. section 726(a) does not authorize interest on such administrative expense claim.

√ **Background:**

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No. 04-10298

UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

In re WILLADEEN REED
Debtor

MAX R. TARBOX, CHAPTER 7 TRUSTEE
Appellant,

v.

UNITED STATES TRUSTEE FOR THE NORTHERN DISTRICT OF TEXAS
Appellee.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF TEXAS

BRIEF FOR APPELLEE UNITED STATES TRUSTEE

DONALD F. WALTON
Acting General Counsel

P. MATTHEW SUTKO
MICHELE M. MANSFIELD
Department of Justice
Executive Office for United States Trustees
Washington, D.C. 20530
(202) 307-1399, Fax (202) 307-2397

Attorneys for William T. Neary,
United States Trustee

Of Counsel

WILLIAM S. PARKINSON
Department of Justice
Office of the United States Trustee
1100 Commerce Street
Room 976
Dallas, Texas 75242

Certificate of Interested Persons

(1) *Tarbox v. United States Trustee* (*In re Reed*), No. 04-10298;

(2) The undersigned counsel of record certifies that the following listed persons and entities as described in the fourth sentence of Rule 28.2.1 have an interest in the outcome of this case. These representations are made in order that the judges of this court may evaluate possible disqualification or recusal.

Parties

Appellant	Max R. Tarbox, chapter 7 trustee
Appellee	William T. Neary, United States Trustee

Counsel

For Appellant
Max R. Tarbox
Law Offices of Max R. Tarbox
3223 S. Loop 289, Suite 414
Lubbock, TX 79423
(806) 780-5955, Fax (806) 780-5956

For Appellee
P. Matthew Sutko
Michele M. Mansfield
Executive Office for United States Trustees
20 Massachusetts Ave., N.W.
Suite 8000
Washington, D.C. 20530
(202) 307-1399, Fax (202) 307-2397

William S. Parkinson
Office of the United States Trustee
1100 Commerce Street
Room 976
Dallas, TX 75242
(214) 767-8967

For Amicus Curiae Samuel K. Crocker
Crocker & Niarhos
Suite 2720, Renaissance Tower
611 Commerce Street
Nashville, TN 37203
(615) 726-3322, Fax (615) 726-6330

Other Interested Parties

Debtor Willadeen Reed
805 NW 10th Street
Andrews, TX 79714

Amicus Curiae National Association of Bankruptcy Trustees

Michele M. Mansfield
Attorney of Record for William T. Neary, United States Trustee

STATEMENT REGARDING ORAL ARGUMENT

The United States Trustee respectfully requests that the Court schedule oral argument for this appeal.

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No. 04-10298

UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

In re WILLADEEN REED,
Debtor

MAX R. TARBOX, CHAPTER 7 TRUSTEE
Appellant

v.

UNITED STATES TRUSTEE FOR THE NORTHERN DISTRICT OF TEXAS
Appellee

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF TEXAS

BRIEF FOR APPELLEE UNITED STATES TRUSTEE

STATEMENT OF JURISDICTION

The bankruptcy court had jurisdiction over Wiladeen Reed's chapter 7 bankruptcy case under 28 U.S.C. 157 and 1334. Mr. Max R. Tarbox was appointed to act as the chapter 7 trustee in Ms. Reed's case. *See* 11 U.S.C. 701(a)(1) and 702(d) (trustee appointment procedures). Mr. Tarbox obtained an order in the case under 11 U.S.C. 327(a) to appoint his law firm as counsel to the trustee. R. 2-14 at Nos. 7, 8. On June 16, 2003, the bankruptcy court entered an order approving Mr. Tarbox's final report filed under 11 U.S.C. 704(9), and allowing him final compensation as an attorney and as a trustee under 11 U.S.C. 330(a). R. 3-96. Mr. Tarbox also sought interest on his compensation, which the court denied. *Id.*

On June 24, 2003, Mr. Tarbox filed a timely notice of appeal from that order to the United States District Court for the Northern District of Texas. R. 2-01; *see* Fed. R. Bankr. P. 8002(a). The district court had jurisdiction to hear the appeal under 28 U.S.C. 158(a). *See also* R. 1-35. On February 9, 2004, the district court affirmed the bankruptcy court's order refusing to authorize interest. R. 1-34, 35. Mr. Tarbox filed a timely notice of appeal to this Court from the district court's order on February 27, 2004. R. 1-49.

By letter dated March 25, 2004, this Court asked the parties to brief the question of "[w]hether the Order from which appeal is taken in this bankruptcy case, affirming the holding that interest on administrative fees and expenses of the trustee are not allowed, is a final order for purposes of appeal. [*See In re*] *Aegis Specialty Marketing Inc. of Ala.* 68 F.3d 919 (5th Cir. 1995)." Both parties to this appeal agree that the lower courts' orders are final. *See* Appellant Br. at 18-20. Because the orders are final, this Court has jurisdiction to hear Mr. Tarbox's appeal under 28 U.S.C. 158(d).

This Court has jurisdiction to hear "appeals from all final decisions, judgments, orders, and decrees." 28 U.S.C. 158(d). Finality of an order, for purposes of appeal pursuant to 28 U.S.C. 158(d), is determined case-by-case. *Aegis Specialty Mktg., Inc. v. Ferlita* (*In re Aegis Specialty Mktg., Inc. of Ala.*), 68 F.3d 919, 921 (5th Cir. 1999). To be considered final within the context of bankruptcy, an order must constitute a "final determination of the rights of the parties to secure the relief they seek," or must be a "final disposition of 'a discrete dispute within the larger bankruptcy case.'" *Bartee v. Tara Colony Homeowners Ass'n* (*In re Bartee*), 212 F.3d 277, 282 (5th Cir. 2000) (citations omitted).

The bankruptcy court's order awarding final compensation to Mr. Tarbox under 11 U.S.C. 330(a) was final. It conclusively determined his attorney and trustee compensation for the work performed in the Reed bankruptcy case, and unconditionally refused to authorize interest on his fees. This Court, like other circuit courts, has invariably treated such final fee award orders as final. *See*, *e.g.*, *Peele v. Cunningham (In re Tex. Sec., Inc.)*, 218 F.3d 443 (5th Cir. 2000) (adjudicating appeal from a final fee award under 11 U.S.C. 330(a)); *Andrews & Kurth v. Family Snacks, Inc. (In re Pro-Snax Distrib., Inc.)*, 157 F.3d 414 (5th Cir. 1998) (holding section 330(a) does not authorize payments from estate funds to counsel for chapter 11 debtors out of possession); *Cont'l Bank and Trust Co. of*

Chicago v. Wooten (In re Evangeline Ref. Co.), 890 F.2d 1312 (5th Cir. 1989) (reviewing interim and final fees awarded in a case in an appeal taken from the final fee award). *See also In re McLaughlin*, 244 B.R. 474, 477 (Bankr. M.D. Ala. 2000) (order approving trustee's final report and allowing compensation is a "final order"). We are unaware of any circuit decision holding that final fee award orders in bankruptcy cases are interlocutory. *See*, *e.g., Iannochino v. Rodolakis (In re Iannochino)*, 242 F.3d 36, 44 (1st Cir. 2001) (holding that "a fee award that determines all of the compensation owed to an attorney under section 330 may be considered final.").

Similarly, the district court's order was final. It unconditionally affirmed the bankruptcy court's refusal to award interest to Mr. Tarbox on his section 330(a) compensation. Absent reversal by this Court, Mr. Tarbox will not receive interest on his fees in the Reed bankruptcy case. For these reasons, this Court has jurisdiction over Mr. Tarbox's appeal.

STANDARD OF REVIEW

This court reviews a bankruptcy court's findings of fact for clear error and its conclusions of law *de novo*. *See, e.g., Total Minatome Corp. v. Jack/Wade Drilling, Inc*. (*In re Jack/Wade Drilling, Inc.*), 258 F.3d 385, 387 (5th Cir. 2001).

This appeal involves a purely legal question of statutory construction which this Court reviews *de novo.*

STATEMENT OF THE ISSUE PRESENTED FOR REVIEW

Whether the lower courts erred in declining to approve post-petition interest on the compensation to be paid to the trustee under 11 U.S.C. 330(a) and 503(b)(2) of the Bankruptcy Code, where 11 U.S.C. 726(a) does not authorize interest on such administrative expense claims?

STATEMENT OF THE CASE

Willadeen Reed ("Debtor") filed a voluntary petition for relief under chapter 7 of the Bankruptcy Code, 11 U.S.C. 701 *et seq*., on May 14, 1999, and shortly thereafter, Max R. Tarbox was appointed as the chapter 7 trustee to administer the Debtor's bankruptcy estate. *See* R. 2-13. Mr. Tarbox received court authorization under 11 U.S.C. 327(a) to hire an independent accountant and Mr. Tarbox's law firm to assist him in administering the case. R. 2-14, No. 8; 2-15, No. 25. At the end of the case, the bankruptcy court awarded compensation to Mr. Tarbox and the accountant under 11 U.S.C. 330(a). R. 2-4. Mr. Tarbox's Final Report and Proposed Distribution ("Final Report") proposed to pay interest on this compensation, R. 3-18, 35, and the United States Trustee objected.[1] R. 3-58. After a hearing, the bankruptcy court concluded that Mr. Tarbox and the accountant were not entitled to interest. R. 3-89; *see also* R. 3-64 to 88 (hearing transcript). Therefore, the court entered an order approving the Final Report and allowing compensation but denying interest. R. 3-96. The district court affirmed the bankruptcy court's decision, holding trustee and professional compensation paid under section 11 U.S.C. 503, not 726(a)(1), and consequently, payment of interest is not allowed under section 726(a)(5). R. 1-46. Mr. Tarbox timely appealed that order to this Court. R. 1-49.

STATEMENT OF FACTS

I. Statutory Framework

A. Overview of Chapter 7 Case Administration

Chapter 7 of the Bankruptcy Code, 11 U.S.C. 701 *et seq.*, is a liquidation provision. In a chapter 7 case, a bankruptcy trustee liquidates the assets a debtor

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[1] The United States Trustee is an official of the United States Department of Justice, charged by statute with the duty to oversee and supervise the administration of bankruptcy cases. 28 U.S.C. 586(a). The United States Trustee is expressly given standing under to raise and be heard on any issue under title 11, except that the United States Trustee may not file a reorganization plan under chapter 11. 11 U.S.C. 307. A chapter 7 trustee is required to file a final account of the administration of a bankruptcy estate with both the court and with the United States Trustee. 11 U.S.C. 704(9).

has as of the date of the filing, and after payment of administrative expense claims, divides those assets among pre-bankruptcy petition creditors according the Bankruptcy Code's priority scheme. A voluntary chapter 7 bankruptcy case commences when the debtor files a bankruptcy petition. 11 U.S.C. 301; Fed. R. Bankr. P. 1002(a). Filing also constitutes "an order for relief" in the case, which acts to maintain the status quo while the case is administered. *Id.* Shortly after the order for relief takes effect, the United States Trustee, who is a Department of Justice official charged with the oversight of administration of bankruptcy cases, appoints a chapter 7 bankruptcy trustee.[2] A chapter 7 bankruptcy trustee is a disinterested person (a lawyer, certified public accountant, or other qualified individual) appointed to administer the debtor's estate for the benefit of pre-petition creditors. *See* 11 U.S.C. 704 (duties of a trustee); 28 U.S.C. 586(d); 28 C.F.R. 58.3(b), 58.4(b). The trustee is a representative of the estate, and is charged with specific statutory duties necessary to collect and reduce to money property of the estate. 11 U.S.C. 323(a); 704(1)-(9). A trustee is authorized to

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[2] The United States Trustee initially appoints an interim trustee. 11 U.S.C. 701. The interim trustee becomes permanent at the time of the meeting of creditors under section 341 of the Bankruptcy Code unless the creditors exercise their right to elect a different trustee. 11 U.S.C. 702(d). The meeting of creditors, and therefore the permanent appointment of the interim trustee, occurs sometime between forty and sixty days after the order for relief. 11 U.S.C. 341; Fed. R. Bankr. P. 2003(a).

seek court permission to employ professionals to assist in the performance of those duties, including attorneys, accountants, and auctioneers. 11 U.S.C. 327.

B. Allowance of Compensation of Trustees and Professionals Under 11 U.S.C. 503(b)(2) and Payment under 503(a)

Neither chapter 7 bankruptcy trustees nor professionals employed by the estate are government employees, and their compensation comes from the private bankruptcy estate. In order to receive payment, a trustee or a professional must be properly employed under either 11 U.S.C. 701 and 702(d) (trustee appointment) or 11 U.S.C. 327 (professional employment), and his compensation must be awarded under 11 U.S.C. 330(a). *Lamie v. United States Trustee*, 124 S. Ct. 1023, 1027 (2004); *see also* Fed. R. Bankr. P. 2016(a) (application for compensation for services).

Section 503(b) of the Bankruptcy Code authorizes bankruptcy courts to allow "administrative expenses" that arise after a bankruptcy petition is filed. 11 U.S.C. 503(b). Section 503(b)(2) specifically authorizes the allowance of compensation that has been awarded to a trustee or a professional under section 330(a).[3] 11 U.S.C. 503(b)(2). Under section 503(a), an entity with an

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[3] The amount of trustee fees that the court may award under 11 U.S.C. 330(a) is subject to the statutory limits of section 326(a). 11 U.S.C. 326(a).

administrative expense may file a "request for payment" of such an administrative expense claim. 11 U.S.C. 503(a).

C. Priorities Under 11 U.S.C. 507(a)

In most chapter 7 bankruptcy cases there are not enough funds generated from the liquidation of estate assets to pay all claims in full. In recognition of this, Congress has established a "priority" of payment system mandating that specified claims receive full payment as a prerequisite to claims in lower categories receiving any payment. *See* 11 U.S.C. 507(a) (establishing priorities). Under that scheme, trustee and professional fees receive first priority. *Id.* Under 11 U.S.C. 507(a)(1), certain filing fees, and administrative expense claims approved under 11 U.S.C. 503(b)(2), receive "priority" over all other types of claims. 11 U.S.C. 507(a)(1). In turn, section 503(b)(2) authorizes the payment of "compensation and reimbursement awarded [to trustees and professionals] under section 330(a)." 11 U.S.C. 503(b)(2). *See Texas v. Lowe* (*In re H.L.S. Energy Co., Inc.*), 151 F.3d 434, 437 (5th Cir. 1998) (conceptual justification for administrative expense priority is that creditors must pay for those expenses necessary to produce distribution to which they are entitled).

The remainder of section 507(a)(1) lists eight categories of claims that are entitled to lesser priority. Those categories include pre-petition employee wages and salaries, claims related to contributions to an employee benefit plan, alimony, maintenance and support, certain farming and fishing costs, and specific pre-petition tax claims. *See* 11 U.S.C. 507(a)(2)-(9). Other than administrative expense claims and court fees under section 507(a)(1), all other priority claims are pre-petition obligations of the debtor. *See* 11 U.S.C. 507(a)(1)-(9). Priority is the same whether the case is under chapter 7, 11, 12, or 13. 11 U.S.C. 103 (chapters 1, 3, and 5 of the Bankruptcy Code apply to cases under chapters 7, 11, 12, and 13. Administrative expenses, including trustee and professional compensation retain top priority for payment whether they are paid shortly after they are incurred or paid at the same time as final distribution to creditors under section 726(a). Any claim paid during the pendency of the case is subject to disgorgement prior to the final distribution as a result of the mandatory nature of the Code's priority scheme.

D. Distribution to Creditors Under 11 U.S.C. 726(a)

At the conclusion of a chapter 7 liquidation case, the chapter 7 trustee submits to the United States Trustee and files with the court a final report and an account of the administration of the estate. *See* 11 U.S.C. 704(9) (requiring this report). Once the court resolves any objections to the final report, the trustee distributes funds generated from the liquidation of estate property to pre-petition creditors in accordance with section 726 of the Bankruptcy Code. 11 U.S.C. 726.

Section 726(a) provides for the distribution of estate property in chapter 7 cases. 11 U.S.C. 726(a). The first four categories consist of various unsecured claims. *See* 11 U.S.C. 726(a)(1)-(4). The fifth category applies to the payment of post-petition interest "on any claim paid under" the first four categories. 11 U.S.C. 726(a)(5). Finally, any surplus property is distributed to the debtor. 11 U.S.C. 726(a)(6).

Of relevance in this appeal is section 726(a)(1), which provides that estate property is first distributed in payment of section 507 priority claims where proof has been filed under section 501. 11 U.S.C. 726(a)(1). Prior to the Bankruptcy Reform Act of 1994 ("the Act"), 108 Stat. 4106, section 726(a)(1) simply provided for the distribution of property of the estate to priority claims, specifically, "in payment of claims of the kind specified in and in the order specified in" section 507. Effective for cases filed after October 22, 1994, however, section 726(a)(1) was amended to restrict distribution under the section to claims for which a proof of claim had been "timely filed under" section 501, or had been "tardily filed before the date on which the trustee commences distribution under [section 726]." 11 U.S.C. 726(a)(1) (as amended by 1994 Act).

Only "creditors" and indenture trustees may file proofs of claims under section 501.[4] *See* 11 U.S.C. 501(a) ("A creditor or an indenture trustee may file a proof of claim."). The Bankruptcy Code defines "creditor" as an "entity that has a claim against the debtor that arose at the time of or before the order for relief concerning the debtor."[5] 11 U.S.C. 101(10)(A). A "proof of claim" is defined by the Bankruptcy Rules as "a written statement setting forth a creditor's claim." Fed. R. Bankr. P. 3001(a). A proof of claim must substantially conform to Official Form 10 and must be executed by the creditor or the creditor's authorized agent.[6] Fed. R. Bankr. P. 3001(a), (b); Fed. R. Bankr. P. Official Form 10. It is clear under the Bankruptcy Code and Rules that the procedures with respect to proof of claims apply only to creditors.[7] A pre-petition claim of a creditor, "proof of which

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[4] Indenture trustee is defined in 11 U.S.C. 101(29). Indenture is defined in 11 U.S.C. 101(28). Those provisions have no relevance to this appeal.

[5] 11 U.S.C. 101(10)(B) and (C) also give creditor status to holders of certain specialized claims that are not at issue in this appeal. Within the context of bankruptcy, a "claim" refers generically and broadly to any "right to payment" or "right to equitable remedy." 11 U.S.C. 101(5).

[6] The exception to this rule, which is not relevant in this appeal, is under certain circumstances where a creditor fails to file a proof of claim, the debtor, codebtor, or trustee may file the proof of claim on behalf of the creditor. *See* Fed. R. Bankr. P. 3004, 3005.

[7] *See, e.g.*, 11 U.S.C. 501 (creditor may file proof of claim); Fed. R. Bankr. P. 3001 (proof of claim sets forth creditor's claim) (proof of claim executed by creditor); Fed. R. Bankr. P. 3002 (creditor must file proof of claim for it to be

is filed under section 501," is "deemed allowed" absent an objection. 11 U.S.C. 502. *Compare with* 11 U.S.C. 503(b)(2) (trustee and professional administrative fees may be allowed and paid only after notice and a hearing).

II. Facts of This Case

Willadeen Reed ("Debtor") filed a voluntary petition for relief under chapter 7 of the Bankruptcy Code on May 14, 1999, and Mr. Tarbox was appointed as trustee shortly thereafter. R. 3-89; R. 2-13. During the case, Mr. Tarbox requested and received court authorization to employ his law firm as counsel to the trustee and to hire an accountant pursuant to section 327 of the Bankruptcy Code.[8] R. 2-14; R. 2-15.

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allowed); Fed. R. Bankr. P. 3003(c) (creditor in chapter 11 may file proof of claim); Fed. R. Bankr. P. 3004 (debtor or trustee may file proof of claim where creditor fails to do so); Fed. R. Bankr. P. 3005 (where creditor fails to file a proof of claim); Fed. R. Bankr. P. 3006 (creditor may withdraw claim); Fed. R. Bankr. P. Official Form 10 (Proof of Claim). Further, the "Proof of Claim" form specifically states that it "should not be used to make a claim for an administrative expense" and that a "'request' for payment of an administrative expense may be filed pursuant to 11 U.S.C. [section] 503." Fed. R. Bankr. P. Official Form 10; *see also* Fed. R. Bankr. P. 9013 (request for an order shall be by written motion).

[8] Mr. Tarbox filed an application for employment of counsel under 11 U.S.C. 327 on July 20, 1999 and received court authorization on July 21, 1999. R. 2-14. Mr. Tarbox filed an application for employment of the accountant on July 1, 2002 and on July 2, 2002 received court authorization. R. 2-15.

On December 27, 2002, at the conclusion of the case, Mr. Tarbox submitted motions for compensation pursuant to 11 U.S.C. 330(a) of the Bankruptcy Code and Fed. R. Bankr. P. 2016. R. 3-43; R. 3-50. On the same day, he submitted his proposed Final Report pursuant to 11 U.S.C. 704(9). R. 3-18. Mr. Tarbox's report proposed the payment of interest on his, his attorney's and his accountant's fees and expenses, based on his assumption that his section 330(a) applications would be approved. R. 3-35. The Final Report reflected unpaid administrative expense claims of $4,541.11 (trustee compensation); $488.63 (trustee expenses); $1,507.50 (attorney compensation); $60.93 (attorney expenses); and $838.00 (accountant compensation). R 3-22. The Report proposed interest payments to unsecured creditor claims in the amount of $35,310.85. R. 3-33; *see also* R. 3-34 to 3-36. The proposed interest payment amounts or administratiove expense claims were as follows: $259.55 (trustee's fees); $30.01 (trustee's expenses); $92.59 (trustee's attorney expenses), $92.59 (trustee's attorney fees); $3.74 (trustee's attorney expenses); $51.47 (accounting fees); $1.66 (IRS claim); $112.46 (interest on IRS claim). R. 3-35. The United States Trustee objected to Mr. Tarbox's Final Report on the grounds that it proposed to pay interest on section 503(b)(2) administrative expense claims from the date of the petition rather than from the date the claim arose or was allowed. R. 3-58.

There was a surplus in this case after all claims were paid in full. *See* R. 3-18 to 3-42. Under section 726(a)(5), that meant "claim[s] paid under" section 726(a)(1)-(4) were entitled to post-petition interest "at the legal rate from the date of the filing of the petition." 11 U.S.C. 726(a)(5). The trustee and the United States Trustee agreed that administrative expense claims were "claim[s] paid under" section 726(a)(1), but disagreed on the calculation of the interest.[9]

Following a hearing, the court entered a memorandum opinion on May 16, 2003, and an Order Approving Trustee's Final Report and Allowing Compensation on June 16, 2003. R. 3-89, 3-96. The order awarded the requested compensation to Mr. Tarbox and his professionals under section 330 and authorized payment of such compensation under section 503(b)(2), but denied the payment of interest entirely under section 726(a)(5). R. 3-96. The bankruptcy court found at the threshold that administrative expense claims, such as the

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[9] On appeal to the district court, the United States Trustee advanced the same position it had in the bankruptcy case, and did not adopt the reasoning of the bankruptcy court. However, upon further review, the United States Trustee now agrees with the reasoning of the courts below that administrative expense claims are not claims paid under section 726(a)(1) so as to be entitled to payment of interest under section 726(a)(5). If this Court finds to the contrary, it should award interest on the trustee's compensation claims dating from the date the award of the compensation under the rule established by *United States Trustee v. Fishback* (*In re Glados, Inc.*), 83 F.3d 1360 (11th Cir. 1996) (construing 11 U.S.C. 726(a)(1) as it existed prior to its 1994 amendment).

trustee's fees and professional fees, are not "claim[s] paid under" section 726(a)(1). R. 3-94. The court focused on the plain language of section 726(a)(1), which provides for distribution of estate property, first, "in payment of claims of a kind specified . . . in section 507, *proof of which is timely filed under [section 501]* or tardily filed before the date on which the trustee commences distribution under this section." R. 3-93; *see also* 11 U.S.C. 726(a)(1) (emphasis added). The court concluded that even where there is a surplus of estate property, interest is not payable on administrative expense claims under 11 U.S.C. 726(a)(5) which arise during the pendency of a chapter 7 case for which no proof of claim is filed under 11 U.S.C. 501. R. 3-94. The court pointed out that it is impossible for administrative expense claims to meet that criteria, since only "creditors" may file proofs of claim under section 501 and by definition, administrative expense claimants, for purposes of an administrative expense claim, cannot, by statutory definition, be creditors. R. 3-94. The court concluded that trustees' fees were not claims paid under section 726(a)(5) and were not entitled to any interest under section 726(a)(5). R. 3-94. Based on this conclusion, the court denied the payment of interest on the fees and expenses of Mr. Tarbox, his counsel, and his accountant. R. 3-96. Mr. Tarbox filed a notice of appeal to the district court on June 24, 2003. R. 2-1.

The district court adopted and elaborated upon the analysis of the bankruptcy court, and affirmed the holding of the bankruptcy court that interest may not be paid on administrative expense claims under section 726(a)(5). R. 1-34. In reaching its conclusion, the district court "[took] to heart the Supreme Court's instruction that 'interpretations of a statute which would produce absurd results are to be avoided if alternative interpretations consistent with the legislative purpose are available," its "duty to give effect, if possible, to every clause and word of a statute, and its "reluctan[ce] to treat statutory terms as surplusage in any setting." R. 1-43 to 1-44 (citations omitted). Accordingly, the district court noted that section 507 clearly "draws within its compass both [administrative expense claims] and [pre-petition claims]," but refused to "prematurely halt its analysis there." R. 1-45. The court then concluded that "the general, inclusive reference to [section] 507 is limited by the clause referring to [the filing of proofs of claims under section] 501." *Id.* The district court "refuse[d] to treat the clause as surplusage." *Id.* Giving meaning to the section 501 clause of section 726(a)(1), the court concluded that the provision is inapplicable to administrative expense claims. R. 1-3.

The court reasoned that section 501 addresses the filing of "proofs of claims" by "creditors." R. 1-45. The court concluded that the trustee and other professionals, as well as other holders of administrative expense claims "do not constitute claim-filing creditors under section 501 since their claims" arose post-petition, and that "although 726(a)(1) seems to include them by reference to" section 507 claims, administrative expense claims are "winnowed out by the reference to [section] 501, because they are not of the kind proof of which is timely filed under [section] 501 for pre-petition claims by creditors." R. 1-45 to 1-46. Conversely, the lack of reference in section 726(a)(1) to section 503 (the administrative expense claim "equivalent" of 501), precludes administrative expense claims from being "draw[n] in" to 726(a)(1). *See id.* Finally, the court concluded that since 726(a)(1) does not apply to administrative expense claims, then administrative expense claims cannot be "claim[s] paid under" that section and consequently are not entitled to any interest payments under the plain language of section 726(a)(5). *Id.*

The court, although basing its holding on a plain language construction of the statute, found "no compelling reason to suppose" that the intent of Congress was to allow the payment of interest on administrative expense claims under section 726(a)(5). R. 1-46. Moreover, the court found that "adequate provision is made within the rest of the Code for payment of the trustee's administrative fees and expenses" under section 330 (approval and regulation of fees), section 326 (cap on fees), section 507 (priority of fees), and section 503 (payment of fees). *Id.* Stating that "[t]here is no reason to suspect that a further rule concerning these disbursements of administrative expenses would be buried within a section concerned with the procedures and priorities for the final distribution of property of the estate to unsecured creditors," R. 1-46, 47; the court then noted this Court's reasoning in *Security State Bank v. IRS (In re Van Gerpen)*, 267 F.3d 453, 456 (5th Cir. 2001), that disbursement of "'estate funds to pay administrative expenses incurred by the trustee in the process of converting estate assets to cash' are 'markedly different'" from distribution within the context of section 726. R. 1-47. Finally, the court noted that the provision for interim compensation under section 331 meant that "the trustee does not have to wait until the final distribution to receive payment," and the "fact that he is allowed to [obtain interim compensation] under a reasonable schedule does not suggest" to the court "that Congress either felt compelled to or intended to provide for interest for those claims, especially within the section dealing with final distributions to unsecured creditors." R. 1-48.

SUMMARY OF ARGUMENT

Prior to 1994, it was generally accepted that trustees and professionals could receive interest under section 726(a)(5) of the Bankruptcy Code on commissions awarded under section 330(a). *See, e.g.*, *Boldt v. Crake* (*In re Riverside-Linden Inv. Co.*), 945 F.2d 320 (9th Cir. 1991) (allowing interest from the date fees were awarded under 11 U.S.C. 330); *United States Trustee v. Fishback* (*In re Glados, Inc.*), 83 F.3d 1360 (11th Cir. 1996) (same). Five statutes combined to produce that result: section 330(a) (authorizing trustee awards); section 503(b)(2) (allowing the payment of section 330(a) awards as administrative expenses); section 507(a)(1) (giving section 503(b) claims priority); section 726(a)(1) (authorizing the satisfaction of section 507 claims); and 726(a)(5) (allowing interest on claims that fell under section 726(a)(1)).

That changed in 1994 because Congress amended section 726(a)(1) to restrict distributions under that section solely to pre-petition creditor claims filed under section 501 of the Code, and to tardily filed pre-petition claims. That meant trustee administrative expense claims fell outside section 726(a)(1) and therefore were no longer entitled to interest under section 726(a)(5). Failing to appreciate the significance of this change, Mr. Tarbox and the amicus curiae focus on the issue adjudicated in *Glados* and *Riverside-Linden*– when does interest begins accruing under section 726(a)(5) on section 330 fee awards. But, as the lower courts in this case correctly recognized, that issue is no longer relevant because amended section 726(a) no longer authorizes interest on such claims at all.

Section 726(a)(1) applies only to a claim "proof of which is timely filed under section 501" of the Code, or when such a claim is tardily filed. Mr. Tarbox did not file a claim under section 501. Nor could he. Section 501 applies only to creditor claims and section 101(10) restricts creditor claims to those that arise before the debtor files his bankruptcy petition. Mr. Tarbox's claim arises from work performed after the petition was filed. As the lower courts correctly concluded, his claim constituted a post-petition administrative expense claim based on the trustee and attorneys fees awarded to him under section 330(a) of the Bankruptcy Code.

Because his claims fall outside section 726(a)(1), as amended, he has no right to interest under section 726(a)(5). Instead, his section 330(a) awards, once "allowed" under section 503(b)(2), were eligible for "payment" under section 503(a), which does not provide for interest.

ARGUMENT

The lower courts properly declined to approve post-petition interest on the compensation to be paid to the trustee under sections 330(a), 503(b)(2), and 503(a), where section 726(a) does not authorize interest on such administrative expense claims.

1. The plain language of section 726(a) does not allow the payment of interest on trustee fees because the 1994 amendment to the section limited payment of interest to pre-petition claims of creditors. Prior to 1994, section 726(a) appeared to authorize the payment of trustee fees and other administrative expense claims, but courts were split as to when interest on trustee awards begins to accrue. However, in 1994, section 726(a) was amended so as to apply only to pre-petition creditors and exclude trustee fees and other post-petition claims. *See* Bankruptcy Reform Act of 1994, 108 Stat. 4106. Accordingly, the issue of *when* interest accrues on trustee fees under section 726(a)(5) became a non-issue in 1994, and the court decisions on this issue are inapposite to this appeal.[10]

2. The starting point for construing a statute "is the existing statutory text" and "not the predecessor statute[']s." *Lamie v. United States Trustee*, 124 S. Ct. 1023, 1030 (2004) (citations omitted). *See also Richardson v. United States*, 526 U.S. 813, 818 (1999) (a court must "look first to the language" of the statutory text); *Boyce v. Greenway* (*In re Greenway*), 71 F.3d 1177, 1179 (5th Cir. 1996) (same). Section 726(a)(1), as amended, is inapplicable to trustee fees because trustee fees

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[10] Mr. Tarbox principally relies on two decisions, *Vogt* and *Smith,* that neither of which considered the effect of the 1994 amendment, much less applied it. See *In re Vogt*, 250 B.R. 250 (Bankr. M.D. La. 2000); *In re Smith*, 267 B.R. 770, 771 (Bankr. W.D. Tex. 2001); *compare with* 11 U.S.C. 726(a)(1).

fail to meet the criteria of having filed a proof of claim under section 501. Section 726(a)(1) provides for distribution of estate property in payment of (1) "claims of a kind specified in and in the order specified in [11 U.S.C. 507]," and (2) "proof of which is timely filed under [11 U.S.C. 501] or tardily filed before the date on which the trustee commences distribution under [section 726]." 11 U.S.C. 726(a)(1). Trustee fees are "of a kind specified under" section 507. 11 U.S.C. 507(a)(1) (administrative expense claims allowed under section 503(b)); 503(b)(2) (compensation and reimbursement awarded under section 330); 330(a) (compensation to trustees and other professionals). However, section 501 is inapplicable to trustee fees. Trustee and professionals seeking compensation never file a "proof of claim" under section 501, which is limited to the claims pre-petition creditors. *See* 11 U.S.C. 501(a) (limiting the filing of proofs of claims to those filed by "[a] creditor"); 101(10)(A) (defining creditor as one who holds a pre-petition claim); 11 U.S.C. 101(5) (defining claim).

A trustee is not a creditor under section 501 because they do not hold a pre-petition claim. 11 U.S.C. 101(10)(A) (defining creditor). Instead, as the lower courts correctly held, trustees and their professionals perform their services entirely post-petition, which takes them out of the Code's definition of creditor and precludes them from filing creditor claims under section 501.[11] R. 2-11, 1-45. In response to the reasoning of the lower courts, Mr. Tarbox asserts that a trustee is a "creditor" under section 501 because he has an unliquidated, contingent, and unmatured claim in every case and may file "proof" under section 501. *See* Appellant Br. at 12. His reasoning fails to withstand scrutiny for four independent reasons.[12]

First, to be employed to act as a trustee, Mr. Tarbox had to be a "disinterested person" under 11 U.S.C. 701(a)(1), and by definition a "disinterested person" may not be a creditor. 11 U.S.C. 101(14)(A) ("'disinterested person' means person that- (A) is not a creditor * * *."). Under Mr. Tarbox's reasoning, a chapter 7 trustee, as a "creditor," would never be disinterested and could never be appointed in any case, which is a clearly absurd

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[11] The Bankruptcy Code and Rules have established very specific procedures for the allowance and payment of professional compensation which are entirely unrelated to section 501. An application is filed under Fed. R. Bankr. P. 2016 and after notice and a hearing, the court may allow compensation under section 330(a) and allow the claim under section 503(b)(2) and authorize its "payment" under section 503(a).

[12] Even if Mr. Tarbox was a creditor entitled to file a proof of claim under section 501, he did not file a proof of claim under section 501. Therefore, his claim for fees would still fail to meet the criteria of section 726(a)(1).

result. Second, a creditor, as defined by section 101(10)(A),[13] must have a claim that arose at the time of or prior to the entry of the order for relief. Mr. Tarbox contends that a chapter 7 trustee is appointed "at the time of" the order for relief, and that "a trustee assumes his duties to the estate upon the petition filing [and simultaneously the order for relief], so as to give rise to a claim at that time." Appellant Br. at 12. Under 11 U.S.C. 701, however, a chapter 7 trustee is appointed "*after* the order for relief." Third, a chapter 7 trustee does not meet the definition of a creditor under section 101(10)(A), because he is not an entity that has "a claim against *the debtor*," but rather against the *estate*. 11 U.S.C. 101(10) (emphasis added); *see* 11 U.S.C. 323(a) ("The trustee in a case under [title 11] is the representative of the estate."). Fourth, the trustee's claim is an administrative expense claim, and a claim cannot be both a pre-petition creditor claim and a post-petition administrative expense claim. *See Midland Cent. Appraisal Dist. v. Midland Indus. Serv. Corp. (In re Midland Indus. Serv. Corp.)*, 35 F.3d 164, 166 (5th Cir. 1994). Section 326(a) of the Code specifically provides that a chapter 7 trustee's compensation may be allowed under section 330, and section 503(a) and (b)(2) specifically provide that, after notice and a hearing, compensation allowed

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[13] Sections 101(10)(B) and (C), which contain additional definitions of creditor, are not relevant to this appeal.

under section 330 is paid as administrative expense claim, not as a claim of a creditor. 11 U.S.C. 503(a) and (b)(2); *compare* 11 U.S.C. 501 (creditor may file proof of claim), 502(a) (claim for which proof filed under 501 deemed allowed without notice and a hearing).

3. Section 726(a) applies only to creditor claims, not administrative expense claims, and there is no justification for disregarding the plain language of the statute to include section 330 trustee compensation. Significantly, the position advanced by Mr. Tarbox requires much more than the interpretation of an ambiguous word or phrase – it requires this Court to excise the entire "proof of which is filed under 501" clause added to section 726(a)(1) in 1994. "There is a basic difference between filling a gap left by Congress' silence and rewriting rules that Congress has affirmatively and specifically enacted." *Mobil Oil Corp. v. Higginbotham*, 436 U.S. 618, 625 (1978). The lower courts recognized this, and accorded proper "deference to the supremacy of the Legislature" in choosing the words of a federal statute. *United States v. Locke*, 471 U.S. 84, 95 (1985) (Court's unwillingness to "soften the import of Congress' chosen words" longstanding (citation omitted)).

This Court must apply amended section 726(a)(1)'s plain language unless it produces an absurd result. *See, e.g.*, *Lamie v. United States Trustee*, 124 S. Ct.

1023, 1030 (2004).[14] There is nothing absurd about amended section 726(a)(1)'s treatment of interest on trustee administrative expense claims. As amended, the section continues to allow interest under section 726(a)(5) from the date of the filing of the petition on a series of pre-petition creditor claims that exist as of the date of the filing of the petition.[14] It simply no longer authorizes interest on administrative expense claims, like Mr. Tarbox's, that do not exist as of the date that interest begins to accrue under section 726(a)(5). This rectifies an absurdity that existed under the superceded statute. Prior to 1994, the text of section 726(a)(1) allowed trustees to receive interest from date of the filing of the bankruptcy petition even though they had no fee award on which interest could accrue and they had not yet performed any services in the case. Given this absurdity, the Ninth and Eleventh circuits refused to apply the plain language of the pre-1994 statute, and did not allow interest to begin accruing until trustees obtained final fee awards. *United States Trustee v. Fishback (In re Glados),* 83 F.3d 1360, 1365-66 (11th Cir. 1996); *Boldt v. Crake (In re Riverside-Linden Inv.*

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[14] As amended, section 726(a)(5) continues to authorize interest on the other section 507 claims incorporated by reference in section 726(a)(1), as well as claims under sections 726(a)(2)-(4). These pre-petition creditor claims exist at the time of the filing of the petition.

Co.), 945 F.2d 320, 323 (9th Cir. 1991). By adding the section 501 requirement to section 726(a)(1) the 1994 amendment took trustee administrative expense claims outside the ambit of section 726(a)(1), and rectified the prior statute's absurdity. Thus, the 1994 amendment is not absurd and should be applied according to its plain language.

4. Nor is there any reason to assume that administrative expense claims must fall under section 726(a) in order to receive payment. The argument of Mr. Tarbox and the amicus curiae for disregarding the plain language of section 726(a)(1) is that the lower courts' reasoning does away with all mechanisms for payment of administrative expense claims. However, section 726(a) is unnecessary to allow payment of administrative expense claims because sections 330(a), 503(b)(2), and 503(a) provide the mechanism for such allowance. 11 U.S.C. 330(a) (award); 502(b)(2) (allowance); 503(a) (payment). *See also Milwaukee Engraving Co., Inc.* 219 F.3d 635 (7th Cir. 2000) (construing these provisions); *F/S Airlease II, Inc. v. Simon* (*In re F/S Airlease II, Inc.*), 844 F.2d 99 (3d Cir. 1988) (same); *Cushman & Wakefield of Conn., Inc. v. Keren Ltd. P'ship (In re Keren Ltd. P'ship)*, 189 F.3d 86 (2nd Cir. 1999).

Further, Mr. Tarbox and the amicus curiae's construction disregards this Court's prior recognition that administrative expense claims are not "paid" under section 726(a). In *Security State Bank v. IRS* (*In re Van Gerpen*), this Court, while addressing the proper interpretation of the phrase "commences distribution" under section 726(a), agreed that "while payments made on account of compensation and other administrative expense applications must be accounted for, it is not necessary that they be claims paid within the final distribution." 267 F.3d 453, 456 (5th Cir. 2001) (citations omitted). Mr. Tarbox and the amicus curiae's contention that administrative expense claims must be paid under section 726(a)(1) or not at all cannot stand under *Van Gerpen*. Instead, administrative expense claims are allowed under section 503(b)(2) and "payment" is made under section 503(a).

5. Finally, the lower courts' interpretation of section 726(a)(1) draws support from a Second Circuit decision holding the term "proof of which is filed under section 501" appearing in 11 U.S.C. 502(a) also excludes post-petition administrative expense claims. *Nostas Assocs. v. Costich* (*In re Klein Sleep Products, Inc.*), 78 F.3d 18 (2d Cir. 1996); *See also* 11 U.S.C. 502(a) ("A claim or interest, proof of which is filed under section 501 of this title * * *"). In *Klein Sleep*, the Second Circuit held that a damage claim for future rent arising from a trustee's rejection of an assumed lease was an administrative expense. *Klein Sleep*, 78 F.3d at 28. The court then ruled that section 502(b)(6)'s cap on future

rent was inapplicable to administrative expense claims because section 502(a) applies only to claims "proof of which is filed under section 501[,]" and administrative expense claims are not such claims. *Id.* Because section 726(a)(1) uses the same phrase, it should be interpreted the same way. *See, e.g., Ratzlaf v. United States*, 510 U.S. 135, 143 (1994) (term appearing in several statutes should be read the same way).

Conclusion

For these reasons, the United States Trustee respectfully asks this Court to affirm the orders entered below.

Respectfully Submitted,
WILLIAM T. NEARY
United States Trustee

By:________________________________

Donald F. Walton
Acting General Counsel

P. Matthew Sutko
Michele M. Mansfield
Counsel for United States Trustee
Department of Justice
Executive Office for United States Trustees
20 Massachusetts Ave., N.W.,
Suite 8000
Washington, D.C. 20530
(202) 307-1399

CERTIFICATE OF SERVICE

I do hereby certify that on June 17th, 2004, a true copy of the foregoing document and a diskette containing the brief in PDF format was sent by first class mail, postage prepaid, to the following:

Max Tarbox
3223 South Loop 289
Suite 414
Lubbock, TX 79423

Samuel K. Crocker
Crocker & Niarhos
Suite 2720, Renaissance Tower
611 Commerce Street
Nashville, TN 37203

____
Michele M. Mansfield

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S.D. Miss.

3. ("CCN") ***CURRENT*** CASE NO.

No.: 1:08-cv-00032-HSO-JMR

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P. Matthew Sutko, Melissa R. Burgess, R. Michael Bolen, Christopher J. Steiskal

(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***

BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s)

&

√ Any Miscellaneous ***BACKGROUND***

• Whether the bankruptcy court correctly dismissed the Tates' bankruptcy case under 11 U.S. C. § 707(b)(1) and (2) because they sought to claim a transportation ownership expense when they had no loan or lease payment.

√ **Background:**

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FOR THE SOUTHERN DISTRICT OF MISSISSIPPI

CASE NO. 1:08CV00032-HSO-JMR

IN RE TROY EDWIN TATE AND ELAINE BURRIS TATE
Debtors

TROY EDWIN TATE AND ELAINE BURRIS TATE
Appellants

v.

R. MICHAEL BOLEN, UNITED STATES TRUSTEE
Appellee

ON APPEAL FROM THE UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF MISSISSIPPI

THE HONORABLE EDWARD R. GAINES, PRESIDING
Bankruptcy Case No. 07-50028 ERG

BRIEF OF THE APPELLEE R. MICHAEL BOLEN, UNITED STATES TRUSTEE

OF COUNSEL

ROBERTA A. DeANGELIS
Acting General Counsel

P. MATTHEW SUTKO
MELISSA R. BURGESS
Department of Justice
Executive Office for U.S. Trustees
20 Massachusetts Avenue, N.W.
Washington, D.C. 20530

R. MICHAEL BOLEN
United States Trustee

CHRISTOPHER J. STEISKAL
(MSB #101654)
Department of Justice
Office of the United States Trustee
100 West Capitol Street, Suite 706
Jackson, MS 39269
TEL: (601) 965-5241
FAX: (601) 965-5226
EMAIL: christopher.j.steiskal@usdoj.gov

ATTORNEY FOR APPELLEE

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BASIS OF APPELLATE JURISDICTION

The United States Bankruptcy Court for the Southern District of Mississippi had jurisdiction under 28 U.S.C. §§ 157(b) and 1334(a) to hear the underlying case, commenced by the filing of a voluntary petition under chapter 7 of the Bankruptcy Code, 11 U.S.C. § 701, *et seq*. On December 18, 2007, the bankruptcy court entered an order granting the United States Trustee's motion to dismiss Troy and Elaine Burris Tate's case for abuse pursuant to 11 U.S.C. § 707(b)(1). On December 26, 2007, the Tates filed a timely notice of appeal from that order. *See* 28 U.S.C. § 158(c)(2); Fed. R. Bankr. P. 8002(a). This Court has jurisdiction over this appeal under 28 U.S.C. § 158(a)(1).

STATEMENT OF THE ISSUES

Whether the bankruptcy court correctly dismissed the Tates' bankruptcy case under 11 U.S.C. § 707(b)(1) and (2).

STANDARD OF REVIEW

______A district court reviews a bankruptcy court's findings of fact under a clearly erroneous standard. *In re Chesnut*, 422 F.3d 298, 301 (5th Cir. 2005); *Continental Casualty Co. v. Gullett*, 253 B.R. 796, 803 (S.D. Tex. 1999); *Byrd v. Bank of Mississippi*, 207 B.R. 131, 133 (S.D. Miss. 1997). A district court reviews a bankruptcy court's conclusions of law *de novo*. *Chesnut*, 422 F.3d at 301; *Gullett*, 253 B.R. at 803; *Byrd*, 207 B.R. at 133. Whether the bankruptcy court erred in dismissing the Tates' bankruptcy case under 11 U.S.C. § 707(b)(1) based on 11 U.S.C. § 707(b)(2)'s presumption of abuse is a question of law subject to *de novo* review.

STATEMENT OF THE CASE

On January 10, 2007, Mr. Troy Edwin Tate and Mrs. Elaine Burris Tate (the "TATES") filed a petition for relief under chapter 7 of the Bankruptcy Code. On March 19, 2007, the United States Trustee filed a motion to dismiss the Tates' case for abuse under 11 U.S.C. § 707(b)(1) based on a presumption of abuse that arose as a matter of law under 11 U.S.C. § 707(b)(2) and mandated dismissal. On December 18, 2007, the bankruptcy court granted the United States Trustee's motion and dismissed the Tates' case.[1] This appeal followed.

STATEMENT OF THE FACTS

I. Statutory Framework

A. 2005 Reform Act

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (the "2005 REFORM ACT") significantly amended the Bankruptcy Code by, among other things, adding a new means test for determining whether granting a discharge to a chapter 7 individual debtor with primarily consumer debts would be an abuse.[2] *See* 11 U.S.C. § 707(b)(1). The means test is the "heart" of the 2005 Reform Act's consumer bankruptcy reforms and acts as a "screening mechanism . . . to ensure that debtors repay creditors the maximum they can afford." H.R. Rep. 109-31 at 1 (I) (2005), *as reprinted in* 2005 U.S.C.C.A.N. 88, 89. Congress enacted the means test to prevent debtors from obtaining chapter 7 relief when they have an ability to repay their creditors. Under prior law, "some bankruptcy debtors [were] able to repay a significant portion of their debts," but

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[1] *In re Tate*, No. 07-50028 ERG, 2007 WL 4532122, slip op. (Bankr. S.D. Miss. Dec. 18, 2007).

[2] S. 256, Pub. L. No., 109-8, 119 Stat. 23. The 2005 Reform Act's general effective date is for bankruptcy cases filed on or after October 17, 2005.

were not doing so because the law contained "no clear mandate requiring these debtors to repay their debts." *Id.* at 5 and n.18, *as reprinted in* 2005 U.S.C.C.A.N. 88, 92.

Before the 2005 Reform Act was adopted, section 707(b) authorized dismissal based on a finding that granting a discharge of debts would be a "substantial abuse" of chapter 7. It also required courts to presume that a debtor was entitled to a chapter 7 discharge. The 2005 Reform Act repealed the presumption in favor of granting a chapter 7 discharge and replaced it with a new one: granting a chapter 7 discharge to a debtor is now presumed to be an "abuse" of chapter 7 if a detailed mathematical formula set out in the statute, commonly referred to as the "means test," yields to the debtor a minimum amount of monthly disposable income. *See* 11 U.S.C. § 707(b)(2). The 2005 Reform Act now commands dismissal where the court finds that granting relief would be an "abuse" of chapter 7 under the circumstances described in newly-added subsections (b)(2) and (b)(3). In cases where the presumption of abuse does not arise or is rebutted under subsection (b)(2), section 707(b)(3) allows the court to find abuse where the debtor filed the petition in bad faith or the totality of the circumstances of the debtor's financial situation demonstrates abuse.

B. Section 707(b)(2)'s Means Test

Section 707(b)(2)'s means test requires the bankruptcy court to perform a series of calculations to determine whether granting a chapter 7 discharge to a debtor would be a presumed abuse warranting dismissal of the case or conversion to another chapter of the Bankruptcy Code. *See* 11 U.S.C. § 707(b)(1), 707(b)(2)(A). If the presumption of abuse under section 707(b)(2) arises, the debtor may attempt to rebut the presumption by demonstrating special circumstances that justify income or expense adjustments for which there is no reasonable alternative. 11 U.S.C. § 707(b)(2)(B). If the presumption does not arise or is rebutted, section 707(b)(3) requires the court to consider whether the case is an abuse due to the debtor's bad faith or the totality of the circumstances of the debtor's financial situation demonstrates abuse. 11 U.S.C. § 707(b)(3)(A) and (B).

The means test only applies to debtors whose income is above the applicable state median. 11 U.S.C. § 707(b)(7). To calculate whether such high-income debtors' cases are presumptively abusive under section 707(b)(2), the Bankruptcy Code requires them to file Form 22A, Statement of Current Monthly Income and Means Test Calculation ("FORM 22A" or "MEANS TEST FORM"). 11 U.S.C. §§ 521 and 707(b)(2)(C). This is an Official Form and a part of the Federal Rules of Bankruptcy Procedure. *See* Fed. R. Bankr. P. Official Form 22A.

To implement the mathematical formula set out in section 707(b)(2), the Means Test Form first establishes a debtor's "current monthly income" ("CMI"), which is the debtor's average income for the six calendar months preceding the month of the bankruptcy filing. *See* 11 U.S.C. § 101(10A). If a debtor's annualized CMI is below the applicable state median family income – *i.e.*, if the debtor is a poorer debtor – the debtor's case will not be presumed abusive and cannot be dismissed under the means test. 11 U.S.C. § 707(b)(7). When, however, annualized CMI exceeds the applicable median family income – *i.e.*, the debtor is a higher-income debtor, as is in the Tates' case– section 707(b)(2)(A) prescribes a statutorily mandated calculation that yields the debtor's monthly disposable income by reducing CMI by certain enumerated categories of expenses. *See* 11 U.S.C. § 707(b)(2)(A)(ii), (iii) and (iv). Under the means test's math, disposable income constitutes the presumptive amount debtors can repay creditors. *Id.*

If an above-median debtor's monthly disposable income, determined by deducting allowed expenses from CMI, is equal to or exceeds $166.67 per month (or $10,000 over 60 months), the presumption of abuse arises. 11 U.S.C. § 707(b)(2).[3] If the debtor's monthly disposable income is less than $100.00 per month (or $6,000 over 60 months), the presumption of abuse does not arise. 11 U.S.C. § 707(b)(2)(A)(I). If the debtor's monthly disposable income is between $100 per month and $166.67 per month (between $6,000 and $10,000 over 60 months), the presumption of abuse arises if the disposable income, over 60 months, is sufficient to pay 25 percent of the debtor's nonpriorirty unsecured debt. *Id.*

At issue in this appeal is whether the Tates qualify to deduct on their Means Test Form the transportation ownership expense under the Internal Revenue Services'("IRS") Local Standards to calculate their monthly disposable income.

To determine what expenses can be deducted from CMI in determining current monthly disposable income, section 707(b)(2)(A)(ii)(I) provides that a debtor's "monthly expenses shall be the debtor's *applicable* monthly expense amounts specified under the National Standards and Local Standards and the debtor's actual monthly expenses for the categories specified as Other Necessary Expenses issued by the Internal Revenue Service for the area in which the debtor resides." 11 U.S.C. § 707(b)(2)(A)(ii)(I) (emphasis added). The IRS' Local Standards include transportation and housing related expenses and apportion transportation expenses in two components. *See* IRS Collection Financial Standards, under heading "Local Standards: Transportation," *available at* http://www.irs.gov/individuals/article/0,,id=96543,00.html.[4] The first component includes costs

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[3] Pursuant to section 104 of the Bankruptcy Code, dollar amounts set forth in Title 11 applicable to the presumption of abuse determination under the means test were adjusted by the United States Judicial Conference effective April 1, 2007. 72 Fed. Reg. 7082 (Feb. 14, 2007). This case is not subject to the new dollar amounts.

[4] The IRS revised its Collection Financial Standards, effective October 1, 2007, and such revisions were made applicable to bankruptcy cases filed as of January 1, 2008. *See* IRS Collection Financial Standards, under heading "Local Standards: Transportation," *available at* http://www.irs.gov/individuals/article/0,,id=96543,00.html.. Because the Tates' case was filed on January 10, 2007, only the Collection Financial Standards in effect prior to

associated with operating the vehicle while the second component includes costs associated with financing the vehicle, *i.e.* vehicle ownership. *Id*. This appeal involves only the second component – whether the Tates can claim a transportation ownership expense.

If section 707(b)(2) allows the Tates the full transportation ownership expense deduction, the presumption of abuse does not arise and this case should not be dismissed. However, if the bankruptcy court correctly determined that section 707(b)(2) does not allow the Tates to claim these vehicle ownership deductions in this case, then this Court should affirm the bankruptcy court's decision.

II. Factual Background[5]

Mr. Troy Edwin Tate and Mrs. Elaine Burris Tate filed a voluntary petition for relief under chapter 7 of the Bankruptcy Code on January 10, 2007. (DE 1). Mr. Tate works as a ballast control operator for BP America Production Company and Mrs. Tate is a nursery worker for Trinity United Methodist Church of Picayune, Mississippi. (DE 3). The Tates' debt obligations are primarily consumer debts. (*Id.*). The Tates' nonpriority unsecured debt totals $91,993.29. (*Id.*).

The Tates filed their Means Test Form on January 10, 2007. (DE 5). It listed their current monthly income as $7,830.35, for an annualized monthly income of $93,964.20. (*Id.*). The

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October 1, 2007, are applicable to their case. For the Court's convenience, a true and correct pdf copy of the Collection Financial Standards applicable to this case are attached as Exhibit "A" and incorporated herein by reference. It is important to note, however, that the revisions made by the IRS effective October 1, 2007 do not change any result in this case. As set forth in the current Collection Financial Standards, the Local Standard for Vehicle Operation is still made expressly contingent on the existence of a loan or lease payment on a vehicle. *See id.* As explained by the IRS, the recent revisions to the Local Standards were made to create equal allowances for first and second vehicles, add a separate public transportation allowance and reorganize the manner in which taxpayers in certain counties calculate their transportation operating expenses. *See id.*, under heading "Recent Revisions."

[5] All references to the Record on Appeal are designated by the letters "DE" for "docket entry" and the bankruptcy court's docket entry number.

applicable annualized median family income for a family of four in Mississippi is $47,726.00. (*Id.*). Accordingly, the Tates' current monthly income exceeded the applicable state median family income amount by $46,238.20, which meant the Tates were required to complete the expense portion of Form 22A. (*See* 11 U.S.C. § 707(b)(7)).

The Tates owned four vehicles on the date they filed their bankruptcy petition. (DE 3). The Tates own three vehicles free and clear of liens: a 2001 Chevrolet Silverado, a 1992 Chevrolet Silverado and a 1967 Chevrolet Camaro. (*Id.*). The Tates subsequently abandoned their only secured debt on the fourth vehicle, a 1999 Toyota Solara. (*Id.*).[6] On February 8, 2007, the bankruptcy court entered an order authorizing the secured creditor to repossess and sell the Toyota Solara. (DE 14).

On the Means Test Form the Tates filled out, they claimed deductions under section 707(b)(2) totaling $7,692.69, which resulted in monthly disposable income of $137.66. (DE 5). That was below the threshold of $166.67 required for the presumption of abuse to arise. (*Id.*). In making these calculations, the Tates claimed the IRS Standard transportation ownership/lease expenses for two vehicles on Lines 23 and 24 of their Means Test Form, in the amounts of $471.00 and $332.00, respectively. (DE 5).[7] The Tates claimed a total of $1,146.00 for transportation

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[6] "Abandonment constitutes 'a divestiture of all of the estate's interests in the property ... [P]roperty may be abandoned ... to any party with a possessory interest in it.'" *In re Gibson*, 218 B.R. 900, 904 (Bankr. E.D. Ark. 1997). "The term 'abandonment' is defined to mean 'desert, surrender, forsake, or cede...To give up absolutely ... to relinquish all connection with or concern in; to desert.'" *In re Robertson*, 72 B.R. 2, 4 (Bankr. D. Colo. 1985) (citations omitted). An abandonment of title to property must be 'clear and unmistakable.' *Id*.

[7] In addition to these amounts, the Tates claimed a $343.00 deduction for the IRS Standard "transportation, vehicle operation/public transportation expense" for two or more vehicles on Line 22. (*Id.*). Based on the Internal Revenue Manual, the United States Trustee would permit the Tates an additional $200.00 operating expense per vehicle [for a total deduction of $743.00 on Line 22] because the Tates' vehicles are over six years old. (*See* Internal Revenue Manual, Part 5 [entitled "Collecting Process"], Chapter 8, § 5.8.5.5.2, Treatment of Non-Business Transportation Expenses, which may be found on the IRS website at http://www.irs.gov/irm/part5/ch08s05.html).

deductions on Means Test Form Lines 22, 23 and 24. (*Id.*).

11 U.S.C. § 704(b)(1) requires United States Trustees to review all of the materials debtors file to ensure their accuracy. Upon reviewing the Tates' materials, the United States Trustee determined that section 707(b)(2) did not entitle them to claim the transportation ownership expense deductions on Form 22A because the Tates own their vehicles free and clear of liens. (DE 21, 34). The United States Trustee determined, however, that the Tates were entitled to an extra $200.00 per vehicle for operating expenses on Means Test Form Line 22 because of the age of their vehicles. (*Id.*). Therefore, the United States Trustee calculated that the Tates' total deduction amount for transportation expenses was $743.00. (DE 21). After eliminating the transportation ownership expenses on Means Test Form Lines 23 and 24, the United States Trustee recalculated the Tates' monthly disposable income and determined that the Tates had at least $355.04 per month that could be used to repay creditors. (*Id.*).

Since the amount the United States Trustee calculated exceeded the presumption threshold of $166.67, the United States Trustee filed a statement under section 704(b)(1) on February 16, 2007, that the presumption of abuse arose in the Tates' case. (DE 16).

On March 19, 2007, the United States Trustee moved to dismiss the Tates' bankruptcy case under 11 U.S.C. § 707(b)(1) based on the presumption of abuse under section 707(b)(2). (DE 21). The Tates objected to the United States Trustee's motion to dismiss on March 27, 2007. (DE 24). In their objection, and later in their response brief, the Tates admitted they own their vehicles free and clear of encumbrances. (DE 24, 36). However, the Tates asserted that the language of the 2005

However, even after allowing this additional expense, the United States Trustee determined that the presumption of abuse still arose in this case. (DE 16, 21).

Committee Notes for Form 22A permitted them to deduct their transportation ownership expenses. (*Id.*).

After briefing on the transportation ownership expense issue (DE 34 and DE 36), the bankruptcy court granted the United States Trustee's motion and dismissed the Tates' case under section 707(b)(2). (DE 37, 38). The bankruptcy court held the Tates failed the means test because "the transportation ownership expense should not be taken if no actual car payment exists." (DE 37). The Tates timely filed their notice of appeal from the bankruptcy court's December 18, 2007, dismissal order on December 26, 2007. (DE 44). *See* 11 U.S.C. §158(c)(2); Fed. R. Bankr. P. 8002(a).

SUMMARY OF THE ARGUMENT

The bankruptcy court correctly dismissed this case as an abuse of chapter 7 of the Bankruptcy Code. Under section 707(b)(2) of the Bankruptcy Code, cases are dismissed for abuse when a debtor's income, less statutorily prescribed expenses, leaves more than $166.67 in monthly disposable income. In this case, the bankruptcy court agreed with the United States Trustee that the Tates have at least $355.04 in monthly disposable income because they were not permitted to claim ownership expenses for two vehicles they own free and clear of any loan or lease payment. On appeal, the Tates do not contest the bankruptcy court's conclusion that their case must be dismissed if they improperly claimed transportation expenses for these vehicles. But the Tates argue that they may claim loan or lease payments under the statute even though these payments do not exist.

The bankruptcy court correctly ruled the Tates could not claim vehicle loan or lease payments because the law allows them to claim only "applicable" expenses under section 707(b)(2)(A)(ii)(I), and they own their vehicles free and clear. By using the word "applicable," Congress limited eligibility for expenses under the Local Standards to debtors for whom the expenses *apply*. Because the vehicle ownership expense, intended for acquisition/financing of a vehicle, does not apply with respect to the Tates' vehicles, the bankruptcy court correctly held that they were not eligible to deduct the expenses under the means test.

The bankruptcy court's reading of the statute is identical to the reading that all five appellate courts to have considered the issue to date have given to section 707(b)(2)(A)(ii)(I). It is the best reading of the statutory language because it gives meaning to all the words in section 707(b)(2)(A)(ii)I). On the other hand, the Tates' proffered construction reads the word "applicable" out of the statute altogether.

Reading "applicable" in section 707(b)(2) as requiring a loan or lease payment as a prerequisite to the deduction also has the salutary effect of applying the means tests in a manner that is consistent with the Internal Revenue Service's longstanding application of this standard. Under section 707(b)(2), the means test employs certain standard expenses issued by the IRS. 11 U.S.C. § 707(b)(2)(A)(ii)(I). In applying its standards to taxpayers, the IRS does not allow taxpayers to claim vehicle ownership expenses absent a monthly car payment expense. *See* IRS Collection Financial Standards attached hereto as Exhibit A; *see also* n.4, *supra*. Congress' use of "applicable" in section 707(b)(2) means this expense should be denied to debtors like the Tates, who do not have a car loan or lease, for the same reasons the IRS does not allow taxpayers to claim such phantom expenses.

Finally, the bankruptcy court's order comports with sound notions of public policy and the primary purpose of Congress in passing bankruptcy reform legislation in 2005 – including the amendments at issue in this appeal. The 2005 legislation was intended to ensure that debtors would repay their debts when they can. By not allowing the Tates to claim phantom expenses for their vehicles, the bankruptcy court furthered that purpose.

ARGUMENT

I. THE BANKRUPTCY COURT PROPERLY DISALLOWED THE TATES' CLAIMED VEHICLE OWNERSHIP EXPENSES BECAUSE SUCH EXPENSES ONLY APPLY TO DEBTORS WHO, UNLIKE THE TATES, MAKE PAYMENTS ON ENCUMBERED VEHICLES.

The Tates agree the bankruptcy court could dismiss their case if it correctly ruled they could not claim loan or lease payments on vehicles they own free and clear of such payments. The bankruptcy court's ruling denying these expenses and dismissing their case merits affirmance because the Bankruptcy Code does not allow the Tates to claim such inapplicable expenses.

A. Transportation Ownership Expenses Are Not "Applicable" to the Tates Because They Do Not Make Any Payments for Ownership of a Vehicle.

The Bankruptcy Code allows debtors to claim only transportation ownership expenses that are "applicable" to them. 11 U.S.C. § 707(b)(2)(A)(ii)(I). The Tates have no "applicable" transportation ownership expenses because they do not have secured debt or lease payment obligations for their vehicles. (DE 3). Their attempt to claim expenses they do not have is prohibited by the Bankruptcy Code.

Section 707(b)(2)(A)(ii)(I) of the Bankruptcy Code provides that a "debtor's monthly expenses shall be the *debtor's applicable* monthly expense amounts specified under the . . . Local Standards . . . issued by the Internal Revenue Service. . . ." 11 U.S.C. § 707(b)(2)(A)(ii)(I) (emphasis added). The statute thus expressly provides that before the specific IRS expense amounts may be included in the debtor's allowed monthly expenses, the expense must itself first be applicable to the debtor. *Id.*

The Bankruptcy Code does not define the word "applicable." Where a statutory term is undefined, it is a basic principle of statutory construction that courts should give such terms their ordinary meanings. *E.g., Smith v. U.S.*, 508 U.S. 223, 228 (1993) ("When a word is not defined by statute, we normally construe it in accord with its ordinary or natural meaning.").

The dictionary defines "applicable" to mean "applying or capable of being applied; relevant; suitable; appropriate." *Random House Unabridged Dictionary* (2006).

This ordinary meaning should be given to the term "applicable" as it appears in section 707(b)(2)(A)(ii)(I) since there is no clear indication that Congress intended to give such term a different meaning. *See Thompson v. Goetzmann*, 337 F.3d 489, 498 n.20 (5th Cir. 2003) ("[D]ictionaries are a principal source for ascertaining the ordinary meaning of statutory language."). *See also In re Meade,*[8] EP-07-CV-121-DB, slip op. at 5 (W.D. Tex. Jan 24, 2008); *In re Deadmond*, 2008 WL 1991165 (D. Mont. Jan. 22, 2008); *In re Ransom*, 2007 WL 4625248 at *6 (B.A.P. 9th Cir. Dec. 27, 2007) (recognizing that "applicable," in its ordinary sense, means "capable of or suitable for being applied," and concluding that the vehicle ownership expense is not "capable of being applied to the debtor if he does not make any lease or loan payments.").

Like all five appellate courts that have considered this issue to date,[9] the bankruptcy court in the Tates' case applied the ordinary meaning of "applicable" to deny the Tates' ownership

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[8] A copy of the *Meade* slip opinion is attached hereto as Exhibit "B" and incorporated by reference.

[9] To date, all published lower courts in the Fifth Circuit also have held that a debtor must possess a loan or lease payment in order to take the transportation ownership expense on the means test. *See Meade*, EP-07-CV-121-DB, slip op. at 8 (W.D. Tex. Jan 24, 2008); *In re Brown*, 376 B.R. 601, 603 (Bankr. S.D. Tex. 2007); *In re Ceasar*, 364 B.R. 257, 262 (Bankr. W.D. La. 2007); *In re Pampas*, 369 B.R. 290, 296-97 (Bankr. M.D. La. 2007); *In re Devilliers*, 358 B.R. 849, 864 (Bankr. E.D. La. 2007); *In re Hardacre*,338 B.R. 718, 728 (Bankr. N.D. Tex. 2006); *In re Barraza*, 346 B.R. 724, 728 (Bankr. N.D. Tex. 2006); *In re Oliver*, 350 B.R. 294, 301 (Bankr. W.D. Tex. 2006).

expenses they do not have. Here, the Tates seek to claim an expense for two non-existent loan or lease payments. By inserting the word "applicable" in section 707(b)(2)(A)(ii)(I), Congress limited eligibility for expenses under the Local Standards to a debtor for whom such expenses are "relevant; suitable; appropriate" – thereby excluding the Tates' non-existent expenses.

In contrast to the ordinary meaning of "applicable" that universally has been adopted by appellate courts, the Tates suggest that "applicable" means that debtors may claim ownership expenses they do not have because "applicable" merely refers to "the number of vehicles owned or leased by the debtor and where the debtor resides." Appellants' Br. at 8. Under the Tates' reading, they can claim a vehicle loan or lease payment as an expense on the Means Test Form for each car they own even if they do not have such an expense. This interpretation strips "applicable" of any meaning in the statute. *See, e.g., Deadmond*, 2008 WL 191165 at *4 ("The word ['applicable'] must mean something, and if some monthly expenses are applicable, then other monthly expenses are not applicable."); *Meade*, slip op. at 5 ("If the debtor can claim the deduction, the statute then permits an eligible debtor to select the amount listed in the IRS Standards."); *Ransom*, 2007 WL 4625248 at *6 (granting debtors an allowance for ownership expenses they do not have would "read[] 'applicable' right out of the Bankruptcy Code"); *In re Ross-Tousey*,[10] 368 B.R. at 765 (E.D. Wis. 2007) ("Had Congress intended to indiscriminately allow all expense amounts specified in the National and Local Standards, it would have written 707(b)(2)(A)(ii)(I) [without using the word 'applicable.']"); *In re Hartwick*, 373 B.R. 645, 650 (D. Minn. 2007) (debtor's "actual" expense does not control the amount of the deduction, but the debtor must still have some expense in the first place before the Standard amount becomes "applicable.").

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[10] This case is currently on appeal to the Seventh Circuit, Case No. 07-2503.

Further, in arguing for a contrary interpretation, the Tates overextend the distinction between the words "actual" and "applicable" in section 707(b)(2)(A)(ii)(I). *See* Appellants' Br. at 8-9. They argue that because Congress used both words in the statute, and the words have different meanings, they need not have any "actual" expense for the ownership expense to be "applicable." *Id.* This logic is misguided, however, because, as the *Ross-Tousey* court explained, there is no indication in section 707(b)(2)(A)(ii)(I) that Congress intended the words "applicable" and "actual" to have essentially *opposite* meanings – which is what the Tates argue. *Ross-Tousey*, 368 B.R. at 765. Rather, the better reading of "applicable" in the context of section 707(b)(2)(A)(ii)(I) is that it may have *two* meanings: first, the ownership expense is "applicable" if the debtor makes a loan or lease payment on a vehicle, and second, the amount allowed to the debtor is the "applicable" amount provided under the IRS Local Standards, and not the "actual" amount. *See Hartwick*, 373 B.R. at 653; *Ross-Tousey*, 368 B.R. at 765 ("This reading gives meaning to the distinction between 'applicable' and 'actual' without taking a further step to conclude that 'applicable' means 'nonexistent' or 'fictional.'").

By giving the term "applicable" its logical, common-sense meaning, a determination of allowable expenses under the means test becomes a two-step process. The first step is eligibility-*i.e.*, does the debtor qualify for a transportation ownership expense? If so, then the second step is to quantify the expense amount the eligible debtor is allowed by looking at the IRS Standard amounts that are specified for the number of vehicles owned by the debtor and where the debtor lives. The Bankruptcy Court properly rejected the Tates' reading because it impermissibly skips the first step of determining whether they are eligible for the ownership expense by virtue of having a loan or lease payment for a vehicle. Instead, it proceeds directly to the second by only considering the amount the IRS would allow eligible taxpayers to claim for ownership of two vehicles. *Accord In re Devilliers*, 358 B.R. 849, 864 (Bankr. E.D. La. 2007) (concluding that the ownership expense "is not the equivalent of an allowance for depreciation or an invitation for a debtor to 'save' for the ultimate replacement of an existing vehicle . . . . [instead, it is] designed to assist with the acquisition of a vehicle on credit").

B. The Bankruptcy Court's Interpretation of "Applicable" in Section 707(b)(2) has the Salutary Effect of Treating the IRS Transportation Standard the Same Way the IRS Treats These Expenses.

Prohibiting the Tates from deducting nonexistent transportation ownership expenses has the additional benefit of treating inapplicable expenses in bankruptcy cases the same way the IRS has long treated them. In providing which deductions a debtor may take under the means test, Congress specifically stated that a debtor is permitted to deduct "the debtor's *applicable* monthly expense amounts specified under the . . . Local Standards. . .issued by the *Internal Revenue Service*." 11 U.S.C. § 707(b)(2)(A)(ii)(I) (emphasis added). Accordingly, how the IRS applies the standards that it developed for its debt collection purposes is instructive on the question of how the same standards might be applied in bankruptcy cases under section 707(b)(2). *See, e.g., Hartwick*, 373 B.R. at 650-51 ("[I]n order to determine whether the expense Standards issued by the IRS are 'applicable,' the most logical resource to consult is the IRS."). *See also In re Slusher*, 359 B.R. 290, 309 (Bankr. D. Nev. 2007) ("[I]f guidance is sought on the meaning of the IRS standards that Congress incorporated into the Bankruptcy Code, practical reason would suggest that court should consider the full manner by which the IRS uses these standards.").

Contrary to the Tates' assertion that it would be "inappropriate" to consider how the IRS applies its own standards [Appellants' Br. at 6], legislative history of the 2005 Reform Act fully supports the conclusion that Congress intended for the IRS Standards to govern here. The House Report accompanying the Act provided that "[i]n addition to other specified expenses, the debtor's monthly expenses – exclusive of any payments for debts (unless otherwise permitted) – must be the applicable monthly amounts set forth in the [IRS] Financial Analysis Handbook as Necessary Expenses under the National and Local Standards categories. . ." H.R. Rep. No. 109-31(I), at 99-100 & n.65 (2005) (also noting that transportation expenses under the Local Transportation Standards include expenses for "vehicle payments").

The IRS's Collection Financial Standards in effect when the Tates filed their case corroborate the bankruptcy court's construction of the term "applicable." The Collection Financial Standards note that the transportation standards consist of nationwide figures for monthly loan or lease payments, and additional amounts for monthly operating costs. However, "[i]f a taxpayer has no car payment, or no car, [only] the operating costs portion of the transportation standard is used to come up with the allowable transportation expense." Ex. A; *see* n.4*, supra*. *See also* Internal Revenue Manual, Financial Analysis Handbook, Pt. 5, ch. 15, § 5.15.1.7(4.B)); IRS Financial Analysis Handbook, Pt. 5, ch. 15, § 5.15.1.7(4.B) (providing for purposes of IRS collection that if taxpayer has no vehicle loan or lease payments, the ownership cost is not applied), *available at* www.irs.gov/irm/part5/ch15s01.html.

Those IRS Collection Financial Standards reveal that the IRS's ownership expense was calculated based on car financing data.[11] This offers further guidance that the ownership expense was intended to account for the expense of financing a vehicle over time and is inapplicable if a debtor has no such acquisition financing expense. *See* Ex. A (stating that the vehicle ownership

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[11] *See* n.4, *supra*.

expense calculated by the IRS is based on the "five-year average of new and used car financing data compiled by the Federal Reserve Board of Governors"). It is not simply a cost associated with owning a car, such as repair or maintenance. *Id.* As such, the IRS does not treat the "ownership cost" expense as applicable when a taxpayer does not have a monthly expense related to financing a car. The same thing happens under the means test because the means test allows debtors to claim only an "applicable" car expense – not a phantom one.

Finally, as discussed above, considering IRS practice in interpreting "applicable" expenses in section 707(b)(2)(A)(ii)(I) does not, as the Tates suggest [Appellants' Br. at 8-9], negate the section's later allowance of "actual" monthly expenses in the IRS categories of Other Necessary Expenses. Rather, "a natural reading" of section 707(b)(2)(A)(ii)(I) indicates that the words "actual" and "applicable" limit the relevant expense deductions in different ways. *Slusher*, 359 B.R. at 308 ("Had Congress intended to indiscriminately allow all expense amounts specified in the National and Local Standards, it would have written section 707(b)(2)(A)(ii)(I) to read, 'The debtor's monthly expenses shall be the monthly amounts specified under the National Standards and the Local Standards . . . .' rather than 'The debtor's monthly expenses shall be *the debtor's applicable* monthly expense amounts specified under the National and Local Standards.'").

C. The Construction of Section 707(b)(2)(A)(ii)(I) Adopted To Date By All Appellate Courts Better Implements Bankruptcy Policy.

The Tates' proffered statutory construction would lead to arbitrary and unfair results, and would contribute to bankruptcy abuse. Under their interpretation of section 707(b)(2)(A)(ii)(I), "debtors who own two unusable cars rusting in their back yard would be entitled to the windfall benefit of both ownership and operating expense deductions although they, in fact, incur no expenses by owning the vehicles." *Hartwick*, 373 B.R. at 652 (citations omitted). This statutory reading has been rejected by appellate courts because it "defies common sense." *Deadmond*, 2008 WL 191165 at *4.

The Tates claim that the interpretation of "applicable" suggested by the United States Trustee and adopted by all five appellate courts to consider it, creates an arbitrary distinction between a hypothetical debtor who has a car payment of only $100 per month who would be entitled to the full $471 Local Standard for ownership and another debtor who does not have a car loan and cannot take any deduction. Appellants' Br. at 10. The Tates suggest that this result unfairly discriminates between two similarly situated debtors. This is wrong, however, because these two debtors are *not* similarly situated. The debtor who does not have a car payment, like the Tates, has no "applicable" expense. For this reason, appellate decisions on 707(b)(2)(A)(ii)(I) have not found such distinctions persuasive. *See Ross-Tousey*, 368 B.R. at 767-68 (it is "unreasonable to expect that the complex and individualized issues involving a debtor's finances are meant to be addressed through an objective and standardized system like the means test."); *Hartwick*, 373 B.R. at 652 ("[A] line must be drawn somewhere, and any interpretation will result in some unfairness.").[12]

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[12] Moreover, the Tates' hypothetical fails to recognize that the result of the means test is not necessarily a guarantee that the hypothetical debtor with a car payment will receive a discharge while the debtor with no applicable expense will not. A case filed by *either* debtor could still be subject to dismissal under section 707(b)(3) based on the totality of the circumstances of their financial situation if the debtor has an ability to repay his or her debts. Section 707(b) allows cases to be dismissed in two ways. First, above-median income debtors can have their cases dismissed under section 707(b)(2) when they fail the means test. Second, debtors with an actual ability to repay creditors can have their cases dismissed under section 707(b)(3) even if they pass the means test. See 11 U.S.C. § 707(b)(3)(B) (requiring that in cases where presumption of abuse "does not arise or is rebutted," the court shall consider whether dismissal is proper because "the totality of the circumstances . . . of the debtor's financial situation demonstrates abuse"). *Cf. In re Cortez*, 457 F.3d 448, 456 (5th Cir. 2006) (considering a debtor's ability to pay in deciding whether to dismiss a debtor's case under the "totality of the circumstances" analysis that applied to the pre-2005 Reform Act section 707(b)).

By allowing debtors to deduct only "applicable" expenses, section 707(b)(2)(A)(ii)(I) ensures debtors do not evade repaying their debts when they can. *See* H.R. Rep. No. 109-31 (I) at 1 (2005), *reprinted in* 2005 U.S.C.C.A.N. 88, 89 (noting that the "heart" of the 2005 Reform Act was to "ensure that debtors repay creditors the maximum they can afford.").

Not surprisingly, all five appellate courts that have decided the issue in this appeal have interpreted "applicable" in section 707(b)(2)(A)(ii)(I) in the same manner as the court below, in part, because the Tates' proffered reading is not faithful to the purpose underlying section 707(b)(2)'s means test. As the *Ross-Tousey* court noted, "if it really is that simple, the statute would not seem to achieve its purpose" of ensuring that debtors are allowed expenses for the necessities of life but pay creditors from what remains. *Ross-Tousey*, 368 B.R at 766 (E.D. Wis. 2007). A debtor's ability to pay creditors is not affected by mere vehicle *ownership* but by *payments* on a car. Accordingly, section 707(b)(2)(A)(ii)(I) does not focus on how many cars a debtor owns, but how many cars he or she makes payments on every month. *Id.* ("The statute is only concerned about protecting the debtor's ability to continue owning a car, and if the debtor already owns the car, the debtor is adequately protected."); *see also Hartwick*, 373 B.R. at 652 (same). As such, interpreting "applicable" in section 707(b)(2)(A)(ii)(I) to permit the Tates to claim vehicle expenses based not on their actual car payments, but solely based on the number of vehicles they own, would not further the means test's goal of maximizing payments to creditors where possible.

D. The Committee Notes to Official Form 22A Do Not Support the Tates' Interpretation of 11 U.S.C. § 707(b)(2)(A)(ii)(I).

The Tates contend that their interpretation of section 707(b)(2)(A)(ii)(I) is supported by Official Form 22A. Appellants' Br. at 10-12. Specifically, the Tates cite the Advisory Committee

Note to the Form, which provides that "amounts specified by the IRS in the Local Standards are treated by the IRS as a cap on actual expenses, but because § 707(b)(2)(A)(ii)(I) provides for deduction in the 'amounts specified under the Local Standards,' the forms treat these amounts as allowed deductions." Advisory Comm. Notes on Forms 22A, 22B, & 22C, p. 3, *available at* http://www.uscourts.gov/bkforms/bankruptcy_forms.html.

The Tates' reliance on the Form and the Committee Note is wrong for two reasons.

First, not even the Bankruptcy Rules, much less the notes to them, may substitute Bankruptcy Code provisions. *See* 28 U.S.C. § 2075 (bankruptcy rules cannot modify rights). For that reason, the Committee Note to the Rules cannot change what "applicable" means in 11 U.S.C. § 707(b)(2)(A)(ii)(I). "[N]ational or local forms are only valid to the extent that they conform to the substantive provisions of the Bankruptcy Code," and "it is axiomatic that guidelines in a form cannot stand as independent authority in opposition to the Bankruptcy Code itself." *See Ransom*, 380 B.R. at 805, n.13.

______Second, the Tates misread the Committee Note because the question here is not whether the expense categories covered by the IRS Standards apply in bankruptcy as an allowance (*i.e.*, debtors get the full amount if eligible) or a cap on actual expenses (*i.e.*, debtors get the lesser of the Standard or their actual car payment). Instead, the question is whether a debtor qualifies for the IRS Standard allowance in the first place for an expense he does not even incur. If the debtor qualifies for the expense because he *has* an applicable monthly expense, he can deduct the full amount of the applicable expense that is specified under the IRS Local Standards under the means test, regardless of the amount he actually spends. Even though the *amount* of the expense deduction is an allowance and is not variable based on a debtor's "actual" expenses, the expense deduction is, like other expense deductions, only available if a debtor in fact incurs expenses in the first place – if it is *applicable*. *See Ross-Tousey*, 368 B.R. at 766 (analogizing the eligibility requirement for vehicle ownership expenses under the IRS Local Standards to eligibility requirements to claim individuals as dependents and receive a standardized income tax exemption under the Internal Revenue Code).

______As discussed above, the Bankruptcy Code prohibits debtors who, like the Tates, have no "applicable" vehicle ownership expense from deducting such expenses under the means test. As a result, neither the Means Test Form nor the committee note to the form may be read to contravene this prohibition.

CONCLUSION

______For these reasons, the United States Trustee respectfully requests this Court affirm the order entered below.

______RESPECTFULLY SUBMITTED, this the 29th day of February, 2008**.**

R. MICHAEL BOLEN
United States Trustee
Region 5, Districts of
Louisiana and Mississippi

By: */s/Christopher J. Steiskal*
CHRISTOPHER J. STEISKAL

Christopher J. Steiskal (MSB #101654)
Department of Justice
Office of the United States Trustee
100 West Capitol Street, Suite 706
Jackson, MS 39269
TEL: (601) 965-5241
FAX: (601) 965-5226
EMAIL: christopher.j.steiskal@usdoj.gov

OF COUNSEL:

ROBERTA A. DEANGELIS
Acting General Counsel

P. MATTHEW SUTKO
MELISSA R. BURGESS
Executive Office for United States Trustees
U.S. Department of Justice
20 Massachusetts Avenue, NW
Washington, DC 20530

CERTIFICATE OF SERVICE

I, CHRISTOPHER J. STEISKAL, do hereby certify that a copy of the foregoing pleading has been served this day on the below named individual(s) via first class U.S. Mail at the address listed below or by Notice of Electronic Filing via the email address on file with the court's CM/ECF system:

Mary Schillesci McPherson, Esq.	Kimberly R. Lentz, Esq.
MCPHERSON & MCPHERSON	CHAPTER 7 TRUSTEE
2434 Highway 53 South	2012 23rd Avenue
Poplarville, MS 39470	Gulfport, MS 39501

DATED, this the 29th day of February, 2008.

/s/Christopher J. Steiskal
CHRISTOPHER J. STEISKAL

Internal Revenue Service
United States Department of the Treasury

Collection Financial Standards

General

Collection Financial Standards are used to help determine a taxpayer's ability to pay a delinquent tax liability.

Allowances for food, clothing and other items, known as the National Standards, apply nationwide except for Alaska and Hawaii, which have their own tables. Taxpayers are allowed the total National Standards amount for their family size and income level, without questioning amounts actually spent.

Maximum allowances for housing and utilities and transportation, known as the Local Standards, vary by location. Unlike the National Standards, the taxpayer is allowed the amount actually spent or the standard, whichever is less.

Food, Clothing and Other Items

National Standards for reasonable amounts have been established for five necessary expenses: food, housekeeping supplies, apparel and services, personal care products and services, and miscellaneous.

All standards except miscellaneous are derived from the Bureau of Labor Statistics (BLS) Consumer Expenditure Survey (CES). The miscellaneous standard has been established by the IRS.

Alaska and Hawaii

Due to their unique geographic circumstances and higher cost of living, separate standards for food, clothing and other items have been established for Alaska and Hawaii .

Housing and Utilities

The housing and utilities standards are derived from Census and BLS data, and are provided by state down to the county level.

Transportation

The transportation standards consist of nationwide figures for monthly loan or lease payments referred to as ownership costs, and additional amounts for monthly operating costs broken down by Census Region and Metropolitan Statistical Area (MSA). Public transportation is included under operating costs. A conversion chart has been provided with the standards which shows which IRS districts fall under each Census Region, as well as the counties included in each MSA. The ownership cost portion of the transportation standard, although it

tabbies EXHIBIT "A"

applies nationwide, is still considered part of the Local Standards.

The ownership costs provide maximum allowances for the lease or purchase of up to two automobiles if allowed as a necessary expense. The operating costs are derived from BLS data.

If a taxpayer has a car payment, the allowable ownership cost added to the allowable operating cost equals the allowable transportation expense. If a taxpayer has no car payment, or no car, only the operating costs portion of the transportation standard is used to come up with the allowable transportation expense.

Recent Revisions

The Local Standards for housing and utilities and transportation were revised on 02/01/06 to:

- add family size to the housing and utilities allowances (two or less, three, and four or more);
- base automobile ownership/leasing costs on the five-year average of new and used car financing data compiled by the Federal Reserve Board of Governors; and,
- reflect updated information from the Bureau of Labor Statistics.
- Housing and Utility Standards have been established in 2006 for U.S. Territories

The revised Local Standards for housing and utilities and transportation are effective for financial analysis conducted on or after January 1, 2006.

FILED
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CLERK, U.S. DISTRICT COURT
WESTERN DISTRICT OF TEXAS
BY ________ DEPUTY

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF TEXAS
EL PASO DIVISION

IN RE: LYNN MEADE, **Debtor**	§ § §	
LYNN MEADE, **Appellant**	§ § §	
v.	§	**EP-07-CV-121-DB**
CHARLES F. McVAY, United States Trustee, Region 7, **Appellee.**	§ § § § §	

APPEAL FROM THE UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF TEXAS
EL PASO DIVISION
CASE NO. 06-31066-RCM, CHAPTER 7

Appellant Lynn Meade ("Meade") filed a brief on April 20, 2007, appealing the United States Bankruptcy Court's ("Bankruptcy Court") February 28, 2007 "Order On Motion Of The United States Trustee To Dismiss Under 11 U.S.C. § 707(b)." On May 7, 2007, Appellee Charles F. McVay, United States Trustee, Region 7 ("U. S. Trustee"), filed a "Brief Of The Appellee Charles F. McVay United States Trustee" ("Response"). After due consideration, the Court affirms the Bankruptcy Court's dismissal of Meade's Petition for the reasons that follow.

BACKGROUND

This is an appeal arising from an Order of the United States Bankruptcy Court, dismissing a Petition on September 30, 2006, wherein Meade sought relief under Chapter 7 of the Bankruptcy Code. The case stems from Meade's attempt to claim a Transportation Ownership/Lease Expense without having an ownership payment. On said date, Meade filed a petition for relief under Chapter 7 of the Bankruptcy Code, which included the Statement of

EXHIBIT
"B"

Current Monthly Income and Means Test Calculation ("Means Test"). The Means Test uses a complex mathematical formula - set out in § 707(b)(2) - to calculate a debtor's disposable monthly income. A disposable monthly income greater than $166.67 gives rise to a presumption of abuse and requires dismissal of the case as an abuse of Chapter 7 Bankruptcy proceedings. *See* 11 U.S.C.A. § 707(b)(2)(A)(ii)(I).

Because Meade's monthly income exceeded the median Texas monthly income,[1] she was required to complete the expense portion of the Means Test. Therein, Meade claimed monthly expenses greater than her income, resulting in a negative monthly income.[2] Although Meade did not have a vehicle purchase or lease payment, she deducted $471.00 as a "Local Standards" Transportation Ownership/Lease Expense. Meade owns one vehicle, a 1996 Subaru Legacy Wagon, outright and free of any liens. The U.S. Trustee contested this deduction, and substituted a $200 deduction, pursuant to Internal Revenue Service ("IRS") guidelines.[3] Meade's disposable monthly income was then calculated at $303.97, based on the U.S. Trustee's expense

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[1] Meade's monthly income - $3,830.00 ($45,963.60 annual) - was greater than the corresponding median Texas monthly income.

[2] Meade's disposable monthly income was calculated at negative $6.03 after deducting $3,836.33 in monthly expenses.

[3] The IRS permits a $200 deduction for operating a vehicle over six years old, and/or with reported mileage of at least 75,000 miles, with no reported loan or lease payment obligation. *See* INTERNAL REVENUE SERVICE, UNITED STATES DEP'T OF TREASURY, INTERNAL REVENUE MANUEL, FINANCIAL ANALYSIS HANDBOOK, TREATMENT OF NON-BUSINESS TRANSPORTATION EXPENSES, OWNERSHIP EXPENSES, Part 5, Chapter 15 § 5.8.5.5.2(3), [hereinafter FINANCIAL ANALYSIS HANDBOOK] http://www.irs.gov/irm/part5/ch08s05.html.

adjustment, along with other minor adjustments,[4] giving rise to a presumption of abuse of the bankruptcy proceedings.

On December 8, 2006, the U.S. Trustee filed a Motion to Dismiss for an abuse of Chapter 7 Bankruptcy Proceedings. The Bankruptcy Court granted the Motion to Dismiss, finding that Meade's case was presumptively abusive, and that the debtor failed to demonstrate special circumstances to rebut that presumption.[5] The appeal from the Bankruptcy Court's ruling ensued.

STANDARD OF REVIEW

Title 28 U.S.C. § 158 confers jurisdiction on district courts to hear appeals from the final judgments, orders, and decrees of bankruptcy courts sitting within the same judicial district. 28 U.S.C.A. § 158(a)(1) (West 2006). When a district court reviews a bankruptcy court's decision, it functions as an appellate court and utilizes the same standard of review generally applied by a federal court of appeals. In general, "a bankruptcy court's findings of fact are subject to the clearly erroneous standard of review and conclusions of law are reviewed de novo." *In re Smyth*, 207 F.3d 758, 761 (5th Cir. 2000) (citing *Matter of Sadkin*, 36 F.3d 473, 475 (5th Cir. 1994)). The issue on appeal is whether a debtor is allowed, under 11 U.S.C. § 707(b)(2)(A)(ii)(I), to claim an expense for vehicle financing when the debtor has no vehicle financing expense. As the issue before the Court involves a question of law, the Court reviews the Bankruptcy Court's decision *de novo*.

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[4] Meade did not contest these incidental adjustments, nor does she raise the issue in the instant appeal.

[5] Meade does not appeal the Bankruptcy Court's decision stating that she failed to demonstrate special circumstances to rebut the presumption of abuse.

DISCUSSION

In her appeal, Meade argues three points of law: (1) the plain language of the Bankruptcy Code allows her to deduct a Transportation Ownership/Lease Expense even though she does not have an ownership payment; (2) case law precedent allows her to claim said deduction; and (3) public policy should allow for said deduction. The Court addresses Meade's contentions in turn.

1. The Bankruptcy Code

Meade contends that a plain reading of § 707(b)(2)(A)(ii)(I) allows her to deduct a transportation ownership expense in the amount of $471.00, although Meade does not have an existing vehicle ownership payment. In other words, Meade argues that the statute permits debtors to claim the Local Standard ownership expense based on their possession of a vehicle. The U.S. Trustee responds that the statute plainly requires a two-step determination to deduct the appropriate transportation expense, the first of which requires the debtor to have an ownership expense. The Court finds Meade's argument unconvincing.

The plain language of a statute is regarded as conclusive, with the exception of rare circumstances in which the result of a literal application directly contradicts the drafters' intent. *See United States v. Ron Pair Enter. Inc.*, 489 U.S. 235, 242 (1989). Generally, statutory interpretation requires a court to accord undefined statutory terms their ordinary and common meaning. *See Burns v. Alcala*, 420 U.S. 575, 580-81 (1975).

The statute at issue reads, in relevant part:

> The debtor's monthly expenses shall be the debtor's *applicable* monthly expense amounts specified under the National Standards and Local Standards, and the debtor's *actual* monthly expenses for

> the categories specified as Other Necessary Expenses issued by the Internal Revenue Service for the area in which the debtor resides . . .

11 U.S.C.A. § 707(b)(2)(A)(ii)(I) (West 2005) (emphasis added). The statute permits a debtor to deduct "applicable" monthly expenses as defined by the IRS National and Local Standards ("IRS Standards"), and "actual" monthly expenses that the IRS defines as "Other Necessary Expenses." *In re Pampas*, 369 B.R. 290, 295-96 (Bankr. M.D. La. 2007). The outcome of the instant case hinges on the plain meaning of the term "applicable" and in reconciling Congress' intent with use of the term "actual" in the same sentence.

"Applicable" is defined as "capable of or suitable for being applied: APPROPRIATE." MERRIAM WEBSTER'S COLLEGIATE DICTIONARY 56 (10th ed. 1996). In the statute, "applicable" is positioned before the phrase "monthly expense amounts specified under the [standards]."[6] Placement of the term "applicable" indicates that the transportation ownership expense is to be deducted only by the appropriate debtor. In other words, the debtor must be eligible to claim the deduction by having an existing monthly transportation ownership expense. If the debtor can claim the deduction, the statute then permits an eligible debtor to select the amount listed in the IRS Standards. Pursuant to Meade's reading, the debtor would be automatically eligible for a standard deduction - the sole determination being the selection of an amount based on the applicable geographic location. Contrary to Meade's contention, the Court finds that the plain reading of the Bankruptcy Code allows a deduction for transportation ownership expenses, but only by those debtors who are eligible to declare such deductions.

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[6] The statute does not state, "The debtor's monthly expenses shall be the debtor's monthly expense amounts specified under the *applicable* [] Standards," as argued by Meade.

Further, Meade posits that Congress' decision to use "applicable" rather than "actual" evinces congressional intent that a debtor's existing, or non-existing, expense is irrelevant for purposes of claiming the transportation ownership deduction. "Actual" is defined as "existing in act and not merely potentially . . . . existing in fact or reality." MERRIAM WEBSTER'S COLLEGIATE DICTIONARY 12. The term "actual" is positioned before the phrase, "for the categories specified as Other Necessary Expenses," indicating that debtors may deduct their existing costs in this specific category. Thus, the statute permits deductions in an amount equal to debtors' existing costs in "other" categories. In contrast, for the transportation category, Congress intended all eligible debtors - but only eligible debtors - to have a standard across-the-board deduction. *See In re Pampas*, 369 B.R. at 296.

Additional support for the Court's statutory interpretation is found in the IRS Standards.[7] The IRS Standards recognize two sub-categories of transportation expenses: "ownership costs," and "operating costs."[8] "Ownership costs" are based on the "five-year

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[7] Congress intended courts to utilize current IRS policies to define statutory terms and calculate expenses. *See Pampas*, 369 B.R. at 296-97. *See also, e.g., In re Medina*, 362 B.R. 799, 802 (Bankr. S.D. Tex. 2007) (discussing the utilization of IRS guidelines as one of three possible means for interpreting a term not expressly defined in the Bankruptcy Code). While courts are not bound to follow IRS procedures and standards, they should be used as guides for interpreting the Bankruptcy Code. *See In re Ceasar*, 364 B.R. 257, 262 (Bankr. W.D. La. 2007); *see also Pampas*, 369 B.R. at 297 n.29.

[8] According to the IRS:

> The transportation standards consist of nationwide figures for monthly loan or lease payments referred to as *ownership costs*, and additional amounts for monthly operating costs . . . . If a taxpayer has a car payment, the allowable ownership cost added to the allowable operating cost equals the allowable transportation expense. If a taxpayer has *no car payment only the operating costs portion of the transportation standard is used* to come up with the

(continued...)

average of new and used car *financing* data compiled by the Federal Reserve Bureau of Governors."[9] Thus, the IRS Standards emphasize acquisition expenses, rather than maintenance or operating expenses, indicating that ownership and maintenance are separate and distinct expenses. *See id.* In fact, the IRS indicates in the Financial Analysis Handbook that car owners without a car payment should exclude that expense in calculating the total transportation expense. FINANCIAL ANALYSIS HANDBOOK § 5.15.1.7(4.B). Thus, like the IRS, the Court interprets the Bankruptcy Code as excluding a debtor's deduction of an "ownership" expense when the debtor does not have an existing car payment. Therefore, the Court is of the opinion that the plain meaning of "applicable" necessitates an existing ownership or lease payment for a debtor to claim an ownership or lease payment deduction.

Here, it is undisputed that Meade does not have an ownership or finance payment on her sole vehicle, a 1996 Subaru. As a result, Meade is not eligible to claim a Transportation Ownership/Lease Expense in the amount of $471. Therefore, the Court is of the opinion that the Bankruptcy Court's decision denying Meade's deduction was accurate, and its decision to dismiss Meade's bankruptcy proceeding is affirmed.

2. *Existing Case Law*

Meade avers that a "plethora" of case law supports her reading of the Bankruptcy

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(...continued)

allowable transportation expense.

FINANCIAL ANALYSIS HANDBOOK, ALLOWABLE EXPENSE OVERVIEW, Part 5, Chapter 15 § 5.15.1.7(4.B), http://www.irs.gov/irm/part5/ch15s01.html (emphasis added).

[9] INTERNAL REVENUE SERVICE, COLLECTION FINANCIAL STANDARDS, http://www.irs.gov/individuals/index.html (follow "Collection Financial Standards" hyperlink; scroll down to "Recent Revisions") (emphasis added).

Code. In that regard, Meade posits that *In re Fowler*, 349 B.R. 414 (Bankr. D. Del. 2006), and its progeny[10] hold precedential value before the Court. Unfortunately for Meade, her cited cases are not precedent in the United States Court of Appeals for the Fifth Circuit ("Fifth Circuit"). Further, the bankruptcy court decisions from within the Fifth Circuit have expressly rejected *Fowler* and Meade's line of reasoning.[11] What is more, Meade concedes that Fifth Circuit case law does not support her contention. Thus, the Court finds the decisions issued by the bankruptcy courts within the Fifth Circuit persuasive. Therefore, the Court is of the opinion that the Bankruptcy Court properly dismissed Meade's claim, and its decision is affirmed.

3. *Public Policy*

Lastly, Meade argues that the Court's affirmation of the Bankruptcy Court's judgment "could lead to some absurd result," based on public policy grounds. Meade's public policy argument mirrors the line of reasoning found in the *Fowler* opinion. *See Fowler* 349 B.R. at 418. As stated above, the Court declines to follow the *Fowler* decision. Therefore, as the Court had disposed of Meade's argument above, it need not address her public policy argument. Thus, the Court is of the opinion that the Bankruptcy Court's decision was appropriate and should be affirmed.

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[10] *See, e.g., In re Wilson*, 356 B.R. 114 (Bankr. D. Del. 2006); *In re Haley*, 354 B.R. 340 (Bankr. N.H. 2006); *In re Hartwick*, 352 B.R. 867 (Bankr. D. Minn. 2006), *rev'd in part Fokkena v. Hartwick*, 373 B.R. 645, 649 (D. Minn. 2007) (holding that debtor who owned her car outright was not entitled to take standard vehicle ownership deduction); *In re Farrar-Johnson*, 353 B.R. 224 (Bankr. N.D. Ill. 2006); *In re Demonica*, 345 B.R. 895 (Bankr. N.D. Ill. 2006).

[11] *See, e.g., Ceasar*, 364 B.R. at 262 (holding that no ownership allowance could be claimed on a car owned free and clear of liens); *In re Devilliers*, 358 B.R. 849 (Bankr. E.D. La. 2007) (same); *Pampas* 369 B.R. 290 (same); *In re Barraza*, 346 B.R. 724 (Bankr. N.D. Tex. 2006) (same); *In re Hardacre*, 338 B.R. 718 (Bankr. N.D. Tex. 2006) (same); *In re Oliver*, 350 B.R. 294 (Bankr. W.D. Tex. 2006) (same).

CONCLUSION

The Court finds that the Bankruptcy Court properly dismissed Meade's Chapter 7 Petition as an abuse of bankruptcy proceedings, and affirms its decision. First, the plain reading of § 707(b)(2)(A)(ii)(I) requires the debtor to qualify for a deduction by having an existing ownership or lease payment on a vehicle before selecting the applicable deduction amount. Second, Meade's cited case law has been expressly rejected by a line of decisions issued from bankruptcy courts within the Fifth Circuit, which the Court finds persuasive. Finally, the Court declines to address Meade's policy argument, because it stems from case law the Court rejects. Based on the foregoing analysis, the Court affirms the decision of the Bankruptcy Court.

Accordingly, **IT IS HEREBY ORDERED** that the United States Bankruptcy Court's Order Granting Motion to Dismiss entered on February 28, 2007, is **AFFIRMED**.

SIGNED this **24th** day of **January, 2008.**

THE HONORABLE DAVID BRIONES
UNITED STATES DISTRICT JUDGE

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WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*
In re: Troy Edwin Tate and Elaine Burris Tate (Troy Edwin Tate and Elaine Burris Tate v. R. Michael Bolen, United States Trustee)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*
5th Cir.

3. ("CCN") ***CURRENT*** CASE NO.
No.: 08-60953

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*
No.: 1:08-cv-32
Court: S.D. Miss.
(Identify judge & cite, if any)

5. ("SO") ***SOURCE***
U.S. TRUSTEES

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*
Filed: December 30, 2008
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7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g., "UST/OGC"]*
Christopher J. Steiskal, David I. Gold, P. Matthew Sutko, R. Michael Bolen
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s)
• Did the bankruptcy court and the district court err in ruling that the debtors could not claim vehicle ownership expense amounts under the means test on vehicles for which they have no vehicle ownership expenses?

&

√ Any Miscellaneous ***BACKGROUND***

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IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

In re TROY EDWIN TATE AND
ELAINE BURRIS TATE,

Debtors.

TROY EDWIN TATE AND
ELAINE BURRIS TATE,

Debtors-Appellants,

v.

R. MICHAEL BOLEN,

United States Trustee-Appellee.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF MISSISSIPPI

BRIEF FOR THE UNITED STATES TRUSTEE
AS APPELLEE

R. MICHAEL BOLEN
United States Trustee

RAMONA D. ELLIOTT
General Counsel
P. MATTHEW SUTKO
Associate General Counsel
DAVID I. GOLD
Trial Attorney
Executive Office for United States Trustees
Department of Justice
20 Massachusetts Avenue, N.W.
Washington, D.C. 20530

CHRISTOPHER J. STEISKAL
Trial Attorney
Office of the United States Trustee
Department of Justice
100 W. Capitol Street, Suite 706
Jackson, MS. 39269
Tel: (601) 965-5241 ext. 130
Fax: (601) 965-5226
Email: christopher.j.steiskal@usdoj.gov

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TROY EDWIN TATE AND
ELAINE BURRIS TATE,
Debtors-Appellants,
v.
R. MICHAEL BOLEN,
United States Trustee-Appellee.

CERTIFICATE OF INTERESTED PERSONS

The undersigned counsel of record for the United States Trustee as Appellee certifies that the following listed persons and entities as described in the fourth sentence of Rule 28.2.1 have an interest in the outcome of this case. These representations are made in order that the Judges of this Court may evaluate possible disqualification or recusal.

1. Troy Edwin Tate, Elaine Burris Tate–Appellants;
2. Mary S. McPherson, McPherson & McPherson, Attorney of Record for Appellants;
3. R. Michael Bolen, United States Trustee–Appellee
4. Ramona D. Elliot, P. Matthew Sutko, David I. Gold, Christopher J. Steiskal, Attorneys of Record for Appellee.

Christopher J. Steiskal
CHRISTOPHER J. STEISKAL
ATTORNEY OF RECORD FOR APPELLEE

STATEMENT CONCERNING ORAL ARGUMENT

As this is a matter of first impression in this Circuit, the United States Trustee requests oral argument.

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JURISDICTIONAL STATEMENT

On December 18, 2007, the United States Bankruptcy Court for the Southern District of Mississippi entered a final order granting the United States Trustee's motion to dismiss Troy Edwin Tate's and Elaine Burris Tate's (the "Tates") case under 11 U.S.C. §§ 707(b)(1) and (2). (R. 1).[1] The bankruptcy court had jurisdiction over that proceeding under 28 U.S.C. §§ 157 and 1334. (R. 2). On December 26, 2007, the Tates timely filed a notice of appeal from that order to the United States District Court for the Southern District of Mississippi under 28 U.S.C. § 158(c)(2) and Fed. R. Bankr. P. 8002(a). (R. 3). On September 29, 2008, the district court entered a final order affirming the bankruptcy court's December 18, 2007, order dismissing the Tates' bankruptcy case. (R. 4). On October 6, 2008, the Tates timely filed a notice of appeal to this Court under Fed. R. App. P. 4(a)(1)(B). (R. 5). This Court has jurisdiction pursuant to 28 U.S.C. §§ 158(d)(1) and 1291.

STATEMENT OF THE ISSUE

The Bankruptcy Code allows debtors to claim a vehicle ownership expense, in a set amount, when that expense is "applicable." *See* 11 U.S.C. § 707(b)(2)(A)(ii)(I). The expense amount is a standardized dollar value debtors may claim to account for vehicle loan or lease payments. The debtors in this case claimed such a set amount for two vehicles, even though they had no loan or lease payments for either vehicle.

The question presented is: Did the bankruptcy court and the district court err in ruling that the Tates could not claim vehicle ownership expense amounts on vehicles for which they have no vehicle ownership expenses?

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[1] "R" denotes a citation to the United States Trustee's "Record Excerpts" filed contemporaneously with this brief.

STATEMENT OF THE CASE

On January 10, 2007, the Tates filed a joint voluntary petition for relief under the debt liquidation provisions of chapter 7 of the Bankruptcy Code. *See* 11 U.S.C. § 701 et seq. On March 19, 2007, the United States Trustee filed a motion to dismiss the Tates' case for abuse under 11 U.S.C. § 707(b)(1) because a presumption of abuse arose as a matter of law under 11 U.S.C. Section 707(b)(2). On December 18, 2007, the United States Bankruptcy Court for the Southern District of Mississippi granted the United States Trustee's motion and entered an order dismissing the Tates' case. On December 26, 2007, the Tates timely filed a notice of appeal from the bankruptcy court's order to the United States District Court for the Southern District of Mississippi. On September 29, 2008, the district court entered an order affirming the bankruptcy court's December 18, 2007, dismissal order. This appeal followed.

STATEMENT OF THE FACTS

I. STATUTORY BACKGROUND.

United States Trustees are Department of Justice Officials appointed by the Attorney General, who supervise the administration of chapter 7 and 13 bankruptcy cases in all federal judicial districts within this circuit. *See* 28 U.S.C. § 581-589(a). *See also* H.R. Rep. No. 95-595, at 88 (1977), *as reprinted in* 1978 U.S.C.C.A.N. 5963, 6049 (United States Trustees "serve as bankruptcy watch-dogs to prevent fraud, dishonesty, and overreaching in the bankruptcy arena.").

During fiscal year 2007, according to data collected by the United States Trustee Program, 451,012 non-business chapter 7 cases were filed nationwide, excluding the judicial districts of Alabama and North Carolina, whose data were not collected. Of these cases, the United States Trustees filed 3,370 motions to dismiss under section 707(b)(2) of the Bankruptcy Code, and 1,441 statements declining to seek dismissal when a presumption of abuse existed.

This appeal involves the interpretation of section 707(b)(2), which Congress added to the Bankruptcy Code in the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (the "2005 Act").[2] The 2005 Act significantly altered how debtors obtain chapter 7 bankruptcy relief.

One of the innovations of the 2005 Act is means testing. Under the means test, above-median income debtors' cases are presumed abusive as a matter of law when their historic income reduced by prescribed expenses and expense amounts yields a net income that exceeds $166.66 per month.[3] By enacting the means test, Congress mandated that debtors who can pay that amount per month or more should not receive chapter 7 relief.

The means test lies at the "heart" of the 2005 Act's consumer bankruptcy reforms and acts "to ensure that debtors repay creditors the maximum they can afford." H.R. Rep. 109-31 at 1 (I) (2005), *as reprinted in* 2005 U.S.C.C.A.N. 88, 89. Under prior law, "some bankruptcy debtors [were] able to repay a significant portion of their debts," but were not doing so because the law contained "no clear mandate requiring these debtors to repay their debts." *Id.* at 5 and n.18, 2005 U.S.C.C.A.N. at 92. Congress enacted the means test to prevent debtors from obtaining chapter 7 relief when they have an ability to repay their creditors.

In section 707 of the Bankruptcy Code – which addresses dismissal of abusive chapter 7 petitions – Congress implemented the means test by establishing special rules for debtors whose

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[2] Pub. L. No. 109-8, 119 Stat. 23 (2005). The 2005 Act applies to the Tates' case, because the Act's general effective date is for cases filed on or after October 17, 2005.

[3] The dollar amounts went up slightly for cases filed after April 1, 2007. 72 Fed. Reg. 7082 (Feb. 14, 2007). *See also* 11 U.S.C. § 104. This case is not subject to the new dollar amounts.

current monthly income, reduced by permitted expenses, exceeds a threshold for abuse under a specified formula. *See* 11 U.S.C. § 707(b)(2). The means test requires a court to perform a series of calculations to determine whether the grant of a chapter 7 discharge to a debtor would be a presumed abuse warranting dismissal of a case (or, if the debtor consents, conversion to another chapter of the Bankruptcy Code). *See* 11 U.S.C. § 707(b)(1) and (b)(2)(A).

The means test only applies to debtors whose income exceeds the median for their state. *See* 11 U.S.C. § 707(b)(7). Under the means test, debtors first determine their average income for the six calendar months preceding the month of their bankruptcy filing. *See* 11 U.S.C. § 101(10A). If this averaged amount, multiplied by twelve, is below the median income for the debtor's state and household size, the debtor's case cannot be dismissed under the means test. *See* 11 U.S.C. § 707(b)(7).

However, if this averaged amount exceeds the median income for the debtor's state and household size – as in the Tates' case – section 707(b)(2)(A) prescribes a statutorily mandated calculation that yields an amount a debtor is presumed to be able to repay her creditors. This presumptive amount, commonly referred to as a debtor's monthly disposable income, is obtained by reducing a debtor's averaged income by certain enumerated categories of expenses. *See* 11 U.S.C. § 707(b)(2)(A)(ii), (iii) and (iv).

To calculate whether such higher income debtors' cases are presumptively abusive, debtors file a means test form. *See* 11 U.S.C. §§ 521 and 707(b)(2)(C). The Bankruptcy Code prescribes what expenses are deducted on the means test form in determining a debtor's monthly disposable income. Section 707(b)(2)(A)(ii)(I) permits debtors to deduct:

(a) certain prescribed "actual" expenses; and

(b) other “applicable” expense amounts.

See 11 U.S.C. § 707(b)(2)(A)(ii)(I). A debtor may also deduct additional expenses identified in other subsections of section 707(b)(2)(A). *See* 11 U.S.C. § 707(b)(2)(A)(ii)(II)-(V), and 707(b)(2)(A)(iii) and (iv).

“Applicable” expense amounts are not the debtor’s actual expenses. Instead, they are the static amounts listed in the Internal Revenue Service’s Local and National Standards. *See* 11 U.S.C. § 707(b)(2)(A)(ii)(I).

After subtracting these permitted expenses, if an above-median debtor’s monthly disposable income exceeds $166.66 per month (or $10,000 over a 60 month period), the debtor’s case is presumed to be an abuse. *See* 11 U.S.C. § 707(b)(2)(A)(i). If the debtor’s monthly disposable income is less than $100.00 per month (or $6,000 over a 60 month period), the presumption of abuse does not arise. *Id.* Finally, if the debtor’s monthly disposable income is between $100 per month and $166.67 per month (*i.e.*, between $6,000 and $10,000 over a 60 month period), the presumption of abuse arises if the debtor’s monthly disposable income, over a 60 month period, is sufficient to pay 25 percent of the debtor’ s nonpriority unsecured debt.[4] *Id.*

If, as in the Tates’ case, the presumption arises, the case is presumed to be an abuse of chapter 7 as a matter of law. *See* 11 U.S.C. § 707(b)(2)(A)(i). Section 707(b) generally requires such cases to be dismissed, or if the debtor consents, converted to chapter 13.[5] *See* 11 U.S.C. §

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[4] The amount of a debtor’s nonpriority unsecured debt is generally determined by reference to a debtor’s bankruptcy Schedule F.

[5] The only alternative occurs when a debtor is able to rebut the presumption of abuse by demonstrating special circumstances that justify additional expenses or adjustments of income for which there is no reasonable alternative. *See* 11 U.S.C. § 707(b)(2)(B).

707(b)(1). In a chapter 13 case, a debtor must use all of her income to repay creditors over a five year period. *See* 11 U.S.C. § 1325.

This appeal poses a question about one part of the means test's expense-side calculation of disposable income related to vehicle ownership expenses under the IRS Local Standards. Transportation expenses incorporate two components: (1) monthly expenses for costs associated with operating vehicles and (2) monthly expenses for costs associated with purchasing or leasing vehicles. *See* IRS Collection Financial Standards, under heading "Local Standards: Transportation," *available at http://www.irs.gov/individuals/article/0,,id=96543,00.html.*[6] All debtors receive monthly transportation expenses based on either public transportation costs or the costs associated with operating one or two vehicles. *Id.* Operating expenses include amounts for vehicle maintenance, fuel, state and local registration, required inspection, parking fees, tolls, and driver's license fees. *Id.* The ownership expense allowance under the IRS Standards is one amount for each vehicle that is based on the average cost of financing a vehicle as determined annually by the Federal Reserve Board. *Id.* Independent of operating expenses, when applicable, debtors can claim a standardized amount to reflect a loan or lease payment. *Id.* Like the operating expense, the ownership expense, which covers vehicle lease or purchase payments, is limited to no more than two vehicles. *Id.*

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[6] The IRS revised its Collection Financial Standards, effective October 1, 2007, and such revisions were made applicable to bankruptcy cases filed as of January 1, 2008. *See* IRS Collection Financial Standards, under heading "Local Standards: Transportation," *available at http://www.irs.gov/individuals/article/0,,id=96543,00.html.* Because the Tates' case was filed on January 10, 2007, only the Collection Financial Standards in effect prior to October 1, 2007, are applicable to their case. For the Court's convenience, a true and correct pdf copy of the Collection Financial Standards applicable to this case, which the United States Trustee hereby incorporates by reference, can be found at United States Trustee Appendix "A".

Specifically at issue in this appeal is whether a standardized vehicle ownership deduction is "applicable" under section 707(b)(2)(A)(ii)(I) when the Tates have no associated vehicle ownership expenses.

II. THE FACTS AND PROCEEDINGS BELOW

The Tates live in Carriere, Mississippi. On January 10, 2007, they filed a joint voluntary petition for relief under the liquidation provisions of chapter 7 of the Bankruptcy Code. (R. 6). The Tates own three Chevrolets.[7] (R. 7). Each of those vehicles is owned free and clear of liens, which means that the Tates have no monthly payments on them. (*Id.*).

The Tates have $7,830.35 in average monthly income, or $93,964.20 per year. (R. 9, at lines 12 and 13). The Tates' income is almost double the $47,726.00 annual median income for the Tates' household size in Mississippi. (*Id.* at line 14). Because the Tates' income was well above the Mississippi median, sections 707(b)(2) and (7) of the Bankruptcy Code required them to complete their means test form to determine whether their filing was an abuse as a matter of law. (*Id.* at lines 19-56).

The Tates listed expense deductions of $7,692.69 on their means test form. (*Id.* at line 47). In making these calculations, the Tates claimed the IRS Local Standard transportation ownership expense for two vehicles in the amounts of $471.00 and $332.00, respectively.[8] (*Id.* at lines 23 and 24). This resulted in claimed monthly disposable income on their means test form in the amount of

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[7] On February 8, 2007, the bankruptcy court entered an order authorizing secured creditor Trustmark National Bank to repossess and sell a Toyota owned by the Tates. (R. 8, at Dkt. No. 14).

[8] In addition, the Tates claimed a $343.00 deduction for the IRS Local Standard "transportation, vehicle operation/public transportation expense" for two or more vehicles (*Id.* at line 22).

$137.66 which was slightly below the $166.67 required for the presumption of abuse to arise. (*Id.* at lines 50-52).

On March 19, 2007, the United States Trustee, pursuant to section 704(b)(2) of the Bankruptcy Code, filed his section 707(b)(2) motion to dismiss the Tates' case for abuse. (R. 2; R. 8, at Dkt. No. 21). The motion claimed the Tates miscalculated their claimed expenses on the means test.[9] (R. 2). The United States Trustee also alleged that the Tates failed the means test when their expenses were calculated correctly. (*Id.*).

The crux of the dispute concerned the Tates' attempt to claim two standardized vehicle ownership expense amounts for vehicles for which they had no loan or lease payments. (*Id.*). The United States Trustee sought dismissal because his adjustments gave the Tates $355.04 in monthly disposable income that could be used to repay creditors. (*Id.*). This yielded a presumption of abuse in the Tates' case because it exceeded the statutory abuse threshold established by $188.37 per month. (*Id.*).

On March 27, 2007, the Tates filed an opposition to the United States Trustee's motion. (R. 8, at Dkt. No. 24; R. 10). The opposition conceded the Tates owned their vehicles free and clear of liens, but asserted that language contained in the Advisory Committee Notes to the means test form [*see* Fed. R. Bankr. P. Official Form 22A (which is the form debtors use to determine whether the presumption of abuse arises under section 707(b)(2) of the Bankruptcy Code)] permitted the Tates

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[9] The United States Trustee permitted the Tates' $343.00 deduction for vehicle "operating" expenses. In addition, based on the Internal Revenue Manual, the United States Trustee permitted the Tates an additional $200.00 operating expense for ***each*** of these vehicles because the IRS allows additional deductions for such older cars. *See* IRS Internal Revenue Manual, Part 5, Ch. 8, § 5.8.5.5.2, *available at http://www.irs.gov/irm/part5/ch08s05.html* (providing for additional $200.00 operating expense under specified conditions). However, even after allowing this additional expense, the United States Trustee still determined that the presumption of abuse arose in this case.

to deduct vehicle ownership expense amounts for vehicles with no corresponding ownership expenses. (R. 10).

On December 18, 2007, the bankruptcy court granted the United States Trustee's motion to dismiss the Tates' case pursuant to 11 U.S.C. § 707(b)(1). (R. 1). In doing so, the bankruptcy court considered a variety of authorities related to the United States Trustee's motion, and determined that the United States Trustee's construction of section 707(b)(2)(A)(ii)(I) was the better one. (*Id.*).

The Tates appealed, and on September 29, 2008, the United States District Court for the Southern District of Mississippi entered a final order and memorandum opinion affirming the bankruptcy court's December 18, 2007, order. (R. 4). In its memorandum opinion, the district court noted that while the transportation ownership expense issue had not been conclusively resolved in this Circuit, "the weight of persuasive authority in this Circuit holds that a 'debtor may not deduct the vehicle ownership expense unless the debtor has a monthly note or lease payment on a vehicle.'" (*Id.*).

On October 6, 2008, the Tates then filed a notice of appeal to this Court under Fed. R. App. P. 4(a)(1)(B). (R. 5).

STANDARD OF REVIEW

This appeal involves a question of law, which this Court reviews *de novo*. *See Robertson v. Dennis (In re Dennis)*, 330 F. 3d 696, 701 (5th Cir. 2003).

SUMMARY OF ARGUMENT

Both the district court and the bankruptcy court ruled that the Tates have no "applicable" vehicle ownership expense amount to claim under section 707(b)(2)(A)(ii)(I) of the Bankruptcy Code because they have no associated loan or lease expenses on their vehicles. Their rulings best interpret section 707(b)(2)(A)(ii)(I) for five reasons:

First, the Tates cannot claim a standardized vehicle ownership expense amount on their vehicles because section 707(b)(2)(A)(ii)(I) allows a debtor to claim it only when it is "applicable" to the debtor's vehicles. The standardized vehicle ownership amount deduction is not applicable here because the Tates have no associated vehicle ownership expenses. Reading the word "applicable" in section 707(b)(2)(A)(ii)(I) as limiting expense amounts to debtors who have associated expenses is the best construction of this section because it:

> (a) uses the ordinary dictionary meaning of "applicable," and does so in a way that gives meaning to each word in the section;
>
> (b) fulfills Congress' stated reasons for enacting the section; and
>
> (c) most equitably implements bankruptcy policy - both for debtors and for creditors.

Second, this construction also gives meaning to every word in section 707(b)(2)(A)(ii)(I), something the Tates' construction does not because their reading renders the word "applicable" superfluous.

Third, the 2005 Act's legislative history supports this interpretation of section 707(b)(2)(A)(ii)(I). It reveals Congress enacted the new law to ensure debtors would repay their debts when they were able, and to eliminate loopholes and incentives for debtor abuse in discharging debts when a portion could be repaid. Allowing the Tates to claim a fictional expense amount diverges from the purposes of the 2005 Act.

Fourth, reading "applicable" in section 707(b)(2)(A)(ii)(I) to require a loan or lease payment fosters sound public policy. Barring above-median-income debtors like the Tates from claiming inapplicable ownership expense amounts is fair because it simply prevents them from claiming a monthly expense for an expense they do not have. This interpretation does not hurt lower-income debtors because they are not subject to section 707(b)(2)(A)(ii)(I) in the first place. *See* 11 U.S.C. § 707(b)(7). It is also fair to creditors because they will receive payments on their debts when debtors have the financial ability to repay.

Fifth, the bankruptcy system has four safety valves to ensure that higher-income debtors without loan or lease payments will not suffer by being denied phantom vehicle expenses. First, when they have older vehicles, they receive an additional $200 monthly expense allowance for up to two vehicles to fund the operation of these older vehicles. Second, even if the presumption of abuse arises, they may nonetheless obtain bankruptcy relief. Indeed, if the debtor's case presents an abuse of chapter 7, the debtor may elect to convert her chapter 7 case to a case under chapter 13 or chapter 11, both of which, unlike chapter 7, require that a debtor repay a portion of her debts over time through a repayment plan. *See* 11 U.S.C. 707(b)(1). Third, nothing prevents an above-median-income chapter 7 debtor whose case is dismissed from later refiling, and appropriately deducting expenses for loan or lease payments for a vehicle obtained on credit after the dismissal. Finally, the United States Trustee has express statutory authority to decline to bring a motion to dismiss. *See* 11 U.S.C. § 704(b)(2). Thus, the government need not move to dismiss a case that fails the means test if the debtor will experience a significant reduction in income, or if the debtor establishes the need to purchase a vehicle shortly after the filing of her case.

Conversely, the Tates' interpretation of the statute (a) renders the term "applicable" superfluous; (b) confuses the distinction between the words "applicable" and "actual" found in section 707(b)(2)(A)(ii)(I); and (c) misconstrues the phrase "shall not include payments for debts" found in section 707(b)(2)(A)(ii)(I). Further, the Tates' reliance on the means test form and the Advisory Committee Notes to that form is misplaced because neither purports to alter the statute and could not alter the statute even if it sought to do so.

Finally, while the United States Court of Appeals for the Seventh Circuit recently decided this issue in favor of the Tate's position [*see Ross-Tousey v. Neary*, -- F.3d -- , 2008 WL 5234070 (7th Cir. Dec. 17, 2008)], that decision should not be followed by this Court for two reasons. First, *Ross-Tousey* primarily relied on a majority opinion of a divided Sixth Circuit Bankruptcy Appellate Panel, whose decision was entered *after* briefing was completed in *Ross-Tousey*. *See Ross-Tousey*, 2008 WL 5234070 (*citing* and *quoting* extensively from *Hildebrand v. Kimbro (In re Kimbro)*, 389 B.R. 518 (B.A.P. 6th Cir. 2008)). Accordingly, the Seventh Circuit did not have the benefit of the government's views regarding the divided Sixth Circuit bankruptcy appellate panel's opinion prior to reaching its own decision. Second, the opinion on which *Ross-Tousey* primarily relies, *Kimbro*, has been described as "a superb effort to weave a seemingly robust cloth from somewhat thin threads." *Kimbro*, 389 B.R. at 532 (Fulton, J., dissenting). Specifically, the majority in *Kimbro* (a) misapprehended the United States' construction of the words "applicable" and "actual" in section 707(b)(2)(A)(ii)(I); (b) erroneously concluded that the vehicle ownership amount was necessary to cover operating costs, when a different IRS expense standard governs those types of expense; (c) erroneously ruled section 707(b)(2)(A)(ii)(I)'s statement that "monthly expenses of the debtor shall not include any payments for debts" justifies the allowance; (d) erroneously relied upon legislative history of a statute never enacted; and (e) inappropriately declined to adopt the dictionary meaning of the word "applicable." *See Kimbro*, 389 B.R. at 518-31.

ARGUMENT

I. A VEHICLE OWNERSHIP EXPENSE AMOUNT IS "APPLICABLE" UNDER SECTION 707(b)(2)(A)(ii)(I) OF THE BANKRUPTCY CODE ONLY WHEN DEBTORS ARE MAKING A CORRESPONDING LOAN OR LEASE PAYMENT ON THEIR VEHICLES, WHICH THE TATES ARE NOT.

A. Vehicle ownership expense amounts are not "applicable" to debtors who make no loan or lease payments.

The Bankruptcy Code permits above-median-income debtors like the Tates to claim a vehicle ownership expense amount in a set amount when that expense is "applicable." *See* 11 U.S.C. § 707(b)(2)(A)(ii)(I). Section 707(b)(2)(A)(ii)(I) provides that a debtor's "monthly expenses shall be the debtor's *applicable* monthly expense amounts specified under the . . . Local Standards . . . issued by the Internal Revenue Service. . . ." 11 U.S.C. § 707(b)(2)(A)(ii)(I) (emphasis added).

The Bankruptcy Code does not define the term "applicable." Nor has the United States Trustee identified any Supreme Court or Fifth Circuit decision providing a definition in the bankruptcy court context. Accordingly, where, as here, a statutory term is undefined, the term should be given its ordinary meaning. *Smith v. United States*, 508 U.S. 223, 228 (1993) ("When a word is not defined by statute, we normally construe it in accord with its ordinary or natural meaning."); *Hamilton v. United Healthcare of Louisiana, Inc.*, 310 F.3d 385, 391 (5th Cir. 2002) ("A fundamental canon of statutory construction instructs that in the absence of a statutory definition, we give terms their ordinary meaning.").

The dictionary defines "applicable" to mean "capable of being applied: having relevance . . . fit, suitable, or right to be applied: APPROPRIATE" *Webster's Third New International Dictionary*, at 105 (1981) (emphasis in original). Such a meaning should therefore be imparted to the term "applicable" used in section 707(b)(2)(A)(ii)(I). *See Hartford Underwriters Ins. Co. v.*

Union Planters Bank, N.A., 530 U.S. 1, 6 (2000) ("when the statute's language is plain, the sole function of the courts-at least where the disposition required by the text is not absurd-is to enforce it according to its terms.") (internal quotations omitted). *See also Thompson v. Goetzmann*, 337 F.3d 489, 498 n.20 (5th Cir. 2003) ("[D]ictionaries are a principal source for ascertaining the ordinary meaning of statutory language.").

The bankruptcy and district courts' interpretations of section 707(b)(2)(A)(ii)(I) is consistent with this ordinary meaning because they do not allow debtors to claim a monthly vehicle ownership expense amount when they have no associated monthly loan or lease expenses.

As articulated by the Ninth Circuit bankruptcy appellate panel in *Ransom*, "[g]iven the ordinary sense of the term 'applicable,' how is the vehicle ownership expense allowance ***capable of being applied*** to [a] debtor if he does not make any lease or loan payments on the vehicle?" *Ransom v. MBNA America Bank, N.A. (In re Ransom)*, 380 B.R. 799, 807-8 (B.A.P. 9th Cir. 2007) (emphasis in original). The answer is, it is not. If a debtor, like the Tates, has no loan or lease payments on her vehicle, then there is simply no expense capable of being applied. For this reason alone, the lower courts' orders, which applied the dictionary meaning of the term "applicable" in dismissing the Tates case as abusive, should be affirmed.

Indeed, if there were ever any doubt regarding what Congress intended the term "applicable" to mean under section 707(b)(2)(A)(ii)(I), it would be answered in the next subsection of the Bankruptcy Code: subsection 707(b)(2)(A)(ii)(II). That subsection states, in relevant part, that a "debtor's monthly expenses may include, ***if applicable***, the continuation of *actual* expenses paid by the debtor . . . for care and support of an elderly, chronically ill, or disabled household member or member of the debtor's immediate family. . . ." 11 U.S.C. § 707(b)(2)(A)(ii)(II) (emphasis added).

Thus, Congress used the term "applicable" under section 707(b)(2)(A)(ii)(II) to only allow expenses to debtors if those expenses literally *apply* to that particular debtor.

Accordingly, because it is a basic rule of statutory construction that "'identical words used in different parts of the same act are intended to have the same meaning[,]'" *Comm. of Internal Revenue v. Lundy*, 516 U.S. 235, 250 (1996) (citations omitted), the same meaning of the term "applicable" in section 707(b)(2)(A)(ii)(II) should be given to the term "applicable" in section 707(b)(2)(A)(ii)(I).

Many appellate decisions agree with the bankruptcy court and district court in this case that when debtors, such as the Tates, have no loan or lease expenses on their vehicles, they cannot deduct a monthly vehicle loan or lease expense amount on their means test form pursuant to section 707(b)(2)(A)(ii)(I). *See Babin v. Wilson (In re Wilson)*, 383 B.R. 729 (B.A.P. 8th Cir. 2008); *Grossman v. Sawdy (In re Sawdy)*, 384 B.R. 199 (E.D. Wis. 2008), *overruled sub nom. Ross-Tousey*, 2008 WL 5234070; *Wieland v. Thomas (In re Thomas)*, 382 B.R. 793 (D. Kan. 2008); *Meade v. McVay (In re Meade)*, 384 B.R. 132 (W.D. Tex. 2008); *United States Trustee v. Deadmond (In re Deadmond)*, 2008 WL 191165 (D. Mont. Jan. 22, 2008); *Ransom*, 380 B.R. at 799, *appeal pending* Case No. 08-15066 (9th Cir. Jan. 4, 2008); *Fokkena v. Hartwick (In re Hartwick)*, 373 B.R. 645 (D. Minn. 2007). *But see Ross-Tousey*, 2008 WL 5234070; *Pearson v. Stewart (In re Pearson)*, 390 B.R. 706 (B.A.P. 10th Cir. 2008), *appeal pending* Case No. 08-8060 (10th Cir. Aug. 19, 2008); *Kimbro*, 389 B.R. at 518, *appeal pending* Case No. 08-5871 (6th Cir., Aug. 24, 2008); *Clippard v. Ragle (In re Ragle)*, 395 B.R. 387 (E.D. Ky. 2008); *Brunner v. Armstrong (In re Armstrong)*, 395 B.R. 127 (E.D. Wash. 2008); *Musselman v. eCast Settlement Corp.*, 394 B.R. 801 (E.D. N.C. 2008).

The bankruptcy and district courts' rulings in this case are consistent with the bulk of the published Fifth Circuit bankruptcy court opinions on this topic as well. *See In re Owsley*, 384 B.R. 739 (Bankr. N.D. Tex. 2008); *In re White*, 393 B.R. 436 (Bankr. N.D. Miss. 2008); *In re Brown*, 376 B.R. 601 (Bankr. S.D. Tex. 2007); *In re Pampas*, 369 B.R. 290 (Bankr. M.D. La. 2007); *In re Ceasar*, 364 B.R. 257 (Bankr. W.D. La. 2007); *In re Devilliers*, 358 B.R. 849 (Bankr. E.D. La. 2007); *In re Oliver*, 350 B.R. 294 (Bankr. W.D. Tex. 2006); *In re Barraza*, 346 B.R. 724 (Bankr. N.D. Tex. 2006); *In re Lara*, 347 B.R. 198 (Bankr. N.D. Tex. 2006); *In re Hardacre*, 338 B.R. 718 (Bankr. N.D. Tex. 2006). *But see In re Leary*, 2008 WL 1782636 (Bankr. S.D. Tex. 2008).

B. The Tates' reading of Section 707(b)(2)(A)(ii)(I) renders the term "applicable" superfluous.

Under the Tates' interpretation of section 707(b)(2)(A)(ii)(I), the term "applicable" modifies the phrase "amounts specified under the . . . Local Standards" not the debtor's "monthly expense." *See* Appellant's Brief, at 8-9 (*citing Kimbro*, 389 B.R. at 518; *In re Chamberlain*, 369 B.R. 519, 524 (Bankr. D. Ariz. 2007)). However, if that were so, Congress could just have easily stated in section 707(b)(2)(A)(ii)(I) that:

> a "debtor's monthly expenses shall be the debtor's **~~applicable~~** monthly expense amounts specified under the . . . Local Standards . . . issued by the Internal Revenue Service. . . ."

See Ransom, 380 B.R. at 808 (concluding that such a construction would "read[] 'applicable' right out of the Bankruptcy Code."). After all, striking out the word "applicable" would still lead debtors to the same line under the IRS Local Standards, and if that is all Congress intended, there was no need to use the word "applicable" at all. Instead, Congress deliberately chose to include the term "applicable" in section 707(b)(2)(A)(ii)(I). Accordingly, because "courts should strive to give operative meaning to every word in a statute," *see Cooper Indus., Inc. v. Aviall Servs., Inc.*, 543 U.S. 157, 167 (2004), *Tesfamichael v. Gonzales*, 411 F.3d 169, 175 (5th Cir. 2005), the word "applicable" must be read as adding something to the statute, and the Tates' interpretation of section 707(b)(2)(A)(ii)(I) fails. *See Deadmond*, 2008 WL 191165, at *4 ("The word ['applicable'] must mean something, and if some monthly expenses are applicable, then other monthly expenses are not applicable.").

Because the Tates' reading of section 707(b)(2)(A)(ii)(I) renders the term "applicable" superfluous, the term *must* have a different meaning than the one they ascribe. *See generally Cooper Indus., Inc.*, 543 U.S. at 167; *Tesfamichael*, 411 F.3d at 175. As we explain above, the word "applicable" does have a different meaning. Under its dictionary meaning, the word exists to allow debtors to claim a standard vehicle expense amount that is applicable because they have a loan or lease expense.

C. The Tates confuse the distinction between the words "applicable" and "actual" in section 707(b)(2)(A)(ii)(I).

In their brief, the Tates suggest that requiring debtors to incur a monthly cost in an expense category before deducting the corresponding IRS standard expense amount would read "applicable" as meaning "actual." Appellant's Brief, at 8-9. This leads the Tates to conclude that the term "applicable" cannot mean debtors have a corresponding expense because that would give identical meaning to two different terms Congress used in the same statute. *Id.* at 9 (construing section 707(b)(2)(A)(ii)(I), which uses both terms).

What the Tates' argument fails to recognize, however, is that the lower courts' construction gives the words "applicable" and "actual" entirely ***different*** meanings in section 707(b)(2)(A)(ii)(I).

Contrary to the Tates' suggestion, vehicle expense amounts under section 707(b)(2)(A)(ii)(I) are not the debtor's "actual," or literal, vehicle ownership expenses. To the contrary, they are static, fixed-amounts, drawn from the IRS Standards, used ***regardless*** of the debtor's "actual" expenses. *See Hartwick*, 373 B.R. at 650 (recognizing that a debtor's "actual" expense does not control the amount of the vehicle ownership deduction under section 707(b)(2)(A)(ii)(I)). Debtors receive $471.00 for the first vehicle that has an associated loan or lease payment, and $332.00 for the second. *See* United States Trustee Appendix "A." These are the opposite of "actual" expenses.

Under the bankruptcy court's and district court's interpretation of section 707(b)(2)(A)(ii)(I), all a court is required to do is determine whether a vehicle ownership cost exists. *See Sawdy*, 384 B.R. 214 (the standard vehicle ownership expense amount "is to be used if and only if the debtor actually has the monthly expense of an actual car payment"). Once it is determined that a debtor has a loan or lease payment, the standardized $471.00 and $332.00 amounts are used in the means test, ***not*** a debtor's actual, literal, monthly expenditures. Thus, the bankruptcy court's and district court's interpretation of section 707(b)(2)(A)(ii)(I) gives each word in the statute its proper meaning – that is, debtors may claim actual expenses for some expense categories, but must claim standardized expense amounts for vehicles that have associated loan or lease payments. *See Thomas*, 382 B.R. at 797 (use of the word "'applicable' . . . does not suggest an intent by Congress that the numbers should simply be plucked from the Standards for a debtor's expenses under the means test as if in a vacuum, without reference to the *context and meaning* of those numbers.") (emphasis in original).

Because the terms "applicable" and "actual" have different meanings under section 707(b)(2)(A)(ii)(I), the Tates' concern regarding an overlap of definitions is erroneous. *See Thomas*, 382 B.R. at 793 (finding that "the juxtaposition of 'applicable . . . amounts' and 'actual . . . expenses' in the statute is not inconsistent with the Court's interpretation" that vehicle ownership expense amounts are only applicable if a debtor is making loan or lease payments on a vehicle); *Meade*, 384 B.R. at 136 (explaining how the terms "applicable" and "actual" have different meanings under section 707(b)(2)(A)(ii)(I)).

Indeed, even if the terms "applicable" and "actual" meant the same thing in section 707(b)(2)(A)(ii)(I), the Supreme Court has recognized that there is nothing wrong with two different words within a single section of a statute being synonymous. *See Wachovia Bank v. Schmidt*, 546 U.S. 303, 314 (2006) ("Congress may well have comprehended the words 'located' and 'established,' as used in [28 U.S.C.] § 1348, not as contrasting, but as synonymous or alternative terms."). Thus, the Tates' argument fails for this reason as well.

A reconciliation of terms within a statute should do the least damage to the language enacted by Congress, and should afford the maximum amount of credence to the canon that all words in a statute should be given effect. Accordingly, because the Tates' reconciliation of the terms "applicable" and "actual" found in section 707(b)(2)(A)(ii)(I) fails to accomplish this, it should be rejected.

D. The Tates also misapprehend the purpose and meaning of the phrase "shall not include payments for debts" in section 707(b)(2)(A)(ii)(I).

Section 707(b)(2)(A)(ii)(I) also provides that "Notwithstanding any other provision of this clause, the monthly expenses for the debtor shall not include any payments for debts." *See* 11 U.S.C. § 707(b)(2)(A)(ii)(I). The Tates suggest, without further explanation, that this phrase supports their position that Congress intended to allow an ownership expense even when a debtor has no payment or lease obligations. *See* Appellant's Brief, at 8 (*citing Kimbro*, 539 B.R. at 518, which in turn *cites* section 707(b)(2)(A)(ii)(I) for the proposition stated).

The Tates' reading suffers from three flaws. First, the Tates misunderstand why section 707(b)(2)(A)(ii)(I) includes the prohibition against deduction of debts. It does so to clarify that debtors must deduct applicable standardized expense amounts from their income rather than their debt payments. *Cf. In re Knight*, 370 B.R. 429, 436-37 (Bankr. N.D. Ga. 2007) (holding section 707(b)(2)(A) "preclude[d] deduction" of a debt on the means test).[10]

Second, the Tates' reading fails to appreciate why the means test uses standardized expense amounts in the first place. It uses them not to deduct "debt" from income, but to deduct reasonable, standardized expense amounts from income. It does that in order to determine whether a debtor, after deducting "applicable" standardized expenses, has $166.67 or more left over each month to repay unsecured debts. Thus, the expense amounts exist to determine how much will be left over to pay debts; they do not themselves constitute debts.

Finally, the Tates' reading leads to an inequitable result. Under their reading, only debtors who have no car payments could claim the standardized deduction. Those who actually have a corresponding loan or lease obligation could not claim the standardized expense amount because it would be prohibited as a "payment for debt" under section 707(b)(2)(A)(ii)(I).

That reading turns the statute upside down. Under it, debtors with indebtedness could not claim an "applicable" standardized expense amount. But debtors who at least need the standardized expense amount deduction - because they have no associated indebtedness, could. That construction makes no sense.

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[10] Section 707(b)(2)(A)(iii) allows debtors to deduct secured debt payments. It does so because the means test is used to determine how much income is left over to pay unsecured debt. To obtain that figure, it is necessary to deduct secured debt payments.

II. AFFIRMING THE LOWER COURT'S READING OF SECTION 707(b)(2)(A)(ii)(I) AS LIMITING VEHICLE OWNERSHIP EXPENSE AMOUNTS TO DEBTORS WHO HAVE LOAN OR LEASE PAYMENTS FULFILLS TWO GOALS CONGRESS EXPRESSED IN ENACTING THE 2005 ACT: ENSURING THAT ABOVE-MEDIAN INCOME DEBTORS REPAY THEIR DEBTS WHEN THEY CAN, AND ELIMINATING ABUSE.

A. Congress passed the 2005 Act to maximize debtor repayment to creditors and to eliminate opportunities for bankruptcy abuse.

In interpreting "applicable" in § 707(b)(2)(A)(ii)(I), this Court may consider the relevant legislative history to determine the statute's objectives and illuminate its text. *See Almendarez-Torres v. United States*, 523 U.S. 224, 228 (1998) ("We therefore look to the statute before us and ask what Congress intended...In answering this question, we look to the statute's language, structure, subject matter, context, and history-factors that typically help courts determine a statute's objectives and thereby illuminate its text."); *Crandon v. United States*, 494 U.S. 152, 158 (1990) ("In determining the meaning of the statute, we look not only to the particular statutory language, but to the design of the statute as a whole and to its object and policy.").

The "heart" of the 2005 Act is the means test, which seeks to "ensure that debtors repay creditors the maximum they can afford." H.R. Rep. No. 109-31 (I), at 1, U.S.C.C.A.N. at 89.[11] *See also Schultz v. United States*, 529 F.3d 343, 347 (6th Cir. 2008) ("The centerpiece of the [2005 Act] is the imposition of a 'means test' for chapter 7 filers."). *Cf. Thomas*, 382 B.R. at 798 ("If a debtor were permitted a car ownership allowance when he actually incurs no such expense, application of the means test would not accurately reflect the debtor's ability to repay creditors, and the purpose of the statute would be frustrated.").

Congress felt this aspect of bankruptcy reform legislation was so important that it included

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[11] There is no Senate Report or Conference Report to the 2005 Act.

this language in the very first paragraph, of the very first page, of the 2005 Act's legislative history. *See* H.R. Rep. No. 109-31 (I), at 1, 2005 U.S.C.C.A.N. at 89.

Congress saw fit to reiterate this point when it addressed this specific provision in the legislative history. *Id.* at 97-100. Given how important this was to Congress, the statute should be interpreted in accordance with the overarching goal that underpins the 2005 Act.

Further, the 2005 Act also sought to eliminate "loopholes and incentives" in the system "that allow and – sometimes – even encourage opportunistic personal filings and abuse." H.R. Rep. No. 109-31 (I), at 5, 2005 U.S.C.C.A.N. at 92.

Ensuring, as the lower courts did here, that above-median-income debtors are eligible to claim standardized deductions for vehicle ownership expenses only when they have such expenses honors congressional intent that debtors repay their debts when they are able. *See Ransom*, 380 B.R. at 807 ("[W]hat is important is the payments that debtors actually make, not how many cars they own, because the payments that debtors make are what actually affect their ability to make payments to their creditors."); *Wilson*, 383 B.R. at 733 (noting that for above-median-income chapter 13 debtors, the "purpose" of the 2005 Act was to "require" such debtors "to make more funds available to their unsecured creditors"); *Hartwick*, 373 B.R. at 652.

B. The Tates' interpretation of section 707(b)(2)(A)(ii)(I) would yield inequitable results not contemplated by Congress.

The Tates' interpretation of section 707(b)(2)(A)(ii)(I) would frustrate the 2005 Act's goal of proper repayment by allowing above-median-income debtors to claim phantom expenses that do not apply to them. Under the Tates' reading of section 707(b)(2)(A)(ii)(I), a higher-income debtor with an inoperable car "rusting away in his backyard" could claim the ownership expense amount simply because the car is an "automobile" and he "owns" it. *Neary v. Ross-Tousey (In re Ross-*

Tousey), 368 B.R. 762, at 768 (E.D. Wis. 2007), *rev'd*, 2008 WL 5234070. This statutory reading has been rejected by a number of appellate courts because it "defies common sense." *Deadmond*, 2008 WL 191165 at *4.

III. ALTHOUGH THE DISTRICT COURT DID NOT CHOOSE TO RELY ON THE IRS' METHODOLOGY AS A GROUND FOR ITS DECISION, THE DISTRICT COURT'S INTERPRETATION OF SECTION 707(b)(2)(A)(ii)(I) IS CONSISTENT WITH THE IRS'S REFUSAL TO ALLOW PARTIES TO CLAIM NONEXISTENT VEHICLE OWNERSHIP EXPENSES UNDER ITS LOCAL STANDARDS.

In their brief, the Tates make much of the fact that several of the cases supporting the United States Trustee's position apparently look to language contained in the Internal Revenue Manual and the Internal Revenue Service's Collection Financial Standards for support.[12] *See* Appellant's Brief, at 9-10 (*citing Ransom*, 380 B.R. at 799; *Meade*, 384 B.R. at 132; *Wilson*, 383 B.R. at 729; *Sawdy*,

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[12] Criticism of these cases primarily stems from the fact that Congress did not expressly incorporate the documents in question into the Bankruptcy Code. *See, e.g., Kimbro*, 389 B.R. at 524-27; *Ross-Tousey*, 2008 WL 5234070, at *9. While that is true, consideration of the Internal Revenue Manual and the Internal Revenue Service's Collection Financial Standards is still entirely appropriate for two reasons.

First, the language of the 2005 Act does not indicate any intent to preclude reference to the IRS's application of its own expense standards. *See* Pub. L. No. 109-8, 119 Stat. 23 (2005). Indeed, it requires that deductions be taken "under" the Local Standards. *Id.* Further, the legislative history of the 2005 Act specifically references the IRS Financial Analysis Handbook in describing applicable expense amounts. *See* H.R. Rep. No. 109-31(I), 2005 U.S.C.C.A.N. at 99-100.

Second, many of the cases critical of consideration of the Internal Revenue Manual and the Internal Revenue Service's Collection Financial Standards rely themselves on legislative history, from a statute never enacted, to support such criticism. *See, e.g., Ross-Tousey*, 2008 WL 5234070, at *9 (referencing house report to 1998 reform bill never enacted), *Kimbro*, 389 B.R. at 525-26 (same). However, the law of this Circuit expressly precludes such an approach. *See Interstate Natural Gas Co. v. Federal Power Comm.*, 156 F.2d 949, 952 (5th Cir. 1946) ("the legislative history of a bill that was not adopted ***cannot*** be resorted to to construe a bill that was.") (emphasis added), *aff'd.* 331 U.S. 682 (1947). *See also Com. of Puerto Rico v. Blumenthal*, 642 F.2d 622, 635 n.23 (D.C. Cir. 1980) ("[Appellant's] argument that we should not consider the legislative history of a bill that was never enacted represents a correct statement of the law.").

Accordingly, because "the essence of statutory construction is to find the thought beneath the words," consideration of the Internal Revenue Manual and the Internal Revenue Service's Collection Financial Standards is proper. *United States ex. rel. Knauff v. Shaughnessy*, 338 U.S. 537, 547 (1950) (Frankfurter, J., dissenting).

384 B.R. at 199; *Hartwick*, 373 B.R. at 645; and *Neary*, 368 B.R. at 762). What the Tates fail to mention, however, is that *none* of these cases rely exclusively on the Internal Revenue Manual and the Collection Financial Standards to reach their conclusions. Rather, each engaged in an extensive statutory analysis of section 707(b)(2)(A)(ii)(I) prior to determining that debtors should not be allowed to claim a nonexistent ownership expense under section 707(b)(2)(A)(ii)(I). That is what the lower courts did here. It is what the United States Trustee asks this Court to do in this case. Indeed, the district court did not even mention the Internal Revenue Manual or the Collection Financial Standards in its opinion. Accordingly, to ask this Court to reverse the district court for improperly relying on a theory it never adopted, as the Tates appear to do, is inappropriate.

Nevertheless, had the district court relied on such support, there are two reasons why the IRS's eligibility criteria for deductions under its Local Standards support the district court's interpretation of the textual phrase this Court is called upon to interpret in this appeal.

First, section 707(b)(2)(A)(ii)(I)'s text requires that expense amounts be those established "under" the IRS standards. *See* 11 U.S.C. § 707(b)(2)(A)(ii)(I). This textual "reference to amounts specified 'under' the Standards indicates that one should use the numbers that result when the Standards are applied as they usually are." *Thomas*, 382 B.R. at 798. Indeed, as explained by one appellate court, given the text of the statute, "the most logical resource to consult is the IRS." *Hartwick*, 373 B.R. at 650.

Under its Local Standard for vehicle ownership, the IRS prohibits vehicle ownership deductions if an individual has no loan or lease payments.[13] *See* IRS Internal Revenue Manual, Pt.

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[13] For individuals with ***existing*** vehicle ownership costs, the IRS applies the expense deduction as a "cap," under which an individual may take the lower of his actual expense or the standardized expense amount. *See* IRS Collection Financial Standards (stating that under the Local (continued...)

5, Ch. 15, § 5.15.1.7(4.B), *available at http://www.irs.gov/irm/part5/ch15s01.html* (providing that if a taxpayer has no vehicle loan or lease payments, the Local Standard ownership cost cannot be claimed by the taxpayer). The district court's construction similarly applies section 707(b)(2)(A)(ii)(I) to deny nonexistent transportation expenses, albeit on a conclusion grounded on the statute's text. *Accord Sawdy*, 384 B.R. at 204 (finding it "logical to look at the actual IRS Collection Financial Standards in determining the applicable expense Standards in bankruptcy actions"); *Thomas*, 382 B.R. at 798 ("[I]t does not appear that Congress intended to adopt only the numbers contained in the Standards without the context and meaning provided by the IRS in creating the Standards and in its normal application of those numbers.").

Second, Congress was interested in more than the mere numbers found in the IRS Local Standards in crafting section 707(b)(2)(A)(ii)(I). The House Report to the legislation provides that the debtor's monthly expenses "must be the applicable monthly amounts set forth in the [IRS] Financial Analysis Handbook as Necessary Expenses under the National and Local Standards categories." H.R. Rep. No. 109-31 (I), 2005 U.S.C.C.A.N. at 99-100 (2005). The Financial Analysis Handbook provides that the Local Standard ownership cost cannot be claimed if a taxpayer has no vehicle loan or lease payments.[14] *See* IRS Internal Revenue Manual, Pt. 5, Ch. 15, § 5.15.1.7(4.B), *available at http://www.irs.gov/irm/part5/ch15s01.html.*

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[13](...continued)
Standards, "the taxpayer is allowed the amount actually spent or the standard, whichever is less"). The Bankruptcy Code, in turn, prescribes a different application for debtors with existing ownership costs: in calculating disposable income, it permits debtors the entire expense amount. *See* 11 U.S.C. 707(b)(2)(A)(ii)(I) (providing that the applicable expense amount "shall be" the amount "specified" under the IRS Local Standard).

[14] Thus, for the other reasons advanced in this brief, the district court ruling should be affirmed even if this Court concludes that the IRS's application has no bearing.

IV. THE BANKRUPTCY AND DISTRICT COURTS' CONSTRUCTION OF SECTION 707(b)(2)(A)(ii)(I) IMPLEMENTS SOUND BANKRUPTCY POLICY.

A. Their interpretation is fair to debtors and creditors.

The district court's interpretation of section 707(b)(2)(A)(ii)(I) is fair. It does not hurt below-median-income debtors – those who comprise the vast majority of bankruptcy filers – because such debtors are not subject to section 707(b)(2)'s means test in the first place. *See* 11 U.S.C. 707(b)(7).

The bankruptcy and district courts' reading of section 707(b)(2)(A)(ii)(I) are also fair because they ensure that above-median-income debtors will repay their debts when they can. In enacting the 2005 Act, Congress was concerned that under the prior system, "some bankruptcy debtors are able to repay a significant portion of their debts" but are not required to do so. H.R. Rep. No. 109-31 (I), at 5, 2005 U.S.C.C.A.N. at 92.

Finally, the lower courts' interpretation is fair to creditors because they recognize that debtors with a financial ability to repay creditors a monthly amount above the statutory threshold in section 707(b)(2) should be subject to paying back their creditors outside of chapter 7. By contrast, the Tates' interpretation is unfair to creditors because it would allow above-median-income debtors to use nonexistent expenses to lower their disposable income below the threshold for the presumption of abuse. Rather than being subject to higher repayments outside chapter 7, such debtors would instead discharge debts they are able to pay.[15]

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[15] It has been argued that permitting the vehicle ownership expense deduction only when a debtor has loan or lease payments would allow an unfair windfall for a hypothetical debtor with only a few or a single monthly payment remaining on his vehicle. *See Neary*, 368 B.R. at 767-68, *rev'd.*, 2008 WL 5234070. This argument fails to recognize that even when such debtors pass the means test their cases may still be dismissed based on the totality of the circumstances of their financial situations (*e.g.*, their ability to repay debts going forward given the imminent satisfaction of their vehicle loan or lease obligation). *See* 11 U.S.C. § 707(b)(3)(B) (providing for the dismissal of cases for abuse based on the totality of the circumstances of a debtor's financial situation).

B. Their interpretation protects debtors who lack vehicle ownership expenses from hardship.

Under the bankruptcy and district courts' interpretations, at least four safety valves are available to prevent hardships against above-median-income debtors who have no vehicle ownership expenses. First, where debtors own older or higher-mileage vehicles, they are afforded special protection. Debtors who own unencumbered vehicles over 6 years old or with 75,000 or more miles are entitled to an additional $200 in monthly operating expenses per vehicle. *See* IRS Internal Revenue Manual, Pt. 5, Ch. 8, § 5.8.5.5.2, *available at http://www.irs.gov/irm/part5/ch08s05.html. See also Ransom*, 380 B.R. at 808 (recognizing $200 additional allowance); *Hartwick*, 373 B.R. at 652 (same); *Wilson*, 383 B.R. at 729 (same).

Second, even if the presumption of abuse arises for an above-median-income debtor, the debtor may nonetheless obtain bankruptcy relief. Indeed, if the debtor's case presents an abuse of chapter 7, the debtor may elect to convert her chapter 7 case to a case under chapter 13 or chapter 11, both of which, unlike chapter 7, require that a debtor repay debts over time through a repayment plan. *See* 11 U.S.C. 707(b)(1).

Third, nothing prevents an above-median-income chapter 7 debtor whose case is dismissed from later refiling, and appropriately deducting expenses for loan or lease payments for a vehicle obtained after the dismissal. A debtor whose monthly disposable income drops below the statutory presumption of abuse threshold is also free to refile and obtain a discharge.[16]

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[16] Upon refiling, the debtor will face the possibility of a time-limited automatic stay if she files within a year of the dismissal. *See* 11 U.S.C. 362(c)(3)(A). However, the debtor may also obtain relief from this limitation under section 362(c)(3)(B). *See* 11 U.S.C. § 362(c)(3)(B) (providing for extension of automatic stay upon demonstration that current case was filed in good faith).

Fourth, the United States Trustee may decline to bring a motion to dismiss in the event a debtor experiences a significant reduction in income, or in the event a debtor establishes the need to purchase a vehicle shortly after the filing of her case. *See* 11 U.S.C. § 704(b)(2) (providing for the filing of a statement indicating why United States Trustee does not consider a motion to dismiss to be appropriate notwithstanding that a presumption of abuse arises). Indeed, as previously noted, the United States Trustee declined to seek dismissal when a presumption of abuse arose in 1,441 separate cases filed during fiscal year 2007. *See* United States Trustee's Brief, *supra*, at 2-3.

V. THE TATES' RELIANCE ON THE MEANS TEST FORM AND THE BANKRUPTCY ADVISORY COMMITTEE NOTES TO THE MEANS TEST FORM IS MISPLACED FOR TWO REASONS – THEY DO NOT ADDRESS THE ISSUE BEFORE THIS COURT, AND COULD NOT SUPERCEDE A STATUTE EVEN IF THEY DID.

The Tates argue that because their means test form fails to contain any language limiting the ownership expense under section 707(b)(2)(A)(ii)(I) to debtors with debt payments, this Court should follow suit. *See* Appellant's Brief, at 11. The Tates reliance on the means test form is misplaced. First, the text of the statute controls, not a form.[17] *See* 28 U.S.C. § 2075 (stating that the "Supreme Court shall have the power to prescribe by general rules, the forms of process, writs, pleadings, and motions, and the practice and procedure in cases under title 11" but that "[s]uch rules shall not abridge, enlarge, or modify any substantive right."); Fed. R. Bankr. P. 9009 ("forms shall be construed to be consistent with these rules and the Code."). Second, the means test form does not

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[17] Beyond that, an advisory committee's comments cannot alter statutorily adopted language either. *See generally Whitehouse v. United States Dist. Court for Dist. of Rhode Island*, 53 F.3d 1349, 1364-65 (1st Cir. 1995) (referencing advisory committee comment to Fed. R. Crim. P. 57). *See also* 28 U.S.C. § 2075 (described above); *Term Loan Holder Comm. v. Ozer Group, L.L.C. (In re Caldor Group)*, 303 F.3d 161, 170 (2d. Cir. 2002) ("forsaking the plain meaning of a provision of the Bankruptcy Code solely because that meaning conflicts with a bankruptcy rule would run afoul of 28 U.S.C. § 2075.").

even opine on this subject. *See* Fed. R. Bankr. P. Official Form 22A. Rather, it merely states "Check the number of vehicles for which ***you claim*** an ownership/lease expense (You may not claim an ownership/lease expense for more than two vehicles.)." *Id.* (Emphasis added). Third, the Tates fail to cite any authority to support this conclusion, and those courts that have opined on the subject of form versus statute have concluded that statutory language prevails. *See Coop v. Lasowski (In re Lasowski)*, 384 B.R. 205, 210 (B.A.P. 8th Cir. 2008) (noting that the Bankruptcy Code, not the chapter 13 means test form, controls the calculation of disposable income); *In re Anderson*, 383 B.R. 699, 703 n.8 (Bankr. S.D. Ohio 2008) (same); *In re Graham*, 363 B.R. 844, 850 (Bankr. S.D. Ohio 2007) (same); *In re Arnold*, 376 B.R. 652 (Bankr. M.D. Tenn. 2007) (same). *See also Dove-Nation v. eCast Settlement Corp. (In re Dove-Nation)*, 318 B.R. 147, 153 (B.A.P. 8th Cir. 2004) (instructional language contained on form does not override clear statutory language).

VI. THIS COURT SHOULD NOT FOLLOW THE SEVENTH CIRCUIT'S DECISION IN *ROSS-TOUSEY*.

On December 17, 2008, the United States Court of Appeals for the Seventh Circuit decided *Ross-Tousey v. Neary*. *See Ross-Tousey*, 2008 WL 5234070. *Ross-Tousey* is the first circuit decision to interpret the word "applicable" in section 707(b)(2)(A)(ii)(I).[18] *Ross-Tousey* primarily relied on interpretive conclusions reached by a divided Sixth Circuit bankruptcy appellate panel in *Kimbro*, whose decision was entered *after* briefing was completed in *Ross-Tousey*. *See Ross-Tousey*, 2008 WL 5234070, at *5-10 (*citing* and *quoting* extensively from *Kimbro*, 389 B.R. at 518). Accordingly, the Seventh Circuit did not have the benefit of the government's views regarding the *Kimbro* decision prior to reaching its own decision in *Ross-Tousey*.

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[18] *But see Ransom*, 380 B.R. at 799, *appeal pending* Case No. 08-15066 (9th Cir., Jan. 4, 2008); *Pearson*, 390 B.R. at 706, *appeal pending* Case No. 08-8060 (10th Cir., Aug. 19, 2008); *Kimbro*, 389 B.R. at 518, *appeal pending* Case No. 08-5871 (6th Cir., Aug. 24, 2008).

Had the United States Trustee had the opportunity to share those views with the Seventh Circuit he would have argued the following:

First, while the majority in *Kimbro* concluded that the United States Trustee's construction of section 707(b)(2)(A)(ii)(I) improperly gave the same meaning to the words "applicable" and "actual" in section 707(b)(2)(A)(ii)(I), the government's reading actually gives them different ones. *Compare Kimbro*, 389 B.R. at 523-24 *with* United States Trustee's Brief, *supra.* at 16-19. Indeed, this juxtaposition of terms was explained by the dissent in *Kimbro* when it stated that "Congress intended and used the phrases 'applicable monthly expense amounts' . . . and 'actual expenses' . . . simply in recognition of the differing ways in which the IRS uses the National Standards and Local Standards versus the Other Necessary Expense Categories." *Kimbro*, 389 B.R. at 533 (Fulton, J., dissenting).

Second, while the majority in *Kimbro* concluded that the vehicle ownership amount was necessary to cover operating costs, *see Kimbro*, 389 B.R. at 531 (referencing "depreciation, insurance, licensing fees and taxes"), that is factually wrong. To the contrary, a wholly different IRS expense standard governs those types of vehicle expenses. As explained previously, the IRS local standard for transportation is broken down into two subcategories – "ownership costs" and "operating costs;" and "operating costs" include expenses for vehicle maintenance, fuel, state and local registration, required inspection, parking fees, tolls, and driver's license fees. *See* United States Trustee's Brief, *supra*, at 6-7 (*citing* IRS Collection Financial Standards, *available at* United States Trustee Appendix "A" and at *http://www.irs.gov/individuals/article/0,,id=96543,00.html.*)

Third, while the *Kimbro* majority ruled that the phrase "monthly expenses of the debtor shall not include any payments for debts" found in section 707(b)(2)(A)(ii)(I) justifies an ownership expense allowance, *see Kimbro*, 389 B.R. at 523, it does not. Rather, debtors for whom the ownership expense is applicable receive a fixed standard allowance that is the dollar amount under the applicable standard, not the dollar amount associated with a "payment for a debt." *See* United States Trustee's Brief, *supra*, at 19-20.

Fourth, while the *Kimbro* majority relied upon the legislative history of a statute never enacted in order to support its conclusion, *see Kimbro.*, 389 B.R. at 525-27, such an approach has been expressly rejected by at least two circuit courts of appeal (including this Circuit) presumably because it opens the door to the potential subversion of statutory language actually voted on by Congress and signed into law by the President. *See, e.g., Interstate Natural Gas Co.*, 156 F.2d at 952 ("the legislative history of a bill that was not adopted ***cannot*** be resorted to construe a bill that was."), *aff'd*, 331 U.S. 682 (1947) (emphasis added). *See also Blumenthal*, 642 F.2d at 635 n.23 ("[Appellant's] argument that we should not consider the legislative history of a bill that was never enacted represents a correct statement of the law."). Morever, as we discuss above, the legislative history of this statute supports the statutory construction of the word "applicable" adopted by both the bankruptcy court and district court in this case. *See* United States Trustee's Brief, *supra*, at 20-22.

Fifth, and most significantly, the *Kimbro* majority declined to apply the dictionary meaning of the word "applicable" during the course of its statutory analysis of section 707(b)(2)(A)(ii)(I). *See Kimbro*, 389 B.R. at 522-23. Had *Kimbro* applied its definition, as the lower courts in this case did, it would have invariably ended up asking how the vehicle ownership expense allowance is "capable of being applied" to a debtor if the debtor does not make any lease or loan payments on a vehicle. *See, e.g., Ransom*, 380 B.R. at 807-808. Accordingly, because the majority in *Kimbro* failed to take this fundamental step as part of its statutory analysis, its construction of section 707(b)(2)(A)(ii)(I) is suspect.

For each of these reasons, *Ross-Tousey*, which primarily relied on the majority opinion in *Kimbro*, should not be followed by this Court.

CONCLUSION

For these reasons, the United States Trustee respectfully asks the Court to affirm the order entered below.

RESPECTFULLY SUBMITTED, this the 30th day of December, 2008.

R. MICHAEL BOLEN
United States Trustee

Christopher J. Steiskal
CHRISTOPHER J. STEISKAL
Trial Attorney (MSB #101654)
Office of the United States Trustee
Department of Justice
100 W. Capitol Street, Suite 706
Jackson, MS 39269
Tel: (601) 965-5241 ext. 130
Fax: (601) 965-5226
Email: christopher.j.steiskal@usdoj.gov

RAMONA D. ELLIOTT
General Counsel
P. MATTHEW SUTKO
Associate General Counsel
DAVID I. GOLD
Trial Attorney
Executive Office for United States Trustees
Department of Justice
20 Massachusetts Avenue, N.W.
Washington, D.C. 20530

CERTIFICATE OF SERVICE

I, CHRISTOPHER J. STEISKAL, do hereby certify that a copy of the foregoing Brief of the United States as Appellee has been served this day on the below named individual(s) via first class U.S. Mail at the address listed below:

Mary Schillesci McPherson
McPherson & McPherson
2434 Highway 53 South
Poplarville, MS 39470

DATED, this the 30th day of December, 2008.

Christopher J. Steiskal
CHRISTOPHER J. STEISKAL

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DATED, this the 30th day of December, 2008.

R. MICHAEL BOLEN,
United States Trustee Region 5

Christopher J. Steiskal
CHRISTOPHER J. STEISKAL (MSB #101654)
Trial Attorney
Office of the United States Trustee
Department of Justice
100 W. Capitol Street, Suite 706
Jackson, MS. 39269
Tel: (601) 965-5241 ext. 130
Fax: (601) 965-5226
Email: christopher.j.steiskal@usdoj.gov

BRIEF BANK — "SUMMARY SHEET"

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WESTLAW CODES

1. **("TI")** ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*
Chana Taub and Esther Newhouse v. Diana G. Adams, United States Trustee for Region 2, Lori Lapin Jones, As Chapter 11 Trustee, Simon Taub and Pnina Kaufman (In re Chana Taub)

2. **("CO")** ***CURRENT*** COURT *[E.g., "CTA9"]*
E.D.N.Y.

3. **("CCN")** ***CURRENT*** CASE NO.
No.: 10-cv-2600 (CBA), 10-cv-2611 (CBA)

4. **("PCN")** ***PRIOR*** CASE NO. - & COURT *[IF ANY]*
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Noah Schottenstein, P. Matthew Sutko, Ramona D. Elliott, Alicia M. Leonhard
(UST/OGC: 202-307-1399/FAX-2397)

8. **("TO")** ***TOPIC***
BANKRUPTCY

9. **("SU")** ● ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***
● Whether the bankruptcy court abused its discretion when it directed the appointment of a chapter 11 trustee under 11 U.S.C. § 1104(a)(2) and (3).

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IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF NEW YORK

In re:	:	
	:	
CHANA TAUB,	:	Bankruptcy Case No. 08-44210 (ESS)
	:	
Debtor	:	
--	x	
	:	
CHANA TAUB and ESTHER NEWHOUSE,	:	Civ. App. Nos. 10-cv-2600 (CBA)
	:	10-cv-2611 (CBA)
Appellants,	:	
v.	:	
	:	
DIANA G. ADAMS, UNITED STATES	:	
TRUSTEE FOR REGION 2, LORI LAPIN	:	
JONES, AS CHAPTER 11 TRUSTEE,	:	
SIMON TAUB and PNINA KAUFMAN,	:	
	:	
Appellees.	:	
--	x	

BRIEF OF APPELLEE THE UNITED STATES TRUSTEE

Alicia M. Leonhard
Assistant United States Trustee
Office of the United States Trustee
United States Department of Justice
271 Cadman Plaza East, Suite 4529
Brooklyn, New York 11201
Phone: 718.422.4960
Facsimile: 718.422.4990
E-Mail: Alicia.M.Leonhard@usdoj.gov

Ramona D. Elliott
General Counsel
P. Matthew Sutko
Associate General Counsel
Noah Schottenstein
Trial Attorney
Executive Office for United States Trustees
United States Department of Justice
20 Massachusetts Avenue, N.W., Suite 8100
Washington, D.C. 20530
Phone: 202.307.1399

Counsel for the United States Trustee

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I. INTRODUCTION AND STATEMENT OF JURISDICTION

Appellants Chana Taub (the "Debtor") and Esther Newhouse ("Ms. Newhouse") (collectively, the "Appellants") appeal an order of the United States Bankruptcy Court for the Eastern District of New York, Brooklyn Division, entered on April 9, 2010 (the "Trustee Order"), which directed the United States Trustee to appoint a chapter 11 trustee in the Debtor's case under 11 U.S.C. § 1104(a)(2), because appointment of a trustee is in the best interests of creditors and the estate, and 11 U.S.C. § 1104(a)(3), because there was cause to convert or dismiss the case under 11 U.S.C. § 1112(b). [ER, Vol. 1, Ex. 3, at 5.][1] The United States Trustee respectfully requests that this Court affirm the Trustee Order.[2]

The bankruptcy court entered the Trustee Order pursuant to an order to show cause (the "Order to Show Cause" entered on January 21, 2010. [ER, Vol I, Exhibit 13, at 104.] The Trustee Order is a final order under 28 U.S.C. § 158(a)(1). *See In re American Preferred Prescription, Inc.*, 255 F.3d 87, 92 (2d Cir. 2001) (a bankruptcy court order directing the appointment of a chapter 11 trustee is a final judgment for purposes of appeal). *See also In re Pegasus Agency, Inc.*, 101 F.3d 882, 885 (2d Cir. 1996) (a bankruptcy court order is final if it "completely resolve[s] all of the issues pertaining to a discrete claim, including issues as to the proper relief") (citations omitted). The Debtor and Ms. Kaufman filed timely notices of appeal on April 16 and 23, 2010, respectively. [ER, Vol. I, Ex. 2, at 3, and Ex. 1, at 1.] *See* 28 U.S.C. § 158(c)(2) and Fed. R. Bankr. P. 8002(a). This Court, therefore, has jurisdiction to hear the appeal under 28 U.S.C. § 158(a)(1).

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[1] "ER" refers to the Excerpts from the Record on Appeal filed with the Appellee's Brief. "Vol. [#]" refers to the volume of the ER. "Ex. [#]" refers to the exhibit of the document in the ER, and "at #" refers to the consecutively numbered pages in the ER.

[2] Under 11 U.S.C. § 307, the United States Trustee may appear and be heard on any issue in any case or proceeding under the Bankruptcy Code.

II. STATEMENT OF THE ISSUES ON APPEAL

A. Whether the bankruptcy court abused its discretion when it directed the appointment of a chapter 11 trustee under 11 U.S.C. §§ 1104(a)(2);

B. Whether the bankruptcy court abused its discretion when it directed the appointment of a chapter 11 trustee under 11 U.S.C. § 1104(a)(3);

C. Whether the bankruptcy court abused its discretion when it simultaneously entered the Trustee Order and the order restraining the Debtor's estranged husband, Simon Taub ("Mr. Taub"), from interfering with the Debtor's management of property of the bankruptcy estate (the "Restraining Order"); and

D. Whether the bankruptcy court abused its discretion when it declined to authorize the chapter 11 trustee (the "Trustee") to administer property in which the Debtor claims an equitable interest.

III. STANDARD OF APPELLATE REVIEW

An appellate court reviews a bankruptcy court's order directing the appointment of a chapter 11 trustee for abuse of discretion. *In re Marvel Entertainment Group, Inc.*, 140 F.3d 463, 470 (3d Cir. 1998). *See also In re Fairwood Corp.*, 1 Fed. App. 12, 2001 WL 11045, at *1 (2d Cir. Jan. 4, 2001). A bankruptcy court abuses its discretion when it bases its decision on "an error of law or a clearly erroneous finding of fact, or a decision that, 'though not necessarily the product of legal error or a clearly erroneous factual finding[,] cannot be located within the range of permissible decisions.'" *In re Dana Corp.*, 574 F.3d 129, 145 (2d Cir. 2009) (citations omitted). The court reviews a finding that there is cause to convert or dismiss a chapter 11 case under 11 U.S.C. § 1112(b) for clear error. *In re C-TC 9th Avenue Partnership*, 113 F.3d 1304, 1312 (2d Cir. 1997).

IV. SUMMARY OF ARGUMENT

The bankruptcy court properly exercised its discretion when it ordered the appointment of a chapter 11 trustee under 11 U.S.C. § 1104(a)(2) because appointment of a trustee was in the best interests of creditors and the estate. There was clear and convincing evidence in the record to support the court's findings that (1) the Debtor's retention, or attempted retention, of eight bankruptcy lawyers over twenty-one months impaired her ability to manage her case effectively; (2) the Debtor did not meet her administrative obligations as a chapter 11 debtor in possession; (3) the acrimony between the Debtor and her creditors impaired her ability to reorganize; (4) the Debtor's conflicting roles interfered with her ability to act in the best interest of creditors and the estate; and (5) the appointment of a trustee would benefit the bankruptcy estate.

The bankruptcy court properly exercised its discretion when it ordered the appointment of a chapter 11 trustee under 11 U.S.C. § 1104(a)(3) on grounds that cause existed to convert or dismiss the case under 11 U.S.C.§ 1112(b). There was substantial evidence of continuing loss to or diminution of the bankruptcy estate and the absence of a reasonable likelihood of rehabilitation under 11 U.S.C.§ 1112(b)(4)(A).

The bankruptcy court properly exercised its discretion when it entered the Restraining Order and the Trustee Order at the same time a year after the Debtor filed the Motion to Restrain. Mr. Taub has failed to comply with prior restraining orders and there was no evidence in the record demonstrating that the Restraining Order would be any more effective, and the record shows that it was the Debtor, not the court, who caused the delay in adjudicating the motion.

The bankruptcy court properly exercised its discretion when it declined to authorize the Trustee to manage properties in which the Debtor claimed an equitable interest. Chapter 11 trustees are only authorized to take possession and control of property of the bankruptcy estate. The equitable interests were inchoate and not property of the estate, and accordingly, the Trustee had no authority over them. This Court should, therefore, affirm the Trustee Order.

V. STATEMENT OF THE FACTS

A. The Debtor

The Debtor filed an individual voluntary chapter 11 case *pro se* on July 1, 2008 (the "Petition Date"). [ER, Vol. II, Ex. 15, at 210.] On July 16, 2008, the Debtor filed an application to retain Rachel S. Blumenfeld as her bankruptcy counsel. [ER, Vol. II, Exhibit 14, at 112-113, ECF Doc. No. 11.] On July 25, 2008, the Debtor filed an application to substitute Joel M. Shafferman as her bankruptcy counsel. [ER, Vol. II, Exhibit 14, at 114, ECF Doc. No. 20.] On August 4, 2008, the bankruptcy court entered an order approving Mr. Shafferman's retention. [ER, Vol. II, Exhibit 14, at 116, ECF Doc. No. 33.]

The Debtor managed the property of her estate as a debtor in possession until the appointment of the Trustee on April 13, 2010. The United States Trustee was unable to form a committee of unsecured creditors in the case. The case involves four main parties, the Debtor and her sister, Ms. Newhouse, on one side, and the Debtor's estranged spouse, Mr. Taub, and his sister, Pnina Kaufman ("Ms. Kaufman"), on the other.

In May 2007, the Debtor sued Mr. Taub for divorce in the New York State Supreme Court, King's County.[3] [ER, Vol. I, Ex. 6, at 53.] On June 1, 2007, the state court entered an order (the "State Court Restraining Order") (i) authorizing the Debtor to manage rental real properties held in her name, located at 4819 14th Avenue, Brooklyn, New York (the "14th Avenue Property") and 1259 52nd Street, Brooklyn, New York (the "52nd Street Property"), including collecting rents and paying all expenses; and (ii) directing Mr. Taub to provide support to this two youngest children and to pay all expenses, including the mortgage, of the marital residence located at 4823 49th Avenue (the "Marital Residence"), which is also held in the Debtor's name, and to keep the Marital Residence out of foreclosure. [ER, Vol. II, Ex. 23, at 233-236.] On October 30, 2007, the court vacated the portion of the order that authorized the Debtor to collect rents, in light of litigation pending before another judge. *See* Appellant's Exhibit B, Part 3. The Debtor has repeatedly alleged that Mr. Taub violated the order, which resulted in foreclosure complaints against all three properties. [ER, Vol. II, Ex. 6, at 57, and Vol. III, Ex. 34, at 329, and Ex. 36, at 332.] Mr. Taub claims that the Debtor is bound by the order and violates it when she attempts to collect rents. [ER, Vol. II, Ex. 23, at 239-240.] The Debtor filed her chapter 11 case because of the impending foreclosures "as a last resort to save my assets." [ER, Vol. III, Ex. 39, at 359.]

B. Assets and Liabilities

On Schedule A, *Real Property*, filed on July 16, 2008, the Debtor claims ownership interests in ten real properties with an aggregate value of $40.3 million. [ER, Vol. II, Ex. 16, at

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[3] The Debtor originally filed for divorce in June 2005 on grounds of "cruel and inhuman treatment." [ER, Vol. 1, Ex. 6, at 52.] That case was dismissed in May 2007. *Id.*

213-214.] She holds sole title to the Marital Property, which she values at $1.3 million, the 14th Avenue Property, which she values at $1.5 million, and the 52nd Street Property, valued at $1.5 million. *Id*. According to Schedule D, *Creditors Holding Secured Claims*, the Marital Property and the 14th Avenue Property are encumbered by mortgages and other liens in the aggregate amount of $1,025,120.12. [ER, Vol. II, Ex. 17, at 215.] Both the Marital Property and the 14th Avenue Property were in foreclosure on the Petition Date. [ER, Vol. II, Ex. 22, at 230-231, Statement of Financial Affairs, Question 4.] The Debtor did not schedule any mortgages or other encumbrances on the 52nd Street Property. [ER, Vol. II, Ex. 17, at 215-216.] The Debtor also claims joint ownership with Mr. Taub in a summer home located at 85 Forshay Road, Monsey, New York (the "Forshay Road Property"). [ER, Vol. II, Ex. 16, at 214.] The Forshay Road Property is encumbered by a mortgage in the amount of $280,000 and a foreclosure was pending on the Petition Date. [ER, Vol. II, Ex. 17, at 216, and Ex. 22, at 230-231, Question 4.] The 52nd Street Property, the 14th Avenue Property and the Forshay Road Property (collectively, the "Rental Properties") generate rent revenues. [ER, Vol. I. Ex. 6, at 55, and Vol. III, Ex. 53, at 447.] The Debtor also scheduled an equitable interest in property located at 27 Grand Avenue, Brooklyn, New York, 10 Grand Avenue, Brooklyn, New York, and 6-8 Grand Avenue, Brooklyn, New York (collectively, the "Grand Avenue Properties"), and claims to own three properties located in Israel but did not state the nature or value of her ownership interest. [ER, Vol. II, Ex. 16, at 213.]

On Schedule E, *Creditors Holding Unsecured Priority Claims*, the Debtor listed claims in the total amount of $56,414.68 for real property taxes and water and sewer charges related to the 14th Avenue Property, the 52nd Street Property and the Marital Residence. [ER, Vol. II, Ex.

18, at 218-219.] On Schedule F, *Creditors Holding Unsecured Nonpriority Claims*, the Debtor scheduled general unsecured claims totaling $18,240,872.98. [ER, Vol. II, Ex. 19, at 220-224.] Most of the scheduled unsecured debt is lawyers' claims for legal fees. *Id.*

C. Income and Expenses

On Schedule I, *Current Income of Individual Debtor*, the Debtor claimed to have income from real property in the amount of $2,538 per month and support from family members in the amount of $5,000 per month. [ER, Vol. II, Ex. 21, at 225.] Her expenses on Schedule J, *Current Expenditures of Individual Debtor*, totaled $24,657 per month, including mortgage payments of $12,000 and $3,350 for utilities. [ER, Vol. II, Ex. 22, at 226-227.]

In her monthly operating report for February 2010, the Debtor listed rental income of $4,587.60. [ER, Vol. III, Ex. 52, at 447.] She listed expenses totaling $4,507.44, for among other things, utilities for the 14th Avenue Property and the 52nd Street Property, insurance and repairs for the 52nd Street Property and the 14th Ave. Property. [ER, Vol. III, Ex. 52, at 447.] The Debtor claims that the Rental Properties were fully rented, she would earn $11,850 per month. [ER, Vol. III, Ex. 45, at 375-376.]

The Debtor has admitted that she has not paid the mortgages for the Marital Residence, the Forshay Road Property and the 14th Street Property since the Petition Date. [ER, Vol. 1, Ex. 6, at 66.] The monthly mortgage payment for the Marital Residence is $5,019.19 and the post petition arrearages are in excess of $150,978.08. [ER, Vol. III, Ex. 45, at 369 and 376.] The monthly mortgage payment for the Forshay Road Property is $2,974.18. [ER, Vol. III, Ex. 45, at 376.]. Prepetition arrearages for the Forshay Road Property total $96,043.34 and post petition arrearages are $53,535.24. [ER, Vol. III, Ex. 53, at 448, and Vol. I, Ex. 6, at 56.] The monthly mortgage for the 14th Avenue Property is $2,933.17, with pre- and post petition arrearages as of February 2010 of $51,500.56 and $57,750.39, respectively. [ER, Vol. III, Ex. 53, at 448, and Vol. I, Ex. 6, at 56. Post petition arrearages for the 14th Avenue Property, the Forshay Road Property and the Marital Residence total $262,263.71. However, the Debtor claims that the mortgage on the Marital Property is Mr. Taub's responsibility under the State Court Restraining Order. [ER, Vol. III, Ex. 53, at 448.] The Debtor also claims that, since July 2005, Mr. Taub has diverted rents from the Rental Properties in the cumulative amount of $442,460.05. [ER, Vol. I, Ex. 6, at 53 and 67.]

D. Disputes Between the Parties and the Failed Mediation

Mr. Taub's alleged diversion of the rents and the Debtor's authority to manage the Rental Properties have been issues since the beginning of the case. [ER, Vol. II, Ex. 25, at 256-257, and Ex. 23, at 239-240, Vol. III, Ex. 36, at 332 and Ex. 45, at 368.] Mr. Taub and the Debtor have also repeatedly blamed each other for the failure to pay administrative expenses related to the Marital Residence and the Rental Properties in letters and pleadings filed with the bankruptcy court. [ER, Vol. II, Ex. 14, ECF 70 and 76, Ex. 24, at 246-248.]

1. Mr. Taub's First Motion to Dismiss

On July 30, 2008, Mr. Taub filed a motion to dismiss the Debtor's case (the "First Motion to Dismiss"), alleging that the Debtor had misappropriated rents and other funds and had failed to pay mortgages and other expenses related to the Rental Properties and the Marital Residence. [ER, Vol. II, Ex. 24, at 240.] He alleged that the Debtor filed the case in bad faith to obtain a tactical advantage in the divorce case where she had already "lost in scorched earth tactics." [ER, Vol. II, Ex. 24, at 237.] In her opposition, the Debtor called Mr. Taub "immoral, indecent and sadistic." [ER, Vol. II, Ex. 25, at 276.] She accused him of "looting" the properties and "intimidating" her tenants and forging her signature to steal from her bank accounts. [ER, Vol. II, Ex. 25, at 257.]

2. The Debtor's Complaint for Injunctive Relief Against Mr. Taub (Adv. Pro. No. 08-1170 (ESS)

On July 29, 2008, the Debtor filed a complaint for injunctive relief seeking to enjoin Mr. Taub from collecting rents from the Rental Properties (Adv. Pro. No. 08-01170 (ESS)). [ER, Vol. II, Ex. 26, at 280.] The Debtor also sought a preliminary injunction by order to show cause (the "Motion for Preliminary Injunction"), seeking, among other things, an order restraining Mr. Taub from interfering in the management of the Debtor's properties, authorizing the Debtor to collect rents for the properties, directing Mr. Taub to turn over rents collected and to provide an accounting of rents collected and expenses paid. [ER, Vol. II, Ex. 27, at 295.]

On July 30, 2008, the bankruptcy court entered an order scheduling a hearing on the order to show cause and granting limited interim relief (the "TRO"). [ER, Vol. II, Ex. 28, at 312.] Among other things, pending a hearing, the TRO restrained Mr. Taub from collecting rents generated by the Rental Properties until further order of the court and authorized the Debtor to collect rents from the Rental Properties for August 2008 and deposit them in Joel Shafferman's escrow account. [ER, Vol. II, Ex. 23, at 314.] At the hearing held on July 31, 2008, the bankruptcy court also "so ordered" an agreement of the parties that they would not sell, transfer, mortgage the Rental Properties or otherwise diminish them in value. [ER, Vol. II, Ex. 26, at 282, July 31, 2008 Docket Entry.] This order is still in effect. [ER, Vol. I, Ex. 4, at 13.]

The parties attempted to work out a consent order with respect to the collection of rent and payment of expenses related to the Rental Properties to resolve both the First Motion to Dismiss and the Motion for Preliminary Injunction. The Debtor filed a form of proposed order (the "Proposed Consent Order") on August 15, 2008. [ER, Vol. II, Ex. 14, at 117, ECF Doc. No 13.] However, on August 13, 2008, the Debtor filed a motion to substitute Craig Heller as her bankruptcy counsel. [ER, Vol. II, Ex. 14, at 117, ECF Doc. No. 40.] The court never approved Mr. Heller's retention because the Debtor fired him on August 25, 2010. [ER, Vol. III, Ex. 30, at 318.] On October 30, 2008, Erica Itzhak appeared at a hearing on behalf of the Debtor. [ER, Vol. III, Ex. 54, at 454, Lines 14-17.] Although Ms. Itzhak told the court that she would file a retention application that day, she did not, and she never appeared for the Debtor again. [ER, Vol. III, Ex. 54, at 457, Lines 4-22.] On November 12, 2008, the Debtor filed an application to retain the law firm of LaMonica Herbst and Maniscalco ("LaMonica") as bankruptcy counsel. [ER, Vol. II, Exhibit 14, at 124, ECF Doc. No. 92.] On November 20, 2008, however, LaMonica filed a letter withdrawing as proposed counsel. [ER, Vol. II, Exhibit 14, at 125, ECF Doc. No. 96.] Thereafter, the Debtor appeared *pro se* in the case from August 25, 2008 to December 17, 2008, when she finally retained substitute counsel. [ER, Vol. II, Ex. 14 at 149, ECF Doc. No. 127.] The parties never reached an agreement on the terms of the Proposed Consent Order.

3. Mr. Taub's Motion for Relief from Stay

On September 28, 2008, Mr. Taub filed a motion for abstention and relief from the automatic stay to allow the New York Supreme Court to determine the equitable division of property in the divorce (the "Motion for Relief from Stay"). [ER, Vol. II, Ex. 14, at 122, ECF Doc. Nos. 80-82.] The bankruptcy court adjourned the hearing on the Motion for Relief from Stay several times at both the Debtor's and Mr. Taub's request. [ER, Ex 14, at 121, ECF Doc. No. 86, 125, ECF Doc. No. 96, and 126, ECF Doc. No. 107.]

4. Ms. Kaufman's Adversary Proceeding to Impose a Constructive Trust on the 52nd Street Property in Favor of Moishe Taub (Adv. Pro. No. 08-01424 (ESS))

On December 1, 2008, Ms. Kaufman filed an adversary proceeding against the Debtor seeking to impose a constructive trust on the 52nd Street Property in favor of her and Mr. Taub's father, Moishe Taub. [ER, Vol. II, Ex. 14, at 147, ECF Doc. No. 114.] During the course of the adversary proceeding, the Debtor and Ms. Kaufman became embroiled in numerous discovery disputes that delayed adjudication of the issues.

5. The Mediation

On December 10, 2008, the bankruptcy court entered an order referring all of the pending disputes between the parties to mediation and directing the parties to submit a stipulation and mediation order. [ER, Vol. II, Ex. 14, at 129, ECF Doc. No. 125.] After nearly four months without counsel, the Debtor filed an application and a supplemental application to retain Dennis Houdek as bankruptcy counsel on December 18, 2008. [ER, Vol. II, Exhibit 14, at 130, ECF Doc. Nos. 129 and 131.] On January 30, 2009, the bankruptcy court entered an order approving Mr. Houdek's retention. [ER, Vol. II, Exhibit 14, at 123, ECF Doc. No. 164].

The parties could not agree on the term of a stipulation and mediation order. [ER, Vol. II, Ex. 14, at 129-130, ECF Doc. Nos. 127 and 130-135.] Therefore, the bankruptcy court issued a supplemental order referring the issues to mediation on December 23, 2008, which directed the parties to submit a stipulation authorizing the retention of a mediator and to raise procedural issues with the mediator. [ER, Vol. II, Ex. 14, at 131, ECF Doc. No. 145.] The parties again could not agree to the terms of a stipulation and order. [ER, Vol. II, Ex. 14, ECF Doc. Nos. 152, 253, 155, 158, 160, 161, and 165.] The bankruptcy court, therefore, entered a second supplemental mediation order on February 3, 2009, setting forth the terms of the mediation.

[ER, Vol. III, Ex. 40, at 343.]

The mediator held a number of sessions with the parties, but the mediation was ultimately unsuccessful. On August 6, 2009, the mediator filed a letter informing the Court that the Debtor had refused to pay her portion of his fee. [ER, Vol. II, Ex. 41, at 348.] On October 27, 2009, the Court entered an order directing the Debtor to pay the mediator's fee. [ER, Vol. II, Ex. 42, at 350.] To date, the Debtor has not paid the mediator's fee. [ER, Vol. I, Ex. 4, at 12-13.]

6. The Debtor's Complaint to Avoid Fraudulent Conveyance of the Grand Avenue Properties and to Impose a Constructive Trust (Adv. Pro. No. 09-01027 (ESS))

On February 9, 2009, the Debtor filed a complaint to avoid fraudulent conveyances or to impose a constructive trust in her favor. The complaint alleged that Mr. Taub had transferred the Grand Avenue Properties to his daughters from a previous marriage for no consideration and was claiming that the Debtor no longer had any equitable interest in them. [ER, Vol. III, Ex. 43, at 354.] On June 1, 2009, Mr. Taub filed a motion requesting that the bankruptcy court abstain from deciding the issues in the Adversary Proceeding. [ER, Vol. II, Ex. 43, at 357, ECF Doc. No. 10.] The Debtor and Ms. Newhouse opposed the motion. [ER, Vol. II, Ex. 43, at 357-358, ECF Doc. Nos. 13-16 and 19.] The bankruptcy court held a hearing on the motion on July 22, 2009 and reserved decision. [ER, Vol. II, Ex. 43, at 358, July 22, 2009 Docket Entry.] On August 14, 2009, the Court entered a memorandum decision and order granting the motion. [ER, Vol. III, Ex. 43, at 359, at 32, ECF Doc. Nos. 20 and 21.]

7. The Debtor's Motion to Restrain

On February 23, 2009, the Debtor filed a motion to restrain Mr. Taub from interfering with the Debtor's management of the estate and to compel him to turn over and account for rent and pay rent for his apartment at the 14th Avenue Property (the "Motion to Restrain") in *Taub v.*

Taub, Adv. Pro. No. 08-01170. [ER, Vol. III, Ex. 45, at 367.] The bankruptcy court set the hearing for March 13, 2009, adjourned the hearing to April 7, 2009, and then further adjourned the hearing at the debtor request. [ER, Vol. II, Ex. 26, at 287-288, March 13, 2009 Docket Entry, ECF Doc. No. 27, and April 7, 2009 Docket Entry.]

On June 1, 2009, Mr. Taub filed a motion to abstain and the parties turned their attention to litigating this motion. [ER, Vol. II, Ex. 26, at 289-290, ECF Doc Nos. 33-38.] On August 14, 2009, the Court entered a memorandum decision and order denying the motion. [ER, Vol. II, Ex. 26, at 289-290, ECF 39 and 40.]

On September 23, 2009, the bankruptcy court entered a scheduling order for the Motion to Restrain, which set a discovery deadline of November 6, 2009, and a pretrial conference for October 27, 2009. [ER, Vol II, Ex. 26, at 291, ECF Doc. No. 41.] On October 21, 2009, the Debtor filed a motion to extend time to complete discovery. [ER, Vol II, Ex. 26, at 291-292, ECF Doc. No. 43.] At a hearing on December 2, 2009, the court extended the discovery deadline until December 7, 2009, and set an adjourned pretrial conference for January 20, 2010. [ER, Vol II, Ex. 26, at 292, December 2, 2009 Docket Entry.] The court set the hearing on the Motion to Restrain for February 25, 2010. [ER, Vol. II, Ex. 26, at 293, January 20, 2010 Docket Entry.]

8. The Motion to Compel

On February 17, 2009, Ms. Kaufman filed a motion to compel the Debtor to pay administrative expenses relating to the 52nd Street Property in the amount of $15,315 (the "Motion to Compel"). [ER, Vol. III, Ex. 44, at 361.] In response, the Debtor filed a cross motion to restrain Ms. Kaufman from interfering in her management of the 52nd Street Property. [ER, Vol. III, Ex. 44, at 361.] Ms. Kaufman filed responses in opposition to the cross motion and in support of the Motion to Compel on April 1, 2009, and April 22, 2009. [ER, Vol. II, Ex. 14, at 139, ECF Do. No.192, and 145, ECF Doc. No. 219.] The Debtor filed a responsive affirmation on April 23, 2009. [ER, Vol. II, Ex. 14, at 145, ECF Doc. No. 223.] Ms. Kaufman and Mr. Taub filed replies on April 23, 2009 and April 26, 2090, respectively. [ER, Vol. II, Ex. 14, at 145, ECF Doc. No. 223 and 224.] The bankruptcy court adjourned the hearing on the Motion to Compel pending completion of mediation. [ER, Vol. II, Ex. 14, at 145, ECF Doc. No. 223 and 224.]

9. The Bankruptcy Court's Order Granting the Motion for Relief from Stay.

After the parties were unable to come to a resolution of the issues between them in mediation, the bankruptcy court set a hearing on the Motion for Relief from Stay for July 22, 2009 and entered a memorandum decision and order on August 14, 2009 (the "Relief from Stay Order"), modifying the automatic stay to allow the state court to proceed to judgment in the divorce case, including determining the equitable division of property. [ER, Vol. II, Ex. 14, at 165, ECF Doc. Nos. 316 and 317.] On August 27, 2009, the Debtor filed a motion for reconsideration of the Relief from Stay Order. [ER, Vol. II, Ex. 14, at 166, ECF Doc. No. 326.] The Court denied the motion in a decision and order entered on December 11, 2009. [ER, Vol. II, Ex. 14, at 179-180, ECF Doc. Nos. 396-397.] On December 18, 2009, the Debtor filed a *pro se* notice of appeal of the order denying reconsideration of the Relief from Stay Order. [ER, Vol. II, Ex. 14, at 180, ECF Doc. No. 402.] On December 23, 2009, the Debtor filed a motion for stay pending appeal, also *pro se*, but withdrew it at a hearing held on January 4, 2010. [ER, Vol. II, Ex. 14, at 181, ECF Doc. No. 409, and 182, January 4, 2010 Docket Entry.] The appeal was docketed in this Court on February 2, 2010 (Civil No. 10-cv-00428 (CBA)), but the Debtor withdrew it on June 16, 2010.

10. Disputes Over the Debtor’s Disclosure and Payment of Administrative Expenses

Over the course of the case, the Debtor and Ms. Newhouse, on the one hand, and Mr. Taub and Ms. Kaufman on the other, had numerous formal and informal disputes regarding the Debtor’s disclosure and payment of administrative expenses, in addition to the Motion to Compel. For example, on May 15, 2009, Mr. Taub filed a motion to compel the Debtor to disclose unpaid administrative obligations. [ER, Vol. II, Ex. 14, at 149, ECF Doc. No. 240.] The Debtor opposed the motion, arguing that the information requested was duplicative of disclosures made in her monthly operating reports. [ER, Vol. II, Ex. 14, at 151, ECF Doc. No. 252.] The court set the hearing on the motion for June 29, 2009, and ordered the parties to meet and confer to resolve the issues raised in the motion prior to that time. [ER, Vol. II, Ex. 14, at 155, June 29, 2009 Docket Entry.] At the hearing, the Debtor agreed to file a status report on pre and post petition real estate taxes by July 7, 2009. The Debtor filed the status report on July 16, 2010. [ER, Vol. III, Ex. 47, at 419.] In it, she alleged that Mr. Taub had forged her name on a forbearance agreement with the taxing authorities with respect to prepetition tax liens on the 52nd Street Property that she only learned about when she filed the petition. *Id*. She disclosed that prepetition tax delinquencies total $1,460.27. She stated that the post petition quarterly tax liability is $1,864.82 and that she was current. *Id*. at 420.

At a hearing held on December 2, 2009, the Court ordered the Debtor to provide an accounting of post-petition real estate taxes, utilities, Environmental Control Board (“ECB”) violations, and other expenses associated with the Marital Properties and the Rental Properties. ER, Vol. II, Ex. 14, at 179, December 2, 2009 Docket Entry.] In a letter filed with the Court on December 11, 2009, the Debtor provided an accounting for the 52nd Street Property but not the others. [ER. Vol. III, Ex. 48, at 423.] She claimed that she was current on utility payments, insurance and real estate taxes, but behind on water bills because the bill had gone up from $1,000 to $5,000 per month. *Id*. In addition, she stated that only one out of six tenants was paying rent, which had resulted in post petition rent arrearages of $53,763. *Id*.

However, Ms. Kaufman, in a letter filed on December 18, 2009, alleged that the Debtor owed real estate taxes on all four properties in the total amount of $11,152.48, representing arrears for two quarters. [ER. Vol. III, Ex. 49, at 425-426.] She also alleged, among other things, that the Debtor had not paid the water bill for the 52nd Street Property since September 2008 and owed $10,206.13 and owed over $10,000 for water service for the Marital Residence. *Id*. at 426. She also stated that there were outstanding ECB fines on the 52nd Street Property in the amount of $15,000. *Id*.

11. The Debtor's and Mr. Taub's Cross Motions to Restrain Each Other From Diverting Mail

On December 24, 2009, Mr. Taub filed a motion to restrain the Debtor from diverting his mail (the "Mail Motion"), and on January 15, 2010, the Debtor filed a cross motion *pro se* to restrain Mr. Taub from diverting her mail (the "Mail Cross Motion"). [ER. Vol. III, Exs. 50-51, at 428-433.] The Debtor filed the Mail Cross Motion *pro se* even though Mr. Houdek represented her. [ER, Vol. III, Ex. 52, at 440.] At a hearing held on January 4, 2010, the Debtor appeared with John Macron as her proposed substitute counsel and informed Mr. Houdek that she was terminating his services. [ER, Ex. 55, at 462, Lines 10-24, and 463, Lines 1-3.] On January 9, 2010, Mr. Houdek filed a final application for compensation and a motion to withdraw as counsel. [ER, Vol. II, Ex. 14, at 183, ECF Doc. No. 420.] The Debtor filed an application to retain Mr. Macron on January 14, 2010, but withdrew it on January 19, 2010. [ER, Vol. II, Ex. 14, at 183-184, ECF Doc. Nos. 422 and 426.] On January 20, 2010, Mr. Houdek filed a supplemental affirmation in support of the motion to withdraw. [ER, Vol. III, Exhibit 52, at 439.] In it, he stated that the Debtor filed the Cross Motion *pro se* without his knowledge and that although she had fired him at the January 4, 2010, he understood that he represented the Debtor until the court entered an order approving his withdrawal. *Id*. at 440. Therefore, on January 20, 2010, he filed an amended Cross Motion for the Debtor to add his signature as Debtor's counsel. *Id*. On January 22, 2010, the court entered an order approving the motion to withdraw. [ER, Vol. II, Exhibit 14, at 187, ECF Doc. No. 442.] On February 25, 2010, the Court entered an order directing both the Debtor and Mr. Taub to turn over mail and to refrain from interfering with each other's mail delivery. [ER, Ex. 14, at 188, ECF Doc. No. 489.]

12. Mr. Taub's Second Motion to Dismiss

On December 29, 2009, Mr. Taub filed a second motion to dismiss the case (the "Second Motion to Dismiss"). [ER, Ex. 14, at 182, ECF Doc. No. 416.] The bankruptcy court set the hearing on the Second Motion to Dismiss for February 25, 2010. [January 20, 2010 Docket Entry.]

E. The Order to Show Cause

On January 21, 2010, the Court issued the Order to Show Cause why a chapter 11 trustee should not be appointed, with a hearing to be held on February 25, 2010. [ER, Vol. I, Ex.13, at 104.] The United States Trustee, Ms. Kaufman and Mr. Taub filed memoranda in support of an order directing the appointment of a trustee. [ER, Vol. II, Ex. 14, at 190-191, ECF Doc. Nos. 470, 471, and 475.] The Debtor and Ms. Newhouse opposed the appointment of a trustee. [ER, Vol. II, Ex.14, at 190-191, ECF Doc. Nos. 477 and 479.]

The Debtor filed her objection *pro se* because she had not yet retained counsel after the court approved Mr. Houdek's withdrawal. [ER, Vol. 1, Ex. 6, at 49.] On January 28, 2010, she asked the bankruptcy court to adjourn the Order to Show Cause and all other proceedings for sixty days so that she could find counsel. [ER, Vol. 1, Ex.12, at 102.] On February 2, 2010, the court denied the request. [ER, Vol. 1, Ex. 11, at 100.] On February 23, 2010, the Debtor filed an application to retain David Carlebach as counsel and to borrow funds from Ms. Newhouse to pay a retainer, and Mr. Carlebach represented her at the hearing on February 25, 2010.[4] [ER, Vol. II, Exhibit 14, at 198, ECF Doc. No. 480.]

On February 25, 2010, the Court heard arguments regarding appointment of a chapter 11 trustee, the Motion to Compel and the Motion to Restrain and adjourned the Second Motion to Dismiss. *See* February 25, 2010 Docket Entries. After the hearing, the Court took the Order to Show Cause, the Motion to Compel and the Motion to Restrain under advisement. *Id*.

F. The Decision and Trustee Order

On April 9, 2010, the bankruptcy court entered a decision resolving the Motion to Compel and the Cross-Motion and directing the appointment of a chapter 11 trustee, pursuant to the Order to Show Cause, under 11 U.S.C. §§ 1104(a)(2) and (3) (the "Decision"). [ER, Vol. 1, Ex. 3, at 5.] In the Decision, the court noted that the Motion to Restrain sought to direct Mr. Taub to comply with terms of the Bankruptcy Code, which is usually not required because "compliance is expected, by the debtor and creditors alike." [ER, Vol. I, Ex. 4, at 22.] However, the court stated that because of the "difficulties and disputes between the Debtor and Mr. Taub . . the Court is satisfied that the record warrants the entry of an order directing Mr. Taub and his agents not to interfere with the management of property of the estate." [ER, Vol. I, Ex. 4, at 22-

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[4] The Debtor amended the application on March 22, 2010. [ER, Vol. II, Ex. 14, at 197, ECF Doc. No. 515.] On June 17, 2010, the bankruptcy court entered a consent order approving Mr. Carlebach's retention from February 23, 2010 through April 12, 2010 and denying approval of a loan to the bankruptcy estate for the retainer. [ER, Vol. II, Exhibit 14, at 209, ECF Doc. No. 601.]

23.] The court also ordered Mr. Taub to account for and turn over any rents he collected from the Rental Properties and to vacate the apartment at the 14th Avenue or pay rent. [ER, Vol. I, Ex. 4, at 23-24.] The court declined to order Mr. Taub to make prepetition payments required under orders of the state court. [ER, Vol. I, Ex. 4, at 26.]

In granting the Motion to Compel, the court noted that, as with the Motion to Restrain, it was unusual to order debtors to comply with the Bankruptcy Code. [ER, Vol. I, Ex. 4, at 2] However, the court held that, of the “unpaid expenses and mounting losses that have marked the Debtor’s management of the estate from its inception in July 2008 show no signs of abating,” and thus an order compelling the Debtor to pay the administrative expenses associated with the 52nd Street Property was warranted. [ER, Vol. I, Ex. 4, at 29.]

The bankruptcy court held that appointment of a trustee was in the best interests of creditors and the estate under Section 1104(a)(2). Specifically, the court found that the Debtor’s retention, or proposed retention, of at least eight counsel over the course of the case impaired her ability to manage her case effectively and to move it toward a prompt resolution. [ER, Vol. I, Ex. 4, at 34-35.] As grounds for the appointment of a trustee, the court also cited the Debtor’s failure to remain current on post-petition expenses and to comply with court orders, the acrimony among the parties, and conflicting roles as debtor in possession, landlord and litigant had eroded her creditors’ confidence in her ability to carry out her duties in bankruptcy. [ER, Vol. I, Ex. 4, at 36.] The court also held that appointment of a trustee was warranted under Section 1104(a)(3) because the diminution in the value of the estate and the absence of a reasonable likelihood of rehabilitation constituted cause to convert or dismiss the case under 11 U.S.C. § 1112(b)(4)(A). [ER, Vol. I, Ex. 4, at 39-43.]

G. Appointment of the Trustee

On April 13, 2010, after consulting with parties in interest, the United States Trustee appointed Lori Lapin Jones as trustee. [ER, Vol. II, Ex. 14, at 198, ECF Doc. No. 522.] The court approved the appointment on April 13, 2010. [ER, Vol. II, Ex. 14, at 198, ECF Doc. No. 524.] The Debtor files a timely notice of appeal of the Trustee Order on April 16, 2010 and Ms. Newhouse filed her notice of appeal on April 23, 2010.

VI. ARGUMENT

A. The Bankruptcy Court Did Not Abuse Its Discretion When It Directed the Appointment of a Chapter 11 Trustee under 11 U.S.C. § 1104(a)(2).

Under 11 U.S.C. § 1104(a)(2),

> (a) At any time after the commencement of the case but before confirmation of a plan, on request of a party in interest or the United States trustee, and after notice and a hearing, the court shall order the appointment of a trustee —
>
> . . . .
>
> (2) if such appointment is in the interests of creditors, any equity security holders, and other interests of the estate . . . .

11 U.S.C. § 1104(a)(2).

Under Section 1104(a)(2), the bankruptcy court has the discretion to order the appointment of a chapter 11 trustee when "when to do so would serve the parties' and the estate's interests." *Marvel Entertainment*, 140 F.3d at 474. *See also In re Sharon Steel Corp.*, 871 F.2d 1217, 1226 (3d Cir. 1989) (Section 1104(a) creates a flexible standard for the appointment of a trustee when it "addresses the interests of creditors, equity security holders and other interests of the estate"). Courts review a variety of factors to determine whether to exercise their discretion, including the debtor's performance in chapter 11 and prospects for rehabilitation, whether the creditors in the case have confidence in the debtor's ability to reorganize, and whether benefits derived from the appointment of a trustee outweigh the burdens. *In re Ridgemour Meyer Properties, LLC*, 413 B.R. 101, 112 (Bankr. S.D.N.Y. 2008).

The party seeking the appointment of a chapter 11 trustee under Section 1104(a)(2) has the burden of showing, by clear and convincing evidence, that appointment of a trustee is in the best interests of creditors and the estate.[5] *In re 1031 Tax Group, LLC*, 374 B.R. 78, 85 (Bankr. S.D.N.Y. 2007). *See also Sharon Steel*, 871 F.2d at 1226 (the movant must show that appointment of a trustee is warranted by clear and convincing evidence).

Here, the bankruptcy court found that, based on the entire record, the appointment of a chapter 11 trustee was warranted for five reasons. First, the Debtor's retention, or proposed retention, of at least eight lawyers during the case impaired her ability to effectively manage the case and to move it toward a prompt resolution. [ER, Vol. I, Ex. 3, at 34-36.] Second, the Debtor failed to meet her administrative obligations. *Id.* at 35. Third, the relationship between the Debtor and the main creditors in the case was acrimonious and unproductive. *Id*. at 37. Fourth, as a debtor in possession, the Debtor was "weighed down by conflicting roles and conflicts of interest" and her most active creditors had lost confidence in her ability to carry out her duties as debtor in possession. *Id.* at 37. Fifth, the record supports the court's finding that the appointment of chapter 11 trustee would benefit the bankruptcy estate. *Id.* at 37-39.

Because there is clear and convincing evidence in the record to support these findings, none of them is clearly erroneous, and the bankruptcy court did not abuse its discretion in directing the appointment of a chapter 11 trustee under 11 U.S.C. § 1104(a)(2)

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[5] The Second Circuit has stated that the United States Trustee has the burden of showing by "clear and convincing evidence" that the appointment of a trustee is warranted. *In re Bayou Group, LLC,* 564 F.3d 541, 546 (2d Cir. 2009). The United States Trustee respectfully suggests that the burden of proof should only be a "preponderance of the evidence." *See, e.g. Tradex Corp. v. Morse*, 339 B.R.823, (D. Mass. 2006). Nonetheless, regardless of which burden was used in this case, the bankruptcy court did not abuse its discretion in directing the appointment of a trustee.

1. The Bankruptcy Court Did Not Clearly Err When It Found that the Debtor's Retention, or Proposed Retention, of at Least Eight Attorneys Impaired her Ability to Manage the Case Effectively.

There is clear and convincing evidence in the record to support the court's finding that the Debtor's serial retention, or attempted retention, of eight bankruptcy lawyers impaired her ability to manage her case effectively and to move toward a prompt resolution. This, coupled with her inability to develop cooperative relationships with retained counsel, contributed to the Debtor's utter lack of progress toward proposing and confirming a plan over nearly two years.

In the first two months of the case, the Debtor retained and then fired three bankruptcy lawyers. During the twenty-one months between the Petition Date and the appointment of the Trustee, the Debtor retained, or attempted to retain, a total of at least eight lawyers, and she appeared *pro se* for significant periods of time.

The Debtor sought bankruptcy court approval of Ms. Blumenfeld's retention after the Petition Date on July 16, 2008. [ER, Vol. II, Ex. 14, at 112-113, ECF Doc. No. 11.] Just nine days later and before the bankruptcy court approved Ms. Blumenfeld's retention, the Debtor filed an application to retain Mr. Shafferman as substitute counsel. [ER, Vol. II, Ex. 14, at 114, ECF Doc. No. 21.] Days after the court approved Mr. Shafferman's retention on August 4, 2008, the Debtor terminated his services. [ER, Vol. II, Ex. 4, at 116-117, ECF Docs. 33 and 40.] The Debtor then filed an application to retain Mr. Heller on August 13, 2008, but then fired him in a letter dated, August 22, 2008, that she filed with the court on August 25, 2008. [ER, Vol. III, Exs. 30 and 31, at 317-324.] Ms. Itzhak appeared at one hearing held on October 30, 2008 but the Debtor did not seek to retain her. [ER, Vol. III, Ex. 54, at 454, Lines 14-17.] On November 12, 2008, the Debtor filed an application to retain LaMonica, but the firm withdrew the application eight days later on November 20, 2008. [ER, Vol. II, Ex. 14, at 124-125, ECF

Doc. Nos. 92 and 96.] After that, the Debtor appeared *pro se* until December 18, 2008 when she sought court approval of the retention of Mr. Houdek. [ER, Vol. II, Ex. 14, at 130, ECF Doc. Nos.129 and 131.] The court approved Mr. Houdek's application by order entered on January 30, 2009. [ER, Vol. II, Ex. 14, at 134, ECF Doc. No. 164.] The Debtor terminated Mr. Houdek on January 4, 2010 when she appeared in court with Mr. Macron as proposed substitute counsel. [ER, Ex. 55, at 462, Lines 10-24, and 463, Lines 1-3.] The Debtor filed an application to retain Mr. Macron on January 14, 2010, but withdrew it on January 19, 2010. [ER, Vol. II, Ex. 14, at 1183-184, ECF Doc. Nos. 422 and 426.] Finally, the Debtor sought court approval of the retention of Mr. Carlebach on February 23, 2010, and the court approved his retention on June 17, 2010. [ER, Vol. II, Ex. 14, at 191, ECF Doc. No. 480, and 209, ECF Doc. No.601.]

The Debtor's relationships with counsel were contentious and unproductive. In a letter filed with the bankruptcy court, the Debtor stated that she terminated Ms. Blumenfeld because she "constantly deals with Mr. Fox, [Mr. Taub's attorney,] that he is always referring clients and business to her [and she] would not recuse Mr. Fox – that she would rather recuse herself." [ER, Vol. III, Ex. 30, at 320.] According to the Debtor, Mr. Shafferman "seemed to compromise my interests," apparently because he had included in the Proposed Consent Order, "Mr. Fox's ridiculous dictates that were not discussed in court, [and] I felt that I needed an attorney who would not be intimidated and who would honestly pursue my interests." [ER, Vol. III, Ex. 30, at 318.] The Debtor fired Mr. Heller in a letter, dated August 22, 2008 and filed with the court, because "**<u>YOU HAVE VIOLATED YOUR OWN CONTRACT TO ADVOCATE ON MY BEHALF</u>[.]"** [ER, Vol. III, Ex. 30, at 318.] (Emphasis in original.) The Debtor took issue with Mr. Heller's request, after he had a discussion with Mr. Fox, that she immediately send the August rent checks from the Rental Properties to him by Fed Ex so that he could deposit them in his escrow account in compliance with the parties' agreement. *Id.* at 318-319. She wrote:

> **Why did you not simultaneously demand from Mr. Fox that Simon Taub also Fed-Ex the JULY rents he was illegally keeping from my properties?** ***Why did you assist Mr. Fox in his demands against me, while refusing to advocate likewise on my behalf?***

Id. (emphasis in original).

In letter, dated November 21, 2008 filed with the court, the Debtor blamed Mr. Taub for LaMonica's withdrawal, stating that, "It seems that everywhere I turn, Simon Taub is sabotaging and frustrating all my efforts in order to achieve justice." [ER, Vol. III, Ex. 37. at 336.] She alleged that Simon and his "boys' club" had warned prior attorneys to stay away from her case, and that, "It is clear to me that the only logical reason for [LaMonica's withdrawal] is the same as that which happened to my previous attorney." *Id.* LaMonica responded that the firm had never spoken to Mr. Taub or any of his representatives, except for Mr. Fox, and that Mr. Taub had not threatened or intimidated the firm so that it would withdraw. [ER, Vol. III, Ex. 38 at 339.] Mr. Houdek represented the Debtor for over a year. Yet he learned that the Debtor had terminated his services when he appeared at a court hearing on January 4, 2010 to find Mr. Macron who appeared at the hearing as substitute counsel. [ER, Ex. 55, at 462, Lines 10-24, and 463, Lines 1-3.] In his motion to withdraw, Mr. Houdek stated that the Debtor had ceased communicating with him and that the attorney-client relationship was irrevocably severed. [RA, Vol. III, Ex. 52, at 440.] With respect to all of the attorneys she fired, the Debtor apparently perceived their negotiations or cooperation with Mr. Taub and Mr. Fox and their refusal to litigate or to make demands as a sign of weakness and disloyalty and a failure to zealously represent her interests.

The Debtor's serial retention of counsel and her unproductive relationships with retained counsel, interspersed with periods she represented herself, were significant factors in the lack of progress in the case. For example, firing Mr. Shafferman and then Mr. Heller in rapid succession effectively cut off the negotiations of a settlement of her Motion for Preliminary Injunction and Mr. Taub's First Motion to Dismiss and resulted in delay and a proliferation of contentious litigation. The settlement negotiations were extant in August 2008, but because the Debtor was without counsel, she made no attempt to negotiate and took no effective action until she filed the Motion to Restrain on February 23, 2009, some six months later, after she had retained Mr. Houdek in December 2008. [ER, Vol. III, Ex. 45, at 367.] During the nearly four months that she was *pro se*, the Debtor requested relief in letters filed with the court, rather than by properly noticed motion, and the record does not reveal that she made any attempts to resolve any issues consensually. On August 22, 2008, for example, the Debtor filed a letter with the court describing Mr. Taub's alleged diversion of rents and asking the court to order an accounting an direct Mr. Taub to per rent for his apartment at the 14th Avenue Property. [ER, Vol. III, Ex. 29, at 315-316.] She wrote letters to the court enclosing her filed contentious correspondence with Mr. Fox over reimbursement of expenses. [ER, Vol. III, Exs. 34, 35 and 36.] On November 21, 2008, the Debtor filed a letter requesting authority to collect rents in which she accused Mr. Taub of sabotage and asked the court to order him to pay her $2,000 per month in rent. [ER, Vol. III, Ex. 37, at 336.]

Even before she terminated Mr. Houdek, the Debtor took it upon herself to file the Mail Cross Motion, without notice to Mr. Houdek, which required him to sign it after the fact to comply with Rule 11. [ER, Vol. III, Ex. 40, at 440.] She filed the notice of appeal of the order denying reconsideration of the Relief from Stay Order and the motion for stay pending appeal herself. [ER, Vol. II, Ex. 14, at 181-182, ECF Doc. Nos. 409 and 414.] On December 28, 2009, the Debtor notified the court that she was without counsel and requested an indefinite adjournment of the hearing on the motion for stay pending appeal until after she retained counsel [ER. Vol. III, Ex. 55, at 466-468.] She withdrew the request and the motion at the hearing on January 4, 2010 after the court admonished her for filing documents *pro se* when she was represented by counsel. *Id*. On January 28, 2010, after the court approved Mr. Houdek's withdrawal, the Debtor requested a sixty-day adjournment of all proceedings in the case to allow to time to retain counsel. [ER, Vol. 1, Ex.12, at 102.] She stated, "There is no prejudice to Simon Taub or to anyone else, because as long as my properties are under the protection of the bankruptcy code [*sic*], nothing will happen in sixty days." *Id.* On February 2, 2010, the court entered an order denying the request for a stay. [ER, Vol. II, Ex. 14, at 189, ECF Doc. No. 459.] Rather than cooperate with counsel to bring some resolution to a case filed in 2008, the Debtor spent two months pursuing an appeal that she eventually abandoned, attempted to delay the case with a sixty-day adjournment of all matters, and litigated with Mr. Taub over the delivery of mail.

Based on the entire record, the Debtor's serial retention of eight lawyers and her uncooperative and contentious relationships with them contributed to her failure to resolve any issues in nearly two years and impeded the progress of the case. The bankruptcy court did not, therefore, commit clear error.

2. There is Clear and Convincing Evidence in the Record that the Debtor Failed to Meet Her Administrative Obligations.

The bankruptcy court did not clearly err when it found that the Debtor has not met her administrative obligations during the case. The Debtor has admitted that she has not paid the mortgages on the Marital Residence, the14th Street Property and the Forshay Road Property since the Petition Date. [ER, Vol. 1, Ex. 6, at 66.] The monthly mortgage payment for the Marital Residence is $5,019.19 and the post petition arrearages are in excess of $150,978.08.

[ER, Vol. III, Ex. 45, at 369 and 376.] The monthly mortgage payment for the Forshay Road Property is $2,974.18. [ER, Vol. III, Ex. 45, at 376.]. Prepetition arrearages for the Forshay Road Property total $96,043.34 and post petition arrearages are $53,535.24. [ER, Vol. III, Ex. 53, at 448, and Vol. I, Ex. 6, at 56.] The monthly mortgage for the 14th Avenue Property is $2,933.17, with pre- and post petition arrearages as of February 2010 of $51,500.56 and $57,750.39, respectively. [ER, Vol. III, Ex. 53, at 448, and Vol. I, Ex. 6, at 56.] However, the Debtor claims that the mortgage on the Marital Property is Mr. Taub's responsibility under the State Court Restraining Order. [ER, Vol. III, Ex. 53, at 448.] The Debtor also claims that, since July 2005, Mr. Taub has diverted rents from the Rental Properties in the cumulative amount of $442,460.05. [ER, Vol. I, Ex. 6, at 53 and 67.]

The Debtor stated that she was one quarter delinquent on real property tax payments for the 52nd Street Property. [ER, Vol. III, Ex. 48, at 423.] According to Ms. Kaufman, however, the Debtor owes $11,152.48 for two quarters. [ER, Vol. III, Ex. 55, at 164-166.] The Debtor also owes $10,206.13 for post-petition water and sewer charges which encumber the 52nd Street Property. [ER, Vol. III, Ex. 49, at 425-426.]

In addition, the Debtor has incurred significant professional fees. On August 6, 2009, mediator Simeon Baum filed a letter with the court stating that the Debtor owed him $14,732.20. [ER, Vol. II, Ex. 41, at 348-350.] After a status conference, the court entered an order, on October 27, 2009, directing the Debtor to pay Mr. Baum. [ER, Vol. II, Ex. 42, at 350.] To date, however, the Debtor has not paid him. [ER, Vol. I, Ex. 4, at 12-13.] In addition, on February 26, 2010, the court awarded Mr. Houdek fees in the amount of $316,262.60, with the payment to be addressed at a later date. [ER. Vol. II, Ex. 14, at 194, ECF Doc. 492.]

The Debtor has consistently maintained that she is not responsible for the mortgage on the Marital Property under orders issued in the divorce action and she argues on appeal that the court clearly erred in including these payments when it calculated the Debtor's accrued and unpaid administrative expenses. *See* Brief, at 43. The Debtor also attempts to excuse her failure to pay administrative expenses related to Rental Properties by casting blame on Mr. Taub. [ER, Vol. III, Ex. 53, at 448.]

A debtor in possession has fiduciary duties to the bankruptcy estate. *In re Brook Valley VII Joint Venture*, 496 F.2d 892, 900 (8th Cir. 2007). The debtor in possession has the powers and duties of a trustee and "must collect the property of the estate[,]" *Louisiana World Exposition v. Fed. Ins. Co.*, 858 F.3d 233, 246 (5th Cir. 1988) (emphasis in original), and account for all property received under 11 U.S.C. §§ 1106(a)(1) and 704(2). *Commodity Futures Trading Commission v. Weintraub*, 471 U.S. 343, 252 (1985). The debtor in possession also has a fiduciary duty to "protect and conserve property in its possession for the benefit of creditors." *Marvel Entertainment*, 140 F.3d at 474, *quoting In re Ionosphere Clubs, Inc*., 113 B.R. 164, 169 (Bankr. S.D.N.Y. 1990) (internal quotation marks omitted). To fulfill these duties, the debtor in possession must "refrain from acting in a manner which could damage the estate, or hinder a successful reorganization . . . ." *In re Sharon Steel Corp.*, 86 B.R. 455, 457 (Bankr. W. D. Pa. 1998). A debtor in possession has a duty to pay post petition taxes as they become due to preserve the value of the estate. *In re Berryhill*, 189 B.R. 463, 465 (Bankr. N. D. Ind. 1995). Likewise, a debtor in possession must make post petition mortgage payments because the failure to remain current encumbers, rather than preserves, the value of the estate. *In re Miell*, 419 B.R. 357, 368 (Bankr. N. D. Iowa 2009). A debtor in possession may not delegate its duty to conserve property of the estate where it results in abdication of that duty. *In re Mushroom Transp. Co., Inc*., 382 F.3d 325, 339 (3d Cir. 2004).

As a debtor in possession, the Debtor had a duty to protect and conserve estate property. *See Marvel Entertainment*, 140 F.3d at 474 (debtors in possession have a fiduciary duty to conserve estate property). She holds sole title to the Marital Residence, [ER, Vol. II, Exhibit 16, at 213] and by definition, the Marital Property is property of the bankruptcy estate. *See* 11 U.S.C. § 541. It is, therefore, the Debtor's obligation to, not only preserve the value of the Marital Residence, but also to refrain from diminishing its value. *See Sharon Steel*, 86 B.R. at 457 (a debtor in possession has a duty to "refrain from acting in a manner which could damage the estate, or hinder a successful reorganization").

The state court orders do not relieve the Debtor of her fiduciary duties as a debtor in possession and the Debtor cannot abdicate her duties based on her position that Mr. Taub is responsible for the payments. *See Mushroom Transport*, 382 F.3d at 339 (debtor in possession may not delegate fiduciary duties where it results in abdication of those duties). If Mr. Taub is violating the state court orders, the Debtor may seek relief in state court, including entry of money judgment. *See Siddiqui v. Siddiqui*, 118 A.D.2d 846, 847, 500 N.Y.S.2d 333 (N.Y.A.D. 2 Dept. 1986) (spouse may seek a money judgment for arrears under a temporary support order). To date, there is no evidence in the record that she has taken any steps to enforce them.

3. The Court Did Not Clearly Err When It Found that the Acrimony Between the Debtor and Creditors Impaired the Debtor's Ability to Reorganize.

Grounds exist under Section 1104(a)(2) where "deep seeded conflict and animosity between a debtor and its creditors are at the heart of [a] bankruptcy case" and impair the debtor's ability to reorganize. *Marvel Entertainment*, 140 F.3d at 474. The appointment of a trustee is warranted where "the parties are sharply divided on many issues, and are presently incapable of solving them[.]" *Id.* at 475.

As the court noted in the Decision, this case "has been marked from the outset by acrimony, contentiousness, distrust and the Debtor's failure to make any progress over twenty-one months toward the proposal and confirmation of a plan of reorganization." [ER, Vol. I, Ex.4, at 8.] Rather than deal with the issues in the case and attempt to find common ground, the parties have made public personal attacks and inflammatory allegations, filed numerous adversary proceedings and contested matters and litigated every issue, no matter how minor. Every party in this case must bear responsibility for acrimony and its effect on the progress of the case.

Numerous documents in the record of the case show the enmity and mistrust between the Debtor and Mr. Taub. Throughout the case, Mr. Taub and the Debtor have attacked each other's character and made accusations of malfeasance, including misappropriating funds and interference in their financial affairs.

For example, the Debtor accused him of waste and malfeasance because he had "looted" rents from the Rental Properties and deliberately failed to pay related expenses. [ER, Vol. III, Ex. 46 at 408, Vol. II, Ex. 25, at 257, Ex. 27, at 305.] She accused him of "sabotaging" her financial affairs and the bankruptcy case, vandalizing the Rental Properties and threatening her tenants and lawyers. [ER, Vol. 1, Ex. 46, at 413-414, Vol. III, Ex. 37, at 336.] She called the allegations in the First Motion to Dismiss fraudulent and prejudicial. [ER, Vol. II, Ex. 25, at 254.] Mr. Taub accused the Debtor of misappropriating $1 million prior to the Petition Date and labeled her untrustworthy." [ER, Vol. II, Ex. 24, at 238.]

There were also accusations and counter accusations of mismanagement of the Rental Properties. The Debtor disputed Mr. Taub's accounting of receipts and disbursements for July 2009 and Mr. Taub filed motions to compel the Debtor to accurately disclose rents and expenses. [ER, Vol. II, Ex. 14, at 139, ECF Doc. No. 183, and 149, ECF Doc. No. 240, and Vol. III, Ex. 29, at 315.] The Debtor and Ms. Kaufman disputed each other's accounting of unpaid administrative expenses related to the 52nd Street Property in letters to the court and pleadings. [ER, Vol. III, Ex. 44, at 361, Ex. 46, at 399, Ex.48, at 423, and Ex. 49, at 425.]

Based on the record, the parties conducted contentious litigation even over the smallest issues and they could not agree to anything. The parties filed no fewer than 144 letters with the court, many of which requested relief or aired the parties' disputes. [ER., Vol. I1, Ex. 14.] They filed a total of nineteen substantive motions. [ER, Vol. II, Ex. 14, ECF Doc. Nos.26, 71, 80, 82, 155, 172, 179, 184, 222, 240, 260, 326, 354, 409, 412, 416, 425, 444, and 447.] The Debtor filed three adversary proceedings and Ms. Kaufman filed one. The parties spent much of their time embroiled in litigation of discovery disputes. They began discovery in the case on November 26, 2008, but the court did not enter the last discovery order until January 20, 2010. [ER, Vol. 1, Ex. 14, ECF Doc. Nos. 104 and 366.] Over that fourteen-month period, the parties filed twenty-five discovery notices, motions and letters requesting discovery conferences. [ER, Vol. II, Ex. 14, ECF Doc. Nos. 104-106, 108, 126,138,169,188-191, 193, 246-248, 266, 282, 284, 318, 322, 329, 331, 359, and 366.]

There are four appeals pending before this Court. The Debtor appealed the Trustee Order (10-cv-02600 (CBA), the Restraining Order (10-cv-02599) and the Compel Order (10-cv-02492

(CBA) and Ms. Newhouse appealed the Trustee Order (10-cv-2611). In the appeal of the Trustee Order, the Debtor filed a motion for stay pending appeal before the bankruptcy court on May 19, 2010. After the court denied the motion, she filed a motion for stay pending appeal in this Court on June 1, 2010 (10-cv-2493). This Court denied the motion on June 15, 2010.

The Debtor is no closer to proposing and confirming a plan than she was on the Petition Date. The parties' *ad hominem* remarks and inflammatory accusations and voluminous litigation continued throughout the case. Their enmity and mistrust for each other and their penchant to litigate rather than settle even the smallest disputes show that the parties are incapable of working together productively to resolve the issues in the case. The bankruptcy court, therefore, did no clearly err when it found that the contentious relationships among the parties impaired the progress of the case.

4. The Record of the Case Shows that the Debtor's Conflicting Roles Interfered with Her Ability to Act in the Best Interests of Creditors and the Estate.

The court may also order the appointment of a chapter 11 trustee under Section 1104(a)(2) where the debtor has a conflict of interest that interferes with its ability to carry out its fiduciary duties as a debtor in possession. *In re Eurospark Industries*, 424 B.R. 621, 629 (Bankr. E.D.N.Y. 2010). Debtors in possession are fiduciaries and must act in the best interests of creditors and the estate. *Brook Valley*, 496 F.2d at 900. Therefore, the court should direct the appointment of a chapter 11 trustee under Section 1104(a)(2) when a debtor suffers from material conflicts of interest which call into question its ability to make impartial investigations and decisions that are in the best interest of creditors and the estate. *In re Ridgemour Meyer Properties, LLC*, 413 B.R. 101,113 (Bankr. S.D.N.Y. 2008).

"A debtor in possession does not act in his own interests, but rather in the interests of the creditors." *In re J.T.R. Corp.*, 958 F.2d 602, 605 (4th Cir. 1992). *See also In re Bowman*, 181 B.R. 836, 843 (Bankr. D. Md. 1995) (a debtor in possession cannot ignore his fiduciary duties by putting his interests ahead of his creditors). A conflict also arises when the debtor in possession seeks to continue litigation, rather than agree to a proposed settlement, because the settlement is insufficient to benefit him personally. *Eurospark*, 424 B.R. at 629.

When a debtor files a chapter 11 case, the bankruptcy estate is created under 11 U.S.C. § 541. On the petition date, the debtor becomes a debtor in possession with the powers and duties of a trustee under 11 U.S.C. §§ 1101 and 1107(a). *In re Vienna Park Properties*, 976 F.2d 106, 110 (2d Cir. 1992). The debtor in possession and the debtor are separate entities with different property interests and duties. *In re McClelland*, 418 B.R. 61, 67 (Bankr. S.D.N.Y. 2009). The debtor in possession has fiduciary duties to creditors and the bankruptcy estate. *Id*. "Individual chapter 11 debtors may be faced with the inconsistent roles of acting both as a zealous representative of the estate and a champion of their own personal rights." *In re Devine*, 131 B.R. 952, 956 (Bankr. S. D. Tex. 1991). If these inconsistent roles interfere with the debtor's ability to exercise his or her fiduciary duties to creditors, appointment of a chapter 11 trustee under Section 1104(a)(2) is appropriate. *Id*. at 956-957.

Here, the Debtor is involved in a bitter divorce with Mr. Taub which involves her entitlement to property, including the equitable division of assets and the determination of the Debtor's equitable interest in the Grand Avenue Properties. [ER, Vol. I, Ex. 6, at 49.] The Debtor's affidavits and letters demonstrate that the Debtor is consumed with her disputes with Mr. Taub and that she is intent on getting what she considers her fair share of the marital estate.

She asked the bankruptcy to take jurisdiction of the Grand Avenue Properties so that she could be "remunerated for her legitimate claims" on the rents and because she perceives that the state court judge is biased against her. [ER, Vol. I., Ex. 6, at 68-70, ER, Vol. III, Ex. 29, at 317, Ex. 36, at 333.]

In bankruptcy court, the Debtor regularly aired her personal disputes with Mr. Taub in letters and affidavits. [*e.g.*, ER, Vol. 1, Ex. 6, at 49, and Vol. III, Ex. 37, at 336 and Ex. 45, at 367.] The Debtor and Mr. Taub sought relief against each other beneficial to one but detrimental to the other. Creditors were harmed because of the time and resources spent in litigating personal disputes. For example, Mr. Taub filed the Mail Motion and the Debtor filed the Counter Mail Motion because they could not agree to exchange mail. Not only did the estate incur attorneys' fees, but the bankruptcy court had to hold a hearing and enter an order wasting time and resources. In addition, the Debtor and Mr. Taub spent over a year litigating discovery disputes which did little more than increase administrative expenses.

5. The Court Did Not Clearly Err When It Found that Appointment of Trustee Would Benefit the Estate.

A chapter 11 trustee is a fiduciary and the estate's sole representative. *See* 11 U.S.C. §§ 323(a), 1106 and 704. The duties of a trustee include investigating the debtor's acts, conduct, assets, liabilities and financial condition and filing a plan as soon as practicable, filing a report with the court of why the trustee will not file a plan or recommending conversion to chapter 7. 11 U.S.C. § 1106(a)(3) and (5).

Here, the Trustee will be able to objectively investigate the value of the Debtor's assets and assess her ability to reorganize. *See Eurospark*, 424 B.R. at 633 (a trustee will be able to "preside over the case in an objective and impartial manner to bring this case to a swift and successful conclusion") (citation omitted). As an impartial fiduciary, she will be able to foster a resolution of the case free of the contentious and acrimonious history of the case. The bankruptcy court properly found that appointment of a chapter 11 trustee would be beneficial to the estate.

B. The Bankruptcy Court Did Not Abuse Its Discretion When It Directed the Appointment of a Chapter 11 Trustee under 11 U.S.C. § 1104(a)(3).

Under 11 U.S.C. § 1104(a)(3),

> (a) At any time after the commencement of the case but before confirmation of a plan, on request of a party in interest or the United States trustee, and after notice and a hearing, the court shall order the appointment of a trustee —
>
> . . . .
>
> > (3) if grounds exist to convert or dismiss the case under section 1112(b) but the court determines that the appointment of a trustee or an examiner is in the best interests of creditors and the estate.

11 U.S.C. § 1104(a)(3).

11 U.S.C. § 1112(b) governs the conversion or dismissal of chapter 11 cases. It provides, in part, that:

> (1) Except as provided in paragraph (2) of this subsection, subsection (c) of this section, and section 1104(a)(3), on request of a party in interest, and after notice and a hearing, absent unusual circumstances specifically identified by the court that establish that the requested conversion or dismissal is not in the best interests of creditors and the estate, the court shall convert a case under this chapter to a case under chapter 7 or dismiss a case under this chapter, whichever is in the best interests of creditors and the estate, if the movant establishes cause.
>
> . . . .
>
> (4) For purposes of this subsection, the term "cause" includes –
>
> > (A) substantial or continuing loss to or diminution of the estate and the absence of a reasonable likelihood of rehabilitation;
> >
> > . . . .

11 U.S.C. § 1112(b)(1) and (4)(A).

Under Section 1104(a)(3), if there is substantial or continuing loss to or diminution of the estate and the absence of a reasonable likelihood of rehabilitation, there is cause to convert or dismiss the case under Section 1112(b)(4)(A), and the court has the discretion to order the appointment of a chapter 11 trustee. *In re LG Motors, Inc.*, 422 B.R. 110, 115-116 (Bankr. N. D. Ill. 2009). Under Section 1112(b)(4)(A), there is cause to convert or dismiss if there are both continuing loss or diminution of the estate and little reasonable likelihood of rehabilitation. *In re Wahlie*, 417 B.R. 10, 11 (Bankr. N. D. Ohio 2009). The purpose of Section 1112(b)(4)(A) is to "preserve estate assets by preventing the debtor in possession from gambling on the enterprise at the creditors' expense when there is no hope of rehabilitation." *Loop Corp. v. U. S. Trustee (In re Loop Corp.*, 379 F.3d 511, 517 (8th Cir. 2004), *quoting In re Lizerac Realty Corp.*, 188 B.R. 499, 503 (Bankr. S.D.N.Y. 1995) (interpreting 11 U.S.C. § 1112(b)).[6]

"To determine whether there are continuing losses or diminution, the court must make a full evaluation of the present condition of the estate, not merely look at a debtor's financial statements." *In re AdBrite Corp.*, 290 B.R. 209, 215 (Bankr. S.D.N.Y. 2003). There need not be significant diminution to satisfy the first prong of Section 1112(b)(4)(A). *In re East Coast Airways, Ltd.*, 146 B.R. 325, 336 (Bankr. E.D.N.Y. 1992); *In re Kanterman*, 88 B.R. 26, 29 (S.D.N.Y. 1988). An estate's liability for administrative expenses in and of itself constitutes a diminution in value. *Loop Corp.*, 379 F.3d at 517; *In re Lyons Transportation Lines, Inc.*, 123 B.R. 526, 531 (Bankr. W. D. Pa. 1991). Specifically, the debtor's failure to pay administrative

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[6] Because the language of Section 1112(b)(4)(A), enacted in 2005, is almost identical to the language in the prior provision, Section 1112(b)(1), cases interpreting Section 1112(b)(1) are equally applicable to Section 1112(b)(4)(A). *In re Gateway Access Solutions, Inc.*, 374 B.R. 556, 563 (Bankr. M. D. Pa. 2007).

expenses associated with real property is evidence of diminution. *Kanterman*, 88 B.R. at 29. Likewise, the failure to pay post petition taxes also evidences a continuing loss to or diminution of the estate. *Berryhill*, 189 B.R. at 466. *See also In re FRGR Managing Member*, LLC, 419 B.R. 576, 581 (Bankr. S.D.N.Y. 2009) (accrual of professional fees constitutes continuing losses). A debtor's negative post-petition cash flow and inability to pay current expenses establishes that a debtor has continuing losses. *AdBrite,* 290 B.R. at 215. Negative cash flow alone may be sufficient to constitute "continuing loss to or diminution of the estate." *Loop Corp.,* 379 F.3d at 515-516.

"[R]ehabilitation means to put back in good condition and reestablish on a sound basis." *AdBrite,* 290 B.R. at 216. *See also Loop Corp.*, 379 F.3d at 516 (courts have consistently held that "rehabilitation" refers to the debtor's ability to revive its business as a going concern). The issue is whether "the debtor's business prospects justify continuance of the reorganization effort." *LG Motors,* 422 B.R. at 116. "Rehabilitation does not mean the same thing as reorganization for purposes of Chapter 11 because a reorganization may include a complete liquidation." *In re Rundlett*, 136 B.R. 376, 380 (Bankr. S.D.N.Y. 1992). Rehabilitation connotes that "the debtor will be reestablished on a sound financial basis, which implies establishing a cash flow from which current obligations can be met." *Id.* If the debtor is unable or unwilling to formulate a chapter 11 plan within a reasonable amount of time and cannot offer a valid excuse for the failure to do so, there is usually an absence of likelihood of rehabilitation. *Hansen, Inc. v. Tiana Queen Motel, Inc.*, 749 F.2d 146, 151-52 (2d Cir. 1984). The possibility that a meritorious lawsuit will bring funds into the estate is similarly irrelevant, *FRGR,* 419 B.R. at 583-84, as is the debtor's "boundless confidence" that reorganization will be successful is irrelevant in determining a reasonable likelihood of rehabilitation. *Tiana Queen.*, 749 F.2d at 151.

The court correctly found that there was cause under Section 1112(b)(A(4). There is ample evidence in the record that the estate is suffering continuing losses or diminution. The record shows that Debtor has incurred significant unpaid administrative costs. [RA, Vol. I, Ex. 6, at 56 and 66, ER, Vol. II, Ex. 14, at 194, ECF Doc. No. 492, and Vol. III, Ex. 45, at 376, Ex. 53, at 447-448.]

Based on the record, there is no reasonable likelihood of rehabilitation. The Debtor is nowhere near proposing a plan after nearly two years in chapter 11 and the case has been characterized by antagonism and contentious litigation which makes progress unlikely. The Debtor's plan hinges on a windfall from the equitable division of property in the divorce action and the payment of the large debt that Mr. Taub allegedly owes her, which is speculative at best, since the divorce has already been pending for three years and Mr. Taub would likely vigorously litigate any attempt to collect. [ER, Vol. 1, Ex. 6, at 51 and 55-58, and Vol. III, Ex. 30, at 317.]

Based on the entire record, the court's finding that there was continuing loss to or diminution of the estate and the absence of a likehihood of rehabilitation was not clearly erroneous. The court, therefore, did not abuse its discretion when it ordered the appointment of a chapter 11 trustee under 11 U.S.C. §§ 1104(a)(3) and 1112(b).

C. The Bankruptcy Court Did Not Abuse its Discretion When it Simultaneously Entered the Trustee Order and the Restraining Order.

According to the Debtor, it was an abuse of discretion for the bankruptcy court to order the appointment of a trustee rather than allow the Debtor to remain in possession and reap the benefits of the Restraining Order, to freely manage property of the estate for the first time. *See* Brief, at 22. This argument ignores, however, that both the state court and the bankruptcy court addressed the issue of Mr. Taub's interference with little apparent impact on his behavior. The state court order compelling Mr. Taub to pay child support and maintain the Marital Residence has been in effect for three years. Yet the Debtor had to request the same relief in the Motion for Preliminary Injunction and the Motion to Restrain in the bankruptcy court.

The Debtor also faults the court for not disposing of the issue earlier. *See* Brief, at 22.. However, the record shows that it was the Debtor and Mr. Taub, not the court, who delayed consideration of the Motion for Preliminary Injunction and the Motion to Restrain.

After the Debtor filed the Motion for Preliminary Injunction on July 30, 2008, the court scheduled a hearing for July 31, 2008 and issued the TRO to protect the Debtor's rights. [ER, Vol. II, Ex. 28, at 312.] At the hearing, the court "so ordered" an agreement that the parties would not sell, transfer, mortgage or otherwise diminish the value of the Rental Properties. [ER, Vol. II, Ex. 14, at 282, July 31, 2008 Docket Entry.] The court encouraged the parties work out an agreement of this issue and Mr. Taub's First Motion to Dismiss. During the negotiations, the Debtor hired and fired two lawyers and then appeared *pro se* for the next four months and the negotiations broke down. [ER, Vol. II, Ex. 14, at 115-118, ECF Doc. Nos. 33, 40, 50-53, and Ex. 26, at 282, Vol. III, Ex. 30, at 318, Ex. 54, at 457, Lines 4-22.] The court then referred the parties to mediation, which was not successful. [ER, Ex. II, Ex. 14, at 129-131, ECF Doc. Nos.127 and 130-135, and 145, and Vol. III, Ex. 40, at 343.] The parties then began discovery on November 26, 2008. [ER, Vol. II, Ex. 14, ECF Doc. Nos. 104 and 366.]

After the Debtor retained Mr. Houdek, she filed the Motion to Restrain on February 23, 2009. [ER, Vol. II, Ex. 26, at 286, ECF Doc. No. 22.] The court held regular status conferences on the Motion to Restrain. [ER, Vol. II, Ex. 26, at 286-289.] However, the parties became embroiled in contentious discovery litigation which was not resolved until January 20, 2010.

[ER, Vol. II, Ex. 14, ECF Doc. Nos. 104-106, 108, 126,138,169,188-191, 193, 246-248, 266, 282, 284, 318, 322, 329, 331, 359, and 366.] The next day the court issued the Order to Show Cause, with a return date of February 25, 2010, and set the hearing on the Motion to Restrain for the same date. On January 28, 2010, the Debtor requested a sixty-day adjournment of the hearing on the Motion to Restrain and all other matters, because the Debtor fired Mr. Houdek, who withdrew by order of the court on January 22, 2010. The court, however, denied her request and promptly heard and decided the Motion to Restrain. The bankruptcy court did not, therefore, abuse its discretion when it entered the Restraining Order and the Trustee Order at the same time.

D. The Bankruptcy Court Did Not Abuse its Discretion When it Declined to Authorize the Trustee to Administer Property in Which the Debtor Claims an Equitable Interest.

The Debtor alleges that the bankruptcy court abused its discretion when it refused to authorize the Trustee to administer the Grand Avenue Properties, in which the Debtor claims an equitable interest. *See* Brief, at 46 A trustee has the right to possession and control of property of the estate. *See* 11 U.S.C. §§ 323, 541, 1101 and 1106. Under New York law, a spouse's equitable interest in property is inchoate until the entry of a judgment of divorce and that inchoate interest is accordingly not property of the bankruptcy estate. *DiGeronimo v. Weissberg (In re DiGeronimo)*, 354 B.R. 625, 637 (Bankr. E.D.N.Y. 2006). In *Taub v. Taub (In re Taub),* 413 B.R. 69, 91 (Bankr. E.D.N.Y. 2009), the bankruptcy court held that the Debtor's inchoate equitable interest in the Grand Avenue Properties was not property of the bankruptcy estate. The Trustee, therefore, cannot manage the Grand Avenue Properties and the Court did not abuse its discretion.

VII. CONCLUSION

For these reasons, the United States Trustee respectfully asks this Court to affirm the Trustee Order entered below.

Dated: Brooklyn, New York
June 25, 2010

Respectfully submitted

DIANA G. ADAMS
UNITED STATES TRUSTEE

By: */s/ Alicia M. Leonhard*
Alicia M. Leonhard
Assistant United States Trustee

Office of the United States Trustee
United States Department of Justice
271 Cadman Plaza East
Suite 4529
Brooklyn, New York 11201
Phone: 718.422.4960
Facsimile: 718.422.4990
Alicia.M.Leonhard@usdoj.gov

Ramona D. Elliott
General Counsel
P. Matthew Sutko
Associate General Counsel
Noah Schottenstein
Trial Attorney
Executive Office for United States Trustees
United States Department of Justice
20 Massachusetts Avenue, N.W., Suite 8100
Washington, D.C. 20530
Phone: 202.307.1399

BRIEF BANK — "SUMMARY SHEET"

Printed Wed.-5/5/4 (16:24)

WESTLAW CODES

1. ("TI") TITLE OF CASE [E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]	Taylor v. Stuart
2. ("CO") CURRENT COURT [E.g., "CTA9"]	CA8
3. ("CCN") CURRENT CASE NO.	No.: 99-3831
4. ("PCN") PRIOR CASE NO. & COURT [IF ANY]	No.: 4-98-cv-90353 Court: USDC D SD (Identify judge & cite, if any)
5. ("SO") SOURCE	**U.S. TRUSTEES**
6. ("DA") DATE OF FILING & TYPE OF BRIEF [E.g., "Opening Brief," "Reply," "Amicus," etc.]	Filed: 1999 Type: Brief for the Appellee (UST)
7. ("AU") PRINCIPAL AUTHORS & OFFICE [E.g.,"UST/OGC"]	Paul W. Bridenhagen, Esq., OGC/DOJ (UST/OGC: 202-307-1399/FAX-2397)
8. ("TO") TOPIC	**BANKRUPTCY**
9. ("SU") ● SUMMARY OF KEY ISSUE(s) & √ Any Miscellaneous BACKGROUND	● Whether the lower courts erred in considering exempt post-petition pension benefits to be income in a substantial abuse analysis pursuant to §707(b). √ **Background:**
10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)	C:\WINNT\Profiles\smiddlet\Desktop\depository\Taylor01.wpd
11. DO YOU RECOMMEND POSTING IN UST BRIEFBANK?	| X | YES | | NO NAME: Steven Eggert DATE: Tue.-5/4/4 (14:36)

IN THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

GERALD E. TAYLOR and
BETTY A. TAYLOR

Debtors-Appellants,

v.

BARBARA G. STUART,
UNITED STATES TRUSTEE,

Appellee.

Appeal No. 99-3831SIDM

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF SOUTH DAKOTA
SOUTHERN DIVISION

DISTRICT COURT NO. 4-98-CV-90353
HON. ROBERT W. PRATT, PRESIDING

BRIEF OF THE UNITED STATES TRUSTEE, APPELLEE

BARBARA G. STUART
United States Trustee

JAMES L. SNYDER
Assistant United States Trustee
MARTHA L. DAVIS
General Counsel

PAUL W. BRIDENHAGEN
Attorney
Executive Office for
United States Trustees
901 E Street, N.W., Suite 780
Washington, D.C. 20530

SUMMARY OF THE CASE AND STATEMENT CONCERNING ORAL ARGUMENT

This appeal involves the question of whether debtors-appellees' Gerald E. and Betty A. Taylor's ("Taylors") chapter 7 case was properly dismissed for substantial abuse pursuant to section 707(b) of the Bankruptcy Code. 11 U.S.C. § 707(b). The bankruptcy court dismissed the Taylors' case, holding that they had the ability to pay creditors. The bankruptcy court's decision was based on stipulated facts which state that the Taylors could pay their creditors either 59.91% or 99.84% under a three or five year plan, respectively, if Gerald Taylor's ERISA[1]-qualified pension benefits were included as disposable income in a hypothetical chapter 13 case. On appeal, the district court affirmed, relying on, inter alia, the Eighth Circuit's decisions in In re Walton, 866 F.2d 981, 982 (8th Cir. 1989) and In re Koch,109 F.3d 1285, 1285, 1288 (8th Cir. 1997). In the Koch case, this Court held that property which is otherwise exempt from inclusion in a debtors' estate may be considered in assessing whether a debtor has the ability to pay creditors. The U.S. Trustee believes that the Koch decision is controlling in this case.

Oral argument is unnecessary, because no facts are in dispute and the single issue of law raised in this appeal was conclusively decided in In re Koch, 109 F.3d 1285, 1285, 1288

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[1] Employee Retirement Income Security Act of 1974

(8th Cir. 1997)(holding that exempt workers' compensation benefits could be considered in assessing the debtors' ability to repay a substantial portion of their debts).

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STATEMENT CONCERNING APPELLATE JURISDICTION

The U.S. Trustee is satisfied with the Statement of Appellate Jurisdiction and, pursuant to Rule 28(b) of the Federal Rules of Civil Procedure, declines to present any alternative formulation thereof.

STATEMENT OF THE ISSUE PRESENTED

The U.S. Trustee disagrees with the Taylors' Statement of Issues Presented. Taylor Brief at 2. Rather than the three issues set forth by the Taylors, only one issue is presented by this appeal: Whether the lower courts erred in considering exempt post-petition pension benefits to be income in a substantial abuse analysis pursuant to 11 U.S.C. § 707(b).

The most apposite cases in this matter are as follows:

In re Koch, 109 F.3d 1285(8th Cir. 1997);

In re Fonder, 974 F.2d 996 (8th Cir. 1992);

In re Harris, 960 F.2d 74 (8th Cir. 1992);

In re Walton, 866 F.2d 981 (8th Cir. 1989).

APPLICABLE STANDARD OF APPELLATE REVIEW

The applicable standard of review on appeal is de novo with respect this issue, which is a question of law. Miller v. Farmers Home Administration, 16 F.3d 240 (8th Cir. 1994).

STATEMENT OF THE CASE AND OF THE FACTS

With one exception, the U.S. Trustee is satisfied with the Statement of the Case, including the Statement of the Facts contained therein, as presented by the Taylors in their brief("Taylor Brief") and, pursuant to Rule 28(b)of the Federal Rules of Civil Procedure declines to present any alternative formulation thereof. The U.S. Trustee disagrees with the last paragraph of the Statement of Facts that asserts the lower courts decisions constitute reversible error. Taylor Brief at 8. That assertion is a conclusion of law and is incorrect.

SUMMARY OF THE ARGUMENT

With the enactment of 11 U.S.C. § 707(b), Congress has authorized courts to dismiss those cases which they determine would constitute a substantial abuse of the bankruptcy system. In re Walton, 866 F.2d 981, 982 (8th Cir. 1989). The Eighth Circuit has determined that where debtors have the ability to pay their creditors, dismissal of their chapter 7 case under section 707(b) is appropriate. Id. Ability to pay is assessed by reference to a debtors' ability to fund a hypothetical plan of reorganization under chapter 13 of the Bankruptcy Code. Id.; In re Koch,109 F.3d 1285(8th Cir. 1997). In funding a chapter 13 plan, courts are guided by § 1325(b), which requires that debtors' "disposable income" will be applied to make payments under their plans. Koch, 109 F.3d at 1289.

Disposable income is defined as income not necessary to support a debtor, a debtor's dependents, or a debtor's business. 11 U.S.C. § 1325(b)(2). Further, nothing in the language of section 1325(b)(2) limits disposable income to non-exempt property. Thus, the lower courts properly ruled that Gerald Taylor's pension benefits may be considered in assessing the Taylors' ability to pay creditors.

In this case, the Taylors have stipulated that they can pay their creditors if they so choose. Taylor Brief at 6-7. They prefer instead to pay nothing, arguing they cannot be compelled to commit ERISA-qualified pension benefits, which they claim may not be alienated to creditors, 29 U.S.C. § 1056(d)(1), to fund a chapter 13 plan. App. at 104-108.[2] Chapter 13, however, contains no language indicating that exempt post-petition income is not "income" under section 1325(b)(2). App. at 108 (Order at 5), citing Koch, 109 F.3d at 1289. Moreover, consideration of exempt income pursuant to section 1325(b)(2) does not alienate Gerald Taylor's pension benefits: Chapter 13 relief is voluntary. As this Court stated in Koch, the disposable income limitation in § 1325(b) simply defines the terms upon which Congress has made the benefits of Chapter 13 available." Koch, 109 F.3d at 1289.

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[2] "App." refers to the Appellate Appendix filed by the Taylor in this matter.

ARGUMENT

THE LOWER COURTS CORRECTLY CONSIDERED TAYLORS' PENSION INCOME AS PART OF ITS SUBSTANTIAL ABUSE ANALYSIS IN ASSESSING THEIR ABILITY TO PAY DEBTS

The Eighth Circuit has recognized that "[w]ith the enactment of the Bankruptcy Amendments and Federal Judgeship Act of 1984

[, Pub. L. 98-353, 98 Stat. 353] ("1984 Act"), debtors no longer have unfettered access to voluntary Chapter 7 relief." In re Walton, 866 F.2d 981, 982 (8th Cir. 1989). Pursuant to the 1984 Act, Congress substantially amended section 707 of the Bankruptcy Code, by adding section 707(b), which provides in relevant part as follows:

> (b) After notice and a hearing, the court, on its own motion or on a motion by the United States trustee, but not at the request or suggestion of any party in interest, may dismiss a case filed by an individual debtor under this chapter whose debts are primarily consumer debts if it finds that the granting of relief would be a substantial abuse of the provisions of this chapter. There shall be a presumption in favor of granting the relief requested by the debtor.

11 U.S.C. § 707(b) (emphasis added).

The Eighth Circuit has determined, in light of its legislative history, that section 707(b) was "aimed primarily at stemming the use of Chapter 7 relief by unneedy debtors." Walton, 866 F.2d at 983 (citing S. Rep No. 65, 98th Cong., 1st Sess. 3 (1983)). (emphasis added). Consequently, the Eighth

Circuit has expressed the belief that section 707(b) "upholds creditors' interests in obtaining repayment where such repayment would not be a burden on the debtors." Id. at 983 (quoting S. Rep. No. 65 at 53). See also, Fonder v. United States, 974 F.2d 996, 999 (8th Cir. 1992) and United States v. Harris, 960 F.2d 74, 76 (8th Cir. 1992)(both reaffirming the Walton decision). Although the term "substantial abuse" is not defined in section 707(b) or elsewhere in the Bankruptcy Code, the Eighth Circuit has determined that Congress expressly declined to adopt a rigid, mechanical approach, but opted rather for an undefined, flexible "substantial abuse" standard, the focus of which is a debtor's ability to pay debts owed to creditors. Walton, 866 F.2d at 983.

Most recently, the Eighth Circuit reaffirmed its "substantial abuse" analysis in In re Koch, 109 F.3d 1285, 1288 (8th Cir. 1997), rejecting the debtors' argument that disability payments, exempt under state law, could not be considered in assessing the debtors' ability to pay their creditors. See In re Kornfield, 164 F.3d 778, 784 (2d Cir. 1999) (relying on Koch in determining that lower courts properly considered pension assets, including an ERISA pension). In In re Koch, the Eighth Circuit observed that Walton had resolved two primary issues in a substantial abuse analysis. First, that a crucial issue in determining whether a case should be dismissed is a debtor's ability to pay creditors, noting that "substantial ability to pay creditors *standing alone* warrants dismissal of a Chapter 7 case for substantial abuse." In re Koch, 109 F.3d at 1288 (emphasis in original). Second, the Eighth Circuit stated that ability to repay creditors for substantial abuse purposes is assessed by evaluating whether a debtor could fund a hypothetical Chapter 13 plan. Id.

In funding a Chapter 13 plan, Congress has required that, if any creditor objects, the plan must "provide[] that all of the debtor's disposable income to be received [during the three year plan] will be applied to make payments under the plan." In re Koch, 109 F.3d at 1289, quoting 11 U.S.C. § 1325(b)(1)(B). "Disposable income" is defined as that income not necessary to support a debtor, a debtor's dependants or a debtor's business. 11 U.S.C. § 1325(b)(2).

In this case, both the bankruptcy court and the district court correctly applied these principles to the stipulated facts of this case and held that Gerald Taylor's pension benefits are properly considered in assessing the Taylors' ability to pay their creditors. App. at 96 (bankruptcy court transcript at 9-11) and App. at 104-108 (district court Order). The debtors stipulated that they have, as a matter of law, the ability to pay their creditors if Gerald Taylor's income from the Deere & Co. pension is considered in the disposable income analysis under a "hypothetical Chapter 13 plan analysis". Specifically, quoting verbatim from their brief, the Taylors concede that:

> 1. The Taylors' income ($4,603.48) exceeded their reasonable monthly expenses ($2,799.64) by $1,803.84 per month (App. p. 63, para. 12);
>
> 2 In a hypothetical Chapter 13 plan, $1,803.84 monthly would generate a 36-month dividend to unsecured creditors of $64,938.24, and a 60-month dividend of $108,230.40; a 59.91% and 99.84% payout respectively based on the Taylors $108,400.00 total unsecured debt; (App. p. 63, para. 13); and
>
> 3. If Gerald Taylor's income from the Deere & Co. Pension **was** includable as disposable income distributable to creditors for purposes of a "hypothetical Chapter 13 plan analysis" pursuant to 11 U.S.C. § 707(b) as a matter of law, the Taylors had the ability to repay a substantial portion of their unsecured consumer debt. (App. p. 64, para. 14).

Taylor Brief, at 4 (emphasis in original).[3]

Rather than taking advantage of the statutory protections available under Chapter 13 that would enable them to pay their debts, the Taylors apparently prefer to pay their creditors nothing, arguing that they cannot be forced to use the proceeds of the Deere & Co. pension, which is a qualified plan under the Employee Retirement Income Security Act of 1974 ("ERISA"). Taylor Brief, at 7. Specifically, the Taylors argue that the pension benefits payable from Deere & Co. are exempt from inclusion in a Chapter 13 plan because of the anti-alienation

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[3] "App." refers to the Appellate Appendix filed by the Taylors in this matter.

provision in ERISA contained in 29 U.S.C. § 1056(d)(1). Id. They further rely on the Supreme Court case of Patterson v. Schumate, 504 U.S. 753 (1992) for the proposition that there is no bankruptcy exception to ERISA's anti-alienation provision.

The Taylors argument that they cannot be compelled to fund a Chapter 13 plan with exempt income ignores the central question concerning substantial abuse inquiry as developed under Walton and its progeny, including In re Koch. That question is not whether the debtors can be compelled to pay their debt -- no Chapter 7 debtor can be compelled to do so. See Walton, 866 F.2d at 984, fn.6 (citing In re Edwards, 50 B.R. 933, 939 (Bankr. S.D.N.Y. 1985)) ("Although Code § 707(b) may have the effect of relegating a debtor to a Chapter 13 if he wants any bankruptcy relief, **any decision to utilize Chapter 13 remains that of the debtor.**" (emphasis added)); In re Koch, 109 F.3d at 1290 ("Chapter 13 relief remains wholly voluntary, and debtors whose Chapter 7 petitions are dismissed for substantial abuse are not compelled to file for Chapter 13 relief.").

The question is instead whether the debtors have the **ability** to repay their creditors. Indeed, as the Eighth Circuit stated in In re Fonder,

> While the Walton\Harris test for substantial abuse focuses on whether the debtor can fund a Chapter 13 plan, the essential inquiry

> remains whether the debtor's ability to repay creditors with future income is sufficient to make the Chapter 7 liquidating bankruptcy a substantial abuse of the [Bankruptcy] Code.

974 F.2d 996, 999 (8th Cir. 1992). (emphasis added). See also In re Morse, 164 B.R. 651, 656 (Bankr. E.D. Wash. 1994) ("While the court does not dispute that debtors are entitled to any exemption which they may validly claim, **the ability to claim an exemption is an independent issue from whether debtors have the ability to repay their debts**." (emphasis added)); In re Anatal, 85 B.R. 838 (Bankr. W.D. Mo. 1988) (injecting considerations of exempt property or money into the section 707(b) analysis is inappropriate, where central inquiry is simply whether debtor has the ability to pay creditors).

The Taylors’ argument is that the anti-alienation provision in section 1056(d)(1), as construed in the Patterson v. Schumate decision, precludes a court from considering ERISA-qualified pension proceeds in an “ability to pay” analysis. The district court correctly rejected this premise, noting that while section 1056(d)(1) precludes a creditor in a Chapter 7 liquidation from attaching those proceeds, nothing prevents a debtor from funding a Chapter 13 plan with either exempt or non-exempt income. App. at 94, citing In re Hagel, 184 B.R. 793, 798 (Bankr. 9th Cir. 1995)(despite anti-alienation provision, social security disability benefits are properly considered in assessing the debtors' ability to fund a chapter 13 plan and noting that pursuant to section 1322(b) of the Bankruptcy Code debtors may make payments from either exempt or -non-exempt property). See also In re Morse, 164 B.R. 651 (E.D. Wash. 1994)(social security benefits) and In re Schnabel, 153 B.R. 809 (N.D. Ill. 1993)(same).

This conclusion is wholly consistent with the Eighth Circuit's decision in Koch, wherein the Court stated as follows:

> Congress is free to limit Chapter 7 protection to truly needy debtors who cannot fund a Chapter 13 plan with exempt or non-exempt income. We conclude that Congress did just that when it enacted § 707(b) and § 1325(b) in the 1984 amendments.

In re Koch, 109 F.3d at 1290. The decisions of both the district court and the bankruptcy court are, therefore, consistent with both the relevant statutory provisions and the Eighth Circuit's precedent. Therefore, the district court's decision should be affirmed.

CONCLUSION

For the reasons set forth, the U.S. Trustee respectfully urges this Court to affirm the decision of the district court.

BARBARA G. STUART
United States Trustee

JAMES L. SNYDER
Assistant United States Trustee

MARTHA L. DAVIS
General Counsel

PAUL W. BRIDENHAGEN
Attorney
Executive Office for
U.S. Trustees
901 E. Street, N.W., Suite 780
Washington, D.C. 20530
Tele: 202/307-1399

BRIEF BANK — "SUMMARY SHEET" *Printed Wed-7/15/09 15:52*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	In re Niles C. Taylor and Angela J. Taylor (The Udren Law firm, Mark J. Udren, Esq., and Lorraine Doyle, Esq. v. Roberta A. DeAngelis, Acting United States Trustee for Region 3)
2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	E.D. Pa.
3. ("CCN") ***CURRENT*** CASE NO.	No.: 09-2479
4. ("PCN") ***PRIOR*** CASE NO. - & COURT *[IF ANY]*	No.: 07-15385-SR Court: Bankr. E.D. Pa. *(Identify judge & cite, if any)*
5. ("SO") ***SOURCE***	**U.S. TRUSTEES**
6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	Filed: July 8, 2009 Type: Brief for Appellee, Roberta A. DeAngelis, Acting United States Trustee
7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*	Robert J. Schneider, George M. Conway, John P. Sheahan, P. Matthew Sutko, Frederic J. Baker *(UST/OGC: 202-307-1399/FAX-2397)*
8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	• Whether the bankruptcy court erred by entering an order requiring ethics training and other relief under Rule 9011 against the attorneys and law firm from a creditor that filed pleadings and a proof of claim without making an adequate factual investigation.
10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)	
11. DO YOU RECOMMEND POSTING IN UST BRIEFBANK?	| x | YES | | NO ***NAME:*** Linda Figueroa ***DATE:***

No. 09-2479

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

In re NILES C. TAYLOR AND ANGELA J. TAYLOR,

Debtors.

THE UDREN LAW FIRM, MARK J. UDREN, ESQ.,
AND LORRAINE DOYLE, ESQ.

Appellants,

v.

ROBERTA A. DeANGELIS, Acting United States Trustee for Region 3

Appellee.

ON APPEAL FROM THE UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

BRIEF FOR APPELLEE, ROBERTA A. DeANGELIS, ACTING UNITED STATES TRUSTEE

Ramona D. Elliott
General Counsel
P. Matthew Sutko
Associate General Counsel
John P. Sheahan
Department of Justice
Executive Office for U.S. Trustees
20 Massachusetts Ave, N.W.
Washington, DC 20530
(202) 307-1399

Frederic J. Baker
Senior Assistant United States Trustee
Robert J. Schneider
George M. Conway
Department of Justice
Office of the United States Trustee
833 Chestnut Street, Suite 500
Philadelphia, PA 19107
(215) 597-4411

Attorneys for Appellee Roberta A. DeAngelis, Acting United States Trustee

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STATEMENT OF JURISDICTION

The bankruptcy court had jurisdiction over this chapter 13 proceeding under 28 U.S.C. § 157(a). The sanctions order below is a final collateral order over which this Court has jurisdiction under 28 U.S.C. § 158(a)(1). *See Martin v. Brown*, 63 F.3d 1252, 1258 (3d Cir. 1995). The bankruptcy court entered its sanctions order pursuant to Fed. R. Bankr. P. 9011 on April 15, 2009, and the appellants' appeal from this order is timely under 11 U.S.C. § 158(c)(2) and Fed. R. Bankr. P. 8002(a).

STATEMENT OF APPROPRIATE STANDARD OF APPELLATE REVIEW

The bankruptcy court's legal findings are reviewed *de novo*, and its factual findings are reviewed for clear error. *Fellheimer, Eichen & Braverman P.C. v. Charter Techs., Inc.*, 57 F.3d 1215, 1223 (3d Cir. 1995). The bankruptcy court's findings of fact will not be set aside unless they are either "completely devoid of minimum evidentiary support displaying some hue of credibility or bear[ ] no rational relationship to the supportive evidentiary data." *Id.*; *see also* Fed. R. Bankr. P. 8013 ("[F]indings of fact, whether based on oral or documentary evidence, shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the bankruptcy court to judge the credibility of the witnesses.").

Sanctions imposed under Fed. R. Bankr. P. 9011 ("Rule 9011"), which is the bankruptcy counterpart of Fed. R. Civ. P. 11 ("Rule 11"), are reviewed using an abuse of discretion standard, because the trial court "is best acquainted with the local bar's litigation practices and thus best situated to determine when a sanction is warranted to serve Rule 11's goal of specific and general deterrence." *Cooter & Gell v. Hartmarx Corp.*, 496 U.S. 384, 404 (1990).

STATEMENT OF THE CASE

Lorraine Gazzara Doyle is an attorney employed by the Udren Law Offices P.C. (the "Udren Firm"). In the chapter 13 bankruptcy case of Niles and Angela Taylor, Ms. Doyle filed a motion for relief from the automatic stay on behalf of the Taylors' mortgage lender, and also filed a reply to the Taylors' objection to the lenders' proof of claim. Ms. Doyle failed to conduct a reasonable inquiry under Rule 9011(b) before filing these pleadings. As a result, following four evidentiary hearings, the bankruptcy court issued an order on April 15, 2009, imposing remedial non-monetary sanctions under Rule 9011(c) against Ms. Doyle and the Udren Firm. Ms. Doyle, the Udren Firm, and Mark J. Udren have timely appealed this order.

STATEMENT OF FACTS

On September 16, 2007, the Taylors filed a voluntary joint petition under chapter 13 of title 11, United States Code. D.I. 1.[1] The Taylors and their three children resided in a home that the schedules filed in support of their petition valued at $190,000, subject to a $103,000 mortgage held by HSBC Mortgage Corporation (USA) ("HSBC"). *Id*.

On October 9, 2007, Maria Borreson, an attorney employed by the Denver, Colorado law firm Moss Codillis, L.L.P. ("Moss Codillis"), filed a proof of claim ("Proof of Claim") pursuant to 11 U.S.C. § 501 as authorized agent for HSBC. *See* Claims Register for Case No. 07-15385, Claim 8-1. The Proof of Claim represented that HSBC held a secured claim of $93,256.29 against the Taylors' home, and it listed that same amount as the value of the Taylors' home. *Id.* HSBC attached an exhibit to its Proof of Claim stating that, beginning October 1, 2007, the Taylors' monthly

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[1] Citations to items on the electronic docket of the bankruptcy case below are indicated as "D.I. [docket item number]."

payment was $1,264.02. *Id.* Through an apparent error, the Proof of Claim included as an attachment a copy of a note unrelated to the Taylors or their property.[2] *Id.*

On January 15, 2008, a motion for relief from the automatic stay ("Motion for Stay Relief") was filed on behalf of HSBC by Ms. Doyle.[3] D.I. 18. Granting such a motion permits secured creditors to foreclose on property held by the debtor. *See* 11 U.S.C. § 362.

HSBC's Motion for Stay Relief stated that the Taylors had "failed to make the current monthly payments" since the filing of their petition, and alleged three missed payments of $1,455.83 per month, totaling $4,367.49. *Id.* The Motion for Stay Relief did not acknowledge having received any payments from the Taylors after the filing of their petition. *Id.* The Motion for Stay Relief alleged that the Taylors owed a balance of $4,302 in post-petition monthly payments and late charges. *Id.* The Motion for Stay Relief also represented that "Debtor(s) has/have inconsequential or no equity in the premises[.]" *Id.*

Ms. Doyle, representing HSBC, served the Taylors on January 15, 2008, with a request for admissions pursuant to Fed. R. Bankr. P. 7036 ("Request for Admissions"), which sought to have

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[2] The Proof of Claim contained several errors, as HSBC acknowledged by filing two amendments. The first amendment, filed on May 12, 2008, by Ms. Borreson of Moss Codillis, contained only the proof of claim (Official Form 10) and one exhibit; the proof of claim provided no value for the Taylors' home, and the exhibit stated that as of October 1, 2007, the Taylors' monthly payment was $1,455.83. *See* Claims Register for Case No. 07-15385, Claim 8-2. The second amendment, filed on July 7, 2008, by HSBC Vice President Kimberly Graves, made numerous additions and corrections, including but not limited to the following: reducing HSBC's claim to $92,298.98; stating that the Taylors' home had a value of $190,000; and attaching a Note evincing the Taylors' obligation to Hart Mortgage Corp., the original lender in 1992. *See* Claims Register for Case No. 07-15385, Claim 8-3.

[3] The Motion for Stay Relief contained the signature line "/s/ Lorraine Gazzara Doyle," which establishes that the document was electronically filed by Ms. Doyle for purposes of Rule 9011 pursuant to the bankruptcy court's Standing Order M03-3005, Provisions for Electronic Case Filing.

the Taylors admit that they owed $4,302 in post-petition monthly payments and late charges, that they had not made payments to the chapter 13 trustee under their repayment plan, and that they had inconsequential or no equity in their home. D.I. 20.

On February 4, 2008, the Taylors filed an objection to the Motion for Stay Relief, and on March 17, 2008, the Taylors filed an objection to the Proof of Claim. D.I. 22, 31. Among other contentions, the Taylors stated that the amount claimed as due by HSBC was inaccurate because HSBC was improperly charging the Taylors for flood insurance. D.I. 31.[4]

On March 19, 2008, the Taylors' counsel filed an amended objection to the Motion for Stay Relief. D.I. 33. The amended objection attached six checks payable by the Taylors to HSBC in the amount of $1,277.12. *Id*. The Taylors alleged those checks constituted payments for October 2007 through December 2008. *Id*. For the October 2007 through January 2008 payments, both the front and back of the checks were provided, indicating that HSBC had received the payments as of March 19, 2008. *Id*. The February 2008 payment was dated March 8, 2008, and the March 2008 payment was dated March 17, 2008; only the front of those checks was provided, indicating that HSBC had not yet received these payments as of March 19, 2008. *Id.*

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[4] The Taylors' proof of claim objection alleged that the Taylors did not require flood insurance as they did not actually reside in a flood zone. The Taylors accordingly asked the bankruptcy court to order HSBC to (i) provide an accounting, (ii) cease and desist from charging the Taylors additional unnecessary flood insurance premiums, and (iii) credit the Taylors the portion of their past payments that had been applied to unnecessary flood insurance premiums. D.I. 31. As of July 15, 2008, their home was removed from the flood zone. *See* D.I. 65 (Transcript of July 23, 2008, hearing) at 34:3-4. HSBC subsequently credited some flood insurance premiums and late fees to the Taylors' account. *Id*. at 36:13-18.

Ms. Doyle filed a reply to the objection to the Proof of Claim on March 27, 2008 ("Reply to Proof of Claim Objection").[5] D.I. 36. The Reply to Proof of Claim Objection stated that "[a]ll figures contained in the proof of claim accurately reflect actual sums expended or costs incurred by Mortgagee prior to the date of the Debtors' bankruptcy filing and/or charges to which Mortgagee is contractually entitled and which the Debtors are contractually obligated to pay." *Id*.

On May 1, 2008, a hearing was held on the Motion for Stay Relief and the objection to the Proof of Claim. D.I. 54 (Transcript of May 1, 2008, Hearing). David Fitzgibbon, an Udren Firm associate who argued Ms. Doyle's Motion for Stay Relief at the hearing, acknowledged that HSBC had indeed received the Taylors' October and November payments as of the date the Motion for Stay Relief was filed. *Id.* at 7:6-14. As the payments did not include the disputed flood insurance premium, however, they were "put in suspense." *Id*. at 7:8, 11-12. Mr. Fitzgibbon conceded that a portion of the November payment was taken from "suspense" to make whole the allegedly deficient October payment, and the remaining $1,040.18 from the November payment was held "in suspense" until the Taylors made additional payments from which funds could be applied to make the allegedly deficient November payment whole. *Id.* at 7:12-17.

The only evidence presented in support of the Motion for Stay Relief was the Request for Admissions, which had not been answered by the Taylors. *Id*. at 9:5-16. The bankruptcy court, however, realized that by February 15, 2008 – i.e., the date answers to the Request for Admissions were due – HSBC had received the December and January payments (albeit minus the disputed flood insurance premium). *Id*. at 35:17-19. As a result, the bankruptcy court found that the

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[5] The Reply to Proof of Claim Objection contained the signature line "/s/ Lorraine Gazzara Doyle," which indicates that the document was electronically filed by Ms. Doyle for purposes of Rule 9011 pursuant to the bankruptcy court's Standing Order M03-3005, Provisions for Electronic Case Filing.

admissions relied upon by the Udren Firm were "not accurate" as of the date of the hearing, yet "[the Udren Firm] had that evidence in your possession and you went ahead like you never saw it."[6] *Id*. at 35:10, 36:3-4; 42:2-3.

The bankruptcy court denied the Motion for Stay Relief as "questionably in bad faith." *Id*. at 41:17-19, 45:21-22. In addition, the bankruptcy court directed Mr. Fitzgibbon to "pass it up the line that I was not pleased with this motion for relief," but that the court was "cutting them a break this time." *Id*. at 45:16-17, 45:20-21. An order was entered denying the Motion for Stay Relief "for reasons stated on the record." D.I. 49.

As for the Proof of Claim – which addressed only the pre-petition amount owed by the Taylors to HSBC – the hearing on the Taylors' objection was adjourned to June 5, 2008, and the Udren Firm was directed to obtain an accounting from HSBC of its handling of the Taylors' pre-petition payments to determine the amount of the Taylors' arrearage.[7] D.I. 54 at 43:13 through 45:12.

At the June 5, 2008 hearing, which took place on the return date of the Taylors' objection to the Proof of Claim, Mr. Fitzgibbon stated that he had requested an accounting, but that HSBC had

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[6] In addition to the monthly payment information, the other "admissions" requested by the Udren Firm were apparently also false, as the Taylors were making payments to the trustee and had equity in their home. *See* D.I. 54 (Transcript of May 1, 2008, Hearing) at 46:10-11 (Court: "And [Mrs. Taylor]'s making current payments?" Chapter 13 Trustee's Counsel: "She is, Your Honor."); Claims Register for Case No. 07-15385, Claim 8-3 (amended proof of claim acknowledging $190,000 as value of the Taylors' home).

[7] Confirmation of the Taylors' repayment plan was also continued to June 5, 2008. D.I. 46. This was apparently because the Taylors' proposed plan payments would not cover the arrearage claimed in the Proof of Claim; thus, the pre-petition accounting to be provided by HSBC, which would determine the Taylors' actual arrearage, was necessary to determine plan feasibility. D.I. 54 at 43:25 through 44:7 (underfunding of claimed arrearage); 46:7-8 (confirmation was among the matters adjourned to June 5, 2008).

not yet provided it. D.I. 55 (Transcript of June 5, 2008, Hearing) at 5:5-6. He informed the court that the Udren Firm uses "a program called NewTrak to communicate with them," and he had made a NewTrak inquiry but had yet to receive a response. *Id*. at 8:10-17. Mr. Fitzgibbon also stated that he had no way to contact his client other than by making an electronic inquiry through the NewTrak system. *Id*. at 9:1-4. Mr. Fitzgibbon further stated that, because Moss Codillis, HSBC's national counsel, had filed the Proof of Claim, the Udren Firm did not have the NewTrak "screen prints" used to prepare the Proof of Claim. *Id*. at 8:12-14, 9:9. The bankruptcy court stated that it would enter an order directing Moss Codillis "and anybody who had anything to do with it" to appear and testify so that the court could "find out what the debtor [sic] owes." *Id*. at 21:16-24. The bankruptcy court also advised Mr. Fitzgibbon that it was "issuing an order to show cause on [the Udren Firm], too, for filing these things with – without having any knowledge. . . [a]nd filing answers that – without any knowledge." *Id*. at 22:3-6.

Thereafter, on June 9, 2008, the bankruptcy court entered an order that required specified persons to appear and provide testimony regarding whether sanctions should be imposed given the "questionable practices" identified at the May 1, 2008, and June 5, 2008, hearings. D.I. 52. The questionable practices regarding which the court sought testimony included "pressing a relief motion on admissions that were known to be untrue, and signing and filing pleadings without knowledge or inquiry regarding the matters pled therein." *Id*. n.1. The specific persons directed to appear and provide testimony included, among others, Mr. Fitzgibbon, Ms. Doyle, and "[t]he partner in charge of HSBC's bankruptcy work" at the Udren Firm. *Id*. In appearing to testify regarding their questionable practices, the specified Udren Firm attorneys were advised that the purpose of the hearing included "to investigate the practices employed in this case by HSBC and its attorneys and agents ***and consider whether sanctions should issue against HSBC, its attorneys and agents***."[8] *Id*. n.5 (emphasis added).

The resulting investigation took place over four evidentiary hearings at which a number of witnesses from HSBC, Moss Codillis, and the Udren Firm testified. *See* D.I. 65 (Transcript of July 23, 2008, Hearing); D.I. 70 (Transcript of August 8, 2008, Hearing); D.I. 122 (Transcript of October 23, 2008, Hearing); D.I. 169 (Transcript of December 17, 2008, Hearing).

At the beginning of the first of these hearings, on July 23, 2008, the bankruptcy court stated, "as a prefatory matter" to clarify "what [its] concerns were," the following:

> [E]very Proof of Claim objection needs to be defended in good faith. We have a situation here where one person is filing the Proof of Claim, another one is defending. I have a question about access to client files, access to information, the communication and so forth. ***Related to that is the Rule 11 obligation***; there must be a colorable basis for a claim ***after due inquiry***. Again, that comes back to the reference to data and information, the review of filings that are made with the client, discovery duties.

D.I. 65 at 8:25, 9:1, 9:14-22 (emphasis added). Similarly, at the second evidentiary hearing on August 8, 2008, the bankruptcy court stated as follows during Mr. Fitzgibbons' direct testimony:

> I'm not trying to elicit whether [the Udren Firm was] correct in [the] motion for relief or correct in [the] objection to claim. But what I'm trying to elicit is what do creditors do in preparation for filing these motions to ensure that they are – and ***what did they look at? . . . . What did they verify?***

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[8] The bankruptcy court's June 9, 2008, order also invited the Office of the United States Trustee to participate, and the Office of the United States Trustee began its own investigation into the practices of Moss Codillis and HSBC's loan servicer in this case, Lender Processing Services, Inc., f/k/a Fidelity National Information Services, Inc. ("LPS"), creator of NewTrak. The Office of the United States Trustee's investigation is ongoing.

D.I. 70 at 35:9-16 (emphasis added). Members of the Udren Firm, including Ms. Doyle, were present at both of these hearings. D.I. 65 at 1-2 (appearances at July 23, 2008, hearing); D.I. 70 at 1 (appearances at August 8, 2008, hearing).

During the course of the evidentiary hearings, the following relevant testimony was elicited regarding NewTrak and the documents filed in the Taylors' case:

HSBC's case management system, which is used to track payments received from borrowers such as the Taylors, can be accessed by its national counsel, Moss Codillis, but cannot be accessed by local counsel such as the Udren Firm. D.I. 65 at 67:13-14. Local counsel only have access to NewTrak, which is simply a communication tool provided by LPS through which a case can be electronically referred to local counsel and local counsel can communicate with HSBC and LPS. *Id.* at 68:22-23; 73:5-6, 16-19; 74:24-25; 172:17-24. When a stay relief motion is desired, NewTrak "provid[es] the attorney with minimal – the minimal information that they would need to file" the motion. *Id.* at 78:5-7 (testimony of HSBC Vice President Kimberly Graves). If communication through NewTrak is not sufficient or a timely response is not received, HSBC has an "escalation procedure" whereby local counsel can communicate directly with HSBC personnel. D.I. 65 at 109:14-25; 110:1-4; 114:25; 115:1-4. Notwithstanding this escalation procedure, however, the Udren Firm instructs its employees to communicate through NewTrak. D.I. 169 at 79:22-23.

Mark J. Udren is the Udren Firm's president and sole shareholder. D.I. 122 at 90:13-15. Mr. Udren has been a practicing attorney for many years. *Id.* at 90:5-6. He testified that because "time frames . . . drive[ ] the clients," his firm is "time frame driven." *Id.* at 124:22-23, 125:6. As a result, Mr. Udren strives to be the "fastest attorney" in relation to others to whom a servicer might refer business. *Id.* at 125:7. Given this perceived need to quickly turn around matters such as motions for stay relief, the Udren Firm "rel[ies] on [NewTrak] dramatically." *Id*. at 91:23-25. Despite its alleged importance to his firm's turnaround time, however, Mr. Udren acknowledged that he is not familiar with how NewTrak works, as it is "beyond [his] capabilities." *Id*. at 127:22-23.

In the Taylors' case, the Proof of Claim was prepared by a "processor" at Moss Codillis who is not legally trained. D.I. 65 at 137:20-21. Maria Borreson, the Moss Codillis attorney who signed and filed the Proof of Claim, did not actually review it before it was filed. *Id*. at 151:1-6. Although the Moss Codillis processors review HSBC's actual payment information in preparing proofs of claim, Ms. Borreson acknowledged that she does not know whether the information received from HSBC is accurate. *Id*. at 122:25; 123:1-3; 150:23. Indeed, Ms. Borreson acknowledged that the Proof of Claim in the Taylors' case had the wrong Note attached and also contained erroneous information regarding the monthly payment amount. *Id*. at 144:13-15.

Ms. Doyle, managing attorney of the Udren Firm, has been a practicing attorney for over 28 years. D.I. 169 at 5:15, 21. She acknowledged that, in preparing the Reply to Proof of Claim Objection, she simply relied on the erroneous and unreviewed Proof of Claim filed by Moss Codillis. D.I. 169 at 58:19-20. Although she reviewed the reply before it was filed in her name, she testified that she conducted no inquiry beyond reviewing the information received through NewTrak because that information "seemed accurate." *Id*. at 55:8-10; 57:4. Ms. Doyle presumed that the information on NewTrak had originated with HSBC and not the loan servicer, LPS, but she did not know and had not sought to verify the information because she "had no reason to disbelieve" it. *Id*. at 56:24, 57:3-5; 61:1-8.

Similarly, Ms. Doyle did nothing to verify the Taylors' payment history before signing and filing the Motion for Stay Relief, as her practice is to "rely on the allegations supplied by my client or on behalf of my client." *Id*. at 30:14-17. Instead, she merely reviewed hard copies of the "screen prints" provided through NewTrak. *Id*. at 7:17-18; 8:4, 8-9; 9:1; 31:11. The Udren Firm processors who prepared the motion had also relied solely on the "screen prints," as did Mr. Fitzgibbon in his initial review. D.I. 70 at 36:4-5; 36:19; 104:14; 120:21, 25; 121:4-5. Ms. Doyle acknowledged that she neither accessed NewTrak nor contacted HSBC to verify the accuracy of the information contained in the "screen prints." D.I. 169 at 50:4; 39:8. Indeed, Ms. Doyle did not know who had put the information onto NewTrak; she "presume[d] it was somebody from [LPS]," the loan servicer, and not HSBC, and she simply assumed that the information had been supplied to LPS by HSBC. *Id*. at 31:5-23; 40:23, 41:1-7. In addition, despite the explicit statement in the Motion for Stay Relief regarding the Taylors' alleged lack of equity in their home, Ms. Doyle testified that she made absolutely no inquiry into the veracity of that factual allegation. *Id*. at 38:15-25, 39:1.

After the completion of testimony, the parties submitted briefs regarding the issues raised during the court's investigation resulting from the June 9, 2008, order. D.I. 160 (submission filed under seal on behalf of the Udren Firm in response to the Acting United States Trustee's supplemental memorandum of law filed under seal on January 21, 2009, in support of her motion to conduct an examination of LPS pursuant to Fed. R. Bankr. P. 2004).

On April 15, 2009, the bankruptcy court issued an opinion in which it made findings based on its investigation and issued non-monetary sanctions against Ms. Doyle and Mr. Udren. D.I. 193. The bankruptcy court found that "certain practices and procedures employed by HSBC, its agents and attorneys . . . have created an environment where Rule 9011 duties have been subordinated to efficiency and cost-savings so as to require sanctions." *Id*., slip op. at 3. The bankruptcy court found that Mr. Fitzgibbon violated Rule 9011 by advocating the Motion for Stay Relief "on admissions he knew to be then untrue." *Id.*, slip op. at 51. The bankruptcy court also found that Ms. Doyle had violated Rule 9011 because she had "failed to observe her duty to make reasonable inquiry" regarding the Motion for Stay Relief and Reply to Proof of Claim Objection. *Id.*, slip op. at 50-51. The bankruptcy court also found that "the Udren Firm . . . is jointly responsible with [its attorneys] Doyle and Fitzgibbon for these breaches." *Id.*, slip op. at 52.

The bankruptcy court did not impose a sanction upon Mr. Fitzgibbon because he was a young and inexperienced lawyer when he committed his Rule 9011 violation. *Id.* Ms. Doyle, however, was found to "be so enmeshed in the assembly line of managing the bankruptcy department's volume mortgage lender practice that she has lost sight of her duty to the court and has compromised her ethical obligations." *Id.* As a result, the bankruptcy court held that Ms. Doyle must take three continuing legal education credits in professional responsibility and ethics over and above any general continuing legal education obligation she already has. *Id.*

As for the Udren Firm, "since policy emanates from the top" the bankruptcy court held that (i) Mr. Udren, who "sets the tone and establishes [the Udren Firm's] culture," must obtain training in NewTrak, (ii) Mr. Udren must spend one day observing his employees as they handle NewTrak referrals, and (iii) Mr. Udren and Ms. Doyle must "conduct a training session for all members of the [Udren Firm's] bankruptcy department in the appropriate use of [HSBC's] escalation procedure and the requirements of Rule 9011 with respect to pre-filing due diligence." *Id.*, slip op. at 52-53.

The bankruptcy court entered an order embodying its decision on April 15, 2009.[9] D.I. 194. A timely notice of appeal was filed on April 27, 2009, by Ms. Doyle, Mr. Udren, and the Udren Firm ("Appellants"). D.I. 207.

SUMMARY OF ARGUMENT

Every written paper presented to the bankruptcy court is subject to Rule 9011(b), which imposes an affirmative duty on every attorney signing or filing a document to first conduct "an inquiry reasonable after the circumstances" to ensure the validity of the factual and legal assertions contained in the document. To avoid sanction under Rule 9011(c), the attorney must show not only that the document was accurate, but also that the pre-signing inquiry was reasonable under the circumstances. The applicable standard is an objective standard, not a subjective, "akin to contempt" standard.

When a bankruptcy court seeks to impose Rule 9011(c) sanctions *sua sponte*, it must first issue an order describing the specific conduct that appears to violate Rule 9011 and directing the attorney or law firm to show cause why it has not violated Rule 9011(b). The reason for this requirement is to ensure due process. Here, the bankruptcy court entered an order that ordered the Udren Firm attorneys involved in this case to appear and testify, regarding specific conduct

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[9] The April 15, 2009, order also directed HSBC to transmit to each all law firm it employs a letter outlining HSBC's escalation procedure, explaining that HSBC is to be contacted directly when necessary, and instructing the law firm to circulate among all attorneys in its bankruptcy department a copy of the bankruptcy court's April 15, 2009, opinion. D.I. 194. This paragraph of the April 15, 2009, order formed the basis of a motion for a stay pending appeal filed by the Appellants on May 7, 2009, and granted on June 4, 2009. D.I. 208 (motion for stay pending appeal); D.I. 248 (order granting stay pending appeal). As the HSBC portion of the order is not addressed in the Appellants' Brief, however, they apparently no longer consider the directive to HSBC to be a reversible "sanction" against the Udren Firm. Moreover, the HSBC portion of the order is not properly before this Court on appeal because HSBC, the party to whom it is directed, has not appealed the April 15, 2009, order.

taken by Udren Firm attorneys, at a hearing at which sanctions would be considered. At the outset of those hearings, moreover, the bankruptcy court specifically noted that the scope of its inquiry included consideration of possible Rule 9011 sanctions. After four evidentiary hearings at which the Udren Firm attorneys testified, and after reviewing written submissions by the parties, the bankruptcy court issued an order finding that Mr. Fitzgibbon and Ms. Doyle had violated Rule 9011(b) and imposing nonmonetary sanctions on Ms. Doyle and the Udren Firm under Rule 9011(c). The procedure used by the bankruptcy court provided sufficient due process, was not an abuse of discretion, and was, at most, harmless error.

The finding that Ms. Doyle had violated Rule 9011(b) was not an abuse of discretion, as her own testimony revealed that she did not conduct an inquiry reasonable under the circumstances before filing two documents with the bankruptcy court. The bankruptcy court's sanction – that Ms. Doyle obtain three additional credits of continuing legal education in professional responsibility and ethics – was not an abuse of discretion.

As Ms. Doyle was properly found to have violated Rule 9011(b), the Udren Firm was also subject to sanction under Rule 9011(c). The bankruptcy court's sanction – that Mr. Udren learn about the NewTrak system, observe his staff in its handling of NewTrak referrals for one day, and that Mr. Udren and Ms. Doyle conduct an in-house educational seminar regarding HSBC's escalation procedure and the due diligence requirements of Rule 9011 – was not an abuse of discretion.

ARGUMENT

I. THE PROCEDURE USED BY THE BANKRUPTCY COURT WAS CONSISTENT WITH RULE 9011(c)(1)(B), AND DOES NOT CONSTITUTE REVERSIBLE ERROR

A. Ms. Doyle, Mr. Udren, and the Udren Firm Had Notice of the Conduct For Which Sanctions Were Imposed

Every written paper[10] presented to the bankruptcy court is subject to Rule 9011, subsection (b) of which provides that, "[b]y presenting to the court (whether by signing, filing, submitting, or later advocating) a . . . written motion, or other paper, an attorney . . . is certifying that to the best of the [attorney]'s knowledge, information, and belief, ***formed after an inquiry reasonable under the circumstances***," the document is not presented for an improper purpose, contains legal contentions warranted by existing law, contains factual contentions with evidentiary support, and contains denials of factual contentions that are either warranted on the evidence or reasonably based on a lack of information or belief. Fed. R. Bankr. P. 9011(b) (emphasis added). Under Rule 9011(c), sanctions may be imposed "upon the attorneys, law firms, or parties that have violated subdivision (b) or are responsible for the violation."

To avoid Rule 9011 sanctions, an attorney must not only show the legal and factual validity of a document she signed and filed – she must also show that, before signing and filing it, she conducted a reasonable inquiry.[11] *Business Guides, Inc. v. Chromatic Commc'ns Enters., Inc*., 498 U.S. 533, 551 (1991) (Rule 11 "states unambiguously that any signer must conduct a

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[10] Pursuant to Fed. R. Bankr. P. 5005(a)(2), any document filed by electronic means constitutes a written paper for purposes of the Federal Rules of Bankruptcy Procedure, including Rule 9011.

[11] As Rule 9011 is the bankruptcy equivalent of Fed. R. Civ. P. 11, cases interpreting Rule 11 are used when necessary to analyze the propriety of sanctions under Rule 9011. *See Landon v. Hunt*, 977 F.2d 829, 833 n.3 (3d Cir. 1992).

‘reasonable inquiry’ or face sanctions”); *see also Vista Mfg. Inc. v. Trac-4 Inc.*, 131 F.R.D. 134, 138 (N.D. Ind. 1990) (“[A party] may not demonstrate compliance with Rule 11 by showing that it was right. It must demonstrate compliance by showing that its pre-filing inquiry was reasonable.”). Failure to conduct a reasonable inquiry is sanctionable even if the pleading is factually and legally correct, as “a signer making an inadequate inquiry into the sufficiency of the facts and law underlying a document will not be saved from a Rule 11 sanction by the stroke of luck that the document happened to be justified.” *Garr v. U.S. Healthcare, Inc.*, 22 F.3d 1274, 1279 (3d Cir. 1994).

In this case, the bankruptcy court was concerned that the Motion for Stay Relief and Reply to Proof of Claim Objection were signed, filed, and later advocated without Udren Firm attorneys conducting an inquiry reasonable under the circumstances. The bankruptcy court stated as much at the June 5, 2008, hearing, by telling Mr. Fitzgibbon “I’m issuing an order to show cause on your firm, too, for filing these things with – without having any knowledge. And filing answers that – without any knowledge.” *See* D.I. 55 at 22:3-6. In addition, the June 9, 2008, order expressly stated that the “questionable practices” to be investigated included “pressing a relief motion on admissions that were known to be untrue, and ***signing and filing pleadings without knowledge or inquiry regarding the matters pled therein.***” D.I. 52 n.1 (emphasis added). It is disingenuous for the Appellants to protest that they had no idea why the bankruptcy court was conducting its investigation.

In any case, the Appellants do not explain how placing a different title on the bankruptcy court’s proceedings would have affected the substantive outcome of those proceedings, nor do they suggest that any part of the bankruptcy court’s analysis would be different if the court was forced to reconsider those same sanctions on remand under the rubric of Rule 9011. The Appellants do not contend they were confused about the subject matter of the bankruptcy court's investigation, and they do not suggest that their defense was affected by uncertainty over the statutory basis for sanctions. Accordingly, even if the bankruptcy court erred by not referencing Rule 9011 more explicitly in connection with its investigation of the Appellants, such error was harmless.

B. The Bankruptcy Court Did Not Err By Looking To Objective Conduct, And Not Subjective Bad Faith, When Determining Whether Rule 9011 Sanctions Were Warranted

The Third Circuit has held that "[t]he imposition of Rule 11 sanctions . . . requires only a showing of objectively unreasonable conduct," and does not require a showing of subjective bad faith. *Fellheimer, Eichen & Braverman P.C. v. Charter Techs., Inc.*, 57 F.3d at 1225 (awarding sanctions upon motion of opposing party). The Appellants nevertheless ask this Court to adopt a subjective, "akin to contempt" standard where the Rule 9011 action is brought by the court *sua sponte* rather than by a party on motion. Appellant's Brief at 18-19. This subjective standard, which has only been adopted by the Second Circuit (over a strong dissent),[12] is apparently based

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[12] Other Circuits have acknowledged that the 1993 Advisory Committee Notes state that *sua sponte* Rule 11 motions will arise only in situations "akin to contempt," but not one has adopted the substantive, "bad faith" standard urged by the Appellants. *See, e.g.*, *Kaplan v. Daimlerchrysler, A.G.*, 331 F.3d 1251, 1255-56 (11th Cir. 2003) (agreeing with courts adopting "akin to contempt" rationale in *dicta*, but declining to adopt Second Circuit *mens rea* requirement); *Hunter v. Earthgrains Co. Bakery*, 281 F.3d 144, 151, 153 (4th Cir. 2002) (noting in *dicta* that courts are "obliged to use extra care in imposing [*sua sponte*] sanctions on offending lawyers" and noting the "Advisory Committee contemplated that a *sua sponte* show cause order would only be used 'in situations that are akin to a contempt of court,'" but nonetheless stating that the appropriate Rule 11 standard is one of objective reasonableness); *cf. MHC Inv. Co. v. Racom Corp.*, 323 F.3d 620, 623-24 (8th Cir. 2003) (stating that Rule 11 standard "is applied with particular strictness where, as here, the sanctions are imposed on the court's own motion," but affirming $25,000 sanction without finding subjective bad faith).

on the fact that Rule 9011(c)(1)(A) provides a 21-day “safe harbor” when the action is brought on motion, while Rule 9011(c)(1)(B) contains no “safe harbor” when the action is brought by the court *sua sponte*. *See In re Pennie & Edmonds LLP*, 323 F.3d 86, 91 (2d Cir. 2003).

Although the Third Circuit has not yet ruled on the issue, other courts have rejected the holding of *Pennie & Edmonds* and have not required proof of subjective bad faith where the sanctions proceeding is initiated by the court *sua sponte*. *See, e.g., Jenkins v. Methodist Hosps. of Dallas, Inc.*, 478 F.3d 255, 264 (5th Cir. 2007), *cert. denied*, 128 S. Ct. 181 (2007); *Young v. City of Providence*, 404 F.3d 33, 39 (1st Cir. 2005). The Fifth Circuit found that, notwithstanding the procedural differences between actions brought *sua sponte* and those brought on motion, regardless of who initiates the inquiry “the party subject to sanctions is given the opportunity to show why they should not be imposed.” *Jenkins v. Methodist Hosps. of Dallas, Inc.*, 478 F.3d at 264. The First Circuit noted that the “akin to contempt” theory is based on a statement in the 1993 Advisory Committee Notes, but not on the actual text of Rule 11. *Young v. City of Providence*, 404 F.3d at 39. Indeed, it is far more likely that an adversarial party would invoke Rule 9011 for slight cause, so it makes little sense to impose a stricter standard on actions brought by the court *sua sponte*. *Id*. at 40.

The language of Rule 9011 supports the holding of *Jenkins* and *Young*. Rule 9011 imposes an affirmative duty to conduct an “inquiry ***reasonable under the circumstances***.” Fed. R. Bankr. P. 9011(b) (emphasis added); *see also Business Guides, Inc. v. Chromatic Commc’ns Enters., Inc.*, 498 U.S. at 551 (Rule 11 “imposes . . . an affirmative duty to conduct a reasonable inquiry into the facts and law before filing”). Although Rule 9011(c)(1)(A) was amended to add the “safe harbor” provision, no change was made to Rule 9011(b) or elsewhere to change the inquiry from an objective “reasonable under the circumstances” inquiry to a subjective, good-faith inquiry. Had the drafters of the Rule intended to provide for a heightened *mens rea* standard for court-initiated proceedings, they would have included appropriate language in the Rule itself, as the language of the Rule holds more weight than do the Advisory Committee Notes. *See First Nat’l Bank of Lincolnwood v. Levine (In re Evanston Motor Co.)*, 735 F.2d 1029, 1031-32 (7th Cir. 1984) (interpreting rule so as to not “give the Advisory Committee’s general guidance greater vitality than the clear language of the rule itself”); *cf. United States v. Carey*, 120 F.3d 509, 512 (4th Cir. 1997), *cert. denied*, 522 U.S. 1120 (1998) (with regard to the Federal Rules of Criminal Procedure, “the Advisory Committee Note is not the law; the rule is”).

Even if this Court thought a substantive bad faith standard should apply when the Rule 9011 action is initiated by the bankruptcy court *sua sponte*, it “would not be free to implement this standard outside of the rulemaking process.” *See Business Guides, Inc. v. Chromatic Commc’ns Enters., Inc*., 498 U.S. at 549 (refusing to read a subjective bad faith standard into Rule 11 for sanctions against represented parties). As Rule 9011 is written, there is no difference in the standard regardless of whether the action is initiated by a party or by the court. In each instance the signer of the document must show that it conducted an inquiry reasonable under the circumstances.[13]

In light of the foregoing, the Appellants’ request to apply a subjective standard should be rejected. As the objective standard applied by the bankruptcy court was consistent with Supreme Court and Third Circuit precedent interpreting Rules 11 and 9011, it was not reversible error.

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[13] To the extent that this Court does adopt a subjective bad faith standard for Rule 9011 sanctions, this case should be remanded to the bankruptcy court to determine if such standard has been met.

C. The Bankruptcy Court Provided the Appellants With Ample Due Process Before Imposing Sanctions

Rule 9011(c) requires "notice and a reasonable opportunity to respond" before a sanction may be imposed. Under Rule 9011(c)(1)(B), the bankruptcy court may initiate Rule 9011 proceedings by "enter[ing] an order describing the specific conduct that appears to violate subsection (b) and directing an attorney, law firm, or party to show cause why it has not violated subdivision (b) with respect thereto." The Rule 9011(c)(1)(B) requirements are intended to ensure that sanctioned parties receive due process.

The Third Circuit has held that, when sanctioning attorneys, due process requires "particularized notice" and "a meaningful opportunity to be heard." *Fellheimer, Eichen & Braverman P.C. v. Charter Techs., Inc.*, 57 F.3d at 1225-27. The notice required, however, need not necessarily state the precise provision under which sanctions are to be imposed, provided the attorney has advance notice that the court is considering sanctions for specified actions. *Id.* at 1226 (where notice did not state that court would use its inherent power to impose sanctions, law firm nevertheless had sufficient advance notice that sanctions for bad faith conduct were being considered). As for an attorney's opportunity to be heard, it is sufficient if after receiving notice of the sanctionable conduct the attorney has ample opportunity to be heard on the record and sufficient time to brief the issue. *Id.* at 1227.

The bankruptcy court below initiated Rule 9011 proceedings by means of the June 9, 2008, order. Although that order was not termed an "order to show cause," it did ***order*** Ms. Doyle and "[t]he partner in charge of HSBC's bankruptcy work" at the Udren Firm to appear and testify. In addition, it ordered them to testify regarding ***specific conduct*** taken by the Udren Firm, namely advocating the Motion for Stay Relief by presenting "admissions" known to be false, and filing documents without first conducting a reasonable inquiry. Also, it expressly warned that ***sanctions*** for this conduct were being considered. Although the June 9, 2008, order did not expressly refer to Rule 9011(b), it is difficult to imagine what other sanctions the Udren Firm thought could be applicable to its filing papers without conducting a reasonable inquiry. If there was any doubt, it was clearly dispelled when, at the beginning of the first hearing held on the June 9, 2008, order, the bankruptcy court stated that Rule 11 was implicated by papers filed by the Udren Firm without a reasonable inquiry.

In objecting to the procedure used by the bankruptcy court, the Appellants seek to exalt form over substance. They received all of the process to which they were due under Rule 9011(c), especially in light of the exceptionally lenient educational "sanctions" ultimately imposed by the bankruptcy court. The Appellants were sanctioned over ten months after the bankruptcy court issued its June 8, 2008, order. During that extended period the Appellants had the opportunity to provide extensive testimony at four evidentiary hearings as well as a written submission. They knew from at least July 23, 2008, if not June 9, 2008, that they were subject to Rule 9011 sanctions based on the filing of documents without reasonable inquiry. As a result, they were not blindsided by the bankruptcy court's imposition of Rule 9011 sanctions in April 2009.

Indeed, the Appellants have not been hamstrung in presenting their position to the bankruptcy court. Through counsel, they have exhaustively presented their position – they simply believe they did nothing sanctionable. It is difficult to imagine how much more of a showing they could have made if the bankruptcy court's order had been called an "order to show cause" and had expressly referred to Rule 9011(b). Given the thorough record developed below, a remand for further proceedings would be a waste of judicial time and resources.

The procedure used by the bankruptcy court was consistent with Rule 9011(c)(1)(B). Even if such procedure was erroneous, moreover, such error was harmless. Accordingly, the ruling of the bankruptcy court should be affirmed.

II. THE BANKRUPTCY COURT DID NOT ERR IN SANCTIONING MS. DOYLE UNDER RULE 9011 FOR HER FAILURE TO CONDUCT A REASONABLE INQUIRY BEFORE SIGNING AND FILING DOCUMENTS

A. Ms. Doyle Did Not Conduct an Inquiry Reasonable Under the Circumstances

The bankruptcy court imposed a mild non-monetary sanction on Ms. Doyle because she "failed to observe her duty to make reasonable inquiry of the two documents she signed." D.I. 193, slip op. at 50. By Ms. Doyle's own admission, her "inquiry" regarding the Motion for Stay Relief was limited to a review of the same NewTrak "screen prints" that a Udren Firm processor had used to draft the document, and she made no inquiry whatsoever as to facts underlying the Reply to Proof of Claim Objection since it "seemed accurate." D.I. 169 at 7:17-18; 8:4, 8-9; 9:1; 31:11; 55:8-10; 58:19-20. Although she was content to simply rely on the Proof of Claim and NewTrak "screen prints," she had no idea what the source of those numbers was. *Id.* at 31:5-23; 40:23, 41:1-7; 56:24, 57:3-5; 61:1-8. There was no sworn testimony or other evidence that time pressures precluded her from doing a more thorough inquiry. Indeed, it apparently never occurred to Ms. Doyle to do any further inquiry, as the Udren Firm's policy appears to have been to simply review NewTrak "screen prints" in preparing documents for filing with the court.

The bankruptcy court's finding that the documents signed and filed by Ms. Doyle were "rote averments from form pleadings signed without any inquiry" was consistent with the record developed below, and so was not reversible error. A reasonable attorney would not have signed and filed such pleadings without first conducting an inquiry beyond blind reliance on unverified numbers provided from an unknown source.

The Appellants' brief does not even address the reasonableness of Ms. Doyle's pre-signing inquiry. Instead, it concentrates on whether the pleadings filed were factually accurate. Appellants' Brief at 21-25, 27. But, as the Third Circuit has held, an attorney who signs a pleading without conducting a reasonable inquiry is subject to Rule 11 sanction even if the information in the document turns out to be correct.[14] *Garr v. U.S. Healthcare, Inc.*, 22 F.3d at 1279.

When she signed and filed the Motion for Stay Relief, Ms. Doyle knew only that it was consistent with the "screen prints" received from NewTrak; she had no idea whether the information was accurate, or even whether HSBC or an agent acting on its behalf had put the information on NewTrak. Although the Appellants will presumably argue that they reasonably relied on information provided by their client, that argument is unavailing because "[b]lind reliance on the client is seldom a sufficient inquiry" for Rule 9011 purposes. *See In re Kunstler,* 914 F.2d 505, 514 (4th Cir. 1990); *Southern Leasing Partners, Ltd. v. McMullan,* 801 F.2d 783, 788 (5th Cir. 1986); *Brubaker Kitchens, Inc. v. Brown,* 2006 WL 3682180 *3 (E.D. Pa. Dec. 11, 2006), *aff'd,* 280 F. App'x 174 (3d Cir. 2008).

Similarly, when she signed the Reply to Proof of Claim Objection, Ms. Doyle knew only that it was consistent with the Proof of Claim filed by Moss Codillis; she had no idea whether the information was accurate. Although Ms. Doyle might have counted on Ms. Borreson of Moss

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[14] In any event, both the Motion for Stay Relief and the Reply to Proof of Claim Objection stated that the Taylors had no equity in their home – which was not accurate, in light of HSBC's second amended proof of claim's acknowledgment that the Taylors' home is valued at $190,000. *See* Claims Register for Case No. 07-15385, Claim 8-3.

Codillis having conducted a reasonable inquiry before filing the Proof of Claim, she had no way of knowing whether Ms. Borreson actually had conducted such an inquiry (and indeed, Ms. Borreson had not). This case shows the wisdom in the Third Circuit's directive that "Rule 11 requires that an attorney signing a pleading must make a reasonable inquiry *personally*," as signing counsel can never be certain that prior reviewing counsel (or paralegals, or processors) actually conducted an inquiry. *See Garr v. U.S. Healthcare*, 22 F.3d at 1280 (emphasis in original)

The Appellants' Brief attempts at 22-24 to deflect attention to the Taylors' counsel. These arguments are unavailing, however, as the Taylors' counsel's actions had no affect whatsoever on Ms. Doyle's pre-signing inquiry. The question on appeal is whether Ms. Doyle conducted an inquiry reasonable under the circumstances, not whether the Taylor's counsel acquitted herself well in this case.

The Appellants' Brief also assumes that Ms. Doyle's sanction was imposed vicariously based on the actions of Mr. Fitzgibbon. Appellants' Brief at 26-27. As the bankruptcy court's decision makes clear, however, Ms. Doyle was appropriately sanctioned due to her own failure to conduct an inquiry reasonable under the circumstances before signing and filing documents with the bankruptcy court. *See In re Mroz*, 65 F.3d 1567, 1573 (11th Cir. 1995) (holding that where "an attorney has failed to conduct a reasonable inquiry into the matter, then the court is obligated to impose sanctions even if the attorney had a good faith belief that the claim was sound").

B. The Sanction Imposed by the Bankruptcy Court Was Reasonable

Under Rule 9011(c)(2), sanctions may include "directives of a nonmonetary nature." Sanctions "shall be limited to what is sufficient to deter repetition of such conduct or comparable conduct by others similarly situated." Fed. R. Bankr. P. 9011(c)(2). The order imposing sanctions "shall describe the conduct determined to constitute a violation of [Rule 9011] and explain the basis for the sanction imposed."

The bankruptcy court below ordered Ms. Doyle to obtain three continuing legal education credits in professional responsibility and ethics. This is the kind of "nonmonetary sanction" envisioned by Rule 9011(c)(2). *See* 1993 Advisory Committee Notes to Rule 11 ("The court has available a variety of possible sanctions to impose for violations, such as . . . requiring participation in seminars or other educational programs[.]"). In addition, although the April 15, 2009, order did not itself describe the sanctionable conduct, it expressly provided that it was based on "the reasons stated in the accompanying Opinion" – and the bankruptcy court's 58-page opinion describes the conduct determined to violate Rule 9011 and explains the basis for the sanction imposed. As a result, the only remaining question is whether the nonmonetary sanction imposed is the least sanction that will deter Ms. Doyle and others similarly situated from signing and filing documents without conducting an independent inquiry reasonable under the circumstances.

The Appellants assert that Ms. Doyle's mild sanction is "a manifest injustice" and "in the nature of an ethical violation." Appellants' Brief at 27. Given the record developed below, requiring Ms. Doyle to obtain an additional three hours of continuing legal education is hardly a "manifest injustice"; indeed, the bankruptcy court could easily have imposed a monetary sanction, but chose not to. *Cf. In re Ulmer*, 363 B.R. 777, 785 (Bankr. D.S.C. 2007) (imposing sanction of $500 per violation where pleadings were filed without review of attesting attorney); *In re Rivera*, 342 B.R. 435, 464 (Bankr. D.N.J. 2006), *aff'd*, 2007 WL 1946656 (D.N.J. June 29, 2007) (imposing sanction of $500 per violation where attorney filed faked certification with court, notwithstanding alleged accuracy of data contained therein). Similarly, had the bankruptcy court actually wanted to make an ethics referral, it easily could have done so on this record. *See In re Rivera*, 342 B.R. at 468 (referring signing attorney and firm's managing partner to Chief Judge of District Court for further review and ethics disciplinary proceedings). Learning about ethics and being referred to the state ethics authorities are two dramatically different things. Indeed, as attending an educational course can only lead to Ms. Doyle's betterment, it can hardly be called a "sanction" at all.

In this case, the evidence demonstrates that Ms. Doyle's errors were caused in part by a firm culture that emphasizes speed over reasonable inquiry. Consequently, the bankruptcy court did not abuse its discretion when it concluded that a sanction greater than a mere reprimand was necessary to deter Ms. Doyle and other Udren Firm attorneys from similar violations of Rule 9011 in the future.

III. THE BANKRUPTCY COURT DID NOT ERR IN SANCTIONING THE UDREN FIRM IN LIGHT OF MS. DOYLE'S VIOLATIONS OF RULE 9011

A. The Bankruptcy Court Did Not Err in Sanctioning the Udren Firm for the Rule 9011 Violations of its Attorneys

The introductory paragraph to Rule 9011(c) and Rule 9011(c)(1)(B) both expressly refer to "law firms" as being subject to sanction for Rule 9011(b) violations. As law firms can only act through the humans that comprise them, these references to "law firms" can only mean that law firms are subject to sanction under Rule 9011(c)(1)(B) if their partners, associates, or employees are found to have violated Rule 9011(b). *See In re Rivera*, 342 B.R. at 463 (holding law firm and attorney jointly liable for lawyer's Rule 9011 violation).

In addition, while Rule 9011(c)(1)(A) expressly states that "[a]bsent exceptional circumstances, a law firm shall be held jointly responsible for violations committed by its partners, associates, and employees," that does not mean law firms may ***only*** be sanctioned when a party moves under Rule 9011(c)(1)(A). There is no logical reason for such a distinction; just because law firms are expressly sanctionable under Rule 9011(c)(1)(A) does not mean they are not sanctionable under Rule 9011(c)(1)(B). After all, the statement in Rule 9011(c)(1)(A) lays out a default – law firms are to be sanctioned for violations committed by their partners, associates, and employees "absent extraordinary circumstances." If sanctioning law firms is the rule, then it is no less the rule when sanctions are initiated by the court rather than a party.[15]

The bankruptcy court below found that Mr. Fitzgibbon and Ms. Doyle had both committed Rule 9011(b) violations. As Rule 9011 provides for the sanction of a law firm whose attorney commits a Rule 9011(b) violation, the bankruptcy court did not err in imposing a sanction on the Udren Firm.

Although the bankruptcy court's April 15, 2009, sanction order named Mr. Udren and

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[15] In Rule 11, the language regarding law firms being jointly responsible is located in the "general" section of Rule 11(c)(1), which corresponds to the introductory, unnumbered paragraph of Rule 9011(c). When Rule 9011 was amended in 1997 to conform with the 1993 amendments to Rule 11, however, this language was inserted into Rule 9011(c)(1)(A) – which is actually the equivalent of Rule 11(c)(2). It would appear that the language was simply inserted into the wrong paragraph; as the 1997 amendments were intended to bring Rule 9011 in line with Rule 11, the language should have been inserted into the introductory paragraph to Rule 9011(c). *See* 1997 Advisory Committee Note to Rule 9011 ("This rule is amended to conform to the 1993 changes to [Rule] 11.").

Ms. Doyle, rather than the Udren Firm itself, in imposing the sanction to learn about NewTrak and teach about the escalation procedure and Rule 9011 due diligence, this is simply because the bankruptcy court imposed an educational "sanction" that must of necessity must be imposed on an individual rather than an entity. Had the bankruptcy court imposed a monetary sanction, it could have been separately imposed against the Udren Firm's coffers, which are distinct from the personal accounts of Mr. Udren and Ms. Doyle. A non-monetary educational sanction, on the other hand, must necessarily be imposed not on the artificial entity "the Udren Firm" but on the persons responsible for the firm's bankruptcy practice – namely, Mr. Udren (its president and 100% shareholder) and Ms. Doyle (its managing attorney). Thus, the bankruptcy court's naming of Mr. Udren in the April 15, 2009, order is best viewed as a sanction against the Udren Firm, not against Mr. Udren personally.

B. The Sanction Imposed by the Bankruptcy Court Was Reasonable

As with the sanction imposed on Ms. Doyle, the bankruptcy court only directed the Udren Firm to engage in education. Although it is unclear in any case why the Udren Firm would resist an opportunity to correct practices that have led to erroneous filings, they cannot demonstrate that such a remedy is inappropriate or burdensome. *Cf. U.S. Nat'l Bank Ass'n v. Sullivan-Moore*, 406 F.3d 465, 471-72 (7th Cir. 2005) (finding "nothing excessive or unduly burdensome" with ordering law firm attorneys to attend 16-hour course in civil procedure where firm attorney had violated Rule 11 in foreclosure proceedings).

As the bankruptcy court decided not to impose a monetary sanction on the Udren Firm, an imaginative nonmonetary sanction was required.[16] A sanction against the firm in addition to

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[16] Although the Appellants' Brief at 26 n.8 states that the Udren Firm has arranged for training on NewTrak, there is no suggestion that the Udren Firm has also scheduled internal education

Ms. Doyle was necessary because, given the internal and external forces on Udren Firm attorneys to process documents quickly, imposing a sanction only against Ms. Doyle will not ensure that other Udren Firm attorneys comply with Rule 9011 in the future. *See* 1993 Advisory Committee Note to Rule 11 (an inquiry regarding sanctioning a law firm in addition to an individual attorney "may be appropriate in cases involving . . . institutional parties that frequently impose substantial restrictions on the discretion of individual attorneys employed by it"). Similarly, a mere reprimand would do nothing in the face of the internal and external pressure to cut corners so as to file pleadings faster than the competition.

Given the Udren Firm's "speed" culture, which led to Mr. Fitzgibbon's and Ms. Doyle's Rule 9011 violations, the educational sanction arrived at by the bankruptcy court is the mildest sanction likely to get the Udren Firm's attorneys to ensure that their pre-filing inquiries and subsequent advocacy of documents filed with the court in future cases do not run afoul of Rule 9011. And, education regarding Rule 9011 appears to be sorely needed at the Udren Firm. Even with their decades of experience, Ms. Doyle and Mr. Udren see nothing wrong with cutting ethical corners by filing documents without doing any more of an inquiry than simply ensuring that the numbers on the page equal the numbers on a screen displaying data input by an unknown source. While the Udren Firm's desire to process documents quickly may be understandable, when the end result of these documents is to remove a family from its home it is not too much to ask creditors and their counsel to turn sharp corners.

As the bankruptcy court's sanction against the Udren Firm is consistent with the

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regarding HSBC's escalation procedure and the due diligence requirements of Rule 9011 – which is actually more important than the bankruptcy court's direction that Mr. Udren familiarize himself with the workings of NewTrak.

nonmonetary sanctions contemplated by Rule 9011, it was not an abuse of discretion, and should be affirmed.

CONCLUSION

For these reasons, the Acting United States Trustee respectfully asks this Court to affirm the bankruptcy court's order.

Respectfully submitted,

ROBERTA A. DEANGELIS
ACTING UNITED STATES TRUSTEE
REGION 3

By: /s/ Frederic J. Baker
Frederic J. Baker, Senior Assistant United States Trustee
Robert J. Schneider
George M. Conway
United States Department of Justice
Office of the United States Trustee
833 Chestnut Street, Suite 500
Philadelphia, PA 19107
(215) 597-4411

P. Matthew Sutko
John P. Sheahan
United States Department of Justice
Executive Office for United States Trustees
20 Massachusetts Ave, N.W.
Washington, DC 20530
(202) 307-1399

Dated: July 2, 2009

BRIEF BANK — "SUMMARY SHEET" *Printed Wed-11/17/10 16:16*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*

Niles C. Taylor and Angela J. Taylor v. Roberta A. DeAngelis (In re Niles C. Taylor; Angela J. Taylor)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*

3rd. Cir.

3. ("CCN") ***CURRENT*** CASE NO.

No.: 10-2154

4. ("PCN") ***PRIOR*** CASE NO. - & COURT *[IF ANY]*

No.: 09-2479

Court: E. D. Pa.

(Identify judge & cite, if any)

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Robert J. Schneider, George M. Conway, John P. Sheahan, P. Matthew Sutko, Ramona Elliott, Frederic J. Baker

(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***

BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s)

&

√ Any Miscellaneous ***BACKGROUND***

- Did the district court err when it reversed the bankruptcy court's order imposing sanctions and remedial relief against the Udren Firm, Mr. Udren, and Ms. Doyle? The district court also reversed the bankruptcy court's sanctions against HSBC.

10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)

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UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

10-2154

In re: NILES C. TAYLOR; ANGELA J. TAYLOR,

Debtors.

ROBERTA A. DeANGELIS, United States Trustee,

Appellant.

Appeal from the United States District Court for the
Eastern District of Pennsylvania

Case No. 09-2479
Bankruptcy Case No. 07-15385

BRIEF OF APPELLANT, ROBERTA A. DeANGELIS, UNITED STATES TRUSTEE, REGION 3

Of Counsel:	Prepared and submitted by:
RAMONA ELLIOTT General Counsel P. MATTHEW SUTKO Associate General Counsel JOHN P. SHEAHAN Trial Attorney United States Department of Justice Executive Office for United States Trustees 20 Massachusetts Ave. NW, Suite 8100 Washington, D.C. 20530 (202) 307-1399	FREDERIC J. BAKER Senior Assistant United States Trustee ROBERT J. SCHNEIDER GEORGE M. CONWAY Trial Attorneys United States Department of Justice Office of the United States Trustee 833 Chestnut Street, Suite 500 Philadelphia, PA 19107 (215) 597-4411

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STATEMENT OF BASIS OF APPELLATE JURISDICTION

The bankruptcy court had jurisdiction over this chapter 13 proceeding under 28 U.S.C. § 157(a). The district court had appellate jurisdiction over the bankruptcy court's final order imposing sanctions pursuant to Fed. R. Bankr. P. 9011 as to appellants Mark J. Udren, Lorraine Doyle, and the Udren Law Offices, P.C. (collectively, "Udren" or the "Udren Firm") under 28 U.S.C. § 158(a)(1). The district court lacked appellate jurisdiction over the bankruptcy court's order as to HSBC Mortgage Corporation (USA) ("HSBC"). HSBC did not file a notice of appeal of the bankruptcy court's decision and was not otherwise a party to the appeal filed by Mr. Udren, Ms. Doyle, and the Udren Firm.

The United States Trustee timely filed a notice of appeal from the district court's order on April 19, 2010. This Court has jurisdiction over the district court's final order under 28 U.S.C. § 158(d).

STATEMENT OF ISSUES

1. Did the district court err when it reversed the bankruptcy court's order imposing sanctions and remedial relief against the Udren Firm, Mr. Udren, and Ms. Doyle?

2. Did the district court exceed its appellate jurisdiction when it reversed the bankruptcy court's order as to HSBC, notwithstanding HSBC's failure to file a notice of appeal from the order of the bankruptcy court?

STATEMENT OF RELATED CASES

The United States Trustee is aware of no proceedings or cases on appeal before this Court that are related to this case.

STATEMENT OF THE STANDARD OF REVIEW

This Court reviews the legal findings of the bankruptcy court *de novo*, and reviews the factual findings of the bankruptcy court for clear error. *Fellheimer, Eichen & Braverman P.C. v. Charter Techs., Inc.*, 57 F.3d 1215, 1223 (3d Cir. 1995). Under the clearly erroneous standard, the bankruptcy court's findings may be set aside only if they are either "completely devoid of evidentiary support" or "bear[] no rational relationship to the supportive evidentiary data." *Id.*

A trial court's decision to impose sanctions is reviewed for abuse of discretion. *See Cooter & Gell v. Hartmarx Corp.*, 496 U.S. 384, 404 (1990) (holding that "an appellate court should apply an abuse-of-discretion standard in reviewing all aspects" of a trial court's sanctions decision); *In re Gioioso*, 979 F.2d 956, 961 (3d Cir. 1991) (holding that sanctioning court is vested with "considerable discretion" in choosing what sanction to impose) (internal citations omitted); *Travelers Ins. Co. v. St. Jude Hosp. of Kenner, La., Inc.*, 38 F.3d 1414, 1417 (5th Cir. 1994) ("In sum, in reviewing the imposition of sanctions, we do not substitute our judgment for that of the district court in enforcing acceptable standards of conduct."), *citing Topalian v. Ehrman*, 3 F.3d 931, 935 (5th Cir.1993); *see also Evans v. Buchanan*, 555 F.2d 373, 378-79 (3d Cir. 1997) (noting that an "improper use of discretion exists only when the judicial action is arbitrary, fanciful, or unreasonable or when improper standards, criteria, or procedures are used . . .our task on review is not to substitute the remedy we could have imposed[.]"). Because this is the same standard of review that the district court was required to apply in itsreview of the bankruptcy court's order, this Court's standard of review over the district court's ruling is plenary. *In re Goody's Family Clothing Inc.*, 610 F.3d 812, 816 (3d Cir. 2010).

STATEMENT OF THE CASE

A. Statutory Framework

1. The proof of claim process

In bankruptcy cases, a creditor typically establishes its rights against the debtor by filing a document known as a proof of claim. Fed. R. Bankr. P. 3001(d); Official Form 10. By rule, the proof of claim must include a statement of the amount of the claim, the nature of the claim, and, if the claim is secured, a description of the property securing the claim. Official Form 10. In addition, when the claim is based on a writing, the proof of claim must attach documentation for the claim, including evidence that any lien securing the claim has been perfected. Fed. R. Bankr. P. 3001(c), (d).

The bankruptcy system relies on creditors themselves, in the first instance, to ensure the accuracy of their own claims. In particular, under the Bankruptcy Code, a properly filed proof of claim is presumptively deemed valid in the amount stated, and such a claim may be automatically allowed unless the debtor or another party objects. 11 U.S.C. § 502(a); *see also* Fed. R. Bankr. P. 3007. For this reason, Rule 9011 requires that a party filing a proof of claim must make a good faith investigation into the claim's validity and accuracy before submitting the claim. *See Adair v. Sherman*, 230 F.3d 890, 895 n.8 (7th Cir. 2000) (noting that party filing proof of claim that lacked evidentiary support could be sanctioned under Rule 9011).

2. The bankruptcy automatic stay

Once a bankruptcy case commences, a secured lender is initially precluded from foreclosing on its collateral by section 362 of the Bankruptcy Code, which imposes an "automatic stay" of most debt collection activities. 11 U.S.C. § 362(a). The creditor may, however, file a motion requesting that the court modify the stay "for cause" in order to permit it to commence or continue foreclosure proceedings. 11 U.S.C. § 362(d)(1). Such "cause" may include, among other things, a debtor's failure to make required payments on the secured debt during the period after the bankruptcy filing. *See In re Johnson*, 196 F. App'x 112, 115 (3rd Cir. 2006).

3. Sanctions under Bankruptcy Rule 9011

This is an appeal of a bankruptcy court order imposing non-monetary sanctions under Rule 9011 of the Federal Rules of Bankruptcy Procedure. Rule 9011 is the bankruptcy analog to Federal Rule of Civil Procedure 11. *In re Schaefer Salt Recovery, Inc.*, 542 F.3d 90, 97 (3d Cir. 2008) ("Rule 9011 [is] in most respects a twin of Rule 11 tweaked for the bankruptcy setting."). Under Rule 9011(b), an attorney or unrepresented party who signs or advocates a pleading before the court "is certifying that to the best of the person's knowledge, information, and belief, *formed after an inquiry reasonable under the circumstances,* . . . the allegations and other factual contentions have evidentiary support or, if specifically so identified, are likely to have evidentiary support after a reasonable opportunity for further investigation or discovery." Fed. R. Bankr. P. 9011(b)(3) (emphasis added).

When a court determines that Rule 9011(b) has been violated, it may impose an "appropriate sanction" on the attorneys, law firms, or parties that violated that section, or who are "responsible for the violation." Fed. R. Bankr. P. 9011(c). Such a sanction "shall be limited to what is sufficient to deter repetition of such conduct or comparable conduct by others similarly situated," and may take the form of, among other things, "directives of a nonmonetary nature." Fed. R. Bankr. P. 9011(c)(2).

B. Course of Proceedings and Disposition Below

This appeal arises out of an order issued by the bankruptcy court on June 9, 2008, directed to HSBC and its attorneys, following the bankruptcy court's determination that HSBC had engaged in questionable practices in a bankruptcy case in connection with its filing of an erroneous proof of claim and a factually inaccurate motion for relief from the automatic stay. (App. 96). Following four lengthy evidentiary hearings, the bankruptcy court issued a decision finding violations of Rule 9011 by HSBC and certain of its attorneys, and exercised its discretion to impose modest non-monetary sanctions against HSBC, the Udren Firm, and two senior Udren attorneys, Mr. Udren and Ms. Doyle. (App. 181). The Udren Firm and its attorneys, but not HSBC, appealed the bankruptcy court's order to the district court. (App. 240). Notwithstanding HSBC's failure to file a notice of appeal, on February 18, 2010, the district court reversed as to all parties. (App. 15). On April 19, 2010, the United States, which defended the bankruptcy court's order before the district court, filed a timely notice of appeal to this Court. (App. 16).

STATEMENT OF THE FACTS

A. HSBC files an erroneous proof of claim in the Taylor bankruptcy case.

On September 16, 2007, Niles and Angela Taylor filed a voluntary petition for relief under chapter 13 of the Bankruptcy Code. (App. 58). In schedules accompanying the petition the Taylors listed HSBC as a creditor holding a mortgage on their personal residence.

On October 9, 2007, HSBC filed its proof of claim. (App. 242). HSBC delegated the task of drafting its proof of claim to the law firm of Moss Codilis, LLP, which serves as HSBC's national claims agent, and which prepared the claim based on information retrieved from HSBC's computerized mortgage servicing database. Jul. 23, 2008 Tr. at 134 (testimony of Maria Borresen, Compliance Director of Moss Codilis) (App. 138). That proof of claim was not, however, reviewed by any employee of HSBC prior to filing. *Id.* at 69 (testimony of Kimberley Graves, HSBC's Vice President in charge of bankruptcy) (App. 125). As it later turned out, that initial proof of claim contained several errors: the amount of the Taylors' monthly payment was incorrectly stated, a copy of the wrong mortgage note was attached as an exhibit, and the value of the Taylors' home was understated by approximately $100,000. *Id.* at 144 (testimony of Ms. Borresen) (App. 140). *See also* Claims Register for Case No. 07-15385, Claim 8-3 (amended proof of claim by HSBC correcting errors) (App. 257).

At the time of the Taylors' bankruptcy filing, the administration of the Taylors' loan was further complicated by the existence of an ongoing payment dispute between the Taylors and HSBC. Prior to the Taylors' bankruptcy, HSBC determined that the Taylors were required to carry flood insurance, and accordingly force-placed a flood insurance policy on the Taylors' property. The premiums for that insurance were added to the Taylors' payment obligation. The Taylors disputed that any flood insurance was necessary, and began withholding an amount equal to their flood insurance premium from their monthly payments. May 1, 2008 Tr. at 15 (testimony of Ms. Taylor) (App. 105).

B. The Udren Firm files inaccurate pleadings and makes misleading representations to the court in the course of its representation of HSBC.

As a result of the flood insurance dispute and the payment discrepancy, by January, 2008, HSBC's internal records indicated that the Taylors were delinquent on their mortgage. Following its standard procedures, HSBC then retained the Udren Firm to seek relief from the automatic stay. Dec. 17, 2008 Tr. at 6 (testimony of Ms. Doyle) (App. 164). The Udren Firm is one of the law firms used by HSBC for cases filed in the Eastern District of Pennsylvania. Oct. 23, 2008 Tr.

at 93 (testimony of Mr. Udren) (App. 155). Mr. Udren is the sole shareholder of the Udren Firm, which employs approximately ten attorneys and more than one hundred paralegals. *Id.* at 95 (App. 157). Ms. Doyle is a managing attorney at the Udren Firm with more than twenty-seven years of experience as a lawyer. Dec. 17, 2008 Tr. at 5-6 (App. 163-64).

Notably, virtually all of the communications between the Udren Firm and its client relevant to the Taylor case were conducted through a computerized intermediary, NewTrak. NewTrak, which was described at trial as a "communication tool," is a computer program designed and maintained by a third-party contractor, Lender Processing Services ("LPS"), which manages much of the day-to-day administration of HSBC's mortgage portfolio.[1] Jul. 23, 2008 Tr. at 171 (testimony of Ms. Graves) (App. 141). Among other functions, NewTrak automatically selected the Udren Firm as HSBC's counsel in the Taylor case, and automatically generated a set of instructions and background information on the basis of which the Udren Firm was directed to prepare the motion for relief from stay. *Id.* at 73-74, 78 (App. 129-30, 134). Both the selection of counsel and the

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[1] At the time of certain of the events related to this appeal, LPS was known as Fidelity National Information Services, Inc. ("Fidelity"). LPS was spun off from Fidelity as a separate entity on July 2, 2008.

generation of the instructions were performed by NewTrak without any direct human involvement or oversight. *Id.* at 76-77 (App. 132-33).

According to Mr. Udren, the Udren Firm relies "dramatically" on NewTrak, without which the firm would be unable to practice at its current fee levels. Oct. 23, 2008 Tr. at 91 (App. 153) (testimony of Mr. Udren). Despite its alleged importance to his firm, however, Mr. Udren is not familiar with how NewTrak works, as it is "beyond [his] capabilities." *Id.* at 127 (App. 162).

The Udren Firm does not enjoy full access to HSBC's mortgage servicing database. Instead, the background information transmitted to the Udren Firm by NewTrak is limited to the "minimal information that [the Udren Firm] would need." Jul. 23, 2008 Tr. at 78 (testimony of Ms. Graves) (App. 134). This information was compiled and transmitted by NewTrak along with the referral, and was limited to a statement of the loan number, mortgagor's name and address, payment amounts, late fees, and amounts past due. *Id.*

1. Ms. Doyle files a factually inaccurate motion for relief from stay and set of requests for admission.

On January 15, 2008, Ms. Doyle entered her appearance as counsel for HSBC. (App. 64). On that same date, Ms. Doyle filed a motion for relief from the automatic stay seeking to foreclose on the Taylors' residence. (App. 65). Among other things, that motion recited that the Taylors had "fail[ed] to make . . .

post-petition monthly payments and late charges" for the dates "11/1/2007 through 1/15/2008," and further stated that "[d]ebtor(s) has/have inconsequential or no equity in the premises." *Id.* Ms. Doyle's motion stated that the amount of the Taylors' monthly payment was $1,455.83, an amount that was higher than the erroneous monthly payment listed on the proof of claim. (App. 66). Finally, the motion alleged, in the alternative, that the Taylors were in default on their other payments under their chapter 13 plan.[2] *Id.* The motion did not discuss or mention the ongoing flood insurance dispute.

According to the testimony of David Fitzgibbon, the Udren Firm associate who handled the Taylor case on behalf of HSBC, the motion for relief from stay was actually prepared by non-attorney employees of the Udren Firm, who relied exclusively on the limited information furnished through NewTrak. Aug. 8, 2008 Tr. at 36, 104, 120-21 (App. 147, 149-51). For her part, Ms. Doyle testified that she did nothing to verify the Taylors' payment history before signing and filing the motion for relief from stay, as her practice is to "rely on the allegations supplied by my client or on behalf of my client." Dec. 17, 2008 Tr. at 30. (App. 168). Instead,

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[2] The Taylors' chapter 13 plan proposed that they would pay $541.48 per month for sixty months in satisfaction of the claims of unsecured creditors. (App. 61). These payments were to be collected and disbursed by the chapter 13 trustee, an individual appointed by the United States Trustee to administer chapter 13 estates in the Eastern District of Pennsylvania. 11 U.S.C. § 1302.

she merely reviewed hard copies of the "screen prints" provided through NewTrak. *Id.* at 7-9, 31 (App. 165-67, 169).

Ms. Doyle acknowledged that she neither accessed NewTrak nor contacted HSBC to verify the accuracy of the information contained in the "screen prints." *Id.* at 39, 50 (App. 171, 174). Indeed, Ms. Doyle did not know who had put the information onto NewTrak; she "presume[d] it was somebody from [LPS]," HSBC's contractor, and not HSBC, and she simply assumed that the information had been supplied to LPS by HSBC. *Id.* at 31, 40-41 (App. 169, 172-73). In addition, despite the explicit statement in the motion for relief from stay regarding the Taylors' alleged lack of equity in their home, Ms. Doyle testified that she made absolutely no inquiry into the veracity of that factual allegation. *Id.* at 39-39 (App. 170-71).

At the same time that the Udren Firm filed its motion for relief from stay on behalf of HSBC, it served the Taylors with a set of requests for admission pursuant to Fed. R. Bankr. P. 7036. (App. 68). The requests for admission mirrored the allegations of the motion, and requested that the Taylors admit that they had made no monthly mortgage payments from November 2007 until January 2008, that they had made no payments under the chapter 13 plan, and that they had no equity in their home. *Id.*

The principal factual allegations of the motion and the requests for admission were incorrect. As the documentation submitted by the Taylors would reveal, and as HSBC's amended proof of claim would eventually acknowledge, the Taylors had tendered checks to HSBC for every month from October, 2007 through January, 2008, although in an amount that excluded the disputed flood insurance premium. (App. 79). Each of these checks had been cashed by HSBC. *Id.* In addition, testimony at trial would confirm that the Taylors were current on their other payments under their chapter 13 plan. *See* May 1, 2008 Tr. at 46 (Court: "And [Ms. Taylor]'s making current payments?" Chapter 13 Trustee's Counsel: "She is, Your Honor.") (App. 113). Lastly, as noted, the claim that the Taylors lacked equity in their home was also incorrect. *See* Claims Register for Case No. 07-15385, Claim 8-3 (amended proof of claim acknowledging $190,000 as value of the Taylors' home) (App. 257).

On February 4, 2008, the Taylors filed a response to the motion for relief from stay in which they specifically disputed the allegation that they had failed to make payment to HSBC. (App. 70). In an amended pleading, the Taylors documented their contentions by submitting copies of six checks they had tendered to HSBC during the period they had allegedly failed to make payment, four of which HSBC had already cashed. (App. 79).

2. Ms. Doyle files an inaccurate response to the Taylors' objection to the proof of claim, again without performing any investigation.

On March 17, 2008, the Taylors filed an objection to HSBC's proof of claim. (App. 74). Among other contentions, the Taylors stated that the monthly mortgage payment was inaccurate because HSBC was improperly charging them for flood insurance. *Id.* According to the Taylors, the $178.71 difference between the $1,277.12 monthly payment by the Taylors and the $1,455.83 per month sought by HSBC was attributable to the dispute over the necessity of flood insurance. *Id.* The Taylors did not , however, reply to the requests for admission, apparently because of their counsel's erroneous belief that their objection to the motion for relief from stay made such a response unnecessary.

On March 27, 2008, the Udren Firm, through Ms. Doyle, filed a response to the claim objection. (App. 96). Although the Taylors' pleading had made clear that the flood insurance issue was the principal point of contention, the Udren Firm's response did not address that topic at all, but instead contained only a boilerplate statement that "[a]ll figures contained in the proof of claim accurately reflect actual sums expended or costs incurred by Mortgagee prior the date of Debtors' bankruptcy filing and/or charges to which Mortgagee is contractually entitled and which the Debtors are contractually obligated to pay." *Id.* That statement was inaccurate because the HSBC proof of claim set forth an incorrect monthly payment, which also differed from the higher payment amount the Udren Firm claimed was due in the motion for relief from stay. Jul. 23, 2008 Tr. at 144 (testimony of Ms. Borresen) (App. 140).

As with the earlier motion for relief from stay, Ms. Doyle testified that she made no inquiry beyond reviewing the information received through NewTrak because that information "seemed accurate." Dec. 17, 2008 Tr. at 55, 57 (App. 175, 177). Ms. Doyle presumed that the information on NewTrak had originated with HSBC and not LPS, but she did not know and had not sought to verify the information because she "had no reason to disbelieve" it. *Id.* at 56-57, 61 (App. 176-77, 180).

3. The Udren Firm advocates the motion for relief from stay based on "admissions" that it knows to be untrue.

On May 1, 2008, the bankruptcy court held a hearing with respect to the motion for relief as well as the Taylors' objection to HSBC's proof of claim. (App. 100). Representing HSBC at that hearing was Mr. Fitzgibbon, a recent law school graduate who had been employed by the Udren Firm for less than six months. Aug. 8, 2008 Tr. at 26-27 (testimony of Mr. Fitzgibbon) (App. 144-145). At the hearing, Mr. Fitzgibbon acknowledged that at the time the motion for relief from stay was filed, HSBC had already received a mortgage payment for

November, 2007.[3] This was contrary to the assertion in the motion for relief from stay that HSBC had not received post-petition monthly mortgage payments for November 2007 through January 2008. While there was a legitimate dispute between the parties as to the appropriate amount for the mortgage payments, the representation in the motion for relief that the Taylors had made no payment in November 2007 was not correct.

Although he acknowledged the existence of the payments received since November, Mr. Fitzgibbon nevertheless urged the bankruptcy court to grant the motion for relief from stay, based on the Taylors' failure to file a separate response to the admittedly erroneous requests for admission. May 1, 2008 Tr. at 9 (App. 102). The bankruptcy court rejected this argument, observing that the requests for admission were "not accurate" as of the date of the May 1 hearing, yet "[the Udren Firm] had that evidence in your possession and you went ahead like you never saw it." *Id.* at 35-36, 41 (App. 106-07, 109). As a result, the bankruptcy court denied the motion for relief from stay as "questionably in bad faith." *Id.* at 41, 45 (App.

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[3] According to Mr. Fitzgibbon, because the amounts paid by the Taylors did not include payment for a disputed flood insurance premium, they were "put in suspense." Upon receipt of the November 2007 payment, HSBC allocated a portion of that payment to make up for the alleged October shortfall between the $1,277.12 payment sent by the Taylors and the $1,445.83 claimed due by HSBC. May 1, 2008 Tr. at 7 (App. 100). None of this was explained in the motion for relief from stay or in the requests for admission.

108, 112). In addition, the bankruptcy court directed Mr. Fitzgibbon to "pass it up the line that I was not pleased with this motion for relief," but that the court was "cutting them a break this time." *Id.* at 45 (App. 112).

4. Mr. Fitzgibbon states his mistaken belief that he is prohibited from communicating with HSBC directly.

Following the May 1, 2008 hearing, the bankruptcy court directed the Udren Firm to obtain an accounting from HSBC of its handling of the Taylors' prepetition payments to determine the correct amount of the Taylors' arrearage. *Id.* at 43-45 (App. 110-112)

At the next hearing before the bankruptcy court, on June 5, 2008, Mr. Fitzgibbon stated that he had requested an accounting, but that HSBC had not yet provided it. Jun. 5, 2008 Tr. at 5 (App. 114). When pressed for an explanation, Mr. Fitzgibbon informed the court that he had placed "numerous requests" for accountings via NewTrak, but had yet to receive any response. *Id.* at 8 (App. 117). Mr. Fitzgibbon further explained that he had no ability to communicate with HSBC except through NewTrak. *Id.* at 8-9. (App. 117-18).[4]

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[4] THE COURT: Well, you can't get – you can't even – you – all you can do is open up a computer. You can't even speak to anybody you're telling me.

MR. FITZGIBBON: Yes.

THE COURT: There's nobody that will return your call.

Mr. Fitzgibbon's belief that no direct communication was possible appears to have been mistaken. According to the testimony of Ms. Graves, an "escalation matrix" exists that would permit outside counsel to bypass NewTrak and communicate directly with higher-level HSBC employees. Jul. 23, 2008 Tr. at 114-15 (App. 135-36). There was no evidence that such a procedure was ever made known to Mr. Fitzgibbon, however, and the bankruptcy court found Mr. Fitzgibbon to be credible when he stated that he believed that NewTrak was his only permissible means of communication. (App. 198).

C. The bankruptcy court holds an evidentiary hearing and orders non-monetary sanctions against HSBC, the Udren Firm, Mr. Udren and Ms. Doyle.

On June 9, 2008, the bankruptcy court entered an order directing, among other persons, Mr. Fitzgibbon, Ms. Doyle, and Mr. Udren to appear and provide testimony regarding whether sanctions should be imposed given the "questionable practices" identified at the May 1 and June 5 hearings. (App. 96). These questionable practices included "pressing a relief motion on admissions that were known to be untrue, and signing and filing pleadings without knowledge or inquiry

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MR. FITZGIBBON: No.

Jun. 5, 2008 Tr. at 8-9 (App. 117-118).

regarding the matters pled therein." *Id.* n.1. The bankruptcy court further stated that a purpose of the hearings was "to investigate the practices employed in this case by HSBC and its attorneys and agents and consider whether sanctions should issue against HSBC, its attorneys and agents." *Id.* n.5 (emphasis added).

As the bankruptcy court made clear at the outset of the hearing, a principal focus of its inquiry was the "Rule 11 obligation" and the question of whether HSBC's attorneys had engaged in sanctionable conduct by their failure to conduct a "due inquiry" when filing their pleadings. Jul. 23, 2008 Tr. at 8-9 (App. 120-21). The bankruptcy court further explained that it was "not trying to elicit whether [the Udren Firm was] correct in [the] motion for relief or correct in [the] objection to claim," but that it was "trying to elicit . . . [what] creditors do in preparation for filing these motions." Aug. 8, 2008 Tr. at 35 (App. 146) (emphasis added).

The investigation took place over four evidentiary hearings at which a number of witnesses from HSBC, Moss Codilis, and the Udren Firm testified. (App. 120, 144, 152, 163). The testimony concerned both the automated process generally used by HSBC and its agents in pursuing claims as a mortgage servicer as well as the specific problems with the filings in the Taylor case.

Based on the evidence received at the four hearings, the bankruptcy court ordered non-monetary sanctions against HSBC, the Udren Firm, Mr. Udren, and

Ms. Doyle. (App. 181). The bankruptcy court based these sanctions on its finding that "certain practices and procedures employed by HSBC, its agents and attorneys . . . have created an environment where Rule 9011 duties have been subordinated to efficiency and cost-savings so as to require sanctions." (App. 183).

The bankruptcy court found that Mr. Fitzgibbon violated Rule 9011 by advocating the motion for relief from stay "on admissions he knew to be then untrue." (App. 231). The bankruptcy court also found that Ms. Doyle had violated Rule 9011 because she had "failed to observe her duty to make reasonable inquiry" regarding the motion for relief from stay and the response to the claim objection. (App. 230-31). The bankruptcy court also found that "the Udren Firm . . . is jointly responsible with [its attorneys] Doyle and Fitzgibbon for these breaches." (App. 232).

The bankruptcy court did not impose a sanction upon Mr. Fitzgibbon because he was a young and inexperienced lawyer when he committed his Rule 9011 violation. *Id.* The bankruptcy court found Ms. Doyle, however, to "be so enmeshed in the assembly line of managing the bankruptcy department's volume mortgage lender practice that she has lost sight of her duty to the court and has compromised her ethical obligations." *Id.* As a result, the bankruptcy court held that Ms. Doyle must take three continuing legal education ("CLE") credits in professional responsibility and ethics over and above any general continuing legal education obligation she already has. *Id.*

As for the Udren Firm and Mr. Udren, "since policy emanates from the top" the bankruptcy court held that (i) Mr. Udren, who "sets the tone and establishes [the Udren Firm's] culture," must obtain training in NewTrak, (ii) Mr. Udren must spend one day observing his employees as they handle NewTrak referrals, and (iii) Mr. Udren and Ms. Doyle must "conduct a training session for all members of the [Udren Firm's] bankruptcy department in the appropriate use of [HSBC's] escalation procedure and the requirements of Rule 9011 with respect to pre-filing due diligence." (App. 232-33).

The bankruptcy court also found the Udren Firm "jointly responsible with Doyle and Fitzgibbon for these breaches." (App. 232). However, the court found that because "[t]he Udren Firm has incurred the cost of retaining counsel who has appeared and filed written memoranda on its behalf [and] its attorneys and paraprofessionals have lost valuable time in connection with the hearings and depositions conducted in furtherance of these proceedings" the court considered these costs adequate penalties. *Id.*

The bankruptcy court ordered HSBC to send a copy of the court's opinion to all the law firms it uses in bankruptcy proceedings together with a letter setting forth HSBC's escalation policy and assuring the law firms "that use of direct contact by a firm with HSBC would not reflect adversely on the firm." (App. 235). Finally, the bankruptcy court found that sanctions were not warranted against LPS of Moss Codilis based on the existing record.[5] (App. 234).

Ms. Doyle, Mr. Udren, and the Udren Firm filed a timely notice of appeal of the bankruptcy court's order on April 27, 2009. (App. 240). HSBC did not appeal the bankruptcy court's order.

D. The district court reverses the sanctions order as to the appellants and HSBC.

On February 18, 2010, the United States District Court for the Eastern District of Pennsylvania issued an order reversing the order of the bankruptcy court. The district court held that the bankruptcy court had abused its discretion in ordering sanctions against Ms. Doyle, Mr. Udren, and the Udren Firm. (App. 15). The district court's decision rested on two principal grounds. First, because the district court concluded that the Taylors' attorney was "at least equally at fault" for the delay in resolving the payment dispute, sanctions against HSBC and its

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[5] The bankrupcy court declined to sanciton Moss Codilis based on its observation that the United States Trustee was engaged in an ongoing investigation of Moss Codilis's conduct, and that a sanction based on Moss Codilis's activities in the Taylor case would therefore be "premature on this record." (App. 234). Accordingly, the bankruptcy court "le[ft] the matter of Moss to the UST's contemplated further investigation." *Id.*

attorneys were inappropriate. Second, the district court criticized the bankruptcy court for using a Rule 9011 sanction to "send a message" to other similarly situated law firms and lenders. Finally, with respect to Mr. Udren individually, the district court concluded that Rule 9011 was inapplicable because Mr. Udren did not personally sign any pleading in the case. (App. 11). The district court also reversed the sanctions ordered against HSBC, on the grounds that the requirement that it disseminate the bankruptcy court decision was "inextricably intertwined with the sanctions against the appellants and must be reversed as well." *Id.* On April 20, 2010, the United States Trustee filed a timely notice of appeal of the district court's order. (App. 16).

SUMMARY OF ARGUMENT

The bankruptcy court properly exercised its discretion by sanctioning the Udren Firm, Mr. Udren, and Ms. Doyle. At the behest of its client, HSBC, the Udren Firm and its attorneys adopted a series of procedures that effectively sacrificed accuracy and oversight in favor of speed and efficiency. In this case, however, that lack of oversight led to errors in the Udren Firm's pleadings and representations, causing needless delay and a waste of judicial resources over what should have been a routine and easily resolvable payment dispute. Neither the pursuit of efficiency nor the wishes of their client justifies the Udren Firm's and its senior attorneys' decision to abdicate their responsibilities to the court under Rule 9011.

The actual remedies imposed by the bankruptcy court, moreover, are exceptionally mild, and do little more than require that the Udren Firm and its senior attorneys take steps to ensure that they are mindful of their professional obligations in the future.   Given the clear record of multiple Rule 9011 violations by the Udren Firm, Mr. Udren and Ms. Doyle in this case, those sanctions are not excessive.

The bankruptcy court's sanctions should also be affirmed as to HSBC. Although those sanctions are, in any case, also well supported by the record, HSBC failed to appeal that order, and by reversing a sanctions order against a non-appellant, the district court exceeded its jurisdiction.

ARGUMENT

I. The district court erred when it reversed the bankruptcy court's order imposing sanctions and remedial relief against the Udren Firm, Mr. Udren, and Ms. Doyle.

A. The bankruptcy court's finding that the Udren Firm and its attorneys violated Rule 9011(b) was supported by the evidence at trial.

Pursuant to Rule 9011(b), every time an attorney files a paper in bankruptcy court that attorney is certifying that, to the best of his or her "knowledge, information and belief," the factual contentions in that filing "have evidentiary support or . . . are likely to have evidentiary support after a reasonable opportunity for further investigation or discovery." Fed. R. Bankr. P. 9011(b)(3). This knowledge, information, and belief must be based on "an inquiry reasonable under the circumstances." Fed. R. Bankr. P. 9011(b). The duty of inquiry is a "personal, nondelegable responsibility" of the signer. *Garr v. U.S. Healthcare, Inc.*, 22 F.3d 1274, 1278 (3d Cir. 1994) (quoting *Pavelic & LeFlore v. Marvel Entm't Gr.*, 493 U.S. 120, 127 (1989)).

It is the degree of inquiry that determines whether an attorney has violated Rule 9011(b). An attorney has not violated the rule where despite a reasonable inquiry, a factual contention is later determined to be incorrect. *Garr,* 22 F.3d. at 1279. Likewise, however, an attorney is not spared sanctions where they made no reasonable inquiry but "by the stroke of luck that the document happened to be justified." *Id.* (quoting *Vista Mfg. v. Trac-4 Inc.*, 131 F.R.D. 134, 138 (N.D. Ind. 1990) ("A shot in the dark is a sanctionable event, even if it somehow hits the mark.")).

1. Rule 9011(b) authorizes courts to impose sanctions based on an objective, rather than subjective, standard of liability.

In this case, the uncontroverted evidence at trial demonstrates that the Udren Firm and its attorneys engaged in objectively unreasonable conduct by representing facts to the bankruptcy court that it did little or nothing to verify. No separate finding of bad faith was required because, as this Court consistently has held, the objective unreasonableness of the Udren Firm's conduct alone is sufficient to trigger Rule 9011 sanctions. *See Fellheimer*, 57 F.3d at 1225; *Bradgate Assocs. v. Fellows, Read & Assocs.*, 999 F.2d 745, 753 (3d Cir. 1993) ("We have consistently noted that the Rule 11 test is now an objective one of reasonableness which seeks to discourage pleadings without factual foundation, even though the paper was not filed in subjective bad faith.") (internal quotations omitted).

The fact that sanctions were imposed as part of a proceeding issued by the bankruptcy court sua sponte, rather than on the motion of a party, does not alter this standard. As a majority of circuits have concluded, the plain language of Rule 9011 dictates an objective standard of liability, even in circumstances where the offending party has no practical ability to withdraw the pleading. *See Young v. City of Providence ex rel. Napolitano*, 404 F.3d 33, 39-40 (1st Cir. 2005) (noting that "a specific purpose of the 1993 revision of Rule 11 was to reject . . . a bad faith requirement" and applying objective standard to court-initiated sanctions proceeding); *see also Jenkins v. Methodist Hospitals of Dallas, Inc.*, 478 F.3d 255, 264 (5th Cir. 2007) (same).

In so ruling, the First and Fifth Circuits rejected a contrary ruling from the Second Circuit, which imposed a subjective standard of liability in a case where the attorney violating Rule 11 was not given a safe harbor within which to withdraw the pleading. *In re Pennie & Edmonds LLP*, 323 F.3d 86 (2d Cir. 2003). *Pennie*, which was decided over a sharp dissent, has not been adopted by any other circuit, and this Court should reject its holding for the same reasons as did the First and Fifth Circuits. In particular, as the *Pennie* dissent noted, the *Pennie* majority impermissibly imported a procedural distinction from Rule 11(c) (equivalent to Bankruptcy Rule 9011(c)), which addresses *how* sanctions may be initiated, into Rule 11(b), which deals with the separate question of *whether* sanctionable conduct has occurred. *Pennie*, 323 F.3d at 94. As both the First and Fifth Circuits have observed, the *Pennie* majority created a substantive exception to Rule 11(b) that has no basis in the text of the rule and which contradicts its express purpose. *See Jenkins*, 478 F.3d at 264 (finding "[no] basis" for the *Pennie*'s distinction between court-initiated and party-initiated sanctions); *Young*, 404 F.3d at 40 (finding that the holding of *Pennie* could not be reconciled with text or purpose of Rule 11). Accordingly, this Court should follow the First and Fifth circuits by applying an objective, rather than subjective, standard to the Rule 9011 sanctions in this case.

2. The bankruptcy court's finding that the Udren Firm and its attorneys acted in an objectively unreasonable manner is supported by the evidence.

The bankruptcy court's finding that the conduct of the Udren Firm and its attorneys was objectively unreasonable is not clearly erroneous. The bankruptcy court based this finding on three separate pleadings that were prepared based on an objectively inadequate factual investigation: the motion for relief from stay, the requests for admission, and the response to the claim objection. It also is undisputed that each of these pleadings was materially inaccurate. Both the motion for relief from stay and the requests for admission averred that the debtors had made no post-petition payments to HSBC, had no equity in their home, and had not made plan payments. The response to the claim objection was also inaccurate in that it claimed the monthly post-petition amount was accurate despite earlier filings by the Udren Firm setting forth a different amount.

a. *Ms. Doyle.*

A reasonable inquiry by Ms. Doyle would have uncovered the factual inaccuracies in her pleadings. Ms. Doyle's own testimony confirms that she conducted no meaningful inquiry into the accuracy of filings prior to filing them. By Ms. Doyle's own admission, her "inquiry" regarding the motion for relief from stay was limited to a review of the same NewTrak "screen prints" that an Udren

Firm processor had used to draft the document, and she made no inquiry whatsoever as to facts underlying the response to the claim objection since it "seemed accurate." Dec. 17, 2008 Tr. at 7-9, 31, 57-58 (App. 165-68,175-77).

In fact, Ms. Doyle had no idea whether the information was accurate, or even whether HSBC or an agent acting on its behalf had put the information on NewTrak. Ms. Doyle served less as counsel and more as a proofreader. So long as the numbers inputted by staff at her firm matched what appeared on the screen they used to prepare the filing, she was satisfied. As the bankruptcy court explained:

> Doyle did not function as a lawyer but rather acted as a blind signatory who at best checked numbers. She signed off on her paralegal's preparation of a form motion and admissions and was prepared to press for relief from stay when, by Udren's own admission, the problem was a dispute over a $180 monthly shortfall in the payment amount due to the insurance premium dispute.

(App. 230).

b. *Mr. Udren and the Udren Firm.*

The bankruptcy court also did not err by imposing sanctions against Mr. Udren and the Udren Firm. The text of Rule 9011 and the advisory committee notes to Rule 11 make it clear that sanctions may be imposed on persons beyond the signer. Subdivision (c) provides that "the court may, subject to the conditions stated below, impose an appropriate sanction upon the attorneys, law firms, or parties that have violated subdivision (b) *or are responsible for the violation.*" Fed. R. Bankr. P. 9011(c) (emphasis added). *See also U.S. Bank Nat. Ass'n, N.D. v. Sullivan-Moore*, 406 F.3d 465 (7th Cir. 2005) (imposing sanctions on law firm representing mortgagee in foreclosure proceeding). The 1993 advisory committee notes to Rule 11 state that "[t]he revision permits the court to consider whether *other attorneys in the firm*, co-counsel, other law firms, or the party itself should be held accountable for their part in causing a violation." Fed. R. Civ. P. 11 advisory comm. notes (1993) (emphasis added). The district court was wrong to reverse the sanctions against Mr. Udren simply because he did not sign the pleadings at issue.

The evidence at trial supports the bankruptcy court's conclusion that the errors in the Taylors' case were due not just to the personal mistakes of Mr. Fitzgibbon and Ms. Doyle, but to objectively unreasonable firm policies and a firm culture that fostered those errors. (App. 233) (attributing errors to "[t]he culture of the firm [Mr. Udren] has fostered [that] appears to value production over professionalism . . . ."). The testimony before the bankruptcy court revealed a firm that assembles pleadings according to a process resembling an assembly line, where junior attorneys are not trained in how to corroborate their pleadings, and where communications between attorney and client were at least implicitly discouraged. For this reason, the bankruptcy court did not err in finding a violation of Rule 9011 by the Udren Firm, as well as by Mr. Udren, who is ultimately responsible for his firm's culture and policies.

B. The alleged incompetence of the Taylors' attorney does not negate the Rule 9011 violations by the Udren Firm and its attorneys.

Although the district court placed great emphasis on what it perceived as the inadequate performance in the Taylors' bankruptcy counsel when it reversed the bankruptcy court's sanctions order, such fact is not relevant to the underlying question of whether the Udren Firm itself violated Rule 9011. The district court's determination that the Taylors' counsel was "equally at fault" for the errors in the Taylors' case is inconsistent with the facts of the case. At most, the Taylors' counsel erred by neglecting to respond to the requests for admission and by filing a pleading in response to the motion for relief from the stay which contained factual errors of its own. Both of these acts, however, occurred after two of the principal Rule 9011 violations of the Udren Firm and its attorneys– specifically, the filing of the erroneous motion and requests for admission– were already complete.

Nor is this a case where the sanctions should be reversed based on some theory of unclean hands. The remedies in this case were not requested by the Taylors, and do nothing to benefit the Taylors personally. Rather, the nonmonetary relief ordered against the Udren Firm and its attorneys is designed to protect the administration of justice in future cases. *See Estate of Calloway v.*

Marvel Entm't Gp., 9 F.3d 237, 241 (2d Cir. 1993) ("Rule 11 is not a fee-shifting mechanism and does not create an entitlement in adverse parties to compensatory damages or attorney's fees . . . [r]ather it is intended "to maintain the integrity of the system of federal practice or procedure"). As such, any question of the Taylors' conduct is not relevant to the issue of whether the sanctions against the Udren Firm was an abuse of discretion.

C. The nonmonetary nature of the sanctions imposed by the bankruptcy court was appropriate.

The type of sanctions a court may impose are "limited to what is sufficient to deter repetition of such conduct or comparable conduct by others similarly situated." Fed. R. Bankr. P. 9011(c)(2). Nonetheless, the sanctioning court has broad latitude in the type of sanctions it may impose. *See* Fed. R. Civ. P. 11 advisory comm. notes (1993) ("The court has significant discretion in determining what sanctions, if any, should be imposed.").

The sanctions imposed here were not particularly onerous: three hours of continuing legal education, a requirement that Mr. Udren spend a day familiarizing himself with his employees' day-to-day work, and a requirement that the firm as a whole undertake in-house training to prevent the recurrence of the errors in this case. It is well-established in this circuit that such remedies are an appropriate form of relief for Rule 9011 violations. *See Balthazar v. Atlantic City Med. Ctr.*, 137 F. App'x 482, 490-91 (3d Cir. 2005) (affirming sanctions order that imposed compulsory legal education); *Langer v. Monarch Life Ins. Co.*, 966 F.2d 786, 811 (3d Cir. 1992) ("What is "appropriate" may be a warm friendly discussion on the record, a hard-nosed reprimand in open court, *compulsory legal education*, monetary sanctions, or other measures appropriate to the circumstances.") (quoting *Thomas v. Capital Security Svcs., Inc.*, 836 F.2d 866, 878 (5th Cir. 1988) (en banc) (emphasis added).

Furthermore, the bankruptcy court did not abuse its discretion by imposing a form of sanction that was intended, at least in part, to deter misconduct by other similarly-situated attorneys. As the text of Rule 9011 makes clear, sanctions may be imposed for, among other things, the purpose of "deter[ring] repetition of such conduct by others similarly situated." Fed. R. Bankr. P. 9011(c)(2). As this Court has observed, the public nature of a sanction against an attorney may serve an important public policy by educating other attorneys. *See Gary v. Braddock Cemetery and Consol Energy*, 334 F. App'x 465, 467 (3d Cir. 2009) (affirming reprimand as appropriate sanction under Rule 11 because it would "reverberate" within the legal community).

D. The bankruptcy court provided the appellants with ample notice before imposing sanctions.

Rule 9011(c) permits a court to impose sanctions only “after notice and a reasonable opportunity to respond.” Fed. R. Bank. P. 9011(c); *see also Fellheimer*, 57 F.3d at 1225 (“‘[P]rior to sanctioning an attorney, a court must provide the party to be sanctioned with notice of and some opportunity to respond to the charges’ in order to satisfy the requirements of due process.”) (quoting *Jones v. Pittsburgh Nat’l Corp.*, 899 F.2d 1350, 1357 (3d Cir. 1990)). Subdivision (c)(1)(B) requires that, when the sanctions process is initiated by a court, the court must “enter an order describing the specific conduct that appears to violate and directing attorney, law firm, or party to show cause why it has not violated subdivision (b) with respect thereto.” Fed. R. Bankr. P. 9011(c)(1)(B).

The sum of the bankruptcy court’s statements before and during its four evidentiary hearings, as well as the court’s June 9, 2008 order, placed the Udren Firm and its attorneys on ample notice of the nature of the court’s inquiry and the specific conduct for which they might be held liable. In particular, at the June 5, 2008 hearing on the Taylors’ objection to the proof of claim the bankruptcy court informed Mr. Fitzgibbon that “I’m issuing an order to show cause on your firm, too, for filing these things with – without having any knowledge. And filing answers that – without any knowledge.” Jun. 5, 2008 Tr. at 22 (App. 119).

In its very next order, entered four days later on June 9, 2008, the bankruptcy court noted that "during the course of . . . hearings [on the motion for relief from stay and the objection to the proof of claim] certain questionable practices engaged in by attorneys and agents of HSBC were revealed." (App. 96). The bankruptcy court identified these practices as "includ[ing] pressing a relief motion on admissions that were known to be untrue, and signing and filing pleadings without knowledge or inquiry regarding the matters pled therein." *Id*. Finally, the bankruptcy court identified one of the purposes of the hearing was to "consider whether sanctions should issue against HSBC, its attorneys and agents." (App. 98).

The fact that the bankruptcy court did not specifically identify the pleadings at issue is also irrelevant. As of the June 9 order, the *only* filings the Udren Firm had made on behalf of HSBC were: a notice of appearance; the motion for relief; the requests for admission and a certification of no response to those requests; and the response to the Taylors' objection to the proof of claim. There was no need to be more specific because, apart from the non-substantive notice of appearance, every filing the Udren Firm made in the Taylors' case was at issue.

Although this order was not captioned an order to show cause and does not cite directly to Rule 9011, it follows closely on the heels of the bankruptcy court's stated intention of issuing such an order and closely tracks the language of Rule 9011 when it suggests that attorneys and agents of HSBC "sign[ed] and fil[ed] pleadings without knowledge or inquiry regarding the matters pled therein. (App. 96). It strains credulity for the appellees to argue that this order was not the order to show cause the bankruptcy court promised just four days earlier and it is difficult to believe that the attorneys at the Udren Firm were not on notice that the bankruptcy court was considering sanctions pursuant to Rule 9011.

Any lingering uncertainty of the appellees should certainly have been dispelled by the bankruptcy court's opening statement at the June 9, 2008 hearing (at which Ms. Doyle and Mr. Udren were present):

> [E]very Proof of Claim objection needs to be defended in good faith. We have a situation here where one person is filing the Proof of Claim, another one is defending. I have a question about access to client files, access to information, the communication and so forth.
>
> *Related to that is the Rule 11 obligation*; there must be a colorable basis for a claim after due inquiry. Again, that comes back to the reference to data and information, the review of filings that are made with the client, discovery duties.

Jul 23, 2008 Tr. at 8-9 (App. 120-21) (emphasis added).

In addition to adequate notice, the appellees had an adequate opportunity to be heard. The bankruptcy court conducted four evidentiary hearings on possible sanctions against HSBC and its attorneys and agents. Members of the Udren Firm testified at three of these hearings. Particularly in light of the minimal sanctions ultimately imposed, a CLE course and a day spent observing and training employees, such notice and opportunity to be heard more than satisfied the procedural rights of the appellees.

II. The district court lacked jurisdiction to reverse the bankruptcy court's decision to impose sanctions against HSBC.

HSBC did not join in Ms. Doyle and Mr. Udren's appeal of the bankruptcy court's decision and did not file a separate notice of appeal. Nonetheless, the district court found that the sanctions ordered against HSBC were "inextricably intertwined" with the sanctions ordered against Ms. Doyle, Mr. Udren and the Udren Firm, and reversed the order as to HSBC. (App. 15). The district court did not, however, discuss any evidence or make any findings in support of its conclusion that the remedies ordered by the bankruptcy court against HSBC were intertwined with those against the appellants.

"As a general rule, a party aggrieved by a decision of the district court must file an appeal in order to receive relief from the decision." *United States v. Tabor Court Realty Corp.*, 943 F.2d 335, 342 (3d Cir. 1991) (citing *United States v. Hickey*, 84 U.S. (17 Wall.) 9, 13, 21 L.Ed. 559 (1872)). However, an appellate court may reverse as to a non-appealing party if the interests of an appellant and a non-appealing party are "inextricably intertwined." *Tabor Court*, 943 F.2d at 344.

This Court has limited this situation to cases where it would be "*impossible* to grant relief to one party without granting relief to the other." *Id.* (emphasis added); *see also Repola v. Morbark Indus.*, 980 F.2d 938, 940-41 (3rd Cir. 1993) (refusing to extend *Tabor* to case where failure to grant relief to non-appellant would create results that were logically inconsistent, but not impossible).

In this case it is possible to reverse as to the Udren Firm and its attorneys without also reversing as to HSBC. The bankruptcy court ordered HSBC to disseminate its decision to ensure that HSBC's other network attorneys would be aware both of the errors that occurred in this case, and of fact that an escalation procedure was available to correct similar errors in the future. Even if this Court concluded that the sanctions against the Udren Firm and its attorneys were somehow defective, that result would not change the historical fact of the errors in the Taylors' case, which are not in dispute. Because the purpose of the bankruptcy court's order as to HSBC was to educate HSBC's other law firms of the facts and history of this case, it could be logically consistent to preserve that part of the order even in the event that the remaining sanctions were vacated. Accordingly, the district court erred by concluding that the remedies in this case are intertwined, and erred by reversing as to HSBC in the absence of a notice of appeal.

CONCLUSION

For the reasons set forth above, the United States Trustee requests that this Court reverse the decision of the district court and affirm the decision of the bankruptcy court.

* * *

Respectfully submitted this the 15th day of November, 2010.

ROBERTA A. DeANGELIS
UNITED STATES TRUSTEE

Of Counsel:

RAMONA ELLIOTT
General Counsel
P. MATTHEW SUTKO
Associate General Counsel
JOHN P. SHEAHAN
Trial Attorney
United States Department of Justice
Executive Office for United States Trustees
20 Massachusetts, Ave. NW, Suite 8100
Washington, D.C. 20530
(202) 307-1399

Prepared and submitted by:

FREDERIC J. BAKER
Senior Assistant United States
Trustee
ROBERT J. SCHNEIDER
GEORGE M. CONWAY
Trial Attorneys

United States Department of Justice
Office of the United States Trustee
833 Chestnut Street, Suite 500
Philadelphia, PA 19107
(215) 597-4411

CERTIFICATE OF COMPLIANCE WITH FEDERAL RULE OF APPELLATE PROCEDURE 32(a) AND L.A.R. 31.1(c)

Compliance With Type-Volume Limitation, Typeface Requirements, and Type Style Requirements

1. This brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B) because it contains a total of 9168 words.

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3. This brief complies with the electronic filing requirements of Local Rule31.1(c) because the text of the electronic brief is identical to the text in the paper copies and a virus check has been run on the computer file containing the electronic version of the brief, and no virus was detected.

Dated: November 15, 2010

/s/ *George M. Conway*
GEORGE M. CONWAY
Trial Attorney
United States Department of Justice
Office of the United States Trustee
833 Chestnut Street, Suite 500
Philadelphia, PA 19107
(215) 597-4411

CERTIFICATE OF SERVICE

I certify that I am over the age of 18 and that on this date I caused two copies of the foregoing Brief of Appellee Roberta A. DeAngelis, United States Trustee, Region 3, to be deposited in the U.S. Mail, first class postage prepaid, addressed to each of the following at the address shown herein:

Jonathan J. Bart, Esq.
Daniel S. Bernheim, III, Esq.
Dashika R. Wellington, Esq.
Wilentz, Goldman & Spitzer
Two Penn Center Plaza
Suite 910
Philadelphia, PA 19102-0000

Steven K. Eisenberg, Esq.
Stern & Eisenberg
261 Old York Road
410 The Pavilion
Jenkintown, PA 19046-0000

Dated: November 15, 2010

/s/ ***George M. Conway***
GEORGE M. CONWAY
Trial Attorney
United States Department of Justice
Office of the United States Trustee
833 Chestnut Street, Suite 500
Philadelphia, PA 19107
(215) 597-4411

BRIEF BANK — 'SUMMARY SHEET" *Printed Mon-3/5/07 14:31*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	In re: Tbryd Enterprises, LLC (Wayland, Bryd and Villegas v. McVay, UST)
2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	(S.D. Tex)
3. ("CCN") ***CURRENT*** CASE NO.	No.:7:06-CV-87
4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*	No.: 06-30078-H1-11 Court: (Bankr. S.D. Tex) *(Identify judge & cite, if any)*
5. ("SO") ***SOURCE***	**U.S. TRUSTEES**
6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	Filed: December 22, 2006 Type: BRIEF FOR APPELLEE, UNITED STATES TRUSTEE
7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*	Charles McVay , Stephen Statham, P. Matthew Sutko and T. Patrick Tinker *(UST/OGC: 202-307-1399/FAX-2397)*
8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") ● ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	● Did the Bankruptcy Court lack jurisdiction because it issued criminal sanctions, and should the District Court conduct a *de novo* trial? Did the Bankruptcy Court violate appellants' due process rights by giving no advance notice of the hearing on Wayland's recusal request and by denying that request? Did the Bankruptcy Court abuse its discretion by imposing sanctions on the appellants? √ **Background:**
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UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
McALLEN DIVISION

In re:

TBYRD ENTERPRISES, LLC Bankr. Case No. 06-30078-H1-11

Debtor.
_______________________________/

THOMAS G. WAYLAND,
TIMOTHY W. BYRD, and
JOHN E. VILLEGAS,

Appellants, Distr Ct. Case No. 7:06-CV-87

v.

CHARLES McVAY,
UNITED STATES TRUSTEE,

Appellee.
_______________________________/

BRIEF FOR APPELLEE, UNITED STATES TRUSTEE

Office of the United States Trustee
Department of Justice

Charles McVay
United States Trustee, Region 7

P. Matthew Sutko
Executive Office for United States Trustees
Department of Justice
20 Massachusetts Ave., N.W., Ste. 8000
Washington, D.C. 20530

Stephen Statham
Office of the U.S. Trustee
Department of Justice
Trial Attorney
515 Rusk Ave., Room 3516
Houston, TX 77002
Tel. 713-718-4650, x252
Fax. 713-718-4670
Stephen.Statham@usdoj.gov

T. Patrick Tinker
Office of the U.S. Trustee
Department of Justice
Trial Attorney
501 E. Polk St., Ste. 1200
Tampa, FL 33602
Tel. 813-228-2000
Fax. 813-228-2303
Thomas.P.Tinker@usdoj.gov

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STATUTES AND RULES

STATEMENT OF JURISDICTION

The United States Trustee filed a motion seeking dismissal of the bankruptcy case of Tbyrd Enterprises L.L.C. (“Tbyrd”) and seeking an order to show cause why Thomas Wayland, Timothy Byrd, and John E. Villegas should not be sanctioned for filing Tbyrd’s voluntary petition in bad faith. Dkt. 22. Such relief was sought pursuant to 11 U.S.C. § 1112(b) (governing dismissal of a chapter 11 bankruptcy case), 11 U.S.C. § 105, and Federal Rule of Bankruptcy Procedure 9011. The motion initiated a “core proceeding" under 28 U.S.C. § 157(b)(2), as it called into question the very filing of the bankruptcy case and the responsibility of the named persons for that filing. Consequently, the Bankruptcy Court properly exercised jurisdiction under 28 U.S.C. § 157(b)(1).

On February 8, 2006, following a hearing on the United States Trustee’s motion, the Bankruptcy Court issued the requested order directing Thomas Wayland, Timothy Byrd, and John E. Villegas to show cause why they should not be sanctioned for filing Tbyrd’s case in bad faith. Dkt. 39.

On March 8, 2006, the Bankruptcy Court conducted the final evidentiary hearing on the order to show cause and announced its rulings. March 8, 2006 Transcript. Unfortunately, the entry of the Bankruptcy Court’s memorandum opinion and sanctions orders on two dockets resulted in a series of related appeals. The opinion and orders reflect Tbyrd’s caption, Case No. 06-30078-H1-11, but they also include the caption of an adversary proceeding from a different case, In re BFG Investments, L.L.C., Adv. Proc. No. 05-07029. The Tbyrd case was the locus of the United States Trustee’s motion, the order to show cause, the relevant pleadings by the parties, and all the hearings on the matters raised by the United States Trustee. The BFG adversary proceeding, however, addressed the same real estate, and presumably that was the reason for the dual caption. See Order Denying Motions to Vacate, dkt. 101. In any event, clerical error resulted in different dates for entry of the opinion and the sanctions orders in the Tbyrd case and the BFG adversary proceeding. *See* Tbyrd docket entries 79, 80, 81, 82, 83 (summarily describing clerical error).

On March 13, 2006, the bankruptcy clerk's office entered the memorandum opinion and the sanctions orders in the BFG adversary proceeding. BFG adv. dkt. 22 through 26. Thomas Wayland, Timothy Byrd, and John Villegas filed timely notices of appeal from the sanctions orders on March 23, 2006. BFG adv. dkt 34, 42. They then stated the issues on appeal and designated the record on appeal by way of filings in the BFG case, docket entries 37, 38, 41. Mr. Villegas' appeal was docketed in the District Court as Civil Action 06-CV-109, and assigned to the Honorable Randy Crane (McAllen Division). The appeals of Mr. Wayland and Mr. Bird were docketed as Civil Action 06-CV-87, and assigned to the Honorable Ricardo H. Hinojosa.

On March 29, 2006, the Bankruptcy Court's opinion and sanctions orders were entered on the Tbyrd bankruptcy case docket. Each docket entry recites that clerical error caused the delay in docketing. The opinion and sanctions orders are identical to those filed previously in the BFG adversary proceeding. With respect to these orders, the notices of appeal did not comply with Federal Rule of Bankruptcy Procedure 8002(a) (notice of appeal must be filed within ten days of denial of motion for reconsideration).[1] *See* docket entries 90, 101, 103, 104. All of these appeals on the Tbyrd docket were assigned to the Honorable Kenneth Hoyt, Civil Action 06-1925. Subsequently, all appeals have been consolidated within Civil Action 06-CV-87 (McAllen Division).

Irrespective of the late appeals in the Tbyrd case, the timely appeals filed in the BFG case support jurisdiction in this Court from the BFG orders. The Bankruptcy Court has already held, in the Tbyrd case, that the sanction orders contemplate a single payment by each of the sanctioned persons, irrespective of the each order being entered in two matters. Dkt. 101. Consequently, this Court has effective jurisdiction over the sanctions orders under 28 U.S.C. § 158(a), based on the timely appeals in the BFG case.

STATEMENT OF THE ISSUES

Thomas Wayland and Timothy Byrd filed a joint appellants' brief, and raise the following issues:

(i) Did the Bankruptcy Court lack jurisdiction because it issued criminal sanctions, and should the District Court conduct a *de novo* trial?

(ii) Did the Bankruptcy Court violate appellants' due process rights by giving no advance notice of the hearing on Wayland's recusal request and by denying that request?

---

[1] It appears that the untimeliness may not be excusable neglect under Federal Rule of Bankruptcy Procedure 8002(c)(2). *See United States v. Eluterio Mauro Leijano-Cruz,* 2006 WL 3734214 (5th Cir. Dec. 20, 2006) (addressing excusable neglect where untimely notice of appeal filed in a criminal case).

(iii) Did the Bankruptcy Court abuse its discretion by imposing sanctions on the appellants?

STANDARDS OF REVIEW

On appeal, this Court reviews the Bankruptcy Court's conclusions of law *de novo*. *In re First City Bancorporation of Texas, Inc.*, 282 F.3d 864, 867 (5th Cir. 2002). This Court must uphold the Bankruptcy Court's findings of fact unless they are clearly erroneous. *Id.;* Fed. R. Bankr. Proc. 8013. The Bankruptcy Court's imposition of sanctions is discretionary, and therefore this Court must review such sanctions for an abuse of discretion. *Id.*; *In re Terrebonne Fuel and Lube, Inc.*, 108 F.3d 609, 613 (5th Cir. 1997).

STATEMENT OF THE CASE

I. PRE-PETITION EVENTS

Prior to the filing of Tbyrd's bankruptcy case, BFG Investments, L.L.C. ("BFG") filed its chapter 11 petition, Case No. 05-70173 (McAllen Division). BFG's counsel was Kelly K. McKinnis ("McKinnis"). John E. Villegas is the majority equity owner and the manager of BFG. BFG's assets included various parcels of real estate as to which Texas State Bank held deeds of trust**.** March 8, 2006 Transcript at 92-93.

On April 11, 2005, the Bankruptcy Court entered an agreed order authorizing BFG's use of cash collateral arising from BFG's real estate. BFG dkt. 32. The agreed order provided that the automatic stay would automatically terminate as to Texas State Bank's remedies with respect to the real estate should BFG fail to timely cure an event of default declared by Texas State Bank. *Id*.

On or about October 11, 2005, Texas State Bank declared an event of default. On November 1, 2005, BFG commenced an action in state court seeking to enjoin Texas State Bank from selling the real estate through foreclosure proceedings. On November 3, 2005, Texas State Bank removed the state court action to the bankruptcy court, Adv. Proc. 05-7029. Texas State Bank then noticed a foreclosure sale for January 3, 2006 at 10:00 a.m.

On or about December 29, 2006, Thomas Wayland received a power of attorney from an investor-client, Angel Sanchez-Torres. According to Mr. Wayland, the power of attorney authorized him to purchase property on behalf of Mr. Sanchez-Torres. March 8, 2006 Transcript at 32-33.

On December 30, 2005, the Bankruptcy Court entered an agreed temporary restraining order that permitted Texas State Bank to proceed with matters preparatory to the foreclosure sale of BFG's real estate, but temporarily enjoined the actual sale pending further consideration of a preliminary injunction on January 3, 2006 at 8:30 a.m. BFG dkt. 12.

On January 1, 2006, Thomas Wayland met with Tim W. Byrd, the owner of a corporate shell named Tbyrd Enterprises, L.L.C. ("Tbyrd"). They accomplished a sale of the corporate shell from Mr. Byrd to Mr. Sanchez-Torres for the price of $1,000 cash. March 8, 2006 Transcript at 30-31.

On January 2, 2006, Mr. Wayland met with John Villegas at approximately 10:00 p.m. The meeting resumed at approximately 7:00 a.m. on January 3, 2006. *Id.* at 23, 28; Order at 6. At the latter meeting, Mr. Villegas deeded essentially all of BFG's assets to Tbyrd Enterprises, L.L.C. ("Tbyrd"), in exchange for a $1,000,000 promissory note secured by a wraparound mortgage. *Id.* In other words, Tbyrd received title subject to the liens of Texas State Bank and BFG.

During the morning meeting on January 2, 2006, Thomas Wayland states that John Villegas and he discussed the possibility that a bankruptcy petition might need to be filed for Tbyrd, depending on the outcome of the hearing on January 3, 2006. Mr. Wayland testified that he assumed the hearing was for a secured creditor's motion seeking relief from the automatic stay. *Id.* at 33-35. Mr. Wayland further testified that he thought there would be "a grace period" during which the Tbyrd bankruptcy case could be filed, and he testified that he prepared a couple of pages for a bankruptcy filing but that he couldn't print them. *Id.* at 38.

Mr. Villegas disputes that he discussed the filing of the Tbyrd bankruptcy petition in advance of the fact, either at the 7:00 am meeting or after the preliminary injunction hearing was concluded. He stated that he thought the property transfer itself would stop the foreclosure. *Id.* at 125.

At the conclusion of the 7:00 a.m. meeting, Kelly McKinnis arrived at Thomas Wayland's office and escorted Mr. Villegas to the preliminary injunction hearing before Judge Isgur. Mr. Wayland testified that he did not tell Kelly McKinnis of the asset transfer, and there is no evidence that Mr. McKinnis learned of the transfer until after the preliminary injunction hearing was concluded. After Villegas and McKinnis left, Mr. Wayland proceeded to record the deed. *Id.* at 34. He then had no further contact with Mr. Villegas and Mr. McKinnis until after the injunction hearing.

Mr. Villegas did not disclose the sale at the injunction hearing, although he testified on behalf of BFG as the owner of the real estate that was being foreclosed. The primary issue at the hearing was whether there was an insurance default (which would justify the termination of the stay so that the foreclosure sale could proceed as early as 10:00 on the same day). At the conclusion of the injunction hearing, the Bankruptcy Court determined that there was an insurance default and he therefore declined to enjoin the foreclosure sale. BFG adv. dkt. 14.

After recording the deed, Thomas Wayland asserts that he received a telephone call from John Villegas stating that BFG had lost the preliminary injunction hearing and that Mr. Wayland needed to file the bankruptcy petition for Tbyrd. Mr. Villegas disputes that conversation. Messrs. Wayland and McKinnis then discussed by phone Mr. Wayland's inability to print the Tbyrd bankruptcy petition, and Mr. Wayland prevailed upon Mr. McKinnis to electronically file the Tbyrd bankruptcy petition. *Id.* at 39-40. After it was electronically filed, Kelly McKinnis faxed confirmation of the filing to Mr. Wayland, who had that fax presented to Texas State Bank's agent at the foreclosure sale. *Id.* at 42-43. Tbyrd's bankruptcy petition thus had the effect of stopping Texas State Bank's foreclosure sale due to imposition of the automatic stay to protect Tbyrd.

On January 4, 2006, Texas State Bank filed an emergency motion seeking conversion of the BFG case to chapter 7 or, alternatively, the appointment of a chapter 11 trustee. On January 5, 2006, Judge Richard S. Schmidt conducted the emergency hearing in the BFG case, and entered an order that same date converting the case to chapter 7. BFG dkt. 73. On January 6, 2006, Judge Schmidt entered a further order with detailed findings and conclusions of law. That order directed court personnel to transmit a transcript of the January 5, 2006 hearing together with exhibits to the United States Attorney, to consider criminal investigation and prosecution. In a separate paragraph of the order, the bankruptcy court directed the court's personnel to send the same materials to the United States Trustee's Office, and directed the United States Trustee to investigate to consider whether the actions of BFG, Mr. Villegas, McKinnis, Mr. Byrd, or Wayland rise to the level of civil and criminal contempt, and to file a motion to show cause with the bankruptcy court or the district court as appropriate. BFG dkt. 76.

II. EVENTS IN TBYRD'S BANKRUPTCY CASE

On January 3, 2006, Messrs. McKinnis and Thomas Wayland filed the chapter 11 bankruptcy petition on behalf of Tbyrd, thereby stopping Texas State Bank's foreclosure sale. The petition had typed "signatures" of Mr. Wayland as counsel and Tim Byrd as managing member. Dkt. 1. Kelly McKinnis electronically filed the docket on Mr. Wayland's behalf.

On January 9, 2006, Texas State Bank filed a motion seeking relief from the automatic stay in the Tbyrd case. On January 10, 2006, Judge Isgur conducted a hearing on the motion. Tbyrd was not represented at the hearing, but consented to the relief sought by Texas State Bank. The Office of the United States Trustee indicated at the hearing its intention to file a motion to examine the transactions, with the likely respondents being BFG and TBYRD, their counsel, and their corporate representatives. Judge Isgur indicated that he could hear the matter on February 8, 2006. *See* docket entry dated January 10, 2006. He then issued a stay relief order that terminated the automatic stay as to Tbyrd and enjoined Tbyrd from transferring any interest in the real estate. He also determined that it was appropriate to enter a separate order turning possession of the real estate over to the Bank

On January 24, 2006, Judge Isgur issued an order that referenced the United States Trustee's announcement of the intent to file a sanctions motion, and directed the United States Trustee to file a status report by January 31, 2006. The order also directed the Debtor to file its schedules by January 31, 2006. The order also set a status conference for February 8, 2006, and directed Tbyrd's counsel, Tbyrd's principal owner and its principal operating officer to appear at the status conference.

On January 25, 2006, the United States Trustee filed the United States Trustee's Motion to Show Cause in Tbyrd's bankruptcy case. Dkt. 22. The Motion sought an order directing various persons to appear and show cause why they should not be sanctioned and the bankruptcy case dismissed. The United States Trustee identified the following persons as respondents: Tbyrd; BFG; Thomas Wayland; Kelly McKinnis; Tim Byrd; and John Villegas. The United States Trustee requested such relief pursuant to 11 U.S.C. §§ 105(a), 521(a)(1), and 1112(b)(1), and also pursuant to Federal Rule of Bankruptcy Procedure 9011. The

United States Trustee alleged that the respondents attempted to frustrate foreclosure sales of BFG's real property by transferring the property to Tbyrd and then filing a bankruptcy petition for Tbyrd after the Bankruptcy Court lifted the automatic stay and denied BFG's request for injunctive relief. The United States Trustee also alleged that Tbyrd's failure to prosecute its chapter 11 case demonstrated its lack of good faith in filing the case. On January 31, the United States Trustee filed a status report which recite the general facts leading to the filing of the United States Trustee's motion.

Beginning on January 31, 2006, Thomas Wayland filed a series of pleadings, and Judge Isgur issued a series of orders, as follows:

(i) On January 31, 2006, Mr. Wayland filed a Notice to the Court in response to the January 24, 2006 order to show cause (directing the filing of schedules and statements by January 31, 2006). Mr. Wayland stated that the new managing partner of Tbyrd was Angel Sanchez Torres. Mr. Wayland further stated that he had been removed as counsel and that Mr. Byrd had been removed as principal of Tbyrd. Consequently, Messrs. Wayland and Byrd allegedly could not sign and file the required bankruptcy documents.

(ii) On February 1, 2006, the Bankruptcy Court issued an Order to Show Cause directing that Mr. Byrd and Mr. Wayland appear at the February 8, 2006 hearing to explain why the schedules and statements had not been timely filed and why they should not be held in civil contempt for such failure. The Bankruptcy Court also held that Thomas Wayland remained counsel of record until the Court allowed his withdrawal from the case.

(iii) On February 7, 2006, Mr. Wayland filed an Unopposed Motion for Extension of

Time (dkt. 31) requesting that the February 8, 2006 hearing be continued so as to afford him time to travel to Mexico to attempt to convince Angel Sanchez Torres to change his position as to the case and to sign the schedules. On February 8, 2006, the Bankruptcy Court entered an order that denied the motion for continuance, holding that Mr. Wayland had given no bona fide basis for not appearing at the hearing.

(iv) On February 8, 2006, Mr. Wayland filed various documents, including two more motions (dkt. nos. 33, 34) seeking continuance of the orders to show cause that the Bankruptcy Court had issued for failure to file the schedules, and also including a Response and Objection to Judge's Order to Show Cause for No Schedules (dkt. 37). That document included the following statement:

> "Tbyrd never received one asset, nor one dime after the warranty deed that would make filling out the schedules anything but mere speculation at this point. So, the signed order is asking for impossibility, except to file one as of this date, which would be zero. What is the point? This does appear to have the making of being strictly punitive in nature, if not the Court over-reaching its judicial purview and it trying to entrap and setup the Respondents."

Id. at 3-4. The Response also included some inappropriate and disrespectful language. *Id.* at 5.

At the hearings on February 8, 2006, the Bankruptcy Court denied both continuance motions and chastised Mr. Wayland for the offensive language contained in the Response. February 8, 2006 Transcript at 17; dkt. nos. 40, 41. The Bankruptcy Court declined, however, to find Mr. Wayland in contempt under the Court's order to show cause, but issued an arrest warrant for Mr. Byrd, providing for his release upon production of the required schedules and statements. Memorandum Opinion Regarding Civil Contempt and Order Imposing Sanctions and Ordering Confinement, dkt. no. 43. The Court also sanctioned Tbyrd $500 per day until such documents were prepared and filed. *Id.*

Also on February 8, 2006, the Bankruptcy Court briefly addressed a document titled "Texas State Bank's Notification of Action of John Villegas, Principal of BFG Investments, LLC (Said Actions Relate to the U.S. Trustee's Show Cause Action)," dkt. no. 32. This document addressed John Villegas' filing of pleadings in state court on February 6, 2006, seeking to obtain a temporary restraining order against Texas State Bank's foreclosure sale of the real estate. The Court declined to consider the document as Texas State Bank acknowledged that it was not currently seeking any relief with respect to Mr. Villegas' action. Judge Isgur, however, verbally warned Mr. Villegas to cease any efforts to interfere, stating that the property belongs to one of the two bankruptcy estates and Mr. Villegas "need[s] to stop breaking the law. Stop, period." Febr. 8, 2006 Transcript at 22.

The Bankruptcy Court addressed the United States Trustee's motion on a preliminary basis. The United States Trustee suggested that the motion should be treated as a two-step procedure, whereby the Court would first issue the order to show cause, and then the substance of the issues could be addressed at a subsequent hearing following the passage of at least 21 days. *Id.* at 20. While Federal Rule of Bankruptcy Procedure 9011 does not allow for 21 days to withdraw or correct a petition (that time period is provided for respondents to withdraw or correct other types of documents that they filed), the two-step procedure allowed time for the parties to respond to an order to show cause. All respondents present at the hearing (i.e. not Mr. Byrd) indicated their consent to that procedure. *Id.* at 20-22. All persons also stated on the record that they did not require additional detail in the United States Trustee's proposed order to show cause. *Id* at 23. The Bankruptcy Court then issued the short order to show cause based on the United States Trustee's motion, scheduling the hearing for March 8, 2006. Dkt. 39

In response to the Court's civil contempt order and the arrest warrant, Tbyrd filed schedules and statements (dkt. nos. 44,45). Judge Isgur issued an order on February 13, 2006, finding the documents deficient. (dkt. 52). Tbyrd filed a motion to reconsider (dkt. 54), and Mr. Byrd appeared to testify on February 13, 2006 with respect to his inability to prepare adequate schedules and statements. The Bankruptcy Court made the following statement at the hearing:

> "The more I hear about this case, the worse it gets. I cannot believe that a lawyer would contact a client and ask him to do what Mr. Byrd was asked to do and to file a petition in bankruptcy for a corporation which had absolutely no assets, no capital, no bank account, and was attempting to acquire assets illegally out of another bankruptcy estate. For a lawyer to involve his client in that is, from what I've heard so far, inexcusable conduct. We'll see.
>
> That may leave Mr. Byrd, who's still signing this petition – and he's charged with signing the petition – liable for sanctions of the Court, perhaps liable for criminal charges, from what Judge Schmidt has put down in his case. I don't know. But it doesn't leave him in civil contempt of this Court, because it is a defense to civil contempt if it is impossible to comply, and Mr. Byrd is not able to comply."

February 8, 2006 Transcript. On the basis of Mr. Byrd's testimony, the Court therefore issued an amended order removing Mr. Byrd from civil contempt with respect to Tbyrd's schedules and statements, but continued to require Tbyrd to correct the deficiencies in those documents. Dkt. 55.

On February 23, 2006, Mr. Wayland filed a motion seeking to withdraw as Tbyrd's counsel. Dkt. 60. He also filed a motion seeking to "withdraw" the bankruptcy petition or, in the alternative, requesting that the March 8, 2006 hearing be continued for 20 days. This motion was based largely on Mr. Wayland's belief that BFG may not have had good title to the property or may not have been a "legal entity." He also asserted that the events since the filing of the case, i.e. the relief granted to Texas State Bank, made the bankruptcy case moot. Dkt. 61.

On March 7, 2006, Kelly McKinnis filed a motion seeking to have the United States Trustee's motion for sanctions dismissed or transferred to the McAllen Division based on improper venue. Dkt. 68. Mr. McKinnis argued that the real estate at issue was located in the McAllen Division, and BFG itself was in McAllen. Mr. McKinnis alleged that trying the matter in Houston deprived BFG of due process. The Bankruptcy Court denied the motion, in part, because venue is a "district" issue, and also because the dispositive action – the filing of the bankruptcy petition for Tbyrd – was done in the Houston Division. Dkt. 71.

On March 8, 2006, Thomas Wayland filed an Amended Response and Objections to Show Cause Hearing. Dkt. 55. Included in the document, at page 14, is the following language:

> Respondent submits that trying claims against Respondents by a Judge that made the ruling against the seller in the underlying case pending in the McAllen Division deprives Respondent of due process."

Id. at 14. This statement might be viewed as suggesting that Judge Isgur should recuse himself based on the fact that he was the judge who denied the injunction sought by BFG to forestall foreclosure.

At the March 8, 2006 trial, Judge Isgur addressed Thomas Wayland's apparent suggestion that Judge Isgur should recuse himself, and the court invited Mr. Wayland to present any evidence supporting recusal. Mr. Wayland generally referenced the series of motions he had filed, and the court's denial of those motions. He also stated that "the fact that the Court has indicated that there might be some criminal conduct has been very alarming and upsetting to me and gives me the appearance that there is not total objectivity, which I can understand the aggravation for making a prior ruling in another case, that my clients did not understand the scope that would have on the court." He also stated: "And to the degree that the Court's prior ruling in the other case affects this, you know, I think we've been tainted." He concluded "Now, for BFG, you know, I understand the Court, but it appears to me that my client, Mr. Byrd, and myself and have been lumped into a bundle with them . . we just don't feel like we're a part of them. We've been lumped into that bundle." *Id.* at 5-10. The Court reviewed the case law and held that there was no basis for recusal. *Id.* at 13-16. This holding was memorialized in an order entered March 8, 2006. Dkt. no. 71.[2]

Messrs. Wayland, Byrd, Villegas and McKinnis testified at trial. None of the

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[2] No appeal was taken directly from the order denying recusal, but a recusal order is interlocutory, and for purposes of appeal was presumably merged into the final sanctions orders. *See generally C. A. May Marine Supply Company, v. Brunswick Corp.*, 649 F.2d 1049, 1056 (5th Cir. 1981) (where claims or issues are inextricably entwined, each may be reviewed even though not referenced in the notice of appeal).

respondents asserted any lack of personal jurisdiction. As noted above, the respondents had all acknowledged, at the February 8, 2006 hearing, that the order to show cause contained sufficient detail to inform them of the general grounds for which sanctions were being sought.

The basic facts developed at trial were, in large measure, uncontested -- with just a few exceptions. John Villegas disputed Thomas Wayland's assertion that they discussed the filing of the Tbyrd bankruptcy petition in advance of the fact. Mr. Villegas stated that he thought the property transfer itself would stop the foreclosure. March 8, 2006 Transcript at 125. Mr. Wayland acknowledged that he pressured Mr. McKinnis into electronically filing the petition on Mr. Wayland's behalf, after he learned that the foreclosure sale would be going forward. Mr. Wayland stated, however, that he did not believe any harm would come from the filing, as it would afford time to work out a deal with Texas State Bank. He said he "fully intended for Texas State Bank to get paid." *Id.* at 39-41, 175.

The United States Trustee's counsel explored the sanctions issue with Mr. Wayland on the stand:

> Q. Do you think you violated Rule 9011 in this case by your actions or inactions?
>
> A. In evaluating that and doing a lot of soul searching and now have a much better understanding of the Reform Act, to the degree that I didn't investigate the transaction, yes. To the degree of TByrd's, no, because they had no bad past and I knew what their future could be." He further acknowledged the options that the court had available for sanctions:
>
> Q. You realize that the Court in this proceeding has a lot of options available to it?
>
> A. I do.
>
> Q. Those options can be restricting your practice before it. Agreed?
>
> A. Bankruptcy Court, yes.
>
> Q. You can be subject to monetary fines or sanctions?
>
> A. Yes.
>
> Q. You could be directed to take additional CLE or ethics courses?
>
> A. Yes.

When asked what monetary sanctions Mr. Wayland himself thought the court should impose – if the court found that he violated Rule 9011 or participated in a bad faith filing -- Mr. Wayland ultimately suggested $2,5000 as a maximum penalty. *Id.* at 54-56.

III. THE SANCTIONS ORDERS

The Bankruptcy Court found that Mr. Wayland arranged the purchase of BFG's assets by Tbyrd, and that he was Tbyrd's "principle business decision maker and the sole lawyer. Accordingly, he holds primary responsibility for all of Tbyrd's conduct."

Memorandum Opinion, dkt. 79, at 8. Mr. Wayland had his “printed” signature and that of Tim Byrd placed on the voluntary petition. Dkt. 1. Mr. Wayland had testified that he knew of BFG’s bankruptcy case and the hearing scheduled for January 3, 2006, and that he had the petition prepared and filed after learning that the real estate foreclosure sale was about to proceed. The Bankruptcy Court found that “Mr. Wayland conducted no investigation into whether the Bankruptcy Court had authorized the sale of BFG’s assets.” Memorandum Opinion, dkt 79, at 9. “Mr. Wayland knew that he had placed the newly acquired real estate into a corporate shell with no assets. Nevertheless, he caused BFG (sic) to file a chapter 11 petition within three hours of the time that it received the deed.” *Id.* at 10. The Court further found that Mr. Wayland was not “disinterested” – a requirement to serve as chapter 11 counsel for a debtor in possession. *Id.; see* 11 U.S.C. §§ 101(14), 327 and 1107(a) (imposing disinterestedness requirement on counsel for a chapter 11 debtor in possession).

The Bankruptcy Court found that Mr. Villegas transferred all of BFG’s assets to Tbyrd in return for a $1,000,000 promissory note, in contravention of the Bankruptcy Code, 11 U.S.C. § 363 (precluding sales of estate assets “outside the ordinary course of business” unless court approval is obtained). The Court found that Mr. Villegas also discussed with Mr. Wayland the filing of the bankruptcy case for Tbyrd, and that he indeed demanded that the bankruptcy case be filed. Memorandum Opinion at 7.

The Bankruptcy Court found that "in the space of a few hours, Mr. Byrd willingly executed a $1,000,000 promissory note by Tbyrd, a deed of trust for recording in the real property records, and Tbyrd's chapter 11 bankruptcy petition. Mr. Byrd conducted no investigation. Instead, he blindly did as instructed by Mr. Wayland." *Id.* at 10-11. "The court finds him to be a willing actor." *Id.* at 11.

The Bankruptcy Court sanctioned Thomas Wayland $25,000, John Villegas $25,000, and Tim Byrd $5,000. In addition, he barred Mr. Wayland from representing clients before him in the future, and he enjoined Mr. Villegas and Mr. Byrd from taking certain actions with respect to bankruptcy matters.

The Bankruptcy Court also made referrals to other authorities. Finding that each of the appellants "willfully transferred property out of BFG's bankruptcy estate with the intent to defeat the provisions of title 11," so that there were violations of 18 U.S.C. 152(5), Judge Isgur made criminal referrals with respect to Wayland and Mr. Villegas under 18 U.S.C. 3057(a). In addition, Judge Isgur referred Wayland to the Texas Bar pursuant to Rule 8.04 of the Texas Disciplinary Rules of Professional Conduct and to the District Court pursuant to Rule 5 of the Rules of Discipline of the U.S. District Court for the Southern District of Texas.[3]

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[3] The sanctions orders did not resolve the issue of dismissal of Tbyrd's case. Post-trial, the United States Trustee filed a new motion to dismiss the case asserting further grounds for dismissal. The Bankruptcy Court issued an order abating that motion pending resolution of the appeals. Dkt. 107, 121.

SUMMARY OF THE ARGUMENT

The United States Trustee did not seek criminal sanctions, and none of the orders or proceedings indicate otherwise. The United States Trustee's motion sought dismissal of the bankruptcy case and sanctions for the filing of the case in bad faith. The United States Trustee sought that relief under 11 U.S.C. §§ 105 and 1112(b), and Federal Rule of Bankruptcy Procedure 9011, and thereby commenced a core proceeding within the Bankruptcy Court's primary grant of bankruptcy jurisdiction. Appellants mistakenly argue that the Bankruptcy Court lacked appropriate jurisdiction to address sanctions, because the monetary sanctions are criminal in nature. The Bankruptcy Court, however, clearly did not intend to impose any criminal sanctions. This is clear from the express language of the sanctions orders, which provide that the matter is referred to the United States Attorney to consider whether criminal investigation and prosecution may be appropriate. Nonetheless, the United States Trustee concludes that as a matter of law the monetary sanctions imposed by the Bankruptcy Court did exceed the Court's inherent authority to sanction persons for bad faith conduct. For that reason, the United States Trustee suggests that the District Court should reverse and remand with respect to the monetary sanctions, so that the Bankruptcy Court may determine appropriate monetary sanctions, if any, in accordance with the Bankruptcy Court's inherent authority and/or pursuant to Federal Rule of Bankruptcy Procedure 9011.

ARGUMENT

The United States Trustee's motion sought sanctions against the appellants pursuant to Federal Rule of Bankruptcy Procedure 9011 and the court's inherent authority under 11 U.S.C. § 105. This commenced a "core proceeding" under 28 U.S.C. § 157. The Bankruptcy Court then imposed sanctions under its inherent authority and 11 U.S.C. § 105. The Bankruptcy Court did not rule upon the United States Trustee's request for sanctions under Fed. R. Bankr. P. 9011. The United States Trustee concedes that the monetary sanctions should be reversed because they cannot be supported under the Bankruptcy Court's inherent power. The matter, however, should be remanded for the Bankruptcy Court to determine appropriate sanctions consistent with its inherent authority and/or Rule 9011.

I. THE UNITED STATES TRUSTEE'S MOTION COMMENCED A CORE PROCEEDING WITHIN THE BANKRUPTCY COURT'S JURISDICTION

The Appellants err in concluding, based on the nature of the monetary sanctions, that the Bankruptcy Court lacked jurisdiction to impose any sanctions at all. The Bankruptcy Court has jurisdiction to enter final orders in all "core proceedings." A core proceeding includes all "matters concerning the administration of the estate." 28 U.S.C. § 157. A "proceeding is core under [§]157 if it invokes a substantive right provided by title 11 or if it is a proceeding that, by its nature, could arise only in the context of a bankruptcy case. *In re Case*, 937 F.2d 1014, 1019 (5th Cir. 1991) (quoting *Matter of Wood*, 825 F.2d 90 (5th Cir. 1987). The filing of the bankruptcy petition pursuant to 11 U.S.C. § 301, as well as a motion seeking dismissal of such a case under 11 U.S.C. § 1112(b), concern the appropriateness of the Bankruptcy Court's administration of the case at all, and thus it profoundly impacts the rights of all parties in the case to have their concerns addressed by the Bankruptcy Court. It is therefore difficult to conceive of a proceeding that is more "core" to the Bankruptcy Court's responsibilities. The mere fact that the relief is sought, *inter alia*, under the Bankruptcy Court's inherent authority does not render it non-core, or render the Bankruptcy Court's decision subject to *de novo* review. *See First City Bancorporation of Texas, Inc.*, 270 B.R. 807 (N.D. Tex. 2001), aff'd 282 F.3d 864 (5th Cir. 2002) ("The court does not determine *de novo* the level of sanctions, if any, to be imposed, only whether the bankruptcy court abused its discretion.") In its First City decision affirming the bankruptcy court, the Fifth Circuit reviewed the bankruptcy court's sanctions for an abuse of discretion, using a clearly erroneous standard as to findings of fact and only deciding issues of law *de novo*. 282 F.3d at 867. The Appellants reliance on *In re Continental Air Lines, Inc. (Continental Airlines, Inc. v. Hillblom)*, 61 B.R. 758 (S.D. Tex. 1986), is thus misplaced because the case is dated. *See In re Skinner*, 917 F.2d 444, 448 (10th Cir. 1990) (citing case law regarding contempt proceedings as "core," and referencing earlier contrary authority); *see also* 2001 Advisory Committee Note to Federal Rule of Bankruptcy Procedure 9020 (describing the basis for the amendment in new circuit court authority for bankruptcy courts' civil contempt power, and describing the earlier rule's *de novo* review requirement as unnecessarily restrictive)

II. THE BANKRUPTCY COURT'S ORDER, THOUGH BASED ON THE COURT'S INHERENT AUTHORITY, EXCEEDED THE SCOPE OF THAT AUTHORITY WITH RESPECT TO THE IMPOSITION OF THE

MONETARY SANCTIONS.

A. THE BANKRUPTCY COURT'S INHERENT AUTHORITY TO SANCTION MISCONDUCT

The Bankruptcy Court based its monetary sanctions on the Court's "inherent authority," relying upon *Chambers v. NASCO, Inc.*, 501 U.S. 32 (1991). In *Chambers*, the U.S. Supreme Court affirmed a federal court's imposition of monetary sanctions in the form of attorney fees based on the court's "inherent authority" to sanction certain kinds of misconduct. Specifically, federal courts are not limited to the sanctions permitted or required by express statutes and rules, but may impose sanctions pursuant their inherent authority.

Although the monetary sanctions imposed in *Chambers* were compensatory attorneys' fees, Judge Isgur rejected the notion that permissible sanctions are limited to attorney fees. Judge Isgur looked to Federal Rule of Bankruptcy Procedure 9011(c) for guidance as to the kinds of sanctions that may be imposed. Pursuant to Rule 9011(c), the court may impose both monetary and non-monetary sanctions, but such sanctions "shall be limited to what is sufficient to deter repetition of such conduct or comparable conduct by others similarly situated." The Bankruptcy Judge's legal analysis follows that from a decision that he issued a few months earlier, *In re Porcheddu*, 2006 WL 360530 (Bankr. S.D. Tex. Febr. 6, 2006) (sanctioning a law firm under Rule 9011 for misrepresenting the accuracy of time records)

Chambers remains good precedent for the proposition that, when imposing sanctions for misconduct, federal courts are not limited to the sanctions permitted or required by express statutes and rules. Federal courts retain "inherent" authority to address certain kinds of misconduct:

> It has long been understood that "[c]ertain implied powers must necessarily result to our Courts of justice from the nature of their institution," powers "which cannot be dispensed with in a Court, because they are necessary to the exercise of all others." *United States v. Hudson,* 7 Cranch 32, 34, 3 L.Ed. 259 (1812); see also *Roadway Express, Inc. v. Piper*, 447 U.S. 752, 764, 100 S.Ct. 2455, 2463, 65 L.Ed.2d 488 (1980) (citing *Hudson*). For this reason, "Courts of justice are universally acknowledged to be vested, by their very creation, with power to impose silence, respect, and decorum, in their presence, and submission to their lawful mandates." *Anderson v. Dunn,* 6 Wheat. 204, 227, 5 L.Ed. 242 (1821); see also *Ex parte Robinson*, 19 Wall. 505, 510, 22 L.Ed. 205 (1874). These powers are "governed not by rule or statute but by the control necessarily vested in courts to manage their own affairs so as to achieve the orderly and expeditious disposition of cases." *Link v. Wabash R. Co.,* 370 U.S. 626, 630-631, 82 S.Ct. 1386, 1388-1389, 8 L.Ed.2d 734 (1962).

Chambers v. NASCO, Inc., 501 U.S. 32, 43 (1991). Unfortunately, the *Chambers* decision provides little guidance as to how such inherent authority should be exercised with respect to sanctions other than attorneys fees awarded to opposing counsel. The Bankruptcy Court's reliance on Rule 9011(c) for guidance led the Court to issue sanctions under the Court's inherent authority in a manner contrary to prevailing case law.

B. THE BANKRUPTCY COURT'S INHERENT AUTHORITY DOES NOT EXTEND TO CRIMINAL SANCTIONS

Irrespective of the court's "inherent authority" under *Chambers*, a federal court may not impose "criminal" sanctions without providing criminal due process protections, and such specialized procedures were not employed here. The possible exceptions are for "direct contempt sanctions" (to maintain order in open court) and "petty fines," because these do not give rise to immediate and extensive criminal due process protections. *See Hicks v. Feiock*, 485 U.S. 624, 632 (1988) ("criminal penalties may not be imposed on someone who has not been afforded the protections that the Constitution requires of such criminal proceedings"*);* *International Union, United Mine Workers of America v. Bagwell*, 512 U.S. 821, 827-34 (1992) (reviewing the limited circumstances where criminal due process protections may not apply).

The monetary sanctions in this case are contrary to established Fifth Circuit and Supreme Court precedent with respect to courts' inherent authority. *See In re Hipp, Inc*., 895 F.2d 1503, 1509 (5th Cir. 1990); *In re Terrebonne Fuel and Lube, Inc.*, 108 F.3d 609, 613, n.3 (5th Cir. 1997) (citing *Hipp* with approval); *see also Crowe v. Smith*, 151 F.3d 217, 226 (5th Cir. 1998) (reversing district court fines payable to court because they were imposed in civil proceeding and thus violated criminal due process right to independent prosecutor). The distinction between civil and criminal contempt can sometimes be difficult to draw. "[W]hether a contempt is civil or criminal turns on the 'character and purpose' of the sanction involved." *International Union, United Mine Workers of America v. Bagwell*, 512 U.S. 821, 827 (1992). "Most contempt sanctions, like most criminal punishments, to some extent punish a prior offense as well as coerce an offender's future obedience." *Id.* at 828. With respect to fines, however, the rule is that a non-compensatory fine issued for contempt "is civil only if the contemnor is afforded an opportunity to purge . . . Thus, a 'flat, unconditional fine' totaling even as little as $50 announced after a finding of contempt is criminal if the contemnor has no subsequent opportunity to reduce or avoid the fine through compliance." *Id.* at 829 (citations omitted).

The monetary sanctions on appeal cannot be construed as "petty" fines payable to the court. Judge Isgur took care to set the amounts high enough to effectively deter others from similar wrongful conduct. *See generally Crowe v. Smith*, 151 F.3d 217, 229 n.12 (5th Cir. 1998) ("We need not decide today what the precise limit is for a "petty" fine, because $75,000 is manifestly non-petty in the case of an individual, just as $5 million is non-petty in the case of a corporation. We note, however, that the *Bagwell* Court strongly suggested, without deciding, that $5000 was an appropriate limit for individuals, and $10,000 for corporations.") (citing *Bagwell,* 512 U.S. at 837 n. 5).

A strict standard of review further weighs against support for Judge Isgur's monetary sanctions. Although the appellate court reviews the imposition of sanctions under a federal court's inherent power for an "abuse of discretion," such a standard of review is actually a high standard in this context, because the court's ability to impose sanctions under its inherent authority is itself limited. The Fifth Circuit describes the standard at some length in *Crowe,* 151 F.3d at 226:

> We review a district court's imposition of sanctions under its inherent power for abuse of discretion. *Dawson v. United States*, 68 F.3d 886, 895 (5th Cir.1995); *Chambers v. NASCO, Inc.*, 501 U.S. 32, 55, 111 S.Ct. 2123, 115 L.Ed.2d 27 (1991). Nonetheless, "the threshold for the use of inherent power sanctions is high." *Elliott v. Tilton,* 64 F.3d 213, 217 (5th Cir.1995). The inherent power "is not a broad reservoir of power, ready at an imperial hand, but a limited source; an implied power squeezed from the need to make the court function." *Chambers,* 501 U.S. at 42, 111 S.Ct. 2123 (quoting *NASCO, Inc. v. Calcasieu Television and Radio, Inc.*, 894 F.2d 696, 702 (5th Cir.1990)). Perhaps for this reason, we have repeatedly emphasized that, where the inherent power is involved, " 'our review is not perfunctory.' " *Dawson*, 68 F.3d at 896 (quoting *Shepherd v. American Broadcasting Companies,* 62 F.3d 1469, 1475 (D.C. Cir.1995)). "As the Supreme Court has explained, '[b]ecause inherent powers are shielded from direct democratic controls, they must be exercised with restraint

> and discretion.' " *Shepherd*, 62 F.3d at 1475 (quoting *Roadway Express, Inc. v. Piper*, 447 U.S. 752, 764, 100 S.Ct. 2455, 65 L.Ed.2d 488 (1980)).

The Supreme Court has described the danger of abuse even more expansively:

> Unlike most areas of law, where a legislature defines both the sanctionable conduct and the penalty to be imposed, civil contempt proceedings leave the offended judge solely responsible for identifying, prosecuting, adjudicating, and sanctioning the contumacious conduct. Contumacy "often strikes at the most vulnerable and human qualities of a judge's temperament," *Bloom*, 391 U.S., at 202, 88 S.Ct., at 1482, and its fusion of legislative, executive, and judicial powers "summons forth ... the prospect of 'the most tyrannical licentiousness,' " *Young v. United States ex rel. Vuitton et Fils S.A.,* 481 U.S. 787, 822, 107 S.Ct. 2124, 2145, 95 L.Ed.2d 740 (1987) (SCALIA, J., concurring in judgment), quoting *Anderson,* 6 Wheat., at 228.

International Union, United Mine Workers of America v. Bagwell, 512 U.S. 821, 831 (1992).

As a result of such potential for abuse, case law has focused extensively on the nature of the contemptuous conduct and the extent of procedural protections to be afforded in such circumstances. The Supreme Court's "jurisprudence in the contempt area has attempted to balance the competing concerns of necessity and potential arbitrariness by allowing a relatively unencumbered contempt power when its exercise is most essential, and requiring progressively greater procedural protections when other considerations come into play." *Id.* at 832. As the contempt sanction becomes criminal in nature, "an even more compelling argument can be made [than in ordinary criminal cases] for providing a right to jury trial as a protection against the arbitrary exercise of official power." *Id.* at 831-32 (quoting *Bloom v. Illinois*, 391 U.S. 194, 202 (1968).

Much of the above-described case law has developed in regard to the courts' inherent ability to sanction contempt. In the instant case, however, Judge Isgur was not called upon to sanction persons for contempt of a prior court order. Rather, the United States Trustee sought sanctions for bad faith conduct in connection with the filing of the Tbyrd bankruptcy petition. But this distinction should not give rise to a different legal standard, as the criminal due process protections would be the same.

Where a court has sought to impose sanctions as part of a civil proceeding but some of the sanctions are criminal in nature, the criminal sanctions are appropriately reversed and the matter remanded for further proceedings consistent with that ruling. *See Crowe v. Smith*, 151 F.3d 217, 235-36 (5th Cir. 1998) (court may vacate criminal sanction for failure to comply with criminal procedure, yet affirm the civil sanctions that were imposed) (citing *Lamarf Financial Corp. v. Adams,* 918 F.2d 564, 567 (5th Cir. 1990).

III. THE BANKRUPTCY COURT DID NOT ERR IN DENYING RECUSAL

The Appellants argue that the Bankruptcy Court denied them due process of law because there was not sufficient notice that the issue of recusal was going to be heard at the trial on March 8, 2006. Mr. Wayland, however, did not timely seek recusal, and indeed he did not expressly request such relief, either by using the term itself or by reference to the applicable statute, 28 U.S.C. § 455. The Bankruptcy Court appropriately raised the issue on March 8, 2006 because, on that same date, in Mr. Wayland's Amended Response and Objections to Show Cause Hearing, Mr. Wayland appeared to perhaps be seeking recusal. The Bankruptcy Court therefore raised the matter as a necessary prelude to conducting the trial, even though the document at issue did not reference recusal in either its caption or in any prayer for relief. Appellants presented no evidence of bias on the part of Judge Isgur, but simply argued in a general manner on the basis of his past rulings and comments in the BFG and Tbyrd cases. The Bankruptcy Court appropriately relied on the basis of well-established case law that recusal was not required. *Liteky v. United States*, 510 U.S. 540 (1994) ("Opinions formed by the judge on the basis of facts introduced or evidence occurring in the course of the current proceedings, or of prior proceedings, do not constitute a basis for a bias or partiality motion unless they display a deep seated favoritism or antagonism that would make fair judgment impossible. Judicial remarks during the course of a trial that are critical or disapproving of, or even hostile to, counsel, the parties, or their cases, ordinarily do not support a bias or partiality challenge. They may do so if they reveal an opinion that derives from an extrajudicial source; and they will do so if they reveal such a high degree of favoritism or antagonism as to make fair judgment possible."); *see also United States v. Bremers*, 195 F.3d 221 (5th Cir. 1999).

CONCLUSION

For these reasons, the United States Trustee respectfully asks this Court to vacate the monetary sanctions entered below, reverse the Bankruptcy Court's orders to that extent, and remand this proceeding to the Bankruptcy Court with instructions to determine what relief, if any, to impose under it's inherent authority or under Federal Rule of Bankruptcy Procedure 9011.

Dated: December 22, 2006

Respectfully submitted,

Office of the United States Trustee
Department of Justice

Charles McVay
United States Trustee, Region 7

P. Matthew Sutko
Executive Office for United States Trustees
Department of Justice
20 Massachusetts Ave., N.W., Ste. 8000
Washington, D.C. 20530

Stephen Statham
Office of the U.S. Trustee
Department of Justice
Trial Attorney
515 Rusk Ave., Room 3516
Houston, TX 77002
Tel. 713-718-4650, x252
Fax. 713-718-4670
Stephen.Statham@usdoj.gov

T. Patrick Tinker
Office of the U.S. Trustee
Department of Justice
Trial Attorney
501 E. Polk St., Ste. 1200
Tampa, FL 33602
Tel. 813-228-2000
Fax. 813-228-2303
Thomas.P.Tinker@usdoj.gov

CERTIFICATE OF SERVICE

I certify that on this the 22st day of December 2006, true and correct copies of the BRIEF FOR APPELLEE, UNITED STATES TRUSTEE were served on the parties listed below by ECF or United States Mail:

By: /s/ Stephen D. Statham
Stephen D. Statham

Tim W. Byrd
P.O. Box 9033
College Station, Texas 77845

Thomas G. Wayland
1630 N. 10th Street
McAllen, Texas 78501

John E. Villegas
1616 E. Griffin Parkway, PMB 110
Mission, Texas 78572

Kelly K. McKinnis
612 Nolana Loop, Suite 240
McAllen, Texas 78504

Michael B. Schmidt
555 N. Carancahua, Suite 1550
Corpus Christi, Texas 78478

Mark Alan Twenhafel
2424 North 10th Street, Suite 200
McAllen, Texas 78501

Jose Gonzales
106 S 12th Ave., Suite 119-B
Edinburg, Texas 78539

BRIEF BANK — "SUMMARY SHEET"

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WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	In re Tbyrd Enterprise, LLC (Bryd, et al. v. UST)
2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	D. Tex.
3. ("CCN") ***CURRENT*** CASE NO.	No.: 7:07-cv-00304
4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*	No.: 06-30078-H1-11 Court: Bankr. Tex. *(Identify judge & cite, if any)*
5. ("SO") ***SOURCE***	**U.S. TRUSTEES**
6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	Filed: May 27, 2008 Type: Brief for the Appellee, United States Trustee
7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*	Stephen Statham, Charles McVay, T. Patrick Tinker, P. Matthew Sutko, *(UST/OGC: 202-307-1399/FAX-2397)*
8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	•Whether the bankruptcy court imposed appropriate civil sanctions under federal rule of bankruptcy procedures 9011.
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BEFORE THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
McALLEN DIVISION

In re

TBYRD ENTERPRISES, LLC Bankr. Case No. 06-30078-H1-11

Debtor.
_____________________________________/

THOMAS G. WAYLAND and
TIMOTHY W. BYRD

Appellants, Distr Ct. Case No. 7:07-CV-00304

v.

CHARLES McVAY,
UNITED STATES TRUSTEE,

Appellee.
_____________________________________/

BRIEF FOR THE APPELLEE, UNITED STATES TRUSTEE

Office of the United States Trustee
Department of Justice

Charles McVay
United States Trustee, Region 7

Stephen Statham
Office of the U.S. Trustee
Department of Justice
Trial Attorney
515 Rusk Ave., Room 3516
Houston, TX 77002
Tel. 713-718-4650, x252
Fax. 713-718-4670
Stephen.Statham@usdoj.gov

P. Matthew Sutko
Executive Office for United States Trustees
Department of Justice
20 Massachusetts Ave., N.W., Ste. 8000
Washington, D.C. 20530

T. Patrick Tinker
Office of the U.S. Trustee
Department of Justice
Trial Attorney
501 E. Polk St., Ste. 1200
Tampa, FL 33602
Tel. 813-228-2000
Fax. 813-228-2303
Thomas.P.Tinker@usdoj.gov

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STATUTES AND RULES

STATEMENT OF JURISDICTION

On January 25, 2006, the United States Trustee filed a motion in the United States Bankruptcy Court for the Southern District of Texas (the "Bankruptcy Court") seeking dismissal of the bankruptcy case of Tbyrd Enterprises L.L.C. ("Tbyrd") and seeking an order to show cause why Thomas Wayland and Timothy Byrd (the "Appellants") should not be sanctioned for filing Tbyrd's voluntary petition in bad faith. Bankr. Case No. 06-30078-H1-11, dkt. 22. The United States Trustee sought sanctions under the Bankruptcy Court's "inherent authority" and Fed. R. Bankr. P. 9011 (which is modeled after Fed. R. Civ. P. 11). The motion initiated a "core proceeding" under 28 U.S.C. § 157(b)(2), as it called into question the very filing of the bankruptcy case and the responsibility of the Appellants for that filing. The Bankruptcy Court properly exercised jurisdiction of that core proceeding under 28 U.S.C. § 157(b)(1). *See Citizens Bank & Trust Co. v. Case (In re Case)*, 937 F.2d 1014 (5th Cir. 1991) ("a proceeding is core under [§] 157 if it invokes a substantive right provided by title 11 or if it is a proceeding that, by its nature, could arise only in the context of a bankruptcy case.") (quoting *Matter of Wood*, 825 F.2d 90, 97 (5th Cir. 1987)).

On March 29, 2006, the Bankruptcy Court entered a memorandum opinion and orders imposing sanctions on the Appellants. Tbyrd dkt. 79, 82, 83.[1] The Appellants timely appealed to this Court, which exercised appellate jurisdiction under 28 U.S.C. § 158(a). See Case No.

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[1] Many of the docket entries in the Tbyrd bankruptcy case are duplicated in a separate adversary proceeding in the bankruptcy case of BFG Investments, L.L.C., Case No. 05-70173, Adv. Proc. No. 05-07029. Because the latter entries are duplicative, the United States Trustee has limited his Bankruptcy Court citations to those found on the Tbyrd docket.

7:06-cv-87.

On March 30, 2007, this Court affirmed most of the Bankruptcy Court's findings of fact and conclusions of law, but remanded the matter for the Bankruptcy Court to assess civil monetary sanctions and to consider whether the bankruptcy court should certify any criminal contempt issue to the District Court. Dkt. 58.

On remand, the Bankruptcy Court conducted an evidentiary hearing on September 18, 2007. The issue of civil sanctions was again a "core proceeding" as defined by 28 U.S.C. § 157(b)(2), and the District Court's order contemplated the Bankruptcy Court's final resolution of the civil sanctions issue. By contrast, the District Court directed the Bankruptcy Court merely to determine whether it should certify any criminal contempt issue to the District Court for the District Court to resolve, leaving any actual criminal contempt to be determined by the District Court. The Bankruptcy Court never sought to exercise any criminal contempt authority, and the Bankruptcy Court eventually determined that it was inappropriate even to certify such an issue to the District Court. On December 7, 2007, the Bankruptcy Court entered its memorandum opinion and orders imposing civil monetary sanctions on the Appellants under Fec. R. Bankr. P. 9011 and declining to certify any criminal contempt issue. Tbyrd dkt. 171 through 174.

On December 17, 2007, the Appellants timely appealed the December 7, 2007 orders to this Court. Tbyrd dkt.179. The orders on appeal conclusively resolved all matters pending on remand. This Court has jurisdiction over appeals of the Bankruptcy Court's final orders under 28 U.S.C. § 158(a).

Mr. Wayland challenges the Bankruptcy Court's imposition of sanctions under Rule 9011 as tantamount to the imposition of criminal contempt sanctions that exceed the Bankruptcy Court's jurisdiction. Because the sanctions are appropriate civil sanctions, Mr. Wayland's jurisdictional argument necessarily fails. The United States Trustee addresses the civil nature of the sanctions in the Argument section of this brief.

STATEMENT OF THE ISSUES

This appeal presents the following issue: Did the Bankruptcy Court err by imposing criminal contempt sanctions under Federal Rule of Bankruptcy Procedure 9011?

STANDARDS OF REVIEW

On appeal, this Court reviews the Bankruptcy Court's conclusions of law *de novo*. *In re First City Bancorporation of Texas, Inc.*, 282 F.3d 864, 867 (5th Cir. 2002). This Court must uphold the Bankruptcy Court's findings of fact unless they are clearly erroneous. *Id.*; Fed. R. Bankr. P. 8013. The Bankruptcy Court's imposition of sanctions under Fed. R. Bankr. P. 9011 is discretionary, and therefore this Court must review such sanctions for an abuse of discretion. *See Krim v. First City Bancorporation Inc. (In re First City Bancorporation Inc.)*, 282 F.3d 864, 867 (5th Cir. 2002) (*per curiam*). "A court abuses its discretion when its ruling is based on an erroneous view of the law or on a clearly erroneous assessment of the evidence." *Id.* (citing *Chaves v. M/V Medina Star*, 47 F.3d 153, 156 (5th Cir. 1995)).

STATEMENT OF THE CASE

I. NATURE OF THE CASE

This appeal is taken from a remand issued in a prior appeal, Case No. 7:06-cv-87. The

Bankruptcy Court had sanctioned the Appellants for the bad faith filing of Tbyrd's bankruptcy case. The Bankruptcy Court found that Mr. Wayland had arranged Tbyrd's purchase of assets from another bankruptcy debtor, BFG Investments, L.L.C. ("BFG") in order to frustrate the foreclosure sale of BFG's assets after the Bankruptcy Court had refused to stop the sale. In regard to Tbyrd's bankruptcy filing, the Bankruptcy Court found that Mr. Wayland was Tbyrd's "principle business decision maker and the sole lawyer. Accordingly, he holds primary responsibility for all of Tbyrd's conduct." Memorandum Opinion, dkt. 79, at 8. Mr. Wayland had his "printed" signature and that of Tim Byrd placed on Tbyrd's voluntary petition. Dkt. 1. Mr. Wayland knew of BFG's bankruptcy case and the hearing scheduled for January 3, 2006, and he had the petition prepared and filed after learning that the real estate foreclosure sale was about to proceed. The Bankruptcy Court found that "Mr. Wayland conducted no investigation into whether the Bankruptcy Court had authorized the sale of BFG's assets." Memorandum Opinion, dkt 79, at 9. "Mr. Wayland knew that he had placed the newly acquired real estate into a corporate shell with no assets. Nevertheless, he caused BFG (sic) to file a chapter 11 petition within three hours of the time that it received the deed." *Id.* at 10. The Bankruptcy Court also found that Mr. Wayland was not even qualified under the bankruptcy laws to serve as Tbyrd's bankruptcy counsel. *Id.*

The Bankruptcy Court similarly found Mr. Byrd responsible for the Tbyrd bankruptcy filing. The Bankruptcy Court found that "in the space of a few hours, Mr. Byrd willingly executed a $1,000,000 promissory note by Tbyrd, a deed of trust for recording in the real property records, and Tbyrd's chapter 11 bankruptcy petition. Mr. Byrd conducted no investigation. Instead, he blindly did as instructed by Mr. Wayland." *Id.* at 10-11. "The court finds him to be a willing actor." *Id.* at 11.

On March 29, 2006, the Bankruptcy Court entered a memorandum opinion and orders imposing sanctions on the Appellants. Tbyrd dkt. 79, 82, 83. The Bankruptcy Court sanctioned Mr. Wayland $25,000 and Mr. Byrd $5,000. The Bankruptcy Court also sanctioned two other persons who were not parties in the Tbyrd bankruptcy case.[2] *Id.* The Bankruptcy Court chose to sanction all four persons under its inherent power, but used Fed. R. Bankr. P. 9011(c) for guidance as to the types of sanctions that the could be imposed. Tbyrd dkt. 79, Memorandum Opinion, at 16.

On March 30, 2007, this Court entered its judgment affirming most of the Bankruptcy Court's findings of fact and conclusions of law, and affirming its finding that the Appellants filed the Tbyrd bankruptcy petition in bad faith. Case No. 7:06-cv-87, dkt. 58.

The District Court reversed the Bankruptcy Court's orders in part, however, finding that the Bankruptcy Court had imposed non-compensatory sanctions in a manner that exceeded its inherent authority. *Id.* The District Court remanded the matter for the Bankruptcy Court to: (i) assess civil monetary sanctions and (ii) determine whether it would be appropriate to certify any criminal contempt to the District Court for the District Court to address. *Id.*

On remand, the Bankruptcy Court conducted an evidentiary hearing to address the

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[2] Kelly McKinnis was counsel for BFG; he did not appeal the Bankruptcy Court's first order. John Villegas was a principal of BFG and an appellee in the first appeal. On remand, the Bankruptcy Court held that Rule 9011 did not support sanctions against Mr. Villegas and no appeal has been taken from that ruling.

imposition of sanctions under the Bankruptcy Court's inherent authority and Fed. R. Bankr. P. 9011. After hearing the evidence and arguments, the Bankruptcy Court entered orders declining to certify any criminal contempt to the District Court but imposing civil monetary sanctions. It relied solely upon Fed. R. Bankr. P. 9011 as authority for the sanctions. Tbyrd dkt. 171 through 174.

II. FURTHER COURSE OF THE PROCEEDINGS

On March 20, 2008, this Court conducted a status conference with respect to the earlier appeal, Case No. 7:06-cv-87. In that appeal, the Appellants had filed a post-judgment motion for rehearing, as well as a motion seeking to stay the Bankruptcy Court from proceeding on remand. The Court denied both motions, and concluded that the absence of a stay allowed the Bankruptcy Court to proceed on remand.[3] Dkt. 83, 84.

On March 20, 2008, the Court also conducted a status conference in the instant appeal. The Court granted Mr. Wayland's motion to withdraw as counsel for Mr. Byrd. The Court also

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[3] The Appellants filed a notice of appeal to the Fifth Circuit from the post-judgment orders. Because the orders were non-appealable, the notice of appeal to the Fifth Circuit should not have any jurisdictional significance for either the remand or the instant appeal. *United States v. Hitchmon*, 602 F.2d 689, 694 (5th Cir. 1979) (". .. [F]iling a notice of appeal from a nonappealable order should not divest the district court of jurisdiction . . . The contrary rule leaves the court powerless to prevent intentional dilatory tactics, forecloses without remedy the nonappealing party's right to continuing trial court jurisdiction, and inhibits the smooth and efficient functioning of the judicial process.") The Court's orders were nonappealable because the remand to the Bankruptcy Court rendered the entire matter interlocutory and the Appellants never sought leave to pursue an interlocutory appeal. Indeed, the United States Court of Appeals has also denied the Appellants' petition for writ of mandamus which similarly sought to prevent the Bankruptcy Court from proceeding on remand. Court of Appeals Case No. 07-40770, dkt. entry of Aug. 14, 2007.

established a briefing schedule and scheduled oral argument for June 11, 2008. Minute entry of March 20, 2007.

Mr. Wayland filed an amended brief as appellant on May 4, 2008, to which this Brief responds. Dkt. 14. Mr. Byrd has not filed a brief in support of his appeal, nor did he seek to adopt Mr. Wayland's brief.

III. STATEMENT OF THE FACTS ESTABLISHED ON REMAND

A. The Evidentiary Record on Remand

On remand, the Bankruptcy Court directed the parties to establish a further evidentiary record for the determination of appropriate civil sanctions, if any. The Bankruptcy Court directed the Appellants to file various financial documents with the Bankruptcy Court, including financial statements, tax returns, bank statements, listings of assets, documents reflecting the source of funds used for posting bonds in the cases, and any collateral pledged to secure the bonds. Tbyrd dkt. 144. The Appellants submitted these documents under seal to the Bankruptcy Court. Tbyrd Dkt. 148,149, 150,152. The Bankruptcy Court also directed the United States Trustee, the chapter 7 trustee and the Appellants to file briefs on various issues, including whether sanctions could be imposed under Fed. R. Bankr. P. 9011(c)(1)(B) or under the court's inherent authority against persons who filed or orchestrated the filing of, a chapter 11 petition in bad faith, and how such sanctions should be determined. Tbyrd dkt. 144, 158 through 159.

On September 18, 2007, the Bankruptcy Court conducted an evidentiary hearing regarding the imposition of civil sanctions under either the Court's inherent authority or Fed. R. Civ. P. 9011. As a preliminary matter, the Bankruptcy Court granted an unopposed request by the United States Trustee to carry forward the evidence from the original March 8, 2006 evidentiary hearing for the purpose of determining appropriate sanctions on remand. Transcript at 12-13. At the September 18, 2007 hearing, each of the Appellants then testified regarding their respective backgrounds, employment, health, and financial conditions. Transcript, at 13-34 (Mr. Wayland) and 34-43 (Mr. Byrd). Additionally, Mr. Wayland introduced various exhibits into evidence, including a promissory note with which he obtained funds for an appeal bond, certain medical documentation, and checking account information. *Id.* at 27-28.

B. Mr. Wayland's Testimony Regarding his Conduct and Appropriate Sanctions

During the evidentiary hearing, Mr. Wayland testified regarding his acceptance of responsibility for the Tbyrd filing:

> Q: Mr. Wayland, you obviously reviewed the initial opinion that was issued from the March the 8th, 2006 hearing?
> A: Yes.
> Q: And you understand the Court's concerns in the findings regarding your role and the role of the other respondents in the Tbyrd bankruptcy case?
> A: I do now.
> Q: And you understand that the Court's factual findings regarding the rule have been upheld by the district court on appeal?
> A: Yes I do.
> Q: Do you accept responsibility for the conduct that was found to have occurred by the Court?
> A: Yes I do.
> Q: And you understand that your acceptance of that responsibility may, and in all probability will, have additional consequences?
> A: Yes, I understand.

Transcript at 13-14.

Mr. Wayland also testified regarding the sanctions that he might be able to pay:

> The Court: And although you think that you should pay Mr. Statham's fees, you don't think that I can order it and you haven't voluntarily paid the fees to him: is that right?
> The Witness: (No verbal response)
> The Court : So I can't order it and make you do it and you haven't agreed to voluntarily do it but you think it's the right thing to do?
> The Witness: Your Honor, I would love to end everything today and I would be willing to agree to that today.
> The Court: I'm not making a compromise. What I want to know is: what are you taking responsibility for? Have you voluntarily agreed to pay his fees?
> The Witness: Your honor, I have offered numerous times to his office and when he gets up here, I will ask him on the stand to try and settle this thing.
> The Court: I'm not talking about whether you've trying to settle, I want to know whether you're taking responsibility independently here?
> The Witness: I've offered him more than the amount to try and take responsibility for that.
> The Court: Have you paid him anything?
> The Witness: Your Honor, it - - his response to me is his office was unwilling to accept my offer. I offered him $ 10,000. [4]

Transcript at 33-34. During closing argument, Mr. Wayland then repeated his willingness to resolve the sanctions issue for the sum of $10,000, requesting ". . . that the Court take into consideration, you know, our limited financial resources and, again, to lay, as an offer or judgment of such, the $10,000." Transcript at 82.

C. Mr. Byrd's Testimony Regarding His Culpability

Mr. Byrd also testified regarding his culpability for the filing of the Tbyrd bankruptcy petition:

> The Court: Anything you want to add?
> The Witness: No, I think I've said - - just apologize to you and the Court for anything I may have done wrong.
> The Court: What did you think you did wrong?

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[4] It was the position of the United States Trustee that he could not unilaterally compromise the Bankruptcy Court's show cause order.

> The Witness: I don't know. I mean, at the time - - I mean, I understand what your statement was but at the time it occurred, I didn't deliberately do it.
> The Court: But looking back, do you think you did - - I mean, I understand you're apologizing but do you have any idea what you're apologizing for, for what you did wrong?
> The Witness: Yes.
> The Court: What is it?
> The Witness: That I shouldn't have acted as the agent when I sold it. I'm kind of confused on this thing, your Honor.
> The Court: What I'm concerned about is: if you don't know what you did wrong, how are you going to know not to do it again?
> The Witness: well, I'm just stating that I went on the advice of an attorney who relied on the advice of another attorney that what I was doing at the time was legal or else I wouldn't have got involved with anything.
> The Court: I understand that part but it sounds like you don't know - - you're apologizing because somebody told you to apologize but you don't know what you did wrong; it that - -
> The Witness: I'm apologizing because the Court feels like I did something wrong or ruled that I did something wrong.
> The Court: And what did you do wrong?
> The Witness: All this legal stuff is just over my head, Your Honor.
> The Court: All right, sir. You can step down, Mr. Byrd.

Transcript at 42-43. At the conclusion of closing arguments, the Court commented on Mr. Byrd's testimony:

> "And it's the wrong answer that you won't trust any lawyer when, Mr. Byrd, if you're asked to serve in a capacity that you know you can't serve in and when you know you have nothing to do with the entity and when you know you're just a straw man for somebody else, you know it was wrong when you did it . . . ."

Transcript at 92.

D. The Bankruptcy Court's Ruling

On December 7, 2007, the Bankruptcy Court issued its Memorandum Opinion and orders on remand. Tbyrd dkt. 171, 172, 174. The Bankruptcy court found that the "sole purpose of the filing of Tbyrd's bankruptcy purpose was to stop a planned foreclosure sale by

Texas State Bank." Memorandum Opinion at 3. "There is no question that the filing of the chapter 11 petition was done in bad faith in violation of Rule 9011. The reasons why this Court determined the filing to be in bad faith, which were affirmed by the District Court, are patent. The conduct was directly under taken . . . by Wayland and Byrd." *Id.* at 10.

The Bankruptcy Court acknowledged Mr. Byrd's financial limitations when imposing sanctions, but held that a $5,000 sanction was nonetheless necessary for deterrence of such conduct by Mr. Byrd in the future:

> ". . . [T]he Court concludes that Byrd's expressions of remorse were insincere. Byrd completely failed to grasp his own wrongdoing. He had apparently decided to express remorse, only because such expressions are expected in a sanctions hearing. He had no comprehension of his own conduct or why it was wrong. Meaningful remorse would require a sufficient amount of inquiry to assure that one did not repeat the wrongful conduct . . . The Court rejects his expressions of remorse. His future conduct will not be deterred in the absence of a monetary sanction. The Court imposes monetary sanctions against Byrd to assure he will finally inquire as to why his conduct was wrong. The Court originally imposed a $5,000 sanction against Byrd. Given his financial situation, that is a substantial sanction. It is imposed solely for his conduct that violated Rule 9011. It is necessary for deterrence. No adjustment is appropriate."

Id. at 13. In contrast, the Bankruptcy Court accepted Mr. Wayland's expressions of remorse. The Bankruptcy Court also accepted Mr. Wayland's "offer" of $10,000 as an appropriate sanction, concluding that it was a sufficient sanction to deter others who may be similarly situated:

> ". . . Wayland requested that this Court reduce the sanction against him from $25,000 to $10,000. The Court finds that request reasonable and a *bona fide* acceptance of responsibility, assuming it is carried to fruition. The Court is aware that a State Bar Disciplinary proceeding has been commenced against Wayland arising out of his conduct in this case. That proceeding along with a $10,000 sanction is sufficient to deter others who are similarly situated."

Id. at 14.

SUMMARY OF THE ARGUMENT

The Bankruptcy Court previously found, and this Court affirmed, that the Tbyrd bankruptcy petition was filed in bad faith. On remand, Mr. Wayland acknowledged his responsibility for the filing of the bad faith petition. Mr. Byrd purported to do the same, though with little remorse. The Bankruptcy Court then imposed civil sanctions under Fed. R. Bankr. P. 9011. Mr. Wayland now argues that the Rule 9011 sanctions are impermissible "criminal contempt orders" that exceed the Bankruptcy Court's jurisdiction. That objection must fail for two reasons.

First, the Bankruptcy Court expressly rejected any conclusion that the Appellants engaged in criminal contempt, and instead imposed sanctions under the strict requirements of Fed. R. Bankr. P. 9011(c)2). The Bankruptcy Court carefully reviewed the Appellants' financial situation, their understanding of their actions, and their willingness to accept responsibility for those actions. The Bankruptcy Court then limited the monetary penalties to those amounts necessary to achieve the deterrence function required under Rule 9011, in this case $10,000 to be paid by Mr. Wayland and $5,000 to be paid by Mr. Byrd. The Bankruptcy Court fully complied with the dictates of Rule 9011(c)(2).

Second, Mr. Wayland argues that the sanctions are impermissible "criminal contempt" sanctions under case law interpreting federal courts' "inherent authority." Because the Bankruptcy Court properly imposed sanctions under Rule 9011, case law limiting sanctions under the courts' "inherent authority" does not apply. The Bankruptcy Court therefore did not exceed its jurisdiction by imposing criminal contempt sanctions.

ARGUMENT

I. THE BANKRUPTCY COURT IMPOSED APPROPRIATE CIVIL SANCTIONS ON THE APPELLANTS UNDER FED. R. BANKR. P. 9011

______Mr. Wayland and Mr. Byrd were both responsible for the bad faith filing of Tbyrd's bankruptcy petition. Tbyrd Dkt. 171, Memorandum Opinion, at 10. Federal Rule of Bankruptcy Procedure 9011 provides a mechanism for bankruptcy courts to impose sanctions on attorneys and parties who present a petition to the court "for any improper purpose, such as to harass or to cause unnecessary delay or needless expense in the cost of litigation; . . . ." Fed. R. Bankr. P. 9011(b)(1). Sanctions may be sought by motion or imposed on the court's own initiative. Fed. R. Bankr. P. 9011(c)(1). But the sanctions must be appropriate. This appeal raises the issue of whether the Bankruptcy Court imposed sanctions of the type and nature prescribed under Rule 9011(c)(2).

Sanctions imposed under Fed. R. Bankr. P. 9011 are, like sanctions under Fed. R. Civ. P. 11, reviewed "under the abuse of discretion standard." *Krim v. First City Bancorporation Inc. (In re First City Bancorporation Inc.)*, 282 F.3d 864, 867 (5th Cir. 2002) (*per curium*); *In re Dragoo*, 186 F.3d 614, 616 (5th Cir. 1999); *Keiter v. Straka*, 192 B.R. 150, 154 (S.D. Tex. 1996). The lower court "would necessarily abuse its discretion if it based its ruling on an erroneous view of the law or on a clearly erroneous assessment of the evidence." *Cooter & Gell v. Hartmarx Corp.*, 496 U.S. 384, 405 (1990).

The abuse of discretion standard of review has a solid basis in the policies that underlay

Rule 11. The trial court

> ". . . is best acquainted with the local bar's litigation practices and thus best situated to determine when a sanction is warranted to serve Rule 11's goal of specific and general deterrence. Deference to the determination of courts on the front lines of litigation will enhance these courts' ability to control litigants before them. Such deference will streamline the litigation process by freeing appellate courts from the duty of reweighing evidence and reconsidering facts already weighed and considered by the [lower] court; it will also discourage litigants from pursuing marginal appeals, thus reducing the amount of satellite litigation."

Id. at 404; *see also Whitehead v. Food Max of Miss., Inc.*, 332 F.3d 796, 803 (5th Cir. 2003)(quoting *Cooter & Gell*) . Nonetheless, the trial court's discretion is necessarily limited by Rule 9011 itself.

Rule 9011(c)(2) prescribes the sanctions that may be imposed for violations of the rule:

> "A sanction imposed for violation of this rule *shall be limited to what is sufficient to deter repetition of such conduct or comparable conduct by others similarly situated.* Subject to the limitations in subparagraphs (A) and (B), *the sanction may consist of*, or include, directives of a nonmonetary nature, *an order to pay a penalty into court*, or, if imposed on motion and warranted for effective deterrence, an order directing payment to the movant of some or all of the reasonable attorneys' fees and other expenses incurred as a direct result of the violation."

(emphasis added). Rule 9011 thus expressly authorizes the Bankruptcy Court to order the payment of a penalty into the court. That penalty, however, must be limited to what is sufficient to deter repetition of the conduct either by the person being sanctioned or by others similarly situated.

On remand, the Bankruptcy Court's rulings were based on a thorough evidentiary record, including extensive exhibits and testimony from the Appellants regarding their respective backgrounds, employment, health, and financial conditions. *See especially* Transcript, at 13-34

(Mr. Wayland) and 34-43 (Mr. Byrd). Most important, the Bankruptcy Court carefully reviewed the Appellants' conduct as well as their understanding of that conduct and the deterrent function to be served by any sanction. *See* Memorandum Opinion, at 2-3, 13-14.

The Bankruptcy Court considered Mr. Wayland's apparent acceptance of responsibility and concluded that a $10,000 sanction, together with a State Bar Disciplinary proceeding that had been commenced against him, would be sufficient to deter others who were similarly situated. Memorandum Opinion at 14. This sanction was a sixty percent reduction of the previous, $25,000 sanction imposed on Mr. Wayland. More important, the sanction was the very same amount that Mr. Wayland himself offered to pay. September 18, 2007 Transcript, at 33-34, 82. Mr. Wayland's characterization of the sanction as a "scorch earth policy" in his Brief (at p. 6) is thus contradicted by his own testimony at trial. Consequently, this Court should conclude that the Bankruptcy Court did not abuse its discretion in imposing a sanction of that amount.

When determining Mr. Byrd's sanction, the Bankruptcy Court considered both his conduct and his financial condition. The Bankruptcy Court had previously imposed a $5,000 sanction on Mr. Byrd. Order, Tbyrd dkt. 82. On remand, the Bankruptcy Court considered his lack of remorse for his own improper conduct and, most important, his apparent failure to have ever inquired as to what he had done wrong. Transcript at 42-43; Memorandum Opinion at 13. While the Bankruptcy Court found that Mr. Byrd had limited financial means, the Court concluded that anything less that a $5,000 sanction would not have a sufficient deterrent effect on Mr. Byrd. *Id.* Insofar as the prior $5,000 sanction had not already caused Mr. Byrd to reflect seriously upon his actions in the Tbyrd, it can hardly be maintained that a lesser sum would have the required effect. This Court should therefore also conclude that the sanction of Mr. Byrd was also not an abuse of discretion.

II. THE BANKRUPTCY COURT DID NOT EXCEED ITS JURISDICTION BY IMPOSING "CRIMINAL CONTEMPT" SANCTIONS USING ITS INHERENT AUTHORITY

Mr. Wayland asserts that the Bankruptcy Court exceeded its authority by imposing "criminal contempt" sanctions using its inherent authority. Amended Brief, at xx, 3-8. The Bankruptcy Court, however, did not base its sanctions on its inherent authority, and only imposed sanctions under Rule 9011. Rule 9011 precisely defines the conduct that is subject to that rule, and it also prescribes the sanctions that a court may impose based on such conduct. The Bankruptcy Court followed the requirements of Rule 9011(c)(2) in imposing sanctions and, because the payment of penalties to the Bankruptcy Court is expressly authorized by Rule 9011(c)(2), the sanctions are not "criminal contempt" sanctions merely because they are payable to the Bankruptcy Court. Indeed, the Bankruptcy Court expressly determined that there was no criminal contempt and therefore declined to certify such an issue to this Court. The Bankruptcy Court therefore did not exceed its jurisdiction by imposing "criminal contempt" sanctions on the Appellants.

CONCLUSION

For these reasons, the United States Trustee respectfully asks this Court to affirm the Bankruptcy Court's ruling following remand.

Dated: May 27, 2008

Respectfully submitted,

Office of the United States Trustee
Department of Justice

Charles McVay
United States Trustee, Region 7

P. Matthew Sutko
Executive Office for United States Trustees
Department of Justice
20 Massachusetts Ave., N.W., Ste. 8000
Washington, D.C. 20530

Stephen Statham
Office of the U.S. Trustee
Department of Justice
Trial Attorney
515 Rusk Ave., Room 3516
Houston, TX 77002
Tel. 713-718-4650, x252
Fax. 713-718-4670
Stephen.Statham@usdoj.gov

T. Patrick Tinker
Office of the U.S. Trustee
Department of Justice
Trial Attorney
501 E. Polk St., Ste. 1200
Tampa, FL 33602
Tel. 813-228-2000
Fax. 813-228-2303
Thomas.P.Tinker@usdoj.gov

CERTIFICATE OF SERVICE

I certify that on this the 27th day of May 2088, true and correct copies of the BRIEF FOR APPELLEE, UNITED STATES TRUSTEE were served on the parties listed below by ECF or United States Mail:

By: /s/ Stephen D. Statham
Stephen D. Statham

Tim W. Byrd
P.O. Box 9033
College Station, Texas 77845

Thomas G. Wayland
1630 N. 10th Street
McAllen, Texas 78501

John E. Villegas
1616 E. Griffin Parkway, PMB 110
Mission, Texas 78572

Kelly K. McKinnis
612 Nolana Loop, Suite 240
McAllen, Texas 78504

Michael B. Schmidt
555 N. Carancahua, Suite 1550
Corpus Christi, Texas 78478

Mark Alan Twenhafel
2424 North 10th Street, Suite 200
McAllen, Texas 78501

Jose Gonzales
106 S 12th Ave., Suite 119-B
Edinburg, Texas 78539

BRIEF BANK — "SUMMARY SHEET" *Printed Wed-7/15/09 11:13*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	In re TByrd Enterprises, LLC (Thomas G. Wayland; Timothy W. Byrd v. United States Trustee Charles F. McVay)
2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	5th Cir.
3. ("CCN") ***CURRENT*** CASE NO.	No.: 08-41104
4. ("PCN") ***PRIOR*** CASE NO. - & COURT *[IF ANY]*	No.: 7:07-cv-304 Court: S.D. Tex. *(Identify judge & cite, if any)*
5. ("SO") ***SOURCE***	**U.S. TRUSTEES**
6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	Filed: July 14, 2009 Type: Brief for the United States Trustee as Appellee
7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*	Stephen D. Statham, John P. Sheahan, P. Matthew Sutko, Charles F. McVay *(UST/OGC: 202-307-1399/FAX-2397)*
8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	• Whether the bankruptcy court's order, which imposed sanctions under Rule 9011 against an attorney and his client for orchestrating a bad faith bankruptcy filing and evading the court's orders in another bankruptcy case, was supported by the evidence and within the court's subject matter jurisdiction.
10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)	
11. DO YOU RECOMMEND POSTING IN UST BRIEFBANK?	| x | YES | | NO ***NAME:*** Linda Figueroa ***DATE:***

Case No. 08-41104

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

In the Matter Of: TBYRD ENTERPRISES LLC

Debtor

THOMAS G. WAYLAND; TIMOTHY W. BYRD,

Appellants

v.

U S TRUSTEE CHARLES F. McVAY,

Appellee

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF TEXAS

BRIEF FOR THE UNITED STATES TRUSTEE
AS APPELLEE

RAMONA D. ELLIOTT
General Counsel
P. MATTHEW SUTKO
Associate General Counsel
JOHN P. SHEAHAN
Department of Justice
20 Massachusetts Avenue, NW
Washington, DC 20530
Telephone: (202) 307-1399
Facsimile: (202) 307-2397
email: john.sheahan@usdoj.gov

CHARLES F. MCVAY
United States Trustee
STEPHEN D. STATHAM
Department of Justice
515 Rusk, Suite 3516
Houston, Texas 77002
Telephone: (713) 718-4650
Facsimile: (713) 718-4680

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JURISDICTIONAL STATEMENT

On December 7, 2007, the United States Bankruptcy Court for the Southern District of Texas entered orders imposing civil sanctions against appellants Thomas G. Wayland and Timothy W. Byrd pursuant to Fed. R. Bankr. P. 9011. The bankruptcy court had jurisdiction over that proceeding under 28 U.S.C. §§ 157 and 1334. On December 17, 2007, Mr. Wayland and Mr. Byrd filed timely notices of appeal to the United States District Court for the Southern District of Texas under 28 U.S.C. § 158(c)(2) and Fed. R. Bankr. P. 8002(a). On September 30, 2008, the district court entered a final order affirming the orders of the bankruptcy court. On October 10, 2008, Mr. Wayland and Mr. Byrd filed timely notices of appeal to this Court under Fed. R. App. P. 4(a)(1)(B). This Court has jurisdiction pursuant to 28 U.S.C. §§ 158(d)(1) and 1291.

STATEMENT OF THE ISSUES PRESENTED FOR REVIEW

Although Mr. Wayland's brief purports to identify seven issues on appeal, his opening brief, which was subsequently adopted by Mr. Byrd, consolidates those seven issues into the following four distinct questions:

1. Did the bankruptcy court commit clear error when it concluded that Mr. Wayland violated Fed. R. Bankr. P. 9011?

2. Did the bankruptcy court have subject matter jurisdiction under 28

U.S.C. §§ 157 and 1334 to enter a final order sanctioning Mr. Wayland under Fed. R. Bankr. P. 9011?

3. Did the sanctions order entered by the bankruptcy court under Fed. R. Bankr. P. 9011 constitute a finding of criminal contempt, which the bankruptcy court lacked authority to determine?

4. Did the district court lack jurisdiction to remand the bankruptcy court's initial order for further proceedings regarding monetary sanctions, under the rule announced by this Court in *United States v. Coscarelli*, 149 F.3d 342 (5th Cir. 1998) (en banc)?

STATEMENT OF THE CASE

On January 3, 2006, TByrd, Enterprises, LLC ("TByrd") filed a voluntary petition for relief in the United States Bankruptcy Court for the Southern District of Texas under chapter 11 of the United States Bankruptcy Code, 11 U.S.C. §§ 101-1532 (the "Bankruptcy Code"). [TByrd Dkt. 1].[1] Mr. Wayland and Mr. Byrd each signed TByrd's chapter 11 petition. [*Id.*]. On February 8, 2008, the bankruptcy court issued an order to show cause why Mr. Wayland and Mr. Byrd

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[1] "BFG Dkt. _" indicates documents filed in the docket of the adversary proceeding *BFG Investments, L.L.C. v. Texas State Bank*, Adv. No. 05-07029. "TByrd Dkt. __" indicates documents filed in the docket of the chapter 11 case In re TByrd Enterprises, L.L.C. , No. 06-30078. "Dist. Ct. Dkt. __" indicated documents filed in the appellate proceedings before the United States District Court for the Southern District of Texas, cases no. 06-00087 and 07-00304.

should not be sanctioned for filing the TByrd bankruptcy petition in bad faith. [TByrd Dkt. 39]. On March 13, 2006, following an evidentiary hearing, the bankruptcy court issued orders imposing monetary and non-monetary sanctions against Mr. Wayland and Mr. Byrd. [TByrd Dkt. 82, 83]. On March 30, 2007, the district court entered an order affirming the bankruptcy court's factual findings and the non-monetary sanctions, but remanding the matter for further proceedings regarding the monetary portion of the sanctions order. [Dist. Ct., Case No. 06-00087, Dkt. 58]. On December 7, 2007, following an additional evidentiary hearing on remand, the bankruptcy court again imposed civil monetary sanctions against Mr. Wayland and Mr. Byrd under Fed. R. Bankr. P. 9011. [TByrd Dkt. 172, 174]. On September 30, 2008, the district court affirmed the bankruptcy court's order following remand. [Dist. Ct., Case No. 07-00304, Dkt. 29]. This appeal followed.

STATEMENT OF THE FACTS

_____This appeal arises out of a scheme to circumvent the authority of the United States Bankruptcy Court in one case through the filing of a bad faith chapter 11 petition in another case. The bankruptcy court imposed modest monetary sanctions against Mr. Wayland and Mr. Byrd after determining that they were willing participants in that scheme, and Mr. Wayland and Mr. Byrd now appeal from that order.

1. Mr. Wayland and Mr. Byrd participate in a scheme to circumvent the authority of the bankruptcy court through the unauthorized transfer of estate assets.

In March 1, 2005, BFG Investments, LLC ("BFG") filed a petition for chapter 11 relief in the United States Bankruptcy Court for the Southern District of Texas, docketed as case no. 05-70173. At the time of its bankruptcy filing, BFG was a real estate investment company that owned certain properties encumbered by liens in favor of Texas State Bank ("TSB"). *See* Mar. 8, 2006 Tr. at 93 [TByrd Dkt. 100] (testimony of Mr. Villegas). John E. Villegas was the equity owner and principal manager of BFG. *Id.* at 92. BFG was represented by Kelly K. McKinnis as its bankruptcy counsel. *Id.* at 149 (testimony of Mr. McKinnis).

On April 11, 2005, the bankruptcy court entered an agreed order authorizing BFG to use collateral in which TSB had a security interest, subject to certain conditions designed to protect the interests of TSB. [BFG Dkt. 10, Ex. 1]. Although 11 U.S.C. § 362(a) ordinarily prohibits secured creditors from exercising any remedies against the property of debtors in bankruptcy, one of the terms of the cash collateral order was that a default by BFG would permit TSB to proceed with a foreclosure action without any further action by the bankruptcy court. [*Id.*].

After BFG violated the cash collateral agreement by failing to maintain insurance on the properties subject to TSB's security interest, TSB declared BFG in default and posted those properties for foreclosure pursuant to the terms of that order. In response, BFG obtained an *ex parte* temporary restraining order in state court that enjoined the foreclosure. TSB then removed BFG's state court injunction action to the bankruptcy court, which issued an agreed temporary stay and scheduled a hearing on BFG's request for a preliminary injunction for January 3, 2006, at 8:30 a.m. [BFG Dkt. 12].

Mr. Villegas later testified that he prepared to place BFG's property beyond the reach of TSB if, as seemed likely, the bankruptcy court denied his request for injunctive relief. *See* Mar. 8, 2006 Tr. at 94 (testimony of Mr. Villegas). Mr. Villegas's plan was to "buy some time" by engineering an undisclosed sale of virtually all of BFG's assets to a third party, which would immediately file a bankruptcy petition of its own. *Id.* at 100. Mr. Villegas apparently hoped that his stratagem would delay TSB's ability to exercise its foreclosure rights, since the purchaser's bankruptcy filing would give rise to a fresh automatic stay under 11 U.S.C. § 362(a) from which TSB would be forced to seek relief.[2]

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[2] Section 362(a) of the Bankruptcy Code provides that the filing of a bankruptcy petition "operates as a stay, applicable to all entities, of . . . any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate." 11 U.S.C. § 362(a)(3). As a result, a secured creditor generally may not enforce its state law foreclosure remedies against property in the debtor's possession unless, after notice and a hearing, it obtains an order from the bankruptcy court granting it relief from the automatic stay. 11 U.S.C. § 362(d).

Mr. Villegas's strategy had at least one major flaw. As the bankruptcy court later concluded, it violated the Bankruptcy Code and gave rise to possible criminal violations. [TByrd Dkt. 79 at 12-13]. Under 11 U.S.C. § 363, bankruptcy debtors are prohibited from disposing of assets outside the ordinary course of business absent bankruptcy court approval, which Mr. Villegas did not seek to obtain. The diversion of assets from a bankruptcy estate is also a federal criminal offense under 18 U.S.C. § 152, which prohibits the transfer or receipt of property with the intent of defeating the provisions of the Bankruptcy Code. In addition, under 18 U.S.C. § 157, it is a crime to file a bankruptcy petition for the purpose of executing or concealing a fraud.

In the days leading up to the January 3, 2006 hearing, Mr. Villegas sought to recruit partners who would assist his scheme by taking title to the BFG assets. *Id.* at 97. Mr. Villegas found such partners in Mr.Wayland and Mr. Byrd. Mr. Wayland is an attorney whose practice includes the acquisition of distressed properties on behalf of foreign investors. *Id.* at 27 (testimony of Mr. Wayland). Mr. Byrd was a former client and occasional employee of Mr. Wayland who owned TByrd, a dormant corporate shell that, as of late 2005, had no assets or business. *Id.* at 83-84, 87 (testimony of Mr. Byrd). On or about December 31, 2005, Mr. Byrd sold the TByrd shell for $1,000 to a foreign client of Mr. Wayland.

Id. at 85. Mr. Wayland made this purchase under a power of attorney that authorized him to locate and invest in assets on his client's behalf. *Id.* at 29, 32 (testimony of Mr. Wayland).

During the night of January 2, 2006, on the eve of the bankruptcy court's hearing on BFG's motion for an injunction, Mr. Villegas and Mr. Wayland reached an agreement for BFG to sell substantially all of its assets to TByrd in exchange for a promissory note and deed of trust. *Id.* at 23. Mr. Wayland negotiated this sale despite the fact that he was aware both that BFG was a debtor in a bankruptcy case, and that a preliminary injunction hearing regarding those same assets was scheduled for the next morning. *Id.* at 25-26.

Mr. Byrd, acting at Mr. Wayland's direction, signed the deed of trust and promissory note as president of TByrd. *Id.* at 85-86 (testimony of Mr. Byrd). Mr. Byrd testified that he agreed to execute these documents in return for Mr. Wayland's promise to pay him $1,500 and to hire him at $20 per hour for website design services. *Id.* at 66 (testimony of Mr. Wayland); 86 (testimony of Mr. Byrd).

2. Immediately after acquiring the assets of BFG, Mr. Wayland and Mr. Byrd cause TByrd to file its own bankruptcy petition.

At the injunction hearing held on January 3, 2006, Mr. Villegas testified but did not disclose to the bankruptcy court that BFG had purportedly sold the properties on which TSB was seeking to foreclose. *Id.* at 126 (testimony of Mr. Villegas). At that hearing, the bankruptcy court concluded that BFG had breached its agreement with TSB, lifted its temporary stay, and denied BFG's request for an injunction. [BFG Dkt. 14]. As he left the hearing, Mr. Villegas telephoned Mr. Wayland and demanded that he immediately place TByrd into bankruptcy. *See* Mar. 8, 2006 Tr. at 39 (testimony of Mr. Wayland). Mr. Wayland complied with this request, and at 9:55 a.m. on January 3, 2006, TByrd filed a petition for chapter 11 bankruptcy relief, just five minutes before the start of the scheduled foreclosure sale of the BFG properties. [TByrd Dkt. 1].

At the time that it filed for chapter 11 relief, TByrd had no capital, no employees, and no books and records. TByrd's only assets were the properties it acquired within hours of its bankruptcy filing, and its only debt was the promissory note it issued in connection with that transaction. As the bankruptcy court later concluded, the "sole purpose" of the TByrd bankruptcy petition was "to achieve delay and to find a way to avoid the effects of the orders issued in BFG's bankruptcy case." [TByrd Dkt. 79 at 15] .

The TByrd bankruptcy petition also contained at least two misstatements that had the effect of concealing the true roles of Mr. Wayland and Mr. Byrd. Mr.

Wayland signed the chapter 11 petition as TByrd's attorney, without disclosing that he held a power of attorney that effectively made him TByrd's sole decision maker. Had Mr. Wayland disclosed this fact, he would have been precluded from acting as TByrd's attorney under section 327 of the Bankruptcy Code, which provides that only attorneys who are disinterested may represent chapter 11 debtors.[3] The TByrd petition was also signed by Mr. Byrd, who inaccurately represented that he was the "managing member" of TByrd. [TByrd Dkt. 1].

TSB learned of the sale of the BFG assets and TByrd's bankruptcy at approximately 11:30 a.m. on January 3, 2006, when, at Mr. Wayland's direction, a legal assistant employed by Mr. McKinnis met the representatives of TSB at the foreclosure sale and presented them with a copy of the deed to TByrd and the TByrd bankruptcy petition. *See* Mar. 8, 2006 Tr. at 44 (testimony of Mr. Wayland). As a result of Mr. Wayland's actions, the foreclosure sale of the BFG properties did not go forward. *Id*.

On January 9, 2006, TSB filed a motion in the TByrd bankruptcy case

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[3] Under section 327 of the Bankruptcy Code, a chapter 11 debtor may employ attorneys "that do not hold or represent an interest adverse to the estate, and that are disinterested." 11 U.S.C. §327(a). The Bankruptcy Code further defines "disinterested person" as a person who, among other things, is not an "insider" of the debtor. 11 U.S.C. §101(14)(A). The term "insider," in turn, includes a "person in control of the debtor" if the debtor is a corporation or partnership. 11 U.S.C. §101(31)(B)(iv), (C)(v). The bankruptcy court found, and Mr. Wayland appears not to dispute, that Mr. Wayland was not "disinterested" and was consequently ineligible for employment as an attorney under these provisions. [TByrd Dkt. 79 at 10].

seeking relief from the automatic stay in order to take possession of the BFG assets. [TByrd Dkt. 11]. Despite the fact that the BFG assets were also the only assets of TByrd, Mr. Wayland did not appear at the hearing on TSB's motion and did not file any opposition to TSB's request for relief. On January 10, 2006, the TByrd bankruptcy court entered orders granting TSB's motion and giving TSB immediate possession of the properties illegally transferred to TByrd. [TByrd Dkt. 12, 13].

3. The bankruptcy court sanctions the participants in the BFG-TByrd transactions, including Mr. Wayland and Mr. Byrd.

On January 25, 2006, the United States Trustee filed a motion in the TByrd bankruptcy case for an order to show cause why TByrd, BFG, Mr. Byrd, Mr. Wayland, Mr. Villegas, and Mr. McKinnis should not be sanctioned pursuant to Fed. R. Bankr. P. 9011 ("Rule 9011") for their misconduct relating to BFG and TByrd. [TByrd Dkt. 79].[4] On February 8, 2006, the bankruptcy court granted the United States Trustee's motion and scheduled an evidentiary hearing for March 8,

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[4] The United States Trustee Program is the component of the Department of Justice that enforces federal bankruptcy law. *See* H.R. Rep. No. 95-595 at 110 (1977) (describing United States Trustees' "obligation to execute and enforce the bankruptcy laws"). Among other duties, United States Trustees are authorized to commence "proceedings in the bankruptcy courts in particular cases in which a particular action taken or proposed to be taken deviate[d] from the standards established by the . . . bankruptcy code." H.R. Rep. No. 95-989 at 88, 109 (1977), *quoted in In re A-1 Trash Pickup*, 802 F.2d 774, 775 (4th Cir. 1986). The United States Trustee may raise and be heard on any issue in any chapter 11 case. *See* 11 U.S.C. § 307.

2006 on whether sanctions should be issued. [TByrd Dkt. 39]. At that hearing, the bankruptcy court heard sworn testimony from Mr. Wayland, Mr. Byrd, Mr. Villegas, and Mr. McKinnis regarding the circumstances of the sale of BFG's assets to TByrd and the subsequent TByrd bankruptcy filing.

On March 13, 2006, the bankruptcy court issued an order imposing sanctions against all four individual respondents (the "First Sanctions Order"). [TByrd Dkt. 79].[5] That order contained, among other things, the following findings of fact relating to Mr. Wayland and Mr. Byrd, none of which Mr. Wayland and Mr. Byrd appear to dispute:

- Acting through his power of attorney, Mr. Wayland was "the principal business decision maker and the sole lawyer" for TByrd at all times relevant to the events in question. Mr. Wayland made the decisions to have TByrd acquire BFG's assets and file a bankruptcy petition. *Id.* at 8.
- Although Mr. Wayland knew that BFG was a debtor in bankruptcy and was aware of the preliminary injunction hearing, he "conducted no investigation into whether the Bankruptcy Court had authorized the sale of BFG's assets."

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[5] Due to a clerical error by the clerk of the bankruptcy court, the First Sanctions Order initially was entered on the docket of the BFG preliminary injunction proceeding, and it was from that order that Mr. Wayland and Mr. Byrd appealed. On March 29, 2006, the clerk of the bankruptcy court corrected its error and entered the First Sanctions Order on the TByrd bankruptcy docket.

Id. at 10.

- TByrd's bankruptcy petition, which stated that Mr. Byrd was TByrd's "Managing Member," was false because Mr. Wayland, and not Mr. Byrd, was the only person with actual authority over TByrd. *Id.* at 10.
- Mr. Wayland signed the TByrd bankruptcy petition as its attorney despite the fact that, as the person in control of TByrd, he was not "disinterested" and therefore ineligible to serve as counsel to a chapter 11 debtor under 11 U.S.C. § 327. Mr. Wayland failed to disclose his true relation to TByrd to the bankruptcy court. *Id.*
- Mr. Byrd signed the documents relating to TByrd's purchase of the BFG assets and the factually inaccurate TByrd bankruptcy petition without conducting any investigation. Instead, Mr. Byrd, who understood that he was being used as a straw man, "blindly did as instructed by Mr. Wayland." *Id.* at 11. Mr. Byrd did so "in exchange for money" because Mr. Wayland had promised to retain him as a consultant for TByrd. *Id.* at 22. Despite his claims of ignorance, Mr. Byrd was a "willing actor" in the BFG-TByrd fraud. *Id.* at 11.

The bankruptcy court imposed monetary sanctions of $25,000 against Mr. Villegas, $25,000 against Mr. Wayland, $5,000 against Mr. Byrd, and $5,000 against Mr. McKinnis. *Id.* at 19-23. In Mr. Wayland's case, the bankruptcy court further found that his conduct would have justified a much higher sanction, but exercised its discretion to impose a smaller sanction based on Mr. Wayland's limited financial resources. *Id.* at 21. In addition, the bankruptcy court issued an injunction requiring Mr. Villegas and Mr. Byrd to obtain advance, written court approval before filing any future bankruptcy petitions. The bankruptcy court referred Mr. Wayland and Mr. McKinnis to the state and federal bar authorities for possible professional discipline, and issued a criminal referral of Mr. Wayland and Mr. Villegas to the United States Attorney. *Id.* at 19, 22.[6]

Although the United States Trustee's motion to show cause had requested sanctions under Rule 9011, the First Sanctions Order appeared to rely on a separate source of sanctioning authority, the inherent powers of the bankruptcy court. *See Chambers v. NASCO, Inc.*, 501 U.S. 32 (1991). The First Sanctions Order did not expressly reach the issue of whether sanctions were also appropriate under Rule 9011.

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[6] The bankruptcy court referred Mr. Villegas and Mr. Wayland to the United States Attorney pursuant to 18 U.S.C. § 3057, which requires a bankruptcy judge to report criminal conduct to the United States attorney whenever he has a "reasonable grounds for believing" that a party has committed a federal bankruptcy crime under 18 U.S.C. §§ 151-158.

4. On remand, the bankruptcy court issues a second order clarifying the basis for the civil monetary sanctions against Mr. Wayland and Mr. Byrd.

All sanctioned parties except Mr. McKinnis appealed the First Sanctions Order to the United States District Court. The United States filed a brief in partial support of the bankruptcy court's ruling. [Dist. Ct., Case No. 06-00087, Dkt. No. 44]. Although the United States defended the bankruptcy court's factual findings, it requested that the district court remand the case in order for the bankruptcy court to clarify the basis for its ruling in light of *In re Hipp, Inc.*, 895 F.2d 1503, 1509 (5th Cir. 1990), a decision by this Court that limits the power of bankruptcy courts in this circuit to impose criminal penalties under its inherent powers. Accordingly, the United States requested the district court order remand in order for the bankruptcy court to determine whether it could order civil sanctions under Rule 9011.

The district court conducted a consolidated hearing on the appeals on March 29, 2007. On March 30, 2007, the district court affirmed the First Sanctions Order with the exception of the portion of that order that imposed monetary sanctions. [Dist. Ct., Case No. 06-00087, Dkt. No. 58]. The district court remanded the order to the bankruptcy court to consider two issues: (1) whether civil monetary sanctions should be assessed, and (2) whether any criminal contempt issue should be certified to the district court.

Mr. Wayland and Mr. Byrd filed a motion for rehearing in the district court and a motion to stay the remand to the bankruptcy court, both of which the district court denied. [Dist. Ct., Case No. 06-00087, Dkt. No. 83, 84]. Mr. Wayland and Mr. Byrd subsequently attempted to appeal the district court's interlocutory order denying rehearing to this Court. This Court dismissed that appeal due to lack of jurisdiction on August 18, 2008.

On remand, the bankruptcy court conducted a further evidentiary hearing to consider sanctions against Mr. Villegas, Mr. Wayland, and Mr. Byrd. On December 7, 2007, after hearing the evidence and arguments, the bankruptcy court issued an order in which it clarified that the basis for the civil monetary sanctions against Mr. Wayland and Mr. Byrd was Rule 9011, and declined to certify a criminal contempt matter to the district court (the "Second Sanctions Order"). [TByrd Dkt. 171]. The court withdrew the monetary sanction against Mr. Villegas and reduced Mr. Wayland's Rule 9011 sanction to $10,000, based on his perceived remorse. Because the bankruptcy court concluded that Mr. Byrd's remorse was not sincere, it did not reduce the $5,000 sanction against Mr. Byrd.

On September 30, 2008, the district court affirmed the Second Sanctions Order. [Dist. Ct., Case No. 07-00304, Dkt. 29]. On October 10, 2008, Mr.

Wayland and Mr. Byrd filed a timely notice of appeal to this Court.[7]

STATEMENT OF THE STANDARD OF REVIEW

This Court reviews the district court's affirmance of the bankruptcy court's Rule 9011 order "by applying the same standard of review to the bankruptcy court decision that the district court applied." *In re Martinez*, 564 F.3d 719, 725 (5th Cir. 2009). Accordingly, this Court reviews the bankruptcy court's conclusions of law *de novo*. *In re First City Bancorporation of Texas, Inc.*, 282 F.3d 864, 867 (5th Cir. 2002). The bankruptcy court's findings of fact must be upheld unless they are clearly erroneous. *Id.* The Court reviews the bankruptcy court's decision to impose sanctions under Rule 9011 for abuse of discretion. *Id.* Under that standard, the bankruptcy court's sanctions must be upheld unless this Court determines that the bankruptcy court's ruling "is based on an erroneous view of the law or on a clearly erroneous assessment of the evidence." *Id.* (internal citation omitted).

SUMMARY OF ARGUMENT

The bankruptcy court did not err by imposing Rule 9011 sanctions against Mr. Wayland and Mr. Byrd. As the undisputed evidence of this case demonstrates, Mr. Wayland and Mr. Byrd engaged in a serious abuse of the

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[7] Mr. Villegas did not appeal the Second Sanctions Order and is not a party to this appeal.

bankruptcy process, first by assisting Mr. Villegas in his unlawful scheme to conceal the assets of BFG, and afterwards by filing an inaccurate bankruptcy petition in a bad faith effort to frustrate the bankruptcy court's order permitting TSB to foreclose on its collateral. Under these circumstances, the bankruptcy court did not abuse its discretion in concluding that monetary Rule 9011 sanctions were warranted.

Mr. Wayland and Mr. Byrd have not demonstrated that the bankruptcy court's finding that they violated Rule 9011 was clearly erroneous. The bankruptcy court made numerous specific and independent factual findings regarding the intentional nature of Mr. Wayland and Mr. Byrd's misconduct, all of which are amply supported by the sworn testimony and evidence in the record below. Mr. Wayland and Mr. Byrd have not identified any instance in which the bankruptcy court misconstrued a fact or overlooked relevant evidence. Furthermore, despite their attempt to portray the decision to place TByrd into bankruptcy as a legitimate legal tactic that was made in good faith, there was a sufficient evidentiary basis for the bankruptcy court to conclude otherwise. Accordingly, there is no basis to overturn the bankruptcy court's factual findings regarding Mr. Wayland and Mr. Byrd's misconduct.

The bankruptcy court had subject matter jurisdiction to sanction Mr.

Wayland and Mr. Byrd. Under the bankruptcy jurisdictional scheme established by title 28, United States Code, a proceeding for sanctions under Rule 9011 is considered to be a matter which "aris[es] in" a bankruptcy case, and is therefore a matter for which bankruptcy courts are authorized to issue final orders under 28 U.S.C. §§ 157 and 1334.

Mr. Wayland and Mr Byrd misconstrue the record of this case by their argument that the sanctions entered against them constitute an impermissible criminal contempt order. As the bankruptcy court made abundantly clear in the Second Sanctions Order, the sanctions are based on Rule 9011, not on any theory of criminal contempt, and the bankruptcy court expressly declined to certify any matter for a criminal contempt prosecution. Moreover, to the extent Mr. Wayland and Mr. Byrd argue that any Rule 9011 sanction that is payable to the clerk of the court automatically must be recharacterized as a criminal contempt judgment, such theory is devoid of legal support and lacks merit.

Finally, Mr. Wayland and Mr. Byrd's assertion that the bankruptcy court was precluded from sanctioning them on remand because of the United States' failure to appeal from the First Sanctions Order lacks merit. The First Sanctions Order did not result in any adverse judgment from which the United States could have appealed, and the district court had jurisdiction to order a remand for clarification regarding an issue that was raised but not addressed in the First Sanctions Order.

ARGUMENT

A. THE BANKRUPTCY COURT'S FINDING THAT MR. WAYLAND AND MR. BYRD VIOLATED RULE 9011 WAS NOT CLEARLY ERRONEOUS

1. The record supports the bankruptcy court's determination that Mr. Wayland and Mr. Byrd filed the TByrd bankruptcy petition for an improper purpose.

Under Rule 9011, parties and attorneys are liable for sanctions if they present a "petition pleading, . . . or other paper" to the court that is filed for an "improper purpose," that is frivolous or factually unsupported, or that is filed without reasonable inquiry. Fed. R. Bankr. P. 9011(a), (b). Like any other pleading, the filing of a bankruptcy petition is subject to Rule 9011, and the filing of a false or abusive petition is among the conduct that may trigger Rule 9011 sanctions. *See In re Thomas*, 223 Fed. App'x 310, 315 (5th Cir. 2007) (affirming sanctions under Rule 9011 against attorney who filed bankruptcy petition for improper purpose).

Among other circumstances, this Court has recognized that Rule 9011 sanctions are appropriate where a bankruptcy petition is filed for the purpose of the "hindrance and delay" of creditors . . . and "without any bona fide reorganization intent." *In re Bourroughs*, 240 F.3d 1074, 2000 WL 1835304 (5th Cir. Nov. 30, 2000). The bankruptcy court correctly found that both circumstances were present in this case. As Mr. Wayland's own testimony demonstrates, the filing of the TByrd bankruptcy petition was in response to the decision of the bankruptcy court that cleared the way for TSB to conduct its foreclosure sale of the properties that had been illegally acquired by TByrd. That filing had the sole purpose and, at least in the short term, the effect of hindering TSB from realizing the relief it had obtained from the bankruptcy court.

Although Mr. Wayland and Mr. Byrd do not suggest any other motive for filing the TByrd bankruptcy petition, they dispute the bankruptcy court's conclusion that TByrd never had any legitimate reorganization purpose. Rather, Mr. Wayland and Mr. Byrd argue that "there was an extremely high probability of a successful reorganization," but for the bankruptcy court's action in awarding possession of the BFG properties to TSB. (Br. 11). As such, Mr. Wayland and Mr. Byrd argue that it was this action of the bankruptcy court, and not any misconduct by Mr. Wayland or Mr. Byrd, that "caused the harm to the creditors" in this case. *Id.*

Mr. Wayland and Mr. Byrd's suggestion that TByrd had a "high probability" of reorganization finds no support in the evidence. TByrd had no business and, outside of any claims against it arising from the BFG transaction, no creditors.[8] TByrd's only assets were the properties it had illegally acquired from BFG, which were the subject of a pending foreclosure proceeding. Despite this, TByrd never opposed TSB's motion for immediate possession of the BFG properties, and Mr. Wayland himself advised TSB that TByrd would consent to that relief. As the bankruptcy court correctly noted, had Mr. Wayland sincerely intended to reorganize TByrd, his complete inaction in response to the TSB motion would be inexplicable.

At best, Mr. Wayland and Mr. Byrd's apparent business plan consisted of nothing more than an attempt to force TSB to renegotiate for relief it had already obtained while TByrd retained assets that it had acquired illegally. Mr. Wayland and Mr. Byrd fail to explain why this strategy should be treated as a legitimate reorganization tactic. For this reason, Mr. Wayland and Mr. Byrd's contention that the TByrd bankruptcy petition suffered from only "a technical or procedure [sic] shortcoming" has no merit. (Br. 12). In any event, the bankruptcy court did

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[8] Because of this, Mr. Wayland and Mr. Byrd's repeated insistence that their reorganization strategy would have enable all creditors to be "paid in full" is particularly disingenuous. At most, TByrd's creditors would have consisted of BFG and TSB. Because BFG's claim arose from the sale of property that it had no right to sell, its right to any payment from TByrd was, at the very best, highly questionable. In any event, Mr. Wayland and Mr. Byrd do not explain how continued evasion of the bankruptcy court's order permitting foreclosure would have benefitted TSB.

not commit clear error by rejecting Mr. Wayland and Mr. Byrd's justification of their behavior, and its factual finding that Mr. Wayland and Mr. Byrd acted in bad faith should be affirmed on appeal.

2. Mr. Wayland and Mr. Byrd's Rule 9011 violation is not excused by their claim that no party was harmed by their misconduct.

In the alternative, Mr. Wayland and Mr. Byrd contend that the bankruptcy court should not have sanctioned them for filing a bad faith bankruptcy petition "without a showing of detriment to the bankruptcy estate or its creditor/s." (Br. 12). The fraudulent transactions involving BFG and TByrd were not, however, a victimless wrong. Rather, as the record reflects, Mr. Wayland and Mr. Byrd's filing of a bad faith bankruptcy petition forced TSB to endure an unwarranted additional delay before it could exercise its foreclosure remedies, and forced TSB to incur additional expenses and risk before it could unwind the fraudulent sale of BFG's assets. In addition, the bankruptcy court itself was harmed by Mr. Wayland and Mr. Byrd's misconduct. By filing a frivolous chapter 11 petition, Mr. Wayland and Mr. Byrd caused an unnecessary drain on judicial resources, and forced the bankruptcy court to expend considerable time and attention disposing of TByrd's bankruptcy case. In this case, the harm to both TSB and the court system was a sufficient basis for sanctions. *See In re Merrill*, 192 B.R. 245, 251

(Bankr. D. Colo. 1995) (noting that one of the purposes of Rule 9011 is to deter abusive filings that consume scarce judicial resources).

Even if this Court were to accept Mr. Wayland and Mr. Byrd's contention that no party was harmed by their misconduct, moreover, this would not negate their violation of Rule 9011. One principal purpose of Rule 9011 is deterrence, *see Smith Int'l, Inc. v. Texas Commerce Bank*, 844 F.2d 1193, 1197 (5th Cir. 1988), and actual damages are not a prerequisite to liability under that rule. In this case, the sanctions ordered by the bankruptcy court are intended to deter, not compensate. As a result, Mr. Wayland and Mr. Byrd's contention that no party was harmed has no relevance to the issue of whether their conduct violated Rule 9011.

3. In the alternative, the bankruptcy court's undisputed findings that Mr. Wayland and Mr. Byrd failed to conduct a reasonable investigation and filed a factually inaccurate petition are each an independent basis for Rule 9011 liability.

Finally, although Mr. Wayland and Mr. Byrd dispute the bankruptcy court's finding that they filed the TByrd petition for an improper purpose, that was only one of several independent findings on which the bankruptcy court based its Rule 9011 sanction. In particular, the bankruptcy court also found that Mr. Wayland and Mr. Byrd failed to conduct a reasonable investigation prior to filing the TByrd bankruptcy petition, and that Mr. Wayland and Mr. Byrd misstated facts on that petition. [TByrd Dkt. 79 at 10]. Mr. Wayland and Mr. Byrd do not challenge either of these findings on appeal. Under Rule 9011, each of these findings is an independently sufficient basis for sanctions. *See* Fed. R. Bankr. P. 9011(b), (c)(3); *In re Tucker*, 224 F.3d 766, 2000 WL 992448 (5th Cir. June 28, 2000) (unpublished decision) (affirming Rule 9011 sanction against attorney who filed reaffirmation agreement without conducting any investigation of whether agreement was valid); *Thomas*, 223 Fed. App'x at 314 (affirming Rule 9011 sanction against attorney who filed false bankruptcy petition).

As a result, even if this Court were to accept Mr. Wayland and Mr. Byrd's factually unsupported assertion that they filed the TByrd bankruptcy petition in good faith, they have not demonstrated any basis for disturbing the bankruptcy court's ruling that they violated Rule 9011.

B. UNDER 28 U.S.C. §§ 157 AND 1334, THE BANKRUPTCY COURT HAD CORE SUBJECT MATTER JURISDICTION TO IMPOSE RULE 9011 SANCTIONS AGAINST MR. WAYLAND AND MR. BYRD.

In this case, the monetary sanctions imposed by the bankruptcy court are specifically authorized by Rule 9011. *See* Fed. R. Bankr. P. 9011(c)(2) (listing "an order to pay a penalty into court" among sanctions that may be ordered by the bankruptcy court). Mr. Wayland and Mr. Byrd argue that this rule violates the jurisdictional scheme established by 28 U.S.C. § 1334 to the extent that it permits the bankruptcy judge, an Article I judge, to impose monetary sanctions. (Br. 3-4). Mr. Wayland and Mr. Byrd's argument, for which they offer no pertinent support, appears to be based on a mistaken reading of the bankruptcy jurisdictional statutes. In any event, this Court has consistently recognized that bankruptcy judges have jurisdiction to issue final orders that sanction misconduct in their own proceedings, and Mr. Wayland and Mr. Byrd offer no persuasive reason to depart from this long-established principle.

Congress enacted the jurisdictional scheme set forth in section 1334 of title 28 in response to the Supreme Court's decision in *Northern Pipeline Constr. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50 (1982). That section specifies that district courts have original and exclusive jurisdiction over all cases under title 11. *See* 28 U.S.C. § 1334. In addition, district courts have original bankruptcy subject matter jurisdiction over three types of civil proceedings: (1) matters "arising under title 11," (2) matters "arising in" a bankruptcy case, and (3) matters "related to" a bankruptcy case. 11 U.S.C. § 1334(b).[9] The significance of this classification is

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[9] Under 28 U.S.C. § 157(a) and District Court General Order 2005-6, all "arising in," "arising under," and "related to" bankruptcy proceedings in the Southern District of Texas are automatically referred to the bankruptcy court.

that under 28 U.S.C. § 157(b)(1) and (c)(1), “arising under” and “arising in” matters are treated as “core” bankruptcy matters, for which the bankruptcy court can enter a final judgment, while “related to” matters are non-core proceedings in which the bankruptcy court’s power is limited to submitting proposed findings of fact and conclusions of law to the district court, unless all parties consent to its entry of a final judgment. *See In re Allegheny Health, Education and Research Foundation*, 383 F.3d 169, 175 (3d Cir. 2004).

In this case, Mr. Wayland and Mr. Byrd presume, without explanation, that a Rule 9011 sanctions proceeding falls within the bankruptcy court’s “related to” jurisdiction, but that it is not a “core” bankruptcy matter involving the restructuring of debtor-creditor relations. (Br. 3). This presumption is mistaken. As this Court has previously observed, “[a] *sine qua non* in restructuring the debtor-creditor relationship is the court’s ability to police the fiduciaries . . . who are responsible for managing the debtor’s estate in the best interest of creditors.” *In re Southmark Corp.*, 163 F.3d 925, 931 (5th Cir. 1999) (holding that lawsuit alleging malpractice by attorneys of chapter 11 debtors was core). In particular, by its own terms, Rule 9011 only relates to misconduct that occurs in connection with a bankruptcy case, and a Rule 9011 proceeding cannot exist outside of bankruptcy. For this reason, a Rule 9011 sanction is a paradigmatic example of an "arising in" matter over which the bankruptcy court exercises core subject matter jurisdiction. *See In re U.S. Brass Corp.*, 301 F.3d 296, 304 (5th Cir. 2002) (defining "arising in" matter as "a proceding that, by its nature, could arise only in the context of a bankruptcy case").

As a result, as every court to have considered the matter has agreed, sanctions proceedings are core matters over which bankruptcy judges have jurisdiction to issue final orders. *See In re Memorial Estates, Inc.*, 950 F.2d 1364, 1370 (7th Cir. 1991) (holding that motion for sanctions under Rule 9011 was core); *In re Menk*, 241 B.R. 896, 912 (B.A.P. 9th Cir. 1999) (same); *In re Akl*, 397 B.R. 546, 555 (Bankr. D.D.C. 2008) (same); *In re Kitchin*, 327 B.R. 337, 359 (Bankr. N.D. Ill. 2005) (same). This conclusion, moreover, is consistent with numerous decisions of this Court affirming sanctions orders by bankruptcy courts. *See In re Yorkshire, LLC*, 540 F.3d 328, 333 (5th Cir. 2008) (affirming award of sanctions pursuant to bankruptcy court's inherent powers); *In re Williams*, 226 Fed. App'x 384, 388 (5th Cir. 2007) (affirming bankruptcy court order awarding Rule 9011 sanctions); *Thomas*, 223 Fed. App'x at 315 (same).[10] Accordingly,

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[10] In arguing that the Rule 9011 sancitons proceeding in this case was non-core, Mr. Wayland and Mr. Byrd rely on *In re Continental Air Lines*, 61 B.R. 758 (S.D. Tex. 1986), a case decided shortly after the enactment of the present bankruptcy jurisdictional system, which held that a bankruptcy court could not hold a non-debtor in civil contempt for filing a lawsuit in a separate forum in violation of an injunction that the bankruptcy court had improperly issued. *Continental* is not persuasive authority in the present case, for at least three reasons: first, the

there is no merit to Mr. Wayland and Mr. Byrd's argument that the bankruptcy court lacked subject matter jurisdiction to issue a final sanctions order against them.

C. MR. WAYLAND AND MR. BYRD'S ARGUMENT THAT THE BANKRUPTCY COURT LACKS CRIMINAL CONTEMPT POWER IS INAPPOSITE BECAUSE THE BANKRUPTCY COURT IMPOSED SANCTIONS UNDER RULE 9011 AND NOT THROUGH A CRIMINAL CONTEMPT PROCEEDING.

Following a remand that was ordered for the express purpose of clarifying the nature of the sanctions in this case, the bankruptcy court declined to certify this matter for criminal contempt and issued sanctions under the specific authority of Rule 9011(c). Despite this clarification, however, Mr. Wayland and Mr. Byrd continue to characterize the sanctions against them as "akin" to criminal contempt sanctions, for no reason other than because they are payable to the clerk of the

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Continental holding is limited to the specific question of the bankruptcy court's inherent contempt jurisdiction, and does not purport to address the jurisdiction of the bankruptcy court to exercise its rule-based sanction powers. *Id.* at 774-75. Second, the reasoning of *Continental* was based largely on the then-existing version of Fed. R. Bankr. P. 9020, which required motions for contempt to be filed in district courts. *Id.* at 775. Since *Continental* was decided, however, Fed. R. Bankr. P. 9020 has been rewritten, and the specific language on which the *Continental* court relied has been removed from the rule. *See In re Xacur*, 116 Fed. App'x 516, 518 (5th Cir. 2004) (noting that as a result of amendment to Rule 9020, there is no longer doubt that bankruptcy judges have authority to hold parties in civil contempt). Third, even before the amendment to Rule 9020 was enacted, *Continental's* principal holding that bankruptcy courts lack civil contempt power was overturned by a decision of this Court, which recognized the power of bankruptcy courts to issue civil contempt orders under section 105 of the Bankruptcy Code. *See In re Terrebone Fuel & Lube, Inc.*, 108 F.3d 609, 613 (5th Cir. 1997). For each of these reasons, *Continental* fails to support Mr. Wayland and Mr. Byrd's argument that the bankruptcy court lacked core jurisdiction to issue a Rule 9011 sanction.

court. (Br. 6-7).

Mr. Wayland and Mr. Byrd's argument rests on the false premise that because criminal contempt sanctions are not compensatory, any non-compensatory sanction (including a Rule 9011(c) sanction) automatically constitutes criminal contempt. This argument overlooks the fact that contempt sanctions and Rule 9011 sanctions are distinct remedies, which serve different purposes and raise different due process concerns. In particular, contempt is "committed when a person violates an order of court which requires that person in specific and definite language to do or refrain from doing an act or series of acts." *Lichtenstein v. Lichtenstein*, 425 F.2d 1111, 1113 (3d Cir. 1970). By contrast, in this case, although Mr. Wayland and Mr. Byrd abused the bankruptcy process and participated in a violation of a criminal statute, they were not sanctioned for violating any specific court directive. As the bankruptcy court correctly found, while such misconduct is sanctionable, it is not contempt. [TByrd Dkt. 171 at 5].

A second fundamental difference between a contempt sanction and a Rule 9011 sanction is that they serve different purposes. A non-compensatory sanction under Rule 9011(c) is designed to deter future misconduct, and the amount of that sanction is limited to whatever is "reasonably necessary to deter repetition of the conduct." *In re Deville*, 361 F.3d 539, 553 (9th Cir. 2004). By contrast, criminal contempt is punitive and is directed to past conduct. *Id.; see also United States v. Kouri-Perez,* 187 F.3d 1, 6-7 (1st Cir. 1999) (noting distinction between punitive contempt sanctions and other non-compensatory sanctions).

As a result, as both this Court and every other appellate court to have considered the issue has agreed, federal courts may issue non-compensatory sanctions without resorting to their criminal contempt powers. *See United States v. Alves*, 136 Fed. App'x 616, 617 (5th Cir. 2005) (rejecting argument that $750 fine ordered against attorney was in the nature of criminal contempt); *Deville*, 361 F.3d at 553 (rejecting argument that bankruptcy court was required to conduct criminal contempt trial before sanctioning debtor and his counsel under Rule 9011); *Kouri-Perez*, 187 F.3d at 9 (rejecting "contention that the sanction imposed against appellants necessarily amounted to an adjudication of criminal contempt" simply because it was non-compensatory); *Eisenberg v. Univ. of New Mexico*, 936 F.2d 1131, 1137 (10th Cir. 1991) (trial court could order non-compensatory sanction against attorney who filed pleading without adequate investigation "without the more stringent due process afforded upon a finding of criminal contempt"); *Donaldson v. Clark*, 819 F.2d 1551, 1558-59 (11th Cir. 1987) (holding that it was not necessary for court to follow procedures applicable to criminal contempt proceeding when sanctioning attorney pursuant to Fed. R. Civ.

P. 11).

Although this Court has held that bankruptcy judges lack the power to punish criminal contempt under their inherent powers, *see In re Hipp, Inc.*, 895 F.2d 1503, 1509 (5th Cir. 1990), it has never extended that holding to prohibit bankruptcy courts from issuing the deterrent sanctions specifically authorized under Rule 9011(c)(2). Significantly, although *Hipp* was decided nearly two decades ago, no lower court within this circuit has ever suggested (as Mr. Wayland and Mr. Byrd do here) that *Hipp* circumscribes the bankruptcy court's Rule 9011 sanction powers. Rather, non-compensatory monetary civil sanctions under that rule continue to be routine in this circuit. *See, e.g.*, *In re Brown*, Case No. 06-80516, 2007 WL 4105967 (Bankr. S.D. Tex. Nov. 16, 2007) (ordering attorney to pay $300 to court as deterrent sanction under Rule 9011(c)); *In re Schaefer*, 154 B.R. 227, 232 (Bankr. S.D. Tex. 1993) (ordering sanction against pro se debtor of $2,000, payable to the United States Treasury, pursuant to Rule 9011). Accordingly, Mr. Wayland and Mr. Byrd's characterization of the bankruptcy court's Rule 9011 order as a criminal contempt judgment is without merit.

D. *COSCARELLI* DID NOT PRECLUDE THE BANKRUPTCY COURT FROM IMPOSING RULE 9011 SANCTIONS ON REMAND

Lastly, Mr. Wayland and Mr. Byrd argue that the bankruptcy court was powerless to impose sanctions on remand, because the United States and the chapter 7 trustee did not file a notice of appeal from the First Sanctions Order. In so arguing, Mr. Wayland and Mr. Byrd rely on this Court's decision in *United States v. Coscarelli*, 149 F.3d 342 (5th Cir. 1998) (en banc). (Br. 1-2). Mr. Wayland and Mr. Byrd's reliance on this decision in misplaced.

In *Coscarelli*, a defendant was convicted of a federal crime, but was given a sentence that did not comport with the statutory sentencing guidelines. On appeal, a panel of this Court reversed the underlying conviction, despite the defendant's failure to file a notice of appeal relating to his conviction. Following an *en banc* hearing, this Court reversed the panel decision on the grounds that the panel lacked jurisdiction to consider the merits of the conviction because no notice of appeal had been filed. *Id.* at 343.

Mr. Wayland and Mr. Byrd's attempt to analogize this case to *Coscarelli* is unpersuasive. Although Mr. Wayland and Mr. Byrd suggest that the bankruptcy court expressly "fail[ed] to impose civil sanctions" in the First Sanctions Order, which they treat as a substantive ruling equivalent to the criminal conviction in

Coscarelli, the bankruptcy court made no such determination. Rather, the bankruptcy court issued an order that imposed civil sanctions but erroneously cited to its inherent authority, rather than Rule 9011, as the source of its sanctioning authority. At no point of that decision, however, did the bankruptcy court ever hold that Rule 9011 sanctions were unavailable. Rather, because of its decision to rely on its inherent powers, the bankruptcy court never found it necessary to reach the issue of sanctions under Rule 9011. Under these circumstances, it is appropriate and within the appellate court's jurisdiction to remand in order to permit the lower court to clarify the basis for its ruling. *See, e.g.*, *Wright v. Allstate Ins. Co.*, 415 F.3d 384, 391 (5th Cir. 2005) (remanding trial court's denial of motion to amend complaint where there were several possible bases for denial, and it was not clear on which basis the court issued its ruling); *Crowe v. Smith,* 151 F.3d 217, 240 (5th Cir. 1998) (vacating trial court order that issued sanctions under incorrect theory, and remanding case for determination of whether sanctions could be sustained under alternative theory).

In addition, the United States could not have filed a notice of appeal of the First Sanctions Order because that order did not result in any judgment adverse to the United States, and there was consequently nothing for the United States to appeal. Although it did not rely on the same theory argued by the United States, the First Sanctions Order granted the precise relief that the United States had sought in its original motion for an order to show cause. As a result, the United States was not aggrieved by the First Sanctions Order, and there was no basis for it to file a cross-appeal. *See Chouinard v. Chouinard*, 568 F.2d 430, 433 (5th Cir. 1978) (holding that only "party aggrieved" by original judgment may file cross appeal). Moreover, a party defending a ruling on appeal may argue, as the United States did here, that the appellate court should affirm on a different theory than that relied on by the trial court. *Id.* As a result, the district court did not exceed its jurisdiction by remanding the case to the bankruptcy court for clarification of an issue that was raised but not fully addressed in the First Sanctions Order.

CONCLUSION

For these reasons, the United States respectfully asks this Court to affirm the judgment of the district court.

Dated: July 14, 2009

/s/ John P. Sheahan

RAMONA D. ELLIOTT General Counsel P. MATTHEW SUTKO Associate General Counsel JOHN P. SHEAHAN Department of Justice 20 Massachusetts Avenue, NW Washington, DC 20530 Telephone: (202) 307-1399 Facsimile: (202) 307-2397 email: john.sheahan@usdoj.gov	CHARLES F. MCVAY United States Trustee STEPHEN D. STATHAM Department of Justice 515 Rusk, Suite 3516 Houston, Texas 77002 Telephone: (713) 718-4650 Facsimile: (713) 718-4680

CERTIFICATE OF COMPLIANCE WITH FED. R. APP. P. 32(a)

I hereby certify that the foregoing brief complies with the typeface requirements in Fed. R. App. P. 32(a)(5) and the page and type-volume limitation in Fed. R. App. P. 32(a)(7). I also certify that the foregoing brief is proportionately spaced, using Times New Roman font, 14 point type. Based on a word count under Corel Word Perfect 12, this brief contains 8,227 words excluding the table of contents, table of authorities, and certificates of counsel.

/s/ John P. Sheahan
John P. Sheahan
Attorney for the United States

CERTIFICATE OF SERVICE

I hereby certify that on July 14, 2009, I served the foregoing Brief for the United States as Appellee on the following by sending one paper copy of the brief and one electronic copy in pdf format on disk by overnight mail to:

Thomas G. Wayland
1630 N. 10th Street
McAllen, Texas 78501

Timothy W. Byrd
301 Amherst
College Station, Texas 77840

DATED, this 14th day of July, 2009.

/s/ John P. Sheahan
John P. Sheahan
Attorney for the United States

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&

√ Any Miscellaneous BACKGROUND

! Houlihan Lokey Howard & Zukin Financial Advisors (Houlihan) and the Official Unsecured Creditors' Committee (Committee) are challenging the bankruptcy court's decision denying the Committee's application to retain Houlihan as its financial advisor under broad indemnification provisions. On appeal, they argue that the bankruptcy court failed to examine the particulars of this case and instead rejected the proposed terms based on a finding that such terms are per se unreasonable in the bankruptcy context. They also argue that the bankruptcy appellate panel (BAP), in affirming the decision of the bankruptcy court, erred by asking whether the proposed exoneration and indemnification provisions were in the best interests of the estate, and accordingly, that it erred in holding that the bankruptcy court's factual finding that the proposed indemnification terms were not reasonable was clearly erroneous.

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No. 02-3607

IN THE UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

In re: THERMADYNE HOLDINGS CORP., et al.,
Debtors

OFFICIAL UNSECURED CREDITORS’ COMMITTEE, et al.,
Appellants,

v.

JOEL PELOFSKY,
Appellee.

ON APPEAL FROM THE UNITED STATES BANKRUPTCY APPELLATE
PANEL FOR THE EIGHTH CIRCUIT

BRIEF FOR FEDERAL APPELLEE

ROBERT D. McCALLUM, JR.
Assistant Attorney General

RAYMOND W. GRUENDER, III
United States Attorney

WILLIAM KANTER
(202) 514-4575
ARA B. GERSHENGORN
(202) 514-4690
Attorneys, Appellate Staff
Civil Division, Room 9545
Department of Justice
601 “D” Street, N.W.
Washington, D.C. 20530-0001

OF COUNSEL:

JOSEPH A. GUZINSKI
General Counsel

P. MATTHEW SUTKO
Attorney
Executive Office
for United States Trustees

SUMMARY OF THE CASE

The Thermadyne creditors’ committee filed an application under 11 U.S.C. 1103(a) seeking court permission to retain Houlihan, Lokey, Howard & Zukin as a bankruptcy professional. In ruling on that application, the bankruptcy court declined to approve one of the terms and conditions of employment the Committee sought for Houlihan - indemnification and exculpation of Houlihan for wrongful acts. Appellants are challenging the bankruptcy appellate panel’s decision affirming that holding. Appellants contend (1) that the BAP incorrectly held that the bankruptcy court had not applied a per se rule against indemnification provisions; and (2) that the bankruptcy court clearly erred in finding that the indemnification provisions were not reasonable in this case.

The BAP’s decision in this case constitutes a final order over which this Court has jurisdiction. The BAP, furthermore, correctly held that the bankruptcy court did not apply a per se rule and instead found that the proposed indemnification provisions were not reasonable <u>in this case</u>. Finally, the BAP, applying the appropriate standard, correctly determined not only that the bankruptcy court’s factual findings were not clearly erroneous, but also that they were well supported by the record before the bankruptcy court. The government stands ready to present oral argument if the Court believes argument will facilitate its deliberations in this case.

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STATEMENT OF JURISDICTION

The bankruptcy court had jurisdiction over the creditors' committee's application to employ Houlihan, Lokey, Howard & Zukin, under 28 U.S.C. 157(a) and (b). The bankruptcy appellate panel (BAP) had jurisdiction to hear the appeal from the bankruptcy court's order declining to approve the proposed exoneration and indemnification provisions under 28 U.S.C. 158. The BAP entered judgment on October 3, 2002. A timely notice of appeal was filed on October 11, 2002. Although this Court has not addressed whether an order ruling upon an application to employ a bankruptcy professional under 11 U.S.C. 1103(a), and declining to approve a term or condition of employment under 11 U.S.C. 328(a), is final for purposes of appellate jurisdiction, we submit that under this Circuit's test of finality, such an order should be held to be final. This Court accordingly would have jurisdiction under 28 U.S.C. 158(d). See discussion infra at 17-20.

STATEMENT OF THE ISSUES

The bankruptcy court held that the exoneration and indemnification provisions sought by Houlihan Lokey Howard & Zukin Financial Advisors (Houlihan) were unreasonable in this case and accordingly granted the application of the Official Unsecured Creditors' Committee (Committee) to employ Houlihan, but without those provisions. The bankruptcy appellate panel affirmed. The issues raised on this appeal are:

1. Whether this Court has jurisdiction over this appeal.

   A. Decisions:

   United States Trustee v. Koch (In re Koch), 109 F.3d 1285 (8th Cir. 1997)

   B. Statutes and Rules:

   28 U.S.C. 158(d)

2. Whether the bankruptcy court's decision was the application of a per se rule, or, as the court stated and the BAP held, a conclusion about this case.

   A. Decisions:

   In re Arochem Corp., 176 F.3d 610 (2d Cir. 1999)

   B. Statutes and Rules:

   11 U.S.C. 328(a)

   11 U.S.C. 1103(a)

3. Whether the bankruptcy court’s factual finding, upheld by the BAP, that the proposed indemnification provisions were not reasonable, was clearly erroneous.

A. Decisions:

In re Gillett Holdings, Inc., 137 B.R. 452 (Bankr. D. Colo. 1991)

Zolfo, Cooper & Co. v. Sunbeam-Oster Co., 50 F.3d 253 (3d Cir. 1995)

B. Statutes and Rules:

11 U.S.C. 1103(a)

11 U.S.C. 328(a)

STATEMENT OF THE CASE

Houlihan Lokey Howard & Zukin Financial Advisors (Houlihan) and the Official Unsecured Creditors’ Committee (Committee) are challenging the bankruptcy court’s decision denying the Committee’s application to retain Houlihan as its financial advisor under broad indemnification provisions. On appeal, they argue that the bankruptcy court failed to examine the particulars of this case and instead rejected the proposed terms based on a finding that such terms are per se unreasonable in the bankruptcy context. They also argue that the bankruptcy appellate panel (BAP), in affirming the decision of the bankruptcy court, erred by asking whether the proposed exoneration and indemnification provisions were in the best interests of the estate, and accordingly, that it erred in holding that the bankruptcy court’s factual finding that the proposed indemnification terms were not reasonable was clearly erroneous.

STATEMENT OF FACTS

A. Statutory Provisions Involved.

1. 28 U.S.C. 158(d). 28 U.S.C. 158(d) provides:

> The courts of appeals shall have jurisdiction of appeals from all final decisions, judgments, orders, and decrees entered under subsections (a) and (b) of this section.

Subsection (b) provides for the establishment of a bankruptcy appellate panel with jurisdiction to hear and determine appeals.

2. 11 U.S.C. 1102(a)(1). 11 U.S.C. 1102(a)(1) provides, with an exception not relevant to this case:

> [A]s soon as practicable after the order for relief under chapter 11 of this title, the United States trustee shall appoint a committee of creditors holding unsecured claims and may appoint additional committees of creditors or of equity security holders as the United States trustee deems appropriate.

3. 11 U.S.C. 1103(a). 11 U.S.C. 1103(a) provides:

> At a scheduled meeting of a committee appointed under section 1102 of this title, at which a majority of the members of such committee are present, and with the court's approval, such committee may select and authorize the employment by such committee of one or more attorneys, accountants, or other agents, to represent or perform services for such committee.

4. 11 U.S.C. 328(a). 11 U.S.C. 328(a) provides:

> The trustee, or a committee appointed under section 1102 of this title, with the court’s approval, may employ or authorize the employment of a professional person under section 327 or 1103 of this title, as the case may be, on any reasonable terms and conditions of employment, including on a retainer, on an hourly basis, or on a contingent fee basis. Notwithstanding such terms and conditions, the court may allow

> compensation different from the compensation provided under such terms and conditions after the conclusion of such employment, if such terms and conditions prove to have been improvident in light of developments not capable of being anticipated at the time of the fixing of such terms and conditions.

Pertinent Facts.

1. Bankruptcy Proceedings.

Thermadyne Holdings Corporation (“Thermadyne”), through its direct and indirect operating subsidiaries, is a global manufacturer of cutting and welding products with approximately 1400 employees. In November 2001, Thermadyne and various subsidiaries filed petitions for relief under Chapter 11 of the Bankruptcy Code. JA 11.

In December 2001, the United States Trustee appointed an unsecured creditors’ committee (the Committee).[1] Shortly

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[1] The United States Trustee is an Executive Branch official who supervises the administration of bankruptcy cases and trustees. 28 U.S.C. 581 through 589 (specifying the duties of United States Trustees). Congress made United States Trustees responsible for "protecting the public interest and ensuring that bankruptcy cases are conducted according to the law." H.R. Rep. No. 95-595, 109 (1978), reprinted in 1978 U.S.C.C.A.N. 5963, 6070; see 28 U.S.C. 586; 11 U.S.C. 307; H.R. Rep. No. 99-764, 27 (1986), reprinted in 1986 U.S.C.C.A.N. 5227, 5240 (U.S. Trustee has "standing to raise, appear, and be heard on any issue in any case or proceeding under title 11, U.S. Code -- except that the U.S. Trustee may not file a plan in a chapter 11 case"); United States Trustee v. Price Waterhouse, 19 F.3d 138, 141 (3d Cir. 1994). The U.S. Trustee also is responsible for monitoring creditors’ committees. See 28 U.S.C. 586. Pursuant to 11 U.S.C. 1102, the United States Trustee appoints and determines the membership of an unsecured creditors’ committee. The committee’s membership generally includes a number of the largest unsecured creditors. The committee is different from the debtor in possession who controls the estate. The committee and the debtor in possession each may employ their own professionals to assist in the bankruptcy. See 11 U.S.C. 1103 (employment of

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thereafter, the Committee filed an application, pursuant to 11 U.S.C. 1103(a), to retain Houlihan, Lokey, Howard & Zukin Financial Advisors, Inc. (“Houlihan”) as a bankruptcy professional to provide an array of financial services, including evaluating the assets and liabilities of the debtors and their subsidiaries; analyzing and reviewing the financial and operating statements of the debtors; evaluating all aspects of any debtor financing and exit financing; providing valuation or other financial analyses as the Committee might require; assessing the financial issues and options concerning a sale of the debtors or reorganization plan; preparing, analyzing, and explaining any plan to the Committee; and providing testimony in court on behalf of the Committee if necessary. JA 95-6.

The proposed terms and conditions of Houlihan’s employment included a suggested compensation package of $125,000 per month, and a transaction fee of one percent of the value of the cash and securities received by holders of Committee Debt upon the conclusion of any transaction.[2] JA 96.

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[1](...continued)
professionals by the committee); 11 U.S.C. 327 (employment by trustee). (Although Section 327 refers to the “trustee”, the provisions of Section 327 apply equally to debtors in possession. <u>See</u> 11 U.S.C. § 1107(b) (describing rights of debtor in possession); <u>In re First Jersey Securities, Inc.</u>, 180 F.3d 504, 509 (3d Cir. 1999).)

[2] The proposed transaction fee specified that notwithstanding the formula, it was not to exceed $2 million nor be less than $350,000.

The engagement letter, whose proposed terms were incorporated within the Committee's 11 U.S.C. 1103(a) application, also contained extensive indemnification and exculpation provisions that the Committee's 1103(a) motion asked the bankruptcy court to approve. These provisions were designed to enable Houlihan to avoid the risk and responsibility for any losses, claims, damages, or liabilities arising out of the agreement, out of any actions taken or omitted, or out of any transaction or proposed transaction. All indemnification was to be provided by the debtors. The Committee's application also sought court authorization to require the debtors to reimburse Houlihan for costs and legal fees in the event Houlihan was sued in connection with, or otherwise held liable for, its work on behalf of the Committee. JA 177.[3] Prior to the bankruptcy court's ruling on the application to employ, the Committee and Houlihan conceded that Houlihan could not be indemnified for losses judicially determined to have resulted from its willful misconduct or gross negligence and modified the application accordingly. JA 11.

In January 2002, the U.S. Trustee filed an Objection to the Application focusing on the indemnification provisions and advocating a per se prohibition on such provisions as contrary to public policy and professionalism. JA 11. The bankruptcy court

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[3] The full text of the proposed indemnification provisions is at pages 177-78 of the Joint Appendix.

held a hearing later that month, and in February 2002, issued its Memorandum Opinion and Order ("bankruptcy court opinion").

2. Bankruptcy Court Opinion.

In the bankruptcy court opinion, the court held that "in this case the indemnification provisions are unreasonable." JA 10. The court first looked to Section 328 of the Bankruptcy Code which provides that a professional person may be employed "'on any reasonable terms and conditions of employment.'" JA 12 (emphasis bankruptcy court's). The court accordingly stated that the "focus" of its analysis is on the term "'reasonable'" and "specifically whether the terms of the indemnity agreement included in the engagement letter are reasonable." JA 12. The bankruptcy court noted that Houlihan and the Committee had identified three reasons for which their proposed terms were reasonable: market conditions, economic conditions, and the choice of the Committee.

As to market conditions, the bankruptcy court rejected the argument that prevalent terms outside the bankruptcy environment automatically rendered reasonable those same terms for professionals working in a bankruptcy. JA 13. The court found that "[p]revailing employment terms and conditions are to be considered, but should only be one factor in the analysis of 'reasonable' in the totality of the circumstances." JA 13. The bankruptcy court noted that cases "rightly held" that rates of pay should not be diminished merely because a professional was employed by a chapter 11 debtor or committee, and accordingly, the bankruptcy court approved the proposed payment to Houlihan of $125,000 per month.

The bankruptcy court held, however, that the other terms of engagement, especially non-monetary terms, “should be considered in terms of the debtor’s bankruptcy environment.” JA 14. “What is reasonable must be assessed with due regard for the particular and unique circumstances of each bankruptcy case and for the fair and equitable administration of the bankruptcy estate.” JA 14.

In this case, the court noted that Houlihan had been selected as a “professional financial advisor” chosen for its “superior knowledge and experience relative to the Committee.” Particularly in light of that superior expertise that Houlihan was to provide, the court held that the estate should not be “expos[ed] . . . to unlimited liability through indemnity and exculpation” and that it was “simply unreasonable” for the estate through the Committee to bear such a risk. JA 14.

The bankruptcy court then turned to Houlihan’s second argument, that “in each of their ‘over 100 engagements per year’ there are dissatisfied parties who pose an economic risk to Houlihan Lokey,” JA 14 (quoting Declaration of Jonathan B. Cleveland, ¶ 8), and that “[b]ecause Houlihan Lokey is a relatively small private investment banking firm (notwithstanding the one hundred plus engagements and the restructuring of over $40 billion), they do not and cannot insure against this risk,” JA 15 (citing id. ¶ 9). The bankruptcy court found that if, as Houlihan and the Committee were contending, economic conditions are such as to spur litigation, there is “even greater cause to protect the estate from this risk.” JA 15. The bankruptcy court further found that “[i]t will be impossible to secure and maximize the value of the estate where the negligent actions of a highly compensated, professional service provider could cause the estate’s liquidation.” JA 15.

The bankruptcy court also relied on the fact that Houlihan, although indicating that it could not insure against the risk of negligence, also stated that it would require a substantial increase in fees to adequately insure. Particularly concerned with what the bankruptcy court perceived in this case to be an “uncapped risk to the estate” flowing from the indemnification provisions, the bankruptcy court determined that such quantifiable higher fees would be preferable to the proposed unlimited indemnification provisions because the fees would impose a finite cost to the estate such that “the impact on the value of the estate is certain.” JA 15.

Finally, with respect to Houlihan’s contention that without the indemnification provisions, it would have to decline the engagement, thereby depriving the Committee of its expertise and of the Committee’s choice of service provider, resulting in “‘real and substantial economic costs’” to the estate from higher fees or the forced selection of a less qualified advisor, JA 16 (quoting Houlihan’s Response to UST Objection to Application at 18), the bankruptcy court held that the argument “propounds rank speculation.” JA 16. The Committee, the bankruptcy court held, remained free to choose whichever service provider it wanted on any reasonable terms and conditions. The bankruptcy court found, however, that the proposed indemnification provisions were not reasonable in this case. The "[f]ees should be finite, the impact on the value of the estate should be certain, and there should not be an uncapped risk to the estate which saddles it with unlimited liability." JA 16.

Houlihan and the Committee filed a motion to reconsider which was denied by the bankruptcy court. They then appealed to the Bankruptcy Appellate Panel for the Eighth Circuit.[4]

3. Bankruptcy Appellate Panel Decision.

Reviewing the bankruptcy court's "findings of fact for clear error and review[ing] its legal conclusions de novo," the bankruptcy appellate panel unanimously affirmed the bankruptcy court's decision. Bankruptcy Appellate Panel Opinion ("BAP Op.") at 6-7, 16.[5] The BAP first rejected Houlihan's contention that the bankruptcy court had applied a per se rule in finding that the proposed indemnification provisions were not reasonable. Although the BAP noted that the bankruptcy court "in isolated

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[4] The bankruptcy court also denied the proposed indemnification provisions for Rothschild, Inc. as investment bankers to the debtors. Rothschild appealed its adverse decision to the District Court for the Eastern District of Missouri. That decision is pending.

[5] The BAP also had before it a challenge to the bankruptcy court's denial of Houlihan's motion to reconsider. The BAP reviewed this claim for abuse of discretion and affirmed as to it as well. BAP Op. 16. Appellants have not appealed from that aspect of the BAP's holding.

statements” expressed “strong views” on indemnification and exculpation of professionals “employed in a bankruptcy case in general,” the BAP held that the bankruptcy court “did not apply a per se rule in this case.” BAP Op. at 8. “Reading the bankruptcy court’s opinion in totality, we find that the opinion definitely discusses reasons why the indemnity and exculpation provisions were not reasonable under the circumstances of this case.” Id. at 8-9. The BAP noted the bankruptcy court’s attentiveness to the particular facts and circumstances of this case exemplified by, inter alia, the bankruptcy court’s findings that “‘in this case the indemnification provisions are unreasonable,’” BAP Op. at 9 (quoting Bankruptcy Court Opinion at 1) (emphasis BAP’s); that “‘under the circumstances of this case . . . non-monetary terms, should be considered in terms of the debtors’ bankruptcy environment,’” BAP Op. at 9 (quoting Bankruptcy Court Opinion at 4-5) (emphases BAP’s); that “for this estate to bear the risk of unlimited liability and exculpation was simply unreasonable,” BAP Op. at 9, 10 (citing Bankruptcy Court Order at 5); that “the impact and financial risk to this estate should be finite and certain,” and that because “such risks were not [finite and certain], it was unreasonable under the circumstances of this case to approve the indemnification and exculpation provisions,” BAP Op. at 10.

The BAP then evaluated whether the bankruptcy court had erred in finding that the provisions were unreasonable, and held that it had not. The BAP noted that Houlihan and the Committee bore the burden of establishing that such terms of employment were reasonable under the circumstances and that they had not met that burden. Like the bankruptcy court, the BAP noted that Houlihan and the Committee argued in effect that because indemnification provisions are “routine outside of bankruptcy” they are “per se reasonable” in bankruptcy. BAP Op. at 11. (emphasis BAP’s). And like the bankruptcy court, the BAP rejected this argument. Ibid. The BAP held that Houlihan and the Committee had failed to present evidence of why such provisions would be reasonable in the context of this case. “[A]ppellants neglect the fact that 11 U.S.C. § 328(a) requires that they prove the disputed provisions are reasonable under the circumstances of this case, and the appellants simply do not address this issue.” Ibid. (emphasis BAP’s).

The BAP also noted that Houlihan and the Committee argued for the need for indemnification in the existing economic and corporate litigation climates. In response to these arguments before the bankruptcy court, the BAP noted, the bankruptcy court had found that “if economic conditions are such as to spur dissatisfied parties to litigation, there is even greater cause to protect the estate from that risk” and “under the circumstances, it is prudent and reasonable that such a risk be borne by the party providing the service.” BAP Op. at 13. The BAP held that these findings were not clearly erroneous.

The BAP further held that there was insufficient evidence to support Houlihan’s contention that it could not obtain indemnity insurance, or that the Committee would not be able to obtain comparable services to those offered by Houlihan for the same price without such indemnity provisions.[6] The BAP found that "[a]gain, the appellants are arguing why indemnity and exculpation is reasonable for <u>itself</u>, not why it is reasonable for the estate to bear such a risk in the totality of the circumstances." <u>Ibid</u>. (emphasis BAP's).

The BAP also examined Houlihan's contention that the estate would be burdened with increased economic costs if the proposed indemnification provisions were not approved. The BAP noted that the bankruptcy court had held as to this argument that even assuming higher fees would be required, such fees would have a finite and certain impact on the value of the estate which the court found preferable to the potentially unlimited financial risk the estate would face if the indemnification provisions were approved. The BAP held that this finding of the bankruptcy court was not clearly erroneous. BAP Op. at 13-14.

Finally, the BAP noted the unusual circumstances of this case: "a professional firm hired by the committee for its own use during the bankruptcy, yet requiring the debtor, a non-client, to indemnify the firm." BAP Op. at 14.[7] The BAP held that

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[6] The BAP, like the bankruptcy court, rejected Houlihan's reliance on the Declaration of Jonathan Cleveland that Houlihan could not adequately insure, finding that the statement both "lacks foundation" and is "internally inconsistent." BAP Op. at 13 n.10.

[7] Although it is the Committee that is seeking in this case to employ Houlihan, under the proposed indemnification
(continued...)

"[n]eglecting this unique difference causes the appellants' argument, that market conditions warrant the finding that the disputed provisions under the circumstances of this case are reasonable," to be "highly speculative at best," since when the debtor is not the client, it has virtually no control over any negligent acts the firm may commit. Ibid.

The BAP accordingly held that "[t]he bankruptcy court found that the indemnity and exculpation provisions in the Houlihan Lokey engagement agreement were not reasonable under the circumstances of the case. This finding was not clearly erroneous." It further held that "the bankruptcy court did not abuse its discretion in not approving the employment under the proposed terms." BAP Op. at 16.

STANDARD OF REVIEW

This Court's standard of review is the same as that of the BAP. "[W]e review the bankruptcy court's factual findings for clear error and its conclusions of law de novo." In re Vote, 276 F.3d 1024, 1026 (8th Cir. 2002). This Court has noted that "[w]hile our review is a searching and independent one, we also realize that we are the second court charged with reviewing the bankruptcy court's factual findings for clear error," and that accordingly, "'[t]o be clearly erroneous, a decision must strike

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[7] (...continued) provisions, the debtors are responsible for indemnifying Houlihan. Thus, as the BAP noted, under the indemnification provisions, the party that is indemnifying the professional is not the party for whom the professional is working.

us as more than just maybe or probably wrong; it must . . . strike us as wrong with the force of a five-week old, unrefrigerated dead fish.'" In re Papio Keno Club, Inc., 262 F.3d 725, 729 (8th Cir. 2001) (quoting Parts and Elec. Motors, Inc. v. Sterling Elec., Inc., 866 F.2d 228, 233 (7th Cir. 1988), cert. denied, 493 U.S. 847 (1989)). Thus while this Court is "always mindful of our duty to independently review the record, we think this description is a particularly accurate reflection of when we will reverse a bankruptcy court's factual finding that has been upheld by the BAP – we do not treat the BAP as a mere way station on the road to this court." In re Papio Keno Club, 262 F.3d at 729.

SUMMARY OF ARGUMENT

1. The Court should exercise jurisdiction over this appeal. Although this Court has not explicitly addressed whether an appeal from an order denying proposed indemnification provisions for a bankruptcy professional constitutes a final order for purposes of appellate review, such an order should be held to be final under this Court's finality test. The order at issue in this case fully resolves this discrete segment of the Thermadyne bankruptcy case, there remain no additional procedures for the bankruptcy court to perform as to this issue following this Court's decision, and a delay in obtaining review could potentially prevent the aggrieved party from obtaining effective relief. Although a later reversal on this issue likely would not require recommencement of the entire proceeding, there is no interest to be served from a delay.

2. The BAP correctly held that the bankruptcy court did not apply a rule of per se unreasonableness to this case. Instead, the bankruptcy court examined the evidence put forth by Houlihan and the Committee and held that they had not satisfied their burden of establishing that the proposed indemnification provisions were reasonable under the facts and circumstances of this case.

3. As the bankruptcy court found, Houlihan and the Committee failed to meet their burden of proof, as the moving party, that, under the circumstances of this case, the proposed indemnification provisions were reasonable. Appellants failed to present sufficient evidence to support such a finding. They further failed to justify the broad unlimited exposure that the proposed indemnification provisions would impose on the debtors in this case. The bankruptcy court’s factual finding that the proposed indemnification provisions are unreasonable is, as the BAP held, well supported by the record in this case and not clearly erroneous.

ARGUMENT

I. THE ORDER IN THIS CASE CONSTITUTES A FINAL APPEALABLE ORDER OVER WHICH THIS COURT HAS JURISDICTION.

Under the Bankruptcy Code, this Court has jurisdiction over "all final decisions, judgments, orders, and decrees" entered by a district court or a bankruptcy appellate panel on appeal from a bankruptcy court. 28 U.S.C. 158(d).[8] The test of finality in a bankruptcy case is more flexible than in other cases. See, e.g., In re Jenkins & Assocs., 296 F.3d 730, 731 (8th Cir. 2002). This Court has identified three factors it uses in determining when an order is final for purposes of Section 158(d): (1) "'the extent to which . . . the order leaves the bankruptcy court nothing to do but execute the order; (2) the extent to which delay in obtaining review would prevent the aggrieved party from obtaining effective relief; (3) the extent to which a later reversal on that issue would require recommencement of the entire proceeding.'" In re Koch, 109 F.3d 1285, 1287 (8th Cir. 1997) (quoting In re Olson, 730 F.2d 1109, 1109 (8th Cir. 1984)). This Court has found, however, that the absence of one of the factors is not fatal to a determination of finality. See, e.g., ibid. (holding that orders granting or denying dismissal of Chapter 7 case for substantial abuse are appealable even though the first

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[8] This Court also can exercise jurisdiction over interlocutory appeals under certain circumstances. See 28 U.S.C. 1292 (establishing this Court's jurisdiction to hear appeals from interlocutory orders). Those circumstances are not present in this case.

factor was not satisfied because the district court had remanded the case to the bankruptcy court for further proceedings).

Under this Court's finality test, an order denying indemnification provisions for a bankruptcy professional should be held to be final and appealable. As to the first prong of this Court's test, the order from this Court will leave the bankruptcy court with nothing to do but execute the order. There are, for example, no additional fact-finding proceedings required in this case. Compare, e.g., In re Vekco, 792 F.2d 744 (8th Cir. 1986) (not a final order where the district court in remanding specifically anticipated that the bankruptcy court would further develop the record and exercise considerable discretion in resolving the issue remanded to it).

As to the second prong of the test, a delay in obtaining review could prevent Houlihan from obtaining relief. A bankruptcy plan which could interfere with Houlihan's ability to collect indemnification funds could be approved in the interim. In that circumstance, a subsequent decision authorizing the indemnification provisions either could be difficult to enforce, or might interfere with the approved plan.

As to the third prong of this Court's finality test, although recommencement of the entire proceeding likely would not be required if the bankruptcy court's decision were reversed at a later time, even absent this concern, overall the test weighs in favor of a determination that the BAP's decision is final.

This Court has noted that “[f]inality for bankruptcy purposes is a complex subject and courts deciding appealability questions must take into account the peculiar needs of the bankruptcy process.” In re Yukon Energy Corp., 138 F.3d 1254, 1258 (8th Cir. 1998) (internal quotation marks omitted). In this case, there is arguably no purpose which would be served by a delay in the decision at issue, and the order at issue here “finally resolve[s] a discrete segment of th[e] proceeding.” In re Kasden, 141 F.3d 1288, 1290 (8th Cir. 1998).

On a related issue, the circuit courts of appeals disagree as to whether an order denying the retention of professionals is a final appealable order. See, e.g., In re Kurtzman, 194 F.3d 54, 57 (2d Cir. 1999) (holding such an order is final); In re First Jersey Sec., Inc., 180 F.3d 504, 508 (3d Cir. 1999) (same), but see In re S.S. Retail Stores, Corp., 162 F.3d 1230 (9th Cir. 1998) (holding order denying approval is not final); In re Smyth, 207 F.3d 758 (5th Cir. 2000) (same).[9] The only circuit court to have addressed whether an order approving or denying indemnification for bankruptcy professionals is final, held that such an order was final for purposes of review. See In re United Artists, 315 F.3d 217, 225 (3d Cir. 2003) (interpreting the order as an order approving a professional’s retention). We submit that the order of the BAP in this case should be held to be a final and appealable order.

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[9] The BAP in this case treated the order of the bankruptcy court as an order denying the application for employment of Houlihan under the proposed terms. See BAP Op. at 6 n.6.

II. THE BAP CORRECTLY HELD THAT THE BANKRUPTCY COURT DID NOT APPLY A PER SE RULE AGAINST INDEMNIFICATION AGREEMENTS.

Subject to certain restrictions, the unsecured creditors' committee in a bankruptcy may apply to the court to obtain permission to employ professionals to "represent or perform services" for the committee. 11 U.S.C. 1103(a). If the bankruptcy court determines it is appropriate to retain the professional, the court must then review the proposed terms of employment to determine whether they are reasonable. See 11 U.S.C. 328(a). When doing so, the bankruptcy court must exercise its discretion in a manner that takes into account the particular facts and circumstances surrounding each case. See, e.g., In re Arochem Corp., 176 F.3d 610, 621 (2d Cir. 1999) (citing 3 Collier on Bankruptcy, ¶ 327.04[1][a]).

On appeal, Houlihan and the Committee contend that the BAP "ignored the Bankruptcy Court's adoption of the per se rule." App. Br. 15. It is appellants, however, that misread the bankruptcy court's opinion. As the BAP found, the bankruptcy court did make statements expressing strong views about indemnification and exculpation, but, as the BAP also held, it is clear that the bankruptcy court examined the evidence in this case and found it lacking.

The bankruptcy court stated throughout its opinion that it needed to evaluate the reasonableness of the proposed terms within the context of this case. See, e.g., JA 10 ("the Court concludes that in this case the indemnification provisions are unreasonable"); JA 12 (the focus of the Court's analysis under

Section 328(a) is “specifically whether the terms of the indemnity agreement included in the engagement letter are reasonable”); JA 13 (finding Houlihan’s argument “unavailing under the circumstances of this case”); JA 14 (“What is reasonable must be assessed with due regard for the particular and unique circumstances of each bankruptcy case and for the fair and equitable administration of the bankruptcy estate.” (all emphases added)). Houlihan and the Committee ignore these numerous references which indicate that the bankruptcy court was well aware of and fulfilling its duty of examining the unique circumstances of the particular case before it in evaluating whether the proposed indemnification provisions were reasonable.

Moreover, these numerous references to the particular facts of this case were not mere lip service to the requirement that the bankruptcy court conduct an analysis of the particular case. Throughout its opinion, the bankruptcy court found that Houlihan and the Committee had failed to meet their burden, as the movants, in establishing that for this case the proposed indemnification provisions were reasonable. Thus, for example, in rejecting their contention that economic conditions required such indemnification provisions, the bankruptcy court noted that while Houlihan claimed that it does not and cannot insure against the economic risk, the firm also noted that an employment agreement that did not include the proposed indemnification provisions would require a substantial increase in fees to adequately insure against these risks. The bankruptcy court determined that the increase in fees was preferable in this case to the uncapped blank check liability that the estate would face under the indemnification provisions. Accordingly, the bankruptcy court found Houlihan’s argument insufficient justification for sustaining a finding that the provisions were reasonable.

The record in this case fully supports the bankruptcy court’s decision, given the lack of any showing by Houlihan and the Committee to support the reasonableness of the indemnification provisions in this case. The court could have reached a different result if, for example, Houlihan and the Committee had demonstrated that the estate’s liability under the indemnification provisions was, in some way, limited. Similarly, the bankruptcy court’s decision could have been different if the liability proposed did not include the cost of defense, the cost of settlements, or if it was proposed in light of some clearly pending claim. There is no basis for finding that a difference in these or other factors might not have changed the bankruptcy court’s decision.

The bankruptcy court also evaluated the particular circumstances of this case with respect to Houlihan’s argument that the Committee would be unable to select the advisor it wanted in the absence of the proposed indemnification provisions. Here, too, the bankruptcy court found that there was insufficient evidence to support such a finding in this case. As the bankruptcy court indicated, “[t]his argument propounds rank speculation.” JA 16. Again, however, if Houlihan and the Committee had presented evidence that the Committee was unable to select the advisor it wanted or was unable to find a service provider without including such provisions, the bankruptcy court under those circumstances might not have refused the proposed provisions. Houlihan and the Committee seek to obscure the fact that they failed to meet their evidentiary burden by arguing that the bankruptcy court applied a per se test in this case. But as the BAP held, it was appellants’ own failure to address the circumstances of the case and present evidence justifying the inclusion of the proposed provisions in this case that led the bankruptcy court to find that the provisions were not reasonable here.

III. THE BANKRUPTCY COURT’S FINDING THAT HOULIHAN AND THE COMMITTEE FAILED TO SATISFY THEIR BURDEN OF ESTABLISHING THAT THE PROPOSED INDEMNIFICATION PROVISIONS WERE REASONABLE WAS, AS THE BAP HELD, NOT CLEARLY ERRONEOUS.

Based on the evidence before it, the bankruptcy court in this case held that the proposed indemnification provisions were not reasonable. That factual finding, well supported by the record in this case, was affirmed by the BAP, and Houlihan and the Committee fall well short of establishing on appeal that the finding is clearly erroneous.

As Houlihan and the Committee concede, <u>see</u>, <u>e.g.</u>, App. Br. 21-22, they, as the moving party, had the burden of establishing that the proposed indemnification provisions were reasonable in this case. <u>See</u>, <u>e.g.</u>, <u>In re Geraci</u>, 138 F.3d 314, 318 (7th Cir.), <u>cert. denied</u>, 525 U.S. 821 (1998); <u>Zolfo, Cooper & Co. v.</u>

Sunbeam-Oster Co., 50 F.3d 253, 259 n.5 (3d Cir. 1995); In re Gillett Holdings, Inc., 137 B.R. 452, 455 (Bankr. D. Colo. 1991).

Only one circuit court of appeals has addressed the use of indemnification provisions for bankruptcy professionals. In In re United Artists, 315 F.3d 217 (3d Cir. 2003), the Third Circuit faced an appeal from a bankruptcy court order (and the district court's affirmance of that order) approving the retention of bankruptcy professionals under terms including an indemnification provision. The U.S. Trustee argued in that case that such provisions were per se unreasonable, but the Third Circuit disagreed. The court held that indemnification provisions were not per se unreasonable in every bankruptcy case. See 315 F.3d at 235 (Alito, J., concurring) ("The opinion of the court, as I understand it, holds only that the 'reasonableness' standard of 11 U.S.C. § 328(a) does not categorically prohibit indemnification of financial advisors, as the United States Trustee argues.").

The United Artists case is inapposite here. In United Artists, the United States Trustee did not litigate the reasonableness in that particular case of the proposed provisions. The only question before the Third Circuit was whether indemnification clauses are per se unreasonable in all cases.

Although the United States pressed such an argument before the bankruptcy court in this case, that court failed to adopt a per se prohibition. The bankruptcy court in this case did not hold that indemnification provisions are per se unreasonable. Instead, it held that the proposed provisions were not reasonable in this case. Given the bankruptcy court’s holding, the United States Trustee argued before the BAP that it could affirm either upon the bankruptcy court’s conclusion that the moving parties had failed to meet their burden of establishing reasonableness in this particular case, or, alternatively, on the per se argument. Affirming the bankruptcy court, the BAP held that Houlihan and the Committee failed to demonstrate that the proposed indemnification provisions were reasonable. On this appeal, the U.S. Trustee argues only that the holdings of the bankruptcy court and the BAP were correct and does not argue for a per se rule.

In support of their contention that they presented “undisputed evidence” of reasonableness to the bankruptcy court, Houlihan and the Committee argue on appeal that they established (1) that the indemnification provisions were standard terms and conditions of employment in the marketplace; (2) that Houlihan made modifications to the agreement that, when combined with the fact that it had never invoked indemnification in any other engagement, significantly reduced the potential risk to the debtors; (3) in light of the economic and litigation environment, there was a significant need for these provisions; and (4) the provisions were negotiated at arms-length by sophisticated professionals. App. Br. 23-24. Remarkably, Houlihan and the Committee continue to make the same mistake that they accuse the bankruptcy court of making: failing to establish reasonableness for this case. Virtually all of appellants' evidence is not specific to this case. Rather, appellants continue to rely on the market approach and the fact that Houlihan frequently obtains such indemnification in other cases and contexts. They fail, however, to indicate why such provisions are appropriate in this particular bankruptcy.

Indeed, appellants continue to maintain that it is the market's standard "'that is to be the controlling standard under the relevant provisions of the Bankruptcy Code.'" Appellants Br. 30 (quoting In re Comdisco, No. 01 B 24795 (Bankr. N.D. Ill. 2002)). There is, however, no basis for finding that the market approach is the sole determinant of reasonableness. Indeed, the market approach is not mentioned anywhere in the analysis of the reasonableness of terms and conditions under Section 328(a). Instead, Houlihan and the Committee import this factor from the last of a list of considerations set out in Section 330(a)(3) for use in determining whether, at the time of payment, actual compensation sought by a bankruptcy professional is reasonable. See 11 U.S.C. 330(a) (after notice and hearings, the bankruptcy court may award to a professional "reasonable compensation for actual, necessary services rendered" by the professional and in determining "the amount of reasonable compensation to be awarded" the court shall consider all relevant factors including the time spent on the services, the rates charged, whether the services were necessary, whether the services were performed in a reasonable amount of time, and whether the compensation is reasonable based on the “customary compensation charged by comparably skilled practitioners” in non-bankruptcy cases).

While it may make sense for bankruptcy courts to consider the non-bankruptcy market in evaluating the reasonableness of proposed terms – and both the bankruptcy court and the BAP explicitly considered it in evaluating reasonableness –, it alone is not dispositive of the question of reasonableness, and no court of appeals ever has suggested that it is.

The only circuit court to address indemnification provisions for bankruptcy professionals at all, held as to market conditions that the fact that indemnification provisions are common in the marketplace “does not automatically make them ‘reasonable’” in the bankruptcy context since the court’s approach is “‘market driven’” not “‘market-determined.’” <u>In re United Artists</u>, 315 F.3d at 229. And it certainly was not clearly erroneous for the bankruptcy court to find that it should consider other factors in addition to the practice of the non-bankruptcy market.[10]

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[10] Houlihan and the Committee also overstate the prevalence and breadth of these provisions in bankruptcy cases. A number of bankruptcy courts have rejected efforts to include such provisions, or have approved them only with scopes much narrower than those of the proposed agreements in this case. <u>See</u>, <u>e.g.</u>, <u>In re Metricom, Inc.</u>, 275 B.R. 364 (Bankr. N.D. Cal. 2002); <u>In re Gillett Holdings, Inc.</u>, 137 B.R. 452 (Bankr. D. Colo. 1991); <u>In re Mortgage & Realty Trust</u>, 123 B.R. 626 (Bankr. C.D. Cal. 1991); <u>In re Allegheny Int’l, Inc.</u>, 100 B.R. 244 (W.D. Pa. 1989); <u>see also</u> <u>In re DEC Int’l, Inc.</u>, 282 B.R. 423, 426-29 (W.D. Wis. 2002)(summarizing cases). Even the district court in <u>In re Comdisco</u>, the case on which Appellants heavily rely, noted that while the courts have “almost uniformly declined to impose a blanket prohibition against their use,” “[m]ost of the courts

(continued...)

Houlihan and the Committee also argue that the bankruptcy court "imposed upon the Committee a mandate that it attempt to find a financial advisor that would take the engagement without the market indemnification provisions." Appellants Br. 33. The court imposed no such requirement; it simply found that appellants had failed to establish reasonableness. If the Committee had shown that it could not find a financial advisor absent such provisions, that might have weighed in favor of a finding that the proposed indemnification provisions were reasonable; nevertheless, there was no requirement that such evidence be presented, and even if it had, no reason to conclude that countervailing factors still might not have led a court to find the proposed terms unreasonable. Appellants simply confuse what was necessary with what might have been sufficient.

Houlihan and the Committee further contend that while "no evidence" was presented, the BAP and the bankruptcy court concluded that the indemnification provisions could pose potentially unlimited risk upon the estate if approved. Again appellants erroneously shift the burden in this case. It was not incumbent upon the courts below or U.S. Trustee to establish that

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[10](...continued) addressing indemnity clauses for financial advisors have expressed reservations about them." In re Comdisco, 2002 WL 31109431 (N.D. Ill. 2002). (The district court in In re Comdisco did not address the reasonableness of the particular agreements in the case and held only that there was no per se bar against such agreements.)

there was an unlimited risk; rather, the burden was on appellants to establish that any risk was reasonable.

Moreover, the risk was obvious from the work Houlihan was being retained to do. Houlihan was retained to value this debtors’ assets and assist in evaluating the liabilities of the debtors and their subsidiaries; analyze and review the financial and operating statements of the debtors; evaluate all aspects of any debtor financing and exit financing; provide valuation or other financial analyses as the Committee might require; assess the financial issues and options concerning a sale of the debtors or reorganization plan; and prepare, analyze, and explain any plan to the Committee. These are among the most important tasks that can be performed in a Chapter 11 reorganization case. The court knew, as would any participant in the bankruptcy process, that significant losses could occur if Houlihan performed them negligently.

Appellants’ claim that there was no evidence of the potentially unlimited impact on the estate is also absurd in light of the fact that the liability protection afforded under the proposed indemnification provisions is wholly uncapped. The provision serves as a potential blank check for Houlihan, including indemnification for costs of defense and settlements. Indeed, the very case which is touted as the justification for indemnification provisions, see, e.g., In re United Artists, 315 F.3d at 229, demonstrates the enormous potential liability that the estate here could face. See In re Merry-Go-Round Enters., Inc., 244 B.R. 327 (Bankr. D. Md. 2000) (accounting firm settled negligence, malpractice, fraud, and fraudulent concealment suit for $185 million). And even if the risk were not so extensive, it is nonetheless unknown and unknowable under the proposed provisions.[11] One of the principal objectives in bankruptcy is to quantify with specificity the liabilities of the estate. An indemnification provision such as the one proposed by Houlihan renders that effort unfeasible.[12]

Houlihan and the Committee do make one case-specific argument: that the indemnification provisions were the product of arms-length negotiations. This one factor – even if true – is insufficient to make the provisions reasonable and in any event, is certainly insufficient to render the bankruptcy court's factual finding, that the provisions were unreasonable, clearly erroneous.

Houlihan and the Committee seek to divert this Court's attention from the BAP's affirmance of the bankruptcy court's decision by claiming that the BAP mistakenly required them to establish that the provisions would be in the best interest of

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[11] Appellants misleadingly state that "even the BAP had to admit that the risk . . . was likely de minimis." App. Br. at 38. What the BAP actually stated was that even if the risk were de minimis, that risk was not necessarily reasonable to impose on the estate.

[12] Furthermore, as the BAP recognized, the risk from the uncapped indemnification provisions in this case is exacerbated by the fact that it is the debtors who are responsible for the payments, but the Committee that is Houlihan's client. The debtors are thus being asked in this case to provide unlimited indemnification for a professional over which they have no control.

the estate. This argument is a red herring. The BAP clearly applied a test of whether the indemnification provisions were reasonable. See, e.g., BAP Op. at 9 (discussing whether the bankruptcy judge erred in finding that the indemnification provisions were "unreasonable" under the circumstances of this case); id. at 10 ("the appropriate inquiry, and the inquiry made by the bankruptcy court, is whether taken as a whole the terms of the retention are unreasonable"); ibid. (holding that the bankruptcy court discusses reasons why the indemnity and exculpation provisions were not reasonable under the circumstances of this case); ibid. (bankruptcy judge considered factors to ultimately find that the indemnity and exculpation provisions were not reasonable under 11 U.S.C. 328(a)); id. at 9-10 ("[k]eeping within the analysis of reasonableness under the circumstances . . . the bankruptcy court found that . . . the risk of unlimited liability and exculpation was simply unreasonable"); id. at 10 (bankruptcy court found that because the impact and financial risk to the estate were not finite and certain, it was "unreasonable" under the circumstances of this case to approve the indemnification and exculpation provisions); id. at 11 ("the question for the bankruptcy court was whether the terms and conditions of Houlihan Lokey's employment were reasonable under the circumstances"); id. at 12 (agreeing with the bankruptcy court that "what is reasonable is not and has not been defined solely by what market conditions suggest" and that the market is "but one factor in the analysis of what is reasonable under the circumstances”); id. at 13 (finding that appellants failed to argue why it is “reasonable” for the estate to bear the risk of liability).[13]

Furthermore, even if the BAP had adopted a “best interests” test, and assuming arguendo that such a test was not the correct test, any such error would be immaterial to this appeal. It is well established that this Court applies the same standard of review to the bankruptcy court decision as does the BAP. Appellants do not contend that the bankruptcy court applied the wrong test, so even if the wrong test were applied by the BAP, Houlihan and the Committee cannot establish that the bankruptcy court’s factual finding that the provisions were unreasonable – the finding that this Court reviews – is clearly erroneous.[14]

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[13] Moreover, there is nothing wrong with asking whether a term or condition of employment will benefit the bankruptcy estate. The purpose of chapter 11 cases is to produce a plan of reorganization that can be approved and which will maximize creditor recoveries. Indeed, much of the work Houlihan was employed to do was help devise a feasible plan. If a bankruptcy court were to determine that a term of employment was not in the best interest of the estate, it would be the court’s duty to reject it. Certainly it was not unreasonable here for the lower court to find it significant that Houlihan sought a blank check that could have imposed very large losses upon this bankruptcy estate.

[14] Appellants’ heavy emphasis on the analysis of reasonableness with respect to compensation, see App. Br. 19-21, is also misplaced. Most of the factors cited by appellants in their brief – time spent on services, rates charged for services, amount of time spent compared with the complexity of the case – obviously have no bearing on the reasonableness of indemnification provisions. Cf. In re Mortgage & Realty Trust, 123 B.R. at 631 (“compensation” as used in 11 U.S.C. 330 “is to be provided in money or money’s worth” and an indemnification provision “does not fall within the scope of this statutory language”). The bankruptcy court in this case explicitly held (continued...)

The bankruptcy court determined that the evidence presented by Houlihan and the Committee was insufficient, for the purposes of this case, to establish that the proposed indemnification provisions were reasonable. That finding was well supported by the record in this case and, as the BAP held, was not clearly erroneous. Furthermore, based on that finding, the bankruptcy court did not abuse its discretion in rejecting the proposed provisions.[15]

CONCLUSION

For the foregoing reasons, this Court should affirm the judgment of the bankruptcy appellate panel.

Respectfully submitted,

ROBERT D. McCALLUM, JR.
Assistant Attorney General

RAYMOND W. GRUENDER, III
United States Attorney

WILLIAM KANTER
(202) 514-4575
ARA B. GERSHENGORN
(202) 514-4690
Attorneys, Appellate Staff

OF COUNSEL:

JOSEPH A. GUZINSKI
General Counsel

P. MATTHEW SUTKO
Attorney
Executive Office

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[14](...continued)
that the proposed compensation here was reasonable. What appellants failed to establish was that the indemnification provisions were reasonable.

[15] Houlihan and the Committee do not appear to argue that if the bankruptcy court was not clearly erroneous in finding the provisions unreasonable, the court's rejection of the provisions constituted an abuse of discretion. Nor would there by any basis for such an argument. There is no reason in this case, and appellants point to none, for the bankruptcy court to have determined that it should approve provisions it had held are unreasonable.

for United States Trustees

Civil Division, Room 9545
Department of Justice
601 “D” Street, N.W.
Washington, D.C. 20530-0001

FEBRUARY 2003

CERTIFICATE OF SERVICE

I hereby certify that on this ____th day of February, 2003, I caused an original and ten copies of the foregoing BRIEF FOR FEDERAL APPELLEE and one electronic copy to be filed with the Court by overnight delivery and caused two copies of the foregoing brief and one electronic copy to be served by overnight delivery, upon

David A. Warfield
Husch & Eppenberger, LLC
190 Carondelet Plaza, Suite 600
St. Louis, MO 63105-3441

Richard A. Chesley
Houlihan, Lokey, Howard & Zukin
123 N. Wacker Drive, Suite 400
Chicago, IL 60606-1700

____
ARA B. GERSHENGORN
Attorney

CERTIFICATE OF COMPLIANCE

Pursuant to Rule 32(a)(7)(C) of the Federal Rules of Appellate Procedure, I hereby certify that the foregoing brief is presented in monospaced Courier font of 10 characters per inch. This brief (excluding the cover, summary of the case, tables of contents and authorities, and certificates of service and compliance) contains _____ words, according to the count of this office's word processing system. I certify that the foregoing brief was prepared using WordPerfect 9.0 and that the electronic copy of the brief has been scanned for viruses and that it is virus free.

____
ARA B. GERSHENGORN
Attorney

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WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	In re: Douglas M. Thigpen (Thigpen v. UST)
2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	D Ill.
3. ("CCN") ***CURRENT*** CASE NO.	No.: 06 C 3020
4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*	No.: 05-63958 Court: Bankr. Ill. *(Identify judge & cite, if any)*
5. ("SO") ***SOURCE***	**U.S. TRUSTEES**
6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	Filed: November 19, 2007 Type: Brief for the Appellee United States Trustee
7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*	Kathryn Gleason, M. Gretchen Silver, Larry E. Wahlquist, P. Matthew Sutko *(UST/OGC: 202-307-1399/FAX-2397)*
8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	• Whether 11 U.S.C. § 109(h) prohibits individuals from seeking bankruptcy relief unless they complete a credit counseling course prior to filing for bankruptcy to help them assess their financial situation and to explore possible alternatives to bankruptcy. √ **Background:**
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UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ILLINOIS

DOUGLAS M. THIGPEN,	)	
	)	Case No. 06 C 3020
Appellant.	)	
	)	Hon. James F. Holderman
v.	)	
	)	
WILLIAM T. NEARY, ***et al.***,	)	
	)	
Appellees.	)	
	)	
	)	
In re	)	Chapter 7 Case
	)	
DOUGLAS M. THIGPEN,	)	Case No. 05 B 63958
	)	
Debtor.	)	Hon. John H. Squires
	)	

BRIEF FOR THE APPELLEE UNITED STATES TRUSTEE

WILLIAM T. NEARY,
UNITED STATES TRUSTEE, REGION 11

Kathryn Gleason
M. Gretchen Silver
Office of the United States Trustee
227 West Monroe Street, Suite 3350
Chicago, Illinois 60606
Telephone (312) 353-5054
Facsimile (312) 886-5794

Of Counsel
Roberta A. DeAngelis
Acting General Counsel

P. Matthew Sutko
Ramona D. Elliott
Larry E. Wahlquist
Office of the General Counsel
Executive Office for United States Trustees
United States Department of Justice
20 Massachusetts, Ave. N.W., Suite 8100
Washington, D.C. 20530
(202) 307-1399

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STATEMENT OF JURISDICTION

The United States Bankruptcy Court for the Northern District of Illinois had jurisdiction over Mr. Thigpen's chapter 7 bankruptcy case under 28 U.S.C. § 157(a) and (b). That court entered its Order Granting Trustee's Motion to Dismiss Case on February 6, 2006 and its Order Denying Mr. Thigpen's Request to Continue/Reschedule Hearing on February 7, 2006. Mr. Thigpen timely appealed these orders to this Court under 28 U.S.C. § 158(c)(2) and Fed. R. Bankr. P. 8002(a) on February 15, 2006. This Court has jurisdiction over this appeal under 28 U.S.C. § 158(a).

STATEMENT OF THE ISSUE

11 U.S.C.§ 109(h) prohibits individuals from seeking bankruptcy relief unless they complete a credit counseling course prior to filing for bankruptcy to help them assess their financial situation and to explore possible alternatives to bankruptcy. Douglas M. Thigpen, the Appellant, failed to do that. Given this failure, did the bankruptcy court err when it refused to continue the hearing on the motion to dismiss, and dismissed Mr. Thigpen's bankruptcy case, when he filed his Motion to Continue after the statutory limit of 45 days for requesting a temporary deferral to obtain credit counseling?

STANDARD OF APPELLATE REVIEW

This Court reviews the bankruptcy court's findings of fact with the clearly erroneous standard. Conclusions of law are reviewed de novo. *In re Woodbrook Assoc.*, 19 F.3d 312, 316 (7th Cir. 1994).

STATEMENT OF THE CASE

Douglas M. Thigpen, the debtor and appellant, filed a voluntary chapter 7 petition on December 14, 2005. [Docket #1].[1] Mr. Thigpen did not file with his petition a certificate of credit counseling establishing that he had received credit counseling before filing for bankruptcy, or a temporary deferral certification requesting additional time to obtain credit counseling due to exigent circumstances. *See* 11 U.S.C. §§ 109(h) and 521(b). Based on this failure, the United States Trustee filed his Motion to Dismiss Case (the "Motion to Dismiss") asserting that Mr. Thigpen was ineligible to be a debtor under the Bankruptcy Code. [Docket #9]. On February 2, 2006, Mr. Thigpen filed his Motion to Continue/Reschedule Hearing (the "Motion to Continue"). [Docket #11]. At the February 3, 2006, hearing on the Motion to Dismiss, the bankruptcy court denied the Motion to Continue and dismissed the bankruptcy case. Mr. Thigpen timely appealed these orders on February 15, 2006. [Docket #17].

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[1] Mr. Thigpen timely filed his Notice of Appeal of the Order Granting the Trustee's Motion to Dismiss Case and the Order Denying Motion to Continue/Reschedule on February 15, 2006. However, Mr. Thigpen never filed a designation of the items to be included in the record on appeal or a statement of the issues to be presented as required by Fed. R. Bankr. P. 8006. Even though the record was not complete for purposes of appeal, the bankruptcy clerk transmitted the appeal to the clerk of this Court. *See* Fed. R. Bankr. P. 8007(b). To assist this Court in deciding this appeal, contemporaneously with filing this brief, the United States Trustee filed a motion requesting leave to designate items to be included in the record on appeal.

STATEMENT OF THE FACTS

I. Statutory Framework

On April 20, 2005, the President signed the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA"), Public Law 109-8, 119 Stat. 23. The BAPCPA made the most substantial changes to the Bankruptcy Code since 1978. Included in the BAPCPA's amendments is a new debtor eligibility requirement added as subsection (h) to section 109 of title 11.

11 U.S.C. § 109(h)(1) requires that all individual debtors, with limited exceptions, obtain a "briefing that outlined the opportunities for available credit counseling," commonly referred to as credit counseling, before filing for bankruptcy.[2] This requirement is imposed upon all individual debtors as an eligibility pre-requisite before entering the bankruptcy system. A debtor can seek a temporary deferral from this credit counseling requirement if the debtor can demonstrate to the bankruptcy court that he or she could not obtain credit counseling before filing bankruptcy due to exigent circumstances. 11 U.S.C. § 109(h)(3).[3] If the bankruptcy court determines that exigent circumstances exist, the debtor may be granted additional time to receive the required credit

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[2] Specifically, Section 109(h) provides that "an individual may not be a debtor under this title unless such individual has, during the 180-day period preceding the date of filing of the petition by such individual, received from an approved nonprofit budget and credit counseling agency described in section 111(a) an individual or group briefing (including a briefing conducted by telephone or on the Internet) that outlined the opportunities for available credit counseling and assisted such individual in performing a related budget analysis."

[3] In order to qualify for this temporary deferral, a debtor must also show that he or she requested credit counseling from an approved agency, but that the agency was unable to provide counseling within five days of the debtor's request, and that the request is "satisfactory" to the court. 11 U.S.C. § 109(h)(3)(A)(ii) and (iii).

counseling, up to a maximum of 45 days. However, in "no case" may the bankruptcy court extend the temporary deferral beyond this statutory deadline of 45 days. 11 U.S.C. § 109(h)(3)(B).

A debtor may obtain a permanent waiver from the credit counseling requirement if the United States Trustee waives an entire judicial district due to inadequate credit counseling agencies or if a debtor demonstrates to the bankruptcy court, after notice and a hearing, that the debtor, after reasonable effort, is either incapacitated, disabled, or on active military duty in a military combat zone. 11 U.S.C. §109(h)(2) and (4).

II. Factual Background

On December 14, 2005, Mr. Thigpen filed a voluntary chapter 7 petition *pro se*. [Docket #1]. Mr. Thigpen did not file with his petition a certificate of credit counseling establishing that he had received credit counseling before filing for bankruptcy, or a temporary deferral certification requesting additional time to obtain credit counseling due to exigent circumstances.

The United States Trustee filed the Motion to Dismiss on January 24, 2006, which was noticed for hearing on February 3, 2006. [Docket #9]. On January 30, 2006, Mr. Thigpen delivered his Motion to Continue to the prison authorities where he was incarcerated, and it was filed on February 2, 2006. [Docket #11]. The Motion to Continue requests an extension of time to respond to the Motion to Dismiss and to hire counsel to represent him in the case. *Id.*

At the February 3, 2006 hearing, the bankruptcy court denied the Motion to Continue and dismissed the bankruptcy case. [Docket ## 13 and 14]. Mr. Thigpen timely appealed these orders on February 15, 2006. [Docket #17].

SUMMARY OF ARGUMENT

Mr. Thigpen suggests the bankruptcy court violated his due process rights when it denied his Motion to Continue to obtain counsel and to respond to the United States Trustee's Motion to Dismiss. *See* Appellant's Brief, p.7 - 9. Mr. Thigpen is mistaken for three reasons: (1) the statutory deadline for credit counseling extensions had already expired before he filed his continuance motion so an attorney, even if one could have been obtained, could not have changed the outcome; (2) similarly, continuing the case would only have delayed dismissal because the bankruptcy court did not possess the authority to grant Mr. Thigpen additional time to obtain credit counseling due to the statutory deadline; and (3) continuance motions are within the discretion of the bankruptcy court and the court did not abuse that discretion in denying Mr. Thigpen's request based on the facts of this case.

11 U.S.C. § 109(h) requires debtors to obtain credit counseling before filing a bankruptcy petition to be eligible for bankruptcy relief. The only exception that allows for post-petition credit counseling is found in section 109(h)(3). This exception authorizes a court to grant a temporary deferral for obtaining credit counseling up to a maximum of 45 days post-petition if the court is satisfied with the debtor's certification of exigent circumstances. Mr. Thigpen never obtained credit counseling pre-petition and did not file a certification of exigent circumstances requesting a temporary deferral. Even if Mr. Thigpen's Motion to Continue could be construed as a certification of exigent circumstances that warrant a temporary deferral, the court could not grant Mr. Thigpen additional time to obtain credit counseling since the Bankruptcy Code expressly limits a court's discretion to grant additional time to a maximum of 45 days. Mr. Thigpen delivered his Motion to Continue to prison authorities after these 45 days had already lapsed. Because the court did not

possess the authority to extend the time for Mr. Thigpen to obtain credit counseling, there was no reason to allow Mr. Thigpen additional time to respond to the United States Trustee's Motion to Dismiss or to obtain counsel. Even if Mr. Thigpen obtained legal representation, his counsel could not change the fact that his Motion to Continue was filed too late and the court was bound to dismiss his case.

Further, continuance motions are within the discretion of the trial court and will only be reversed if the court acted unreasonably. Because the court lacked the authority to grant Mr. Thigpen additional time to obtain credit counseling, the court acted within its discretion in denying Mr. Thigpen's Motion to Continue. Accordingly, the court properly dismissed Mr. Thigpen's case.

ARGUMENT

Section 109 of the Bankruptcy Code unequivocally requires debtors to obtain credit counseling *before* filing for bankruptcy. *See* 11 U.S.C. § 109(h). In so doing, section 109(h) effectuates Congress' stated intent to compel "debtors to participate in credit counseling programs before filing for bankruptcy relief... [in order] to give consumers in financial distress an opportunity to learn about the consequences of bankruptcy... before they decide to file for bankruptcy relief." H.R. Rep. No. 109-31, part 1, at 18 (2005) (Conf. Rep.).

Failure to obtain credit counseling prior to filing a bankruptcy petition renders an individual ineligible to be a debtor under the Bankruptcy Code. *See In re Gossett*, 369 B.R. 361, 365 (Bankr. N.D. Ill. 2007) (Section 109(h)(1) "is sometimes referred to as the ticket into consumer bankruptcy for individual debtors, and is an eligibility requirement for relief with certain exceptions"); *In re Cobb*, 343 B.R. 204, 207 (Bankr. E.D. Ark. 2006) ("[m]ake no mistake about Congress' intention: individual debtors must have credit counseling before they are eligible for relief under any chapter of the Bankruptcy Code"); *In re Rios*, 336 B.R. 177, 179 (Bankr. S.D.N.Y. 2005) ("Under the BAPCPA, Congressional intent is clear that credit counseling is required prior to filing, as a prerequisite for bankruptcy relief, to provide putative debtors with the opportunity to make informed choices as to financial alternatives available"); *In re Valdez*, 335 B.R. 801, 803 (Bankr. S.D. Fla. 2005) (holding that individual who filed pro se Chapter 13 petition did not qualify as a debtor as she did not fulfill the pre-petition budget and credit counseling requirement); *In re Gee*, 332 B.R. 602, 604 (Bankr. W.D. Mo. 2005) ("[w]ithout a waiver, Debtor is clearly ineligible to be a debtor under § 109(h)(1) because she did not obtain the required credit counseling services within 180 days prior to the filing of the petition").

There are only three exceptions to this requirement, which include: (1) residing in a district where the United States Trustee has waived the credit counseling requirement; (2) filing a certification of exigent circumstances that the court determines warrant a 45 day temporary deferral; and (3) being unable, after reasonable effort, to obtain credit counseling due to incapacity, disability, or active military duty in a combat zone. 11 U.S.C. § 109(h)(2),(3), and (4). None of these exceptions apply in the present case, nor has Mr. Thigpen presented any evidence or even alleged that he qualifies for any of these exceptions.

Section 109(h)(3) permits a debtor to obtain a temporary deferral to receive credit counseling after filing the petition if exigent circumstances exist and if the credit counseling is received no more than 45 days after the date the bankruptcy petition is filed. Congress emphasized that the 45th day was the outer limit for compliance: "in no case may the exemption apply to that debtor after the date that is 30 days after the debtor files a petition, except that the court, for cause, may order an additional 15 days." 11 U.S.C. § 109(h)(3)(B).

Even if the bankruptcy court had construed Mr. Thigpen's Motion to Continue to be a request for a temporary deferral to receive credit counseling due to exigent circumstances under section 109(h)(3)(A), that exception does not apply in this case because the Motion to Continue was delivered to prison authorities on January 30, 2006, and filed on February 2, 2006. These dates are more than 45 days after the December 14, 2005, date of filing the petition in this case. Section 109(h)(3)(B) expressly limits a court's authority to grant temporary deferrals to 45 days after the petition is filed. Therefore, the court did not possess the authority to grant Mr. Thigpen additional time to obtain credit counseling when he filed his Motion to Continue. *See Clippard v. Bass*. 365 B.R. 131 (W.D. Tenn. 2007) (in reversing the bankruptcy court for granting a debtor 49 days to obtain counseling post-petition, the district court stated, "the plain language of 11 U.S.C. 109(h)(3)(B) states that in 'no case' may a temporary deferral extend beyond forty-five days").[4] Because the court could not grant Mr. Thigpen more time, there was no reason for a continuance of the hearing on the Motion to Dismiss.

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[4] In addition to being filed too late to be considered a valid certification of exigent circumstances that warrant a temporary deferral, Mr. Thigpen's Motion to Continue fails to satisfy the substantive requirements of such a certification by failing to identify the exigency that caused him to file bankruptcy without first obtaining credit counseling, as well as indicating that he requested credit counseling from an approved credit counseling agency pre-petition, but was unable to obtain the counseling within five days of his request. 11 U.S.C. § 109(h)(3)(A)(i) and (ii). *See also In re McBride,* 354 B.R. 95 (Bankr. D.S.C. 2006)(court denied incarcerated debtor's request for exigent circumstances temporary deferral because, among other things, debtor failed to comply with section 109(h)(3)(A)(ii) requirement that debtor request credit counseling before filing petition); *In re Latovljevic*, 343 B.R. 817 (Bankr. N.D. W.Va. 2006) (same).

Furthermore, the Supreme Court has ruled that continuance motions are within the discretion of the trial court, and that "there are no mechanical tests for deciding when a denial of a continuance is so arbitrary as to violate due process. The answer must be found in the circumstances present in every case, particularly in the reasons presented to the trial judge at the time the request is denied." *Ungar v. Sarafite*, 376 U.S. 575, 589 (1964). *See also Research Systems Corp. v. IPSOS Publicite, et al.*, 276 F.3d 914, 919 (7th Cir. 2002) ("'We review the trial court's denial of a continuance for abuse of discretion.... Matters of trial management are for the district judge; we intervene only when it is apparent that the judge has acted unreasonably'") (quoting *United States v. $94,000 in United States Currency*, 2 F.3d 778, 787 (7th Cir. 1993), and *N. Ind. Pub. Serv. Co. v. Carbon County Coal Co.*, 799 F.2d 265, 269 (7th Cir. 1986)).

In Mr. Thigpen's Motion to Continue, he asserts that he does not understand the law and needs an attorney "to file the needed petitions or documents in this matter." *See* Appellant's Motion to Continue, p. 1. However, Mr. Thigpen filed his petition *pro se* on December 14, 2005, and had over a month to locate an attorney to assist him in his bankruptcy. Further, it is well established that legal counsel is not a right in bankruptcy; "the right to counsel only exists in favor of an indigent whose physical liberty is at stake." *In re Eagle*, 373 B.R. 609, 612 (B.A.P. 8th Cir. 2007) (citing *Lassiter v. Dep't of Soc. Servs. of Durham County*, 452 U.S. 18, 26-27 (1981)). *See also In re Merritt*, 186 B.R. 924, 934 (Bankr. S.D. Ohio 1995) (bankruptcy court denied incarcerated debtor's request for an attorney, stating that "[t]here is no right to counsel in a civil case") (citations omitted). Even if the court granted Mr. Thigpen time to obtain counsel, his case would have been dismissed for failure to obtain credit counseling since the 45 day statutory deadline in section 109(h)(3)(B) had already lapsed when he filed his Motion to Continue. Obtaining legal counsel could not change that result. Therefore, if any error exists it is harmless error.

The facts in this case demonstrate the bankruptcy court did not abuse its discretion. Mr. Thigpen did not obtain credit counseling before filing his petition as the Bankruptcy Code requires, nor does he qualify for an exception. The bankruptcy court was not empowered to grant Mr. Thigpen additional time to obtain credit counseling since he filed his Motion to Continue after the 45 day limit established in Section 109(h)(3)(B). Therefore, the bankruptcy court acted reasonably, and within its discretion, in denying Mr. Thigpen's Motion to Continue. Finally, Mr. Thigpen has not provided any case law that supports his position that the bankruptcy court abused its discretion. Accordingly, Mr. Thigpen's due process rights were not violated since the bankruptcy court was bound to dismiss his case due to his ineligibility to be a debtor. Thus, the bankruptcy court properly denied Mr. Thigpen's Motion to Continue and dismissed his case.[5]

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[5] Mr. Thigpen is not without a remedy. He may obtain credit counseling at any time and file a new bankruptcy petition.

CONCLUSION

For these reasons, the United States Trustee respectfully asks this Court to affirm the orders entered below.

RESPECTFULLY SUBMITTED:
WILLIAM T. NEARY
UNITED STATES TRUSTEE

DATED: 11/19/2007

BY: /S/ *M. Gretchen Silver*
M. Gretchen Silver, an attorney for the
United States Trustee

Kathryn Gleason
M. Gretchen Silver
Office of the United States Trustee
227 West Monroe Street, Suite 3350
Chicago, Illinois 60606
Telephone (312) 353-5054

BRIEF BANK — “SUMMARY SHEET”

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WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*
In re: Richard W. Thomas and Kathy Lee Thomas (UST v. Richard Thomas, et al.)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*
D. Kan.

3. ("CCN") ***CURRENT*** CASE NO.
No.: 07-cv-02493-JWL-JPO

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*
No.: 06-21108-7
Court: Bankr. Kan.
(Identify judge & cite, if any)

5. ("SO") ***SOURCE***
U.S. TRUSTEES

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*
Filed: December 17, 2007
Type: Brief of the Appellant Richard A. Wieland, Acting United States Trustee

7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*
P. Matthew Sutko, Melissa R. Burgess, Sean E. Martin, David P. Eron and Richard A. Wieland
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***
• Whether 11 U.S.C. § 707(b)(2)(A)(ii)(I)’s use of the word “applicable” means debtors cannot claim an ownership expense on a vehicle not burdened by a lease or a secured debt payment.
√ **Background:**

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BEFORE THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF KANSAS

CASE NO. 07-CV-02493-JWL-JPO

IN RE RICHARD W. THOMAS AND KATHY LEE THOMAS
Debtors.

RICHARD A. WIELAND, ACTING UNITED STATES TRUSTEE
Appellant,

v.

RICHARD W. THOMAS AND KATHY LEE THOMAS
Appellees.

ON APPEAL FROM THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF KANSAS

THE HONORABLE ROBERT D. BERGER, PRESIDING
Bankruptcy Case No. 06-21108-7

BRIEF OF THE APPELLANT RICHARD A. WIELAND, ACTING UNITED STATES TRUSTEE

Of Counsel

ROBERTA A. DeANGELIS
Acting General Counsel

P. MATTHEW SUTKO
MELISSA R. BURGESS
SEAN E. MARTIN
Department of Justice
Executive Office for United States Trustees
20 Massachusetts Avenue, NW
Washington, D.C. 20530

RICHARD A. WIELAND
Acting United States Trustee

DAVID P. ERON
Office of the United States Trustee
Department of Justice
301 N. Main Street, Suite 1150
Wichita, KS 67202
Telephone: (316) 269-6176
Fax: (316) 269-6182

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JURISDICTIONAL STATEMENT

The United States Bankruptcy Court for the District of Kansas had jurisdiction under 28 U.S.C. §§ 157(b) and 1334(a) to hear the underlying case, commenced by the filing of a voluntary petition under chapter 7 of the Bankruptcy Code, 11 U.S.C. § 701, et seq. On October 2, 2007, the bankruptcy court entered an order denying the United States Trustee's motion to dismiss Richard and Kathy Thomases' case for abuse of chapter 7. On October 12, 2007, the United States Trustee filed a timely notice of appeal from that order. See 28 U.S.C. § 158(c)(2); Fed. R. Bankr. P. 8002(a). This Court has jurisdiction over this appeal under 28 U.S.C. § 158(a)(1).

STATEMENT OF THE ISSUE

Did the bankruptcy court err by ruling that the Thomases could claim transportation "ownership expenses," for purposes of the section 707(b)(2) means test, for vehicles on which they are not making any loan or lease payments?

STATEMENT OF THE CASE

This appeal challenges a bankruptcy court order denying the United States Trustee's motion to dismiss a chapter 7 case for presumed abuse under the means test in section 707(b)(2).

On July 27, 2006, Richard and Kelly Thomas filed a voluntary petition for relief under chapter 7 of the Bankruptcy Code. In their required bankruptcy filings, the Thomases claimed ownership expenses for two vehicles they owned free and clear. Without credit for the deductions, the Thomases' case would be presumptively abusive of chapter 7. The Thomases also acknowledged that they had $1,513.04 in actual monthly net income based on their Schedules I and J. Therefore, the United States Trustee filed a motion to dismiss for abuse of chapter 7.[1] The

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[1] Section 707(b)(1) provides that the United States Trustee may file a motion to dismiss. The Bankruptcy Code also provides that United States Trustees "may raise and may appear and be heard

United States Trustee claimed that the Thomases' case was a presumed abuse under section 707(b)(2), and alternatively that that the totality of the circumstances of their financial situation demonstrated abuse under section 707(b)(3)(B).

The bankruptcy court denied the United States Trustee's motion to dismiss in its entirety. It ruled that the Thomases could take the transportation ownership expense deduction, even though they had no loan or lease payments on their vehicles. Therefore, the bankruptcy court held their case was not presumptively abusive under section 707(b)(2). The bankruptcy court also ruled that the debtors' case did not demonstrate abuse under section 707(b)(3)(B). This appeal followed.

STATEMENT OF THE FACTS

I. Statutory Framework

An individual who seeks to discharge past debts may file a petition under chapter 7 of the Bankruptcy Code. See 11 U.S.C. § 701, et seq. By filing such a petition, the individual "commences" a bankruptcy case and becomes a "debtor." See 11 U.S.C. § 301(a), 101(13). Barring debtor misconduct or other special situations, the bankruptcy court will eventually issue an order discharging most of the debtor's pre-petition financial obligations. See 11 U.S.C. § 727.

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("2005 Reform Act") made significant changes to the Bankruptcy Code, including a new means test for chapter

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on any issue in any case or proceeding" under the Bankruptcy Code. 11 U.S.C. § 307. United States Trustees are senior officials of the Department of Justice appointed by the Attorney General to supervise the administration of bankruptcy cases. 28 U.S.C. §§ 581-89 (specifying the powers and duties of United States Trustees). See generally Morganstern v. Revco D.S. Inc. (In re Revco D.S., Inc.), 898 F.2d 498, 500 (6th Cir. 1990) (explaining that United States Trustees oversee the bankruptcy process, protect the public interest, and ensure that bankruptcy cases are conducted according to law).

7 individual debtors with primarily consumer debts.[2] See 11 U.S.C. § 707(b)(1). "The heart of the bill's consumer bankruptcy reforms consists of the implementation of an income/expense screening mechanism . . . which is intended to ensure that debtors repay creditors the maximum they can afford." H.R. Rep. 109-31 at 1 (I) (2005), *as reprinted in* 2005 U.S.C.C.A.N. 88, 89.

The legislative history to the 2005 Reform Act reveals that Congress meant to prevent debtors from obtaining chapter 7 relief if they had an ability to repay their creditors. Although "some bankruptcy debtors are able to repay a significant portion of their debts," Congress was driven to act because existing law had "no clear mandate requiring these debtors to repay their debts." Id. at 5 & n.18, *as reprinted in* 2005 U.S.C.C.A.N. 88, 92.

As part of this effort, Congress significantly amended section 707(b) of the Bankruptcy Code, which governs dismissal of chapter 7 bankruptcy cases. As it existed prior to the 2005 Reform Act, section 707(b) only authorized dismissal based on a finding that allowing the debtor relief (i.e., granting a discharge of debts) constituted a "substantial abuse" of chapter 7. Prior to its 2005 amendment, section 707(b) also required courts to presume that a debtor was entitled to relief under chapter 7 of the Bankruptcy Code. Section 707(b) now authorizes dismissal where the court finds that the granting of relief would be an "abuse" of chapter 7. "Abuse" may be found by the bankruptcy court under the circumstances described in newly added subsections (b)(2) and (b)(3). Further, section 707(b)(2) repealed the former presumption in favor of a debtor obtaining bankruptcy relief and replaced it with a new presumption: a case will be presumed to be an "abuse" of chapter 7 if a detailed mathematical formula set out in the statute, commonly referred to as the "means test," yields a minimum amount of monthly disposable income. See 11 U.S.C. § 707(b)(2).

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[2] S. 256, Pub. L. No. 109-8, 119 Stat. 23. The 2005 Reform Act's general effective date is for bankruptcy cases filed on or after October 17, 2005.

When a presumption of abuse does not arise or is rebutted under subsection (b)(2), section 707(b)(3) allows the court to find abuse where the debtor filed the petition in bad faith, or the totality of the circumstances demonstrates abuse.

A. *Section 707(b)(2)*

The means test of section 707(b)(2) requires the bankruptcy court to use a series of calculations when determining whether the presumption of abuse arises. See 11 U.S.C. § 707(b)(2)(A). Specifically, the means test calculates a debtor's "current monthly income" ("CMI") based on the debtor's average income for the six calendar months preceding the month of the bankruptcy filing. See 11 U.S.C. § 101(10A). If a debtor's annualized CMI is below the applicable state median family income, the debtor's case will not be presumed abusive under 11 U.S.C. § 707(b)(7). When the annualized CMI is above the applicable median family income, however, as is the case here, section 707(b)(2)(A) refers bankruptcy courts next to the debtor's monthly disposable income available to repay creditors by reducing CMI by certain enumerated categories of expenses. See 11 U.S.C. § 707(b)(2)(A)(ii), (iii), and (iv).

If the debtor's monthly disposable income, determined by deducting allowed expenses from CMI, is less than $100 per month (or $6,000 over 60 months), the presumption of abuse does not arise. 11 U.S.C. § 707(b)(2)(A)(I).[3] If the debtor's monthly disposable income is equal to or exceeds $166.67 per month (or $10,000 over 60 months), the presumption of abuse does arise. Id. If the debtor's monthly disposable income is between $100 and $166.67 per month (between $6,000 and $10,000 over 60 months), the presumption of abuse arises if the disposable income, over 60

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[3] Under section 104 of the Bankruptcy Code, statutory dollar amounts set forth for the determination of presumed abuse under the means test were adjusted by the Judicial Conference of the United States effective April 1, 2007. 72 Fed. Reg. 7082 (Feb. 14, 2007). This case is not subject to the recent dollar amount adjustments.

months, is sufficient to pay 25 percent of the debtor's nonpriority unsecured debt. Id. If the presumption of abuse under section 707(b)(2) arises after completion of the means test, the debtor may attempt to rebut the presumption by demonstrating special circumstances that justify income or expense adjustments for which there is no reasonable alternative. 11 U.S.C. § 707(b)(2)(B).[4]

Each debtor who, like the Thomases, has primarily consumer debts is required to file, in conjunction with the bankruptcy schedules and statement of financial affairs, a Statement of Current Monthly Income and Means Test Calculation, Official Form 22A ("Form 22A"). 11 U.S.C. §§ 521 and 707(b)(2)(c). The purpose of Form 22A is to calculate monthly disposable income following the formula set forth in section 707(b)(2), and determine whether the presumption of abuse arises.

At issue in this appeal is whether the Thomases correctly deducted transportation ownership costs under the Local Standards issued by the Internal Revenue Service in preparing their Form 22A and calculating their monthly disposable income. In determining the expenses to be deducted from CMI in arriving at monthly disposable income, section 707(b)(2)(A)(ii)(I) provides that a debtor's "monthly expenses shall be the debtor's *applicable* monthly expense amounts specified under the National Standards and Local Standards and the debtor's actual monthly expenses for the categories specified as Other Necessary Expenses issued by the Internal Revenue Service for the area in which the debtor resides . . . ." 11 U.S.C. § 707(b)(2)(A)(ii)(I) (emphasis added).

The Local Standards issued by the IRS apportion transportation expenses into two components.[5] The first component includes costs associated with financing vehicle acquisition, i.e.,

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[4] Were this Court to reverse the order entered below that the presumption of abuse did not arise, this Court should remand to allow the Thomases to attempt to establish special circumstances. See 11 U.S.C. § 707(b)(2)(B).

[5] For this Court's convenience, a true and correct pdf copy of the applicable Collection Financial

the vehicle ownership costs. Id. The second component is associated with the costs of vehicle operation. Id. The Thomases deducted two vehicle ownership expenses on their Form 22A, but they admit that they do not have any "ownership" expenses (i.e., a loan or lease payment).

II. Factual Background

The Thomases filed a chapter 7 bankruptcy petition on July 27, 2006 to discharge almost $120,000 in credit card debt and other unsecured consumer debt. Bankruptcy Docket ("BD") 1, pp. 20-22. On their Form 22A, the Thomases reported their CMI as $4,786.70, which translates into annualized gross income of $57,440.40. See id, p. 39. Because this gross income exceeded the applicable Kansas state median family income, they were required to complete the expense portion of Form 22A. See 11 U.S.C. § 707(b)(7).

In computing expenses on Form 22A, the Thomases claimed transportation ownership expenses for two vehicles. BD 1, p. 40. On Line 23, they claimed a transportation ownership expense of $471 for a 2000 Ford F-150 truck. Id. On Line 24, they claimed a transportation ownership expense of $332 for a 1996 Mercury Villager LS minivan. Id. The Thomases own these vehicles free and clear of any debt. Id., p. 17; BD 18, p. 1.

Standards is attached as Exhibit A and incorporated herein by reference. The IRS revised its Collection Financial Standards, effective October 1, 2007, and such revisions will be made applicable to bankruptcy cases filed as of January 1, 2008. *See* IRS Collection Financial Standards, "Local Standards: Transportation," *at* http://www.irs.gov/individuals/article/0,,id=96543,00.html. Because the Thomases filed their case on July 27, 2006, only the Collection Financial Standards in effect prior to October 1, 2007, are applicable. See 11 U.S.C. § 707(b)(2)(A)(ii)(I) (stating that the IRS standards will be those "in effect on the date of the order for relief"). Moreover, the revisions made by the IRS effective October 1, 2007 would not change the result in this case. As the revised standards set forth, the Local Standard for ownership costs is still made expressly contingent on the existence of a loan or lease payment on a vehicle. See id.

As required by 11 U.S.C. § 704, the United States Trustee reviewed all materials submitted by the Thomases, including Form 22A, and concluded that the presumption of abuse arose. BD 9.[6] The United States Trustee moved to dismiss the Thomases' case as an abuse under 11 U.S.C. § 707(b)(1). BD 11. The United States Trustee determined that the Thomases' claimed deductions for transportation ownership on Form 22A were not allowable under section 707(b)(2)(A)(ii)(I) because they owned their vehicles outright and therefore had no applicable transportation ownership expense. BD11, pp. 12-14, 27.[7] The United States Trustee calculated that the Thomases had monthly disposable income of $389.39 under the means test of section 707(b)(2). BD 11, p. 27. This exceeded the $166.67 presumption of abuse threshold under section 707(b)(2)(A) by $222.72.

Under oath, the Thomases disclosed in their required Schedules I and J that their actual monthly net income available for repaying unsecured debt was $977.05, BD 1 pp. 25-27, but later acknowledged that these forms inadvertently included a nonexistent $535.99 auto payment expense. BD 1, p. 17; BD 11, p. 16; BD 18, p. 1. Therefore, by their own account, the Thomases had $1,513.04 in monthly net income. After reviewing the materials filed by the Thomases, including their schedules, the United States Trustee concluded that the totality of the circumstances of the debtors' financial situation demonstrated abuse. Accordingly, in his motion to dismiss, the United States Trustee also alleged that the totality of the circumstances of the Thomases' financial situation demonstrated abuse of chapter 7 under section 707(b)(3).

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[6] Section 704(b)(1) requires that the United States Trustee review all materials filed by individual chapter 7 debtors and file a statement as to whether the debtor's case would be presumed to be an abuse of section 707(b). See 11 U.S.C. § 704(b)(1)(A).

[7] Due to the age of the Thomases' vehicles and the inapplicability of the ownership expenses, the United States Trustee determined that the Thomases were entitled to additional operating expenses of $200 for each of their two vehicles. See Internal Revenue Manual at section 5.8.5.5.2, available at: http://www.irs.gov/irm/part5/ch08s05.html.

The Thomases objected to the section 707(b)(2) portion of the United States Trustee's dismissal motion on November 11, 2006. BD 18. The parties then briefed the section 707(b)(2) issue. See BD 23, 24.

On October 2, 2007, the bankruptcy court entered an order denying the United States Trustee's motion to dismiss in its entirety. BD 27. The bankruptcy court ruled that the Thomases were entitled to claim the transportation ownership expense for their two vehicles even though they did not have any car payments. Id., pp. 2-4. The bankruptcy court also ruled that, because the Thomases could claim the transportation ownership expenses, the "totality of the circumstances" test under section 707(b)(3) "fails to establish abuse." Id., p. 2.

On October 12, 2007, the United States Trustee timely filed a notice of appeal, and filed an election under 28 U.S.C. § 158(c)(1) to have this appeal heard by the United States District Court for the District of Kansas. BD 31, 34.

SUMMARY OF ARGUMENT

The bankruptcy court erred in denying the United States Trustee's motion to dismiss for presumed abuse because it misinterpreted when debtors can claim transportation ownership expenses under section 707(b)(2). The court held that the Thomases were entitled to deduct transportation ownership expenses for both of their vehicles, even though they owned these vehicles free and clear. This conclusion is incorrect because the Thomases may claim only "applicable" ownership expenses under section 707(b)(2), and they had no applicable expenses for ownership of a car because neither of their vehicles was subject to a loan or lease payment. By using the word "applicable," Congress limited eligibility for expenses under the Local Standards to debtors for whom the expenses apply. Because the transportation ownership expense does not apply with respect to the Thomases' vehicles, the bankruptcy court erred in holding that the Thomases were eligible to deduct the expenses under the means test. Therefore, the presumption of abuse arose in their case under section 707(b)(2).[8]

Reading "applicable" in section 707(b)(2) this way has the salutary effect of applying the means test in a manner that is consistent with the IRS's longstanding application of the transportation ownership expense. In applying its Local Standards to taxpayers, the IRS does not allow taxpayers to claim transportation ownership expenses absent a monthly car payment expense. See Ex. A.

The bankruptcy court's order also conflicts with the primary purpose of Congress in passing the 2005 bankruptcy reform amendments at issue in this appeal. The 2005 Reform Act was intended to ensure that debtors repay their debts when they can. By allowing the Thomases to claim non-existent ownership expenses for their vehicles, the bankruptcy court frustrated that purpose.

STANDARD OF REVIEW

A court's interpretation of the Bankruptcy Code is a legal conclusion subject to de novo review. In re M & L Business Mach. Co., Inc., 84 F.3d 1330, 1334-35 (10th Cir. 1996). The bankruptcy court's legal conclusion that section 707(b)(2) allowed the Thomases to deduct transportation ownership expenses for two vehicles when they had no loan or lease payments is a question of law subject to *de novo* review.

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[8] The United States Trustee asks that this Court remand so the Thomases can seek to establish special circumstances to rebut the presumption of abuse. See 11 U.S.C. § 707(b)(2)(B). The United States Trustee is not appealing the section 707(b)(3) portion of the bankruptcy court's order. The bankruptcy court decided the section 707(b)(3) issue *sua sponte* without briefing by the parties, so the issue has not been fully developed, and the United States Trustee believes that reversal and remand is appropriate on the section 707(b)(2) issue.

ARGUMENT

I. Transportation ownership expenses were not "applicable" to the Thomases, because no such expenses existed.

A. *The bankruptcy court erred in holding that the Thomases were eligible to claim the IRS Local Standards for ownership for their vehicles because the expense was not applicable to them.*

The bankruptcy court's order denying the United States Trustee's motion to dismiss should be reversed because it fails to recognize that the Bankruptcy Code only allows a debtor to claim transportation ownership expenses that are "applicable" to that debtor. 11 U.S.C. § 707(b)(2)(A)(ii)(I). The Thomases do not have any "applicable" transportation ownership expense because they own their vehicles outright. Their attempt to claim an expense that they do not have is prohibited by the Bankruptcy Code. The Code allows a debtor to claim only "applicable" expenses, not fictional ones. For this reason, the order entered below merits reversal.

1. Transportation ownership expenses are allowable only if "applicable" to the debtors.

Section 707(b)(2)(A)(ii)(I) of the Bankruptcy Code provides that a "debtor's monthly expenses shall be the debtor's *applicable* monthly expense amounts specified under the . . . Local Standards . . . issued by the Internal Revenue Service. . . ." 11 U.S.C. § 707(b)(2)(A)(ii)(I) (emphasis added). The statute expressly provides that before the specific IRS expense amounts may be included in the debtor's allowed monthly expenses, the expense must itself first be applicable to the debtor. Id.

The Bankruptcy Code does not define the word "applicable." Nor has the United States Trustee identified any Supreme Court or Tenth Circuit decision providing a definition in the bankruptcy context. Where, as here, a statutory term is undefined, a basic principle of statutory construction provides that courts should give such terms their ordinary meanings. E.g., Smith v. U.S., 508 U.S. 223, 228 (1993) ("When a word is not defined by statute, we normally construe it in accord with its ordinary or natural meaning."); United States v. Gonzales, 456 F.3d 1178 , 1182 (10th Cir. 2006) ("When a statute does not specifically define a term, we construe the term in accord with its ordinary or natural meaning."). The dictionary defines "applicable" to mean applying or capable of being applied; relevant; suitable; appropriate. *Random House Unabridged Dictionary* (2006). Accordingly, such a meaning should be imparted to the term "applicable" as it appears in section 707(b)(2)(A)(ii)(I) absent clear indication that Congress intended to give such term a different meaning. See Mississippi v. Louisiana, 506 U.S. 73, 78 (1992) (using dictionary to define the word "exclusive"); United States v. Montgomery, 468 F.3d 715, 720 n.3 (10th Cir. 2006) (applying dictionary definitions to the word "involving").

The bankruptcy court's order is inconsistent with the ordinary or natural meaning of "applicable" because it allows debtors like the Thomases to deduct expenses that do not apply to them. Here, the Thomases seek to claim an expense for two non-existent loan or lease payments. By inserting the word "applicable" in section 707(b)(2)(A)(ii)(I), Congress limited eligibility for expenses under the Local Standards to a debtor for whom such expenses are "relevant; suitable; appropriate" – thereby excluding non-existent expenses. Because the Thomases did not have vehicle financing expenses for either of their vehicles, the IRS vehicle ownership expense did not apply.

Not surprisingly, both appellate courts that have interpreted "applicable" in section 707(b)(2)(A)(ii)(I) have rejected the bankruptcy court's interpretation. In re Ross-Tousey, 368 B.R. 762, 766 (E.D. Wis. 2007); In re Hartwick, 373 B.R. 645, 649-50 (D. Minn. 2007). They did so, in part, because the bankruptcy court's reading is not faithful to the purpose underlying section 707(b)(2)'s means test. As the Ross-Tousey court noted, "if it really is that simple, the statute would not seem to achieve its purpose" of ensuring that debtors are allowed expenses for the necessities of life but pay creditors from what remains. Ross-Tousey, 368 B.R at 766 (E.D. Wis. 2007). See also In re Howell, 366 B.R. 153, 157 (Bankr. D. Kan. 2007) ("[D]enying debtors the ownership allowance when they have no ownership expense (*i.e*. loan or lease payments) is entirely consistent with one of the apparent objectives of BAPCPA: to ensure that debtors actually pay what they are capable of paying to unsecured creditors.").

The bankruptcy court's interpretation also fails to appreciate that a debtor's ability to pay creditors is not affected by mere vehicle ownership but by payments on a car. Accordingly, section 707(b)(2)(A)(ii)(I) does not focus on how many cars a debtor owns, but how many cars he or she makes payments on every month. Ross-Tousey, 368 B.R. at 766 ("The statute is only concerned about protecting the debtor's ability to continue owning a car, and if the debtor already owns the car, the debtor is adequately protected."); see also Hartwick, 373 B.R. at 652 (same).

The bankruptcy court also overextended the distinction between the word "actual" and "applicable" in section 707(b)(2)(A)(ii)(I). See BD 27 at p. 3. The bankruptcy court concluded that because Congress used both words in the statute, and the words have different meanings, debtors like the Thomases need not have any "actual" expense for the ownership expense to be "applicable." Id. This logic is misguided, however, because, as the Ross-Tousey court explained, there is no indication in section 707(b)(2)(A)(ii)(I) that Congress intended the words "applicable" and "actual" to have essentially opposite meanings. Ross-Tousey, 368 B.R. at 765. Rather, the better reading of "applicable" in the context of section 707(b)(2)(A)(ii)(I) is that it may have two meanings: first, the ownership expense is "applicable" if the debtor makes a loan or lease payment on a vehicle, and second, the amount allowed to the debtor is the "applicable" amount provided under the IRS Local Standards, and not the "actual" amount. See Hartwick, 373 B.R. at 653; Ross-Tousey, 368 B.R. at 765 ("This reading gives meaning to the distinction between 'applicable' and 'actual' without taking a further step to conclude that 'applicable' means "nonexistent' or 'fictional.'").

By giving the term "applicable" its proper meaning, a determination of allowable expenses under the means test is a two-step process. The first step is eligibility—i.e., does the debtor qualify for a transportation ownership expense? If so, then the second step is to quantify the expense amount the eligible debtor is allowed by looking at the IRS Standard amounts that are specified for the number of vehicles owned by the debtor and where the debtor lives. The bankruptcy court's ruling impermissibly skips the first step of determining whether the Thomases are eligible for the ownership expense by virtue of having a loan or lease payment for a vehicle. Instead, it proceeds directly to the second by only considering the amount the IRS would allow eligible taxpayers to claim for ownership of two vehicles. Accord In re Devilliers, 358 B.R. 849, 864 (Bankr. E.D. La. 2007) (concluding that the ownership expense "is not the equivalent of an allowance for depreciation or an invitation for a debtor to 'save' for the ultimate replacement of an existing vehicle . . . . [instead, it is] designed to assist with the acquisition of a vehicle on credit").

2. The United States Trustee's construction of "applicable" in section 707(b)(2) has the salutary effect of treating transportation costs the same way in bankruptcy cases that the IRS treats them.

Reversal of the bankruptcy court's order allowing the Thomases to deduct nonexistent transportation ownership expenses has the additional benefit of treating inapplicable expenses in bankruptcy cases the way the IRS has long treated them. In providing which deductions a debtor may take under the means test, Congress specifically stated that a debtor is permitted to deduct "the debtor's *applicable* monthly expense amounts specified under the . . .Local Standards . . .issued by the *Internal Revenue Service*." 11 U.S.C. § 707(b)(2)(A)(ii)(I) (emphasis added). Accordingly, how the IRS applies the standards that it developed for its debt collection purposes is instructive on the question of how the same standards might be applied in bankruptcy cases under section 707(b)(2). See, e.g., Hartwick, 373 B.R. at 650-51 ("[I]n order to determine whether the expense Standards issued by the IRS are 'applicable,' the most logical resource to consult is the IRS."). See also In re Slusher, 359 B.R. 290, 309 (Bankr. D. Nev. 2007) ("[I]f guidance is sought on the meaning of the IRS standards that Congress incorporated into the Bankruptcy Code, practical reason would suggest that court should consider the full manner by which the IRS uses these standards.").

The IRS Collection Financial Standards in effect when the Thomases filed their case fully support the United States Trustee's construction of the term "applicable," and provide as follows:

> The transportation standards consist of nationwide figures for monthly loan or lease payments referred to as ownership costs, and additional amounts for monthly operating costs . . . . The ownership costs provided maximum allowances for the lease or purchase of up to two automobiles if allowed as a necessary expense . . . . If a taxpayer has a car payment, the allowable ownership cost added to the allowable operating cost equals the allowable transportation expense. **If a taxpayer has no car payment, or no car, the operating costs portion of the transportation standard is used to come up with the allowable transportation expense.**

Ex. A; see supra n.5. See also BD 11, Ex. C (Internal Revenue Manual, Financial Analysis Handbook, Pt. 5, ch. 15, § 5.15.1.7(4.B)); IRS Financial Analysis Handbook, Pt. 5, ch. 15, § 5.15.1.7(4.B) (providing for purposes of IRS collection that if taxpayer has no vehicle loan or lease payments, the ownership cost is not applied), *available at* www.irs.gov/irm/part5/ch15s01.html.

Those IRS Collection Financial Standards reveal that IRS's ownership expense was calculated based on car financing data.[9] This offers further guidance that the ownership expense was intended to account for the expense of financing a vehicle over time and is inapplicable if a debtor has no such acquisition financing expense. See Ex. A (stating that the vehicle ownership expense calculated by the IRS is based on the "five-year average of new and used car financing data compiled by the Federal Reserve Board of Governors).

As of the date the Thomases filed their bankruptcy petition, the "ownership cost" was specifically calculated by the IRS based on the cost to finance the acquisition of a vehicle, and not simply a cost associated with owning a car, such as repair or maintenance. As such, the IRS does not treat the "ownership cost" expense as applicable when a taxpayer does not have a monthly expense related to financing a car. The same thing happens under the means test because the means test allows debtors to claim only an "applicable" car expense – not a phantom one.

Further, considering IRS practice in interpreting "applicable" expenses in section 707(b)(2)(A)(ii)(I) does not negate the section's later allowance of "actual" monthly expenses in the IRS categories of Other Necessary Expenses. Rather, "a natural reading" of section 707(b)(2)(A)(ii)(I) indicates that the words "actual" and "applicable" limit the relevant expense deductions in different ways. Slusher, 359 B.R. at 308 ("Had Congress intended to indiscriminately allow all expense amounts specified in the National and Local Standards, it would have written section 707(b)(2)(A)(ii)(I) to read, 'The debtor's monthly expenses shall be the monthly amounts specified under the National Standards and the Local Standards . . . .' rather than 'The debtor's

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[9] See n.5, supra.

monthly expenses shall be *the debtor's applicable* monthly expense amounts specified under the National and Local Standards.'") Id.

B. *The bankruptcy court's order conflicts with the major goals of the 2005 amendments to the Bankruptcy Code.*

The bankruptcy court's order is also inconsistent with Congress' purpose in implementing bankruptcy reform. Congress amended the Bankruptcy Code in 2005 to rectify perceived abuses in the bankruptcy process. The "heart" of these reforms was to "ensure that debtors repay creditors the maximum they can afford." H.R. Rep. No. 109-31 (I) at 1 (2005), *reprinted in* 2005 U.S.C.C.A.N. 88, 89. In cases such as this one, where the Thomases have no loan or lease payment, Congress has established a system which does not provide them an expense deduction for vehicle financing. "Allowing debtors to deduct from their disposable income a fictional ownership allowance would give debtors with unencumbered vehicles a windfall at the expense of their unsecured creditors." In re Howell, 366 B.R. 153, 157 (Bankr. D. Kan. 2007).

CONCLUSION

For all of these reasons, the United States Trustee respectfully asks this Court to reverse the October 2, 2007 order entered by the bankruptcy court denying the United States Trustee's motion to dismiss, and remand this case to the bankruptcy court for further proceedings.

Respectfully submitted,

RICHARD A. WIELAND
Acting United States Trustee

s/ *David P. Eron*
DAVID P. ERON
Office of the United States Trustee
Department of Justice
California State Bar No. 223033
301 North Main, Suite 1150
Wichita, Kansas 67202
316-269-6176
316-269-6182-FAX

Of Counsel

ROBERTA A. DeANGELIS
Acting General Counsel

P. MATTHEW SUTKO
MELISSA R. BURGESS
SEAN E. MARTIN
Department of Justice
Executive Office for United States Trustees
20 Massachusetts Avenue, NW
Washington, D.C. 20530

EXHIBIT A

Internal Revenue Service
United States Department of the Treasury

Collection Financial Standards

General

Collection Financial Standards are used to help determine a taxpayer's ability to pay a delinquent tax liability.

Allowances for food, clothing and other items, known as the National Standards, apply nationwide except for Alaska and Hawaii, which have their own tables. Taxpayers are allowed the total National Standards amount for their family size and income level, without questioning amounts actually spent.

Maximum allowances for housing and utilities and transportation, known as the Local Standards, vary by location. Unlike the National Standards, the taxpayer is allowed the amount actually spent or the standard, whichever is less.

Food, Clothing and Other Items

National Standards for reasonable amounts have been established for five necessary expenses: food, housekeeping supplies, apparel and services, personal care products and services, and miscellaneous.

All standards except miscellaneous are derived from the Bureau of Labor Statistics (BLS) Consumer Expenditure Survey (CES). The miscellaneous standard has been established by the IRS.

Alaska and Hawaii

Due to their unique geographic circumstances and higher cost of living, separate standards for food, clothing and other items have been established for Alaska and Hawaii .

Housing and Utilities

The housing and utilities standards are derived from Census and BLS data, and are provided by state down to the county level.

Transportation

The transportation standards consist of nationwide figures for monthly loan or lease payments referred to as ownership costs, and additional amounts for monthly operating costs broken down by Census Region and Metropolitan Statistical Area (MSA). Public transportation is included under operating costs. A conversion chart has been provided with the standards which shows which IRS districts fall under each Census Region, as well as the counties included in each MSA. The ownership cost portion of the transportation standard, although it

applies nationwide, is still considered part of the Local Standards.

The ownership costs provide maximum allowances for the lease or purchase of up to two automobiles if allowed as a necessary expense. The operating costs are derived from BLS data.

If a taxpayer has a car payment, the allowable ownership cost added to the allowable operating cost equals the allowable transportation expense. If a taxpayer has no car payment, or no car, only the operating costs portion of the transportation standard is used to come up with the allowable transportation expense.

Recent Revisions

The Local Standards for housing and utilities and transportation were revised on 02/01/06 to:

- add family size to the housing and utilities allowances (two or less, three, and four or more);
- base automobile ownership/leasing costs on the five-year average of new and used car financing data compiled by the Federal Reserve Board of Governors; and,
- reflect updated information from the Bureau of Labor Statistics.
- Housing and Utility Standards have been established in 2006 for U.S. Territories

The revised Local Standards for housing and utilities and transportation are effective for financial analysis conducted on or after January 1, 2006.

BRIEF BANK — 'SUMMARY SHEET" *Printed Wed-1/30/08 14:17*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*
In re: Richard W. Thomas and Kathy Lee Thomas (UST v. Richard Thomas, et al.)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*
D. Kan.

3. ("CCN") ***CURRENT*** CASE NO.
No.: 07-cv-02493-JWL-JPO

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*
No.: 06-21108-7
Court: Bankr. Kan.
(Identify judge & cite, if any)

5. ("SO") ***SOURCE***
U.S. TRUSTEES

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*
Filed: January 28, 2008
Type: Reply Brief of the Appellant Richard A. Wieland, United States Trustee

7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*
P. Matthew Sutko, Melissa R. Burgess, Sean E. Martin, David P. Eron and Richard A. Wieland
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***
• Whether 11 U.S.C. § 707(b)(2)(A)(ii)(I)’s use of the word “applicable” means debtors cannot claim an ownership expense on a vehicle not burdened by a lease or a secured debt payment.
√ **Background:**

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THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF KANSAS

CASE NO. 07-CV-02493-JWL-JPO

IN RE: RICHARD W. THOMAS AND KATHY LEE THOMAS
Debtors.

RICHARD A. WIELAND, UNITED STATES TRUSTEE
Appellant,

v.

RICHARD W. THOMAS AND KATHY LEE THOMAS
Appellees.

ON APPEAL FROM THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF KANSAS

THE HONORABLE ROBERT D. BERGER, PRESIDING
Bankruptcy Case No. 06-21108-7

REPLY BRIEF OF THE APPELLANT RICHARD A. WIELAND, UNITED STATES TRUSTEE

Of Counsel

ROBERTA A. DeANGELIS
Acting General Counsel

P. MATTHEW SUTKO
MELISSA R. BURGESS
Department of Justice
Executive Office for United States Trustees
20 Massachusetts Avenue, NW
Washington, D.C. 20530

RICHARD A. WIELAND
United States Trustee

DAVID P. ERON
Office of the United States Trustee
Department of Justice
301 N. Main Street, Suite 1150
Wichita, KS 67202
Telephone: (316) 269-6176
Fax: (316) 269-6182

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ARGUMENT

In his opening brief, the United States Trustee established that the Thomases are not entitled to vehicle ownership expenses because these expenses are only available under the Bankruptcy Code if debtors are making loan or lease payments. The Thomases are not. This construction of section 707(b)(2)(A)(ii)(I) has been adopted by all five appellate courts that have interpreted the statute.[1] In their response, the Thomases ignore the common-sense reality that the ownership expenses must be "applicable" in the first place for debtors to claim them. Because the Thomases do not have any vehicle payments, the vehicle ownership expense is not applicable to them.

The Thomases suggest that legal authority interpreting section 707(b)(2)(A)(ii)(I) has shown a trend in their favor, Thomas Brief at 13, but their list of cases is incomplete and inaccurate. And all five appellate decisions interpreting "applicable" in section 707(b)(2)(A)(ii)(I) – including three since the United States Trustee filed his opening brief – have read the statute like the United States Trustee does.

The Thomases make a series of policy arguments in support of their interpretation. None are new. Many were made to the other appellate courts that have already rejected the Thomases' construction of section 707(b)(2)(A)(ii)(I). And as we explain below, the appellate courts' interpretation of section 707(b)(2)(A)(ii)(I) is fair because it ensures cases are fairly and properly administered.

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[1] See Meade v. McVay, No. EP-07-CV-121-DB (W.D. Tex. Jan. 24, 2008)(a copy of this decision is attached hereto as Exhibit "A"); United States Trustee v. Deadmond (In re Deadmond), No. CV 07-15-H-CCL, 2008 WL 191165 (D. Mont. Jan. 21, 2008); Ransom v. MBNA America Bank, N.A. (In re Ransom), – B.R. –, 2007 WL 4625248 (B.A.P. 9th Cir. Dec. 27, 2007); Neary v. Ross-Tousey (In re Ross-Tousey), 368 B.R. 762 (E.D. Wis. 2007); Fokkena v. Hartwick (In re Hartwick), 373 B.R. 645 (D. Minn. 2007).

I. The appellate courts' interpretation of 11 U.S.C. § 707(b)(2)(A)(ii)(I) recognizes that nonexistent expenses cannot be "applicable" to debtors.

By its plain terms, section 707(b)(2)(A)(ii)(I) requires that the IRS expenses be "applicable" before a debtor may claim the expenses. See Meade v. McVay (In re Meade), EP-07-CV-121-DB, slip op. at 5 (W.D. Tex. Jan. 24, 2008) (affirming bankruptcy court after concluding that "[p]lacement of the term 'applicable' indicates that the transportation ownership expense is to be deducted only by the appropriate debtor . . . [who is] eligible to claim the deduction by having an existing monthly transportation ownership expense"); United States Trustee v. Deadmond (In re Deadmond), No. CV 07-15-H-CCL, 2008 WL 191165 at *4 (D. Mont. Jan. 21, 2008) (reversing bankruptcy court order after concluding that the "plain meaning" of section 707(b)(2)(A)(ii)(I) "requires that debtors who have no vehicle lease or loan payment be allowed no applicable monthly transportation ownership expense amount"); Fokkena v. Hartwick (In re Hartwick), 373 B.R. 645, 650 (D. Minn. 2007) (reversing bankruptcy court after concluding that under the "plain meaning" of "applicable" in section 707(b)(2)(A)(ii)(I), "the debtor must actually have a loan or lease payment obligation" to claim the ownership expenses). Since the Thomases did not have any "applicable" vehicle payments, the ownership expense should not have been allowed by the bankruptcy court.

The Thomases' contrary reading of the statute renders the word "applicable" superfluous. The Thomases argue that "applicable" means solely that "debtors are permitted to claim the Local Standards ownership expenses based on the number of vehicles the debtor owns, rather than on the number for which the debtor makes payments." Thomas Brief at 5-6. But this interpretation strips "applicable" of any meaning. See Neary v. Ross-Tousey (In re Ross-Tousey), 368 B.R. 762, 765 (E.D. Wis. 2007) ("Had Congress intended to indiscriminately allow all expense amounts specified in the National and Local Standards, it would have written 707(b)(2)(A)(ii)(I) [without using the word 'applicable.']").

The Thomases' reading allows debtors to claim expenses that do not exist by claiming the expense amount on the IRS tables based on the number of cars owned, regardless of whether ownership expenses actually apply. See Ransom v. MBNA America Bank, N.A. (In re Ransom), – B.R. –, 2007 WL 4625248 at *6 (B.A.P. 9th Cir. Dec. 27, 2007) (warning that granting debtors an allowance for ownership expenses they do not have would "read[] 'applicable' right out of the Bankruptcy Code"); Deadmond, 2008 WL 191165 at *4 ("The word ['applicable'] must mean something, and if some monthly expenses are applicable, then other monthly expenses are not applicable."); Meade, slip op. at 5 ("If the debtor can claim the deduction, the statute then permits an eligible debtor to select the amount listed in the IRS Standards.").

Rather than being empty verbiage in the statute, the word "applicable" prohibits debtors from claiming deductions they do not have. As the appellate courts that have interpreted section 707(b)(2)(A)(ii)(I) agree, "applicable" should be given its ordinary definition in the statute. See Meade, slip op. at 5; Deadmond, 2008 WL 191165 at *4; Ransom, 2007 WL 4625248 at *6 (recognizing that "applicable," in its ordinary sense, means "'capable of or suitable for being applied,'" and concluding that the vehicle ownership expense is not "capable of being applied to the debtor if he does not make any lease or loan payments . . . ."). See also Dole Food Co. v. Patrickson, 538 U.S. 468, 476 - 77 (2003) ("Absent a statutory text or structure that requires us to depart from normal rules of construction, we should not construe the statute in a manner that is strained and, at the same time, would render a statutory term superfluous.") (citing Mertens v. Hewitt Assocs., 508 U.S. 248, 258 (1993) ("We will not read the statute to render the modifier superfluous."); United

States v. Nordic Village, Inc., 503 U.S. 30, 36 (1992) (declining to adopt a construction that would violate the "settled rule that a statute must, if possible, be construed in such fashion that every word has some operative effect").

Under the ordinary meaning of "applicable," debtors need loan or lease payments in order to claim a vehicle ownership expense. See United States Trustee's Opening Brief at 14. Therefore, this expense is inapplicable in the Thomases' case because they have no such payment on their vehicles.

II. The Thomases ignore the unbroken line of appellate case law holding that nonexistent expenses cannot be "applicable" to debtors.

To bolster their contention that a "growing number" of bankruptcy courts do not support the United States Trustee's interpretation, the Thomases attached to their brief a list of cases. See Thomas Brief at 13, 17-19. But this list omits nine cases that adopted the United States Trustee's position,[2] while misconstruing the holdings of a number of other cases the Thomases did include.[3]

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[2] In re Tate, 2007 WL 4532122 (Bankr. S.D. Miss. Dec. 18, 2007); In re Brown, 376 B.R. 601 (Bankr. S.D. Tex. 2007); In re Masur, 2007 WL 3231725 (Bankr. D.S.D. October 30, 2007); In re Ransom, Case No. 06-11566 (Bankr. D. Nev. June 6, 2007), aff'd, ---B.R.---, 2007 WL 4625248 (B.A.P. 9th Cir. Dec. 27, 2007); In re Bennett, 371 B.R. 440 (Bankr. C.D. Cal. 2007); In re Canales, 377 B.R. 658 (Bankr. C.D. Cal. 2007); In re Garcia, 2007 WL 2692232 (Bankr. D. Ariz. Sept. 11, 2007); In re Rezentes, 368 B.R. 55 (Bankr. D. Haw. 2007); In re McDaniel, Case No. 06-62786 (Bankr. N.D. Ga. August 24, 2007).

[3] Some of the cases listed by the Thomases do not hold that a vehicle ownership allowance is permitted regardless of any car expense. See, e.g., In re Williams, Case No. 07-00396 (Bankr. E.D.N.C. October 25, 2007) (holding that a debtor may take the full mortgage allowance, even if his actual mortgage payment is less; the United States Trustee concurs with this opinion); In re Aprea, 368 B.R. 558 (Bankr. E.D. Tex. 2007) (holding that a single debtor with no dependants may not claim vehicle ownership expenses for two vehicles); In re Demonica, 345 B.R. 895 (Bankr. N.D. Ill. 2006) (holding that a debtor who does not own a vehicle, but makes payments for use of vehicle is entitled to ownership expense; in *dicta*, court noted that it agreed with case law adopting the United States Trustee's position on the vehicle ownership expense issue). Similarly, no relevant opinion or order appears to have been issued in the listed case In re Davis, Case No. 06-06978 (Bankr. M.D. Tenn. 2007).

More significant than an arithmetic tally of bankruptcy court decisions is the fact that a growing and unbroken line of appellate case law now holds that nonexistent vehicle expenses cannot be "applicable" under section 707(b)(2)(A)(ii)(I). See Meade, slip op. at 5; Deadmond, 2008 WL 191165; Ransom, 2007 WL 4625248; Ross-Tousey, 368 B.R. 762; Hartwick, 373 B.R. 645. The appellate courts have unanimously rejected the reading proposed by the Thomases. Id.

Beyond the textual reasons already discussed in this brief, these appellate courts rejected the same interpretation the Thomases are proferring now because disallowing nonexistent vehicle operating expenses is fully harmonious with congressional intent. See, e.g., Ransom, 2007 WL 4625248 at *7 ("Denying debtors the ownership allowance when they have no ownership expense (i.e. loan or lease payments) is entirely consistent" with the objective of the 2005 Reform Act to ensure that debtors repay as much of their debt as reasonable possible.); Ross-Tousey, 368 B.R. at 768 (concluding that section 707(b)(2)(A)(ii)(I) "is only concerned about protecting the debtor's ability to continue owning a car, and if the debtor already owns the car, the debtor is adequately protected"); Hartwick, 373 B.R. at 652.

III. The appellate courts' construction of section 707(b)(2)(A)(ii)(I) better implements bankruptcy policy.

The Thomases' proferred statutory construction would lead to arbitrary and unfair results, and would contribute to bankruptcy abuse. Under their interpretation of section 707(b)(2)(A)(ii)(I), "debtors who own two unusable cars rusting in their back yard would be entitled to the windfall benefit of both ownership and operating expense deductions although they, in fact, incur no expenses by owning the vehicles." Hartwick, 373 B.R. at 652 (citing Ross-Tousey, 368 B.R. at 767-69). This statutory reading "defies common sense." Deadmond, 2008 WL 191165 at *4. By allowing debtors to deduct only "applicable" expenses, section 707(b)(2)(A)(ii)(I) ensures debtors do not evade repaying their debts when they can.

The Thomases claim that the interpretation of "applicable" suggested by the United States Trustee and adopted by all five appellate courts to interpret it, creates an arbitrary distinction between a hypothetical Debtor A who pays off her car loan the month before filing and a Debtor B with a single payment remaining at the time she files her case. Thomas Brief at 11-12. In that hypothetical, Debtor A would not be entitled to a vehicle ownership expense while Debtor B would receive the full allowance.

The appellate decisions on 707(b)(2)(A)(ii)(I) have not found this hypothetical persuasive. See Ross-Tousey, 368 B.R. at 767-68 ("Congress has chosen to employ an objective framework rather than authorizing courts to delve into much detail about the condition of debtors' automobiles and the number of payments remaining."); Hartwick, 373 B.R. at 652 ("[A] line must be drawn somewhere, and any interpretation will result in some unfairness."). Moreover, the Thomases' hypothetical fails to recognize that Debtor B's case would likely be dismissed under section 707(b)(3) based on the totality of the circumstances of her financial situation. Section 707(b) allows cases to be dismissed in two ways. First, above-median income debtors can have their cases dismissed under section 707(b)(2) when they fail the means test. Second, debtors with an actual ability to repay creditors can have their cases dismissed under section 707(b)(3) even if they pass the means test. See 11 U.S.C. § 707(b)(3)(B) (requiring that in cases where presumption of abuse "does not arise or is rebutted," the court shall consider whether dismissal is proper because "the totality of the circumstances . . . of the debtor's financial situation demonstrates abuse"). Cf. In re Stewart, 175 F.3d 796, 809 (10th Cir. 1999) (holding that a debtor's ability to pay is a primary factor in deciding whether to dismiss a debtor's case under the "totality of the circumstances" analysis that applied to the pre-2005 Reform Act section 707(b)).

Whenever a debtor, like Debtor B in the Thomases' hypothetical, can repay debts because the imminent satisfaction of a car loan will result in hundreds of dollars more each month in disposable income, his or her case will merit dismissal under section 707(b)(3). Cf. Stewart, 175 F.3d at 809 (upholding bankruptcy court's dismissal under pre-2005 Reform Act section 707(b) where the debtor's "earning potential well exceeds his monthly expenses").

The Thomases alternatively argue that requiring that expenses exist before they are "applicable" discriminates against debtors who cannot afford newer cars that are more likely to involve loan or lease payments. See Thomas Brief at 12-13.

This argument has also been uniformly rejected by the appellate courts. See Ransom, 2007 WL 4625248 at *6; Hartwick, 373 B.R. at 652. The Thomases' argument is also incorrect for three reasons. First, the means test does not apply to a debtor whose income is below the applicable median family income in the state in which the debtor resides at the time of filing. 11 U.S.C. § 707(b)(7).[4] Thus, the vast majority of debtors are never subject to the means test – and therefore the vehicle ownership expense requirement – at all.

Second, where higher-income debtors do have older or higher-mileage vehicles, those debtors are shielded from potential harm. Debtors who own a vehicle over 6 years old and/or with 75,000 or more miles without a loan or lease payment are entitled to an additional $200 in monthly operating expenses. See Internal Revenue Manual, Pt. 5, ch. 8, § 5.8.5.5.2 ("Treatment of Non-

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[4] According to data compiled by the United States Trustee Program, from October 2005 through March 2007, only 7.9% of chapter 7 debtors had income above the applicable state median. See Clifford J. White III, *Making Bankruptcy Reform Work: A Progress Report in Year 2*, 26 Am. Bankr. Inst. J. 16 (June 2007).

Business Transportation Expenses"), available at http://www.irs.gov/irm/part5/ch08s05.html. See also Ransom, 2007 WL 4625248 at *6; Hartwick, 373 B.R. at 652.[5]

Third, debtors are also shielded from potential harm by the "special circumstances" allowance built into the chapter 7 means test. See 11 U.S.C. § 707(b)(2)(B); Ransom, 2007 WL 4625248 at *6. This provision allows debtors to overcome failing the means test under section 707(b)(2) if they can demonstrate special circumstances "for which there is no reasonable alternative" that justify increased expenses. See id.; United States Trustee's Opening Brief at 5 n.4.

As a final policy argument, the Thomases suggest that the appellate courts' interpretation of section 707(b)(2)(A)(ii)(I) will foster abuse, because debtors will have a new incentive to incur new vehicle debt just prior to filing bankruptcy. See Thomas Brief at 15. The Thomases' argument overlooks the key fact that a debtor's passing the means test does not end the Bankruptcy Code's inquiry into whether a case presents an abuse of chapter 7. For such situations, Congress permits dismissal for filings in bad faith or when the totality of a debtor's financial situation demonstrates abuse. See 11 U.S.C. § 707(b)(3)(A), (B) (requiring that in cases where presumption of abuse "does not arise or is rebutted," the court shall consider whether dismissal is proper because "the debtor

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[5] The Thomases misunderstand the vehicle ownership expense's purpose. The vehicle ownership expense allows debtors to claim a standardized amount when they are making payments on a car. See In re Devilliers, 358 B.R. 849, 864 (Bankr. E.D. La. 2007) (recognizing that the ownership allowance "is not the equivalent of an allowance for depreciation or an invitation for a debtor to 'save' for the ultimate replacement of an existing vehicle. Instead, the deduction is designed to assist with the acquisition of a vehicle on credit."). Car maintenance, by contrast, is covered by a different IRS standard expense that covers operating expenses. The vehicle operating expense gives debtors, including the Thomases, an allowance for all vehicles owned, regardless of loan or lease payments. See UST Brief, Ex. A; IRS Financial Analysis Handbook, Pt. 5, ch. 15, § 5.15.1.7(4.B) ("If a taxpayer has no car payment only the operating costs portion of the transportation standard is used to figure the allowable transportation expense."), available at www.irs.gov/irm/part5/ch15s01.html.

filed the petition in bad faith" or "the totality of the circumstances . . . of the debtor's financial situation demonstrates abuse").[6]

Thus, were a debtor prepared to incur debt for the sole purpose of filing chapter 7 bankruptcy, his or her case could be dismissed under section 707(b)(3). It was established, under the more demanding "substantial abuse" standard for dismissal that predated the 2005 Reform Act,[7] that a debtor's purposeful accumulation of debt in contemplation of bankruptcy could justify dismissal. See In re Price, 353 F.3d 1135 1139-40 (9th Cir. 2004) (describing factors relevant to justifying dismissal, including "[w]hether the debtor has engaged in eve-of-bankruptcy purchases"); see also, e.g., In re Higuera, 199 B.R. 196, 199 (Bankr. W.D. Okla. 1996) (recognizing that eve-of-bankruptcy purchases or transactions are a factor to consider in dismissing a debtor's petition); In re Charles, 334 B.R. 207, 222 (Bankr. S.D. Tex. 2005) ("It is settled law that a debtor's good faith should be questioned if the debtor makes purchases in contemplation of a bankruptcy case."); In re

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[6] The Thomases also suggest that section 526(a)(4), which prohibits attorneys from encouraging debtors to incur more debt in anticipation of bankruptcy, is unconstitutional. Thomas Brief at 15. That issue is before the Second, Fifth, Eighth and Ninth circuits, but it is irrelevant here. Section 526(a)(4) regulates attorney conduct, not debtors' decisions to take on new debt on the eve of bankruptcy. It is universally accepted that debtors who engage in pre-bankruptcy spending sprees can have their cases dismissed for that misconduct. See In re Stewart, 175 F.3d 796, 809-10 (10th Cir. 1999) (affirming dismissal under pre-2005 Reform Act version of section 707(b) after noting that bankruptcy relief "is not intended to remedy the consequences of extravagant spending" and questioning a debtor's good faith in filing a bankruptcy petition); In re Krohn, 886 F.2d 123, 126 (6th Cir. 1989) (holding "eve of bankruptcy purchases" can justify dismissal under pre-2005 Reform Act version of section 707(b)). Debtors who load up on debt by buying cars they do not need and cannot afford will have their cases dismissed under section 707(b)(3), just like other debtors have in years past.

[7] Section 707(b) now permits dismissal for simple "abuse." See 11 U.S.C. § 707(b)(1).

Rathbun, 309 B.R. 901, 904 (Bankr. N.D. Tex. 2004); In re Aiello, 284 B.R. 756, 761 (Bankr. E.D.N.Y. 2002).[8]

The appellate courts' interpretation of section 707(b)(2)(A)(ii)(I) is fair. It credits a critical objective of the 2005 Reform Act: ensuring "that debtors repay as much of their debt as reasonably possible." Ransom, 2007 WL 4625248 at *7. In the context of the Act, shielding money from creditors by allowing debtors to claim a nonexistent expense runs afoul of congressional intent. See Deadmond, 2008 WL 191165 at *4. The appellate courts' interpretation also dovetails with other provisions of the Bankruptcy Code that ensure that needy debtors can receive credit for vehicle operating expenses and that there is a remedy for abusive claims of these expenses.

CONCLUSION

For these reasons, and for those set forth in his opening brief, the United States Trustee respectfully asks this Court to reverse the order entered below, and remand this case to the bankruptcy court for further proceedings.

RICHARD A. WIELAND
United States Trustee
s/ *David P. Eron*
DAVID P. ERON
Office of the United States Trustee
Department of Justice
California State Bar No. 223033
301 North Main, Suite 1150
Wichita, Kansas 67202
316-269-6176
316-269-6182-FAX
David.P.Eron@usdoj.gov

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[8] As the Supreme Court recently explained in a chapter 13 case, bad faith pre-petition conduct by a debtor justifies dismissal of the petition because such a debtor "is not a member of the class of 'honest but unfortunate debtor[s]' that the bankruptcy laws were enacted to protect." Marrama v. Citizens Bank, 127 S. Ct. 1105, 1111 (2007) (quoting Grogan v. Garner, 498 U.S. 279, 287 (1991)).

EXHIBIT A

FILED
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CLERK, US DISTRICT COURT
WESTERN DISTRICT OF TEXAS
BY ______ DEPUTY

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF TEXAS
EL PASO DIVISION

IN RE: LYNN MEADE, **Debtor**	§ § §	
LYNN MEADE, **Appellant**	§ § §	
v.	§	**EP-07-CV-121-DB**
CHARLES F. McVAY, United States Trustee, Region 7, **Appellee.**	§ § § §	

APPEAL FROM THE UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF TEXAS
EL PASO DIVISION
CASE NO. 06-31066-RCM, CHAPTER 7

Appellant Lynn Meade ("Meade") filed a brief on April 20, 2007, appealing the United States Bankruptcy Court's ("Bankruptcy Court") February 28, 2007 "Order On Motion Of The United States Trustee To Dismiss Under 11 U.S.C. § 707(b)." On May 7, 2007, Appellee Charles F. McVay, United States Trustee, Region 7 ("U. S. Trustee"), filed a "Brief Of The Appellee Charles F. McVay United States Trustee" ("Response"). After due consideration, the Court affirms the Bankruptcy Court's dismissal of Meade's Petition for the reasons that follow.

BACKGROUND

This is an appeal arising from an Order of the United States Bankruptcy Court, dismissing a Petition on September 30, 2006, wherein Meade sought relief under Chapter 7 of the Bankruptcy Code. The case stems from Meade's attempt to claim a Transportation Ownership/Lease Expense without having an ownership payment. On said date, Meade filed a petition for relief under Chapter 7 of the Bankruptcy Code, which included the Statement of

Current Monthly Income and Means Test Calculation ("Means Test"). The Means Test uses a complex mathematical formula - set out in § 707(b)(2) - to calculate a debtor's disposable monthly income. A disposable monthly income greater than $166.67 gives rise to a presumption of abuse and requires dismissal of the case as an abuse of Chapter 7 Bankruptcy proceedings. *See* 11 U.S.C.A. § 707(b)(2)(A)(ii)(I).

Because Meade's monthly income exceeded the median Texas monthly income,[1] she was required to complete the expense portion of the Means Test. Therein, Meade claimed monthly expenses greater than her income, resulting in a negative monthly income.[2] Although Meade did not have a vehicle purchase or lease payment, she deducted $471.00 as a "Local Standards" Transportation Ownership/Lease Expense. Meade owns one vehicle, a 1996 Subaru Legacy Wagon, outright and free of any liens. The U.S. Trustee contested this deduction, and substituted a $200 deduction, pursuant to Internal Revenue Service ("IRS") guidelines.[3] Meade's disposable monthly income was then calculated at $303.97, based on the U.S. Trustee's expense

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[1] Meade's monthly income - $3,830.00 ($45,963.60 annual) - was greater than the corresponding median Texas monthly income.

[2] Meade's disposable monthly income was calculated at negative $6.03 after deducting $3,836.33 in monthly expenses.

[3] The IRS permits a $200 deduction for operating a vehicle over six years old, and/or with reported mileage of at least 75,000 miles, with no reported loan or lease payment obligation. *See* INTERNAL REVENUE SERVICE, UNITED STATES DEP'T OF TREASURY, INTERNAL REVENUE MANUEL, FINANCIAL ANALYSIS HANDBOOK, TREATMENT OF NON-BUSINESS TRANSPORTATION EXPENSES, OWNERSHIP EXPENSES, Part 5, Chapter 15 § 5.8.5.5.2(3), [hereinafter FINANCIAL ANALYSIS HANDBOOK] http://www.irs.gov/irm/part5/ch08s05.html.

adjustment, along with other minor adjustments,[4] giving rise to a presumption of abuse of the bankruptcy proceedings.

On December 8, 2006, the U.S. Trustee filed a Motion to Dismiss for an abuse of Chapter 7 Bankruptcy Proceedings. The Bankruptcy Court granted the Motion to Dismiss, finding that Meade's case was presumptively abusive, and that the debtor failed to demonstrate special circumstances to rebut that presumption.[5] The appeal from the Bankruptcy Court's ruling ensued.

STANDARD OF REVIEW

Title 28 U.S.C. § 158 confers jurisdiction on district courts to hear appeals from the final judgments, orders, and decrees of bankruptcy courts sitting within the same judicial district. 28 U.S.C.A. § 158(a)(1) (West 2006). When a district court reviews a bankruptcy court's decision, it functions as an appellate court and utilizes the same standard of review generally applied by a federal court of appeals. In general, "a bankruptcy court's findings of fact are subject to the clearly erroneous standard of review and conclusions of law are reviewed de novo." *In re Smyth*, 207 F.3d 758, 761 (5th Cir. 2000) (citing *Matter of Sadkin*, 36 F.3d 473, 475 (5th Cir. 1994)). The issue on appeal is whether a debtor is allowed, under 11 U.S.C. § 707(b)(2)(A)(ii)(I), to claim an expense for vehicle financing when the debtor has no vehicle financing expense. As the issue before the Court involves a question of law, the Court reviews the Bankruptcy Court's decision *de novo*.

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[4] Meade did not contest these incidental adjustments, nor does she raise the issue in the instant appeal.

[5] Meade does not appeal the Bankruptcy Court's decision stating that she failed to demonstrate special circumstances to rebut the presumption of abuse.

DISCUSSION

In her appeal, Meade argues three points of law: (1) the plain language of the Bankruptcy Code allows her to deduct a Transportation Ownership/Lease Expense even though she does not have an ownership payment; (2) case law precedent allows her to claim said deduction; and (3) public policy should allow for said deduction. The Court addresses Meade's contentions in turn.

1. The Bankruptcy Code

Meade contends that a plain reading of § 707(b)(2)(A)(ii)(I) allows her to deduct a transportation ownership expense in the amount of $471.00, although Meade does not have an existing vehicle ownership payment. In other words, Meade argues that the statute permits debtors to claim the Local Standard ownership expense based on their possession of a vehicle. The U.S. Trustee responds that the statute plainly requires a two-step determination to deduct the appropriate transportation expense, the first of which requires the debtor to have an ownership expense. The Court finds Meade's argument unconvincing.

The plain language of a statute is regarded as conclusive, with the exception of rare circumstances in which the result of a literal application directly contradicts the drafters' intent. *See United States v. Ron Pair Enter. Inc.*, 489 U.S. 235, 242 (1989). Generally, statutory interpretation requires a court to accord undefined statutory terms their ordinary and common meaning. *See Burns v. Alcala*, 420 U.S. 575, 580-81 (1975).

The statute at issue reads, in relevant part:

> The debtor's monthly expenses shall be the debtor's *applicable* monthly expense amounts specified under the National Standards and Local Standards, and the debtor's *actual* monthly expenses for

> the categories specified as Other Necessary Expenses issued by the Internal Revenue Service for the area in which the debtor resides . . .

11 U.S.C.A. § 707(b)(2)(A)(ii)(I) (West 2005) (emphasis added). The statute permits a debtor to deduct "applicable" monthly expenses as defined by the IRS National and Local Standards ("IRS Standards"), and "actual" monthly expenses that the IRS defines as "Other Necessary Expenses." *In re Pampas*, 369 B.R. 290, 295-96 (Bankr. M.D. La. 2007). The outcome of the instant case hinges on the plain meaning of the term "applicable" and in reconciling Congress' intent with use of the term "actual" in the same sentence.

"Applicable" is defined as "capable of or suitable for being applied: APPROPRIATE." MERRIAM WEBSTER'S COLLEGIATE DICTIONARY 56 (10th ed. 1996). In the statute, "applicable" is positioned before the phrase "monthly expense amounts specified under the [standards]."[6] Placement of the term "applicable" indicates that the transportation ownership expense is to be deducted only by the appropriate debtor. In other words, the debtor must be eligible to claim the deduction by having an existing monthly transportation ownership expense. If the debtor can claim the deduction, the statute then permits an eligible debtor to select the amount listed in the IRS Standards. Pursuant to Meade's reading, the debtor would be automatically eligible for a standard deduction - the sole determination being the selection of an amount based on the applicable geographic location. Contrary to Meade's contention, the Court finds that the plain reading of the Bankruptcy Code allows a deduction for transportation ownership expenses, but only by those debtors who are eligible to declare such deductions.

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[6] The statute does not state, "The debtor's monthly expenses shall be the debtor's monthly expense amounts specified under the *applicable* [] Standards," as argued by Meade.

Further, Meade posits that Congress' decision to use "applicable" rather than "actual" evinces congressional intent that a debtor's existing, or non-existing, expense is irrelevant for purposes of claiming the transportation ownership deduction. "Actual" is defined as "existing in act and not merely potentially . . . . existing in fact or reality." MERRIAM WEBSTER'S COLLEGIATE DICTIONARY 12. The term "actual" is positioned before the phrase, "for the categories specified as Other Necessary Expenses," indicating that debtors may deduct their existing costs in this specific category. Thus, the statute permits deductions in an amount equal to debtors' existing costs in "other" categories. In contrast, for the transportation category, Congress intended all eligible debtors - but only eligible debtors - to have a standard across-the-board deduction. *See In re Pampas*, 369 B.R. at 296.

Additional support for the Court's statutory interpretation is found in the IRS Standards.[7] The IRS Standards recognize two sub-categories of transportation expenses: "ownership costs," and "operating costs."[8] "Ownership costs" are based on the "five-year

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[7] Congress intended courts to utilize current IRS policies to define statutory terms and calculate expenses. *See Pampas*, 369 B.R. at 296-97. *See also, e.g., In re Medina*, 362 B.R. 799, 802 (Bankr. S.D. Tex. 2007) (discussing the utilization of IRS guidelines as one of three possible means for interpreting a term not expressly defined in the Bankruptcy Code). While courts are not bound to follow IRS procedures and standards, they should be used as guides for interpreting the Bankruptcy Code. *See In re Ceasar*, 364 B.R. 257, 262 (Bankr. W.D. La. 2007); *see also Pampas*, 369 B.R. at 297 n.29.

[8] According to the IRS:

> The transportation standards consist of nationwide figures for monthly loan or lease payments referred to as *ownership costs*, and additional amounts for monthly operating costs . . . . If a taxpayer has a car payment, the allowable ownership cost added to the allowable operating cost equals the allowable transportation expense. If a taxpayer has *no car payment only the operating costs portion of the transportation standard is used* to come up with the

(continued...)

average of new and used car *financing* data compiled by the Federal Reserve Bureau of Governors."[9] Thus, the IRS Standards emphasize acquisition expenses, rather than maintenance or operating expenses, indicating that ownership and maintenance are separate and distinct expenses. *See id.* In fact, the IRS indicates in the Financial Analysis Handbook that car owners without a car payment should exclude that expense in calculating the total transportation expense. FINANCIAL ANALYSIS HANDBOOK § 5.15.1.7(4.B). Thus, like the IRS, the Court interprets the Bankruptcy Code as excluding a debtor's deduction of an "ownership" expense when the debtor does not have an existing car payment. Therefore, the Court is of the opinion that the plain meaning of "applicable" necessitates an existing ownership or lease payment for a debtor to claim an ownership or lease payment deduction.

Here, it is undisputed that Meade does not have an ownership or finance payment on her sole vehicle, a 1996 Subaru. As a result, Meade is not eligible to claim a Transportation Ownership/Lease Expense in the amount of $471. Therefore, the Court is of the opinion that the Bankruptcy Court's decision denying Meade's deduction was accurate, and its decision to dismiss Meade's bankruptcy proceeding is affirmed.

2. *Existing Case Law*

Meade avers that a "plethora" of case law supports her reading of the Bankruptcy

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(...continued)

allowable transportation expense.

FINANCIAL ANALYSIS HANDBOOK, ALLOWABLE EXPENSE OVERVIEW, Part 5, Chapter 15 § 5.15.1.7(4.B), http://www.irs.gov/irm/part5/ch15s01.html (emphasis added).

[9] INTERNAL REVENUE SERVICE, COLLECTION FINANCIAL STANDARDS, http://www.irs.gov/individuals/index.html (follow "Collection Financial Standards" hyperlink; scroll down to "Recent Revisions") (emphasis added).

Code. In that regard, Meade posits that *In re Fowler*, 349 B.R. 414 (Bankr. D. Del. 2006), and its progeny[10] hold precedential value before the Court. Unfortunately for Meade, her cited cases are not precedent in the United States Court of Appeals for the Fifth Circuit ("Fifth Circuit"). Further, the bankruptcy court decisions from within the Fifth Circuit have expressly rejected *Fowler* and Meade's line of reasoning.[11] What is more, Meade concedes that Fifth Circuit case law does not support her contention. Thus, the Court finds the decisions issued by the bankruptcy courts within the Fifth Circuit persuasive. Therefore, the Court is of the opinion that the Bankruptcy Court properly dismissed Meade's claim, and its decision is affirmed.

3. *Public Policy*

Lastly, Meade argues that the Court's affirmation of the Bankruptcy Court's judgment "could lead to some absurd result," based on public policy grounds. Meade's public policy argument mirrors the line of reasoning found in the *Fowler* opinion. *See Fowler* 349 B.R. at 418. As stated above, the Court declines to follow the *Fowler* decision. Therefore, as the Court had disposed of Meade's argument above, it need not address her public policy argument. Thus, the Court is of the opinion that the Bankruptcy Court's decision was appropriate and should be affirmed.

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[10] *See, e.g., In re Wilson*, 356 B.R. 114 (Bankr. D. Del. 2006); *In re Haley*, 354 B.R. 340 (Bankr. N.H. 2006); *In re Hartwick*, 352 B.R. 867 (Bankr. D. Minn. 2006), *rev'd in part Fokkena v. Hartwick*, 373 B.R. 645, 649 (D. Minn. 2007) (holding that debtor who owned her car outright was not entitled to take standard vehicle ownership deduction); *In re Farrar-Johnson*, 353 B.R. 224 (Bankr. N.D. Ill. 2006); *In re Demonica*, 345 B.R. 895 (Bankr. N.D. Ill. 2006).

[11] *See, e.g., Ceasar*, 364 B.R. at 262 (holding that no ownership allowance could be claimed on a car owned free and clear of liens); *In re Devilliers*, 358 B.R. 849 (Bankr. E.D. La. 2007) (same); *Pampas* 369 B.R. 290 (same); *In re Barraza*, 346 B.R. 724 (Bankr. N.D. Tex. 2006) (same); *In re Hardacre*, 338 B.R. 718 (Bankr. N.D. Tex. 2006) (same); *In re Oliver*, 350 B.R. 294 (Bankr. W.D. Tex. 2006) (same).

CONCLUSION

The Court finds that the Bankruptcy Court properly dismissed Meade's Chapter 7 Petition as an abuse of bankruptcy proceedings, and affirms its decision. First, the plain reading of § 707(b)(2)(A)(ii)(I) requires the debtor to qualify for a deduction by having an existing ownership or lease payment on a vehicle before selecting the applicable deduction amount. Second, Meade's cited case law has been expressly rejected by a line of decisions issued from bankruptcy courts within the Fifth Circuit, which the Court finds persuasive. Finally, the Court declines to address Meade's policy argument, because it stems from case law the Court rejects. Based on the foregoing analysis, the Court affirms the decision of the Bankruptcy Court.

Accordingly, **IT IS HEREBY ORDERED** that the United States Bankruptcy Court's Order Granting Motion to Dismiss entered on February 28, 2007, is **AFFIRMED**.

SIGNED this **24th** day of **January, 2008**.

THE HONORABLE DAVID BRIONES
UNITED STATES DISTRICT JUDGE

BRIEF BANK — "SUMMARY SHEET"

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WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*
In re George Thomas, Jr. And Doris Ann Thomas (Hildebrand v. Thomas)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*
BAP 6th Cir.

3. ("CCN") ***CURRENT*** CASE NO.
No.: 08-8014

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*
No.: 07-bk-07019
Court: Bankr. Tenn.
(Identify judge & cite, if any)

5. ("SO") ***SOURCE***
U.S. TRUSTEES

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*
Filed: April 30, 2008
Type: Brief for the United States Trustee as Amicus Curiae Supporting Reversal

7. **("AU") *PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*
David Levine, P. Matthew Sutko, Beth Roberts Derrick, Richard F. Clippard
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***

●Whether section 1325(b)(1) requires debtors to commit all of their "projected disposable income" to creditors over the applicable commitment period.

●Whether section 707(b)(2)(A)(iii) prohibits debtors from subtracting from their disposable income calculations payments for collateral the debtors are surrendering under their chapter 13 plans.

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NO. 08-8014

BANKRUPTCY APPELLATE PANEL
OF THE SIXTH CIRCUIT

In re:

IN RE GEORGE THOMAS, JR. and
DORIS ANN THOMAS,

DEBTOR,

HENRY E. HILDEBRAND, III, Trustee,

Appellant

vs.

GORDON THOMAS, JR. and
DORIS ANN THOMAS,

Appellees.

By order entered March 28, 2008, the appeal in the *In re Jones*, Case No. 08-8015, was consolidated for all purposes with the appeal in *In re Thomas*, Case No. 08-8014, under which both appeals now proceed.

BRIEF FOR THE UNITED STATES TRUSTEE AS AMICUS CURIAE SUPPORTING REVERSAL

Oral Argument Is Not Requested

OF COUNSEL:

ROBERTA A. DEANGELIS
Acting General Counsel

P. MATTHEW SUTKO
DAVID A. LEVINE
Executive Office for United States Trustees
Department of Justice
20 Massachusetts Avenue, N.W.
Washington, D.C. 20530

RICHARD F. CLIPPARD
United States Trustee

BETH ROBERTS DERRICK
Assistant United States Trustee
Office of the United States Trustee
Department of Justice
701 Broadway, Suite 318
Nashville, TN 37203
Telephone: (615) 736-2258
Fax: (615) 736-2260

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INTEREST OF THE UNITED STATES

This United States Trustee submits this brief as amicus curiae supporting reversal of the bankruptcy court's orders. Cf. Fed. R. App. P. 29(a) (permitting the United States to file an amicus curiae brief without the consent of the parties or leave of court). This appeal calls upon this Court to examine a statutory provision affecting chapter 13 bankruptcy cases, 11 U.S.C. § 1325(b). Section 1325(b) makes two chapter 7 provisions – 11 U.S.C. § 707(b)(2)(A) and (B) – applicable to chapter 13 cases.

The United States has a direct interest in the proper construction of these provisions because United States Trustees, who are Justice Department officials appointed by the Attorney General, supervise the administration of chapter 7 and chapter 13 bankruptcy cases in all federal judicial districts within this circuit. 28 U.S.C. § 581-589a. See also H.R. Rep. No. 95-595, at 88 (1977) (United States Trustees "serve as bankruptcy watch-dogs to prevent fraud, dishonesty, and overreaching in the bankruptcy arena."); *In re Revco D.S., Inc.*, 898 F.2d 498, 500 (6th Cir. 1990).

This appeal affects the United States' interests for two distinct reasons:

First, by applying section 1325(b), this Court will determine how much above-median-income chapter 13 debtors must repay their creditors in their chapter 13 repayment plans. The United States has an interest in that question because United States Trustees "supervise the administration of [chapter 13] cases and trustees," monitor chapter 13 plans, and file comments with the court regarding such chapter 13 plans in connection with plan confirmation hearings under section 1324 of the Code. 28 U.S.C. § 586(a)(3)(C).

Second, because section 1325(b) incorporates the chapter 7 means test under section 707(b)(2), this appeal may also impact what expenses above-median-income chapter 7 debtors can claim on the means test. The means test determines whether an above median-income-debtor's chapter 7 case should be dismissed as abusive. See 11 U.S.C. § 707(b)(1) and (2).

United States Trustees play a unique role in chapter 7 cases because section 704(b) requires them to review all such cases and, whenever a case is deemed presumptively abusive under the statutory means test, either (a) seek its dismissal, or (b) file a statement declining to seek dismissal. See 11 U.S.C. § 704(b). In fiscal year 2007, United States Trustees filed 3,370 motions to dismiss under section 707(b)(2) and 1,441 statements declining to seek dismissal when a presumption of abuse existed in a case. One of the allowed means test expenses implicated in this appeal – payments on secured debts under section 707(b)(2)(A)(iii) – is critical to the United States Trustee's analysis of whether the presumption of abuse arises.

In light of these interests, the United States submits this brief to share its views on the interpretation of sections 1325(b) and 707(b)(2)(A). See 28 U.S.C. § 517 (authorizing Department of Justice "to attend to the interests of the United States in a suit pending in a court of the United States").

STANDARD OF REVIEW

On appeal, the bankruptcy court's findings of fact are reviewed under the clearly erroneous standard but the appellate court reviews the bankruptcy court's conclusions of law *de novo*. *Rembert v. AT&T Universal Card Servs.,* 141 F.3d 277, 280 (6th Cir. 1998)*; Michel v. Federated Dept. Stores, Inc.,* 44 F.3d 1310, 1315 (6th Cir. 1995). No disputed questions of fact exist, so review here is de novo.

STATEMENT OF THE ISSUE

Whether the bankruptcy court erred in confirming the debtors' chapter 13 plans over the chapter 13 trustee's objections, when the plan payments were predicated on disposable income calculations that included deductions for payments on property the debtors would never make because they were surrendering the property to secured creditors.

STATEMENT OF THE FACTS

I. Statutory Framework

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("Reform Act")[1] significantly altered how chapter 13 debtors obtain chapter 13 bankruptcy relief.

In a chapter 13 case, a debtor's unsecured creditors or trustee may insist the debtor devote all of his "projected disposable income" to repay unsecured creditors. See 11 U.S.C. § 1325(b)(1). Disposable income is a net number: income less expenses.

Under the Reform Act, an above-median-income debtor, like the debtors in these appeals, determines disposable income by first calculating his gross income.[2] Next, the debtor deducts his permitted expenses, which include "amounts reasonably necessary to be expended" for maintenance or support or necessary business expenses. See 11 U.S.C. § 1325(b)(2) and (3).

Above-median-income chapter 13 debtors determine "amounts reasonably necessary to be expended . . .in accordance with" 11 U.S.C. § 707(b)(2)(A)(ii), (iii), and (iv). 11 U.S.C. § 1325(b)(3) (incorporating those provisions). Relevant to the issues involved in this appeal is section 707(b)(2)(A)(iii), which allows as payments on secured debt amounts that will be "due in each month of the 60 months following the date of the petition." 11 U.S.C. § 707(b)(2)(A)(iii). Deducting allowed expenses from a debtor's income yields a net number - disposable income.

Under section 1325(b)(1), when the chapter 13 trustee or an unsecured creditor objects to confirmation, the plan must provide "that all of the debtor's projected disposable income to be received in the applicable commitment period beginning on the date that the first payment is due

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[1] Pub. L. No. 109-8, 119 Stat. 23 (2005).

[2] The term "current monthly income" itself is defined in the Code. 11 U.S.C. § 101(10A).

under the plan will be applied to make payments to unsecured creditors under the plan." 11 U.S.C. § 1325(b)(1).

II. Factual Background

Debtors Gordon Thomas, Jr. and Doris Ann Thomas (Case No. 08-8014) and Anthony Shane Jones and Shana Lee Jones (Case No. 08-8015) filed petitions under Chapter 13 of the Bankruptcy Code in the United States Bankruptcy Court for the Middle District of Tennessee.[3] Both cases present similar facts. Both the Thomases and the Jones are above-median income debtors and represented by the same attorney. Aplt. App. A, D p. 2, M, P p. 2. Both debtors also filed chapter 13 plans that indicated an intent to surrender property that was subject to secured liens. Aplt. App. C p. 3, O p. 3. In particular, the Thomases scheduled secured debts for four vehicles but filed a plan stating their intent to surrender three of them.[4] Aplt. App. N pp. 16-17, O p. 3. The Jones's plan proposed to surrender real property valued at $121,000. Aplt. App. B p. 10, C p. 3.

Both debtors also calculated their disposable income by completing a Statement of Current Monthly Income and Calculation of Commitment Period and Disposable Income (Official Form 22C). Aplt. App. D, P. In their respective Official Forms 22C, the debtors both calculated their disposable income by deducting as future expenses the monthly payments on property that they intended to surrender. Aplt. App. D p. 5, P p. 5. Specifically, the Thomases deducted monthly payments on the three vehicles they intended to surrender, which totaled $1,344.10. Aplt. App. P p. 5. The Jones deducted $1,007 as a future monthly debt payment on the real property they were surrendering, even though their actual rent payment was only $800. Aplt. App. B p. 26, D p. 5.

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[3] By order entered on March 28, 2008, his Court consolidated the cases for all purposes.

[4] Despite surrendering these vehicles, however, the Thomases would not have to do without transportation: they intended to continue making payments on a fourth vehicle and to use a company truck provided by Mr. Thomas's employer. (Chapter 13 plan; Schedule J).

By including in their Form 22C secured debt payments they would never make, the debtors substantially reduced their disposable income. Aplt. App. D p. 5, P pp. 5-6. Since the debtors used their Form 22C disposable income calculation to calculate their plan payment, both chapter 13 plans proposed to pay unsecured creditors substantially less than the debtors had the ability to pay. Aplt. App. C, D, O, P. Specifically, the Thomases' plan payment was reduced by $1344.10, and the Jones reduced their plan payment by at least $207.[5] Aplt. App. C, D, O, P.

The Chapter 13 trustee objected to plan confirmation in both cases because the proposed plans failed to provide for the payment of all the debtors' disposable income to unsecured creditors, as required by 11 U.S.C. §1325(b)(1). Aplt. App. E, Q. The bankruptcy court denied the trustee's objection and confirmed the debtors' proposed plans. Aplt. App. G, S. In an oral opinion, the bankruptcy court held that the debtors' intent in surrendering the collateral was irrelevant. Aplt. App. L p. 6, X p.6. Instead, the bankruptcy court found that the debtors were required to deduct those collateralized debt payments contractually due in each of the 60 months following the date of the petition. Aplt. App. L p. 5, X p. 5. The bankruptcy court interpreted the phrase "contractually due" in section 707(b)(2)(A) as those debts owed under legal contract as of the petition date. Aplt. App. L p. 6, X p. 6.

SUMMARY OF ARGUMENT

This Court should reverse the orders entered below for any of three independent reasons. First, when a creditor or the chapter 13 trustee objects to confirmation of a chapter 13 plan, section 1325(b)(1) prohibits bankruptcy courts from confirming the plan unless the debtor provides all of his projected disposable income to repay unsecured creditors during the applicable commitment period. Projected disposable income is a forward-looking concept that requires the court to exclude

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[5] Over the 60 month chapter 13 plan term, the net effect of the reduced plan payments would be to substantially reduce the distribution to unsecured creditors.

expenses that the debtors do not or will not incur. Accordingly, bankruptcy courts cannot confirm chapter 13 plans when the plan payment is based on disposable income calculations that include deductions for payments on property that the debtor will surrender to secured creditors.

Second, in calculating their disposable income under section 1325(b)(2), debtors may only deduct from their current monthly income "amounts reasonably necessary to be expended". Payments on property the debtor is surrendering, by definition, will never be "expended," and therefore cannot be "reasonably necessary". Thus, the Bankruptcy Code erred in confirming the debtors' chapter 13 plans, because they included secured debt payments on property the debtors were surrendering.

Third, in accordance with section 707(b)(2)(A)(iii), which is incorporated in above-median-income chapter 13 cases by section 1325(b)(3), excluding payments on property a debtor is surrendering from a debtor's disposable income calculations is the proper interpretation of section 707(b)(2)(A)(iii), which only allows deduction of amounts "scheduled as contractually due" to secured creditors.

ARGUMENT

I. Section 1325(b)(1) requires debtors to commit all of their "projected disposable income" to creditors over the applicable commitment period.

Under section 1325(b)(1), bankruptcy courts may not confirm chapter 13 plans over the chapter 13 trustee's objection unless "the plan provides that all of the debtor's projected disposable income to be received in the applicable commitment period. . .will be applied to make payments to unsecured creditors under the plan." 11 U.S.C. § 1325(b)(1). The chapter 13 trustee objected to the chapter 13 plans filed by the Joneses and the Thomases. Accordingly, the bankruptcy court should not have confirmed the plans because they failed to provide for payment of all the debtors' projected disposable income over the applicable commitment period.

A. Under section 1325(b)(1), "projected disposable income" is a future-oriented concept that does not permit debtors to subtract secured debt payments as expenses when the property at issue will be surrendered under the plan.

This Court has not interpreted the phrase "projected disposable income" in light of the Reform Act's amendments to section 1325(b).[6] In considering this phrase, this Court should adopt an interpretation of section 1325(b) that not only gives meaning to the definition of "disposable income" under section 1325(b)(2), but that also properly treats "projected" as a future-oriented concept, as required by the language of section 1325(b)(1). Under this approach, the debtor's historical income and expense deductions under section 707(b)(2)(A)(ii), (iii), and (iv) are a starting point, and should be carried forward throughout the term of the plan, absent evidence to the contrary. However, where evidence demonstrates that the debtor is likely to have a significant change in income or expenses during the life of the chapter 13 plan, the Court should consider this evidence in its calculations of the debtor's projected disposable income.

Prior to the Reform Act, section 1325(b)(1) provided that "all of the debtor's projected disposable income to be received in the three-year period beginning on the date that the first payment is due under the plan will be applied to make payments under the plan." 11 U.S.C. § 1325(b)(1). The Bankruptcy Code defined "disposable income" as "income not reasonably necessary for maintaining or supporting the debtor or a dependent, with that determination made on an estimated basis of plan confirmation." *In re Pak,* 378 B.R. 257 (B.A.P. 9th Cir. 2007) quoting, *In re Slusher*, 359 B.R. 290, 294 (Bankr. D. Nev. 2007); 11 U.S.C. § 1325(b)(2). Courts routinely projected or estimated a debtor's disposable income during the plan confirmation process by taking into account anticipated changes in their financial circumstances, primarily by utilizing Schedules

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[6] The issue is, however, currently pending before this Court in another case, *In re Petro,* BAP No. 08-8009. The United States Trustee filed an amicus brief in support of the chapter 13 trustee in that case, advocating reversal of the bankruptcy court on the issue.

I and J. See *In re Pak*, 357 B.R. 549, 553 (Bankr. N.D. Cal. 2006) *aff'd In re Pak*, 378 B.R. 257 (B.A.P. 9th Cir. 2007).

Section 1325(b)(1) now requires that all of the debtor's projected disposable income "be applied to make payments to unsecured creditors. . ." 11 U.S.C. § 1325(b)(1). "Projected disposable income" remains undefined; however, section 1325(b)(2) now defines "disposable income" as "current monthly income received by the debtor . . .less amounts reasonably necessary to be expended" for maintenance or support or necessary business expenses. In other words, to calculate "projected disposable income," a court must now start with the historical data from the six months prior to filing, *i.e.*, current monthly income and the debtor's allowed and actual expenses, and "project" that difference over the applicable commitment period.

Statutory words must be construed in context. *Hibbs v. Winn*, 542 U.S. 88, 101 (2004). In this context the term "projected" refers to a forecast or estimate of an expected future financial reality.[7] The calculation of "projected" financial data may well begin with historical data, but it does not end there, and it certainly does not entail a rigid and inviolable assumption that projected income will necessarily be identical to the debtor's past financial condition even when the available facts demonstrate otherwise. The forward looking nature of projected disposable income is reinforced by the requirement that a plan provide all the debtor's projected disposable income "to be received" during the plan period, and that these amounts "will be applied to make payments" to unsecured creditors. 11 U.S.C. § 1325(b)(1)(B).

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[7] See *The Random House Dict. of the English Lang.*, 1546 (2d ed. 1987) (defining to "project" as *inter alia*, "to set forth or calculate (some future thing); *They projected the building costs for the next five years*.") *Webster's Third New Int'l Dict.* 1813 (1993) (defining "projected" as, *inter alia*, "planned for future execution: contrived, proposed," as "[projected] outlays for new plant and equipment"). See also *In re Chriss-Price*, 376 B.R. 648 (Bankr. M.D. Tenn. 2006) (applying dictionary definition of "projected" and finding that projected "refers to the future" and that courts "must consider both future and historical finances of the debtor in determining compliance with 11 U.S.C. § 1325(b)(1)(B).").

Three appellate courts have embraced this approach. They read "projected disposable income" in section 1325 as presumptively starting with the historical disposable income figure but allow significant changes in the debtor's income or expenses to be considered when that figure inaccurately projects the debtor's ability to fund a chapter 13 plan over the life of that plan. See *In re Lanning*, 380 B.R. 17 (B.A.P. 10th Cir. 2007); *In re Pak*, 378 B.R. 257 (B.A.P. 9th Cir. 2007); *In re Kibbe*, 361 B.R. 301 (B.A.P. 1st Cir. 2007). But see *In re Frederickson*, 375 B.R. 829 (B.A.P. 8th Cir. 2007) (finding, in dicta, that "projected disposable income is the disposable income calculated on Form 22C extrapolated over the applicable commitment period."); *In re Mancl*, 381 B.R. 537 (W.D. Wis.2008) (projected disposable income is simply disposable income projected forward over term of plan).

This interpretation not only is faithful to the new definition of "disposable income" in section 1325(b)(2) as an historical number but also treats "projected" disposable income as a future-oriented concept, as required by the language of section 1325(b)(1). See *In re Pak*, 378 B.R. at 264-65; *In re Kibbe*, 361 B.R. at 307-08. Accordingly, it is unsurprising that courts have applied this forward-looking analysis in denying plan confirmation when debtors' disposable income calculations included payments for secured debts on surrendered property. See *In re Smith*, 383 B.R. 441, 453-54 (Bankr. E.D. Wis. 2008) (denying plan confirmation where debtors subtracted mortgage payments on home they were surrendering because they failed to commit all of their "projected disposable income" as required under 11 U.S.C. § 1325(b)); *In re Love*, 350 B.R. 611 (Bankr. M.D. Ala. 2006) ("One would not project or anticipate that a payment would be made on a secured indebtedness where the collateral had been returned. Similarly, a Chapter 13 plan is necessarily a forward looking document.").

Because projected disposable income under section 1325(b)(1) is a forward-looking concept, the bankruptcy court should not have confirmed the debtors' chapter 13 plans when the debtors would never make payments on property they were surrendering under their chapter 13 plans.

B. Under section 1325(b)(3), "disposable income" is a future-oriented concept that does not permit debtors to subtract amounts they will never "expend" because they are surrendering the property under the plan.

Section 1325(b)(2) defines disposable income to include "current monthly income received by the debtor. . .less amounts reasonably necessary to be expended. . ." 11 U.S.C. § 1325(b)(2). For above-median-income debtors, section 1325(b)(3) provides that "amounts reasonably necessary to be expended . . .shall be determined in accordance with [section 707(b)(2)(A) and (B)]." 11 U.S.C. § 1325(b)(3).

The phrase "reasonably necessary to be expended" in section 1325(b)(3) is future-oriented. "It requires debtors, and courts, to look into the future to determine, inasmuch as possible, what expenses the debtor will have during the life of the plan." *In re Smith*, 383 B.R. 441, 454 (Bankr. E.D. Wis. 2008). Indeed, to give this phrase meaning, one must consider whether the debtor will actually "expend" any amounts going forward. Id. See also *In re Renicker*, 342 B.R. 304, 309 (Bankr. W.D. Mo. 2006) (concluding that the "plain language of section 1325(b)(2) unambiguously indicates that prospective - not historical - expenses are to be used to calculate disposable income"). Payments on property a debtor is surrendering, by definition, will never be "expended," and therefore cannot be "reasonably necessary" for the debtor's support. *In re Coleman,* 382 B.R. 759, 763 (Bankr. W.D. Ark. 2008); *In re McPherson*, 350 B.R. 38, 45-46 (Bankr. W.D. Va. 2006) (payments the debtor does not propose to make, and is not required to make under the debtor's plan cannot be reasonably necessary for the debtor's support).

Because they will never be "reasonably necessary to be expended," section 1325(b)(3) prohibits debtors such as the Thomases and the Joneses from deducting from their disposable income secured debt payments on property they are surrendering. Therefore, this Court should reverse the bankruptcy court's confirmation orders entered below.

II. Section 707(b)(2)(A)(iii) prohibits debtors from subtracting from their disposable income calculations payments for collateral the debtors are surrendering under their chapter 13 plans.

In confirming the debtors' chapter 13 plans, the bankruptcy court incorrectly ruled that the debtors could claim secured debt expenses under section 707(b)(2)(A)(iii) for property the debtors were surrendering. See Aplt. App. L p. 6, X p. 6. There are four reasons why this is so.

First, the terms of section 707(b)(2)(A)(iii) contemplate that future expenses will be used to determine whether a debtor will have sufficient disposable income going forward. The statute provides: "[t]he debtor's average monthly payments on account of secured debts shall be calculated as the sum of . . .the total of all amounts scheduled as contractually due to secured creditors in each month of the 60 months *following* the date of the petition."[8] In examining the meaning of a statute, courts begin with the statute's plain language, and avoid constructions that render some words redundant or another part of the same statute superfluous. *United States v. Alaska*, 521 U.S. 1, 59 (1997) ("The Court will avoid an interpretation of a statute that renders some words altogether

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[8] 11 U.S.C. § 707(b)(2)(A)(iii) provides:

> [t]he debtor's average monthly payments on account of secured debts shall be calculated as the sum of –
>
> (I) the total of all amounts scheduled as contractually due to secured creditors in each month of the 60 months following the date of the petition; and
>
> (II) any additional payments to secured creditors necessary for the debtor, in filing a plan under chapter 13 of this title, to maintain possession of the debtor's primary residence, motor vehicle, or other property necessary for the support of the debtor and the debtor's dependents, that serves as collateral for secured debts;
>
> divided by 60.

redundant").

The dictionary defines "following" as "subsequent to," "next in the order of time" or in the future. *Merriam-Webster Online Dictionary* (2007).[9] This meaning should be imparted to the term "following" as it appears in section 707(b)(2)(A)(iii), absent clear indication that Congress intended to give the term a different meaning. *Bailey v. United States*, 516 U.S. 137, 144-45 (1995) (turning to the dictionary definition of a term in order to determine its statutory meaning). Using the common, ordinary meaning of "following," section 707(b)(2)(A)(iii) would only allow deductions for payments to secured creditors that will be made 'subsequent to" or "after" the petition date, and payments for surrendered property that will never be made do not qualify. See *In re Naut*, 2008 WL 191297 at *9 (Bankr. E.D. Pa. Jan. 22, 2008) (applying dictionary definition of "following" to conclude that loan payments must actually be due in each of the 60 months after the bankruptcy filing before the debtor can claim the expense under the means test).

Second, the fact that Congress employed the phrase "scheduled as contractually due" in the section is consistent with this reading of the term "following." Significantly, Congress has "used the phrase 'scheduled as' several times in the Bankruptcy Code. . .to refer to whether a debt is identified on a debtor's bankruptcy schedules." *In re Skaggs*, 349 B.R. 594, 599 (Bankr. E.D. Mo. 2006).[10] This use of the phrase "scheduled as contractually due" thus signals that secured debts are permissible deductions under section 707(b)(2)(A)(iii) only to the extent they are legitimately on

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[9] Available at: http://www.m-w.com/dictionary/following

[10] See, e.g., 11 U.S.C. § 1111(a) ("wherein a claim or interest is not deemed filed if it is scheduled as disputed, contingent or unliquidated"). Other examples where the term "scheduled" is used to refer to a debtor's bankruptcy schedules include 11 U.S.C. § 523(a)(3) (individual debtor not discharged from debt "neither listed nor scheduled under section 521(l)[sic] of this title. . .") and 11 U.S.C. § 554(c) ("Unless the court orders otherwise, any property scheduled under section 521(l) of this title not otherwise administered at the time of the closing of a case is abandoned to the debtor and administered for purposes of section 350 of this title.").

the debtor's schedules as a debt to be paid in the 60 months after the debtor filed bankruptcy. Where, as here, the debtors filed chapter 13 plans with their petition indicating an intent to surrender secured property, the debtors' disposable income calculations cannot include payments on the surrendered property.

"When Congress amends the bankruptcy laws, it does not write 'on a clean slate'". *Dewsnup v. Timm*, 502 U.S. 410, 419 (1992). The prior bankruptcy law's ". . .longstanding meaning forms the background against which Congress legislates. . .[and] [t]he courts presume that Congress will use clear language if it intends to alter an established" meaning. *Skaggs*, 349 B.R. at 599 (citing *Firstar Bank v. Faul*, 253 F.3d 982, 988 (7th Cir. 2001)). Accordingly, a debtor's "schedules and statements form the basis from which . . .[a] court should determine whether a debt is 'scheduled as contractually due.'" Id. The entire phrase "average monthly payments on account of secured debts scheduled as contractually due in each month of the 60 months following the date of the petition" is best construed as contemplating a forward-looking calculation. *In re Ray*, 362 B.R. 680, 685 (Bankr. D. S.C. 2007). The Joneses' and Thomases' schedules and statements, including their statements in their chapter 13 plans that they intended to surrender collateral to their secured creditors, form the basis from which this Court should determine whether they will be making future payments "with respect to the property of the estate which secures those debts."

Third, an examination of section 707(b)(2)(A)(iii)(I) in context with its "conjunctive partner," section 707(b)(2)(A)(iii)(II), "reinforces the conclusion that § 707(b)(2)(A)(iii)(I) applies only to payments on debts secured by collateral that a debtor intends to keep." *In re Burden*, 380 B.R. 194, 202 (Bankr. W.D. Mo. 2007). Section 707(b)(2)(A)(iii)(II) allows, in addition to secured debt payments scheduled as contractually due, deductions for "any additional payments to secured creditors necessary for the debtor, in filing a plan under chapter 13 of this title, to maintain possession of the debtor's primary residence. . ." Allowing only debtors who intend to retain property to deduct secured debt expenses is harmonious with the explicitly forward-looking nature of section 707(b)(2)(A)(iii)(II), which contemplates an evaluation of a debtor's intention to maintain possession of property." Id. at 201-02.

Two lines of cases take an opposite view of section 707(b)(2)(A)(iii), one holding that the words "contractually due" are controlling, and the other holding that the words "contractually due" control unless the collateral is actually surrendered.[11] The "contractually due unless actually surrendered" courts allow chapter 7 debtors to deduct payments on secured debt except when the collateral has actually been surrendered to the secured creditor. These cases, however, and their analysis, should be rejected.[12]

These lines of cases present no unified structure for the analysis of section 707(b)(2)(A)(iii). Their analyses are fundamentally irreconcilable – the first holds that the means test is designed to be an historic reading of a debtor's financial condition as of the petition date, while the second requires consideration of some events occurring after the petition date be considered. More importantly, neither line takes into account or gives effect to all words and provisions of section 707(b)(2)(A)(iii), whereas the construction advanced by the United States Trustee does.

Section 707(b)(2)(A)(iii) "allows debtors to deduct their average monthly payments on secured debts based upon those amounts that will be contractually due during the 60 month period

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[11] See e.g., *In re Walker*, 2006 WL 1314125, at *4 (Bankr. N.D. Ga. May 1, 2006) (surrender of collateral does not change fact that payments are contractually due); see also *Fokkena v. Hartwick*, 373 B.R. 645, 653-55 (D. Minn. 2007); *In re Mundy*, 363 B.R. 407, 412-13 (Bankr. M.D. Pa. 2007).

[12] See, e.g., *In re Singletary*, 354 B.R. 455, 467 (Bankr. S.D. Tex. 2006); see also *In re Nockerts*, 357 B.R. 497 (Bankr. E.D. Wis. 2006); c.f. *In re Brandenburg*, 2007 WL 1459402 (Bankr. E.D. Wis. May 15, 2007) (finding mortgage debt not "scheduled as contractually due" as of date of state law foreclosure sale).

following the petition." *In re Edmunds,* 350 B.R. 636, 645 (Bankr. D. S.C. 2006). The method used to determine whether an expense for secured debt may be deducted under the statute must therefore consider the amount, if any, that will actually be paid by the debtor in the future. Proper application of section 707(b)(2)(A)(iii) thus requires courts to credit a debtor's intent to surrender collateral and make no future payments to secured creditors.

Fourth, the United States Trustee's approach is also consistent with Congress' stated intent in enacting the Reform Act, which was to make certain that debtors "repay creditors the maximum they can afford." H.R. Rep. No. 109-31 (I) at 1 (2005), *reprinted in* 2005 U.S.C.C.A.N. 88, 89. Permitting the Joneses and the Thomases to reduce their disposable income by secured debt expenses for collateral they intend to surrender would conflict with Congress' intent in enacting the Reform Act.

CONCLUSION

For these reasons, we respectfully ask this Court to reverse the order of the bankruptcy court in its entirety.

Respectfully submitted,

RICHARD F. CLIPPARD
United States Trustee

____
Beth Roberts Derrick
Assistant United States Trustee
Office of the United States Trustee
701 Broadway, Suite 318
Nashville, TN 37203
Telephone: (615)736-2258
Fax: (615)7369-2260

Of Counsel

P. Matthew Sutko
David A. Levine
Executive Office for United States Trustees
Department of Justice
20 Massachusetts Avenue, N.W.
Suite 8000
Washington, D.C. 20530
(202) 307-1399

CERTIFICATE OF SERVICE

I hereby certify that on the 30th day of April, 2008 the original and five true and correct copies of the foregoing were sent by Federal Express to the U.S. Bankruptcy Appellate Panel of the Sixth Circuit, 540 Potter Stewart United States Courthouse, 100 E. Fifth Street, Cincinnati, OH 45202-3988, and that true and correct copies were deposited in the United States Mail, First Class, postage prepaid to the following:

J. ROBERT HARLAN
J. ROBERT HARLAN & ASSOC.
PO BOX 949
COLUMBIA, TN 38402-0949

HENRY EDWARD HILDEBRAND, III
OFFICE OF THE CHAPTER 13 TRUSTEE
PO BOX 190664
NASHVILLE, TN 37219-0664

Beth Roberts Derrick

BRIEF BANK — "SUMMARY SHEET" *Printed Tue-1/25/11 11:8*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*

Chaya Chalon Thomas v. Richard A. Wieland, United States Trustee (In re Chaya Chalon Thomas)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*

10 th Cir.

3. ("CCN") ***CURRENT*** CASE NO.

No.: 10-6226

4. ("PCN") ***PRIOR*** CASE NO. - & COURT *[IF ANY]*

No.: 5:09-cv-01386-D

Court: W. D. Okla.

(Identify judge & cite, if any)

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U.S. TRUSTEES

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*

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Charles E. Snyder, Noah M. Schottenstein, P. Matthew Sutko, Ramona D. Elliott, Charles S. Glidewell, Richard A. Wieland

(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***

BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s)

&

√ Any Miscellaneous ***BACKGROUND***

• Did the district court abuse its discretion when it dismissed Ms. Thomas's bankruptcy appeal because she did not pay her filing fees and failed to demonstrate her eligibility to proceed in forma pauperis under 28 U.S. C. §§ 1915 or 1930(f)?

10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)

11. DO YOU RECOMMEND POSTING IN UST BRIEFBANK?| x | | | ***NAME:*** Linda Figueroa

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No. 10-6226

IN THE UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

In re CHAYA CHALON THOMAS,

Debtor.

CHAYA CHALON THOMAS,

Appellant,

v.

RICHARD A. WIELAND, UNITED STATES TRUSTEE,

Appellee.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE
WESTERN DISTRICT OF OKLAHOMA,
DISTRICT JUDGE TIMOTHY D. DeGIUSTI

BRIEF FOR APPELLEE RICHARD A. WIELAND, UNITED STATES TRUSTEE

RAMONA D. ELLIOTT
General Counsel
P. MATTHEW SUTKO
Associate General Counsel
NOAH M. SCHOTTENSTEIN
Trial Attorney

United States Department of Justice
Executive Office for United States
Trustees
20 Massachusetts Avenue N.W.
Washington, D.C. 20530
(202) 307-1399
noah.m.schottenstein@usdoj.gov

RICHARD A. WIELAND
United States Trustee
CHARLES S. GLIDEWELL
Assistant United States Trustee
CHARLES E. SNYDER
Trial Attorney

United States Department of Justice
Office of the United States Trustee
215 Dean A. McGee, Fourth Floor
Oklahoma City, OK 73102
(405) 231-5961
charles.snyder@usdoj.gov

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STATEMENT OF RELATED CASES

There are no prior appeals in this case. There is a separate appeal arising from the same underlying bankruptcy case that this appeal arises from. See Thomas v. RCB Bank of Nichols Hills (In re Thomas), No. 10-6228 (10th Cir. filed Oct. 5, 2010).

STATEMENT OF APPELLATE JURISDICTION

The bankruptcy court had jurisdiction over Ms. Chaya Chalon Thomas's chapter 13 bankruptcy case under 28 U.S.C. §§ 157 and 1334(a). The bankruptcy court's final order dismissing Ms. Thomas's case under 11 U.S.C. § 1307(c) for bad faith was entered on October 29, 2009. Ms. Thomas filed a motion to alter or amend judgment on November 11, 2009. The bankruptcy court denied that motion on December 9, 2009. Ms. Thomas then timely filed a notice of appeal from both orders under 28 U.S.C. § 158(c)(2) and Fed. R. Bankr. P. 8002(a) on December 21, 2009.

The United States District Court for the Western District of Oklahoma had jurisdiction over Ms. Thomas's appeal under 28 U.S.C. § 158(a)(1). The district court order dismissing Ms. Thomas's appeal for failure to pay her filing fees under Fed. R. Bankr. P. 8001(a) was entered on August 18, 2010. Ms. Thomas timely filed a notice of appeal from that dismissal order under Fed. R. App. P. 4(a)(1)(B) on October 5, 2010.

This Court has jurisdiction to review the district court's dismissal order under 28 U.S.C. § 158(d)(1).

STATEMENT OF THE ISSUES

Did the district court abuse its discretion when it dismissed Ms. Thomas's bankruptcy appeal because she did not pay her filing fees and failed to demonstrate her eligibility to proceed in forma pauperis under 28 U.S.C. §§ 1915 or 1930(f)?

STANDARD OF REVIEW

This Court reviews a dismissal based on failure to comply with procedural rules or a court order for abuse of discretion. Nielsen v. Price, 17 F.3d 1276, 1277 (10th Cir. 1994). This Court also reviews a court's denial of an application to proceed in forma pauperis for abuse of discretion. Lister v. Dep't of Treasury, 408 F.3d 1309, 1312 (10th Cir. 2005).

"An abuse of discretion occurs when the district court's decision is arbitrary, capricious, or whimsical, or results in a manifestly unreasonable judgment." Moothart v. Bell, 21 F.3d 1499, 1504-05 (10th Cir. 1994). Under the abuse of discretion standard, the district court's decision will not be disturbed unless "it finds no support in the record, deviates from the appropriate legal standard, or follows from a plainly implausible, irrational, or erroneous reading of the record." United States v. Robinson, 39 F.3d 1115, 1116 (10th Cir. 1994).

Questions of statutory interpretation are reviewed de novo. United States v. McGinty, 610 F.3d 1242, 1245 (10th Cir. 2010).

STATEMENT OF THE CASE

I. Statutory Framework

A. Dismissals for Failure to Comply With Procedural Rules Under Fed. R. Bankr. P. 8001(a)

The Federal Rules of Bankruptcy Procedure “govern procedure in cases under title 11 of the United States Code.” Fed. R. Bankr. P. 1001. The 8000-series Bankruptcy Rules govern appeals to the district courts and the bankruptcy appellate panels.

Under Fed. R. Bankr. P. 8001(a), “[a]n appellant’s failure to take any step other than timely filing a notice of appeal does not affect the validity of the appeal, but is ground only for such action as the district court or bankruptcy appellate panel deems appropriate, which may include dismissal of the appeal.”

B. The Availability of Fee Waivers in Bankruptcy Appeals

There is no 8000-series Bankruptcy Rule governing fee waivers on appeal. But under 28 U.S.C. § 1930(f) a court may wave bankruptcy fees in three circumstances. First, when an individual chapter 7 debtor has “income less than 150 percent of the income official poverty line” and “is unable to pay the fee in installments,” the court may waive the fee for the commencement of the case. 28 U.S.C. § 1930(f)(1). Second, the court may waive all other fees for “such debtors.” 28 U.S.C. § 1930(f)(2). Third, “in accordance with Judicial Conference policy,” the court may waive fees “for other debtors and creditors.” 28 U.S.C.

§ 1930(f)(3). The Bankruptcy Court Miscellaneous Fee Schedule, however, does not contain a provision allowing a court to waive the fees for filing an appeal. Administrative Office of the U.S. Courts, Bankruptcy Court Miscellaneous Fee Schedule § 14 (2010), available at http://www.uscourts.gov/FormsAndFees/Fees/BankruptcyCourtMiscellaneousFeeSchedule.aspx.

Under 28 U.S.C. § 1915(a)(1), "any court of the United States" may waive filing fees for any person who submits an affidavit including a statement of all assets demonstrating the inability to pay the filing fees, and a statement explaining the nature of the appeal and the belief that the person is entitled to redress.

II. Statement of the Facts and Proceedings Below

A. Ms. Thomas files for chapter 13 bankruptcy relief with over $700,000 in declared assets and under $30,000 in liabilities.

Ms. Chaya Chalon Thomas filed a pro se voluntary petition for relief under chapter 13 of the Bankruptcy Code on July 20, 2009. Chapter 13 Voluntary Petition dated 7/20/2009, B.C. Dkt. No. 1.[1] Ms. Thomas claims to be a self-employed paralegal. Summary of Schedules and Statement of Financial Affairs dated 8/3/2009, B.C. Dkt. No. 10 at 23. She reported earning $1,250 per month in business income and receiving $500 per month in child support payments. Id. at

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[1] All references to the bankruptcy court record are designated as "B.C. Dkt. No." All references to the district court record are designated as "D.C. Dkt. No." All references to the transcript of the bankruptcy court hearing dated 8/27/2009 are designated as "Tr."

41. She scheduled $29,481 in liabilities, primarily in credit card and student loan debt. Id. at 17-20. And she disclosed over $713,900 in assets.[2] Id. at 1.

Ms. Thomas's assets include (1) $5,000 in cash located in her home, id. at 8; (2) an unknown amount of shares in a corporation named "The Phoenix Syndicate," id. at 9; (3) 50% of a rental property worth $140,000, id.; and (4) $576,000 in accounts receivable. Id. at 10. The $576,000 in receivables came from two sources. First, $72,000 for rents on a property located at 2455 Unit 5 Manchester Drive in The Village, Oklahoma from "Ms. Betty Jean Wagner, Rick Wagner, Judy Davis & G. Von Thomas Atty. Inc." Id. Second, $504,000 for unpaid salary from "G. Von Thomas, Attorney, Inc., Essex & Associates, Ltd., The Phoenix Syndicate, Versatility Inc. Plus, and Village Investments Plus Fund." Id.

B. Ms. Thomas lists property she does not own in her bankruptcy schedules.

In addition, Ms. Thomas claimed an "Undetermined Equitable Interest" in her home at 4200 Bristol Lane in Edmond, Oklahoma. Id. at 4. But the property records for Oklahoma County do not show that Ms. Thomas owns the Bristol Lane property. Instead, property records list Mr. Clyde A. Riggs as the sole owner of

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[2] Ms. Thomas declared over $1 million in assets on the face of her bankruptcy petition. Chapter 13 Voluntary Petition dated 7/20/2009, B.C. Dkt. No. 1 at 1. But in her bankruptcy schedules, she values her home at an "unknown" value, personal property at $713,900, and lists no other assets. Summary of Schedules and Statement of Financial Affairs dated 8/3/2009, B.C. Dkt. No. 10 at 1. Although the difference between her petition and her schedules indicate that the house should be valued at around $300,000, this brief will only refer to the value of the assets quantified in her schedules.

the property. United States Trustee's Mot. to Dismiss dated 9/30/2009, B.C. Dkt. No. 25 at Ex. A. Mr. Riggs purchased the Bristol Lane property in 2001. Id. at Ex. C. Ever since, Mr. Riggs has been the sole taxpayer on the property. Id. at Ex. B.

Mr. Riggs originally leased the property to The Phoenix Syndicate, through Judy Davis — Ms. Thomas's business partner. Tr. at 17-18. The lease expired by its own terms. Id. at 18. The tenants stopped paying rent, but they never left. Id. at 17.

Ultimately, Mr. Riggs brought a forcible entry and detainer lawsuit to remove Ms. Thomas and her family from the premises. See United States Trustee's Mot. to Dismiss dated 9/30/2009, B.C. Dkt. No. 25 at 2; see also Riggs v. Thomas, No. SC-2009-13866 (D. Okla. Cty. filed July 21, 2009), available at http://www.oscn.net. Ms. Thomas's bankruptcy filing created an automatic stay under 11 U.S.C. § 362, which stopped the eviction.

C. Ms. Thomas requests a continuance at the meeting of her creditors to retain counsel, but never again appears at any proceeding, either in person or through counsel.

On August 20, 2009, Ms. Thomas appeared at the initial meeting of her creditors, which is mandatory under 11 U.S.C. § 341 (requiring the debtor to answer questions posed at the meeting). She testified under oath that the information in her schedules was accurate. Tr. at 27-28. But after realizing that Mr. Riggs's attorney was present, Ms. Thomas requested a continuance to retain counsel. Id. at 32-33. The chapter 13 trustee conducting the meeting consented, and ordered Ms. Thomas to provide affidavits verifying the accuracy of the information listed in her schedules when the meeting resumed. Id. at 34. After consulting with Ms. Thomas, the chapter 13 trustee suspended the meeting by announcing that it would be continued until September 10, 2009, and warned Ms. Thomas that if she did not reappear, he would file a motion to dismiss her case. Id.

Ms. Thomas never obtained counsel, produced documents, or appeared at the meeting on September 10, 2009. Id. at 33-34; Docket Text Entry dated 9/15/2009. The chapter 13 trustee subsequently filed a motion to dismiss her case. Trustee's Mot. to Dismiss Case for Failure to Appear dated 9/14/2009, B.C. Dkt. No. 16. On the day the motion to dismiss was scheduled for a hearing, September 22, 2009, Ms. Thomas filed a 14-page objection to the chapter 13 trustee's motion to dismiss (1) denying that she failed to appear at the original section 341 meeting, (2) blaming the chapter 13 trustee for delays in the case, (3) contesting her legal obligations under section 341, and (4) requesting sanctions against the chapter 13 trustee "for its disregard of the law." Objection dated 9/22/2009, B.C. Dkt. No. 21. Ms. Thomas, however, did not appear at the hearing, so the bankruptcy court postponed it until October 14, 2009, to give her an opportunity to participate. Minute Order dated 9/23/2009, B.C. Dkt. 22.

D. Ms. Thomas files a complaint against RCB Bank for a violation of the automatic stay in a case that was dismissed in 2001.

On September 30, 2009, the United States Trustee moved to dismiss Ms. Thomas's chapter 13 case for bad faith.[3] United States Trustee's Mot. to Dismiss dated 9/30/2009, B.C. Dkt. No. 25. The United States Trustee argued that Ms. Thomas was squatting on Mr. Riggs's property and her misconduct in the case — lying about her ownership of the Bristol Lane property, failure to attend her continued section 341 meeting, and failure to appear in court to defend her objection — was intended to cloud title to the Bristol Lane property, delay her bankruptcy case, and frustrate Mr. Riggs's state court litigation. Id. at 5-6.

Two days later, Ms. Thomas filed a complaint against RCB Bank of Nichols Hills for allegedly violating the automatic stay when the bank foreclosed in 2001 on a residence located at 1403 Cassidy Lane, where Ms. Thomas lived with her parents at the time. Adversary Case 09-1153, Compl. dated 10/2/2009, B.C. Dkt. 26; see Thomas v. RCB Bank of Nichols Hills, No. 09-1153 (Bankr. W.D. Okla

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[3] The United States Trustee is an official of the United States Department of Justice appointed by the Attorney General to supervise the administration of bankruptcy cases. 28 U.S.C. § 581. "The United States trustee may raise and may appear and be heard on any issue in any case or proceeding under this title but may not file a plan pursuant to section 1121(c) of this title." 11 U.S.C. § 307. Courts have repeatedly held that the United States Trustee has standing under section 307 to appear and be heard on any issue in any bankruptcy case, despite the lack of pecuniary interest in the outcome. See Morgenstern v. Revco D.S., Inc. (In re Revco D.S., Inc.), 898 F.2d 498, 500 (6th Cir. 1990); see also Adams v. Zarnel (In re Zarnel), 619 F.3d 156, 161 (2d Cir. 2010); Stanley v. McCormick (In re Donovan Corp.), 215 F.3d 929, 930 (9th Cir. 2000) ("The United States trustee may . . . intervene and appear at any level of the proceedings from the bankruptcy court on . . . as either a party or an amicus.").

filed Oct. 2, 2009). Ms. Thomas demanded a million dollars in damages for stay violations that allegedly occurred a decade earlier in the bankruptcy cases of her parents, Gerald Von Thomas and Shirley Levingston Thomas. Id. at 6.

Soon after Ms. Thomas filed that complaint, she filed a 16-page objection to the United States Trustee's motion to dismiss her chapter 13 case. Objection dated 10/7/2009, B.C. Dkt. No. 33. According to Ms. Thomas, the existence of her adversary complaint "weighed heavily" against dismissing her case. Id. at 4. Ms. Thomas also raised seven objections to the United States Trustee's alleged "veiled" activities, such as the "Veiled Representation of a Private Citizen." Id. at 7-15. She provided no evidence or legal authority in support of these objections. Id.

Ms. Thomas's filings mirrored those her mother, Shirley Levingston Thomas, had filed in 2007 as part of her chapter 13 bankruptcy case. Response to Mot. for Miscellaneous Relief dated 11/17/2009, B.C. Dkt. No. 47 at 2. In that case, the bankruptcy court sanctioned Shirley Thomas for asserting an interest in property in which she had no title, and awarded attorneys' fees multiple times because she had "repeatedly filed frivolous bankruptcies, adversary proceedings, and pleadings, and she had repeatedly failed to appear in prosecution of her frivolous filings." Harmon Family Trust v. Thomas (In re Thomas), No. 09-6015, 348 F. App'x 413, 2009 WL 3241288 (10th Cir. Oct. 9, 2009) (unpublished); see In re Thomas, No. 07-10442 (Bankr. W.D. Okla. filed Feb. 21, 2007) (lead bankruptcy case). This Court affirmed those sanctions, and additionally sanctioned Shirley Thomas for bringing a frivolous appeal, awarding $8,500 in attorneys' fees to the appellees in that case. Id.

E. The bankruptcy court dismisses Ms. Thomas's case for bad faith.

The bankruptcy court rescheduled the October 14, 2009, hearing until October 27, 2009, to consider both the United States Trustee's and the chapter 13 trustee's motions at the same time. Docket Text Entry dated 10/14/2009, B.C. Dkt. No. 37.

Ms. Thomas did not appear at the hearing. The United States Trustee called Mr. Riggs, who testified that he had never met Ms. Thomas. Tr. at 13. Mr. Riggs explained that he was the sole owner of the property. Id. at 14. He had, however, previously leased it to The Phoenix Syndicate, through Judy Davis — Ms. Thomas's business partner. Id. at 17-18. That lease expired by its own terms. Id. at 18. The tenants stopped paying rent, but they never left the premises. Id. at 17.

The chapter 13 trustee then testified about what occurred at the section 341 meeting on August 20, 2009. Id. at 23. He recalled how Ms. Thomas requested the continuance immediately after Mr. Riggs's attorney announced himself, and how she agreed to provide documents and affidavits to verify the information in her bankruptcy petition. Id. at 24-25. To date, she has never provided any of that information. Id. at 25. In further support, he introduced an audio recording of the testimony Ms. Thomas gave at the section 341 meeting. Id. at 27-42.

After hearing all of the testimony, the bankruptcy court stated it was intending to dismiss her chapter 13 case with prejudice to re-filing for 180 days. Id. at 44. On October 29, 2009, the bankruptcy court issued a written order dismissing Ms. Thomas's case under section 11 U.S.C. § 1307(c) for bad faith and under 11 U.S.C. § 109(g) for willful failure of the debtor to appear before the court. Order Granting Mot. to Dismiss Case dated 10/29/2009, B.C. Dkt. No. 43.

On December 9, 2009, Ms. Thomas filed a motion to alter or amend the judgment, requesting that the bankruptcy court (1) explain what had happened at the hearing on the motion to dismiss, (2) update her on the status of her outstanding motions, and (3) clarify its order. Mot. to Alter or Amend dated 11/09/2009, B.C. Dkt. No. 46. The bankruptcy court set the motion for a hearing on December 8, 2009. Notice dated 11/25/2009, B.C. Dkt. No. 48.

For the fourth time in a row, Ms. Thomas failed to appear. Order Denying Mot. dated 12/09/2009, B.C. Dkt. No. 55. The bankruptcy court denied the motion for failure to prosecute on December 9, 2009. Id.

F. Ms. Thomas files an application to proceed in forma pauperis on appeal that is inconsistent with her bankruptcy schedules.

On December 21, 2009, Ms. Thomas timely filed a notice of appeal from the orders dismissing her chapter 13 case and denying her motion to alter or amend judgment. Notice of Appeal to District Court dated 12/21/2009, B.C. Dkt. No. 61. At the same time, she filed an application to proceed in forma pauperis on appeal. Appl. to Proceed in District Court Without Prepaying Fees or Costs re: Appeal dated 11/21/2009, B.C. Dkt. No. 63.

Ms. Thomas's declaration of penury was inconsistent with the assets she listed in her bankruptcy schedules under penalty of perjury. Ms. Thomas's IFP application "incorporated by reference" those bankruptcy schedules. Id. at 2. But her schedules list $500 per month in child support payments that she did not include on her IFP application, and $713,900 worth of personal property, including $5,000 in cash on hand and ownership rights in various corporations, joint ventures, and investment funds. Summary of Schedules and Statement of Financial Affairs dated 8/3/2009, B.C. Dkt. No. 10 at 7-9, 23. Her IFP application did not explain why she could no longer pay her own costs or how her financial situation had changed. Appl. to Proceed in District Court Without Prepaying Fees or Costs re: Appeal dated 11/21/2009, B.C. Dkt. No. 63. She also failed to provide any authority in support of her application. Id.

G. The bankruptcy court denies Ms. Thomas's application to proceed in forma pauperis on appeal and orders her to pay the filing fee within seven days.

On February 26, 2010, the bankruptcy court denied the IFP application under 28 U.S.C. §§ 1915 or 1930(f), citing four reasons. Order Denying Mot. dated 2/26/2010, B.C. Dkt. No. 76. First, Ms. Thomas's application was deficient on the merits regarding her inability to pay the filing fee. Id. at 2. Second, a bankruptcy court is not a "court of the United States" that could grant relief under section 1915(a)(1). Id. Third, Ms. Thomas was ineligible for a fee waiver under section 1930(f)(2) because it only applies to a debtor who was granted a fee waiver under section 1930(f)(1), which she had not received. Id. at 4. Finally, Ms. Thomas was ineligible under section 1930(f)(3) because the Bankruptcy Court Miscellaneous Fee Schedule does not provide authority to waive the filing fee for an appeal. Id. at 5. Therefore, the court ordered Ms. Thomas to pay the filing fee within seven days. Id.

Ms. Thomas never appealed that order, nor did she ever pay the filing fee. Order Regarding Non-payment of Filing Fee for Notice of Appeal dated 3/11/2010, B.C. Dkt. 79.

H. The district court, after giving Ms. Thomas notice and an opportunity to respond, dismisses Ms. Thomas's appeal for failure to pay the filing fee.

Ten days after the bankruptcy court's deadline expired, on March 15, 2010, the district court entered an order directing Ms. Thomas to show cause why her appeal should not be dismissed for failure to pay the filing fee. Order to Show Cause dated 3/15/2010, D.C. Dkt. No. 12.

Ms. Thomas responded with an 18-page brief raising a variety of arguments. Resp. to Order to Show Cause dated 3/26/2010, D.C. Dkt. No. 13. Ms. Thomas argued that her case should not be dismissed because the bankruptcy court erred in holding that it did not have the authority to grant her IFP application. Id. at 5-8. Her other arguments included (1) the bankruptcy court did not have the authority to grant her IFP application, id. at 11; (2) the language used in her declaration conformed to the requirements of 28 U.S.C. § 1746 (requiring declarations made under penalty of perjury be evidenced in a standardized manner), id. at 14; (3) her arguments on appeal were meritorious, id.; (4) the merits of her underlying bankruptcy appeal were not frivolous, id. at 15; and (5) the United States Trustee engaged in sanctionable conduct under United Student Aid Funds, Inc. v. Espinosa, 130 S.Ct. 1367 (2010) (concerning the finality of an order erroneously discharging a student loan). Id. at 16.

After waiting five months, the district court dismissed the appeal on August 18, 2010. Order Dismissing Appeal dated 8/18/2010, D.C. Dkt. No. 22. The district court, agreeing with the bankruptcy court's reasoning, found Ms. Thomas's response unpersuasive. Id. at 2. The court observed how "Debtor in this case has wholly failed to comply" with the statutory requirement that she document her inability to pay the appellate filing fee. Id. at 3. The "balance of Debtor's response" to the show cause order did not "demonstrate good cause for her failure to pay the required filing fee to pursue this appeal." Id.

Ms. Thomas timely filed a notice of appeal to this Court on October 5, 2010. Notice of Appeal dated 10/5/2010, D.C. Dkt. No. 23.

SUMMARY OF THE ARGUMENT

An appellant must pay a filing fee with their notice of appeal. Ms. Thomas did not. Nor did she meet her burden of establishing her eligibility to proceed in forma pauperis. To the contrary, her bankruptcy schedules, which she never repudiated, represented to the bankruptcy court and to her creditors — under penalty of perjury — that she had monthly income and over $700,000 in assets. The bankruptcy court denied Ms. Thomas's application to proceed in forma pauperis and directed her to pay the filing fee.

After Ms. Thomas refused to pay the filing fee, the district court issued a show cause order notifying Ms. Thomas that it was intending to dismiss her case for failure to pay it. That order also instructed her to explain why she had failed to comply with the bankruptcy court's order. Ms. Thomas responded with a variety of inapposite arguments, including a collateral attack on the bankruptcy court's order, but evaded the issue of her non-compliance. After waiting for five months, and after carefully considering Ms. Thomas's response, the district court dismissed her appeal.

The district court's dismissal of Ms. Thomas's case was appropriate for two reasons. First, Ms. Thomas was not eligible for a fee waiver — as a matter of fact or as a matter of law — under 28 U.S.C. §§ 1915 or 1930(f). That conclusion is unremarkable, as Ms. Thomas's application to proceed in forma pauperis "incorporates by reference" her bankruptcy schedules, in which she claims to have regular business income, over $700,000 in assets, and under $30,000 in liabilities.

Second, the district court dismissed her appeal only after carefully considering the circumstances of Ms. Thomas's case. The district court (1) gave Ms. Thomas extra time to pay her appellate filing fees, (2) issued a show cause order providing her with notice it was considering dismissal and an opportunity to respond, and (3) responded to Ms. Thomas's arguments and explained that she did not provide good cause for refusing to pay her filing fees.

On appeal, Ms. Thomas makes nine arguments. But only three pertain to the district court's alleged error, and none present anything more than conclusory statements of error, made without any supporting references to the record or relevant legal authority. The remaining six arguments have nothing to do with the order on appeal. Therefore, this Court should not consider them, as Ms. Thomas shows no reason why this Court should deviate from the general rule of refusing to consider issues not decided in the order below.

ARGUMENT

I. The district court did not abuse its discretion when it dismissed Ms. Thomas's appeal for failure to pay the filing fee.

A. Ms. Thomas is not eligible to proceed in forma pauperis on appeal.

There is no 8000-series-appellate Bankruptcy Rule governing requests to proceed in forma pauperis in a bankruptcy appeal, and neither the bankruptcy court nor the district court has a local rule that incorporates Fed. R. App. P. 24. Nor do the two statutes that allow fee waivers in other circumstances allow Ms. Thomas to proceed IFP on appeal.

The first statute is 28 U.S.C. § 1930(f). It allows courts to waive only those fees that are promulgated under the Bankruptcy Court Miscellaneous Fee Schedule. 28 U.S.C. § 1930(f); see Administrative Office of the U.S. Courts, Bankruptcy Court Miscellaneous Fee Schedule (2010), available at http://www.uscourts.gov/FormsAndFees/Fees/BankruptcyCourtMiscellaneousFeeSchedule.aspx (establishing the filing fee for bankruptcy appeals). The second statute is 28 U.S.C. § 1915, which allows a "court of the United States" to waive filing fees when the litigant is unable to pay them. 28 U.S.C. § 1915. Ms. Thomas's IFP application was properly denied under both statutes.

1. The district court was entitled to deny Ms. Thomas's in forma pauperis application under 28 U.S.C. § 1930(f).

A court may wave bankruptcy fees in only three circumstances under section 1930(f). None of these circumstances apply to Ms. Thomas's appeal from the dismissal of her chapter 13 case.

First, when an individual chapter 7 debtor has "income less than 150 percent of the income official poverty line" and "is unable to pay the fee in installments," the court may waive the fee for the commencement of the case. 28 U.S.C. § 1930(f)(1). Second, the court may waive all other fees for "such debtors." 28 U.S.C. § 1930(f)(2). Third, "in accordance with Judicial Conference policy," the court may waive fees "for other debtors and creditors." 28 U.S.C. § 1930(f)(3). The Bankruptcy Court Miscellaneous Fee Schedule, however, does not contain a provision allowing a court to waive the fees for filing an appeal. Bankruptcy Court Miscellaneous Fee Schedule § 14.

There is no circuit court authority on whether a court may waive appellate filing fees under section 1930(f)(3). And of the few lower court decisions applying the fee waiver provisions of section 1930(f), none provide useful guidance for interpreting this statute. See, e.g., In re Belcher, 410 B.R. 206, 218 (Bankr. W.D. Va. 2009) (restating the statutory language).

The legislative history on section 1930(f) is limited as well. It describes the fee waiver provisions as allowing the court "to waive the chapter 7 filing fee for an individual and certain other fees under subsections (b) and (c) of section 1930 if such individual's income is less than 150 percent of the official poverty level . . . and the individual is unable to pay in installments." H.R. Rep. 109-31 (2005) at 89, reprinted in 2005 U.S.C.C.A.N. 88, 155.

Here, the district court correctly held that Ms. Thomas is not eligible to proceed IFP on appeal from the dismissal of her chapter 13 case under section 1930(f). First, Ms. Thomas's IFP application could not be granted under subsection (f)(2) because she is a chapter 13 debtor. Chapter 13 Voluntary Petition dated 7/20/2009, B.C. Dkt. No. 1. That provision applies only to chapter 7 debtors who meet the income eligibility criteria set forth in subsection (f)(1). § 1930(f)(2).

Second, her IFP application could not be granted under subsection (f)(3) because a court may only waive fees under subsection (f)(3) in accord with Judicial Conference policy. § 1930(f)(3). The Bankruptcy Court Miscellaneous Fee Schedule does not provide for a waiver of the appellate filing fee. Compare Bankruptcy Court Miscellaneous Fee Schedule § 4 (authorizing a bankruptcy judge to waive, for "good cause," the fee for amending the debtor's schedules, lists of creditors, or mailing lists) with id. § 14 (providing no authorization for waiving the filing fee for a bankruptcy appeal).

Furthermore, even if this Court holds that the appellate filing fee could be waived under subsection (f)(3), Ms. Thomas did not show that she needs such relief. That is because of the regular monthly income and the assets she claimed under penalty of perjury in her bankruptcy schedules. See infra Part I.A.2. Accordingly, Ms. Thomas is not eligible for relief under section 1930(f).[4]

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[4] The bankruptcy court, whose reasoning the district court relied upon, committed harmless error in holding the phrase "such debtors" in subsection (f)(2) to mean that subsection (f)(2) only applies when a debtor commences a chapter 7 case under a subsection (f)(1) fee waiver. Order Denying Mot. dated 2/26/2010, B.C. Dkt. No. 76.at 4.

Rather, the phrase "such debtors" in subsection (f)(2) refers to individual chapter 7 debtors who meet the income eligibility criteria set forth in subsection (f)(1). This position is consistent with the legislative history, which describes the statute as waiving "the chapter 7 filing fee for an individual and certain other fees under subsections (b) and (c) if . . . such individual's income" is less than the statutory criteria. H.R. Rep. 109-31 at 89. The operative phrase "such individual's income" links the availability for a fee waiver to the chapter 7 debtor's income, not their initial filing status.

Had Congress intended to limit those "other fees" only to chapter 7 debtors who filed under subsection (f)(1), there would be no reason for subsection (f)(2) to be distinct because there would be only one class of eligible individuals. Instead, the division of subsections (f)(1) and (f)(2) make sense because debtors do not always finish a bankruptcy case in the same chapter the case was filed under. The lower courts' interpretation would prevent debtors whose cases are converted to chapter 7 from other chapters of the Bankruptcy Code from obtaining relief, no matter how desperate their financial situation is. That was not Congress's intent.

Nevertheless, this error is harmless because Ms. Thomas is a chapter 13 debtor and is therefore ineligible for relief under any provision of section 1930(f).

2. Alternatively, the district court correctly held that Ms. Thomas did not establish her eligibility to proceed in forma pauperis under 28 U.S.C. § 1915.

The district court was also correct when it held that Ms. Thomas's IFP application could not be granted under 28 U.S.C. § 1915. Section 1915(a)(1) provides that "any court of the United States may authorize the commencement . . . of any suit, action or proceeding . . . or appeal therein, without prepayment of fees" for any person who submits an affidavit including a statement of all assets demonstrating the inability to pay the filing fees, and a statement explaining the nature of the appeal and the belief that the person is entitled to redress. Lister v. Dep't of Treasury, 408 F.3d 1309, 1312 (10th Cir. 2005) (explaining section 1915).

"[I]n order to succeed on a motion to proceed IFP, the movant must show a financial inability to pay the required filing fees, as well as the existence of a reasoned, nonfrivolous argument on the law and facts in support of the issues raised in the action." Id. A "bald assertion" that the applicant is not employed or does not have enough money is insufficient. Id. at 1313. A court does not abuse its discretion by denying an IFP application when an individual has "failed to provide the court with sufficient information from which the court can ascertain her financial status." Id.

Although there is no binding Tenth Circuit precedent, this Court has stated its belief that a bankruptcy court is not a "court of the United States" that can grant relief under section 1915. Satterfield v. Malloy (In re Satterfield), No. 08-5185, 337 F. App’x 739, 2009 WL 1788987 (10th Cir. Jun 24, 2009) (unpublished). Therefore, the bankruptcy court below correctly held that it could not grant Ms. Thomas’s IFP application under section 1915, even if she had shown herself to be indigent.

In this appeal, the government takes no position with respect to whether a bankruptcy court is “a court of the United States” that has authority to waive filing fees under section 1915. Answering that question is not necessary for this Court to affirm the order below, because the district court considered the merits of Ms. Thomas’s IFP application and found that she had failed to provide a factual basis for granting that relief. The record fully supports that finding.

Ms. Thomas’s IFP application primarily incorporated her bankruptcy schedules. Appl. to Proceed in District Court Without Prepaying Fees or Costs re: Appeal dated 11/21/2009, B.C. Dkt. No. 63 at 2. Even if that is considered an acceptable method of providing “sufficient information,” see Lister, 408 F.3d at 1313, it shows that Ms. Thomas has regular monthly income, plus substantial resources inconsistent with her declaration of penury — over $700,000 in assets, by her own admission.

In her bankruptcy schedules, Ms. Thomas listed “unknown” amounts of real property and $713,900 worth of personal property, including $5,000 in cash on hand and ownership rights in various corporations, joint ventures, and investment funds. Summary of Schedules and Statement of Financial Affairs dated 8/3/2009, B.C. Dkt. No. 10 at 7-9. The application does not explain why she cannnot pay her own costs with those assets or how her financial situation has changed since then. Appl. to Proceed in District Court Without Prepaying Fees or Costs re: Appeal dated 11/21/2009, B.C. Dkt. No. 63.

Ms. Thomas also fails to provide any authority in support of her application or the required statement explaining the nature of the appeal. Id. That is significant, because based on the face of the application, Ms. Thomas cannot in good faith assert that her appeal is meritorious. It is impossible to reconcile her request to continue her chapter 13 bankruptcy case — in which she must repay her creditors out of her current income — at the same time she swears that she cannot even afford to pay the $225 filing fee for an appeal.

In sum, Ms. Thomas's IFP application is not only without any factual basis under either section 1915 or section 1930(f), it is internally inconsistent. She cannot show that she qualifies to proceed IFP on appeal.[5] Lister, 408 F.3d at 1313.

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[5] The district court's order may also be affirmed under 28 U.S.C. § 1915(e)(2)(B), which requires the court to dismiss a case "at any time if the court determines that . . . the allegation of poverty is untrue" or that "the action . . . is frivolous or malicious [or] fails to state a claim on which relief may be granted." Lister, 408 F.3d at 1312. This Court may affirm a lower court's decision on any grounds for which there is a sufficient record to make a legal conclusion. Jenkins v. Hodes (In re Hodes), 402 F.3d 1005, 1011 (10th Cir. 2005).

B. The district court carefully considered the circumstances of Ms. Thomas's case before dismissing her appeal.

Under Fed. R. Bankr. P. 8001(a), a district court has the discretion to dismiss an appeal for failure to comply with procedural rules or a court order. Nielsen v. Price, 17 F.3d 1276, 1277 (10th Cir. 1994); Wallin v. Martel (In re Martel), No. 08-1488, 328 F. App'x 584, 2009 WL 1313915 (10th Cir. May 13, 2009) (unpublished) ("Bankruptcy Rule 8001(a) expressly confers authority on the [district court] to take action it deems appropriate, including dismissal, when litigants fail to comply with its filing requirements.").

When making this determination, the court must consider whether dismissal is appropriate within the circumstances of the case. Nielsen, 17 F.3d at 1277 (citing Balaber-Strauss v. Reichard (In re Tampa Chain Co.), 835 F.2d 54, 56 (2d Cir. 1987). Although it should be imposed "carefully," this Court has explained that "dismissal is an appropriate disposition against a party who disregards court orders and fails to proceed as required by court rules." Lundahl v. Eves (In re Lundahl), No. 04-4040, 109 F. App'x 384, 2004 WL 2110724 (10th Cir. Sept. 23, 2004) (unpublished).

This rule equally applies to pro se litigants. Although pro se filings must be construed liberally, this Court "has repeatedly insisted that pro se parties follow the same rules of procedure that govern other litigants." Nielsen, 17 F.3d at 1277; see Garret v. Selby Connor Maddux & Janer, 425 F.3d 836, 840 (10th Cir. 2005) (observing that such allowances extend to "the pro se plaintiff's failure to cite proper legal authority . . . or his unfamiliarity with pleading requirements"). And this Court has previously affirmed dismissals for failure to pay filing fees under Fed. R. Bankr. P. 8001(a) when, after receiving notice and an opportunity to respond, a pro se appellant failed to pay filing fees. See Martel, 328 F. App'x 584 (unpublished) (finding no abuse of discretion in dismissing bankruptcy appeal after the appellant was given four months, two written warnings, and clear instructions to pay his filing fees).

Here, the district court did not abuse its discretion in dismissing Ms. Thomas's appeal. The court carefully and fully considered the circumstances of Ms. Thomas's case before ordering its dismissal. It did so by (1) giving Ms. Thomas extra time to pay her filing fees before dismissing her appeal; (2) issuing a show cause order that (a) put her on notice it was considering dismissing her appeal for her failure to pay filing fees and (b) provided an opportunity for her to respond; and (3) addressed Ms. Thomas's arguments and explained that she demonstrated a lack of "good cause." Finally, this process led to the correct result. The record, which is replete with examples of Ms. Thomas's misconduct, fully supports the district court's decision to dismiss her appeal.

1. The district court gave Ms. Thomas extra time to pay the appellate filing fee before dismissing her appeal.

First, the district court was patient with Ms. Thomas and acted with repose throughout the appeal. The bankruptcy court originally granted Ms. Thomas a seven-day extension to pay the filing fee, which expired on March 5, 2010. Order Denying Mot. dated 2/26/2010, B.C. Dkt. No. 76 at 5. When that deadline passed, the district court waited ten days, until March 15, 2010, to issue its show cause order. Order to Show Cause dated 3/15/2010, D.C. Dkt. No. 12. The district court had possession of the record and, after receiving Ms. Thomas's show cause response on March 26, 2010, the court took the issue under consideration for nearly five months before dismissing the appeal on August 18, 2010. Order Dismissing Appeal dated 8/18/2010, D.C. Dkt. No. 22. That gave her extra time to pay the filing fee or submit better proof that she could not.

This demonstrates that the district court carefully considered its decision and did not act in haste. This Court has affirmed dismissals where litigants have been given shorter periods of time to comply with a court order to pay filing fees. See Martel, 328 F. App'x 584 (unpublished) (waiting four months); see also Fitzsimmons v. Nolden (In re Fitzsimmons), 920 F.2d 1468, 1474 (9th Cir. 1990) (observing that "placing the case at the bottom of the calendar" evidences consideration of the sanction prior to dismissing an appeal).

2. The district court's show cause order notified Ms. Thomas it was considering dismissal and provided her with an opportunity to respond.

Second, the district court gave Ms. Thomas ample notice and opportunity to respond. The district court's show cause order stated that the bankruptcy court had denied her IFP application, the extended deadline for paying the filing fee had expired, and the fee had not been paid. Order to Show Cause dated 3/15/2010, D.C. Dkt. No. 12. The district court explained that it was authorized to dismiss her appeal under Fed. R. Bankr. P. 8001(a), and directed Ms. Thomas "to show cause why the appeal should not be dismissed for her failure to timely pay the filing fee."[6] Id. The court gave Ms. Thomas 11 days to respond, and notified her that "failure to comply with this order will result in dismissal of the appeal." Id.

Ms. Thomas responded by filing an 18-page brief. Resp. to Order to Show Cause dated 3/26/2010, D.C. Dkt. No. 13. Her brief addressed the merits of the bankruptcy court's order denying her IFP application and argued the merits of her bankruptcy appeal as cause against dismissal. Id. Even though she is a pro se litigant, Ms. Thomas understood (1) the district court was intending to dismiss her case and (2) the reason why the district court was intending to dismiss her case.

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[6] The show cause order literally refers to "11 U.S.C. § 8001(a)." This mistake did not prejudice Ms. Thomas's ability to respond, as she referred to Fed. R. Bankr. P. 8001(a) throughout her response to the show cause order. Resp. to Order to Show Cause dated 3/26/2010, D.C. Dkt. No. 13 at 10.

Thus, she had free and fair opportunity to raise any arguments against dismissal, offer mitigating circumstances, or remedy her problem by paying the filing fee.

This demonstrates that the district court provided the litigant with due process. When a court provides a litigant with due process, there is no abuse of discretion. See Martel, 328 F. App'x 584 (unpublished) (finding no abuse of discretion in dismissing bankruptcy appeal when the appellant had notice and opportunity to respond, but still failed to pay filing fees).

3. The district court addressed Ms. Thomas's arguments and explained that she did not demonstrate "good cause."

Third, the district court accounted for Ms. Thomas's arguments and the circumstances of the case in general. For example, in its opinion, the court carefully distinguished the Seventh Circuit decision that Ms. Thomas substantially relied upon and suggested was binding authority. Order Dismissing Appeal dated 8/18/2010, D.C. Dkt. No. 22 at 2. The district court discussed what the holding of the case was, why the case did not represent the position that Ms. Thomas offered it as authority for, and even explained to Ms. Thomas that it was not required to follow case law from the Seventh Circuit. Id. The district court then reviewed the arguments that the bankruptcy court made and, articulating those same reasons, agreed that Ms. Thomas was not eligible for relief under 28 U.S.C. §§ 1915 or 1930(f).[7] Id. at 2-3.

Furthermore, the district court (1) pointed out that the bankruptcy court had also ruled on the merits, an essential fact that Ms. Thomas "ignores," id. at 3; (2) found that Ms. Thomas had failed to sufficiently document her inability to pay the appellate filing fee, id.; and (3) found that Ms. Thomas did not "demonstrate good cause" for failing to pay the filing fee. Id. The court also noted that Ms. Thomas "fails to present an argument" as to why she is refusing to comply with the bankruptcy court's order, and instead chose to argue the merits of her bankruptcy appeal. Id.

These findings are substantially supported by the record. As discussed above, rather than demonstrate her financial inability to pay the filing fees, Ms. Thomas's IFP application alleges regular business income and over $700,000 in assets. See supra Part I.A.2. And the record evidences Ms. Thomas's propensity for disregarding any obligation to produce information in support of her claims. See, e.g., Tr. at 24-25 (describing Ms. Thomas's failure to appear at or produce documents for her continued section 341 meeting); Response to Mot. for

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[7] The lower courts harmlessly erred in holding that section 1930(f)(2) only applies when a debtor commences a chapter 7 case under a section 1930(f)(1) fee waiver, because it did not effect Ms. Thomas's eligibility for relief under section 1930(f). See supra at Part I.A.1.

Miscellaneous Relief dated 11/17/2009, B.C. Dkt. No. 47 at 1-2 (describing Ms. Thomas's failure to respond to the United States Trustee's subpoena).

This demonstrates that the district court paid close attention to the record and considered all of the circumstances of the case when it rendered judgment. Therefore, the court's decision was not arbitrary, capricious, whimsical, or manifestly unreasonable. See Moothart v. Bell, 21 F.3d 1499, 1505 (10th Cir. 1994) (finding no abuse of discretion when a trial court held that a single statement could not be construed as a waiver after the court took the opportunity to review that statement in the wider context of the record).

II. This Court may dismiss Ms. Thomas's appeal because it is frivolous.

Allegations of error that are merely listed without supporting argument are deemed waived. Christian Heritage Acad. v. Okla. Secondary Sch. Activities Ass'n, 483 F.3d 1025, 1031 (10th Cir. 2007). Although this Court may make some allowances for a pro se litigant's unfamiliarity with technical requirements, under Fed. R. App. P. 28 the brief must contain more than generalized assertions of error. Garrett v. Selby Connor Maddux & Janer, 425 F.3d 836, 841 (10th Cir. 2005).

When a pro se litigant fails to comply with Rule 28, this Court "cannot fill the void by crafting arguments and performing the necessary legal research." Id. (quotation omitted). A list of issues and a statement of support consisting of conclusory allegations with no citations to the record or supporting legal authority is not considered adequate briefing. Id.

Of the nine arguments that Ms. Thomas raises, only three pertain to the dismissal order now on appeal: issues one, three, and four. And those arguments lack factual and legal support.

Under issues one and three, Ms. Thomas argues that the district court violated her constitutional due process and equal protection rights by denying her IFP application and dismissing her case. But Ms. Thomas never explains how the district court violated her constitutional rights and cites wholly irrelevant case law. Appellant's Br. at 16-18 (citing Boddie v. Connecticut, 401 U.S. 371 (1971) (holding that state courts could not deny indigent litigants access to the courts to bring an action for divorce) and Lister v. Dep't of Treasury, 408 F.3d 1309, 1312 (10th Cir. 2005) (holding that the denial of IFP applications are final, appealable orders)).

Under issue four, Ms. Thomas alleges that the district court's findings of fact were unsupported by the record. Id. at 18. Yet she fails to show what findings of fact she contests and what in the record is contradictory. Id. at 19.

Notably, Ms. Thomas's only factual contention is one that she raises in her constitutional claim, instead of in her evidentiary claim. Under issue three, she asserts that her IFP application "comports with 28 U.S.C. § 1746." Id. at 18.

Section 1746 requires that declarations made under penalty of perjury be evidenced in a standardized manner. 28 U.S.C. § 1746. That Ms. Thomas validly swore to the accuracy of her IFP application under penalty of perjury does not mean that the statements she made within are factually correct. Nor does it mean that the lower courts had to accept that allegation of indigency when her bankruptcy schedules, which she also filed under penalty of perjury, shows she has both income and assets with which to pay the filing fee. See supra Part I.A.2.

This Court has dismissed substantially similar appeals as frivolous. See Harmon Family Trust v. Thomas (In re Thomas), No. 09-6015, 348 F. App'x 413, 2009 WL 3241288 (10th Cir. Oct. 9, 2009) (unpublished) (dismissing Ms. Thomas's mother, Shirley Thomas, for raising similar arguments). Here too Ms. Thomas's allegations of error are unsupported and are therefore waived. See id.; see also Garret, 425 F.3d at 841. Thus, she cannot demonstrate that the district court abused its discretion in dismissing her bankruptcy appeal.

III. Additionally, this Court should ignore Ms. Thomas's arguments on the merits of her bankruptcy appeal and her other requests for relief.

Although Ms. Thomas's other six arguments are similarly flawed, this Court need not consider whether it should reach those arguments because they have been improperly raised.

The "general rule" is that "a federal appellate court does not consider an issue not passed upon below." Walker v. Mather (In re Walker), 959 F.2d 894, 896 (10th Cir. 1992). This means that on an appeal from a district court's dismissal for failure to prosecute, the merits of the bankruptcy appeal are not on review. Nielsen, 17 F.3d at 1277. An appellant "cannot bootstrap its argument on the merits into a defense against having to comply with the procedural rules." M.A. Baheth & Co. v. Schott (In re M.A. Bahehth Constr. Co.), 118 F.3d 1082, 1084 (5th Cir. 1997).

The order on appeal to this Court dismissed Ms. Thomas's case only because of her failure to pay the filing fee for her bankruptcy appeal. But Ms. Thomas asserts six arguments that do not arise from the order decided below. Appellant's Br. at 16-25 (issues 2, 5-9). Instead, she litigates the merits of her bankruptcy appeal and seeks to obtain relief with respect to other issues in her chapter 13 bankruptcy case. Id. at 29 (requesting relief with respect to Ms. Thomas's motion to quash the United States Trustee's subpoena).

This Court has previously refused to consider issues not decided by the order on appeal. See In re Thomas, 348 F. App'x 413 (unpublished) (refusing to consider other arguments for relief); see also Tollefsen v. U.S. Bank Nat'l Ass'n (In re Tollefsen), No. 08-5059, 315 Fed. App'x 683, 2009 WL 500659 (10th Cir. Mar. 2, 2009) (unpublished) (refusing to address merits arguments on review of a procedural dismissal). Ms. Thomas provides no cause for this Court to deviate from that rule. Therefore, those arguments need not be considered.

CONCLUSION

For these reasons, the United States Trustee respectfully asks this Court to affirm the order entered below.

Respectfully submitted,

RICHARD A. WIELAND
United States Trustee

By: /s/ Noah M. Schottenstein
Trial Attorney

Dated: January 20, 2011

RAMONA D. ELLIOTT
General Counsel
P. MATTHEW SUTKO
Associate General Counsel
NOAH M. SCHOTTENSTEIN
Trial Attorney

United States Department of Justice
Executive Office for United States
Trustees
20 Massachusetts Avenue N.W.
Washington, D.C. 20530
(202) 307-1399
noah.m.schottenstein@usdoj.gov

CHARLES S. GLIDEWELL
Assistant United States Trustee
CHARLES E. SNYDER
Trial Attorney

United States Department of Justice
Office of the United States Trustee
215 Dean A. McGee, Fourth Floor
Oklahoma City, OK 73102
(405) 231-5961
charles.snyder@usdoj.gov

CERTIFICATE OF COMPLIANCE

I certify that this brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) because it is proportionately spaced, using Times Roman font, 14 point type.

I certify that this brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B) because this brief contains 8,239 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii).

I certify that (1) all required privacy redactions have been made; (2) this ECF submission is an exact copy of document filed in hard copy with the clerk; and (3) this ECF submission was scanned for viruses with: Microsoft Forefront Client Security, antivirus definition version 1.95.4343.0 on January 20, 2011, and according to the program is free of viruses.

s/Noah M. Schottenstein
Noah M. Schottenstein
Attorney for the United States Trustee

Dated: January 20, 2011

CERTIFICATE OF SERVICE

I certify that a single hard copy of this brief and a single copy of the appendix was served via first class mail, postage prepaid on:

Chaya Chalon Thomas
4200 Bristol Lane
Edmond, OK 73034-7379

I certify that I filed the brief by sending seven hard copies of the brief and two copies of the appendix to the Clerk, United States Court of Appeals for the Tenth Circuit, via Federal Express, for overnight delivery.

s/Noah M. Schottenstein
Noah M. Schottenstein
Attorney for the United States Trustee

Dated: January 20, 2011

ADDENDUM

IN THE UNITED STATES DISTRICT COURT FOR THE
WESTERN DISTRICT OF OKLAHOMA

IN RE: CHAYA CHALON THOMAS,	)	
	)	
Debtor/Appellant,	)	No. CIV-09-1386-D
	)	
vs.	)	
	)	APPEAL FROM UNITED STATES
	)	BANKRUPTCY COURT FOR THE
	)	WESTERN DISTRICT OF
RICHARD A. WIELAND, United States Trustee,	)	OKLAHOMA:
	)	CASE NO. BK-09-13859-NLJ;
Appellee.	)	(CHAPTER 13)
	)	

ORDER

On December 21, 2009, Debtor Chaya Chalon Thomas ("Debtor") filed a Notice of Appeal of several Orders entered by the United States Bankruptcy Court for the Western District of Oklahoma in her Chapter 13 Bankruptcy proceeding. Specifically, Debtor seeks this Court's reversal of the Bankruptcy Court's October 29, 2009 Order Dismissing Case with Prejudice and its December 9, 2009 Order Denying the Debtor's Motion to Alter or Amend and her Motion for Findings of Fact and Conclusions of Law.

Debtor, who appears pro se, filed in the Bankruptcy Court an Application to Proceed *In Forma Pauperis* on Appeal; on February 26, 2010, the Bankruptcy Court denied the Application and directed Debtor to pay the $255 filing fee within seven days to avoid striking the Notice of Appeal. The Bankruptcy Court's Order, filed in the Bankruptcy Court as Document No. 76, was transmitted to this Court in a supplemental transmittal of Notice of Appeal [Doc. No. 10]. Debtor did not pay the filing fee. On March 15, 2010, the undersigned entered an Order [Doc. No. 12] directing Debtor to show cause why her appeal should not be stricken by this Court in accordance with 11 U. S. C.

§ 8001(a).

Debtor responded to the show cause order by arguing the Bankruptcy Court's Order denying her *in forma pauperis* application was erroneous. Construing the Order as concluding only that the Bankruptcy Court lacked authority to grant the application, Debtor argues that such authority is conferred on the Bankruptcy Court and, in effect, asks this Court to overrule the Bankruptcy Court's Order. In support of her contention, she relies on and discusses at length an unpublished Seventh Circuit Court of Appeals decision, *In re Richmond*, 247 F. App'x 831 (7th Cir. 2007), in which the Seventh Circuit held that, under a previous version of the Bankruptcy Code, a bankruptcy court had authority to consider a creditor's application to bring an adversary proceeding *in forma pauperis* in a pending Chapter 7 bankruptcy proceeding. The Seventh Circuit discussed at length the rights of creditors, and expressly limited its ruling to creditor applications in connection with adversary proceedings. 247 F. App'x at 833-34. The Seventh Circuit did not, as Debtor suggests, extend that ruling to a debtor's application to proceed *in forma pauperis* on appeal; in fact, it discussed the distinction between creditor and debtor rights in such cases. The facts of *Richmond* and the holding of the Seventh Circuit, are distinguishable from this case; in any event, this Court is not required to follow the ruling of the Seventh Circuit.

As the Bankruptcy Court discussed in some detail in its Order denying Debtor's *in forma pauperis* application, the provisions of 28 U. S. C. § 1930(f) regarding a bankruptcy court's authorization to waive fees do not apply to this case. *See* Bankruptcy Court Order, pages 4-5. None of the provisions of § 1930(f) apply to Debtor; moreover, the general § 1930(f)(3) provision authorizing waiver of fees for "other debtors" is limited to circumstances which are "in accordance with Judicial Conference Policy." 28 U. S. C. § 1930(f)(3). As the Bankruptcy Court noted, the

Judicial Conference has prescribed a Bankruptcy Court Miscellaneous Fee Schedule, and § 1930(f)(3) authorizes waiver only of the fees listed in the Fee Schedule. The Fee Schedule prescribes a filing fee for an appeal of a bankruptcy order; however, the Fee Schedule contains no provision authorizing the waiver of the filing fee.

Although Debtor disagrees with the Bankruptcy Court's foregoing determinations regarding its authority to grant her *in forma pauperis* application, she ignores the fact that the Bankruptcy Court also considered the merits of her application. In the Order, the Bankruptcy Court noted that, assuming it had the authority to grant the application, the provisions of 28 U. S. C. 1915(a)(1) govern a court's consideration of the merits of an *in forma pauperis* application. As the Bankruptcy Court correctly concluded, Debtor in this case has wholly failed to comply with the statutory requirement that she submit "an affidavit that includes a statement of all assets," documenting her inability to pay the appellate filing fee. 28 U. S. C. § 1915(a)(1). In this case, Debtor has never presented the required affidavit or other information required by § 1915(a)(1) to the Bankruptcy Court or to this Court. Thus, her application was properly denied by the Bankruptcy Court on that basis.

The balance of Debtor's response to this Court's March 15, 2010 Order [Doc. No. 12] does not demonstrate good cause for her failure to pay the required filing fee to pursue this appeal. She devotes most of her argument to the purported merits of her appeal, and fails to present an argument in response to this Court's Order that she show cause for her failure to pay the required filing fee by the extended deadline provided by the Bankruptcy Court. Notwithstanding her subsequent efforts to amend her notice of appeal, Debtor has ignored the requirements of the Court's show cause order. Her arguments do not warrant the waiver of the requirement that she pay the filing fee to proceed with her appeal.

In accordance with 11 U. S. C. § 8001(a), the District Court is authorized to dismiss the appeal for Debtor's failure to "take any step other than timely filing a notice of appeal." In this case, Debtor was given ample opportunity to comply with the Court's orders regarding payment of the filing fee or submission of the material required by 28 U. S. C. § 1915(a). She has failed to do so, and she has not shown good cause for that failure. Accordingly, the appeal is hereby DISMISSED.[1]

IT IS SO ORDERED this 18th day of August, 2010.

TIMOTHY D. DEGIUSTI
UNITED STATES DISTRICT JUDGE

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[1] The dismissal of this action renders moot the Appellee's motion to dismiss the notice of appeal and amended notice of appeal [Doc. No. 18] and Debtor's motion to strike the motion to dismiss [Doc. No. 20].

(c) Each district court by rule or standing order may require advance payment of fees.

(June 25, 1948, ch. 646, 62 Stat. 954; Pub. L. 95–598, title II, §244, Nov. 6, 1978, 92 Stat. 2671; Pub. L. 99–336, §4(a), June 19, 1986, 100 Stat. 637; Pub. L. 99–500, §101(b) [title IV, §407(a)], Oct. 18, 1986, 100 Stat. 1783–39, 1783–64, and Pub. L. 99–591, §101(b) [title IV, §407(a)], Oct. 30, 1986, 100 Stat. 3341–39, 3341–64; Pub. L. 104–317, title IV, §401(a), Oct. 19, 1996, 110 Stat. 3853; Pub. L. 108–447, div. B, title III, §307(a), Dec. 8, 2004, 118 Stat. 2895; Pub. L. 109–171, title X, §10001(a), Feb. 8, 2006, 120 Stat. 183.)

Historical and Revision Notes

Based on title 28, U.S.C., 1940 ed., §§549, 553 and 555 (R.S. §828; June 28, 1902, ch. 1301, §1, 32 Stat. 476; Feb. 11, 1925, ch. 204, §§2, 6, 8, 43 Stat. 857, 858; Jan. 22, 1927, ch. 50, §2, 44 Stat. 1023; Jan. 31, 1928, ch. 14, §1, 45 Stat. 54; Mar. 3, 1942, ch. 124, §2, 56 Stat. 122; Sept. 27, 1944, ch. 414, §§1, 4, 5, 58 Stat. 743, 744).

Section consolidates sections 549, 553, and 555 of title 28, U.S.C., 1940 ed., as amended with necessary changes of phraseology.

The phrase ‘‘filing fee’’ was substituted for the inconsistent and misleading words of sections 549 and 553 of title 28, U.S.C., 1940 ed., ‘‘as full payment for all services to be rendered by the clerk’’ etc. thus removing the necessity for including exceptions and referring to other sections containing provisions for additional fees.

The provision in section 549 of title 28, U.S.C., 1940 ed., for payment of fees by the parties instituting criminal proceedings by indictment or information, was omitted. Such proceedings are instituted only by the United States from which costs cannot be exacted.

The provision in section 549 of title 28, U.S.C., 1940 ed., for taxation of fees as costs, was omitted as covered by section 1920 of this title.

Words ‘‘or appeal from a deportation order of a United States Commissioner’’ in section 553 of title 28, U.S.C., 1940 ed., were omitted as obsolete since repeal of the Chinese Exclusion Act by act Dec. 17, 1943, ch. 344, §1, 57 Stat. 600. Appeal was formerly conferred by section 282 of title 8, U.S.C., 1940 ed., Aliens and Nationality.

Subsection (d) excepting the District of Columbia, was added to preserve the existing schedule of fees prescribed by section 11–1509 of the District of Columbia Code, 1940 ed.

Codification

Pub. L. 99–591 is a corrected version of Pub. L. 99–500.

Amendments

2006—Subsec. (a). Pub. L. 109–171 substituted ‘‘$350’’ for ‘‘$250’’.

2004—Subsec. (a). Pub. L. 108–447 substituted ‘‘$250’’ for ‘‘$150’’.

1996—Subsec. (a). Pub. L. 104–317 substituted ‘‘$150’’ for ‘‘$120’’.

1986—Subsec. (a). Pub. L. 99–500 and Pub. L. 99–591 substituted ‘‘$120’’ for ‘‘$60’’.

Subsec. (d). Pub. L. 99–336 struck out subsec. (d) which provided that section was not applicable to District of Columbia.

1978—Subsec. (a). Pub. L. 95–598 substituted ‘‘$60’’ for ‘‘$15’’.

Effective Date of 2006 Amendment

Pub. L. 109–171, title X, §10001(d), Feb. 8, 2006, 120 Stat. 184, provided that: ‘‘This section [amending this section and enacting provisions set out as notes under sections 1913 and 1931 of this title] and the amendment made by this section shall take effect 60 days after the date of the enactment of this Act [Feb. 8, 2006].’’

Effective Date of 2004 Amendment

Pub. L. 108–447, div. B, title III, §307(c), Dec. 8, 2004, 118 Stat. 2895, provided that: ‘‘This section [amending this section and section 1931 of this title] shall take effect 60 days after the date of the enactment of this Act [Dec. 8, 2004].’’

Effective Date of 1996 Amendment

Section 401(c) of Pub. L. 104–317 provided that: ‘‘This section [amending this section and section 1931 of this title] shall take effect 60 days after the date of the enactment of this Act [Oct. 19, 1996].’’

Effective Date of 1986 Amendment

Section 4(c) of Pub. L. 99–336 provided that: ‘‘The amendments made by this section [amending this section] shall apply with respect to any civil action, suit, or proceeding instituted on or after the date of the enactment of this Act [June 19, 1986].’’

Effective Date of 1978 Amendment

Amendment by Pub. L. 95–598 effective Oct. 1, 1979, see section 402(c) of Pub. L. 95–598, set out as an Effective Date note preceding section 101 of Title 11, Bankruptcy.

Court Fees for Electronic Access to Information

Judicial Conference to prescribe reasonable fees for collection by courts under this section for access to information available through automatic data processing equipment and fees to be deposited in Judiciary Automation Fund, see section 303 of Pub. L. 102–140, set out as a note under section 1913 of this title.

§1915. Proceedings in forma pauperis

(a)(1) Subject to subsection (b), any court of the United States may authorize the commencement, prosecution or defense of any suit, action or proceeding, civil or criminal, or appeal therein, without prepayment of fees or security therefor, by a person who submits an affidavit that includes a statement of all assets such prisoner possesses that the person is unable to pay such fees or give security therefor. Such affidavit shall state the nature of the action, defense or appeal and affiant's belief that the person is entitled to redress.

(2) A prisoner seeking to bring a civil action or appeal a judgment in a civil action or proceeding without prepayment of fees or security therefor, in addition to filing the affidavit filed under paragraph (1), shall submit a certified copy of the trust fund account statement (or institutional equivalent) for the prisoner for the 6-month period immediately preceding the filing of the complaint or notice of appeal, obtained from the appropriate official of each prison at which the prisoner is or was confined.

(3) An appeal may not be taken in forma pauperis if the trial court certifies in writing that it is not taken in good faith.

(b)(1) Notwithstanding subsection (a), if a prisoner brings a civil action or files an appeal in forma pauperis, the prisoner shall be required to pay the full amount of a filing fee. The court shall assess and, when funds exist, collect, as a partial payment of any court fees required by law, an initial partial filing fee of 20 percent of the greater of—

(A) the average monthly deposits to the prisoner's account; or

(B) the average monthly balance in the prisoner's account for the 6-month period immediately preceding the filing of the complaint or notice of appeal.

(2) After payment of the initial partial filing fee, the prisoner shall be required to make

monthly payments of 20 percent of the preceding month's income credited to the prisoner's account. The agency having custody of the prisoner shall forward payments from the prisoner's account to the clerk of the court each time the amount in the account exceeds $10 until the filing fees are paid.

(3) In no event shall the filing fee collected exceed the amount of fees permitted by statute for the commencement of a civil action or an appeal of a civil action or criminal judgment.

(4) In no event shall a prisoner be prohibited from bringing a civil action or appealing a civil or criminal judgment for the reason that the prisoner has no assets and no means by which to pay the initial partial filing fee.

(c) Upon the filing of an affidavit in accordance with subsections (a) and (b) and the prepayment of any partial filing fee as may be required under subsection (b), the court may direct payment by the United States of the expenses of (1) printing the record on appeal in any civil or criminal case, if such printing is required by the appellate court; (2) preparing a transcript of proceedings before a United States magistrate judge in any civil or criminal case, if such transcript is required by the district court, in the case of proceedings conducted under section 636(b) of this title or under section 3401(b) of title 18, United States Code; and (3) printing the record on appeal if such printing is required by the appellate court, in the case of proceedings conducted pursuant to section 636(c) of this title. Such expenses shall be paid when authorized by the Director of the Administrative Office of the United States Courts.

(d) The officers of the court shall issue and serve all process, and perform all duties in such cases. Witnesses shall attend as in other cases, and the same remedies shall be available as are provided for by law in other cases.

(e)(1) The court may request an attorney to represent any person unable to afford counsel.

(2) Notwithstanding any filing fee, or any portion thereof, that may have been paid, the court shall dismiss the case at any time if the court determines that—

- (A) the allegation of poverty is untrue; or
- (B) the action or appeal—
  - (i) is frivolous or malicious;
  - (ii) fails to state a claim on which relief may be granted; or
  - (iii) seeks monetary relief against a defendant who is immune from such relief.

(f)(1) Judgment may be rendered for costs at the conclusion of the suit or action as in other proceedings, but the United States shall not be liable for any of the costs thus incurred. If the United States has paid the cost of a stenographic transcript or printed record for the prevailing party, the same shall be taxed in favor of the United States.

(2)(A) If the judgment against a prisoner includes the payment of costs under this subsection, the prisoner shall be required to pay the full amount of the costs ordered.

(B) The prisoner shall be required to make payments for costs under this subsection in the same manner as is provided for filing fees under subsection (a)(2).

(C) In no event shall the costs collected exceed the amount of the costs ordered by the court.

(g) In no event shall a prisoner bring a civil action or appeal a judgment in a civil action or proceeding under this section if the prisoner has, on 3 or more prior occasions, while incarcerated or detained in any facility, brought an action or appeal in a court of the United States that was dismissed on the grounds that it is frivolous, malicious, or fails to state a claim upon which relief may be granted, unless the prisoner is under imminent danger of serious physical injury.

(h) As used in this section, the term "prisoner" means any person incarcerated or detained in any facility who is accused of, convicted of, sentenced for, or adjudicated delinquent for, violations of criminal law or the terms and conditions of parole, probation, pretrial release, or diversionary program.

(June 25, 1948, ch. 646, 62 Stat. 954; May 24, 1949, ch. 139, § 98, 63 Stat. 104; Oct. 31, 1951, ch. 655, § 51(b), (c), 65 Stat. 727; Pub. L. 86–320, Sept. 21, 1959, 73 Stat. 590; Pub. L. 96–82, § 6, Oct. 10, 1979, 93 Stat. 645; Pub. L. 101–650, title III, § 321, Dec. 1, 1990, 104 Stat. 5117; Pub. L. 104–134, title I, § 101[(a)] [title VIII, § 804(a), (c)–(e)], Apr. 26, 1996, 110 Stat. 1321, 1321–73 to 1321–75; renumbered title I, Pub. L. 104–140, § 1(a), May 2, 1996, 110 Stat. 1327.)

HISTORICAL AND REVISION NOTES

1948 ACT

Based on title 28, U.S.C., 1940 ed., §§ 9a(c)(e), 832, 833, 834, 835, and 836 (July 20, 1892, ch. 209, §§ 1–5, 27 Stat. 252; June 25, 1910, ch. 435, 36 Stat. 866; Mar. 3, 1911, ch. 231, § 5a, as added Jan. 20, 1944, ch. 3, § 1, 58 Stat. 5; June 27, 1922, ch. 246, 42 Stat. 666; Jan. 31, 1928, ch. 14, § 1, 45 Stat. 54).

Section consolidates a part of section 9a(c)(e) with sections 832–836 of title 28, U.S.C., 1940 ed.

For distribution of other provisions of section 9a of title 28, U.S.C., 1940 ed., see Distribution Table.

Section 832 of title 28, U.S.C., 1940 ed., was completely rewritten, and constitutes subsections (a) and (b).

Words "and willful false swearing in any affidavit provided for in this section or section 832 of this title, shall be punishable as perjury as in other cases," in section 833 of title 28, U.S.C., 1940 ed., were omitted as covered by the general perjury statute, title 18, U.S.C., 1940 ed., § 231 (H.R. 1600, 80th Cong., sec. 1621).

A proviso in section 836 of title 28, U.S.C., 1940 ed., that the United States should not be liable for costs was deleted as covered by section 2412 of this title.

The provision in section 9a(e) of title 28, U.S.C., 1940 ed., respecting stenographic transcripts furnished on appeals in civil cases is extended by subsection (b) of the revised section to include criminal cases. Obviously it would be inconsistent to furnish the same to a poor person in a civil case involving money only and to deny it in a criminal proceeding where life and liberty are in jeopardy.

The provision of section 832 of title 28, U.S.C., 1940 ed., for payment when authorized by the Attorney General was revised to substitute the Director of the Administrative Office of the United States Courts who now disburses such items.

Changes in phraseology were made.

1949 ACT

This amendment clarifies the meaning of subsection (b) of section 1915 of title 28, U.S.C., and supplies, in subsection (e) of section 1915, an inadvertent omission to make possible the recovery of public funds expended in printing the record for persons successfully suing in forma pauperis.

AMENDMENTS

1996—Subsec. (a). Pub. L. 104–134, §101[(a)] [title VIII, §804(a)(1)], designated first paragraph as par. (1), substituted "Subject to subsection (b), any" for "Any", struck out "and costs" after "of fees", substituted "submits an affidavit that includes a statement of all assets such prisoner possesses" for "makes affidavit", substituted "such fees" for "such costs", substituted "the person" for "he" in two places, added par. (2), and designated last paragraph as par. (3).

Subsec. (b). Pub. L. 104–134, §101[(a)] [title VIII, §804(a)(3)], added subsec. (b). Former subsec. (b) redesignated (c).

Subsec. (c). Pub. L. 104–134, §101[(a)] [title VIII, §804(a)(2), (4)], redesignated subsec. (b) as (c) and substituted "subsections (a) and (b) and the prepayment of any partial filing fee as may be required under subsection (b)" for "subsection (a) of this section". Former subsec. (c) redesignated (d).

Subsec. (d). Pub. L. 104–134, §101[(a)] [title VIII, §804(a)(2)], redesignated subsec. (c) as (d). Former subsec. (d) redesignated (e).

Subsec. (e). Pub. L. 104–134, §101[(a)] [title VIII, §804(a)(5)], amended subsec. (e) generally. Prior to amendment, subsec. (e) read as follows: "The court may request an attorney to represent any such person unable to employ counsel and may dismiss the case if the allegation of poverty is untrue, or if satisfied that the action is frivolous or malicious."

Pub. L. 104–134, §101[(a)] [title VIII, §804(a)(2)], redesignated subsec. (d) as (e). Former subsec. (e) redesignated (f).

Subsec. (f). Pub. L. 104–134, §101[(a)] [title VIII, §804(a)(2), (c)], redesignated subsec. (e) as (f), designated existing provisions as par. (1) and substituted "proceedings" for "cases", and added par. (2).

Subsec. (g). Pub. L. 104–134, §101[(a)] [title VIII, §804(d)], added subsec. (g).

Subsec. (h). Pub. L. 104–134, §101[(a)] [title VIII, §804(e)], added subsec. (h).

1979—Subsec. (b). Pub. L. 96–82 substituted "Upon the filing of an affidavit in accordance with subsection (a) of this section, the court may direct payment by the United States of the expenses of (1) printing the record on appeal in any civil or criminal case, if such printing is required by the appellate court; (2) preparing a transcript of proceedings before a United States magistrate in any civil or criminal case, if such transcript is required by the district court, in the case of proceedings conducted under section 636(b) of this title or under section 3401(b) of title 18, United States Code; and (3) printing the record on appeal if such printing is required by the appellate court, in the case of proceedings conducted pursuant to section 636(c) of this title" and "Such expenses shall be paid when authorized by the Director of the Administrative Office of the United States Courts" for "In any civil or criminal case the court may, upon the filing of a like affidavit, direct that the expense of printing the record on appeal, if such printing is required by the appellate court, be paid by the United States, and the same shall be paid when authorized by the Director of the Administrative Office of the United States Courts".

1959—Subsec. (a). Pub. L. 86–320 substituted "person" for "citizen".

1951—Subsec. (b). Act Oct. 31, 1951, struck out "furnishing a stenographic transcript and" after "expense of".

Subsec. (e). Act Oct. 31, 1951, inserted provision that the United States shall not be liable for any of the costs incurred.

1949—Subsec. (b). Act May 24, 1949, §98(a), inserted "such printing is" between "if" and "required".

Subsec. (e). Act May 24, 1949, §98(b), inserted "or printed record" after "stenographic transcript".

CHANGE OF NAME

"United States magistrate judge" substituted for "United States magistrate" in subsec. (c) pursuant to section 321 of Pub. L. 101–650, set out as a note under section 631 of this title.

§ 1915A. Screening

(a) SCREENING.—The court shall review, before docketing, if feasible or, in any event, as soon as practicable after docketing, a complaint in a civil action in which a prisoner seeks redress from a governmental entity or officer or employee of a governmental entity.

(b) GROUNDS FOR DISMISSAL.—On review, the court shall identify cognizable claims or dismiss the complaint, or any portion of the complaint, if the complaint—

(1) is frivolous, malicious, or fails to state a claim upon which relief may be granted; or

(2) seeks monetary relief from a defendant who is immune from such relief.

(c) DEFINITION.—As used in this section, the term "prisoner" means any person incarcerated or detained in any facility who is accused of, convicted of, sentenced for, or adjudicated delinquent for, violations of criminal law or the terms and conditions of parole, probation, pretrial release, or diversionary program.

(Added Pub. L. 104–134, title I, §101[(a)] [title VIII, §805(a)], Apr. 26, 1996, 110 Stat. 1321, 1321–75; renumbered title I, Pub. L. 104–140, §1(a), May 2, 1996, 110 Stat. 1327.)

§ 1916. Seamen's suits

In all courts of the United States, seamen may institute and prosecute suits and appeals in their own names and for their own benefit for wages or salvage or the enforcement of laws enacted for their health or safety without prepaying fees or costs or furnishing security therefor.

(June 25, 1948, ch. 646, 62 Stat. 955.)

HISTORICAL AND REVISION NOTES

Based on title 28, U.S.C., 1940 ed., §837 (June 12, 1917, ch. 27, §1, 40 Stat. 157; July 1, 1918, ch. 113, §1, 40 Stat. 683).

Changes in phraseology were made.

§ 1917. District courts; fee on filing notice of or petition for appeal

Upon the filing of any separate or joint notice of appeal or application for appeal or upon the receipt of any order allowing, or notice of the allowance of, an appeal or of a writ of certiorari $5 shall be paid to the clerk of the district court, by the appellant or petitioner.

(June 25, 1948, ch. 646, 62 Stat. 955.)

HISTORICAL AND REVISION NOTES

Based on title 28, U.S.C., 1940 ed., §552 (Feb. 11, 1925, ch. 204, §5, 43 Stat. 857; Jan. 31, 1928, ch. 14, §1, 45 Stat. 54; Sept. 27, 1944, ch. 414, §3, 58 Stat. 744).

Words "to the clerk of the district court" were added to clarify the intent of Congress, as shown by the title of the 1944 act containing this section, and by the text of such Act in its entirety.

Words "as an additional fee in said suit or action, or proceeding in bankruptcy" were omitted. The entire text of the basic 1944 act shows that Congress intended it to apply to all actions, suits and proceedings, including bankruptcy proceedings, and nowhere else in such act is any reference made to bankruptcy proceedings.

Changes were made in phraseology.

COURT FEES FOR ELECTRONIC ACCESS TO INFORMATION

Judicial Conference to prescribe reasonable fees for collection by courts under this section for access to information available through automatic data processing equipment and fees to be deposited in Judiciary Automation Fund, see section 303 of Pub. L. 102–140, set out as a note under section 1913 of this title.

§ 1927. Counsel's liability for excessive costs

Any attorney or other person admitted to conduct cases in any court of the United States or any Territory thereof who so multiplies the proceedings in any case unreasonably and vexatiously may be required by the court to satisfy personally the excess costs, expenses, and attorneys' fees reasonably incurred because of such conduct.

(June 25, 1948, ch. 646, 62 Stat. 957; Pub. L. 96–349, § 3, Sept. 12, 1980, 94 Stat. 1156.)

HISTORICAL AND REVISION NOTES

Based on title 28, U.S.C., 1940 ed., § 829 (R.S. § 982).

Word ''personally'' was inserted upon authority of *Motion Picture Patents Co. v. Steiner et al.*, 1912, 201 F. 63, 119 C.C.A. 401. Reference to ''proctor'' was omitted as covered by the revised section.

See definition of ''court of the United States'' in section 451 of this title.

Changes were made in phraseology.

AMENDMENTS

1980—Pub. L. 96–349 substituted judicial authorization to require attorneys to satisfy excess costs, expenses, and attorneys' fees reasonably incurred because of multiplication of proceedings for such prior authority to impose liability for increased costs based on multiplication of proceedings.

§ 1928. Patent infringement action; disclaimer not filed

Whenever a judgment is rendered for the plaintiff in any patent infringement action involving a part of a patent and it appears that the patentee, in his specifications, claimed to be, but was not, the original and first inventor or discoverer of any material or substantial part of the thing patented, no costs shall be included in such judgment, unless the proper disclaimer has been filed in the United States Patent and Trademark Office prior to the commencement of the action.

(June 25, 1948, ch. 646, 62 Stat. 957; Pub. L. 106–113, div. B, § 1000(a)(9) [title IV, § 4732(b)(17)], Nov. 29, 1999, 113 Stat. 1536, 1501A–585.)

HISTORICAL AND REVISION NOTES

Based on title 28, U.S.C., 1940 ed., § 821 (R.S. § 973).

Word ''action'' was substituted for ''any suit at law or in equity'' to conform with Rule 2 of the Federal Rules of Civil Procedure.

Words ''or decree'' were omitted after ''judgment,'' because a judgment under Rule 54(a) of the Federal Rules of Civil Procedure by definition includes a decree.

Changes were made in phraseology.

AMENDMENTS

1999—Pub. L. 106–113 substituted ''United States Patent and Trademark Office'' for ''Patent Office''.

EFFECTIVE DATE OF 1999 AMENDMENT

Amendment by Pub. L. 106–113 effective 4 months after Nov. 29, 1999, see section 1000(a)(9) [title IV, § 4731] of Pub. L. 106–113, set out as a note under section 1 of Title 35, Patents.

§ 1929. Extraordinary expenses not expressly authorized

Where the ministerial officers of the United States incur extraordinary expense in executing Acts of Congress, the payment of which is not specifically provided for, the Attorney General may allow the payment thereof.

(June 25, 1948, ch. 646, 62 Stat. 957.)

HISTORICAL AND REVISION NOTES

Based on title 28, U.S.C., 1940 ed., § 577 (R.S. § 846; Feb. 18, 1875, ch. 80, § 1, Stat. 318; May 28, 1896, ch. 252, § 13, 29 Stat. 183; May 27, 1908, ch. 200, § 1, 35 Stat. 375; Mar. 3, 1911, ch. 231, § 291, 36 Stat. 1167; Feb. 26, 1919, ch. 49, § 7, 40 Stat. 1182; Oct. 13, 1941, ch. 431, § 1, 55 Stat. 736).

Provision for payment of expenses under section 577 of title 28, U.S.C., 1940 ed., from appropriations for expenses of the judiciary was omitted as unnecessary. Such expenses are carried in the Judiciary Appropriation Acts and will continue without this provision.

The first sentence of said section 577 is incorporated in section 551 of this title.

The qualifying phrase ''under the special taxation of the district court in which the said services have been or shall be rendered, to be paid from the appropriation for defraying the expenses of the Judiciary,'' was omitted, and the functions of allowing extraordinary expenses was vested in the Attorney General instead of the President. Neither the President nor the district judge should be burdened with such duty since the Attorney General only has the information upon which to act.

Changes were made in phraseology.

§ 1930. Bankruptcy fees

(a) The parties commencing a case under title 11 shall pay to the clerk of the district court or the clerk of the bankruptcy court, if one has been certified pursuant to section 156(b) of this title, the following filing fees:

(1) For a case commenced under—

(A) chapter 7 of title 11, $245, and

(B) chapter 13 of title 11, $235.

(2) For a case commenced under chapter 9 of title 11, equal to the fee specified in paragraph (3) for filing a case under chapter 11 of title 11. The amount by which the fee payable under this paragraph exceeds $300 shall be deposited in the fund established under section 1931 of this title.

(3) For a case commenced under chapter 11 of title 11 that does not concern a railroad, as defined in section 101 of title 11, $1,000.

(4) For a case commenced under chapter 11 of title 11 concerning a railroad, as so defined, $1,000.

(5) For a case commenced under chapter 12 of title 11, $200.

(6) In addition to the filing fee paid to the clerk, a quarterly fee shall be paid to the United States trustee, for deposit in the Treasury, in each case under chapter 11 of title 11 for each quarter (including any fraction thereof) until the case is converted or dismissed, whichever occurs first. The fee shall be $250 for each quarter in which disbursements total less than $15,000; $500 for each quarter in which disbursements total $15,000 or more but less than $75,000; $750 for each quarter in which disburse-

ments total $75,000 or more but less than $150,000; $1,250 for each quarter in which disbursements total $150,000 or more but less than $225,000; $1,500 for each quarter in which disbursements total $225,000 or more but less than $300,000; $3,750 for each quarter in which disbursements total $300,000 or more but less than $1,000,000; $5,000 for each quarter in which disbursements total $1,000,000 or more but less than $2,000,000; $7,500 for each quarter in which disbursements total $2,000,000 or more but less than $3,000,000; $8,000 for each quarter in which disbursements total $3,000,000 or more but less than $5,000,000; $10,000 for each quarter in which disbursements total $5,000,000 or more. The fee shall be payable on the last day of the calendar month following the calendar quarter for which the fee is owed.

(7) In districts that are not part of a United States trustee region as defined in section 581 of this title, the Judicial Conference of the United States may require the debtor in a case under chapter 11 of title 11 to pay fees equal to those imposed by paragraph (6) of this subsection. Such fees shall be deposited as offsetting receipts to the fund established under section 1931 of this title and shall remain available until expended.

An individual commencing a voluntary case or a joint case under title 11 may pay such fee in installments. For converting, on request of the debtor, a case under chapter 7, or 13 of title 11, to a case under chapter 11 of title 11, the debtor shall pay to the clerk of the district court or the clerk of the bankruptcy court, if one has been certified pursuant to section 156(b) of this title, a fee of the amount equal to the difference between the fee specified in paragraph (3) and the fee specified in paragraph (1).

(b) The Judicial Conference of the United States may prescribe additional fees in cases under title 11 of the same kind as the Judicial Conference prescribes under section 1914(b) of this title.

(c) Upon the filing of any separate or joint notice of appeal or application for appeal or upon the receipt of any order allowing, or notice of the allowance of, an appeal or a writ of certiorari $5 shall be paid to the clerk of the court, by the appellant or petitioner.

(d) Whenever any case or proceeding is dismissed in any bankruptcy court for want of jurisdiction, such court may order the payment of just costs.

(e) The clerk of the court may collect only the fees prescribed under this section.

(f)(1) Under the procedures prescribed by the Judicial Conference of the United States, the district court or the bankruptcy court may waive the filing fee in a case under chapter 7 of title 11 for an individual if the court determines that such individual has income less than 150 percent of the income official poverty line (as defined by the Office of Management and Budget, and revised annually in accordance with section 673(2) of the Omnibus Budget Reconciliation Act of 1981) applicable to a family of the size involved and is unable to pay that fee in installments. For purposes of this paragraph, the term ‘‘filing fee’’ means the filing fee required by subsection (a), or any other fee prescribed by the Judicial Conference under subsections (b) and (c) that is payable to the clerk upon the commencement of a case under chapter 7.

(2) The district court or the bankruptcy court may waive for such debtors other fees prescribed under subsections (b) and (c).

(3) This subsection does not restrict the district court or the bankruptcy court from waiving, in accordance with Judicial Conference policy, fees prescribed under this section for other debtors and creditors.

(Added Pub. L. 95–598, title II, § 246(a), Nov. 6, 1978, 92 Stat. 2671; amended Pub. L. 98–353, title I, § 111(a), (b), July 10, 1984, 98 Stat. 342; Pub. L. 99–500, § 101(b) [title IV, § 407(b)], Oct. 18, 1986, 100 Stat. 1783–39, 1783–64, and Pub. L. 99–591, § 101(b) [title IV, § 407(b)], Oct. 30, 1986, 100 Stat. 3341–39, 3341–64; Pub. L. 99–554, title I, §§ 117, 144(f), Oct. 27, 1986, 100 Stat. 3095, 3097; Pub. L. 101–162, title IV, § 406(a), Nov. 21, 1989, 103 Stat. 1016; Pub. L. 102–140, title I, § 111(a), Oct. 28, 1991, 105 Stat. 795; Pub. L. 103–121, title I, § 111(a)(1), (b)(1), Oct. 27, 1993, 107 Stat. 1164; Pub. L. 104–91, title I, § 101(a), Jan. 6, 1996, 110 Stat. 11, amended Pub. L. 104–99, title II, § 211, Jan. 26, 1996, 110 Stat. 37; Pub. L. 104–208, div. A, title I, § 101(a) [title I, § 109(a)], Sept. 30, 1996, 110 Stat. 3009, 3009–18; Pub. L. 106–113, div. B, § 1000(a)(1) [title I, § 113], Nov. 29, 1999, 113 Stat. 1535, 1501A–20; Pub. L. 106–518, title I, §§ 103–105, Nov. 13, 2000, 114 Stat. 2411, 2412; Pub. L. 109–8, title III, § 325(a), title IV, § 418, Apr. 20, 2005, 119 Stat. 98, 108; Pub. L. 109–13, div. A, title VI, § 6058(a), May 11, 2005, 119 Stat. 297; Pub. L. 109–171, title X, § 10101(a), Feb. 8, 2006, 120 Stat. 184.)

REFERENCES IN TEXT

Section 673(2) of the Omnibus Budget Reconciliation Act of 1981, referred to in subsec. (f)(1), is section 673(2) of Pub. L. 97–35, which is classified to section 9902(2) of Title 42, The Public Health and Welfare.

CODIFICATION

Amendment by Pub. L. 104–91 is based on section 111(a) of H.R. 2076, One Hundred Fourth Congress, as passed by House of Representatives on Dec. 6, 1995, which was enacted into law by Pub. L. 104–91.

Pub. L. 99–591 is a corrected version of Pub. L. 99–500.

AMENDMENTS

2006—Subsec. (a)(1). Pub. L. 109–171, § 10101(a)(1), substituted ‘‘$245’’ for ‘‘$220’’ in subpar. (A) and ‘‘$235’’ for ‘‘$150’’ in subpar. (B).

Subsec. (a)(2). Pub. L. 109–171, § 10101(a)(2), which directed substitution of ‘‘$2,750’’ for ‘‘$1,000’’ in par. (2), could not be executed because ‘‘$1,000’’ does not appear in par. (2).

2005—Subsec. (a). Pub. L. 109–8, § 418(1), substituted ‘‘The parties’’ for ‘‘Notwithstanding section 1915 of this title, the parties’’ in introductory provisions.

Subsec. (a)(1). Pub. L. 109–8, § 325(a)(1), as amended by Pub. L. 109–13, added par. (1) and struck out former par. (1), which read as follows: ‘‘For a case commenced under chapter 7 or 13 of title 11, $155.’’

Subsec. (a)(3). Pub. L. 109–8, § 325(a)(2), as amended by Pub. L. 109–13, substituted ‘‘$1,000’’ for ‘‘$800’’.

Subsec. (f). Pub. L. 109–8, § 418(2), added subsec. (f).

2000—Subsec. (a). Pub. L. 106–518, § 104, substituted ‘‘the amount equal to the difference between the fee specified in paragraph (3) and the fee specified in paragraph (1)’’ for ‘‘$400’’ in concluding provisions.

Subsec. (a)(2). Pub. L. 106–518, § 103, substituted ‘‘equal to the fee specified in paragraph (3) for filing a case under chapter 11 of title 11. The amount by which the fee payable under this paragraph exceeds $300 shall be deposited in the fund established under section 1931 of this title'' for ''$300''.

Subsec. (a)(7). Pub. L. 106–518, § 105, which directed amendment of subsec. (a) by adding par. (7) at end, was executed by adding par. (7) after par. (6) and before concluding provisions to reflect the probable intent of Congress.

1999—Subsec. (a)(1). Pub. L. 106–113 substituted ''$155'' for ''$130''.

1996—Subsec. (a)(3). Pub. L. 104–208 inserted a dollar sign before ''800''.

Subsec. (a)(6). Pub. L. 104–208 substituted ''$500 for each quarter in which disbursements total $15,000 or more but less than $75,000; $750 for each quarter in which disbursements total $75,000 or more but less than $150,000; $1,250 for each quarter in which disbursements total $150,000 or more but less than $225,000; $1,500 for each quarter in which disbursements total $225,000 or more but less than $300,000; $3,750 for each quarter in which disbursements total $300,000 or more but less than $1,000,000; $5,000 for each quarter in which disbursements total $1,000,000 or more but less than $2,000,000; $7,500 for each quarter in which disbursements total $2,000,000 or more but less than $3,000,000; $8,000 for each quarter in which disbursements total $3,000,000 or more but less than $5,000,000; $10,000 for each quarter in which disbursements total $5,000,000 or more. The fee shall be payable on the last day of the calendar month following the calendar quarter for which the fee is owed.'' for ''$500 for each quarter in which disbursements total $15,000 or more but less than $150,000; $1,250 or each quarter in which disbursements total $150,000 or more but less than $300,000; $3,750 for each quarter in which disbursements total $300,000 or more but less than $3,000,000; $5,000 for each quarter in which disbursements total $3,000,000 or more. The fee shall be payable on the last day of the calendar month following the calendar quarter for which the fee is owed.''

Pub. L. 104–91, as amended by Pub. L. 104–99, struck out ''a plan is confirmed or'' before ''the case is converted''.

1993—Subsec. (a)(1). Pub. L. 103–121, § 111(a)(1), substituted ''$130'' for ''$120''.

Subsec. (a)(3). Pub. L. 103–81, § 111(b)(1), substituted ''800'' for ''$600''.

1991—Subsec. (a)(3). Pub. L. 102–140, § 111(a)(1), substituted ''$600'' for ''$500''.

Subsec. (a)(6). Pub. L. 102–140, § 111(a)(2), substituted ''$250'' for ''$150'', ''$500'' for ''$300'', ''$1,250'' for ''$750'', ''$3,750'' for ''$2,250'', and ''$5,000'' for ''$3,000''.

1989—Subsec. (a)(1). Pub. L. 101–162 substituted ''$120'' for ''$90''.

1986—Subsec. (a). Pub. L. 99–554, §§ 117(5), 144(f), in introductory and closing provisions, substituted ''of the district court or the clerk of the bankruptcy court, if one has been certified pursuant to section 156(b) of this title'' for ''of the court'', and in closing provisions, inserted provision that for conversion, on request of the debtor, of a case under chapter 7 or 13 of title 11, to a case under chapter 11 of title 11, the debtor pay to the clerk of the court a fee of $400.

Subsec. (a)(1). Pub. L. 99–500 and Pub. L. 99–591, Pub. L. 99–554, § 117(1), amended par. (1) identically substituting ''$90'' for ''$60''.

Subsec. (a)(3). Pub. L. 99–554, § 117(2), substituted ''$500'' for ''$200''.

Subsec. (a)(4). Pub. L. 99–554, § 117(3), substituted ''$1,000'' for ''$500''.

Subsec. (a)(5), (6). Pub. L. 99–554, § 117(4), added pars. (5) and (6).

1984—Pub. L. 98–353, § 111(b), substituted ''fees'' for ''courts'' in section catchline.

Subsecs. (a), (c), (e). Pub. L. 98–353, § 111(a), substituted ''clerk of the court'' for ''clerk of the bankruptcy court''.

Effective Date of 2006 Amendment

Pub. L. 109–171, title X, § 10101(c), Feb. 8, 2006, 120 Stat. 184, provided that: ''This section [amending this section and enacting provisions set out as a note under section 1931 of this title] and the amendments made by this section shall take effect 60 days after the date of the enactment of this Act [Feb. 8, 2006].''

Effective Date of 2005 Amendments

Amendment by Pub. L. 109–13 effective immediately after the enactment of Pub. L. 109–8, Apr. 20, 2005, see section 6058(b) of Pub. L. 109–13, set out as a note under section 589a of this title.

Amendment by Pub. L. 109–8 effective 180 days after Apr. 20, 2005, and not applicable with respect to cases commenced under Title 11, Bankruptcy, before such effective date, except as otherwise provided, see section 1501 of Pub. L. 109–8, set out as a note under section 101 of Title 11.

Effective Date of 1999 Amendment

Pub. L. 106–113, div. B, § 1000(a)(1) [title I, § 113], Nov. 29, 1999, 113 Stat. 1535, 1501A–20, provided that the amendment made by section 1000(a)(1) [title I, § 113] is effective 30 days after Nov. 29, 1999.

Effective Date of 1993 Amendment

Section 111(a) of Pub. L. 103–121 provided in part that the amendment made by that section is effective 30 days after Oct. 27, 1993.

Section 111(b) of Pub. L. 103–121 provided in part that the amendment made by that section is effective 30 days after Oct. 27, 1993.

Effective Date of 1991 Amendment

Section 111 of Pub. L. 102–140 provided that the amendment made by that section is effective 60 days after Oct. 28, 1991.

Effective Date of 1989 Amendment; Miscellaneous Fees

Section 406(a) of Pub. L. 101–162 provided that: ''Section 1930(a)(1) of title 28, United States Code, is amended by striking out '$90' and inserting in lieu thereof '$120'. Pursuant to section 1930(b) of title 28, the Judicial Conference of the United States shall prescribe a fee of $60 on motions seeking relief from the automatic stay under 11 U.S.C. section 362(b) and motions to compel abandonment of property of the estate. The fees established pursuant to the preceding two sentences shall take effect 30 days after the enactment of this Act [Nov. 21, 1989].''

Effective Date of 1986 Amendment

Amendment by Pub. L. 99–554 effective 30 days after Oct. 27, 1986, with effective date and applicability of enactment of subsec. (a)(6) of this section by section 117(4) of Pub. L. 99–554 dependent upon the judicial district involved, see section 302(a), (d), (e) of Pub. L. 99–554, set out as a note under section 581 of this title.

Effective Date of 1984 Amendment

Amendment by Pub. L. 98–353 effective July 10, 1984, see section 122(a) of Pub. L. 98–353, set out as an Effective Date note under section 151 of this title.

Effective Date

Section effective Oct. 1, 1979, see section 402(c) of Pub. L. 95–598, set out as a note preceding section 101 of Title 11, Bankruptcy.

Use of Increased Receipts

Pub. L. 109–8, title III, § 325(e), Apr. 20, 2005, 119 Stat. 99, which provided for the disposition of certain fees collected under section 1930 of this title during the 5-year period beginning on Apr. 20, 2005, greater than the amount that would have been collected had the amendment by Pub. L. 109–8, § 325(a), not been made, was omitted in the general amendment of section 325 of Pub. L. 109–8 by Pub. L. 109–13, div. A, title VI, § 6058, May 11, 2005, 119 Stat. 297, effective immediately after the enactment of Pub. L. 109–8, Apr. 20, 2005.

Accrual and Payment of Quarterly Fees in Chapter 11 Cases After Jan. 27, 1996; Confirmation Status of Plans

Section 101(a) of Pub. L. 104–91, as amended by Pub. L. 104–208, div. A, title I, §101(a) [title I, §109(d)], Sept. 30, 1996, 110 Stat. 3009, 3009–19, provided in part: ‘‘That, notwithstanding any other provision of law, the fees under 28 U.S.C. 1930(a)(6) shall accrue and be payable from and after January 27, 1996, in all cases (including, without limitation, any cases pending as of that date), regardless of confirmation status of their plans’’.

Report on Bankruptcy Fees

Section 111(d) of Pub. L. 103–121 provided that:

‘‘(1) Report required.—Not later than March 31, 1998, the Judicial Conference of the United States shall submit to the Committees on the Judiciary of the House of Representatives and the Senate, a report relating to the bankruptcy fee system and the impact of such system on various participants in bankruptcy cases.

‘‘(2) Contents of report.—Such report shall include—

‘‘(A)(i) an estimate of the costs and benefits that would result from waiving bankruptcy fees payable by debtors who are individuals, and

‘‘(ii) recommendations regarding various revenue sources to offset the net cost of waiving such fees; and

‘‘(B)(i) an evaluation of the effects that would result in cases under chapters 11 and 13 of title 11, United States Code, from using a graduated bankruptcy fee system based on assets, liabilities, or both of the debtor, and

‘‘(ii) recommendations regarding various methods to implement such a graduated bankruptcy fee system.

‘‘(3) Waiver of fees in selected districts.—For purposes of carrying out paragraphs (1) and (2), the Judicial Conference of the United States shall carry out in not more than six judicial districts, throughout the 3-year period beginning on October 1, 1994, a program under which fees payable under section 1930 of title 28, United States Code, may be waived in cases under chapter 7 of title 11, United States Code, for debtors who are individuals unable to pay such fees in installments.

‘‘(4) Study of graduated fee system.—For purposes of carrying out paragraphs (1) and (2), the Judicial Conference of the United States shall carry out, in not fewer than six judicial districts, a study to estimate the results that would occur in cases under chapters 11 and 13 of title 11, United States Code, if filing fees payable under section 1930 of title 28, United States Code, were paid on a graduated scale based on assets, liabilities, or both of the debtor.’’

Court Fees for Electronic Access to Information

Judicial Conference to prescribe reasonable fees for collection by courts under this section for access to information available through automatic data processing equipment and fees to be deposited in Judiciary Automation Fund, see section 303 of Pub. L. 102–140, set out as a note under section 1913 of this title.

Issuance of Notices to Creditors and Other Interested Parties

Section 403 of Pub. L. 101–162 provided that: ‘‘Notwithstanding any other provision of law, for fiscal year 1990 and hereafter, (a) The Administrative Office of the United States Courts, or any other agency or instrumentality of the United States, is prohibited from restricting solely to staff of the Clerks of the United States Bankruptcy Courts the issuance of notices to creditors and other interested parties. (b) The Administrative Office shall permit and encourage the preparation and mailing of such notices to be performed by or at the expense of the debtors, trustees or such other interested parties as the Court may direct and approve. (c) The Director of the Administrative Office of the United States Courts shall make appropriate provisions for the use of and accounting for any postage required pursuant to such directives.’’

Collection and Disposition of Fees in Bankruptcy Cases

Section 404(a) of Pub. L. 101–162 provided that: ‘‘For fiscal year 1990 and hereafter, such fees as shall be collected for the preparation and mailing of notices in bankruptcy cases as prescribed by the Judicial Conference of the United States pursuant to 28 U.S.C. 1930(b) shall be deposited to the ‘Courts of Appeals, District Courts, and Other Judicial Services, Salaries and Expenses’ appropriation to be used for salaries and other expenses incurred in providing these services.’’

§1931. Disposition of filing fees

(a) Of the amounts paid to the clerk of court as a fee under section 1914(a) or as part of a judgment for costs under section 2412(a)(2) of this title, $190 shall be deposited into a special fund of the Treasury to be available to offset funds appropriated for the operation and maintenance of the courts of the United States.

(b) If the court authorizes a fee under section 1914(a) or an amount included in a judgment for costs under section 2412(a)(2) of this title of less than $250, the entire fee or amount, up to $190, shall be deposited into the special fund provided in this section.

(Added Pub. L. 99–500, §101(b) [title IV, §407(c)], Oct. 18, 1986, 100 Stat. 1783–39, 1783–64, and Pub. L. 99–591, §101(b) [title IV, §407(c)], Oct. 30, 1986, 100 Stat. 3341–39, 3341–64; amended Pub. L. 101–162, title IV, §406(d), Nov. 21, 1989, 103 Stat. 1016; Pub. L. 102–572, title III, §301(b), Oct. 29, 1992, 106 Stat. 4511; Pub. L. 104–317, title IV, §401(b), Oct. 19, 1996, 110 Stat. 3853; Pub. L. 108–447, div. B, title III, §307(b), Dec. 8, 2004, 118 Stat. 2895.)

Codification

Pub. L. 99–591 is a corrected version of Pub. L. 99–500.

Amendments

2004—Subsec. (a). Pub. L. 108–447, §307(b)(1), substituted ‘‘$190’’ for ‘‘$90’’.

Subsec. (b). Pub. L. 108–447, §307(b)(2), substituted ‘‘$250’’ for ‘‘$150’’ and ‘‘$190’’ for ‘‘$90’’.

1996—Subsec. (a). Pub. L. 104–317, §401(b)(1), substituted ‘‘$90’’ for ‘‘$60’’.

Subsec. (b). Pub. L. 104–317, §401(b)(2), substituted ‘‘$150’’ for ‘‘$120’’ and ‘‘$90’’ for ‘‘$60’’.

1992—Pub. L. 102–572 substituted present provisions for former provisions which read as follows:

‘‘The following portion of moneys paid to the clerk of court as filing fees under this chapter shall be deposited into a special fund of the Treasury to be available to offset funds appropriated for the operation and maintenance of the courts of the United States:

‘‘Under section 1914(a), $60.’’

1989—Pub. L. 101–162, which directed that ‘‘as provided in annual appropriation acts’’ be struck out before colon, was executed by striking out ‘‘as provided in annual appropriation Acts’’ before colon as probable intent of Congress.

Effective Date of 2004 Amendment

Amendment by Pub. L. 108–447 effective 60 days after Dec. 8, 2004, see section 307(c) of Pub. L. 108–447, set out as a note under section 1914 of this title.

Effective Date of 1996 Amendment

Amendment by Pub. L. 104–317 effective 60 days after Oct. 19, 1996, see section 401(c) of Pub. L. 104–317, set out as a note under section 1914 of this title.

BANKRUPTCY COURT MISCELLANEOUS FEE SCHEDULE

Bankruptcy Court Miscellaneous Fee Schedule
Effective 1/01/2010

Bankruptcy Court Miscellaneous Fee Schedule (28 U.S.C. § 1930)

The fees included in the Bankruptcy Court Miscellaneous Fee Schedule are to be charged for services provided by the bankruptcy courts.

- The United States should not be charged fees under this schedule, with the exception of those specifically prescribed in Items 1, 3 and 5 when the information requested is available through remote electronic access.
- Federal agencies or programs that are funded from judiciary appropriations (agencies, organizations, and individuals providing services authorized by the Criminal Justice Act, 18 U.S.C. § 3006A, and bankruptcy administrators) should not be charged any fees under this schedule.

(1) For reproducing any document, $.50 per page. This fee applies to services rendered on behalf of the United States if the document requested is available through electronic access.

(2) For certification of any document, $9.
For exemplification of any document, $18.

(3) For reproduction of an audio recording of a court proceeding, $26. This fee applies to services rendered on behalf of the United States if the recording is available electronically.

(4) For filing an amendment to the debtor’s schedules of creditors, lists of creditors, or mailing list, $26, except:

- The bankruptcy judge may, for good cause, waive the charge in any case.
- This fee must not be charged if -
  - the amendment is to change the address of a creditor or an attorney for a creditor listed on the schedules; or
  - the amendment is to add the name and address of an attorney for a creditor listed on the schedules.

(5) For conducting a search of the bankruptcy court records, $26 per name or item searched. This fee applies to services rendered on behalf of the United States if the information requested is available through electronic access.

(6) For filing a complaint, $250, except:

- If the trustee or debtor-in-possession files the complaint, the fee must be paid only by the estate, to the extent there is an estate.
- This fee must not be charged if -
  - the debtor is the plaintiff; or
  - a child support creditor or representative files the complaint and submits the form required by § 304(g) of the Bankruptcy Reform Act of 1994.

(7) For filing any document that is not related to a pending case or proceeding, $39.

(8) Administrative fee for filing a case under Title 11 or when a motion to divide a joint case under Title 11 is filed, $39.

(9) For payment to trustees pursuant to 11 U.S.C. § 330(b)(2), a $15 fee applies in the following circumstances:

- For filing a petition under Chapter 7.
- For filing a motion to reopen a Chapter 7 case.
- For filing a motion to divide a joint Chapter 7 case.
- For filing a motion to convert a case to a Chapter 7 case.
- For filing a notice of conversion to a Chapter 7 case.

(10) In addition to any fees imposed under Item 9, above, the following fees must be collected:

- For filing a motion to convert a Chapter 12 case to a Chapter 7 case or a notice of conversion pursuant to 11 U.S.C. § 1208(a), $45.
- For filing a motion to convert a Chapter 13 case to a Chapter 7 case or a notice of conversion pursuant to 11 U.S.C. § 1307(a), $10.

The fee amounts in this item are derived from the fees prescribed in 28 U.S.C. §1930(a).

If the trustee files the motion to convert, the fee is payable only from the estate that exists prior to conversion.

If the filing fee for the chapter to which the case is requested to be converted is less than the fee paid at the commencement of the case, no refund may be provided.

(11) For filing a motion to reopen, the following fees apply:

- For filing a motion to reopen a Chapter 7 case, $245.
- For filing a motion to reopen a Chapter 9 case, $1000.
- For filing a motion to reopen a Chapter 11 case, $1000.

- For filing a motion to reopen a Chapter 12 case, $200.
- For filing a motion to reopen a Chapter 13 case, $235.
- For filing a motion to reopen a Chapter 15 case, $1000.

The fee amounts in this item are derived from the fees prescribed in 28 U.S.C.§ 1930(a).

The reopening fee must be charged when a case has been closed without a discharge being entered.

The court may waive this fee under appropriate circumstances or may defer payment of the fee from trustees pending discovery of additional assets. If payment is deferred, the fee should be waived if no additional assets are discovered.

The reopening fee must not be charged in the following situations:

- to permit a party to file a complaint to obtain a determination under Rule 4007(b); or
- when a debtor files a motion to reopen a case based upon an alleged violation of the terms of the discharge under 11 U.S.C. § 524; or
- when the reopening is to correct an administrative error.

(12) For retrieval of a record from a Federal Records Center, National Archives, or other storage location removed from the place of business of the court, $45.

(13) For a check paid into the court which is returned for lack of funds, $45.

(14) For filing an appeal or cross appeal from a judgment, order, or decree, $250.

This fee is collected in addition to the statutory fee of $5 that is collected under 28 U.S.C. § 1930 (c) when a notice of appeal is filed.

Parties filing a joint notice of appeal should pay only one fee.

If a trustee or debtor-in-possession is the appellant, the fee must be paid only by the estate, to the extent there is an estate.

Upon notice from the court of appeals that a direct appeal or direct cross-appeal has been authorized, an additional fee of $200 must be collected

(15) For filing a case under Chapter 15 of the Bankruptcy Code, $1000.

This fee is derived from and equal to the fee prescribed in 28 U.S.C. § 1930(a)(3) for filing a case commenced under Chapter 11 of Title 11.

(16) The court may charge and collect fees commensurate with the cost of providing copies of the local rules of court. The court may also distribute copies of the local rules without charge.

(17) The clerk shall assess a charge for the handling of registry funds deposited with the court, to be assessed from interest earnings and in accordance with the detailed fee schedule issued by the Director of the Administrative Office of the United States Courts.

(18) For a motion filed by the debtor to divide a joint case filed under 11 U.S.C. § 302, the following fees apply:

- For filing a motion to divide a joint Chapter 7 case, $245.
- For filing a motion to divide a joint Chapter 11 case, $1000.
- For filing a motion to divide a joint Chapter 12 case, $200.
- For filing a motion to divide a joint Chapter 13 case, $235.

These fees are derived from and equal to the filing fees prescribed in 28 U.S.C.§ 1930(a).

(19) For filing the following motions, $150:

- To terminate, annul, modify or condition the automatic stay;
- To compel abandonment of property of the estate pursuant to Rule 6007(b) of the Federal Rules of Bankruptcy Procedure; or
- To withdraw the reference of a case or proceeding under 28 U.S.C. § 157(d).

This fee must not be collected in the following situations:

- For a motion for relief from the co-debtor stay;
- For a stipulation for court approval of an agreement for relief from a stay; or
- For a motion filed by a child support creditor or its representative, if the form required by § 304(g) of the Bankruptcy Reform Act of 1994 is filed.

BRIEF BANK — 'SUMMARY SHEET"

Printed Thu-11/9/06 14:51

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*
Gargula, UST v Thompson

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*
DC SD Ind.

3. ("CCN") ***CURRENT*** CASE NO.
No.: 06-01033

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*
No.: 06-01031
Court: Bankr. SD Ind.
(Identify judge & cite, if any)

5. ("SO") ***SOURCE***
U.S. TRUSTEES

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*
Filed: August 31, 2006
Type: Brief for the Appellant, UST

7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*
Beth Kramer, Trial Attorney OUST, Ind.
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") ● ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***

● Under section 301 of the Bankruptcy Code, the filing of a petition commences a bankruptcy case. In a variety of contexts, federal courts routinely dismiss cases that lack merit, including cases brought in the absence of subject matter jurisdiction. Given that law, did the Bankruptcy Court err when it ruled that the Thompsons' petition had not commenced a case, and terminated the bankruptcy proceeding by striking the case on its own initiative, while denying the motion to reconsider and instead to dismiss the case.

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UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF INDIANA
INDIANAPOLIS DIVISION

NANCY J. GARGULA, UNITED STATES TRUSTEE,	)	
Appellant,	)	
vs.	)	IP 1:06-cv-01033-LJM-WTL DISTRICT COURT CASE NUMBER
GREGORY ARLEN THOMPSON and SUZANNE ANNETTE THOMPSON,	)	
Appellees.	)	
IN RE:	)	
GREGORY ARLEN THOMPSON and SUZANNE ANNETTE THOMPSON,	)	IP 06-01031-AJM-13 BANKRUPTCY COURT CASE NUMBER
Debtors.	)	

BRIEF BY THE UNITED STATES TRUSTEE, APPELLANT, IN SUPPORT OF APPEAL OF ORDER STRIKING THE CASE AND ORDER DENYING THE UNITED STATES TRUSTEE'S MOTION TO RECONSIDER ENTRY OF THE ORDER STRIKING THE CASE

NANCY J. GARGULA **UNITED STATES TRUSTEE, REGION 10** **Beth Kramer, Trial Attorney** United States Department of Justice Office of the United States Trustee 101 West Ohio Street, Suite1000 Indianapolis, Indiana 46204 (317) 226-6101 Telephone (317) 226-6356 Fax	<u>Of Counsel</u> **Roberta A. DeAngelis** Acting General Counsel **P. Matthew Sutko** **Lisa A. Tracy** **Larry E. Wahlquist** Office of the General Counsel Executive Office for United States Trustees United States Department of Justice 20 Massachusetts Avenue, N.W., Suite 8100 Washington, D.C. 20530

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STATEMENT OF JURISDICTION

The United States Bankruptcy Court for the Southern District of Indiana had jurisdiction over this Chapter 13 bankruptcy case pursuant to 28 U.S.C. §157(b). This appeal is taken from an order the bankruptcy court entered on March 16, 2006 striking the Thompson's petition in bankruptcy based on their failure to comply with 11 U.S.C. § 109(h) and closing the Thompson's case. In addition, this appeal is taken from a related order the bankruptcy court entered on June 5, 2006, denying the United States Trustee's motion seeking reconsideration of the March 16 order and asking instead that the Thompson's bankruptcy case be dismissed. The United States Trustee filed a timely notice of appeal from the orders pursuant to 28 U.S.C. §158(c)(2) and Fed. R. Bankr. P. 8002(a) on June 8, 2006.[1] This Court has jurisdiction over this appeal pursuant to 28 U.S.C. §158(a)(1).

STATEMENT OF THE ISSUE

Under section 301 of the Bankruptcy Code, the filing of a petition commences a bankruptcy case. In a variety of contexts, federal courts routinely dismiss cases that lack merit, including cases brought in the absence of subject matter jurisdiction. Given that law, did the Bankruptcy Court err when it ruled that the Thompsons' petition had not commenced a case, and terminated the bankruptcy proceeding by striking the case on its own initiative, while denying the motion to reconsider and instead to dismiss the case?

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[1] Congress has authorized the United States Attorney General to appoint 21 United States trustees, each to serve in a specific geographic region of the United States. *See generally* 28 U.S.C. §581 et seq. (establishing the United States Trustee Program). United States Trustees "supervise the administration of cases and trustees" in all bankruptcy cases within his or her region through the exercise of a range of oversight responsibilities. 28 U.S.C. §586(a)(3). *See generally In re Revco D.S., Inc.*, 898 F.2d 498, 500 (6th Cir. 1990) (explaining that United States trustees oversee the bankruptcy process, protect the public interest, and ensure that bankruptcy cases are conducted according to law). United States Trustees may raise, appear, and be heard on any issue in any case or proceeding under Title 11. 11 U.S.C. §307; *See also In re Revco D.S., Inc.*, 898 F.2d at 500 (upholding broad appellate standing of United States trustees).

STANDARD OF REVIEW

The bankruptcy court is the finder of fact in a bankruptcy case. *Matter of Lefkas General Partners*, 112 F.3d 896, 900 (7th Cir. 1997). When the district court is the appellate court for a bankruptcy case, it reviews the bankruptcy court's factual findings under the clearly erroneous standard and its conclusions of law de novo. *Id.* This appeal presents only a legal question. A bankruptcy court's construction of a bankruptcy statute is a legal conclusion which the court on appeal reviews de novo. *Meyer v. Rigdon*, 36 F.3d 1375 (7th Cir. 1994).

STATEMENT OF THE CASE

This appeal presents an important recurring issue that has arisen under the Bankruptcy Code as amended by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA). That new law requires individuals to obtain credit counseling from an approved agency before seeking bankruptcy relief. *See* 11 U.S.C. §109(h). On March 15, 2006, Gregory Arlen Thompson and Suzanne Annette Thompson ("The Thompsons") filed a petition under Chapter 13 of the Bankruptcy Code without satisfying the Code's pre-filing credit counseling requirement. As a result, the Court ordered on March 16, 2006 that the Thompsons' petition be stricken. The United States Trustee, however, was not provided an opportunity to object to the portion of the order striking the petition. Accordingly, the United States Trustee filed a request to reconsider the entry of the order and asked the Court instead to dismiss the case. The United States Trustee did so because the nature of the relief granted could have substantial impact upon the Thompsons' creditors. On June 5, 2006, the Bankruptcy Court, following a minority line of cases, entered an order denying the United States Trustee's Motion to Reconsider and ordered the petition stricken. The United States Trustee then timely filed these appeals.

STATEMENT OF FACTS

1. Statutory Framework

Chapter 3 of the Bankruptcy Code, 11 U.S.C. §301, *et seq.*, governs the commencement and administration of bankruptcy cases. Under section 301, "a voluntary case under a chapter of [the Bankruptcy Code] is commenced by the filing with the bankruptcy court of a petition under such chapter by an entity that may be a debtor under such chapter." 11 U.S.C. §301. The commencement of a case under section 301 is significant for many reasons. For example, under 28 U.S.C. §1930(a), "parties commencing a case under title 11" are required to pay the clerk of the bankruptcy court a fee. 28 U.S.C. §1930(a). When a debtor commences a chapter 13 case under section 301, the court assigns the debtor a case number and the automatic stay goes into effect.

Section 109 establishes rules that govern eligibility to be a debtor under the Bankruptcy Code. This section includes general rules that affect the eligibility of individuals to proceed as debtors under each chapter of the Bankruptcy Code. For example, under §109(g), no individual may be a debtor if that individual had a case pending at any time during the preceding 180 days if the prior case "was dismissed by the court for willful failure of the debtor to abide by orders of the court." 11 U.S.C. §109(g)(1). Section 109 also places restrictions on the types of individuals who may proceed as debtors under specific chapters of the Bankruptcy Code. *See* 11 U.S.C. §109. The section provides that only individuals with regular income who have unsecured debts of less than $307,675 and secured debts of less than $922,975 may be debtors under chapter 13 of the Bankruptcy Code. *See* 11 U.S.C. §109(e).

The BAPCPA amended §109 in 2005 to require, as an additional element of eligibility to be a debtor under any chapter of the Bankruptcy Code, that all individuals receive credit counseling during the 180-day period prior to filing a petition in bankruptcy. *See* 11 U.S.C. §109(h)(1). [2]

Section 707, of Chapter 7, entitled *Dismissal of a case or conversion to a case under chapter 11 or 13*, establishes that "a court may dismiss a case under [Chapter 7] . . . for cause..." 11 U.S.C. 707(a). It includes a nonexhaustive list of reasons that may constitute cause to dismiss a Chapter 7 bankruptcy case. *See* 11 U.S.C. §707(a). Section 1307, of Chapter 13, entitled *Conversion or dismissal***,** establishes that a debtor may convert a case to Chapter 7 at any time, that the court shall dismiss a case upon request of a debtor whose case has not previously been converted from another chapter, and that "...the court may convert a case under [Chapter 13] to a case under Chapter 7 of [Title 11]**,** or may dismiss a case under [Chapter 13], whichever is in the best interest of creditors and the estate, for cause..." 11 U.S.C. § 1307. It also includes a nonexhaustive list of reasons that may constitute cause to convert or dismiss a Chapter 13 case.

2. Factual Background

The Thompsons are not strangers to the bankruptcy process. The above bankruptcy case is their sixth bankruptcy filing[3]. The Thompsons filed a chapter 7 (Transcript of hearing held April 21, 2006 at 5, hereinafter "Tr.") on January 20, 1995,[4] and received a discharge. They next filed a Chapter 13 on

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[2] Under this new provision, debtors may seek an extension of the pre-filing requirement of up to forty-five days after filing if they can establish, among other things, that exigent circumstances required that they file for bankruptcy protection before obtaining the required credit counseling. *See* 11 U.S.C. §109(h)(3). In addition, upon notice and a hearing, a debtor may seek waiver of the credit counseling requirement altogether if the debtor can establish that he or she is incapacitated, disabled or on active military duty in a military combat zone. *See* 11 U.S.C. §109(h)(4). Those sections are not at issue in this appeal.

[3] Since the striking of the case at issue on this appeal, the Thompsons filed a seventh bankruptcy case. On July 19, 2006, they filed Case Number 06-03998 under Chapter 13.

[4] Case Number 95-00435. Although this case was not identified by number at the April 21, 2006 hearing, the docket is an official record of this court.

June 11, 2002.[5] That case was eventually dismissed on April 1, 2003. (*See* f.n.5). The Thompsons filed their third case on February 19, 2004.[6] (Tr. at 6, UST Exhibit-2, hereinafter "UST Ex-"). That case was under chapter 13 and was dismissed on October 5, 2004, for failure to make plan payments. (*Id*). On February 17, 2005, they filed another Chapter 13.[7] (Tr. at 6, UST Ex-3). That case was dismissed on March 3, 2005, for failure to complete the filing. (*Id*). On September 14, 2005, the Thompsons filed their fifth case, a Chapter 13,[8] which was again dismissed for failure to complete the filing. (Tr. at 6, UST Ex-4). That case was dismissed twice. After it was dismissed the first time on September 22, 2005, the Thompsons requested it be reinstated. (UST Ex- 4). The court granted their motion to reinstate but ultimately dismissed the case again on December 20, 2005, when the Thompsons still failed to complete the filing. (*Id*).

The present case was filed on March 15, 2006. (Tr. at 7, D.[9] at 1). The Thompsons did not file a credit counseling certificate with their petition or a certification of exigent circumstances as required for all cases filed after October 17, 2005, pursuant to the BAPCPA. The Bankruptcy Code requires a debtor to file a certificate from an approved credit counseling agency as proof that the debtor has fulfilled the credit counseling requirement of 11 U.S.C. §109(h). *See* 11 U.S.C. §521(b)(1). Interim Rules 1007(b)(3) and (c) require that the certificate of credit counseling be filed with the bankruptcy

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[5] Case Number 02-10020 . Although this case was not identified at the April 21, 2006 hearing, the docket is an official record of this court.

[6] Case Number 04-02410.

[7] Case Number 05-02246 .

[8] Case Number 05-18870 .

[9] "D. at __" refers to the official docket number in the bankruptcy court's case docket.

petition in a voluntary case.[10] *See* Int. R. Fed. Bankr. P.1007(b)(3) and (c). Thus, the Thompsons may not be debtors under the Bankruptcy Code. 11 U.S.C. § 109(h).

Rather than dismissing the case, the Bankruptcy Court struck the petition and closed the case. (D. at 5). The United States Trustee filed a request to reconsider the entry of the order striking the petition and asked the Court instead to, dismiss the case. (D. at 8). The court held a hearing on April 21, 2006 (D. at 16) and issued it's order denying the United States Trustee's motion to reconsider. (D. at 17). The bankruptcy court ruled that it was appropriate to strike the Thompson's petition. *Id.* The bankruptcy court noted that under changes made by the BAPCPA, the automatic stay under 11 U.S.C. §362 has been modified with respect to people who file successive bankruptcy cases. *Id*. Under section 362(c)(3), when a debtor has had a prior case pending within the preceding one-year period that was subsequently dismissed, the automatic stay in the next case shall terminate automatically on the thirtieth day after the filing of that case unless a debtor is able to establish by motion that the later case is in good faith as to the creditors to be stayed. *See* 11 U.S.C. § 362(c)(3). In order to protect the Thompsons from the impact of this new change in a subsequent case, and to deny their creditors of its advantage, the bankruptcy court ordered that the petition be stricken. (D. at 17). The United States Trustee timely appealed that order to this Court. (D. at 19; Notice of Appeal).

SUMMARY OF THE ARGUMENT

Federal courts dismiss improperly filed cases - they do not strike them. Courts dismiss cases for many reasons, including lack of jurisdiction, and failure to state a claim upon which relief may be

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[10] The Interim Bankruptcy Rules were prepared by the Advisory Committee on Bankruptcy Rules and recommended for local court adoption to implement changes made by the BAPCPA. Pursuant to a standing order dated October 17, 2005, the Bankruptcy Court for the Southern District of Indiana adopted the Interim Rules. *See* October 17, 2005 General Order 05-0002 on Adoption of Interim Bankruptcy Rules.

granted. The same has always been true in bankruptcy. Under section 301 of the Bankruptcy Code, the filing of a petition commences a bankruptcy case. The Bankruptcy Code, consistent with other federal law, makes no provision for striking petitions or cases as a method of disposing of bankruptcy cases.

Despite this, the court below denied the United States Trustee's motion to reconsider the entry of the order striking the case and instead to dismiss the Thompsons' bankruptcy case, even though there is no question that the case was filed improperly. Instead, the court, on its own initiative, entered an order striking the case even though no federal statute professes to authorize the closure of federal cases by striking. That was error.

That error circumvents important statutory directives, and harms both debtors and creditors. It also engenders confusion because the Bankruptcy Code explains in detail what happens to dismissed cases and how dismissal affects the rights of the various parties to a bankruptcy case, but it says nothing about the effect of striking. See 11 U.S.C. § 349. For these reasons, this case should be remanded with instructions that the court below dismiss the Thompsons' improperly filed bankruptcy case.

ARGUMENT

1. Dismissal Is the Only Proper Disposition of the Thompsons' Improperly Filed Bankruptcy Case.

Federal district courts routinely dismiss improperly pleaded cases under Fed. R. Civ. P. 12(b) - they do not strike them.[11] *See, e.g., Kirksey v. R.J. Reynolds Tobacco Co.*, 168 F.3d 1039 (7th Cir. 1997)(Seventh Circuit affirmed district court's dismissal of case for failure to state a claim upon which relief could be granted)*; Small v. Chao*, 398 F.3d 894 (7th Cir. 2004)(affirming dismissal for lack of subject matter jurisdiction and for failure to state a claim); *Cont'l Cas. Co. v. American Nat. Ins.*

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[11] Bankruptcy courts are units of the district courts. 28 U.S.C. §151

Co.,417 F.3d 727, 733 (7th Cir. 2005); ("[t]he district court ultimately dismissed this case because the forum selection clauses in the [contract] required arbitration in other districts... [w]e have held dismissal under these circumstances to be appropriate"); *Continental Insurance Company v. M/V Orsula*, 354 F.3d 603 (7th Cir. 2003)(same); *United States ex rel. Garst v. Lockheed-Martin Corporation*, 328 F.3d 374 (7th Cir. 2003), *cert. denied* 540 U.S. 968, 124 S.Ct. 450, 157 L.Ed.2d 313 (2003), *reh. denied* 540 U.S. 1097, 124 S.Ct. 975, 157 L.Ed.2d 809 (2003)(dismissal under Fed.R.Civ.P. 9(b) for failure to conform complaint to pleading rules affirmed).

Indeed, the United States Code makes clear that even cases filed without jurisdiction are dismissed. *See* 28 U.S.C. §1919 (governing the imposition of costs in district court cases "dismissed" for "want of jurisdiction"). *See also*, *Capitol Leasing Co. v. FDIC*, 999 F.2d 188 (7th Cir. 1994)(affirming Fed. R. Civ. P. 12(b)(1) dismissal of claims for lack of subject matter jurisdiction)*;* *Smith v. United States*, 196 F.3d 774 (7th Cir. 1999), *cert. denied* 529 U.S. 1068, 120 S.Ct. 1676, 146 L.Ed.2d 485 (2000)(same). Bankruptcy is no different. The filing of a petition commences a case. 11 U.S.C. §301. Every chapter of the Bankruptcy Code includes a separate section expressly providing for the "dismissal" of a debtor's case for "cause" when it is improper for the case to proceed. See 11 U.S.C. §707(a) (providing for "dismiss[al]" of a chapter 7 case for "cause"); see also 11 U.S.C. §1112(b) (providing for dismissal or conversion of a chapter 11 case for "cause"); see also 11 U.S.C. §1208 (providing for dismissal or conversion of a chapter 12 case for "cause"); see also 11 U.S.C. §1307(c) (providing for dismissal or conversion of a chapter 13 case for "cause").[12]

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[12] Each section contains a non-exclusive list of grounds for dismissal. The terms "includes" and " including" in those sections are not limiting. 11 U.S.C. § 102(3). *See In re C-TC 9th Avenue Partnership*, 113 F.3d 1304, 1311 (2d Cir. 1997); *In re Griffieth*, 209 B.R. 823, 827 (Bankr. N.D.N.Y. 1996; *In re Zick*, 931 F.2d 1124, 1126-1127 (6th Cir. 1991); *In re Prud'Homme*, 161 B.R. 747, 749 (Bankr. E.D.N.Y. 1993). *Cf. In re Eclair Bakery, Ltd.*, 255

In fact, prior to changes made by the BAPCPA, bankruptcy courts routinely dismissed cases where individuals were determined to be ineligible to be debtors by operation of 11 U.S.C. §109. The government has reviewed over 800 decisions entered prior to the enactment of the BAPCPA where eligibility under § 109 was at issue, and it is not aware of a single case or petition that was stricken as a method of disposing of the underlying case. Bankruptcy courts have consistently dismissed cases when individuals or entities were ineligible to be debtors. *See, e.g., In re Hubbard*, 333 B.R. 377, 388 (Bankr. S.D. Tex. 2005)(noting that "[t]his Court and others have generally 'dismissed' cases that were filed by ineligible debtors").

Historically, bankruptcy courts, like district courts, have dismissed cases for a variety of reasons, including jurisdictional defects and improper venue. *See* Fed. R. Bankr. P. 1014 (providing that cases filed in an improper district shall either be dismissed or transferred); see also 28 U.S.C. §1930(d)(providing that "[w]henever any case or proceeding is dismissed in any bankruptcy court for want of jurisdiction, such court may order the payment of just costs") (emphasis added).

Given this settled law, it is not surprising that the vast majority of courts have dismissed cases upon concluding the person seeking bankruptcy protection was ineligible to be a debtor under 11 U.S.C. §109(h). *See, e.g., Dixon v. LaBarge, Jr. (In re Dixon)*, 338 B.R. 383, 389 (8th Cir. B.A.P. 2006); *In re Afolabi*, 343 B.R.195, 200 (Bankr. S.D. Ind. 2006) ("The Court has no discretion but to dismiss a case when the debtor fails to file a certification in compliance with [§109(h)]"). In addition, most courts that have considered the issue have dismissed rather than struck cases in which individuals have been

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B.R. 121, 137 (Bankr. S.D.N.Y. 2000)(in context of motion for relief from stay, observing that each of Code sections 707(a), 1112(b), 1307(c) and 362(d)(1) states that the authority it provides--dismissal or relief from stay, respectively--may be granted for "cause," and lists one or more examples of cause, each precedes the list with the word "includes," and none of those lists is exhaustive).

ineligible to be debtors because they did not obtain credit counseling. *See In re Seaman*, 340 B.R. 698 (Bankr. E.D.N.Y. 2006); *In re Ross*, 338 B.R. 134 (Bankr. N.D. Ga. 2006); *In re Mills*, 341 B.R. 106 (Bankr. D. Colo. 2006); *In re Bell*, 2006 WL 1132907, slip op. (Bankr. D. Colo. 2006); *In re Taylor*, 2006 Bankr. LEXIS 689 (Bankr.N.D.Cal. 2006); *In re Racette*, 343 B.R. 200 (Bankr. E.D. Wis. 2006); *In re Tomco*, 339 B.R. 145 (Bankr. W.D. Pa. 2006); *In re Wilson*, No. 06-60870, 2006 WL 2055742 (Bankr. N.D.N.Y. 2006); *In re Westover*, No. 06-10183, 2006 WL 1982751, slip op. (Bankr. D. Vt. 2006); But see *In re Carey*, 341 B.R. 798 (Bankr. M.D. Fla. 2006); *In re Hubbard*, 333 B.R. 373 (Bankr. S.D. Tex. 2005); *In re Salazar*, 339 B.R. 622 (Bankr. S.D. Tex. 2006); *In re Rios*, 336 B.R. 177 (Bankr. S.D.N.Y. 2005); *In re Elmendorf*, 345 B.R.486 (Bankr. S.D. N.Y. 2006).

The bankruptcy court identified no provision of the Bankruptcy Code or other federal law that specifically allows courts to terminate federal bankruptcy cases by striking the pleading that commenced the case while leaving the underlying case in limbo. Nor can they, because no such provision exists.[13]

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[13] In addition, the only reference to the "striking" of any document in the Federal Rules of Bankruptcy Procedure is found in Fed. R. Bankr. P. 7012(b) and 9011. Rule 7012(b), incorporates by reference Fed. R. Civ. P. 12(e) and (f). Rule 12(e) allows a court to strike a pleading where there is a prior existing order to amend the pleading and the order has not been obeyed. Rule 12(f) allows for motions to strike in the context of adversary proceedings. According to this rule, such motions may be made by a party before responding to a pleading or by a court on its own initiative, and the court may "order stricken from any pleading any insufficient defense or any redundant, immaterial, impertinent, or scandalous matter." Fed. R. Civ. P. 12(f). Motions to strike, however, are not favored. *Salcer v. Envicon Equities Corp.*, 744 F.2d 935, 939 (2d Cir. 1984), *cert. granted and judgment remanded on other grounds*, 478 U.S. 1015 (1986); *FDIC v. Abel, et al.*, 1995 WL 716729 at * 12 (S.D.N.Y. 1995); *Brokke v. Stauffer Chem. Co.*, 703 F. Supp. 215, 223 (D. Conn. 1988). A motion to "strike" under Rule 12(f) also only pertains to the striking of material contained in a pleading. *In re Kershaw*, 59 B.R. 618, 620 (Bankr. D. Tenn. 1986). Moreover, such motions are not intended to raise substantial, disputed questions of law. *Mohegan Tribe v. Conn.*, 528 F. Supp. 1359, 1362 (D. Conn. 1982) ("The presence of a substantial or seriously disputed question of law will preclude a district court from granting a motion to strike."). Rule 9011 requires that papers filed in bankruptcy courts be signed by at least one attorney of record or by the party herself if she is unrepresented. Rule 9011(a) provides that "an unsigned paper shall be stricken unless omission of the signature is

As discussed above, improperly filed federal cases are dismissed, not stricken, and each chapter of the Bankruptcy Code contains a provision for dismissing - not striking - improperly filed cases.

2. Section 109 is Not a Jurisdictional Statute and Even if it Were, Cases Filed in Violation of Section 109 Would Need to be Dismissed Rather than Stricken.

Although the court below expressly held that it had jurisdiction, some bankruptcy courts have erroneously stricken cases because they believe (1) section 109(h) is a jurisdictional statute and (2) courts must strike petitions filed without jurisdiction under section 109. Both of these conclusions are wrong.

Supreme Court precedent makes clear that eligibility statutes like section 109 are not jurisdictional. Instead, jurisdictional provisions are those that actually define the jurisdiction of federal courts, most typically those set forth in title 28 of the United States code. Most recently in *Arbaugh v. Y & H Corp*.,--- U.S. ----, 126 S.Ct. 1235, 163 L.Ed.2d 1097 (Feb. 22, 2006), the Supreme Court ruled that eligibility provisions in federal statutes do not confer or contract subject-matter jurisdiction. In *Arbaugh*, the Supreme Court was asked to determine whether an employee-numerosity requirement in Title VII for establishing a defendant/restaurant's “employer” status was jurisdictional, or whether it was merely an element of a bartender/waitress's claim for relief under Title VII. *Id*. The Court held that the definition of an “employer” in the statute was an element of the plaintiff’s claim for relief, the satisfaction of which the defendant employer conceded when it failed to raise the issue prior to the trial on the merits. *Id*. at 1245. The Supreme Court declined to find that the defendant’s status as an “employer” was a jurisdictional requirement that could be questioned at any stage of litigation. *Id*. In making its determination, the Supreme Court noted that courts have an obligation to determine whether

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corrected promptly after being called to the attention of the attorney or party.” Fed. R. Bankr. P. 9011(a).

subject-matter jurisdiction exists, even in the absence of a challenge from any party. *Id*. It concluded that nothing in Title VII's text indicated that Congress intended courts, on their own motion, to assure that the employee-numerosity requirement is met. *Id*. at 1244.

In rendering its decision, the Supreme Court commented that courts have been imprecise regarding jurisdictional issues noting that "[s]ubject matter jurisdiction in federal-question cases is sometimes erroneously conflated with a plaintiff's need and ability to prove the defendant bound by the federal law asserted as the predicate for relief-a merits-related determination." *Id*. at 1242 (quoting 2 J. Moore et al., MOORE'S FEDERAL PRACTICE § 12.30[1], p. 12-36.1 (3d ed. 2005). In addition, in order to avoid the "'unfair[ness]" and 'waste of judicial resources. . . entailed in tying the employee-numerosity requirement to subject-matter jurisdiction," the Supreme Court advised courts to "to refrain from constricting § 1331 or Title VII's jurisdictional provision, 42 U.S.C. § 2000e-5(f)(3), and to leave the ball in Congress' court." *Arbaugh*, 126 S.Ct. at 1245. It noted that Congress is free to instruct that certain elements of a claim for relief "shall count as jurisdictional, ... [b]ut when Congress does not rank a statutory limitation on coverage as jurisdictional, courts should treat the restriction as nonjurisdictional in character." *Id*.

Nothing under Title 11 indicates that Congress intended courts, on their own motion, to assure that the debtor eligibility provisions are satisfied. In addition, 28 U.S.C. §§1334 and 157 are the jurisdictional statutes that confer bankruptcy jurisdiction. *See, e.g., Rudd v. Laughlin,* 866 F.2d 1040, 1041 (8th Cir. 1989); *Promenade Nat'l Bank v. Phillips (In re Phillips),* 844 F.2d 230, 235-36 n.2 (5th Cir. 1988); *In re Republic Trust & Savings Co.,* 59 B.R. 606, 609 (N.D. Okla. 1986). Section 109 does not speak in jurisdictional terms, and does not refer in any way to the jurisdiction of the bankruptcy courts. *Arbaugh,* 126 S.Ct. at 1245. Therefore, the Thompsons commenced a case under the

Bankruptcy Code despite the fact that they were ineligible to be debtors, and the bankruptcy court possessed the jurisdiction to dispose of the case under the Bankruptcy Code.

3. Other Federal Statutes Make Clear that the Thompsons Filed a Bankruptcy Case, and Everything That Happened in Their Case Underscores That Fact.

Other federal statutes and the administration of the Thompsons' case make clear they had a bankruptcy case that needed to be dismissed. Among other things, (i) a "case" number was assigned to their case, (ii) the bankruptcy court accepted a filing fee under 28 U.S.C. §1930(a),[14] and (iii) the automatic stay went into effect.[15] Each of these actions underscores the obvious fact that the Thompsons' decision to file a bankruptcy petition commenced a bankruptcy case.

4. Striking Petitions Creates Substantial Uncertainty under the Bankruptcy Code That Is Harmful to Debtors and Creditors Alike, and Creates Confusion Regarding the Rights of Interested Parties.

The Bankruptcy Code dedicates an entire section of the Code, 11 U.S.C. §349, to explaining the effect of a dismissed case on the rights of the various parties to a bankruptcy proceeding. *See* 11 U.S.C. §349. Section 349 provides, among other things, that: (i) dismissal of a bankruptcy case reinstates any proceeding or custodianship superseded under section 521; (ii) dismissal vacates any order under sections 522(i)(1), 542, 550, or 553, and (iii) dismissal revests the property of the estate in the entity in which such property was vested immediately before commencement of the case. 11 U.S.C. §349. Therefore, terminating a case through striking rather than dismissal will engender substantial confusion

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[14] Under 28 U.S.C. §1930(a), "parties commencing a case under title 11" are required to pay the clerk of the bankruptcy court a fee for a case commenced under chapter 7 or 13 of the Bankruptcy Code. 28 U.S.C. 1930(a). The bankruptcy court collected a filing fee of $189.00 from the Thompsons when they commenced their case. *See* Unnumbered docket entry dated 03/15/2006.

[15] *See* 11 U.S.C. §362(a) (stating that a petition filed under section 301, 302, or 303 of title 11 operates as a stay of various debt collection and enforcement actions).

and potential prejudice because there are no corresponding instructions in the Code or elsewhere regarding the impact of striking a petition.[16]

Furthermore, the bankruptcy court's construction of 11 U.S.C. § 301 is wholly unworkable. The bankruptcy court found that a "'case' has not 'commenced' until it is determined that the debtor filing the petition is eligible for bankruptcy relief under § 109(h)." (D. at 17, Order at p. 13). Applying this construction of § 301 to the other debtor eligibility provisions of § 109 underscores the error of the court's logic. For example, section 109(e) conditions chapter 13 eligibility on debt and income thresholds. Whether a debtor satisfies those thresholds will not be apparent in all cases. A debtor could conduct a case for weeks or months until it is determined whether the debtor is eligible to be a debtor. Under the bankruptcy court's logic, no case would have existed even though litigation would have proceeded for months. That is an impossible construction of section 301 and is wholly foreign to the way it has been applied and the way courts have consistently dealt with improperly filed cases – both in bankruptcy and outside.

Nor does the text of section 301 mandate the result the lower court suggests. All section 301 does is define when a case is a proper one - when it is filed by an eligible debtor. But the Thompsons, like many other ineligible debtors, filed a case that was docketed as a case, and was treated as such - including by the court below.[17] Nothing in the text of section 301 prohibits dismissal of such improperly

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[16] In addition, striking a case, rather than dismissing creates substantial uncertainty about the rights and obligations of debtors and creditors in stricken cases. *See, e.g., In re Ross*, 338 B.R. 134, 139 (Bankr. N.D. Ga. 2006)(explaining that striking cases could have an unintended result of harming debtors who have had their homes foreclosed due to the absence of the stay in a voided case).

[17] On March 17, 2006, for example, the bankruptcy court sent the Thompsons a deficiency notice telling them they had failed to sign their bankruptcy petition, and it noted that if the deficiency was not remedied by March 29, 2006, the Thompsons' "Bankruptcy case [would] be

filed cases. To the contrary, section 301 says absolutely nothing about how cases filed by ineligible debtors should be terminated. As we explain above, we have reviewed hundreds of such cases, and bankruptcy courts dismissed them all. That bankruptcy court practice is wholly consistent with the way all other improperly filed cases are terminated in the federal system, through dismissal. Given that section 301 says nothing about how improperly filed cases should be terminated, it cannot fairly be read as prohibiting dismissal.

5. Striking Petitions Circumvents Statutory Restrictions Upon Debtors Who Have Previously Had a Bankruptcy Case Dismissed.

Congress amended the automatic stay provisions of section 362 of the Bankruptcy Code in 2005 in order to limit a debtor’s right to operate under the automatic stay when the debtor has previously had a case "dismissed" by a bankruptcy court. 11 U.S.C. §362(c)(3) (imposing these new restrictions in cases succeeding previously "dismissed" cases). Congress did so because it concluded it was unfair to allow debtors to file multiple bankruptcy cases and automatically reap the substantial benefits of the automatic stay of creditor actions in each case. *See* H.R. Rep. No. 109-31, pt. 1, at 2 (2005), U.S. Code Cong. & Admin. News 2005, pp. 88, 89 (setting forth Congress’ conclusions on this point).

Section 362(c)(3) provides that where a debtor has had a prior case "dismissed" within the preceding one-year period, the automatic stay in the next case shall terminate automatically on the thirtieth day after the filing of that case unless a debtor is able to establish by motion that the later case is in good faith as to the creditors to be stayed. See 11 U.S.C. §362(c)(3).

By striking rather than dismissing the Thompsons’ case, the order entered below risks

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dismissed immediately without further notice at the expiration of the due date . . ." (D. at 4). By sending its deficiency notice, the bankruptcy court correctly recognized that a case existed despite deficiencies in the petition and that the appropriate disposition of that case required its dismissal.

circumventing section 362(c)(3)'s new limitation by disposing of a case without "dismissing" it. Some courts have concluded that striking a case rather than dismissing it - the term employed in section 362(c)(3) - frees debtors from section 362(c)(3)'s restrictions upon the use of the automatic stay in a subsequent case. In the government's view, it is not appropriate to vitiate Congress' mandate in section 362(c)(3) by refusing to dismiss cases filed in violation of section 109. For the Bankruptcy System to function optimally, creditors and debtors alike must have faith that time-honored procedures - like dismissing improperly filed cases - will be neutrally applied in all cases. Conversely, faith in the Bankruptcy System will diminish were parties in interest to conclude that neutral bankruptcy rules were being ignored simply to evade policy dictates mandated by Congress that a particular court might deem unwise.

That is not to say the Thompsons cannot take full advantage of the automatic stay in a subsequent bankruptcy case. To the contrary, section 362 allows debtors to obtain the full benefit of the stay in a subsequent case if they prove their first case was filed in "good faith." *See* §362(c)(3) (allowing a debtor to obtain the full benefit of the stay if the debtor establishes the first case was filed in "good faith"). *See also In re Seaman,* 340 B.R. 698, 706 (Bankr. E.D.N.Y. 2006) (discussing this point). As some courts have stated, "a dismissal under Section 109(h) . . . does not appear to establish any lack of good faith." *Id. See also In re Carr,* 344 B.R. 776 (Bankr. N.D.W.Va. 2006) (concluding a debtor's second filed bankruptcy case was in good faith so as to warrant extension of the automatic stay beyond 30 days as provided in section 362(c)(3)). Under those courts' rationale, the Thompsons might well be able to take full advantage of the automatic stay notwithstanding the dismissal of their prior cases if they can demonstrate good faith to the court. If they are unable to demonstrate such good faith, then the absence of a stay in the subsequent case is appropriate. At a minimum, the necessity under section

362(c)(3) of filing a motion to extend the stay in a second case is the procedure Congress mandated. This carefully conceived balance should not be vitiated by striking rather than dismissing bankruptcy cases.

CONCLUSION

For these reasons, the United States Trustee respectfully asks this Court to reverse the order entered below and remand this case with instructions to the bankruptcy court to enter an order dismissing the Thompsons' bankruptcy case.

Respectfully submitted,

NANCY J. GARGULA
UNITED STATES TRUSTEE

BY: /s/ BETH KRAMER
Beth Kramer
Trial Attorney

Office of United States Trustee
101 West Ohio Street, Suite 1000
Indianapolis, IN 46204
TEL: (317) 226-6101
FAX: (317) 226-6356

CERTIFICATE OF SERVICE

I certify that a copy of the foregoing has been sent by first class United States mail, or through the Clerk's electronic noticing system, this 31st day of August, 2006, to the following:

Gregory Arlen Thompson
Suzanne Annette Thompson
5746 N. S.R. 39
Lizton, IN 46149

By: /s/ BETH KRAMER
Beth Kramer

ADDENDUM

11 U.S.C. §109 – Who may be a debtor

(a) Notwithstanding any other provision of this section, only a person that resides or has a domicile, a place of business, or property in the United States, or a municipality, may be a debtor under this title.

(b) A person may be a debtor under chapter 7 of this title only if such person is not--

(1) a railroad;

(2) a domestic insurance company, bank, savings bank, cooperative bank, savings and loan association, building and loan association, homestead association, a New Markets Venture Capital company as defined in section 351 of the Small Business Investment Act of 1958, a small business investment company licensed by the Small Business Administration under section 301 of the Small Business Investment Act of 1958, credit union, or industrial bank or similar institution which is an insured bank as defined in section 3(h) of the Federal Deposit Insurance Act, except that an uninsured State member bank, or a corporation organized under section 25A of the Federal Reserve Act, which operates, or operates as, a multilateral clearing organization pursuant to section 409 of the Federal Deposit Insurance Corporation Improvement Act of 1991 may be a debtor if a petition is filed at the direction of the Board of Governors of the Federal Reserve System; or

(3)(A) a foreign insurance company, engaged in such business in the United States; or

(B) a foreign bank, savings bank, cooperative bank, savings and loan association, building and loan association, or credit union, that has a branch or agency (as defined in section 1(b) of the International Banking Act of 1978 in the United States.

(c) An entity may be a debtor under chapter 9 of this title if and only if such entity--

(1) is a municipality;

(2) is specifically authorized, in its capacity as a municipality or by name, to be a debtor under such chapter by State law, or by a governmental officer or organization empowered by State law to authorize such entity to be a debtor under such chapter;

(3) is insolvent;

(4) desires to effect a plan to adjust such debts; and

(5)(A) has obtained the agreement of creditors holding at least a majority in amount of the claims of each class that such entity intends to impair under a plan in a case under such chapter;

(B) has negotiated in good faith with creditors and has failed to obtain the agreement of creditors holding at least a majority in amount of the claims of each class that such entity intends to impair under a plan in a case under such chapter;

(C) is unable to negotiate with creditors because such negotiation is impracticable; or

(D) reasonably believes that a creditor may attempt to obtain a transfer that is avoidable under section 547 of this title.

(d) Only a railroad, a person that may be a debtor under chapter 7 of this title (except a stockbroker or a commodity broker), and an uninsured State member bank, or a corporation organized under section 25A of the Federal Reserve Act, which operates, or operates as, a multilateral clearing organization pursuant to section 409 of the Federal Deposit Insurance Corporation Improvement Act of 1991 may be a debtor under chapter 11 of this title.

(e) Only an individual with regular income that owes, on the date of the filing of the petition, noncontingent, liquidated, unsecured debts of less than $307,675 [FN1] and noncontingent, liquidated, secured debts of less than $922,975 [FN1], or an individual with regular income and such individual's spouse, except a stockbroker or a commodity broker, that owe, on the date of the filing of the petition, noncontingent, liquidated, unsecured debts that aggregate less than $307,675 [FN1] and noncontingent, liquidated, secured debts of less than $922,975 [FN1] may be a debtor under chapter 13 of this title.

(f) Only a family farmer or family fisherman with regular annual income may be a debtor under chapter 12 of this title.

(g) Notwithstanding any other provision of this section, no individual or family farmer may be a debtor under this title who has been a debtor in a case pending under this title at any time in the preceding 180 days if--

(1) the case was dismissed by the court for willful failure of the debtor to abide by orders of the court, or to appear before the court in proper prosecution of the case; or

(2) the debtor requested and obtained the voluntary dismissal of the case following the filing of a request for relief from the automatic stay provided by section 362 of this title.

(h)(1) Subject to paragraphs (2) and (3), and notwithstanding any other provision of this section, an individual may not be a debtor under this title unless such individual has, during the 180-day period preceding the date of filing of the petition by such individual, received from an approved nonprofit budget and credit counseling agency described in section 111(a) an individual or group briefing (including a briefing conducted by telephone or on the Internet) that outlined the opportunities for available credit counseling and assisted such individual in performing a related budget analysis.

(2)(A) Paragraph (1) shall not apply with respect to a debtor who resides in a district for which the United States trustee (or the bankruptcy administrator, if any) determines that the approved nonprofit budget and credit counseling agencies for such district are not reasonably able to provide adequate services to the additional individuals who would otherwise seek credit counseling from such agencies by reason of the requirements of paragraph (1).

(B) The United States trustee (or the bankruptcy administrator, if any) who makes a determination described in subparagraph (A) shall review such determination not later than 1 year after the date of such determination, and not less frequently than annually thereafter. Notwithstanding the preceding sentence, a nonprofit budget and credit counseling agency may be disapproved by the United States trustee (or the bankruptcy administrator, if any) at any time.

(3)(A) Subject to subparagraph (B), the requirements of paragraph (1) shall not apply with respect to a debtor who submits to the court a certification that--

(i) describes exigent circumstances that merit a waiver of the requirements of paragraph (1);

(ii) states that the debtor requested credit counseling services from an approved nonprofit budget and credit counseling agency, but was unable to obtain the services referred to in paragraph (1) during the 5-day period beginning on the date on which the debtor made that request; and

(iii) is satisfactory to the court.

(B) With respect to a debtor, an exemption under subparagraph (A) shall cease to apply to that debtor on the date on which the debtor meets the requirements of paragraph (1), but in no case may the exemption apply to that debtor after the date that is 30 days after the debtor files a petition, except that the court, for cause, may order an additional 15 days.

(4) The requirements of paragraph (1) shall not apply with respect to a debtor whom the court determines, after notice and hearing, is unable to complete those requirements because of incapacity, disability, or active military duty in a military combat zone. For the purposes of this paragraph, incapacity means that the debtor is impaired by reason of mental illness or mental deficiency so that he is incapable of realizing and making rational decisions with respect to his financial responsibilities; and "disability" means that the debtor is so physically impaired as to be unable, after reasonable effort, to participate in an in person, telephone, or Internet briefing required under paragraph (1).

11 U.S.C. §301 – Voluntary cases

(a) A voluntary case under a chapter of this title is commenced by the filing with the bankruptcy court of a petition under such chapter by an entity that may be a debtor under such chapter.

(b) The commencement of a voluntary case under a chapter of this title constitutes an order for relief under such chapter.

11 U.S.C. §707(a) – Dismissal of a case or conversion to a case under chapter 11 or 13

(a) The court may dismiss a case under this chapter only after notice and a hearing and only for cause, including--

(1) unreasonable delay by the debtor that is prejudicial to creditors;

(2) nonpayment of any fees or charges required under chapter 123 of title 28; and

(3) failure of the debtor in a voluntary case to file, within fifteen days or such additional time as the court may allow after the filing of the petition commencing such case, the information required by paragraph (1) of section 521, but only on a motion by the United States trustee.

11 U.S.C. §1307(c) - Dismissal or Conversion.

(c) Except as provided in subsection (e) of this section, on request of a party in interest or the United States trustee and after notice and a hearing, the court may convert a case under this chapter to a case under chapter 7 of this title, or may dismiss a case under this chapter, whichever is in the best interests of creditors and the estate, for cause, including--

(1) unreasonable delay by the debtor that is prejudicial to creditors;

(2) nonpayment of any fees and charges required under chapter 123 of title 28;

(3) failure to file a plan timely under section 1321 of this title;

(4) failure to commence making timely payments under section 1326 of this title;

(5) denial of confirmation of a plan under section 1325 of this title and denial of a request made for additional time for filing another plan or a modification of a plan;

(6) material default by the debtor with respect to a term of a confirmed plan;

(7) revocation of the order of confirmation under section 1330 of this title, and denial of confirmation of

a modified plan under section 1329 of this title;

(8) termination of a confirmed plan by reason of the occurrence of a condition specified in the plan other than completion of payments under the plan;

(9) only on request of the United States trustee, failure of the debtor to file, within fifteen days, or such additional time as the court may allow, after the filing of the petition commencing such case, the information required by paragraph (1) of section 521;

(10) only on request of the United States trustee, failure to timely file the information required by paragraph (2) of section 521; or

(11) failure of the debtor to pay any domestic support obligation that first becomes payable after the date of the filing of the petition.

28 U.S.C. §157 – Procedures

(a) Each district court may provide that any or all cases under title 11 and any or all proceedings arising under title 11 or arising in or related to a case under title 11 shall be referred to the bankruptcy judges for the district.

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

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

(A) matters concerning the administration of the estate;

(B) allowance or disallowance of claims against the estate or exemptions from property of the estate, and estimation of claims or interests for the purposes of confirming a plan under chapter 11, 12, or 13 of title 11 but not the liquidation or estimation of contingent or unliquidated personal injury tort or wrongful death claims against the estate for purposes of distribution in a case under title 11;

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

(D) orders in respect to obtaining credit;

(E) orders to turn over property of the estate;

(F) proceedings to determine, avoid, or recover preferences;

(G) motions to terminate, annul, or modify the automatic stay;

(H) proceedings to determine, avoid, or recover fraudulent conveyances;

(I) determinations as to the dischargeability of particular debts;

(J) objections to discharges;

(K) determinations of the validity, extent, or priority of liens;

(L) confirmations of plans;

(M) orders approving the use or lease of property, including the use of cash collateral;

(N) orders approving the sale of property other than property resulting from claims brought by the estate against persons who have not filed claims against the estate;

(O) other proceedings affecting the liquidation of the assets of the estate or the adjustment of the debtor-creditor or the equity security holder relationship, except personal injury tort or wrongful death claims; and

(P) recognition of foreign proceedings and other matters under chapter 15 of title 11.

(3) The bankruptcy judge shall determine, on the judge's own motion or on timely motion of a party, whether a proceeding is a core proceeding under this subsection or is a proceeding that is otherwise related to a case under title 11. A determination that a proceeding is not a core proceeding shall not be made solely on the basis that its resolution may be affected by State law.

(4) Non-core proceedings under section 157(b)(2)(B) of title 28, United States Code, shall not be subject to the mandatory abstention provisions of section 1334(c)(2).

(5) The district court shall order that personal injury tort and wrongful death claims shall be tried in the district court in which the bankruptcy case is pending, or in the district court in the district in which the claim arose, as determined by the district court in which the bankruptcy case is pending.

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

(2) Notwithstanding the provisions of paragraph (1) of this subsection, the district court, with the consent of all the parties to the proceeding, may refer a proceeding related to a case under title 11 to a bankruptcy judge to hear and determine and to enter appropriate orders and judgments, subject to review under section 158 of this title.

(d) The district court may withdraw, in whole or in part, any case or proceeding referred under this section, on its own motion or on timely motion of any party, for cause shown. The district court shall, on timely motion of a party, so withdraw a proceeding if the court determines that resolution of the proceeding requires consideration of both title 11 and other laws of the United States regulating organizations or activities affecting interstate commerce.

(e) If the right to a jury trial applies in a proceeding that may be heard under this section by a bankruptcy judge, the bankruptcy judge may conduct the jury trial if specially designated to exercise such jurisdiction by the district court and with the express consent of all the parties.

28 U.S.C. §1334 – Bankruptcy cases and proceedings

(a) Except as provided in subsection (b) of this section, the district courts shall have original and exclusive jurisdiction of all cases under title 11.

(b) Except as provided in subsection (e)(2), and notwithstanding any Act of Congress that confers exclusive jurisdiction on a court or courts other than the district courts, the district courts shall have original but not exclusive jurisdiction of all civil proceedings arising under title 11, or arising in or related to cases under title 11.

(c)(1) Except with respect to a case under chapter 15 of title 11, nothing in this section prevents a district court in the interest of justice, or in the interest of comity with State courts or respect for State law, from abstaining from hearing a particular proceeding arising under title 11 or arising in or related to a case under title 11.

(2) Upon timely motion of a party in a proceeding based upon a State law claim or State law cause of action, related to a case under title 11 but not arising under title 11 or arising in a case under title 11, with respect to which an action could not have been commenced in a court of the United States absent jurisdiction under this section, the district court shall abstain from hearing such proceeding if an action is commenced, and can be timely adjudicated, in a State forum of appropriate jurisdiction.

(d) Any decision to abstain or not to abstain made under subsection (c) (other than a decision not to abstain in a proceeding described in subsection (c)(2)) is not reviewable by appeal or otherwise by the court of appeals under section 158(d), 1291, or 1292 of this title or by the Supreme Court of the United States under section 1254 of this title. Subsection (c) and this subsection shall not be construed to limit the applicability of the stay provided for by section 362 of title 11, United States Code, as such section applies to an action affecting the property of the estate in bankruptcy.

(e) The district court in which a case under title 11 is commenced or is pending shall have exclusive jurisdiction--

(1) of all the property, wherever located, of the debtor as of the commencement of such case, and of property of the estate; and

(2) over all claims or causes of action that involve construction of section 327 of title 11, United States Code, or rules relating to disclosure requirements under section 327.

BRIEF BANK — 'SUMMARY SHEET" *Printed Fri-3/23/07 10:55*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	In re: Thompson (Eisen v. Thompson)
2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	N.D. Ohio
3. ("CCN") ***CURRENT*** CASE NO.	No.: 1:06-cv-02843
4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*	No.: 06-10024 Court: (Bankr. N.D. Ohio) *(Identify judge & cite, if any)*
5. ("SO") ***SOURCE***	**U.S. TRUSTEES**
6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	Filed: March 22. 2007 Type: REPLY BRIEF OF THE APPELLANT SAUL EISEN UNITED STATES TRUSTEE
7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*	Dean Wyman; David Levine; P. Matthew Sutko *(UST/OGC: 202-307-1399/FAX-2397)*
8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") ● ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	● Whether debtor's may deduct 401(k) loan payment under 11U.S.C. §707 (b)(2)'s means test? √ **Background:**
10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)	
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IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

In re GREGORY B. THOMPSON and
PATRICIA A. THOMPSON,
Civil No. 1:06-cv-02843
Judge Dan Aaron Polster

SAUL EISEN
United States Trustee, Region 9

Appellant

v.

GREGORY B. THOMPSON and,
PATRICIA A. THOMPSON

Appellees

On Appeal from the United States Bankruptcy Court
for the Northern District of Ohio
Eastern Division

REPLY BRIEF OF THE APPELLANT SAUL EISEN UNITED STATES TRUSTEE

SAUL EISEN
UNITED STATES TRUSTEE
REGION 9

Dean P. Wyman
Senior Trial Attorney
Department of Justice
Office of the U.S. Trustee
Howard M. Metzenbaum U.S. Courthouse
201 Superior Ave. , Suite 441
Cleveland, Ohio 44114

(216) 522-7800 ext. 231
(216) 522-7193 Fax

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I. Introduction

A. This appeal merits adjudication because it presents a pure question of law, one that will determine whether the Thompsons' chapter 7 case must be presumed abusive as a matter of federal law - an issue that recurs every time a chapter 7 debtor contends a 401(k) loan payment alters the Congressionally mandated Means Test analysis that United States Trustees are statutorily obligated to perform in every chapter 7 case.

This Court contacted the parties to this appeal on February 16, 2007, to ask them to participate in a telephonic conference later that day. At that conference, this Court posed two questions to counsel for the United States Trustee[1]: **(1)** whether the United States Trustee still wishes to proceed with the appeal in light of this Court's expressed view that this case might not constitute a good test case to determine the question of law presented by this appeal - whether debtors may deduct 401(k) loan repayments under 11 U.S.C. § 707(b)(2)'s means test, and **(2)** whether the United States Trustee deems that question of law to be one of national importance.[2]

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[1] United States Trustees are senior officials of the Department of Justice appointed by the Attorney General of the United States. 28 U.S.C. § 581. Each United States Trustee "supervise[s] the administration of [bankruptcy] cases and trustees" within his or her geographic region. 28 U.S.C. §581 - 589. *See generally Morgenstern v. Revco D.S. Inc. (In re Revco D.S., Inc.),* 898 F.2d 498, 500 (6th Cir 1990).

[2] This Court entered a minute entry after the hearing, which states:

> Minutes of proceedings [non-document]. Telephone Conference held on 2/16/07 before Judge Dan Aaron Polster. The Court held a teleconference with counsel in this case on February 16, 2007. The Trustee has agreed to take a fresh look at this case and if it still wishes to proceed with the appeal, to file a reply brief addressing not only the issues raised in the debtors' response brief, but also why this case, which presents only a theoretical possibility of paying creditors back beginning in 2009, is of national importance (i.e., it involves a new federal bankruptcy statute about which cases are arising daily across this country). The Trustee's new deadline for filing its reply brief is March 22, 2007, and the Debtor's shall file a surreply brief no later than April 23, 1007. (P,R) Modified text of docket entry on 2/21/2007 (B, B).

See Docket entry dated February 16, 2007, as modified on February 21, 2007.

The United States Trustee Program brought this appeal because prompt resolution of this recurring legal issue will benefit debtors, creditors, the Program, and the lower courts. This issue merits prompt resolution because The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 requires United States Trustees to conduct a means test analysis for every chapter 7 debtor.

In this case, the United States Trustee and the Thompsons disagree how the United States Trustee and the bankruptcy court should account for a 401(k) loan repayment when calculating the Thompsons' means test. Just like this United States Trustee, each of the nation's twenty-one United States Trustees must factor in 401(k) loan repayments when performing the means test calculations Congress requires them to perform in every chapter 7 case. How United States Trustees should account for those loan repayments in their means test calculations is a recurring issue because debtors often borrow from 401(k) plans prior to entering bankruptcy. *Cf.* Bill Lubinger, *Try to Avoid Retirement Plan Loans, Clev. Plain Dealer*, July 11, 2004 at G3 (noting that almost a quarter of 401(k) plan participants borrowed from their 401(k) loans in 2002, at an average amount of $6,765 per borrower). The published decision entered below squarely addresses this pure question of law. Bankruptcy courts in the Southern District of Ohio, the Western District of Texas, and the Central District of California have acknowledged that decision in addressing this same legal issue.

The court below presumably published its decision in recognition that this is a recurring issue of some significance. And that is so. In the 2005 Abuse Prevention Act, Congress created a new statutory presumption of abuse in chapter 7 cases. 11 U.S.C. § 707(b)(2). Congress statutorily mandated that a presumption of abuse arises whenever chapter 7 debtors can repay as little as $167 a month, or $10,000 over five years, as that number is calculated under the means test. 11 U.S.C. § 707(b)(2)(A)(2). Congress thus mandated as a matter of federal law that debtors shall not receive chapter 7 relief whenever they can pay as little as $10,000 over 60 months - as that number is determined under its means test.[3]

Congress went further in the Abuse Prevention Act. It also required every United States Trustee to file a motion to dismiss every chapter 7 case in which the means test yields a calculation that specifies debtors can pay as little as $10,000 over five years. 11 U.S.C. § 704(b)(2).[4] This United States Trustee would violate that statutory charge if he did not determine whether the Thompsons' monthly disposable income is more than $167 under the means test, or if he were to fail to move dismiss their case once he concludes it exceeds $167.

The United States Trustee conducted a means testing analysis in the Thompsons' case. Under his understanding of the law, the Thompsons' means test establishes they can pay roughly $26,760, Open. br. at 10, more than double what Congress decreed mandates dismissal of their case absent special circumstances they have not proven.

The Thompsons and the court below disagreed with the United States Trustee's means test calculation. In their view, the Thompsons' 401(k) loan repayment obligation constitutes a secured debt that increases the Thompsons' expenses and allows them to pass the means test.

The impact of the parties' disagreement is profound - if the United States Trustee is correct, the Thompsons' chapter 7 case is abusive as a matter of federal law and this United States Trustee has a statutory obligation to move to dismiss it. If the Thompsons are right, they will be able to discharge all their debts in chapter 7 rather than allowing their creditors to pursue payment outside

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[3] Absent the debtor establishing special circumstances.

[4] Unless the debtor convinces the United States Trustee that the filing of a motion to dismiss is not appropriate, something that did not happen in this case. 11 U.S.C. § 704(b)(2).

bankruptcy or through a chapter 13 repayment plan.

The significance of the United States Trustee's statutory responsibility to seek dismissal of cases deemed abusive under the means test takes sharp focus when one reflects that more than 833,000 chapter 7 bankruptcy cases were filed in 2006. *Marrama v. Citizens Bank of Massachusetts*, 127 S.Ct. 1105, 1111, n. 10 (2007). In each such chapter 7 case, the Bankruptcy Code specifically requires the United States Trustee to review all materials filed in every non-business chapter 7 case to determine whether a presumption of abuse arises under section 707(b)(2)'s means test.

The United States Trustee presses this appeal based upon a studied legal conclusion - firmly grounded in the Code's text and Sixth Circuit decisions analyzing secured debt - that 401(k) loan repayments are not secured debt and therefore cannot alter the formula specified in the Abuse Prevention Act's section 707(b)(2) means test.

Given the United States' views in this regard, it is important that this legal question be resolved by the courts as quickly as possible. Expeditiously removing doubt about the status of section 401(k) loan repayments is fair to United States Trustees and debtors alike - and to creditors and bankruptcy courts as well. Because the pure question of law presented by this appeal must be applied neutrally across a wide spectrum of debtors in many different financial circumstances, it is appropriate to address the issue on its merits, not with reference to the circumstances of any specific set of debtors, and to do so as quickly as possible. This appeal helps accomplish those goals.

Finally, this Court questioned at the telephonic hearing whether a presumption under

Congress' means test that these debtors can pay $21,000 is a meaningful number.[5] Congress foreclosed that inquiry by enacting section 704(b)(2), which mandates that an ability to repay $167 or more per month - $10,000 in total - creates a presumption of abuse, and by requiring the United States Trustee to move to dismiss these debtors' chapter 7 case because their means test yields a number more than double that. Thus, under federal law, a $21,000 repayment figure is not merely legally significant, it creates a statutory presumption in favor of dismissal.[6]

B. Background

The United States Trustee's opening brief established that the bankruptcy court erred when it ruled that 11 U.S.C. § 707(b)(2)(A)(iii) permits debtors to deduct retirement loan repayments, and that the debtors therefore passed section 707(b)(2)'s means test. The debtors have proffered a variety of arguments to support the bankruptcy court's ruling. In the end, however, they critically fail to explain how money a debtor borrows from his own retirement account can ever be a "debt"

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[5] The means test figure calculated by the United States Trustee resulted precisely in a sixty month repayment figure of $26,764.20 ($446.07 per month times 60 months). See Open. br. at 10.

[6] In chapter 7 cases, $21,000 is actually a large number. Under pre-Abuse Prevention Act law, approximately 96% of chapter 7 cases produced no recovery for creditors. *Brief of Respondent in Lamie v. United States Trustee*, 2003 WL 21839367 at 38 ("The data that the United States Trustees maintain on chapter 7 cases in the regions they supervise reveal that 96% of chapter 7 cases closed during 2002, i.e., 1,001,697 of the 1,041,065 chapter 7 cases, had no assets in the estate to pay anything to counsel (or creditors for that matter)."). Nor has the Supreme Court declined to grant certiorari to decide a recurring bankruptcy issue because the amount at issue was small. In *Lamie v. United States Trustee*, 540 U.S. 526 (2004), for example, the Supreme Court granted certiorari to decide a recurring question of law under chapter 7 even though the amount at issue was $1,000. *See Brief of Respondent in Lamie v. United States Trustee*, 2003 WL 21839367 at 3 ("The United States Trustee objected to the application to the extent that it requested $1000 in compensation for services rendered after the case was converted to a chapter 7 proceeding."). *See also Jenkins v. United States Trustee (In re Boldt)*, 130 F.3d 1335, 1337 (9th Cir. 1997) (United States court of appeals deems it appropriate to issue a precedential decision to adjudicate an issue under chapter 7 that arose from a $353.50 dispute).

– much less a secured debt owed to a secured creditor – within the meaning of the Bankruptcy Code. The unavoidable fact is that section 707(b)(2)(A)(iii) only allows a deduction under the means test for payments on account of "debts" that are "secured," calculated with reference to amounts due to "secured creditors." Mr. Thompson's retirement plan loan repayments do not qualify under section 707(b)(2)(A)(iii) for at least three reasons.

First, retirement loans are not "debts" under 11 U.S.C. § 101(12) of the Bankruptcy Code because no debtor-creditor relationship exists between the debtors and their retirement plan administrator. Second, retirement loans are not "secured" obligations owed to a "secured creditor" under the Bankruptcy Code because Mr. Thompson's interest in his retirement account was never property of the debtors' bankruptcy estate. Third, allowing debtors to claim retirement loan repayments under the means test would contravene the public policy objectives of bankruptcy reform legislation – to require debtors to repay their debts when they can.

Alternatively, debtors incorrectly assert that if Mr. Thompson's 401(k) loan repayments are not "debts" under the Bankruptcy Code, they are nevertheless allowed under the means test as involuntary deductions within the Internal Revenue Service's categories of "other necessary expenses" under section 707(b)(2)(A)(ii)(I). To the contrary, 401(k) loan repayments are not "involuntary deductions" because they are not a requirement of Mr. Thompson's employment.

Without the deduction for retirement plan loan repayments, the parties agree that the statutory presumption of abuse arises in this case. The debtors can only rebut this presumption by establishing "special circumstances" as defined in 11 U.S.C. § 707(b)(2)(B). As the United States Trustee established in his opening brief, the bankruptcy court erred by holding these debtors established special circumstances to rebut their failure to pass the means test because their 401(k) loan repayment is not a special circumstance for which there is no reasonable alternative. 11 U.S.C. § 707(b)(2)(B).

II. Section 707(b)(2)(A)(iii) does not permit debtors to deduct retirement account loan repayments.

A. Debtors have not established that amounts borrowed from Mr. Thompson's own retirement accounts qualifies as a "debt" under the Bankruptcy Code.

In our opening brief, we established that a debtor's retirement loan is not a "debt" under the Bankruptcy Code – a conclusion the Second Circuit has reached, and which the Sixth Circuit has followed. *In re Mullen,* 696 F.2d 470 (6thCir. 1983); *In re Villarie,* 648 F.2d 810 (2d Cir. 1981). In response, the debtors ask this Court to split with the Second and Sixth Circuits by ruling that retirement loans are debts under the Code. They do so under a misplaced theory that the Abuse Prevention Act's amendments to sections 362(b)(19) and 523(a)(18) of the Bankruptcy Code somehow expand the Code's definition of "debts" to include 401(k) loan repayments. Debtors' Brief at 10.

These statutes, however, are irrelevant. Neither purports to expand or alter the definition of "debt" under 11 U.S.C. § 101(12). Instead, they reflect a "functional approach" that does not resolve the question of whether retirement loans are "debts" under the Code. 4 Collier on Bankruptcy ¶ 523.24A (15th ed. Rev. 2006). The first, section 362(b)(19), simply provides that withholding from a debtor's wages for retirement loan repayments is not subject to the automatic stay of actions that arises when a bankruptcy case is filed.[7] *Id.* Likewise, if a debtor's retirement loan is a debt, the second, section 523(a)(18), merely provides that it cannot be discharged in bankruptcy. *Id.*

Debtors also misstate the holdings of two pre-Abuse Prevention Act cases, *In re*

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[7] *See* 11 U.S.C. § 362(a).

Harshbarger, 66 F.3d 775 (6th Cir. 1995) and *In re Anes*, 195 F.3d 177 (3rd Cir. 1999), contending that "based on this and similar precedent, other courts have held that pension loans do not constitute secured 'claims' or 'debts' under the Bankruptcy Code." Debtors' Brief at 8-9. Both of these cases held that retirement loan repayments were not reasonable or necessary for a debtor's maintenance or support in proposing a chapter 13 repayment plan. But they also expressly declined to consider whether retirement loan repayments were debts or secured debts under the Bankruptcy Code. *In re Anes*, 194 F.3d 177, 181 n. 3 (3rd Cir. 1999)("Having determined that the proposed payments are an inappropriate use of disposable income, we need not consider whether Debtors have secured debts to their retirement systems."); *In re Harshbarger,* 66 F. 3d 775, 778 (6th Cir. 1995)("As we hold that the District Court was correct in upholding the decision to reject debtors' Plan based on § 1325(b), it is unnecessary to reach the question of whether, under bankruptcy law, the loan taken against debtors' ERISA-qualified account was an enforceable debt.").

B. Debtors have not established that repayments on account of funds Mr. Thompson borrowed from his 401(k) account are payments on account of "secured debts" to a "secured creditor."

Section 707(b)(2)(A)(iii) allows debtors to deduct payments on account of "secured debts" which are calculated with reference to amounts scheduled as contractually due to "secured creditors." In our opening brief, we acknowledged that, outside of bankruptcy, ERISA law only permits loans that are "adequately secured" (*See* 29 U.S.C. §§ 1106 & 1108) and that Mr. Thompson granted a "lien" against the balance of his retirement account. However, the Bankruptcy Code defines secured obligations more narrowly than nonbankruptcy law, and that a retirement loan is not a secured debt owed to a secured creditor within the meaning of the Bankruptcy Code for bankruptcy purposes. In particular, we argued that Mr. Thompson's obligation falls outside the

Bankruptcy Code's concept of a secured debt, which is predicated on the estate holding an interest in the property. 11 U.S.C. § 506. Debtor's Brief at 18-21.

Debtors concede that Mr. Thompson's interest in his 401(k) account is not property of debtors' bankruptcy estate. Debtors' Brief at 13. Nevertheless, debtors suggest that Mr. Thompson's 401(k) plan administrator is a "secured creditor" because the debtors' estate has "an interest in" Mr. Thompson's 401(k) account. The debtors' argument fails for two reasons.

First, Mr. Thompson's 401(k) plan administrator does not qualify as a "secured creditor" as a matter of Sixth Circuit law. As the Sixth Circuit has explained, a bankruptcy creditor may only qualify as a "secured creditor" if it has an interest in collateral that is property of the debtor's bankruptcy estate. *In re Foremost Mfg. Co.*, 137 F.3d 919, 924 (6th Cir. 1998) ("Although the bankruptcy court argued that ABC is in a position similar to that of a secured creditor, it was wrong in at least one important sense. A secured creditor has an interest in collateral, but that collateral is the property of the estate."). Because Mr. Thompson's 401(k) plan administrator does not have an interest in collateral that is property of the debtors' bankruptcy estate, the plan administrator cannot be a secured creditor.

Second, the primary case on which debtors rely for their argument that their bankruptcy estate holds an interest in Mr. Thompson's 401(k) account, *In re Perkins*, 134 B.R. 408, 411 (Bankr. E.D. Cal. 1991), is wrong as a matter of law. As we discussed in our opening brief, section 541(c)(2) of the Bankruptcy Code, which defines property of the estate, excludes any interest in a debtor's ERISA-qualified retirement account, including a 401(k) account, from ever entering the bankruptcy estate. *Patterson v. Shumate*, 504 U.S. 753, 758-760 (1992); *United States Internal Revenue Service v. Snyder*, 343 F.3d. 1171, 1178 (9th Cir. 2003) ("[Section 541(c)(2)] provides that trust anti-alienation provisions otherwise enforceable under nonbankruptcy law will operate in a bankruptcy estate to prevent the transfer of the debtor's interest in the trust to the bankruptcy estate."). Furthermore, the Ninth Circuit has rejected the rationale of *Perkins* and held that "[b]ecause [the debtor's] interest in [his ERISA-qualified pension plan] is not property of the bankruptcy estate, it cannot be used to secure the IRS's claim under § 506(a)."). Accordingly, under the plain language of section 541(c)(2), Mr. Thompson's interest in his 401(k) account was never transferred to the debtors' bankruptcy estate. As we argued in our opening brief, property in which the estate has no interest cannot be the basis for a secured claim.

The second case cited by the debtors, *In re May*, 194 B.R. 853 (Bankr. D.S.D. 1996), similarly fails to support the debtors' argument. It merely holds that the phrase "property in which the estate has an interest" under section 506(a) of the Bankruptcy Code "may include a debtor's exempt property when valuing a secured claim for compliance with § 1325(a)(5)." *Id.* at 858. The court recognized, however, that "[p]roperty that secured a claim against the debtor that was never a part of the bankruptcy estate, such as assets of a third party, will not, of course, be included in the creditor's secured claim for plan treatment." *Id.*

C. Sound notions of public policy support the United States Trustee's reading of the means test

In our opening brief, we argued that allowing debtors to claim retirement loan repayments under the means test would contravene the explicit and reasonable public policy objectives of the Abuse Prevention Act, which was enacted to require above median income debtors to repay their debts when Congress' means test determines they can. We also argued that the debtors could repay over $21,000 to unsecured creditors in a chapter 13 case. United States Trustee's Brief at 24. In response, debtors argue that our interpretation renders the statute absurd because if the debtors converted their case to chapter 13, they would be permitted to continue making Mr. Thompson's 401(k) loan repayments in accordance with 11 U.S.C. § 1322(f). Debtors' Brief at 15-16. As a result, they might not have sufficient disposable income to immediately fund a chapter 13 repayment plan, and their expenses might increase in the future, eliminating their ability to pay in the future.

As an initial matter, disallowing 401(k) loan repayments in a chapter 7 case will not lead to "absurd" results merely because the payments are allowed in chapter 13. A statute only produces an "absurd" result when "the interpretation is clearly at odds with Congress's intent in drafting the statute. . ." *U.S. v. Coatoam*, 245 F.3d 553, 558 (6th Cir. 2001) *citing United States v. Ron Pair Enters., Inc.*, 489 U.S. 235, 242 (1989)("The plain meaning of legislation should be conclusive, except in the rare cases in which the literal application of a statute will produce a result demonstrably at odds with the intentions of its drafters. In such cases, the intention of the drafters, rather than the strict language, controls.")[8]. As we argued in our opening brief, the purpose of the Abuse Prevention Act's amendments to the Bankruptcy Code was to ensure that where debt repayment is possible, debtors should not receive chapter 7 relief without attempting to repay their debts. Appellant's Brief at 5. Requiring debtors to attempt repayment before eliminating their debt is consistent with this purpose.

Further, nothing in section 707(b) of the Bankruptcy Code directs bankruptcy courts to consider results that may occur in a chapter 13 case. Because the debtors filed their case under chapter 7, and not under chapter 13, the relevant circumstances for determining whether the presumption of abuse arises should not be viewed from the standpoint of a hypothetical chapter 13

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[8] The high threshold that must be met to establish absurdity is made clear by the paucity of Supreme Court decisions relying upon it as a ground for recasting federal statutes.

case. *In re Johns*, 342 B.R. 626, 629 (Bankr. E.D.Okla. 2006). More significantly, however, nothing in the record indicates that the debtors will not be able to repay a significant portion of their debt when Mr. Thompson's 401(k) loans are repaid in November 2008. While debtors' expenses may increase in the next two years, their wages may also increase. If debtors' circumstances change in the future and they are unable to repay their debts, nothing prevents them from filing a new bankruptcy case or, if they elect to convert to chapter 13, converting their case back to chapter 7 if their circumstances change.

III. The bankruptcy court correctly determined that Mr. Thompson's 401(K) loan repayments do not qualify as an "Other Necessary Expense" under 11 U.S.C. § 707(b)(2)(A)(ii).

Under the means test, debtors may deduct their "actual monthly expenses for the categories specified as Other Necessary Expenses issued by the Internal Revenue Service. . ." except to the extent the IRS's categories of "Other Necessary Expenses" permit repayment of debts. 11 U.S.C. § 707(b)(2)(A)(ii)(I).[9] The bankruptcy court held that Mr. Thompson's 401(k) loan obligation was a "debt" under the Bankruptcy Code. Accordingly, the bankruptcy court concluded that the loan repayments could not qualify as an allowed expense under section 707(b)(2)(A)(ii)(I). The debtors argue that if Mr. Thompson's 401(k) loan obligation is not a secured debt, then the payments are allowed as "Other Necessary Expenses."

Section 5.15.1.10 of the IRS's Internal Revenue Manual identifies sixteen categories of "Other Expenses" allowed if they meet the "necessary expense test" because they provide for the

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[9] Section 707(b)(2)(A)(ii)(I) provides that "[n]otwithstanding any other provision of this clause [which includes the allowance of Other Necessary Expenses], the monthly expenses of the debtor shall not include any payments for debts."

taxpayer's health and welfare or for the production of income.[10] None of these categories specifically address 401(k) loan repayments. Debtors assert, however, that Mr. Thompson's 401(k) loan repayments qualify within one category of Other Necessary Expenses, titled "involuntary deductions." To qualify as an "involuntary deduction," the expense must be "a requirement of the job; *i.e.*, union dues, uniforms, work shoes."

For example, an employee's failure to pay union dues or wear a required uniform or shoes may result in the employee losing his job. *See, e.g., St. John's Mercy Health Systems v. N.L.R.B.*, 436 F.3d 843, 844 (8th Cir. 2006)(noting that the National Labor Relations Act authorizes collective bargaining agreements containing union security provisions that require union membership and payment of dues as a condition of continued employment). In contrast, the debtors did not provide any evidence below that failure to repay the loan will have any adverse impact on his job. Mr. Thompson's 401(k) loan documents do not require Mr. Thompson to repay his 401(k) loan as a condition of his employment. (Debtors' Ex. 1-10).

Thus, Mr. Thompson's voluntary agreement to repay his retirement loan via automatic payroll deduction simply is not a job requirement. *See In re Barraza*, 346 B.R. 724, 730-31 (Bankr. N.D.Tex. 2006)(holding debtor's 401(k) loan repayment did not qualify as an "other necessary expense"); *In re Lenton*, 2006 WL 3850011, *3-*4 (Bankr. E.D. Pa. Dec. 15, 2006)("The fact that Debtor took a loan . . .under terms that mandate repayment by payroll deduction does not change the nature of the funds when Debtor repays them."). Because Mr. Thompson voluntarily contributed funds to his 401(k) account, and voluntarily borrowed those funds from the plan, his repayment of

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[10] Section 5.15.1.10 of the Internal Revenue Manual is available at http://www.irs.gov/irm/part5/ch15s01.html#d0e182570.

amounts borrowed "represent repayment of voluntary contributions." *In re Lenton*, 2006 WL 3850011 at *4.

IV. Debtors have not established that repaying Mr. Thompson's 401(k) loan is a special circumstance for which they have no reasonable alternative under 11 U.S.C. § 707(b)(2)(B).

Section 707(b)(2)(B) permits debtors to rebut the presumption of abuse by establishing "special circumstances, such as a serious medical condition or call or order to active duty in the Armed Forces . . .for which there is no reasonable alternative." Our opening brief explained the bankruptcy court erred by ruling that, even presuming the debtors failed the means test, the debtors established special circumstances under section 707(b)(2)(B), which precluded dismissal. Specifically, we argued this ruling constituted error for three separate and independent reasons. United States Trustee's Brief at 25-28.

First, as we argued in our opening brief, under the doctrine of *ejusdem generis*, Mr. Thompson's 401(k) loan repayments are not special circumstances as a matter of law because they are not similar to the two special circumstances identified in section 707(b)(2)(B). United States Trustee's Brief at 26-27. Applying a similar principle of statutory construction known as *noscitur a sociis*, results in the same conclusion. Under this principle, "a general term is interpreted within the context of the accompanying words 'to avoid the giving of unintended breadth to the Acts of Congress." *Kurinsky v. U.S.*, 33 F.3d 594, 597 (6th Cir. 1994).

Second, the phrase "such as" includes "other matters of the same kind which are not specifically enumerated by the standard." *Donovan v. Anheuser-Busch, Inc.* 666 F.2d 315, 327 (8th Cir. 1981). The examples that Congress used to give meaning to the term "special circumstances" in section 707(b)(2)(B) concern circumstances beyond the debtors' control. *In re Delunas*, 2007 WL

737763 at *2 (Bankr. E.D. Mo. March 6, 2007). Thus, it follows that circumstances that can qualify as "special" to rebut the presumption of abuse must relate to similar circumstances.

The phrase "such as" is more limiting than the term "including," which is a defined term under the Bankruptcy Code that Congress could have (but did not) use in section 707(b)(2)(B). Under the Bankruptcy Code's rules of construction, the term "including" is not limiting, and is used as a word of extension or enlargement. 11 U.S.C. §102(3). *Am. Surety Co., v. Marotta*, 287 U.S. 513, 517 (1933)("Include" is used as a word of extension or enlargement rather than one of limitation.) If Congress had intended "special circumstances" to have an expansive definition and scope, as debtors would have the Court believe, it would have stated that "special circumstances include" a serious medical condition or a call to active duty. It did not. Instead, Congress used the more restrictive term "such as" when identifying the situations that might constitute special circumstances.

Debtors' brief fails to address the language of section 707(b)(2)(B) and instead focuses on Congressional floor statements, made prior to the Abuse Prevention Act's enactment, that purport to explain that Congress did not intend the statutory examples to be limiting. Debtors' Brief at 23. Debtors' resort to legislative history is inappropriate because the statute is not ambiguous and limiting "special circumstances" does not produce a result demonstratively at odds with the purpose of bankruptcy reform legislation. *United States v. Ron Pair Enterprises*, 489 U.S. 235, 242, (1989). In addition, "[t]o the extent legislative history of [the Abuse Prevention Act] can be used to resolve any arguable ambiguity in the statutory language, it is of dubious assistance" because no joint conference statement or report of floor managers exists. *In re Sorrell*, 2007 WL 211276 at *7 (Bankr. S.D. Ohio Jan. 26, 2007) *citing Begier v. IRS*, 496 U.S. 53, 64 (1990).

Alternatively, debtors argue that the universe of allowable special circumstances is broad enough to include almost any circumstance that may befall a debtor, and that limiting special circumstances to the two mentioned in section 707(b)(2)(B) would render the statute "impotent". Debtors' Brief at 23. Special circumstances are not limited to the two statutory examples. However, special circumstances must be within the same exceptional category as a serious medical condition or a call to active duty.

In addition, debtors' argument ignores the fact that special circumstances permit adjustments to income as well as expenses. Debtors assert, without explanation, that the means test itself provides a mechanism to adjust a debtor's income. Debtors' Brief at 23-24. This is incorrect. Income under the means test is strictly defined by statute, 11 U.S.C. § 101(10A), and the special circumstances provision is the only mechanism that can adjust a debtor's income. Thus, for example, if a debtor who worked prior to his bankruptcy filing was diagnosed with a serious medical condition that left him unable to work, that could qualify as a special circumstances.

In this case, the bankruptcy court erred by finding that the mere repayment of 401(k) loans is within the same class of extraordinary special circumstances beyond the debtors' control, such as a serious medical condition or call to active duty. The repayment of the loans is not within the same class as a serious medical condition or call to active duty. Because 11 U.S.C. §707(b)(2)(B)(I) limits and restricts the special circumstances to those of the same type as the statutory examples, the Bankruptcy Court's conclusion of law that a 401(k) loan repayment constitutes a special circumstance should be reversed.

V. Conclusion

For these reasons, the United States Trustee respectfully asks this Court to reverse the order denying the motion to dismiss the case entered below and remand this case with instructions to the bankruptcy court to correctly apply the statutory provisions of 11 U.S.C. § 707(b)(2).

Dated: March 22, 2007

Respectfully submitted,

/s/Dean Wyman
Dean Wyman, Esq.
Trial Attorney
Department of Justice
#0007848
Office of the United States Trustee,
Suite 441, H.M. Metzenbaum U.S. Courthouse
201 Superior Avenue
Cleveland, Ohio 44114
Dean.P.Wyman@usdoj.gov

CERTIFICATE OF SERVICE

I certify that on March 22, 2007, a copy of the foregoing "Reply Brief of the Appellant Saul Eisen United States Trustee" was filed electronically. Notice of this filing will be sent by operation of the Court's electronic filing system to all parties indicated on the electronic filing receipt. All other parties will be served by regular U.S. mail. Parties may access this filing through the Court's system.

/s/Dean Wyman
Dean Wyman

BRIEF BANK — "SUMMARY SHEET" *Printed Mon.-9/10/1 (13:43)*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*
In re JULIA KERRINE TODD

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*
Bankr. W.D. Wash.

3. ("CCN") ***CURRENT*** CASE NO.
No.: 01-12339

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*
No.: N/A
Court:
(Identify judge & cite, if any)

5. ("SO") ***SOURCE***
U.S. TRUSTEES

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*
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William L. Courshon, Trial Attorney/Region 18 (206-553-2000)
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") ! ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***

! A Chapter 7 trustee should not be allowed to sell propety in which Debtor has no equity, because the sale would result in no benefit to the estate.

! The trustee should not be allowed to use 11 U.S.C. § 724(b) to subordinate an IRS tax lien to the trustee's administrative expenses incurred in connection with the sale of property in which the Debtor has no equity.

√ **Background:** On June 29, 2001, the Bankruptcy Court denied the private trustee's motion to list & sell property.

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Judge: Thomas T. Glover
Chapter 7
Hearing Location: Seattle, WA
Hearing Date: June 29, 2001
Hearing Time: 9:30 a.m.
Response Date: June 25, 2001

UNITED STATES BANKRUPTCY COURT
FOR THE WESTERN DISTRICT OF WASHINGTON
AT SEATTLE

In re	)	No. 01-12339
	)	
JULIA KERRINE TODD,	)	UNITED STATES TRUSTEE'S OBJECTION TO TRUSTEE'S MOTION FOR AUTHORITY TO LIST AND SELL PROPERTY AND MEMORANDUM OF LAW IN SUPPORT THEREOF
Debtor.	)	

The United States Trustee ("U.S. Trustee") objects to the Chapter 7 Trustee's Motion for Authority to List and Sell Property and files this memorandum of law in support of the U.S. Trustee's objection.

STATEMENT OF THE FACTS

The debtor, Julia Kerrine Todd, filed a voluntary petition under Chapter 7 of the Bankruptcy Code on March 6, 2001. Michael B. McCarty was appointed to serve as Chapter 7 Trustee in this case. On June 4, 2001, the debtor filed a motion to compel the trustee to abandon real property, i.e., the debtor's residence at 18333 - N.E. 146th Way, Woodinville, Washington. The real property is listed in the debtor's Schedule A with a value of $370,000. As set forth in the debtor's Schedule D, the property is subject to the following liens and encumbrances:

Washington Mutual Bank	$220,242.00
U.S. Bank	$25,000.00
Sun Mountain Sports, Inc. Judgment	$21,233.25
Federal Tax Lien	$117,727.12
TOTAL LIENS AND ENCUMBRANCES	**$384,202.37**

The foregoing does not include any accrued interest on the Sun Mountain Sports judgment or federal tax lien after the date of filing of the petition. The debtor' schedules indicate that the debtor has no unencumbered or nonexempt assets. See debtor's Schedules A, B, C, and D.

On or about June 8, 2001, the Chapter 7 Trustee filed a Response to Debtor's Motion to Compel Abandonment, Objection to Exemptions, and Motion for Authority List and Sell Property, wherein the Trustee opposed the debtor's motion to compel abandonment and requested that the Court authorize the Trustee to sell the debtor's residence free and clear of liens for the benefit of the Internal Revenue Service ("IRS") and other secured creditors and to subordinate the tax lien to pay administrative expenses, i.e., the trustee's fees and expenses associated with the sale of the property. The Trustee has neither shown nor suggested that unsecured creditors would benefit from the sale.[1]

ARGUMENT

A. UNDER THE CIRCUMSTANCES, THE TRUSTEE SHOULD NOT BE PERMITTED TO SELL PROPERTY IN WHICH THE ESTATE HAS NO INTEREST.

First and foremost among the statutory duties of a Chapter 7 bankruptcy trustee is the duty

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[1] Although the Trustee has objected to the debtor's exemptions to the extent that such exempt property may be used to pay a tax lien under 11 U.S.C. § 522(c)(2)(B), the debtor's exempt property consists primarily of household goods of minimal value. See debtor's Schedule C.

to "collect and reduce to money the property of the estate for which such trustee serves, and close such estate as expeditiously as is compatible with the best interests of parties in interest". 11 U.S.C. § 704(1). The trustee, as fiduciary, represents all creditors of the debtor, secured and unsecured. However, the trustee primarily represents unsecured creditors, and represents secured creditors only in his capacity as a custodian of property in which they have a lien. Ford Motor Credit Co. v. Weaver, 680 F.2d 451, 462 n.8 (6th Cir. 1982); In re Speir, 190 B.R. 657 (Bankr. N.D. Ala. 1995); In re Peckinpaugh, 50 B.R. 865, 869 (Bankr. N.D. Ohio 1985).

The primary role of the trustee is to administer the estate, turning over to the secured creditors by appropriate action the property to which they are entitled and in which there is no equity for the estate, and to marshal for the benefit of the general creditors the maximum funds available for distribution. It is only where the secured property has a potential equity for general creditors or to protect that secured property that the trustee should become involved therein. In re Crutcher Concrete Construction, 218 B.R. 376, 380 (Bankr. W.D. Ky. 1998); In re Crisp, 26 B.R. 274 (Bankr. W.D. Ky. 1982). A Chapter 7 trustee may sell a debtor's property under 11 U.S.C. § 363, but generally only to benefit the unsecured creditors. In re Crutcher Concrete Construction, 218 B.R. at 380; In re Williamson, 94 B.R. 958, 962 (Bankr. S.D. Ohio 1988); see also In re Riverside Investment Partnership, 674 F.2d 634, 640 (7th Cir. 1982) ("As a general rule, the bankruptcy court should not order property sold 'free and clear of' liens unless the court is satisfied that the sale proceeds *will fully compensate secured lienholders and produce some equity for the benefit of the bankrupt's estate.*"). Secured creditors by consent and the trustee by acquiescence cannot impose upon the Court the duty to serve as a foreclosure or collection forum. In re Crisp, 26 B.R. at 275.

Secured creditors, for the most part, should be able to look to their collateral for satisfaction of their claims. If there is no equity in the collateral for the bankruptcy estate, the trustee may abandon the property pursuant to 11 U.S.C. § 554(a).[2/] In re Pearson Industries, Inc., 178 B.R. 753, 761 (Bankr. C.D. Ill. 1995); In re Thu Viet Dinh, 80 B.R. 819, 822 (Bankr. S.D. Miss. 1987).

Thus, in In re Feinstein Family Partnership, 247 B.R. 502 (Bankr. M.D. Fla. 2000), the court denied the Chapter 7 trustee's motion to sell the debtor's real property free and clear of liens, refusing to allow the trustee to act as liquidating agent for a secured creditor in selling property to the creditor upon a credit bid, where there was no equity in the property. In so ruling , the court in Feinstein stated, "It is now almost universally recognized that where the estate has no equity in a property, abandonment is virtually always appropriate because no unsecured creditor could benefit from the administration. Id. at 507; see In re Landreneau, 74 B.R. 13, 14 (Bankr. W.D. La. 1987) (court held that trustee could not sell property in which there was no equity by "offset bid", whereby secured creditor would bid amount of secured debt owed to creditor plus administrative expenses); see also In re Williamson, 94 B.R. at 963 (Chapter 7 trustee's expenses in selling property could not be reimbursed as "necessary expenses" pursuant to 11 U.S.C. § 506(c), where it was apparent at the time of sale that no potential equity existed for the estate).

Similarly, the courts have held that a Chapter 7 trustee is not entitled to compensation on the sale of fully secured property in bankruptcy cases. See In re Lambert Implement Co., 44 B.R. 860

2/ Abandonment of such property is necessary for the trustee to avoid exposing the estate or the trustee to liability for damages resulting from the retention of the property, see In re Reich, 54 B.R. 995 (Bankr. E.D. Mich. 1985), or to liability for any taxes resulting from the gain realized on the sale of estate property. See In re Bentley, 916 F.2d 431 (8th Cir. 1990).

(Bankr. W.D. Ky. 1984); In re B & L Enterprises, Inc., 26 B.R. 220, 223 (Bankr. W.D. Ky. 1982); In re Truitt, 15 B.R. 169, 170 (Bankr. N.D. Ga. 1981); see also In re Lan Associates XI, L.P., 192 F.3d 109, 119-120 (3d Cir. 1999) (value of credit bid could not be included in base on which Chapter 7 trustee's compensation was calculated, where credit bid more closely resembled an abandonment or turning over of property to secured creditor rather than sale to third party). In Lambert Implement Co., the court held in 14 bankruptcy cases consolidated for purposes of hearing that trustees are not entitled to collect statutory commissions on sales of fully secured property, where secured creditors were to receive all or substantially all of the funds in the hands of the trustees after payment of the trustees' commissions and expenses of sale, in absence of sound and documented reasons for proceeding with the disposition of properties in expectation of a benefit to unsecured creditors. 44 B.R. at 861. In so holding, the court cited to a policy statement of the Administrative Office of United States Courts ("AOUSC"), which provided as follows:

> ... the trustee as representative of the estate should not (under usual circumstances) be engaging in activities such as the sale of fully secured property where there is no potential equity for general unsecured creditors and with the trustee enhancing his compensation with no corresponding benefit to the general estate...
> Aside from abandonment, where there will be no equity for general creditors, there is a substantial problem which the court should put a quick end to, when the trustee appears to be acting in his own self-interest rather than in the interest of the estate.

In re Lambert Implement Co., 44 B.R. at 862.[3/]

[3/] This same policy is still in effect in jurisdictions which are not subject to case administration by the United States Trustee Program, i.e., the districts of Alabama and North Carolina. See Trustee and Estate Administration Oversight Manual for Bankruptcy Administrators, Bankruptcy Division, Administrative Office of United States Courts, Volume II, § 22.03(d), at E-41, a true copy of which is attached as Exhibit "A" to the Declaration of William L. Courshon in Support of U.S. Trustee's Objection to Trustee's Motion for Authority to List and Sell Property ("Declaration"). The policy

In the instant case, there is no equity in the debtor's property. The proposed sale of such property by the Chapter 7 Trustee would benefit only the IRS and other secured creditors to the extent of their secured claims, as well as the Trustee himself, and would result in no benefit to the estate. For the foregoing reasons, the trustee's motion for authority to list and sell the property should be denied, and the Trustee should be required to abandon such property.

B. THE TRUSTEE SHOULD NOT BE PERMITTED TO SUBORDINATE THE IRS'S TAX LIEN TO ADMINISTRATIVE EXPENSE CLAIMS PURSUANT TO 11 U.S.C. § 724(b), WHERE THE SALE OF PROPERTY SUBJECT TO TAX LIEN DOES NOT BENEFIT THE ESTATE AND RESULTS IN PAYMENT OF ADMINISTRATIVE EXPENSES ASSOCIATED ONLY WITH THE SALE.

Although there is no equity in the debtor's real property, the Trustee intends to rely on 11 U.S.C. § 724(b) to subordinate the IRS's tax lien to the trustee's administrative expenses incurred in connection with the sale of the property.

Title 11 U.S.C. § 724(b) provides as follows:

> (b) Property in which the estate has an interest and that is subject to a lien that is not avoidable under this title and that secures an allowed claim for a tax, or proceeds of such property, shall be distributed–
>
> (1) first, to any holder of an allowed claim secured by a lien on such property that is not avoidable under this title and that is senior to such tax lien;
>
> (2) second, to any holder of a claim of a kind specified in section 507(a)(1), 507(a)(2), 507(a)(3), 507(a)(4), 507(a)(5), 507(a)(6), or 507(a)(7) of this title, to the extent of the amount of such allowed tax claim that is secured by such tax lien;

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of the AOUSC is fully consistent with the policy of the United States Trustee Program with respect to the sale of fully secured property by Chapter 7 trustees, as set forth in the Handbook for Chapter 7 Trustees, Executive Office for United States Trustees, Chapter 8, ¶ K.4, at 8-20, a true copy of which is attached as Exhibit "B" to the Declaration.

> (3) third, to the holder of such tax lien, to the extent that such holder's allowed tax claim that is secured by such tax lien exceeds any amount distributed under paragraph (2) of this subsection;
>
> (4) fourth, to any holder of an allowed claim secured by a lien on such property that is not avoidable under this title and that is junior to such tax lien;
>
> (5) fifth, to the holder of such tax lien, to the extent that such holder's allowed claim secured by such tax lien is not paid under paragraph (3) of this subsection; and
>
> (6) sixth, to the estate.

11 U.S.C. § 724(b). Section 724(b) provides for the subordination of tax liens to administrative expense claims and other priority unsecured claims under 11 U.S.C. § 507(a), except for priority tax claims under § 507(a)(8) and priority claims under § 507(a)(9) for obligations to a government agency for the debtor's failure to maintain the capital of an insured depository institution. The Trustee states incorrectly that "[t]he purpose of this statute, indeed the only rationale for this statute, is to encourage trustees to collect taxes." See Trustee's Response to Motion to Compel Abandonment, Objection to Exemptions, and Motion for Authority to List and Sell Property, at 2, ll. 11-12.

The legislative history of § 724(b) sets forth Congress's intent in enacting the provision as part of the Bankruptcy Reform Act of 1978 as follows:

> Subsection (b) governs tax liens. It is derived from section 67c(3) of the Bankruptcy Act, without substantial modification in result. It subordinates tax liens to administrative expense and wage claims, and solves certain circuity of liens problems that arise in connection with the subordination. The order of distribution of property subject to a tax lien is as follows: First, to holders of liens senior to the tax liens; second, to administrative expenses, wage claims, and consumer creditors

> that are granted priority,[4] but only to the extent of the amount of allowed tax claim secured by the lien. In other words, the priority claims step into the shoes of the tax collector. Third, to the tax claimant, to the extent that priority claimants did not use up his entire claim. Fourth, to junior lien holders. Fifth, to the tax collector to the extent that he was not paid under paragraph (3). Finally, any remaining property goes to the estate. The result of these provisions are to leave senior and junior lienors and holders of unsecured claims undisturbed. If there are any liens that are equal in status to the tax lien, they share pari passu with the tax lien under the distribution provisions of this subsection. [Footnote added.]

H.R. Rep. No. 595, 95th Cong., 1st Sess. 382 (1977). Thus, § 724(b) was derived from § 67c(3) of the Chandler Act of 1938, which introduced to the Bankruptcy Act the concept of subordination of certain statutory liens to certain priority claims, i.e., claims for wages and administrative expenses. See In re Darnell, 834 F.2d 1263, 1266 (6th Cir. 1987). In 1966, Section 67c(3) was amended, and the legislative history for that amendment provides as follows:

> ...The committee believes that if the policy of the Chandler Act to protect the costs of administration and wages is to be given effect, it is necessary to postpone to the costs of administration and wages at least those tax liens which are on personal property and are unaccompanied by possession.[5] It would be grossly unfair for **the bankruptcy court and the attorneys who have labored to wind up the bankrupt's affairs and to accumulate an estate for distribution** to receive nothing for their labor. It is also socially desirable that the claims of the wage earner who is normally entirely dependent upon his wages for the necessity of life should be paid to the extent of the restriction in Section 64a(2) before the estate is subject to the heavy burden of all tax liens. [Footnote added; emphasis added.]

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[4] Section 724(b) was subsequently amended in 1984, 1986, and 1994 to incorporate additional priority claims that have been added under § 507(a). See 6 Collier on Bankruptcy ¶ 724.LH.[3], at 724-20 - 724-21 (Lawrence P. King ed., 15th ed. rev. 2000).

[5] In the 1978 Bankruptcy Code, the policy of postponement or subordination of tax liens was continued and expanded, since § 724(b) applies to real property liens as well as tax liens on personal property, and it contains no requirement that the property be unaccompanied by possession. See In re Granite Lumber Co., 63 B.R. at 471.

H.R. Rep. No. 686, 89th Cong., 1st Sess. (1965), U.S. Code & Admin. News at 2442, 2462, quoted in In re Granite Lumber Co., 63 B.R. 466, 470-471 (Bankr. D. Mont. 1986); see also In re Darnell, 834 F.2d at 1266.

Thus, the legislative history for § 724(b) evidences that the purpose of this statute is not to encourage trustees to collect taxes on behalf of governmental taxing agencies, as the Trustee submits, but rather to the contrary. The policy of § 724(b) (and of its predecessor, § 67c(3) of the Bankruptcy Act) is to insure payment of **preexisting and outstanding** administrative expense claims (incurred for the benefit of the estate), wage claims, and other priority unsecured claims, at the expense of the lien claims of such taxing agencies.

In the case of In re Kerton Industrial, 151 B.R. 101 (E.D. Mich. 1991), the bankruptcy court entered an order authorizing the Chapter 7 trustee to sell certain fully encumbered real and personal property and to subordinate a real property tax lien to the trustee's administrative expenses associated only with the sale of the property, where there were no outstanding and preexisting administrative expenses. On appeal, the district court reversed the bankruptcy court's ruling and held that the tax lien could not be subordinated under § 724(b) where the sale of fully encumbered property did not result in any benefit to the estate, and the only priority claims that were to be paid as a result of such subordination were administrative claims incurred solely in connection with the sale. The court held that subordination pursuant to § 724(b) requires a benefit to the estate and is not proper when the sale proceeds do not go to pay any **preexisting and outstanding** administrative claims. See In re Kerton Industrial, 151 B.R. at 103; see also In re Prairie Mining, Inc., 194 B.R. 248, 252 (Bankr. D. Kan. 1995); 6 Collier on Bankruptcy ¶ 724.03[4][c], at 724-14 - 724-15 (Lawrence P. King ed., 15th ed.

rev. 2000). In so holding, the court in Kerton stated, "Obviously, a sale which pays only expenses incurred as a result of the sale does not benefit the estate whatsoever." 151 B.R. at 103. The court also cited to the policy of the United States Trustee Program against the sale of fully secured assets as set forth in the Handbook for Chapter 7 Trustees of the Executive Office for United States Trustees. See id.; Declaration, Exhibit "B".

In contrast with Kerton, a case illustrating the proper application of § 724(b) is In re K.C. Machine & Tool Co., 816 F.2d 238 (6th Cir. 1987). In K.C. Machine, although the property in question was fully secured, the case had been converted from Chapter 11 to Chapter 7, and the estate had incurred substantial administrative expenses in the Chapter 11 case, including postpetition debts due to 35 trade creditors. The U.S. Court of Appeals for the Sixth Circuit held that subordination under § 724(b) was appropriate because administration of the property in that case resulted in a benefit to the estate, where the sale of the property secured a fund equal to the amount of the tax liens, in excess of $156,000, to pay Chapter 11 administrative creditors. 816 F.2d at 246. The court further concluded that compelled abandonment was not available where administration promised a benefit to the estate by virtue of § 724(b). Id. at 247.

The court's holdings in both Kerton and K.C. Machine are fully consistent with the legislative purpose of § 724(b), i.e., that subordination of tax liens under that provision is intended for payment of preexisting and outstanding administrative expenses, wages, and other priority claims, as opposed to administrative expenses arising solely in connection with the sale of fully secured property without any benefit to the estate.

In the instant case, like Kerton, and unlike K.C. Machine, the Trustee proposes to sell fully secured property without any benefit to the estate and to subordinate the IRS's tax lien to pay administrative expenses arising solely in connection with the property sale. The subordination of the IRS's tax lien in this case to pay the Trustee's administrative expenses, i.e., his fees and expenses incurred solely in connection with the sale, are contrary to the legislative purpose of § 724(a), as well as applicable legal authority. For the foregoing reasons, the Trustee should not be permitted to subordinate the IRS's tax lien pursuant to § 724(b), where only the Trustee, the IRS, and other secured creditors would benefit from the Trustee's proposed actions.

CONCLUSION

For the foregoing reasons, the U.S. Trustee respectfully requests that this Court enter an order denying the Trustee's Motion for Authority to List and Sell Property and granting the debtor's Motion to Compel Trustee to Abandon Property.

DATED this ______ day of June, 2001.

Respectfully submitted,

____
William L. Courshon, WSBA # 20468
Attorney for Jan Samuel Ostrovsky,
United States Trustee

BRIEF BANK — 'SUMMARY SHEET" *Printed Fri-3/2/07 12:25*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*
William T. Neary, UST v. Marvin F. Ross- Tousey and Deborah H. Tousey

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*
(ED WI)

3. ("CCN") ***CURRENT*** CASE NO.
No.: Appeal No. 07-C-0065 (WCG)

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*
No.: 06-24573
Court: (Bankr. ED WI)
(Identify judge & cite, if any)

5. ("SO") ***SOURCE***
U.S. TRUSTEES

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*
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William Neary, UST; David Asbach, AUST; Matthew Sutko, Trial attorney; and Thomas Kerns, Trial Attorney
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***
- whether the court below: erred by ruling as a matter of law that the Debtors could claim an "automobile ownership expense" for debt financing that took the Debtors outside section 707(b)(2)'s statutory means test even though these Debtors had no "automobile ownership expense" because they owned their cars debt-free; or, if the Debtors passed the means test, more issues on page 2 of brief

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UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF WISCONSIN

In the Matter of:

MARVIN F. ROSS-TOUSEY and
DEBORAH H. TOUSEY,

Bkr. Case No. 2006-24573-SVK

Debtors.

WILLIAM T. NEARY,
United States Trustee,

Appellant,

v.

Appeal No. 07-C-0065 (WCG)

MARVIN F. ROSS-TOUSEY and
DEBORAH H. TOUSEY,

Appellees.

ON APPEAL FROM THE UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF WISCONSIN

THE HONORABLE SUSAN V. KELLEY, PRESIDING
Case No. 2006-24573

BRIEF OF THE PLAINTIFF-APPELLANT, UNITED STATES TRUSTEE

Of Counsel:

ROBERTA A. DeANGELIS
Acting General Counsel

Matthew Sutko
Thomas C. Kearns
United States Department of Justice
Executive Office for United States Trustees
20 Massachusetts Avenue, NW
Washington, D.C. 20530

United States Trustee
WILLIAM T. NEARY

DAVID W. ASBACH
Assistant United States Trustee
Office of the United States Trustee
517 East Wisconsin Avenue, Room 430
Milwaukee, WI 53202
(414) 297-4499; Fax: (414) 297-4478

(202) 307-1399

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JURISDICTIONAL STATEMENT

The United States Bankruptcy Court for the Eastern District of Wisconsin has jurisdiction over the underlying case, initiated by Marvin Ross-Tousey and Deborah Tousey on August 18, 2006, by their filing of a voluntary petition under chapter 7 of the Bankruptcy Code,[1] 11 U.S.C. §§ 701, *et seq*. *See also* 28 U.S.C. §§ 157(b), 1334(a).

On December 11, 2006, the bankruptcy court denied the United States Trustee's motion to dismiss the bankruptcy case under 11 U.S.C. § 707(b)(1) for abuse. This appeal is taken from a final order that court entered on December 14, 2006, denying the United States Trustee's motion. The United States Trustee filed a timely notice of appeal from that order under 28 U.S.C. § 158(c)(2) and Fed. R. Bankr. P. 8002(a) on December 20, 2006.[2] This Court has jurisdiction over this appeal under 28 U.S.C. § 158(a)(1).

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[1] As used herein, the term "Bankruptcy Code" refers to 11 U.S.C. §§ 101 - 1529, *et seq.*

[2] Congress has authorized the United States Attorney General to appoint 21 United States trustees, each to serve in a specific geographic region of the United States. *See generally* 28 U.S.C. § 581, *et seq.* (establishing the United States Trustee Program). The United States trustees are senior officials of the Department of Justice. *Id.* The United States trustees "supervise the administration of cases and trustees" in all bankruptcy cases within his or her region through the exercise of a range of oversight responsibilities. 28 U.S.C. § 586(a)(3). *See generally Morganstern v. Revco D.C. Inc. (In re Revco D.S., Inc.)*, 898 F.2d 498, 500 (6th Cir. 1990) (explaining that United States trustees oversee the bankruptcy process, protect the public interest, and ensure that bankruptcy cases are conducted according to law.). United States trustees may raise, appear, and be heard on any issue in any case or proceeding under Title 11. 11 U.S.C. § 307; *See also In re Revco D.S., Inc.*, 898 F.2d at 499-500 (upholding broad appellate standing of United States trustees).

STATEMENT OF THE ISSUES

The United States Trustee sought dismissal of these Debtors' chapter 7 case on two alternative grounds, (a) because the Debtors failed § 707(b)(2)'s means test and, (b) presuming the Debtors passed the means test, because the Debtors' case constituted an abuse under § 707(b)(3)(B)'s totality of the circumstances test. Given this, the issues presented to this Court for determination are whether the court below:

1. erred by ruling as a matter of law that the Debtors could claim an "automobile ownership expense" for debt financing that took the Debtors outside section 707(b)(2)'s statutory means test even though these Debtors had no "automobile ownership expense" because they owned their cars debt-free; or, if the Debtors passed the means test,

2. erred by limiting the "totality of the circumstances" analysis to the income and expenses reported by the Debtors on their B22A Form B22A, when in denying the United States Trustee's motion to dismiss the Debtors' bankruptcy case under 11 U.S.C. § 707(b)(3)(B) the uncontroverted facts showed that, based on their actual income and expenses, the Debtors have significant monthly disposable income available to repay creditors ?

Should this Court determine the court below erred on either ground, this Court should reverse and remand for adjudication of the motion to dismiss on its merits.

STANDARD OF REVIEW

The bankruptcy court's findings on "[b]oth questions of law and mixed questions of law and fact are reviewed *de novo*." *Mungo v. Taylor*, 355 F.3d 969, 974 (7th Cir. 2004) (citing *In re Ebbler Furniture and Appliances, Inc.*, 804 F.2d 87, 89 (7th Cir. 1986)). The bankruptcy court's factual findings are reviewed for clear error. *In re Doctors Hosp. Of Hyde Park,* Inc., ---- F.3d ----, 2007 WL 79701 (7th Cir. Jan. 12, 2007); *In re Crivello*, 134 F.3d 831, 835 (7th Cir. 1998); Fed. R. Bankr. P. 8013.

> [A] judge abuses his discretion when his decision is based on an erroneous conclusion of law or where the record contains no evidence on which he rationally could have based that decision, . . . or where the supposed facts found are clearly erroneous as found.

Deitchman v. E.R. Squibb & Sons, Inc., 740 F.2d 556, 563-564 (7th Cir. 1984) (citation omitted).

Whether the bankruptcy court properly allowed Debtors to deduct an ownership expense under the means test when they had no loan or lease payment is a question of law and is therefore subject to *de novo* review. Whether the bankruptcy court properly limited its analysis of Debtors' income and expenses to those contained in their B22A Form B22A in considering the totality of the circumstances in Debtors' case under 11 U.S.C. § 707(b)(3) is also question of law subject to *de novo* review.

STATEMENT OF THE CASE

On August 18, 2006, Marvin and Deborah Ross-Tousey (the "Debtors") filed a petition for relief under chapter 7 of the Bankruptcy Code. (R. 2).[3] On October 30, 2006, the United States Trustee filed a motion to dismiss the case under 11 U.S.C. § 707(b), asserting that it would be an abuse of chapter 7 to grant the Debtors a discharge. (R. 7).

The United States Trustee's motion was based, first, on the statutory presumption, codified under 11 U.S.C. § 707(b)(2), that granting the Debtors a chapter 7 discharge is an abuse of chapter 7 of the Bankruptcy Code when the Debtors have sufficient disposable income to repay their unsecured creditors at least $166.67 per month. In particular, the United States Trustee argued that under the objective formula used to determine whether a chapter 7 debtor has an ability to pay and the bankruptcy case is therefore presumptively abusive, the Debtors could not qualify for an expense allowance for vehicles referred to as vehicle "ownership costs" under the Local Standards issued by the Internal Revenue Service. This expense standard, the United States Trustee asserted, does not apply to the Debtors who are not making a monthly loan or lease payments because they own their vehicles free and clear of liens.

In the alternative, the United States Trustee argued that if the presumption of abuse did not arise or the Debtors rebutted the presumption, the case should be dismissed under 11 U.S.C. § 707(b)(3)(B) because the totality of the circumstances surrounding the Debtors'

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[3] In this brief, "R." followed by a number refers to an entry on the district court docket.

financial situation, including having significant actual monthly disposable income demonstrated abuse.

On December 11, 2006, after an evidentiary hearing, the bankruptcy court denied the United States Trustee's motion to dismiss the case as a presumed abuse of chapter 7, concluding consistent with the court's prior decision in an earlier chapter 13 case, *In re Grunert*, 353 B.R. 591 (Bankr.E.D. Wis. 2006), that 11 U.S.C. § 707(b)(2)(A)(ii) authorized all debtors who own a vehicle, including the Debtors, to reduce their current monthly income by the IRS Local Transportation Expense Standard that the IRS allows for vehicle financing costs. The bankruptcy court also concluded, after limiting its analysis of Debtors' ability to pay to the expenses and income that were provided on Debtors' Form B22A, that under 11 U.S.C. § 707(b)(3)(B) the totality of the circumstances of the Debtors' financial situation did not demonstrate abuse. The United States Trustee timely filed this appeal.

STATEMENT OF THE FACTS

I. Statutory Framework

On October 17, 2005, most provisions of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (the "BAPCPA"), S. 256, Pub. L. No. 109-8, 119 Stat. 23, took effect, implementing significant changes to the Bankruptcy Code. As part of this effort, Congress amended § 707(b) of the Bankruptcy Code, which governs dismissal of chapter 7 bankruptcy cases. Congress enacted the § 707(b) amendments to curb bankruptcy abuse by, *inter alia*, dismissing cases filed by chapter 7 debtors who seek discharge of their debts despite having the ability to repay their creditors. *See* 151 Cong. Rec. S1856 (Mar. 1, 2005) (statement of Sen. Charles Grassley). Senator Grassley explained the purpose behind the BAPCPA amendments, "It is this simple: if repayment is possible, then [a debtor] will be channeled into chapter 13 of the Bankruptcy Code which requires people to repay a portion of their debt . . . ." *Id.*

As it existed prior to BAPCPA, § 707(b) only authorized dismissal based on a finding that allowing the debtor relief constituted a "substantial abuse" of chapter 7. Further, § 707(b) prior to its amendment by BAPCPA required courts to presume that a debtor was entitled to relief under chapter 7 of the Bankruptcy Code. Section 707(b) now authorizes dismissal where the court finds that the granting of relief would be an "abuse" of chapter 7. As amended by the BAPCPA, § 707(b)(2) repealed the former presumption and replaced it with a new presumption: a case is an "abuse" of chapter 7 if a detailed mathematical formula set out in the statute, commonly referred to as the "means test," yields a minimum amount of monthly disposable income.

The means test uses a series of calculations to determine whether the § 707(b)(2) presumption of abuse arises. *See* 11 U.S.C. § 707(b)(2)(A). Specifically, the means test calculates a debtor's current monthly income, as defined under 11 U.S.C. § 101(10A) (hereafter "CMI"), based on the debtor's average income for the six calendar months preceding the month of the bankruptcy filing. If the debtor's CMI is above the applicable state median family income, as is the case here, 11 U.S.C. § 707(b)(2)(A) calculates the debtor's monthly disposable income available to repay creditors by reducing the CMI by certain categories of expenses identified in 11 U.S.C. § 707(b)(2)(A)(ii), (iii), and (iv). If a debtor's monthly disposable income, calculated by reducing the CMI by allowed expenses under 11 U.S.C. § 707(b)(2)(A)(ii) - (iv), is less than $100 per month (or $6,000 over 60 months), the presumption of abuse does not arise. 11 U.S.C. § 707(b)(2)(A)(i). If the debtor's monthly disposable income is equal to or exceeds $167 per month (or $10,000 over 60 months), the presumption of abuse does arise. *Id.* If the debtor's monthly disposable income is between $100 and $167 per month (between $6,000 and $10,000 over 60 months), the presumption of abuse arises if the disposable income, over 60 months, is sufficient to pay 25 percent of the debtor's nonpriority unsecured debt. *Id.*

Each debtor with primarily consumer debts is required to file, in conjunction with their bankruptcy schedules and statement of financial affairs, a Statement of Current Monthly Income and Means Test Calculation, Official Form B22A ("Form B22A"). 11 U.S.C.

§ 521 and § 707(b)(2)(C). In Chapter 7 cases the main purpose of the Form B22A is to calculate monthly disposable income (ability to pay) following the formula set forth in 11 U.S.C. § 707(b)(2), and determine whether the presumption of abuse arises.

If no presumption of abuse arises under § 707(b)(2) based on the means test, or if the presumption is rebutted under 11 U.S.C. § 707(b)(2)(B) by the debtor by demonstrating special circumstances that justify income or expense adjustments for which there is no reasonable alternative, 11 U.S.C. § 707(b)(3) directs courts to consider whether the case should nonetheless be dismissed as an "abuse" of chapter 7. In particular, the court "shall consider" whether the case was filed in "bad faith," 11 U.S.C. § 707(b)(3)(A), <u>or</u> whether "the totality of the circumstances of the debtor's financial situation . . . demonstrates abuse," 11 U.S.C. § 707(b)(3)(B).

Accordingly, §§ 707(b)(2) and (b)(3) provide distinct and separate bases upon which the court may determine that a chapter 7 case is abusive: first, by presuming the case is an abuse based on the means test, or second, in cases where the presumption does not arise or is rebutted by finding that the case is an abuse of chapter 7 based upon bad faith or upon the totality of the circumstances of the debtor's financial situation.

II. Factual Background

1. The Debtors are married with no dependents. (R. 1-12).
2. Debtors are both employed at the Mohican North Star Casino and have been so employed for approximately 13 years. (R. 1-48, p. 21).

3. Relative to their motor vehicles, on line 22 of their Form B22A, the Debtors included a deduction of $358 for "transportation vehicle operation" expense. (R. 1-3). This expense amount, for two or more vehicles, is taken from the IRS Transportation Standards, Operating Costs and Public Transportation Costs, published by the IRS.

4. On Lines 23 & 24 of the Form B22A the Debtors took deductions of $471 and $332, respectively, for a "transportation ownership/lease expense." (R. 1-3). This expense amount is taken from the IRS Transportation Standards, Ownership Costs, which are published by the IRS. Thus, the Debtors claimed a total transportation expense for their vehicles of $1,161 per month.

5. The Debtors do not have a monthly payment obligation with respect to the vehicles. (R. 1-12, Schedules D & J).

6. The United States Trustee recalculated the Debtors' monthly disposable income by: (a) eliminating the $471 and $332 deductions on lines 23 and 24; and (b) allowing the Debtors an additional transportation vehicle operating expense of $400 on account of the age of two vehicles (for a total operating expense of $758 on line 22).[4] Under

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[4] The Debtors' vehicles include a 1989 Dodge minivan, 1969 Chevrolet truck, 1986 Ford truck, 1994 Ford wagon, 1996 Geo Metro, and a 1993 Pontiac Bonneville . (R1-12, Schedule B, Question 25). The United States Trustee allows an additional $200 operating expense under the means test for each debtor who owns a vehicle, six years or older or with more than 75,000 miles, based on the Internal Revenue Manual which allows such an additional vehicle operating expense. *See* Internal Revenue Manual, Part 5, (entitled Collecting Process), Chapter 8, § 5.8.5.5.2, Treatment of Non-Business Transportation Expenses, which may be found at the IRS website at http://www/irs/gov/irm/part5/ch08s05.html.

the United States Trustee's calculations, the Debtors' monthly disposable income was $260.50, which when multiplied by 60, substantially exceeds $10,000 and the presumption of abuse therefore arises.

7. On their bankruptcy schedules I and J, the Debtors stated the following:

   a. Schedule I - Current Income of individual Debtor(s): Debtors list gross income of $2,338.40 and $2,623.00, respectively; in addition to standard withholdings Debtors deduct $86.00 for a 401K contribution from Mr. Ross-Tousey's income, and $20.00 for a 401K contribution and $50 for a tribal loan repayment from Mrs. Ross-Tousey's income. Mrs. Ross-Tousey also receives a per-capita distribution of $292.33. The total combined net income scheduled is $3,618.88 . (R. 1-12, Schedule I).

   b. Schedule J - Current Expenditures of Individual Debtor(s): Debtors list expenses including $600 for home maintenance; $500 for transportation; $155.82 for a time share; $42.39 for a vacuum cleaner payment; and $500 for replacement vehicle. The net monthly income scheduled is <50.83>. (R. 1-12, Schedule J).

8. On October 30, 2006, the United States Trustee filed a motion to dismiss the Debtors' bankruptcy case pursuant to 11 U.S.C. § 707(b)(1). (R. 1-7, 1-8).

9. On December 11, 2006, the bankruptcy court held an evidentiary hearing on the United States Trustee's motion to dismiss, during which Mrs. Ross-Tousey testified.

10. Mrs. Ross-Tousey testified that since the time of filing, both her and her husband's income had increased. (R. 1-48, p. 23).

11. Mrs. Ross-Tousey testified that at the time of filing Debtors intended to surrender both their time share and vacuum cleaner/air purifier, and that the last payments on the vacuum cleaner/air purifier and time share were made pre-petition in August and September 2006, respectively. (R. 1-48, pp. 28-29).

12. Mrs. Ross-Tousey admitted that Debtors had not been making any payments for approximately $1,300 in monthly expenses listed on Schedule J for: home repairs ($600); vehicle replacement ($500); time share ($155.82); and vacuum cleaner/air purifier ($42.37). (R. 1-48, pp. 28-29, 35-36).

13. Mrs. Ross-Tousey testified Debtors had saved $2,000 since filing but had not begun any repairs on their home nor replaced any of their vehicles. (R. 1-48, 36-38).

SUMMARY OF THE ARGUMENT

The court below erred in denying the United States Trustee's motion to dismiss this bankruptcy case under 11 U.S.C. § 707(b)(2) and under § 707(b)(3)(B). Under § 707(b)(2), a debtor's cases is presumed abusive as a matter of law and must be dismissed absent special circumstances if the debtor fails § 707(b)(2)'s statutory "means test." Here the Debtors would have failed the means test but for the bankruptcy court's legal ruling, based on its earlier decision in *In re Grunert*, that the Debtors could claim an "automobile ownership expense" for vehicle debt financing even though the Debtors had no vehicle financing expense because they owned their vehicles debt-free. Whether Debtors can take such imaginary deductions under Congress' 2005 amendment to § 707 is an important question of law that arises relatively frequently in chapter 7 bankruptcy cases. This Court is one of the first appellate courts to consider it.

The bankruptcy court erred as a matter of law by misinterpreting the automobile debt financing allowance. In its application of the means test, the bankruptcy court interpreted § 707(b)(2) to allow the Debtors to subtract expenses that they do not incur on a monthly basis. Even though the Debtors do not make monthly payments to purchase or lease a car, the bankruptcy court ruled that in addition to a monthly car operating expenses allowance of $358, the Debtors were also entitled to subtract a monthly expense of $471 for car one and $332 for car two (totaling $803) in calculating Debtors' monthly disposable income. These additional "imaginary" expenses correspondingly reduced the Debtors' monthly disposable income under the means test by $403.[5] Allowing the Debtors to subtract ownership costs even though they have no applicable vehicle financing expenses stands the means test on its head, eliminating disposable income otherwise reported on Official Form B22A of the Federal Rules of Bankruptcy Procedure and available to repay creditors.

After disallowing a car financing expense the Debtors do not actually incur, the Debtors' monthly disposable income under the means test is $260.50 which is well above the $166.67 threshold amount, and the presumption of abuse arises. This case must therefore be remanded to the bankruptcy court for further evidentiary proceedings in accordance with § 707(b)(2), including allowing debtors an opportunity to try and rebut the presumption by demonstrating that special circumstances that justify an income or expense adjustment.[6]

Alternatively, the bankruptcy court erred by determining that the Debtors' filing was not an abuse based on the "totality of the circumstances" under 11 U.S.C. § 707(b)(3). The bankruptcy court improperly restricted consideration of the Debtors' ability to pay to the amounts contained on Debtors' Form B22A, when there was evidence that certain expenses

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[5] When the United States Trustee recalculated the Debtors' Form B22A monthly disposable income, an additional $200 operating expense was allowed under the means test for each Debtor's primary vehicle. *See* fn. 6, *supra*.

[6] It is premature to address the merits of a special circumstances rebuttal argument. However, some bankruptcy courts have ruled that extraordinary transportation expenses can constitute special circumstances that justify an expense adjustment that rebuts the presumption of abuse, while other courts would not consider these type of expense adjustments to qualify as special circumstances. *Compare In re Pederson*, 2006 WL 3000104, at *3-4 (Bankr. N.D. Iowa 2006) *with In re Johns*, 342 B.R. 626, 628-29 (Bankr. E.D. Okla.2006).

on the Form B22A did not reflect the reasonably anticipated expenses they actually incur on a monthly basis. Thus, the bankruptcy court must be reversed and the case remanded to the bankruptcy court for consideration of the United States Trustee's motion to dismiss under 11 U.S.C. § 707(b)(3)(B) based on the totality of the circumstances, including the Debtors' actual ability to repay their debts.

ARGUMENT

I. Pursuant to the Plain Language of 11 U.S.C. § 707(b)(2), Interpretive Case Law and Legislative Intent, the IRS Local Standard for Vehicle Acquisition Is Not Applicable to Debtors Who Do Not Have Monthly Loan or Lease Payments.

On Lines 23 and 24 of their Official Form B22A, which is an official form of the Federal Rules of Bankruptcy Procedure, the Debtors claimed allowances for the IRS Local Standard referred to as vehicle ownership costs, even though they own their vehicles free and clear of liens. (R. 1-3). In denying the United States Trustee's Motion to Dismiss, the bankruptcy court allowed the Debtors to reduce their Current Monthly Income ("CMI") by the IRS Standard for vehicle financing costs for two vehicles, $471 for car one and $332 for car two, even though Debtors do not have any monthly payment obligation associated with the vehicles. Because this holding is contrary to the plain language and legislative intent of 11 U.S.C. § 707(b)(2)(A)(ii)(I), it must be reversed.

A. The Plain Language of 11 U.S.C. § 707(b)(2) Limits the IRS Local Standards, Including the Local Standard Referred to as Vehicle Ownership Cost, to Debtors for Whom the Expense is "Applicable"

Section 707(b)(2)(A)(ii)(I) of the Bankruptcy Code provides that a debtor's monthly expenses shall be the debtor's "*applicable* monthly expense amounts specified under the . . . Local Standards . . . issued by the Internal Revenue Service." 11 U.S.C. § 707(b)(2)(A)(ii)(I) (emphasis added). The plain language of the statute thus specifically provides that before the specific IRS expense amounts may be included in the debtor's allowed monthly expenses, the expense itself must first be *applicable* to the debtor.

As recently stated by the court in *In re Devilliers*, ---- B.R. ----, 2007 WL 92504 (Bankr. E.D. La. January 9, 2007), by using the word "applicable" in section 707(b)(2)(A)(ii)(I), Congress limited eligibility for expenses under the Local Standards to debtors for whom the expenses actually apply. Only after "a determination is made as to the type of expenses allowed and applicable to the debtor" may the debtor claim the amount set forth under the IRS Local Transportation Standards. *In re Devilliers*, 2007 WL 92504 at *6 (Bankr. E.D. La. January 9, 2007). *See also In re Wiggs,* ---- B.R. ----, 2006 WL 2246432, *2-3 (Bankr. N.D. Ill. 2006) (in application of § 707(b)(2)(A)(ii)(I) in context of § 1325 of the Bankruptcy Code, court finds that the statute is "clear and unambiguous," and that the "term 'applicable' modifies the amounts specified to limit the expenses to only those that apply," such that debtors were not allowed to include the standard ownership expense for transportation ownership when they did not have a payment on the vehicle). *Accord In re Demonica*, 345 B.R. 895, 904 (Bankr. N.D. Ill. 2006).[7]

Thus, the plain language of § 707(b)(2)(A)(ii)(I) specifically provides a two-step process for bankruptcy courts to employ before the specific IRS expense amounts may be included in the debtor's allowed monthly expenses. First, the debtor must be eligible to

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[7] *Demonica* is relied on by the bankruptcy court in *In re Fowler*, 349 B.R. 414 (Bankr.D.Del. 2006), a case that is cited and relied upon by the court below in its *Grunert* decision. The *Fowler* court misconstrues *In re Demonica*. In fact, *In re Demonica* like the *In re Wiggs* decision, held that a loan or lease payment was required in order to qualify for the IRS Transportation Ownership Cost expense Standard. The *Demonica* Court allowed the debtor to take an expense adjustment because the debtor in that case established that he actually made payments on the vehicle at issue, even though he did not have a contractual liability on the vehicle loan. *In re Demonica*, 345 B.R. at 905.

claim the expense category, that is, the expense itself must be *applicable* to the debtor. Second, if the expense is *applicable* to the debtor, then the specified amount for the debtor's locale is selected from the IRS Local Standards. Thus, a plain reading of the statute leads to the conclusion that Congress necessarily restricted each of the categories of expense allowances in that section, including the IRS Local Standards for transportation, to those debtors for whom such expenses *apply*.

B. The Internal Revenue Service's Application of Its Own Local Standard for Vehicle Acquisition Costs, and Interpretive Case Law, Support the United States Trustee's Reading of 11 U.S.C. § 707(b)(2)(A)(ii)(I).

To determine whether the expense standards issued by the IRS are applicable, the most logical resource to consult is the source of the expense standards, the IRS. On page two of its Collection Financial Standards under the heading "Transportation," the IRS provides as follows:

> The transportation standards consist of nationwide figures for monthly loan or lease payments referred to as ownership costs, and additional amounts for monthly operating costs . . . . The ownership costs provide maximum allowances for the lease or purchase of up to two automobiles if allowed as a necessary expense . . . . If a taxpayer has a car payment, the allowable ownership cost added to the allowable operating cost equals the allowable transportation expense**. If a taxpayer has no car payment, or no car, the operating costs portion of the transportation standard is used to come up with the allowable transportation expense.**

See IRS Collection Standards (emphasis added), available at ww.irs.gov/individuals/article/0,,id=96543,00.html; *see also* Internal Revenue Manual, Financial Analysis Handbook, Pt. 5, ch. 15, § 5.15.1.7(4.B), available at www.irs.gov/irm/part5/ch15s01.html.

Thus, according to the IRS, if the debtor does not have a loan or lease payment obligation, then the Local Standard referred to as vehicle ownership costs is not "applicable." If the debtor's vehicle is subject to a monthly loan or lease payment obligation, however, then in addition to the vehicle "operating cost" expense, the "ownership cost" is also "applicable," and shall be the dollar amount specified by the IRS. This application of the means test is supported by the significant bankruptcy court authority.[8]

The court below, in its *Grunert* decision, which was followed without discussion in this case, concurred with the courts in *In re Farrar-Johnson* and *In re Fowler* in drawing a distinction between "applicable" and "actual" expenses. In particular, citing *Farrar-Johnson,* the court stated in *Grunert:*

> Congress drew a distinction in the statute between 'applicable' expenses on the one hand and actual' expenses on the other. "Other Necessary Expenses" must be debtor's "actual" expenses. Expenses under the "Local Standards," in contrast, need only be those "applicable" to the debtor–because of where he lives and how large his household is. It makes no difference whether he "actually" has them."

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[8] *See In re Barraza*, 346 B.R. 724, 728-29 (Bankr. N.D. Tex. 2006) (debtor not entitled to standard ownership allowance for vehicle without a loan or lease payment); *In re McGuire*, 342 B.R. 608, 613-14 (Bankr. W.D. Mo. 2006) (chapter 13 debtors not permitted standard ownership allowance for vehicle owned free and clear of liens). *See also*, *In re Harris*, 353 B.R. 304, 307-309 (Bankr. E.D. Okla. 2006); *In re Hardacre*, 338 B.R. 718, 723-24 (Bankr N.D. Tex. 2006); *In re Oliver*, 350 B.R. 294, 301 (Bankr. W.D. Tex. 2006); *In re Wiggs*, ---- B.R. ----, 2006 WL 2246432, at *2-3 (Bankr. N.D. Ill. August 4, 2006); *In re Carlin*, 348 B.R. 795 (Bankr. D. Or. 2006); *but see In re Fowler*, 349 B.R. 414 (Bankr. D. Del. 2006) (debtors may deduct ownership expenses for a vehicle for which they do not make car payments); *In re Haley*, 354 B.R. 340, 2006 WL 2987947 (Bankr. D. N.H. October 18, 2006) (same); *In re Farrar-Johnson*, 353 B.R. 224 (Bankr. N.D. Ill. 2006) (debtors entitled to deduct IRS Local Standard for housing even though they had no actual housing expense); *In re Zak*, ---- B.R. ----, 2007 WL 143065 (Bankr. N.D. Ohio January 12, 2007).

Grunert, 353 B.R. at 593 (citing *In re Farrar-Johnson,* 353 B.R. at 230-231). This reasoning was recently considered and appropriately rejected by the bankruptcy court in *In re Slusher*, ---- B.R. ----, 2007 WL 118009 (Bankr. D. Nev. January 17, 2007).

As explained by the *Slusher* court, when Congress developed the means test, it "could have started from scratch, and created a system that was rigid but easy to administer, such as how many view workers' compensation or social security schemes." *Id.* at *12. Instead, Congress "incorporated into the Bankruptcy Code an existing, administrative system that the IRS had long had in place." *Id.* This incorporation "strongly suggests that courts should look to how the IRS determined those standards; that is, as to how the IRS would have applied them in similar circumstances." *Id.* at * 14**.** Thus, "if guidance is sought on the meaning of the IRS standards Congress incorporated into the Bankruptcy Code, practical reason would suggest that court should consider the full manner by which the IRS uses these standards." *Id.*

The *Slusher* court also considered and rejected the notion entertained by some courts, *e.g. In re Fowler*, 349 B.R. 414 (Bankr. D. Del. 2006), and used by the court below in its incorporation of the *In re Grunert* conclusions, that considering IRS practice in interpreting "applicable" expenses in section 707(b)(2)(A)(ii)(I) would negate the section's later allowance of "actual" monthly expenses in the IRS categories of Other Necessary Expenses. As the *Slusher* court correctly explained, "a natural reading" of § 707(b)(2)(A)(ii)(I) indicates that the words "actual" and "applicable" limit the relevant expense deductions in different ways. *In re Slusher*, ---- B. R. ----, 2006 WL 118009 at *13. The *Slusher* Court stated:

> [O]ne is a limitless deduction within the specified categories of Other Necessary Expenses, and the other is a deduction limited to the amount and type specified by the IRS. Had Congress intended to indiscriminately allow all expense amounts specified in the National and Local Standards, it would have written section 707(b)(2)(A)(ii)(I) to read, "The debtor's monthly expenses shall be the monthly amounts specified under the National Standards and Local Standards . . ." rather than "The debtor's monthly expenses shall be *the debtor's applicable* monthly expenses amounts specified under the National and Local Standards." This distinction may not appear from the dictionary definitions of both terms, but it did, and does, belong to the IRS' historical and practical use of those standards at the time Congress adopted BAPCPA. In referring to such specialized standards, it would be quite odd if Congress intended to preclude courts from examining the context in which the authoring agency, the IRS, used and employed those standards."

Id. (emphasis in original; citation omitted).

In addition to the IRS Collection Financial Standards themselves, the IRS also publishes guidelines, including the Internal Revenue Manual, that support a reading of § 707(b)(2)(A)(ii)(I) that requires debtors to have an actual loan or lease payment obligation on a vehicle before the Local Standard referred to as ownership cost "applies." Recent revisions to the Collection Financial Standards also make clear that the "ownership cost" is calculated by the IRS based on the "five-year average of new and used car financing data compiled by the Federal Reserve Board of Governors." *See* IRS Collection Financial Standards cited above (at section entitled "Recent Revisions"). As such, the "ownership cost" is intended to account for the reasonable expense of financing a vehicle over five years and is inapplicable if a debtor has no such acquisition financing expense.

Accordingly, guidance in applying its expense standards published by the IRS make clear that the "ownership cost" portion of the Local Transportation Standards is intended to apply only in situations where the debtor has a monthly vehicle acquisition financing expense, *i.e.*, has a monthly vehicle lease or loan payment. *Cf. McGuire*, 342 B.R. at 613 ("Thus, if a debtor is not incurring expenses for the purchase or lease of a vehicle, the debtor cannot claim a vehicle ownership expense under the IRS standards.") "Because the Local Standards are issued by the IRS, it is instructive to refer to publications of that organization for guidance as to the types of 'debt payments' that can reduce allowances under the Local Standards." *Hardacre*, 338 B.R. at 726.

C. Congressional Intent Supports Allowing the IRS Local Standard for Vehicle Ownership Costs Only to Debtors Who Have An Applicable Ownership Expense.

The United States Trustee's interpretation of section 707(b)(2)(A)(ii)(I) is necessary to give effect to the intent of Congress in enacting the means testing provisions of the BAPCPA. *See, e.g., Owner-Operator Independent Driver's Ass'n, Inc. v. New Prime, Inc.*, 192 F.3d 778, 785 (8th Cir. 1999) (while court's principal focus must be on the language of the relevant statute, court cannot ignore the broader perspective and may use legislative history to confirm most plausible construction of statute) (*citing Wisconsin Public Intervenor v. Mortier*, 501 U.S. 597, 610 (1991)).

Congressional intent to remove judicial discretion regarding whether a debtor with ability to pay should be dismissed from chapter 7, is demonstrated by early committee reports on the bankruptcy reform legislation introduced in 2000.[9] This legislative history provides:

> . . . [It] is intended to both remove unequivocally the bankruptcy court's discretion with regard to whether a debtor with ability to pay should be dismissed from chapter 7, and to restrict as much as possible reliance upon judicial discretion to determine the debtor's ability to pay. Limited judicial discretion remains to deal with the hardship case, but that discretion is not to be abused by lax enforcement of the standards . . . .

146 Cong. Rec. S11683-11729 at 11700 (section-by-section explanation of HR 2415), Dec. 7, 2000.

By allowing every debtor who owns a car to take the IRS Transportation "car financing cost" expense in addition to the IRS Transportation "operating cost" expense and not limiting this expense allowance to debtors who really incur monthly vehicle acquisition finance expenses, the bankruptcy court has in fact reserved for itself more judicial discretion. Under the bankruptcy court's interpretation that the debtor's real expenses are irrelevant, most of the abuse motions will be considered under § 707(b)(3), where the court has broader discretion and no presumptions apply. This result frustrates the purpose of the means test as a whole and is exactly the opposite of what Congress intended by adding the bright line means test under the BAPCPA. *Id.*

For all these reasons, the bankruptcy court's determination that § 707(b)(2)(A)(ii)(I) authorizes the Debtors to reduce their CMI for a vehicle ownership expense when the Debtors have no ownership or lease payment must be reversed, and the case remanded to

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[9] Because there is very little legislative history pertaining to the BAPCPA itself, legislative history pertaining to its substantially similar predecessor may be instructive.

the bankruptcy court for further proceedings in accordance with the presumption of abuse that arises in this case under 11 U.S.C. § 707(b)(2).

II. The Bankruptcy Court Erred By Failing to Consider the Debtors' Ability to Pay in Assessing the Totality of the Circumstances Under 11 U.S.C. § 707(b)(3).

11 U.S.C. Section 707(b)(3) provides that dismissal for abuse may be considered "in a case in which the presumption [of abuse pursuant to § 707(b)(2)] does not arise or is rebutted." Section 707(b)(3) further provides that when determining a motion to dismiss under the subsection, the court shall consider whether "the totality of the circumstances . . . of the debtor's financial situation demonstrates abuse." Thus, assuming *arguendo* that no presumption of abuse arises in this case under the means test, the totality of the circumstances must be considered in determining whether the Debtors' bankruptcy filing constitutes an abuse under § 707(b)(3).

At the hearing on December 11, 2006, prior to the presentation of any evidence, the bankruptcy court erroneously determined that because the debtors had "above the median" income the court's evaluation of the debtors' ability to pay, under the totality of the circumstances, was limited to the income and expense amounts contained on the Form B22A. The court stated:

> [I]f [an] above-median debtor passes the means test, then the totality of the circumstances cannot include inappropriate expense deductions on schedule J because the means test is where we are to perform it and how we are to perform it, and part of the means test is looking back and looking at the date of the petition and if – **I'm saying that the totality of the circumstances has to be more than something's wrong on schedule J because your schedule J arguments are subsumed for above-median debtors by the means test**. (December 11 Hearing Transcript at 14) (emphasis added).

* * *

> [I]f you're above median and you have passed this [the means test], the totality of the circumstances don't suggest an abuse because this is the test Congress wanted to substitute. (December 11 Hearing Transcript at 15-16).

By reading § 707(b)(2) as the last word in determining a debtor's ability to pay for abuse purposes the bankruptcy court eviscerates from § 707(b)(3) an important function of adding flexibility to address financial circumstances that have changed from the date the Form B22A was prepared.

A. The Debtors' Actual Ability to Repay Their Debts Must Be Considered Under Section 707(b)(3).

The bankruptcy court in *In re Mestemaker*, ---- B.R. ----, 2007 WL 79306 (Bankr.N.D.Ohio Jan. 10, 2007) recently addressed the ability to pay issue in the context of above[10] median income debtors. In *Mestemaker,* the debtors' actual income exceeded their expenses by nearly $300 per month, but their disposable income under the means test calculation was under the amount which would trigger a presumption of abuse. The United States Trustee moved for dismissal under § 707(b)(3) based on the totality of the circumstances, and the debtors objected arguing, *inter alia,* that the means test was conclusive as to their ability to pay. The bankruptcy court found that the plain language of § 707(b)(3) required the court to evaluate the debtors' actual income and expenses

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[10] Relative to below the median income debtors, courts that have addressed the issue in reported decisions have uniformly found that a debtor's ability to pay may be considered as part of the totality of the circumstances of the debtor's financial situation under § 707(b)(3)(B). *See, e.g., In re Pak,* 343 B.R.239, 241 (Bankr. N.D. Cal. 2006); *In re Paret*, 342 B.R.12, 17 (Bankr. D.Del. 2006).

notwithstanding the result of the means test. *Id. Accord In re Hare*, 2007 WL 201249, *2 (Bankr. E.D. Cal. Jan. 24, 2007) (slip copy) (Section 707(b)(3) is an independent review for abuse distinct from the means test, consistent with the structure of § 707(b).

The court in *Mestemaker* concluded that considering the debtor's financial situation allows § 707(b)(3) to function as intended – as a counterpart to the rebuttal provision of § 707(b)(2)(B):

> Section 707(b)(2)(B) provides the circumstances under which the presumption of abuse may be rebutted . . . . To the extent that a debtor succeeds in rebutting the presumption of abuse, the presumption dissipates and the party moving for dismissal based upon abuse has the burden of showing such abuse independent of the means test calculation.
>
> In light of the fact that Congress specifically addressed the situation where a debtor has greater expenses and/or lower income than what is accounted for under the means test calculation, it is unreasonable to interpret § 707(b) as not providing for circumstances where a debtor has fewer expenses and/or higher income than what is set forth under the means test. The plain language of § 707(b)(3) provides for a court to consider that very circumstance. . . . **The plain meaning of the phrase "debtor's financial situation" must include a debtor's actual income and expenses, since such information is the starting point for any analysis of an individual's financial situation. There is no provision in § 707(b) stating that the means test is the only method through which a court may determine whether there is abuse based on a debtor's ability to pay. Rather, the plain language of § 707(b)(3), read in conjunction with § 707(b)(1) and (2), is clear and compels a conclusion that a court must consider a debtor's actual debt-paying ability in ruling on a motion to dismiss based on abuse where the presumption does not arise or is rebutted.**

In re Mestemaker, ---- B.R. ----, 2007 WL 79306 at *4 (citations omitted)(emphasis added).

The analysis required by § 707(b)(3) is necessarily subjective and does not limit the court's discretion to consider a debtor's ability to pay in making a determination whether the case filing constitutes an abuse. To the contrary, § 707(b)(3) effectively *requires* the court to consider a debtor's ability to pay outside of the confines of the means test because it expressly requires the court to consider the "totality" of the debtors "financial situation" in determining whether the debtor's case is an abuse. *See, e.g., In re Lenton*, ---- B.R. ----, 2006 WL 3850011 at *8 (Bankr. E.D. Pa. Dec. 15, 2006) ("The broad language 'totality of the circumstances' and 'financial situation' clearly encompasses a debtor's ability to pay."). Accordingly, to have meaning, the phrase "totality of the circumstances of the debtor's financial situation" in § 707(b)(3) must also include consideration of the debtor's ability to pay his or her debts. *See also In re McUne*, ---- B.R. ----, 2006 WL 3734388 at *1 (Bankr. D.Or. Dec. 19, 2006) ("what could be more central to a debtor's financial situation than his income and expenses") *(citing In re Pak*, 343 B.R. 239, 241 (Bankr. N.D.Cal. 2006)).

B. The § 707(b)(2) Means Test and Form B22A are a Mechanical Proxy for the Debtors' Ability to Pay Unsecured Creditors, But Does Not Constitute the Debtors' Ability to Pay Under § 707(b)(3)'s Totality of the Circumstances.

As discussed, supra, at 6-7, § 707(b)(2) imposes a mechanical means test. The means test is a calculation of monthly disposable income which represents the amount available to a debtor to pay their accrued unsecured debts. In order to determine the debtor's ability to pay under the means test contained in § 707(b)(2), a debtor completes Form B22A.[11] Applying this statutory provision, on Form B22A the debtor inserts categories of income and categories of expenses in accordance with the statutory methodology. Regarding

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[11] Subsection (b)(2) incorporates certain defined terms in setting forth its income and expense methodology, such as "current monthly income" which is set forth in 11 U.S.C. § 101(10A). Form B22A then provides for a mathematical computation of the debtor's ability to pay, employing the § 707(b)(2) income and expense methodology.

expenses, the methodology instructs the debtor to use standardized amounts for certain expense categories and actual amounts for other expense categories.

The purpose of the § 707(b)(2)(A) and Form B22A exercise is to provide the United States Trustee, the case trustee, creditors and ultimately the bankruptcy court, with an initial, streamlined, day of preparation assessment - a proxy - of the debtor's ability to repay their accrued unsecured debts. In most cases, this streamlined proxy is sufficient to determine the debtor's ability to pay. However, in other cases the court must undertake a more comprehensive analysis of the debtor's repayment ability. The Form B22A proxy may not be a reliable proxy of the debtor's repayment ability because: (1) a change of circumstances impacts the amounts of income included in the proxy calculation; (2) a change of circumstances impacts the expense amounts included in the proxy calculation; (3) the expense amounts in the proxy calculation are not reasonable or necessary for the particular debtor; and (4) expense amounts are included in the proxy that the debtor does not actually incur on a monthly basis.

Consequently, Congress included in § 707(b) provisions which incorporate flexibility to assess and if necessary make adjustments to the ability to pay proxy calculated under § 707(b)(2)(A). Sections 707(b)(2)(B) and 707(b)(3)(B) provide flexibility to address situations if a party demonstrates that the Form B22A is not a reliable proxy on a particular case. *See In re Casey*, ---- B.R. ----, 2006 WL 3071401, *4 (Bankr. E.D. Wash. 2006) (in context of chapter 13 case, Form B22A calculation is "modified by any anticipated change in financial circumstances . . . .").

1. Decreased Income

The income on the Form B22A proxy includes amounts the debtor received in the six full months before the month in which the petition is filed. Obviously, there are situations in which a debtor reasonably anticipates lower income than is reported on the proxy form. These situations include: a job loss, cutback on overtime requirements, or a one time income event such as a relocation bonus or a lump sum back-pay settlement. The flexibility in § 707(b) to address these reduced income situations is found at § 707(b)(2)(B), the "special circumstances" provision. In these reduced income situations, a debtor can establish through admissible evidence that there is an adjustment that must be made to the income amount reported on the Form B22A because the amount on the B22A is not reflective of the monthly income the debtor reasonably anticipates receiving. *See In re Zimmerman*, 2007 WL 295452, *8 (slip copy) (Bankr. N.D. Ohio 2007).

2. Increased Income

There also may be situations with increased income. *In re Pak*, 343 B.R.239 (Bankr. N.D. Cal. 2006), is a good example. Debtor was unemployed for 5 of the 6 months used to calculate income on the proxy B22A form because he had been unemployed. Evidence established that the income on the proxy B22 Form was not reflective of debtor's income because it only included 1/6th of his reasonably anticipated income. The court therefore dismissed the case under section 707(b)(3).[12]

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[12] In response to the court's granting the United States Trustee's § 707(b)(3) motion, the *In re Pak* debtor converted his case to chapter 13. In chapter 13, he sought to confirm a plan using the Form B22A income which represented only 1/6th of his reasonably

3. Decreased Expenses

A party may also assert that the Form B22A proxy is not reflective of the debtor's ability to pay under Section 707(b)(3) because one or more expenses are not reasonable and necessary or are not actually incurred. Examples of this type of claim would be a mortgage on a vacation or second home, or monthly payment for a loan on a boat or other recreation vehicle, which are an allowed expense deduction under section 707(b)(2)(A)(iii) but which are generally considered luxuries not reasonable or necessary for the debtor. The United States Trustee is not aware of any reported decisions[13] regarding challenges that an expense allowed under the (b)(2) means test should not be allowed when a more comprehensive analysis is conducted under Section 707(b)(3) because the expense is not reasonable or necessary. In addition, this includes property for which some courts allow the debtor to take Form B22A proxy expense deduction notwithstanding that such property is being surrendered by the debtor and will have no payments post-petition for secured debt, and situations like the case where the debtor is allowed to take expense deductions for the IRS

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anticipated income and the court denied confirmation. *See In re Pak*, 343 B.R. 239 (Bankr. N.D. Cal. 2006). Following objections by the chapter 13 trustee and United States Trustee, the court considered plan confirmation in the context of sections 1325(b)'s "projected disposable income", which has been applied by other courts as providing flexibility to address circumstances changed from the proxy form, just as the totality of the circumstances under section 707(b)(3) provides flexibility to account for changed circumstances.

[13] One reason for the absence of reported decisions is because the debtor may convert to chapter 13 in conjunction with a successful § 707(b)(3) motion, and thus no decision is reported. *See In re Nockerts*, ---- B.R. ----, 2006 WL 3689465 (Bankr. E.D. Wis. December 14, 2006).

Standard for vehicle acquisition financing costs even though the debtor has no loan or lease payment obligation.

C. Considering the Debtors' Ability to Pay Is Wholly Consistent With BAPCPA's Legislative History.

Through enactment of the BAPCPA, Congress sought to adopt a broad approach to § 707(b)(3), including the additional discretion to consider a debtor's actual ability to pay as part of the totality of the circumstances, as outlined by the First Circuit in *In re Lamanna*, 153 F. 3d 1 (1st Cir. 1998). As stated in a committee report on the bankruptcy reform legislation introduced in 2000:

> [S]ituations in which courts dismiss debtors from Chapter 7 today clearly continue to be grounds for dismissal under HR 2415, including such cases as In re Lamanna,153 F.3d 1 (1st Cir. 1998). In addition, since the standard is "abuse" rather than "substantial abuse," the courts are clearly given ***additional discretion*** to control abusive use of chapter 7 when that is appropriate . . . .

146 Cong. Rec. S11683-11729 (section by section explanation of HR 2415), Dec. 7, 2000 (emphasis added). A reading of amended § 707(b)(3) that requires courts to rely only on a petition-date-snapshot of the debtor's financial circumstances represented by the Form B22A, in considering a debtor's ability to pay, would thwart the statute's purpose. This interpretation would make it *more* difficult for judges to dismiss cases that are abuses of the chapter 7 provisions, rather than to *increase* the court's power to curb such abuses.

Congress has expressly approved the application of the test set forth in *Lamanna* and indicated that it did not intend for the means test to foreclose inquiry into a debtor's ability to pay under the totality of the circumstances analysis in § 707(b)(3). In applying pre-

BAPCPA § 707(b), the First Circuit stated in *Lamanna* that the totality of the circumstances test "demands a comprehensive review of the debtor's current and **potential financial situation**." *Lamanna,* 153 F.3d at 4 (emphasis added).

D. Considering the Debtors' Ability to Pay Is Wholly Consistent With the Sixth Circuit's Interpretation of § 707(b)(3)(B)'s Substantially Similar Predecessor.

The Sixth Circuit has long held that in considering motions to dismiss under § 707(b) that a debtor's ability to pay is the primary factor in evaluating the totality of the circumstances, and that such ability to pay *alone* may warrant dismissal. *In re Krohn*, 886 F. 2d 123, 126-127 (6th Cir. 1989). In *Krohn*, the Court stated that:

> Among the factors to be considered in deciding whether a debtor is needy is his ability to repay his debts out of future earnings. That factor alone may be sufficient to warrant dismissal. For example, a court would not be justified in concluding that a debtor is needy and worthy of discharge, where his disposable income permits liquidation of his consumer debts with relative ease.

Id. at 126 (citations omitted) (emphasis added). More recently, the Sixth Circuit categorically reaffirmed and followed this principle in *In re Behlke*, 358 F.3d 429, 434-435 (6th Cir. 2004) (affirming dismissal where debtors had the ability to repay a percentage of their debts). In *Behlke*, the Court of Appeals explained that the totality of the circumstances test evaluates whether the debtor is needy and whether he has the ability to repay his debts:

> In addition to evaluating ability to pay debts out of future income, other factors to be taken into account to determine if the debtors are "needy" include whether debtors enjoy a stable source of income, whether debtors'

> expenses can be reduced significantly without depriving them of adequate food, clothing, shelter and other necessities and whether debtors' financial situation is the result of an unforseen catastrophic event.

Id. at 437 (citing *Krohn*).

As articulated by the *Lamanna* court, and as provided in *Krohn*, the primary factor under the totality of the circumstances test is the court's assessment of the debtor's ability to fund a chapter 13 plan out of future disposable income. *Id.*, n. 7.

E. The Bankruptcy Court's Refusal to Consider Debtor's Ability to Pay Based on Their Decreased Expenses and Increased Income Was Erroneous.

In considering the Debtors' ability to pay in this case the bankruptcy court should have considered the following evidence and testimony. First, the Debtors own six vehicles. (R. 1-12, Schedule B). The Debtors therefore may not need to procure a replacement vehicle. The Debtors presented no evidence regarding when they anticipated a replacement vehicle or the anticipated cost or credit terms for such a vehicle. *See, In re Lenton, supra*, 2006 WL 3850011 at *11.

Second, the Debtors testified they had made no post-petition payments on their time share or the vacuum cleaner, included as Schedule J Expenses for $155.82 and $42.39, and that these assets would be surrendered (R. 1-48, pp. 35-36).

Third, the Debtors testified that in the four months post-petition, Debtors had compiled $2,000 in cash after paying monthly expenses. (R. 1-48, pp. 36-38, 63-65). This equates to $500 per month of actual net income for the Debtors.

Based on the evidence and undisputed testimony, Debtors appear to have actual net monthly income in the amount of at least $200 which they can devote to paying creditors. The repayment threshold for abuse Congress established under the BAPCPA is $100 - $167, depending on the level of unsecured debt. 11 U.S.C. § 707(b)(2)(A)(i). More than $167 in monthly disposable income is sufficient to support dismissal under § 707(b) regardless of debt level. Expense amounts on Debtors' Form B22A that were allowed by the bankruptcy court were not expenses incurred by the Debtors on a monthly basis based on the evidence presented. The United States Trustee established that a more comprehensive assessment of the Debtors' finances was warranted under § 707(b)(3)'s totality of the circumstances. Thus, the bankruptcy court's decision must be reversed for the court to examine the evidence of repayment ability on the United States Trustee's Section 707(b)(3) motion to dismiss and not just mechanically apply the expense amounts set forth on the Debtors' Form B22A.

CONCLUSION

For all these reasons, the United States Trustee respectfully asks this Court to reverse the December 11, 2006 Order entered by the bankruptcy court denying the United States Trustee's motion to dismiss, and remand this case to the bankruptcy court for further proceedings.

Respectfully submitted at Milwaukee, Wisconsin, this 9th day of February, 2007.

WILLIAM T. NEARY
UNITED STATES TRUSTEE

By: /s/
David W. Asbach
Assistant United States Trustee
David W. Asbach Bar Number: 1003651
Attorney for Appellant
Office of the United States Trustee
Eastern District of Wisconsin
517 East Wisconsin Avenue, Room 430
Milwaukee, WI 53202
Phone: (414) 297-4499; Fax: (414) 297-4478
E-Mail: dave.w.asbach@usdoj.gov

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In re Marvin Ross Tousey and Deborah Tousey (UST v. Tousey)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*
7th Cir.

3. ("CCN") ***CURRENT*** CASE NO.
No.: 07-2503

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Sean E. Martin, David W. Asbach, Michelle S. Y. Cramer, P. Matthew Sutko, William T. Neary
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***
•Does a debtor have an "applicable" vehicle ownership expense under 11 U.S.C. 707(b)(2)(A)(ii)(I) when the debtor has no loan or lease payment on the vehicle?

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IN THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

In re MARVIN ROSS-TOUSEY and DEBORAH TOUSEY,
Debtors.

MARVIN ROSS-TOUSEY and DEBORAH TOUSEY,
Debtors-Appellants,

v.

WILLIAM T. NEARY,
United States Trustee-Appellee.

ON APPEAL FROM
THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF WISCONSIN

BRIEF OF APPELLEE WILLIAM T. NEARY, UNITED STATES TRUSTEE

ROBERTA A. DEANGELIS
Acting General Counsel

P. MATTHEW SUTKO
Associate General Counsel
SEAN E. MARTIN
Executive Office for United States Trustees
Department of Justice
20 Massachusetts Avenue, N.W.
Washington, D.C. 20530
(202) 307-1399

COURT OF APPEALS DOCKET NO. 07-2503

IN THE UNITED STATES COURT OF APPEALS
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In re MARVIN ROSS-TOUSEY and DEBORAH TOUSEY,
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MARVIN ROSS-TOUSEY and DEBORAH TOUSEY,
Debtors-Appellants,

v.

WILLIAM T. NEARY,
United States Trustee-Appellee.

ON APPEAL FROM
THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF WISCONSIN

BRIEF OF APPELLEE WILLIAM T. NEARY, UNITED STATES TRUSTEE

ROBERTA A. DEANGELIS
Acting General Counsel

P. MATTHEW SUTKO
Associate General Counsel
SEAN E. MARTIN
Executive Office for United States Trustees
Department of Justice
20 Massachusetts Avenue, N.W.
Washington, D.C. 20530
(202) 307-1399

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JURISDICTIONAL STATEMENT

Summary

The jurisdictional summary in the appellant's brief is complete and correct. The bankruptcy court had jurisdiction over the bankruptcy case of debtors Marvin Ross-Tousey and Deborah Tousey (the "Debtors") under 28 U.S.C. 157. The district court had appellate jurisdiction under 28 U.S.C. 158(a)(1). This Court has jurisdiction under 28 U.S.C. 158(d)(1). The Debtors timely filed a notice of appeal on June 20, 2007, from the district court order entered May 21, 2007.

Jurisdictional Discussion

This discussion addresses three distinct jurisdictional matters. First, because this Court has never addressed whether bankruptcy court orders denying section 707(b) motions to dismiss are final orders, we explain why they are. Second, we acknowledge the United States Trustee's section 707(b)(2) claim was untimely filed, but explain that the Debtors waived this non-jurisdictional defect by not raising it before the trial court or on appeal. Third, we explain that the district court's order reversing the bankruptcy court, and remanding for further proceedings, is final because there are no significant further proceedings for the bankruptcy court to decide upon remand.

A. The bankruptcy court order is final.

1. The bankruptcy court order is final because it "resolve[d] all contested issues on the merits and [left] only the distribution of estate assets to be completed." Matter of Wade, 991 F.2d 402, 406 (7th Cir. 1993). The United States Trustee's section 707(b) motion to dismiss instituted a contested matter governed by Federal Rule of Bankruptcy Procedure 9014. See also Fed. R. Bankr. P. 1017(f)(1) (Rule 9014 governs proceedings to dismiss a case). The order denying the motion resolved that contested matter. See In re UAL Corp., 408 F.3d 847, 850 (7th Cir. 2005) (an order resolving a contested matter is final if equivalent to the disposition of a stand-alone suit).

The bankruptcy court's order denying the motion to dismiss resolved the issue of the United States Trustee's claim that granting relief to the debtor was an abuse of chapter 7, and rejected the relief sought by the United States Trustee's motion. The order was a formal adjudication of the section 707(b) proceeding: it determined the right of the debtor to proceed and determined the case would not be dismissed for abuse. This is the epitome of a final order. See In re Morse Electric Co., 805 F.2d 262, 265 (7th Cir.1986) ("Finality of the order comes from the fact that it resolves all of [the appellant's] claims . . .").

2. The bankruptcy court order denying the United States Trustee's

section 707(b) motion is more final than most bankruptcy court orders determining contested matters, because the Bankruptcy Code's statutory deadline for moving to dismiss this case for presumed abuse, set out in section 704(b)(2), has expired. See 11 U.S.C. 704(b)(2) (establishing a 30-day deadline for the United States Trustee to file a motion to dismiss under section 707(b)(2) measured from the date of the United States Trustee's filing an initial statement under section 704(b)(1) regarding whether the case would be a presumed abuse under section 707(b)(2)). In addition, the deadline for bringing a motion to dismiss for abuse under section 707(b)(3) has expired. See Interim Fed. R. Bankr. P. 1017(e)(2) (establishing that a motion to dismiss for abuse under section 707(b)(3) must be brought within 60 days after the first date set for the meeting of creditors).

In this case, the deadline for the United States Trustee to file a motion to dismiss for presumed abuse under section 707(b)(2) expired on October 30, 2006.[1] The deadline for filing a motion to dismiss for abuse under section 707(b)(3) expired on November 20, 2006.[2]

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[1] October 30, 2006 is 30 days after September 29, 2006, the date when the United States timely filed his statement under section 704(b)(1). See United States Trustee's Appendix, p. 3.

[2] November 20, 2006 is 60 days after September 21, 2006, the first date set for the meeting of creditors. See United States Trustee's Appendix, p. 11.

Therefore, in the section 707(b) context, the bankruptcy court can longer consider whether grounds exist for dismissal of the case for abuse, because the deadlines expired under section 704(b)(2) and Interim Rule 1017(e)(2).

Other types of motions to dismiss bankruptcy cases are not subject to the time bar that restricts section 707(b) motions. For example, a motion to dismiss a chapter 7 case for "cause" under section 707(a) has no statutory or Bankruptcy Rule deadline and could be renewed if denied. See also 11 U.S.C. 1112(b) (permitting dismissal of chapter 11 case for "cause" but establishing no deadlines for seeking such dismissal; the Bankruptcy Rules also set no relevant deadline); 11 U.S.C. 521(i) (setting grounds for "automatic[]" dismissal but establishing no deadlines for seeking orders dismissing such cases; the Bankruptcy Rules also set no relevant deadline). But see Schwartz v. Geltzer (In re Smith), 507 F.3d 64 (2d Cir. 2007) (treating the denial of a section 707(a) motion as final without analysis).

3. Although the United States Supreme Court and this Court have not specifically addressed whether orders denying section 707(b) motions are final, the clear weight of circuit law supports the conclusion that they are. Three United States courts of appeals – the Eighth, Third, and Fifth – have adjudicated appeals from bankruptcy court orders denying section 707(b) motions to dismiss under the

pre-2005 version of the statute. Two expressly held such orders are final. See Stuart v. Koch (In re Koch), 109 F.3d 1285, 1289 (8th Cir. 1997) (holding that an order denying a section 707(b) motion to dismiss a chapter 7 case for substantial abuse is final); In re Christian, 804 F.2d 46, 47-48 (3d Cir. 1986) (same). See also In re Cortez, 457 F.3d 448, 453-54 (5th Cir. 2006) (treating as final a bankruptcy court order denying the United States Trustee's section 707(b) motion to dismiss for substantial abuse).

4. These rulings are consistent with Seventh Circuit decisions treating a variety of orders finally deciding discrete disputes within bankruptcy cases as final. This Court has held, for example, that orders disposing of claims by creditors are final. See In re Morse Electric Co., 805 F.2d 262 (7th Cir. 1986). It has held that orders approving or failing to approve the sale of a debtor's property are final. See In re Sax, 796 F.2d 994, 996-97 (7th Cir. 1986). This Court has also held that orders resolving a controversy over who has the right to property are final. See In re Kaiser, 791 F.2d 73, 74 (7th Cir. 1986). It has further held that orders reopening bankruptcy proceedings are final. See In re Joslyn's Estate, 171 F.2d 159, 164 (7th Cir. 1948). Similarly, this Court has also recognized the following orders as final: orders denying relief from an automatic stay; orders determining exemptions; orders on sanctions; orders on appointments of trustees;

and orders confirming a bankruptcy plan. See Matter of Wade, 991 F.2d 402, 406 (7th Cir. 1992).

By contrast, bankruptcy court orders deemed interlocutory by this Court differ from the final determination in the Debtors' case, because those orders did not definitively decide a discrete proceeding within the case. In In re Salem, for example, this Court held that an order refusing to convert a closed chapter 7 case in New York into an existing chapter 13 case in Illinois was interlocutory. In re Salem, 465 F.3d 767, 774 (7th Cir. 2006). In In re Klein, similarly, this Court dismissed for lack of finality the appeal of an order not confirming the election of a chapter 7 trustee. In re Klein, 940 F.2d 1075, 1077 (7th Cir. 1991) (holding that order "did not resolve the substantive rights of the parties in any way, but merely decided one procedural question along the way."). Similarly, this Court ruled that denial of a motion to stay an order approving an interim distribution was not a final order, because the appellants had not established any entitlement to the funds in question. Matter of Forty-Eight Insulations, Inc., 115 F.3d 1294, 1299 (7th Cir. 1997). These cases are distinguishable from the Debtors' case because the bankruptcy court order in their case completely adjudicated the contested matter, and the United States Trustee can assert no further claims to dismiss their case under section 707(b).

Also distinguishable on two grounds is In re Vlasek, where this Court held that the denial of a pro se debtor's motion to dismiss his chapter 7 case was not final. In re Vlasek, 325 F.3d 955 (7th Cir. 2002). Vlasek is distinguishable first because, as we explain above, the denial of a section 707(b) motion is different from the denial of a motion to dismiss a bankruptcy case on other grounds. A section 707(b) motion is the functional equivalent of a cause of action and must be filed within a specified time period. When, as here, that deadline has expired, the denial order is final.

In Vlasek, the pro se debtor's motion to dismiss his case was not brought under section 707. Indeed, the motion did not reference any provision of the Bankruptcy Code. The basis for the motion consisted of the debtor's allegations, raised nearly two-and-a-half years into the case, that his mother had fraudulently signed his name to the petition. Id. at 958. In contrast to deadlines limiting the United States Trustee's motion in the Debtors' case, and the fact that future motions are time-barred, nothing would have prevented the debtor in Vlasek from filing multiple motions to dismiss throughout the years in which his case was open.[3]

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[3] In contrast to the deadlines that bar the United States Trustee from filing any further section 707(b) motion in the Debtors' case, nothing would prevent a party in a chapter 11 case from filing multiple motions to dismiss while a case is

Vlasek is also distinguishable because it addressed a unique circumstance that is not present in this matter. The practical effect of Vlasek was to avoid depriving a pro se debtor of his ability to appeal a fundamental ruling in his case. Vlasek's holding that the order was interlocutory did not preclude review, but rather allowed this Court to undertake review, in the face of an argument by the chapter 7 trustee, as appellee, that the debtor had forfeited his right to challenge the order by failing to file an immediate appeal. Id. at 960.

Because the bankruptcy court order constituted a final adjudication by the bankruptcy court of this controversy, it is an final order subject to appeal under 28 U.S.C. 158(a)(1).

B. The bankruptcy court had jurisdiction over the United States Trustee's untimely claim that the presumption of abuse arose in the Debtors' case under section 707(b)(2), because the statutory deadline for filing this claim is not a jurisdictional limit and the Debtors waived any objection to untimeliness.

Section 704(b) of the Bankruptcy Code sets a deadline for filing motions to dismiss chapter 7 cases for presumed abuse under section 707(b)(2) of the Code. 11 U.S.C. 704(b)(1)(A) (requiring the United States Trustee to file a statement

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open. See 11 U.S.C. 1112(b) (permitting dismissal of chapter 11 case for "cause" but establishing no deadlines for seeking such dismissal; the Bankruptcy Rules also set no relevant deadline). This Court has held that denials of motions to dismiss chapter 11 petitions are generally not final. See In re Jartran, Inc., 886 F.2d 859, 863-64 (7th Cir. 1989).

whether the debtor's case is presumed abusive under section 707(b)(2) within ten days of a debtor's 11 U.S.C. 341 meeting of creditors); and 704(b)(2) (requiring the United States Trustee to file a motion to dismiss under section 707(b)(2) within thirty days from the filing of the section 704(b)(1)(A) statement).

In this case, the United States Trustee timely filed the initial ten-day statement required by section 704(b)(1)(A) on September 29, 2006. United States Trustee's Appendix, p. 3. This obligated him to file a motion to dismiss for presumed abuse under section 707(b)(2) no later than October 30, 2006, the thirtieth day after filing the section 704(b)(1) statement. See 11 U.S.C. 704(b)(2).

On that October 30, 2006 deadline, the United States Trustee filed a motion to dismiss for abuse under section 707(b)(1) and 707(b)(3)(B) (allowing dismissal for abuse based upon the totality of the debtor's financial circumstances). See United States Trustee's Appendix, pp. 14-17. But the United States Trustee did not raise a section 707(b)(2) claim until he supplemented his dismissal motion with that claim on November 2, 2006. See id. at pp. 18-22.

The United States Trustee's November 2, 2006, section 707(b)(2) supplement referenced Fed. R. Civ. P. 15, which allows an amendment as a matter of course before a responsive pleading is filed, and allows such an amendment to relate back to the date of the original filing in certain circumstances. See Fed. R.

Civ. P. 15((a)(1) (amendment) and Fed. R. Civ. P. 15(c) (relation back).

But Rule 15 did not apply to the United States Trustee's motion to dismiss. Under the Bankruptcy Rules, Fed. R. Bankr. P. 7015 incorporates Fed. R. Civ. 15 into bankruptcy adversary proceedings, which are governed by the 7000 series of the Bankruptcy Rules. Adversary proceedings are instituted by filing complaints. Fed. R. Bankr. P. 7003. But the United States Trustee did not file a complaint. As required, he filed a motion to dismiss, which triggered a contested matter governed by Fed. R. Bankr. P. 9014. Rule 9014 imports some of the 7000 series rules into contested matters, but not Rule 7015. Thus, the United States Trustee's attempt to use Fed. R. Civ. P. 15 to supplement his section 707(b)(3) count with a section 707(b)(2) count was improper.

The debtors did not object to this error before the bankruptcy court. Nor did they raise it as an assignment of error in their appeal to the district court. Nor did they raise it in the opening brief filed they filed with this Court.

That means the United States Trustee's error is waived because section 704(b)'s deadline for filing motions to dismiss is not jurisdictional. See Arbaugh v. Y&H Corp., 546 U.S. 500, 504 (2006) (non-jurisdictional defects are waived unless they are raised prior to the entry of an order ruling on the merits).

Statutory limits are jurisdictional only when Congress "clearly states" that they are jurisdictional. Arbaugh, 546 U.S. at 513. Typically, jurisdictional statutes are found in Title 28 of the United States Code. See Kontrick v. Ryan, 540 U.S. 443, 452-53 (2004) (recognizing that Title 28 determines the jurisdiction of the bankruptcy courts); In re Supreme Beef Processors, Inc., 468 F.3d 248, 258 (5th Cir. 2006) (concluding that if Congress wanted to modify bankruptcy court jurisdiction "it likely would have amended 28 U.S.C. 1334 . . ., not the substantive provisions of [the Bankruptcy Code].").

Arbaugh held that "when Congress does not rank a statutory limitation . . . as jurisdictional, courts should treat the restriction as nonjurisdictional in character." Id. Arbaugh emphasized that a statutory limitation is nonjurisdictional if it "does not speak in jurisdictional terms or refer in any way to the jurisdiction of the [trial] courts." Id. at 515 (internal quotation omitted).

Under these standards, section 704(b) is not jurisdictional. First, section 704(b) is not part of Title 28. Instead, 28 U.S.C. 157 and 1334 determine bankruptcy court jurisdiction. Section 704(b), in turn, sets deadlines for United States Trustees to proceed in filing motions to dismiss based upon a presumption of abuse before bankruptcy courts acting under their Title 28 jurisdiction.

Second, the deadlines identified in section 704(b) are not jurisdictional because Congress did not clearly state that they were jurisdictional. See Arbaugh, 546 U.S. at 514. Section 704(b) does not speak in jurisdictional terms or refer in any way to the jurisdiction of bankruptcy courts. See id. at 515. In fact, section 704 is titled "Trustee's duties." 11 U.S.C. 704.

At most, the section 704(b)(2) deadline constituted a statute of limitations for the dismissal claim based upon a presumption of abuse that the Debtors failed to raise as an affirmative defense at any time prior to the bankruptcy court's decision on the merits of the United States Trustee's section 707(b) motion to dismiss.[4] See United States v. Baldwin, 414 F.3d 791, 795 (7th Cir. 2005) (recognizing that expiration of the statute of limitations is an affirmative defense, not a bar to jurisdiction), overruled on other grounds by United States v. Parker, 508 F.3d 434 (7th Cir. 2007). And the Debtors failed to preserve this issue on appeal because they did not press it before the district court and have not pressed it before this Court. See In re Pugh, 158 F.3d 530, 530 (11th Cir. 1998) (holding that the deadlines for trustee actions under 11 U.S.C. 546(a) and 549(d) are waivable statutes of limitations).

Therefore, the untimeliness of the United States Trustee's claim for

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[4] But cf. In re Cadwallder, 2007 WL 1864154 at *9 (Bankr. S.D. Tex. June 28, 2007) (concluding that section 704 is "a mandate for U.S. Trustee action imposed for the benefit of the Court and other parties in interest, not a deadline" and that "even if the U.S. Trustee had not met the § 704(b) deadlines, the motion would not be time barred merely for that reason").

dismissal for presumed abuse does not constitute a basis for dismissing this appeal or reversing the district court's order. Timeliness could have been raised prior to the bankruptcy court's deciding the motion to dismiss, because it was an element of the United States Trustee's claim. But this untimeliness did not deprive the bankruptcy court of jurisdiction to hear and decide the contested matter, and did not deprive the district court or this Court of jurisdiction to review that order on appeal.

C. The district court order is final.

The district court order is final under 28 U.S.C. 158(d)(1). The district court remanded the case for further proceedings. Neary v. Ross-Tousey (In re Ross-Tousey), 368 B.R. 762, 769 (E.D. Wis. 2007). Typically, this would make the district court order interlocutory. But in this case, the Debtors waived their right under 11 U.S.C. 707(b)(2)(B) to attempt to rebut the presumption of abuse in their case on remand. See Debtors' Response Opposing Motion to Dismiss at 4; United States Trustee's Reply to Debtors' Response at 2. Under these circumstances, remand to the bankruptcy court would involve only the ministerial task of dismissing the case, without any significant further proceedings. See In re Riggsby, 745 F.2d 1153, 1156 (7th Cir. 1984) (holding that a district court decision in a bankruptcy appeal is not final when it remands for "significant further proceedings"); In re Fox, 762 F.2d 54, 55 (7th Cir. 1985) (holding that a district court decision in a bankruptcy appeal is final if it remands only for a "ministerial" task).

STATEMENT OF THE ISSUE

The Bankruptcy Code allows debtors to deduct a vehicle ownership expense, in a set amount, when "applicable." 11 U.S.C. 707(b)(2)(A)(ii)(I). The ownership expense amount is a figure for monthly loan or lease payments. The Debtors in this case claimed such a set amount even though they had no vehicle ownership expenses, i.e., they did not have a monthly loan or lease payment.

The question presented is: Did the district court err in ruling the Debtors could not claim that expense because it was not "applicable" in their case?

STATEMENT OF THE CASE

This appeal addresses whether these Debtors may claim a vehicle ownership expense deduction under the bankruptcy means test that applies to chapter 7 debtors with above-median incomes. See 11 U.S.C. 707(b)(2). The Debtors filed a voluntary chapter 7 bankruptcy petition. The United States Trustee filed a motion to dismiss their case for abuse under 11 U.S.C. 707(b)(1). The United States Trustee argued that the Debtors' monthly disposable income exceeded the statutory amount that triggers a presumption of abuse under section 707(b)(2), and that under section 707(b)(3)(B) the case was an abuse when the totality of the debtors' financial circumstances was considered. The United States Trustee argued that in calculating their disposable income, the Debtors improperly deducted $803 per month for vehicle ownership expenses under section 707(b)(2)(A)(ii)(I) when they in fact had no ownership expenses at all. The bankruptcy court denied the United States Trustee's motion. The district court reversed, holding that the vehicle ownership deduction was not "applicable" to the Debtors under section 707(b)(2)(A)(ii)(I), because they owned their vehicles free and clear. The Debtors appealed to this Court.

STATUTORY BACKGROUND

This appeal involves the interpretation of provisions added to the Bankruptcy Code, 11 U.S.C. 101, et seq., by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("2005 Act").[5]

A. The means test Congress added to the Bankruptcy Code in 2005 determines whether above-median-income debtors' chapter 7 cases are subject to dismissal under 11 U.S.C. 707(b) as presumptively abusive.

In the 2005 Act, Congress revised section 707(b) of the Bankruptcy Code to add a means test to identify chapter 7 cases that are presumptively abusive because

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[5] Pub. L. No. 109-8, 119 Stat. 23 (2005). The 2005 Act applies to the Debtors' case, because the act's general effective date is for cases filed on or after October 17, 2005.

debtors have the ability to pay a portion of their unsecured debt.

Under the section 707(b)(2) means test, a presumption of abuse arises when an above-median-income debtor's monthly income,[6] less enumerated expenses, exceeds $167 per month. See 11 U.S.C. 707(b)(7), 707(b)(2)(A)(i).[7]

Section 704(b) requires United States Trustees to review all individual chapter 7 cases and, whenever a case is presumptively abusive under the statute, either (a) seek its dismissal or conversion, or (b) file a statement declining to seek dismissal. See 11 U.S.C. 704(b).[8] In fiscal year 2007, United States Trustees filed nationally 3,370 motions to dismiss for presumed abuse and filed 1,441 statements

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[6] Monthly income used for means test calculations is defined in the Code as "current monthly income." See 11 U.S.C. 101(10A).

[7] The $167 threshold is the result of dividing $10,000 by 60 under the formula set out in 11 U.S.C. 707(b)(2)(A)(i). Under section 104 of the Bankruptcy Code, this dollar amount was increased by the Judicial Conference of the United States effective April 1, 2007. Revision of Certain Dollar Amounts in the Bankruptcy Code Prescribed Under Section 104(b) of the Code, 72 Fed. Reg. 7082, 7082-83 (Feb. 14, 2007). This increased dollar amount does not apply to the Debtors' case.

[8] United States Trustees, who are Justice Department officials appointed by the Attorney General, supervise the administration of bankruptcy cases in all judicial districts within this circuit. 28 U.S.C. 581-589a. See also H.R. Rep. No. 95-595, at 88 (1977) (explaining that United States Trustees "serve as bankruptcy watch-dogs to prevent fraud, dishonesty, and overreaching in the bankruptcy arena").

declining to seek dismissal when a presumption of abuse existed in a case.

If the presumption of abuse arises under section 707(b)(2), an above-median-income debtor may rebut it only by demonstrating “special circumstances,” and only to the extent such special circumstances “justify additional expenses or adjustments to current monthly income for which there is no reasonable alternative.” 11 U.S.C. 707(b)(2)(B)(i).

If the presumption of abuse does not arise based on the means test or is rebutted, the bankruptcy court must consider whether the debtor filed the petition in bad faith or whether the totality of the circumstances of the debtor’s financial situation demonstrates abuse justifying dismissal. 11 U.S.C. 707(b)(3)(A) (bad faith) and (B) (totality of the debtor’s financial circumstances).

B. Above-median-income debtors use the expense categories enumerated in section 707(b)(2)(A) to determine their allowed expenses under the means test.

Under the section 707(b)(2) means test, above-median-income chapter 7 debtors determine their permissible expenses under the formula found in 11 U.S.C. 707(b)(2)(A).[9] Approximately 10% of bankruptcy filers have above-median

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[9] Above-median-income chapter 13 debtors also determine their expenses under sections 707(b)(2)(A) and (B). See 11 U.S.C. 1325(b)(3) (incorporating these sections into chapter 13 for determining expenses for above-median-income chapter 13 debtors).

incomes and are thereby subject to the means test.[10] Section 707(b)(2)(A)(ii)(I) permits these debtors to deduct (a) certain prescribed "actual" expenses, and (b) other "applicable" expense amounts. Applicable expense amounts are determined under the IRS Local and National Standards. Id.

This appeal involves one part of the calculation of expenses for an above-median-income debtor under the means test – whether a debtor who has no monthly vehicle loan or lease payment expenses can claim a vehicle ownership expense amount under section 707(b)(2)(A)(ii)(I) when calculating his disposable income.

Section 707(b)(2)(A)(ii)(I) states that expense amounts are determined "under" the IRS Local Standards that the IRS uses to determine whether delinquent taxpayers have the financial ability to repay their tax obligations. The IRS Local Standards allow debtors to claim an expense amount to cover monthly vehicle loan or lease payments. See IRS Collection Financial Standards, Local Standards: Transportation (explaining that the vehicle ownership Local Standard

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[10] During fiscal year 2007, according to data collected by the United States Trustee Program, 451,012 non-business chapter 7 cases were filed nationwide, excluding the judicial districts in Alabama and North Carolina. See 28 U.S.C. 581(a)(1)-(21) (excluding the federal judicial districts in Alabama and North Carolina from the United States Trustee Program). Of these chapter 7 cases, roughly 45,000 involved debtors with above-median incomes subject to the means test and the requirements of section 707(b)(2)(A)(ii)(I).

is a "figure[] for monthly loan or lease payments").[11]

If an IRS Local Standard is applicable to a debtor, the debtor may deduct the precise dollar amount the standard sets out. See 11 U.S.C. 707(b)(2)(A)(ii)(I) (providing that the applicable expense amount "shall be" the amount "specified" under the IRS Local Standard).

In this case, the Debtors have no loan or lease payments on their vehicles, so this appeal requires this Court to determine whether they may nonetheless deduct $803 under the IRS Local Standard to avoid the presumption of abuse that would otherwise arise in their case.

STATEMENT OF THE FACTS

On August 18, 2006, the Debtors filed a voluntary petition under chapter 7 of the Bankruptcy Code. United States Trustee's Appendix, p. 1. The Debtors live in Mattoon, Wisconsin and are each longstanding employees at the Mohican North Star Casino in Bowler, Wisconsin. Id. at p. 8; Debtors' Appendix 3, Schedule I.

The Debtors' means test form listed a household income above the applicable state median income level. Id. at lines 13-15. The applicable state median income

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[11] We attach the IRS Collection Financial Standards in our addendum. Because the Debtors filed their case on July 5, 2006, the Collection Financial Standards in effect prior to October 1, 2007, are controlling. See 11 U.S.C. 707(b)(2)(A)(ii)(I) (stating that the IRS standards will be those "as in effect on the date of the order for relief").

for Wisconsin was $49,918.[12] Id. at line 14. The Debtors' income was $62,349.60. Id. at line 13.

Because their means test calculations listed no disposable income, the Debtors claimed that the presumption of abuse did not arise. Id. at line 52. They did so because they claimed a $803 ownership expense deduction under the IRS Local Standard for two vehicles, although they own these vehicles free and clear of any loan or lease obligation. Id. at lines 23-24 ($471 + $332 = $803). Moreover, among the expenses the Debtors listed on their means test form were payments of more than $150 per month on a time-share at Fox Hills Resort. Debtors' Appendix 2, Official Form 22A at line 42a.

On October 30, 2006, the United States Trustee filed a motion to dismiss the Debtors' case for abuse under section 707(b).[13] United States Trustee's Appendix,

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[12] The chapter 7 means test form, Fed. R. Bankr. P. Official Form 22A, is a new form developed after the enactment of the 2005 Act. This form helps chapter 7 debtors calculate income and expenses under the means test.

The means test form was approved by the Judicial Conference of the United States.

[13] On October 30, 2006, the United States Trustee filed his motion to dismiss for abuse under section 707(b)(1) and initially asserted that the case was an abuse based upon the totality of the circumstances of the debtors' financial situation under section 707(b)(3)(B). See United States Trustee's Appendix, pp. 14-17. On November 2, 2006, the United States Trustee supplemented the motion and asserted also that a presumption of abuse under section 707(b)(2) mandated case

pp. 14-22. Under the United States Trustee's analysis, the presumption arose under section 707(b)(2) because the Debtors had monthly disposable income of $260.50, which exceeded the $167 presumed abuse statutory threshold in section 707(b)(2)(A)(I). See Debtors' Appendix 4, United States Trustee's recalculated means test, lines 50, 52.

The United States Trustee's calculation did not allow the Debtors a $803 vehicle ownership expense amount under section 707(b)(2)(A)(ii)(I). Id. at lines 23-24. The United States Trustee's calculation did allow the Debtors a $758 monthly vehicle operating expense deduction for their two vehicles: the $358 monthly deduction for their two vehicles under the IRS Local Standard, along with an additional $200 monthly deduction for each vehicle under the IRS's special allowance for older or high-mileage vehicles. United States Trustee's Appendix, p. 22.

The United States Trustee also requested dismissal for abuse under section 707(b)(3)(B) (allowing dismissal based on the totality of the circumstances of a debtor's financial situation if the presumption of abuse arises or is rebutted). See United States Trustee's Appendix, p. 14.

On December 14, 2006, the United States Bankruptcy Court for the Eastern

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dismissal. See id. at pp. 18-22.

District of Wisconsin denied the United States Trustee's motion to dismiss for abuse, concluding no presumption of abuse arose under section 707(b)(2) and that the totality of the circumstances of the debtors' financial situation did not establish abuse under section 707(b)(3)(B). See id. at pp. 23-24, 25. The bankruptcy court read 11 U.S.C. 707(b)(2)(A)(ii)(I) as allowing the Debtors to take monthly ownership expense deductions, even though they had no loans or leases on their vehicles. Id. at pp. 23-24. The United States Trustee appealed. Id. at p. 26.

On May 21, 2007, the United States District Court for the Eastern District of Wisconsin reversed. Neary v. Ross-Tousey (In re Ross-Tousey), 368 B.R. 762 (E.D. Wis. 2007). The district court held that debtors may not claim vehicle ownership expense amounts under section 707(b)(2)(A)(ii)(I) for vehicles owned free and clear of any liens and encumbrances. Id. at 768. The district court concluded that the presumption of abuse arose in the Debtors' case and remanded for further proceedings to determine whether the Debtors could rebut this presumption. Id. at 768-69. Because it concluded the presumption of abuse arose under section 707(b)(2), the district court did not address the United States Trustee's alternative argument that the lower court erred in declining the case under section 707(b)(3)(B).

The Debtors appealed to this Court. United States Trustee's Appendix, p. 27-

28. The United States Trustee moved to dismiss the appeal for lack of finality because the remand ordered by the district court would involve the significant factual determination whether the Debtors had “special circumstances” sufficient to rebut the presumption of abuse under section 707(b)(2). United States Trustee’s Motion to Dismiss at 4-5. The Debtors responded by stating for the first time that they had no special circumstances they would raise on remand. Debtors’ Response at 4. Due to that concession, the United States Trustee filed a reply agreeing this Court has jurisdiction because the remand ordered by the district court would not involve significant further proceedings. United States Trustee’s Reply at 2. On February 15, 2008, this Court denied the United States Trustee’s motion to dismiss this appeal.

SUMMARY OF ARGUMENT

The district court ruled the Debtors have no “applicable” monthly vehicle ownership expense amount to claim under section 707(b)(2)(A)(ii)(I) because they have no monthly loan or lease expense obligations on their vehicles.

I. This interpretation best reads the statute because it (a) uses the ordinary dictionary meaning of “applicable,” and does so in a way that gives meaning to each word in the statute; (b) fulfills Congress’ stated reasons for enacting the section; (c) determines expense eligibility in the same way the Internal Revenue Service does "under" the IRS standards referenced in section 707(b)(2)(A)(ii)(I); and (d) is fair as a matter of bankruptcy policy.

A. Giving "applicable" its ordinary definition in section 707(b)(2)(A)(ii)(I) validates the district court's interpretation of the statute. That ordinary definition yields a statute that allows debtors who have monthly expenses in an expense category to claim the IRS expense amount, while at the same time preventing debtors who lack monthly expenses in a category from avoiding dismissal by claiming phantom expenses. It also gives meaning to every word in the section, something the Debtors' construction does not. It is therefore no surprise that the eight lower appellate courts that have interpreted the meaning of "applicable" in section 707(b)(2)(A)(ii)(I) – six United States district courts and two bankruptcy appellate panels – have rejected the construction of "applicable" the Debtors advance before this Court.[14] Moreover, the Debtors' grammatical criticisms

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[14] Grossman v. Sawdy (In re Sawdy), __ B.R. __, 2008 WL 789116 (E.D. Wis. March 17, 2008); Wieland v. Thomas (In re Thomas), 382 B.R. 793 (D. Kan. 2008); Meade v. McVay (In re Meade), __B.R. __, 2008 WL 792060 (W.D. Tex. Jan. 24, 2008); United States Trustee v. Deadmond (In re Deadmond), 2008 WL 191165 (D. Mont. Jan. 22, 2008); Fokkena v. Hartwick (In re Hartwick), 373 B.R. 645 (D. Minn. 2007); Neary v. Ross-Tousey (In re Ross-Tousey), 368 B.R. 762 (E.D. Wis. 2007); Babin v. Wilson (In re Wilson), __ B.R. __, 2008 WL 681102 (B.A.P. 8th Cir. March 14, 2008); Ransom v. MBNA America Bank, N.A.(In re Ransom), 380 B.R. 799 (B.A.P. 9th Cir. 2007), appeal pending No. 08-15066 (9th Cir.).

of the district court's interpretation are themselves grammatically incorrect. Even if they were right, they would not establish that nonexistent expenses make an expense amount "applicable" to them under the ordinary definition of the word applicable.

B. The 2005 Act's legislative history supports the district court's interpretation of section 707(b)(2)(A)(ii)(I). The House Report to the legislation reveals Congress enacted the new law to ensure debtors would repay their debts when they were able, and to eliminate loopholes and incentives for debtor abuse in discharging debts when a portion could be repaid. The district court's construction fulfills these congressional goals. The Debtors' construction does not.

C. Although the district court did not choose to rely on the IRS's methodology as a ground for its decision, the district court's interpretation of section 707(b)(2)(A)(ii)(I) is consistent with the IRS's refusal to allow parties to deduct nonexistent vehicle ownership expenses under its Local Standards. This is further support for the district court's interpretation because section 707(b)(2)(A)(ii)(I)'s text and its legislative history indicate Congress wanted courts to employ the IRS's methodology in determining whether debtors are eligible to

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We reference the district courts and bankruptcy appellate panels as appellate courts because they have jurisdiction over appeals from bankruptcy court orders. *See* 28 U.S.C. 158(a)-(c). *But* *cf.* *Midlock v. Apple Vacations West, Inc.*, 406 F.3d 453, 457-58 (7th Cir. 2005) ("[A] district court decision does not have stare decisis effect; it is not a precedent.").

deduct standard expense amounts in particular cases.[15] The district court's interpretation achieves that; the Debtors' interpretation does not.

D. The district court's interpretation also fosters sound public policy. Its interpretation does not affect below-median-income debtors, because they are not subject to the means test in the first place. See 11 U.S.C. 707(b)(7). Nor is it unfair to above-median-income debtors. It merely requires them to repay their debts when they are able. It is also fair to creditors because it ensures that debtors who have more than $167 per month available to repay debts cannot discharge these debts in a chapter 7 case.

Finally, the bankruptcy system has three safety valves to ensure that above-median debtors without loan or lease payments will not suffer by being denied phantom vehicle expenses. First, if debtors have older vehicles, they are entitled to an additional $200 monthly expense allowance per vehicle, for up to two vehicles, to fund the operation of these older vehicles. Second, debtors may convert to chapter 13 if their disposable income exceeds the statutory threshold in chapter 7, rather than simply have their cases dismissed and lose the protections of bankruptcy. Third, debtors whose cases are dismissed may refile if their allowed expenses

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[15] As we explain in footnote 23, the IRS and the statute determine threshold eligibility to claim an expense identically, although the expense amounts eligible individuals can claim may differ.

subsequently increase or their income decreases.

II. Should this Court determine that the presumption of abuse did not arise in the Debtors' case under section 707(b)(2), this Court should remand so the district court can consider whether the bankruptcy court erred in denying the United States Trustee's motion to dismiss the Debtors' case under section 707(b)(3). The United States Trustee pressed this issue below, but because it decided the case under section 707(b)(2) the district court found it unnecessary to pass upon it.

ARGUMENT

I. THE DISTRICT COURT CORRECTLY RULED DEBTORS CANNOT CLAIM A VEHICLE OWNERSHIP DEDUCTION UNDER SECTION 707(b)(2)(A)(ii)(I) OF THE BANKRUPTCY CODE WHEN THEY HAVE NO VEHICLE OWNERSHIP EXPENSES.

The United States Trustee asks this Court to affirm the district court's ruling that section 707(b)(2)(A)(ii)(I) of the Bankruptcy Code does not allow the Debtors to evade the presumption of abuse by claiming an inapplicable vehicle ownership expense. The district court ruled the presumption of abuse arose in the Debtors' case, because they could not deduct a vehicle ownership expense amount when they had no vehicle ownership expenses.

This case presents an issue of statutory interpretation that this Court reviews *de novo*. Frey v. EPA, 403 F.3d 828, 833 (7th Cir. 2005).

A. The district court's interpretation is the best reading of section 707(b)(2)(A)(ii)(I).

1. Vehicle ownership expense amounts are only applicable if a debtor is making loan or lease payments on a vehicle.

The Bankruptcy Code permits above-median-income individuals, including these Debtors, to claim a vehicle ownership expense amount when that expense is "applicable." 11 U.S.C. 707(b)(2)(A)(ii)(I). Section 707(b)(2)(A)(ii)(I) provides that a "debtor's monthly expenses shall be the debtor's applicable monthly expense amounts specified under the . . . Local Standards . . . issued by the Internal Revenue Service. . . ." 11 U.S.C. 707(b)(2)(A)(ii)(I) (emphasis added). The statute thus expressly provides that before a specific expense amount may be deducted by a debtor under the IRS Local Standards, the expense amount must first be applicable to the debtor. Id.

"Applicable" is not defined in the Bankruptcy Code, so the word should be given its ordinary meaning. Smith v. United States, 508 U.S. 223, 228 (1993) ("When a word is not defined by statute, we normally construe it in accord with its ordinary or natural meaning."); Carmichael v. The Payment Center, Inc., 336 F.3d 636, 640 (7th Cir. 2003) ("Without a statutory definition, we construe [a] term in accordance with its ordinary or natural meaning, a meaning which may be supplied by a dictionary.") (internal quotation omitted)).

The dictionary defines "applicable" to mean "capable of being applied: having relevance . . . fit, suitable, or right to be applied: APPROPRIATE" Webster's Third New International Dictionary at 105 (1981) (emphasis in original).[16]

The district court applied this ordinary meaning in concluding the Debtors could not deduct a monthly vehicle loan/lease expense amount when they had no monthly loan or lease expenses on their vehicles. Ross-Tousey, 368 B.R. at 766 (concluding that Congress's choice to standardize the ownership expense allowance "does not mean it also chose to make the Standards into fixed allowances guaranteed to every car owner"). The point here is simple – a debtor has no section 707(b)(2)(A)(ii)(I) vehicle ownership expense amounts that are "capable of being applied" to him if he does not make any lease or loan payments. See Ransom v. MBNA America Bank, N.A. (In re Ransom), 380 B.R. 799, 807-08 (B.A.P. 9th Cir. 2007). All lower appellate decisions agree on this point, and reject the Debtors' contrary interpretation. Grossman v. Sawdy (In re Sawdy), __ B.R. __, 2008 WL

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[16] This Court has not defined "applicable" in a bankruptcy context, but has observed that it is a "protean word that takes color from context; it lacks a single, enduring meaning." Sierra Club v. EPA, 375 F.3d 537, 541 (7th Cir. 2004). The district court's construction of "applicable" within section 707(b)(2)(A)(ii)(I) recognizes the proper contextual meaning of the word.

789116 (E.D. Wis. March 17, 2008); Wieland v. Thomas (In re Thomas), 382 B.R. 793 (D. Kan. 2008); Meade v. McVay (In re Meade), __B.R. __, 2008 WL 792060 (W.D. Tex. Jan. 24, 2008); United States Trustee v. Deadmond (In re Deadmond), 2008 WL 191165 (D. Mont. Jan. 22, 2008); Fokkena v. Hartwick (In re Hartwick), 373 B.R. 645 (D. Minn. 2007); Babin v. Wilson (In re Wilson), __ B.R. __, 2008 WL 681102 (B.A.P. 8th Cir. March 14, 2008).

2. The Debtors' interpretation of section 707(b)(2)(A)(ii)(I) is grammatically erroneous and renders the word "applicable" superfluous.

The Debtors attack the district court's interpretation on a grammatical basis, claiming that "applicable" in section 707(b)(2)(A)(ii)(I) modifies "amounts specified," not "monthly expense." Debtor's Br. at 18. They claim "monthly expense" is itself an adjective that also modifies "amounts specified." Id. From this claim, the Debtors reach the conclusion that "applicable" refers only to the "number of cars owned by the debtor," because the "only basis" for finding the applicable amount is the "various categories under which the amounts are set forth." Id. at 19. Under the Debtors' reading, they can claim the amount under the IRS Local Standards for each car they own even if they do not have any loan or lease payments.[17] Id.

The Debtors' grammatical interpretation is erroneous for two reasons. First, "monthly expense" is not an adjective. The word "monthly" is an adjective, like "applicable," and it modifies the compound noun "expense amount." See Webster's Third New International Dictionary at 800 (1981) (indicating that "expense" is a noun but not an adjective, that "expense account" is a noun, and that "expense constant" is a noun).

Second, the Debtors' grammatical construction of section 707(b)(2)(A)(ii)(I) ignores this Court's teaching that words must be viewed "not in isolation but in the context of the terms that surround them." Matter of Merchants Grain, Inc., 93 F.3d 1347, 1354 (7th Cir. 1996). The word "applicable" modifies the term that directly follows it: "monthly expense amounts." But the Debtors would skip the two words immediately following "applicable" – "monthly expense" – in order to cherry-pick the isolated term "amounts specified" as the nouns that "applicable" modifies. This approach of "slicing a statute into phrases" while ignoring the context of surrounding words, is "a formula for disaster." Freeman United Coal Mining Co. v.

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[17] One of the bankruptcy court decisions the Debtors rely upon in their opening brief has been reversed. See Debtors' Br. at 14 (citing In re Sawdy, 362 B.R. 898 (Bankr. E.D. Wis. 2007), since rejected, and vacated for further proceedings by Grossman v. Sawdy, __ B.R. __, 2008 WL 789116 (E.D. Wis. March 17, 2008)).

Foster, 30 F.3d 834, 838 (7th Cir. 1994).

Even assuming for the sake of argument that "applicable" modifies only "amounts specified," the Debtors' argument gets them nowhere in their contention that they are eligible for an ownership expense deduction regardless of whether they have any ownership expenses. That is because the amount specified under the IRS Local Standards is still not "applicable" to them under the ordinary dictionary definition of the word: the Debtors have no ownership expenses in the first place, so the specified amount is not capable of being applied to them and not relevant to their case.[18]

The Debtors' reading of "applicable" is also flawed because it renders that word superfluous. See Debtors' Br. at 17. Under the Debtors' interpretation, section 707(b)(2)(A)(ii)(I) would have the same meaning without the word "applicable" in it. The Debtors suggest the word simply instructs debtors to go to the IRS standards referenced in section 707(b)(2)(A)(ii)(I) and locate the standard

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[18] In calculating disposable income, so long as a debtor incurs some vehicle ownership expense, i.e., the expense is applicable to the debtor, the debtor is entitled to list the full amount specified under the IRS Local Standards, even if the debtor's "actual" expense is lower. See 11 U.S.C. 707(b)(2)(A)(ii)(I) (providing that the applicable expense amount "shall be" the amount "specified" under the IRS Local Standards). See also Hartwick, 373 B.R. at 650 (recognizing that any vehicle ownership expense will make a debtor eligible for the full IRS standard amount).

dollar figure it establishes for a debtor's locality and for the number of vehicles the debtor has. Debtors' Br. at 18. But debtors would do the same thing if the word were not in the statute because the statute would still provide "[t]he debtor's monthly expense shall be the debtor's ~~applicable~~ monthly expense amounts" under the IRS standards. 11 U.S.C. 707(b)(2)(A)(ii)(I) (emphasis added). This phrasing would still lead the debtor to the same line under the Local Standards that the Debtors suggest the word "applicable" exists to accomplish. Ross-Tousey, 368 B.R. at 765 (E.D. Wis. 2007) ("Had Congress intended to indiscriminately allow all expense amounts specified in the National and Local Standards, it would have written 707(b)(2)(A)(ii)(I) [without using the word 'applicable.']"); Ransom, 380 B.R. at 808 (concluding that the Debtors' construction would "read[] 'applicable' right out of the Bankruptcy Code"); Deadmond, 2008 WL 191165 at *4 ("The word ['applicable'] must mean something, and if some monthly expenses are applicable, then other monthly expenses are not applicable.").

Because the Debtors' reading renders "applicable" superfluous, the word must have a different meaning than the one they ascribe. See generally Cooper Indus., Inc. v. Aviall Servs., Inc., 543 U.S. 157, 167 (2004) (courts "must, if possible, construe a statute to give every word some operative effect"); Witzke v. Fernal, 376 F.3d 744, 753 (7th Cir. 2004) ("We must read a statute to give effect to each word so as to avoid rendering any words meaningless, redundant, or superfluous.”). As we explain above, the word “applicable” does have a different meaning. Under its dictionary meaning, the word exists to allow debtors to claim a standard vehicle expense amount that is applicable because they have a loan or lease expense.[19]

B. The district court’s interpretation of section 707(b)(2)(A)(ii)(I) fulfills two goals Congress expressed in enacting the 2005 Act: ensuring that above-median-income debtors repay their debts when they can, and eliminating abuse.

1. Congress passed the 2005 Act to maximize debtor repayment to creditors and to eliminate opportunities for bankruptcy abuse.

In interpreting “applicable” in 707(b)(2)(A)(ii)(I), this Court may consider the

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[19] Section 707(b)(2)(A)(ii)(I) includes the proviso that monthly expenses may not include any “payments for debts.” In contrast to the suggestion the Debtors offer, see Debtors’ Br. at 20, debtors for whom the ownership expense is applicable do not deduct their “payments” for debts. Instead, debtors receive a fixed standard allowance that is the dollar amount under the applicable standard.

The “payment for debts” language ensures that debtors do not deduct their actual payments for debts under section 707(b)(2)(A)(ii)(I) for categories in the IRS’s Other Necessary Expenses. Other Necessary Expenses categories include secured debt payments, repayments of delinquent tax debts, and student loans. See IRS Internal Revenue Manual, Financial Analysis Handbook, Pt. 5, ch. 15, § 5.15.1.10, available at http://www.irs.gov/irm/part5/ch15s01.html#d0e195695. Secured debt payments may be deducted under section 707(b)(2)(A)(iii), and repayments of delinquent tax debts may be deducted under section 707(b)(2)(A)(iv). Student loan payments, however, may not be deducted under the means test for above-median debtors.

relevant legislative history to determine the statute's objectives and illuminate its text. Boim v. Quranic Literacy Inst. and Holy Land Found. for Relief and Dev., 291 F.3d 1000, 1009 (7th Cir. 2002). See also Gillespie v. Trans Union Corp., 482 F.3d 907, 910 (7th Cir. 2007) (examining statutory language and legislative history to determine meaning of word undefined in statute).

The "heart" of the 2005 Act is the means test, which seeks to "ensure that debtors repay creditors the maximum they can afford." H.R. Rep. No. 109-31 (I), at 1 (2005), reprinted in 2005 U.S.C.C.A.N. 88, 89.[20] Cf. Thomas, 382 B.R. at 798 ("If a debtor were permitted a car ownership allowance when he actually incurs no such expense, application of the means test would not accurately reflect the debtor's ability to repay creditors, and the purpose of the statute would be frustrated."). The 2005 Act also seeks to eliminate "loopholes and incentives" in the system "that allow and – sometimes – even encourage opportunistic personal filings and abuse." H.R. Rep. No. 109-31 (I), at 5, 2005 U.S.C.C.A.N. at 92.

Ensuring that above-median-income debtors are eligible to claim standardized deductions for vehicle ownership expenses only when they have ownership expenses honors congressional intent that such debtors repay their debts when they are able. See Ross-Tousey, 368 B.R. at 766 ("The statute is only concerned about

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[20] There is no Senate Report or Conference Report to the 2005 Act.

protecting the debtor's ability to continue owning a car, and if the debtor already owns the car, the debtor is adequately protected."); Hartwick, 373 B.R. at 652 (same); Ransom, 380 B.R. at 807 ("[W]hat is important is the payments that debtors actually make, not how many cars they own, because the payments that debtors make are what actually affect their ability to make payments to their creditors."); Wilson, __ B.R. __, 2008 WL 681102 at *3 (noting that for above-median-income chapter 13 debtors, the "purpose" of the 2005 Act was to "require" such debtors "to make more funds available to their unsecured creditors").

The House Report for the 2005 Act confirms the district court's interpretation of section 707(b)(2)(A)(ii)(I) is fully consistent with the intent of the act. See, e.g., United States v. Robinson, 8 F.3d 418, 421 (7th Cir. 1993) (examining legislative history and finding it "consistent" with statutory language).

2. The Debtors' interpretation of section 707(b)(2)(A)(ii)(I) would yield results that conflict with congressional intent.

The Debtors' interpretation of section 707(b)(2)(A)(ii)(I) would frustrate the 2005 Act's goal of proper repayment by allowing above-median-income debtors to claim phantom expenses that do not apply to them.[21] As the district court

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[21] By incorrectly deducting $803 in monthly ownership expense amounts for nonexistent monthly expenses in calculating disposable income, the Debtors' interpretation of section 707(b)(2)(A)(ii)(I) would deprive creditors of significant payments the creditors would otherwise receive in a chapter 13 plan. In chapter

concluded, when a debtor "has no monthly ownership expenses, it makes no sense to deduct an ownership expense to shield it from creditors." Ross-Tousey, 368 B.R. at 766.

Under the Debtors' reading of section 707(b)(2)(A)(ii)(I), a higher-income debtor with an inoperable car "rusting away in his backyard" could claim the ownership expense amount simply because the car is an "automobile" and he "owns" it. Ross-Tousey, 368 B.R. at 768. This statutory reading has been rejected by lower appellate courts because it "defies common sense." Deadmond, 2008 WL 191165 at *4.

C. Although the district court did not choose to rely on the IRS's methodology as a ground for its decision, the district court's interpretation of section 707(b)(2)(A)(ii)(I) is consistent with the IRS's refusal to allow parties to claim nonexistent vehicle ownership expenses under its Local Standard.

The Debtors concede the district court did not base its decision on how the IRS determines threshold eligibility for deductions under its standards.[22] Debtors'

13, debtors are required to devote all of their disposable income to repaying unsecured creditors. See 11 U.S.C. 1325(b)(1)(B).

[22] The district court opinion nowhere references or relies upon the IRS's approach that individuals without ownership expenses are not eligible for the ownership expense deduction under the Local Standard. See Ross-Tousey, 368 B.R. 762.

Nevertheless, the amicus brief of the National Association of Consumer Bankruptcy Attorneys (NACBA) contends that the district court "adopt[ed]" the

Br. at 24. The Debtors nevertheless insist courts could not consult the IRS's own threshold eligibility framework and advance that as a ground for reversing the district court. Id. at 22-26, 29.

The district court's construction should not be rejected for improperly relying upon an analysis it never mentioned. Even if the district court could be reversed for such an odd reason, the IRS's eligibility criteria for deductions under its Local Standards support the district court's construction of section 707(b)(2)(A)(ii)(I). There are two reasons why this is so.

First, section 707(b)(2)(A)(ii)(I)'s text requires that expense amounts be those established "under" the IRS standards. 11 U.S.C. 707(b)(2)(A)(ii)(I). This textual "reference to amounts specified 'under' the Standards indicates that one should use the numbers that result when the Standards are applied as they usually are." Thomas, 382 B.R. at 798. Given the text of the statute, "the most logical resource to consult is the IRS" to determine whether the IRS's Local Standard is "applicable" to a particular debtor. Hartwick, 373 B.R. at 650-51.

Under its Local Standard for vehicle ownership, the IRS prohibits vehicle ownership deductions if an individual has no loan or lease payments.[23] See IRS

IRS's approach. NACBA Amicus Br. at 18.

[23] For individuals with existing vehicle ownership costs, the IRS applies the expense deduction as a "cap," under which an individual may take the lower of his

Internal Revenue Manual, Financial Analysis Handbook, Pt. 5, ch. 15, § 5.15.1.7(4.B) (providing that if a taxpayer has no vehicle loan or lease payments, the Local Standard ownership cost cannot be claimed by the taxpayer); id., § 5.15.1.7(4.B), available at www.irs.gov/irm/part5/ch15s01.html.

The district court's construction applies section 707(b)(2)(A)(ii)(I) to deny the nonexistent expenses that the IRS also disallows under its Local Standards. Accord Sawdy, 2008 WL 789116 at *4 (finding it "logical to look at the actual IRS Collection Financial Standards in determining the applicable expense Standards in bankruptcy actions"); Thomas, 382 B.R. at 798 ("[I]t does not appear that Congress intended to adopt only the numbers contained in the Standards without the context and meaning provided by the IRS in creating the Standards and in its normal application of those numbers.").

Second, Congress was interested in more than the mere numbers found in the IRS Local Standards in crafting section 707(b)(2)(A)(ii)(I). The House Report to the

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actual expense or the standardized expense amount. See Appendix, IRS Collection Financial Standards (stating that under the Local Standards, "the taxpayer is allowed the amount actually spent or the standard, whichever is less").

As the Debtors recognize, the Bankruptcy Code prescribes a different application for debtors with existing ownership costs: in calculating disposable income, it permits debtors the entire expense amount. See 11 U.S.C. 707(b)(2)(A)(ii)(I) (providing that the applicable expense amount "shall be" the amount "specified" under the IRS Local Standard); Debtors' Br. at 8, 16.

legislation provides that the debtor's monthly expenses "must be the applicable monthly amounts set forth in the [IRS] Financial Analysis Handbook as Necessary Expenses under the National and Local Standards categories." H.R. Rep. No. 109-31(I), at 99-100 (2005).[24] The Financial Analysis Handbook provides that the Local Standard ownership cost cannot be claimed if a taxpayer has no vehicle loan or lease payments.[25] See IRS Internal Revenue Manual, Financial Analysis Handbook, Pt. 5, ch. 15, § 5.15.1.7(4.B), available at www.irs.gov/irm/part5/ch15s01.html.

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[24] The Debtors argue that language from an unenacted version of bankruptcy legislation from a prior session of Congress reveals that the 2005 Act meant to forbid courts from consulting the IRS methodology. Debtors' Br. at 24-25. The Debtors attach special importance to the fact that section 707(b)(2)(A)(ii)(I) of the 2005 Act defines allowable expenses differently than the proposed 1998 legislation, which included a specific reference to the IRS's Financial Analysis Handbook.

This argument has two significant weaknesses. First, the language of the 2005 Act does not indicate any intent to preclude reference to the IRS's application of its own expense standards and requires that deductions be taken "under" the Local Standards. Second, the legislative history of the 2005 Act specifically references the IRS Financial Analysis Handbook in describing "applicable" expense amounts. See H.R. Rep. 109-31 (I), at 99-100 (2005).

[25] For the other reasons advanced by the district court and in this brief, the district court ruling should be affirmed even if this Court concludes that the IRS's application has no bearing.

D. The district court's construction of section 707(b)(2)(A)(ii)(I) implements sound bankruptcy policy.

1. The district court's reading is fair to debtors and creditors.

The district court's interpretation of section 707(b)(2)(A)(ii)(I) is fair. It does not hurt below-median-income debtors – those who comprise the vast majority of bankruptcy filers – because such debtors are not subject to section 707(b)(2) in the first place. See 11 U.S.C. 707(b)(7).

The district court's reading of section 707(b)(2)(A)(ii)(I) is also fair because it ensures that above-median-income debtors will repay their debts when they can. In enacting the 2005 Act, Congress was concerned that under the prior system, "some bankruptcy debtors are able to repay a significant portion of their debts" but are not required to do so. H.R. Rep. No. 109-31 (I), at 5 (2005), reprinted in 2005 U.S.C.C.A.N. 88, 92.

The district court's interpretation is fair to creditors because it recognizes that debtors with a financial ability to repay creditors a monthly amount above the statutory threshold in section 707(b)(2) should be subject to paying back their creditors outside of chapter 7. By contrast, the Debtors' interpretation is unfair to creditors because it would allow above-median-income debtors to use nonexistent expenses to lower their disposable income below the threshold for the presumption of abuse. Rather than being subject to higher repayments outside chapter 7, such debtors would instead discharge debts they are able to pay.[26]

2. The bankruptcy system protects debtors who lack vehicle ownership expenses from hardship.

Under the district court's interpretation, at least three safety valves are available to prevent hardships against above-median-income debtors who have no vehicle ownership expenses. First, where debtors own older or higher-mileage vehicles, they are afforded special protection. Debtors who own unencumbered vehicles over 6 years old or with 75,000 or more miles are entitled to an additional $200 in monthly operating expenses per vehicle. See IRS Internal Revenue Manual, Pt. 5, ch. 8, § 5.8.5.5.2 ("Treatment of Non-Business Transportation Expenses"), available at http://www.irs.gov/irm/part5/ch08s05.html. See also Ransom, 380 B.R. at 808 (recognizing $200 additional allowance); Hartwick, 373 B.R. at 652 (same); Wilson, 2008 WL 681102 at *4 (same).

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[26] It has been argued unsuccessfully before the lower appellate courts that permitting the vehicle ownership expense deduction only when a debtor has loan or lease payments would allow an unfair windfall for a hypothetical debtor with only a few or a single monthly payment remaining on his vehicle. See, e.g., Ross-Tousey, 368 B.R. at 767-68 (rejecting this argument). This argument fails to recognize that such cases should be dismissed under section 707(b)(3)(B) based on the totality of the circumstances of the debtors' financial situations. Even when debtors pass the means test, they face dismissal under section 707(b)(3)(B) when they will be able to repay debts given the imminent satisfaction of vehicle loan or lease obligations.

Second, even if the presumption of abuse arises for an above-median-income debtor, the debtor may nonetheless obtain bankruptcy relief. Even if the debtor's case presents an abuse of chapter 7, the debtor may elect to convert his chapter 7 case to a case under chapter 13 or chapter 11 both of which, unlike chapter 7, requires such a debtor to repay debts through a repayment plan. See 11 U.S.C. 707(b)(1).

Third, nothing prevents an above-median-income chapter 7 debtor whose case is dismissed from later refiling and appropriately deducting expenses for loan or lease payments for a vehicle obtained after the dismissal. A debtor whose monthly disposable income drops below the statutory presumption of abuse threshold is also free to refile and obtain a discharge.[27]

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[27] Upon refiling, the debtor will face the possibility of a time-limited automatic stay if he files within a year of the dismissal. See 11 U.S.C. 362(c)(3)(A). The debtor may, however, also obtain relief from this limitation under section 362(c)(3)(B).

II. IF THIS COURT RULES THAT DEBTORS MAY CLAIM A VEHICLE OWNERSHIP EXPENSE DEDUCTION WITHOUT ANY EXISTING OWNERSHIP EXPENSES, IT SHOULD REMAND SO THE DISTRICT COURT CAN DECIDE WHETHER THE TOTALITY OF THE CIRCUMSTANCES OF THE DEBTORS' FINANCIAL SITUATION DEMONSTRATES ABUSE.

Should this Court accept the Debtors' construction of section 707(b)(2)(A)(ii)(I), it should remand this case to the district court. In ruling that the presumption of abuse arose under section 707(b)(2), the district court did not reach the alternative argument briefed by the United States Trustee that the totality of the circumstances of the Debtors' financial situation demonstrated abuse under section 707(b)(3)(B). Remand would allow the district court to consider whether the bankruptcy court erred in denying the United States Trustee's motion to dismiss for abuse under section 707(b)(3)(B). See Walker v. Wallace Auto Sales, Inc., 155 F.3d 927, 936 (7th Cir. 1998) (remanding for consideration of issue not initially reached by the district court).

CONCLUSION

For these reasons, the United States respectfully asks this Court to affirm the decision of the United States District Court for the Eastern District of Wisconsin, reversing the decision of the United States Bankruptcy Court for the Eastern District of Wisconsin.

Respectfully submitted,

ROBERTA A. DEANGELIS
Acting General Counsel

P. MATTHEW SUTKO
Associate General Counsel
SEAN E. MARTIN
Executive Office for United States Trustees
Department of Justice
20 Massachusetts Avenue, N.W.
Washington, D.C. 20530
(202) 307-1399

CERTIFICATE OF COMPLIANCE

I certify that this brief is proportionately spaced, using Times Roman font, 14 point type. Based on a word count under Corel Word Perfect 12, this brief contains 10,706 words, excluding the table of contents, table of authorities, addendum, appendix, and certificates of counsel.

Sean E. Martin
Attorney for the United States Trustee

CERTIFICATE OF SERVICE

I hereby certify that on April 22, 2008, I served the foregoing brief for the United States Trustee on the following by sending two copies of the brief and one disk, by Federal Express Next Business Day Delivery to:

George B. Goyke, Esq.
Goyke, Tillisch & Higgins LLP
207 Grand Avenue
Wausau, WI 54403

Tara Twomey, Esq.
National Association of Consumer Bankruptcy Attorneys
1501 The Alameda
San Jose, CA 95126

I also certify that on April 22, 2008, I filed the brief by sending the original, fifteen copies, and one disk to the Clerk, United States Court of Appeals for the Seventh Circuit, by Federal Express Next Business Day Delivery at the following address:

Clerk of Court
United States Court of Appeals for the Seventh Circuit
219 South Dearborn Street, Room 2722
Chicago, IL 60604

Sean E. Martin
Attorney for the United States Trustee

ADDENDUM

11 U.S.C. 707(b)(2)(A)(ii)(I)

The debtor's monthly expenses shall be the debtor's applicable monthly expense amounts specified under the National Standards and Local Standards, and the debtor's actual monthly expenses for the categories specified as Other Necessary Expenses issued by the Internal Revenue Service for the area in which the debtor resides, as in effect on the date of the order for relief, for the debtor, the dependents of the debtor, and the spouse of the debtor in a joint case, if the spouse is not otherwise a dependent. Such expenses shall include reasonably necessary health insurance, disability insurance, and health savings account expenses for the debtor, the spouse of the debtor, or the dependents of the debtor. Notwithstanding any other provision of this clause, the monthly expenses of the debtor shall not include any payments for debts. In addition, the debtor's monthly expenses shall include the debtor's reasonably necessary expenses incurred to maintain the safety of the debtor and the family of the debtor from family violence as identified under section 309 of the Family Violence Prevention and Services Act, or other applicable Federal law. The expenses included in the debtor's monthly expenses described in the preceding sentence shall be kept confidential by the court. In addition, if it is demonstrated that it is reasonable and necessary, the debtor's monthly expenses may also include an additional allowance for food and clothing of up to 5 percent of the food and clothing categories as specified by the National Standards issued by the Internal Revenue Service.

IRS Collection Financial Standards

Internal Revenue Service
United States Department of the Treasury

Collection Financial Standards

General

Collection Financial Standards are used to help determine a taxpayer's ability to pay a delinquent tax liability.

Allowances for food, clothing and other items, known as the National Standards, apply nationwide except for Alaska and Hawaii, which have their own tables. Taxpayers are allowed the total National Standards amount for their family size and income level, without questioning amounts actually spent.

Maximum allowances for housing and utilities and transportation, known as the Local Standards, vary by location. Unlike the National Standards, the taxpayer is allowed the amount actually spent or the standard, whichever is less.

Food, Clothing and Other Items

National Standards for reasonable amounts have been established for five necessary expenses: food, housekeeping supplies, apparel and services, personal care products and services, and miscellaneous.

All standards except miscellaneous are derived from the Bureau of Labor Statistics (BLS) Consumer Expenditure Survey (CES). The miscellaneous standard has been established by the IRS.

Alaska and Hawaii

Due to their unique geographic circumstances and higher cost of living, separate standards for food, clothing and other items have been established for Alaska and Hawaii .

Housing and Utilities

The housing and utilities standards are derived from Census and BLS data, and are provided by state down to the county level.

Transportation

The transportation standards consist of nationwide figures for monthly loan or lease payments referred to as ownership costs, and additional amounts for monthly operating costs broken down by Census Region and Metropolitan Statistical Area (MSA). Public transportation is included under operating costs. A conversion chart has been provided with the standards which shows which IRS districts fall under each Census Region, as well as the counties included in each MSA. The ownership cost portion of the transportation standard, although it

applies nationwide, is still considered part of the Local Standards.

The ownership costs provide maximum allowances for the lease or purchase of up to two automobiles if allowed as a necessary expense. The operating costs are derived from BLS data.

If a taxpayer has a car payment, the allowable ownership cost added to the allowable operating cost equals the allowable transportation expense. If a taxpayer has no car payment, or no car, only the operating costs portion of the transportation standard is used to come up with the allowable transportation expense.

Recent Revisions

The Local Standards for housing and utilities and transportation were revised on 02/01/06 to:

- add family size to the housing and utilities allowances (two or less, three, and four or more);
- base automobile ownership/leasing costs on the five-year average of new and used car financing data compiled by the Federal Reserve Board of Governors; and,
- reflect updated information from the Bureau of Labor Statistics.
- Housing and Utility Standards have been established in 2006 for U.S. Territories

The revised Local Standards for housing and utilities and transportation are effective for financial analysis conducted on or after January 1, 2006.

APPENDIX

MEASNSYES, NTCAPR, MEANSYES

U.S. Bankruptcy Court
Eastern District of Wisconsin (Milwaukee)
Bankruptcy Petition #: 06-24573-svk

Assigned to: Susan V. Kelley
Chapter 7
Voluntary
No asset

Date Filed: 08/18/2006

Debtor **Marvin Floyd Ross-Tousey** P.O. Box 47 Mattoon, WI 54450 SSN: xxx-xx-9764 ***fka*** **Marvin F. Ross**	represented by	**George B. Goyke** P.O. Box 2188 Wausau, WI 54402-2188 715-849-8100 Email: goyke@grandlawyers.com
Joint Debtor **Deborah Helene Tousey** P.O. Box 47 Mattoon, WI 54450 SSN: xxx-xx-8935	represented by	**George B. Goyke** (See above for address)
Trustee **Paul G. Swanson** 107 Church Avenue P.O. Box 617 Oshkosh, WI 54903-0617 920-235-6690		
U.S. Trustee **Office Of the U. S. Trustee** 517 East Wisconsin Ave. Room 430 Milwaukee, WI 53202 414-297-4499	represented by	**Michelle S. Y. Cramer** U.S. Trustee 517 E. Wisconsin Ave. Milwaukee, WI 53202 414-297-4499 Email: michelle.cramer@usdoj.gov

Filing Date	#	Docket Text
08/18/2006	1 pgs: 28	Chapter 7 Voluntary Petition . Filed by Marvin Floyd Ross-Tousey, Deborah Helene Tousey Government Proof of Claim due by 2/14/2007. Schedule I due 9/5/2006. Schedule J due 9/5/2006. Incomplete Filings due by 9/5/2006. (Goyke, George) Receipt Number 00314900, Fee Amount: $299. (baj 08/21/06) (Entered:

		08/18/2006)
08/18/2006	5 pgs: 2	First Meeting of Creditors to be held on 09/21/2006 at 12:00 PM in Green Bay, Room 604. Last day to oppose discharge or dischargeability is 11/20/2006. (Goyke, George) (Entered: 08/18/2006)
08/18/2006	2 pgs: 5	Statement of Current Monthly Income - Form 22 . Filed by George B. Goyke on behalf of Debtor Marvin Floyd Ross-Tousey, Joint Debtor Deborah Helene Tousey. (Goyke, George) (Entered: 08/18/2006)
08/18/2006	3 pgs: 2	Certificate of Credit Counseling Filed by George B. Goyke on behalf of Debtor Marvin Floyd Ross-Tousey, Joint Debtor Deborah Helene Tousey. (Goyke, George) (Entered: 08/18/2006)
08/18/2006	4 pgs: 6	Employee Income Records ~~Statement of Current Monthly Income - Form 22~~ *PAYMENT ADVICES*. Filed by George B. Goyke on behalf of Debtor Marvin Floyd Ross-Tousey, Joint Debtor Deborah Helene Tousey. (Goyke, George) (Entered: 08/18/2006)
08/21/2006	6 pgs: 2	Notice of Deficiency. (kjl, Deputy Clerk) (Entered: 08/21/2006)
08/23/2006	7 pgs: 3	BNC Certificate of Mailing - Meeting of Creditors. (RE: 5 Meeting (Chapter 7)) Service Date 08/23/2006. (Admin.) (Entered: 08/24/2006)
08/23/2006	8 pgs: 3	BNC Certificate of Mailing - PDF Document. (RE: 6 Notice (Generic)) Service Date 08/23/2006. (Admin.) (Entered: 08/24/2006)
09/05/2006	9 pgs: 1, 2	Motion to Extend Time to Schedules I and J with Notice of Motion filed by George B. Goyke on behalf of Debtor Marvin Floyd Ross-Tousey, Joint Debtor Deborah Helene Tousey. Objections due by 9/20/2006. (Attachments: # 1 Notice) (Goyke, George) (Entered: 09/05/2006)
09/08/2006	10 pgs: 2	Schedule I , Schedule J Filed by George B. Goyke on behalf of Debtor Marvin Floyd Ross-Tousey, Joint Debtor Deborah Helene Tousey RE: 1 Voluntary Petition (Chapter 7), Voluntary Petition (Chapter 7). (Goyke, George) (Entered: 09/08/2006)
09/15/2006	11 pgs: 1	Document lodged: Form 21 - Statement of Social Security Number. (kaz, Deputy Clerk) (Entered: 09/15/2006)
09/22/2006	12 pgs: 1	Order signed on 9/22/06 Granting 9 Motion to Extend Time to file Schedules I & J to 9/20/2006. (mle, Deputy Clerk) (Entered: 09/22/2006)

09/24/2006	13 pgs: 2	BNC Certificate of Mailing - PDF Document. (RE: 12 Order on Motion to Extend Time) Service Date 09/24/2006. (Admin.) (Entered: 09/25/2006)
09/26/2006	14 pgs: 1	Trustee's Report of No Distribution . (jam, Deputy Clerk) (Entered: 09/26/2006)
09/29/2006		As required by 11 U.S.C. sec. 704(b)(1)(A), the U.S. Trustee has reviewed the materials filed by the debtor(s). Having considered these materials in reference to the criteria set forth in 11 U.S.C. sec. 707(b)(2)(A), and pursuant to 11 U.S.C. sec. 704(b)(2), the U.S. Trustee has determined that:(1) the case is presumed to be an abuse under sec. 707(b); and (2) the product of the current monthly income, multiplied by 12, is not less than the requirements specified in sec. 704(b)(2)(A) or (B). As required by 11 U.S.C. sec. 704(b)(2), the U.S. Trustee will file a motion to dismiss or convert under sec. 707(b) or file a statement setting forth the reasons the U.S. Trustee does not consider such a motion to be appropriate not later than 30 days after the first meeting of creditors. Debtors may rebut the presumption of abuse only if special circumstances can be demonstrated as set forth in 11 U.S.C. sec. 707(b)(2)(B). Filed by Trustee Office Of the U. S. Trustee. (Cramer, Michelle) (Entered: 09/29/2006)
10/10/2006	15 pgs: 3	Reaffirmation Agreement with M&I Marshall & Ilsley Bank Filed by George B. Goyke on behalf of Debtor Marvin Floyd Ross-Tousey, Joint Debtor Deborah Helene Tousey. with Declaration of the Attorney for the Debtor. Disclosures, Instructions and Notice to Debtor have been filed with this Reaffirmation. (Goyke, George) (Entered: 10/10/2006)
10/12/2006		The Court has reviewed the Reaffirmation Agreement with M&I Marshall & Ilsley Bank (15) and since the debtors were represented by counsel during the negotiation of the Agreement and the Court considers the presumption of undue hardship to have been successfully rebutted, no hearing will be held. (pab, Judicial Assistant) (Entered: 10/12/2006)
10/19/2006	16 pgs: 1	Notice of Statement of Abuse Filed by the U.S. Trustee. (amc, Deputy Clerk) (Entered: 10/19/2006)
10/21/2006	17 pgs: 2	BNC Certificate of Mailing - PDF Document. (RE: 16 Notice (Generic)) Service Date 10/21/2006. (Admin.) (Entered: 10/21/2006)
10/23/2006	18 pgs: 2	Notice to debtor(s) regarding the Requirements to File a Certification of Completion of Course Concerning Personal Financial Management. (admin) (Entered: 10/23/2006)
10/25/2006	19	BNC Certificate of Mailing. (RE: 18 Financial Deficiency Notice to

	pgs: 3	Creditors) Service Date 10/25/2006. (Admin.) (Entered: 10/26/2006)
10/30/2006	20 pgs: 4	Motion to Dismiss Case for Abuse filed by U.S. Trustee Office Of the U. S. Trustee. (Office Of the U. S. Trustee,) (Entered: 10/30/2006)
10/31/2006	21 pgs: 1	Notice of Appearance and Request for Notice Filed by on behalf of Creditor Household Bank (SB), NA. (Spallas, Nichlas) (Entered: 10/31/2006)
11/01/2006	22 pgs: 1	Declaration of Mailing Re: Motion by the United States Trustee to Dismiss filed by David W. Ashach Assistant U.S. Trustee. (os3, Deputy Clerk) (Entered: 11/02/2006)
11/01/2006	23 pgs: 1	Declaration of Mailing Re: Motion by the United States Trustee to Dismiss filed by Linda L. Saladin, Office Of the U.S. Trustee. (os3, Deputy Clerk) (Entered: 11/02/2006)
11/02/2006	24 pgs: 5, 5, 6	Support/Supplement Re: *Motion to Dismiss Case for Abuse* Filed by on behalf of U.S. Trustee Office Of the U. S. Trustee RE: 20 Motion to Dismiss Case for Abuse . (Attachments: # 1 Exhibit # 2 Exhibit) (Office of the U.S. Trustee (staff),) (Entered: 11/02/2006)
11/02/2006	25 pgs: 1	Certificate of Service Filed by Office Of the U. S. Trustee RE: 24 Support/Supplement. (Office of the U.S. Trustee (staff)) (Entered: 11/02/2006)
11/06/2006	26 pgs: 1	Notice of Hearing regarding the U.S. Trustee's Motion to Dismiss this case as an abuse pursuant to 11 U.S.C. Section 707(b)(3) (20). Hearing to be held on 12/11/2006 at 12:30 p.m. at Northeast WI Technical College, 2740 West Mason Street, Rm. SC207, Green Bay, WI. (pab, Judicial Assistant) (Entered: 11/06/2006)
11/08/2006	27 pgs: 2	BNC Certificate of Mailing - PDF Document. (RE: 26 Notice of Hearing,) Service Date 11/08/2006. (Admin.) (Entered: 11/09/2006)
12/07/2006	28 pgs: 1, 28, 1, 1, 5, 6, 6	Exhibit *List* filed by Michelle S.Y. Cramer on behalf of the Office Of the U. S. Trustee. (Cramer, Michelle) (Entered: 12/07/2006)
12/07/2006	29 pgs: 7	Exhibit *6 to Exhibit List filed on 12/7/07* by Michelle S.Y. Cramer on behalf of the Office Of the U.S. Trustee. (Cramer, Michelle) (Entered: 12/07/2006)
12/08/2006	30 pgs: 1, 6, 2, 6, 1	Exhibit *List - Amended - with Exhibits 7A, 7B, 8, filed by Michelle S.Y. Cramer on behalf of the* Office Of the U. S. Trustee. (Cramer, Michelle) (Entered: 12/08/2006)

12/08/2006	31 pgs: 1, 5, 5, 2	Exhibit *List of Debtors for evidentiary hearing* Filed by George B. Goyke on behalf of Debtor Marvin Floyd Ross-Tousey, Joint Debtor Deborah Helene Tousey RE: 20 Motion to Dismiss Case for Abuse . (Attachments: # 1 Exhibit # 2 Exhibit # 3 Exhibit) (Goyke, George) (Entered: 12/08/2006)
12/08/2006	32 pgs: 10	Brief *in Opposition to Motion to Dismiss* Filed by George B. Goyke on behalf of Debtor Marvin Floyd Ross-Tousey, Joint Debtor Deborah Helene Tousey RE: 20 Motion to Dismiss Case for Abuse . (Goyke, George) (Entered: 12/08/2006)
12/08/2006	33 pgs: 1, 5, 5, 29, 35, 42, 2	Exhibit *List of Debtors* Filed by George B. Goyke on behalf of Debtor Marvin Floyd Ross-Tousey, Joint Debtor Deborah Helene Tousey RE: 20 Motion to Dismiss Case for Abuse . (Attachments: # 1 Exhibit # 2 Exhibit # 3 Exhibit # 4 Exhibit # 5 Exhibit # 6 Exhibit) (Goyke, George) (Entered: 12/08/2006)
12/14/2006	34 pgs: 1	Order Denying U.S. Trustee's Motion to Dismiss (Related Doc # 20) Signed on 12/14/2006. (Laffredi, Timothy) (Entered: 12/14/2006)
12/14/2006	35 pgs: 3	Financial Management Course Certificate Filed by George B. Goyke on behalf of Debtor Marvin Floyd Ross-Tousey, Joint Debtor Deborah Helene Tousey. (Goyke, George) (Entered: 12/14/2006)
12/16/2006	36 pgs: 2	BNC Certificate of Mailing - PDF Document. (RE: 34 Order on Motion to Dismiss Case for Abuse) Service Date 12/16/2006. (Admin.) (Entered: 12/17/2006)
12/20/2006	37 pgs: 1	Notice of Appeal Filed by U.S. Trustee Office Of the U. S. Trustee (RE: 34 Order on Motion to Dismiss Case for Abuse). (Cramer, Michelle) Receipt Number Exempt, Fee Amount: $255. (rdj 12/21/06) (Entered: 12/20/2006)
12/20/2006	38 pgs: 1	Certificate of Service Filed by Michelle S. Y. Cramer on behalf of U.S. Trustee Office Of the U. S. Trustee RE: 37 Notice of Appeal. (Cramer, Michelle) (Entered: 12/20/2006)
12/21/2006	39 pgs: 3	Certificate of Service on Marvin Floyd Ross-Tousey, Deborah Helene Tousey, Office of the U.S. Trustee, George B. Goyke, Paul G. Swanson(Chapter 7 Trustee), David W. Asbach, and Michelle S.Y. Cramer RE: 37 Notice of Appeal. (sko, Deputy Clerk) (Entered: 12/21/2006)
12/21/2006	40 pgs: 83	Transcript of Proceedings held 12/11/2006. (cah, Deputy Clerk) (Entered: 12/21/2006)
12/23/2006	41	BNC Certificate of Mailing - PDF Document. (RE: 39 Certificate of

	pgs: 4	Service) Service Date 12/23/2006. (Admin.) (Entered: 12/24/2006)
12/29/2006	42 pgs: 1	Statement of Issues on Appeal, Filed by U.S. Trustee Office Of the U. S. Trustee (RE: 37 Notice of Appeal). (Cramer, Michelle) (Entered: 12/29/2006)
12/29/2006	43 pgs: 2	Appellant Designation of Contents For Inclusion in Record On Appeal Filed by U.S. Trustee Office Of the U. S. Trustee (RE: 37 Notice of Appeal, 42 Statement of Issues on Appeal). Appellee designation due by 1/8/2007. Transmission of Designation Due by 1/29/2007. (Cramer, Michelle) (Entered: 12/29/2006)
12/29/2006	44 pgs: 1	Certificate of Service Filed by Michelle S. Y. Cramer on behalf of U.S. Trustee Office Of the U. S. Trustee RE: 42 Statement of Issues on Appeal, 43 Appellant Designation,. (Cramer, Michelle) (Entered: 12/29/2006)
01/19/2007	45 pgs: 2	Transmittal and Receipt of Record on Appeal received by the U.S. District Court. Civil Case Number 07-C-0065, assigned to Judge Griesbach (RE: 37 Notice of Appeal). (mlf, Deputy Clerk) (Entered: 01/19/2007)
01/21/2007	46 pgs: 3	BNC Certificate of Mailing - PDF Document. (RE: 45 Transmittal of Receipt Record on Appeal (USDC)) Service Date 01/21/2007. (Admin.) (Entered: 01/22/2007)
05/22/2007	47 pgs: 1	Notice of Hearing to consider the *status of this case considering the decision on Appeal.* Hearing to be held on 6/4/2007 at 01:00 PM Telephone Hearing (Kelley, Susan) (Entered: 05/22/2007)
05/23/2007	48 pgs: 16	Record on Appeal Returned from District Court on: 05/23/2007 Decision: The case is remanded to the court for further proceedings. (rsb, Deputy Clerk) (Entered: 05/23/2007)
05/24/2007	49 pgs: 2	BNC Certificate of Mailing - PDF Document. (RE: 47 Notice of Hearing) Service Date 05/24/2007. (Admin.) (Entered: 05/25/2007)
06/04/2007		Status Conference held on 6/4/07 per the Court's request (47). Attorney Goyke informed the Court that he was planning on filing an Appeal of the District Court's decision to the 7th Circuit. The Court placed this matter on its suspense calendar for 90 days and will follow up with the parties as to the status of the appeal by 9/4/2007. (kmf, Courtroom Deputy) (Entered: 06/04/2007)
08/06/2007	50 pgs: 3	Motion for Certification to Court of Appeals filed by George B. Goyke on behalf of Debtor Marvin Floyd Ross-Tousey, Joint Debtor Deborah Helene Tousey. (Goyke, George) (Entered: 08/06/2007)

08/10/2007	51 pgs: 1	Order Denying Request for Certification (50) Signed on 8/10/2007. (kmf, Courtroom Deputy) (Entered: 08/10/2007)
08/10/2007	52 pgs: 4	BNC Certificate of Mailing - PDF Document. (RE: 50 Motion for Certification to Court of Appeals filed by Debtor Marvin Floyd Ross-Tousey, Joint Debtor Deborah Helene Tousey) Service Date 08/10/2007. (Admin.) (Entered: 08/11/2007)
08/12/2007	53 pgs: 2	BNC Certificate of Mailing - PDF Document. (RE: 51 Order on Motion for Certification to Court of Appeals) Service Date 08/12/2007. (Admin.) (Entered: 08/13/2007)

PACER Service Center

Transaction Receipt

04/21/2008 08:38:20

PACER Login:	du4850	**Client Code:**	
Description:	Docket Report	**Search Criteria:**	06-24573-svk Fil or Ent: filed Doc From: 0 Doc To: 99999999 Term: included Format: HTML
Billable Pages:	4	**Cost:**	0.32

(Official Form 1) (10/05)

FORM B1

United States Bankruptcy Court
Eastern District of Wisconsin

Voluntary Petition

Name of Debtor (if individual, enter Last, First, Middle): **Ross-Tousey, Marvin Floyd**	Name of Joint Debtor (Spouse) (Last, First, Middle): **Tousey, Deborah Helene**
All Other Names used by the Debtor in the last 8 years (include married, maiden, and trade names): **Marvin F. Ross**	All Other Names used by the Joint Debtor in the last 8 years (include married, maiden, and trade names):
Last four digits of Soc. Sec. No./Complete EIN or other Tax I.D. No. (if more than one, state all): **9764**	Last four digits of Soc. Sec. No./Complete EIN or other Tax I.D. No. (if more than one, state all): **8935**
Street Address of Debtor (No. & Street, City, State & Zip Code): **P.O. Box 47** **Mattoon, WI** ZIPCODE **54450**	Street Address of Joint Debtor (No. & Street, City, State & Zip Code): **P.O. Box 47** **Mattoon, WI** ZIPCODE **54450**
County of Residence or of the Principal Place of Business: **Shawano**	County of Residence or of the Principal Place of Business: **Shawano**
Mailing Address of Debtor (if different from street address) ZIPCODE	Mailing Address of Joint Debtor (if different from street address): ZIPCODE

Location of Principal Assets of Business Debtor (if different from street address above):

ZIPCODE

Type of Debtor (Form of Organization)
(Check one box.)

☑ Individual (includes Joint Debtors)
☐ Corporation (includes LLC and LLP)
☐ Partnership
☐ Other (If debtor is not one of the above entities, check this box and provide the information requested below.)
State type of entity:

Nature of Business
(Check all applicable boxes.)

☐ Health Care Business
☐ Single Asset Real Estate as defined in 11 U.S.C. § 101(51B)
☐ Railroad
☐ Stockbroker
☐ Commodity Broker
☐ Clearing Bank
☐ Nonprofit Organization qualified under 15 U.S.C. § 501(c)(3)

Chapter of Bankruptcy Code Under Which the Petition is Filed (Check one box)

☑ Chapter 7
☐ Chapter 9
☐ Chapter 11
☐ Chapter 12
☐ Chapter 13
☐ Chapter 15 Petition for Recognition of a Foreign Main Proceeding
☐ Chapter 15 Petition for Recognition of a Foreign Nonmain Proceeding

Nature of Debts (Check one box)

☑ Consumer/Non-Business ☐ Business

Filing Fee (Check one box)

☑ Full Filing Fee attached
☐ Filing Fee to be paid in installments (Applicable to individuals only). Must attach signed application for the court's consideration certifying that the debtor is unable to pay fee except in installments. Rule 1006(b). See Official Form 3A.
☐ Filing Fee waiver requested (Applicable to chapter 7 individuals only). Must attach signed application for the court's consideration. See Official Form 3B.

Chapter 11 Debtors:

Check one box:

☐ Debtor is a small business debtor as defined in 11 U.S.C. § 101(51D).
☐ Debtor is not a small business debtor as defined in 11 U.S.C. § 101(51D).

Check if:

☐ Debtor's aggregate noncontingent liquidated debts owed to non-insiders or affiliates are less than $2 million.

Statistical/Administrative Information

☐ Debtor estimates that funds will be available for distribution to unsecured creditors.
☑ Debtor estimates that, after any exempt property is excluded and administrative expenses paid, there will be no funds available for distribution to unsecured creditors.

THIS SPACE IS FOR COURT USE ONLY

Estimated Number of Creditors

1-49	50-99	100-199	200-999	1,000-5,000	5,001-10,000	10,001-25,000	25,001-50,000	50,001-100,000	Over 100,000
☑	☐	☐	☐	☐	☐	☐	☐	☐	☐

Estimated Assets

$0 to $50,000	$50,001 to $100,000	$100,001 to $500,000	$500,001 to $1 million	$1,000,001 to $10 million	$10,000,001 to $50 million	$50,000,001 to $100 million	More than $100 million
☐	☑	☐	☐	☐	☐	☐	☐

Estimated Debts

$0 to $50,000	$50,001 to $100,000	$100,001 to $500,000	$500,001 to $1 million	$1,000,001 to $10 million	$10,000,001 to $50 million	$50,000,001 to $100 million	More than $100 million
☐	☐	☑	☐	☐	☐	☐	☐

Voluntary Petition *(This page must be completed and filed in every case)*	Name of Debtor(s): **Ross-Tousey, Marvin Floyd & Tousey, Deborah Helene**

Prior Bankruptcy Case Filed Within Last 8 Years (If more than one, attach additional sheet)

Location Where Filed: **None**	Case Number:	Date Filed:

Pending Bankruptcy Case Filed by any Spouse, Partner or Affiliate of this Debtor (If more than one, attach additional sheet)

Name of Debtor: **None**	Case Number:	Date Filed:
District:	Relationship:	Judge:

Exhibit A

(To be completed if debtor is required to file periodic reports (e.g., forms 10K and 10Q) with the Securities and Exchange Commission pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 and is requesting relief under chapter 11.)

☐ Exhibit A is attached and made a part of this petition.

Exhibit B

(To be completed if debtor is an individual whose debts are primarily consumer debts)

I, the attorney for the petitioner named in the foregoing petition, declare that I have informed the petitioner that [he or she] may proceed under chapter 7, 11, 12, or 13 of title 11, United States Code, and have explained the relief available under each such chapter.

I further certify that I delivered to the debtor the notice required by § 342(b) of the Bankruptcy Code.

X ***/s/ George B. Goyke*** **8/17/06**

Signature of Attorney for Debtor(s) Date

Exhibit C

Does the debtor own or have possession of any property that poses or is alleged to pose a threat of imminent and identifiable harm to public health or safety?

☐ Yes, and Exhibit C is attached and made a part of this petition.

☑ No

Certification Concerning Debt Counseling by Individual/Joint Debtor(s)

☑ I/we have received approved budget and credit counseling during the 180-day period preceding the filing of this petition

☐ I/we request a waiver of the requirement to obtain budget and credit counseling prior to filing based on exigent circumstances. (Must attach certification describing.)

Information Regarding the Debtor (Check the Applicable Boxes)

Venue (Check any applicable box)

☑ Debtor has been domiciled or has had a residence, principal place of business, or principal assets in this District for 180 days immediately preceding the date of this petition or for a longer part of such 180 days than in any other District.

☐ There is a bankruptcy case concerning debtor's affiliate, general partner, or partnership pending in this District.

☐ Debtor is a debtor in a foreign proceeding and has its principal place of business or principal assets in the United States in this District, or has no principal place of business or assets in the United States but is a defendant in an action or proceeding [in a federal or state court] in this District, or the interests of the parties will be served in regard to the relief sought in this District.

Statement by a Debtor Who Resides as a Tenant of Residential Property

Check all applicable boxes.

☐ Landlord has a judgment against the debtor for possession of debtor's residence. (If box checked, complete the following.)

(Name of landlord or lessor that obtained judgment)

(Address of landlord or lessor)

☐ Debtor claims that under applicable nonbankruptcy law, there are circumstances under which the debtor would be permitted to cure the entire monetary default that gave rise to the judgment for possession, after the judgment for possession was entered, and

☐ Debtor has included in this petition the deposit with the court of any rent that would become due during the 30-day period after the filing of the petition.

Voluntary Petition

(This page must be completed and filed in every case)

Name of Debtor(s):

Ross-Tousey, Marvin Floyd & Tousey, Deborah Helene

Signatures

Signature(s) of Debtor(s) (Individual/Joint)

I declare under penalty of perjury that the information provided in this petition is true and correct.

[If petitioner is an individual whose debts are primarily consumer debts and has chosen to file under Chapter 7] I am aware that I may proceed under chapter 7, 11, 12 or 13 of title 11, United State Code, understand the relief available under each such chapter, and choose to proceed under chapter 7.

[If no attorney represents me and no bankruptcy petition preparer signs the petition] I have obtained and read the notice required by § 342(b) of the Bankruptcy Code.

I request relief in accordance with the chapter of title 11, United States Code, specified in this petition.

X ***/s/ Marvin F. Ross-Tousey***

Signature of Debtor **Marvin F. Ross-Tousey**

X ***/s/ Deborah H. Tousey***

Signature of Joint Debtor **Deborah H. Tousey**

Telephone Number (If not represented by attorney)

August 17, 2006

Date

Signature of a Foreign Representative

I declare under penalty of perjury that the information provided in this petition is true and correct, that I am the foreign representative of a debtor in a foreign main proceeding, and that I am authorized to file this petition. A certified copy of the order granting recognition is attached.

(Check one box only)

☐ I request relief in accordance with chapter 15 of title 11, United States Code. Certified copies of the documents required by § 1515 of title 11 are attached.

☐ Pursuant to § 1511 of title 11, United States Code, I request relief in accordance with the chapter of title 11 specified in this petition. A certified copy of the order granting recognition of the foreign main proceeding is attached.

X

Signature of Foreign Representative

X

Printed Name of Foreign Representative

Date

Signature of Attorney

X ***/s/ George B. Goyke***

Signature of Attorney for Debtor(s)

George B. Goyke 1001340

Printed Name of Attorney for Debtor(s)

Goyke, Tillisch & Higgins LLP

Firm Name

P.O. Box 2188

Address

Wausau, WI 54402-2188

(715) 849-8100

Telephone Number

August 17, 2006

Date

Signature of Debtor (Corporation/Partnership)

I declare under penalty of perjury that the information provided in this petition is true and correct, and that I have been authorized to file this petition on behalf of the debtor.

The debtor requests relief in accordance with the chapter of title 11, United States Code, specified in this petition.

X

Signature of Authorized Individual

Printed Name of Authorized Individual

Title of Authorized Individual

Date

Signature of Non-Attorney Petition Preparer

I declare under penalty of perjury that: 1) I am a bankruptcy petition preparer as defined in 11 U.S.C. § 110; 2) I prepared this document for compensation and have provided the debtor with a copy of this document and the notices and information required under 11 U.S.C. §§ 110(b), 110(h) and 342(b); 3) if rules or guidelines have been promulgated pursuant to 11 U.S.C. § 110 setting a maximum fee for services chargeable by bankruptcy petition preparers, I have given the debtor notice of the maximum amount before preparing any document for filing for a debtor or accepting any fee from the debtor, as required in that section. Official Form 19B is attached.

Printed Name and title, if any, of Bankruptcy Petition Preparer

Social Security Number (If the bankruptcy petition preparer is not an individual, state the Social Security number of the officer, principal, responsible person or partner of the bankruptcy petition preparer.) (Required by 11 U.S.C. § 110.)

Address

X

Signature of Bankruptcy Petition Preparer or officer, principal, responsible person, or partner whose social security number is provided above.

Date

Names and Social Security numbers of all other individuals who prepared or assisted in preparing this document unless the bankruptcy petition preparer is not an individual:

If more than one person prepared this document, attach additional sheets conforming to the appropriate official form for each person.

A bankruptcy petition preparer's failure to comply with the provisions of title 11 and the Federal Rules of Bankruptcy Procedure may result in fines or imprisonment or both 11 U.S.C. § 110; 18 U.S.C. § 156.

UNITED STATES BANKRUPTCY COURT
Eastern District of Wisconsin

Notice of Chapter 7 Bankruptcy Case, Meeting of Creditors, and Deadlines

A Chapter 7 bankruptcy case concerning the debtor(s) listed below was filed on 8/18/06.

This notice contains important information for the debtor(s) and creditors. All documents filed in the case may be viewed at the bankruptcy clerk's office at the address listed below. NOTE: No employee of the United States Bankruptcy Court may give legal advice. You may want to consult an attorney to protect your rights.

See Reverse Side For Additional Information.

Name(s) used by the debtor(s) in the last 8 years (including married, maiden, trade) and address:

Marvin Floyd Ross−Tousey
fka Marvin F. Ross
P.O. Box 47
Mattoon, WI 54450

Deborah Helene Tousey
P.O. Box 47
Mattoon, WI 54450

Case Number: 06−24573−svk	Social Security/Taxpayer ID/Employer ID/Other Nos.: xxx−xx−9764 xxx−xx−8935
Attorney for Debtor(s) (name and address): George B. Goyke P.O. Box 2188 Wausau, WI 54402−2188 Telephone number: 715−849−8100	Bankruptcy Trustee (name and address): Paul G. Swanson 107 Church Avenue P.O. Box 617 Oshkosh, WI 54903−0617 Telephone number: 920−235−6690

Meeting of Creditors

The debtor(s) must attend this meeting.

Date: **September 21, 2006** Time: **12:00 PM**

Location: **Green Bay City Hall, Room 604, 100 North Jefferson, Green Bay, WI 54301**

Presumption of Abuse under 11 U.S.C. § 707(b)

See "Presumption of Abuse" on reverse side.

The presumption of abuse does not arise.

Deadlines:

Papers must be *received* by the bankruptcy clerk's office by the following deadlines:

Deadline to File a Complaint Objecting to Discharge of the Debtor *or* to Determine Dischargeability of Certain Debts: 11/20/06

Deadline to Object to Exemptions:

Thirty (30) days after the *conclusion* of the meeting of creditors.

Creditors May Not Take Certain Actions:

In most instances, the filing of a bankruptcy case automatically stays certain collections and other actions against the debtor and the debtor's property. Under certain circumstances, the stay may be limited to 30 days, or not exist at all; although the debtor can request the court to extend or impose a stay. If you attempt to collect a debt or take other action in violation of the Bankruptcy Code, you may be penalized. Consult a lawyer to determine your rights in this case.

Please Do Not File a Proof of Claim Unless You Receive a Notice To Do So.

Foreign Creditors

A creditor to whom this notice is sent at a foreign address should read the information under "Do Not File a Proof of Claim at This Time" on the reverse side.

Address of the Bankruptcy Clerk's Office: Room 126, U.S. Courthouse 517 East Wisconsin Avenue Milwaukee WI 53202−4581 Telephone number: (414) 297−3291 VCIS number: (414) 297−3582 or Toll Free (877) 781−7277 Court Web Site: http://www.wieb.uscourts.gov	**For the Court:** Clerk of the Bankruptcy Court: CHRISTOPHER L. AUSTIN
Clerk's Office Hours: 8:30 a.m. − 4:30 p.m. (Central Time)	Date: 8/21/06

ADDITIONAL INFORMATION

FORM B9A (10/05)

Filing of Chapter 7 Bankruptcy Case	A bankruptcy case under Chapter 7 of the Bankruptcy Code (Title 11, United States Code) has been filed in this court by or against the debtor(s) listed on the front side, and an order for relief has been entered.
Legal Advice	No employee of the United States Bankruptcy Court may give legal advice.
Creditors Generally May Not Take Certain Actions	Prohibited collection actions are listed in Bankruptcy Code §362. Common examples of prohibited actions include contacting the debtor by telephone, mail, or otherwise to demand repayment; taking actions to collect money or to obtain property from the debtor; repossessing the debtor's property; or starting or continuing lawsuits or foreclosures; or garnishing or deducting from the debtor's wages. Under certain circumstances, the stay may be limited to 30 days, or not exist at all; although the debtor can request the court to extend or impose the stay.
Presumption of Abuse	If the presumption of abuse arises, creditors may have the right to file a motion to dismiss the case under § 707(b) of the Bankruptcy Code. The debtor may rebut the presumption by showing special circumstances.
Meeting of Creditors	A meeting of creditors is scheduled for the date, time, and location listed on the front side. *The debtor (both spouses in a joint case) must be present at the meeting, with photo identification and proof of social security number, to be questioned under oath by the trustee and by creditors.* **Failure of the debtor to appear at the meeting of creditors may result in dismissal of this case without further notice.** Creditors are welcome to attend but are not required to do so. The meeting may be continued and concluded at a later date without further notice.
Debtor Must File Required Information	Subject to 11 USC §521(i)(2) and (4) and notwithstanding 11 USC §707(a), if the debtor fails to file all of the information required under 11 USC §521(a)(1) within 45 days of the date of filing the petition, this case will be dismissed without further notice.
Do Not File a Proof of Claim at This Time	There does not appear to be any property available to the trustee to pay creditors. *You therefore should not file a proof of claim at this time.* If it later appears that assets are available to pay creditors, you will be sent another notice telling you that you may file a proof of claim, and informing you of the deadline for filing your proof of claim. If this notice is mailed to a creditor at a foreign address, the creditor may file a motion requesting the court to extend the deadline.
Discharge of Debts	The debtor is seeking a discharge of most debts, which may include your debt. A discharge means that you may never try to collect the debt from the debtor. If you believe that the debtor is not entitled to receive a discharge under Bankruptcy Code §727(a) *or* that a debt owed to you is not dischargeable under Bankruptcy Code §523(a)(2), (4), or (6), you must start a lawsuit by filing a complaint in the bankruptcy clerk's office by the "Deadline to File a Complaint Objecting to Discharge of the Debtor or to Determine Dischargeability of Certain Debts" listed on the front side. The bankruptcy clerk's office must receive the complaint and any required filing fee by that deadline.
Exempt Property	The debtor is permitted by law to keep certain property as exempt. Exempt property will not be sold and distributed to creditors. The debtor must file a list of all property claimed as exempt. You may inspect that list at the bankruptcy clerk's office. If you believe that an exemption claimed by the debtor is not authorized by law, you may file an objection to that exemption. The bankruptcy clerk's office must receive any objection by the "Deadline to Object to Exemptions" listed on the front side.
Bankruptcy Clerk's Office	Any paper that you file in this bankruptcy case should be filed at the bankruptcy clerk's office at the address listed on the front side. You may inspect all papers filed, including the lists of the debtor's property, debts, and property claimed as exempt, at the bankruptcy clerk's office.
Foreign Creditors	Consult a lawyer familiar with United States bankruptcy law if you have any questions regarding your rights in this case.

−− Refer to Other Side for Important Deadlines and Notices −−

BAE SYSTEMS

Bankruptcy Noticing Center
2525 Network Place, 3rd Floor
Herndon, Virginia 20171-3514

CERTIFICATE OF SERVICE

```
District/off: 0757-2          User: rdj                Page 1 of 1               Date Rcvd: Aug 21, 2006
Case: 06-24573                Form ID: b9a             Total Served: 31


The following entities were served by first class mail on Aug 23, 2006.
db          +Marvin Floyd Ross-Tousey,   P.O. Box 47,   Mattoon, WI 54450-0047
jdb         +Deborah Helene Tousey,   P.O. Box 47,   Mattoon, WI 54450-0047
aty          George B. Goyke,   P.O. Box 2188,   Wausau, WI  54402-2188
tr           Paul G. Swanson,   107 Church Avenue,   P.O. Box 617,   Oshkosh, WI  54903-0617
smg          Wisconsin  Department  Of Revenue,   Special Procedures Unit,   P.O. Box 8901,
               Madison, WI  53708-8901
ust         +Office Of the U. S. Trustee,   517 East Wisconsin Ave.,   Room 430,   Milwaukee, WI 53202-4510
4841298      Aspirus Clinics,   P.O. Box 8004,   Wausau, WI  54402-8004
4841299      Bank Card Services,   P.O. Box 1111,   Madison, WI  53701-1111
4841301      Bay Finance Company LLC,   P.O. Box 4681,   Chicago, IL  60680-4681
4841302      Citi Cards,   P.O. Box 660370,   Dallas, TX  75266-0370
4841303      Citi Cards,   P.O. Box 6077,   Sioux Falls, SD  57117-6077
4841304      Direct Merchants Bank,   P.O. Box 22128,   Tulsa, OK  74121-2128
4841306     +Fox Hills Resort,   P.O. Box 129,   Mishicot, WI 54228-0129
4841311      Jerry D. Mccormack,   Attorney At Law,   P.O. Box,   Antigo, WI  54409
4841312      Kostka & Associates,   P.O. Box 1291,   Wausau, WI  54402-1291
4841313     +Langlade Memorial Hospital,   112 E. Fifth Avenue,   Antigo, WI 54409-2710
4841314      M&I Marshall And Ilsley Bank,   P.O. Box 3203,   Milwaukee, WI  53201-3203
4841315     +Mattoon State Bank,   P.O. Box 170,   Mattoon, WI 54450-0170
4841317      Sears Credit Card,   P.O. Box 6924,   The Lakes, NV  88901-6924
4841318     +State Of Wisconsin,   Department Of Revenue,   P.O. Box 8902,   Madison, WI 53708-8902
4841319     +State Of Wisconsin Workforce Development,   P.O. Box 8914,   Madison, WI 53708-8914
4841320     +Stockbridge-Munsee Community,   Mohican Loan Dept.,   P.O. Box 70,   Bowler, WI 54416-0070
4841321      U.S. Attorney,   530 Federal Bldg. 517 East Wisconsin Ave,   Milwaukee, WI  53202
4841322     +Wausau Hearing Aid Center,   425 Pine Ridge Blvd., Ste 305,   Wausau, WI 54401-4124

The following entities were served by electronic transmission on Aug 21, 2006 and receipt of the transmission
was confirmed on:
4841300      EDI: BANKAMER.COM Aug 21 2006 19:54:00     Bank Of America,   P.O. Box 1390,
               Norfolk, VA  23501-1390
4841305     +EDI: DISCOVER.COM Aug 21 2006 19:54:00     Discover Financial Services,   P.O. Box 7086,
               Dover, DE 19903-7086
4841307     +EDI: TSYS.COM Aug 21 2006 19:54:00     GE Money Bank,   Attn:  Bankruptcy Dept.,   P.O. Box 103104,
               Roswell, GA 30076-9104
4841310     +EDI: IRS.COM Aug 21 2006 19:54:00     Internal Revenue Service,   Department Of The Treasury,
               P.O. Box 21126,   Philadelphia, PA 19114-0326
4841308     +EDI: IRS.COM Aug 21 2006 19:54:00     Internal Revenue Service,   Insolvency Unit - Stop 5301 MIL,
               310 W. Wisconsin Avenue,   Milwaukee, WI 53203-2213
4841309     +EDI: IRS.COM Aug 21 2006 19:54:00     Internal Revenue Service,   Department Of The Treasury,
               P.O. Box 21125,   Philadelphia, PA 19114-0325
4841316      EDI: TSYS.COM Aug 21 2006 19:54:00     Retail Services,   P.O. Box 15521,
               Wilmington, DE  19850-5521
4841317      EDI: SEARS.COM Aug 21 2006 19:54:00     Sears Credit Card,   P.O. Box 6924,
               The Lakes, NV  88901-6924
                                                                                                  TOTAL: 8

           ***** BYPASSED RECIPIENTS *****
NONE.                                                                                             TOTAL: 0

Addresses marked '+' were corrected by inserting the ZIP or replacing an incorrect ZIP.
USPS regulations require that automation-compatible mail display the correct ZIP.
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I, Joseph Speetjens, declare under the penalty of perjury that I have served the attached document on the above listed entities in the manner shown, and prepared the Certificate of Service and that it is true and correct to the best of my information and belief.

First Meeting of Creditor Notices only (Official Form 9): Pursuant to Fed. R. Bank. P. 2002(a)(1), a notice containing the complete Social Security Number (SSN) of the debtor(s) was furnished to all parties listed. This official court copy contains the redacted SSN as required by the bankruptcy rules and the Judiciary's privacy policies.

Date: Aug 23, 2006 **Signature:** Joseph Speetjens

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF WISCONSIN

In re: MARVIN F. ROSS-TOUSEY and
DEBORAH H. TOUSEY

Debtors.

Case No. 2006-24573-SVK

(Chapter 7)

MOTION BY THE UNITED STATES TRUSTEE TO DISMISS

NOW COMES the United States Trustee, by Attorney David W. Asbach, who hereby moves to dismiss this case as an abuse pursuant to 11 U.S.C. §707(b)(3) on the following grounds:

1. This Court has jurisdiction over this motion pursuant to 28 U.S.C. §157 and §1334. The United States Trustee has standing to file this motion pursuant to 28 U.S.C. §586(a) and 11 U.S.C. §307. This is a core proceeding.
2. On August 18, 2006, Marvin F. Ross-Tousey and Deborah H. Tousey ("Debtors") commenced this case by filing a voluntary petition under Chapter 7 of the Bankruptcy Code.
3. This case should be dismissed as an abuse of the bankruptcy system, pursuant to 707(b)(1) and (b)(3)(B).
4. In considering the totality of the circumstances, the courts consider at least five factors:
    a. Whether there was any sudden illness, calamity, unemployment or disability;
    b. Whether the debtor made purchases in excess of his or her ability to pay;
    c. Whether the debtor's budget is excessive or unreasonable;
    d. Whether the schedules and statement of financial affairs reasonably and accurately

Attorney David W. Asbach
Office of the United States Trustee
517 E. Wisconsin Avenue, Suite 430
Milwaukee, WI 53202
(414) 297-4499 Fax (414) 297-4478

reflects the debtor’s true financial condition; and

e. Whether the debtor’s petition is filed in good faith.

In re Green, 934 F.2d 568,572 (4th Cir. 1991).

5. The Debtors’ Schedule I sets forth total monthly net income in the amount of $3,618.88 with no changes of more than 10% expected within the next year. However, the U.S. Trustee asserts that certain deductions should be added back into that figure, namely:

   a. Contributions to a 401(k) plan in the amount of $106 per month. See In re Cohen, 246 B.R. 658, 665-67 (Bankr. D.Colo. 2000).

Eliminating these deductions results in net monthly income in the approximate amount of **$3,699.44.** [$3,618.88 + ($106 x 76%) = $3,699.44]

6. The Debtors’ Schedule J contains expenses which appear unreasonable and beyond the amounts necessary for the maintenance and support of the Debtors, including:

   a. Home Maintenance. The Debtors assert they spend $600 per month on home maintenance. However, it is not clear the Debtors have actually been spending this amount per month and the Debtors have not provided any documentation to support this expense. At a minimum, this expense should be reduced by $254 to the IRS standards of $346 per month for non-mortgage expenses.

   b. Replacement Vehicle. The Debtors assert they are reserving $500 per month for a “replacement vehicle.” Again, however, it is not clear the Debtors have actually been saving this amount per month on average. The Debtors’ Schedule B does not appear to reflect an account where this money was deposited. Moreover, the Debtors own 6 vehicles. At a minimum, this expense should be reduced by $29 to the IRS standards for the ownership expense for one vehicle in the amount of $471 per month.

c. Time Share. The Debtors list a monthly payment of $155.82 for a time share. This expense does not appear necessary for the maintenance and support of the Debtors, and therefore should be excluded from their expenses. To the extent this obligation is a secured debt, the Debtors have not expressed an intention to reaffirm it.

d. Vacuum. The Debtors list a monthly installment payment of $42.39 on a debt to Bay Finance for a vacuum cleaner loan with a balance of $2,021.52 per Schedule F. This expense does not appear necessary for the maintenance and support of the Debtors, and therefore should be excluded. The Debtors could easily find a more reasonably priced vacuum cleaner and avoid monthly payments. Moreover, the Debtors have not expressed an intention to reaffirm the debt to Bay Finance.

7. Reducing the expenses on Schedule J as described above would lower the Debtors' total monthly expenses to **$3,188.50**.

8. Based upon the above analysis, the Debtors would be able to pay a meaningful portion of their debts in a Chapter 13 Plan, approximated as follows:

Monthly Income:	$3,699.44	
Monthly Expenses:	$3,188.50	
Excess Monthly Income ($):	$510.94	
Total Unsecured Claims:	$75,323.63	**% Div. to Unsec'd Creditors:**
Funds ($) avail. for 36 mo. Ch. 13 Plan:	$18,393.84	24.42%
Funds ($) avail. for 60 mo. Ch. 13 Plan:	$30,656.40	40.70%

9. As demonstrated, the Debtors have the ability to pay a meaningful dividend to their unsecured creditors over the life of a five-year Chapter 13 plan and there appears to be no reason for their unwillingness or inability to do so.

WHEREFORE, the United States Trustee requests the Court enter an order dismissing this case as an abuse.

The U.S. Trustee is not filing a brief with this pleading but reserves the right to file a responsive brief if necessary.

Dated: October 30, 2006.

WILLIAM T. NEARY
UNITED STATES TRUSTEE

/s/
David W. Asbach
Assistant United States Trustee

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF WISCONSIN

In re: MARVIN F. ROSS-TOUSEY and DEBORAH H. TOUSEY,

Debtors.

Case No. 06-24573-SVK
(Chapter 7)

SUPPLEMENT TO U.S. TRUSTEE'S MOTION TO DISMISS

NOW COMES U.S. Trustee William T. Neary, by Attorney David W. Asbach, having filed a Motion to Dismiss on October 30, 2006 and now, pursuant to FRCP 15(d), moves the court to supplement the above described motion as follows:

1. The U.S. Trustee, relying on information provided by the Debtor, performed his own calculations and determined that the presumption of abuse arises in this case. See Exhibit 2.

Statutory Definition of Presumption of Abuse

2. Section 707(b)(1) provides that the Court may dismiss a case filed by an individual whose debts are primarily consumer debts if it finds that granting relief would be an abuse of the provisions of Chapter 7.

3. Section 707(b)(2)(A)(i) requires the Court to presume that a Chapter 7 filing is abusive when the Current Monthly Income (CMI) reduced by amounts determined under §707(b)(2)(A) (ii), (iii), and (iv), and multiplied by 60 is not less than the lesser of –

Attorney David W. Asbach
Office of the United States Trustee
517 E. Wisconsin Avenue, Suite 430
Milwaukee, WI 53202
(414) 297-4499 Fax (414) 297-4478

(I) 25 percent of the nonpriority unsecured claims in the case, or $6,000, whichever is greater; or

(II) $10,000.

4. Therefore, if the monthly net income is $166.67 or more (at least $10,000 to fund a 60-month plan), the filing is presumed abusive.

5. If the presumption of abuse arises, debtors may rebut it only by demonstrating special circumstances, such as a serious medical condition or a call or an order to active duty in the Armed Forces, and only to the extent such special circumstances justify additional expenses or adjustments to CMI for which there is no reasonable alternative. §707(b)(2)(B)(i). Debtors must provide a detailed explanation of the special circumstances, itemize and document each additional expense or adjustment of income, and attest under oath to the accuracy of the information provided. §707(b)(2)(B)(ii) and (iii).

6. In the event debtors can establish special circumstances of the kind described in §707(b)(2)(B)(i), they can rebut the presumption of abuse only if they can demonstrate that the additional expenses or adjustments to income cause the product of their reduced monthly net income, when multiplied by 60, to be the lesser of (1) 25% of the nonpriority unsecured debts or $6,000, whichever is greater, or (2) $10,000. §707(b)(2)(B)(iv).

7. The U.S. Trustee timely filed all documents as required by 704(b)(1)(A).

The U.S. Trustee's Corrected Form B22A Demonstrates that the Presumption of Abuse Arises in This Case

8. On their Form B22A, Debtor Marvin Ross-Tousey reported monthly gross wages of $2,516.48 and Debtor Deborah Tousey reported monthly gross wages of $2,679.32. See Exhibit 1, Line 3.

9. The Debtors stated that their Total CMI was $5,195.80 and their annualized income was $62,349.60. See Exhibit 1, Lines 12 and 13. The Debtors claimed a household size of two. See Exhibit 1, Line 14. The applicable state median income for a family of two is $49,918. The Debtors' annualized income reported on the amended Form B22A exceeds the applicable median income.

10. Because their income exceeded the applicable state median family income, the Debtors were required to complete the remainder of amended Form B22A. After completing the remainder of Form B22A, the Debtors checked the box indicating that the presumption of abuse did not arise in their case.

11. Based on materials filed by the Debtors and the U.S. Trustee's calculations of allowable expenses and deductions, the U.S. Trustee prepared a corrected Form B22A . See Exhibit 2.

12. The corrected Form B22A adjusts the figures listed on the Debtors' Form B22A for local standards; housing and utilities adjustment (Line 21), vehicle operation expenses (Line 22) and vehicle ownership expenses (Lines 23 and 24).

13. The corrected Form B22A reveals that the Debtors' actual monthly disposable income is $260.50. Exhibit 2, Line 50.

14. As $260.50 exceeds $166.67, the corrected B22A Form shows that the presumption of abuse arises in this case.

A. Local Standards; housing and utilities adjustment

15. The Debtors include the amount of $50 for repairs to their home on Line 21. However, the expenses reflected at Line 20A already includes home maintenance and repairs. Moreover, the Debtors have not provided documentation to prove this extra expense. Therefore, the amount has been removed from Line 21 on the corrected Form B22A.

B. Transportation/Vehicle Operating and Ownership Expenses

16. The Debtors operate multiple vehicles and, accordingly, they may deduct the operating expenses for two vehicles on Line 22. The Local Standards for vehicle operating expenses for two vehicles is $358.

17. However, the Debtors own all these vehicles free and clear of any liens.

18. Nevertheless, the Debtors claimed to have ownership expenses for these two vehicles and then entered "zero" on Line 23b and 24b. By asserting that they have ownership expenses associated with two vehicles, ownership expenses are added the Form B22A calculations, Line 23 and Line 24, increasing the allowable expenses under §707(b)(2)(A)(ii)(I).

19. The Debtors cannot claim an ownership expense on Line 23 and 24 because these vehicles are neither financed nor leased. <u>In re Barraza</u>, 346 BR 724, 727 (N.D.Texas 2006)

20. Under IRS collection guidelines, which are incorporated by reference into §707(b)(2), the debtor may add $200 to the transportation expenses for a vehicle that is either (1) more than six years old or (2) has over 75,000 miles and requires no associated ownership expense. I.R.M. §5.8.5.5.2., Barraza at 729.

21. In the present case, the Debtors own two vehicles that fit within the parameters described in ¶ 20. Therefore, they are entitled to an additional operating expense of $200 per vehicle, for a total adjustment of Line 22 to $758.

22. The corrected Form B22A adjusts Line 22 from $358 to $758, and removes the ownership expenses claimed on Lines 23 and 24. See Exhibit 2.

This Case Should Be Dismissed Pursuant to §707(b)(1)

25. To date, the Debtors have not come forward with any evidence of special circumstances to rebut the presumption of abuse as required by §707(b)(2)(B).

26. In the alternative, if the Court does not find the presumption of abuse arises or is rebutted, the Court shall consider whether this case should be dismissed for bad faith or under the totality of the circumstances. §707(b)(3)(A) and (B).

DATED: November 2, 2006

Respectfully submitted,

WILLIAM T. NEARY
U.S. TRUSTEE

/s/
David W. Asbach
Assistant U.S. Trustee

when they were considered an abuse. The provision was replaced with a means test for debtors whose income were above the median, and in addition, if the debtors were able to establish that there wasn't a presumption of abuse under the means test or if they successfully rebutted the presumption of abuse, then under 707(b)(3) the case can be dismissed as an abuse based on the totality of the circumstances under 707(b)(2), that is when applying the means test there's a presumption of abuse if the debtors' income less -- currently monthly income less the enumerated expenses exceeds a certain amount, under 707(b)(3) there is no presumption and the U.S. trustee must prove by a preponderance of the evidence that the totality of the circumstances demonstrates that the debtors' case is an abuse. There's no presumption either way. There's no presumption in favor of bankruptcy relief. There's no presumption in favor of abuse.

In this case, The Court has ruled that and does continue to affirm that even though the debtors do not have loans on the vehicles, they are entitled to take ownership expense deductions for two vehicles and this they have done. That authority for that is in RE Grunert, and that decision is available on The Court's web site. Once we allow those deductions, then the other two that the U.S. trustee was concerned about was the $50 repair allowance and the $150 or so expense for a time share that the debtors do not intend to keep. Even if we subtract those from the authorized and allowed expenses, we still do not reach a failure of the means test. So that the 707(b)(2) motion is denied.

Turning to the 707(b)(3), the totality of the circumstances the U.S. trustee's case is grounded in and sounds very much like the old 707(b) motions that were brought, the U.S. trustee points to perhaps an excessive amount being budget for repairs, which then are not made, instead the debtors have used the money for other items; medical expenses, helping children that may be -- they may be legally not dependent but if the debtor needs to spend extra money on gas in order to visit a child in the hospital, I have a hard time -- and I would have had a hard time pre-BAPCPA -- and I will continue to have a hard time now saying that's an abuse. The debtors live, it seems to me, quite frugally. The

UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF WISCONSIN

In re:	Chapter 7
Marvin Floyd Ross-Tousey and Deborah Helene Tousey, Debtors.	Case No. 06-24573-svk

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ORDER DENYING U.S. TRUSTEE'S MOTION TO DISMISS

For the reasons stated on the record on December 11, 2006,

IT IS THEREFORE ORDERED: that the U.S. Trustee's Motion to Dismiss is denied.

Dated: December 14, 2006

By the Court:

Susan Kelley

Susan V. Kelley
U.S. Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF WISCONSIN

MARVIN F. ROSS-TOUSEY and DEBORAH H. TOUSEY,	Case No.: 2006-24573-SVK (Chapter 7)
Debtors.	

NOTICE OF APPEAL

COMES NOW the United States Trustee, by Attorney Michelle S. Y. Cramer, Attorney for the Office of the United States Trustee, who appeals under 28 U.S.C. § 158(a) from the order of the bankruptcy judge, the Honorable Susan V. Kelley, denying the U.S. Trustee's Motion to Dismiss, entered on December 14, 2006.

The names of all parties to the order appealed from and the names, addresses, and telephone numbers of their respective attorneys are as follows:

Marvin F. Ross-Tousey and Deborah H. Tousey P.O. Box 47 Mattoon, WI 54450	Represented by:	Attorney George B. Goyke P.O. Box 2188 Wausau, WI 54402-2188 (715) 849-8100
Paul G. Swanson, Trustee 107 Church Avenue P.O. Box 617 Oshkosh, WI 54903-0617 (920) 235-6690		
Office of the U.S. Trustee 517 East Wisconsin Avenue, Room 430 Milwaukee, WI 53202 (414)297-4499	Represented by:	David W. Asbach Assistant U.S. Trustee Room 430 517 E. Wisconsin Avenue Milwaukee, WI 53202 (414) 297-4499

Dated: December 20, 2006.

Respectfully submitted,

WILLIAM T. NEARY
UNITED STATES TRUSTEE

/s/
Michelle S. Y. Cramer
Attorney for the U.S. Trustee

Attorney Michelle S. Y. Cramer
Office of the United States Trustee
517 East Wisconsin Avenue, Suite 430
Milwaukee, WI 53202
(414) 297-4499 Fax (414) 297-4478

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF WISCONSIN

U.S. DISTRICT COURT
EASTERN DISTRICT-WI
FILED

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In the Matter of:

MARVIN ROSS-TOUSEY and
DEBORAH TOUSEY,

Debtors,

WILLIAM T. NEARY,
United States Trustee,

Appellant,

v.

Case No. 07-C-65

MARVIN ROSS-TOUSEY and
DEBORAH TOUSEY,

Appellees.

NOTICE OF APPEAL

PLEASE TAKE NOTICE that the Appellees, Marvin Ross-Tousey and Deborah Tousey, by their attorney, George B. Goyke of Goyke, Tillisch & Higgins, LLP, appeal from the judgment (Docket No. 9) of the U.S. District Court for the Eastern District of Wisconsin, Hon. William C. Griesbach presiding, to the U.S. Court of Appeals for the Seventh Circuit.

The parties to the Judgment appealed from and the names, addresses and telephone numbers of their respective attorneys are as follows:

Appellees (of District Ct. action):

Marvin Ross-Tousey and Deborah Tousey
P.O. Box 47
Mattoon, WI 54450

Attorney for Appellees:

George B. Goyke
GOYKE, TILLISCH & HIGGINS, LLP
207 Grand Avenue
P.O. Box 2188
Wausau, WI 54402-2188
(715) 849-8100

Appellants (of District Ct. action):

Office of the US Trustee
United States Department of Justice
517 E. Wisconsin Avenue, Room 430
Milwaukee, WI 53202

Attorneys for Appellants

David Walter Asbach
Office of the US Trustee
United States Department of Justice
517 E. Wisconsin Avenue, Room 430
Milwaukee, WI 53202
(414) 297-4499

Michelle SY Cramer
Office of the US Trustee
United States Department of Justice
517 E. Wisconsin Avenue, Room 430
Milwaukee, WI 53202
(414) 297-4499

Trustee:

Paul G. Swanson
Steinhilber Swanson Mares Marone & McDermott
107 Church Ave
P.O. Box 617
Oshkosh, WI 54903-0617
(920) 235-6690

Dated this 19th day of June, 2007.

GOYKE, TILLISCH & HIGGINS LLP

George B. Goyke
Attorney for Debtors/Appellees
P.O. Box 2188
Wausau, WI 54402-2188
(715) 849-8100
Wis. Bar No. 1001340

BRIEF BANK — "SUMMARY SHEET" *Printed Thu-9/18/08 9:39*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]* — In re Trusted Net Media Holdings, LLC (Trusted Net Media Holdings v. The Morrison Agency, Inc.)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]* — 11th Cir.

3. ("CCN") ***CURRENT*** CASE NO. — No.: 07-13429

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]* — No.: 1:06-cv-02575-TCB

Court: N.D. Ga.

(Identify judge & cite, if any)

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7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]* — John S. Koppel, William Kanter, P. Matthew Sutko

(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC*** — **BANKRUPTCY**

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND*** — • Whether the requirements set forth in 11 U.S.C. § 303(b) for commencing an involuntary bankruptcy proceeding are subject to waiver or are jurisdictional in nature, and therefore not subject to waiver.

10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)

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NAME: Linda Figueroa

DATE:

No. 07-13429

IN THE UNITED STATES COURT OF APPEALS
FOR THE ELEVENTH CIRCUIT

In re TRUSTED NET MEDIA HOLDINGS, LLC,

Debtor.

TRUSTED NET MEDIA HOLDINGS, LLC,

Plaintiff-Appellant,

v.
THE MORRISON AGENCY, INC.,

Defendant-Appellee.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF GEORGIA

EN BANC BRIEF FOR THE UNITED STATES AS AMICUS CURIAE SUPPORTING APPELLEE

OF COUNSEL:

RAMONA D. ELLIOTT
General Counsel

P. MATTHEW SUTKO
Associate General Counsel
Executive Office for United States Trustees
Department of Justice
20 Massachusetts Avenue, N.W.
Washington, D.C. 20530

GREGORY G. KATSAS
Assistant Attorney General

WILLIAM KANTER
(202) 514-4575
JOHN S. KOPPEL
(202) 514-2495
Attorneys, Appellate Staff
Civil Division, Room 7264
Department of Justice
950 Pennsylvania Avenue, N.W.
Washington, D.C. 20530-0001

CERTIFICATE OF INTERESTED PERSONS

AND CORPORATE DISCLOSURE STATEMENT

In re Trusted Net Media Holdings, LLC v. The Morrison Agency, Inc., No. 07-13429

Pursuant to Eleventh Circuit Rule 26.1-1, I certify that the following persons and entities have or may have an interest in the outcome of this case:

1. Accelerated Growth Partners, LLC
2. Hon. Timothy S. Batten, Sr.
3. Bodyfelt, Mount, Stroup & Chamberlain, LLP
4. Ramona D. Elliott
5. June M. Garrett
6. Ralph Goldberg
7. Greenberg, Traurig
8. Greenleaf Capital Partners, II, LLC
9. Michael Hirsh
10. Barbara T. Huffman
11. David W. Huffman
12. Jon David Huffman
13. Gregory G. Katsas
14. William Kanter
15. James Michael King
16. John S. Koppel
17. Ira K. McKee

18. Robert A. Morrison

19. The Morrison Agency, Inc.

20. Hon. C. Ray Mullins

21. Hayden R. Pace

22. B. Emory Potter

23. James Robert Sacea

24. Robert B. Silliman

25. P. Matthew Sutko

26. TN Holdings, LLC

27. Robert Trauner

28. Trusted Net Media Holding

29. United States of America

JOHN S. KOPPEL
Attorney

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IN THE UNITED STATES COURT OF APPEALS
FOR THE ELEVENTH CIRCUIT

No. 07-13429

In re TRUSTED NET MEDIA HOLDINGS, LLC,

Debtor.

TRUSTED NET MEDIA HOLDINGS, LLC,

Plaintiff-Appellant,

v.

THE MORRISON AGENCY, INC.,

Defendant-Appellee.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF GEORGIA

EN BANC BRIEF FOR THE UNITED STATES AS AMICUS CURIAE SUPPORTING APPELLEE

INTRODUCTION

Pursuant to Fed. R. App. P. 29 and 11th Cir. R. 35-9, the United States submits this brief as amicus curiae in support of appellee, urging affirmance of the district court's ruling. The United States will address the following question, set forth in the Court's notice of July 18, 2008:

Are the requirements in 11 U.S.C. § 303(b) for filing an involuntary bankruptcy petition subject to waiver or are they subject matter jurisdictional in nature, such that they cannot be waived?

In the first instance, however, the United States will also address this Court's jurisdiction over the instant appeal.

INTEREST OF THE UNITED STATES

The Attorney General appoints United States Trustees to supervise the administration of bankruptcy cases and trustees in regions comprising the vast majority of the federal judicial districts. 28 U.S.C. §§ 581-589a. United States Trustees "serve as bankruptcy watch-dogs to prevent fraud, dishonesty, and overreaching in the bankruptcy arena." H.R. Rep. No. 595, 95th Cong., 1st Sess. 88 (1977), as reprinted in 1978 U.S.C.C.A.N. 5963, 6049. The United States Trustee Program thus acts in the public interest to promote the efficiency, and to protect and preserve the integrity, of the bankruptcy system. To this end, Congress has provided that "[t]he United States trustee may raise and may appear and be heard on any issue in any case or proceeding . . . ." 11 U.S.C. § 307; see In re Donovan Corp., 215 F.3d 929, 930 (9th Cir. 2000).

In this brief, the United States respectfully offers this Court its views on the correct interpretation of 11 U.S.C. § 303(b). See 28 U.S.C. § 517 (authorizing

Department of Justice "to attend to the interests of the United States in a suit pending in a court of the United States").

STATEMENT OF THE ISSUE

Whether the requirements set forth in 11 U.S.C. § 303(b) for commencing an involuntary bankruptcy proceeding are jurisdictional in nature, and therefore not subject to waiver.

STATEMENT OF THE CASE

A. Statute Involved.

At the time the involuntary bankruptcy petition was filed in the instant case, the relevant statute stated in pertinent part that:

> An involuntary case against a person is commenced by the filing with the bankruptcy court of a petition under chapter 7 or 11 of this title -- (1) by three or more entities, each of which is either a holder of a claim, against such person that is not contingent as to liability or the subject of a bona fide dispute, or an indenture trustee representing such a holder, if such claims aggregate at least $11,625 more than the value of any lien on property of the debtor securing such claims held by the holders of such claims; [or] (2) if there are fewer than 12 such holders, excluding any [employees, insiders, and transferees of certain voidable transfers], by one or more of such holders that hold in the aggregate at least $11,625 of such claims . . . .

11 U.S.C. § 303(b) (2001).

B. Facts of the Case.

The pertinent facts are set forth in the panel opinion. Slip op. 2-5. The statute at issue is 11 U.S.C. § 303(b) (reproduced in section A, supra), which authorizes the commencement of a bankruptcy case through the filing of an involuntary bankruptcy petition against a debtor, under specified conditions concerning the number of creditors, the non-contingent, undisputed character of their claims, and the aggregate amount of the claims. See slip op. 2-3, 8-11. The following subsection, 11 U.S.C. § 303(c), allows the addition of creditors prior to dismissal of a defectively filed petition, while § 303(h), 11 U.S.C. § 303(h), further provides that "[i]f the petition is not timely controverted, the court shall order relief against the debtor in an involuntary case under the chapter under which the petition was filed." Id.

Briefly, creditor Morrison Agency, Inc. ("petitioner"), filed an involuntary chapter 7 bankruptcy petition against debtor Trusted Net Media Holdings, LLC, on April 20, 2002, claiming that the petition met the requirements of 11 U.S.C. § 303(b). Slip op. 2. Debtor did not file a response, and on May 15, 2002, the bankruptcy court entered an Order for Relief and appointed a chapter 7 trustee. Id. at 3. Administration of the bankruptcy case then proceeded. Id.

In April 2004, creditor David W. Huffman (an officer and controlling member of debtor) filed a motion to dismiss the case, arguing inter alia that petitioner did not satisfy the requirements of section 303(b), both because petitioner's claim was the subject of a bona fide dispute and because petitioner did not meet the statutory criteria regarding the number of creditors. Slip op. 3-4. The chapter 7 trustee opposed the motion and, after holding a hearing, the bankruptcy court denied it on May 13, 2004. Id. at 4. Creditor Huffman did not appeal. Id.

Subsequently, more than two years later, debtor filed a motion to dismiss, essentially for the same reasons presented by creditor Huffman in 2004. Id. at 4-5. On October 10, 2006, the bankruptcy court denied the motion, holding that "§ 303(b) of the Bankruptcy Code was not jurisdictional and that 'any argument by the Debtor that the petitioning creditor's claims are the subject of a bona fide dispute or that more than one petitioning creditor was required to put this Debtor into bankruptcy has been waived.'" Id. at 5. Debtor appealed, and the district court affirmed the bankruptcy court's ruling.

Debtor appealed, and a panel of this Court (Hull, Wilson, JJ., Albritton, D.J. (sitting by designation)) reversed. See slip op. 2, 27. The panel made clear that it agreed with the holding of the bankruptcy court herein and the Ninth Circuit in In re Rubin, 769 F.2d 611 (9th Cir. 1985), to the effect that section 303(b) is not jurisdictional, and that it disagreed with the contrary ruling of the Second Circuit in In re BDC 56 LLC, 330 F.3d 111 (2d Cir. 2003). Slip op. 11-19. Regarding the merits of the section 303(b) question, the panel was persuaded by the text and structure of section 303 as a whole (and especially sections (c) and (h), see p. 4, supra), the Ninth Circuit's analysis in In re Rubin, supra, and the ruling of the Eleventh Circuit in In re Pugh, 158 F.3d 530, 530 (11th Cir. 1998), to the effect that other provisions of the Bankruptcy Code were not jurisdictional, that 11 U.S.C. § 303(b) is not a jurisdictional provision. Slip op. 11-19. The panel, however, concluded that under Bonner v. City of Pritchard, 661 F.2d 1206, 1207 (11th Cir. 1981) (en banc), it was bound by the contrary decision of the former Fifth Circuit in In re All Media Properties, Inc., 646 F.2d 193 (5th Cir. 1981). Slip op. 19-26.

On May 14, 2008, defendant-appellee filed a timely petition for rehearing en banc. On June 19, 2008, the Court granted the petition and vacated the panel opinion.

SUMMARY OF ARGUMENT

1. First, although we conclude that this Court has jurisdiction over the instant appeal, we consider it our duty to flag the issue for the Court, as it must assure itself that it has jurisdiction to entertain the appeal. Although the matter is not entirely free from doubt, we believe that the district court's order affirming the bankruptcy court's denial of the motion to dismiss the involuntary petition is a final order appealable under 28 U.S.C. § 158(d).

2. Next, with respect to the question of whether the requirements of 11 U.S.C. § 303(b) are jurisdictional in nature, we agree with the panel's view that these requirements do not affect subject matter jurisdiction, and are subject to waiver. "'Jurisdiction,'" as the Supreme Court has reiterated on several occasions of late, "'is a word of many, too many, meanings.'" Rockwell Int'l Corp. v. United States, 127 S. Ct. 1397, 1405 (2007), quoting Steel Co. v. Citizens for Better Environment, 523 U.S. 83, 90, 118 S. Ct. 1003, 1010 (1998); Arbaugh v. Y&H Corp., 546 U.S. 500, 510, 126 S. Ct. 1235, 1242 (2006) (same). In its most recent rulings, the Court has distinguished among statutory requirements that are truly "jurisdictional" in character and statutory claims processing requirements that are either "absolute" or "subject to waiver." See, e.g., John R. Sand & Gravel Corp. v. United States, 128 S. Ct. 750, 753-56 (2008); Bowles v. Russell, 127 S. Ct. 2360, 2363-65 (2007); Arbaugh v. Y&H Corp., 546 U.S. at 510-16, 126 S. Ct. At 1242-45. Examination of the Court's recent precedents leads to the conclusion that the panel in the instant case correctly concluded that the requirements of 11 U.S.C. § 303(b) are waivable statutory claims processing requirements.

ARGUMENT

I. THE COURT HAS JURISDICTION OVER THE INSTANT APPEAL.

At the outset, we consider it our duty to flag for the Court the issue of appellate jurisdiction, in light of the Court's obligation to assure itself that subject matter jurisdiction exists. See, e.g., United States v. Storer Broad. Co., 351 U.S. 192, 196, 76 S. Ct. 763, 766-67 (1956); In re Donovan, 532 F.3d 1132, 1136 (11th Cir. 2008); In re Walker, 515 F.3d 1204, 1210 (11th Cir. 2008). "A court of appeals has jurisdiction over only final judgments and orders arising from a bankruptcy proceeding, whereas the district court may review interlocutory judgments and orders as well." Id. at 1210, citing In re F.D.R. Hickory House, 60 F.3d 724, 725 (11th Cir. 1995); see also, e.g., In re Hillsborough Holdings Corp., 116 F.3d 1391, 1393 (11th Cir. 1997); In re Martin Bros. Toolmakers, Inc., 796 F.2d 1435, 1437-38 (11th Cir. 1986).

In our view, as the First Circuit has held, to be final, "a bankruptcy order need not resolve all of the issues in the proceeding, but it must finally dispose of all the issues pertaining to a discrete dispute within the larger proceeding." In re Perry, 391 F.3d 282, 285 (1st Cir. 2004); see also In re Cortez, 457 F.3d 448, 453-54 (5th Cir. 2006) (order denying motion to dismiss chapter 7 bankruptcy petition for abuse treated as final); In re Koch, 109 F.3d 1285, 1289 (8th Cir. 1997) (order denying motion to dismiss chapter 7 bankruptcy petition for abuse held to be final); In re Christian, 804 F.2d 46, 47-48 (3d Cir. 1986) (same). Under this analysis, an order denying a motion to dismiss an involuntary bankruptcy petition is manifestly a final, appealable order.

In its recent decision in In re Donovan, supra, however, this Court appears to have adopted a narrower view of finality in the bankruptcy context. Although we respectfully disagree with the approach and holding of In re Donovan, it is the law of the Circuit, unless or until it is overruled by the Court en banc.

Thus, under In re Donovan, there may be an issue as to this Court's own jurisdiction here, because under the latter ruling it is far from clear that the district court's affirmance of a bankruptcy court's denial of a motion to dismiss a bankruptcy petition is a final order appealable under 28 U.S.C. § 158(d)(1). See In re Donovan, 532 F.3d at 1136-37 (holding that order denying motion to dismiss converted Chapter 7 bankruptcy case on abuse grounds was not an appealable final order); but cf. In re Walker, 515 F.3d at 1210 (holding that district court order affirming removal of trustee was an appealable final order); compare also, e.g., In re Mason, 709 F.2d 1313, 1315-18 (9th Cir. 1983) (court of appeals had jurisdiction to review denial of motion to vacate order of relief entered on involuntary petition), and In re McGinnis, 296 F.3d 730, 731 (8th Cir. 2002) (court of appeals had jurisdiction to review order of relief entered on involuntary bankruptcy petition), with In re Vlasek, 325 F.3d 955, 960-61 (7th Cir. 2003) (court of appeals did not have jurisdiction to review order denying debtor's motion to dismiss his voluntary bankruptcy petition).

In In re Donovan, however, the Court reaffirmed that "the finality requirement is met where practical considerations require it." In re Donovan, 532 F.3d at 1137 n.1, citing In re Walker, 515 F.3d at 1210. Here, as in In re Walker, where the removal of a trustee was at issue, practical considerations require immediate review, inasmuch as the entire existence of the bankruptcy proceeding -- and not merely its conversion from a chapter 13 proceeding to a chapter 7 proceeding (as in In re Donovan, see 534 F.3d at 1137 n.2), with its concomitant effect on individual creditors' claims -- is at stake.

Furthermore, in In re F.D.R. Hickory House, supra, the Court reiterated that it "will review immediately 'even an order of marginal finality . . . if the question presented is fundamental to further conduct of the case.'" 60 F.3d at 727 (citations omitted). Unlike the "insubstantial sum" which did not warrant immediate review in the latter case, however, the issue of whether the requirements of 11 U.S.C. § 303(b) go to subject matter jurisdiction -- an issue that this Court has seen fit to decide en banc -- is just such a question. It calls for immediate resolution.

Accordingly, in the government's view, although the question may be a close one under In re Donovan, this Court has jurisdiction over the instant appeal. We would be happy to provide further briefing on this issue, however, should the Court deem it advisable.

II. 11 U.S.C. § 303(b) IS NOT A JURISDICTIONAL PROVISION.

With respect to the merits, the United States agrees with the panel's cogent analysis of the jurisdictional issue posed by 11 U.S.C. § 303(b). The en banc Court should either distinguish or overrule the Fifth Circuit ruling that the panel felt compelled to follow under Eleventh Circuit case law. Recent Supreme Court jurisprudence makes clear that the term "jurisdictional" should not be bandied about loosely, and that provisions such as the one at issue in this case are not jurisdictional in nature.

In its most recent rulings in this area, the Supreme Court has distinguished among statutory requirements that are truly "jurisdictional" in character and statutory claims processing requirements that are either "absolute" or "subject to waiver." See, e.g., John R. Sand & Gravel Corp. v. United States, 128 S. Ct. 750, 753-56 (2008); Bowles v. Russell, 127 S. Ct. 2360, 2363-65 (2007); Arbaugh v. Y&H Corp., 546 U.S. 500, 510-16, 126 S. Ct. 1235, 1242-45 (2006); Steel Co. v. Citizens for Better Environment, 523 U.S. 83, 90, 118 S. Ct. 1003, 1010 (1998). Applying this formulation in the case at bar, the correct conclusion is that the requirements of 11 U.S.C. § 303(b) are waivable statutory claims processing requirements.

A. In Arbaugh, the Supreme Court cautioned that courts have at times erroneously called a limitation jurisdictional that was actually simply an element of the claim:

> On the subject-matter jurisdiction/ingredient-of-claim-for-relief dichotomy, this Court and others have been less than meticulous. "Subject matter jurisdiction in federal-question cases is sometimes erroneously conflated with a plaintiff's need and ability to prove the defendant bound by the federal law asserted as the predicate for relief -- a merits-related determination."

546 U.S. at 511, 126 S. Ct. at 1242 (quoting 2 J. Moore et al., Moore's Federal Practice, § 12.30[1], at 12-36.1 (3d ed. 2005)); see also Steel Co., 523 U.S. at 90, 118 S. Ct. at 1010 ("'Jurisdiction . . . is a word of many, too many, meanings'"). To prevent such mischaracterizations, the Arbaugh Court issued a "readily administrable bright line rule":

> If the Legislature clearly states that a threshold limitation on a statute's scope shall count as jurisdictional, then courts and litigants will be duly instructed . . . . But when Congress does not rank a statutory limitation on coverage as jurisdictional, courts should treat the restriction as non-jurisdictional in character.

546 U.S. at 515-16, 126 S. Ct. at 1245.

Thus, as a general matter, statutory requirements are jurisdictional only when Congress "clearly states" that they are jurisdictional. 546 U.S. at 515, 126 S. Ct. at 1245. Typically -- but not invariably -- jurisdictional statutes are found in Title 28 of the United States Code. See 546 U.S. at 513-16, 126 S. Ct. at 1243-45; Kontrick v. Ryan, 540 U.S. 443, 452-53, 124 S. Ct. 906, 913-14 (2004) (recognizing that Title 28 determines the jurisdiction of the bankruptcy courts); In re Supreme Beef Processors, Inc., 468 F.3d 248, 258 (5th Cir. 2006) (concluding that if Congress wanted to modify bankruptcy court jurisdiction "it likely would have amended 28 U.S.C. 1334 . . . , not the substantive provisions of [the Bankruptcy Code].").

Arbaugh further held that "when Congress does not rank a statutory limitation . . . as jurisdictional, courts should treat the restriction as nonjurisdictional in character." Arbaugh, 546 U.S. at 516, 126 S. Ct. at 1245. And the Arbaugh Court emphasized that a statutory limitation is nonjurisdictional if it "does not speak in jurisdictional terms or refer in any way to the jurisdiction of the [trial] courts." 546 U.S. at 515, 126 S. Ct. at 1245 (citation and internal quotation omitted).

Under these standards, section 303(b) is not jurisdictional. The requirements identified in the statute are not jurisdictional because Congress did not clearly state or indicate that they were jurisdictional. See Arbaugh, 546 U.S. at 514, 126 S. Ct. at 1244. Section 303(b) does not speak in jurisdictional terms or refer in any way to the jurisdiction of bankruptcy courts. See 546 U.S. at 515, 126 S. Ct. at 1245. Section 303 is titled "Involuntary cases," and it sets forth the criteria for "commenc[ing]" such cases, but it does not use the language of jurisdiction. See 11 U.S.C. § 303.

Moreover, section 303(b) is not part of Title 28. Instead, 28 U.S.C. §§ 157 and 1334 determine bankruptcy court jurisdiction. Section 303(b), in turn, merely establishes the criteria for filing an involuntary bankruptcy petition before bankruptcy courts acting under their Title 28 jurisdiction. Compare also 11 U.S.C. § 105 (Bankruptcy Code provision specifying powers of bankruptcy courts).

At most, as the Ninth Circuit has held, the section 303(b) requirements constitute substantive elements of an involuntary bankruptcy petition, subject to waiver by virtue of the failure of a debtor (and/or another interested party with standing) to challenge them in a timely manner. In re Rubin, 769 F.2d 611 (9th Cir. 1985); compare, e.g., United States v. Baldwin, 414 F.3d 791, 795 (7th Cir. 2005) (recognizing that expiration of the statute of limitations is an affirmative defense, not a bar to jurisdiction), overruled on other grounds by United States v. Parker, 508 F.3d 434 (7th Cir. 2007). And the debtor and other creditors herein failed to raise the issue in timely fashion. Compare In re Pugh, 158 F.3d 530, 530 (11th Cir. 1998) (holding that the deadlines for trustee actions under 11 U.S.C. §§ 546(a) and 549(d) are waivable statutes of limitations).

Furthermore, the "timely controver[sion]" provision of 11 U.S.C. § 303, section 303(h), 11 U.S.C. § 303(h), itself suggests that the requirements of section 303(b) are not jurisdictional. Subject matter jurisdiction defects by definition are never waived, and therefore are not subject to such a "timely controver[sion]" requirement. Similarly, section 303(c) of the statute, 11 U.S.C. § 303(c), which permits the addition of creditors to a defectively filed petition prior to dismissal of that petition, suggests that section 303(b) does not establish jurisdictional requirements, inasmuch as a true defect of subject matter jurisdiction could not be cured by such an expedient device. See Arbaugh, 546 U.S. at 513-16, 126 S. Ct. at 1243-45 (stating, inter alia, that "when a federal court concludes that it lacks subject-matter jurisdiction, the court must dismiss the complaint in its entirety").

In the instant case, the allegedly noncompliant involuntary bankruptcy petition was filed in April 2002; the debtor did not respond, and the bankruptcy court then appointed a chapter 7 trustee in May 2002. Creditor Huffman did not move to dismiss the case for noncompliance with section 303(b) until April 2004 (and he did not appeal the denial of his motion the following month), whereas the debtor did not move to dismiss on these grounds for another two years, i.e., until the summer of 2006. Under these circumstances, the purported noncompliance with section 303(b) has been waived, because section 303(b)'s requirements are not jurisdictional. See

Arbaugh, 546 U.S. at 504, 126 S. Ct. at 1238-39 (non-jurisdictional defects are waived unless they are raised in a timely fashion). The involuntary petition was not "timely controverted" within the meaning of 11 U.S.C. § 303(h). Therefore, the alleged deficiencies of the involuntary petition should not constitute a basis for reversing the district court's order.

B. Nor do the Supreme Court's post-Arbaugh rulings in Rockwell Int'l Corp. v. United States, 127 S. Ct. 1397 (2007), Bowles v. Russell, supra, and John R. Sand & Gravel Corp. v. United States, supra, suggest that 11 U.S.C. § 303(b) is either a jurisdictional provision or a mandatory claims processing provision that cannot be waived. In Rockwell Int'l Corp., the Court held that in section 3730(e)(4) of the False Claims Act, 31 U.S.C. § 3730(e)(4), "the jurisdictional nature of the original-source requirement is clear ex visceribus verborum," and further stressed that the Court had "already stated that § 3730(e)(4) speaks to 'the power of a particular court' as well as 'the substantive rights of the parties.'" Rockwell Int'l Corp., 127 S. Ct. at 1406 (citation omitted). In Bowles, the Court reiterated its observation in Kontrick, 540 U.S. at 453 and n.8, 124 S. Ct. at 914 and n.8, that statutory time limit for taking a civil appeal -- set forth in section 2107 of Title 28 of the U.S. Code -- "contains the type of statutory time constraints that would limit a court's jurisdiction," Bowles, 127 S. Ct. at 2364-65, and therefore held that "the timely filing of a notice of appeal in a civil case is a jurisdictional requirement." Id. at 2366. The Court reached a similar conclusion regarding the Court of Claims limitation statute, 28 U.S.C. § 2501 -- also found in Title 28 of the U.S. Code -- in John R. Sand & Gravel Co., 128 S. Ct. at 753-56.

These decisions are not controlling in the instant case, which does not involve a provision of Title 28 of the U.S. Code, but rather a provision of the Bankruptcy Code, 11 U.S.C. § 101 et seq., that makes no mention of jurisdiction and certainly is not jurisdictional "ex visceribus verborum," Rockwell Int'l Corp., supra. And the language quoted at pp. 11-13, supra, from Arbaugh -- a case that dealt with an employee-numerosity requirement for Title VII suits -- indeed suggests that, particularly with respect to statutory conditions other than time limits, it must be clearly indicated in the statute that Congress intended the condition to be jurisdictional. See Arbaugh 546 U.S. at 513-16, 126 S. Ct. at 1243-45; see also Rockwell Int'l Corp. 127 S. Ct. at 1406. That is manifestly not the case here.

The debtor relies principally upon Canute S.S. Co. v. Pittsburgh & West Virginia Coal Co., 263 U.S. 244, 44 S. Ct. 67 (1923), which held that "the filing of a petition, sufficient upon its face, by three petitioners alleging that they are creditors holding provable claims of the requisite amount, the insolvency of the Defendant and the commission of an act of bankruptcy within the preceding four months, clearly gives the bankruptcy court jurisdiction of the proceeding." 263 U.S. at 248-49, 44 S. Ct. at 68. As the panel opinion states, however, "Morrison's petition listed Morrison as the only petitioning creditor of Trusted Net, and described Morrison's claim against Trusted Net as 'Trade Debt/Judgment' in an amount '[n]ot less than [$]534,000.00'"; furthermore, "Morrison's involuntary petition stated that Morrison was 'eligible to file this petition pursuant to 11 U.S.C. § 303(b).'" Slip op. 2. Given these averments, and the fact that § 303(b)(2) authorized the filing of a petition by a single creditor if there were fewer than twelve creditors with noncontingent, undisputed claims in excess of $11,625 (see p. 3, supra), the petition was "sufficient upon its face" within the meaning of Canute. See In re Mason, 709 F.2d 1313, 1318-19 (9th Cir. 1983) ("We agree with the lower court's determination that Mason waived his right to present this defense by failing to raise it in an answer to the petition. The lack of the requisite number of petitioning creditors did not deprive the bankruptcy court of jurisdiction to enter a valid order for relief.") (citing, inter alia, Canute); In re Rubin, 769 F.2d at 614 n.3 (discussing Mason, and stating that "these requirements are not jurisdictional in the technical sense of subject matter jurisdiction, but are instead substantive matters which must be proved or waived for petitioning creditors to prevail in involuntary proceedings. . . . The fact that Mason . . . permitted waivers indicated that the requirements were not truly prerequisites to subject matter jurisdiction, since parties cannot confer subject matter jurisdiction on a federal court by their consent.") (citation omitted). Furthermore, to the extent that dicta in Canute may be read to suggest that the requirements of section 303(b) are jurisdictional, the opinion's use of the term "jurisdiction" should be viewed in light of the recent decisions of the Supreme Court discussed herein, which painstakingly analyze the concept of subject matter jurisdiction. See, e.g., Arbaugh, 546 U.S. at 510 ("'Jurisdiction . . . is a word of many, too many, meanings'") (quoting Steel Co., 523 U.S. at 90).

C. Finally, policy considerations militate strongly in favor of the conclusion that 11 U.S.C. § 303(b) is neither jurisdictional in nature, nor a mandatory claims processing rule that cannot be waived. As the history of this case itself demonstrates, bankruptcy cases can go on for many years, and they frequently involve many parties and numerous distinct proceedings. Thus, as a practical matter, it is in the interests of all concerned -- i.e., the courts and the parties -- that issues of the type presented by section 303(b), regarding the validity of an involuntary bankruptcy petition that initiates a bankruptcy case, be resolved promptly and conclusively at the outset of the case, either by adjudication or by waiver, before a great deal of time has been invested and effort expended; nor should parties to bankruptcy proceedings be given an incentive to hang back and belatedly raise "jurisdictional" objections if and when they are dissatisfied with the course of the proceedings.[1] And nothing in the language of the statute, the text and structure of the Bankruptcy Code, or the legislative history of the Code indicates that Congress intended otherwise.

CONCLUSION

For the foregoing reasons, the order of the district court should be affirmed.

Respectfully submitted,

OF COUNSEL:

RAMONA D. ELLIOTT
General Counsel

P. MATTHEW SUTKO
Associate General Counsel
Executive Office for United States Trustees
Department of Justice
20 Massachusetts Avenue, N.W.
Washington, D.C. 20530

GREGORY G. KATSAS
Assistant Attorney General

WILLIAM KANTER
(202) 514-4575
JOHN S. KOPPEL
(202) 514-2495
Attorneys, Appellate Staff
Civil Division, Room 7264
Department of Justice
950 Pennsylvania Avenue, N.W.
Washington, D.C. 20530-0001

SEPTEMBER 2008

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[1] We do not mean to suggest any such bad faith conduct in the instant case, but merely underscore a theoretical but very real danger of a holding that section 303(b) is jurisdictional.

CERTIFICATE OF COMPLIANCE

I certify that this brief is proportionately spaced, using Times Roman font, 14 point type. Based on a word count under Corel Word Perfect 12, this brief contains 4,590 words, excluding the table of contents, table of authorities, and certificates of counsel.

JOHN S. KOPPEL
Attorney

CERTIFICATE OF SERVICE

I hereby certify that on September 16, 2008, I served the foregoing En Banc Brief for the United States as Amicus Curiae in Support of Appellee on the following by causing two copies of the brief to be sent by Federal Express, for overnight delivery, to:

Ralph Goldberg, Esquire
755 Commerce Drive, Suite 600
Decatur, GA 30030-2619

Michael James King, Esquire
GREENBERG TRAURIG
3290 Northside Parkway, NW, Suite 400
Atlanta, GA 30327-2268

I also certify that on the same date, I filed the brief by causing an original and eighteen copies to be sent to the Clerk, United States Court of Appeals for the Eleventh Circuit, by Federal Express, for overnight delivery.

JOHN S. KOPPEL
Attorney

BRIEF BANK — "SUMMARY SHEET"

Printed Mon.-1/11/99 (17:06)

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	**IN RE UNCLE BUD'S, INC. (VERGOS v. UNCLE BUD'S, INC.)**
2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	M.D. TENN.
3. ("CCN") ***CURRENT*** CASE NO.	No.: Civil Action No. 3-97-0296 (District Judge Higgins)
4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*	No.: Bankr. No. 95-01239-GP3 (Chap. 11) Court: Bankr. M.D. TENN. (Chief Judge Paine); 206 B.R. 889 (Feb. 19, 1997) *(Identify judge & cite, if any)*
5. ("SO") ***SOURCE***	**U.S. TRUSTEES**
6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	Filed: September 30, 1997 Type: APPELLANT-UST's OPENING BRIEF
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8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") ! ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	! The plain language of 11 U.S.C. 1930(a)(6), as subsequently made even clearer by clarifying legislation, states that "quarterly fees" are payable in all pending chapter 11 cases regardless of confirmation status. And a confirmed plan cannot not affect debtors' liability for quarterly fees arising after plan confirmation. √ **Background:** District Ct. agreed with the UST and reversed the Bankr. Ct. in *Vergos v. Uncle Buds*, __ B.R.__, 1998 WL 652542 (M.D. Tenn., Aug. 17, 1998) (concluding that "§ 1930(a)(6) applies to debtors & that they owe post-confirmation fees regardless of the fact that their confirmation plan does not explicitly require such fees" & "§1930(a)(6) is neither unconstitutionally vague,...retroactive [nor a] taking").
10. PATH TO FILE LOCATION: (e.g., S:\GENERAL COUNSEL\BRFBANK\etc...)	S:\GENERAL COUNSEL\BrfBank\To-West-Net\GROUP03 West-Net\UncBud1.wpd
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UNITED STATES DISTRICT COURT
MIDDLE DISTRICT OF TENNESSEE

In re:

UNCLE BUD'S, INC.,

Debtor.

Case No. 95-01239-GP3
Chapter 11

ELLEN B. VERGOS
UNITED STATES TRUSTEE,

Appellant,

v.

UNCLE BUD'S, INC.,

Appellee.

Civil Action No. 3: 97-0296
Judge Higgins

BRIEF OF UNITED STATES TRUSTEE, APPELLANT

(ORAL ARGUMENT REQUESTED)

ELLEN B. VERGOS
UNITED STATES TRUSTEE
Office of the U.S. Trustee
318 Customs House
701 Broadway
Nashville, Tennessee 37203
(615) 736-2254
Michael E. Collins
Attorney-Advisor

September 30, 1997

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FEDERAL CASES

MISCELLANEOUS

STATEMENT OF JURISDICTION

The bankruptcy court had jurisdiction over this proceeding under 28 U.S.C. §1334(a) and § 157(b). This court has jurisdiction over the appeal of the final order of the bankruptcy court under 28 U.S.C. §§ 1334(a) and 158(a).

STATEMENT OF THE ISSUE

Whether the bankruptcy court erred in failing to require Debtors to pay post-confirmation quarterly fees as provided for in 28 U.S.C. § 1930(a)(6), as amended and clarified by Public Laws 104-99 and 104-208.

STANDARD OF REVIEW

The standard of review on appeal from a final order of the bankruptcy court is clearly erroneous as to findings of fact and *de novo* as to conclusions of law. In re Caldwell, 851 F.2d 852, 857 (6th Cir. 1988). Because none of the facts in this matter are contested and the issue involves only the construction of a federal statute, the standard of review is *de novo*.

STATEMENT OF THE CASE

Uncle Bud’s, Inc., filed a voluntary petition for relief under chapter 11 of the Bankruptcy Code on February 23, 1995. [Dkt. No. 1]. Subsequently, two related companies also filed voluntarily for chapter 11 relief on March 20, 1995, Stewart's Ferry Joint Venture, Bk. No. 95-01871-GP3-11 and Uncle Bud's of Franklin, Inc., Bk. No. 95-01872-GP3-11. All three cases were consolidated for joint administration by order entered June 9, 1995. [Dkt. No. 53]. The three debtors (collectively, "Debtors") elected to be treated as small businesses.[1]

On July 12, 1995, the Debtors filed a joint chapter 11 plan. The plan provided, in relevant part, that "[a]ll fees payable under 28 U.S.C. § 1930, as determined by the Court at the hearing on confirmation, shall be paid in full in cash on the Effective Date of the Plan." [Dkt. No. 154, Exh. 10, p. 17]. The Effective Date was defined in the plan, with certain qualifications not relevant here, as "the later of (i) the first business day following the forty-fifth (45th) day after entry by the Court of an order confirming the Plan, or (ii) the first business day after such order has become final and unappealable . . .." [Dkt. No. 154, Exh. 10, p. 3] The plan made no further references to section 1930 fees and made no reference to any claims arising post-confirmation.

The plan was confirmed by order of the bankruptcy court entered August 31, 1995. [Dkt. No. 154, Exh. 12]. Effective January 27, 1996, Congress amended section 1930(a)(6) of title 28 of the United States Code to require chapter 11 debtors to pay quarterly fees during the post-confirmation stage of the case. The Debtors each paid the post-confirmation quarterly fee owing for the first quarter of 1996, but failed to pay any fees due and owing for subsequent quarters. [Dkt. No. 154]. On April 15, 1996, the Debtors filed the Final Report and Motion for Final Decree Closing the Cases. [Dkt. No. 121]. The U.S. Trustee timely objected to the entry of the final decree on the basis that Debtors had not paid all post-confirmation quarterly fees owing pursuant to section 1930(a)(6). [Dkt. No. 124]. The bankruptcy court overruled the U.S.

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[1] The bankruptcy court order from which this appeal arises adjudicated the quarterly fee issue for four otherwise unrelated cases: the Uncle Bud's, Inc., Ligonier Powders, Inc., Creekstone Apartments Associates, Inc., and Milton and Jessie Woods. The United States Trustee settled the quarterly fee issue in each of the cases, except Uncle Bud's, Inc.

Trustee's objection and granted the Debtors' motion for a final decree on February 20, 1997. [Dkt. No. 165]. The bankruptcy court's findings of fact and legal conclusions were set forth in its Memorandum Opinion, entered on February 20, 1997. In re Uncle Bud's Inc., et al., 206 B.R. 889 (Bankr. M.D. Tenn. 1997). The U.S. Trustee filed a timely notice of appeal from the bankruptcy court's decision. [Dkt. No. 167].

ARGUMENT

The bankruptcy court's determination that post-confirmation fees are payable in cases confirmed prior to January 26, 1996, only if the plans specifically required payment of post-confirmation fees is in error for several reasons. First, the bankruptcy court's failure to analyze correctly section 1930(a)(6), as amended, led the court to erroneously conclude that the statute did not provide an end point for the payment of quarterly fees and that it was therefore "absurd." However, the plain language of amended section 1930(a)(6), as subsequently made even clearer by clarifying legislation, is subject to only one valid interpretation — i.e., that quarterly fees are payable in all pending chapter 11 cases without limitation and regardless of confirmation status. A second basis for the bankruptcy court's decision that the Debtors were not liable for post-confirmation fees was the erroneous conclusion that the terms of the Debtors' confirmed plan operated to bind the U.S. Trustee and Congress with respect to fees originating four months after the plan was confirmed. The provisions of the Bankruptcy Code, as well as Supreme Court precedent, clearly indicate that a confirmed plan can not and does not affect the Debtors' liability for quarterly fees and other claims that arise after the plan is confirmed. Finally, the bankruptcy court identified several concerns, including the constitutionality of amended section 1930(a)(6) as applied to debtors with confirmed plans, potential res judicata concerns, potential conflicts with various provisions of the Bankruptcy Code and considerations of equity, that led it to construe amended section as inapplicable to the Debtors. None of these concerns are valid and none justifies the bankruptcy court's rejection of the only reasonable reading of section 1930(a)(6) — that quarterly fees are payable until the earlier of dismissal, conversion, or closing of the case by entry of a final decree. The bankruptcy court's decision should therefore be reversed.

I. THE BANKRUPTCY COURT ERRED IN FAILING TO REQUIRE PAYMENT OF POST-CONFIRMATION FEES PURSUANT TO AMENDED SECTION 1930(a)(6), WHICH CLEARLY AND UNAMBIGUOUSLY REQUIRES THE PAYMENT OF QUARTERLY FEES IN ALL CHAPTER 11 CASES PENDING AS OF JANUARY 27, 1997, REGARDLESS OF WHETHER THE CASES HAVE CONFIRMED PLANS.

The Supreme Court has advised that the ultimate goal of statutory construction is to give effect to Congressional intent in enacting the statute at issue. United States v. Ron Pair Enterprises, Inc., 489 U.S. 235, 242-43 (1989). In construing a statute, the courts first look to the plain statutory language as the best evidence of congressional intent. CSX Transportation v. Easterwood, 507 U.S. 658, 663 (1993).

Prior to January 26, 1996, section 1930(a)(6) required that a quarterly fee be paid to the United States Trustee "until a plan is confirmed or the case is converted or dismissed, whichever occurs first." On January 27, 1996, this provision was amended by section 211 of the Balanced Budget Downpayment Act, I, Pub. L. No. 104-99, 110 Stat. 26, 37-38 (1996) ("Public Law 104-99"). Section 1930(a)(6) now provides in relevant part as follows, with the language stricken by Public Law 104-99 redlined in the text:

> In addition to the filing fees paid to the clerk, a quarterly fee shall be paid to the United States trustee in each case under chapter 11 of title 11 for each quarter (including any fraction thereof) until [~~a plan is confirmed or~~] the case is converted or dismissed, whichever occurs first.

28 U.S.C. § 1930(a)(6) (1996).

As is evident from the above quoted text, the only change was the deletion of the words "a plan is confirmed or" from the text of section 1930(a)(6). The intended effect of this amendment was to extend a debtor's obligation to pay quarterly fees into the post-confirmation period, thereby increasing the fees collected by the U.S. Trustee Program in each case. McLean Square Associates, C.P., 201 B.R. 436, 439 (Bankr. E.D. Va. 1996); see also In re Foxcroft Square Co., 198 B.R. 99 (E.D. Pa. 1996); In re Upton Printing, 197 B.R. 616 (E.D. La. 1996); In re Central Florida Electric, Inc., 197 B.R. 380 (M.D. Fla. 1996).

Following the January 26, 1996 amendment to section 1930(a)(6), however, a number of bankruptcy courts refused to require payment of post-confirmation quarterly fees in those cases with previously confirmed plans based primarily on their conclusion that Congress failed to adequately prescribe the statute’s reach. See, e.g., In re Hudson Oil Company, Inc., 200 B.R. 52 (Bankr. D. Kan. 1996), rev’d, 210 B.R. 380 (D. Kan. 1997); In re Precision Autocraft, Inc., 197 B.R. 901 (Bankr. W.D. Wash. 1996) rev'd, United States Trustee v. Precision Autocraft, Inc., 206 B.R. 662 (W.D. Wash., January 9, 1997). In response, Congress enacted clarifying legislation pursuant to the Omnibus Appropriations Act for Fiscal Year 1997. Public Law 104-208, 110 Stat. 3009 (September 30, 1996). Title I of Public Law 104-208 contains a section entitled “General Provisions for the Department of Justice.” Section 109(d) of the General Provisions provides as follows:

> Section 101 (a) of Public Law 104-91, as amended by section 211 of Public Law 104-99, is further amended by inserting ": Provided further, That, notwithstanding any other provision of law, the fees under 28 U.S.C. 1930(a)(6) shall accrue and be payable from and after January 27, 1996, in all cases (including, without limitation, any cases pending as of that date), regardless of confirmation status of their plans" after "enacted into law".

Pub. L. 104-208, 110 Stat. 3009 (September 30, 1996) (emphasis added). By further amending section 1930(a)(6), Congress clarified that post-confirmation quarterly fees were payable in all pending cases, even those cases in which a plan was confirmed prior to the effective date of the statute. H.R. Conf. Rep. No. 3620, 104th Cong. Sess., 142 Cong. Rec. H11644, H11850 (daily ed. September 28, 1996); see also In re Hudson Oil Co., 210 B.R. 380, 383 (D. Kan. 1997).

In its Memorandum Opinion, the bankruptcy court appeared to acknowledge that passage of the September 30, 1996 amendment indicated that Congress intended amended section 1930(a)(6) to apply to all pending cases. In re Uncle Bud's Inc., 206 B.R. at 899. The bankruptcy court nonetheless refused to require the Debtors to pay post-confirmation fees, in part, because it incorrectly believed that amended section 1930(a)(6) was "absurd" as written. Id. at 899-900. The bankruptcy court based this conclusion on the faulty premise that the language of section 1930(a)(6) requires successful chapter 11 debtors to pay quarterly fees *ad infinitum*. Id. at 900.

The bankruptcy court's statutory analysis is in error because it incorrectly focuses on an isolated phrase in amended section 1930(a)(6). The entire relevant portion of amended section 1930(a)(6) provides that "a quarterly fee shall be paid to the United States trustee in each case under chapter 11 of title 11 for each quarter . . . until the case is converted or dismissed, whichever occurs first." (emphasis added). Thus, as the plain language of the statute demonstrates, the obligation to pay quarterly fees is triggered by and tied to the existence of a chapter 11 case.

As indicated above, section 1930(a)(6) previously required a fee to be paid in all pending chapter 11 cases until one of the following terminating events occurred: 1) a plan was confirmed, 2) the case was converted to a case under another chapter of the Bankruptcy Code; or 3) the case was dismissed. By striking out the words "a plan is confirmed or" Congress merely removed one of the terminating events — plan confirmation — expressly indicating its intent that payment of quarterly fees should continue throughout the post-confirmation period.

Amended section 1930(a)(6) does not explicitly state that quarterly fees cease to accrue when the case is closed. Because the obligation to pay those fees is triggered by and tied to the existence of the chapter 11 case, however, that obligation necessarily terminates when a case is no longer pending, i.e., after a case has been converted to another chapter, dismissed, or closed by entry of a final decree. See 11 U.S.C. § 350; Fed. R. Bankr. P. 3022; McLean Square Associates, C.P., 201 B.R. 436, 439 (Bankr. E.D. Va. 1996) (legislative history demonstrates that payment of quarterly fees is required until case is closed by final decree). In the McLean Square case, the bankruptcy court recognized the only proper construction of amended section 1930(a)(6):

> We agree that the plain language of the statute is clear. The amendment requires quarterly fees be paid until a case is converted or dismissed. A case may be converted or dismissed at any time before or after a plan is confirmed up until the moment the court enters the final decree closing the case. At that time, conversion or dismissal is no longer possible. The logical conclusion is that when a case is closed, the obligation to pay quarterly fees terminates because the possibility of conversion or dismissal no longer exists. There is no ambiguity here, Congress simply did not state the obvious. . . .

201 B.R. at 439 (emphasis added).

Numerous other courts have reached the same conclusion. For example, in Vergos v. Tiner's Air Conditioning & Heat, Inc., No. 96-2812, slip op. at 4-5 (W.D. Tenn. August 29, 1997)(copy attached), the Hon. Julia Smith Gibbons focused on the introductory phrase of section 1930(a)(6) which requires that the quarterly fee be paid in "each case under chapter 11 of title 11." According to Judge Gibbons, this language made clear that the fees terminated upon the closing of the case because, as a result of the closing, there no longer existed a case under title 11. Id. at 5. Similarly, in In re Beechknoll Nursing Homes, Inc., No. C-1-97-165, slip op. at 8 (S.D. Ohio, September 12, 1997)(copy attached), the Hon. Sandra S. Beckwith held that, based on the statutory language and legislative history, Congress intended quarterly fees to be paid through the entry of a final decree. Additionally, in United States Trustee v. CF&I Fabricators of Utah, No. 2-96-CV-920C, slip op. at 5 (D. Utah, April 24, 1997)(copy attached), the Hon. Tena Campbell reversed the bankruptcy court's decision in In re CF&I Fabricators of Utah, 199 B.R. 986 (Bankr. D. Utah 1996), and held that quarterly fees were payable until the case was converted, dismissed or successfully terminated. See also, In re Jr. Food Mart of Arkansas, 201 B.R. 522 (Bankr. E.D. Al. 1996); In re Driggs, 206 B.R. 787, 791 (Bankr. D. Md. 1997); In re Richardson Serv. Corp., 210 B.R. 332, 333 (Bankr. W.D. Mo. 1997)(a logical construction of the statute requires "payment of the U.S. Trustee's fee until conversion, dismissal, or until entry of the Final Decree.")(emphasis in original); In re SeaEscape Cruises, Ltd., 201 B.R. 321, 322 (Bankr. S.D. Fla. 1996).

As the McLean Square court and other courts have recognized, Congress intentionally tied the quarterly fee obligation to the pendency of a chapter 11 case. By not expressly providing that the quarterly fee obligation should terminate when the case is closed pursuant to a final decree, Congress simply did not state the obvious. The bankruptcy court's construction of the statute to the contrary is in error.

II. THE BANKRUPTCY COURT ERRED IN HOLDING THAT QUARTERLY FEES ARE PAYABLE IN PENDING CASES WITH PLANS CONFIRMED PRIOR TO JANUARY 27, 1996, ONLY IF SUCH PLANS SPECIFICALLY PROVIDED FOR PAYMENT OF POST-CONFIRMATION FEES.

The bankruptcy court's holding that the Debtors are only liable to pay the fees imposed by section 1930(a)(6) if the confirmed plan expressly provided for the payment of such post-confirmation fees is inconsistent with the intent of Congress that the fees be paid in all pending cases and is therefore necessarily in error. In reaching its decision, the bankruptcy court incorrectly concluded that the Debtors' plan bound the U.S. Trustee. However, both the Bankruptcy Code and Supreme Court precedent make clear that the plan is not binding on the U.S. Trustee with respect to post-confirmation quarterly fees. Consequently, the bankruptcy court decision should be reversed.

The bankruptcy court decision fails to address the Supreme Court's holding in Holywell Corporation v. Smith, 112 S.Ct. 1021 (1992), which directly conflicts with the bankruptcy court's analysis. In Holywell, the Supreme Court examined the binding effect of a confirmed plan and held the plan could not bind the United States or any creditor with respect to claims that accrued post-confirmation. Id. at 1028. In Holywell, the chapter 11 debtor had achieved confirmation of a plan which placed all of the debtors' property in a trust and appointed a trustee to liquidate the trust assets and distribute the same to creditors of the debtors' estates. Id. at 1023-24. The plan made no provision, however, for the payment of taxes by the trustee or the filing of tax returns. Id. at 1024. The plan was confirmed by the Court, with no objection from the United States. Id.

After the plan was confirmed, the trustee, who was appointed pursuant to the plan, liquidated various property resulting in capital gains to one of the debtors. The trustee then sought a declaratory judgement from the bankruptcy court that the trustee did not have to pay the taxes or file the returns. Id. The trustee argued, *inter alia*, that the terms of the confirmed plan, which did not provide for the filing of tax returns or the payment of taxes post-confirmation, were binding on the United States. Id. at 1027.

On appeal, the Supreme Court flatly rejected the trustee's argument. The Supreme Court noted that the liability to pay the taxes did not accrue until the time for filing the returns, which was after the plan was confirmed in that case. Id. at 1027-28. Relying on the plain language of section 1141(a) of the Bankruptcy Code, which specifies that the plan is binding on "creditors," and section 101(10) of the Bankruptcy Code, which specifies that a "creditor" is an entity holding various pre-confirmation claims, the Supreme Court concluded that the plan could not bind the United States, or any other creditor, with respect to post-confirmation claims. Id. at 1028.

The post-confirmation fees at issue in the present case are no different than the post-confirmation taxes sought by the United States in Holywell. In each case, the liability did not accrue until events occurred post-confirmation. In Holywell, the tax did not accrue until the time for filing the tax return. In the present case, the post-confirmation quarterly fees did not begin to accrue until the end of the first full quarter of 1996 and were based on disbursements made from January 27, 1996, until the entry of the final decree closing the case. Accordingly, consistent with the Supreme Court's decision in Holywell, the Debtors' plan does not relieve the Debtors from liability for quarterly fees that arose after the Debtors' plan was confirmed.

In the present case, the bankruptcy court decision, in essence, forever binds both the U.S. Trustee and the United States Congress to the terms of the Debtors' confirmed plan.[2/] As noted previously, the bankruptcy court held that the Debtors were not liable for quarterly fees that accrued post-confirmation because the plan, which was confirmed long before the Congress even created post-confirmation quarterly fees, made no provision at all for such fees. Such a ruling effectively requires the U.S. Trustee to undertake the impossible task of predicting what future fees may be imposed upon the Debtor by Congress. Indeed, in the present case, at the time the Debtor's plan was confirmed, there was no indication from Congress that it intended to amend section 1930(a)(6).

Taken to its logical conclusion, the bankruptcy court decision would have the effect of insulating the Debtor from, for example, any future tax liability, since the Debtors' plan does not provide for post-confirmation income and property tax payments. See In re Richardson Serv. Corp., 210 B.R. 332, 335 (Bankr. W.D. Mo. 1997)("carried to its logical conclusion, Debtor's

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[2/] The bankruptcy court's conclusion that the U.S. Trustee is bound by the terms of the Debtors' confirmed plan was directly contrary to section 1141 of the Bankruptcy Code. Section 1141(a) provides that

> the provisions of a confirmed plan bind the debtor, any entity issuing securities under the plan, any entity acquiring property under the plan, and any creditor, equity security holder, or general partner in the debtor, whether or not the claim or interest of such creditor, equity security holder, or general partner is impaired under the plan and whether or not such creditor, equity security holder, or general partner has accepted the plan.

11 U.S.C. § 1141(a). However, the United States Trustee does not fall within the definition of any entity listed in section 1141(a). Section 101(10) of the Bankruptcy Code, in basic terms, defines "creditor" as an entity with a pre-petition claim. Since the U.S. Trustee does not hold a pre-petition claim in this case, she is not a creditor. The U.S. Trustee also does not fall within any other category of claimant denoted in section 1141(a). Thus, according to section 1141(a), the U.S. Trustee is not bound by the terms of the confirmed plan.

argument would in effect immunize a debtor from any new assessments or increases in taxes or fees occurring post confirmation"). The Debtor may even be able to avoid having to pay any vendor claims that arise post-confirmation. Clearly, the bankruptcy court decision gives a much broader meaning to "discharge" than ever intended by Congress in creating the Bankruptcy Code.[3/]

Such a global discharge is clearly unwarranted, especially since the Debtors' plan does not even address its post-confirmation liability for any fees under section 1930. Rather, the plan merely provides that "[a]ll fees payable under 28 U.S.C. § 1930, as determined by the Court at the hearing on confirmation, shall be paid in full in cash on the Effective Date of the Plan." At the time of confirmation, the only U.S. Trustee fees "payable" were those that had accrued prior to confirmation.[4/] The Debtors' plan does not address post-confirmation quarterly fees because at the time of confirmation no such fees existed. Consequently, the plan can not in any way bind the U.S. Trustee with respect to post-confirmation fees.

The United States Trustee is before this Court seeking only to collect an obligation of the Debtors that arose by operation of federal law after the plan of reorganization was confirmed.

[3/] The situation can be analogized to one where a confirmed plan provides for the debtor to file one or more post-confirmation adversary proceedings but which does not provide that the debtor will have to pay any filing fees associated with the adversary proceedings. Like the U.S. Trustee's quarterly fees, the filing fees payable to the court clerk arise under section 1930 of title 28. For the debtor to argue that he is insulated from having to pay the adversary filing fees because his confirmed plan did not provide for the payment of such fees would be ludicrous. The confirmed plan does not bind the court clerk with respect to fees under section 1930 that arise post-confirmation, just as the plan does not bind the U.S. Trustee with respect to post-confirmation fees.

[4/] The term "payable" is defined in Black's Law Dictionary as meaning "[c]apable of being paid; suitable to be paid; admitting or demanding payment; justly due; legally enforceable." Black's Law Dictionary 1016 (5th Ed. 1979).

Pursuant to sections 101(10) and 1141(a) of the Bankruptcy Code and the Supreme Court's holding in Holywell, the Debtors' plan does not insulate the Debtor from paying the fees and taxes lawfully imposed post-confirmation by Congress. Accordingly, the bankruptcy court decision, which purports to bind the U.S. Trustee and Congress with respect to post-confirmation claims, should be reversed.

III. THE CONSIDERATIONS THAT LED THE BANKRUPTCY COURT TO HOLD THAT SECTION 1930(a)(6) DOES NOT REQUIRE THE PAYMENT OF QUARTERLY FEES BY THE DEBTORS ARE WITHOUT MERIT.

As discussed above, section 1930(a)(6), as amended and clarified by Public Laws 104-99 and 104-208, provides that quarterly fees are payable in all pending cases. In holding that quarterly fees were payable only in cases in which a debtor's plan provided for such payment, the bankruptcy court identified several concerns that it concluded militated in favor of its holding. Those concerns included the constitutionality of amended section 1930(a)(6) as applied to debtors with confirmed plans, potential res judicata concerns, potential conflicts with various provisions of the Bankruptcy Code and considerations of equity. The bankruptcy court determined that in construing amended section 1930(a)(6), it must balance these concerns. In re Uncle Bud's Inc., 206 B.R. at 902. None of these concerns are valid, nor do they justify the bankruptcy court rejecting the only reasonable reading of section 1930(a)(6) — that quarterly fees are payable until the earlier of dismissal, conversion, or closing of the case by entry of a final decree.

A. The Application of Section 1930(a)(6) to Pending Cases Which Had Confirmed Plans Prior to January 27, 1996, Is Neither Impermissibly Retroactive, Nor Violative of Any Provision of the Constitution.

In rejecting the notion that the quarterly fees were payable despite the provisions of the confirmed plan, the bankruptcy court first stated that "[t]he debtors argue with some persuasive force that [requiring the debtors to pay quarterly fees until the case is dismissed, converted or closed] would violate due process, is unconstitutionally retroactive, and is too vague to be enforced." In re Uncle Bud's Inc., 206 B.R. 889, 900 (Bankr. M.D. Tenn. 1997). On this basis, without the benefit of a plethora of cases in which such constitutional concerns regarding post-confirmation quarterly fees have been rejected, the bankruptcy court determined that the U.S. Trustee's argument could not be sustained. See, e.g. In re Hudson Oil Co., 210 B.R. 380 (D. Kan. 1997); In re Lancy, 208 B.R. 481 (Bankr. D. Ariz. 1997); In re Maruky, Inc., 206 B.R. 225 (Bankr. S.D. Cal. 1997); In re Burk Development Co., 205 B.R. 778 (Bankr. M.D. La. 1997). An analytical review of the Constitutional concerns raised by the bankruptcy court reveals that such concerns are illusory and do not support a direct departure from Congress's clearly stated intent in amending section 1930(a)(6).

The bankruptcy court's main concern was that application of amended section 1930(a)(6) to debtors with plans confirmed prior to January 27, 1996, would be impermissibly retroactive and a violation of substantive due process. However, section 1930(a)(6), as amended, only requires the payment of quarterly fees in chapter 11 cases prospectively from the effective date of the amended statute. Consequently, section 1930(a)(6) is not unconstitutionally retroactive. Furthermore, even if section 1930(a)(6) were retroactive, it is economic legislation that is rationally related to a legitimate government purpose. Consequently, it does not, under any interpretation, violate due process.

In determining whether a statute is impermissibly retroactive, the court must determine "whether Congress has expressly prescribed the statute's proper reach." Landgraf v. USI Film Prods., 114 S. Ct. 1483, 1499 (1994). Obviously, if Congress has prescribed the statute's reach and such reach is prospective only, not retroactive, then the statute should be upheld. A statute is retroactive if it "attaches new legal consequences to events completed before its enactment." Id. at 1499. However, "[a] statute does not operate 'retrospectively' merely because it . . . upsets expectations based on prior law." Id. For example, a statute banning gambling may adversely affect a person who began constructing a casino prior to the statute's enactment, yet the statute would not be unconstitutionally retroactive for that reason. Id. at 1499 n.24.

If, on the other hand, Congress has expressly prescribed the statute's proper reach and such reach is retroactive, the question becomes whether statute is supported by a rational legislative purpose. United States v. Carlton, 114 S. Ct. 2018, 2022 (1994); In re Richardson Serv. Corp., 210 B.R. 332, 334 (Bankr. W.D. Mo. 1997)(citing Landgraf, 114 S. Ct. at 1505, 1508 and Carlton, 114 S. Ct. at 2020). If Congress did have a rational basis for enacting the legislation, then the court should uphold the legislation despite its retroactive effect. Carlton, 114 S. Ct. at 2022.

In the present case, Congress clearly and unequivocally prescribed the reach of section 1930(a)(6) in its September 1996 amendment, which provided that "the fees under [section 1930(a)(6)] shall accrue and be payable from and after January 27, 1996, in all cases (including, without limitation, any cases pending as of that date), regardless of confirmation status of their plans." Pub. L. 104-208, 110 Stat. 3009 (Sept. 30, 1996); see also In re Hudson Oil Co., 210 B.R. 380, 383 (D. Kan. 1997)("the text of the [September 1996] amendment leaves little doubt (if any) that Congress intended the January 1996 amendment to 28 U.S.C. § 1930(a)(6) to apply to all pending chapter 11 cases, including those with plans confirmed prior to the effective date of the amendment."). Since Congress prescribed the precise reach of the statute, the next question is whether section 1930(a)(6) operates retroactively. Clearly, the September 1996 Amendment gives the amended statute only prospective effect. In other words, chapter 11 debtors, whose plans were confirmed prior to January 27, 1996, are not to be assessed a quarterly fee based on the period between confirmation of their plans and January 27, 1996. Since section 1930(a)(6) operates only prospectively, the statute should be upheld.

Even if the court determined that section 1930(a)(6) had some retroactive effect, the statute still should be upheld because it is supported by a rational legislative purpose. In amending section 1930(a)(6), Congress clearly expressed its intent to provide additional funding for the United States Trustee Program. Furthermore, Congress wanted the additional funding to come from those entities that use the bankruptcy system. These intentions clearly provide a rational legislative basis for the amendment of section 1930(a)(6), even if the legislation were deemed retroactive. <u>In re Hudson Oil Co.</u>, 210 B.R. 380, 383 (D. Kan. 1997)("Congressional concern over declining quarterly fee revenues led Congress to adopt these changes [to section 1930(a)(6)] and the corresponding fees rationally address this concern."); <u>In re Richardson Serv. Corp.</u>, 210 B.R. 332, 334-35 (Bankr. W.D. Mo. 1997). Thus, section 1930(a)(6), as applied to debtors with plans confirmed prior to January 27, 1996, fully satisfies the due process analysis.

B. <u>Requiring the Payment of Quarterly Fees in Cases with Plans Confirmed Prior to January 27, 1996, Until Such Cases Are Dismissed, Converted or Closed Does Not Conflict with Any Provisions of the Bankruptcy Code.</u>

In determining that the Debtor should not have to pay the quarterly fees required by section 1930(a)(6), the bankruptcy court stated that the application of section 1930(a)(6) to debtors with plans confirmed prior to January 27, 1996, would conflict with sections 1141(a), 1141(b), 1142(a), and 1127(b) of the Bankruptcy Code. However, the perceived conflicts arose from the court's erroneous presumption that the terms of the confirmed plan bound the U.S. Trustee with respect to the quarterly fees that arose after the plan was confirmed.

As noted previously, section 1141(a) of the Bankruptcy Code specifies all of the entities that are bound by a confirmed plan in a chapter 11 case. Section 1141(a), however, only operates to bind such entities as to their pre-confirmation claims. Holywell v. Smith, 112 S. Ct. 1021, 1028 (1992). Thus, requiring the Debtors to pay the quarterly fees as intended by Congress in no way conflicts with section 1141(a). Similarly, section 1930(a)(6) as applied to these Debtors does not conflict with sections 1141(b) and 1142(a) of the Bankruptcy Code, both of which merely set forth terms related to the confirmed plan, but which do not relate to the U.S. Trustee or to post-confirmation claimants.

Section 1930(a)(6), as applied to the Debtors, also does not conflict with section 1127(b) of the Bankruptcy Code. Section 1127(b) provides that "[t]he proponent of a plan or the reorganized debtor may modify such plan at any time after confirmation of such plan and before substantial consummation of such plan . . ." 11 U.S.C. § 1127(b). According to the bankruptcy court, the U.S. Trustee's effort to collect the fees that Congress imposed on the Debtors is an effort by the U.S. Trustee to modify the plan even though the U.S. Trustee is not a party entitled to modify the plan under section 1127(b). This argument is also based on the erroneous assumption that the terms of the confirmed plan operate to bind post-confirmation claimants. However, as noted previously, sections 1141(a) and 101(10) of the Bankruptcy Code, as well as the Supreme Court decision in Holywell, clearly indicate that the U.S. Trustee and Congress are not bound by the plan. Since the plan is not binding with regard to post-confirmation fees, the U.S. Trustee has absolutely no need nor desire to amend the Debtors' plan. Consequently, the U.S. Trustee's efforts to collect the fees imposed by Congress do not conflict with section 1127(b).

Finally, the bankruptcy court indicated that allowing fees to accrue post confirmation would conflict with section 1129(a)(12) of the Bankruptcy Code. Section 1129(a)(12) provides that a plan will be confirmed only if, "[a]ll fees payable under section 1930 of title 28, as determined by the court at the hearing on confirmation of the plan, have been paid or the plan provides for the payment of all such fees on the effective date of the plan." 11 U.S.C. § 1129(a)(12). The operative word in section 1129(a)(12) is "payable," which is defined as "capable of being paid; suitable to being paid; admitting or demanding payment; justly due; legally enforceable." Black's Law Dictionary 1016 (5th ed. 1979). Based on that definition, section 1129(a)(12) should properly be read as requiring the debtor to pay all fees due and owing as of confirmation on or before the effective date of the plan. Section 1129(a)(12) does not address the timing of payment of section 1930(a)(6) fees that accrue post-confirmation. Accordingly, the bankruptcy court's characterization of the U.S. Trustee's efforts to collect the fees as a disguised effort to modify the plan and its concern regarding a perceived conflict between section 1930(a)(6) of title 28 and various sections of the Bankruptcy Code are simply wrong as a matter of law.

C. The Imposition of Fees Post-Confirmation on the Debtor Does Not in Any Way Implicate the Principles of *Res Judicata*.

The third reason why the bankruptcy court rejected the U.S. Trustee's argument that fees must be paid to the U.S. Trustee post-confirmation until the case is converted, dismissed or closed, is that the Debtors' confirmed plan precluded the imposition of such fees under principles of *res judicata*. While the bankruptcy court was correct in determining that the confirmation order was a final order, the court incorrectly assumed that the order affected the post-confirmation claim of the U.S. Trustee. As discussed before, the confirmed plan does not bind the U.S. Trustee or Congress with respect to post-confirmation fees and, consequently, the principles of *res judicata* do not apply. See Donaldson v. Bernstein, 104 F.3d 547, 555 (3d Cir. 1997)("Claims for post-confirmation acts are not barred by the *res judicata* effect of the confirmation order.").

For an order in a prior action to have *res judicata* effect with respect to a claim in a later action, four elements must be satisfied. First, the earlier order must be a final decision on the merits. Sanders Confectionery Prods., Inc. v. Heller Financial, Inc., 973 F.2d 474, 480 (6th Cir. 1992), cert. denied, 506 U.S. 1079 (1993) (citing King v. South Cent. Bell Tel. & Tel. Co., 790 F.2d 524 (6th Cir. 1986)). Second, the later case must involve the same parties as in the prior action. Id. Third, the second action must raise an issue that was actually litigated or should have been litigated in the first case. Id. Finally, the causes of action in each case must share a similar identity. Id.

In the present case, the bankruptcy court order clearly fails the third element needed for *res judicata* effect. Specifically, the U.S. Trustee's claim for post-confirmation fees is not an issue that was or should have been litigated in conjunction with the plan confirmation. First, the statutory imposition of post-confirmation fees did not occur until after the plan was confirmed. Consequently, it would have been impossible to litigate the issue of post-confirmation fees at the time of confirmation. Second, even if the parties could have foretold of the future imposition of fees, such fees would not have accrued as of confirmation. The U.S. Trustee's claim arises from post-confirmation events that could not have been accurately predicted at the time of confirmation of the plan. Thus, the issue of post-confirmation was not and could not have been litigated in conjunction with the hearing on confirmation of the Debtors' plan. Consequently, the confirmation order does not have a *res judicata* effect with respect to the Debtors' liability for post-confirmation fees under section 1930(a)6). Donaldson v. Bernstein, 104 F.3d 547, 555 (3d Cir. 1997) ("Creditors whose claims arise from and after confirmation are not barred by the event of confirmation from asserting such claims, except to the extent that they arise from pre-confirmation acts")(quoting In re Pavlovich, 952 F.2d 114, 119 (5th Cir. 1992)).

D. Although the Bankruptcy Court Clearly Has Jurisdiction Post-Confirmation to Determine Issues Regarding Quarterly Fees, the Determination of Whether Jurisdiction Exists Has No Bearing on How Section 1930(a)(6) Should Be Interpreted.

Finally, the bankruptcy court decided that section 1930(a)(6) did not require the Debtor to pay post-confirmation fees on the basis that extending the payment of quarterly fees through the closing of the case would present issues of bankruptcy court jurisdiction. This analysis is faulty on two grounds. First, the jurisdiction of the bankruptcy court is created by 28 U.S.C. § 157, which does not include any specific limitation on bankruptcy court jurisdiction of cases with confirmed plans. Thus, the bankruptcy court would have jurisdiction post-confirmation to hear matters arising in or arising under a case under title 11, such as post-confirmation quarterly fee issues. Second, assuming *arguendo* that the bankruptcy court would not have jurisdiction to enforce the collection of quarterly fees post-confirmation, such a determination should lead only to the conclusion that the court had no jurisdiction to rule on the matter before it. Consequently, the bankruptcy court's reference to jurisdictional issues as a basis for relieving the Debtor of its obligation to pay post-confirmation quarterly fees is incorrect.

Clearly the bankruptcy court has jurisdiction post-confirmation to determine issues relating to fees payable under section 1930(a)(6). The bankruptcy court's jurisdiction to hear bankruptcy matters arises under 28 U.S.C. §§ 1334(a) and 157.[5/] Section 1334 provides that the district courts have original jurisdiction over bankruptcy cases and section 157(a) provides that "[e]ach district court may provide that any or all cases arising under title 11 and any or all proceedings arising under title 11 or arising in or related to a case under title 11 shall be referred to the bankruptcy judges for the district." 28 U.S.C. § 157(a). Furthermore, 28 U.S.C. § 157(b)(1) provides that "[b]ankruptcy judges may hear and determine all cases under title 11 and all core proceedings arising under title 11, or arising in a case under title 11 . . .." 28 U.S.C. § 157(b)(1). "Sections 1334 and 157 of title 28 are the sources of subject matter jurisdiction for the bankruptcy courts." In re Refrigerant Reclamation Corp., 186 B.R. 78, 80 (Bankr. M.D. Tenn. 1995).

[5/] Although post-confirmation jurisdiction of a bankruptcy court is often discussed in terms of whether section 1142 or the confirmed plan allows the bankruptcy court to consider a matter, neither section 1142 nor a debtor's plan of reorganization is jurisdictional. In re Holly's Inc., 172 B.R. 545 (Bankr. W.D. Mich. 1994) aff'd, 178 B.R. 711 (W.D. Mich. 1995); 8 Lawrence P. King, et al., Collier on Bankruptcy ¶ 1142.04[1] (15th ed. 1997).

Nowhere in sections 1334 and 157 of title 28 is there any provision limiting the jurisdiction of the bankruptcy court post-confirmation. Rather, the bankruptcy court continues to retain jurisdiction post-confirmation to hear and adjudicate any core proceedings related to the bankruptcy case. In re Holly's Inc., 172 B.R. 545, 554 (Bankr. W.D. Mich. 1994), aff'd, 178 B.R. 711 (W.D. Mich. 1995) ("nothing in the language of section 1334 even remotely suggests that confirmation of a plan alters the basic jurisdictional analysis for bankruptcy cases and proceedings."). Since the fees arising under section 1930(a)(6) only arise in the context of a chapter 11 case, it is clear that the bankruptcy court has jurisdiction to adjudicate all issues related to such fees, so long as the bankruptcy case remains open.[6]

The breadth of bankruptcy court jurisdiction over confirmed chapter 11 cases was recently addressed in In re Refrigerant Reclamation Corporation, 186 B.R. 78 (Bankr. M.D. Tenn. 1995). In the Refrigerant case, after confirmation of the debtor's plan of reorganization but prior to the entry of a final decree, the debtor filed an adversary proceeding seeking relief from various requests for information made by one of the creditors in the case. Id. at 79. The creditor believed it was entitled to the information pursuant to certain agreements made by the debtor in conjunc-

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[6] If the bankruptcy court did not have jurisdiction to compel the payment of post-confirmation quarterly fees, then an absurd result would ensue. In particular, the bankruptcy would have the authority post-confirmation to convert a case to chapter 7 or dismiss it if the debtor fails to pay quarterly fees, but would have no authority to direct the debtor to pay those fees. See 11 U.S.C. § 1112(b)(10) (providing that the failure to pay quarterly fees is cause for dismissal or conversion of the case); Smith v. Lee, 201 B.R. 267 (D. Nev. 1996)(bankruptcy statute providing for revesting of property in debtor upon confirmation did not deprive bankruptcy court of jurisdiction to enter post-confirmation conversion order); In re Cinderella Clothing Indus., 93 B.R. 373 (Bankr. E.D. Pa. 1988)(bankruptcy courts retain authority post-confirmation to dismiss or convert case under 11 U.S.C. § 1112(b)).

tion with the chapter 11 plan. However, the creditor argued that the dispute was a breach of contract action over which the bankruptcy court had no subject matter jurisdiction. Id. at 79-80.

In determining whether it had jurisdiction over the dispute, the bankruptcy court first recognized a number of reported decisions which hold that the post-confirmation jurisdiction of bankruptcy courts is more limited than the jurisdiction pre-confirmation. Id. at 80-81. However, the court rejected that line of cases based on the broad jurisdictional grant in 28 U.S.C. §§ 1334 and 157 of title 28 of the United States Code, which does not create any distinction between pre- or post-confirmation cases. Id. at 80. The court further analyzed the history of bankruptcy court jurisdiction, noting that the judiciary's reluctance to exercise post-confirmation jurisdiction stemmed from the former Bankruptcy Act, which specifically limited post-confirmation jurisdiction. However, in 1978, Congress rejected the jurisdictional scheme present in the Bankruptcy Act and "enacted a single grant of comprehensive jurisdiction that would enable the bankruptcy courts to deal 'efficiently and expeditiously with all matters connected with the bankruptcy estate.'" Id. at 81 (quoting Celotex Corp. v. Edwards, 115 S. Ct. 1493, 1498-99 (1995)). Under the present jurisdictional scheme, the analysis of whether bankruptcy court jurisdiction exists over a particular dispute is the same regardless of whether the dispute arises before or after confirmation. In other words, if the proceeding is "related to" the bankruptcy case, then the bankruptcy court has jurisdiction even if a plan has been confirmed in the case. Id. at 82.

All issues regarding fees arising under section 1930(a)(6) clearly fall within the jurisdictional grant of sections 1334 and 157 of title 28. The Debtors' obligation to pay quarterly fees by its very nature could arise only in the context of a bankruptcy case. Consequently, it is necessarily a "proceeding arising in a case under title 11 or, at a minimum, a proceeding related to a case under title 11." In re Marcus Hook Development Park, Inc., 943 F.2d 261, 264 (3d Cir. 1991) (in determining jurisdiction under section 1334, a court "need only determine 'whether a matter is at least related to the bankruptcy.'"). The bankruptcy court therefore has jurisdiction to require the Debtors to pay the mandated fees. See 28 U.S.C. §§ 1334 & 157(b)(1).

In any event, the existence or non-existence of jurisdiction only applies to the bankruptcy court's ability to hear and decide the post-confirmation fee issue. It does not dictate the validity of section 1930(a)(6) or how it should be applied to the Debtors in this case. Furthermore, even if the bankruptcy court does not have jurisdiction to hear the matter, the district court clearly has jurisdiction to enforce the federal statute. Consequently, the issue of post-confirmation jurisdiction does not affect the determination of whether the Debtors are liable for post-confirmation fees.

In sum, the bankruptcy court had no basis for rejecting the plain language of section 1930(a)(6) which requires the Debtors to pay a fee to the U.S. Trustee for each quarter from and after January 27, 1996, until a final decree is entered in the case. Section 1930(a)(6) does not conflict with any provision of the Constitution or the Bankruptcy Code, and is not defeated by principles of *res judicata*. Furthermore, the bankruptcy court clearly has jurisdiction to decide all matters related to section 1930(a)(6) fees, at least until the bankruptcy case is closed. Consequently, the bankruptcy court erred in failing to require the Debtor to pay all the post-confirmation fees accrued pursuant to section 1930(a)(6).

CONCLUSION

The 1996 amendments to section 1930(a)(6) of title 28 of the United States Code were intended by Congress to increase the fees collected by the U.S. Trustee Program in chapter 11 cases. The amendments clearly require that from January 27, 1996, all cases pending as of that date or thereafter filed are required to pay a fee to the U.S. Trustee for each quarter that the case is pending, regardless of whether the debtor confirmed a reorganization plan before, during or after January 27, 1996. The bankruptcy court refused to apply the statute as intended by Congress based on a misreading of the statute and concerns regarding illusory Constitutional issues. Section 1930(a)(6) does not offend any provision of the Constitution and is completely consistent with the provisions of the Bankruptcy Code. Consequently, the Bankruptcy Court erred in failing to require the Debtor to pay post-confirmation quarterly fees to the U.S. Trustee. Accordingly, the U.S. Trustee respectfully requests that the bankruptcy decision be reversed.

STATEMENT CONCERNING ORAL ARGUMENT

Oral argument is requested because the legal issues raised in this appeal are complex and the resolution of such issues would be facilitated by oral argument.

Dated: September 30, 1997
Nashville, Tennessee

Respectfully submitted,

ELLEN B. VERGOS
UNITED STATES TRUSTEE

____
Michael E. Collins, Esq.
Office of the U.S. Trustee
701 Broadway, Suite 318
Nashville, Tennessee 37203
(615) 736-2254

BRIEF BANK — "SUMMARY SHEET"

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WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	Herman Jan Van Eck v. Tracy Hope Davis United States Trustee for Region 2, GRP Loan LLC, DLJ Mortgage Capital Inc., and Hunt Leibert Jacobson PC (In re Herman Jan Van Eck)
2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	D. Conn.
3. ("CCN") ***CURRENT*** CASE NO.	No.: 3:10-cv-01107SRU
4. ("PCN") ***PRIOR*** CASE NO. - & COURT *[IF ANY]*	No.: 08-32911 Court: Bankr. D. Conn. *(Identify judge & cite, if any)*
5. ("SO") ***SOURCE***	**U.S. TRUSTEES**
6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	Filed: August 24, 2010 Type: United States Trustee's Motion to Dismiss Debtor's Appeal as Untimely
7. **("AU") *PRINCIPAL AUTHORS & OFFICE*** [E.g.,"UST/OGC"]	Holley L. Claiborn, Catherine Sevcenko, P. Matthew Sutko, Tracy Hope Davis *(UST/OGC: 202-307-1399/FAX-2397)*
8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	• Did the debtor comply with the Bankruptcy rules that only allow a litigant 14 days to appeal an adverse final order.
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UNITED STATES DISTRICT COURT
DISTRICT OF CONNECTICUT

In re

HERMAN JAN VAN ECK,

Debtor.

Civil Action No.
3:10-cv-01107SRU

HERMAN JAN VAN ECK,

Appellant,

v.

TRACY HOPE DAVIS,
UNITED STATES TRUSTEE FOR REGION 2,
GRP LOAN LLC,
DLJ MORTGAGE CAPITAL INC., and
HUNT LEIBERT JACOBSON PC,

Appellees.

UNITED STATES TRUSTEE'S MOTION TO DISMISS DEBTOR'S APPEAL AS UNTIMELY

Tracy Hope Davis, the United States Trustee for Region 2, hereby moves to dismiss Mr. Van Eck's untimely appeal of the bankruptcy court's dismissal of his chapter 11 case.

INTRODUCTION

Under section 158 of title 28, this Court has jurisdiction to consider an appeal from a bankruptcy court only if the appeal is taken "in the time provided by Rule 8002 of the Bankruptcy Rules." 28 U.S.C. § 158(c)(2). Under Rule 8002(a), a notice of appeal must be filed within 14 days of the date of entry of the order appealed. Mr. Van Eck filed his notice of appeal of the order dismissing his bankruptcy case more than three months after it was entered. His appeal is untimely and therefore must be dismissed.

FACTS

Mr. Van Eck filed a voluntary chapter 11 petition on September 5, 2008. Bankr. Dkt. 1. His case was dismissed on March 16, 2010 because he failed to maintain appropriate insurance, which put the assets of the estate at risk. *In re Herman Jan Van Eck*, 425 B.R. 54, 61 (Bankr. D. Conn. 2010) (Bankr. Dkt. 303). The case was also dismissed on the alternate ground that Mr. Van Eck was using his chapter 11 case to re-litigate issues that had been decided in state court. *Id.* at 63. The bankruptcy court barred Mr. Van Eck from filing another bankruptcy petition for two years. *Id*. at 69; Bankr. Dkt. 304. However, the bankruptcy court retained jurisdiction over any litigation needed to confirm that Mr. Van Eck provided his correct social security number on his bankruptcy filing. *Id*. at 72; Bankr. Dkt. 304. The order dismissing the case was entered on March 16, 2010. Bankr. Dkt. 304.

Subsequently, creditors DLJ Mortgage Capital, Inc. and GRP Loan, LLC moved the bankruptcy court to direct the Social Security Administration to confirm Mr. Van Eck's social security number under seal. Bankr. Dkt. 305. The bankruptcy court took the requested action. On June 14, 2010, the bankruptcy court confirmed that Mr. Van Eck's registered social security number did not match the number on his petition. Bankr. Dkt. 335.

On June 28, 2010, Mr. Van Eck filed a notice of appeal for review of the bankruptcy court's "Judgment of Dismissal" that had been entered on March 16, 2010. Bankr. Dkt. 337. He did not appeal the litigation related to his social security number, which had been decided and entered on June 14, 2010. *Id.*

ANALYSIS

For the reasons set forth below, Mr. Van Eck's June 28 notice of appeal was untimely to perfect an appeal from the March 16 order dismissing his case.

A. Mr. Van Eck's Appeal Must be Dismissed Because He Filed His Notice of Appeal Almost Three Months after the Statutory Deadline.

Mr. Van Eck did not comply with the bankruptcy rules that only allow a litigant 14 days to appeal an adverse final order. An order to dismiss a case is a final order. *See In re Chateaugay Corp.*, 826 F.2d 1177, 1179 (2d Cir. 1987) (indicating that "[a] final order 'ends the litigation on the merits and leaves nothing for the court to do but exercise the judgment'") (quoting *Catlin v. United States*, 324 U.S. 229, 233 (1945)). An order can be final in bankruptcy even if it does not resolve all of the issues raised in the case, "but it must completely resolve all of the issues pertaining to a discrete claim . . . ." *In re Fugazy Express*, 982 F.2d 769, 776 (2d Cir. 1992). The order dismissing Mr. Van Eck's case ended consideration of the merits of his chapter 11 filing and therefore was a final order.

After the final order dismissing his case was entered into the docket on March 16, 2010, Mr. Van Eck accordingly had 14 days to file a notice of appeal. Bankr. Dkt. 304; Fed R. Bankr. P. 8002(a). The 14-day appeal clock expired on March 30, 2010. Mr. Van Eck's June 28 notice of appeal was therefore untimely to perfect an appeal from the March 16 dismissal order. Bankr. Dkt. 337.

B. Because Mr. Van Eck's Appeal was Untimely, this Court Does Not Have Jurisdiction to Hear His Appeal.

The deadline established by Rule 8002(a) of the Federal Rules of Bankruptcy Procedure is mandatory and jurisdictional. This Court thus does not have subject matter jurisdiction to hear Mr. Van Eck's appeal because he filed his notice of appeal over three months after the dismissal order was entered into the docket.

This case is governed by the Supreme Court case *Bowles v. Russell,* which held that if Congress established a time limit for taking an appeal in a statute, "that limitation is more than a simple 'claim-processing rule.'" *Bowles v. Russell*, 551 U.S. 205, 213 (2007). It is jurisdictional. *Id.* at 206; *Ruiz-Martinez v. Mukasey*, 516 F.3d 102, 118 (2d Cir. 2008) (quoting *Bowles*). *See also In re Wiersma*, 483 F.3d 933, 938 (9th Cir. 2007) ("[T]he failure to timely file a notice of appeal is a jurisdictional defect barring appellate review.") (citation and internal quotation marks omitted). Without proper jurisdiction, a court does not have power to hear a case, and therefore "jurisdiction can never be forfeited or waived." *United States v. Cotton*, 535 U.S. 625, 630 (2002).

The *Bowles* holding applies to appeals in bankruptcy for two reasons. First, the Rule 8002(a) requirement that appeals be timely filed is incorporated into title 28. Section 158(c)(2) provides that appeals in bankruptcy shall be taken "in the time provided by Rule 8002 of the Bankruptcy Rules." This reference to Rule 8002 is located in the same section of the statute that grants district courts jurisdiction to hear bankruptcy appeals. *See* 28 U.S.C. §§ 158(a)-(b). Because the time limitation is statutory, it is mandatory and jurisdictional.[1]

Second, federal case law has for over 100 years treated time limits for filing a notice of appeal as jurisdictional. *Bowles*, 551 U.S. at 206 (stating that it has "long and repeatedly [been] held that the time limits for filing a notice of appeal are jurisdictional in nature"). Specifically, Rule 4(a) of the Federal Rules of Appellate Procedure, after which Rule 8002(a) was expressly modeled, is

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[1] *Cf. Kontrick v. Ryan*, 540 U.S. 443, 454 (2004) (holding that failure to comply with the time requirement in Fed. R. Bankr. P. 4004 did not affect the court's subject-matter jurisdiction). Critical to the Court's analysis in *Kontrick* was the fact that "[n]o statute . . . specifies a time limit for filing a complaint objecting to the debtor's discharge." 540 U.S. at 448. That is not the case here. By contrast to the time limit in Bankruptcy Rule 4004, the time limit for appeals to the district court in bankruptcy cases derives from 28 U.S.C. § 158. *See also Bowles v. Russell*, 551 U.S. at 210 ("Although several of our recent decisions have undertaken to clarify the distinction between claims-processing rules and jurisdictional rules, none of them calls into question our longstanding treatment of statutory time limits for taking an appeal as jurisdictional.").

“mandatory and jurisdictional.” *See Browder v. Dir. of Corr. of Ill.*, 434 U.S. 257, 264 (1978); *Siemon v. Emigrant Savs. Bank (In re Siemon)*, 421 F.3d 167, 169 (2d Cir. 2005). Mr. Van Eck appealed the bankruptcy court’s dismissal order more than three months after it was entered. His failure to file a timely notice of appeal deprives this Court of jurisdiction to review the bankruptcy court’s dismissal order. *White v. United States*, 183 B.R. 356, 358 (D. Conn. 1995).

CONCLUSION

For all of the foregoing reasons, this Court should dismiss this appeal for lack of jurisdiction.

Dated: August 24, 2010
New Haven, Connecticut

Respectfully submitted,
TRACY HOPE DAVIS
UNITED STATES TRUSTEE FOR REGION 2

By: /s/ Holley L. Claiborn
Holley L. Claiborn /ct 17216
Trial Attorney
Office of the United States Trustee
Giaimo Federal Building
150 Court Street, Room 302
New Haven, CT 06510
Telephone: (203) 773-2210
Fax: (203)773-2217
Holley.L.Claiborn@usdoj.gov

SO ORDERED AND APPROVED

________________________________ Date: ____________________

United States District Judge

CERTIFICATE OF SERVICE

I hereby certify that on August 24, 2010, a copy of the foregoing United States Trustee's Motion to Dismiss Debtor's Appeal as Untimely was filed electronically and served by mail on anyone unable to accept electronic filing. Notice of this filing will be sent to by e-mail to all parties by operation of the court's electronic filing system or by mail to anyone unable to accept electronic filing as indicated on the Notice of Electronic Filing. Parties may access this filing through the Court's CM/ECF System.

<u>Via First Class U.S. Mail</u>
Herman Jan Van Eck
P.O. Box 16
Ivoryton, CT 06442

<u>Via CM/ECF</u>

Jane W. Arnone
janearnoneesq@aol.com

Kim L. McCabe
kim.mccabe@usdoj.gov

Ndidi N. Moses
Ndidi.Moses@usdoj.gov

Irving H. Perlmutter
lpolino@upslaw.com

Christine L. Sciarrino
Christine.Sciarrino@usdoj.gov,Lisa.Hagy@usdoj.gov,USACT.ECF@usdoj.gov

Linda St. Pierre
lstpierre@huntleibert.com

Benjamin T. Staskiewicz
bstaskiewicz@huntleibert.com

Peter A. Ventre
pventre@huntleibert.com

Lorraine M. Weil
kathleen_mooney@ctb.uscourts.gov

By: /s/ Holley L. Claiborn
Holley L. Claiborn /ct 17216
Trial Attorney
Office of the United States Trustee
Giaimo Federal Building
150 Court Street, Room 302
New Haven, CT 06510
Telephone: (203) 773-2210
Fax: (203)773-2217
Holley.L.Claiborn@usdoj.gov

BRIEF BANK — 'SUMMARY SHEET" *Printed Mon-5/23/11 11:18*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	U.S. Trustee v. Vesper
2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	D. Alaska
3. ("CCN") ***CURRENT*** CASE NO.	No.: 3:07-cv-00130 TMB
4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*	No.: 06-00565 DMD Court: Bankr. Alaska *(Identify judge & cite, if any)*
5. ("SO") ***SOURCE***	**U.S. TRUSTEES**
6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	Filed: June 2007 Type: Brief of Appellant U.S. Trustee
7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*	Kay Hill, P. Matthew Sutko, Melissa Burgess *(UST/OGC: 202-307-1399/FAX-2397)*
8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	●Given that 11 U.S.C. § 707(b)(2)(A)(ii)(I) allows only "applicable" vehicle in ownership expenses to be deducted under the means test, did the bankruptcy court err allowing Ms. Vesper to deduct them when she had no expense for automobile ownership? **√ Background:**
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ILENE J. LASHINSKY

United States Trustee

KAY HILL
Assistant United States Trustee
Department of Justice
605 West 4th Avenue, Room 250
Anchorage, Alaska 99501
Telephone: (907) 271-2600
e-mail: Kay.Hill@usdoj.gov

Of Counsel:
ROBERTA A. DeANGELIS
Acting General Counsel

P. MATTHEW SUTKO
MELISSA R. BURGESS
Department of Justice
Executive Office for U.S. Trustees
20 Massachusetts Avenue, NW
Washington, D.C. 20530
Telephone: (202) 307-1399

ATTORNEYS FOR APPELLANT

IN THE UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF ALASKA

OFFICE OF THE UNITED STATES	)	Case No. 3-07-cv-00130-TMB
TRUSTEE,	)	
Appellant,	)	**BRIEF OF APPELLANT**
	)	**OFFICE OF THE**
v.	)	**UNITED STATES TRUSTEE**
	)	
KRISTEN JOAN VESPER,	)	
	)	On Appeal from the U. S. Bankr. Court
Appellee.	)	In re Kristen Joan Vesper, Debtor
	)	Case No. 06-00565-DMD Chapter 7

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JURISDICTIONAL STATEMENT

The United States Bankruptcy Court for the District of Alaska had jurisdiction under 28 U.S.C. §§ 157(b) and 1334(a) over Kristen Joan Vesper's voluntary chapter 7 bankruptcy case.

On June 28, 2007, the bankruptcy court entered a Memorandum of Opinion and Order denying the United States Trustee's motion to dismiss Ms. Vesper's case for abuse. The United States Trustee filed a timely notice of appeal from that order under 28 U.S.C. § 158(c)(2) and Fed. R. Bankr. P. 8002(a) on July 5, 2007. This Court has jurisdiction over this appeal under 28 U.S.C. § 158(a)(1).

STATEMENT OF THE ISSUE

11 U.S.C. § 707(b) provides for dismissal where the granting of a chapter 7 discharge to a debtor would be an abuse. Section 707(b)(2) employs a means test as a tool for presuming abuse in cases where a debtor's income, minus allowed expenses, yields a certain minimum amount of monthly disposable income. Ms. Vesper, the debtor in this case, "passed" the means test because the bankruptcy court ruled she was eligible to claim vehicle ownership expenses, even though she did not have a loan or lease payment for either of her two vehicles. Given that 11 U.S.C. § 707(b)(2)(A)(ii)(I) allows only "applicable" vehicle ownership expenses to be deducted under the means test, did the bankruptcy court err in allowing Ms. Vesper to deduct them when she had no expense for automobile ownership?

STANDARD OF REVIEW

In an appeal taken from a bankruptcy court order, a district court reviews the bankruptcy court's findings on questions of law *de novo*. *In re Emery*, 317 F.3d 1064, 1069 (9th Cir. 2003) (citing *In re Allen*, 300 F.3d 1055, 1058 (9th Cir. 2002)). The bankruptcy court's holding that 11 U.S.C. § 707 allowed Ms. Vesper to deduct vehicle ownership expenses for two vehicles when she had no loan or lease payments is a question of law and therefore subject to *de novo* review.

STATEMENT OF THE CASE

On December 22, 2006, Ms. Vesper filed a petition for relief under chapter 7 of the Bankruptcy Code. (DE 1: Petition).[1] On March 22, 2007, the United States Trustee timely filed a motion to dismiss Ms. Vesper's case for abuse under 11 U.S.C. § 707(b), along with a memorandum in support of her motion.[2] (DE 22, 23). Ms. Vesper filed an objection to the motion on April 30, 2007. (DE 28).

The bankruptcy court heard the parties' arguments at a hearing on the United States

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[1] Alaska Local Bankruptcy Rule ("AK LBR") 8010-1(a)(2) provides that references to the record on appeal must be made either to (**A**) the docket entry number and page of the pleading or (**B**) the volume and page of the transcript of any oral proceedings. All references to "DE [number]" refer to the bankruptcy court's docket entry number of the item which was designated in the Record on Appeal by appellant. Where possible, page numbers and/or the document title have been included. All references to "TR" refer to the transcript of the May 23, 2007, hearing, which is contained in a single volume, was also designated as part of the record by appellant and is docketed at DE 45. Appellee did not designate any items for the record.

[2] Congress has authorized the United States Attorney General to appoint 21 United States Trustees, each to serve in a specific geographic region of the United States. *See generally* 28 U.S.C. § 581, *et seq.* (establishing the United States Trustee Program). United States Trustees are senior officials of the Department of Justice. *Id.* United States Trustees "supervise the administration of cases and trustees" in all bankruptcy cases within his or her region through the exercise of a range of oversight responsibilities. 28 U.S.C. § 586(a)(3). *See generally In re Castillo*, 297 F.3d 940, 950 (9th Cir. 2002) (explaining that the United States Trustee is the "watchdog" of the bankruptcy system). United States Trustees may raise, appear, and be heard on any issue in any case or proceeding under title 11. 11 U.S.C. § 307; *See also In re Donovan Corp.*, 215 F.3d 929, 930 (9th Cir. 2000) (upholding broad appellate standing of United States Trustees).

Trustee's motion held on May 23, 2007. (DE 31). The bankruptcy court concluded that the presumption of abuse did not arise under 11 U.S.C. § 707 and entered a memorandum and order denying the United States Trustee's motion to dismiss on June 28, 2007. (DE 32, 33). On July 5, 2007, the United States Trustee timely filed a Notice of Appeal and an election under 28 U.S.C. § 158(c)(1) to have this appeal heard by the United States District Court for the District of Alaska. (DE 34, 35).

STATEMENT OF THE FACTS

I. <u>Statutory Framework.</u>

On October 17, 2005, most provisions of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23 (Apr. 20, 2005), took effect, implementing significant changes to the Bankruptcy Code. As part of this effort, Congress significantly amended section 707(b) of the Bankruptcy Code, which governs dismissal of chapter 7 bankruptcy cases. The general goal of Congress in its complete overhaul of section 707(b) was to ensure "that those who can afford to repay some portion of their unsecured debts be required to do so . . . ." 151 Cong. Rec. S2470 (March 10, 2005).

As it existed prior to the 2005 Reform Act, section 707(b) only authorized dismissal based on a finding that allowing the debtor relief (<u>i.e.</u>, granting a discharge of debts) constituted a "substantial abuse" of chapter 7. Prior to its 2005 amendment, section 707(b) also required courts to presume that a debtor was entitled to relief under chapter 7 of the Bankruptcy Code. Section 707(b) now authorizes dismissal where the court finds that the granting of relief would be an "abuse" of chapter 7. As amended, section 707(b)(2) repealed the former presumption in favor of a debtor obtaining bankruptcy relief and replaced it with a new presumption: a case presumptively is an “abuse” of chapter 7 if a detailed mathematical formula set out in the statute, commonly referred to as the “means test,” yields a minimum amount of monthly disposable income. *See* 11 U.S.C. § 707(b)(2).

The means test requires courts sitting in bankruptcy to use a series of calculations when determining whether the section 707(b)(2) presumption of abuse arises. *See* 11 U.S.C. § 707(b)(2)(A). Specifically, the means test calculates a debtor’s “current monthly income” (“CMI”) based on the debtor’s average income for the six calendar months preceding the month of the bankruptcy filing. *See* 11 U.S.C. § 101(10A). If a debtor’s CMI is below the applicable state median family income, the debtor’s case will not be presumed abusive under 11 U.S.C. § 707(b)(7). When, as is the case here, however, the CMI is above $166.67, section 707(b)(2)(A) refers bankruptcy courts next to the debtor’s monthly disposable income available to repay creditors by reducing the CMI by certain enumerated categories of expenses. *See* 11 U.S.C. § 707(b)(2)(A)(ii), (iii), and (iv).

At issue in this appeal is whether Ms. Vesper is eligible to deduct vehicle ownership costs under Local Standards issued by the Internal Revenue Service in calculating her monthly disposable income. Determination of that issue will establish whether this case is presumptively abusive under 11 U.S.C. § 707(b)(1) and (2). In determining the expenses to be deducted from CMI in arriving at the current monthly disposable income, section 707(b)(2)(A)(ii)(I) provides that a debtor’s “monthly expenses shall be the debtor’s *applicable* monthly expense amounts specified under the National Standards and Local Standards and the debtor’s actual monthly expenses for the categories specified as Other Necessary Expenses issued by the Internal Revenue Service for the area in which the debtor resides . . . ." 11 U.S.C. § 707(b)(2)(A)(ii)(I) (emphasis added). The Local Standards issued by the Internal Revenue Service include transportation and housing related expenses, and apportion transportation expenses into two components. *See* IRS Collection Financial Standards, under heading "Local Standards: Transportation," available at http://www.irs.gov/individuals/article/0,,id=96543,00.html.[3] The first component includes costs associated with financing vehicle acquisition, *i.e.*, the vehicle ownership costs. *Id.* The second component is associated with the costs of vehicle operation. *Id.*

If the debtor's monthly disposable income, determined by deducting allowed expenses from CMI, is less than $100 per month (or $6,000 over 60 months), the presumption of abuse does not arise. 11 U.S.C. § 707(b)(2)(A)(i)(I).[4] If the debtor's monthly disposable income is

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[3] The IRS revised its Collection Financial Standards, effective October 1, 2007, and such revisions will be made applicable to bankruptcy cases filed as of January 1, 2008. *See id.* Because Ms. Vesper's case was filed on December 22, 2006, only the Collection Financial Standards in effect prior to October 1, 2007, are applicable to Ms. Vesper's case. For the Court's convenience, a true and correct pdf copy of the Collection Financial Standards applicable to this case are attached as Exhibit "A" and incorporated herein by reference. It is important to note, however, that the revisions made by the IRS effective October 1, 2007 do not change any result in this case. As set forth in the current Collection Financial Standards, the Local Standard for Vehicle Operation is still made expressly contingent on the existence of a loan or lease payment on a vehicle. *See id.* As explained by the IRS, the recent revisions to the Local Standards were made to create equal allowances for first and second vehicles, add a separate public transportation allowance and reorganize the manner in which taxpayers in certain counties calculate their transportation operating expenses. *See id.*, under heading "Recent Revisions."

[4] Pursuant to section 104 of the Bankruptcy Code, dollar amounts set forth in title 11 applicable to a determination of presumed abuse under the means test were adjusted by the

equal to or exceeds $166.67 per month (or $10,000 over 60 months), the presumption of abuse does arise. *Id.* If the debtor's monthly disposable income is between $100 and $166.67 per month (between $6,000 and $10,000 over 60 months), the presumption of abuse arises if the disposable income, over 60 months, is sufficient to pay 25 percent of the debtor's nonpriority unsecured debt. *Id.*

If the presumption of abuse under section 707(b)(2) arises after completion of the means test, the debtor may attempt to rebut the presumption by demonstrating special circumstances that justify income or expense adjustments for which there is no reasonable alternative. 11 U.S.C. § 707(b)(2)(B).[5]

Each debtor who, like Ms. Vesper, has primarily consumer debts is required to file, in conjunction with the bankruptcy schedules and statement of financial affairs, a Statement of Current Monthly Income and Means Test Calculation, Official Form 22A ("Form 22A"). 11 U.S.C. §§ 521 and 707(b)(2)(C). The purpose of Form 22A is to calculate monthly disposable income following the formula set forth in section 707(b)(2), and determine whether the presumption of abuse arises.

II. Factual Background.

Ms. Vesper is a registered nurse. (DE 1: Schedule B, line 23; Schedule I). She lives in Fairbanks with her two children. (DE 1: Petition, p. 1; Schedule I). She filed a chapter 7

Judicial Conference of the United States effective April 1, 2007. 72 Fed. Reg. 7082 (Feb. 14, 2007). This case is not subject to the recent dollar amount adjustments.

[5] Were this court to reverse the order entered below, this case should be remanded so Ms. Vesper could attempt to establish special circumstances, should she believe they exist.

bankruptcy petition to discharge her debts on December 22, 2006. (DE 1: Petition, p. 2). Her debts are primarily consumer debts. (DE 1: Petition, p. 1; Schedules D, E and F; Summary of Schedules). On both her Form 22A and her schedules filed with her petition, Ms. Vesper reported her current monthly income as $5,690.27, which translates into annualized gross income of $68,283.24. (DE 1: Schedule I; DE 5: Lines 3, 11 and 13). Because this annualized amount exceeded the applicable Alaska state median, she was required to complete the expense portion of Official Form 22A–Current Monthly Income and Means Test Calculation. She filed an amended Form 22A on February 23, 2007 and listed the same current monthly income of $5,690.27, or $68,283.24 per year. (DE 18: Lines 3, 11 and 13).

In computing expenses on her amended Form 22A, Ms. Vesper claimed transportation ownership expenses for two vehicles on lines 23 and 24. (DE 18: p. 3). On line 23, she claimed a transportation ownership expense of $471 for a 2006 Subaru. (*Id.*). She claimed a transportation ownership expense of $332 for a 1997 Ford Explorer on line 24. (*Id.*). Ms. Vesper owns these vehicles free and clear of any debt. (DE 1: Schedule D; DE 28, p. 2).[6]

As required by 11 U.S.C. § 704, the United States Trustee reviewed all materials submitted by Ms. Vesper, including her Form 22A, and concluded that the presumption of abuse arose. (DE 24). The United States Trustee determined that Ms. Vesper's claimed deductions for vehicle ownership expenses on Lines 23 and 24 of her Form 22A were not allowable under

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[6] Under the terms of her 2006 divorce decree, Ms. Vesper's ex-husband had paid off the debt on the 2006 Subaru. (DE 28: pp. 1-2; Exhibit 1, p. 4). The divorce settlement also recognized Ms. Vesper's ownership of the 1997 Ford Explorer, which her son uses to attend school. (DE 28: Exhibit 1, p. 4.; TR., p. 16).

section 707(b)(2)(A)(ii)(I) because Ms. Vesper owned her vehicles outright and therefore had no applicable vehicle ownership expense. Accordingly, in determining whether the United States Trustee believed a presumption of abuse arose, the United States Trustee concluded that Ms. Vesper's section 707(b)(2) proffered expenses for two vehicle ownership deductions on Lines 23 and 24 of Form 22A were improper. (DE 22: Motion, p. 5; Exhibit 1 to Motion, p. 3). The United States Trustee also determined that other adjustments were appropriate.[7] (DE 22: Motion, pp. 5-7.) Given that, the United States Trustee calculated that Ms. Vesper had 60-month disposable income of $18,900 on line 51 of Form 22A, or $315 per month. (DE 22: Exhibit 2, p. 6). This exceeded the amount under 707(b) by $148, triggering the presumption of abuse.

Having concluded that the presumption of abuse under 707(b) existed in Ms. Vesper's case, the United States Trustee moved to dismiss Ms. Vesper's case as an abuse under 11 U.S.C. § 707(b)(1). (DE 22).

On April 30, 2007, Ms. Vesper filed an opposition to the United States Trustee's motion to dismiss. (DE 28). In it, she argued that section 707(b)(2)(A)(ii)(I) permits her to deduct the Local Standard for Vehicle Ownership even thought she does not have a loan or lease payment on either of her vehicles. (*Id.*).

The bankruptcy conducted a hearing on the motion to dismiss on May 23, 2007. (DE

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[7] In her motion, the United States Trustee identified a number of other adjustments to Ms. Vesper's Form 22A as well, including the following: elimination of a deduction for additional utility expenses on Line 21, elimination of a deduction for Ms. Vesper's 401(k) loan as a mandatory payroll deduction on Line 26, reduction of the deduction for excess home energy costs on Line 37, reduction of the additional food and clothing expense on Line 39 and correction of an error in Ms. Vesper's calculation of allowed deductions for debt payments on Line 46. (DE 22). Only the Vehicle Ownership expenses are at issue in this appeal.

31). At that hearing, Ms. Vesper agreed the presumption of abuse arose under section 707(b)(2) if she could not claim transportation ownership expenses on the Subaru and Explorer. (TR., pp. 8 and 19). At the close of the May 23, 2007 telephonic hearing, the bankruptcy court took the matter under advisement. (DE 31).

By order entered June 28, 2007, the court denied the United States Trustee's motion, finding that Ms. Vesper was entitled to claim the car ownership deductions for the two vehicles even though she did not have any car payments. (DE 33). In its Memorandum Regarding Dismissal, the court reviewed other decisions that came to opposing conclusions on whether debtors are entitled to claim the IRS Local Standard for Vehicle Ownership on Form 22A if they do not have a car payment, and agreed with those courts following *In re Fowler*, 349 B.R. 414 (Bankr. D.Del. 2006) that debtors may in fact do so. (DE 32, pp. 9-13). This appeal followed.

SUMMARY OF ARGUMENT

The bankruptcy court erred as a matter of law in denying the United States Trustee's motion to dismiss. It did so by misinterpreting when debtors can claim a vehicle ownership expense under section 707(b)(2). The court held that Ms. Vesper was entitled to deduct vehicle ownership expenses for the 2006 Subaru and 1997 Explorer, even though those vehicles were owned free and clear of encumbrances. This conclusion of law was incorrect because the law allows Ms. Vesper to claim only "applicable" expenses under section 707(b)(2), and she had no applicable vehicle ownership expenses because neither vehicle was subject to a loan or lease payment. By using the word "applicable," Congress limited eligibility for expenses under the Local Standards to debtors for whom the expenses apply. Because the vehicle acquisition/financing expense does not apply with respect to Ms. Vesper's vehicles, the bankruptcy court erred in holding that she was eligible to deduct the expenses under the means test.

Significantly, reading "applicable" in section 707(b)(2) this way has the salutory effect of applying the means tests in a manner that is consistent with the Internal Revenue Service's longstanding application of this standard. Under section 707(b)(2), the means test looks to the IRS to establish certain standard expenses. 11 U.S.C. § 707(b)(2)(A)(ii)(I). In applying its standards to taxpayers, the IRS does not allow taxpayers to claim vehicle ownership expenses absent a monthly car payment expense. *See* IRS Collection Financial Standards attached hereto as Exhibit A; *see also* n.3, *supra*. Congress' use of "applicable" in section 707(b)(2) means this expense should be denied to debtors like Ms. Vesper, who do not have a car loan or lease, for the same reasons the IRS does not allow taxpayers to claim such phantom expenses.

Finally, the bankruptcy court's order conflicts with sound notions of public policy and the primary purpose of Congress in passing bankruptcy reform legislation in 2005 – including the amendments at issue in this appeal. The 2005 legislation was intended to ensure that debtors would repay their debts when they can. By allowing Ms. Vesper to claim a phantom expense for her vehicles, the bankruptcy court subverted that purpose.

ARGUMENT

I. <u>The bankruptcy court erred in holding that Ms. Vesper was eligible to claim the IRS Local Standards for vehicle ownership for her vehicles because the expense was not applicable to her.</u>

The bankruptcy court's order denying the United States Trustee's motion to dismiss should be reversed because it fails to recognize that the Bankruptcy Code only allows debtors to claim vehicle ownership expenses that are "applicable" to the debtor. 11 U.S.C. § 707(b)(2)(A)(ii)(I). Ms. Vesper does not have any "applicable" vehicle ownership expense because she owns her vehicles outright. Her attempt to claim what is a phantom expense is prohibited by the Bankruptcy Code because the Code allows debtors to claim only "applicable" expenses, not phantom ones. For this reason, the order entered below merits reversal.

A. ***Vehicle ownership expenses are allowable only if "applicable" to the debtor***.

Section 707(b)(2)(A)(ii)(I) of the Bankruptcy Code provides that a "debtor's monthly expenses shall be the debtor's *applicable* monthly expense amounts specified under the . . . Local Standards . . . issued by the Internal Revenue Service. . . ." 11 U.S.C. § 707(b)(2)(A)(ii)(I) (emphasis added). The statute expressly provides that before the specific IRS expense amounts may be included in the debtor's allowed monthly expenses, the expense must itself first be <u>applicable</u> to the debtor. *Id*.

The Bankruptcy Code does not define the word "applicable," nor has the United States Trustee identified any Supreme Court or Ninth Circuit decision that provides a definition in the bankruptcy context.[8] Where, as here, a statutory term is undefined, a basic principle of statutory

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[8] *But see, Fong v. Glover*, 197 F.2d 710, 711 (9th Cir. 1952) (defining "applicable" as it appears in the Federal Rules of Civil Procedure as "capable of being applied.")

construction provides that courts should give such terms their ordinary meanings. *E.g., Smith v. U.S.*, 508 U.S. 223, 228 (1993) ("When a word is not defined by statute, we normally construe it in accord with its ordinary or natural meaning."). The dictionary defines "applicable" to mean applying or capable of being applied; relevant; suitable; appropriate. *Random House Unabridged Dictionary* (2006). Accordingly, such a meaning should be imparted to the term "applicable" as it appears in section 707(b)(2)(A)(ii)(I) absent clear indication that Congress intended to give such term a different meaning. *See Johnson v. Aljian*, 490 F.3d 778, 780 (9th Cir. 2007) (*quoting U.S. v. TRW Rifle 7.62x51 mm Caliber*, 447 F.3d 686, 689 (9th Cir. 2006) ("[W]e follow the common practice of consulting dictionary definitions to clarify their ordinary meaning[ ] and look to how the terms were defined at the time [the statute] was adopted.").

The bankruptcy court's order is inconsistent with the ordinary, common sense definition of "applicable" because it allows debtors like Ms. Vesper to deduct expenses that do not apply to them. Here, Ms. Vesper seeks to claim a loan or lease payment, but she has none. By inserting the word "applicable" in section 707(b)(2)(A)(ii)(I), Congress limited eligibility for expenses under the Local Standards to debtors for whom such expenses are "relevant; suitable; appropriate" – thereby excluding phantom ones. Because Ms. Vesper did not have vehicle financing expenses for either of her vehicles, the IRS vehicle ownership expense did not apply to *her* for those vehicles.

The only two appellate courts to have considered the issue to date have read "applicable" this way, and both reversed bankruptcy courts that read "applicable" the way the lower court in

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this case did. *See In re Hartwick*, 373 B.R. 645, 650 (D. Minn. 2007) ("word 'applicable' in [section 707(b)(2)(A)(ii)(I)] means that, before the expense amount can be included in the debtor's allowed monthly expenses, the expense itself must actually be applicable to the debtor-in other words, the debtor must actually have a loan or lease payment obligation"); *In re Ross-Tousey*, 368 B.R. 762, 764-67 (E.D. Wis. 2007) (holding that word "applicable" in section 707(b)(2)(A)(ii)(I) means that "ownership expenses must exist" in the form of an actual loan or lease payment). *Cf. In re Devilliers*, 358 B.R. 849, 859 (Bankr. E.D. La. 2007) (debtor may claim IRS ownership expense only after "a determination is made as to the type of expenses allowed <u>and applicable</u> to the debtor"); *In re Carlin*, 348 B.R. 795, 798 (Bankr. D. Or. 2006) (statute plainly and unambiguously does not allow the vehicle operating expense at issue to "free and clear" owners.).

Hartwick and *Ross-Tousey* reversed the lower court rulings in those cases because those courts, like the court here, failed to give the word "applicable" its ordinary meaning. Instead, courts like the one below created an arbitrary distinction between the word "actual" and "applicable" expenses in section 707(b)(2)(A)(ii)(I).[9] *See, e.g., Fowler,* 349 B.R. at 418 ("The use of 'actual' with respect to the Other Necessary Expenses and 'applicable' with respect to the National and Local Standards must mean that Congress intended two different applications.) The bankruptcy court here agreed that "applicable" and "actual" must have different meanings since Congress used both terms in the statute and, therefore, debtors like Ms. Vesper need not

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[9] Section 707(b)(2)(A)(ii)(I) allows debtors to claim deductions for their "applicable" expense amounts specified under the IRS Local and National Standards, as well as "actual" expenses "for the categories specified as Other Necessary Expenses issued by the [IRS]."

have any "actual" expense for the Ownership Expense Standard to be "applicable." (DE 32, p. 5, 9). This logic is misguided, however. As the *Ross-Tousey* court explained, there is no indication in section 707(b)(2)(A)(ii)(I) that Congress intended the words "applicable" and "actual" to have essentially *opposite* meanings. *Ross-Tousey,* 368 B.R. at 765. Rather, as *Ross-Tousey* held, the better reading of "applicable" in the context of section 707(b)(2)(A)(ii)(I) is that it may have two meanings: first, the ownership expense is "applicable" if the debtor makes a loan or lease payment on a vehicle, and second, the *amount* allowed to the debtor is the "applicable" amount provided under the IRS Standards, and not the "actual" amount. *Id.*; *see also Hartwick*, 373 B.R. at 653. "This reading gives meaning to the distinction between 'applicable' and 'actual' without taking a further step to conclude that 'applicable' means 'nonexistent' or 'fictional.'" *Ross-Tousey*, 368 B.R. at 765.

By using the term "applicable" in this way, a determination of allowable expenses under the means test is a two-step process. The first step is eligibility – *i.e.*, does the debtor qualify for an expense allowance in the category at issue? If so, then the second step is to quantify the expense amount the eligible debtor is allowed by looking at the IRS Standard amounts that are specified for the number of vehicles owned by the debtor and where the debtor lives. *See, e.g., Carlin*, 348 B.R. at 798 ("There is nothing absurd in Congress drawing the line for vehicle ownership expense eligibility at those debtors who are making payments on the vehicle."). The bankruptcy court's ruling impermissibly skips the first step of determining whether Ms. Vesper is *eligible* for the Ownership expense by virtue of having a loan or lease payment for a vehicle, and proceeds directly to the second -- only considering the *amount* the IRS would allow eligible taxpayers to claim for ownership of two vehicles.

B. *The UST's construction of "applicable" in section 707(b)(2) has the salutory effect of treating transportation costs the same way in bankruptcy cases that the IRS treats them.*

Reversal of the bankruptcy court's order allowing Ms. Vesper to deduct vehicle financing expenses that she does not have has the additional benefit of treating inapplicable phantom expenses in bankruptcy cases the way the IRS has long treated them. In providing which deductions debtors may take under the means test, Congress specifically stated that debtors are permitted to deduct "the debtor's *applicable* monthly expense amounts specified under the . . .Local Standards . . .issued by the *Internal Revenue Service*." 11 U.S.C. § 707(b)(2)(A)(ii)(I) (emphasis added). Accordingly, how the Internal Revenue Service applies the Standards that it developed for its own internal debt collection purposes is instructive on the question of how the same Standards might be applied in bankruptcy cases under section 707(b)(2). *See, e.g., Hartwick*, 373 B.R. at 650-51 ("in order to determine whether the expense Standards issued by the IRS are 'applicable,' the most logical resource to consult is the IRS"). *See also In re Slusher*, 359 B.R. 290, 309 (Bankr. D. Nev. 2007) ("if guidance is sought on the meaning of the IRS standards that Congress incorporated into the Bankruptcy Code, practical reason would suggest that court should consider the full manner by which the IRS uses these standards.").

The IRS Collection Financial Standards in effect as of the date of Ms. Vesper's bankruptcy filing[10] fully support the United States Trustee's construction of the term "applicable," and provide as follows:

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[10] *See* n.3, *supra*.

> The transportation standards consist of nationwide figures for monthly loan or lease payments referred to as ownership costs, and additional amounts for monthly operating costs . . . . The ownership costs provided maximum allowances for the lease or purchase of up to two automobiles if allowed as a necessary expense . . . . If a taxpayer has a car payment, the allowable ownership cost added to the allowable operating cost equals the allowable transportation expense. **If a taxpayer has no car payment, or no car, the operating costs portion of the transportation standard is used to come up with the allowable transportation expense.**

See IRS Collection Standards attached hereto as Exhibit A (emphasis added); *see also* Internal Revenue Manual, Financial Analysis Handbook, Pt. 5, ch. 15, § 5.15.1.7(4.B), available at http://www.irs.gov/irm/part5/ch15s01.html#d0e187819.

As of the date Ms. Vesper filed her bankruptcy petition,[11] the "ownership cost" was specifically calculated by the IRS based on the cost to finance the acquisition of a vehicle, and not simply a cost associated with owning a car, such as repair or maintenance. The IRS noted that the "ownership cost" Standards are based on the "**five-year average of new and used car financing data compiled by the Federal Reserve Board of Governors**." *See id.* (emphasis added). As such, the IRS does not treat the "ownership cost" expense as applicable when a taxpayer does not have a monthly expense related to financing a car. In exercising its discretion to collect taxes, the IRS recognizes that taxpayers may claim the vehicle "ownership cost" portion of the Local Transportation Standards only in situations where the taxpayer has a monthly vehicle acquisition financing expense, *i.e.*, has a monthly vehicle loan or lease payment. *See id.*

The court below expressed concern that the IRS Manual differs from section 707(b)(2)'s

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[11] *See* Note 3, *supra*.

means test, and that Congress therefore chose to “cherry pick” from the IRS Manual because the Manual lets taxpayers deduct the actual amount of their car payment – up to the cap set out in the IRS’ Local Standards, but the means test allows debtors to claim the full amount of the Local Standard, even if their car payment is less. (DE 32, p. 10, 12). That is irrelevant. The relevant point is the IRS has expressed its discretion to prohibit individuals from claiming a car payment when they have none. The exact same thing happens under the means test because it allows debtors to claim only an “applicable” car expense – not a phantom one.

Further, considering IRS practice in interpreting “applicable” expenses in section 707(b)(2)(A)(ii)(I) does not negate the section’s later allowance of “actual” monthly expenses in the IRS categories of Other Necessary Expenses, as the bankruptcy court erroneously concluded. (DE 32, p. 5, 9). Rather, “a natural reading” of section 707(b)(2)(A)(ii)(I) indicates that the words “actual” and “applicable” limit the relevant expense deductions in different ways. *Slusher*, 359 B.R. at 308. “Had Congress intended to indiscriminately allow all expense amounts specified in the National and Local Standards, it would have written section 707(b)(2)(A)(ii)(I) to read, ‘The debtor’s monthly expenses shall be the monthly amounts specified under the National Standards and the Local Standards ....’ rather than ‘The debtor’s monthly expenses shall be *the debtor’s applicable* monthly expense amounts specified under the National and Local Standards.’” *Id.* (Emphasis in original).

II. The bankruptcy court's order conflicts with the major goals of the 2005 amendments to the Bankruptcy Code.

The bankruptcy court's order is also inconsistent with Congress' goals and purpose in implementing bankruptcy reform.[12] Congress amended the Bankruptcy Code in 2005 to rectify perceived abuses in the bankruptcy process. "Among the abuses identified by Congress was the easy access to chapter 7 liquidation proceedings by consumer debtors who, if required to file under chapter 13, could afford to pay some dividend to their unsecured creditors." *In re Hardacre,* 338 B.R.718, 720 (Bankr. N.D. Tex. 2006) (*citing* 151 Cong. Rec. S2459, 2469-70 (March 10, 2005)). A "primary goal" of the 2005 Reform Act was to "ensure that debtors repay creditors the maximum they can afford." *In re Lenton*, 358 B.R. 651 (Bankr. E.D. Pa. 2006) (*citing* H.R. Rep. No. 109-31, pt. 1, at 1 (2005), *reprinted in* 2005 U.S.C.C.A.N. 88, 89). In cases such as this one, where the debtor has no loan or lease payment, Congress has established a system which does not provide her an expense deduction for vehicle financing. "Allowing debtors to deduct from their disposable income a fictional ownership allowance would give debtors with unencumbered vehicles a windfall at the expense of their unsecured creditors." *In re Howell,* 366 B.R. 153, 157 (Bankr. D.Kan. 2007).

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[12] The bankruptcy court conceded this, stating that its reading of section 707(b)(2)(A)(ii)(I) "may appear to conflict with one of the express purposes of the means testing calculation, which was to 'ensure that debtors repay creditors the maximum they can afford.'" (DE 32, p. 9).

CONCLUSION

For all of these reasons, the United States Trustee respectfully asks this Court to reverse the June 28, 2007 order entered by the bankruptcy court denying the United States Trustee's motion to dismiss, and remand this case to the bankruptcy court for further proceedings.

Respectfully submitted,

ILENE J. LASHINSKY
United States Trustee

By: /s/ Kay Hill
Kay Hill
Assistant U.S. Trustee
Department of Justice
Office of the U.S. Trustee
605 W. 4th Avenue, Room 250
Anchorage, Alaska 99501
Telephone: (907) 271-2600
Facsimile: (907) 271-2610
E-mail: Kay.Hill@usdoj.gov

Of Counsel

Roberta DeAngelis
Acting General Counsel

P. Matthew Sutko
Associate General Counsel
Melissa R. Burgess
Trial Attorney
Executive Office for United States Trustees
Department of Justice
20 Massachusetts Ave., N.W.,
Suite 8000
Washington, D.C. 20530
(202) 307-1399

Victoria Farms II

(Cite as: 1993 WL 901110 (USTBRIEFS))

[*1] Title (TI): MARK ST. ANGELO, UST v. VICTORIA FARMS, INC. — REPLY BRIEF FOR APPELLANT, U.S. TRUSTEE
Court (CO): CTA9, U.S. Court of Appeals (9th Cir.)
Current-Case (CCN): No. 93-15254
Previous-Case (PCN): CV-F-92-5169-REC; 90-15066-A-11F
Source (SO): U.S. TRUSTEES
Date-of-Filing (DA): July 12, 1993
Author (AU): Martha L. Davis, General Counsel & T. Patrick Tinker, Attorney (202-307-1399)
Topic (TO): BANKRUPTCY — Constitutionality & calculation of quarterly fees under 28 U.S.C. § 1930(a)(6).

Summary (SU): 28 U.S.C. § 1930(a)(6) does not permit Debtors to exclude disbursements from secured creditors in calculating the quarterly fee. The District Court erred in exempting payments to secured creditors from the quarterly fee calculation, and this contravenes Congress' intent to fund the USTP. Accord: St. Angelo v. Victoria Farms, 38 F.3d 1525 (9th Cir. 1994), as modified 43 F.3d 969 (9th Cir. 1994) (holding that § 317(a) of the Judicial Improvements Act of 1990 unconstitutionally imposes "non-uniform" fees in bankruptcy).

COURT OF APPEALS CASE NO. 93-15254
DISTRICT COURT CASE NO. CV-F-92-5169-REC
BANKRUPTCY COURT CASE NO. 90-15066-A-11F

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

MARK ST. ANGELO, Acting U.S. Trustee for Region 17
Plaintiff - Appellant
v.
VICTORIA FARMS, INC.,
Defendant - Appellee

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF CALIFORNIA

REPLY BRIEF

MARK ST. ANGELO
Acting United States Trustee for Region 17
250 Montgomery St., Suite 910
San Francisco, CA 94104-3401
(415) 705-3300

MARTHA L. DAVIS
General Counsel
T. PATRICK TINKER
Attorney
Executive Office for United States Trustees
901 E Street, N.W., Suite 780
Washington, D.C. 20530
(202) 307-1399

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ARGUMENT

I. THE UNITED STATES TRUSTEE PROGRAM IS FULLY CONSISTENT WITH THE "UNIFORMITY CLAUSE" OF THE CONSTITUTION.

Victoria Farms, Inc. (the "Debtor") asserts that it is not liable for the United States Trustee's quarterly fees under 28 U.S.C. § 1930(a)(6), because the statute creating the United States Trustee Program and the quarterly fee requirement is unconstitutional on the ground that it violates the Uniformity Clause, Article I, section 8, clause 4, of the U.S. Constitution. Because this argument was not raised before the bankruptcy court, and the District Court declined to address it on appeal (D. Ct. Opinion at 2, n.1), the Debtor seeks to convert it into a jurisdictional claim in order to justify asking this Court to hear the argument now. Thus, the Debtor argues that since the underlying statute is unconstitutional, the United States Trustee is a "non- entity [that] does not have standing to be heard in this case." [**FN**1] (Brief at 3)

The Debtor's belated challenge to the constitutionality of the U.S. Trustee Program should not be heard for the first time in this Court. See Crane v. The Arizona Republic, 972 F.2d 1511, 1520 (9th Cir. 1992); Bolker v. Commissioner, 760 F.2d 1039, 1042 (9th Cir. 1985) ("As a general rule, we will not consider an issue raised for the first time on appeal."). In any event, the challenge is wholly without merit.

[*3] As a preliminary matter, there is a presumption that legislation passed by Congress is constitutional. See, e.g., Duke Power Co. v. Carolina Environmental Study Group, Inc., 438 U.S. 59, 83 (1978); Usery v. Turner Elkhorn Mining Co., 428 U.S. 1, 15 (1976). This presumption is particularly appropriate here.

The Uniformity Clause provides that Congress has the power "To establish an uniform Rule of Naturalization, and uniform Laws on the subject of Bankruptcies throughout the United States . . . ." U.S. Const. art. I, § 8, cl. 4. This Clause was an extension of power to Congress to create a substantive insolvency law, applicable nationwide, in order to prevent one state from denying effect to the relief granted by another state. Since "[u]niformity among state debtor insolvency laws was an impossibility and the practice of passing private bankruptcy laws was subject to abuse if the legislators were less than honest," the Framers "sought to provide Congress with the power to enact uniform laws on the subject enforceable among the States" and "to prohibit Congress from enacting private bankruptcy laws." Railway Labor Executives Ass'n v. Gibbons, 455 U.S. 457, 472 (1982).

The statute governing the U.S. Trustee Program is not an insolvency law; it created a purely administrative program designed to "separate the administrative duties in bankruptcy from the judicial tasks, leaving the bankruptcy judges free to resolve disputes untainted by knowledge of administrative matters unnecessary and perhaps prejudicial to an impartial judicial determination." H.R. Rep. No. 764, 99th Cong., 2d Sess. 18, reprinted in 1986 U.S.C.C.A.N. 5227, 5230. The Program was specifically created to separate certain administrative responsibilities from the courts' adjudicative responsibilities. Because it is an administrative program and not an insolvency law, the U.S. Trustee Program is not subject to the Uniformity Clause at all. [**FN**2]

Even if it were subject to that Clause, however, the Program would qualify as uniform because it applies in essentially the same manner in every area of the country. Hanover National Bank v. Moyses, 186 U.S. 181, 190 (1902) (geographical uniformity satisfied where "general operation of the law is uniform although it may result in certain particulars differently in different states"); see Regional Rail Reorganization Cases, 419 U.S. 102, 158 (1974); Vanston Bondholders Protective Committee v. Green, 329 U.S. 156, 172 (1946) (Frankfurter, J., concurring).

When Congress created the U.S. Trustee Program in the Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, § 224, 92 Stat. 2662 (1978), it established it as a pilot program, with 10 U.S. Trustees appointed to administer 18 federal judicial districts. Following an evaluation of the pilot program, see generally H.R. Rep. No. 764, supra, at 18-20; 1986 U.S.C.C.A.N. at 5230-31, Congress made the U.S. Trustee Program permanent in 1986 for all federal judicial districts, in the Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1986, §§ 301-02, Pub. L. No. 99-554, 100 Stat. 3118-24 (1986). In so doing, however, Congress determined to continue a phase-in of the Program, see In re Prines, 867 F.2d 478, 482 (8th Cir. 1989), grouping pilot districts with non-pilot districts and creating four classes of districts covered by the Program.

[*4] In the first class of districts (consisting of nearly all the original pilot districts), the Program took effect immediately (§ 301); in the second class, it took effect 30 days following certification by the Attorney General but not later than 270 days from the date of enactment (§ 302(d)(1)); in the third, it also took effect 30 days following certification by the Attorney General but not later than 2 years from the date of enactment (§ 302(d)(2)); and in the fourth, it took effect upon election by the district judges in the district but not later than October 1, 1992 (§ 302(d)(3)). [**FN**3] This fourth class of districts, consisting of the districts established for the states of Alabama and North Carolina, is the only class for which the Program is not yet in effect.

The Debtor's argument that this has created a lack of geographical uniformity (Brief at 5-9) cannot be taken seriously, since the statute by its own terms applies in essentially the same manner (other than with respect to its effective date) throughout the United States. In other words, Congress has created a uniform program but has continued the incremental approach it employed originally in establishing the pilot program, by phasing in the permanent program. This phase-in is wholly consistent with the Uniformity Clause: "The uniformity required by Article I, § 8, Clause 4, is geographical, not temporal." In re Penn Central Transportation Co., 384 F. Supp. 895, 916 (Regional Rail Reorg. Ct. 1974) (Friendly, J.) (geographic limitation in statute read as equivalent to temporal limitation outside proscription of Clause). No court has ever invalidated a bankruptcy law on uniformity grounds simply because the law was phased in over a period of time. [**FN**4]

II. THE APPEAL IS NOT MOOT

The Debtor claims that this appeal is moot because the Debtor's bankruptcy case has been dismissed and the Debtor disbursed all of the funds received from the sale. An appeal is not moot, however, unless it is impossible for a court to fashion effective relief. In re Spirtos, 992 F.2d 1004 (9th Cir. 1993); In re International Environmental Dynamics, Inc., 718 F.2d 322, 326 (9th Cir. 1983). The burden is on the movant to demonstrate that an appeal is moot. Matter of the Brickyard, 735 F.2d 1154, 1159 (9th Cir. 1984).

The dismissal of the Debtor's case did not render this appeal moot, because the controversy on appeal does not assume a continuing effort by the Debtor to rehabilitate its financial affairs under the Bankruptcy Code. See, e.g. In re Dahlguist, 751 F.2d 295, 298 (8th Cir. 1985) ("while the dismissal of a bankruptcy action indicates discontinuation of the attempt to restructure the debtor's financial affairs under the auspices of the federal court, it does not necessarily moot all issues collateral or ancillary to the bankruptcy proceedings"); U.S.A. Motel Corp. v. Danning, 521 F.2d 117 (9th Cir. 1975) (compensation issue addressed after dismissal of bankruptcy case); see generally 11 U.S.C. § 349(b) (describing the effect of dismissal). Regardless of whether the case has been dismissed, the Debtor can be held liable for the full amount of quarterly fees at issue in this appeal.

[*5] The distribution of the sale proceeds also does not render the appeal moot, because the U.S. Trustee does not assert a claim to specific funds. If this Court were to reverse the district court, the quarterly fees may be collected from any unencumbered assets held by Victoria Farms, Inc. There is nothing in the record of this appeal demonstrating that a judgment for the amount of the quarterly fees ($3,850) could not be collected from the Debtor, if not now, then in the future.

Beyond these principles which weigh in favor of finding this appeal not moot, are the disturbing factual circumstances of the case. The Debtor remained in chapter 11 for close to one year after the filing of the U.S. Trustee's motion to dismiss the case. During that time, the Debtor utilized the bankruptcy laws to sell a substantial portion of its estate, effecting a distribution of the proceeds without going through the usual plan confirmation procedure. After reaping the benefits of the bankruptcy laws, the Debtor then claimed that it need not pay the quarterly fees owed by all debtors under chapter 11. This Court should entertain the merits of the appeal, to ensure that this Debtor as well as other debtors perform their statutory duty to pay the quarterly fees. Finally, there is the broad precedential effect of the district court's decision, and the effect which such a decision could have on the financing of the United States Trustee Program and the administration of the bankruptcy system.

III. THE SECURED CREDITORS DID NOT OWN THE REAL PROPERTY CONVEYED UNDER THE DEEDS OF TRUST

As the U.S. Trustee demonstrates in his opening brief, all disbursements must be included when calculating the quarterly fee. The Debtor asserts, however, that payments to the beneficiaries of deeds of trust cannot be included, because they constitute property of the beneficiaries, not property of the estate. In other words, the Debtor argues that the deeds of trust effectively conveyed the real property to the trust deed beneficiaries at the time the deeds were created.

The Debtor's contention is contrary to long-established California case law and bankruptcy law. The deeds of trust were not absolute conveyances of the real property, but rather had the effect of creating a lien on the property. The case law cited and quoted by the Debtor is directly contrary to the Debtor's own position. See Monterey S.P. Partnership v. W. L. Bangham, Inc., 49 Cal. 3d 454, 460, 261 Cal. Rptr. 587, 590 (1989), as well as Coast Bank v. Minderhout, 32 Cal. Rptr. 584, 587 (1963), aff'd and opinion vacated on other grounds, 61 Cal.2d 311, 38 Cal. Rptr. 505, 392 P.2d 265 (1964). As the Debtor recognized in its own bankruptcy schedules, the real property became part of the Debtor's bankruptcy estate at the commencement of the case. See 11 U.S.C. § 541(a)(1). The deed of trust beneficiaries then had an interest in "property of the estate", and thus had "secured claims". 11 U.S.C. §§ 101(37) and 506(a). See generally United States v. Whiting Pools, Inc., 462 U.S. 198, 203-04 (1983) (property subject to liens is property of the estate).

[*6] The Debtor's citation of In re Madrid, 725 F.2d 1197 (9th Cir.), cert. denied, 469 U.S. 833 (1984), similarly provides no support for the Debtor's contentions. The case concerned a prebankruptcy sale of real estate, which the debtor attempted to void as a "fraudulent conveyance" under 11 U.S.C. § 548(a). The Court held that the deed of trust was "perfected" more than one year prior to the commencement of the case, and that the lender's interest under the deed of trust therefore could not be avoided. See 11 U.S.C. § 548(d) (defining "transfer" for purposes of section 548 as dating from perfection of a creditors' interest). Madrid, 725 F.2d at 1200.

The Debtor thus cites no good authority for his assertion that payments to trust deed beneficiaries are to be excluded from the calculation of quarterly fees. To the contrary, the plain language of 28 U.S.C. § 1930(a)(6) requires that payments to secured creditors be included as "disbursements" when calculating the quarterly fees. The statute makes no distinctions among the recipients of disbursements, such as those drawn by the district court and the Debtor. Moreover, the exclusion of payments to secured creditors is contrary to the purpose of the statute, because it would absolve many debtors who benefit from chapter 11 from having to pay a substantial portion of the quarterly fees otherwise owing, and would impair an important mechanism chosen by Congress for funding the administration of the bankruptcy system.

CONCLUSION

For all the foregoing reasons, the United States Trustee urges that the orders of the district court be reversed insofar as they exclude payments to secured creditors from the calculation of quarterly fees under 28 U.S.C. § 1930(a)(6).

Respectfully submitted,
MARK ST. ANGELO
Acting United States Trustee for Region 17
250 Montgomery St., Suite 910
San Francisco, CA 94104-3401
(415) 705-3300

MARTHA L. DAVIS
General Counsel
T. PATRICK TINKER
Attorney
Executive Office for United States Trustees
901 E Street, N.W., Suite 780
Washington, D.C. 20530
(202) 307-1399

CERTIFICATE OF SERVICE

I hereby certify that I have served a copy of the foregoing Reply Brief by pre-paid first class mail on this 12th day of July, 1993, upon the person listed below:

Riley C. Walter
McCormick, Barstow, Sheppard, Wayte & Carruth
P.O. Box 24013
1331 Fulton Mall
Fresno, CA 93779-4013

T. Patrick Tinker

FOOTNOTES

FN1. The Debtor's argument that the U.S. Trustee lacks standing to be heard in this case (Brief at 2-3) is based entirely on the contention that the U.S. Trustee Program is unconstitutional. The U.S. Trustee has standing under the Bankruptcy Code to raise and be heard on issues in bankruptcy cases: "The United States trustee may raise and may appear and be heard on any issue in any case or proceeding under this title but may not file a [reorganization] plan pursuant to section 1121(c) of this title." 11 U.S.C. § 307. This includes standing to take an appeal. See In re Clark, 927 F.2d 793, 796 (4th Cir. 1991) (denial of motion to dismiss chapter 7 case); In re Plaza de Diego Shopping Center, Inc., 911 F.2d 820, 824 (1st Cir. 1990) (order appointing chapter 11 trustee); In re Revco D.S., Inc., 898 F.2d 498, 499-500 (6th Cir. 1990) (order refusing to appoint chapter 11 trustee).

FN2. In the same sense, the bankruptcy courts in each district may promulgate local rules that operate solely within the district. Fed. R. Bankr. P. 9029. These local rules do not run afoul of the Uniformity Clause, because they are administrative or procedural -- not substantive -- in nature. See In re Walat, 87 B.R. 408, 412-13 (Bankr. E.D. Va.), aff'd, 89 B.R. 11 (E.D. Va. 1988).

FN3. This date was subsequently extended until October 1, 2002. Judicial Improvements Act of 1990, § 317(a), 104 Stat. 5115 (1990).

FN4. This phase-in has allowed Congress to continue to evaluate the operation of the Program in comparison with the districts in Alabama and North Carolina, where the administrative functions are still being handled by the judiciary. See generally General Accounting Office, Bankruptcy Administration: Justification Lacking for Continuing Two Parallel Programs, Sept. 1992 (GAO/GGD-92-133) (comparison of relative efficiencies, costs, and results achieved in sample districts in each program).

1993 WL 901110 (USTBRIEFS)

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(Cite as: 1993 WL 901111 (USTBRIEFS))

[*1] Title (TI):	MARK ST. ANGELO, UST v. VICTORIA FARMS, INC. — BRIEF FOR APPELLANT, U.S. TRUSTEE
Court (CO):	CTA9, U.S. Court of Appeals (9th Cir.)
Current-Case (CCN):	No. 93-15254
Previous-Case (PCN):	CV-F-92-5169-REC; 90-15066-A-11F
Source (SO):	U.S. TRUSTEES
Date-of-Filing (DA):	May 10, 1993
Author (AU):	Martha L. Davis, General Counsel & T. Patrick Tinker, Attorney (202-307-1399)
Topic (TO):	BANKRUPTCY — Calculation of quarterly fees under 28 U.S.C. § 1930(a)(6).
Summary (SU):	28 U.S.C. § 1930(a)(6) does not permit Debtors to exclude disbursements from secured creditors in calculating the quarterly fee. The District Court erred in exempting payments to secured creditors from the quarterly fee calculation, and this contravenes Congress' intent to fund the USTP. Accord: St. Angelo v. Victoria Farms, 38 F.3d 1525 (9th Cir. 1994), as modified 43 F.3d 969 (9th Cir. 1994) (holding that § 317(a) of the Judicial Improvements Act of 1990 unconstitutionally imposes "non-uniform" fees in bankruptcy).

COURT OF APPEALS CASE NO. 93-15254
DISTRICT COURT CASE NO. CV-F-92-5169-REC
BANKRUPTCY COURT CASE NO. 90-15066-A-11F

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

MARK ST. ANGELO, Acting U.S. Trustee for Region 17
Plaintiff - Appellant
v.
VICTORIA FARMS, INC.,
Defendant - Appellee

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF CALIFORNIA

BRIEF FOR THE APPELLANT

MARK ST. ANGELO
Acting United States Trustee for Region 17
250 Montgomery St., Suite 910
San Francisco, CA 94104-3401
(415) 705-3300

MARTHA L. DAVIS
General Counsel
T. PATRICK TINKER
Attorney
Executive Office for United States Trustees
901 E Street, N.W., Suite 780
Washington, D.C. 20530
(202) 307-1399

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STATEMENT OF THE ISSUE AND STANDARD OF REVIEW

The issue on appeal is whether payments to secured creditors from the proceeds of a sale of secured property are "disbursements" for the purpose of calculating quarterly fees owed by a chapter 11 debtor under 28 U.S.C. § 1930(a)(6).

The Court must review the bankruptcy court's findings of fact under the clearly erroneous standard. Fed. R. Bankr. P. 8013. The lower courts' conclusions of law are reviewed de novo. In re Commercial Western Finance Corp., 761 F.2d 1329, 1333 (9th Cir. 1985). Because the issue on appeal only involves a question of law, the applicable standard of review in this case is de novo.

STATEMENT OF JURISDICTION

This appeal arises from the bankruptcy case of Victoria Farms, Inc. The appeal is taken from the final [**FN**1] orders of the United States District Court for the Eastern District of California, entered on October 6, 1992 and November 24, 1992, reversing in part a final order of the United States Bankruptcy Court for the Eastern District of California, entered on February 6, 1992.

The orders on appeal concern the amount of the quarterly fee owed by the Debtor under 28 U.S.C. § 1930(a)(6). The bankruptcy court's jurisdiction was based on 28 U.S.C. § 157(a), and the district court's jurisdiction was based on 28 U.S.C. § 158(a). This Court's jurisdiction is based on 28 U.S.C. §§ 158(d) and 1291.

[*3] The notice of appeal to the district court was timely filed on February 14, 1992. On October 16, 1992, a timely motion for rehearing under Federal Rule of Bankruptcy Procedure 8015 was filed regarding the district court's order entered October 6, 1992. The notice of appeal from the district court's orders was then timely filed on January 22, 1993, in accordance with Rules 4(a) and 6(b) of the Federal Rules of Appellate Procedure.

STATEMENT OF THE CASE

On October 23, 1990, Victoria Farms, Inc. (the "Debtor") filed for relief under the reorganization provisions of chapter 11 of the Bankruptcy Code, 11 U.S.C. §§ 1101 et seq. The Debtor's bankruptcy estate included a farm that was encumbered by first and second deeds of trust, as well as other liens. Motion for Order Authorizing Distribution of Proceeds and Notice of Hearing Thereon, at 2-4.

On March 11, 1991, the United States Trustee [**FN**2] filed a motion to dismiss or convert the Debtor's case under 11 U.S.C. § 1112(b). B. Ct. Dkt. at 24. Among the various grounds stated in the motion, the United States Trustee asserted that the Debtor had failed to pay fees and charges required under chapter 123 of title 28, including quarterly fees owed under 28 U.S.C. § 1930(a)(6). [**FN**3] Motion to Dismiss or Convert, at 2. The United States Trustee's motion was continued several times during the course of 1991.

On August 15, 1991, the Debtor filed a motion to sell the farm free and clear of liens. B. Ct. Dkt. at 46. On October 4, 1991, the bankruptcy court authorized the Debtor to sell the farm pursuant to the terms of an agreement by the parties. B. Ct. Dkt. at 55. The property was sold to Triple R Farms for the total sum of $594,804.60. Motion for Order Authorizing Distribution of Proceeds and Notice of Hearing Thereon, at 2.

Pursuant to the court's October 4, 1991 order and the sale agreement, the proceeds of the sale were first used to pay the secured claim of Equitable Life Assurance Society of the United States, which held a first deed of trust on the property, and to pay certain real property taxes, assessments and other costs of the sale. [**FN**4] The sum of $5,772.00 was then paid to the Debtor's bankruptcy estate as a surcharge under 11 U.S.C. § 506(c). The balance of the proceeds -- $130,434.98 -- was placed into an account with the Debtor's counsel. The Debtor then filed a motion for authority to distribute the monies in that account. Motion for Order Authorizing Distribution of Proceeds and Notice of Hearing Thereon, at 2-3.

On January 8, 1992, the court heard the United States Trustee's motion to dismiss or convert the case, and the Debtor indicated that it would consent to a dismissal of its case following distribution of the sale proceeds from the impound account. Transcript of January 8, 1992, at 3-4. The United States Trustee's motion was continued to January 29, 1992, to be heard in conjunction with the Debtor's motion for authorization to distribute the balance of the sale proceeds.

[*4] The United States Trustee objected to the Debtor's proposed treatment of the sale proceeds, asserting that the Debtor should be required to pay quarterly fees on the disbursements to the first lienholder and the other claimants. The quarterly fees based on all these disbursements would total $4,250.00, [**FN**5] and would be payable from any unencumbered assets of the estate (for example, the surcharge of $5,772.00 that was recovered by the Debtor under 11 U.S.C. § 506(c)). The United States Trustee requested that the Debtor's dismissal be conditioned on the payment of such quarterly fees. Objection to Motion for Distribution of Proceeds, at 2.

In its opinion dated February 5, 1992, the bankruptcy court held that the quarterly fees may be calculated only on the basis of "direct" disbursements by the Debtor. [**FN**6] Insofar as the Debtor had agreed to pay the minimal quarterly fees owing under section 1930(a)(6), as determined without reference to payments of the sale proceeds, the court dismissed the Debtor's case without conditioning the dismissal on payment of the additional quarterly fees sought by the United States Trustee. B. Ct. Memorandum Opinion, at 7.

On appeal, the district court reversed in part. The district court held that quarterly fees must be calculated on the basis of direct and indirect disbursements. D. Ct. Opinion, at 10. Neither the United States Trustee nor the Debtor have appealed the district court's resolution of that issue. The district court, however, then further held that quarterly fees cannot be based on amounts disbursed to secured creditors. Id. The United States Trustee appeals that discrete issue.

SUMMARY OF THE ARGUMENT

The plain language of 28 U.S.C. § 1930(a)(6) requires that a quarterly fee be paid by every chapter 11 debtor based on the disbursements that have been made in the case, without distinction as to types of disbursements. The district court's exclusion of payments to secured creditors is contrary to the language of the quarterly fee statute and finds no cognizable support in the case law interpreting the statute. The statute does not call for case-by-case determinations on questions such as who paid the monies on behalf of the debtor, who received the funds, or the nature of the claim that was paid. Payments made to secured creditors, or to any other types of creditors, constitute disbursements under the plain language of 28 U.S.C. § 1930(a)(6).

In addition, the exclusion of payments to secured creditors will seriously undermine the mechanism that Congress has established to fund the United States Trustee Program. Payments to secured creditors occur frequently in chapter 11 cases, where debtors' assets are generally heavily encumbered by mortgages and other liens. The exclusion of payments to secured creditors under section 1930(a)(6) will significantly impede the fiscal balance struck by Congress in its provision for funding the administrative responsibilities of the Program.

ARGUMENT

I. THE PLAIN LANGUAGE OF 28 U.S.C. § 1930(a)(6) DOES NOT PERMIT THE DEBTOR TO EXCLUDE DISBURSEMENTS TO SECURED CREDITORS IN CALCULATING THE QUARTERLY FEE

[*5] By law, every debtor with a case pending under chapter 11 of the Bankruptcy Code must pay a fee each quarter to the United States Trustee. 28 U.S.C. § 1930(a)(6). The quarterly fee calculation is simple and straightforward. The statute provides as follows:

> (6) In addition to the filing fee paid to the clerk, a quarterly fee shall be paid to the United States trustee, for deposit in the Treasury, in each case under chapter 11 of title 11 for each quarter (including any fraction thereof) until a plan is confirmed or the case is converted or dismissed, whichever occurs first. The fee shall be $250 for each quarter in which disbursements total less than $15,000; $500 for each quarter in which disbursements total $15,000 or more but less than $150,000; $1,250 for each quarter in which disbursements total $150,000 or more but less than $300,000; $3,750 for each quarter in which disbursements total $300,000 or more but less than $3,000,000; $5,000 for each quarter in which disbursements total $3,000,000 or more. The fee shall be payable on the last day of the calendar month following the calendar quarter for which the fee is owed.

28 U.S.C. § 1930(a)(6). The plain language of the statute imposes no limitations on "disbursements."

"The search for Congressional intent begins with the language of the statute," Steadman v. SEC, 450 U.S. 91, 97 (1981). In interpreting the language, "the fundamental canon of statutory construction is that... words will be interpreted as taking their ordinary... common meaning." Perrin v. United States, 444 U.S. 37, 42 (1979). See also Wilshire Westwood Assoc. v. Atlantic Richfield Corp., 881 F.2d 801, 803-04 (9th Cir. 1989).

The district court properly recognized that the term "disbursements" is not defined in the statute, and that "Congress has 'provided absolutely no discussions regarding the definition of 'disbursements'." D. Ct. Opinion, at 9 (quoting In re Wernerstruck, Inc., 130 B.R. 86, 88 (D.S.D. 1991) and In re Ozark Beverage Co., 105 B.R. 510, 512 (Bankr. E.D. Mo. 1989)). "Therefore, the court must rely solely on the plain meaning of the statute in order to determine Congress' intent in enacting the statute." Opinion, at 9 (citing Ozark Beverage Co., 105 B.R. at 512). Black's Law Dictionary (6th ed. 1990) defines "disbursement" as "to pay out, commonly from a fund. To make payment in settlement of a debt or account payable." In this case, the disbursements of the sale proceeds of the Debtor's property were clearly payments from a fund in settlement of debts.

In applying this "plain meaning" approach, the district court concluded:

> the ordinary, plain meaning of the statutory language is that payments made by the debtor attributable to property of the debtor whether directly or by a third party acting on the debtor's behalf are to be included in calculating the fees due to the United States trustee pursuant to Section 1930(a)(6).

[*6] D. Ct. Opinion, at 10. The United States Trustee agrees with the district court's conclusion to the extent that it reversed the bankruptcy court and found that payments made on behalf of a debtor must be included in the quarterly fee calculation without regard to whether the debtor made the payment "directly" -- because the statute does not make distinctions based on who actually paid out the monies.

The district court erred, however, when it then proceeded to carve out an exception for payments made to secured creditors from the proceeds of their collateral. The statute refers only to disbursements, and does not distinguish between disbursements to secured and unsecured creditors. Consequently, the distinction cannot be read into section 1930(a)(6). As the district court itself noted in reversing the bankruptcy court's decision, the court must rely on the plain meaning of the statute to determine Congress' intent, and "[t]here is a basic difference between filling a gap left by Congress' silence and rewriting rules that Congress has affirmatively and specifically enacted." D. Ct. Opinion, at 9 (citing Mobil Oil Corp. v. Higginbotham, 436 U.S. 618, 625 (1978)).

The United States Trustee is unaware of any case law providing plausible support for the district court's decision. Rather, the "plain meaning" approach to section 1930(a)(6) has been universally followed in a variety of contexts. See, e.g., In re Hays Builders, Inc., 144 B.R. 778, 780 (W.D. Tenn. 1992), reversing 96 B.R. 142 (Bankr. W.D. Tenn. 1989) ("disbursements" include both direct and indirect payments); In re Wernerstruck, Inc., 130 B.R. 86 (D.S.D. 1991), reversing 122 B.R. 1017 (Bankr. D.S.D. 1991) ("disbursements" include debtor's prepayments on revolving line of credit); Ozark Beverage Co., 105 B.R. 510 (Bankr. E.D. Mo. 1989) ("disbursements" include payment of post-petition expenses); See also In re Torres-Ruiz, 123 B.R. 696 (D.P.R. 1990) (quarterly fees are owed even when no disbursements have been made, because the language of the statute does not require minimal disbursements).

Indeed, some of the very cases cited by the district court in construing section 1930(a)(6) involved quarterly fees based on disbursements to secured creditors. See Hays Builders, 96 B.R. at 143; Ozark Beverage Co., 105 B.R. at 511 (Bankr. E.D. Mo. 1989). Those courts applied the "plain meaning" approach without finding it necessary to distinguish between disbursements to secured and unsecured creditors. In Hays Builders, the debtor owned certain real property that was subject to mortgages as well as other liens. The debtor sold the property during the reorganization proceeding, and a portion of the sale proceeds was then disbursed to secured creditors through a third party. 144 B.R. at 779-80. The district court in Hays Builders simply applied the statute as written, rejecting the purported distinction between direct and indirect disbursements.

[*7] The court in Ozark Beverage Co. similarly applied the statute as written. Ironically, the debtor in Ozark Beverage Co. argued that disbursement "means any payment to a pre-petition secured creditor"! 105 B.R. at 511. The court in that case rejected the debtor's argument that only such payments are disbursements under section 1930(a)(6), and concluded that payments of administrative expenses incurred during the case were also disbursements.

In summary, the district court below purported to apply a "plain meaning" approach to the statute, but then created an exception that finds no plausible basis in the language of the statute.

II. THE COURT ERRED IN DETERMINING THAT PAYMENTS TO SECURED CREDITORS ARE EXEMPT FROM THE QUARTERLY FEE CALCULATION

In its opinion of October 6, 1992, the district court stated:

> [T]he court concludes that the ordinary, plain meaning of the statutory language is that payments made by the debtor attributable to property of the debtor whether directly or by a third party acting on the debtor's behalf are to be included in calculating the fees due to the United States trustee pursuant to Section 1930(a)(6). This construction excludes any payment made to a secured creditor of the proceeds of the sale of that security. However, it does not exclude distributions of proceeds of the sale of secured property to the debtor or persons or entities other than the secured creditor or secured creditors.
>
> Therefore, the court reverses the Bankruptcy Court to the extent that its ruling implies that no distribution of proceeds of the sale of property securing a debt is a "disbursements" within the meaning of the statute.

D. Ct. Opinion at 10 (emphasis added). The opinion presents little more than a conclusory statement that payments to secured creditors from the proceeds of collateral are not disbursements for purposes of section 1930(a)(6). [**FN**7]

While the United States Trustee can only speculate as to the basis for the district court's distinction, presumably the court believed that the proceeds of a sale of collateral are not "attributable to property of the debtor." See also Transcript of November 16, 1992, at 6-7 (district court questioned the extent of the Debtor's "equity" interest in the property). However, under the bankruptcy laws, the Debtor clearly had an interest in the real estate and its proceeds.

Pursuant to 11 U.S.C. § 541(a)(1), property of the estate includes "all legal or equitable interests of the debtor in property as of the commencement of the case." The real estate was therefore "property of the estate" pursuant to 11 U.S.C. § 541(a)(1). The Debtor recognized this very fact when it listed the farm on its schedule of assets at the commencement of the Bankruptcy Case. B. Ct. Dkt. at 1. Consequently, the sale proceeds also constituted property of the estate pursuant to 11 U.S.C. § 541(a)(6). See Bradt v.

Woodlawn Auto Workers, F.C.U., 757 F.2d, 515 (1st Cir. 1985) (the conversion of property from one form to another does not alter its character as estate property); cf. Reconstruction Finance Corp. v. Cohen, 179 F.2d 773, 776 (10th Cir. 1950).

[*8] The presence of deeds of trust on the property does not negate the interest of the Debtor's bankruptcy estate in the property. "In practical effect, if not in legal parlance, a deed of trust is a lien on the property." Monterey S.P. Partnership v. W. L. Bangham, Inc., 49 Cal.3d 454, 460, 261 Cal. Reptr. 587, 590 (1989). While the real estate was subject to security interests and other liens, the property was nonetheless owned by the Debtor prior to the commencement of the case, and that interest passed to the bankruptcy estate. Of course, the bankruptcy estate's interest was held subject to the liens, and provided a means of recourse if the Debtor did not pay the debts owed to those creditors. But the Debtor retained the right to use the property in the bankruptcy case on behalf of the bankruptcy estate.

Moreover, the bankruptcy estate's interest in mortgaged property was recognized by the United States Supreme Court in United States v. Whiting Pools, Inc., 462 U.S. 198, 203-204 (1983):

> [T]o facilitate the rehabilitation of the debtor's business, all the debtor's property must be included in the reorganization estate.
>
> This authorization extends even to property of the estate in which a creditor has a secured interest. §§ 363(b) and (c); see H.R. Rep. No. 95-595, p. 182 (1977). Although Congress might have safeguarded the interests of secured creditors outright by excluding from the estate any property subject to a secured interest, it chose instead to include such property in the estate and to provide secured creditors with "adequate protection" for their interests.

(emphasis supplied).

The United States Trustee therefore maintains that the disbursements of the sale proceeds to the secured creditors must be considered disbursements under section 1930(a)(6). [**FN**8]

III. THE DISTRICT COURT'S DECISION CONTRAVENES CONGRESS' INTENT TO FUND THE UNITED STATES TRUSTEE PROGRAM

The United States Trustee plays an important role in supervising the administration of bankruptcy cases, and that role is financed by those who invoke the protections of the bankruptcy laws. [**FN**9] In chapter 11 cases, the United States Trustee receives a portion of the filing fee that is paid at the commencement of the chapter 11 case, 28 U.S.C. § 1930(a)(3), as well as a fee that is paid each quarter during the case, 28 U.S.C. § 1930(a)(6). The quarterly fee is gauged by the amount of money disbursed by the debtor, and the time for payment is specified in the statute. The debtor's obligation to pay the quarterly fee arises by operation of law, and "no court order or other judicial act is a prerequisite, either to fix the amount of the fee or to require its payment." In re K & M Printing & Lithographing, Inc., 135 B.R. 404, 406 (Bankr. D. Or. 1992).

Any decision that contravenes the express language of this statute adversely affects the fiscal balance struck by Congress. The quarterly fee was designed to apportion the cost of the United States Trustee Program fairly on users, and the statute ensures that the Program "will be paid for by the users of the bankruptcy system -- not by the taxpayer". H.R. Rep. No. 764, 99th Cong., 2d Sess. 22 (1986), reprinted in 1986 U.S.C.C.A.N. 5227, 5234 (1986). "The U. S. Trustee Program should not have to be self-funding... However, in this time of budget deficit concerns, self-funding becomes a necessity." Id. at 26. Where Congress has drafted a statute so as to carry out a manifest fiscal purpose, the courts should construe the provision so as to fully effectuate that purpose. Cf. Federal Crop Ins. Corp. v. Merrill, 332 U.S. 380, 385 (1947) (duty of the courts in protecting the public fisc).

[*9] Congress surely crafted the quarterly fee provision with knowledge of the impact it would have on chapter 11 debtors. Modest fees are assessed on a graduated scale according to the amounts of moneys disbursed in a case. A ceiling was also imposed, such that the quarterly fee cannot exceed $5,000 per quarter.

This funding mechanism is seriously jeopardized by any decision that allows payments to secured creditors to be excepted from the otherwise clear application of the statute. Payments to secured creditors are pervasive in chapter 11 cases, because debtors seldom have substantial unencumbered assets. Secured creditors frequently have a lien on all of a debtor's assets, including cash. Payments from such "cash collateral" regularly occur pursuant to the terms of prebankruptcy loan agreements (e.g. installment loans), pursuant to postpetition financing arrangements under 11 U.S.C. § 364 (e.g. revolving lines of credit), and as adequate protection payments under 11 U.S.C. 361. This appeal thus presents just one of the circumstances in which the general rule announced by the district court will adversely impact the fiscal balance struck by Congress.

Finally, recognition must be given to the basic premise for assessing the quarterly fees. The quarterly fee is a "user fee", assessed against the debtor who benefits from the provisions of chapter 11 of the Bankruptcy Code. The rights and responsibilities of a debtor in chapter 11 are inextricably tied with the United States Trustee's administrative responsibilities in the case. The Debtor in the instant case had full advantage of the protections afforded by chapter 11 for more than 15 months, and was able to retain possession of its assets until they could be sold, at which point the Debtor then consented to dismissal.

As a corollary to the benefits obtained from chapter 11, the Debtor is obligated to pay quarterly fees. [**FN**10] The amount of those fees is based on one objective criteria -- the disbursements in the case. By employing this simple unit of measure, Congress clearly did not intend that the quarterly fee calculation should turn on labels or distinctions such as the one the district court attempts to create here. Just as the courts in the past refused to read exceptions into the referee's salary statute, § 40(c)(2) Bankruptcy Act of 1898 (11 U.S.C. § 68(c)(2)(a), repealed 1979), the Court should refrain from creating an exception to the clear language of 28 U.S.C. § 1930(a)(6). "The fact that the rules do not permit the tailoring of fees to particular circumstances does not lessen their validity; to the contrary, this approach is in keeping with the clearly expressed will of Congress." In re Shoreline Concrete Co., 831 F.2d 903, 906 (9th Cir. 1987) (upholding the Judicial Conference's rules that established a "bright-line" test for the payment of the user fees that funded bankruptcy referees' salaries).

CONCLUSION

For all the foregoing reasons, the United States Trustee urges that the orders of the district court be reversed insofar as they exclude payments to secured creditors from the calculation of quarterly fees under 28 U.S.C. § 1930(a)(6).

[*1]0 Respectfully submitted,

MARK ST. ANGELO
Acting United States Trustee for Region 17
250 Montgomery St., Suite 910
San Francisco, CA 94104-3401
(415) 705-3300

MARTHA L. DAVIS
General Counsel
T. PATRICK TINKER
Attorney
Executive Office for United States Trustees
901 E Street, N.W., Suite 780
Washington, D.C. 20530
(202) 307-1399

STATEMENT OF RELATED CASES

The Appellant has knowledge of no related cases currently pending before this court.

STATEMENT REGARDING THE BANKRUPTCY COURT

This appeal arises from a proceeding that was initially decided by a bankruptcy court. Pursuant to Ninth Circuit Rule 28-2.9, the Appellant hereby informs the Court that the initial order in this matter was issued by the Honorable Richard T. Ford, United States Bankruptcy Judge, United States Bankruptcy Court for the Eastern District of California, United States Courthouse, 1130 "O" Street, Fresno, California, 93721.

CERTIFICATE OF SERVICE

I hereby certify that I have served a copy of the foregoing brief by pre-paid first class mail on this 10th day of May, 1993, upon the person listed below:

Riley C. Walter
McCormick, Barstow, Sheppard, Wayte & Carruth
P.O. Box 24013
1331 Fulton Mall
Fresno, CA 93779-4013

T. Patrick Tinker

-- FOOTNOTES --

FN1. In bankruptcy matters, "the rules of finality developed under ... 28 U.S.C. § 1291 (1982) are given a flexible reading." In re Victoria Station, Inc., 840 F.2d 682, 683 (9th Cir. 1988). The issue on appeal concerns the types of disbursements that must be considered in determining the quarterly fee. Because the district court determined that the amount of the quarterly fee should have been based on disbursements that included payments not considered by the bankruptcy court, the district court remanded for the bankruptcy court to reassess the quarterly fee owing by the Debtor and to reconsider whether a contingent dismissal might have been appropriate given the district court's construction of 28 U.S.C. § 1930(a)(6). The remand is ministerial, because the amount of the quarterly fee owing under 28 U.S.C. § 1930(a)(6) does not change with the district court's analysis, so that the district court's decision effectively determined the outcome of the case. See In re Stanton, 766 F.2d 1283, 1287-88 (9th Cir. 1985); In re Crevier, 820 F.2d 1553, 1555 (9th Cir. 1987).

FN2. The United States Trustee is an official of the United States Department of Justice, charged by statute with the duty to oversee and supervise the administration of bankruptcy cases. 28 U.S.C. § 586(a). The United States Trustee is expressly given standing under 11 U.S.C. § 307 to raise and be heard on any issue under title 11, except that the United States Trustee may not file a chapter 11 plan of reorganization.

FN3. The quarterly fees are payable to the United States Trustee and deposited in the United States Trustee System Fund pursuant to 28 U.S.C. 589a(b)(5) and (f)(2), for use as a source of appropriated funds for the United States Trustee Program.

FN4. Specifically, Equitable Life Assurance Society of the United States received $421,447.57 because of its first priority lien on the property. Apparently, the sum of $37,150.05 was then paid for various taxes, assessments and costs of the sale. Motion for Order Authorizing Distribution of Sale Proceeds and Notice of Hearing Thereon, at 2-3. The propriety of these payments is not at issue.

FN5. The sum of $3,750.00 would have been owed for the fourth quarter of 1991, based on disbursements of sale proceeds exceeding $300,000. The sum of $500.00 would have been owed for the first quarter of 1992, based on disbursements of the balance of the sale proceeds. The Debtor has paid $400.00 in fees for the two quarters. The Debtor therefore still owes $3,850.00 of the total $4,250.00.

FN6. The disbursements at issue had not been made by the Debtor directly but by an escrow agent, and then by the Debtor's counsel. Response to Objection to Motion for Distribution of Proceeds, at 3.

FN7. Because the court's analysis was so cursory, the United States Trustee moved the district court for a rehearing, noting the lack of authority for the court's position. D. Ct. Dkt. at 37. The district court denied that motion in a per curiam order that does nothing further to explain its analysis. D. Ct. Dkt. at 41.

FN8. Because the real estate and its proceeds were clearly property of the estate, this Court need not address the issue of whether, in fact, disbursements must be "attributable to property of the debtor".

FN9. The responsibilities and duties of the United States Trustee are set forth at 28 U.S.C. § 586(a) and throughout the Bankruptcy Code. The sources of funding for the United States Trustee Program are set forth at 28 U.S.C. § 589a.

FN10. Failure to pay the quarterly fees can be a ground for dismissal or conversion of the case under 11 U.S.C. § 1112(b)(10).

1993 WL 901111 (USTBRIEFS)

END OF DOCUMENT

Victoria Farms III

(Cite as: 1994 WL 1004481 (USTBRIEFS))

[*1] Title (TI):	MARK ST. ANGELO, UST v. VICTORIA FARMS, INC. — PETITION FOR PANEL REHEARING BY APPELLANT, U.S. TRUSTEE
Court (CO):	CTA9, U.S. Court of Appeals (9th Cir.)
Current-Case (CCN):	No. 93-15254
Previous-Case (PCN):	CV-F-92-5169-REC; 90-15066-A-11F
Source (SO):	U.S. TRUSTEES
Date-of-Filing (DA):	December 15, 1994
Author (AU):	Martha L. Davis, General Counsel & T. Patrick Tinker, Attorney (202-307-1399)
Topic (TO):	BANKRUPTCY — Constitutionality & calculation of quarterly fees under 28 U.S.C. § 1930(a)(6).
Summary (SU):	Arguing that: (1) the panel majority failed to give proper consideration to the administrative nature of the UST's statutory duties; (2) the panel majority failed to give appropriate deference to Congress's statutory plan; & (3) the panel's decision disrupts the USTP & encourages nationwide litigation. Accord: St. Angelo v. Victoria Farms, 38 F.3d 1525 (9th Cir. 1994), as modified 43 F.3d 969 (9th Cir. 1994) (holding that § 317(a) of the Judicial Improvements Act of 1990 unconstitutionally imposes "non-uniform" fees in bankruptcy).

No. 93-15254

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

LINDA EKSTROM STANLEY, U.S. Trustee for Region 17,
Plaintiff-Appellant,
v.
VICTORIA FARMS, INC.,
Defendant-Appellee.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF CALIFORNIA

PETITION FOR PANEL REHEARING

FRANK W. HUNGER
Assistant Attorney General
CHARLES JOSEPH STEVENS
United States Attorney
MARK B. STERN
(202) 514-5089
EDWARD HIMMELFARB
(202) 514-3547
Attorneys, Appellate Staff
Civil Division, Room 7124
Department of Justice
Washington, D.C. 20530-0001

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[*2] In re Walat, 87 Bankr. 408 (Bankr. E.D. Va.), aff'd, 89 Bankr. 11 (E.D. Va. 1988)
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Uniformity Clause, U.S. Const., art. I, § 8, cl. 4 . . passim

Statutes:

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General Accounting Office, Bankruptcy Administration: Justification Lacking for Continuing Two Parallel Programs, Sept. 1992 (GAO/GGD-92-133)

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

No. 93-15254

LINDA EKSTROM STANLEY, U.S. Trustee for Region 17, [**FN**1]
Plaintiff-Appellant,
v.

VICTORIA FARMS, INC.,
Defendant-Appellee.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF CALIFORNIA

PETITION FOR PANEL REHEARING

Pursuant to Rule 40 of the Federal Rules of Appellate Procedure, the appellant, Linda Ekstrom Stanley, U.S. Trustee for Region 17, hereby petitions for panel rehearing as to Part III.A. of the panel's opinion.

INTRODUCTION

This case involves a constitutional challenge under the Uniformity Clause [**FN**2] to the U.S. Trustees Program, which operates as an agency within the Department of Justice and is charged with conducting the administrative oversight for the bankruptcy system at present, in all but six federal judicial districts.

Prior to 1982, when the Supreme Court struck down a substantive law governing the bankruptcy of only one railroad in the entire country, it "ha[d] never invalidated a bankruptcy law for lack of uniformity," Railway Labor Executives Ass'n v. Gibbons, 455 U.S. 457, 469 (1982), and it has never done so again. In Uniformity Clause cases, the Supreme Court has not undertaken a searching review of Congress's actions; it has held that "[t]he uniformity requirement is not a straitjacket" for Congress, id., and that there is "flexibility inherent in" the clause. Regional Rail Reorganization Act Cases, 419 U.S. 102, 158 (1974).

The panel majority here unnecessarily reached out to invalidate part of an Act of Congress under the Uniformity Clause -- unnecessarily, because the panel's constitutional determination in Part III.A. of its decision had no effect on the ultimate disposition of this litigation. The majority's ruling was also incorrect; it failed to give proper consideration to the administrative nature of the U.S. Trustees' statutory duties and to give proper deference to the deliberate congressional decision to phase the Program in gradually. The panel's decision was not compelled by the policies of the Uniformity Clause or the case law, and put this Court at odds with another circuit. Its effect is to create uncertainty in the U.S. Trustees Program, and to encourage a constitutional challenge by every person outside the Ninth Circuit who claims to be adversely affected by the operation of the Program. We, therefore, request that the panel rehear this case and withdraw Part III.A. of its decision.

STATEMENT

A. THE UNITED STATES TRUSTEES PROGRAM.

[*3] 1. The U.S. Trustees Program was created by Congress in 1978 in order to "separate the administrative duties in bankruptcy from the judicial tasks, leaving the bankruptcy judges free to resolve disputes untainted by knowledge of administrative matters unnecessary and perhaps prejudicial to an impartial judicial determination." H.R. Rep. No. 764, 99th Cong., 2d Sess. 18, reprinted in 1986 U.S.C.C.A.N. 5227, 5230. Until the Bankruptcy Reform Act was passed in 1978, administration of individual bankruptcy cases was the responsibility of bankruptcy judges.

Because of the bankruptcy judges' "dual responsibilities -- administrative and judicial," there was a "close relationship between bankruptcy judges, trustees, trustees' attorneys, and the bankruptcy bar that led to the perception that there was a 'bankruptcy ring' that had the inside track on all bankruptcy matters." General Accounting Office, Bankruptcy Administration: Justification Lacking for Continuing Two Parallel Programs, Sept. 1992 (GAO/GGD-92-133), at 4; see H.R. Rep. No. 595, 95th Cong., 2d Sess. 95, reprinted in 1978 U.S.C.C.A.N. 5963, 6056-57 (discussing "bankruptcy ring"). Congress, accordingly, created the U.S. Trustees Program as an agency within the Department of Justice to take over the administrative responsibilities for bankruptcy cases.

The administrative duties of the U.S. Trustees are set forth in 28 U.S.C. 586(a). Principally, the U.S. Trustee is to "establish, maintain, and supervise a panel of private trustees that are eligible and available to serve as trustees in cases under chapter 7 of title 11," and to "supervise the administration of" chapter 7, 11, or 13 bankruptcy cases by "monitoring applications [by a trustee, examiner, or professional person] for compensation and reimbursement," "monitoring plans and disclosure statements" in chapter 11 cases, "monitoring plans filed under chapters 12 and 13," ensuring that "all reports, schedules, and fees required to be filed" under titles 11 and 28 of the United States Code are properly and timely filed, "monitoring creditors' committees appointed under title 11," making criminal referrals to the United States Attorney, "monitoring the progress of cases under title 11" to prevent undue delay, and "monitoring applications filed [for employment of professional persons] under section 327 of title 11." 28 U.S.C. 586(a)(1) & (3)(A) - (H). In addition, the U.S. Trustee is authorized to serve as a bankruptcy trustee when required under title 11 and to deposit or invest money received as bankruptcy trustee in such cases. 28 U.S.C. 586(a)(2), (4) & (5). Finally, the U.S. Trustee is instructed to "make such reports as the Attorney General directs." 28 U.S.C. 586(a)(6).

The U.S. Trustees Program is designed to be self-financing through the imposition of fees paid out of the debtor's estate. There is a statutory schedule of quarterly fees found in 28 U.S.C. 1930(a)(6).

2. Congress initially established the U.S. Trustees Program in 1978 as a pilot program in 18 federal judicial districts. Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, § 1501, 92 Stat. 2652 (1978). Following an evaluation of the pilot program, Congress made the U.S. Trustees Program permanent in 1986 for all federal judicial districts. However, Congress decided to phase in the Program, bringing some districts into the program later than others. [**FN**3] Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1986, §§ 301-02, Pub. L. No. 99-554, 100 Stat. 3118-24 (1986). The last six judicial districts, covering the states of Alabama and North Carolina, were to come within the Program no later than October 1, 1992, and in the meantime the

administrative duties were handled by the Bankruptcy Administrator system, an independent program within the judicial branch. In 1990, Congress extended the deadline for those six districts to October 1, 2002. Judicial Improvements Act of 1990, § 317(a), 104 Stat. 5115 (1990).

B. STATEMENT OF FACTS AND COURSE OF PROCEEDINGS.

[*4] 1. Victoria Farms, Inc., is a chapter 11 debtor whose bankruptcy estate included real property subject to first and second deeds of trust and various liens. In October 1991, the debtor obtained bankruptcy court approval of the sale of the real property. The proceeds of sale were to go first to pay the holder of a first deed of trust on the property, and then to pay real property taxes and other charges. The balance of sale proceeds would be placed in an impound account controlled by the debtor-in-possession's counsel. (Dist. Ct. Op. at 4)

In January 1992, the debtor moved for an order authorizing distribution of the sale proceeds, and the U.S. Trustee objected on the ground that the debtor should be required to pay the quarterly fees owing the U.S. Trustee under § 1930(a)(6) for the fourth quarter of 1991 and the first quarter of 1992. The bankruptcy court granted the debtor's motion and dismissed the case, ordering that the U.S. Trustee's quarterly fees be "calculated only on actual disbursements and not on constructive disbursements." (Bankr. Ct. Judg.) Although it is not clear from the opinion, it appears that the bankruptcy court considered the disbursement from the impound account to have been "constructive" because it was made by someone other than the debtor, namely, the debtor's counsel.

The U.S. Trustee appealed to the district court. The court declined to address the debtor's Uniformity Clause challenge to the U.S. Trustees Program, since it had not been raised below. (Dist. Ct. Op. at 2 n.1) The court held that a disbursement was to be excluded from calculation of the quarterly fee only if it was a payment made to a secured creditor from the proceeds of the underlying property. (Id. at 10) It remanded the case to the bankruptcy court to assess the U.S. Trustee's quarterly fees. (Id. at 11)

2. The U.S. Trustee then took an appeal to this Court, arguing that the district court's standard for calculating the quarterly fee was incorrect. This Court reversed, over a partial dissent by Judge Poole.

The panel majority first determined that it was appropriate to consider the constitutional issue even though it had not been addressed by the district court, and held that section 317(a) of the Judicial Improvements Act of 1990 -- the ten-year extension of the opt-in deadline for the judicial districts in Alabama and North Carolina -- violated the Uniformity Clause. The majority held that the U.S. Trustee statute was substantive and not administrative, because it "governs the relationship between creditor and debtor," and "has a concrete effect upon the relief available to creditors." Slip op. at 13243. The majority stated that there could be no "geographically isolated problems" that would justify the non-uniformity; since creditors and debtors in Alabama and North Carolina are governed by a less costly system, section 317 violated the Uniformity Clause. Id. at 13244, 13246. Observing that Congress had provided no explicit rationale for the phase-in, the majority declared that "[u]nder any standard of review, when Congress provides no justification for enacting a non-uniform law, its decision can only be considered to be irrational and arbitrary." Id. at 13246.

[*5] Based on what it described as principles of "judicial restraint," id. at 12347, the panel majority held that only the 1990 extension of the effective date for the six districts in Alabama and North Carolina was invalid, and not the entire Program. The result, in the majority's view, was a valid uniform law that could properly be applied to the debtor before it. Accordingly, the majority turned to the fee issue, and held that the U.S. Trustee was entitled to his fee.

A partial dissent by Judge Poole criticized the majority for "deciding a constitutional issue which has not effect on the review of the controversy before it, but which will undoubtedly spawn litigation" in other courts. Id. at 13254 (dissenting opinion). The dissent also explained that the panel had "assume[d], without any empirical footing, a great deal about the effect of the United States Trustee on the relationship between debtors and creditors," noting that there was "tremendous local variation in the practice of bankruptcy" independent of the U.S. Trustee. Id. Finally, the dissent observed that the U.S. Trustee's presence appears to make resolution of bankruptcy matters "more cost efficient," id. at 13255, rather than more expensive, as the majority believed. The majority's conclusion about the law's constitutionality was based on "empirical conjectures" of the sort "best left to Congress," which had decided to introduce the Program throughout all geographic regions of the country in four separate stages. Id.

ARGUMENT

I. THE PANEL MAJORITY FAILED TO GIVE PROPER CONSIDERATION TO THE ADMINISTRATIVE NATURE OF THE U.S. TRUSTEES' STATUTORY DUTIES.

The panel majority gave insufficient attention to the administrative nature of the U.S. Trustee's statutory duties, holding instead that the relevant question under the Uniformity Clause is whether the statute "governs the relationship between creditor and debtor." Slip op. at 13243. This holding is not supported by the policies of the Uniformity Clause or by any precedent.

The principal purpose of the Uniformity Clause was to enable Congress to pass a nationwide bankruptcy law that would prevent one state from denying effect to the relief granted by another state. As the Supreme Court has explained, "[u]niformity among state debtor insolvency laws was an impossibility and the practice of passing private bankruptcy laws was subject to abuse if the legislators were less than honest"; the Framers therefore "sought to provide Congress with the power to enact uniform laws on the subject enforceable among the States" and "to prohibit Congress from enacting private bankruptcy laws." Gibbons, 455 U.S. at 472. The Court has upheld substantive bankruptcy legislation that incorporated the differing laws of the various states, explaining that the "general operation of the law is uniform although it may result in certain particulars differently in different states." Hanover National Bank v. Moyses, 186 U.S. 181, 189-90 (1902). It has also upheld substantive bankruptcy statutes treating "railroad bankruptcies as a distinctive and special problem" and has permitted Congress to "take into account differences that exist between different parts of the country." Regional Railroad Reorganization Act Cases, 419 U.S. at 159.

[*6] Unlike these non-uniform substantive bankruptcy statutes, the U.S. Trustees statute is designed to further the efficient administration of bankruptcy matters, not to alter substantive bankruptcy law. The majority's assertion that the U.S. Trustee statute "governs the relationship between creditor and debtor," and "has a concrete effect upon the relief available to debtors" because debtors are required to pay a quarterly fee, slip op. at 13243, is inaccurate. The U.S. Trustees' statutory duties are administrative in nature; they are described in terms such as "supervise," "monitor," "notify," and "make . . . reports." 28 U.S.C. 586(a). See also pp. 3-4, supra. The statute leaves the substantive debtor-creditor relationship unchanged; it simply provides for an administrative watchdog, the U.S. Trustee, who is responsible for ensuring the fairness and efficiency of the process by which the debtor and creditor resolve their rights and obligations under the substantive law of bankruptcy.

The majority also erred in concluding that the U.S. Trustee's quarterly fee under 28 U.S.C. 1930(a)(6) affected the substantive relief available under the bankruptcy laws. The U.S. Trustee's fee is merely a user fee; Congress intended the Program to be "self-funding and [to] be paid for by the users of the bankruptcy system -- not by the taxpayer." H.R. Rep. No. 764, supra, at 22, reprinted in 1986 U.S.C.C.A.N. at 5234. There is nothing in the record in this case to support the majority's "conjecture[]," slip op. at 13255 (dissenting opinion), that the U.S. Trustee system is more expensive overall for the debtor than the Bankruptcy Administrator system, id. at 13243, 13246. [**FN**4]

II. THE PANEL MAJORITY FAILED TO GIVE APPROPRIATE DEFERENCE TO CONGRESS'S STATUTORY PLAN.

Even assuming the uniformity requirement was implicated by the U.S. Trustee statute, the panel majority failed to apply the high level of deference due the congressional purposes behind the phase-in. The majority's declaration that Congress's action was "arbitrary and irrational" and that the law would be invalid "[u]nder any standard of review," slip op. at 13246, was incorrect.

To begin with, the majority failed to recognize that Congress has, in fact, applied the statute in all federal judicial districts; it has merely phased in its application. The majority cited no authority indicating that the Uniformity Clause would bar a phase-in, and we have found none. Moreover, the phase-in makes eminent practical sense. It should be understood as a means by which Congress has pursued a policy of gradualism permitting continued evaluation of the efficacy of the Program. Cf. City of New Orleans v. Dukes, 427 U.S. 297, 303 (1976) (per curiam) ("[l]egislatures may implement their program step by step"); id. at 305 ("gradual approach" permissible). Congress first created a pilot program; in 1986, it made the U.S. Trustee Program permanent nationwide, but phased it in by gradually adding groups of judicial districts to the Program; and, in 1990, it extended the time in which it could evaluate the success of the Program in relation to the Bankruptcy Adminstrator program in effect in Alabama and North Carolina, where the administrative functions are still being handled by the judiciary. See generally GAO Report, supra (comparing relative efficiencies, costs, and results achieved in sample districts in each program). [**FN**5]

[*7] Rather than determining which standard of review applied, the majority simply held that Congress's failure to specify explicitly its justification for the phase-in made the statute invalid under any standard of review. Slip op. at 13246. This was error. Since the purpose of the Uniformity Clause is to ensure similar treatment of similar debtors, see Regional Railroad Reorganization Act Cases, 419 U.S. at 159, the appropriate standard of review of Congress's reason for non-uniformity should be a deferential one, comparable to "rational basis" review in the equal protection context. Cf. United States v. Kras, 409 U.S. 434, 446 (1973) (bankruptcy classifications given rational-basis review under the Equal Protection Clause). The Supreme Court has never insisted on searching review in Uniformity Clause cases; it has held that "[t]he uniformity requirement is not a straitjacket" for Congress, Gibbons, 455 U.S. at 457; see Regional Rail Re-organization Act Cases, 419 U.S. at 158 (noting "flexibility inherent in" the clause), and has only once struck down a statute as non-uniform -- when the statute's application to a single debtor gave it no alternative. Gibbons, 455 U.S. at 473 (law addressed to "one named debtor can hardly be considered uniform").

Under a standard of review comparable to "rational basis," the statute's temporary non-uniformity may be justified as a means of permitting Congress to continue evaluating the Program's efficacy. "Rational basis" review requires that a statute be upheld unless there is no conceivable rational basis for it, and the legislative distinction may be based on "rational speculation unsupported by evidence or empirical data." Heller v. Doe, 113 S. Ct. 2637, 2642 (1993). The courts "never require a legislature to articulate its reasons for enacting a statute, [and] it is entirely irrelevant for constitutional purposes whether the conceived reason for the challenged distinction actually motivated the legislature." FCC v. Beach Comm., Inc., 113 S. Ct. 2096, 2102 (1993). Thus, the majority erred here in requiring an explicit statement of congressional intent. Slip op. at 13245-46.

III. THE DECISION UNNECESSARILY DISRUPTS THE U.S. TRUSTEES PROGRAM AND ENCOURAGES LITIGATION ACROSS THE COUNTRY.

Invalidating an Act of Congress on constitutional grounds is, as Justice Holmes noted, "the gravest and most delicate duty [a court] is called upon to perform." Blodgett v. Holden, 275 U.S. 142, 148 (1927). In the circumstances of this case, it was also an unnecessary duty. The panel majority unnecessarily reached out to "decid[e] a constitutional issue which has no effect on the review of the controversy before it, but which will undoubtedly spawn litigation" in other courts. Slip op. at 13254 (dissenting opinion).

Ordinarily, a constitutional decision will profoundly affect the outcome of a case. Here, however, the invalidation of section 317(a) had no effect, because the majority was able to treat the statute as uniform and to hold that the U.S. Trustee was entitled to his quarterly fee. Slip op. at 13249-52. Since the U.S. Trustee was entitled to the fee whether or not section 317(a) was constitutional, it would have been more consistent with "judicial restraint," id. at 13247, to have pointed this out without actually deciding the Uniformity Clause issue.

[*8] Beyond the narrow confines of this litigation, the majority's unnecessary resolution of the constitutional issue is of great consequence. The U.S. Trustees Program currently operates in 88 of the 94 federal judicial districts nationwide, 73 of which are outside the Ninth Circuit. The majority's decision serves to encourage every debtor in one of those 73 districts (perhaps also those in Alabama and North Carolina) and every other party believing itself to be adversely affected by an action of a U.S. Trustee to raise a similar constitutional challenge. The resulting disruption of the U.S. Trustees Program nationwide and the fostering of voluminous litigation across the country will place an undue burden on the U.S. Trustees, the federal courts, and parties to bankruptcy proceedings.

In addition, the majority's constitutional conclusion here already places this Court at odds with the Eighth Circuit, [**FN**6] and other courts are certain to weigh in on this issue. We recognize that the debtor here presented an interesting and unusual constitutional issue, but the panel was not compelled to decide it, and in light of the systemic disruption the decision is likely to cause, should not have done so.

CONCLUSION

For the foregoing reasons, the panel should rehear the case and withdraw Part III.A. of its decision.

Respectfully submitted,
FRANK W. HUNGER
Assistant Attorney General
CHARLES JOSEPH STEVENS
United States Attorney
MARK B. STERN
(202) 514-5089
EDWARD HIMMELFARB
(202) 514-3547
Attorneys, Appellate Staff
Civil Division, Room 7124
Department of Justice
Washington, D.C. 20530-0001
DECEMBER 1994

CERTIFICATE OF SERVICE

I hereby certify that on this 15th day of December 1994, I served the foregoing Petition For Panel Rehearing, upon opposing counsel by causing two copies to be mailed, postage prepaid, to:

Riley C. Walter, Esquire
McCormick, Barstow, Sheppard, Wayte & Carruth
1331 Fulton Mall
Fresno, CA 93721

Jayleen A. Morris

FOOTNOTES

FN1. Linda Ekstrom Stanley is now the U.S. Trustee for Region 17 and should be substituted for Mark St. Angelo pursuant to Rule 43(c) of the Federal Rules of Appellate Procedure.

FN2. The Uniformity Clause confers on Congress the power to "establish . . . uniform Laws on the subject of Bankruptcies throughout the United States," U.S. Const. art. I, § 8, cl. 4.

FN3. In the first class of districts (consisting of nearly all the original pilot districts), the Program took effect immediately; in the second class, it took effect 30 days following certification by the Attorney General but not later than 270 days from the date of enactment; in the third, it also took effect 30 days following certification by the Attorney General but not later than 2 years from the date of enactment; and in the fourth, it was to take effect upon election by the district judges in the district but not later than October 1, 1992.

FN4. The administrative functions of the U.S. Trustee no more affect the relief available to debtors than do the local bankruptcy court rules, which by definition are non-uniform. See In re Walat, 87 Bankr. 408, 412-13 (Bankr. E.D. Va.), aff'd, 89 Bankr. 11 (E.D. Va. 1988) (local rule requiring a certain form for chapter 13 plans and directing court clerk to reject for filing any nonconforming plan does not violate Uniformity Clause).

FN5. The majority erred in minimizing the significance of this GAO report, the very existence of which demonstrates that Congress was in fact interested in evaluating the relative merits of the two programs. The majority incorrectly interpreted the GAO's statement that it "could not find any justification for continuing two separate programs," GAO Report at 16; see slip op. at 13241, as indicating that Congress never had a basis for its decision to phase the Program in. The GAO's statement simply meant that no further evaluation was needed and that Congress should forge ahead with its longstanding decision to implement the Program nationwide. See GAO Report at 17 (Recommendations to Congress). We do not dispute that a perceived problem with the pilot program in Alabama contributed to one aspect of the phase-in, but the decision to phase in the Program was a far more expansive one concerning all 94 judicial districts across the country, not just three districts in Alabama and three in North Carolina. In any event, an "alleged illicit legislative motive" is not a basis for striking down an otherwise constitutional statute. See United States v. O'Brien, 391 U.S. 367, 383 (1968).

FN6. In In re Prines, 867 F.2d 478 (8th Cir. 1989), the debtors characterized their challenge as an equal protection claim that debtors in non- pilot districts were not subject to quarterly fees until one year after the district was certified, 867 F.2d at 484, and argued that "some measure of heightened scrutiny is required because of the Constitution's provision for uniform bankruptcy laws, see, U.S. Const. art. I, § 8." Id. at 485. The Eighth Circuit concluded, however, that classifications found in bankruptcy legislation are subject to rational-basis review, and that "this statutory scheme is rationally related to the legitimate governmental interest of establishing a nationwide self-supporting trustee system." Id. The panel majority here distinguished Prines as merely an equal-protection case, slip op. at 13247 n.6, but since essentially the same standard of review would apply to the Uniformity Clause issue, this does not distinguish the case.

1994 WL 1004481 (USTBRIEFS)

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1. (“TI”) ***TITLE*** OF CASE *[E.g., “SMITH v. U.S. TRUSTEE (IN RE SMITH)”]*	IN RE VICTORY MARKETS, INC.
2. (“CO”) ***CURRENT*** COURT *[E.g., “CTA9”]*	Bankr. N.D. N.Y.
3. (“CCN”) ***CURRENT*** CASE NO.	No.: No. 95-63366 (Chap. 11) (Gerling, C.J.)
4. (“PCN”) ***PRIOR*** CASE NO. & COURT *[IF ANY]*	No.: N/A Court: *(Identify judge & cite, if any)*
5. (“SO”) ***SOURCE***	**U.S. TRUSTEES**
6. (“DA”) ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., “Opening Brief,” “Reply,” “Amicus,” etc.]*	Filed: Nov. 29, 1995 Type: MEMORANDUM OF LAW IN SUPPORT OF UST’S OBJECTION TO APPOINTMENT TO OFFICIAL COMMITTEE OF UNSECURED CREDITORS
7. (“AU”) ***PRINCIPAL AUTHORS & OFFICE*** *[E.g., “UST/OGC”]*	Martha L. Davis (UST/OGC) Michael E. Collins (UST/Region 2, Utica, NY) *(UST/OGC: 202-307-1399/FAX-2397)*
8. (“TO”) ***TOPIC***	**BANKRUPTCY**
9. (“SU”) ! ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	! Composition of Committees is Vested in UST’s sole discretion under 11 U.S.C. § 1102. √ **Background:** 1986 amendments to Bankruptcy Code eliminated Court’s power to change the size or composition of committees appointed by the UST under § 1102; and Rule 2020 cannot be used to circumvent the UST’s power to appoint creditor committees.
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UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF NEW YORK

In re:	)	
VICTORY MARKETS, INC.,	)	**Case No. 95-63366**
	)	**Chapter 11**
Debtor.	)	**[Nov. 29, 1995]**

MEMORANDUM OF LAW IN SUPPORT OF OBJECTION OF THE UNITED STATES TRUSTEE TO FIRST PLAZA'S MOTION SEEKING APPOINTMENT TO OFFICIAL COMMITTEE OF UNSECURED CREDITORS

To Hon. Stephen D. Gerling, Chief U.S. Bankruptcy Judge:

The United States Trustee for the Northern District of New York respectfully submits this Memorandum of Law in support of the objection interposed by the United States Trustee with regard to the motion by Mellon Bank, N.A. (hereinafter "First Plaza"), seeking appointment to the official committee of unsecured creditors. The allegations of First Plaza that the United States Trustee acted arbitrarily and capriciously in this case are simply not supported in view of **all** of the pertinent facts. The facts clearly indicate that First Plaza has an actual conflict of interest by virtue of its significant ownership interest in the debtor's parent corporation, Victory Holdings, Inc. ("VHI"). Additionally, the committee, as created by the United States Trustee, adequately represents the make-up of the entire unsecured creditor body. However, this Court need not reach these issues in view of the 1986 amendment to 11 U.S.C. § 1102, which clearly leaves full discretion regarding committee composition with the United States Trustee.

STATEMENT OF FACTS

The statement of facts included in First Plaza's Memorandum of Law selectively, and conveniently for First Plaza, excludes facts that are relevant to a determination of the issues presented in the motion and makes inaccurate representations as to other pertinent facts. These misrepresentations, including what appears to be an intentional omission of pertinent facts, must be clarified in order for the Court to adequately address the issues before the Court.

On September 20, 1995, the debtor, Victory Markets, Inc., filed a voluntary petition for relief under chapter 11 of the Bankruptcy Code. Immediately upon the filing of the case, the United States Trustee undertook to solicit the twenty largest creditors for interest in serving on an official committee of unsecured creditors. Initially, the United States Trustee relied on the list of twenty largest unsecured creditors as filed by the debtor pursuant to FRBP 1007(d). That list appropriately did not include First Plaza in compliance with the FRBP 1007(d) requirement that the list exclude insiders.

The United States Trustee's solicitation efforts initially included mailing solicitation forms to each of the twenty largest creditors. Next, an appropriate date for an organizational meeting was determined and the United States Trustee proceeded to call each of the twenty largest creditors to advise such creditors of the date and time of the meeting, namely October 6, 1995, at 10:00 a.m. The meeting was scheduled on an expedited basis in order to allow the creditor's committee an opportunity to review the post-petition financing arrangements and cash collateral matters that are scheduled for final hearings during October. The United States Trustee also ensured that the twenty largest creditors received the solicitation forms. Additionally, the United States Trustee received a seemingly endless chain of telephone inquiries from creditors, each of whom were sent solicitation forms and were advised of the time and place of the organizational meeting. As a result of the United States Trustee's efforts in this case, 26 creditors returned solicitation forms indicating their interest in serving on the unsecured creditors committee.[1]

Within a few days after the filing of this bankruptcy case, the United States Trustee learned of First Plaza's interest in serving on the creditors committee. The United States Trustee requested that First Plaza submit a solicitation form. First Plaza provided a letter in support of its appointment to the committee on or about September 27, 1995. See Exhibit 1. Soon after learning of First Plaza's status as an unsecured creditor and upon review of the case, it was determined that First Plaza was an affiliate of the debtor's parent corporation, Victory Holdings, Inc. ("VHI"), and as such was an insider of the debtor pursuant to 11 U.S.C. § 101(31)(E).

In order to determine whether First Plaza should be appointed to the committee, the United States Trustee began investigating the relationship that First Plaza has with the debtor. From September 25, 1995, through October 5, 1995, the United States Trustee had numerous telephone conversations and in person conversations with Stephen A. Donato, Esq., counsel for First Plaza. These discussions all pertained to whether First Plaza would be a member of the unsecured creditor committee. On September 25, 27, 29, October 2 and 3, the United States Trustee conversed by telephone with Stephen A. Donato, Esq. Additionally, on September 29, 1995, Mr. Collins participated in a telephone conference with Mr. Donato and Luc Despins, Esq., of Kirkland & Ellis, regarding the appointment of the committee. On October 3, 1995, Kim Lefebvre, Esq., Assistant United States Trustee, discussed committee issues with Mr. Donato. On October 5, 1995, the night

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[1] The United States trustee also received approximately 25 solicitation forms regarding the committee for the New Almac's Inc. bankruptcy case. In all the United States trustee received over 50 solicitation forms.

before the organizational meeting, Mr. Collins, Mr. Lefebvre, and Brian Masumoto, Esq., of the New York City U.S. Trustee's office, conferred with Mr. Despins regarding additional information needed to determine whether First Plaza should be appointed to the unsecured creditor committee. Finally, on October 6, 1995, prior to the organizational meeting, Mr. Lefebvre approached Mr. Donato and requested that certain information, which had been requested of Mr. Despins, be provided. Mr. Donato provided the information immediately prior to the start of the organizational meeting.

In further efforts to determine whether First Plaza had a conflict of interest that would preclude its membership on the committee, and in addition to the telephone conferences, the United States Trustee sent letters on September 28, 1995, and September 29, 1995, requesting numerous documents and other information from First Plaza. See Exhibits 2 and 3. Said letters requested that the information be provided on or before October 2, 1995. On September 29, 1995, the United States Trustee received a response letter from First Plaza which did not fully provide the information requested and which indicated that the rest of the information would be provided by October 2, 1995. See Exhibit 4. The United states Trustee responded with a letter dated October 1, 1995, which reiterated the request for information. See Exhibit 5. On October 2, 1995, the United States Trustee received a letter from Luc Despins, Esq., of Kirkland & Ellis, which responded to some of the requests of the United States Trustee. See Exhibit 6. Particularly notable are the inconsistencies between that letter and the factual assertions included in the motion before this Court. In particular, Mr. Despins states in his letter that First Plaza has only voted its shares twice, while First Plaza asserts in its motion that such shares have been voted on three occasions. Additionally, both the letter and the motion fail to state that the First Plaza has the power to place a director on the Board of Directors of VHI.

On October 3, 1995, First Plaza provided certain documents pertaining to the loan that is the basis for First Plaza's unsecured claim, as requested by the United States Trustee.[2] See Exhibits 7 and 8. Michael Collins, Esq., of the United States Trustee's office in Utica, reviewed each of the documents pertaining to the First Plaza debt and delivered copies of the documents to the Albany U.S. Trustee's office for further review. On October 5, 1995, Kim Lefebvre, Esq., Assistant United States Trustee, and Brian Masumoto, Esq., from the New York City U.S. Trustee office, travelled to Utica to assist in forming the committee. A substantial portion of time was spent by Mr. Collins, Mr. Lefebvre, and Mr. Masumoto in further reviewing the documents and information regarding the First Plaza claim. Based on all the information received, the United States Trustee determined that First Plaza has an actual conflict of interest by virtue of its ownership interest in VHI.

In making the determination, the following facts, among others, were considered:

1) First Plaza owns approximately 37% of VHI, which owns 100% of the debtor corporation. Consequently, First Plaza effectively owns 37% of the debtor.

2) First Plaza has voted its shares on several occasions since 1992, indicating that First Plaza exercises some control over the activities of VHI. As noted above, First Plaza has been inconsistent in its recollection of how many times it voted its shares. Additionally, First Plaza represents to the Court that it only voted regarding "technical" matters. However, as disclosed in Exhibit 6, First Plaza voted regarding a stock split and regarding a restructuring in 1994. These matters can hardly be considered "technical." Upon information and belief, First Plaza made no effort to clarify its representation prior to the appointment of the committee.

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[2] By this time, the United States trustee had already obtained the documents from the debtor's attorney.

3) First Plaza has the ability to place a director on the Board of Directors of VHI at any time based on its significant ownership interest. Even though First Plaza claims never to have placed any director on the board, the power to exercise such option gives First Plaza some measure of control over VHI.

4) No single entity holds over 50% of the stock of VHI. Consequently, an alignment between First Plaza and another shareholder of VHI could give absolute control over VHI to First Plaza.

5) Upon information and belief, Centre Capital Investors, L.P. ("Centre Capital"), which holds approximately 43.8% of the stock of VHI, and First Plaza are involved in numerous investments together. Consequently, it is likely that the interests of First Plaza and Centre Capital are aligned such that First Plaza and Centre Capital jointly control VHI.

6) In light of First Plaza's interest and control over VHI, First Plaza's presence on the unsecured creditors committee poses an obvious conflict of interest. First, confidential information regarding strategies of the committee in plan negotiations would be compromised if an owner of the debtor were included as a member of the committee. Additionally, allowing an owner of the debtor to negotiate issues with the debtor, such as plan provisions, is effectively allowing the debtor to negotiate with itself. In light of these facts and others, the United States Trustee determined that First Plaza should not be appointed to the Official Unsecured Creditor Committee.

In addition to the efforts to determine the true nature of First Plaza's ownership interest, the United States Trustee made similar efforts to obtain documentation regarding the other unsecured claims. Requests for information regarding the bondholders were made upon Shawmut Bank, N.A. as indenture trustee, Timothy Clark, Esq., representing approximately $40,000,000 of the

$60,000,000 of outstanding bonds, and Jeffrey Dove, Esq., the debtor's attorney. Additionally, Mr. Dove was requested to and did provide substantial information regarding the First Plaza debt, the bond debt, and the trade debt.

On the evening of October 5, 1995, after reviewing the facts regarding First Plaza, Mr. Collins, Mr. Lefebvre, and Mr. Masumoto reviewed the 26 solicitation forms received. Upon request, the debtor provided a breakdown of the different types of trade debt involved and provided the debtor's records regarding the amounts owed to the various creditors. The United States Trustee made a preliminary decision as to the numbers and types of creditors to be included in the committee. At the organizational meeting on October 6, 1995, the United States Trustee made the final decision as to which creditors should be appointed to the committee. A notice of appointment of Unsecured Creditor Committee was filed on October 6, 1995. See Exhibit 9. **Contrary to the assertion made by First Plaza in its Memorandum of Law, the United States Trustee had absolutely no discussion with any representative of First Plaza at the organizational meeting as to the reason that First Plaza was not selected to the Unsecured Creditors' Committee**. The representation made by First Plaza in that regard is completely unfounded.

On the afternoon of October 6, 1995, First Plaza filed the present motion and the Court allowed the hearing to be held on less than one business day of notice to the United States Trustee and the Official Unsecured Creditors' Committee.

DISCUSSION

I. Composition of committees is vested in the sole discretion of the United States Trustee pursuant to 11 U.S.C. § 1102

A review of the plain language of section 1102, as well as the legislative history of that section, clearly indicates that the United States Trustee is entrusted with the appointment of committees and that the composition of any committees so appointed is fully within the discretion of the United States Trustee. Such discretion is not subject to review by the Court.

Prior to 1986, section 1102 of the Bankruptcy Code provided that the Court could appoint committees under section 1102(a) and could change the composition of any such committee upon motion by a party in interest pursuant to section 1102(c). Prior to 1986, section 1102(c) stated clearly that

> [o]n request of a party in interest and after notice and a hearing, the court may change the membership or the size of a committee appointed under subsection (a) of this section if the membership of such committee is not representative of the different kinds of claims or interests to be represented.

11 U.S.C. § 1102(c)(1988). Thus, prior to 1986, the bankruptcy courts had the authority to make changes in membership and or size of any committee appointed under section 1102.

In 1986, the Bankruptcy Code was substantially amended by Congress to, inter alia, expand the United States trustee program nationwide. In providing for the specific responsibilities of the United States Trustees, Congress made significant amendments to section 1102. First, Congress amended section 1102(a) to provide that the United States trustee, rather than the Court, would be responsible for appointing committees. Additionally, Congress completely deleted section 1102(c), thereby eliminating the power of the Court to change the size or composition of committees appointed by the United States Trustee. In re Wheeler Technology, Inc., 139 B.R. 235, 239 (9th Cir. BAP 1992); In re Drexel Burnham Lambert Group, Inc., 118 B.R. 209, 210-11 (Bankr. S.D.N.Y.

1990); In re Hills Stores Co., 137 B.R. 4, 8 (Bankr. S.D.N.Y. 1992); Matter of Gates Engineering Co., 104 B.R. 653, 654 (Bankr. D. Del. 1989).

The present version of section 1102(a)(1) of the Bankruptcy Code provides that

> as soon as practicable after the order for relief under chapter 11 of this title, the United States trustee shall appoint a committee of creditors holding unsecured claims and may appoint additional committees of creditors or of equity security holders as the United States trustee deems appropriate.

11 U.S.C. § 1102(a)(1995). Section 1102(a)(2) provides that the Court may order that additional committees be appointed after notice and hearing "if necessary to assure adequate representation of creditors." This power to order the appointment of additional committees is the court's sole remedy for claims of inadequate representation. In re Drexel Burnham Lambert Group, Inc., 118 B.R. 209, 211 (Bankr. S.D.N.Y. 1990). However, if the Court decides that an additional committee is indeed necessary in any particular case, the United States Trustee is still given the sole authority to appoint the committee. See 11 U.S.C. § 1102(a)(2)(1995)("[t]he United States trustee shall appoint any such committee"); In re Hills Stores Co., 137 B.R. at 8.

The Ninth Circuit Bankruptcy Appellate Panel appears to be the only appellate court to have reviewed the issue of whether a bankruptcy court may effect a change in the composition of a committee in view of the 1986 amendments to section 1102. In In re Wheeler Technology, Inc., supra, the Ninth Circuit reviewed a decision by the bankruptcy court which ordered that a particular creditor be removed from the unsecured creditor committee as a sanction for violating the automatic stay. While the creditor did not dispute the finding that it had violated the automatic stay, the creditor appealed the bankruptcy judge's order requiring removal from the committee.

In reviewing the bankruptcy court decision, the BAP quickly concluded that the bankruptcy court had no authority to effect a change in the composition of the creditors committee. The BAP reviewed the 1986 amendments to section 1102 and concluded that "[t]he power to appoint and delete members of the Creditors' Committee now resides **exclusively** with the U.S. Trustee." Id. at 239 (emphasis added). Additionally, the BAP noted that section 105 could not be used by the Court to modify the membership of a committee because such action would be "contrary to the legislative history and Congressional intent in deleting subsection (c) of § 1102." Id., citing Matter of Gates Engineering Co., 104 B.R. at 654.

In addition to the Ninth Circuit BAP, the Southern District of New York has also concluded in several cases that the bankruptcy courts have no authority to change the membership of creditor committees. See In re Drexel Burnham Lambert Group, Inc., 118 B.R. 209, 210 (Bankr. S.D.N.Y. 1990); In re Hills Stores Co.., 137 B.R. 4, 8 (Bankr. S.D.N.Y. 1992). In In re Drexel Burnham Lambert Group, Inc., 118 B.R. at 210, a creditor moved the court to compel the United States Trustee to add the creditor to the committee of unsecured creditors. The creditor had made a formal request to the United States Trustee to be added to the committee, but such request was refused.

The analysis of the court in resolving the matter was almost identical to that utilized by the Ninth Circuit BAP. The Drexel court first recited the present version of section 1102(a), then noted "the absence of any indication in the statute that the court may add to or delete an unsecured creditor from a committee." Id. at 210. The court was also aware that section 1102(c), which had previously provided the court with specific authority to alter the composition of creditors' committees, had been deleted by the 1986 amendments. Id. Properly following the statutory language strictly, the court concluded that section 1102 does not authorize the court to add or delete creditors from committees appointed pursuant to 1102(a). Id. at 210-11. Furthermore, the court concluded that section 105 could not provide such authorization, stating that "[s]ection 105(a) states that a court may issue orders 'necessary and appropriate to carry out the provisions of this title,' not in ignorance of what Congress has wrought." Id. at 211. The court, however, did recognize that it had the ability to address inadequate representation problems, but only through creation of other committees. Id.; see 11 U.S.C. § 1102(a)(2).

The well-reasoned analysis of Judge Buschman in Drexel, as well as the analysis of the Ninth Circuit BAP, should be followed by this court.[3] Indeed, the conclusion reached by Judge Buschman is the only conclusion that makes sense in light of the language of section 1102 and the 1986 amendments thereto. If Congress had intended that the court have authority to alter the composition of committees, why did it delete section 1102(c)? The only explanation is that Congress wanted to remove the bankruptcy courts from the administrative aspects of cases and, consequently, vested sole discretion in the United States Trustee as to the composition of committees.

In the Memorandum of Law submitted by First Plaza, several cases are offered to support the proposition that the court may alter the membership of committees appointed under section 1102(a). However, these cases should be disregarded as either being factually inapposite or being based on a flawed interpretation of the provisions of the Bankruptcy Code.

The first case cited by First Plaza in support of the Court's ability to alter the composition of a committee is In re First RepublicBank Corp., 95 B.R. 58 (Bankr. N.D. Tex. 1988). In that case,

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[3] Judge Tina Brozman of the Southern District, in In re Hills Stores Co., 137 B.R. 4 (Bankr. S.D.N.Y. 1992), cited the Drexel decision with approval in concluding that "[w]hile [the court] may order the appointment of additional committees under § 1102(a)(2) of the Code, the statute no longer permits the addition or deletion of members of committees by the court." Id. at 8.

the creditors' committee moved the court to order the removal of a committee member based on an alleged conflict of interest. A request had been made by the committee on the U.S. Trustee to remove the member, but such request had been refused due to the U.S. Trustee's determination that the member did not have a conflict.

While the court ultimately refused to change the composition of the committee, the court analyzed, arguably in *dicta*, whether it could review the decision of the United States Trustee in refusing to alter the committee. The court first noted that section 1102(c) had been deleted by Congress, but concluded that section 105(a) authorized the court to "review the United States trustee's decision on the question of committee membership to determine if the trustee acted arbitrarily and capriciously." The court, however, never decided what the remedy would be if the court concluded that the United States Trustee had, in the court's opinion, acted arbitrarily and capriciously. Apparently, however, the court felt that section 105 would authorize it to alter the composition of the committee, even though such power is reserved exclusively to the United States Trustee by the Bankruptcy Code.

Such a conclusion is contrary to the notion that "a [bankruptcy] court may not employ its equitable powers to achieve a result not contemplated by the [Bankruptcy] Code." Matter of Fesco Plastics Corp., 996 F.2d 152, 154 (7th Cir. 1993). The Bankruptcy Code provides that the United States Trustee has the sole discretion to determine the composition of committees and, consequently, the court should not use section 105 to alter that result. See In re Drexel Burnham Lambert Group, Inc., 118 B.R. 209, 211 (Bankr. S.D.N.Y. 1990)(specifically stating that section 105 cannot be used to allow the court to alter the composition of creditor committees); In re Wheeler Tech., Inc., 139 B.R. 235 (9th Cir. BAP 1992)(same); Matter of Gates Eng'g Co., 104 B.R. 653, 654 (Bankr. D. Del.

1989)("However, the court cannot under the provisions of § 105 circumvent the unambiguous language . . . of the Code . . . in light of the deletion of subsection (c) in 1986."). Consequently, the dicta in In re First RepublicBank Corp., supra, should be rejected by the this Court.

The debtor also cites Matter of Columbia Gas System, Inc., 133 B.R. 174 (Bankr. D. Del. 1991), for the proposition that the Court may review the decision of the United states Trustee regarding the committee composition under an abuse of discretion standard. However, the court in Columbia Gas based its holding on an untenable interpretation of the legislative history of section 1102 and a complete misreading of several cases. First, the court analyzes the deletion of section 1102(c) and concludes that "the legislative history indicates the Court's power to change committee membership was removed as a housekeeping measure merely to keep section 1102 internally consistent." However, the court gives absolutely no basis for such a conclusion other than the intent of Congress to relieve the courts of administrative matters. Additionally, the argument that section 1102(c) was removed to keep section 1102 "internally consistent" makes no sense. Had Congress intended that the courts would have the ability to alter the composition of committees, Congress obviously would have left section 1102(c) intact. There is nothing in section 1102(c) that is internally inconsistent with the other provisions of section 1102. Consequently, the argument that Congress removed section 1102(c) as a "housekeeping measure" is untenable.

The Columbia Gas court also misread the case of Matter of Gates Eng'g Co., 104 B.R. 653 (Bankr. D. Del. 1989). The court states that the Gates court held that "a U.S. Trustee's refusal to appoint a creditor was subject to the deferent abuse of discretion standard." Matter of Columbia Gas System, Inc., 133 B.R. at 175. However, **nowhere in the Gates decision is there any reference to an abuse of discretion standard**. To the contrary, the Gates court concluded that section 105 of the Code did not authorize the court to circumvent the unambiguous language of section 1102 "in light of the deletion of subsection (c) in 1986." Matter of Gates Eng'g Co., 104 B.R. at 654. Additionally the Gates court stated that "the Code does not give any creditor the right to serve on a committee. That selection is within the discretion of the U.S. Trustee." Consequently, the Columbia Gas court completely misread the Gates decision.

Finally, the Columbia Gas court misread the decision In re Drexel Burnham Lambert Group, Inc., 118 B.R. 209 (Bankr. S.D.N.Y. 1990). In deciding to disregard the Drexel case, the Columbia Gas court states that the court in Drexel "did not review Gates [supra] or consider whether 11 U.S.C. § 105(a) gives bankruptcy courts the ability to remedy an abuse of discretion by the U.S. Trustee." However, it was unnecessary for Drexel to review Gates because the cases are consistent. Both cases hold that the Court cannot change the composition of creditor committees. Also, the Drexel court did address whether section 105(a) authorized it "to correct abuses by the U.S. Trustee." In re Drexel Burnham Lambert Group, Inc., 118 B.R. at 211-12. The Drexel court explicitly rejected such a notion stating that "[s]ection 105(a) states that a court may issue orders 'necessary and appropriate to carry out the provisions of this title,' not in ignorance of what Congress has wrought."

Since it is apparent that the Columbia Gas court was operating under various misapprehensions, its decision should be given little or no weight. Had the Columbia Gas court accurately analyzed the decisions in Gates and Drexel, its decision may have been different.

Finally, First Plaza relies on In re Texaco, Inc., 79 B.R. 560 (Bankr. S.D.N.Y. 1987), for support of its request that the court order that First Plaza be added to the creditor committee. As stated by Judge Buschman in In re Drexel Burnham Lambert Group, Inc., 118 B.R. 209 (Bankr. S.D.N.Y. 1990), "[i]n *Texaco*, the Court noted the expense of two committees and effectively merged one committee into another without any discussion of the present language of section 1102 or the repeal of former section 1102(c)."[4] Id. at 210. Consequently, just as Judge Buschman dismissed the Texaco case, this court should give little or no weight to Texaco because that court failed to analyze the issue before this court.

Each of the cases cited by First Plaza should be disregarded and the motion to add First Plaza to the creditors committee in this case should be denied. The clear intent of Congress in amending section 1102 was to place the full discretion in committee composition with the United states Trustee. The Congress left with the court the ability to compel the U,.S. Trustee to appoint additional committees, where the committees presently in place did not adequately represent the creditor interests. Consequently, this Court should deny the motion of First Plaza.

II. FRBP Rule 2020 does not authorize the Court to provide the relief requested

In its motion, First Plaza cites in passing FRBP 2020 in support of the relief requested. However, FRBP 2020 is not applicable in this case because the decision regarding the composition of committees has been committed to the discretion of the United States Trustee by law.

Federal Rule of Bankruptcy Procedure ("FRBP") 2020 provides that "[a] proceeding to contest any act or failure to act by the United States trustee is governed by Rule 9014." Consequently, the Court has the power to review acts of the United States Trustee to make sure that such acts are in compliance with the requirements of the Bankruptcy Code. For example, as noted in the Advisory Committee Note to FRBP 2020,

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[4] It is noteworthy that the court in Texaco relied heavily on the decision of Judge Buschman in In re McLean Industries, Inc., 70 B.R. 852 (Bankr. S.D.N.Y. 1987). However, Judge Buschman specifically held that his McLean decision was inapplicable to this issue. Who better to define the scope of a judge's ruling than the judge that made the ruling?

> if the United States trustee schedules a § 341 meeting to be held 90 days after the petition is filed, and a party in interest wishes to challenge the propriety of that act in view of § 341(a) of the Code and Rule 2003 which requires that the meeting be held not more than 40 days after the order for relief, [FRBP 2020] permits the party to do so by motion.

However, the Advisory Committee Note to FRBP 2020 further states that "[FRBP 2020] is not intended to limit the discretion of the United States trustee, provided that the United States trustee's act is authorized by, and in compliance with, the Code, title 28, these rules, and other applicable law."

In the present case, the United States Trustee action in appointing a committee of unsecured creditors is authorized by section 1102(a) of the Bankruptcy Code. Furthermore, the United States Trustee has fully complied with all applicable law in forming the committee. On October 6, 1995, as soon as practicable after the order for relief, the United States Trustee appointed the committee of creditors holding unsecured claims in full compliance with section 1102(a)(1). No other requirements pertaining to committee formation appear in the Bankruptcy Code or the Federal Rules of Bankruptcy Procedure. Accordingly, since the United States Trustee's actions in this case were authorized, and such actions were in full compliance with all applicable law, section 2020 does not authorize the Court to limit the discretion of the United States Trustee regarding the proper composition of the committee. Consequently, this Court should deny the motion of First Plaza.

III. The decision of the United States Trustee regarding the compostion of the Committee was proper in light of First Plaza's actual conflict of interest.

First Plaza makes the argument that the United States Trustee excluded First Plaza from the committee based on their status as an insider. While it is true that First Plaza is an insider of the debtor pursuant to section 101(31)(E) of the Bankruptcy Code, that fact alone did not end the U.S. Trustee's inquiry as to whether First Plaza should be included as a member of the committee. Indeed, if that fact alone ended the United States Trustee's inquiry, why did the United States Trustee continue to request information and documentation up until the morning of the organizational meeting?

Beyond the misapprehension of First Plaza, the truth is that the decision to exclude First Plaza was based on its actual conflict of interest, which, as it happens, arises simultaneously with First Plaza's status as an insider. The facts as set forth herein indicate, among other things, that First Plaza holds 37% of the voting shares of the debtor's parent corporation, that First Plaza has the power to exercise significant control of VHI, and the debtor, by virtue of First Plaza's power to vote its shares and appoint a director of VHI, that First Plaza has exercised its power to vote its shares at least three times in the past three years, and that First Plaza has a relationship with Centre Capital Investors, the owner of 45% of the voting shares of VHI, that transcends their connection in this case. These factors indicate that First Plaza's presence on the committee would hinder the ability of the committee to represent the interests of the unsecured creditors in this case and, in fact, would not be representative of the different kinds of claims to be represented.

In determining the issue of what creditors should be appointed to the unsecured creditors committee, the United States Trustee did not take the matter lightly. As noted in the Statement of Facts, supra, the United States Trustee personnel undertook a diligent effort to encourage as much creditor participation as possible and to obtain as much information as possible regarding all of the unsecured creditors. Included in this inquiry was a substantial devotion to understanding the true nature of First Plaza's ownership interest in VHI. The information obtained in that inquiry, as set forth in the Statement of Facts. supra, clearly indicates that First Plaza's ownership interest in VHI is such that First Plaza would have a conflict of interest if chosen to be a member of the unsecured creditor committee. Perhaps more importantly, there is a strong concern regarding the confidentiality of discussions that the creditors' committee may have regarding the case. Consequently, even if this Court decides that section 105 allows the Court to take any action regardless of contrary provisions of the Bankruptcy Code, this Court should agree that First Plaza would have an actual conflict of interest as a member of the unsecured creditor committee.

Even if this Court questioned whether an actual conflict of interest exists, the facts related herein clearly indicate that the United States Trustee's decision to appoint a committee of unsecured creditors that does not include First Plaza was not arbitrary and capricious, and was not an abuse of discretion.

IV. **The Unsecured Creditor Committee, as appointed, adequately represents all unsecured creditors.**

The Unsecured Creditor Committee, as appointed by the United States Trustee, fully represents all unsecured creditors. The debtor in this case has the following debt: Trade/Union debt approximately $20,000,000; First Plaza approximately $20,000,000; and Bond debt approximately $60,000,000. Consequently, the total bond debt equals approximately 60% of the total unsecured claims and the total non-bond debt equals approximately 40% of the total unsecured claims. The breakdown of the composition of the committee is such that the bondholders represent 55.5% of the committee members and the non-bond creditors represent 44.4% of the committee. Consequently, the committee as appointed is representative of the entire unsecured creditor body.

First Plaza claims that its exclusion from the committee causes the committee not to be representative of the entire unsecured creditor body. However, First Plaza acknowledges that its debt is pari passu with the trade creditors. Consequently, any actions taken by the unsecured creditors to protect their interests will protect the interests of First Plaza, at least with respect to the unsecured claims. Additionally, efforts made by the bond holders to maximize their claims will benefit First Plaza since the bondholders are subordinated to First Plaza. Thus, First Plaza's interests as an unsecured creditor (perhaps not as an owner) are adequately represented on the committee.

First Plaza tends to indicate that it was "excluded" from the committee, as if it had some right to be on the committee. Clearly, however, the Bankruptcy Code does not provide to any creditor a right to be a member of an unsecured creditor committee no matter how large such creditor's claim is. Additionally, "[n]owhere does the Code mandate a committee must faithfully reproduce the exact complexion of the creditor body." In re Hills Stores Co., 137 B.R. 4, 7 (Bankr. S.D.N.Y. 1992). Indeed, the United States Trustee was unable to place a creditor on the committee that represents the non-food trade creditors. No membership on the committee was given to a frozen goods supplier. Yet the committee can still represent their interests. Since there are endless distinctions between creditors, the only way to have a truly representative committee is to place all of the unsecured creditors on the committee. While such a result is obviously ridiculous, it demonstrates the folly of First Plaza's argument.

In the present case, the United States Trustee has formed a committee that adequately represents the unsecured creditor interests involved in this case. To the extent that any of the 17 creditors that wanted to be on the committee but were excluded continue to feel unrepresented, such entities are free to represent themselves. As noted by Judge Brozman in In re Hills Stores Co., 137 B.R. at 8, the excluded creditors "are not precluded from forming an unofficial committee, retaining counsel and a financial advisor and seeking reimbursement of their expenses to the extent that they make a substantial contribution to the case, as permitted and even envisioned by § 503(b) of the Code."

CONCLUSION

In 1986, the Congress of the United States created the United States Trustee program and conferred on the program certain discretionary responsibilities, including determining the appropriate composition of creditor's committees. The Congress expressly decided to take the Court out of such matters by deleting section 1102(c), which had previously given the Court the power to change the composition of committees. This action by the Congress clearly indicates that the Court may not add First Plaza to the Unsecured Creditors' Committee in this case.

If the Court decides that it has the authority to exercise powers given expressly to the United States Trustee, the Court should still deny First Plaza's motion. The facts of this case clearly indicate that First Plaza would have an actual conflict of interest if placed on the Official Unsecured Creditor's Committee, and that such conflict would work to the detriment of the entire unsecured creditor class. Furthermore, the committee as appointed adequately represents the entire unsecured creditor body, including the unsecured claim of First Plaza. Consequently, the United States Trustee acted properly and did not abuse its discretion in appointing a committee that does not include First Plaza. Accordingly, this Court should deny the motion of First Plaza.

Date: November 29, 1995
Utica, New York

Respectfully submitted,

ARTHUR J. GONZALEZ
UNITED STATES TRUSTEE

____
Michael E. Collins, Esq.
Office of the U.S. Trustee

10 Broad Street, Room 105
Utica, New York 13501
(315) 793-8191

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF NEW YORK

In re:	)	
	)	
VICTORY MARKETS, INC.,	)	**Case No. 95-63366**
	)	**Chapter 11**
Debtor.	)	

EXHIBITS REGARDING OBJECTION OF THE UNITED STATES TRUSTEE TO MOTION, UNDER 11 U.S.C. § 105(a), SEEKING APPOINTMENT TO OFFICIAL COMMITTEE OF UNSECURED CREDITORS

Exhibit No.	
1	Letter from Stephen A. Donato, Esq., to Michael E. Collins, Esq., dated September 27, 1995.
2	Letter from the United States Trustee to Stephen A. Donato, Esq., dated September 28, 1995.
3	Letter from the United States Trustee to Stephen A. Donato, Esq., dated September 29, 1995.
4	Letter from Stephen A. Donato, Esq., to Michael E. Collins, Esq., dated September 29, 1995.
5	Letter from the United States Trustee to Stephen A. Donato, Esq., dated October 1, 1995.
6	Letter (not dated) from Luc Despins, Esq., to Michael E. Collins, Esq., sent by facsimile on October 2, 1995.
7	Loan Agreement between Victory Market's Inc. and First Plaza for $15,000,000 dated August 14, 1992, including related documents.
8	Loan Agreement between Victory Market's Inc. and First Plaza for $1,980,000 dated January 28, 1994, including related documents.

Date: November 29, 1995
Utica, New York

Respectfully submitted,

ARTHUR J. GONZALEZ
UNITED STATES TRUSTEE

Michael E. Collins, Esq.
Office of the U.S. Trustee
10 Broad Street, Room 105
Utica, New York 13501

(315) 793-8191

BRIEF BANK — "SUMMARY SHEET"

Printed Fri.-1/8/99 (12:05)

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	IN RE VICTORY MARKETS, INC. (MELLON BANK, N.A. v. U.S. TRUSTEE)
2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	U.S. District Court (N.D. N.Y.)
3. ("CCN") ***CURRENT*** CASE NO.	No.: Civil Action No. 3:95-CV-1619
4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*	No.: 95-63366 (Chap. 11) Court: Bankr. N.D. N.Y. (Gerling, C.J.) *(Identify judge & cite, if any)*
5. ("SO") ***SOURCE***	**U.S. TRUSTEES**
6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	Filed: Feb. 20, 1996 Type: BRIEF FOR APPELLEE, U.S. TRUSTEE [MARY E. TOM, Acting]
7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g., "UST/OGC"]*	Martha L. Davis (UST/OGC) Michael E. Collins (UST/Region 2, Utica, NY) *(UST/OGC: 202-307-1399/FAX-2397)*
8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") ! ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	! Composition of Committees is Vested in UST's Sole Discretion under 11 U.S.C. § 1102. √ **Background:** Bankruptcy court correctly denied appellant's motion for appointment to the Unsecured Creditors Committee, based on the plain language of the Code and applicable legislative history. Section 105(a) does not provide a basis for the court to disregard Congress' clear intent in repealing § 1102(c). Further, judicial review is inappropriate here & the APA is inapplicable.
10. PATH TO FILE LOCATION: (e.g., S:\GENERAL COUNSEL\BRFBANK\etc...)	S:\General Counse\BrfBank\ToWest\VICMKT2.wpd
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UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF NEW YORK

	)	
In re:	)	
	)	
VICTORY MARKETS, INC.,	)	**Case No. 95-63366**
	)	**Chapter 11**
Debtor.	)	
	)	
	)	
MELLON BANK, N.A., as Trustee for FIRST PLAZA GROUP TRUST,	)	
	)	
	)	**Civil Action No.**
Appellant,	)	**3:95-CV-1619**
	)	
v.	)	
	)	**Hon. Thomas J. McAvoy**
UNITED STATES TRUSTEE,	)	
	)	
Appellee.	)	
	)	
	)	

APPELLEE'S BRIEF

MARY ELIZABETH TOM
ACTING UNITED STATES TRUSTEE
Office of the U.S. Trustee
10 Broad Street, Room 105
Utica, New York 13501
(315) 793-8191
Michael E. Collins
Assistant U.S. Trustee

FEBRUARY 20, 1996

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF NEW YORK

In re:	)	
VICTORY MARKETS, INC.,	)	**Case No. 95-63366** **Chapter 11**
Debtor.	)	
MELLON BANK, N.A., as Trustee for FIRST PLAZA GROUP TRUST,	)	
Appellant,	)	**Civil Action No. 3:95-CV-1619**
v.	)	
	)	**Hon. Thomas J. McAvoy**
UNITED STATES TRUSTEE,	)	
Appellee.	)	

APPELLEE'S BRIEF

The United States Trustee for the Northern District of New York respectfully submits this brief in support of the October 13, 1995, order of the Hon. Stephen D. Gerling, which denied the motion of Mellon Bank, N.A. (hereinafter "Appellant"), seeking appointment to the official committee of unsecured creditors. Based on an analysis of the applicable provisions of the United States Code, the legislative history, the case law, and pertinent policy considerations, the decision of Judge Gerling was correct as a matter of law and should be affirmed.

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PRELIMINARY STATEMENT

The legal issue in this appeal, as denoted by the Appellant, cannot serve as the basis for overturning the bankruptcy court decision. The Appellant frames the issue in terms of whether the bankruptcy court can review the U.S. Trustee's decision with regard to the composition of the committee of unsecured creditors. However, the bankruptcy court never reached the issue of whether it could review the U.S. Trustee's actions; rather, the bankruptcy court held that it could not grant the relief requested. The U.S. Trustee does not challenge in this appeal the bankruptcy court's power to review the U.S. Trustee's actions under section 105(a) of the Bankruptcy Code. Thus, there is no real dispute in that regard. The only real dispute is whether the Court can change the composition of the creditors' committee in the face of Congressional intent to shelter the court from committee composition issues. Consequently, this Court should disregard the Appellant's efforts to confuse the real issue in this appeal with arguments regarding the reviewability of U.S. Trustee decisions.

While accurately defining the scope of the bankruptcy court decision is appropriate, it is somewhat inconsequential because this Court does not have jurisdiction to entertain this appeal. As set forth in the Statement of Jurisdiction, infra, the bankruptcy court decision is an interlocutory order, for which leave to appeal is required. However, the Appellant never obtained such leave. Additionally, even if leave to appeal were requested, such request would have to be denied based on the Appellant's failure to satisfy the requirements for leave to appeal an interlocutory order. Finally, the appeal should be dismissed on jurisdictional grounds because the Appellant does not have standing to appeal. Particularly, the Appellant can demonstrate no injury resulting from the bankruptcy court decision. Thus, the appeal should be dismissed with no need to consider the merit, or lack thereof, of the Appellant's arguments.

Regardless of the jurisdictional deficiencies, the appeal should be denied on the merits. In this appeal, the Appellant seeks to have the Court compel the bankruptcy court to review the composition of creditors' committees in every case where a creditor is disappointed that it was not selected as a member of such committee. Yet the statute that gave the bankruptcy court the power to do exactly what the appellant requests -- change the membership of the unsecured creditors' committee -- was repealed in 1986. Specifically, Congress repealed section 1102(c) which provided that "[o]n request of a party in interest and after notice and a hearing, the court may change the membership or the size of a committee appointed under subsection (a) of this section if the membership of such committee is not representative of the different kinds of claims or interests to be represented." By deleting that provision, Congress indicated quite clearly that the bankruptcy courts should be spared from this administrative task which affects no substantive rights. This Court should not vitiate Congress's clear intent in repealing section 1102(c).

Congress did give the bankruptcy courts the power to ensure adequate representation under section 1102(a)(2). To the extent a class of creditors lacks adequate representation, section 1102(a)(2) permits the court to order the appointment of additional creditors' committees to ensure adequate representation, **but confers the authority to appoint such committee solely on the U.S. Trustee**. Thus, even though section 1102(a)(2) is directed at the appointment of committees (other than unsecured creditors' committees), Congress's intent to remove the court from the appointment process is plainly evident.

The bankruptcy court in the present case recognized Congress's intent and properly held that it could not change the composition of the unsecured creditors' committee. The bankruptcy court also rejected the Appellant's argument that the court's equity powers allow the court to disregard Congressional intent. Since the decision of the bankruptcy court was legally correct and logically sound, the U.S. Trustee urges this Court to affirm that decision.

STATEMENT OF JURISDICTION

This Court need not reach the merits of this appeal since the order of the bankruptcy court was not an appealable order. According to 28 U.S.C. § 158(a), "[t]he district courts of the United States shall have jurisdiction to hear appeals (1) from final judgments, orders, and decrees; (2) from interlocutory orders and decrees issued under section 1121(d) of title 11 . . .; and (3) with leave of the court, from other interlocutory orders and decrees . . .." The order that forms the basis of the instant appeal is an interlocutory order, not a final order. See In re American Cabinets & Woodcrafting Corp., 159 B.R. 969, 971 (M.D. Fla. 1993) (holding that "an order is not final if it only disposes of an incidental procedural issue during the bankruptcy proceedings."). The bankruptcy court order is also not in any way related to an extension of time to file a plan under section 1121(d) of the Bankruptcy Code. Consequently, the only avenue for judicial review of the bankruptcy court decision is by leave of this Court. However, such leave was never requested nor granted.

It is axiomatic that leave to appeal an interlocutory order should be granted "only if the order (1) involves a controlling question of law (2) over which there is a substantial ground for difference of opinion and (3) if an immediate appeal would materially advance the ultimate termination of the litigation. In re Ionosphere Clubs, Inc., 179 B.R. 24, 28 (S.D.N.Y 1995). Assuming, *arguendo*, that the first two factors can be demonstrated, the Appellant cannot demonstrate that this appeal will materially advance the ultimate termination of the bankruptcy case. In order to demonstrate that the termination of the case will be materially advanced by the appeal, the party must be able to show that they cannot raise their rights in future proceedings. See In re Ionosphere Clubs, Inc., 179 B.R. at 29 (holding that, with respect to an appeal from an order approving a disclosure statement, the order was not appealable where the appellants could assert their rights at the confirmation hearing). In the present case, the Appellant is free to seek the appointment of an additional committee and to assert and protect all of its rights under the Bankruptcy Code. Such rights are in no way affected by the bankruptcy court decision. Consequently, the Appellant cannot meet the requirements for appeal of an interlocutory order and, accordingly, the appeal should be dismissed.

The Appellant also lacks standing based on the same analysis as set forth above. The requirements for standing are well-settled:

> "[T]he irreducible constitutional minimum of standing contains three elements. First, the plaintiff must have suffered an 'injury in fact' -- an invasion of a legally protected interest which is (a) concrete and particularized, and (b) actual or imminent, not conjectural or hypothetical. Second, there must be a causal connection between the injury and the conduct complained of . . .. Third, it must be likely, as opposed to merely speculative, that the injury will be redressed by a favorable decision."

United States v. Hays, ___ U.S. ___, 115 S. Ct. 2431, 2435 (1995)(quoting Lujan v. Defenders of Wildlife, 504 U.S. 555, 560-61 (1992)). The Appellant in the present case, however, cannot articulate a "concrete and particularized" injury resulting from the U.S. Trustee's committee appointment decision. Any injury that the Appellant may try to proffer would be merely "conjectural or hypothetical" and would not serve as a basis for standing in this appeal.

The Appellant's membership or non-membership on a committee does not affect the Appellant's standing in the bankruptcy case nor its priority under the Bankruptcy Code.[1] See cf. In re Gates Engineering Co., 104 B.R. 653, 655 (Bankr. D. Del. 1989)(noting that "the right to vote as a committee member may or may not be of prime importance" since the creditor may participate in the committee "ex-officio"). In fact, membership on the committee is more likely stifle a creditor's ability to protect its own interest because that creditor must act as a fiduciary for the entire unsecured creditor class. See

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[1] Where a particular creditor has a significant stake in the proceeding, that creditor can generally represent their own interest with or without a committee. Cf. In re Hills Stores Co., 137 B.R. 4, 8 (Bankr. S.D.N.Y. 1992). Additionally, creditors "are not precluded from forming an unofficial committee, retaining counsel and a financial advisor and seeking reimbursement of their expenses to the extent that they make a substantial contribution to the case, as permitted and even envisioned by § 503(b) of the Code." In re Hills Stores Co., 137 B.R. at 8.

Woods v. City Nat'l Bank & Trust Co., 312 U.S. 262, 268-69 (1941); In re Bohack Corp., 607 F.2d 258, 262 n.4 (2d Cir. 1979); In re Johns-Manville Corp., 26 B.R. 919, 924 (Bankr. S.D.N.Y. 1983); In re MAP International, Inc., 105 B.R. 5 (Bankr. E.D. Pa. 1989). If a creditor uses its position on the creditors' committee to further its own cause at the expense of the other creditors represented, then that creditor is subject to removal from the committee as well as possible liability for breach of fiduciary obligations. In re Johns-Manville Corp., 26 B.R. at 925.

Additionally, the Bankruptcy Code provides no right to membership on a creditors' committee to any creditor. In re Gates Engineering Co., 104 B.R. 653, 655 (Bankr. D. Del. 1989); see also In re Drexel Burnham Lambert Group, Inc., 118 B.R. 209, 211 (Bankr. S.D.N.Y. 1990). Section 1102(b)(1) provides some guidance as to how the membership of the committee may be determined, but the language is clearly "only 'precatory' and 'nonbinding." In re Drexel Burnham Lambert Group, Inc., 118 B.R. at 211 (quoting H.R. Rep. No. 595, 95th Cong., 1st Sess. 401-02 (1977)). Accordingly, unsecured creditors have a "right" to have their interests as a class represented by a committee (so long as qualified creditors are willing to serve), but no right as to the composition of such committee. In the present case, there has been no abrogation of the rights of unsecured creditors because their interests as a class are adequately represented by a committee duly appointed by the U.S. Trustee.

Since membership on the committee of unsecured creditors can not be used to further the individual interests of the committee member, the Appellant cannot articulate any legitimate, cognizable injury. Any injury that the Appellant could possibly argue would inevitably relate to an intention to utilize committee membership to further the Appellant's own interests, in violation of the fiduciary responsibilities attendant to committee membership. Such an injury would be, at best, conjectural and hypothetical, and would not serve to satisfy the Constitutional requirements for standing. Consequently, this appeal should be denied on jurisdictional grounds.

STATEMENT OF ISSUE

Whether the Bankruptcy Court correctly concluded that, as a matter of law, it could not order the appointment of the Appellant to the Official Committee of Unsecured Creditors.

STATEMENT OF FACTS

On September 20, 1995, the debtor, Victory Markets, Inc., d/b/a Great American Food Stores (the "debtor"), filed a voluntary petition for relief under chapter 11 of the Bankruptcy Code. Immediately upon the filing of the case, the U.S. Trustee undertook to solicit the twenty largest creditors for interest in serving on an official committee of unsecured creditors. The U.S. Trustee's solicitation efforts initially included mailing solicitation forms to each of the twenty largest creditors. Next, an appropriate date for an organizational meeting was determined and the U.S. Trustee proceeded to telephone each of the twenty largest creditors to advise such creditors of the date and time of the meeting, namely October 6, 1995, at 10:00 a.m.[2] The meeting was scheduled on an expedited basis in order to allow the creditors' committee an opportunity to review the post-petition financing arrangements and cash collateral matters that were scheduled for final hearings during October 1995.

Within a few days after the filing of this bankruptcy case, the U.S. Trustee learned of the Appellant's interest in serving on the creditors' committee. The U.S. Trustee requested that the Appellant submit a solicitation form. From September 25, 1995, through October 6, 1995, the U.S. Trustee engaged in a diligent effort to understand the true nature of the Appellant's involvement in the case. This inquiry included numerous telephone and in person conversations with counsel for the Appellant, requests for numerous documents and other information by letter, and an in-depth review of

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[2] Prior to the organizational meeting, the United States Trustee received a seemingly endless chain of telephone inquiries from creditors, each of whom were sent solicitation forms and were advised of the time and place of the organizational meeting. As a result of the United States Trustee's efforts in this case, 26 creditors returned solicitation forms indicating their interest in serving on the unsecured creditors committee.

all documents received pertaining to the Appellant's relationship to the debtor and other parties in interest.[3] The U.S. Trustee's efforts in determining the proper composition of the committee was fully in accordance with U.S. Trustee policies and procedures, as well as the applicable provisions of the Bankruptcy Code and Federal Rules of Bankruptcy Procedure.

In concluding that the Appellant should not be appointed to the Official Committee of Unsecured Creditors, the following facts, among others, were considered:

1) The Appellant owns approximately 37% of the stock of Victory Holdings, Inc. ("VHI"), which owns 100% of the debtor corporation. Since the ability to exercise control over the parent corporation is the functional equivalent of an ability to exercise control over a wholly-owned subsidiary of the parent, the Appellant in effect owns and controls 37% of the debtor.

2) The Appellant has voted its shares on at least three occasions since 1992, indicating that the Appellant, in fact, exercises control over the activities of VHI.[4] Indeed, the occasions on which the Appellant exercised its vote were with regard to a stock split and a restructuring in 1994.

3) The Appellant has the ability to place a director on the Board of Directors of VHI at any time based on its significant ownership interest.

4) No single entity holds over 50% of the stock of VHI. Thus, an alignment between the Appellant and another shareholder could give absolute control over VHI to the Appellant.

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[3] Much of the information supplied by the Appellant was inconsistent, at best. For example, Mr. Despins stated in a letter to the United States Trustee that the Appellant had only voted its shares twice, while the Appellant acknowledged in its motion before the bankruptcy court that such shares have been voted on three occasions. Additionally, the letter fails to disclose that (i) the Appellant has the power to place a director on the Board of Directors of VHI and (ii) that the Appellant is a guarantor of the debtor's indebtedness to C&S Grocers, Inc., which supplies the debtor with approximately 80% of its inventory.

[4] At the time of the organizational meeting, the United States Trustee had been informed of only two occasions in which the Appellant had voted its shares.

5) The U.S. Trustee's investigation revealed that Centre Capital Investors, L.P. ("Centre Capital"), which holds approximately 43.8% of the stock of VHI, and the Appellant are involved in numerous investments together. Consequently, it is likely that the interests of the Appellant and Centre Capital are aligned such that they jointly control VHI.

6) In light of the Appellant's interest and control over VHI, the Appellant's presence on the unsecured creditors' committee poses an obvious conflict of interest. Confidential information regarding strategies of the committee in plan negotiations would be compromised if an insider that *de facto* owns and controls the debtor were included as a member of the committee.

On the evening of October 5, 1995, after reviewing the facts regarding the Appellant, the U.S. Trustee office personnel reviewed the 26 solicitation forms received. Upon request of the U.S. Trustee, the debtor provided a breakdown of the different types of trade debt involved and the amounts owed to the various creditors. The U.S. Trustee made a preliminary decision as to the numbers and types of creditors to be included in the committee. At the organizational meeting on October 6, 1995, the U.S. Trustee made the final decision as to which creditors should be appointed to the committee. A notice of appointment of Unsecured Creditor Committee was filed on October 6, 1995.[5]

ARGUMENT[6]

I. THE BANKRUPTCY COURT CORRECTLY DENIED THE APPELLANT'S MOTION FOR APPOINTMENT TO THE COMMITTEE OF UNSECURED CREDITORS BASED

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[5] A much more detailed account of the United States Trustee's efforts in forming the committee is set forth in the Memorandum of Law in Support of Objection of the United States Trustee to First Plaza's Motion Seeking Appointment to Official Committee of Unsecured Creditors dated October 9, 1995.

[6] As discussed in the Statement of Jurisdiction, supra, this appeal should also be denied on jurisdictional grounds. Not only has the Appellant failed to demonstrate that appeal of the interlocutory order is appropriate, but also has not established its own standing in this matter. Thus, this Court need not entertain the appeal in the first instance.

ON THE PLAIN LANGUAGE OF THE BANKRUPTCY CODE AND THE APPLICABLE LEGISLATIVE HISTORY.

The bankruptcy court acted properly in denying the Appellant's request to be appointed to the Official Committee of Unsecured Creditors based on a determination that such relief was not available under the plain language of Section 1102. A review of the language and legislative history of section 1102 clearly indicates that the U.S. Trustee is entrusted with the task of appointing an unsecured creditors' committee in each chapter 11 case and that the composition of any committee so appointed is fully within the discretion of the U.S. Trustee. Furthermore, the bankruptcy court's role is limited to the creation of additional committees if necessary for adequate representation. However, since the Appellant never requested relief in the form of an additional committee, the bankruptcy court rightfully concluded that the motion had to be denied.

Prior to 1986, section 1102 of the Bankruptcy Code provided for the exact type of relief that the Appellant requests. The pre-1986 version of section 1102(a) provided that the bankruptcy court had sole authority to appoint a committee of unsecured creditors. 11 U.S.C. § 1102(a)(1) (1978) (amended 1986). Furthermore, Section 1102(c), which was repealed in 1986, provided that

> [o]n request of a party in interest and after notice and a hearing, the court may change the membership or the size of a committee appointed under subsection (a) of this section if the membership of such committee is not representative of the different kinds of claims or interests to be represented.

11 U.S.C. § 1102(c) (repealed 1986). Thus, prior to 1986, the bankruptcy courts had specific authority to appoint committees under section 1102(a) and to change the membership and size of any such committee.

In this pre-1986 period, many concerns arose regarding the court's role in creating creditors' committees. A substantial concern related to a perceived bias on the part of the court toward its hand-picked committee. See In re McLean Indus., Inc., 70 B.R. 852, 856 (Bankr. S.D.N.Y. 1987)(citing H.R.

Rep. No. 764, 99th Cong., 2d Sess. 18 (1986)). Additionally, there was concern that the court would necessarily obtain information regarding various parties during the selection process which could taint future proceedings. Id. Consequently, the advent of the U.S. Trustee Program provided an avenue for Congress to take the courts out of the committee selection process.

In 1986, the Bankruptcy Code was substantially amended by Congress to, *inter alia*, expand the U.S. Trustee program nationwide. In providing for the specific responsibilities of the U.S. Trustees, Congress made significant amendments to section 1102. First, Congress amended section 1102(a) to provide that the U.S. Trustee, rather than the Court, would be responsible for appointing committees. Additionally and significantly, Congress completely deleted section 1102(c), thereby eliminating the power of the Court to change the size or composition of committees appointed by the U.S. Trustee. In re Wheeler Technology, Inc., 139 B.R. 235, 239 (Bankr. 9th Cir. 1992); In re Drexel Burnham Lambert Group, Inc., 118 B.R. 209, 210-11 (Bankr. S.D.N.Y. 1990); In re Hills Stores Co., 137 B.R. 4, 8 (Bankr. S.D.N.Y. 1992); In re Gates Engineering Co., 104 B.R. 653, 654 (Bankr. D. Del. 1989).

The present version of section 1102(a)(1) of the Bankruptcy Code provides that

> as soon as practicable after the order for relief under chapter 11 of this title, the United States trustee shall appoint a committee of creditors holding unsecured claims and may appoint additional committees of creditors or of equity security holders as the United States trustee deems appropriate.

11 U.S.C. § 1102(a)(1) (1986). The language of section 1102(a)(1) (1986), unlike its predecessor, provides absolutely no role for the court in the appointment process. In fact, the appointment of the unsecured creditors' committee is effective upon the filing of a notice of appointment by the U.S. Trustee, **with no court order**.

The court, however, does play a significant role in the determination of adequate representation. Section 1102(a)(2) provides that the Court may order that additional committees be appointed after notice and hearing "if necessary to assure adequate representation of creditors." This power to order the appointment of additional committees gives the court the ability to remedy claims of inadequate representation, but relieves the court of the actual administrative task of deciding the membership of such committees. See In re Drexel Burnham Lambert Group, Inc., 118 B.R. 209, 211 (Bankr. S.D.N.Y. 1990). Indeed, if the Court decides that an additional committee is necessary in any particular case, the U.S. Trustee is still given the sole authority to appoint such committee. See 11 U.S.C. § 1102(a)(2)("[t]-he United States trustee shall appoint any such committee"); In re Hills Stores Co., 137 B.R. at 8. Consequently, the language and history of 11 U.S.C. § 1102 clearly indicate that the bankruptcy court is not to expend its valuable time in the administrative task of determining the composition of creditors' committees. Accordingly, the bankruptcy court in the present case properly denied the Appellant's motion.

II. THE BANKRUPTCY COURT DECISION IS SUPPORTED BY A MAJORITY OF PUBLISHED DECISIONS ON THIS ISSUE, INCLUDING THREE DECISIONS FROM THE SOUTHERN DISTRICT OF NEW YORK.

An apparent majority of courts directly addressing the issue presently before this Court has held that a bankruptcy court may not change the composition of a section 1102(a) committee of unsecured creditors. In reaching this conclusion, the courts have reviewed the language and legislative history of section 1102, analyzed the policy arguments, and considered the applicability of section 105(a). In the end, these courts recognized the intent of Congress to shelter the courts from composing or recomposing creditors' committees and properly refused to use their equity powers under section 105(a) to circumvent this Congressional intent.

For example, the Ninth Circuit Bankruptcy Appellate Panel ("BAP"), in In re Wheeler Technology, Inc., 139 B.R. 235 (Bankr. 9th Cir. 1992), which appears to be the only appellate case addressing the issue presently before this Court, held that the bankruptcy court may not effect a change in the composition of a committee in view of the 1986 amendments to section 1102. The Ninth Circuit BAP reviewed a decision by the bankruptcy court which ordered that a particular creditor be removed from the unsecured creditor committee as a sanction for violating the automatic stay. Id. at 237. While the creditor did not dispute the finding that it had violated the automatic stay, the creditor appealed the bankruptcy judge's order requiring removal from the committee. Id. at 238 n.5.

In reviewing and ultimately reversing the bankruptcy court decision, the BAP concluded that the bankruptcy court had no authority to effect a change in the composition of the creditors' committee. Id. at 239. The BAP reviewed the 1986 amendments to section 1102 and held that "[t]he power to appoint and delete members of the Creditors' Committee now resides **exclusively** with the U.S. Trustee." Id. (emphasis added). Additionally, the BAP noted that section 105(a) could not be used by the court to modify the membership of a committee because such action would be "contrary to the legislative history and Congressional intent in deleting subsection (c) of § 1102." Id., citing In re Gates Engineering Co., 104 B.R. at 654.

In addition to the Ninth Circuit BAP, the bankruptcy courts in the Southern District of New York have unanimously concluded that courts have no authority to change the membership of creditor committees in light of the 1986 amendments to section 1102. See In re Drexel Burnham Lambert Group, Inc., 118 B.R. 209, 210 (Bankr. S.D.N.Y. 1990)(Buschman, J., presiding); In re Hills Stores Co.., 137 B.R. 4, 8 (Bankr. S.D.N.Y. 1992)(Brozman, J., presiding); In re Texaco, 79 B.R. 560, 565-66 (Bankr. S.D.N.Y. 1987)(Schwartzberg, J., presiding); see also In re McLean Indus., Inc., 70 B.R 852, 856 n.2 (Bankr. S.D.N.Y. 1987)(Buschman, J., presiding)("Thus, [based on Congress's repeal of section 1102(c),] the court no longer has the option to change committee membership."). For example, in In re Drexel Burnham Lambert Group, Inc., 118 B.R. at 210, a creditor moved the court to compel the

U.S. Trustee to add the creditor to the committee of unsecured creditors. The creditor had made a formal request to the U.S. Trustee to be added to the committee, but such request was refused. Id.

The analysis of the court in resolving the matter was very similar to that utilized by the Ninth Circuit BAP. The Drexel court first recited the present version of section 1102(a), then noted "the absence of any indication in the statute that the court may add to or delete an unsecured creditor from a committee." Id. at 210. The court was also aware that section 1102(c), which had previously provided the court with specific authority to alter the composition of creditors' committees, had been repealed by the 1986 amendments. Id. Properly following the statutory language strictly, the court concluded that section 1102 does not authorize the court to add or delete creditors from committees appointed pursuant to 1102(a). Id. at 210-11. Furthermore, the court concluded that section 105(a) could not provide such authorization, stating that section 105(a) allows a court to "issue orders 'necessary and appropriate to carry out the provisions of this title,' not in ignorance of what Congress has wrought." Id. at 211. The court, however, did recognize that it had the ability to address inadequate representation problems, but only through creation of additional committees. Id.; see 11 U.S.C. § 1102(a)(2).

The well-reasoned analysis of Judge Buschman in Drexel, as well as the analysis of the Ninth Circuit BAP, should be followed by this Court.[7] Indeed, the conclusion reached by Judge Buschman is the only conclusion that makes sense in light of the language of section 1102 and the 1986 amendments thereto. If Congress had intended that the court have authority to alter the composition of committees, why did it delete section 1102(c)? The only explanation is that Congress wanted to remove the

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[7] Judge Tina Brozman of the Southern District, in In re Hills Stores Co., 137 B.R. 4 (Bankr. S.D.N.Y. 1992), cited the Drexel decision with approval in concluding that "[w]hile [the court] may order the appointment of additional *committees* under § 1102(a)(2) of the Code, the statute no longer permits the addition or deletion of *members* of committees by the court." Id. at 8.

bankruptcy courts from the administrative aspects of cases and, consequently, vested sole discretion in the U.S. Trustee as to the composition of committees.

III. SECTION 105(a) OF THE BANKRUPTCY CODE DOES NOT PROVIDE A BASIS FOR THE COURT TO DISREGARD THE CLEAR INTENT OF CONGRESS IN REPEALING SECTION 1102(c).

The cases cited by the Appellant in support of the court's ability to change the composition of creditors' committees, even in light of the repeal of section 1102(c), rely on the court's equity power under section 105(a). However, while the bankruptcy courts do retain some equity power under section 105(a), the courts are not empowered to use those equity powers in derogation of Congress's intent. Rather, the equity powers were intended to provide the bankruptcy court an avenue for ensuring that Congress's intent is achieved. Consequently, the use of section 105(a) to achieve a result not intended by Congress would constitute an abuse of the court's equity powers.

Section 105(a) of the Bankruptcy Code provides that "[t]he court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title." 11 U.S.C. § 105(a). However, this provision only allows the court the ability to use equity to "fulfill some specific Code provision." In re Fesco Plastics Corp., 996 F.2d 152, 154 (7th Cir. 1993)(citing Norwest Bank Worthington v. Ahlers, 485 U.S. 197, 206 (1988)). In other words, "when a specific Code section addresses an issue, a court may not employ equitable powers to achieve a result not contemplated by the Code." Id. (citing In re Morristown & Erie R. Co., 885 F.2d 98, 100 (3d Cir. 1989)); see also In re Joint E. & S. Dist. Asbestos Litigation, 982 F.2d 721, 751 (2d Cir. 1992). In the present case, the result contemplated by the Code with respect to the formation of creditors' committees is that the U.S. Trustee has sole authority to appoint the committees and the courts are limited to addressing whether additional committees are needed to ensure adequate representation. Thus, section 105(a) of the Code cannot be used to compel the Court to re-enter the committee formation process.

The Appellant proffers In re Columbia Gas System, Inc., 133 B.R. 174 (Bankr. D. Del. 1991), for the proposition that the Court may review the decision of the U.S. Trustee regarding the committee composition under an abuse of discretion standard. However, the court in Columbia Gas based its holding on an untenable interpretation of its powers under section 105(a).

In Columbia Gas, the U.S. Trustee had appointed the Official Committee of Unsecured Creditors and had refused a creditor's request to be placed on the committee. Id. at 175. The creditor then moved the bankruptcy court for an order directing the U.S. Trustee to appoint the creditor as a member of the Official Committee of Unsecured Creditors (the "Committee"). Id. at 174. Prior to the hearing on the creditor's motion, the Committee moved the court to adjourn the creditor's motion and allow briefing on the issue of whether the creditor's motion should fail as a matter of law. Id. at 174-75.

In addressing the Committee's motion, the Columbia Gas court recognized that the deletion of section 1102(c) evidenced Congress's intent that the bankruptcy courts "cannot substitute [their] judgment for that of the U.S. Trustee regarding the composition of the Committee." Id. at 175. However, the court did a dance around this acknowledgment of Congressional intent.[8] The court held that, although it cannot change the composition of unsecured creditors' committees, it can review the U.S. Trustee's actions in appointing the committee under an abuse of discretion standard pursuant to section 105(a). Id. While the court did not expressly address the remedy available if the court concluded that the U.S. Trustee abused its discretion, the court did note that section 105(a) would allow the court

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[8] In analyzing the deletion of section 1102(c), the court concluded that "the legislative history indicates the Court's power to change committee membership was removed as a housekeeping measure merely to keep section 1102 internally consistent." Id. at 175. Certainly, the court's analysis is not plausible. Had Congress intended that the courts would retain the ability to alter the composition of committees, Congress obviously would have left section 1102(c) intact. The provisions of section 1102(c) would have been perfectly consistent with the 1986 amendments to section 1102, if Congress had intended that the courts retain the ability to change the composition of creditors' committees.

to order "necessary or appropriate relief." Id. at 176. Thus, the court inferred that section 105(a) could be used to dodge the intent of Congress in deleting section 1102(c). See also In re Plabell Rubber Products, 140 B.R. 179 (Bankr. N.D. Ohio 1992) (holding that the court could change the composition of a creditors' committee pursuant to section 105(a), despite the repeal of section 1102(c)).

As noted above, the conclusion reached by the Columbia Gas court is contrary to the notion that "a [bankruptcy] court may not employ its equitable powers to achieve a result not contemplated by the [Bankruptcy] Code." In re Fesco Plastics Corp., 996 F.2d 152, 154 (7th Cir. 1993); see also Norwest Bank Worthington v. Ahlers, 485 U.S. 197, 206 (1988)("whatever equitable powers remain in the bankruptcy courts must and can only be exercised within the confines of the Bankruptcy Code"); In re Ionosphere, 922 F.2d 984, 995 (2d Cir. 1990)("[t]he bankruptcy court's equitable powers cannot be exercised in derogation of other sections of the Bankruptcy Code"). The Bankruptcy Code provides that the U.S. Trustee has the sole discretion to determine the composition of committees and, consequently, the court should not use section 105(a) to alter that result. See In re Drexel Burnham Lambert Group, Inc., 118 B.R. 209, 211 (Bankr. S.D.N.Y. 1990)(specifically stating that section 105(a) cannot be used to allow the court to alter the composition of creditor committees); In re Wheeler Tech., Inc., 139 B.R. 235 (Bankr. 9th Cir. 1992)(same); In re Gates Eng'g Co., 104 B.R. 653, 654 (Bankr. D. Del. 1989)("the court cannot under the provisions of § 105 circumvent the unambiguous language . . . of the Code . . . in light of the deletion of subsection (c) in 1986.").

Finally, the Appellant relies on In re Texaco, Inc., 79 B.R. 560 (Bankr. S.D.N.Y. 1987), for support of its request that the court order that the Appellant be added to the creditor committee. In Texaco, however, the court specifically recognized that, in light of the deletion of section 1102(c), the power to change the size or composition of creditors' committees lies exclusively with the U.S. Trustee. Id. at 565-66. The court ultimately concluded that, because section 1102 was silent regarding the elimination or merger of committees, the court could merge two already formed committees while remaining consistent with the intent of Congress.[9] Id. at 566-67. In reaching that decision, the court, of necessity, addressed whether its determination regarding adequate representation should be made on a *de novo* basis. Id. at 566. The court correctly concluded that the section 1102(a)(2) issue of adequate representation was a legal issue that the court should consider *de novo* in deciding whether to order the appointment of an additional committee. Id. However, the court (1) specifically recognized that, even if it decided that the creditor was not adequately represented, the court could not add or delete individual members from a creditors' committee and (2) never addressed the question of whether the court could review the actions of the U.S. Trustee. See id. Thus, the decision in Texaco actually supports the U.S. Trustee's position in this appeal.[10]

Each of the cases cited by the Appellant should be disregarded and the bankruptcy court's Memorandum-Decision denying the motion to add the Appellant to the creditors' committee in this case should be affirmed. The clear intent of Congress in amending section 1102 was to place the full discretion in committee composition with the U.S. Trustee. The Congress left with the court the ability to compel the U.S. Trustee to appoint additional committees, where needed to ensure adequate representation. Section 105(a) should not be used to vitiate Congress's intent.

IV. THE PROPRIETY OF JUDICIAL REVIEW OF THE U.S. TRUSTEE'S ACTIONS

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[9] The committees to which the Texaco court was referring had both presumably been appointed by the U.S. Trustee. In any event, the question of whether a court may combine two committees is not presently before this Court.

[10] The Texaco court does state that "[a]ccordingly, it follows that if upon request of an interested party, the United States Trustee does not agree to change the membership or size of a committee . . ., such party may apply to the court for such relief." In re Texaco, Inc., 79 B.R. at 566. However, based on the context of the quote, the court was merely referring to its ability to order the appointment of additional committees pursuant to section 1102(a)(2).

A. The Bankruptcy Court's Decision Did Not Preclude Review of the United States Trustee's Actions; Rather, the Bankruptcy Court Held Only That It Could Not Grant the Relief Requested.

The issue on appeal, as stated by the Appellant, does not serve as a basis for reversing the Bankruptcy Court decision from which this appeal arises. The Appellant has framed the issue in terms of whether the bankruptcy courts have the ability to review decisions of the U.S. Trustee; however, the bankruptcy court never indicated that it did not have the power to review decisions of the U.S. Trustee. Rather, the bankruptcy court decided that, as a matter of law, it did not have the power to grant the specific relief requested by the Appellant. (Memorandum-Decision at 12). Consequently, a decision as to whether the Court has the ability to review decisions of the U.S. Trustee is not a proper issue for appeal.

The Bankruptcy Court's decision was based on a straight-forward analysis of language and history of section 1102, which led directly to the conclusion that the Court could not grant the Appellant's request that the bankruptcy court "issue an Order pursuant to 11 U.S.C. § 105(a) directing the Office of the U.S. Trustee to appoint [the Appellant] as a member of the Official Committee of Unsecured Creditors . . .." (First Plaza's Motion at 9). The court simply concluded that, regardless of whether it had authority to review the actions of the United States Trustee, it could not change the composition of creditors' committees in light of section 1102. Furthermore, the court was unwilling to utilize its equity powers to circumvent the intent of Congress. Thus, the bankruptcy court never reached the issue of whether it could review the actions of the U.S. Trustee in forming the committee. Accordingly, that issue is not ripe for review by this Court.

1. The Bankruptcy Court Has the Power to Review the Make-up of Committees to Determine if Additional Committees Are Needed for Adequate Representation.

Although the bankruptcy court never addressed the issue of its ability to review the action of the U.S. Trustee, it clearly recognized its own ability, pursuant to Section 1102(a)(2), to make a determination of whether classes of creditors were adequately represented. (Memorandum-Decision at 12); see cf. In re McLean Indus., Inc., 70 B.R. 852, 856 (Bankr. S.D.N.Y. 1987). The court rightly concluded that the sole statutory remedy for an inadequately represented class was the creation of an additional committee. (Memorandum-Decision at 10). Since the Appellant never requested relief in the form of an additional committee, the court concluded that it need not review the issue of adequate representation. (Memorandum-Decision at 12).

While section 1102(a)(2) provides for the appointment of additional committees to ensure adequate representation, it does not provide for the review of actions of the U.S. Trustee, nor for alterations to the composition of an existing creditors' committees. Section 1102(a)(2) provides that

> [o]n request of a party in interest, the court may order the appointment of additional committees of creditors or of equity security holders if necessary to assure adequate representation of creditors or of equity security holders. The United States trustee shall appoint any such committee.

11 U.S.C. § 1102(a)(2). By its own terms, section 1102(a)(2) does nothing other than provide a mechanism for appointment of additional committees.[11] It was simply never intended as a source of

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[11] Section 1102(a)(2) was created to allow the court an avenue to ensure that all classes of creditors are adequately represented in bankruptcy proceedings. In a particular case, a creditor class, such as equity security holders, may need a separate committee appointed to ensure that the group as a whole has adequate representation. Since the Code does not require that a committee of equity security holders be appointed, a procedure was needed so that the court could ensure that such a committee would be formed where necessary. Thus, section 1102(a)(2) allows the court to order the appointment of a committee of equity security holders, or of any other group of creditors, where necessary to ensure that the class is adequately represented in the proceedings. This intent was explicitly set forth in the House Report:

> [Under the new chapter 11 reorganization chapter,] [t]here will be at least one committee in each case. Because unsecured creditors are normally the largest body of creditors and most in need of representation, the bill requires that there be a committee of unsecured creditors. The [newly created chapter 11] permits the plan of reorganization to affect secured debt and equity as well as unsecured debt.

authority for review of actions of the U.S. Trustee or for altering the composition of committees. Consequently, the Appellant's reliance on section 1102(a)(2) is completely misplaced.

2. The Bankruptcy Court Did Not Utilize the "Negative Pregnant" Analysis Discussed in *Field v. Mans* in Denying the Relief Requested by the Appellant.

The bankruptcy court's analysis and interpretation of section 1102 did not utilize the "negative pregnant" type of analysis that was addressed recently by the Supreme Court in Field v. Mans, 116 S. Ct. 437 (1995). Rather, the bankruptcy court relied on the fact that the Congress **specifically repealed section 1102(c) which, prior to its repeal, had authorized the Court to grant the specific relief requested by the Appellant.** Consequently, the Field case is not applicable to the present situation.

In Field, the Supreme Court was faced with two sections of the Bankruptcy Code, sections 523(a)(2)(A) and 523(a)(2)(B), both of which provide circumstances under which a bankruptcy claim can be held non-dischargeable. Id. at 441. The issue before the Supreme Court was whether section 523(a)(2)(A) required a showing of "reasonable reliance" by the creditor as a prerequisite to relief, even though the section did not specifically denote such a requirement. Id. at 440. The creditors argued that, because section 523(a)(2)(B) specifically included a requirement that the creditor reasonably rely on the false statement by the debtor, Congress, by not denoting specifically that reasonable reliance was required in section 523(a)(2)(A), must have intended that "reasonable reliance" would not be required for relief under that section. Id. at 442. This argument was referred to by the Supreme Court as a "negative pregnant"; i.e. "that an express statutory requirement here, contrasted with statutory silence there, shows an intent to confine the requirement to the specified instance." Id. While the Supreme

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> Thus, the bill also provides for additional committees, with status equal to that of the unsecured creditors' committee, when such additional committees are needed to represent various other interests in the case, including secured creditors, subordinated creditors, and equity security holders.

H.R. Rep. No. 595, 95th Cong., 1st Sess., at 235 (1977) (citations omitted).

Court accepted the negative pregnant as a useful part of statutory analysis, the Court determined that, **based on the facts in the case before it**, the negative pregnant "should not be elevated to the level of interpretive trump card." Id.

In the present case, the Court did not utilize a negative pregnant analysis. As noted in Field, the negative pregnant analysis follows the reasoning "that an express statutory requirement here, contrasted with statutory silence there, shows an intent to confine the requirement to the specified instance." Id. at 442. However, in the present case, the statutory silence was specifically and intentionally created by the Congress when it repealed section 1102(c). The bankruptcy court made no comparison between section 1102 and any other section, which would lend to a negative pregnant analysis. Clearly, no need for a negative pregnant analysis exists when an act of Congress so plainly demonstrates its intent.

The distinction between the bankruptcy court's analysis in the present case with the type of analysis in Field becomes very apparent when the facts of Field are hypothetically adjusted to match the facts in the present case. Suppose the Supreme Court, in analyzing section 523(a)(2)(A), reviewed the history of that subsection and determined that, at one time, the subsection included a specific requirement that the creditor demonstrate reasonable reliance. Further suppose that, prior to the Field case, Congress had purposefully deleted from section 523(a)(2)(A) the requirement of reasonable reliance. Such a deletion, in this hypothetical situation, would be clear evidence of Congress's intent that reasonable reliance need not be proved. If the facts in this hypothetical were true, then the Supreme Court would not have needed to address the negative pregnant argument because the specific deletion of the reasonable reliance requirement would have clearly indicated Congress's intent.

The situation articulated in the hypothetical is the same as in the present case. Here, section 1102 at one time provided for the specific relief that the Appellant seeks. However, in 1986, Congress specifically and intentionally repealed that section, demonstrating its intent to shield the bankruptcy courts from involvement in the administrative task of composing creditors' committees. The specific intent demonstrated by the repeal of section 1102(c) is self-evident; thus, the negative pregnant analysis is not applicable to this case.

B. The Administrative Procedures Act Is Inapplicable to This Appeal.

1. A Determination on Appeal Regarding the Applicability of the Administrative Procedures Act Should Be Precluded Because the Issue Was Not Raised by the Appellant in Bankruptcy Court.

The Appellants arguments relating to the applicability of review under the APA should not be considered on appeal since relief under that statute was never requested by the Appellant in the bankruptcy court. See In re Drexel Burnham Lambert Group, Inc., 118 B.R. 209, 211 n.1 (Bankr. S.D.N.Y. 1990)(the court refused to consider the creditor's APA argument holding that "[t]his belated brief raising new issues is untimely and the issue of judicial review is a substantial issue not to be raised at the last minute."). While it is true that this Court retains discretion to decide issues that were not presented to the bankruptcy court, "the general rule is that a federal appellate court does not consider an issue not passed upon below" unless a failure to consider the issue will lead to manifest injustice. In re Lionel Corp., 29 F.3d 88, 92 (2d Cir. 1994)(citations omitted); In re Macrose Industries Corp., 186 B.R. 789, 802 (E.D.N.Y. 1995). In the present case, the record clearly reflects that the Appellant never requested review under the APA in the bankruptcy court. Consequently, the U.S. Trustee did not address the APA and neither did the bankruptcy court. So the question is whether a failure to review the APA issue will be "manifestly unjust."

In this case, this Court's decision not to review the applicability of the APA will not be manifestly unjust. The Second Circuit has held that "a manifest injustice will not occur when the moving party has other means by which it can obtain a successful result." In re Macrose Industries Corp., 186 B.R. at 802 (citing In re Lionel Corp., 29 F.3d at 92). In this instance, the Appellant is not precluded from moving the bankruptcy court to review the actions of the U.S. Trustee pursuant to the APA, in the event that this Court affirms the decision of the bankruptcy court with respect to section 105(a). Consequently, the Appellant has an alternate means by which it can at least attempt to obtain a successful result with respect to the APA. With such an available alternative, the Appellant's request that this Court review the APA issue should be denied.

2. The Appellant Does Not Have Standing Under the Administrative Procedures Act Because No "Injury in Fact" Has Been Asserted.

In addition to the Appellant's failure to request relief under the APA in bankruptcy court, the Appellant lacks standing to bring an action under the APA. Pursuant to section 702 of the APA, the right to seek review of an "agency action" is limited to those persons "suffering legal wrong because of agency action, or adversely affected or aggrieved by agency action within the meaning of a relevant statute . . .." 5 U.S.C. § 702. In determining what constitutes a "legal wrong," the courts have devised a two part test: a petitioner must (1) demonstrate an "injury in fact" caused by the agency action, and (2) must assert that the alleged injury was within the "zone of interests" to be protected by the statute in question. Sierra Club v. Morton, 405 U.S. 727, 733 (1972); Gull Airborne Instruments, Inc. v. Weinberger, 694 F.2d 838 (D.C. Cir. 1982). In the present case, the Appellant has no standing under the APA because it has suffered no injury in fact by the alleged agency action in question.

The committee of unsecured creditors, or any other committee, is a creature of administrative convenience. The unsecured creditors' committee, once formed by the U.S. Trustee pursuant to section 1102(a), is charged with representing the unsecured creditor interests as a whole. In that regard, each member of the committee undertakes a fiduciary obligation to the entire unsecured creditor class. Woods v. City Nat'l Bank & Trust Co., 312 U.S. 262, 268-69 (1941); In re Bohack Corp., 607 F.2d 258, 262 n.4 (2d Cir. 1979); In re Johns-Manville Corp., 26 B.R. 919, 924 (Bankr. S.D.N.Y. 1983); In re MAP

International, Inc., 105 B.R. 5 (Bankr. E.D. Pa. 1989). The members of the unsecured creditor committee, in accordance with their fiduciary obligations, may not use the committee to further their own individual interests, unless those interests correspond to the interests of the unsecured creditor class as a whole. See In re Johns-Manville Corp., 26 B.R. at 925. Consequently, the rights and powers of a particular creditor are not enhanced by membership on the committee, except to the same degree that all creditors' interests are enhanced by the creation of a committee.

Accordingly, an unsecured creditor incurs no injury by not being appointed to the committee of unsecured creditors. As long as a committee is appointed as required by section 1102(a) and regardless of what specific creditors are on the committee, all unsecured creditors will receive the benefits of the committee equally. Thus, a specific creditor, such as the Appellant, cannot show any legitimate injury caused by the U.S. Trustee's decision. Any injury that the Appellant could possibly allege would arise from a desire to utilize the membership on the committee in order to further the Appellant's own interests, which would be a breach of fiduciary obligation. Certainly, such an injury should not serve as a basis for standing under the APA. Thus, since the Appellant has suffered no injury in fact, the Appellant has no standing to seek review under the APA of the U.S. Trustee's actions.[12]

3. The United States Trustee's Decision Regarding the Composition of the Committee Is Not Reviewable Under the APA Because the Composition of the Committee Is Committed to Agency Discretion by Statute.

Even if the Appellant had properly raised the issue in the bankruptcy court, and even if the Appellant had standing, the Appellant's request for review under the APA would have to be denied because the composition of creditors' committees is vested in the discretion of the U.S. Trustee. Pursuant to the plain language of 5 U.S.C. § 701(a)(1), the provisions of the APA are not applicable in

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[12] The foregoing analysis also indicates that the Appellant lacks standing to contest the contest the composition of the creditors' committee at all. See Statement of Jurisdiction, supra.

situations where "statutes preclude judicial review." In the present case, section 1102 of the Bankruptcy Code precludes judicial review of the composition of creditor committees and commits the appointment of creditors' committees to the discretion of the U.S. Trustee. Consequently, the APA offers no basis for review of the U.S. Trustee's committee appointment decisions.

In determining whether a statute precludes judicial review under the APA, both the language of the statute and the purposes of the statute must be considered. Shaltry v. United States, 182 B.R. 836, 840 (D. Ariz. 1995). The inquiry is "statute specific . . . and relates to the language of the statute and whether the general purposes of the statute would be endangered by judicial review." Id. (quoting County of Esmeralda v. United States Dep't of Energy, 925 F.2d 1216, 1218 (9th Cir. 1991)). As noted above, the 1986 amendments to section 1102 effectively took the court out of the committee appointment process. Those amendments furthered Congress's expressed intent of relieving the courts of administrative tasks. However, to allow judicial review of the U.S. Trustee's decisions regarding the composition of committees would effectively nullify the purpose of the 1986 amendments by thrusting the court back into the administrative role of composing creditors' committees. Thus, judicial review itself contradicts Congress's intent, making the APA inapplicable.

Additionally, there is no standard by which the Court can judge the U.S. Trustee's exercise of discretion. According to the Supreme Court, an agency action is not reviewable under the APA if "the statute [from which the agency action derives] is drawn so that a Court would have no meaningful standard against which to judge the Agency's exercise of discretion." Heckler v. Chaney, 470 U.S. 821, 830 (1985). In this case, section 1102(a)(1) sets forth no standards for court review. Additionally, section 1102(b)(1) sets no standards for review of U.S. Trustee appointment decisions, except perhaps with respect to appointment of committees organized before the commencement of the case. Without such a standard, review under the APA is not appropriate.

A similar situation was addressed in Joelson v. United States, 179 B.R. 857 (Bankr. N.D. Ohio 1995). In that case, a former chapter 7 panel trustee, *inter alia*, sought review under the APA of the U.S. Trustee's action in removing the trustee from the panel. Id. at 859. The court held that no standard existed by which the court could review the U.S. Trustee's actions. Id. at 861-62. Consequently, review under the APA was held to be improper. Id. at 862.

The bankruptcy court first noted that a determination as to reviewability must be made prior to any review under the APA. Id. at 860 (quoting Heckler, 470 U.S. at 821). The court then reviewed 28 U.S.C. § 586, which vests the power to appoint and supervise the panel trustees within the discretion of the U.S. Trustee. That statute provides that the U.S. Trustee "shall . . . establish, maintain and supervise a panel of private trustees that are eligible and available to serve as trustees in cases under chapter 7 of title 11." 28 U.S.C. § 586. Additionally, the statute provides for the supervisory role of the U.S. Trustee over "the administration of cases and trustees in cases under chapter 7, 11, 12, or 13 of title 11." Id. Based on the statutory language, the court concluded that "there is no judicial standard against which to evaluate a U.S. Trustee's exercise of discretion regarding the membership in the Panel of Trustees." Joelson, 179 B.R. at 861. Consequently, the court held that, "as a result of the discretion afforded to the U.S. Trustee, the decision to remove a Panel member renders that decision immune from judicial review under the APA." Id. at 862.

The facts in Joelson are quite similar to the facts in the present case. First, just as in the present case, the court in Joelson was analyzing a task that, prior to 1986, had been vested in the court. Before the advent of the U.S. Trustee program, the court was responsible for appointing chapter 7 trustees. See 11 U.S.C. § 701(a) (1978) (amended 1986). However, based on the same policy concerns that arose with respect to the bankruptcy courts' involvement in selecting creditors' committees, Congress chose to divest the Court of the role of appointing trustees and place that task with the U.S. Trustee. See H.R.

Rep. No. 764, 99th Cong., 2d Sess. 18 (1986). Thus, from a policy perspective, the Joelson case is identical to the instant case.

Second, 11 U.S.C. § 586, which was relied on heavily by the Joelson court, is also applicable in the present case. In providing for the supervision of cases and trustees, section 586 provides that the U.S. Trustee "shall . . . (1) supervise the administration of cases . . . by, whenever the United States trustee considers it to be appropriate . . . (E) monitoring creditors' committees appointed under title 11." 11 U.S.C. § 586. Section 586 further provides that the U.S. Trustee shall "(5) perform the duties prescribed for the United States trustee under title 11 and this title, and such duties consistent with title 11 and this title as the Attorney General may prescribe." Id. These provisions clearly give the U.S. Trustee, as officer of the Attorney General, the discretion to monitor creditors' committees and take whatever action deemed necessary with respect to such committees, so long as such actions are consistent with titles 11 and 28 of the United States Code. In light of such discretion, this Court should take notice of the reasoning in Joelson and hold that the APA is inapplicable to the U.S. Trustee's decisions under section 1102(a)(1).

Since the language and history of section 1102 indicate Congress's intent to (1) relieve the court of the administrate task of appointing committees, and (2) to vest the U.S. Trustee with discretion regarding the composition of committees, this Court should hold that the U.S. Trustee's actions with respect to section 1102 fall within the exemption in section 701(a)(1) of the APA, such that review under the APA is precluded.

C. FRBP 2020 In No Way Authorizes Review of U.S. Trustee Actions; Rather It Merely Specifies a Procedure for Situations in Which a Statutory Basis for Review of the U.S. Trustee Exists.

Federal Rule of Bankruptcy Procedure ("FRBP") 2020 does not provide a basis for review of any actions by the U.S. Trustee, including actions related to committee formation. Rather, FRBP 2020 merely provides for the applicable procedure where a basis for review of the U.S. Trustee exists under the Bankruptcy Code or some other statute. Certainly, a rule of procedure cannot operate as statutory law nor create substantive rights. See 28 U.S.C. § 2075 ("[the FRBP] shall not abridge, enlarge, or modify any substantive right"); In re Waindel, ___ F.3d ___, 1995 WL 561471 (5th Cir. 1995). Consequently, neither FRBP 2020, nor any other rule of procedure, creates a basis for review of the U.S. Trustee.

FRBP 2020 is applicable, however, where the court reviews whether U.S. Trustee actions are in compliance with the applicable provisions of the Bankruptcy Code and Federal Rules of Bankruptcy Procedure. For example, the Advisory Committee Note to FRBP 2020 provides the following example:

> if the United States trustee schedules a § 341 meeting to be held 90 days after the petition is filed, and a party in interest wishes to challenge the propriety of that act in view of § 341(a) of the Code and Rule 2003 which requires that the meeting be held not more than 40 days after the order for relief, [FRBP 2020] permits the party to do so by motion.

Fed. R. Bankr. P. 2020 advisory committee's note. But see In re Brown Transport Truckload, Inc., 161 B.R. 735, 738 (Bankr. N.D. Ga. 1993)(holding that FRBP 2003 is void where it conflicts with the section 341 of the Bankruptcy Code, which requires only that the initial meeting of creditors be held within a "reasonable time"). Thus, FRBP 2020 allows the moving party to contest the U.S. Trustee's actions by motion pursuant to FRBP 9014, rather than by summons and complaint. However, FRBP 2020 does not provide the basis for review.

Even if the FRBP provided a basis for review, the Advisory Committee Notes clearly denote that no basis exists for review of discretionary acts by the U.S. Trustee. Specifically, the Advisory Committee Note to FRBP 2020 further states that **"[FRBP 2020] is not intended to limit the discretion of the United States trustee, provided that the United States trustee's act is authorized by, and in compliance with, the Code, title 28, these rules, and other applicable law**." Fed. R.

Bankr. P. 2020 advisory committee's note. Thus, where the U.S. Trustee's actions are discretionary, FRBP 2020 is not applicable.

In the present case, the U.S. Trustee action in appointing a committee of unsecured creditors is authorized by section 1102(a) of the Bankruptcy Code. Furthermore, the U.S. Trustee has fully complied with all applicable law in forming the committee. On October 6, 1995, as soon as practicable after the order for relief, the U.S. Trustee appointed the committee of creditors holding unsecured claims in full compliance with section 1102(a)(1). No other requirements pertaining to committee formation appear in the Bankruptcy Code or the Federal Rules of Bankruptcy Procedure. Rather, the actual composition of the committee is left to the discretion of the U.S. Trustee. Accordingly, since the U.S. Trustee's actions in this case were authorized, and such actions were in full compliance with all applicable law, section 2020 does not authorize the Court to limit the discretion of the U.S. Trustee regarding the proper composition of the committee. Consequently, FRBP 2020 supports the conclusion that the decision of the bankruptcy court should be affirmed.

D. The Power to Order the Appointment of Additional Committees Does Not Include a Lesser Remedy of Re-Composing an Existing Committee.

While it is true that the courts have the power to order the appointment of additional committees, such power does not include the lesser power of altering the size of an existing committee. The plain language of the statute compels this conclusion. While considerations of cost to the debtor are important in the context of a bankruptcy case, they are not appropriate considerations in determining this question of law, especially where economic considerations were not the basis for section 1102. In other words, "[t]he potential added cost is not sufficient in itself to deprive the creditors of the formation of an additional committee if one is otherwise appropriate." In re Hills Stores Co., 137 B.R. 4, 6 (Bankr.

S.D.N.Y. 1992). Thus, while the court should consider economic conditions when such consideration is consistent with the provisions of the Bankruptcy Code, the intent of Congress should not be usurped by the court's own determinations regarding the economics of the case. Furthermore, the intent of Congress should not be compromised through the disingenuous argument that power to appoint additional committees includes the lesser power of changing the composition of committees, especially where the language of section 1102(a)(2) specifically denotes that the U.S. Trustee has sole authority to appoint committees.

CONCLUSION

Based on the foregoing analysis of the language and history of section 1102, Congress's intent to remove bankruptcy courts from the administrative task of appointing the committee of unsecured creditors is clear. Since the bankruptcy court recognized this intent, and properly concluded that it could not circumvent that intent through the use of section 105(a) or any other statute, the decision of the bankruptcy court should be affirmed.

Date: February 20, 1996
Utica, New York

Respectfully submitted,

MARY ELIZABETH TOM
ACTING UNITED STATES TRUSTEE

By: ________________________
Michael E. Collins, Esq.
Assistant U.S. Trustee
Office of the U.S. Trustee
10 Broad Street, Room 105
Utica, New York 13501
(315) 793-8191

BRIEF BANK — "SUMMARY SHEET" Printed Wed.-12/15/99 (9:42)

WESTLAW CODES	
1. ("TI") TITLE OF CASE [E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]	**WALLER v. NASUTI (IN RE VINSON)**
2. ("CO") CURRENT COURT [E.g., "CTA9"]	**U.S. District Court (N.D.GA.)**
3. ("CCN") CURRENT CASE NO.	**No.: 2:99-CV-184-WCO**
4. ("PCN") PRIOR CASE NO. & COURT [IF ANY]	**No.: 96-20394-REB** **U.S. Bankruptcy Ct. (N.D.GA., GAINEVSILLE DIV.) (BRIZENDINE, J.)** (Identify judge & cite, if any)
5. ("SO") SOURCE	**U.S. TRUSTEES**
6. ("DA") DATE OF FILING & TYPE OF BRIEF [E.g., "Opening Brief," "Reply," "Amicus," etc.]	**Filed: NOV. 16, 1999** **Type: BRIEF FOR APPELLEE, U.S. TRUSTEE**
7. ("AU") PRINCIPAL AUTHORS & OFFICE [E.g.,"UST/OGC"]	**JAMES H. MORAWETZ & GUY G. GEBHARDT** UST/ATLANTA (404-331-4437/FAX-4464) (UST/OGC: 202-307-1399/FAX-2397)
8. ("TO") TOPIC	**BANKRUPTCY**
9. ("SU") ● SUMMARY OF KEY ISSUE(s)	● Authority of Bankruptcy Judges to assess monetary sanctions for professional misconduct
&	
/ Any Miscellaneous BACKGROUND	/ **Background:** Appellant served as debtor's counsel in underlying bankruptcy proceedings, and was sanctioned $33,663 by Bankruptcy Court for participating in sales of bankruptcy estate assets & distributing proceeds without notice to creditors or court approval, in violation of Bankruptcy Code (11 U.S.C. § 101, et seq.).
10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)	D:\Web Briefs\To-West-Net\To-West (WPD)\Group04\vinson1.wpd
11. DO YOU RECOMMEND POSTING IN UST BRIEFBANK?	☒ YES ☐ NO NAME: JIM MORAWETZ DATE: Wed.-12/15/99 (9:03)

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF GEORGIA
GAINESVILLE DIVISION

IN RE:	:	
	:	
TERRY L. VINSON,	:	CIVIC ACTION FILE NO.
	:	2:99-CV-184-WCO
DEBTOR.	:	
______________________________	:	
	:	
EDMUND A. WALLER,	:	BANKRUPTCY CASE NO.
	:	96-20394-REB
Appellant,	:	
	:	
vs.	:	
	:	
ALBERT F. NASUTI, CHAPTER 7	:	
TRUSTEE and C. DAVID BUTLER,	:	
UNITED STATES TRUSTEE,	:	
	:	
Appellees.	:	

BRIEF OF UNITED STATES TRUSTEE AS APPELLEE

C. DAVID BUTLER
United States Trustee
Region 21

GUY G. GEBHARDT
Assistant United States Trustee
Georgia Bar No. 288550

JAMES H. MORAWETZ
Senior Attorney
Georgia Bar No. 521900

United States Department of Justice
Office of the United States Trustee
362 Richard Russell Building
75 Spring Street
Atlanta, Georgia 30303
Tel: (404) 331-4437

November 16, 1999

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STATEMENT OF BASIS OF APPELLATE JURISDICTION

This is an appeal from an order assessing sanctions against the Appellant in the amount of $33,663.58 for professional misconduct in which he was deemed to have engaged as counsel for the debtor in a bankruptcy case. This Court has jurisdiction over the appeal pursuant to 28 U.S.C. § 158(a)(1), which provides, in pertinent part, as follows:

> The district courts of the United States shall have jurisdiction to hear appeals
>
> (1) from final judgments, orders, and decrees; ... of bankruptcy judges entered in cases and proceedings referred to the bankruptcy judges under section 157 of this title. ...

The judgment appealed from may be considered "final" for purposes of appeal even though the underlying bankruptcy case from which it arises remains open. "[A] more flexible standard of finality" exists in bankruptcy proceedings because they "'often continue for long periods of time, and discrete claims are often resolved at various times over the course of the proceedings.'" In re Prudential Lines, Inc., 59 F.3d 327, 331 (2nd Cir. 1995)(citation omitted). Accord In re Martin Bros. Toolmakers, Inc., 796 F.2d 1435, 1437 (11th Cir. 1986). For a bankruptcy order to be considered final for purposes of appeal, it "need not resolve all of the issues raised by the bankruptcy;

but it must completely resolve all of the issues pertaining to a discrete claim, including issues as to the proper relief." In re Integrated Resources, Inc., 3 F.3d 49, 53 (2nd Cir. 1993)(emphasis from original). Accord In re Saco Local Development Corp., 711 F.2d 441, 443-6 (1st Cir. 1983); In re Red Carpet Corp. of Panama City Beach, 902 F.2d 883, 890 (11th Cir. 1990). The order from which this appeal is taken clearly meets this test.

ISSUE PRESENTED

The issue presented by this appeal is whether the Bankruptcy Court was authorized to assess monetary sanctions against the Appellant in an amount calculated to be necessary to redress the injury to creditors caused by his disregard of the laws governing the administration of bankruptcy estates.

STATEMENT OF THE CASE

The Appellant, Edmund A. Waller, Esq., served as counsel for the Debtor in the bankruptcy case of In re: Terry L. Vinson, No. 96-20394, both during the initial pendency of the case as a chapter 11 proceeding and after its conversion to a chapter 7 proceeding. He brings this appeal from an order and judgment assessing sanctions against him in the amount of $33,663.58 for participating in sales of bankruptcy estate assets and distributing the proceeds of such sales without notice to creditors or bankruptcy court approval, in violation of the requirements of the Bankruptcy Code. The amount of the sanctions was the amount calculated by the Court to be necessary to compensate unsecured creditors injured by Appellant's disregard of the Bankruptcy Code.[1/]

The Bankruptcy Court entered its ruling at the conclusion of an evidentiary hearing ("the Hearing") which took place over

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[1/] In addition to assessing monetary sanctions, the Bankruptcy Court also prohibited Appellant "from representing a Debtor or Creditor in a Chapter 11 case in the United States Bankruptcy Court for the Northern District of Georgia for a period of six (6) months or until such time as he has completed and provided written proof to the Court [that] he has completed not less than thirty (30) hours of CLE seminars in bankruptcy, to include five (5) hours of professionalism and ethics." However, Appellant does not challenge this portion of the Bankruptcy Court's ruling on appeal.

portions of several days. Appellant chose not to include a transcript of the testimony adduced at the Hearing in the record on appeal. However, the record does include a transcript of the Court's findings of fact announced at the conclusion of the Hearing, R-71,[2/] along with copies of the exhibits introduced into evidence during the Hearing. The record also includes a Joint Stipulation of Undisputed Facts entered into by the Chapter 7 Trustee and the Appellant prior to the Hearing. R-69. The United States Trustee submits that the following facts are established by the record before this Court, combined with the admissions contained in Appellant's brief.

The Debtor, Terry L. Vinson, filed a voluntary petition for relief under chapter 11 of the Bankruptcy Code on March 5, 1996. R-1. Appellant signed the petition as the Debtor's counsel of record and received a $1,000 fee from the Debtor's mother, Mary

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[2/] References to the record on appeal are to the docket number assigned to the document by the Clerk of the Bankruptcy Court (e.g., R-1), except that the exhibits introduced at the Hearing are referenced by exhibit number. (E.g., Trustee's Exhibit 1).

Lazell Vinson, in connection with the filing. R-1;[3] R-69, Stipulation 8.

On his Schedules A and D filed with the petition, the Debtor listed real estate assets valued at $370,000, subject to secured claims totaling $230,302. R-1. The schedules did not indicate that any of these properties was jointly owned by any other person.

Subsequent to the filing of the petition, an auction was conducted without notice to creditors or court approval at which certain of the Debtor’s properties were sold for a combined price of $237,151.50. Appellant’s Brief, p. 1; R-69, Stipulations 4-6. Appellant maintains that he did not learn of this auction until several days after it occurred, when he was contacted by the auction company for assistance in closing the sales. Appellant’s Brief, page 2. He states that he took no action on this request for approximately a month, “because there was no court approval of the sale and because it was ... impossible to devise a plan [of reorganization] that would be approved ...” Id. However, he ultimately proceeded to close the

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[3] Included towards the end of R-1, which consists of the petition, schedules and statement of financial affairs filed on March 5, 1996, is a document entitled, “Disclosure of Compensation Under 11 U.S.C. § 329 and Bankruptcy Rule 2016(b),” wherein Appellant discloses his receipt of these fees, along with the $800 filing fee.

sales and to distribute the proceeds, again without notice to creditors or Bankruptcy Court approval, based on his mistaken belief that he could avoid court scrutiny of his actions by simply dismissing the case. Id.

Included in the record as Trustee's Exhibit 3 are copies of various checks produced by Appellant evidencing the manner in which he disbursed the auction proceeds. It is evident from the list appearing at page one of this Exhibit that most of these checks were issued on September 20, 1996, which, according to the two closing statements introduced into evidence as Trustee's Exhibit 6, was the date the sales were closed. It can be discerned from Trustee's Exhibit 3, combined with an earlier accounting of the disbursements submitted by Appellant in his "Response to Chapter 7 Trustee's Motion to Disgorge Fees" filed several months before the Hearing,[4/] that after satisfying liens against the properties[5/] and paying the auctioneer's commission and other closing costs, Appellant distributed the remaining

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[4/] This document is included in the record on appeal either as R-56 or as R-57. The Bankruptcy Court's Docket erroneously identifies both entries as Appellant's response to the United States Trustee's motion for disgorgement of fees. Presumably, one or the other of these two entries is actually Appellant's Response to Chapter 7 Trustee's Motion to Disgorge Fees.

[5/] In his effort to satisfy all liens against the properties, Appellant paid off judgments without regard to whether they were avoidable under Chapter 5 of the Bankruptcy Code.

proceeds to the Debtor’s ex-wife, the former Janice Vinson, and to a few favored unsecured creditors.[6]

Included in Trustee’s Exhibit 3 are three checks totaling in excess of $19,000 which represent disbursements made to or on behalf of the ex-wife.[7] Appellant refers to these disbursements in his brief as the ex-wife’s “share of the proceeds.” Appellant’s Brief, p. 2. The last of these three checks, in the amount of $17,405.07, was not written until October 30, 1996, more than a month after the sales were closed and only a day before the entry of the order converting the case to a chapter 7 proceeding. R-12.[8] Although not previously disclosed to the Chapter 7 Trustee, it was revealed at the Hearing that Appellant paid the ex-wife an additional $4,148.34 from the auction proceeds in March of 1997, more than four months after the case

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[6] The unsecured debts which were paid were apparently those on which the ex-wife was an obligor.

[7] These are, specifically, checks 3308, 3311 and 3357. Check No. 3308, in the amount of $375.00, was made payable to Verdery & Oliver, the law firm which represented the ex-wife in the couple’s divorce case. See Trustee’s Exhibit 3, page 28. Check No. 3311, in the amount of $1,513.14, was made payable directly to the ex-wife. Check No. 3357, in the amount of $17,405.07, was made payable to “Winslow H. Verdery Trust Account.”

[8] This was almost a month after the United States Trustee moved to convert the case to a Chapter 7 proceeding, R-7, and, as shown by the conversion order, a week after the hearing at which the Bankruptcy Court announced its decision to convert the case.

was converted. Defendant's Exhibit 1. In addition, Appellant paid himself a fee of $5,000 from funds which he maintains belonged to the ex-wife by virtue of her ownership interest in the properties. Appellant's Brief, pp. 2&3; R-69, Stipulation 9.[9/]

The Debtor and his ex-wife were divorced pursuant to a Final Judgement and Decree of Divorce ("the Divorce Decree" or "the Decree") entered by consent of the parties less than two weeks before the filing of the Debtor's chapter 11 petition. Trustee's Exhibit 2. The Divorce Decree gave the Debtor a period of 18 months to pay certain debts for which the ex-wife was liable, failing which she would "obtain and retain a one-half undivided interest in and to all the property owned by the parties, or either of them." Id. at p.5. The Decree further provided that the ex-wife would "obtain and retain an ownership interest" in the properties pending the payment of these debts. However, upon payment of the debts in full she was obligated by the Decree to quit-claim her interest in the properties to the Debtor, Id. at pp.4-5; and the Debtor was likewise entitled to the net proceeds from any sale of the properties "[u]pon full

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[9/] Appellant chose not to seek Bankruptcy Court approval of this fee pursuant to 11 U.S.C. § 330(a), taking the position that because it was not paid from estate funds court approval was not required.

satisfaction of all indebtedness of the parties, and upon [his] full compliance with all terms of the Orders in this case ..." Id. at p.4. Given these provisions, it is, of course, unlikely that a bankruptcy trustee would have treated the ex-wife as having an interest in the auction proceeds superior to that of the bankruptcy estate.[10]

On September 23, 1996, three days after the sales were closed, Appellant filed a "voluntary dismissal" of the chapter 11 case, R-5. Approximately a week later the United States Trustee filed a motion to convert the case to a chapter 7 proceeding, noting that the bankruptcy schedules disclosed the existence of sufficient equity in the estate's real estate assets to pay all creditors in full. R-7. Appellant responded by amending the Debtor's Schedule A to show that he owned only a half interest in two of the properties and by amending his Schedule D to add four judgment creditors, including the ex-wife, as secured creditors. R-11. Nowhere in this amendment was it disclosed that any of the properties had been sold. Appellant mailed a service copy of the amendment to the Office of the United States Trustee on October 17, 1996, accompanied by a

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[10] Moreover, because the Divorce Decree was entered on the eve of the bankruptcy filing, it was potentially subject to avoidance pursuant to 11 U.S.C. § 547 to the extent that it operated to transfer any interest in the Debtor's property to the ex-wife.

transmittal letter in which he discussed certain problems which had prevented him from devising a confirmable plan of reorganization, again without disclosing that any of the Debtor’s properties had been sold. R-8.

As previously indicated, the Court entered its order converting the case to a chapter 7 proceeding on October 31, 1996. R-12. Albert F. Nasuti was appointed Chapter 7 Trustee on that same date, and both he and the United States Trustee subsequently filed separate motions seeking to require Appellant to disgorge all fees received in connection with the case. R-51 & R-53. The United States Trustee’s motion was thereafter amended to add a request for the imposition of monetary sanctions against Appellant in an amount sufficient to redress the injury to unsecured creditors who were omitted from Appellant’s distribution scheme. R-63. In imposing sanctions, the Court characterized Appellant’s conduct as “intentional, misleading and deceitful to this court and its representatives.” R-71, p. 13. Despite this finding, the Court denied the motions for disgorgement of fees out of concern that such disgorgement might benefit non-creditors of the bankruptcy estate to the detriment of creditors, given Appellant’s contention that his fees were paid by third parties. R-71 at pp. 12-13; R-72, par. 2.

ARGUMENT

I A BANKRUPTCY COURT HAS THE AUTHORITY TO ASSESS MONETARY SANCTIONS AGAINST AN ATTORNEY FOR ENGAGING IN PROFESSIONAL MISCONDUCT IN A PROCEEDING PENDING BEFORE IT.

A bankruptcy court has broad powers under 11 U.S.C. § 105(a) to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title." It has been held that "[t]he court may[] on its own motion or upon the request of any party in interest, including the trustee, invoke its powers under § 105(a) and order a professional to repay unauthorized disbursements to the estate." In re E Z Feed Cube Co., Ltd., 123 B.R. 69, 74 (Bankr.D.Or.1991). Accord Cuevas-Segarra v. Contreras, 134 F.2d 458 (1stCir.1998)(requiring repayment of funds obtained from unauthorized settlement of malpractice action).

In dealing with misconduct by attorneys, the bankruptcy court's powers are broader even than those conferred by § 105(a). In Glatter v. Miroz (In re Miroz)November 15, 1999, 65 F.3d 1567, 1575 (11th Cir.1995), the Eleventh Circuit held, with specific reference to bankruptcy courts, that a federal court has the inherent power "to control and discipline attorneys appearing before it," stating that the imposition of sanctions for professional misconduct by counsel "'transcends a court's equitable power concerning relations between the parties and reaches a court’s inherent power to police itself ...’” Id., quoting from Chambers v. NASCO, 501 U.S. 32, 46 (111 S.Ct. 2123, 2133, 115 LE2d 27, 46) (1991).

The scope of Appellant’s disregard for his ethical and professional obligations in this case is staggering. His conduct was unethical in that, by his own account, he accepted a $5,000 fee from the ex-wife for closing the sales and distributing the proceeds, even though, as observed by the Bankruptcy Court, her claim to an ownership interest in the properties made her the primary adversary of the estate. R-71 at p.8.

Under 11 U.S.C. § 1107, a debtor in possession “bear[s] essentially the same fiduciary obligation to creditors ... as would the trustee for a debtor out of possession.” Commodity Futures Trading Commission v. Weintraub, 471 U.S. 343, 355, 105 S.Ct. 1986, 1994 (1985). It follows that counsel for a chapter 11 debtor in possession likewise owes a fiduciary duty to the bankruptcy estate and its creditors. As stated by the court in In re Rivers, 167 B.R. 288, 301 (N.D.Ga.1994):

> The professional’s duties run not merely to the person or persons holding the office of the fiduciary but to the trust to which the fiduciary owes allegiance. Thus, in a Chapter 11 case, an attorney for a debtor in possession must balance a role as counsellor to the debtor with the role of officer of the court and fiduciary to the bankruptcy estate. When the interests of the former conflict with those of the latter, it is the estate and the court to which the attorney owes the highest allegiance.

Accord In re Rusty Jones, Inc., 134 B.R. 321 (Bankr. N.D. Ill. 1991); In re E Z Feed Cube Co., Ltd., supra, 123 B.R. at 74.

Given his fiduciary obligations to the bankruptcy estate and the wording of the Divorce Decree, Appellant's acceptance of compensation from the ex-wife was clearly violative of his ethical obligations under Rule 3-105 of the Code of Professional Responsibility (Canon 5), which provides that "[a] lawyer should exercise independent professional judgment on behalf of a client." Indeed, Judge Brizendine characterized the disbursements to the ex-wife as the equivalent of a "hidden deal" reforming the Decree in her favor, Id. at pp.10-11, and stated that in his entire career as an attorney and a judge he had "never seen ... conduct by an officer of the court this bad in handling a ... Chapter 11 bankruptcy estate." R-71 at p. 11.

In addition to violating his ethical obligations to the bankruptcy estate and its creditors, Appellant also violated his professional obligations as an officer of the court. Under 11 U.S.C. § 363(b)(1) and Bankruptcy Rules 2002 and 6004, any sale of estate property by a trustee or debtor in possession[11] outside the ordinary course of business requires bankruptcy court approval, obtained "after notice and a hearing." Notice to

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[11] With certain specified exceptions not applicable here, a debtor in possession has all the rights and duties of a chapter 11 trustee pursuant to 11 U.S.C. § 1107(a).

creditors and court approval, in the form of an order confirming a plan of reorganization, are likewise required before the net proceeds of such a sale can be distributed to creditors. Appellant was well aware that both the auction and his subsequent distribution of the proceeds were violative of these provisions of the Bankruptcy Code, and under the circumstances his motion to dismiss the case and his related amendments to the Debtor's bankruptcy schedules can only be viewed as a deliberate attempt to mislead and deceive the court. The Court was not only authorized under § 105(a) and Mroz to impose sanctions for this conduct, it would have been remiss had it not done so.

II THE CHAPTER 7 TRUSTEE WAS NOT REQUIRED TO "MITIGATE DAMAGES" BY FILING AVOIDANCE ACTIONS AGAINST THE RECIPIENTS OF APPELLANT'S DISTRIBUTIONS PURSUANT TO 11 U.S.C. § 549.

Without citing any supporting authority, Appellant contends that the Chapter 7 Trustee was required to "mitigate damages" by filing avoidance actions pursuant to 11 U.S.C. § 549 to recover any unauthorized transfers of funds which may have occurred as a result of the manner in which the auction proceeds were distributed. This contention is without merit for several reasons. First, the Court's objective in imposing sanctions against Appellant was not merely to redress the injury to the estate resulting from Appellant's conduct but also to hold Appellant accountable as an officer of the court for his actions, a goal which obviously would not have been achieved by requiring the Trustee to sue the recipients of the distributions pursuant to 11 U.S.C. § 549. Second, there has been no showing that such an approach would have been cost effective in light of the number of recipients, the amount in controversy with respect to each of them, and the collectibility of any judgments obtained. Finally, it was not only the Chapter 7 Trustee who was seeking the imposition of sanctions but also the United States Trustee, who lacked standing to bring avoidance actions on behalf of the bankruptcy estate and therefore could not have been required to “mitigate damages” in this manner.

As noted by the Court in Mroz, supra, a “primary aspect” of the inherent powers vested in courts to control and manage their affairs “‘is the ability to fashion an appropriate sanction for conduct which abuses the judicial process.’” Id., 65 F.3d at 1575 (citation omitted). In assessing monetary sanctions for such abuse, it is entirely appropriate to attempt to redress the damage caused by the conduct. Id.

Appellant unquestionably abused the process of the Bankruptcy Court by invoking the automatic stay of 11 U.S.C. § 362 to enable the Debtor to retain possession and control of his properties while disregarding the substantive and procedural rights afforded by the Bankruptcy Code to ensure that all creditors receive fair and equitable treatment. Acting either pursuant to its inherent powers under Mroz or pursuant to its statutory powers under 11 U.S.C. § 105(a), the Bankruptcy Court was authorized to assess sanctions against Appellant in an amount calculated to compensate creditors injured as a result of his misconduct.

III THE REQUEST FOR IMPOSITION OF SANCTIONS WAS NOT BARRED BY THE STATUTE OF LIMITATIONS APPLICABLE TO 11 U.S.C. § 549.

The two-year statute of limitations contained in 11 U.S.C. § 549 applies only to actions brought pursuant to that section and does not constrain or limit the ability of the court to impose sanctions against an attorney for professional misconduct. See Cuevas-Segarra v. Contreras, supra, 134 F.2d at 460; In re E Z Feed Cube Co., Ltd., supra, 123 B.R. at 74. Moreover, Appellant raised no statute of limitations defense in the Bankruptcy Court, with the result that any such defense which might otherwise have been available to him was waived pursuant to Rule 8(c) of the Federal Rule of Civil Procedure and Rule 7008 of the Federal Rules of Bankruptcy Procedure. Indeed, Appellant stipulated that the bankruptcy court had jurisdiction “to hear the [motions] and issue rulings under 11 U.S.C. §329 and §105, or as otherwise provided under its inherent power.” R-69, Stipulation 3; R-71 at p.2.

IV THE BANKRUPTCY COURT WAS AUTHORIZED TO CONCLUDE FROM THE EVIDENCE THAT THE EX-WIFE WAS NOT ENTITLED TO THE DISTRIBUTIONS SHE RECEIVED.

Appellant contends that in calculating the amount of the monetary sanctions assessed against him, the Bankruptcy Court incorrectly concluded that the distributions which he made to or on behalf of the ex-wife were improper. Appellant maintains that the ex-wife was entitled to these distributions "not only as a ½ owner of some of the parcels of land, but also as a judgment creditor under her divorce decree." Appellant's Brief, page 5.

As previously indicated, the Divorce Decree operated by its terms to divest the ex-wife of any ownership interest in the properties owned by the parties, provided all the debts referenced in the Decree were paid in full within 18 months.[12/] However, Appellant declined to give effect to these provisions and, having done so, paid himself a fee from what he considered to be the ex-wife's "share of the proceeds." Appellant's Brief, page 2. The Bankruptcy Court was obviously deeply disturbed both by Appellant's failure to appreciate the ethical problems raised by this conduct and by his general lack of awareness of the

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[12/] Moreover, because the Decree was entered on the eve of the bankruptcy filing, it was potentially avoidable under 11 U.S.C. § 547 to the extent it operated to transfer any property interest from the Debtor to the ex-wife.

fiduciary role which he had assumed as counsel for the estate, and for this reason the Court included in its order a provision prohibiting him from representing chapter 11 debtors or creditors for a period of six months or until he completed thirty hours of attendance at bankruptcy seminars, including five hours of professionalism and ethics. R-72, par. 4; R-71 at pp. 3-5.

Given the language of the Divorce Decree, there is simply no basis in the record for a conclusion that the ex-wife was entitled to any portion of the auction proceeds. More importantly, to the extent she asserted an interest in the proceeds which was superior to that of the bankruptcy estate, the issue could be resolved only through adversary proceedings in which she and the estate were represented by separate counsel. Indeed, by arguing on appeal that the ex-wife was entitled to the distributions she received, Appellant continues, in effect, to engage in the same type of unethical conduct for which he was sanctioned by the Bankruptcy Court.

V THE BANKRUPTCY COURT'S EXERCISE OF ITS INHERENT POWER TO SANCTION AN ATTORNEY FOR IMPROPER CONDUCT DID NOT CONSTITUTE AN ABUSE OF DISCRETION.

Appellant contends that the Bankruptcy Court abused its inherent power to impose sanctions under Mroz, supra, because the evidence did not establish any bad faith conduct on his part but merely a "'goof' on the interpretation of the law." Appellant’s Brief, p. 6. This is ludicrous. Appellant admits that he made the decision to close the sales and distribute the proceeds following at least a month of reflection over the illegality of the auction. Appellant’s Brief, pp. 1-2. Moreover, it is clear from his brief, as it was from his testimony during the hearing, that he reached this decision based purely on considerations of expediency. After disbursing the proceeds in a manner which favored the interests of the ex-wife over the interests of the bankruptcy estate and its creditors, he then sought to conceal his conduct from the Bankruptcy Court and the United States Trustee by representing, through his motion to dismiss and the related amendments to the Debtor’s schedules, that the estate’s interest in the properties remained intact. For Appellant to characterize this course of action as mere “goof” is nothing short of outrageous.

CONCLUSION

For the foregoing reasons, the United States Trustee respectfully submits that the Bankruptcy Court’s order and judgment assessing monetary sanctions against Appellant should be affirmed in its entirety.

Respectfully submitted,

C. DAVID BUTLER
United States Trustee
Region 21

GUY G. GEBHARDT
Assistant United States Trustee
Georgia Bar No. 288550

JAMES H. MORAWETZ
Senior Attorney
Georgia Bar No. 521900

Office of the United States Trustee
362 Richard Russell Building
75 Spring Street
Atlanta, Georgia 30303
Tel: (404) 331-4437

November 16, 1999

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing BRIEF OF UNITED STATES TRUSTEE AS APPELLEE was this day sent by U.S. Mail, properly addressed and with correct postage, to the following:

Edmund A. Waller, Esq.
500 Spring Street
Gainesville, GA 30501

Albert F. Nasuti, Esq.
Thompson, O'Brien, Kemp & Nasuti, P.C.
4845 Jimmy Carter Blvd.
Norcross, GA 30093

This the 16th day of November 1999.

JAMES H. MORAWETZ
Senior Attorney

BRIEF BANK — "SUMMARY SHEET" *Printed Tue-11/16/10 14:18*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	Sophie Cahen Vorburger v. Tracy Hope Davis, as United States Trustee (In re Sophie Cahen Vorburger)
2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	S. D. N.Y.
3. ("CCN") ***CURRENT*** CASE NO.	No.: 1:10-cv-08264-PKC
4. ("PCN") ***PRIOR*** CASE NO. - & COURT *[IF ANY]*	No.: 09-B-13871 (AJG) Court: Bankr. S. D. N.Y. *(Identify judge & cite, if any)*
5. ("SO") ***SOURCE***	**U.S. TRUSTEES**
6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	Filed: November 4, 2010 Type: United States Trustee's Motion to Dismiss Debtor's Appeal as Untimely, and for Failure to Pay Prescribed Filing Fee
7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*	Andy Velez-Rivera, Noah Schottenstein, P. Matthew Sutko, Kathleen Schmitt, Tracy Hope Davis *(UST/OGC: 202-307-1399/FAX-2397)*
8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	• Whether the bankruptcy court has jurisdiction under 28 U.S.C. § 158(c)(2) to consider an appeal from a bankruptcy court order when the notice of appeal was untimely filed under Rule 8002.
10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)	

11. DO YOU RECOMMEND POSTING IN UST BRIEFBANK?| x | | | ***NAME:*** Linda Figueroa

YES NO ***DATE:***

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

In re SOPHIE CAHEN VORBURGER, Debtor.	Civil No. 1:10-cv-08264-PKC
SOPHIE CAHEN VORBURGER, Appellant, vs. TRACY HOPE DAVIS, as UNITED STATES TRUSTEE, Appellee.	(Bankruptcy Appeals)

UNITED STATES TRUSTEE'S MOTION TO DISMISS DEBTOR'S APPEAL AS UNTIMELY, AND FOR FAILURE TO PAY PRESCRIBED FILING FEE

Appellant Tracy Hope Davis, the United States Trustee for Region 2 (the "United States Trustee"), moves to dismiss Appellee Sophie C. Vorburger's appeal of the bankruptcy court's dismissal of her chapter 11 case as untimely filed under 28 U.S.C. § 158(c)(2).

INTRODUCTION

Under 28 U.S.C. § 158(c)(2), this Court has jurisdiction to consider an appeal from a bankruptcy court order if the appeal is taken "in the time provided by Rule 8002 of the Bankruptcy Rules." 28 U.S.C. § 158(c)(2). Under Federal Rule of Bankruptcy Procedure 8002(a), a notice of appeal must be filed within 14 days of the date of entry of the order appealed from. Fed. R. Bankr. P. 8002(a). Ms. Vorburger filed her notice of appeal from the order dismissing her bankruptcy case more than two weeks after it was entered. Her appeal is untimely and therefore must be dismissed.

Furthermore, the bankruptcy court has denied Ms. Vorburger's request to proceed *in forma pauperis* in this appeal, and she has not paid the prescribed filing fee. This appeal may also be dismissed based on these grounds.

FACTS

Ms. Vorburger filed a voluntary petition for relief under chapter 11 of the Bankruptcy Code on June 17, 2009 (the "Petition Date"). Bankr. Dkt. 1. Ms. Vorburger's reorganization is predicated on the sale of two properties — one in Pennsylvania, the other a Manhattan cooperative apartment. Bankr. Dkt. 63, at 1. On November 10, 2009, the United States Trustee moved to dismiss the case with a one-year bar, or alternatively convert the case to chapter 7 (the "Dismissal

Motion"), for three reasons: (1) Ms. Vorburger's delay in obtaining a sale order for Pennsylvania property, (2) Ms. Vorburger had not filed required mandatory monthly operating reports for the five-month period from June 2009 through (and including) October 2009, and (3) Ms. Vorburger had not paid statutory fees due pursuant to 28 U.S.C. § 1930(a)(6). Bankr. Dkt. 28 (Memorandum of Law, at 13-18).[1]

The bankruptcy court continued the hearing on the Dismissal Motion multiple times in order to give Ms. Vorburger additional opportunities to market and sell her properties. Bankr. Dkt. 63, at 1. The automatic stay, however, was lifted as to Ms. Vorburger's Pennsylvania property. Bankr. Dkt. 46. Furthermore, with respect to Ms. Vorburger's Manhattan apartment, because she filed her current bankruptcy case shortly after the dismissal of a prior bankruptcy case, the bankruptcy court ruled on June 10, 2010 that the automatic stay does not apply pursuant to 11 U.S.C. § 362(j).[2] Bankr. Dkt. 58.

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[1] Under 11 U.S.C. §§ 1112(b)(4)(F) or 1112(b)(4)(K), a chapter 11 debtor's failure to satisfy timely any filing or reporting requirement, or failure to pay any fees or charges required under chapter 123 of title 28, respectively, may constitute cause for the dismissal of the case.

[2] Ms. Vorburger filed a separate Notice of Appeal from a different order determining that the automatic stay did not apply to Ms. Vorburger's Manhattan apartment. Bankr. Dkt. 68 (the "Reconsideration Order"). The United States Trustee was not a party in the proceedings leading to the entry of the Reconsideration Order and is not a party in Ms. Vorburger's appeal thereof. The United States Trustee is a party only in the appeal of the Dismissal Order. Bankr. Dkt. 70.

The bankruptcy court held a hearing on the Dismissal Motion on September 8, 2010. At the time, even though Ms. Vorburger had filed a one-page statement of income and expenses for August through October 2009 in response to the United States Trustee's initial filing of the Dismissal Motion, she failed to file operating reports since that time, or pay statutory fees to the United States Trustee during the entire pendency of her case. Bankr. Dkt. 63, at 3.

Ms. Vorburger's bankruptcy case was dismissed on September 10, 2010. Order (A) Dismissing Chapter 11 Case; (B) Imposing One-Year Bar to Future Bankruptcy Filings; and (C) Setting Forth Related Relief (the "Dismissal Order"), Bankr. Dkt. 70. The bankruptcy court barred Ms. Vorburger from filing another bankruptcy case for one year without first obtaining obtaining leave of court. Bankr. Dkt. 70, at 1. The Dismissal Order was entered on the docket of Ms. Vorburger's case on September 10, 2010. Bankr. Dkt. 70.

On September 30, 2010, Ms. Vorburger filed a Notice of Appeal for review of the bankruptcy court's Dismissal Order that had been entered on September 10, 2010. Bankr. Dkt. 72.

On October 12, 2010, Ms. Vorburger filed an application with the bankruptcy court, seeking leave to proceed *in forma pauperis* in connection with her appeal of the Dismissal Order. Bankr. Dkt. 75. The bankruptcy court, however, denied the application on October 21, 2010, without prejudice for Ms. Vorburger to seek relief before this Court. Bankr. Dkt. 79. To date, the dockets of Ms. Vorburger's bankruptcy case and of this appeal do not indicate that the filing fee regarding this appeal has been paid or that Ms. Vorburger has sought related relief from this Court.

ANALYSIS

Ms. Vorburger's September 30 notice of appeal was untimely to perfect an appeal from the September 10 order dismissing her bankruptcy case.

A. Ms. Vorburger's Appeal Must be Dismissed Because She Filed Her Notice of Appeal After the Statutory Deadline.

Ms. Vorburger did not comply with the 28 U.S.C. § 158(c)(2), which only allows a litigant the 14 days specified in Fed. R. Bankr. P. 8002(a) to appeal an adverse final order.[3] An order to dismiss a case is a final order. *See In re Chateaugay Corp.*, 826 F.2d 1177, 1179 (2d Cir. 1987) (indicating that "[a] final order 'ends the litigation on the merits and leaves nothing for the court to do but

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[3] Section 158(c)(2) of title 28 states, "An appeal under subsections (a) and (b) of this section shall be taken in the same manner as appeals in civil proceedings generally are taken to the courts of appeals from the district courts and in the time provided by Rule 8002 of the Bankruptcy Rules." Bankruptcy Rule 8002(a) states, "The notice of appeal shall be filed with the clerk within 14 days of the date of the entry of the judgment, order, or decree appealed from."

exercise the judgment'") (quoting *Catlin v. United States*, 324 U.S. 229, 233 (1945)). An order can be final in bankruptcy even if it does not resolve all of the issues raised in the case, "but it must completely resolve all of the issues pertaining to a discrete claim . . . ." *In re Fugazy Express*, 982 F.2d 769, 776 (2d Cir. 1992). The order dismissing Ms. Vorburger's bankruptcy case ended consideration of the merits of her chapter 11 filing and therefore was a final order.

After the final order dismissing her bankruptcy case was entered into the docket of the bankruptcy court on September 10, 2010, Ms. Vorburger accordingly had 14 days to file a notice of appeal. Bankr. Dkt. 70; 28 U.S.C. § 158(c)(2); Fed. R. Bankr. P. 8002(a). The 14-day appeal period expired on September 24, 2010. Ms. Vorburger's September 30 notice of appeal was therefore untimely to perfect an appeal from the September 10 dismissal order. Bankr. Dkt. 72.

B. Because Ms. Vorburger's Appeal Was Untimely, This Court Does Not Have Jurisdiction to Hear Her Appeal.

The deadline established by 28 U.S.C. § 158(c)(2), which incorporates Bankruptcy Rule 8002(a)'s 14-day deadline, is mandatory and jurisdictional. Thus, this Court does not have subject matter jurisdiction to hear Ms. Vorburger's appeal because she filed her notice of appeal over two weeks after the bankruptcy court entered the dismissal order.

This appeal is governed by the Supreme Court's decision in *Bowles v. Russell*, which held that if Congress established a time limit for taking an appeal in a statute, "that limitation is more than a simple 'claim-processing rule.'" *Bowles v. Russell*, 551 U.S. 205, 213 (2007). It is jurisdictional. *Id.,* at 206; *Ruiz-Martinez v. Mukasey*, 516 F.3d 102, 118 (2d Cir. 2008) (quoting *Bowles*); *see also In re Wiersma*, 483 F.3d 933, 938 (9th Cir. 2007) ("[T]he failure to timely file a notice of appeal is a jurisdictional defect barring appellate review.") (citation and internal quotation marks omitted). Without proper jurisdiction, a court does not have power to hear a case, and therefore "jurisdiction can never be forfeited or waived." *United States v. Cotton*, 535 U.S. 625, 630 (2002).

Here, the period of time for filing a notice of appeal is not merely established by Rule; it is established by section 158(c)(2) of title 28, which provides that appeals in bankruptcy shall be taken "in the time provided by Rule 8002 of the Bankruptcy Rules." This reference to Rule 8002 is located in the same section of the statute that grants district courts jurisdiction to hear bankruptcy appeals. *See* 28 U.S.C. §§ 158(a)-(b). Because the time limitation is statutory, it is mandatory and jurisdictional.

All of the United States Courts of Appeals agree that bankruptcy appeals must be dismissed when, as here, the appellant has not timely filed a notice of appeal. *See*, *e.g.*, *In re Siemon*, 421 F.3d 167, 169 (2d Cir. 2005); *In re Bond*, 254 F.3d 669, 673 (7th Cir. 2001); *Hamilton v. Lake Elmo Bank (In re Delta Eng'g Int'l, Inc.)*, 270 F.3d 584, 586 (8th Cir. 2001); *Williams v. EMC Mortgage Corp. (In re Williams)*, 216 F.3d 1295, 1298 (11th Cir. 2000); *Stangel v. United States (In re Stangel)*, 219 F.3d 498, 500 (5th Cir. 2000); *Shareholders v. Sound Radio, Inc.*, 109 F.3d 873, 879 (3d Cir. 1997); *Anderson v. Mouradick (In re Mouradick)*, 13 F.3d 326, 327 (9th Cir. 1994); *Deyhimy v. Rupp (In re Herwitt)*, 970 F.2d 709, 710 (10th Cir. 1992); *In re Abdallah*, 778 F.2d 75, 77 (1st Cir. 1985).

Second, federal case law has for over 100 years treated time limits for filing a notice of appeal as jurisdictional. *Bowles*, 551 U.S. at 206 (stating that it has "long and repeatedly [been] held that the time limits for filing a notice of appeal are jurisdictional in nature"). Ms. Vorburger appealed the bankruptcy court's dismissal order more than 14 days after it was entered. Bankr. Dkt. 72. Her failure to file a timely notice of appeal, "regardless of whether [Ms. Vorburger] can demonstrate excusable neglect," deprives this Court of jurisdiction to review the bankruptcy court's dismissal order. *Siemon*, 421 F.3d at 169.

C. The Appeal Should Also be Dismissed Because Ms. Vorburger has Not Paid the Prescribed Filing Fee

Despite the denial of her application to proceed in this appeal *in forma pauperis*, Ms. Vorburger has failed to pay the filing fee required by 28 U.S.C. § 1930(b) pursuant to the *Bankruptcy Court Miscellaneous Fee Schedule. Administrative Office of the U.S. Courts, Bankruptcy Court Miscellaneous Fee Schedule* § 14 (2010). Failure to pay the filing fee constitutes a failure to prosecute the appeal under Bankruptcy Rule 8001(a), which is a basis for this Court to dismiss this appeal. *Sydlar v. Swimelar*, No. 6:10-34, 2010 WL 2522362 (N.D.N.Y. June 14, 2010), *citing Chambers v. NASCO, Inc.*, 501 U.S. 32, 44 (1991); *see also Michalek v. Ring*, No. 96-5139, 1997 WL 738556 (2d Cir. Nov. 21, 1997) (affirming district court's dismissal of bankruptcy appeal for failure to pay appellate filing fee); *Smith v. Nagle Houses, Inc.*, 2005 WL 1773765 (S.D.N.Y. July 25, 2005) (dismissing bankruptcy appeal when the filing fee was not paid and proceeding *in forma pauperis* was not authorized). Accordingly, this appeal may also be dismissed due to Ms. Vorburger's failure to pay the required filing fee.

CONCLUSION

For all of the foregoing reasons, this Court should dismiss this appeal.

Dated:New York, New York
November 4, 2010

Respectfully Submitted,

TRACY HOPE DAVIS
UNITED STATES TRUSTEE
FOR REGION 2

By: ***/s/ Andrew D. Velez-Rivera***
Trial Attorney
33 Whitehall Street, 21st Floor
New York, New York 10004
Tel. No. (212) 510-0500
Fax No. (212) 268-2255

BRIEF BANK — 'SUMMARY SHEET"

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WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]* — Redmond v. Wagers (In re Wagers)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]* — 10th Cir.

3. ("CCN") ***CURRENT*** CASE NO. — No.: 07-3000

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*

No.: 06-56

Court: B.A.P. 10th Cir.

(Identify judge & cite, if any)

5. ("SO") ***SOURCE*** — **U.S. TRUSTEES**

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*

Filed: April 25, 2007

Type: Brief for the United States as Amicus Curiae in support of Appellee

7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]* — P. Matthew Sutko, Sean Martin, Peter Keisler, William Kanter, Sushma Soni

(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC*** — **BANKRUPTCY**

9. ("SU") ● ***SUMMARY*** OF KEY ISSUE(s)

&

√ Any Miscellaneous ***BACKGROUND***

●Whether these pre-petition funds became property of the estate and therefore can not be used to pay fees incurred post-petition when counsel was not employed by the trustee.

√ **Background:**

10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)

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NAME: Holly Walter

DATE:

No. 07-3000

IN THE UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

CHRISTOPHER J. REDMOND,

Plaintiff-Appellee,

v.

LENTZ & CLARK, P.A.,
MAX R. WAGERS & GEORGIA A. WAGERS,

Defendants-Appellants.

ON APPEAL FROM THE UNITED STATES BANKRUPTCY
APPELLATE PANEL FOR THE TENTH CIRCUIT

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE IN SUPPORT OF APPELLEE

OF COUNSEL:

ROBERTA A. DEANGELIS
Acting General Counsel

P. MATTHEW SUTKO
SEAN E. MARTIN
Executive Office for United States Trustees
United States Department of Justice
20 Massachusetts Avenue, N.W.,
Suite 8000
Washington, D.C. 20530

PETER D. KEISLER
Assistant Attorney General

WILLIAM KANTER
(202) 514-4575
SUSHMA SONI
(202) 514-4331
Attorneys, Appellate Staff
Civil Division, Room 7218
Department of Justice
950 Pennsylvania Avenue, N.W.
Washington, D.C. 20530-0001

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IN THE UNITED STATES COURT OF APPEALS
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CHRISTOPHER J. REDMOND,

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ON APPEAL FROM THE UNITED STATES BANKRUPTCY
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BRIEF FOR THE UNITED STATES AS AMICUS CURIAE IN SUPPORT OF APPELLEE

Pursuant to Rule 29 of the Federal Rules of Appellate Procedure and 28 U.S.C. § 517, the United States submits this brief as amicus curiae supporting appellee Christopher J. Redmond, the chapter 7 trustee.

STATEMENT OF INTEREST OF THE UNITED STATES

The Attorney General appoints United States Trustees to supervise the administration of bankruptcy cases and trustees in regions comprising the vast majority of the federal judicial districts. 28 U.S.C. § 581-589a. United States Trustees "serve as bankruptcy watch-dogs to prevent fraud, dishonesty, and overreaching in the bankruptcy arena." H.R. Rep. No. 95-595, at 88 (1977). The United States Trustee Program thus acts in the public interest to promote the efficiency and to protect and preserve the integrity of the bankruptcy system. To this end, Congress has provided that "[t]he United States trustee may raise and may appear and be heard on any issue in any case or proceeding." 11 U.S.C. § 307.

At issue in this appeal is whether the pre-petition funds paid as a retainer for services in connection with a chapter 7 bankruptcy became property of the estate, and therefore cannot be used to pay fees incurred post-petition, when the law firm was not employed by the trustee. This issue touches on an area of great concern to the United States Trustee, and one that is highly regulated by the Bankruptcy Code: the payment of attorneys' fees in connection with bankruptcy. Allowing the law firm in this case to recover from property of the estate would undermine Congress's clear intention that the case trustee, subject to court approval, determines what work, if any, counsel can perform at estate expense.

The United States Trustee, as the independent watchdog of the bankruptcy system, acts to ensure the Bankruptcy Code is applied properly in bankruptcy cases. Allowing debtor law firms to recover post-petition fees from property of the estate would violate the Code, and thereby deny creditors the full extent of the recoveries they are lawfully entitled to receive in bankruptcy cases. In addition, because a number of federal agencies, including the Department of Housing and Urban Development, the Commerce Department's Economic Development Administration, the Small Business Administration, the Internal Revenue Service, and the Federal Deposit Insurance Corporation, regularly appear as creditors in chapter 7 proceedings, the United States has a separate, direct interest in preventing debtors from dissipating the estate's assets through payments to debtors' personal counsel, for activities that do not necessarily benefit the estate.

STATEMENT OF THE ISSUE PRESENTED FOR REVIEW

Before filing their petition for bankruptcy, the debtors in this case paid a cash retainer and assigned tax refunds to their counsel for services rendered and to be rendered in connection with the bankruptcy. At issue is whether these pre-petition funds became property of the estate, and therefore cannot be used to pay fees incurred post-petition when counsel was not employed by the trustee.

STATEMENT OF THE CASE

Debtors Max and Georgia Wagers paid a pre-petition retainer, consisting of cash and assigned tax refunds, to their legal counsel for services rendered and to be rendered in connection with their chapter 7 bankruptcy. The chapter 7 trustee subsequently filed an adversary action, seeking to recover the retainer as property of the bankruptcy estate. The bankruptcy court granted partial summary judgment for the law firm, concluding that the payments were not property of the estate because the assignment by the debtors clearly expressed their intent to divest themselves of control over the tax refunds. The Bankruptcy Appellate Panel for the Tenth Circuit reversed. The panel held that the assignment did not transfer ownership of the retainer under Kansas law; that the retainer was indeed property of the estate; and that, under Lamie v. United States Tr., 540 U.S. 526 (2004), the law firm could not be paid from estate property for their post-petition services because they were not employed under 11 U.S.C. § 327.

STATEMENT OF FACTS

A. **The Bankruptcy Code**.[1]

The commencement of a bankruptcy case creates an estate consisting of certain property, "wherever located and by whomever held," 11 U.S.C. § 541(a), including "all legal or equitable interests of the debtor in property as of the commencement of the case," id. at § 541(a)(1). An entity "in possession, custody,

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[1] The statutes and regulatory provisions most pertinent to this case are included in the addendum to this brief.

or control" of such property must turn it over to the trustee in the case. 11 U.S.C. § 542(a); see also 11 U.S.C. § 362(a)(3) (prohibiting "any act * * * to exercise control over property of the estate").

The Code authorizes a court to award compensation to "a trustee, a consumer privacy ombudsman appointed under section 332, an examiner, an ombudsman appointed under section 333, or a professional person employed under section 327 or 1103." 11 U.S.C. § 330(a)(1) ("Compensation of officers"). Section 327(a) ("Employment of professional persons") permits the trustee, with the court's approval, to employ attorneys to "represent or assist the trustee" in carrying out his duties, while § 327(e) authorizes the trustee to "employ, for a specified special purpose" other than representing the trustee, an attorney who has represented the debtor. Section 329 authorizes the court to review the reasonableness of an attorney's compensation, regardless of its source, when the payment was made within one year of the filing date. "Any attorney representing a debtor in a case under this title * * * whether or not such attorney applies for compensation under this title, shall file with the court a statement of the compensation paid or agreed to be paid, if such payment or agreement was made after one year before the date of the filing of the petition[.]" 11 U.S.C. § 329(a). A court may cancel an agreement or order return of any payment that exceeds the reasonable value of such services. 11 U.S.C. § 329(b).

B. Proceedings Below.

1. The facts are uncontested. In May 2003, debtors Max and Georgia Wagers hired the law firm of Lentz & Clark, P.A. to advise them about their financial situation, and subsequently paid them a $5,000 cash retainer.[2] 355 B.R. 268, 270 (10th Cir. BAP 2006). On October 22, 2003, the debtors assigned the firm any tax refunds they might obtain for 2003 and prior years as an additional retainer "for services rendered or to be rendered." Appellee Appendix ("App.") 374. The next day, with the firm's assistance, the debtors filed a joint chapter 7 petition. Id. After filing, the debtors received tax refunds exceeding $50,000, all of which were deposited into the firm's trust account. 355 B.R. at 270. After payment of all its pre-petition fees, the firm had about $1,000 remaining of its initial cash retainer, which it applied toward partial payment of post-petition fees.

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[2] "The three most common types of legal retainer are: (1) 'classic' (or 'availability'), which ensures an attorney's availability to represent the client; (2) 'flat fee,' which consists of an agreed amount payable for performance of a specific task; and (3) 'security,' which consists of an advance payment that assures payment for future services. * * * Typically, security retainers are placed into the attorney's trust account, out of which fees are paid once they have been earned." 355 B.R. 268, 271 n.6 (10th Cir. BAP 2006); see also Barron v. Countryman, 432 F.3d 590, 595-96 (5th Cir. 2005).

Id. The post-petition fees and expenses through September 2004 totaled slightly more than $13,000. Id. The firm never sought or gained employment by the trustee pursuant to § 327.

Christopher Redmond, trustee for the debtors' bankruptcy estate, brought an adversary proceeding to require the firm to turn over the post-petition remainder of the cash retainer (about $1,000) and the assigned refunds to the estate.[3] The trustee moved for partial summary judgment, arguing that under Kansas law, the cash retainer and tax refunds were the property of the debtors, and hence, became property of the estate; and that 11 U.S.C. § 330, as construed by Lamie v. United States Tr., 540 U.S. 526 (2004), allows estate compensation of debtors' counsel for post-petition services only if the firm were employed as authorized by 11 U.S.C. § 327, which was not the case here. App. 377. The firm filed a counter-

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[3] The trustee's complaint alleged (1) the debtors' assignment gave the firm a security interest in, rather than ownership of, the refunds, which are therefore estate property that must be turned over to the trustee; (2) the transfer should be avoided as fraudulent under § 548, because the debtors received less than reasonably equivalent value from the firm in return for the assignment; (3) the trustee can recover the refunds under § 550 of the Code; (4) the refunds are property of the estate that the trustee can use, sell or lease under § 363, so the firm must turn them over to the trustee as required by § 542; (5) the refunds should be returned to the estate under § 329 because they exceeded the reasonable value of legal services provided pre-petition; and (6) any lien that the firm might have on the refunds is avoidable under § 544 as invalid, unperfected, and subordinate to the trustee's rights. App. 376 n.10.

motion for partial summary judgment, arguing that 11 U.S.C. § 329, rather than § 330, governs the firm's right to compensation; and that the estate's interest in the retained funds was limited to a contingent right to receive any balance remaining after the firm's fees and expenses are paid. Id. at 377-78.

2. On February 23, 2006, the bankruptcy court granted partial summary judgment for the firm, holding that "the advance payments, including the assignment of future tax refunds, are not property of the estate;" that the estate's interest in the cash and tax refunds on the date of filing was limited to the contingent right to receive the remainder after the firm's pre- and post-petition fees are paid; and that § 329, rather than § 330, controls the payment of attorneys' fees from the retainer. App. 373. The bankruptcy court found that the assignment "clearly expresses" the debtors' intent to "divest[] themselves of all right of control over the refunds." Id. at 386. The bankruptcy court found that this "absolute assignment" distinguished this case from decisions in which other courts, applying other states' law, had adopted the trustee's view that pre-petition retainers become the property of the estate to the extent that fees have not been earned pre-petition. Id. at 395-96.[4] And since the retainer was not estate property,

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[4] The bankruptcy court also suggested that in light of Lamie's holding that the chapter 7 debtor's attorney does not qualify for fees under § 330 unless

(continued...)

the reasonable fee limitation of § 329 controls the propriety of paying the firm's post-petition fees from the pre-petition retainer, to the exclusion of other Code provisions. Id. at 400-01.

In reaching these conclusions, the bankruptcy court emphasized that taking cash and assignments of tax refunds for both pre- and post-petition services was an accepted practice to assure payment of attorneys' fees; that chapter 7 debtors' counsel provide "valued and essential services postpetition;" and that the trustee's approach "would undermine the unique role" played by the chapter 7 debtors' counsel. Id. at 378-84. In contrast to the trustee's approach, the bankruptcy court reasoned, its own construction of § 541 and § 329 promotes the public policy of preserving the integrity of the bankruptcy system. Id. at 403-04. Accordingly, the bankruptcy court denied the trustee's motion, granted the firm's motion, and retained jurisdiction to determine the remaining counts in the complaint. Id. at 405.

3. The trustee appealed to the Tenth Circuit Bankruptcy Appellate Panel, which reversed. 355 B.R. 268 (10th Cir. BAP 2006). The Bankruptcy Appellate

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[4](...continued)
employed by the trustee under § 327, these courts "may wish to more carefully consider the property interests which arise when debtors transfer property prepetition for payment of postpetition services." App. 396.

Panel concluded that this case could not be distinguished from Lamie, which held that under the plain language of § 330, only attorneys employed under § 327 may be paid from estate property for post-petition services. 355 B.R. at 271-73. The panel noted that before 1994, § 330(a) specifically authorized courts to award payment to the debtor's attorney from estate funds, but that in the Bankruptcy Reform Act of 1994, Pub. L. No. 103-394, Congress amended § 330 to delete reference to the debtor's attorney. Id. at 272.

The Bankruptcy Appellate Panel found that the assignment "was intended to pay fees and costs as they were incurred, with the remainder, if any, to be returned to the Debtors." Id. at 274. Thus, the assignment was not a full transfer of ownership under Kansas law, and the tax refunds were the property of the estate. Id. at 273-75, citing, inter alia, In re Barowsky, 946 F.2d 1516, 1517-19 (10th Cir. 1991); In re Scimeca, 962 P.2d 1080, 1091-92 (Kan. 1998). The Bankruptcy Appellate Panel found its conclusion to be consistent with three other courts that "have held, post-Lamie, that money paid pre-petition to secure payment of attorney's fees remains property of the client until earned by provision of services." 355 B.R. at 275, citing In re On-Line Servs., 324 B.R. 342, 346 (8th Cir. BAP 2005); Barron v. Countrymen, 432 F.3d 590, 595-96 (5th Cir. 2005); In re CK Liquidation, 343 B.R. 376, 385 (D. Mass. 2006). The panel further noted that the bankruptcy court's reliance on the assignment "breaks down in light of * * * [its] failure to distinguish between the tax refunds, which were formally assigned, and the cash retainer, which was not": "If simple payment of a cash retainer constitutes an 'assignment' that transfers full ownership of those funds, then every retainer paid without an express reservation of ownership would belong solely to the attorney," a position that the majority of courts have not adopted. 355 B.R. at 374 n.26. The panel rejected the bankruptcy court's finding that the debtors retained only a contingent, reversionary interest in the retainer, stating that (1) the Kansas Supreme Court would more likely hold that the firm had only a contingent interest in the funds, and (2) "even a contingent, reversionary interest is included in a debtor's estate under § 541." Id. at 276, citing In re Montgomery, 224 F.3d 1193, 1194-95 (10th Cir. 2000).

The Bankruptcy Appellate Panel noted that the bankruptcy court's contrary ruling "was driven, at least in part, by public policy." 355 B.R. at 273. While sharing the bankruptcy court's concerns regarding the integrity of the bankruptcy system, id., and adequate payment of debtors' counsel, the BAP stated that it could not "ignore Lamie in favor of a preferred result." Id. at 276. "[S]ince the assigned refunds were [the] property of the Debtors' estate, and the Firm was not employed by the Trustee pursuant to § 327, * * * the Firm may not use pre-petition funds to pay its post-petition fees" in this case. Id.

SUMMARY OF ARGUMENT

The Bankruptcy Code reflects a long-standing concern with the payment of attorneys' fees in connection with bankruptcy proceedings, and most closely regulates those fees for which attorneys seek payment from the bankruptcy estate. Construing the Code, the Supreme Court has held that fees cannot be awarded to the debtor's attorney from estate funds in a chapter 7 case unless the attorney was employed by the trustee and approved by the court. Lamie v. United States Tr., 540 U.S. 526, 538-39 (2004). Here, the debtors' law firm seeks to use the debtors' pre-petition security retainer to pay for post-petition services rendered during the chapter 7 proceedings, although the firm was neither employed by the trustee nor approved by the court.

Neither applicable state law nor the Code permit such a result. Under Kansas law, the type of retainer at issue here remains the client's money until earned, In the Matter of Scimeca, 962 P.2d 1080, 1091 (Kan. 1998), and hence any unearned funds became property of the bankruptcy estate on the date the bankruptcy petition was filed. To permit recovery under such circumstances would circumvent the Code's careful regulation of attorneys' fees and allow the dissipation of debtors' pre-petition assets through payments to counsel for activities that do not necessarily benefit the estate.

ARGUMENT

THE PRE-PETITION RETAINER PAID TO LENTZ & CLARK CONSTITUTES PROPERTY OF THE ESTATE, AND THEREFORE MAY NOT BE USED TO PAY FEES THAT WERE INCURRED POST-PETITION.

A. The language and structure of the Bankruptcy Code reflect long-standing concern with the payment of attorneys' fees in connection with bankruptcy proceedings. See S. Rep. No. 95-989, at 39 (1978), reprinted in 1978 U.S.C.C.A.N. 5787, 5825 ("Payments to a debtor's attorney provide serious potential for evasion of creditor protection provisions of the bankruptcy laws, and serious potential for overreaching by the debtor's attorney, and should be subject to careful scrutiny.") (discussing 11 U.S.C. § 329); see generally In re Griffin, 313 B.R. 757, 764 (Bankr. N.D. Ill. 2004) ("The Bankruptcy Code as a whole is very concerned with conflicts of interest, defective disclosure, and excessive compensation."). The Code most closely regulates those fees for which attorneys seek payment from the bankruptcy estate. As is relevant here, requests for payment from the chapter 7 estate require close interplay among several different code provisions: 11 U.S.C. § 327, which authorizes the trustee to appoint an attorney as a "professional person;" 11 U.S.C. § 330(a)(1), which authorizes the court to award compensation to persons employed under § 327; and 11 U.S.C. § 503(b)(2), which authorizes the estate to pay compensation awarded under § 330(a)(1) as an administrative expense (which, in turn, receives first payment priority under § 507(a)(1)).

This procedure for seeking fees from the chapter 7 estate is exclusive. "[Section] 330(a)(1) does not authorize compensation awards to debtors' attorneys from estate funds, unless they are employed as authorized by § 327. If the attorney is to be paid from estate funds under § 330(a)(1) in a Chapter 7 case, he must be employed by the trustee and approved by the court." Lamie v. United States Tr., 540 U.S. 526, 538-39 (2004).[5] Moreover, § 330 authorizes the award of fees only to the extent that the services provided are reasonable, actual, necessary, and beneficial to the estate.

Fees paid from non-estate funds – i.e., by the chapter 7 debtor post-petition, or by a third party – are also reviewed, though less closely and under a less

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[5] Although the Code at one point allowed debtors' attorneys to be compensated under § 330 even if not appointed under § 327, that provision was deleted by Congress as "part of a Reform Act designed to curtail abuses in fee awards," a purpose that the deletion furthered "by ensuring that Chapter 7 debtors' attorneys would receive no estate compensation absent the trustee's authorization of their work." Lamie, 540 U.S. at 540.

stringent standard. While the debtor is free to employ an attorney to assist him, all such attorneys, "whether or not such attorney applies for compensation under this title," must file with the court a statement of compensation paid or agreed to be paid, for all payments or agreements made within one year before the date the bankruptcy petition was filed. 11 U.S.C. § 329(a); Bankr. Rule 2016 (requiring professional service providers to submit to court a detailed statement of services rendered and expenses incurred). This holds true even if the attorney was not the debtor's counsel on the date of the filing, see In re Downs, 103 F.3d 472, 477 (6th Cir. 1996). A bankruptcy court may cancel an agreement or order return of any payment that exceeds the reasonable value of such services. 11 U.S.C. § 329(b); Bankr. Rule 2017. As the Bankruptcy Appellate Panel correctly understood, § 329 merely establishes limits on an attorney's otherwise existing right to accept payment: It creates no entitlement to be paid fees from estate funds under § 330 or any other section of the Code.

Under 11 U.S.C. § 327(a), an attorney may be disqualified not only because he is not disinterested, but also because he holds an "interest adverse to the estate." In re Pierce, 809 F.2d 1356, 1363 (8th Cir. 1987). The bankruptcy court's broad discretion in awarding and denying fees paid in connection with bankruptcy proceedings empowers the court to order disgorgement as a sanction to debtors' counsel for nondisclosure, see In re Prudhomme, 43 F.3d 1000, 1003-04 (5th Cir. 1995), citing, inter alia, Woods v. City Nat'l Bank & Trust Co., 312 U.S. 262, 268 (1941) (using denial of compensation as tool for strict enforcement of conflict-of-interest rules), even if the fees to be disgorged were not paid from the bankruptcy estate, see In re 5900 Assocs., Inc., 468 F.3d 326, 330 (6th Cir. 2006) (discussing cases).

B. In short, if the cash retainer and tax refunds are not property of the estate, then those monies are subject to a "reasonableness" review by the bankruptcy court under § 329. But if the cash retainer and tax refunds constitute estate property, then under Lamie, they cannot be used to compensate the Wagers' counsel where, as here, counsel were not employed as authorized by § 327. Thus, the central issue in this appeal is whether those monies constitute property of the chapter 7 estate, a question left unresolved by the Lamie decision.[6]

1. Section 541 provides that the commencement of a bankruptcy case creates an estate consisting of certain property, "wherever located and by whomever held," including "all legal or equitable interests of the debtor in property as of the commencement of the case." 11 U.S.C. § 541(a)(1). "That

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[6] In re CK Liquidation Corp., 343 B.R. 376, 382 (D. Mass. 2006) (noting that Lamie did not challenge Fourth Circuit's state-law determination that the particular retainer in his case was property of the estate, rather than of petitioner).

statutory language reflects Congress' intent to define estate property in the broadest possible sense." In re Hines, 147 F.3d 1185, 1189 (9th Cir. 1998), citing United States v. Whiting Pools, Inc., 462 U.S. 198, 204-05 (1983); see also S. Rep. No. 95-989, at 82, reprinted in 1978 U.S.C.C.A.N. 5787, 5868; see generally In re World Commc'ns, Inc., 72 B.R. 498, 500 (D. Utah 1987) (legislative intent behind the Code is that § 541(a)(1) "includes every conceivable interest of the debtor in the estate") (citation omitted). The Tenth Circuit has noted "Congress' clear intent that contingent interests are to be included in the property of a bankruptcy estate." In re Montgomery, 224 F.3d 1193, 1195 (10th Cir. 2000) (holding contingent earned income credits to be part of estate).

"[W]hile the Bankruptcy Code defines what interests may become property of the estate, it is nonbankruptcy law that defines the scope and existence of those interests." Paul v. Monts, 906 F.2d 1468, 1475 (10th Cir. 1990). This principle, which the Supreme Court stated in Butner v. United States, 440 U.S. 48, 54 (1979) (construing Bankruptcy Act), "applies to the interpretation of the property rights attributable to attorney retainer agreements as to other property governed by state law." Barron v. Countryman, 432 F.3d 590, 595 (5th Cir. 2005). "Funds paid to an attorney by a client for services 'become property of the estate only if, under applicable state law, the debtor has an interest in the [funds] at the time of filing the bankruptcy case.'" In re Hill, 355 B.R. 260, 262 (Bankr. D. Or. 2006) (emphasis in original); In re McDonald Bros. Constr., 114 B.R. 989, 997 (Bankr. N.D. Ill. 1990) ("It is state law, rather than the Code, that defines the extent of a debtor's interest [in] * * * a retainer, and hence whether the retainer is property of the estate under Section 541.").

2. Whether the Wagers retained a property interest in the cash retainer and tax refunds depends on the terms of their retainer agreement, as construed in light of Kansas contract law and state bar ethical rules and regulations. See generally In re Equip. Servs., Inc., 290 F.3d 739, 746 (4th Cir. 2002) (employing this analysis), aff'd sub nom. Lamie v. United States Tr., 540 U.S. 526 (2004); In re E-Z Serve Convenience Stores, 299 B.R. 126, 130 (Bankr. M.D.N.C. 2003), aff'd, 318 B.R. 637 (M.D.N.C. 2004).[7] Although Kansas contract law does not address property interests in attorney retainers, there is ample case law addressing this issue in the context of attorney disciplinary proceedings. The Kansas Supreme Court has distinguished between a retainer that is to be earned by future services performed by an attorney, which "remains the client's money and subject to [Model Rule of

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[7] Cf. In re Mahendra, 131 F.3d 750, 755 (8th Cir. 1997) (determining whether interest is part of bankruptcy estate requires 3-part inquiry into (1) whether item constitutes "property" under § 541(a)(1); (2) what is debtor's interest in the property under state law; and (3) whether the debtor had the property interest at the time of filing), cert. denied, 523 U.S. 1107 (1998).

Professional Conduct] 1.15," and a nonrefundable retainer paid to commit the attorney to represent the client and not as a fee to be earned through future services, which "is earned by the attorney when paid and is the attorney's money." In the Matter of Scimeca, 962 P.2d 1080, 1091 (Kan. 1998); see generally Indian Motocycle Assocs. III Ltd. P'ship v. Massachusetts Hous. Fin. Agency, 66 F.3d 1246, 1255 (1st Cir. 1995) ("Under the ethical rules applicable in most jurisdictions, [security retainers] * * * remain property of the client until applied by counsel in payment of legal services actually performed."). "Absent clear language that [a] retainer is paid solely to commit the attorney to represent the client and not as a fee to be earned by future services, it is refundable" and must be segregated and safeguarded in an identifiable client account under Rule 1.15. In the Matter of Scimeca, 962 P.2d at 1092.

While the type of retainer involved is a question of fact, and depends on the intent of the parties, see generally Indian Motocycle Assocs., 66 F.3d at 1254 (citing cases), there does not appear to be any dispute here that the Wagers' purpose in paying cash and assigning their tax refund to counsel was to pay for bankruptcy services rendered pre- and post-petition, with the remainder to be turned over to the trustee – a form of "security" retainer. Appellee Br. 5. Counsel's actions in depositing the refunds into the firm's trust account confirm that counsel shared this understanding, as does the size of the retainer (approximately $55,000, compared to about $4,000 in pre-petition billings). Thus, under Scimeca, the retainer in this case was to be considered the Wagers' money until earned, and the unearned portion of the retainer became property of the estate on the petition date under § 541.

The law firm's suggestion in its opening brief that the debtors, and hence the estate, had only a contingent reversionary interest in the unearned portion of the retainer (Appellant's Br. 6-17) cannot be squared with the fact that (1) under Scimeca and Kansas disciplinary rules, the law firm was required to segregate the this money from law firm accounts, because it belonged to the Wagers, and (2) up to the petition date, the Wagers, like any clients, had an absolute right to discharge them, see In re Hines, 147 F.3d at 1191, and to obtain refund of the retainer, In re Hill, 355 B.R. at 263. The law firm's attempt to analogize the retainer to an escrow or security deposit, in which individuals may have only a "potential" interest (Appellant's Br. 11, 13), is therefore wide of the mark. And as the Bankruptcy Appellate Panel correctly noted, even contingent interests are included in a debtor's estate under § 541. 355 B.R. at 276, citing In re Montgomery, 224 F.3d at 1194-95.

Although the law firm asserts a contractual interest in the unearned portion of the retainer (Applt. Br. 6, 8, 14 n.7), as of the petition date, the Wagers "lost the right to authorize [counsels'] * * * legal services which could potentially further encumber this asset of the bankruptcy estate," a right that then belonged solely to the chapter 7 trustee. See In re Mahendra, 131 F.3d 750, 755 (8th Cir. 1997), cert. denied, 523 U.S. 1107 (1998). Indeed, allowing the law firm to recover its fees from property of the estate would eviscerate the principle that the trustee determines (subject to the court's approval) what work, if any, counsel can perform at estate expense. The Code's comprehensive regulation of attorneys' fees cannot be circumvented by private agreement between the debtor and his attorney. In re 5900 Assocs., Inc., 468 F.3d 326, 329-30 (6th Cir. 2006) (law firm and debtor cannot abrogate bankruptcy court's duty to review fees by entering into a state law contract).[8]

This result is consistent with the only case that has construed the effect of a similar retainer under Kansas ethics rules. In re Hodes, 239 B.R. 239, 242-43 (Bankr. D. Kan. 1999) ("Under Kansas law, an advance fee payment retainer to be earned by future services[] is property of the client and thus is property of that

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[8] The law firm's reference to Kansas attorney retaining liens (Appellant's Br. 17 n.9) attempts to raise an argument already waived, since this issue was not raised below.

client's bankruptcy estate."), aff'd in part, rev'd in part on other grounds, 289 B.R. 5 (D. Kan. 2003). Other courts, reviewing similar retainers under applicable state law, have reached the same conclusion. See In re Equip. Servs., 290 F.3d at 746-47 (concluding, based on Virginia disciplinary rules, that security retainer was property of estate); In re Prudoff, 186 B.R. 64, 66-67 (Bankr. E.D. Va. 1995) (concluding, on basis of Virginia Rules of Disciplinary Procedure, that debtor maintained interest in unearned portion of pre-petition retainer sufficient to constitute property of chapter 7 estate); In re Hill, 355 B.R. at 263 (holding that under Oregon law, retainer remains client's property until earned by attorney, and at time of filing debtor owed no fees, so pre-petition retainer could not be used to pay post-petition fees if attorney not employed by trustee);[9] cf. Barron v. Countryman, 432 F.3d at 597 (under local rules, "advanced payment retainer" was counsel's property and did not become property of the estate); but see In re

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[9] A number of federal courts have also reached the same conclusion without any reference to state law. See generally In re Downs, 103 F.3d at 478 ("Retainers paid to counsel for the debtor are to be held in trust for the debtor, and the debtor's equitable interest in the trust is property of the estate.") (citing bankruptcy cases); In re E-Z Serve Convenience Stores, 299 B.R. at 132 (debtors' rights in advance fee with characteristics of security retainer arose pre-petition and therefore became property of estate upon bankruptcy filing under § 541); In re McDonald Bros. Constr., 114 B.R. at 996 (while debtor's interest in pre-petition retainer is matter of state law, "[a] number of bankruptcy decisions have nevertheless held, without reference to state law, that prepetition retainers are property of the estate").

Channel Master Holdings, Inc., 309 B.R. 855 (Bankr. D. Del. 2004) (allowing attorney to apply pre-petition retainer to payment of post-conversion attorneys' fees).

3. The fact that the retainer consists, in part, of assigned tax refunds is not ultimately controlling. The portion of an income tax refund that is based upon the pre-petition portion of a taxable year ordinarily constitutes property of the bankruptcy estate. In re Barowsky, 946 F.2d 1516, 1518 (10th Cir. 1991). It is generally true that, as the law firm notes, under Kansas law, "an assignment passes all of the assignor's title or interest to the assignee, and divests the assignor of all right of control over the subject matter of the assignment." Army Nat'l Bank v. Equity Developers, Inc., 774 P.2d 919, 932 (Kan. 1989) (cite omitted). And one bankruptcy court in Kansas has held that a tax refund assigned to counsel before the bankruptcy petition was filed, as a flat-fee retainer for services rendered and to be rendered, immediately became the attorney's property, with the debtors retaining only a reversionary interest in it. In re Miller, No. 05-25745, 2006 WL 3627745, *2-3 (Bankr. D. Kan. 2006).

However, Miller did not involve a security retainer, which the retainer in this case unquestionably is. See Appellee Br. 5 (quoting Wagers' and counsel's testimony that assignment was intended to pay for fees incurred in the proceeding, with remainder to be turned over to the trustee). Indeed, Miller's outcome would have been entirely different if it had involved a security retainer, in light of the Kansas requirement that client funds used for a security retainer do not become the property of the attorney until earned, and therefore must remain segregated. Nothing in Kansas law suggests that a client's funds can be treated differently depending on whether they consist of cash or assigned funds. Indeed, the bankruptcy court in this case drew no distinction between the two in its analysis. See App. 389.[10]

4. Substantive federal law imposed an affirmative obligation upon the law firm to turn over the pre-petition retainer to the chapter 7 trustee. 11 U.S.C. § 542(a); see also 11 U.S.C. § 362(a)(3). Because this section of the Code mandates turn over, the attorney cannot decline to follow it, keep the retainer, and use the estate funds it contains to pay for its post-petition work. Requiring all third parties, including attorneys, to comply with § 542(a) fosters important policy goals underlying the Code, while preserving debtors' ability to obtain counsel without resorting to the use of bankruptcy estate funds. First, in chapter 7

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[10] If the assignment did indeed transfer "the Debtors' right, title, and interest" in the tax refunds to the law firm, as the bankruptcy court believed, App. 396, then the retainer would not in fact be a security retainer, but another type of retainer entirely. See supra note 2. But as stated above, the parties clearly intended the cash and assigned refund to serve as a security retainer.

bankruptcies, unlike other forms of bankruptcy protection, liquidation for the benefit of creditors is the primary objective, not further protection for debtors. See generally In re Equip. Servs., 290 F.3d at 744-45 (noting that in chapter 7 liquidation proceeding, "the Trustee is authorized to hire attorneys at estate expense as needed to help liquidate the estate, negating the need for the assistance of the debtor's attorney"; and that "a debtor's attorney cannot do the type of good work that could enlarge the estate in a Chapter 11 proceeding because a Chapter 7 proceeding is a zero-sum game").

Second, most of the legal and fact-finding work in an individual chapter 7 case is completed before the petition is filed and the estate is created. Thus, in Lamie, the Supreme Court quoted a bankruptcy treatise for the proposition that most debtors' counsel would accept a chapter 7 case only after being paid, pre-petition, an amount to cover the standard pre-petition fee and pre-petition filing costs. 540 U.S. at 537, citing Stanley B. Bernstein et al., Collier Compensation, Employment and Appointment of Trustees and Professionals in Bankruptcy Cases ¶ 3.02[1], p. 3-2 (2002); see also In re On-Line Servs. Ltd., 324 B.R. 342, 349 (8th Cir. BAP 2005) ("An attorney who accepts a Chapter 7 case on a flat fee basis may well be asked to later prove that the fee is a reasonable one, but once paid prepetition such fee is not an asset of the estate."); In re Griffin, 313 B.R. at 769 (noting that debtor could enter into limited pre-petition contract with counsel, that did not provide for any post-petition services).

And finally, debtors with post-petition income are free to pay counsel from their personal post-petition assets. A debtor could enter into a reaffirmation agreement with counsel, whereby the debtor would agree to pay counsel out of post-petition assets for bankruptcy services contracted for pre-petition, which would otherwise be discharged in bankruptcy. In re Griffin, 313 B.R. at 769. Or the debtor could simply contract separately, post-petition, for legal services as needed.

In any event, to the extent that "Congress has been delinquent in failing to deal expressly with the always-present problem of arranging in advance for the payment of services to be rendered after the filing in bankruptcy," In re Hines, 147 F.3d at 1189, that is a problem to be corrected by Congress rather than the courts. As the Seventh Circuit noted in a chapter 7 case, interpreting § 329, the Bankruptcy Code is a "complex compromise" among debtors and different kinds of creditors, of which the debtor's attorney is only one. "Judges are not entitled to override the legislative approach with a lawyer-centric public policy that puts members of their own social class higher in the priority list at the expense of other creditors, or of the debtors themselves." Bethea v. Adams, 352 F.3d 1125, 1128 (7th Cir. 2003), cert. denied, 541 U.S. 1043 (2004).

CONCLUSION

For the foregoing reasons, this Court should affirm the decision of the Bankruptcy Appellate Panel for the Tenth Circuit, reversing the decision of the Bankruptcy Court.

Respectfully submitted,

OF COUNSEL:

ROBERTA A. DEANGELIS
Acting General Counsel

P. MATTHEW SUTKO
SEAN E. MARTIN
Executive Office for United States Trustees
United States Department of Justice
20 Massachusetts Avenue, N.W.,
Suite 8000
Washington, D.C. 20530

PETER D. KEISLER
Assistant Attorney General

WILLIAM KANTER
(202) 514-4575
SUSHMA SONI /s/
(202) 514-4331
Attorneys, Appellate Staff
Civil Division, Room 7218
Department of Justice
950 Pennsylvania Avenue, N.W.
Washington, D.C. 20530-0001

APRIL 2007

CERTIFICATE OF SERVICE

I hereby certify that on April 25, 2007, I served an original and seven copies of the foregoing "BRIEF FOR THE UNITED STATES AS AMICUS CURIAE IN SUPPORT OF APPELLEE" by overnight mail, postage prepaid, on the Clerk for the U.S. Court of Appeals for the Tenth Circuit and two (2) copies of the brief by overnight mail on:

Carl R. Clark
Jeffrey A. Deines
Lentz & Clark, PA
P.O. Box 12167
Overland Park, KS 66282-2167

Christopher J. Redmond
P. Glen Smith
Scottie S. Kleypas
Husch & Eppenberger, LLC
11150 Overbrook Road, Suite 350
Leawood, KS 66211-2298

/s/
Sushma Soni
Counsel for the United States

CERTIFICATE OF COMPLIANCE

Pursuant to Rule 32(a)(7) of the Federal Rules of Appellate Procedure and 10th Cir. R. 32.1, I hereby certify that the foregoing brief was prepared using Corel Wordperfect 12 and complies with the type and volume limitations set forth in Rule 32 of the Federal Rules of Appellate Procedure. I further certify that the font used is 14 point Times New Roman, for text and footnotes, and the computerized word count for the foregoing brief (excluding exempt material) is 6304.

/s/
Sushma Soni
Counsel for the United States

CERTIFICATE OF DIGITAL SUBMISSION

Pursuant to this Court's Emergency General Order of October 20, 2004, and amended most recently on January 1, 2006, I hereby certify (1) that no privacy redactions were required to be made on this Amicus Curiae brief, (2) that the brief submitted in Digital Form electronically is an exact copy of the written brief filed with the Clerk, and (3) that the digital submission has been scanned for viruses using Trend Micro OfficeScan Client, Product Version 6.5, and is free from viruses according to that program.

April 25, 2007

/s/
Sushma Soni
Counsel for the United States

BRIEF BANK — "SUMMARY SHEET" *Printed Tue-2/8/11 15:24*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*

Daniel M. McDermott, United States Trustee v. Jeffrey Allen Wallace (In re Jeffrey Allen Wallace)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*

B.A.P. 6th Cir.

3. ("CCN") ***CURRENT*** CASE NO.

No.: 10-8055

4. ("PCN") ***PRIOR*** CASE NO. - & COURT *[IF ANY]*

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Catherine B. Sevcenko, P. Matthew Sutko, Christine H. Black

(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***

BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s)

&

√ Any Miscellaneous ***BACKGROUND***

• Whether the Bankruptcy Appellate Panel under 28 U.S.C. § 158 has jurisdiction to consider an appeal from a bankruptcy court only if the appeal is taken "in the time provided by Rule 8002 of the Bankruptcy Rules."

10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)

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UNITED STATES BANKRUPTCY COURT
APPELLATE PANEL
FOR THE SIXTH CIRCUIT

In re:	
Jeffrey Allen Wallace	Chapter 7 Bankruptcy Case No. 08-63006 Honorable Russ Kendig
Debtor.	
Daniel M. McDermott United States Trustee Plaintiff-Appellee	
v.	Adv. Pro. No. 09-6055
Jeffrey Allen Wallace Defendant-Appellant	BAP Case No.: 10-8055

UNITED STATES TRUSTEE'S MOTION TO DISMISS DUE TO UNTIMELY NOTICE OF APPEAL

The Plaintiff-Appellee, Daniel M. McDermott, United States Trustee[1] moves this Court

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[1] The United States Trustee is an official of the United States Department of Justice appointed by the Attorney General to supervise the administration of bankruptcy cases. 28 U.S.C. §581(a)(21). The United States Trustee is authorized to object to the discharge of the debtor. 11 U.S.C. §727(c)(1).

for an order dismissing this appeal from the bankruptcy court order entered on July 7, 2010 denying his bankruptcy discharge due to lack of jurisdiction because defendant-appellant filed his Notice of Appeal on August 5, 2010, which is more than fourteen days after the bankruptcy court entered the order denying his bankruptcy discharge.

PROCEDURAL HISTORY

Jeffrey Allen Wallace ("debtor") filed a voluntary petition for relief under chapter 7 of the Bankruptcy Code on September 12, 2008 (Bankruptcy Case No. 08-63006). (Bankr. Doc. 1).

On April 8, 2010, United States Trustee Daniel M. McDermott filed a complaint objecting to the discharge of the debtor pursuant to 11 U.S.C. §§ 727(a)(2), (a)(3) and (a)(4). (Adversary Doc. 1). The United States Trustee alleged that on his schedules and statements filed in the bankruptcy court, the debtor failed to identify (a) his 50% ownership interest in a business known as Alliance Baseball Academy LLC, d.b.a. Professional Baseball Academy; (b) his interest in an IRA; (c) transfers made to the IRA; and (d) the existence of a counterclaim asserted in the civil action, *Alliance Baseball Academy vs. Jeffrey A. Wallace, et al.*, pending in Court of Common Pleas of Summit County, Case No.: 2008 CV2638. Further, the United States Trustee alleged that the debtor fraudulently obtained funds through checks written either to cash or himself, or through counter checks from Alliance Baseball Academy, LLC, or Professional Baseball Academy. Finally, the United States Trustee alleged that the debtor failed to keep documents, including books, records, and papers, from which his financial condition or the business transactions of Alliance Baseball Academy LLC might be ascertained.

After the filing of a motion for default judgment by the United States Trustee, the debtor submitted his answer to the complaint on June 15, 2009. (Adversary Doc. 14-Answer). On

October 8, 2009, the Court entered an order granting leave to answer and denying the United States Trustee's motion for default judgment. (Adversary Doc. 18).

On June 23, 2009, the Bankruptcy Court issued its trial scheduling order, setting the complaint for evidentiary hearing. (Adversary Doc. 16). The debtor failed to comply with the scheduling order. On the eve of trial, the United States Trustee filed a *Motion in Limine* requesting that the debtor be prohibited from presenting a defense to the complaint as a result of his failure to comply with the Court's pre-trial scheduling order. (Adversary Doc. 25). On October 29, 2009, the Court issued an order denying debtor's discharge, which it amended a few days later to clarify that the debtor was denied a discharge. (Adversary Docs. 29, 31). Debtor filed a motion to vacate this judgment and to reset the complaint for trial. (Adversary Doc. 28) On March 9, 2010, the Court granted in part the motion to vacate, but in doing so assessed a $750 sanction against Chris Manos, counsel for the debtor, for his failure to comply with the Court's pre-trial scheduling order. (Adversary Doc. 37). The Court ultimately scheduled the complaint for trial on May 10, 2010. The trial was conducted over two days.

On July 7, 2010, the Court issued a six-page written opinion and accompanying order again granting judgment in favor of the United States Trustee and denying debtor's discharge under 11 U.S.C. §§ 727(a)(2) and (a)(4). (Adversary Doc. 52, 53).

On August 5, 2010, 28 days after the entry of judgment, debtor filed a notice of appeal from this final judgment. (Adversary Doc. 56).

BRIEF IN SUPPORT

Under 28 U.S.C. § 158, this Court has jurisdiction to consider an appeal from a bankruptcy court only if the appeal is taken "in the time provided by Rule 8002 of the

Bankruptcy Rules." 28 U.S.C. § 158(c)(2). Under Fed. R. Bankr. P. 8002(a), a notice of appeal must be filed no later than 14 days after the entry of judgment. The time requirements imposed under Fed. R. Bankr. P. 8002 are jurisdictional and shall be strictly construed. *Walker v. Bank of Cadiz* (*In re LBL Sports Center, Inc.*), 684 F.2d 410 (6th Cir. 1982); *Owens v. United States Bankruptcy Court*, (*In re Owens*), 129 F.3d 1264 (Table),1997 WL 693555 (6th Cir. Oct. 31, 1997). This rule is uniformly followed. *In re Herwit*, 970 F.2d 709, 710 (10th Cir. 1992); *In re Siemon*, 421 F.3d 167,169 (2d Cir. 2005); *In re Universal Minerals, Inc.*, 755 F.2d 309, 311 (3d Cir. 1985).

This case is govern by the Supreme Court case *Bowles v. Russell,* which held that if Congress established a time limit for taking an appeal in a statute, "that limitation is more than a simple 'claim-processing rule.'" *Bowles v. Russell*, 551 U.S. 205, 213 (2007). It is jurisdictional. *Id.* at 206; *Ruiz-Martinez v. Mukasey*, 516 F.3d 102, 118 (2d Cir. 2008) (quoting *Bowles*). *See also In re Wiersma*, 483 F.3d 933, 938 (9th Cir. 2007) ("[T]he failure to timely file a notice of appeal is a jurisdictional defect barring appellate review.") (citation and internal quotation marks omitted). Without proper jurisdiction, a court does not have power to hear a case, and therefore "jurisdiction can never be forfeited or waived." *United States v. Cotton*, 535 U.S. 625, 630 (2002).

The *Bowles* holding applies to appeals in bankruptcy for two reasons. First, the Rule 8002(a) requirement that appeals be timely filed is incorporated into title 28. Section 158(c)(2) provides that appeals in bankruptcy shall be taken "in the time provided by Rule 8002 of the Bankruptcy Rules." This reference to Rule 8002 is located in the same section of the statute that grants district courts jurisdiction to hear bankruptcy appeals. See 28 U.S.C. §§ 158(a)-(b).

Because the time limitation is statutory, it is mandatory and jurisdictional.[2]

In this matter, the Bankruptcy Court's order on July 7, 2010 denying Mr. Wallace's discharge constitutes a final judgment. (Adversary Doc. 53); *In re Basso*, 397 B.R. 556, 562 (B.A.P. 1st Cir. 2000). Mr. Wallace filed his notice of appeal from the order denying discharge on August 5, 2010. (Adversary Doc. 56). To perfect his appeal from the order denying discharge, Mr. Wallace needed to file a notice of appeal no later than July 21, 2010. Mr. Wallace filed his appeal more than fourteen days after the order denying discharge was entered. As a result, the Bankruptcy Appellate Panel is without jurisdiction over the appeal, and it should be dismissed. *In re Linder*, 215 B.R. 826, 832 (6 Cir. BAP 1998); *Ultimate Appliance CC v. Kirby Co.*, 601 F. 3d 414 (6th Cir. 2010) (explaining that Federal Rule of Appellate Procedure time limits are mandatory).

CONCLUSION

In setting forth the jurisdiction of the Bankruptcy Appellate Panel, 28 U.S.C. § 158(c)(2) requires adherence to the time periods established by Fed. R. Bankr. P. 8002. When a time period for perfecting a timely notice of appeal is set forth in a statute, it is jurisdictional. *See Bowles v. Russell*, 551 U.S. 205, 213 (2007). Because Mr. Wallace's notice of appeal was

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[2] *Cf. Kontrick v. Ryan*, 540 U.S. 443, 454 (2004) (holding that failure to comply with the time requirement in Fed. R. Bankr. P. 4004 did not affect the court's subject-matter jurisdiction). Critical to the Court's analysis in *Kontrick* was the fact that "[n]o statute . . . specifies a time limit for filing a complaint objecting to the debtor's discharge." 540 U.S. at 448. That is not the case here. By contrast to the time limit in Bankruptcy Rule 4004, the time limit for appeals to the district court in bankruptcy cases derives from 28 U.S.C. § 158. *See also Bowles v. Russell*, 551 U.S. at 210 ("Although several of our recent decisions have undertaken to clarify the distinction between claims-processing rules and jurisdictional rules, none of them calls into question our longstanding treatment of statutory time limits for taking an appeal as jurisdictional.").

untimely, this Court lacks jurisdiction over the appeal and the appeal should be dismissed.

Dated: August 18, 2010

Respectfully submitted,

Daniel M. McDermott
United States Trustee
Region 9

/s/ Dean P. Wyman
Dean P. Wyman (Ohio #0007848)
Senior Trial Attorney
Office of the U.S. Trustee
Suite 441, H.M. Metzenbaum U.S.
Courthouse
Cleveland, Ohio 44114
216-522-7800, ext. 231
216-522-7193
Dean.P.Wyman@usdoj.gov

Certificate of Service

I certify I mailed a copy of the foregoing **UNITED STATES TRUSTEE'S MOTION TO DISMISS DUE TO UNTIMELY NOTICE OF APPEAL** on this 18th day of August, 2010 to attorney for defendant-appellant, Jeffrey Wallace, Chris G. Manos, Esq., 2745 Nesbitt Avenue, Akron, Ohio 44319.

/s/ Dean Wyman
Dean Wyman

BRIEF BANK — 'SUMMARY SHEET" *Printed Thu-5/18/06 10:53*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	US Trustee, Region Four v Wamsley (In re Wamsley)
2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	ND W. Va.
3. ("CCN") ***CURRENT*** CASE NO.	No.: 06-00041
4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*	No.: Bankr. 02-22959, Adversary 04-00044 Court: Bankr. ND W Va *(Identify judge & cite, if any)*
5. ("SO") ***SOURCE***	**U.S. TRUSTEES**
6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	Filed: May 2006 Type: Brief of the Appellee UST
7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*	Douglas A. Kilmer, Trial Attorney Region 4 *(UST/OGC: 202-307-1399/FAX- 2397)*
8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	• Whether the Bankruptcy Court committed clear error in revoking the discharge of the Debtor when the preponderance of the evidence showed the Debtor obtained his discharge through fraud. √ **Background:**
10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)	Y:\seggert\My Files\BriefBank-Web\Wamsley\WamsleySum.wpd
11. DO YOU RECOMMEND POSTING IN UST BRIEFBANK?	| X | YES | | NO ***NAME:*** Steven Eggert ***DATE:*** Thu-5/18/06 9:31

District Court Case No. 2:06-cv-00041

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF WEST VIRGINIA

In Re:

CHARLES E. WAMSLEY, JR.	**Bankruptcy Case No. 2:02-bk-22959**
Debtor	**Chapter 7**
W. CLARKSON MCDOW, JR.	**Adversary Proceeding No. 2:04-ap-00044**
U.S. TRUSTEE, REGION FOUR	
Appellee	
v.	**District Court Case No. 2:06-cv-00041**
CHARLES E. WAMSLEY, JR.,	
Appellant	

ON APPEAL FROM THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF WEST VIRGINIA

BRIEF OF APPELLEE UNITED STATES TRUSTEE

Douglas A. Kilmer
Trial Attorney
Office of United States Trustee
2025 United States Courthouse
300 Virginia Street East
Charleston WV 25301

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STATEMENT OF BASIS FOR APPELLATE JURISDICTION

The Bankruptcy Court had subject matter jurisdiction based on 28 U.S.C. § 1334 and 28 U.S.C. § 157(b)(1). The District Court has jurisdiction of this appeal under 28 U.S.C. § 158(a).

STATEMENT OF STANDARD OF REVIEW

The applicable standard of review on appeal from the Bankruptcy Court is that findings of fact shall not be set aside unless clearly erroneous, and conclusions of law are reviewed *de novo*. *In re Merry-Go-Round Enter., Inc.,* 400 F.3d 219, 2005 WL 418692 (4th Cir. 2005). A bankruptcy court determination of fraud regarding discharges is reviewed for clear error. *Williamson v. Fireman's Fund Ins. Co.,* 828 F.2d 249, 251 (4th Cir.1987); *Dean v. McDow*, 299 B.R. 133,139 (E.D.Va.2003); Fed.R.Bankr.P. 8013.

STATEMENT OF THE ISSUE

Did the Bankruptcy Court Commit Clear Error in Revoking the Discharge of the Debtor, When the Preponderance of the Evidence Showed the Debtor Obtained His Discharge Through Fraud?

STATEMENT OF THE CASE

Charles E. Wamsley, Jr., the debtor/defendant/appellant, filed a voluntary petition for relief under Chapter 11 of the Bankruptcy Code on September 11, 2002. The bankruptcy court converted the Chapter 11 reorganization case to a Chapter 7 liquidation case on March 31, 2003. Thereafter, the bankruptcy court granted the debtor a discharge on September 4, 2003.

After the debtor received his discharge from the bankruptcy court, the United States Trustee received information from the case trustee which indicated that there were grounds to revoke the discharge, on the basis that the discharge was obtained through the fraud of the debtor, pursuant to 11 U.S.C. §727(d)(1). Thereafter, the United States Trustee filed a complaint in the bankruptcy court requesting that the bankruptcy court revoke the discharge of the debtor. The complaint set forth eight specific acts committed by the debtor that constituted fraud.

First, the debtor fraudulently transferred his interest in two parcels of real property within one year before the filing of the petition. Second, when the debtor filed his bankruptcy case, he failed to disclose the transfers of the real property in his statement of financial affairs and falsely stated under oath that he made no transfers of real property within one year before the petition date. Third, at his first meeting of creditors, the debtor: (1) falsely testified under oath that the statement of financial affairs was true and correct; and (2) falsely testified under oath that he had made no transfers of real property within one year prior to the petition date. Fourth, after the case was converted to a Chapter 7 liquidation, the debtor executed an amended statement of financial affairs and again failed to disclose the transfers of the real property and falsely stated under oath that he made no transfers of real property within one year before the petition date. Fifth, after the case converted to a Chapter 7 liquidation, the debtor appeared at a second meeting of creditors and (1) falsely testified under oath that the amended statement of financial affairs was true and correct, and (2) again falsely testified under oath that he had made no transfers of property within one year prior to the petition date. Sixth, after the case converted to Chapter 7 liquidation, the trustee took possession of and sold the machinery, equipment and tools listed by the debtor in his schedules; the debtor represented to the Trustee that this machinery, equipment and tools were the only machinery, equipment and tools owned by the debtor, when in fact the debtor also owned other machinery, equipment and tools that was not disclosed by the debtor to the trustee and was concealed from the trustee. Seven, prior to filing his bankruptcy petition, the debtor filed certain amended federal income tax returns that showed substantial tax overpayments and requested a refund of those overpayments. However, the debtor failed to disclose the pending refund in his original bankruptcy schedules and in his amended bankruptcy schedules that were each signed under oath. Furthermore, the debtor testified under oath at his first and second meetings of creditors that his schedules and amended schedules were true and correct, when in fact the schedules and amended schedules failed to disclose the pending tax refund. In fact, the debtor later received a substantial refund from the Internal Revenue Service in the amount of $54,432 and disposed of the funds instead of turning them over to the trustee as required by law.

The complaint alleged that, as a result of these actions, the debtor obtained his discharge by fraud, because the disclosure by the debtor of these actions prior to receiving the discharge would have been grounds for denial of the discharge before it was issued. A trial was held in the bankruptcy court, after which the court revoked the debtor’s discharge.

ARGUMENT

I. THE BANKRUPTCY COURT DID NOT ERR IN REVOKING THE DISCHARGE OF THE DEBTOR, BECAUSE THE PREPONDERANCE OF THE EVIDENCE SHOWED THE DEBTOR OBTAINED HIS DISCHARGE THROUGH FRAUD

(A) A Debtor Has a Duty to Disclose Assets and Financial Affairs, and a Debtor Who Does Not Make Complete and Truthful Disclosures May Not Receive a Discharge or May Have the Discharge Revoked

The duty of disclosure is a basic prerequisite to obtaining a discharge in bankruptcy. *In re Trinsey*, 114 B.R.86,91(Bankr.E.D.Pa.1990). Bankruptcy trustees and creditors are entitled to know the extent of the debtor's assets which might have satisfied debts and the disposition of those assets. The trustee and creditors have a right to receive information that will allow them to evaluate the case and to administer the estate's property. *In re Olbur*, 314 B.R.732,744 (Bankr.N.D.Ill.2004). As stated in *In re Bren*, 303 B.R. 610, 614 (8th Cir. BAP 2004): “Neither the trustee nor the creditors should be required to engage in a laborious tug-of-war to drag the simple truth into the glare of daylight.” Complete financial disclosure is therefore “a condition precedent to the privilege of discharge.” The duty of disclosure is critical with respect to two particular requirements imposed upon a debtor in bankruptcy.

First, a debtor is required to file schedules and a statement of financial affairs at the commencement of the case, in which the debtor is required to list all of his assets, liabilities, income, and expenses, and is required to make certain disclosures regarding his financial affairs. 11 U.S.C. §521(a); Fed.R.Bankr.P. 1007(b). That these schedules and statements must be true and correct is punctuated by the requirement that they be verified by the debtor. Fed.R.Bankr.P. 1008. The importance of having a debtor submit complete and accurate bankruptcy schedules is paramount; the bankruptcy system relies heavily on self-reporting by debtors. *In re Mertz*, 955 F.2d 596, 598 (8th Cir.1992)("[T]he petition, including schedules and statements, must be accurate and reliable, without the necessity of digging out and conducting independent examinations to get the facts.")

Second, a debtor is required to appear and to testify under oath at a meeting of creditors after the commencement of the case. 11 U.S.C. § 343. In addition, a debtor is required to appear and testify at another meeting of creditors if the case is converted to a case under another chapter of the bankruptcy code.

After a debtor files a bankruptcy petition, a debtor will normally receive a discharge of debts, which prohibits creditors from collecting those debts after the bankruptcy case is concluded. However, the bankruptcy court may not grant a debtor a discharge for a number of specific causes set forth in 11 U.S.C. § 727(a). One predominant cause for the court to deny a discharge is the fraudulent transfer, destruction, removal or concealment of property before or after the case is filed. 11 U.S.C. § 727(a)(2). In addition, a discharge may be denied if a debtor knowingly and fraudulently makes a false oath or account in the case. 11 U.S.C. § 727(a)(4)(A).

An action to deny the discharge is prosecuted in the bankruptcy court as an adversary proceeding pursuant to Fed.R.Bankr.P. 7001(4) and is commenced by filing a complaint. Fed.R.Bankr.P.7003. The complaint must be filed within 60 days after the first meeting of creditors. Fed.R.Bankr.P.4004(a). If no party objects to the discharge before that time period expires, the bankruptcy court must grant the discharge. Fed.R.Bankr.P. 4004(c). In this case, there was no objection to the debtor’ s discharge and the court granted the discharge.

There are times when there may be grounds to object to the discharge, but the grounds are not known to a party until after the discharge is granted. In such cases, the party may commence a proceeding to request that the bankruptcy court revoke the discharge pursuant to 11 U.S.C. § 727(d). The statute provides that :

> On request of the trustee, a creditor, or the United States trustee, and after notice and a hearing, the court shall revoke a discharge granted under subsection (a) of this section if-
>
> (1) such discharge was obtained through the fraud of the debtor, and the requesting party did not know of such fraud until after the granting of such discharge;
>
> (2) the debtor acquired property that is property of the estate, or became entitled to acquire property that would be property of the estate, and knowingly and fraudulently failed to report the acquisition of or entitlement to such property, or to deliver or surrender such property to the trustee; or
>
> (3) the debtor committed an act specified in subsection (a)(6) of this section.

11 U.S.C. § 727(d).

An action to revoke a discharge is generally governed by many of the same procedural rules that apply to a proceeding to deny a discharge. The action is commenced in the bankruptcy court as an adversary proceeding pursuant to Fed.R.Bankr.P. 7001(4) and is commenced by filing a complaint. Fed.R.Bankr.P. 7003. If the complaint requests revocation of the discharge because the debtor obtained the discharge through fraud, the complaint must be filed within one year after the discharge is granted. 11 U.S.C. § 727(e)(1). In the proceeding, the party requesting revocation of the discharge has the burden of proof. Fed.R.Bankr.P. 4005 . In a discharge proceeding, the standard of proof is the preponderance of the evidence. *Farouki v. Emirates Bank Intern*., Ltd., 14 F.3d 244,249 (4th Cir.1994).

The revocation of a discharge under 11 U.S.C. § 727(d)(1) requires that the debtor must have committed a fraud which would have barred the discharge had the fraud been known prior to the discharge. *In re Edmonds*, 924 F.2d 176, 180 (10th Cir.1991). The fraud must have been discovered by the complaining party after the discharge. *Id*. In other words, fraud that would be grounds to revoke a discharge under § 727(d)(1) may be shown by the same grounds for denial of discharge under § 727(a). *In re George*, 179 B.R. 17, 22 (Bankr.W.D.N.Y.1995).

(B) There Was Sufficient Evidence That the Debtor Obtained His Discharge Through Fraud By Transferring His Interest in Two Parcels of Real Property With the Intent to Hinder, Delay or Defraud Creditors or the Trustee, as Set Forth in Count One of the Complaint.

The testimony and exhibits at trial clearly showed that the debtor fraudulently conveyed his interest in two parcels of real property within one year before he filed bankruptcy, which is grounds to deny a discharge under 11 U.S.C. § 727(a)(2)(A) or revoke a discharge under 11 U.S.C. § 727(d)(1). A discharge may be denied (or revoked) if "the debtor, with intent to hinder, delay or defraud a creditor or an officer of the estate charged with custody of property under this title, has transferred, removed, destroyed, mutilated or concealed ... (A) property of the debtor, within one year before the date of the filing of the petition . . . ." 11 U.S.C. § 727(a)(2)(A).

The transfers of real property in this case were clearly fraudulent transfers. The evidence showed that debtor, on or about January 22, 2002, within one year prior to filing his bankruptcy petition on September 11, 2002, transferred his interest in two parcels of real estate in Tucker County, West Virginia. (U.S.Trustee's Exhibits 5 & 6; Trial Trans.P.87). The debtor transferred his interest in the first parcel to Susan G. Wamsley, as evidenced by a deed signed by Charles E. Wamsley on January 23, 2002 and recorded in the Tucker County Clerk's Office in Deed Book No. 170, at page 385, on January 28, 2002. (Trustee's Ex.5). The debtor transferred his interest in the second parcel to Michael Wamsley, as evidenced by a deed signed by Charles E. Wamsley on January 24, 2002, and recorded in the Tucker County Clerk's Office in Deed Book No. 170, at page 387, on January 28, 2002. (Trustee's Ex.6).

In order to determine that a transfer or conveyance is fraudulent, the courts have developed a number of indicia in bankruptcy cases. The factors indicating whether a transfer is fraudulent include: a close relationship between the transferor and transferee; the transfer is in anticipation of litigation; the debtor's financial condition at the time of transfer; the percentage of debtor's property that was transferred; the receipt of inadequate consideration for the transfer; and the debtor's continued use of property after the transfer. *In re Kaiser*, 722 F.2d 1574,1582-83 (2nd Cir.1983); *In re Woodfield*, 978 F.2d.516 (9th Cir.1992).

It has not been disputed that these transfers were made to related parties of the debtor, his wife and his brother. In addition, the transfers were made without consideration, evidenced by the testimony of the debtor at his meeting of creditors on June 4, 2003 conducted by the case trustee. (Trustee's Ex.4, Pg.20-22; Trial Trans.P.83-84) A presumption of fraudulent intent arises when transfers between related parties are made without adequate consideration, and this presumption shifts the burden of proof to debtor to establish the absence of fraudulent intent. *Tavenner v. Smoot*, 257 F.3d 401, 408 (4th Cir.2001). The record in this case clearly shows that the debtor did not carry the burden of proving the absence of fraudulent intent regarding these transfers.

These transfers hindered and delayed the trustee, in that they required the bankruptcy trustee to file complaints to commence proceedings to set aside the transfers and to recover the value of the property for the estate. (Trial Trans.P.88-89; Trustee's Ex.7). In addition, these transfers hindered at least one creditor, Heron Cove LLC, who obtained a judgment against the debtor in the Circuit Court of Garrett County, Maryland just days after these properties were transferred by the debtor. This fact was alleged in the complaint and admitted in the debtor's answer. The transfer of property shortly after the entry of a judgment is indicative of a fraudulent transfer. *Ford v. Poston,* 773 F.2d 52, 54 (4th Cir. 1985). It would be consistent that a transfer on the eve of judgment is also indicative of fraudulent intent.

The fraudulent nature of these transfers by the debtor is further evidenced by the fact that instead of disclosing the transfers as required by law, the debtor: (1) failed to disclose the transfers on his original Statement of Financial Affairs that was filed with the court on September 23, 2002; (2) denied that he made any pre-bankruptcy transfers in his testimony at his first meeting of creditors on October 22, 2002; (3) failed to disclose the transfers in his amended Statement of Financial Affairs that was filed with the court on May 22, 2003; (4) did not admit to the transfers at his second meeting of creditors on June 4, 2003, until he was confronted with specific questions about the transfers and confronted with the deeds. The failures to disclose the transfers is addressed in more detail below in Paragraph C.

At trial, the debtor denied that he had signed the deeds and denied knowledge of the deeds that transferred the properties transfers. He even denied knowing he had an interest in the properties at the time he filed bankruptcy. However, these were simply self-serving declarations at trial to save the debtor's discharge which were contradicted by prior sworn testimony of the debtor. At his second meeting of creditors, the debtor at first generally denied making any pre-bankruptcy transfers of real estate. (Trustees Ex.4, P.8),. But upon questioning by the trustee that included the specific facts of these transfers , the debtor finally admitted that he had transferred thee properties to his wife and brother. (Trustee's Ex.4,P.10; Trial Trans.P.82). In subsequent questioning by a creditor, the debtor was confronted with questions regarding the specific facts and the actual deeds and again admitted making the transfers. (Trustee's Ex.4, P.20-22.)(Trial Trans.P.86-87). More importantly, when the debtor was shown copies of the deeds at this second meeting, he did not dispute that the signatures on the deeds were his signatures. (Trial Ex.4,P.22; Trial Trans.P.86). And the debtor's signatures on those deeds were properly acknowledged by a notary public under seal. (Trustee's Ex.5, 6). It is interesting that there was no testimony from the notary public who acknowledged the signatures of Mr.

Wamsley and no testimony from Mrs. Wamsley who apparently co-signed the deeds with Mr. Wamsley.

In conclusion, there was sufficient evidence that the debtor transferred his interest in two parcels of real property within the year before he filed bankruptcy with the intent to hinder, delay or defraud creditors or the trustee as set forth in Count One of the complaint.

(C) There Was Sufficient Evidence That the Debtor Obtained His Discharge Through Fraud by Making Multiple False Oaths Regarding the Fraudulent Transfers of Real Property, as Alleged in Count Two, Count Three, Count Four, and Count Five of the Complaint.

The testimony and exhibits at trial clearly showed that the debtor made multiple false oaths regarding his transfers of his interest in two parcels of real property, as described above in Paragraph B. Any one of these false oaths is grounds to deny a discharge under 11 U.S.C. §727(a)(4)(A) or to revoke a discharge under 11 U.S.C. § 727(d)(1). A discharge may be denied (or revoked) if the debtor knowingly and fraudulently, in or in connection with the case - (A) made a false oath or account." 11 U.S.C. § 727(a)(4)(A).

(1) The debtor failed to disclose the transfers of real estate on his original Statement of Financial Affairs that was filed with the Court on September 23, 2002. (Trustee's Ex.1). These statements included Question 10 - Other Transfers, which required the debtor to list all property transferred outside the ordinary course of business within one year preceding commencement of the case. The debtor answered that question by affirmatively stating "NONE." The debtor should have listed the real estate transfers that he made to his wife and his brother. As indicated above in Paragraph B, the debtor did in fact transfer his interest in two parcels of real property, within one year prior to the petition date. The debtor signed these Statements under penalty of perjury that he had read the answers contained in the Statements and that they were true and correct. Moreover, the debtor later testified at his first meeting of creditors that he signed these statements, that he had reviewed the statements and schedules before he signed them, and that everything on the statements was correct. (Trustee's Ex.2; Trial

Trans.P.22-24). The debtor's false answer to Question 10 of the statement of financial affairs under penalty of perjury constituted a false oath.

(2) The debtor made a false oath at his first meeting of creditors held on October 22, 2002 pursuant to 11 U.S.C. § 341 and testified under oath in response to questions by the U.S. Trustee and creditors. The debtor testified that he signed the original statement of financial affairs, that he had read them before he signed them, that everything in the statements was true and correct, and that there were no omissions from those statements or schedules. This statement was false, because the original statement of financial affairs was not correct and had omitted the transfers of real property, as described above in Paragraph B. At that same meeting, the debtor further testified under oath that (1) he had made no transfers of property within one year prior to the petition date, (2) at the time of the meeting, he still owned everything he owned in September of 2001, and (3) that he had not transferred anything to any of his relatives (Trustee’s Ex.2, P.66). In fact, the debtor had transferred his interest in two parcels of real property, within one year prior to the petition date, and the transfers were both to relatives. These false statements under oath at the first meeting of creditors constituted a false oath.

(3) After the case was converted to Chapter 7 and a bankruptcy trustee was appointed, the debtor executed an amended Statement of Financial Affairs that were filed with the Court on May 22, 2003. These amended statements were on the same forms and included the same questions as the original statements the debtor filed when he first filed his bankruptcy case, and which were discussed above in Paragraph 1. These amended Statements included Question 10 - Other Transfers, which required the debtor to list all property transferred outside the ordinary course of business within one year preceding commencement of the case. The debtor again answered that question by affirmatively stating “NONE.” As indicated in Paragraph B above, the defendant did in fact transfer his interest in two parcels of real property, within one year prior to the petition date. The debtor again signed these amended statements under penalty of perjury that he had read the answers contained in the Statements and that they were true and correct. The false answer to Question 10 of the amended Statement of Financial Affairs under penalty of perjury constituted a false oath. Furthermore, the debtor testified at his second meeting of creditors regarding these amended statements, and testified under oath that he signed

these statements, that he had reviewed the statements before he signed them, and that everything on the statements was correct. (Trustee's Ex.4; Trial Trans.P.22-24).

(4) The debtor again made several false oaths regarding the fraudulent transfers at his second meeting of creditors. After the Chapter 11 case was converted to Chapter 7, the debtor appeared at a second meeting of creditors conducted by the Chapter 7 trustee on June 4, 2003 and testified under oath. The debtor testified that he signed the amended statement of financial affairs, that he had read the amended statement of financial affairs before he signed them, that everything in the statements was true and correct, and that there were no omissions from those statements or schedules. (Trustee's Ex.4, P.7). This statement was false, because the amended statement of financial affairs was not correct and had omitted the transfers of real property, as described above in Paragraph B. Later in the meeting, the debtor specifically testified under oath that he had not owned any real estate in the last four years, other than what was listed on the schedules and amended schedules. (Trustee's Ex. 4, P.8). This statement was false, because the defendant did in fact own other real property in the last four years and had transferred his interest in two parcels of real property within one year prior to the petition date, as shown above in Paragraph B.

The complaint alleges four instances where the debtor made a false oath. In order to prove a debtor obtained a discharge by fraud by making a false oath, it must be shown that (1) the debtor knowingly and fraudulently made a false oath in or in connection with the bankruptcy proceeding, and (2) the oath concerned a material fact. *Williamson v. Fireman's Fund Ins. Co.*, 828 F.2d 249 (4th Cir.1987). The requirement that a false oath has been made "fraudulently" may be satisfied in one of two ways. First, fraudulent intent may be established by circumstantial evidence, or by inference drawn from a course of conduct. Second, proof of a "reckless indifference to the truth" constitutes the "functional equivalent of fraud." *In re Hatton*, 204 B.R. 477, 484 (E.D.Va.1997). Because a determination regarding fraudulent intent depends largely upon an assessment of the credibility and demeanor of the debtor, deference to the bankruptcy court's findings is particularly appropriate. *Williamson v. Fireman's Fund Ins. Co.*, 828 F.2d 249, 252 (4th Cir.1987).

The evidence presented at the trial in this case would easily support the second method of finding fraudulent intent. While any single omission or error may be the result of an innocent mistake, multiple inaccuracies are evidence of a pattern of reckless and cavalier disregard for the truth serious enough to supply the necessary fraudulent intent required by 11 U.S.C. § 727(a)(4)(A). *In re Hatton*, 204 B.R. at 484; *Dean v. McDow*, 299 B.R. 133, 140 (E.D.Va.2003). In this proceeding, there was more than sufficient evidence to show that the debtor knew of the transfers, that the transfers were presumed fraudulent and were in fact fraudulent. The omission of valuable assets from bankruptcy schedules is a material fact. *Id.* The property interests transferred by the debtor were valuable and material assets; the fraudulent conveyance proceeding initiated by the trustee recovered $24,832 for the bankruptcy estate and its creditors. (Trial Trans.P.91).

At trial, the debtor defended the omission of these transfers from his statement of financial affairs and his testimony at the meetings of creditors by denying that he had signed the deeds and by denying that he had knowledge of the deeds when he filed bankruptcy, reviewed his statements and testified at the meetings. He further testified that he did not even know he had an interest in the properties at the time he filed bankruptcy. However, these were simply self-serving declarations at trial to save the debtor’s discharge which were contradicted by the deeds prior sworn testimony of the debtor. At his second meeting of creditors, the debtor at first generally denied making any pre-bankruptcy transfers of real estate. (Trial Ex.4, Pg.8),. But upon questioning by the trustee that included the specific facts of these transfers , the debtor finally admitted that he had transferred thee properties to his wife and brother. (Trial Ex.4, Pg.10), (Trial Trans. Pg.82). In subsequent questioning at the second meeting by a creditor, the debtor was confronted with questions regarding the specific facts and the actual deeds and again admitted making the transfers. (Trial Ex.4, Pg.20-22, Trial Trans. P. 86,87). More importantly, when the debtor was shown copies of the deeds at this second meeting, he did not dispute that the signatures on the deeds were his signatures. (Trial Ex.4, Pg 22; Trial Trans. P. 86). And the debtor’s signatures on those deeds were properly acknowledged by a notary public under seal. (Trial Ex.5, 6). It is interesting that there was no testimony from the notary public who acknowledged the signatures of Mr. Wamsley and no testimony from Mrs. Wamsley who apparently co-signed the deeds with Mr. Wamsley.

The debtor has also asserted that many of his omissions from his schedules and statements were the fault of his first attorney. This defense is not supported by the facts or the law. The debtor’s first attorney who prepared the statements testified at trial that when he prepared the statements he was not aware of the transfers. (Trial Trans. P.143-144). Furthermore, even if the attorney failed to list the transfers on the statements, the debtor had the opportunity to bring those omissions to the attention of his attorney before he signed them and had the opportunity to bring those omissions to the attention of the U.S. Trustee at the first meeting of creditors or of the case trustee at the second meeting of creditors, when he was asked about the information in those statements and was specifically asked about transfers of real estate. When a debtor has declared under penalty of perjury that he has read his petition and schedules and that they are true and correct, the debtor--not his lawyer--is accountable for any errors and omissions. *In re Olbur*, 314 B.R. 732, (Bankr.N.D.Ill.2004).

The inference may be drawn from the record in this case that the debtor may not have thoroughly read or paid attention to his schedules and statements before he read them, contrary to his verification on those documents and contrary to his testimony at his meeting of creditors that he did read them. But a debtor who does not read his schedules or does not pay close attention to the schedules before he signs them emphasizes rather than undermines fraudulent intent, and corroborates evidence that the debtor wilfully made a false oath within the meaning of § 727(a)(4)(A). *Dean v. McDow*, 299 B.R. 133.139 (E.D.Va.2003).

Finally, the debtor’s brief focuses on the statement of the bankruptcy judge when ruling from the bench that the judge did not think the debtor lied and did not commit perjury. The meaning of those statements is not clear in relation to the false oath allegations. However, the context of the statement indicates the judge was more concerned with the overall nature of the case rather than focus on each individual allegation. (Trial Trans.P.266). It certainly cannot be construed as a finding that the debtor did not make false oath as alleged in the complaint.

In conclusion, there was sufficient evidence that the debtor made multiple false oaths in failing to disclose the fraudulent transfers of real property in each of the above instances within the meaning of § 727(a)(4)(A), in his original statements of financial affairs, at his first meeting of creditors, on his amended statement of financial affairs, and at his second meeting of creditors, as alleged in Count 2, Count 3, Count 4 and Count 5 of the complaint.

(E) There was sufficient evidence that the debtor obtained his discharge through fraud by making several false oaths in his original Schedule B and in his amended Schedule B that he owned no tax refund, and by further testifying under oath at his meeting of creditors that the Schedules were true and correct, as alleged in Count Seven of the complaint.

The testimony and exhibits at trial clearly showed that the debtor made multiple false oaths when he failed to disclose his right to receive a tax refund that was property of the estate. Any one of these false oaths is grounds to deny a discharge under 11 U.S.C. §727(a)(4)(A) or revoke a discharge under 11 U.S.C. §727(d)(1). A discharge may be denied (or revoked) if "the debtor knowingly and fraudulently, in or in connection with the case - (A) made a false oath or account . . . .." 11 U.S.C. § 727(a)(4)(A).

There is no dispute that the defendant filed amended federal income tax returns for the years 1999 and 2000 in November 2001, prior to filing his bankruptcy petition and schedules. There is no dispute that these amended tax returns showed an overpayment of federal income tax for those two years that entitled the debtor to a refund. (Trustee's Ex.14,15). There is no dispute that the debtor failed to disclose the potential tax refunds on his first bankruptcy schedules and his amended bankruptcy schedules. There is no dispute that in October 2003, after the debtor had received his discharge, the debtor received that refund from the Internal Revenue Service. (Trustee's Ex.14,15). There is no dispute that, when the bankruptcy trustee learned of the refund, he commenced proceedings against the debtor and against his wife to recover the tax refund for the bankruptcy estate. In those proceedings, the Court determined that (1) the tax refund was property of the bankruptcy estate of the debtor; (2) the defendant and his wife, Susan Wamsley, received the tax refund and transferred the funds to a third party (Parsons Woodworking, LLC) instead of transferring the funds to the bankruptcy estate. (Trustee's Ex.18).

When the defendant signed his original schedules, he had already filed the amended tax returns that requested refunds. The debtor was required to disclose all liquidated, contingent and unliquidated debts, specifically including tax refunds. In response to Schedule B, Question 17 regarding tax refunds, the debtor answered by affirmatively stating "NONE" and did not disclose his pending tax refund. (Trustee's Ex.1,Sch.B). The debtor signed these schedules under penalty of perjury that he had read the answers contained in the schedules and that they were true and correct. This was clearly a false oath regarding the tax refund.

After the debtor filed his petition and schedules, he appeared at his first meeting of creditors and testified under oath that his schedules were true and correct. (Trial Trans.P.25; Trustee's Ex.2, P.7-8). This is another false oath: as shown above, the schedules were not correct because they contained a false statement that the debtor was not entitled to a tax refund.

Thereafter, when the case was converted from Chapter 11 to Chapter 7, the debtor amended his bankruptcy schedules. But the debtor again answered Question 17 regarding tax refunds by affirmatively stating "NONE" and did not disclose his pending tax refund. (Trustee's Ex.3,Sch.B). The debtor signed these amended schedules under penalty of perjury. These written declarations have the force and effect of oaths. This was clearly another false oath regarding the tax refunds.

After the case was converted to Chapter 7 and the debtor amended his bankruptcy schedules, the debtor appeared at his second meeting of creditors and testified under oath that his amended schedules were true and correct. (Trial Trans.P.64-65; Trustee's Ex.4,P.7-8). This is another false oath: as shown above, the amended schedules were not true and correct because they contained a false statement that the debtor was not entitled to a tax refund.

The debtor had a number of opportunities to correct the omission of the tax refund from his schedules, but never did so. He could have corrected the schedules when questioned about them at his first meeting of creditors. He did not. He could have corrected the omission when he executed his amended schedules. He did not. Instead of correcting the omission, he perpetuated it by again omitting the tax refund. He could have corrected the omission at his second meeting of creditors before the case trustee. He did not. Instead of correcting it he testified that the schedules were in fact true and correct.

A debtor is required to disclose on his schedules any tax refunds to which he may be entitled. *Mertz v. Rott*, 955 F.2d 596 (8th Cir. 1992). For such a false oath to bar a discharge, the false statement must be "material" and the failure to disclose a tax refund is a material omission that can provide the basis for a false oath that will bar a bankruptcy discharge. *Id.*

In *Mertz*, the Court upheld the denial of a discharge for omission of a tax refund, and in determining whether the omission was intentional found it significant that the debtor "has given three false oaths and has had not one opportunity, but three opportunities to correct any errors or omissions." *Id*, at 598.

The debtor has again attempted to blame these omissions and false oaths on his first attorney. However, even if a debtor's attorney does not ask him about tax refunds, it is not reasonable for a debtor to rely on that failure. See *In re Colvin*, 288 B.R. 477 (Bankr. E.D.Mich.2003). In *Colvin*, the Court found the debtor's failure to disclose a tax refund was an intentional concealment, and based its finding on the fact that the debtor's schedules clearly require a debtor to disclose tax refunds, that the debtor had stated under penalty of perjury that they had no tax refunds, and had stated that they had read the schedules and that they were true. Again, when a debtor has declared under penalty of perjury that he has read his petition and schedules and that they are true and correct, the debtor--not his lawyer--is accountable for any errors and omissions. *In re Olbur*, 314 B.R. 732, (Bankr.N.D.Ill.2004).

The debtor testified at his meeting of creditors that he did not believe he was going to receive the tax refund, because he believed the Internal Revenue Service would offset the refund against other tax obligations the debtor owed to the IRS. This belief, even if true, is not a defense to the debtor's failure to disclose the refund in his schedules. In this case, after the debtor filed his schedules and amended schedules, and after he testified at his two meetings of creditors, the debtor received the tax refunds that he had requested in the amended tax returns he had filed prior to his bankruptcy.

The bankruptcy court, in revoking the debtor's discharge, gave great weight to the fact that the debtor retained the refund and signed the check over to his wife, who used it in her business. The debtor, if he truly believed he was not entitled to the refund, would have contacted someone regarding this error, whether it be his attorney, his accountant, the trustee, or the IRS revenue officer. The fact the debtor failed to disclose the refund even after its receipt clearly indicates the fraudulent nature of his failure to disclose the refund during his case. *In re Reese*, 203 B.R. 425 (Bankr.N.D.Ill.1997).

The bankruptcy code specifically provides that a debtor's discharge may be revoked if the debtor acquires property of the (bankruptcy) estate and knowingly and fraudulently fails to report the acquisition of such property or fails to deliver or surrender such property to the trustee. 11 U.S.C. § 727(d)(2). A tax refund for pre-bankruptcy periods but receivable by the debtor after filing bankruptcy is property of the bankruptcy estate. *Segal v. Rochell,* 382 U.S. 375, 86 S.Ct. 511, 15 L.Ed.2d 428 (1966). The complaint filed by the U.S. Trustee did not specifically plead this ground for revoking the debtor's discharge. But the statute makes it clear that a debtor who receives property of the estate has a duty to report it to the trustee and to turn the property over to the trustee. The debtor clearly violated both of these duties when he failed to report the unexpected tax refund, failed to turn it over to the trustee, and instead diverted it to his wife. This behavior by the debtor is clearly grounds to revoke a discharge. *In re Reese*, 203 B.R. 425 (Bankr.N.D.Ill.1997). But more importantly, it sheds a great deal of light on the debtor's fraudulent intent in failing to disclose the tax refund in his bankruptcy schedules, as alleged in Count VI of the complaint.

In conclusion, there was ample evidence at trial that the debtor obtained his discharge through fraud by making several false oaths in his original Schedule B and in his amended Schedule B that he was owed no tax refund, and by further testifying under oath at his meeting of creditors that the Schedules were true and correct, as alleged in Count Seven of the complaint.

(F) There was sufficient evidence that the debtor obtained his discharge through fraud by concealing tools and equipment as alleged in Count Six of the complaint.

The testimony and exhibits at trial clearly showed that the debtor concealed a substantial amount of machinery tools and equipment, which is grounds to deny a discharge under 11 U.S.C. §727(a)(2) or revoke a discharge under 11 U.S.C. §727(d)(1). A discharge may be denied (or revoked) if “the debtor, with intent to hinder, delay or defraud a creditor or an officer of the estate charged with custody of property under this title, has transferred, removed, destroyed, mutilated or concealed ... (B) property of the estate, after the date of the filing of the petition . . . .” 11 U.S.C. § 727(a)(2).

At the beginning of the case, the debtor filed original schedules that listed only 7 items of machinery and equipment valued at $100,000. (Trustee’s Ex.1, Sch.B). The debtor signed the schedules under penalty of perjury that he had read them and that they were true and correct.

Later, at his meeting of creditors, the debtor testified under oath that he had signed the schedules, that he read them before he signed them and that they were true and correct. (Trustee's Ex.2, P.7-8). At that meeting, there was testimony regarding tools and equipment, and the debtor referred to the items that he had listed on original Schedule B and testified that "That is basically all the equipment." When the U.S. Trustee suggested that his business should have additional items, the debtor merely stated there were also a few miter boxes and table saws. (Trustee's Ex.2, P.62)

After the case was converted to Chapter 7, the trustee employed an auctioneer who visited the debtors business premises and, with the debtor's assistance, took possession of what the trustee and auctioneer thought was all of the machinery, equipment and tools owned by the debtor. (Trial Trans.P.59-61). Moreover, the auctioneer relied upon the debtor to designate what items belonged to the debtor and what items did not belong to the debtor. (Trial Trans.P.171-172, 177). But instead of the seven items the debtor had disclosed on the original schedules, the trustee's auctioneer collected and offered for sale over 300 items of machinery, equipment and tools. (Trial Trans.P.60-61). These items brought over $168,710 at the auction. (Trial Trans.P.79). These items are itemized on the trustee's motion to approve the sale. (Trustee's Ex. 10). The machinery, equipment and tools actually recovered by the trustee from the debtor's business premises far exceeded the seven items the debtor had listed on his bankruptcy schedules, and that the original schedules omitted a material amount of machinery tools and equipment.

After the Chapter 7 trustee conducted his auction of 300+ items that the debtor had turned over to the auctioneer, the trustee learned that not all of the debtor's machinery tools and equipment had been turned over by the debtor and included in the first sale. The trustee's auctioneer then visited the debtor's premises and two other locations, pursuant to a Court order, and collected additional items of tools and equipment that were not previously turned over for the first auction. (Trial Trans.P.75-6, Trans.P.179). These additional items were (1) items that were left over from the first sale, (2) items that were recovered from a garage or storage facility, and (2) items that were recovered from a truck. Trans P.179. This second group of over 315 additional pieces is itemized on the auctioneer's inventory. (Trial Trans.P.80; Trustee's Ex.12).

It can be concluded from this evidence that the debtor did not disclose a substantial amount of his machinery, tools, and equipment on his original bankruptcy schedules. It can also be concluded that the debtor did not disclose all of this unlisted machinery tools and equipment to the U.S. Trustee at the first meeting of creditors. Furthermore, is can also be concluded from the evidence that when the trustee and his auctioneer visited the debtor's business premises to collect and inventory the machinery, tools and equipment for sale, the debtor while appearing to be cooperative, did not turn over all of the tools and equipment, specifically including those items not located on the business premises that the trustee discovered in a storage facility and vehicle located away from the business premises.

The concealment of assets as a basis for denial or revocation of a bankruptcy discharge includes conduct, such as placing assets beyond the reach of creditors or withholding knowledge of the assets by failure or refusal to divulge information. "Concealment ··· includes preventing discovery, fraudulently transferring or withholding knowledge or information required by law to be made known." *United States v. Turner*, 725 F.2d 1154, 1157 (8th Cir.1999); *In re Scott*, 172 F.3d 959 (7th Cir.1984). In this case, the debtor concealed a substantial amount of machinery, tools and equipment by (1) failing to disclose them on the schedules, (2) failing to disclose them to the U.S. Trustee at the first meeting of creditors, even after being prompted; and (3) most importantly, failing to disclose them and turn them over to the trustee and his auctioneer when they were collected for the first auction. The assets that were concealed were material, over 500 items of tools ane equipment valued at over $100,000.

The debtor offered several defenses at trial. There was much testimony from the debtor and his brother as to why all the debtors tools and equipment were not sold by the trustee at the first auction. There was some testimony that the debtor believed some of the assets did not belong to corporation he owned. (Trial Trans.P.153). But this testimony is clearly contradicted by the debtor's prior testimony at the two meetings of creditors where he firmly testified that his corporations did not own any personal property such as machinery, tools, and equipment. There was also some testimony that the debtor did not turn over to the trustee items that he believed were exempt under the bankruptcy law. However, under the bankruptcy law, a debtor is required to list all of his assets on his bankruptcy schedules, and it does not absolve the debtor who fails to disclose assets he believes might be exempt and not subject to sale by the trustee.

As a general rule, the materiality and intent of an omission is not lessened by the fact that the believes the concealed assets might be exempt, as all assets must be disclosed by a debtor. *Mertz v. Rott*, 955 F.2d 596,598 (8th Cir.1992); *Morris Plan Industrial Bank v. Finn*, 149 F.2d 591, 592 (2d Cir.1945).

The extent of the concealment can be most vividly seen by comparing the debtor's original schedules that listed only 7 items of machinery tools, and equipment, with the two inventories of items recovered and sold by the trustee at the two auction sales. It is obvious from that comparison that the debtor failed to disclose and concealed a substantial amount of tools and equipment. The debtor's assertions as to why particular items were not sold by the trustee does not save the fact that the debtor failed to disclose numerous items on his schedules or at his meetings of creditors.

After the case was converted to Chapter 7, the debtor filed amended schedules (Trustee Ex.3). The debtor also signed these amended schedules under penalty of perjury that he had read them and that they were true and correct. This time on Schedule B, Question 24 the debtor listed 28 items of machinery, tools and equipment. The debtor listed the seven items that had been listed on the first schedules, and added an additional 21 items. (Trustee's Ex.3, Sch.B.).

Thereafter, on the defendant appeared at the second meeting of creditors and testified under oath that he had signed the amended schedules, that he had reviewed the amended schedules before he had signed them, that they reflected all of his assets and where they are located, and that he listed all of his equipment. (Trial Ex. 4, Pg.7).

In conclusion, there was sufficient evidence at trial that the debtor obtained his discharge through fraud by concealing substantial machinery, tools, and equipment, by failing to disclose those items on his original Schedule B and in his amended Schedule B, by failing to disclose those items at his first and second meeting of creditors, and by failing to turn those items over to the trustee when the trustee was collecting and inventorying the debtors assets for the first auction, as alleged in Count Seven of the complaint.

CONCLUSION

Based upon the foregoing, the United States Trustee requests that this Court enter an order sustaining the Bankruptcy Court's order revoking the discharge of the debtor, and for such additional or other relief as the Court may deem appropriate.

Respectfully submitted,
W. CLARKSON MCDOW
UNITED STATES TRUSTEE
By /s/ Douglas A. Kilmer
Trial Attorney
Office of United States Trustee
2025 United States Courthouse
300 Virginia Street East
Charleston WV 25301
(304) 347-3404

CERTIFICATE OF SERVICE

I hereby certify that on this date I served the foregoing **BRIEF OF THE APPELLEE UNITED STATES TRUSTEE** on the attorney for the Appellant by electronic service.

Date: May 8, 2006 /s/ Douglas A. Kilmer

Thomas H. Fluharty, Esq.
Electronically Via ECF E-Mail

BRIEF BANK — 'SUMMARY SHEET" *Printed Thu-5/18/06 10:33*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	Ward and Associates, P.C. v UST and Diane Reed, Ch 11 Trustee (In re Network Cancer Care L.P.)
2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	CTA5
3. ("CCN") ***CURRENT*** CASE NO.	No.: 05-11147
4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*	No.: Court: DC ND Texas *(Identify judge & cite, if any)*
5. ("SO") ***SOURCE***	**U.S. TRUSTEES**
6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	Filed: January 2006 Type: Brief for the Appellee, UST
7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*	Erin Marie Schmidt, Trial Attorney Dallas, Region 6 *(UST/OGC: 202-307-1399/FAX-2397)*
8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	• THERE ARE **FOUR ISSUES** ON APPEAL- SEE BRIEF- 1) Whether the District Court erred in affirming that the Bankruptcy. Court had jurisdiction to review attorney's fees incurred by counsel after the confirmation of the Debtor's plan of confirmation. √ **Background:**
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No. 05-11147

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

In Re: NETWORK CANCER CARE, L.P.

Debtor.

LLOYD WARD and ASSOCIATES P.C.,

Appellant,

v.

UNITED STATES TRUSTEE AND DIANE REED, CHAPTER 11 TRUSTEE,

Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF TEXAS

BRIEF FOR THE APPELLEE

WILLIAM T. NEARY,
UNITED STATES TRUSTEE REGION 6

ERIN MARIE SCHMIDT,
Trial Attorney
DEPARTMENT OF JUSTICE
1100 Commerce St. Rm. 976
Dallas, Texas 75242
(214) 767-8967 x235 (tel)
(214) 767-8971 (fax)
Attorney for the Appellee
United States Trustee

CERTIFICATE OF INTERESTED PERSONS

The undersigned counsel of record certifies that the following listed persons and entities as described in the fourth sentence of Rule 28.2.1 have an interest in the outcome of this case. These representations are made in order that the judges of this court may evaluate possible disqualification or recusal.

Lloyd Ward & Associates P.C. – Appellant

Lloyd Ward – counsel for Lloyd Ward & Associates P.C.

Dr. Odette Campbell – former shareholder of Debtor

William T. Neary – United States Trustee, Appellee

Mary Frances Durham – Counsel for the United States Trustee

Erin Marie Schmidt – Counsel for the United States Trustee

Diane G. Reed – Chapter 11 Trustee, Appellee

David Elmquist – Counsel for Diane G. Reed

Matthew Ferris – Counsel for Diane G. Reed

See the List of Creditors from the In re Network Cancer Care, L.P. matrix on file with the Bankruptcy Clerk.

Attorney of Record, Erin Marie Schmidt

STATEMENT OF ORAL ARGUMENT

Appellee believes that the district court’s result is correct and should be affirmed. We stand ready to present oral argument if the Court would find argument to be of assistance.

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No. 05-11147

IN THE UNITED STATES COURT OF APPEALS
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UNITED STATES TRUSTEE AND DIANE REED, CHAPTER 11 TRUSTEE,

Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF TEXAS

BRIEF FOR THE APPELLEE

STATEMENT OF JURISDICTION

On appeal is the district court's order affirming the bankruptcy court's September 17, 2004 order denying Ward's motion to be employed nunc pro tunc under 11 U.S. § 327(a*)*, denying his application for fees under 11 U.S.C. § 330, and ordering the disgorgement of $63,297.72 in fees. Record on Appeal ("R."), Volume ("V.") 2 at 453-458, and R., V.1 at 249 through V. 2 at 261.

Lloyd Ward and Associates P.C. ("Ward") presents four issues on appeal from the district court's decision:

1. Whether the district court erred in affirming that the bankruptcy court had jurisdiction to review attorney's fees incurred by counsel after confirmation of the Debtor's plan of confirmation.

2. Whether the district court erred in affirming that the bankruptcy court had jurisdiction to order the filing of employment and fee applications nunc pro tunc for professional work performed between the confirmation of the Debtor's plan of reorganization and the revocation of the order of confirmation.

3. Whether the district court erred in finding that the defects in the order revoking confirmation were irrelevant.

4. Whether the district court erred in failing to find that the bankruptcy court denied Ward due process by ordering the filing of a nunc pro tunc application for employment and payment of fees and not an adversarial proceeding.

R., V. 2 at 470-471.

This Court has jurisdiction under 28 U.S.C. § 158(d) to review the district court’s findings for issues one, two, and four. The district court had jurisdiction to review these issues on appeal from the bankruptcy court’s decision under 28 U.S.C. § 158(c).

This Court and the district court do not have jurisdiction over the merits of the appeal on Ward’s third issue because Ward failed to timely appeal the bankruptcy court’s March 4, 2004 order revoking the order of confirmation. R.,V. 2 at 461-463. See 28 U.S.C. § 158(c)(2) and Fed. R. Bankr. Proc. 8002. When a district court lacks subject matter jurisdiction, a circuit court of appeals also lacks jurisdiction. See Don Vincente Macias, Inc. v. Texas Gulf Trawling Co., Inc. (In re Don Vincente Macias, Inc.), 168 F.3d 209, 211 (5th Cir. 1999).

The bankruptcy court had jurisdiction under 28 U.S.C. § 157(a) and (b) to hear the underlying case, a voluntary petition and plan of reorganization under Chapter 11 of the Bankruptcy Code. 11 U.S.C. § 1101, et seq. See also 28 U.S.C. § 151, § 1334. The bankruptcy court’s September 17, 2004 decision constituted a final and immediately appealable order. R., V. 1 at 249 through V.2 at 261. See In re Koch, 109 F.3d 1285, 1287 (8th Cir. 1997); In re Christian, 804 F.2d 46 (3rd Cir. 1986).

Ward challenges the bankruptcy court’s subject matter jurisdiction with regard to its authority to review Ward’s post-confirmation employment and fees (Issues one and two). R., V. 2 at 470. The issue of subject matter jurisdiction will be addressed in the Argument section, p. _____.

STATEMENT OF THE ISSUES

The issues presented by Ward on appeal are described in the Jurisdiction section of this brief. These issues may be restated as follows:

1. Did the bankruptcy court have authority under 11 U.S.C. § 327 to disqualify Ward’s representation of the Debtor between the time of his retention and effective date of the plan of reorganization?

2. Did the bankruptcy court have authority to review Ward’s employment and fees for the period between the effective date of the plan and the date the order of confirmation was revoked for fraud under 11 U.S.C. § 1144?

STATEMENT OF THE CASE

Network Cancer Care, Inc. (“Debtor”) and its president and chief share holder, Dr. Odette Campbell, retained Lloyd Ward and Associates, P.C. (“Ward”) as counsel after the confirmation of the Debtor’s second amended chapter 11 plan of reorganization. Ward did not file a motion to be employed with the court under 11 U.S.C. § 327(a) nor did he file a statement of compensation under Fed. R. Bankr. Proc. 2016(b). In his capacity as counsel, Ward represented both the Debtor and Dr. Campbell in a real estate transaction transferring the Debtor’s largest asset, a cancer care center in Plano, to a third party entity called Plano Cancer Network, L.P. (“Plano Network”). Plano Network in turn was controlled by a trust set up for the benefit of Dr. Campbell’s minor children. The Debtor received no consideration for this transaction and even guaranteed a secured loan taken out by Plano Network to pay off the lien against the transferred property. Ward received $63,297.72 in fees for these and other services for the period October 14, 2003 through February 9, 2004.

Because of the transfer of the Plano property and the Debtor’s failure to retain new management pursuant to the plan, the Bankruptcy Court revoked the order of confirmation under 11 U.S.C. § 1144. Prior to the revocation of the order of confirmation, the United States Trustee had filed a motion to disqualify Ward as counsel and for disgorgement of his fees. After revocation, the bankruptcy court entered an agreed order in which Ward agreed to 1. file a motion for be employed nunc pro tunc under 11 U.S.C. § 327(a); 2. file an application for compensation under 11 U.S.C. § 330; and 3. file a statement of compensation under Fed. R. Bankr. Proc. 2016(b).

Ward subsequently filed a motion for employment under § 327(a) and an application for compensation under § 330 but did not file a Rule 2016(b) statement. In his motion and application, Ward challenged the bankruptcy court's jurisdiction over his employment and fees. On September 17, 2004, the bankruptcy court denied Ward's motion and application and ordered the disgorgement of $63,297.72 in compensation. Ward appealed the bankruptcy court's order to the district court, which the district court then affirmed. Ward has appealed the district court's order to this Court.

STATEMENT OF THE FACTS

I. Statutory and Regulatory Background

a. The Chapter 11 Debtor-in-Possession.

A person seeking bankruptcy protection may file a voluntary petition under Chapter 11 of the Bankruptcy Code. See 11 U.S.C. § 1101, et seq. Chapter 11 bankruptcy allows a debtor to continue operating its business while restructuring its debts. See 11 U.S.C. § 1108.

Upon filing its petition, a chapter 11 debtor becomes a debtor-in-possession with virtually all of the rights, powers, and duties of a trustee. See 11 U.S.C. § 1101 (1) and § 1107. At filing, the debtor's assets are transferred to a new legal entity: the bankruptcy "estate." See 11 U.S.C. § 541(a). Unless the bankruptcy court appoints a Chapter 11 trustee, the debtor-in-possession administers the estate for the benefit of its creditors. See 11 U.S.C. § 1104 and § 1107. Because a debtor-in-possession has the rights and duties of a trustee, it owes a fiduciary duty to both the bankruptcy estate and the court. CFTC v. Weintraub, 471 U.S. 343, 355, 105 S.Ct. 1986, 1994 (1985)("The willingness of courts to leave debtors-in-possession is premised upon an assurance that the officers and managing employees can be depended upon to carry out the fiduciary responsibilities of a trustee.")(quoting Wolf v. Weinstein, 372 U.S. 633, 651 (1963).

b. Retention of Professionals.

The debtor-in-possession may retain professionals to assist with these administrative duties under 11 U.S.C. § 327(a), which provides:

> Except as otherwise provided in this section, the trustee, with the court's approval, may employ one or more attorneys, accountants, appraisers, auctioneers, or other professional persons, that do not hold or represent an interest adverse to the estate, and that are disinterested persons, to represent or assist the trustee in carrying out the trustee's duties under this title.

"Disinterested" persons have no "interest materially adverse to the interest of the estate or any class of creditors, ..., by reason of any direct or indirect relationship to, connection with, or interest in, the debtor, ..., or for any other reason." See 11 U.S.C. § 101(14) and § 327(a).

Any attorney representing a debtor in connection with a bankruptcy case must also file a statement with the court disclosing the dates, amounts, and source of payments received. See 11 U.S.C. § 329(a) and Fed. R. Bankr. Proc. 2016. An attorney retained by a Chapter 11 debtor-in-possession is therefore subject to both 11 U.S.C. § 327(a) and § 329 because of the debtor-in-possession's dual status as debtor and trustee.

A professional retained under 11 U.S.C. § 327(a) must file a fee application with the bankruptcy court prior to being paid from the estate. 11 U.S.C. § 330(a). Professionals who are not qualified for employment under § 327(a) cannot be paid from the estate. 11 U.S.C. § 330; Lamie v. United States Trustee, 540 U.S. 526, 538-39, 124 S.Ct. 1023, 1032 (2004). Disgorged fees are to be paid back into the estate if those funds either 1) would have been property of the estate or 2) were to have been paid on behalf of the Debtor under a Chapter 11 plan of reorganization. 11 U.S.C. § 329(b)(1).

c. Confirmation of Chapter 11 Plan of Reorganization.

The debtor-in-possession or a party in interest may file a plan of reorganization which provides for the payment of creditors. 11 U.S.C. § 1121 and § 1123. The plan is submitted to creditors for voting. 11 U.S.C. § 1126. After voting, the bankruptcy court then conducts a confirmation hearing to determine whether the plan complies with the Bankruptcy Code. See 11 U.S.C. § 1128 and § 1129. If the plan has received enough votes and comports with 11 U.S.C. § 1129, the bankruptcy court may enter an order confirming the plan.

Confirmation of a plan of reorganization typically vests the assets of the estate into the reorganized debtor, thereby terminating the bankruptcy estate. 11 U.S.C. § 1141(b). A plan of reorganization may specifically provide, however, that the estate vest in the reorganized debtor on a date other than confirmation. Id. This vesting date is typically called the "effective date" in many plans of reorganization.

After confirmation and the vesting of the estate in the reorganized debtor, the bankruptcy court's involvement in monitoring the chapter 11 case is reduced. See Bank of Louisiana v. Craig's Stores of Texas, Inc. (In re Craig's Stores of Texas, Inc.), 266 F.3d 388, 390[1] (5th Cir. 2001). The bankruptcy court still retains power, however, to ensure that the reorganized debtor carries out the confirmed plan and to comply with its orders. 11 U.S.C. § 1142.

d. Revocation of Confirmation.

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[1] "After a Debtor's reorganization plan has been confirmed, the Debtor's estate, and thus bankruptcy jurisdiction, ceases to exist, other than for matters pertaining to the implementation or execution of the plan." Craig's Stores, 266 F.3d at 390. While the estate typically ceases upon confirmation once the estate vests in the reorganized Debtor, the plan may provide otherwise as discussed within. 11 U.S.C. § 1142(b). It is the United States Trustee's position that the estate ceases upon transfer of assets to the reorganized Debtor and not confirmation itself per

The bankruptcy court may revoke an order of confirmation if such order was procured by fraud. 11 U.S.C. § 1144. A bankruptcy court merely needs to find the debtor acted fraudulently to revoke; the bankruptcy court need not find that a creditor relied on such fraud. See Tenn-Fla Partners v. First Union National Bank of Florida (In re Tenn-Fla Partners), 229 B.R. 720, 729-730 (W.D. Tenn. 1999) aff'd by 226 F.3d 746 (6th Cir. 2000). Fraud on the court is defined as "a fraud perpetrated by officers of the court so that the judicial machinery cannot perform in the usual manner its impartial task of adjudging cases that are presented for adjudication." Harbold v. Commissioner, 51 F.3d 618, 622 (6th Cir. 1995). A debtor-in-possession would be deemed an officer of the court because of its status as a fiduciary of the estate.

II. The Present Litigation

a. The Bankruptcy Proceedings

Network Cancer Care, L.P. ("Debtor") filed its voluntary chapter 11 petition on October 26, 2002. At the time of filing, the Debtor operated three cancer treatment facilities, one each in Plano, Irving, and Denton, Texas. The Debtor owned the real estate at its location in Plano, and leased the other

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two locations. Dr. Odette Campbell, the principal officer of the Debtor, is a medical doctor who treated cancer patients at the Debtor's facilities.

After several contested hearings, the Court entered the order confirming the Debtor's Modified Second Amended Chapter 11 Plan ("Plan") on September 26, 2003[2]. R., V.1 at 214-16. A key provision of the Plan was that Dr. Campbell would no longer be involved in the management of the Debtor but would still be permitted to provide services as a medical doctor. R., V. 1 at 206-207.

Paragraph 8.1 of the Plan provided that “[u]ntil this Reorganization Case is closed, the Bankruptcy Court shall retain such jurisdiction as is legally permissible, including that which is necessary to insure that the purpose and intent of this plan is carried out….” R., V. 1 at 209.

The Plan also provided that its effective date was thirty days after entry of the confirmation order, and that the confirmation date was the date of the entry of a "Final Order" of confirmation. R., V. 1 at 180. The Plan defined a "Final Order" as an order as to which the time for appeal has expired. R., V. 1 at 180. The court entered the order of

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[2] The Court actually signed the order of confirmation on September 25, 2003. The order was not entered on the bankruptcy court’s docket until September 26, 2003. Because the Plan refers to entry of the order, September 26, 2003 is the controlling date. R., V.1 at 180.

confirmation on September 26, 2003, so the order was final ten days later on October 6, 2003. R., V. 1 at 214-216. See 28 U.S.C. § 158(c)(2) and Fed. R. Bankr. Proc. 8002(a)(notice of appeal must be filed with the clerk within ten days of entry of the judgment, order, or decree appealed from). The "Reorganized Debtor" assumed assets and liabilities on the effective date under Plan Paragraph 5.1. R., V.1 at 203.

After confirmation but prior to the effective date, Lloyd Ward and Associates, P.C.'s commenced work as attorney for both the Debtor and Dr. Campbell on October 14, 2003. R., V. 2 at 274 lines 2 through 24; Supplementary Record (“Supp. R.”), V. 2 at 179 - 182. On November 6, 2003, Ward filed his motion to substitute as Debtor's attorney, which asserted his retention was necessary because “[t]here is [sic] the further issues relating to the continued compliance with the Debtor’s Second Amended Plan of Reorganization.” Supp. R., V. 4 at 330-331. Despite this assertion, Ward later claimed he did not read the Plan in its entirety prior to being retained by the Debtor. R., V. 2 at 270 lines 6 through 15. Ward did not disclose his dual representation of the Debtor and Dr. Campbell in his substitution motion. See Supp.R., V.4 at 330-331. Neither the motion to substitute nor the order substituting counse1 sought or permitted *nunc pro tunc* employment to October 14, 2003 under 11 U.S.C. § 327(a).

Supp. R., V. 4 at 330-332.

The Debtor paid Ward $63,297.72 between October 21, 2003 and January 12, 2004. Supp.R., V.4 at 140. Of this amount, Ward received $44,500 prior to the effective date of November 5, 2003. Supp. R., V.2 at 140.

The Debtor did not hire a new executive to take over management of the reorganized Debtor and Dr. Campbell continued to operate the business after confirmation. Supp.R., V. 4 at 388 line 1 through 389 line 25. During November 2003, the Debtor transferred its Plano property, valued by the Debtor at about $2.5 million, to Plano Cancer Network, L.P. ("Plano Network"), an entity formed by Ward and owned and/or controlled by Dr. Campbell for the benefit of her minor children. R., V.2 at 252. The property was transferred for $1.8 million, with all of the proceeds going to the secured lender, Colonial Bank. Supp.R., V. 4 at 428, line 15 through 429, line 29. Ward claims that these actions were taken to save the Plano property from foreclosure by Colonial Bank, a secured creditor. R., V. 2 at 270 lines 16 through 22.

In addition to representing both the Debtor and Dr. Campbell, Ward also represented Plano Network. Supp. R., V. 2 at 183. Ward issued an opinion letter on Plano Network’s behalf to a potential take-out lender in which he represented that he was acting as counsel for both Plano Network ands the Debtor, which guaranteed the new financing. Supp. R., V. 2 at 186-188.

On December 18, 2003, the bankruptcy court issued a Show Cause Order on for the Debtor's representative to appear and explain why the Debtor had not hired an executive to manage in compliance with the Plan. Supp.R., V. 4 at 335. At the court's Show Cause hearing on January 6, 2004, Ward appeared as attorney for the Debtor but without a representative as required by the order. Supp.R., V. 4 at 355 lines 7-9; 356 lines 22-2. Ward revealed that the Debtor did not have an executive officer operating the Debtor as required by the plan, that Dr. Campbell was operating the business, and that the Debtor transferred its Plano property to Plano Network. Supp.R., V. 4 at 388 line 1 through 389 line 25; 427 line 1 through 428 line 18.

On January 23, 2004, the bankruptcy court set a hearing on its intent to revoke confirmation under 11 U.S.C. § 1144. Supp.R., V. 4 at 337. The Court subsequently determined that the Debtor procured its order of confirmation by fraud, and revoked the order confirming the plan under 11 U.S.C. § 1144 on March 3, 2004. Supp. R., V.2 at 135. The United States Trustee appointed Diane Reed ("Trustee") as Chapter 11 trustee to administer the reconstituted estate. Supp. R., V. 6 at

708-709.

Prior to the bankruptcy court's order revoking the order of confirmation, the United States Trustee filed his Motion to Disgorge Fees and Disqualify Lloyd Ward from Representing the Debtor and Reorganized Debtor ("Motion to Disgorge"). Supp.R., V.2 at 124 - 128. After confirmation was revoked, Ward signed an agreed order resolving the Motion to Disgorge which provided that Ward would file a motion to be employed *nunc pro tunc* under 11 U.S.C. § 327, an application for fees and expenses under 11 U.S.C. § 330, and a statement under Fed. R. Bankr. Proc. 2016 disclosing the date, amount, and source of fee payments to him. Supp.Rec., V. 2 at 136.

Ward filed a motion to be employed and an application for fees, but did not file a separate statement disclosing the date, amount, and source of fee payments to him. Supp.R., V. 2 at 137-157. Ward revealed that the Debtor had paid him $44,500 in the month of October 2003, prior to the effective date of the plan, and $18,787.72 after the effective date. Supp.V., V.2 at 140.

The bankruptcy court denied Ward's motion for *nunc pro tunc* employment under 11 U.S.C. § 327(a) and his application for compensation under 11 U.S.C. § 330(a) and ordered Ward to disgorge $63,297.72. R., V.1 at 249 through V.2 at 261. In its Memorandum Decision and Order, the bankruptcy court determined it had jurisdiction to supervise the Debtor’s choice of counsel after the effective date of the plan because Ward was retained to assist the Debtor with carrying out the plan of reorganization. R., V.2 at 256. The bankruptcy court also held that the Debtor should have sought the bankruptcy court’s approval for Ward’s employment prior to the effective date because the Debtor was still a debtor-in-possession at that time. R., V.2 at 255.

The bankruptcy court denied Ward’s motion for employment under § 327(a) because of his simultaneous representation of the Debtor, Dr. Campbell, and Plano Network, a situation the court described as “ludicrous:”

> …The services Ward claims to have provided to the estate – saving the Plano Property from Colonial’s foreclosure, removing certain lien claims from the Plano Property, and assisting in the Preston refinancing to another of Ward’s clients, PCN – are at the heart of the fraudulent conduct which caused confirmation to be revoked.

R., V.2 at 258. The bankruptcy court also found Ward’s conduct had been sloppy at best and fraudulent at worst:

> At worst, Ward was an active participant in the fraudulent conduct that occurred following his engagement on October 14, 2003. The Court need not decide where along that spectrum Ward’s conduct lies, since even under the best case scenario, Ward cannot be retained consistent with either the spirit of, or the literal requirements of, the Bankruptcy Code.

R., V.2 at 259-260.

The bankruptcy court made the following comment in a footnote:

> Ward argues that he is entitled to protection from disgorgement due to his good faith reliance on the Confirmation Order. While Section 1144 of the Bankruptcy Code provides certain protections to those parties who acquire rights in good faith reliance upon a confirmation order when confirmation is later revoked, there is no evidence in the record from which the Court could credibly find that Ward relied in good faith upon the Confirmation Order in his dealings with the Debtor, thereby entitling him to any such protection.

R., V.2 at 261, n.10.

The bankruptcy court denied Ward's application for compensation because he was not qualified to serve as counsel. R., V. 2 at 259-260. Ward was ordered to disgorge, within ten days of entry of the order, the $63,297.72 in fees and expenses paid to him by the Debtor without court approval. R., V. 2 at 260-261. Ward has not disgorged these fees to the estate as of this date.

b. District Court Proceedings

Ward appealed the bankruptcy court's September 17, 2004 memorandum decision and order. The district court affirmed the bankruptcy court's decision and found that: 1) he bankruptcy court had jurisdiction to require that the Debtor obtain court approval before employing Ward prior to the effective date; 2) the bankruptcy court did not err legally or clearly err factually in determining that the Debtor could not employ Ward because of his representation of interests adverse to the estate; 3) the bankruptcy court did not err in denying his application for fees and expenses because he agreed to the procedure the court followed; 4) the bankruptcy court did not err in ordering Ward to disgorge the $63,297.72 in compensation; and 5) Ward's arguments regarding the defects in the bankruptcy court's order revoking the order of confirmation were irrelevant. R., V.2 at 453-458.

STANDARD OF REVIEW

This appeal involves questions of law that this Court reviews de novo. See In re Ramba, Inc., 416 F.3d 394, 398 (5th Cir. 2005).

SUMMARY OF ARGUMENT

Sections 327(a) and 330(a) of the Bankruptcy Code require attorneys to obtain prior court approval before performing work or receiving compensation in a bankruptcy case for representing a debtor-in-possession. Cf. Lamie v. United States Trustee, 540 U.S. 526, 538-39, 124 S.Ct. 1023, 1032 (2004). Network Cancer Care confirmed its chapter 11 plan on September 26, 2003. Mr. Ward billed $44,500 in fees between the plan's confirmation date and the plan's effective date despite neither requesting nor receiving authorization under § 327(a) to do so. Under section 5.1 of the Plan, Network remained a "debtor-in-possession" until its Plan became effective. For that reason, the bankruptcy court properly denied Mr. Ward the $44,500 in fees he sought to charge Network, a debtor-in-possession, for work Mr. Ward performed prior to the effective date of Network's plan.

Mr. Ward also sought $18,797.72 in fees for work he performed after Network's plan became effective on November 5, 2003. The court concluded Mr. Ward was at all times ineligible under § 327(a) to be retained as debtor's counsel because he helped Network engage in gross misconduct by transferring its most valuable asset after the effective date to a trust Network's owner set up for her children. The court found this violated the terms of Network's confirmed plan. The court also found Mr. Ward's conduct violated a prior court order by simultaneously representing Network and its principal. Last, the court found Mr. Ward's acted sloppily at best and with fraudulent intent at worst in assisting Network in its fraudulent scheme.

On appeal, Mr. Ward does not contest court's findings that he acted improperly. Nor could he - the record amply supports them. Instead, he suggests the bankruptcy court lacked "jurisdiction" to deny him fees for the work he performed after Network's chapter 11 Plan became effective. That is plainly wrong. 28 U.S.C. § 157 and §

1334 give bankruptcy courts broad jurisdiction over open bankruptcy cases, and matters relating to them. Network’s case was open at all relevant points in this case, including beyond the effective date of Network’s plan. Indeed, its case remains open today. Thus, the bankruptcy court had statutory jurisdiction under 28 U.S.C. § 157 and § 1334.

The government agrees, however, that § 327 and § 330 did not authorize the bankruptcy court to deny Mr. Ward the $18,787.72 in fees he earned after the chapter 11 Plan became effective. Those provisions do not apply after a chapter 11 debtor’s reorganization plan becomes effective; those sections apply only to debtors-in-possession who are managing bankruptcy estates and Network ceased to be a debtor-in-possession upon the effective date of its plan. See 11 U.S.C. § 541 (the commencement of a case creates a bankruptcy estate); § 1107(a) (debtors-in-possession manage the bankruptcy estate); § 1141(b) and (c) (a confirmed plan takes property from the debtor-in-possession, who represents the estate, and vests it in the reconstituted debtor free of all creditor claims).

Nevertheless, this Court should affirm the bankruptcy court’s order for the disgorgement of $18,787.72 in fees Ward received after the effective date under two alternative grounds for affirmance. First, Section 8.1 of Network’s Plan “retain[ed] [in the bankruptcy court] such jurisdiction as is legally permissible, including that which is necessary to insure that the purpose and intent of this plan is carried out.” Given the bankruptcy court’s finding that Ward’s conduct enabled Network to fraudulently prevent the carrying out of its Plan, this Court can affirm the denial of those fees under section 8.1 of the Plan because Ward’s conduct ran afoul of this section.

Alternatively, this Court can affirm in light of the lower court’s findings because the bankruptcy court revoked Network’s confirmed Plan under 11 U.S.C. § 1144 for fraud. Section 1144 protects the claims of most people who deal with debtors during the time after a plan is confirmed and before it is revoked. That includes attorneys who provide services to debtors with confirmed plans. But § 1144 does not protect entities who did not acquire their rights in good faith during that period. Ward is one of those people. Given the lower court’s finding that he facilitated Network’s fraud and that there was nothing in the record that would lead it to believe that Ward relied on the confirmation order in good faith, Ward’s fees fall within that narrow class of claims that are voided by plan revocation and this forms a separate and independent alternative basis for ordering Ward to disgorge his $18,797.72 in fees.

ARGUMENT

1. The bankruptcy court had power to deny Ward's employment and compensation for the period between his retention and the effective date of the plan because the Debtor was a debtor-in-possession.

Ward was subject to 11 U.S.C. § 327(a) between confirmation and the effective date because the Debtor remained a debtor-in-possession at that time. A debtor-in-possession must obtain the bankruptcy court's approval prior to retaining counsel. 11 U.S.C. § 327(a) and § 1107. Without this approval, a professional cannot be paid from the bankruptcy estate. 11 U.S.C. § 330(a); see Lamie v. United States Trustee, 540 U.S. 526, 538-39, 124 S.Ct. 1023, 1032 (2004)(attorney for converted Chapter 7 debtor could not be compensated from bankruptcy estate because 11 U.S.C. § 330(a) excluded attorneys for debtor).

Ward argues that debtors no longer need the bankruptcy court's approval prior to retaining professionals after confirmation. Ward Brief at 17. Ward is correct in that property of the estate usually vests in the debtor upon confirmation. 11 U.S.C. § 1141(b). The reorganized debtor need not seek the bankruptcy court's approval prior to retaining professionals because there is no longer an estate from which to pay them. However, a plan of reorganization may provide for the vesting of the estate at a date other than confirmation. 11 U.S.C. § 1144(b). Under these circumstances, the debtor remains a debtor-in-possession even after confirmation. Cunningham v. Healthco, Inc., 824 F.2d 1448, 1460 (5th Cir. 1987)(debtor remained debtor-in-possession even after confirmation of a chapter 11 plan because plan provided for continued administration of the bankruptcy estate under § 1141(b)).

Under Section 5.1 of the confirmed Plan, the Debtor remained a debtor-in-possession until the effective date, and not confirmation. R., V.1 at 203. The Plan specifically provided that its assets did not vest in another entity until at least forty-five days after the entry of the confirmation order on the docket. R., V.1 at 203. Therefore, the Debtor operated as a debtor-in-possession until its assets vested in the reorganized Debtor on November 5, 2003. Ward's argument that the effective date does not matter would nullify the specific terms in the plan and 11 U.S.C. § 1141(b).

For the period between confirmation and the effective date (September 26, 2003 through November 5, 2003), Ward received $44,500 from the estate. Supp.R., V. 2 at 140. The bankruptcy court did not abuse its discretion when it denied

Ward’s retention and compensation for this period because he did not qualify for employment under 11 U.S.C. § 327(a). R., V.2 at 255. Section 327(a) requires that counsel must be a disinterested person, which is “a person that does not have an interest materially adverse to the interest of the estate or any class of creditors, ..., by reason of any direct or indirect relationship to, connection with, or interest in, the Debtor, ..., or for any other reason." 11 U.S.C. § 101(14).

The bankruptcy court specifically found that Ward was not disinterested because he represented both the Debtor and the Debtor’s principal, Dr. Campbell, at the time of his retention[3]. R., V.2 at 257-258. The bankruptcy court also found that Ward represented Plano Network, the entity created for the benefit of Dr. Campbell’s minor children and to whom the Debtor transferred its Plano property for no consideration. R., V.2 at 258-259.

Because Ward was disqualified from employment under § 327(a), he was not eligible to receive fees from the estate prior to the effective date. 11 U.S.C. § 330(a). Therefore the bankruptcy court did not commit clear error when it denied Ward’s fees of $44,500, which were the fees received by Ward during the period between confirmation (September 26, 2003) and the effective date (November 5, 2003).

2. **The bankruptcy court had authority to review Ward's retention and compensation for the period between the effective date of the plan and the revocation of the order of confirmation.**

Between November 5, 2003, the date the Plan went effective, and March 3, 2004, the date the order of confirmation was revoked, Ward continued to perform additional work on the Debtor's behalf. Supp.R., V.2 at 135. The reorganized Debtor paid Ward an additional $18,787.72 between the effective date and the revocation of the confirmation order. Supp. R., V.2 at 140. The bankruptcy court had authority to review Ward's employment and fees for this period under two alternative theories. First, the confirmed Plan and 11 U.S.C. § 1142 granted the bankruptcy court authority to review Ward's retention and fees because he was employed to assist the debtor with executing the Plan. Second, the bankruptcy court had authority to order Ward to disgorge his fees after revoking the order confirming the Plan because Ward did not rely on the confirmation order in good faith. 11 U.S.C. § 1144(1).

a. **Section 8.1 of the plan of reorganization granted the bankruptcy court authority to review Ward's post-confirmation employment and fees.**

The bankruptcy court retained authority over Ward's

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[3] Ward does not appeal the bankruptcy court's findings of fact.

employment and fees for the period between confirmation and revocation of the order of confirmation because Section 8.1 of the Plan granted the bankruptcy court continuing power to "retain such jurisdiction as is legally permissible, including that which is necessary to insure that the purpose and intent of this plan is carried out…" R., V. 1 at 209. The bankruptcy court also had authority under 11 U.S.C. § 1142(b):

> The court may direct the Debtor and any other necessary party…to perform any other act....that is necessary for the consummation of the plan.

The bankruptcy court retains jurisdiction/authority under 11 U.S.C. § 1142 to address fundamental questions of plan interpretation and administration and to interpret its own orders. In re John-Mansville Corp., 97 B.R. 174, 180 (Bankr. S.D.N.Y. 1989).

The bankruptcy court appropriately ordered Ward to disgorge the $18,787.72 in fees paid between the effective date and revocation of confirmation because Ward assisted the Debtor in frustrating the Plan. While the bankruptcy court ordered Ward to disgorge his fees because he was not disinterested under § 327(a), the United States Trustee believes that disgorgement of fees should have been ordered under the Court's authority per Section 8.1 of the Plan and 11 U.S.C. § 1142, and this Court can affirm on these alternative bases.[4] R., V.2 at 256. Although the bankruptcy court did not specifically find that Ward himself acted fraudulently, it found that "[t]he services Ward claims to have provided to the estate – saving the Plano Property from Colonial's foreclosure, removing certain lien claims from the Plano Property, and assisting in the Preston refinancing to another of Ward's clients, PCN – are at the heart of the fraudulent conduct which caused confirmation to be revoked." R., V.2 at 258. Ward's actions on behalf of the Debtor and Dr. Campbell are intrinsically linked with those events leading to the revocation of the order of confirmation and thereby frustrating the purpose of the Plan.

Ward incorrectly questions the bankruptcy court's subject matter jurisdiction by confusing subject matter jurisdiction with the type of authority defined as "jurisdiction" by Section 8.1 of the plan of reorganization.[5] Ward Brief at 14 –

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[4] City of Morgan City v. South Louisiana Elec. Co-op Ass'n, 31 F.3d 319, 322 (5th Cir. 1994)(appellate court may rely upon alternative bases to affirm)(citing United States v. Early, 27 F.3d 140, 142 (5th Cir. 1994)). Alternatively, this Court could remand to the bankruptcy court for consideration of these issues. The government suggests, however, that substantial judicial resources will be saved by deciding these alternative bases arguments in this appeal.

[5] "Clarity would be facilitated if courts and litigants used the label "jurisdictional" not for claim-processing rules, but only for prescriptions delineating the classes of cases (subject-matter jurisdiction) and the persons (personal jurisdiction) falling within a court's adjudicatory authority." Kontrick v. Ryan, 540 U.S. 443, 455, 124 S.Ct. 906, 915 (2004).

15. “Jurisdiction” refers solely to the question whether a court has constitutional and statutory jurisdiction to decide a particular case or controversy although, as the Supreme Court has explained, even judicial decisions at times use it incorrectly when they are actually analyzing the ‘remedial powers of the court” in a particular circumstance. See Steel Co. v. Citizens for a Better Environment, 523 U.S. 83, 90-91, 118 S.Ct. 1003, 1011 (1998). Ward misuses the term in his brief as did Section 8.1 of the Plan. See R., V.1 at 209. The section of the Plan did not grant the bankruptcy court statutory jurisdiction; instead, it gave the court *authority* in the same way a federal statute grants a court the *authority* to take a specific action in a case over which it possesses statutory jurisdiction under Title 28 of the United States Code. Even if the Plan did not provide for this authority, § 1142(b) enables the bankruptcy court to “direct the Debtor and any other necessary party…to perform any other act…that is necessary for the consummation of the plan.”

Thus while Ward is correct that § 327 and § 330 do not apply to professionals retained after the effective date, the bankruptcy court still retained sufficient authority under § 1142 and Section 8.1 of the Plan to deny Ward’s compensation because of the unusual fact that his conduct facilitated the fraud related to the revocation of Network’s confirmed Plan.

Specifically, Paragraph 8.1 of the Plan provides "[u]ntil this Reorganization Case is closed, the Bankruptcy Court shall retain such jurisdiction as is legally permissible, including that which is necessary to insure that the purpose and intent of this plan is carried out…." R., V. 1 at 209. The bankruptcy court found that Ward was "an active participant in the fraudulent conduct" that occurred after confirmation; specifically, Ward assisted Dr. Campbell with transferring assets of the Debtor to a trust held for the benefit of her children. R., V.2 at 259-260. Ward not only failed in his duty to assist the Debtor with carrying out "the purpose and intent of the plan," he facilitated the Debtor's fraudulent acts.

Finally, the bankruptcy court clearly retained subject matter jurisdiction over the reorganized Debtor under 28 U.S.C. § 1334 and § 157. The Fifth Circuit Court of Appeals has devised a test for determining whether a bankruptcy court has retained subject matter jurisdiction after confirmation. U.S. Brass Corp. v. Travelers Insurance Group, Inc. (In re U.S. Brass Corp.), 301 F.3d 296, 304-305 (5th Cir. 2002). The first step of this analysis is to determine whether the district court had subject matter jurisdiction over the bankruptcy matter under 28 U.S.C. § 1334. U.S. Brass at 304. If the district court has jurisdiction under 28 U.S.C. §

1334(b), the second step is to determine whether the district court may refer this matter to the bankruptcy court as a core proceeding under 11 U.S.C. § 157(b)(1). Id. If the matter is a core proceeding, the court must determine whether the matter pertains to "the implementation or execution of the plan." Id.; see also Bank of Louisiana v. Craig's Stores of Texas, Inc. (In re Craig's Stores of Texas, Inc., 266 F.3d 388, 390 (5th Cir. 2001).

Ward's post-confirmation employment and compensation meet the U.S. Brass criteria for bankruptcy court subject matter jurisdiction. First, the district court has jurisdiction over the Ward's employment and compensation because they are "related to" a Chapter 11 bankruptcy. See U.S. Brass, 301 F.3d at 304; 28 U.S.C. § 1334. Second, the matter is a core proceeding under 28 U.S.C. § 157(b)(2) because it "invokes a substantive right provided by title 11 or…is a proceeding that, by its nature, could arise only in the context of a bankruptcy case." See U.S. Brass, 301 F.3d at 304. Finally, this matter directly pertains to the implementation or execution of a plan because Ward was hired to assist the Debtor with fulfilling its Plan obligations. Supp.R., V.4 at 331. See U.S. Brass at 304-305. The bankruptcy court therefore retained subject matter jurisdiction over Ward's entitlement to fees after confirmation and Ward forfeited his right to fees under Section 8.1 of the Plan by hindering the Plan's execution.

b. **In the alternative, the bankruptcy court had authority under 11 U.S.C. § 1144(1) to order Ward to disgorge his fees because he did not rely on the order of confirmation in good faith.**

In the alternative, the bankruptcy court did not abuse its discretion in ordering Ward to disgorge his fees because the court's findings support the conclusion by this Court that ward did not rely on the order of confirmation in good faith. 11 U.S.C. § 1144(1). In this particular case, the bankruptcy court revoked the order confirming the plan of reorganization under 11 U.S.C. § 1144, which allows revocation if such order was procured by fraud. Supp. R., V.2 at 135. 11 U.S.C. § 1144. Section 1144 voids the order of confirmation, removes a debtor's authority to operate under the plan, and questions the reorganized debtor's actions. In re Ogden Modulars, Inc., 207 B.R. 198, 200 (Bankr. E.D. Missouri 1997)[6].

Section 1144(1) contemplates that revocation orders will include provisions "to protect any entity acquiring rights in

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[6] The Ogden Modulars bankruptcy court reasoned that "[a]ny consideration of the post-confirmation/pre-revocation dealings between the Debtor and other parties will in the first instance assume the premise that the Debtor had been operating as a Debtor in Possession during that period." 207 B.R. at 200. The United States Trustee does not agree with this reasoning because it denies due process to parties who were paid under the plan prior to revocation. A more reasonable analysis would have been for the Ogden court to determine whether parties received rights n

good faith reliance on the order of confirmation." 11 U.S.C. § 1144(1); see Tenn-Fla Partners v. First Union National Bank of Florida (in re Tenn-Fla Partners), 229 B.R. 720, 737 (W.D. Tenn. 1999), aff'd 226 F.3d 746 (6th Cir. 2000); see also In re Circle K Corp., 171 B.R. 666, 669 (Bankr. D. Ariz. 1994)("Section 1144 recognizes that revocation of a Chapter 11 plan impacts innocent third parties…The statutory language expressly considers that parties rely on a confirmation order").

By its plain language, § 1144(1) does not protect parties like Ward, who did not rely on the plan in good faith, and courts therefore have authority to order such parties to disgorge any payments received or property transferred to them while the plan was effective. 11 U.S.C. § 1144(1).

Disgorgement of Ward's post-effective date fees under § 1144(1) is appropriate under the facts of this case because Ward directly facilitated the fraud leading to the revocation of the order of confirmation. As the bankruptcy court specifically found, there is "no credible evidence in the record from which the Court could credibly find that Ward relied on in good faith upon the Confirmation Order in his dealings with the Debtor, thereby entitling him to any such protection." R., V.2 at 261, n.10. Ward did not even rely on

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good faith as contemplated by § 1144(1).

the Plan because he did not read it in its entirety at the time he was retained by the Debtor. R., V.2 at 270 lines 6 through 13.

Ward argues that the order revoking confirmation was improper because it failed to "contain such provisions as are necessary to protect any entity acquiring rights in good faith reliance on the order of confirmation." Ward Brief at 27. Supp. R., V.2 at 135; 11 U.S.C. § 1144(1). While the order should have contained this language, the district court correctly concluded that this was irrelevant to Ward's appeal because Ward did not rely on the order of confirmation in good faith. Moreover, Ward's quibbling with the revocation order's language is irrelevant here because he falls outside any protection the order would have granted parties who, unlike him, relied on the order in good faith in dealing with the reconstituted Debtor. R., V.2 at 457. Furthermore, the bankruptcy court clearly would not have found Ward to have received property in good faith in reliance on the Plan. <u>See</u> R., V.2 at 261 n.10.

Furthermore, Ward failed to timely appeal the order revoking the order of confirmation; the order is therefore final. 28 U.S.C. § 158 (c)(2) and Fed. R. Bankr. Proc. 8002(a)(bankruptcy orders must be appealed within ten days of entry).

3. Ward is not eligible to a jury trial.

Ward asserts that he was denied due process because the action for disgorgement should have been tried in an adversary proceeding before a jury. Ward Brief at 29. Ward was not denied this right because he did not have a Seventh Amendment[7] right to a jury trial. The Supreme Court devised a two-part test to determine whether a Seventh Amendment right to a jury trial exists. Granfinanciera, S.A. v. Nordberg, 492 U.S. 33, 41, 109 S.Ct. 2782, 2790, 106 L.Ed. 2d 26 (1989). First, the court compares the statutory cause of action being asserted with English 18th century actions brought at the time the Amendment was adopted. For the right to a jury trial to exist the statutory action must be analogous to an 18th century English common law cause of action that was tried at law. Id. at 41-42.

Second, the court reviews the remedy sought to determine whether it is legal or equitable in nature. Only if the remedy sought is legal does a jury trial right exists. Id. at 42 (quoting Tull v. United States, 481 U.S. 412, 417-418 (1987). Further, the Court noted that greater weight should

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[7] The Seventh Amendment provides in relevant part:

In Suits at common law, where the value in controversy shall exceed twenty dollars, the right of trial by jury shall be preserved[.]

be given to the second part of the test. Granfinanciera, 492 U.S. at 42, 109 S.Ct. at 2790.

Ward's assertion that he would have been entitled to a trial by jury fails the Granfinanciera test. First, the request for disgorgement of compensation would not have existed at English Common Law because the request would have arisen under Title 11. Thus, under the first part of the Granfinanciera, no right to a jury trial exists on Ward's compensation or employment. See Id. at 42, 109 S.Ct. at 2790. With regard to the second part, disgorgement of profits is equitable because such damages are restitutionary in nature. Local No. 391 v. Terry, 494 U.S. 558, 570-71, 110 S.Ct. 1339, 1348 (1990). Because Ward fails both parts of the Granfinanciera test, he is not entitled to a jury trial.

In the alternative, Ward waived his right to a trial by jury because he failed to file a timely jury trial demand. Fed. R. Civ. P. 38(b)(permits a party "demand a trial by jury of any issue triable of right by a jury," provided the demand is served within ten days "after the service of the last pleading directed to such issue"); incorporated by reference by Fed. R. Bankr. P. 9015. Ward has never filed a request for a jury trial.

CONCLUSION

The district court's order affirming the bankruptcy court's order of September 17, 2004 should be affirmed

January 20, 2006

William T. Neary
United States Trustee
Erin Marie Schmidt
Department of Justice
Office of the United States Trustee
1100 Commerce Street, Room 976
Dallas, TX 75242
(214) 767-8967, ext. 241

CERTIFICATE OF COMPLIANCE

In accordance with Fed. R. App. P. 32(a)(7)(C), I hereby certify that the foregoing Brief of the Appellee is monospaced in 12-point Courier New font and was produced on Microsoft Word. Exclusive of the provisions exempted by Fed.R. App. P. 32(a)(7)(B)(iii), this brief contains 7,729 words, according to Microsoft Office Word 2003.

____
Erin Marie Schmidt
Attorney for the Appellee

CERTIFICATE OF SERVICE

I hereby certify that on January 20, 2006, I servied the foregoing BRIEF FOR THE APPELLEE, along with a virus-free computer CD containing the full text of the brief, upon the clerk of the Court of Appeals and upon counsel of record, by causing copies to be sent by Federal Express overnight mail to:

David Elmquist,
Attorney for Diane Reed, Chapter 11 Trustee
Winstead Sechrest & Minick, P.C.
5400 Renaissance Tower
1201 Elm Street
Dallas, TX 75270

Diane Reed, Chapter 11 Trustee
501 N. College St.
Waxahachie, TX 75165

Lloyd Ward
Lloyd Ward & Associates, P.C.
5644 LBJ Freeway, Ste. 201
Dallas, TX 75240

____
Erin Marie Schmidt
Attorney for the Appellee

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WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	Roeder v. Ward, et al. (In re Ward)
2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	D. Pa.
3. ("CCN") ***CURRENT*** CASE NO.	No.: 08-00071 SJM
4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*	No.: 06-10389 WWB Court: Bankr. Pa. *(Identify judge & cite, if any)*
5. ("SO") ***SOURCE***	**U.S. TRUSTEES**
6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	Filed: April 23, 2008 Type: Amicus Brief of the United States Trustee
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8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	•Whether the BAPCPA Amendments to section 326, chapter 7 trustee compensation must determined as a commission based upon the percentages provided in section 326 absent extraordinary circumstances unrelated to section 330(a)(3) factors.
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IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF PENNSYLVANIA

Civil Action No. 08-00071 SJM

In re: DONALD W. WARD and JEAN M. WARD,
Debtors.

Bankruptcy Case No. 06-10389 WWB

RICHARD W. ROEDER, ESQUIRE, TRUSTEE,
Appellant,

v.

NO APPELLEE

APPEAL FROM THE UNITED STATES BANKRUPTCY COURT
FOR THE WESTERN DISTRICT OF PENNSYLVANIA
(The Honorable Warren W. Bentz, Bankruptcy Judge)

AMICUS BRIEF OF UNITED STATES TRUSTEE

UNITED STATES DEPARTMENT OF JUSTICE
OFFICE OF THE UNITED STATES TRUSTEE
Joseph S. Sisca
Assistant United States Trustee
PA I.D. 46719
Liberty Center, Suite 970
1001 Liberty Avenue
Pittsburgh, PA 15222
(412) 644-4756 *telephone*
(412) 644-4785 *facsimile*

and

UNITED STATES DEPARTMENT OF JUSTICE
EXECUTIVE OFFICE FOR UNITED STATES TRUSTEES
Office of General Counsel
Roberta A. DeAngelis, Acting General Counsel
20 Massachusetts Avenue
Washington, DC 20530

Counsel for Amicus Curiae, United States Trustee

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INTEREST OF THE UNITED STATES

This appeal calls upon this Court to examine recent statutory amendments affecting chapter 7 bankruptcy cases and trustees serving in such cases. 11 U.S.C. §§ 330(a)(3) and (7).

The United States has a direct interest in the proper construction of these provisions because United States Trustees, who are Justice Department officials appointed by the Attorney General, supervise the administration of chapter 7 bankruptcy cases and trustees in such cases in all federal judicial districts within this circuit. 28 U.S.C. §§ 581-589b. *See also* H.R. Rep. No. 95-595, at 88 (1977) (United States Trustees "serve as bankruptcy watch-dogs to prevent fraud, dishonesty, and overreaching in the bankruptcy arena"); *In re Castillo*, 297 F.3d 940, 950 (9th Cir. 2002) (citing this legislative history).

The United States has two separate and distinct interests in this matter. First, the United States Trustee has the statutory duty to "establish, maintain, and supervise a panel of private trustees that are eligible and available to serve as trustees in cases under chapter 7 of title 11." 28 U.S.C. § 586(a)(1). Second, the United States Trustee has the statutory duty to supervise the administration of "cases and trustees in cases under chapter 7" by "reviewing . . . applications filed for compensation and reimbursement under section 330" and "filing . . . comments with respect to such application and, if the United States Trustee considers it to be appropriate, objections to such application." 28 U.S.C. §§ 586(a)(3)(A)(i) and (ii).

In light of these interests, the United States submits this brief to share its views on the proper construction of §§ 330(a)(3) and (7). *See* 28 U.S.C. § 517 (authorizing the Department of Justice "to attend to the interests of the United States in a suit pending in a court of the United

States"). *See also* 11 U.S.C. § 307 ("[t]he United States trustee may raise and may appear and be heard on any issue in any case or proceeding"); *In re Donovan Corp.*, 215 F.3d 929, 930 (9th Cir. 2000) (interpreting § 307).

I. STATEMENT OF THE CASE

A. BACKGROUND.

The Bankruptcy Abuse and Consumer Protection Act of 2005, Public Law 109-8, 119 Stat. 23 (2005) ("BAPCPA"), made significant amendments to 11 U.S.C. § 330, which governs compensation for bankruptcy professionals. The amendments replaced the former open-ended reasonableness standard with commission-based compensation for chapter 7 trustees.

The bankruptcy court, however, scrutinized the trustee's request for compensation as if the law had not changed. It applied an analysis that is indistinguishable from pre-BAPCPA law. In short, the bankruptcy court decided this case in exactly the same manner as it would have prior to the BAPCPA amendments - openly acknowledging that it was applying the same frame of analysis, relying largely on the same pre-BAPCPA authorities, and, most importantly, arriving at the same result.

B. DEBTORS' CHAPTER 7 CASE.

The debtors, Donald W. Ward and Jean M. Ward, filed a voluntary petition for chapter 7 relief on April 14, 2006. Richard W. Roeder, Esq. was appointed as chapter 7 trustee on April 17, 2006. Thereafter, Mr. Roeder conducted sales of real estate and commercial inventory. The sales generated total gross receipts of $118,761.24 for disbursement to creditors.

Mr. Roeder requested compensation in the amount of the full statutory commission authorized by sections 330(a)(7) and 326 of the Bankruptcy Code. No party in interest objected to the request for fees, but the bankruptcy court independently scrutinized the fee request. In doing so, the bankruptcy court failed to follow the statutory amendments.

C. THE CHAPTER 7 TRUSTEE'S APPLICATION FOR COMPENSATION.

The trustee's application for compensation requested a commission in the amount of $9,188.04 based on his disbursement of proceeds from the sales of real estate and commercial inventory. This figure represents the full statutory commission to which he is entitled pursuant to 11 U.S.C. §§ 330(a)(7) and 326. Section 330(a)(7) provides:

> In determining the amount of reasonable compensation to be awarded to a trustee, the court shall treat such compensation as a commission, based on section 326.[1]

The trustee provided notice of his request for the full statutory commission of $9,188.04 to all parties in interest. No objections were filed, but the bankruptcy court reduced the compensation request *sua sponte*, declining to award the full commission called for pursuant to 11 U.S.C. §§ 330(a)(7) and 326.

At an initial hearing on December 4, 2006, the bankruptcy court questioned the chapter 7 trustee regarding his interpretation of § 330(a)(7):

MR. ROEDER: This is one of those post-October 17 cases, where my understanding has been that the fee of the Trustee is to be considered as a commission.

THE COURT: What makes that rule?

MR. ROEDER: That's part of the change in the law.

THE COURT: Show me.

---

[1] Emphasis supplied.

* * *

MR. ROEDER: Now, I think 330, Sub 7 has a reference . . .

THE COURT: It's the same as it used to say . . .

* * *

THE COURT: [Y]ou think that overrules all the case law that's preceded it?

MR. ROEDER: Well, it was an effort on the part of those Trustees who were organized and petitioning in order to clarify it and make it a commission . . .

* * *

THE COURT: [T]he Court still has to consider the reasonableness of the fees, and that takes into consideration everything that's done. *Just like we did before.*

MR. ROEDER: Well, I will --

THE COURT: *I don't see any difference with the -- the old Johnson criteria. . . .*[2]

The bankruptcy court authorized briefing by the chapter 7 trustee concerning the new commission standards. After the filing of his brief, as well as briefs in support of the trustee's position by the panel trustees of the Western District of Pennsylvania and the United States Trustee as *amica curiae*, the bankruptcy court entered an interlocutory order and opinion on April 13, 2007 which ruled against the trustee and again failed to recognize that the law had fundamentally changed.[3] In the April 13, 2007 order, the bankruptcy court "propose[d] to enter

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[2] December 4, 2006 transcript at 4-6 (emphasis supplied). As discussed below, the "old Johnson criteria" refers to a Lodestar review of trustee compensation based largely on time spent, an approach that was superceded by the BAPCPA amendments, it no longer being permissible to consider this factor for chapter 7 trustees. *Johnson v. Georgia Highway Express, Inc.*, 488 F.2d 714 (5th Cir. 1974).

[3] *In re Ward*, 366 B.R. 470 (Bankr. W.D. Pa. 2007).

an order which allows trustee compensation of $5,000" but afforded the trustee "10 days to request an evidentiary hearing. . . ."

On April 19, 2007, the trustee did so and a hearing was held on May 23, 2007. On February 8, 2008, the bankruptcy court entered an order indicating that the hearing "did not modify the Court's view on the amount of reasonable compensation as expressed in the OPINION of April 13, 2007." That order allowed compensation of $5,000 to Mr. Roeder as chapter 7 trustee.[4] The trustee's appeal followed.

II. STANDARD OF REVIEW

On appeal, a bankruptcy court's findings of fact are reviewed for clear error, while its legal conclusions are reviewed *de novo*. *In re Trans World Airlines, Inc.*, 322 F.3d 283, 287 (3d Cir. 2003). A *de novo* review of legal questions requires this court to review questions of law independent of the bankruptcy court's determination. *In re Schaffrath*, 214 B.R. 153, 154 (6th Cir. BAP 1997); *In re Guilbert,* 176 B.R. 302, 305 (D.R.I. 1995) ("where a question of law is at issue, this Court is required to 'make a judgment independent of the bankruptcy court's, without deference to that court's analysis and conclusions'"), *quoting In re Nobleman*, 129 B.R. 98, 99 (N.D. Tex. 1991); *In re Mozingo*, 234 B.R. 867, 869 (E.D. Pa. 1999) ("*De novo* review requires the district court to make its own legal conclusions, 'without deferential regard to those

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[4] At the May 23, 2007 hearing, the court stated that "I would be happy if I could read that statute the way [urged by the trustee and the United States Trustee]." The court further noted that reducing counsel fees was "the most difficult part of [his] job" and the "worst element." May 23, 2007 transcript at 34. The United States Trustee respectfully suggests that Congress has acted to relieve bankruptcy judges of this distasteful duty, by mandating the award of a commission.

made by the bankruptcy court'"), *quoting In re Graves,* 156 B.R. 949, 954 (E.D. Pa. 1993), *aff'd,* 33 F.3d 242 (3d Cir. 1994).

This appeal involves questions of law only. The opinion below is therefore entitled to no deference.

III. ARGUMENT

A. PURSUANT TO THE BAPCPA AMENDMENTS, CHAPTER 7 TRUSTEE COMPENSATION MUST BE DETERMINED AS A COMMISSION BASED UPON THE PERCENTAGES PROVIDED IN SECTION 326, ABSENT EXTRAORDINARY CIRCUMSTANCES UNRELATED TO SECTION 330(a)(3) FACTORS.

Section 407 of the BAPCPA amended § 330 in two ways that affect the compensation of chapter 7 trustees.[5] First, it specifically eliminated the amount of time spent on services as a

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[5] As amended, § 330(a)(3) currently reads as follows:

> (3) ~~(A)~~ In determining the amount of reasonable compensation to be awarded ***to an examiner, trustee under chapter 11, or professional person,*** the court shall consider the nature, the extent, and the value of such services, taking into account all relevant factors, including -
>
> > (A) the time spent on such services;
> > (B) the rates charged for such services;
> > (C) whether the services were necessary to the administration of, or beneficial at the time at which the service was rendered toward the completion of, a case under this title;
> > (D) whether the services were performed within a reasonable amount of time commensurate with the complexity, the importance, and nature of the problem, issue, or task addressed;~~and~~
> > ***(E) with respect to a professional person, whether the person is board certified or otherwise has demonstrated skill and experience in the bankruptcy field; and***
> > ~~(E)~~ ***(F)*** whether the compensation is reasonable based on the customary compensation charged by comparably skilled practitioners in cases other than cases under this title.

The removal of the first designation "(A)" was purely a technical amendment to eliminate the use consideration for chapter 7 trustees, by amending § 330(a)(3) to add to the initial paragraph the following critical restrictive language: "to an examiner, trustee under chapter 11, or professional person." Second, section 407 added a new subparagraph (7) to § 330(a) that provides as follows: "[i]n determining the amount of reasonable compensation to be awarded to a trustee, the court shall treat such compensation as a commission, based on section 326."

These provisions transformed the standards for awarding trustee compensation. Read together, they establish a strong presumption that trustee compensation must be calculated as a commission and allowed in the amounts specified by § 326.

Prior to BAPCPA's amendment limiting § 330(a)(3) to examiners, trustees under chapter 11 or professional persons, a bankruptcy court was directed to consider those factors delineated in § 330(a)(3) in assessing the reasonableness of trustee compensation, including hours spent by the trustee. This analysis frequently resulted in reductions of fee requests from § 326 maximum amounts. Those maximum amounts were regarded as a cap - a limitation of fees - and not an entitlement.

With the BAPCPA, Congress fundamentally changed the manner of chapter 7 trustee compensation, by mandating the awarding of a commission and eliminating the cap/limitation concept.

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of that designation on two sub-paragraphs. The language in bold indicates the language added by the BAPCPA amendments.

The plain language[6] of amended § 330(a)(3), which contains the factors formally utilized to reduce compensation from the commission amounts, now specifically limits that section's application - and therefore the consideration of such factors and time expended and hourly rates - to only three types of officers: examiners, chapter 11 trustees, and professional persons. Chapter 7 trustees were excluded.

It is critical to note that there is no disagreement on this point - it is unmistakable and indisputable. The bankruptcy court itself recognized that "[s]pecifically missing from those persons to [whom] § 330(a)(3) is applicable is a Chapter 7 Trustee." *Ward,* 366 B.R. at 473.

Accordingly, for professionals *other than* chapter 7 trustees, bankruptcy courts must consider such factors as the time expended and the hourly rates charged. The contrary must now be the case for chapter 7 trustees. The language of amended § 330(a)(3) permits but one interpretation: Congress no longer intended bankruptcy courts to determine the reasonableness of chapter 7 trustees' fees according to such considerations as the amount of time spent, the appropriateness of the hourly rates requested and the customary compensation for comparable, non-bankruptcy work. Otherwise, Congress would not have excluded chapter 7 trustees from § 330(a)(3). Courts are now forbidden to consider these factors. It is difficult indeed to imagine a more clear directive.

Moreover, having purposely eliminated chapter 7 trustees from § 330(a)(3), Congress substituted a new unambiguous commission standard of compensation for chapter 7 trustees

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[6] "It is axiomatic that '[t]he starting point in every case involving construction of a statute is the language itself.'" *Landreth Timber Co. v. Landreth,* 471 U.S. 681, 685 (1985), *quoting Blue Chip Stamps v. Manor Drug Stores,* 421 U.S. 723, 756 (1975) (POWELL, J., concurring).

through the enactment of § 330(a)(7). The plain language of § 330(a)(7) requires that the reasonable compensation of a trustee *shall* be treated as a commission, based on § 326.[7]

Because § 330(a)(7) directs that reasonable compensation must be treated as a "commission" based on § 326, it is necessary to consider the meaning of that term. Courts apply a "fundamental canon of statutory construction . . . that, unless otherwise defined, words will be interpreted as taking their ordinary, contemporary, common meaning." *Perrin v. United States*, 444 U.S. 37, 42 (1979). "Commission" is not defined in the Bankruptcy Code but commonly means a "percentage of money taken in on sale, given as pay to a sales clerk or agent." *Webster's New World Dictionary of the American Language* 285 (2d ed. 1972). Even when viewed as a legal term, its meaning is virtually the same. For example, its legal usage is a "fee paid to an agent or employee for a particular transaction, usu. as a percentage of the money received from the transaction < a real-estate agent's commission >." *Black's Law Dictionary* 264 (7th ed. 1999).

In mandating that a trustee's reasonable compensation "shall" be determined according to a "commission" based on § 326 - supplanting the former § 330(a)(3) analysis - the BAPCPA amendments require that § 326 be the starting point for the determination of a chapter 7 trustee's reasonable compensation. *See Kelly v. Robinson*, 479 U.S. 36, 43 (1986) (statutory text is the starting point for statutory construction). Moreover, because a commission, by definition, is

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[7] Section 330(a)(7) does not expressly limit its application to a chapter 7 trustee's compensation, but instead simply references the compensation of a trustee. Nonetheless, the compensation of chapter 11 trustees is specifically provided for in § 330(a)(3), while standing trustees in chapters 12 and 13 are compensated pursuant to 28 U.S.C. § 586(e). Therefore, considering the overall context of the amendments to § 330, it is evident that Congress intended § 330(a)(7) to apply only to chapter 7 trustees. *See Davis v. Mich. Dept. of Treasury*, 489 U.S. 803, 809 (1989) ("[i]t is a fundamental canon of statutory construction that the words of a statute must be read in their context and with a view to their place in the overall statutory scheme").

compensation based on a percentage of funds, such compensation must be determined according to the percentages of disbursements made by the chapter 7 trustee "to parties in interest, excluding the debtor, but including holders of secured claims" as specified in § 326(a).[8]

Congress did not, however, entirely sever the connection between chapter 7 trustee compensation and the standard of reasonableness required by § 330(a)(1). Both § 326(a) and § 330(a)(7) employ the terminology of "reasonable" compensation, and § 330(a)(2) provides that the "court may . . . award compensation that is less than the amount of compensation that is requested." The interplay between §§ 326(a), 330(a)(1), 330(a)(2) and 330(a)(7) requires that the trustee's fee must be determined in the first instance according to the commission amounts specified in § 326(a), unless such amounts would constitute unreasonable compensation based on factors *other than* those identified in § 330(a)(3), from which the chapter 7 trustees have been specifically exempted.[9]

Any other approach would disregard the fact that chapter 7 trustee compensation was excluded from consideration pursuant to the § 330(a)(3) factors - as even the bankruptcy court

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[8] The specified percentages under § 326 are as follows:

%	range of disbursements		
25%	$0	-	$ 5,000
10%	> $5,000	-	$50,000
5%	> $50,000	-	$1,000,000
3%	>$1,000,000		

[9] The United States Trustee respectfully submits that the statutory provisions are best harmonized by reading them to create a strong presumption that the commission must be awarded, rather than by reading § 330(a)(7) out of the statute.

specifically acknowledges. Moreoever, an alternative construction would fail to give meaning to all provisions of the statute, most notably § 330(a)(7), which would be rendered surplusage.[10]

The applicable BAPCPA amendments require that a chapter 7 trustee's compensation be determined as a commission, absent extraordinary circumstances that are unrelated to the § 330(a)(3) factors. Such circumstances will occur only in the rare and unusual case. There is no suggestion that they are present in this case.[11]

B. THE CASES INTERPRETING SECTION 330(a)(7) FAIL TO FAITHFULLY FOLLOW THE BAPCPA AMENDMENTS.

There are no opinions by United States Courts of Appeal or District Courts addressing the trustee commission mandated by § 330(a)(7). All reported decisions are by bankruptcy courts. To date there have been five substantive decisions, all of which are treated below. Unfortunately, the decisions are contradictory and confusing. Some struggle to reconcile the amendments with prior standards; others - including the opinion of the bankruptcy court - do not even appear to recognize that the law has changed.

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[10] *See Duncan v. Walker*, 533 U.S. 167, 174 (2001) ("It is our duty to give effect, if possible, to every clause and word of a statute. . . . [Because] this rule [is] a cardinal principle of statutory construction . . . a statute ought . . . to be so construed that . . . no clause, sentence, or word shall be superfluous, void, or insignificant") (internal quotations and citations omitted). *See also, 2A N. SINGER, STATUTES AND STATUTORY CONSTRUCTION* § 46:7 (6th ed. 2003) ("The legislature is presumed to have intended to avoid surplusage in the words and sentences and therefore it is permissible to interpret the statute to avoid such a pitfall.")

[11] For example, if the trustee had delegated a substantial portion of case administration, or if the trustee's administration fell below acceptable standards, a court might reduce the trustee's commission in accordance with § 330(a)(2), based on factors other than those set forth in § 330(a)(3).

The first decision to interpret § 330(a)(7) was *In re Clemens*, 349 B.R. 725 (Bankr. D. Utah 2006). Because *Clemens* was cited extensively by the bankruptcy court and relied on by subsequent authorities, that decision is discussed in some length.

Clemens is a seriously flawed opinion that has done immense damage to the coherent development of the law by undermining Congress' unmistakable intent to transform trustee compensation standards. In *Clemens*, the court determined that the language of § 330(a), as amended by the BAPCPA, requires courts to determine the reasonableness of a chapter 7 trustee's fees according to the *Johnson* Lodestar factors.[12] The court further concluded that the BAPCPA amendments require only that it include a consideration of the provisions of § 326. Id. at 729. The court determined that pursuant to the decision in *In re Miniscribe Corporation*, 309 F.3d 1234 (10th Cir. 2002), § 330(a)(1) required that the *Johnson* Lodestar factors supplement the factors set forth in § 330(a)(3). *Clemens,* 349 B.R. at 727-30. The court further reasoned that although Congress had amended § 330(a)(3) to make that section inapplicable to chapter 7 trustee compensation, it had not amended § 330(a)(1). The court asserted that under *Miniscribe,* the *Johnson* factors were derived from § 330(a)(1) and concluded that because Congress had not amended § 330(a)(1), the Lodestar analysis must continue to be part of the reasonableness analysis concerning chapter 7 trustee fees. Id. at 729-30. Because the Lodestar factors were in its view still part of the reasonableness analysis, the court determined that

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[12] As discussed in *Clemens*, the *Johnson* "Lodestar factors" are: 1) the time and labor involved; 2) the novelty and difficulty of the issues involved; 3) the requisite skill to perform the services properly; 4) the preclusion of other employment; 5) the customary charges by other professionals; 6) the contingent nature of the fee; 7) time limitations imposed by acceptance of the employment; 8) the amount generated for the creditors and the results obtained; 9) the experience, reputation, and ability of the professional; 10) the undesirability of the case; and 11) awards in similar cases. *Clemens*, 349 B.R. at 728, n. 7.

§ 330(a)(7) had a very small impact on pre-BAPCPA practice in awarding trustee fees.[13]

Clemens correctly recognized that the former § 330(a)(3) analysis and the Lodestar analysis substantially overlap. Id. at 730, n. 19, *quoting In re Marlar*, 315 B.R. 81, 84 (Bankr. W.D. Ark. 2004) ("Although stated differently, these criteria [Lodestar factors] are similar to the factors enumerated by the statute"). There is indeed, a good reason for this similarity.

Section 330(a)(3) was added to § 330 pursuant to the Bankruptcy Reform Act of 1994, Pub. L. 103-394, title I, 117, title II, 224(b), 108 Stat. 4119, 4130, and thereby clarified many of the judicial standards and practices regarding the allowance of professional fees. *Ferrara & Hantman v. Alvarez (In re Engel)*, 124 F.3d 567, 572 n. 10 (3d Cir. 1997). Among the standards codified in § 330(a)(3) were the *Johnson* Lodestar factors. *In re Eliapio,* 298 B.R. 392, 398, n. 9 (Bankr. 9th Cir. 2003) (factors set forth in § 330(a)(3) are codification of *Johnson* factors); *In re King*, 350 B.R. 327, 331-32 (Bankr. S.D. Tex. 2006) (same); *In re Vernon-Williams*, 343 B.R. 766, 795 (Bankr. E.D. Va. 2006) ("Congress has now, in effect, substantially codified the holding in *Johnson v. Georgia Highway Express, Inc., 488 F.2d 714 (5th Cir.1974),* into § 330(a)(3) of the Bankruptcy Code"); *In re Unger & Associates, Inc.*, 277 B.R. 694, 697 (Bankr. E.D. Tex. 2001) (same); *In re Reconversion Technologies, Inc.*, 216 B.R. 46, 52 (Bankr. N.D. Okla. 1997) (same).

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[13] The court remarked that "its holding may mean that the terms of § 330(a)(7) have a small impact on pre-BAPCPA practice in awarding Trustees fees" and even acknowledged that "[t]o some extent this might conflict with the general rule of statutory interpretation that a Court should avoid surplusage." *Clemens*, 349 B.R. at 731. The court also noted that under its view "the recent amendments to § 330(a)(3) will likely have little effect on the Court's review of chapter 7 Trustee's fees," id. at 730 n. 20; that "[r]ead literally, § 330(a)(7) adds little to the inquiry required by § 330(a)," id. at 730; and that "it means very little to call this compensation a 'commission.'" Id.

Pursuant to the Bankruptcy Reform Act of 1994, § 330(a)(3) provided that "[i]n determining the amount of reasonable compensation to be awarded, the court shall consider the nature, the extent, and the value of such services, taking into account all relevant factors. . . ." Given the directive that the courts consider "all relevant factors" in determining reasonable compensation, it is clear that Congress intended this subparagraph to control the valuation of professional services provided to the bankruptcy estate. This conclusion is buttressed by the fact that Congress codified many of the *Johnson* Lodestar factors in this subparagraph, as those factors were developed by the courts to assist in the determination of what constituted reasonable compensation for professionals. In light of its legislative history, it is clear that when Congress amended § 330(a)(3) to exclude any consideration of the nature, extent and value of a chapter 7 trustee's services, it intended that the courts were not to consider either the enumerated factors set forth in § 330(a)(3) or the substantially similar Lodestar factors derived from the *Johnson case.*[14]

The *Clemens* court recognized the overlap between § 330(a)(3) and the Lodestar factors, concluded that the plain language of § 330(a)(3) prohibits application of the factors enumerated thereunder to chapter 7 trustees, and yet found that § 330(a)(1) mandates the consideration of those same factors under *Johnson*. A statutory construction that leads to such an absurd result should be avoided. *Webster v. Reproductive Health Services*, 492 U.S. 490, 514 (1989) ("The basic rule of statutory construction is to first seek the legislative intention, and to effectuate it if possible, and the law favors constructions which harmonize with reason, and which tend to avoid

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[14] The *Clemens* court implicitly recognizes that Congress intended this result, but remarks that "[i]t is beyond our province to rescue Congress from its drafting errors." *Clemens*, 349 B.R. at 730, n. 7. We respectfully suggest that there was no drafting error. Congress determined that trustee compensation "shall" be treated as a "commission" and so stated.

unjust, absurd, unreasonable or confiscatory results, or oppression"), *quoting State ex rel. Stern Brothers & Co. v. Stilley*, 337 S.W.2d 934, 939 (Mo. 1960).

It should be noted that the *Clemens* court did not consider the amendments to be totally irrelevant - notwithstanding the foregoing analysis, the court found that it

> must now determine reasonableness with an eye on the statutory cap. Thus, the Court might easily conclude that although the Trustee's itemization supports a much lower award, the Trustee is entitled to a higher amount in light of its consideration for § 326(a) as part of its reasonableness determination.

Clemens, 349 B.R. at 731. The court added to its Lodestar factors "[t]he amount resulting from the calculations under § 326 (a)." Id. at 732.[15] It required documentation from the trustee showing the hours spent, and denied the fee request without prejudice. Id. at 733.[16]

The bankruptcy court's April 13, 2007 opinion cited *Clemens* at length, but without recognition of *Clemens'* admonition to determine reasonableness "with an eye on the statutory cap." The bankruptcy court indicated that if it were to apply a strict Lodestar standard, it would award approximately $2,000, but it instead determined to award trustee compensation of $5,000, without articulating standards that would enable a meaningful review of its award. *Ward*, 366 B.R. at 476. The bankruptcy court's opinion is addressed in detail below.

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[15] The court also explained that it considers whether any party in interest objects to the fee request, as well as any input from the United States Trustee. Id. In our case, no party objected to the fee request, which the United States Trustee supports.

[16] In *Clemens,* the trustee requested a commission of $11,631.76. Ironically, after the trustee submitted the requested itemization, the court ultimately awarded him the full $11,631.76. *See* Chapter 7 Trustee's Final Report and Account, docket no. 53 in case no. 06-20124, United States Bankruptcy Court for the District of Utah. Further, the docket reflects that there was no briefing of the issue. Thus the entire misguided development of the law was based on a case that ultimately awarded the trustee a full commission, and in which there was no briefing that would have provided the opportunity for a careful consideration of the amendments.

In re McKinney, 374 B.R. 726 (Bankr. N.D. Cal. 2007) ("*McKinney I*"), held that "time spent is still a relevant factor, even if it is no longer the starting point for calculating chapter 7 trustee compensation." Id. at 728. The opinion recognizes that "BAPCPA changed how chapter 7 trustee compensation is to be determined." Id. at 729.[17] It suggests that the commission amount is now the starting point in the analysis, but the court must consider a variety of factors - including time spent - to determine whether the commission amount "constitutes unreasonably large compensation." Id. at 730. However the court explicitly denied that it was employing a Lodestar test.[18] The trustee was ordered to file time records. Id. at 732.

The *McKinney I* court makes little effort to conceal that it is substituting its own judgment for that of Congress. In the face of § 330(a)(7)'s directive that compensation "shall" be a commission, the court pejoratively responds that "slavish reliance on the amount distributed to creditors is an inappropriate way to determine reasonable compensation for chapter 7 trustees." Id. at 731. But Congress already decided the issue by enacting a commission standard. It is not the court's place to determine whether Congress' judgment is "inappropriate."

In re Mack Properties, Inc., 381 B.R. 793 (Bankr. M.D. Fla. 2007), relied in part on *Clemens, Ward* and *McKinney I*. The bankruptcy court concluded that "[t]he Court, pursuant to

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[17] Unlike *Clemens*, *McKinney I* holds that "[u]nder BAPCPA, the court is directed to apply the Lodestar approach only in determining the compensation of "an examiner, **chapter 11 trustee**, or professional person." Id. (emphasis in original, footnote omitted).

[18] "The court does not employ a Lodestar approach when it considers time spent along with other factors in determining whether the statutory maximum constitutes unreasonably large compensation in a particular case." Id.

the clear, unambiguous language of Sections 326 and 330, will continue to apply the reasonableness standard in Chapter 7 trustee compensation determinations." *Mack Properties,* 381 B.R. at 799.[19] Like *McKinney I, Mack* similarly acknowledges - openly - that it is substituting its judgment for that of Congress, remarking that "[e]mploying a strict maximum commission award . . . may result in unjust and inequitable results." Id.

In *Mack,* the trustee requested compensation in the commission amount of $39,893.75. The court declared that "[a] reasonable fee for the Trustee's services in this case is $15,000.00." Id. at 796, 799. Given the absence of an explanation for the derivation of that amount, the award has an arbitrary quality. Congress mandated a more objective standard.

In *In re McKinney*, 383 B.R. 490 (Bankr. N.D. Cal. 2008) ("*McKinney II*"), the court revisited § 330 after the trustee submitted the time records required by *McKinney I. McKinney II* correctly recognized that § 330(a)(7) "creates a presumption that the statutory maximum constitutes reasonable compensation. . . . " Id. at 492. Unfortunately it holds that the presumption can be rebutted by a factor, the consideration of which Congress forbade: the "presumption is rebutted in the present case because the statutory maximum is substantially disproportionate to the value of the services Trustee was required to perform." Id. The court elaborated:

> Section 330(a)(7) creates a presumption that the statutory maximum is reasonable compensation. If the court, after reviewing time records and all other relevant facts and circumstances, determines that the statutory maximum is not substantially disproportionate to the value of the services required from the

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[19] According to the *Mack* court, "[h]ad Congress intended to eliminate discretion from a compensation determination, it would have used the imperative 'shall' rather than 'may' in Section 326." Id. at 797 (footnote omitted). But Congress, as has been noted, most definitely used "shall" when discussing the commission in § 330(a)(7) - Congress directed that courts "shall" treat the § 326 amounts as a commission.

> trustee, the court should award the statutory maximum. If, after such review, the court determines that the statutory maximum is substantially disproportionate to the value of the trustee's services, the court should award as a "reasonable commission" the maximum amount that is not substantially disproportionate to the value of the trustee's services to the estate.

Id. at 494.

The court's "substantially disproportionate" test is merely a euphemism for the Lodestar analysis that it earlier claimed to have rejected. The test requires that fees should be reduced if the implied hourly rates are too high.[20]

In summary, the authorities are hopelessly contradictory, which should not be surprising because none of them have based their reasoning faithfully in the statute. *Clemens* employs a Lodestar analysis which includes the commission amount as one factor. *McKinney I* specifically repudiates the Lodestar approach as well as any "slavish reliance" on the commission amount mandated by Congress. It employs the commission amount as a starting point, but considers other factors to determine whether the commission amount would constitute "unreasonably large compensation." *Mack Properties* adopts a reasonableness standard. *McKinney II* recognizes a presumption requiring the commission amount unless that amount is "substantially disproportionate" to the "value" of the trustees services, in which case courts should award the maximum amount that is not substantially disproportionate.

Bankruptcy courts have, therefore, undermined and largely disregarded clearly expressed legislative intent to transform trustee compensation from reasonableness review to a commission

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[20] In other words, the fee request will be reduced if the "value" of the trustee's services - presumably determined by multiplying hours spent by the trustee's hourly rate - is "substantially disproportionate," presumably meaning significantly less than the commission amount. This test obviously gives significant weight to time spent, notwithstanding the elimination of chapter 7 trustees from § 330(a)(3). We respectfully submit that Congress has already determined that the "value" of the services is the commission amount.

standard. Some courts - including the court below - fail to acknowledge that the law has changed. Other courts struggle to reconcile an inherently conflicted approach - that compensation is to be a commission but must also be reasonable. The United States Trustee submits that these courts are viewing this perceived dilemma through the prism of decades of old law that afforded them unbridled discretion, as witnessed by the bankruptcy court's reliance on four (4) pre-BAPCPA cases (discussed below). As a result, these courts perceive an inconsistency where there is none - Congress in fact determined that the commission amount is presumptively reasonable, and should not be reduced according to those factors set forth in § 330(a)(3). The infirmity is in not reading the statute as a whole and according deference to what Congress sought to accomplish. The courts are placing undue emphasis on the word "reasonable" - as if applying prior law - and diminishing the "commission" requirement if not ignoring it entirely.

C. THE BANKRUPTCY COURT FAILED TO ARTICULATE OR APPLY COGNIZABLE LEGAL STANDARDS.

The bankruptcy court likewise failed faithfully to follow the BAPCPA amendments. It enunciated no cognizable legal standards for review of trustee compensation. Rather, it employed reasonableness review based largely on the very factors that it concedes were specifically made inapplicable to chapter 7 trustee compensation.[21] The bankruptcy court openly disregarded the BAPCPA amendments, as demonstrated by its statement at the December 4, 2006 hearing that it didn't "see any difference."

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[21] As noted, the bankruptcy court explicitly recognized that "[s]pecifically missing from those persons to [whom] § 330(a)(3) is applicable is a Chapter 7 Trustee." *Ward,* 366 B.R. at 473.

The bankruptcy court began its analysis with an extended approving quotation from *Clemens*. *Ward*, 366 B.R. at 474-75. As noted, *Clemens* has been the fountainhead for misapplication of the law.

The bankruptcy court's opinion also contains a lengthy approving quotation from *Collier on Bankruptcy*, id. at 475-76. *Collier* predicts that the "primary effect of the change should be that, in the majority of cases, a trustee's allowed fee will presumptively be the statutory commission amount." Id. at 475. But the bankruptcy court recognizes no such presumption. Instead, the bankruptcy court relies on another passage from *Collier* contemplating a reasonableness standard of review that encompasses an analysis of hours expended that in many cases will be indistinguishable from the superseded Lodestar approach:

> there may be cases where the amount of "moneys disbursed" by the trustee may be very high in relation to the services performed . . . [C]ases where there are significant disbursements without a proportionate effort by the trustee, are examples of cases where the commission fee may not be reasonable. . . [C]ourts will need to assess whether the implied hourly rate is so high as to render the fee not reasonable.[22]

The bankruptcy court then applies *Collier's* "proportionate effort" formulation of the Lodestar.[23] It posits that an appropriate hourly fee would result in compensation of approximately $2,000, but, inexplicably, "proposes to allow Trustee Compensation in the amount of $5,000" because "the Court has always recognized that the trustees often perform services in cases where

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[22] Id. at 475-76, *citing L. King, Collier on Bankruptcy*, ¶ 330.03 [1][a] (15th ed. rev'd 2006).

[23] The "proportionate effort" formulation - much like the "substantially disproportionate" test of *McKinney II* - is another euphemism for analysis of hours spent.

they end up with an estate of little or no value and receive little or no compensation, and therefore, been liberal in awarding trustee fees." *Ward,* 366 B.R. at 476.[24]

Notwithstanding its lengthy quotation from *Clemens*, the bankruptcy court did not follow *Clemens* by recognizing the statutory change in its analysis. *Clemens* at least acknowledges that a court must "consider the provisions of § 326 *as a part of* its reasonableness inquiry," 349 B.R. at 731 (emphasis in original), permitting § 330(a)(7) to "supplement the Court's Lodestar analysis." Id. Moreoever, *Clemens* concludes that courts "must now determine reasonableness with an eye on the statutory cap." Id.

But the bankruptcy court appears to regard the amendments as a nullity, employing the precise analysis that it applied pre-BAPCPA. It has said as much. It reiterated the very standards that it had applied in review of trustee compensation pre-BAPCPA, consistent with its view that nothing has changed.[25] Astonishingly, the opinion cites four (4) *pre-BAPCPA* cases for the proposition that "[c]ourts have emphasized repeatedly that a trustee is not entitled to the maximum fee allowed under § 326(a)." *Ward,* 366 B.R. at 473.[26] This citation illustrates in a microcosm the bankruptcy court's disregard for the whole point of Congress' enactment of

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[24] It is respectfully suggested that Congress likewise recognized this difficulty - that in many cases chapter 7 trustees receive little or no compensation - and decided to address it by mandating a commission, rather than leaving compensation decisions to the generosity of bankruptcy judges.

[25] As noted, at the December 4, 2006 hearing, the bankruptcy court stated that it would consider reasonableness "[j]ust like we did before."

[26] The cases are *In re Narragansett Clothing Co.*, 210 B.R. 432 (1st Cir. BAP 1997); *In re Biskup*, 236 B.R. 332 (Bankr. W.D. Pa. 1999); *In re Guyana Dev. Corp.*, 201 B.R. 462 (Bankr. S.D. Tex. 1996) and *In re Lan Associates*, 192 F. 3d 109 (3d Cir. 1999).

§ 330(a)(7) - to reverse those very holdings and replace them with a commission - with entitlement to maximum fee absent unusual or extraordinary factors.[27]

This court is urged to enter an order that requires the bankruptcy court to faithfully apply § 330(a)(7) in accordance with clearly expressed legislative intent. Section 330(a)(7) requires that the full commission be presumptively allowed unless circumstances are demonstrated that render the commission unreasonable, other than through factors identified in § 330(a)(3), which Congress made inapplicable to chapter 7 trustees.

IV. CONCLUSION

Congress determined that trustee compensation "shall" be treated "as a commission." Congress did not enact language permitting a bankruptcy court to award a commission unless the bankruptcy court felt that the resulting implied hourly rate would be "too high."

The bankruptcy court must therefore be reversed. It applied incorrect legal standards. On remand, the bankruptcy court should be directed to treat § 326 as a commission that can only be rebutted with specific considerations other than those identified in § 330(a)(3), as Congress imposed a strong presumption that the commission constitutes reasonable compensation.

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[27] The legislative history indicates that the BAPCPA amendments "add a provision that requires a court, in determining the amount of reasonable compensation to award a trustee, to treat such compensation as a commission pursuant to section 326 of the Bankruptcy Code." H.R. 109-31, 109th Cong., 1st sess. BAPCPA of 2005 § 407 (April 8, 2005).

Respectfully Submitted,

KELLY BEAUDIN STAPLETON
UNITED STATES TRUSTEE

Dated: April 23, 2008

By: /s/ Joseph S. Sisca
Joseph S. Sisca
Assistant United States Trustee
PA ID 46719
Liberty Center, Suite 970
1001 Liberty Avenue
Pittsburgh, Pennsylvania 15222
(412) 644-4756 Telephone
(412) 644-4785 Facsimile

BRIEF BANK — "SUMMARY SHEET"

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WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*
In re Michael R. Ware (Michael R. Ware v. David F. Wurst, Ronald C. Becker, United States Trustee)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*
BAP 9^{rd} Cir.

3. ("CCN") ***CURRENT*** CASE NO.
No.: OR-09-1082

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*
No.: 08-62504
Court: Bankr. Or.
(Identify judge & cite, if any)

5. ("SO") ***SOURCE***
U.S. TRUSTEES

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*
Filed: April 7, 2009
Type: Brief Re Finality of Appellees United States Trustee and Ronald C. Becker

7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*
James D. Perkins
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***
• Whether a bankruptcy court's 12(b)(6) order dismissing only some of the claims (there a counterclaim) in an adversary proceeding is interlocutory and is not appealable without a Rule 54(b) certification.

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NAME: Linda Figueroa
DATE:

JAMES D. PERKINS, WSBA #12996
Office of the United States Trustee
United States Dept. of Justice
920 West Riverside, Room 593
Spokane, WA 99201
Telephone (509) 353-2999
Fax (509) 353-3124

UNITED STATES BANKRUPTCY APPELLATE PANEL OF THE NINTH CIRCUIT

In re: Michael R. Ware Debtor	BAP No. OR-09-1082 Bk. No. 08-62504 Adv. No. 08-06200
Michael R. Ware, Appellant, v. David F. Wurst, Ronald C. Becker, United States Trustee, Appellees	**BRIEF RE FINALITY OF APPELLEES UNITED STATES TRUSTEE AND RONALD C. BECKER**

Appellees United States Trustee and Ronald C. Becker ("UST Appellees") submit this brief to address the issue of finality raised by the Clerk of the Court's Order Re Finality dated March 18, 2009.

BACKGROUND

Because there is not yet a record on appeal, the UST Appellees are filing concurrently with this Brief an Appendix containing the Complaint, Answer with Cross-Counter Claim, and the Appellees' Motions to Dismiss. The Order of Dismissal being appealed is already in the record as an attachment to the Notice of Appeal. Those documents establish the following fundamental facts relevant to the issue of finality:

1. This case began as an adversary proceeding filed by the United States Trustee against Appellant Michael Ware seeking to deny his bankruptcy discharge. The primary basis for the United States Trustee's action was Mr. Ware's alleged failure to disclose to the Bankruptcy Court the existence of a $35,000 settlement of an attorney malpractice claim Mr. Ware received approximately 6 months before filing his Chapter 7 bankruptcy.
2. Mr. Ware responded to the United States Trustee's complaint with an Answer which added Mr. Becker (the United States Trustee's attorney) and Appellee David Wurst (the Chapter 7 Trustee) as plaintiffs in the caption and which contained a section Mr. Ware captioned a "Cross-Counter Claim." It is the UST Appellees' belief that this section of Mr. Ware's answer is intended to state a counter-claim against the United States Trustee and third-party claims against Mr. Becker and Mr. Wurst.
3. The UST Appellees filed a motion asking the Bankruptcy Court to dismiss these "Cross-Counter Claims" against the United States Trustee and Mr. Becker, which the Bankruptcy Court did by Order dated March 3, 2009 (the "Dismissal Order"). It is that order which Mr. Ware has appealed.
4. The United States Trustee's original complaint seeking denial of discharge has not been resolved and is still pending before the Bankruptcy Court.

DISCUSSION

The Dismissal Order is not a final order because it only resolves Mr. Ware's claims against the UST Appellees and Mr. Wurst, and does not resolve the United States Trustee's claim against Mr. Ware seeking denial of his discharge. That issue is still being litigated in the Bankruptcy Court. Because the Dismissal Order does not resolve all the claims of all the parties and because there is no Rule 54(b) finality certification that order is not final. See *Fed. R. Bankr. P. 7054(a)* (incorporating Fed. R. Civ. P. 54(b) into adversary proceedings). A bankruptcy court's 12(b)(6) order dismissing only some of the claims (there a counterclaim) in an adversary proceeding is interlocutory and is not appealable without a Rule 54(b) certification. *In re King City Transit Mix, Inc.,* 738 F.2d 1065 (9th Cir. 1984).

Neither is there a basis for granting leave to appeal in this case. There is no significant legal issue necessitating early review involved here; only the issue of whether the allegations contained in Mr. Ware's "Cross-Counter Claim" state an actionable claim against the UST Appellees. Furthermore, an immediate appeal in this case would not result in more efficient litigation. Quite to the contrary, reversing the Bankruptcy Court at this stage of the case would re-inject the disruption caused by Mr. Ware's tactic of naming the United States Trustee's attorney as a party.

In addition to all the usual factors which disfavor piecemeal appeals, the current procedural posture of the case allows the United States Trustee to proceed with his discharge denial claim in the normal course of such litigation with his normal counsel. Once the litigation of that claim is complete, if Mr. Ware's claims are still relevant he may pursue them by appeal or by a request for reconsideration to the Bankruptcy Court. Even if the Order of Dismissal is then overturned on appeal, the impact of Mr. Ware's tactic on the discharge denial litigation will be avoided. Given that the United States Trustee's denial of discharge claim is factually distinct from Mr. Ware's "Cross-Counter Claim,"[1] such a result will not result in litigation-related inefficiencies.

CONCLUSION

The Dismissal Order is not a final order and may not be appealed as a matter of right. Leave to appeal should not be granted because there is no significant legal issue presented. Allowing an interlocutory appeal would complicate the litigation and make it more expensive, resulting in litigation inefficiencies. This appeal should be dismissed for lack of jurisdiction.

Dated: April 7, 2009

Respectfully submitted,

/s/ *James D. Perkins*
JAMES D. PERKINS, WSBA #12996
Attorney for the United States Trustee and
Ronald C. Becker

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[1] The former focuses on Mr. Ware's failure to disclose his malpractice claim and settlement to the Bankruptcy Court and the Chapter 7 Trustee, while the latter seems to focus on the actions of the Chapter 7 Trustee and the UST Appellees in learning about those malpractice claims and recovering the remaining malpractice settlement proceeds from Mr. Ware's malpractice attorney.

BRIEF BANK — "SUMMARY SHEET" *Printed Wed-6/25/08 11:2*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]* In re Robert Earl Washburn (Babin v. Washburn)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]* 8th Cir.

3. ("CCN") ***CURRENT*** CASE NO. No.: 08-2024

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]* No.: 4:07-bk-11351

Court: E.D. Ark.

(Identify judge & cite, if any)

5. ("SO") ***SOURCE*** **U.S. TRUSTEES**

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]* Filed: June 23, 2008

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7. **("AU")** ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]* David A. Levine, Matthew Sutko, Roberta A. DeAngelis

(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC*** **BANKRUPTCY**

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s)

&

√ Any Miscellaneous ***BACKGROUND***

• Whether the bankruptcy court erred in ruling that debtors can claim a vehicle ownership deduction under section 707(b)(2)(A)(ii)(I) of the bankruptcy code even when they have no vehicle ownership expenses.

10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)

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(Consolidated with Case No. 08-2023)

IN THE UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

In re ROBERT EARL WASHBURN,
Debtor.

JOYCE BRADLEY BABIN,
Chapter 13 Trustee - Appellant,

v.

ROBERT EARL WASHBURN,
Debtor - Appellee.

ON APPEAL FROM
THE UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF ARKANSAS

BRIEF FOR THE UNITED STATES AS *AMICUS CURIAE* SUPPORTING REVERSAL

ROBERTA A. DEANGELIS
Acting General Counsel
P. MATTHEW SUTKO
Associate General Counsel
DAVID A. LEVINE
Executive Office for
United States Trustees
Department of Justice
20 Massachusetts Ave., N.W.
Washington, D.C. 20530

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TABLE OF AUTHORITIES

FEDERAL CASES

FEDERAL STATUTES

OTHER AUTHORITIES

The United States submits this brief under Fed. R. App. P. 29 as amicus curiae supporting reversal, Joyce Babin, chapter 13 trustee, and eCAST Settlement Corporation, as agent for Bank of America/FIA Card Services, formerly MBNA.

INTEREST OF THE UNITED STATES

This appeal calls upon this Court to interpret a statutory provision affecting chapter 13 bankruptcy cases, 11 U.S.C. 1325(b)(3). Section 1325(b)(3) makes two chapter 7 provisions – 11 U.S.C. 707(b)(2)(A) and (B) – applicable to chapter 13 cases.

The United States has a direct interest in the proper construction of these provisions because United States Trustees, who are Justice Department officials appointed by the Attorney General, supervise the administration of chapter 7 and chapter 13 bankruptcy cases in all federal judicial districts within this circuit. 28 U.S.C. 581-589a. See also H.R. Rep. No. 95-595, at 88 (1977) (United States Trustees "serve as bankruptcy watch-dogs to prevent fraud, dishonesty, and overreaching in the bankruptcy arena."); Charges of Unprofessional Conduct Against 199-37 v. Stuart, 249 F.3d 821, 824 (8th Cir. 2001) (citing this legislative history).

This appeal affects the United States' interests for two distinct reasons:

First, by applying section 1325(b)(3), this Court will determine how much above-median-income chapter 13 debtors must repay their creditors in their chapter 13 repayment plans. The United States has an interest in that question because United States Trustees "supervise the administration of [chapter 13] cases and trustees," monitor chapter 13 plans, and file comments with the court regarding such chapter 13 plans in connection with plan confirmation hearings under section 1324 of the Code. 28 U.S.C. 586(a)(3)(C).

Second, because section 1325(b)(3) incorporates two parts of the chapter 7 means test, sections 707(b)(2)(A) and (B), this appeal will also determine what expenses above-median-income chapter 7 debtors can claim on the means test. The means test determines whether an above-median-income debtor's chapter 7 case should be dismissed as abusive. See 11 U.S.C. 707(b)(1) and (2).

United States Trustees play a unique role in chapter 7 means test cases because section 704(b) requires them to review all such cases and, whenever a case is deemed presumptively abusive under the statute, either (a) seek its dismissal, or (b) file a statement declining to seek dismissal. See 11 U.S.C. 704(b). See also Schultz v. United States, 2008 WL 2229495 at *2 (6th Cir. June 2, 2008) (describing the United States Trustee's duties to enforce the chapter 7 means test under the 2005 Act). In fiscal year 2007, United States Trustees filed 3,370 motions to dismiss under section 707(b)(2) and 1,441 statements declining to seek dismissal when a presumption of abuse existed in a case.

Given these interests, the United States submits this brief to share its views on the application of sections 1325(b)(3) and 707(b)(2)(A). See 28 U.S.C. 517 (authorizing the Department of Justice "to attend to the interests of the United States in a suit pending in a court of the United States"). See also 11 U.S.C. 307 ("The United States trustee may raise and may appear and be heard on any issue in any case or proceeding.").

STATEMENT OF THE ISSUE

The Bankruptcy Code allows debtors to claim a vehicle ownership expense, in a set amount, when it is "applicable." 11 U.S.C. 707(b)(2)(A)(ii)(I). The expense amount is a standardized dollar value debtors may claim to account for vehicle loan or lease payments. The debtor in this case claimed such a set amount even though he has no loan or lease payments.

The question presented is: Did the bankruptcy court err in ruling Mr. Washburn could claim that expense amount when he had no associated expense?

STATUTORY BACKGROUND

This appeal involves the interpretation of provisions added to the Bankruptcy

Code, 11 U.S.C. 101, et seq., by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005.[1] The 2005 Act significantly altered how chapter 13 debtors obtain chapter 13 bankruptcy relief.

In a chapter 13 case, a debtor's unsecured creditors or trustee may insist the debtor devote all of his "projected disposable income" to repay unsecured creditors over a period of up to five years. See 11 U.S.C. 1325(b)(1). Disposable income is a net number: income less allowed expenses.

Under the 2005 Act, an above-median-income debtor, like Mr. Washburn, determines disposable income by first calculating his gross income.[2] Next, the debtor deducts permitted expenses. See 11 U.S.C. 1325(b)(2).

Above-median-income chapter 13 debtors determine their permitted expenses by employing the formula found in 11 U.S.C. 707(b)(2)(A) and (B). 11 U.S.C. 1325(b)(3) (incorporating those provisions). Section 707(b)(2)(A)(ii)(I) permits

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[1] Pub. L. No. 109-8, 119 Stat. 23 (2005). The 2005 Act applies to Mr. Washburn's case, because the act's general effective date is for cases filed on or after October 17, 2005.

[2] The Bankruptcy Code defines income as "current monthly income received by the debtor." 11 U.S.C. 1325(b)(2). It defines "current monthly income" in 11 U.S.C. 101(10A).

debtors to deduct **(a)** certain prescribed "actual" expenses, and **(b)** other "applicable" expense amounts. Applicable expense amounts are not the debtor's actual expenses. Instead, they are the static amounts listed in the Internal Revenue Service's Local and National Standards.[3] Id. Last, a debtor may deduct additional expenses identified in other subsections of section 707(b)(2)(A). That yields a net number – disposable income, which establishes the minimum an above-median-income debtor must pay to unsecured creditors under a chapter 13 plan. 11 U.S.C. 1325(b)(1)(B).

This appeal poses a question about one part of the expense-side calculation of disposable income – whether a standardized vehicle ownership amount deduction is "applicable" under section 707(b)(2)(A)(ii)(I) when the debtor has no associated vehicle ownership expense. Mr. Washburn has no loan or lease payments on his vehicle, so this appeal requires this Court to determine whether he may nonetheless claim the IRS Local Standard expense amount of $471 for each month of his 60-month plan.

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[3] The IRS Collection Financial Standards are in this brief's addendum. Because Mr. Washburn filed his case on March 15, 2007, the Collection Financial Standards in effect prior to October 1, 2007, are applicable. See 11 U.S.C. 707(b)(2)(A)(ii)(I) (stating that the IRS standards will be those "as in effect on the date of the order for relief").

STATEMENT OF FACTS

On March 15, 2007, Mr. Washburn filed a voluntary petition under chapter 13 of the Bankruptcy Code. *See* Appellant eCAST Settlement Corporation's App. pp. 6-8.[4] His means test form calculated monthly disposable income of $379.73.[5] Id. at p. 36. In making this calculation, Mr. Washburn claimed on his means test form a $471 monthly vehicle ownership expense deduction under the IRS Local Standard, although he owns his vehicle free and clear of any loan or lease obligation. Id. at p. 14, p. 18,[6] p. 34, line 28.

Mr. Washburn's chapter 13 repayment plan proposed to pay $430 monthly to unsecured creditors over 60 months. Id. at p. 41.

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[4] Appellant eCAST Settlement Corporation's Appendix was filed in Case No. 08-8023, which has been consolidated with this appeal.

[5] The chapter 13 means test form, Fed. R. Bankr. P. Official Form 22C, facilitates the computation of a chapter 13 debtor's income and expenses under the 2005 Act.

The means test form was approved by the Judicial Conference of the United States and the Federal Rules of Bankruptcy Procedure require all chapter 13 debtors to file the form. See Fed. R. Bankr. P. 1007(b)(6).

[6] If Mr. Washburn's vehicle were subject to a loan or lease obligation, he would have reported that fact on either Schedule D, titled "Creditors Holding Secured Claims," or Schedule G, titled "Executory Contracts and Unexpired Leases."

The chapter 13 trustee and an unsecured creditor, eCAST, each objected to confirmation of Mr. Washburn's plan. Id. at pp. 46 - 52. They argued Mr. Washburn could not reduce creditor payments by claiming a vehicle ownership expense amount because he had no associated vehicle ownership expenses. They alleged that striking that inapplicable expense amount yields monthly disposable income of $861.26 to repay unsecured creditors. Id. at pp. 46 - 57, pp. 75 - 89. This is $390.26 more than Mr. Washburn's plan proposed paying his creditors. Mr. Washburn countered that he was entitled to claim the expense amount regardless of whether his car was paid in full. Id. at pp. 68 - 74.

The United States Bankruptcy Court for the Eastern District of Arkansas overruled the objections of the trustee and eCAST and confirmed Mr. Washburn's plan. Id. at pp. 90 - 92. In so doing, the bankruptcy court adopted the reasoning of In re Wilson, 373 B.R. 638 (Bankr. W.D. Ark. 2007), which held debtors may deduct the standardized vehicle ownership expense amount even when they have no associated vehicle ownership expenses.[7] Id. at p. 91.

On April 15, 2008, the bankruptcy court certified its decision for direct

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[7] The Bankruptcy Appellate Panel for the Eighth Circuit reversed the Wilson bankruptcy court in Babin v. Wilson (In re Wilson), 383 B.R. 729 (B.A.P. 8th Cir. 2008).

appeal to this Court, and this Court entered an order on May 6, 2008, granting permission to appeal pursuant to 28 U.S.C. 158(d). Id. at pp. 106 - 07, p. 122.

SUMMARY OF ARGUMENT

Mr. Robert Earl Washburn, a chapter 13 debtor, seeks to shield $28,260 from his creditors by claiming a standardized vehicle ownership expense amount under 11 U.S.C. 707(b)(2)(A)(ii)(I).[8] The bankruptcy court allowed Mr. Washburn to claim this expense amount, overruling separate objections lodged by the chapter 13 trustee who administers Mr. Washburn's chapter 13 bankruptcy case, and by one of Mr. Washburn's creditors. That ruling conflicts with a ruling of the Bankruptcy Appellate Panel of the Eighth Circuit, Babin v. Wilson (In re Wilson), 383 B.R. 729 (B.A.P. 8th Cir. 2008), and with the overwhelming weight of bankruptcy appellate panel and district court rulings.[9]

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[8] Section 1325(b)(3) incorporates section 707(b)(2)(A)(ii)(I) into Mr. Washburn's chapter 13 bankruptcy case.

[9] Grossman v. Sawdy (In re Sawdy), 384 B.R. 199 (E.D. Wis. 2008); Wieland v. Thomas (In re Thomas), 382 B.R. 793 (D. Kan. 2008); Meade v. McVay (In re Meade), 384 B.R. 132 (W.D. Tex. 2008); United States Trustee v. Deadmond (In re Deadmond), 2008 WL 191165 (D. Mont. Jan. 22, 2008); Fokkena v. Hartwick (In re Hartwick), 373 B.R. 645 (D. Minn. 2007); Neary v. Ross-Tousey (In re Ross-Tousey), 368 B.R. 762 (E.D. Wis. 2007) appeal pending No. 07-2503 (7th Cir.); Ransom v. MBNA America Bank, N.A.(In re Ransom), 380 B.R. 799 (B.A.P. 9th Cir. 2007) appeal pending No. 08-15066 (9th Cir.). But see Hildebrand v. Kimbro (In re Kimbro), 2008 WL 2369141 (B.A.P. 6th Cir. June 12, 2008) (divided court concluded that "applicable" simply directs debtors to pick out and use the dollar amounts set forth in tables published by the Internal Revenue Service as part of the IRS's Local Standards); United States Trustee v. Vesper (In

Mr. Washburn cannot claim this standardized expense amount because section 707(b)(2)(A)(ii)(I) restricts it to "applicable" cases. The standardized vehicle ownership amount deduction is not applicable in Mr. Washburn's case because he has no associated vehicle ownership expense.

Reading the word "applicable" in section 707(b)(2)(A)(ii)(I) as limiting expense amounts to debtors who have associated expenses is the best construction of this section because it (1) uses the ordinary dictionary meaning of "applicable," and does so in a way that gives meaning to each word in the section; (2) fulfills Congress' stated reasons for enacting the section; (3) determines expense eligibility in the same way the Internal Revenue Service does "under" the IRS standards referenced in section 707(b)(2)(A)(ii)(I); and (4) most equitably implements bankruptcy policy - both for debtors and for creditors.

1. Giving "applicable" its ordinary definition in section 707(b)(2)(A)(ii)(I) yields a statute that allows debtors who have monthly expenses to claim the expense amount set out in the IRS Standards. At the same time, it prevents debtors who lack monthly expenses from claiming phantom expense amounts. This construction also gives meaning to every word in the section,

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re Vesper), No. 3:07-cv-00130, slip op. (D. Alaska June 12, 2008).

something the bankruptcy court's construction does not.

2. The 2005 Act's legislative history supports this interpretation of section 707(b)(2)(A)(ii)(I). The Act's House Report reveals Congress enacted the new law to ensure debtors would repay their debts when they were able, and to eliminate loopholes and incentives for debtor abuse in discharging debts when a portion could be repaid. Allowing Mr. Washburn to claim a fictional expense amount diverges from the purpose of the 2005 Act.

3. Reading "applicable" in section 707(b)(2)(A)(ii)(I) to require a loan or lease payment also has the salutary effect of applying the means test in a manner that is consistent with the IRS's refusal to allow taxpayers to deduct nonexistent vehicle ownership expenses under its Local Standards. This is significant because section 707(b)(2)(A)(ii)(I)'s text and its legislative history indicate Congress wanted courts to employ the IRS's methodology in determining whether debtors may deduct standard expense amounts.

4. It also fosters sound public policy. Barring above-median-income debtors like Mr. Washburn from claiming inapplicable ownership expense amounts is fair because it simply prevents them from claiming something they do not have. This interpretation does not hurt lower-income debtors, because they are not subject to section 707(b)(2)(A)(ii)(I) in the first place. See 11 U.S.C. 1325(b)(3). It is also fair to creditors because they will receive payments on their debts when debtors have the financial ability to repay.

Finally, the bankruptcy system has two safety valves to ensure that higher-income debtors without loan or lease payments will not suffer by being denied phantom vehicle expenses. First, when they have older vehicles, they receive an additional $200 monthly expense allowance for up to two vehicles to fund the operation of these older vehicles. Second, these chapter 13 debtors can modify their court confirmed repayment plan under section 1329(a) if they require a new car during the course of repaying their creditors.

ARGUMENT

THE BANKRUPTCY COURT ERRED IN RULING THAT DEBTORS CAN CLAIM A VEHICLE OWNERSHIP DEDUCTION UNDER SECTION 707(b)(2)(A)(ii)(I) OF THE BANKRUPTCY CODE EVEN WHEN THEY HAVE NO VEHICLE OWNERSHIP EXPENSES.

The United States asks this Court to reverse the bankruptcy court's ruling that section 707(b)(2)(A)(ii)(I) allows Mr. Washburn to reduce his disposable income available to repay creditors by claiming an inapplicable vehicle ownership expense. This case presents an issue of statutory interpretation that this Court reviews *de* *novo*. In re Juhl Enters, Inc., 921 F.2d 800, 802 (8th Cir. 1990).

I. A vehicle ownership expense amount is "applicable" under section 707(b)(2)(A)(ii)(I) only when a debtor is making a corresponding loan or lease payments on the vehicle.

A. Vehicle ownership expense amounts are not "applicable" to a debtor who makes no loan or lease payment on a vehicle.

The Bankruptcy Code permits above-median-income individuals to claim a vehicle ownership expense amount when that expense is "applicable." 11 U.S.C. 707(b)(2)(A)(ii)(I). Section 707(b)(2)(A)(ii)(I) provides that a "debtor's monthly expenses shall be the debtor's applicable monthly expense amounts specified under the . . . Local Standards . . . issued by the Internal Revenue Service. . . ." 11 U.S.C. 707(b)(2)(A)(ii)(I) (emphasis added).

"Applicable" is not defined in the Bankruptcy Code, so the word should be given its ordinary meaning. Smith v. United States, 508 U.S. 223, 228 (1993) ("When a word is not defined by statute, we normally construe it in accord with its ordinary or natural meaning."); Cudworth v. Midcontinent Commc'ns, 380 F.3d 375, 381 (8th Cir. 2004) (same). This Court "often turns to a commonly used dictionary to ascertain a word's ordinary meaning." Schumacher v. Cargill Meat Solutions Corp., 515 F.3d 867, 871 (8th Cir. 2008).

The dictionary defines "applicable" to mean "capable of being applied:

having relevance . . . fit, suitable, or right to be applied: APPROPRIATE" Webster's Third New International Dictionary at 105 (1981) (emphasis in original).

The bankruptcy court's ruling is inconsistent with the ordinary, common sense definition of "applicable" because it allows debtors like Mr. Washburn to deduct a monthly vehicle loan/lease expense amount when they have no associated monthly loan or lease expenses on their vehicles. See In re Ross-Tousey, 368 B.R. 762 (E.D. Wis. 2007) (section 707(b)(2)(A)(ii)(I) does not make such "fixed allowances guaranteed to every car owner").

The point here is simple – a debtor has no section 707(b)(2)(A)(ii)(I) vehicle ownership expense amounts that are "capable of being applied" to him if he does not make any loan or lease payments. Ransom v. MBNA America Bank, N.A. (In re Ransom), 380 B.R. 799, 807-08 (B.A.P. 9th Cir. 2007). The overwhelming majority of lower appellate decisions agree on this point, and reject the bankruptcy court's contrary interpretation. Babin v. Wilson (In re Wilson), 383 B.R. 729 (B.A.P. 8th Cir. 2008); Grossman v. Sawdy (In re Sawdy), 384 B.R. 199 (E.D. Wis. 2008); Wieland v. Thomas (In re Thomas), 382 B.R. 793 (D. Kan. 2008); Meade v. McVay (In re Meade), 384 B.R. 132 (W.D. Tex. 2008); United States Trustee v. Deadmond (In re Deadmond), 2008 WL 191165 (D. Mont. Jan. 22, 2008); Fokkena

v. Hartwick (In re Hartwick), 373 B.R. 645 (D. Minn. 2007); In re Ross-Tousey, 368 B.R. 762 (E.D. Wis. 2007); In re Ransom, 380 B.R. at 807-08. But see Hildebrand v. Kimbro (In re Kimbro), 2008 WL 2369141 (B.A.P. 6th Cir. June 12, 2008) (divided court concluded that "applicable" simply directs debtors to pick out and use the dollar amounts set forth in tables published by the Internal Revenue Service as part of the IRS's Local Standards); In re Vesper, No. 3:07-cv-00130, slip op. at 3 - 4 (D. Alaska June 12, 2008) (unpublished opinion) (finding ownership costs are "applicable" as long as a debtor owns a vehicle).

B. The bankruptcy court's interpretation of section 707(b)(2)(A)(ii)(I) suffers from three flaws the Eighth Circuit Bankruptcy Appellate Panel's interpretation in Babin v. Wilson avoids: (a) conflating "applicable" with "actual," (b) rendering "applicable" superfluous, and (c) misinterpreting the official means test form.

The bankruptcy court followed the reasoning of the bankruptcy court in In re Wilson, 373 B.R. 638 (Bankr. W.D. Ark. 2007), rev'd 383 B.R. 729 (B.A.P. 8th Cir. 2008). Like the Wilson bankruptcy court, the court below concluded section 707(b)(2)(A)(ii)(I) entitles debtors to claim vehicle ownership expenses, even when they have no loan or lease payment. Id. Neither bankruptcy court reads "applicable" as an eligibility requirement. Instead, they conclude "nothing" contained in section 707(b)(2)(A)(ii)(I) or Form 22C requires debtors to "have current automobile ownership expense[s] as a prerequisite to claiming the [IRS vehicle ownership expense]," so all debtors can claim the expense amount for every vehicle they own. In re Wilson, 373 B.R. at 644.

This interpretation suffers from at least three flaws:

First, it confuses the distinction between the words "actual" and "applicable" in section 707(b)(2)(A)(ii)(I). The court below ruled that conditioning an expense amount deduction upon the existence of an expense would require "applicable" to mean "actual" in section 707(b)(2)(A)(ii)(I). *See* Appellant eCAST Settlement Corporation's App. at p. 91.[10] (relying upon Wilson, 373 B.R. at 643-44). This gave the court pause because both these words appear in different parts of section 707(b)(2)(A)(ii)(I). Id. This led the court to rule "applicable" cannot mean debtors must have an associated expense because that would give identical meaning to two different words Congress used in the same statute. Id.

This conclusion fails to recognize the words "applicable" and "actual" have different meanings in section 707(b)(2)(A)(ii)(I) because "expense amounts" – the words following "applicable" in the statute – do **not** refer to "actual" costs. In re Hartwick, 373 B.R. at 650 (recognizing that a debtor's "actual" expense does not

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[10] Appellant eCAST Settlement Corporation's Appendix was filed in Case No. 08-8023, which has been consolidated with this appeal.

control the amount of the vehicle ownership deduction" under section 707(b)(2)(A)(ii)(I)). To the contrary, vehicle expense amounts are static numbers drawn from the IRS Local and National Standards; they are not the debtor's actual vehicle ownership expenses. These fixed amounts are used regardless of the debtor's "actual" expenses.[11] Id.

Because "applicable" and "actual" have different meanings, the bankruptcy court's concern about overlapping definitions was simply incorrect, and led to an incorrect reading of the statute. See In re Ross-Tousey, 368 B.R. at 765 (the United States' reading "gives meaning to the distinction between 'applicable' and 'actual' without taking a further step to conclude that 'applicable' means 'nonexistent' or 'fictional.'"); In re Thomas, 2008 WL 597586 at *4 (same); In re Meade, 382 B.R. at 798 (same).

The bankruptcy court's reading would be wrong, however, even if "applicable" and "actual" meant the same thing in section 707(b)(2)(A)(ii)(I). As

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[11] In calculating disposable income the debtor is entitled to list the full amount specified under the IRS Local Standard so long as the debtor incurs some vehicle ownership expense, i.e., the expense is applicable to the debtor. See 11 U.S.C. 707(b)(2)(A)(ii)(I) (providing that the applicable expense amount "shall be" the amount "specified" under the IRS Local Standard). See also In re Hartwick, 373 B.R. at 650 (recognizing that any vehicle ownership expense will make a debtor eligible for the full IRS standard amount).

the Supreme Court has recognized, there is nothing wrong with two different words within a single section being synonyms. Wachovia Bank v. Schmidt, 546 U.S. 303, 314 (2006) (noting "Congress may well have comprehended the words 'located' and 'established,' as used in [28 U.S.C.] § 1348, not as contrasting, but as synonymous or alternative terms"). Therefore, even should this Court conclude that "applicable" is synonymous with "actual" in section 707(b)(2)(A)(ii)(I), Mr. Washburn would remain ineligible for a vehicle ownership expense amount because he has no "actual" ownership expenses.

Second, the bankruptcy court's reading of "applicable" renders it superfluous. Under its reading, section 707(b)(2)(A)(ii)(I) would have the same meaning without the word "applicable" in it. The bankruptcy court in Wilson suggests the word simply instructs debtors to go to the IRS standards referenced in section 707(b)(2)(A)(ii)(I) and locate the standard dollar figure it establishes for a debtor's locality and for the number of vehicles the debtor has. In re Wilson, 373 B.R. at 642-43. But debtors would do the same thing if the word were not in the statute because the statute would then read "[t]he debtor's monthly expenses shall be the debtor's ~~applicable~~ monthly expense amounts" under the IRS standards. 11 U.S.C. 707(b)(2)(A)(ii)(I) (emphasis added). Striking out the word "applicable" would still lead the debtor to the same line under the Local Standards that the bankruptcy court suggests the word "applicable" exists to accomplish. In re Ross-Tousey, 368 B.R. at 765 (E.D. Wis. 2007) ("Had Congress intended to indiscriminately allow all expense amounts specified in the National and Local Standards, it would have written 707(b)(2)(A)(ii)(I) [without using the word 'applicable.']"); In re Ransom, 380 B.R. at 808 (concluding that the Debtors' construction would "read[] 'applicable' right out of the Bankruptcy Code"); In re Deadmond, 2008 WL 191165 at *4 ("The word ['applicable] must mean something, and if some monthly expenses are applicable, then other monthly expenses are not applicable.").

Because the bankruptcy court's reading renders "applicable" superfluous, the word must have a different meaning than the one the court ascribed. See generally Cooper Indus., Inc. v. Aviall Servs., Inc., 543 U.S. 157, 167 (2004)(courts "must, if possible, construe a statue to give every word some operative effect"); United States v. Gomez-Hernandez, 300 F.3d 974, 979 (8th Cir. 2002) (observing that courts should "avoid a statutory construction that would render another part of the same statute superfluous."). As we explain above, the word "applicable" does have a different meaning. Under its dictionary meaning, the word exists to allow debtors to claim a standard vehicle expense amount that is applicable because they have a loan or lease expense.[12]

Third, the Wilson bankruptcy court and the court below were wrong in concluding the means test form allows debtors to claim vehicle ownership amounts when they do not have associated expenses. See In re Wilson, 373 B.R. 638, 642

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[12] Section 707(b)(2) includes the proviso that monthly expenses may not include any "payments for debts." Although not raised by the bankruptcy court in this case, two members of a divided Sixth Circuit bankruptcy appellate panel recently found that this provision establishes that Congress intended to allow an ownership expense even when a debtor has no debt payment on a vehicle. In re Kimbro, 2008 WL 2369141 at * 4. This reading misinterprets the term "payments for debts." Debtors for whom the ownership expense is applicable receive a fixed standard allowance that is the dollar amount under the applicable standard. This is not a "payment for a debt." Cf. 11 U.S.C. 707(b)(2)(A)(iii) (which allows an expense deduction for a debtor's actual average monthly secured debt payments to creditors). The "payment for debts" language exists merely to ensure debtors do not double-deduct their actual payments for debts under section 707(b)(2)(A)(ii)(I) and then claim overlapping expenses for certain categories in the IRS's Other Necessary Expenses, such as secured debt payments and repayment of delinquent tax debts, as those are already allowed elsewhere under the means test. See IRS Internal Revenue Manual, Financial Analysis Handbook, Pt. 5, ch. 15, § 5.15.1.10, available at http://www.irs.gov/irm/part5/ch15s01.html#d0e195695. (listing categories of Other Necessary Expenses). See also 707(b)(2)(A)(iii) (permitting deduction for secured debts under the means test) and 707(b)(2)(A)(iv) (permitting deduction for tax debts under the means test). And it also ensures debtors do not deduct their student loan payments under the means test, even though the IRS categorizes them as an "Other Necessary Expense." See In re Knight, 370 B.R. 429, 436-37 (Bankr. N.D. Ga. 2007) (concluding that the plain language of section 707(b)(2)(A)(ii) "precludes deduction" of student loan payments as an expense under the means test).

(opining that if Form 22C “is filled out correctly the debtor is always allowed at least the standard ownership cost regardless of the existence of or the amount of an actual automobile expense payment”). See also Official Form 22C, line 28 (the portion of the chapter 13 means test form that permits debtors to “claim” vehicle ownership expenses).

First, the form merely instructs debtors to “check the number of vehicles for which you **claim** an ownership/lease expense.” Official Form 22C, line 28 (emphasis added). It does not define what ownership expense amounts debtors may lawfully deduct under section 707(b)(2)(A)(ii)(I). Nor does it purport to define “applicable”.

Second, section 707(b)(2)(A)(ii)(I) determines which “applicable” expense amounts debtors may deduct – not the form. See In re Lasowski, 384 B.R. 205 (B.A.P. 8th Cir. 2008) (noting that the Bankruptcy Code, not the chapter 13 means test form, controls the calculation of amounts to be excluded from disposable income). And federal law prohibits an official form from being interpreted as altering the meaning of “applicable” in section 707(b)(2)(A)(ii)(I). 28 U.S.C. 2075 (providing that the Federal Rules of Bankruptcy Procedure “shall not abridge, enlarge, or modify any substantive right”); In re Beaty, 306 F.3d 914, 924 (9th Cir.

2002) ("[A] Bankruptcy Rule cannot create an exception to the Bankruptcy Code . . . ") (internal quotation omitted) <u>In re Ransom</u>, 380 B.R. at 805 n. 13 ("[N]ational or local forms are only valid to the extent that they conform to the substantive provisions of the Bankruptcy Code," and "it is axiomatic that guidelines in a form cannot stand as independent authority in opposition to the Bankruptcy Code itself.")

II. Reading section 707(b)(2)(A)(ii)(I) to limit vehicle ownership expense amounts to debtors with loan or lease payments fulfills two goals Congress expressed in enacting the 2005 Act: ensuring that above-median-income debtors repay their debts when they can, and eliminating abuse.

A. Congress passed the 2005 Act to maximize debtor repayment to creditors and to eliminate opportunities for bankruptcy abuse.

In interpreting "applicable" in section 707(b)(2)(A)(ii)(I), this Court may look to its legislative history to determine the statute's objectives and illuminate its text. <u>Porter v. Commissioner</u>, 856 F.2d 1205, 1209 (8th Cir. 1988) (examining legislative history to determine meaning of word undefined in a statute).

The "heart" of the 2005 Act is the means test, which seeks to "ensure that debtors repay creditors the maximum they can afford." H.R. Rep. No. 109-31 (I), at 1 (2005), <u>reprinted</u> <u>in</u> 2005 U.S.C.C.A.N. 88, 89.[13] <u>Cf.</u> <u>In re Thomas</u>, 382 B.R. at 798 ("If a debtor were permitted a car ownership allowance when he actually incurs

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[13] There is no Senate Report or Conference Report to the 2005 Act.

no such expense, application of the means test would not accurately reflect the debtor's ability to repay creditors, and the purpose of the statue would be frustrated."). The 2005 Act also seeks to eliminate "loopholes and incentives" in the system "that allow and – sometimes – even encourage opportunistic personal filings and abuse." H.R. Rep. No. 109-31 (I), at 5, 2005 U.S.C.C.A.N. at 92.

Ensuring that above-median-income debtors claim vehicle ownership expense amounts only when they have associated ownership expenses fulfills Congress' intent that such debtors repay their debts when they are able. See In re Ross-Tousey, 368 B.R. at 766 ("The statute is only concerned about protecting the debtor's ability to continue owning a car, and if the debtor already owns the car, the debtor is adequately protected."); In re Hartwick, 373 B.R. at 652 (same); In re Ransom, 380 B.R. at 807 ("[W]hat is important is the payments that debtors actually make, not how many cars they own, because the payments that debtors make are what actually affect their ability to make payments to their creditors."); Babin v. Wilson (B.A.P.), 383 B.R. at 733 (noting that for above-median-income chapter 13 debtors, the "purpose" of the 2005 Act was to "require" such debtors "to make more funds available to their unsecured creditors").

B. The bankruptcy court's interpretation of section 707(b)(2)(A)(ii)(I) would yield results that conflict with congressional intent.

The bankruptcy court's interpretation of section 707(b)(2)(A)(ii)(I) would frustrate the 2005 Act's goal of proper repayment by allowing above-median-income debtors to claim phantom expenses that do not apply to them.[14] In re Ross-Tousey, 368 B.R. at 766 (when a debtor "has no monthly ownership expenses, it makes no sense to deduct an ownership expense to shield it from creditors.").

Under the bankruptcy court's reading of section 707(b)(2)(A)(ii)(I), a higher-income debtor with an inoperable car "rusting away in his backyard" could claim the ownership expense amount simply because the car is an "automobile" and he "owns" it. In re Ross-Tousey, 368 B.R. at 768. This statutory reading has been rejected by lower appellate courts because it "defies common sense." In re Deadmond, 2008 WL 191165 at *4.

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[14] By incorrectly allowing Mr. Washburn to deduct $471 in monthly ownership expense amounts for nonexistent costs in calculating disposable income, the bankruptcy court's interpretation of section 707(b)(2)(A)(ii)(I) would reduce payments to creditors by $28,260 over his 60-month plan (60 months x $471 = $28,260).

III. The bankruptcy court's interpretation of section 707(b)(2)(A)(ii)(I) is inconsistent with the IRS's refusal to allow parties to claim nonexistent vehicle ownership expenses under its Local Standard.

Reversal of the bankruptcy court's order allowing Mr. Washburn to deduct vehicle ownership expenses that he does not have has the additional benefit of treating inapplicable phantom expenses in bankruptcy cases the way the IRS has long treated them. There are two reasons why this is so.

First, section 707(b)(2)(A)(ii)(I)'s text requires that expense amounts be those established "under" the IRS standards. 11 U.S.C. 707(b)(2)(A)(ii)(I). This textual "reference to amounts specified 'under' the Standards indicates that one should use the numbers that result when the Standards are applied as they usually are." In re Thomas, 382 B.R. at 798. Given the text of the statute, "the most logical resource to consult is the IRS" to determine whether the IRS's Local Standard is "applicable" to a particular debtor. In re Hartwick, 373 B.R. at 650-51.

Under its Local Standard for vehicle ownership, the IRS prohibits vehicle ownership deductions if an individual has no loan or lease payments. See IRS Internal Revenue Manual, Financial Analysis Handbook, Pt. 5, ch. 15 § 5.15.1.7(4.B) (providing that if a taxpayer has no vehicle loan or lease payments, the Local Standard ownership cost cannot be claimed by the taxpayer); id., §

5.15.1.7(4.B), available at www.irs.gov/irm/part5/ch15s01.html.

The bankruptcy court's construction improperly applies section 707(b)(2)(A)(ii)(I) to allow the nonexistent expenses that the IRS disallows under its Local Standards. Accord In re Sawdy, 2008 WL 789116 at *4 (finding it "logical to look at the actual IRS Collection Financial Standards in determining the applicable expense Standards in bankruptcy actions"); In re Thomas, 382 B.R. at 798 ("[I]t does not appear that Congress intended to adopt only the numbers contained in the Standards without the context and meaning provided by the IRS in creating the Standards and in its normal application of those numbers.").

Second, Congress was interested in more than the mere numbers found in the IRS Local Standards in crafting section 707(b)(2)(A)(ii)(I). The Act's House Report explains that the debtor's monthly expenses "must be the applicable monthly expense amounts set forth in the [IRS] Financial Analysis Handbook as Necessary Expenses under the National and Local Standards categories." H.R. Rep. No. 109-31(I), at 99-100 (2005).[15] The Financial Analysis Handbook provides that the Local

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[15] In a recent decision, a divided Sixth Circuit bankruptcy appellate panel ignored the relevant legislative history and instead applied legislative history from an unenacted version of bankruptcy reform legislation considered by a prior Congress. In re Kimbro, 2008 WL 2369141 at *6. This led the panel majority to conclude the 2005 Act meant to exclude consideration of the Internal Revenue

Standard ownership cost cannot be claimed if a taxpayer has no vehicle loan or lease payments. See IRS Internal Revenue Manual, Financial Analysis Handbook, Pt. 5, ch. 15, § 5.15.1.7(4.B), available at www.irs.gov/irm/part5/ch15s01.html.

IV. Barring above-median-income debtors from claiming phantom vehicle ownership expenses implements sound bankruptcy policy.

A. Reading section 707(b)(2)(A)(ii)(I) to limit vehicle ownership expenses to debtors with a loan or lease payment is fair to debtors and creditors.

Reading section 707(b)(2)(A)(ii)(I) to limit vehicle ownership expenses to debtors with a loan or lease payment is fair. This is so because it establishes a threshold – the existence of vehicle loan or lease payments – for claiming a standardized ownership expense amount, one that is consistent for all chapter 13 debtors. Significantly, section 1325(b)(2) independently requires below-median-income debtors to incur an expense to claim a deduction. See 11 U.S.C. 1325(b)(2) (allowing such debtors only "reasonably necessary" expenses). Reading "applicable" as requiring above-median-income debtors to have an associated

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Manual. Id. This conclusion suffers from two flaws. First, the language of the 2005 Act does not indicate any intent to preclude reference to the IRS's application of its own expense standards and requires that deductions be taken "under" the Local Standards. Second, the legislative history of the 2005 Act specifically references the IRS Financial Analysis Handbook in describing "applicable" expense amounts. See H.R. Rep. No. 109-31(I), at 99-100 (2005).

expenses means these debtors will not be able to claim phantom expenses that less wealthy debtors cannot.

Nor does our interpretation adversely affect below-median income debtors – those most likely to file bankruptcy petitions – because such debtors are not subject to section 707(b)(2)(A)(ii)(I) in the first place. See 11 U.S.C. 1325(b)(3). These below-median-income debtors represent approximately 73% of the men and women who seek chapter 13 protection.[16] Similarly, in chapter 7 bankruptcies, section 707(b)(2)(A)(ii)(I) only applies to the 10% of debtors with above-median incomes.[17] See Schultz v. United States, 2008 WL 2229495 at *1 (6th Cir. June 2,

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[16] There were 307,521 non-business chapter 13 cases filed in fiscal year 2007. See U.S. Courts, Bankruptcy Statistics, 2007 Fiscal Year by Chapter, available at http://www.uscourts.gov/bnkrpctystats/sept2007/f2table.xls. Of these cases, the United States estimates that 83,030 cases may have been filed by above-median-income debtors. The United States' estimate is based on a 2006 survey conducted by RAND across a sample of nine judicial districts that estimated that 27% of chapter 13 cases were filed by above-median-income debtors. See The Bankruptcy Abuse and Consumer Protection Act of 2005: Evaluation of the Effects of Using IRS Expense Standards to Calculate a Debtor's Monthly Disposable Income, RAND Institute for Civil Justice at x, 23, available at www.usdoj.gov/ust/eo/public_affairs/reports_studies/index.htm.

[17] During fiscal year 2007, according to data collected by the United States Trustee Program, 451,012 non-business chapter 7 cases were filed nationwide, excluding the judicial districts in Alabama and North Carolina, whose data were not collected. Of these chapter 7 cases, only 10% had above-median incomes and were thereby subject to the means test and the requirements of section 707(b)(2)(A)(ii)(I).

2008) (noting that under 11 U.S.C. 707(b)(7), the presumption of abuse cannot arise with respect to below-median-income debtors).

Our interpretation is also fair to creditors. Congress enacted the 2005 Act because under prior law "some bankruptcy debtors are able to repay a significant portion of their debts" but were not required to do so. H.R. Rep. No. 109-31 (I), at 5 (2005), reprinted in 2005 U.S.C.C.A.N. 88, 92. Our interpretation of section 707(b)(2)(A)(ii)(I) ensures that above-median-income debtors will not avoid repaying their debts by claiming expense amounts when those debtors have no associated expense.

B. Other Bankruptcy Code provisions adequately protect above-median-income debtors who own vehicles, but lack vehicle ownership expenses.

Notwithstanding our reading of section 707(b)(2)(A)(ii)(I), at least two safety valves are available to prevent hardships against above-median-income debtors who own vehicles but have no vehicle ownership expenses.

First, every debtor who owns a vehicle, whether or not it is subject to a loan or lease payment, receives an unrelated vehicle operating expense under the IRS

Local Standards.[18] And, debtors who own unencumbered vehicles that are six or more years old or have 75,000 or more miles, also receive an additional $200 in monthly vehicle expense deduction per vehicle. See IRS Internal Revenue Manual, Pt. 5, ch. 8, § 5.8.5.5.2 ("Treatment of Non-Business Transportation Expenses"), available at http://www.irs.gov/irm/part5/ch08s05.htm. See also In re Ransom, 380 B.R. at 808 (recognizing $200 additional allowance); In re Hartwick, 373 B.R. at 652 (same); Babin v. Wilson (B.A.P.), 383 B.R. at 734 (same).

Second, if any debtor needs a new vehicle during the course of his chapter 13 plan, the debtor can move to modify his plan to reduce payments to creditors to account for the new expense. See 11 U.S.C. 1329(a); Babin v. Wilson, 383 B.R. 729, 734 (B.A.P. 8th Cir. 2008) ("[I]n the event a debtor needs a new car during the course of a case, the debtor can move to modify the plan based on changed circumstances."). For debtors who require a new vehicle, plan modification is

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[18] Operating expenses include vehicle insurance, maintenance, fuel, state and local registration, required inspection, parking fees, tolls, and driver's license fees. In a recent decision, a divided Sixth Circuit bankruptcy appellate panel incorrectly characterized many of these operating expenses as "ownership expenses" and failed to acknowledge that all debtors who incur operating expenses receive the allowance under the IRS Local Standards. *In re Kimbro*, 2008 WL 2369141 at *11-12.

appropriate because financing the vehicle usually indicates a substantial change in a debtor's ability to pay that was not already taken into account at the time of plan confirmation. Cf. Education Assistance Corp. v. Zellner, 827 F.2d 1222, 1226 (8th Cir. 1987)(noting that if the debtor's income increased in the future, the creditor could move to modify the debtor's plan under section 1329(a)).

CONCLUSION

For these reasons, the United States respectfully asks this Court to reverse the order of the United States Bankruptcy Court for the Eastern District of Arkansas and remand for further proceedings.

Respectfully submitted,

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ROBERTA A. DEANGELIS
Acting General Counsel

P. MATTHEW SUTKO
Associate General Counsel

DAVID A. LEVINE
Executive Office for United States Trustees
Department of Justice
20 Massachusetts Avenue, N.W.
Washington, D.C. 20530

CERTIFICATE OF COMPLIANCE WITH FED. R. APP. P. 32(a)

I hereby certify that the foregoing brief complies with the typeface requirements in Fed. R. App. P. 32(a)(5), the page and type-volume limitation in Fed. R. App. 32(a)(7), and Eighth Circuit Rule 28A(d). I also certify that the foregoing brief is proportionately spaced, using Times Roman font, 14 point type. Based on a word count under Corel Word Perfect 12, this brief contains 6,917 words excluding the table of contents, table of authorities, addenda, and certificates of counsel.

David A. Levine
Attorney for the United States
as Amicus Curiae

CERTIFICATE OF SERVICE

I hereby certify that on June 23, 2008, I served the foregoing Brief for the United States as *Amicus Curiae* in Support of Appellant on the following by sending two copies of the brief by Federal Express, to:

Gilbert B. Weisman, Esq.
William A. McNeal, Esq.
eCAST Settlement Corporation
c/o Becket & Lee LLP
P.O. Box 3001
Malvern, PA 19355
Counsel for Appellant eCAST Settlement Corporation

Joyce Bradley Babin, Esq.
Chapter 13 Standing Trustee
P.O. Box 8064
Little Rock, AR 72203-8064
Appellant / Chapter 13 Trustee

David K. Lester, Esq.
P.O. Box 1515
Cabot, AR 72023
Counsel for Debtor, Robert Earl Washburn

I also certify that I filed the brief by sending an original, ten copies, and one digital version on a CD-ROM to the Clerk, United States Court of Appeals for the Eighth Circuit, by Federal Express at the following address:

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St. Louis, MO 63102

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____
David A. Levine
Attorney for the United States
as Amicus Curiae

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WESTLAW CODES

1. **("TI")** ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*
Gary A. Washington and Michele A. Washington v. W. Clarkson McDow, Jr. United States Trustee for Region 4 (In re Gary A. Washington and Michele A. Washington)

2. **("CO")** ***CURRENT*** COURT *[E.g., "CTA9"]*
D. S.C.

3. **("CCN")** ***CURRENT*** CASE NO.
No.: 3:10-3061-CMC-JRM

4. **("PCN")** ***PRIOR*** CASE NO. - & COURT *[IF ANY]*
No.: 09-08248-dd
Court: Bankr. S. C.
(Identify judge & cite, if any)

5. **("SO")** ***SOURCE***
U.S. TRUSTEES

6. **("DA")** ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*
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Linda K. Barr, Noah M. Schottenstein, P. Matthew Sutko, Ramona D. Elliott
(UST/OGC: 202-307-1399/FAX-2397)

8. **("TO")** ***TOPIC***
BANKRUPTCY

9. **("SU")** • ***SUMMARY*** OF KEY ISSUE(s)

&

√ Any Miscellaneous ***BACKGROUND***

- Whether the bankruptcy court abused its discretion by dismissing the Washingtons' chapter 11 petition under 11 U.S.C. § 1112(b)(4), which allows courts to dismiss chapter 11 cases for cause.

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IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF SOUTH CAROLINA

In re

Gary A. Washington and
Michele A. Washington,

Debtors.

___________________________________/

Gary A. Washington and
Michele A. Washington,

Appellants.

vs.

W. Clarkson McDow, Jr.,
United States Trustee for
Region 4,

Appellee.

___________________________________/

C/A No. 3:10-3061-CMC-JRM

On appeal from the United States
Bankruptcy Court for the District
of South Carolina, Case No. 09-08248-dd

BRIEF FOR THE APPELLEE

Linda K. Barr
Dist. Ct. Id. No. 6284
Trial Attorney
Office of the United States Trustee
United States Department of Justice
1835 Assembly Street, Suite 953
Columbia, South Carolina 29201
linda.k.barr@usdoj.gov
(803) 765-5219

RAMONA D. ELLIOTT
General Counsel
P. MATTHEW SUTKO
Associate General Counsel
NOAH M. SCHOTTENSTEIN
Trial Attorney
Executive Office for United States Trustees
United States Department of Justice
20 Massachusetts Avenue N.W.
Washington, D.C. 20530

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UNITED STATES DISTRICT COURT
DISTRICT OF SOUTH CAROLINA

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Gary A. Washington and
Michele A. Washington,

Debtors.

_________________________________/

Gary A. Washington and
Michele A. Washington, C/A No. 3:10-3061-CMC-JRM

Appellants.

vs.

W. Clarkson McDow, Jr.,
United States Trustee for
Region 4,

Appellee.

_________________________________/

BRIEF FOR THE APPELLEE

JURISDICTIONAL STATEMENT

The bankruptcy court had jurisdiction under 28 U.S.C. §§ 157(a) and (b) and 1334(a) to issue its final order dismissing the chapter 11 bankruptcy case of Mr. Gary Washington and Mrs. Michele Washington. The bankruptcy court entered its dismissal order on September 27, 2010. On October 5, 2010, the Washingtons filed a notice of appeal, which is timely under 28 U.S.C. §§ 158(a) and (c)(2) and Fed. R. Bankr. P. 8002(a) . This Court has appellate jurisdiction under

28 U.S.C. § 158(a)(1), a statutory provision under which district courts have jurisdiction to hear appeals from final judgments, orders, and decrees of bankruptcy judges.

STATEMENT OF THE ISSUE

Whether the bankruptcy court abused its discretion by dismissing the Washingtons' chapter 11 petition under 11 U.S.C. § 1112(b)(4)[1], which allows courts to dismiss chapter 11 cases for cause.

STANDARD OF REVIEW

This Court reviews a decision of the bankruptcy court dismissing a case under § 1112(b) for abuse of discretion. *Jackson v. United States*, 131 F.3d 134 (4th Cir. 1997). "A reviewing court may determine that the Bankruptcy Court abused its discretion only when there is a definite and firm conviction that the court below committed a clear error of judgment." *Id.* This occurs when "(1) the decision was based on an erroneous conclusion of law, (2) the record contains no evidence on which the bankruptcy court could have based its decision, or (3) the factual findings are clearly erroneous." *Id.*

A finding of fact is clearly erroneous "when although there is evidence to support it, the reviewing court on the entire evidence is left with the definite and firm conviction that a mistake has been committed" *Anderson v. City of Bessemer City*, 470 U.S. 564, 573 (1985).

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[1] All further references to the Bankruptcy Code, 11 U.S.C. §§ 101 *et seq.*, will be by section number only.

STATEMENT OF THE CASE

On August 4, 2010, the United States Trustee filed a motion to dismiss the Washingtons' case under § 1112(b) because they (1) repeatedly failed to comply with the Bankruptcy Code's reporting requirements and (2) had no prospect for successfully reorganizing. The bankruptcy court agreed with the United States Trustee and dismissed the Washingtons' case. The Washingtons appealed the dismissal order to this Court.

STATUTORY FRAMEWORK

I. Dismissal Under § 1112(b)

Section 1112(b)(1) of the Bankruptcy Code provides that a debtor's case may be dismissed or converted for "cause."[2] Section 1112(b)(4) then lists several subsections that

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[2] Effective December 20, 2010, § 1112(b) was amended to read as follows:

> (b)(1) Except as provided in paragraph (2) and subsection (c), on request of a party in interest, and after notice and a hearing, the court shall convert a case under this chapter to a case under chapter 7 or dismiss a case under this chapter, whichever is in the best interests of creditors and the estate, for cause unless the court determines that the appointment under section 1104(a) of a trustee or an examiner is in the best interests of creditors and the estate.
> (2) The court may not convert a case under this chapter to a case under chapter 7 or dismiss a case under this chapter if the court finds and specifically identifies unusual circumstances establishing that converting or dismissing the case is not in the best interests of creditors and the estate, and the debtor or any other party in interest establishes that—
>> (A) there is a reasonable likelihood that a plan will be confirmed within the time frames established in sections 1121(e) and 1129(e) of this title, or if such sections do not apply, within a reasonable period of time; and
>> (B) the grounds for granting such relief include an act or omission of the debtor other than under paragraph (4)(A)—
>>> (i) for which there exists a reasonable justification for the act or omission; and
>>> (ii) that will be cured within a reasonable period of time fixed by the court.

The amendment does not impact this case.

provide examples of cause, which “includes —

> (A) substantial or continuing loss or diminution of the estate and the absence of reasonable likelihood of rehabilitation;
>
> (F) unexcused failure to satisfy timely any filing or reporting requirement established by this title or by any rule applicable to a case under this chapter; and
>
> (J) failure to file a disclosure statement, or to file or confirm a plan, within the time fixed by this title or by order of the court.”

§§ 1112(b)(4)(A), (F), (J). Under § 102(3), the term “including” is “not limiting,” so §1112(b)(4)’s list is not exhaustive.

II. The Proposal and Confirmation of Chapter 11 Reorganization Plans

A chapter 11 debtor may file a reorganization plan at any time, including when the case is commenced. § 1121. This plan must conform to the requirements of the Bankruptcy Code, be accepted by the creditors, and be confirmed by the bankruptcy court before the debtor may enact the reorganization plan. §§ 1123 (establishing requirements for the content of a plan), 1126 (requiring creditor acceptance of a plan), 1129 (establishing requirements for the bankruptcy court to confirm a plan). Before a debtor may solicit support for a reorganization plan, it must also provide creditors with a disclosure statement providing "adequate information" allowing a creditor to make an "informed judgment" about the viability of the reorganization plan. § 1125. The disclosure statement often includes historic information, assumptions, accounting and valuation calculations, anticipated litigation, management information, business conditions, tax consequences, and other legal, financial, or economic circumstances that would be relevant to a creditor's decision to accept or reject a proposed plan.

Disclosure statements must be approved by the bankruptcy court. § 1125(b). The South Carolina Local Bankruptcy Rules establish a timeline for this process.

SCLBR 3016-1(a) provides: "Unless otherwise ordered by the Court, a disclosure statement and plan of reorganization shall be filed by the debtor or trustee no later than one hundred eighty (180) days after entry of the order for relief. The debtor, trustee, or other plan proponent shall prosecute its disclosure statement and plan in a timely manner."

SCLBR 3016-1(c) provides: "Denial of Confirmation. If any plan of reorganization or disclosure statement filed by the debtor, trustee, or other plan proponent is not confirmed or approved by the Court, any amendment, modification, or supplement necessary to correct the deficiency must be filed within fourteen (14) days or whatever time period the Court may require. Failure to timely comply may be deemed a failure to prosecute the case and may constitute grounds for dismissal or conversion without further notice or hearing."

STATEMENT OF THE FACTS

On November 2, 2009, the Washingtons filed a voluntary petition for bankruptcy relief under chapter 11 of the Bankruptcy Code. Chapter 11 Voluntary Petition filed on 11/2/09. The Washingtons own almost $1 million in property. Summary of Schedules. In addition to their residence, they own two time shares — one in Orlando and the other in Myrtle Beach — and three rental properties, including a business park for entrepreneurs and two residential buildings. *See* Schedule A - Real Property. The Washingtons have a variety of businesses for which Mr. Washington is primarily responsible. Statement of Financial Affairs at 8; *See* Transcript of

9/14/10 hearing, page 60, lines 20-24. Mr. Washington's primary business is Carolina Procurement Institute (CPI), which is operated out of the Gervais business park, and is a consulting firm assisting small businesses. *See* Transcript of 8/3/10 hearing, page 9.

After filing for bankruptcy, the Washingtons' disclosure statement and chapter 11 reorganization plan were due to be filed with the bankruptcy court within 180 days of their bankruptcy petition. *See* South Carolina Bankruptcy Local Rule (SCBLR) 3016-1(a). The feasibility of the plan that they filed was contingent upon obtaining a certain level of income from the Washingtons' businesses, but the disclosure statement did not provide sufficient information about their current sources of income or their ability to fund the reorganization plan, such as by providing valuations for the Washingtons' properties. Reorganization Plan and Disclosure Statement filed 4/30/10. Therefore, the United States Trustee objected to the disclosure statement on the ground that it did not provide creditors enough information to evaluate the Washingtons' plan. Objection to Disclosure Statement filed 6/14/10.

The bankruptcy court scheduled a hearing on whether to approve the Washingtons' disclosure statement for June 24, 2010. Docket Text Entry 61. At the Washingtons' request, the bankruptcy court continued the hearing on the disclosure statement to August 3, 2010, providing the Washingtons with an additional 40 days to address the deficiencies with their disclosure statement. Docket Text Entry 79.

On July 12, 2010, the Washingtons filed an application to retain an appraiser, which was approved by the Court on July 14, 2010. Docket Text Entry 85. But they never filed an amended disclosure statement. *See* Transcript of 8/3/10 hearing, page 5, lines 15-16. At the August 3, 2010, continued hearing on the disclosure statement, the Washingtons' attorney requested another continuance because the appraisals had not been completed and Mr. Washington needed more time to gather information. *See* Transcript of 8/3/10 hearing, page 5, lines 22-25. The Washingtons maintained that the appraisals were critical to their disclosure statement and plan, and their attorney admitted that the disclosure statement they originally filed on April 30, 2010, was inadequate. *See* Transcript of 8/3/10 hearing, page 6, lines 1-4. The United States Trustee did not consent to the continuance because there were still significant deficiencies with the disclosure statement that remained uncured, such as the failure of the Washingtons to provide adequate information regarding their sources of income, their projected disposable income, and their inability to fund the plan as evidenced by their proposed payment of only $8,686 to unsecured creditors over 20 years (less than 1% of the amount owed). *See* Transcript of 8/3/10 hearing, page 4-5, lines 18-7. In addition, even if the Washingtons had found additional income, it was not sufficient or reliable enough to have the plan confirmed. *See* Transcript of 8/3/10 hearing, page 21, lines 14-25. The United States Trustee indicated that it would move to dismiss the case. *Id.*

Mr. Washington testified in great detail at the August 3, 2010 hearing about various actions he had taken to obtain the appraisals, decrease expenses and increase revenues in an effort to improve their ability to fund a reorganization plan, such as laying off employees and reducing the amount of vacancies in their rental properties. *See* Transcript of 8/3/10 hearing, pages 9-18. Mr. Washington testified that he had obtained new tenants at the Gervais Professional Suites (also known as 1815 Gervais) that increased rental income by $2,600, bringing the monthly income to $4,500 to $5,000. *See* Transcript of 8/3/10 hearing, page 9, lines 8 - 12. He had five tenants evicted from 2917 River Drive which took five or six months to “move them out of the facility”. *See* Transcript of 8/3/10 hearing, page 10, lines 8 - 11. In regards to CPI, Mr. Washington testified he had obtained several new contracts which had increased the monthly revenues from $6,000 to $8,000 to $18, 800 in June 2010 and $26,000 in July 2010. *See* Transcript of 8/3/10 hearing, page 9, lines 17 - 19. He also removed one of his employees to reduce expenses by $1,100 to $1,400 per month. *See* Transcript of 8/3/10 hearing, page 11, lines 3 - 5.

In regards to the appraisals, which the Washingtons needed for their disclosure statement and plan, Mr. Washington testified that he had asked Mr. Hendrix to appraise the properties because he had previously appraised onel of the residential properties. However, once he learned that Mr. Hendrix could not provide a commercial appraisal, another appraiser was located who Mr. Washington “paid him out of my pocket.” “I’ve paid him over $2,200 on a $4,500 debt of the appraisals.” *See* Transcript of 8/3/10 hearing, page 12, lines 7 - 17.

Mr. Washington also acknowledged that the accountant he had been using to complete the monthly operating reports was “not cutting it” and he had retained a company called RBJ Accountants to take over the accounting responsibilities. “I have to pay them another thousand dollars to remove the documentation from her [current accountant] so I can stay faithful to what I need to do.” *See* Transcript of 8/3/10 hearing, pages 14 - 15.

Following Mr. Washington’s testimony, the bankruptcy court did not approve the Washingtons’ disclosure statement, but informed them that they should submit a new one as soon as possible because the court would consider it along with the United States Trustee forthcoming motion to dismiss. *See* Transcript of 8/3/10 hearing, page 22, lines 2-7.

On August 4, 2010, the United States Trustee filed a motion under § 1112(b) to dismiss the Washingtons' case, and the bankruptcy court scheduled the next hearing for five weeks later, on September 14, 2010. The Washingtons filed a new disclosure statement at 10:39 pm on September 13, 2010. *See* Disclosure Statement filed 9/13/10, page 1 (ECF Timestamp).

At the hearing on the motion to dismiss, the bankruptcy court heard testimony from Ms. Julie Smoak, a bankruptcy analyst for the United States Trustee, who testified about the Washingtons' problems with the management of the estate, the untimely payment of quarterly fees, and the persistent nature of their financial difficulties. Ms. Smoak testified that the Washingtons had repeatedly failed to file their monthly operating reports reflecting their post-petition activities which were due on the 20th of each month. The only reports which had been timely filed were May, July and August 2010. *See* Transcript of 9/14/10 hearing, page 14, lines 6 - 14. Ms. Smoak further testified that the August 2010 monthly operating report did not appear to be complete and accurate. The description of expenses paid in the August report included transactions for June and July. *See* Transcript of 9/14/10 hearing, pages 14 - 17. Ms. Smoak also testified to the Washingtons' failure to use their debtor-in-possession bank account as required. *See* Transcript of 9/14/10 hearing, pages 33 - 34. Ms. Smoak provided testimony regarding the Washingtons' failure to pay quarterly fees as required by 28 U.S.C. § 1930(a)(6). *See* Transcript of 9/14/10 hearing, page 12, lines 3 - 25.

The bankruptcy court also heard testimony from Mr. Washington about his compliance with the administrative duties of the estate and the sustainability of his new sources of income. Mr. Washington acknowledged in his testimony that the quarterly fees were not paid when they were due because he did not have the funds at the time. *See* Transcript of 9/14/10 hearing, pages 35 - 36. Mr. Washington testified he personally completed the August 2010 monthly operating report and that it had the errors noted by Ms. Smoak. *See* Transcript of 9/14/10 hearing, pages 40 -41; 45 - 47. Mr. Washington also testified that he was not using the debtor-in-possession bank account because it was a hindrance to his operation of his businesses. *See* Transcript of 9/14/10 hearing, page 52, lines 1 - 10.

While the bankruptcy court did not find the administrative deficiencies provided sufficient cause for dismissal because the deficiencies were cured at the time of the hearing, the bankruptcy court found that the repeated problems in meeting the administrative requirements did not provide confidence in the Washingtons' ability to propose a confirmable plan and successfully reorganize. Order at 6.

On September 27, 2010, the bankruptcy court issued its order dismissing the Washingtons' case. The court dismissed the case on two principal grounds. First, it found there was cause to dismiss under § 1112(b)(4)(A) because, despite the Washingtons' efforts, the bankruptcy estate continued to operate at a loss and the Washingtons' inability to increase their rental income. Order at 4. For example, at the August 3, 2010 hearing, Mr. Washington had included new tenants in explaining how he had increased revenues. *See* Transcript of 8/3/10 hearing, page 9, lines 10 - 11. However, at the September 14, 2010 hearing, it became clear that one of the tenants had not yet taken possession of the premises due to her husband's hospitalization and that she was still trying to obtain a loan. *See* Transcript of 9/14/10 hearing, pages 56-57. The other tenant was a new lease with a doctor's office for $1,250 per month, but the rent actually starts at $600 per month and does not increase to $1,250 per month until

October 2011. *See* Transcript of 9/14/10 hearing, page 56, lines 11 - 13; Disclosure Statement filed 9/13/10, Exhibit 3. Mr. Washington also testified that he had evicted five tenants from one of his residential properties and it had taken five to six months to move them out. *See* Transcript of 8/3/10 hearing, page 10, lines 2-11. But the disclosure statement reflects that four evictions were still in progress. Disclosure Statement filed 9/13/10, Exhibit 4.

Second, the bankruptcy court found there was cause to dismiss under § 1112(b)(4)(J) because the Washingtons failed to timely submit an amended plan that included all of the information required by the bankruptcy court. Order at 6. As previously discussed, the bankruptcy court found that the administrative deficiencies indicated an inability by the Washingtons to place a confirmable plan before the court. The bankruptcy court's finding that any plan was likely to be followed by liquidation was supported by the Washingtons' inability to timely pay the quarterly fees, inability to timely pay an adequate protection payment until funds cleared, inability to pay expenses without using funds from Mr. Washington's retirement account, and inability to retain employees due to insufficient funds. *See* Transcript of 9/14/10 hearing, pages 35 - 36; pages 63 - 64; 43; 86, respectively.

The bankruptcy court also found there was no cause for dismissal under section 1112(b)(4)(F) (failure to satisfy timely reporting requirements) because, although the Washingtons had problems complying with filing and reporting requirements in the past, they were now current. Order at 5. Finally, because the Washingtons' assets were fully secured, the bankruptcy court held it was in the best interests of the creditors and the estate to dismiss the case rather than convert it to one under chapter 7. Order at 6.

SUMMARY OF THE ARGUMENT

The bankruptcy court did not abuse its discretion in ruling that cause had been shown for dismissing the Washingtons' case. The bankruptcy court had broad discretion in finding cause, and substantial evidence supports its decision. The bankruptcy court did not clearly err in finding that there was cause to dismiss under § 1112(b)(4)(J) because the Washingtons failed to timely submit a plan that was confirmable and/or not likely to followed by liquidation. Alternatively, the bankruptcy court did not clearly err in finding that there was cause to dismiss under § 1112(b)(4)(A) because the Washingtons were operating at a net loss, and had no opportunity or resources to develop new business. Therefore, the bankruptcy court's order dismissing the Washingtons' case should be affirmed.

ARGUMENT

I. The bankruptcy court did not abuse its discretion in dismissing the Washingtons' bankruptcy case for cause under § 1112(b)(4).

Under § 1112(b), a bankruptcy court may dismiss a chapter 11 bankruptcy case "for cause" if there are no "unusual circumstances" that establish that dismissal "is not in the best interests of the creditors and the estate." § 1112(b). Section 1112(b)(4) sets forth a list of 16 examples of what could constitute cause, "including — (A) substantial or continuing loss to or diminution of the estate and the absence of a reasonable likelihood of rehabilitation" and "(J) failure to file a disclosure statement, or to file or confirm a plan, within the time fixed . . . by the court." §§ 1112(b)(4)(A), (J). "[T]his list is illustrative, not exhaustive." *C-TC 9th Ave. P'ship* *v. Norton Co. (In re C-TC 9th Ave. P'ship)*, 113 F.3d 1304, 1311 (2d Cir. 1997); § 102(3) (stating that "including" is "not limiting" in the Bankruptcy Code).

Courts are given broad discretion in determining what may constitute sufficient cause for the dismissal or conversion of a case. *Jackson v. United States*, 131 F.3d 134 (4th Cir. 1997).

Here, the record provides ample basis for the bankruptcy court's finding cause to dismiss the Washingtons' bankruptcy case.

A. The bankruptcy court did not commit clear error in finding that cause for dismissal exists under section 1112(b)(4)(J).

Section 1112(b)(4)(J) provides that cause for dismissal exists if the debtor fails to file or confirm a disclosure statement or plan within the time fixed by this title or by order of the court. § 1112(b)(4)(J). "[A] debtor cannot wallow in chapter 11. The debtor must prosecute his or her case to a prompt and successful conclusion." *In re Tornheim*, 181 B.R. 161, 164 (Bankr. S.D.N.Y. 1995). A court may dismiss a case "if the debtor lacks the ability to formulate a plan or to carry one out." *Id.*; *see, e.g.*, *In re J.D. Mfg., Inc.*, No. 07-36751, 2008 WL 4533690, at *4 (Bankr. S.D. Tex. Oct. 2, 2008) (finding cause to dismiss based upon the debtor's failure to comply with the basic requirements of a disclosure statement and failure to make amendments as directed by the court).

Here, the local rules require the debtor to file a plan and disclosure statement within 180 days of the date the bankruptcy case is filed. SCLBR 3016-1(a). If the disclosure statement or reorganization plan are not confirmed, the failure to timely comply and correct the deficiency may constitute grounds for dismissal. SCLBR 3016-1(c).

The Washingtons filed a disclosure statement and plan within 180 days of the filing of their bankruptcy case, but they later admitted that the disclosure statement could not be approved as it was filed. *See* Transcript of 8/3/10 hearing, page 6, lines 1-3. The Washingtons were given an extra month to fix the deficiencies with their disclosure statement and obtain an independent appraisal for their properties. *See* Docket Text Entries 79, 85. But they never filed an amended disclosure statement to correct the deficiencies. *See* Transcript of 8/3/10 hearing, page 5, lines 15-16.

Mr. Washington had excuses and justifications for the delay. He testified at the August 3, 2010, hearing that he had engaged an appraiser named Mr. Hendrix and "I've paid him over $2,200 on a $4,500 debt of the appraisals." *See* Transcript of 8/3/10 hearing, page 12, lines 7-17. Mr. Washington selected Mr. Hendrix because he had previously conducted an appraisal on one of their residential properties (7602 Hunt Club). However, Mr. Hendrix could not appraise commercial property, and Mr. Washington found the amount quoted by the appraiser Mr. Hendrix located to be too high. Therefore, Mr. Washington located another person (Boston McLean) to conduct the appraisals on the commercial property. *See* Transcript of 9/14/10 hearing, page 42, lines 10 - 24.

Mr. Washington also claimed that the trouble with his financial reporting was due to his accountant. *See* Transcript of 8/3/10 hearing, pages 14-15. Mr. Washington testified that he had hired Yvette Jones with Jones Financial Company to prepare the monthly operating reports because he was back and forth from the Mayo Clinic. *See* Transcript of 9/14/10 hearing, page 35. However, Ms. Jones was unable to timely provide the reports to him despite several conversations regarding the need to have them completed by the 16th of each month. *See*

Transcript of 9/14/10 hearing, pages 40 - 41. Mr. Washington engaged RBJ, an accounting firm, but when the bankruptcy court noted its concern regarding the use of a professional which had not been approved by the bankruptcy court, Mr. Washington decided not to engage them. *See* Transcript of 9/14/10 hearing, page 41. Ultimately Mr. Washington completed the August 2010 monthly operating report himself, but it contained various errors that Mr. Washington acknowledged. *See* Transcript of 9/14/10 hearing, page 46.

But none of this suggested, in any tangible way, how the Washingtons would ever propose a workable chapter 11 reorganization plan. In fact, it causes greater concern about Mr. Washington's capabilities. At the end of the August 3, 2010, hearing the bankruptcy court voiced concern about the Washingtons retaining and paying professionals without court approval as required by § 327 of the Bankruptcy Code, which evidenced that Mr. Washington was not administering the bankruptcy estate in conformity with the Bankruptcy Code. The bankruptcy court stated at the end of the August 3, 2010 hearing, "[I]f rules aren't followed with respect to financial disclosure and professional employment, I think it's going to make it very much more difficult to defeat a motion to dismiss the case." *See* Transcript of 8/3/10 hearing, page 23. Oddly, at the September 14, 2010, hearing Mr. Washington testified he had never paid either party any money. *See* Transcript of 9/14/10 hearing, page 87, line 20.

At the August 3, 2010, hearing the Washingtons were given an opportunity to file a new disclosure statement prior to the hearing on the motion to dismiss on September 14, 2010. *See* Transcript of 8/3/10 hearing, page 22, lines 8-5. The bankruptcy court cautioned them to do so "quickly" to provide enough time for it to be circulated and offer people an opportunity to object to it. *Id.*; *see* § 1125(b) (requiring notice and hearing before the court may approve a disclosure statement).

The Washingtons filed a new disclosure statement at 10:39 pm on September 13, 2010. *See* Disclosure Statement filed 9/13/10, page 1 (ECF Timestamp). Such timing was not sufficient to allow creditors and parties in interest to review the disclosure statement. Moreover, the disclosure statement provided the same treatment for South Carolina Community Bank, who had objected to the plan filed on April 30, 2010[3], paid unsecured creditors over a 25-year period, and included information on revenues which were not supported by Mr. Washington's testimony.

The Washingtons filed a disclosure statement they knew was insufficient, and then failed to timely correct their disclosure statement, despite receiving two extensions. Therefore, the bankruptcy court was well within its discretion in finding cause to dismiss the Washingtons' case under § 1112(b)(4)(J) (providing cause upon the failure to timely file a disclosure statement).

B. Alternatively, the bankruptcy court did not commit clear error in finding that cause for dismissal exists under section 1112(b)(4)(A).

A bankruptcy court may find cause to dismiss a case under section 1112(b)(4)(A) when two criteria are met: (1) continuing loss or diminution of the estate and (2) the absence of a reasonable likelihood of rehabilitation. § 1112(b)(4)(A). The purpose of this section "is to preserve estate assets by preventing the debtor in possession from gambling on the enterprise at

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[3] *See* South Carolina Community Bank Objection to Confirmation filed May 10, 2010, Docket Entry #63.

the creditors' expense when there is no hope of rehabilitation." *Loop Corp. v. U.S. Trustee*, 379 F.3d 511, 516 (8th Cir. 2004). The Washingtons' case satisfies both criteria.

1. Continuing Loss or Diminution to the Estate

"To determine whether there is a continuing loss to or diminution of the estate, a court must make a full evaluation of the present condition of the estate, not merely look at the debtor's financial statements." *In re AdBrite Corp.*, 290 B.R. 209, 215 (Bankr. S.D.N.Y. 2003). "The absence of a reliable source of income together with the inability to pay current expenses is sufficient to show continuing loss." *In re Quail Farm, LLC*, No. 09-298, 2010 WL 1849867, at *3 (Bankr. N.D. W.Va. May 5, 2010).

With respect to this factor, the bankruptcy court found that the Washingtons' estate "continues to operate at a loss if all operating expenses and mortgage obligations are paid." Order at 4. The Washingtons contend this finding was erroneous because their monthly operating reports showed an increase in income. Appellant's Br. at 7. But they are wrong because they ignore the inconvenient, and uncontested, fact that the monthly operating reports showed inflated net income by failing to account for a number of off-the-book expenses.

The Washingtons' monthly operating reports stated the following expenses and net income:

Month	Expense	Net Income
November 2009	$11,335.87	-$5,718.87
December 2009	$4,126.59	$1,490.41
January 2010	$4,152.22	$1,152.78
February 2010	$6,772.98	$337.02

March 2010	$8,216	$29
April 2010	$8,466	$29
May 2010	$7,968	$527
June 2010	$14,391	$5,110
July 2010	$24,834	$2,202
August 2010	$19,595	$4,177

This computation of income and expenses does not include all expenses incurred. Mr. Washington testified that he made several payments to creditors which were not reflected on the monthly operating reports. For example, Mr. Washington testified that the first mortgage payment on his home, for $515 or $525, would not have been on any of the monthly operating reports. *See* Transcript of 9/14/10 hearing, pages 82-84.

Mr. Washington also explained that he had spent around $8,000 in maintenance costs. *See* Transcript of 8/3/10 hearing, page 16, lines 18-21. But a review of the monthly operating reports (MOR) only show $3,688 in maintenance and repairs, installation and similar items, leaving $4,312 in undisclosed expenses. *See* amended August MOR--window $50 and 1815 maintenance $80; July MOR--repairs and maintenance $850, deposit installation $739, upfit to rent out $800; June MOR--repairs and maintenance $450; May MOR--repairs and maintenance $121; April MOR--repairs and maintenance $99; March MOR--repairs and maintenance $125; February MOR--repairs and maintenance $99; and December MOR--thermostat $275.

In addition, Ms. Smoak, a bankruptcy analyst for the United States Trustee, testified that the Washingtons made other allowed payments to creditors that were not included in the monthly operating reports: $1,250 for February 2010, $400 for April 2010, $400 for May 2010, and $276 for May 2010. *See* Transcript of 9/14/10 hearing, pages 22-23. These payments totaled $7,476.

Furthermore, despite the increase in net income, Mr. Washington's conduct evidences a continuing loss to the estate. Mr. Washington had to use part of the $5,400 he borrowed from his 401k retirement account to cover expenses. *See* Transcript of 9/14/10 hearing, pages 43-45. Mr. Washington also delayed paying one of the adequate protection payments so the check would not bounce while waiting for funds to clear. *See* Transcript of 9/14/10 hearing, pages 63 -64.

The bankruptcy court is entitled to rely upon the entirety of the record and is not required to rely solely upon the Washingtons' financial statements. *AdBrite*, 290 B.R. at 215. And here, the entirety of the record shows that all these undisclosed expenses exceeded the net income reflected on the monthly operating reports. Despite operating under the protection of the Bankruptcy Code for nine months, the Washingtons' generated net income of $15,054.21, but had net expenses of $17,506.87, leaving a cumulative $2,452 deficit. Therefore, the bankruptcy court did not commit clear error in finding a continuing loss to the estate. Order at 4.

<u>2.</u> **<u>Absence of a Reasonable Likelihood of Rehabilitation</u>**

Rehabilitation has consistently been understood to "refer to the debtor's ability to restore the viability of its business." *Loop,* 379 F.3d at 516. This contemplates the successful maintenance or re-establishment of business operations. *Douglas Asphalt Co. v. Walton (In re Douglas Asphalt Co.),* No. 510-055, 2010 WL 4777534, at *3 (S.D. Ga. Nov. 16, 2010).

When making this determination, a bankruptcy court need not "blindly accept" a debtor's mere optimism about the prospects of reorganization based on speculation. *Loop,* 379 F.3d at

518. Instead, a court should assess the evidence critically, in light of the debtor's history on the record. *Id.* And that is what the bankruptcy court did.

Here, the bankruptcy court found that the Washingtons did not "have a realistic prospect of reorganizing their financial affairs." Order at 4. The bankruptcy court's finding was based on: (1) "Mr. Washington's efforts to handle the ordinary daily operation of CPI detract from his developing new business;" (2) Mr. Washington has "several tenants who have not been paying rent and cannot count upon potential new tenants in light of his previous testimony "concerning potential new tenants who failed to take occupancy and pay rent;" (3) the Washingtons' "substantial debt" as reflected by the bankruptcy schedules; and (4) Mrs. Washington's ongoing, significant medical expenses. Order at 4.

The Washingtons argue this finding was clearly erroneous because the bankruptcy court ignored that they were "making more money" and had "improved efficiency,"and was "speculating" about Mr. Washington's ability to run the business in the future. Appellant's Br. at 10. This argument, however, ignores Mr. Washington's own testimony, which fully supports the bankruptcy court's findings, as follows.

First, Mr. Washington testified that the "core" of his ability to reorganize was the income from operating CPI. *See* Transcript of 9/14/10 hearing, page 59, lines 9-13. Moreover, Mr. Washington testified that CPI could not make money if he was not working there. *See* Transcript of 9/14/10 hearing, page 68, lines 4-7, page 84- 85, lines 19-25, lines 1-4. Mr. Washington also testified that he would make substantially more money if he had a team to work for him, but he could not employ anyone because "I was in such bad shape." *Id.* Mr. Washington terminated employees of CPI “to make it feasible to make payments that I need to make to everybody that I owe.” *See* Transcript of 9/14/10 hearing, page 86, lines 10-18.

But that left Mr. Washington overburdened with day to day operations. He testified, “I am doing everything now. I don’t have the employee, I don’t have – I am doing it. So, from 6:00 am in the morning to around 7:30 pm at night, that’s where I’m at . . . running – you know, going to different site visits.” *See* Transcript of 9/14/10 hearing, page 60, lines 20-24. As the bankruptcy court correctly observed, “Mr. Washington’s efforts to handle the ordinary daily operation of CPI detract from his developing new business.” Order at 4.

Despite these efforts and the increased income, the monthly operating reports show — and perhaps understate — that while the Washingtons’ income increased from June through August, their expenses also increased. Expenses were 74%, 92%, and 82% of the income respectively, with the highest income month having the corresponding highest percentage of expenses (92%), contradicting the Washingtons’ belief in their increased efficiency.

Mr. Washington admits that he has done everything he can to reduce expenses and increase income. *See* Transcript of 8/3/10 hearing, page 16, lines 23-24. Yet Mr. Washington still could not meet all of his financial obligations on time. For instance, he had to delay making a payment to one of his creditors so the check would not bounce while waiting for funds to clear. *See* Transcript of 9/14/10 hearing, pages 63 -64. And the Washingtons presented no evidence that they would be able to hire employees in the future to further increase revenues.

Second, the record shows it is unlikely that the Washingtons will be able to collect the rents that they rely upon in their disclosure statement. That is because Mr. Washington included rent from tenants that he could not collect or had inflated the revenue he expected to receive.

In discussing sources of revenues to the fund the plan, the third exhibit of the disclosure statement includes $7,229 for rental income from the Gervais Street properties. Disclosure Statement filed 9/13/10, Exhibit 3. But the Washingtons admit that they have only collected $3,537 from these tenants. *See* August monthly operating report and Transcript of 9/14/10 hearing, page 75, lines 10-13. For example, Mr. Washington had included a new tenant who had not yet taken possession of the premises due to her husband's hospitalization and that she was still trying to obtain a loan. *See* Transcript of 9/14/10 hearing, pages 56-57. Mr. Washington testified that the "$3,000 a month for the bottom [floor] being rented, that should have happened already, but I can't make a person do anything." *See* Transcript of 9/14/10 hearing, page 71, lines 17 - 19. He testified that the new tenant would begin making $200 or $300 per month payments in September for storage. *See* Transcript of 9/14/10 hearing, page 65, lines 8 - 14.

Mr. Washington further testified that he had a new lease with a doctor's office for $1,250 per month, but the rent reflected on the third exhibit of the disclosure statement shows rent starting at $600 per month and not increasing to $1,250 per month until October 2011. *See* Transcript of 9/14/10 hearing, page 56, lines 11 - 13; Disclosure Statement filed 9/13/10, Exhibit 3. He also stated that he had evicted five tenants from one of his residential properties and it had taken five to six months to move them out. *See* Transcript of 8/3/10 hearing, page 10, lines 2-11. But the September 13, 2010, disclosure statement reflects that four evictions were still in progress. Disclosure Statement filed 9/13/10, Exhibit 4.

Third, the record shows that the Washingtons have little equity in their property that they could use to revitalize their business. According to their bankruptcy schedules, their rental properties are fully secured. *See* Schedule A - Real Property.

Fourth, Mr. Washington testified that Mrs. Washington has significant medical expenses that are likely to be ongoing and are not covered by insurance. *See* Transcript of 9/14/10 hearing, pages 52-53; page 61, lines 18-24. This will cause a further burden on Mr. Washington's time and on the family's finances, as the Washingtons have been "running up and down the road to Florida . . . to have special tests done." *See* Transcript of 9/14/10 hearing, page 52, lines 24-25. This evidences another reason why the Washingtons would have substantial difficulty reorganizing their business affairs.

Thus, the record fully supports the bankruptcy court's purported "speculation" about Mr. Washington's ability to revitalize his business prospects. The bankruptcy court was not required to accept Mr. Washington's optimistic testimony regarding his ability to increase his profits and fund a reorganization plan. *Loop*, 379 F.3d at 518; *see* Transcript of 9/14/10 hearing, page 95, lines 11-21 ("Mr. Washington is always very optimistic about the future. And always seems to have something just on the horizon that's going to cure the problem."). Instead, the record shows that the estate continued to operate at a loss and that Washingtons did not prove that they had a reasonable prospect of reorganization. Therefore, the bankruptcy court did not abuse its discretion when it found cause to dismiss the Washingtons' bankruptcy case.

II. The bankruptcy court did not abuse its discretion by failing to hold a separate hearing on the Washingtons' new disclosure statement.

The Washingtons contend that because the bankruptcy court did not wait "about two months" and hold an independent hearing on their new disclosure statement, they were not given a reasonable opportunity to demonstrate their newfound viability and to seek approval of their newly filed disclosure statement prior to dismissal. Appellant's Br. at 12-13. They are wrong.

Section 1112(b) provides that “after notice and a hearing” the court may dismiss a case under this chapter. § 1112(b). The Bankruptcy Code defines “notice and a hearing” as “notice as is appropriate in the particular circumstances, and such opportunity for a hearing as is appropriate in the particular circumstances.” § 102(1)(A). Additionally, the Bankruptcy Code “authorizes an act without an actual hearing if such notice is given properly and if such a hearing is not requested timely by a party in interest.” § 102(1)(B)(I).

Within the Fourth Circuit, a bankruptcy court need not always hold an independent evidentiary hearing prior to the entry of a § 1112(b) order. *Finney v. Smith (In re Finney)*, 992 F.2d 43, 46 (4th Cir. 1993). An additional hearing is not necessary when the record shows that a party already had an “adequate opportunity” to address the issue before the bankruptcy court. *Id.* The Fourth Circuit described that “adequate opportunity” as “at least a day’s notice . . . along with an opportunity to respond (although not necessarily an independent hearing).” *Id*. Other circuits agree. *See, e.g.*, *Loop Corp. v. U.S. Trustee*, 379 F.3d 511, 516 (8th Cir. 2004); *C-TC 9th Ave. P'ship v. Norton Co. (In re C-TC 9th Ave. P’ship)*, 113 F.3d 1304, 1312 (2d Cir. 1997); *Sullivan Cent. Plaza I, Ltd. v. Bancobost Real Estate Capital Corp. (In re Sullivan Cent. Plaza I, Ltd.)*, 935 F.2d 723, 727 (5th Cir. 1991).

The bankruptcy court did not err by entering the dismissal order in this case. First, the Washingtons never requested additional time or a separate hearing from the bankruptcy court. Because they did not raise this issue below, the argument has been waived on appeal. *Dee-K Enter., Inc. v. Heveafil Sdn. Bhd.*, 299 F.3d 281, 289 (4th Cir. 2002) (holding that an argument not pursued in the trial court had been waived on appeal).

Second, the Washingtons' argument still fails on the merits. When the bankruptcy court disapproved their disclosure statement at the hearing on August 3, 2010, the court informed the Washingtons that it would consider the viability of a new disclosure statement in tandem with the United States Trustee's motion to dismiss, which would be at least 20 days in the future. *See* Transcript of 8/13/10 hearing, page 22, lines 3, 18-19. The Washingtons filed a new disclosure statement, Mr. Washington testified, and their counsel had a full and fair opportunity to argue at the hearing on the motion to dismiss.

Therefore, the Washingtons had an "adequate opportunity" to develop the record and address the issue before the bankruptcy court. *Finney*, 992 F.2d at 46. The bankruptcy court was not required to wait another two months to see if Mr. Washington's optimistic projections would finally materialize. *C-TC 9th Ave. P'ship*, 113 F.3d at 1312 ("When the record is sufficiently well developed to allow the bankruptcy court to draw the necessary inferences to dismiss a Chapter 11 case for cause, the bankruptcy court may do so.").

CONCLUSION

For these reasons, the United States Trustee respectfully asks this Court to affirm the order entered below.

W. Clarkson McDow, Jr.
United States Trustee, Region 4

By: s/ Linda K. Barr
Linda K. Barr, Id. 6284
Trial Attorney
Office of the United States Trustee
1835 Assembly Street, Suite 953
Columbia, South Carolina 29201
(803) 765-5219
(803) 765-5260 (facsimile)
linda.k.barr@usdoj.gov

January 18, 2011

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF SOUTH CAROLINA

In re

Gary A. Washington and
Michele A. Washington,

Debtors.

_________________________________/

Gary A. Washington and
Michele A. Washington,

C/A No. 3:10-3061-CMC-JRM

Appellants.

vs.

On appeal from the United States
Bankruptcy Court for the District
of South Carolina, Case No. 99-8248

W. Clarkson McDow, Jr.,
United States Trustee for
Region 4,

Appellee.

_________________________________/

CERTIFICATE OF SERVICE

I hereby certify that on January 18, 2011, I electronically filed the foregoing document with the Clerk of the Court using the ECF system; and I hereby certify that I have mailed by United States Postal Service the document to the following, including, any non-ECF participants:

Gary A. Washington
1324 Furman Drive
Sumter, South Carolina 29154-1420

Michelle A. Washington
1324 Furman Drive
Sumter, South Carolina 29154-1420

W. Clarkson McDow, Jr.
United States Trustee, Region 4

By: s/ Linda K. Barr
Linda K. Barr, Id. 6284
Trial Attorney
Office of the United States Trustee
1835 Assembly Street, Suite 953
Columbia, South Carolina 29201
(803) 765-5219
(803) 765-5260 (facsimile)
linda.k.barr@usdoj.gov

January 18, 2011

BRIEF BANK — 'SUMMARY SHEET" Printed Thu-9/16/04 9:14

WESTLAW CODES

1. ("TI") TITLE OF CASE [E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]
Weinschneider v. Hoseman (In the Matter of Weinscheinder)

2. ("CO") CURRENT COURT [E.g., "CTA9"]
CTA7

3. ("CCN") CURRENT CASE NO.
No.: 04-1828

4. ("PCN") PRIOR CASE NO. & COURT [IF ANY]
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Court: D Ill.
(Identify judge & cite, if any)

5. ("SO") SOURCE
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7. ("AU") PRINCIPAL AUTHORS & OFFICE [E.g.,"UST/OGC"]
Teal Miller, Esq., Appellate Staff, Civil Division, DOJ
P. Matthew Sutko, Esq., EOUST/DOJ
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") TOPIC
BANKRUPTCY

9. ("SU") ! SUMMARY OF KEY ISSUE(s) & √ Any Miscellaneous BACKGROUND

! Whether appellant can recover attorney's fees and expenses from a bankruptcy estate under § 503(b)(1)(A).

Whether, as a matter of ILL. Law, appellant can recover attorney's fees and expenses as damages for the breach of covenant not to sue even though the covenant does not provide for them.

Whether, if appellant has a valid claim, that claim is entitled to priority under § 503 and 507 of the Bankruptcy Code.

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No. 04-1828

IN THE UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

In the Matter of
SIDNEY WEINSCHNEIDER, Debtor,

SIDNEY WEINSCHNEIDER, Appellant

v.

DANIEL HOSEMAN, Trustee of the Estate
of Sidney Weinschneider, Appellee.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS

BRIEF FOR THE UNITED STATES TRUSTEE

IRA BODENSTEIN
United States Trustee

P. MATTHEW SUTKO
Executive Office for
United States Trustees
Department of Justice
20 Massachusetts Ave., N.W.
Washington, DC 20530

CONSTANTINE HAVALIS
Office of the U.S. Trustee
Chicago, IL

PETER D. KEISLER
Assistant Attorney General

WILLIAM KANTER
202-514-4575
TEAL LUTHY MILLER
202-514-5048
Attorneys, Appellate Staff
Civil Division, Room 9607
Department of Justice
601 "D" Street, N.W.
Washington, D.C. 20530-0001

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No. 04-1828

In the Matter of
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SIDNEY WEINSCHNEIDER, Appellant

v.

DANIEL HOSEMAN, Trustee of the Estate
of Sidney Weinschneider, Appellee.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS

BRIEF FOR THE UNITED STATES TRUSTEE

JURISDICTIONAL STATEMENT

The jurisdictional statement in appellant's brief is correct, but incomplete. It omits mention of the date of filing of the notice of appeal, as required by Circuit Rule 28(a)(2)(IV). The district court's final judgment was entered on March 10, 2004. WA-36.[1] The appellant's notice of appeal was filed on March 31, 2004. See Dist. Ct. docket number 15.

As required by Circuit Rule 28(a)(3)(iii), the United States Trustee notes that the district court's decision did not remand

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[1] Citations to "WA" are to the appendix attached to the Brief for the Appellant.

the case to the bankruptcy court for further consideration, and its judgment is a final appealable order.

STATEMENT OF THE ISSUES PRESENTED FOR REVIEW

In a prior appeal, this Court held that a release and covenant not to sue between trustee Daniel Hoseman and debtor Sidney Weinschneider barred the trustee from suing for a declaration that certain property belonged to the bankruptcy estate, and that the trustee could not prove that the release and covenant were fraudulently induced. Although Weinschneider supported the trustee's motion for authorization to bring the declaratory action, Weinschneider now seeks to recover his attorney's fees and costs for defending the trustee's suit as damages for breach of contract.

The questions presented are:

1. Whether appellant Sidney Weinschneider can recover attorney's fees and expenses from the bankruptcy estate under Section 503(b)(1)(A) of the Bankruptcy Code.

2. Whether, as a matter of Illinois law, Weinschneider can recover attorney's fees and expenses as damages for the breach of the covenant not to sue even though the covenant does not provide for them.

3. Whether, if Weinschneider has a valid contract claim, that claim is entitled to priority under Sections 503 and 507 of the Bankruptcy Code.

STATEMENT OF THE CASE

I. Course Of Proceedings Below

In Hoseman v. Weinschneider, 322 F.3d 468, 470 (7th Cir. 2003), this Court determined that a release and covenant not to sue barred the trustee of appellant's bankruptcy estate from seeking a declaration from the bankruptcy court whether a certain legal claim was property of the estate. After that decision, appellant sought to collect his attorney's fees and expenses from defending the declaratory action as administrative expenses of the bankruptcy estate. The bankruptcy court and the district court rejected his claim for fees. See WA-19; WA-23; WA-27. This appeal followed.

II. Statutory Background

1. The United States Trustees supervise the administration of bankruptcy cases and the conduct of case trustees within specified geographic regions. See 28 U.S.C. § 581-589. The Bankruptcy Code provides that "[t]he United States trustee may raise and may appear and be heard on any issue in any case or proceeding under this Title." 11 U.S.C. § 307. Congress also has specifically directed United States Trustees to "review[] *** applications filed for compensation and reimbursement under section 330 of title 11[] and *** [to] fil[e] with the court" any "objections to such application." 28 U.S.C. § 586(a)(3)(A)(i) and (ii).

The United States Trustee also has authority to appoint a case trustee for a bankruptcy estate. See 11 U.S.C. §§ 701(a) and 702(d). In a chapter 7 bankruptcy, the case trustee's duties include the duty to "collect and reduce to money the property of the estate." 11 U.S.C. § 704(1).

2. Section 507 of the Bankruptcy Code provides that the administrative expenses of a bankruptcy estate have priority over other claims. See 11 U.S.C. § 507(a)(1) ("administrative expenses allowed under section 503(b) of this title" shall be paid "first"). Section 503(b), in turn, specifies what expenses should be allowed as administrative expenses. See 11 U.S.C. § 503. Those administrative expenses include, as relevant here, "the actual, necessary costs and expenses of preserving the estate, including wages, salaries, or commissions for services rendered after the commencement of the case," 11 U.S.C. § 503(b)(1)(A), and "compensation and reimbursement awarded under section 330(a) of this title," 11 U.S.C. § 503(b)(2).

III. Statement Of The Facts

Appellant Sidney Weinschneider operated and partially owned nursing homes in the Chicago area. See Hoseman v. Weinschneider, 322 F.3d 468, 470 (7th Cir. 2003). In 1989, he sought protection under the debt reorganization provisions of chapter 11 of the Bankruptcy Code, 11 U.S.C. § 1101, et seq. See Hoseman, 322 F.3d at 471. In 1990, Weinschneider's chapter 11 case was converted to a chapter 7 case. See id. The United States Trustee appointed appellee Daniel Hoseman as trustee of the Weinschneider estate, as provided in 11 U.S.C. § 704. See id. This case concerns Weinschneider's claim for attorney's fees and expenses from his defense of a suit brought against him by the trustee.

In December 1996, the trustee executed a release and covenant not to sue on behalf of the Weinschneider estate. See Hoseman, 322 F.3d at 471.[2] The release "remise[d], release[d] and forever discharge[d] all claims, known or unknown, against [Weinschneider, his wife, and certain trusts]." Id. The covenant barred the trustee from "instituting, prosecuting or participating in any suit or action, at law or in equity, or to take any action to collect, enforce or recover on any claim, known or unknown, which the [bankruptcy estate] may, could or have against [Weinschneider, his wife, and certain trusts]." Id. In return, Weinschneider and others surrendered property worth one million dollars to the bankruptcy estate. See id.

In February 1996, Weinschneider filed a breach of contract action in Illinois state court against G.W. Burton and associates (Burton), claiming a stake in Burton's nursing home management operation. See id. Burton answered Weinschneider's second

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[2] The trustee executed the release and covenant pursuant to the settlement of a 1992 action brought against Weinschneider by the Official Unsecured Creditors' Committee. See Hoseman, 322 F.3d at 471.

amended complaint with the assertion that the claim belonged to the chapter 7 bankruptcy estate, and not to Weinschneider. See Exhibit A, Answer and Objection to Debtor's Application for Allowance and Payment of Administrative Expense Claims, Bankr. Ct. docket number 389. In September 1997, the state court ordered that it would defer adjudicating Weinschneider's complaint while Weinschneider brought the question of the claim's ownership to the bankruptcy court. See id., Exhibit B.

Although Weinschneider amended his Bankruptcy Schedule B-3 in 1995 to disclose the claim against Burton, see Hoseman, 322 F.3d at 471-72, Weinschneider did not inform the bankruptcy court or the trustee of his Illinois suit when he filed it. See WA-28. Indeed, the trustee did not learn about the suit until after he had executed the release and covenant not to sue. See Hoseman, 322 F.3d at 472 (suit filed in February 1996); id. at 471 (release and covenant executed in December 1996); 1a (letter informing trustee of Illinois suit dated October 1997). In October 1997, after Burton had asserted in the state court proceeding that the claim belonged to the bankruptcy estate, Weinschneider asked the trustee to sign an affidavit concluding that the interest in Burton was not part of the bankruptcy estate. See 1a-7a.[3] The trustee did not sign the affidavit.

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[3] Citations to a number followed by "a" are to the appendix bound with this brief.

In order to settle the ownership of the claim, the trustee filed an application with the bankruptcy court to employ attorneys on a contingency basis to seek a declaratory judgment that the claim was property of the bankruptcy estate. See 8a-13a; see also 11 U.S.C. § 704(1) (requiring trustees to "collect and reduce to money the property of the estate"). The application to the court proposed to file an adversary complaint against Weinschneider for a declaratory judgment "that Sidney Weinschneider's interest in the pending State Court litigation is property of his Bankruptcy Estate pursuant to 11 U.S.C. 541, and if successful, to pursue Debtor's claim against G.W. Burton." See 10a.

Weinschneider supported the trustee's request to retain counsel to sue him. See 14a-19a. Weinschneider agreed that "[e]xpedited resolution of the Trustee's rights is appropriate in view of Mr. Weinschneider's age (68) and the need to stop the [state court] defendants from unfairly exploiting bankruptcy issues in the state court case." 15a. His prayer for relief asked the court for the entry of an order:

> 1. Granting the Trustee's application to retain counsel on a contingent fee basis, but limiting the scope of authority to retain counsel to the prosecution or defense of an adversary proceeding in this Court for the purpose of determining the rightful owner of the claim asserted in Weinschneider v. G. W. Burton & Associates Ltd, et al., Case No. 96 L 1371, Circuit Court of Cook County, Illinois;

> 2. Requiring the Trustee to file an adversary proceeding before this Court to determine ownership of said claim on or before February 28, 1998.

Id. at 18a. Weinschneider did not contend that the proposed action would violate the release and covenant not to sue between Weinschneider and the trustee. See 14a-19a.

The bankruptcy court granted the trustee's motion for authorization to file suit against Weinschneider, ordering that "[t]he trustee shall file his adversary complaint seeking a determination of the ownership of Sidney Weinschneider's claim against [Burton] on or before February 27, 1998." 27a. The trustee brought a timely suit pursuant to this authorization. See Hoseman, 322 F.3d at 472.

Weinschneider defended the trustee's action on the ground that his state claim arose after he filed for bankruptcy and therefore was not part of the bankruptcy estate. See id. He also contended, for the first time, that the trustee's declaratory judgment action was barred by the release and covenant not to sue. See id. The trustee responded that the release and covenant were void because Weinschneider fraudulently induced their execution by failing to disclose the full extent of his interest in Burton before the trustee executed them, including the breach of contract action. See id.

The bankruptcy court ruled that Weinschneider's lawsuit was the property of the bankruptcy estate and that Weinschneider fraudulently induced the trustee's execution of the release and covenant. See id. The district court reversed, holding that the release and covenant not to sue were not fraudulently induced by Weinschneider and that those documents, by their terms, barred the trustee's suit. See id. at 473.

This Court affirmed the district court, concluding that the release and covenant not to sue barred the declaratory action. See id. at 473. It sustained the district court's determination that the trustee had not met his burden of proving the second element of fraudulent inducement: that Weinschneider knew or believed that he was making a false statement when he asserted in June 1995 on his amended Schedule B-3 that his claim against Burton was acquired post-petition. Id. at 476-77.

After this Court's decision, Weinschneider filed a motion with the bankruptcy court requesting that the estate reimburse the attorney's fees and expenses that he incurred in defending the trustee's adversary proceeding as a first priority expense of the estate. See 29a-34a. Weinschneider averred that his fees and costs amount to more than $500,000. See 32a.

Weinschneider contended that his attorney's fees and expenses were administrative expenses under Section 503(b) of the Bankruptcy Code that were entitled to priority status under Section 507(a)(1). See 33a. According to Weinschneider, his attorney's fees and expenses constituted administrative expenses under Reading Co. v. Brown, 391 U.S. 471 (1968). That case interpreted the 1898 Bankruptcy Act, which, like section 503(b)(1)(A), treats "the actual and necessary costs and expense of preserving the estate subsequent to filing the petition" as administrative expenses, as allowing businesses adjoining a debtor's property to obtain administrative expense priority for damages negligently caused by the debtor while it was operating in bankruptcy. See Reading, 391 U.S. at 475; 485. The trustee and the United States Trustee opposed Weinschneider's application.

The bankruptcy court denied Weinschneider's motion to tax his fees and costs to the bankruptcy estate. See WA-19-22. The court rejected the argument that the contract provided for attorney's fees on the ground that "Illinois case law establishes that attorney's fees are not recoverable for breach of a covenant not to sue in the absence of specific language to that effect." WA-21. For that reason, the court found it unnecessary to decide whether the Reading doctrine might justify relief. See WA-21.

Weinschneider sought reconsideration, arguing that he was entitled to attorney's fees because the Illinois Supreme Court would interpret the covenant not to sue as authorizing fees. The court denied the motion, finding the authority that Weinschneider cited to be inapposite. See WA-23-25.

Weinschneider timely appealed the adverse merits ruling to the United States District Court for the Northern District of Illinois. By memorandum opinion and order entered March 10, 2004, the district court affirmed. See WA-27. The district court concluded that Weinschneider's contract-based fee claim failed under Illinois law because the covenant not to sue did not include an attorney's fee provision. See WA-30-32. The court also rejected Weinschneider's alternative argument that sections 503(b) and 507(a)(1) of the Bankruptcy Code constituted an independent basis for allowing recovery of a Chapter 7 debtor's attorney's fees. See WA-32-35. The court concluded the Reading doctrine was "inapplicable" because "[c]ourts applying the Reading doctrine have narrowed its reach to debts incurred as a result of a trustee's wrongful conduct, including 'tort-like' behavior, wilful statutory violations or initiation of frivolous litigation." WA-34 (emphasis in original). The district court determined there was "no indication that the Trustee's declaratory judgment action was frivolous or brought in bad faith. Rather, the Trustee advanced a good faith argument below that the covenant not to sue was fraudulently induced and . . . the bankruptcy court" ruled for the trustee before reviewing courts overturned that decision. WA-35. The court concluded by suggesting "[t]he estate should not be penalized for the Trustee's good faith execution of his duties." Id.

This appeal followed.

SUMMARY OF ARGUMENT

Weinschneider's attorney's fees and expenses do not qualify as administrative expenses under the Bankruptcy Code. This Court's decision in In re Milwaukee Engraving, Co., 219 F.3d 637 (7th Cir. 2000), makes clear that attorney's fees are not available under subsection 503(b)(1)(A), and may be obtained, if at all, under subsection (b)(2). And the Supreme Court's recent decision in Lamie v. United States Trustee, 124 S. Ct. 1023 (2004), makes clear that attorney's fees are available under subsection 503(b)(2) only when the attorney is employed under Sections 327 and 330 of the Code. Because Weinschneider's attorneys were not employed under Sections 327 and 330 of the Code, he is not entitled to attorney's fees.

Perhaps for this reason, Weinschneider characterizes his claim as a claim for damages "in the form of legal expenses and attorneys fees," rather than a direct claim for attorney's fees. See 29a. But his fees are damages only if he has a right to them under Illinois contract law. For this reason, his claim for fees is derivative of his Illinois contract claim, and he has no freestanding claim under the Bankruptcy Code.

Weinschneider does not have a valid claim to attorney's fees as contract damages under Illinois law. Neither the release nor the covenant not to sue provides for attorney's fees in the event of breach, and Illinois law does not award attorney's fees for breach of contract unless the contract explicitly provides for them. Moreover, Weinschneider's failure to raise the release and covenant when the trustee sought authorization to sue means that Weinschneider's argument for fees is barred by laches.

If this court nevertheless holds that Weinschneider is entitled to fees under Illinois law, those fees should not be given priority under section 503(b)(1)(A) and Reading Co. v. Brown, 391 U.S. 471 (1968). Because the trustee acted properly and Weinschneider is estopped from arguing otherwise by his own support for the trustee's motion for authorization to sue, because the claim is based in contract, not tort, and because the claim did not arise out of the ongoing operation of the debtor's business, Reading provides no basis for priority for the state law claim.

STANDARD OF REVIEW

The district court's decision depends on legal conclusions reviewable de novo. See Hoseman v. Weinschneider, 322 F.3d 468, 473 (7th Cir. 2003) (citing In re Image Worldwide, Ltd., 139 F.3d 574, 576 (7th Cir. 1998)).

ARGUMENT

I. Weinschneider Has No Freestanding Right To His Fees And Expenses Under The Bankruptcy Code.

Weinschneider suggests that he is entitled to fees as a matter of federal law under Reading Co. v. Brown, 391 U.S. 471 (1968), and Section 503 of the Bankruptcy Code independent of his state law contract claim. _See_ Brief for Appellants at 15-16. _Reading_ does not support that contention.

Reading considered the availability of tort damages under a provision of the 1898 Bankruptcy Act, which like Section 503(b)(1)(A) provided payment for "the actual and necessary costs and expense of preserving the estate subsequent to filing the petition."[4] _Reading_, 391 U.S. at 475. In _Reading_, a building owned by the debtor burned while the debtor was under the protection of a bankruptcy receivership. _See_ _id._ at 473. The owner of a building that neighbored the debtor's building claimed the damages that he suffered in the fire as administrative expenses. _See_ _id._ For purposes of deciding whether his claim would receive administrative priority, the court stated that it "would be assumed that the damage to petitioner's property resulted from the negligence of the receiver and a workman he employed." _Id_. at 474.

Reading held that the claim for damages was allowable as an "actual and necessary" expense of preserving the estate even

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[4] As relevant here, Section 64a provided that

> The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment shall be (1) the costs and expenses of administration, including the actual and necessary costs and expense of preserving the estate subsequent to filing the petition.

11 U.S.C. 104(a)(1) (repealed 1978).

though the negligence that led to the fire did not benefit the estate, because the receiver's operation of the business was an essential element of the debtor's rehabilitation. Reading, 391 U.S. at 485. But Reading did not recognize a freestanding right to payment under the 1898 Act. Instead, the Court assumed that the tort creditor in that case had a valid negligence claim against the trustee; the question was whether that claim qualified as an administrative expense entitled to priority. In this case, there is no basis for a similar assumption.

An award of administrative expenses to Weinschneider would be one of two things: a direct award of attorney's fees, or an award of contract damages in the form of attorney's fees.[5] The Supreme Court's recent decision in Lamie v. United States Trustee, 124 S. Ct. 1023 (2004), bars Weinschneider from collecting his fees directly as attorney's fees. That means that Weinschneider may obtain his fees from the estate only if he can show that they are contract damages that happen to take the form of attorney's fees. But in order to show that the fees are actually contract damages, Weinschneider has to show that he has a valid claim to contract damages under Illinois law.[6]

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[5] Weinschneider has not alleged a tort-based claim, or that he is entitled to recovery under any subsection of 503(b) other than subsection (b)(1)(A).

[6] The covenant not to sue in this case is governed by Illinois law. See Hoseman v. Weinschneider, 322 F.3d 468, 473 (7th Cir. 2003).

A. Lamie Bars Weinschneider From Collecting His Attorney's Fees As Attorney's Fees.

Section 503(B)(1)(A) is the catchall payment provision of Section 503. It permits generally "the [payment of] actual, necessary costs and expenses of preserving the estate, including wages, salaries, or commissions for services rendered after the commencement of the case," as administrative expenses. 11 U.S.C. § 503(b)(1)(A). Section 503(b)(2) is a more specific provision concerning the payment of compensation including attorney's fees as administrative expenses, and it limits those fees to "compensation and reimbursement awarded under section 330(a)." 11 U.S.C. § 503(b)(2).

Section 330(a), in turn, covers "reasonable compensation for actual, necessary services rendered by" an attorney employed under Section 327. 11 U.S.C. § 330(a). And Section 327 authorizes a trustee — and only a trustee — to employ an attorney "with the court's approval." 11 U.S.C. § 327. Sections 327 and 330, taken together, prohibit compensation awards to an attorney from a chapter 7 estate unless the attorney is employed as authorized by Section 327. See Lamie, 124 S. Ct. at 1032 ("[i]f the attorney is to be paid from estate funds under § 330(a)(1) in a chapter 7 case, he must be employed by the trustee and approved by the court" as required by Section 327). Weinschneider does not – and could not – show that his attorneys were employed as authorized under Section 327. See id.

The more specific provisions of Section 503(b)(2) control the more general provisions of Section 503(b)(1)(A). By "making express provision for employment [of attorneys] under § 327, payment under § 330, and priority under § 503(b)(2), the Code logically forecloses the possibility of treating § 503(b)(1)(A) as authority to pay (and give priority to) claims that do not meet its substantive requirements." In re Milwaukee Engraving Co., 219 F.3d 635, 636 (7th Cir. 2000) (citing In re Singson, 41 F.3d 316, 320 (7th Cir. 1994)); accord F/S Airlease II, Inc. v. Simon, 844 F.2d 99, 108-109 (3d Cir. 1988) (same); In re Keren Limited Partnership, 189 F.3d 86, 88 (2d Cir. 1999) (same). Accordingly, Weinschneider may not collect attorney's fees under Section 503(b)(1)(A).

B. Weinschneider's Claim For Fees As Contract Damages Depends On His Contract Claim.

Weinschneider's application for administrative expenses sometimes refers to his attorney's fees as "damages in the form of legal expenses and attorneys fees," rather than simply as attorney's fees. See 29a. But if they are damages, then they must be damages from breach of contract. The Bankruptcy Code does not create contract rights, and the breach of contract claim is a creature of Illinois law, not the Bankruptcy Code. See In re Sheridan, 174 B.R. 763, 767 (N.D. Ill. 1994) ("An administrative claim, like any claim, must be based on some legal duty and a corresponding right to payment.").

Weinschneider contends that Section 503(b)(1)(A) and Reading sometimes provide for an award of damages "without relying on state law," when fundamental fairness requires an award. See Brief for Appellants at 15. But whether or not that contention is correct (a question this Court need not decide), Weinschneider's particular claim does depend on state law; it arises out of the trustee's breach of the covenant not to sue. Weinschneider has not alleged a tort-based claim or suggested that he can collect damages under any provision of Section 503(b) other than 503(b)(1)(A). And Weinschneider has no argument that the trustee's action denied him fundamental fairness apart from his argument that the trustee violated his contractual obligations. Nothing in the Bankruptcy Code suggests that the trustee should have refrained from establishing whether the claim against Burton was property of the estate; to the contrary, the trustee's duties under the Code obligated him to pursue the declaratory action. See 11 U.S.C. § 704(1). Accordingly, Weinschneider has no claim independent of his contract claim that his fees are administrative expenses.

Weinschneider's argument that "fundamental fairness," by itself, can give rise to a right to payment of attorney's fees as attorney's fees under Section 503(b)(1)(A) is ultimately an effort to circumvent Lamie. See Lamie, 124 S.Ct at 1030 (stating that a "debtor's attorney not engaged as provided by § 327 is simply not included within the class of persons eligible for compensation"); Milwaukee Engraving, 219 F.3d at 637 ("One might as well erase § 503(b)(2) from the statute if attorneys may stake their claims under § 503(b)(1)(A) even when ineligible under §§ 327, 330, and 503(b)(2)."). There is no unfairness except for the breach of contract. Either his claim is for contract damages, and thus derivative of his claim under Illinois law, or it is a claim for attorney's fees, and thus barred by Lamie.[7] Accordingly, Weinschneider must show that he has a right to attorney's fees under Illinois contract law in order to show that his fees are an administrative expense of the bankruptcy estate.

II. Weinschneider's Illinois Contract Claim Is Meritless.

The covenant not to sue between the trustee and Weinschneider "makes no express provision for an award of attorneys fees in the event of breach." WA-30. For this reason, the lower courts properly held that Weinschneider does not have a valid claim for attorney's fees for breach of the covenant.

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[7] The theory that attorney's fees are available as contract damages is in tension with Lamie even in this case, where the recovery would arise - if at all - exclusively from state law principles independent of the bankruptcy proceeding. In other cases, the theory could be irreconcilable with Lamie. For example, Lamie would bar the trustee from entering into a contract that contained a provision obligating the estate to pay a debtor's chapter 7 attorneys fees, and Lamie would also bar a claim for contract damages in the form of attorney's fees arising out of such a contract. Lamie squarely prohibits the siphoning of estate funds to pay the attorney's fees of professionals who are not eligible to be retained and compensated under sections 327 and 330.

A. Illinois Does Not Allow Attorney's Fees For Breach Of Contract Unless The Contract Expressly Provided For Fees.

Under Illinois law, attorney's fees and costs "are not allowable to the successful party in the absence of a statute, or in the absence of some agreement or stipulation specifically authorizing the allowance thereof." Ritter v. Ritter, 46 N.E.2d 41, 43 (Ill. 1943). Although the Supreme Court of Illinois has not applied this rule in a case concerning the breach of a covenant not to sue, courts applying Illinois law in this context have followed Ritter and held that a party cannot recover attorney's fees based on another party's breach of a covenant not to sue unless (1) the covenant specifies that attorney's fees are recoverable or (2) there is an independent statutory basis for a fee award. See Child v. Lincoln Enters., Inc., 200 N.E. 2d 751, 754 (Ill. App. 1964); Isaacs v. Caterpillar, Inc., 702 F. Supp. 711, 714 (C.D. Ill. 1988).

The lower courts in this case properly treated Childs and Isaacs as persuasive when they determined that attorney's fees and costs were not available under Illinois law. Ritter simply applies the American rule that attorney's fees and costs are not available unless the parties have agreed to them or a statute provides for them. See Midwest Grain Prods. of Ill., Inc. v. Productization, Inc., 228 F.3d 784, 792 (7th Cir. 2000), ("Illinois also follows the American rule, under which parties normally bear their own legal costs."). Ritter states that there "is no principle of the common law that permits a successful litigant to recover from his losing adversary the costs and expenses of the litigation." Ritter, 46 N.E.2d at 43. Child is a straightforward application of the American rule. The rule bars Weinschneider's claim.

Weinschneider nevertheless argues that he is entitled to attorney's fees and costs under a line of nineteenth century cases that predate Ritter and provide that when a tortfeasor's acts require an innocent party to defend himself in a suit brought by a third party, the innocent party may recover the costs of defending the suit as damages in a suit against the tortfeasor. See Brief for Appellant 17-22 (citing Himes v. Keighblingher, 14 Ill. 469 (1853); McEwen v. Kerfoot, 37 Ill. 530 (1865); Philpot v. Taylor, 75 Ill. 309 (1874)).

Contrary to Weinschneider's suggestion, these cases do not show that attorney's fees are available under his contract.[8]

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[8] As explained, the cases apply a rule of tort law. See Himes v. Keighblingher, 14 Ill. 469 (1853) (when plaintiff delivered a deed to the defendant to be held as evidence, but defendant willfully and maliciously recorded the deed in favor of a third party, plaintiff may sue the defendant for the costs associated with proving that the deed was never legally delivered); McEwen v. Kerfoot, 37 Ill. 530 (1865) (where plaintiff sued to recover the commission on a sale of land purportedly made to a third party by plaintiff for defendant, and defendant showed that plaintiff was not his agent and lacked the authority to sell the land, defendant could recover from plaintiff his costs for defending against the third party's claim to the land and set them off against plaintiff's claim for the

They stand for the separate proposition, recognized by this Court in Champion Parts v. Oppenheimer & Co., 878 F.2d 1003, 1006 (7th Cir. 1989), that if "one consequence of the tortfeasor's actions is to involve a person in litigation with others, the expenses incurred in that litigation are held to be damages no less compensable than any other element of damage resulting from the tort."

The rule is inapposite to this case. Weinschneider's contention that the trustee's declaratory judgment action breached the covenant not to sue sounds in contract, not in tort. And in any event, as explained below in Section III, the trustee's decision to pursue a declaratory judgment was not wrongful; the trustee acted in reliance on the bankruptcy court's authorization to sue and in pursuit of his obligation to identify and reduce to money the property of the estate.

Indeed, because Weinschneider himself supported the trustee's motion to the bankruptcy court for authority to pursue the case, his contention that the trustee's suit was wrongful is barred by laches.[9] Laches bars the lack of due diligence by one

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commission); Philpot v. Taylor, 75 Ill. 309 (1874) (when a party falsely pretending to be the agent of the owner of land executes a contract for a sale of the land, and the purchaser sues the owner for specific performance of the sale, the pretend agent is liable to the owner for the damages that the owner sustains in defending the suit).

[9] Although laches generally is an affirmative defenses that must be pleaded in the lower court, that rule does not apply here

party from prejudicing the opposing party. See Van Milligan v. Board of Fire & Police Commissioners, 630 N.E.2d 830 (Ill. 1994). It applies when a litigant has knowledge of a right but fails to assert it in a timely manner. See Sundance Homes, Inc. v. County of Du Page, 746 N.E.2d 254, 262 (Ill. 2001).

Weinschneider did not timely alert the court or the trustee to his belief that the trustee's declaratory action violated the covenant not to sue. He supported the trustee's motion for authorization to bring the suit; only after the suit had begun did he claim that the action breached his contract rights. See 14a-19a. His failure to exercise due diligence and inform the bankruptcy court and the trustee that he believed the suit violated his agreement with the trustee prejudiced the trustee, because the trustee might well have declined to bring the suit if he had known Weinschneider's position.

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because the fee dispute arose from a contested matter governed by Fed. R. Bankr. P. 9014. Contested matters are instituted by motions. See Fed. R. Bankr. P. 9013 (motions) and 9014 (contested matters). Rule 9014(c) provides that some rules governing adversary proceedings apply to contested matters. But because Rule 9014(c) does not incorporate Rule 7012, which requires parties in adversary proceedings to file an answer and plead "every defense," affirmative defenses need not be pled in response to contested matters. Also, laches is a proper basis for affirming because this Court may affirm "on any ground that the record supports and that was raised, but not passed on, in the court below." United States v. Gimbel, 782 F.2d 89, 91 n.3 (7th Cir. 1986); Answer and Objection to Debtor's Application for Allowance and Payment of Administrative Expense Claims, Bankr. Ct. docket number 389, at 8 (noting that Weinschneider did not raise the release issue until after the bankruptcy court authorized the trustee to file the declaratory action).

This court should also reject Weinschneider's suggestion that the covenant not to sue is analogous to a duty-to-defend in an insurance contract. See Brief for Appellants at 22-24. Treating the covenant in this way would be contrary to the American rule. Attorney's fees are recoverable for breach of a duty-to-defend clause because a duty-to-defend clause obligates the insurer to bear the costs of litigation. A duty-to-defend clause has the same effect, then, as an express clause providing for attorney's fees in the event of a breach. The cases providing that attorney's fees are available for breach of a duty-to-defend are a straightforward application of the rule that attorney's fees are recoverable for breach of a contract when the contract provides for them. Because the covenant not to sue in this case does not provide for attorney's fees, they are not available under Illinois law.

B. Weinschneider's Contention That The Contract Should Be Construed To Include A Provision For Fees Has No Foundation In Illinois Contract Law.

Although Weinschneider concedes that the release and covenant not to sue do not include a provision for attorney's fees, he argues that this Court should read a fees provision into the contract because otherwise the release makes the covenant superfluous. See Brief for Appellants at 27. As this argument is incorrect and provides no basis to rewrite a contract, it must be rejected.

Weinschneider's contention that the release and the covenant not to sue are redundant is incorrect. A release and a covenant not to sue are not the same thing. "Illinois has long recognized a clear distinction between the legal effect of a release and a covenant not to sue. A release extinguishes a cause of action whereas a covenant not to sue affects only the right to bring suit and not the cause of action itself." Pate v. City of Sesser, 393 N.E.2d 1146, 1151 (Ill. App. 1979) (citing City of Chicago v. Babcock, 32 N.E. 271 (Ill. 1892); Holcomb v. Flavin, 216 N.E.2d 811 (Ill. 1966)). Also, "an unqualified release of one joint tortfeasor operates to discharge all joint tortfeasors, while a covenant not to sue has no such effect." Id. (citations omitted).

In any event, under Illinois law, a redundancy – if there were one – would be no basis to look beyond the clear terms of this contract. A court may not add provisions to an unambiguous contract even if they might make the contract more equitable. See Lakeland Property Owners Association v. Larson, 459 N.E.2d 1164, 1168 (Ill. App. 1984).

III. Even If Weinschneider's Contract Claim Had Merit, It Would Not Be Entitled To Priority Under Reading.

Even if Weinschneider's claim for attorney's fees under Illinois law had merit, it would not be entitled to priority under Section 503(b)(1)(A), Section 507, and Reading. As noted, Reading held that a negligence claim for damages was allowable as "actual and necessary" expenses of the estate entitled to priority because the receiver's operation of the business was an essential element to the rehabilitation of the debtor. Reading, 391 U.S. at 485. Weinschneider's contract claim is fundamentally different from the tort creditor's claim in Reading for four important reasons, discussed in turn.[10]

A. The Trustee Acted Properly.

The receiver in Reading was negligent, but the trustee in this case acted properly. As this Court recently reconfirmed, Reading does not provide a basis for treating damages caused by a trustee as actual and necessary expenses of preserving a bankruptcy estate when the estate or the bankruptcy court has not "committed [an] impropriety that might justify compensation." Corporate Assets, Inc. v. Paloian, 368 F.3d 761, 773 (7th Cir. 2004). And as the district court correctly determined, the chapter 7 trustee did not commit any impropriety in pursuing a declaratory judgment on the ownership of the claims against Burton. See WA-34.

As the district court observed, "there is no indication that the Trustee's declaratory judgment action was frivolous or brought in bad faith. Rather, the trustee advanced a good faith argument below that the covenant not to sue was fraudulently

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[10] If not given priority under Section 507, the contract claim would probably fall under 11 U.S.C. § 726(a)(6).

induced and, therefore, did not bar the declaratory judgment action." WA-35. The trustee received authorization from the bankruptcy court before filing the claim. 25a. And pursing the claim was in furtherance of the trustee's statutory obligation to "collect and reduce to money the property of the estate." 11 U.S.C. § 704(1).

Although Weinschneider suggests that this Court's decision that the suit breached the covenant not to sue demonstrates that the trustee's action was "wrongful," that claim cannot be squared with the history of the suit. As the district court noted, the "bankruptcy court held that the Trustee's claim had sufficient merit to survive summary judgment and, after trial, agreed with the Trustee's position." WA-35. That the trustee's arguments ultimately were not successful on appeal is no basis for concluding either that the action was not initiated in good faith or was inconsistent with the Trustee's fiduciary obligations to the estate. As the district court concluded, the "estate should not be penalized for the Trustee's good faith execution of his duties." WA-35.

Weinschneider is incorrect that the district court's conclusion that the trustee acted in good faith was not based on competent evidence. <u>See</u> Brief for Appellants at 13, n.2. The bankruptcy court entered an order authorizing the trustee to retain counsel to file suit, and Weinschneider supported the trustee's request. The trustee was entitled to rely on that order as settling the question whether bringing suit was proper. In any event, Weinschneider's claim for fees does not allege bad faith, see 29a-34a, even though the burden of proving entitlement to priority payment as an administrative expense rests with the party requesting it, see Woods v. City Nat. Bank & Trust Co., 312 U.S. 262, 268 (1941).

In re Jack/Wade Drilling, Inc., 258 F.3d 385 (5th Cir. 2001), rejected a claim for administrative priority for attorney's fees as damages for the breach of a contract not to sue even though that contract (unlike the covenant in this case) expressly provided for attorney's fees in the event of breach. The Fifth Circuit declined to interpret Reading as requiring priority for an attorney's fees award to a party who successfully defends litigation brought by a chapter 7 trustee. The court explained that the party's claim for fees was not entitled to priority under section 503(b)(1)(A) because "the actions of the trustee were taken in the course of responsibly carrying out the duties of his position." Id. at 391. As Jack/Wade recognizes, it is the duty of the trustee in a chapter 7 bankruptcy "to identify and liquidate all existing claims on which the trustee has a good faith belief the estate is entitled to recover." Id. (citing Watkins v. Sedberry, 261 U.S. 571, 576 (1923)). To penalize the estate when the trustee faithfully carries out these duties would undermine the incentive structure established by the Bankruptcy Code. Id. at 391 (footnote omitted).

Weinschneider contends that Jack/Wade is distinguishable because the trustee in Jack/Wade sued on contract claims that arose pre-petition, whereas the trustee here sued on contract claims that arose post-petition. See Brief for Appellants at 14. But the relevant question is not when the underlying claim arose, but when the allegedly wrongful suit was filed. In both Jack/Wade and this case, the claim for attorney's fees was for fees from defending a suit brought by the trustee after the petition for bankruptcy was filed. In both cases, the trustee brought the suit as part of his duty to recover property of the estate. There is no relevant distinction.

Finally, contrary to Weinschneider's assertions, nothing in Yorke v. N.L.R.B., 709 F.2d 1138 (7th Cir. 1983), or In re Met-L-Wood Corporation, 115 B.R. 133 (N.D. Ill. 1990), suggests that Reading can apply when the trustee has acted properly. To be sure, Yorke does not mention the Reading requirement that the trustee's action be wrongful. But it also does not apply Reading. Its only citation to Reading is a "cf." citation to support the proposition that, because a trustee's obligation to bargain with a union when terminating operations in a liquidation arises from "the Trustee's decision . . . in the overall interests of the creditors, the costs concomitant with that decision properly can be attributed to the Trustee's efforts to 'preserve the estate,'" it can be considered an administrative expense of preserving the estate. See id. at 1143.

And Met-L-Wood Corp., in affirming an award of attorney's fees incurred by the debtor's attorneys in the successful defense of suit brought by the trustee, noted that the trustee's suits did not have "any merit whatsoever." 115 B.R. at 136.[11] As the bankruptcy court's initial ruling in the declaratory action makes clear, that is not true here. See Hoseman, 322 F.3d at 472. Yorke and In re Met-L-Wood Corporation provide no exception to the rule that Reading does not apply when the trustee has not committed some "impropriety that might justify compensation." Corporate Assets, 368 F.3d at 773.

B. Weinschneider Is Estopped From Arguing That The Trustee's Suit Was Improper.

Weinschneider's support for the bankruptcy court order authorizing the trustee to hire counsel to pursue the claim against Burton estops him from arguing now that the trustee's action was improper. Judicial estoppel is an equitable doctrine providing that a party who prevails on one ground in a lawsuit may not later repudiate that ground. See United States v. Hook, 195 F.3d 299, 306 (7th Cir. 1999). The doctrine "reduce[s] fraud in the legal process by forcing a modicum of consistency on a

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[11] Met-L-Wood also has been abrogated to the extent that its statements on attorney's fees are inconsistent with Lamie.

repeating litigant." Ladd v. ITT Corp., 148 F.3d 753, 756 (7th Cir. 1998). Judicial estoppel may apply when (1) the later position is clearly inconsistent with the earlier position; (2) the facts at issue are the same in both cases; (3) the party to be estopped convinced the first court to adopt its position; and (4) the party seeking to assert an inconsistent position would derive an unfair advantage or impose an unfair detriment on the opposing party if not estopped. Hook, 195 F.3d at 306; see also In re Superior Crew Boats, Inc., No. 03-30692 (5th Cir. June 18, 2004) (debtor estopped from bringing personal injury claim by failure to timely disclose claim to bankruptcy court).

Weinschneider has taken inconsistent positions before the bankruptcy court, first urging the bankruptcy court to grant the trustee's motion for authorization to hire counsel to sue him without raising the covenant not to sue, and then later claiming that he was entitled to receive attorney's fees for defending the declaratory action because the action breached the covenant not to sue. Weinschneider's position that the trustee should be authorized to sue him prevailed; the bankruptcy court granted the trustee's motion. The same facts are involved in the two cases, because Weinschneider's claim for fees arises out of the action instituted as a result of the bankruptcy court's authorization. And Weinschneider would derive an unfair benefit from his inconsistent positions, because when he made the determination to support the trustee's motion to sue him, he did so to enable himself to pursue his claim against Burton in the Illinois courts. He should thus be estopped from arguing that the trustee's suit was improper.[12]

C. Unlike Reading, This Bankruptcy Case Is A Liquidation.

That the bankruptcy estate at issue here was undergoing chapter 7 liquidation rather than chapter 11 reorganization is another important difference from Reading. Reading stressed that the debtor was operating when the damages were inflicted by the fire. See Reading, 391 U.S. at 475 ("the words 'preserving the estate' include the larger objective, common to arrangements, of operating the debtor's business with a view of rehabilitating it."); id. at 478 ("the question is whether the fire claimants should be subordinated to, should share equally with, or should collect ahead of those creditors for whose benefit the continued operation of the business . . . was allowed."); id. at 479 (the "business [was] operating. . . . for the benefit of the creditors and with the hope of rehabilitation. That benefit and that rehabilitation are worthy objectives. But it would be inconsistent with . . . the rule of fairness in bankruptcy to seek these objectives at the cost of excluding tort creditors. . . ."); id. at 483 ("analogous cases suggest that 'actual and

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[12] Estoppel, like laches, is generally an affirmative defense. But for the reasons given in footnote 9 the Court could affirm on the basis of estoppel.

necessary costs' should include costs ordinarily incident to operation of a business, and not be limited to costs without which rehabilitation would be impossible."); and id. at 485 n.12 ("[a]mong other expenses incident to conducting a business and therefore allowable as an administrative expenditure").

These statements make clear that the continuing operation of a business was integral to Reading's holding. And this Court has recognized this aspect of Reading, stating that it is "well settled that expenses incurred by the debtor-in-possession in attempting to rehabilitate the business during reorganization are within the ambit of § 503." In re Jartan, Inc. 732 F.2d 584, 586 (7th Cir. 1984) (emphasis added). But in this case, the trustee's violation of the covenant not to sue occurred in Weinschneider's chapter 7 liquidation case. In general, chapter 7 estates liquidate; they do not reorganize. While Section 721 of the Bankruptcy Code, 11 U.S.C. 721, authorizes trustees to obtain court permission "to operate the business of the debtor for a limited period," the trustee in this case did not operate any business.

As the First Circuit has noted, applying Reading in an ordinary, nonoperating liquidation proceeding "appears extremely problematic, as one fundamental justification for the priority is that general creditors stand to benefit from the post-petition operation of the debtor's business, either through the immediate generation of operating profits or through the ultimate reorganization of the debtor as a viable business entity." Woburn Assoc. v. Kahn (In re Hemingway Transport, Inc.), 954 F.2d. 1, 5 n.5. (1st Cir. 1992). Suing for a declaration that the claim against Burton belonged to the estate did not benefit the creditors in the relevant sense that it might have substantially improved the condition of the bankruptcy entity. Whether the claim against Burton was property of the estate was determined by the facts surrounding the creation of Burton, not by the continuing function of the bankruptcy entity under the trustee's management. The trustee's suit merely sought a declaration of the legal effect of those facts. Accordingly, Reading's rationale that tort creditor's damages were administrative expenses because the general creditors stood to benefit from the trustee's operation of the debtor's business, and the damages were caused by the operation of the business, does not apply to this case.

D. Weinschneider's Claim Sounds In Contract, Not Tort.

Weinschneider's claim is based on breach of contract, which does not come within the Reading doctrine. This Court has expressed skepticism about whether the Reading exception can apply when the creditor's claim is based on a breach of contract, see In re J. Catton Farms, Inc., 779 F.2d 1242 (7th Cir. 1985), noting that in "Reading the Court had stressed the involuntary nature of the tort victim's relationship to the bankrupt," _id._ at 1249 (citing _Reading_, 391 U.S. at 478). In this case, Weinschneider's participation in the declaratory action can hardly be called involuntary; he assented to the trustee's motion for authority to bring the suit. _Compare_ _Catton Farms_, 779 F.2d at 1249-50. Accordingly, the logic of _Reading_ does not support affording administrative priority to Weinschneider's contract damages, if he is entitled to damages.

CONCLUSION

For the foregoing reasons, this Court should affirm the judgment of the district court.

Respectfully submitted,

PETER D. KEISLER
Assistant Attorney General

WILLIAM KANTER
202-514-4575
TEAL LUTHY MILLER
202-514-5048
Attorneys, Appellate Staff
Civil Division, Room 9607
Department of Justice
601 "D" Street, N.W.
Washington, D.C. 20530-0001

JULY 2004

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Teal Luthy Miller
Attorney for the United States
July 12, 2004

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(In re Life Service Systems, Inc.)

2. ("CO") CURRENT COURT [E.g., "CTA9"]
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•1) Can bankruptcy professional breach their fiduciary duties by violating, for example, their duty not to usurp a corporate opportunity, their duty of loyalty, or their duty to disclosure, even if their breach does not involve taking property of the bankruptcy estate? 2) If so, did the court below commit clear error in weighing the evidence and in holding that Westmoreland breached its fiduciary duties to its fellow creditors in this case.

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Case Number 99-110J

THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF PENNSYLVANIA

In re LIFE SERVICE SYSTEMS, INC.

WESTMORELAND HUMAN OPPORTUNITIES, INC.,

Appellant,

v.

JAMES R. WALSH, *et al.*,

Appellees.

ON APPEAL FROM THE UNITED STATES BANKRUPTCY COURT
FOR THE WESTERN DISTRICT OF PENNSYLVANIA

BRIEF FOR THE APPELLEE
DONALD F. WALTON, THE ACTING UNITED STATES TRUSTEE

Joseph A. Guzinski
General Counsel

P. Matthew Sutko
Executive Office for U.S. Trustees
Department of Justice
901 E Street, N.W., Suite 780
Washington, D.C. 20530
(202) 307-1399 *telephone*
(202) 307-2397 *facsimile*

Joseph S. Sisca
Assistant United States Trustee
Office of the U.S. Trustee
Department of Justice
PA ID 46719
Liberty Center, Suite 970
1001 Liberty Avenue
Pittsburgh, PA. 15222
(412) 644-4756 *telephone*
(412) 644-4785 *facsimile*

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JURISDICTIONAL STATEMENT

The bankruptcy court's June 20, 2002 order, finding that Westmoreland Human Opportunities, Inc. breached its fiduciary duties to its fellow creditors, was a final order. Westmoreland timely filed its notice of appeal from that order on June 28, 2002. AD 57.[1] Fed. R. Bankr. P. 8002(a). This Court has jurisdiction to hear this appeal under 28 U.S.C. 158(a)(1). The United States Trustee has standing to participate in this case. 11 U.S.C. 307; *United States Trustee v. Price Waterhouse,* 19 F.3d 138, 140 (3d Cir. 1994) (applying section 307).

STATEMENT OF THE ISSUES PRESENTED FOR REVIEW

1. Can bankruptcy professionals breach their fiduciary duties by violating, for example, their duty not to usurp a corporate opportunity, their duty of loyalty, or their duty of disclosure, even if their breach does not involve taking property of the bankruptcy estate?

2. If so, did the court below commit clear error in weighing the evidence and in holding that Westmoreland breached its fiduciary duties to its fellow creditors in

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[1/] References to the docket in the adversary proceeding are identified as **AD [docket number]**; references to the docket in the bankruptcy proceeding are identified as **BD [docket number]**; references to orders and opinions are identified as **[date] Order [page]**; references to transcript pages are identified as **[date] Tr [page]**; and transcript exhibits are identified as **[date] Tr [plaintiff or defendant's] Ex [number]**.

this case?

STATEMENT OF THE CASE

In 1995, the Department of Housing and Urban Development selected Life Service Systems, Inc. to receive grant monies under the federal Supportive Housing Program. *Westmoreland Human Opportunities, Inc. v. Walsh*, 246 F.3d 233, 236 (3d Cir. 2001). Under the grant, Life Service provided care to the homeless in Westmoreland County, Pennsylvania. *See* November 9, 1998 Tr Plf Ex 1 (Life Service's grant application); Plf Ex 2 (HUD's August 23, 1995 conditional approval); Plf Ex 4 (HUD's Feb. 5, 1996 final approval); and Plf Ex 5 (executed grant agreement and February 9, 1996 transmittal).

Soon thereafter, Life Service began experiencing financial difficulties. *Westmoreland*, 246 F.3d at 236. On January 14, 1997, Life Service sought protection under the reorganization provisions of chapter 11 of the Bankruptcy Code, 11 U.S.C. 1101, *et seq*. BD 1.

Section 1102(a)(1) of the Bankruptcy Code authorizes the United States Trustee to create a committee of creditors holding unsecured claims.[2] 11 U.S.C.

[2/] United States Trustees are officials of the Department of Justice appointed by the Attorney General to supervise the administration of bankruptcy cases and trustees. *See* 28 U.S.C. 581-589 (specifying the powers of United States Trustees); *United States Trustee v. Columbia Gas Sys., Inc. (In re Columbia Gas Sys., Inc.)*, 33 F.3d 294, 296 (3d Cir. 1994) (United States Trustees oversee the bankruptcy process, 1102(a)(1). Committees "perform . . . services . . . in the interest of those represented. " 11 U.S.C. 1103(c)(5). In addition to tasks specifically authorized by statute, committees have broad residual authority to investigate "any" "matter relevant to the case." 11 U.S.C. 1103(c)(2).

On January 31, 1997, the United States Trustee appointed an unsecured creditors' committee in the Life Service case. BD 6. Westmoreland was one of Life Service's largest creditors, and it accepted an invitation to join the committee.[3] *Id.*; *Westmoreland*, 246 F.3d at 236-37. The committee sought court approval on March 26, 1997 to employ F. Scott Gray, and the firm of Sable, Makoroff & Gufsky, to act as counsel, which the court approved on April 30, 1997. BD 15 and 30. *See* 11 U.S.C. 1103(a) (committee authorized to select counsel), and 327(a) (court must approve counsel selections).

Life Service's bankruptcy filing caused HUD to issue a declaration of

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protect the public interest, and ensure that bankruptcy cases are conducted according to law)(*citing* H.R. Rep. No. 95-595, 109 (1977)); *United States Trustee v. Revco D.S., Inc. (In re Revco D.S., Inc.)*, 898 F.2d 498, 499 (6th Cir. 1990) ("[t]he United States trustee, an officer of the Executive Branch, represents *** [the] public interest"). "The United States Trustee is the 'watchdog' of the bankruptcy system . . . charged with preventing fraud and abuse and with 'fill[ing] the vacuum' caused by possible creditor inactivity." *Curry v. Castillo (In re Castillo)*, 297 F.3d 940, 950 (9th Cir. 2002).

[3/] Westmoreland served on the committee from January 31, 1997 until September of that year. BD 6; February 17, 1999 Tr at 128-29.

default under the HUD grant on January 23, 1997. November 9, 1998 Tr Plf Ex 11. HUD's default notice nevertheless encouraged Life Services to try to retain the grant:

> Believing that a cancellation of the Program would be unfortunate for the Homeless of Westmoreland County, HUD, however, remains open to any suggestion and advice by LSS as to how you think the program can be saved. To that end we are prepared to grant you thirty days to come up with a workable plan . . . Please advise us what you are prepared to do in this matter. We sincerely hope the project can be saved . . . .

Id.

During this time, Life Service was managed by another company, Adelphoi, Inc. February 17, 1999 Tr at 30. In order to fulfill a secret plan it had concocted with Westmoreland to divide Life Service's assets between them, Adelphoi caused Life Services to take no action in response to HUD's offer to try to retain the grant. *See, e.g,* April 23, 1999 Order at 6-7; June 20, 2002 Order at 5-6, 16-18. Life Service never responded to the letter and never sought to convince HUD to allow it to perform under the HUD grant. *Id.*

On March 4, 1997, HUD sent another letter to the debtor, whereby HUD once again invited the debtor to submit a 'work-out plan' for the continued implementation of the program. *Id.* Again, Adelphoi caused the debtor not to respond. *Id.*

From January of 1997, Westmoreland worked in concert with Adelphoi to transfer Life Service's real property to an entity affiliated with Adelphoi, to deny Life Services any chance to act as HUD's grantee in the future, and to secure the grant for itself. *See, e.g.,* February 17, 1999 Tr at 57-59; April 23, 1999 Order at 6-7; June 20, 2002 Order at 5-6, 16-18.

On May 27, 1997, HUD and Westmoreland entered into an "amendment" to the supportive housing agreement executed previously by the debtor and HUD. Under it, Westmoreland succeeded to the debtor's rights and obligations and became entitled to receive and draw down the remaining $937,136 in funds HUD had set aside for the program. *Id.* at 7-8; February 17, 1999 Tr at 10, 46-47. Westmoreland did not disclose this to its fellow creditors or to the other members of the creditors' committee. April 18, 2002 Tr at 24 (counsel for Westmoreland does not "dispute that the disclosure of the actual assumption of the HUD contract [sic] in May was not specifically disclosed"); Tr at 53 (Westmoreland's counsel admits the creditors' committee "didn't know [the grant] was transferred").

The committee first learned of Westmoreland and Adelphoi's scheme to transfer the grant in April 1997, roughly one month before the HUD grant was transferred; when it did, the committee filed a motion on April 16, 1997, asking for the appointment of a trustee. *Id.* at 38-41; BD 20. *See* 11 U.S.C. 1104(a) (specifying the bases for appointing a chapter 11 trustee). In paragraph 17 of its motion, the committee disclosed its recent discovery that Adelphoi, who was supposed to be managing the debtor for the benefit of the creditors, had instead "negotiated [the debtor's division between] itself and Westmoreland." BD 20. The committee made clear in paragraph 14 that time was of the essence in appointing a trustee because Westmoreland and Adelphoi were "pursuing plans to take some of the Debtor's contracts." *Id.*

The court denied the committee's April 16, 1997, motion to appoint a trustee because the court believed the HUD grant would not be transferred without a court order. *See* April 18, 2002 Tr at 24, 53; BD 25 (Adelphoi's opposition); BD 26 (Westmoreland's opposition); BD 27 (hearing on motion to appoint); BD 29 (order denying motion). A trustee ultimately was appointed in November 1997. *See* BD 190 (order appointing trustee). Mr. James Walsh was appointed to act as the trustee. BD 191.

After investigating Life Service's affairs, Mr. Walsh filed separate adversary actions against Adelphoi and Westmoreland on February 27, 1998, alleging breach of fiduciary duties.[4] Mr. Walsh's complaint against Westmoreland

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[4] The Adelphoi adversary proceeding settled before trial. April 23, 1999 Order at 10.

alleged that Westmoreland breached its fiduciary duties by taking the HUD grant, which was property of the Westmoreland bankruptcy estate. AD 1.

The trustee's action against Westmoreland was tried on November 9, 1998 and February 17, 1999. At trial, Mr. Tay Waltenbaugh testified on behalf of Westmoreland. February 19, 1999 Tr at 5-62. Mr. Waltenbaugh had been Westmoreland's CEO since roughly 1990. *Id.* at 6. Mr. Waltenbaugh testified that he was contacted in January 1997 by Mr. James Bendel, the Executive Director of Adelphoi, Inc., about the HUD grant. *Id.* at 8. Mr. Bendel suggested that an affiliate of Adelphoi, Westmoreland CHODO, could obtain title to Life Service's real property, and Westmoreland could take the HUD grant from Life Service.[5] February 17, 1999 Tr at 27-33.

On cross-examination, Mr. Waltenbaugh admitted that Westmoreland was working with Adelphoi to take the HUD grant at the same time it sat on the creditors; committee:

> "Q. So – after the bankruptcy, while WHO is on the committee, you're talking to Adelphoi who is running [the debtor], about taking over this HUD

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[5] At trial, Mr. Daniel Pagliari, Westmoreland's counsel, offered to "stipulate that discussions took place between Adelphoi, WHO and HUD concerning the transfer of the [HUD] grant from [Life Service] to [Westmoreland], either immediately prior to the bankruptcy petition being filed, or immediately thereafter. We'll stipulate to that." February 17, 1999 Tr at 33.

grant, is that correct?

A. Right.

February 17, 1999 Tr at 37.

The February 18, 1997 minutes of Westmoreland's board of directors confirmed that Westmoreland sought to obtain the HUD grant before the expiration of the 30-day period HUD initially gave Life Service to retain the grant.[6] February 17, 1999 Tr Plf Ex 15 (Westmoreland's minutes); February 17, 1999 Tr at 34-35 (introduction of minutes into evidence); November 9, 1998 Tr Plf Ex 11 (HUD's 30 day letter). These minutes reveal that during this period, when Westmoreland also sat on the creditors' committee, Westmoreland "and Adelphoi [were] in negotiations . . . regarding the homeless shelter coming to [Westmoreland] . . . [Westmoreland] will administer the entire grant, [and] Adelphoi Inc. will own and maintain the property" then owned by the debtor, Life Service. February 17, 1999 Tr at 35-36 (testimony of Westmoreland CEO Waltenbaugh reading the minutes of Westmoreland's February 18, 1997 board meeting).

Mr. Waltenbaugh admitted at trial that even as of June 1997, he had not told

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[6] As we discuss above, HUD later extended the debtor's time to try to retain the future benefits of the HUD grant.

anybody about the transfer of the HUD grant from the debtor to Westmoreland. February 17, 1999 Tr at 46-48. He also admitted he had never told the "official committee of unsecured creditors that [Westmoreland] was negotiating with Adelphoi . . . to get this contract." *Id.* at 47. Nor did he disclose any of those facts to the court. *Id.*

During this hearing, Mr. Waltenbaugh acknowledged yet again that Westmoreland did not tell its fellow creditors about its actions:

> Q. [Life Service's] did all the work to get the grant, [Life Service] paid its employees, incurred all the costs, and [Westmoreland] just stood up and said give us the grant? And got it?
>
> A. We – yeah I guess.
>
> Q. While [Westmoreland] was on the committee?
>
> A. Right.
>
> Q. And while WHO didn't tell the Committee that [Westmoreland had taken over] the grant?
>
> A. Right.

Id. at 53.

Westmoreland also admitted at trial that it did nothing to help Life Service retain the HUD grant; nor did it try to ensure that the grant's proceeds could help pay the claims of its fellow creditors, or help Life Service successfully reorganize in bankruptcy. February 17, 1999 Tr at 59. At trial Mr. Waltenbaugh also admitted that he never asked if anyone would pay more for the grant than Westmoreland did, even though Westmoreland was on the committee. *Id.* at 37, 59.

Mr. Vincent S. Zeli, Westmoreland's Vice President of Finance, also acted as Westmoreland's representative on the Life Service unsecured creditors' committee. February 17, 1999 Tr at 128-29. Mr. Zeli admitted at trial that he did not disclose to the committee that HUD had assigned the grant to Westmoreland. February 17, 1999 Tr at 130, 131-32.

Mr. Scott Gray, counsel to the creditors' committee, confirmed that Westmoreland never told the committee about its arrangement with Adelphoi, or its attempt to have the HUD grant transferred from the debtor to Westmoreland. April 18, 2002 Tr at 38-41. Mr. Gray explained that the committee "only found out about [Westmoreland's] involvement with Adelphoi through a meeting [the committee] requested with HUD," which occurred around "April, 1997." *Id.* at 38-39. "It was at that point in time that [the committee] learned that Adelphoi and WHO were trying to get the contract for themselves." *Id.* at 39.

Committee counsel also "learned that [Westmoreland] was passing documents onto other people other than committee members. And they were working for people other than the best interests of the unsecured creditors in the case." *Id.* Mr. Gray testified at trial that he asked Westmoreland's representative on the committee to resign because Westmoreland was improperly giving confidential information to people who were not on the committee and who held an adverse interest. February 17, 1999 Tr at 135-36.

On April 23, 1999, the bankruptcy court entered judgment in favor of the trustee. It found that "even though it sat on the committee of unsecured creditors at the time, WHO did not disclose to other general unsecured creditors or to the court that it had an 'understanding' with Adelphoi. They secretly agreed that Adelphoi would purchase 49 Division Street and that WHO would assume debtor's HUD grant and would house individuals in the property. Shortly thereafter WHO became the successor recipient of the HUD funds without providing any consideration to the bankruptcy estate, without notice to unsecured creditors and without obtaining prior court approval. WHO did not, however, house eligible individuals at 49 Division Street when an individual with whom WHO did not have an 'understanding' outbid Westmoreland CHODO and purchased the property. Apparently, WHO would only do business with Adelphoi's corporate relative." April 23, 1999 Order at 11.

Based on these facts, the court below concluded that "WHO breached the fiduciary duty it owed to general unsecured creditors as a result of its membership on the committee of unsecured creditors in that its conduct was blatantly self-aggrandizing" and resulted in Westmoreland improperly taking the grant, which was property of the Life Service bankruptcy estate. *Id.* at 19. This Court then affirmed. December 17, 1999 Order.

The United States Court of Appeals for the Third Circuit reversed, holding Westmoreland had not breached its fiduciary duty as a committee member by taking estate property because the HUD grant was not property of the bankruptcy estate. *Westmoreland*, 246 F.3d at 242-56. The Third Circuit remanded two questions for further consideration:

> 1. Whether a fiduciary obligation to fellow unsecured creditors can arise out of a transaction involving an item of property that does not qualify as property of the estate; and,
>
> 2. If so, whether, based on the specific facts of Westmoreland's case, did Westmoreland breach such a fiduciary duty.

Westmoreland, 246 F.3d at 258

By order dated June 4, 2001, this Court remanded this adversary proceeding to the bankruptcy court for further proceedings consistent with the opinion of the Third Circuit. After briefing by the parties, the bankruptcy court conducted a hearing on April 18, 2002. The bankruptcy court entered an order on June 20, 2002 granting the trustee's complaint in adversary 98-02082-BM. AD 55. The bankruptcy court concluded that creditors' committee members can breach their fiduciary duties in ways other than by taking estate property. June 20, 2002 Order at 9-15. The court then concluded that Westmoreland "breached its fiduciary obligations to fellow general unsecured creditors when it arranged to have itself named as the successor grantee of the supportive housing program" and this "reduc[ed] rather than maximiz[ed] distribution to the class of general unsecured creditors" that Westmoreland had a fiduciary duty to represent. *Id.* at 18-19. This appeal followed.

STANDARD OF REVIEW

The bankruptcy court's legal conclusion that committee members can breach their fiduciary duties in ways other than by taking estate property is subject to plenary review by this Court. *Cinicola v. Scharffenberger*, 248 F.3d 110, 115 n.1 (3d Cir. 2001). The bankruptcy court's factual finding that Westmoreland breached its fiduciary duties must be sustained on appeal unless it was clearly erroneous. *Id.*

SUMMARY OF ARGUMENT

No court has ever held that bankruptcy fiduciaries can breach their fiduciary duties only by taking estate property. To the contrary, there are a number of universally recognized fiduciary duties whose breach need not involve property of the estate. These include the duty not to usurp a corporate opportunity, the duty of loyalty, and the duty of disclosure.

It is important that committee members continue to fulfill these important fiduciary duties in all cases, including those in which committee members do not seek to acquire property of the estate. Public confidence in the Bankruptcy System would be seriously undermined if fiduciaries were free to usurp corporate opportunities, shield important information from fellow creditors, act disloyally, leak confidential information, and take secret actions that reduce creditor recoveries in bankruptcy cases.

In this case, Westmoreland breached its duty not to usurp a corporate opportunity, its duty of loyalty, and its duty to disclose. By violating each of these duties Westmoreland failed the creditors it was bound by law to protect. Collectively, Westmoreland's breaches rise to a level of misconduct rarely encountered in bankruptcy cases.

ARGUMENT

Committee Members are Fiduciaries

Creditors' committees have broad powers and perform important functions in chapter 11 cases. *See* 11 U.S.C. 1103(c) (specifying committee powers). As the court below explained, a creditors' committee "is supposed to act as a 'watchdog' on behalf of the larger body of general unsecured creditors whose interests it is charged with representing." April 23, 1999 Order at 18 (*citing Matter of Advisory Committee of Major Funding Corp.*, 109 F.3d 219, 224 (5th Cir. 1997)). In many cases, "the responsibility for monitoring the operations of the debtor and its compliance with appropriate bankruptcy procedures has fallen largely to the creditors' committee," *Phar-Mor, Inc. v. Coopers & Lybrand,* 22 F.3d 1228, 1240 (3d Cir. 1994), and to the United States Trustee.

The creditors' committee is the creditors' advocate. It investigates the debtor for them. 11 U.S.C. 1103(c)(2). It analyzes whether the debtor should continue doing business. *Id.* It acts as the creditors' representative in dealings with the debtor and with the chapter 11 trustee. 11 U.S.C. 1103(c)(1). It prepares a plan of reorganization if that is appropriate, and responds to plans that other parties propose. 11 U.S.C. 1103(c)(3). If the debtor is not managing its affairs appropriately, the committee protects creditors by requesting the appointment of a trustee. 11 U.S.C. 1103(c)(4). Finally, it has broad residual responsibility to "perform such other services" as are necessary to protect the "interest of those represented." 11 U.S.C. 1103(c)(5).

These important tasks are performed by only a handful of the creditors - most typically seven[7], who represent the collective interests of the entire creditor class. For this Representative System to function effectively, the general creditor body must have confidence that their committee members will protect their collective interests, act as their advocate, serve them loyally, and take no action that could diminish their recovery.

To ensure this, the law imposes affirmative duties and significant restrictions upon committee members. As the Supreme Court has squarely held, committee members are fiduciaries, *Woods v. City National Bank & Trust Co.*, 312 U.S. 262, 268-69 (1941) (bondholder committee members have a fiduciary duty to their bondholders), and the Third Circuit has specifically held here that Westmoreland had "a fiduciary duty . . . toward [its] constituent members." [8]

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[7] *See* 11 U.S.C. 1102(b)(1) ("A committee of creditors . . . shall ordinarily consist of the persons, willing to serve, that hold the seven largest claims against the debtor . . . .").

[8] In *Woods*, the lower courts denied compensation and ordered reimbursement because the fiduciary breached its duties. *Woods*, 312 U.S. at 263. In this case, the court imposed a damages remedy to compensate creditors for the losses the

Westmoreland, 246 F.3d at 256, 257 (*following In re PWS Holding Corp.*, 228 F.3d 224, 246 (3d Cir. 2000)).

As a bankruptcy fiduciary, a committee member must "protect [the committee] constituents' interests." *Official Unsecured Creditors' Committee v. Michaels (In re Marin Motor Oil., Inc.)*, 689 F.2d 445, 455-56 (3d Cir. 1982) (committee members "represent the various classes of creditors and equity security holders from which they are selected" and "provide supervision of the debtor in possession and of the trustee") (*citing* H.R. Rep. No. 95-595, 95th Cong., 2d Sess. 401, *reprinted in* 1978 U.S. Code Cong. & Ad. News 5963, 6357)). "A committee member violates its fiduciary duty by pursuing a course of action that furthers its self-interest to the potential detriment of fellow committee members." *Westmoreland*, 246 F.3d at 256.

When it agreed to become a committee member, Westmoreland obligated itself as a matter of law to act differently than a mere creditor would. *See, e.g., Woods*, 312 U.S. at 269; *Westmoreland*, 246 F.3d at 257; *In re Mountain States Power Co.*, 118 F.2d 405, 407 (3d Cir. 1941) (a shareholder committee member breached his fiduciary duty by purchasing stock in the debtor). Individual creditors in bankruptcy cases typically have no fiduciary duties toward each other.

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court determined flowed from Westmoreland's breach. June 20, 2002 Order at 19.

Each creditor seeks to maximize its personal return in the case. By joining a committee, however, committee members assume a legal obligation to protect the interest of the entire creditor class, not merely their own. *Woods*, 312 U.S. at 269; *Mountain States*, 118 F.2d at 407.

Westmoreland Breached its Fiduciary Duty to not Usurp a Corporate Opportunity

It is settled law that a fiduciary has a duty not to usurp a corporate opportunity. *See., e.g., Citicorp Venture Capital, Ltd. v. Committee of Creditors,* 160 F.3d 982, 987 (3d Cir. 1998) (bankruptcy fiduciary breached its fiduciary duties to the debtor and the creditors by usurping a corporate opportunity that was unrelated to any purchase of property of the estate); *Brown v. Presbyterian Ministers Fund*, 484 F.2d 998, 1004-05 (3d Cir. 1973) (applying state law in holding that a corporate fiduciary cannot seize corporate opportunities that his or her corporate employer has not chosen to forego).

In *Citicorp*, the Third Circuit specifically found a breach of fiduciary duty in a transaction that did not involve property of the estate. In that case, Citicorp Venture Capital had an employee on the chapter 11 debtor's board of directors and, consequently, owed a fiduciary duty to the debtor and its creditors. *Citicorp,* 160 F.3d at 985. Citicorp violated its fiduciary duty by purchasing notes drawn on the debtor for the purpose of making a profit and influencing the debtor's reorganization in its own favor. *Id.* at 987. Although the transactions by definition did not involve property of the estate - they involved purchases of debt obligations owed by the estate - the Third Circuit held Citicorp's actions constituted "a paradigm case of inequitable conduct by a fiduciary as that concept has been developed in the case law." *Id.*

Citicorp establishes that fiduciary duties are breached in the absence of a transaction involving property of the estate. *See also Young v. Higbee Co.*, 324 U.S. 204 (1945) (former committee members breached their fiduciary duties to fellow creditors by selling corporate notes that were not property of the bankruptcy estate); *Brown*, 484 F.2d at 1004 (usurpation of a corporate opportunity constituted a breach of fiduciary duty under state law).[9]

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[9] Support for these holdings are found in decisions defining criminal bankruptcy fraud under 18 U.S.C. 152. They squarely hold that the absence of estate property does not absolve a debtor from criminal liability for making false disclosures about assets because even potential assets must be disclosed. *United States v. Cherek*, 734 F.2d 1248, 1254 (7th Cir. 1984), *cert. denied*, 471 U.S. 1014 (1985)("the statute requires a bankrupt to disclose the existence of assets whose immediate status in bankruptcy is uncertain. Even if the asset is not ultimately determined to be property of the estate under the technical rules of the Federal Bankruptcy Code, Section 152 properly imposes sanctions on those who preempt a court's determination by failing to report the asset"); *United States v. Beard*, 913 F.2d 193, 197 (5th Cir. 1990)(the defendant "was under the duty to disclose to the court the existence of assets whose immediate status in the bankruptcy is uncertain, even if that asset is ultimately determined to be outside the bankruptcy

Westmoreland attempts to distinguish *Citicorp* on three grounds. First it argues *Citicorp* does not apply because the debtor in that case could have taken title to the securities but Life Service could never have "owned" the HUD grant. *Appellant's Br* at 13. This argument is wrong for a number of reasons. First, *Citicorp* never made such a distinction. To the contrary, the *Citicorp* panel held the opportunity to purchase the securities was a corporate opportunity notwithstanding Citicorp's argument that the debtor "was not in a financial or legal position to purchase the notes ." *Citicorp*, 160 F.3d at 988.

Second, Westmoreland cites no case holding that the corporate opportunity doctrine is limited solely to corporate opportunities that would result in the fee simple ownership of an estate asset, and we are aware of none. Certainly, the Supreme Court and the Third Circuit have not imposed any such restriction upon the doctrine.

Finally, such a restriction makes no sense. Suppose a creditor were inclined to loan some dump trucks to a builder who was in bankruptcy at no cost in order to help the builder continue its operations and thereby maximize the chance it would reorganize. If a committee member interjected itself, and convinced the creditor to let it use the dump trucks instead, the creditor class as a whole would suffer a

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estate").

"potential" loss [10] because the debtor had lost the opportunity to use free trucks. There is no reason to presume a court would not hold this was a *prima facie* violation of the corporate opportunity doctrine merely because the corporate opportunity involved a no-cost use of the trucks rather than a potential transfer of title.

Westmoreland is similarly incorrect when it argues that *Citicorp* is inapplicable because "the Court of Appeals found that Citicorp Venture Capital breached its fiduciary duty to the debtor" rather than to the creditors. *Appellant's Br* at 16. *Citicorp* expressly found that the corporate director's fiduciary duties ran not only to the debtor but, as here, to the creditors as well. *Citicorp*, 160 F.3d at 987. On this point *Citicorp* is fully consistent with the Supreme Court's holding in *CFTC v. Weintraub*, 471 U.S. 343, 355 (1985), where the Court concluded "if a debtor remains in possession . . . the debtor's directors[, such as the Citicorp director, have a] . . . fiduciary obligation to creditors and shareholders."[11]

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[10] "Potential" loss is the standard the Third Circuit articulated in this case for determining whether Westmoreland breached its fiduciary duty. *Westmoreland*, 246 F.3d at 256. On remand, the bankruptcy court found that Westmoreland had caused actual losses. June 20, 2002 Order at 18.

[11] *Accord Official Committee of Unsecured Creditors of United Healthcare System, Inc. v. United Healthcare System, Inc. (In re United Healthcare System, Inc.*), 200 F.3d 170, 177 n. 9 (3d Cir. 1999) (applying *Weintraub* in finding that "a debtor-in-possession is a fiduciary for its estate and its creditors").

Finally, Westmoreland argues that *Citicorp* is inapplicable because it involved a usurpation of a fiduciary duty imposed upon corporate officers, not committee members, and committee members should be treated less "stringently." *Appellant's Br* at 16-17. There is a short answer to this assertion: it is inconsistent with Supreme Court and Third Circuit law. Both make clear that the fiduciary duties of bankruptcy professionals are at least as stringent as those imposed upon persons in the private sector. The Supreme Court holds committee members to very high fiduciary standards. *Woods*, 312 U.S. at 268 (holding that "[o]nly **strict** adherence to . . . equitable principles [of fiduciary law] can keep the standard of conduct for [committee member] fiduciaries 'at a level higher than that trodden by the crowd'") (*citing* Cardozo, C.J., in *Meinhard v. Salmon*, 249 N.Y. 458, 464, 164 N.E. 545, 546 (1928)) (emphasis supplied)). *See also Mosser v. Darrow*, 341 U.S. 267, 271 (1951) (trustees are subject to "strict prohibitions");[12] *Weintraub*, 471 U.S. at 355 (holding debtors in possession have a fiduciary duty to their

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[12] *See Dodson v. Huff (In re Smythe)*, 207 F.3d 758, 761 (5th Cir. 2002) (noting that in *Mosser*, "[t]he Supreme Court has held that a trustee should be "surcharged" – that is, held personally liable – for willfully and deliberately breaching his fiduciary duty of loyalty").

creditors).[13]

Similarly, in *Mountain States*, the Third Circuit held, in defining the duties of committee members, that "[u]ncompromising rigidity has been the attitude of courts of equity when petitioned to undermine . . . the strict duties imposed on fiduciaries " *Mountain States*, 118 F.2d at 407 (*quoting Meinhard*, 249 N.Y. at 464, 164 N.E. at 546). Adopting Chief Judge Cardozo's analysis in *Meinhard*, the Third Circuit "held [the stockholders' committee member] to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior. As to this there has developed a tradition that is unbending and inveterate." *Id.*

"Many forms of conduct permissible in a workaday world for those acting at arm's length, are forbidden to those bound by fiduciary ties" in bankruptcy cases. *Mountain States*, 118 F.2d at 407 (*quoting Meinhard*, 249 N.Y. at 464, 164 N.E. at

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[13] "In *Weintraub*, the Supreme Court noted that "the willingness of courts to leave debtors in possession 'is premised upon an assurance that the officers and managing employees can be depended upon to carry out the fiduciary responsibilities of a trustee.'" *Weintraub*, 471 U.S. at 355 (citations and internal quotations omitted).

Weintraub underscores that fiduciary duties can be breached in the absence of a taking of property of the estate. A debtor in possession cannot purchase property it already owns. Nevertheless, it clearly operates under a number of fiduciary duties, which restrict the debtor's conduct, and protect shareholders and creditors.

546). In the workaday world of solvent companies it might be entirely appropriate for a creditor to wrest a valuable grant from its debtor. It might also be appropriate for a creditor to diminish the ability of other creditors to recover from that debtor. But bankruptcy is different. A committee member may not snatch an opportunity that might benefit the creditors, and Westmoreland's conduct in doing that constituted a classic breach of the duty not to usurp a corporate opportunity.

Westmoreland Breached Its Duty of Loyalty

All fiduciaries operate under a duty of loyalty. *See*, *e.g.*, *Woods*, 312 U.S. at 268 (holding that a member of a bondholders committee has a duty of loyalty to the bondholders); *Mountain States*, 118 F.2d at 407 (holding that committee members are bound by a duty of "undivided loyalty"); *In re Mesta Machine Co.*, 67 B.R. 151, 156 (Bankr. W.D. Pa. 1986) ("[a]s fiduciaries, counsel and committee members have obligations of fidelity, undivided loyalty and impartial service in the interest of creditors they represent") (citation omitted). *See also Mosser*, 341 U.S. at 271(holding a trustee liable for breach of the duty of loyalty because "[e]quity tolerates in bankruptcy trustees no interest adverse to the trust"); *United States v. O'Hagan,* 521 U.S. 642, 653 (1997) ("[a] fiduciary who pretends loyalty to the principal while secretly converting the principal's information for personal gain . . . dupes or defrauds the principal" and is liable for that misconduct) (citation and internal quotation marks omitted)).

Committee members must meet very high standards of loyalty. *Woods*, 312 U.S. at 269; *Young v. Higbee Co.*, 324 U.S. 204 (1945) (former stockholders' committee members violated their continuing fiduciary duties to their constituents by settling litigation that could have benefitted the entire stockholder class after they resigned from the committee). *See also Mosser*, 341 U.S. at 271 (applying the duty of loyalty to a bankruptcy trustee). Their duty of loyalty requires them to "avoid acting upon any matter which may result in a benefit to him in particular as opposed to the members of the class which he represents . . ." *In re Nationwide Sports Distributors, Inc.*, 227 B.R. 455, 464 (Bankr. E.D. Pa. 1998) (citation omitted). Nothing compelled Westmoreland to serve on the creditors' committee. But having voluntarily chosen to do so Westmoreland, like the committee members in *Woods* and *Young*, had a "representative responsibility"[14] to loyally protect the interests of all creditors, not merely its own.

As *Woods*, *Young*, and *Mosser* make clear, it is axiomatic that the duty of loyalty does not apply solely to the purchase and sale of estate property. Under section 1103(c) of the Code, committee members perform many tasks. 11 U.S.C. 1103(c). Nothing in that statute or bankruptcy case law indicates that committee members may be disloyal whenever they are doing things other than purchasing

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[14] *Young*, 324 U.S. at 212.

property of the estate. Such an odd construction would render the duty of loyalty a nullity whenever committee members carry out tasks such as investigating the debtor's affairs, proposing plans of reorganization, valuing corporate opportunities, or recommending the appointment of an examiner or a trustee.

In this case, Westmoreland violated its duty of loyalty to its constituent members in a number of ways. Rather than striving to ensure that the debtor's estate would produce the maximum return possible for its fellow unsecured creditors, Westmoreland conspired with Adelphoi to strip real property from the debtor and divert the debtor's HUD grant to Westmoreland. April 23, 1999 Order at 6-9, 18-20; June 20, 2002 Order at 4-6, 16-19. This falls far short of the undivided loyalty required of a fiduciary. *Woods*, 312 U.S. at 269; *Mountain States*, 118 F.2d at 407.

Westmoreland also violated its duty of loyalty by failing to fulfill its role as a committee member. Section 1103(c)(3) empowers the creditors' committee to help devise a plan of reorganization that will benefit the creditor class. Rather than loyally taking action that would facilitate the development of such a plan - and thereby ensuring a better prospect of a meaningful return for the unsecured creditor class - Westmoreland did everything possible to make a plan of reorganization impossible. By its own admission, Westmoreland did nothing to maximize creditor recoveries from the retention of the HUD grant, or from its transfer. February 17, 1999 Tr at 37, 59. Instead, unbeknownst to the court, the committee, and the creditor body, at the very time that HUD was inviting the debtor to devise a method to keep its grant, Westmoreland was seeking to have HUD transfer the grant away from the debtor and to it, and was conspiring to have the debtor's real property transferred to Adelphoi. *See, e.g., id.* at 58. Given the overwhelming evidence establishing Westmoreland and Adelphoi's plot, the court below did not commit clear error in finding that Westmoreland breached its fiduciary duty by "concoct[ing] a secret scheme" with Adelphoi. April 23, 1999 Order at 6.

On appeal, Westmoreland contends its disloyalty is not actionable because it was no secret.[15] *Appellant's Br* at 8-9. Westmoreland suggests the committee knew about its misconduct. *Id.* It argues, for example, that paragraphs 14 and 17 of the committee's April 16, 1997, motion for the appointment of a trustee, BD 20, mentions Westmoreland's scheme. *Appellant's Br* at 8-9.

Westmoreland misinterprets the record. Life Service went into bankruptcy on January, 14, 1997. BD 1. HUD's letter extending Life Service's opportunity to retain the HUD grant was written on January 23, 1997. November 9, 1998 Tr Plf

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[15] It cites no authority to support this contention.

Ex 11. In January - May, while it was on the committee, Westmoreland was putting into action its scheme to transfer the grant to itself and was not telling the court, the committee or the creditors. *See, e.g.,* February 19, 1999 Tr at 8, 27-33, 35-37, 47-48, 59, 128-32, 136 (admissions of Westmoreland's corporate officers).

The unrebutted testimony adduced at trial establishes that Westmoreland never told the committee about its arrangement with Adelphoi during the months of January, February, March, April, or May of 1997, or about its attempts to have the HUD grant transferred from the debtor to Westmoreland. April 18, 2002 Tr at 38-41. Mr. Gray, counsel for the creditors' committee explained that the committee "only found out about [Westmoreland's] involvement with Adelphoi through a meeting [the committee] requested with HUD," which occurred around "April, 1997." *Id.* at 38-39. "It was at that point in time that [the committee] learned that Adelphoi and WHO were trying to get the contract for themselves." *Id.* at 39.

When the committee learned of Westmoreland's conduct, it filed a motion for the appointment of a trustee on April 16, 1997. *Id.*; BD 20. *See* 11 U.S.C. 1104(a) (specifying the bases for appointing a chapter 11 trustee). Westmoreland is correct that paragraphs 14 and 17 describe some of Westmoreland's and Adelphoi's misconduct, but it did so to justify why these recent discoveries were so serious that a trustee should be appointed in the case. *See* BD 20 (motion to appoint trustee).

On remand, the bankruptcy court asked Westmoreland why it had not disclosed the scheme to transfer the HUD grant in January, "at the beginning." April 18, 2002 Tr at 52. Westmoreland's counsel offered no explanation but countered that "the committee knew as early April."[16] *Id.* Of course, this was months after the bankruptcy, months after the scheme was devised, months after Westmoreland joined the committee, and on the eve of the grant's transfer. Hiding such important facts for months falls short of meeting a committee member's duty of loyalty.

Westmoreland compounded this breach of loyalty with a second independent breach - it took confidential committee information and gave it to third parties. Committee counsel Gray testified that he had to ask Westmoreland's representative on the committee to resign because Westmoreland was improperly giving confidential information to people who were not on the committee and who held an adverse interest. February 17, 1999 Tr at 135-36. Based on its weighing

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[16] In response to the court's questioning, Westmoreland's counsel freely admitted that Westmoreland did not disclose the grant's transfer to the interested parties or to the court. *Id.* at 53-55. As the court noted, Westmoreland's actions in January, February, March, April - and beyond - were "[a] secret to me –." *Id.* at 53.

of the testimony in the case, the bankruptcy court found that Westmoreland "shar[ed] confidential information with third parties having an interest adverse to the debtor's other unsecured creditors." June 20, 2002 Order at 5. Standing alone, this act of disloyalty would be sufficient to justify a finding of breach of fiduciary duty.

Westmoreland Breached its Duty of Disclosure

Westmoreland breached its fiduciary duty to disclose relevant information to the creditor class. The law requires a fiduciary "to disclose opportunities available to the corporation." *Brown*, 484 F.2d at 1004; *In re Allegheny International, Inc.*, 954 F.2d 167, 179-80 (3d Cir. 1992) (under Pennsylvania law corporate executive violates its common law duty of loyalty by failing to inform the corporation to whom he owes a duty about significant events); *Seidman v. OTS*, 37 F.3d 911, 935 n.34 (3d Cir. 1994) ("A fiduciary's duty of candor is encompassed within the duty of loyalty. The duty of candor requires corporate fiduciaries to disclose all material information relevant to corporate decisions from which they may derive a personal benefit") (citations and internal quotations omitted)); *Arst v. Stifel, Nicolaus & Co.*, 86 F.3d 973, 979 (10th Cir. 1996) (the "duty of loyalty as an agent included a duty to disclose"); *Shea v. Esensten*, 107 F.3d 625, 628 (8th Cir.), *cert. denied*, 522 U.S. 914 (1997) (under ERISA, "the duty to disclose material information is the core of a fiduciary's responsibility, animating the common law of trusts long before the enactment of ERISA") (citation omitted)).

Westmoreland's duty to disclose "required that it share everything that it knew [with the creditors'] Committee." *Citicorp*, 160 F.3d at 988. Westmoreland violated its duty to disclose by keeping secret about the plot to strip the debtor of its real property and to transfer the grant. April 23, 1999 Order at 6-8; June 20, 2002 Order at 6; April 18, 2002 Tr at 53-55. Westmoreland's fellow unsecured creditors would have found these facts significant. The debtor's real property was a principal asset of the bankruptcy estate. A principal source of cash-flow was the HUD grant. Without them, reorganization was impossible. In addition, grant proceeds could have funded payments to creditors. By retaining the HUD grant for an additional period of time, Life Service could have augmented creditor recoveries even if its efforts at reorganization ultimately proved unsuccessful. Finally, transferring the HUD grant had the legal effect of creating additional creditor claims, which also diminished creditor recoveries. Accordingly, Westmoreland's failure to disclose these facts constitutes a separate and independent basis for concluding it breached its fiduciary duties to its fellow creditors.

Sound Notions of Public Policy Support Affirmance

Westmoreland asks this Court to free it from a typical fiduciary's duty of loyalty, duty to disclose, and duty not to seize a corporate opportunity. *Appellant's Br* at 14 (purporting to ask this Court to create the "narrowest" of exceptions). Supreme Court and Third Circuit authority foreclose such exception-making by mandating that bankruptcy fiduciaries be held to high fiduciary standards. *Woods*, 312 U.S. at 268; *Mosser*, 341 U.S. at 271; *Young*, 324 U.S. at 210-12; *Mountain States*, 118 F.2d at 407.

Even if it were possible to craft such exceptions within the bounds of existing law, it would be unwise to do so. A fiduciary's duties are defined by a century of jurisprudence. If one wishes to become a bankruptcy fiduciary, it is easy to ascertain what the traditional fiduciary duties are. Similarly, those who must rely upon the loyalty and integrity of bankruptcy fiduciaries know what standards fiduciaries typically must meet. We see no good reason to blur those bright lines. Doing so would only encourage some fiduciaries to test the limits of acceptable practice and diminish the confidence that debtors and creditors will have in the integrity and predictability of the Bankruptcy System.

This is not the kind of case that calls for exceptions. Exculpation would sanction a committee member's transfer of $937,136 in grant funds in a circumstance where the committee member schemed against the debtor and its fellow creditors, hid that conduct from the court, the parties in interest and the United States Trustee, divulged confidential information to third parties, caused creditor losses, and made impossible any reorganization of this debtor.

Seventy-five years ago, Chief Judge Cardozo warned about the "'disintegrating erosion' [caused by creating] particular exceptions" to fiduciary standards. *Meinhard v. Salmon*, 249 N.Y. 458, 464, 164 N.E. 545, 546 (1928). In rejecting exception-making, he declared that fiduciary standards "will not consciously be lowered by any judgment of this court". *Id.* The court below has similarly concluded that condoning Westmoreland's conduct "would . . . seriously erode the prophylactic purpose of the proscription against self-dealing." April 23, 1999 Order at 20.

Moreover, many activities that occur in bankruptcy cases have nothing whatever to do with property of the estate. It would make no sense in those instances to allow fiduciaries to act in complete disregard of accepted fiduciary standards of conduct. For example, a debtor might bid on an asset that the debtor was interested in purchasing. If the committee member outbid the debtor (perhaps through a straw party), it would clearly usurp a corporate opportunity, even though no property of the estate was acquired. Or suppose a committee member knew real property that the debtor proposed to purchase was contaminated, rendering it worth a small fraction of the purchase price that the debtor was about to pay. If the creditor did not warn the creditors, it should be held to have violated its duties of loyalty and disclosure, even though it acquired no property of the estate. Or envision a situation where a committee member, out of simple malice, approached a supplier and convinced it to cease doing business with the debtor. No property of the estate would be acquired, but the conduct would be unacceptable for a fiduciary. In each of these scenarios, the nature of the conduct warrants a finding of breach of duty.

Property of the estate and fiduciary duty are distinct legal concepts. There exists no basis in statute, case law or logic for treating them as mutually dependant. Nor is there any reason to conclude the absence of property of the estate can negate or override fiduciary duties owed by committee members.

Fiduciary standards derive from state corporate governance law, ERISA and pension law, labor law, receivership law, and banking law. Both the Supreme Court and the Third Circuit have looked to that law when crafting the fiduciary law of bankruptcy.[17] Nothing in the law and no public policy justifies radically

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[17] In *Woods*, the Supreme Court relied heavily upon *Meinhard* - a decision interpreting state joint-venture law, as did the Third Circuit in *Mountain States*. Similarly, the Third Circuit followed the state law decision it previously rendered

contracting bankruptcy fiduciary law by engrafting a property of the estate restriction that has never before been applied in any case, an exception that cannot be reconciled with bankruptcy decisions finding breaches in its absence, and one that would transport bankruptcy law far outside the mainstream of fiduciary jurisprudence.

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in *Brown* when it was called upon its *Citicorp* to define when a bankruptcy fiduciary usurps a debtor's corporate opportunity.

CONCLUSION

For the foregoing reasons, the Acting United States Trustee respectfully asks this Court to affirm the bankruptcy court's ruling that Westmoreland breached its fiduciary duties in the Life Service bankruptcy case.

Respectfully Submitted,

Joseph A. Guzinski
General Counsel

By ______________________________
P. Matthew Sutko
Office of the General Counsel
Executive Office for United States Trustees
Department of Justice
901 E Street, Northwest, Suite 780
Washington, D.C. 20530

Joseph S. Sisca
Assistant United States Trustee
PA ID 46719
Department of Justice
Office of the United States Trustee
Liberty Center, Suite 970
1001 Liberty Avenue
Pittsburgh, Pennsylvania
(412) 644-4756 Telephone
(412) 644-4785 Facsimile

Counsel for Donald F. Walton,
The Acting United States Trustee

CERTIFICATE OF SERVICE

I hereby certify that true and correct copies of the foregoing BRIEF OF APPELLEE, DONALD F. WALTON, THE ACTING UNITED STATES TRUSTEE, were served upon the parties listed below via United States First Class Mail, postage prepaid, on the 13th day of September 2002:

James R. Walsh, Esquire
Spence Custer Saylor Wolfe and Rose
400 U.S. Bank Building
P.O. Box 280
Johnstown, PA 15907

Daniel B. Pagliari, Esquire
Paletta & Pagliari, L.L.P.
2773 Leechburg Road
Lower Burrell, PA 15068

F. Scott Gray, Esq.
Makoroff & Gusky, P.C.
7th Floor, Frick Building
Pittsburgh, PA 15222

Terence O'Halloran, Esq.
15 East Otterman Street
Greensburg, PA 15601

____
P. Matthew Sutko

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2. **("CO")** *CURRENT* COURT *[E.g., "CTA9"]* — CTA9

3. **("CCN")** *CURRENT* CASE NO. — No.: 05-35246, 05-35248

4. **("PCN")** *PRIOR* CASE NO. & COURT *[IF ANY]* — No.:

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P. Matthew Sutko, Esq., UST/EOUST

(UST/OGC: 202-307-1399/FAX-2397)

8. **("TO")** *TOPIC* — BANKRUPTCY

9. **("SU")** ● *SUMMARY* OF KEY ISSUE(s) & √ Any Miscellaneous *BACKGROUND*

● 1. Did the bankruptcy court abuse its discretion by dismissing the Wiersmas' chapter 11 bankruptcy case under 11 U.S.C. 1112(b)?

2. Does this Court lack jurisdiction over untimely appeals of final orders of a bankruptcy court where a timely notice of appeal is a jurisdictional prerequisite under 28 U.S.C. 158(c)?

√ Background:

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UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

Case Nos. 05-35246, 05-35248

In re JIM LEE WIERSMA and PATRICIA DARLENE WIERSMA,
Debtors

JIM LEE WIERSMA and PATRICIA WIERSMA,
Appellants

v.

BANK OF THE WEST f/k/a/ UNITED CALIFORNIA BANK;
UNITED STATES TRUSTEE,
Appellees

APPELLEE UNITED STATES TRUSTEE'S BRIEF

ROBERTA DeANGELIS
Acting General Counsel

P. MATTHEW SUTKO
MICHELE M. MANSFIELD
Executive Office for United States Trustees
20 Massachusetts Ave., N.W., Suite 8000
Washington, D.C. 20530
(202) 307-1399

JEFFREY G. HOWE
304 North 8th Street, Room 347
Boise, Idaho 83702
(208) 334-1300
Counsel for Appellee,
Ilene J. Lashinsky, United States Trustee

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UNITED STATES COURT OF APPEALS
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APPELLEE UNITED STATES TRUSTEE'S BRIEF

Statement of Jurisdiction

Jim Lee Wiersma and Patricia Darlene Wiersma, debtors in bankruptcy, filed a notice appealing three orders of the bankruptcy court entered April 4, 2003; February 11, 2003; and September 20, 2002, respectively. As discussed in the Argument section, p. 20, *infra*, this Court has jurisdiction only over the April 4, 2003, order.[1/]

[1/] The bankruptcy appellate panel held that it had jurisdiction to review a portion of the February 11, 2003, order. On February 11, 2003, the bankruptcy court entered an order with two provisions. First, it denied the confirmation of the

(a) On April 4, 2003, the bankruptcy court entered a final order dismissing the Wiersmas' bankruptcy case under 11 U.S.C. 1112(b). ER Tab 18 p. 851.[2] The bankruptcy court had jurisdiction to do so under 28 U.S.C. 157. The bankruptcy appellate panel below had jurisdiction to review this order under 28 U.S.C. 158(b).

(b) The April 4 order dismissing the case is a final order. *See, e.g.*, *Dominguez v. Miller* (*In re Dominguez*), 51 F.3d 1502, 1506 (9th Cir. 1995) (dismissal of action is final and appealable if it terminates all possibilities of litigation on merits). The basis for this Court's jurisdiction over this appeal is 28 U.S.C. 158(d).

(c) The Wiersmas filed a timely notice of appeal of the April 4 dismissal order on April 9, 2003. *See* 28 U.S.C. 158(c); Fed. R. Bankr. P. 8002; ER Tab 19

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debtors' chapter 11 plan, and second, it granted a motion approving a settlement. ER, Tab 13, pp. 812-814. The BAP found that the order denying confirmation was interlocutory, and therefore merged into the final dismissal order of April 4. The United States Trustee does not oppose the review of this portion of the order. *See, e.g., Elliott v. Frontier Properties, Inc.* (*In re Four Seasons Properties, Inc.*), 979 F.2d 1358, 1364 (9th Cir. 1992) (review of interlocutory order that becomes part of final order reviewable upon appeal of final order).

The bankruptcy court's settlement approval in the February 11 order, on the other hand, is final for appeal purposes, and the April 9 notice of appeal was untimely as to this portion of the order. Both the BAP and this Court lack jurisdiction over untimely filed appeals of final orders of the bankruptcy court. *See* Argument, p. 20, *infra*.

[2] Bank of the West's Excerpts of Record are cited as "ER." It was not necessary for the United States Trustee to submit any supplemental excerpts of the record.

p. 854. The BAP judgment was entered on February 1, 2005, ER Tab 25, p. 881, and the Wiersmas filed a timely notice of appeal on February 25, 2005. ER Tab 22 p. 2; *see also* Tab 22, p. 6 (amended notice). On March 9, 2005, appellee Bank of the West filed a notice of cross-appeal. ER Tab 26, p. 924.

Statement of the Issues

1. Did the bankruptcy court abuse its discretion by dismissing the Wiersmas' chapter 11 bankruptcy case under 11 U.S.C. 1112(b)?

2. Does this Court lack jurisdiction over untimely appeals of final orders of a bankruptcy court where a timely notice of appeal is a jurisdictional prerequisite under 28 U.S.C. 158(c)?

Standard of Review

This Court independently reviews the bankruptcy court's decision without giving deference to the bankruptcy appellate panel. *See, e.g., Cossu v. Jefferson Pilot Sec. Corp.* (*In re Cossu*), 410 F.3d 591, 595 (9th Cir. 2005) (citation omitted). A bankruptcy court's conclusions of law are reviewed *de novo* and its findings of fact are reviewed for clear error. *Price v. United States Trustee (In re Price)*, 353 F.3d 1135, 1138 (9th Cir. 2004). The standard of appellate review of the conversion or dismissal of a chapter 11 bankruptcy case is abuse of discretion. *See, e.g., Marsch v. Marsch* (*In re Marsch*), 36 F.3rd 825, 828 (9th Cir. 1994); *Price*, 353 F.3d at 1138. Questions of subject matter jurisdiction are reviewed *de novo*. *See, e.g., Montana v. Goldin (In re Pegasus Gold Corp.)*, 394 F.3d 1189, 1193 (9th Cir. 2005).

Statement of the Case

Jim Lee Wiersma and Patricia Darlene Wiersma were Idaho dairy farmers who filed a voluntary petition for bankruptcy under the reorganization provisions of chapter 11 of the Bankruptcy Code. The Wiersmas filed four different plans of reorganization that were not confirmed, and their case was ultimately dismissed on the motion of the United States Trustee under 11 U.S.C. 1112(b). The Wiersmas appealed this dismissal and the bankruptcy appellate panel affirmed.

The Wiersmas also appeal two previously entered orders: a September 20, 2002, order determining the secured status of two creditors and a February 11, 2003, order approving a settlement and denying confirmation of the Wiersmas' third amended plan. The BAP affirmed both orders but held the appeal of the February 11 settlement approval and the appeal of the September 20 secured status determination were moot. The Wiersmas appealed to this Court and the Bank cross-appealed.

Statement of Facts

The Wiersmas are dairy farmers who formerly operated a dairy in Idaho. The growth of the Wiersmas' operation over time was financed in large part by loans from what is now known as Bank of the West ("the Bank"). *See* ER Tab 2,

p. 23. To secure their loans, the Wiersmas granted the Bank a security interest in, among other things, accounts and contract rights, general intangibles, farm products, livestock, milk products quota monies and other property in possession. ER Tab 1, pp. 1-21.

During their expansion, the Wiersmas hired Gietzen Electric to provide electrical services in connection with building construction. *See* ER Tab 2, p. 22. The Wiersmas allege that the work done by Gietzen resulted in electrical shocks causing physical injury to the Wiersmas' dairy cattle. *See, e.g.*, ER Tab 9, pp. 500-501. Because of the damages suffered and the cost to remedy the problems, the Wiersmas filed a state court lawsuit against Gietzen. ER Tab 2, pp. 22-23. During the pendency of the litigation, on October 1, 2001, the Wiersmas filed a petition for relief under chapter 11 of the Bankruptcy Code. ER Tab 27, p. 980; *see* 11 U.S.C. 1101, *et seq*.

While in bankruptcy, the Wiersmas terminated their dairy operation. ER Tab 12, p. 753. After the last of the Wiersmas' dairy cattle were sold, the Bank and O.H. Kruse Grain and Milling (nka Ferndale Grain), an entity which had provided feed to the Wiersmas' cattle, both asserted a secured interest in the Gietzen lawsuit.

During the bankruptcy proceeding, the Wiersmas and Geitzen entered into a settlement agreement. ER Tab 7, pp. 130-142. Subsequently, the Wiersmas filed a motion in the bankruptcy court to determine the secured status of the Bank and Kruse/Ferndale. ER Tab 27, p. 996; *see also* ER Tab 2, pp. 22-53 (bankruptcy court's memorandum of decision). The court determined that the Bank and Kruse/Ferndale both held valid and enforceable security interests in the Wiersmas' claim against Gietzen and in any proceeds of any settlement or other recovery on the claim. ER Tab 3, p. 54; Tab 2, pp. 22-53.[3/]

During this time, the Wiersmas were attempting in vain to propose a confirmable plan. They ultimately filed four plans, none of which were confirmed. The Wiersmas first filed a plan of reorganization in May 2002, ER Tab 27, p. 993, and then an amended plan in October 2002. ER Tab 27, p. 1002; *see also* ER Tab 5, pp. 60-126 (transcript of November 19, 2002, hearing where the court denied confirmation). The Wiersmas filed a third plan (a second amended plan) in December 2002. ER Tab 27, p. 1007. In their second amended plan, the Wiersmas proposed to use the settlement from the Gietzen litigation to purchase cows in Georgia where the Wiersmas would move and operate a dairy. *See* ER Tab 8, pp. 143-311 (transcript of December 20, 2002, hearing on confirmation of second amended plan). The Wiersmas intended to lease an existing dairy farm and

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[3/] The Wiersmas and Kruse/Ferndale timely appealed this order to the BAP, but the appeal was ultimately dismissed. *See* note 6, p. 22, *infra*.

purchase the cows from that farm. *Id.* At the hearing on the second amended plan, the court denied confirmation but granted the Wiersmas additional time to propose a consensual plan. ER Tab 12, p. 808. The Wiersmas then filed a fourth plan (the third amended plan), which the court found was still neither feasible nor consensual, and therefore denied confirmation. *Id.* at 843.

On February 25, 2002, prior to the time the issues relating to the Geitzen lawsuit were raised in the bankruptcy court, the United States Trustee[4/] filed a motion to dismiss the case pursuant to 11 U.S.C. 1112. ER Tab 27, p. 991. At that time, the Wiersmas had not yet filed a disclosure statement or plan despite having been under the protection of chapter 11 of the Bankruptcy Code for almost five months. Moreover, the Wiersmas had not filed monthly financial or operating reports as required by 11 U.S.C. 704(8), 1106, 1107 and Fed. R. Bankr. P. 2015. The court ultimately deferred ruling until the March 28, 2003, hearing. ER Tab 12, p. 808. Having offered the Wiersmas an opportunity to convert voluntarily to chapter 7, the bankruptcy court dismissed the Wiersmas case for cause under section 1112(b). ER Tab 18, p. 851; ER Tab 12, p. 843.

The court made findings of fact and conclusions of law on the record and

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[4/] The United States Trustee is a Department of Justice official who has authority to supervise the administration of bankruptcy cases and to monitor their progress. 28 U.S.C. 586. The United States Trustee has the authority to raise and appear and be heard on any issue in any bankruptcy case. 11 U.S.C. 307.

incorporated the reasoning previously set forth in a February 11, 2003, memorandum. In that memorandum, the court outlined its principal concerns about the Wiersmas' reorganization proposal, but reserved ruling so the Wiersmas would have additional time to negotiate a consensual plan with the Bank. ER Tab 12, p. 808. The court found two primary defects in the Wiersmas' second amended plan – first, the plan did not treat the Bank's allowed secured claim fairly and equitably as required by 11 U.S.C. 1129(a), ER Tab 12, p. 798-99, and second, the Wiersmas failed to prove that their plan was feasible and would not likely be followed by the need for further reorganization or liquidation. ER Tab 12, p. 801, 806. At the time of the March 28, 2003, ruling, the court found that these two concerns had not been abated. ER Tab 17, p. 831.

In addition to the feasibility issue, the court noted the inadequacy of the Wiersmas' proposed treatment of the Bank's secured claim under 11 U.S.C. 1129(b)(2)(A)(iii). Specifically, the court stated that it "seriously doubts" that the Bank would "realize the indubitable equivalent of its claim under the debtors' plan, which could prevent confirmation." *Id.* Summarizing its reasoning, the court found that under all of the circumstances and based upon its "comparison of the bank's rights now, with their rights under the debtors' proposed third amended plan, together with an assessment of their risk now versus the risk under the debtor's plan," it "firmly believes that debtors' proposal to pay the bank through the plan hardly constitutes the indubitable equivalent of the bank's current status." ER Tab 17, pp. 841-842. Accordingly, upon its fourth denial of confirmation, the court also dismissed the Wiersmas' case. ER Tab 18, p. 851.

On appeal, the BAP affirmed the bankruptcy court's dismissal of the case. ER Tab 26, p. 917. The BAP reasoned that the Wiersmas' third amended plan did not adequately address the bankruptcy court's concerns and found the bankruptcy court did not abuse its discretion when it found the plan was not feasible, ER Tab 26, p. 917, concluding that Wiersmas' new proposals in their final plan "were nothing more than 'beating a dead horse,' (or here a dead cow), and did not remove the bankruptcy court's substantial doubt [with respect to the previous plan]." ER Tab 25, p. 917.

Next, the panel found that the bankruptcy court correctly denied confirmation of the second amended plan because the plan did not provide the Bank the "indubitable equivalent" of its secured claim as required by 11 U.S.C. 1129(b)(2)(A)(iii). ER Tab 25, p. 910. Further, the BAP concluded that the bankruptcy court's determination that the second amended plan was not feasible under 11 U.S.C. 1129(a)(11) was correct. *Id.* at 913-915. Finally, the panel dismissed as moot the appeal of the February 11 order approving the settlement and the September 20 order determining secured status. *Id.* at 884.

Summary of the Argument

The bankruptcy court's findings and conclusions support the existence of cause to dismiss under 11 U.S.C. 1112(b) on at least two independent grounds. First, the Wiersmas were unable to effectuate a plan, which is cause for dismissal under section 1112(b)(2). Despite numerous opportunities to negotiate a consensual plan and filing four separate plans, the Wiersmas still failed to demonstrate the feasibility of a successful reorganization chapter 11 of the Bankruptcy Code. Moreover, the treatment of the Bank under the Wiersmas' third amended plan violated 11 U.S.C. 1129 and rendered confirmation unlikely, constituting further cause under 1112(b)(2). Second, every plan proposed by the Wiersmas was denied, and the Wiersmas' request for additional time was denied, constituting cause for dismissal under 1112(b)(5).

Argument

I. The bankruptcy court did not abuse its discretion to dismiss the Wiersmas' bankruptcy case because, as reflected by the record, there was ample cause for dismissal under 11 U.S.C. 1112(b).

Congress granted the bankruptcy courts great discretion to convert or dismiss a chapter 11 bankruptcy case for "cause" under 11 U.S.C. 1112(b). *See, e.g., Pioneer Liquidating Corp. v. United States Trustee (In re Consol. Pioneer*

Mortgage Entities), 264 F.3d 803, 806 (9th Cir. 2001); *Marsch v. Marsch (In re Marsch*), 36 F.3d 825, 828 (9th Cir. 1994). Section 1112(b) provides a non-exhaustive list of factors constituting cause. 11 U.S.C. 1112(b); *see also* House Report No. 595, 95th Cong. 1st Sess 405-406 (1977) and Senate Report No. 989, 95th Cong., 2d Sess. 117-118 (1978) (section 1112(b)'s list of grounds for conversion or dismissal is not exhaustive). This Court should reverse a bankruptcy court's dismissal for cause only if it is "based on an erroneous conclusion of law or when the record contains no evidence on which [the bankruptcy court] rationally could have based that decision." *Consol. Pioneer Mortgage Entities*, 264 F.3d at 806-807 (citations omitted).

A. Cause to dismiss the Wiersmas' chapter 11 bankruptcy case existed under 11 U.S.C. 1112(b)(2) because the Wiersmas' proposed plans were not feasible.

The bankruptcy court's finding that all of the Wiersmas' proposed plans lacked feasibility is abundantly supported in the record and constitutes cause for dismissal under 1112(b)(2). *See* 11 U.S.C. 1112(b)(2) ("inability to effectuate a plan" is cause). Dismissal under 1112(b)(2) is proper where "the court determines that it is unreasonable to expect that a plan can be confirmed in the chapter 11 case." *In re Woodbrook Assocs.*, 19 F.3d 312, 316 (7th Cir. 1994). With respect to confirmation of the debtors' plans, the responsibility ultimately fell to the bankruptcy court to determine "whether the things which are to be done after confirmation can be done as a practical matter under the facts." *Clarkson v. Cooke Sales and Serv. Co. (In re Clarkson)*, 767 F.2d 417, 420 (8th Cir. 1985).

The difficulties foreseen by the bankruptcy court in this case were realistic. The Wiersmas had never operated a dairy in Georgia. The use of all of the settlement proceeds for the proposed purchase of dairy cows left the Wiersmas with no equity in the new farming operation, no financial cushion, and no working capital. For these reasons, as well as the fact that it had already granted the Wiersmas numerous chances to effectuate a plan, the bankruptcy court found cause for dismissal of the Wiersmas' case.

The court clearly articulated at least five reasons for its conclusion that the Wiersmas' continuation in chapter 11 was not feasible under any of the plans thus far proposed. First, the court noted that the Wiersmas "have proposed four separate plans to their creditors but have been unable to achieve a consensus on confirmation of [a] plan." ER Tab 17, p. 832. Moreover, in its February 11 order, the court explicitly outlined its concerns with respect to the Wiersmas' plans. Despite its opinion that the Wiersmas "have had ample time to ponder their predicament and plot their course," the court granted them more time to work out a solution with the Bank. *Id.; see also* ER Tab 5, p. 93 (court had previously ordered mediation). Despite knowing the court's precise concerns and being granted time to implement solutions, the Wiersmas' third amended plan also failed to address the court's articulated concerns.

Second, the court found that the Wiersmas' plans were not feasible because of the "paramount" fact that the Wiersmas "do not propose to save an existing operation through reorganization" but "propose to start up a brand new substantial business, operating [a] fair distan[ce] from Idaho." ER Tab 17, p. 833. Further, the court noted its concern over the fact that the Wiersmas would be starting over "in a totally new business environment" in a location in which they have not had "real experience." *Id.* Under those circumstances, the court "continue[d] to harbor serious reservations about the debtors' ability to succeed in their new venture." *Id.* at 833.

Third, the court found that under the third amended plan the Wiersmas would "continue to be burdened by extremely high levels of debt service" that would not allow them to "weather a significant downturn in the market or negative effects on their production levels" and further, would allow them "no breathing room at all" if they had a "bad month or two." *Id.* at 833-834. Fourth, the court expressed concern that under the third amended plan the debtors would have "precious little equity" in their new operation and that "[n]early all the risks of failure in this case will be born [sic] by the creditors, not the debtors." ER Tab 17, p. 834. Fifth, the court found that the Wiersmas would "have only a small amount of working capital available to them" and a proposed balloon payment at the end of the thirty-six month loan. ER Tab 17, p. 834. The court registered its concern on the record, noting the Wiersmas "would have to show that in three years they would be able to obtain the financing or other resources to pay off the bank's large claim." *Id.* at 835. The court, however, found "nothing in the present record to persuade [it] that [the Wiersmas] had that ability [to ensure they could pay off the claim]." *Id.*

Even the testimony of the Wiersmas' expert witness supports the bankruptcy court's finding that the feasibility of the Wiersmas' plan was doubtful at best. Despite his general testimony at the confirmation hearing, Bob Matlick, who testified he thought the Wiersmas' proposed operation was "workable," ER Tab 8, p. 199, he revealed a number of profound uncertainties. Risks, not associated with dairy farming in Idaho, but clearly evident with the intended move to Georgia, were highlighted in the testimony of the Wiersmas' own expert. Mr. Matlick testified the market for milk from the Georgia dairy market differed from the Idaho market, because most milk in Georgia "goes fluid" rather than being made into cheese. ER Tab 8, p. 181. His incontrovertible testimony also highlighted that milk production was lower in the Florida and Georgia region than Idaho, ER Tab 8, p. 183, with heat and humidity as contributing factors. *Id.* at 221. Mr. Matlick indicated that his projections of the Wiersmas' milk production were greater than the production of the current owner of the Georgia dairy, attributing the increase to the Wiersmas' intention to milk three times a day, rather than twice a day like the current owners of the dairy. ER Tab 8, p. 182. He also testified that he did not use the current market price in Georgia to estimating cash flow because he liked "to look at historical numbers, as well as projected futures numbers." *Id.* at 192.

In addition to the uncertainties involved with the implementation of the Wiersmas' various plans, there were also risks, particularly for the Bank. The plans proposed to use all of the settlement proceeds in which the Bank claimed a security interest to purchase cows, and to grant the Bank a lien against all the cows until the secured claim was satisfied. This heightened the risk to the lender. Moreover, the plans did not provide the Bank a lien in replacement cattle, milk or milk proceeds. The level of risk to the Bank was supported by the record: Mr. Matlick testified that dairy prices were "off the historical highs" and that fluctuations in milk prices had been seen. ER Tab 8, p. 208. He acknowledged that "(c)urrently, [and] in the past eight months, the dairy industry had been stressed financially." ER Tab 8 p. 237. Finally, the Wiersmas' expert acknowledged that not all dairy operations were successful, and he admitted that he did not have any idea about the failure rate for dairy operations in southern Georgia. ER Tab 8, p. 234.

The Wiersmas maintain their plans were feasible. But "[s]incerity, honesty, and willingness are not sufficient to make the plan feasible, and neither are any visionary promises." *Clarkson*, 767 F.2d at 420. The Bankruptcy Code requires that a bankruptcy court confirm a plan only if "[c]onfirmation of the plan is not likely to be followed by the liquidation, or the need for further reorganization, of the debtor or any successor to the debtor under the plan, unless such liquidation or reorganization is proposed in the plan." 11 U.S.C. 1129(a)(11). In order for a chapter 11 plan to be confirmed, the proponent must demonstrate that the requirements of 11 U.S.C. 1129 are satisfied by a preponderance of the evidence. *Arnold and Baker Farms*, 177 B.R. 648, 654 (B.A.P. 9th Cir. 1994), *aff'd on other grounds*, 85 F.3d 1815 (1996). To demonstrate that a plan is feasible, a chapter 11 debtor must demonstrate "a reasonable probability of success." *Acequia, Inc. v. Clinton (In re Acequia*), 787 F.2d 1352, 1364 (9th Cir. 1986).

In this case, the Wiersmas sought to initiate an altogether new dairy farming operation in a geographical area far distant from their previous farms in a different climate and different market. With all of uncertainties and risks, the Wiersmas failed to establish "a reasonable probability" of success under their plans of reorganization. The Wiersmas were unable to file an acceptable plan even after being granted repeated opportunities to demonstrate the feasibility of their plans; this alone may constitute grounds for dismissal. *See, e.g., Hall v. Vance*, 887 F.2d 1041, 1044 (10th Cir. 1989) (dismissal proper where debtors failed to file a confirmable plan within eight months of petition, regardless of reason for failure).

Additionally, the bankruptcy court found the Wiersmas' third amended plan failed to meet the requirements of 11 U.S.C. 1129, thus rendering the plan unconfirmable. The plan bifurcated the Bank's claim into secured and unsecured portions. ER Tab 12, p. 790. As the court noted, "[a]s to the secured component, although the Bank has voted to reject" the plan, the Wiersmas "can nonetheless obtain confirmation over that rejection if they prove the Plan's treatment of the Bank's claim satisfies one of the three standards" of 11 U.S.C. 1129(b)(2)(A)." ER Tab 12, p. 791. In this case, the plan must meet the requirement of section 1129(b)(2)(A)(iii) by providing the Bank the "indubitable equivalent" of its secured claim. Currently, the Bank's interest is secured by cash, the "ultimate collateral." ER Tab 12, p. 795. The Wiersmas' plan, which proposed to use the cash to purchase cows and pay the bank over time, does not provide the Bank the same security. "The moment the [Wiersmas] exchange the $1.6 million in settlement proceeds for ownership of approximately 800 dairy animals in Georgia, the Bank is subjected to new, different, and potentially challenging risks of getting paid." ER Tab 12, p. 795. These additional enumerated risks mean that the Bank is not recognizing the "indubitable equivalent" of its secured claim, and therefore, the plan is not confirmable over the Bank's objection. *See Arnold & Baker Farms v. United States (In re Arnold & Baker Farms*), 85 F.3d 1415, 1421-22 (9th Cir. 1996) (to the extent a debtor seeks to alter the collateral securing a creditor's loan, providing the indubitable equivalent within the cram down provision of 11 U.S.C. 1129(b)(2)(A)(iii) requires that substitute collateral not increase the creditor's risk exposure). This forms an additional basis of cause under 11 U.S.C. 1112(b)(3). *Accord Windsor on the River Assocs. v. Balcor Real Estate Fin., Inc.* (*In re Windsor on the River Assocs*.), 7 F.3d 127 (8th Cir. 1993); *Lumber Exch. Bldg. Ltd. P'ship v. Mut. Life Ins. Co. of New York* (*In re Lumber Exch. Bldg. Ltd P'ship*), 968 F.2d 647 (8th Cir. 1992).

B. Cause existed for dismissal of the Wiersmas' chapter 11 bankruptcy case under 11 U.S.C. 1112(b)(5) because none of their proposed plans were confirmed.

Pursuant to 1112(b)(5), the bankruptcy court may dismiss a case for cause, including "denial of confirmation of every proposed plan and denial of a request made for additional time for filing another plan or a modification of a plan." 11

U.S.C. 1112(b)(5). The rationale behind 1112(b)(5) as "cause" for dismissal stems from the broad discretion exercised by bankruptcy courts to permit parties to submit numerous and alternative plans, but also their broad "discretion to say when enough is enough." *In re Woodbrook Assocs*., 19 F.3d 312, 322 (7th Cir. 1994). In light of the firmly-held convictions of a majority of struggling chapter 11 debtors that, given just one more chance, they will be able to successfully reorganize, this function of the court is often exercised and essential to the efficiency of the bankruptcy system.

The bankruptcy court demonstrated a great deal of patience with the Wiersmas' attempts to achieve plan confirmation. The fact remains, however, that none of these plans were confirmable. The court even granted the Wiersmas' one more "last chance" when it declined to dismiss the case after the February 11 hearing and gave them more time to work out a plan that the creditors would accept and allow to be confirmed. Ultimately, after denying confirmation of every plan that the Wiersmas proposed, the court determined that "enough was enough" and declined to grant the Wiersmas additional time to file a fourth amended plan. As a result, the bankruptcy court was well within its discretion to dismiss the Wiersmas' case under 11 U.S.C. 1112(b)(5).

2. The bankruptcy appellate panel and this Court lack jurisdiction over the February 11 and September 20 orders because there was no timely notice of appeal as required by 28 U.S.C. 158(c).

The timely filing of a notice of appeal is "mandatory and jurisdictional." *Browder v. Director, Dep't of Corr.*, 434 U.S. 257, 264 (1978); *see also In re Slimick*, 928 F.2d 304, 309 (9th Cir. 1990); *Greene v. United States* (*In re Souza*), 795 F.2d 855, 856-57 (9th Cir. 1986). Section 158(c)(2) of title 28 grants appellate jurisdiction only where the notice of appeal is filed in compliance with the time limits set forth in Fed. R. Bankr. P. 8002.

The jurisdiction of a bankruptcy appellate panel to review final judgments, orders and decrees of bankruptcy judges is established by 28 U.S.C. 158(b) and 158(c)(2). *Accord Hamilton v. Lake Elmo Bank* (*In re Delta Eng'g Int'l, Inc.*), 270 F.3d 584, 585 (8th Cir. 2001) (bankruptcy appellate panel jurisdiction conferred by 28 U.S.C. 158(b) and (c)). Therefore, jurisdiction cannot be expanded beyond what is authorized by section 158. Subsection 158(c)(2) expressly incorporates a time frame for appealing bankruptcy decisions to the district courts and BAPs, requiring that such appeals "shall be taken in the same manner as appeals in civil proceedings generally are taken to the courts of appeals from the district courts," and "*in the time provided by Rule 8002 of the Bankruptcy Rules*." 28 U.S.C. 158(c)(2) (emphasis added). In turn, unless extended as specified, Rule 8002(a) requires a notice of appeal be filed within ten days of the bankruptcy court's order.[5] *See, e.,g.*, *In re Bond*, 254 F.3d 669, 673 (7th Cir. 2001) (to perfect an appeal of a final judgment filed under section 158 and confer appellate jurisdiction, notice of appeal must be filed within ten days of bankruptcy court's decision); *River Prod. Co., Inc. v. Webb* (*In re Topco, Inc.*), 894 F.2d 727, 734 (5th Cir. 1990) (appeals under section 158(a) must comply with time requirements of section 158(c)) (citing Fed. R. Bankr. P. 8002).

With respect to the September 20, 2002, and February 11, 2003, orders, the April 9, 2003, notice of appeal was filed untimely under 28 U.S.C. 158 and Rule 8002. The debtors filed a timely motion for reconsideration of the February 11, 2003, order, which tolled the time for filing a notice of appeal until ten days after the court's ruling on that motion. *See* Fed. R. Bankr. P. 8002(b). The reconsideration motion was denied by an order entered on March 28, 2003. ER Tab 27, p. 1015. Therefore, the time to file a notice of appeal of the February 11, 2003, order ran on April 7, 2003, with the result that the Wiersmas' April 9, 2003, notice of appeal was untimely. *See* Fed. R. Bankr. P. 8002.

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[5] It is worth noting that 28 U.S.C. 158(c)(2), not Fed. R. Bankr. P. 8002, creates the jurisdictional requirement of a timely appeal. As the Supreme Court recently noted in *Kontrick v. Ryan*, procedural rules may not create or withdraw jurisdiction. 124 S. Ct. 906, 914 (2004). Unlike the statute at issue in *Kontrick*, however, section 158(c)(2) is one of the "[c]ertain statutory provisions" which "contain built-in time constraints." *Kontrick v. Ryan*, 124 S. Ct. 906, 914 (2004).

Likewise, with respect to the September 20, 2002, order, the April 9, 2003, notice that initiated the instant appeal[6/] was clearly untimely, having been filed more than six months after entry of the order.[7/]

Where a district court or BAP lacks subject matter jurisdiction, a circuit court of appeals also lacks jurisdiction. *See, e.g., Lievsay v. Western Fin. Sav. Bank* (*In re Lievsay*), 118 F.3d 661, 662 (9th Cir. 1997) (court of appeals has jurisdiction over final orders of BAP); *Don Vincente Macias, Inc. v. Texas Gulf Trawling Co., Inc. (In re Don Vincente Macias, Inc.),* 168 F.3d 209, 211 (5th Cir.

[6/] The debtor previously appealed the September 20, 2002, order, but these appeals were dismissed and mandates were issued on March 6, 2003, and the dismissal was never appealed. On September 8, 2003, the BAP vacated the orders dismissing the appeals, reinstated them, and constructively consolidated them with the instant appeal. The BAP lacked jurisdiction to do so because it had not recalled its mandate. *See, e.g., Sunset Sales, Inc. v. Clarendon Nat'l Ins. Co.* (*In re Sunset Sales, Inc.*), 195 F.3d 568, 572 (10th Cir. 1999); *Neary v. Padilla* (*In re Padilla*), 222 F.3d 1184, 1189-90 (9th Cir. 2000); *Ellis v. United States Dist. Ct. for the Western Dist. of Washington*, 360 F.3d 1022, 1022-23 (9th Cir. 2004) (mandate is a "secondary decree relinquishing jurisdiction over the case to the [lower] court."); *United States v. Ruiz-Alvarez*, 211 F.3d 1181, 1184 (9th Cir. 2000); *Beardslee v. Brown,* 393 F.3d 899, 901 (9th Cir. 2004); *see also, e.g., Calderon v. Thompson*, 523 U.S. 538, 550 (1998) (mandates should be recalled only in "extraordinary circumstances").

[7/] The BAP incorrectly concluded it had subject matter jurisdiction over the appeal of the September 2002, even though there was no timely notice of appeal. The basis for this conclusion is the court had mistakenly dismissed the appeal in 2002, and it had "inherent authority to rectify an inadvertent misapprehension of the actual facts and correct an order to reflect the court's intentions." ER Tab 25, p. 896 at 16 (citations omitted).

1999)*; Weston v. Mann* (*In re Weston*), 18 F.3d 860, 862 (10th Cir. 1994); *Colon v. Hart* (*In re Colon*), 941 F.2d 242, 244 (3d Cir. 1991).

"Federal courts are not courts of general jurisdiction; they have only the power that is authorized by article III of the Constitution and the statutes enacted by Congress thereto." *Bender v. Williamsport Area Sch. Dist.*, 475 U.S. 534, 541 (1986). Subject matter jurisdiction can be raised at any time, "even initially at the highest appellate interest." *Grupo Dataflux v. Atlas Global Group, L.P.*, 541 U.S. 567, 576 (2004) (quoting *Kontrick v. Ryan*, 124 S. Ct. 906, 915 (2004)). Moreover, an objection to a federal court's subject matter jurisdiction cannot be forfeited. *Id.; see also Kontrick*, 124 S. Ct. at 916. Nor can subject-matter jurisdiction be conferred by agreement of the parties or a defect in jurisdiction waived. *See, e.g.*, *United States v. Cotton*, 535 U.S. 625, 630-31 (2002). Therefore, this Court lacks jurisdiction over the appeal of the bankruptcy court orders entered September 20, 2002, and February 11, 2002, and the appeal should be dismissed with respect to those orders.

Conclusion

For the aforementioned reasons, the United States Trustee respectfully requests that the appeal of the September 20, 2002, order and the February 11, 2003, orders be DISMISSED and that the April 4, 2003, order of the bankruptcy court dismissing the bankruptcy case be AFFIRMED.

Dated:

Ilene J. Lashinsky
United States Trustee
U.S. Department of Justice

____

Michele M. Mansfield
Trial Attorney
Department of Justice
20 Massachusetts Ave., N.W., Ste 8000
(202) 307-1399
Fax (202) 307-2397

ADDENDUM

11 U.S.C. 1112

Sec. 1112. Conversion or dismissal

(a) The debtor may convert a case under this chapter to a case under chapter 7 of this title unless--

(1) the debtor is not a debtor in possession;

(2) the case originally was commenced as an involuntary case under this chapter; or

(3) the case was converted to a case under this chapter other than on the debtor's request.

(b) Except as provided in subsection (c) of this section, on request of a party in interest or the United States trustee or bankruptcy administrator, and after notice and a hearing, the court may convert a case under this chapter to a case under chapter 7 of this title or may dismiss a case under this chapter, whichever is in the best interest of creditors and the estate, for cause, including--

(1) continuing loss to or diminution of the estate and absence of a reasonable likelihood of rehabilitation;

(2) inability to effectuate a plan;

(3) unreasonable delay by the debtor that is prejudicial to creditors;

(4) failure to propose a plan under section 1121 of this title within any time fixed by the court;

(5) denial of confirmation of every proposed plan and denial of a request made for additional time for filing another plan or a modification of a plan;

(6) revocation of an order of confirmation under section 1144 of this title, and denial of confirmation of another plan or a modified plan under section 1129 of this title;

(7) inability to effectuate substantial consummation of a confirmed plan;

(8) material default by the debtor with respect to a confirmed plan;

(9) termination of a plan by reason of the occurrence of a condition specified in the plan; or

(10) nonpayment of any fees or charges required under chapter 123 of title 28.

(c) The court may not convert a case under this chapter to a case under chapter 7 of this title if the debtor is a farmer or a corporation that is not a moneyed, business, or commercial corporation, unless the debtor requests such conversion.

(d) The court may convert a case under this chapter to a case under chapter 12 or 13 of this title only if--

(1) the debtor requests such conversion;

(2) the debtor has not been discharged under section 1141(d) of this title; and

(3) if the debtor requests conversion to chapter 12 of this title, such conversion is equitable.

(e) Except as provided in subsections (c) and (f), the court, on request of the United States trustee, may convert a case under this chapter to a case under chapter 7 of this title or may dismiss a case under this chapter, whichever is in the best interest of creditors and the estate if the debtor in a voluntary case fails to file, within fifteen days after the filing of the petition commencing such case or such additional time as the court may allow, the information required by paragraph (1) of section 521, including a list containing the names and addresses of the holders of the twenty largest unsecured claims (or of all unsecured claims if there are fewer than twenty unsecured claims), and the approximate dollar amounts of each of such claims.

(f) Notwithstanding any other provision of this section, a case may not be converted to a case under another chapter of this title unless the debtor may be a debtor under such chapter.

11 U.S.C. 1129

Sec. 1129. Confirmation of plan

(a) The court shall confirm a plan only if all of the following requirements are met:

(1) The plan complies with the applicable provisions of this title.

(2) The proponent of the plan complies with the applicable provisions of this title.

(3) The plan has been proposed in good faith and not by any means forbidden by law.

(4) Any payment made or to be made by the proponent, by the debtor, or by a person issuing securities or acquiring property under the plan, for services or for costs and expenses in or in connection with the case, or in connection with the plan and incident to the case, has been approved by, or is subject to the approval of, the court as reasonable.

(5)(A)(i) The proponent of the plan has disclosed the identity and affiliations of any individual proposed to serve, after confirmation of the plan, as a director, officer, or voting trustee of the debtor, an affiliate of the debtor participating in a joint plan with the debtor, or a successor to the debtor under the plan; and

(ii) the appointment to, or continuance in, such office of such individual, is consistent with the interests of creditors and equity security holders and with public policy; and

(B) the proponent of the plan has disclosed the identity of any insider that will be employed or retained by the reorganized debtor, and the nature of any compensation for such insider.

(6) Any governmental regulatory commission with jurisdiction, after confirmation of the plan, over the rates of the debtor has approved any rate change provided for in the plan, or such rate change is expressly conditioned on such approval.

(7) With respect to each impaired class of claims or interests--

(A) each holder of a claim or interest of such class--

(i) has accepted the plan; or

(ii) will receive or retain under the plan on account of such claim or interest property of a value, as of the effective date of the plan, that is not less than the amount that such holder would so receive or retain if the debtor were liquidated under chapter 7 of this title on such date; or

(B) if section 1111(b)(2) of this title applies to the claims of such class, each holder of a claim of such class will receive or retain under the plan on account of such claim property of a value, as of the effective date of the plan, that is not less than the value of such holder's interest in the estate's interest in the property that secures such claims.

(8) With respect to each class of claims or interests--

(A) such class has accepted the plan; or

(B) such class is not impaired under the plan.

(9) Except to the extent that the holder of a particular claim has agreed to a different treatment of such claim, the plan provides that--

(A) with respect to a claim of a kind specified in section 507(a)(1) or 507(a)(2) of this title, on the effective date of the plan, the holder of such claim will receive on account of such claim cash equal to the allowed amount of such claim;

(B) with respect to a class of claims of a kind specified in section 507(a)(3), 507(a)(4), 507(a)(5), 507(a)(6), or 507(a)(7) of this title, each holder of a claim of such class will receive--

(i) if such class has accepted the plan, deferred cash payments of a value, as of the effective date of the plan, equal to the allowed amount of such claim; or

(ii) if such class has not accepted the plan, cash on the effective date of the plan equal to the allowed amount of such claim; and

(C) with respect to a claim of a kind specified in section 507(a)(8) of this title, the holder of such claim will receive on account of such claim deferred cash payments, over a period not exceeding six years after the date of assessment of such claim, of a value, as of the effective date of the plan, equal to the allowed amount of such claim.

(10) If a class of claims is impaired under the plan, at least one class of claims that is impaired under the plan has accepted the

plan, determined without including any acceptance of the plan by any insider.

(11) Confirmation of the plan is not likely to be followed by the liquidation, or the need for further financial reorganization, of the debtor or any successor to the debtor under the plan, unless such liquidation or reorganization is proposed in the plan.

(12) All fees payable under section 1930 of title 28, as determined by the court at the hearing on confirmation of the plan, have been paid or the plan provides for the payment of all such fees on the effective date of the plan.

(13) The plan provides for the continuation after its effective date of payment of all retiree benefits, as that term is defined in section 1114 of this title, at the level established pursuant to subsection (e)(1)(B) or (g) of section 1114 of this title, at any time prior to confirmation of the plan, for the duration of the period the debtor has obligated itself to provide such benefits.

(b)(1) Notwithstanding section 510(a) of this title, if all of the applicable requirements of subsection (a) of this section other than paragraph (8) are met with respect to a plan, the court, on request of the proponent of the plan, shall confirm the plan notwithstanding the requirements of such paragraph if the plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan.

(2) For the purpose of this subsection, the condition that a plan be fair and equitable with respect to a class includes the following requirements:

(A) With respect to a class of secured claims, the plan provides--

(i)(I) that the holders of such claims retain the liens securing such claims, whether the property subject to such liens is retained by the debtor or transferred to another entity, to the extent of the allowed amount of such claims; and

(II) that each holder of a claim of such class receive on account of such claim deferred cash payments totaling at least the allowed amount of such claim, of a value, as of the effective date of the plan, of at least the value of such holder's interest in the estate's interest in such property;

(ii) for the sale, subject to section 363(k) of this title, of any property that is subject to the liens securing such claims, free and clear of such liens, with such liens to attach to the proceeds of such sale, and the treatment of such liens on proceeds under clause (i) or (iii) of this subparagraph; or

(iii) for the realization by such holders of the indubitable equivalent of such claims.

(B) With respect to a class of unsecured claims--

(i) the plan provides that each holder of a claim of such class receive or retain on account of such claim property of a value, as of the effective date of the plan, equal to the allowed amount of such claim; or

(ii) the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any property.

(C) With respect to a class of interests--

(i) the plan provides that each holder of an interest of such class receive or retain on account of such interest property of a value, as of the effective date of the plan, equal to the greatest of the allowed amount of any fixed liquidation preference to which such holder is entitled, any fixed redemption price to which such holder is entitled, or the value of such interest; or

(ii) the holder of any interest that is junior to the interests of such class will not receive or retain under the plan on account of such junior interest any property.

(c) Notwithstanding subsections (a) and (b) of this section and except as provided in section 1127(b) of this title, the court may confirm only one plan, unless the order of confirmation in the case has been revoked under section 1144 of this title. If the requirements of subsections (a) and (b) of this section are met with respect to more than one plan, the court shall consider the preferences of creditors and equity security holders in determining which plan to confirm.

(d) Notwithstanding any other provision of this section, on request of a party in interest that is a governmental unit, the court may not confirm a plan if the principal purpose of the plan is the avoidance of taxes or the avoidance of the application of section 5 of the Securities Act of 1933. In any hearing under this subsection, the governmental unit has the burden of proof on the issue of avoidance.

28 U.S.C. 158

Section 158. Appeals

(a) The district courts of the United States shall have jurisdiction to hear appeals

(1) from final judgments, orders, and decrees;

(2) from interlocutory orders and decrees issued under section 1121(d) of title 11 increasing or reducing the time periods referred to in section 1121 of such title; and

(3) with leave of the court, from other interlocutory orders and decrees; and, with leave of the court, from interlocutory orders and decrees, of bankruptcy judges entered in cases and proceedings referred to the bankruptcy judges under section 157 of this title. An appeal under this subsection shall be taken only to the district court for the judicial district in which the bankruptcy judge is serving.

(b)(1) The judicial council of a circuit shall establish a bankruptcy appellate panel service composed of bankruptcy judges of the districts in the circuit who are appointed by the judicial council in accordance with paragraph (3), to hear and determine, with the consent of all the parties, appeals under subsection (a) unless the judicial council finds that–

(A) there are insufficient judicial resources available in the circuit; or

(B) establishment of such service would result in undue delay or increased cost to parties in cases under title 11.

Not later than 90 days after making the finding, the judicial council shall submit to the Judicial Conference of the United States a report containing the factual basis of such finding.

(2) (A) A judicial council may reconsider, at any time, the finding described in paragraph (1).

(B) On the request of a majority of the district judges in a circuit for which a bankruptcy appellate panel service is established under paragraph (1), made after the expiration of the 1-year period beginning on the date such service is established, the judicial council of the circuit shall determine whether a circumstance specified in subparagraph (A) or (B) of such paragraph exists.

(C) On its own motion, after the expiration of the 3-year period beginning on the date a bankruptcy appellate panel service is established under paragraph (1), the judicial council of the circuit may determine whether a circumstance specified in subparagraph (A) or (B) of such paragraph exists.

(D) If the judicial council finds that either of such circumstances exists, the judicial council may provide for the completion of the appeals then pending before such service and the orderly termination of such service.

(3) Bankruptcy judges appointed under paragraph (1) shall be appointed and may be reappointed under such paragraph.

(4) If authorized by the Judicial Conference of the United States, the judicial councils of 2 or more circuits may establish a joint bankruptcy appellate panel comprised of bankruptcy judges from the districts within the circuits for which such panel is established, to hear and determine, upon the consent of all the parties, appeals under subsection (a) of this section.

(5) An appeal to be heard under this subsection shall be heard by a panel of 3 members of the bankruptcy appellate panel service, except that a member of such service may not hear an appeal originating in the district for which such member is appointed or designated under section 152 of this title.

(6) Appeals may not be heard under this subsection by a panel of the bankruptcy appellate panel service unless the district judges for the district in which the appeals occur, by majority vote, have authorized such service to hear and determine appeals originating in such district.

(c)(1) Subject to subsection (b), each appeal under subsection (a) shall be heard by a 3-judge panel of the bankruptcy appellate panel service established under subsection (b)(1) unless–

(A) the appellant elects at the time of filing the appeal; or

(B) any other party elects, not later than 30 days after service of notice of the appeal;

to have such appeal heard by the district court.

(2) An appeal under subsections (a) and (b) of this section shall be taken in the same manner as appeals in civil proceedings generally are taken to the courts of appeals from the district courts and in the time provided by Rule 8002 of the Bankruptcy Rules.

(d) The courts of appeals shall have jurisdiction of appeals from all final decisions, judgments, orders, and decrees entered under subsections (a) and (b) of this section.

Related Cases

I certify that I am not aware of any pending related cases before this Court.

______________________________________ ________________
Signed Dated

Certificate of Compliance

I certify that the foregoing is in compliance with the type-volume limitation. This brief, including table of contents, table of authorities, addendums and certificates contains 9729 words according to the WordPerfect9 program in which it was created.

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I certify that on the____ day of July, 2005, I filed the original and fifteen copies of the foregoing document to the Clerk of Court, United States Court of Appeals for the Ninth Circuit, P.O. Box 193939, San Francisco, CA 94119-3939, by placing such in the United States mail, postage prepaid.

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Brent T. Robinson
Ling & Robinson
P.O. Box 396
Rupert, ID 83350

Kelly McConnell
Givens Pursley
601 West Bannock Street
Boise, ID 83702

William Hollifield
249 Third Avenue East
P.O. Box 66
Twin Falls, ID 83303

Signed:________________________________

Date:____________________

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1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*
CAPLIN & DRYSDALE, CHARTERED v. THE UNITED STATES TRUSTEE

E.D.L.A.

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*

3. ("CCN") ***CURRENT*** CASE NO.
No.: 06-9964

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*
No.: 00-10992
Court: Bankr. E.D.L.A
(Identify judge & cite, if any)

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Eric Bradford
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***

A bankruptcy court may award estate professionals "reasonable § compensation for actual, necessary services" under 11 U.S.C. § 330(a)(1)(A). In determining "reasonable" compensation, a bankruptcy court may consider a non-exclusive list of five "relevant factors" pertaining to the "nature, the extent and the value" of the services rendered, including "the customary compensation charged by comparably skilled practitioners" in non-bankruptcy cases. 11 U.S.C. 330(a)(3)(E).

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UNITED STATES DISTRICT COURT EASTERN DISTRICT OF LOUISIANA

CAPLIN & DRYSDALE, CHARTERED
v.
THE UNITED STATES TRUSTEE, REGION 5
CIVIL ACTION NO. 06-9964 SECT. "R" MAG. 5

IN RE: THE BABCOCK & WILCOX COMPANY ET AL.
BANKRUPTCY COURT DOCKET NO. 00-10992 SECT. "B"

ON APPEAL FROM A DECISION OF
THE UNITED STATES BANKRUPTCY COURT,
EASTERN DISTRICT OF LOUISIANA,
TO THE UNITED STATES DISTRICT COURT,
EASTERN DISTRICT OF LOUISIANA

BRIEF OF THE UNITED STATES TRUSTEE, REGION 5

R. MICHAEL BOLEN
United States Trustee, Region 5
Judicial Districts of
Louisiana and Mississippi
Mary S. Langston (22818)
Robert C. Gravolet (8404)
400 Poydras Street
Suite 2110
New Orleans, Louisiana 70130
ATTORNEYS FOR APPELLEE

Of Counsel:
Roberta A. DeAngelis
Acting General Counsel
P. Matthew Sutko
Walter W. Theus, Jr.
Executive Office for United States Trustees
20 Massachusetts Avenue, NW
Washington, D.C. 20530

Eric Bradford
Office of the United States Trustee
10 Causeway Street, Room 1184
Boston, Massachusetts 02222

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STATEMENT OF JURISDICTION

The United States Bankruptcy Court for the Eastern District of Louisiana had jurisdiction over the Babcock & Wilcox Company chapter 11 bankruptcy cases under 28 U.S.C. § 157(a) and (b) and 1334(a). ACD 27.[1] On July 27, 2006, the bankruptcy court approved a final fee award of $6,387,522.11 to Caplin & Drysdale, Chartered ("Caplin") as counsel for the Asbestos Claimants' Committee ("Committee"). ACD 37. The order allowed Caplin to recover 573.7 hours of non-working travel time at 50% of its normal hourly rates, reducing the firm's fees by $135,685.80, or 2% of the total requested. Id. The order also reimbursed Caplin for coach rather than first class airfare, reducing the firm's expenses by $33,266.23, or 4% of the total requested. Id. The bankruptcy court denied Caplin's motion for reconsideration of a prior, interlocutory fee order. Id. Caplin appealed the bankruptcy court's July 27, 2006 order by notice of appeal filed under 28 U.S.C. § 158(c)(2) and Fed. R. Bankr. P. 8002 on July 28, 2006. ACD 38. This Court has jurisdiction over this appeal under 28 U.S.C. § 158(a)(1).

STANDARD OF REVIEW

A bankruptcy court's ultimate award of fees is reviewed for abuse of discretion. In re Cahill, 428 F.3d 536, 539 (5th Cir. 2005).[2] Subsidiary factual determinations, including those

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[1] The United States Trustee refers to the record below by citing to Caplin's appendix as "ACD __" and to the United States Trustee's appendix as "AUS __."

[2] "An abuse of discretion occurs where the bankruptcy court (1) applies an improper legal standard or follows improper procedures in calculating the fee award, or (2) rests its decision on findings of fact that are clearly erroneous . . . Accordingly, we review the bankruptcy court's legal conclusions de novo and its findings of fact for clear error . . . ." Id. (citations omitted). See In re Walker, 168 B.R. 114, 117 and 122 (E.D. La. 1994) (holding that "[t]he factual determination with respect to a fee award is within the discretion of the bankruptcy court and, therefore, should also be reviewed deferentially under an abuse of discretion standard . . . .") (affirming order granting fees for violation of the automatic stay under 11 U.S.C. § 362).

pertaining to the prevailing billing practices in a professional's community and the reasonableness of its hourly rates, can be reversed only upon a showing of clear error. Id. at 542; League of United Latin American Citizens #4552 v. Roscoe Ind. School District, 119 F.3d 1228, 1234 – 1235 (5th Cir. 1997). This deferential standard is appropriate here, owing to "the bankruptcy judge's closeness to the issues raised in an application for attorneys' fees; the bankruptcy judge has not only presided over the evidentiary hearing, but also had the opportunity to observe the performance of the attorney throughout his employment in the bankruptcy court . . . ." Cahill at 542 (internal quotations omitted). See In re Coho Energy, Inc., 395 F.3d 198, 204 (5th Cir.2004).[3]

STATEMENT OF THE ISSUES PRESENTED FOR REVIEW

1. A bankruptcy court may award estate professionals "reasonable compensation for actual, necessary services" under 11 U.S.C. § 330(a)(1)(A). In determining "reasonable" compensation, a bankruptcy court may consider a non-exclusive list of five "relevant factors" pertaining to the "nature, the extent and the value" of the services rendered, including "the customary compensation charged by comparably skilled practitioners" in non-bankruptcy cases. 11 U.S.C. § 330(a)(3)(E). A professional bears the burden of proving that its fees are both necessary and "reasonable." If it fails to do so, the bankruptcy court may "award compensation

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[3] Neither of the cases cited by Caplin & Drysdale as supporting de novo review pertains to an appeal of an order granting fees and expenses under any section of the Bankruptcy Code, including 11 U.S.C. § 330(a). See Appellant's Opening Brief at 2 – 3. Scurlock Permian Corp. v. Krafsur (Matter of El Paso Refinery, LP), 171 F.3d 249, 253 (5th Cir. 1999) (reversing preference judgment under 11 U.S.C. § 547(b)); Bustamante v. Cueva (In re Cueva), 371 F.3d 232, 235 – 236 (5th Cir. 2004) (affirming reversal of declaratory judgment under 11 U.S.C. § 362(a)). C/f Watkins v. Fordice, 807 F.Supp. 406, 414 (S.D. Miss. 1992), vacated and remanded on other grounds, 7 F.3d 453, 459 (5th Cir. 1993) (holding that the district court's decision to reduce an attorney's hourly rate for travel time by 50% as part of an award of attorneys' fees under the Civil Rights Act of 1964, 42 U.S.C. § 2000e-5(k), was not an abuse of discretion).

that is less than the amount of compensation that is requested . . . ." 11 U.S.C. § 330(a)(2). At a March 12, 2003 hearing, Caplin failed to meet its burden of proof under section 330(a)(1)(A), because it presented no evidence of any of the five "relevant factors," including whether comparably skilled practitioners in its New York and Washington, D.C. practice areas billed their non-bankruptcy clients for non-working travel time at their full hourly rates. 11 U.S.C. § 330(a)(3)(E). At best, Caplin offered only unsupported opinion testimony regarding its preferred billing practices. Given Caplin's failure to meet its burden of proof, did the bankruptcy court abuse its discretion in awarding the firm fees for non-working travel time at 50% of its hourly rates?

2. A bankruptcy court may authorize reimbursement of estate professionals' "necessary" expenses under 11 U.S.C. § 330(a)(1)(B). A professional bears the burden of proving that its expenses are "necessary." If it fails to do so, the bankruptcy court may "award compensation that is less than the amount of compensation that is requested . . . ." 11 U.S.C. § 330(a)(2). At a March 12, 2003 hearing, Caplin offered no evidence that flying its professionals first class was required to accomplish the proper representation of the Committee. Caplin demonstrated only that it routinely charged its clients for first class air travel. Where Caplin failed to provide evidence that first class airfare expenses were necessary under section § 330(a)(2), did the bankruptcy court abuse its discretion in reimbursing its airfare expenses at coach rates?

STATEMENT OF THE CASE

The Babcock & Wilcox Company and three affiliates filed chapter 11 bankruptcy cases in an effort to reorganize their businesses. The United States Trustee appointed the Committee under 11 U.S.C. § 1102(a). AUS 3. Acting under 11 U.S.C. § 1103(a), the bankruptcy court appointed Caplin to serve as counsel for the Committee. AUS 6. The bankruptcy court authorized estate professionals, including Caplin, to receive interim compensation and reimbursement of fees.

The United States Trustee objected to Caplin's first interim fee application under 11 U.S.C. § 330(a), because it sought to charge the estates for non-productive professional travel time at its full hourly rates and for first class, rather than coach, airfare. AUS 13. No other bankruptcy professionals asked for similar fees and expenses.

Pending final resolution by the bankruptcy court, the United States Trustee and Caplin agreed that Caplin could collect these amounts on an interim basis. AUS 17 – 19 and 21 - 22; ACD 2, 3, 4, 5, 6, 7. The United States Trustee objected to Caplin's seventh interim fee application and renewed its previously-expressed concerns. ACD 8, 10.

The bankruptcy court conducted an evidentiary hearing on Caplin's seventh interim fee application on March 12, 2003. ADC 1. The court sustained the United States Trustee's objections. ACD 1, 14. Caplin appealed. ACD 15.

The court's March 12, 2003 order was interlocutory. ACD 15, 16 and 18. With the approval of this Court, Caplin dismissed its appeal, and the parties preserved the issues until the bankruptcy court considered Caplin's final fee application. ACD 18, 27, 28.

Caplin filed its final fee application on April 17, 2006. ACD 27. It also asked the bankruptcy court to reconsider its March 12, 2003 order. Id.

The bankruptcy court entered an order dated July 27, 2006 that awarded Caplin final fees and expenses totaling $6,387,522.11. ACD 37. The order awarded non-working travel time at 50% of Caplin's hourly rates, reducing its total fees by $135,685.80 or 2%. Id. The order also reimbursed Caplin for its airfare expenses at coach rather than first class, reducing its total expenses by $33,266.23 or 4%. Id. The July 27, 2006 order also denied Caplin's request for reconsideration. Id. This appeal followed. ACD 38.

STATEMENT OF THE FACTS

A. Statutory Framework

The Bankruptcy Code, 11 U.S.C. § 101 et seq., regulates the retention, compensation and payment of bankruptcy professionals in chapter 11 and 7 cases. It grants significant discretion to bankruptcy courts in calculating reasonable professional fees in order to protect estate assets and to promote the integrity of the bankruptcy system. The United States Trustee has standing to object to bankruptcy professional fee applications in chapter 11 and 7 cases. 28 U.S.C. § 586(a)(3)(A); 11 U.S.C. § 307 and § 330(a)(2).

Section 1102(a) authorizes the United States Trustee to appoint one or more unsecured creditors' committees. A creditors' committee may hire bankruptcy professionals to assist it in fulfilling its responsibilities "with the court's approval . . . ." 11 U.S.C. § 1103. These professionals, as well as those employed by the debtor, are entitled to first priority payment under 11 U.S.C. § 503(a) and § 507(a)(1) ahead of general unsecured creditors.

The Bankruptcy Code provides two mechanisms for compensating committee professionals. Section 328(a), which is inapplicable here, authorizes a committee to employ professionals "on any reasonable terms and conditions of employment, including on a retainer, on an hourly basis, or on a contingent fee basis . . . ." 11 U.S.C. § 328(a). Section 328(a) permits a bankruptcy court subsequently to award different compensation only if the pre-approved "terms and conditions of employment prove to have been improvident in light of developments not capable of being anticipated at the time of the fixing of such terms and conditions . . . ."

Section 330(a) authorizes a bankruptcy court to pay committee professionals "reasonable" compensation for their "actual and necessary services." 11 U.S.C. § 330(a)(1)(A). The court may authorize reimbursement of the professionals' "actual" expenses if they are "necessary." 11 U.S.C. § 330(a)(1)(B). Section 330's requirements regarding reasonable compensation and reimbursement of necessary expenses are particularly important in the context of a creditors' committee, because its professionals' fees are paid by the bankruptcy estate, not the committee members. 11 U.S.C. § 503(b)(3).

Bankruptcy professionals bear the burden of demonstrating their entitlement to fees and expenses under 11 U.S.C. § 330(a). If a professional fails to meet his burden of proof under 11 U.S.C. § 330(a), the bankruptcy court, with or without an objection from a party in interest, may award compensation "less than the amount of compensation that is requested . . . ." 11 U.S.C. § 330(a)(2). Moreover, section 330(a)(4) prohibits the bankruptcy court from awarding compensation for "unnecessary duplication of services . . . or . . . services that were not . . . reasonably likely to benefit the debtor's estate . . . or . . . necessary to the administration of the estate . . . ." 11 U.S.C. § 330(a)(4). Section 331 authorizes bankruptcy professionals to seek interim compensation on the same basis as under section 330(a). 11 U.S.C. § 331.

United States Trustees are officials of the Department of Justice appointed by the Attorney General to supervise the administration of bankruptcy cases and trustees. See 28 U.S.C. §§ 581-589 (specifying the powers and duties of United States Trustees).[4] Congress has

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[4] See also In re Columbia Gas Sys., Inc., 33 F.3d 294, 296 (3d Cir. 1994) (United States Trustees oversee the bankruptcy process, protect the public interest, and ensure that bankruptcy cases are conducted according to law) (citing H.R. Rep. No. 95-595, 109 (1977)); United States Trustee v. Revco D.S., Inc. (In re Revco D.S., Inc.), 898 F.2d 498, 499 (6th Cir. 1990) ("[t]he United States trustee, an officer of the Executive Branch, represents . . . [the] public interest . . . ."); In re Castillo, 297 F.3d 940, 950 (9th Cir. 2002) ("The United States Trustee is the 'watchdog' of the bankruptcy system . . . charged with preventing fraud and abuse and with 'fill[ing] the vacuum' caused by

expressly authorized United States Trustees to comment upon and object to fee applications filed by bankruptcy professionals. 28 U.S.C. § 586(a)(3)(A); 11 U.S.C. § 307 and § 330(a)(2). The United States Trustees have issued guidelines regarding bankruptcy professional fee applications in chapter 11 and 7 cases. 28 C.F.R. Pt. 58, App. A (1996).

B. Factual Background.

The Babcock & Wilcox Company, together with three affiliates, Diamond Power International, Inc., Babcock & Wilcox Construction Co., Inc. and Americon, Inc., sought relief under the debt reorganization provisions of chapter 11 of the Bankruptcy Code, 11 U.S.C. § 1101, et seq., by petitions filed on February 22, 2000.[5] That same day, the bankruptcy court entered orders authorizing joint administration of the debtors' cases and establishing procedures for interim compensation of estate professionals, including those employed by official committees.[6]

The United States Trustee appointed the Committee under 11 U.S.C. § 1102 on March 3, 2000. AUS 4. The Committee filed an application to retain Caplin as its counsel on March 3, 2000. AUS 2. The application neither attached an executed retention agreement between the Committee and Caplin nor otherwise specified the terms and conditions of Caplin's employment,

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possible creditor inactivity . . . .").

[5] The United States Trustee reprints the principal statutes it relies upon, 11 U.S.C. § 330(a), 503, 507, 1102 and 1103, in an addendum attached to this brief.

[6] The interim compensation order authorized professionals to submit 20 day trailing fee statements to the debtors, with copies to "service parties," for worked performed during the previous month. It required the debtors to pay 80% of the requested fees and 100% of the requested expenses upon receipt of a fee statement, unless one of the service parties objected upon ten days negative notice. The interim compensation order also required professionals to file with the bankruptcy court formal fee applications approximately every four months under 11 U.S.C. § 331. The bankruptcy court modified certain terms of the order on June 28, 2000.

including the range of hourly rates to be charged by the firm's professionals. It did not state that Caplin intended to charge non-working travel time at its full hourly rate and to request reimbursement for airfare expenses at first class rates. Id.

The application did not attempt to establish a compensation plan for Caplin under 11 U.S.C. § 328(a). Id. Instead, it made Caplin's fees and expenses payable only after bankruptcy court approval for reasonableness and necessity under 11 U.S.C. § 330(a). Id.

As required by Bankruptcy Rule 2014, the Committee attached an affidavit from the Caplin attorney responsible for the case, Elihu Inselbuch. Fed. R. Bankr. P. 2014. Like the application, the affidavit did not specify the terms and conditions upon with Caplin agreed to work, and it referenced no written retention agreement.[7] AUS 2.

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[7] In reciting Caplin & Drysdale's qualifications to serve as committee counsel, Attorney Inselbuch pointed out that the firm represented the creditors' committee "involving Raytech Corporation . . . in a chapter 11 proceeding currently approaching confirmation in the Bankruptcy Court for the District of Connecticut . . . ." AUS 4.

Given the complexity of the debtors' cases, the estates retained more than 20 professionals with "national" bankruptcy practices located in Los Angeles, New York, Chicago, Washington, D.C. and Wilmington. These constituencies also retained local, New Orleans professionals. The bankruptcy court did not authorize any professional employed by the debtors or any committee to charge the estates for non-working travel time at its full hourly rates and first class airfare expenses.

By order dated March 16, 2000, the bankruptcy court granted the Committee's application to employ Caplin retroactively to March 3, 2000. AUS 4. The order stated that "Caplin & Drysdale is to be allowed compensation and reimbursement for its expenses in accordance with Sections 330(a) and 331 of the Bankruptcy Code . . . ." Id.

On September 22, 2000, the United States Trustee filed an omnibus objection to the first interim fee applications filed by five estate professionals, including Caplin. ACD 2; AUS 11. Among other things, the United States Trustee raised concerns about fees and expenses attributable to travel and meals. Id.

The bankruptcy court conducted an evidentiary hearing on the United States Trustee's objection on September 27, 2000. AUS 13. The United States Trustee requested that the bankruptcy court determine appropriate hourly rates for the professionals. Id. at 20 – 21. Attorney Inselbuch testified that Caplin's hourly rates set forth in its first interim fee application were the same as those it charged its clients "across the board," that they were consistent with those charged by comparable firms in its practice areas – New York and Washington, D.C. - and that other bankruptcy courts had recently approved them.[8] Id. at 22 – 24. He did not mention

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[8] In response to the court's questions, Attorney Inselbuch stated that the Bridgeport, Connecticut bankruptcy court had approved Caplin's hourly rates in a case (presumably Raytech), where the firm represented a creditors' committee. Id. at 25 - 26.

whether Caplin and/or the other firms in its practice area billed their non-bankruptcy clients for non-working travel time at their full hourly rates. He also did not testify whether Caplin and/or similar firms charged their non-bankruptcy clients for first class airfare rather than coach. After hearing the testimony, the bankruptcy court authorized Caplin to bill the estates at its normal hourly rates.[9] Id. at 31 – 32. The court made no modifications to the terms of Caplin's employment under its March 16, 2000 order, and it did not limit its discretion to review Caplin's fees and expenses at the end of the case under 11 U.S.C. § 330(a). AUS 4.

By agreed order dated March 1, 2001, the bankruptcy court approved Caplin's first interim application and granted it fees and expenses totaling $516,641.32. ACD 2; AUS 15. The order preserved the United States Trustee's objections to Caplin's charging the estates for non-working travel time at its full hourly rates and for first class, rather than coach, airfare. Id. It nevertheless authorized the debtors to continue paying Caplin 100% of the disputed amounts "pending the resolution of Caplin & Drysdale's final fee application . . . ." Id.[10]

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[9] In setting Caplin's hourly rate, the court essentially conducted a section 330(a) analysis, placing emphasis upon the fact that other bankruptcy courts had awarded similar rates. It stated:

> I've listened to the testimony and I'm convinced that that's the going rate and the markets in which these lawyers and their firms primarily practice, and the law on bankruptcy in the . . . last few years - - since the Bankruptcy Code is that bankruptcy attorneys are paid the same amount as other practitioners . . .
>
> And, more importantly, bankruptcy judges have approved these fees, these rates in other cases, so I'm going to approve the rates . . . .

Id. at 31 – 32.

[10] The agreed order provided in relevant part:

> with the approval of the United States Trustee's office, the objections by the United States Trustee to the first-class travel by Caplin & Drysdale attorneys and the billing of nonproductive travel time at the full hourly

Caplin filed six interim fee applications covering the period March 3, 2000 through February 28, 2002. ACD 2, 3, 4, 5, 6, 7. Each interim application attached separate appendices describing the firm's services and expenses. Id. The appendices demonstrated that Caplin billed the estate for non-working travel time at the firm's full hourly rates and for first class airfare. Id. Each application quantified the difference between the cost of first class and coach airfare, but it offered no explanation for booking first class seats instead of coach. Id.

The bankruptcy court entered orders approving Caplin's first six interim fee applications and awarding the firm fees and expenses totaling $4,156,325.01. ACD 2, 3, 4, 5, 6, 7; AUS 15, 16, 18, 19, 21, 22 and 23. Consistent with the March 1, 2001 agreed order, these orders preserved the United States Trustee's objections to non-productive travel time and first class airfare. Id.

The United States Trustee objected to Caplin's seventh interim fee application on February 21, 2003 in order to obtain "final [bankruptcy court] resolution . . . ." of its prior objections. ACD 8, 10. The United States Trustee argued under 11 U.S.C. § 330(a)(1) that Caplin & Drysdale's charging the estate for non-working travel time at its professionals' full hourly rates was not reasonable and that its requesting reimbursement for first class travel airfare expenses, "when lesser rates or alternative travel . . . ." were available, was not necessary. ACD 10. The United States Trustee further argued that meal expenses exceeding $50 per professional per day were unnecessary. ACD 10.

> rates have been preserved, and . . . 100% of the amounts billed in those categories will be paid to Caplin & Drysdale pending the resolution of Caplin & Drysdale's final fee application and release of any remaining holdback fee . . . .

Id.

Caplin responded on March 4, 2003. ACD 11. In support of its response, Caplin attached an affidavit executed by Attorney Inselbuch, an unsigned form "Engagement Letter for New Client and Returning Client" ("Form Engagement Letter") and a chart comparing Attorney Inselbuch's fees for travel time under different billing scenarios.[11] ACD 11. Attorney Inselbuch also testified as Caplin's sole witness at a March 12, 2003 evidentiary hearing on its seventh interim fee application.[12] ACD 1 at 14 - 70.

In both his testimony and affidavit, however, Attorney Inselbuch focused on Caplin's preferred billing practices. ACD 1 and 11. Caplin offered no evidence that comparably skilled practitioners in Los Angeles, Chicago, Wilmington, New Orleans, New York and/or Washington, D.C. billed their non-bankruptcy clients for non-working travel time at their full hourly rates. Id. Caplin similarly failed to demonstrate that charging the estates for first class rather than coach airfare was necessary. Id. See Argument, infra at I and II.

After hearing the evidence and the argument of counsel, the bankruptcy court sustained the United States Trustee's objections. ACD 1 at 78 – 79.

> I've listened to the evidence, read the briefs, studied . . . the issues . . . I'm going to disallow the portion of the application that seeks reimbursement for first-class [air]fare. I've not allowed it in any other case, and any other firms. I'm not going to change the rule here.
>
> I understand the justification put forth and I accept Mr. Inselbuch's testimony, but I have a lot of discretion in this matter and I'm not going to change the ordinary rules. We've already changed the ordinary rules applicable in this Court in a

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[11] In its response, Caplin waived the meal expense issue and agreed to the $50 per day limitation, stating "[a]lthough it is our experience that no one can obtain three reasonable meals even under marginally comfortable circumstances in New Orleans for $50, without renting an apartment and cooking them oneself Caplin & Drysdale will adhere to a $50 per diem reimbursement cap on out of town meals . . . ." (ACD 11 at 14).

[12] At the March 12, 2003, the parties agreed that the United States Trustee's objections to Caplin's seventh interim fee application also applied to Caplin's eighth interim fee application. ACD 1 at 60.

> great respect to accommodate hourly fees and various other billing differences that take place in other parts of the country, but we're going to stand fast on this one.
>
> As to the hourly rate for travel time, I'm going to deny those portions of the fee application that seeks payment at the full hourly rate for travel time . . . .

ACD 1 at 78 – 79.

The bankruptcy court incorporated its ruling in an order dated March 19, 2003.[13] ACD 14. Caplin & Drysdale appealed the bankruptcy court's March 19, 2003 order on March 21, 2003. ACD 15. The United States Trustee moved to dismiss the appeal as interlocutory on April 10, 2003. ACD 16. By order dated May 20, 2003, this Court approved a stipulation dismissing the appeal, "without prejudice to Caplin & Drysdale's right to litigate said appeal at such time as a final order is rendered in these bankruptcy cases . . . ." ACD 18.

The bankruptcy court subsequently entered orders approving Caplin's ninth through seventeen interim fee applications, subject to the restrictions established by the March 19, 2003 order. ACD 14, 17, 19, 20, 21, 22, 23, 24, 25 and 26.

Caplin filed its final fee application on January 27, 2006. ACD 27. The application quantified and compared Caplin's fees for non-productive travel time using both its full and half rates. Id. It similarly quantified and compared its airfare expenses using both first class and coach rates. Id.

The application requested that the bankruptcy court reconsider its March 12, 2003 order. Id. The United States Trustee renewed its objections on June 21, 2006. ACD 29. The bankruptcy court made minor corrections to its March 19, 2003 order on April 19, 2006. ACD 28.

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[13] The order also denied Caplin's request for non-working travel time at its full hourly rates and first class airfare in its eighth interim fee application. Id.

By order dated July 27, 2006, the bankruptcy court awarded Caplin final fees and expenses as counsel for the Committee totaling $6,387,522.11 under 11 U.S.C. § 330(a). ACD 37. Consistent with its March 19, 2003 order, the bankruptcy court made two adjustments to Caplin's requested fees and expenses, which it otherwise allowed in full. ACD 37.

First, it allowed Caplin to recover 573.7 hours of non-working travel time at 50% of its normal hourly rates, reducing the firm's fees by $135,685.80, or 2% of the total requested. ACD 27, 28 and 37. Second, the court authorized the estates to reimburse Caplin for airfare expenses at the coach rather than first class rates, reducing its expenses by $33,266.23, or 4% of the total requested. ACD 37. The order did not reduce the number of hours that Caplin claimed as working or non-working travel time, and it made no other adjustments to Caplin's requested hourly rates and requested expenses. Id.

The July 27, 2006 order made final the bankruptcy court's March 19, 2003 order. ACD 37. It also denied Caplin's motion for reconsideration of the March 19, 2003 order. Id.

Caplin filed its notice of appeal on July 28, 2006. ACD 38.

SUMMARY OF ARGUMENT

The bankruptcy court did not abuse its discretion by reducing Caplin's hourly rates for non-working travel time by 50%, because Caplin failed to meet its burden of proof under 11 U.S.C. § 330(a)(1)(A). The evidence that Caplin adduced at the March 12, 2003 did not establish any of the five "relevant factors" for determining reasonableness under 11 U.S.C. § 330(a)(3)(A) – (E), including whether billing the estate for non-working travel time at its professionals' full hourly rates comported with the practices of comparable firms performing non-bankruptcy services. 11 U.S.C. § 330(a)(3)(E). At best, Caplin offered only unsupported opinion testimony regarding its preferred billing practices.

Similarly, the bankruptcy court did not abuse its discretion by reimbursing Caplin for coach rather than first class airfare expenses, because Caplin failed to meet its burden of proof under 11 U.S.C. § 330(a)(1)(B). At the March 12, 2003 hearing, Caplin did not offer evidence that flying its professionals first class was required to accomplish the proper representation of the Committee. Caplin offered evidence demonstrating only that it routinely charged its clients for first class air travel.

ARGUMENT

I. The Bankruptcy Court Did Not Abuse Its Discretion by Awarding Caplin Fees For Non-Working Travel Time At 50% Of Its Hourly Rates

A. Bankruptcy Courts have substantial discretion in calculating reasonable fees under section 330(a).

Section 330(a) grants a bankruptcy court broad discretion to pay committee professionals only if, and insofar as, their "actual" services are "necessary" and their fees are "reasonable." 11 U.S.C. § 330(a). Cahill, 428 F.3d at 539; In re Busy Beaver Building Centers, Inc., 19 F.3d 833, 840 (3rd Cir. 1994). In determining "reasonable" compensation, a bankruptcy court may consider a non-exclusive list of five "relevant factors" pertaining to the "nature, the extent and the value" of the services rendered, "including — (A) the time spent on such services; (B) the rates charged for such services; (C) whether the services were necessary to the administration of, or beneficial at the time at which the services were rendered toward the completion of, a case under this title; (D) whether the services were performed within a reasonable amount of time . . . ; and (E) whether the compensation is reasonable based on the customary compensation charged by comparably skilled practitioners in cases other than cases under this title . . . ." 11 U.S.C. § 330(a)(3). In re Teraforce Technology Corp., 347 B.R. 838, 846 – 847 (Bankr. N.D. Tex. 2006).

Section 330(a)(1) requires that a bankruptcy court determine whether a professional's services are "necessary" prior to quantifying "reasonable" fees. In re Temple Retirement Community, Inc., 97 B.R. 333, 339 (Bankr. W.D. Tex. 1989) (holding that "[s]ection 330(a)(1) imposes a two-step analysis. As a threshold matter, the court must first satisfy itself that services rendered were in fact necessary and appropriate. Then the court must find that the compensation requested for those services is reasonable, with reference to the factors delineated in Section 330(a)[(3)] . . . ."). "The main inquiry under § 330 is whether the post-petition services were necessary and benefited the estate . . . ." Pro-Snax Distributors, Inc. v. Andrews & Kurth, L.L.P (In re Pro-Snax Distributors, Inc.), 212 B.R. 834, 389 (N.D. Tex. 1997), affirmed sub nom Andrews & Kurth, L..L. P. v. Family Snax, Inc. (In re Pro-Snax Distributors, Inc.), 157 F.3d 414, 426 (5th Cir. 1998) (internal quotations omitted) (adopting a "stricter" test for awarding professional fees under section 330(a)(1) and holding "we are disinclined to hold that any time need only be reasonable to be compensable . . . we believe it important to stress that any work performed by legal counsel on behalf of the debtor must be of material benefit to the estate . . . .").

Section 330(a) represents a market-based approach for compensating bankruptcy professionals insofar as it allows them to earn fees equivalent to those charged by comparable professionals in non-bankruptcy cases. Busy Beaver, 19 F.3d 833, 849 – 850 (holding that order denying paralegal fees as "overhead" was an abuse of discretion, because bankruptcy court failed to consider evidence that comparable firms in the applicant's market billed those fees directly to their clients).[14] Congress enacted section 330(a) in order to abrogate the standards of

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[14] Accord, Zolfo, Cooper & Co. v. Sunbeam-Oster Co., Inc., 50 F.3d 253, 258 (3rd Cir. 1995) (holding that bankruptcy court's order reducing a professional's hourly rates was not an abuse of discretion, where court considered evidence of the prevailing hourly rates for comparable professionals in the market).

conservatism and economy of the estate that were paramount under the former Bankruptcy Act and to attract talented professionals to the field. Id. Section 330(a), however, does not entitle bankruptcy professionals to receive higher compensation than their non-bankruptcy counterparts. In re Manoa Fin. Co., 853 F.2d 687, 690 (9th Cir. 1988).

Bankruptcy courts temper market-driven compensation by exercising their independent authority to review fee applications in the same way as a private client would. Busy Beaver, 19 F.3d at 848. The prospect of post facto bankruptcy court review under section 330(a) should ensure that bankruptcy professionals will exercise billing judgment to excise unnecessary or unreasonable charges from their bills before submitting them. Id. at 855 – 856. Section 330(a)(2) expressly authorizes courts, however, in the exercise of their discretion, to "award compensation that is less than the amount requested . . . ." Cahill, 428 F.3d at 539. Moreover, section 330(a)(4) prohibits the bankruptcy court from awarding compensation for "unnecessary duplication of services . . . or . . . services that were not . . . reasonably likely to benefit the debtor's estate . . . or . . . necessary to the administration of the estate . . . ." Section 331 authorizes bankruptcy professionals to seek interim compensation on the same basis as under section 330(a). See Teraforce Technology Corp., 347 B.R. at 846 – 847.

Bankruptcy courts use the "lodestar" method, which was adopted from non-bankruptcy, fee-shifting cases, to calculate "reasonable" fees under section 330(a). See Matter of First Colonial Corp. of America, 544 F.2d 1291 (5th Cir.1977), cert. denied, 431 U.S. 904 (1977), citing Johnson v. Georgia Highway Express, Inc., 488 F.2d 714 (5th Cir.1974) (interpreting the Civil Rights Act of 1964, 42 U.S.C. A. § 2000e-5(k)). "A court computes the lodestar by multiplying the number of hours an attorney would reasonably spend for the same type of work by the prevailing hourly rate in the community . . . A court then may adjust the lodestar up or down based on the factors contained in § 330 and its consideration of the twelve factors listed in Johnson . . . ."[15] Cahill, 428 F.3d at 539 - 540.

A bankruptcy court, which is itself an expert on fee issues, uses its experience as a starting point for determining prevailing billing practices in the market under the lodestar and section 330(a). Busy Beaver, 19 F.3d at 854. While the court is not bound by the evidence offered by an applicant, it cannot rely solely on its own judgment when "confronted with undisputed, credible, contrary evidence of market practices in the record . . . ." Id. at 848. "[T]he focus on comparability should turn to the community or marketplace within which the services were rendered. The court must be guided not merely by what rate the applicant charges its nonbankruptcy clients, but by what range of rates is charged by attorneys of comparable competence for comparable services in the comparable community or market place . . . ." In re El Paso Refinery, Inc., 257 B.R. 809, 831 (Bankr. W.D. Tex. 2000) (citation omitted).

The applicant bears the burden of proving both "the reasonableness and necessity of fees requested in the fee application . . . ." Continental Ill. Nat'l Bank & Trust Co. of Chicago v. Charles N. Wooten, Ltd. (In re Evangeline Refining Co.), 890 F.2d 1312, 1326 (5th Cir.1989). "This burden is not to be taken lightly, especially given that every dollar expended on legal fees results in a dollar less that is available for distribution to the creditors or use by debtor." In re Pettibone Corp., 74

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[15] Cahill summarized the Johnson factors in a footnote as "(1) the time and labor required; (2) the novelty and difficulty of the questions; (3) the skill requisite to perform the legal service properly; (4) the preclusion of other employment by the attorney due to acceptance of the case; (5) the customary fee; (6) whether the fee is fixed or contingent; (7) time limitations imposed by the client or the circumstances; (8) the amount involved and the results obtained; (9) the experience, reputation and ability of the attorneys; (10) the "undesirability" of the case; (11) the nature and length of the professional relationship with the client; and (12) awards in similar cases . . . ." Id. citing Johnson, 488 F.2d at 719).

B.R. 293, 299 - 300 (Bankr. N.D. Ill. 1987). The applicant bears the specific burden "of proving the prevailing 'community rate' . . . ." El Paso Refinery, L.P., 257 B.R. at 833.

B. Caplin failed to meet its burden of proving that charging the estates for non-working travel time at its full hourly rates was "reasonable" under section 330(a).

The factual record below demonstrates that Caplin failed to meet its burden of proof under 11 U.S.C. § 330(a). The evidence that Caplin offered in support of its fee applications at the March 12, 2003 hearing – the affidavit, its attachments and testimony of Attorney Inselbuch - confirmed, at most, the firm's preferred billing practices. ACD 1, 11. It did not establish any of the five "relevant factors" for determining reasonableness under 11 U.S.C. § 330(a)(3), including whether billing the estate for non-working travel time at its professionals' full hourly rates comported with the practices of comparable firms performing non-bankruptcy services under 11 U.S.C. § 330(a)(3)(E).

i. Attorney Inselbuch's testimony established only Caplin's preferred billing practices.

Attorney Inselbuch's testimony at the March 12, 2003 hearing was equivocal and contradictory.

On direct and redirect examination by one of his partners, Attorney Inselbuch testified that it was Caplin's regular and customary practice to bill its non-bankruptcy commercial clients for all travel time at its full hourly rate, that doing so was consistent with his prior work experience at another New York City law firm, Gilbert, Siegel & Young, and that no clients or courts involved in these matters had ever complained about it. ACD 1 at 18 – 23; 64 - 66.[16]

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[16] "And I would have to assume, Your Honor, that given my stature in the firm and status within the firm, if there were any dispute of any consequence with any significant client in the firm, I would know about it . . . ." ACD 1 at 65. "I've never had a court hold that our - - the way we calculated our [lodestar], for example, in class action litigation had to be altered to provide for some reduction crediting travel time. I don't remember that

Caplin, he said, expected to get paid what it charged, period. ACD 1 at 22. Attorney Inselbuch also stated that Caplin's standard engagement letter, which tracked the Form Engagement Letter and was based upon the "District of Columbia rules," obligated all clients to pay portal to portal travel time at full rates and first class airfare expenses ACD 1 at 18 – 19.

He then opined:

> It is my general understanding based upon conversations that I've had with other firms and with clients throughout the city that as a general proposition, law firms create their billing rates on the assumption that they will bill clients for travel time at the full rates and be paid for them.
>
> If you did it otherwise, you would have to in effect change your billing rates and raise them to accommodate a reduction for payments for travel time and this would in effect discriminate between the clients who require the travel time and the clients who do not require the travel time . . . .

ACD 1 at 22 - 23.

Attorney Inselbuch, who was not qualified as an expert, offered no basis for this opinion, other than his personal experience as a practitioner. ACD 1 at 22 – 23. For example, he did not state whether he had obtained recent form engagement letters or fee schedules from comparable New Orleans, Washington, D.C. or New York law firms demonstrating either that they charged their non-bankruptcy clients full hourly rates for travel time or that they had been required to increase their hourly rates to compensate for clients who refused to do so. ACD 1 at 22 – 23. Attorney Inselbuch did not ask the bankruptcy court under Federal Rule of Evidence 201 to take judicial notice of the hourly rates or billing practices of comparably-skilled professionals employed in the Babcock & Wilcox cases. He referenced no other New Orleans bankruptcy cases employing comparable professionals.

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issue ever coming up with a court . . . ." ACD 1 at 49.

On cross and re-cross examination by the United States Trustee, Attorney Inselbuch conceded that Caplin had not entered into a written retention agreement with the committee, because “[w]e don’t use engagement letters in bankruptcy cases . . . ” ACD 1 at 37 – 38; 43. He agreed that the Form Engagement Letter did not expressly authorize Caplin to charge its non-bankruptcy clients its full hourly rates for non-working travel time and for first class airfare. ACD 1 at 41. He also agreed that Caplin’s March 3, 2000 employment application did not expressly authorize the firm charge the bankruptcy estates for the same items. ACD 1 at 43.

Attorney Inselbuch conceded that he did not review each engagement letter with new or existing clients as it was approved by the firm. ACD 1 at 67. He nevertheless insisted that all of Caplin engagement letters incorporated the firm’s (apparently unwritten) policy of requiring clients to pay full rates for travel time and first class airfare and that the firm’s employment terms could altered in its, not the client’s, favor. ACD 1 at 67. “I am quite convinced that I would have been consulted if there were any significant modification for a client – to a client’s retention agreement. Indeed, the changes in these fee letters usually are on the upside, not the downside . . . .” ACD 1 at 67.[17] He could point to no document codifying the firm’s unwritten policy, however. Id.

In response to further questioning, Attorney Inselbuch agreed that the Committee had retained two additional professionals, the Tersigni Consulting Group and Gilbert & Heintz, and that these firm’s were located in Caplin’s Washington, D.C. and New York practice areas. ACD 1 at 44 – 45. He agreed that Caplin reviewed these firms’ fee applications. ACD 1 at 44 – 45.

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[17] Attorney Inselbuch stated that all fees billed to non-bankruptcy clients were “subject to review by the billing partner at the end of the day to make certain that the fees being charged, or being sought are reasonable . . . .” ACD 1 at 43. He added that clients who disagreed with Caplin & Drysdale on their bills could “fire” the firm at any time. ACD 1 at 54.

But he claimed ignorance when told that neither Tersigni nor Gilbert & Heintz billed the bankruptcy estates for their full hourly rates for non-working travel time and first class airfare. ACD 1 at 44 – 45.

When asked why firms other than Caplin were not billing their full hourly rates for non-working travel time and first class airfare, Attorney Inselbuch replied "Because you [the United States Trustee] became a nuisance about it . . . ." ACD 1 at 58 – 59.

Finally, Attorney Inselbuch acknowledged that Caplin currently represented committees in comparable bankruptcy cases pending in Delaware. ACD 1 at 49 -50; 52 - 53. He admitted that Delaware's local rules prohibited professionals from charging non-working travel time at their full rate. ACD 1 at 49 -50; 52 - 53. He also admitted that Caplin had agreed to comply with the local rules in cases pending in Delaware, although "we take the position the rules are unfair to the lawyers and to the clients . . . ." ACD 1 at 50; 53.

ii. Caplin failed to demonstrate that billing for non-working travel time at its full hourly rates reflected prevailing market practices under section 330(a)(3)(E).

Based upon Attorney Inselbuch's testimony, Caplin argues that the record below was "undisputed" in demonstrating the firm's customary billing practices. Accordingly, Caplin says, the bankruptcy court erred as a matter of law in reducing its full hourly rates for non-working travel time under section 330(a)(1). Appellant's Opening Brief at 7. This is incorrect, because it not only misstates the requirements of section 330(a) but also mischaracterizes the evidence below.

In order to establish that its billing the estates for non-productive travel at its full hourly rate was reasonable under the comparability standard of section 330(a)(3)(E), Caplin had to adduce "undisputed, credible . . . evidence . . ." that its doing so reflected "market practices . . . "

Busy Beaver Building Centers, Inc., 19 F.3d at 848 (emphasis added). Attorney Inselbuch's testimony provided no such evidence – it did not demonstrate that New York and Washington law firms with practices comparable to Caplin's charged their non-bankruptcy clients for travel time at their full hourly rates. Caplin's evidence pertained solely to the firm's preferred billing practices. Zolfo, Cooper & Co. v. Sunbeam-Oster Co., Inc., 50 F.3d at 260. Caplin's summation effectively captured both of these shortcomings.

> You heard Mr. Inselbuch's testimony concerning what the customary practice of Caplin & Drysdale is with regard to billing for travel time. You heard his testimony with regard to what his practice was at his other firm. I would submit to you that the evidence is unchallenged. Caplin & Drysdale's regular and customary practice is to bill 100 percent of its hourly rate for travel time . . .
>
> [The] statutory command [of 11 U.S.C. § 330(a)] . . . talks about looking at cases outside of bankruptcy and what's the customary practice outside of there. And here the only evidence before you is that the customary practice of is that Caplin & Drysdale charges its full hourly rate for travel time . . .

ACD 1 at 71 – 74 (emphasis added).

Moreover, while testifying that no court had ever denied Caplin's request for non-working travel time at its normal hourly rate, Attorney Inselbuch did not mention a Connecticut district court decision that arguably affected Caplin's success in doing so while the Babcock & Wilcox bankruptcy cases were pending.

In In re Raytech Corp., 241 B.R. 785 (D. Conn. 1999), the district court vacated and remanded a bankruptcy court order awarding Wolf Block, counsel to the creditors' committee, fees for non-working travel time at its full rate, because the record contained no evidence that doing so was the prevailing market practice among comparably skilled professionals in non-bankruptcy cases. The opinion was issued on August 13, 1999, approximately six months before the Babcock & Wilcox cases were filed in New Orleans. Based upon Attorney Inselbuch's testimony and sworn statements in the Babcock & Wilcox cases, it appears that Caplin was Wolf Block's successor.[18]

The Raytech court stated:

> In awarding these firms their full hourly rates for nonproductive travel time, however, the bankruptcy court failed to consider whether other attorneys in the relevant market customarily charge their non-bankruptcy clients their full hourly legal service rate for nonproductive travel time, and only considered the practices of the applicant attorneys. In fact, there was no finding with respect to the relevant legal market, nor was there any record contained in the application or established at the hearing with respect to travel billing practices in that market . . .

Id. at 789.

According to Attorney Inselbuch, Caplin was submitting fee applications in the Raytech case at least through September 27, 2000, and it probably did so thereafter. AUS 13 at 24. While it is unclear whether the Bridgeport bankruptcy court enforced district court's order prospectively as to Caplin, the Raytech decision was, at minimum, relevant to informing Attorney Inselbuch's opinion testimony under 11 U.S.C. § 330(a)(3)(E).

Caplin's reliance on Strook, Strook & Lavan v. Hillsborough Holdings Corp. (In re Hillsborough Holdings Corp.), 127 F.3d 1398, 1401 – 1402 (11th Cir. 1997) in support of its argument that the bankruptcy court committed "legal" error in awarding it fees for non-

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[18] Attorney Inselbuch stated in his March 3, 2000 Bankruptcy Rule 2014 affidavit that Caplin represented the creditors' committee "involving Raytech Corporation . . . in a chapter 11 proceeding currently approaching confirmation in the Bankruptcy Court for the District of Connecticut . . . ." AUS 4 (emphasis added). At the September 27, 2000 evidentiary hearing, he testified that the bankruptcy court should approve Caplin's normal hourly rates, because "these rates have been approved and are being paid in two other bankruptcies, one in Bridgeport, Connecticut and one in Pittsburgh, Pennsylvania, both of which are similar to this proceeding, in the sense that they involve asbestos liabilities, but neither of which is the size and scope of this bankruptcy . . . ." AUS 13 at 22. He added that "Your Honor, in fee applications that have been filed and approved, both in the bankruptcy court in Bridgeport, Connecticut and the bankruptcy court in Pittsburgh, Pennsylvania. These same rates have been approved and are being paid. . . ." Id. at 24 (emphasis added).

productive travel time at 50% of its hourly rates is misplaced. There, the bankruptcy court denied the applicants' request that they be reimbursed for categories of identifiable expenses, such as postage, secretarial services and computer research charges, which they customarily passed through to their clients, because such expenses were appropriately borne as "overhead." Id. The Eleventh Circuit reversed, holding that the bankruptcy court's decision, which it rendered at the outset of the case and without considering any evidence of professionals' billing practices, constituted legal error. Id.

Unlike Hillsborough, the bankruptcy court here did not limit Caplin's ability to present evidence. Attorney Inselbuch's testimony established, at most, Caplin's preferred billing practices, reflected his opinion only and, contrary to its argument here, did not entitle Caplin to judgment as a matter of law, because it did not establish prevailing billing practices of comparable firms. "Section 330(a) does not authorize the bankruptcy court to award attorney fees for services otherwise not borne by private non-bankruptcy clients . . . . " Raytech, 241 B.R. at 790. "Billable hours are not necessarily compensable hours . . . ." In re Gillett Holdings, Inc., 137 B.R. 475, 481 (Bankr. D. Col. 1992).

The bankruptcy court appropriately exercised its independent expertise in evaluating Caplin's hourly rates for non-productive travel time and discounting Caplin's evidence. In a case presenting facts similar to those here, the debtor's financial advisor, Zolfo, argued that it was entitled to its "customary" rates. Zolfo, Cooper & Co. v. Sunbeam-Oster Co., Inc., 50 F.3d at 260. As evidence of its rates, Zolfo offered the affidavit attached to its employment application, an engagement letter in a separate bankruptcy case and a schedule of rates paid by the debtor's parent corporation in a takeover transaction. Id. The bankruptcy court considered this evidence but declined to be bound by it. Instead, it looked to rates charged by comparable professionals in the market where the court sat, and it reduced Zolfo's hourly rates accordingly. The Third Circuit affirmed, holding that "Zolfo, Cooper bore the burden of proof to demonstrate its customary fees were warranted and did not carry it . . . ." Id. See also Commercial Financial Services, Inc. v. Houlihan Lokey, 427 F.3d 804 (10th Cir. 2005) (affirming order that reduced financial adviser's fee application by 53%, where bankruptcy court looked to hourly rates of comparable professionals rather than to adviser's proffer of customary flat monthly rates).

The bankruptcy court did not abuse its discretion by accepting Caplin's proffer as evidence of only its preferred billing practices rather than as conclusive evidence of prevailing market practices for comparable firms in New York and Washington, D.C. The record below supports the bankruptcy court's awarding Caplin fees for non-productive travel time at 50% of its normal hourly rates. Accordingly, the Court should affirm the July 27, 2006 order.

iii. Caplin failed to demonstrate that billing for non-working travel time at its full hourly rates was necessary and materially benefited the estates.

Similarly, Attorney Inselbuch's testimony failed to demonstrate that billing for non-working travel time at its full hourly rates was necessary and materially benefited the estate. Pro-Snax Distributors, Inc., 157 F.3d at 426; 11 U.S.C. § 330(a)(4). Accordingly, the Court should affirm the July 27, 2006 order.

iv. The bankruptcy court's order is supported by Fifth Circuit fee-shifting cases reducing hourly rates for non-working travel time.

The bankruptcy court's July 27, 2006 order is supported by Fifth Circuit cases that have reviewed fee awards under fee-shifting cases, such as the Civil Rights Act of 1964, and reduced the hourly rates charged by attorneys for non-productive travel time. See Watkins v. Fordice, 7 F.3d 453, 459 (5th Cir. 1993) (reducing hourly rates for non-productive travel time by 50% in case brought under the Voting Rights Act of 1965, 42 U.S.C. § 1973*l*(e)); Shipes v. Trinity Industries, Inc., 987 F.2d 311, 320 (5th Cir. 1993) (reducing hourly rates for travel time in case brought under the Civil Rights Act of 1964, 42 U.S.C. § 2000, et seq.). United States District Courts have concurred. See e.g. Kirksey v. Danks, 608 F.Supp. 1448, 1456 (S.D. Miss. 1985) (reducing hourly rates for travel time in case brought under the Voting Rights Act of 1965 by 50%). Accord Martin v. Mabus, 734 F.Supp. 1216, 1227 (S.D. Miss. 1999) (noting in connection with award of fees under the Voting Rights Act of 1965 that "time [spent working on an airplane] simply cannot be 100% efficient . . ." and awarding "'productive' travel time at 75% of the hourly market rate . . . ."); Major v. Treen, 700 F.Supp. 1422, 1432 (E.D. La. 1988) (reducing by 50% the hourly rate for travel under the Civil Rights Act of 1871, 42 U.S.C. § 1983 and the Voting Rights Act of 1965. The court noted "[w]ork done while traveling is not as efficient as work done in the office and should therefore be compensated at a lower rate . . . Similarly, travel time with no work claimed is not compensable . . . or compensable at a lower hourly rate . . . .") (citations omitted).[19]

v. The bankruptcy court's order is supported by bankruptcy court decisions reducing hourly rates for non-working travel time.

The July 27, 2006 order is also supported by bankruptcy decisions holding that non-working travel time should be compensated at 50% of a professional's hourly rate under 11 U.S.C. § 330(a). In re Landing, Inc., 122 B.R. 701, 704 – 705 (Bankr. N.D. Ohio 1990); accord, (In re Caribbean Construction Services, Inc., 283 B.R. 388, 395 (Bankr. D.V.I. 2002); In re Automobile Warranty Corp., 138 B.R. 72, 78 (Bankr. D. Colo. 1991); In re Bank of New

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[19] See also Guidry v. Jen Marine, LLC, 2003 WL 23095590 (E.D. La. 2003) (awarding non-productive travel time at 50% of the hourly rate under Fed. R. Civ. P. 37) (Roby, J.); Tasch, Inc. v. United Staffing & Associates, Inc., 2003 WL 109790 (E.D. La. 2003) (same).

England Corp., 134 B.R. 450 (Bankr. D. Mass. 1991), aff'd, 142 B.R. 548 (D. Mass. 1992) (awarding travel time at the requested 50% rate); Teraforce Technology Corp., 347 B.R. at 860 (same). See In re Gillett Holdings, Inc., 143 B.R. 256, 487 – 489 (Bankr. D. Colo. 1992) (reducing travel time of debtor's investment banker by 50% and noting "even when travel is reasonably necessary, it may not be fully compensable because it is rarely totally productive . . . .") (internal quotations omitted).

Since Caplin failed to meet its burden of proof under section 330(a)(3)(E), this Court should affirm the July 27, 2006 order.

vi. Caplin could have protected itself through section 328(a), but it chose not to do so.

Section 328(a) authorizes a committee to obtain prior court approval of a professional's compensation plan, such as through a contingent fee arrangement. Pre-approval eliminates any uncertainty as to the professional's compensation arising from the bankruptcy court's post-facto review under section 330(a)(1). Daniels v. Barron (In re Barron), 325 F.3d 690, 692 - 693 (5th Cir. 2003). Section 328(a) permits a bankruptcy court subsequently to award different compensation if "developments, which made the approved plan improvident, had been incapable of anticipation at the time the award was granted . . . ." Id. at 693.

Caplin could have protected itself by obtaining prior bankruptcy court approval of its billing practices under section 328(a). It chose not to do so, however. Daniels v. Barron (In re Barron), 325 F.3d 690 (5th Cir. 2003). Accordingly, the Court should affirm the July 27, 2006 order.

vii. Any error committed by the bankruptcy court was harmless.

A bankruptcy court's error is reversible only if it affected substantial rights of the applicant. See Stewart v. Law Offices of Dennis Olson, 93 B.R. 91, 94 (N.D. Tex. 1988). The bankruptcy court reduced Caplin's fees and expenses by 2% and expenses by 4%, respectively. ACD 37. Assuming that the bankruptcy court's reductions were erroneous, they did not affect substantial rights of Caplin. Accordingly, the Court should affirm the July 27, 2006 order. Zolfo, Cooper & Co. v. Sunbeam-Oster Co., Inc., 50 F.3d at 261 (declining to reverse 12% fee reductions, because "[no] court, viewing a record of this magnitude from the distance inherent in appellate review, could assess the reasonability of a reduction as slight as ten percent with flawless precision . . . ." (internal quotations omitted).

II. The Bankruptcy Court Did Not Abuse Its Discretion by Reimbursing Caplin For Coach Rather Than First Class Airfare Expenses

A bankruptcy court may authorize reimbursement of committee professionals' "actual" expenses only if they are "necessary." 11 U.S.C. § 330(a)(1)(B). In re Needham, 279 B.R. 519, 521 (W.D. La. 2001). An applicant bears the burden of establishing that it is entitled to expenses. In re Gillett Holdings, Inc., 137 B.R. 475, 489 – 490 (Bankr. D. Colo. 1992) "The Court will not assume any expense is necessary . . . An expense is necessary if it was incurred because it was required to accomplish the proper representation of the client . . . ." Id. (internal quotations omitted).

The United States Trustee's Fee Guidelines, 28 CFR Part 58 (1996), the Local Rules for District of Columbia and the Local Rules for the Southern District of New York all prohibit first class airfare. Copies of each are attached hereto as part of the addendum.

i. Caplin failed to demonstrate that billing for first class airfare was "necessary" under section 330(a)(1)(B).

Under direct examination, Attorney Inselbuch testified that Caplin professionals always flew first class in order to save time waiting in "congested airports" to board the plane and to reduce the risk of getting bumped off an oversold flight, particularly since "there are very few flights [between Washington, D.C. or New York and New Orleans] . . . ." ACD 1 at 24.[20] However, he did not ask the bankruptcy court under Federal Rule of Evidence 201 to take judicial notice of any airline flight schedules published on the Internet, which might have corroborated the paucity of flights between New Orleans and the firm's practice areas. Using those schedules or historical booking data, Attorney Inselbuch provided the court with no specific examples of how reserving first class seats prevented Caplin & Drysdale's professionals from being bumped off fully booked flights to New Orleans.[21]

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[20] In his affidavit, Attorney Inselbuch also stated that "[o]n several trips from New York to New Orleans I would have been unable to board the airplane had I not had first class seats . . . ." ACD 11. This statement, like Attorney Inselbuch's testimony at the March 12, 2003 hearing, leaves several questions unanswered. Did he reserve his first class seat at the last minute using an online travel ticketing service, such as Travelocity or Orbitz, directly through the airline's website or through a travel agent? If so, what prevented him from reserving a coach seat the same way? The fact that Caplin & Drysdale's fee applications broke out the difference between first class and coach fares suggests that coach seats were available. ACD 2 – 9, 17, 19 – 27.

[21] A review of Caplin & Drysdale's fee applications indicates only one instance where one of its professionals had to book a first class seat, because coach class was full. In its December 17, 2001 fifth interim fee application, the firm notes that it had to fly one of its paralegals, Stacie M. Evans, first class on August 7, 2001, "because coach sold out . . . ." ACD 6. Her contemporaneous time records for that day demonstrate that she billed two hours to "travel time," 5.8 hours to "[a]ssist[ing] NDF in preparation for future depositions by compiling and organizing exhibits to be used in the depositions of Murphy and Burkhart . . ." and .8 hours to "[a]nalyze, compile and index correspondence and pleadings filed in adversary proceedings . . . ." ACD 6 at exhibits "E," "K" and "M". Ms. Evans time records do not indicate that flying in first class enhanced her ability to perform work either on behalf of the bankruptcy estates or any other client.

Attorney Inselbuch also offered no evidence that flying first class reduced Caplin overall travel time to and from New Orleans. He cited no specific emergencies that required the firm to fly first class to New Orleans, and he identified no instances where the firm's professionals could perform their jobs only in first class.

Attorney Inselbuch testified that traveling first class enabled its professionals to work in transit:

> We can work on a plane in first-class . . . [Y]ou can't assume that you will be able to work in coach class, because there is very little room. You . . . are unable to spread out materials and do any sensible work, and worse yet, you never know who will be sitting next to you, and you never know what other security issues might arise . . .

ACD 1 at 24 – 25.

Yet he failed to demonstrate that working in first class was uniformly efficient and beneficial to the debtors' estates vis a vis office time for the same tasks. C/f Gillett Holdings, Inc. 137 B.R. at 491 (noting that travel time "is rarely totally productive . . . .") (internal quotations omitted).

He identified no instances where flying the firm's professionals first class allowed them to arrive more prepared for trials or negotiations than if they had flown coach, and he did not demonstrate that common sense precautions employed in first class to protect client confidences would not work in coach.

The bulk of Attorney Inselbuch's direct testimony focused upon the idea that flying first class saved money for Caplin's clients, because it allowed attorneys to work while traveling. ACD 1 at 24 - 25. He stated:

> [I]ronically, I believe that it is less expensive for the clients for us to fly in first-class where we can work on the client's matters rather than sit in coach class where we can't work on the client's matters and the time we would otherwise

> devote to either of those – that client's matters or other clients' matters for which the client wouldn't pay so-called travel time would be added on either before or after the flight . . . .

ACD 1 at 24 - 25.

Citing the chart attached to his affidavit, Attorney Inselbuch attempted to demonstrate that flying first class saved money for the Babcock & Wilcox bankruptcy estates. ACD 25 – 30. This analysis demonstrated only hypothetical savings, however. It was also irrelevant to the issue of whether first class travel was necessary to its representing the client. In short, it established no nexus between flying first class and material benefit to the estate.

On cross-examination, Attorney Inselbuch conceded that Caplin routinely flew first class if it were available and that the firm allowed its professionals to keep frequent flier miles instead of applying them to offset client travel costs. ACD 1 at 45; 47.

Attorney Inselbuch's testimony did not establish that Caplin's flying first class was "necessary" under section 330(a)(1)(B). In re Gillett Holdings, Inc., 137 B.R. at 489.

Separately, assuming that the bankruptcy court's reductions were erroneous, they did not affect substantial rights of Caplin. Accordingly, the Court should affirm the July 27, 2006 order. Zolfo, Cooper & Co. v. Sunbeam-Oster Co., Inc., 50 F.3d at 261

CONCLUSION

The bankruptcy court did not abuse its discretion by awarding Caplin fees for non-working travel time at 50% of its normal hourly rates, because Caplin failed to meet its burden of proof that its fees were "reasonable" under 11 U.S.C. § 330(a)(1)(A). The evidence that Caplin adduced at the March 12, 2003 did not establish any of the five "relevant factors" for determining reasonableness under 11 U.S.C. § 330(a)(3), including whether billing the estate for non-working travel time at its professionals' full hourly rates comported with the practices of comparable firms performing non-bankruptcy services under 11 U.S.C. § 330(a)(3)(E).

Similarly, the bankruptcy court did not abuse its discretion by reimbursing Caplin for coach rather than first class airfare expenses, because Caplin did not meet its burden of proving that those expenses were "necessary" under 11 U.S.C. § 330(a)(1)(B).

For these reasons, the United States Trustee respectfully asks this Court to affirm the order entered below.

Respectfully submitted,

R. MICHAEL BOLEN
United States Trustee, Region 5
Judicial Districts of
Louisiana and Mississippi

s/Mary S. Langston
Mary S. Langston (22818)
Robert C. Gravolet (8404)
400 Poydras Street
Suite 2110
New Orleans, Louisiana 70130
(504) 589-4018 Telephone
(504) 589-4096 Facsimile

ATTORNEYS FOR APPELLEE

OF COUNSEL:
Roberta A. DeAngelis
Acting General Counsel

P. Matthew Sutko
Walter W. Theus, Jr.
Executive Office for United States Trustees
Department of Justice
20 Massachusetts Ave., N.W.
Washington, D.C. 20530
(202) 307-1399 Telephone
(202) 307-2397 Facsimile

Eric K. Bradford
Office of the United States Trustee
Department of Justice
10 Causeway Street, Room 1184
Boston, MA 02222-1043
(617) 788-0415 Telephone
(617) 565-6368 Facsimile

CERTIFICATE OF SERVICE

I certify that on February 21, 2007, true and correct copies of the (1) **BRIEF OF THE UNITED STATES TRUSTEE, REGION 5,** and (2) **APPENDIX PREPARED BY THE UNITED STATES TRUSTEE, REGION 5** were served by United States mail, First Class postage pre-paid, or by email upon the individuals listed below.

Robert Gravolet
Office of the United States Trustee
400 Poydras Street, Suite 2110
New Orleans, LA 70130
(504) 589-4018 Telephone
(504) 589-4096 Facsimile

Elihu Inselbuch, Esq.
Caplin & Drysdale, Chartered
375 Park Avenue, 35th Floor
New York, NY 10152
(Counsel for Appellant)

Dennis M. Laborde, Esq.
Baldwin & Haspel, LLC
1100 Poydras Street
New Orleans, LA 70163-2200
(Counsel for Appellant)

STATUTORY ADDENDUM

11 U.S.C. § 330(a). Compensation of officers

(a)(1) After notice to the parties in interest and the United States Trustee and a hearing, and subject to sections 326, 328, and 329, the court may award to a trustee, an examiner, a professional person employed under section 327 or 1103--

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

(B) reimbursement for actual, necessary expenses.

(2) The court may, on its own motion or on the motion of the United States Trustee, the United States Trustee for the District or Region, the trustee for the estate, or any other party in interest, award compensation that is less than the amount of compensation that is requested.

(3)(A) In determining the amount of reasonable compensation to be awarded, the court shall consider the nature, the extent, and the value of such services, taking into account all relevant factors, including--

(A) the time spent on such services;

(B) the rates charged for such services;

(C) whether the services were necessary to the administration of, or beneficial at the time at which the service was rendered toward the completion of, a case under this title;

(D) whether the services were performed within a reasonable amount of time commensurate with the complexity, importance, and nature of the problem, issue, or task addressed; and

(E) whether the compensation is reasonable based on the customary compensation charged by comparably skilled practitioners in cases other than cases under this title.

(4)(A) Except as provided in subparagraph (B), the court shall not allow compensation for--

(i) unnecessary duplication of services; or

(ii) services that were not--

(I) reasonably likely to benefit the debtor's estate; or
(II) necessary to the administration of the case.

(B) In a chapter 12 or chapter 13 case in which the debtor is an individual, the court may allow reasonable compensation to the debtor's attorney for representing the interests of the debtor in connection with the bankruptcy case based on a consideration of the benefit and necessity of such services to the debtor and the other factors set forth in this section.

(5) The court shall reduce the amount of compensation awarded under this section by the amount of any interim compensation awarded under section 331, and, if the amount of such interim compensation exceeds the amount of compensation awarded under this section, may order the return of the excess to the estate.

(6) Any compensation awarded for the preparation of a fee application shall be based on the level and skill reasonably required to prepare the application.

11 U.S.C. § 503. Allowance of administrative expenses

(a) An entity may timely file a request for payment of an administrative expense, or may tardily file such request if permitted by the court for cause.

(b) After notice and a hearing, there shall be allowed administrative expenses, other than claims allowed under section 502(f) of this title, including--

* * *

(2) compensation and reimbursement awarded under section 330(a) of this title;

11 U.S.C. § 507(a). Priorities

(a) The following expenses and claims have priority in the following order:

(1) First, administrative expenses allowed under section 503(b) of this title, and any fees and charges assessed against the estate under chapter 123 of title 28.

1102. Creditors’ and equity security holders' committees

(a)(1) Except as provided in paragraph (3), as soon as practicable after the order for relief under chapter 11 of this title, the United States trustee shall appoint a committee of creditors holding unsecured claims and may appoint additional committees of creditors or of equity security holders as the United States trustee deems appropriate.

Section 1103. Powers and duties of committees

(a) At a scheduled meeting of a committee appointed under section 1102 of this title, at which a majority of the members of such committee are present, and with the court's approval, such committee may select and authorize the employment by such committee of one or more attorneys, accountants, or other agents, to represent or perform services for such committee.

BRIEF BANK — 'SUMMARY SHEET" *Printed Wed-8/30/06 13:54*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]* — Clippard, UST v Wilks (In re Wilks)

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3. ("CCN") ***CURRENT*** CASE NO. — No.: **0:06-CV-108-HRW**

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*

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Larry E. Wahlquist, Esq. OGC

(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC*** — **BANKRUPTCY**

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***

- Under section 301 of the Bankruptcy Code, the filing of a petition commences a bankruptcy case. In a variety of contexts, federal courts routinely dismiss cases that lack merit, including cases brought in the absence of subject matter jurisdiction. Given that law, did the court below err when it ruled Mr. Wilks' petition had not commenced a case and ended Mr. Wilks' bankruptcy proceeding by striking the petition while refusing to dismiss the underlying bankruptcy case?

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UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF KENTUCKY
ASHLAND DIVISION

In re:

CHARLES WILLIAM WILKS,)
Debtor.)
______________________________)
)
RICHARD F. CLIPPARD,)
UNITED STATES TRUSTEE,)
Appellant,)
)
v.)
)
CHARLES WILLIAM WILKS,)
Appellee.)
______________________________)

CIVIL ACTION NO. 0:06-CV-108-HRW

BRIEF FOR THE APPELLANT

"ELECTRONICALLY FILED"

RICHARD F. CLIPPARD
UNITED STATES TRUSTEE, REG 8

JOHN R. STONITSCH
Assistant United States Trustee
United States Department of Justice
Office of the United States Trustee
100 E. Vine St. Ste. 500
Lexington, KY 40507
(859) 233-2822 Telephone
(859) 233-2834 Fax
Email: john.r.stonitsch@usdoj.gov

Of Counsel
Roberta A. DeAngelis
Acting General Counsel

P. Matthew Sutko
Lisa A. Tracy
Larry E. Wahlquist
Office of the General Counsel
Executive Office for United States Trustees
United States Department of Justice
20 Massachusetts, Ave. N.W., Suite 8100
Washington, D.C. 20530
(202) 307-1399

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STATEMENT OF JURISDICTION

The United States Bankruptcy Court for the Eastern District of Kentucky had jurisdiction over Mr. Charles Wilks' chapter 7 bankruptcy case under 28 U.S.C. 157(b). This appeal is taken from an order that court entered on June 16, 2006 striking Mr. Wilks' petition in bankruptcy over the objection of the United States Trustee, who had asked instead that Mr. Wilks' bankruptcy case be dismissed. The United States Trustee filed a timely notice of appeal from that order under 28 U.S.C. 158(c)(2) and Fed. R. Bankr. P. 8002(a) on June 23, 2006.[1] This Court has jurisdiction over this appeal under 28 U.S.C. 158(a)(1).

STATEMENT OF THE ISSUE

Under section 301 of the Bankruptcy Code, the filing of a petition commences a bankruptcy case. In a variety of contexts, federal courts routinely dismiss cases that lack merit, including cases brought in the absence of subject matter jurisdiction. Given that law, did the court below err when it ruled Mr. Wilks' petition had not commenced a case and ended Mr. Wilks' bankruptcy proceeding by striking the petition while refusing to dismiss the underlying bankruptcy case?

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[1] Congress has authorized the United States Attorney General to appoint 21 United States trustees, each to serve in a specific geographic region of the United States. *See generally* 28 U.S.C. 581 et seq. (establishing United States Trustee Program). The United States trustees are senior officials of the Department of Justice. *Id*. United States Trustees "supervise the administration of cases and trustees" in all bankruptcy cases within his or her region through the exercise of a range of oversight responsibilities. 28 U.S.C. 586(a)(3). *See generally Morganstern v. Revco D.S. Inc. (In re Revco D.S., Inc.),* 898 F.2d 498, 500 (6th Cir. 1990) (explaining that United States trustees oversee the bankruptcy process, protect the public interest, and ensure that bankruptcy cases are conducted according to law). United States Trustees may raise, appear, and be heard on any issue in any case or proceeding under Title 11. 11 U.S.C. 307; *See also In re Revco D.S., Inc*., 898 F.2d at 499-500 (upholding broad appellate standing of United States trustees).

STATEMENT OF THE CASE

This appeal presents an important recurring issue that has arisen under the new Bankruptcy Code as amended by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA). That new law requires individuals to obtain credit counseling from an approved agency before seeking bankruptcy relief. *See* 11 U.S.C. 109(h). On February 28, 2006, Mr. Wilks filed his petition under chapter 7 of the Bankruptcy Code without satisfying the Code's pre-filing credit counseling requirement. Mr. Wilks acknowledged that his failure to satisfy the credit counseling requirement rendered him ineligible to be a debtor and filed a motion to strike his case. The United States Trustee opposed the motion to strike and asked, instead, that Mr. Wilks' case be dismissed. The United States Trustee did so because the nature of the relief granted could have substantial impact upon Mr. Wilks' creditors. On June 16, 2006, the bankruptcy court, following a minority line of cases, entered an order that Mr. Wilks' petition be stricken. The United States Trustee then timely filed this appeal.

STATEMENT OF FACTS

1. Statutory Framework

Chapter 3 of the Bankruptcy Code, 11 U.S.C. 301, *et seq*., governs the commencement and administration of bankruptcy cases. Under section 301, "a voluntary case under a chapter of [the Bankruptcy Code] is commenced by the filing with the bankruptcy court of a petition under such chapter by an entity that may be a debtor under such chapter." 11 U.S.C. 301.

The commencement of a case under section 301 is significant for many reasons. For example, under 28 U.S.C. 1930(a), "parties commencing a case under title 11" are required to pay the clerk of the bankruptcy court a fee for a case commenced under chapter 7 of the Bankruptcy Code. 28 U.S.C. 1930(a). When a debtor commences a chapter 7 case under section 301, the court issues a notice of the debtor's bankruptcy filing to the debtor's creditors, assigning the debtor a case number and advising the debtor's creditors that "the filing of the bankruptcy case automatically stays certain collection and other actions against the debtor." (R. at 6; Notice of Chapter 7 Bankruptcy Case, Meeting of Creditors, & Deadlines).[2] In addition, under 11 U.S.C. 701, the United States Trustee must appoint a disinterested person to "serve as interim trustee in the case." 11 U.S.C. 701(a)(1).

Section 109 establishes rules that govern eligibility to be a debtor under the Bankruptcy Code. This section includes general rules that affect the eligibility of individuals to proceed as debtors under each chapter of the Bankruptcy Code. For example, under section 109(g), no individual may be a debtor under the Bankruptcy Code if that individual had a case pending at any time during the preceding 180 days if the prior case "was dismissed by the court for willful failure of the debtor to abide by orders of the court." 11 U.S.C. 109(g). Section 109 also places restrictions on the types of individuals who may proceed as debtors under specific chapters of the Bankruptcy Code. *See* 11 U.S.C. 109. For example, only individuals with regular income who have unsecured debts of less than $307,675 and secured debts of less than $922,975 may be debtors under chapter 13 of the Bankruptcy Code. *See* 11 U.S.C. 109(e).

The BAPCPA amended Section 109 in 2005 to require, as an additional element of eligibility to be a debtor under any chapter of the Bankruptcy Code, that all individuals receive credit counseling during the 180-day period prior to filing a petition in bankruptcy. *See* 11 U.S.C. 109(h)(1). [3]

Section 707, of Chapter 7, entitled *Dismissal of a case or conversion to a case under chapter 11 or 13*, establishes that "a court may dismiss a case under [chapter 7] . . . for cause."

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[2] "R. at __" refers to the official docket number in the bankruptcy court's case docket.

[3] Under this new provision, debtors may seek an extension of the pre-filing requirement of up to forty-five days after filing if they can establish, among other things, that exigent circumstances required that they file for bankruptcy protection before obtaining the required credit counseling. *See* 11 U.S.C. 109(h)(3). In addition, upon notice and a hearing, a debtor may seek waiver of the credit counseling requirement altogether if the debtor can establish that he or she is incapacitated, disabled or on active military duty in a military combat zone. *See* 11 U.S.C. 109(h)(4). Those sections are not at issue in this appeal.

11 U.S.C. 707(a). It includes a nonexhaustive list of reasons that may constitute cause to dismiss a chapter 7 bankruptcy case. *See* 11 U.S.C. 707(a).

2. Factual Background

Mr. Wilks filed a petition for relief under chapter 7 of the Bankruptcy Code on February 28, 2006. (R. at 1; Voluntary Petition). Mr. Wilks was assisted in the preparation and filing of his bankruptcy petition by his bankruptcy counsel, *id*., who continued to represent Mr. Wilks throughout his bankruptcy proceedings. (R. at 11; Motion to Strike Case).[4] Mr. Wilks checked the box on his bankruptcy petition indicating that he had "received approved budget and credit counseling during the 180-day period preceding the filing of [his] petition," and he signed his petition. (R. at 1; Voluntary Petition). Debtors are required to sign their bankruptcy petitions under penalty of perjury declaring that the information provided in the petition is true and correct. *Id*. The Bankruptcy Code requires a debtor to file a certificate from the approved credit counseling agency as proof that the debtor has fulfilled the credit counseling requirement of 11 U.S.C. 109(h). *See* 11 U.S.C. 521(b)(1). Interim Rules 1007(b)(3) and (c) require that the certificate of credit counseling be filed with the bankruptcy petition in a voluntary case.[5] *See* Int. R. Fed. Bankr. P.1007(b)(3) and (c).

Mr. Wilks did not file the certificate of credit counseling until March 31, 2006. (R at 10; Certificate of Credit Counseling). Despite Mr. Wilks' declaration on his petition that he had obtained the required pre-petition credit counseling, the certificate indicated that Mr. Wilks had

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[4] Though the court docketed this motion as a Motion to Strike Petition, counsel for the Debtor actually titled said motion as a Motion to Strike Case.

[5] The Interim Bankruptcy Rules were prepared by the Advisory Committee on Bankruptcy Rules and recommended for local court adoption to implement changes made by the BAPCPA. Pursuant to a standing order dated October 14, 2005, the Bankruptcy Court for the Eastern District of Kentucky adopted the Interim Rules in their entirety as the local rules of the court. *See* October 14, 2005 Standing Order on Adoption of Interim Bankruptcy Rules.

not obtained credit counseling until March 21, 2006, more than twenty days after he filed his bankruptcy petition. *Id*.

On the same day that he filed his certificate of credit counseling, Mr. Wilks filed a motion to strike his bankruptcy case. (R. at 11; Motion to Strike Case). In his motion, he acknowledged that he was ineligible to be a debtor. *Id*. Mr. Wilks claimed, however, that because he was not eligible to be a debtor, he did not commence a bankruptcy case. *Id*. He therefore requested that his petition be stricken as opposed to having his case be dismissed. *Id*.

The United States Trustee filed an objection to Mr. Wilks' motion to strike. (R. at 12; Objection by the United States Trustee). He asked that the bankruptcy court dismiss Mr. Wilks' case. *Id*.

Based on the parties' briefs, the bankruptcy court ruled that it was appropriate to strike Mr. Wilks' petition "as not having been properly filed as a bankruptcy case." (R. at 18; Order Granting Debtor's Motion to Strike Petition). The bankruptcy court noted that under changes made by the BAPCPA, the automatic stay under 11 U.S.C. 362 has been modified with respect to people who file successive bankruptcy cases. *Id*. Under section 362(c)(3), when a debtor has had a prior case pending within the preceding one-year period that was subsequently dismissed, the automatic stay in the next case shall terminate automatically on the thirtieth day after the filing of that case unless a debtor is able to establish by motion that the later case is in good faith as to the creditors to be stayed. *See* 11 U.S.C. 362(c)(3). In order to protect Mr. Wilks from the impact of this new change in a subsequent case, and to deny his creditors of its advantage, the bankruptcy court ordered that the petition be stricken. (R. at 18; Order Granting Debtor's Motion to Strike Petition). The United States Trustee timely appealed that order to this Court. (R. at 21; Notice of Appeal).

Both Mr. Wilks and the United States Trustee agree that the requirements of section 109(h) were not met and that Mr. Wilks' bankruptcy case cannot proceed. (R. at 15; Wilks'

Memorandum in Response to the Objection of the United States Trustee). The question raised, however, is the proper disposition of the case once an individual is determined to be ineligible to be a debtor under the Bankruptcy Code.

SUMMARY OF THE ARGUMENT

Federal courts dismiss improperly filed cases - they do not strike them. Courts dismiss cases for many reasons, including lack of jurisdiction, and failure to state a claim upon which relief may be granted. The same has always been true in bankruptcy. Under section 301 of the Bankruptcy Code, the filing of a petition commences a bankruptcy case. The Bankruptcy Code, consistent with other federal law, makes no provision for striking petitions or cases as a method of disposing of bankruptcy cases.

Despite this, the court below declined to dismiss Mr. Wilkes' bankruptcy case, even though all the parties agreed the case was filed improperly; instead, the court, granted Mr. Wilks' motion to strike even though no federal statute professes to authorize the closure of federal cases by striking. That was error.

That error circumvents important statutory directives, and harms both debtors and creditors. It also engenders confusion because the Bankruptcy Code explains in detail what happens to dismissed cases and how dismissal affects the rights of the various parties to a bankruptcy case, but it says nothing about the effect of striking. See 11 U.S.C. 349. For these reasons, this case should be remanded with instructions that the court below dismiss Mr. Wilks' improperly filed bankruptcy case.

STANDARD OF REVIEW

The bankruptcy court is the finder of fact in a bankruptcy case. *Harden v. Caldwell (In re Caldwell)*, 851 F.2d 852, 857 (6th Cir. 1988). When the district court is the appellate court for a bankruptcy case, it reviews the bankruptcy court's factual findings under the clearly erroneous standard and its conclusions of law de novo. *Id.* This appeal presents only a legal question. De novo review of legal questions requires this Court to review questions of law independent of the bankruptcy court's determination of the law. *In re Schaffrath*, 214 B.R. 153, 154 (6th Cir. BAP 1997) (citations omitted).

ARGUMENT

1. Dismissal Is the Only Proper Disposition of Mr. Wilks' Improperly Filed Bankruptcy Case.

Federal district courts routinely dismiss improperly pleaded cases under Fed. R. Civ. P. 12(b) - they do not strike them.[6] *See, e.g., Harrod v. Uunet Tech., Inc.*, 22 Fed.Appx. 570, 571 (6th Cir. 2001) (Sixth Circuit affirmed district court's dismissal of case for failure to state a claim upon which relief could be granted pursuant to Fed.R.Civ.P. 12(b)(6)); *Universal Express, Inc. v. U.S. S.E.C.*, 2006 WL 1004381, slip op. (11th Cir. 2006) (a "motion to dismiss may be granted for defect in jurisdictional, venue, or process, see Fed.R.Civ.P. 12(b)(1)-(5), or for failure to state a claim, see id. R. 12(b)(6)"); *Cont'l Cas. Co. v. American Nat. Ins. Co.*,417 F.3d 727, 733 (7th Cir. 2005); ("[t]he district court ultimately dismissed this case because the forum selection clauses in the [contract] required arbitration in other districts... [w]e have held dismissal under these circumstances to be appropriate"); *Miller v. Yokohama Tire Corp.,* 358 F.3d 616, 618 (9th Cir. 2004) (Ninth Circuit affirmed district court's dismissal of case under Rule 12(b)(6)); *ProEnglish v. Bush,* 70 Fed.Appx. 84 (4th Cir. 2003) (Fourth Circuit affirmed district court's dismissal of case for lack of ripeness).

Indeed, the United States Code makes clear that even cases filed without jurisdiction are dismissed. *See* 28 U.S.C. 1919 (governing the imposition of costs in district court cases "dismissed" for "want of jurisdiction"). *See also, Ogle v. Church of God,* 153 Fed.Appx. 371, 375, 376 (6th Cir. 2005) ("we affirm [the district court's] holding that it lacked subject matter jurisdiction over this case as a matter of First Amendment law and its dismissal of the case");

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[6] Bankruptcy courts are units of the district courts. 28 U.S.C. 151

Roberts v. U.S., 2006 WL 1866858, slip op. at *4 (6th Cir. 2006) (“the district court properly dismissed [plaintiff’s] lawsuit without prejudice for lack of subject-matter jurisdiction); *Coles v. Granville*, 448 F.3d 853, 866 (6th Cir. 2006); (the plaintiff “has no injury necessary to make his case ripe for federal review. On this basis alone, the district court's dismissal without prejudice, in lieu of abstention, was not an abuse of discretion”); *Int’l Bhd. of Teamsters v. United Parcel Service* Co., 447 F.3d 491 (6th Cir. 2006) (Sixth Circuit affirmed district court’s dismissal of case for lack of statutory jurisdiction”).

Bankruptcy is no different. The filing of a petition commences a case. 11 U.S.C. 301. Every chapter of the Bankruptcy Code includes a separate section expressly providing for the “dismissal” of debtors’ cases for “cause” when it is improper for the case to proceed. See 11 U.S.C. 707(a) (providing for “dismiss[al]” of a chapter 7 case for “cause”); see also 11 U.S.C. 1112(b) (providing for dismissal or conversion of a chapter 11 case for “cause”); see also 11 U.S.C. 1208 (providing for dismissal or conversion of a chapter 12 case for “cause”); see also 11 U.S.C. 1307(c) (providing for dismissal or conversion of a chapter 13 case for “cause”).

In fact, as the court below acknowledged in its ruling, prior to changes made by the BAPCPA, bankruptcy courts routinely dismissed cases where individuals were determined to be ineligible to be debtors by operation of 11 U.S.C. 109. (R. at 18; Order Granting Debtor’s Motion to Strike Petition). The government has reviewed over 800 decisions entered prior to the enactment of the BAPCPA where eligibility under section 109 was at issue, and it is not aware of a single case or petition that was stricken as a method of disposing of the underlying case. Bankruptcy courts have consistently dismissed cases when individuals or entities were ineligible to be debtors. *See, e.g.*, *In re Hubbard*, 333 B.R. 377, 388 (Bankr. S.D. Tex. 2005)(noting that “[t]his Court and others have generally ‘dismissed’ cases that were filed by ineligible debtors”).

Historically, bankruptcy courts, like district courts, have dismissed cases for a variety of reasons, including jurisdictional defects and improper venue. *See* Fed. R. Bankr. P. 1014 (providing that cases filed in an improper district shall either be dismissed or transferred); see also 28 U.S.C. §1930(d)(providing that "[w]henever any case or proceeding is dismissed in any bankruptcy court for want of jurisdiction, such court may order the payment of just costs") (emphasis added).

Given this settled law, it is not surprising that the vast majority of courts have dismissed cases upon concluding the person seeking bankruptcy protection was ineligible to be a debtor under 11 U.S.C. 109(h). *See, e.g., Dixon v. LaBarge, Jr. (In re Dixon),* 338 B.R. 383, 389 (8th Cir. B.A.P. 2006). In addition, most courts that have considered the issue have dismissed rather than struck cases in which individuals have been ineligible to be debtors because they did not obtain credit counseling. *See In re Seaman*, 340 B.R. 698 (Bankr. E.D.N.Y. 2006); *In re Ross,* 338 B.R. 134 (Bankr. N.D. Ga. 2006); *In re Mills*, 341 B.R. 106 (Bankr. D. Colo. 2006); *In re Bell*, 2006 WL 1132907, slip op. (Bankr. D. Colo. 2006); *In re Taylor*, 2006 Bankr. LEXIS 689 (Bankr.N.D.Cal. 2006); *In re Racette*, 343 B.R. 200 (Bankr. E.D. Wis. 2006); *In re Tomco*, 339 B.R. 145 (Bankr. W.D. Pa. 2006); *In re Wilson,* No. 06-60870, 2006 WL 2055742 (Bankr. N.D.N.Y. 2006); *In re Westover*, No. 06-10183, 2006 WL 1982751, slip op. (Bankr. D. Vt. 2006); But see *In re Carey,* 341 B.R. 798 (Bankr. M.D. Fla. 2006); *In re Hubbard*, 333 B.R. 373 (Bankr. S.D. Tex. 2005); *In re Salazar*, 339 B.R. 622 (Bankr. S.D. Tex. 2006); *In re Rios*, 336 B.R. 177 (Bankr. S.D.N.Y. 2005); *In re Elmendorf*, 2006 Bankr. LEXIS 1369 (Bankr. S.D.N.Y. 2006); *In re Thompson*, No. 06-01031, 2006 WL 1766528 (Bankr. S.D. Ind. 2006).

Neither Mr. Wilks nor the bankruptcy court identified any provision of the Bankruptcy Code or other federal law that allows courts to terminate federal bankruptcy cases by striking the pleading that commenced the case while leaving the underlying case in limbo. Nor can they, because no such provision exists.[7] The lower court decision cited only one statute, 11 U.S.C.

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[7] In addition, the only reference to the "striking" of any document in the Federal Rules of Bankruptcy Procedure is found in Fed. R. Bankr. P. 7012(b) and 9011. Rule 7012(b), incorporates by reference Fed. R. Civ. P. 12(e) and (f). Rule 12(e) allows a court to strike a

105(a).[8] However, both its plain language and binding Sixth Circuit precedent make clear that this provision cannot be used, as the court would use it here, to deviate from the use of dismissal to terminate improperly filed cases.

By its terms, section 105 nowhere authorizes courts to dispose of cases by striking. To the contrary, it only authorizes courts to take actions that are consistent with the Code. As the Sixth Circuit and many other courts have held, section 105 cannot be employed to deviate from federal law. See *Pertuso v. Ford Motor Credit Co.*, 233 F.3d 417, 423 (6th Cir. 2000) (establishing that a bankruptcy court may not use section 105(a) to legislate additional remedies that are otherwise unavailable under applicable law.); *Matter of Kelvin Publishing, Inc.*, 72 F.3d 129 (6th Cir.

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pleading where there is a prior existing order to amend the pleading and the order has not been obeyed. Rule 12(f) allows for motions to strike in the context of adversary proceedings. According to this rule, such motions may be made by a party before responding to a pleading or by a court on its own initiative, and the court may "order stricken from any pleading any insufficient defense or any redundant, immaterial, impertinent, or scandalous matter." Fed. R. Civ. P. 12(f). Motions to strike, however, are not favored. *Salcer v. Envicon Equities Corp.*, 744 F.2d 935, 939 (2d Cir. 1984), *cert. granted and judgment remanded on other grounds*, 478 U.S. 1015 (1986); *FDIC v. Abel, et al.*, 1995 WL 716729 at * 12 (S.D.N.Y. 1995); *Brokke v. Stauffer Chem. Co.*, 703 F. Supp. 215, 223 (D. Conn. 1988). A motion to "strike" under Rule 12(f) also only pertains to the striking of material contained in a pleading. *In re Kershaw,* 59 B.R. 618, 620 (Bankr. D. Tenn. 1986). Moreover, such motions are not intended to raise substantial, disputed questions of law. *Mohegan Tribe v. Conn.*, 528 F. Supp. 1359, 1362 (D. Conn. 1982) ("The presence of a substantial or seriously disputed question of law will preclude a district court from granting a motion to strike."). Rule 9011 requires that papers filed in bankruptcy courts be signed by at least one attorney of record or by the party herself if she is unrepresented. Rule 9011(a) provides that "an unsigned paper shall be stricken unless omission of the signature is corrected promptly after being called to the attention of the attorney or party." Fed. R. Bankr. P. 9011(a).

[8] Section 105 provides:

> The court may issue any order, process, or judgment that is *necessary or appropriate to carry out the provisions of this title.* No provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, sua sponte, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process.

11 U.S.C. 105(a) (emphasis added).

1995)); see also *United States v. Sutton*, 786 F.2d 1305, 1308 (5th Cir.1986) (citing *Southern Ry. Co. v. Johnson Bronze Co.*, 758 F.2d 137, 141 (3d Cir.1985) (same).

As we discuss above, improperly filed federal cases are dismissed, not stricken, and each chapter of the Bankruptcy Code contains a provision for dismissing - not striking - improperly filed cases. As Sixth Circuit authority underscores, section 105 cannot be used to deviate from that law.

2. It is Error to Strike Cases Under the Theory that 11 U.S.C. 109 is a Jurisdictional Statute Because: (1) It is Not and, (2) Even if it Were, Cases Filed in Violation of Section 109 Would Need to be Dismissed Rather than Stricken.

Although the court below did not expressly purport to do so, some bankruptcy courts have erroneously stricken cases because they believe (1) section 109(h) is a jurisdictional statute and (2) courts must strike petitions filed without jurisdiction under section 109.[9] Both of these conclusions are wrong. To the extent those erroneous beliefs formed any basis for the bankruptcy court's holding, the bankruptcy court erred as a matter of law in relying upon them.

Supreme Court and the Sixth Circuit precedent make clear that eligibility statutes like section 109 are not jurisdictional. Instead, jurisdictional provisions are those that actually define the jurisdiction of federal courts, most typically those set forth in title 28 of the United States code. Most recently in *Arbaugh v. Y & H Corp.*,--- U.S. ----, 126 S.Ct. 1235, 163 L.Ed.2d 1097 (Feb. 22, 2006), the Supreme Court ruled that eligibility provisions in federal statutes do not confer or contract subject-matter jurisdiction. In *Arbaugh*, the Supreme Court was asked to determine whether an employee-numerosity requirement in Title VII for establishing a defendant/restaurant's "employer" status was jurisdictional, or whether it was merely an element of a bartender/waitress's claim for relief under Title VII. *Id*. The Court held that the definition of an "employer" in the statute was an element of the plaintiff's claim for relief, the satisfaction

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[9] The court below did state, without elaboration, that Mr. Wilks' petition was "not properly filed as a bankruptcy case." (R. at 18; Order Granting Debtor's Motion to Strike Petition).

of which the defendant employer conceded when it failed to raise the issue prior to the trial on the merits. *Id*. at 1245. The Supreme Court declined to find that the defendant's status as an "employer" was a jurisdictional requirement that could be questioned at any stage of litigation. *Id*. In making its determination, the Supreme Court noted that courts have an obligation to determine whether subject-matter jurisdiction exists, even in the absence of a challenge from any party. *Id*. It concluded that nothing in Title VII's text indicated that Congress intended courts, on their own motion, to assure that the employee-numerosity requirement is met. *Id*. at 1244.

In rendering its decision, the Supreme Court commented that courts have been imprecise regarding jurisdictional issues noting that "[s]ubject matter jurisdiction in federal-question cases is sometimes erroneously conflated with a plaintiff's need and ability to prove the defendant bound by the federal law asserted as the predicate for relief-a merits-related determination." *Id*. at 1242 (quoting 2 J. Moore et al., MOORE'S FEDERAL PRACTICE § 12.30[1], p. 12-36.1 (3d ed. 2005). In addition, in order to avoid the "'unfair[ness]" and 'waste of judicial resources. . . entailed in tying the employee-numerosity requirement to subject-matter jurisdiction," the Supreme Court advised courts to "to refrain from constricting § 1331 or Title VII's jurisdictional provision, 42 U.S.C. § 2000e-5(f)(3), and to leave the ball in Congress' court." *Arbaugh*, 126 S.Ct. at 1245. It noted that Congress is free to instruct that certain elements of a claim for relief "shall count as jurisdictional, ... [b]ut when Congress does not rank a statutory limitation on coverage as jurisdictional, courts should treat the restriction as nonjurisdictional in character." *Id*.

Even more recently, the Sixth Circuit in *Cobb v. Contract Transp., Inc.*, 452 F.3d 543 (6th Cir. 2006), heeded the Supreme Court's ruling in *Arbaugh* and overruled its prior holding in *Douglas v. E.G. Baldwin & Associates*, 150 F.3d 604 (6th Cir.1998) that an eligibility statute was jurisdictional. Drawing heavily upon *Arbaugh*, the Sixth Circuit concluded that the district court clearly had subject matter jurisdiction over a driver's Family and Medical Leave Act

(FMLA) claims, as the FMLA's definitions of “employer” and “eligible employee” were not jurisdictional in nature. *Cobb*, 2006 WL 1749628 at *4. In rendering its decision, the Sixth Circuit noted that the Supreme Court has issued a number of decisions in the past three years “instructing courts of appeals to properly distinguish between subject-matter jurisdiction and other limits on a court's authority.” Id. at *5. See e.g. *Eberhart v. United States*, --- U.S.----, 126 S.Ct. 403, 405, 163 L.Ed.2d 14 (2005); see also *Kontrick v. Ryan*, 540 U.S. 443, 453-54, 124 S.Ct. 906, 157 L.Ed.2d 867 (2004). The Sixth Circuit noted that, as a consequence of those Supreme Court decisions, “[a] panel of this Court recently held that these cases overrule prior panel precedent construing the eligibility sections of federal statutes as jurisdictional in nature.” *Id.* at *5; see also *Primax Recoveries, Inc. v. Gunter*, 433 F.3d 515, 519 (6th Cir. 2006).

Similar to the “employer” and “eligible employee” provisions of the FMLA discussed in *Cobb*, section 109 establishes eligibility to be a debtor under the Bankruptcy Code. Nothing under Title 11 indicates that Congress intended courts, on their own motion, to assure that the debtor eligibility provisions are satisfied. In addition, 28 U.S.C. 1334 and 157 are the jurisdictional statutes that confer bankruptcy jurisdiction. *See, e.g., Rudd v. Laughlin*, 866 F.2d 1040, 1041 (8th Cir. 1989); *Promenade Nat’l Bank v. Phillips (In re Phillips),* 844 F.2d 230, 235-36 n.2 (5th Cir. 1988); *In re Republic Trust & Savings Co.*, 59 B.R. 606, 609 (N.D. Okla. 1986). Section 109 does not speak in jurisdictional terms, and does not refer in any way to the jurisdiction of the bankruptcy courts. *Arbaugh*, 126 S.Ct. at 1245. Therefore, under the case law controlling in this circuit, Mr. Wilks commenced a case under the Bankruptcy Code despite the fact that he later admitted that he was ineligible to be a debtor, and the bankruptcy court possessed the jurisdiction to dispose of the case under the Bankruptcy Code.

3. Other Federal Statues Make Clear that Mr. Wilks Filed A Bankruptcy Case, and Everything That Happened in His Case Underscores That Fact.

Other federal statutes and the administration of Mr. Wilks' case make clear Mr. Wilks had a bankruptcy case that needed to be dismissed. Among other things, (i) a "case" number was been assigned to his case,[10] (ii) a chapter 7 "case" trustee was appointed to supervise his case,[11] (iii) the bankruptcy court accepted a "case" filing fee under 28 U.S.C. 1930(a),[12] and (iv) the debtor's creditors were advised that the "filing of the bankruptcy case" operates as a stay of any action they may take to collect any debts owed by the debtor.[13] Each of these actions underscores the obvious fact that Mr. Wilks' decision to file a bankruptcy petition commenced a bankruptcy case.

4. Striking Petitions Creates Substantial Uncertainty under the Bankruptcy Code That Is Harmful to Debtors and Creditors Alike, and Creates Confusion Regarding the Rights of Interested Parties.

The Bankruptcy Code dedicates an entire section of the Code, 11 U.S.C. 349, to explaining the effect of a dismissed case on the rights of the various parties to a bankruptcy proceeding. *See* 11 U.S.C. 349. Section 349 provides, among other things, that: (i) dismissal of a bankruptcy case reinstates any proceeding or custodianship superseded under section 521; (ii) dismissal vacates any order under sections 522(i)(1), 542, 550, or 553, and (iii) dismissal revests the property of the estate in the entity in which such property was vested immediately before commencement of the case. 11 U.S.C. 349. Therefore, terminating a case through striking rather

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[10] *See* R. at 6; Notice of Chapter 7 Bankruptcy Case (assigning "Case" number 06-10030 to Mr. Wilks' case).

[11] *See* R. at 4; Notice of Appointment of Interim Trustee and Fixing of Bond (appointing Phaedra Spradlin as the interim trustee assigned to Mr. Wilks' case pursuant to 11 U.S.C. 701).

[12] Under 28 U.S.C. 1930(a), "parties commencing a case under title 11" are required to pay the clerk of the bankruptcy court a fee for a case commenced under chapter 7 of the Bankruptcy Code. 28 U.S.C. 1930(a). The Bankruptcy Court collected a filing fee of $274 from Mr. Wilks when he commenced his case. (R. at 2; Receipt of Filing Fee for Chapter 7 Voluntary Petition).

[13] *See* R. at 6; Notice of Chapter 7 Bankruptcy Case, Meeting of Creditors, & Deadlines (advising Mr. Wilks' creditors that "the filing of the bankruptcy case automatically stays certain collection and other actions against the debtor").

than dismissal will engender substantial confusion and potential prejudice because there are no corresponding instructions in the Code or elsewhere regarding the impact of striking a petition.[14]

5. Striking Petitions Circumvents Statutory Restrictions Upon Debtors Who Have Previously Had a Bankruptcy Case Dismissed.

Congress amended the automatic stay provisions of section 362 of the Bankruptcy Code in 2005 in order to limit a debtor's right to operate under the automatic stay when the debtor has previously had a case "dismissed" by a bankruptcy court. 11 U.S.C. 362(c)(3) (imposing these new restrictions in cases succeeding previously "dismissed" cases). Congress did so because it concluded it was unfair to allow debtors to file multiple bankruptcy cases and automatically reap the substantial benefits of the automatic stay of creditor actions in each case. *See* H.R. Rep. No. 109-31, pt. 1, at 2 (2005), U.S. Code Cong. & Admin. News 2005, pp. 88, 89 (setting forth Congress' conclusions on this point).

Section 362(c)(3) provides that where a debtor has had a prior case "dismissed" within the preceding one-year period, the automatic stay in the next case shall terminate automatically on the thirtieth day after the filing of that case unless a debtor is able to establish by motion that the later case is in good faith as to the creditors to be stayed. See 11 U.S.C. 362(c)(3).

By striking rather than dismissing Mr. Wilks' petition, the order entered below risks circumventing section 362(c)(3)'s new limitation by disposing of a case without "dismissing" it. Some courts have concluded that striking a case rather than dismissing it - the term employed in section 362(c)(3) - frees debtors from section 362(c)(3)'s restrictions upon the use of the automatic stay in a subsequent case. In the government's view, it is not appropriate to vitiate Congress' mandate in section 362(c)(3) by refusing to dismiss cases filed in violation of section

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[14] In addition, striking a case, rather than dismissing creates substantial uncertainty about the rights and obligations of debtors and creditors in stricken cases. *See, e.g., In re Ross*, 338 B.R. 134, 139 (Bankr. N.D. Ga. 2006)(explaining that striking cases could have an unintended result of harming debtors who have had their homes foreclosed due to the absence of the stay in a voided case).

109. For the Bankruptcy System to function optimally, creditors and debtors alike must have faith that time-honored procedures - like dismissing improperly filed cases - will be neutrally applied in all cases. Conversely, faith in the Bankruptcy System will diminish were parties in interest to conclude that neutral bankruptcy rules were being ignored simply to evade policy dictates mandated by Congress that a particular court might deem unwise.

That is not to say Mr. Wilks cannot take full advantage of the automatic stay in a subsequent bankruptcy case. To the contrary, section 362 allows debtors to obtain the full benefit of the stay in a subsequent case if they prove their first case was filed in "good faith." *See* 362(c)(3) (allowing a debtor to obtain the full benefit of the stay if the debtor establishes the first case was filed in "good faith"). *See also In re Seaman,* 340 B.R. 698, 706 (Bankr. E.D.N.Y. 2006) (discussing this point). As some courts have stated, "a dismissal under Section 109(h) . . . does not appear to establish any lack of good faith." *Id*. Under those decisions' rationale, Mr. Wilks might well be able to take full advantage of the automatic stay notwithstanding the dismissal of his prior case. At a minimum, the necessity under section 362(c)(3) of filing a motion to extend the stay in a second case is the procedure Congress mandated. It should not be vitiated by striking rather than dismissing bankruptcy cases.[15]

CONCLUSION

For these reasons, the United States Trustee respectfully asks this Court to reverse the order entered below and remand this case with instructions to the bankruptcy court to enter an order dismissing Mr. Wilks' Chapter 7 bankruptcy case.

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[15] Although Mr. Wilks sought to have his first case declared a legal nullity at the end of its life, Mr. Wilks enjoyed the benefits of the automatic stay in that bankruptcy case for more than twenty days before he admitted that he was ineligible to be a debtor and filed his motion asking that his petition be stricken.

Respectfully submitted,

RICHARD F. CLIPPARD
UNITED STATES TRUSTEE, REG 8

JOHN R. STONITSCH
ASSISTANT U.S. TRUSTEE

BY: /s/ John R. Stonitsch
Office of the United States Trustee
United States Department of Justice
100 E. Vine St. Ste. 500
Lexington, KY 40507
(859) 233-2822 Telephone
(859) 233-2834 Fax
Email:john.r.stonitsch@usdoj.gov

CERTIFICATE OF SERVICE

I hereby certified that on August [ ], 2006, I electronically filed the foregoing with the clerk of the court by using the CM/ECF system, which will send a notice of electronic filing to the following: Paul Stewart Snyder, Attorney for the Debtor.

/s/ John R. Stonitsch

ADDENDUM

11 U.S.C. 109 – Who may be a debtor

(a) Notwithstanding any other provision of this section, only a person that resides or has a domicile, a place of business, or property in the United States, or a municipality, may be a debtor under this title.

(b) A person may be a debtor under chapter 7 of this title only if such person is not--

(1) a railroad;

(2) a domestic insurance company, bank, savings bank, cooperative bank, savings and loan association, building and loan association, homestead association, a New Markets Venture Capital company as defined in section 351 of the Small Business Investment Act of 1958, a small business investment company licensed by the Small Business Administration under section 301 of the Small Business Investment Act of 1958, credit union, or industrial bank or similar institution which is an insured bank as defined in section 3(h) of the Federal Deposit Insurance Act, except that an uninsured State member bank, or a corporation organized under section 25A of the Federal Reserve Act, which operates, or operates as, a multilateral clearing organization pursuant to section 409 of the Federal Deposit Insurance Corporation Improvement Act of 1991 may be a debtor if a petition is filed at the direction of the Board of Governors of the Federal Reserve System; or

(3)(A) a foreign insurance company, engaged in such business in the United States; or

(B) a foreign bank, savings bank, cooperative bank, savings and loan association, building and loan association, or credit union, that has a branch or agency (as defined in section 1(b) of the International Banking Act of 1978 in the United States.

(c) An entity may be a debtor under chapter 9 of this title if and only if such entity--

(1) is a municipality;

(2) is specifically authorized, in its capacity as a municipality or by name, to be a debtor under such chapter by State law, or by a governmental officer or organization empowered by State law to authorize such entity to be a debtor under such chapter;

(3) is insolvent;

(4) desires to effect a plan to adjust such debts; and

(5)(A) has obtained the agreement of creditors holding at least a majority in amount of the claims of each class that such entity intends to impair under a plan in a case under such chapter;

(B) has negotiated in good faith with creditors and has failed to obtain the agreement of creditors holding at least a majority in amount of the claims of each class that such entity intends to impair under a plan in a case under such chapter;

(C) is unable to negotiate with creditors because such negotiation is impracticable; or

(D) reasonably believes that a creditor may attempt to obtain a transfer that is avoidable under section 547 of this title.

(d) Only a railroad, a person that may be a debtor under chapter 7 of this title (except a stockbroker or a commodity broker), and an uninsured State member bank, or a corporation organized under section 25A of the Federal Reserve Act, which operates, or operates as, a multilateral clearing organization pursuant to section 409 of the Federal Deposit Insurance Corporation Improvement Act of 1991 may be a debtor under chapter 11 of this title.

(e) Only an individual with regular income that owes, on the date of the filing of the petition, noncontingent, liquidated, unsecured debts of less than $307,675 [FN1] and noncontingent, liquidated, secured debts of less than $922,975 [FN1], or an individual with regular income and such individual's spouse, except a stockbroker or a commodity broker, that owe, on the date of the filing of the petition, noncontingent, liquidated, unsecured debts that aggregate less than $307,675 [FN1] and noncontingent, liquidated, secured debts of less than $922,975 [FN1] may be a debtor under chapter 13 of this title.

(f) Only a family farmer or family fisherman with regular annual income may be a debtor under chapter 12 of this title.

(g) Notwithstanding any other provision of this section, no individual or family farmer may be a debtor under this title who has been a debtor in a case pending under this title at any time in the preceding 180 days if--

(1) the case was dismissed by the court for willful failure of the debtor to abide by orders of the court, or to appear before the court in proper prosecution of the case; or

(2) the debtor requested and obtained the voluntary dismissal of the case following the filing of a request for relief from the automatic stay provided by section 362 of this title.

(h)(1) Subject to paragraphs (2) and (3), and notwithstanding any other provision of this section, an individual may not be a debtor under this title unless such individual has, during the 180-day period preceding the date of filing of the petition by such individual, received from an approved nonprofit budget and credit counseling agency described in section 111(a) an individual or group briefing (including a briefing conducted by telephone or on the Internet) that outlined the opportunities for available credit counseling and assisted such individual in performing a related budget analysis.

(2)(A) Paragraph (1) shall not apply with respect to a debtor who resides in a district for which the United States trustee (or the bankruptcy administrator, if any) determines that the approved nonprofit budget and credit counseling agencies for such district are not reasonably able to provide adequate services to the additional individuals who would otherwise seek credit counseling from such agencies by reason of the requirements of paragraph (1).

(B) The United States trustee (or the bankruptcy administrator, if any) who makes a determination described in subparagraph (A) shall review such determination not later than 1 year after the date of such determination, and not less frequently than annually thereafter.

Notwithstanding the preceding sentence, a nonprofit budget and credit counseling agency may be disapproved by the United States trustee (or the bankruptcy administrator, if any) at any time.

(3)(A) Subject to subparagraph (B), the requirements of paragraph (1) shall not apply with respect to a debtor who submits to the court a certification that--

(i) describes exigent circumstances that merit a waiver of the requirements of paragraph (1);

(ii) states that the debtor requested credit counseling services from an approved nonprofit budget and credit counseling agency, but was unable to obtain the services referred to in paragraph (1) during the 5-day period beginning on the date on which the debtor made that request; and

(iii) is satisfactory to the court.

(B) With respect to a debtor, an exemption under subparagraph (A) shall cease to apply to that debtor on the date on which the debtor meets the requirements of paragraph (1), but in no case may the exemption apply to that debtor after the date that is 30 days after the debtor files a petition, except that the court, for cause, may order an additional 15 days.

(4) The requirements of paragraph (1) shall not apply with respect to a debtor whom the court determines, after notice and hearing, is unable to complete those requirements because of incapacity, disability, or active military duty in a military combat zone. For the purposes of this paragraph, incapacity means that the debtor is impaired by reason of mental illness or mental deficiency so that he is incapable of realizing and making rational decisions with respect to his financial responsibilities; and "disability" means that the debtor is so physically impaired as to be unable, after reasonable effort, to participate in an in person, telephone, or Internet briefing required under paragraph (1).

11 U.S.C. 301 – Voluntary cases

(a) A voluntary case under a chapter of this title is commenced by the filing with the bankruptcy court of a petition under such chapter by an entity that may be a debtor under such chapter.

(b) The commencement of a voluntary case under a chapter of this title constitutes an order for relief under such chapter.

11 U.S.C. 707(a) – Dismissal of a case or conversion to a case under chapter 11 or 13

(a) The court may dismiss a case under this chapter only after notice and a hearing and only for cause, including--

(1) unreasonable delay by the debtor that is prejudicial to creditors;

(2) nonpayment of any fees or charges required under chapter 123 of title 28; and

(3) failure of the debtor in a voluntary case to file, within fifteen days or such additional time as the court may allow after the filing of the petition commencing such case, the information required by paragraph (1) of section 521, but only on a motion by the United States trustee.

28 U.S.C. 157 – Procedures

(a) Each district court may provide that any or all cases under title 11 and any or all proceedings arising under title 11 or arising in or related to a case under title 11 shall be referred to the bankruptcy judges for the district.

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

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

(A) matters concerning the administration of the estate;

(B) allowance or disallowance of claims against the estate or exemptions from property of the estate, and estimation of claims or interests for the purposes of confirming a plan under chapter 11, 12, or 13 of title 11 but not the liquidation or estimation of contingent or unliquidated personal injury tort or wrongful death claims against the estate for purposes of distribution in a case under title 11;

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

(D) orders in respect to obtaining credit;

(E) orders to turn over property of the estate;

(F) proceedings to determine, avoid, or recover preferences;

(G) motions to terminate, annul, or modify the automatic stay;

(H) proceedings to determine, avoid, or recover fraudulent conveyances;

(I) determinations as to the dischargeability of particular debts;

(J) objections to discharges;

(K) determinations of the validity, extent, or priority of liens;

(L) confirmations of plans;

(M) orders approving the use or lease of property, including the use of cash collateral;

(N) orders approving the sale of property other than property resulting from claims brought by the estate against persons who have not filed claims against the estate;

(O) other proceedings affecting the liquidation of the assets of the estate or the adjustment of the debtor-creditor or the equity security holder relationship, except personal injury tort or wrongful death claims; and

(P) recognition of foreign proceedings and other matters under chapter 15 of title 11.

(3) The bankruptcy judge shall determine, on the judge's own motion or on timely motion of a party, whether a proceeding is a core proceeding under this subsection or is a proceeding that is otherwise related to a case under title 11. A determination that a proceeding is not a core proceeding shall not be made solely on the basis that its resolution may be affected by State law.

(4) Non-core proceedings under section 157(b)(2)(B) of title 28, United States Code, shall not be subject to the mandatory abstention provisions of section 1334(c)(2).

(5) The district court shall order that personal injury tort and wrongful death claims shall be tried in the district court in which the bankruptcy case is pending, or in the district court in the district in which the claim arose, as determined by the district court in which the bankruptcy case is pending.

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

(2) Notwithstanding the provisions of paragraph (1) of this subsection, the district court, with the consent of all the parties to the proceeding, may refer a proceeding related to a case under title 11 to a bankruptcy judge to hear and determine and to enter appropriate orders and judgments, subject to review under section 158 of this title.

(d) The district court may withdraw, in whole or in part, any case or proceeding referred under this section, on its own motion or on timely motion of any party, for cause shown. The district court shall, on timely motion of a party, so withdraw a proceeding if the court determines that resolution of the proceeding requires consideration of both title 11 and other laws of the United States regulating organizations or activities affecting interstate commerce.

(e) If the right to a jury trial applies in a proceeding that may be heard under this section by a bankruptcy judge, the bankruptcy judge may conduct the jury trial if specially designated to exercise such jurisdiction by the district court and with the express consent of all the parties.

28 U.S.C. 1334 – Bankruptcy cases and proceedings

(a) Except as provided in subsection (b) of this section, the district courts shall have original and exclusive jurisdiction of all cases under title 11.

(b) Except as provided in subsection (e)(2), and notwithstanding any Act of Congress that confers exclusive jurisdiction on a court or courts other than the district courts, the district courts shall have original but not exclusive jurisdiction of all civil proceedings arising under title 11, or arising in or related to cases under title 11.

(c)(1) Except with respect to a case under chapter 15 of title 11, nothing in this section prevents a district court in the interest of justice, or in the interest of comity with State courts or respect for State law, from abstaining from hearing a particular proceeding arising under title 11 or arising in or related to a case under title 11.

(2) Upon timely motion of a party in a proceeding based upon a State law claim or State law cause of action, related to a case under title 11 but not arising under title 11 or arising in a case under title 11, with respect to which an action could not have been commenced in a court of the United States absent jurisdiction under this section, the district court shall abstain from hearing such proceeding if an action is commenced, and can be timely adjudicated, in a State forum of appropriate jurisdiction.

(d) Any decision to abstain or not to abstain made under subsection (c) (other than a decision not to abstain in a proceeding described in subsection (c)(2)) is not reviewable by appeal or otherwise by the court of appeals under section 158(d), 1291, or 1292 of this title or by the Supreme Court of the United States under section 1254 of this title. Subsection (c) and this subsection shall not be construed to limit the applicability of the stay provided for by section 362 of title 11, United States Code, as such section applies to an action affecting the property of the estate in bankruptcy.

(e) The district court in which a case under title 11 is commenced or is pending shall have exclusive jurisdiction--

(1) of all the property, wherever located, of the debtor as of the commencement of such case, and of property of the estate; and

(2) over all claims or causes of action that involve construction of section 327 of title 11, United States Code, or rules relating to disclosure requirements under section 327.

BRIEF BANK — "SUMMARY SHEET" *Printed Thu-6/17/10 14:39*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*

In re: Gregory Williams and Joyce Williams (Gregory S. Williams, Sr. And Joyce I. Williams v. W. Clarkson McDow, Jr. United States Trustee for Region 4)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*

W. D. Va.

3. ("CCN") ***CURRENT*** CASE NO.

No.: 5:10-cv-00049

4. ("PCN") ***PRIOR*** CASE NO. - & COURT *[IF ANY]*

No.: 08-50781

Court: Bankr. W.D. Va.

(Identify judge & cite, if any)

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U.S. TRUSTEES

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*

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7. **("AU")** ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*

Margaret K. Garber, Catherine B. Sevcenko, P. Matthew Sutko, Ramona D. Elliott, W. Clarkson McDow, Jr.

(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***

BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s)

&

√ Any Miscellaneous ***BACKGROUND***

• Whether the bankruptcy court abused its discretion in determining that the debtors' monthly income is high enough to create a presumption of abuse.

10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)

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NAME: Linda Figueroa

DATE:

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF VIRGINIA
HARRISONBURG DIVISION

IN RE:	)	
GREGORY WILLIAMS	)	Bankruptcy Case No. 08-50781
JOYCE WILLIAMS	)	Hon. Ross W. Krumm
DEBTORS	)	
______________________________	)	
	)	
GREGORY S. WILLIAMS, SR.	)	District Court Case No. 5:10CV00049
JOYCE I. WILLIAMS	)	
APPELLANTS,	)	Hon. Glen E. Conrad
	)	
V.	)	
	)	
W. CLARKSON MCDOW, JR.	)	
UNITED STATES TRUSTEE FOR	)	
REGION 4	)	
	)	
APPELLEE.	)	

ON APPEAL FROM THE UNITED STATES BANKRUPTCY COURT
FOR THE WESTERN DISTRICT OF VIRGINIA

BRIEF OF APPELLEE W. CLARKSON MCDOW, JR., UNITED STATES TRUSTEE

RAMONA D. ELLIOTT
General Counsel

P. MATTHEW SUTKO
Associate General Counsel

CATHERINE B. SEVCENKO
Trial Attorney
Executive Office for United States Trustees
Department of Justice
20 Massachusetts Avenue, N.W.
Washington, D.C. 20530
Phone: (202) 307-1399
Fax: (202) 307-2397

W. CLARKSON MCDOW, JR.
United States Trustee for Region 4

MARGARET K. GARBER
Trial Attorney

Office of the United States Trustee
Department of Justice
210 First Street, Suite 505
Roanoke, VA 24011
Phone: (540) 857-2806
Fax:(540) 857-2844

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I. INTRODUCTION

On August 1, 2008, the debtors, Gregory and Joyce Williams, filed a voluntary petition in the United States Bankruptcy Court for the Western District of Virginia, Harrisonburg Division. They now challenge the bankruptcy court's determination that their chapter 7 petition is abusive under section 707(b)(2) of title 11 and should be dismissed.

Because Mr. and Mrs. Williams's household income exceeded the applicable median family income amount, the United States Trustee reviewed the case, determined that they had disposable income triggering the presumption of abuse under section 707(b)(2), and timely filed a motion to dismiss the case.

In its Memorandum Opinion issued on March 3, 2010, the bankruptcy court found that Mr. and Mrs. Williams had monthly disposable income of $197.07, which created a presumption of abuse under section 707(b)(2). It further found that they had not rebutted this presumption. The bankruptcy court thus granted the United States Trustee's motion to dismiss. That decision, which was based upon the evidence before the court at that juncture, should be affirmed.

Throughout the proceedings below, Mr. and Mrs. Williams changed the figures on their schedules and means test, first in reaction to the United States Trustee's review, and then in post trial briefing. They also presented revised figures in their opening brief to this Court. None of these recalculations rebut the presumption of abuse that requires their case to be dismissed under section 707(b)(2).

II. STATEMENT OF THE CASE

A. Statutory Framework

Most individual debtors seek bankruptcy relief either under chapter 7 or chapter 13. Under chapter 7, "an individual debtor receives an immediate unconditional discharge of personal liability for certain debts in exchange for relinquishing his or her nonexempt assets to a bankruptcy trustee for liquidation and distribution to creditors." H.R. Rep. 109-31(I), at 10; *see* 11 U.S.C. §§ 701–727. By contrast, under chapter 13, "a debtor commits to repay some portion of his or her financial obligations" over a specified period "in exchange for retaining nonexempt assets and receiving a broader discharge of debt than is available under chapter 7." H.R. Rep. 109-31(I), at 10; *see* 11 U.S.C. §§ 1321–1330. Under the Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549, a debtor could freely choose whether to file for bankruptcy under chapter 7 or chapter 13. *See* H.R. Rep. 109-31(I), at 11.

Responding to perceived shortcomings of the Bankruptcy Code which allowed debtors to obtain chapter 7 relief when they in fact had resources to repay creditors to some extent, Congress held hearings over five years to determine what measures it could adopt "to ensure that debtors repay creditors the maximum they can afford." H.R. Rep. 109-31(I), at 2. As a result of those hearings, Congress determined that it should adopt "needs-based reforms," which would limit the availability of chapter 7 relief to those who Congress believed could not afford to repay a portion of their debts out of future income. *Id.* at 12.

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA" or "2005 Act") implemented these reforms. Before the 2005 Act, section 707(b) authorized dismissal based on a finding that granting a discharge of debts would be a "substantial abuse" of chapter 7. Before the 2005 Act, section 707(b) also required courts to presume that a debtor was entitled to relief under chapter 7 of the Bankruptcy Code. In contrast, the Act now authorizes the bankruptcy court to dismiss a petition filed under chapter 7 or, with the debtor's consent, to convert such a petition to a case under chapters 11 or 13 "if it finds that the granting of relief would be an abuse of the provisions of this chapter." 11 U.S.C. § 707(b)(1).

Congress enacted enforcement provisions to ensure that these reforms would be implemented. Under the 2005 Act, the U.S. Trustee (or the bankruptcy administrator) reviews a chapter 7 debtor's petition and files with the court a statement explaining whether the presumption of abuse arises under section 707(b). 11 U.S.C. § 704(b)(1). If the U.S. Trustee determines that the presumption of abuse arises, he then files either a motion to dismiss or convert the chapter 7 petition, or a statement explaining why he believes such a motion is not appropriate. 11 U.S.C. § 704(b)(2).

The Bankruptcy Code prescribes a specific process for determining if a case is abusive. First, a court is to compare the debtor's annualized “current monthly income” to the “median family income” of a similarly sized family in the debtor’s state. The court calculates a debtor’s “current monthly income” (“CMI”) based on the debtor’s average income for the six calendar months preceding the month of the bankruptcy filing. 11 U.S.C. § 101(10A). If a debtor’s annualized CMI is below the applicable state median family income, the debtor’s case will not be presumed abusive. 11 U.S.C. § 707(b)(7); *see* H.R. Rep. 109-31(I), at 15. Where the debtor's current monthly income exceeds the median family income, however, a means test is used to calculate the debtor's monthly disposable income.

The amount of the debtor's monthly disposable income is determined by following a formula, set forth in 11 U.S.C. § 707(b)(2), which subtracts certain necessary expenses from the debtor’s current monthly income, such as the cost of food, clothing, housing, utilities and health care. 11 U.S.C. § 707(b)(2)(A)(ii). In addition, the debtor may deduct "monthly payments on account of secured debts," averaged over the 60 months following the date of the petition. 11 U.S.C. § 707(b)(2)(A)(iii).

Every debtor in a chapter 7 case who owes primarily consumer debt is required to file a statement of current monthly income and means test calculation in conjunction with their bankruptcy schedules and statement of financial affairs. Fed. R. Bankr. Official Form 22A; 11 U.S.C.§ 521; 11 U.S.C. § 707(b)(2)(C) (mandating means test); Fed. R. Bankr. P. 1007(b)(4) (same). In chapter 7 cases, the main purpose of the means test is to calculate monthly disposable income (ability to pay) following the formula set forth in 11 U.S.C. § 707(b)(2), and to determine whether the presumption of abuse arises. 11 U.S.C. § 707(b)(2)(A).

When annualized CMI exceeds the applicable median family income, section 707(b)(2)(A) requires a debtor to calculate his or her monthly disposable income available to repay creditors by reducing CMI by certain enumerated categories of expenses, such as the cost of food, clothing, utilities and health care. *See* 11 U.S.C. § 707(b)(2)(A)(ii).[1] In addition, the debtor may deduct "monthly

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[1] Section 707(b)(2)(A)(ii) provides debtors with an extensive list of expenses that a debtor may deduct from current monthly income. These expenses fall into five categories. The first category includes basic expenses and are determined based on IRS regulations. 11 U.S.C. § 707(b)(2)(A)(ii)(I). The second category of expenses allows debtors to claim, if applicable and appropriate to do so, expenses related to the care of disabled, chronically ill or elderly family members. 11

payments on account of secured debts," averaged over the 60 months following the date of the petition. 11 U.S.C. § 707(b)(2)(A)(iii).

Based on the calculations of the means test, the debtor's monthly disposable income, determined by deducting allowed expenses from CMI, is determined. It is that number that determines whether there is a presumption of abuse. If the debtor's monthly disposable income is less than $109.58 per month (or $6,575 over 60 months), the presumption of abuse does not arise. If the debtor's monthly disposable income is equal to or exceeds $182.50 per month (or $10,950 over 60 months), the presumption of abuse arises. If the above median income debtor's monthly disposable income is between $109.58 and $182.50.67 per month, the presumption of abuse arises if that amount, over 60 months, is sufficient to pay at least 25% of the debtor's nonpriority unsecured debt. 11 U.S.C. § 707(b)(2)(A)(i).

The presumption of abuse under section 707(b)(2) can be rebutted if the debtor establishes "special circumstances, such as a serious medical condition or a

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U.S.C. § 707(b)(2)(A)(ii)(II). If the debtor is eligible for chapter 13, the third category allows the debtors to deduct the administrative costs associated with a chapter 13 plan. 11 U.S.C. § 707(b)(2)(A)(ii)(III). The fourth category of expenses, if justified, allows debtors to claim the expenses incurred to send children under the age of 18 to private or public school. 11 U.S.C. § 707(b)(2)(A)(ii)(IV). Finally, the fifth category of expenses allows debtors to claim expenses incurred for home energy costs in excess of the amount proscribed in the first category. 11 U.S.C. § 707(b)(2)(A)(ii)(V).

call or order to active duty in the Armed Forces" and demonstrates that necessary expenses associated with those special circumstances reduce the debtor's current monthly income below the specified benchmarks. 11 U.S.C. § 707(b)(2)(B).

Even if the presumption of abuse does not arise or is rebutted under section 707(b)(2), a chapter 7 petition may be dismissed for abuse under section 707(b)(3), which requires the bankruptcy court to consider whether "the totality of the circumstances . . . of the debtor's financial situation demonstrates abuse." 11 U.S.C. § 707(b)(3)(B).

B. Statement of Facts

In 2008, the year in which they filed for bankruptcy protection, Mr. and Mrs. Williams's household income exceeded $79,000. *United States Trustee Exhibit No 2*. They earned in more than $80,000 during 2007. *UST Ex. No. 3.* As of the date of trial, Mrs. Williams had been employed by Team Electric Service for eight years as an office manager. *Trial Tr. at 29.* Mr. Williams had been employed by Ksyela *Pere et Fils* for twelve years as a driver and warehouse employee. *Trial Tr. at 7*. On their bankruptcy schedule I they listed their annual income as $85,526, which is

131% of the median income in Virginia of $65,342 for a family of two.[2] *UST Ex. No. 21*.

On their means test, the debtors claimed to have current monthly income of $7,127.24. *UST Ex. No. 1*. That amount was subsequently revised upwards to $7,601.45 upon discovery that Mr. Williams had not reported all of his overtime. Williams Post-Trial Br. at 3 [Dkt #64] (accepting United States Trustee's income figures). After Mr. and Mrs. Williams calculated their expenses, however, they claimed a *negative* net monthly income of $611.00. *UST Ex. No. 1, Form B22.* In addition, Mr. and Mrs. Williams owed more than $30,000 in unsecured debt. *UST Ex. No. 1, Schedule F.*

Because Mr. and Mrs. Williams earned above average income, the United States Trustee analyzed their filings to determine whether their case should be dismissed under section 707(b)(2). After the United States Trustee's Office completed its investigation of Mr. and Mrs. Williams's schedules, staff members made the adjustments to their calculations, including:

1. Reducing Mr. and Mrs. Williams's telecommunication costs to $100 per month;

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[2] Initially, Mr. and Mrs. Williams omitted some of Mr. Williams's overtime pay, bringing their income up to $91,217, which is 140% of the state median. *UST Ex. 21.*

2. Eliminating $200 per month allowance to Mrs. Williams's adult daughter;

3. Adjusting Mr. and Mrs. Williams's health insurance allowance;[3] and

4. Eliminating Mr. and Mrs. Williams's $162.08 monthly IRA contribution.

See UST Ex. 21; *Trial Tr. at 60-61.* Based on these adjustments, and others not at issue here, the United States Trustee concluded Mr. and Mrs. Williams had monthly disposable income of $174.82 per month–rather than the negative $611 they had indicated on their means test. *See UST Ex. 1, 21*; *Trial Tr. at 61.* The United States Trustee therefore concluded they had enough monthly income to trigger a presumption of abuse because if Mr. and Mrs. Williams paid their creditors $172.82 per month over 60 months they could repay more than 25% of their unsecured debts. 11 U.S.C. 707(b)(2)(A)(i)(I). On October 22, 2008, the United States Trustee therefore filed a motion to dismiss the case on the basis that Mr. and Mrs. Williams could repay their creditors at least in part and therefore their chapter 7 filing was abusive. [Dkt #17].

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[3] Mr. and Mrs. Williams claimed $543 for health insurance costs on their Schedule J. They put $469 for that expense on their means test. The United States Trustee reviewed Mr. and Mrs. Williams's actual pay stubs and concluded that their health insurance cost was $508.92.

At trial, the bankruptcy court heard extensive evidence concerning Mr. and Mrs. Williams's financial situation. It learned that in the two and a half years before filing for bankruptcy, Mr. and Mrs. Williams had taken on a significant amount of secured consumer debt. In 2003, they purchased a 2003 GMC pickup truck for $30,685.00. *UST Ex. No. 12*. In 2005, they incurred more than $26,000 in debt to purchase a brand new 2006 Pontiac G6. *UST Ex. No. 12*.

Also in 2005, at approximately the same time that Mrs. Williams identified the onset of their financial problems, she and her husband also purchased an 18-foot Bayliner boat. *Trial Tr. at 18*. In response to the bankruptcy court's questioning about the decision to buy a boat at that point, Mrs. Williams testified as follows:

> Court: So is it fair to say that beginning in 2005 you started to experience expenses considerably more than what you were bringing home in your pay and that's why you went to the credit cards?
>
> A: It was very, very tight and sometimes yes. And also the date that things were due sometimes we just didn't have it and we were trying, or I was trying to avoid late charges.
>
> Q: And when was the boat purchased?
>
> A: I can tell you it was paid in '07, so probably '05. And that's just a proximity.
>
> Q: And those payments were about $315 a month?
>
> A: That's correct. *Trial Tr. at 47-48.*

After purchasing the boat, Mr. and Mrs. Williams purchased a house in 2006. *Trial Tr. at 10*; *UST Ex. Nos. 9-11.* They made no down payment on the house but took out an adjustable rate mortgage for $198,000. *UST Ex. No. 10.* On the same day, they obtained a Credit Line Deed of Trust for $49,500. *UST Ex. No. 11*; *Trial Tr. at 14.* At approximately the same time they purchased their home, Mr. and Mrs. Williams financed a new 32 inch LG television. They bought new furniture for the house on credit. They also financed installation of a hot tub. *Trial Tr. at 11-12.*

By 2007, Mr. and Mrs. Williams paid off the boat in full. *Trial Tr. at 49.* They have listed the boat as an exempt asset worth $6,400 on their Schedule C.[4] By listing it as exempt, they seek to discharge all their debts but exit bankruptcy with ownership and control of the boat free of all creditor claims.

At the hearing, neither Mr. or Mrs. Williams could pinpoint exactly when or what started their financial problems. Mrs. Williams testified, however, that some medical expenses went up in 2005. *Trial Tr. at 47.* She also testified that they

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[4] When a chapter 7 debtor lists an asset as exempt, he or she will be able to keep the asset after their debts have been discharged. 11 U.S.C. § 522. As of the date of filing, and as of the date of the trial conducted in this matter, Mr. and Mrs. Williams were current on their house payment, the payments on their vehicle and, with the exception of the hot tub, all of their furniture and appliance payments. They planned to keep all this property and the boat. *UST Ex. 1, Schedule C.*

depended on her husband's overtime work to makes ends meet but that his overtime had been reduced. *Trial Tr. at 40*.

Against the backdrop of Mr. and Mrs. Williams's general financial situation, the trial testimony focused on four disputed expenses. These expenses are at the heart of this case because, if allowed, they would give Mr. and Mrs. Williams monthly disposable income that would not generate a presumption of abuse.

First, Mr. and Mrs. Williams argued that they were entitled to satellite and internet costs of $199 per month, rather than the $100 allocated by the United States Trustee. *Trial Tr. at 66.*

Second, Mr. and Mrs. Williams claimed entitlement to the $200 per month support payment of Mrs. Williams's 40-year old daughter, Jennifer Swanson. *UST Ex. 1, Schedule J*. They argued that the daughter needed their help because she had suffered a brutal childhood trauma and had had problems functioning socially ever since. *Trial Tr. at 24-25.* The United States Trustee has disallowed the cost because Ms. Swanson was able to work and to pursue a master's degree at Strayer University. *Trial Tr. at 22-23.*

Third, Mr. and Mrs. Williams argued that if they were not entitled to an expense for their monthly IRA contribution, their monthly income tax expense should be increased to reflect the additional tax since they would no longer be able to treat the $162.08 per month as pre-tax income. *Trial Tr. at 71.*

In response, the United States Trustee questioned the basis for the $86 per month personal property expense levied on the cars registered to Mr. and Mrs. Williams. At trial, Mr. Williams was asked about a Ford Focus on their personal property tax bill that had not been listed on their schedules. After reviewing the bill, Mr. Williams testified "I don't know how that [Ford Focus] got on my personal property tax" and it appeared to be a mistake. He added that he did not think he paid the bill. *Trial Tr. at 20-21.* There was no testimony regarding what the correct personal property tax expense figure should be.

After the trial, the parties submitted post-trial briefs. Mr. and Mrs. Williams did not raise the IRA issue in their brief. They also did not press their $200 per month expense for Ms. Swanson. Instead, they argued that they were entitled to a personal property tax expense of $49.59, rather than $86. *Williams Post-Trial Br. at 3.* They argued that under the case law of the Western District of Virginia, they were entitled to $150 in monthly telecommunications expenses, which would include phone and internet. *Id.* at 4. Based on these expenses, Mr. and Mrs. Williams maintained that they passed the means test, even if the other expenses in dispute were eliminated. *Id.* at 5.

After reviewing the evidence and testimony, the bankruptcy court ruled that their case should be dismissed because it was abusive under section 707(b)(1). In making that ruling, the bankruptcy court ruled on the parties' disputes about Mr. and Mrs. Williams's appropriate expenses. Specifically:

First, the bankruptcy court denied Mr. and Mrs. Williams's revised personal property tax claim of $49.59 per month because "[t]he Debtors have not produced any evidence in support of [it]." *Mem. Op. at 6.*

Second, the bankruptcy court rejected Mr. and Mrs. Williams's argument that precedent in the Western District of Virginia entitled them to $150 per month in telecommunications costs. *Mem. Op. at 8.* The bankruptcy court held that they were only entitled to costs that are "necessary to health and welfare" and not otherwise captured in the IRS expense allowances incorporated into the means test. *Id.* The bankruptcy court thus limited telecommunication costs to $51 per month to reflect internet costs related to Mr. and Mrs. Williams's employment. *Mem. Op. at 9.*

Third, the bankruptcy court disallowed the $200 monthly expense for Ms. Swanson, Ms. Williams's adult daughter. *Mem. Op. at 10.* Mr. and Mrs. Williams did not produce any evidence that the $200 was for actual expenses that were reasonable and necessary for Ms. Swanson's care. *Mem. Op. at 11.* Nor was there any evidence that she is “elderly, chronically ill, or disabled,” as required in section 707(b)(2)(A)(ii)(II).[5] *Id.*

Based on its rulings, the bankruptcy court calculated that Mr. and Mrs. Williams had monthly disposable income of $197.07, triggering a presumption of abuse under sections 707(b)(1) and (2). *Mem. Op. at 12-13.* The bankruptcy court then found that Mr. and Mrs. Williams had failed to rebut the presumption of abuse under section 707(b)(2). *Mem. Op. at 13.* It did not address the United States Trustee’s argument that the case also could be dismissed under subsections 707(b)(1) and (3). *Id.*

Mr. and Mrs. Williams timely filed a Notice of Appeal.

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[5] The bankruptcy court did not address the IRA issue because Mr. and Mrs. Williams had not raised it in their post-trial brief.

III. STANDARD OF REVIEW

A bankruptcy court’s findings of fact are reviewed for clear error and its conclusions of law are reviewed de novo. *In re White*, 487 F.3d 199, 204 (4th Cir. 2007).

IV. SUMMARY OF THE ARGUMENT

The bankruptcy court dismissed this case, as required by section 707(b)(2), because their disposable income exceeded the statutory maximum for bankruptcy relief. That ruling should be affirmed because the United States Trustee met its burden of proof to demonstrate a prima facie case that Mr. and Mrs. Williams’s income and expenses constituted an abusive filing and they failed to rebut that presumption.

On their original chapter 7 means test, Mr. and Mrs. Williams claimed monthly disposable income of *negative* $611.11, although their combined income for a family of two was approximately $90,000 per year. The United States Trustee challenged many of their proposed expenses. Relevant to this appeal, the United States Trustee established a prima facie case on three challenged expenses. First that Ms. Williams’s 40-year old daughter was not qualified for family support. Second, Mr. and Mrs. Williams could not justify their personal property expense. Third, that their telecommunications costs were inflated.

In response, Mr. and Mrs. Williams could not provide evidence that they had to support Ms. Swanson because she was disabled. Nor could they include expenses for a Ford Escort on their personal property tax bill that they claimed they did not own. Nor could they explain how $150 per month for telecommunications charges was necessary to maintain their health and welfare. The bankruptcy court did not commit clear error when it disallowed the proposed expenses.

Thereafter, in post-trial briefing, Mr. and Mrs. Williams increased their disposable monthly income from negative $611.11 to $107.56 on a revised means test attached to their brief. [Dkt. #64]. This amount is still below the mandatory level for dismissal, however. On appeal, Mr. and Mrs. Williams proffer revised expense amounts, resulting in a new monthly disposable income figure. On page 3 of their brief to this Court, Mr. and Mrs. Williams claim monthly disposable income of $62.48; on page 8, they claim $68.76. *Appellant Br. at 3, 8.* All of these figures have one thing in common: they create a monthly disposable income that falls below the section 707(b)(2) cut-off for a presumption of abuse.

This Court need not sift through the documents – here numbering over 800 pages – to determine if any one of hundreds of figures should be adjusted up or down in order to arrive at an accurate calculation of Mr. and Mrs. Williams's net monthly income. It is too late for that. The United States Trustee established his prima facie case and the bankruptcy court relied upon the data adverted by the parties. Mr. and Mrs. Williams had ample opportunity to rebut the presumption of abuse that the United States Trustee established. They failed to do so. The bankruptcy court's ruling derived from the data in the record, is not clearly erroneous, and should be affirmed on the merits.

Even if this Court were to find that the bankruptcy court abused its discretion in finding Mr. and Mrs. Williams's case abusive under section 707(b)(2), it could not reverse this case in favor of Mr. and Mrs. Williams. The United States Trustee argued below that the totality of the Mr. and Mrs. Williams's financial circumstances demonstrated an ability to re-pay their creditors, making their case abusive under section 707(b)(3)(B). The statute mandates that a bankruptcy court review a debtor's full financial situation if it finds that the filing is not presumptively abusive. 11 U.S.C. § 707(b)(3) (stating that the court "shall" consider the factors in 707(b)(3)(A)&(B) if the presumption of abuse is overcome). The bankruptcy court did not do that analysis because it found Mr. and Mrs. Williams's case to be abusive under section 707(b)(2). If this Court disagrees, then it should remand so that the bankruptcy court can complete the section 707(b)(3)(B) analysis.

V. ARGUMENT

A. The Bankruptcy Court Did Not Abuse Its Discretion In Determining that Mr. and Mrs. Williams's Monthly Income Is High Enough to Create a Presumption of Abuse.

On appeal, Mr. and Mrs. Williams do not challenge that the United States Trustee established a prima facie case that their chapter 7 case is presumptively abusive. They do not challenge the bankruptcy court's application of the Bankruptcy Code to their case. Instead they argue that the bankruptcy court abused its discretion by not accepting their figures for expenses related to health insurance, personal property tax, and increased taxes due to the disallowance of their IRA contributions. They conclude that, had the bankruptcy court accepted their calculations, their monthly income would fall below the cut-off amount for a presumption of abuse under 707(b)(2). *Appellant Br. at 2*. The figures that Mr. and Mrs. Williams offer on appeal, however, are inaccurate, unsupported, or both.

As Mr. and Mrs. Williams do not challenge the United States Trustee's prima facie case of abuse, they have the burden of proving the accuracy of their calculations. *In re Meade*, 420 B.R. 291, 303 (Bankr. W.D. Va. 2009). The bankruptcy court did not abuse its discretion in finding that they had failed to meet that burden.

In their brief to this Court, Mr. and Mrs. Williams advocate alternative figures for three expense amounts that they argue would change the outcome of the case. The three issues before this Court are:

> 1. The bankruptcy court committed clear error by calculating the debtors' health insurance costs to be $469 per month;
>
> 2. The bankruptcy court committed clear error by stating that there was no evidence for their claim of an additional $49.59 per month in personal property taxes; and
>
> 3. The United States Trustee should have increased their tax expenses when he disallowed their monthly IRA contribution.

1. *Health Insurance*

The Williams argue to this Court for the first time in this case that their health insurance costs are more than $469 per month – the number they themselves put on their means test filed with the bankruptcy court on August 1, 2008 and which the bankruptcy court used in its analysis. *UST Ex. 1, Form 22A (Means Test Form), Line 34.* In contrast, they claimed a payroll deduction of $543 for health insurance on their schedule I (Current Monthly Expenditures), *UST Ex. 1, Schedule I.* After analyzing the debtor's pay stubs, the United States Trustee concluded their monthly health insurance cost was $508.92. *UST Exhibit 21.*

This Court is not an appropriate forum for the debtors to refine the accuracy of their calculations. *See Tele-Communications, Inc. v. C.I.R.*, 104 F.3d 1229, 1233 (10th Cir. 1997) (stating that the appellate court "should not be considered a 'second shot' forum . . . where secondary, back-up theories may be mounted for the first time"). Mr. and Mrs. Williams never defended their assertion that $543 was the correct amount for their health insurance costs. They never filed an amended means test correcting the $469 figure for health insurance expenses to bring the issue to the bankruptcy court's attention. They never asked the bankruptcy court to approve the United States Trustee's figure of $508.92, which they have adopted on appeal. *Appellant Br. at 3-4.*

Mr. and Mrs. Williams did not raise the issue of these conflicting numbers at any time in the proceedings below. They are, therefore, precluded from raising the accuracy of their health insurance cost figure now. *Greenberg v. Crossroads Systems, Inc.*, 364 F.3d 657, 669 (5th Cir. 2004) (stating that prohibition against raising issues on appeal is "especially true where the assertion first raised on appeal is factual"). The bankruptcy court did not abuse its discretion in relying on the $469 figure that Mr. and Mrs. Williams themselves provided on their means test and that was signed under penalty of perjury.

And even if the bankruptcy court used the incorrect figure, and abused its discretion in doing so, the error is harmless. The bankruptcy court found that the debtors have monthly disposable income of $197.07. *Mem. Op. at 13.* Mr. and

Mrs. Williams claim that the bankruptcy court undervalued their health insurance costs by $39.92 per month. *Appellant Br. at 4.* Assuming that is true, their monthly disposable income would be $157.15, which is still high enough to create a presumption of abuse. 11 U.S.C. 707(b)(2)(A)(i)(I); *Appellant Br. at 4* (stating that $127.67 in monthly disposable income is the cut-off for a presumption of abuse).

2. *Personal Property Tax*

Mr. and Mrs. Williams have not produced any credible evidence to support their personal property tax expense. They first claimed $86 per month and then reduced the amount to $49.59. The bankruptcy court was not obligated to delve through the record in order to determine whether Mr. and Mrs. Williams's calculations were correct. *Federal Deposit Ins. Corp. v. La Rambla Shopping Center, Inc.*, 791 F.2d 215, 223 (1st Cir. 1986) (Breyer, J.); *see also United States v. Frazier*, 394 F.2d 258, 262 (4th Cir. 1968) (stating it is not "incumbent upon the trial judge to rummage through the file on behalf of the defendant."). The bankruptcy court did not abuse its discretion in finding that Mr. and Mrs. Williams had not justified their personal property tax claim.

Mr. and Mrs. Williams initially claimed $86 per month on their schedule J for personal property tax, for which they provided no explanation. They submitted two property tax bills as trial exhibits, one for $595.11 and the other for $142.59.[6] At the hearing, when asked about a Ford Escort which was on both tax bills, but was not listed as an asset of the debtors, Mr. Williams testified there was an in error in the tax bill. He stated that the Ford Escort might have belonged to his son at some point and that he did not think he paid the tax bill. *Trial Tr. at 20-21*. There was no other testimony or evidence to support a claim to personal property tax expense.

Mr. and Mrs. Williams attached a revised means test form to their post-trial brief which reduced their personal property tax claim from $86 to $49.59 per month.[7] However, the latter figure is apparently derived by dividing the annual state property tax bill, $595.11, which includes the Ford Escort, by 12 to obtain the revised monthly figure of $49.59. In essence, the debtors are still claiming the property tax on a car Mr. Williams denied owning under oath.

Given the ambiguities in the record and Mr. and Mrs. Williams's failure to clarify them, the bankruptcy court did not abuse its discretion in disallowing the personal property tax expense. Even if Mr. and Mrs. Williams were entitled to

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[6] $595.11 + $142.59 / 12 = $61.47, leaving the $86.00 figure unexplained. The United States Trustee assumes that one bill was for county property tax and the other for town tax, but the debtors do not explain why there are two bills.

[7] Mr. and Mrs. Williams never formally amended any of their schedules.

some personal property tax expense, “[a]n appellate court ‘cannot assume the functions of a special master and roam at large over the record, . . . any attempt on its part to do so would probably do a great deal more harm than good.’” *Wheatley v. Wicomico County*, 390 F.3d 328, 335 (4th Cir. 2004) (quoting *Hutchinson v. Fidelity Inv. Ass'n*, 106 F.2d 431, 436 (4th Cir. 1939)). The bankruptcy court judged the credibility of the evidence and testimony before it and did not abuse its discretion when it found that Mr. and Mrs. Williams had not presented “any evidence in support of the property tax.” *Mem. Op. at 6.*

Again, even if the bankruptcy court improperly denied this expense, the error would be harmless. Even allowing for an additional $49.59 deduction, Mr. and Mrs. Williams would still have monthly disposable income of $147.48, which would trigger the presumption. 11 U.S.C. 707(b)(2)(A)(i)(I).

3. *IRA Deduction*

Finally, Mr. and Mrs. Williams revive the IRA tax argument they alluded to at the hearing below, but did not include in their post-trial brief, and therefore was not addressed in the bankruptcy court’s opinion. *Trial Tr. at 5*. A legal theory that is not developed is not preserved for appeal. *Beaudett v. City of Hampton*, 775 F.2d 1274, 1278 (4th Cir. 1985) (“fleeting references” insufficient to preserve questions on appeal) (discussing limits of leniency given to pro se litigants).

Nevertheless, Mr. and Mrs. Williams assert now that they are entitled to additional tax expense based on an IRA contribution that the United States Trustee disallowed. They still do not provide case law or other support for the claim, however. They merely assert that the additional monthly income would be taxed at 24 percent without explaining how that number was reached or providing any evidence of its accuracy. Except for Mr. and Mrs. Williams's bald assertions as to the applicable tax rate, there is nothing for this Court to review.

As with the other expenses, were the bankruptcy court to have abused its discretion, the error would be harmless. Mr. and Mrs. Williams argue that they are entitled to an extra expense of $38.89 per month, which, if granted, would not put their disposable income below their admitted $127 threshold for abuse.

In fact, this Court would have to find that the bankruptcy court abused its discretion on two of the three disputed expense items before it could hold for Mr. and Mrs. Williams on the question of presumption of abuse.

B. Were this Court to Hold that Mr. and Mrs. Williams's Means Test Does Not Raise A Presumption of Abuse, It Should Remand to Consider Whether Dismissal is Appropriate under 11 U.S.C. § 707(b)(3).

If this Court determines that Mr. and Mrs. Williams's case is either not presumptively abusive or that the debtors have rebutted the presumption of abuse, it would have to remand the case. The bankruptcy court must consider whether to dismiss their case based upon either the debtors' bad faith, 11 U.S.C. § 707(b)(3)(A), or the totality of their financial circumstances. 11 U.S.C. § 707(b)(3)(B). This analysis is mandatory. 11 U.S.C. § 707(b)(3). It should be done by the bankruptcy court; an appellate court generally may not consider an issue that has not been passed on below. *Liberty Corp. v. NCNB Nat. Bank of S.C.*, 984 F.2d 1383, 1389 (4th Cir. 1993).

VI. CONCLUSION

For the reasons above, the United States Trustee respectfully asks this Court to affirm the decision of the bankruptcy court below, or, in the alternate, remand for consideration of whether this case warrants dismissal under section 707(b)(3).

/s/ Margaret K. Garber

RAMONA D. ELLIOTT
General Counsel

P. MATTHEW SUTKO
Associate General Counsel

CATHERINE B. SEVCENKO
Trial Attorney
Executive Office for United States Trustees
Department of Justice
20 Massachusetts Avenue, N.W.
Department of Justice
Washington, D.C. 20530
Phone: (202) 307-1399
Fax: (202) 307-2397

W. CLARKSON MCDOW, JR.
United States Trustee for Region 4

MARGARET K. GARBER
Trial Attorney
Virginia State Bar No. 34412
Office of the U.S. Trustee
Office of the United States Trustee
210 First Street, Suite 505
Roanoke, VA 24011
Phone: (540)857-2806
Fax: (540) 857-2844

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing was filed into the CM/ECF system on this the 11th day of June, 2010 which caused same to be served on all parties registered to receive notice in this case.

/s/ Margaret K. Garber

BRIEF BANK — "SUMMARY SHEET"

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WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	Jack M. Williamson v. Office of the United States Trustee, Donald F. Walton, United States Trustee, Region 21
2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	S.D. Ga.
3. ("CCN") ***CURRENT*** CASE NO.	No.: 6:08-cv-00097-BAE-GRS
4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*	No.: 07-60416 Court: Bankr. S.D. Ga. *(Identify judge & cite, if any)*
5. ("SO") ***SOURCE***	**U.S. TRUSTEES**
6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	Filed: December 18, 2008 Type: Brief of Appellee Donald F. Walton, United States Trustee, Region 21
7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g., "UST/OGC"]*	Matthew Mills, Paul Bridenhagen, Matthew Sutko, Donald Walton *(UST/OGC: 202-307-1399/FAX-2397)*
8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	• Did the bankruptcy court err in holding that the debtor did not have an unqualified right to dismiss his bankruptcy case under 11 U.S.C. section 1208(b) when the debtor committed fraud in connection with his case and the United States Trustee requested conversion to chapter 7 pursuant to 11 U.S.C. section 1208(d)?
10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)	
11. DO YOU RECOMMEND POSTING IN UST BRIEFBANK?	☒ YES ☐ NO ***NAME:*** Linda Figueroa ***DATE:***

IN THE UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF GEORGIA

CASE NO. CV608-097

JACK M. WILLIAMSON,

Appellant,

v.

OFFICE OF THE UNITED STATES TRUSTEE,
DONALD F. WALTON, UNITED STATES
TRUSTEE, REGION 21

Appellee

On Appeal from the United States Bankruptcy Court
for the Southern District of Georgia

BRIEF OF APPELLEE DONALD F. WALTON, UNITED STATES TRUSTEE, REGION 21

Of Counsel:

RAMONA D. ELLIOTT
General Counsel
P. MATTHEW SUTKO
Office of the General Counsel
Executive Office for United States Trustees
United States Department of Justice
20 Massachusetts, Ave. NW, Ste 8100
Washington, D.C. 20530
Tel: (202) 307-1399

MATTHEW E. MILLS
Assistant United States Trustee
Georgia Bar No. 509718
Office of the United States Trustee
222 West Oglethorpe Avenue
Suite 302
Savannah, Georgia 31401
(912) 652-4112

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STATEMENT OF JURISDICTION

This appeal arises from a final order issued by the United States Bankruptcy Court for the Southern District of Georgia (Lamar W. Davis, Jr., C.J.) on September 3, 2008, finding that the chapter 12 debtor Jack M. Williamson committed fraud in connection with his bankruptcy case and therefore he did not have an unqualified right to dismiss his chapter 12 case. This Court has jurisdiction over this appeal pursuant to 28 U.S.C. section 158(a).

STATEMENT OF ISSUES PRESENTED

Did the Bankruptcy Court err in holding that the debtor did not have an unqualified right to dismiss his bankruptcy case under 11 U.S.C. section 1208(b) when the debtor committed fraud in connection with his case and the United States Trustee requested conversion to chapter 7 pursuant to 11 U.S.C. section 1208(d)?

STANDARD OF APPELLATE REVIEW

Appellate Courts "independently review the bankruptcy court's decision, applying the 'clearly erroneous' standard to findings of fact and *de novo* review to conclusions of law'. . . . [Where the issue] poses a mixed question of law and fact, [the court applies] the clearly erroneous standard, unless the bankruptcy court's analysis was 'infected by legal error...'" In re Winthrop Old Farm Nurseries, Inc., 50 F.3d 72, 73 (1st Cir. 1995) (citations omitted). See also Fed. R. Bankr. P. 8013 (standard of appellate review).[1]

STATEMENT OF THE CASE

This appeal involves the intersection between 11 U.S.C. sections 1208(b) and (d),[2] specifically whether a chapter 12 debtor has an absolute right to dismiss his case after the debtor has committed fraud. Appellant Jack M. Williamson asserts that a chapter 12 debtor has an unqualified absolute right to dismiss his bankruptcy case pursuant to 11 U.S.C. section 1208(b), which provides as follows:

> On request of the debtor at any time, if the case has not been converted under section 706 or 1112 of this title, the court shall dismiss a case under this chapter. Any waiver of the right to dismiss under this subsection is unenforceable.

Appellant asserts that because he filed his motion to dismiss before another

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[1] A finding of fact is clearly erroneous "when although there is evidence to support it, the reviewing court on the evidence is left with the definite and firm conviction that a mistake has been committed. . . ." United States v. United States Gypsum Co., 333 U.S. 364, 395, 68 S.Ct. 525, 542, 92 L.Ed. 756, 766 (1948). "When the finding of fact is premised on an improper legal standard, or a proper one is improperly applied, that finding loses the insulation of the clearly erroneous rule. . . ." Wilson v. Huffman (In re Missionary Baptist Foundation of America, Inc., 712 F.2d 206, 209 (5th Cir. 1983).

[2] 11 U.S. C. § 1208 is attached in its entirety as Exhibit A.

party made a request to convert,[3] he has an unqualified absolute right to dismissal under any circumstances.

The United States Trustee submits that Appellant's fraudulent conduct merits the application of 11 U.S.C. section 1208(d) which provides as follows:

> On request of a party in interest, and after notice and a hearing, the court may dismiss a case under this chapter or convert a case under this chapter to a case under chapter 7 of this title upon a showing that the debtor has committed fraud in connection with the case.

The Bankruptcy Court, like the overwhelming majority of courts addressing this issue, held that Appellant, due to his fraudulent conduct, did not have an absolute right to dismiss his chapter 12 case. The court provided four independent reasons why a fraudulent chapter 12 debtor cannot use section 1208(b) to defeat the express language of section 1208(d). First, the Eleventh Circuit has held that section 1208(d) applies in cases of debtor fraud (In re Cotton, 992 F.2d 311 (11th Cir. (M.D. Ga.) 1993)). Second, if courts were to adopt the position of Appellant, the absolute right to dismiss under section 1208(b) would undermine the express authority granted to courts under section1208(d) and would render that subsection

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[3] Appellant filed his Motion to Dismiss on June 19, 2008 [District Court Docket No. 6] in the wake of the discovery of his fraudulent activities in connection with his chapter 12 case. Appellee United States Trustee filed an Objection the next day on June 20, 2008, requesting conversion to chapter 7 [District Court Docket No. 7].

useless. Third, the main purpose of the Bankruptcy Code is to provide a fresh start for the honest but unfortunate debtor, not to provide a shield for those who exploit the code's protection and then seek to escape judicial authority when their fraudulent schemes are exposed. Fourth, even if section 1208(b) requires dismissal of a chapter 12 case upon a debtor's request, its language does not require *immediate* dismissal, which means a court may consider a request to convert made subsequent to the debtor's motion to dismiss. Memorandum and Order of September 3, 2008, pp. 8-10, District Court Docket No. 12.

Appellant appeals from the Memorandum and Order, contending that the Bankruptcy Court erred in holding that the debtor did not have an unqualified right for immediate dismissal under section 1208(b).

STATEMENT OF FACTS

There are no facts in dispute. Following the evidentiary hearing of July 18, 2008, the Bankruptcy Court concluded that Appellant committed fraud, finding the case to be "replete with instances of concealment, false statements, and omissions that collectively evidence an intent to manipulate the bankruptcy process." Memorandum and Order of September 3, 2008, p. 11, District Court Docket No. 12. Specifically, the court found that Appellant failed to reveal "that he owned J & K Farms and at least four bank accounts," as well as "a large crop disaster claim."

Id. Appellant continued his fraud on the court by filing "false monthly operating reports concealing large bank balances in the unrevealed accounts" and "concealed numerous large FSA deposits to his accounts." Id. Finally, "he withdrew large sums of money from one of the accounts, ... apparently the proceeds of his unrevealed crop disaster claim, and hid it in a corn bin from which he claims it has allegedly been stolen." Id. The Bankruptcy Court concluded Appellant's conduct to be "indefensible under any standard of conduct for debtors under bankruptcy protection, amounts to fraud on the Court and his creditors, and presents a text-book case for conversion under § 1208(d)." Id. at 12.

Appellant did not appeal the judicial finding of fraud. To the extent that 11 U.S.C. section 1208(d) requires "a showing that the debtor has committed fraud in connection with the case," Appellant concedes that such a showing occurred.

The only other facts relevant to this appeal are the dates of Appellant's Motion to Dismiss and Appellee's Objection thereto. Appellant filed his Motion to Dismiss on June 19, 2008 [District Court Docket No. 6] after the discovery of fraudulent activities in connection with his chapter 12 case. Appellee United States Trustee filed an Objection the next day on June 20, 2008, requesting conversion to chapter 7 [District Court Docket No. 7].

SUMMARY OF ARGUMENT

Appellant contends that subsection 1208(b) of the Bankruptcy Code gives chapter 12 debtors an absolute right to dismiss their bankruptcy cases. See 11 U.S.C. § 1208(b) (upon a debtor's request for dismissal "at any time" the court "shall dismiss" the case). Typically this is so. But in cases like this, where the debtor has engaged in fraud, subsection 1208(d) governs because it expressly authorizes courts to convert a chapter 12 case to chapter 7 if the debtor has committed fraud. 11 U.S.C. § 1208(d) ("[o]n request of a party in interest, and after notice and a hearing, the court may dismiss a case under this chapter or convert a case under this chapter to a case under chapter 7 of this title upon a showing that the debtor has committed fraud in connection with the case."). This more specific provision, dealing only with fraud cases, governs here, rather than the more general provision allowing for dismissal of chapter 12 cases.

With a virtually unanimous voice, courts have concluded that a chapter 12 debtor's general right under section 1208(b) to voluntarily dismiss a case gives way to the more specific rule in subsection 1208(d) that courts can convert cases involving debtor fraud to a chapter 7 liquidation proceeding. The court below followed the majority rule. Its ruling on this point merits affirmance by this Court.

Further support for the lower court's reading is drawn from the text of subsection 1208(e). That subsection provides that "[n]otwithstanding any other provision of this section," a case cannot be converted to another chapter if the debtor is ineligible to be a debtor in that chapter. 11 U.S.C. § 1208(e). Significantly, Congress did not put this "notwithstanding" language into section 1208(b), which supports the bankruptcy court's conclusion that the general right to dismiss is tempered by the court's power under section 1208(d) to convert instead in fraud-specific cases. If section 1208(b) had stated a debtor could dismiss "notwithstanding" section 1208(d), then section 1208(b) would control. The lack of such language in 1208(b) indicates that the more specific provision of 1208(d) should apply in cases of debtor fraud.

The lower court's conversion can also be affirmed as an exercise of the court's inherent power to sanction bad faith conduct. That right is universally recognized. Although chapter 12 debtors typically can dismiss their cases under subsection 1208(b), when as here they engage in bad faith, bankruptcy courts have inherent to sanction such conduct by denying dismissal.

Finally, Appellant's status as a "farmer" under 11 U.S.C. section 101(20) is irrelevant to this case. Appellant was never placed into an "involuntary" chapter 7 case as an initial matter. Rather, Appellant filed a voluntary chapter 12 case and thus subjected himself to all provisions in chapter 12, including section 1208(d).

ARGUMENT AND CITATION OF AUTHORITY

I. As between subsections 1208(b) and (d), subsection (d) is more specific to debtor fraud and therefore (d) is applicable.

A fundamental rule of statutory construction is that a more specific provision controls over a general one. Nat’l Cable & Telecommunications Ass'n, Inc. v. Gulf Power Co., 534 U.S. 327, 335 (2002) (specific statutory language controls over more general language when there is conflict); Clifford F. MacEvoy Co. v. U.S. for Use and Benefit of Calvin Tomkins Co., 322 U.S. 102, 107 (1944) (specific terms prevail over general in same or another statute which otherwise might be controlling); Medberry v. Crosby, 351 F.3d 1049 (11th Cir. 2003) (canon of statutory construction provides that the more specific takes precedence over the more general); Nguyen v. U.S., 2008 WL 4631719 (11th Cir. 2008) (to extent of any overlap, the more specific statutory provision trumps the general one).

Given this rule of construction, subsection (d) should apply to the case. Subsection (b) and its provision for voluntary dismissal applies in a *general* manner to *all* chapter 12 debtors, whereas subsection (d) applies to a more specific group - the atypical debtor who commits fraud in connection with the bankruptcy case. Thus, subsection (d) is more narrowly tailored to fit this situation. To the extent that the more specific statutory provision applies, subsection (d) fits the bill.

II. The right to dismiss under subsection1208(b) should not be construed in isolation.

Appellant argues that subsection 1208(b) mandates dismissal regardless of any provision for conversion in situations of debtor fraud. Appellant focuses only on the words "[o]n request of the debtor *at any time*, ... the court *shall dismiss* a case under this chapter" to the detriment of other parts of the statute, which is inconsistent with proper construction.

> When interpreting a statute we look not only to the express language, however, but also to the overall purpose of the act. The Supreme Court has directed that we not "construe statutory phrases in isolation." [cit.] We must also consider "the design of the statute as a whole and ... its object and policy." [cit.]

Graven v. Fink (In re Graven), 936 F.2d 378, 385 (8th Cir. 1991).

The words "at any time" and "shall dismiss" should not be construed in isolation to grant an absolute right to immediate dismissal. Subsection (b) should be read in conjunction with section 1208 as a whole, including (d)'s provision for conversion to chapter 7 in cases of debtor fraud. Moreover, the phrase "[o]n request of the debtor *at any time*" refers to the time frame in which a debtor may make the request; it does not speak to the circumstances under which dismissal may occur. At most, the phrase confers the right to seek dismissal without regard to time frame, not an absolute right to dismiss under any circumstances.

III. Cases addressing the interplay between subsections 1208(b) and (d) hold that subsection (d) is applicable in cases of debtor fraud.

Almost every court addressing the interplay between subsections 1208(b) and (d) has agreed that subsection (d) applies when a chapter 12 debtor commits fraud, even if the debtor has filed a motion to dismiss under subsection (b). *See* Graven v. Fink (In re Graven), 936 F.2d 378 (8th Cir. 1991); In re Cotton, 992 F.2d 311 (11th Cir. (M.D. Ga.) 1993) (debtor has absolute right to dismissal if debtor has not engaged in fraud); In re Foster, 121 B.R. 961 (Bankr. N.D. Texas 1990) (when facts show that debtors have abused legal process and bankruptcy process through fraud, bankruptcy court has authority to convert chapter 12 case to chapter 7 liquidation, even though debtors have filed motion to dismiss chapter 12 case); In re Cromer Farms, Inc., 2000 WL 33740256 (Bankr. M.D. Ga. July 18, 2000) (stating “the court agrees with cases that hold that a debtor's right to voluntarily dismiss a Chapter 12 case is not unlimited” and “it was not Congress's intent in enacting § 1208(b) of the Code that chapter 12 become ‘a frequently traveled thoroughfare for the unscrupulous seeking to hinder, delay and defraud their creditors.’"); In re Goza, 142 B.R. 766 (Bankr. S.D. Miss. 1992) (court may delay action on debtor's voluntary dismissal until debtor provides an accounting); In re Neal, 181 B.R. 560 (D. Utah 1995) (if party in interest requests conversion for fraud under section 1208(d) before court acts on debtor's motion to dismiss, bankruptcy court may convert case); In re Red Cliff Farms, Inc., 1994 WL 324560 (D. Kan., June 23, 1994). But see In re Davenport, 175 B.R. 355 (Bankr. E.D. Cal. 1994) (chapter 12 debtors have unqualified right to dismissal).

The seminal case is Graven v. Fink (In re Graven), 936 F.2d 378 (8th Cir. 1991), in which the Eighth Circuit addressed the tension between the competing subsections. In Graven, the trustee discovered that chapter 12 debtors had concealed transfers of real and personal property into a family-owned corporation for no consideration. When the debtors moved to dismiss their case under subsection 1208(b), the trustee filed a motion to convert the case to chapter 7 based on the fraudulent conduct. The bankruptcy court rejected the debtor's argument about an absolute right to dismiss and converted their case to chapter 7. The district court affirmed and the debtors appealed to the Eighth Circuit.

The Eighth Circuit began its analysis by explaining that the purpose of the Bankruptcy Code is to protect the honest debtor, not to provide a shield for those who "exploit the code's protection then seek to escape judicial authority when their fraudulent schemes are exposed." Id. at 385. Quoting the bankruptcy court, the Eighth Circuit explained:

> To adopt the interpretation of § 1208(b) and (d) favored by the debtors ... would lead to endless abuse of the bankruptcy process ... and would

> clearly thwart the clear purpose of Chapter 12, which is to provide relief for the honest debtor, and the intent of Congress in adopting § 1208(d).
>
> Recognizing an absolute right to dismissal under section 1208(b) would also completely undermine the express authority Congress granted the courts under section 1208(d) and would render that subsection useless.
>
> * * *
>
> We conclude that the broad purpose of the bankruptcy code, including Chapter 12, is best served by interpreting section 1208(d) to allow a court to convert a case to Chapter 7 upon a showing of fraud even though the debtor has moved for dismissal under subsection (b).

Id. at 385-86.

The Eighth Circuit concluded its analysis by noting that the Gravens, like the instant Appellant, were attempting to evade the ramifications of their own misconduct:

> The Gravens filed their motion to dismiss one year and seventy-three days after filing their Chapter 12 petition. Having enjoyed the code's protection for that period of time, they abruptly sought dismissal just as the bankruptcy court prepared to hear the evidence of their wrongdoing. We are convinced that the broad purposes of the bankruptcy code are not served by such cynical manipulation of the bankruptcy process. We therefore hold that once fraud has become an issue in a case, the court may delay action on a section 1208(b) motion for dismissal long enough to allow an investigation of the alleged fraud. If fraud is shown, the court may, under 11 U.S.C. § 1208(d), convert the Chapter 12 case to Chapter 7 despite the debtor's motion to dismiss.

Id. at 387.

IV. The case cited by Appellant is unpersuasive and is at tension with the recent Supreme Court decision *In re Maramma*.

In support of his argument that subsection 1208(b) always provides an absolute right to dismiss, the debtor relies upon In re Davenport, 175 B.R. 355 (Bankr. E.D. Cal. 1994). Davenport is the only case to conclude that subsection 1208(b) provides an absolute right to dismiss in the context of debtor fraud. In Davenport, after it was discovered that the debtor had committed fraud, the debtor filed a motion to dismiss his chapter 12 case. A creditor then requested that the court hold the debtor's voluntary dismissal in abeyance until the creditor could file a counter-motion to convert the case to chapter 7. The bankruptcy court originally granted the creditor's request on the basis of authority from other jurisdictions (such as In re Graven, *supra*) and issued a formal order, over the opposition of the debtor, ruling that the debtor's dismissal could be delayed to allow an investigation of fraud. Davenport, 175 B.R. at 355-56.

On April 12, 1994, seven days before the hearing on the creditor's counter-motion, the Ninth Circuit Bankruptcy Appellate Panel issued In re Beatty, 162 B.R. 853 (9th Cir. BAP 1994), construing a chapter 13 debtor's right to dismiss as absolute even when a competing creditor's motion to convert is pending. Davenport, 175 B.R. at 356 (*citing* Beatty). The debtor in Davenport renewed his request for immediate dismissal, asking the bankruptcy court to review Beatty.

The bankruptcy court then reversed its prior ruling and held that a chapter 12 debtor has an unqualified right to dismiss even if the debtor's good faith is in question. The court's reliance on Beatty is apparent from the following excerpt:

> Prior to issuing its memorandum decision directing dismissal of debtors' case, the court twice accepted this line of cases urged by Bank [holding debtor's right to dismiss under 1208(b) is limited by 1208(d) in situations of fraud]. However, upon reflection and consideration of the case law, including the Bankruptcy Appellate Panel's decision in In re Beatty, 162 B.R. 853 (9th Cir. BAP 1994), the court rejects this authority in favor of determining debtors' right to dismiss under section 1208(b) to be unqualified.

Davenport, 175 B.R. at 357. Thus, the decision in Davenport was based upon the precedential authority of the Ninth Circuit BAP in Beatty.

Thirteen years after Beatty, the Supreme Court of the United States decided the case of Marrama v. Citizens Bank of Massachusetts, 549 U.S. 365, 127 S.Ct. 1105 (2007), holding that a debtor's right under 11 U.S.C. § 706(a) to convert a chapter 7 case to chapter 13 did not apply when the debtor has engaged in bad faith. The Supreme Court read 11 U.S.C. § 1307(c), which allows dismissal of bad faith cases, to mean that bad faith debtors cannot obtain chapter 13 relief. Because they are not eligible for such relief, bad faith debtors cannot exercise their right under section 706(a) to convert. Id.

Subsequent to Marrama, the Ninth Circuit addressed a bankruptcy debtor's "absolute" right to dismiss/convert in the face of debtor fraud. Rosson v.

Fitzgerald (In re Rosson),[4] 545 F.3d. 764 (9th Cir. (Wash.) 2008). In Rosson, the Ninth Circuit expressly abrogated Beatty, and held that bad faith conduct precludes a debtor from utilizing an otherwise unqualified right under the Code:

> The conflict between § 1307(b) and (c) has divided courts, including two of our sister circuits, with some courts holding that a debtor has an absolute right to dismiss under § 1307(b), notwithstanding pending motions to convert under § 1307(c), while other courts hold that a bankruptcy court retains the power to convert a case under § 1307(c), even in the face of a debtor's request for dismissal under § 1307(b).

Rosson, 545 F.3d at 771.

The debtors' original brief in Rosson argued that subsection 1307(b) provided an absolute right to dismiss (citing Beatty and other cases), but the Marrama decision occurred in the interim, and the Ninth Circuit described the change in the law as follows:

> Although we have not weighed in on this question, our circuit's Bankruptcy Appellate Panel (BAP) adopted the "absolute right" approach in *Beatty*. [cit. omitted] In his opening brief, Rosson argues

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[4] In Rosson v. Fitzgerald (In re Rosson), 545 F.3d. 764 (9th Cir. (Wash.) 2008), a chapter 13 debtor acted in defiance of a bankruptcy court order by failing to deposit $185,000 in arbitration proceeds with the chapter 13 trustee. Instead, the debtor used a substantial portion of the proceeds to remodel his home. When the trustee and bankruptcy court discovered the situation, the debtor invoked his right to withdraw from bankruptcy under 11 U.S.C. § 1307(b) and requested dismissal. The bankruptcy court denied the motion, stating that it would be a "gross miscarriage of justice to allow [Rosson] to dismiss this case and abscond with [estate] proceeds." Rosson, 545 F.3d at 769. The district court affirmed the decision and the debtor appealed to the Ninth Circuit.

> that we should follow and adopt *Beatty* and hold that the bankruptcy court abused its discretion by refusing to grant his request for dismissal, which was filed prior to the court's formal order converting the case to Chapter 7.
>
> * * *
>
> After Rosson filed his opening brief, however, the Supreme Court issued *Marrama v. Citizens Bank of Massachusetts,* – U.S. –, 127 S.Ct. 1105, 166 L.Ed.2d 956 (2007). In *Marrama*, the Court firmly rejected the analysis that the [Ninth Circuit] BAP applied in *Croston* - the case that followed and reaffirmed *Beatty* - and implicitly abrogated *Beatty* as well.
>
> After *Marrama*, ... the ‘absolute right’ position is no longer viable.
>
> * * *
>
> Moreover, although *Marrama* did not address the exact issue decided in *Beatty*, it is clear that, after *Marrama*, *Beatty* too is no longer good law, insofar as it holds that a Chapter 13 debtor has an absolute right to dismiss under § 1307(b).

<u>Rosson</u>, 545 F.3d at 772-73.

Thus, the case cited in Appellant’s brief (<u>Davenport</u>), which is the *only* case to hold that subsection 1208(b) provides an absolute right to dismiss in the context of debtor fraud, is no longer good law, having been implicitly overruled by circuit precedent. <u>Davenport</u> relied heavily upon <u>Beatty</u>, a Ninth Circuit BAP decision which has been expressly abrogated by the Ninth Circuit Court of Appeals.

V. The only Eleventh Circuit opinion addressing a debtor's right to dismiss under subsection 1208(b) indicates that the right is limited by debtor fraud.

The Eleventh Circuit addressed a chapter 12 debtor's right to dismiss under section 1208(b) the case In re Cotton, 992 F.2d 311 (11th Cir. 1993), in which the circuit made the following statement: "[w]e hold that the debtor does have a right to immediate dismissal, provided that the case has not been converted to an involuntary proceeding and the debtor has not engaged in fraud that would make immediate dismissal unjust." In re Cotton, 992 F.2d at 312. Although Cotton does not describe how subsections (b) and (d) interrelate, it did hold that, at a minimum, courts can delay dismissal in bad faith cases.

Appellant suggests that this statement in Cotton supports his argument that subsection 1208(b) provides a fraudulent debtor with the right to *immediate* dismissal under any circumstances (i.e. dismissal that occurs instantly upon the filing of a motion to dismiss). Appellant argues that the second part of the statement should be ignored because the court in Cotton was not adjudicating a situation involving debtor fraud and therefore the second phrase is meaningless dicta. Appellant's Brief, p. 13-14.

Appellant's argument is without merit. First, the Eleventh Circuit clearly intended the *entire* statement to provide guidance about a chapter 12 debtor's right to dismiss and the limitations thereof. For purposes of the instant appeal, the statement supports the underlying ruling that a chapter 12 debtor's right to dismiss is limited by section 1208(d) in cases of debtor fraud. Second, as explained by the Eighth Circuit, "[n]othing in subsection (b) requires that a court act immediately upon a debtor's request for a voluntary dismissal." Graven, 936 F.2d at 385; see also In re Neal, 181 B.R. 560 (D. Utah 1995) (section 1208(b) does not mandate immediate dismissal, and thus, if, before bankruptcy court acts on debtor's dismissal request, party in interest requests conversion for fraud under section 1208(d), bankruptcy court may convert case); In re Red Cliff Farms, Inc., 1994 WL 324560 at *2 (D. Kan., June 23, 1994) ("neither Chapter 12 nor Chapter 13 contains language indicating that such a dismissal, even if mandatory, must occur immediately.")

VI. Appellant's construction leads to inequitable results.

The Appellant's suggestion that subsection 1208(b) bestows an "immediate" and unconditional right to dismissal would lead to absurd and unwanted results. It should make no difference that Appellant filed his motion to dismiss one day before the United States Trustee filed a responsive pleading requesting conversion to chapter 7. The central concern is the fraud itself, not who wins a race to the courthouse once a debtor realizes that his fraud has been discovered.

VII. Alternatively, the bankruptcy court's ruling can be affirmed as an exercise of its inherent power to sanction bad faith conduct, a power that is augmented by 11 U.S.C. § 105(a).

Courts of law possess a "'well-acknowledged' inherent power ... to levy sanctions in response to abusive litigation practices." Roadway Express, Inc. v. Piper, 447 U.S. 752, 765 (1980) (citing Link v. Wabash R.R., 370 U.S. 626, 632 (1962)). "It has long been understood that '[c]ertain implied powers must necessarily result to our Courts of justice from the nature of their institution,' powers 'which cannot be dispensed with in a Court, because they are necessary to the exercise of all others.'" Chambers v. NASCO, Inc., 501 U.S. 32, 43 (1991) (quoting United States v. Hudson, 11 U.S. (7 Cranch) 32, 34 (1812)). "These powers are 'governed not by rule or statute but by the control necessarily vested in courts to manage their own affairs so as to achieve the orderly and expeditious disposition of cases.'" Ibid. (quoting Link, 370 U.S. at 630-631). One "primary aspect" of a court's inherent powers is "the ability to fashion an appropriate sanction for conduct which abuses the judicial process." Chambers, 501 U.S. at 44-45. A court thus confronted with a party's bad faith in seeking judicial relief or in litigating an action has the discretion to respond with a variety of sanctions.

The Eleventh Circuit, like all circuits, recognizes that bankruptcy courts possess the inherent power to sanction misconduct. See In re Mroz, 65 F.3d 1567, 1575 (11th Cir. 1995) (the fact that rules such as Rule 11 and Bankruptcy Rule 9011 have been promulgated by Congress does not displace a court's inherent power to impose sanctions for a parties' bad faith conduct); Jove Engineering Inc. v. IRS, 92 F.3d 1539, 1153 (11th Cir. 1996) ("Courts have inherent contempt powers in all proceedings, including bankruptcy, to 'achieve the orderly and expeditious disposition of cases.'").

A clear expression of congressional intent is required to displace a court's inherent power to sanction bad faith conduct. Chambers, 501 U.S. at 47. Accordingly, although "the exercise of the inherent power of lower federal courts can be limited by statute and rule," this Court will '"not lightly assume that Congress has intended to depart from established principles,' such as the scope of a court's inherent power." Ibid. (quoting Weinberger v. Romero-Barcelo, 456 U.S. 305, 313 (1982)).

The Bankruptcy Code, far from displacing the inherent powers of courts, expressly recognizes a bankruptcy court's authority to sanction litigants for abusive litigation practices. The Code states that "[n]o provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, sua sponte, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to *prevent an abuse of process.*" 11 U.S.C. 105(a) (emphasis added); see 132 CONG. REC. 28, 610 (1986) (statement of Sen. Hatch) (section 105(a) "allows a bankruptcy court to take any action on its own, or to make any necessary determination to prevent an abuse of process and to help expedite a case in a proper and justified manner"). It is well established that bankruptcy courts have the power to sanction parties for bad faith conduct in bankruptcy proceedings.

To be sure, section 105(a) does not empower bankruptcy courts to act contrary to other direct commands of the Code. Cf. Northwest Bank Worthington v. Ahlers, 485 U.S. 197, 206 (1988) ("whatever equitable powers remain in the bankruptcy courts must and can only be exercised within the confines of the Bankruptcy Code"). But section 105(a) expressly cautions against reading provisions to confer an absolute right that would trump a court's ability to sanction misconduct. More broadly, section 105(a) reflects Congress's intent not to displace the established power of courts to impose appropriate orders to prevent an abuse of process. Thus, absent an express provision in the Code that limits a court's inherent power, the bankruptcy court retains the discretion to impose appropriate sanctions in response to a litigant's bad faith.

Subsection 1208(b) does not expressly address, much less limit, a court's inherent power to sanction bad faith conduct. The statutory text, at most, gives rise to a presumptive right of the debtor to dismissal; it does not restrict, either expressly or implicitly, the ability of the court to exercise its inherent power to respond to abusive tactics or bad faith by the debtor. In keeping with the approach expressed in section 105(a), such a provision should not be read to prevent courts from "taking any action ... to prevent an abuse of process." 11 U.S.C. 105(a).

When a debtor intentionally misrepresents his financial condition in the bankruptcy proceeding, it is appropriate for a bankruptcy court to exercise its inherent power by denying the debtor's request for withdrawal from bankruptcy. Such misconduct constitutes an egregious abuse of the bankruptcy system, which has always limited relief to the "*honest* but unfortunate" debtor. Local Loan Co. v. Hunt, 292 U.S. 234, 244-245 (1934) (emphasis added). "[T]he successful functioning of the bankruptcy act hinges both upon the bankrupt's veracity and his willingness to make a full disclosure" of his assets and financial condition. Boroff v. Tully (In re Tully), 818 F.2d 106, 110 (1st Cir. 1987); In re Little, 245 B.R. 351, 353-354 (Bankr. E.D. Mo. 2000) ("Perhaps to a greater degree than any other segment of our justice system, Bankruptcy depends on the integrity of the information supplied by its principal participant, the debtor.")

Accordingly, Appellee United States Trustee submits that the Bankruptcy Court properly exercised its inherent power, as supported by § 105(a), to sanction

Appellant's misconduct by denying his motion to dismiss and converting the case to chapter 7. See Marrama, 549 U.S. 365, 127 S.Ct. at 1111-12. ("Indeed, as the Solicitor General has argued in his brief *amicus curiae,* even if § 105(a) had not been enacted, the inherent power of every federal court to sanction 'abusive litigation practices' [cit. omitted] might well provide an adequate justification for a prompt, rather than a delayed, ruling on a unmeritorious attempt to qualify as a debtor under Chapter 13"); see also Marrama, 549 U.S. 365, 127 S.Ct at 1116-17 (wherein Justice Alito, speaking for the dissent, states "Ultimately, § 105(a) and a bankruptcy court's inherent power may have a role to play in a case such as this . . . . Bankruptcy courts have used their statutory and equitable authority to craft various remedies for a range of bad faith conduct" and cites section 105(a) and the use of inherent power by various bankruptcy courts in Footnotes 4 - 9).

VIII. The Appellant's status as a "farmer" under 11 U.S.C. section 101(20) does not preclude conversion to chapter 7.

Appellant contends his status as "farmer" under 11 U.S.C. section 101(20) precludes conversion to chapter 7. As support for this proposition, he relies upon 11 U.S.C. section 303(a) which states that an involuntary chapter 7 case may not be filed against a farmer. These code sections are inapplicable to this case. First, Appellant was never placed in an involuntary chapter 7 bankruptcy. He filed a voluntary chapter 12 bankruptcy and thus subjected himself to all applicable Code provisions, including section 1208(d). As the district court noted in In re Red Cliff, 1994 WL 324560 at *2 (D. Kan., June 23, 1994), “a debtor obtains important and tangible advantages through filing a petition under Chapter 12. If chapter 12 debtors were allowed subsequently to dismiss the case immune from scrutiny for fraud, ‘Chapter 12 would quickly change from an avenue for the ‘honest, but unfortunate debtor’ seeking to get a fresh start to a frequently traveled thoroughfare for the unscrupulous seeking to hinder, delay and defraud their creditors.’” Red Cliff, 1994 WL 324560 at *2 (citing In re Goza, 142 B.R. at 771).

Second, Appellant’s broad interpretation of section 303(a) would mean that a chapter 12 case could never be converted without the debtor’s consent. Such a reading would render section 1208(d), and its provision for conversion in cases of fraud, utterly superfluous.

Appellant’s Brief at page 15 cites section 1112(c) which provides that “the court may not convert a case under this chapter [11] to a case under chapter 7 of this title if the debtor is a farmer ... unless the debtor requests such a conversion.” Section 1112(c) is entirely inapplicable here. Appellant did not file a chapter 11 case; he filed a chapter 12 case and subjected himself to all sections of chapter 12, including 1208(d) and the possibility of conversion upon a showing of fraud.

IX. It was appropriate for the Bankruptcy Court to convert the case to chapter 7.

On page 12 of his Brief, Appellant argues that conversion to chapter 7 was unnecessary because "it only provides creditors/trustees the ability to bring adversarial proceedings for non-dischargeability of debt" and "[i]f the Debtor's case was dismissed, the Debtor would still be liable as the Debtor has not received a discharge." Appellant's Brief, p. 12.

Appellant is correct that conversion allowed the United States Trustee to seek denial of discharge under 11 U.S.C. section 727 based upon Appellant's concealment of assets. But conversion was appropriate for other reasons, namely (1) it was difficult to know if there was/is equity for distribution to creditors due to Appellant's dishonesty with respect to his assets; (2) a neutral chapter 7 trustee is best suited to make a determination about equity and to identify avoidance actions; (3) the adversary under 11 U.S.C. section 727 is beneficial to creditors in that all debts will remain in existence; and (4) at the evidentiary hearing on July 18, 2008, and subsequently, Appellant's creditors supported conversion to chapter 7. See Objection to Appellant's Motion to Dismiss filed June 23, 2008 by Peoples Bank (District Court Docket No. 8); Objection to Appellant's Motion to Dismiss filed July 3, 2008 by Montgomery Bank (District Court Docket No. 9).

CONCLUSION

For these reasons, the Appellee United States Trustee respectfully asks this Court to affirm the order entered below.

Respectfully submitted this 18th day of December, 2008.

DONALD F. WALTON, UNITED STATES
TRUSTEE, REGION 21

By: *<u>/s/ Matthew E. Mills</u>*
Matthew E. Mills
Assistant United States Trustee
Office of the United States Trustee
222 West Oglethorpe Avenue, Suite 302
Savannah, Georgia 31401
(912) 652-4112

OF COUNSEL:

Ramona D. Elliot
General Counsel

P. Matthew Sutko
Office of the General Counsel
Executive Office for United States Trustees
United States Department of Justice
20 Massachusetts, Ave. N.W., Suite 8100
Washington, D.C. 20530
Tel: (202) 307-1399

CERTIFICATE OF SERVICE

The undersigned hereby certifies that the within and foregoing **BRIEF OF APPELLEE DONALD F. WALTON, UNITED STATES TRUSTEE, REGION 21** has this day been served upon the following parties by mailing a copy of the same through the United States Mail bearing sufficient postage thereon. In addition, electronic service will be received by those parties that are entitled to receive such service in this case through the electronic filing system of this Court.

Jon A. Levis, Esq.
P. O. Box 129
Swainsboro, GA 30401

Jack M. Williamson, Jr.
1135 Rackettown Road
Lyons, Georgia 30436

This 18th day of December, 2008.

/s/ Matthew E. Mills
Matthew E. Mills, Asst. U.S. Trustee
Office of United States Trustee
222 W. Oglethorpe Avenue, Suite 302
Savannah, Georgia 31401
(912) 652-4112

BRIEF BANK — "SUMMARY SHEET" *Printed Mon-5/23/11 12:26*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	In Jack M. Williamson (Williamson v. Donald F. Walton, United States Trustee, Region 21)
2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	11th Cir
3. ("CCN") ***CURRENT*** CASE NO.	No.: 09-11391-B
4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*	No.: 6:08-cv-00097-BAE Court: S.D. Ga. *(Identify judge & cite, if any)*
5. ("SO") ***SOURCE***	**U.S. TRUSTEES**
6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	Filed: May 15, 2009 Type: Statement of Appellee, the United States Trustee, In Response to Jurisdictional Question Raised by the Court.
7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*	Matthew Mills, David Gold, P. Matthew Sutko, Donald Walton *(UST/OGC: 202-307-1399/FAX-2397)*
8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	• Whether circuit courts of appeals have jurisdiction to review an order converting a bankruptcy case from chapter 12 to 7 and denying a motion to dismiss.
10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)	
11. DO YOU RECOMMEND POSTING IN UST BRIEFBANK?	☒ YES ☐ NO ***NAME:*** Linda Figueroa ***DATE:***

IN THE UNITED STATES COURT OF APPEALS
FOR THE ELEVENTH CIRCUIT

IN RE:)
)
JACK M. WILLIAMSON,)
)
Appellant)
v.) Appeal No. 09-11391-B
)
DONALD F. WALTON,)
UNITED STATES TRUSTEE,)
REGION 21,)
)
Appellee)
______________________________)

STATEMENT OF APPELLEE, THE UNITED STATES TRUSTEE, IN RESPONSE TO JURISDICTIONAL QUESTION RAISED BY THE COURT

1. On April 9, 2009, this Court issued a Memorandum to Counsel or Parties, asking the parties to address whether the Court has jurisdiction over this appeal. This Court does have jurisdiction for the reasons given below.[1]

2. Appellant Jack Williamson filed a voluntary motion to dismiss his chapter 12 case, which the United States Trustee opposed because the Appellant had

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[1] The question posed by the Court was framed as follows: Whether this Court has jurisdiction to review the district court's March 4, 2009, order and judgment affirming the bankruptcy court's order converting the debtor's Chapter 12 case to Chapter 7 and denying his motion to dismiss the case? *See* 28 U.S.C. § 158(a); 11 U.S.C. § 1208(d); *Barben v. Donovan (In re Donovan)*, 532 F.3d 1134, 1136-37 (11th Cir. 2008).

committed bankruptcy fraud. The United States Trustee requested conversion to chapter 7, as opposed to dismissal. The bankruptcy court found that Appellant had committed fraud, denied his motion to dismiss, and converted the case to chapter 7.

3. The United States Trustee believes it is important to clarify that courts of appeal have jurisdiction to review an order converting a bankruptcy case from chapter 12 to 7 and denying a motion to dismiss.[2] Two separate statutes provide this jurisdiction. First, 28 U.S.C. § 158(d) allows this Court to consider appeals from "all final decisions, judgments, orders, and decrees" entered in a bankruptcy case. *See* 28 U.S.C. § 158(d). Second, 28 U.S.C. § 1291 provides jurisdiction for this Court to consider appeals from "all final decisions" of a district court concerning, *inter alia*, a bankruptcy case below. *See* 28 U.S.C. § 1291.

4. Significantly, section 158(d) is more expansive than 28 U.S.C. § 1291

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[2] The United States Trustee Program reviews bankruptcy cases for abuse and files thousands of motions to dismiss in Chapter 7 cases annually. For example, in fiscal year 2007, United States Trustees, according to United States Trustee Program records, filed 3,370 motions to dismiss under section 707(b)(2) of the Bankruptcy Code in judicial districts throughout the United States. Further, United States Trustees are statutorily responsible for supervising the administration of all bankruptcy cases, in all federal judicial districts other than those located in North Carolina and Alabama. *See* 28 U.S.C. § 586(a)(3).

because it provides for jurisdiction over “judgments” and “orders” and “decrees” in addition to “final decisions.” The statutory text indicates that this Court takes a broad view when determining questions of power to consider the merits of this appeal.

5. Under section 158(d), an order converting a chapter 12 bankruptcy case to one under chapter 7 and denying a debtor’s motion to dismiss, is a final, appealable order under the broad language of 28 U.S.C. § 158(d) for two reasons.

6. First, conversion of a chapter 12 case to one under chapter 7 dramatically affects the outcome of a bankruptcy case: in a chapter 12 case, a debtor reorganizes over time, and remains in possession of his property during the reorganization process. *See* 11 U.S.C. § 1207(b). In contrast, upon conversion to chapter 7, a debtor’s assets are liquidated for the benefit of creditors in as expeditious a manner as possible. Moreover, a debtor will not receive a discharge in chapter 12 until his repayment plan is complete, *see* 11 U.S.C. § 1228, whereas upon conversion to chapter 7, a debtor generally receives his discharge shortly after conversion.

7. Second, conversion of a chapter 12 case to one under chapter 7 conclusively adjudicates the question of whether a debtor has an absolute right to dismiss

his chapter 12 case. When conversion to chapter 7 occurs, a bankruptcy debtor no longer has the opportunity to claim an absolute right to dismiss. Rather, upon conversion a debtor must show "cause" in order to obtain a dismissal of his bankruptcy case. *See* 11 U.S.C. § 707(a). At the same time a debtor whose case has been converted, no longer has the opportunity to reconvert his case to another chapter. *See* 11 U.S.C. § 706(a) (providing that chapter 7 debtor may only reconvert to chapter 11, 12, or 13 if case has not previously been converted under sections 1112, 1208, or 1307 of the Bankruptcy Code). Accordingly, as part of the process of converting from one chapter to another, the discrete issue of a debtor's alleged absolute right to dismiss his chapter 12 case is adjudicated in a complete and final manner.

8. *Barben v. Donovan (In re Donovan),* does not mandate dismissal. It did not address the question here - whether an order affirmatively converting a case is final. Instead, it ruled an order denying relief, a motion to dismiss, was interlocutory. There is a fundamental difference between orders affirmatively granting relief and those that deny relief.

9. Nor is there even a hard and fast rule whether denials of motions to dismiss are final. For example, the *Donovan* decision relied upon a Seventh Circuit decision, *Jartran,* for the proposition that denials of dismissals are

interlocutory. *See In re Donovan*, 532 F.3d at 1137 (*citing In re Jartran*, 886 F.2d 859, 864 (7th Cir. 1989). But, a subsequent Seventh Circuit decision ruled that *Jartran* set no hard and fast rule. *See In re Ross Tousey*, 549 F.3d 1148, 1153 n.2 (7th Cir. 2008). A court must evaluate the facts of each denial in determining whether a particular denial is final. *Id.* In *Ross Tousey*, that factual analysis led the court to rule that the denial of that particular motion to dismiss was final. *Id.*

10. This Court also does not treat all denials of motions to dismiss as interlocutory. To the contrary, this Court, sitting *en banc*, post-*Donovan*, reached the merits of an appeal from an order denying a motion to dismiss a bankruptcy case. *In re Trusted Net Media Holdings, LLC*, 550 F.3d 1035 (11th Cir. 2008). In *Trusted Net Media*, the United States, acting as amicus:

    (a) raised the issue of whether denials of motions to dismiss are always interlocutory within this Circuit,

    (b) brought to this Court's attention the 2008 panel decision in *Donovan*, and

    (c) argued nonetheless that the bankruptcy court order in *Trusted Net Media* was final.

See EN BANC BRIEF FOR THE UNITED STATES AS AMICUS CURIAE

SUPPORTING APPELLEE, at pages 8-11 (copy attached).

11. It would appear this Court agreed with the United States that the bankruptcy court order denying the motion to dismiss in *Trusted Net Media* was a final order, because this Court reached the merits in *Trusted Net Media*, which it could not have done had the underlying order been interlocutory. *In re Walker*, 515 F.3d 1204, 1210 (11th Cir. 2008) (court of appeals has jurisdiction over only final judgments and orders arising from bankruptcy proceeding, whereas district court may review interlocutory judgments and orders as well).

12. Given all this, it is not surprising that other circuits have treated conversion orders as final. *See In re Graven*, 936 F.2d 378 (8th Cir. 1991) (reaching merits of order converting case from one under chapter 12 to one under chapter 7); *In re Foster*, 945 F.2d 400 (5th Cir. 1991) (Table) (same) (affirming district court without opinion). Given the broad parameters of 28 U.S.C. § 158(d), and the facts establishing finality here, this Court should treat this conversion motion as final too, and should exercise jurisdiction over this appeal.

Respectfully submitted this 15th day of May, 2009.

DONALD F. WALTON
UNITED STATES TRUSTEE, REGION 21

By:___________________________________
Matthew E. Mills
Assistant United States Trustee
Office of United States Trustee
United States Department of Justice
222 West Oglethorpe Avenue, Suite 302
Savannah, Georgia 31401
(912) 652-4112

CERTIFICATE OF SERVICE

I, the undersigned, hereby certify that a copy of the foregoing *STATEMENT OF APPELLEE, THE UNITED STATES TRUSTEE, IN RESPONSE TO JURISDICTIONAL QUESTION RAISED BY THE COURT*, has this day been served upon the following parties by mailing a copy of the same through the United States Mail bearing sufficient postage thereon. In addition, electronic service will be received by those parties that are entitled to receive such service in this case

through the electronic filing system of this Court.

Jack M. Williamson
1135 Racket Town Road
Lyons, Georgia 30436-3428

This the 15th day of May, 2009.

____
Matthew E. Mills
Assistant United States Trustee

Office of United States Trustee
222 West Oglethorpe Avenue, Suite 302
Savannah, Georgia 31401
(912) 652-4112

BRIEF BANK — 'SUMMARY SHEET" *Printed Wed-11/28/07 9:45*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]* In re Wilson (Babin v. Wilson)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]* 8th Cir. B.A.P.

3. ("CCN") ***CURRENT*** CASE NO. No.: 07-6050

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*

No.: 06-72193

Court: Bankr. W.D. Ark.

(Identify judge & cite, if any)

5. ("SO") ***SOURCE*** **U.S. TRUSTEES**

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*

Filed: Nov. 2007

Type: Brief for UST as Amicus Curiae Supporting Appellant

7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]* P. Matthew Sutko, Thomas Kearns, Nancy Gargula, Charles Tucker, Jim Hollis

(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC*** **BANKRUPTCY**

9. ("SU") ● ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***

●Whether the Bankruptcy Court erred by holding that the debtors could claim the IRS standard expense allowance for vehicle financing in the calculation of their disposable income even though the debtor had no vehicle financing expense because they owned their cars debt free.

√ **Background:**

10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)

11. DO YOU RECOMMEND POSTING IN UST BRIEFBANK? | x | YES | | NO ***NAME:*** Holly Walter ***DATE:***

UNITED STATES BANKRUPTCY APPELLATE PANEL
FOR THE EIGHTH CIRCUIT

IN RE: GREGORY WILSON and LORI A. WILSON Debtors	Bkr. Case No. 6:06-bk-72193M
JOYCE BABIN, Chapter 13 Trustee, Appellant v.	Appeal No. 07-6050
GREGORY A. WILSON and LORI A. WILSON, Appellees	

ON APPEAL FROM THE UNITED STATES BANKRUPTCY COURT
FOR THE WESTERN DISTRICT OF ARKANSAS

BRIEF FOR THE UNITED STATE TRUSTEE
AS AMICUS CURIAE SUPPORTING APPELLANT

Of Counsel

ROBERTA A. DeANGELIS
General Counsel

P. Matthew Sutko
Thomas C. Kearns
United States Department of Justice
Executive Office for United States Trustee

NANCY J. GARGULA
United States Trustee

CHARLES W. TUCKER
Assistant United States Trustee
United States Department of Justice
Office of the U.S. Trustee
200 West Capitol, Suite 1200
Little Rock, AR 72201

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INTEREST OF THE UNITED STATES

The Attorney General appoints United States Trustees to supervise the administration of bankruptcy cases and trustees in regions comprising the vast majority of federal judicial districts. 28 U.S.C. §§ 581-589a. United States Trustees "serve as bankruptcy watchdogs to prevent fraud, dishonesty, and overreaching in the bankruptcy arena." H.R. Rep. No. 595, 95th Cong., 1st Sess. 88 (1977). The United States Trusteee Program thus acts in the public interest to promote the efficiency and to protect and preserve the integrity of the bankruptcy system. By statute, "[t]he United States Trustee may raise and may appear and be heard on any issue in any case or proceeding under this Title." 11 U.S.C. § 307. *See also In re Revco D.S., Inc.* 898 F.2d at 499-500 (upholding broad appellate standing of United States Trustees).

This case involves a dispute over confirmation of a plan under Chapter 13 of the Bankruptcy Code. In this matter, the United States Trustee has two separate and distinct interests. First, the United States Trustee has the statutory duty to oversee the administration of Chapter 13 cases, which includes monitoring and, if necessary, objecting to Chapter 13 plans under 11 U.S.C. § 1324. 28 U.S.C. § 586(a)(3)(C). Second, the United States Trustee has an interest in this appeal because the issue on appeal directly implicates 11 U.S.C. § 707(b), which the United States Trustee oversees pursuant to duties set forth in 11 U.S.C. § 704(b), and under which United States Trustees regularly seek relief involving the same legal issue.

The question of law involved in this appeal is not limited to the Wilsons. Rather, it will apply globally to thousands of debtors in a myriad of different financial circumstances who will file bankruptcy cases in this district and nationally. For this reason, the United States Trustee respectfully offers this Court its views on whether Debtors in a Chapter 13 case may deduct the IRS Local Standard expense for vehicle financing costs, even though they Debtors do not make monthly note or lease payments.

STATEMENT OF APPELLATE JURISDICTION

The Bankruptcy Court had jurisdiction over this matter pursuant to 28 U.S.C. § 1334(b) and § 157(b)(2)(L). The Bankruptcy Appellate Panel has jurisdiction over this appeal pursuant to 28 U.S.C. § 158(a)(1)and (b) and Federal Rule of Bankruptcy Procedure 8001. Joyce Babin, Chapter 13 Trustee, appeals from orders of the United States Bankruptcy Court, Western District of Arkansas, overruling her Objection to Confirmation of Chapter 13 Plan filed in the case of the Debtors, Gregory A. Wilson and Lori A. Wilson ("Debtors" or "Wilsons"), and confirming the Wilsons' chapter 13 plan.

The Wilsons filed their chapter 13 case and proposed a plan of reorganization on September 29, 2006. On November 29, 2006, the Chapter 13 Trustee timely filed an Objection to Confirmation of the Debtors' plan. The Objection was heard on April 18, 2007. On April 19, 2007, pursuant to the Court's hearing, the Chapter 13 Trustee and the Debtors submitted Stipulations to the Bankruptcy Court. On May 17, 2007, the parties submitted Briefs. On July 30, 2007, the Bankruptcy Court entered discrete Orders overruling the Chapter 13 Trustee's Objection and Confirming the Wilsons' plan. On August 8, 2007, the Chapter 13 Trustee filed her Notice of Appeal.

STATEMENT OF ISSUES PRESENTED FOR REVIEW

The Chapter 13 Trustee objected to confirmation of the Debtors' modified plan on the grounds that it did not commit all of the Debtors' disposable income to the plan as required under 11U.S.C. § 1325(b)(1)(B). The Bankruptcy Court overruled the Chapter 13 Trustee's objection and confirmed the plan, holding that the Debtors could properly claim the IRS Standard expense allowance for vehicle ownership, notwithstanding that the Debtors had no vehicle loan or lease payment, thereby substantially reducing the funds available to pay creditors under the plan.

In this case, the Debtors' income exceeds the family median income for the State of Arkansas. In chapter 13 bankruptcy cases, when the debtors' income exceeds their state's family median income, 11 U.S.C. § 1325(b)(3) requires the debtors to use the "means test" provisions of 11 U.S.C. § 707(B)(2)(A) and (B) to determine their expenses. Given that 11 U.S.C. 707(B)(2)(A)(ii)(I) allows only "applicable" vehicle ownership expenses to be deducted under the means test, the issue presented to this court for determination is whether the Bankruptcy Court erred by holding that the Debtors could claim the IRS Standard expense allowance for vehicle financing in the calculation of their disposable income, even though the Wilsons had no vehicle financing expense because they owned their cars debt free.

STANDARD OF REVIEW

The Bankruptcy Appellate Panel reviews the Bankruptcy Court's factual findings for clear error and the conclusions of law *de novo. DeBold v. Case,* 452 F.3d 756, 761 (8th Cir. 2006); *Litzinger v. Litzinger (In re Litzinger),* 340 B.R. 897, 903 (8th Cir. BAP 2006); *Ford v. Student Loan Guarantee Foundation (In re Ford),* 269 B.R. 673, 675 (8th Cir. BAP 2001) [citing *Andresen v. Nebraska Student Loan Program, Inc. (In re Andresen),* 232 B.R. 127, 128 (8th Cir. BAP 1999)]; *Eibert v. Pelican (In re Eibert),* 162 F.3d 523, 525 (8th Cir. 1998). In this case, the facts are not in dispute. Therefore, the Bankruptcy Court's interpretations of the relevant provisions, including 11 U.S.C. §§ 707(b)(2), 1322(a), and 1325, are legal conclusions that are reviewed *de novo.*

STATUTORY FRAMEWORK AND BACKGROUND

I. Statutory Framework

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA") altered the analysis bankruptcy courts must employ when determining whether to confirm proposed Chapter 13 repayment plans. When, as here, a trustee or holder of an allowed unsecured claim objects to plan confirmation, 11 U.S.C. § 1325(b)(1) conditions plan confirmation upon the debtors committing all of their "projected disposable income" to payments to unsecured creditors through the Chapter 13 plan. "Disposable income" is the current monthly income received by the debtors (other than child support payments, foster care payments, or disability payments for a dependent child) less amounts reasonably necessary to be expended. 11 U.S.C. § 1325(b)(2). The term "current monthly income" is the average monthly income from all sources that the debtors receive during the six-month period ending on the last day of the calendar month immediately preceding the date of the commencement of the case, including any amount paid by a third party on a regular basis for the household expenses of the debtor or the debtor's dependents, but excluding benefits received under the Social Security Act. 11 U.S.C. § 101(10A). For above-median-income debtors, the "amounts reasonably necessary to be expended" are determined "in accordance with" § 707(b)(2)(A)[1] and (B), which provides various specific expense categories from which debtors may reduce their "current monthly income."[2] 11 U.S.C. § 1325(b)(3).

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[1] As amended by the BAPCPA, § 707(b)(2) repealed the former presumption in favor of the debtor, and replaced it with a new presumption. A case is an "abuse"

The "means test" provisions of §§ 707(b)(2)(A) and (B) are used in determining the expenses of Chapter 13 debtors, like these debtors, whose income exceeds their state's family median income. 11 U.S.C. § 1325(b)(3). In determining expenses, § 707(b)(2)(A)(ii)(I) provides that a debtor's "monthly expenses shall be the debtor's *applicable* monthly expense amounts specified under the National Standards and Local Standards and the debtor's actual monthly expenses for the categories specified as Other Necessary Expenses issued by the Internal Revenue Service for the area in which the debtor resides…." 11 U.S.C. § 707(b)(2)(A)(ii)(I) (emphasis added).

II. Factual Background

The Debtors own two vehicles, a 2002 Ford F-150 and a 1999 Toyota 4-Runner Sport Utility Vehicle. App. 32, 34.[3] They own them outright; neither vehicle is encumbered by debt. *Id.* In their Form 22C, Lines 28 and 29, Debtors claimed the IRS Standard "transportation ownership/lease expense" in the amounts of $471 and $332, respectively, for both vehicles. App. 62.[4]

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of Chapter 7 if a detailed mathematical formula set out in the statute, commonly referred to as the "means test," yields a minimum amount of monthly disposable income. The means test uses a series of calculations to determine whether the § 707(b)(2) presumption of abuse arises in Chapter 7 cases. *See* 11 U.S.C. § 707(b)(2)(A).

[2] Form 22C, which debtors must file pursuant to Interim Federal Rule of Bankruptcy Procedure 1007(b)(6), serves, in part, to calculate debtor's "current monthly income."

[3] In this brief, "App." followed by a number refers to the record on appeal set forth in the docket of the Bankruptcy Court for this case.

[4] These amounts are in addition to the "vehicle operation expenses" for two or more vehicles of $336 taken by the Debtors on Line 27. Because the vehicles are

The Chapter 13 Trustee filed an objection to confirmation of the Debtors' Chapter 13 plan, claiming the plan failed to provide all of the Debtors' disposable income for the payment of creditors, contrary to 11 U.S.C. §§ 1325(a)(3) and (b)(1)(B). The Chapter 13 Trustee argued that the Debtors had more income to devote to paying creditors because they were improperly claiming the IRS Standard expense for vehicle financing expenses, even though that expense deduction was not applicable because these Debtors have no vehicle or lease payments. App. 71.

On July 30, 2007, the United States Bankruptcy Court for the Western District of Arkansas entered orders overruling the Chapter 13 Trustee's objection to the Debtors' plan and confirming the Debtors' Chapter 13 plan. The Court ruled that the Debtors were entitled to reduce their disposable income by the amount of the IRS Standard expenses allowance for vehicle financing costs even though they had no vehicle financing costs. On August 8, 2007, the Trustee timely filed her notice of appeal of the Court's orders of July 30, 2007.

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each over six years old, the United States Trustee would also allow the Debtors an additional $200 operating expense per vehicle, based on the Internal Revenue Manual which allows such an additional vehicle operating expenses. *See* Internal Revenue Manual, Part 5 (entitled Collecting Process), Chapter 8, § 5.8.5.5.2, Treatment of Non-Business Transportation Expenses, which may be found on the IRS website at http://www/irs/gov/irm/part5/ch08s05.html.

SUMMARY OF ARGUMENT

The bankruptcy court erred as a matter of law in overruling the Chapter 13 Trustee's objection to confirmation and confirming the Wilsons' Chapter 13 plan. It did so by misinterpreting when debtors can claim a vehicle ownership expense under section 707(b)(2). The court held that the Wilsons were entitled to deduct $803 in vehicle ownership expenses for their 2002 Ford F-150 and 1999 Toyota 4-Runner Sport Utility Vehicle, even though those vehicles were owned free and clear of encumbrances. This conclusion of law by the bankruptcy court was incorrect because the law allows the Wilsons to claim only "applicable" expenses under section 707(b)(2), and they had no applicable vehicle ownership expenses because neither vehicle was subject to a loan or lease payment. By using the word "applicable," Congress limited eligibility for expenses under the Local Standards to debtors for whom the expenses apply. Because the vehicle acquisition/financing expense does not apply with respect to the Wilsons' vehicles, the bankruptcy court erred in holding they were eligible to deduct the expenses under the means test.

Significantly, reading "applicable" in section 707(b)(2) this way has the salutary effect of applying the means test in a manner that is inconsistent with the Internal Revenue Service's longstanding application of this standard. Under section 707(b)(2), the means test looks to the IRS to establish certain standard expenses. 11 U.S.C. § 707(b)(2)(A)(i)(I). In applying its standards to taxpayers, the IRS does not allow taxpayers to claim vehicle ownership expenses absent a monthly car expense. *See* IRS Collection Financial Standards attached hereto as

Exhibit 4 of the Addenda.[5] Congress' use of "applicable" in § 707(b)(2) means this expense should be denied to debtors like the Wilsons, who do not have a car loan or lease, for the same reasons the IRS does not allow taxpayers to claim such phantom expenses.

Finally, the bankruptcy court's order overruling the Chapter 13 Trustee's objection to confirmation of the Wilsons' plan conflicts with sound notions of public policy and the primary purpose of Congress in passing bankruptcy reform legislation in 2005 - including the amendments at issue in this appeal. The 2005 legislation was intended to ensure that debtors repay their debts when they can. By allowing the Wilsons to claim a fictional expense for their two vehicles, the bankruptcy court subverted that purpose.

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[5] The IRS revised its Collection Financial Standards, effective October 1, 2007, and such revisions will be made applicable to bankruptcy cases filed as of January 1, 2008. Because the Wilsons' case was filed on September 29, 2006, only the Collection Financial Standards in effect prior to October 1, 2007, are applicable to the Wilsons' case. For the Court's convenience, a true and correct PDF copy of the Collection Financial Standards applicable to this case are attached as Exhibit "4" on the Addenda and incorporated herein by reference. It is important to note, however, that the revisions made by the IRS effective October 1, 2007, do not change any result in this case. As set forth in the current Collection Financial Standards, the Local Standard for Vehicle Operation is still made expressly contingent on the existence of a loan or lease payment on a vehicle. *See Id.* As explained by the IRS, the recent revisions to the Local Standards were made to create equal allowances for first and second vehicles, add a separate public transportation allowance and reorganize the manner in which taxpayers in certain counties calculate their transportation operating expenses. *See Id.,* under heading "Recent Revisions."

ARGUMENT

I.

THE BANKRUPTCY COURT ERRED IN HOLDING THAT THE WILSONS WERE ELIGIBLE TO CLAIM THE IRS LOCAL STANDARDS FOR VEHICLE OWNERSHIP FOR THEIR VEHICLES BECAUSE THE EXPENSE WAS NOT APPLICABLE TO THEM.

The bankruptcy court's order overruling the Chapter 13 trustee's objection to confirmation of the Wilsons' plan should be reversed because it fails to recognize that the Bankruptcy Code only allows debtors to claim vehicle expenses that are applicable to the debtors. 11 U.S.C. § 707(B)(2)(A)(II)(I). The Wilsons do not have any "applicable" vehicle ownership expense because they own their vehicles outright. Their attempt to claim what is a phantom expense is prohibited by the Bankruptcy Code because the Code allows debtors to claim only "applicable" expenses, not phantom ones. For this reason, the order entered by the bankruptcy court merits reversal.

A. Vehicle ownership expenses are allowable only if "applicable" to the debtors.

Section 707(b)(2)(A)(ii)(I) of the Bankruptcy Code provides that a "debtor's monthly expenses shall be the debtor's *applicable* monthly expense amounts specified under the...Local Standards...issued by the Internal Revenue Service..." 11 U.S.C. § 707(b0(2)(A)(ii)(I) (emphasis added). The statute expressly provides that before the specific IRS expense amounts may be included in the debtor's allowed monthly expenses, the expense must itself first be applicable to the debtor. *Id.*

The Bankruptcy Code does not define the word "applicable," nor has the United States Trustee identified any Supreme Court or Eighth Circuit decision that provides a definition in the bankruptcy context.[6] Where, as here, a statutory term is undefined, a basic principle of statutory construction provides that courts should give such terms their ordinary meanings. *E.g., Smith v. U.S.*, 508 U.S. 223, 228 (1993) ("When a word is not defined by statute, we normally construe it in accord with its ordinary or natural meaning."). *See also Watson v. Ray*, 192 F.3d 1153, 1155 (8th Cir. 1999) (stating that, "When interpreting a statute the court starts with the statute's plain meaning."). The dictionary defines "applicable" to mean applying or capable of being applied; relevant; suitable; appropriate. *Random House Unabridged Dictionary* (2006). Accordingly, such a meaning should be imparted to the term "applicable" as it appears in section 707(b)(2)(A)(ii)(I) absent clear indication that Congress intended to give such term a different meaning. *See Johnson v. Aljian*, 490 F3d 778,780 (9th Cir. 2007) (*quoting U.S. v. TRW Rifle 7.62x51 Meter Caliber*, 447 F.3d 686,689 (9th Cir. 2006) ("[W}e follow the common practice of consulting dictionary definitions to clarify their ordinary meaning[] and look to how the terms were defined at the time [the statute] was adopted.").

The bankruptcy court's order is inconsistent with the ordinary, common sense definition of "applicable" because it allows debtors like the Wilsons to

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[6] *But see, Fong v. Glover,* 197 F.2d 710, 711 (9th Cir. 1952) (defining "applicable" as it appears in the Federal Rules of Civil Procedure as "capable of being applied.")

deduct expenses that do not apply to them. Here, the Wilsons seek to claim a loan or lease payment, but they have none. If the expenses which the Wilsons do not incur on a monthly basis are disallowed, they have the ability to repay their unsecured creditors $25,977, which is sixty-one percent (61%) of their total scheduled unsecured claims in a 60-month repayment plan under Chapter 13 of the Bankruptcy Code. By inserting the word "applicable" in section 707(b)(2)(A)(ii)(I), Congress limited eligibility for expenses under the Local Standards to debtors for whom such expenses are "relevant; suitable; appropriate"--thereby excluding phantom ones. Because the Wilsons did not have vehicle financing expenses for either of their vehicles, the IRS ownership expense does not apply to those vehicles.

The only two appellate courts to have considered the issue to date have read "applicable" this way, and reversed the bankruptcy courts that read "applicable" the way the bankruptcy court in this case did. *See In re Hartwick*, 373 B.R. 645, 650 (D. Minn. 2007) (finding that "word 'applicable' in [section 707(b)(2)(A)(ii)(I)] means that, before the expense amount can be included in the debtor's allowed monthly expenses, the expense itself must actually be applicable to the debtor–in other words, the debtor must actually have a loan or lease payment obligation"); *In re Ross-Tousey*, 368 B.R. 762, 764-67 (E.D. Wis. 2007) (holding that word "applicable" in section 707(b)(2)(A)(ii)(I) means that 'ownership expenses must exist" in the form of an actual loan or lease payment). *Cf In re Devilliers*, 358 B.R. 849, 859 (Bankr. E.D. La. 2007) (stating that debtors may claim IRS ownership expense only after "a determination is made as to the type of expenses allowed and applicable to the debtor"); *In re Carlin*, 348 B.R. 795, 798 (Bankr. D. Or. 2006) (finding that statute plainly and unambiguously does not allow the vehicle operating expense at issue to "free and clear" owners).

Hartwick and *Ross-Tousey* reversed the bankruptcy court rulings in those cases because those courts, like the bankruptcy court here, failed to give the word "applicable" its ordinary meaning. Instead, bankruptcy courts, like the one in this case, created an arbitrary distinction between the word "actual" and "applicable" expenses in section 707(b)(2)(A)(ii)(I) (footnote in draft). *See, e.g., Fowler*, 349, 414, 418 (stating "The use of 'actual' with respect to the Other Necessary Expenses and 'applicable' with respect to the National and Local Standards must mean that Congress intended two different applications.) The bankruptcy court here agreed that "applicable" and "actual" must have different meanings as Congress used both terms in the statute and, therefore, debtors like the Wilsons need not have any "actual" expense for the Ownership Expense Standard to be "applicable." App. __(p. 7 of op.) This logic is misguided, however. As the *Ross-Tousey* court explained, there is no indication in section 707(b)(2)(A)(ii)(I) that Congress intended the words "applicable" and "actual" to have essentially *opposite* meanings. *Ross-Tousey*, 368 B.R. at 765. Rather, as *Ross-Tousey* held, the better reading of "applicable" in the context of section 707(b)(2)(A)(ii)(I) is that it may have two meanings: first, the ownership expense is "applicable" if the debtor makes a loan or lease payment on a vehicle, and second, the *amount* allowed to the debtor is the "applicable" amount provided under the IRS Standards, and not the "actual" amount." *Id.*, *see also Hartwick*, 373 B.R. at 653. "This reading gives meaning to the distinction between 'applicable' and 'actual' without taking a further step to conclude that 'applicable' means "nonexistent' or 'fictional.'" *Ross-Tousey*, 368 B.R. at 765.

By using the term "applicable" in this way, a determination of allowable expenses under the means test is a two-step process. The first step is eligibility—*i.e.,* does the debtor qualify for an expense allowance in the category at issue? If so, then the second step is to quantify the expense amount the eligible debtor is allowed by looking at the IRS Standard amounts that are specified for the number of vehicles owned by the debtor and where the debtor lives. *See. e.g., Carlin*, 348 B.R. at 798 ("There is nothing absurd in Congress drawing the line for vehicle ownership expense eligibility at those debtors who are making payments on the vehicle."). The bankruptcy court's ruling impermissibly skips the first step of determining whether the Wilsons are *eligible* for the ownership expense by virtue of having a loan or lease payment for a vehicle, and proceeds directly to the second—only considering the *amount* the IRS would allow eligible taxpayers to claim for ownership of two vehicles.

B. The UST's construction of "applicable" in § 707(b)(2) has the salutary effect of treating transportation costs the same way in bankruptcy cases that the IRS treats them.

Reversal of the bankruptcy court's order allowing the Wilsons to deduct vehicle financing expenses that they do not have has the additional benefit of treating inapplicable phantom expenses in bankruptcy cases the way the IRS has long treated them. In providing which deductions debtors may take under the means test, Congress specifically stated that debtors are permitted to deduct "the debtor's *applicable* monthly expense amounts specified under the...Local Standards...issued by the *Internal Revenue Service*." 11 U.S.C. § 707(b)(2)(A)(ii)(I) (emphasis added). Accordingly, how the Internal Revenue Service applies the Standards that it developed for its own internal debt collection purposes is instructive on the question of how the same Standards might be applied in bankruptcy cases under section 707(b)(2). *See. e.g., Hartwick*, 373 B.R. at 650-51 ("in order to determine whether the expense Standards issued by the IRS are 'applicable,' the most logical resource to consult is the IRS"). *See also In re Slusher,* 359 B.R. 290, 309 (Bankr. D. Nev. 2007) ("if guidance is sought on the meaning of the IRS standards that Congress incorporated into the Bankruptcy Code, practical reason would suggest that court should consider the full manner by which the IRS uses these standards.").

The IRS Collection Financial Standards in effect as of the date of the Wilsons' bankruptcy filing[7] fully support the United States Trustee's construction of the term "applicable" and provide as follows:

> The transportation standards consist of nationwide figures for monthly loan or lease payments referred to as ownership costs, and additional amounts for monthly operating costs....The ownership costs provided maximum allowances for the lease or purchase of up to two automobiles if allowed as a necessary expense....If a taxpayer has a car payment, the allowable ownership cost added to the allowable operating cost equals the allowable transportation expense. **If a taxpayer has no car payment, or no car, the operating costs portion of the transportation standard is used to come up with the allowable transportation expense.**

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[7] *See* Footnote 5, *supra.*

See IRS Collection Standards attached hereto as Exhibit A (emphasis added); *see also* Internal Revenue Manual, Financial Analysis Handbook, Pt. 5, ch. 15, § 5.15.1.7(4.B), available at http://www.irs.gov/irm/part5/ch15s01.html#d0e187819.

As of the date the Wilsons filed their bankruptcy petition,[8] the "ownership cost" was specifically calculated by the IRS based on the cost to finance the acquisition of a vehicle, and not simply a cost associated with owning a car, such as repair or maintenance. The IRS noted that the "ownership cost" Standards are based on the **"five-year average of new and used car financing data compiled by the Federal Reserve Board of Governors."** *See Id.* (emphasis added). As such, the IRS does not treat the "ownership cost" expense as applicable when a taxpayer does not have a monthly expense related to financing a car. In exercising its discretion to collect taxes, the IRS recognizes that taxpayers may claim the vehicle "ownership cost" portion of the Local Transportation Standards only in situations where the taxpayer has a monthly vehicle acquisition financing expense, *i.e.,* has a monthly vehicle loan or lease payment. *See Id.*

The court below agreed that the IRS Manual differs from section 707(b)(2)'s means test, and that the IRS Manual lets taxpayers deduct the actual amount of their car payment or the IRS' Local Standards, whichever is less (Op. at pp. 4-5), but the Standards are not statutory nor promulgated by regulation. (Op. at p. 4). That charge is irrelevant. The relevant point is the IRS has expressed its

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[8] *See* Footnote 5, *supra.*

discretion to prohibit individuals from claiming a car payment when they have none. The exact same thing happens under the means test because it allows debtors to claim only an "applicable" car expense—not a phantom one.

Further, considering IRS practice in interpreting "applicable" expenses in section 707(b)(2)(A)(ii)(I) does not negate the section's later allowance of "actual" monthly expenses in the IRS categories of Other Necessary Expenses. Rather, "a natural reading" of section 707(b)(2)(A)(ii)(I) indicates that the words "actual" and "applicable" limit the relevant expense deductions in different ways. *Slusher,* 359 B.R. at 308. "Had Congress intended to indiscriminately allow all expense amounts specified in the National and Local Standards, it would have written section 707(b)(2)(A)(ii)(I) to read, "The debtor's monthly expenses shall be the monthly amounts specified under the National Standards and the Local Standards....' rather than 'The debtor's monthly expenses shall be *the debtor's applicable* monthly expense amounts specified under the National and Local Standards." *Id.* (Emphasis in original).

II.

THE BANKRUPTCY COURT'S ORDER CONFLICTS WITH THE MAJOR GOALS OF THE 2005 AMENDMENTS TO THE BANKRUPTCY CODE.

The bankruptcy court's order is also inconsistent with Congress' goals and purpose in implementing bankruptcy reform.[9] Congress amended the Bankruptcy

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[9] The bankruptcy court conceded this, stating that its reading of section 707(b)(2)(A)(ii)(I) "may appear to conflict with one of the express purposes of the means testing calculation, which was to 'ensure that debtors repay creditors the maximum they can afford.'"

Code in 2005 to rectify perceived abuses in the bankruptcy process. "Among the abuses identified by Congress was the easy access to chapter 7 liquidation proceedings by consumer debtors who, if required to file under chapter 13, could afford to pay some dividend to their unsecured creditors." *Hardacre,* 338 B.R. at 720 (*citing* 151 Cong. Rec. S2459, 2469-70 (March 10, 2005)). A "primary goal" of the 2005 Reform Act was to "ensure that debtors repay creditors the maximum they can afford." *In re Lenton*, 358 B.R. 651 (Bankr. E.D. Pa. 2006) (*citing* H.R. Rep. No. 109-31, pt. 1, at 1 (2005), *reprinted in* 2005 U.S.C.C.A.N. 88, 89). In cases such as this one, where the Wilsons have no loan or lease payment, Congress has established a system which does not provide them an expense deduction for vehicle financing. "Allowing debtors to deduct from their disposable income a ficational ownership allowance would give debtors with unencumbered vehicles a windfall at the expense of their unsecured creditors." *In re Howell,* 366 B.R. 153, 157 (Bankr. D. Kan. 2007).

CONCLUSION

For all of these reasons, the United States Trustee respectfully asks this Court to reverse the July 30, 2007, Orders entered by the bankruptcy court overruling the Chapter 13 Trustee's objection to confirmation of the Debtors' plan and confirming the Debtors' plan, and remand this case to the bankruptcy court for further proceedings.

Respectfully submitted,

NANCY J. GARGULA
UNITED STATES TRUSTEE

CHARLES W. TUCKER
ASSISTANT UNITED STATES TRUSTEE

By Jim Hollis
Jim Hollis (AR Bar No. 78072)
Trial Attorney
200 West Capitol, Suite 1200
Little Rock, AR 72201
Telephone: (501) 324-7357
Fax: (501) 324-7388
E-mail: jim.hollis@usdoj.gov

CERTIFICATE OF COMPLIANCE WITH L.R. BAP 8TH CIR. 8010A

The undersigned hereby certifies that the foregoing Amicus Curiae Brief complies with the type-volume limitations of L.R. BAP 8th Cir. 8010A. The Amicus Curiae Brief was prepared with word processing software, Microsoft Word 2003. The typeface used is Arial with 12-point typeface. The total number of words, exclusive of pages containing the table of contents, table of citations, statement of the basis of appellate jurisdiction, statement of the issues, and standard of review is 3,222.

The undersigned further certifies that one computer diskette, appropriately labeled, containing the full text in one document has been provided to the Eighth Circuit Bankruptcy Appellate Panel, along with the filing of the Amicus Curiae Brief on behalf of the United States Trustee. The computer diskette is certified to be virus-free.

The undersigned further certifies that on November 13, 2007, two copies of the United States Trustee's Amicus Curiae Brief have been sent for filing to the Eighth Circuit Bankruptcy Appellate Panel by United States Priority Mail and to the following by parties by United States Mail, postage prepaid, to the parties listed below:

Sherry Daves, Esq.
Attorney for Debtors, Gregory A. and Lori A. Wilson
455 West Grand
Hot Springs, AR 71901

Joyce Bradley Babin, Esq.
Chapter 13 Trustee
Post Office Box 8064
Little Rock, AR 72203-8064

The Honorable James G. Mixon
United States Bankruptcy Judge
300 West Second Street
Little Rock, AR 72201

Jim Hollis

Jim Hollis

ADDENDA

1. Order Overruling Chapter 13 Trustee's Objection to Confirmation (Slip Opinion)
2. Order Overruling Trustee's Objection to Confirmation (West Reporter Version)
3. Order Confirming Chapter 13 Plan
4. IRS Collection Financial Standards

C
In re Wilson
Bkrtcy.W.D.Ark.,2007.

United States Bankruptcy Court,W.D. Arkansas,Hot Springs Division.
In re Gregory and Lori WILSON, Debtors.
No. 6:06-bk-72193M.

July 30, 2007.

Background: Chapter 13 trustee objected to plan proposed by above-median-income debtors, on "projected disposable income" grounds, and specifically challenged debtors' ability, in computing their disposable income, to take vehicle ownership expense deductions for vehicles that they owned outright.

Holding: The Bankruptcy Court, James G. Mixon, J., held that debtors were entitled to deduct standard vehicle ownership expense for which they qualified based on number of vehicles which they owned, as being "applicable" vehicle ownership expense to which they were entitled, notwithstanding that debtors owned their vehicles outright and thus had no "actual" ownership payments.

Objection overruled.

[1] Bankruptcy 51 ⚷3705

51 Bankruptcy
  51XVIII Individual Debt Adjustment
    51k3704 Plan
      51k3705 k. Claims and Assets; Propriety and Feasibility in General. Most Cited Cases

Under the "means" test, as applied in Chapter 13 case of above-median-income debtors to allow debtors to determine whether they were devoting all of their "projected disposable income" to payment of unsecured creditors under plan, debtors were entitled to deduct standard vehicle ownership expense for which they qualified based on number of vehicles which they owned, as being "applicable" vehicle ownership expense to which they were entitled, notwithstanding that debtors owned their vehicles outright and thus had no "actual" ownership payments; term "applicable," as used in bankruptcy statute that authorized debtors to deduct "applicable monthly expense amounts" under the "National and Local Standards," had to be contrasted with "actual," as used later in same statute in allowing debtors to deduct only their actual "Other Necessary Expenses." 11 U.S.C.A. §§ 707(b)(2)(A)(ii)(I), 1325(b)(3).

[2] Bankruptcy 51 ⚷2021.1

51 Bankruptcy
  51I In General
    51I(B) Constitutional and Statutory Provisions
      51k2021 Construction and Operation
        51k2021.1 k. In General. Most Cited Cases

Task of bankruptcy court in construing provision added to the Code by the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA) was to follow language of statute as it was written. Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, § 1, 11 U.S.C.A. § 101 note.

[3] Bankruptcy 51 ⚷2264(1)

51 Bankruptcy
  51III The Case
    51III(C) Voluntary Cases
      51k2259 Dismissal
        51k2264 Proceedings; Motion or Sua Sponte Action
          51k2264(1) k. In General. Most Cited Cases

Bankruptcy 51 ⚷3705

51 Bankruptcy
  51XVIII Individual Debt Adjustment
    51k3704 Plan
      51k3705 k. Claims and Assets; Propriety and Feasibility in General. Most Cited Cases

Major objective of Congress in enacting the "means" test, as measure of whether Chapter 7 case was presumptively abusive or whether above-median-income Chapter 13 debtors were devoting all of their "projected disposable income" to payment of unsecured creditors under plan, was to remove judicial discretion from process. 11 U.S.C.A. §§ 707(b)(2), 1325(b)(1)(B), (b)(3).

Sherry Daves, Attorney at Law, Hot Springs, AR, for Debtors.

JAMES G. MIXON, Bankruptcy Judge.
On September 29, 2006, Gregory A. Wilson and Lori A. Wilson (Debtors) filed a voluntary petition for relief under the provisions of Chapter 13 of the United States Bankruptcy Code. This case is, therefore, governed by the new provisions contained in the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA).

On November 29, 2006, the Trustee filed a timely objection to confirmation of the Debtors' proposed plan. The objection was based on the Debtors' claim of vehicle ownership expenses on Form B22C for vehicles that the Debtors own free and clear of any liens. A hearing on the Trustee's objection was held in Hot Springs, Arkansas, on April 18, 2007. The parties agreed to submit the matter upon written stipulated facts, exhibits, and briefs. The matter was taken under advisement pending receipt and review of the stipulations and briefs. The matter before the Court is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(L), and the Court has jurisdiction to enter a final judgment in the case.

On Schedule B, the Debtors list an ownership interest in two vehicles, a 2002 Ford F 150 Truck and a 1999 Toyota 4-Runner sport utility vehicle. (Ex. 1.) Both vehicles are unencumbered by any security interests and the Debtors have no current automobile ownership expense. The Debtors value the 1999 Toyota at $5,000.00 and the 2002 Ford F-150 Truck at $9,325.00. (Ex. 1.)

The Debtors' statement of combined monthly income is $5,968.50. Computed on an annual basis, their income is $71,622.00. (Ex. 2.) The applicable median income for a family of two in the State of Arkansas is $38,438.00. (Ex. 2.) Because the Debtors' annual income is above the median income, they are required by 11 U.S.C. § 1325(b)(3) to compute the amount of disposable income available to pay to unsecured creditors by using the means test provided for in 11 U.S.C. § 707(b)(2).FN1 The computation required by 11 U.S.C. § 707(b) is made on official form B22C, which is required by the interim Federal Rules of Bankruptcy Procedure 1007(b)(6), adopted on October 14, 2005 in the Eastern and Western Districts of Arkansas by General Order 25.

The calculations made by the Debtors using Form B22C compute to a negative $370.04 available to pay to unsecured creditors. (Ex. 3.) Among the deductions allowed by Form B22C is a deduction for the ownership expense of two automobiles. (Ex. 3.) The Debtors' first automobile allowance is $471.00 and the allowance for the second automobile is $332.00. (Ex. 3.) If the automobile expenses are not included in the deductions from current monthly income, the result will compute to the sum of $432.96 per month available for distribution to unsecured creditors. The Debtors' plan proposes to pay $100.00 a month for 60 months. (Ex. 2.) After payment of attorney's fees, trustee's fees, and priority claims, this would leave a total of $636.00 for distribution to the allowed claims of general unsecured creditors.

The Trustee argues that the Debtors may not take the Internal Revenue Service (IRS) Local Standard deduction for vehicle ownership costs if the Debtors have no actual vehicle payment. The Debtors argue that pursuant to BAPCPA Congress created a fixed allowance for vehicle ownership deductions, regardless of whether the Debtors have an actual vehicle payment. Both parties have filed briefs pointing out that the courts considering this issue are hopelessly split.

[1] The statute applicable to this issue is 11 U.S.C. § 707(b)(2)(A)(ii)(I):

The debtor's monthly expenses shall be the debtor's applicable monthly expense amounts specified under the National Standards and Local Standards, and the debtor's actual monthly expenses for the categories specified as Other Necessary Expenses issued by the Internal Revenue Service for the area in which the debtor resides, as in effect on the date of the order for relief, for the debtor....[FN2]

The National and Local Standards referenced in 11 U.S.C. § 707(b)(2)(A)(ii)(I) are standards used by the IRS to determine a taxpayer's ability to pay a delinquent tax liability. *In reHaley,* 354 B.R. 340, 342 (Bankr.D.N.H.2006) (citing *In re Fowler,* 349 B.R. 414, 416-417 (Bankr.D.Del.2006)). The Local Standards include: (1) an expense for ownership costs based on the number of vehicles owned by the taxpayer and (2) an expense for operating costs based on the number of vehicles owned by the taxpayer and the taxpayer's location. *In re Haley,* 354 B.R. at 342-43 (citing *In re Fowler,* 349 B.R. at 416-417). The issue raised in the case at bar regards only the Debtors' allowable ownership costs.

Two bankruptcy courts in the Eighth Circuit have directly considered this issue and reached opposite results. *See In re McGuire,* 342 B.R. 608, 613 (Bankr.W.D.Mo.2006) (disallowing Standard expense unless debtor actually has a vehicle expense); *In re Hartwick,* 352 B.R. 867, 869 (Bankr.D.Minn.2006)(ruling BAPCPA mandates that debtors use the higher of the Local Standard expense or the actual expense and the rule does not change if the actual expense is zero).*See also In re Skaggs,* 349 B.R. 594, 600 (Bankr.E.D.Mo.2006) (stating in dicta that a debtor is allowed either the Local Standard expense or the amount the debtor actually spends).

A number of cases are consistent with *In re McGuire* and hold that a debtor must have an existing vehicle payment or ownership expense in order to be eligible for the standard deduction. *See In re Wiggs,* No. 06 B 70203, 2006 WL 2246432 (Bankr.N.D.Ill. Aug.4, 2006)(the vehicle ownership expense is not allowed as it is not "applicable" to the debtor because there is no expense incurred for the purchase or lease of the vehicle); *In re Hardacre,* 338 B.R. 718 (Bankr.N.D.Tex.2006) (based on the Collection Financial Standards, Local Standards do not permit a debtor to claim an ownership deduction for a vehicle owned free and clear by the debtor).*See also In re Howell,* 366 B.R. 153 (Bankr.D.Kan.2007); *In re Ceasar,* 364 B.R. 257 (Bankr.W.D.La.2007); *In re Slusher,* 359 B.R. 290 (Bankr.D.Nev.2007); *In re Devilliers,* 358 B.R. 849 (Bankr.E.D.La.2007); *In re Harris,* 353 B.R. 304 (Bankr.E.D.Okla.2006); *In re Carlin,* 348 B.R. 795 (Bankr.D.Or.2006); *In re Oliver,* 350 B.R. 294 (Bankr.W.D.Tex.2006); *In re Barraza,* 346 B.R. 724 (Bankr.N.D.Tex.2006); *In re Lara,* 347 B.R. 198 (Bankr.N.D.Tex.2006).*Cf. In re Demonica,* 345 B.R. 895 (Bankr.N.D.Ill.2006)(finding *McGuire* reasoning persuasive, and while the debtor did not own or lease the vehicle, the debtor did make monthly payments for a vehicle owned by the non-debtor spouse and so was allowed the deduction).

However, many other cases construe the applicable statute consistent with Judge O'Brien's opinion in *In re Hartwick* and allow the standard vehicle ownership expense whether or not the debtor has an actual vehicle ownership expense.[FN3]*See In re Grunert,* 353 B.R. 591 (Bankr.E.D.Wis.2006) (allowing standard deduction even if debtor has no vehicle payment by following plain meaning of the statute by comparing the use of "actual" and "applicable" and legislative history); *In re Haley,* 354 B.R. 340 (Bankr.D.N.H.2006) (opining that Bankruptcy Code and IRS use ownership expense for different purposes; section 707(b) uses IRS standard not as a cap but as a fixed allowance; therefore, debtor may use standard deduction for vehicle ownership expense even though debtor owes no car payment); *In re Fowler,* 349 B.R. 414 (Bankr.D.Del.2006) (stating that according to the plain language of section 707(b)(2)(A)(ii)(I) the debtor's monthly expense shall be a fixed amount specified under the Local Standards; there is no reference in that language to use of Local Standards as a cap).*See also In re Lynch,* 368 B.R. 487 (Bankr.E.D.Va.2007); *In re Chamberlain,* 369 B.R. 519 (Bankr.D.Ariz.2007); *In re Swan,* 368 B.R. 12 (Bankr.N.D.Cal.2007); *In re Zaporski,* 366 B.R.

758 (Bankr.E.D.Mich.2007); *In re Watson*, 366 B.R. 523 (Bankr.D.Md.2007); *In re Enright*, No. 06-10747, 2007 WL 748432 (Bankr.M.D.N.C. March 6, 2007); *In re Crews*, Nos. 06-13117, 06-15255, 2007 WL 626041 (Bankr.N.D.Ohio Feb.23, 2007); *In re Sawdy*, 362 B.R. 898 (Bankr.E.D.Wis.2007); *In re Zak*, 361 B.R. 481 (Bankr.N.D.Ohio 2007); *In re Wilson*, 356 B.R. 114 (Bankr.D.Del.2006); *In re Prince*, No. 06-10328C-7G, 2006 WL 3501281 (Bankr.M.D.N.C. Nov.30, 2006); *In re Naslund*, 359 B.R. 781 (Bankr.D.Mont.2006); *In re McIvor*, No. 06-42566, 2006 WL 3949172 (E.D.Mich. Nov. 15, 2006).*Cf.* *In re Farrar-Johnson*, 353 B.R. 224 (Bankr.N.D.Ill.2006) (Congress drew a distinction when using "actual" to qualify other necessary expenses and "applicable" to qualify monthly expenses under the National and Local Standards; therefore, the debtor may claim a housing expense on Form B22C even if he has no housing expense).

The United States Trustee's publication dealing with the allowable expenses for transportation does not address the methodology of applying the Local Standards.[FN4]The IRS web site containing the allowable expenses for transportation states the following:

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The Form B22C attempts to follow the language of 11 U.S.C. § 707(b). If the form is filled out correctly the debtor is always allowed at least the standard ownership cost regardless of the existence of or the amount of an actual automobile expense payment.[FN6]According to Collier's, "[t]he better view is that ... the ownership allowance specified in the standards is the minimum amount to be deducted for the expense of car ownership rather than the remaining car payments on a vehicle, if any...." 6 Collier's on Bankruptcy, ¶ 707.05[2][c][I] at 707-44 (Alan N. Resnick and Henry J. Sommers et. al. eds., 15th ed. rev.2006). A document not referred to by the Bankruptcy Code, called the Internal Revenue Manual (IRM), purports to give instructions on how the transportation expenses are to be applied.[FN7]The IRS treats the standard operating cost as the maximum a delinquent taxpayer may claim. According to the IRM, "[t]axpayers will be allowed the local standard or the amount actually paid, whichever is less."The Internal Revenue Manual § 5.15.1.7(4). The IRM also provides that "[i]f a taxpayer has no car payment only the operating cost portion of the transportation standard is used to figure the allowable transportation expense."The Internal Revenue Manual § 5.15.1.7(4)(B). As one court observed, "[p]art of the problem in resolving this issue lies in the level of informality of the standards; they are not statutory, nor are they promulgated by regulation.... They are part of an internal administrative process used to help determine a taxpayer's ability to pay a delinquent tax liability."*In re Slusher*, 359 B.R. 290, 307 (Bankr.D.Nev.2007).

Judge O'Brien explained:

The IRS directive has no application to determining the debtor's applicable expense amounts specified under the ... Local Standards as part of the means test. IRS use of the Local Standards [for collecting delinquent taxes] is the opposite of that mandated by BAPCPA [Form B22C and 707(b)(2)(A)(ii)(I)], that is the applicable IRS allowed amount is either the Standard amount or actual amount, whichever is lower.

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Of course, the IRS directives reflect IRS policy to disallow any Standard amount where the actual expense is 0. How could they instruct otherwise?

In re Hartwick, 352 B.R. 867, 869 (Bankr.D.Minn.2006).The Honorable Eugene R. Wedoff commented on this issue as follows:

[T]here is a question of whether an ownership expense may be claimed by a debtor who owns a car free of any lien. The language quoted from the IRM states that if the debtor makes no car payments, the ownership expense amount may not be claimed. Indeed, this result follows necessarily from the IRM's treatment of the Local Standards as caps on actual expenditures: if a taxpayer has no car payments, the taxpayer obviously cannot claim a Local Standard amount intended to cap actual car payment expenses. However, since the means test treats the Local Standards not as caps but as fixed allowances, it is more reasonable to permit a debtor to claim the Local Standards ownership expense based on the number of vehicles the debtor owns or leases, rather than on the number for which the debtor makes payments. This approach reflects the reality that a car for which the debtor no longer makes payments may soon need to be replaced (so that the debtor will actually have ownership expenses), and it avoids arbitrary distinctions between debtors who have only a few car payments left at the time of their bankruptcy filing and those who finished making their car payments just before the filing.

Eugene R. Wedoff, *Means Testing in the New § 707(b)*, 79 Am. Bankr.L.J. 231, 257-258 (Spring 2005).

This issue was also discussed by Judge Lundin. He opined:

When is a Chapter 13 debtor entitled to "ownership costs" as part of allowable living expenses for transportation under the Local Standards issued by the IRS? If the debtor owns one car, the statute can be interpreted to allow the debtor the National Ownership Cost Allowance for a first car ($475). The statute does not require the debtor to have a car payment to have ownership costs. If the debtor owns one car, the debtor gets the $475 per month ownership cost allowance without regard to the existence or amount of debt associated with that ownership.

The drafters of Official Form B22C accept the position at Lines 27, 28 and 29 that the debtor gets ownership costs under the Local Standards for Transportation for each vehicle for which the debtor has a "claim" of "ownership/lease expense." Consistent with the IRS Local Standards for Transportation, the debtor can claim an ownership/lease expense for up to two vehicles.

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The statute does not link or condition a Chapter 13 debtor's entitlement to ownership costs to debt or any particular amount of debt secured by the car. To do so would make no economic sense either. Imagine a debtor who owns a car that is fully paid for. If a car payment or car debt is a predicate to the ownership costs component of the Local Standards for Transportation, then this debtor would not be entitled to the $475-per-month first-car allowance by the IRS. An identical debtor who has the good sense to borrow $100 or $500 before the petition and grant a security interest in the car would be entitled to almost the entire $475-per-month allowance notwithstanding the complete absence of economic reality. More reasonably, "ownership costs" are allowed if the Chapter 13 debtor owns one or more cars without regard to debt secured by a car. This does create the perverse incentive that Chapter 13 debtors should definitely own at least two cars when they file a Chapter 13 petition-any cars will do. A $500 car is worth the same $475-per-month ownership cost as a $15,000 car. This is how the statute is written.

5 Keith M. Lundin, Chapter 13 Bankruptcy § 476.9 (3d ed. 2000 & Supp.2006).

Many courts focus on the word "applicable" contained in 11 U.S.C. § 707(b)(2)(ii)(I). Some of the courts conclude that if the debtor has no vehicle ownership expense then the Local Standards are not "applicable." I respectfully disagree; the word "applicable" must be analyzed in the context of the entire statute. "Applicable" modifies "the monthly expense amounts specified under ... Local Standards."Congress within the same sentence chose to use "actual" to modify "Other Necessary Expenses." As one Judge observed, "Congress drew a distinction in the statute between 'applicable' expenses on the one hand and 'actual' expenses on the other. 'Other Necessary Expenses' must be the debtor's 'actual' expenses. Expenses under the 'Local Standards' in contrast, need only be those 'applicable' to the debtor-because of where he lives or how large his household is. It makes no difference whether he 'actually' has them."*In reFarrar-Johnson*, 353 B.R. 224, 230-231 (Bankr.N.D.Ill.2006). Nothing contained in Form B22C or 11 U.S.C. § 707(b)(2)(A)(ii)(I) requires that the Debtors must have current automobile ownership expense as a prerequisite to claiming the Local Standard deduction amount specified by the IRS. Requiring an existing vehicle payment as a prerequisite to entitlement to the Local Standard deduction amounts to a rewriting of the statute in order for the outcome to make more sense.

In the so-called "good old days" before BAPCPA's enactment, mentioned by Judge Goldgar in *In re Farrar-Johnson,* 353 B.R. 224, 228 (Bankr.N.D.Ill.2006), Bankruptcy Courts would have examined Schedules I and J in this case to determine disposable income and would not have allowed the debtors an expense deduction that did not exist. Congress changed that when they enacted BAPCPA by removing any discretion from the Bankruptcy Court in these matters and creating a mechanical test based in part on hypothetical numbers.

Some would argue, as many cases do, that it makes no sense to allow a vehicle ownership expense according to Local Standards if the debtors have no vehicle payment at all. This has obvious logical appeal. But does it make any more sense if the debtors have a $100.00 vehicle payment, but are still allowed to deduct $471.00 as if that were their vehicle payment? Does it make any sense to allow anything but a debtor's actual expense? Does it make any sense that the gift of non-existent expenses are conferred only on above-median income debtors? FN8

[2] The irony is palpable that Congress' efforts to eliminate perceived abuses in the bankruptcy system by forcing debtors into Chapter 13 also diminishes payments to unsecured creditors by mandating the use of fictitious amounts of income and expenses. However, the task of the Bankruptcy Court is to follow the language of the statute as it was written. See Henry J. Sommer, *Trying to Make Sense Out of Nonsense: Representing Consumers Under the "Bankruptcy Abuse Prevention and Consumer Protection Act of 2005,"* 79 Am. Bankr.L.J. 191 (Spring 2005).

Judge O'Brien's comments in *In re Hartwick* are appropriate. He stated:

> The argument that the statute should be read to disallow the Standard amount where no actual debt exists at filing largely rests on the assertion that such best serves the gatekeeping purposes of 11 U.S.C. § 707(b). But, as discussed below, Congress locked the Courts out of the means test, and judicial discretion has no role in it.
>
> ....
>
> Congress has already determined the fairness of the application of the means test, and a major objective of the legislation was to remove judicial discretion from the process.

[3] I agree with Judge O'Brien's analysis. Therefore, for these reasons the objection to confirmation is overruled.

IT IS SO ORDERED.

FN1. This requirement is technically not applicable unless the Trustee or an unsecured creditor objects to confirmation. *See*11 U.S.C. § 1325(b)(1-3) (2006).

FN2. The Local Standard amounts are found on the internet at www.usdoj.gov/ust/.

FN3. As one Judge observed, there is "a clear trend towards allowing the expense deduction."*In re Lynch,* 368 B.R. 487, 491.This trend is evident in that more of the recent opinions are allowing the deduction regardless of whether the debtor has an actual ownership expense or not.

FN4. See www.usdoj.gov/ust/eo/bapcpa/index.htm.

FN5. See www.irs.gov/businesses/small/article/0,,id=104623,00.html

FN6. See Official Form B22C, question 28.

FN7. See

www.irs.gov/irm/part5/ch15s01.html#d0e182782.

FN8. Debtors whose income is below the state medium income do not use the means test or Form B22C. These debtor's disposable income is determined by reference to Schedules I and J. See 11 U.S.C. § 1325(b)(3); 8 Collier on Bankr.¶ 1325.08[c][ii].

Bkrtcy.W.D.Ark.,2007.
In re Wilson
373 B.R. 638, Bankr. L. Rep. P 80,999

END OF DOCUMENT

IN THE UNITED STATES BANKRUPTCY COURT
EASTERN AND WESTERN DISTRICTS OF ARKANSAS

RE: Gregory A Wilson and Lori A Wilson

CASE NO: 6:06-bk-72193 M
Chapter 13

ORDER CONFIRMING CHAPTER 13 PLAN

The Court finds that the plan as filed by the debtors complies with all provisions of Chapter 13 and with all other provisions of Title 11 of the United States Code; that all fees, charges, or amounts required under Chapter 123 of Title 28 or by the plan, to be paid before confirmation, have been paid; that the plan has been proposed in good faith and not by any means forbidden by law; that the plan complies with Section 1325, of the United States Bankruptcy Code, and that the plan should be confirmed. Therefore,

IT IS ORDERED:

1. That the plan should be and hereby is confirmed. To effectuate the plan, the debtors shall pay to the Trustee according to the plan, which plan shall not exceed 60 months. The payments shall continue until further orders of the Court.

$99.99 Monthly

2. Notwithstanding any plan term to the contrary, the debtor(s) may not obtain a refund or disbursement from the trustee without a court order after notice and hearing.

3. That the administrative expenses and compensation of the Trustee shall be paid in full pursuant to 11 U.S.C. Section 503(b) and Section 1326(b)(2), and that, to effectuate this provision, the Trustee shall receive such percentage fee of plan payments as may be periodically fixed by the Attorney General pursuant to 28 U.S.C. Section 586(e), which percentage fee shall not exceed ten percent (10%) of disbursements.

4. Whenever the plan confirmed by this order refers to the debt, debts, claim or claims of creditors, such reference shall be construed to mean allowed claim or allowed claims. The total amount of an allowed claim shall be the amount stated on a proof of claim properly filed by or on behalf of such creditor, unless the Court determines a different amount following the filing of an objection to such claim.

IT IS SO ORDERED

Date: 07/30/2007

/s/ James G. Mixon

James G. Mixon
U.S. Bankruptcy Judge

IN THE UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF ARKANSAS
HOT SPRINGS DIVISION

IN RE: GREGORY AND LORI WILSON,

Debtors.

CASE NO. 6:06-bk-72193M
(CHAPTER 13)

ORDER

On September 29, 2006, Gregory A. Wilson and Lori A. Wilson (Debtors) filed a voluntary petition for relief under the provisions of Chapter 13 of the United States Bankruptcy Code. This case is, therefore, governed by the new provisions contained in the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA).

On November 29, 2006, the Trustee filed a timely objection to confirmation of the Debtors' proposed plan. The objection was based on the Debtors' claim of vehicle ownership expenses on Form B22C for vehicles that the Debtors own free and clear of any liens. A hearing on the Trustee's objection was held in Hot Springs, Arkansas, on April 18, 2007. The parties agreed to submit the matter upon written stipulated facts, exhibits, and briefs. The matter was taken under advisement pending receipt and review of the stipulations and briefs. The matter before the Court is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(L), and the Court has jurisdiction to enter a final judgment in the case.

FACTS

On Schedule B, the Debtors list an ownership interest in two vehicles, a 2002 Ford F150 Truck and a 1999 Toyota 4-Runner sport utility vehicle. (Ex. 1.) Both vehicles are unencumbered by any security interests and the Debtors have no current automobile ownership

EOD 7/30/2007
by L Williams

expense. The Debtors value the 1999 Toyota at $5,000.00 and the 2002 Ford F-150 Truck at $9,325.00. (Ex. 1.)

The Debtors' statement of combined monthly income is $5,968.50. Computed on an annual basis, their income is $71,622.00. (Ex. 2.) The applicable median income for a family of two in the State of Arkansas is $38,438.00. (Ex. 2.) Because the Debtors' annual income is above the median income, they are required by 11 U.S.C. § 1325(b)(3) to compute the amount of disposable income available to pay to unsecured creditors by using the means test provided for in 11 U.S.C. § 707(b)(2).[1] The computation required by 11 U.S.C. § 707(b) is made on official form B22C, which is required by the interim Federal Rules of Bankruptcy Procedure 1007(b)(6), adopted on October 14, 2005 in the Eastern and Western Districts of Arkansas by General Order 25.

The calculations made by the Debtors using Form B22C compute to a negative $370.04 available to pay to unsecured creditors. (Ex. 3.) Among the deductions allowed by Form B22C is a deduction for the ownership expense of two automobiles. (Ex. 3.) The Debtors' first automobile allowance is $471.00 and the allowance for the second automobile is $332.00. (Ex. 3.) If the automobile expenses are not included in the deductions from current monthly income, the result will compute to the sum of $432.96 per month available for distribution to unsecured creditors. The Debtors' plan proposes to pay $100.00 a month for 60 months. (Ex. 2.) After payment of attorney's fees, trustee's fees, and priority claims, this would leave a total of $636.00 for distribution to the allowed claims of general unsecured creditors.

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[1] This requirement is technically not applicable unless the Trustee or an unsecured creditor objects to confirmation. *See* 11 U.S.C. § 1325(b)(1-3) (2006).

ARGUMENT

The Trustee argues that the Debtors may not take the Internal Revenue Service (IRS) Local Standard deduction for vehicle ownership costs if the Debtors have no actual vehicle payment. The Debtors argue that pursuant to BAPCPA Congress created a fixed allowance for vehicle ownership deductions, regardless of whether the Debtors have an actual vehicle payment. Both parties have filed briefs pointing out that the courts considering this issue are hopelessly split.

DISCUSSION

The statute applicable to this issue is 11 U.S.C. § 707(b)(2)(A)(ii)(I):

> The debtor's monthly expenses shall be the debtor's applicable monthly expense amounts specified under the National Standards and Local Standards, and the debtor's actual monthly expenses for the categories specified as Other Necessary Expenses issued by the Internal Revenue Service for the area in which the debtor resides, as in effect on the date of the order for relief, for the debtor . . . .[2]

The National and Local Standards referenced in 11 U.S.C. § 707(b)(2)(A)(ii)(I) are standards used by the IRS to determine a taxpayer's ability to pay a delinquent tax liability. In re Haley, 354 B.R. 340, 342 (Bankr. D. N.H. 2006) (citing In re Fowler, 349 B.R. 414, 416-417 (Bankr. D. Del. 2006)). The Local Standards include: (1) an expense for ownership costs based on the number of vehicles owned by the taxpayer and (2) an expense for operating costs based on the number of vehicles owned by the taxpayer and the taxpayer's location. In re Haley, 354 B.R. at 342-43 (citing In re Fowler, 349 B.R. at 416-417). The issue raised in the case at bar regards only the Debtors' allowable ownership costs.

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[2] The Local Standard amounts are found on the internet at www.usdoj.gov/ust/.

Two bankruptcy courts in the Eighth Circuit have directly considered this issue and reached opposite results. See In re McGuire, 342 B.R. 608, 613 (Bankr. W.D. Mo. 2006) (disallowing Standard expense unless debtor actually has a vehicle expense); In re Hartwick, 352 B.R. 867, 869 (Bankr. D. Minn. 2006)(ruling BAPCPA mandates that debtors use the higher of the Local Standard expense or the actual expense and the rule does not change if the actual expense is zero). See also In re Skaggs, 349 B.R. 594, 600 (Bankr. E.D. Mo. 2006) (stating in dicta that a debtor is allowed either the Local Standard expense or the amount the debtor actually spends).

A number of cases are consistent with In re McGuire and hold that a debtor must have an existing vehicle payment or ownership expense in order to be eligible for the standard deduction. See In re Wiggs, No. 06 B 70203, 2006 WL 2246432 (Bankr. N.D. Ill. Aug. 4, 2006)(the vehicle ownership expense is not allowed as it is not "applicable" to the debtor because there is no expense incurred for the purchase or lease of the vehicle); In re Hardacre, 338 B.R. 718 (Bankr. N.D. Tex. 2006) (based on the Collection Financial Standards, Local Standards do not permit a debtor to claim an ownership deduction for a vehicle owned free and clear by the debtor). See also In re Howell, No. 06011652, 2007 WL 1237832 (Bankr. D. Kan. April 26, 2007); In re Ceasar, 364 B.R. 257 (Bankr. W.D. La. 2007); In re Slusher, 359 B.R. 290 (Bankr. D. Nev. 2007); In re Devilliers, 358 B.R. 849 (Bankr. E.D. La. 2007); In re Harris, 353 B.R. 304 (Bankr. E.D. Okla. 2006); In re Carlin, 348 B.R. 795 (Bankr. D. Or. 2006); In re Oliver, 350 B.R. 294 (Bankr. W.D. Tex. 2006); In re Barraza, 346 B.R. 724 (Bankr. N.D. Tex. 2006); In re Lara, 347 B.R. 198 (Bankr. N.D. Tex. 2006). Cf. In re Demonica, 345 B.R. 895 (Bankr. N.D. Ill. 2006)(finding McGuire reasoning persuasive, and while the debtor did not own or lease the vehicle, the debtor did make monthly payments for a vehicle owned by the non-debtor spouse and so was allowed the deduction).

However, many other cases construe the applicable statute consistent with Judge O'Brien's opinion in In re Hartwick and allow the standard vehicle ownership expense whether or not the debtor has an actual vehicle ownership expense.[3] See In re Grunert, 353 B.R. 591 (Bankr. E.D. Wis. 2006) (allowing standard deduction even if debtor has no vehicle payment by following plain meaning of the statute by comparing the use of "actual" and "applicable" and legislative history); In re Haley, 354 B.R. 340 (Bankr. D. N.H. 2006) (opining that Bankruptcy Code and IRS use ownership expense for different purposes; section 707(b) uses IRS standard not as a cap but as a fixed allowance; therefore, debtor may use standard deduction for vehicle ownership expense even though debtor owes no car payment); In re Fowler, 349 B.R. 414 (Bankr. D. Del. 2006) (stating that according to the plain language of section 707(b)(2)(A)(ii)(I) the debtor's monthly expense shall be a fixed amount specified under the Local Standards; there is no reference in that language to use of Local Standards as a cap). See also In re Lynch, No. 06-33193, 2007 WL 1387987 (Bankr. E.D. Va. May 8, 2007); In re Chamberlain, No. 06-01774, 2007 WL 1355894 (Bankr. D. Ariz. April 26, 2007); In re Swan, No. 06-50708, 2007 WL 1146485 (Bankr. N.D. Cal. April 18, 2007); In re Zaporski, No. 06-51617, 2007 WL 1186032 (Bankr. E.D. Mich. April 17, 2007); In re Watson, Nos. 06-11948, 2007 WL 1086582 (Bankr. D. Md. April 11, 2007); In re Enright, No. 06-10747, 2007 WL 748432 (Bankr. M.D.N.C. March

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[3] As one Judge observed, there is "a clear trend towards allowing the expense deduction." In re Lynch, 2007 WL 1387987, at *2. This trend is evident in that more of the recent opinions are allowing the deduction regardless of whether the debtor has an actual ownership expense or not.

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The Honorable Eugene R. Wedoff commented on this issue as follows:

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[7] See www.irs.gov/irm/part5/ch15s01.html#d0e182782.

> [T]here is a question of whether an ownership expense may be claimed by a debtor who owns a car free of any lien. The language quoted from the IRM states that if the debtor makes no car payments, the ownership expense amount may not be claimed. Indeed, this result follows necessarily from the IRM's treatment of the Local Standards as caps on actual expenditures: if a taxpayer has no car payments, the taxpayer obviously cannot claim a Local Standard amount intended to cap actual car payment expenses. However, since the means test treats the Local Standards not as caps but as fixed allowances, it is more reasonable to permit a debtor to claim the Local Standards ownership expense based on the number of vehicles the debtor owns or leases, rather than on the number for which the debtor makes payments. This approach reflects the reality that a car for which the debtor no longer makes payments may soon need to be replaced (so that the debtor will actually have ownership expenses), and it avoids arbitrary distinctions between debtors who have only a few car payments left at the time of their bankruptcy filing and those who finished making their car payments just before the filing.

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Many courts focus on the word "applicable" contained in 11 U.S.C. § 707(b)(2)(ii)(I). Some of the courts conclude that if the debtor has no vehicle ownership expense then the Local Standards are not "applicable." I respectfully disagree; the word "applicable" must be analyzed in the context of the entire statute. "Applicable" modifies "the monthly expense amounts specified under . . . Local Standards." Congress within the same sentence chose to use "actual" to modify "Other Necessary Expenses." As one Judge observed, "Congress drew a distinction in the statute between 'applicable' expenses on the one hand and 'actual' expenses on the other. 'Other Necessary Expenses' must be the debtor's 'actual' expenses. Expenses under the 'Local Standards' in contrast, need only be those 'applicable' to the debtor-because of where he lives or how large his household is. It makes no difference whether he 'actually' has them." In re Farrar-Johnson, 353 B.R. 224, 230-231 (Bankr. N. D. Ill. 2006). Nothing contained in Form B22C or 11 U.S.C. § 707(b)(2)(A)(ii)(I) requires that the Debtors must have current automobile ownership expense as a prerequisite to claiming the Local Standard deduction amount specified by the IRS. Requiring an existing vehicle payment as a prerequisite to entitlement to the Local Standard deduction amounts to a rewriting of the statute in order for the outcome to make more sense.

In the so-called "good old days" before BAPCPA's enactment, mentioned by Judge Goldgar in In re Farrar-Johnson, 353 B.R. 225, 228 (Bankr. N.D. Ill. 2006), Bankruptcy Courts would have examined Schedules I and J in this case to determine disposable income and would not have allowed the debtors an expense deduction that did not exist. Congress changed that when they enacted BAPCPA by removing any discretion from the Bankruptcy Court in these matters and creating a mechanical test based in part on hypothetical numbers.

Some would argue, as many cases do, that it makes no sense to allow a vehicle ownership expense according to Local Standards if the debtors have no vehicle payment at all. This has obvious logical appeal. But does it make any more sense if the debtors have a $100.00 vehicle payment, but are still allowed to deduct $471.00 as if that were their vehicle payment? Does it make any sense to allow anything but a debtor's actual expense? Does it make any sense that the gift of non-existent expenses are conferred only on above-median income debtors? [8]

The irony is palpable that Congress' efforts to eliminate perceived abuses in the bankruptcy system by forcing debtors into Chapter 13 also diminishes payments to unsecured creditors by mandating the use of fictitious amounts of income and expenses. However, the task of the Bankruptcy Court is to follow the language of the statute as it was written. See Henry J. Sommer, Trying to Make Sense Out of Nonsense: Representing Consumers Under the "Bankruptcy Abuse Prevention and Consumer Protection Act of 2005," 79 Am. Bankr. L. J. 191

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[8] Debtors whose income is below the state medium income do not use the means test or Form B22C. These debtor's disposable income is determined by reference to Schedules I and J. See 11 U.S.C. § 1325(b)(3); 8 Collier on Bankr. ¶ 1325.08[c][ii].

(Spring 2005).

Judge O'Brien's comments in In re Hartwick are appropriate. He stated:

> The argument that the statute should be read to disallow the Standard amount where no actual debt exists at filing largely rests on the assertion that such best serves the gatekeeping purposes of 11 U.S.C. § 707(b). But, as discussed below, Congress locked the Courts out of the means test, and judicial discretion has no role in it.
>
> . . . .
>
> Congress has already determined the fairness of the application of the means test, and a major objective of the legislation was to remove judicial discretion from the process.

I agree with Judge O'Brien's analysis. Therefore, for these reasons the objection to confirmation is overruled.

IT IS SO ORDERED.

James G. Mixon

U.S. BANKRUPTCY JUDGE

DATE: 7/30/07

cc: Joyce Babin, Chapter 13 Trustee
Sherry Daves, Esq.
Debtors

Means Testing Desktop Reference

(Cases Filed Between February 13, 2006 and September 30, 2006, Inclusive)

Region: 13
Field Office: Little Rock, Arkansas

Census Median Income Figures

State: Arkansas

STATE	1 EARNER	FAMILY SIZE		
		2 PEOPLE	3 PEOPLE	4 PEOPLE *
ARKANSAS	$29,930	$38,438	$42,629	$51,478

** Add $6,300 for each individual in excess of 4.*

IRS National Standards for Allowable Living Expenses

One Person National Standards
Based on Gross Monthly Income

Item	**less than $833**	**$833 to $1,249**	**$1,250 to $1,666**	**$1,667 to $2,499**	**$2,500 to $3,333**	**$3,334 to $4,166**	**$4,167 to $5,833**	**$5,834 and over**
Food	175	203	232	257	292	333	373	483
Housekeeping supplies	18	24	30	31	32	33	34	49
Apparel & services	47	48	62	68	89	104	140	217
Personal care products & services	17	24	27	32	33	41	46	57
Miscellaneous	110	110	110	110	110	110	110	110

Total	**$367**	**$409**	**$461**	**$498**	**$556**	**$621**	**$703**	**$916**
Bankruptcy Allowable Living Expenses – National Standards (See 11 U.S.C. § 707(b)(2)(A)(ii)(I))								
Food & Clothing (Apparel & services)*	222	251	294	325	381	437	513	700
5% of Food & Clothing	**11**	**13**	**15**	**16**	**19**	**22**	**26**	**35**

Two Persons National Standards
Based on Gross Monthly Income

Item	**less than $833**	**$833 to $1,249**	**$1,250 to $1,666**	**$1,667 to $2,499**	**$2,500 to $3,333**	**$3,334 to $4,166**	**$4,167 to $5,833**	**$5,834 and over**
Food	305	306	322	368	418	460	514	723
Housekeeping supplies	27	33	42	43	50	51	55	85
Apparel & services	83	91	92	93	98	126	141	277
Personal care products & services	25	27	33	37	40	50	56	83
Miscellaneous	138	138	138	138	138	138	138	138
Total	**$578**	**$595**	**$627**	**$679**	**$744**	**$825**	**$904**	**$1,306**
Bankruptcy Allowable Living Expenses – National Standards (See 11 U.S.C. § 707(b)(2)(A)(ii)(I))								
Food & Clothing (Apparel & services)*	388	397	414	461	516	586	655	1000
5% of Food & Clothing	**19**	**20**	**21**	**23**	**26**	**29**	**33**	**50**

Three Persons National Standards
Based on Gross Monthly Income

Item	**less than $833**	**$833 to $1,249**	**$1,250 to $1,666**	**$1,667 to $2,499**	**$2,500 to $3,333**	**$3,334 to $4,166**	**$4,167 to $5,833**	**$5,834 and over**

Food	422	423	424	425	512	513	565	754
Housekeeping supplies	41	42	43	44	51	52	61	86
Apparel & services	143	144	145	146	154	155	168	278
Personal care products & services	30	33	34	38	41	51	57	84
Miscellaneous	166	166	166	166	166	166	166	166
Total	**$802**	**$808**	**$812**	**$819**	**$924**	**$937**	**$1,017**	**$1,368**

Bankruptcy Allowable Living Expenses – National Standards (See 11 U.S.C. § 707(b)(2)(A)(ii)(I))

Food & Clothing (Apparel & services)*	565	567	569	571	666	668	733	1032
5% of Food & Clothing	**28**	**28**	**28**	**29**	**33**	**33**	**37**	**52**

Four Persons National Standards
Based on Gross Monthly Income

Item	**less than $833**	**$833 to $1,249**	**$1,250 to $1,666**	**$1,667 to $2,499**	**$2,500 to $3,333**	**$3,334 to $4,166**	**$4,167 to $5,833**	**$5,834 and over**
Food	433	463	501	502	558	574	685	868
Housekeeping supplies	42	43	44	46	52	53	66	94
Apparel & services	144	145	151	152	190	191	201	302
Personal care products & services	44	46	47	48	49	52	58	89
Miscellaneous	193	193	193	193	193	193	193	193
Total	**$856**	**$890**	**$936**	**$941**	**$1,042**	**$1,063**	**$1,203**	**$1,546**

Bankruptcy Allowable Living Expenses – National Standards (See 11 U.S.C. § 707(b)(2)(A)(ii)(I))

Item	less than $833	$833 to $1,249	$1,250 to $1,666	$1,667 to $2,499	$2,500 to $3,333	$3,334 to $4,166	$4,167 to $5,833	$5,834 and over
Food & Clothing (Apparel & services)*	577	608	652	654	748	765	886	1170
5% of Food & Clothing	**29**	**30**	**33**	**33**	**37**	**38**	**44**	**59**

More than Four Persons National Standards
Based on Gross Monthly Income

Item	less than $833	$833 to $1,249	$1,250 to $1,666	$1,667 to $2,499	$2,500 to $3,333	$3,334 to $4,166	$4,167 to $5,833	$5,834 and over
For each additional person, add to four person total allowance:	**$138**	**$149**	**$160**	**$171**	**$182**	**$193**	**$204**	**$216**
Bankruptcy Allowable Living Expenses – National Standards (See 11 U.S.C. § 707(b)(2)(A)(ii)(I))								
Food & Clothing (Apparel & services)*	$93	$102	$111	$119	$131	$139	$150	$163
5% of Food & Clothing	**5**	**5**	**6**	**6**	**7**	**7**	**8**	**8**

* This total may differ from the combination of the two amounts on the table above due to rounding.

IRS Local Housing and Utilities Expense Standards

State: Arkansas
Field Office: Little Rock

	Family Size and Expense Type					
	1 or 2 Person		3 Person		4 or More Persons	
	Non-Mortgage	Mortgage/ Rent	Non-Mortgage	Mortgage/ Rent	Non-Mortgage	Mortgage/ Rent
Arkansas County	$350	$382	$411	$450	$473	$518
Ashley County	$344	$392	$405	$461	$465	$531
Baxter County	$306	$424	$360	$499	$414	$574
Benton County	$298	$596	$351	$701	$404	$805
Boone County	$306	$447	$360	$525	$414	$604
Bradley County	$336	$314	$395	$370	$455	$424
Calhoun County	$322	$275	$378	$324	$435	$372
Carroll County	$320	$438	$376	$516	$433	$593
Chicot County	$367	$332	$432	$391	$497	$449
Clark County	$326	$446	$384	$524	$442	$602
Clay County	$303	$286	$357	$336	$410	$387
Cleburne County	$325	$485	$382	$571	$439	$656
Cleveland County	$338	$333	$398	$392	$457	$451
Columbia County	$343	$424	$403	$499	$464	$574
Conway County	$324	$413	$381	$486	$438	$559
Craighead County	$304	$525	$358	$617	$412	$710
Crawford County	$293	$459	$344	$540	$396	$621
Crittenden County	$314	$501	$369	$589	$425	$677
Cross County	$346	$444	$407	$523	$468	$601
Dallas County	$321	$309	$377	$364	$434	$418
Desha County	$344	$359	$405	$422	$465	$486
Drew County	$344	$425	$405	$500	$465	$575
Faulkner County	$317	$587	$373	$690	$429	$794
Franklin County	$286	$377	$336	$443	$387	$509
Fulton County	$301	$341	$354	$401	$408	$461
Garland County	$328	$489	$386	$576	$444	$662
Grant County	$350	$434	$411	$511	$473	$587
Greene County	$301	$414	$354	$487	$408	$559
Hempstead County	$315	$359	$370	$423	$426	$486
Hot Spring County	$322	$379	$378	$447	$435	$514
Howard County	$319	$378	$375	$445	$431	$513
Independence County	$319	$406	$375	$478	$431	$551
Izard County	$311	$349	$366	$410	$421	$471
Jackson County	$325	$323	$382	$380	$439	$438
Jefferson County	$351	$414	$413	$487	$474	$561
Johnson County	$285	$375	$335	$441	$385	$507

Lafayette County	$321	$302	$377	$356	$434	$409
Lawrence County	$302	$317	$356	$372	$409	$428
Lee County	$328	$318	$386	$374	$444	$430
Lincoln County	$339	$319	$399	$375	$459	$431
Little River County	$317	$394	$373	$463	$429	$533
Logan County	$291	$360	$342	$424	$393	$488
Lonoke County	$325	$564	$382	$664	$439	$764
Madison County	$284	$371	$334	$436	$384	$502
Marion County	$308	$409	$362	$481	$417	$553
Miller County	$304	$454	$358	$534	$412	$614
Mississippi County	$327	$429	$385	$505	$443	$580
Monroe County	$353	$309	$415	$363	$477	$418
Montgomery County	$315	$321	$370	$379	$426	$435
Nevada County	$321	$319	$377	$376	$434	$432
Newton County	$271	$340	$319	$400	$367	$460
Ouachita County	$325	$366	$383	$429	$440	$494
Perry County	$318	$395	$374	$465	$430	$534
Phillips County	$339	$363	$399	$427	$459	$491
Pike County	$315	$351	$370	$414	$426	$476
Poinsett County	$322	$349	$378	$412	$435	$473
Polk County	$295	$360	$346	$424	$398	$488
Pope County	$309	$450	$364	$529	$418	$609
Prairie County	$354	$370	$416	$436	$478	$502
Pulaski County	$337	$601	$397	$706	$456	$812
Randolph County	$291	$328	$342	$386	$393	$444
Saline County	$334	$587	$393	$691	$452	$794
Scott County	$279	$328	$328	$386	$377	$445
Searcy County	$281	$356	$331	$419	$380	$482
Sebastian County	$297	$495	$350	$582	$402	$670
Sevier County	$296	$349	$349	$410	$401	$472
Sharp County	$294	$330	$345	$389	$397	$447
St. Francis County	$336	$391	$395	$461	$455	$529
Stone County	$309	$377	$364	$443	$418	$510
Union County	$349	$414	$410	$488	$472	$561
Van Buren County	$302	$376	$356	$442	$409	$508
Washington County	$295	$589	$348	$692	$400	$796
White County	$326	$445	$384	$523	$442	$601
Woodruff County	$327	$275	$385	$324	$443	$372
Yell County	$322	$395	$378	$465	$435	$535

IRS Local Transportation* Expense Standards

State: Arkansas
Field Office: Little Rock

All counties covered by the Little Rock Office use the figures below for the South Census Region.

Operating Costs & Public Transportation Costs

(Line 22, Form B22A)
(Line 27, Form B22C)

In order to use the data, you must determine in what Census Bureau region the Debtor's state is located and whether the Debtor's county is located in a MSA. (All counties covered by the Little Rock Office are in the South Census Region.)

Region	No Car	One Car	Two Cars
South Census Region	$203	$260	$343

Ownership Costs

(if Debtor has a vehicle loan or lease payment)
(Lines 23 and 24, Form B22A)
(Lines 28 and 29, Form B22C)

	First Car	Second Car
National	$471	$332

* Does not include personal property taxes.

BRIEF BANK — "SUMMARY SHEET" *Printed Thu-7/23/09 10:34*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*
In re Murray Windman and Pauline Windman (Arthur G. Lawrence v. The United States Trustee, Los Angeles)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*
BAP 9th Cir.

3. ("CCN") ***CURRENT*** CASE NO.
No.: CC-08-1080

4. ("PCN") ***PRIOR*** CASE NO. - & COURT *[IF ANY]*
No.: 2:07-bk-17535 BB
Court: Bankr. C.D. Ca.
(Identify judge & cite, if any)

5. ("SO") ***SOURCE***
U.S. TRUSTEES

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*
Filed: July 20, 2009
Type: Opening Brief for the United States Trustee for Region 16

7. **("AU")** ***PRINCIPAL AUTHORS & OFFICE*** [E.g.,"UST/OGC"]
Kenneth G. Lau, Saleela K. Salahuddin, Catherine B. Sevcenko, P. Matthew Sutko, Jill Sturtevant
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***
• 1) Whether the bankruptcy court had jurisdiction to order reduction of fees in two sequential chapter 11 bankruptcy cases as part of the proceedings in the second case after the first had been closed. 2) Whether the bankruptcy court abused its discretion by ordering a bankruptcy attorney to return fees under 11 U.S.C. § 329(a) because he ignored the procedural requirements under the Bankruptcy Code and provided negligible, if any, benefit to the debtors.

10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)

11. DO YOU RECOMMEND POSTING IN UST BRIEFBANK?
| x | YES | | NO
NAME: Linda Figueroa
DATE:

JILL STURTEVANT, *Assistant U. S. Trustee* (SBN 89395)
KENNETH G. LAU, *Trial Attorney* (SBN 155314)
OFFICE OF THE UNITED STATES TRUSTEE
UNITED STATES DEPARTMENT OF JUSTICE
725 South Figueroa Street, Ste 2600
Los Angeles, California 90017
Telephone: (213) 894-4480
Facsimile: (213) 814-2603

RAMONA D. ELLIOTT, *General Counsel*
P. MATTHEW SUTKO, *Associate General Counsel*
CATHERINE B. SEVCENKO, *Trial Attorney*
SALEELA KHANUM SALAHUDDIN, *Trial Attorney*
United States Department of Justice
Executive Office for United States Trustees
20 Massachusetts Ave, N.W.
Washington, DC 20530

Attorneys for Appellee,
The United States Trustee, PETER C. ANDERSON

UNITED STATES BANKRUPTCY APPELLATE PANEL FOR THE NINTH CIRCUIT

In re MURRAY WINDMAN and PAULINE WINDMAN, Debtors.	Bankr. No. 2:07-bk-17535 BB Chapter 11 Bankruptcy Judge, Sheri Bluebond, presiding
ARTHUR G. LAWRENCE, Appellant, v. THE UNITED STATES TRUSTEE, Los Angeles, Appellee.	BAP No.: CC-08-1080 On Appeal from the United States Bankruptcy Court for the Central District of California

OPENING BRIEF OF APPELLEE,

THE UNITED STATES TRUSTEE FOR REGION 16

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TABLE OF AUTHORITIES

RULES

I.

STATEMENT OF BASIS OF APPELLATE JURISDICTION

Sections 157(b)(1) and (2) of Title 28 of the United States Code confer jurisdiction upon bankruptcy courts to hear and determine all core proceedings under title 11 of the United States Code. The adjudication of a fee reduction motion filed under 11 U.S.C. § 329 of the Bankruptcy Code is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(A).

On March 7, 2007, the bankruptcy court, pursuant to 11 U.S.C. § 329, denied Arthur G. Lawrence, the appellant, $8,850.00 of the $12,928.00 in legal fees he received from his former clients, Pauline and Murray Windman (the "debtors"). This was a final order over which this Court has jurisdiction. 28 U.S.C. § 158(a)(1), (c)(1)(B).

II.

STATEMENT OF ISSUES PRESENTED

1. Whether the bankruptcy court had jurisdiction to order reduction of fees in two sequential chapter 11 bankruptcy cases as part of the proceedings in the second case after the first had been closed.

2. Whether the bankruptcy court abused its discretion by ordering a bankruptcy attorney to return fees under 11 U.S.C. § 329(a) because he ignored the procedural requirements under the Bankruptcy Code and provided negligible, if any, benefit to the debtors.

III.

STATEMENT OF THE CASE

This is a fee reduction case. On June 22, 2007, Murray Windman, aged 94, and his wife Pauline Windman, aged 88, filed a chapter 11 bankruptcy petition (*Windman I*) under the guidance of their then-attorney, Arthur G. Lawrence. The bankruptcy court dismissed this case on August 10, 2007, because the debtors had failed to obtain pre-petition credit counseling. Nineteen days later, on August 29, 2007, Mr. Lawrence filed a second chapter 11 petition (*Windman II*) on their behalf, submitting the same inaccurate schedules that he submitted in *Windman I*. Mr. Lawrence was suspended from the practice of law 20 days later for failing to pass the Multistate Professional Responsibility Exam. The California State Bar had ordered him to take the test as part of a stipulated six-month suspension for appropriating client funds, including a $5,000 settlement for a homeless woman. The court dismissed *Windman II* on November 1, 200,7 with a 180-day refiling bar and a finding of bad faith after the debtors' new attorney acknowledged that they had filed for chapter 11 protection to gain respite in a state court dispute over a real estate deal.

Mr. Lawrence nevertheless requested compensation from the court in *Windman II*, prompting the United States Trustee to file a motion under 11 U.S.C. § 329 for reduction of fees. After two hearings, Mr. Lawrence failed to produce credible evidence of the nature and timing of the services he provided his clients, or of the compensation he had received. The court awarded him $1,000 for each of the two chapter 11 cases and ordered him to return $8,850.

Mr. Lawrence has appealed to this Court on two grounds: first, that the bankruptcy court did not have jurisdiction to order a reduction in fees; and second, that the bankruptcy court abused its discretion in awarding him $2,000 for a representation that produced two dismissed chapter 11 petitions and a finding of bad faith for his clients.

IV.

RELEVANT FACTS

The debtors in this case are an elderly couple. Murray Windman, 94, has severe mobility problems, and Pauline, 88, has seriously impaired vision. (E.R.,[1] D, p. 19, ll. 1-7.) The appellant, Arthur G. Lawrence, represented them between June and November 2007, when he filed two consecutive chapter 11 bankruptcy cases on their behalf. (E.R., D, pp. 13-17.) The first chapter 11 bankruptcy case, Case No. 2:07- bk-15236 BB ("*Windman I*") was dismissed on August 10, 2007, principally because the debtors failed to obtain pre-petition credit counseling. (E.R., C, pp. 11-12.) Mr. Lawrence filed the second chapter 11 case, Case No. 2:07-bk-17535 BB ("*Windman II*") on August 29, 2007. (E.R., D, 13-17.) On September 18, 2007, the State Bar of California suspended Mr. Lawrence from practicing law because he failed the Multistate Professional Responsibility Examination. (A.E.R., 7, p. 129, ¶ 28.) He had been required to take the test as part of a stipulated disciplinary action for, among other things, misappropriating client funds, including a $5,000 settlement intended to benefit a homeless woman, whose name Mr. Lawrence cannot recall. (A.E.R., 1, p. 33.) Mr. Lawrence charged the debtors $600 for traveling to their home to inform them of his newest suspension. (A.E.R., 7, p. 136; 11, p. 175, ll. 12-24.)

The debtors paid for the professional assistance of Mr. Lawrence in their chapter 11 cases, even though he did not file an application under 11 U.S.C. § 327(a) to be employed as debtors' attorney in either *Windman I* or *Windman II*. (A.E.R., 11, p. 171, ll. 11-24.) In both bankruptcy cases, Mr. Lawrence failed to help ensure his clients complied with basic requirements of the Bankruptcy Code, and he submitted inaccurate and incomplete schedules in both *Windman* I and *Windman* II. (E.R., G, p. 43, ll.3-10, p. 44, ll.7-25, p. 45, ll.1-19, and p. 48, ll.5-19;

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[1] "E.R." refers to the 'Appellant's Appendix of Exhibits' and is followed by a reference to a lettered exhibit and then, as appropriate, by page number(s) therein. "A.E.R." refers to the 'Appellee's Appendix of Exhibits' and is likewise followed by a reference to a numbered exhibit and then, as appropriate, by page number(s) therein.

A.E.R., pp.14-15, ll. 16-26 and 1-22; 10, p. 195-196, ll. 15-24 and ll. 1-20.)   After he was suspended from practice, the debtors hired another attorney, but Mr. Lawrence tried to remain on the case, styling himself a "business advisor." (E.R., 11, p. 171, l. 21).

The new attorney, Lorraine Howell, worked with the debtors and the United States Trustee to identify, and correct, all the mistakes in the debtors' schedules. (A.E.R., 9, pp. 156-158.) Ms. Howell explained to the court that the debtors had filed bankruptcy primarily "for the purpose of having a place to breath[e] and to reorganize their matters because they found themselves in a real property dispute among family members in the California Superior Court." (E.R., D, p. 19, ll. 8-12.) The material deficiencies in the debtors' filings, and the admission that the purpose of declaring bankruptcy was related to state court litigation rather than financial distress, led to the United States Trustee's motion to dismiss *Windman II* pursuant to 11 U.S.C. § 1112(b) and § 109(g). (E.R., D, pp. 13-28; A.E.R., 1, pp. 1-38; 10, pp. 199-200.)

After the hearing on the motion to dismiss, the bankruptcy court found that the same errors that appeared in the debtors' schedules in *Windman I* remained unremedied or tardily-corrected in debtors' schedules. (E.R., D, pp. 13-28; E.R., E, pp. 29-31; A.E.R., 2, pp. 39-41; 11, pp.171, 176-177, 195.) The bankruptcy court also found that Mr. Lawrence had poorly served his clients by repeatedly failing to seek or obtain court approval for his employment, in violation of 11 U.S.C. § 327(a). (E.R., D, pp. 13-28 and E, pp. 29-31; A.E.R., 2, pp. 39-41; 11, pp.171, 176-177, 195.)

Based on this evidence, the bankruptcy court dismissed *Windman II* with a 180-day refiling bar, in part because of the "admitted fact that the sole purpose of the instant filing was to gain leverage or other advantage with state court litigation regarding the partition of real property and not to resolve any other financial difficulties." (E.R., E, pp. 29, ll. 24-28.) The court found that the petitions had been filed in bad faith and ordered the debtors and Mr. Lawrence to reimburse counsel in the state court litigation for the costs associated with challenging their chapter 11 filing. (A.E.R., 2, p. 39.) Finally, the order retained jurisdiction to adjudicate the merits of a separate motion under 11 U.S.C. § 329 seeking reduction of fees paid to Mr. Lawrence. (E.R., E, pp. 30, ll. 4-8.) Neither the debtors nor Mr. Lawrence appealed that order.

The United States Trustee then filed his motion to reduce fees, pursuant to 11 U.S.C. § 329. (E.R., G, pp. 41-50.) When he filed *Windman II*, Mr. Lawrence requested a $10,000 retainer. (A.E.R., 12, p. 213-214.) The United States Trustee's fee reduction motion alleged that the debtors relied upon Mr. Lawrence to complete and file their schedules and guide them through chapter 11. (E.R., G, pp. 48-49.) The United States Trustee also alleged that Mr. Lawrence, despite collecting $12,928.00 in fees – of which $2,078 was attributed to paying the filing fees in *Windman I* and *Windman II* – filed the same error-filled petition in both bankruptcy cases. (A.E.R., 5, pp. 90-94; 6, pp. 100-109; 7, pp.125-131, 8, pp. 140-141; 9, pp. 156-157; 10, pp. 161-165; 11, pp. 170-173.) The United States Trustee also alleged that Mr. Lawrence's bar suspension, which occurred on September 18, 2007, required the debtors to hire and pay for another attorney, but Mr. Lawrence improperly continued to provide services to the debtors – including attending the 11 U.S.C. § 341(a) meeting of creditors along with the debtors' second attorney – and bill himself as "Business Counselor." (A.E.R, 9, p. 147 and pp. 156-157; 10, pp. 161-165; 11, pp. 176-178, 184-185.)

At the hearing on February 7, 2008, the court made a tentative ruling that it would order return of the $10,000 retainer, which it found excessive for the 20 days Mr. Lawrence was involved in *Windman II* before he was suspended for failing the Multistate Professional Responsibility Exam. (A.E.R., 5, p. 108.)

The court's tentative ruling prompted Mr. Lawrence to remember that he had received most of his compensation during the course of *Windman I*.

> **Mr. Lawrence:** Statement in there that I paid, uh, I was paid a retainer of $10,000, uh, for the filing of the second chapter bankruptcy work is error. That has to be amended, and I have to apologize for that mistake.
>
> **Court:** Wait, so the 10,000 was for both cases?
>
> **Mr. Lawrence:** The $10,000 were the monies that I received from the very beginning, which was on or about June 22, June 21, um, roughly nine weeks before that. And I'm not going to refer to the bill or the dates or the amounts because the Court doesn't have the benefit of, um, seeing it.

(A.E.R., 6, p. 108, ll. 1-11.)

Based on the confusion arising from Mr. Lawrence's new recollections, the court granted a continuance for Mr. Lawrence to submit further documentation to the court. On February 26, 2008, Mr. Lawrence submitted a disclosure of compensation that stated he had received $2,139.50 for compensation in *Windman II*. (A.E.R., 9, p 147.) He failed to submit any evidence substantiating his fee claims except for a billing statement that was created between the two February hearings. (A.E.R., 11, p. 174.) The only contemporary record of payment was a handwritten note put together by the debtors' bookkeeper. (E.R., I, p. 56.)

On February 28, 2008, the bankruptcy court found that Mr. Lawrence, whether acting as the debtors' attorney, or in some other professional capacity, failed to provide advice or services to his clients reasonably valued at the amount he charged them, and this conduct violated 11 U.S.C. § 329. (A.E.R., 11, p. 200. ll. 4-19, pp. 201-202, ll. 7-24 and ll.1-12.) The court limited Mr. Lawrence's aggregate compensation for both cases to $2,000, which was "more than 13 hours worth of services that I'm saying you should be compensated for, but no more because the services that were rendered were really substandard in this case." (A.E.R., 10, p. 200, ll. 16-19.)

Excluding filing fees, the amount of the court-approved compensation was approximately $8,000 less than Mr. Lawrence had received from his clients, and he was ordered to refund the excess. The court also ordered Mr. Lawrence to pay

$8,850 to the counsel of the debtors' opponents in the state court litigation in partial satisfaction of the award given in light of the finding of a bad faith filing. (A.E.R., 10, p. 203; 11, pp. 202-204; E.R., H, pp. 51-52.) The finding of bad faith was ultimately expunged by agreement of the parties, but the debtors and Mr. Lawrence remained liable for attorney fees. (E.R., J, p. 57-59.)

V.

APPLICABLE STANDARD OF REVIEW

The question whether the bankruptcy court had jurisdiction to reduce Mr. Lawrence's fees in the *Windman* cases is a question of law that is reviewed *de novo*; any factual findings are reviewed for clear error. *In re Ferrell*, 539 F.3d 1186, 1189 (9th Cir. 2008). A bankruptcy court's reduction of attorney's fees is reviewed for abuse of discretion. *In re Mednet*, 251 B.R. 103, 106 (9th Cir. B.A.P 2000). A court abuses its discretion when the record contains no evidence to support its decision. *MGIC Indemnity Corp. v. Moore*, 952 F.2d 1120, 1122 (9th Cir. 1991). Findings are reviewed under the clearly erroneous standard. Fed. R. Bankr. P. 8013.

VI.

SUMMARY OF ARGUMENT

The bankruptcy court had jurisdiction over the United States Trustee's motion to reduce fees in *Windman II*. Although less certain, precedent from various circuits, including the Ninth Circuit, support the conclusion that the court had jurisdiction to reduce *Windman I* fees in the *Windman II* case. That is so because all the parties were the same in both cases, and Mr. Lawrence put his *Windman I* fees at issue in *Windman II*.

As part of *Windman II*, Mr. Lawrence requested the court approve a retainer of $10,000. In February 2008, six months after filing his request, Mr. Lawrence informed the court that he remembered he actually had earned only $2,139.50 in *Windman II*, and received the balance while *Windman I* was pending. After two hearings, the court allowed Mr. Lawrence to keep $1,000 for each case and to pay $8,850 towards the attorney fees that the debtors owed to the lawyer in their state court proceedings as a result of the finding that they had filed for chapter 11 protection in bad faith.

No serious argument can be made that the court did not have jurisdiction over the fee-reduction motion in *Windman II*. The court had full authority under 11 U.S.C. § 329 to limit Mr. Lawrence's compensation in that case to $1,000.

Under Ninth Circuit precedent, it appears that the court could also reduce the fees Mr. Lawrence received during *Windman I*. A bankruptcy court retains jurisdiction over a dismissed case in order to monitor post-dismissal activities such as authorization of attorney fees. Section 1334 of Title 28 of the United States Code also gives a bankruptcy court general jurisdiction over matters arising under Title 11. This authority arguably could include adjudication of fee disputes after a case has been closed. Accordingly, when the court ruled on the United States Trustee's motion to reduce fees, it apparently acted within its jurisdiction.

The bankruptcy court did not abuse its discretion when it reduced Mr. Lawrence's fees. He failed to inform his elderly clients that they needed credit counseling before filing *Windman I*, prompting its dismissal. The schedules he submitted on the debtors' behalf were substandard. Mr. Lawrence was suspended from the practice of law 20 days after filing *Windman II*. He charged his clients $600 – two hours for travel and two hours of meeting time – to inform them he had failed the MPRE and was temporarily unable to practice law.

The bankruptcy court's finding that Mr. Lawrence did not provide value to the debtors should be affirmed.

VII.

ARGUMENT

A. THE BANKRUPTCY COURT RETAINED JURISDICTION TO REVIEW AND REDUCE MR. LAWRENCE'S FEES.

The jurisdictional issue in this case has two components: the court's authority to order reduction of *Windman I* fees in *Windman II*, and its authority to order the same in *Windman II*. As a starting point, the court's authority to reduce Mr. Lawrence's *Windman II* fees under 11 U.S.C. § 329 in *Windman II* is incontrovertible.

When Mr. Lawrence filed *Windman II* on behalf of the debtors, he invoked the jurisdiction of the court to provide bankruptcy protection. 11 U.S.C. § 301. The case was assigned to Judge Sheri Bluebond, the same judge who had presided over *Windman I*. (A.E.R., 1, p.6.) Accordingly, the court had jurisdiction over the case and to ensure compliance with the precise set of procedures that an attorney must complete in order to be compensated from a bankruptcy estate, including approving appointment of debtor's counsel, pursuant to 11 U.S.C. § 327, and authorization of payment upon submission of detailed billing records and justification for services rendered, pursuant to 11 U.S.C. § 329(a). It also had the power to find that a fee requested "exceeds the reasonable value of any such services, [and to] . . . order the return of such payment, to the extent excessive to" either the estate or the entity that made the payment. 11 U.S.C. 329(b). By Mr. Lawrence's own admission, he earned $2,139.50 in *Windman II* and requested authorization from the court to keep those funds. (A.E.R., 9, p. 147.) The court allowed him to keep $1,000 for his work in *Windman II*. (A.E.R., 10, p. 179, ll. 21-24.) It had full jurisdiction to order him to return the remaining fees.

The more novel issue is whether the bankruptcy court had jurisdiction to order Mr. Lawrence to keep $1,000 for his services in *Windman I* and return the rest. As a preliminary matter, disciplinary proceedings, including disgorgement of fees, are core proceedings. *Cf. In re Henderson*, 360 B.R. 477, 483-84 (Bankr. D. S.C. 2006) (citing *In re Lehtinen*, 332 B.R. 404 (9th Cir. BAP 2005), *aff'd* 564 F.3d 1052 (9th Cir. 2008)); (A.E.R., 10, p. 201, ll. 17-22.) Therefore, the bankruptcy court had jurisdiction as a general matter to reduce Mr. Lawrence's fees based on his lack of competence and failure to follow the Bankruptcy Rules.

The specific issue is whether the court had authority to order Mr. Lawrence to return fees earned in connection with *Windman I* in its order in *Windman II*. The parties in *Windman I* and *II* were identical, and the same bankruptcy judge presided over both cases. Therefore, there is no concern that one judge interfered with the docket of a fellow-judge. *Windman I* was the judge's case. If the judge retained jurisdiction over it, then the judge could properly adjudicate the fee issue. *Cf. Snell v. Cleveland, Inc.*, 316 F.3d 822 (9th Cir. 2002) (holding that judge erred in vacating judgment in an earlier action before another judge upon determining that diversity jurisdiction had not been adequately proven in the first case).

Windman I was dismissed on August 10, 2007, and closed on August 29, 2008. Defining a bankruptcy court's jurisdiction after dismissal of a case, and to what extent closing a case bears on that jurisdiction has been described as "[t]wo poorly-charted areas of [the] swamp [of 28 U.S.C. 1334]." *Aheong v. Mellon Mortg. Co.* (*In re Aheong*), 276 B.R. 233, 239 (B.A.P 9th Cir. 2002). In the Ninth Circuit, however, bankruptcy courts maintain jurisdiction over dismissed cases, which includes adjudication of a post-dismissal application for an award of attorney's fees. *In re Taylor*, 884 F.2d 478, 481 (9th Cir. 1989); *see In re Elias*, 188 F.3d 1160, 1162 (9th Cir. 1999); *Angelo v. Victoria Farms, Inc.*, 38 F.3d 1525, 1533 (9th Cir. 1994) (superceded by statute on other grounds) ("A court may properly award fees even after a bankruptcy case has been dismissed."). Therefore the dismissal of *Windman I* did not preclude Judge Bluebond from exercising jurisdiction to consider Mr. Lawrence's fee request for services allegedly rendered in *Windman I*, as the same court and same judge had presided over that case and had retained jurisdiction over it, despite its dismissal.

Nor does it appear that Judge Bluebond was prohibited from exercising jurisdiction over Mr. Lawrence's fee request because *Windman I* had been closed and never reopened. In a recent case, the United States District Court for the

Central District of California, reviewing a bankruptcy court decision, considered whether a bankruptcy court could issue a contempt citation after the case had been closed. *Sole Survivor Corp. v. Buxbaum*, No. CV 07-3858-GW, 2009 U.S. Dist. LEXIS 9400 (C.D. Cal. Jan. 22, 2009). Retained jurisdiction, which refers to jurisdiction retained by a court after a case has been dismissed, is not a proper basis for making a fee decision in a closed case. *Id.* at *13 (citing *In re Pavelich*, 229 B.R. 777, 781 (B.A.P. 9th Cir. 1999) (stating that retained jurisdiction can only be a theory for a motion in a dismissed case because the Bankruptcy Code treats "closing and dismissal as mutually exclusive."); *Aheong*, 276 B.R. at 239 (calling dismissing and closing a case "two separate events"). However, under the general "arising under" jurisdiction of 28 U.S.C. § 1334, a bankruptcy court can exercise jurisdiction over a closed case. *See In re Brown*, 371 B.R. 486, 494-95 (N.D. Okla. 2007) (stating that its "jurisdiction to review [ ] fees is not dependent on whether the status of the case stands as open, closed, pending, or dismissed"). Furthermore, the bankruptcy court's "arising under" jurisdiction can provide authority to adjudicate matters in a closed case without reopening it. *Menk v. Lapaglia* (*In re Menk*), 241 B.R. 896 (B.A.P. 9th Cir. 1999); *Aheong*, 276 B.R. at 240 ("'reopening a closed case is not a jurisdictional prerequisite to subject-matter jurisdiction under [Section] 1334(b)'") (citing *Menk*).

The *Sole Survivor* court held that seeking an order for contempt fell within the jurisdiction identified in *Menk* and *Aheong*: "Similarly, the Clerk's administrative act of ordering the bankruptcy case 'closed' did not have any jurisdictional significance." *Sole Survivor*, 2009 U.S. Dist. LEXIS, at *16.[2] It would not be a

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[2] Courts from numerous circuits have recognized this assessment. *See Dery v. Cumberland Cas. & Sur. Co.*, 468 F.3d 326, 330 (6th Cir. 2006) (citing cases for the rule that a bankruptcy court may retain jurisdiction "even after the underlying case has been adjudicated or dismissed"); *GMX Resources v. Kleborn (In re Petroleum Prod. Mgmt.)*, 282 B.R. 9, 14-15 (B.A.P. 10th Cir. 2002) (citing cases for the rule that for the rule that reopening a closed case is a ministerial act with no

large step for this Court to determine that a bankruptcy judge has “arising under” jurisdiction over fee reduction motion under 11 U.S.C. 329, whether or not the underlying case is reopened, under the reasoning of *Sole Survivor*.

The jurisdictional conundrum can be solved in another way. The court below stated that “the $1,000 per case will be the total amount due for both cases, period.” (A.E.R., 11, p. 179, ll. 22-24.) If this Court finds the bankruptcy court lacked jurisdiction to reduce fees in *Windman I*, it should do three things. First, this Court should affirm the bankruptcy court’s decision that Mr. Lawrence’s fees should be limited to $1,000 in Windman #2, as there are no jurisdictional issues in that case. Second, since the bankruptcy court did not make a finding concerning the allocation of fees received in the two cases, it would also be appropriate to remand for the court to clarify the amount of fees Mr. Lawrence received, as a matter of fact, in each case. Third, this Court should remand the case to allow the United States Trustee to file a motion to reopen *Windman I* to adjudicate the propriety of the fees Mr. Lawrence took in that case.

B. THE BANKRUPTCY COURT DID NOT ABUSE ITS DISCRETION BY REDUCING MR. LAWRENCE’S FEES.

No argument can be made the bankruptcy court abused its discretion by reducing Mr. Lawrence’s fees based on his behavior in *Windman I* and *II*. He failed to disclose his proposed fee arrangement to the court, which is sufficient grounds for a fee reduction.[3] 11 U.S.C. §§ 327(a) and 329; Fed. R. Bankr. P. 2014; *see, e.g.*, *In*

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independent legal significance); *Leinbach v. Reigle (In re Ramelah)*, No. 08-5074, 2009 WL 1213953 (E.D. Pa. May 5, 2009) (district court on appeal affirming order to reduce attorney fees in sequential closed cases, regardless of whether they were re-opened our not).

[3] While Mr. Lawrence filed a tardy disclosure of compensation on February 26, 2008, one he filed181 days after he filed the petition in *Windman II*, he did so

re Park-Helena Corp., 63 F.3d 877, 880 (9th Cir. 1995). Another justification for the fee reduction rests with Mr. Lawrence's misconduct. *See generally In re Pillowtex, Inc.*, 304 F.3d 246 (3d Cir. 2002); *United States Trustee v. First Jersey Secur., Inc., (In re First Jersey Securities, Inc.)*, 180 F.3d 504, 514, and n.9 (3d Cir. 1999). The bankruptcy court was within its discretion in granting the fee reduction motion under 11 U.S.C. 329 because the debtors paid Mr. Lawrence over $10,000 and received nothing in return.[4] *See* 11 U.S.C. § 329(b) and Fed. R. Bankr. P. 2017(b). In fact, the debtors were arguably worse off than they had been before they engaged Mr. Lawrence. Specifically, the court found:

- Mr. Lawrence submitted grossly inaccurate schedules for the debtors, failing to correct any of the errors made in the first filing in the second case. (A.E.R., 11, p. 182) (referring to a $65 cable bill that was listed as a $6,500 obligation).
- Mr. Lawrence failed to advise his clients that they needed to complete credit counseling before filing chapter 11 bankruptcy, resulting in the dismissal of their case and creating a "detriment" because they were "behind the eight ball coming in a second time." (A.E.R., 1, p. 6; 11, p. 178.)
- Mr. Lawrence improperly charged the debtors $600 to travel to

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only in response to the United States Trustee's fee reduction motion. Even after that, Mr. Lawrence never sought the required bankruptcy court approval of his employment. In ordering a reduction in Mr. Lawrence's fees, the bankruptcy court acknowledged this fact, stating "[t]he Court never authorized the employment of Mr. Lawrence in either of the Windmans' bankruptcy cases . . . . On that basis alone, it could be argued that the entirety of any amounts paid to Mr. Lawrence . . . should be disgorged." (A.E.R., 5, p. 93).

[4] Mr. Lawrence, in his brief, discusses a finding by the bankruptcy court in its dismissal of *Windman* II that the debtors had filed in bad faith, alleging that there was no basis for such a finding. (Appellant's Opening Br. at 6-7.) Mr. Lawrence's discussion misleads this Court because the grounds cited in the United States Trustee's fee reduction motion, brought pursuant to 11 U.S.C. § 329, did not depend upon the bankruptcy court's bad faith finding. Indeed, a November 18, 2008 stipulation to resolve a related district court appeal, Case No. CV08-1498 TJH, to which the United States Trustee was neither a party, removed the bad faith finding. (E.R., J, p.58, ll.10-11 and 16-18.)

their home to inform them that he had been suspended from the practice of law for failing the MPRE. (A.E.R., 7, p. 129, ¶ 28; 11, p. 175, ll. 12-24.)

- Mr. Lawrence improperly tried to charge the debtors as a "business consultant" after he was suspended from practicing law. (A.E.R., 9, p. 147; 5, p. 91.)
- Mr. Lawrence never substantiated or provided an evidentiary basis for the fees he charged debtors, although the court continued the case for two weeks after his initial failure to do so. (A.E.R., 5, p. 92.) (commenting on Mr. Lawrence's "relatively haphazard system for keeping track of time spent for the Windmans.")

Mr. Lawrence's opening brief inexplicably places sole responsibility for his failings, particularly his failure to submit "reports, statements and other documents," upon the debtors, aged 94 and 88 respectively, and both lacking any knowledge of bankruptcy law. (Appellant's Opening Br. at 9.) The brief continues "[t]he Attorney is not a guarantor that the debtors comply with the requirements for filing of schedules, and if they do not, it should not be attributed to the Debtor's lawyers." *Id*. Although a voluminous record chronicles Mr. Lawrence's many short-comings as a lawyer, his statement, standing by itself, indicates he had no inkling of his duty to provide services with a reasonable value to his clients. The bankruptcy court did not abuse its discretion in ordering a fee reduction.

VIII.

CONCLUSION

For the foregoing reasons, the United States Trustee respectfully asks this Court to affirm the bankruptcy court's decision below.

Dated: July 20, 2009 Respectfully submitted,

PETER ANDERSON, UNITED STATES
TRUSTEE, REGION 16

By: _________________________
KENNETH G. LAU
Attorney for the United States Trustee

Ramona D. Elliott
General Counsel
P. Matthew Sutko
Associate General Counsel
Catherine B. Sevcenko
Trial Attorney
Saleela Khanum Salahuddin
Trial Attorney
United States Department of Justice
Executive Office for United States Trustees
20 Massachusetts Ave, N.W.
Washington, DC 20530

CERTIFICATE OF COMPLIANCE

I certify that, pursuant to BAP Rule 8010(a)-1, Federal Rule of Appellate Procedure 32(a)(7)(C) and Ninth Circuit Rule 32-1, the attached Appellee's Responsive Brief is proportionately spaced, has a typeface of 14 points or more, and contains 5721 words, (as calculated by the word processor).

Dated: July 20, 2009

Respectfully submitted,
UNITED STATES TRUSTEE

By: ________________________
KENNETH G. LAU
Attorney for the United States Trustee

STATEMENT OF RELATED CASES

Appellee, United States Trustee, is not aware of any related cases currently pending before this Court.

Dated: July 20, 2009

Respectfully submitted,

UNITED STATES TRUSTEE

By: ________________________

KENNETH G. LAU

Attorney for the United States Trustee

DECLARATION OF SERVICE BY MAIL

STATE OF CALIFORNIA

COUNTY OF LOS ANGELES

I am employed in the County of Los Angeles, State of California, in the Office of the United States Trustee under the supervision of a member of the bar of this Court at whose direction the service was made; I am over the age of eighteen (18) and not a party to the within action; and my business address is 725 South Figueroa Street, Suite 2600, Los Angeles, California 90017.

On ____________________, I served the foregoing document described as APPELLEE'S OPENING BRIEF on the interested parties at their last known address in this action by placing a true and correct copy thereof in a sealed envelope with postage thereon fully prepaid in the United States Mail at Los Angeles, California, addressed as follows:

FORMER DEBTORS and DEBTORS IN POSSESSION/Appellees:
Pauline and Murray Windman
2050 Bagley Avenue
Los Angeles, CA 90034

APPELLANT:
Arthur G. Lawrence
3592 Rosemead Boulevard
Box 340
Rosemead, CA 91770

Debtor's Proposed Counsel/Appellee Brownstein:
Lorraine Howell, Esq.
LAW OFFICES
301 E. 17th St., Ste. 210
Costa Mesa, CA 92626

-and-

William H. Brownstein, Esq.
WILLIAM H. BROWNSTEIN & ASSOCIATES, P.C.
1250 Sixth St., Ste. 205
Santa Monica, CA 90401-1637

Co-Counsel for the Trust Plaintiffs/Appellee Kreis:
John P. Kreis, Esq.
350 S. Grand Ave., Ste. 1520
Los Angeles, CA 90071

-and-

G. Richard Green, Esq.
GREEN & MARKER
1875 Century Park East, Ste. 1880
Los Angeles, CA 90067

Counsel for Appellee Haney, Buchanan & Patterson, LLP:
Michelle Tamkin, Esq.
Haney, Buchanan & Patterson, LLP
707 Wilshire Blvd., 53rd Flr.
Los Angeles, CA 90017

I declare under penalty of perjury that the foregoing is true and correct.

I declare under the penalty of perjury that the foregoing is true and correct.

DATED:

____

BRIEF BANK — "SUMMARY SHEET" *Printed Thu-3/17/11 16:6*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*: Arthur Lawrence v. United States Trustee (In re Murray and Pauline Windman)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*: 9th Cir.

3. ("CCN") ***CURRENT*** CASE NO.: No.: 09-60055

4. ("PCN") ***PRIOR*** CASE NO. - & COURT *[IF ANY]*: No.: 08-1080

Court: B.A.P. 9th Cir.

(Identify judge & cite, if any)

5. ("SO") ***SOURCE***: **U.S. TRUSTEES**

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Type: Brief for the United States Trustee

7. **("AU") *PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*: Jill Sturtevant, Catherine Sevcenko, P. Matthew Sutko, Ramona D. Elliott, Peter C. Anderson

(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***: **BANKRUPTCY**

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***: • 1). Did the bankruptcy court abuse its discretion when it limited Mr. Lawrence's compensation to $2,000 for his work on the Windmans' two chapter 11 bankruptcy cases? 2). Did the bankruptcy court act properly when it ordered Mr. Lawrence to return fees he may have received in the Windmans' predecessor, closed, case at a hearing in the follow-on, open, case?

10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)

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NO. 09-60055
IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

In re MURRAY & PAULINE WINDMAN,
Debtors.

ARTHUR LAWRENCE,
Appellant,

v.

UNITED STATES TRUSTEE,
Appellee.

ON APPEAL FROM THE UNITED STATES BANKRUPTCY APPELLATE PANEL OF THE NINTH CIRCUIT

BRIEF FOR THE UNITED STATES TRUSTEE

RAMONA D. ELLIOTT
General Counsel

P. MATTHEW SUTKO
Associate General Counsel

CATHERINE SEVCENKO
Trial Attorney

Executive Office for United States Trustees
Department of Justice
20 Massachusetts Avenue, N.W.
Washington, D.C. 20530
Phone: (202) 307-1399
Fax: (202) 307-2397

PETER C. ANDERSON
United States Trustee for Region 16

JILL STURTEVANT
Assistant United States Trustee for Region 16

Department of Justice
725 South Figueroa Street, Ste 2600
Los Angeles, California 90017
Ph: (213) 894-4480
Fax: (213) 814-2603

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JURISDICTIONAL STATEMENT

This is an appeal from the bankruptcy court's order reducing Appellant Arthur Lawrence's attorney fees in two cases because his efforts in them did not benefit his clients, debtors Murray and Pauline Windman. These reductions were independently authorized by two federal statutes, 11 U.S.C. §§ 329 and 330. Reduction of attorney fees is a core matter. 28 U.S.C. § 157(b)(2)(A); *Price v. Lehtinen (In re Lehtinen)*, 564 F.3d 1052, 1058 (9th Cir. 2009). The bankruptcy court had jurisdiction under 28 U.S.C. §§ 157(b)(1)-(2).[1] An order reducing fees is final. 28 U.S.C. § 158(a)(1); *Law Offices of Nicholas A. Franke v. Tiffany (In re Lewis)*, 113 F.3d 1040, 1043-44 (9th Cir. 1997).

Mr. Lawrence timely appealed the bankruptcy court's order on March 17, 2008 to the Bankruptcy Appellate Panel of the Ninth Circuit. 28 U.S.C. § 158(e)(2); Fed R. Bankr. P. 8002(a). The appellate panel had jurisdiction under 28 U.S.C. § 158(c)(1). It affirmed the bankruptcy court's order on November 18, 2009. Mr. Lawrence then filed a timely notice of appeal to this Court on December 17, 2009. Fed. R. App. P. 4(a)(1)(B) & 6(b)(1). This Court has jurisdiction under 28 U.S.C. § 158(d)(1).

STATEMENT OF THE ISSUES

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[1] Mr. Lawrence's argument that the bankruptcy court did not have jurisdiction to reduce his fees in one of the two cases is incorrect for the reasons explained in section II of the Argument portion of this brief. *See* United States Trustee Br. at 25.

1. Did the bankruptcy court abuse its discretion when it limited Mr. Lawrence's compensation to $2,000 for his work on the Windmans' two chapter 11 bankruptcy cases?

2. Did the bankruptcy court act properly when it ordered Mr. Lawrence to return fees he may have received in the Windmans' predecessor, closed, case at a hearing in the follow-on, open, case?

STATEMENT OF THE CASE

I. Statutory Framework

A. Attorney's Fees

The Bankruptcy Code regulates the employment and compensation of bankruptcy professionals. Bankruptcy courts have significant discretion when determining whether professional fees are reasonable. 11 U.S.C. §§ 329-331.

Attorneys must obtain court approval to be retained as bankruptcy counsel for chapter 11 debtors. *See, e.g.*, 11 U.S.C. §§ 327(a); 11 U.S.C. § 1107; Fed. R. Bankr. P. 2014(a) (describing application process and requirements). In such cases, attorneys must establish that their fee requests satisfy the standards set out in 11 U.S.C. § 330(a). *See also* 11 U.S.C. § 330(a)(1)(A) (mandating "reasonable compensation"); 11 U.S.C. § 330(a)(3)(A)-(F); 11 U.S.C. § 330(a)(4)(A)(ii)(I)-(II) (prohibiting compensation for services not "reasonably likely" to benefit the estate or "necessary" for its "administration").

Independent of that, section 329(a) of the Bankruptcy Code requires every attorney representing a debtor in any type of a bankruptcy case to file a statement of the compensation paid, or agreed to be paid, for services related to the bankruptcy case. 11 U.S.C. § 329(a); Fed. R. Bankr. P. 2016. Section 329 mandates that every bankruptcy attorney demonstrate that the fee sought does not "exceed[] the reasonable value of any such services;" if it does, the court may reduce or deny the fee altogether. 11 U.S.C. § 329(b).

B. Jurisdiction

A bankruptcy court's jurisdiction is established by statute. Section 1334(a) of title 28 gives district courts "original and exclusive" jurisdiction of "all cases" under title 11. 28 U.S.C. § 1334(a). Subsection 1334(b) gives federal district courts non-exclusive subject matter jurisdiction over "all civil proceedings arising under title 11, or arising in or related to cases under title 11." 28 U.S.C. § 1334(b). Bankruptcy judges are "units" of the district court. 28 U.S.C. § 151.

Section 157(a) of title 28 allows district courts to refer to a bankruptcy judge "any or all cases under title 11 and any or all proceedings arising under title 11 or arising in or related to a case under title 11." 28 U.S.C. § 157(a). Upon such referral, a bankruptcy judge has jurisdiction to enter final orders in all "cases under title 11" and in "all core proceedings arising under title 11 or arising in a case under title 11." 28 U.S.C. § 157(b)(1).

A core proceeding includes all "matters concerning the administration of the estate." 28 U.S.C. § 157(b)(2)(A). Section 1334 of title 28 gives courts sitting in bankruptcy "exclusive jurisdiction . . . over all claims or causes of action" that involve the retention of bankruptcy professionals. 28 U.S.C. § 1334(e)(2).

In this case Mr. Lawrence suggests that the bankruptcy court did not have jurisdiction to set his fees in one of these two interrelated cases because it was closed. Br. at 17-18. Sections 1334 and 157 of title 28 do not explicitly address whether such jurisdiction extends to administrative matters that arise in closed cases. The United States believes, however, there is jurisdiction to establish the fees the Windmans must pay Mr. Lawrence in both of those cases. We address that issue in Section II of the Argument portion of this brief. *See* United States Trustee Br. at 25.

II. STATEMENT OF FACTS

The debtors in this case were an elderly couple. Murray Windman, who was 94 at the time the petition was filed, has since passed away. His wife Pauline, 88, has seriously impaired vision. ER at 19. The appellant, Arthur G. Lawrence, represented them between June and November 2007, when he filed two consecutive chapter 11 bankruptcy cases on their behalf. ER at 13-17.

Mr. Lawrence filed the first chapter 11 case, No. 07-15236 (the "predecessor case" or "*Windman I*"), on June 22, 2007. AER at 215. The bankruptcy court issued a notice of deficiency because Mr. Lawrence had not filed mandatory bankruptcy

Schedules B, C, D, E, F, A, G, H, I, J, Form 22B, a Statement of Financial Affairs and an Employee Income Record. AER at 224. The bankruptcy court also issued a Case Commencement Deficiency Notice, noting the omission of nine documents, including a Statement of Related Cases, a Summary of Schedules, Disclosure of Attorney Compensation, and a Certificate of Credit Counseling. AER at 226.

Mr. Lawrence has admitted that the schedules submitted in *Windman I* were prepared "in haste" and thus contained "numerous errors . . . including obvious typographical errors." AER at 50, ¶ 3. And he admitted "there were a number of items that were not given full attention at the outset." AER at 51, ¶ 6.

On August 6, 2007, Mr. Lawrence filed the omitted Summary of Schedules in the predecessor case. AER at 228. He also filed a disclosure of attorney compensation, dated August 6, 2007, revealing that he had received $10,000 as a retainer and with the notation "at $150 per hour." AER at 252. Mr. Lawrence certified that "the foregoing is a complete statement of any agreement or arrangement for payment to me for representation of the debtor(s) in *this* bankruptcy proceeding." AER at 252 (emphasis added). He did not seek employment authorization from the bankruptcy court under 11 U.S.C. § 327, nor did he request approval from the court for his compensation, as required under sections 329 and 330 of the Bankruptcy Code. *See generally* AER at 9-14.

The bankruptcy court dismissed the predecessor chapter 11 bankruptcy case on August 10, 2007, principally because Mr. Lawrence filed it although the Windmans had not obtained the pre-petition credit counseling required by 11 U.S.C. § 109(h)(1). ER at 11-12. The clerk closed the case on August 30, 2007. AER at 14.

One day before the first case closed, on August 29, 2007, Mr. Lawrence filed a second chapter 11 case for the Windmans, No. 07-17535 (the "follow-on case" or "*Windman II*"). AER at 261. The case was assigned to the same judge. ER at 15. Mr. Lawrence filed many of the same flawed schedules.[2] AER at 261. Again the bankruptcy court issued deficiency notices due to missing schedules and other missing documents. AER 301-304. Mr. Lawrence afterwards worked with the Windmans' bookkeeper to make handwritten corrections to the submitted schedules and "many of the handwritten corrections" were entered into the record on October 2, 2007 at the meeting of creditors required by 11 U.S.C. § 341. AER at 50, ¶¶ 4-5.

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[2] For instance, in the first petition, Mr. Lawrence's address is "Law Offices of Arthuer [sic] G. Lawrence 1089 santa [sic] Anita Avenue;" the same errors appear on the August 29 filing. On the second filing, the date June 22, 2007 by the signatures has been crossed out and the date August 20, 2007 written in by hand. *Compare* AED at 215-17 (Official Form 1 filed June 22, 2007) *with* AED at 261-63 (Official Form 1 filed Aug. 29, 2007). The follow-on petition has two Statements of Related Cases: the first is dated August 20, 2007 and states that the Windmans had no previous bankruptcy filings. AER at 264. The second is dated August 28, 2007 and lists *Windman I*. The Summary of Schedules and the Schedules in the follow-on case (07-17535) lists the Case Number of the predecessor case (07-15236). AER at 266-287. The Statement of Financial Affairs in the follow-on case has the same "year to date" figure for non-employment income, although it was filed two months later. *Compare* AER 247 *with* AER 283.

Mr. Lawrence included an attorney compensation disclosure statement in the follow-on filing, dated August 20, 2007, in which he represented that he had received a $10,000 retainer and agreed to work for $150 per hour. AER at 213. He certified again that the disclosed compensation reflected the payment agreed upon for his representation in "this" bankruptcy proceeding. AER at 213. He again did not seek authorization from the bankruptcy court to represent the Windmans' chapter 11 estate, as required by section 327. AER at 171, 176, 177.

Less than three weeks after filing *Windman II*, the State Bar of California suspended Mr. Lawrence from practicing law because he failed the Multistate Professional Responsibility Examination. AER at 129, ¶ 28. California had required him to take the test as part of a stipulated disciplinary action for commingling client funds. AER at 16, 22, 33. Mr. Lawrence charged the debtors $600 for traveling to their home to inform them of his suspension. AER at 136, 177. After he was suspended from practice, Mr. Lawrence tried to remain on the case, styling himself a "business advisor," but he continued to work without seeking or obtaining court authorization under section 327 to act as a bankruptcy professional. AER at 171, 176.

The Windmans hired a new attorney, Lorraine Howell, paying her $4,000 to represent them.[3] AER at 196. Ms. Howell worked with the debtors to identify and

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[3] Ms. Howell is also counsel of record for Mr. Lawrence in this appeal.

correct most of the mistakes in the debtors' schedules. AER at 156-158. After reviewing the case, Ms. Howell explained to the court that the debtors had filed bankruptcy primarily "for the purpose of having a place to breath[e] and to reorganize their matters because they found themselves in a real property dispute among family members in the California Superior Court." ER at 19.

The United States Trustee moved to dismiss *Windman II* for "cause" under 11 U.S.C. § 1112(b) because the schedules that Mr. Lawrence had submitted remained deficient and he had not complied with reporting requirements and other court rules. AER at 1-5. In addition, Wayne Windman and other litigants in the state court proceeding filed a motion for attorney's fees on the grounds that the chapter 11 filing had been done in bad faith. ER at 35-36. After briefing and a hearing, the bankruptcy court granted the motion to dismiss with a 180-day refiling bar. ER at 29-30. It found the Windmans' case had been filed in bad faith due to 1) numerous compliance issues; 2) uncorrected errors in filings; and 3) the "admitted fact that the sole purpose of the instant filing was to gain leverage or other advantage with state court litigation regarding the partition of real property and not to resolve any other financial difficulties." *Id.* The court also granted Wayne Windman's motion and ordered the debtors and Mr. Lawrence jointly to reimburse him and his co-litigants in the state court case for $18,000 in fees that their counsel had charged for dealing with the bad-faith bankruptcy court litigation. ER at 35-37. The dismissal order also retained jurisdiction to adjudicate a motion by the United States Trustee to reduce Mr. Lawrence's fees. ER at 30.

The United States Trustee filed a motion to reduce Mr. Lawrence's fees in *Windman II* to zero because 1) Mr. Lawrence failed to "competently represent" the Windmans and 2) he failed to "comply with the rules governing employment of professionals in bankruptcy cases." ER at 41-42, 44, 46. At the fee-motion hearing on February 7, 2008, the bankruptcy court tentatively ruled that Mr. Lawrence must return his $10,000 retainer that he had disclosed he had received in *Windman II.* AER at 213. The court found it was excessive compensation for the 20 days Mr. Lawrence was involved in *Windman II* before he was suspended for failing the Multistate Professional Responsibility Exam. AER at 107-08.

After the court explained its tentative ruling denying all fees in *Windman II*, Mr. Lawrence stated that his disclosure that he had been paid a retainer of $10,000 in *Windman II* was incorrect. Facing a complete denial of fees in *Windman II*, he testified:

> Mr. Lawrence: [My] statement in there that I paid, uh, I was paid a retainer of $10,000, uh, for the filing of the second chapter bankruptcy work is error. That has to be amended, and I have to apologize for that mistake.
>
> Court: Wait, so the 10,000 was for both cases?
>
> Mr. Lawrence: The $10,000 were the monies that I received from the very beginning, which was on or about June 22, June 21, um, roughly nine weeks before that. And I'm not going to refer to the bill or the dates or the amounts because the Court doesn't have the benefit of, um, seeing it.

AER at 110.

Based on the confusion arising from Mr. Lawrence's last-minute change in testimony, the bankruptcy court continued the hearing so that Mr. Lawrence could submit additional billing records to prove in what case(s) he had received fees. AER at 113. On February 26, 2008, Mr. Lawrence submitted an amended disclosure of attorney compensation that stated he had received $2,139.50 for compensation in *Windman II*. AER at 147. He failed, however, to submit any evidence substantiating his fee claims or a declaration explaining his billing methods. AER at 173-174.

Instead, he submitted a billing statement that he had created between the two February hearings. AER at 132-36. The Statement contained several entries that had nothing to do with the Windmans bankruptcy cases. For instance, he charged four hours to meet with the Windmans "at Factors Deli" to "review two Superior Court law suits." AER at 132. He billed them six hours to inspect a building in Culver City "to analyze its value." AER at 133-34. He also billed five hours, including two hours travel time, to "gather information regarding the Haney Law firm's billing and their efforts to lease vacant space in the Washington Blvd property." AER at 135.

In contrast, he billed one hour to "work[] with Mr. Goe's office to prepare Second Petition for Chapter 11," yet charged four hours to file the petition. AER at 135. He billed $1,275 for his work as a "business advisor" after he was suspended from the practice of law. AER at 136. Finally, he neglected to bill for preparing and filing three extensions of time on July 6, 19, and 27, 2007. AER at 132-36. The billing statement also does not reflect any work done on the status report he submitted out of time at a hearing on August 8, 2007. *Id.*

After reviewing Mr. Lawrence's billing statement, the bankruptcy court stated that there was nothing in it "that makes me think it's reliable." AER at 175; *see* AER at 92 (commenting on Mr. Lawrence's "relatively haphazard system for keeping track of time spent for the Windmans").

The only record of payment in the record that was contemporaneously prepared is a one-page handwritten note by the Windmans' bookkeeper. ER at 56.

On February 28, 2008, the bankruptcy court conducted a second hearing on Mr. Lawrence's fee application, which produced a 40-page transcript. The colloquy between the bankruptcy court and Mr. Lawrence takes up approximately 17 pages. AER at 188-205.

The bankruptcy court admonished Mr. Lawrence three times to focus his comments on the fee issue, asking that he proceed more quickly in fairness to other litigants.[4] Finally, the bankruptcy court stated "Okay, so I'm going to give you a total

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[4] "Okay, I need you to make your simple statement more quickly. If you'll notice, I have a pretty full courtroom of people waiting. So if you - I understand that you have a manner of delivering things, and I hate to interfere with your personal style, but it-we need to pick it up a little bit." AER at 191.

"Okay, sir, you need to focus your remarks more quickly. You need to move more quickly through this, or I'm going to need to terminate this, this hearing . . . ."

of five *more* minutes to make remarks here . . . it isn't just that I have other parties waiting, it's that what you're telling me is not helpful and not relevant to the issues I need to focus on." AER at 197 (emphasis added).

At the end of Mr. Lawrence's presentation, the court found that Mr. Lawrence's advice and services to his clients could not be reasonably valued at $10,000 and that his fees were not justified under 11 U.S.C. § 329. AER at 200-202. The court limited Mr. Lawrence's aggregate compensation for both cases to $2,000: "That [$2,000] would be intended to be the total amount due, the $1,000 per case will be the total amount due for both cases, period." AER at 179. The bankruptcy court did not award more because "the services that were rendered were really substandard in this case." AER at 200. The bankruptcy court also considered the fact that *Windman II* was filed in bad faith, although that aspect of the case was "not a dispositive factor" in the decision to reduce Mr. Lawrence's fees to $1,000 for each case. AER at 200.

When Mr. Lawrence attempted to argue that issues related to his performance should be adjudicated by the California state bar, the bankruptcy court stated that "under 28 U.S.C. 1334, [this court] does have exclusive jurisdiction over the issue of what's an appropriate amount to allow as compensation for services rendered by a bankruptcy attorney in a bankruptcy case." AER at 201. Mr. Lawrence responded

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Id. at 194.

that his position was that "for the work I did, when I did it, and how I did it, has no place being looked at by Your Honor in this case. It doesn't come within your jurisdiction." AER at 202.

The bankruptcy court ordered Mr. Lawrence to return $8,850 by paying the money to the Windmans' opponents in the state court litigation in partial satisfaction of the November 7, 2007 award they had received against him from the bankruptcy court because *Windman II* was filed in bad faith. AER at 202-204; ER at 52.[5]

A. Appeal to the Bankruptcy Appellate Panel

Mr. Lawrence appealed to the bankruptcy appellate panel of the Ninth Circuit on two grounds: first, the bankruptcy court did not have jurisdiction to order a reduction in fees; and, second, it abused its discretion in awarding him $2,000 for his representation of the Windmans.

In an unpublished opinion, the bankruptcy appellate panel affirmed the reduction of fees to $1,000 for Mr. Lawrence's work in each of the two *Windman* cases. *Lawrence v. United States Trustee (In re Windman)*, 08-1080, slip op. at 2 (B.A.P. 9th Cir. Nov. 18, 2009) ("Mem. Op."); United States Trustee Supp. ER at 32. It held that the bankruptcy court had not abused its discretion in finding Mr. Lawrence's legal

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[5] The finding of bad faith was ultimately expunged by agreement of the parties on appeal in a separate case, but the debtors and Mr. Lawrence remained jointly liable for attorney fees. ER at 57-59.

representation to be "substandard." Mem. Op. at 7; United States Trustee Supp. ER at 37 (stating that "there is . . . ample evidence in the record to support such a determination [of poor representation]").

The bankruptcy appellate panel held that the bankruptcy court did not lose its jurisdiction to address outstanding fee issues in *Windman I* after it was dismissed and closed, because a motion to reduce fees under section 329 is a core proceeding "arising under" the court's jurisdiction as provided for in title 28, section 1334(b). *Id.* at 9. The panel stated that "we think" that the bankruptcy court could order the reduction of fees without "formally reopening the case under § 350." *Id.* at 10. It did not decide the issue because "on these facts, any error was harmless." *Id.* The panel also suggested that the fee reduction order should be upheld on equitable grounds because any confusion was due to Mr. Lawrence's lack of candor with the bankruptcy court. *Id.* at 11.

Mr. Lawrence filed a timely appeal to this Court. United States Trustee Supp. ER at 1-2.

STANDARD OF REVIEW

This Court reviews decisions of the bankruptcy appellate panel *de novo* and applies the same standard of review as the panel applied to the bankruptcy court's decision. *Boyajian v. New Falls Corp. (In re Boyajian)*, 564 F.3d 1088, 1090 (9th Cir. 2009). In this case, the bankruptcy appellate panel reviewed the bankruptcy court's conclusions of law *de novo* and its findings of fact for clear error. Mem. Op. at 6; United States Trustee Supp. ER at 36; *see Scott v. United States Trustee (In re Doser)*, 412 F.3d 1056, 1061 (9th Cir. 2005).

The bankruptcy court's jurisdiction over Mr. Lawrence's fees in the *Windman* cases is a question of law that is reviewed *de novo*. *McDonald v. Checks-N-Advance (In re Ferrell)*, 539 F.3d 1186, 1189 (9th Cir. 2008). A bankruptcy court's reduction of attorney's fees is reviewed for abuse of discretion. *Roberts, Sheridan & Kotel, PC v. Bergen Brunswick Drug Co. (In re Mednet)*, 251 B.R. 103, 106 (B.A.P. 9th Cir. 2000).

SUMMARY OF THE ARGUMENT

1. The bankruptcy court did not abuse its discretion when it reduced Mr. Lawrence's fees in two sequential chapter 11 cases to $2,000 because of the "substandard" service he provided. Under section 329 of the Bankruptcy Code, a bankruptcy court may reduce or eliminate attorney fees if the compensation "exceeds the reasonable value" of the services provided.

Mr. Lawrence did not serve his clients well; in fact, they were in a worse position after they followed Mr. Lawrence's legal advice. Both of their bankruptcy cases were dismissed. The first case ended because Mr. Lawrence allowed his clients to file before receiving mandatory pre-bankruptcy credit counseling. Mr. Lawrence's filings in the first case were full of errors, the vast majority of which he did not correct when he re-filed the schedules in the second case.

The results of the second case were even worse. In addition to taking issue with his flawed schedules and filings, the court ruled that the follow-on case had been filed in bad faith. As a result, the Windmans were prohibited from receiving bankruptcy relief for 180 days. They had to pay a second attorney an additional $4,000 to correct the errors and bring the second case to a close. And the Windmans were ordered jointly with Mr. Lawrence to reimburse the litigants in the state-court case $18,000 in the attorney fees that they incurred protecting their rights in the bankruptcy case.

Given Mr. Lawrence's incompetent representation, the bankruptcy court did not abuse its discretion in reducing his fees.

2. There are three factors that made it proper for the bankruptcy court to reduce Mr. Lawrence's fees, regardless of whether they were earned in the dismissed case (*Windman II*) or the dismissed and closed case (*Windman I*).

First, Mr. Lawrence created the ambiguity about when he received his fees when he claimed at the last minute that he received $10,000 in the follow-on case was a "mistake." Facing denial of these fees, he tried to convince the court that he had received the money in *Windman I*, in an apparent attempt to create doubt about the court's jurisdiction. In that way, he hoped to stop the court from implementing its tentative decision to reduce his fees to zero. But he had no right to fees in *Windman I* either, both due to his poor work and because he had never been appointed under section 327.[6]

Second, the predecessor and follow-on cases are mirror images of each other. They involve the same parties, issues, and are before the same judge, who anticipated having the follow-on case assigned to her. In fact, the two cases even were both open at the same time for one day. No one is prejudiced by the court's decision to handle the fee issue in one case.

Third, case law from the Supreme Court, and this Court demonstrate that a court's jurisdiction is at its zenith when addressing issues related to the administration of justice, particularly the conduct of an officer of the court. This is particularly true when a court must consider whether the conduct of the attorney before it warrants a reduction of fees. Bankruptcy courts in particular have an affirmative duty to ensure that attorney fees are reasonable because they are paid out of the debtor's estate and thus reduce the dividend otherwise available to creditors.

In fact, had the bankruptcy court accepted Mr. Lawrence's assertion it did not have jurisdiction over his fees, it would have made meaningless its finding that Mr. Lawrence represented his clients poorly. It also would have acquiesced in the violation of sections 327, 329 and 330 of the Bankruptcy Code in both cases, which

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[6] *See Lamie v. United States Trustee*, 540 U.S. 526, 533-34 (2004) (holding chapter 11 counsel must be retained under section 327to receive fees).

only authorize compensation that is commensurate with the quality of the services rendered.

3. Mr. Lawrence's other arguments for why he should be able to keep $10,000 for services that were detrimental to his clients are without merit:

- **Value of Service**: Mr. Lawrence merely asserts that the work he did on the Windmans' state-court litigation was in contemplation of, or connected to, the bankruptcy cases and therefore is compensable. He has not produced credible billing records. Furthermore, his service in bankruptcy to the Windmans was so poor that it cannot be offset by other work, even if it were relevant to the bankruptcy cases.
- **Due Process and Judicial Bias:** The bankruptcy court held two hearings on the fee issue, allowed three rounds of briefing, and gave Mr. Lawrence a second opportunity to produce contemporaneous billing records, affording him ample due process. In the end, the court let him keep $2,000 in spite of his poor representation, undermining any allegation of bias.
- **Bad Faith Filing of *Windman II***: The bankruptcy court reduced Mr. Windman's fees because of his "substandard" legal representation. Because the bad faith finding was not a "dispositive factor" for reducing fees, its expungement – even if legally valid – does not change the result here.

- **Mootness:** The reduction of fees is not moot simply because the bankruptcy court designated a recipient of the funds who has now been paid, something Mr. Lawrence alleges but does not prove. The determining factor is the quality of the services, not who receives the refund.

The bankruptcy court's decision to reduce Mr. Lawrence's fees to $2,000 should be affirmed.

ARGUMENT

I. The Bankruptcy Court Did Not Abuse Its Discretion by Reducing Mr. Lawrence's Fees Because Its Findings that He Served His Clients Poorly and Ignored the Bankruptcy Code's Requirements Concerning Attorney Compensation Were Not Clearly Erroneous.

A. Mr. Lawrence is not entitled to $10,000 because the Bankruptcy Code requires that an attorney's compensation be commensurate with the value the attorney has provided to the estate, and the bankruptcy court's finding that Mr. Lawrence's representation was "substandard" is not clearly erroneous.

The bankruptcy court did not commit clear error in finding that Mr. Lawrence's representation of the debtors was "substandard." Under the Bankruptcy Code, a professional can only be paid an amount that reflects the value his or her work has brought to the estate. 11 U.S.C. § 330(a)(3) (tying the amount of compensation to the "value" of the services and the "benefit" rendered to the estate); 11 U.S.C. § 329 (authorizing courts to order attorneys to return excessive fees to debtors).

The bankruptcy court's finding that Mr. Lawrence's representation of the elderly Windmans was substandard is amply supported by the record. For instance:

- In June 2007, Mr. Lawrence filed a chapter 11 petition for his clients that he admits was filled with "numerous errors . . . including obvious typographical errors." AER at 50. The petition also failed to include a number of required forms. AER at 224, 226.

- Mr. Lawrence failed to advise his clients that they needed to complete credit counseling before filing chapter 11 bankruptcy, which led to *Windman I* being dismissed, creating a "detriment" because they were "behind the eight ball coming in a second time." AER at 6, 178.
- On August 29, one day before *Windman I* was closed, Mr. Lawrence filed the same error-ridden petition to commence the follow-on chapter 11 case, *Windman II*. AER at 183, 241, 279 (listing, for example, a $65 cable television bill as a $6,500 obligation on Schedule F in both cases).
- Mr. Lawrence represented the Windmans for less than a month in the follow-on case. He was suspended from the practice of law after that because he failed the Multi-State Professional Responsibility Exam, which the State Bar of California had ordered him to take as part of a disciplinary proceeding.

For comparison, an attorney who filed an incomplete and erroneous bankruptcy petition, failed to inform the debtors about the bankruptcy process, and tried to persuade them to dismiss their petition without explaining the consequences, had to return all the fees he received. *Hale v. United States Trustee*, 509 F.3d 1139, 1147 (9th Cir. 2007). Mr. Lawrence's representation of the Windmans is of the same, or lower, caliber.

Mr. Lawrence's efforts on behalf of the Windmans resulted in two error-filled chapter 11 petitions, two dismissals of their bankruptcy cases – the second with a bad faith finding, leading to a 180-day filing bar against them. His work also caused an $18,000 liability for third-party attorney fees, $2,078 in filing fees, and $4,000 in fees to substitute counsel. AER at 105, 178-79, 196; ER at 27. Plus the Windmans had to pay Mr. Lawrence himself $2,000. Not only did Mr. Lawrence's services not benefit the Windmans, they were worse off than they had been before they met Mr. Lawrence. ER at 36. Under these circumstances, the bankruptcy court did not clearly err in concluding that Mr. Lawrence did not render any beneficial service to the Windmans and thus his fees should be reduced.

B. Far from abusing its discretion, the bankruptcy court generously gave Mr. Lawrence $2,000 in fees although he failed to comply with the requirements in the Bankruptcy Code that professionals must follow to receive compensation.

Mr. Lawrence wants to shield his fees by arguing he earned them in *Windman I*. Mr. Lawrence's ploy cannot work. He has no legal basis to claim fees in the predecessor case for three reasons.

Under sections 327 and 1107, the Windmans needed court approval to employ Mr. Lawrence before he could work on the case for compensation. 11 U.S.C. § 327; 11 U.S.C. § 1107; Fed. R. Bankr. P. 2014(a) (describing employment application process). Failure to obtain court authorization prohibits fees. *See Lamie*, 540 U.S. at

529. *Neben & Starrett Inc. v. Chart well Fin. Corp (In re Park-Helena Corp.*), 63 F.3d 877, 883 (9th Cir. 1995); *In re Lewis*, 113 F.3d at 1040. *See also Mehdipour v. Marcus & Millichap (In re Mehdipour)*, 202 B.R. 474, 480 (B.A.P. 9th Cir. 1996) (stating that these rules "are not discretionary").

It is undisputed that Mr. Lawrence did not request employment authorization under section 327 in either case. Given this, the bankruptcy court would not have abused its discretion had it denied all fees in both cases. Instead it allowed Mr. Lawrence to keep $2,000, although he had ignored the Code requirements for employment authorization.

Second, an attorney must seek approval for the amount of compensation received so that the bankruptcy court and other parties in interest may verify it is reasonable. 11 U.S.C. §§ 329, 330. Complete candor in disclosing what compensation was received within the year before the filing of the bankruptcy petition is required. 11 U.S.C. § 329. Any inaccuracy regarding the time of receipt of a retainer is alone sufficient grounds to reduce fees. *Lewis*, 113 F.3d at 1045. Thus, the bankruptcy court did not abuse its discretion in reducing Mr. Lawrence's fees because of his admission that his attorney disclosure in the follow-on case was a "mistake."

Attorneys are required to disclose compensation and seek court approval to "protect the debtor from the debtor's attorney" by making sure the debtor is not overcharged. *Id.* at 1044. Furthermore, bankruptcy courts have an affirmative duty to review all fees because they are paid out of the debtor's estate and thus reduce the dividend otherwise available to creditors. *In re Busy Beaver Bldg. Centers, Inc.,* 19 F.3d 833, 841 (3d Cir. 1994); *In re Dorsett*, 297 B.R. 620, 624 (Bankr. E.D. Cal. 2003) (chapter 13 case) (citing *In re Montgomery Drilling Co.*, 121 B.R. 32, 35 (Bankr. E.D. Cal. 1990) (chapter 11 case)). Therefore, an attorney may not keep fees received without court authorization. *See* Fed. R. Bankr. P. 2016(a) (stating an attorney "shall" file an application for compensation); *cf. In re Pedersen*, 229 B.R. 445, 449 (Bankr. E.D. Cal. 1999) ("To obtain court approval of attorneys' fees outside of the chapter 13 fee guidelines, a fee application must be filed.").

It is undisputed that Mr. Lawrence did not seek approval for his fees in the predecessor case. 11 U.S.C. §§ 329-330; *see generally* docket in case 07-15236, AER 9-14. The bankruptcy court did not abuse its discretion in giving him $1,000 for his work in *Windman I* because he had neglected to seek any court authorization for fees.

Third, a bankruptcy court has discretion to refuse to approve fees if the applicant cannot produce contemporaneous billing statements. *See Hensley v. Eckerhart*, 461 U.S. 424, 433 (1982). It is undisputed that Mr. Lawrence did not provide a contemporaneous record of the fees he charged the Windmans in either case.[7]

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[7] The only contemporaneous evidence regarding Mr. Lawrence's fees is a handwritten note by the Windmans' bookkeeper. ER at 56. The court continued the case for two weeks after the initial hearing so that Mr. Lawrence could produce additional credible documentation, which he was not able to do. AER at 114-115, 175.

Furthermore, a court has discretion not to award fees if it does not find reconstructed billing statements credible. *See United States v. $12,248 U.S. Currency*, 957 F.2d 1513, 1521 (9th Cir.1992). The bankruptcy court found that nothing in the billing statement that Mr. Lawrence recreated "makes me think it's reliable." AER at 175.

Faced with evidence of Mr. Lawrence's detrimental service to the Windmans, with his lack of billing records, and with his admission that his Attorney Compensation Disclosure was false, the bankruptcy court acted properly in reducing Mr. Lawrence's fees to $1,000 for his work in each case.

II. Under the Circumstances of this Case, the Bankruptcy Court Properly Ordered Mr. Lawrence to Return Fees No Matter When He Received Them.

A. The bankruptcy court could assert jurisdiction to reduce Mr. Lawrence's fees to $1,000 in *Windman II* after the case had been dismissed.

The bankruptcy court ordered the fee reduction in *Windman II* after the case had been dismissed but before it was closed. Mr. Lawrence does not challenge the bankruptcy court's jurisdiction over his fees in *Windman II*. *See* Br. at 17. Nor could he. The court expressly retained jurisdiction to decide the fee issue. ER at 30. Furthermore, it had the power to do so because "bankruptcy courts have broad powers over fees paid to attorneys." Mem. Op. at 9; United States Trustee Supp. ER at 39 (citing 28 U.S.C. § 1334); *see e.g., Park Ave. Assoc. LLC v. Park Ave. Garage, LLC*

(In re Park Ave. Garage, LLC), Nos. 10-455 & 10-391, 2010 WL 5071879, at *1, n.2 (2d Cir. Dec. 14, 2010) (summary order).

. The bankruptcy appellate panel below relied on *In re Aheong* to hold the bankruptcy court had jurisdiction to reduce attorney fees even if the case were dismissed. Mem. Op. at 9-10 (United States Trustee Supp. ER at 39-40) (discussing *Aheong v. Mellon Mortg. Co. (In re Aheong)*, 276 B.R. 233, 244 (9th Cir BAP 2002)). It concluded that section 1334, which applies to bankruptcy courts through 28 U.S.C. § 157(a), allowed a bankruptcy court to hear any request for relief under Bankruptcy Code, including, section 329. *Id.* (holding that an attorney fee adjudication is a "core proceeding arising under title 11" under 28 U.S.C. § 157(b)(1) & (2)(A)).

This Court has also approved consideration of attorney fee issues after the main bankruptcy petition has been dismissed but before the case is closed. *Tsafaroff v. Taylor (In re Taylor)*, 884 F.2d 478, 481 (9th Cir. 1989) (stating that a bankruptcy court retains jurisdiction to dispose of "ancillary matters" such as "an award of attorney's fees for services rendered in connection with the underlying action"); *see also Battle Ground Plaza, LLC v. Ray (In re Ray)*, – F.3d – , No. 09-60005, 2010 WL 4160135, at *9 (9th Cir. Oct. 25, 2010); *U.S.A. Motel Corp. v. Danning*, 521 F.2d 117 (9th Cir. 1975) (affirming a fee award rendered after a chapter 11 case was dismissed).

In analogous situations, the Supreme Court has allowed courts to address attorney fee issues after the underlying case is completed because "[i]t is well established that a federal court may consider collateral issues after an action is no longer pending." *Cooter & Gell v. Hartmarx Corp.*, 496 U.S. 384, 395 (1990) (awarding Rule 11 sanctions against an attorney) (citing *Sprague v. Ticonic Nat'l Bank*, 307 U.S. 161(1939)). In *Sprague*, the Court held that an attorney fee application cannot be fully assessed until the underlying litigation is over and therefore a federal court can consider a request for attorney fees "years after a judgment on the merits." *See Sprague*, 307 U.S. at 170; *Chambers v. NASCO Inc.*, 501 U.S. 32, 56 (1991) (taxing attorney fees after judgment).

Furthermore, *Cooter* itself held that a court has jurisdiction to consider Rule 11 sanctions after the underlying case is terminated because the violation occurs during the case when the meritless papers are filed. *Cooter*, 496 U.S. at 395. If a litigant could escape sanction simply by dismissing the case, the deterrent effect of Rule 11 would be lost. *Id.* at 398.

Similarly, Mr. Lawrence rendered "substandard" services to the Windmans throughout his representation. He should not be able to avoid the consequences simply because his poor lawyering led to the dismissal of the case. *See also NASCO*, 501 U.S. 32, 55 (1991) (allowing court to sanction of attorneys fees after final judgment).

Mr. Lawrence's reliance on *Taylor* for the proposition that a bankruptcy court cannot reduce fees in a dismissed case is misplaced. Br. at 16. Although *Taylor* says that a bankruptcy court may not grant new relief after a case has been dismissed, 884 F.2d at 481, it also carves out an exception that allows courts to deal with "ancillary matters" such as attorney fees after dismissal. *Id.* The bankruptcy court did not order any "new relief" as Mr. Lawrence asserts. Br. 16-17. Rather, it dealt with the question of Mr. Lawrence's compensation after *Windman II* had been dismissed and it became clear how detrimental Mr. Lawrence's representation had been. *NASCO*, 501 U.S. at 55; *Sprague*, 307 U.S. at 170.

Finally, Mr. Lawrence is responsible for the fact that bankruptcy court did not address fees in the predecessor case because he did not seek employment authorization or approval for fees. 11 U.S.C. § 327, 330. He cannot ignore the requirements of the Bankruptcy Code and then seek to profit from his inaction.

The bankruptcy court acted properly in exercising its jurisdiction even after *Windman II* had been dismissed to order Mr. Lawrence to keep $1,000 in fees and return the balance.

B. The Bankruptcy Court Also Acted Properly In Reducing Mr. Lawrence's Fees in the Predecessor Case, *Windman I*, to $1,000.

The only procedural difference between the two *Windman* cases is that the predecessor case was both dismissed and closed without addressing attorney fees whereas the follow-on case dealt with the fee issue post dismissal but before closure.

This Court has not ruled on whether closing a case terminates the bankruptcy court's jurisdiction over attorney fees.[8] It has addressed the issue in *dicta*, however, observing that such jurisdiction can be proper in the case of attorney fees. *Elias v. United States Trustee* (*In re Elias)*, 188 F.3d 1160, 1161 (9th Cir. 1999) (stating that reopening a case "was not necessary for a determination of fees in favor of Elias").

On the issue of whether the bankruptcy court could reduce fees without "formally reopening" *Windman I* the bankruptcy appellate panel stated "[w]e think it could." *Id.* at 10. It did not decide the matter, however, because any failure to reopen was "harmless error." *Id.*

Other lower courts in this circuit have concluded that in the bankruptcy context closing a case does not necessarily affect jurisdiction. *Menk v. Lapaglia (In re Menk*), 241 B.R. 896, 910-11 (B.A.P. 9th Cir. 1999) ("[R]eopening a closed case is not a jurisdictional prerequisite to subject-matter jurisdiction under § 1334(b)."); *Sole Survivor Corp. v. Buxbaum*, No. CV 07-3858, 2009 U.S. Dist. LEXIS 9400, at *16 (C.D. Cal. Jan. 22, 2009) (stating that closing a bankruptcy case is an administrative act done by the clerk of court that has no jurisdictional significance); *Aheong*, 276 B.R. at 244.[9]

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[8] This jurisdictional argument is based on the fact that attorney fees are at issue. The United States Trustee does not take any position concerning bankruptcy court jurisdiction in closed cases as a general matter.

[9] In a "Notice to Appellants" the United States District Court for the Southern District of Florida, acting in a bankruptcy appeal, stated: "The Court's indication in its Order that the case was closed, which was included in the order for statistical

Finally, the United States Trustee has located two cases that are directly on-point and in both cases the courts – one bankruptcy, one district – held that the authority of a bankruptcy court to police fees stretches back into closed cases. *Leinbach v. Reigle (In re Ramelah)*, No. 08-5074, 2009 WL 1213953, at *7 (E.D. Pa. May 5, 2009) ("the *Ramelah III* Bankruptcy Court acted properly to order disgorgement of a fee associated with a prior closed case"). The *Brown* court found that its "jurisdiction to review such fees is not dependent on whether the status of the case stands as open, closed, pending, or dismissed." *In re Brown*, 371 B.R. 486, 494 (Bankr. N.D. Okla. 2007) (ordering disgorgement in a pending 2006 bankruptcy case of fees charged in two related, but dismissed, 2003 bankruptcy cases).

Remalah and *Brown* are directly on point. They involve poor performance by a lawyer who failed to disclose fees and who represented the debtors in serial cases. The United States Trustee is not aware of any case with this fact pattern with the opposite result.

Interpreting bankruptcy court jurisdiction to allow attorney fee determinations at any stage of this case makes sense. Although section 1334(b), which is the bankruptcy-specific jurisdictional provision, does not speak in terms of closed cases,

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purposes only, does not require a subsequent order reopening the case in order to permit a party to file a timely motion for reconsideration." *Law Works USA Inc. v. Walton*, No. 10-60731, (S.D. Fla. entered Oct. 6, 2010) (Dkt. #28) (available on PACER).

the legislative history to its similar predecessor, repealed section 1471(b), expressly stated that jurisdiction exists over closed cases. Section 1334(b) went into effect on July 10, 1984. Act of July 10, 1984, Pub. L. 98-353, 98 Stat. 333. Its predecessor, 28 U.S.C. § 1471(b), was enacted in 1978 and was superceded by the enactment of section 1334(b). Act of Nov. 6, 1978, Pub. L. 95-598, 92 Stat. 2667.

The legislative history of section 1334(b)'s similarly-worded predecessor noted it gave bankruptcy courts jurisdiction to take action in closed cases."[10] H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 445 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5787, 6400. The legislative history states that bankruptcy court jurisdiction "also includes any disputes related to administrative matters in a bankruptcy case. The use of the term 'proceeding,' though, is not intended to confine the bankruptcy case. *Very often, issues will arise after the case is closed. . . . The bankruptcy courts will be able to hear these proceedings because they arise under Title 11*." *Id.* (emphasis added).

The United States does not mean to suggest that bankruptcy courts are free to act outside the ambit of any case. To exercise jurisdiction, it must have a vehicle - an open case - through which to act.

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[10] This legislative history is significant because the text of the relevant part of section 1471, which is section 1471(b), mirrors the relevant part of section 1334 of title 28, which is section 1334(b). *Compare* 28 U.S.C. 1471(b) (repealed) (granting bankruptcy courts jurisdiction over "all civil proceedings arising under title 11 or arising in or related to cases under title 11") *with* 28 U.S.C. § 1334(b) (bestowing jurisdiction on "all civil proceedings arising under title 11, or arising in or related to cases under title 11"). The full text is appended in the Addendum at 12-13.

Here there was a case - the Windmans' follow-on bankruptcy, which overlapped the predecessor case by one day. The two cases had the same judge. They had the same parties. The pleadings were virtually identical because Mr. Lawrence appears to have largely reprinted the predecessor case's pleadings and resubmitted them in *Windman II*. And Mr. Lawrence put his fees in the first case at issue in the second one by first alleging he had received $10,000 in the second case and then changing his story to allege $8,000 of that $10,000 was actually earned in the first.

There may be cases where section 1334(b) is not broad enough to allow courts to take actions in open cases that occurred in a prior one. But this situation, which involves identical facts and law, and sits at the core of a bankruptcy court's jurisdiction - adjudicating fees - is one in which the bankruptcy court had jurisdiction to adjudicate Mr. Lawrence's fees in the first case after Mr. Lawrence put them at issue in the follow-on case.

Were this Court to have concerns over the bankruptcy court's power to order a fee reduction in a closed case, however, the solution would be to affirm the fee reduction for the open case (*Windman II*) and remand with instructions so that the bankruptcy court could re-open the predecessor case and enter the fee reduction order in that case as well. 11 U.S.C. § 350. There is no legal justification for allowing Mr. Lawrence to keep his full retainer.

III. Mr. Lawrence's Arguments that the Bankruptcy Court Improperly Reduced His Fees Are Unpersuasive.

A. Mr. Lawrence's argument that his work in the Windmans' state-court real estate action was "in connection with" or "in contemplation of" the Windmans' two bankruptcy cases has been waived, is not supported by the evidence, and does not redeem his poor performance in the bankruptcy cases.

Mr. Lawrence argues that other work that he did for the Windmans in connection with a non-bankruptcy state-law suit property suit was "in connection with" or "in contemplation of" their bankruptcy case, and thus he is entitled to the full amount of his fees. Br. at 9-11. This argument is without merit for three reasons. It is waived; it is not supported by the evidence; and services related to state-court litigation cannot offset Mr. Lawrence's detrimental representation of the Windmans in the bankruptcy court.

Mr. Lawrence did not raise the issue of his state-court litigation work for the Windmans in his opening brief to the bankruptcy appellate panel. *Lawrence v. United States Trustee (In re Windman)*, No. 08-1080, Doc. #91291691 (filed Apr. 9, 2009).[11] An issue not raised on appeal is waived. "It is a fundamental rule of federal appellate procedure that only such points as are made in the court below or such questions as

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[11] This Court may take judicial notice of Mr. Lawrence's briefs below. *O'Rourke v. Seaboard* (*In re E.R. Fegert, Inc.*), 887 F.2d 955, 958 (9th Cir. 1989). In addition, the United States Trustee has filed a motion to supplement the record in order to provide excerpts from the briefs in his Supplemental Record Excerpts.

are there raised will be reviewed on appeal[.]" *Kottemann v. Commissioner of Internal Revenue*, 81 F.2d 621, 623 (9th Cir. 1936).[12]

And Mr. Lawrence only made a general argument about the value of his services in his reply brief to the bankruptcy appellate panel, mentioning his work in the state-court litigation. This, however, did not preserve the issue for two reasons.

First, a litigant may not raise an issue for the first time on appeal in a reply brief. *United States v. Montoya*, 45 F.3d 1286, 1300 (9th Cir.), *cert. denied*, 516 U.S. 814 (1995). *But see Baldwin v. Marshack (In re Baldwin)*, 70 B.R. 612, 617 (B.A.P. 9th Cir. 1987) (stating that raising an issue for the first time in a reply brief is "disfavored"). Second, Mr. Lawrence did not argue that his state-court litigation work was "connected to" or "in anticipation of" the Windmans' bankruptcy cases until this appeal. Even in his brief to this Court, he does not discuss the tests used to determine if legal services do qualify under section 329. *In re Perrine*, 369 B.R. 571, 580 (Bankr. C.D. Cal. 2007); *In re Rheuban*, 121 B.R. 368, 378 (Bankr. C.D. Cal. 1990). An underdeveloped argument is likewise waived. *See In re Aimster Copyright Litig.*, 334 F.3d 643, 656 (7th Cir. 2003).

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[12] A district court may decide an issue of law that was not raised in the bankruptcy court, if it is supported by the record. *Pizza of Hawaii, Inc. v. Shakey's, Inc. (In re Pizza of Hawaii, Inc.)*, 761 F.2d 1374, 1379 (9th Cir.1985). Here, however, Mr. Lawrence is attempting for the first time to interpret section 329 based on facts that he has not proven and which the bankruptcy court did not find.

In addition, the lack of reliable evidence is fatal to Mr. Lawrence's argument. The bankruptcy court did not abuse its discretion in finding that his billing statements were not credible. AER at 175. Therefore, Mr. Lawrence has not met his burden as appellant to show that 1) he did work related to the state-court litigation and 2) that his services had a connection to the bankruptcy case that would satisfy section 329 and 3) that his services provided value to the chapter 11 estate, as required by section 330.

Finally, Mr. Lawrence is left with the bankruptcy court's finding that his services were "substandard." Mr. Lawrence does not explain how any legal work that led to the dismissal of the *Windman II* bankruptcy case could possibly warrant compensation under section 329. The bankruptcy court did not clearly err in finding that Mr. Lawrence provided no benefit to the estate, "other than stalling, which is an inappropriate benefit . . . ." AER at 179.

B. The bankruptcy court's finding that the Windmans' case was filed in bad faith may have been "expunged" in an appeal settlement, but this is irrelevant to the bankruptcy court's decision to reduce Mr. Lawrence's fees.

Mr. Lawrence argues that the district court on appeal approved a settlement in which the bankruptcy court's "bad faith" finding was "expunged" from the record, making the reduction of his fees clearly erroneous. Br. at 12; ER at 63-64 (Order). This argument is unpersuasive.

Mr. Lawrence is making the remarkable suggestion that he should get full fees because he filed a bankruptcy case in bad faith. Such conduct should be sanctioned, regardless of whether the sanctioned party subsequently persuades the other party to give up the bad faith finding for a payment of money, which is what happened here.[13]

The bankruptcy court discussed the fact that *Windman II* was dismissed as a bad-faith filing but that aspect of the case was not the "dispositive factor" that caused the bankruptcy court to reduce Mr. Lawrence's fees. Instead, "the problem [was] . . . that the services weren't adequately rendered in order to make that bankruptcy filing survive." AER at 199-200. The decision to reduce Mr. Lawrence's fees resulted from 1) the limited services he rendered to the Windmans and 2) the poor quality of the services he did perform. AER at 102-103. Specifically, Mr. Lawrence's efforts resulted in two dismissed bankruptcy cases and cost his clients "a fair amount of money," only a part of which was attributable to Mr. Lawrence's advice to file for bankruptcy to delay state-court litigation. AER at 195-96.

C. The fee-reduction order is not "moot."

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[13] Although the issue is not before this Court, a losing party may not expunge, i.e. vacate, a court finding through an agreement with the prevailing party, as was done here. *United States Bancorp Mortg. Co. v. Bonner Mall Partnership*, 513 U.S. 18, 26 (1994) ("It is petitioner's burden, as the party seeking relief from the status quo of the appellate judgment, to demonstrate . . . equitable entitlement to the extraordinary remedy of vacatur.").

Mr. Lawrence's argument that the fee-reduction order is "moot" is without merit. The bankruptcy court ordered Mr. Lawrence to return $8,850 in fees to Wayne Windman, the lead state-court plaintiff. The payment was to satisfy in part the court's earlier order that the Windmans and Mr. Lawrence were jointly and severally liable for the attorney fees associated with the bad-faith chapter 11 filing. AER at 202-203; ER at 51-52 (Order). Mr. Lawrence now alleges, without support in the record, that the $18,000 due to the state-court plaintiffs has been paid and therefore following the bankruptcy court's order would result in a "double-payment." Br. at 13.

Even if it is true that the attorney-fee debt has been satisfied, it does not follow that the order that Mr. Lawrence return fees is "moot." *Id.* This is so because section 329 governs this case. It provides that a court may "order the return of any such payment, to the extent excessive, to – . . . (2) the entity that made such payment." 11 U.S.C. § 329(b)(2). Mr. Lawrence's fees were reduced because he did not render valuable service to the Windmans under section 329 and 330 of the Bankruptcy Code. AER at 200. The mechanics of returning the fees is a separate issue from the legal basis for ordering the fee reduction in the first place.

If Mr. Lawrence or the Windmans have reimbursed Wayne Windman for his attorney fees, he should inform the bankruptcy court. At that point, the court could redirect payment, most likely to his surviving client, Mrs. Pauline Windman.[14] That, rather than keeping the $8,500 in excessive fees, is the avenue Mr. Lawrence should take if the sanction has been paid.

D. Mr. Lawrence's due process rights were not violated.

Mr. Lawrence's argument that his due process rights were violated because the bankruptcy court did not give him sufficient time to speak at the fee hearings borders on the frivolous for two reasons. Br. at 19-21. First, there is no constitutional right to oral argument. *Toquero v. I.N.S.*, 956 F.2d 193, 196, n.4 (9th Cir. 1992). Second, the bankruptcy court afforded Mr. Lawrence ample time to present his case.

The bankruptcy court held two hearings on the United States Trustee's fee reduction motion – the first on February 7, 2008 and the second on February 28th. The judge continued the first hearing after Mr. Lawrence changed his story by testifying that his attorney disclosure form in *Windman II* was inaccurate and that he had received his retainer during the predecessor case. AER at 110. The court gave Mr. Lawrence an extra two weeks to provide billing records to clarify the situation, although they should have already been submitted to the court. AER at 115.

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[14] Nor does Mr. Lawrence's assertion that Mrs. Windman wants him to keep the money, Br. at 13, factor into the analysis. One purpose of section 329 is to safeguard debtors against the "serious potential for overreaching by the debtor's attorney" in the bankruptcy context. S. Rep. No. 95-989, 95th Cong., 2d. Sess., 1978 U.S.C.C.A.N. 5787; *In re Hill*, 5 B.R. 541, 542 (Bankr. C.D. Cal. 1980) (stating it is the court's "duty under § 329 of the Code to see that the debtor is not imposed upon by her counsel").

At the second fee hearing, the bankruptcy court engaged Mr. Lawrence for 17 transcript pages. AER 188-205. The court requested twice that Mr. Lawrence focus his comments to issues relevant to the fee motion. AER at 191, 194. It then stated "Okay, so I'm going to give you a total of five *more* minutes to make remarks here . . . it isn't just that I have other parties waiting, it's that what you're telling me is not helpful and not relevant to the issues I need to focus on." AER at 197 (emphasis added).

A court is not required to work with a litigant, particularly one who has been licensed as an attorney, so that it can extract information to allow it to construct a cogent argument. *See Toquero*, 956 F.2d at 196, n.4. Mr. Lawrence was given ample opportunity to present his case. His failure to persuade the bankruptcy court does not violate his due process rights.

CONCLUSION

For these reasons, the United States Trustee respectfully asks this Court to affirm the decisions entered below.

Dated: December 16, 2010

Respectfully submitted,

United States Trustee for Region 16

PETER C. ANDERSON JILL STURTEVANT

Assistant United States Trustee for
Region 16

Department of Justice
725 South Figueroa Street, Ste 2600
Los Angeles, California 90017
Ph: (213) 894-4480
Fax: (213) 814-2603

/s/ Catherine B. Sevcenko
Trial Attorney

RAMONA D. ELLIOTT
General Counsel

P. MATTHEW SUTKO
Associate General Counsel

CATHERINE B. SEVCENKO
Trial Attorney

Executive Office for United States
Trustees
Department of Justice
20 Massachusetts Avenue, N.W.
Washington, D.C. 20530
Ph: (202) 307-1399
Fax: (202) 307-2397

CERTIFICATE OF COMPLIANCE WITH FRAP 32(a)(7)(c)

I hereby certify that the foregoing brief complies with the typeface requirements in FRAP 32(a)(5) and the page and type-volume limitation in FRAP 28.1(e) & 32(a)(7). I also certify that the foregoing brief was prepared using Corel Word Perfect 12, is proportionately spaced, using Garamond font,14 point type. Based on a word count under Corel WordPerfect 12, this brief contains **9,827** words excluding the table of contents, table of authorities, and certificates of counsel.

/s/Catherine B. Sevcenko
Catherine B. Sevcenko

STATEMENT OF RELATED CASES

Appellee, United States Trustee, is not aware of any related cases currently pending before this Court.

Dated: December 16, 2010.

Respectfully submitted,
/s/ Catherine B. Sevcenko

CERTIFICATE OF SERVICE

Under penalty of perjury, I certify that, on the date this document was filed, December 16, 2010, a copy of this document, along with a copy of the Required Documents for the Record Excerpts, was mailed via first-class mail as follows:

Lorraine Howell, Esq.
Law Offices of Lorraine Howell
301 E. 17th Street, Suite 210
Wells Fargo Building
Costa Mesa, CA 92627

In addition, on the date this document was filed, four copies of the United States Trustee's Required Supplemental Record Excerpts were mailed to the Court as follows:

Clerk, United States Court of Appeals
for the Ninth Circuit
95 Seventh Street
San Francisco, CA 94103

/s/ Catherine B. Sevcenko
Catherine Sevcenko
Trial Attorney
Office of the General Counsel
U.S. Trustees Program
20 Massachusetts Avenue, NW
Suite 8000
Washington, DC 20530
(202) 305-2757
catherine.b.sevcenko@usdoj.gov

ADDENDUM

BRIEF BANK — "SUMMARY SHEET" *Printed Wed-12/10/08 15:41*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*
In re: Daryl Withrow (Lafayette v. Collins and Morse, UST)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*
B.A.P. 1st Cir.

3. ("CCN") ***CURRENT*** CASE NO.
No.: 08-055

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*
No.: 07-41243-HJB
Court: Bankr. Mass.
(Identify judge & cite, if any)

5. ("SO") ***SOURCE***
U.S. TRUSTEES

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*
Filed: December 8, 2008
Type: Brief of Appellee, United States Trustee

7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g., "UST/OGC"]*
Richard King, Stephen Meunier, David Gold, Matthew Sutko, Phoebe Morse
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s)

&

√ Any Miscellaneous ***BACKGROUND***

• Did the bankruptcy court abuse its discretion in imposing sanctions pursuant to Fed. R. Bankr. P. 9011(c) and 11 U.S.C. § 707(b)(4)?

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UNITED STATES BANKRUPTCY APPELLATE PANEL
FOR THE FIRST CIRCUIT

BAP NO. MW 08-055

DARYL WITHROW,
Debtor.

FRANCIS LAFAYETTE,
Appellant,

v.

JOSEPH B. COLLINS, Chapter 7 Trustee,
and PHOEBE MORSE, United States Trustee,
Appellees.

ON APPEAL FROM THE UNITED STATES BANKRUPTCY COURT FOR THE DISTRICT OF MASSACHUSETTS

CASE NO. 07-41243-HJB

BRIEF OF APPELLEE, UNITED STATES TRUSTEE

Ramona D. Elliot
General Counsel
P. Matthew Sutko
Associate General Counsel
Department of Justice
Executive Office for United States Trustee
20 Massachusetts Avenue, NW
Washington, DC 20530

Phoebe Morse
United States Trustee
Stephen E. Meunier, Esq.
Trial Attorney
Office of the United States Trustee
Department of Justice
446 Main Street, 14th Floor
Worcester, MA 01608
Tel: (508) 793-0555, ext. 119

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STATEMENT OF JURISDICTION

This appeal arises from a final order issued by the United States Bankruptcy Court for the District of Massachusetts (Henry J. Boroff, C.J.) on July 3, 2008, finding that attorney Francis Lafayette violated Fed. R. Bankr. P. 9011 and 11 U.S.C. § 707(b)(4), and imposing sanctions against Mr. Lafayette in the amount of $3,585. This Court has jurisdiction over this appeal under 28 U.S.C. § 158 (a) and (c).

STATEMENT OF ISSUE PRESENTED

Did the bankruptcy court abuse its discretion in imposing sanctions pursuant to Fed. R. Bankr. P. 9011(c) and 11 U.S.C. § 707(b)(4)?

STANDARD OF APPELLATE REVIEW

Appellate courts "independently review the bankruptcy court's decision, applying the 'clearly erroneous' standard to findings of fact and *de novo* review to conclusions of law'. . . . [Where the issue] poses a mixed question of law and fact, [the court applies] the clearly erroneous standard, unless the bankruptcy court's analysis was 'infected by legal error. . . .'" In re Winthrop Old Farm Nurseries, Inc., 50 F.3d 72, 73 (1st Cir. 1995) (citations omitted). See also Fed. R. Bankr. P. 8013 (standard of appellate review).[1] An appellate court may reverse sanctions imposed under Rule 9011 for manifest abuse of discretion. Kristan v. Turner (In re Kristan), 395 B.R. 500, 506 (B.A.P. 1st Cir. 2008).

STATEMENT OF THE CASE

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[1] A finding of fact is clearly erroneous "when although there is evidence to support it, the reviewing court on the evidence is left with the definite and firm conviction that a mistake has been committed. . . ." United States v. United States Gypsum Co., 333 U.S. 364, 395, 68 S.Ct. 525, 542, 92 L.Ed. 756, 766 (1948). "When the finding of fact is premised on an improper legal standard, or a proper one is improperly applied, that finding loses the insulation of the clearly erroneous rule. . . ." Wilson v. Huffman (In re Missionary Baptist Foundation of America, Inc., 712 F.2d 206, 209 (5th Cir. 1983).

On April 9, 2007, attorney Francis J. Lafayette ("Mr. Lafayette") filed a voluntary petition for relief under the reorganization provisions of chapter 13 of the Bankruptcy Code on behalf of his client, Mr. Daryl Withrow ("Debtor"). On April 20, 2007, the case was voluntarily converted to chapter 7. Due to its concerns regarding the veracity of certain papers filed by Mr. Lafayette in this case, the bankruptcy court, on September 6, 2007, entered an order requiring Mr. Lafayette to show cause why he should not be sanctioned for misrepresentations, omissions, and errors contained on the Debtor's bankruptcy Schedules, Statement of Financial Affairs, and Rebuttal of Presumption of Abuse (the "Show Cause Order"). On November 7, 2007, pursuant to Mr. Lafayette's request, an evidentiary hearing was held to consider the bankruptcy court's Show Cause Order. Finally, on July 3, 2008, the bankruptcy court entered an order, and related memorandum decision, imposing sanctions on Mr. Lafayette pursuant to Fed. R. Bankr. P. 9011(c)(1)(B) and 11 U.S.C. § 707(b)(4)(C) and (D). Mr. Lafayette now appeals from that order.[2]

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[2] The bankruptcy court's July 3, 2008, order also rescheduled a related hearing on Mr. Lafayette's fee application in this case. That hearing was held before the bankruptcy court on July 16, 2008. At that hearing, the bankruptcy court entered an order disallowing Mr. Lafayette's fees and requiring Mr. Lafayette to disgorge $1,195.00 previously received from the Debtor. On July 26, 2008, Mr. Lafayette filed a notice of appeal from the bankruptcy court's July 16, 2008 order. Nevertheless, because Mr. Lafayette failed to timely comply with Bankruptcy Rule 8006 with respect to that appeal, that appeal was dismissed on August 22, 2008.

STATEMENT OF FACTS[3]

On April 9, 2007, the Debtor, by and through his counsel, Mr. Lafayette, filed a voluntary petition for relief under the reorganization provisions of chapter 13 of the Bankruptcy Code in the United States Bankruptcy Court for the District of Massachusetts, Western Division. UST App. at 1-12. The filing consisted only of the voluntary petition for relief and the matrix of creditors. Shortly thereafter, the bankruptcy court ordered the Debtor to file the remaining documents required by section 521 of the Bankruptcy Code, and Fed. R. Bankr. P. 1007, by April 25, 2007. UST App. at 13-14.

On April 20, 2007, the Debtor voluntarily converted his case to a liquidation case under chapter 7 of the Bankruptcy Code. UST App. at 15-16. At that time, the bankruptcy court issued a new order requiring that all missing documents required pursuant to section 521 of the Bankruptcy Code, and Fed. R. Bankr. P. 1007, be filed by May 8, 2007. UST App. at 17-18.

On May 9, 2007, one day beyond that deadline, Mr. Lafayette filed a motion to extend time requesting that the May 8, 2007 deadline imposed by the bankruptcy court to file the Debtor's missing documents be extended once again to May 25, 2008. UST App. at 19. That same day, the bankruptcy court granted the extension despite its tardiness. UST App. at 21. The Court did not comment upon Mr. Lafayette's failure to explain why the motion was being filed after the deadline had passed. Id.

On May 24, 2007, Mr. Lafayette filed the documents required by the bankruptcy court's

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[3] References in this Statement of Facts do not cite to the Record Appendix because the Record Appendix was not served on the United States Trustee. Instead, attached to this brief is a document titled "Appendix of Appellee, the United States Trustee," which contains pertinent portions of the record on appeal. References to this Appendix will be cited as UST App. at ___.

May 9, 2007 order, and also filed a document he styled "Rebuttal of Presumption of Undue Hardship."[4] UST App. at 22-66. The rebuttal sought to preserve a chapter 7 discharge for the Debtor due to "special circumstances." Id. at 66. The rebuttal claimed that the Debtor's average monthly income of $5,333.33 (allegedly derived from the Debtor's means test form) was based on overtime pay that he no longer received. Id. Consequently, the rebuttal stated that the Debtor's average monthly income had been reduced to $4,000.00. Id. The rebuttal also claimed that the Debtor's mother had suffered a stroke subsequent to the Debtor filing the case, and that he would have to pay $100.00 per month to help support her. Id.

On June 4, 2007, Joseph B. Collins, chapter 7 trustee for the Debtor's bankruptcy estate, filed a response to the rebuttal. UST App. at 67-73. The trustee claimed that the rebuttal was false and misleading for a number of reasons. Id. at 68-69. First, the trustee claimed that the Debtor's means test form did not list $5,333.33 as his average monthly income; it actually listed his average monthly income as $4,834.22. Id. Second, the trustee claimed that recent pay stubs from the Debtor's employer evidenced that the Debtor was, in fact, still receiving overtime pay. Id. Third, the trustee claimed that Debtor's mother had suffered her stroke before the commencement of the case, not after it. Id.

On July 17, 2007, Mr. Lafayette filed an interim application for compensation in this case, requesting compensation in the amount of $1,195.00.[5] UST App. at 74-88. On July 27, 2007, the trustee objected to the application on the grounds that because certain papers filed by

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[4] In preparing the Debtor's means test form, Mr. Lafayette checked the box indicating that a presumption of abuse arose under section 707(b)(2) of the Bankruptcy Code. UST App. at 60.

[5] Mr. Lafayette is required to file an application for compensation with the bankruptcy court in every case in which he serves as counsel in the District of Massachusetts. See In re LaFrance, 311 B. R. 1, 25 (Bankr. D. Mass. 2004).

Mr. Lafayette in this case were false and misleading, and because the Debtor testified at his section 341 meeting of creditors that he had fully and truthfully informed Mr. Lafayette about the facts and circumstances related to those papers, compensation was not appropriate. UST App. at 89-93. The trustee reiterated the claims made in his June 4, 2007 response to the Debtor's "Rebuttal of Presumption of Hardship," and noted that notwithstanding that the Debtor's Schedule B only reflected one bank account, the Debtor admitted to having seven bank accounts at his section 341 meeting of creditors. Id. The United States Trustee objected to Mr. Lafayette's application as well, for the same reasons cited by the trustee. UST App. at 94-95.

On August 3, 2007, the Debtor, through Mr. Lafayette, filed an affidavit seeking to clarify the discrepancies pointed out by the trustee in his objection to Mr. Lafayette's fee application. UST App. at 96-100. Among other things, the Debtor stated that the failure to list all of his bank accounts on his schedules and statements was due to his own forgetfulness. Id. Further, the Debtor reaffirmed his financial commitment to his mother. Id.

On September 5, 2007, the bankruptcy court held a hearing on Mr. Lafayette's fee application. UST App. at 108. At this hearing, the trustee and Mr. Lafayette proposed a settlement in which Mr. Lafayette would pay the trustee $1,000.00 to compensate him for his time and expenses incurred due to Mr. Lafayette's errors in this case. In re Withrow, 391 B. R. 217, 222 (Bankr. D. Mass. 2008). The bankruptcy court did not approve this settlement, and indicated that a Rule 9011 sanction might be appropriate. Id. Mr. Lafayette objected, and requested an evidentiary hearing on the matter. Id. The bankruptcy court then entered the Show Cause Order in order to provide Mr. Lafayette with the evidentiary hearing he had requested. UST App. at 117.

On October 18, 2007, the trustee filed an affidavit with the bankruptcy court, pointing out additional errors with the Debtor's schedules and statements. UST App. at 118. Among other things, the trustee stated that Mr. Lafayette, on behalf of the Debtor, failed to exempt the Debtor's equity in his home and automobile on Schedule C. Id. at 119-20. Further, the trustee repeated his concerns about the misleading nature of the Debtor's schedules, and other papers filed with the bankruptcy court concerning the Debtor's mother and overtime pay. Id. at 122-23.

On November 4, 2007, the Debtor, acting through Mr. Lafayette, filed an affidavit in response to the trustee's October 18, 2007 affidavit. UST App. at 128. In it, the Debtor continued to deny that he had received overtime pay, and stated that medical conditions caused him to answer questions incorrectly at times. Id. Further, the affidavit stated that amended schedules had been filed by the Debtor. Id.

In his affidavit the Debtor also gave two valuations for his home. UST App. at 128. (*compare* paragraph 6 of the affidavit, which states a value of $179,900 for the Debtor's home *with* paragraph 7 of the affidavit, which states a value of $177,000 for the Debtor's home).

On November 6, 2007, two days after the Debtor's November 4, 2007 affidavit was filed, Mr. Lafayette filed amendments to the Debtor's Schedules A, B, C, and Statement of Financial Affairs with the bankruptcy court. UST App. at 109, 137.

On November 7, 2007, the bankruptcy court held the show cause hearing requested by Mr. Lafayette. UST App. at 152. At that hearing, Mr. Lafayette admitted that the Debtor's schedules contained errors related to Debtor's claimed exemptions. Id. at 163. Mr. Lafayette also admitted that he had helped the Debtor prepare and file his November 4, 2007 affidavit. Id. at 193. Mr. Lafayette claimed that the omission of the Debtor's bank accounts on the Debtor's schedules and/or statement of financial affairs was due to the Debtor's forgetfulness and was justified by the minimal balances in those accounts. Id. at 191. Mr. Lafayette also conceded that he had made mistakes on the Debtor's means test form. Id. at 175. Finally, when questioned at length by the bankruptcy court concerning alleged inconsistencies and errors regarding the Debtor's actual income as reported on Schedule I,[6] and the actual income reflected on the Debtor's May 24, 2007 "Rebuttal of Presumption of Undue Hardship,"[7] Mr. Lafayette's sole response was to cite the $4,834.22 in current monthly income reflected on the Debtor's means test form and state that "you would logically assume that the monthly income is less if that overtime pay is taken away." Id. at 189.

On July 3, 2008, the bankruptcy court issued a memorandum decision regarding the Show Cause Order. UST App. at 209. It ruled that Mr. Lafayette had engaged in misconduct, and specifically found that Mr. Lafayette had failed to: **(1)** properly review information provided by the Debtor with respect to his prepetition income; **(2)** identify contradictions and inconsistencies on the Debtor's schedules and statement of financial affairs, May 24, 2007 "Rebuttal of Presumption of Undue Hardship," and affidavits submitted on behalf of the Debtor, before the filing of those documents; **(3)** promptly correct those contradictions and inconsistencies; and **(4)** place himself in a position of being able to explain the reasons for those contradictions and inconsistencies to the bankruptcy court in the context of the November 7, 2007 show cause hearing. Id..

Based upon these findings, the bankruptcy court, in an order entered that same day, imposed sanctions against Mr. Lafayette under Federal Rule of Bankruptcy Procedure 9011 and section 707(b)(4) of the Bankruptcy Code. UST App. at 223. The bankruptcy court imposed

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[6] The Debtor's Schedule I reflects actual gross income in the amount of $3,309.73. UST App. at 47.

[7] The Rebuttal reflects actual gross income in the amount of $4,000, plus or minus. UST App. at 48.

these sanctions in the amount of $3,585, and directed that they be made payable to the case trustee within thirty days. Id.

On July 14, 2008, Mr. Lafayette filed his notice of appeal from the bankruptcy court's July 3, 2008 order.[8] UST App. at 225.

SUMMARY OF ARGUMENT

Because neither the bankruptcy court's findings regarding the basis for sanctions, nor the modest $3,585 in sanctions imposed constitute an abuse of discretion, this Court should affirm the bankruptcy court's July 3, 2008 order. See Fed. R. Bankr. P. 8013; Western Auto Supply Co. v. Savage Arms, Inc. (In re Savage Industries, Inc.), 43 F.3d 714, 719-20 (1st Cir. 1994).

ARGUMENT

A. The Bankruptcy Court Had an Adequate Factual Basis to Impose Sanctions Under Rule 9011 and Section 707(b)(4).

Federal Rule of Bankruptcy Procedure 9011(b)(3) requires attorneys practicing before the bankruptcy courts to certify that, to the best of their knowledge, information, and belief, formed after an inquiry reasonable under the circumstances, factual contentions contained in papers submitted to the bankruptcy courts have evidentiary support, or are likely to have evidentiary support after a reasonable opportunity for further investigation or discovery. See Fed. R. Bankr. P. 9011(b)(3). Similarly, section 707(b)(4)(C) of the Bankruptcy Code provides that the signature of an attorney on a petition, pleading, or written motion shall constitute a certification

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[8] Although Mr. Lafayette's notice of appeal is styled as an appeal to the United States District Court for the District of Massachusetts, he failed to file a separate statement of election to appeal to the district court as required by Fed. R. Bankr. P. 8001 (e) and 28 U.S.C. § 158 (c)(1). Accordingly, on July 28, 2008, this Court entered an order denying a transfer of the instant appeal to the district court.

that the attorney has: (a) performed a reasonable investigation into the circumstances that gave rise to the petition, pleading, or written motion; and (b) determined that the petition, pleading, or written motion is well grounded in fact, and is warranted by existing law, or a good faith extension, modification, or reversal of existing law. See 11 U.S.C. § 707(b)(4)(C). Here, as demonstrated below, the bankruptcy court found that Mr. Lafayette failed to comply with each of these provisions.[9]

First, the bankruptcy court expressly found that Mr. Lafayette helped prepare and file the November 4, 2007 affidavit that stated that amendments to the Debtor's schedules had been filed when those amendments were not actually filed with the Court until *two days later*. See Withrow, 391 B.R at 224.

Second, the bankruptcy court noted that Mr. Lafayette had conceded error regarding the inconsistent treatment of current monthly income on the Debtor's "Rebuttal of Presumption of Undue Hardship" (which stated that the Debtor's average current monthly income in reference to Line 3 on the Debtor's means test form was $5,333.33), and the Debtor's actual means test form (which only reflected $4,834.22 in current monthly income at Line 3). Id.

Third, the bankruptcy court described differences between the Debtor's "Rebuttal of Presumption of Undue Hardship" (which listed actual monthly income without overtime pay in the amount of $4,000) and the Debtor's Schedule I (which listed actual monthly income without overtime pay in the amount of $3,309.73). Id. Moreover, the bankruptcy court found it

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[9] The bankruptcy court's memorandum decision also referenced section 707(b)(4)(D) of the Bankruptcy Code. See In re Withrow, 391 B.R. 217 (Bankr. D. Mass. 2008). However, the memorandum decision fails to discuss exactly what information contained on the Debtor's *schedules* is incorrect, and the sanction award is most appropriately affirmed under Rule 9011 and section 707(b)(4)(C) of the Bankruptcy Code. Id.

significant that Mr. Lafayette was completely unable to explain the bases for these differences. Id.

Finally, the bankruptcy court relied upon differences between the Debtor's "Rebuttal of Presumption of Undue Hardship" (which indicated that the Debtor anticipated that he would have to assist his mother financially for an indefinite period of time after the filing of his case) and the Debtor's Schedule J (which provided that the Debtor did not reasonably anticipate a significant increase or decrease in expenses in the upcoming year). Id., at 224-25.

Each of these findings were wholly derived from the papers filed in this case by Mr. Lafayette, or from Mr. Lafayette's testimony at the November 7, 2007 Show Cause Hearing. UST App. at 160-208. On appeal, Mr. Lafayette does not argue any of these findings are clearly erroneous. See Appellant's Brief. Accordingly, because nothing in the record before this Court indicates that the above-referenced findings were clearly erroneous, the bankruptcy court's July 3, 2008 order should be affirmed because there was a substantial basis on the record to impose sanctions under Rule 9011 and section 707(b)(4) of the Bankruptcy Code. See Fed. R. Bankr. P. 8013; In re Winthrop Old Farm Nurseries, Inc., 50 F.3d at 73.

B. The Bankruptcy Court Had an Adequate Legal Basis to Impose Sanctions Under Rule 9011 and Section 707(b)(4).

Pursuant to Federal Rule of Bankruptcy Procedure 9011(c), if, after notice and an opportunity to respond, a bankruptcy court determines that Federal Rule of Bankruptcy Procedure 9011(b) has been violated, the court may impose an appropriate sanction upon an attorney.[10] See Fed. R. Bankr. P. 9011(c). The First Circuit has imposed a standard of reasonableness for a Rule 11 inquiry. See Navarro-Ayala v. Nunez, 968 F.2d 1421, 1425 (1st Cir. 1992); Cruz v. Savage, 896 F.2d 626, 631 (1st Cir. 1990) (same).

Similarly, section 707(b)(4)(C) of the Bankruptcy Code, by its plain language, imposes a standard of reasonableness with respect to the type of investigation that counsel is required to conduct prior to the filing of petitions, pleadings, or written motions in a bankruptcy court. See 11 U.S.C. § 707(b)(4)(C) (requiring certification that a "reasonable investigation" has been performed). In this regard, at least one bankruptcy court has held that the certification required under section 707(b)(4)(C) is analogous to the certification long imposed under Federal Rule of Bankruptcy Procedure 9011(b). See In re Robertson, 370 B. R. 804, 809 n.8 (Bankr. D. Minn. 2007).

Here, the bankruptcy court had more than adequate legal basis for determining that Mr. Lafayette failed to meet the standard of reasonableness required of him under Rule 9011(b) and section 707(b)(4)(C) of the Bankruptcy Code. For example, when Mr. Lafayette prepared and filed the Debtor's "Rebuttal of Presumption of Undue Hardship" in this case, he should have known what the Debtor's means test form indicated with respect to current monthly income, what the Debtor's Schedule I indicated with respect to actual income, and what the Debtor's Schedule J indicated with respect to the Debtor's anticipated future expenses because each of these documents were filed on the *very same day* as the Debtor's Debtor's "Rebuttal of Presumption of Undue Hardship." UST App. at 104-05. However, rather than conducting the

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[10] "Because Rule 9011 is derived from Federal Rule of Civil Procedure 11, the First Circuit has explained that 'Rule 11 jurisprudence is largely transferable to Rule 9011 cases.'" White v. Burdick, (In re CK Liquidation Corp,), 321 B.R. 355, 361(B.A.P. 1st Cir. 2005) (citing Featherstone v. Goldman (In re D.C. Sullivan Co.), 843 F.2d 596, 598 (1st Cir. 1988)).

most basic of inquiries with respect to these papers, much less the reasonable inquiry required by Rule 9011 and section 707(b)(4)(C), Mr. Lafayette submitted the Debtor's "Rebuttal of Presumption of Undue Hardship" with numerous factually inaccurate statements to the bankruptcy court. See supra, at 9-10 (discussing discrepancies between information contained on Debtor's means test form, Schedule I, and Schedule J, and Debtor's "Rebuttal of Presumption of Undue Hardship"). Accordingly, the bankruptcy court's conclusion that Mr. Lafayette failed to exhibit the standard of reasonableness required under Rule 9011(b) and section 707(b)(4)(C) of the Bankruptcy Code did not constitute an abuse of discretion.

C. The Bankruptcy Court Acted Within its Discretion in Imposing Sanctions In the Amount of $3,585.

"In reviewing the propriety of a Bankruptcy Rule 9011 sanction, an [appellate court] should 'defer, within broad limits, to the bankruptcy court's exercise of its sound discretion.'" Kristan, 395 B.R. at 510 (quoting Navarro-Ayala v. Nunez, 968 F.2d at 1426). Here, the bankruptcy court analyzed five factors in considering what type of sanction to impose against Mr. Lafayette: (1) the egregiousness of the conduct complained of; (2) the extent of the harm caused; (3) the deterrence to others of repeating the conduct; and (4) whether the conduct is repetitive of conduct for which the actor has been previously criticized.[11] Withrow, 391 B. R. at 229.

In reaching its decision to impose $3,585 in sanctions, the bankruptcy court specifically noted that Mr. Lafayette's representation of consumer debtors had previously been the subject of considerable criticism. Id., at 229 (citing In re LaFrance, 311 B. R. at 25 (court described Mr.

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[11] On appeal, Mr. Lafayette does not suggest that the $3,585.00 sanction imposed against him was inappropriate. Rather, he appears to take issue with the fact that the bankruptcy court chose to impose sanctions at all. See UST App. at 246.

Lafayette's practices as "sloppy, careless and unprofessional" and ordered Mr. Lafayette to file fee applications in every case he filed); In re LeClair, 360 B. R. 388 (Bankr. D. Mass. 2006) (even after the LaFrance decision, many fee applications of Mr. Lafayette denied because he continued to provide poor quality services to his consumer debtor clients)). Further, the bankruptcy court went to great lengths in its findings of fact to specifically demonstrate the problems associated with Mr., Lafayette's conduct in this case. Withrow, 391 B.R. at 220-25.

The bankruptcy court pointed out that, Mr. Lafayette had an extensive history of providing poor quality service to his consumer debtor clients and of "sloppy, careless and unprofessional" practices. Id., at 229.

The same can be said for the case at hand, where among other things, his errors and omissions placed Debtor in the untenable position of having to possibly defend against numerous false oath claims due to factually erroneous information contained in the "Rebuttal of Presumption of Undue Hardship." See supra, at 9-10 (discussing discrepancies between information contained on Debtor's means test form, Schedule I, and Schedule J, and Debtor's "Rebuttal of Presumption of Undue Hardship"); see also Withrow, 391 B.R. at 229 ("After all of the argument and testimony, the Court still is not sure what the Debtor earned in the six months prior to the filing of the petition or what the Debtor earns now. Nor is the Court sure whether the Debtor intended to mislead the Court with respect to the information provided in his bankruptcy papers or his section 341 meeting testimony."). Accordingly, because the sanction imposed by the bankruptcy court appropriately serves to deter Mr. Lafayette from repeating the conduct that occurred in this case, and others, it should be affirmed.[12]

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[12] The bankruptcy court's July 3, 2008 order required that Mr. Lafayette tender sanctions to the trustee. See UST App. at 223. While section 707(b)(4)(C) of the Bankruptcy Code is silent with respect to who may receive sanctions imposed under it, Rule 9011 is not. See Fed. R.

CONCLUSION

For these reasons, the United States Trustee respectfully asks the Court to affirm the order entered below.

Respectfully submitted,

PHOEBE MORSE,
United States Trustee

____
By: Phoebe Morse
United States Trustee
Stephen E. Meunier
Trial Attorney
Department of Justice
Office of the United States Trustee
446 Main Street, 14th Floor
Worcester, MA 01608
Tel: (508) 793-0555, ext. 119
Fax:(508) 793-0558
Email: Stephen.Meunier@usdoj.gov

Dated: December 8, 2008

Bankr. P. 9011(c)(2) (providing for payment to court and movant). Accordingly, should this Court conclude that sanctions under Rule 9011 *alone* is appropriate, the Court may wish to consider remand *solely* to direct payment of those sanctions to the bankruptcy court. Otherwise, the trustee could keep the sanction as section 707(b)(4)(B) expressly authorizes an award to the trustee.

CERTIFICATE OF SERVICE

The undersigned hereby certifies that on this 8th day of December, 2008, a copy of the Appellee's Brief of the United States Trustee was served via first class mail, postage pre-paid, upon the following:

Richard C. Donovan, Clerk
Bankruptcy Appellate Panel, First Circuit
John Joseph Moakley U.S. Courthouse
1 Courthouse Way, Suite 2-500
Boston, MA 02210

Francis Lafayette, Esq.
PO Box 1020
Palmer, MA 01069

Joseph B. Collins, Esq.
Hendel & Collins P.C.
101 State Street
Springfield, MA 01103

Daryl Withrow
26 Village Road
Springfield, MA 01129

____
Stephen E. Meunier, Esq.
Trial Attorney
United States Department of Justice
Office of the United States Trustee
446 Main Street, 14th Floor
Worcester, MA 01608

BRIEF BANK — "SUMMARY SHEET" *Printed Wed.-3/31/4 (10:23)*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	DeAngelis v. Woodworkers Warehouse, Inc. (In re Woodworkers Warehouse, Inc.)
2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	D. Del.
3. ("CCN") ***CURRENT*** CASE NO.	No.: 04-124
4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*	No.: 03-13655 Court: Bankr. D. Del. *(Identify judge & cite, if any)*
5. ("SO") ***SOURCE***	**U.S. TRUSTEES**
6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	Filed: March 22, 2004 Type: Appellant's Opening Brief
7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** *[E.g.,"UST/OGC"]*	Joseph J. McMahon, Jr. and Robert Schneider Trial Attorneys DOJ/UST *(UST/OGC: 202-307-1399/FAX-2397)*
8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") ! ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	! Whether or not the bankruptcy court erred in failing to determine that the firm's representation encompassed matters which constitute "represent[ing] the trustee [i.e. the debtor in possession] in conducting the case" that are proscribed by 11 U.S. § 327(e) √ **Background:**
10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)	D:\MyFiles\BriefBank-Web\Warehouse\WarehouseSum.wpd
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UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF DELAWARE

In re :

WOODWORKERS WAREHOUSE, INC., :

Debtor. :

Chapter 11

Case No. 03-13655 (JBR)

ROBERTA A. DeANGELIS, Acting
United States Trustee for Region 3, :

Appellant, :

v. : Case No. 04-124 (JJF)

WOODWORKERS WAREHOUSE, INC., :

Appellee. :

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DISTRICT OF DELAWARE
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APPELLANT'S OPENING BRIEF

JOSEPH J. MCMAHON, JR.
ROBERT J. SCHNEIDER
TRIAL ATTORNEYS
UNITED STATES DEPARTMENT OF JUSTICE
OFFICE OF THE UNITED STATES TRUSTEE
J. Caleb Boggs Federal Courthouse
844 King Street, Suite 2313, Lockbox 35
Wilmington, DE 19801
(302) 573-6491
(302) 573-6497 (Fax)

Attorneys for Appellant

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STATEMENT OF ISSUE PRESENTED

In approving the Debtor's application to employ special counsel, did the bankruptcy court err in failing to determine that the firm's representation encompassed matters which constitute "represent[ing] the trustee [i.e., the debtor in possession] in conducting the case" that are proscribed by 11 U.S.C. § 327(e)?

STATEMENT OF APPROPRIATE STANDARD OF APPELLATE REVIEW

A bankruptcy court's decision to approve an application for employment under 11 U.S.C. § 327 is reviewed for abuse of discretion. *See In re Pillowtex, Inc.*, 304 F.3d 246, 250 (3d Cir. 2002) (citing *In re Marvel Entm't Group, Inc.*, 140 F.3d 463, 470 (3d Cir. 1998)). A bankruptcy court abuses its discretion when its decision is based on "a clearly erroneous finding of fact, an errant conclusion of law, or an improper application of law to fact." *See Marvel*, 140 F.3d at 470. The Acting United States Trustee submits that the bankruptcy court's decision to approve the employment of special counsel under 11 U.S.C. § 327(e) is premised upon an erroneous conclusion of law. This Court conducts a *de novo* review of the bankruptcy court's conclusions of law. *See, e.g., Rode v. Dellarciprete*, 892 F.2d 1177, 1182 (3d Cir. 1990); *In re Hechinger Inv. Co.*, 276 B.R. 43, 45 (D. Del. 2002).

STATEMENT OF THE CASE

Woodworkers Warehouse, Inc. (the "Debtor"), a debtor in possession, has substantially the same rights that a trustee serving in a chapter 11 case enjoys. One of those rights is the right to employ professional persons under 11 U.S.C. § 327(e) ("Section 327(e)"). Section 327(e) authorizes the Debtor to employ, "for a specified special purpose, <u>other than to represent the trustee in conducting the case</u>, an attorney that has represented the debtor, if in the best interest of the estate, and if such attorney does not represent or hold any interest adverse to the debtor or to the estate with respect to the matter on which such attorney is to be employed" (emphasis added). This appeal addresses a simple question: what constitutes "represent[ing] the trustee in conducting the case" under Section 327(e)?

At the outset of the case, the Debtor applied to the bankruptcy court to employ Kronish Lieb Weiner & Hellman LLP ("Kronish Lieb") as its general bankruptcy counsel pursuant to 11 U.S.C. § 327(a) ("Section 327(a)"). Section 327(a) permits the trustee to employ counsel for purposes of "represent[ing] or assist[ing] the trustee in carrying out the trustee's duties under [the Bankruptcy Code]." In order to employ a professional under Section 327(a), the applicant must demonstrate that the proposed professional "do[es] not hold or represent an interest adverse to the estate . . . [and is a] disinterested person[]." *Id.* Roberta A. DeAngelis, Acting United States Trustee for Region 3 (the "U.S. Trustee"), objected to the Debtor's application to employ Kronish Lieb under Section 327(a) on grounds that the firm had a disqualifying conflict of interest stemming from its representation of the official committee of unsecured creditors in a prior bankruptcy case. After a hearing, the bankruptcy court denied the Debtor's application to employ Kronish Lieb under Section 327(a). In a published memorandum supporting its ruling on the application, the bankruptcy court agreed with the U.S. Trustee that Kronish Lieb had a disabling conflict of interest which prevented the firm from representing or assisting the Debtor in carrying out its duties under the Bankruptcy Code.

The Debtor subsequently filed an application to employ Kronish Lieb as special counsel under Section 327(e), nunc pro tunc to the petition date. The Debtor proposed that Kronish Lieb be permitted to represent it in connection with a wide range of matters, including the preparation of papers, negotiations of contested items, and appearances on the Debtor's behalf in bankruptcy court related to the following matters: (a) asset sales, including the sale of substantially all of the Debtor's inventory, its major asset, and the disposition of executory contracts; (b) the Debtor's use of cash collateral; and (c) the key employee retention program proposed by the Debtor. Given that the bankruptcy court correctly decided that Kronish Lieb was disqualified from serving as general bankruptcy counsel to the Debtor due to the firm's conflict of interest, and given that the proposed scope of Kronish Lieb's employment involved representing the Debtor in conducting the case, the U.S. Trustee objected to the Debtor's application to employ Kronish Lieb as special counsel. Notwithstanding the fact that the bankruptcy court previously ruled that Kronish Lieb could not represent or assist the Debtor in carrying out its responsibilities under the Bankruptcy Code, the bankruptcy court granted the Debtor's application to employ Kronish Lieb as special counsel. This appeal followed.

STATEMENT OF THE FACTS

The Debtor was formed in October, 2001 as part of a confirmed plan of reorganization in a prior chapter 11 proceeding. Trend-Lines, Inc. and Post-Tool, Inc. (the "Prior Debtors") filed chapter 11 petitions in the United States Bankruptcy Court for the District of Massachusetts (the "Prior Cases"). R.22 (Debtor's response to 327(a) objection) at ¶ 2(a). The Debtor and its predecessor were a specialty retailer of power and hand tools and accessories, primarily for use in woodworking and light construction, operating retail stores under the "Woodworkers Warehouse" name. R.4 (Welker affidavit) at ¶ 4; R.53 (Disclosure statement in Prior Cases) at § 4.1. Kronish Lieb served as counsel to the Official Committee of Unsecured Creditors (the "Prior Committee") in the Prior Cases. R.22 (Debtor's response to 327(a) objection) at ¶ 2(b).

As part of a joint reorganization plan in the Prior Cases, the Prior Debtors and the Prior

Committee proposed that, in satisfaction of their claims, general unsecured creditors would receive both a pro rata share of a cash distribution of $2 million (which was to be paid on January 15, 2002) and shares of common stock in "Newco." R.22 (Debtor's response to 327(a) objection) at ¶ 2(d). The plan in the Prior Cases called for the continued operation of the Woodworkers Warehouse retail stores. R.53 (Disclosure Statement in Prior Cases) at § 5.15.[1] The Prior Debtors' remaining assets were liquidated. R.53 (Disclosure Statement in Prior Cases) at § 5.15.

The joint reorganization plan in the Prior Cases was confirmed on October 17, 2001. R.22 (Debtor's response to 327(a) objection) at ¶ 2(c). The plan went effective on October 19, 2001. On or about the effective date of the plan, the reorganized debtor was merged into "Newco," forming the Debtor. R.22 (Debtor's response to 327(a) objection) at ¶ 2(g). The equity stake promised to unsecured creditors under the plan was distributed. However, the cash distribution of $2 million provided for under the plan was never paid. R.50 (12/29/03 Tr.) 52:14-24.

The Debtor filed a voluntary petition under chapter 11 of the Bankruptcy Code on December 2, 2003 (the "Petition Date"). R.1 (Petition). On the Petition Date, the Debtor operated 93 stores located in the New England and Mid-Atlantic regions. R.4 (Welker affidavit) at ¶ 4.

To operate its business post-petition as a debtor in possession, the Debtor needed to be able to use its cash, which was subject to the first-priority, perfected security interest of its primary lenders. R.5 (Cash collateral motion) at ¶ 18. The Bankruptcy Code restricts the Debtor's ability to use cash and cash equivalents ("cash collateral") subject to a security interest; the Debtor may only

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[1] Having obtained the Debtor's consent, the U.S. Trustee will be filing either an uncontested motion or a stipulation to supplement the record with the trial exhibits which were offered by the U.S. Trustee and admitted into evidence the hearing on the 327(a) Application. The disclosure statement from the Prior Cases is one of those exhibits.

use cash collateral if (a) each entity with an interest in the cash collateral consents to such use or (b) the court, after notice and a hearing, authorizes the use of cash collateral consistent with the provisions of 11 U.S.C. § 363. Accordingly, on the Petition Date, the Debtor filed a motion for authority to use its cash collateral and for related relief. R.5 (Cash collateral motion). Throughout the case, the Debtor reached a series of agreements with its primary lenders which enabled its use of cash collateral. R.9 (1st interim cash collateral order); R.16 (2nd interim cash collateral order).

Prior to filing for bankruptcy protection, the Debtor determined that it would not be able to meet its working capital needs, debt service requirements and planned capital expenditures through the end of fiscal year 2003. R.6 (Welker affidavit) at ¶ 8. Thus, the Debtor planned to quickly wind-down its operations by means of "going out of business" ("GOB") sales. R.6 (Welker affidavit) at ¶ 9. On the Petition Date, the Debtor filed an emergency motion to establish bidding procedures for the sale of its primary asset – inventory – and to set dates for the related auction and sale. R.4 (GOB sale motion). The emergency motion indicated that the Debtor had entered into an agreement with a group of liquidators to purchase the inventory for approximately one-half of its retail price, subject to higher and better offers at auction.[2] R.4 (GOB sale motion) at ¶ 19. Given that bidders would likely factor in the number of days available during the holiday season in submitting their bids, the bankruptcy court approved a short schedule for the sale of the inventory at the Debtor's request. The bankruptcy court scheduled the auction of the inventory for December 4 and the related sale hearing for December 5. R.10 (Bidding procedures order) at ¶¶ 7, 9. A competing bid to purchase the inventory for approximately 55% of the retail price was approved at the December 5 sale hearing.

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[2] The "stalking horse" bid was also subject to adjustment as described in the agency agreement appended to the bidding procedures motion.

R.15 (Sale order); R.14 (Agency agreement).

The Debtor also filed a motion for entry of an order authorizing retention payments to "key employees" under 11 U.S.C. §§ 105(a) and 363(b)(1) (the "KERP Motion") on the Petition Date. R.8 (KERP motion). The Debtor sought authority to pay nine employees a total of $400,000 and 10% of the net recovery from the liquidation of the Debtor's assets in excess of all sums due the Debtor's primary secured lender. R.8 (KERP motion) at ¶¶ 9, 10. The proffered purpose of the KERP Motion was to keep certain employees with the company as long as the liquidation effort necessitated their presence. R.8 (KERP motion) at ¶ 14. The Debtor maintained that its "ability to stabilize and preserve its business operations and assets [would] be substantially hindered if the Debtor [was] unable to retain the services of the Key Employees." R.8 (KERP motion) at ¶ 11. After negotiations with the Official Committee of Unsecured Creditors ("OCUC"), the Debtor was able to reach an agreement on a modified key employee retention program which, when compared to the Debtor's original request, provided for substantially reduced payments. R.51 (1/8/04 Tr.) 5:22 - 9:21.

In connection with its bankruptcy filing, the Debtor sought to employ Kronish Lieb pursuant to 11 U.S.C. § 327(a) as its bankruptcy counsel (the "327(a) Application"). R.2 (327(a) Application). The U.S. Trustee objected to the 327(a) Application on grounds that Kronish Lieb had a disqualifying conflict of interest stemming from its representation of the Prior Committee. R.20 (327(a) objection). Given that Kronish Lieb advised the Prior Committee in connection with its proposal of, and support for, the reorganization plan in the Prior Cases, the U.S. Trustee submitted that Kronish Lieb could not advise the Debtor with regard to the bankruptcy treatment and/or discharge of claims and interests that were created by that plan. R.20 (327(a) objection) at ¶ 17. In its response to the U.S. Trustee's objection to the 327(a) Application, the Debtor insisted that Kronish Lieb did not have a disqualifying conflict. R.22 (Debtor's response to 327(a) objection).

After a hearing was held on the 327(a) Application, the bankruptcy court denied the 327(a) Application. R.27 (327(a) order). In the memorandum issued in support of its denial of the 327(a) Application, the bankruptcy court essentially adopted the U.S. Trustee's argument as to why Kronish Lieb was unfit to assist the Debtor in performing its duties under the Bankruptcy Code:

> At a minimum the retention of KLWH [Kronish Lieb] would create an appearance of a conflict. KLWH's retention, however, would do more; KLWH has a potential conflict and perhaps even an actual conflict. KLWH represented the co-proponent of the plan in the Massachusetts Bankruptcy; the Committee urged its constituencies to vote in favor of the plan. Now that it is clear that the plan cannot be fully consummated, KLWH seeks to represent the very party that defaulted on its obligation to KLWH's former clients in a case that arises, in part, because of those defaults . . . . R.36 (327(a) memorandum) at 4.

The Debtor did not appeal from the bankruptcy court's ruling on the 327(a) Application.

The bankruptcy court's order denying the 327(a) Application stated that, "[s]hould the Debtor require services of KLWH as special counsel on some basis, the Court would consider such an application on an expedited basis." R.27 (327(a) order) at 2. The day after the 327(a) Application was denied, the Debtor filed an application to employ Kronish Lieb as special counsel under 11 U.S.C. § 327(e) *nunc pro tunc* to the Petition Date (the "327(e) Application"). R.29 (327(e) application). In the 327(e) Application, the Debtor described the proposed scope of Kronish Lieb's employment as follows:

> (a) prepare and prosecute on behalf of the Debtor, as Debtor in possession, all necessary motions, applications, answers, orders, reports, and papers in connection with the sale of the Debtor's assets, including inventory, intellectual property, unexpired leases and

> executory contracts, furniture, fixtures and equipment. Thus far, KLWH has successfully arranged a bidding process, enticed other liquidators to bid, conducted an auction and drafted the document signed by the liquidator which has generated over $3 million additional dollars in excess of the first bid delivered to the Debtor, at the request of the Debtor's bank. KLWH has also been intricately involved in the continuing efforts to maximize proceeds from the sale of other assets of the Debtors [sic];
>
> (b) prepare and prosecute on behalf of the Debtor, as Debtor in possession, all necessary motions, answers, orders, and papers in connection with the Debtor's use of cash collateral;
>
> (c) prepare and prosecute on behalf of the Debtor, as Debtor in possession, all necessary motions, applications, answers, orders, reports, and papers in connection with the Debtor's request to make certain key employee retention payments. The KERP program has been negotiated with the Debtor's Board of Directors and is now the subject of intense negotiations with the creditors' committee; and
>
> (d) handle other minor administrative matters such as obtaining continuation of insurance. R.29 (327(e) application) at ¶ 8.

The U.S. Trustee objected to the 327(e) Application on grounds that, in direct contravention of 11 U.S.C. § 327(e), the Debtor sought to employ Kronish Lieb "to represent the trustee in conducting the case." R.31 (327(e) objection) at ¶ 12. In the 327(e) Application and its response to the U.S. Trustee's objection thereto, the Debtor did not cite any published authority which stated that representing the trustee in connection with the use of cash collateral, the sale of substantially all of the estate's assets, and obtaining court approval of a key employee retention program could be authorized under Section 327(e). R.29 (327(e) application); R.35 (Debtor's response to 327(e) objection).

At the hearing on the 327(e) Application, the U.S. Trustee argued that, given the impermissibly broad scope of Kronish Lieb's proposed employment, the 327(e) Application "might as well be labeled a [m]otion to [r]econsider [the bankruptcy court's] prior ruling with respect to [the 327(a) Application]." R.51 (1/8/04 Tr.) 16:3-6. The U.S. Trustee pointed out that "the tasks for which the Debtor is now seeking to employ Kronish Lieb as special counsel are a good chunk of this particular case." R.51 (Tr. 1/8/04) 16:11-14. After hearing argument, and without explaining the reasons for its decision, the bankruptcy court immediately directed the Debtor to provide an order which authorized Kronish Lieb's employment as special counsel under 11 U.S.C. § 327(e) *nunc pro tunc* to the Petition Date with regard to asset sales, cash collateral, and the key employee retention program.[3] R.51 (Tr. 1/8/04) 18:22 - 19:13. The bankruptcy court entered the order on January 13, 2004. R.42 (327(e) order). The U.S. Trustee filed her notice of appeal from the order on January 23, 2004. R.47 (Notice of appeal).

SUMMARY OF ARGUMENT

The bankruptcy court erred in failing to strictly apply Section 327(e)'s prohibition against employing special counsel to represent the debtor in possession in conducting the case. The Supreme Court and the United States Court of Appeals for the Third Circuit have consistently ruled that statutory language must be applied in accordance with the plain meaning of its terms. In this case, the bankruptcy court authorized Kronish Lieb to represent and assist the Debtor in performing duties central to the Debtor's bankruptcy proceeding. The bankruptcy court's ruling is contrary to the clear, unambiguous language of Section 327(e). The ruling also runs counter to the legislative history supporting Section 327(e), which indicates that the "specified, special purpose" for which

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[3] The bankruptcy court did not approve the "catch-all" provision that was proposed. Instead, the court ruled that, if the Debtor, the Official Committee of Unsecured Creditors, and the U.S. Trustee agreed that Kronish Lieb's employment should be expanded to encompass certain services, Kronish Lieb would be authorized to provide those services upon the filing of an appropriate notice and certification. If the parties could not agree on whether the employment should be expanded, then the Debtor would have to file another application with the bankruptcy court.

counsel may be retained under Section 327(e) must be unrelated to the Debtor's reorganization.

Kronish Lieb's representation of the Debtor, as authorized by the bankruptcy court, involves three general subject areas that are all central to the Debtor's reorganization. The bankruptcy court authorized Kronish Lieb to represent it in connection with obtaining court approval for the use of its cash collateral. Without use of its cash, the Debtor would have not been able to move forward with its chapter 11 case. In addition, the bankruptcy court authorized Kronish Lieb to represent the Debtor in connection with asset sales and the related disposition of executory contracts. The Debtor's asset sales included the sale of substantially all of its inventory by means of a "going out of business sale." The bankruptcy court also authorized the Debtor to employ Kronish Lieb to represent it in connection with the preparation and negotiation of the Debtor's key employee retention program, as well as appearing before the bankruptcy court with regard to the motion to approve the program. The program provided for certain payments to personnel the Debtor believed were critical to the successful completion of the bankruptcy case

The bankruptcy court's decision to authorize Kronish Lieb's employment under Section 327(e) for the specified services is especially troubling in light of the bankruptcy court's prior ruling that the firm was not qualified to serve as general bankruptcy counsel under Section 327(a). Courts have routinely rejected efforts to circumvent the conflict and disinterestedness prerequisites of Section 327(a) by permitting counsel to be employed under Section 327(e) to assist the trustee in conducting the case. In this case, the bankruptcy court itself ruled that Kronish Lieb could not represent the Debtor under Section 327(a) due to a conflict of interest. Accordingly, by overlooking the limitations on the permissible scope of employment under Section 327(e) and permitting the Debtor to employ Kronish Lieb to provide services central to the Debtor's case, the bankruptcy court undercut its prior ruling.

ARGUMENT

I. THE BANKRUPTCY COURT ERRED IN FAILING TO STRICTLY APPLY THE SECTION 327(e) PROHIBITION AGAINST EMPLOYING SPECIAL COUNSEL TO REPRESENT THE DEBTOR IN POSSESSION IN CONDUCTING THE CASE

Section 327(e) states that a Chapter 11 debtor in possession[4] may employ,

> with the court's approval, for a specified special purpose, other than to represent the trustee in conducting the case, an attorney that has represented the debtor, if in the best interest of the estate, and if such attorney does not represent or hold any interest adverse to the debtor or to the estate with respect to the matter on which such attorney is to be employed. 11 U.S.C. § 327(e) (emphasis added).

The statutory language is exceptionally clear, and it establishes the following six specific criteria, each of which must be present before an attorney may be employed by a debtor in possession pursuant to Section 327(e):

(1) the court must approve the employment;

(2) the employment must be for a "specified special purpose;"

(3) the "specified special purpose" cannot constitute the representation of the debtor in possession in conducting the case;

(4) the attorney to be employed must have previously represented the debtor;

(5) the employment must be in the best interest of the estate; and

(6) the attorney must not represent or hold any interest adverse to

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[4] Although Section 327(e) refers to the "trustee," pursuant to 11 U.S.C. § 1107 most of the rights, powers, and duties of a trustee in a Chapter 11 case are conferred upon the debtor in possession. This includes the trustee's power to employ professional persons under 11 U.S.C. § 327. *See United States Trustee v. Price Waterhouse*, 19 F.3d 138, 141 (3d Cir. 1994). *See also* Fed. R. Bankr. P. 9001(10) ("'Trustee' includes a debtor in possession in a Chapter 11 case.").

> the debtor or the estate with respect to the matter on which the attorney is to be employed.

The Supreme Court has repeatedly stressed that the plain language of the Bankruptcy Code must be applied as written, even if the result is harsh. *See, e.g., Lamie v. United States Trustee,* ___ U.S. ___, 124 S.Ct. 1023, 1032 (2004) ("Our unwillingness to soften the import of Congress' chosen words even if we believe the words lead to a harsh outcome is longstanding."); *Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A.*, 530 U.S. 1, 6 (2000) ("when the statute's language is plain, the sole function of the courts – at least where the disposition required by the text is not absurd – is to enforce it according to its terms") (internal quotation marks omitted). In addition, the Third Circuit has strictly applied statutory limitations on employment under 11 U.S.C. § 327. *See United States Trustee v. Price Waterhouse*, 19 F.3d 138, 141-42 (3d Cir. 1994). Indeed, this Court has previously held that the "clear and unequivocal" language of Section 327(e) must be strictly applied. *See MeesPierson Inc. v. Strategic Telecom Inc.*, 202 B.R. 845, 850 (D. Del. 1996) (reversing bankruptcy court's authorization of employment as special counsel of attorney disqualified under Section 327(a) where attorney had not previously represented debtor).

In light of this precedent, Section 327(e) cannot be interpreted such that some clauses are read strictly and others are read loosely. It is not sufficient under Section 327(e) to simply specify in counsel's employment application the services to be rendered; if any of the proposed services constitute the representation of the Debtor in conducting the case, employment under Section 327(e) is prohibited as a matter of law. *See In re Neuman*, 138 B.R. 683, 686 (S.D.N.Y. 1992) ("[I]t is clear both from the language of § 327(e) and from the framework of § 327 more generally that, even if there is a special purpose, it is crucial that the appointment not be part of the trustee's general duty of conducting the case.").

Section 327(a) is the only statutory provision pursuant to which counsel may be employed "to represent or assist the [debtor in possession] in carrying out [the debtor in possession's] duties under [the Bankruptcy Code]." *See* 11 U.S.C. § 327(a). Congress clearly intended Section 327(e) to apply to a much narrower set of circumstances, and did not intend for it to be used as an indirect avenue for employment of conflicted counsel to represent the debtor in carrying out its general duties. Congress' use of the singular – a "specified, special purpose," as opposed to numerous purposes – indicates that Section 327(e) "may be limited to cases involving a single lawsuit or a discrete and specialized advisory role (i.e. tax, securities, antitrust, etc.)." *See In re First Am. Health Care of Ga., Inc.*, 1996 WL 33404562 at *3 (Bankr. S.D. Ga., Apr. 18, 1996).

The legislative history supports the strict interpretation of Section 327(e)'s prohibition regarding "conducting the case":

> [Section 327(e)] does not authorize the employment of the debtor's attorney to represent the estate generally or represent the trustee in the conduct of the bankruptcy case. The subsection will most likely be used when the debtor is involved in complex litigation, and changing attorneys in the middle of the case after the bankruptcy case has commenced would be detrimental to the progress of that other litigation.

H.R. Rep. No. 595, 95th Cong., 1st Sess. 328 (1977), reprinted at 1978 U.S.C.C.A.N. 5824-25. In addition, a leading commentator has stated that the "special purpose" for which an attorney may be employed under Section 327(e) "must be unrelated to the reorganization of the debtor." *See* 3 Lawrence P. King, Collier on Bankruptcy ¶ 327.04[9][b] at 327-61 (15th ed. rev'd 2003) (emphasis added).

In the proceedings before the bankruptcy court, the Debtor did not cite any published authority which stated that representing the trustee in connection with the use of cash collateral, the sale of substantially all of the estate's assets, and obtaining court approval of a key employee retention program could be authorized under Section 327(e). Given that Kronish Lieb's services were central to the conduct of the case, the bankruptcy court should have strictly applied Section 327(e) and rejected the application. In light of the statutory prohibition against employing special counsel to represent the Debtor in conducting the case, the Bankruptcy Court's decision was erroneous, and should be reversed.

II. THE BANKRUPTCY COURT ERRED IN AUTHORIZING THE EMPLOYMENT OF KRONISH LIEB TO RENDER SERVICES THAT CONSTITUTE THE REPRESENTATION OF THE DEBTOR IN CONDUCTING THE CASE UNDER SECTION 327(e)

Pursuant to 11 U.S.C. § 1107, most of the rights, duties, and powers that the Bankruptcy Code places on trustees must be carried out by Chapter 11 debtors in possession. An analysis of the various statutory duties imposed on Chapter 11 debtors in possession shows that the services to be rendered by Kronish Lieb constitute the representation of the Debtor in conducting the case.

Both as part of its duty to operate the business (*see* 11 U.S.C. § 1108) and as a separate statutory duty, a debtor in possession has the duty of obtaining consensual or court-authorized use of cash collateral under 11 U.S.C. § 363(c)(2). As the Debtor argued before the bankruptcy court, the operation of the Debtor's business, and thus the successful sale of the Debtor's assets, would have been impossible without the use of cash collateral. Therefore, Kronish Lieb's representation of the Debtor with regard to use of cash collateral constitutes representing the Debtor in conducting the case. *See Interstate Dist. Ctr. Assocs. (A), Ltd.*, 137 B.R. 826, 833 (Bankr. D. Colo. 1992) (representation in connection with restructuring Debtor's financing "clearly beyond the scope and intent of Section 327(e)"); *In re Hempstead Realty Assocs.*, 34 B.R. 624, 625 (Bankr. S.D.N.Y. 1983) (giving Debtor legal advice in connection with its "powers and duties as debtor in possession" within conduct of case).

Among the most important statutory duties of a debtor in possession in a liquidating case are the duties to comply with the strictures of 11 U.S.C. §§ 363 and 365 when selling estate assets and dealing with executory contracts. In the instant case, Kronish Lieb's intended services regarding the sale of substantially all of the Debtor's assets, as well as assuming and assigning executory contracts, constitute the representation of the Debtor in conducting the most important part of this case. Every other aspect of this case, including the preparation of a plan of liquidation, hinges on the sale of the Debtor's assets. *See In re Tidewater Mem. Hosp., Inc.*, 110 B.R. 221, 228 (Bankr. E.D. Va. 1989) (denying employment under Section 327(e) where services included negotiating sale of debtor's business upon which plan would be based).

In addition, Kronish Lieb's proposed services include representing the Debtor with regard to the Debtor's efforts to obtain approval of the KERP motion. Retention programs for key employees are approved when they are shown to be vital to the debtor's successful operations, or successful sale in a liquidating chapter 11 such as the instant case. *See, e.g., In re Montgomery Ward Holding Corp.*, 242 B.R. 147, 155 (Bankr. D. Del. 1999). As the retention of key employees is, in the Debtor's judgment, fundamental to the Debtor's ability to successfully carry out its liquidation, Kronish Lieb's representation of the Debtor with regard to the KERP motion constitutes representing the Debtor in conducting the case. Further, the KERP motion was a contested matter in the main bankruptcy case. Therefore, Kronish Lieb's representation of the Debtor with regard to the KERP motion falls squarely within the conduct of the case.[5]

Unlike the typical use of special counsel, Kronish Lieb has not been employed for a tangential purpose, such as continuing to pursue pre-petition litigation or addressing a discrete non-bankruptcy law issue. Instead, Kronish Lieb has been employed to render services that are central to the Debtor's ability to successfully complete its chapter 11 case. As Kronish Lieb's proposed services are far too broad to meet Section 327(e)'s prohibition against representing the Debtor in conducting the case, the bankruptcy court's decision was erroneous, and should be reversed.

III. THE BANKRUPTCY COURT ERRED IN AUTHORIZING THE EMPLOYMENT OF COUNSEL DISQUALIFIED UNDER SECTION 327(a) TO ACT AS SPECIAL COUNSEL TO REPRESENT THE DEBTOR IN CONDUCTING THE CASE UNDER SECTION 327(e)

The statutory scrutiny of an application to employ special counsel under Section 327(e) should be heightened where, as in the instant case, proposed counsel is disqualified from being employed under Section 327(a). Section 327(e) is not a wide-open back door through which the Debtor can employ otherwise disqualified counsel to represent it in carrying out its duties; to the contrary, Section 327(e) contains specific unambiguous exclusionary hurdles that must each be cleared before special counsel may be employed. Under the coherent system established by Congress, the only attorney who may represent a debtor in possession in its conduct of the case is one employed under Section 327(a). In the instant case, that attorney is the Bayard Firm. Kronish Lieb's disqualification under Section 327(a) thereby prohibits it from being employed under any statutory provision to represent the Debtor in carrying out the basic duties that constitute "conducting

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[5] The Debtor's request to employ Kronish Lieb with regard to prosecution of the KERP motion before the bankruptcy court is substantially different than a request to employ special counsel in connection with labor law issues that are not central to the conduct of the bankruptcy proceeding. In this case, the Debtor has employed the firm of Robinson & Cole LLP as special labor law counsel for that purpose. R.18 (Special labor counsel application).

the case."

The U.S. Trustee is unaware of any reported decision in any judicial district in which the court interpreted the Section 327(e) "conducting the case" prohibition as nevertheless allowing an attorney disqualified under Section 327(a) to be employed as special counsel under Section 327(e) to represent the debtor in possession in carrying out its basic duties. To the contrary, as the following analysis will show, for over twenty years reported decisions throughout the nation have uniformly held that Section 327(e) is not a back door through which counsel disqualified under Section 327(a) can be employed to represent the debtor in possession in carrying out duties central to the success of the Chapter 11 case.

Although the U.S. Trustee is unaware of any reported decisions by this Court analyzing Section 327(e)'s "conducting the case" terminology, the United States District Court for the Southern District of New York has weighed in on the issue. In *In re Neuman*, 138 B.R. 683 (S.D.N.Y. 1992), the debtor sought to employ counsel disqualified under Section 327(a) to pursue Medicare and Medicaid issues limited to one creditor and one kind of claim. *Id.* at 686. The court stated that, as specific as this purpose was, it nevertheless constituted "a large part of conducting this case." *Id.* The court reversed the bankruptcy court's authorization of the attorney's employment under Section 327(e) and held that, given the disinterestedness requirement of Section 327(a), "disinterestedness is a requirement for anyone representing the trustee in conducting any part of the case." *Id.* at 686.

Bankruptcy courts addressing the issue have also overwhelmingly held that counsel disqualified under Section 327(a) cannot be employed under Section 327(e) to represent the debtor in possession in carrying out the basic duties attendant to conducting the case. For example, in *In re Michigan Interstate Railway Co.*, 32 B.R. 327, 330 (Bankr. E.D. Mich. 1983), the court termed "sheer sophistry" the debtor's attempt to characterize its attorney as special counsel just to get around the strictures of Section 327(a). Similarly, in *In re Hempstead Realty Assocs.*, 34 B.R. 624 (Bankr. S.D.N.Y. 1983), an attorney sought employment not as "general counsel" under Section 327(a), but only as special counsel under Section 327(e). In denying the request, the court noted that the determining factor is not the label the attorney gives himself, but rather the duties to be performed. *See id.* at 625. As "the professional services to be performed . . . [were] more appropriately the sort of legal work that general counsel for a Chapter 11 debtor must pursue," the employment was denied. *Id.*

Thereafter, in *In re Tidewater Memorial Hospital, Inc.*, 110 B.R. 221, 223 (Bankr. E.D. Va. 1989), the debtor sought to employ an attorney disqualified under Section 327(a) as special counsel under Section 327(e) to represent the debtor in soliciting and negotiating proposals for the sale of the debtor's hospital. The court rejected the application on grounds that (1) the attorney was disqualified under Section 327(a), and (2) the services for which he was to be employed were so related to the debtor's reorganization as to be "tantamount to representing the debtor in the conduct of the case." *Id.* at 228. The court held that "counsel who cannot meet the disinterestedness standard of § 327(a) should not be able to bypass this requirement through employment as special counsel." *Id.*

Later, in *In re Interstate Distribution Center Assocs. (A), Ltd.*, 137 B.R. 826 (Bankr. D. Colo. 1992), the debtor sought to employ an attorney disqualified under Section 327(a) as special counsel under Section 327(e) for services which included the negotiation of financing. The court stated that "[t]he suggestion that the contemplated services do 'not necessarily fall under the purview of services normally rendered by general bankruptcy counsel' is sophistry, as the case law clearly demonstrates." *Id.* at 833. The court denied the application, as "[t]he Bankruptcy Code certainly does not allow attorneys to change hats at their own whim in order that its specific requirements may be circumvented." *Id.* at 834 (internal quotations omitted).

In *In re Argus Group 1700, Inc.*, 199 B.R. 525 (Bankr. E.D. Pa. 1996), a case within the Third Circuit, the debtor sought to employ an attorney disqualified under Section 327(a) to serve as special counsel under Section 327(e) to pursue a specific piece of litigation termed by the court "the *sine qua non* of the bankruptcy case." *Id.* at 527. The court stated that, while "at first blush" the proposed services appeared to be for a sufficiently limited purpose, in actuality the litigation in question "*is* the bankruptcy case." *Id.* at 530 (emphasis added). The court held that "the more rigorous standards" of Section 327(a) should be applied to counsel rendering services on which the success of the entire case turned. *Id.* at 531. Thus, the court denied employment under Section 327(e), stating that "[g]iven that the role of litigation is preeminent . . . , litigation counsel, not bankruptcy counsel, is the primary legal adviser," leaving "a very limited role for bankruptcy counsel." *Id.*

In *In re First American Health Care of Ga., Inc.*, 1996 WL 33404562 (Bankr. S.D. Ga. April 18, 1996), the debtor sought to employ an attorney disqualified under Section 327(a) to serve as special counsel to render specialized services related to Medicare litigation. *Id.* at *2. The court stated that "when analyzing the prospective employment of counsel pursuant to Section 327(e), the bankruptcy court should consider not only the 'special' purpose specified in the application, but all relevant facts surrounding the debtor's bankruptcy[.]" *Id.* at *3. The court further stressed that the exception to Section 327(a) created by Section 327(e) "must be narrowly construed to avoid evisceration of the general rule." *Id.* at *4. The court held that the Medicare litigation "will strike at the very heart of or be central to the Debtors' conduct of this Chapter 11 case," since "the outcome . . . will dictate the manner in which Debtors' bankruptcy counsel can conduct the case and determine in large measure the success of this Chapter 11 case." *Id.* at *6. The court denied the employment under Section 327(e), as to do otherwise "would potentially grant the firm a position of influence and control which should only be reserved for general counsel." *Id.*

In light of the overwhelming weight of authority, it is clear that the services to be rendered by Kronish Lieb are the kind of services for which employment as special counsel under Section 327(e) is not authorized. Any decisions to the contrary are in error, as they simply view Section 327(e) as a back door through which counsel disqualified under Section 327(a) may nevertheless be employed to represent the debtor in possession in conducting the case. As the bankruptcy court's decision was contrary to the jurisprudence regarding the employment of counsel disqualified under Section 327(a) to serve as special counsel to represent the debtor in possession in conducting the case, it was erroneous as a matter of law and should be reversed.

IV. THE BANKRUPTCY COURT ERRED BY FAILING TO MAKE ITS FINDINGS OF FACT AND CONCLUSIONS OF LAW A MATTER OF RECORD

In adjudicating the disputed 327(e) Application, the bankruptcy court was obligated to identify its findings of fact and conclusions of law on the record. *See, e.g., In re Pillowtex,* 304 F.3d 246, 255 (3d Cir. 2002) (remanding professional employment application for further proceedings). The bankruptcy court failed to do so. After hearing oral argument, the bankruptcy court simply directed Kronish Lieb to submit a form of order that authorized the firm to represent the Debtor. R.51 (1/8/04 Tr.) 18:22 - 19:13. Thus, the bankruptcy court has left the parties in interest to guess the basis for its decision. Therefore, even if this Court believes that an outright reversal of the bankruptcy court's order is not warranted, at a minimum this matter should be remanded to the bankruptcy court so that it may clearly articulate the basis for its ruling.

CONCLUSION

WHEREFORE the U.S. Trustee requests that this Court reverse the bankruptcy court's order dated January 13, 2004 or, alternatively, remand the matter to the bankruptcy court with directions to make its findings of fact and conclusions of law related to its ruling on the 327(e) Application a matter of record.

Respectfully submitted,

ROBERTA A. DeANGELIS
ACTING UNITED STATES TRUSTEE

BY: Joseph J. McMahon, Jr.
Joseph J. McMahon, Jr., Esquire
Robert J. Schneider, Esquire
Trial Attorneys
United States Department of Justice
Office of the United States Trustee
J. Caleb Boggs Federal Building
844 King Street, Room 2207, Lockbox 35
Wilmington, DE 19801
(302) 573-6491
(302) 573-6497 (Fax)

Date: March 22, 2004

CERTIFICATE OF SERVICE

I certify that, on March 22, 2004, I caused to be served to the following persons via first class United States mail, postage prepaid, copies of the Acting United States Trustee's Opening Brief:

Steven M. Yoder, Esquire
THE BAYARD FIRM
222 Delaware Avenue, Suite 900
P.O. Box 25130
Wilmington, DE 19899
Fax: (302) 658-6395

Lawrence C. Gottlieb, Esquire
KRONISH LIEB WEINER &
HELLMAN LLP
1114 Avenue of the Americas
New York, NY 10036
Fax: (212) 479-6275

Donald J. Detweiler, Esquire
SAUL EWING LLP
222 Delaware Avenue, Suite 1200
P.O. Box 1266
Wilmington, DE 19899
Fax: (302) 421-6813

Irving E. Walker, Esquire
SAUL EWING LLP
100 South Charles Street
Baltimore, MD 21201-2773
Fax: (410) 332-8862

Stuart M. Brown, Esquire
BUCHANAN INGERSOLL P.C.
1201 North Market Street, Suite 1501
Wilmington, DE 19801
Fax: (302) 428-3996

Louis T. DeLucia, Esquire
BUCHANAN INGERSOLL P.C.
700 Alexander Park
Suite 300
Princeton, NJ 08540
Fax: (609) 520-0360

Delores Stump
Delores Stump
Legal Clerk

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2. **("CO")** *CURRENT* COURT *[E.g., "CTA9"]* — M.D. Tenn

3. **("CCN")** *CURRENT* CASE NO. — No.: 3:04-0971, 3:04-0972, 3:04-0973 & 3:04-0974

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7. **("AU")** *PRINCIPAL AUTHORS & OFFICE [E.g.,"UST/OGC"]* — Teresa C. Azan, AUST
   P. Matthew Sutko, OGC/EOUST
   (UST/OGC: 202-307-1399/FAX-2397)

8. **("TO")** *TOPIC* — BANKRUPTCY

9. **("SU")** ● *SUMMARY* OF KEY ISSUE(s) & √ Any Miscellaneous *BACKGROUND* — ●1. Whether the bankruptcy court abused its discretion by properly adjudicating matters under § 110 as promulgated by Congress pursuant to Article I, section 8, clause 4 of the United States Constitution. 2. Whether the bankruptcy court abused its discretion by failing to provide Appellants a trial by jury when no appropriate demand for a jury trial was made. 3. Whether Appellants were denied freedom of speech under the First Amendment when the commercial speech is deceptive, misleading and illegal. 4. Whether the bankruptcy court abused its discretion when it correctly entered and certified facts under 11 U.S.C. § 110(i)(1) upon finding an overwhelming amount of evidence demonstrating unfair and deceptive practices.

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UNITED STATES DISTRICT COURT
MIDDLE DISTRICT OF TENNESSEE
NASHVILLE DIVISION

VINCENT GOULD, d/b/a We the People
Forms and Service Center of Nashville and
WE THE PEOPLE FORMS AND SERVICE
CENTERS USA, INC., a California corporation,

Appellants,

v.

RICHARD F. CLIPPARD,
United States Trustee, Region 8,
Middle District of Tennessee,

Appellee.

Civil No. 3:04-0971
JUDGE TRAUGER

CONSOLIDATED WITH
Civ. Nos. 3:04-0972, 3:04-0973
and 3:04-0974

VINCENT GOULD and SHANNON GOULD,
d/b/a We the People Forms and Service Center
of Nashville,

Appellants,

v.

LINDA MARIE SMITH, MICHAEL SCOTT TOALSON,
and HENRY DEAN FINCH,

Appellees.

BRIEF OF APPELLEE, RICHARD F. CLIPPARD, UNITED STATES TRUSTEE, REGION 8, MIDDLE DISTRICT TENNESSEE

Teresa C. Azan (TN BPR #14075)
United States Department of Justice
Office of the United States Trustee
318 Customs House, 701 Broadway
Nashville, TN 37203
Tel: 615-736-2254 (ext. 229)
Fax: 615-736-2260
Email: teresa.azan@usdoj.gov

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BASIS OF APPELLATE JURISDICTION

This Court has jurisdiction over this appeal pursuant to 28 U.S.C. § 158(a).

ISSUES PRESENTED

1. Whether the bankruptcy court abused its discretion by properly adjudicating matters under § 110 as promulgated by Congress pursuant to Article I, section 8, clause 4 of the United States Constitution.
2. Whether the bankruptcy court abused its discretion by failing to provide Appellants a trial by jury when no appropriate demand for a jury trial was made.
3. Whether Appellants were denied freedom of speech under the First Amendment when the commercial speech is deceptive, misleading and illegal.
4. Whether the bankruptcy court abused its discretion when it correctly entered and certified facts under 11 U.S.C. § 110(i)(1) upon finding an overwhelming amount of evidence demonstrating unfair and deceptive practices.
5. Whether the bankruptcy court abused its discretion when it correctly entered a final order for injunctive relief under 11 U.S.C.§ 110(j) after finding significant evidence of repeated violations under § 110.
6. Whether the bankruptcy court abused its discretion when it correctly found that the fee charged by Appellants was in excess of the services rendered in light of the unfair and deceptive acts committed by We the People.
7. Whether the bankruptcy court abused its discretion when, based on the testimony and overwhelming documentary evidence, it found Appellants engaged in the unauthorized practice of law.

APPLICABLE STANDARDS OF REVIEW

This Court reviews the Bankruptcy Court's findings of fact with the clearly erroneous standard. Taunt v. Hurtado (In re Hurtado), 342 F.3d 528, 531 (6th Cir. 2003). The bankruptcy court's application of law to fact is reviewed *de novo* with a standard for abuse of discretion. In re Burns, 322 F.3d 421 (6th Cir. 2003).

STATEMENT OF THE CASE

This case is on appeal from a memorandum and order issued by the bankruptcy court for the Middle District of Tennessee dated October 6, 2004[1], arising out of four consolidated cases involving the third-party complaints of three debtors (Finch, Toalson and Smith) against Vincent and Shannon Gould and We the People Nashville; and an adversary proceeding filed by the United States Trustee for the Middle District of Tennessee (U.S. Trustee) for (1) violations of § 110; (2) fines under § 110(b), (c), (f); (3) turnover of any excessive fee under subsection (h); (4) a finding of unfair and deceptive acts under subsections (i) and (j); (5) a finding of the unauthorized practice of law under subsection (k); and (6) injunctive relief under subsection (j). The United States Trustee filed his adversary action against Vincent Gould, We the People Forms and Service Center of Nashville and We the People Forms and Service Centers, USA, Inc., a California corporation. A trial on the four consolidated cases was held July 28, 2004 and adjourned to September 22, 2004, at which time the trial was competed. The Defendants (Appellants) in the proceedings appeal from a favorable decision for the United States Trustee and third-party complainants/debtors.

STATEMENT OF THE FACTS

A. Objection to Appellants' Statement of Facts

The United States Trustee objects to certain "facts" stated by Appellants. More particularly, those statements dealing with "the organized bars attitude" and the "legal monopoly" the "organized bar" desires to retain for its own.[1] The appellate record is devoid of such evidence. The Appellants do not reference the trial transcript or any exhibit to substantiate such facts as being part of this record on appeal. These "facts" are poorly veiled as argument and are irrelevant, nonsensical and unnecessary.

B. United States Trustee's Relevant, Additional Facts

Until April 4, 2004, Vincent Gould d/b/a We the People Forms and Service Center of Nashville ("WTP") in Nashville, Tennessee as a franchisee of We the People Forms and Service Centers, USA, Inc., a California corporation ("WTP-USA") conducted business in a store on Thompson Lane.[2] We the People assisted and "prepared" bankruptcy petitions for *pro se* debtors. The business advertised We the People's services using newspapers, circulars, the yellow pages, Graffiti Indoors and bus benches showing their telephone number as "44-LEGAL."[3] We the People charge $199 for their services.[4] Mr. Gould operated the business until he sold it back to the franchisor a year later for $59,500.[5]

Customers who paid the $199 fee charged by WTP received a blue folder with (1) a bankruptcy document preparation agreement stating that WTP has a "supervising attorney" who will assist a customer if the customer has questions, (2) a WTP chapter 7 petition customer information workbook with questions to be filled out by customers ("Workbook"), (3) a bankruptcy overview-chapter 7-Tennessee ("Overview"), (4) a Tennessee bankruptcy

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[1] Appellants' Brief in Support of Their Appeal from the Bankruptcy Court's Memorandum Opinion and Order of October 6, 2004, filed with this Court on August 29, 2005, at 9-10. Said brief will be cited herein as "Appellants' Brief"

[2] Tr.II at 65-6. For consistency, the United States Trustee shall likewise refer to the trial transcript of July 28, 2004, as "Tr. I" and the trial transcript of September 20, 2004, as "Tr. II."

[3] 2004 WL 2272152, at *2.

[4] Tr.I at 110.

[5] Tr.II at 124.

exemption table showing a list of exemptions with corresponding Tennessee Code Annotated sections, (5) a sheet entitled, "Tips on Filing a Chapter 7 Bankruptcy," (6) a "We the People Tennessee Step By Step Guide to Bankruptcy Workout," (7) a list of where to file your bankruptcy petition broken down by city, county and district, and (8) a price list of products offered.[6] Once a customer completed the Workbook, it was sent to a processing center with a "PO" or tracking number.[7] The customer was called to pick-up or view the petition, statements and schedules.[8]

Antoinette Inmon, a 25-year old patient service coordinator at Vanderbilt Hospital[9], went to WTP after seeing an ad in the newspaper advertising bankruptcies for $199.[10] Ms. Inmon recalled the telephone number as "44-LEGAL"[11] Ms. Inmon decided to file for bankruptcy after a vehicle she returned to the place she originally purchased it from began garnishing her paycheck.[12] She called WTP and explained her "situation" to Mr. Gould who could see her right away.[13] Ms. Inmon went to WTP immediately and was greeted by Mr. Gould who gave her a packet to fill out.[14] The packet contained a Workbook, in the form of a long questionnaire, which Ms. Inmon began to fill in at the store.[15] Ms. Inmon testified that whenever she came to a question she did not understand Mr. Gould explained the question or provided her examples to help her answer the question.[16]

As Ms. Inmon reviewed her Workbook during her testimony, Ms. Inmon identified a number of places in her Workbook where the writing was not hers.[17] Ms. Inmon testified that there were questions that were filled out that she did not provide information for, questions that were marked through, but she did not do it, and other anomalies.[18] Ms. Inmon

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[6] 2004 WL 2272152, at *21; Tr.II at 84-85.
[7] Tr.II at 104.
[8] Tr.I at 244-245.
[9] Tr.I at 228.
[10] Tr.I at 229.
[11] Tr.I at 230.
[12] Tr.I at 229.
[13] Tr.I at 230.
[14] Tr.I at 231.
[15] Tr.I at 232.
[16] Id.
[17] Tr.I at 233-241.
[18] Id.

never gave anyone permission to write those answers in the Workbook for her.[19]

Mr. Gould also helped Ms. Inmon value her vehicle and advised her to use a "quick sale" value.[20] She paid Mr. Gould $199 once she finished her paperwork.[21] Ms. Inmon then went back to WTP to get her Official Statement, Schedules and petition.[22] Ms. Inmon was never given her Workbook so she could compare the information in the Workbook with the Official Statements and Schedules and petition that were typed.[23] Ms. Inmon took the documents provided by WTP and filed for bankruptcy in the Middle District of Tennessee.

SUMMARY OF ARGUMENT

This case deals with questions which Appellants have repeatedly raised and which courts through out the country have repeatedly rejected. Those questions are: (1) the scope of Congress' power under the Bankruptcy Clause; (2) the Appellants' First Amendment rights; (3) the finding by the bankruptcy court that Appellants' conduct rose to the level of deceptive and unfair practices; (4) the finding by the bankruptcy court that Appellants' engaged in the unauthorized practice of law; and (5) the finding by the bankruptcy court that Appellants violated §§ 110(b)(1), (c)(1), (c)(2), (f)(1), (h), (i), (j) and (k). Courts having the opportunity to entertain these issues, both at the trial court level and at the appellate level, have rejected these arguments.[24]

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[19] Id.

[20] Tr.I at 243.

[21] Tr.I at 242.

[22] Tr.I at 244.

[23] Tr.I at 246.

[24] In re Boettcher, 262 B.R. 94 (Bankr.N.D.Ca. 2001) (where the court found that a petition preparer who selected a document form prepared by an attorney for We The People, Inc. was practicing law without a license); In re Moore, 283 B.R. 852 (Bankr.E.D.N.C. 2002) (where the court found that We The People, Inc. was the petition preparer and the preparer handing out the Overview was a deceptive and unfair practice); In re Doser, 281 B.R. 292 (Bankr.D.Idaho 2002) *aff'd* In re Doser, 412 F.3d 1056 (9th Cir. 2005) (bankruptcy court found that distribution of the Overview was the unauthorized practice of law and the bankruptcy petition preparer engaged in deceptive and unfair practice by suggesting her attorney-reviewed forms had special value); In re Buck, 290 B.R. 758 (Bankr.C.D.Cal. 2003) (We the People's violation of § 110(g)) *aff'd* In re Buck, 307 B.R. 157 (C.D.Cal. 2003); In re Douglas, 304 B.R. 223 (Bankr.D.Md. 2003) (Congress had sufficient power under the Bankruptcy Clause to enact legislation in order to protect debtors from fraudulent or deceptive acts of bankruptcy petition preparers, which threatened to interfere with their access to relief from debt under the Bankruptcy Code; and no violation of free speech rights); In re Evans, 153 B.R. 960 (Bankr.E.D.Pa. 1993) (where the court found that We-The-People-supported services provided by the bankruptcy petition preparer had little value); In re Moore, 290 B.R. 287 (Bankr.E.D.N.C. 2003) (violations under § 110); In re Shoup, 290 B.R. 768 (Bankr.C.D.Cal. 2003) (We the People's violation of § 110(g)) *aff'd* In re Shoup, 307 B.R. 164 (C.D.Cal. 2004); In re Graham, 2004 WL 1052963 (Bankr.M.D.N.C. 2004) *aff'd* Anderson v. West, 2005 WL 1719934 (M.D.N.C. 2005) (where bankruptcy court found that We the People, Inc. needed to be disclosed as a bankruptcy petition preparer and that handing out the Overview and suggesting a client could consult with a We The People attorney were deceptive practices); In re Rose, 314 B.R. 663 (Bankr.E.D.Tenn. 2004) (where court found We the People franchisee's preparation services for bankruptcy documents performed more than mere typing services for clients and, thus, engaged in the unauthorized practice of law under Tennessee law, in violation of the

Most recently, the Ninth Circuit Court of Appeals in Doser v. United States Trustee (In re Doser),[25] denied to give any legitimacy to the very arguments made by Appellants to this appeal. In the Doser case, the circuit court failed to accept the notion that Congress exceeded its authority under Art. I, Sec. 8, Cl. 4, when it enacted 11 U.S.C. § 110 to regulate the conduct of bankruptcy petition preparers.[26] The Court rejected appellant's argument that subsections (h), (i) and (j) are vague and overbroad because they somehow fail to provide adequate notice of the conduct to be sanctioned, or because they somehow fail to provide guidance to a court which must enforce the mandates of the statute.[27] The court likewise did not give credence to Appellant's contention that its bundle of services (use of a "supervising attorney and providing customers an 'Overview' and 'Workbook'"), was not a fraudulent, unfair, or deceptive act.[28]

The district court, in Doser,[29] validated the bankruptcy court's position that providing customers the Overview and Workbook "was a fraudulent, unfair or deceptive act" under § 110.[30] The Doser[31]bankruptcy court held that the distribution of these materials constituted the unauthorized practice of law and amounted to a deceptive and unfair practice in violation of § 110.[32] These are the very same arguments Appellants are making in this appeal and which courts have resoundingly rejected.

The bankruptcy court in the Inmon case found that it was deceptive and unfair for Appellants to provide an erroneous Overview, Workbook and packet of information.[33] Appellants cannot refute that the information contained in the Overview was inaccurate. Nor can Appellants deny that question number ten in the Workbook dealing with the transfer of

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section of the Bankruptcy Code regulating the conduct of petition preparers); In re Barcelo, 313 B.R. 135 (Bankr.E.D.N.Y. 2004) (same); In re Paysour, 313 B.R. 109 (Bankr.E.D.N.Y. 2004) (finding a number of violations under § 110).

[25] 412 F.3d 1056, 1061-1064 (9th Cir. 2005). (the case on appeal dealt with a We the People franchisee).

[26] Appellants' Brief, at 18-22.

[27] In re Doser, 412 F.3d at 1065.

[28] Id. at 1064-65.

[29] 292 B.R. 652 (D.Idaho 2003).

[30] Id. at 659-60.

[31] 281 B.R. 292 (BankrD.Idaho. 2002).

[32] Id. at 309.

[33] In re Inmon, 2004 WL 2272152, at *26.

property was patently wrong, and caused the chapter 7 trustee to file § 727 complaints against some of the Appellees. The bankruptcy court much like other courts throughout the country also rejected Appellants argument that their conduct is not unfair and deceptive and does not rise to the level of unauthorized practice of law.[34]

ARGUMENT

Appellants raise ten separate issues on appeal. The United States Trustee will combine and address only eight of those issues pertaining directly to his complaint filed in the Inmon adversary proceeding. The two remaining issues regarding adjudication of the third-party complaints will be left to the respective Appellees to address.[35]

The Appellants argue the bankruptcy court erred because by making findings under § 110 the court intended only to punish non-lawyers for "providing generalized legal information, document preparation services and adjuncts to those services" at a low cost.[36] The bankruptcy court did not commit reversible error on any of the issues raised by Appellants nor did the court punish Appellants merely because they were non-lawyers providing document preparation services under § 110. Instead, the bankruptcy court applied § 110 as intended by Congress. With an overwhelming amount of evidence, the bankruptcy court concluded that the repeated conduct of Appellants violated § 110 and warranted the remedies enumerated under the statute. The bankruptcy court sought to enjoin a business practice that was detrimental to the public. The services Appellants provided were not innocuous. The evidence established, their method of doing business had a negative impact on the debtors involved in this appeal. Appellants' bundle of services and behavior showed such an intentional disregard of the Bankruptcy Code as to rise to the level of unfair and deceptive acts for which injunctive relief was necessary. Because the bankruptcy court

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[34] *See supra* note 25.

[35] The Appellees contend the bankruptcy court committed reversible error when it adjudicated the third-party complaint despite dismissal of the underlying § 727 actions brought by the chapter 7 trustee, and entered a final order with respect to the breach of contract claims; Appellants' Brief at 1.

[36] Appellants' Brief at 7.

applied the statute in the way Congress intended, potential bankruptcy consumers are no longer prey to the unfair and deceptive acts of We the People and their franchisee in this jurisdiction. A brief discussion of the overview and history of this consumer protection legislation is instructive.

I. OVERVIEW & HISTORY OF 11 U.S.C. § 110

A. OVERVIEW OF 11 U.S.C. § 110

In 1994, Congress enacted 11 U.S.C. § 110 as part of the Bankruptcy Reform Act, Pub. L. No. 103-394, 308, 108 Stat. 4135 (Oct. 22, 1994) in order to address the "growing problem of bankruptcy preparers who abuse the system in the course of preparing documents for debtors to file in bankruptcy court."[37] Section 110 applies to any "bankruptcy petition preparer." A bankruptcy petition preparer is defined as "a person other than an attorney or an employee of an attorney, who prepares for compensation a document for filing" in a bankruptcy case.[38]

The statute requires bankruptcy petition preparers to sign each document prepared for filing in a bankruptcy case and to include on each document the preparer's name, address and Social Security number.[39] Bankruptcy petition preparers are also required to provide the debtor a copy of each document for filing.[40] Section 110 prohibits petition preparers from executing documents on behalf of debtors,[41] from advertising their services as "legal,"[42] and from collecting or receiving any payment from the debtor for court fees in connection with the filing of the petition.[43] The statute provides for fines of not more than $500 for each violation of these requirements.[44]

Section 110 authorizes additional methods of enforcement against bankruptcy petition

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[37] 140 Cong. Rec S. 4506 (daily ed. April 20, 1994) (statement of Senator Metzenbaum); *See also* In re Bush, 275 B.R. 69 (Bankr.D.Idaho 2002), In re Farness, 244 B.R. 464 (Bankr.D.Idaho 2000) (for a discussion of the purpose of § 110).

[38] § 110(a).

[39] §§ 110(b) and (c).

[40] § 110(d).

[41] § 110(e).

[42] § 110(f).

[43] § 110(g).

[44] §§ 110(b)(2), (c)(3), (d)(2), (e)(2), (g)(2), (h)(4).

preparers, including actions for damages for the negligent or intentional disregard of the Bankruptcy Code or any "fraudulent, unfair, or deceptive act,"[45] and for injunctive relief.[46] The statute provides that any fees "in excess of the value of services rendered for the documents prepared" shall be disallowed and ordered to be turned over to the bankruptcy trustee.[47]

B. SECTION 110 IS A CONSUMER PROTECTION STATUTE

Title 11 U.S.C. § 110 is a consumer protection statute intended by Congress to protect consumers from fraudulent and deceptive conduct by bankruptcy petition preparers.[48] Although the Bankruptcy Code and other laws expressly addressed attorney misconduct,[49] prior to the enactment of § 110, there were no statutory legal tools available to address non-attorneys seeking to profit at the expense of individuals unwilling or financially unable to hire legal counsel.[50] The legislative history for § 110 unequivocally expresses Congress' resolve to stem the widespread national problem of fraudulent and deceptive practices directed against unsophisticated consumers by bankruptcy petition preparers. The legislative history expresses Congress' concerns in enacting this statute:

> This section adds a new section to * * * title 11 * * * to create standards and penalties pertaining to bankruptcy petition preparers. Bankruptcy petition preparers not employed or supervised by any attorney have proliferated across the country. While it is permissible for a petition preparer to provide services solely limited to typing, far too many of them also attempt to provide legal advice and legal

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[45] § 110(i).

[46] § 110(j).

[47] § 110(h)(2).

[48] Doser v. United States Trustee (In re Doser), 292 B.R. 652, 655-58 (D. Idaho 2003), *aff'd* 412 F.3d 1056 (9th Cir. 2005); In re Alexander, 284 B.R. 626, 632 (Bankr. N.D. Ohio 2002); In re Guttierez, 248 B.R. 287, 297 n.27 (Bankr. W.D. Tex. 2000); In re Farness, 244 B.R. 464, 468 (Bankr. D. Idaho 2000); Fessenden v. Ireland (In re Hobbs), 213 B.R. 207, 210 (Bankr. D. Me. 1997); U.S. Trustee v. PLA People's Law-Arizona, Inc., (In re Green), 197 B.R. 878, 879 (Bankr. D. Ariz. 1996).

[49] Attorneys are subject to the provisions of 11 U.S.C. § 329, and accountable to their clients under common law theories, contract law theories, and applicable state rules of professional conduct.

[50] *See* Ross v. Smith *(In re Gavin)*, 181 B.R. 814, 820 (Bankr. E.D. Pa. 1995).

> services to debtors. These preparers often lack the necessary legal training and ethics regulation to provide such services in an adequate and appropriate manner. These services may take unfair advantage of persons who are ignorant of their rights both inside and outside the bankruptcy system.[51]

Congress passed § 110 to tackle petition preparers who prey on the poor and unsophisticated. It was hoped that the new law would address the abuses of bankruptcy petition preparers and at least provide minimal protection to consumers.[52] The legislation authorizes the bankruptcy court, as the court did in the Inmon case, to utilize statutory tools in order to stop the deceptive practices of petition preparers (We the People) who prey on the unknowing, unsophisticated consumer.

II. SECTION 110 IS A VALID EXERCISE OF CONGRESSIONAL POWER AND THE BANKUPTCY COURT'S FINDINGS OF FACTS & CONCLUSIONS OF LAW ENTERED OCTOBER 6, 2004, DID NOT VIOLATE APPELLANTS' CONSTITUTIONAL RIGHTS.

The Appellants assert A[t]here is nothing in the language of § 110 which authorizes the Bankruptcy Court to adjudicate or regulate matters concerning violations of ' 110.@[53] This includes the ability of the bankruptcy court to make any determinations under § 110(b) through (i).[54] According to Appellants, no authority exists for an Article I bankruptcy court to order injunctive relief or to order fines, penalties, or other damages for violations of § 110.[55] Appellants believe Congress intended only Article III courts to determine and enjoin actions under § 110.[56] Appellants are of the opinion that § 110 is vague and overbroad.

As stated earlier, this argument has been raised and rejected in the Ninth Circuit case of In re Doser.[57] As the Ninth Circuit court acknowledged, § 110 represents a constitutional

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[51] H.R. Rep. 103-834, 103rd Cong., 2nd Sess. 40-41 (Oct. 4, 1994); 140 Cong. Rec. H10770 (Oct. 4, 1994).
[52] 140 Cong. Rec. S. 14597 (daily ed. October 7 1994).
[53] Appellants Brief at 17.
[54] Id. at 16.
[55] Id.
[56] Id.
[57] 412 F.3d 1056, 1061-1064 (9th Cir. 2005).

exercise of Congressional authority under the Bankruptcy Clause of the U.S. Constitution, Art. 1, § 8, cl. 4, that was added to the Bankruptcy Code to Acreate a set of standards and accompanying penalties to regulate bankruptcy petition preparers.@[58] Section 110 does not exceed the scope of Congress' enumerated power under the Bankruptcy Clause. Moreover, courts having considered the constitutional argument raised by Appellants have plainly rejected the argument.[59]

A. The Bankruptcy Clause.

The Bankruptcy Clause empowers Congress "to establish uniform Laws on the subject of Bankruptcies."[60] Congress is also conferred the power then to Amake all Laws which shall be necessary and proper for carrying into Execution@[61] that authority.[62] As the Supreme Court stated in United States v. Fox:[63]

> There is no doubt of the competency of Congress to provide * * * for the enforcement of all legislation necessary or proper to the execution of powers with which it is entrusted. * * * [Congress' Bankruptcy Clause power] may embrace within its legislation *whatever may be deemed important to a complete and effective bankrupt [sic] system. * * * Any act committed with a view of evading the legislation of Congress passed in the execution of any of its powers, or fraudulently securing the benefit of such legislation, may properly be [regulated]* (emphasis added).[64]

Section 110 was enacted "to police fraud and abuse by bankruptcy petition preparers, and it is 'critically needed' to confront the large scale fraudulent conduct of those preparers."[65] Section 110 created a set of standards and penalties to regulate the conduct and practices of bankruptcy petition preparers throughout the country.

The Appellants maintain that the Supreme Court decision in Northern Pipeline Co.

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[58] Id. at 1061

[59] In re Doser, 292 B.R. at 656; In re Moore, 283 B.R. at 856; In re Douglas, 304 B.R. at 236; In re Rose, 314 B.R. at 687; In re Barcelo, 313 B.R. 140.

[60] U.S. Const, art. I, §8, cl.4.

[61] Id. at cl.18.

[62] *See, e.g.,* 28 U.S.C.§1930 (prescribing fees for filing bankruptcy petitions), 18 U.S.C. § 157 (condemning fraud in the filing of bankruptcy documents, or in statements about a proceeding falsely asserted to be pending).

[63] 95 U.S. 670 (1877).

[64] Id . at 672.

[65] In re Rausch, 197 B.R. 109 (Bankr.D.Nev.1996) (*quoting* 140 Cong.Rec. § 14, 597-98 (daily ed. October 7, 1994).

v. Marathon Pipe Line Co. (In re Northern Pipeline)[66] holds that any legislation passed within the ambit of the Bankruptcy Clause must deal directly with the adjustment of the debt relationship between debtor and creditor.[67] Appellants assert that because § 110 was enacted under the Bankruptcy Clause, it is an unconstitutional exercise of legislative authority since § 110 has no direct effect on the debtor-creditor relationship.[68] Appellants posit the argument that Congress' authority under Article I cannot be extended to "reach the conduct of persons who simply provide a service to individuals by giving and assisting them to fill-out forms."[69]

In determining the constitutionality of a Federal statute, the Court should consider the underlying purpose behind the statute to determine whether it falls within the ambit of the Constitutional directive.[70] Congress has stated the purpose of the statute was to curtail the problem of abusive conduct by bankruptcy petition preparers in the course of preparing bankruptcy documents and, ultimately, abuse upon the bankruptcy system as a whole.[71] The preparation of bankruptcy documents combined with ill-informed advice to the debtors does directly affect the debtor-creditor relationship. As such, § 110 falls within the legislative authority under the Bankruptcy Clause and serves the purpose intended by Congress.

Every facet of § 110 is integrally related to the goals and operations of bankruptcy law and the bankruptcy system. Section 110 regulates permissible methods of conduct for preparing petitions and it does so by regulating petition preparers who seek to be paid for services they render. The statute's purpose is to protect debtors from abuse that might otherwise siphon pre-petition assets from the bankruptcy estate and to protect the bankruptcy system from inaccurate forms that might be prepared using fraudulent or deceptive means. Section 110 thus lies within Congress' power to control how bankruptcy litigation is pursued and operates, and is strikingly similar to other federal provisions that are ancillary to

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[66] 458 U.S. 50 (1892); *see* Appellants' Brief at 15-16, 20.

[67] Appellants' Brief at 20.

[68] Id.

[69] Appellants' Brief at19.

[70] *See* U.S. v. Biancofiori, 422 F2d 584, 586 (7th Cir. 1970) *cert. denied,* 398 U.S. 942 (1970) (court relied upon Congressional findings un upholding constitutionality of loansharking laws).

[71] H.R. Rep. 103-834, 103rd Cong., 2nd Sess. 40-41 (Oct. 4, 1994); 140 Cong. Rec. H10770 (Oct. 4, 1994).

bankruptcy proceedings.[72]

Appellants reliance on Northern Pipeline is completely misplaced. Appellant We the People-USA and their respective franchisee fail to acknowledge in their brief that courts presented with this argument uniformly disregard such claim.[73] As the Ninth Circuit Court of Appeals in Doser v. United States Trustee (In re Doser) stated, "[n]owhere in *Northern Pipeline* did the Court limit Congress' substantive power under the Bankruptcy Clause to the restructuring of debtor-creditor relationship."[74] The Ninth Circuit viewed the opposite occurring: "the scope of Congress' power under the Bankruptcy Clause has been recognized as broad."[75] The United States Supreme Court acknowledged in Continental Ill. Nat'l Bank & Trust Co. of Chicago v. Chicago R.I. & P. Ry. Co.,[76] that "[f]rom the beginning, the tendency of legislation and of judicial interpretation has been uniformly in the direction of progressive liberalization in respect of the operation of the bankruptcy power."[77] The constitutional grant of authority has never been interpreted in such limited manner as that proposed by Appellants, and simply cannot be viewed that restrictively.

In further support of their argument, Appellants rely upon In re C.F. Foods, Inc.[78] The case of In re C.F. Foods, Inc. rejected a Bankruptcy Clause claim partly because of Louisville Joint Stock Bank v. Radford.[79] Nothing in either of these cases supports Appellants' position. The C.F. Foods case suggests that, at a minimum, to "all cases where the law causes to be distributed the property of the debtor amongst his creditors," the greatest part of that authority under the Bankruptcy Clause limits that power to "a discharge of the debtor from his contracts."[80] While C.F. Foods indicates that "[a]ll intermediate legislation,

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[72] *See supra* note 63.

[73] Doser v. United States Trustee (In re Doser), 412 F.3d 1056, 1062 (9th Cir. 2005); In re Rose, 314 B.R. 663 (Bankr.E.D.Tenn. 2004); Martini v. We the People Forms & Service Center USA (In re Barcelo), 313 B.R. 135 (Bankr.E.D.N.Y.2004); In re Douglas, 304 B.R. 223 (Bankr.D.Md.2003); and In re Moore, 283 B.R. 852 (Bankr.E.D.N.C.2002).

[74] Id. at 1062.

[75] Id.

[76] 294 U.S. 648 (1935).

[77] Id. at 668.

[78] 2001 WL 1632272 (E.D.Pa 2001) *citing* Louisville Joint Stock Bank v. Radford, 295 U.S. 555, 558 f.n. 18 (1935).

[79] 295 U.S. 555 (1935).

[80] Id.; Appellants' Brief at 19-20.

affecting substance and form, but tending to further the great end of the subject C distribution and discharge C are in the competency and discretion of Congress,"[81] it does not limit the enactment of bankruptcy laws only to those affecting the distribution and discharge in the debtor-creditor relationship. The grant of power goes to "whatever may be deemed appropriate" to effectuate the "bankrupt system" (or title 11 of the United States Code).

Appellants argue that because their work is completed pre-bankruptcy filing, a bankruptcy petition preparer cannot be involved in a bankruptcy case because bankruptcy court jurisdiction is not established pre-filing, but rather only once a case is commenced or filed.[82] For that reason, Appellants view the bankruptcy court as having no jurisdiction over them or their practices under § 110.[83] However, courts having considered this same argument have routinely rejected it. As the bankruptcy court in Moore pointed out, "[t]he petition is essential to the proper operation of the bankruptcy process, and all parties suffer if a petition is improperly prepared."[84] The Ninth Circuit in Doser also noted the importance of the petition and schedules in the bankruptcy process:

> [W]e hold that it is within the meaning of "the subject of Bankruptcy" and within Congress' power to pass uniform laws governing those persons wishing to prepare such documents. Even if not squarely within the meaning of "the subject of Bankruptcies," passing uniform laws for the protection of debtors during the process of preparing the bankruptcy petition is eminently "necessary and proper" to effectuate Congress' power under the Bankruptcy Clause.[85]

There is no greater legislation and form affecting substance and form than the complete and accurate disclosure of information in a debtor's statements and schedules.[86] A

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[81] Appellants' Brief at 19-20.

[82] Id. at 20.

[83] Id.

[84] 283 B.R. 852, 857 (Bankr.E.D.N.C.2002); *see also* In re Doser, 412 F.3d at 1062.

[85] In re Doser, 412 F.3d at 1062.

[86] In re Mascolo, 955 F.2d 274, 278 (1st Cir. 1974) (AThe successful functioning of the bankruptcy act hinges both upon the bankrupt's veracity and his willingness to make full disclosure); Mertz v. Rott, 955 F.2d 596, 598 (8th Cir. 1992) (non-disclosure of exempt tax refund was material because it was an Aasset@ of the estate and therefore bore a Arelationship@ to the estate); In re Sapru, 127 B.R. 306, 316 (Bankr.E.D.N.Y.1991) (non-disclosure of exempt or worthless assets was material because the falsehoods Arelate to the Debtor's assets and business dealings, and taken as a whole are misleading to both the court and the creditors as to the nature and extend of the Debtor's business transactions and estate@); *see also* 18 U.S.C. § 152, which makes it a criminal offense to conceal assets or make a false declaration or statement under penalty of perjury in a bankruptcy case which lends further support for the significance of true and accurate statements and schedules.

debtor's initial filings present the financial information central to the administration of the bankruptcy case and, as Appellant argues, the debtor-creditor relationship. Appellants' argument ignores the fundamental relationship between preparing and filing accurate information. This is at the very core of §110. If a preparer submits to a debtor a set of "prepared" bankruptcy documents that are incorrect or false then § 110 performs its intent. That intent is the ability of Congress under the Bankruptcy Clause to empower a bankruptcy court to determine and address violations under the statute, and thereby uphold the integrity of the bankruptcy system.

That is what the bankruptcy court in Inmon[87] and related proceedings sought to do: address the fundamental relationship between inaccurate statements and schedules "prepared" by Appellants and, consequently, maintain the reliability of the bankruptcy system as a whole. The bankruptcy court found Ms. Inmon's testimony that Appellants changed and manipulated the written answers she had provided in the "Workbook" to Appellants was Acredible, articulate and thorough@.[88] Appellant Gould ineffectively attempted to explain away this business practice. The business practice of manipulating information was further reinforced by another Appellee to this appeal, Mr. Toalson. Mr. Toalson testified that the A$900@ figure in his "Workbook" did not look like his handwriting.[89] If bankruptcy petititon preparers are able to manipulate and change information provided by debtors, then the integrity of the bankruptcy system comes in question. In the Inmon case, the Appellants changed the debtor's answers to the questionnaire, and translated that changed information onto her statements and schedules without her knowledge, permission or consent.[90] The statements and schedules are at the core of the bankruptcy case and bankruptcy administration. They ultimately affect the very debtor-creditor relationship Appellants contend is so crucial to withstand constitutional challenge to § 110. As the Douglas court

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[87] 2004 WL 2272152, *1.

[88] Id. at *26; Tr. I at 232-242.

[89] Tr. I at p. 133, 169-70.

[90] Tr. I at pp. 233-240.

observed when rejecting We the People's argument, A[t]here can be no more fundamental exercise of core subject matter jurisdiction by the bankruptcy court than its policing of professionals whom debtors pay to render service in connection with their case.@[91]

B. The Bankruptcy Court Has Jurisdiction To Hear This Matter Because This Proceeding "Arises Under" Title 11 And Is A "Core" Proceeding.

Appellants' next argue that the instant proceeding could not have an effect on the bankruptcy estate because it is not "related to" the bankruptcy case, it is not "core."[92] In accordance with 28 U.S.C. § 157(a), the district court may refer proceedings to a bankruptcy court "to hear and determine all cases under title 11 and all core proceedings arising under title 11, or arising in a case under title 11, and may enter appropriate orders and judgments."[93] A core proceeding may be decided by the bankruptcy court with a final order. In a non-core matter, the bankruptcy court may only submit proposed findings of fact and conclusions of law to the district court.[94]

It is clear the instant proceeding "arises under" title 11. Section 110 is a statute contained within title 11 of the United States Code (ABankruptcy Code@). Because this proceeding involves exclusively the provision of § 110, it stands to reason it Aarises under@ the Bankruptcy Code.[95]

Once a determination is made that a matter Aarises under@ title 11, the court must determine whether it is a Acore@ proceeding.[96] The Sixth Circuit states:

> While we determined that this matter was at least Arelated to@ the bankruptcy, that determination was for the purpose of determining whether the matter falls within

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[91] 304 B.R. at 232.

[92] Appellants' Brief at 21-22.

[93] 28 U.S.C. § 157(b)(1).

[94] 28 U.S.C. § 157(c). Section 110 is a perfect example of the division of jurisdiction for "core" and "non-core" matters. Pursuant to subsections (b) through (h), the bankruptcy court is given authority to enforce the essential "core" duties of a bankruptcy petition preparer, including proper disclosure of fees and the return of any excess fees. Under subsection (i), the sanctions that are not otherwise described in section 110 are reserved for the district court.

[95] Additionally, proceedings that do not contain Aall the characteristics of a non-core proceeding will [still] be determined to be core.@ Hughes-Bechtol, Inc. v. State of Ohio (In re Hughes-Bechtol), 141 B.R. 946, 948 (Bankr.S.D.Ohio1992).

[96] Michigan Employment Security Comm'n v. Wolverine Radio Co. (In re Wolverine Radio Co.), 930 F.2d 1132, 1144 (6th Cir. 1991).

> the bankruptcy jurisdiction, and we did not need to distinguish between each of the section 1334(b) categories for that purpose. *However, the distinction between categories is relevant for purposes of section 157* (emphasis added).[97]

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> Subsection 157(b)(1) vests full judicial power in bankruptcy courts over Acore proceedings arising under title 11, or arising in a case under title 11.@ The prepositional qualifications of core proceedings are taken from two or three categories of jurisdiction set forth in section 1334(b): proceedings "arising under" title 11, "arising in" title 11 cases, and "related to" title 11 cases. Although the purpose of this language in section 1334(b) is to define conjunctively the scope of jurisdiction, each category has a distinguishable meaning. *These meanings become relevant because section 157 apparently equates core proceedings with the categories of "arising under" and "arising in" proceedings* (emphasis added). [98]

Numerous courts addressing We the People challenges to their subject matter jurisdiction have discarded Appellants' arguments and held that § 110 are core proceedings.[99] Because § 110 is a substantive provision of the Bankruptcy Code, it logically "arises under" title 11. Accordingly, under 28 U.S.C. §§ 1334(b) and 157(b)(1), the Bankruptcy Court had jurisdiction to hear and decide the matter which is now on appeal.

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[97] *Id.*

[98] *Id. quoting* In re Wood, 825 F.2d 90, 96 (5th Cir. 1987).

[99] In re Barcelo, 313 B.R. at 135, 141-3 (Bankr.E.D.N.Y.2004); In re Graves, 279 B.R. 266, 271 (9th Cir.BAP 2002) (§ 110(j) injunction action Ais a core proceeding to be heard and determined by a bankruptcy judge under 28 U.S.C. § 157(b)(1)@); Moore, 283 B.R. at 857; *see also* In re Gabrielson, 217 B.R. 819 (Bankr.Ariz.1998) (request for an injunction against the BPP for violations of § 110 is a core proceeding within the subject matter jurisdiction of bankruptcy court); In re Gomez, 259 B.R. 379 (Bankr.D.Colo.2001) (alleged violations of § 110 present a core proceeding which is within the jurisdiction of bankruptcy court); Robiner v. Home Owners Rescue Service (In re Webb), 227 B.R. 494, 498 (Bankr.S.D.Ohio1998).

III. APPELLANTS FREEDOM OF SPEECH RIGHTS UNDER THE FIRST AMENDMENT HAVE NOT BEEN VIOLATED.

Those courts that have dealt with the freedom of speech argument made by Appellants have likewise rejected this argument as well.[100] Despite those rulings, Appellants continue to insist the bankruptcy court committed error because it has restricted the information We the People can communicate to the public.[101] Appellants believe the freedom not only extends to the right to speak and publish but also the Aperipheral rights to distribute, read, and receive information.@[102] First, it should be acknowledged that a bankruptcy petition preparer's speech is not affected by § 110 as long as the business activity does not violate § 110. This is because § 110 is aimed at Appellants' conduct as a bankruptcy petition preparer not at the distribution of literature.[103] Section 110's terms do not target speech at all, much less speech of particular content or viewpoint. Rather, § 110's undisputed purpose is to protect debtors from abuse by paid bankruptcy petition preparers, regardless of whether such abuse occurs through speech or otherwise.

A. Section 110 Does Not Infringe on Appellants' First Amendment Rights.

The Appellants state that the decision being appealed prohibits any practice by a bankruptcy petition preparer other than providing a typing service, and further prohibits their ability to disseminate material, which is no different than that sold at book stores.[104] They additionally advance the notion that finding Appellants have engaged in the unauthorized practice of law further abrogates their rights under the First Amendment. It is an accepted principle that commercial speech is afforded less protection than other forms of protected

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[100] In re Barcelo, 313 B.R. at 147-48 (Bankr.E.D.N.Y.2004); and In re Doser, 412 F.3d at 1063 (9th Cir. 2005).

[101] Appellants Brief at 22.

[102] Id at 22-23, *citing* Griswold v. Conn., 381 U.S. 479 (1965).

[103] In re Doser, 412 F.3d at 1063 (9th Cir. 2005) *referencing* Ferm v. United States Trustee (In re Crowe), 243 B.R. 43, 50 (9th Cir.BAP 2000) (In rejecting the First Amendment argument the court found that Awhat [the BPP] really sells are his services, not his books@ and concluded that Athere has been no constitutional infringement on his First Amendment rights.@).

[104] Appellants' Brief, p. 23.

expression.[105] The Supreme Court in Central Hudson created a four-part test to assess the protection due commercial speech:

> For commercial speech to come within [the First Amendment], it at least must concern lawful activity and not be misleading. Next, we ask whether the asserted governmental interest is substantial. If both inquiries yield positive answers, we must determine whether the regulation directly advances the government interest asserted, and whether it is not more extensive than is necessary to serve that interest.[106]

In applying the test to the proposition advanced by Appellants, the Ninth Circuit in Doser found "[t]he government has a substantial interest in protecting *pro se* debtors from fraudulent and deceptive practices of non-attorneys who prepare bankruptcy petitions (citation omitted). The statute directly advances that interest because it specifically prohibits fraudulent and deceptive acts by bankruptcy petition preparers and only in the narrow context of the preparation of bankruptcy petitions."[107] The inquiry need go no further because Appellants' conduct in the first instance is an unlawful activity which is misleading.

In the Inmon decision, the bankruptcy court found that Appellants' conduct violated §§ 110(b), (c), (f), (h), (i) and (k). Appellants' business practices rose to the level of unauthorized practice of law (unlawful activity) and Appellants committed unfair and deceptive acts (misleading activity).[108] The proof in Ms. Inmon's case "overwhelmingly" supported the bankruptcy court's conclusion. As stated earlier, Ms. Inmon testified of many instances when someone, other than herself, at We the People changed the information on the "Workbook" she originally completed.[109] The bankruptcy court had the opportunity to review the information and documentation provided to potential bankruptcy customers by

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[105] *See* Cent. Hudson Gas & Elec. Corp. v. Pub. Serv. Comm'n of N.Y., 447 U.S. 557, 562-63 (1980).
[106] Id.
[107] In re Doser, 412 F.3d at 1064.
[108] 2004 WL 2272152, at *26.
[109] Tr. I at 233-41.

Appellants. The bankruptcy judge found the information packet given to Ms. Inmon substantially identical to the package provided the debtor in In re Rose.[110] The bankruptcy court agreed with Judge Stair that the 'packet" alone demonstrated not only the unauthorized practice of law but also unfair and deceptive conduct.[111] The packet was unfair and deceptive: "the Customer Packet provides" problems because the documents alone actually inform potential debtors what to include within their bankruptcy schedules. Judge Stair found that these documents "disseminate legal advice, some of which is misleading and contradictory."[112] Appellants' deceptive and unlawful speech is, therefore, not protected speech.

B. Sections 110(h), (i) and (j) Are Not Vague or Overbroad.

The Appellants also raise the concern that subsections (h), (i) and (j) of § 110 are unconstitutionally vague and overbroad because they fail to provide adequate notice of the conduct to be sanctioned.[113] They believe the statute is vague "when it fails to give a person of ordinary intelligence fair notice that his contemplated conduct is forbidden by statute."[114] As such, Appellants conclude § 110 infringes upon free speech due to the failure of the statute to provide adequate notice of what conduct is permissible.

The Supreme Court has held that, before invoking the "strong medicine" of overbreadth doctrine, a claimant bears the burden of showing, "from the text of [the law] and from actual fact," that "a law's application to protected speech be substantial, not only in an absolute sense, but also relative to the scope of the law's plainly legitimate applications."[115] "Rarely, if ever, will an overbreadth challenge succeed against a law * * * that is not specifically addressed to speech or to conduct necessarily associated with speech."[116] Courts have further explained that, in analyzing overbreadth claims, the "first task is to determine

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[110] *2004 WL 2272152, at *21, n.17.*

[111] Id at *26; *see also* *21, n.16.

[112] Id at 21, n.17 *citing* In re Rose, 316 B.R. at 676.

[113] Appellants' Brief, p. 24-25.

[114] Id at 24 *citing* Papachristou v. City of Jacksonville, 405 U.S. 156 (1972).

[115] Virginia v. Hicks, 123 S.Ct. 2191, 2197-98 (2003).

[116] Id. at 2199.

whether the enactment reaches a substantial amount of constitutionally protected conduct. If it does not, then the overbreadth challenge must fail. The court should then examine the facial vagueness challenge and, assuming the enactment implicates no constitutionally protected conduct, should uphold the challenge only if the enactment is impermissibly vague in all of its applications."[117] It is dispositive that § 110 involves only economic regulation, and does not infringe constitutional rights.[118]

Citing Papachristou v. City of Jacksonville,[119] Appellants make their Fifth Amendment argument with respect to vagueness. However, a statute is not impermissibly vague under the Fifth Amendment if it, "give[s] a person of ordinary intelligence a reasonable opportunity to know what is prohibited, so that he may act accordingly."[120] "Laws regulating economic activity not involving constitutionally protected conduct are subject to a quite lenient test for constitutional sufficiency."[121]

Courts having considered the issue as advanced by Appellants have determined the statute is not vague and have given no consideration to Appellants' arguments. The Barcelo and Doser courts found a person of ordinary intelligence reading § 110 would have fair notice of who is covered by the statute and of what conduct is forbidden by it.[122] These courts deemed § 110 to be extremely clear.

Section 110 unambiguously defines a petition preparer as "a person, other than an attorney or an employee of an attorney, who prepares for compensation a document for filing" by a debtor in a bankruptcy case.[123] "Person" is a definable term under § 101(41) and

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[117] Hotel & Motel Ass'n of Oakland v. City of Oakland, 344 F.3d 959, 971 (9th Cir. 2003) (*quoting* Village of Hoffman Estates v. Flipside, Hoffman Estates, Inc., 455 U.S. 489, 494-95 (1982).

[118] *See, e.g.*, Ohralik v. Ohio State Bar Ass'n, 436 U.S. 447, 463 n. 20 (1978) (holding overbreadth doctrine inapplicable to commercial speech); Craft v. National Park., 34 F.3d 918. 922 (9th Cir. 1994); Nutritional Health Alliance Go Leasing v. NTSB, 800 F.2d 1514, 1525 (9th Cir. 1986); *see also* Nutritional Health Alliance, 144 F.3d at 226 (dismissing overbreadth challenge on ripeness grounds 'absent evidence that the provision "actually bars any truthful, non-misleading speech").

[119] 405 U.S. 156 (1972).

[120] Grayned v. City of Rockford, 92 S.Ct. 2294, 2298-99 (1972); *see also* In re Doser, 292 B.R. at 658 (D.Idaho. 2003).

[121] Village of Hoffman Estates v. Flipside, Hoffman Estates, Inc., 102 S.Ct. 1186, 1191 (1982); *see also* In re Barcelo, 313 B.R. at 144 (Bankr.E.D.N.Y.2004) *citing* Hotel & Motel Ass'n of Oakland v. City of Oakland, 344 F.3d 959, 971 (9th Cir. 2003).

[122] In re Barcelo, 313 B.R. at 144-5 (Bankr.E.D.N.Y.2004); and In re Doser, 292 B.R. at 658 (D.Idaho2003).

[123] § 110(a)(1).

includes a corporation. This provides adequate and fair notice of what parties the statute reaches: Appellants Gould (the franchisee) and We the People-USA (the franchisor).

Section 110(h) unequivocally prohibits the collection of fees "found to be in excess of the value of services rendered for the documents prepared" by a bankruptcy petition preparer. This section certainly specifies the prohibited conduct: no collection of excessive fees. Courts dealing with this portion of Appellants' argument have rejected it and have not struggled in applying this subsection of the statute.[124] Typically, the service to be compensated is typing. The rate of compensation is usually an hourly rate or flat rate. After hearing the evidence on this issue, the bankruptcy court held $30 in the Inmon case to be the value of services rendered for the documents prepared.[125] This evidence was partly based on Sharon Muller's testimony, a paralegal in the area who prepares petitions for a local bankruptcy firm. Mrs. Muller stated that she charged a maximum $30 per hour for each petition she prepared for the firm.[126] The other portion of evidence was Ms. Inmon's testimony that proved the fees were in excess of the value of the services that were rendered to her.[127] Appellants offered no rebuttal evidence. The section provides adequate notice of the conduct prohibited: the collection of excessive fees. As the Barcelo court recognized, courts have not had difficulty in applying this legislative directive to the facts and circumstances of a case and, therefore, no vagueness exists as to this subsection.[128] In view of the foregoing, § 110(h) is not impermissibly vague.

As to Appellants concerns regarding subsection (i), Section 110(i) permits claims

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[124] *See, e.g.,* In re Doser, 292 B.R. at 660-61 (AA BPP's compensation is limited to typing services [for which the BPP] should be compensated at the rate of $30 per hour for three hours.@); In re Moore, 290 B.R. 287, 297-98 (Bankr.E.D.N.C. 2003) (We the People franchisee is limited to typing the documents as directed by his customers); In re Moore, 283 B.R. at 858 *quoting* In re Bush, 275 B.R. 69, 84-85 (Bankr.D.Idaho 2002) (A bankruptcy petition preparer can rightfully perform for debtors only the modest service of transcribing or typing bankruptcy forms that the debtors alone must prepare without assistance); In re Mullikin, 231 B.R. 750, 753 (Bankr.W.D.Mo. 1999) (A[t]he work which a petition preparer may do is simply to type forms@); In re Guttierez, 248 B.R. 287, 299 (Bankr.W.D.Tex. 2000) (§ 110 only permits bankruptcy petition preparer[s] to >type' dictated or handwritten documents that have been prepared prior to the debtor seeking the assistance of the scrivening/typing service@); In re Evans, 153 B.R. 960, 970 (Bankr.E.D.Pa. 1993) (services valued at no more than $100).

[125] 2004 WL 2272152, at *26.

[126] Tr. II at 53-54.

[127] Tr. I at 233-41.

[128] 313 B.R. at 144; s*ee infra* note 106.

based upon the unfair, fraudulent or deceptive acts of a bankruptcy petition preparer. It allows damages if any of the following events occur: (1) dismissal of the case for failure to file necessary documents; (2) a bankruptcy petition preparer's negligent or intentional disregard of the Bankruptcy Code or the Federal Rules of Bankruptcy Procedure; (3) violation of any portion of § 110; or (4) any fraudulent, unfair, or deceptive act committed by the bankruptcy petition preparer. These violations are fairly straightforward and a person of ordinary intelligence undoubtedly knows what the statute means. Appellants, however, deem it necessary for the bankruptcy court to have some "guidance."[129] The implication is that some type of laundry list should have been codified as part of the subsection. Simply because Congress has not set forth a list of what constitutes a fraudulent, unfair, or deceptive act under the subsection does not render the statute unconstitutionally vague. Appellants contend that the bankruptcy court erred because it applied an "I know it when I see it" standard. Nowhere in the court's opinion is this type of standard expressed. The bankruptcy court thoroughly noted the case law under § 110(i) and applied the law to a case "saturated with evidence demonstrating unfair and deceptive practices."[130] As the Barcelo court points out:

> The term "unfair and deceptive" was used by Congress at least as early as 1938, and is used in many federal regulations spanning a broad variety of subjects. *See, e.g.,* 16 C.F.R. § 1.8 (general authority); 7 C.F.R. § 1150.161 (agricultural promotion); 12 C.F.R. § 227.11 (banking); 16 C.F.R. § 14.12 (marketing research); 49 U.S.C. § 41712 (proscribing unfair or deceptive practice by air transporters). There is also ample case law defining "unfair and deceptive acts," and many courts have found that the unauthorized practice of law amounts to unfair and deceptive conduct [citations omitted]. *In light of the common and accepted statutory usage of "unfair and deceptive," and the widely known*

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[129] Appellants' Brief at 25.

[130] In re Inmon, 2004 WL 22772152, at *27.

> *elements of fraudulent conduct, the Court finds that Section 110(i) is not permissibly vague* (emphasis added).[131]

Section 110(j)(1) authorizes the Court to enjoin the bankruptcy petition preparer from conducting business in violation§ 110 or from acting as a bankruptcy petition preparer. "Since the class of persons affected by the statute is adequately defined, and the conduct proscribed is adequately described in each subsection preceding subsection (j), it follows that Section 110(j) gives a person of ordinary intelligence fair notice of what conduct is forbidden."[132] Therefore, § 110(j) is not impermissibly vague.

IV. THE BANKRUPTCY COURT DID NOT DENY APPELLANTS DUE PROCESS RIGHTS WHEN IT IMPOSED FINES AND INJUNCTIVE RELIEF UNDER § 110 AND DID NOT PROVIDE APPELLANTS A JURY TRIAL.

A. The Appellants Received Due Process.

Appellants claim the bankruptcy court erred and denied their due process rights when it imposed "criminal" fines under § 110 and did not utilize a standard of proof that rose to the level of "clear and convincing." First, the fines imposed under § 110 are civil in nature and not criminal.[133] Section 110(j)(1) specifically states that, "the United States trustee may bring *a civil action* to enjoin a bankruptcy petition preparer (emphasis added)." The adversary proceeding initiated by the United States Trustee in the Inmon case was a civil proceeding. Appellants must remember that disgorgement under § 110(h) does not constitute "damages." Rather, disgorgement refunds a debtor the fees in excess of the value of the services rendered, a value capable of being determined by a bankruptcy court.[134]

While the United States Trustee contends that even under a Aclear and convincing@

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[131] In re Barcelo, 313 B.R. at 145 (Bankr.E.D.N.Y.2004).

[132] In re Barcelo at 145; *see also* Doser, 292 B.R. at 658.

[133] Barcelo, 313 B.R. at 151 (ASections 110(b), (c), (d), (e), (f) and (g) fix civil penalties in the form of maximum fines for specified violations of the statute. And the disgorgement of excessive fees under Section 110(h), like other disgorgement remedies, does not constitute damages, nor is it in any way punitive.; Barcelo cites a number of cases for the court's proposition.

[134] Id at 151.

standard the United States Trustee has easily met the standard, the more appropriate standard of proof in bankruptcy is a "preponderance of the evidence."[135] The record is replete with instances of how each and every subsection of § 110 were violated.[136] The significant amount of evidence relied upon by the bankruptcy court came from Appellees' testimony and documentary evidence to which the Appellants stipulated.[137] Despite the United States Trustee's assertion that it has met the clear and convincing standard of proof, preponderance of the evidence is the more appropriate standard in this context.

Appellants' second assertion is that they were denied due process of law because the bankruptcy court imposed fines in accordance with § 110. Nothing in § 110(i)(1) diminishes or takes away authority of the bankruptcy court to enforce the provisions of § 110, or to fine or enjoin any conduct that violates the statute. By virtue of the clear and unambiguous wording of § 110, Appellants were on notice of (1) the prohibited conduct and business practices; (2) that violation of any of the subsections would result in imposition of a maximum fine of $500 for each violation; (3) that the bankruptcy court could rule such business practices to be fraudulent, unfair and deceptive; (4) that such practices could also be ruled as impermissible activities prohibited by law under § 110(k); and (5) that injunctive relief could be issued under § 110(j) in order to prohibit future conduct of activities that are detrimental to the consumer. The complaint filed by the United States Trustee in the underlying adversary proceeding clearly set forth the violations under the statute and the accompanying relief requested. Given the unambiguous language of the statute and the specifically pled complaint of the United States Trustee, Appellants had notice of the alleged violations and the relief requested and, as such, due process was met.

Appellants next contend that due process was violated because injunctive relief was

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[135] Grogan v. Garner, 498 U.S. 279 (1991) (holding that the standard of proof for the dischargeability exceptions under § 523(a) is the ordinary preponderance-of-the-evidence standard).

[136] Tr. 1 at 20-21, 31-35, 43-47, 55-56 (Finch testimony), 72-77, 99-100, 103-109, 111-114, 123-124, 127-136 (Toalson testimony), Tr.I at 184, 187-189, 192-193, 201-206, 208, 213-216 (Smith testimony); Inmon, 2004 WL 2272152, *3-5, *21-22.

[137] It is ironic that Appellants on the one hand argue they are not practicing law but on the other hand argue their actions should be judged under the same standard as attorneys.

issued under § 110(j). As authority for their proposition Appellants cite to Fulton v. McVay (In re Fulton).[138] The Fulton decision has no bearing on the issue raised by Appellants. First, Fulton deals with injunctive relief issued *sua sponte* by the bankruptcy court on an order to show cause if the petition preparers gave legal advice in the course of preparing petitions. In the Inmon case, the United States Trustee filed an adversary proceeding and complaint under Fed.R.Bank.P. 7003, 7004 and 7008 as incorporated by Fed.R.Civ. P. 8. The Appellants answered the complaint. Depositions of the parties were taken by both sides to this appeal. In other words, discovery was accomplished by all parties. Thus, due process for purposes of § 110(j) was achieved. This was not the case in Fulton, which is why the district court overturned the bankruptcy court's decision. Therefore, this line of argument by Appellants has no merit.[139]

B. Appellants Have No Right to A Jury Trial.

Appellants incorrectly argue that they were entitled to a jury trial under the Seventh Amendment to the United States Constitution.[140] As the Graves court noted, "[t]here is a Seventh Amendment right to trial by jury in suits at common law where the amount in controversy exceeds $20.00."[141] In Granfinanciera, S.A. v. Norbert,[142] the U.S. Supreme Court discussed certain factors that determine whether a party has a Seventh Amendment right to a jury trial in a matter pending before a bankruptcy court.[143] Applying those factors to the instant case, (1) no causes of action similar to the cause of action brought here were tried by juries at English common law;[144] (2) the claims against the Appellants are

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[138] 318 B.R. 546 (Colo.2004).

[139] *See* In re Graves, 279 B.R. 266, 272-75 (9thCir.BAP 2002); In re Moore, 290 B.R. 287, 292 (BankrE.D.N.C. 2003); In re Doser, 292 B.R. 652, 658-69 (Bankr.D.Idaho 2003); In re Bankruptcy Petition Preparers Who Are Not Certified Pursuant to Requirements of Arizona Supreme Court, 307 B.R. 134 (9thCir.BAP. 2004); In re Bush, 275 B.R. 69, 84 n.27 (Bankr.D.Idaho 2002) (Courts ruling that even outside of an adversary proceeding bankruptcy courts may issue injunctions).

[140] Appellants' Brief at 12.

[141] 279 B.R. at 272.

[142] 492 U.S. 33 (1989).

[143] Jury trial factors: (1) the statutory action asserted is similar to actions required to be tried before a jury in the English courts of law in the latter 18th century, when the Seventh Amendment to the Constitution was adopted; (2) the remedy sought by Plaintiff is legal, rather than equitable, in nature; (3) the cause of action involves "private" rather than "public" rights; and (4) Congress has not validly assigned resolution of the claim to a non-Article III adjudicative body that does not use a jury as a fact finder.

[144] Section 110 is a consumer protection statute enacted in 1994 to regulate bankruptcy petition preparers. No similar consumer protection laws existed in 18th century England when the Seventh Amendment was adopted.

"equitable" in nature;[145] (3) the adversary proceeding involves a "public" rather than a "private" right;[146] and (4) Congress properly assigned oversight of the conduct of bankruptcy petition preparers to the bankruptcy courts.[147]

The Graves court went on to state that the phrase "suits at common law" denotes suits in which "legal" rights are ascertained and determined, as opposed to those where "equitable" remedies are administered. It includes statutory causes of action that are similar to common law actions that were ordinarily decided in English law courts in the late 1700's, as opposed to those customarily heard by courts of equity or admiralty. Statutory causes of action that are either "equitable" or "legal" but involve "public rights" are not entitled to jury trial.[148] The Graves court held that there is no constitutional right to a jury trial for a § 110(j) injunction, and there is nothing in the text of § 110(j) or its enacting statute which indicates Congress meant to create a statutory jury trial for these injunctions.[149]

The Appellants also cite to Fulton v. McVay[150] as authority for injunctive relief being set aside. Again, the Fulton court reversed an injunction under § 110 because the injunction was issued *sua sponte* by the court as opposed to the injunction having been issued through the course of an adversary proceeding. The case at bar deals with an adversary proceeding, not a *sua sponte* show cause order issued by the bankruptcy court under § 105. Therefore, Appellants' argument with respect to this particular issue has no merit.

Section 157(b)(2) contains a non-exhaustive list of "core proceedings" which Article I bankruptcy judges may adjudicate. Section 157(b)(2)(A) provides for "matters concerning the administration of the estate" as a core item which can be heard by a bankruptcy judge.

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[145] The injunctive remedies are naturally "equitable" in nature. It should also be noted that the fines under §110(b) B (h) are equitable and not legal in nature because they are not intended to make a debtor whole but rather to supplement the injunctive provisions which serve as future deterrents.

[146] The U.S. Trustee is a statutory official acting in his official capacity to enforce a consumer protection statute. Appellants are not asserting a tort or contract action on behalf of private parties or individual debtors. The financial harm caused individual debtors in this case is not related to the relief that was requested. Moreover, the government's interest is in seeing that the laws enacted by Congress are adhered to.

[147] The bankruptcy court is a non-Article III adjudicative body that does not use a jury as a fact finder; s*ee also* section II of the U.S. Trustee's brief.

[148] Id. *citing as an example e.g.,* Granfinanciera S.A. v. Nordberg, 492 U.S. 33, 40-64 (1989).

[149] Id.

[150] 318 B.R. 748 (C.Colo. 2004).

Bankruptcy judges may "hear and determine all cases under title 11 and all core proceedings arising under title 11." As discussed earlier, there is no question that § 110 actions are actions that are "under" the Bankruptcy Code and are "core." Additionally, there is no more fundamental matter concerning the administration of the estate than truthful bankruptcy statements and schedules. In light of the language of § 157 and the consequences that stem from fraudulent and misleading statements and schedules, the statute authorizes bankruptcy courts to hear matters under § 110.

Lastly, even if Appellants had a right to a jury, a party demanding trial by jury must comply with the Rules of Civil and Bankruptcy Procedure in order to perfect their right to jury trial.[151] Federal Rule of Civil Procedure 38 incorporated herein by Fed.R.Bankr.P. 9015, requires that a party must "demand a trial by jury of any issue triable of right by a jury in writing at any time after the commencement of the action and not later than 10 days after the service of the last pleading directed to such issue[.]"[152] "The failure of a party to serve and file a demand as required by this rule constitutes a waiver by the party of trial by jury."[153]

A review of the answer filed by Appellants does not show a demand for a jury trial. A review of the items designated for appeal does not show a motion for demand of a jury trial. The Appellants' objection filed June 8, 2004, to the bankruptcy court's pretrial order makes no demand for a jury trial. The transcripts on appeal do not show an oral motion for a jury trial. In order for the issue of a jury trial to be properly before a bankruptcy court, a request for a jury trial must be made. [154] The Appellants cannot make a last minute jury demand via an argument in a brief. Something more affirmative must be done. The Appellants' jury demand is late and, therefore, untimely under Fed.R.Civ.P. 38.

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[151] *See* Fed.R.Civ.P. 38; Fed.R.Bankr.P. 9015.

[152] Fed.R.Civ.P. 38(b).

[153] Id. at 38(d).

[154] Cochran v. Birkel, 651 F.2d 1219 (6th Cir.1981) (checking the box indicating that a jury had been demanded on the Civil Cover Sheet provides at least substantial compliance with Fed.R.Civ.P. 38. This notation is insufficient); U.S. Leather, Inc. v. Mitchell Mfg. Group, Inc., 276 F.3d 782, (6thCir.2002) (the Court did not find persuasive the claim by Mitchell Corp. that its demand was timely because it was filed within 10 days of the magistrate judge's report and recommendation; defendants may not wait six months before filing a demand for jury trial).

Consequently, Appellants have waived their right to a jury trial.[155]

V. THE BANKRUPTCY COURT DID NOT ERR WHEN IT DETERMINED THAT THE FEE CHARGED BY WE THE PEOPLE PURSUANT TO 11 U.S.C. § 110(f)(1) IS EXCESSIVE.

The bankruptcy court did not abuse its discretion when it held that the value of the services rendered by Appellants was limited to $30.[156] Courts addressing this issue as well have rejected Appellants argument that their services are not in excess of the value of the services rendered.[157] Section 110(h)(2) provides "[t]he court shall disallow and order the immediate turnover to the bankruptcy trustee of any fee referred to in paragraph (1) found to be in excess of the value of services rendered for the documents prepared. An individual debtor may exempt any funds so recovered under section 522(b)." Appellants' violation under this subsection warranted the finding by the court.

The $30 charge was also appropriate given (1) Appellants engaged in the unauthorized practice of law and should not be rewarded for the monetary benefits they received out of their improper and illegal actions, (2) Appellants continued to implement the We the People-USA business model and charge $199 for such services despite rulings from bankruptcy courts that identified unauthorized practice of law problems existing within their business practices, (3) the defective and erroneous nature of Appellants' Workbook; and (4) the systemic alteration of information in the Workbook without the knowledge, consent or permission of the debtors.

The bankruptcy petition preparer bears the burden of establishing entitlement to the fees once the question of reasonableness has been raised.[158] Before determining the reasonableness or "value of services rendered," the Court must first address the issue of

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[155] *See, e.g.,* In re HA-LO Industries, Inc. 326 B.R. 116 (Bkrtcy.N.D.Ill.2005) (motion to strike jury demand granted), *aff'd on other grounds,* HA-LO Industries, Inc. v. CenterPoint Properties Trust, 342 F.3d 794 (7thCir.2003).
[156] In re Inmon, 2004 WL 2272152, *26.
[157] Doser, 412 F.3d at 1065; In re Moore, 283 B.R. at 858; Moore, 290 B.R. at 294; Graham, 2004 WL 1052963, *7 (Bankr.M.D.N.C. 2004); Rose, 314 B.R. at 715.
[158] In re Doser, 281 at 313; In re Bush, 275 B.R. at 85-86.

whether such services were permissible and authorized by law. In other words, if the Court finds that Appellants were engaged in the unauthorized practice of law then the fees are in excess of the value of services rendered and should be turned over. The bankruptcy court for the Southern District of California in In re Kaitangian[159] found the preparer to have engaged in the unauthorized practice of law. Consequently, the petition preparer was ordered to disgorge all fees as they were the "fruits of illegal and improper action."[160] The same is true with Appellants in this case. The conduct of Appellants should not be rewarded by excessive compensation.

Courts have rejected Appellants' argument and have uniformly held that scrivener services are an appropriate measure of compensation for the services rendered by a bankruptcy petition preparer.[161] The evidence showed that a certified paralegal charged no more than $30 per hour for completing statements and schedules.[162] Appellants offered no rebuttal evidence in this regard. Appellants cannot bill for providing the Workbook and Overview or any "discussions" they may have with the debtors. Appellants are prohibited from rendering services connected with this type of deceptive and illegal activity and, therefore, cannot be compensated for providing these services.[163] The statute is clear that the bankruptcy court shall disallow and order the immediate turnover to the bankruptcy trustee of any fee referred to in paragraph (1) of the subsection found to be in excess of the value of services rendered. The Appellants were on notice disgorgement would occur in the event a bankruptcy court deemed their Apreparation@ of documents to be in excessive of the value of services rendered. Appellants were afforded notice and their due process rights were not

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[159] 218 B.R. 102 (Bankr.S.D.Cal. 1998).

[160] Id. at 115; *see also* In re Gavin, 181 B.R. 814, 821 (Bankr.E.D.Pa. 1995).

[161] *See* In re Bush, 275 B.R. at 84-85 (A[a] Bpp can rightfully perform for debtors only the modest service of transcribing or typing bankruptcy forms that the debtors alone must prepare Y. The Court concludes that the proper reference point is what professional typists or word processors would charge.@); In re Doser, 292 B.R. at 660-61 (AA BPP's compensation is limited to typing services Y. At the rate of $30 per hour for three hours.@); In re McDonald, 318 B.R. 37, 46 (Bankr.E.D.N.Y. 2004) (reasonable hourly rate to compensate petition preparer for the three hours that he spent preparing forms and schedules was rate of $50 per hour); In re Guttierez, 248 B.R. 287, 297 (Bankr.W.D.Tex. 2000) (only service BPP can safely offer is transcription of dictated or handwritten notes at a reasonable fee of $50)..

[162] Tr. II at 53-54.

[163] In re Doser, 292 B.R. at 661.

violated.

VI. WE THE PEOPLE-USA IS A PETITION PREPARER AS DEFINED UNDER 11 U.S.C. §110(a).

The Appellant, We the People-USA claims it is not a bankruptcy petition preparer under § 110(a) because We the People-USA does not prepare for compensation a document for filing, and there is no privity between the franchisor and the customer of the franchisee.[164] Section 110(a) provides that a "bankruptcy petition preparer means a person, other than an attorney or an employee of an attorney, who prepares for compensation a document for filing." Subsection (b) of § 110 defines "document for filing" as "a petition or any other document prepared for filing by a debtor in a United States bankruptcy court or a United States district court in connection with a case under this title." Appellant does linguistic gymnastics in its brief in order to avoid liability under the term "preparation." The franchisor tries to escape responsibility by indicating that § 110(b) and (c) uses the words "prepare" rather than type. This argument rings hollow in the face of the myriad of information that is provided to consumers who pay the fee to Appellants for "preparation" of their documents.[165] Appellee Gould testified that "[t]he organization will prepare the petition."[166] As the evidence shows Appellant We the People-USA furnishes the franchisee with a packet of information to be provided to debtors.[167] Throughout the material We the People-USA uses its logo, a bell as its symbol and words "We the People" Appellants train the franchisee on how to utilize those documents.[168] We the People-USA controls the actual typing of the petition; the franchisee is not provided any software for typing or allowed to contract with any other party.[169] We the People-USA disclosed in the Statement of Assistance of Non-Attorney that it was a person or firm that assisted the debtor in connection with this

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[164] Appellants' Brief at 33.
[165] In re Inmon at *23.
[166] Tr. II at 86.
[167] In re Inmon at *21.
[168] Tr. II, at 114-117, 125, 134.
[169] Tr. II, at 123.

bankruptcy case.[170] The bankruptcy court found We the People-USA receives a portion of WTP Nashville's gross profits.[171] We the People-USA is a petition preparer as defined under 11 U.S.C. § 110(a).[172] In the Shoup[173] case, the court found We the People-USA met the statutory definition of "bankruptcy petition preparer."[174] We the People-USA is undeniably a bankruptcy petition preparer under § 110(a). The bankruptcy court in Inmon correctly found Appellant, We the People-USA to be bankruptcy petition preparer who violated § 110.

Appellants raise an additional assertion in this portion of their argument that the bankruptcy court imposed fines on the franchisee, Gould and WTP-USA for improperly advertising in violation of § 110(f)(1), and for which there is no evidence in the record that supports the fine or even the use of the number "44-LEGAL"[175] This statement by Appellants is blatantly wrong. The Appellants stipulated to a list of six advertising items the bankruptcy court points to in rendering its opinion.[176] Additionally, Ms. Inmon had separate recall of the number "44-LEGAL."[177]

Section 110(f)(2) unambiguously states that a bankruptcy petition preparer shall be fined no more than A$500 for each violation.@ Clearly, seven violations occurred and the bankruptcy court correctly imposed a $3,500 fine on each Appellant.[178]

VII. THE BANKRUPTCY COURT PROPERLY DETERMINED THAT APPELLANTS ENGAGED IN THE UNAUTHORIZED PRACTICE OF LAW IN VIOLATION OF 11 U.S.C. §110(i).

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[170] In re Inmon, at *24.

[171] Id. at *23.

[172] 11 U.S.C.§ 110(a) provides:
(a) In this section ---
(1) Abankruptcy petition preparer@ means a person, other than an attorney or an employee of an attorney who prepares for compensation a document for filing; and
(2) Adocument for filing@ means a petition or any other document prepared for filing by a debtor in a United States bankruptcy court or a United States district court in connection with a case under this title.

[173] In re Shoup, 290 B.R. 768, 772 (Bankr.C.D.Cal. 2003).

[174] 290 B.R. at 772 (finding that We the People falls within the statutory definition of >bankruptcy petition preparer because they assist debtors in preparing bankruptcy documents for which they collect a $199 fee).

[175] Appellants' Brief at 37.

[176] Inmon at *24.

[177] Tr.I at 230.

[178] *See* In re Pillot, 286 B.R. 157, 163 (Bankr.C.D.Cal. 2002); Graham at *5 (multiple violations of one subsection aggregating a total fine imposed).

The bankruptcy court did not abuse its discretion when it held that the conduct of Appellants, which rose to the level of a fraudulent, unfair and deceptive act, constituted the unauthorized practice of law ("UPL") in violation of § 110(k). In making such a decision the Inmon bankruptcy court looked at a number of cases, some dealing with Appellants, which held that the unauthorized practice of law constitutes a fraudulent, unfair or deceptive act under § 110(i).[179] Appellants are incorrect in their belief that the bankruptcy court must make some inquiry as to whether Appellants' practices were "likely to mislead" a consumer. No such standard exists under § 110. Courts holding that We the People's actions are misleading review the evidence, which is usually the Overview and Workbook provided by We the People-USA and their franchisees.[180] Appellants' business model along with the conduct of Appellant Gould are business practices that rose to the level of the unauthorized practice of law in Tennessee under T.C.A. § 23-3-101 et seq.

Section 110(k) provides "[n]othing in this section shall be construed to permit activities that are otherwise prohibited by law, including rules and laws that prohibit the unauthorized practice of law." The bankruptcy court properly found Appellants engaged in conduct in violation of state law and enjoined them accordingly.[181]

In cases in which the unauthorized practice of law has been alleged, bankruptcy judges have been held to have the inherent authority to regulate the unauthorized practice of law by non-lawyers in their courts.[182] Numerous bankruptcy courts around the country have made UPL determinations under § 110 by looking to state law and regulations.[183] Tennessee's law on the unauthorized practice of law is not substantively different from other state jurisdictions which have held We the People to have engaged in the unauthorized

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[179] Inmon at *27.

[180] *See* In re Doser, 292 B.R. at 660.

[181] *See*§§ 110(j)((2)(A)(i)((III) and (B).

[182] *See* United States Trustee v. Tank (In re Stacy), 193 B.R. 31, 38 (Bankr.D.Or.1996), Ross v. Smith (*In re Gavin)*, 181 B.R. 814, 820 (Bankr.E.D.Pa.1995), In re Campanella, 207 B.R. 435, 443-44 (Bankr.E.D.Pa.1997).

[183] *See*, *e.g.*, In re Graham, 2004 WL 105296 at *7 (Bankr.M.D.N.C. 2004); In re McDonald, 318 B.R. 37, 46 (Bankr.E.D.N.Y. 2004); In re Moore 290 B.R. 287, 297.; In re Doser, 281 B.R. 292, 306-10 (Bankr.D.Idaho 2002), *aff'd,* Doser v. United States Trustee (In re Doser), 292 B.R. 652, 655-58 (D. Idaho 2003); In re Boettcher, 262 B.R. 94, 96 (Bankr.N.D.Cal. 2001).

practice of law.[184]

Tennessee law provides that the "law business" includes "the advising or counseling for a valuable consideration of any person, or the drawing or procuring of or assisting in the drawing for valuable consideration of any paper, document or instrument affecting or relating to the secular rights or the soliciting of a client directly or indirectly to provide such services."[185] Similarly, the "[p]ractice of law" is defined as "the drawing of papers, pleadings or documents or the performance of any act in such capacity in connection with proceedings pending or prospective before any court."[186] In addressing the relationship between the various statutory subsections, the Tennessee Court of Appeals indicates that both of the aforementioned statutory provisions must be read in conjunction with Tenn.S.Ct.R. § 8.[187] "Thus, the acts included in Tenn. Code Ann. § 23-1-101 constitute the unauthorized practice of law if performed by a non-lawyer only when performing those acts requires the professional judgment of a lawyer." [188]

In the UPL case of Fifteenth Judicial District Unified Bar Association v. Glasgow,[189] the Tennessee appellate court concluded Ms. Glasgow was engaged in the unauthorized practice of law. Ms. Glasgow's conduct, in part, is similar to Appellants'. Ms. Glasgow obtained information from clients using a questionnaire that provided her with customer information. The information concerned such matters as custody agreements, child support, division of the parties' real and personal property. It was from this information that Ms. Glasgow would then "type" divorce papers. Her clients "attested" that they did not receive legal advice in the rendering of her services. The appellate court nonetheless affirmed the trial court's finding that Ms. Glasgow's conduct was the unauthorized practice of law. The court acknowledged that Ms. Glasgow:

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[184] *See,* In re Graham, 2004 WL 105296 at *7; In re Moore 290 B.R. at 297.; In re Doser, 281 B.R. at 306-10; In re Boettcher, 262 B.R. at 96.

[185] Tenn. Code Ann. § 23-3-101(1) (Supp.2003).

[186] Tenn. Code Ann. § 23-3-101(2) (Supp.2003).

[187] Fifteenth Judicial District Unified Bar Association v. Glasgow, 1999 WL 1128847 (Tenn. Ct. App. 1999).

[188] Id.

[189] Id.

> [was] not simply reducing her clients' words to writing or filling in blanks on pre-printed forms at the specific direction of her clients. Rather, she [was] preparing legal documents that require more legal knowledge than is possessed by ordinary lay persons. She is eliciting information from her clients and then incorporating the information into unique legal documents that she creates.[190]

This is exactly what Appellants' practice is in the bankruptcy context. We the People interprets information that is given to them from a Workbook onto Official Forms. The customer never sees the Official Forms during the time he or she provides information to the franchisee. Rather, the Official Forms are presented to the customer only when the information has been processed onto the statements and schedules for final review. The customer never has an opportunity to compare the Official Forms with the Workbook he or she is provided to fill in at the beginning of the process.[191] The Moore bankruptcy court perceptively pointed out that somewhere between the debtor's completed questionnaire and the transferring of the information to the Official Statements and Schedules, decisions were made by We the People that went beyond the services of an outside typist.[192] It is no different in this case. Under the scenario in the Inmon case, the Appellants undoubtedly engaged in the unauthorized practice of law because legal judgment was used in changing and transforming the information in the Workbook onto a complete set of Official Forms without obtaining Ms. Inmon's approval of the changes. Such judgment calls for the professional skill, training and character of a lawyer, and the bankruptcy court was correct to consider this issue.

On July 8, 2004, Appellant We the People-USA and their Knoxville franchisee, Motley 4, LLC, requested the Supreme Court of Tennessee to exercise original jurisdiction over matters involving the authorized practice of law relative to their business practices. On August 26, 2004, the Court issued its *per curiam* order refusing to exercise original

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[190] Id. at *4.
[191] Tr. I at 56, 135-136, 246.
[192] Id. at 293 n. 2.

jurisdiction and denied a stay stating that the "case should proceed in the trial court."[193] The bankruptcy court, being a trier of facts, had authority to hear and decide matters dealing with the unauthorized practice of law and did not abuse its discretion in this regard.

CONCLUSION

For the foregoing reasons, this Court should affirm the decision of the bankruptcy court entered October 6, 2004.

Respectfully submitted,
RICHARD F. CLIPPARD
UNITED STATES TRUSTEE, REGION 8

Dated: September 19, 2005

/s/ Teresa C. Azan (TN BPR #14075)
TERESA C.AZAN, Trial Attorney
United States Department of Justice
Office of the United States Trustee
318 Customs House, 701 Broadway
Nashville, TN 37203
Tel: (615) 736-2254; Fax: (615) 736-2260
Email: teresa.azan@usdoj.gov

ADDENDUM

Order, In re Matter of We the People Forms and Service Center USA, Inc., a California Corporation, and Motley 4, LLC d/b/a We the People Forms and Service Center of Knoxville, a Tennessee Limited Liability Company, No. M2004-01666-SC-OT-CV (Tenn. 2004).

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[193] In re Matter of We the People Forms and Service Center USA, Inc., a California Corporation, and Motley 4, LLC d/b/a We the People Forms and Service Center of Knoxville, a Tennessee Limited Liability Company, No. M2004-01666-SC-OT-CV (Tenn. 2004). Order attached as *Addendum 1*.

CERTIFICATE OF SERVICE

I certify that on September 19, 2005, I filed with the clerk of court, using CM/ECF, which also will cause to be served upon registered users and registered filers a **BRIEF OF APPELLEE, RICHARD F. CLIPPARD, UNITED STATES TRUSTEE, REGION 8, MIDDLE DISTRICT TENNESSEE**. In addition, the persons identified below were also served by U.S. Mail first class, postage prepaid the foregoing.

Drake Holliday
Legal Aid Society of Middle TN & the Cumberlands
300 Deaderick Street
Nashville, TN 37201

T. Larry Edmondson
800 Broadway B Third Floor
Nashville, TN 37203

Robert Evans Lee
Lee & Lee Attorneys at Law, P.C.
100 East Gay Street
Lebanon, TN 37087

Michael J. Passino
323 Union Street
Nashville, TN 37201

Joanne P. Underhill
Greenwood Place
5340 South Quebec Street, Ste 306 North
Greenwood Village, CO 80111

/s/ Teresa C. Azan (TN BRP #14075)

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[1] Richard F. Clippard, United States Trustee v. Vincent Gould, We the People Forms and Service Center of Nashville, We the People Forms and Service Centers, U.S.A., Inc., (In re Inmon), No. 303-0475A, 2004 WL 2272152 (Bankr.M.D.Tenn. 2004).

BRIEF BANK — “SUMMARY SHEET” *Printed Mon-1/31/11 17:1*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*
George S. Wynns v. Tracy Hope Davis, United States Trustee, Region 2

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*
2nd Cir.

3. ("CCN") ***CURRENT*** CASE NO.
No.: 10-2138

4. ("PCN") ***PRIOR*** CASE NO. - & COURT *[IF ANY]*
No.: 09-cv-3208
Court: E.D. N.Y.
(Identify judge & cite, if any)

5. ("SO") ***SOURCE***
U.S. TRUSTEES

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*
Filed: January 21, 2011
Type: Affirmation in Opposition to Appellant George Wynn’s Motion for Summary Reversal

7. ("AU") ***PRINCIPAL AUTHORS & OFFICE*** [E.g.,"UST/OGC"]
Catherine B. Sevcenko, P. Matthew Sutko, Christine H. Black
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***
• Did the district court err when it affirmed the final judgment/order of the bankruptcy court to the extent that summary reversal is appropriate? Are sanctions warranted for the United States Trustee’s decision to seek injunctive and monetary relief based on the appellant’s violations of 11 U.S.C. § 110 and 11 U.S.C. § 528?

10. PATH TO FILE LOCATION:
(e.g., S:\OGC\BRFBANK\etc...)

11. DO YOU RECOMMEND POSTING IN UST BRIEFBANK?| x | | |
YES NO
NAME: Linda Figueroa
DATE:

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

- x
GEORGE S. WYNNS :
Appellant, :
:
- v. - :
:
TRACY HOPE DAVIS, :
UNITED STATES TRUSTEE REGION 2 : AFFIRMATION
Appellee. :
: No. 10-2138
:
- x

AFFIRMATION IN OPPOSITION TO APPELLANT GEORGE WYNN'S MOTION FOR SUMMARY REVERSAL

CHRISTINE H. BLACK, pursuant to title 28, United States Code, section 1746, affirms under penalty of perjury:

1. I am an attorney with the Department of Justice and act as an Assistant United States Trustee for Region 2. I am one of the attorneys responsible for representing the United States in this appeal. I submit this affirmation in opposition to *pro se* Appellant George S. Wynns's motion for summary reversal. I make this affirmation based upon my personal knowledge obtained through my review of the files maintained in my office in the

ordinary course of business and based upon my communication with my colleagues who litigated this case.

2. Mr. Wynns's motion should be denied. The findings of the courts below that Mr Wynns violated sections 110(b), 110(e), and 528 of title 11, and that injunctive relief was appropriate, are supported by the law and facts established at trial.

3. Mr. Wynns is a bankruptcy petition preparer, and a debt relief agency, based in California. His conduct in these professions are governed by 11 U.S.C. § 110 (governing bankruptcy petition preparers) and 11 U.S.C. § § 526-528 (governing debt relief agencies). He has a law degree, but he is not licensed to practice law. Mot. at 3. Through his web site, he agreed to help Jeffrey Giordano, a "debt consultant" in New York, prepare petitions for Mr. Giordano's clients. Mot. at 3. Two of those petitions are at issue in this case.

4. The United States Trustee for Region 2 investigated Mr. Giordano's and Mr. Wynns's conduct as bankruptcy petition preparers and debt relief agencies.[1] This led her to file a complaint with 12 causes of action against

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[1] The United States Trustee Program is the component of the Department of Justice that enforces federal bankruptcy law. *See* H.R. Rep. No. 95-595 at 110 (1977) (describing United States Trustees'

multiple parties, including Mr. Wynns. Ex. at 11-60. Six of those causes of action, including violations of sections 110(b), 110(e), and 528 of title 11, were directed against Mr. Wynns. Ex. at 46, 47, 50, 55-57. None of the other defendants elected to go to trial.

5. Mr. Wynns, represented by counsel, went to trial. The bankruptcy court found that he had violated sections 110(b), 110(e), and 528 of the Bankruptcy Code.

6. Mr. Wynns had violated section 110(b)(2) of title 11 because he did not provide his clients with the written notices required by the Code before he began work on their petitions. 11 U.S.C. § 110(b)(2). It also found that Mr. Wynns violated section 528 because he did not execute a written contract with his clients. 11 U.S.C. § 528. *Adams v. Giordano (In re Clarke)*, 426 B.R. 443, 456 (Bankr. E.D.N.Y. 2009).

"obligation to execute and enforce the bankruptcy laws"). Among other duties, United States Trustees are authorized to commence "proceedings in the bankruptcy courts in particular cases in which a particular action taken or proposed to be taken deviate[d] from the standards established by the . . . bankruptcy code." H.R. Rep. No. 95-989 at 88, 109 (1977) (quoted in *In re A-1 Trash Pickup*, 802 F.2d 774, 775 (4th Cir. 1986)). *See also* 11 U.S.C. § 307.

7. In addition, the bankruptcy court found that Mr. Wynns had also violated 11 U.S.C. § 110(e) by providing legal advice. *In re Clarke*, 426 B.R. at 456. It also found that he engaged in the unauthorized practice of law. *Id.* Finally, it decided that a tailored injunction under 11 U.S.C. § 110(j)(1) against Mr. Wynns was necessary to prevent him from violating the Bankruptcy Code in the future. *Id*.

8. Mr. Wynns, proceeding *pro se*, appealed to the United States District Court for the Eastern District of New York. On appeal he did not challenge the section 110(b) and section 528 convictions. *Wynns v. Adams*, 426 B.R. 457, 461 (E.D.N.Y. 2010). Instead Mr. Wynns disagreed only with the court's conclusions 1) that he had violated 11 U.S.C. § 110(e) by giving legal advice and engaging in unauthorized practice of law; 2) that the bankruptcy court had personal jurisdiction over him; 3) that the United States Trustee had violated his due process rights; 4) that a limited injunction was necessary; and 5) that the statutory fines were warranted. *Id.*

9. Mr. Wynns did not appeal the bankruptcy court findings that he violated 11 U.S.C. § 110(b)(2) and 11 U.S.C. § 528 to the district court. *Id.* This was significant because the two section 110(b)(2) violations independently and fully justified the $750 in fines that the bankruptcy court imposed upon him

and the $4,000 in damages that it ordered him to pay the debtors. *In re Clarke*, 426 B.R. at 456; *see also* 11 U.S.C. § 110(l)(I) (allowing $500 for each violation of section 110); 11 U.S.C. § 110(i)(1)(B) (stating that the court "shall" order the bankruptcy petition preparer to pay each debtor $2,000 or twice the fee paid to the bankruptcy petition preparer – whichever is greater).

10. On appeal, the United States Trustee asked the district court to affirm, with one exception. It asked the court to vacate the award of $2,000 in attorney fees to the United States Trustee because section 110(i)(2) does not allow attorney fees to be paid to the United States Trustee. *See Adams*, 426 B.R. at 465.

11. The district court upheld the injunction, $4,000 in statutory damages and $750 in statutory fines. It also agreed with the United States Trustee and reversed the $2,000 attorney fee award the bankruptcy court had made to her. *Id.* at 466-67.

12. Mr. Wynns appealed to this Court. He submitted a 51-page opening brief that was received by this Court on November 15, 2010. Fed. R. App. P. 31-32. Dkt. #40. The United States Trustee's opposition brief is due March 15, 2011. Dkt. #45.

13. On January 13, 2011 this Court's Clerk's Office received a 24-page "Motion by Appellant for Summary Reversal Of Final Judgment/Order of District Court and Judgment/Order of Bankruptcy Court; Motion for Attorney's Fees, Costs and Sanctions." The motion is supported by 134 pages of exhibits, which includes a ten-page affidavit. Dkt #s 53, 56.

14. For the reasons set out below, the United States Trustee requests that this Court deny Mr. Wynns's motion for summary reversal and deny his motion for sanctions against the United States Trustee.

Discussion

15. Appellate courts can decide cases summarily. Fed. R. App. P. 2 (allowing an appellate court to suspend procedural rules to "expedite its decision or for other good cause"); *Joshua v. United States*, 17 F.3d 378, 380 (Fed. Cir. 1994) (collecting cases); *Groendyke Transport, Inc. v. Davis*, 406 F.2d 1158, 1161-62 (5th Cir. 1969) (holding an appellate court has the power to render summary dispositions). This Court also has the inherent authority to dismiss an appeal that presents "no arguably meritorious issues for . . . consideration." *Pillar v. INS*, 45 F.3d 14, 17 (2d Cir. 1995) (per curiam); IOP 32.1.1 (explaining use of summary orders).

16. Summary disposition is, however, "a rare exception to the completion of the appeal process." *United States v. Davis*, 598 F.3d 10, 13 (2d Cir. 2010); *United States v. Fortner*, 455 F.3d 752, 754 (7th Cir. 2006) (stating summary affirmance is only appropriate in "certain limited circumstances"). The party seeking summary disposition bears a heavy burden to demonstrate that further consideration of the case is not necessary. *Taxpayers Watchdog, Inc. v. Stanley*, 819 F.2d 294, 297-98 (D.C. Cir. 1987).

17. In this circuit, summary disposition is only available when a party has made arguments that are "truly 'frivolous.'" *See Davis*, 598 F.3d at 13; *United States v. Bonilla*, 618 F.3d 102, 108 (2d Cir. 2010). An appeal is frivolous if "the position of one party is so clearly correct as a matter of law that no substantial question regarding the outcome of the appeal exists." *Joshua*, 17 F.3d at 380; *Fortner*, 455 F.3d at 754 (allowing summary affirmance when the arguments in the opening brief are "incomprehensible or completely insubstantial").

18. Furthermore, summary *reversal*, as requested here, is almost never warranted. *Cf. Sills v. Bureau of Prisons*, 761 F.2d 792, 793-94 (D.C. Cir. 1985) (granting summary reversal of the district court's *sua sponte* dismissal of an inmate's constitutional claim without explanation or waiting

for a response from the government). It is appropriate only where the merits are "so clear, plenary briefing, oral argument, and the traditional collegiality of the decisional process would not affect [the Court's] decision." *Id.*

19. Mr. Wynns's motion for summary reversal should be denied for three reasons.

20. First, Mr. Wynns has already filed his opening brief. Dkt. #40. He has chosen to litigate a full appeal. He should not now be permitted to open a second line of attack by filing a motion for summary reversal to refine and expand his opening brief. *Fortner*, 455 F.3d at 754 (reprimanding the appellee for filing a motion for summary disposition while reserving the right to file a full merits brief should the motion be denied).

21. Mr. Wynns's motion is largely a re-hash of the arguments in his opening brief. *Compare* Opening Br. Table of Contents, Dkt. #40, at 1-2 *with* Motion for Summary Reversal, Dkt. #53, at i-ii. Both argue that 1) the bankruptcy court did not have subject matter jurisdiction; 2) the United States Trustee did not prove that an injunction was necessary; 3) jurisdiction cannot be waived; 4) because the United States Trustee did not prove the injunction was necessary, she had not established the existence of a case or controversy. *Id.*

22. Submitting a revised brief under the guise of a Motion for Summary Reversal violates the procedural rules of this Court. It is an end-run around this Court's order that Mr. Wynns submit his opening brief by November 15, 2010. Dkt. #32.

23. This motion also abuses the purpose of summary disposition, which is to streamline court procedures. *Groendyke Transport,*, 406 F.2d at 1161-62. Instead, Mr. Wynns is duplicating the work of this Court by seeking both consideration of his brief and motion for summary reversal. *Fortner*, 455 F.3d at 754.[2]

24. Mr. Wynns has a legal education. There is no reason for this Court to condone Mr. Wynns's gamesmanship in filing this motion to reargue the positions in his opening brief. He should not be allowed to "compel [this Court] to sacrifice either the rights of other waiting suitors [litigants], its own irreplaceable judge time, or administrative efficiency" by considering his arguments multiple times. *Groendyke Transport*, 406 F.2d at 1162.

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[2] To the extent that Mr. Wynns raises new arguments in his Motion for Summary Affirmance, they are waived for the purposes of deciding the merits of this case. The United States Trustee will respond to the arguments made in Mr. Wynns opening brief in her opposition brief, which is due to be filed March 15, 2011.

25. Second, none of the arguments that the United States Trustee has made are "frivolous." The United States Trustee prevailed in the bankruptcy court, and the statutory fines and the injunction were affirmed by the district court. Logically, a winning argument cannot be frivolous. *Cf. Matthew Bender & Co., Inc. v. West Pub. Co.*, 240 F.3d 116, 122-23 (2d Cir. 2001) (holding that a losing argument that prevailed in another court and which several judges supported in dissent cannot be frivolous).

26. Furthermore, the legal arguments Mr. Wynns advocates in this motion are not "so clearly correct that no substantial question regarding the outcome of the appeal can exist." *Joshua*, 17 F.3d at 380. Far from it. They are simply wrong.

27. First, the Bankruptcy Code authorizes bankruptcy courts to "enjoin a bankruptcy petition preparer from engaging in any conduct in violation of this section" if that bankruptcy petition preparer has "engaged in conduct in violation of this section or of any provision of this title." 11 U.S.C. § 110(j)(1)-(2)(i)(I). In this case, Mr. Wynns was a bankruptcy petition preparer who violated section 110(b) and 110(e). The United States Trustee requested injunctive relief. 11 U.S.C. § 110(j)(1). Those undisputed facts provided sufficient grounds for the bankruptcy court to issue its tailored

injunction. Indeed, by not appealing the section 110(b) and section 528 violations, Mr. Wynns implicitly concedes that he engaged in the misconduct the bankruptcy court found he had committed.

28. Mr. Wynns's jurisdictional argument is also incorrect. Bankruptcy courts have jurisdiction over "all cases under title 11, and all core proceedings arising under title 11." 11 U.S.C. § 157(b)(1). A proceeding under section 110(j) is a "core proceeding to be heard and determined by a bankruptcy judge under 28 U.S.C. § 157(b)(1)." *Demos v. Brown (In re Graves)*, 279 B.R. 266, 271 (B.A.P. 9th Cir. 2002). The same is true for a section 528 violation because it involves misconduct by Mr. Wynns in the bankruptcy case.

29. Furthermore, Mr. Wynns is also wrong that the United States Trustee did not have standing to bring the case against him. Mot. at 4, 8. The United States Trustee "may raise any issue and be heard in any case or proceeding under title 11." 11 U.S.C. § 307. This grant of authority makes it "difficult to conceive of a statute that more clearly signifies Congress's intent to confer standing." *In re Columbia Gas Sys.*, 33 F.3d 294, 296 (3d Cir. 1994). Congress gave the United States Trustees such broad standing because they are "responsible for 'protecting the public interest and

ensuring that bankruptcy cases are conducted according to law.'" *Adams v. Zarnel (In re Zarnel)*, 619 F.3d 156, 162 (2d Cir. 2010) (quoting *In re Revco D.S., Inc.*, 898 F.2d 498, 499 (6th Cir. 1990)). Section 110(j) injunction actions fall within the purview of the United States Trustee's standing. *In re Graves*, 279 B.R. at 272.

30. Were there any doubt, the text of section 110 would dispel it because it explicitly authorizes United States Trustees to file proceedings against bankruptcy petition preparers like Mr. Wynns. *See e.g.*, 11 U.S.C. § 110(h)(4) (authorizing United States Trustees to file motions against bankruptcy petition preparers for overcharging); 11 U.S.C. § 110(i)(1) (authorizing United States Trustees to seek damages for any violation of section 110).

31. At the very least, the language of the statute and case law demonstrate that Mr. Wynns is not "clearly correct." Therefore, his motion should be denied.

Sanctions

32. Mr. Wynns seeks sanctions against the United States because he believes that Justice Department attorneys engaged in misconduct in the conduct of their civil prosecution before the

bankruptcy court. Fed. R. Bankr. P. 9011; 28 U.S.C. § 1927. He asks this Court to award sanctions. This Court should deny Mr. Wynns's motion because "[e]xcessively zealous claims that adversary counsel should be sanctioned will not be accorded a friendly reception by this Court." *Davis*, 598 F.3d at 14 (citation omitted).

33. This motion for sanctions should be denied for six reasons.

34. First, Mr. Wynns seeks to sanction the United States for winning its case. The bankruptcy court ruled Mr. Wynns violated sections 110 and 528 of title 11. Mr. Wynns did not even appeal some of those violations. So he cannot now seek to obtain Rule 9011 sanctions when the government's pleadings were appropriately filed.

35. Second, Mr. Wynns now openly asks this Court to impose Rule 9011 sanctions.[3] This is impossible. *See Positive Software*

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[3] In his opening brief, Mr. Wynns states that he "only recently became aware of the protections that Rule 9011(b) is supposed to provide." Br. at 41. His argument that the United States violated Rule 9011 is supposed to "illustrate" that the suit against him was "unreasonable." *Id.* He stops short of requesting sanctions, however, but he notes that this Court could award him fees if it were to issue an Order to Show Cause on its own initiative. *Id.* (citing Fed. R. Bankr. P. 9011(c)(1)(b)).

Solutions, Inc. v. New Century Mortgage Corp., 619 F.3d 458, 461 (5th Cir. 2010) (holding that the district court could not sanction actions that neither occurred before it nor violated its orders). Complaints of misconduct must be brought before the court where the alleged inappropriate actions took place. *See Chambers v. NASCO, Inc.*, 501 U.S. 32, 44 (1991) (stating that courts may sanction behavior to control the litigation before it). Here that is the bankruptcy court where this case was tried.

36. Third, Mr. Wynns has waived his chance to allege misconduct because he has not followed the Rule 9011 procedures which required him to give the United States Trustee an opportunity to rectify the allegedly offending action by withdrawing the complaint. Fed. R. Bankr. P. 9011(c)(1)(A) (requiring a party to serve a Rule 9011 motion 21 days before filing it to give the other party time to withdraw or amend it). Mr. Wynns never complied with this requirement. Because the provision requiring a party to notify its opponent about its intention to file Rule 9011 sanctions is mandatory, Mr. Wynns's motion cannot be considered. *See*

Elliott v. Tilton, 64 F.3d 213, 216 (5th Cir. 1995) (reversing Rule 9011 sanctions because the movant had not complied with the safe harbor provision).

37. Fourth, Mr. Wynns was represented by counsel at trial, who certainly would have taken steps to protect his client's interests, had there been any indication that the United States Trustee was acting improperly.

38. Fifth, Rule 9011 required that Mr. Wynns's motion "be made separately from other matters or requests." Fed. R. Bankr. P. 9011(c)(1)(A). This motion was commingled with his request for summary reversal and his request for section 1927 sanctions. Therefore, it is procedurally improper.

39. Finally, this Court cannot impose sanctions under its own procedures because Mr. Wynns has not alleged any misconduct before this Court. Fed. R. App. P. 46(c); Local Rule 46.2.

40. Mr. Wynns's request for sanctions under 28 U.S.C. § 1927 should also be denied. Unlike the Rule 9011 sanctions, however, Mr. Wynns at least mentioned sanctions under section 1927 in the

district court, which found the claim to be "frivolous." *Adams*, 426 B.R. at 466. He has renewed his request in his opening brief to this Court. Br. at 49-50.

41. Mr. Wynns's request for section 1927 sanctions should be denied for three reasons.

42. First, Mr. Wynns did not raise the issue properly in the bankruptcy court, although he claims that he "requested attorneys' fees before the bankruptcy court." Br. at 50. Under the Bankruptcy Rules, requests for relief not governed by Rule 7001 (specifying matters that must be brought by complaint), are instituted by the filing of motion, which creates a contested matter. Fed. R. Bankr. P. 9013 (governing motions) and 9014 (defining contested matters). Mr. Wynns never filed such a motion in the bankruptcy case. *Cf. Capone v. Weeks*, 326 Fed. App'x 46, 47 (2d Cir. 2009).

43. Nor did Mr. Wynns comply with the notice requirements necessary for seeking section 1927 sanctions. *Gollomp v. Spitzer*, 568 F.3d 355, 368 (2d Cir. 2009) (citation omitted). Because he

did not properly seek section 1927 sanctions in the bankruptcy court, he has waived the opportunity to do so now.

44. Second, Mr. Wynns raises the section 1927 issue in his merits brief. Br. at 49-50. To the extent that this Court should consider his argument at all, it should do so in the context of the appeal itself. Mr. Wynns cannot use this motion for summary reversal to have an issue considered twice. *Fortner*, 455 F.3d at 754.

45. Third, as the district court noted, his claim is "frivolous." *Adams*, 426 B.R. at 466. In this circuit, section 1927 sanctions are awarded "when the attorney's actions are so completely without merit as to require the conclusion that they must have been undertaken for some improper purpose," and upon "a finding of conduct constituting or akin to bad faith." *Gollomp*, 568 F.3d at 368 (citation omitted); *Oliveri v. Thompson*, 803 F.2d 1265, 1273 (2d Cir. 1986).

46. The bankruptcy court found that Mr. Wynns violated sections 110(b), 110(e), and 528 of the Bankruptcy Code. *In re Clarke*, 426 B.R. at 456. Mr. Wynns did not even appeal the decision that he

had violated section 110(b) and 528. *Adams*, 426 B.R. at 461. Therefore, he tacitly concedes that at least two of the United States Trustee's allegations were meritorious, foreclosing any grounds for sanctions under 28 U.S.C. § 1927.

Conclusion

47. The United States Trustee respectfully requests that:

1. This Court deny Mr. Wynns's Motion for Summary Reversal;
2. This Court deny Mr. Wynns's Motion for Sanctions;
3. This Court grant any other relief that it finds to be proper and just.

Dated: Central Islip, New York
January 21, 2011

/s/ Christine H. Black
Christine H. Black, Esquire
Assistant United States Trustee

United States Department of Justice
Office of the United States Trustee
560 Federal Plaza
Central Islip, New York 11722
Tel: (631) 715-7800
Fax: (631) 715-7777

Of Counsel:
Ramona D. Elliot
General Counsel

P. Matthew Sutko
Catherine B. Sevcenko
Office of General Counsel

Executive Office for United States Trustees
United States Department of Justice
20 Massachusetts Avenue. N.W., Suite 8100
Washington, DC 20530
Tel: (202) 307-1399

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

- x
GEORGE S. WYNNS :
Appellant, :
:
- v. - :
:
TRACY HOPE DAVIS, :
UNITED STATES TRUSTEE REGION 2 : Certificate of
: Service
Appellee. :
: No. 10-2138
:
- x

I, Joann C. Lomangino, am employed at the Office of the United States Trustee for Region 2, hereby certify that I caused a copy of the attached Affirmation in Opposition to Appellant George Wynn's Motion for Summary Reversal to be served by via First Class Mail in the State of New York with proper postage affixed and addressed as follows:

George S Wynns
60 29th Street #128
San Franscico CA 94110

Dated: Central Islip, New York
January 21, 2011

/s/ Joann C. Lomangino
Joann C. Lomangino

BRIEF BANK — "SUMMARY SHEET" *Printed Thu-3/17/11 16:15*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*

George S. Wynns v. Tracy Hope Davis, United States Trustee

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*

2d Cir.

3. ("CCN") ***CURRENT*** CASE NO.

No.: 10-2138

4. ("PCN") ***PRIOR*** CASE NO. - & COURT *[IF ANY]*

No.: 09-3208

Court: E.D.N.Y.

(Identify judge & cite, if any)

5. ("SO") ***SOURCE***

U.S. TRUSTEES

6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*

Filed: March 15, 2011

Type: Brief of the Appellee United States Trustee

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Christine H. Black, Catherine B. Sevcenko, P. Matthew Sutko, Ramona D. Elliott, Tracy Hope Davis

(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***

BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***

• Did the bankruptcy court exceed its jurisdiction or abuse its discretion when it 1) ordered Mr. Wynns, a bankruptcy petition preparer, to pay fines and damages because he had violated 11 U.S.C. § 110; 2) issued a limited statutory injunction under 11 U.S.C. § 110(j); and 3) denied Mr. Wynns's request for attorneys fees and costs under 28 U.S.C. 1927?

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No. 10-2138

In the United States Court of Appeals for the Second Circuit

George S. Wynns,
Defendant-Appellant,

v.

Tracy Hope Davis, United States Trustee,
Plaintiff-Appellee.

On Appeal from the United States District Court
for the Eastern District of New York

BRIEF OF THE APPELLEE UNITED STATES TRUSTEE

Ramona D. Elliott
General Counsel

P. Matthew Sutko
Associate General Counsel

Catherine B. Sevcenko
Trial Attorney

United States Department of Justice
Executive Office for United States Trustees
20 Massachusetts Avenue, N.W.
Washington, D.C. 20530
(202) 307-1399
(202) 307-2397 (fax)

Tracy Hope Davis,
United States Trustee, Region 2

Christine H. Black,
Assistant United States Trustee

United States Department of Justice
Office of the United States Trustee
560 Federal Plaza, Suite 560
Central Islip, New York 11722
(631) 715-7800
(631) 715-7777

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STATEMENT OF APPELLATE JURISDICTION

This appeal arises from a complaint filed against several bankruptcy petition preparers and debt relief agencies,[1] including Appellant George Wynns, for violating provisions of title 11 that regulate their practice. The United States Trustee[2] sought fines, statutory damages, and injunctive relief under sections 110 and 526 of the Bankruptcy Code. The bankruptcy court had jurisdiction over that complaint under 28 U.S.C. §§ 1334, 157(b)(1), and (b)(2)(A).

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[1] 11 U.S.C. § 110 (regulating petition preparers) and §§ 11 U.S.C. 526-528 (regulating debt relief agencies).

[2] United States Trustees are officials of the Department of Justice appointed by the Attorney General to supervise the administration of bankruptcy cases and trustees. *See* 28 U.S.C. §§ 581-589; *In re Columbia Gas Sys., Inc.*, 33 F.3d 294, 296 (3d Cir. 1994) (explaining that United States Trustees oversee the bankruptcy process, protect the public interest, and ensure that bankruptcy cases are conducted according to law) (citing H.R. Rep. No. 95-595, 109 (1977)). "The United States Trustee is the 'watchdog' of the bankruptcy system, charged with preventing fraud and abuse and with 'fill[ing] the vacuum' caused by possible creditor inactivity." *In re Castillo*, 297 F.3d 940, 950 (9th Cir. 2002) (alteration in original) (citations omitted). Section 307 of the Bankruptcy Code authorizes the United States Trustee to appear and be heard in this case. 11 U.S.C. § 307; *In re Donovan Corp.*, 215 F.3d 929, 930 (9th Cir. 2000) (stating that the United States Trustee may "intervene and appear at any level of the proceedings from the bankruptcy court on, 11 U.S.C. § 307, as either a party or an amicus") (quoting *Bernard v. Coyne*, 31 F.3d 842, 844 (9th Cir. 1994)).

After the United States Trustee and the other defendants settled, Mr Wynns exercised his right to proceed to trial. After trial, the bankruptcy court entered a final order against him on June 15, 2009, granting the United States Trustee's request for relief under 11 U.S.C. § 110 but exercising its discretion not to impose additional relief under 11 U.S.C. § 526(c)(2). *See e.g., In re Rodriguez*, No. SA-06-CA-323-XR, 2007 WL 593582, at *3 (W.D. Tex. Feb. 20, 2007) (order finding violation of section 110 is final). Mr. Wynns timely appealed the order to the United States District Court for the Eastern District of New York, which affirmed the judgment in part and reversed in part on March 30, 2010. 28 U.S.C. 158(a); Fed. R. Bankr. P. 8002. Mr. Wynns then timely appealed to this Court on May 24, 2010. Fed. R. App. P. 4(a)(1)(A). This Court has jurisdiction over this appeal under 28 U.S.C. §158(d).

STATEMENT OF THE ISSUE

Did the bankruptcy court exceed its jurisdiction or abuse its discretion when it 1) ordered Mr. Wynns, a bankruptcy petition preparer, to pay fines and damages because he had violated 11 U.S.C. §

110; 2) issued a limited statutory injunction under 11 U.S.C. § 110(j); and 3) denied Mr. Wynns's request for attorneys fees and costs under 28 U.S.C. 1927?

STANDARD OF REVIEW

This Court reviews a district court's order in a bankruptcy appeal in plenary fashion, meaning that this Court undertakes an independent examination of the factual findings and legal conclusions of the bankruptcy court. *In re Taylor*, 243 F.3d 124, 128 (2d Cir. 2001). The bankruptcy court's findings of fact are reviewed for clear error and its conclusions of law are reviewed *de novo*. *See In re Lehal Realty Assocs.*, 101 F.3d 272, 276 (2d Cir. 1996). This Court reviews a bankruptcy court's exercise of discretion for abuse. *Id.*

STATEMENT OF THE CASE

I. Statutory Framework

1. Purpose of 11 U.S.C. § 110.

In the Bankruptcy Reform Act in 1994,[3] Congress enacted section 110 to combat the "growing problem of bankruptcy preparers who abuse

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[3] Pub. L. No. 103-394, 108 Stat. 4106 (1994).

the system in the course of preparing documents for debtors to file in bankruptcy court." 140 Cong. Rec. S4504, S4506 (daily ed. Apr. 20, 1994) (statement of Senator Metzenbaum). Congress decided to regulate petition preparers, who "are not employed or supervised by any attorney," because "far too many of them also attempt to provide legal advice and legal services to debtors." H.R. Rep. No. 103-835, 56 (1994), *reprinted in* 1994 U.S.C.C.A.N. 3340, 3365. Congress determined that most of the "petition mills" were located in poor and minority communities, allowing preparers to "prey on the poor and unsophisticated." 140 Cong. Rec. S14597, S14597 (daily ed. Oct. 7, 1994) (statement of Senator Metzenbaum).

Section 110 defines a bankruptcy petition preparer as any "person, other than an attorney or an employee of an attorney, who prepares for compensation a document for filing" in a bankruptcy case. 11 U.S.C. § 110(a)(1). A "document for filing" is a "petition or any other document prepared for filing by a debtor" in a bankruptcy or district court related to a bankruptcy case." 11 U.S.C. § 110(a)(2).

Congress expanded section 110 in 2005 as part of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005[4] because many bankruptcy petition preparers were continuing to give debtors legal advice. *Cf. Milavetz, Gallop & Milavetz, P.A. v. United States*, 130 S. Ct. 1324, 1329-30 (2010) (stating one purpose of BAPCPA was to regulate "professionals who provide bankruptcy assistance to consumer debtors"). The amendments added new disclosure requirements to make clear to debtors that bankruptcy petitioner preparers may provide very limited services.

2. Statutory provisions at issue in Mr. Wynns's case.

The United States Trustee's civil action against Mr. Wynns was grounded on two bankruptcy petition preparer provisions.

First, section 110(b)(2) requires a bankruptcy petition preparer to inform a debtor in writing that he is not an attorney and may not give legal advice "before preparing any document for filing or accepting any fees." 11 U.S.C. § 110(b)(2)(A)-(B). Both the bankruptcy petition

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[4] Pub. L. No. 109-8 § 221, 119 Stat. 59, 194 (Apr. 20, 2005).

preparer and debtor must sign this notice, which is filed with the bankruptcy court. 11 U.S.C. § 110(b)(2)(B)(iii).

Second, section 110(e)(2)(A), a 2005 provision, provides that bankruptcy petition preparers "may not offer a potential bankruptcy debtor any legal advice." A non-exclusive list of what constitutes "legal advice" follows, including a prohibition against advising the debtor about "bankruptcy procedures or rights." 11 U.S.C. § 110(e)(2)(B)(vii).

If a bankruptcy petition preparer violates any of section 110's requirements, or commits any "fraudulent, unfair, or deceptive act," after notice and hearing, the court "shall" order the preparer to pay to the debtor 1) actual damages; 2) the greater of $2,000 or twice the amount the debtor paid for the preparer's services; and 3) reasonable attorney fees. 11 U.S.C. § 110(i)(1)(A)-(C). Furthermore, the preparer can be fined up to $500 for each violation. 11 U.S.C. § 110(l)(1).

Section 110(k) is a savings clause that prevents section 110 from being construed to allow activities "that are otherwise prohibited by law, including rules and laws that prohibit the unauthorized practice of law." 11 U.S.C. § 110(k). The scope of "unauthorized practice of law" is determined by the state law where the bankruptcy court is sitting. *In re McDonald*, 318 B.R. 37 (Bankr. E.D.N.Y. 2004); 2 Collier on Bankruptcy ¶ 110.12 (15th ed. 1997).

The United States Trustee's civil action against Mr. Wynns was also grounded on two debt relief agency provisions. A debt relief agency means "any person who provides any bankruptcy assistance to an assisted person" for compensation or "who is a bankruptcy petition preparer under section 110." 11 U.S.C. § 101(12A).

First, one of the requirements of section 528 is that the debt relief agency execute a written contract with the assisted person within five business days of commencing services, but before the petition is filed. 11 U.S.C. § 528(a)(1). The contract must "clearly and conspicuously" describe the services that the debt relief agency will perform and the fees that will be charged. 11 U.S.C. § 528(a)(1)(A)-(B). The assisted person must receive a copy of the executed contract. 11 U.S.C. § 528(a)(2).

Second, if a debt relief agency violates section 528(a), the contract with the assisted person "shall be void." 11 U.S.C. § 526(c)(1). Liability "shall" consist of fees collected from the assisted person, actual damages, and reasonable attorney fees and costs. *Id.* In addition to state law remedies, the "chief law enforcement officer of a state" may seek injunctive relief and, if successful, be awarded costs and reasonable attorney fees. 11 U.S.C. §§ 526(c)(3); see also 11 U.S.C. § 526(c)(5) (describing circumstances under which the bankruptcy court, United States Trustee, or the debtor may also seek an injunction).

Section 110 also authorizes injunctive relief against petition preparers. A limited injunction enjoining specific actions may be issued if the preparer has violated section 110 or "engaged in any other fraudulent, unfair, or deceptive conduct" and if such "relief is appropriate to prevent the recurrence of such conduct." 11 U.S.C. § 110(j)(1)-(2)(A). Second, a court "may enjoin [a] person from acting as a bankruptcy petition preparer" completely if a more tailored injunction "would not be sufficient to prevent" the bankruptcy petition preparer from interfering with "the proper administration of" the bankruptcy code. 11 U.S.C. § 110(j)(2)(B).

II. Facts

1. Mr. Wynns's work as a bankruptcy petition preparer.

Mr. Wynns is a bankruptcy petition preparer based in California who solicits business through his website.[5] A. at 96-97, 102-03, 113 (admission by counsel). He markets his services primarily to attorneys but also prepares petitions for individuals. A. at 96, 100. He is a law school graduate, although he is not admitted to the bar because he has not submitted the application for moral character qualification. A. at 96. He has a paralegal certification from the National Association of Legal Assistants and a certificate in legal assisting from City College in San Francisco. *Id.*

In 2008, Jeffery Giordano, a non-attorney, who then operated a "debt consultancy business" in New York, contacted Mr. Wynns by phone after seeing Mr. Wynns's website to ask him to prepare bankruptcy petitions for some of Mr. Giordano's clients. A. at 96, 100. Mr. Wynns knew that Giordano was not an attorney. A. at 96. He nevertheless agreed to take on Mr. Giordano's business at the rate of

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[5] www.thebankruptcyassistant.com.

$150 per petition. A. at 97, 100. The two did not have a written agreement. *Id.*

Mr. Giordano sent Mr. Wynns information via e-mail about Charles and Donalee Clarke and George and Theodora Najdek ("Clients"), the debtors in this case. A. at 100. Mr. Wynns accordingly prepared bankruptcy petitions and schedules for them. *See* Fed. R. Bankr. P. Official Form 1 (petition) and Form 6 (schedules); A. at 100, 111. In both cases, Mr. Wynns sent the completed petition to Mr. Giordano electronically. A. at 100, 107-08. Mr. Wynns also testified that he sent Mr. Giordano the necessary disclosure forms and that he expected that Mr. Giordano would share them with the clients. A. at 97, 99, 102.

2. The Clarkes' deficient petition.

When Mr. Clarke filed the bankruptcy petition on behalf of himself and his wife, the clerk informed him that it was deficient because it was missing several disclosure documents. A. at 82. Mr. Clarke immediately contacted Mr. Giordano, who in turn informed Mr. Wynns. A. at 82, 98, 106. Approximately one week later, Mr. Wynns sent the Clarkes an instruction letter and four missing documents. A. at 88, 97. He apologized to the Clarkes, explaining that “I had instructed my computer to include these four forms but for some reason it didn’t pay attention to me, and I did not notice the omission.” A. at 151; A. at 82, 102.

First, Mr. Wynns provided a disclosure stating that a bankruptcy petition preparer may not provide legal advice. A. at 83, 102. Mr. Wynns admitted at trial that he knew that a bankruptcy petition preparer should provide this document before “before preparing any document for filing.”[6] A. at 99. He also admitted that he did not send this disclosure to the Clarkes until he tried to fix their deficient filing. A. at 100. He never sent the information to the Najdeks. A. at 110.

Second, Mr. Wynns provided the two disclosures that explained 1) the responsibilities debtors have under the Bankruptcy Code and 2) a debtor’s right to a written contract with the bankruptcy petition

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[6] 11 U.S.C. § 110(b)(2)(A); Fed. R. Bankr. P. Official Form 19.

preparer.[7] Mr. Wynns explained "these [documents] are just for you to keep. You do not have to send them to the court." A. at 83.

Third, Mr. Wynns included the disclosure of his compensation for preparing their petition.[8] A. at 84-85, 103. He explained that the Clarkes did not have to sign it, but he asked them to file it with the court when they resubmitted the other documents. A. at 83, 102-03.

Finally, Mr. Wynns included his certification of compliance with the Bankruptcy Code requirements for petition preparers and the notice that bankruptcy petition preparers were required to provide to debtors about the scope of their services.[9] A. at 102. Mr. Wynns instructed the Clarkes to sign and date the second page of each form. A. at 83.

In his letter to the Clarkes, Mr. Wynns made three additional statements. He advised the Clarkes to 1) furnish their pay stubs from the last 60 days to the chapter 7 trustee; 2) furnish the chapter 7 trustee with a copy of their most recent tax return promptly; and 3) get

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[7] 11 U.S.C. § 527; 11 U.S.C. § 342(b)(1); Fed. R. Bankr. P. Procedural Form 201(B) (certifying receipt of information).

[8] 11 U.S.C. § 110(h)(2); Procedural Form 280.

[9] Fed. R. Bankr. P. Official Forms 19A, 19B.

their financial management certificate filed no later than 45 days after the creditors meeting. A. at 151. He also wrote that "fortunately the court has allowed us 15 days" to file the missing documents. *Id.* Mr. Wynns also provided a cover letter to the Clerk of the Court for Mr. Clarke to include with the documents. *Id.*

Mr. Clarke testified that without Mr. Wynns's letter and directions, he would not have known what to do with the documents and how to correct the deficient filing:

> Q: So without this letter you wouldn't have known what to do?
> A: Without this letter I would have just taken the paperwork he gave me everything down to the courthouse. That's correct. A. at 88.

Mr. Wynns also sent a second letter directly to the Clerk of the Court on May 1, stating that he "acted as bankruptcy petition preparer for the Clarkes who filed their Chapter 7 case on April 4, 2008." A. at 157-58. He represented to the bankruptcy clerk that the Clarkes had filed the missing forms when they filed their pay advices "around May 8 [sic]." A. at 157. However, "for some unknown reason" the required declarations were “not showing up on the electronic filing system [PACER].” A. at 82, 151.

3. The United States Trustee’s complaint.

On July 1, 2008, the United States Trustee filed a complaint under various sections of title 11 against Mr Giordano and several other defendants, including Mr. Wynns. A. at 9-57. The parts of the complaint relevant to Mr. Wynns alleged that he prepared the Clarkes’ and Najdeks’ bankruptcy petitions without timely disclosing his status as a non-attorney bankruptcy petition preparer, violating section 110(b)(2). A. at 43. It also alleged provided legal advice, in violation of section 110(e)(2), and engaged in the unauthorized practice of law. A. at 46-47. It alleged that he was liable under § 526(c)(2)(A) for not executing a written contract with his Clients, as required by section 528(a). A. at 47-48. It also alleged because he practiced law without a license, his actions were “fraudulent, deceptive, illegal and contrary to public policy.” A. at 51.

The complaint sought monetary relief against Mr. Wynns under section 110(i). A. at 53. It sought a statutory injunction against him under section110(j). A. at 44.

On August 26, 2008, Mr. Wynns, who was represented by counsel at the time, filed a one-page answer to the complaint, asserting he did not act as a bankruptcy petition preparer because he only prepared a draft of the petition. A. at 59. This was followed by an amended answer five months later. A. at 61-76. In these pleadings, Mr. Wynns denied that he had violated section 110, but he did not assert any objection to personal jurisdiction. He first raised the personal jurisdiction issue in a motion for summary judgment filed on January 30, 2009. *Adams v. Giordano*, No. 08-8133 (Bankr. E.D.N.Y., filed Jan. 30, 2009), Dkt. #16, p. 4.

All the other defendants settled with the United States Trustee. Mr Wynns refused to agree to any sanction, arguing that his role was too small to justify any penalty. A. at 78.

4. The bankruptcy court decision.

On May 31, 2009, Judge Robert E. Grossman issued his decision (revised to correct footnotes on June 15, 2009). A. at 5A-6. The bankruptcy court found that Mr. Wynns did not provide the required disclosures as required by section 110(b) and the written contract required under section 528. *Adams v. Giordano (In re Clarke)*, 426 B.R. 443, 452 (Bankr. E.D.N.Y. 2009).[10] Furthermore, it found that "he engaged in the unauthorized practice of law." *Id.* at 454. Specifically, it found that Mr. Wynns improperly "exercised his judgment as to how best [to] simplify the legal process for [the] Clarke[s]." *Id.* at 453.

The bankruptcy found that the letter Mr. Wynns sent Mr. Clarke "went beyond listing the [missing] documents and attaching them." *Id.* at 453-54. Instead, Mr. Wynns advised Mr. Clarke how to rectify the problem of the missing documents and also told Mr. Clarke "he must file additional documents such as pay stubs, certificates, and tax returns, information which was not in the Notice of Deficient Filing."

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[10] The bankruptcy court's decision is included in the United States Trustee's appendix at pages 117 to 136.

Id. at 454. The court found this advice constituted the improper practice of law under New York state law. *Id.*

The bankruptcy court imposed three kinds of sanctions against Mr. Wynns. First, the bankruptcy court fined him $750 for his failure to comply with the disclosure requirements in the Clarke and Najdek cases and for engaging in the unauthorized practice of law in the Clarkes' case. *Id.* at 456 (relying on 11 U.S.C. § 110(l)(1).

Second, it ordered him to pay damages to the Clarkes and the Najdeks of $2,000 each under 11 U.S.C. § 110(i)(1). *Id.* In addition, the bankruptcy court ordered Mr. Wynns to pay a total of $2,000 in attorney fees and damages to the United States Trustee under 11 U.S.C. § 110(i)(2). *Id.*

Finally, the bankruptcy court entered a limited statutory injunction under 11 U.S.C. § 110(j)(2)(A), which authorizes bankruptcy courts to enter injunctions to prevent bankruptcy petition preparers from repeating the sanctioned behavior. *Id.* at 455-56.

The bankruptcy court also found that Mr. Wynns violated the debt relief agency provisions of the Bankruptcy Code because he did not enter into a written contract with his client, something those statutes require. *Id.* at 456; 11 U.S.C. § 528 (requiring debt relief agencies to give their clients written contracts); 526(c)(2) (mandating that contracts that do not comply with section 528 "shall be void"). Despite this liability finding, the bankruptcy court did "not believe that additional relief should be granted" and exercised its discretion not to sanction Mr. Wynns for violating the debt relief agency provisions. *Id.*

Mr. Wynns filed a timely notice of appeal on June 11, 2009, appealing the bankruptcy court's decision that he had engaged in the unauthorized practice of law, thus violating section 110(e)(2). A. at 192-197. He also appealed the bankruptcy court's rejection of his claims that it did not have personal jurisdiction over him and that the United States Trustee had violated his due process rights. He also appealed the bankruptcy court's grant of limited injunctive relief. He did not, however, appeal or argue on appeal to the district court, that the part of the bankruptcy court's order entering judgment for violation of section 110(b) was wrongfully decided. A. at 198-210 (statement of issues on appeal and amended statement of issues).

Because the bankruptcy court did not award any relief for his violation of sections 526 and 528 requiring a debt relief agency to execute a written contract with the debtor, he did not include that issue on appeal. *Id.* The United States Trustee did not appeal or cross-appeal from the bankruptcy court's exercise of discretion under sections 526 and 528.

5. The district court decision.

Judge Joanna Seybert affirmed in part and reversed in part. *Wynns v. Adams*, 426 B.R. 457 (E.D.N.Y. 2010).[11] The district court's order affirmed all the relief that the bankruptcy court had imposed upon Mr. Wynns, except that part of the order directing Mr. Wynns pay $2,000 to the United States Trustee. A. at 137. On appeal, the United States Trustee asked that this aspect of the order be reversed because she was not eligible for costs or attorneys' fees under 11 U.S.C. § 110(i)(2) or (j)(4). The district court did that. *Id.*

The district court did affirm the bankruptcy court's determination that Mr. Wynns had violated section 110(e) by giving the Clarkes legal

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[11] The district court's decision is included in the United States Trustee's appendix at pages 138 to 150.

advice. *Id.* at 465. The district court also agreed that the bankruptcy court had personal jurisdiction over Mr. Wynns, *id.* at 461, and that the United States Trustee had not violated his due process rights or acted improperly by prosecuting the case. *Id.* at 462-63.

The district court nevertheless decided that the bankruptcy court "erred" in equating the prohibition in section 110(e)(2)(A) against bankruptcy petition preparers giving "any legal advice" with a prohibition against the "practice of law." *Wynns*, 426 B.R. at 462. According to the district court, legal advice is only one aspect of the practice of law. *Id.* Therefore, Mr. Wynns could only violate section 110(e)(2)(A) by giving legal advice – not by any other activity that would fall under the broader rubric of "unauthorized practice of law." *Id.* at 463. Accordingly, the district court decided that two of Mr. Wynn's actions – preparing petitions and writing the bankruptcy court clerk – did not fall under the prohibition of providing "legal advice." *Id.* at 465.

But the district court concluded, however, that Mr. Wynns had provided legal advice when he advised the Clarkes to send copies of their tax returns to the chapter 7 trustee "promptly." *Id.* at 464.

Accordingly, the district court "affirmed the bankruptcy court's finding that Mr. Wynns violated § 110(e)(2)(A) but on more limited factual and legal grounds than the bankruptcy court held." *Id.* at 465.

The district court affirmed the bankruptcy court's issuance of a statutory injunctive relief under section 110(j)(2)(A)(ii). *Id.* at 465. It also affirmed the bankruptcy court's imposition of fines and statutory damages under sections 110(l)(1) and 110(i)(1). *Id.* at 465-56. Finally, it affirmed the bankruptcy court's rejection of Mr. Wynns's claim for attorney's fees under 28 U.S.C. § 1927. *Id.* at 466.

Mr. Wynns, proceeding pro se, filed a timely appeal to this Court. After he filed his opening brief, Mr. Wynns also filed a motion for summary reversal, which the United States Trustee opposed. No. 10-2138, Dkt. #s 53, 60, 61.

SUMMARY OF ARGUMENT

Mr. Wynns has not demonstrated any basis to disturb the judgment below. The bankruptcy court did not clearly err in finding that he did not provide the required disclosures to his Clients, thus violating 11 U.S.C. § 110(b). It also did not clearly err in finding that he provided legal advice to the Clarkes, thus violating section 110(e). During the appellate process, Mr. Wynns has abandoned all of his challenges to the bankruptcy court's findings that he violated the Bankruptcy Code. With the exception of the bankruptcy court's imposition of a statutory injunctive relief under section 110(j)(2)(A)(ii), there is no issue left from the bankruptcy court's order for this Court to review.

The bankruptcy court did not err in awarding statutory damages and fines against Mr. Wynns. Section 110(i) states that a bankruptcy court "shall" impose statutory damages of $2,000, payable to the debtor, if a bankruptcy petition preparer "violates this section." It is no longer disputed that Mr. Wynns violated two sections of 110 – more than once. The bankruptcy court was obligated under the statute to assess damages of $2,000 for both the Clarkes and Najdeks against Mr. Wynns. The court did exercise its discretion, as it was entitled to do, by only assessing half of the fines allowed under section 110(l)(1).

Finally, the bankruptcy court did not abuse its discretion in imposing a limited statutory injunction against Mr. Wynns, prohibiting him from future violations of section 110. The bankruptcy court did not abuse its discretion in balancing Mr. Wynns's violations of the Bankruptcy Code with his limited involvement with Mr. Giordano and indication of "some remorse" to determine that a limited injunction was appropriate.

Mr. Wynns rests his appeal on three arguments unrelated to the merits of the bankruptcy case: the bankruptcy court had no subject matter or personal jurisdiction and his due process rights were violated. These arguments are without merit.

First, the bankruptcy court had subject matter jurisdiction over the United States Trustee's civil action under 28 U.S.C. § 157(a). A request for an injunction under section 110 is a core proceeding and bankruptcy judges may "hear and determine all [core] cases. 28 U.S.C. §§ 157(b)(1); 157(b)(2)(A), (O). There is no credible argument that the bankruptcy court lacked jurisdiction over the United States Trustee's civil action.

Mr. Wynns confuses the elements of proof needed to obtain an injunction – which he asserts the United States Trustee did not show –

with the bankruptcy court's subject-matter jurisdiction over any request to enjoin a bankruptcy petition preparer under section 110(j). The Supreme Court has disapproved decisions that conflate jurisdiction with failure to state a claim as "drive-by jurisdictional rulings" that should not be given any precedential value.[12] As the Supreme Court has rejected the blurring of the line between jurisdiction and the elements of a cause of action, this Court should do likewise.

Furthermore, Mr. Wynns's assertion that there is no "case or controversy" between him and the United States Trustee makes no sense. The United States Trustee made a colorable claim nearly three years ago that Mr. Wynns violated the Bankruptcy Code, and thus an injunction was necessary to prevent further misdeeds. The parties have been litigating the issue ever since.

Second, the bankruptcy court did not err in exercising personal jurisdiction over Mr. Wynns. He established minimum contacts with New York by conducting business with Mr. Giordano, corresponding with the Clarkes, and contacting the clerk of the bankruptcy court.

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[12] *Arbaugh v. Y&H Corp.*, 546 U.S. 500, 512 (2006).

Even if that were insufficient to establish personal jurisdiction, Mr. Wynns waived the argument by not bringing it up until after he had filed his answer and amended answer.

Third, the United States Trustee's decision to file a civil action against Mr. Wynns did not violate his due process rights. Mr. Wynns has tacitly conceded that he violated the Code. He did not appeal the bankruptcy court's order imposing liability under section 110(b) to the district court. He has also abandoned before this Court his challenge to the bankruptcy court's finding that he gave legal advice under section 110(e). Mr. Wynns does not explain how a successful civil action with no evidence of misconduct by the United States Trustee could violate his due process rights. Mr. Wynns may not like the result, but the United States Trustee acted properly in her capacity as the "watchdog" of the bankruptcy system.

Finally, Mr. Wynns's claims for sanctions are frivolous. He implicitly acknowledges that his request that this Court impose sanctions on the United States Trustee under Federal Rule of Bankruptcy 9011 is untimely. *See* Br. at 41. Furthermore, this Court has its own rules for imposing attorney discipline and cannot apply the rules of the bankruptcy court *de novo*.

Mr. Wynns presents no evidence that the United States Trustee conducted her case against him improperly or in bad faith. He simply complains that she did not consult with him before including him in her complaint. Br. at 39-40. The district court did not abuse its discretion when it rejected his request for attorneys fees and costs under 28 U.S.C. § 1927 as "frivolous."

ARGUMENT

I. Mr. Wynns Has Abandoned Any Challenge to the Bankruptcy Court's Findings that He Gave Legal Advice and that He Failed to Provide the Mandatory Disclosures, so that this Court Must Affirm the Monetary Relief Imposed by the Bankruptcy Court under 11 U.S.C. §§ 110(l)(1) and 110(i).

Mr. Wynns has either not appealed, or neglected to challenge, the bankruptcy court's finding that he violated sections 110(b) and (e) of title 11. If an appellant does not appeal an issue, it is not before the appellate court. *Hermann v. Moore*, 576 F.2d 453, 455 (2d Cir. 1978). If an appellant does not press an issue on appeal, it is abandoned. *See Norton v. Mathews*, 427 U.S. 524, 531, n.8 (1976) (noting statutory claim was preserved in statement of issues but not briefed and therefore abandoned); *City of New York v. Minetta*, 262 F.3d 169, 180-81 (2d Cir. 2001) (citing cases including one holding that "argument not mentioned in the brief [is] waived"). Here, Mr. Wynns has abandoned his claim that the bankruptcy court abused its discretion in ordering him to pay fines and damages.

The bankruptcy court based its decision that Mr. Wynns should pay fines and damages on two factual findings. First, Mr. Wynns did not notify his clients that he was not an attorney and could only provide typing services. 11 U.S.C. § 110(b)(2); Fed. R. Bankr. P. 9009; *Frankfort Digital Servs., Ltd. v. Kistler (in re Reynoso)*, 477 F.3d 1117, 1125 (9th Cir. 2006). Second, Mr. Wynns improperly gave his clients Mr. and Mrs. Clarke legal advice. 11 U.S.C. § 110(e)(2).

Mr. Wynns has not asserted that the bankruptcy court clearly erred in making these findings. In fact, he did not even appeal to the district court the bankruptcy court's judgment that he failed to provide mandatory disclosures to his clients under section 110(b). A. at 198-210; *Wynns*, 426 B.R. at 461; 11 U.S.C. § 110(b)(2). By not appealing that issue, Mr. Wynns is precluded from raising it now. *Moore*, 576 F.2d at 455. Nor does he attempt to do so.

The district court affirmed the bankruptcy court's finding that Mr. Wynns provided legal advice, thus violating section 110(e). Mr. Wynns's notice of appeal is not entirely clear, but he appealed to this Court all aspects of the district court decision "which affirmed portions of the Final Order of the bankruptcy court entered on or about June 15, 2009." A. at 1-2. Therefore, he did appeal the part of the bankruptcy court's order finding he gave improper legal advice to the Clarkes. *Wynns*, 426 B.R. at 465; 11 U.S.C. § 110(e)(2);

In his opening brief, however, Mr. Wynns did not raise the section 110(e) issue.[13] He does not cite section 110(e) in his brief. *See* Br. at 5 (list of statutes in Table of Authorities). Therefore, Mr. Wynns has abandoned the issue of whether he gave legal advice. *See LoSacco v. City of Middletown*, 71 F.3d 88, 92-93 (2d Cir.1995) (holding that when a litigant, even if proceeding *pro se*, raises an issue before the trial court but does not raise it on appeal, it is abandoned). Furthermore, arguments may not be raised for the first time in a reply brief even if the issue has been raised below. *Knipe v. Skinner*, 999 F.2d 708, 710-11 (2d Cir. 1993).

Mr. Wynns has abandoned any argument that the bankruptcy court committed clear error in finding he failed to provide the Najdeks and Clarkes with required disclosure forms. 11 U.S.C. § 110(b). He has

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[13] There is some dispute as to whether Mr. Wynns engaged in the unauthorized practice of law, which is addressed in section V of this brief. However, the district court affirmed the bankruptcy court's finding that Mr. Wynns gave the Clarkes legal advice, thus violating 11 U.S.C. § 110(e), when he advised them to submit their tax returns to the trustee. *Wynns,* 426 B.R. at 465.

abandoned any argument that the bankruptcy court committed clear error in finding he provided the Clarkes with improper legal advice. 11 U.S.C. § 110(e)(2)(B)(vii) (prohibiting advice on bankruptcy procedures).

The bankruptcy court imposed monetary relief on Mr. Wynns because he violated sections 110(b) and 110(e) of the Bankruptcy Code. A. at 116. Mr. Wynns has abandoned his appeal of the legal basis for the bankruptcy court's decision. No grounds remain upon which this Court could reverse the decision below and it must be affirmed.

II. The Bankruptcy Court Correctly Applied 11 U.S.C. § 110(i) and (l) when Computing the Damages and Fines Imposed Against Mr. Wynns.

The bankruptcy court's award of damages to the debtors was mandated by 11 U.S.C. § 110(i)(1) and should be affirmed. The bankruptcy court did not abuse its discretion when it imposed fines under 11 U.S.C. § 110(l).

If a bankruptcy petition preparer violates section 110, the bankruptcy court must impose statutory damages. Section 110(i) mandates that the court "shall order" the bankruptcy petition preparer to pay the debtor his actual damages, plus no less than $ 2,000. 110 U.S.C. § 110(i)(1); *see Marshall v. Bourque (In re Hartman)*, 208 B.R. 768, (Bankr. D. Mass 1997) ("The use of the term 'shall' [in § 110(g)(2)] indicates that once the Court has found a violation, a fine is mandatory.").

The bankruptcy court found that Mr. Wynns violated 11 U.S.C. § 110(b) in both the Clarkes' and the Najdeks' cases because he did not give them mandatory disclosure forms before preparing their petitions. *Adams*, 426 B.R. at 452. And it found he contravened section 110(e) by giving the Clarkes legal advice. *Id.* at 454. These actions triggered a mandatory damage award of $2,000 to both debtors. 11 U.S.C. § 110(i)(1); *see* A. at 111 (warning by judge to Mr. Wynns that section 110 had "very draconian consequences"). The bankruptcy court did not err in ordering Mr. Wynns to pay a $4,000 damage award.

In addition, a bankruptcy petition preparer who violates any of subsections (b) through (h) of section 110 "may be fined" not more than $500. 11 U.S.C. § 110(l). Mr. Wynns violated section 110 three times by failing to give both the Clarkes and Najdeks disclosure forms and giving the Clarkes legal advice. He was subject to fines of up to $500 each, or a total of $1,500. 11 U.S.C. § 110(l). The bankruptcy court exercised its discretion by only fining Mr. Wynns $750. *Adams*, 426 B.R. at 456. The bankruptcy court did not abuse that discretion by fining him half the statutory amount.

Mr. Wynns argues that the court erred by following the plain language of section 110(i), which mandates damages when a bankruptcy petition preparer "violates this section, **or** commits any act that the court finds to be fraudulent, unfair, or deceptive" (emphasis added). 11 U.S.C. § 110(i)(1). Mr. Wynns contends that "slavish dedication to the literal words of a statute" would create an absurd result. Br. at 28. Instead, he argues that both a statutory violation and a deceptive act are required to trigger the mandatory $2,000 fine because "any other reading would reduce the reference to deceptive acts to "'mere surplusage.'" Br. at 35.

Mr. Wynns's argument fails for at least three reasons. First, Congress made section 110(i)(1) disjunctive, creating two grounds for a damage award: 1) violation of the statute; or 2) deceptive acts. Terms connected in the disjunctive must be given separate meanings. *Garcia v. United States*, 469 U.S. 70, 74 (1984). Under this canon of statutory construction "violation of the statute" is an independent ground for awarding damages. Mr. Wynns violated section 110. Therefore, he is liable to each of his Clients for at least $2,000 in damages. The bankruptcy court properly applied the statute as written. *See Lamie v. United States Trustee*, 540 U.S. 524, 536 (2004).

Second, a plain reading does not create a surplusage and is not absurd. Not every violation of section 110 is "fraudulent, unfair, or deceptive." Conversely, not every deceptive act violates section 110. Therefore, Congress needed both phrases to cover all forms of wrong-doing.

Nor is it absurd to read section 110(i) to mandate the same damage award for "any violation of this section" or a "fraudulent, unfair or deceptive" act. Br. at 32. Mr. Wynns reads "violation" to mean a "minor" mistake or a "technical violation," *i.e.* a lesser offense. *See* Br. at 28. But the plain language of the statute does not limit damages to circumstances that a petition preparer subjectively believes is egregious. The statute creates the liability standard, not the petition preparer. *In re Jarvis*, 351 B.R. 894, 898 (Bankr. E.D. Tenn. 2006) ("Having determined that Mr. Mayton is in violation of §§ 110(b)(2)(A) and (h)(2) [disclosure provisions], §§ 110(i)(1) and (l)(1) mandate the imposition of sanctions."); *Ross v. Smith (In re Gavin)*, 181 B.R. 814, 824 (Bankr. E.D. Pa. 1995) (interpreting identical language in the 1995 version of section 110) (stating that section 110(i) penalties are "triggered if the bankruptcy petition preparer violates the section, i.e. § 110").

The rule is simple. A bankruptcy court is to award damages under section 110(i) for "*any* violation of § 110. *In re Evans*, 413 B.R. 329 (Bankr. E.D. Va. 2009) (emphasis in the original). If a bankruptcy petition preparer offers legal advice to a debtor, as Mr. Wynns did here, then the bankruptcy court must award damages to the debtor. *In re Jay*, – B.R – , No. 09-07138, 2010 WL 3259381, at *20 (Bankr. E.D. Va. Aug. 7, 2010) (stating that the Code "mandates" a $2,000 damage award when a bankruptcy petition preparer gives legal advice).

And Congress knew how to sanction certain violations more severely than others when it deemed it necessary. Section 110 singles out four particular circumstances in which a bankruptcy court "shall" triple the fine assessed against the bankruptcy petition preparer. 11 U.S.C. § 110(l)(2).[14] Congress did not, however, create a hierarchy in section 110(i)(1) under which only fraudulent acts would be subject to the $2,000 damages provision.

Congress wanted to regulate bankruptcy petition preparers more closely; Mr. Wynns's reading of the statute achieves the opposite effect. His idea that the statute should be read to allow one or two "technical violations" of the Bankruptcy Code, *see* Br. at 28, does not comport with the language of the statute or congressional intent.

Finally, Mr. Wynns's argument that the $2,000 damages award applies only to "fraudulent, unfair, or deceptive" conduct does not help him here. Giving legal advice in and of itself constitutes an unfair

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[14] The four circumstances are when a bankruptcy petition preparer 1) advises a debtor to exclude assets from his schedules; 2) advocates the use of a false social security number; 3) fails to tell the debtor that he is applying for bankruptcy relief; and 4) the bankruptcy petition preparer hides his identity. 11 U.S.C. § 110(l)(2)(A)-(D).

practice under section 110. *In re Moore*, 283 B.R. 852, 857 (Bankr. E.D.N.C. 2002). Mr. Wynns has abandoned his contention that he did not give legal advice. Therefore, under the logic of his own argument, the bankruptcy court did not abuse its discretion in requiring him to pay $4,000 in statutory damages.

III. The Statutory Injunction Ordered by the Bankruptcy Court under 11 U.S.C. § 110(j)(2)(A)(ii) was Proper.

The United States Trustee sought to enjoin Mr. Wynns from acting as a bankruptcy petition preparer. 11 U.S.C. § 110(j)(3) (creating a permanent statutory injunction); A. at 51-52. The bankruptcy court did not abuse its discretion when it issued a limited statutory injunction prohibiting Mr. Wynns from violating section 110 in the future. 11 U.S.C. § 110(j)(2)(A); *United States v. W.T. Grant Co.*, 345 U.S. 629, 633 (1953) (stating that an injunction cannot be disturbed unless it had "no reasonable basis"). Mr. Wynns argues that imposing the statutory injunction is improper because "the possibility of any future violations by WYNNS was very remote." Br. at 48.

Mr. Wynns misstates the applicable legal standard for injunctive relief under section 110(j)(2)(A). Br. at 44. Under section 110(j)(2)(A), a bankruptcy court must find that 1) a violation of the statute has occurred and 2) a limited injunction would be "appropriate" to prevent "recurrence" of the improper actions. 11 U.S.C. 110(j)(2)(A)(ii). If so, it can enter that statutory injunction.

The bankruptcy court considered Mr. Wynns's defenses, including the fact that he broke off working with Mr. Giordano and had expressed "some remorse and reflection." *Adams*, 426 B.R. at 455. It therefore rejected the United States Trustee's request for an injunction stopping Mr. Wynns from working as a bankruptcy petition preparer because "Wynns's wrongful conduct could be halted by an injunction against improper conduct itself rather than a permanent injunction." *Id.* at 455-56.

The facts established at trial demonstrate that the bankruptcy court did not abuse its discretion in deciding that it would be "appropriate" to issue a limited statutory injunction. When the bankruptcy court issued the statutory injunction, Mr. Wynns still intended to work as a bankruptcy petition preparer. He was still advertising bankruptcy petition preparer work on his website. *See* A. at

159-191. He had earned his living providing legal support services for twenty years and nothing in the record suggested he was going to change careers. *Adams*, 426 B.R. at 449.

Mr. Wynns had violated multiple provisions of the Bankruptcy Code but had only expressed "some" remorse for his actions. *In re Hennerman*, 351 B.R. 143, 156 (Bankr. D. Colo. 2006) (stating an "intransigent attitude" indicates that a permanent injunction is warranted). He admitted that he knew he was supposed to give his clients the required disclosures before preparing their petitions but had not done so. A. at 91-92, 99, 110. He has consistently blamed his troubles on the United States Trustee. Br. at 8-9, 11, 26, 39-41. The bankruptcy court had a "reasonable basis" in concluding that a limited statutory injunction was appropriate.

Finally, the cases Mr. Wynns cites to show the standard for injunctive relief are not on-point. He cites no bankruptcy cases. Rather, he relies on three cases interpreting unrelated statutes. *Gwaltney v. Chesapeake Bay Fdn.*, 484 U.S. 49, 67 (1987) (citizen suit under Clean Water Act); *United States v. Oregon Medical Soc.*, 343 U.S.

326 (1952) (Sherman Anti-trust Act); *United States v. W.T. Grant Co.*, 345 U.S. 629 (1953) (Clayton Act). None of these statutes have language comparable to 11 U.S.C. § 110(j)(2)(A), and Mr. Wynns does not explain why section 110(j) should be construed identically to these statutes.

IV. Mr. Wynns's Legal Arguments Have No Merit.

1. The bankruptcy court had subject matter jurisdiction over the United States Trustee's complaint against Mr. Wynns.

Mr. Wynns argues at great length that the bankruptcy court did not have jurisdiction over his case because it did not have grounds upon which to enter an injunction. Therefore, it had no case or controversy to adjudicate. This argument misunderstands basic jurisdictional principles.

First, the bankruptcy court had jurisdiction over Mr. Wynns's case, which was based on the United States Trustee's civil action alleging violation of several provisions of title 11. Federal district courts have "original and exclusive jurisdiction over all cases under title 11." 28 U.S.C. § 1334(a). District courts may refer "any or all cases under title 11 and any or all proceedings arising under title 11" to the "bankruptcy judges of the district." 28 U.S.C. § 157(a).

Bankruptcy courts have jurisdiction over "all cases under title 11, and all core proceedings arising under title 11." 11 U.S.C. §§ 157(b)(1), (b)(2)(A), (O). An injunctive proceeding under section 110(j) is a "core proceeding to be heard and determined by a bankruptcy judge under 28 U.S.C. § 157(b)(1)." *Demos v. Brown (In re Graves)*, 279 B.R. 266, 271 (B.A.P. 9th Cir. 2002); *Ferm v. United States Trustee (In re Crowe)*, 243 B.R. 43, 49 (B.A.P. 9th Cir. 2000).

Mr. Wynns argues that a court's error of law – here allegedly issuing a statutory injunction without grounds – divests it of jurisdiction over the case. Br. at 13-22. The Supreme Court has rejected this. *Arbaugh v. Y&H Corp.*, 546 U.S. 500, 510 (2006) ("Jurisdiction . . . is a word of many, too many, meanings") (citation omitted). In *Arbaugh*, the Supreme Court held that the employee-numerosity requirement for establishing that an employer was subject to Title VII was an element of the plaintiff-petitioner's claim for relief – not a jurisdictional requirement. *Id.* at 503. The Court rejected the trial court's decision, affirmed by the Fifth Circuit, that the case had to be dismissed. The district court incorrectly decided that it lacked subject-matter jurisdiction because the defendant-employer did not have 15 employees, the minimum necessary to be subject to a discrimination suit under Title VII. *Id.*

Mr. Wynns makes the same error as the district court did in *Arbaugh*. The United States Trustee had to prove specific elements to obtain injunctive relief. If she had failed to do so, then her claim would have been without merit. Whether she succeeded or failed in her civil action is irrelevant to the question of whether the bankruptcy court had subject-matter jurisdiction over the claim itself. *See id.* at 511 (disapproving as "unrefined dispositions" judicial decisions that do not distinguish between lack of subject-matter jurisdiction and failure to state a claim"); *accord Da Silva v. Kinsho Intern. Corp.*, 229 F.3d 358, 361 (2d Cir. 2000).

The United States Trustee and Mr. Wynns have been disputing his culpability under section 110 of the Bankruptcy Code since the United States Trustee filed her civil action on July 1, 2008. After nearly three years of litigation, it is hard to fathom Mr. Wynns's argument that there is no "case or controversy" between the two parties.

A case or controversy exists when "conflicting contentions of the parties . . . present a real, substantial controversy between parties having adverse legal interests, a dispute definite and concrete, not hypothetical or abstract." *Babbitt v. United Farm Workers Nat. Union*, 442 U.S. 289, 298 (1979) (citations omitted). Mr. Wynns argues that the bankruptcy court did not have subject matter jurisdiction because the only "'controversy' between WYNNS and the UNITED STATES TRUSTEE when she filed suit was the one that she imagined to exist, based upon her failure to make a reasonable inquiry." Br. at 14. But that is how all lawsuits start: one party imagines it has been injured and attempts to prove the injury in court. Whether the party's sense of injury is proven to be real has nothing to do with the court's jurisdiction over the matter.

Here, the United States Trustee alleged that Mr. Wynns violated several provisions of the Bankruptcy Code.[15] After a trial, the bankruptcy court agreed, and the district court affirmed on appeal. It is hard to imagine a more classic case "arising under . . . the laws of the United States" and a "controvers[y] to which the United States [is] a party." Const. Art. III, sec. 2.

2. The bankruptcy court had personal jurisdiction over Mr. Wynns.

Mr. Wynns argues that the bankruptcy court erred by exercising personal jurisdiction over him because he, as a resident of San Francisco, did not establish "minimum contacts" with the Eastern District of New York. Br. at 24. The argument is untenable because 1) it has been waived and 2) it misinterprets basic constitutional law.

Mr. Wynns is incorrect that he preserved his objection to personal jurisdiction because he raised it in his motion for summary judgment.

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[15] Mr. Wynns asserts that the United States Trustee "brought suit solely under section 110(j), since that is the only subsection of section 110 which provides for an action for injunctive relief." Br. at 22. This is untrue. The United States Trustee based her complaint on all of section 110, and sections 105, 526(c)(2) and 528 of the Bankruptcy Code. A. at 11-12.

and his closing memorandum after trial. Bankr. Dkt. #s 16, 22. Before he filed his motion for summary judgment, Mr. Wynns filed an answer and an amended answer to the United States Trustee's complaint, neither of which raised personal jurisdiction. A. at 59-76. By not objecting to personal jurisdiction in his initial pleading, he waived his right to raise the issue. *See* Fed. R. Bankr. P. 7012; Fed. R. Civ. P. 12(b)(1) (providing that defense based on lack of personal jurisdiction is waived if not asserted prior to the filing of a responsive pleading); *see generally Cargill, Inc. v. Sabine Shipping & Trading Co.*, 756 F.2d 224, 228 (2d Cir. 1985) (same).

Mr. Wynns's objection to personal jurisdiction is without merit. Under 11 U.S.C. § 110(j), an enforcement action may be brought either in the home district of the petition preparer or, as was done here, in the home district of any debtor on whose behalf relief was sought. 11 U.S.C. § 110(j)(1).

Section 110(j) does not violate Mr. Wynns's due process rights. It is well-established that when a non-resident defendant has "purposefully directed his activities at residents of the forum, his contacts with the forum are sufficient to support personal jurisdiction in any litigation that results from the alleged injuries that arise out of or relate to those activities." *Burger King Corp. v. Rudzewicz*, 471 U.S. 462, 472 (1985).

In this case, Mr. Wynns knowingly and purposefully directed his activities towards the United States Bankruptcy Court for the Eastern District of New York. He solicited business through the internet. *See* A. at 159-61. He entered into a verbal agreement with Mr. Giordano to prepare petitions for New York debtors and in fact did so. A. at 96. He sent a letter to Mr. Clarke, a resident of New York, instructing him how to fix a deficient filing. A. at 151-52. He sent a letter to the bankruptcy court clerk of the Eastern District of New York on the same subject. A. at 157-58.

Mr. Wynns admits he has legal training. He was familiar with the provisions of 11 U.S.C. § 110 when he took these actions. A. at 99. Accordingly, Mr. Wynns was on notice that his actions could eventually require him to respond to a complaint in the Eastern District of New

York. The United States Trustee's decision to seek relief in that venue does not offend notions or fair play or substantial justice.

3. The United States Trustee did not violate Mr. Wynns's due process rights in filing her civil action.

Mr. Wynns argues that the United States Trustee has violated his due process rights by filing a civil action against him. Br. 11, 25. Mr. Wynns provides no authority for this contention. Nor could he. Mr. Wynns does not have a due process right to avoid liability for violations of the Bankruptcy Code he considers to be insignificant. Nor did the United States Trustee act unreasonably in holding him accountable for an allegedly minor violation of federal law. *Cf. Investors Equity Gp. v. Universal Symetrics Corp.*, 53 F.3d 159, 163 (6th Cir. 1995) (reversing finding of no liability for a "technical" violation of the Michigan securities statute that had "little practical import").

4. Mr. Wynns should not be awarded any fees, costs, or sanctions.

The district court found Mr. Wynns's claim for sanctions under 28 U.S.C. § 1927 to be "frivolous." *Wynns*, 426 B.R. at 466. This conclusion is justified for both procedural and substantive reasons. Mr. Wynns did not file a motion seeking sanctions, as required by the bankruptcy rules. Fed. R. Bankr. P. 7001, 9013; *cf. Capone v. Weeks*, 326 Fed. App'x 46, 47 (2d Cir. 2009). He also ignored the applicable notice requirements. *Gollomp v. Spitzer*, 568 F.3d 355, 368 (2d Cir. 2009) (citation omitted).

In addition, Mr. Wynns has no evidence that the United States Trustee's actions were "so completely without merit as to require the conclusion that they must have been undertaken for some improper purpose." *Id.*; *Oliveri v. Thompson*, 803 F.2d 1265, 1273 (2d Cir. 1986). He complains that the United States Trustee should have consulted with him before filing her complaint. Br. at 39-40. But he offers no legal basis on which failing to follow a defendant's suggested pre-litigation procedure could be a basis for sanctions under 28 U.S.C. § 1927.

Finally, Mr. Wynns raises Federal Rule of Bankruptcy Procedure 9011 to "illustrate" that the suit against him was "unreasonable." Br. at 41. He hints that this Court could award him sanctions it were to issue an Order to Show Cause on its own initiative. *Id.* (citing Fed. R. Bankr. P. 9011(c)(1)(b)).

This veiled claim for sanctions should "not be accorded a friendly reception by this Court." *United States v. Davis*, 598 F.3d 10, 14 (2d Cir. 2010). It has no legal basis because the alleged improper actions did not take place before this Court. *See Chambers v. NASCO, Inc.,* 501 U.S. 32, 44 (1991) (stating that courts may sanction behavior to control the litigation before it). It is merely an excuse to repeat baseless allegations against the United States Trustee.

V. The District Court Incorrectly Interpreted Section 110 as Only Prohibiting Bankruptcy Petition Preparers from Giving "Legal Advice;" Section 110(k) Prohibits Unauthorized Practice of Law as Defined by State Law.

The district court affirmed Mr. Wynns's violation of section 110(e) on a mistakenly narrow interpretation of that section. *Wynns*, 426 B.R. at 462-63, 465. This error did not affect the judgment in the case and thus the United States Trustee did not cross-appeal. *California v. Rooney*, 483 U.S. 307, 310 (1987). However, it is "an inveterate and certain rule" that an appellee may attack the reasoning of the lower court's decision. *Mass. Mut. Life Ins. Co. v. Ludwig*, 426 U.S. 479, 480-81 (1976) (per curiam); *Jenkins v. City of New York*, 478 F.3d 76, 86 (2d Cir. 2007). And this Court conducts its own independent review of the factual findings and legal conclusions of the bankruptcy court. *In re Manville Forest Prods. Corp.,* 896 F.2d 1384, 1388 (2d Cir. 1990). Therefore, for the sake of clarity, this Court should affirm based on the bankruptcy court's interpretation of section 110.

The district court is correct that the language of section 110(e) prohibits bankruptcy petition preparers from giving "legal advice" and that section 110(e) does not contain the phrase "unauthorized practice of law." 11 U.S.C. § 110(e)(2)(A). The district court is also correct that "legal advice" is not the same thing as "practice of law."[16] *Wynns,* 426 B.R. at 462.

But the conclusion that the district court drew – that Mr. Wynns could only be sanctioned for giving advice – misreads 11 U.S.C. § 110(k).

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[16] Bankruptcy courts do not limit violations of section 110(e) to giving personal legal advice, as the district court did here. *See e.g., In re Bagley*, 433 B.R. 325, 333-34 (Bankr. D. Mont. 2010) (soliciting information through a website and choosing exemptions violated 11 U.S.C. § 110(e)); *United States Trustee v. Brown (In re Martin)*, 424 B.R. 496, 507 (Bankr. D.N.M 2010) (finding preparer violated § 110(e)(2) by "practicing law" by, among other things, "applying exemptions to Debtor's property [and] classifying debts as secured or unsecured and priority"). In these cases, the bankruptcy petition preparer did not advise the debtor but took action on the debtor's behalf – much as Mr. Wynns did here when he contacted the bankruptcy court regarding the Clarkes' petition.

That section states: “Nothing in this section shall be construed to permit activities that are otherwise prohibited by law, including rules and laws that prohibit the unauthorized practice of law.” 11 U.S.C. § 110(k). Section 110(k) “makes clear” that bankruptcy petition preparers may not engage in the unauthorized practice of law. *In re Payne*, 414 B.R. 111, 114 (Bankr. W.D. Ky. 2009). Therefore, section 110(e)(2) “must be understood as a general prohibition against the practice of law by bankruptcy petition preparers except where otherwise permitted by applicable law.” *In re Bernales*, 345 B.R. 206, 215 (Bankr. C.D. Cal. 2006).

Section 110(e) creates a federal cause of action for improper “legal advice” by bankruptcy petition preparers. 11 U.S.C. § 110(e)(2)(A). It contains a non-exclusive list of prohibited advice to stop the kind of activity that concerned Congress. 11 U.S.C. § 110(e)(2)(B); *Bernales*, 345 B.R. at 215 (stating § 110(e)(2)(B) is not exclusive).

The Bankruptcy Code’s prohibition of “legal advice” does not put other aspects of the unauthorized practice of law beyond the reach of bankruptcy courts, however. A petition preparer “may not use § 110 as a ‘safe harbor’ if his action is prohibited under the applicable state’s definition of unauthorized practice of law.” *In re Gabrielson*, 217 B.R. 819, 826 (Bankr. D. Ariz. 1998). *See also In re Reynoso*, 477 F.3d at 1125 (“We look to state law for guidance in determining whether Frankfort has engaged in the unauthorized practice of law.”); *In re Martinez*, 72 Fed. App’x 138, 140-141 (5th Cir. 2003) (adopting the district court conclusion that any service beyond typing “is not permitted under state unauthorized practice of law statutes, and so is also not authorized by § 110”).

Therefore, the district court’s interpretation of section 110 would only be correct if Mr. Wynns’s actions that were not “legal advice,” such as advocating for the Clarkes to the bankruptcy court clerk, were allowed under New York law. *In re Tomlinson*, 343 B.R. 400, 407 (E.D.N.Y. 2006). They are not.

Practice of law in New York includes giving instructions and advice about the preparation of legal instruments. *In re Gaftick*, 333 B.R. 177, 186 (Bankr. E.D.N.Y. 2005) (citing *New York County Lawyers’ Assoc. v. Dacey*, 283 N.Y.S. 2d 984, 989, 28 A.D. 2d 161, 165 (1st Dep’t

1967), *rev'd on other grounds*, 21 N.Y.2d 694, 234 N.E.2d 459, 287 N.Y.S. 2d 422 (1967)). *See also Sussman v. Grado*, 192 Misc. 2d 628, 633, 746 N.Y.S.2d 548, 553 (Nassau County Ct. 2002) (stating that when a layman prepares legal documents, that person is practicing law). When a non-attorney simplifies the bankruptcy process for a debtor, that also constitutes the unauthorized practice of law. *Gaftick*, 333 B.R. at 188.

That is precisely what Mr. Wynns did in this case. He told the Clarkes how to rectify a deficient filing. He told them which documents to keep and which to file. He wrote them a cover letter for the bankruptcy court clerk. He independently contacted the clerk to submit the missing documents. All of these actions amounted to an exercise of Mr. Wynns's judgment on how best to fix the deficiency. This "in turn inevitably crosse[d] the line" into the unauthorized practice of law. *Id.* (quotation omitted). Because of section 110(k), the bankruptcy court did not err in sanctioning Mr. Wynns for the unauthorized practice of law.

The United States Trustee raises this point because it is important that courts understand the interplay between sections 110(e) and 110(k). Bankruptcy courts, no less than other courts, must not allow non-attorneys to engage in the unauthorized practice of law in cases before it, something section 110(k) makes clear.

CONCLUSION

For these reasons, the United States Trustee requests that the Court affirm the decisions below.

Dated: March 15, 2011

Respectfully submitted,

Tracy Hope Davis,
United States Trustee, Region 2

by /s/ Catherine Sevcenko

Christine H. Black
Assistant United States Trustee

United States Department of Justice
Office of the United States Trustee
560 Federal Plaza, Suite 560
Central Islip, New York 11722
(631) 715-7800
(631) 715-7777 (fax)

Ramona D. Elliott
General Counsel

P. Matthew Sutko
Associate General Counsel

Catherine B. Sevcenko
Trial Attorney

United States Department of Justice
Executive Office for United States Trustees
20 Massachusetts Avenue, N.W.
Washington, D.C. 20530
(202) 307-1399
(202) 307-2397 (fax)

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(s) /s/ Catherine Sevcenko

Attorney for United States Trustee

Dated: March 15, 2011

UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

CAPTION:

Wynns v.

Davis

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I, Catherine B. Sevcenko, hereby certify under penalty of perjury that on
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Name	Address	City	State	Zip Code
Name	Address	City	State	Zip Code
Name	Address	City	State	Zip Code
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March 15, 2011
Today's Date

/s/ Catherine Sevcenko
Signature

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ADDENDUM
11 U.S.C. § 110

NB: This unofficial compilation of the U.S. Code is current as of Jan. 5, 2009 (see http://www.law.cornell.edu/uscode/uscprint.html).

TITLE 11 - BANKRUPTCY
CHAPTER 1 - GENERAL PROVISIONS

§ 110. Penalty for persons who negligently or fraudulently prepare bankruptcy petitions

(a) In this section—

(1) "bankruptcy petition preparer" means a person, other than an attorney for the debtor or an employee of such attorney under the direct supervision of such attorney, who prepares for compensation a document for filing; and

(2) "document for filing" means a petition or any other document prepared for filing by a debtor in a United States bankruptcy court or a United States district court in connection with a case under this title.

(b) **(1)** A bankruptcy petition preparer who prepares a document for filing shall sign the document and print on the document the preparer's name and address. If a bankruptcy petition preparer is not an individual, then an officer, principal, responsible person, or partner of the bankruptcy petition preparer shall be required to—

(A) sign the document for filing; and

(B) print on the document the name and address of that officer, principal, responsible person, or partner.

(2) **(A)** Before preparing any document for filing or accepting any fees from a debtor, the bankruptcy petition preparer shall provide to the debtor a written notice which shall be on an official form prescribed by the Judicial Conference of the United States in accordance with rule 9009 of the Federal Rules of Bankruptcy Procedure.

(B) The notice under subparagraph (A)—

(i) shall inform the debtor in simple language that a bankruptcy petition preparer is not an attorney and may not practice law or give legal advice;

(ii) may contain a description of examples of legal advice that a bankruptcy petition preparer is not authorized to give, in addition to any advice that the preparer may not give by reason of subsection (e)(2); and

(iii) shall—

(I) be signed by the debtor and, under penalty of perjury, by the bankruptcy petition preparer; and

(II) be filed with any document for filing.

(c) **(1)** A bankruptcy petition preparer who prepares a document for filing shall place on the document, after the preparer's signature, an identifying number that identifies individuals who prepared the document.

(2) **(A)** Subject to subparagraph (B), for purposes of this section, the identifying number of a bankruptcy petition preparer shall be the Social Security account number of each individual who prepared the document or assisted in its preparation.

(B) If a bankruptcy petition preparer is not an individual, the identifying number of the bankruptcy petition preparer shall be the Social Security account number of the officer, principal, responsible person, or partner of the bankruptcy petition preparer.

(d) A bankruptcy petition preparer shall, not later than the time at which a document for filing is presented for the debtor's signature, furnish to the debtor a copy of the document.

(e) **(1)** A bankruptcy petition preparer shall not execute any document on behalf of a debtor.

(2) **(A)** A bankruptcy petition preparer may not offer a potential bankruptcy debtor any legal advice, including any legal advice described in subparagraph (B).

(B) The legal advice referred to in subparagraph (A) includes advising the debtor—

(i) whether—

(I) to file a petition under this title; or

(II) commencing a case under chapter 7, 11, 12, or 13 is appropriate;

(ii) whether the debtor's debts will be discharged in a case under this title;

(iii) whether the debtor will be able to retain the debtor's home, car, or other property after commencing a case under this title;

(iv) concerning—

(I) the tax consequences of a case brought under this title; or

(II) the dischargeability of tax claims;

(v) whether the debtor may or should promise to repay debts to a creditor or enter into a reaffirmation agreement with a creditor to reaffirm a debt;

(vi) concerning how to characterize the nature of the debtor's interests in property or the debtor's debts; or

(vii) concerning bankruptcy procedures and rights.

(f) A bankruptcy petition preparer shall not use the word "legal" or any similar term in any advertisements, or advertise under any category that includes the word "legal" or any similar term.

(g) A bankruptcy petition preparer shall not collect or receive any payment from the debtor or on behalf of the debtor for the court fees in connection with filing the petition.

(h)

(1) The Supreme Court may promulgate rules under section 2075 of title 28, or the Judicial Conference of the United States may prescribe guidelines, for setting a maximum allowable fee chargeable by a bankruptcy petition preparer. A bankruptcy petition preparer shall notify the debtor of any such maximum amount before preparing any document for filing for a debtor or accepting any fee from the debtor.

(2) A declaration under penalty of perjury by the bankruptcy petition preparer shall be filed together with the petition, disclosing any fee received from or on behalf of the debtor within 12 months immediately prior to the filing of the case, and any unpaid fee charged to the debtor. If rules or guidelines setting a maximum fee for services have been promulgated or prescribed under paragraph (1), the declaration under this paragraph shall include a certification that the bankruptcy petition preparer complied with the notification requirement under paragraph (1).

(3)

(A) The court shall disallow and order the immediate turnover to the bankruptcy trustee any fee referred to in paragraph (2) found to be in excess of the value of any services—

(i) rendered by the bankruptcy petition preparer during the 12-month period immediately preceding the date of the filing of the petition; or

(ii) found to be in violation of any rule or guideline promulgated or prescribed under paragraph (1).

(B) All fees charged by a bankruptcy petition preparer may be forfeited in any case in which the bankruptcy petition preparer fails to comply with this subsection or subsection (b), (c), (d), (e), (f), or (g).

(C) An individual may exempt any funds recovered under this paragraph under section 522 (b).

(4) The debtor, the trustee, a creditor, the United States trustee (or the bankruptcy administrator, if any) or the court, on the initiative of the court, may file a motion for an order under paragraph (2).[1]

(5) A bankruptcy petition preparer shall be fined not more than $500 for each failure to comply with a court order to turn over funds within 30 days of service of such order.

(i)

(1) If a bankruptcy petition preparer violates this section or commits any act that the court finds to be fraudulent, unfair, or deceptive, on the motion of the debtor, trustee, United States trustee (or the bankruptcy administrator, if any), and after notice and a hearing, the court shall order the bankruptcy petition preparer to pay to the debtor—

(A) the debtor’s actual damages;

(B) the greater of—

(i) $2,000; or

(ii) twice the amount paid by the debtor to the bankruptcy petition preparer for the preparer’s services; and

(C) reasonable attorneys’ fees and costs in moving for damages under this subsection.

(2) If the trustee or creditor moves for damages on behalf of the debtor under this subsection, the bankruptcy petition preparer shall be ordered to pay the movant the additional amount of $1,000 plus reasonable attorneys’ fees and costs incurred.

(j) **(1)** A debtor for whom a bankruptcy petition preparer has prepared a document for filing, the trustee, a creditor, or the United States trustee in the district in which the bankruptcy petition preparer resides, has conducted business, or the United States trustee in any other district in which the debtor resides may bring a civil action to enjoin a bankruptcy petition preparer from engaging in any conduct in violation of this section or from further acting as a bankruptcy petition preparer.

(2) **(A)** In an action under paragraph (1), if the court finds that—

(i) a bankruptcy petition preparer has—

(I) engaged in conduct in violation of this section or of any provision of this title;

(II) misrepresented the preparer’s experience or education as a bankruptcy petition preparer; or

(III) engaged in any other fraudulent, unfair, or deceptive conduct; and

(ii) injunctive relief is appropriate to prevent the recurrence of such conduct,

the court may enjoin the bankruptcy petition preparer from engaging in such conduct.

(B) If the court finds that a bankruptcy petition preparer has continually engaged in conduct described in subclause (I), (II), or (III) of clause (i) and that an injunction prohibiting such conduct would not be sufficient to prevent such person’s interference with the proper administration of this title, has not paid a penalty imposed under this section, or failed to disgorge all fees ordered by the court the court may enjoin the person from acting as a bankruptcy petition preparer.

(3) The court, as part of its contempt power, may enjoin a bankruptcy petition preparer that has failed to comply with a previous order issued under this section. The injunction under this paragraph may be issued on the motion of the court, the trustee, or the United States trustee (or the bankruptcy administrator, if any).

(4) The court shall award to a debtor, trustee, or creditor that brings a successful action under this subsection reasonable attorneys’ fees and costs of the action, to be paid by the bankruptcy petition preparer.

(k) Nothing in this section shall be construed to permit activities that are otherwise prohibited by law, including rules and laws that prohibit the unauthorized practice of law.

(l) **(1)** A bankruptcy petition preparer who fails to comply with any provision of subsection (b), (c), (d), (e), (f), (g), or (h) may be fined not more than $500 for each such failure.

(2) The court shall triple the amount of a fine assessed under paragraph (1) in any case in which the court finds that a bankruptcy petition preparer—

(A) advised the debtor to exclude assets or income that should have been included on applicable schedules;

(B) advised the debtor to use a false Social Security account number;

(C) failed to inform the debtor that the debtor was filing for relief under this title; or

(D) prepared a document for filing in a manner that failed to disclose the identity of the bankruptcy petition preparer.

(3) A debtor, trustee, creditor, or United States trustee (or the bankruptcy administrator, if any) may file a motion for an order imposing a fine on the bankruptcy petition preparer for any violation of this section.

(4)

(A) Fines imposed under this subsection in judicial districts served by United States trustees shall be paid to the United States trustees, who shall deposit an amount equal to such fines in the United States Trustee Fund.

(B) Fines imposed under this subsection in judicial districts served by bankruptcy administrators shall be deposited as offsetting receipts to the fund established under section 1931 of title 28, and shall remain available until expended to reimburse any appropriation for the amount paid out of such appropriation for expenses of the operation and maintenance of the courts of the United States.

Footnotes

[1] See References in Text note below.

(Added Pub. L. 103–394, title III, § 308(a), Oct. 22, 1994, 108 Stat. 4135; amended Pub. L. 109–8, title II, § 221, title XII, § 1205, Apr. 20, 2005, 119 Stat. 59, 194; Pub. L. 110–161, div. B, title II, § 212(b), Dec. 26, 2007, 121 Stat. 1914.)

References in Text

The Federal Rules of Bankruptcy Procedure, referred to in subsec. (b)(2)(A), are set out in the Appendix to this title.

Paragraph (2), referred to in subsec. (h)(4), was redesignated as par. (3) and repealed and a new par. (3) was added by Pub. L. 109–8, title II, § 221(8)(A), (D), Apr. 20, 2005, 119 Stat. 59. The new par. (3) provides for court orders similar to those provided for in former par. (2).

Amendments

2007—Subsec. (l)(4)(A). Pub. L. 110–161 amended subpar. (A) generally. Prior to amendment, subpar. (A) read as follows: “Fines imposed under this subsection in judicial districts served by United States trustees shall be paid to the United States trustee, who shall deposit an amount equal to such fines in a special account of the United States Trustee System Fund referred to in section 586 (e)(2) of title 28. Amounts deposited under this subparagraph shall be available to fund the enforcement of this section on a national basis.”

2005—Subsec. (a)(1). Pub. L. 109–8, § 221(1), substituted “for the debtor or an employee of such attorney under the direct supervision of such attorney” for “or an employee of an attorney”.

Subsec. (b)(1). Pub. L. 109–8, § 221(2)(A), inserted at end “If a bankruptcy petition preparer is not an individual, then an officer, principal, responsible person, or partner of the bankruptcy petition preparer shall be required to—” and added subpars. (A) and (B).

Subsec. (b)(2). Pub. L. 109–8, § 221(2)(B), added par. (2) and struck out former par. (2) which read as follows: “A bankruptcy petition preparer who fails to comply with paragraph (1) may be fined not more than $500 for each such failure unless the failure is due to reasonable cause.”

Subsec. (c)(2). Pub. L. 109–8, § 221(3)(A), designated existing provisions as subpar. (A), substituted “Subject to subparagraph (B), for purposes” for “For purposes”, and added subpar. (B).

Subsec. (c)(3). Pub. L. 109–8, § 221(3)(B), struck out par. (3) which read as follows: “A bankruptcy petition preparer who fails to comply with paragraph (1) may be fined not more than $500 for each such failure unless the failure is due to reasonable cause.”

Subsec. (d). Pub. L. 109–8, § 221(4), struck out par. (1) designation before “A bankruptcy petition preparer shall” and struck out par. (2) which read as follows: “A bankruptcy petition preparer who fails to comply with paragraph (1) may be fined not more than $500 for each such failure unless the failure is due to reasonable cause.”

Subsec. (e)(2). Pub. L. 109–8, § 221(5), added par. (2) and struck out former par. (2) which read as follows: “A bankruptcy petition preparer may be fined not more than $500 for each document executed in violation of paragraph (1).”

Subsec. (f). Pub. L. 109–8, § 221(6), struck out par. (1) designation before “A bankruptcy petition preparer shall not” and struck out par. (2) which read as follows: “A bankruptcy petition preparer shall be fined not more than $500 for each violation of paragraph (1).”

Subsec. (g). Pub. L. 109–8, § 221(7), struck out par. (1) designation before “A bankruptcy petition preparer shall not” and struck out par. (2) which read as follows: “A bankruptcy petition preparer shall be fined not more than $500 for each violation of paragraph (1).”

Subsec. (h)(1). Pub. L. 109–8, § 221(8)(B), added par. (1). Former par. (1) redesignated (2).

Subsec. (h)(2). Pub. L. 109–8, § 221(8)(A), (C), redesignated par. (1) as (2), substituted “A” for “Within 10 days after the date of the filing of a petition, a bankruptcy petition preparer shall file a”, inserted “by the bankruptcy petition preparer shall be filed together with the petition,” after “perjury”, and inserted at end “If rules or guidelines setting a maximum fee for services have been promulgated or prescribed under paragraph (1), the declaration under this paragraph shall include a certification that the bankruptcy petition preparer complied with the notification requirement under paragraph (1).” Former par. (2) redesignated (3).

Subsec. (h)(3). Pub. L. 109–8, § 221(8)(D), added par. (3) and struck out former par. (3) which read as follows: “The court shall disallow and order the immediate turnover to the bankruptcy trustee of any fee referred to in paragraph (1) found to be in excess of the value of services rendered for the documents prepared. An individual debtor may exempt any funds so recovered under section 522 (b).”

Pub. L. 109–8, § 221(8)(A) redesignated par. (2) as (3). Former par. (3) redesignated (4).

Subsec. (h)(4). Pub. L. 109–8, § 221(8)(E), substituted “the United States trustee (or the bankruptcy administrator, if any) or the court, on the initiative of the court,” for “or the United States trustee”.

Pub. L. 109–8, § 221(8)(A) redesignated par. (3) as (4). Former par. (4) redesignated (5).

Subsec. (h)(5). Pub. L. 109–8, § 221(8)(A) redesignated par. (4) as (5).

Subsec. (i)(1). Pub. L. 109–8, § 221(9), inserted introductory provisions and struck out former introductory provisions which read as follows: “If a bankruptcy case or related proceeding is dismissed because of the failure to file bankruptcy papers, including papers specified in section 521 (1) of this title, the negligence or intentional disregard of this title or the Federal Rules of Bankruptcy Procedure by a bankruptcy petition preparer, or if a bankruptcy petition preparer violates this section or commits any fraudulent, unfair, or deceptive act, the bankruptcy court shall certify that fact to the district court, and the district court, on motion of the debtor, the trustee, or a creditor and after a hearing, shall order the bankruptcy petition preparer to pay to the debtor—”.

Subsec. (j)(2)(A)(i)(I). Pub. L. 109–8, § 221(10)(A)(i), struck out “a violation of which subjects a person to criminal penalty” after “any provision of this title”.

Subsec. (j)(2)(B). Pub. L. 109–8, § 221(10)(A)(ii), substituted “has not paid a penalty” for “or has not paid a penalty” and inserted “or failed to disgorge all fees ordered by the court” after “a penalty imposed under this section,”.

Subsec. (j)(3). Pub. L. 109–8, § 221(10)(C) added par. (3). Former par. (3) redesignated (4).

Subsec. (j)(4). Pub. L. 109–8, § 1205, substituted “attorneys” for “attorney’s”.

Pub. L. 109–8, § 221(10)(B), redesignated par. (3) as (4).

Subsec. (l). Pub. L. 109–8, § 221(11), added subsec. (l).

Effective Date of 2005 Amendment

Amendment by Pub. L. 109–8 effective 180 days after Apr. 20, 2005, and not applicable with respect to cases commenced under this title before such effective date, except as otherwise provided, see section 1501 of Pub. L. 109–8, set out as a note under section 101 of this title.

Effective Date

Section effective Oct. 22, 1994, and not applicable with respect to cases commenced under this title before Oct. 22, 1994, see section 702 of Pub. L. 103–394, set out as an Effective Date of 1994 Amendment note under section 101 of this title.

BRIEF BANK — "SUMMARY SHEET" *Printed Mon-5/23/11 14:15*

WESTLAW CODES

1. **("TI")** ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*
Yamaha Motor Corp. v. Perry Hollow Mgmt Corp. (In re Perry Hollow Mgmt Corp.)

2. **("CO")** ***CURRENT*** COURT *[E.g., "CTA9"]*
1st Cir.

3. **("CCN")** ***CURRENT*** CASE NO.
No.: 01-1747

4. **("PCN")** ***PRIOR*** CASE NO. - & COURT *[IF ANY]*
No.: 1:00-cv-00570-JD
Court: D. NH
(Identify judge & cite, if any)

5. **("SO")** ***SOURCE***
U.S. TRUSTEES

6. **("DA")** ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*
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Robert D. Kamenshine, William Kanter (CIV)
(UST/OGC: 202-307-1399/FAX-2397)

8. **("TO")** ***TOPIC***
BANKRUPTCY

9. **("SU")** • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***
• (1) Whether, under Fed. R. App. P. 4(a)(1)(B), a chapter 11 bankruptcy trustee is an "officer" of the United States. (2) Whether, under Fed. R. App. P. 4(a)(1)(B), the United States, through the United States Trustee, is a "party" to this appeal.

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IN THE UNITED STATES COURT OF APPEALS
FOR THE FIRST CIRCUIT

No. 01-1747

IN RE: PERRY HOLLOW MANAGEMENT COMPANY, INC., AKA PERRY
HOLLOW MGMT CORP.; PERRY HOLLOW GOLF CLUB, INC.,
Debtors

YAMAHA MOTOR CORPORATION, USA,
Appellant,

YAMAHA MOTOR CO., LTD.,
Plaintiff,

v.

PERRY HOLLOW MANAGEMENT COMPANY, INC., AKA PERRY
HOLLOW MGMT CORP.; PERRY HOLLOW GOLF CLUB, INC.,
Debtors-Appellees,

JEFFREY A. SCHREIBER,
Appellee,

GERALDINE L. KARONIS.

**ON APPEAL FROM THE UNITED STATES DISTRICT
COURT FOR THE DISTRICT OF NEW HAMPSHIRE**

BRIEF FOR THE UNITED STATES TRUSTEE

ROBERT D. McCALLUM, JR.
Assistant Attorney General

WILLIAM KANTER
(202) 514-4575
ROBERT D. KAMENSHINE
(202) 514-2494
Attorneys, Appellate Staff
Civil Division, Room 9012
601 D Street, N.W.
Washington, D.C. 20530-0001

IN THE UNITED STATES COURT OF APPEALS
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YAMAHA MOTOR CORPORATION, USA,
Appellant,

YAMAHA MOTOR CO., LTD.,
Plaintiff,

v.

PERRY HOLLOW MANAGEMENT COMPANY, INC., AKA PERRY
HOLLOW MGMT CORP.; PERRY HOLLOW GOLF CLUB, INC.,
Debtors-Appellees,

JEFFREY A. SCHREIBER,
Appellee,

GERALDINE L. KARONIS.

ON APPEAL FROM THE UNITED STATES DISTRICT
COURT FOR THE DISTRICT OF NEW HAMPSHIRE

BRIEF FOR THE UNITED STATES TRUSTEE

STATEMENT OF THE ISSUES PRESENTED FOR REVIEW

1. Whether, under Fed. R. App. P. 4(a)(1)(B), a Chapter 11 bankruptcy trustee is an "officer" of the United States.

2. Whether, under Fed. R. App. P. 4(a)(1)(B), the United States, through the United States Trustee, is a "party" to this appeal.

STATEMENT OF THE CASE

This Chapter 11 bankruptcy appeal involves a dispute between the Chapter 11 trustee, Jeffrey A. Schreiber, and a creditor, Yamaha Motor Corporation, over the validity of Yamaha's lien on a number of golf carts and Schreiber's sale of those cars.[1] Since Yamaha filed its appeal 48 days from the district court's entry of judgment, this Court has jurisdiction of the appeal only if, under Fed. R. App. P. 4(a), the applicable time period for filing a notice of appeal was 60 rather than 30 days. The 60-day period applied only if (1) Schreiber were an "officer" of the United States, or (2) the United States, through the United States Trustee, were a "party" to this appeal. This brief addresses solely the matter of jurisdiction.

I. Course Of Proceedings

A. Bankruptcy Court

In the bankruptcy court, Schreiber instituted an "adversary proceeding" by filing a complaint against Yamaha disputing the validity of the security interest that Yamaha claimed to hold in 72 golf carts owned by the debtors. App. 1. The bankruptcy court found that Yamaha did not have a perfected security interest. Id. at 134. Schreiber then filed a motion seeking permission to sell the golf carts. Id. at 199. Yamaha objected

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[1] This Court has consolidated this case with Yamaha's appeal (No. 01-1841) from the district court's denial of Yamaha's motion to stay the judgment.

to the proposed sale, thereby commencing a separate "contested matter." App. 204. The bankruptcy court approved the sale. Id. at 208. Yamaha appealed to the district court the adverse decisions in the adversary proceeding and the contested matter.

B. District Court

The district court, having consolidated Yamaha's two appeals “for all purposes,” rendered a judgment in favor of Schreiber on both matters. Yamaha then filed the present appeal. Subsequently, the firm filed a second notice of appeal, appealing the district court's denial of Yamaha's motion to stay the judgment pending appeal.

C. Proceedings In This Court

This Court directed Yamaha to show cause why its appeal of the district court's judgment on the adversary proceeding and contested matter should not be dismissed for failing to file a notice of appeal within thirty days as required by Fed. R. App. P. 4(a)(1)(A). Subsequent to the filing of responses by Yamaha and Schreiber, we filed on behalf of the United States Trustee a memorandum addressing the jurisdictional issue. This Court then entered an order, per Judge Selya, in which it concluded that an arguable basis exists for holding that there was jurisdiction. Accordingly, the Court authorized the appeal to proceed and instructed the parties to brief the jurisdictional issue.

Subsequently, this Court ordered that Yamaha's two appeals be consolidated for purposes of briefing and oral argument.

II. The Role Of The United States Trustee

The United States Trustee's Office is an agency of the United States. See Joelson v. United States, 86 F.3d 1413, 1417 (6th Cir. 1996) ("parties * * * do not dispute that the U.S. Trustee's Office is an agency within the definition of the Administrative Procedure Act"); In re Gideon, Inc., 158 B.R. 528, 530-31 (Bankr. S.D. Fla. 1993); 20 Moore's Federal Practice §304.11[2] at 26 (3d ed. 1997). Cf. In re Plaza de Diego Shopping Ctr., Inc., 911 F.2d 820, 824 (1st Cir. 1990). United States Trustees are officials of the Department of Justice appointed by the Attorney General and charged with appointing trustees in bankruptcy cases and supervising the administration of bankruptcy cases.[2] 28 U.S.C. 581-89.

The United States Trustee oversees the bankruptcy process, protects the public interest, and ensures that bankruptcy cases are conducted according to law. See generally United States Tr. v. Columbia Gas Sys., Inc. (In re Columbia Gas Sys., Inc.), 33 F.3d 294, 296 (3d Cir. 1994). To accomplish this objective, "the United States trustee may raise and may appear and be heard on any issue in any case or proceeding under this title * * *." 11 U.S.C. 307.

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[2] Thus, the United States Trustee and the Assistant United States Trustee are "officers" of the United States.

Under 28 U.S.C. 586, establishing the duties of the United States Trustee, the United States Trustee is directed to "establish, maintain, and supervise a panel of private trustees that are eligible and available to serve as trustees in cases under chapter 7 of title 11." 28 U.S.C. 586(a)(1). These trustees owe a fiduciary duty to the bankruptcy estate, not to the government, as would a government official. See 11 U.S.C. 323(a). Further, they are privately compensated, receiving neither compensation nor benefits from the government.

III. Nature Of A Bankruptcy Case

"[B]ankruptcy cases typically involve numerous controversies bearing only a slight relationship to each other." In re G.S.F. Corp., 938 F.2d 1467, 1473 (1st Cir. 1991). Thus, "[t]he Bankruptcy Rules recognize three distinct types of proceedings within a bankruptcy case: adversary proceedings, administrative proceedings, and contested matters." Estancias La Ponderosa Dev. Corp. v. Harrington (In re Harrington), 992 F.2d 3, 6 n.3 (1st Cir. 1993). Cf. Kowal v. Malkemus (In re Thompson), 965 F.2d 1136 (1st Cir. 1992) (discussing the differences between the underlying bankruptcy case and an adversary proceeding).

"Adversary proceedings are most like ordinary civil actions; contested matters are substantially similar; whereas most administrative proceedings are quite dissimilar to ordinary civil actions." Ponderosa, 992 F.3d at 5 n.3. There are, however, significant differences between adversary proceedings and contested matters. Compare Fed. R. Bankr. P. 9014 (discussing contested matters) with Fed. R. Bankr. P. 7001 (defining by exclusion what is an adversary proceeding).

A. Adversary Proceedings

An adversary proceeding, which receives a docket number separate from the main bankruptcy case, is commenced by the filing of a complaint naming specific defendants. Fed. R. Bankr. P. 7003. Parties may commence such proceedings to litigate only those matters specified in Bankruptcy Rule 7001. Fed. R. Bankr. P. 7001. A complaint in an adversary proceeding is adjudicated the same way any piece of litigation is litigated within the federal system. See Fed. R. Bankr. P. 7001, et seq. (specifying those matters that constitute adversary proceedings and establishing rules for litigating adversary proceedings). Adversary proceedings include "a proceeding to determine the validity, priority, or extent of a lien or other interest in property, other than a proceeding under Rule 4003(d)." See Fed. R. Bankr. P. 7001(2).

B. Contested Matters And Sales Of Bankruptcy Estate Property

A contested matter arises when someone files a motion in a case, or files an objection to some proposed course of conduct. See Fed. R. Bankr. P. 9014; United States v. Laughlin (In re Laughlin), 210 B.R. 659, 661 (Bankr. 1st Cir. 1997) ("[w]hen a party files an objection to an administrative matter (such as a professional fee application or notice of sale), it becomes a contested matter (citations omitted)." If an objection is filed, a hearing must be held to adjudicate it. Fed. R. Bankr. P. 6004(e).

The procedures specified in the bankruptcy rules for litigating contested matters are less formal than those specified for adversary proceedings. See Toma Steel Supply Co., Inc. v. Transamerican Natural Gas Corp. (In re Transamerican Natural Gas Corp.), 978 F.2d 1409, 1416 (5th Cir. 1992) ("[u]nlike adversary proceedings, which we have described as 'full blown federal lawsuits within the larger bankruptcy case,' and which are governed by all of the rules in Part VII of the Bankruptcy Rules, contested matters are 'subject to the less elaborate procedures specified in Bankruptcy Rule 9014'"), cert. denied, 509 U.S. 923 (1993). Contested matters do not receive separate docket numbers, there is no complaint, and parties are not formally named. See State Bank of S. Utah v. Gledhill (In re Gledhill), 76 F.3d 1070, 1077 (10th Cir. 1996) ("[i]n general, a party who brings an action designated as an adversary proceeding under Rule 7001 must file a complaint with the bankruptcy court, and serve the adverse party with a summons and a copy of the complaint. See Rule 7003; Rule 7004. In contrast, in a contested matter, relief shall be requested by motion." (internal quotations omitted)).

The proposal by a case trustee to sell property of the estate may give rise to a contested matter. Section 363(b) of the Bankruptcy Code, 11 U.S.C. 363(b), allows trustees to sell estate assets outside the ordinary course of business. It requires prior notice to parties in interest, who may then object. See Fed. R. Bankr. P. 2002(a)(2) (specifying the content of notices). Bankruptcy Rule 6004(b) authorizes parties who wish to oppose proposed sales to file objections with the court. Fed. R. Bankr. P. 6004(b). The rule provides that filing such an objection commences a contested matter "governed by Rule 9014."

IV. Federal Rules Of Appellate Procedure

Fed. R. App. P. 4(a)(1)(B) provides that:

> "[w]hen the United States or its officer or agency is a party, the notice of appeal may be filed by any party within 60 days after the judgment or order appealed from is entered.

V. Facts Of This Case

In the course of the Perry Hollow Golf Club, Inc. and Perry Hollow Management Co., Inc. consolidated chapter 11 bankruptcy case, two disputes arose in the bankruptcy court - - one, an adversary proceeding instituted, under Bankruptcy Rule 7001, by Jeffery A. Schreiber, the chapter 11 trustee, and the other, a contested matter brought, under Bankruptcy Rule 9014, by Yamaha. App. 305-07.

On July 7, 2000, Schreiber instituted an adversary proceeding against Yamaha disputing the validity of a security interest Yamaha claimed to hold in 72 golf carts. Id. at 1. The trustee's complaint asked the court to rule that Yamaha's security interest was unperfected. The Assistant United States Trustee for the District of New Hampshire, Geraldine Karonis, did not participate in this proceeding. On October 17, 2000, after a hearing, the bankruptcy court ruled in Schreiber's favor. Id. at 134.

Then, on October 30, 2000, Schreiber filed a motion seeking permission to sell the golf carts. Id. at 199. Yamaha objected, thereby commencing the contested matter. Id. at 204. Karonis filed no pleadings in the contested matter, but did attend the hearing. There, she neither supported nor opposed the sale, but did ask two questions pertaining to whether the potential purchaser had sufficient financial resources to purchase the golf carts. Id. at 237-38. Ultimately, the bankruptcy court approved the sale. Id. at 208.

Yamaha appealed to the district court both the order in the adversary proceeding and that in the contested matter. By order entered January 8, 2001, the court consolidated Yamaha's appeals "for all purposes." App. 253. The United States Trustee did not enter an appearance in the district court. Nor did the United States Trustee file briefs, motions, or other pleadings. The court's docket sheet listed Yamaha as "appellant," and Schreiber in two separate capacities, as "appellee" and as "trustee," but listed Karonis only as "trustee." On March 27, 2001, the court entered a judgment and order affirming the bankruptcy court’s rulings. Id. at 303-04. On May 7, 2001, the district court issued an order declining to stay its judgment pending appeal. Id. at 331.

On May 14, 2001, forty-eight days after entry of the district court's judgment, Yamaha filed a notice of appeal from the judgment affirming the bankruptcy court's rulings. And then, on June 6, 2001, the firm filed a second notice, appealing the district court’s denial of the stay. Subsequently, this Court directed Yamaha to show cause why its appeal from the March 27 judgment of the district court should not be dismissed for failing to file a notice of appeal within thirty days as required by Fed. R. App. P. 4(a)(1)(A).[3]

On January 9, 2002, this Court, per Judge Selya, issued an order concluding that there was "an arguable basis for applying the 60-day appeal period" and "permit[ting] this appeal to proceed in the normal course." The order noted that "[a]lthough the Office of the United States Trustee states that, apart from

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[3] Yamaha filed a memorandum in which it argued that the rule's 60-day time limit was applicable. Schreiber, responded to the court of appeals' show cause order by stating that he "d[id] not object to Yamaha's response to the Court's Show Cause Order." We filed a memorandum, addressing the arguments raised by Yamaha, which memorandum concluded that the 30-day limit applied.

appointing Jeffrey Schreiber as the Chapter 11 trustee, it took no other action in connection with this case and neither appeared nor filed pleadings in the proceedings, the record indicates that AUST Karonis appeared at a November 14, 2000 hearing on a motion by trustee Schreiber to sell the Yamaha golf carts and, in fact, Karonis cross-examined one of the witnesses." The Court's order instructed the parties to "brief the jurisdictional issue along with the merits issues."[4]

SUMMARY OF ARGUMENT

In our memorandum addressing this Court's jurisdiction, we concluded that the U.S. Trustee was not a party to this appeal. As explained below, however, in light of the participation by Assistant U.S. Trustee Karonis in the contested matter, as highlighted in this Court's subsequent order, we have now concluded that the U.S. Trustee is party to this appeal. We have reached this conclusion because first, Karonis "appear[ed]" in the contested matter pursuant to 11 U.S.C. 307, and second, the district court thereafter consolidated for all purposes the contested matter with the adversary proceeding involving that is directly at issue in this Court. Absent either of these circumstances, the U.S. Trustee would not have been a party.

* * * * *

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[4] In this regard, Yamaha's brief states that "[o]n or about January 9, 2002 the First Circuit Court of Appeals ordered that the March 27, 2001 appeal was timely and that the case is now before this Honorable Court." Yam. Br. 8. Schreiber's brief does not address the issue of jurisdiction.

The 1967 Advisory Committee notes to Rule 4(a) of the Federal Rules Of Appellate Procedure suggest that the rule's drafters contemplated that the 30-day limit for filing an appeal would ordinarily apply in bankruptcy cases. Our analysis confirms that expectation, but establishes that the circumstances of this case warrant applying the 60-day limit, thus establishing the jurisdiction of this Court.

The simple fact that case trustees are selected by the United States Trustee does not make them "officers" of the United States, so as to trigger the 60-day rule in the high percentage of bankruptcy cases in which there is a case trustee. A case trustee is a "private trustee" (28 U.S.C. 586(a)(1)), who is privately compensated and owes a fiduciary duty solely to the estate. _See_ 11 U.S.C. 323(a). Thus, Schreiber, as Chapter 11 trustee, is not an "officer" of the United States under Fed. R. App. P. 4(a).

Since the Office of the United States Trustee is an agency of the United States, its participation as a party in a bankruptcy case would trigger the 60-day period for filing an appeal. But such participation is discretionary, and the mere _potential_ of the Office to become a party is insufficient to trigger that extended period, which otherwise, and contrary to the intent of Rule 4(a), would apply to all bankruptcy cases.

The United States Trustee becomes a party to a "[bankruptcy] case or proceeding" _only_ by the exercise of its right to "raise * * * appear * * * and be heard on any issue." 11 U.S.C. 307.

The keying of the party status of the United States Trustee to the exercise of the power granted by Section 307 implements the philosophy underlying Rule 4, not to create traps for the unwary. This goal is realized by making clear to the participants in the bankruptcy proceeding, the instances in which the United States Trustee has become party.

Here, in the contested matter, the UST was “heard” on the issue as to the sale of the golf carts in that Karonis questioned the prospective buyer of the carts. Accordingly, Karonis, and through her the UST, was a "party" to the contested matter in the bankruptcy court, and thereby became a party to the subsequent appeal of that matter. Importantly, this exercise of discretion to participate affords no basis per se on which to hold that the UST thereby become a party to such other distinct controversies within the overall bankruptcy case, much less the case as a whole.

But here, the district court consolidated the two closely related appeals of the contested matter and the adversary proceeding (the existence of Yamaha's lien being central to both) "for all purposes" (emphasis supplied). This Court has recognized that where two cases are so consolidated they may be treated as one for purposes of appealability. Thus, the effect of the district court's consolidation order was to make Karonis (and through her the UST) parties in the district court. This in turn means that the 60-day rule applied to Yamaha's notice of appeal, and rendered it timely.

ARGUMENT

The 1967 Advisory Committee notes to Rule 4(a) of the Federal Rules Of Appellate Procedure suggest that the drafters of the rule expected the 30-day time limit for filing a notice of appeal to apply in most bankruptcy cases, i.e., that ordinarily the United States, via the United States Trustee, would not be a party so as to trigger the 60-day limit. See Fed. R. App. P. 4(a) advisory committee's notes ("[e]xcept in cases to which the United States or an officer or agency thereof is a party, the change [resulting from application of Rule 4(a)(1)] is a minor one, since a successful litigant in a bankruptcy proceeding may, under [existing law], oblige an aggrieved party to appeal within 30 days after entry of judgment"); See also In re Serratto, 117 F.3d 427, 428-29 (9th Cir. 1997) (citing treatise passages suggesting that 30 days is the typical time for taking an appeal in bankruptcy cases).

The analysis below confirms the expectation of the advisory committee. Nevertheless, the analysis further establishes that the circumstances here are such that Karonis (and through her, the United States Trustee) were parties in the district court, so that the 60-day period applied and Yamaha's appeal was timely.

I

THE CHAPTER 11 TRUSTEE, SCHREIBER, IS NOT AN "OFFICER" OF THE UNITED STATES UNDER Fed. R. App.

P. 4(a), SO AS TO MAKE IT A PARTY TO THIS APPEAL[5]

If private trustees were "officers" of the United States for purposes of Rule 4(a), then almost all bankruptcy cases would be subject to the 60-day deadline (Chapter 11 cases, in which a case trustee is not ordinarily utilized, being only a small percentage of all bankruptcy cases). But this is not the case. Under 28 U.S.C. 586, establishing the duties of the United States Trustee, the United States Trustee is directed to "establish, maintain, and supervise a panel of private trustees that are eligible and available to serve as trustees in cases under chapter 7 of title 11" (emphasis supplied). 28 U.S.C. 586(a)(1).

These trustees owe a fiduciary duty to the bankruptcy estate, not to the government, as would a government official. See 11 U.S.C. 323(a). Further, they are privately compensated, receiving neither compensation nor benefits from the government. Under these circumstances, the simple fact that Schreiber was appointed by the Office of the United States Trustee does not make him an "officer" of the United States within the meaning of Fed. R. App. P. 4(a). In re Serratto, 117 F.3d 427, 428-29 (9th Cir. 1997); In re Greene, 980 F.2d 590, 597 (9th Cir. 1992), cert. denied, 510 U.S. 1039 (1994).[6]

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[5] This part of our argument largely duplicates material contained in the memorandum that we filed in connection with this Court's order to show cause.

[6] See California State Bd. of Equalization v. Sierra Summit, Inc., 490 U.S. 844, 849-50 (1989)("bankruptcy trustee is 'the representative of the estate [of the debtor],' 11 U.S.C. § 323(a)[] * * *, not 'an arm of the Government,'" (quoting

II.

THE EMPOWERMENT OF THE UNITED STATES TRUSTEE TO "RAISE," "APPEAR" AND "BE HEARD ON ANY ISSUE" IN ANY BANKRUPTCY CASE (11 U.S.C. 307) DOES NOT ITSELF MAKE THE UNITED STATES A "PARTY" (Fed. R. App. P. 4(a)) TO THIS APPEAL

The United States Trustee's Office is an agency of the United States. See Joelson v. United States, 86 F.3d 1413, 1417 (6th Cir. 1996) ("parties * * * do not dispute that the U.S. Trustee's Office is an agency within the definition of the Administrative Procedure Act"); In re Gideon, Inc, 158 B.R. 528, 530-31 (Bankr. S.D. Fla. 1993); 20 Moore's Federal Practice §304.11[2] at 26 (3d ed. 1997). Cf. In re Plaza de Diego Shopping Ctr., Inc., 911 F.2d 820, 824 (1st Cir. 1990).[7] Thus its participation as a party in a bankruptcy case would trigger the 60-day period for filing an appeal.

Such participation is discretionary, however, in that, under

Department of Employment v. United States, 385 U.S. 355, 359-360 (1966); Allnutt v. Department of Justice, 99 F. Supp. 2d 673, 678 (D. Md. 2000)(FOIA did not require United States Trustee to turn over records under control of private bankruptcy trustee); Wells v. United States, 98 B.R. 806 (N.D. Ill. 1989) (bankruptcy trustee not agent of United States for purposes of collecting withholding taxes); In re Grand Jury Proceedings, 196 F.R.D. 57, 62 n.9 (S.D. Ohio 2000) (bankruptcy trustee "'"not an officer, agent or instrumentality of the United States"'" for purposes of determining whether seized materials were in custody of the United States). But see United States v. Lowell, 215 F.3d 1331, No. 99-3683, 2000 WL 51927 *1 (7th Cir.)(unpublished) (trustee a government officer for purposes of applying United States Sentencing Guidelines), cert. denied, 531 U.S. 891 (2000).

[7] By the same token, the United States Trustee and the Assistant United States Trustee are "officers" of the United States.

11 U.S.C. 307, "[t]he United States trustee may raise and may appear and be heard on any issue in any case or proceeding under this title * * *" (emphasis supplied). For purposes of a private party, such as Yamaha, invoking the 60-day period of Rule 4(a), the mere potential of the United States Trustee to become a party is insufficient. Otherwise, the 60-day period would apply to all bankruptcy cases, a result that, as shown above, was not contemplated by rule 4(a).

III.

THE SPECIAL CIRCUMSTANCES OF THIS CASE MAKE THE UNITED STATES TRUSTEE A "PARTY" (Fed. R. App. P. 4(a)) TO THIS APPEAL

A. The UST Was "Heard" On The "Issue" (11 U.S.C. 307) In The Contested Matter, And Therefore Became A Party To That Matter

The Office of the United States Trustee becomes a party to a "[bankruptcy] case or proceeding" only by the exercise of its right to right to "raise * * * appear * * * and be heard on any issue."[8] 11 U.S.C. 307. See In re Lloyd Carr & Co., 617 F.2d

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[8] We note that this analysis applies only to participation in contested matters or adversary proceedings. The United States Trustee routinely participates in administrative proceedings that do not involve an adversary process.

882, 883 n.1 (1st Cir. 1980) ("government's participation here was sufficiently active for Abrahams to invoke the 60-day limit of Rule 4(a)"). The keying of the party status of the United States Trustee to the exercise of the power granted by Section 307 furthers the philosophy underlying Rule 4, that this basic rule for defining when a notice of appeals must be filed should not be construed to create traps for the unwary. See Advisory Committee Notes to Rule 4. This goal is realized by making clear to the participants in the bankruptcy proceeding the instances in which the United States Trustee has become party. To require more than having been "heard" would create potential traps because it would require a difficult judgment to decide whether the extent participation by the United States Trustee sufficed to trigger the 60-day rule.

Here, in the contested matter, the UST was "heard" on the issue as to the sale of the golf carts in that Karonis questioned the prospective buyer of the carts. App. 237-238. Accordingly, Karonis, and through her the UST, became a "party" to the contested matter in the bankruptcy court, and thereby became a party to the subsequent appeal of that matter. See Fed. R. App. P. 4(a)(1)(B).

B. That Karonis Was "Heard" In One Contested Matter Did Not Per Se Make The United States Trustee A "Party" To Any Other Such Matter Or Proceeding Within The Bankruptcy Case

As this Court has recognized, a bankruptcy case typically encompasses numerous distinct controversies. And, in appropriate cases, appeals may be taken with respect to final decisions reached in a contested matter or adversary proceedings without waiting for a resolution of the overall bankruptcy case. See Ponderosa, 992 F.2d at 5-6. The United States Trustee may exercise discretion to participate in one or more of such distinct controversies (11 U.S.C. 307).

But where, as is normally the case, the controversy or controversies in which the UST elects to participate are distinct from the other controversies within the same bankruptcy case, there is no warrant for holding that the UST has thereby become a party to such other controversies, much less the bankruptcy case as a whole. To hold otherwise would unjustifiably expand the applicability of the 60-day rule in bankruptcy cases. See In re Lloyd Carr & Co., 617 F.2d 882, 883 n.1 (1st Cir. 1980) ("the mere fact that the United States was a tax creditor in a civil bankruptcy proceeding would not, by itself, assure that the 60-day limit would be appropriate"); Serratto, 117 F.3d at 428 ("[i]t would substantially undermine Rule 4(a) to allow a party to subpoena the U.S. Trustee, however improperly, and thereby gain an additional 30 days in which to file a notice of appeal. As far as Rule 4(a) is concerned, the U.S. Trustee had no involvement in this litigation").

C. The District Court's Consolidation Of The Appeal In The Contested Matter, Where Karonis Was A Party, With That In The Closely Related Adversary Proceeding, Where Karonis Was Not A

Party, Made The United States Trustee A Party For Purposes Of Rule 4(a)

Although the U.S. Trustee did not participate in the district court's proceeding, it did not thereby lose its party status in the district court with respect to the contested matter. See United States v. LTV Corp., 746 F.2d 51, 53 (D.C. Cir. 1984) (per curiam) ("[p]arties to the [district court] record include the original parties and those who have become parties by intervention, substitution, or third-party practice"). And here, the district court consolidated "for all purposes" (emphasis supplied) Yamaha's appeals of the bankruptcy court's orders in the contested matter and the adversary proceeding.[9]

This Court has held that cases "consolidated for purposes of convenience and judicial efficiency" are treated as separate for purposes of appealability. But the Court has distinguished "cases consolidated into one action for all purposes." Bay State HMO Mgmt., Inc. v. Tingley Sys., Inc., 181 F.3d 174, 178-79 n.3 (1st Cir. 1999), cert. denied, 528 U.S. 1187 (2000). Thus, by operation of the district court's consolidation order, Karonis (and through her the UST), who was a party to the contested

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[9] Indeed, there was a close relationship between the contested matter, in which we consider Karonis to have been a party, and the adversary proceeding, in which she had no part. The issue of whether Yamaha had a lien on the 72 golf carts was germane to both disputes in that only a "party in interest" may object to a proposed sale by the case trustee. 11 U.S.C. 363(b). Thus, the order of the district court treats the existence of the lien as the core issue in the case.

matter, became a party to the entire consolidated case (which included the adversary proceeding)in the district court. Accordingly, the 60-day rule applied to Yamaha's notice of appeal, which was timely.

CONCLUSION

For the foregoing reasons, this Court has appellate jurisdiction in this case.

Respectfully submitted,

ROBERT D. McCALLUM, JR.
Assistant Attorney General

WILLIAM KANTER
(202) 514-4575
ROBERT D. KAMENSHINE
(202) 514-2494
Attorneys, Appellate Staff
Civil Division, Room 9012
601 D Street, N.W.
Washington, D.C. 20530-0001

APRIL 2002

CERTIFICATE OF SERVICE

I hereby certify that on this 18th day of April 2002, I filed the foregoing brief and 3 ½-inch computer readable diskette with this Court by causing copies to be mailed, via Federal Express, and served the foregoing brief and 3 ½-inch computer readable diskette upon counsel by causing copies to be mailed, via Federal Express, to:

Diane M. Puckhaber, Esquire
Perkins & Puckhaber, P.A.
3 Maple Street
Concord, NH 03302-1138
606-224-3322

Edward C. Dial, Jr., Esquire
Schreiber & Associates, P.C.
99 Rosewood Drive
Danvers, MA 01923
978-762-0100

ROBERT D. KAMENSHINE
Attorney

CERTIFICATE OF COMPLIANCE

I hereby certify, as required by FRAP 32(a)(7)(C), that on the basis of a word count produced by computer, the foregoing brief contains 5021 words.

ROBERT D. KAMENSHINE
Attorney

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BRIEF BANK — “SUMMARY SHEET”

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WESTLAW CODES

1. (“TI”) TITLE OF CASE [E.g., “SMITH v. U.S. TRUSTEE (IN RE SMITH)”]	Yanicko v. UST, (In re Yanicko)
2. (“CO”) CURRENT COURT [E.g., “CTA9"]	CA3
3. (“CCN”) CURRENT CASE NO.	No.: 97-3210
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&	
√ Any Miscellaneous BACKGROUND	√ **Background:** The bankruptcy court dismissed the debtors' chapter 7 case pursuant to §707(b) of the Bankruptcy Code after concluding it would be substantial abuse of the Code to wipe away the debtors' debts given their conduct and ability to repay their creditors. On appeal, the district court affirmed the bankruptcy court's decision in all respects. This appeal followed.
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No. 97-3210

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

In re Daniel R. Yanicko, Jr. and Cynthia J. Yanicko

Daniel R. Yanicko, Jr. and Cynthia J. Yanicko,

Appellants,

v.

United States Trustee,

Appellee.

On Appeal from the United States District Court
for the Western District of Pennsylvania

BRIEF OF APPELLEE UNITED STATES TRUSTEE

STATEMENT OF JURISDICTION

The bankruptcy court had jurisdiction over this case under 28 U.S.C. 157(b)(1). The appellants timely appealed the bankruptcy court's final order dismissing their bankruptcy case to the United States District Court for the Western District of Pennsylvania. The district court had jurisdiction over that appeal under 28 U.S.C. 158(a)(1). The appellants timely filed a notice of appeal from the district court's order affirming the dismissal, and this Court has jurisdiction over this appeal under 28 U.S.C. 158(d).

STATEMENT OF THE ISSUE

Did the bankruptcy court err in dismissing the Yanickos' bankruptcy petition pursuant to section 707(b) of the Bankruptcy Code?

STATEMENT OF THE CASE AND STATEMENT OF THE FACTS

A. Nature of the Case.

The Yanickos challenge the dismissal of their chapter 7 bankruptcy case. The bankruptcy court dismissed their case pursuant to section 707(b) of the Bankruptcy Code after concluding it would be a substantial abuse of the Code to wipe away the Yanickos' debts given their conduct and given their ability to repay their creditors. On appeal, the district court affirmed the bankruptcy court's decision in all respects. This appeal followed.

B. Factual Background and Proceedings Below.

Daniel R. Yanicko, Jr. is a self-employed orthopedic surgeon. A43; A205.[1/] Dr. Yanicko lives with his wife, Cynthia J. Yanicko, in Sharon, Pennsylvania (A11), a town of 17,000 persons located within the Youngstown, Ohio Standard Metropolitan Statistical Area. Sharon has a low cost of living. The area's median home costs rank 123rd out of 129 SMSAs. See *Median Home Prices Across the USA*, Money, May 13, 1997, available in

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[1/] The citation form "A__" refers to the page on which this information is found in the Appendix for Appellants.

WESTLAW, Allnewsplus file (Youngstown SMSA's $72,100 median home price is 60% of the $119,400 national average).

In 1995, Dr. Yanicko earned $353,570 from his medical practice. A142. In 1994, he earned $317,947. A59. He earned $344,161 in 1993 (A61), and $461,741 in 1992 (A63). Mrs. Yanicko lists her occupation as housewife; she does not work outside the home. A43; A282.

The Yanickos experienced financial difficulties because they did not timely pay their federal income taxes. A251-A253. This occurred after Dr. Yanicko, who is self-employed, stopped withholding enough money from his draw to pay the taxes as they became due. In 1992, he withheld $107,600 in estimated taxes. A64. In 1993, he reduced this to $58,300. A62. In 1994, he reduced it to $4,000. A60. In 1995, he withheld nothing. A143. Because of his large 1992 withholdings, the Yanickos owed only $21,444 in taxes and penalties for 1992. A64. As he stopped withholding adequate amounts to meet his tax burdens, the Yanickos' tax liabilities increased to $41,886 for tax year 1993 (A62), $106,833 for 1994 (A60), and $113,498 for 1995 (A143).

The Yanickos met with bankruptcy counsel in November 1994. A330. Within a short period of time thereafter, they incurred $16,000 in credit card debt for consumer purchases (A258-A260; A321); within approximately two months that amount reached $30,000 (A330).

On June 29, 1995, the Yanickos filed a petition seeking protection under the debt liquidation provisions of chapter 7 of the Bankruptcy Code. A11-A64. Their schedules listed assets of $567,364 and liabilities of $788,941. A13. The Yanickos filed an amended chapter 7 petition on October 19, 1995; it was not significantly different from their initial petition.[2] A65-101.

Much of the Yanickos' general unsecured debt arose from credit card purchases and consumer loans. A82-A88. They owed money on five different American Express accounts, an AT&T Universal card, a Chase Advantage card, a Chemical Bank Shell MasterCard, a Citibank Visa card, a Discover card, an Express Gold card, an MBNA America-MasterCard, an MBNA America-Visa card, and a GM card. Id. Their schedule of unsecured claims lists seventeen additional debts arising from consumer purchases. Id.

The Yanickos' bankruptcy schedules evidenced an intent to live lavishly while in bankruptcy. A44. In them, the Yanickos claimed they needed $16,945 monthly for living expenses, including $635 each month for clothing and $1,500 a month for food. Id. Their schedules reveal they owned four vehicles, a Cadillac DeVille, a Chevrolet Suburban, an Oldsmobile Cutlass, and a GMC Sierra truck. A21. The Yanickos stated in their petition that they intended to keep and maintain all four. A216-

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[2] The Yanickos subsequently prepared an amended Schedule J, which lists expenditures, but did not file it prior to the evidentiary hearing on the motion to dismiss their case. A201.

A218; A26; A46; A47. They also owned two homes, one of which they sought to sell, and a parcel of land. A209-A211; A14.

The Yanickos’ petition revealed their intention to reaffirm the indebtedness securing their houses and cars, and their list of expenditures included debt service for them. A44; A26; A46; A47; A217-A218. On the other hand, the Yanickos’ general unsecured creditors, who are owed $244,921 (A40; A325), would receive nothing because the Yanickos’ secured and priority unsecured debts of $544,020 (A29; A31; A324-A325) exceed their $481,548 in nonexempt assets[3/] (A13; A26; A324). A chapter 7 discharge would, however, free the Yanickos from these debts because general unsecured claims in a chapter 7 case are paid from pre-petition “property of the estate,” not post-petition income, regardless of how substantial that income may be. 11 U.S.C. 541, 726, 727(b).

While in bankruptcy, the Yanickos maintained a lavish lifestyle. They employed full-time domestic help. A226-A228; A320. They remodeled their house. A212; A328. They maintained their country-club privileges — at a cost of $200 a month plus a $200 minimum quarterly dining charge plus assessments. A219; A245-A246; A309; A319. They kept four cars. A216-A218; A309. Mrs. Yanicko spent more than $1,700 for clothes at one store

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[3/] The $481,548 figure is calculated by deducting the Yanickos’ $85,816 in exempt assets (A26) from their $567,364 in total assets (A13).

alone. A323. The family spent at least another $4,500 for clothes. A324. The Yanickos spent more than $1,300 on what they termed "mother's day[s] out." Id. They spent more than $800 purchasing videotapes rather than watching cable or borrowing videos from the local library. A274-A275; A281-A282; A322. They maintained two cellular phones. A211-A212. They spent $800 on jewelry. A277; A279; A280; A323. They spent approximately $1,750 on toys. A271-A274; A278; A280-A281; A322. They spent $1,500 each month on food. A44; A271. Between November 1995 and May 1996 they spent more than $2,000 on their dogs. A323.

The Yanickos also preferred certain pre-petition unsecured creditors by making selective post-petition payments to them. A224-A226; A298-A299; A329. These included Mellon Bank and Visa. Id.

On October 20, 1995, the United States Trustee moved to dismiss the Yanickos' bankruptcy case pursuant to section 707(b) of the Bankruptcy Code.[4/] A102-A104. The debtors opposed the

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[4/] United States Trustees are officials of the Department of Justice appointed by the Attorney General to supervise the administration of bankruptcy cases and trustees. See 28 U.S.C. 581-589 (establishing the United States Trustee Program and the powers of United States Trustees); United States Trustee v. Columbia Gas Systems, Inc. (In re Columbia Gas Systems, Inc.), 33 F.3d 294, 296 (3d Cir. 1994)(United States Trustees oversee the bankruptcy process, protect the public interest, and ensure that bankruptcy cases are conducted according to law)(citing H.R. Rep. No. 595, 95th Cong., 2d Sess. 109 (1977); United States Trustee v. Revco D.S., Inc. (In re Revco), 898 F.2d 498, 499 (6th Cir. 1990) ("[t]he United States trustee, an officer of the Executive Branch, represents . . . [the] public interest").

motion. A105-A106. An evidentiary hearing was held on August 15, 1996. A199-A312. At the end of the hearing, the bankruptcy court found that cause existed to dismiss the Yanickos' bankruptcy petition for substantial abuse under section 707(b). A307-A311.

The bankruptcy court issued an order of dismissal on August 30, 1996. A313. The Yanickos filed a notice of appeal to the district court on September 5, 1996. A9. The bankruptcy court issued an opinion setting forth the court's reasoning on October 15, 1996. A314-A332.

On March 17, 1997, the United States District Court for the Western District of Pennsylvania issued an order and memorandum opinion affirming the bankruptcy court's dismissal of the Yanickos' case. MO1-M07.[5/] On April 14, 1997, the Yanickos filed a notice of appeal to this Court. A333.

STATEMENT OF RELATED CASES AND PROCEEDINGS

The United States Trustee is unaware of any related cases or proceedings.

STATEMENT OF THE STANDARD OR SCOPE OF REVIEW

The standard of review on appeal is clearly erroneous as to findings of fact and de novo as to conclusions of law. Impounded

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[5/] The citation form "MO__" refers to the page on which information is found in the district court's opinion. Pursuant to 3rd Cir. LAR 28.1(a)(iii), the Yanickos have inserted a copy of the district court's opinion at the end of their brief.

(Juvenile R.G.), __ F.3d __, 1997 WL 356922, at *7 (3d Cir. June 30, 1997); In re Sharon Steel Corp., 871 F.2d 1217, 1222-23 (3d Cir. 1989).

SUMMARY OF ARGUMENT

Section 707(b) of the Bankruptcy Code authorizes dismissal of a chapter 7 case if a debtor has primarily consumer debts — a fact the Yanickos concede, and if it would constitute substantial abuse to give the debtor chapter 7 relief. The Yanickos allege the record does not support the bankruptcy court's finding of substantial abuse. Although this Court has not had occasion to construe this term, the Fourth, Sixth, Eighth and Ninth circuits have. These courts employ slightly different tests, but that is not significant to this appeal because the bankruptcy court concluded the Yanickos' case constitutes substantial abuse under all of them, and because this case is a textbook example of substantial abuse. The Yanickos sought to discharge their lawful debts even though they have the ability to repay them; they went on a buying spree before filing bankruptcy; they filed schedules that evidenced their intent to continue living lavishly; they lived extravagantly while in bankruptcy; and they tried to prefer some of their pre-petition creditors.

ARGUMENT

The bankruptcy court acted appropriately in dismissing the Yanickos' petition for substantial abuse. Section 707(b) of the Bankruptcy Code, 11 U.S.C. 707(b), authorizes a bankruptcy court, upon its own motion or upon that of the United States Trustee, to dismiss a debtor's chapter 7 petition if two conditions are met. First, the debts must be primarily consumer debts. This prong is not at issue in this case. A325. The Yanickos acknowledge they have "primarily consumer debts" (A12; A66) and their trial counsel conceded "[t]here is no dispute that these are consumer debts" (A300).

Section 707(b) allows the dismissal of a consumer debt case if "granting of relief would be a substantial abuse of the provisions of this chapter." Section 707(b) establishes a presumption in favor of granting the relief sought by the debtor.

Neither the Bankruptcy Code nor its legislative history define substantial abuse. Green v. Staples (In re Green), 934 F.2d 568, 570-71 (4th Cir. 1991). See also In re Ontiveros, 198 B.R. 284, 288 (C.D. Ill. 1996) (describing the absence of meaningful legislative history).

This Court has not had occasion to interpret this term. Other circuits have created three tests to help determine whether a case constitutes substantial abuse. The Eighth and Ninth Circuits hold that the "primary factor" evidencing substantial abuse is a "bankrupt [who has an] ability to pay his debts out of his income." United States Trustee v. Harris, 960 F.2d 74, 76 (8th Cir. 1992); Zolg v. Kelly (In re Kelly), 841 F.2d 908, 914-15 (9th Cir. 1988). These courts will dismiss a case based solely upon a debtor's ability to use future income to repay a substantial portion of its debt. Id. They espouse this test because it preserves "the bankruptcy courts' ability to dismiss cases filed by debtors who are not dishonest, but who also are not needy." Harris, 960 F.2d at 76 (quoting In re Walton, 866 F.2d 981, 983 (8th Cir. 1989)). This test also has the advantage of relying upon objective data. It measures a debtor's income stream against the amount of its debt.

The Fourth Circuit prefers a more subjective test, which it characterizes as a totality of the circumstances test. Green, 934 F.2d at 572. It places greater emphasis on determining whether a debtor has acted appropriately in seeking bankruptcy protection. In determining whether substantial abuse exists, the Fourth Circuit will consider, among other things, whether the bankruptcy is a product of sudden illness, calamity, disability, or unemployment; whether the debtor has made consumer purchases far in excess of its ability to repay; whether the debtor's proposed family budget is excessive or unreasonable; whether the debtor's schedules and statement of current income and expenses are reasonable and accurate; and whether the petition has been filed in good faith.[6] Id.

The Fourth Circuit agrees with the Eighth and Ninth circuits, however, that a court may consider a debtor’s ability to repay. Id. (court may consider “the relation of the debtor’s future income to his future necessary expenses”). See In re Smurthwaite, 149 B.R. 409, 410 (Bankr. N.D.W. Va. 1992) (Green “gave considerable weight to the debtor’s ability to repay as a factor which it should consider”).

The Sixth Circuit allows courts to consider a debtor’s conduct and its ability to repay. In re Krohn, 886 F.2d 123, 126-27 (6th Cir. 1989) (court may consider a number of factors, including: the ability to repay — and “that factor alone may be sufficient to warrant dismissal”; “eve of bankruptcy purchases”; whether unforeseen or catastrophic events caused the bankruptcy; whether the debtor has a “stable source of future income”; whether the debtor’s schedules evidence good faith; and whether expenses can be reduced significantly).

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[6] The Fourth Circuit does not require that all five criteria be analyzed in every case. Instead, courts must reach decisions on a “case-by-case basis.” Green, 934 F.2d at 572. Accord Kestell v. Kestell (In re Kestell), 99 F.3d 146, 149-50 (4th Cir. 1996) (dismissing pursuant to section 707(b) for lack of good faith because the debtor “sought to avoid paying what he owe[d] to [one specific creditor,] his former wife[,]” without analyzing the other four Green factors).

It not necessary for this Court to adopt one of these tests to determine this appeal because the bankruptcy court held the Yanickos' case constitutes substantial abuse "[u]nder any test we might use." A327. The court found that their misconduct and their ability to repay their debts each justified dismissal.[7] A325-A331.

The bankruptcy court properly dismissed the Yanickos' petition based upon the evidence before it. The Yanickos "suffered no sudden illness, calamity, disability, or unemployment which forced them into bankruptcy." A330. See Green, 934 F.2d at 572 (citing this as a factor justifying dismissal); Krohn, 886 F.2d at 126 (same).

Their irresponsible eve of bankruptcy spending spree justified the dismissal of their case. A330. See Green, 934 F.2d at 572 (citing such purchases as meriting dismissal); Krohn, 886 F.2d at 126 (same). So did their proposed budget, which was "unreasonable and excessive." A331. See Green, 934 F.2d at 572 (citing this as a factor justifying dismissal). Rather than demonstrating an intent to rectify their financial problems, the

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[7] The United States Trustee believes bankruptcy courts should be free to consider all relevant factors but should dismiss a case whenever a debtor has an ability to substantially repay its debts. There is no wisdom in denying repayment to a creditor of an affluent but honest debtor while allowing recovery to a creditor whose debtor is no more well-to-do but is less reputable. Both creditors have the same losses and their debtors have the same ability to alleviate them.

Yanickos' "budget reflect[ed] their intent to continue to live in [lavish] fashion." A331.

The Yanickos' extravagant expenditures while in bankruptcy similarly called their good faith into question. A331. See Green, 934 F.2d at 572 (citing bad faith as a basis for dismissal). This fashionable lifestyle included full-time domestic help (A226-A228; A320); remodeling (A212; A328); country-club privileges (A219; A245-A246; A309; A319); four cars (A216-A218; A309); excessive clothing purchases[8] (A323; A324); $1,300 for "mother's day[s] out" (A324); purchasing hundreds of dollars of videotapes rather than watching cable or borrowing tapes from the local library, and purchasing $1,700 in toys[9] (A271-A274; A274-A275; A278; A280-A281; A281-A282; A322); maintaining cellular phones (A211-A212); buying jewelry (A277; A279; A280; A323); spending $1,500 a month on food[10] (A44; A271); and spending more than $2,000 on their dogs (A323).

While in bankruptcy, the Yanickos also preferred certain unsecured creditors over others. A224-A226; A298-A299. "A major

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[8] See Krohn, 886 F.2d at 124 (citing "large clothing allowance").

[9] See Kelly, 841 F.2d 908, 915 n.9 ("going out to dinner, entertaining people . . . buying toys for the kids or going to the movies" are not "items [that] qualify as reasonably necessary . . . for the maintenance or support of the debtor or a dependent of the debtor" (citations omitted)).

[10] See Krohn, 886 F.2d at 124 (citing "large food bills").

purpose of the bankruptcy process is the equitable distribution of a bankrupt's assets among creditors." Kestell, 99 F.3d at 150. In Kestell, the court dismissed under section 707(b) for bad faith because a debtor tried to avoid lawful payments to his former wife while paying all other creditors. Id. The Yanickos' attempt to prefer some creditors similarly evidences bad faith, and buttresses the bankruptcy court's decision to dismiss their case.

The bankruptcy court also dismissed the Yanickos' case because they have the ability to repay their creditors. A327-A331. The court found the Yanickos have monthly take-home pay of $13,416 after payment of their tax liabilities.[11/] A327-A328. The court concluded the Yanickos could reasonably reduce their monthly expenses to $7,378 by cutting costs nine ways. A329-A330.

Their ability to reduce expenses means there is "no question that the Debtors have an ability to repay creditors." A330. By making reasonable cutbacks in their lifestyle, the Yanickos can pay their creditors more than $6,000 a month, more than $72,000 a year. A327-A330. After June 1998, when they will satisfy their

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[11/] The Internal Revenue Service's claim for back taxes (A81) is a priority unsecured claim that survives discharge. See 11 U.S.C. 523(a)(1)(A) and 507(a)(8). To meet this obligation, the Yanickos worked out a voluntary non-binding repayment plan with the IRS. A232; A294. The bankruptcy court found, however, that "the only reason [they are] making an effort to pay the IRS is that it has greater powers than any other creditor." A311.

prior tax liabilities — and thereby reduce their debt by well more than $100,000 (A31), the Yanickos will have an additional $5,000 a month to pay to creditors (A316; A327-A328; A329-A330), bringing that total up to $130,000 a year. Thus, given the Yanickos' assets and liabilities (A324-A325), they can fully repay all their debts within a few years — even assuming they neither extend the life of their debt service nor negotiate any forgiveness of debt.[12] A330.

The Yanickos are the masters of their financial future. They can repay their debts. A330. They can seek relief under the debt reorganization provisions of chapter 11 of the Code if they need breathing room to reorganize their debts. A330. Indeed, the bankruptcy court did not bar them from filing another chapter 7 petition (A310), and they could do so if their financial circumstances worsen.

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[12] The Yanickos allege the bankruptcy court dismissed their case based upon an erroneous belief they could file a chapter 13 proceeding. Appellants' brief at 12-16. This misstates the record. The bankruptcy court indicated at the hearing that it was unsure whether the Yanickos qualified for chapter 13. A303-A305; A310. Moreover, the court's opinion relied upon Fonder v. United States, 974 F.2d 996, 999 (8th Cir. 1992) to hold that "a debtor need not be eligible for Chapter 13 relief before his Chapter 7 case can be dismissed under §707(b)." A330; see also MO5(rejecting the Yanickos' argument on this point). Accord Krohn, 886 F.2d at 127 ("inability to qualify under Chapter 13 should not be dispositive of whether" to dismiss under 707(b)). Fonder and Krohn accurately state the law; no provision in the Code conditions dismissal upon an ability to obtain chapter 13 relief.

But this case should have been, and properly was, dismissed. "At no point in the [Yanickos'] history, either before or after filing for chapter 7 relief, ha[ve] the debtor[s] shown a sincere resolve to repay [their] obligations and/or to reduce [their] monthly expenses." Krohn, 886 F.2d at 127. The Yanickos will profit as much as their creditors from some "good, old-fashioned belt tightening." Id.

CONCLUSION

For the foregoing reasons, the United States Trustee respectfully asks this Court to affirm the decisions of the bankruptcy and district courts dismissing the Yanickos' bankruptcy case.

Respectfully submitted,

Martha L. Davis
General Counsel

P. Matthew Sutko
Attorney
Department of Justice
Office of the General Counsel
Executive Office for
  United States Trustees
901 E Street, N.W.
Suite 780
Washington, D.C. 20530
telephone:(202) 307-1399
fax :(202) 307-2397

By:____________________________
   P. MATTHEW SUTKO

COUNSEL FOR UNITED STATES TRUSTEE

DATED: August 1, 1997

CERTIFICATE OF BAR MEMBERSHIP

I hereby certify that I am an attorney with the United States Department of Justice, licensed to practice law in the District of Columbia, and a member of the bar of the United States Court of Appeals for the Third Circuit.

____
P. MATTHEW SUTKO

CERTIFICATE OF SERVICE

I hereby certify that on this first day of August, 1997, I have served two copies of the foregoing Brief for Appellee United States Trustee by prepaid first class mail upon the following persons:

P. Raymond Bartholomew, Esquire
701 North Hermitage Road
Hermitage, Pennsylvania 16148

William Pineo, Esquire
764 Park Avenue
P.O. Box 598
Meadville, Pennsylvania 16335

____
P. MATTHEW SUTKO

Dated: August 1, 1997

BRIEF BANK — "SUMMARY SHEET" *Printed Wed-2/3/10 16:35*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*
In re Hau Michael Yuan and Angela Lynn Eichhorst (Hau Michael Yuan and Angela Lynn Eichhorst v. Charles F. McVay)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*
W. D. Tex.

3. ("CCN") ***CURRENT*** CASE NO.
No.: 1:09-cv-00833-SS

4. ("PCN") ***PRIOR*** CASE NO. - & COURT *[IF ANY]*
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(Identify judge & cite, if any)

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Valerie L. Wenger, David I Gold, P. Matthew Sutko, Ramona D. Elliott, Charles F. McVay

(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***
• Whether the bankruptcy court abused its discretion in finding that the filing of this bankruptcy case was abusive under 11 U.S.C. § 707(b)(3)(B).

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IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF TEXAS
AUSTIN DIVISION

In re	§	
	§	
HAU MICHAEL YUAN and	§	
ANGELA LYNN EICHHORST	§	

HAU MICHAEL YUAN and	§	
ANGELA LYNN EICHHORST	§	CASE NO. A09-CA-833SS
	§	
Appellants	§	
	§	
v.	§	
	§	
CHARLES F. MCVAY	§	
UNITED STATES TRUSTEE	§	
	§	
Appellee	§	

ON APPEAL FROM THE UNITED STATES BANKRUPTCY COURT
FOR THE WESTERN DISTRICT OF TEXAS, AUSTIN DIVISION
HONORABLE CRAIG A. GARGOTTA, U.S. BANKRUPTCY JUDGE

BRIEF OF APPELLEE CHARLES F. MCVAY, UNITED STATES TRUSTEE

Of Counsel:

RAMONA D. ELLIOTT
General Counsel

P. MATTHEW SUTKO
Associate General Counsel
DAVID I. GOLD
Trial Attorney
Executive Office for United States Trustees
United States Department of Justice
20 Massachusetts Avenue, N.W.
Washington, D.C. 20530
Ph: (202) 307-1399
Fax: (202) 307-2397

CHARLES F. McVAY
United States Trustee for Region 7

Henry G. Hobbs, Jr.
Assistant United States Trustee
State Bar of Texas No. 0790116
Valerie L. Wenger
Trial Attorney
State Bar of Texas No. 21176300
Office of the United States Trustee
United States Department of Justice
903 San Jacinto Blvd., Rm. 230
Austin, TX 78701
Ph: (512) 916-5328
Fax: (512) 916-5331

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STATEMENT OF JURISDICTION

The bankruptcy court had jurisdiction under 28 U.S.C. §§ 157(a) and (b), and 1334(a) to issue its final order granting the United States Trustee's motion to dismiss the Debtors' chapter 7 bankruptcy case under 11 U.S.C. §§ 707(b)(1) and (b)(3)(B). The bankruptcy court issued its order granting the United States Trustee's motion on October 23, 2009. The Debtors filed a notice of appeal on October 30, 2009, which is timely under 28 U.S.C. §§ 158(a) and (c)(2). This Court has appellate jurisdiction under 28 U.S.C. § 158(a)(1), a statutory provision under which district courts have jurisdiction to hear appeals from final judgments, orders, and decrees of bankruptcy judges.

STANDARD OF REVIEW

On appeal "conclusions of law are reviewed *de novo*, findings of fact are reviewed for clear error, and mixed questions of law and fact are reviewed *de novo*." *In re National Gypsum Co.*, 208 F. 3d 498, 503 (5th Cir. 2000).

In determining whether providing chapter 7 relief to a debtor would constitute abuse under 11 U.S.C. § 707(b)(3), bankruptcy courts apply a "totality of the circumstances" test to the debtor's financial situation. *See* 11 U.S.C. § 707(b)(3)(B). The "totality of the circumstances" test is a "fact-intensive determination" which is reviewed on appeal for abuse of discretion. *Cf. Hebbring v. U.S. Trustee*, 463 F.3d 902, 907-08 (9th Cir. 2006) (pre-2005 Act case).

STATEMENT OF THE ISSUE PRESENTED

The sole issue in this appeal is whether the bankruptcy court abused its discretion in finding that the filing of this bankruptcy case was abusive under 11 U.S.C. § 707(b)(3).

STATEMENT OF THE CASE

On May 31, 2009, the Debtors sought chapter 7 bankruptcy relief in the United States Bankruptcy Court for the Western District of Texas. *See* 11 U.S.C. § 701 *et seq*. On August 13, 2009, the United States Trustee filed a motion to dismiss the Debtors' case for abuse under 11 U.S.C.§§ 707(b)(1) and (b)(3)(B). *See* 11 U.S.C. §§ 707(b)(1) and (b)(3)(B). On September 2, 2009, the Debtors filed a response to the motion to dismiss. On October 23, 2009, the bankruptcy court entered an order granting the United States Trustee's motion to dismiss. This appeal followed.

STATUTORY FRAMEWORK

I. Relief Available to Individual Debtors

The Bankruptcy Code establishes two primary forms of bankruptcy relief for individual debtors – chapter 7 and chapter 13. Under chapter 7, "an individual debtor receives an immediate unconditional discharge of personal liability for certain debts in exchange for relinquishing his or her nonexempt assets to a bankruptcy trustee for liquidation and distribution to creditors." H.R. Rep. 109-31(I), at 10, *as reprinted in* 2005 U.S.C.C.A.N. 88; *see* 11 U.S.C. §§ 701-727. Under chapter 13, "a debtor commits to repay some portion of his or her financial obligations" over a specified period "in exchange for retaining nonexempt assets and receiving a broader discharge of debt than is available under chapter 7." H.R. Rep. 109-31(I), at 10; *see* 11 U.S.C. §§ 1321-1330.

The difference between chapter 7 and 13 is dramatic. In chapter 7 cases, creditors may look solely to debtors' pre-bankruptcy, non-exempt assets for payment. *See* 11 U.S.C. § 541 (limiting property of the estate to debtors' pre-petition assets). Debtors' post-bankruptcy income is not subject to creditor claims. *Id*. Subject to narrow exceptions, debtors receive a complete discharge of all their pre-petition debts in a chapter 7 case. *See* 11 U.S.C. § 727(b).

Chapter 13 is different because debtors must use post-petition income to fund a chapter 13 payment plan. *See* 11 U.S.C. § 1306(a)(2) (property of the bankruptcy estate also includes post-petition income); 11 U.S.C. § 1325(b) (projected disposable income applied to make payments to unsecured creditors). In chapter 13, debtors typically receive a discharge only after they have completed their chapter 13 repayment plans. *See* 11 U.S.C. §§ 1328(a) and (c); *see also* 11 U.S.C. § 1328(b) (listing exceptions to this rule).

II. Former Section 707(b): Dismissal of Chapter 7 Cases for Substantial Abuse

Since 1984, Congress has enacted a series of tests that have allowed courts to dismiss chapter 7 cases to prevent the unjust discharge of pre-petition debts. In 1984, Congress amended chapter 7 to permit dismissal of a chapter 7 bankruptcy petition under § 707(b) if a court found "substantial abuse." Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, § 312, 98 Stat. 333, 335. Congress enacted this amendment to respond "to concerns that some debtors who could easily pay their creditors might resort to chapter 7 to avoid their obligations." H.R. Rep. 109-31(I), at 12 (internal quotation omitted). Two years later, Congress again amended this provision to authorize the United States Trustee to seek dismissal of chapter 7 petitions for "substantial abuse." Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1986, Pub. L. No. 99-554, § 21, 100 Stat. 3088, 3101.

After twenty years' experience, Congress found that these amendments were insufficient to control abuse of chapter 7. Congress identified, among other problems, the "inherent[] vague[ness]" of the "substantial abuse" standard, which led to disagreement in the courts about whether a debtor's ability to repay a significant portion of his or her debts out of future income constitutes substantial abuse, meriting dismissal. H.R. Rep. 109-31(I), at 12. Another problem was that the Bankruptcy Code established "a presumption in favor of granting the relief requested by the debtor," which influenced courts' decisions whether to find substantial abuse. 11 U.S.C. § 707(b) (2000 suppl. 4); *See* H.R. Rep. 109-31(I), at 12.

Responding to these perceived shortcomings of the Bankruptcy Code, Congress held hearings over five years to identify what reforms it could adopt "to ensure that debtors repay creditors the maximum they can afford." H.R. Rep. 109-31(I), at 2, 12. The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (the "2005 Act"), Pub. L. No. 109-8, 119 Stat. 23, implemented the reforms Congress identified.

III. Changes Under the 2005 Act

On October 17, 2005, most provisions of the 2005 Act took effect, thereby implementing significant changes to the Bankruptcy Code. In enacting the 2005 Act, Congress:

> concluded that the complete overhaul of § 707(b) was necessary, with clear, non-discretionary requirements imposed on the bankruptcy court to reject the notion that debtors were entitled to a discharge as a matter of right without regard to their ability to pay and to assure that in practice those with the ability to pay would not be entitled to chapter 7 relief.

146 Cong. Rec. S11700 (December 7, 2000) (*citing*, Sen. Rep. No. 253, 105th Cong., 2nd Sess., and Sen. Rep. No. 540, 105th Cong., 2nd Sess.); *see also* 151 Cong. Rec. S1856 (Mar. 1, 2005). Congress enacted the section 707(b) amendments to curb bankruptcy abuse by, *inter alia*, dismissing chapter 7 cases filed by debtors seeking to have their debts discharged despite having the ability to repay their creditors. *See* 151 Cong. Rec. S1856 (Mar. 1, 2005) (statement of Sen. Charles Grassley).[1] To effectuate this goal, Congress took four important steps.

First, Congress repealed the statutory presumption in favor of granting relief to the debtor.

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[1] In his statement, Senator Grassley explained the purpose behind the section 707(b) amendments as follows: "[i]t is this simple: if repayment is possible, then [a debtor] will be channeled into chapter 13 of the Bankruptcy Code which requires people to repay a portion of their debt. . . ." *Id.*

Compare 11 U.S.C. § 707(b) (1986) *with* 11 U.S.C. § 707(b) (2005).

Second, Congress lowered the standard for dismissal under all subsections of new section 707(b) from "substantial abuse" to mere "abuse." *See* 11 U.S.C. § 707(b)(1) (cases are now dismissed for "abuse"); 11 U.S.C. § 707(b)(2) (subjecting cases to dismissal for abuse); 11 U.S.C. § 707(b)(3) (same).

Third, Congress authorized dismissal when a mathematical formula, known as the "means test," yields monthly disposable income that exceeds a statutory threshold. *See* 11 U.S.C. § 707(b)(2).

Fourth, Congress enacted new § 707(b)(3). This section allows courts to dismiss cases based upon either a debtor's bad faith, *see* 11 U.S.C. § 707(b)(3)(A), or the totality of a debtor's financial circumstances, *see* 11 U.S.C. § 707(b)(3)(B). Thus, even if a presumption of abuse does not arise or is rebutted under section 707(b)(2), a chapter 7 petition should still be dismissed for abuse under section 707(b)(3) when "bad faith" is demonstrated or "the totality of the circumstances . . . of the debtor's financial situation demonstrates abuse." 11 U.S.C. § 707(b)(3)(A) and (B); *In re Ross-Tousey*, 549 F.3d 1148, 1161-62 (7th Cir. 2008).

Sections 707(b)(3)(A) and (B) of the 2005 Act represent a significant departure from old section 707(b) because they clarify that cases can be dismissed either solely for misconduct, under subsection 707(b)(3)(A), or solely based upon the totality of the circumstances of a debtor's financial situation, under section 707(b)(3)(B).

FACTUAL BACKGROUND

On May 31, 2009, the Debtors filed a voluntary petition for relief under the liquidation provisions of chapter 7 of the Bankruptcy Code in the United States Bankruptcy Court for the Western District of Texas. *See* Appellee's Designation of Record (hereinafter "Appellee R.") No. 2. The Debtors own real property located in Littleton, Colorado valued at $185,000. *See* Appellee R. 6. The Debtors do not live there. *See* Appellee R. 2, 6. Instead, one of the Debtors' parents does. *See* Appellee R. 6. The Debtors spend $1,560.39 each month to cover two mortgages on the Colorado home. *See* Appellee R. 3. Beyond supporting that house, the Debtors also spend $2,415.25 each month to lease an apartment in Austin, Texas. *See* Appellee R. 6.

Mr. Yuan is an Investment Analyst with Employees' Retirement System of Texas. *See* Appellee R. 6. He earns roughly $7,500 in gross monthly income. *See* Appellee R. 6. His wife chooses not to work. *See* Appellee R. 6. They have one dependent child. *See* Appellee R. 6.

Based on these factors, among others, the United States Trustee, on August 13, 2009, filed a motion to dismiss the Debtors' bankruptcy case for abuse pursuant to 11 U.S.C. §§ 707(b)(1) and (3) because the totality of the Debtors' financial situation demonstrated they could maintain a different lifestyle while repaying a meaningful portion of their debts.[2] *See* Appellee R. 4. Shortly thereafter, on September 2, 2009, the Debtors opposed the United States Trustee's motion to dismiss. *See* Appellee R. 5.

On October 22, 2009, the bankruptcy court conducted a hearing on the United States Trustee's motion to dismiss. *See* Appellee R. 11. At that hearing, the parties stipulated as to the following facts regarding the Debtors' case:

- Mr. Yuan is currently employed as an investment analyst with the Employees Retirement System of Texas;

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[2] The United States Trustee's motion was not brought under 11 U.S.C. § 707(b)(2). *See* Appellee R. 4.

- Ms. Eichhorst is unemployed;
- The Debtors’ gross monthly income is $7,500.00;
- The Debtors’ net take home income is $5,728.78;
- The Debtors’ monthly rent expense for their apartment located at 801 W. 5th St., Austin, TX, is $2,415.25;
- The Debtors spend an additional $1,560.39 per month for two mortgages on a Colorado home in which Mr. Yuan’s parents live;
- The Debtors’ monthly rental expense is 32% of their gross monthly income, and 42% of their net take home income;
- When the Debtors’ rental expense is combined with their Colorado mortgage expenses, the Debtors spend 53% of their gross monthly income on housing, and 69% of their net monthly take home income on housing;
- The Debtors’ unsecured debt totals $413,150.82;
- The Debtors’ credit card debt totals $201,305.00, or nearly half of the Debtors’ unsecured debt; and
- The Debtors’ $202,786.54 secured debt results from the two mortgages the Debtors’ placed on the Colorado home in which Mr. Yuan’s parents live.

See Appellee R. 11, at 5:13-7:25.[3] The Debtors also proffered testimony from Mr. Yuan, regarding, *inter alia*, the facts and circumstances leading to the Debtors’ bankruptcy filing, their support of Mr. Yuan’s parents, and Mr. Yuan’s status as co-guardian of his niece. *See* Appellee R. 11, at 8:5-8:23; 9:3-9:12.

After considering the facts before it, as well as Mr. Yuan’s proffered testimony, the bankruptcy court found that the Debtors’ case constituted an abuse pursuant to 11 U.S.C. §§

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[3] The parties stipulations of fact were also filed with the bankruptcy court on or about the time of the hearing on the motion to dismiss. *See* Appellee R. 7.

707(b)(1) and (3), and that the dismissal of the Debtors' case was proper. *See* Appellee R. 11, at 27:6-36:20. The bankruptcy court based its ruling on lifestyle choices made by the Debtors affecting their ability to repay their creditors. *See* Appellee R. 11, at 29:4-29:9. Specifically, the bankruptcy court identified Mr. Yuan's support for his family in Colorado, and his decision to live in a downtown rental in Austin, as choices taking up a significant component of the Debtors' income. *See* Appellee R. 11, at 30:5-31:8. In considering these lifestyle choices, the bankruptcy court noted that the overriding theme it was tasked with looking at was "whether or not at the end of the day it's appropriate for the creditors to take a complete hit and not be paid a penny, not be paid a dime on the debts that were incurred in this case because the Debtors made choices about supporting parents in Colorado, about living in downtown Austin. . . ." *See* Appellee R. 11, at 32:6-32:11. The bankruptcy court found that "regrettably for the Debtors at the end of the day if I were to put those on a scale, the portion of the scale that I think tips more is in favor of the creditors." *See* Appellee R. 11, at 32:12-32:14. In doing so, the bankruptcy court expressed its belief that the Debtors **"could make alternative choices and at the end of the day pay something to their creditors**." *See* Appellee R. 11, at 34:2-34:4 (emphasis added). Thus, the bankruptcy court concluded that it was not appropriate to allow the Debtors to proceed in chapter 7 and obtain a discharge.[4] *See* Appellee R. 11, at 34:6-34:10. On October 30, 2009, the Debtors timely appealed that decision to this Court. *See* Appellee R. 8.

SUMMARY OF THE ARGUMENT

The bankruptcy court's order dismissing the Debtors' chapter 7 petition should be

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[4] A copy of the bankruptcy court's order dismissing the Debtors' case is appended to the Debtors' October 30, 2009 motion for leave to appeal. *See* Case No. A09-CA-833SS, Dkt. No. 2.

affirmed. The bankruptcy court did not abuse its discretion in finding abuse under section 707(b)(3)(B)'s "totality of the financial situation" inquiry, and that the Debtors have and did have an ability to make alternative lifestyle choices and thereby pay something to their creditors. In making these findings, the bankruptcy court properly applied the statutory framework of new section 707(b)(3)(B) when it found that the totality of the circumstances of the Debtors' financial situation demonstrated abuse. The court considered all circumstances pertinent to the Debtors' financial situation and correctly concluded that they have the financial ability to repay a portion of their unsecured debts. The Debtors' challenges to the bankruptcy court's dismissal are premised upon an incorrect understanding of section 707(b)(3)(B) and lifestyle choices that the bankruptcy court properly determined to be unacceptable in light of the Debtors' request for a discharge of all of their unsecured debts.

ARGUMENT

I. Under the New Section 707(b)(3)(B), the Bankruptcy Court Did Not Abuse Its Discretion in Relying upon the "Totality of the Debtors' Financial Situation" to Dismiss the Debtors' Chapter 7 Petition

Under new section 707(b)(3)(B), a court deciding whether to dismiss a chapter 7 case must consider whether "the totality of the circumstances (including whether the debtor seeks to reject a personal services contract and the financial need for such rejection as sought by the debtor) of the debtor's financial situation demonstrates abuse." 11 U.S.C. § 707(b)(3)(B). By inserting the phrase "financial situation" in the 2005 Act, Congress signaled a departure from, and narrowing of, the old totality of the circumstances test. *See Connecticut Nat'l Bank v. Germain*, 503 U.S. 249, 253 (1992) (stating that the interpretation of a statute should not render any word superfluous).

Two changes in the statutory language are particularly significant. First, the presumption against a finding of abuse is gone. *Compare* 11 U.S.C. § 707(b) (1986) *with* 11 U.S.C. § 707(b)

(2005); *In re Wolf*, 390 B.R. 825, 831-32 (Bankr. D.S.C. 2008). Second, the standard for finding abuse has been lowered from "substantial abuse" to mere "abuse." 11 U.S.C. § 707(b)(1)-(3). Accordingly, the best reading of new section 707(b)(3)(B) is: if the debtor's financial circumstances demonstrate an ability to pay a meaningful portion of his debts to his creditors, that fact should lead a court to dismiss a chapter 7 case for abuse.

This is consistent with most pre-2005 Act circuit court decisions interpreting old section 707(b). They opined, a debtor's ability to repay a meaningful portion of debt, standing alone, justified dismissal under the heightened test prescribed by the old statute. *See, e.g., In re Stewart*, 175 F.3d 796, 809 (10th Cir. 1999); *In re Kornfield*, 164 F.3d 778, 784 (2d Cir. 1999); *In re Lamanna*, 153 F.3d 1, 4-5 (1st Cir. 1998); *In re Kelley*, 841 F.2d 908 (9th Cir. 1998); *In re Koch*, 109 F.3d 1285, 1288 (8th Cir. 1997); *In re Krohn*, 886 F.2d 123 (6th Cir. 1989). No less is true under new section 707(b)(3)(B), in which Congress lowered the bar for dismissing cases.

While Congress did not define the term "financial situation" in new section 707(b)(3)(B), this Court should give it its ordinary meaning. *Asgrow Seed Co. v. Winterboer*, 513 U.S. 179, 187 (1995) (citations omitted). Both the ordinary meaning and the case law interpretation of 'financial situation' demonstrate that a bankruptcy court should dismiss a chapter 7 case under new section 707(b)(3)(B) when the financial factors of a debtor's income, expenses, assets, and liabilities so warrant.

As a starting point, a debtor's "financial situation" consists of the debtor's reasonable income and expenses. *Ross-Tousey*, 549 F.3d at 1162 (court may consider actual income and expenses); *In re Mestemaker*, 359 B.R. 849, 854-55 (Bankr. N.D. Ohio 2007). Within this inquiry, however, a court must determine and balance "multiple factors," constrained only to the extent that those factors must be economic. *In re Wolf*, 390 B.R. at 832; *In re Haar*, 373 B.R. 493, 500 (N.D.

Ohio 2007).

The "financial situation" factors that a bankruptcy court may consider include: the debtor's assets, liabilities, expenses, and expected future income, and whether any of the debtor's obligations are secured by unnecessary luxury goods. In short, financial factors that are relevant to the determination of the debtor's ability to pay creditors should fall under the bankruptcy's scrutiny. *Wolf*, 390 B.R. at 833 (Bankr. D.S.C. 2008) ("The plain meaning of "financial situation" must necessarily include the debtor's ability to pay creditors."); *Haar*, 373 B.R. at 500.

The intent behind the enactment of the statute bolsters this reading. The 2005 amendments were designed to "respond to many of the factors contributing to the increase in consumer bankruptcy filings, such as lack of personal financial accountability, the proliferation of serial filings, and the absence of effective oversight to eliminate abuse in the system." *Perlin v. Hitachi Capital Am. Corp.*, 497 F.3d 364, 371 (3d Cir. 2007) (quoting H.R. Rep. No. 109-31(I), at 2). By specifying "financial situation," Congress underscored its concern that chapter 7 be reserved for debtors who truly could not repay their creditors by amending the statute. *United States v. Am. Trucking Ass'ns*, 310 U.S. 534, 543 (1940) (stating that the words of a statute are the best indication of its purpose). This is borne out by the legislative history that expressed that "debtors repay creditors the maximum they can afford." H.R. Rep. 109-31(I), at 2, 12.

The bankruptcy court below did not ignore any financial factors in its analysis. Indeed, it carefully considered the Debtors' income, assets, liabilities, and expenditures as required under section 707(b)(3)(B). *See* Appellee R. 11, at 27:6-36:20. The record before the bankruptcy court demonstrated, *inter alia*, that:

- Mr. Yuan is currently employed as an investment analyst with the Employees Retirement System of Texas. *See* Appellee R. 11, at 6:13-6:14; Appellee R. 7.

- Mr. Yuan's gross monthly salary is $7,500.00, and he nets $5,728.78 per month. *See* Appellee R. 11, at 6:14-6:15; Appellee R. 7.

- The Debtors' monthly rent expense for their Austin apartment is $2,415.25, representing 32% of Mr. Yuan's gross monthly income, 42% of his net take home income, and twice the IRS mortgage or rent allowance for a family of three in Travis County, Texas. *See* Appellee R. 11, at 7:4-7:5, 7:14-7:17; Appellee R. 7.

- The Debtors spend an additional $1,560.39 per month for two mortgages on a Colorado home in which Mr. Yuan's parents live. *See* Appellee R. 11, at 6:4-6:6, 7:1-7:3; Appellee R. 6, 7.

- When the Debtors' rental expense is combined with their Colorado mortgage expenses, the Debtors spend 53% of their gross monthly income on housing, and 69% of their net monthly take home income on housing. *See* Appellee R. 11, at 7:5-7:7; Appellee R. 7.

- The Debtors' unsecured debt totals $413,150.82, of which nearly half is credit card debt. *See* Appellee R. 11, at 6:6-6:8; Appellee R. 6, 7.

Each of these financial factors tipped the scale in favor of a finding of abuse in the Debtors' case. *See* Appellee R. 11, at 27:6-36:20. While the Debtors do not agree with how the bankruptcy court balanced these factors with the factors they presented to the court, that does not mean that the bankruptcy court was wrong to consider them, *see, e.g., In re Crink*, 402 B.R. 159 (Bankr. M.D. N.C. 2009) (considering excessive housing costs as part of a section 707(b)(3)(B) analysis),[5] and it

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[5] *See also In re King*, Case No. 08-41975, 2009 WL 62252 (Bankr., E.D. Tex. Jan. 6, 2009) (considering excessive housing costs as part of a section 707(b)(3)(B) analysis); *In re MacNamara*, Case No. 08-03895, 2009 WL 1606985 (Bankr. M.D. Penn. June 5, 2009) (same); *In re Carney*, Case No. 07-31690, 2007 WL 4287855 (Bankr. N.D. Ohio Dec. 5, 2007) (same); *In re Nissen*, Case No. 07-80606, 2007 WL 2915648 (Bankr. D. Neb. Aug. 21, 2007) (same); *In re*

certainly does not mean that the bankruptcy court abused its discretion in finding abuse. Rather, because the bankruptcy court properly reviewed the **totality** of the Debtors' financial circumstances, **as required under section 707(b)(3)(B)**, its order should be affirmed.

II. The Debtors' Legal Arguments are Unavailing

A. Section 707(b)(2)'s "Means Test" Is Irrelevant to the Totality of the Financial Circumstances Analysis under Section 707(b)(3)(B)

The 2005 Act creates a two-step financial analysis for determining if a chapter 7 petition should be dismissed. The first is a mechanical calculation under section 707(b)(2), known as the "means test." The second is a subjective analysis under section 707(b)(3)(B). The plain language of the statute demonstrates that these subsections perform two distinct functions in determining whether a debtor is eligible for a discharge.

The means test, namely the calculations mandated by section 707(b)(2)(A)(i)-(iv), reflects congressional intent that there be an "easily applied formula" to create a presumption of abuse. *In re Henebury*, 361 B.R. 595, 602-03 (Bankr. S.D. Fla. 2007). "Passing the means test" merely means that the court will not "presume abuse exists;" it is not a determination that the debtor is entitled to relief under chapter 7. *See* 11 U.S.C. § 707(b)(2)(A)(i); *In re Lenton*, 358 B.R. 651, 660-61 (Bankr. E.D. Pa. 2006); *In re Booker*, 399 B.R. 662, 666 (Bankr. W.D. Mo. 2009) (stating that the results of the "means test" are "not dispositive").

The means test does more than identify abusive chapter 7 debtors. *In re Fowler*, 349 B.R. 414, 420 (Bankr. D. Del. 2006). It also establishes the burden of proof between the debtor and the moving party, usually the United States Trustee. *Lenton*, 358 B.R. at 660. If the debtor passes the means test, then the United States Trustee has the burden of proof to show abuse. *In re Parada*, 391

Moreland, case No. 05-10519, 2005 WL 1925460 (Bankr. M.D. N.C. Aug. 3, 2005) (same).

B.R. 492, 496 (Bankr. S.D. Fla. 2008). In contrast, debtors who fail the means test must show that a special circumstance exists that would make them eligible for chapter 7 relief. *See* 11 U.S.C. § 707(b)(2)(B)(I). Therefore, the Debtors' argument that certain provisions of the means test are somehow incorporated into section 707(b)(3)(B)'s totality of the circumstances analysis[6] is incorrect. *See Ross-Tousey*, 549 F.3d at 1161-62 (ruling cases that pass section 707(b)(2)(A)'s means test remain subject to dismissal under new section 707(b)(3)(B)).

Instead, the "developing body of case law" confirms a relationship between the means test and section 707(b)(3)(B) that amounts to an objective evaluation of a debtor's financial circumstances followed by a more subjective, flexible consideration of whether discharge is appropriate considering the financial circumstances. *See In re McGillis*, 370 B.R. 720, 747 (Bankr. W.D. Mich. 2007).

The means test is a mechanical, objective application to determine only whether there is a presumption of abuse. *Morse v. Rudler (In re Rudler)*, 576 F.3d 37, 51 (1st Cir. 2009). It is not meant to be a conclusive or comprehensive analysis of whether granting the debtor relief would be an abuse of chapter 7. Toward that end, Congress designed section 707(b)(3)(B) to be a subjective look at the totality of the debtor's financial circumstances. *See In re Krohn*, 886 F.2d 123, 126-27 (6th Cir. 1989) (broad-ranging analysis).

As the Debtors' correctly suggest, section 707(b)(2)'s means test, under appropriate circumstances, allows debtors to deduct secured debt and support related expenses **in calculating whether a presumption of abuse arises**. *See* 11 U.S.C. § 707(b)(2)(A)(ii)(II) (providing, *inter alia*, that a debtor may deduct actual expenses that are reasonable and necessary for the care and

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[6] *See* Debtors' Br. at 8-9 (*citing In re Jensen*, 407 B.R. 378 (Bankr. C.D. Cal. 2009) and 12-14 (*citing* 11 U.S.C. § 707(b)(2)(a)(ii)(II)).

support of an elderly member of the debtor's immediate family); 11 U.S.C. § 707(b)(2)(A)(iii) (providing that a debtor may deduct her average monthly secured debt payments scheduled as contractually due during the 60 months following the date of the petition). However, neither section 707(b)(2)(A)(ii)(II) or section 707(b)(2)(A)(iii) are referenced **anywhere in section 707(b)(3)(A)**. If Congress uses particular language in one section of the statute but not in another, it is "generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion." *Russello v. United States*, 464 U.S. 16, 23 (1983) (citation omitted). Accordingly, this Court should conclude that the inclusion of secured debt and support related expenses in section 707(b)(2)'s means test has no bearing on section 707(b)(3)(B)'s totality of the financial circumstances analysis.

Indeed, the Seventh Circuit, in a post-2005 Act case, rejected the Debtors' reading of section 707(b)(3)(B) on similar grounds. *See Ross-Tousey*, 549 F.3d at 1161-62 (ruling that passing the means test does not foreclose a section 707)(b)(3)(B) analysis). *See also Crink*, 402 B.R. at 168-69 (reaching same conclusion as *Ross-Tousey*); *Booker*, 399 B.R. at 666 (same); *In re Baeza*, 398 B.R. 692, 697-98 (Bankr. E.D. Cal. 2008) (same); *In re Vogeler*, 393 B.R. 240, 243 (Bankr. D. Kan. 2008) (same); *Wolf*, 390 B.R. at 833 (same); *In re Budig*, 387 B.R. 12, 16-17 (Bankr. N.D. Iowa 2008) (same); *In re Schubert*, 384 B.R. 777, 780 (Bankr. S.D. Ohio 2008) (same); *In re Walker*, 383 B.R. 830, 838 (Bankr. S.D. Ga. 2008) (same); *In re Stewart*, 383 B.R. 429, 433 (Bankr. N.D. Ohio 2008) (same); *In re Beckerman*, 381 B.R. 841, 845 (Bankr. E.D. Mich. 2008) (same); *In re Sullivan*, 370 B.R. 314, 320-21 (Bankr. D. Mont. 2007) (same); *In re McCune*, 358 B.R. 397, 399 (Bankr. D. Or.2006) (same); *Lenton*, 358 B.R. at 663 (same).

B. In the Context of a Section 707(b)(3)(B) Analysis, the Debtors' Moral Obligations to Their Family Members Do Not Alter the Text of Section

707(b)(3)(B) or Their Legal Obligations to Their Creditors Under the Bankruptcy Code

The Debtors suggest that, in the context of a section 707(b)(3)(B) analysis, their moral obligations to their family members should somehow trump their legal obligations to their creditors. *See* Appellant's Br. at 12-14. While the Debtors' decision to support their family members (in the form of continued mortgage payments for a home in Colorado in which Mr. Yuan's parents live but the Debtors do not) is commendable, **it is not supported by the law** in the context of a section 707(b)(3)(B) analysis. *See, e.g., In re Siemen*, 294 B.R. 276, 279 (Bankr. E.D. Mich. 2003) (debtors cannot subsidize family members at expense of creditors); *In re Staub*, 256 B.R. 567, 570 (Bankr. M.D. Pa. 2000) (same); *In re Haddad*, 246 B.R. 27, 32 (Bankr. S.D. N.Y. 2000) (same); *In re Duncan*, 201 B.R. 889, 897 (Bankr. W.D. Pa. 1996) (same); *In re Mastromarino*, 197 B.R. 171, 178-79 (Bankr. D. Me. 1996) (citing eight cases in support of same conclusion). The bankruptcy court below recognized this, and properly rejected this argument. *See* Appellee R. 11, at 32:4-32:14. This Court should conclude similarly.[7]

In construing section 707(b)(3)(B), this Court must apply the text of the statute as written. *See Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A.*, 530 U.S. 1, 6 (2000) ("when the statute's language is plain, the sole function of the courts–at least where the disposition required by the text is not absurd–is to enforce it according to its terms.") (internal quotations omitted). As previously explained, the text of section 707(b)(3)(B) requires the dismissal of a chapter 7 case for abuse if the debtor's "financial situation" demonstrates an ability to repay. *See* United States Trustee's Br., *supra*, at 10. A personally held moral belief is not a "financial situation." *Id*. at 11

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[7] This position is also supported by the legislative history to the 2005 Act, which states that in enacting the 2005 Act Congress sought "to ensure that debtors repay creditors the maximum they can afford." H.R. Rep. 109-31(I), at 2, 12.

(discussing factors court may consider in reviewing a debtor's "financial situation"). Therefore, the bankruptcy court below did not err in construing section 707(b)(3)(B).

Indeed, while many of the Debtors' creditors might believe that the "moral" thing for the Debtors to do is to repay their debts, section 707(b)(3)(B) simply does not consider such moral questions. If a court finds that a debtor's "financial situation" supports an abuse finding it may dismiss. *See* 11 U.S.C. § 707(b)(1) and (b)(3)(B). The bankruptcy court below made such a finding. It was not clearly erroneous. Therefore, it should be affirmed.

CONCLUSION

For these reasons, the United States Trustee respectfully asks this Court to affirm the order entered by below.

Respectfully Submitted,

Of Counsel:

RAMONA D. ELLIOTT
General Counsel

P. MATTHEW SUTKO
Associate General Counsel
DAVID I. GOLD
Trial Attorney
Executive Office for United States Trustees
United States Department of Justice
20 Massachusetts Avenue, N.W.
Washington, D.C. 20530
Ph: (202) 307-1399
Fax: (202) 307-2397

CHARLES F. McVAY
United States Trustee for Region 7

/s/ Valerie L. Wenger
Henry G. Hobbs, Jr.
Assistant United States Trustee
State Bar of Texas No. 0790116
Valerie L. Wenger
Trial Attorney
State Bar of Texas No. 21176300
Office of the United States Trustee
United States Department of Justice
903 San Jacinto Blvd., Rm. 230
Austin, TX 78701
(512) 916-5328

CERTIFICATE OF SERVICE

I certify that I forwarded a true and correct copy of the foregoing BRIEF OF APPELLEE CHARLES F. MCVAY, UNITED STATES TRUSTEE by prepaid first class mail to the persons listed below on this the 23rd day of December, 2009.

/s/ Valerie L. Wenger
Valerie L. Wenger

Appellants:
Hau Michael Yuan
Angela Lynn Eichhorst
801 W. 5th St., Apt. 2209
Austin, TX 78703

Appellants' Counsel:
David K. Sergei
David K. Sergei & Associates, P.C.
P.O. Box 887
San Marcos, TX 78666
and by electronic mail to david@sergeilaw.com

BRIEF BANK — “SUMMARY SHEET” *Printed Mon-6/23/08 15:43*

WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]* In re Shayna H. Zarnel, Diana M. Finlay, Lena M. Elmendorf (UST v. Zarnel, et al)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]* 2nd Cir.

3. ("CCN") ***CURRENT*** CASE NO. No.: 07-0090-bk

4. ("PCN") ***PRIOR*** CASE NO. & COURT *[IF ANY]*

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(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC*** **BANKRUPTCY**

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***

• Whether this court has jurisdiction to decide the U.S. Trustee’s Appeal. Where, As here, debtors fail to comply with section 109(h) of the bankruptcy code, the bankruptcy court must dismiss, rather than strike, the case.

10. PATH TO FILE LOCATION: (e.g., S:\OGC\BRFBANK\etc...)

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(consolidated)

IN THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

IN RE: SHAYNA H. ZARNEL, DIANA M. FINLAY, LENA M. ELMENDORF

DIANA G. ADAMS, United States Trustee,

Petitioner-Appellant,

v.

SHAYNA H. ZARNEL, DIANA M. FINLAY, LENA M. ELMENDORF,

Respondents-Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

BRIEF FOR APPELLANT IN RESPONSE TO BRIEF OF COURT-APPOINTED *AMICUS CURIAE*

MICHAEL J. GARCIA
United States Attorney
SEAN H. LANE
DANNA DRORI
Assistant U.S. Attorneys
86 Chambers Street, 3rd Fl.
New York, New York 10007

Of Counsel:

ROBERTA A. DEANGELIS
Acting General Counsel
P. MATTHEW SUTKO
Office of the General Counsel
Executive Office for U.S. Trustees
U.S. Department of Justice
20 Massachusetts Ave., N.W., Suite 8100
Washington, D.C. 20530

GREGORY G. KATSAS
Acting Assistant Attorney General

WILLIAM KANTER
(202) 514-4575
STEPHANIE R. MARCUS
(202) 514-1633
Attorneys, Appellate Staff
Civil Division, Room 7642
U.S. Department of Justice
950 Pennsylvania Ave., N.W.
Washington, D.C. 20530-0001

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INTRODUCTION AND SUMMARY OF ARGUMENT

The present appeal involves an issue that has arisen following Congress' enactment of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA"). Lower courts have divided over how to dispose of a case when a debtor fails to comply with Section 109(h), the new law's credit counseling requirement. The view of a substantial majority of courts -- and that of the United States Trustee[1] ("U.S. Trustee") -- is that where, as here, debtors have not obtained credit counseling or qualified for a temporary waiver of the requirement, their cases should be dismissed. In this case, however, the bankruptcy court denied the U.S. Trustee's motions to dismiss and struck debtors' cases. Because that decision is contrary to the Bankruptcy Code and congressional intent, and will cause substantial uncertainty in bankruptcy proceedings, the U.S. Trustee appealed to the district court. As demonstrated in our opening brief, the district court erred by dismissing the U.S. Trustee's appeal for lack of standing, and, in the alternative, affirming the bankruptcy court's decision on the merits.

1. As Amicus acknowledges (Br. 11-15), the U.S. Trustee has standing to appeal the bankruptcy court's denial of her motions to dismiss. Congress, in Section 307 of the Bankruptcy Code, expressly provided U.S. Trustees with standing to "raise and

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[1] Since we filed our opening brief, appellant Diana G. Adams (then-Acting U.S. Trustee) has been appointed United States Trustee. We changed the caption on our brief cover accordingly.

appear and be heard in any case or proceeding” arising under the Code. 11 U.S.C. § 307. As the courts of appeals that have addressed the issue have unanimously agreed, the U.S. Trustee therefore need not meet the “person aggrieved” standard applicable to private parties’ appellate standing.

2. Although Amicus agrees with the U.S. Trustee that the present appeal is justiciable, he suggests that, absent the exception to the mootness doctrine for cases that are "capable of repetition, yet evading review," this Court would lack jurisdiction. The present case is not moot. To the contrary, a ruling in the U.S. Trustee’s favor would affect the legal rights of the debtors <u>and</u> fully redress the U.S. Trustee’s injury.

3. The bankruptcy court’s decision to strike, rather than dismiss, debtors’ cases is contrary to the Bankruptcy Code and congressional intent, and will cause significant uncertainty in future bankruptcy proceedings. In contrast, the position of the U.S. Trustee that where, as here, a debtor fails to comply with Section 109(h), a court must dismiss the case, reflects a proper interpretation of the Bankruptcy Code, advances congressional intent, and avoids confusion. When an individual files a petition under Section 301, she has commenced a case and triggered the automatic stay. If and when the bankruptcy court later decides that the individual is ineligible to be a debtor under Section 109, the court should dismiss the case for cause.

ARGUMENT

I. THIS COURT HAS JURISDICTION TO DECIDE THE U.S. TRUSTEE'S APPEAL.

A. Standing

As noted, court-appointed Amicus concurs with the U.S. Trustee's contention that she has appellate standing. See Amicus Br. 11-15. We therefore rest on our opening brief on standing.

B. Mootness

Amicus suggests that the present appeal is moot, but falls within the exception to the mootness doctrine for cases that are "capable of repetition, yet evading review." Amicus Br. 15-18. This Court need not reach whether that exception applies, however, because the present appeal is not moot.

Under Article III of the Constitution, a case is moot only where a court is unable to grant the party alleging injury any effective relief. See Church of Scientology of Cal. v. United States, 506 U.S. 9, 12 (1992). So long as the court "can fashion *some* form of meaningful relief, even if it only partially redresses the grievances of the prevailing party, the appeal is not moot." In re United Artists Theatre Co., 315 F.3d 217, 226 (3d Cir. 2003) (internal quotations omitted). Indeed, "when an appellant retains an interest in a case so that a favorable outcome could redound in its favor, the case is not moot." In re Flanagan, 503 F.3d 171, 178 (2nd Cir. 2007).

Relying on the Seventh Circuit's nonprecedential order in In re Thompson, 249 Fed. Appx. 475 (7th Cir. 2007), Amicus contends (Br. 15-16), however, that if the U.S. Trustee prevails in the present appeal, "there will be no actual effect for either Debtors or their creditors." As set forth below, a ruling in the U.S. Trustee's favor would both affect the legal rights of the debtors and fully redress the U.S. Trustee's injury.

1. Affording Relief To The U.S. Trustee Would Affect Debtors' Rights Under The Bankruptcy Code.

If the U.S. Trustee prevails in this appeal, it would affect debtors' legal rights. First, the automatic stay would terminate after 30 days in any bankruptcy case that any of the debtors files within a year from the bankruptcy court's entry of dismissal on remand unless the debtor demonstrates good faith in the subsequent case. Second, the requested relief would make clear that the debtors must report the present case in any future bankruptcy proceeding in the next eight years.

2. Granting Relief To The U.S. Trustee Would Affect The Debtors' Statutory Right To An Automatic Stay.

a. Under BAPCPA, Congress Limited Application Of The Automatic Stay Where Debtors Had A Case Pending In The Prior Year That Was Dismissed.

As set forth in our opening brief (Br. 43), when Congress enacted BAPCPA, it amended 11 U.S.C. § 362, the automatic stay provision. Specifically, Congress provided for limited application of the automatic stay where a "single or joint case of the debtor was pending within the preceding 1-year period but was dismissed[.]" 11 U.S.C. § 362(c)(3) (emphasis added). In such cases, the automatic stay terminates on the 30th day after the debtor files the subsequent case unless the debtor "demonstrates that the filing of the later case is in good faith as to the creditors to be stayed." 11 U.S.C. § 362(c)(3)(A),(B). In addition, Congress provided that if "2 or more single or joint cases of the debtor were pending within the previous year but were dismissed," the automatic stay will not go into effect at the outset of the debtor's subsequent case unless the debtor can demonstrate that the later case is filed in good faith. 11 U.S.C. § 362(c)(4)(A),(B) (emphasis added).

As we explained (Br. 43-44), because the plain language of Section 362(c) applies solely to debtors whose prior cases were "dismissed," where a bankruptcy court strikes the petition and rules that a case never commenced, that proceeding likely would not count as a "case" "pending" in the prior year that was "dismissed" for the purposes of determining in a later case whether and when the automatic stay is triggered. In fact, in Thompson, the bankruptcy court, after determining that it would strike debtors' petition rather than dismiss their case, acknowledged that if the Thompsons did file a petition within a year, the "petition filed under this cause number will not count as a 'case pending and dismissed'" under Section 362(c). In re

Thompson, 344 B.R. 899, 908 (Bankr. S.D. Ind. 2006), aff'd, In re Thompson, No. 06-1033 (S.D. Ind. Dec. 4, 2006), vacated as moot, 249 Fed. Appx. 475 (7th Cir. 2007). In the present case, this Court therefore can afford the U.S. Trustee effective relief by reversing the district court decision, thereby requiring the bankruptcy court to dismiss debtors' cases on remand.

If this Court rules in the U.S. Trustee's favor, it thus will not only afford her effective relief, but will also affect debtors' legal status under the Bankruptcy Code. If any of the debtors files a bankruptcy petition within a year from the entry of dismissal on remand, she will need to seek affirmative relief from the bankruptcy court in order to continue the automatic stay for more than 30 days in the later case. 11 U.S.C. § 362(c)(3). Debtors' creditors would also be affected, since they would not have to go to the time and expense of moving for relief from the stay after 30 days have expired in the later case.

The statutory collateral effects on the debtors and their creditors that would result from a court order granting the U.S. Trustee relief demonstrate that the present appeal is not moot, and provide the debtors with "a stake in the outcome of this litigation." See A.M. v. Butler, 360 F.3d 787, 790 & n.4 (7th Cir. 2004). These statutory effects are particularly significant in light of debtors' history of bankruptcy filings: (1) when debtor Diana Finlay filed her petition in the present case, it was her third bankruptcy filing within a year (see Op. 5, Appendix ("A")-17); (2) debtor Shayna Zarnel's husband had filed five bankruptcy petitions since January 2004 (Op. 6, A-18); and (3) debtor Lena Elmendorf filed another Chapter 7 petition after the bankruptcy court struck the present case. See Docket, In re Elmendorf, No. 06-35926 (Bankr. S.D.N.Y.) (case closed without discharge for failure to file Official Form 23). And whether or not they file for bankruptcy within a year from when a dismissal is ultimately entered on remand, debtors' legal status with respect to filing a petition under the Bankruptcy Code, at least in the following year, will have changed.

b. Debtors' Cases Remain "Pending" Within The Meaning Of Section 362(c) Of The Bankruptcy Code.

Amicus argues (Br. 15-16), however, that the one-year period in which Section 362 limits applicability of the stay has already expired – i.e., it expired one year after the bankruptcy court issued its order striking debtors' cases. In its nonprecedential order in Thompson, the Seventh Circuit reached the same conclusion without analysis. See 249 Fed. Appx. at 476. This Court should reject that interpretation of Section 362(c) because it conflicts with the plain language of the statute; in particular, the definition of the word "pending." Section 362(c) expressly refers to cases that were "pending within the preceding 1-year period but w[ere] dismissed[.]" 11 U.S.C. § 362(c)(3). Debtors' cases commenced when they filed their petitions, and remain pending to this day. The cases are currently "pending" before this Court, since the U.S. Trustee timely appealed the bankruptcy court's orders to the district court, and timely appealed the district court's judgment to this Court.

1. Although the Bankruptcy Code does not define "pending," under the ordinary meaning of the term, a case is "pending" when it has not been finally resolved. Indeed, Black's Law Dictionary defines "pending" as "[r]emaining undecided; awaiting decision." Black's Law Dictionary, 8th Ed. (2004) at 1169; C.F. Trust, Inc. v. Tyler, 318 B.R. 795, 806 (E.D. Va. 2004) (phrase "'pending litigation' plainly encompasses all matters that were then 'pending'" in the case, "whether in the Court of Appeals or the district court"; case is "'pending' if it remains unresolved").

The Supreme Court has applied the ordinary meaning of "pending" in the context of time limits for filing federal petitions for habeas corpus. See Carey v. Saffold, 536 U.S. 214, 219-220 (2002). In Carey, the Court addressed the meaning of the term "pending" in 28 U.S.C. § 2244(d)(2), which provides that "time during which a properly filed application for State post-conviction or other collateral review with respect to the pertinent judgment or claim is pending shall not be counted toward any period of limitation under this subsection." 28 U.S.C. § 2244(d)(2) (emphasis added). The Court held that a prisoner's application for state collateral review remains "pending" within the meaning of Section 2244(d)(2) "as long as the ordinary state collateral review process is 'in continuance,'" which includes the "interval between a lower court's entry of judgment and the timely filing of a notice of appeal (or petition for review) in the next court." 536 U.S. at 219-220. As the Court explained, its interpretation was consistent with the ordinary meaning of "pending": "The dictionary defines 'pending' * * * as 'in continuance' or 'not yet decided.'" Id. at 219. Thus, the Court reasoned, until a prisoner's application for review "has achieved final resolution through the State's post-conviction procedures, by definition it remains 'pending.'" Id. at 220.

Under this reasoning, debtors' cases remain "pending" while on appeal before the district court and the court of appeals. Because the bankruptcy court's orders striking debtors' cases and denying the U.S. Trustee's motions to dismiss did not finally resolve debtors' cases in light of the U.S. Trustee's timely appeals, such cases remain "pending" within the meaning of 11 U.S.C. § 362(c).

2. To support its interpretation, Amicus does not address the plain meaning of the term "pending." Rather, Amicus argues (Br. 16-17) that the U.S. Trustee's interpretation would be inconsistent with Congress's purpose because "a debtor would be forced to endure the restrictions on the automatic stay long after the bankruptcy court resolved the petition and for a period with no correlation to the prior filing."

As an initial matter, such a policy argument cannot trump the plain language of the statute. Connecticut Nat'l Bank v. Germain, 503 U.S. 249, 253-54 (1992) ("[w]e have stated time and again that courts must presume that a legislature says in a statute what it means and means in a statute what it says there"); Collazos v. United States, 368 F.3d 190, 199 (2d Cir. 2004). In any event, the U.S. Trustee's interpretation of Section 362(c) is entirely consistent with Congress's purpose in enacting BAPCPA. By amending Section 362 to limit application of the automatic stay when a debtor had a prior case dismissed in the preceding year, Congress intended to discourage debtors from "bad faith repeat filings." H.R. Rep. No. 31(I), 109th Cong., 1st Sess. at 69 (2005), *reprinted in* 2005 U.S.C.C.A.N. 88, 138. At the same time, however, Congress recognized that such limitations could prove overly harsh as applied in particular cases and therefore provided a debtor who had a prior case dismissed in the preceding year with the opportunity to obtain a continuation of the stay if she demonstrates that she filed the subsequent case in "good faith." 11 U.S.C. §§ 362(c)(3)(B);(c)(4)(B).

Thus, if a debtor has a prior dismissal in the preceding year only because her earlier case was pending for several years due to another party's appeal, she could file a motion for continuation of the stay, which the bankruptcy court could grant if it found that she was acting in good faith in the new bankruptcy proceeding. See In re Seaman, 340 B.R. 698, 709 (Bankr. E.D.N.Y. 2006) (Congress, through enactment of provision allowing debtor to seek continuance of automatic stay in subsequent case, "intended that in appropriate circumstances, a debtor or other party in interest could move promptly to reinstate the protections of the automatic stay").

3. Granting Relief To The U.S. Trustee Affects Debtors' Reporting Requirements In Subsequent Bankruptcy Cases.

In addition, even apart from any impact on the automatic stay, if this Court grants the U.S. Trustee's requested relief, it will affect debtors' reporting requirements in any subsequent bankruptcy filings within the next eight years. See Gov't Br. 48. Official bankruptcy forms require debtors to inform the court of all prior bankruptcy "cases" filed in the past eight years. See Voluntary Petition Official Form 1 at 2. Absent relief from this Court, debtors could believe that because their cases were stricken, and because the bankruptcy court held that they never commenced a case, they are not required to report the present case when they file a subsequent petition. In contrast, if this Court reverses the district court, holds that a case "commenced," and remands for an entry of dismissal by the bankruptcy court, it will be clear that debtors must report the present case. This reporting requirement helps the U.S. Trustee monitor bankruptcy proceedings for abuse by repeat filers. And requiring debtors to report the dismissed case could affect their rights in subsequent bankruptcy cases with respect to, for example, any issue that arises regarding good faith where their history of prior filings is relevant.[2]

4. The U.S. Trustee Is Acting To Protect The Public Interest In Bankruptcy Proceedings, And She Has Suffered An Injury In That Capacity That May Still Be Fully Redressed.

The U.S. Trustee's appeal also satisfies the requirement that the party seeking relief has an injury that can be redressed. As noted, the U.S. Trustee moved to dismiss debtors' cases. The bankruptcy court denied the U.S. Trustee's motions, and the district court affirmed. A reversal by this Court would make clear that the bankruptcy court lacked authority to strike the petition, and would require dismissal of debtors' cases on remand. The U.S. Trustee, who is acting to protect the public interest by ensuring that bankruptcy proceedings are conducted in accordance with the Code, has therefore suffered an injury that can be fully redressed by a favorable decision by this Court.

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[2] In discussing the merits of whether a bankruptcy court should strike a petition or dismiss a case where a debtor has not complied with the credit counseling requirement, Amicus argues (Br. 30 n.11) that the "form accompanying bankruptcy filings could – and, indeed, post-BAPCPA probably should – be changed to seek information about the number of 'petitions' filed." The fact remains, however, that over two years have passed since BAPCPA was enacted, and the form still refers to "cases." Speculation about whether the form could or should be changed does not affect the mootness question.

The U.S. Trustee’s appeal is thus distinguishable from cases in which a plaintiff or appellant no longer has a stake in the litigation, and the Court is accordingly unable to provide effective relief. Unlike, for example, a student who has graduated from school and no longer has a cognizable interest in school policies or regulations, a prisoner who has been released from prison, or a company that has sold its business, the U.S. Trustee’s stake in the present litigation has not changed: she is acting to advance the public interest and to ensure proper and consistent interpretation of the Code.[3]

The Supreme Court recognized this distinction when it held that a school desegregation case that otherwise would have become moot when plaintiff students graduated presented a live case or controversy because the United States had intervened. Pasadena City Bd. Of Educ. v. Spangler, 427 U.S. 424 (1976). Like the present case, where Congress conferred standing on the U.S. Trustee to raise and appear “on any issue” in “any case or proceeding” under the Bankruptcy Code (11 U.S.C. § 307), in Pasadena City Bd., the United States had a statutory right to intervene in the students’ private action. See 427 U.S. at 430 (citing 42 U.S.C. § 2000h-2). In such circumstances, even if the

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[3] See In re Columbia Gas Syst., Inc., 33 F.3d 294, 296-99 (3d Cir. 1994); In re Clark, 927 F.2d 793, 795-96 (4th Cir. 1991); In re Revco D.S., Inc., 898 F.2d 498, 499-500 (6th Cir. 1990); In re Mason, 2007 WL 433077 at *1 (E.D. Ky. Feb. 5, 2007).

plaintiffs who originally filed that private action could no longer obtain effective relief, the United States, which had a public interest stake in ensuring that municipal school boards did not violate students' constitutional rights, could continue with the litigation. See id.

It is in her role in ensuring that bankruptcy proceedings are conducted in accordance with the Code that the U.S. Trustee is injured. And this injury is not in any sense moot, since an order from this Court reversing the district court, thereby requiring dismissal of debtors' cases on remand, would afford effective relief. At the same time, the U.S. Trustee's injury in this case is specific to debtors, as debtors failed to comply with Section 109(h) of the Bankruptcy Code, and their cases therefore should have been dismissed as set forth in the U.S. Trustee's motions in bankruptcy court. Those motions were clearly adverse to debtors in bankruptcy court, and, as outlined above, the U.S. Trustee's appeal remains adverse to debtors' interests.[4] The relief that the U.S. Trustee seeks on appeal would require debtors to file a motion demonstrating good faith in any subsequent bankruptcy case that they file within a year

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[4] Contrary to Amicus' suggestion (Br. 18 n.6), the U.S. Trustee thus is not arguing that, in light of its public interest standing, there need not be a case or controversy under Article III. As we have demonstrated, this case satisfies Article III requirements because a decision in the U.S. Trustee's favor on appeal would fully redress its injury and would affect debtors' statutory rights under the Bankruptcy Code.

from entry of dismissal on remand in order to extend the automatic stay past 30 days; without such relief, debtors are free to file a petition within a year without prejudice. The requested relief would also make clear that debtors must report the present case in any future bankruptcy proceeding in the next eight years, thus making the U.S. Trustee's enforcement and monitoring role easier and more accurate with respect to debtors.

In sum, this case is not moot "because [appellant] has a stake in the outcome of the proceeding and a federal court can effectuate relief should [appellant] prevail on the merits." Church of Scientology, 506 U.S. at 18 n.11.

5. If This Court Disagrees, And Determines That The Appeal Is Moot, It Should Vacate The Decisions Of The Lower Courts.

As demonstrated above, this appeal is not moot. This Court therefore need not reach Amicus' contention (Br. 17-18) that the appeal falls within the exception to the mootness doctrine for cases that are "capable of repetition yet evading review." Should this Court disagree with the U.S. Trustee and Amicus that the case is justiciable, however, it should vacate the decisions of both the district court and the bankruptcy court. See United States v. Munsingwear, Inc., 340 U.S. 36, 39-40 (1950) ("established practice" of Supreme Court when case becomes moot on appeal is to vacate judgment of lower courts); Van Wie v. Pataki, 267 F.3d 109, 115 (2d Cir. 2001).

II. WHERE, AS HERE, DEBTORS FAIL TO COMPLY WITH SECTION 109(h) OF THE BANKRUPTCY CODE, THE BANKRUPTCY COURT MUST DISMISS, RATHER THAN STRIKE, THE CASE.

As we demonstrated in our opening brief, when a debtor does not comply with the credit counseling requirement in Section 109(h) of the Code, the bankruptcy court should dismiss the case rather than strike the case or petition. Indeed, there is no authority in the Bankruptcy Code for striking a petition or case in these circumstances. The U.S. Trustee’s position that a bankruptcy court should dismiss such cases is consistent with the Bankruptcy Code, congressional intent, and the holdings of a substantial majority of courts that have addressed the issue.[5] Amicus advances several arguments in support of its position that the bankruptcy court had authority to strike debtors’ petitions rather than dismiss their cases. None of these arguments is persuasive, however.

A. Debtors Commenced Cases Within The Meaning Of Section 301 Of The Bankruptcy Code.

Amicus argues that bankruptcy courts should strike petitions of ineligible debtors because such debtors cannot commence cases

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[5] See Gov’t Br. 31-32 & n.16. Since we filed our brief, three additional bankruptcy courts have determined that dismissal of the case is the appropriate disposition where a debtor has failed to comply with the credit counseling requirement. In re Francisco, – B.R. –, 2008 WL 244172 (Bankr. D. N.M. 2008); In re Falcone, 370 B.R. 462 (Bankr. D. Mass. 2007); In re Gossett, 369 B.R. 361 (Bankr. N.D. Ill. 2007). One district court has affirmed a bankruptcy court’s decision to strike a petition. Wyttenbach v. Commissioner, 382 B.R. 726 (S.D. Tex. 2008), appeal pending, 5th Cir. No. 08-40321.

under Section 301 of the Code.[6] Pursuant to Section 301, a "voluntary case under a chapter of this title is commenced by the filing with the bankruptcy court of a petition under such chapter by an entity that may be a debtor under such chapter." 11 U.S.C. § 301(a). Amicus argues (Br. 19-21) that there were no "cases" for the bankruptcy court to dismiss because, under Section 301, a case commences only where a petition is filed under a chapter of the Bankruptcy Code by an entity "that may be a debtor under such chapter." Amicus contends (Br. 19-20) that an individual who files a petition without complying with Section 109(h) "may not be a debtor" under the Bankruptcy Code, and thus cannot commence a case under Section 301.

1. Although Amicus purports to rely on the plain language of the Code to support its interpretation, neither the term "may" nor the phrase "may be a debtor" is defined in the Bankruptcy Code. See 11 U.S.C. § 101 (definitions). It is therefore appropriate to refer to the ordinary usage of the term "may," which "as used in § 301 of the Bankruptcy Code means 'might' or is meant to express a 'possibility.'" In re Tomco, 339 B.R. 145, 159 (Bankr. W.D. Pa. 2006).

Amicus argues (Br. 21), however, that in Section 109,

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[6] Although the bankruptcy court below struck debtors' cases, Amicus advocates striking debtors' petitions, and "understands the bankruptcy court to have struck the petitions" despite the clear language of the court's orders striking the cases. A-49-51.

Congress defined the phrase "may be a debtor" for purposes of Section 301 "to *exclude* individuals that do not comply with the credit-counseling requirements." Contrary to Amicus' argument, Section 109 nowhere defines the sense in which Congress used the term "may" or the phrase "may be a debtor" in Section 301. Rather, Section 109 delineates who "may be a debtor" for purposes of determining eligibility for bankruptcy relief under various chapters of the Bankruptcy Code once a case has already commenced; it does not delineate who can commence a case for purposes of Section 301. Because determining whether an individual is eligible to be a debtor under the various subsections of Section 109 (including 109(h)) is often unclear from the face of the petition and may involve disputed issues of fact and law, a debtor who files a petition "may be a debtor" for purposes of commencing a case under Section 301, but nonetheless may subsequently be found ineligible for bankruptcy relief under Section 109. In re Ross, 338 B.R. 134, 138 (Bankr. N.D. Ga. 2006); Tomco, 339 B.R. at 159; Seaman, 340 B.R. at 707; In re Flores, 291 B.R. 44, 61 (Bankr. S.D.N.Y. 2003). Otherwise, numerous bankruptcy cases would be legal nullities, even if they had remained pending for years due to a legal or factual dispute over eligibility under Section 109.

In fact, Amicus' interpretation of how Section 109 limits the phrase "entity that may be a debtor" in Section 301 would apply equally to other subsections of Section 109, because that section as a whole -- not solely subsection (h) –- covers "who may be a debtor" under particular chapters of the Bankruptcy Code. See 11 U.S.C. § 109. Such a result is unworkable because of the uncertainty that it would create in bankruptcy proceedings. E.g., Seaman, 340 B.R. at 707 (striking case would cause questions about "existence and willfulness of an automatic stay violation, and the validity of an action against property taken by a creditor of a petitioner who appears ineligible to be a debtor but later is determined to be eligible"); Ross, 338 B.R. at 140. Creditors and other parties "will not know whether a valid case exists without investigation," and "even if bankruptcy courts can fashion doctrines to avoid unfair results in such void *ab initio* situations, the fact remains that substantial uncertainty will cloud every transaction related to a bankruptcy case." Ross, 338 B.R. at 140-141; In re Jones, 352 B.R. 813, 823-824 (Bankr. S.D. Tex. 2006) (Section 349 of Code addresses effects of dismissals, not effects of striking of petition).

Amicus acknowledges (Br. 21-22) that there may be "proceedings in the bankruptcy court prior to a definitive ruling on whether an individual is eligible to commence a case," but contends that this is no different from the determinations a court must make to decide whether it has subject matter jurisdiction. Amicus' analogy to determinations of subject matter jurisdiction is telling. As noted (Gov't Br. 28-29), when a federal court lacks subject matter jurisdiction, it dismisses the case, it does not strike the complaint or case as a nullity.[7]

Moreover, when a court dismisses a case for lack of subject matter jurisdiction, it is clear that in a subsequent case, the jurisdictional ruling has preclusive effect. A "dismissal for lack of jurisdiction precludes relitigation of the issue actually decided, namely the jurisdictional issue." Perry v. Sheahan, 222 F.3d 309, 318 (7th Cir. 2000); Insurance Corp. Of Ir., Ltd. v. Compagnie des Bauxites de Guinee, 456 U.S. 694, 702 n.9 (1982). In contrast, if every time a court held that it lacked jurisdiction (or, by analogy, if every time a court held that a debtor is ineligible), the entire proceeding became a legal nullity, then the applicability of doctrines such as res judicata and issue preclusion would become highly uncertain.[8] In short, contrary to Amicus' assertion (Br. 30), striking a petition on the ground that a debtor who is ineligible under Section 109(h)

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[7] E.g., Makarova v. United States, 201 F.3d 110 (2d Cir. 2000); Close v. State of New York, 125 F.3d 31 (7th Cir. 1997) (same); see Fed. R. Civ. P. 12(h)(3).

[8] See, e.g., Ross, 338 B.R. at 140 (if "there is a case before the court," then "[d]octrines of waiver or *res judicata* provide potential legal bases for fair resolution" of problems that might arise in case filed by ineligible debtor; however, such doctrines "may be unavailable if the case is void *ab initio*"); Jones, 352 B.R. at 824 (questions that arise from holding that petition filed by ineligible debtor is nullity include "when and how" issue decided prior to striking petition "becomes *res judicata*").

cannot commence a case does create uncertainty and the potential for prejudice to parties to bankruptcy proceedings.[9]

2. In addition, the position of Amicus and the courts below that a debtor who has not complied with Section 109(h) cannot commence a case under Section 301 would apply equally to situations in which individuals file a petition under the wrong chapter of the Code. 11 U.S.C. § 109. Section 301 expressly provides that a "voluntary case under a chapter of this title is commenced by the filing with the bankruptcy court of a petition under such chapter by an entity that may be a debtor under such chapter." 11 U.S.C. § 301 (emphasis added). If Amicus' argument that Section 109 defines the term "may be a debtor" for purposes of Section 301 were adopted, then a petition filed by an individual who is eligible to be a debtor under the Bankruptcy Code, but files a petition under the wrong chapter, would be a legal nullity. That is because under Amicus' interpretation of the plain language, that debtor would not commence a case because

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[9] Moreover, as we explained (Br. 47-48), striking petitions and holding that an ineligible debtor does not commence a case could cause various practical problems involving reporting requirements, filing fees and compensation of trustees. Whether or not these problems could be resolved by changing a bankruptcy form, or by ruling a particular way (cf. Amicus Br. 30 n.11), the point remains that if the U.S. Trustee's position is adopted, bankruptcy courts would not even have to raise such questions, much less answer them: A case would exist until a court determines that the debtor is ineligible, at which time the court would dismiss the case, thus making it clear how such case should be treated for purposes of both limitations on the automatic stay in future cases and for reporting requirements.

she is not an "entity that may be a debtor under such chapter."

Indeed, if adopted, Amicus' argument would extend to a debtor who files a petition under Chapter 13 but is ineligible under Section 109(e). Could a court still convert the Chapter 13 petition to a Chapter 7 petition rather than strike it? The answer provided by the Bankruptcy Code is yes: Section 1307(c) states that "on request of a party in interest or the United States trustee and after notice and a hearing, the court may convert a case under this chapter to a case under chapter 7 of this title." 11 U.S.C. § 1307(c). And, as courts have recognized, ineligibility under Chapter 13 is a valid ground for conversion to Chapter 7. See, e.g., Rudd v. Laughlin, 866 F.2d 1040, 1041 (8th Cir. 1989) (where debtor files Chapter 13 petition but is ineligible under Section 109(e), court has jurisdiction to convert to Chapter 7 and case is not legal nullity); In re Jones, 129 B.R. 1003, 1009 (Bankr. N.D. Ill.) ("the converted case is commenced by the filing of the petition even if the debtor was not eligible for relief under the chapter named in the petition"), aff'd, 134 B.R. 274 (N.D. Ill. 1991).[10]

Under Amicus' logic, however, the bankruptcy court would be

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[10] As the Jones court observed in response to the argument that the filing of a petition by a debtor ineligible under Section 109(e) did not commence a case, "it is metaphysical to argue that there is no 'case' here. If there is no 'case,' then what are the parties doing here and what is that thick file doing in the Clerk's office?" 129 B.R. at 1010.

required to strike the petition as a legal nullity in such circumstances because it did not commence a case. That result demonstrates the flaw in Amicus' purported "plain language" argument -- according to Amicus' interpretation of the phrase "may be a debtor," in Section 301, in order to commence a case, an individual must be eligible pursuant to the particular chapter under which she filed her petition. Otherwise, the petition does not commence a case, and if there is no "case" to dismiss, presumably there is no "case" to convert.

3. Moreover, the "words 'entity that may be a debtor'" that appear in Section 301 "have been in the [Bankruptcy Code] from the outset." In re Francisco, -- B.R. –, 2008 WL 244172 (Bankr. D. N.M. 2008) at *6. There is thus "a usage for that language that predates the enactment of § 109(h)(1) and does not mandate striking the petition for a violation of § 109(h)(1)." Id. Indeed, before the enactment of the credit counseling requirement in Section 109(h), courts routinely dismissed, not struck, cases where the debtor was ineligible under other subsections of Section 109.[11] When Congress enacted BAPCPA, it therefore "was legislating against a background of (1) cases under various chapters dismissed for ineligibility pursuant to § 109," and "(2)

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[11] See, e.g., In re Mazzeo, 131 F.3d 295, 301 (2d Cir. 1997); In re C-TC 9th Ave. P'ship, 113 F.3d 1304, 1313 (2d Cir. 1997); Matter of Estate of Medcare HMO, 998 F.2d 436, 447 (7th Cir. 1993); In re Seaman, 340 B.R. 698, 707 (Bankr. E.D.N.Y. 2006); see Bankr. Op. 24, A-36.

cases not found void *ab initio* for violations of § 109(g)." Id. at *7. Congress did not indicate that the newly-enacted credit counseling requirement in Section 109(h) should be treated any differently from the other eligibility requirements in Section 109. Id.; In re Gossett, 369 B.R. 361, 373-374 (Bankr. N.D. Ill. 2007) ("[t]here is no indication that Congress intended to treat § 109(h) ineligibility any different than any other form of ineligibility in § 109"; thus, dismissal is proper disposition where debtor has failed to comply with § 109(h)).

B. Amicus' Position That The Bankruptcy Court Had Authority To Strike Debtors' Petitions Finds No Support In The Bankruptcy Code And Is Contrary To Congressional Intent.

1. Amicus contends (Br. 25-26) that the U.S. Trustee's reliance on pre-BAPCPA cases that routinely dismiss cases filed by debtors who are ineligible under Section 109 is unsound because "until recently, courts had little reason to be concerned with whether an ineligible debtor's petition should be stricken or his case should be dismissed," whereas after BAPCPA, the results of dismissal can lead to limitation of the automatic stay in future cases. This argument is unavailing. Indeed, "the fact that the consequences of a dismissal are potentially more dire does not by itself warrant a change in what leads to dismissals." Francisco, – B.R. –, 2008 WL 244172 at *7. Moreover, Amicus' position conflicts with Congress's purpose in enacting BAPCPA; indeed, "various provisions of BAPCPA * * * belie any notion that

Congress wrote BAPCPA to benefit debtors."[12] Id.

2. In the alternative, Amicus contends (Br. 26) that, in any event, "it was far from universal before BAPCPA that a bankruptcy court would dismiss a case upon the filing of a petition by an ineligible debtor." In support of this argument, Amicus cites two cases for the proposition that pre-BAPCPA, "several courts struck petitions filed by debtors" found ineligible under Section 109(g). Amicus Br. 26 (citing Rowe v. Ocwen Fed. Bank & Trust, 220 B.R. 591 (E.D. Tex. 1997), aff'd, 178 F.3d 1290 (5th Cir. 1999); In re Keziah, 46 B.R. 551 (Bankr. W.D.N.C. 1985)). But only Keziah involves the striking of a petition (46 B.R. at 555); contrary to Amicus' suggestion, the district court in Rowe repeatedly refers to the bankruptcy court's "dismissal, with prejudice" of debtor's petition because he was ineligible under Section 109(g). Rowe, 220 B.R. at 592-595 (emphasis added). By citing one pre-BAPCPA case in which a court struck a petition, Amicus has failed to cast doubt on the U.S. Trustee's point, and that of the bankruptcy courts upon which she relied, that a substantial majority of courts dismissed, not struck, cases in which debtors were found ineligible under Section 109 pre-BAPCPA. Moreover, Keziah says

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[12] For example, as noted (Gov't Br. 43), in BAPCPA, Congress sought to prevent repeat bankruptcy filers from abusing bankruptcy proceedings by limiting application of the automatic stay where the debtor had a prior case dismissed in the preceding year. 11 U.S.C. §§ 362(c)(3), 362(c)(4).

nothing about Section 301 and the meaning of "entity that may be a debtor" thereunder, nor does it cite any Code provision that authorizes striking a petition as opposed to dismissing the case.

Amicus and the courts below contend, however, that 11 U.S.C. 105(a) provides the bankruptcy court with authority to strike debtors' petitions. Specifically, Amicus argues (Br. 27) that Section 105(a) of the Code allows the bankruptcy court to "effectuate the plain language of § 301 and fill in the interstices of the Code by striking the petition." But as we have shown (Gov't Br. 33-34), Section 105(a), which grants the bankruptcy court authority to "issue any order, process or judgment that is necessary or appropriate to carry out the provisions of [the Code]," by its terms limits the bankruptcy court's equitable power to "carrying out the *provisions* of the Bankruptcy Code, rather than to further the purposes of the Code generally, or otherwise to do the right thing." In re Dairy Mart Convenience Stores, Inc., 351 F.3d 86, 92 (2d Cir. 2003). While provisions of the Code authorize the dismissal of cases for cause, the Code does not provide for the striking of a case or petition. Gov't Br. 29-31, 33-34. Amicus and the courts below thus err by relying on Section 105, because it does not allow the bankruptcy court to take an action that is not authorized under the provisions of the Code.[13] In re Mason, 2007 WL 433077 at *3.

C. Amicus Bases Its Position That The Automatic Stay Is Triggered Even If A Case Does Not Commence On An Additional Error Of Statutory Interpretation.

Amicus parts ways with the bankruptcy court below by arguing that the automatic stay is invoked by a debtor who files a petition without complying with Section 109(h).[14] Amicus Br. 22-

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[13] Nor do Fed. R. Bankr. P. 9011 and 7012(b) advance Amicus' argument. Amicus acknowledges (Br. 28) that neither rule "provides express authorization for the striking of a petition," but claims that they show that "striking a petition is within a bankruptcy court's arsenal of remedies." But as we demonstrated (Gov't Br. 34-35), these rules give the bankruptcy court authority to strike a pleading or portion thereof under specific, limited circumstances that are inapplicable here. See Fed. R. Bankr. P. 9011 (authority to strike unsigned filing if, after receiving notice, party fails to promptly correct omission of signature); Fed. R. Bankr. P. 7012(b) (incorporating Fed. R. Civ. P. 12(e),(f) in adversary proceedings).

[14] Amicus agrees with our position (Gov't Br. 39 n.18) that this Court's pre-BAPCPA decision in In re Casse, 198 F.3d 327 (2d Cir. 1999) does not cast doubt on the conclusion that the automatic stay is invoked. As Amicus states (Br. 25), in Casse, "this Court implicitly recognized that, while an ineligible debtor's filing of a petition triggers the automatic stay, it can be annulled under § 362 on a case-by-case basis[.]"

We disagree with Amicus, however, with respect to his contention (Br. 24) that the Court in Casse concluded "that the ineligible debtor's case was void *ab initio* (in essence, that the debtor had never commenced a case)[.]" Casse did not discuss whether a case commenced under Section 301. In any event, as we explained (Gov't Br. 39 n.18), Casse is distinguishable. First, it did not involve the statutory restriction on eligibility in Section 109; rather, it involved a case in which the debtor violated a prior court order, issued pursuant to the bankruptcy court's authority under Sections 349(a) and 105(a), barring him from filing a subsequent petition. Second, Casse was decided pre-BAPCPA, before Congress's enactment of Section 362(b)(21)(A) made clear its understanding that, in the absence of an express statutory exception to the stay, a petition filed under Section

24; Thompson, 344 B.R. at 906. Amicus' position that the stay is invoked is in significant tension with his position that a petition filed by a debtor ineligible under Section 109 does not commence a case under Section 301. If a petition is a legal nullity that should be stricken from the record, how can it invoke the automatic stay? Like the bankruptcy court in Thompson (344 B.R. at 906), Amicus attempts to reconcile his contradictory positions by arguing that, under Section 362, the mere "filing of a petition operates as a stay" -- regardless of whether the petition commences a case. Amicus Br. 23.

By arguing that the automatic stay is triggered even if a case does not commence under Section 301, Amicus and the Thompson bankruptcy court introduce an additional error of statutory interpretation. Under Section 362(a), "[e]xcept as provided in subsection (b) of this section, a petition filed under section 301, 302 or 303 of this title * * * operates as a stay." 11 U.S.C. § 362(a). Thus, Section 362(a) expressly refers to petitions filed under Sections 301, 302 or 303, which in turn set forth when voluntary, joint or involuntary cases commence under the Bankruptcy Code. 11 U.S.C. §§ 301, 302, 303; see Bankr. Op. 17, A-29. If a case commences, the automatic stay thus takes effect; conversely, if a case does not commence, the automatic

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109(g) "commences a case and results in an automatic stay." Ross, 338 B.R. at 139.

stay is not triggered. It is illogical to argue, as Amicus does, that a petition that should be stricken as a legal nullity nonetheless has the substantial legal effect of invoking the protection of the automatic stay.

Moreover, by taking the position that a petition filed by a debtor ineligible under Section 109(h) does not commence a case but nonetheless triggers the automatic stay, Amicus manages not only to conflict with courts that have held that a case commences when an ineligible debtor files a petition, but also with the bankruptcy court below.[15] Bankr. Op. 17, A-29 ("[a] straightforward reading of § 362(a) indicates that the automatic stay comes into existence only when a case is filed in accordance with §§ 301, 302 or 303 of the BAPCPA"). This inconsistency among courts that advocate striking is also exemplified by the conflict between Wyttenbach v. Commissioner, 382 B.R. 726 (S.D. Tex. 2008), appeal pending, 5th Cir. No. 08-40321, upon which Amicus relies (Br. 24, 28 n.10), and Amicus' position regarding whether the automatic stay is invoked. See Wyttenbach, 382 B.R. at 730 (relying on bankruptcy court holding that striking petition appropriate because stay would not be invoked if

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[15] Amicus' reliance on In re Brown, 342 B.R. 248 (Bankr. D. Md. 2006) illustrates this conflict. Although Brown supports Amicus' position on the automatic stay, it does not support Amicus' argument that there is no "case" to dismiss when a debtor is ineligible. To the contrary, in Brown, the court dismissed debtor's case when it found that her certification of credit counseling was insufficient. 342 B.R. at 250.

petition were struck as legal nullity).

That there is no unified view of the effect of a court’s striking of a case or petition underscores the uncertainty caused by the bankruptcy court’s decision below to strike, rather than dismiss, debtors’ cases. In contrast, the U.S. Trustee’s position that the filing of a petition by a debtor ineligible under Section 109(h) commences a case and invokes the automatic stay is consistent with the plain language of Section 362(a) and with the numerous courts that have held that dismissal is appropriate where a debtor is ineligible under Section 109(h).

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In short, the U.S. Trustee’s position, and that of the majority of courts that have addressed the issue, is consistent with the Bankruptcy Code, reflects congressional intent in enacting BAPCPA and avoids confusion. Thus, this Court should hold that the filing of a petition with the bankruptcy court commences a case under Section 301 and invokes the automatic stay. If and when the bankruptcy court ultimately decides that an individual is ineligible to be a debtor, the court should dismiss the case, and the stay will then terminate.

CONCLUSION

For the foregoing reasons, the judgment of the district court should be reversed.

Respectfully submitted,

MICHAEL J. GARCIA
United States Attorney
SEAN H. LANE
DANNA DRORI
Assistant U.S. Attorney
86 Chambers Street, 3rd Fl.
New York, New York 10007

GREGORY G. KATSAS
Acting Assistant Attorney General

WILLIAM KANTER
(202) 514-4575
STEPHANIE R. MARCUS
(202) 514-1633
Attorneys, Appellate Staff
Civil Division, Room 7642
U.S. Department of Justice
950 Pennsylvania Ave., N.W.
Washington, D.C. 20530-0001

Of Counsel:

ROBERTA A. DEANGELIS
Acting General Counsel
P. MATTHEW SUTKO
Office of the General Counsel
Executive Office for U.S. Trustees
U.S. Department of Justice
20 Massachusetts Ave., N.W., Suite 8100
Washington, D.C. 20530

JUNE 2008

CERTIFICATE OF COMPLIANCE WITH FED. R. APP. P. 32(a)

I hereby certify that the foregoing brief complies with the typeface requirements in Fed. R. App. 32(a)(5), the page and type-volume limitation in Fed. R. App. P. 32(a)(7) and this Court’s February 15, 2008 Order. The brief was prepared in a monospaced font (Courier New) that has 10.5 or fewer characters per inch. The brief is 30 pages long, excluding those parts of the brief set forth in Fed. R. App. P. 32(a)(7)(B)(iii).

Stephanie R. Marcus

ANTI-VIRUS CERTIFICATION FORM

See Second Circuit Interim Local Rule 25(a)(6)

CASE NAME: In re: Shayna H. Zarnel, Diana M. Finlay, Lena M. Elmendorf

DOCKET NUMBER: 07-0090-bk(lead), 07-0091-bk, 07-0092-bk, 07-0097-bk,
07-0098-bk, 07-0099-bk (consolidated).

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I hereby certify that on this 18th day of June, 2008, I caused a PDF version of the foregoing brief to be sent by electronic mail to the Clerk of the U.S. Court of Appeals for the Second Circuit and to Sanford I. Weisburst, Court-Appointed *Amicus Curiae*, and that I sent an original and nine copies of the foregoing brief by Federal Express to:

Ms. Catherine O'Hagan Wolfe
Clerk, United States Court of Appeals
for the Second Circuit
Daniel Patrick Moynihan U.S. Courthouse
500 Pearl Street
New York, NY 10007

I also hereby certify that on this 18th day of June, 2008, I served the foregoing brief upon the following by causing two copies to be sent by Federal Express or first class mail, postage prepaid, as specified, to:

Sanford I. Weisburst
William B. Adams
Quinn Emanuel Urquhart Oliver & Hedges, LLP
51 Madison Avenue, 22nd Floor
New York, NY 10010
(by Federal Express)

Patrick F. Moore, Esq.
299 Main Street
Poughkeepsie, NY 12601
(by first-class mail)

Shayna H. Zarnel
P.O. Box 1171
So. Fallsburg, NY 12779
(by first-class mail)

Lena M. Elmendorf
Box 1378 Route 9G
Hyde Park, NY 12538
(by first-class mail)

Diana M. Finlay
247 Osborne Hill Rd.
Fishkill, NY 12524
(by first-class mail)

Stephanie R. Marcus

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WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*
Diana G. Adams, Acting United States Trustee v. Shayna H. Zarnel, Diana M. Finlay, Lena M. Elemendorf (In re: Shayna H. Zarnel, Diana M. Finlay, Lena M. Elmendorf)

2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*
2nd Cir.

3. ("CCN") ***CURRENT*** CASE NO.
No.: 07-0090-bk, (L), 07-0091-bk, 07-0092-bk, 07-0097-bk, 07-0098-bk, 07-0099-bk (consolidated)

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Stephanie R. Marcus, P. Matthew Sutko, Roberta A. DeAngelis, William Kanter
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***
• 1). Whether the United States Trustee has standing to appeal under 11 U.S.C. § 307. 2) Whether a person who files a bankruptcy petition, but has not complied with the credit counseling requirement under 11 U.S.C. § 109(h), commences a bankruptcy case.

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IN THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

IN RE: SHAYNA H. ZARNEL, DIANA M. FINLAY, LENA M. ELMENDORF

DIANA G. ADAMS, United States Trustee,

Petitioner-Appellant,

v.

SHAYNA H. ZARNEL, DIANA M. FINLAY, LENA M. ELMENDORF,

Respondents-Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

BRIEF FOR APPELLANT IN RESPONSE TO BRIEF OF COURT-APPOINTED *AMICUS CURIAE*

MICHAEL J. GARCIA
United States Attorney
SEAN H. LANE
DANNA DRORI
Assistant U.S. Attorneys
86 Chambers Street, 3rd Fl.
New York, New York 10007

Of Counsel:

ROBERTA A. DEANGELIS
Acting General Counsel
P. MATTHEW SUTKO
Office of the General Counsel
Executive Office for U.S. Trustees
U.S. Department of Justice
20 Massachusetts Ave., N.W., Suite 8100
Washington, D.C. 20530

GREGORY G. KATSAS
Acting Assistant Attorney General

WILLIAM KANTER
(202) 514-4575
STEPHANIE R. MARCUS
(202) 514-1633
Attorneys, Appellate Staff
Civil Division, Room 7642
U.S. Department of Justice
950 Pennsylvania Ave., N.W.
Washington, D.C. 20530-0001

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INTRODUCTION AND SUMMARY OF ARGUMENT

The present appeal involves an issue that has arisen following Congress' enactment of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA"). Lower courts have divided over how to dispose of a case when a debtor fails to comply with Section 109(h), the new law's credit counseling requirement. The view of a substantial majority of courts -- and that of the United States Trustee[1] ("U.S. Trustee") -- is that where, as here, debtors have not obtained credit counseling or qualified for a temporary waiver of the requirement, their cases should be dismissed. In this case, however, the bankruptcy court denied the U.S. Trustee's motions to dismiss and struck debtors' cases. Because that decision is contrary to the Bankruptcy Code and congressional intent, and will cause substantial uncertainty in bankruptcy proceedings, the U.S. Trustee appealed to the district court. As demonstrated in our opening brief, the district court erred by dismissing the U.S. Trustee's appeal for lack of standing, and, in the alternative, affirming the bankruptcy court's decision on the merits.

1. As Amicus acknowledges (Br. 11-15), the U.S. Trustee has standing to appeal the bankruptcy court's denial of her motions to dismiss. Congress, in Section 307 of the Bankruptcy Code, expressly provided U.S. Trustees with standing to "raise and

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[1] Since we filed our opening brief, appellant Diana G. Adams (then-Acting U.S. Trustee) has been appointed United States Trustee. We changed the caption on our brief cover accordingly.

appear and be heard in any case or proceeding” arising under the Code. 11 U.S.C. § 307. As the courts of appeals that have addressed the issue have unanimously agreed, the U.S. Trustee therefore need not meet the “person aggrieved” standard applicable to private parties’ appellate standing.

2. Although Amicus agrees with the U.S. Trustee that the present appeal is justiciable, he suggests that, absent the exception to the mootness doctrine for cases that are "capable of repetition, yet evading review," this Court would lack jurisdiction. The present case is not moot. To the contrary, a ruling in the U.S. Trustee’s favor would affect the legal rights of the debtors and fully redress the U.S. Trustee’s injury.

3. The bankruptcy court’s decision to strike, rather than dismiss, debtors’ cases is contrary to the Bankruptcy Code and congressional intent, and will cause significant uncertainty in future bankruptcy proceedings. In contrast, the position of the U.S. Trustee that where, as here, a debtor fails to comply with Section 109(h), a court must dismiss the case, reflects a proper interpretation of the Bankruptcy Code, advances congressional intent, and avoids confusion. When an individual files a petition under Section 301, she has commenced a case and triggered the automatic stay. If and when the bankruptcy court later decides that the individual is ineligible to be a debtor under Section 109, the court should dismiss the case for cause.

ARGUMENT

I. THIS COURT HAS JURISDICTION TO DECIDE THE U.S. TRUSTEE'S APPEAL.

A. Standing

As noted, court-appointed Amicus concurs with the U.S. Trustee's contention that she has appellate standing. See Amicus Br. 11-15. We therefore rest on our opening brief on standing.

B. Mootness

Amicus suggests that the present appeal is moot, but falls within the exception to the mootness doctrine for cases that are "capable of repetition, yet evading review." Amicus Br. 15-18. This Court need not reach whether that exception applies, however, because the present appeal is not moot.

Under Article III of the Constitution, a case is moot only where a court is unable to grant the party alleging injury any effective relief. See Church of Scientology of Cal. v. United States, 506 U.S. 9, 12 (1992). So long as the court "can fashion *some* form of meaningful relief, even if it only partially redresses the grievances of the prevailing party, the appeal is not moot." In re United Artists Theatre Co., 315 F.3d 217, 226 (3d Cir. 2003) (internal quotations omitted). Indeed, "when an appellant retains an interest in a case so that a favorable outcome could redound in its favor, the case is not moot." In re Flanagan, 503 F.3d 171, 178 (2nd Cir. 2007).

Relying on the Seventh Circuit's nonprecedential order in In re Thompson, 249 Fed. Appx. 475 (7th Cir. 2007), Amicus contends (Br. 15-16), however, that if the U.S. Trustee prevails in the present appeal, "there will be no actual effect for either Debtors or their creditors." As set forth below, a ruling in the U.S. Trustee's favor would both affect the legal rights of the debtors and fully redress the U.S. Trustee's injury.

1. Affording Relief To The U.S. Trustee Would Affect Debtors' Rights Under The Bankruptcy Code.

If the U.S. Trustee prevails in this appeal, it would affect debtors' legal rights. First, the automatic stay would terminate after 30 days in any bankruptcy case that any of the debtors files within a year from the bankruptcy court's entry of dismissal on remand unless the debtor demonstrates good faith in the subsequent case. Second, the requested relief would make clear that the debtors must report the present case in any future bankruptcy proceeding in the next eight years.

2. Granting Relief To The U.S. Trustee Would Affect The Debtors' Statutory Right To An Automatic Stay.

a. Under BAPCPA, Congress Limited Application Of The Automatic Stay Where Debtors Had A Case Pending In The Prior Year That Was Dismissed.

As set forth in our opening brief (Br. 43), when Congress enacted BAPCPA, it amended 11 U.S.C. § 362, the automatic stay provision. Specifically, Congress provided for limited application of the automatic stay where a "single or joint case of the debtor was pending within the preceding 1-year period but was dismissed[.]" 11 U.S.C. § 362(c)(3) (emphasis added). In such cases, the automatic stay terminates on the 30th day after the debtor files the subsequent case unless the debtor "demonstrates that the filing of the later case is in good faith as to the creditors to be stayed." 11 U.S.C. § 362(c)(3)(A),(B). In addition, Congress provided that if "2 or more single or joint cases of the debtor were pending within the previous year but were dismissed," the automatic stay will not go into effect at the outset of the debtor's subsequent case unless the debtor can demonstrate that the later case is filed in good faith. 11 U.S.C. § 362(c)(4)(A),(B) (emphasis added).

As we explained (Br. 43-44), because the plain language of Section 362(c) applies solely to debtors whose prior cases were "dismissed," where a bankruptcy court strikes the petition and rules that a case never commenced, that proceeding likely would not count as a "case" "pending" in the prior year that was "dismissed" for the purposes of determining in a later case whether and when the automatic stay is triggered. In fact, in Thompson, the bankruptcy court, after determining that it would strike debtors' petition rather than dismiss their case, acknowledged that if the Thompsons did file a petition within a year, the "petition filed under this cause number will not count as a 'case pending and dismissed'" under Section 362(c). In re

Thompson, 344 B.R. 899, 908 (Bankr. S.D. Ind. 2006), aff'd, In re Thompson, No. 06-1033 (S.D. Ind. Dec. 4, 2006), vacated as moot, 249 Fed. Appx. 475 (7th Cir. 2007). In the present case, this Court therefore can afford the U.S. Trustee effective relief by reversing the district court decision, thereby requiring the bankruptcy court to dismiss debtors' cases on remand.

If this Court rules in the U.S. Trustee's favor, it thus will not only afford her effective relief, but will also affect debtors' legal status under the Bankruptcy Code. If any of the debtors files a bankruptcy petition within a year from the entry of dismissal on remand, she will need to seek affirmative relief from the bankruptcy court in order to continue the automatic stay for more than 30 days in the later case. 11 U.S.C. § 362(c)(3). Debtors' creditors would also be affected, since they would not have to go to the time and expense of moving for relief from the stay after 30 days have expired in the later case.

The statutory collateral effects on the debtors and their creditors that would result from a court order granting the U.S. Trustee relief demonstrate that the present appeal is not moot, and provide the debtors with "a stake in the outcome of this litigation." See A.M. v. Butler, 360 F.3d 787, 790 & n.4 (7th Cir. 2004). These statutory effects are particularly significant in light of debtors' history of bankruptcy filings: (1) when debtor Diana Finlay filed her petition in the present case, it was her third bankruptcy filing within a year (see Op. 5, Appendix ("A")-17); (2) debtor Shayna Zarnel's husband had filed five bankruptcy petitions since January 2004 (Op. 6, A-18); and (3) debtor Lena Elmendorf filed another Chapter 7 petition after the bankruptcy court struck the present case. See Docket, In re Elmendorf, No. 06-35926 (Bankr. S.D.N.Y.) (case closed without discharge for failure to file Official Form 23). And whether or not they file for bankruptcy within a year from when a dismissal is ultimately entered on remand, debtors' legal status with respect to filing a petition under the Bankruptcy Code, at least in the following year, will have changed.

b. Debtors' Cases Remain "Pending" Within The Meaning Of Section 362(c) Of The Bankruptcy Code.

Amicus argues (Br. 15-16), however, that the one-year period in which Section 362 limits applicability of the stay has already expired – i.e., it expired one year after the bankruptcy court issued its order striking debtors' cases. In its nonprecedential order in Thompson, the Seventh Circuit reached the same conclusion without analysis. See 249 Fed. Appx. at 476. This Court should reject that interpretation of Section 362(c) because it conflicts with the plain language of the statute; in particular, the definition of the word "pending." Section 362(c) expressly refers to cases that were "pending within the preceding 1-year period but w[ere] dismissed[.]" 11 U.S.C. § 362(c)(3). Debtors' cases commenced when they filed their petitions, and remain pending to this day. The cases are currently "pending" before this Court, since the U.S. Trustee timely appealed the bankruptcy court's orders to the district court, and timely appealed the district court's judgment to this Court.

1. Although the Bankruptcy Code does not define "pending," under the ordinary meaning of the term, a case is "pending" when it has not been finally resolved. Indeed, Black's Law Dictionary defines "pending" as "[r]emaining undecided; awaiting decision." Black's Law Dictionary, 8th Ed. (2004) at 1169; C.F. Trust, Inc. v. Tyler, 318 B.R. 795, 806 (E.D. Va. 2004) (phrase "'pending litigation' plainly encompasses all matters that were then 'pending'" in the case, "whether in the Court of Appeals or the district court"; case is "'pending' if it remains unresolved").

The Supreme Court has applied the ordinary meaning of "pending" in the context of time limits for filing federal petitions for habeas corpus. See Carey v. Saffold, 536 U.S. 214, 219-220 (2002). In Carey, the Court addressed the meaning of the term "pending" in 28 U.S.C. § 2244(d)(2), which provides that "time during which a properly filed application for State post-conviction or other collateral review with respect to the pertinent judgment or claim is pending shall not be counted toward any period of limitation under this subsection." 28 U.S.C. § 2244(d)(2) (emphasis added). The Court held that a prisoner's application for state collateral review remains "pending" within the meaning of Section 2244(d)(2) "as long as the ordinary state collateral review process is 'in continuance,'" which includes the "interval between a lower court's entry of judgment and the timely filing of a notice of appeal (or petition for review) in the next court." 536 U.S. at 219-220. As the Court explained, its interpretation was consistent with the ordinary meaning of "pending": "The dictionary defines 'pending' * * * as 'in continuance' or 'not yet decided.'" Id. at 219. Thus, the Court reasoned, until a prisoner's application for review "has achieved final resolution through the State's post-conviction procedures, by definition it remains 'pending.'" Id. at 220.

Under this reasoning, debtors' cases remain "pending" while on appeal before the district court and the court of appeals. Because the bankruptcy court's orders striking debtors' cases and denying the U.S. Trustee's motions to dismiss did not finally resolve debtors' cases in light of the U.S. Trustee's timely appeals, such cases remain "pending" within the meaning of 11 U.S.C. § 362(c).

2. To support its interpretation, Amicus does not address the plain meaning of the term "pending." Rather, Amicus argues (Br. 16-17) that the U.S. Trustee's interpretation would be inconsistent with Congress's purpose because "a debtor would be forced to endure the restrictions on the automatic stay long after the bankruptcy court resolved the petition and for a period with no correlation to the prior filing."

As an initial matter, such a policy argument cannot trump the plain language of the statute. Connecticut Nat'l Bank v. Germain, 503 U.S. 249, 253-54 (1992) ("[w]e have stated time and again that courts must presume that a legislature says in a statute what it means and means in a statute what it says there"); Collazos v. United States, 368 F.3d 190, 199 (2d Cir. 2004). In any event, the U.S. Trustee's interpretation of Section 362(c) is entirely consistent with Congress's purpose in enacting BAPCPA. By amending Section 362 to limit application of the automatic stay when a debtor had a prior case dismissed in the preceding year, Congress intended to discourage debtors from "bad faith repeat filings." H.R. Rep. No. 31(I), 109th Cong., 1st Sess. at 69 (2005), *reprinted in* 2005 U.S.C.C.A.N. 88, 138. At the same time, however, Congress recognized that such limitations could prove overly harsh as applied in particular cases and therefore provided a debtor who had a prior case dismissed in the preceding year with the opportunity to obtain a continuation of the stay if she demonstrates that she filed the subsequent case in "good faith." 11 U.S.C. §§ 362(c)(3)(B);(c)(4)(B).

Thus, if a debtor has a prior dismissal in the preceding year only because her earlier case was pending for several years due to another party's appeal, she could file a motion for continuation of the stay, which the bankruptcy court could grant if it found that she was acting in good faith in the new bankruptcy proceeding. See In re Seaman, 340 B.R. 698, 709 (Bankr. E.D.N.Y. 2006) (Congress, through enactment of provision allowing debtor to seek continuance of automatic stay in subsequent case, "intended that in appropriate circumstances, a debtor or other party in interest could move promptly to reinstate the protections of the automatic stay").

3. Granting Relief To The U.S. Trustee Affects Debtors' Reporting Requirements In Subsequent Bankruptcy Cases.

In addition, even apart from any impact on the automatic stay, if this Court grants the U.S. Trustee's requested relief, it will affect debtors' reporting requirements in any subsequent bankruptcy filings within the next eight years. See Gov't Br. 48. Official bankruptcy forms require debtors to inform the court of all prior bankruptcy "cases" filed in the past eight years. See Voluntary Petition Official Form 1 at 2. Absent relief from this Court, debtors could believe that because their cases were stricken, and because the bankruptcy court held that they never commenced a case, they are not required to report the present case when they file a subsequent petition. In contrast, if this Court reverses the district court, holds that a case "commenced," and remands for an entry of dismissal by the bankruptcy court, it will be clear that debtors must report the present case. This reporting requirement helps the U.S. Trustee monitor bankruptcy proceedings for abuse by repeat filers. And requiring debtors to report the dismissed case could affect their rights in subsequent bankruptcy cases with respect to, for example, any issue that arises regarding good faith where their history of prior filings is relevant.[2]

4. The U.S. Trustee Is Acting To Protect The Public Interest In Bankruptcy Proceedings, And She Has Suffered An Injury In That Capacity That May Still Be Fully Redressed.

The U.S. Trustee's appeal also satisfies the requirement that the party seeking relief has an injury that can be redressed. As noted, the U.S. Trustee moved to dismiss debtors' cases. The bankruptcy court denied the U.S. Trustee's motions, and the district court affirmed. A reversal by this Court would make clear that the bankruptcy court lacked authority to strike the petition, and would require dismissal of debtors' cases on remand. The U.S. Trustee, who is acting to protect the public interest by ensuring that bankruptcy proceedings are conducted in accordance with the Code, has therefore suffered an injury that can be fully redressed by a favorable decision by this Court.

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[2] In discussing the merits of whether a bankruptcy court should strike a petition or dismiss a case where a debtor has not complied with the credit counseling requirement, Amicus argues (Br. 30 n.11) that the "form accompanying bankruptcy filings could – and, indeed, post-BAPCPA probably should – be changed to seek information about the number of 'petitions' filed." The fact remains, however, that over two years have passed since BAPCPA was enacted, and the form still refers to "cases." Speculation about whether the form could or should be changed does not affect the mootness question.

The U.S. Trustee's appeal is thus distinguishable from cases in which a plaintiff or appellant no longer has a stake in the litigation, and the Court is accordingly unable to provide effective relief. Unlike, for example, a student who has graduated from school and no longer has a cognizable interest in school policies or regulations, a prisoner who has been released from prison, or a company that has sold its business, the U.S. Trustee's stake in the present litigation has not changed: she is acting to advance the public interest and to ensure proper and consistent interpretation of the Code.[3]

The Supreme Court recognized this distinction when it held that a school desegregation case that otherwise would have become moot when plaintiff students graduated presented a live case or controversy because the United States had intervened. Pasadena City Bd. Of Educ. v. Spangler, 427 U.S. 424 (1976). Like the present case, where Congress conferred standing on the U.S. Trustee to raise and appear "on any issue" in "any case or proceeding" under the Bankruptcy Code (11 U.S.C. § 307), in Pasadena City Bd., the United States had a statutory right to intervene in the students' private action. See 427 U.S. at 430 (citing 42 U.S.C. § 2000h-2). In such circumstances, even if the

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[3] See In re Columbia Gas Syst., Inc., 33 F.3d 294, 296-99 (3d Cir. 1994); In re Clark, 927 F.2d 793, 795-96 (4th Cir. 1991); In re Revco D.S., Inc., 898 F.2d 498, 499-500 (6th Cir. 1990); In re Mason, 2007 WL 433077 at *1 (E.D. Ky. Feb. 5, 2007).

plaintiffs who originally filed that private action could no longer obtain effective relief, the United States, which had a public interest stake in ensuring that municipal school boards did not violate students' constitutional rights, could continue with the litigation. See id.

It is in her role in ensuring that bankruptcy proceedings are conducted in accordance with the Code that the U.S. Trustee is injured. And this injury is not in any sense moot, since an order from this Court reversing the district court, thereby requiring dismissal of debtors' cases on remand, would afford effective relief. At the same time, the U.S. Trustee's injury in this case is specific to debtors, as debtors failed to comply with Section 109(h) of the Bankruptcy Code, and their cases therefore should have been dismissed as set forth in the U.S. Trustee's motions in bankruptcy court. Those motions were clearly adverse to debtors in bankruptcy court, and, as outlined above, the U.S. Trustee's appeal remains adverse to debtors' interests.[4] The relief that the U.S. Trustee seeks on appeal would require debtors to file a motion demonstrating good faith in any subsequent bankruptcy case that they file within a year

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[4] Contrary to Amicus' suggestion (Br. 18 n.6), the U.S. Trustee thus is not arguing that, in light of its public interest standing, there need not be a case or controversy under Article III. As we have demonstrated, this case satisfies Article III requirements because a decision in the U.S. Trustee's favor on appeal would fully redress its injury and would affect debtors' statutory rights under the Bankruptcy Code.

from entry of dismissal on remand in order to extend the automatic stay past 30 days; without such relief, debtors are free to file a petition within a year without prejudice. The requested relief would also make clear that debtors must report the present case in any future bankruptcy proceeding in the next eight years, thus making the U.S. Trustee's enforcement and monitoring role easier and more accurate with respect to debtors.

In sum, this case is not moot "because [appellant] has a stake in the outcome of the proceeding and a federal court can effectuate relief should [appellant] prevail on the merits." Church of Scientology, 506 U.S. at 18 n.11.

5. If This Court Disagrees, And Determines That The Appeal Is Moot, It Should Vacate The Decisions Of The Lower Courts.

As demonstrated above, this appeal is not moot. This Court therefore need not reach Amicus' contention (Br. 17-18) that the appeal falls within the exception to the mootness doctrine for cases that are "capable of repetition yet evading review." Should this Court disagree with the U.S. Trustee and Amicus that the case is justiciable, however, it should vacate the decisions of both the district court and the bankruptcy court. See United States v. Munsingwear, Inc., 340 U.S. 36, 39-40 (1950) ("established practice" of Supreme Court when case becomes moot on appeal is to vacate judgment of lower courts); Van Wie v. Pataki, 267 F.3d 109, 115 (2d Cir. 2001).

II. WHERE, AS HERE, DEBTORS FAIL TO COMPLY WITH SECTION 109(h) OF THE BANKRUPTCY CODE, THE BANKRUPTCY COURT MUST DISMISS, RATHER THAN STRIKE, THE CASE.

As we demonstrated in our opening brief, when a debtor does not comply with the credit counseling requirement in Section 109(h) of the Code, the bankruptcy court should dismiss the case rather than strike the case or petition. Indeed, there is no authority in the Bankruptcy Code for striking a petition or case in these circumstances. The U.S. Trustee's position that a bankruptcy court should dismiss such cases is consistent with the Bankruptcy Code, congressional intent, and the holdings of a substantial majority of courts that have addressed the issue.[5] Amicus advances several arguments in support of its position that the bankruptcy court had authority to strike debtors' petitions rather than dismiss their cases. None of these arguments is persuasive, however.

A. Debtors Commenced Cases Within The Meaning Of Section 301 Of The Bankruptcy Code.

Amicus argues that bankruptcy courts should strike petitions of ineligible debtors because such debtors cannot commence cases

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[5] See Gov't Br. 31-32 & n.16. Since we filed our brief, three additional bankruptcy courts have determined that dismissal of the case is the appropriate disposition where a debtor has failed to comply with the credit counseling requirement. In re Francisco, – B.R. –, 2008 WL 244172 (Bankr. D. N.M. 2008); In re Falcone, 370 B.R. 462 (Bankr. D. Mass. 2007); In re Gossett, 369 B.R. 361 (Bankr. N.D. Ill. 2007). One district court has affirmed a bankruptcy court's decision to strike a petition. Wyttenbach v. Commissioner, 382 B.R. 726 (S.D. Tex. 2008), appeal pending, 5th Cir. No. 08-40321.

under Section 301 of the Code.[6] Pursuant to Section 301, a "voluntary case under a chapter of this title is commenced by the filing with the bankruptcy court of a petition under such chapter by an entity that may be a debtor under such chapter." 11 U.S.C. § 301(a). Amicus argues (Br. 19-21) that there were no "cases" for the bankruptcy court to dismiss because, under Section 301, a case commences only where a petition is filed under a chapter of the Bankruptcy Code by an entity "that may be a debtor under such chapter." Amicus contends (Br. 19-20) that an individual who files a petition without complying with Section 109(h) "may not be a debtor" under the Bankruptcy Code, and thus cannot commence a case under Section 301.

1. Although Amicus purports to rely on the plain language of the Code to support its interpretation, neither the term "may" nor the phrase "may be a debtor" is defined in the Bankruptcy Code. See 11 U.S.C. § 101 (definitions). It is therefore appropriate to refer to the ordinary usage of the term "may," which "as used in § 301 of the Bankruptcy Code means 'might' or is meant to express a 'possibility.'" In re Tomco, 339 B.R. 145, 159 (Bankr. W.D. Pa. 2006).

Amicus argues (Br. 21), however, that in Section 109,

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[6] Although the bankruptcy court below struck debtors' cases, Amicus advocates striking debtors' petitions, and "understands the bankruptcy court to have struck the petitions" despite the clear language of the court's orders striking the cases. A-49-51.

Congress defined the phrase “may be a debtor” for purposes of Section 301 “to *exclude* individuals that do not comply with the credit-counseling requirements.” Contrary to Amicus’ argument, Section 109 nowhere defines the sense in which Congress used the term “may” or the phrase “may be a debtor” in Section 301. Rather, Section 109 delineates who “may be a debtor” for purposes of determining eligibility for bankruptcy relief under various chapters of the Bankruptcy Code once a case has already commenced; it does not delineate who can commence a case for purposes of Section 301. Because determining whether an individual is eligible to be a debtor under the various subsections of Section 109 (including 109(h)) is often unclear from the face of the petition and may involve disputed issues of fact and law, a debtor who files a petition “may be a debtor” for purposes of commencing a case under Section 301, but nonetheless may subsequently be found ineligible for bankruptcy relief under Section 109. In re Ross, 338 B.R. 134, 138 (Bankr. N.D. Ga. 2006); Tomco, 339 B.R. at 159; Seaman, 340 B.R. at 707; In re Flores, 291 B.R. 44, 61 (Bankr. S.D.N.Y. 2003). Otherwise, numerous bankruptcy cases would be legal nullities, even if they had remained pending for years due to a legal or factual dispute over eligibility under Section 109.

In fact, Amicus’ interpretation of how Section 109 limits the phrase “entity that may be a debtor” in Section 301 would apply equally to other subsections of Section 109, because that section as a whole -- not solely subsection (h) -- covers "who may be a debtor" under particular chapters of the Bankruptcy Code. See 11 U.S.C. § 109. Such a result is unworkable because of the uncertainty that it would create in bankruptcy proceedings. E.g., Seaman, 340 B.R. at 707 (striking case would cause questions about "existence and willfulness of an automatic stay violation, and the validity of an action against property taken by a creditor of a petitioner who appears ineligible to be a debtor but later is determined to be eligible"); Ross, 338 B.R. at 140. Creditors and other parties "will not know whether a valid case exists without investigation," and "even if bankruptcy courts can fashion doctrines to avoid unfair results in such void *ab initio* situations, the fact remains that substantial uncertainty will cloud every transaction related to a bankruptcy case." Ross, 338 B.R. at 140-141; In re Jones, 352 B.R. 813, 823-824 (Bankr. S.D. Tex. 2006) (Section 349 of Code addresses effects of dismissals, not effects of striking of petition).

Amicus acknowledges (Br. 21-22) that there may be "proceedings in the bankruptcy court prior to a definitive ruling on whether an individual is eligible to commence a case," but contends that this is no different from the determinations a court must make to decide whether it has subject matter jurisdiction. Amicus' analogy to determinations of subject matter jurisdiction is telling. As noted (Gov't Br. 28-29), when a federal court lacks subject matter jurisdiction, it dismisses the case, it does not strike the complaint or case as a nullity.[7]

Moreover, when a court dismisses a case for lack of subject matter jurisdiction, it is clear that in a subsequent case, the jurisdictional ruling has preclusive effect. A "dismissal for lack of jurisdiction precludes relitigation of the issue actually decided, namely the jurisdictional issue." Perry v. Sheahan, 222 F.3d 309, 318 (7th Cir. 2000); Insurance Corp. Of Ir., Ltd. v. Compagnie des Bauxites de Guinee, 456 U.S. 694, 702 n.9 (1982). In contrast, if every time a court held that it lacked jurisdiction (or, by analogy, if every time a court held that a debtor is ineligible), the entire proceeding became a legal nullity, then the applicability of doctrines such as res judicata and issue preclusion would become highly uncertain.[8] In short, contrary to Amicus' assertion (Br. 30), striking a petition on the ground that a debtor who is ineligible under Section 109(h)

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[7] E.g., Makarova v. United States, 201 F.3d 110 (2d Cir. 2000); Close v. State of New York, 125 F.3d 31 (7th Cir. 1997) (same); see Fed. R. Civ. P. 12(h)(3).

[8] See, e.g., Ross, 338 B.R. at 140 (if "there is a case before the court," then "[d]octrines of waiver or *res judicata* provide potential legal bases for fair resolution" of problems that might arise in case filed by ineligible debtor; however, such doctrines "may be unavailable if the case is void *ab initio*"); Jones, 352 B.R. at 824 (questions that arise from holding that petition filed by ineligible debtor is nullity include "when and how" issue decided prior to striking petition "becomes *res judicata*").

cannot commence a case does create uncertainty and the potential for prejudice to parties to bankruptcy proceedings.[9]

2. In addition, the position of Amicus and the courts below that a debtor who has not complied with Section 109(h) cannot commence a case under Section 301 would apply equally to situations in which individuals file a petition under the wrong chapter of the Code. 11 U.S.C. § 109. Section 301 expressly provides that a "voluntary case under a chapter of this title is commenced by the filing with the bankruptcy court of a petition under such chapter by an entity that may be a debtor under such chapter." 11 U.S.C. § 301 (emphasis added). If Amicus' argument that Section 109 defines the term "may be a debtor" for purposes of Section 301 were adopted, then a petition filed by an individual who is eligible to be a debtor under the Bankruptcy Code, but files a petition under the wrong chapter, would be a legal nullity. That is because under Amicus' interpretation of the plain language, that debtor would not commence a case because

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[9] Moreover, as we explained (Br. 47-48), striking petitions and holding that an ineligible debtor does not commence a case could cause various practical problems involving reporting requirements, filing fees and compensation of trustees. Whether or not these problems could be resolved by changing a bankruptcy form, or by ruling a particular way (cf. Amicus Br. 30 n.11), the point remains that if the U.S. Trustee's position is adopted, bankruptcy courts would not even have to raise such questions, much less answer them: A case would exist until a court determines that the debtor is ineligible, at which time the court would dismiss the case, thus making it clear how such case should be treated for purposes of both limitations on the automatic stay in future cases and for reporting requirements.

she is not an "entity that may be a debtor under such chapter."

Indeed, if adopted, Amicus' argument would extend to a debtor who files a petition under Chapter 13 but is ineligible under Section 109(e). Could a court still convert the Chapter 13 petition to a Chapter 7 petition rather than strike it? The answer provided by the Bankruptcy Code is yes: Section 1307(c) states that "on request of a party in interest or the United States trustee and after notice and a hearing, the court may convert a case under this chapter to a case under chapter 7 of this title." 11 U.S.C. § 1307(c). And, as courts have recognized, ineligibility under Chapter 13 is a valid ground for conversion to Chapter 7. See, e.g., Rudd v. Laughlin, 866 F.2d 1040, 1041 (8th Cir. 1989) (where debtor files Chapter 13 petition but is ineligible under Section 109(e), court has jurisdiction to convert to Chapter 7 and case is not legal nullity); In re Jones, 129 B.R. 1003, 1009 (Bankr. N.D. Ill.) ("the converted case is commenced by the filing of the petition even if the debtor was not eligible for relief under the chapter named in the petition"), aff'd, 134 B.R. 274 (N.D. Ill. 1991).[10]

Under Amicus' logic, however, the bankruptcy court would be

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[10] As the Jones court observed in response to the argument that the filing of a petition by a debtor ineligible under Section 109(e) did not commence a case, "it is metaphysical to argue that there is no 'case' here. If there is no 'case,' then what are the parties doing here and what is that thick file doing in the Clerk's office?" 129 B.R. at 1010.

required to strike the petition as a legal nullity in such circumstances because it did not commence a case. That result demonstrates the flaw in Amicus' purported "plain language" argument -- according to Amicus' interpretation of the phrase "may be a debtor," in Section 301, in order to commence a case, an individual must be eligible pursuant to the particular chapter under which she filed her petition. Otherwise, the petition does not commence a case, and if there is no "case" to dismiss, presumably there is no "case" to convert.

3. Moreover, the "words 'entity that may be a debtor'" that appear in Section 301 "have been in the [Bankruptcy Code] from the outset." In re Francisco, -- B.R. –, 2008 WL 244172 (Bankr. D. N.M. 2008) at *6. There is thus "a usage for that language that predates the enactment of § 109(h)(1) and does not mandate striking the petition for a violation of § 109(h)(1)." Id. Indeed, before the enactment of the credit counseling requirement in Section 109(h), courts routinely dismissed, not struck, cases where the debtor was ineligible under other subsections of Section 109.[11] When Congress enacted BAPCPA, it therefore "was legislating against a background of (1) cases under various chapters dismissed for ineligibility pursuant to § 109," and "(2)

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[11] See, e.g., In re Mazzeo, 131 F.3d 295, 301 (2d Cir. 1997); In re C-TC 9th Ave. P'ship, 113 F.3d 1304, 1313 (2d Cir. 1997); Matter of Estate of Medcare HMO, 998 F.2d 436, 447 (7th Cir. 1993); In re Seaman, 340 B.R. 698, 707 (Bankr. E.D.N.Y. 2006); see Bankr. Op. 24, A-36.

cases not found void *ab initio* for violations of § 109(g)." Id. at *7. Congress did not indicate that the newly-enacted credit counseling requirement in Section 109(h) should be treated any differently from the other eligibility requirements in Section 109. Id.; In re Gossett, 369 B.R. 361, 373-374 (Bankr. N.D. Ill. 2007) ("[t]here is no indication that Congress intended to treat § 109(h) ineligibility any different than any other form of ineligibility in § 109"; thus, dismissal is proper disposition where debtor has failed to comply with § 109(h)).

B. Amicus' Position That The Bankruptcy Court Had Authority To Strike Debtors' Petitions Finds No Support In The Bankruptcy Code And Is Contrary To Congressional Intent.

1. Amicus contends (Br. 25-26) that the U.S. Trustee's reliance on pre-BAPCPA cases that routinely dismiss cases filed by debtors who are ineligible under Section 109 is unsound because "until recently, courts had little reason to be concerned with whether an ineligible debtor's petition should be stricken or his case should be dismissed," whereas after BAPCPA, the results of dismissal can lead to limitation of the automatic stay in future cases. This argument is unavailing. Indeed, "the fact that the consequences of a dismissal are potentially more dire does not by itself warrant a change in what leads to dismissals." Francisco, – B.R. –, 2008 WL 244172 at *7. Moreover, Amicus' position conflicts with Congress's purpose in enacting BAPCPA; indeed, "various provisions of BAPCPA * * * belie any notion that

Congress wrote BAPCPA to benefit debtors."[12] Id.

2. In the alternative, Amicus contends (Br. 26) that, in any event, "it was far from universal before BAPCPA that a bankruptcy court would dismiss a case upon the filing of a petition by an ineligible debtor." In support of this argument, Amicus cites two cases for the proposition that pre-BAPCPA, "several courts struck petitions filed by debtors" found ineligible under Section 109(g). Amicus Br. 26 (citing Rowe v. Ocwen Fed. Bank & Trust, 220 B.R. 591 (E.D. Tex. 1997), aff'd, 178 F.3d 1290 (5th Cir. 1999); In re Keziah, 46 B.R. 551 (Bankr. W.D.N.C. 1985)). But only Keziah involves the striking of a petition (46 B.R. at 555); contrary to Amicus' suggestion, the district court in Rowe repeatedly refers to the bankruptcy court's "dismissal, with prejudice" of debtor's petition because he was ineligible under Section 109(g). Rowe, 220 B.R. at 592-595 (emphasis added). By citing one pre-BAPCPA case in which a court struck a petition, Amicus has failed to cast doubt on the U.S. Trustee's point, and that of the bankruptcy courts upon which she relied, that a substantial majority of courts dismissed, not struck, cases in which debtors were found ineligible under Section 109 pre-BAPCPA. Moreover, Keziah says

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[12] For example, as noted (Gov't Br. 43), in BAPCPA, Congress sought to prevent repeat bankruptcy filers from abusing bankruptcy proceedings by limiting application of the automatic stay where the debtor had a prior case dismissed in the preceding year. 11 U.S.C. §§ 362(c)(3), 362(c)(4).

nothing about Section 301 and the meaning of "entity that may be a debtor" thereunder, nor does it cite any Code provision that authorizes striking a petition as opposed to dismissing the case.

Amicus and the courts below contend, however, that 11 U.S.C. 105(a) provides the bankruptcy court with authority to strike debtors' petitions. Specifically, Amicus argues (Br. 27) that Section 105(a) of the Code allows the bankruptcy court to "effectuate the plain language of § 301 and fill in the interstices of the Code by striking the petition." But as we have shown (Gov't Br. 33-34), Section 105(a), which grants the bankruptcy court authority to "issue any order, process or judgment that is necessary or appropriate to carry out the provisions of [the Code]," by its terms limits the bankruptcy court's equitable power to "carrying out the *provisions* of the Bankruptcy Code, rather than to further the purposes of the Code generally, or otherwise to do the right thing." In re Dairy Mart Convenience Stores, Inc., 351 F.3d 86, 92 (2d Cir. 2003). While provisions of the Code authorize the dismissal of cases for cause, the Code does not provide for the striking of a case or petition. Gov't Br. 29-31, 33-34. Amicus and the courts below thus err by relying on Section 105, because it does not allow the bankruptcy court to take an action that is not authorized under the provisions of the Code.[13] In re Mason, 2007 WL 433077 at *3.

C. Amicus Bases Its Position That The Automatic Stay Is Triggered Even If A Case Does Not Commence On An Additional Error Of Statutory Interpretation.

Amicus parts ways with the bankruptcy court below by arguing that the automatic stay is invoked by a debtor who files a petition without complying with Section 109(h).[14] Amicus Br. 22-

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[13] Nor do Fed. R. Bankr. P. 9011 and 7012(b) advance Amicus' argument. Amicus acknowledges (Br. 28) that neither rule "provides express authorization for the striking of a petition," but claims that they show that "striking a petition is within a bankruptcy court's arsenal of remedies." But as we demonstrated (Gov't Br. 34-35), these rules give the bankruptcy court authority to strike a pleading or portion thereof under specific, limited circumstances that are inapplicable here. See Fed. R. Bankr. P. 9011 (authority to strike unsigned filing if, after receiving notice, party fails to promptly correct omission of signature); Fed. R. Bankr. P. 7012(b) (incorporating Fed. R. Civ. P. 12(e),(f) in adversary proceedings).

[14] Amicus agrees with our position (Gov't Br. 39 n.18) that this Court's pre-BAPCPA decision in In re Casse, 198 F.3d 327 (2d Cir. 1999) does not cast doubt on the conclusion that the automatic stay is invoked. As Amicus states (Br. 25), in Casse, "this Court implicitly recognized that, while an ineligible debtor's filing of a petition triggers the automatic stay, it can be annulled under § 362 on a case-by-case basis[.]"

We disagree with Amicus, however, with respect to his contention (Br. 24) that the Court in Casse concluded "that the ineligible debtor's case was void *ab initio* (in essence, that the debtor had never commenced a case)[.]" Casse did not discuss whether a case commenced under Section 301. In any event, as we explained (Gov't Br. 39 n.18), Casse is distinguishable. First, it did not involve the statutory restriction on eligibility in Section 109; rather, it involved a case in which the debtor violated a prior court order, issued pursuant to the bankruptcy court's authority under Sections 349(a) and 105(a), barring him from filing a subsequent petition. Second, Casse was decided pre-BAPCPA, before Congress's enactment of Section 362(b)(21)(A) made clear its understanding that, in the absence of an express statutory exception to the stay, a petition filed under Section

24; Thompson, 344 B.R. at 906. Amicus' position that the stay is invoked is in significant tension with his position that a petition filed by a debtor ineligible under Section 109 does not commence a case under Section 301. If a petition is a legal nullity that should be stricken from the record, how can it invoke the automatic stay? Like the bankruptcy court in Thompson (344 B.R. at 906), Amicus attempts to reconcile his contradictory positions by arguing that, under Section 362, the mere "filing of a petition operates as a stay" -- regardless of whether the petition commences a case. Amicus Br. 23.

By arguing that the automatic stay is triggered even if a case does not commence under Section 301, Amicus and the Thompson bankruptcy court introduce an additional error of statutory interpretation. Under Section 362(a), "[e]xcept as provided in subsection (b) of this section, a petition filed under section 301, 302 or 303 of this title * * * operates as a stay." 11 U.S.C. § 362(a). Thus, Section 362(a) expressly refers to petitions filed under Sections 301, 302 or 303, which in turn set forth when voluntary, joint or involuntary cases commence under the Bankruptcy Code. 11 U.S.C. §§ 301, 302, 303; see Bankr. Op. 17, A-29. If a case commences, the automatic stay thus takes effect; conversely, if a case does not commence, the automatic

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109(g) "commences a case and results in an automatic stay." Ross, 338 B.R. at 139.

stay is not triggered. It is illogical to argue, as Amicus does, that a petition that should be stricken as a legal nullity nonetheless has the substantial legal effect of invoking the protection of the automatic stay.

Moreover, by taking the position that a petition filed by a debtor ineligible under Section 109(h) does not commence a case but nonetheless triggers the automatic stay, Amicus manages not only to conflict with courts that have held that a case commences when an ineligible debtor files a petition, but also with the bankruptcy court below.[15] Bankr. Op. 17, A-29 ("[a] straightforward reading of § 362(a) indicates that the automatic stay comes into existence only when a case is filed in accordance with §§ 301, 302 or 303 of the BAPCPA"). This inconsistency among courts that advocate striking is also exemplified by the conflict between Wyttenbach v. Commissioner, 382 B.R. 726 (S.D. Tex. 2008), appeal pending, 5th Cir. No. 08-40321, upon which Amicus relies (Br. 24, 28 n.10), and Amicus' position regarding whether the automatic stay is invoked. See Wyttenbach, 382 B.R. at 730 (relying on bankruptcy court holding that striking petition appropriate because stay would not be invoked if

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[15] Amicus' reliance on In re Brown, 342 B.R. 248 (Bankr. D. Md. 2006) illustrates this conflict. Although Brown supports Amicus' position on the automatic stay, it does not support Amicus' argument that there is no "case" to dismiss when a debtor is ineligible. To the contrary, in Brown, the court dismissed debtor's case when it found that her certification of credit counseling was insufficient. 342 B.R. at 250.

petition were struck as legal nullity).

That there is no unified view of the effect of a court's striking of a case or petition underscores the uncertainty caused by the bankruptcy court's decision below to strike, rather than dismiss, debtors' cases. In contrast, the U.S. Trustee's position that the filing of a petition by a debtor ineligible under Section 109(h) commences a case and invokes the automatic stay is consistent with the plain language of Section 362(a) and with the numerous courts that have held that dismissal is appropriate where a debtor is ineligible under Section 109(h).

* * * * * *

In short, the U.S. Trustee's position, and that of the majority of courts that have addressed the issue, is consistent with the Bankruptcy Code, reflects congressional intent in enacting BAPCPA and avoids confusion. Thus, this Court should hold that the filing of a petition with the bankruptcy court commences a case under Section 301 and invokes the automatic stay. If and when the bankruptcy court ultimately decides that an individual is ineligible to be a debtor, the court should dismiss the case, and the stay will then terminate.

CONCLUSION

For the foregoing reasons, the judgment of the district court should be reversed.

Respectfully submitted,

MICHAEL J. GARCIA
United States Attorney
SEAN H. LANE
DANNA DRORI
Assistant U.S. Attorney
86 Chambers Street, 3rd Fl.
New York, New York 10007

GREGORY G. KATSAS
Acting Assistant Attorney General

WILLIAM KANTER
(202) 514-4575
STEPHANIE R. MARCUS
(202) 514-1633
Attorneys, Appellate Staff
Civil Division, Room 7642
U.S. Department of Justice
950 Pennsylvania Ave., N.W.
Washington, D.C. 20530-0001

Of Counsel:

ROBERTA A. DEANGELIS
Acting General Counsel
P. MATTHEW SUTKO
Office of the General Counsel
Executive Office for U.S. Trustees
U.S. Department of Justice
20 Massachusetts Ave., N.W., Suite 8100
Washington, D.C. 20530

JUNE 2008

CERTIFICATE OF COMPLIANCE WITH FED. R. APP. P. 32(a)

I hereby certify that the foregoing brief complies with the typeface requirements in Fed. R. App. 32(a)(5), the page and type-volume limitation in Fed. R. App. P. 32(a)(7) and this Court's February 15, 2008 Order. The brief was prepared in a monospaced font (Courier New) that has 10.5 or fewer characters per inch. The brief is 30 pages long, excluding those parts of the brief set forth in Fed. R. App. P. 32(a)(7)(B)(iii).

Stephanie R. Marcus

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See Second Circuit Interim Local Rule 25(a)(6)

CASE NAME: In re: Shayna H. Zarnel, Diana M. Finlay, Lena M. Elmendorf

DOCKET NUMBER: 07-0090-bk(lead), 07-0091-bk, 07-0092-bk, 07-0097-bk, 07-0098-bk, 07-0099-bk (consolidated).

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I hereby certify that on this 18th day of June, 2008, I caused a PDF version of the foregoing brief to be sent by electronic mail to the Clerk of the U.S. Court of Appeals for the Second Circuit and to Sanford I. Weisburst, Court-Appointed *Amicus Curiae*, and that I sent an original and nine copies of the foregoing brief by Federal Express to:

Ms. Catherine O'Hagan Wolfe
Clerk, United States Court of Appeals
for the Second Circuit
Daniel Patrick Moynihan U.S. Courthouse
500 Pearl Street
New York, NY 10007

I also hereby certify that on this 18th day of June, 2008, I served the foregoing brief upon the following by causing two copies to be sent by Federal Express or first class mail, postage prepaid, as specified, to:

Sanford I. Weisburst
William B. Adams
Quinn Emanuel Urquhart Oliver & Hedges, LLP
51 Madison Avenue, 22nd Floor
New York, NY 10010
(by Federal Express)

Patrick F. Moore, Esq.
299 Main Street
Poughkeepsie, NY 12601
(by first-class mail)

Shayna H. Zarnel
P.O. Box 1171
So. Fallsburg, NY 12779
(by first-class mail)

Lena M. Elmendorf
Box 1378 Route 9G
Hyde Park, NY 12538
(by first-class mail)

Diana M. Finlay
247 Osborne Hill Rd.
Fishkill, NY 12524
(by first-class mail)

Stephanie R. Marcus

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WESTLAW CODES

1. ("TI") ***TITLE*** OF CASE *[E.g., "SMITH v. U.S. TRUSTEE (IN RE SMITH)"]*	Diana G. Adams, Acting United States Trustee v. Shayna H. Zarnel, Diana M. Finlay, Lena M. Elemendorf (In re: Shayna H. Zarnel, Diana M. Finlay, Lena M. Elmendorf)
2. ("CO") ***CURRENT*** COURT *[E.g., "CTA9"]*	2nd Cir.
3. ("CCN") ***CURRENT*** CASE NO.	No.: 07-0090-bk, (L), 07-0091-bk, 07-0092-bk, 07-0097-bk, 07-0098-bk, 07-0099-bk (consolidated)
4. ("PCN") ***PRIOR*** CASE NO. - & COURT *[IF ANY]*	No.: 06-cv-6041 Court: D. S.D.N.Y. *(Identify judge & cite, if any)*
5. ("SO") ***SOURCE***	**U.S. TRUSTEES**
6. ("DA") ***DATE*** OF FILING ***& TYPE*** OF BRIEF *[E.g., "Opening Brief," "Reply," "Amicus," etc.]*	Filed: April 23, 2007 Type: Brief of Appellant
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8. ("TO") ***TOPIC***	**BANKRUPTCY**
9. ("SU") • ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***	• 1) Whether the United States Trustee has standing to appeal under 11 U.S.C. § 307. 2) Whether a person who files a bankruptcy petition, but has not complied with the credit counseling requirement under 11 U.S.C. § 109(h), commences a bankruptcy case.
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IN THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

Nos. 07-0090-bk(L), 07-0091-bk, 07-0092-bk,
07-0097-bk, 07-0098-bk, 07-0099-bk (consolidated)

IN RE: SHAYNA H. ZARNEL, DIANA M. FINLAY, LENA M. ELMENDORF

DIANA G. ADAMS, Acting United States Trustee,

Petitioner-Appellant,

v.

SHAYNA H. ZARNEL, DIANA M. FINLAY, LENA M. ELMENDORF,

Respondents-Appellees

On Appeal from the United States District Court
for the Southern District of New York

BRIEF FOR APPELLANT

PRELIMINARY STATEMENT

This is an appeal from an order and judgment issued in these consolidated cases by the United States District Court for the Southern District of New York (Brieant, J.). See Special Appendix ("SPA") 1-14.[1] The ruling below is not reported, but is available

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[1] “Special Appendix” refers to the appendix filed as an addendum to this brief pursuant to Circuit Rule 32(d); “appendix” refers to the separately bound volume filed pursuant to Fed. R. App. P. 30 and Circuit Rule 30. When a document does not appear in the special appendix or the appendix, the citation will be to the applicable bankruptcy court record number (Zarnel Record “ZR”; Finlay Record “FR”; Elmendorf Record “ER”) or district court record number for the lead district court case, 06-6039(D.

electronically at Adams v. Finlay, 2006 WL 3240522 (S.D.N.Y. 2006).

JURISDICTIONAL STATEMENT

On July 28, 2006, the United States Bankruptcy Court for the Southern District of New York entered final orders striking the cases of debtors-appellees Shayna H. Zarnel, Diana M. Finlay and Lena M. Elmendorf (collectively “debtors”), thereby denying the relief sought by the Acting United States Trustee (“U.S. Trustee”) in her motions to dismiss the cases. Appendix (“A”) 49-51. The U.S. Trustee filed timely notices of appeal of the bankruptcy court’s orders on July 28, 2006. ZR 36, FR 21, ER 18;[2] see Fed. R. Bankr. P. 8002.

The district court had jurisdiction to hear the U.S. Trustee’s appeals pursuant to 28 U.S.C. § 158(a). On November 8, 2006, the district court entered a final judgment dismissing the U.S. Trustee’s appeals for lack of standing, and, in the alternative, affirming the bankruptcy court’s orders on the merits. SPA-14. The U.S. Trustee filed timely notices of appeal on January 5, 2007. A–52-62; see Fed. R. App. P. 4(a)(1)(B).

Ct. R.), and page or paragraph within the document cited.

[2] As the district court docket sheets reflect, the U.S. Trustee, in an abundance of caution, had previously filed notices of appeal in each of the three cases from the bankruptcy court’s opinion, since that opinion contained language ordering the cases stricken. See A–1, A-3, A-5. The U.S. Trustee subsequently filed a second notice of appeal in each of the three cases after the bankruptcy court entered separate orders striking the respective cases. A-7, A-9, A-11.

This Court has jurisdiction over the consolidated appeals pursuant to 28 U.S.C. § 158(d)(1) and 28 U.S.C. § 1291.[3]

STATEMENT OF THE ISSUES PRESENTED FOR REVIEW

1. Whether the district court erred by dismissing the U.S. Trustee's appeals for lack of standing.

2. Whether the district court erred by, in the alternative, affirming the bankruptcy court's decision to strike, rather than dismiss, debtors' cases for failure to obtain the requisite credit counseling under Section 109(h) of the Bankruptcy Code, 11 U.S.C. § 109(h).

STATEMENT OF THE CASE

Debtors Shayna Zarnel and Diana Finlay filed petitions under Chapter 13 of the Bankruptcy Code, and debtor Lena Elmendorf filed a petition under Chapter 7 of the Code in the United States Bankruptcy Court for the Southern District of New York. ZR 1; FR 1; ER 1. None of the debtors had obtained the requisite credit counseling under 11 U.S.C. § 109(h), nor had they qualified for a temporary waiver of the requirement. See Bankruptcy Court slip opinion ("Bankr. Op.") at 4-7, A-16-19.[4] The U.S. Trustee filed motions to dismiss on this ground under Sections 1307(c) in the

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[3] This Court has consolidated the U.S. Trustee's appeals in the Zarnel, Finlay and Elmendorf cases "for all purposes." See March 5, 2007 Consolidation Order.

[4] The bankruptcy court's opinion is also reported. In re Elmendorf, 345 B.R. 486 (Bankr. S.D.N.Y. 2006).

Zarnel and Finlay cases, and under Section 707(a) in the Elmendorf case. Id.; op. 13, A-25. The bankruptcy court (Morris, J.), considered the motions to dismiss the three cases jointly. Id. at 1-30, A-13-42. Although no party had opposed the U.S. Trustee's motions to dismiss, the court decided to strike, rather than dismiss, the debtors' cases for failure to comply with Section 109(h). Id.

The U.S. Trustee filed timely notices of appeal of the bankruptcy court's orders striking the cases to the United States District Court for the Southern District of New York. ZR 36, FR 21, ER 18. The district court dismissed the U.S. Trustee's appeals, and, in the alternative affirmed the bankruptcy court's orders on the merits. Judgment, SPA-14.

STATEMENT OF FACTS

A. Statutory Framework[5]

1. The U.S. Trustee Program is a component of the Department of Justice that administers and enforces the Bankruptcy Code. See 28 U.S.C. §§ 581-89. U.S. Trustees are senior Justice Department officials appointed by the Attorney General who "supervise the administration of cases and trustees" in all bankruptcy cases within their respective regions. See 28 U.S.C. §§ 581(a), 586(a)(3). As Congress explained, U.S.

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[5] Pertinent statutory provisions are set forth in the Special Appendix attached to this brief.

Trustees “serve as enforcers of the bankruptcy laws by bringing proceedings in bankruptcy courts in particular cases in which a particular action taken or proposed to be taken deviates from the standards established by the proposed Bankruptcy Code.” H.R. Rep. No. 595, 95th Cong., 2d Sess. at 109 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5787, 6070. Congress has expressly granted the U.S. Trustee standing to “raise and * * * appear and be heard on any issue in any case or proceeding” arising under the Bankruptcy Code. 11 U.S.C. § 307.

2. On April 20, 2005, Congress enacted the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (“BAPCPA”), which took effect on October 17, 2005. See Pub. L. 109-8, 119 Stat. 23 (2005). Congress enacted BAPCPA “to improve bankruptcy law and practice by restoring personal responsibility and integrity in the bankruptcy system and ensure that the system is fair for both debtors and creditors.” H.R. Rep. No. 31(I), 109th Cong., 1st Sess. at 2 (2005), *reprinted in* 2005 U.S.C.C.A.N. 88, 89.

As relevant to the present case, BAPCPA amended Section 109 of the Code by adding the requirement that an individual receive credit counseling during the 180-day period before filing a bankruptcy petition. 11 U.S.C. § 109(h)(1).[6] Section 109 of the

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[6] Specifically, Section 109(h) requires that an individual, “during the 180-day period preceding the date of filing of the petition * * * receive[] from an approved nonprofit budget and credit counseling agency described in section 111(a) an individual or group briefing (including a briefing conducted by

Bankruptcy Code sets forth “who may be a debtor” under applicable chapters of the Code. 11 U.S.C. § 109. These eligibility rules include, for example, the requirement that only those individuals who receive “regular income” and who owe less than statutorily-specified amounts in debt, may qualify as debtors under Chapter 13 (11 U.S.C. § 109(e)), and, after BAPCPA, the credit counseling requirement of Section 109(h).

Congress mandated pre-petition credit counseling so that debtors would “make an informed choice about bankruptcy, its alternatives, and consequences.” H.R. Rep. No. 31(I), 109th Cong., 1st Sess. at 2, *reprinted in* 2005 U.S.C.C.A.N. at 89. Under Section 109(h), an individual is ineligible to be a debtor if he does not receive such credit counseling, unless the U.S. Trustee determines that counseling is not reasonably available in the individual’s district, or the individual qualifies for a temporary waiver from the court. 11 U.S.C. § 109(h)(2),(3). To obtain a waiver, the debtor must certify, in a manner “satisfactory to the court,” that (1) exigent circumstances “merit a waiver of” the pre-petition credit counseling requirement, and (2) he requested credit counseling from an approved agency, but was unable to obtain it within 5 days of his request. 11 U.S.C. § 109(h)(3)(A). If the debtor fulfills these

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telephone or on the Internet) that outlined the opportunities for available credit counseling and assisted such individual in performing a related budget analysis.” 11 U.S.C. § 109(h).

conditions, the court can grant a temporary waiver, which can extend until no later than 30 days after the petition is filed, “except that the court, for cause, may order an additional 15 days” for the debtor to obtain credit counseling. 11 U.S.C. § 109(h)(3)(B).

In addition, section 521(b)(1) requires the debtor to file with the court a “certificate from the approved nonprofit budget and credit counseling agency” that provided the required credit counseling. 11 U.S.C. § 521(b)(1).

3. Under Section 301 of the Code, a “voluntary case under a chapter of this title is commenced by the filing with the bankruptcy court of a petition under such chapter by an entity that may be a debtor under such chapter.” 11 U.S.C. § 301(a). In the present case, debtor Lena Elmendorf filed a petition under Chapter 7 of the Bankruptcy Code. Section 707 of the Code provides that a bankruptcy court “may dismiss a case” under Chapter 7 “for cause” after notice and a hearing. 11 U.S.C. § 707(a). Debtors Shayna Zarnel and Diana Finlay filed petitions under Chapter 13 of the Code. Section 1307 of that chapter provides that a bankruptcy court may convert a Chapter 13 case to a case under Chapter 7 or “may dismiss” the case, “whichever is in the best interests of creditors and the estate, for cause” after notice and a hearing. 11 U.S.C. § 1307(c).

Section 362, the “automatic stay” provision of the

Bankruptcy Code, provides that the filing of a petition under Section 301 “operates as a stay” of certain collection and other actions by creditors against the debtor. 11 U.S.C. § 362(a). When it enacted BAPCPA, to discourage debtors from “bad faith repeat filings,” Congress amended Section 362 to limit application of the automatic stay where, in the previous year, a debtor’s case has been “dismissed” by the bankruptcy court. 11 U.S.C. § 362(c)(3); H.R. Rep. No. 31(I), 109th Cong., 1st Sess. at 69, *reprinted in* 2005 U.S.C.C.A.N. at 138.

Accordingly, as amended, Section 362 provides that if a debtor filing a petition under Chapter 7, 11 or 13 had a prior petition dismissed during the preceding year, the automatic stay “shall terminate with respect to the debtor on the 30th day after the filing of the later case.” 11 U.S.C. § 362(c)(3)(A). The debtor may move for a continuation of the stay, and the bankruptcy court may grant the motion if the debtor “demonstrates that the filing of the later case is in good faith as to the creditors to be stayed.” 11 U.S.C. § 362(c)(3)(B). Congress further provided, however, that the debtor’s later case “is presumptively filed not in good faith (but such presumption may be rebutted by clear and convincing evidence to the contrary)” if the debtor had “more than 1 previous case” pending within the prior year, or had a previous case dismissed during the preceding year “after the debtor failed to * * * file or amend the petition or other documents as required by this title or the court without substantial excuse (but mere inadvertence or negligence shall not be a substantial excuse unless the dismissal was caused by the negligence of the debtor's attorney)." 11 U.S.C. § 362(c)(3)(C)(i)(I),(II)(aa).

In addition, the automatic stay will not go into effect at the outset of the case if the debtor had two or more bankruptcy petitions dismissed within the previous year unless the debtor can demonstrate that its later case is filed in good faith. 11 U.S.C. § 362(c)(4)(A),(B). However, the later case is presumed not to be filed in good faith if the debtor either had two or more cases pending in the past year, or had a previous case dismissed in the preceding year for failure to "file or amend the petition or other documents as required by this title or the court without substantial excuse (but mere inadvertence or negligence shall not be a substantial excuse unless the dismissal was caused by the negligence of the debtor's attorney)[.]" 11 U.S.C. § 362(c)(4)(D)(i)(I),(II).

B. The Present Litigation

1. Shayna H. Zarnel

On March 13, 2006, debtor Shayna H. Zarnel, proceeding *pro se*, filed a petition under Chapter 13 of the Bankruptcy Code, and a motion to extend time to seek credit counseling under Section 109(h). ZR 1, 2; Bankr. Op. 6-7, A-18-19. Although this was

Zarnel’s first bankruptcy petition, her husband had filed five bankruptcy petitions since January, 2004. Bankr. Op. 6 & n.7, A–18 & n.7. On April 3, 2006, Zarnel filed a certificate reflecting that she received credit counseling eight days after she filed her petition. ZR 13, Bankr. Op. 7, A-19. The U.S. Trustee filed a motion to dismiss Zarnel’s petition for cause under Section 1307(c), because she had failed to comply with the mandatory pre-petition credit counseling requirement in Section 109(h). ZR 16, Bankr. Op. 7, A-19. On May 23, 2006, the bankruptcy court denied Zarnel’s extension request because she had failed to demonstrate exigent circumstances as required by 11 U.S.C. § 109(h)(3)(A). ZR 18, Bankr. Op. 7, A-19. The court held a hearing on the U.S. Trustee’s motion to dismiss and determined that it would rule on the motion in conjunction with the Finlay and Elmendorf cases. Bankr. Op. 7-8, A–19-20.

2. Diana M. Finlay

On April 3, 2006, Diana M. Finlay, proceeding *pro se*, filed a petition under Chapter 13 of the Bankruptcy Code, and a motion to extend time to seek credit counseling under Section 109(h). FR 1, 2; Bankr. Op. 5, A-17. Two days later, the bankruptcy court denied Finlay’s motion, on the ground that she had failed to comply with the requirement in Section 109(h)(3)(A)(ii) that the debtor certify that she had requested credit counseling from an approved agency, but had been unable to obtain it within five days of her request. FR 6, Bankr. Op. 5, A–17.

Finlay had filed two prior petitions within the preceding year. Bankr. Op. 5, A-17. Because those cases were dismissed, the bankruptcy court found that “no stay came into effect upon the filing of the current petition in accordance with 11 U.S.C. § 362(c)(4)[.]” Id. at 6, A–18. On May 3, 2006, the U.S. Trustee also moved to dismiss Finlay’s petition for cause under Section 1307(c), because she had failed to comply with Section 109(h). FR 11, Bankr. Op. 6, A-18. The court deferred ruling on the U.S. Trustee’s motion so that it could consider it in conjunction with the Zarnel and Elmendorf cases. Bankr. Op. 6, A–18.

3. Lena M. Elmendorf

On November 29, 2005, Lena M. Elmendorf, who was represented by counsel, filed a petition under Chapter 7 of the Bankruptcy Code. ER 1, Bankr. Op. 4, A-16. Elmendorf failed to file either a certificate indicating compliance with the credit counseling requirement or a request for a temporary waiver of the requirement. See Bankr. Op. 4, A-16. On February 1, 2006, the U.S. Trustee filed a motion to dismiss Elmendorf’s petition under Section 707(a) for failure to comply with Section 109(h). ER 7, Bankr. Op. 4-5, A-16-17. The court held a hearing on the U.S. Trustee’s motion, and deferred ruling on it so that it could decide the case together with Zarnel and Finlay. Bankr. Op. 5, A–17.

4. Bankruptcy Court Decision

On July 18, 2006, the bankruptcy court issued an opinion addressing the U.S. Trustee's motions to dismiss in the Zarnel, Finlay and Elmendorf cases. Op. 1-30, A-13-42. At the outset, the court recognized that "[c]redit counseling is an absolute pre-requisite to individual bankruptcy eligibility." Id. at 11, A-23. In the court's view, however, failure to comply with that requirement alone is not "cause" to dismiss a case. Id. at 3-4; 15-27, A-15-16; A-27-39. Rather, consistent with its prior decision in In re Rios, 336 B.R. 177 (Bankr. S.D.N.Y. 2005), the court held that if a debtor fails to obtain credit counseling, her case should be stricken, not dismissed, in the absence of other circumstances indicating that the failure to obtain counseling is "not due to ignorance but as part of a larger scheme to delay or hinder creditors." Id. at 3-4, A-15-16.

Although the court acknowledged (Op. 14, A-26) that the "tide of judicial opinion is against" it, since "almost all cases published subsequent to [its prior decision in] *Rios* dismiss for 'cause' cases filed by debtors ineligible for relief by virtue of Section 109(h)," it nonetheless held that it was appropriate to strike, rather than dismiss, a case in which the debtor failed to obtain credit counseling. The court also ruled that the automatic stay under Section 362 did not go into effect where an individual has neither obtained credit counseling nor received a temporary waiver of the requirement. Id. at 17, A-29. According to the court, a debtor's ineligibility for relief in such circumstances is "incurable," and Congress intended that "incurably ineligible debtors not be permitted to enjoy the protections of the automatic stay." Id. at 23, A-35.

In response to the U.S. Trustee's argument that it lacked authority under the Bankruptcy Code to strike a case, the court stated that "where Congress has not explicitly directed bankruptcy courts to a required outcome, the Court may act within its discretion." Op. 25, A-37. Relying on Section 105(a) of the Bankruptcy Code, which provides bankruptcy courts with authority to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title" (11 U.S.C. § 105(a)), and its "inherent docket management powers," the court denied the U.S. Trustee's motions to dismiss and struck the Elmendorf, Finlay and Zarnel cases.[7] Op. 26-29, A-38-41.

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[7] The bankruptcy court *sua sponte* certified its orders in the three cases to this Court for direct appeal under 28 U.S.C. § 158(d)(2). As we informed the Court, the U.S. Trustee did not request such certification; rather, the U.S. Trustee believed that the issue in the cases would benefit from further litigation before the district court prior to any appeal to this Court. Accordingly, the U.S. Trustee filed timely notices of appeal to the district court, and did not petition this Court for permission to appeal. On November 17, 2006, this Court consolidated and dismissed the appeals because "[n]either the debtors nor the United States Trustee have filed a petition for permission to appeal, pursuant to Federal Rule of Appellate Procedure 5(a)" and "the bankruptcy court is not a "party" within the meaning of Fed. R. App. P. 5(a)." November 17, 2006 Order, Second Circuit Nos. 06-3521, 06-3524, 06-3530.

5. District Court Decision

The district court consolidated the Zarnel, Finlay and Elmendorf cases for decision. D. Ct. Op. 1, SPA-1. On November 8, 2006, the district court entered judgment dismissing the U.S. Trustee's appeals for lack of standing, and, in the alternative, affirming the bankruptcy court's orders "in all respects." SPA-14. The court's ruling that the U.S. Trustee lacked appellate standing appeared to rest on its view that the Trustee was not "substantively aggrieved" by the district court's order. See D. Ct. Op. 6-7, SPA-6-7. Although the court acknowledged that "[o]ne would think that since the United States Trustee has unquestioned standing to move to dismiss a petition, he or she would also have standing to appeal from the denial of such a motion," the court ruled otherwise, based on the "person aggrieved" standard that this Court has applied to private parties' standing to appeal bankruptcy court orders. Id.

The court found it "difficult" to "perceive that the [U.S.] Trustee is aggrieved under the circumstances of these cases." D. Ct. Op. 7, SPA-7. The court stated that "[w]here the Trustee had engaged in the sale of property or some other substantive event, very likely the recourse to a motion to strike as opposed to a motion to dismiss might constitute an abuse of discretion by the Court and might or might not have an adverse effect on some interlocutory action taken by the Trustee in connection with the administration of the estate prior to the striking." Id. However, the court found that since no such actions were taken in the present cases, and no "creditor's rights were limited or affected in any way" by the bankruptcy court's orders, "consideration of the issue must await the proper case." Id. Nonetheless, "[h]aving no great confidence" in its ruling on standing, the court proceeded to decide the merits. Id.

The court agreed with the bankruptcy court that, where, at the time she files a petition, an individual has neither obtained the requisite credit counseling nor qualified for a temporary waiver of the requirement, the automatic stay does not take effect. D. Ct. Op. 8-9, SPA 8-9. The court also held that the bankruptcy court had "an historic and inherent power" to strike a petition in its entirety "for good cause."[8] Id. at 10, SPA-10. The court relied on Bankruptcy Code Section 105(a), which authorizes the bankruptcy court to issue orders that are "'necessary or appropriate to carry out the provisions'" of the Code. Id. at 10-11, SPA 10-11 (quoting 11 U.S.C. § 105(a)). The court found that Congress "has not explicitly directed Bankruptcy Courts to a required outcome" regarding whether a case should be

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[8] The district court erroneously framed the issue as whether the bankruptcy court had the authority to strike a petition, when in fact the bankruptcy court struck all three cases. Indeed, the court appears to misquote the U.S. Trustee's statement of the issue. Compare D. Ct. Op. 5, SPA–5, with U.S. Trustee Br., D. Ct. R. 6 at 1.

stricken or dismissed for failure to comply with Section 109(h), and thus the bankruptcy court did not act *"ultra vires"* by striking "the pleadings in these cases." Id. at 11, SPA-11.

SUMMARY OF ARGUMENT

1. The district court erred by dismissing the U.S. Trustee's appeals for lack of standing. Section 307 of the Bankruptcy Code expressly confers standing on the U.S. Trustee to "raise and * * * appear and be heard on any issue in any case or proceeding" arising under the Bankruptcy Code. 11 U.S.C. § 307. As the courts of appeals that have addressed the issue have unanimously held, the U.S. Trustee thus need not meet the "person aggrieved" standard to have appellate standing. In the present case, the U.S. Trustee seeks to advance the public interest and ensure that bankruptcy cases are conducted consistent with the Code, and therefore has appellate standing regardless of whether she has a pecuniary interest in the appeal.

2. The district court erred by affirming the bankruptcy court's decision to strike debtors' cases. After BAPCPA was enacted, an important issue has arisen regarding the proper manner in which to dispose of a case where, as here, the debtors have failed to comply with the credit counseling requirement in Section 109(h). A substantial majority of courts have agreed with the U.S. Trustee's position that a bankruptcy court must dismiss a case when it determines that debtors are ineligible for

bankruptcy relief due to failure to satisfy the credit counseling requirement.

The U.S. Trustee’s position reflects a proper interpretation of the Bankruptcy Code, advances congressional intent, and avoids uncertainty and confusion in bankruptcy proceedings. While the Bankruptcy Code specifically provides the court with authority to “dismiss” cases for “cause,” and sets forth the effect of such a dismissal on the parties, it does not authorize the striking of a case or petition for failure to meet the credit counseling requirement in Section 109(h). Accordingly, prior to the passage of BAPCPA, courts routinely dismissed -- not struck –- cases for debtors’ failure to meet eligibility requirements under other subsections of Section 109.

Dismissal of cases for failure to comply with Section 109(h) also helps implement Congress’s purpose in amending Section 362 to limit applicability of the automatic stay in cases that are filed within a year of a prior dismissal. Congress intended to deter repeat filers from abusing bankruptcy proceedings, and the decisions of the courts below circumvent this purpose by striking the petition rather than dismissing the case, thereby allowing a debtor to avoid such limits if he files a subsequent petition.

Indeed, the U.S. Trustee’s position provides the only workable and consistent reading of the Code. Under this majority view, when an individual files a petition under Section 301, he has commenced a case, and the automatic stay is triggered. If and when the bankruptcy court later decides that the individual is ineligible to be a debtor under Section 109, the court should dismiss the case for cause. In contrast, the minority of courts that have rejected the U.S. Trustee's position have divided over issues such as whether to dismiss the petition or the case, and whether the automatic stay is invoked by the filing of a petition by an individual who is ineligible for bankruptcy relief under Section 109(h). For this reason, and because the Code does not provide any guidance on the consequences of a bankruptcy court order striking a petition or case, the decisions of the courts below will cause significant uncertainty and potential prejudice to the parties in bankruptcy proceedings.

STATEMENT OF THE STANDARD OF REVIEW

1. Whether the U.S. Trustee has appellate standing is a legal question that this Court reviews *de novo*. See Mid-Hudson Catskill Rural Migrant Ministry, Inc. v. Fine Host Corp., 418 F.3d 168, 173 (2d Cir. 2005).

2. This Court, like the district court, reviews *de novo* the bankruptcy court's legal conclusions, including its construction of the Bankruptcy Code. In re Momentum Mfg. Corp., 25 F.3d 1132, 1136 (2d Cir. 1994). Whether the bankruptcy court had authority under the Bankruptcy Code to strike, rather than dismiss, debtors' cases for failure to comply with Section 109(h) is a

legal question subject to *de novo* review.

ARGUMENT

I. THE U.S. TRUSTEE HAS STANDING TO APPEAL THE BANKRUPTCY COURT'S ORDERS STRIKING DEBTORS' CASES.

The district court dismissed the U.S. Trustee's appeals for lack of standing because the U.S. Trustee did not meet the "person aggrieved" standard that this Court applies to determine a private party's standing to appeal a bankruptcy court order. In doing so, however, the court acknowledged that it had "[n]o great confidence" in its ruling. D. Ct. Op. 6-7, SPA-6–7. This lack of confidence is understandable, since, as set forth below, the district court's holding conflicts with well-established case law addressing the U.S. Trustee's appellate standing.

A. In Section 307 of the Bankruptcy Code, Congress conferred standing on the U.S. Trustee to "raise and * * * appear and be heard on any issue in any case or proceeding" arising under the Bankruptcy Code. 11 U.S.C. § 307. As the Third Circuit has observed, "[i]t is difficult to conceive of a statute that more clearly signifies Congress's intent to confer standing." <u>In re Columbia Gas Sys., Inc.</u>, 33 F.3d 294, 296 (3d Cir. 1994). Accordingly, while this Court has not addressed the issue, the courts of appeals that have addressed it have unanimously held that the U.S. Trustee need not have a pecuniary interest in a bankruptcy case to have standing to appeal. See, <u>e.g.</u>, <u>In re United Artists Theatre Co.</u>, 315 F.3d 217, 225 (3d

Cir. 2003); Columbia Gas, 33 F.3d at 296-99; In re Clark, 927 F.2d 793, 795-96 (4th Cir. 1991); In re Plaza de Diego Shopping Ctr., 911 F.2d 820, 824 (1st Cir. 1990); In re Revco D.S., Inc., 898 F.2d 498, 499-500 (6th Cir. 1990).

Here, the district court erroneously relied on the "person aggrieved" standard, applicable to private parties' standing in bankruptcy appeals, in determining that the U.S. Trustee lacked standing. D. Ct. Op. 6-7, SPA-6-7. As the Fourth Circuit explained, although courts "traditionally have used the 'person aggrieved' test to determine appellate standing in bankruptcy cases," under which a party generally must be "directly and adversely affected pecuniarily," that standard does not apply to U.S. Trustees.[9] Clark, 927 F.2d at 795 (internal quotations omitted).

Indeed, courts have recognized that under Section 307, the Trustee has standing to protect the public interest. E.g., Columbia Gas, 33 F.3d at 296-99; Clark, 927 F.2d at 795-96; Revco, 898 F.2d at 499-500. In so holding, courts have relied on the legislative history of the Bankruptcy Reform Act of 1978 and the Bankruptcy Act of 1986, in which Congress described the U.S. Trustee's role in protecting the public interest and "'ensuring

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[9] Although the "person aggrieved" test was originally codified in Section 39(c) of the Bankruptcy Act, Congress repealed that section in 1978, and the test no longer appears in the statute. Clark, 927 F.2d at 795. Courts have nonetheless continued to apply the test to private parties' appeals. Id.

that bankruptcy cases are conducted according to law.'" Revco, 898 F.2d at 500 (quoting H.R. Rep. No. 595, 95th Cong. 2d Sess. at 109 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5787, 6070); Clark, 927 F.2d at 795 (same). As Congress made clear,"'[t]he U.S. Trustee is given *standing* to raise, appear, and be heard *on any issue in any case* or proceeding under title 11, U.S. Code." Columbia Gas, 33 F.3d at 296 (quoting H.R. Rep. 764, 99th Cong., 2d Sess. 24, 27 (1986), *reprinted in* 1986 U.S.C.C.A.N. 5227, 5240 (emphasis added by court)).

This grant of authority includes standing to appeal the denial of a motion to dismiss; without such standing, the U.S. Trustee Program would be unable to perform its core function of ensuring that bankruptcy proceedings are conducted in accordance with the Code.[10] See Clark, 927 F.2d at 795-96 (U.S. Trustee has standing to appeal denial of § 707(b) motion to dismiss). Even the district court below acknowledged that "[o]ne would think that since the United States Trustee has unquestioned standing to move to dismiss a petition, he or she would also have standing to appeal from the denial of such a motion." D. Ct. Op. 6, SPA–6. In fact, Section 1109(a) of the Code, which provides that the Securities and Exchange Commission (SEC) may "raise and may

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[10] Data maintained by the U.S. Trustee Program indicates that in fiscal year 2006, U.S. Trustees filed over 7,000 motions under Sections 707(a) and 1307(c) alone, which are the provisions under which the U.S. Trustee moved to dismiss before the bankruptcy court.

appear and be heard on any issue in a case under this chapter [Chapter 11], but * * * may not appeal from any judgment, order, or decree entered in the case," demonstrates that Congress can and will expressly limit a government agency's appellate standing when it deems appropriate. 11 U.S.C. § 1109(a). Because neither Section 307 nor any other provision of the Code limits the U.S. Trustee's appellate standing, Congress's intent that the U.S. Trustee have such standing is apparent.

Thus, that this Court has applied the "person aggrieved" standard to determine whether private parties have standing to appeal in bankruptcy cases is not controlling here. See, e.g., International Trade Adm'n v. Rensselaer Polytechnic Inst., 936 F.2d 744, 747 (2d Cir. 1991) (applying "person aggrieved" standard to private litigant). The district court's reliance (Op. 6, SPA-6) on International Trade Adm'n is therefore misplaced. The "persons aggrieved" standard is "not the only test"; to the contrary, "a *public* interest may also give a sufficient stake in the outcome of a bankruptcy case to confer appellate standing." Revco, 898 F.2d at 499. Where, as here, the U.S. Trustee is attempting "to enforce the law in the public interest," she has appellate standing regardless of whether she can meet the "person aggrieved" standard applicable to private parties. Clark, 927 F.2d at 796; Revco, 898 F.2d at 500.

Based on analogous reasoning, this Court rejected an argument that the United States lacked standing in a civil RICO suit because it had not alleged or demonstrated an injury caused by defendant. United States v. Sasso, 215 F.3d 283, 292 (2d Cir. 2000). As this Court explained, a statutory provision, 18 U.S.C. § 1964(b), "authorizes the government to bring suit under § 1964," and "Section 1964(a) contains no requirement that the government show that it was injured." Id.

Nor does the district court's observation (Op. 7. SPA-7) that "[n]o present creditor's rights were limited or affected in any way by the Orders appealed from" change the analysis. Indeed, without directly addressing the pecuniary interest point, the Ninth Circuit has also affirmed the U.S. Trustee's standing to appeal an issue under Section 307, even when creditors had no interest in the appeal.[11] See, e.g., In re Donovan Corp., 215

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[11] In any event, the district court's statement that "[n]o present creditor's rights were limited or affected in any way" by the bankruptcy court's decision to strike, rather than dismiss, the debtors' cases, is inaccurate. As we explain, infra pp. 43-49, striking rather than dismissing a case prejudices the rights of such creditors, by causing uncertainty regarding debtors' status and the existence of the automatic stay in any future cases filed by the debtors. Indeed, one of the debtors, Lena Elmendorf, did file a subsequent petition. See infra n.21. Had the bankruptcy court dismissed the present case, the stay in that case would have terminated after 30 days absent a motion from Elmendorf establishing good faith. See 11 U.S.C. § 362(c)(3). As demonstrated in the text, however, the U.S. Trustee's standing does not depend on whether any creditor is substantively aggrieved. By enacting Section 307, Congress gave the U.S. Trustee a legal right to participate in bankruptcy proceedings to advance the public interest and ensure that bankruptcy laws are properly applied. That right exists regardless of whether creditors' interests are harmed in these or future cases.

F.3d 929, 929-30 (9th Cir. 2000) (although creditors had "expressed no interest" in appeal, U.S. Trustee had standing under Section 307 to "be heard on any issue in any case or proceeding under title 11"); see also In re Pillotex, Inc., 304 F.3d 246, 250 (3d Cir. 2002) (U.S. Trustee has standing to appeal law firm's retention as counsel even though "none of the parties in interest to the bankruptcy objected" to retention of firm).

Applying these principles, the U.S. District Court for the Eastern District of Kentucky recently held that the U.S. Trustee had standing to appeal a bankruptcy court's decision to strike debtors' petitions, rather than dismiss their cases, where, as here, debtors failed to comply with Section 109(h).[12] In re Mason, 2007 WL 433077 at *1 (E.D. Ky. Feb. 5, 2007). The court rejected reliance on the "person aggrieved" standard, and ruled that U.S. Trustees "have broad appellate standing" to protect the public interest. Id. As the court explained, the purpose of the U.S. Trustee's appeal "is to ensure that bankruptcy courts choose the appropriate remedy when a debtor is ineligible for bankruptcy relief because of his or her failure to obtain credit

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[12] In another case raising the same merits question, In re Thompson, No. 06-1033 (S.D. Ind. Dec. 4, 2006), the district court expressed doubts, in dicta, regarding the U.S. Trustee's standing, but declined to decide the issue. See Thompson Order at 4 (attached as Addendum). The U.S. Trustee has appealed the district court's decision in Thompson to the Seventh Circuit. That appeal, which addresses both the standing and merits questions at issue in the present case, is currently pending. In re Thompson, Seventh Cir. No. 07-1240.

counseling," and this purpose "falls within the Trustee's power to ensure that bankruptcy cases are conducted according to the law." Id. This reasoning applies equally to the present case.

B. Supreme Court precedent further supports the U.S. Trustee's appellate standing. As the Court has emphasized, "[e]very government, intrusted by the very terms of its being with powers and duties to be exercised and discharged for the general welfare, has a right to apply to its own courts for any proper assistance in the exercise of the one and the discharge of the other, and it is no sufficient answer to its appeal to one of those courts that it has no pecuniary interest in the matter." In re Debs, 158 U.S. 564, 584 (1895).

In SEC v. United States Realty & Improvement Co., 310 U.S. 434 (1940), for example, the Supreme Court held that the SEC had standing to appeal an order under the Bankruptcy Act even though it had no pecuniary interest in the case; rather, its "only interest" was "a public one." Id. at 460. In fact, the U.S. Trustee has a stronger basis for standing than did the SEC in United States Realty, because Section 307 of the Bankruptcy Code gives the U.S. Trustee the express right to "raise," "appear," and "be heard on any issue in any case or proceeding" arising under the Bankruptcy Code (11 U.S.C. § 307), while the SEC had to rely on Fed. R. Civ. P. 24 provisions for intervention under Chapter XI of the Bankruptcy Act, since it had a statutory right to appear only in Chapter X proceedings. See 310 U.S. at 458. Despite the lack of a statutory right to appear in Chapter XI proceedings under the Bankruptcy Act, the Court ruled that the SEC could intervene and appeal the adverse order allowing a debtor to proceed under Chapter XI because the Commission was "charged with the performance of important public duties in every case brought under Chapter X, which will be thwarted, to the public injury, if a debtor may secure adjustment of his debts in a Chapter XI proceeding when * * * he should be required to proceed, if at all, under Chapter X." Id. at 458-59.[13]

And, as the Supreme Court more recently made clear, its precedent establishes that consistent with Article III of the Constitution, Congress has the authority to confer standing on a federal agency to protect the public interest by ensuring that the statutes that it administers are properly enforced. Director, Office of Workers' Comp. Programs v. Newport News Shipbuilding and Dry Dock Co., 514 U.S. 122, 133 (1995). As the

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[13] United States Realty is also instructive on the more specific issue of when an agency has standing to appeal. The Supreme Court noted that although the SEC had statutory a right to participate in proceedings under Chapter X of the Bankruptcy Act, Congress had provided that the Commission could "not appeal or file any petition for appeal" in such proceedings. 310 U.S. at 461. Nonetheless, because the appeal at issue was in the context of Chapter XI proceedings, the Court held that the statutory limitation on appeals did not apply. Id. Here, in contrast, Congress has placed no such limitation on the U.S. Trustee's ability to appear in appeals under any chapter of the Bankruptcy Code.

Court explained, its prior cases "certainly establish that Congress *could* have conferred standing upon the Director without infringing Article III of the Constitution" (id. at 134); indeed, "the United States Code displays throughout that when an agency in its governmental capacity *is* meant to have standing, Congress says so." Id. at 129. Because Congress has expressly conferred such public interest standing on the U.S. Trustee under the Bankruptcy Code, neither Article III nor the "person aggrieved" standard applicable to private parties poses any bar to allowing the U.S. Trustee to appeal.

II. WHERE, AS HERE, DEBTORS FAIL TO COMPLY WITH SECTION 109(h) OF THE BANKRUPTCY CODE, THE BANKRUPTCY COURT MUST DISMISS, RATHER THAN STRIKE, THE CASE.

The district court's holding that the bankruptcy court had authority to strike, rather than dismiss, debtors' cases raises an important recurring legal issue regarding how a court should dispose of a case when a debtor has not complied with Section 109(h). As we demonstrate below, the majority view that courts should dismiss cases in which debtors fail to comply with Section 109(h) is correct, and provides the only workable interpretation of the Code.

A. Dismissal Is The Only Proper Disposition Of Debtors' Cases Under The Bankruptcy Code.

The district court erred by affirming the bankruptcy court's decision to strike debtors' cases for failure to comply with the credit counseling requirement in Section 109(h). That failure to meet this requirement rendered debtors ineligible to obtain bankruptcy relief does not mean that their cases were legal nullities. To the contrary, even when a court lacks subject matter jurisdiction, it dismisses a case, it does not strike it.[14] E.g., Makarova v. United States, 201 F.3d 110 (2d Cir. 2000) (affirming district court's dismissal of case for lack of subject matter jurisdiction); Close v. State of New York, 125 F.3d 31 (7th Cir. 1997) (same); Electronics Commun'cns Corp. v. Toshiba Am. Consumer Prod., Inc., 129 F.3d 240 (2d Cir. 1997) (affirming dismissal for failure to state a claim); see Fed. R. Civ. P. 12(h)(3) (whenever "it appears * * * that the court lacks

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[14] Under the reasoning of the Supreme Court's decision in Arbaugh v. Y & H Corp., 546 U.S. 500, 126 S. Ct. 1235 (2006), the eligibility requirements in Section 109, while mandatory, are not jurisdictional. See id. at 1244-45 ("when Congress does not rank a statutory limitation on coverage as jurisdictional, courts should treat the restriction as nonjurisdictional in character"). Even prior to Arbaugh, courts of appeals that directly addressed the issue held that the eligibility requirements in Section 109 are not jurisdictional. In re McCloy, 296 F.3d 370, 375 (5th Cir. 2002); In re Hamilton Creek Metropolitan Dist., 143 F.3d 1381, 1385 n.2 (10th Cir. 1998); In re Montgomery, 37 F.3d 413, 415 n.5 (8th Cir. 1994); but cf. Matter of Estate of Medcare HMO, 998 F.2d 436, 447 (7th Cir. 1993) (affirming district court's dismissal of Chapter 11 petition for lack of jurisdiction because debtor ineligible under Section 109(b)(2) without addressing whether Section 109 requirements are jurisdictional). Notably, the bankruptcy court and district courts below agreed that the eligibility requirement in Section 109(h) is not jurisdictional. Bankr. Op. 18, A–30; D. Ct. Op. 12, SPA–12. In any event, this Court need not decide the question, since, as shown in the text, regardless of whether the eligibility requirements in Section 109 are jurisdictional, the proper course is for the court to dismiss a case where, as here, a debtor is ineligible for relief.

jurisdiction over the subject matter, the court shall dismiss the action") (emphasis added). Moreover, if failure to exhaust administrative remedies causes a plaintiff to be ineligible to file suit under a federal statute, the court dismisses, rather than strikes, the case or complaint. E.g., Polera v. Board of Educ. Of Newburgh Enlarged City Sch. Dist., 288 F.3d 478, 491 (2d Cir. 2002) (remanding to district court with instructions to dismiss complaint because plaintiff failed to exhaust administrative remedies); Davenport v. Harry N. Abrams, Inc., 249 F.3d 130, 136 (2d Cir. 2001) (affirming district court's dismissal of action for failure to exhaust administrative remedies).

Nothing in the Bankruptcy Code indicates that the procedure should be any different with respect to failure to comply with Section 109(h). As the Supreme Court has made clear, when a court interprets the Bankruptcy Code, its inquiry "begins where all such inquiries must begin: with the language of the statute itself." United States v. Ron Pair Enterpr., Inc., 489 U.S. 235, 241 (1989). Numerous Code provisions refer to dismissals of cases. Various chapters of the Bankruptcy Code, including Chapter 7 and Chapter 13, provide the bankruptcy court with authority to dismiss a case for cause. See 11 U.S.C. § 707(a); 11 U.S.C. § 1112(b); 11 U.S.C. § 1208; 11 U.S.C. § 1307(c).

As relevant to this case, both Section 707 and Section 1307 provide that a bankruptcy court “may dismiss a case” after notice and a hearing, for cause, “including” under certain enumerated circumstances. 11 U.S.C. §§ 707(a), 1307(c) (emphasis added). The Bankruptcy Code expressly provides that use of the word “including” in Title 11 is “not limiting” (11 U.S.C. § 102(3)), and this Court and other courts thus have recognized that the list of examples of “cause” for dismissal is not exhaustive.[15] See, e.g., In re C-TC 9th Ave. P’ship, 113 F.3d 1304, 1311 (2d Cir. 1997); In re Padilla, 222 F.3d 1184, 1191 (9th Cir. 2000); In re Huckfeldt, 39 F.3d 829, 831 (8th Cir. 1994).

Other provisions of the Code refer to dismissals as well, including Section 349, which explains the effects of a dismissal on the rights of parties to the bankruptcy proceeding. 11 U.S.C. § 349. In addition, Section 362, the automatic stay provision, sets forth the effect of prior dismissals on operation of the automatic stay in subsequent cases filed by the same debtor. 11 U.S.C. § 362(c)(3),(4).

In contrast, the Bankruptcy Code does not provide for the striking of a case or petition. Accordingly, prior to the enactment of the credit counseling requirement in Section 109(h), courts, including this Court, routinely dismissed cases where the

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[15] The bankruptcy court’s reliance (Op. 25, A-37) on the fact that neither Section 707(a) nor 1307(c) specifically mention failure to file a certificate of credit counseling under Section 521(b) as an example of “cause” for dismissal is thus misplaced.

debtor was ineligible for relief under other subsections of Section 109. See, e.g., In re Mazzeo, 131 F.3d 295, 301 (2d Cir. 1997) (affirming dismissal of Chapter 13 proceeding based on debtor’s ineligibility under § 109(e)); In re C-TC 9th Ave. P’ship, 113 F.3d at 1313 (affirming dismissal of case on grounds that debtor ineligible for relief under § 109(d)); Matter of Estate of Medcare HMO, 998 F.2d 436, 447 (7th Cir. 1993) (affirming dismissal of petition based on ineligibility under § 109(b)(2)); In re Seaman, 340 B.R. 698, 707 (Bankr. E.D.N.Y. 2006) (“[d]ismissal is the result in nearly all of the cases filed by petitioners who are ineligible under other subsections of Section 109"); see Bankr. Op. 24, A-36 (one of arguments made against striking is that “[w]hen a debtor ineligible for bankruptcy relief by virtue of other subsections of Section 109 files for relief, the bankruptcy courts have almost unanimously dismissed or converted those cases”).

It is therefore unsurprising that, since the enactment of BAPCPA, a substantial majority of courts have dismissed, not stricken, cases in which a debtor was found to be ineligible for failure to obtain the requisite credit counseling under Section 109(h). See, e.g., In re Seaman, 340 B.R. at 706 n.3 (as of March 30, 2006, thirty-one of thirty-four decisions addressing ineligibility under Section 109(h) “have resulted in dismissal”); In re Wilson, 346 B.R. 59, 64 (Bankr. N.D.N.Y. 2006) (“much greater number of courts to visit the issue have concluded that dismissal of the case is the only appropriate remedy”); Bankr. Op. 3, A-15 (acknowledges “great wave of judicial opinion” against striking case for failure to comply with Section 109(h)). The majority view includes two district court decisions issued after the judgment of the court below in the present case. Clippard v. Bass, – B.R. –, 2007 WL 913929 at *5-*6 (W.D. Tenn. March 13, 2007); In re Mason, 2007 WL 433077 (E.D. Ky. Feb. 5, 2007).[16] This majority view correctly interprets the Code, and is consistent with congressional intent. As we demonstrate below, the decisions of the minority of courts,[17] including the

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[16] See also In re Hedquist, 342 B.R. 295 (8th Cir. BAP 2006); In re Swiatkowski, 356 B.R. 581 (Bankr. E.D.N.Y. 2006); In re Jones, 352 B.R. 813 (Bankr. S.D. Tex. 2006); In re Wilson, 346 B.R. 59 (Bankr. N.D.N.Y. 2006); In re Racette, 343 B.R. 200 (Bankr. E.D. Wisc. 2006); In re Mills, 341 B.R. 106 (Bankr. D. Co. 2006); In re Seaman, 340 B.R. 698 (Bankr. E.D.N.Y. 2006); In re Dansby, 340 B.R. 564 (Bankr. D.S.C. 2006); In re Tomco, 339 B.R. 145 (Bankr. W.D. Pa. 2006); In re Mingueta, 338 B.R. 833 (Bankr. C.D. Cal. 2006); In re Wallace, 338 B.R. 399 (Bankr. E.D. Ark. 2006); In re Ross, 338 B.R. 134 (Bankr. N.D. Ga. 2006); In re Fields, 337 B.R. 173 (Bankr. E.D. Tenn. 2005); In re DiPinto, 336 B.R. 693 (Bankr. E.D. Pa. 2006); In re Rodriguez, 336 B.R. 462 (Bankr. D. Idaho 2005); In re Sosa, 336 B.R. 113 (Bankr. W.D. Tex. 2005); In re Childs, 335 B.R. 623 (Bankr. D. Md. 2005); In re Talib, 335 B.R. 424 (Bankr. W.D. Mo. 2005); In re Davenport, 335 B.R. 218 (Bankr. M.D. Fla. 2005); In re Sukmungsa, 333 B.R. 875 (Bankr. D. Utah 2005); In re Cleaver, 333 B.R. 430 (Bankr. S.D. Ohio 2005); In re Wallert, 332 B.R. 884 (Bankr. D. Minn. 2005); In re LaPorta, 332 B.R. 879 (Bankr. D. Minn. 2005); In re Watson, 332 B.R. 740 (Bankr. E.D. Va. 2005); In re Gee, 332 B.R. 602 (Bankr. W.D. Mo. 2005).

[17] See In re Carey, 341 B.R. 798 (Bankr. M.D. Fla. 2006); In re Rios, 336 B.R. 177 (Bankr. S.D.N.Y. 2005); In re Hubbard, 333 B.R. 377 (Bankr. S.D. Tex. 2005), reconsideration denied, In re

courts below, to strike, rather than dismiss, a case or petition, lack any basis in the Bankruptcy Code, are contrary to congressional intent, and would result in significant confusion and uncertainty among the parties.

B. The Bankruptcy Court Lacks Authority To Strike A Case For Failure To Comply With Section 109(h).

The sole provision of the Bankruptcy Code upon which the courts below relied was Section 105(a), which provides the bankruptcy court with authority to "issue any order, process or judgment that is necessary or appropriate to carry out the provisions of [the Code]." 11 U.S.C. § 105(a); see D. Ct. Op. 11, SPA-11; Bankr. Op. 25-26, A–37-38. Reliance on Section 105(a), however, begs the question of whether the Code allows the bankruptcy court to strike a case for failure to comply with the credit counseling requirement. As this Court has held, Section 105 "[b]y its very terms * * * limits the bankruptcy court's equitable powers, which 'must and can only be exercised within the confines of the Bankruptcy Code.'" <u>FDIC</u> v. <u>Colonial Realty Corp.</u>, 966 F.2d 57, 59 (2d Cir. 1992) (quoting <u>Norwest Bank Worthington</u> v. <u>Ahlers</u>, 485 U.S. 197, 206 (1988)). Thus, Section

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<u>Salazar</u>, 339 B.R. 622 (Bankr. S.D. Tex. 2006), <u>debtors' request for permission to appeal directly to Fifth Circuit denied on other grounds</u>, 193 Fed. Appx. 281, 2006 WL 1877284 (5th Cir. 2006). See also <u>In re Thompson</u>, 344 B.R. 899 (Bankr. S.D. Ind. 2006), <u>aff'd</u>, <u>In re Thompson</u>, No. 06-1033 (S.D. Ind. Dec. 4, 2006). As noted <u>supra</u> n.12, the U.S. Trustee's appeal of the district court's decision in <u>Thompson</u> is pending in the Seventh Circuit. <u>In re Thompson</u>, Seventh Cir. No. 07-1240.

105 “‘cannot be used in a manner inconsistent with the commands of the Bankruptcy Code.’” Id. (quoting In re Plaza de Diego, 911 F.2d at 830-31). Accordingly, the bankruptcy court’s equitable power under Section 105(a) “is the power to exercise equity in carrying out the *provisions* of the Bankruptcy Code, rather than to further the purposes of the Code generally, or otherwise to do the right thing.” In re Dairy Mart Convenience Stores, Inc., 351 F.3d 86, 92 (2d Cir. 2003).

As set forth above, the Code does not provide for the striking of the case, while numerous Code provisions provide for the dismissal of cases for cause. See In re Mason, 2007 WL 433077 at *3 (in reversing bankruptcy court decision to strike petition, district court holds that bankruptcy court was “acting outside its Section 105 discretion”). Thus, there is no authority for the bankruptcy court’s action under the Code. See, e.g., id. (“there is no support for the remedy of striking a debtor’s petition [for failure to comply with Section 109(h)] in the Bankruptcy Code”).

Nor does the district court’s reliance (Op. 9-10, SPA–9-10) on Fed. R. Bankr. P. 9011 and 7012(b), and Fed. R. Civ. P. 12(f) provide any authority to strike a case or petition for failure to comply with the credit counseling requirement. While the Federal Rules of Bankruptcy Procedure provide authority for striking pleadings or portions thereof under specific, limited circumstances, they do not support the bankruptcy court’s decision here. Bankruptcy Rule 9011 allows a bankruptcy court to strike an unsigned filing if, after receiving notice, the party fails to promptly correct the omission of the signature. Determining that a petition is unsigned is clear from the face of the petition itself, and does not require either findings of facts, or legal interpretation of the Code. In contrast, determining whether an individual is eligible to be a debtor under the various subsections of Section 109 often is not clear from the face of the petition, and can involve both disputed factual and legal issues. Most important, Rule 9011(a) on its face does not extend beyond the particular circumstance of an unsigned pleading.

Apart from Rule 9011(a), the only other bankruptcy rule that addresses striking a pleading does not apply to debtors’ cases. Bankruptcy Rule 7012(b) incorporates Fed. R. Civ. P. 12(e) and (f) in adversary proceedings. Fed. R. Bankr. P. 7012(b). But these consolidated cases are not adversary proceedings. See Fed. R. Bankr. P. 7001. And, even if they were, Fed. R. Civ. P. 12(e), which allows a court to strike a pleading where the party who filed the pleading fails to amend it after the court grants a motion for more definite statement, and Fed. R. Civ. P. 12(f), which allows a court to strike “from any pleading any insufficient defense or any redundant, immaterial, impertinent, or scandalous matter," do not provide the bankruptcy court with authority to strike a petition based on a party's ineligibility under Section 109.

C. The Courts Below Erred By Holding That Debtors' Filing Of Their Petitions Did Not Commence Cases Under Section 301.

1. Under Section 301 of the Code, a "voluntary case under a chapter of this title is commenced by the filing with the bankruptcy court of a petition under such chapter by an entity that may be a debtor under such chapter." 11 U.S.C. § 301(a). The bankruptcy and district courts below based their holdings in part on their finding that no "case" existed that could be dismissed, since, pursuant to Sections 301, a case commences only where a petition is filed by an entity or individual "'that may be a debtor under such chapter.'" See D. Ct. Op. 8, SPA-8; Bankr. Op. 15-17, A-27-29. The courts reasoned that if an individual files a petition without complying with Section 109(h), she has not commenced a case under Section 301 because she is ineligible to be a debtor under the Code. See id.

The decisions below misinterpret Section 301. As another bankruptcy court explained in reaching the opposite conclusion, in ordinary usage, "the word 'may' as used in § 301 of the Bankruptcy Code means 'might' or is meant to express a 'possibility.'" In re Tomco, 339 B.R. 145, 159 (Bankr. W.D. Pa. 2006). Moreover, the courts' analysis in the present case would apply equally to situations in which individuals file a petition under the wrong chapter of the Code, or otherwise in violation of Section 109, which delineates “who may be a debtor.” 11 U.S.C. § 109. For example, Section 109(e) conditions chapter 13 eligibility on debt and income thresholds. Whether a debtor meets such thresholds will not be immediately apparent in all cases. A debtor could conduct a case for weeks or months before the court determines that he is ineligible for bankruptcy relief. Under the district and bankruptcy courts’ logic, no case would have existed even though litigation would have proceeded for months. This view of Section 301 is unworkable, and conflicts with how that section was interpreted prior to BAPCPA.

2. In addition, the district and bankruptcy courts’ interpretation of Section 301 creates uncertainty regarding the applicability of Section 362, the automatic stay provision. The bankruptcy court explained that because Section 362(a) provides that “‘a petition filed under **section 301, 302, or 303** of this title * * * operates as a stay,’” a “straightforward reading” of Section 362 “indicates that the automatic stay comes into existence only when a case is filed in accordance with §§ 301, 302 or 303[.]” Bankr. Op. 17, A–29 (quoting 11 U.S.C. § 362(a) (emphasis added by court)). The bankruptcy court thus held that the automatic stay is not invoked where an individual files a petition without complying with the credit counseling requirement because “[w]hen read together, §§ 109(h), 301 and 362(a)

establish that no stay can exist for debtors who fail to obtain the required credit counseling or qualify for an exception." Id.; see also In re Salazar, 339 B.R. 622, 626 (Bankr. S.D. Tex. 2006), debtors' request for permission to appeal directly to Fifth Circuit denied on other grounds, 193 Fed. Appx. 281, 2006 WL 1877284 (5th Cir. 2006).

But viewing the filing of a petition by a debtor whom the court subsequently determines is ineligible as a legal nullity that does not invoke the automatic stay renders superfluous a provision of BAPCPA. In BAPCPA, Congress amended Section 362 to provide that the filing of a petition "does not operate as a stay" of "any act to enforce any lien against or security interest in real property" if the "debtor is ineligible under section 109(g) to be a debtor in a case under this title." 11 U.S.C. § 362(b)(21)(A). Section 109(g) provides that an individual is ineligible to be a debtor if he was a debtor in a pending case in the prior 180 days and (1) that case was "dismissed by the court for willful failure of the debtor to abide by orders of the court, or to appear before the court in proper prosecution of the case," or (2) the debtor "requested and obtained the voluntary dismissal of the case following the filing of a request for relief from the automatic stay[.]" 11 U.S.C. § 109(g). If a filing by a debtor ineligible under Section 109(g) "were void *ab initio* and did not result in an automatic stay under existing law, such an amendment would not have been necessary."[18] In re Ross, 338 B.R. 134, 139 (Bankr. N.D. Ga. 2006); In re Racette, 343 B.R. 200, 203 (Bankr. E.D. Wisc. 2006).

In fact, attempting to avoid the problem of rendering Section 362(b)(21)(A) surplusage, the bankruptcy court in In re

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[18] This Court's pre-BAPCPA decision in In re Casse, 198 F.3d 327 (2d Cir. 1999) does not cast doubt on this conclusion. In Casse, this Court ruled that a bankruptcy court did not abuse its discretion by refusing to vacate a foreclosure sale that occurred after a debtor filed a petition in violation of a prior court order barring him from future filings under the Code. 198 F.3d at 332, 341-42. Although the Court characterized the bankruptcy court's "treatment of the debtor's [petition] as void *ab initio*," (id. at 342), "neither the bankruptcy court nor the Court of Appeals held or implied that there was no automatic stay" in that filing. In re Flores, 291 B.R. 44, 58 (S.D.N.Y. 2003); see Ross, 338 B.R. at 138 n.6. Indeed, the bankruptcy court dismissed the case "'nunc pro tunc'" to the date of filing, thus retroactively abrogating the stay. See Casse, 198 F.3d at 332, 342; Flores, 291 B.R. at 58. And, in ruling that the bankruptcy court did not abuse its discretion, this Court relied upon a case in which the bankruptcy court "used its authority under 11 U.S.C. § 362(d) to lift the automatic stay *ab initio*." Casse, 198 F.3d at 342 (internal quotations omitted). Thus, this Court held that where a debtor files a petition in violation of a court order, the bankruptcy court does not abuse its discretion by retroactively lifting the stay; it did not rule that, even absent the bankruptcy court's nunc pro tunc dismissal, the stay would not have been triggered. Id. In any event, even if the Casse Court had held that the case was "void *ab initio*" in the sense that, even absent the bankruptcy court's nunc pro tunc order, the stay would not have taken effect, it would be distinguishable. First, it did not involve the statutory restriction on eligibility in Section 109; rather, it involved a case in which the debtor violated a prior court order, issued pursuant to the bankruptcy court's authority under Sections 349(a) and 105(a), barring him from filing a subsequent petition. Second, Casse was decided pre-BAPCPA, before Congress's enactment of Section 362(b)(21)(A) made clear its understanding that, in the absence of an express statutory exception to the stay, a petition filed under Section 109(g) "commences a case and results in an automatic stay." Ross, 338 B.R. at 139.

Thompson, which, like the courts below, held that debtors who file a petition without complying with Section 109(h) do not commence a case under Section 301, nonetheless held that the automatic stay was invoked under such circumstances.[19] See 344 B.R. 899 (Bankr. S.D. Ind. 2006), aff'd, In re Thompson, No. 06-1033 (S.D. Ind. Dec. 4, 2006), appeal pending, 7th Cir. No. 07-1240. The Thompson court reasoned that, under Section 362, the "event triggering the stay is the *filing of a petition*" under section 301 or 302 -- not the commencement of a case under those sections of the Code. Id. at 906. The court found that Sections 301 and 302 "allow for petitions to be filed by ineligible debtors, they just don't allow *cases to be commenced* by petitions filed by ineligible debtors," and thus, "it is possible for the stay to be imposed without a case having been commenced." Id.

The Thompson bankruptcy court's analysis introduces a further error of statutory interpretation, however. The court

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[19] The bankruptcy court in the present case did not believe that her interpretation rendered Section 362(b)(21)(A) superfluous because, in her view, Section 109(h) is distinguishable from Section 109(g) because the failure to obtain credit counseling or qualify for an exemption under Section 109(h) is "incurable," and thus, in contrast to cases involving Section 109(g), the automatic stay is never invoked where the debtor has not met that requirement. The wording of Section 109(g) is no less mandatory than that of Section 109(h), however: "Notwithstanding any other provision of this section, no individual * * * may be a debtor under this title" if he had a case pending during the prior 180 days (1) that was dismissed for the reasons set forth in the statute, or (2) in which he sought voluntary dismissal after a creditor filed a request for relief from the automatic stay. 11 U.S.C. § 109(g).

acknowledged that its holding conflicts with both those courts that have held that a case does commence when a debtor ineligible under Section 109(h) files a petition, and with those courts that have held that no case commences under such circumstances. This is not surprising; the Thompson court reached a contrary result only by misinterpreting Section 362 of the Bankruptcy Code. As the bankruptcy court in the present case recognized, under Section 362(a), "[e]xcept as provided in subsection (b) of this section, a petition filed under section 301, 302 or 303 of this title * * * operates as a stay." 11 U.S.C. § 362(a). Thus, Section 362(a) expressly refers to petitions filed under Sections 301, 302 or 303, which in turn set forth when voluntary, joint or involuntary cases commence under the Bankruptcy Code. 11 U.S.C. §§ 301, 302, 303; see Bankr. Op. 17, A-29. If a case commences, the automatic stay therefore takes effect; conversely, if a case does not commence, the automatic stay is not invoked.

The conclusion of the courts below that a debtor's filing of a petition without complying with Section 109(h) does not commence a case thus presents problems of statutory interpretation regardless of whether the court holds that the automatic stay is triggered. Section 362(b)(21)(A) is rendered superfluous by holding that the stay is not invoked; while holding that the stay is invoked conflicts with a "straightforward reading" of Section 362(a). The U.S. Trustee's position, by contrast, does not suffer from either of these problems: a holding that a debtor who files a petition without complying with Section 109(h) does commence a case under Section 301, thereby invoking the automatic stay, is consistent with the plain language of Section 362(a) and does not render Section 362(b)(21)(A) superfluous.

Moreover, the conflict between the bankruptcy court below and the Thompson court regarding the automatic stay demonstrates that within the small minority of courts that have decided to strike a petition or case for failure to meet the credit counseling requirement, there is no unified view of the effect of the court’s action. In addition, such courts differ over whether to strike the petition or the entire case. Compare, e.g., Thompson, 344 B.R. at 906 (striking petition) with Bankr. Op. 28-29, A-40-41 (striking cases).

In contrast, the U.S. Trustee’s interpretation, adopted by the majority of courts, is consistent and provides the only workable interpretation of the Code. When a debtor files a petition under Section 301, that action both commences a case and triggers the automatic stay. If and when a bankruptcy court subsequently determines that the individual is not eligible to be a debtor, either under Section 109(h) or another subsection of Section 109, the court should dismiss the case for cause, and the automatic stay will terminate.

D. The Decisions Of The Courts Below Circumvent Congressional Intent And Will Cause Uncertainty And Confusion In Bankruptcy Proceedings.

1. The courts below further erred by circumventing Congress’s purpose when, as part of BAPCPA, it amended Section 362. In BAPCPA, Congress sought to prevent repeat bankruptcy filers from abusing bankruptcy proceedings by limiting application of the automatic stay where the debtor had a prior case dismissed in the preceding year. 11 U.S.C. §§ 362(c)(3), 362(c)(4). Pursuant to the amendment, if a debtor had a prior case dismissed during the preceding year, the automatic stay “shall terminate * * * on the 30th day after the filing of the later case,” unless the debtor “demonstrates that the filing of the later case is in good faith as to the creditors to be stayed.” 11 U.S.C. § 362(c)(3)(A),(B). And the automatic stay will not go into effect at the outset of the case if the debtor had two or more bankruptcy cases dismissed within the previous year unless the debtor can demonstrate that its later case is filed in good faith. 11 U.S.C. § 362(c)(4)(A),(B).

The plain language of Section 362(c) applies only to debtors who had prior cases “dismissed.” Thus, if a debtor’s prior case or petition is stricken as a nullity, that case likely would not count as a “case” pending in the prior year that was “dismissed” for the purposes of determining, in a subsequent case, whether the automatic stay goes into effect, and how long it remains in effect. See <u>Ross</u>, 338 B.R. at 136 (in deciding to dismiss, not strike, court notes that “striking the petition on the ground that its filing does not commence a case means that, if the individual later files a case, the stricken petition will not count as a ‘pending case’ for purposes of applying § 362(c)”). Indeed, in <u>Thompson</u>, the bankruptcy court, after determining that it would strike debtors’ petition rather than dismiss their case, acknowledged that if the debtors filed a subsequent petition within a year, “the petition filed under this cause number will not count as a ‘case pending and dismissed’ for § 362(c)(3) and (4) purposes.” 344 B.R. at 908.[20]

This result is directly contrary to Congress’s intent in amending Section 362. In BAPCPA, Congress sought to prevent repeat bankruptcy filers from abusing bankruptcy proceedings by

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[20] In the present case, the district court stated (Op. 12, SPA–12) that “it is by no means clear to this Court that striking a Petition as an alternative to dismissal would necessarily be regarded in a future lawsuit as having the apparent benefit to the Debtor which the Bankruptcy Judge in these cases assumes it would have, or that it would exempt the would be Petitioners from the adverse statutory consequences imposed by BAPCA.” But as set forth in the text, based on the plain language of Section 362(c), it is difficult to see how a case or petition that the bankruptcy court strikes as a legal nullity would fall within the plain language of Section 362(c), which applies to pending “cases” that were “dismissed.” Nonetheless, the district court’s comment underscores the uncertainty caused by the bankruptcy court’s decision to strike debtors’ cases; had the court dismissed the cases, there would be no question about whether Section 362(c) would apply to a subsequent bankruptcy proceeding.

limiting application of the automatic stay.[21] See In re Seaman, 340 B.R. at 708 (citing legislative history of BAPCPA). Regardless of whether the courts below believe that these amended provisions impose overly-harsh penalties on debtors (see Bankr. Op. 2, 8, A–14, A-20; D. Ct. Op. 5, SPA–5), they lack the prerogative to create their own exceptions to Section 362(c) by striking, rather than dismissing, a case. See In re Hedquist, 342 B.R. 295, 300 (8th Cir. BAP 2006) (though several courts have commented that "new requirements in Section 109(h) can, in some circumstances, create harsh results," because "those requirements are mandatory, bankruptcy courts have no discretion but to dismiss the case" when debtor fails to comply).

Moreover, it is important to note that Congress provided debtors with the opportunity to avoid the penalties set forth in Sections 362(c)(3) and 362(c)(4) if they demonstrate that their prior dismissed case was filed in "good faith." See 11 U.S.C.

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[21] Debtor Diana Finlay is an example of such a repeat filer, as the present petition was her third bankruptcy filing in the past year. See Bankr. Op. 5, A–17. And although this was debtor Shayna Zarnel's first bankruptcy petition, the bankruptcy court noted that Mrs. Zarnel's husband had filed five bankruptcy petitions since January 2004. Id. at 6, A–18. After the bankruptcy court struck her case, debtor Lena Elmendorf filed another Chapter 7 petition on September 13, 2006. Had the bankruptcy court dismissed, rather than struck, the present case, the stay in Elmendorf's subsequent case would have terminated after 30 days absent a motion from Elmendorf demonstrating good faith. See 11 U.S.C. § 362(c)(3). On February 27, 2007, the bankruptcy court closed Elmendorf's subsequent case without entry of a discharge for failure to file Official Form 23. Docket, In re Elmendorf, No. 06-35926 (Bankr. S.D.N.Y.).

§§ 362(c)(3)(B);(c)(4)(B). And, as the bankruptcy court appeared to recognize, its ruling that the filing of a petition by a debtor who has not met the credit counseling requirement does not commence a case under Section 301, and the automatic stay is therefore not invoked, may prove just as harsh to debtors as would dismissing the case. See Op. 22 n.21, A–34 n.21 ("a debtor whose case is stricken may well face dispossession of assets because no stay was in place to protect them"). Under the holding of the courts below, if a creditor repossesses or forecloses on a debtor's assets after the petition is filed but prior to the striking of the case, the debtor will not be able to rely on the automatic stay. Thus, while a holding that a case did not commence where a debtor failed to comply with Section 109(h) may keep the case from counting as a dismissal in a subsequently filed case, "such 'protection' will be a pyrrhic victory if, in the meantime, a creditor has completed a repossession or foreclosure because of the absence of a stay in the void case." Ross, 338 B.R. at 139. Policy reasons, such as avoiding "draconian consequences" for debtors (D. Ct. Op. 5, SPA-5), therefore do not support the rulings of the courts below.

More important, regardless of whether the bankruptcy court's interpretation advances its policy objectives, its reading of Section 362 is incorrect. Indeed, "[t]he fact that a [bankruptcy] proceeding is equitable does not give the judge a free-floating discretion to redistribute rights in accordance with his personal views of justice and fairness, however enlightened those views may be." In re Kmart Corp., 359 F.3d 866, 871 (7th Cir.), cert. denied, 543 U.S. 986 (1994) (internal quotations omitted).

2. The decision to strike a case or petition also creates substantial uncertainty and potential prejudice to the parties to bankruptcy proceedings. While the Bankruptcy Code is clear regarding the effects of dismissal, there are no corresponding instructions in the Code or elsewhere regarding the impact of striking a petition or case. In fact, one court found that "[p]erhaps the most compelling reason to dismiss the case rather than strike the petition is the confusion that would ensue." In re Racette, 343 B.R. at 203. And even a court that held that it was appropriate to strike a petition for failure to satisfy the credit counseling requirement acknowledged that its holding caused uncertainty: "In determining that an ineligible debtor does not invoke the protections of the automatic stay, an element of uncertainty is infused into the world of consumer bankruptcy." In re Salazar, 339 B.R. at 626. Indeed, as the split between this case and other bankruptcy courts that have decided to strike rather than dismiss illustrates, there is great uncertainty as to whether the automatic stay would apply -- both with respect to the case in which the debtors failed to comply with Section

109(h) and to subsequent cases filed by the same debtors.

The bankruptcy and district court’s ruling that debtors who file petitions without complying with Section 109(h) have not commenced a “case” under Section 301 of the Code also could create confusion or opportunism among debtors in the reporting that is required in bankruptcy filings. Debtors are required to inform the court of all prior bankruptcy “cases” filed in the past eight years. See Voluntary Petition Official Form 1 at 2. Because bankruptcy courts that have stricken cases or petitions have held that such cases never actually commenced, it is foreseeable that an individual could believe that where his petition was stricken, not dismissed, he is not required to report that case when he files a subsequent petition. In addition, “striking petitions would create new burdens and uncertainties for case administration,” and “[n]ew questions would arise,” such as, “whether filing fees should be returned to ineligible petitioners and whether Chapter 7 trustees may be compensated for work on cases that prove to be a nullity or void *ab initio*.” In re Seaman, 340 B.R. at 707; In re Jones, 352 B.R. 813, 823 (S.D. Tex. 2006) (same).

In contrast, “[t]reating an ineligible debtor’s case as filed and dismissing it avoids serious problems that treating a petition as void *ab initio* or as failing to establish jurisdiction creates.” In re Ross, 338 B.R. at 140; In re Tomco, 339 B.R. at 159 (same). Thus, this Court should join the majority of courts that have addressed the issue, and hold that the filing of a petition with the bankruptcy court commences a case under Section 301, which “is a case under title 11, unless and until the bankruptcy court determines that the debtor” is ineligible for bankruptcy relief under Section 109. In re Tomco, 339 B.R. at 161. That filing also invokes the automatic stay. If and when the bankruptcy court ultimately decides that an individual is ineligible to be a debtor, the court should dismiss the case, and the stay will then terminate. See id.

CONCLUSION

For the foregoing reasons, the judgment of the district court should be reversed.

Respectfully submitted,

MICHAEL J. GARCIA
United States Attorney
DANNA DRORI
Assistant U.S. Attorney
86 Chambers Street, 3rd Fl.
New York, New York 10007

Of Counsel:
ROBERTA A. DEANGELIS
Acting General Counsel
P. MATTHEW SUTKO
LISA A. TRACY
SEAN E. MARTIN
Office of the General Counsel
Executive Office for U.S. Trustees
U.S. Department of Justice
20 Massachusetts Ave., N.W., Suite 8100
Washington, D.C. 20530

PETER D. KEISLER
Assistant Attorney General

WILLIAM KANTER
(202) 514-4575
STEPHANIE R. MARCUS
(202) 514-1633
Attorneys, Appellate Staff
Civil Division, Room 7642
U.S. Department of Justice
950 Pennsylvania Ave., N.W.
Washington, D.C. 20530-0001

APRIL 2007

CERTIFICATE OF COMPLIANCE WITH FED. R. APP. P. 32(a)(7)(B)

I hereby certify that the foregoing brief complies with the type-volume limitation in Fed. R. App. P. 32(a)(7)(B). The brief contains 12,947 words according to the word count provided by WordPerfect 12. The brief was prepared in a monospaced font (Courier New) that has 10.5 or fewer characters per inch.

Stephanie R. Marcus

CERTIFICATE CONCERNING VIRUS PROTECTION

I hereby certify that the foregoing Brief For Appellant has been scanned for viruses before being digitally submitted to the Court, and no virus has been detected.

Stephanie R. Marcus

CERTIFICATE OF SERVICE

I hereby certify that on this 23rd day of April, 2007, I caused a PDF version of the foregoing Brief For Appellant to be transmitted via electronic mail to the Clerk of the United States Court of Appeals for the Second Circuit pursuant to Rule 32(a)(1)(A), and I transmitted an original and nine copies of the foregoing Brief For Appellant with the attached Special Appendix to the Clerk by causing them to be sent by Federal Express to:

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for the Second Circuit
Daniel Patrick Moynihan U.S. Courthouse
500 Pearl Street
New York, NY 10007

I also hereby certify that on this 23rd day of April 2007, I served the foregoing Brief For Appellant with the attached Special Appendix upon the following by causing two copies to be sent by Federal Express or first class mail, postage prepaid, as specified, to:

Patrick F. Moore, Esq.
299 Main Street
Poughkeepsie, NY 12601
(by Federal Express)

Shayna H. Zarnel
P.O. Box 1171
So. Fallsburg, NY 12779
(by first-class mail)

Lena M. Elmendorf
Box 1378 Route 9G
Hyde Park, NY 12538
(by first-class mail)

Diana M. Finlay
7 Addison Road
Fishkill, NY 12524
(by first-class mail)

Stephanie R. Marcus

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Adams, UST v. Zelotes

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United States Court of Appeals for the Second Circuit

3. ("CCN") ***CURRENT*** CASE NO.
No.: 07-1853-cv

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Mark Stern and Mark Freeman
(UST/OGC: 202-307-1399/FAX-2397)

8. ("TO") ***TOPIC***
BANKRUPTCY

9. ("SU") ● ***SUMMARY*** OF KEY ISSUE(s) & √ Any Miscellaneous ***BACKGROUND***
●Whether 11 U.S.C. 526(a)(4), which provides that attorneys and other bankruptcy professionals should not advise clients to take on additional debt in contemplation of filing a bankruptcy petition, violates the First Amendment

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07-1853-cv

IN THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

DIANA G. ADAMS,
in her official capacity as
United States Trustee, Region 2,

Defendant-Appellant,

v.

ZENAS ZELOTES, Esq.,

Plaintiff-Appellee.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF CONNECTICUT

BRIEF FOR THE APPELLANT

PETER D. KEISLER
Assistant Attorney General

KEVIN J. O'CONNOR
United States Attorney

MARK B. STERN
(202) 514-5089
MARK R. FREEMAN
(202) 514-5714
Attorneys, Appellate Staff
Civil Division, Room 7531
Department of Justice
950 Pennsylvania Ave., N.W.
Washington, D.C. 20530-0001

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IN THE UNITED STATES COURT OF APPEALS
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Defendant-Appellant,

v.

ZENAS ZELOTES, Esq.,

Plaintiff-Appellee.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF CONNECTICUT

BRIEF FOR THE APPELLANT

DECISION BELOW

The decision below was issued by Senior Judge Peter Dorsey. The opinions of the district court are reported at 352 B.R. 17 and 363 B.R. 660.

STATEMENT OF JURISDICTION

Plaintiff invoked the jurisdiction of the district court pursuant to 28 U.S.C. § 1331. A-5.[1] The district court entered final judgment on March 8, 2007. A-31. Defendant filed a notice of appeal on April 30, 2007, within the time provided by Fed. R.

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[1] "A-__" denotes a citation to the joint appendix.

App. P. 4(a)(1)(B). A-33. This Court has jurisdiction pursuant to 28 U.S.C. § 1291.

STATEMENT OF THE ISSUE

Whether 11 U.S.C. § 526(a)(4), which provides that attorneys and other bankruptcy professionals should not advise clients to take on additional debt in contemplation of filing a bankruptcy petition, violates the First Amendment.

STATEMENT OF THE CASE

As part of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23 (2005), Congress provided that attorneys and other professionals should not advise clients to take on additional debt in contemplation of filing a bankruptcy petition. See 11 U.S.C. § 526(a)(4). Plaintiff, an attorney who represents consumer debtors in bankruptcy, filed this facial challenge to section 526(a)(4), urging that the provision violates the First Amendment. The district court granted summary judgment to plaintiff, concluding that section 526(a)(4) is unconstitutionally overbroad and potentially limits an attorney's ability to provide a client with the best advice.

STATEMENT OF FACTS

A. Statutory Background

1. In the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, Congress enacted "a

comprehensive package of reform measures" designed "to improve bankruptcy law and practice by restoring personal responsibility and integrity in the bankruptcy system and ensure that the system is fair for both debtors and creditors." H.R. Rep. No. 109-31, pt. 1, at 2 (2005), reprinted in 2005 U.S.C.C.A.N. 88, 89 ("House Report"). Described by Congress as "the most comprehensive set of [bankruptcy] reforms in more than 25 years," id. at 3, the Act both modifies the substantive standards for bankruptcy relief and adopts a variety of new measures intended to curb abusive practices that Congress concluded had come to pervade the bankruptcy system.

As part of this reform package, Congress established certain minimum standards of professional conduct for attorneys and other bankruptcy professionals — collectively termed "debt relief agencies" — who provide for-profit services to consumer debtors. See 11 U.S.C. § 101(12A) (definition of "debt relief agency").[2] Misleading and abusive practices by such professionals, Congress determined, had become a substantial cause of unnecessary bankruptcy petitions and, in some circumstances, jeopardized

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[2] The term "debt relief agency" includes "any person" who, for a fee, "provides any bankruptcy assistance to an assisted person." 11 U.S.C. § 101(12A). "Bankruptcy assistance," in turn, is defined to include "providing legal representation." Id. § 101(4A). An "assisted person" is "any person whose debts consist primarily of consumer debts and the value of whose nonexempt property is less than $164,250." Id. § 101(3); cf. id. § 104(a) (adjustment of dollar figures).

debtors’ ability to obtain a discharge of their debts. For example, Congress heard evidence that a civil enforcement initiative undertaken by the United States Trustee Program had “consistently identified * * * misconduct by attorneys and other professionals” as among the sources of abuse in the bankruptcy system. House Report at 5 (citation omitted). Congress therefore responded in the 2005 Act by “strengthening professionalism standards for attorneys and others who assist consumer debtors with their bankruptcy cases.” Id. at 17.

2. The new standards enacted by Congress are principally set forth in 11 U.S.C. §§ 707 and 526-528.[3] Section 707, as amended by the 2005 Act, now requires bankruptcy attorneys to make their own reasonable investigation into the circumstances giving rise to the debtor’s petition, including a specific inquiry into the veracity of the debtor’s debt and asset schedules. See 11 U.S.C. § 707(b)(4)(C)-(D). The legislation further requires that the attorney certify that he has determined that the petition does not constitute an “abuse” under section 707(b). See ibid.

Sections 527 and 528 set forth several interrelated disclosure requirements. Section 527 requires debt relief agencies to provide specific notices to clients, including a

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[3] For the Court’s convenience, these provisions are reproduced in full in the special appendix attached as an addendum to this brief.

description of the different types of relief available in the bankruptcy system. Section 528 similarly requires debt relief agencies to provide clients with written contracts that clearly explain the services that will be provided and the fees that will apply. See 11 U.S.C. § 528(a)(1)-(2). Section 528 also requires debt relief agencies to make certain related disclosures in their advertisements to the public. See id. § 528(a)(3)-(4).

Section 526 lays down four basic rules of professional conduct. Section 526(a)(1) requires debt relief agencies to perform all promised services. Section 526(a)(2) prohibits debt relief agencies from advising an assisted person to make statements that are untrue or misleading in seeking bankruptcy relief. Section 526(a)(3) precludes debt relief agencies from misrepresenting the services they will provide, the benefits that will accrue, or the risks entailed in filing for bankruptcy.

Section 526(a)(4), the provision at issue in this appeal, states:

> A debt relief agency shall not * * * advise an assisted person or prospective assisted person to incur more debt in contemplation of such person filing a case under this title or to pay an attorney or bankruptcy petition preparer fee or charge for services performed as part of preparing for or representing a debtor in a case under this title.

11 U.S.C. § 526(a)(4).

The primary remedy for violations of these sections is a civil action by the debtor, or by the relevant state attorney general, to recover "actual damages" to the debtor. See 11 U.S.C. § 526(c)(2) & (c)(3). A bankruptcy court may impose an "appropriate civil monetary penalty" if it finds intentional violations of these provisions or a clear and consistent practice of violations. Id. § 526(c)(5).

B. Facts and Prior Proceedings

Plaintiff Zenas Zelotes, an attorney who represents consumer debtors in bankruptcy, filed this suit seeking a declaration that section 526(a)(4) is unconstitutional and an injunction prohibiting federal officials from enforcing its provisions. See A-5 (complaint). The district court denied the government's motion to dismiss, holding that the statute violates the First Amendment, and subsequently entered summary judgment for plaintiff. See Zelotes v. Martini, 352 B.R. 17 (D. Conn. 2006); Zelotes v. Adams, 363 B.R. 660 (D. Conn. 2007).[4]

The district court recognized that, in enacting the 2005 reform legislation, Congress sought to eliminate the "'loopholes and incentives [in the present bankruptcy system] that allow and — sometimes — even encourage opportunistic personal filings and abuse.'" See 352 B.R. at 23 (quoting House Report, at 5). The problem, the court stated, was that Congress had not sought to

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[4] The complaint named as the defendant Deirdre A. Martini, who at the time was the United States Trustee for Region 2 (which encompasses Connecticut). A-5. Diana G. Adams, the current U.S. Trustee for Region 2, was later substituted as defendant pursuant to Fed. R. App. P. 25(d). See 363 B.R. at 663 n.3.

"chang[e] the bankruptcy system by closing the loopholes," but instead "enacted § 526(a)(4), a prophylactic rule which prohibits attorneys from advising their clients to take on any additional debt in contemplation of bankruptcy, even when doing so would be lawful." Id. at 24.

The district court observed that, for example, a person contemplating bankruptcy might wish to "'refinanc[e] [debts] at a lower rate to reduce payments and forestall or even prevent entering bankruptcy.'" Ibid. (quoting Hersh v. United States, 347 B.R. 19, 24 (N.D. Tex. 2006), appeal docketed, No. 07-10226 (5th Cir.)). Alternatively, a debtor might "'tak[e] out a loan to obtain the services of bankruptcy attorney, to pay the filing fee in a bankruptcy case," or to "'refinanc[e] a mortgage" to pay off debts. Ibid. (quoting Olsen v. Gonzales, 350 B.R. 906, 916-17 (D. Or. 2006), appeal docketed, No. 07-35616 (9th Cir.)). The government explained that section 526(a)(4) would not prohibit advice about these lawful actions because the attorney would not be advising the client to incur additional debt solely "'in contemplation of filing for bankruptcy.'" 352 B.R. at 24 n.8. The court rejected that contention, declaring that the government's reading "would strain the text of the statute" because "[t]he text * * * indicates that regardless of what the other reasons for incurring debt might be, advising a client to take on more debt in contemplation of bankruptcy is prohibited." Ibid.

The district court concluded that "[b]y prohibiting lawyers from advising clients to take lawful, prudent actions as well as abusive ones, section 526(a)(4) is overbroad and restricts attorney speech beyond what is 'narrow and necessary' to further the governmental interest." Id. at 25 (quoting Gentile v. State Bar of Nevada, 501 U.S. 1030, 1075 (1991)). The district court subsequently entered a permanent injunction barring federal officials from enforcing the statute against plaintiff. See 363 B.R. at 667-68.

SUMMARY OF ARGUMENT

In enacting the Bankruptcy Abuse Prevention and Consumer Protection Act, Congress sought to curb abuses of the bankruptcy system, both by debtors and by the professionals who represent them. Congress thus "strengthen[ed] professionalism standards for attorneys and others who assist consumer debtors with their bankruptcy cases," H.R. Rep. No. 109-31, pt. 1, at 17 (2005), by adopting a range of new requirements for debtors and their representatives, including section 526(a)(4). That section provides that attorneys may not advise clients "to incur more debt in contemplation of" filing a petition for bankruptcy. 11 U.S.C. § 526(a)(4).

Section 526(a)(4) complements other provisions in the 2005 legislation that address the conduct of debtors who amass debt at the eleventh hour in order to take advantage of the Bankruptcy Code's discharge provisions or otherwise manipulate its protections. Among other measures, the 2005 Act restricts the ability of debtors to discharge such debt, and it expands the authority of bankruptcy courts to dismiss petitions for abuse of the bankruptcy system — including in cases in which debtors abuse the Code by deliberately taking on additional debt in contemplation of filing a petition. In addition, the 2005 legislation imposes a new duty on bankruptcy attorneys to certify that the petitions filed by their clients do not constitute an abuse of the Code, and authorizes bankruptcy courts to impose sanctions on attorneys for violations of that duty.

Section 526(a)(4) precludes attorneys and other bankruptcy professionals from encouraging their clients to engage in the same type of abusive accumulation of debt that was the focus of Congress's concern in these provisions. The district court did not suggest that debtors can properly take on additional debt to manipulate the bankruptcy system, or that attorneys are constitutionally entitled to encourage them to do so. Nevertheless, the district court struck down section 526(a)(4) on its face because it believed that the provision would also encompass advice to engage in conduct consistent with the Bankruptcy Code and with the client's legitimate interests.

That reading extends section 526(a)(4) far beyond Congress's purpose. In precluding attorneys from urging their clients to take on additional debt "in contemplation of" a bankruptcy filing, Congress was concerned only with debt purposefully accumulated in order to manipulate the bankruptcy system. Neither the language of the statute nor the relevant legislative history warrants the district court's assumption that section 526(a)(4) would prevent a lawyer from offering candid advice on the legality of a debtor's proposed course of conduct, or that it would prohibit an attorney from urging a client to take actions consistent with the Bankruptcy Code and the client's best interests. A statute should be construed to avoid, rather than to invite, constitutional difficulties, and the court erred in failing to apply this principle in construing section 526(a)(4).

The district court's ruling also departed from fundamental principles of overbreadth analysis. Even under the court's mistakenly broad reading of the statute, section 526(a)(4) could be constitutionally applied in the category of cases at which the statute is actually aimed. In holding section 526(a)(4) facially overbroad, the district court mistakenly failed to consider whether the statute's assertedly impermissible applications would be substantial when judged in relation to the statute's plainly legitimate sweep.

STANDARD OF REVIEW

A facial challenge to the constitutionality of a federal statute presents a question of law subject to de novo review. United States v. Dhafir, 461 F.3d 211, 215 (2d Cir. 2006).

ARGUMENT

CONGRESS CONSTITUTIONALLY REGULATED THE CONDUCT OF BANKRUPTCY PROFESSIONALS BY PRECLUDING THEM FROM ENCOURAGING CLIENTS TO ABUSE THE BANKRUPTCY SYSTEM BY TAKING ON ADDITIONAL DEBT IN CONTEMPLATION OF FILING A PETITION.

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 seeks to curb a variety of abusive practices by consumer debtors and their representatives. A principal concern of the legislation was to address the recurring problem of debtors attempting to exploit the Bankruptcy Code's discharge provisions, or otherwise manipulate the bankruptcy system, by purposefully accumulating additional debt prior to filing a petition for relief. Among other reforms, the 2005 Act expanded the authority of the bankruptcy courts to dismiss petitions for such abuse and required bankruptcy attorneys affirmatively to certify that no basis exists for deeming their clients' petitions abusive.

Section 526(a)(4) complements these reforms by precluding bankruptcy professionals from encouraging their clients to abuse the bankruptcy system by taking on additional debt in contemplation of filing a bankruptcy petition. Because the provision is an unexceptionable regulation of professional conduct that does not impinge upon the First Amendment rights of attorneys or their clients, the judgment of the district court should be reversed.

A. The 2005 Act Addresses Abuses Of The Code By Debtors Who Incur New Debt In Anticipation Of Bankruptcy And By Attorneys Who Encourage Clients To Engage In Such Conduct.

1. Abuses Of The System By Debtors Incurring Additional Debt In Contemplation Of Bankruptcy.

Among the primary abuses addressed in the 2005 Act is the accumulation of new debt in contemplation of filing a petition for bankruptcy. Congress had long been aware that this practice poses a fundamental threat to the Code's twin goals of affording debtors a fresh start while providing an orderly and equitable system of resolving creditors' claims. For example, when Congress enacted 11 U.S.C. § 523(a)(2)(C), which creates a presumption that certain eve-of-bankruptcy debts are not dischargeable, the accompanying Senate Report emphasized that "[e]xcessive debts incurred within a short period prior to the filing of the petition present a special problem: that of 'loading up' in contemplation of bankruptcy." S. Rep. No. 98-65, at 9 (1983). The report explained that "[a] debtor planning [to] file a petition with the bankruptcy court has a strong economic incentive to incur dischargeable debts for either consumable goods or exempt property," noting that "[i]n many instances, the debtor will go on a credit buying spree in contemplation of bankruptcy at a time when the debtor is, in fact, insolvent." Ibid.

As the report concluded, "[n]ot only does this result in direct losses for the creditors that are the victims of the spree, but it also creates a higher absolute level of debt so that all creditors receive less in liquidation. During this period of insolvency preceding the filing of the petition, creditors would not extend credit if they knew the true facts." Ibid. Indeed, as early as 1973, Congress was informed that "the most serious abuse of consumer bankruptcy is the number of instances in which individuals have purchased a sizable quantity of goods and services on credit on the eve of bankruptcy in contemplation of obtaining a discharge." Report of the Commission of the Bankruptcy Laws of the United States, H.R. Doc. No. 93-137, pt. 1, at 11 (July 1973).

In adopting the 2005 Act, Congress expressed concern that these earlier measures had not adequately restricted the ability of debtors to "knowingly load up with credit card purchases or recklessly obtain cash advances and then file for bankruptcy relief." H.R. Rep. No. 109-31, pt. 1, at 15 (2005) ("House Report"). Accordingly, Congress took a series of new steps in the 2005 Act to combat the problem of debts incurred in contemplation of filing for bankruptcy. Thus, the Act reduced the threshold amounts at which certain types of eve-of-bankruptcy debts, such as cash advances, become presumptively fraudulent and therefore nondischargeable.[5] See Pub. L. No. 109-8, § 310, 119 Stat. at 84 (amending 11 U.S.C. § 523(a)(2)(C)).

More fundamentally, Congress greatly expanded the authority of the bankruptcy courts to dismiss petitions for abuse of the bankruptcy system, including in cases in which debtors abuse the Code by purposefully incurring additional debt in contemplation of filing a petition. Even before the 2005 legislation, a bankruptcy court was authorized to dismiss a petition for "substantial abuse" under former 11 U.S.C. § 707(b)(1). See generally In re Kornfield, 164 F.3d 778, 781 (2d Cir. 1999). Moreover, it was established that, under the "substantial abuse" standard, a debtor's purposeful accumulation of debt in contemplation of bankruptcy could justify dismissal of the petition. See, e.g., In re Price, 353 F.3d 1135, 1139-40 (9th Cir. 2004) (describing factors relevant to a finding of substantial abuse, including "[w]hether the debtor has engaged in eve-of-bankruptcy purchases"); In re Charles, 334 B.R. 207, 222 (Bankr. S.D. Tex. 2005) ("It is settled law that a debtor's good faith should be questioned if the debtor makes purchases in contemplation of a bankruptcy case."); In re Rathbun, 309 B.R.

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[5] One of the factors that bankruptcy courts consider in determining whether a debt is fraudulent and nondischargeable, moreover, is "[w]hether or not an attorney has been consulted concerning the filing of bankruptcy before the charges were made." In re Eashai, 87 F.3d 1082, 1087 (9th Cir. 1996); see also In re Mercer, 246 F.3d 391, 408 (5th Cir. 2001) (en banc) ("whether, prior to card-use, an attorney was consulted about bankruptcy").

901, 904 (Bankr. N.D. Tex. 2004); In re Aiello, 284 B.R. 756, 761 (Bankr. E.D.N.Y. 2002).[6]

In the 2005 Act, Congress reduced the threshold finding required under 11 U.S.C. § 707(b) for a bankruptcy court to dismiss a debtor's petition as abusive, from "substantial abuse" to merely "abuse," see House Report at 48, and it repealed the statutory presumption in favor of granting the relief sought by the debtor, see id. at 49; Pub. L. No. 109-8, § 102, 119 Stat. at 27. Congress further made clear that, in determining whether a petition should be dismissed for abuse, a bankruptcy court may properly consider "whether the debtor filed the petition in bad faith" and whether "the totality of the circumstances * * * of the debtor's financial situation demonstrates abuse." 11 U.S.C. § 707(b)(3). At the same time, Congress authorized any party in interest — including, for example, unsecured creditors aggrieved by a debtor's eleventh-hour accumulation of new debt — to file a motion for such relief. See id. § 707(b)(1). Under prior law, only the United States Trustee, or the court on its own motion, could seek to dismiss a petition as abusive. See In re Kornfield, 164 F.3d at 784.

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[6] As the Supreme Court recently explained in the context of chapter 13 debtors, bad faith pre-petition conduct by the debtor justifies dismissal of the petition because such a debtor "is not a member of the class of 'honest but unfortunate debtor[s]' that the bankruptcy laws were enacted to protect." Marrama v. Citizens Bank, 127 S. Ct. 1105, 1111 (2007) (quoting Grogan v. Garner, 498 U.S. 279, 287 (1991)).

2. Abuses Of The System By Lawyers And Other Bankruptcy Professionals.

Congress also responded in the 2005 Act to evidence that attorneys and other bankruptcy professionals often played a critical role in abuse of the bankruptcy system. Citing data collected by the U.S. Trustee Program, the House Report noted that the study "consistently identified" among the sources of abuse "misconduct by attorneys and other professionals" and "problems associated with bankruptcy petition preparers." House Report at 5 (quoting Darling & Redmiles, Protecting the Integrity of the System: the Civil Enforcement Initiative, Am. Bankr. Inst. J. 12 (Sept. 2002)). See also 352 B.R. at 23 (citing report).

The need to address misconduct by bankruptcy professionals was made particularly urgent by the "principal consumer bankruptcy reform" in the 2005 legislation, which was the adoption of a "means testing" mechanism intended to restrict debtors who have the ability to repay at least some of their debts from obtaining a complete discharge under chapter 7. See House Report at 48; see also id. at 3 (describing means testing as the "heart" of the 2005 Act's reform provisions). Under the new means-testing provision, a debtor's petition for complete relief under chapter 7 is presumed to be abusive if the debtor's income exceeds his unsecured debts by a certain ratio. See 11 U.S.C. § 707(b)(2)(A). The effect of the means test is to ensure that debtors who have the ability to repay a portion of their debts are channeled into chapter 13, which provides an opportunity for a structured repayment plan.

As Congress recognized, however, the means test exacerbates the incentive for debtors to manipulate the system by "loading up" on debt in contemplation of filing a petition, because a higher debt ratio can allow an otherwise borderline debtor to avoid the burdens of a chapter 13 repayment plan and obtain a complete and immediate discharge under chapter 7. See Zelotes, 352 B.R. at 23 & n.7 (noting this incentive). Concern was expressed at the congressional hearings that attorneys would respond to the means test by counseling their clients simply to take on additional debt before filing for bankruptcy. As one bankruptcy judge testified, "[t]he more debt that is incurred prior to filing, the more likely the debtor will qualify for chapter 7." Thus, "[p]erverse as it may seem, I can envision debtor's counsel advising their clients to buy the most expensive car that someone will sell them, and sign on to the biggest payment they can afford (at least until the bankruptcy is filed) as a way of increasing their deductions under [the means test]." Bankruptcy Reform Act of 1998: Part I, Hearing on H.R. 3150 before House Judiciary Comm., 105th Cong. 25 (1998) (testimony of Judge Randall Newsome); see also Bankruptcy Reform Act of 1999 (Part II), Hearing before House Judiciary Comm., 106th Cong. 30 (1999) (testimony of Judge William Brown).

Congress addressed these problems in the 2005 Act by "strengthening professionalism standards for attorneys and others who assist consumer debtors with their bankruptcy cases" in return for a fee. House Report at 17. Under the amended provisions of the Code, an attorney who represents a consumer debtor in filing a bankruptcy petition must make his own reasonable investigation into the circumstances giving rise to the debtor's petition, including a specific inquiry into the veracity of the debtor's debt and asset schedules. See 11 U.S.C. § 707(b)(4)(C)-(D). By signing the petition, the attorney personally certifies that he believes the petition is warranted by the facts, that he has no reason to believe the debtor's schedules are incorrect, and that he has determined that the petition does not constitute an "abuse" under section 707(b). See ibid. Congress thus effectively required bankruptcy attorneys to warrant that their clients' pre-petition conduct and financial circumstances — including any assumption of debt in contemplation of bankruptcy — do not provide grounds for dismissal of the petition as abuse of the bankruptcy system.

Two provisions of section 526(a) complement these requirements by precluding attorneys and other "debt relief agencies," see 11 U.S.C. § 101(12A) (definition), from advising consumer debtors to abuse the bankruptcy system. Section 526(a)(2) prohibits attorneys from encouraging clients to make false statements in a bankruptcy proceeding. Section 526(a)(4), at issue here, precludes attorneys from encouraging their clients to abuse the bankruptcy system by taking on additional debt in contemplation of filing a bankruptcy petition.

B. Section 526(a)(4) Constitutionally Restricts Attorneys From Encouraging Clients To Take On Additional Debt In Contemplation of Bankruptcy.

1. The First Amendment Does Not Preclude Restrictions On Attorney Advice To Engage In Improper Conduct.

The district court did not suggest that the First Amendment bars Congress from restricting attorneys from encouraging their clients to abuse the bankruptcy system. Attorneys, like other professionals, are subject to various restrictions in urging their clients to undertake action. See, e.g., ABA Model Rules of Prof. Conduct R. 1.2(d) ("A lawyer shall not counsel a client to engage, or assist a client, in conduct that the lawyer knows is criminal or fraudulent, but a lawyer may discuss the legal consequences of any proposed course of conduct with a client and may counsel or assist a client to make a good-faith effort to determine the validity, scope, meaning, or application of the law."); accord N.Y. Lawyer's Code Prof. Resp. DR 7-102(A)(7); Conn. R. Prof. Conduct 1.2(d); Vermont R. Prof. Conduct 1.2(d).

Regulations of professional ethics of this kind do not violate the First Amendment. See Gentile v. State Bar of Nevada, 501 U.S. 1030, 1071-76 (1991) (discussing the standards governing regulation of attorney speech). Although the district court questioned whether section 526(a)(4) is properly regarded as a regulation of professional conduct, Congress clearly understood the regulation in this manner. See House Report at 17 (describing new provisions as "strengthening professionalism standards for attorneys and others who assist consumer debtors with their bankruptcy cases"). Indeed, the statute addresses conduct that has been held to fall squarely within the scope of Model Rule 1.2(d). See Attorney Grievance Comm'n of Maryland v. Culver, 381 Md. 241, 275-76 (2004) (attorney violated Rule 1.2(d) by advising a client to obtain credit card loans with the intent that the debt be discharged in bankruptcy).

2. Section 526(a)(4) Should Not Be Construed More Broadly Than Necessary To Achieve Congress's Purpose.

The district court nevertheless expressed concern that section 526(a)(4) "prevents lawyers from giving clients the best and most complete advice." 352 B.R. at 24. The court noted various potentially legitimate reasons for a debtor to incur new debt before filing a bankruptcy petition, such as borrowing money from friends or family to purchase an automobile that would allow the debtor to get to work, or refinancing a secured loan to obtain a better rate of interest and lower monthly payments. Ibid. Asserting that section 526(a)(4) would prohibit advice to engage in such "lawful, prudent actions as well as abusive ones," the court invalidated the statute on its face. Id. at 25.

Reading the statute in this manner expands its scope far beyond Congress's purpose to discourage "opportunistic personal filings and abuse." Id. at 23 (quoting House Report at 5). By providing that a debt relief agency shall not advise a client "to incur more debt in contemplation of such person filing a case under this title," § 526(a)(4) (emphasis added), Congress addressed only advice to a debtor to accumulate additional debt for the purpose of manipulating the bankruptcy system, such as by "loading up" on new debt in order to obtain a more advantageous discharge. Like section 526(a)(2), which precludes attorneys from advising clients to make false statements, section 526(a)(4) thus encompasses advice to engage in improper or abusive conduct.

That interpretation follows from Congress's unmistakable purposes in the 2005 Act. As already discussed, section 526(a)(4) represents only one of many measures in the 2005 Act aimed at preventing abuses of the bankruptcy system by debtors and their professional representatives. Among other significant amendments, Congress enhanced the authority of bankruptcy courts to dismiss petitions as abusive, see 11 U.S.C. § 707(b)(1), expanded the definition of "abuse" to take account of a debtor's bad faith in seeking bankruptcy relief, see id. § 707(b)(3), and specifically required bankruptcy attorneys to investigate the facts underlying a debtor's petition and to certify that no basis exists for dismissing the petition as abusive, see 11 U.S.C. § 707(b)(4)(C)-(D). Against the background of such amendments, it is apparent that Congress intended the phrase "to incur more debt in contemplation of" bankruptcy in section 526(a)(4) as a reference to the recognized problem of debtors purposefully accumulating new debt in an effort to abuse the protections of the Bankruptcy Code. Cf. Report of the Commission of the Bankruptcy Laws of the United States, H.R. Doc. No. 93-137, pt. 1, at 11 (observing that "the most serious abuse of consumer bankruptcy is the number of instances in which individuals have purchased a sizable quantity of goods and services on credit on the eve of bankruptcy in contemplation of obtaining a discharge" (emphasis added)).

That understanding, moreover, is consistent with Congress's repeated references, in the legislative histories cited above, to debts incurred to manipulate the bankruptcy system as debts incurred "in contemplation of" bankruptcy. See S. Rep. No. 98-65, at 9 ("In many instances, the debtor will go on a credit buying spree in contemplation of bankruptcy at a time when the debtor is, in fact, insolvent" (emphasis added)); see also Consumer Bankruptcy Reform Act of 1998, S. Rep. No. 105-253, at 83 (1998) (minority views) ("Clearly, debtors should not incur debts with the intention not to repay them, e.g., if they know that they are going to file for bankruptcy," but "debts incurred within 90 days prior to filing may not have been incurred in contemplation of bankruptcy, and thus the isolation of these debts for special treatment is somewhat arbitrary."); cf.

18 U.S.C. § 152(7) (prohibiting the fraudulent transfer or concealment of property "in contemplation of a case under title 11"); In re Charles, 334 B.R. at 222 ("It is settled law that a debtor's good faith should be questioned if the debtor makes purchases in contemplation of a bankruptcy case.").

Section 526(a)(4) therefore has no application to the hypothetical conduct that troubled the district court. An attorney would be free, for example, to advise a client to refinance a loan at a lower interest rate, see 352 B.R. at 24, or to borrow money to purchase a means of transportation to work, see ibid., assuming all necessary disclosures were made to the lenders. In neither case would the attorney be advising the debtor to incur unnecessary debt for the purpose of abusing the bankruptcy system.[7] Cf. Culver, 381 Md. at 275-76 (attorney violated Rule 1.2(d) by advising a client to obtain credit card loans with the intent that the debt be discharged in bankruptcy).

In other contexts, the phrase "in contemplation of bankruptcy" may reflect the broad scope assumed here by the district court. E.g., Conrad, Rubin & Lesser v. Pender, 289 U.S. 472, 478 (1933) (interpreting bankruptcy provision regarding attorney compensation). Plainly, however, the same phrase also

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[7] The district court also did not explain its assumption that refinancing an existing debt — that is, exchanging one loan for another with the same principal balance but a different interest rate or repayment period — would constitute incurring "more debt" within the meaning of section 526(a)(4).

has an accepted narrower meaning. See Black's Law Dictionary 336 (8th ed. 2004) (defining "contemplation of bankruptcy" as "the thought of declaring bankruptcy because of the inability to continue current financial operations, often coupled with action designed to thwart the distribution of assets in a bankruptcy proceeding"); see also In re Mercer, 246 F.3d 391, 421 n.43 (5th Cir. 2001) (en banc) (describing "loading up" as the practice of "incurring card debt in contemplation of bankruptcy"); id. at 421 (referring to "a dishonest but patient debtor who intends to incur card-debt in contemplation of discharge").[8] As the text and purposes of the 2005 Act make clear, it is this narrower sense in which Congress used the phrase in section 526(a)(4).

In any event, the district court erred in adopting the broadest possible reading of the statute without regard to whether it was required by the statutory language and congressional intent. It is fundamental that when "an otherwise acceptable construction of a statute would raise serious constitutional problems," a federal court must "construe the statute to avoid such problems unless such a construction would be plainly contrary to legislative intent." Field Day, LLC v. County of Suffolk, 463 F.3d 167, 177 (2d. Cir. 2006) (quoting

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[8] See also Webster's Third New International Dictionary 491 (1993) (defining "contemplation" to mean, inter alia, "the act of intending or considering a future event"); Random House Dictionary Unabridged 438 (2d ed. 1987) ("contemplate" means, inter alia, "to have as a purpose; intend").

Empire HealthChoice Assur., Inc. v. McVeigh, 396 F.3d 136, 144 (2d Cir. 2005) (quoting Edward J. DeBartolo Corp. v. Fla. Gulf Coast Bldg. & Constr. Trades Council, 485 U.S. 568, 575 (1988))) (internal quotation marks omitted). The district court departed from this principle in failing to adopt — or even address — readings of section 526(a)(4) that would avoid the constitutional difficulties that it postulated.

3. Section 526(a)(4) Does Not Preclude A Candid Discussion Of Legal Options.

The district court also erred in assuming that section 526(a)(4) would preclude a bankruptcy attorney from providing a candid discussion of a client's legal options. Rules governing legal practice commonly distinguish between a circumstance in which an attorney "counsels" (or, in this case, "advises") a course of conduct, and a case in which an attorney simply discusses various options.

Thus, although the ABA Model Rules of Professional Conduct provide that "[a] lawyer shall not counsel a client to engage, or assist a client, in conduct that the lawyer knows is criminal or fraudulent," the same rule also provides that "a lawyer may discuss the legal consequences of any proposed course of conduct with a client and may counsel or assist a client to make a good-faith effort to determine the validity, scope, meaning, or application of the law." ABA Model Rule 1.2(d). The commentary to Model Rule 1.2 underscores the point: "There is a critical distinction between presenting an analysis of legal aspects of questionable conduct and recommending the means by which a crime or fraud might be committed with impunity." ABA Model Rule 1.2, cmt. 9. In section 526(a)(4), Congress intended the phrase "advise * * * to incur more debt" in the same sense of affirmative encouragement. Cf. Webster's Third New International Dictionary 32 (1993) (defining "advise" to mean, inter alia, "counsel" or "recommend").

Contrary to the district court's understanding, therefore, section 526(a)(4) does not "prevent[] lawyers from giving clients the best and most complete advice." 352 B.R. at 24. Like the model rules, section 526(a)(4) reaches only the conduct of an attorney in affirmatively urging ("advis[ing]") a client to pursue a particular course of conduct, without impairing the attorney's ability to offer a candid assessment of the client's legal options. Cf. ABA Model Rule 1.2, cmt. 9 (explaining that the prohibition against advising clients to engage in fraud "does not preclude the lawyer from giving an honest opinion about the actual consequences that appear likely to result from a client's conduct").

The restriction in section 526(a)(4) thus parallels that in section 526(a)(2), which provides that a debt relief agency shall not "counsel or advise any assisted person or prospective assisted person to make a statement in a document filed in a case or proceeding under this title, that is untrue and misleading."

Congress's concern in both provisions was not to proscribe ordinary legal advice, but to prevent attorneys and other bankruptcy professionals from becoming the affirmative engines of bankruptcy abuse, thereby both undermining the policies of the Code and jeopardizing their clients' petitions for relief.

4. The Remedies For Violations of Section 526(a)(4) Are Consistent With Its Purpose Of Restricting Encouragement To Engage In Abusive Conduct That Jeopardizes a Client's Interests.

The remedial provisions of the statute underscore the error of the district court's interpretation. Congress's intent in section 526(a)(4) was to protect consumer debtors from active encouragement by their representatives to engage in conduct that abuses the bankruptcy system and may result in the dismissal of their petition or other sanctions. Consistent with that intent, the principal remedy for a violation of section 526(a)(4) is a suit against the attorney to recover the debtor's "actual damages," as well as restitution of any fees paid by the debtor. <u>See</u> <u>id.</u> § 526(c)(2); <u>see also</u> <u>id.</u> § 526(c)(3)(B) (authorizing suits by state attorneys general to recover "actual damages" on debtor's behalf). The power of the bankruptcy court to impose an "appropriate civil penalty" is limited to cases of intentional violations and patterns of misconduct. <u>See</u> <u>id.</u> § 526(c)(5). Congress's emphasis in these provisions on the debtor's "actual damages" presupposes that the debtor has been injured by the attorney's conduct: advice that is in the debtor's best interests and fully consistent with the Bankruptcy Code does not trigger any remedial provision.

Quite apart from section 526(a)(4), moreover, an attorney faces sanctions under the Bankruptcy Code for actively encouraging a debtor to accumulate additional debt in order to facilitate a bankruptcy filing, because the 2005 Act requires attorneys to certify that the petitions filed by their clients are not abusive. As discussed above, the Act imposed a new duty on every bankruptcy attorney make a reasonable investigation into the factual basis for the debtor’s petition (including a reasonable inquiry into the veracity of the debtor’s debt and asset schedules) and to certify that, in the attorney’s judgment, the petition will not be subject to dismissal for abuse. See 11 U.S.C. § 707(b)(4)(C)-(D); see also id. § 707(b)(4)(A)-(B) (authorizing civil monetary penalties against attorneys who make false certifications). At the same time, Congress lowered the standard for dismissing a petition as abusive, and it made clear that a bankruptcy court, in determining whether to grant such a motion, should consider whether the debtor has acted in bad faith. Id. §§ 707(b)(1), 707(b)(3); cf. In re Charles, 334 B.R. 207, 222 (Bankr. S.D. Tex 2005) (“It is settled law that a debtor's good faith should be questioned if the debtor makes purchases in contemplation of a bankruptcy case.”). Under these circumstances, it is highly unlikely that a bankruptcy attorney could encourage a client to incur unnecessary debts in order to buttress an anticipated bankruptcy filing without himself violating his obligations under the Code. Section 526(a)(4) addresses the increased risk of dismissal resulting from such unethical attorney advice and provides the debtor with remedies against attorneys who encourage abusive conduct.

C. The District Court Failed To Apply Basic Principles of Overbreadth Analysis.

Even outside the context of ethical rules governing attorneys and other closely regulated professions, a statute may not be invalidated on its face solely because of posited concerns raised by some of its potential applications. "[O]verbreadth of a statute must not only be real, but substantial as well, judged in relation to the statute's plainly legitimate sweep." Broadrick v. Oklahoma, 413 U.S. 601, 615 (1973). Thus, even when a restriction is assumed to inhibit some constitutionally protected speech, that assumption may not "'justify prohibiting all enforcement' of the law unless its application to protected speech is substantial, 'not only in an absolute sense, but also relative to the scope of the law's plainly legitimate applications.'" McConnell v. Federal Election Comm'n, 540 U.S. 93, 207 (2003) (quoting Virginia v. Hicks, 539 U.S. 113, 120 (2003)).

The district court did not doubt that, even under its own broad reading of the statute, section 526(a)(4) would be constitutional in many of its applications. The court did not explain why it nevertheless believed facial invalidation was appropriate, even assuming that it was compelled to read the statute to cover instances in which an attorney's advice to encourage additional debt is fully consistent with the Bankruptcy Code and the client's interests.

The district court's error is highlighted by its invalidation of section 526(a)(4) in its entirety, without independently addressing that part of the statute that precludes an attorney from advising a client to incur additional debt in order to pay the attorney's own fees. See 11 U.S.C. § 526(a)(4) ("A debt relief agency shall not * * * advise an assisted person or prospective assisted person to incur more debt * * * to pay an attorney or bankruptcy petition preparer fee or charge for services performed as part of preparing for representing a debtor in a case under this title."). The district court's willingness to strike down section 526(a)(4) on its face, without addressing this part of the statute, underscores the court's failure to recognize the nature of the issues presented by this facial challenge and to adopt a reading of the statute that avoids constitutional questions to the extent possible. Nothing in the record indicates that the attorneys-fee portion of section 526(a)(4) is fatally overbroad, and the district court identified no reason why that provision should be enjoined. Nor, as with its analysis of the remainder of the provision, did the district court explain why any posited defects could not be addressed by reading the provision to avoid any asserted constitutional difficulties.

CONCLUSION

For the foregoing reasons, the judgment of the district court should be reversed.

Respectfully submitted,

PETER D. KEISLER
Assistant Attorney General

KEVIN J. O'CONNOR
United States Attorney

MARK B. STERN
(202) 514-5089
MARK R. FREEMAN
(202) 514-5714
Attorneys, Appellate Staff
Civil Division, Room 7531
Department of Justice
950 Pennsylvania Ave., N.W.
Washington, D.C. 20530-0001

AUGUST 2007

CERTIFICATE OF COMPLIANCE WITH FEDERAL RULE OF APPELLATE PROCEDURE 32(a)(7)(B)

I hereby certify that this brief complies with the type-face and volume limitations set forth in Federal Rule of Appellate Procedure 32(a)(7)(B) because the type face is Courier New, monospaced, twelve-point font (ten characters per inch), and the number of words in this brief is 6,905 according to the count of Corel Wordperfect 12.

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Mark R. Freeman

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I hereby certify that on August 7, 2007, I caused copies of the foregoing brief to be filed with the Court by Federal Express overnight delivery and by e-mail to Briefs@ca2.uscourts.gov, and caused additional copies to be served upon the following counsel by Federal Express overnight delivery and by e-mail:

Zenas Zelotes, Esq.
18 Taylor Dr.
Norwich, CT 06360
(860) 449-0710
zenaszelotes@gmail.com

____
Mark R. Freeman

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Pursuant to Second Circuit Local Rule 32(a)(1)(E), I hereby certify that I have scanned for viruses the PDF version of the foregoing appellant's brief that was submitted in this case as an email attachment to briefs@ca2.uscourts.gov, and no viruses were detected.

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Mark R. Freeman
August 7, 2007

BRIEF BANK — “SUMMARY SHEET” Printed Fri.-8/8/3 (10:29)

WESTLAW CODES

1. (“TI”) TITLE OF CASE [E.g., “SMITH v. U.S. TRUSTEE (IN RE SMITH)”]	In re: Zenith Electronics Corp.
2. (“CO”) CURRENT COURT [E.g., “CTA9”]	The United States Court of Appeals for the Third Circuit
3. (“CCN”) CURRENT CASE NO.	No.: 02-2078
4. (“PCN”) PRIOR CASE NO. & COURT [IF ANY]	No.: 99-cv-00747, 00-00399 Court: The United States District Court for the District of Delaware
5. (“SO”) SOURCE	U.S. TRUSTEES
6. (“DA”) DATE OF FILING & TYPE OF BRIEF [E.g., “Opening Brief,” “Reply,” “Amicus,” etc.]	Filed: Sept. 2002 Type: Brief for the Appellant
7. (“AU”) PRINCIPAL AUTHORS & OFFICE [E.g.,“UST/OGC”]	Appellate Staff, Civil Division, DOJ
8. (“TO”) TOPIC	BANKRUPTCY
9. (“SU”) ! SUMMARY OF KEY ISSUE(s) & √ Any Miscellaneous BACKGROUND	! Whether the district court properly dismissed as equitably moot the U.S. Trustee's appeal of a bankruptcy court order authorizing the payment of professional fees and expenses for work on behalf of the unofficial equity security holders committee, where reversal of the order would require only disgorgement of the fees and their redistribution under the bankruptcy plan, but would not require altering or unraveling of the plan itself. √ Background:
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No. 02-2078

IN THE UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

In re: ZENITH ELECTRONICS CORPORATION,
Debtor

DONALD F. WALTON, ACTING UNITED STATES TRUSTEE FOR REGION 3,
Appellant

v.

UNOFFICIAL COMMITTEE OF EQUITY SECURITY HOLDERS, et al.,
Appellees

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF DELAWARE

BRIEF FOR THE APPELLANT

ROBERT D. McCALLUM, JR.
Assistant Attorney General

COLM F. CONNOLLY
United States Attorney

WILLIAM KANTER
(202) 514-4575
FRANK A. ROSENFELD
(202) 514-0168
Attorneys, Appellate Staff,
Civil Division, Room 9102
Department of Justice,
Washington, D.C. 20530-0001

IN THE UNITED STATES COURT OF APPEALS
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No. 02-2078

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DONALD F. WALTON, ACTING UNITED STATES TRUSTEE FOR REGION 3,
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UNOFFICIAL COMMITTEE OF EQUITY SECURITY HOLDERS;
OFFICIAL COMMITTEE OF EQUITY SECURITY HOLDERS
Appellees

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF DELAWARE

BRIEF FOR THE APPELLANT

STATEMENT OF SUBJECT MATTER AND APPELLATE JURISDICTION

The bankruptcy court had jurisdiction under 28 U.S.C. 157(a) and (b) to hear the underlying case, a voluntary petition under Chapter 11 of the Bankruptcy Code, 11 U.S.C. 1101, et seq. On February 10, 2000, the bankruptcy court entered its final order approving the applications for compensation and reimbursement of expenses (App.). The United States Trustee filed a notice of appeal to the district court from that order on February 22, 2000 (App.). The district court had jurisdiction to hear that appeal under 28 U.S.C. 158(a). The district court filed its final order dismissing that appeal on February 11, 2002 (App.); the order was entered on February 12, 2002 (App.). The United States Trustee filed a notice of appeal to the court of appeals from that order on April 11, 2002 (App.). This Court has jurisdiction to hear that appeal under 28 U.S.C. 158(d).

STATEMENT OF THE ISSUE PRESENTED FOR REVIEW

Whether the district court properly dismissed as equitably moot the U.S. Trustee's appeal of a bankruptcy court order authorizing the payment of professional fees and expenses for work on behalf of the unofficial equity security holders committee, where reversal of the order would require only disgorgement of the fees and their redistribution under the bankruptcy plan, but would not require altering or unraveling of the plan itself.

STATEMENT OF THE CASE

Zenith Electronics Corporation filed a voluntary petition under Chapter 11 of the Bankruptcy Code, 11 U.S.C. 1101, et seq., seeking reorganization under a “prepackaged” plan. A number of shareholders then formed an unofficial committee, which moved the bankruptcy court to direct the United States Trustee to form an official committee of equity security holders. The bankruptcy court granted the motion, heard the official committee during a hearing on confirmation of the proposed plan, rejected the official committee’s objections to the plan, and then approved the plan. The bankruptcy court then granted $76,500 in fees for work performed by lawyers and accountants on behalf of the unofficial committee, plus $867.15 in expenses (App.).[1] The bankruptcy court made the fee award under 11 U.S.C. 503(b)(3)(D) and (b)(4), which permit professional fees and expenses when an party such as an unofficial committee "mak[es] a substantial contribution" to a bankruptcy case.

The U.S. Trustee appealed the fee award to the district court, but the district court dismissed the appeal under the "equitable mootness" doctrine. Under that doctrine, as the district court explained, "an appeal can be dismissed as moot 'when, even though effective relief could conceivably be fashioned, implementation of that relief would be inequitable.'" Order at 5 (App.), quoting <u>In re Continental Airlines</u>, 91 F.3d 553, 559 (3d Cir. 1996)(<u>Continental I</u> or <u>Continental</u>). The district court said that it relied most heavily on two factors cited by this Court in <u>Continental</u>: that the reorganization plan has been substantially consummated and that the U.S. Trustee had not sought a stay of the fee award. Order at 8 (App.).

STATEMENT OF FACTS

1. On August 23, 1999, Zenith Electronics Corporation filed

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[1] The bankruptcy court also awarded fees and expenses for work on behalf of the official committee. Those fees are not in dispute on this appeal.

a voluntary petition for bankruptcy under Chapter 11.[2] The proposed plan was "prepackaged," with the details negotiated in advance between Zenith and its principal shareholder, LG Electronics (LGE), which owned 58% of Zenith's stock and which also had lent millions of dollars to Zenith. See 258 F.3d at 182. Under the plan, inter alia, all existing stock in Zenith would be cancelled for no consideration, and new stock would be issued to LGE alone, in exchange for debt relief. Ibid. Also, $103 million in existing bonds would be exchanged for $50 million in new bonds, bank debt would be refinanced, and debt owed to trade creditors would be unaltered. Ibid.

The minority shareholders, whose shares were proposed to be cancelled under the plan, objected to the plan. The largest minority shareholder, Nordhoff Investments, represented its own interests. The remaining minority shareholders formed an unofficial committee of equity security holders, which had been heavily involved with the negotiations that eventually led to the filing of the Chapter 11 petition. See 258 F.3d at 183. On August 26, 1999, just three days after the petition was filed, the unofficial committee moved the bankruptcy court to order the appointment of an official committee of equity holders under 11

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[2] The underlying facts concerning the Zenith bankruptcy are laid out in greater detail in this Court's decision on a prior appeal in this case, Nordhoff Investments, Inc. v. Zenith Electronics Corp., 258 F.3d 180, 182-84 (3d Cir. 2001).

U.S.C. 1102(a)(2). District Court Order at 3 (App.).

At a hearing on August 27, the United States Trustee objected to the formation of an official committee, arguing that an official committee was unnecessary, since the company was hopelessly insolvent and thus all stock held by members of the proposed committee was to be cancelled under the reorganization plan. The bankruptcy court nevertheless granted the motion that same day and ordered the U.S. Trustee to appoint the official committee. Ibid. The U.S. Trustee filed a notice of appeal on August 31, and on September 8, 1999, she moved in the district court for a stay pending appeal of the order appointing the official committee.[3] The U.S. Trustee also appointed the official committee that same day. The district court denied the stay on September 13. Ibid. The U.S. Trustee's appeal to the district court of the appointment order nevertheless remained pending.

The bankruptcy court held an expedited hearing on confirmation of the proposed reorganization plan, at which Nordhoff and the official committee objected that Zenith was worth far more than the value that was the basis for the plan; the debtor's expert valued the company at $300 million, but the minority shareholders contended that it was actually worth $1.05

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[3] We use female pronouns to reflect that, at the relevant time period, Patricia A. Staiano was the United States Trustee.

billion. See 258 F.3d at 183. The bankruptcy court agreed with the debtor’s valuation and thus, on November 2, 1999, it approved the plan of reorganization. Ibid. The confirmation order included a provision dissolving all committees on November 9. District Court Order at 3 (App.).

On November 19, 1999, ten days after the official committee was dissolved, two law firms and an accounting firm applied for compensation and reimbursement of expenses out of the estate for work done (1) for the unofficial committee prior to September 8, in its efforts to obtain appointment of an official committee, and (2) for the official committee on and after September 8. The U.S. Trustee objected to the fees for the unofficial committee, arguing that the committee did not meet the statutory criteria for reimbursement of fees, namely that the professionals "mak[e] a substantial contribution" to the case. See 11 U.S.C. 503(b)(3)(D), (b)(4). The U.S. Trustee did not, however, object to the fee request for work performed on behalf of the official committee. On February 7, 2000, the bankruptcy court granted fees and expenses for both situations (App.). It allowed $76,500 in fees for work on behalf of the unofficial committee, plus $867.15 in expenses; and it allowed $437,250 in fees and $85,024.45 in expenses for work on behalf of the official committee (App.).

2. The district court consolidated the U.S. Trustee's

appeals from the appointment order and from the fee order (as well as the debtor's appeal from the appointment order). It found first that the appeals from the appointment order are moot under Article III. Order at 4-5 (App.). It found that, since the stay was denied and the official committee was dissolved and no longer exists, the court could grant no effective relief on the appeal of the appointment order. It thus dismissed those appeals.[4]

The district court then dismissed the U.S. Trustee's appeal of the fee order on equitable mootness grounds. Equitable mootness, the court explained, is a doctrine that applies in bankruptcy cases, under which a claim is dismissed even though it is not constitutionally moot (that is, even though relief can still be granted). The court quoted the five factors listed by this Court, sitting en banc, in Continental Airlines, 91 F.3d at 560:

> (1) whether the reorganization plan has been substantially consummated, (2) whether a stay has been obtained, (3) whether the relief requested would affect the rights of parties not before the court, (4) whether the relief requested would affect the success of the plan, and (5) the public policy of affording finality to bankruptcy judgments.

The court then considered each factor in turn.

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[4] The United States Trustee has decided not to raise on appeal this aspect of the district court’s order. As a result, our appeal from the order requiring the appointment of the official committee should no longer be considered to be pending.

On the first factor, the court briefly noted that in a prior decision,[5] it had already found that the reorganization plan was substantially consummated on November 9, 1999, by which time most transactions had been completed. Order at 6 (App.). On the second factor, the court noted that the U.S. Trustee had not sought a stay. Ibid. The court concluded on the third factor that no third parties would be affected by the appeal. Order at 6 (App.). The court found on the fourth factor that "the relief sought will probably not affect the success of the plan. * * * As the [U.S.] Trustee points out, the relief sought here can be granted without disrupting the entire reorganization plan." Order at 7 (App.). On the fifth factor, the court said first that the interest in finality "weighs in favor of dismissing the appeal," but then said that this factor "is

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[5] In that prior decision, In re Zenith Electronics Corp., 250 B.R. 207 (D. Del. 2000), the same district court judge (Sleet, J.) had dismissed as equitably moot the appeals taken to the district court by Nordhoff and by the official committee of equity security holders from the bankruptcy court's order confirming the reorganization plan. The district court's discussion of the "substantial consummation" factor is at 250 B.R. at 213-14. As we explain in more detail in the argument, infra, the district court's analysis in the Nordhoff appeal discussed at great length the idea that a reversal of the confirmation order would require dismantling of the reorganization plan and that "[a]lthough some of the Plan transactions could conceivably be 'reversed,' this would not be easy to accomplish, and other transactions may not be reversible at all." 250 B.R. at 214. This Court then affirmed that order in Nordhoff, supra, finding that the district court "did not abuse its discretion in its analysis of this factor of the equitable mootness test." 258 F.3d at 186.

arguably neutral." Order at 8 (App.). Although the first two factors weigh in favor of dismissal and the next two weigh against dismissal, the court explained that in <u>Continental</u>, this Court gave the first factor "'foremost consideration'" (Order at 8). The district court then set forth several other factors to support its decision: no party other than the U.S. Trustee has appealed; the U.S. Trustee has not explained why she rejected an attempt to agree to a stipulation; and even in the absence of equitable mootness, "fairness may dictate the payment of fees" since the professionals did not act to the detriment of the estate or otherwise improperly. Order at 9 (App.).

SUMMARY OF ARGUMENT

If the United States Trustee’s appeal of the professional fee award in this case is successful, such a decision would only require the attorneys and accountants to disgorge their fees and pay them back to the estate. It thus would have no effect on the overall reorganization plan here, under which a large company changed its stock ownership, reissued its bonds, and refinanced its bank debt. Maintaining the appeal thus would not even remotely meet the standards established by this Court and other courts of appeals for dismissal of an appeal on equitable mootness grounds, under which such dismissal is available only if “‘[the] appeal, if successful, would necessitate the reversal or unraveling of the entire plan of reorganization’ * * * .” <u>PWS</u>

Holding, 228 F.3d at 237 (citation omitted). While this Court in Continental I, 91 F.3d at 560, identified five more-specific factors that the courts should consider when determining whether to dismiss for equitable mootness, the underlying issue that must be examined under each of the factors is the inequity of unraveling a plan of reorganization, long after many parties relied on the plan’s implementation. This appeal raises none of the concerns at issue under the five factors.

Under the first factor, whether the plan has been substantially consummated, the analysis does not end simply because the case meets the statutory definition of that term in 11 U.S.C. 1101(2), namely, that the property has been transferred to the estate and distribution has begun. Rather, this Court then looks at whether the appeal would “disturb the reorganization,” Continental, 91 F.3d at 561. This first factor thus weighs heavily against a finding of equitable mootness because the appeal here would not require that the reorganization be reversed or materially altered. Similarly, under the second factor, whether a stay was obtained, this Court’s concern in Continental again was that, in the absence of a stay, a reorganization plan will be implemented that will be difficult or inequitable to dismantle in the event of a reversal.

The district court itself found that the next two factors weigh against a finding of equitable mootness: whether the appeal would affect parties not before the court and whether it would affect the success of the plan. Indeed, the latter factor is essentially the concern that we have shown underlies all five factors. The district court's finding that this factor was not met should have all but ended the inquiry.

The fifth factor, the interest in finality, also is merely another way of explaining the underlying principle of all five factors, namely that the courts should not dismiss an appeal for equitable mootness unless the appeal, if successful, would unravel a complex bankruptcy reorganization plan upon which many parties have relied since its implementation.

The district court also relied on three other factors, but none of those other factors supports dismissal. First, while no party has appealed the fee award other than the U.S. Trustee, the U.S. Trustee has a special statutory "watchdog" function over matters like this under 11 U.S.C. 307. Congress wanted the U.S. Trustee to press issues involving violations of the Bankruptcy Code even when the creditors decide not to press them. Second, it was not proper for the district court to find that the U.S. Trustee's alleged failure to settle should be held against her. Finally, this Court should reject the district court's holding that it would be independently inequitable to require the professionals to refund their fees, even if the case were not equitably moot. This Court's equitable mootness doctrine is very detailed and complex. It should not add to that doctrine such an ad hoc additional equitable basis for dismissing an appeal.

STANDARD OF REVIEW

In Continental, 91 F.3d at 560, this Court stated that “[b]ecause the [equitable] mootness determination we review here involves a discretionary balancing of equitable and prudential factors rather than the limits of the federal courts’ authority under Article III, using ordinary review principles we review that decision generally for abuse of discretion. * * * A particular case may also raise legal and/or factual issues interspersed with the prudential ones, and then the applicable review standard, plenary or clearly erroneous, will apply.” As we will show, the district court failed to follow the overarching principle for equitable mootness set forth by this Court in Continental: that relief must require the significant dismantling of a bankruptcy plan and doing so must be both highly impractical and unfair to other parties. This failure by the district court to follow the standard in Continental can most fairly be considered an error of law. In the alternative, it is still a basis for reversal by this Court as an abuse of discretion, either because the district court acted outside its range of discretion, or because it applied its discretion in a plainly incorrect way, by not following the analysis in Continental. Notably, in In re PWS Holding Corporation, 228 F.3d 224, 236-37

(3d Cir. 2000), when this Court affirmed the decision of the district court denying equitable mootness, it did not rely on an abuse of discretion analysis, but rather it looked at the merits of the question of whether a successful appeal would require unraveling of the reorganization plan.

ARGUMENT

THE U.S. TRUSTEE'S APPEAL IS NOT "EQUITABLY MOOT" BECAUSE REVERSAL WOULD NOT REQUIRE ANY DISMANTLING OF THE REORGANIZATION PLAN BUT RATHER ONLY THE DISGORGEMENT OF ATTORNEY'S FEES

The appeal by the United States Trustee raises a collateral matter in the context of the reorganization of a major corporation: the propriety of a $76,500 professional fee award, in a bankruptcy case involving a manufacturer which the bankruptcy court found to be worth $300 million as a going concern. See Nordhoff, 258 F.3d at 183. Reversal of the fee award would have no effect on the long-completed reorganization plan or on the operations of the reconstituted debtor, nor would it adversely affect any parties other than the attorneys and accountants who received the fees, and who the U.S. Trustee seeks to argue were not entitled to those fees under the Bankruptcy Code. All that would occur upon reversal would be that the professionals would reimburse the estate for the fees they have received, and the bankruptcy court would distribute those funds as appropriate under the plan (probably by simply giving the cash to the reorganized debtor as an ongoing concern).

Maintaining this appeal thus would not even remotely meet the standards established by this Court and other courts of appeals for dismissal of an appeal on equitable mootness grounds. Dismissal for equitable mootness is available only if "'[the] appeal, if successful, would necessitate the reversal or unraveling of the entire plan of reorganization' * * * ." PWS Holding, 228 F.3d at 237, quoting In re Continental Airlines, 203 F.3d 203, 210 (3d Cir. 2000)(Continental II). This Court used similar analysis in Nordhoff, an earlier appeal also raising a equitable mootness issue in regard to an appeal of the merits in the present case. "In effect," this Court explained, "the equitable mootness doctrine prevents a court from unscrambling complex bankruptcy reorganizations when the appealing party should have acted before the plan became extremely difficult to retract." 258 F.3d at 185. Significantly, the district court held that "the relief sought here can be granted without disrupting the entire reorganization plan. Indeed, * * * ordering the remittance of fees has a minimal effect on the reorganization plan." Order at 7 (App.). Those findings should have led the court to deny dismissal for equitable mootness.

The appeal in Nordhoff, by contrast, would indeed have been difficult to retract, as this Court went on to discuss at some length. See 258 F.3d at 185-91. In that appeal, the Official

Committee, as well as a large minority stockholder, actually wanted to unravel the Zenith reorganization plan, arguing that the company was worth three times as much as the plan assumed, and that therefore it was wrong to cancel the existing stock with no compensation. See 258 F.3d at 186 (describing steps that would be taken if appellants were successful). This Court quoted favorably the district court’s finding that, because reversing of the transactions would be either difficult or impossible, that "‘weighs heavily in favor of dismissal, at least to the extent that the court could not fashion relief that would not result in the dismantling of the plan.’" Ibid., quoting district court order.[6]

In PWS Holdings, this Court declined to order dismissal on equitable mootness grounds, noting that there were “intermediate options” that would require only “alterations to the plan rather than an unraveling of the reorganization.” 228 F.3d at 236-37. Thus, this Court has rejected equitable mootness under circumstances where the consequences of maintaining the appeal were far more significant than here – alterations of the plan itself that allowed it to still operate, as opposed to the mere disgorgement of a small attorney’s fee award in the present case.

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[6] Because Nordhoff was an earlier appeal in the same underlying bankruptcy case, with the Official Committee of Equity Security Holders a party to that appeal as it is to this one, Nordhoff is not just binding Third Circuit precedent but it also is likely law of the case.

Indeed, this Court has repeatedly noted, in broader terms, that “the [equitable mootness] doctrine is ‘limited in scope and [should be] cautiously applied’ * * *.” PWS Holding, 228 F.3d at 236, quoting Continental, 91 F.3d at 559. Accord, Nordhoff, 258 F.3d at 185.

Many other circuits have adopted the equitable mootness doctrine, and they have routinely held that the doctrine exists to prevent litigation from undermining an approved and effected reorganization plan. See Mac Panel Co. v. Virginia Panel Corp., 283 F.3d 522 (4th Cir. 2002) (“[E]quitable mootness is * * * grounded in the notion that, with the passage of time after a judgment in equity and implementation of that judgment, effective relief on appeal becomes impractical, imprudent, and therefore inequitable.”).[7] And the courts have unanimously rejected

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[7] Accord, e.g., In re Grimland, Inc., 243 F.3d 228, 234 (5th Cir. 2001) (“An appeal is equitably moot when a plan of reorganzation has been so substantially consummated that a court can order no effective relief * * *.”); In re Lowenschuss, 171 F.3d 673, 679 (9th Cir. 1999) (“Because we are able to fashion effective relief for events that transpired * * * [appellant’s] appeal is not equitably moot.”); In re Healthco Int’l, Inc., 136 F.3d 45, 48 (1st Cir. 1998) (“The ‘equitable’ mootness test inquires whether * * * developments [evolved] in reliance on the bankruptcy court order to the degree that their remediation has become impracticable or impossible.”); In re Manges, 29 F.3d 1034, 1044 (5th Cir. 1994) (applying equitable mootness because, “at this point, unraveling [the reorganization plan] would be virtually impossible”); In re Envirodyne Industries, Inc., 29 F.3d 301, 304 (7th Cir. 1994) (noting that equitable mootness permits “courts [to] frequently refuse to modify the plan * * * because of the effects of modification on nonparties to the dispute”); In re UNR Industries, Inc., 20 F.3d 766, 769 (7th Cir. 1994) (similar); In re Club Assoc., 956 F.2d 1065, 1069 (11th

equitable mootness as a defense where, as here, relief would require only a simple matter, such as repayment of a fee award to the estate. Thus, in In re S.S. Retail Stores Corp., 216 F.3d 882, 884 (9th Cir. 2000), the Ninth Circuit refused to dismiss an appeal from an attorney's fees order on equitable mootness grounds because "an order compelling disgorgement of [attorney's] fees and expenses would not require the bankruptcy court to unravel a complicated bankruptcy plan. Rather, it would require only that one party disgorge money it has received, money that then would be distributed pursuant to the bankruptcy court's final decree." See also In re AOV, 792 F.2d at 1149 (declining to apply equitable mootness where "the pending challenge to the fees awarded to White & Case [is] still capable of resolution, regardless of the degree of consummation") (emphasis added).[8]

Cir. 1992) ("Central to a finding of mootness is a determination by an appellate court that it cannot grant effective judicial relief. Put another way, the court must determine whether the reorganization plan has been so substantially consummated that effective relief is no longer available."); Central States v. Central Transport, Inc., 841 F.2d 92, 96 (4th Cir. 1988) (similar); In re AOV Industries, Inc., 792 F.2d 1140, 1149 (D.C. Cir. 1986) (noting that the operative doctrinal question is whether, on appeal, "it is impossible to fashion effective relief for all concerned").

[8] Accord In re Grimland, 243 F.3d at 232 ("Reversing the [disputed] surcharge order would simply require Parker to repay TNB. As the surcharge order did not formally reorder the priorities of TNB, Parker, and the other administrative claimants, this appeal presents a simple dispute between TNB and Parker. Accordingly, the appeal is not equitably moot."); In re Lowenschuss, 171 F.3d at 678 ("We disagree [with appellee's position] because this case does not present transactions that

While this Court, sitting en banc in Continental I, 91 F.3d at 560, identified five more-specific factors that the courts should consider when determining whether to dismiss for equitable mootness, the underlying issue that must be examined under each of the factors is the inequity of unraveling a plan of reorganization, long after many parties relied on the plan's implementation. This Court's stated rationale in Nordhoff that we just described at length is actually contained in its discussion of the first factor — substantial consummation of the plan. The other four factors similarly turn most importantly on whether relief on appeal would require unraveling of the plan. Failure to obtain a stay is critical because a stay could have prevented the plan from going into effect. Parties not before the court can be unfairly affected because they relied on the implementation of the plan. The fourth factor actually is whether the relief requested would affect the success of the plan. Finally, the public policy in favor of finality looks at whether third parties have relied upon the confirmation of the plan. Each of the factors circles back to the same premise: equitable mootness will be found only where relief on appeal

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are so complex or difficult to unwind that the doctrine of equitable mootness would apply."); In re Healthco, 136 F.3d at 49 ("Here, of course, * * * there has been no showing that any portion of the settlement proceeds disbursed * * * could not be recovered with relative ease. Accordingly, the equitable mootness doctrine does not bar the present appeal.").

would require the dismantling of a reorganization plan at a point in time when doing so would be too costly. We now turn to discussion of each of the five factors to show how the present appeal does not in any way raise such concerns.

1. Substantial Consummation of the Plan

In Continental, this Court stated that, of the five factors, “the foremost consideration has been whether the reorganization plan has been substantially consummated.” 91 F.3d at 560. But this Court’s analysis of this first factor does not end with the simple finding that the plan meets the technical definition of substantial consummation in the Code, which requires only a showing that substantially all of the property has been transferred to the estate, that the debtor or its successor has assumed the business or the management of substantially all of the property, and that distribution under the plan has commenced. See 11 U.S.C. 1101(2). In Continental, this Court explained that the appellants did not dispute that the plan had been substantially consummated, but the Court did not stop its analysis of the first factor at that point. Instead, it immediately looked at whether the appeal would “disturb the reorganization,” and it concluded that it would do so because the appellants’ claim “was inextricably intertwined with the implementation of the reorganization.” 91 F.3d at 561.

The Court explained that an important consideration under the “substantial consummation” factor was whether the plan “involved ‘many intricate and involved transactions’ and reversal of [the] plan’s confirmation ‘would knock the props out from under’ such transactions and ‘create an unmanageable, uncontrollable situation for the Bankruptcy Court’ * * *.” Ibid., quoting In re Roberts Farms, Inc., 652 F.2d 793, 797 (9th Cir. 1981). This Court found that the appeal met the first factor because “reversal of the order confirming the Plan likely would put Continental back into bankruptcy.” Ibid. In contrast, this Court denied dismissal for equitable mootness in PWS Holding, noting that “[t]he plan has been substantially consummated, but, as noted, the plan could go forward even if the releases were struck” and appellant “now seeks only alterations to the plan * * *.” 228 F.3d at 236-37.

In the present case, the plan does indeed meet the statutory definition of “substantial consummation,” since the property of debtor Zenith has been fully transferred to LGE, its successor, and distributions have not only begun but have been largely completed. The district court so held when it dismissed the appeal from the confirmation order as equitably moot, and this Court noted the facts underlying that conclusion, finding “little question that the plan has been substantially consummated.” 258 F.3d at 185. Presumably, when the district court returned to this factor on the present professional fees appeal and simply incorporated by reference its holding in the confirmation plan appeal (Order at 6, App.), it meant to invoke those findings.

But neither the district court nor this Court in the confirmation plan appeal stopped at the finding that this case meets the statutory definition of substantial consummation. Rather, as this Court's extensive discussion of the first factor shows, the principal matter both courts addressed under the first factor was whether the relief requested on that appeal — reversal of the reorganization plan — was practical. See 258 F.3d at 186. The district court found that reversal of the Zenith plan would not be as difficult as reversal of the Continental plan would have been, but it still found that this "'would not be easy to accomplish, and other transactions may not be reversible at all. This factor, therefore, weighs heavily in favor of dismissal * * *.'" Ibid., quoting district court order. This Court agreed, upholding the district court on the "substantial consummation" factor because "[a]ppellants have not offered any evidence that the plan could be reversed without great difficulty and inequity, and we have reason to believe that the bond redistribution is unretractable."

When the same analysis of the "substantial consummation" factor is applied to the U.S. Trustee's current appeal, the conclusion must follow that the appeal does not meet this first factor. Unlike the appeal by the Official Committee and Nordhoff from the confirmation order, the U.S. Trustee’s appeal will not require that the plan be reversed, nor that the bond redistribution be retracted. Nor will it require any other step even remotely as serious. All it will require will be disgorgement by the attorneys and accountants of a few thousand dollars in fees, and distribution of those funds in an appropriate manner. The acquisition of Zenith by LGE will stand, all other stock will remain cancelled, the bond exchange will be undisturbed, and the banks and other creditors will remain in the same situation. The first and most important factor, then, weighs heavily against a finding of equitable mootness.

2. Failure to Obtain a Stay

The second factor under Continental for determining whether to dismiss an appeal for equitable mootness is whether the appellant obtained a stay of the order it seeks to appeal. This Court’s analysis of this factor bears a strong relationship to its analysis of the first factor, because failure to obtain a stay pending appeal allows the plan to be substantially consummated. In other words, if the appellant does not seek a stay, or if its application for a stay is denied, the reorganization plan will proceed and a later reversal on appeal will require that the plan be dismantled. This second factor is thus merely the other side of the coin to the first factor. As this Court explained in Continental, “the district court had before it an unstayed bankruptcy reorganization plan, and many courts have based their prudential decisions to decline to consider challenges to bankruptcy court orders on the ground that there has been substantial consummation of a plan of reorganization in reliance upon an unstayed confirmation order." 91 F.3d at 561 (emphasis in original). The importance of the second factor, then, is that in the absence of a stay, a reorganization plan will be implemented that will be difficult or inequitable to dismantle in the event of a reversal on appeal.

No such concern should weigh against maintaining the U.S. Trustee's fee appeal here. As with the first factor, failure to obtain a stay of the fee award will not make it difficult or unfair to now reverse that award. Again, the reorganization plan will remain entirely intact. All that will happen on a reversal will be that the parties who were paid the fees will need to pay them back to the estate. That presents no practical difficulty or significant hardship that would have justified the granting of a stay. The law and accounting firms that received the fees are large. They handle considerable amounts of business for which they are paid fees well in excess of the $76,500 total that is at issue here. Indeed, the U.S. Trustee did not appeal from the bankruptcy court's award, in the same fee order, of well in excess of half a million dollars in fees and expenses to the same firms for the work they did for the Official Committee. Were they required to disgorge the fees here, the firms would suffer no grievous injury. And the reorganization plan would only be helped (albeit minimally at best), not harmed, by the receipt of the additional cash payment.

A stay under such circumstances would have been pointless (and would surely have been denied if sought). In S.S. Retail Stores, 216 F.3d at 884, the Ninth Circuit looked mostly at the stay issue when it refused to dismiss an appeal of a fee award on equitable mootness grounds. The court of appeals noted that "counsel was a party before the bankruptcy court and knew the appellant contested the award" and "that the award would be appealed * * *." Moreover, as we earlier noted, the court explained that reversal would require only disgorgement of the fees and their distribution, not the unraveling of the plan. Ibid. The same applies in the present case. Failure to obtain a stay is not a factor that should weigh in favor of dismissal of the U.S. Trustee's appeal on equitable mootness grounds.

3. Parties Not Before the Court

The district court agreed with the U.S. Trustee that the third factor under Continental – whether the appeal will affect the interests of third parties – does not support dismissal of the appeal. Order at 7 (App.). It is indeed impossible to see how this factor could support dismissal here. Reversal of the fee awards will adversely impact only the professional firms that received the fees, all of whom appeared before the bankruptcy court in connection with their fee applications. The district court nevertheless dismissed the appeal, reasoning that this factor (as well as the fourth factor, which we will discuss in a moment) is given less weight than the first two factors, substantial consummation and lack of a stay. Order at 8 (App.). Since the first two factors in fact do not support dismissal for equitable mootness, as we have just shown, this factor is not outweighed by any others.

4. The Success of the Plan

The fourth factor under <u>Continental</u> is whether maintaining the appeal will adversely affect the success of the reorganization plan. Again, the district court agreed with the U.S. Trustee that this factor does not support dismissal on equitable mootness grounds. Order at 7 (App.). Again, the district court concluded, however, that this factor carries less weight than the substantial-consummation and lack-of-a-stay factors. Order at 8 (App.). This conclusion was again in error.

We have already shown in great detail that the concept of whether the appeal would affect the success of the plan is already a necessary part of the analysis of the first two factors, and that if the plan would not be undermined or unraveled, those two factors are not met. At least in the circumstances presented by this case, the fourth factor serves only to reiterate and make explicit those concerns. It is not a wholly distinct factor that can weigh in a manner opposite to the first two factors, but rather it reinforces and explains those first two factors. As we said earlier in our discussion of why this concept is the most important factor underlying all of the others, see p. __, supra, the district court’s finding that an appeal of the fee award would not affect the success of the reorganization plan should have all but ended the inquiry and led to denial of the motion to dismiss the appeal.

5. Finality

The fifth and final factor under Continental is the interest in affording finality to bankruptcy judgments. Like the fourth factor, this factor is simply another way of articulating the underlying principle of the equitable mootness cases, namely that the courts should not impose the unusual remedy of dismissing an appeal that is not constitutionally moot unless the appeal, if successful, would unravel a complex bankruptcy reorganization plan upon which many parties have relied since its implementation. In Continental, this Court said that “[i]ndeed, the importance of allowing approved reorganization plans to go forward in reliance on bankruptcy court confirmation orders may be the central animating force behind the equitable mootness doctrine. * * * Where, as here, investors and other third parties consummated a massive reorganization in reliance on an unstayed confirmation order,” appellate review of the order “would likely undermine public confidence in the finality of bankruptcy confirmation orders and make successful completion of large reorganizations like this more difficult.” 91 F.3d at 565.

In other words, like the third and fourth factors, the finality factor is not an independent inquiry where a conflict among the factors could arise but rather an explanation of how and why the other factors have great weight. Courts will not hear appeals that could unravel a reorganization plan that has already been established and has been in operation for a period of time, because to do so would have a chilling effect on the public’s willingness to enter into business with the reorganized company out of fear that the plan will later be dismantled or heavily altered.

In the present case, by contrast, reversal of the fee award on appeal would not undermine the public expectation of finality of the Zenith reorganization. That plan will not be materially affected. Any reliance by the attorneys and accountants on the finality of the fee award would be both de minimus and unreasonable. No one would have taken any steps in reliance on this fee award, in any way comparable to an investor or a customer signing contracts or buying the company’s stocks or bonds in reliance on the representation that the debtor has reorganized and thus has emerged from bankruptcy as a new, healthy company. Rather, the firms that received the fee awards were simply seeking compensation for their past work, knowing that an issue exists over whether the fees are allowable under the Code, and that the U.S. Trustee has appealed the award. They have no identifiable interest in putting the fee question to a swift conclusion that would not allow time for an appeal. The interest in finality, like the other Continental factors, thus weighs heavily against dismissal for equitable mootness.

6. Other Factors

The district court also cited certain other factors in support of dismissal of the U.S. Trustee's appeal. Order at 8-9 (App.). The district court's first "other factor" was simply its weighing of the five Continental factors, which we have already discussed and need not again address. The district court then turned to several independent factors. None of these other factors supports the dismissal.

a. The district court noted in passing that "no interested party has appealed the fee order" other than the U.S. Trustee. Order at 8 (App.). This is not a reason to dismiss the appeal on equitable grounds. The court's remark here fails to recognize the United States Trustee's special and unique statutory role under section 307 of the Bankruptcy Code, 11 U.S.C. 307, to serve as a "watchdog" for the bankruptcy system. See Morgenstern v. Revco D.S., Inc. (In re Revco D.S., Inc.), 898 F.2d 498 (6th Cir. 1990). This responsibility is particularly strong on such procedural matters as the appointment of official committees and the award of professional fees. Thus, the U.S. Trustee has "public interest standing" under §307 which goes beyond mere pecuniary interest. See United States Trustee v.

Columbia Gas System, Inc. (In re Columbia Gas System, Inc.), 33 F.3d 294, 295-96 (3d Cir. 1994). Indeed, Congress adopted §307 to ensure that someone would press claims to recover fees obtained in violation of the Code, since the creditors often are unable or unwilling to expend the resources necessary to pursue such claims. See Curry v. Castillo (In re Castillo), 297 F.3d 940, 950 (9th Cir. 2002)(U.S. Trustee is "charged with preventing fraud and abuse and with 'fill[ing] the vacuum' caused by possible creditor inactivity").

Nor is it relevant to the balance of equities that other parties (such as the debtor) chose not to join the appeal. The issue is whether it is inequitable to any party to maintain the appeal, not whether all parties have an interest in pursing the appeal. That Zenith did not join this appeal (as it did join the U.S. Trustee's constitutionally-moot appeal of the order appointing the official committee) does not show that the fee appeal is inequitable to it or any other party.

b. Next, the district court concluded that the equities are against the U.S. Trustee because, according to the equity committees, they sought to negotiate a stipulation with the U.S. Trustee but the U.S. Trustee has not explained why she did not agree to such a settlement, which if reached would avoid "expending valuable judicial resources * * *." Order at 8-9 (App.). We will put aside for now whether the equity committees have accurately described the settlement efforts; any settlement negotiations are, of course, off the record. We question, however, the propriety of a court ever basing an adverse ruling on a finding that a party acted inequitably simply by failing to reach a settlement. While there might be special circumstances where failure to settle should be held against a party, no such circumstances exist here. This is simply a matter where one party alleges that it tried to settle and that another party would not agree. While the courts do like to promote alternative dispute resolution, it cannot be that a party's failure to agree to a settlement should be a basis for throwing it out of court. The very job of the courts is to resolve disputes that the parties cannot agree to resolve among themselves. And, as we will discuss in more detail in the next section, it is contrary to the complex analysis developed by this Court to govern the very limited doctrine of equitable mootness that an additional ad hoc factor like failure to settle should be added to the analysis.

c. Finally, the district court held that "even where equitable mootness is inapplicable, fairness may dictate the payment of fees." Order at 9 (App.). The court reasoned that "the [U.S.] Trustee has provided no indication that these professionals acted to the detriment of the estate or that they otherwise acted inappropriately." Ibid. The court relied for this holding on the alternative holding of the Ninth Circuit in S.S. Retail Stores that, although disgorgement of the attorney's fees there would not justify dismissal on equitable mootness grounds, it would still be inequitable to order such disgorgement. See 216 F.3d at 885. This Court should not recognize this alternative equitable rationale.

As we have previously noted, this Court has consistently stated that "the [equitable mootness] doctrine is 'limited in scope and [should be] cautiously applied' * * *." PWS Holding, 228 F.3d at 236, quoting Continental, 91 F.3d at 559. Accord, Nordhoff, 258 F.3d at 185. The Court has thus devoted much effort to developing a detailed and sophisticated analysis of the factors to be applied when determining whether to dismiss a bankruptcy appeal on equitable grounds when it is not constitutionally moot. Continental was itself an en banc decision, and the subsequent cases have carefully considered the nuances of the majority's lengthy opinion. Many other circuits have joined in the effort to develop the law of equitable mootness, and they largely have followed the same analysis as this Court's. It would undermine this careful development of the doctrine of equitable mootness if the courts could find that the doctrine is not met in a particular case, but it could then dismiss an appeal anyway on some vague, ad hoc equitable basis, such as the concept in S.S. Retail Stores that disgorgement of the attorney's fees would be inequitable. This Court should not join the Ninth Circuit in recognizing such an additional equitable basis for dismissing a bankruptcy appeal.

S.S. Retail is also wrong to find an additional equitable ground for dismissing a fee appeal because its holding results in courts ignoring facially valid claims alleging violations of binding provisions of the Bankruptcy Code. The S.S. Retail panel declined to consider a ripe dispute, which the court freely conceded was neither constitutionally moot nor equitably moot. It did so because it concluded that the statutory arguments pressed by the U.S. Trustee, if correct, might produce an inequitable result. S.S. Retail nullified a claim alleging a violation of the Bankruptcy Code not on its merits but simply through inaction — a judicial refusal to adjudicate it. Such a practice does not accord proper weight to validly enacted statutes. In this appeal, the U.S. Trustee alleges that the appellees are not entitled to compensation under section 503 of the Code. If this Court finds this claim is not equitably moot, it should remand it for an adjudication of its merits.

At any rate, S.S. Retail is distinguishable. The Ninth Circuit cited two reasons for its conclusion. First, it said that counsel fully disclosed its potential conflict of interest and never acted improperly. See 216 F.3d at 885. Even assuming for sake of argument that this was somehow a relevant consideration there, it is not relevant here. The ground for the objection to fees there was that counsel was not qualified to represent the debtor because of the conflict of interest. The court of appeals was thus concluding that the merits of the appeal were weak since any ethical violation was in its view not of any real substance. Counsel's actual lack of improper conduct was thus thought there to be relevant to the merits. Here, we are arguing on the merits not that the professionals acted unethically but that they did not substantially contribute to the bankruptcy case. It is thus of no relevance that they did not act improperly. Moreover, their insistence on getting an unnecessary committee appointed, at great expense to the estate, did harm the estate.

The Ninth Circuit's second reason is even more easily distinguishable. The court of appeals reasoned that because the U.S. Trustee did not seek a stay, counsel continued to provide representation to the debtor in reliance on the bankruptcy court's appointment orders. Here, by contrast, the fees in dispute are for work on behalf of the unofficial committee while the bankruptcy court was still considering its motion to appoint an official committee. During that time period the professionals acted on their own initiative, without any reliance on court orders or the lack of a stay. Only after the bankruptcy court ordered the appointment of an official committee did counsel and the accountants have any reasonable expectation of a later fee award when they decided whether to provide professional services, and the U.S. Trustee does not challenge their right to receive fees as of that date.

CONCLUSION

For the foregoing reasons, the judgment of the district court should be reversed and the case should be remanded to the district court with instructions that the district court hear the U.S. Trustee's appeal of the fee award on its merits.

Respectfully submitted,

ROBERT D. McCALLUM, JR.
Assistant Attorney General

COLM F. CONNOLLY
United States Attorney

WILLIAM KANTER
(202) 514-4575

FRANK A. ROSENFELD
(202) 514-0168
Attorneys, Appellate Staff,
Civil Division, Room 9102
Department of Justice,
Washington, D.C. 20530-0001

SEPTEMBER 2002

CERTIFICATE OF COMPLIANCE PURSUANT TO F.R.A.P. 32(a)

I certify, pursuant to Fed. R. App. P. 32(a)(7)(B) and (C) that the attached brief for the appellant is monospaced, has 10.5 or fewer characters per inch, and contains 8516 words.

September 11, 2002

FRANK A. ROSENFELD
Attorney

CERTIFICATE OF BAR MEMBERSHIP

I hereby certify that I am a member of the bar of this Court in good standing.

FRANK A. ROSENFELD

STATEMENT OF RELATED CASES

This Court has previously heard another appeal arising out of the same bankruptcy case, which also raised similar issues: Nordhoff Investments, Inc. v. Zenith Electronics Corp., Nos. 00-2250, 00-2249 (3d Cir., June 21, 2001), reported at 258 F.3d 180. Another case is pending before this Court that does not arise out of the same bankruptcy case but that also raises similar issues: In re: United Artists Theatre Company, No. 01-1351 (3d Cir.), argued December 4, 2001. In addition, a copy of the district court's decision in this case was submitted to the panel deciding In re Pillowtex, No. 01-2775, shortly before oral argument on June 10, 2002, in response to the panel's sua sponte inquiry about the effect of plan confirmation upon the attorney’s fee dispute at issue in that appeal. The merits of the Pillowtex appeal, however, do not concern equitable mootness.

CERTIFICATE OF SERVICE

I hereby certify that on this 11th day of September, 2002, I served the foregoing brief upon the parties by causing copies to be sent by first class mail to:

Norman L. Pernick
J. Kate Stickles
Saul Ewing, LLP
222 Delaware Avenue
Suite 1200
Wilmington, Delaware 19801

FRANK A. ROSENFELD
Attorney

BRIEF BANK — “SUMMARY SHEET” Printed Fri.-8/8/3 (10:29)

WESTLAW CODES

1. (“TI”) TITLE OF CASE [E.g., “SMITH v. U.S. TRUSTEE (IN RE SMITH)”] — In re: Zenith Electronics Corp.

2. (“CO”) CURRENT COURT [E.g., “CTA9"] — The United States Court of Appeals for the Third Circuit

3. (“CCN”) CURRENT CASE NO. — No.: 02-2078

4. (“PCN”) PRIOR CASE NO. & COURT [IF ANY] — No.: 99-cv-00747, 00-00399

Court: The United States District Court for the District of Delaware

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Type: Reply Brief for the Appellant

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8. (“TO”) TOPIC — BANKRUPTCY

9. (“SU”) ! SUMMARY OF KEY ISSUE(s) & √ Any Miscellaneous BACKGROUND

! Whether the district court properly dismissed as equitably moot the U.S. Trustee's appeal of a bankruptcy court order authorizing the payment of professional fees and expenses for work on behalf of the unofficial equity security holders committee, where reversal of the order would require only disgorgement of the fees and their redistribution under the bankruptcy plan, but would not require altering or unraveling of the plan itself.

√ Background:

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No. 02-2078

IN THE UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

In re ZENITH ELECTRONICS CORP.

DONALD WALTON, the ACTING UNITED STATES TRUSTEE,

Appellant,

v.

UNOFFICIAL COMMITTEE OF EQUITY SECURITY HOLDERS, et al.,

Appellees

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF DELAWARE

REPLY BRIEF FOR THE APPELLANT

ROBERT D. McCALLUM, Jr.
Assistant Attorney General

COLM F. CONNOLLY
United States Attorney

William Kanter
Appellate Staff, Civil Division

P. Matthew Sutko
(202) 307-1405
Department of Justice
Office of the General Counsel
Executive Office for U.S. Trustees
20 Massachusetts Ave., N.W.
Washington, D.C. 20530

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No. 02-2078

IN THE UNITED STATES COURT OF APPEALS
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ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF DELAWARE

REPLY BRIEF FOR THE APPELLANT

The Appeal Before the District Court was not Equitably Moot

1. It is "our deep-rooted historic tradition that each person should have his own day in court." *Martin v. Wilks*, 490 U.S. 755, 762 (1989) (citations and internal quotations omitted). This Court prevents the equitable mootness doctrine from unnecessarily denying litigants their day in court by mandating that the doctrine be “limited in scope and cautiously applied.” *In re Continental Airlines*, 91 F.3d 553, 559 (3d Cir. 1996) (en banc), *cert. denied*, 519 U.S. 1057 (1997). Narrowly circumscribing equitable mootness coincides with the Supreme Court's construction of constitutional mootness, which allows dismissal only if it is "impossible for the court to grant any effectual relief whatever." *Church of Scientology v. United States*, 506 U.S. 9, 12 (1992) (citations and internal quotations omitted).

In this case, the United States Trustee presented an important issue to the district court, whether the bankruptcy court's award of compensation under Bankruptcy Code section 503(b)(3)(D) to Katten Muchen Zavis Rosenman, Ernst & Young, and Saul Ewing Remick & Saul, violated *Lebron v. Mechem Fin. Inc.*, 27 F.3d 937, 944 (3d Cir. 1994) (narrowly construing section 503(b)(3)(D)).[1] Those Professionals charged an unofficial equity committee roughly $76,500 to help it obtain court approval for a formal committee. The bankruptcy court required the debtor to pay those fees, concluding the Professionals made a substantial contribution under 503(d)(3)(B). The United States Trustee took the position below that committee-formation work does not satisfy 503(d)(3)(B) as interpreted by *Lebron* because it benefits only the committee class, not the estate. This is a significant question because virtually every large chapter 11 case in

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[1/] Virtually all the expenses and fees under dispute are Katten's, Ernst's, and Saul's, although committee members also seek *de minimis* expenses. For ease of reference we refer to the claimants collectively as the Professionals.

Delaware has committees. The United States Trustee sought guidance from the district court in order to achieve clarity on this issue, and to avoid litigating the same issue in multiple bankruptcy cases.

2. The United States Trustee's opening brief explained why the equitable mootness doctrine does not bar district court review of this final, ripe, non-constitutionally moot appeal. In reply, the Professionals advance four principal arguments why the United States Trustee's appeal was properly dismissed: (a) dismissal was within the district court's broad discretion (Appellees' br. at 1-3); (b) the plan's substantial consummation justified dismissal (Appellees' br. at 10); (c) the absence of a stay of the plan of reorganization justified dismissal (Appellees' br. at 9-11); and (d) "the equities weigh against the United States Trustee" (Appellees' br. at 12-15).

The Professionals note correctly that this Court reviews equitable mootness dismissals under an abuse of discretion standard. *In re Continental*, 91 F.3d at 560. That discretion is limited, however, by Third Circuit precedent. The district court's failure in this case to properly apply that precedent constituted an error of law. *United States v. Askari,* 140 F.3d 536, 539 (3d Cir.1998) (en banc) ("By definition, a district court abuses its discretion when it makes an error of law." (*quoting in part Koon v. United States*, 518 U.S. 81, 100 (1996)), *vacated on other* *grounds*, 159 F.3d 774 (3d Cir.1998).

This Court has addressed equitable mootness in three decisions.[2] Two of them sanctioned dismissal because the appellants sought to unravel substantively consummated plans to the detriment of "non-adverse third parties"[3] who contributed the capital necessary to make confirmation possible. *In re Continental*, 91 F.3d at 560-61 (dismissing an appeal that would "knock the props out from under" the confirmed plan, and injure non-party investors whose "investment had been made" (citations and internal quotations omitted)); and *Nordhoff*, 258 F.3d at 189 (appellants sought to "dissolve the plan"). In the third, this Court refused to dismiss an appeal as equitably moot when the relief sought would have "altered" the plan and "affect[ed] the rights and liabilities of third parties," because that fell short of "unraveling . . . the reorganization." *In re PWS*, 228 F.3d at 236, 237. Finally, the only circuit decision to consider whether substantial consummation equitably moots an appeal from a compensation order, such as the one at issue here, specifically held it does not. *S.S. Retail Stores Corp.*

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[2] *In re Continental Airlines*, 91 F.3d 553 (3d Cir. 1996), *cert. denied*, 519 U.S. 1057 (1997); *In re PWS Holding Corp.*, 228 F.3d 224 (3d Cir. 2000); and *Nordhoff Investments, Inc. v. Zenith Electronics Corp.*, 258 F.3d 180 (3d Cir. 2001).

[3] *Nordhoff*, 258 F.3d at 188.

v. United States Trustee (In re S.S. Retail Stores Corp.), 216 F.3d 882, 884-85 (9th Cir. 2000).

Given this law, it was error for the district court to dismiss the United States Trustee's appeal. *PWS* constitutes a dividing line. Appeals seeking to alter rather than unravel plans are not equitably moot. Here, the United States Trustee's motion did not seek even to alter the plan, much less unravel it. It simply asked that a professional return improperly obtained fees to the debtor. No court of appeals has ever sanctioned the dismissal of an appeal as equitably moot on such flimsy grounds. Doing so would transform the doctrine from one cautiously applied and limited in scope to one that would have no discernable limits. Consistency, predictability, and basic fairness would suffer if district courts could slam shut the courthouse door in such an *ad hoc* fashion.[4]

3. Nor does substantial consummation of Zenith's plan necessitate dismissal of the United States Trustee's appeal.[5] Appellants' br. at 4-10. *PWS* makes that

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[4] An Addendum accompanying this brief provides a table comparing this Court's equitable mootness decisions. It demonstrates that this case falls outside those sets of facts under which this Court has allowed cases to be dismissed as equitably moot.

[5] Section 1101(2) defines substantial consummation:

(2) "substantial consummation" means-

(A) transfer of all or substantially all of the property proposed by the plan to clear. *In re PWS*, 228 F.3d at 235-36 (declining to dismiss an appeal in such a circumstance).

The United States Trustee Program, as the entity charged with administering bankruptcy cases, 28 U.S.C. 586(a)(3), recognizes that this Court and other circuits agree that consummated plans are often best left unraveled, at least in the absence of significant public policy or financial considerations. But the United States Trustee does not request such far-reaching relief in this case, and there is no just reason for barring the United States Trustee's appeal merely because this plan has been substantially consummated.

Substantial consummation serves two specific purposes under the Code. Its primary purpose is to prohibit motions to modify substantially consummated plans. 11 U.S.C. 1127(b) (parties may "modify" a plan only "before substantial consummation of such plan").[6] This prohibition may help explain why circuit courts have consistently dismissed appeals, like *Continental* and *Nordhoff*, which

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be transferred;

(B) assumption by the debtor or the successor to the debtor under the plan of the business or of the management of all or substantially all of the property dealt with by the plan; and

(C) commencement of distribution under the plan.

[6] In addition, section 1112(b)(7) permits dismissal or conversion of a chapter 11 case if the debtor is unable to "effectuate substantial consummation of a confirmed plan." 11 U.S.C. 1112(b)(7).

sought to unravel substantially consummated plans. Those decisions could not rely directly upon 1127(b) because the appellants sought to overturn plan confirmation itself, rather than permission to modify plans. Nevertheless, those attempts to unravel plans arguably conflicted with Congress' objective in section 1127(b) to protect innocent third parties who rely upon the often complex commercial transactions that produce substantially consummated plans.

That concern is absent here. As the Ninth Circuit held in *S.S. Retail*, challenges to fee awards do not unravel plans.[7] *S.S. Retail Stores Corp.*, 216 F.3d at 884-85. To the contrary, when successful, they cause funds to be returned to reconstituted debtors for use in satisfying creditor claims as approved under the plan. *Id.* As the United States Trustee's opening brief explained, Opening br. at 19-22, this appeal will not knock the props out from under this plan, unwind complex commercial transactions, or create an unmanageable, uncontrollable situation for the bankruptcy court. In the absence of all of that, the United States

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[7] The Ninth Circuit held that "an order compelling disgorgement of Gibson, Dunn's fees and expenses would not require the bankruptcy court to unravel a complicated bankruptcy plan. Rather, it would require only that one party disgorge money it has received, money that would then be distributed pursuant to the bankruptcy court's final decree." *S.S. Retail Stores Corp.*, 216 F.3d at 884.

Trustee's appeal should be allowed to go forward.[8]

4. The Professionals also seek to justify dismissal on the basis that the United States Trustee did not obtain a stay of the plan of reorganization. Appellees' br. at 10-11. This misses the point. In *Continental* and *Nordhoff* the absence of a stay was relevant because the appellants appealed the order confirming the plan, alleged the plan was illegal, and asked that it be unraveled.[9] Given their attempts to unravel those plans, this Court determined their failure to obtain stays of the plans was an important part of its equitable mootness calculus. The absence of a stay has no significance here, however, because the United States Trustee appeals from a collateral order that will not unravel the plan. Indeed, it defies common sense to require the United States Trustee to seek to stay a complex plan of reorganization while it litigates a tangential $76,000 dispute.

Nor is it significant that the United States Trustee did not stay the order

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[8] Indeed, the plan contemplates suits like the United States Trustee's. Under Article XI, secs. A and B of Zenith's plan, the bankruptcy court retains jurisdiction to adjudicate administrative claims and fee disputes. Even if that provision were absent from the plan, the availability of disgorgement ensures relief can be obtained from these Professionals without unraveling this plan. *See* footnotes 10 and 13 below, and accompanying text.

[9] *In re Continental*, 91 F.3d at 555 (party "appeal[ed]" from "Continental's revised second amended joint plan of reorganization"); *Nordhoff*, 258 F.3d at 182 (appeal from "the District Court's order approving the Bankruptcy Court's order confirming Zenith's bankruptcy and restructuring plan").

awarding fees to the Professionals. Stays are never sought, nor required, in these types of disputes because it is universally recognized that disgorgement is available if the United States Trustee succeeds on appeal. This Court and other circuits have adjudicated any number of similar fee disputes in the absence of stays; given the availability of disgorgement, none of those appeals were dismissed as constitutionally or equitably moot.[10] Given this well-settled law, there is no basis for dismissing the United States Trustee's appeal due to the absence of a stay.

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[10] *In re Pillowtex, Inc.*, 304 F.3d 246 (3d Cir. 2002) (remanding a fee dispute for a review of the merits and imposition of an appropriate remedy); *United States Trustee v. First Jersey Securities, Inc. (In re First Jersey Securities, Inc.)*, 180 F.3d 504, 514, and n.9 (3d Cir. 1999) (holding that where a debtor's counsel had received a preferential transfer, the bankruptcy court could take "further action" on remand and noting such action could include "not only disgorgement of the preference, but also [] the possible denial or reduction of compensation" (citation and internal quotation omitted)); *Citicorp Venture Capital Ltd.* v. *Committee of Unsecured Creditors*, 160 F.3d 982, 986, 991-92 (3d Cir. 1998) (allowing the pursuit of remedies against a fiduciary of a debtor, including disgorgement, upon remand in a chapter 11 case with a confirmed plan); *United States Trustee* v. *Federated Department Stores, Inc.* (*In re Federated Department Stores, Inc.*), 44 F.3d 1310, 1316 (6th Cir. 1995) (case not equitably moot because bankruptcy court could order disgorgement on remand); *United States* v. *Richman* (*In re Richman*), 124 F.3d 1201 (10th Cir. 1997) (ordering that on remand funds could be disgorged to a chapter 13 debtor who had a confirmed chapter 13 plan). *See also Harold & Williams Development Co. v. United States Trustee (In re Harold & Williams Development Co.)*, 977 F.2d 906, 909 n.1 (4th Cir.1992) (plan confirmation does not moot appeal involving a question whether professional was properly appointed under section 327 of the Code).

5. Finally, the Professionals allege that equity demands dismissal of the United States Trustee's appeal - but their brief never specifically says why. Appellees' br. at 12-15. They touch upon a number of issues relating to this bankruptcy case but never come out and say why any of them require dismissal.[11]

The Professionals do not contend the United States Trustee violated the Bankruptcy Code or committed an ethical lapse in litigating this dispute. To the contrary, the United States Trustee has merely pressed a straight forward legal question, whether section 503(b)(3)(D) of the Code allows their fees to be imposed upon the debtor. There is no evidence in the record below that the United States Trustee is pursuing this question of law for any reason other than its importance to the administration of Delaware bankruptcy cases. Given the absence of serious misconduct, there is no basis for determining that equity demands the dismissal of the United States Trustee's appeal.

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[11] The Professionals do not contend, as the district court did, that unproductive settlement negotiations justify dismissal; nor do they rebut the United States Trustee's argument that she has express statutory authority under 11 U.S.C. 307 to pursue this claim in the absence of other appellants. On the latter point, this Court recently reaffirmed that section 307 confers standing to bring this type of claim. *In re Pillowtex, Inc.*, 304 F.3d at 255 n.7 (*quoting United States Trustee v. Columbia Gas Sys. Inc. (In re Columbia Gas Sys. Inc.*), 33 F.3d 294 (3d Cir.1994), in holding "[i]t is difficult to conceive of a statute that more clearly signifies Congress's intent to confer standing" to pursue claims against bankruptcy professionals).

The *S.S. Retail* Doctrine is not a Valid Alternative Ground for Dismissal

In *S.S. Retail*, the Ninth Circuit held that an appeal brought by the United States Trustee was not equitably moot, but nevertheless declined to reach the merits, and dismissed the appeal because "it would [have] be[en] inequitable to require [the professional] to disgorge" the fees and expenses it allegedly received in violation of a federal statute. *In re SS Retail Stores Corp.*, 216 F.3d at 885. Although the Professionals encourage this Court to adopt *S.S. Retail*, their brief fails to say why. Appellees' br. at 15-16. The United States Trustee explained in her opening brief why this Court should not follow *S.S. Retail*, Opening br. at 30-33; those arguments are not repeated here.

The Professionals suggest the Sixth Circuit reached a similar result in *United States Trustee v. Federated Department Stores, Inc. (In re Federated Department Stores, Inc.)*, 44 F.3d 1310 (6th Cir. 1995). Appellees' br. at 15-16. They are wrong. *Federated* is irreconcilable with *S.S. Retail*. In *Federated,* a bankruptcy professional asked the Sixth Circuit to dismiss an appeal brought by the United States Trustee.[12] The Sixth Circuit declined to do so and - significantly

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[12] Although it did not use the term equitable mootness, *Federated* rejected an equitable mootness challenge, as can be discerned by its analysis of an early equitable mootness decision, *In re Roberts Farms, Inc.*, 652 F.2d 793 (9th Cir.1981). *Federated*, 44 F.3d at 1317.

- adjudicated the merits of the United States Trustee's appeal. After ruling for the United States Trustee on the merits, the court turned to the question of remedy. The Sixth Circuit found it significant that the legal issue presented in *Federated* had been unresolved within the Sixth Circuit during part of the time the professional provided services. In the midst of its representation, the Sixth Circuit resolved the underlying legal issue in *In re Middleton Arms Ltd. Partnership*, 934 F.2d 723 (6th Cir.1991) and subsequently reaffirmed *Middleton* in *In re Eagle-Picher Industries, Inc.*, 999 F.2d 969 (6th Cir.1993). *Federated*, 44 F.3d at 1317-19. Given the law had been unclear before *Middleton* was decided, the court required the professional to disgorge all fees earned after *Middleton* but allowed it to retain the fees it earned prior to the *Middleton* decision. *Federated*, 44 F.3d at 1320 (holding that in light of the "peculiar and unique circumstances" where the law of the circuit was not "settled" prior to that date, "fairness and equity" required that the professional "be compensated at its agreed rate up to" the date *Middleton Arms* was decided).

Limiting a remedy is fundamentally different from refusing to adjudicate a ripe, final, non-constitutionally moot claim. To our knowledge the holding of *S.S. Retail* is unique. No other court has simply refused to adjudicate an appeal it had jurisdiction to hear in the absence of a widely recognized prudential doctrine. Nor is there any need to create a third mootness doctrine, particularly when *S.S. Retail*'s holding draws upon no defining principle and has no discernable parameters.[13]

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[13] The Professionals suggest for the first time in a footnote in their brief that the United States Trustee's appeal may be constitutionally moot because there is no one to recover from. Appellees' br. at 3 n.1. That is wrong. First, the plan expressly provides that the bankruptcy court retains jurisdiction to decide administrative claims and fee disputes. *See* Plan, Article XI, secs. A, B. Second, someone does exist to recover from - Katten Muchin, Ernst & Young, and Saul Ewing. Each was specially awarded fees under the bankruptcy court order, each still exists, and each could be ordered to disgorge fees obtained in violation of section 503(b)(3)(D) and *Lebron*. Finally, individual members of the unofficial committee still exist and a similar remedy could be pursued against them as well.

Conclusion

For the foregoing reasons, the judgment of the district court should be reversed and the case should be remanded to the district court with instructions that the district court hear the United States Trustee's appeal of the fee award on its merits.

ROBERT D. McCALLUM, Jr.
Assistant Attorney General

COLM F. CONNOLLY
United States Attorney

William Kanter
(202) 514-4575
Appellate Staff
Civil Division, Room 9102
Department of Justice
Washington, D.C. 20530-0001

____
P. Matthew Sutko
(202) 307-1405
Office of the General Counsel
Executive Office
for United States Trustees
20 Massachusetts Ave., N.W.
Washington, D.C. 20530

Certificate of Compliance Pursuant to F.R.A.P. 32(a)

I certify pursuant to Fed. R. App. P. 32(a)(7)(B) and (C) that the attached brief for the appellant contains 3882 words.

P. Matthew Sutko

Certificate of Bar Membership

I certify that I am a member of the bar of this Court in good standing.

P. Matthew Sutko

Certificate of Service

I certify that on this _____ day of _________, 2002, I served the foregoing brief upon the parties by causing to be sent by Federal Express to:

Harley J. Goldstein
Katten Muchin Zavis Rosenman
525 West Monroe Street
Suite 1600
Chicago, Illinois 60661

Norman L. Pernick
J. Kate Stickles
Saul Ewing, LLP
222 Delaware Ave.
Suite 1200
Wilmington, Delaware 19801

____
P. Matthew Sutko

ADDENDUM

Table Comparing Third Circuit Equitable Mootness Holdings

Case Name	Substantial Consummation?	Relief Sought	Dismissal?
Continental	Yes	Unraveling plan to take money from non-party investors who invested in reliance on confirmation	**Yes**
Nordhoff	Yes	Unraveling plan that led to “many sales” of corporate debt based upon “the [presumed] creditworthiness of the reorganized debtor”	**Yes**
PWS	Yes	Altering, but not unraveling, plan to take away rights of third parties and expose them to potential liability	**No**
This Appeal	Yes	Litigating a pre-confirmation objection to counsel fees that would neither unravel nor alter the plan and would increase the amount of funds available to creditors without injuring non-parties	**?**